



# Capital Flows: Build-ups and let-downs

*Dr. Laura E. Kodres*

*Monetary and Capital Markets Department*

**June 16, 2009**

---

---

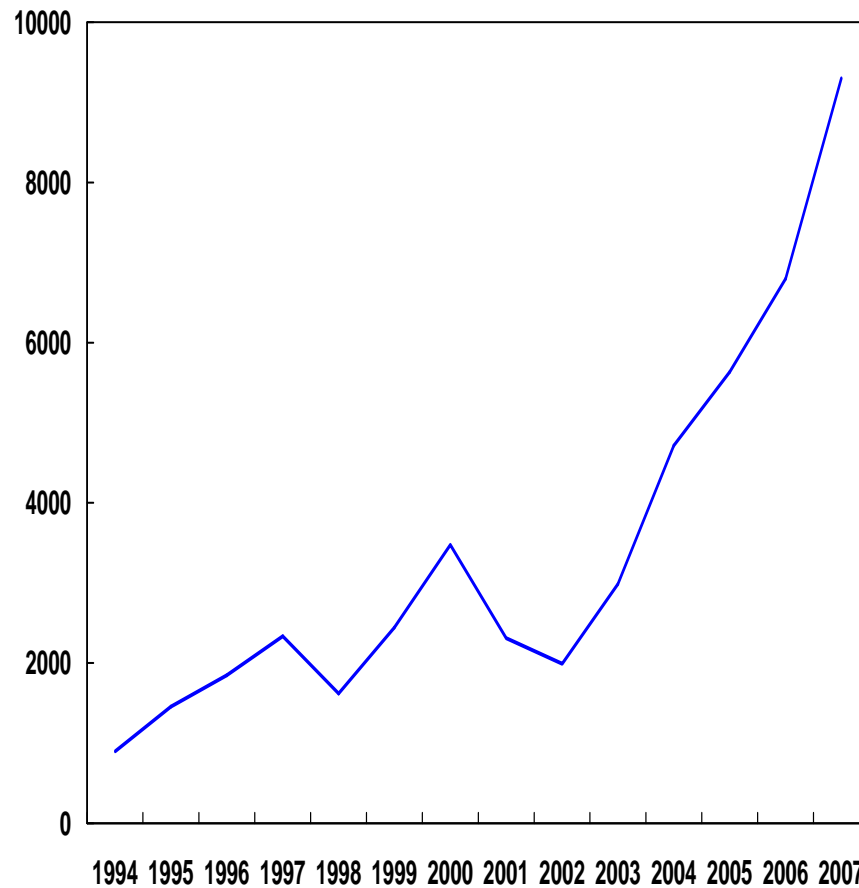
# Outline

- Recent history of capital inflows and net flows
  - Forecasts of capital flows
    - Baseline
    - Econometric work
  - Policies for medium term
    - What financial system characteristics influence capital flows
-

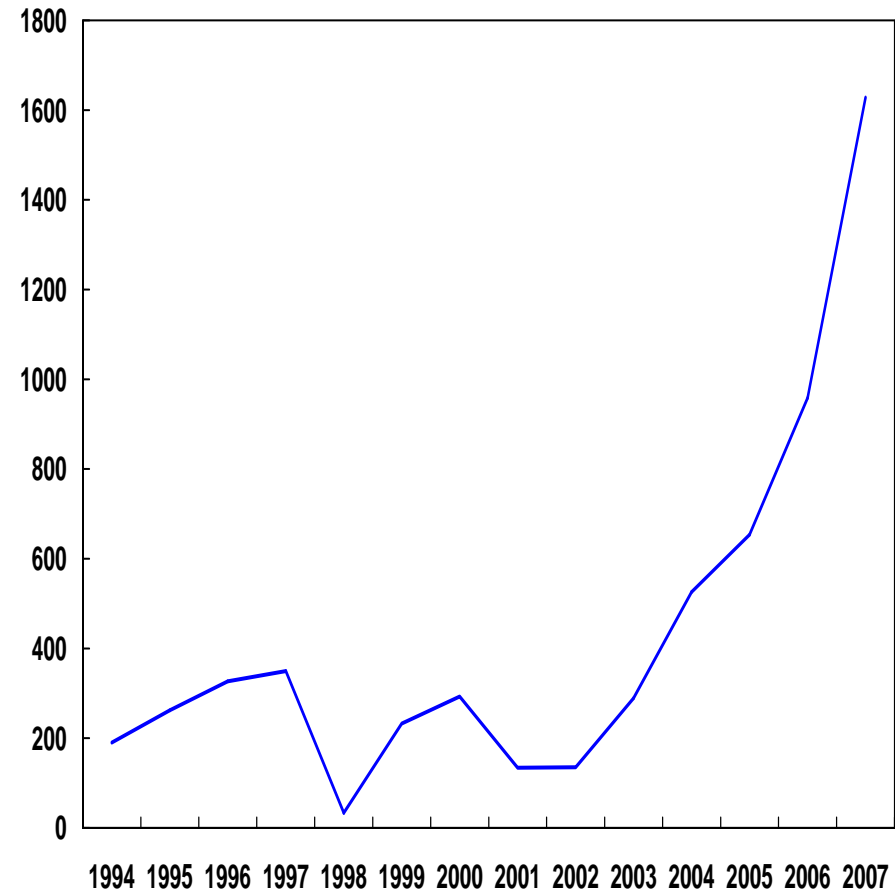
# Total Capital Inflows

(In billions of U.S. dollars)

## Developed and Emerging Market Economies



## Emerging Market economies

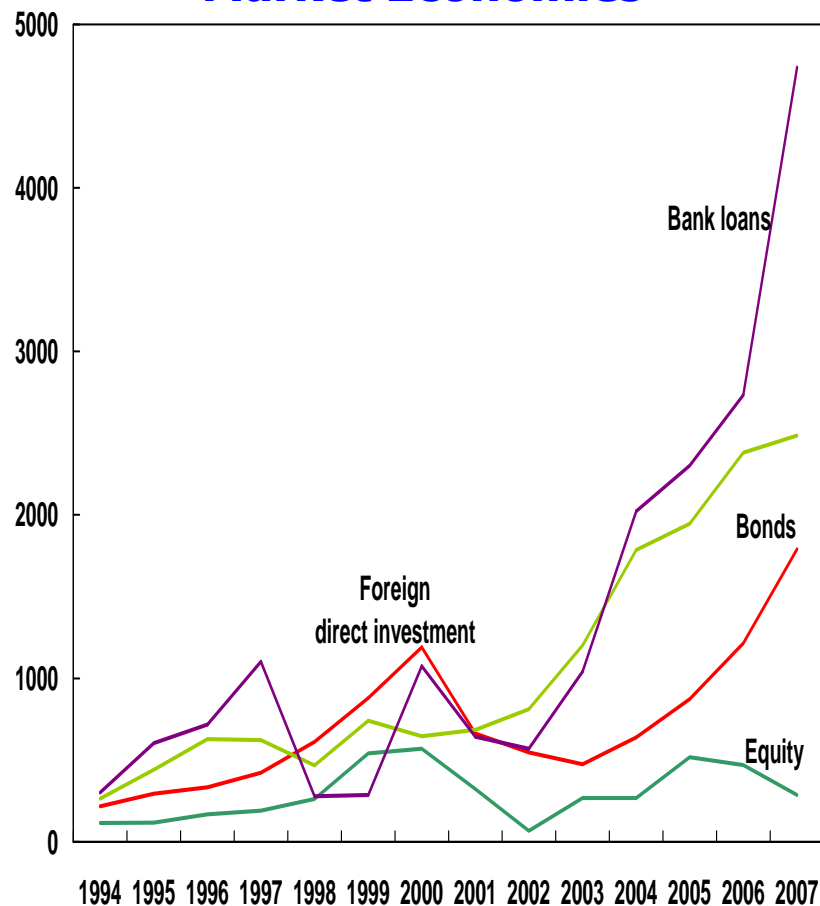


Note: sample of 56 countries comprising 84% of world capital flows.

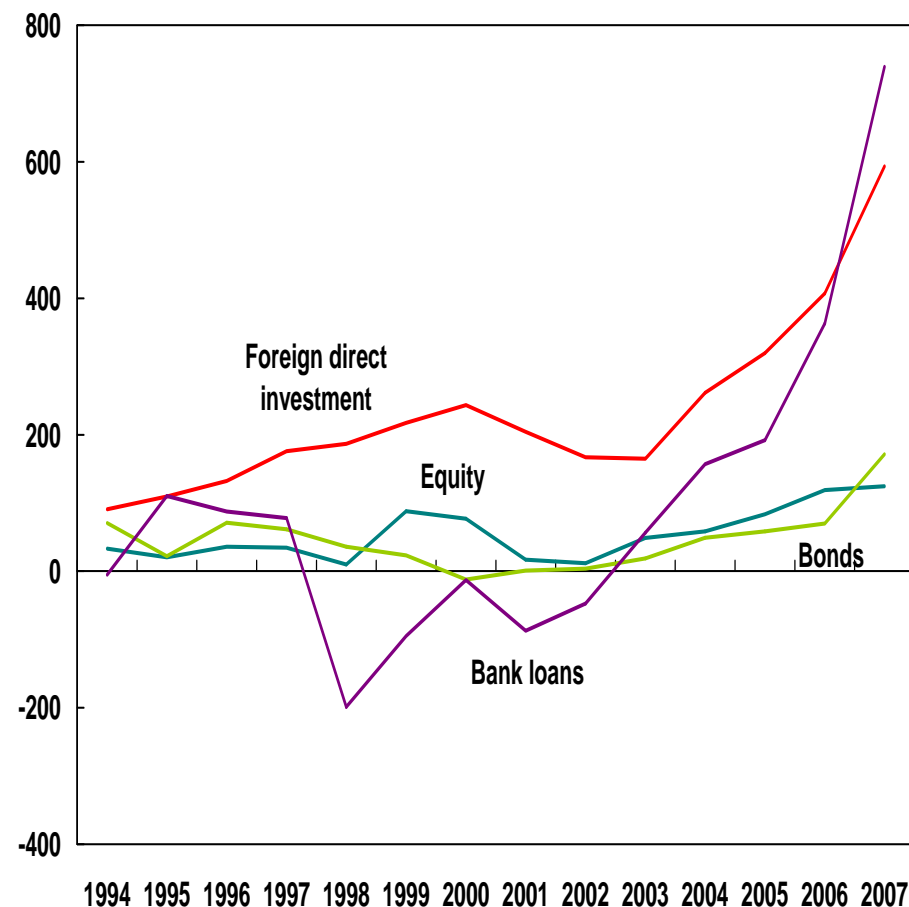
# Composition of Capital Inflows

(In billions of U.S. dollars)

## Developed and Emerging Market Economies



## Emerging Market economies



Note: sample of 56 countries comprising 84% of world capital flows.

