The Institute of International Finance, Inc.
THE GLOBAL ASSOCIATION OF FINANCIAL INSTITUTIONS

Capital Flows to Emerging Economies

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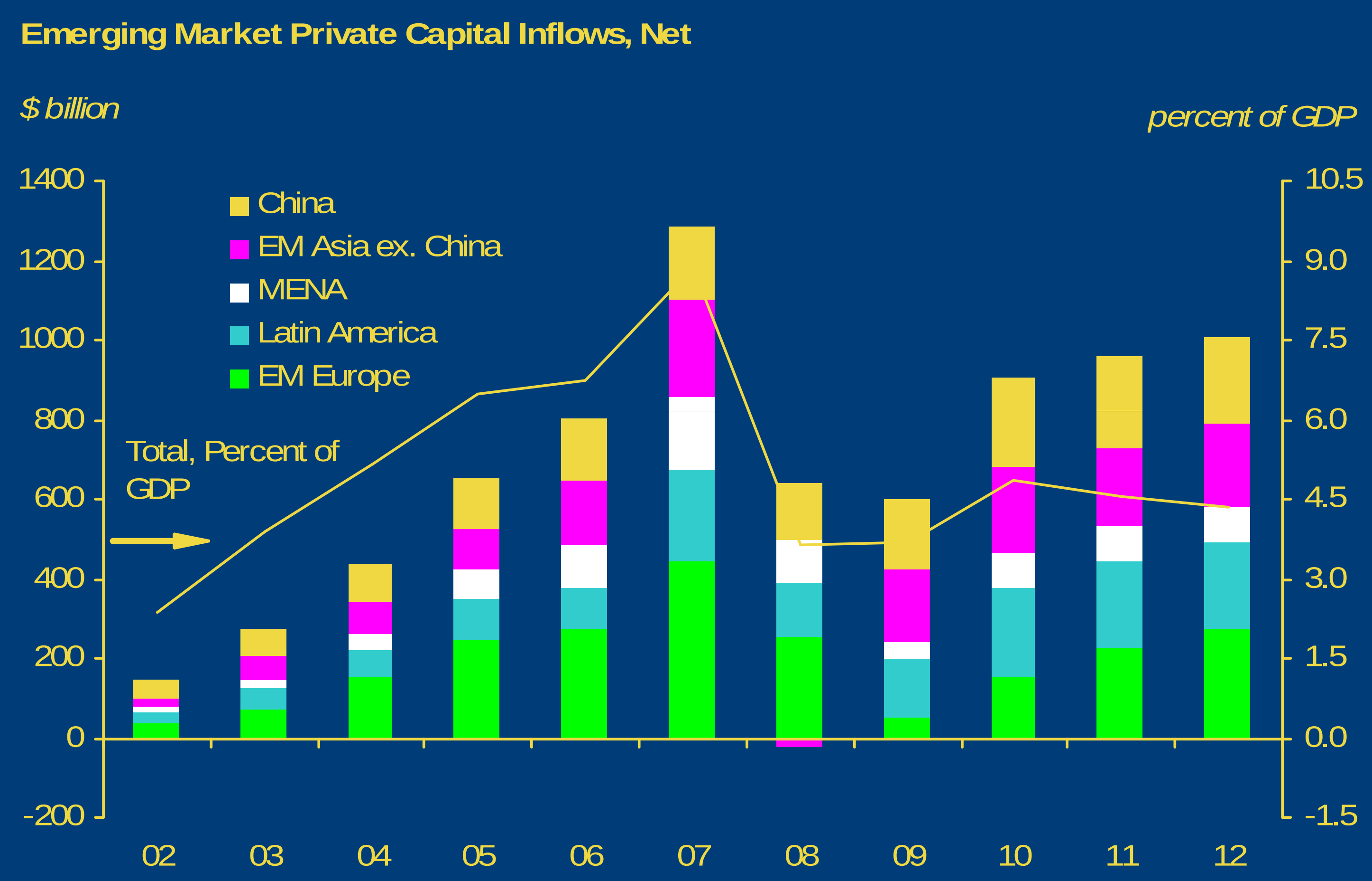
Peterson Institute / Booz Allen Conference
Washington DC
March 10, 2011

