



# Trends in International Capital Flows

Jose G Reis, Alper Oguz, Can Selçuki

December 12, 2013

Ankara, Türkiye



# Recent Global Developments

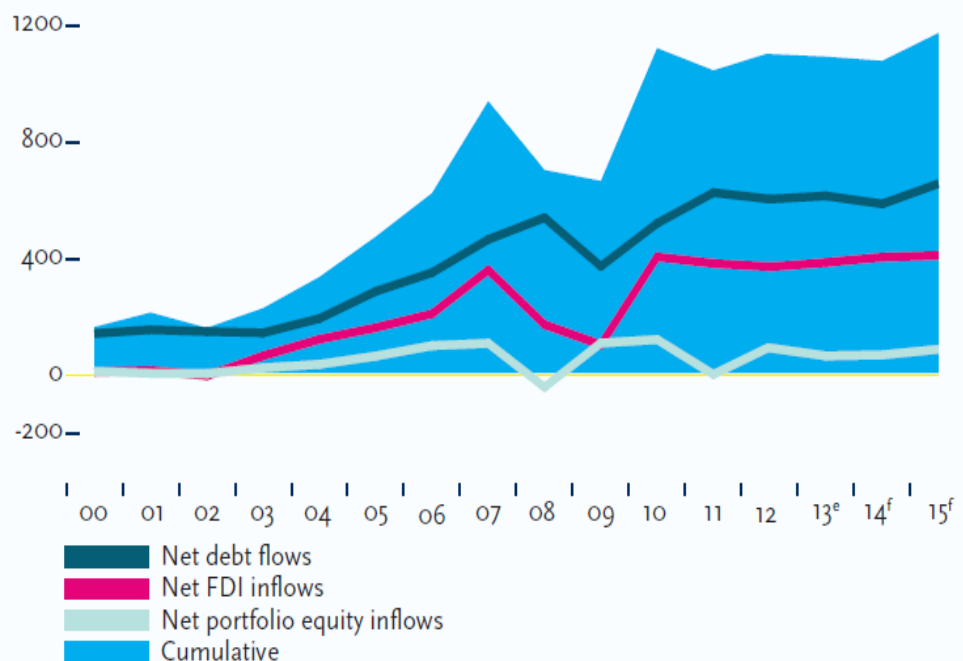
- Global economic growth has continued its weak path in 2013.
- The crisis in the euro zone appears to have receded somewhat since last year, with current concerns more focused on the implications of the end of the monetary cycle in the United States, rising U.S. long-term yields, and a possible slowdown in China.
- The possibility of monetary policy change is posing fresh risks for emerging market economies, where activity could slow and asset quality could weaken.
- Further, any slowdown in Chinese growth would affect many other economies, notably the commodity exporters among the developing markets.
- At the same time, old problems—a fragmented financial system in the euro area and worryingly high public debt in all major advanced economies—remain unresolved and could trigger new crises.
- With all of this in mind, it is perhaps no surprise that foreign direct investment (FDI) levels for developing economies are seeing only a marginal increase in 2013, and are expected to decline next year.



# Short Term Trends for Developing Economies I

NET PRIVATE CAPITAL FLOWS TO DEVELOPING ECONOMIES

\$ billion



Source: World Bank  
e= estimate; f= forecast

- While developing economies have generally weathered the crisis better than their developed counterparts, persistent global softness is affecting the investor mood.
- Against the backdrop of little growth in 2013, global FDI flows are estimated to have increased slightly. In 2013, FDI flows worldwide were an estimated \$1.5 trillion, slightly above the level reached in 2012.
- Improved growth in high-income economies has increased the likelihood that their monetary easing policies will come to an end in the near future.
- Under the current composition of net private capital flows, FDI continues to be the most important private capital flow to developing economies in relation to portfolio investment and private debt.