# Emerging and Developing Economies: Net Capital Flows

(In billions of U.S. dollars)

## Emerging and Developing Economies

	2003	2004	2005	2006	2007	2008	2009	2010
Private direct flows, net	161.3	183.9	243.7	241.4	359.0	459.3	312.8	303.1
Private portfolio investment, net	-3.8	10.0	-5.6	-100.7	39.5	-155.2	-234.5	-195.3
Other private capital flows, net	-3.3	28.0	-11.3	62.2	219.2	-194.6	-268.5	-114.2
Official flows, net	-43.3	-64.9	-98.5	-154.1	-100.5	-60.0	57.6	-28.1
Reserves	-360.6	-501.9	-585.7	-751.7	-1257.8	-865.7	-266.5	-512.2
Total capital flows	-249.7	-344.9	-457.4	-702.9	-740.6	-816.2	-399.1	-546.7

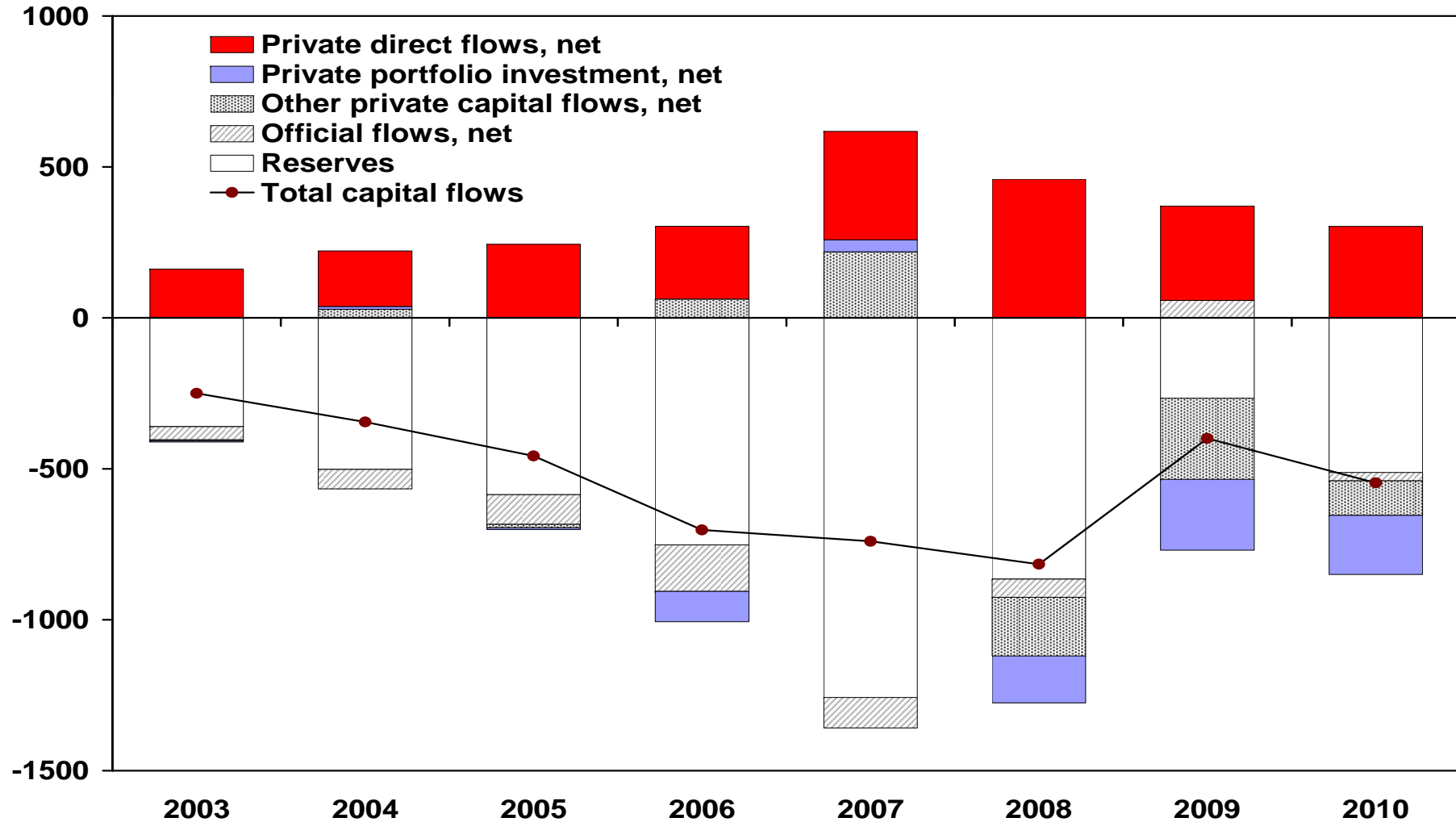
## Central and Eastern Europe

	2003	2004	2005	2006	2007	2008	2009	2010
Private direct flows, net	13.3	30.0	37.4	58.9	72.0	64.1	30.1	32.5
Private portfolio investment, net	9.7	25.3	25.9	9.4	-7.4	-13.2	-6.1	4.6
Other private capital flows, net	19.2	6.1	36.6	51.7	108.9	96.2	-62.4	-23.6
Official flows, net	-2.4	-4.1	0.0	-7.9	-6.0	7.3	26.8	9.6
Reserves	-9.3	-8.1	-36.1	-20.3	-31.2	-9.7	36.6	6.1
Total capital flows	30.5	49.2	63.8	91.8	136.3	144.7	25.0	29.2

Source: IMF, World Economic Outlook.

# Emerging and Developing Economies: Net Capital Flows

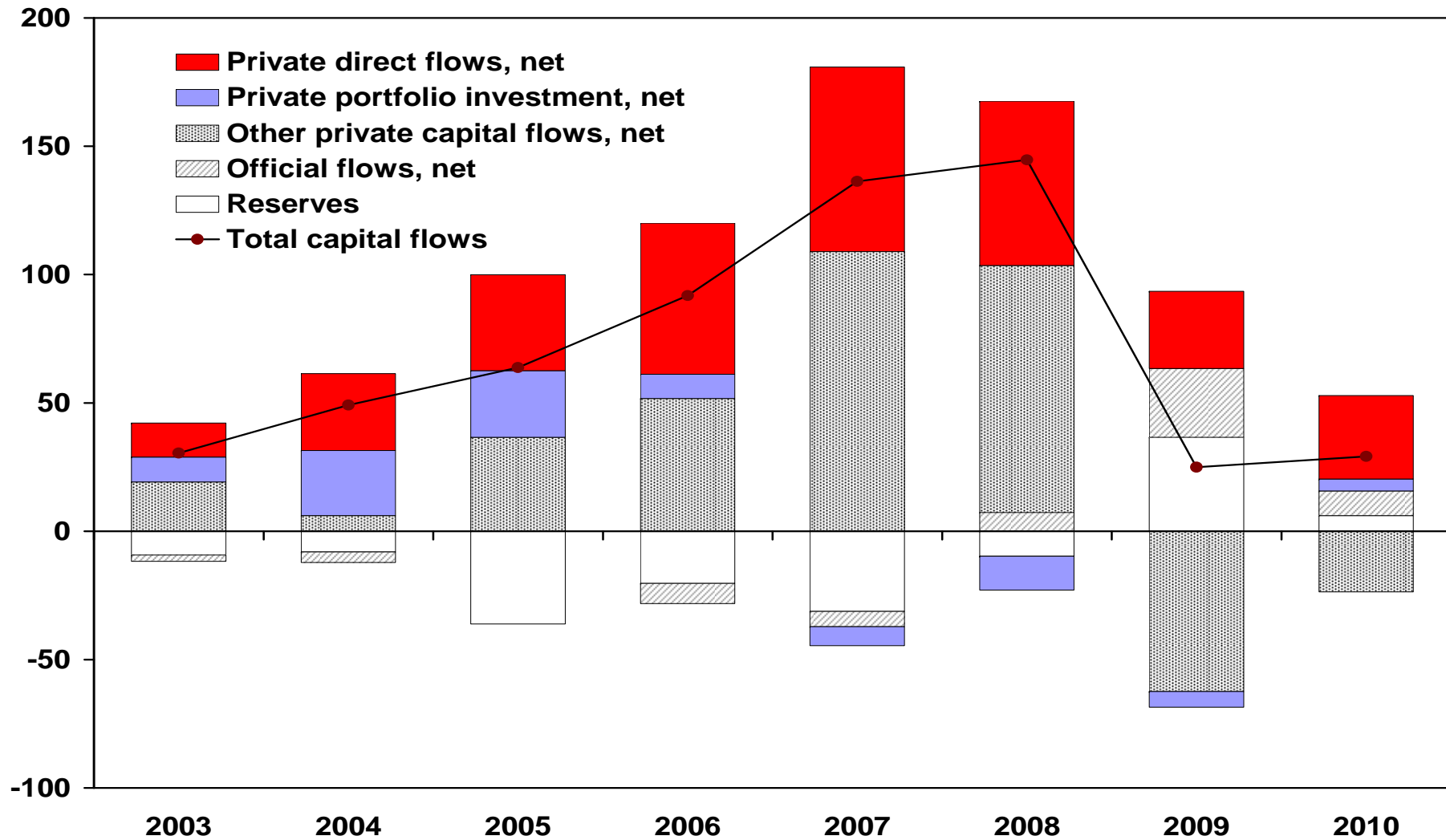
(In billions of U.S. dollars)



Source: IMF, World Economic Outlook.

