Factors causing capital flows in emerging economies

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Abstract

This paper investigates how capital inflows and outflows in emerging countries are affected by global shock variables such as the Volatility Index (VIX). We categorize gross inflows and outflows as foreign direct investment, portfolio investment, and other investment. In addition, we compare the factors that explain the movements of gross capital flows for emerging and developed countries. Our main findings are as follows. First, VIX has an asymmetric effect on other investment flows in developed versus emerging countries. Second, FDI has been relatively less affected by the global financial crisis.

Our results indicate that movements of capital flows, especially other investment flows, differ between developed and emerging countries during high VIX periods. When VIX increases, foreign investors reduce (increase) their purchases (sales) of other assets from emerging economies, while the residents of emerging economies reduce (increase) their purchases (sales) of other foreign assets. This implies that developed country creditors tried to withdraw from emerging countries when the global financial crisis occurred.