Caution on battling speculation

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Most monetary policymakers view a sudden resurgence in capital inflow with a wary eye amid concerns that speculative funds may have found their way into the system, leading to currency instability and asset price bubbles. In Taiwan, a press statement released by the central bank on Thursday, citing excerpts on capital controls and financial stability, suggests that the bank now considers foreign speculative funds its No. 1 target.

The three excerpts, which the bank dubbed “reference materials,” were taken from an interview by Thai newspaper The Nation with Nobel Prize-winning economist Joseph Stiglitz on Aug. 25, the UN Trade and Development Report 2009 and the G7 communique issued last Saturday.

First, the central bank made it clear that it didn’t welcome speculative money by quoting Stiglitz as saying: “You have to recognize how dangerous hot money can be.”

It then quoted the UN trade report by saying: “It would certainly be a step forward if surging capital inflows were no longer perceived as a sign of strength, but as a potential source of disequilibrium.”

Finally, the bank voiced its concern about financial stability by citing the G7 communique: “Excess volatility and disorderly movements in exchange rates have adverse implications for economic and financial stability.”

While the statement said the materials were for public reference only, the general perception in financial circles is that the hawkish, anti-inflation central bank Governor Perng Fai-nan (□□□) is gearing up to fight the inflow of hot money. The strategy has worked in the past, and Perng has built a reputation for killing currency speculation.

The bank has a good reason to worry. The latest Financial Supervisory Commission data revealed that US$2.7 billion out of the US$7.06 billion net inflow of foreign portfolio capital last month was not invested in local stocks, suggesting the money was used to buy New Taiwan dollars.

Several central banks in the region have already expressed concern that the resurgence of capital inflows is threatening the stability of their financial markets, with some choosing to intervene in the market. South Korea, for example, is reportedly considering restricting state-controlled companies’ US dollar loans in a bid to keep the value of the won in check.

Intensifying concern about the volatility of capital inflows makes the central bank’s intervention inevitable. However, the bank should be extremely cautious in exercising capital controls and intervene only when the exchange rate of the NT dollar has deviated sharply from its value, because in some cases it could be counterproductive.

Global investors are now looking for clues on how strong emerging markets — including

Taiwan — can perform once the global crisis ends, compared with relatively slow growth in the US, Europe and Japan. The bank should bear in mind how its capital controls have frequently invited criticism from MSCI Inc or FTSE Group when they were re-weighting Taiwan's market status in their compiled indexes.

No one doubts the central bank's ability to keep the foreign inflows in check, as it has plenty of monetary tools at its disposal. But the bank should stick to its anti-inflation mission and should not use its monetary instruments solely for a shortsighted desire to prolong an export boom by manipulating the exchange rate.

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