# Central and Eastern Europe: Net Capital Flows

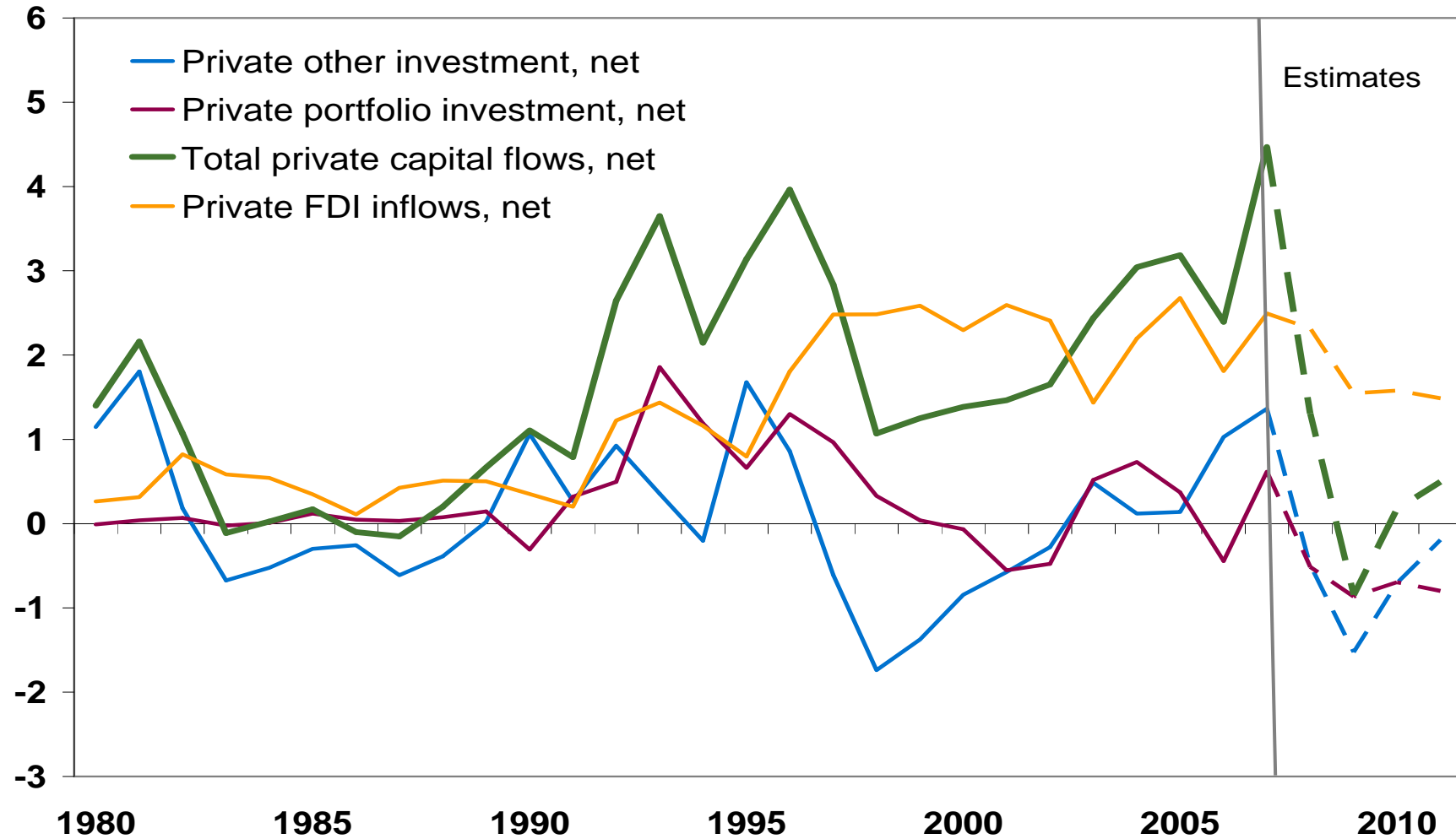
(In billions of U.S. dollars)



Source: IMF, World Economic Outlook.

# Emerging Market Net Private Capital Flows

(In percent of GDP)

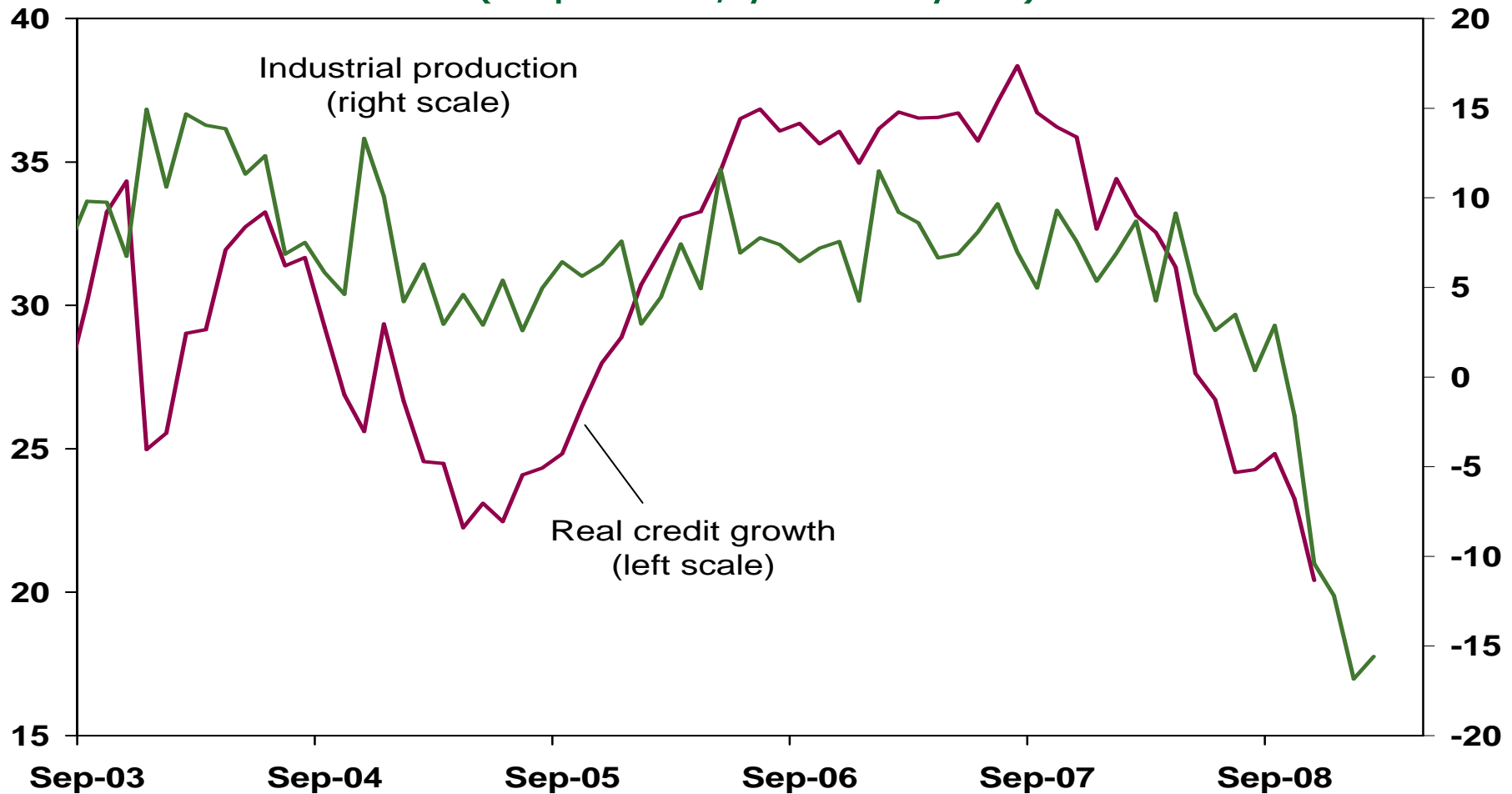


Source: IMF, World Economic Outlook database.