## Short Term Trends for Developing Economies II

### COMPOSITION OF FDI FLOWS TO DEVELOPING ECONOMIES

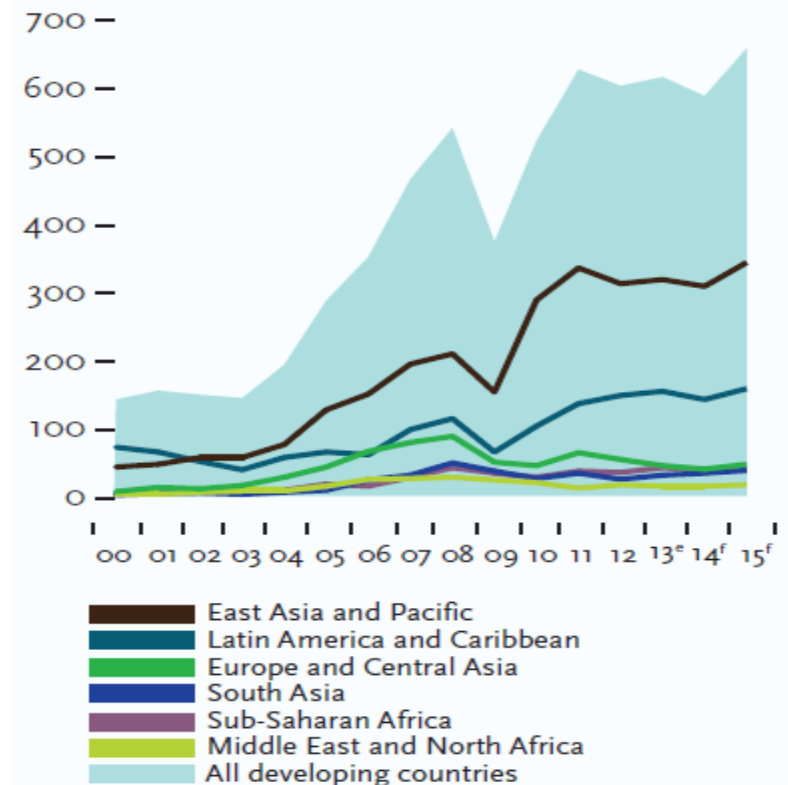
\$ billion



Source: World Bank  
e= estimate

### FDI FLOWS TO DEVELOPING ECONOMIES BY REGION

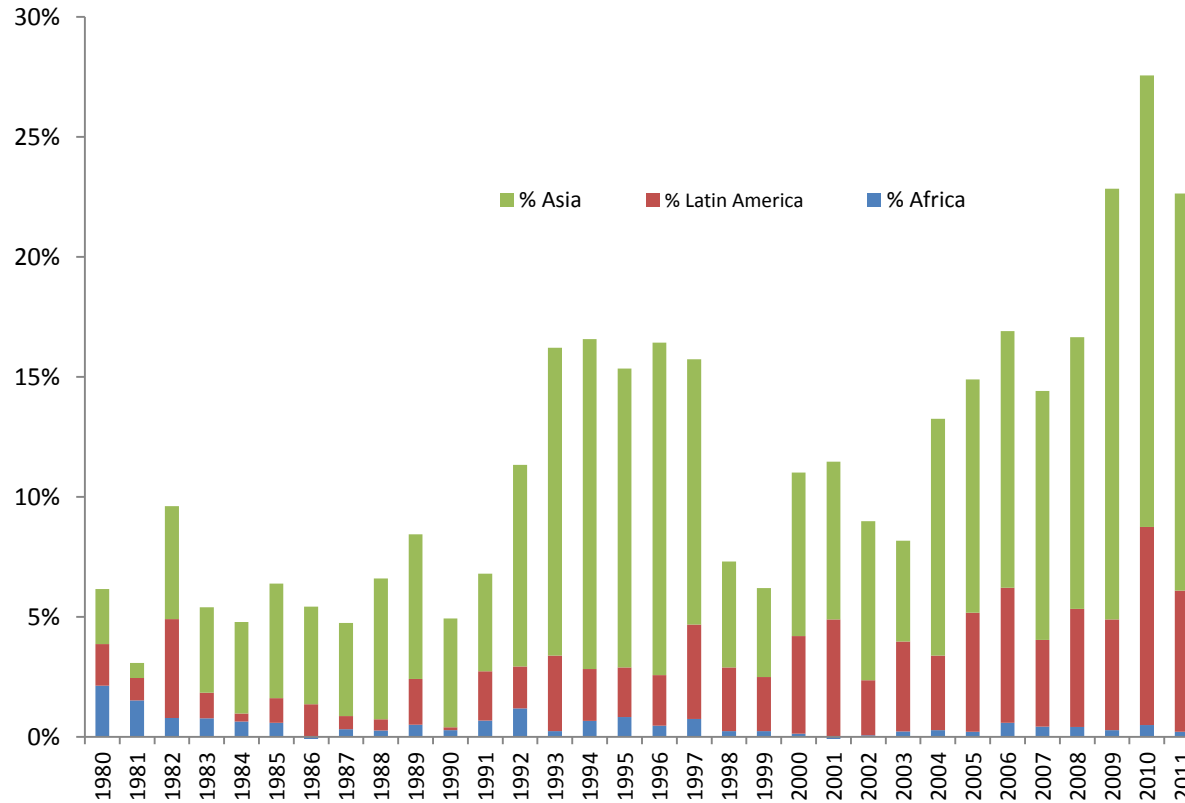
