Int. Fin. Markets, Inst. and Money 23 (2013) 111–135

Contents lists available at SciVerse ScienceDirect

Journal of International Financial Markets, Institutions & Money

journal homepage: www.elsevier.com/locate/intfin

The perils of a central bank's capital control: How substantial is the effect on firm value?

Chaiporn Vithessonthi [a,*], Jittima Tongurai [b,1]

[a] *Mahasarakham Business School, Mahasarakham University, Khamriang, Kantarawichai, Mahasarakham 44150, Thailand*
[b] *NIDA Center of Integrated Tourism Management Studies, National Institute of Development Administration, 118 Sereethai Road, Bangkapi, Bangkok 10240, Thailand*

ARTICLE INFO

Article history:
Received 31 December 2011
Accepted 24 September 2012
Available online 2 October 2012

JEL classification:
F3
G1
G14
G15

Keywords:
Abnormal returns
Capital controls
Exchange rates
Thailand
Unremunerated reserve requirement

ABSTRACT

In this paper we examine the cross-sectional effects of the announcement of the imposition of the unremunerated reserve requirement (URR) in Thailand on stock prices. We show that there are negative abnormal returns following the announcement of the imposition of the URR, and that the effect of the imposition of the URR on stock prices seems to be relatively short lived. Our tests show that firm size, financial risk, and firm profitability have no effect on abnormal returns on the first-trading day following the URR announcement, but the effects of firm size, firm profitability and financial risk on abnormal returns become more evident in later days. We also find some evidence to suggest that there is no industrial effect on abnormal returns around the URR announcement.

© 2012 Elsevier B.V. All rights reserved.

1. Introduction

Although the debate on the desirability and feasibility of capital account restrictions is still ongoing, several scholars such as Fischer (2001) and Forbes (2005, 2007) argue that the market-based capital control, especially, the unremunerated reserve requirement (URR), remains popular amongst

* Corresponding author. Tel.: +66 43 754 333; fax: +66 43 754 422.
E-mail addresses: c.vithessonthi@mac.com (C. Vithessonthi), jittima.t@nida.ac.th (J. Tongurai).
[1] Tel.: +66 2727 3671; fax: +66 2377 7477.

1042-4431/$ – see front matter © 2012 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.intfin.2012.09.006

policy makers in developing countries. From the perspective of monetary authorities, the imposition of capital controls is expected to result in relatively stabilized exchange rates, which in turn helps to maintain and/or stimulate the levels of output and/or employment. In response to large increases of capital inflows to emerging market economies in the 1990s and 2000s, several developing countries imposed capital account restrictions. For instance, Chile, Colombia, Brazil, and Thailand had implemented market-based capital controls in the form of URR in the 1990s and 2000s (see e.g., Clements and Kamil, 2009; Vithessonthi and Tongurai, 2008).

In this paper we argue that the effect of capital controls on macroeconomic variables (e.g., employment) is, at best, indirect and difficult to observe. We believe that the effects of the imposition of capital controls on financial markets (e.g., on asset prices) are more observable. Nevertheless, a stream of research that examines whether the use of capital account restrictions benefits firms and ultimately increases firm value remains scant. In particular, existing research that investigates the effects of the imposition of capital controls on stock prices at the firm level appears to be limited to only a few studies (see e.g., Vithessonthi and Tongurai, 2008, 2009). Thus, our understanding of this issue remains far from complete. Therefore, we provide further evidence on this issue by empirically testing whether the imposition of capital controls benefits firms in the short run.

If we consider the imposition of a capital control as a source of an exogenous liquidity shock that reduces the availability of foreign financial capital in a small and open country, the theory of a liquidity premium in asset returns (see e.g., Becker-Blease and Paul, 2006; He and Xiong, 2012) would predict an inverse effect of the imposition of a capital control on firms' future prospect. For instance, He and Xiong (2012) show that a fall in debt market liquidity results in an increase in the liquidity premium of corporate bonds and credit risk. Suppose that foreign investors are unwilling to provide short-term funds to finance investments in a country that implements controls on short-term capital inflows. Then we expect that a decrease in market liquidity, which tightens firms' financial constraints (Harrison et al., 2004) and causes investors to increase their required rates of returns so as to compensate for increased investment risk (Girard and Rahman, 2007), would increase the cost of capital. This impact on the cost of capital would, thereby, reduce firms' investment and growth opportunities through a fall in the number of positive NPV projects available to the firms.

Anwar and Sun (2011) and Takagi (2002) note that most small and emerging market countries such as Thailand, Malaysia, and the Philippines are generally a bank-based economy in which firms typically rely on financial intermediaries (e.g., banks) as their main source of external financing. If banks and other financial institutions manage to pass the higher costs of international borrowing through their domestic clients, then the imposition of capital controls would lead to higher costs of external financing for firms, thereby suggesting that firms are likely to experience greater financial constraints and higher financing costs during the capital control period (see e.g., Forbes, 2007). This prediction is based on the assumption that the pattern of small- and medium-sized firms' borrowing remains relatively unchanged in the short run. In addition to causing higher costs of financing, the imposition of capital controls causes deterioration in market liquidity, which in turn increases refinancing (or rollover) risk for firms that rely more on short-term financing.

In this study we attempt to address two research questions. First, do investors react favorably to the announcement of the imposition of capital controls in developing countries, as expected by monetary policy makers? Second, could firm-specific characteristics explain variations in unexpected changes in stock prices around the announcement of the imposition of capital controls? Accordingly, the main purpose of this paper is to examine the effect of the imposition of capital controls in emerging market countries on stock prices in recent years. Given that the Bank of Thailand recently imposed the URR, the examination of the effect of the URR in Thailand on stock prices provides us new insights into the repercussions of capital controls in an emerging market economy. In particular, we focus on the Bank of Thailand's announcement of the imposition of the URR on December 18, 2006 (see Bank of Thailand, 2006b,c).

We show that abnormal returns (ARs) around the announcement of the imposition of the URR in Thailand are negative. In addition, we find that both financial and non-financial firms experience negative ARs around the URR announcement. Overall, these findings indicate that investors react negatively to the imposition of the URR, questioning monetary authorities' beliefs that such capital account restrictions are beneficial to firms in small and open economies. Our findings are consistent

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات