An Analysis of Factors Making for Capital Mobility in Emerging Market Countries

While, since the Asian financial crisis, the interest in the impact of foreign capital flows into and out of emerging market countries on the stability of their financial systems grows, the volume of foreign capital flowing into those countries has recently been on a sharp rise. The emerging market countries may face difficulties in securing financial stability in terms of foreign capital flows, in case capital flows respond more sensitively to the economic circumstances of advanced countries than to their own economic circumstances. In view of such concerns, it is crucial to survey and analyze factors giving rise to capital movements in emerging market countries in a bid to maintain financial stability.

Existing studies of factors making for capital mobility in emerging market countries were conducted mostly on nations that had experienced a financial crisis and they focused on the aspect of capital outflows and the factors associated with emerging market countries themselves. However, this paper carries out an analysis involving the classification of the period under analysis into two subperiods - the capital inflow expansion period and the capital inflow contraction period. The factors contributing to capital mobility are also divided into two categories - factors associated with emerging market nations and those linked to advanced countries. In addition, the paper analyzes the factors giving rise to capital movements from the perspective of investors' portfolio selection using a Consumption-based Capital Asset Pricing Model(consumption-based CAPM).

Capital inflows and outflows occur in emerging market nations when investors' preferences about risky assets shift in accordance with changes in elements of the model, that is, the return on risk-free assets, expected return on risky assets, and the co-variance between expected returns on risky assets and economic circumstances. The analysis of this model is borne out by the finding of analysis drawing on the data. During the capital inflow expansion period, changes in the policy rates of advanced countries bring about changes in the return on risk-free assets, thus, leading to capital inflows. Meanwhile, during the capital inflow contraction period, the economic fundamentals of emerging market countries, along with factors associated with the advanced countries, seem to have acted as important factors. Overall, advanced country factors seem to play a more important role than those associated with the emerging market countries. Consequently, there appears to be a possibility that capital outflows may occur in the case of emerging market countries with weak economic fundamentals following changes in advanced countries' economic fundamentals.

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