\$ billion



Source: World Bank  
e= estimate; f= forecast



# Developing Countries: significant increase in outward FDI flows



Source: World Bank, forthcoming

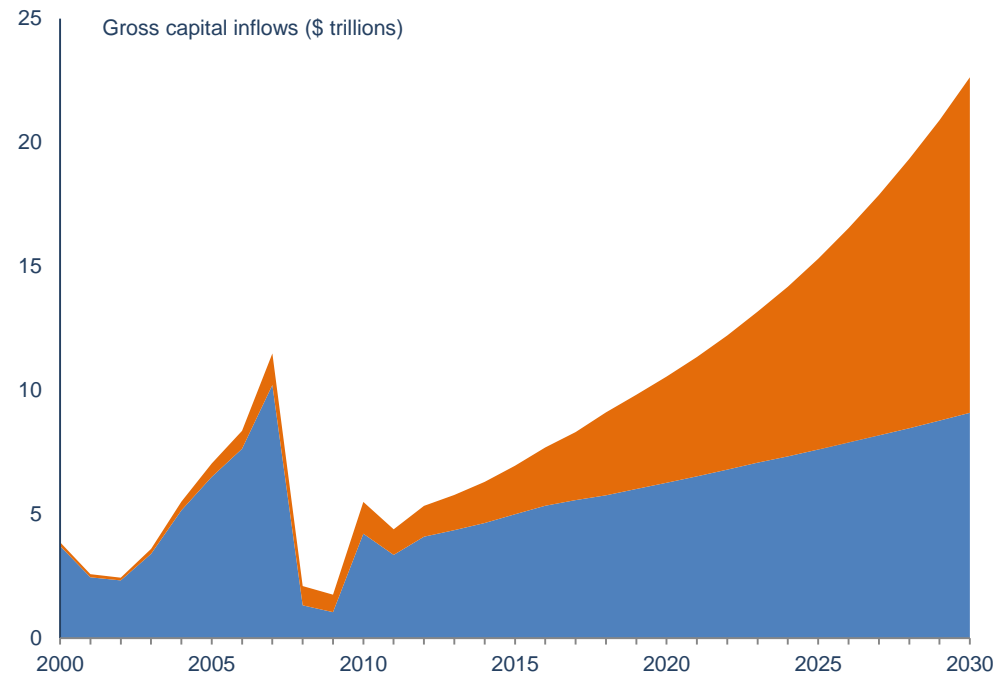
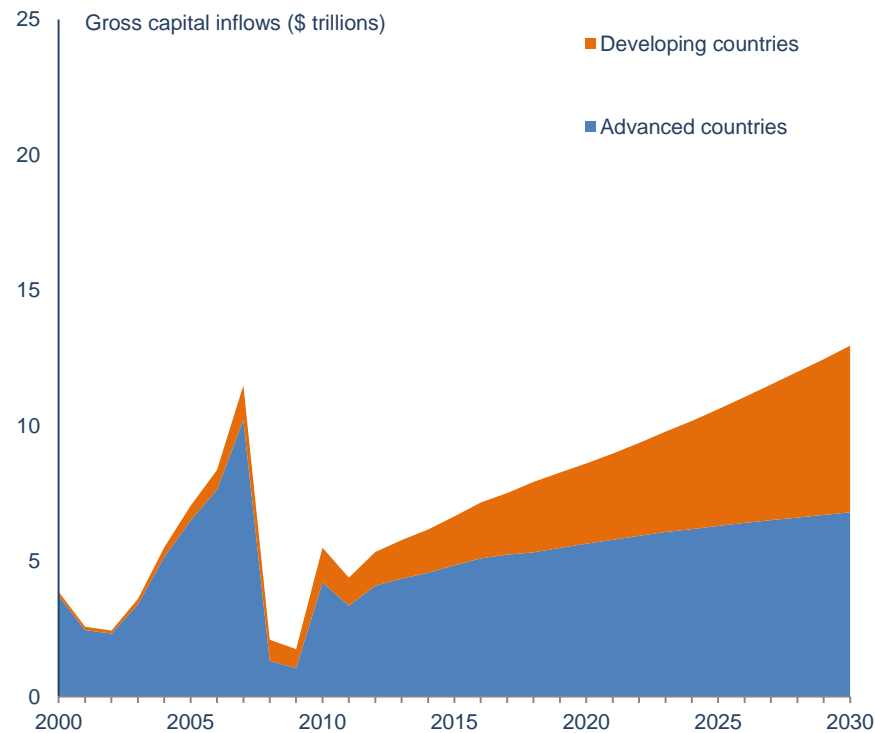