The IIF's Most Recent Capital Flow Estimates and Projections

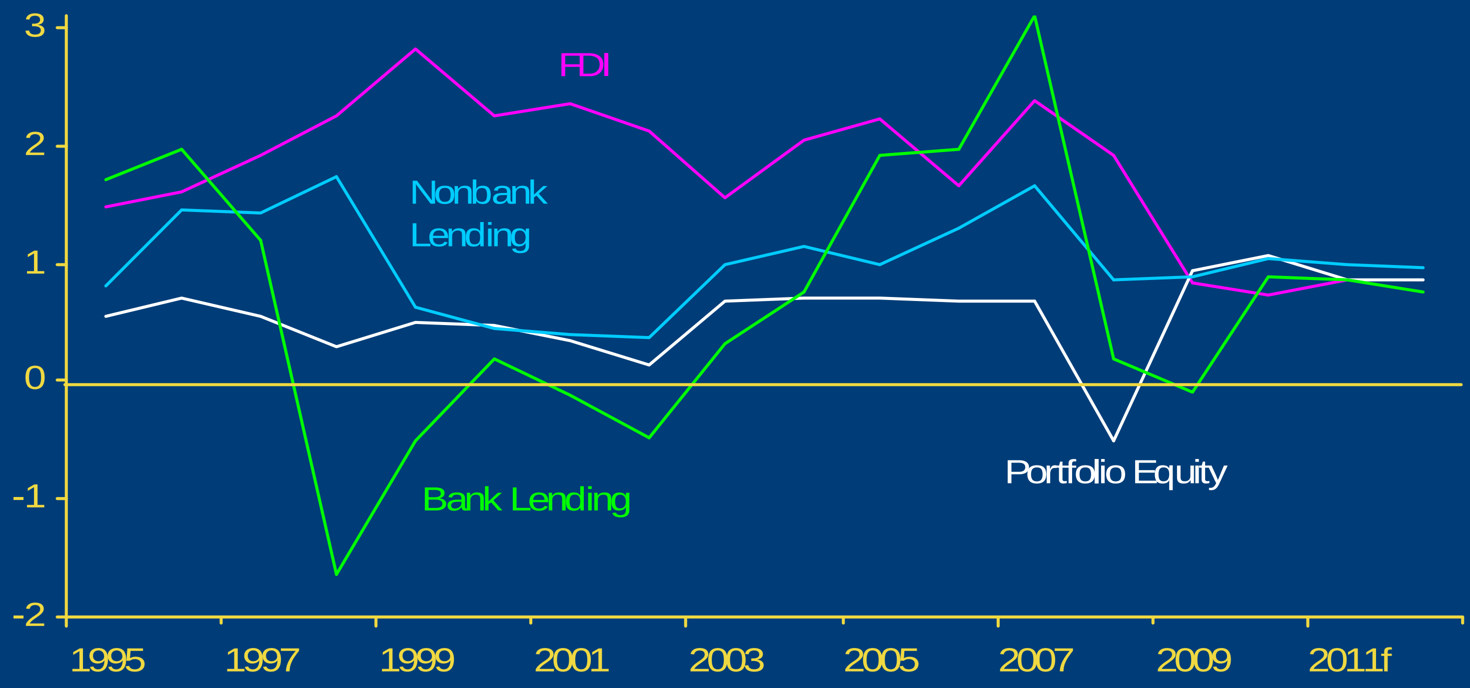
Private capital flows to emerging markets recovered strongly in 2010