# Emerging Europe: Real Credit Growth to the Private Sector and Output

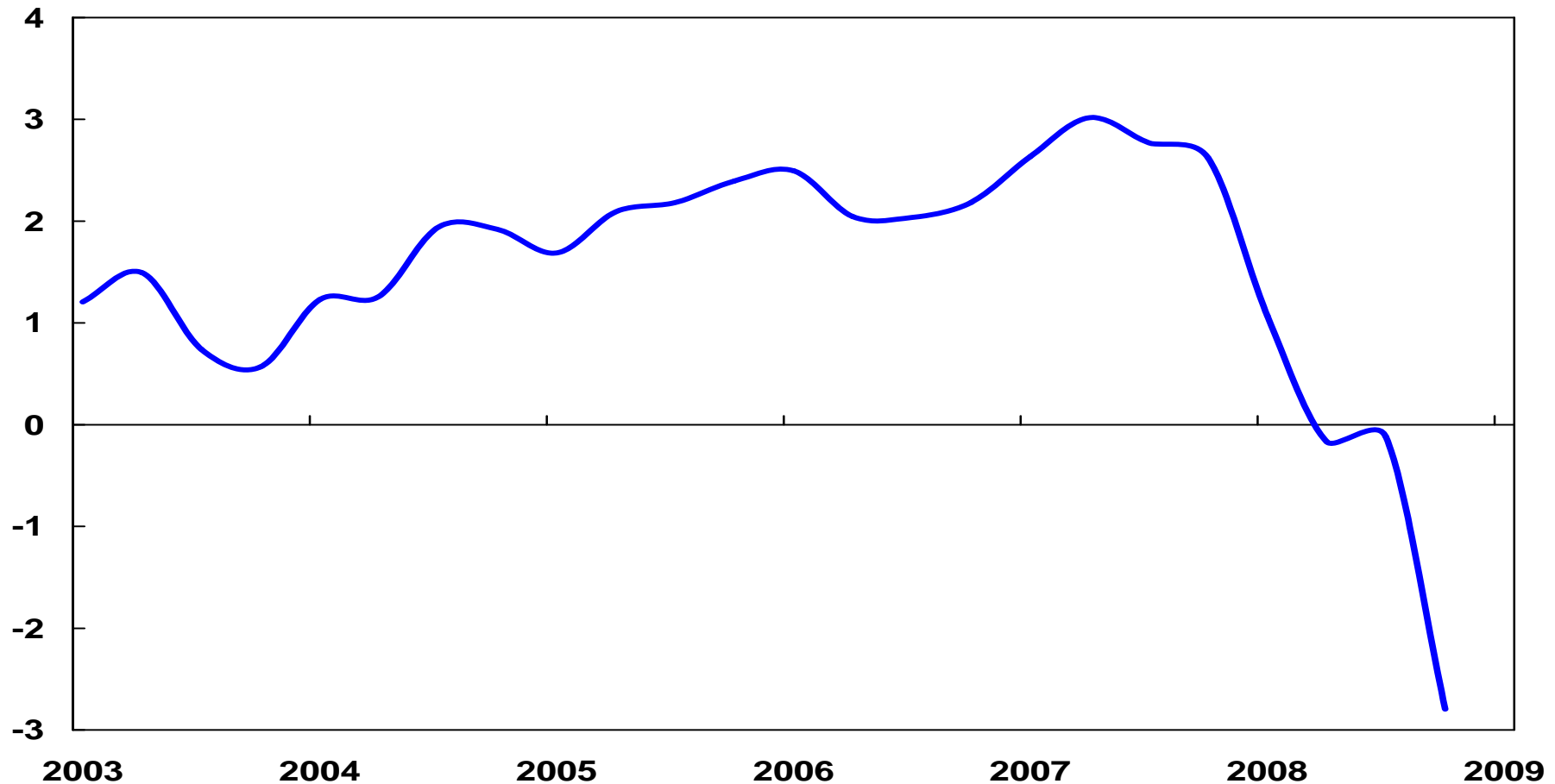
(In percent, year-on-year)



Sources: Bloomberg L.P.; IMF, International Financial Statistics database; and IMF staff estimates.

# Cross-Border Assets as a Proportion of Total Assets

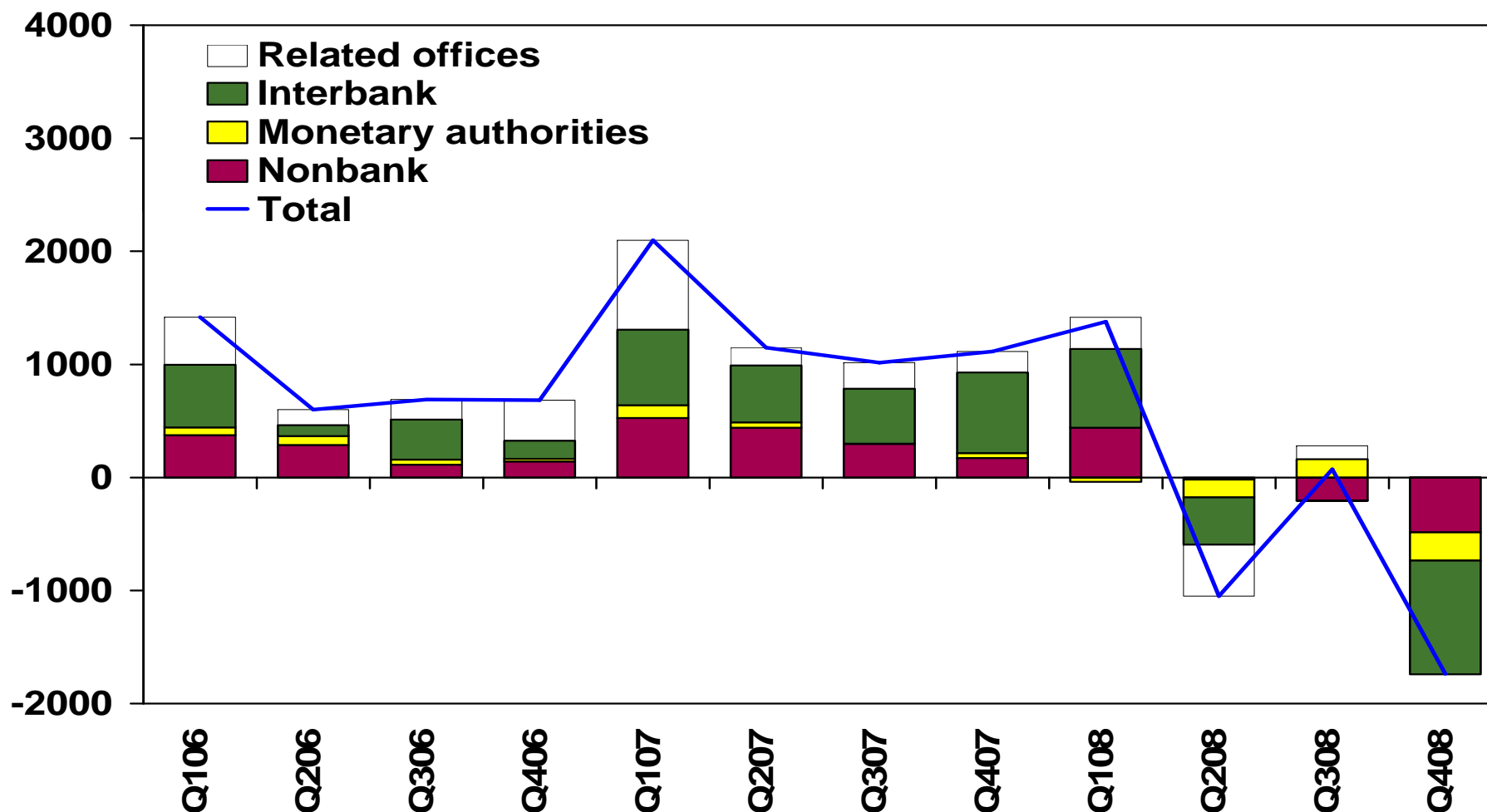
(Annual change in percentage points)



Sources: Bank for International Settlements; and IMF staff estimates.

# BIS Reporting Banks: Cross-Border Liabilities, Exchange-Rate-adjusted Changes

(In billions of U.S. dollars)

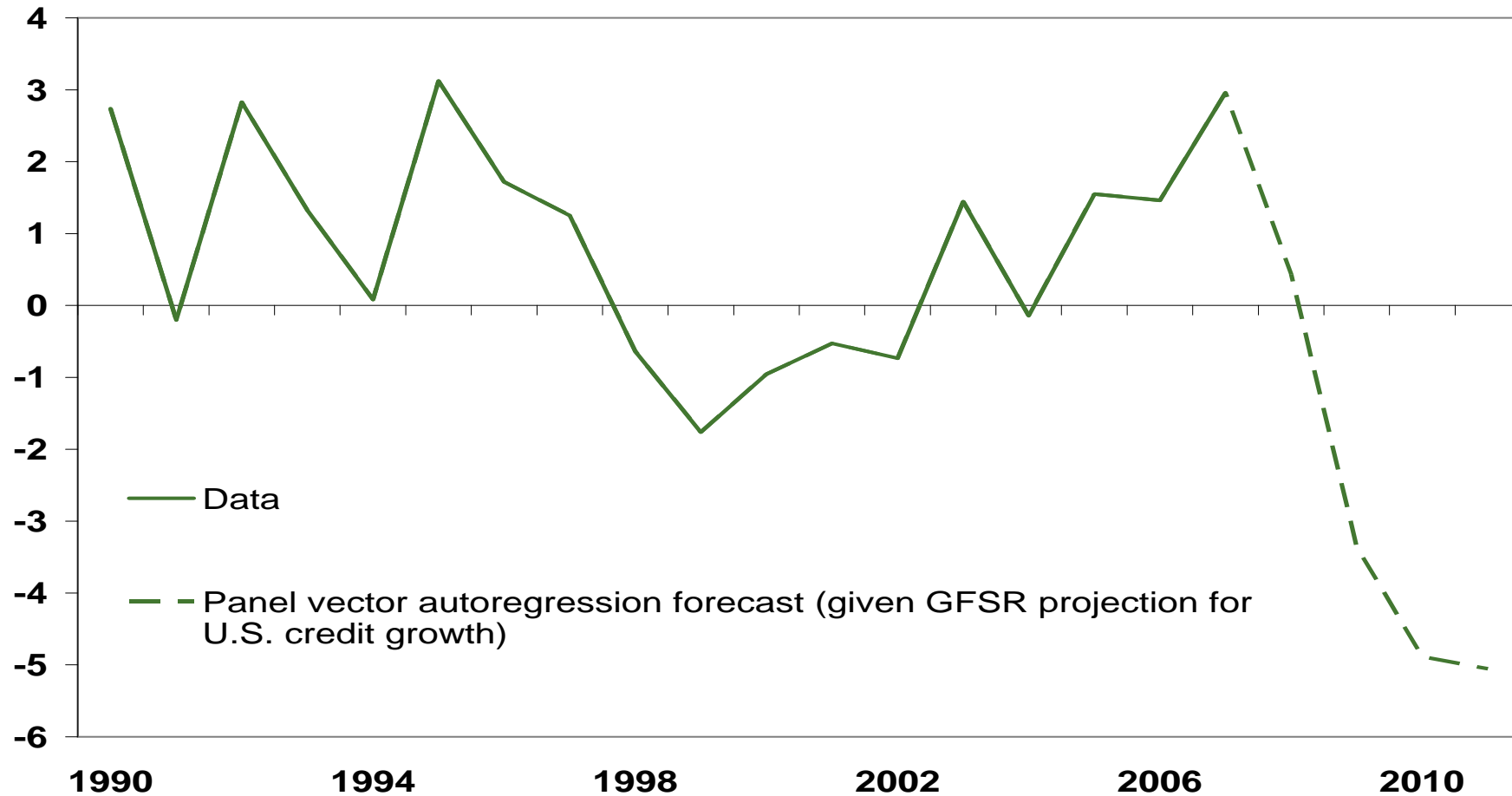


Sources: Bank for International Settlements; and IMF staff estimates.

