Comments by Kyunghun Kim, **on Managing Economic Stability under Volatile Capital Flows: East Asia Perspectives**

Kyunghun Kim: This paper investigates the maintenance of economic stability given volatile capital flows, specifically, focusing on the emerging market economies in East Asia. The author argues that emerging market economies (EMEs) are particularly vulnerable to risks and volatilities from volatile capital flows. Thus, EMEs in East Asia need to have macroeconomic policies and safety nets for economic stability. The policies that the author suggests are a flexible exchange rate, an inflation targeting framework, exchange rate management, and reserve accumulation.

The author should proceed carefully regarding the suggested policy on a more flexible exchange rate. Aghion et al. (2009) show that the impact of exchange rate volatility on productivity growth varies with the degree of financial market development. In the case of EMEs, in which the financial market development is relatively lower than the advanced economies, exchange rate volatility could reduce the productivity growth.

Additionally, a more flexible exchange rate does not guarantee monetary policy independence,[1] especially for EMEs in the integrated financial market. According to conventional wisdom in open macroeconomics, “trilemma” countries with a floating exchange rate regime have monetary policy independence when the financial market is open. Rey (2015), however, shows that trilemma no longer holds, but dilemma holds. The monetary policies are restricted by the global financial cycle regardless of exchange rate regime. What really matters is how the capital account is managed. Rose (2014) found the empirical evidence that supports Rey’s argument. There was no systematic difference in economic output between countries with hard fixers and floating with inflation targetters during the 2008–09 global financial crisis.

In terms of long-run economic growth and the short-run business cycle, policymakers, especially in EMEs, must be careful in adopting a more flexible exchange rate regime

1 Obtaining monetary policy independence is very important over the business cycle because monetary policy works as output stabilizer responding to an external financial shock.

because of the reasons mentioned here. Also, the impact of exchange rate adjustment on current account is ambiguous thanks to a pervasive global value chain.

This paper deals with an important topic, especially for EMEs. Many emerging markets have restricted monetary policy and fiscal policy,al though each country faces a somewhat different economic environment. Given this limited set of policy measures, I agree that EMEs should use whatever policy works, as the author argues. Exchange rate policy is not an exception. Exchange rate policy could be also useful for EMEs with limited policy measures.

References

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