The increase in 2010 flows was driven by private bank lending

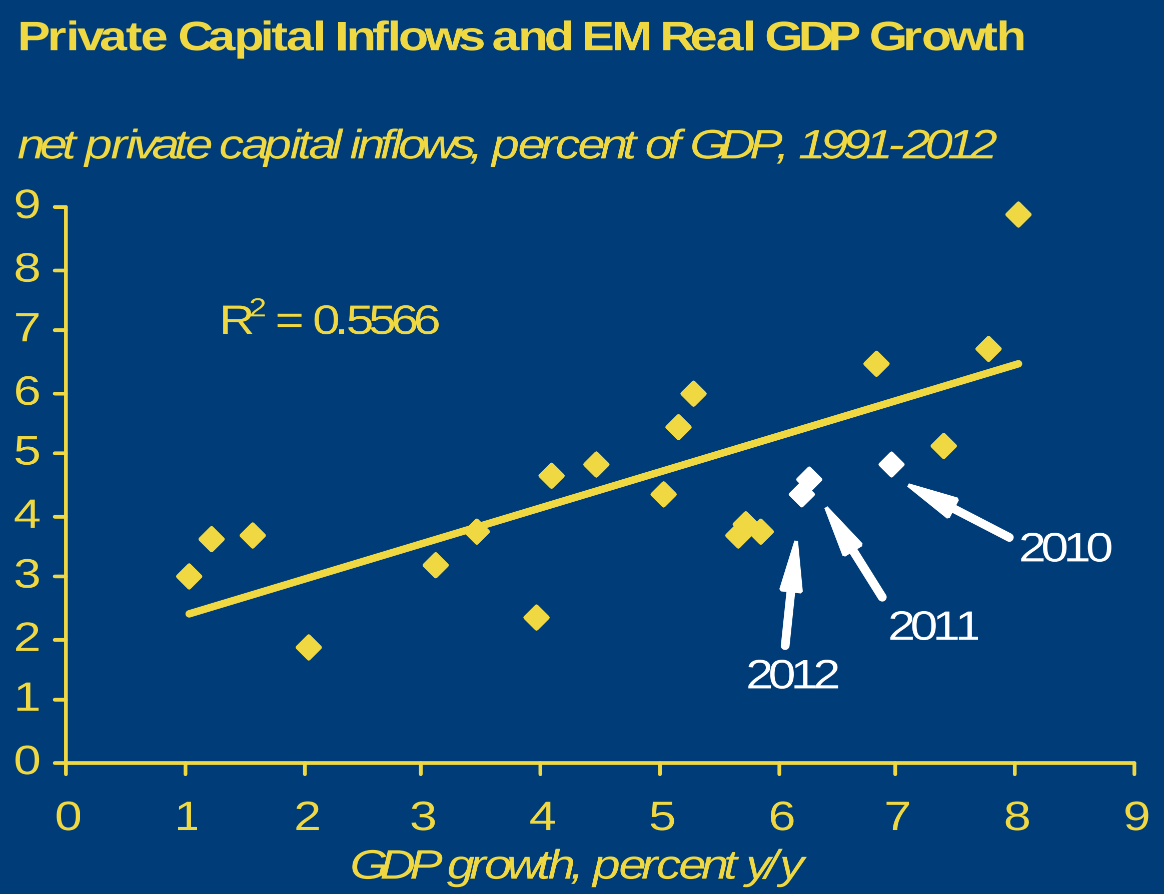
Emerging Market Private Capital Inflows, Net

percent of GDP



Push and Pull Factors Driving EM Capital Inflows

EM economic growth is an important pull factor for capital flows



Global portfolio rebalancing is a structural trend supporting capital inflows to EMs