Note: Related offices refers to banks that are legally similar, the best example being a parent bank in the home country lending to its subsidiary in another country.

# Net Private Other Investment Flows to Emerging Markets

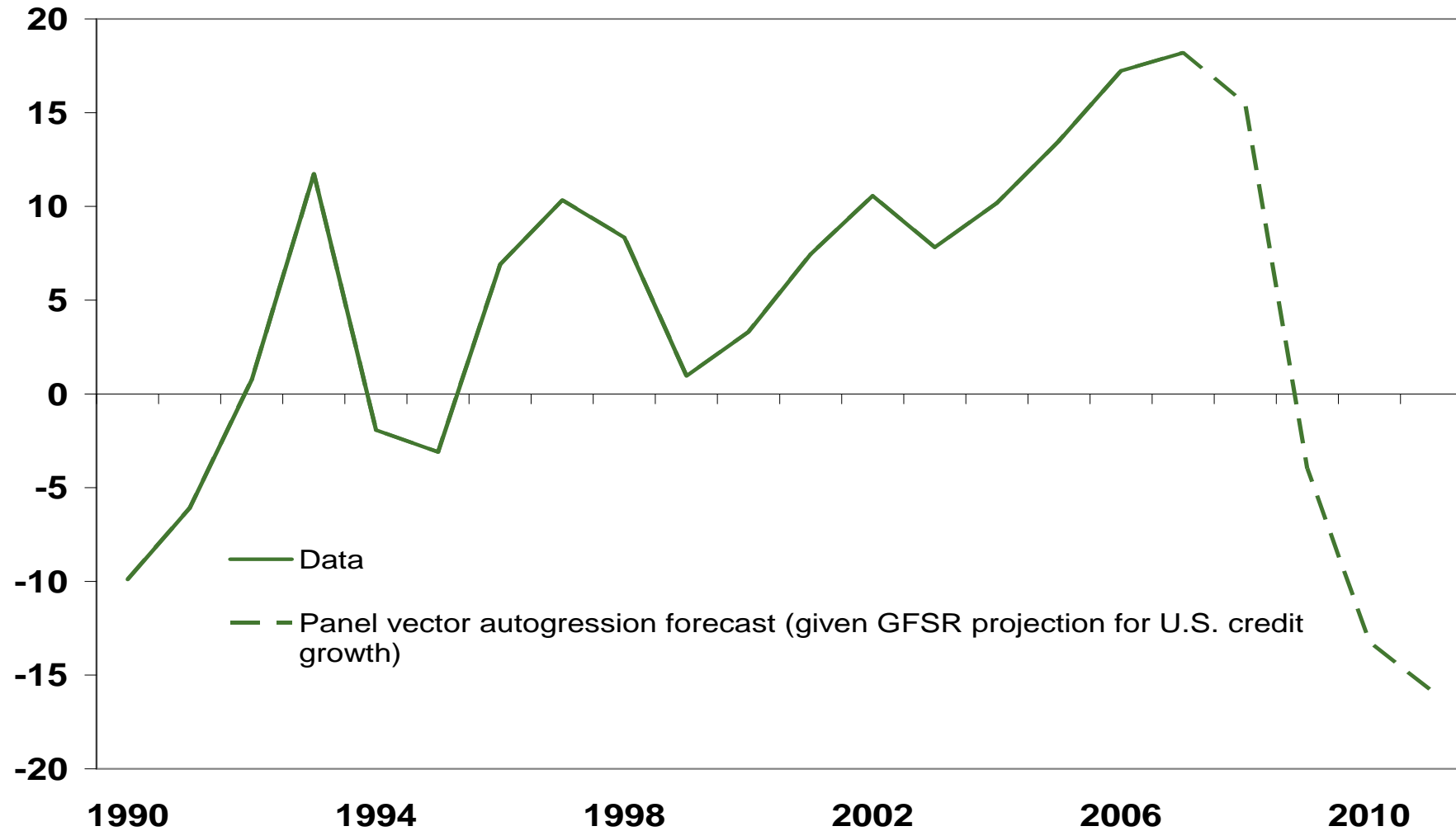
(In percent of GDP, average in panel)



Sources: IMF, World Economic Outlook database; and IMF staff estimates.

# Emerging Market Real Credit Growth

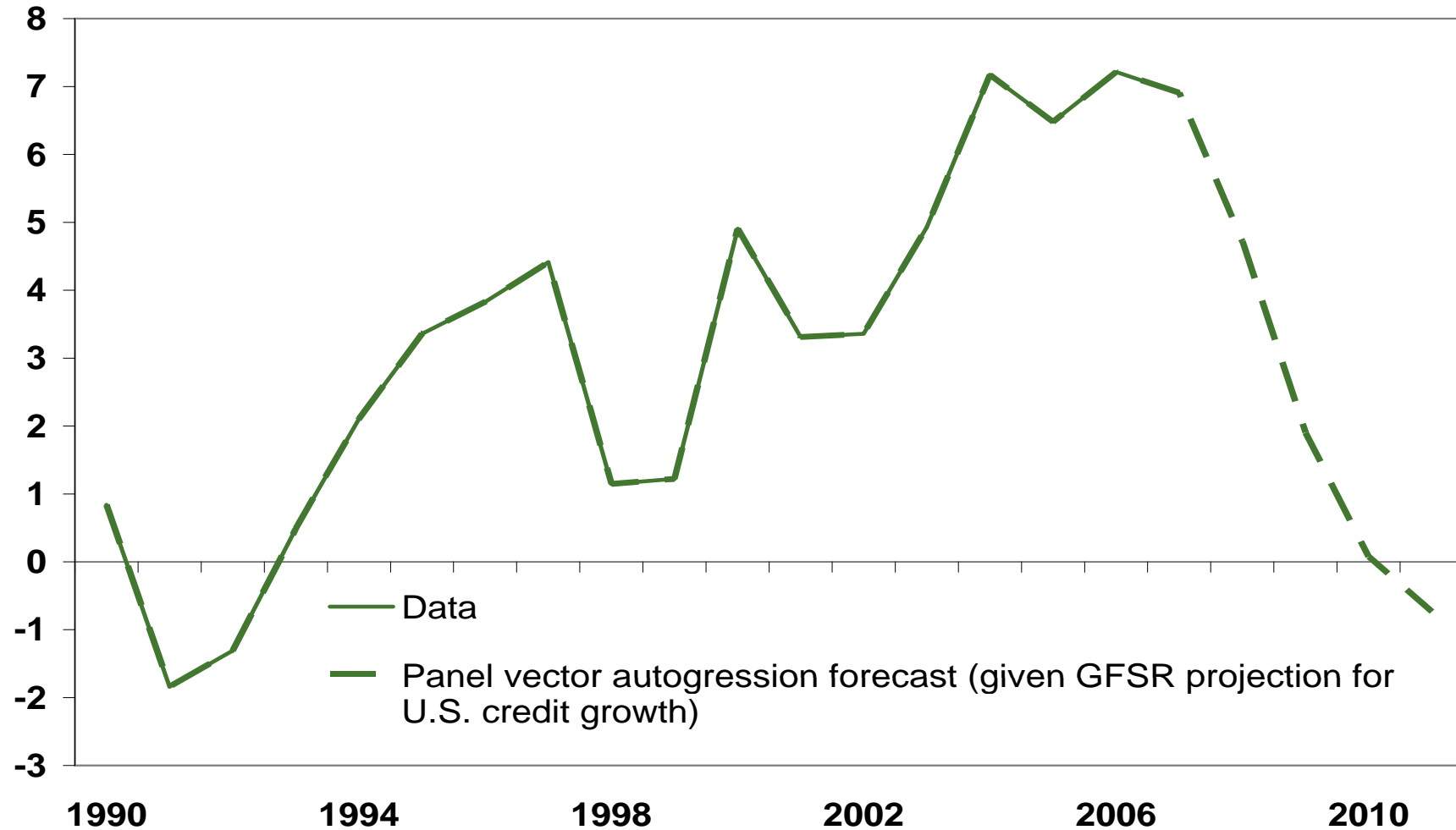
(In percent, year-on-year, average in panel)



Sources: IMF, World Economic Outlook database; and IMF staff estimates.

# Emerging Market GDP Growth

(In percent, year-on-year, average in panel)



Sources: IMF, World Economic Outlook database; and IMF staff estimates.