# Long Term Trends for Developing Economies I



- **A long term perspective and a structural change in international capital flows**

***Developing countries will account for a greater share of gross capital inflows and outflows in the future.*** The scenario analysis estimates that developing countries will account for 47–60 percent of global capital inflows in 2030, up from 23 percent in 2010.





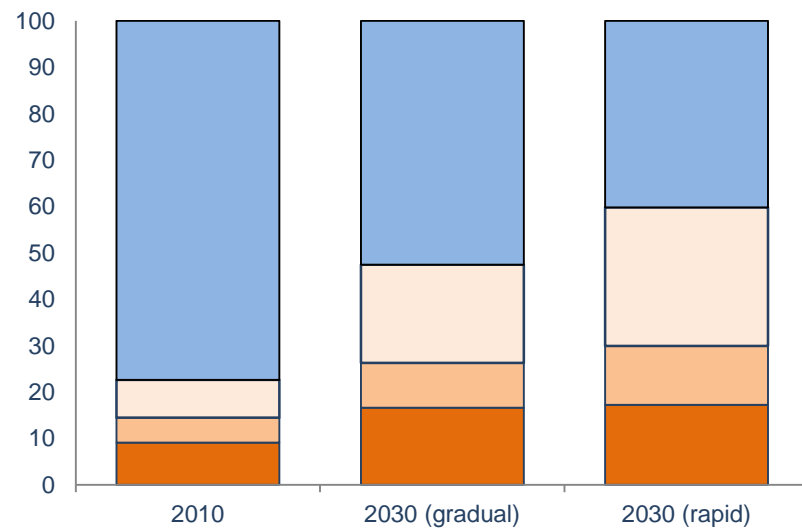
# Long Term Trends for Developing Economies II



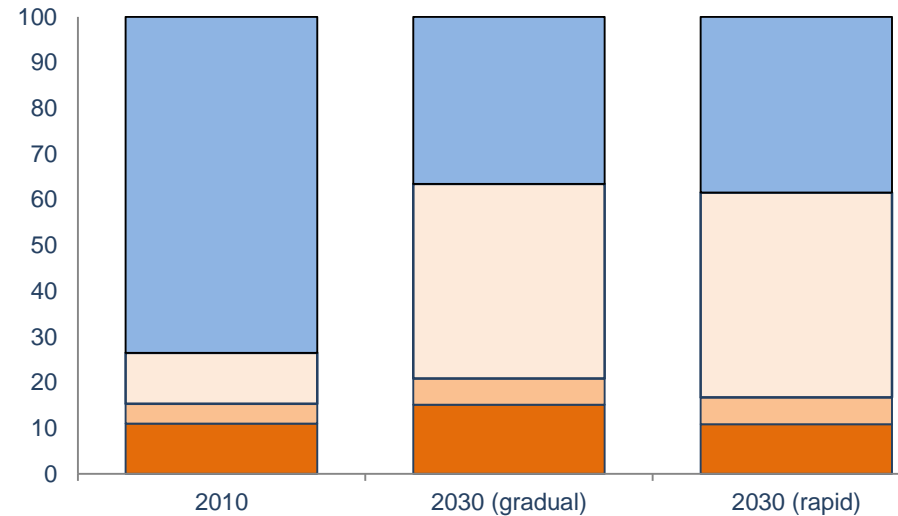
- Expected changes in the regional distribution of capital flows**

China will be an important part of the story, but by no means will it be a China story— nor a BRICs (Brazil, Russia, India, and China) story—alone. Small and medium-size developing countries will collectively matter much more in the global economy than they do today.