EM: Private Capital Inflows and Share of MSCI ACWI*

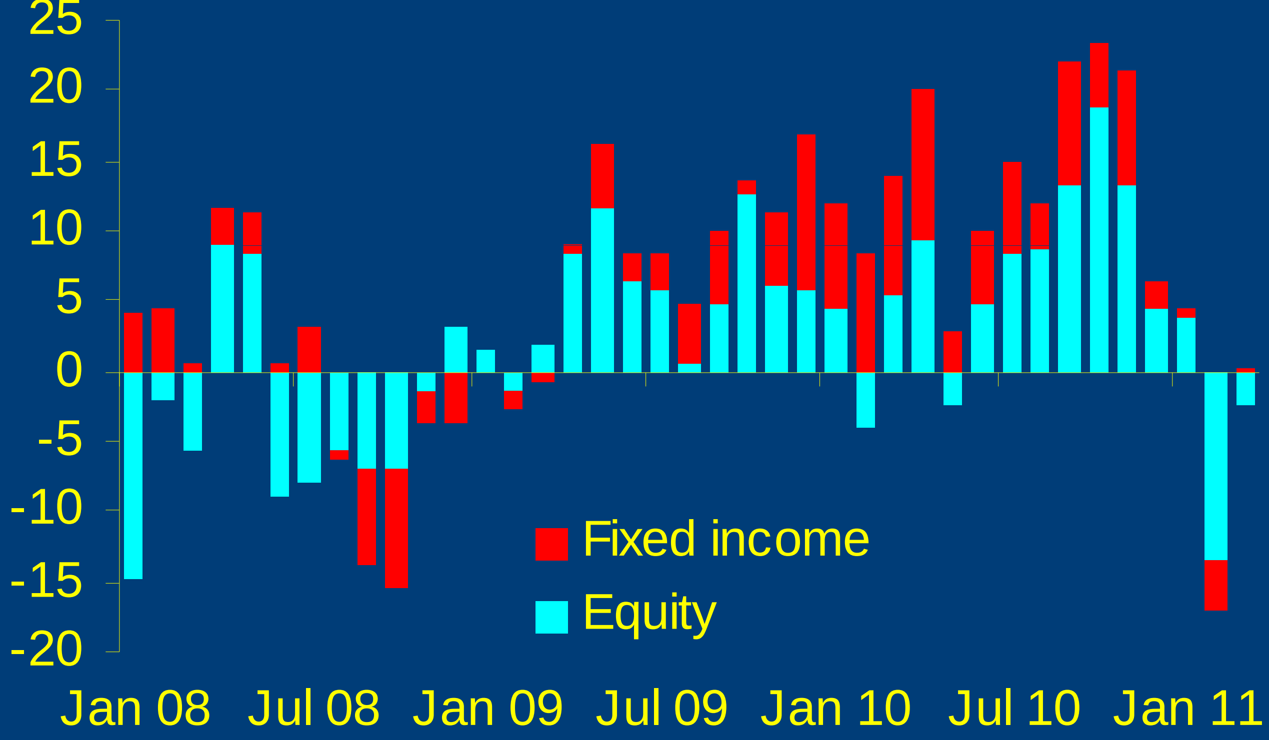
flows in percent of GDP; asset allocation in percent of total