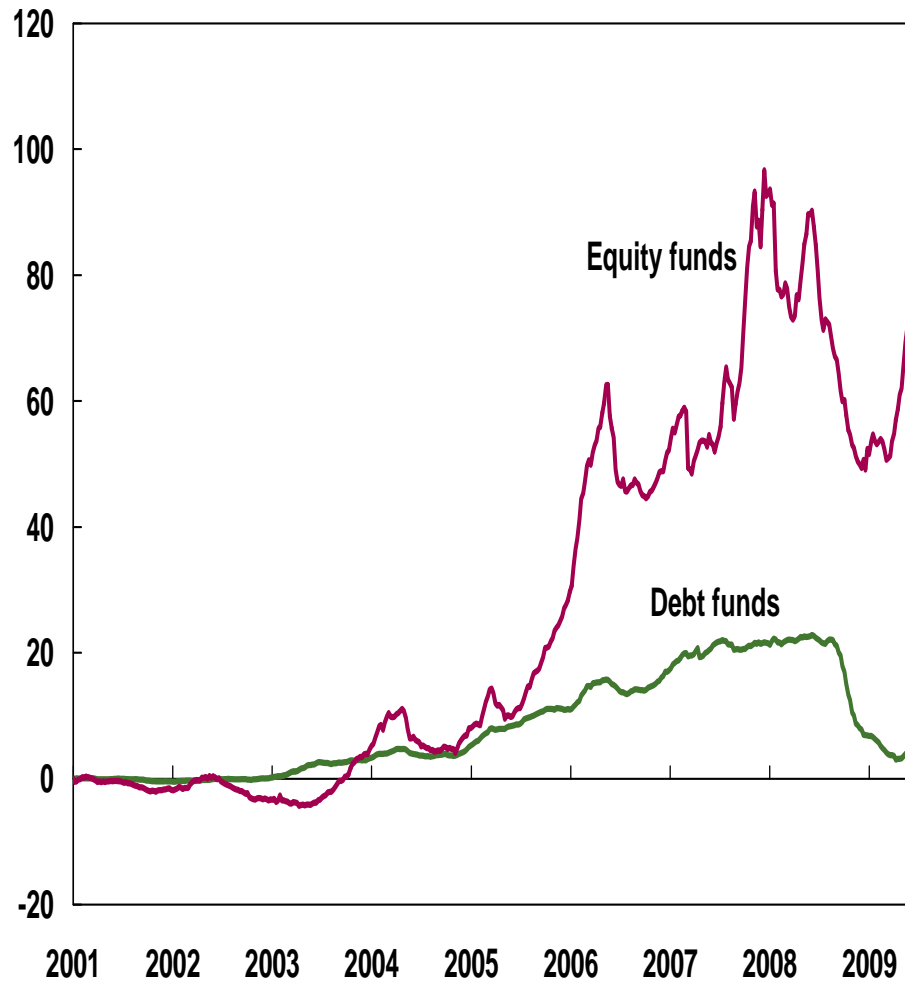
---

# Caveats to Econometric Capital Flows Study

- Constant model coefficients across countries.
  - Assumes “typical” policy response from EM countries, without accounting for larger reserves and better fiscal situations.
  - Does not factor in global policy response and increase funding for IMF and others.
  - Parent-subsidiary relationships perhaps stronger this time, supporting cross-border lending.
-

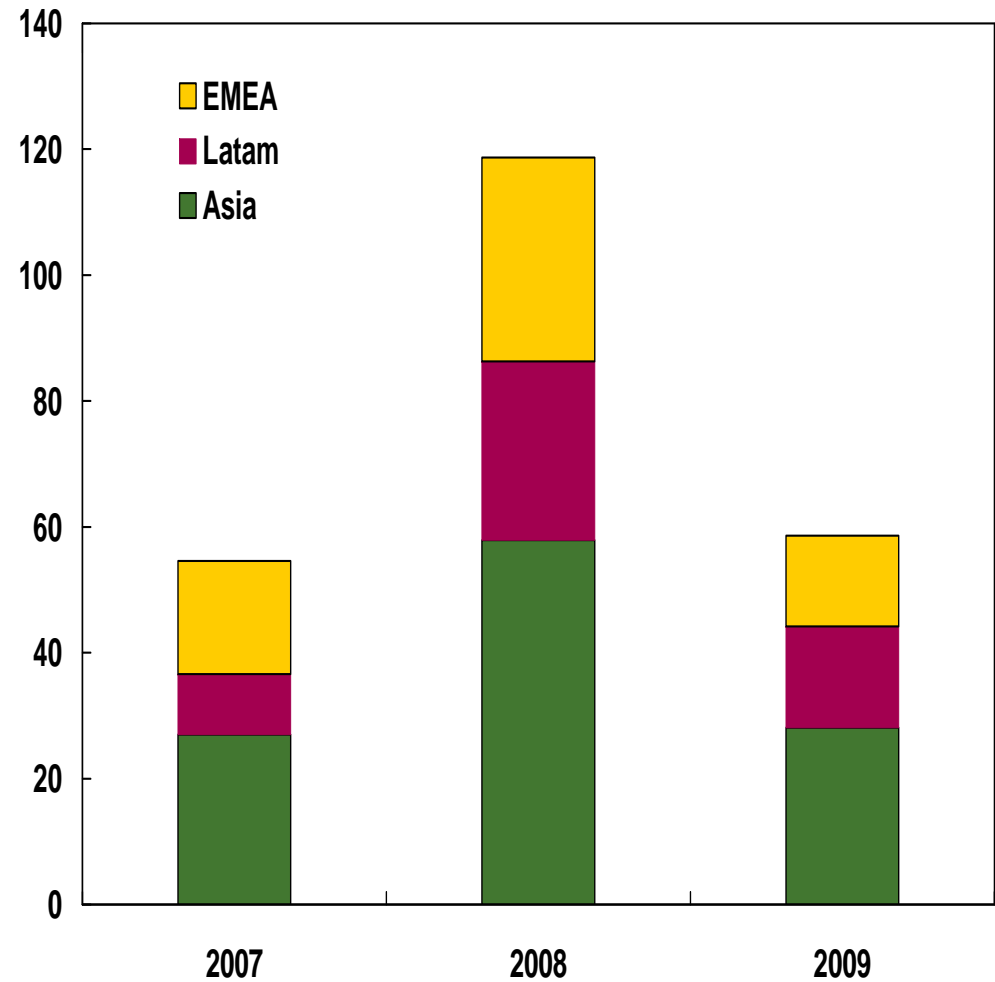
## Cumulative EM Fund Flows

(In billions of U.S. dollars)



## EM Bond Issuance 1/

(In billions of U.S. dollars)



Sources: Emerging Portfolio Research; and Dealogic.  
1/EM bond issuance reflect January–May data for each year.



# Panel Least-Squares Estimation of Determinants of Capital Inflows, 1998-2006 1/

	All Countries	Emerging Markets
<b>Financial Development Indicators</b>		
Equity market turnover	√	√
Equity market capitalization	—	—
Financial openness	√	√
Corporate governance quality	√	—
Accounting standards	—	—
<b>Macroeconomic Factors</b>		
Growth expectation	√	√
Interest rate differential	√	√
Global liquidity	—	—

Sources: Chin and Ito (2006); De Nicolo and others (2006); and IMF staff estimates  
 1/Total capita inflows/GDP. √ = statistically significant.

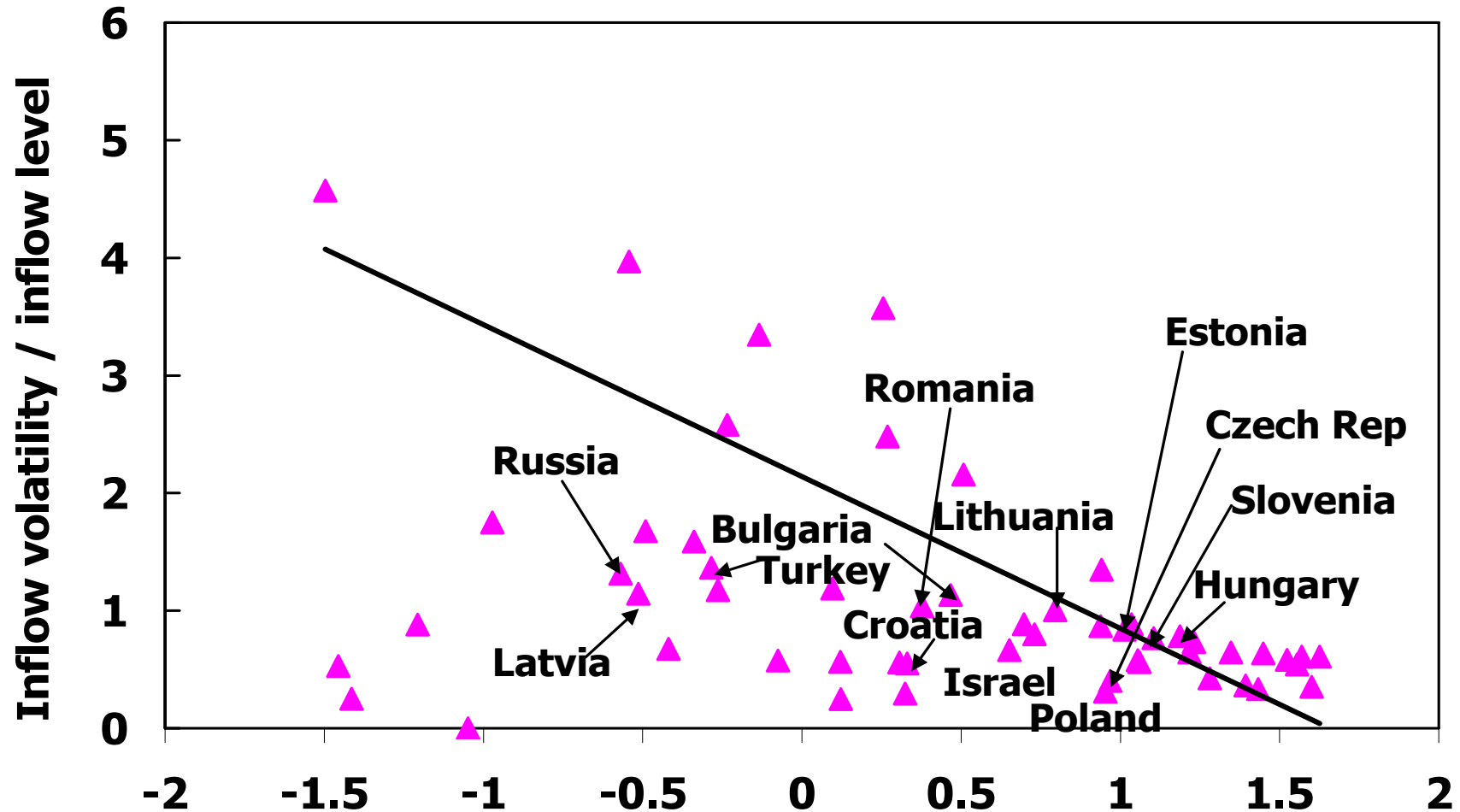
## Panel GMM Estimation of the Determinants of the Standard Deviation of Capital Inflows, 1998-2006 1/

	All Countries	Emerging Markets
<b>Financial Development Indicators</b>		
Equity market turnover	—	—
Equity market capitalization	—	—
Financial openness	√	√
Corporate governance quality	—	—
Accounting standards	—	—
<b>Macroeconomic Factors</b>		
Growth expectation	—	—
Interest rate differential	—	—
Global liquidity	√	√

Sources: Chin and Ito (2006); De Nicolo and others (2006); and IMF staff estimates.  
 1/Standard deviation of total capita inflows/GDP. √ = statistically significant.

