# Are Asset price movements driven by international capital flows? The case of emerging markets

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## What is the question of this paper?

First, what are the factors that drive the CF?
Second, what are HM and how is the HM component of CF differ from the “non-HM” component?
Third, what is the relationship between CF and asset price movements?

## Why should we care about it?

International capital flows (CF) is well-known for its volatility. Policy-makers are not just interested in the growth of GDP, but its variance. Large volatile influences are a policy nightmare. It would trigger booms and busts in asset markets, even threatening the macroeconomic and financial instability, and more developed EM with the better financial system may face the threat of international debt shocks.

## What is the author’s answer?

The stock market prices are significantly associated with capital inflows. The results indicate that countries with lower initial real GDP per capita tend to have larger peak responses of stock prices in the case of FDI and PI hot money shocks. The opposite happens in the case of OI hot money shock. This may lead to a concern about the capacity of the relatively less developed EM to handle hot money.

## How did the author get there?

First, using net capital flow data, they document that the prediction of Neoclassical growth model holds for the Foreign Direct Investment (FDI) but not the Portfolio Investment (PI) and Other Investment (OI). Using gross capital flow data, they find that PI and OI inflows are instead significantly associated with stock market prices.

Second, we study how the HM interact with the asset prices in EM. They take into consideration the temporariness and reversibility properties of hot money and suggest identifying HM through an unobserved-component approach.

They follow that literature and separate the permanent component from the temporary components (HM) of the international capital flows, and make some adjustments.

In statistical part, they first use PCA to extract the variables and then use FAVAR models to estimate prices they need.