*MSCI ACWI = Morgan Stanley Capital International - All Country World Index

Portfolio inflows have fallen significantly in the first part of 2011

EM Funds: Debt and Equity Net Inflows

USD billions, FI includes hard and local currency funds

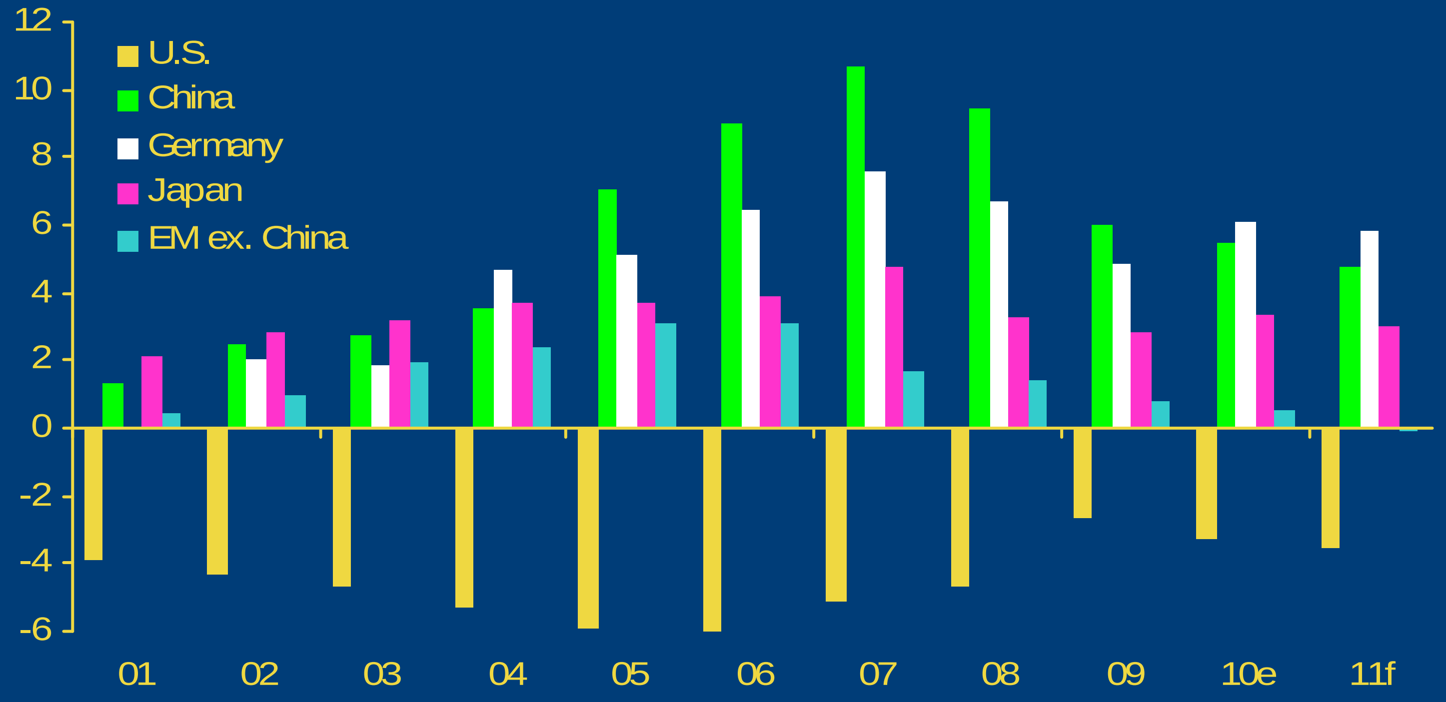


Key Policy Issues

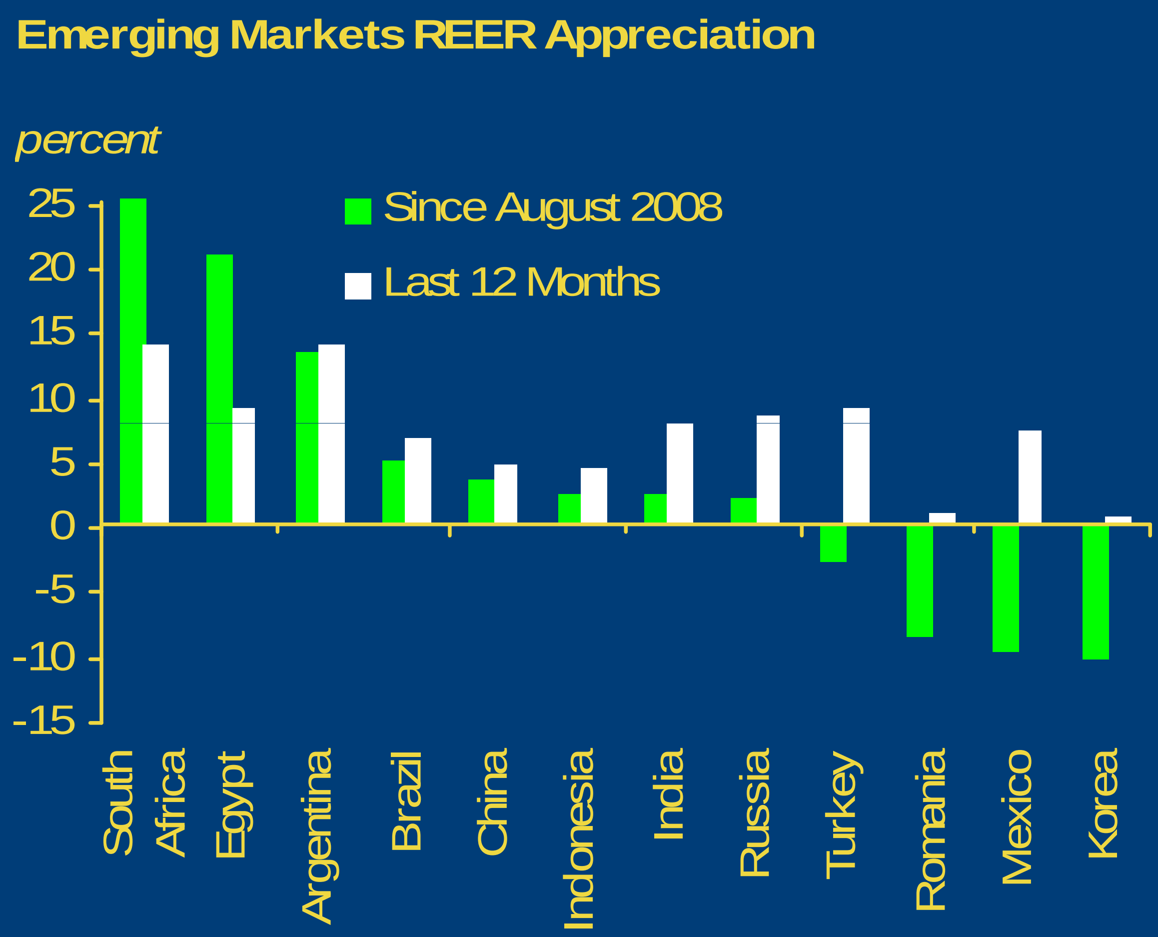
Although global imbalances have narrowed since the crisis they are still large

