Marzunisham Omar: Capital flows management for monetary and financial stability

Remarks by Mr Marzunisham Omar, Assistant Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Seminar and Meeting of the SEACEN Expert Group on Capital Flows, Kuala Lumpur, 11 June 2019.

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I am delighted to be here today. Let me take this opportunity to express Bank Negara Malaysia's appreciation for the collaborative efforts of the SEACEN Centre and the Bank of Japan that have gathered us here for this biennial SEG event.

It has been six years since I last attended the SEG Seminar in Manila, back in 2013 as the newly appointed co-chair. I am truly honoured to have had the opportunity to work alongside Deputy Governor Diwa. Under his capable stewardship and intellectual guidance, the SEG has developed into a beneficial platform for its members since it was established 19 years ago. As we approach two decades of the SEG, it is timely that we re-establish our bearings to ensure we remain relevant and true to the original mission of contributing to the international dialogue on capital flows to ensure that the concerns and interest of the SEACEN group are adequately protected.[1]

As most of our economies continue to face wave after wave of large and often volatile capital flows, I am reminded of the remark by Professor Jon Kabat-Zinn, a professor emeritus of medicine at the University of Massachusetts who famously said: "You can't stop the waves, but you can learn to surf".[2] Just like the surfers who do not have control over the speed and patterns of the waves, policymakers from small open economies do not have much control over the size, speed, and the direction of capital flows that each country faces. Like it or not, capital flow volatility and the risks it entails are a by-product we have to deal with as long as we intend to benefit from free capital mobility. To paraphrase Professor Kabat-Zinn, we can't stop the flows, but we can learn to manage these flows in the best way possible.

Unlike the surfers, however, we policymakers do not have the luxury of repeating a surf when we make a mistake. There is no room for policy missteps as investors can be very unforgiving. This is the reason why it has always been my firm belief that timely sharing of experiences and lessons between policymakers is in itself a big part of policymaking. Candid discussions on policy effectiveness and unintended risks that could arise go a long way in minimising potential policy missteps.

While capital flow volatility will remain a key feature of the global financial system, we have to acknowledge that with heightened uncertainties prevailing in the global economy, capital flow volatility would only intensify. For example, in Malaysia, two-way capital flows have increased by almost three-fold in the aftermath of the Global Financial Crisis.

Yes, we have had large swings in capital flows before and we have been able to manage these surges. What worries me, however, is the fact that monetary and financial stability risks posed by large and destabilising capital flows are expanding, evolving and becoming more entangled.

We are very familiar with the risks posed by volatile capital flows. At the extreme, capital flows can lead to the build-up of domestic vulnerabilities, such as currency mismatches, external indebtedness and broader financial imbalances. These risks are becoming more entwined and complex than ever before. Capital flows undoubtedly complicate efforts to achieve monetary and financial stability. Allowing exchange rate adjustment to deal with capital flows may also be too simplistic.

While capital flow risks have become more complicated, the issue faced by policymakers remains unchanged – that is, how can we better manage these risks and yet maximise the benefits that come with capital flows.

The experience of our economies in dealing with capital flow volatility underscores the need to ensure our economic fundamentals are robust. While this is necessary, it is not sufficient. We have seen how external developments that are beyond our control, such as Taper Tantrum and trade tensions, could trigger periods of sharp capital flow volatility in emerging economies with severe consequences. There are “innocent bystanders” who are gravely impacted.

It is therefore imperative that collectively, we continue to urge the global community to better manage the risks arising from financial openness. More needs to be done at the international level to have, to quote IMF MD Christine Lagarde, “safer capital flows".

Nevertheless, we have to recognise that it is not easy to expect change at the international level. It will definitely take time. While the global community continues to debate and explore possible solutions to manage spillovers and spillbacks of policies in advanced economies, our economies will have to continue to grapple with capital flow volatility and its consequences on financial and macroeconomic stability.

Therefore, I strongly believe that emerging economies must have the necessary domestic policy space in dealing with capital flows. Given the multifaceted risks posed by capital flows, policymakers must be able to avail ourselves of a broad range of policy instruments. These policy instruments include interest rate, exchange rate, macroprudential and capital flow measures.

In deciding which instruments to use, we should avoid ruling out the use of any policy tools upfront. Rather, the choice of instruments needs to be tailored to the specific risks being managed and the circumstances the economy is facing. In addition, the choice of policy instruments also needs to be considered in an integrated manner to increase the efficacy of policies, minimise potential trade-offs, and avoid overburdening of any single policy tool.

Finally, I would like to briefly touch on the role of SEG and SEACEN in dealing with this issue. Earlier, I mentioned the importance of surfers learning how to deal with all types of weather and wave conditions. What I did not mention is the fact that it is impossible for them to learn these skills individually. In Pro Surf Bali, one of the most popular surfing schools in Bali, surfers come together to share their experiences surfing in the toughest conditions, and in doing so, prepare each other for possible eventualities.

The SEG forum on capital flows is in a unique position to achieve this objective. The forum can facilitate deeper awareness and understanding of member countries’ challenges in dealing with capital flows. The frank exchanges of experiences and policies will place member countries on a stronger footing when facing the next wave of capital flows. While I commend the significant development of the SEG forum in the 19 years since its inception, I know we can do so much more to leverage on the experience of each member country here.

There is definitely a role for SEACEN that goes beyond equipping member countries with the necessary skills to manage capital flows. For instance, SEACEN can provide thought leadership on the need for small open economies to have a broad policy toolkit in preserving monetary and financial stability in the face of volatile capital flows. SEACEN can take a leading role in intellectually challenging the prevailing view that capital flow measures should only be considered as a last resort. There is no monopoly on good policies and Asia has plenty to offer. SEACEN can lead the way.

On this note, I look forward to an engaging and fruitful discussion among members in our sessions today. I believe the forum will be thought provoking, with important learning points that will help us better weather the new waves of challenges ahead.

Thank you.

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[1] Terms of Reference of the SEG.

[2] Jon Kabat-Zinn (1994), *Wherever You Go, There You Are*. New York: Hyperion.