

Benefits and Costs: the impact of capital control on growth-at-risk in China

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Abstract

Capital account liberalization is generally beneficial to developing and emerging countries. However, if there is a downside risk in one country, capital control policy can prevent it from exposing to carry trade flows and capital flight and protect it from external financial volatility. In this paper, we study the marginal effects of China's capital control policies on GDP growth distribution and the term structures of such effects. We use the framework extended by Adrian et al. (2019) to estimate the quantile regression of GDP growth on different types of capital control indices and fit the empirical distribution. We find that: (i) the aggregated and granular types of capital control indices are benefit in reducing the downside risk of real GDP growth in medium term whereas they are costly on the upswings of business cycle in near-term. (ii) after we estimate the marginal effects of capital control indices on GDP growth over quantiles, the results show that the heterogeneous effects are stronger in short term than medium term; (iii) these heterogeneous effects are more evident in short term for outflow control index and resident transaction index; (iv) the granular indices show generally heterogeneous effects even if several of them are insignificant.

Keywords: capital control policy, growth-at-risk, quantile regressions, narrative approach.

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