Global Current Account Balances

percent of GDP



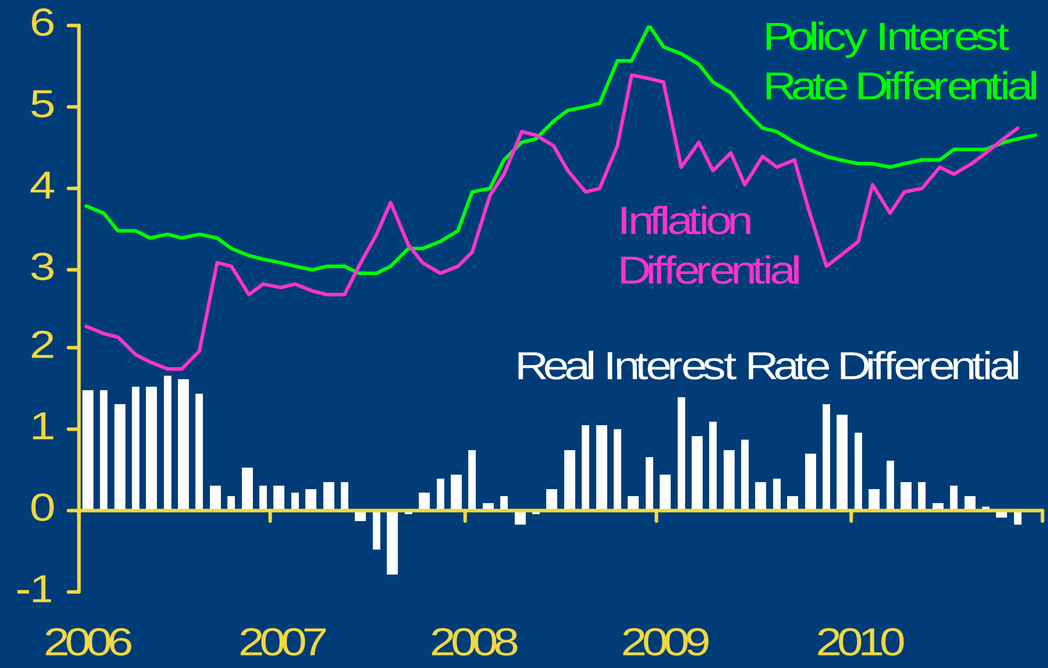
Few EM currencies have appreciated significantly in real terms since mid-2008



