



Emerging Markets Forum

Private Capital Flows to Emerging Market Economies: Major Drivers, Recent Developments and Key Issues

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Private Capital Flows to Emerging Market Economies: Major Drivers, Recent Developments and Key Issues

By V. Sundararajan and Harinder Kohli¹

I. Introduction

The paper presents data on developments in inward private capital flows -- foreign direct investment (FDI), portfolio equity, portfolio debt, and bank financing -- to Emerging Market Economies (EMEs) and outlines their major structural and macroeconomic determinants. The paper focuses mainly on portfolio flows and FDI, with only a limited coverage of bank financing. Drawing on recent developments, selected key issues in managing private capital flows are highlighted for discussion.

A. Definition of EMEs and Data on Capital Flows

There is no single, universally accepted definition of EMEs. We have chosen a broad definition that is used by major investors and their supporting agencies such as those who construct stock indices for various categories of countries. A full list and explanation of EMEs used by us is given in **Annex 1**.

The data reported here are primarily drawn from the Balance of Payment Statistics reported in International Monetary Fund's *International Financial Statistics*, supplemented by country sources, where available, in cases where IFS data are incomplete. In addition, we have consulted 2006 *Global Development Finance* published by the World Bank, but IMF data is our primary source. The definitions used and its relationship to other commonly used data sources are briefly noted in **Annex 2**.

B. Background and Motivation

Net inward private capital flows to EMEs have risen sharply in recent years, while exhibiting significant period-to-period volatility. Some components of capital flows have been more volatile than others. Also, capital flows into some regions have been more volatile than in others.

In 1996-1997 just before the onset of the Asian financial crisis, net inward private capital flows averaged \$284 billion per annum. The size of these flows fell in 1998 to \$160 billion, due to reversals in both portfolio flows and bank lending. It rebounded significantly to \$254 billion (annual average) during the global equity boom in 1999-2000. It fell again in 2001-2002, when the equity boom collapsed, and since then has risen sharply to an annual average of in excess of \$400 billion in 2003-2005.

Asia, which witnessed largest growth in the inflow compared to other regions, also seems to have experienced the greatest volatility. Portfolio and bank inflows show much greater volatility than FDI. Both portfolio and FDI seem concentrated in regions and countries, while significant shifts in regional shares seem to be occurring over time.

¹ We are grateful to Harpaul Alberto Kohli for his valuable assistance in collecting, organizing, analysing and presenting data on which this report is based.

The size, volatility and direction of these flows pose important challenges for policy makers, besides raising important questions for private investors as well. In addition to the challenges posed by massive capital inflows for the conduct of monetary policy, the volatility associated with these flows poses risk management challenges for both the private and public sectors. The issue of how best to mobilize stable capital flows, while ensuring resilience to unavoidable fluctuations in capital movements, is a continuing policy challenge for which country experiences are beginning to provide broad guidance.

The paper aims to briefly summarize as best as possible the underlying forces determining the pattern of inward private capital flows to EMEs, and their components, drawing on recent official reports and academic studies on the subject, and on that basis, presents some issues for discussion.