**Global Gross Capital Inflows (Percent )**



**Global Gross Capital Outflows (Percent)**



- High income countries
- China
- Brazil, India, & Russia
- Other developing countries

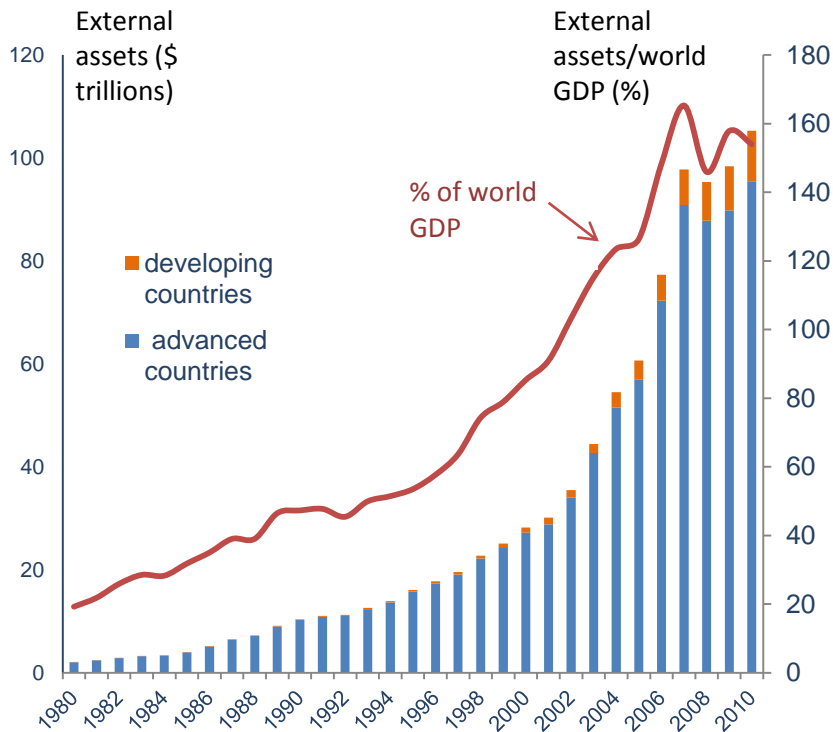
Source: World Bank, Capital for the Future



# Financial Integration Deepening and Volatility of Capital Flows

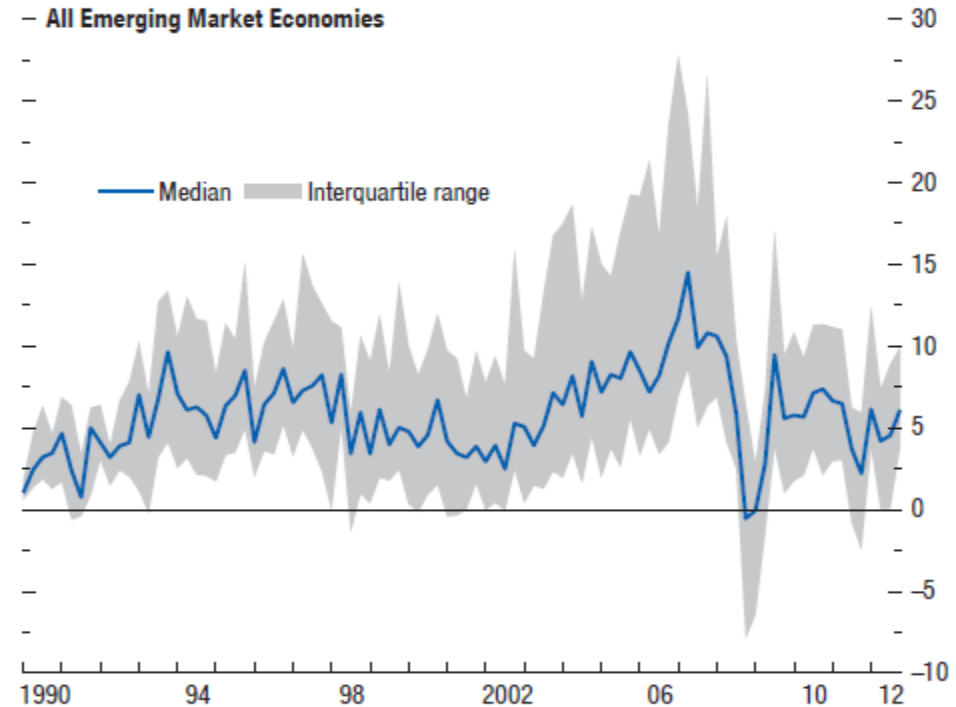


## International Investment Positions and Increasing Financial Globalization:



World Bank Global Development Horizons and IMF International Financial Statistics

## Gross Capital Inflows



Sources: IMF, *Balance of Payments Statistics*; and IMF staff calculations.