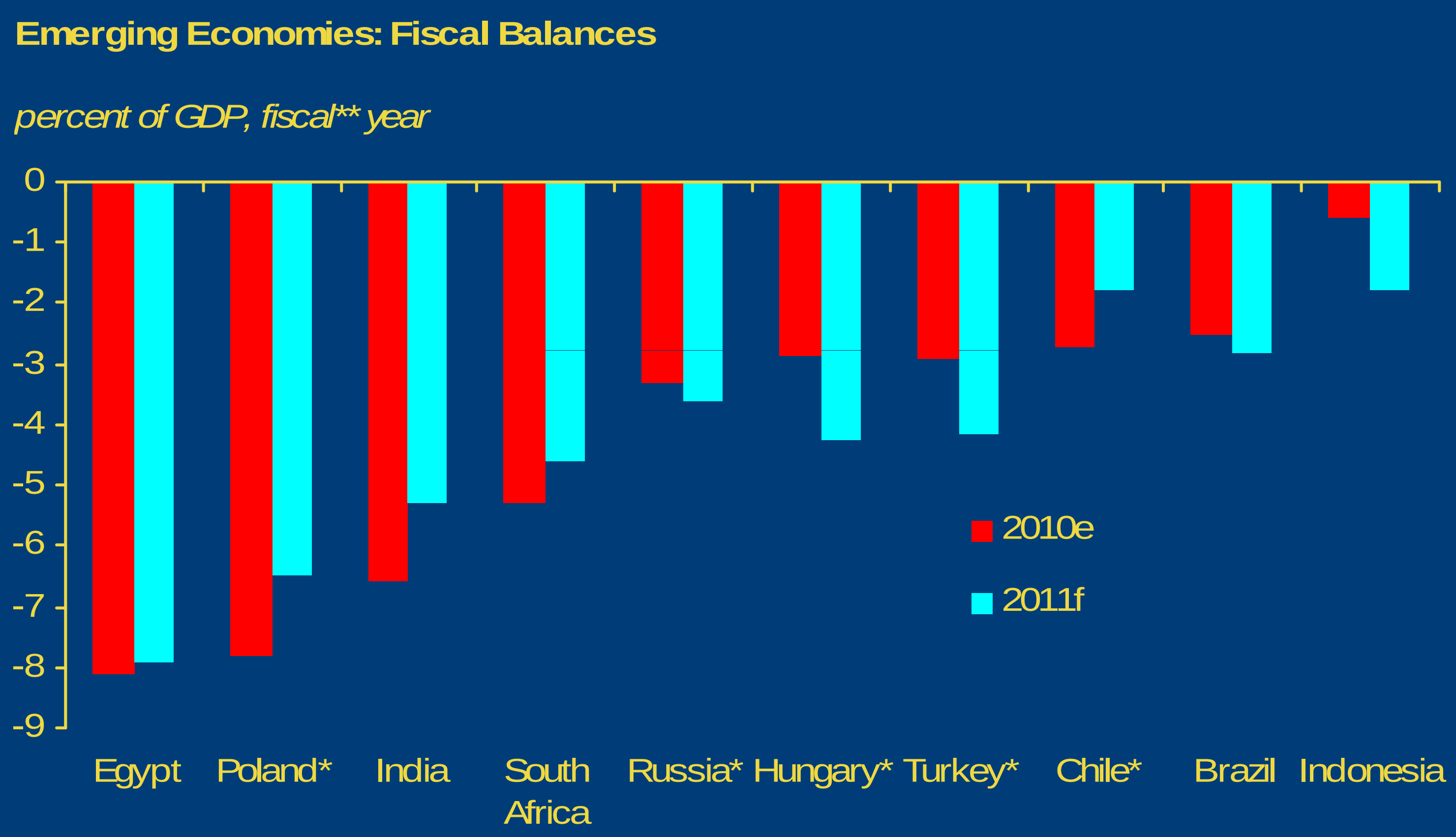
Monetary policy is still very accommodative in EMs, despite rising inflation pressures

Inflation and Interest Rates: Differential EM vs. MM

inflation=percent change oya, interest rates=percent per annum; both EM less Mature, GDP-weighted



