Capital controls or macroprudential regulation: Which is better for land booms and busts?

Yang Zhou, IDE JETRO.
Shigeto Kitano, Kobe University.

Abstract

Emerging markets have experienced land booms and busts along with international capital inflows and outflows repeatedly. This study quantitatively examines the effectiveness of (i) macroprudential policies targeting land markets and (ii) capital controls targeting capital inflows and outflows. We analyze which policy better manages the coincidence between land booms (busts) and capital inflows (outflows). We build a small open economy NK-DSGE model in which banks choose their asset portfolio between physical capital and land subject to financial constraints. The quantitative results show that the superiority of the two policies depends on the type of shock impacting a small open economy. In the case of domestic land market shocks, macroprudential policies enhance welfare, whereas capital controls reduce welfare. Conversely, in the case of foreign interest rate shocks, the superiority of the two policies is reversed: capital controls enhance welfare, while macroprudential policies deteriorate welfare.

Keywords: Capital control, Macroprudential policy, Financial frictions, Balance sheets channel, DSGE

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