# Drivers of Capital Flows to Developing Countries

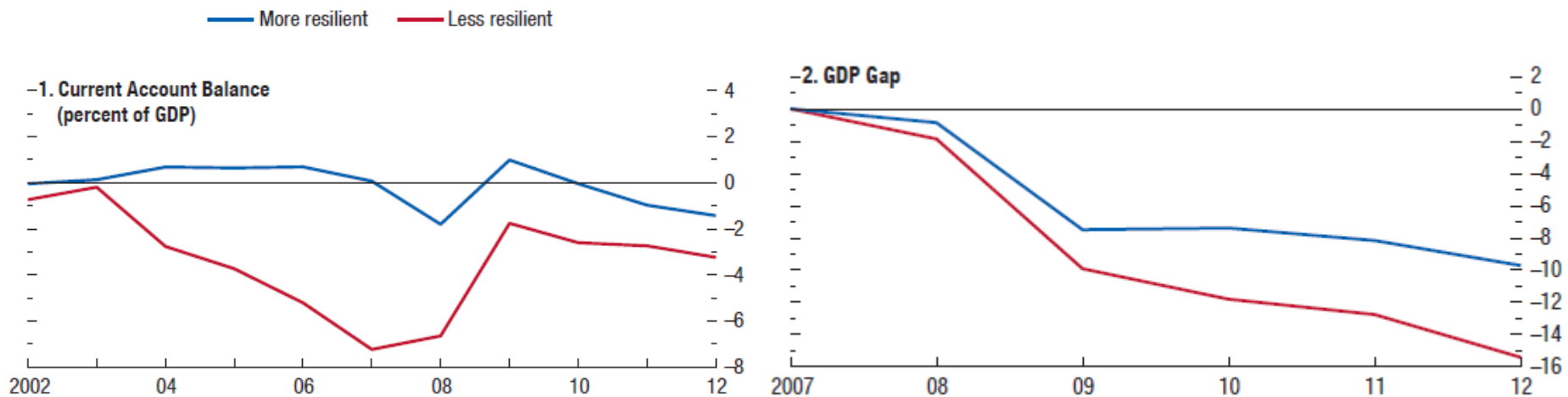


- Empirical Evidence shows that higher levels of capital inflows (FDI, portfolio flows, and bank lending) are associated with:
  1. Increasing financial development and openness (measured by domestic credit to the private sector as a percentage of GDP and the index of capital account openness, respectively)
  2. Higher GDP growth, a lower dependency ratio.
  3. Global monetary conditions.
- Some Drivers for Developing Countries
  - Rapidly growing economies attract increased capital flows because that growth implies sizable investment opportunities and, often, improving creditworthiness and more opportunity for investment diversification.
  - Stronger, more developed financial institutions, in particular, tend to allow developing countries to attract larger capital flows.
  - Demographic conditions also matter: countries with a large share of working-age people tend to attract more capital inflows because of their relatively large labor pools and potential for high rates of productivity growth



# Impact of Volatile Capital Inflows

- Historically, surges in capital inflows to emerging market economies tended to lead to domestic booms and current account deficits and, when the flows reversed, as they almost inevitably did, painful adjustments and sometimes financial crisis. The global financial crisis, however, marked a change from the past. While some countries experienced the classical boom-and-bust cycle in response to volatile international capital flows, many did not.
- Less resilient countries witnessed a large deterioration of the current account in the years preceding the global financial crisis and a subsequent sharp reversal. Those countries also experienced a much stronger contraction of GDP and consumption relative to precrisis trends and a larger increase in unemployment.





# Complex policy challenges will arise from changing patterns of capital flows



- National policy makers seeking to support investment activity in their economies should concentrate their efforts on establishing a favorable investment climate.
- Policy makers will have to recognize the forthcoming increasing demand for services and facilitate the needed accompanying investment.
- Many developing countries still maintain a protectionist stance in the services sector. Many economies, for example, explicitly prohibit foreign direct investment (FDI) in certain “sensitive” or “strategic” services. Such policies will become an increasing burden on efficiency in a global economy where services account for a larger share of output.
- For developing countries over the next 20 years, the issue of financing for infrastructure projects will pose a major challenge. To meet their future infrastructure financing needs, policy makers in developing countries will need to leverage private sector financing through public-private partnerships, as well as tap structured financing from global capital markets.
- The course of global monetary and financial policy making will need to be adjusted as developing countries become responsible for an expected half or more of the world’s capital outflows.
- Policy makers will need to prepare for a greater role of capital markets in international financial intermediation and promote the development of domestic capital markets.



# Teşekkürler