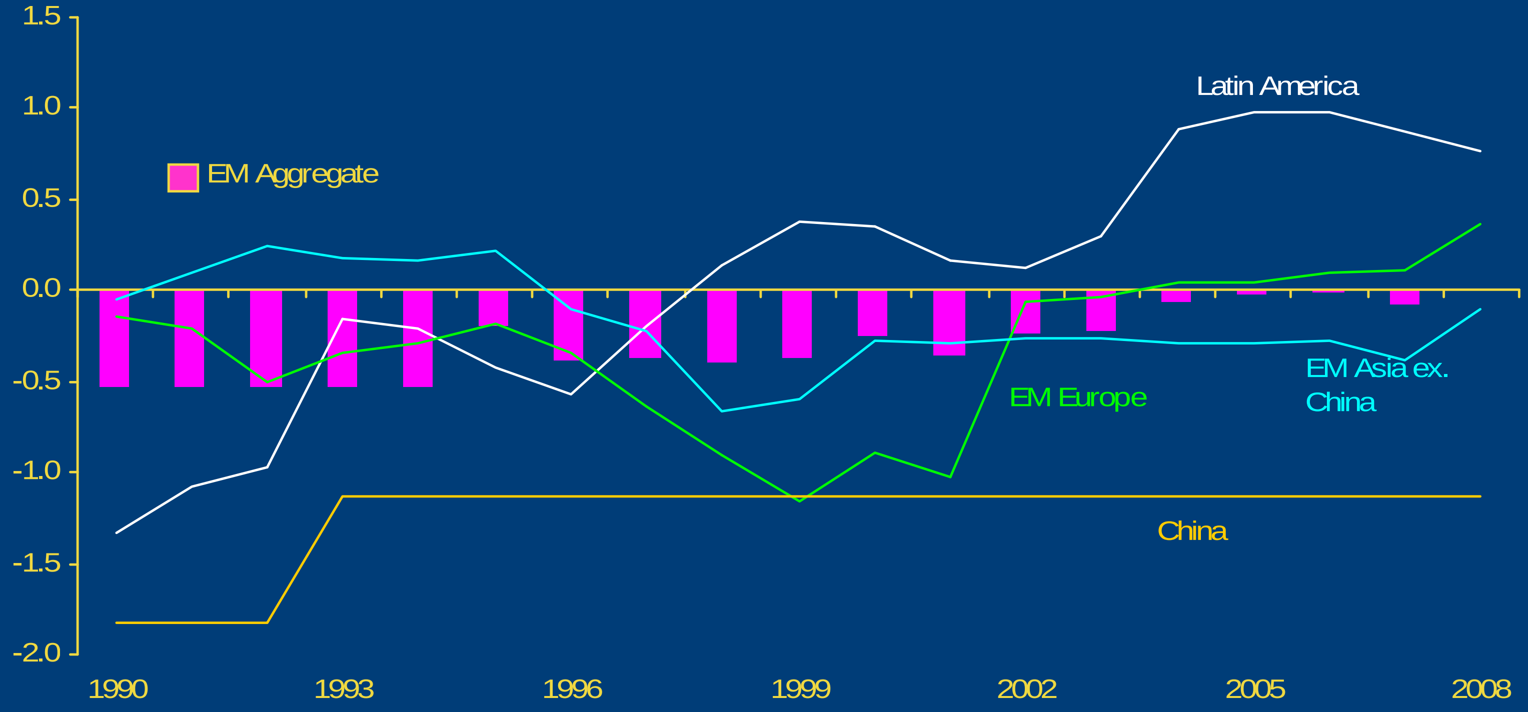
Fiscal policy should do be doing more to help cool EM growth



Further use of capital controls could reverse the trend toward greater financial openness

Financial Openness of Emerging Markets

Chinn-Ito Capital Account Index, higher number = more open; GDP-weighted



Concluding Messages

- Net private capital inflows to EMs are estimated to have been $908 billion in 2010
- We project flows to increase to $960 billion in 2011
- Our 2010 estimate is $187 billion higher than our projection a year ago
- Rising flows are supported by strong EM growth, portfolio rebalancing and abundant global liquidity
- Emerging economies' aggregate current account surplus is projected to narrow over the next two years

Concluding Messages

- Strong private capital inflows raise important policy challenges for emerging market policymakers.
- With nominal growth strong, there is considerable pressure for higher interest rates.
- But expectations of higher rates add to upward pressure on currencies

Concluding Messages

- In response EM policymakers can:

  1. Keep interest rates down
  2. Impose capital controls
  3. Make more use of macroprudential instruments
  4. Tighten fiscal policy
  5. Allow exchange rates to appreciate

- We think a combination of 3, 4 and 5 would be optimal in most cases

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