# Market Infrastructure and Volatility of Total Capital Inflows

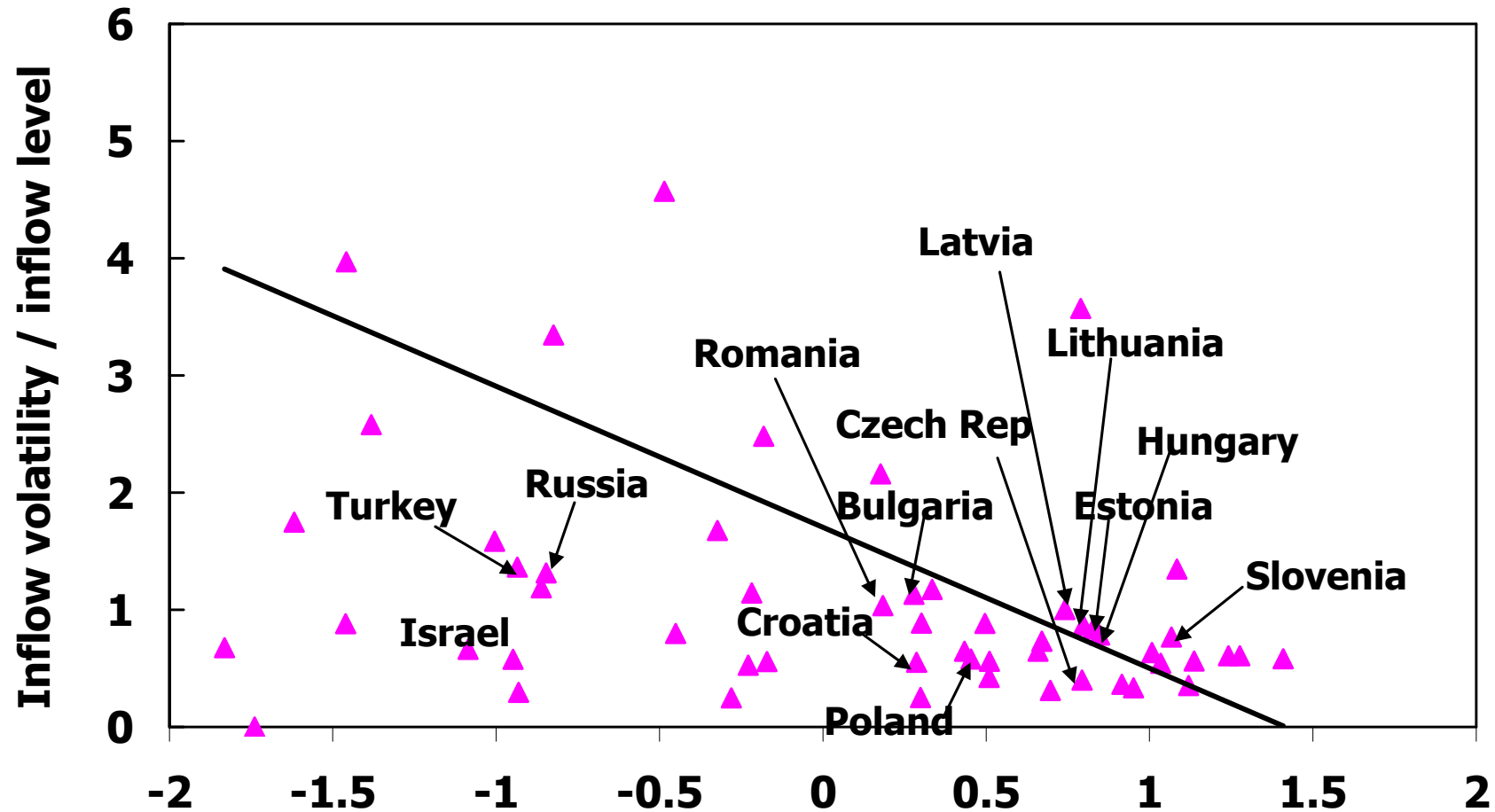
## Voice and Accountability



Note: Inflow volatility measure in absolute values.

# Market Infrastructure and Volatility of Total Capital Inflows

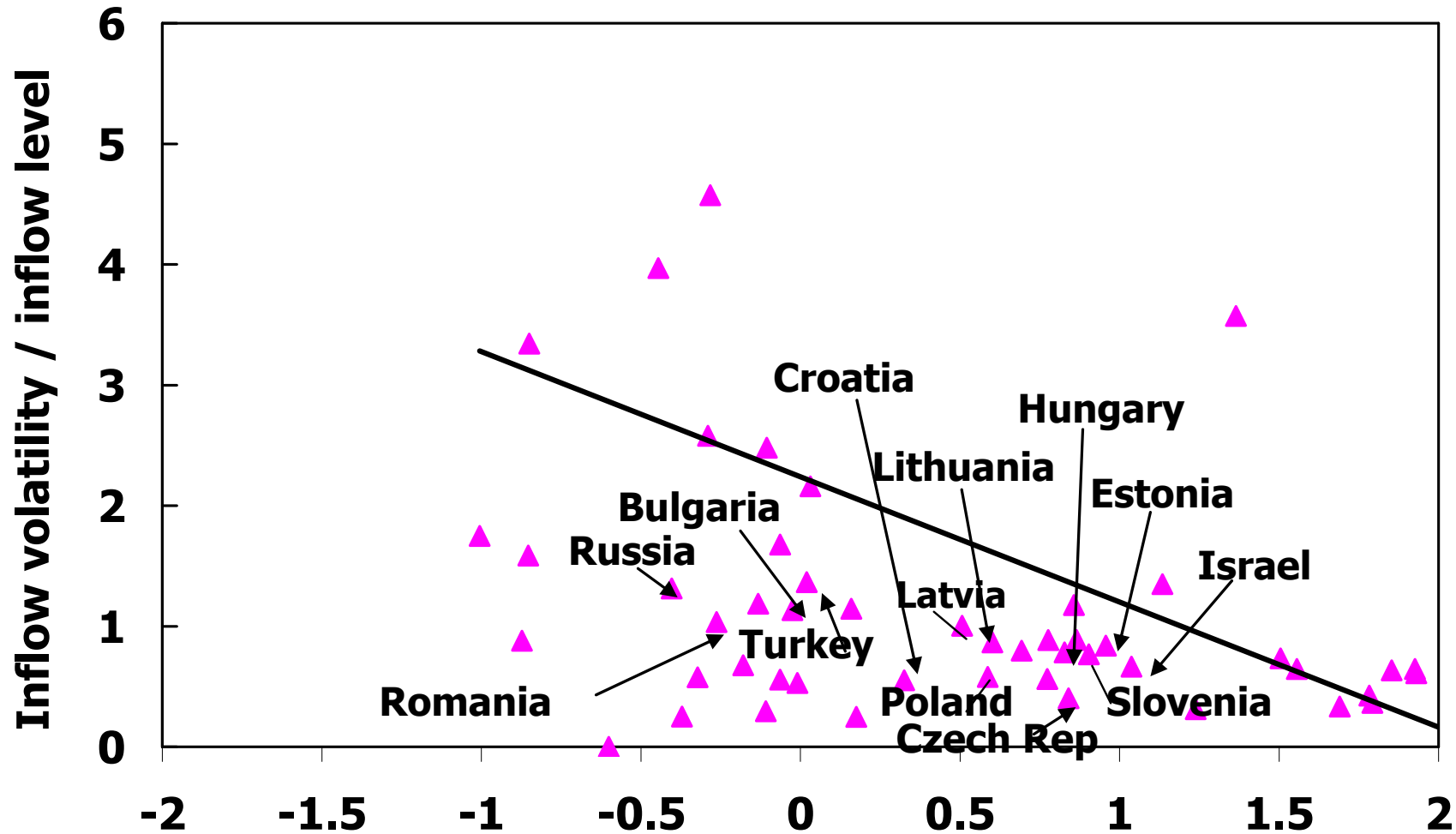
## Political Stability



Note: Inflow volatility measure in absolute values.

# Market Infrastructure and Volatility of Total Capital Inflows

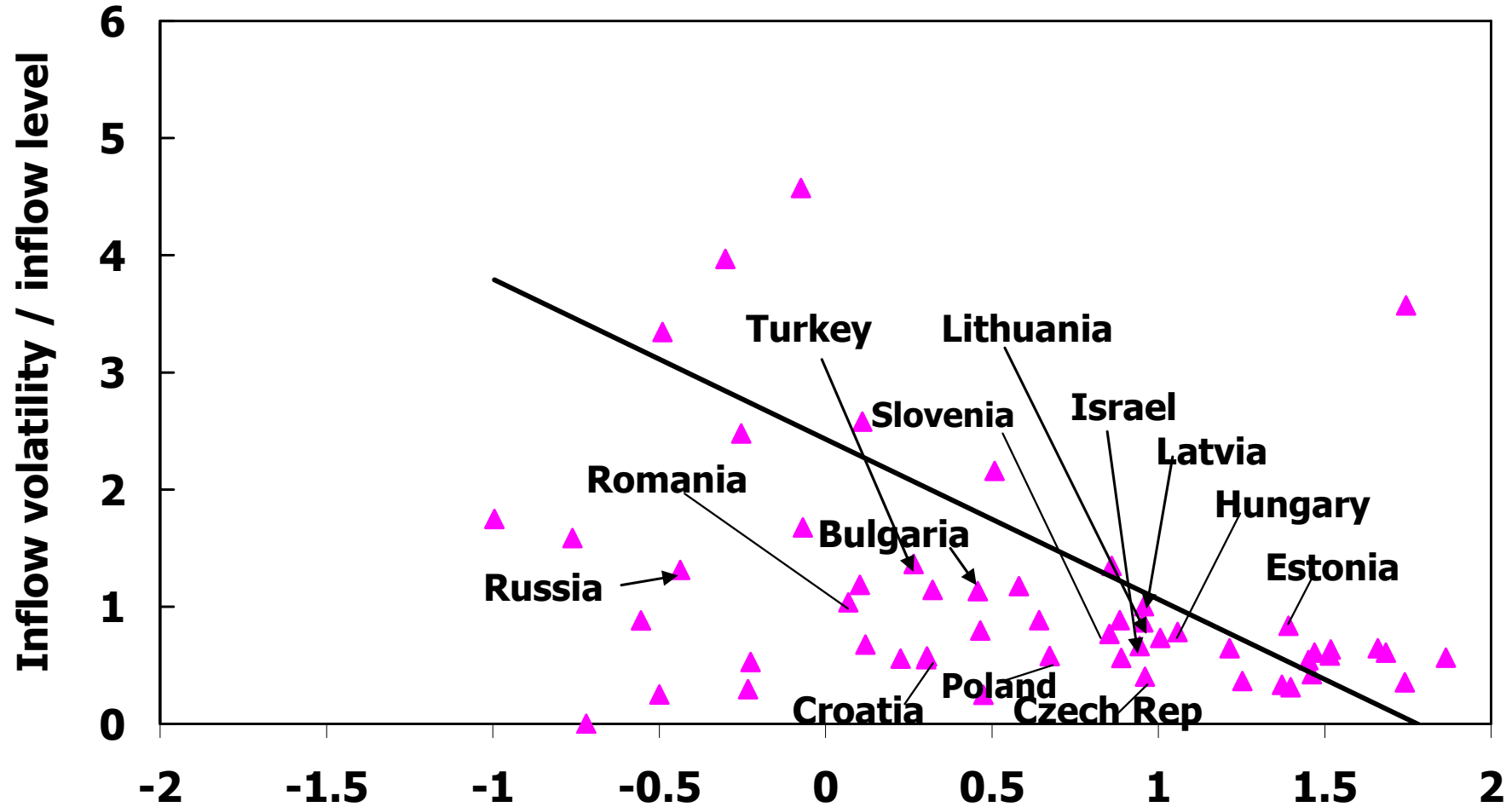
## Government Effectiveness



Note: Inflow volatility measure in absolute values.

# Market Infrastructure and Volatility of Total Capital Inflows

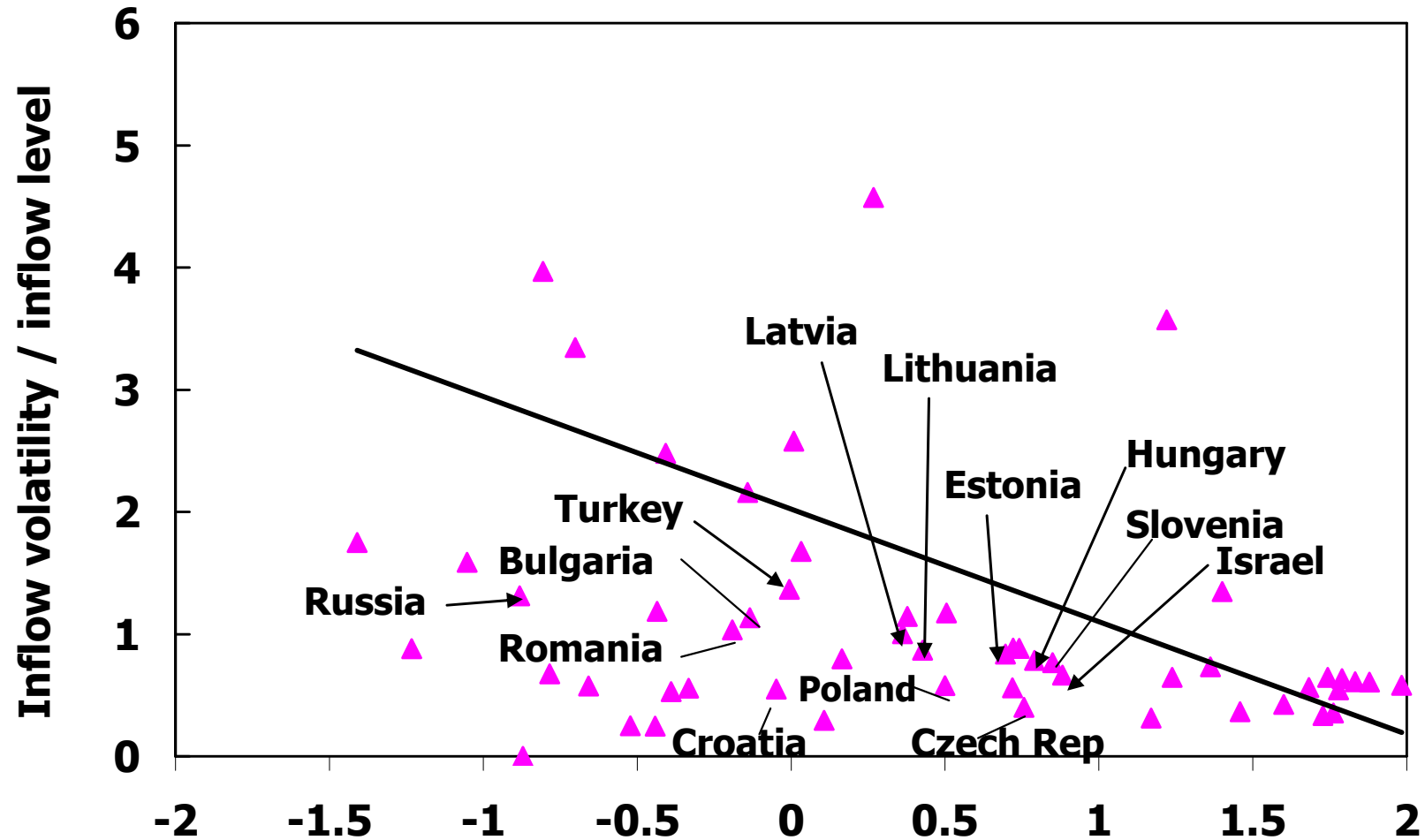
## Regulatory Quality



Note: Inflow volatility measure in absolute values.

# Market Infrastructure and Volatility of Total Capital Inflows

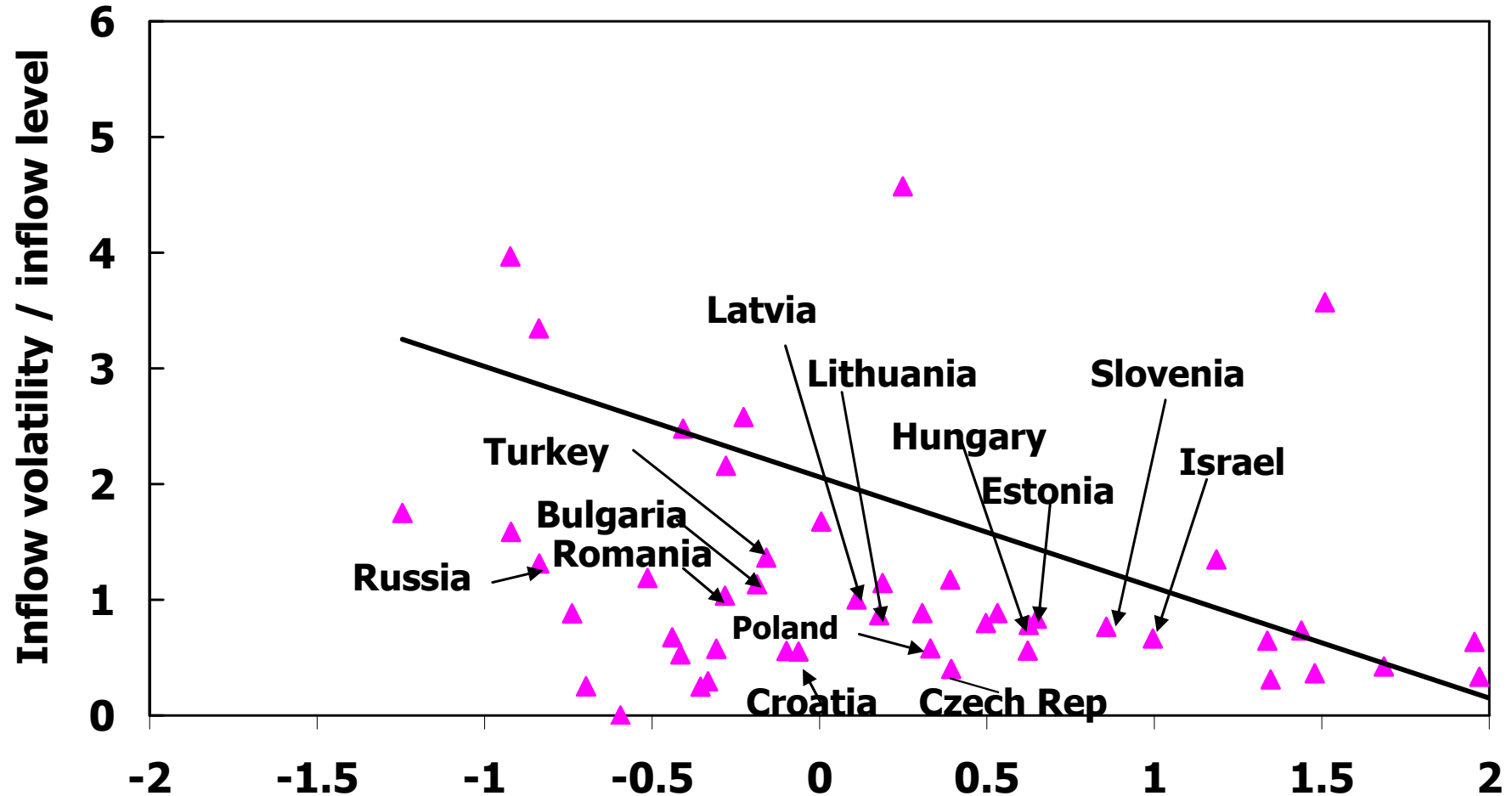
## Rule of Law



Note: Inflow volatility measure in absolute values.

# Market Infrastructure and Volatility of Total Capital Inflows

## Control of Corruption



Note: Inflow volatility measure in absolute values.





# **Capital Flows: Build-ups and Let-downs**

**Dr. Laura E. Kodres, IMF**

**June 16, 2009**