C. Organization of the Paper

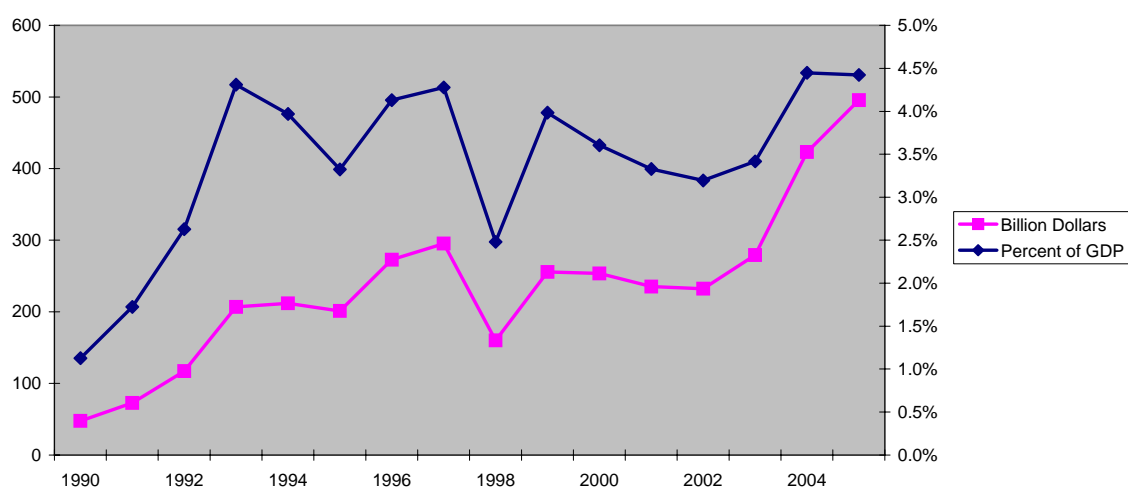
The paper is organized as follows after this introductory section:

- Section 2 will present data on capital flows and will sketch out important features of private capital flows and their components—including their growth, volatility, and relative importance of different forms of capital flows
- Section 3 will highlight developments during 2005, when private capital flows to EMEs reached a new high
- Section 4 will assess and review some of the determinants of private capital inflows. It will also review recent reports and studies on developments in private capital flows, and the structural and financial policy responses by various countries
- Finally, in Section 5, several key issues for discussion are highlighted
- In addition, at the end of the report, a series of graphs and tables present the detailed data (by types of capital flows and by five regions for the period 1990-2005) on which the report is based.

II. Trends in private capital inflows

The overall size and regional trends in private capital inflows -- sum of FDI inflows, net inflows of portfolio debt and equity, and net bank financing, all flows as defined in Annex 1-- are first reviewed, before discussing individual components of private capital flows.

Chart 1: Total Capital Inflows into EME's



Source: IMF's IFS. To fill in missing data, Taiwan's, India's, & Indonesia's Central Bank, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.

Table 1: Total Private Capital Inflows by Region, 1990-2005

Total Capital Inflows	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	1.0	1.3	4.0	2.8	7.3	8.9	7.7	17.1	12.9	14.1	7.4	5.2	1.9	-0.8	11.7	19.0
Americas	32.6	39.4	49.2	89.3	94.6	39.0	90.8	105.0	94.1	86.9	75.9	55.5	40.8	37.1	51.3	69.6
Asia	18.4	32.6	47.7	91.1	101.1	118.6	142.9	99.3	11.1	121.5	146.4	155.3	130.8	168.5	257.5	263.0
Europe	-3.9	-0.7	5.7	17.6	2.8	34.7	30.7	48.8	26.8	24.9	15.3	7.9	50.7	62.7	94.1	133.2
Middle East	-0.4	0.4	10.5	6.1	6.3	0.1	0.7	24.9	15.2	8.4	8.4	11.1	8.0	11.6	8.6	10.6
Total EMF	47.6	72.9	117.0	206.9	212.0	201.2	272.8	295.2	160.0	255.7	253.4	235.2	232.2	279.2	423.2	495.4

TotCapFI/GDP	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	0.4%	0.5%	1.4%	1.0%	2.7%	2.9%	2.4%	5.3%	4.1%	4.5%	2.3%	1.7%	0.6%	-0.2%	2.4%	3.3%
Americas	3.1%	3.6%	4.1%	6.8%	6.3%	2.4%	5.2%	5.5%	4.9%	5.2%	4.1%	3.1%	2.6%	2.3%	2.7%	3.1%
Asia	1.2%	2.0%	2.7%	4.7%	4.4%	4.3%	4.7%	3.2%	0.4%	3.9%	4.3%	4.5%	3.5%	4.0%	5.4%	4.9%
Europe	0.4%	0.1%	0.6%	2.0%	0.3%	3.7%	3.1%	4.9%	3.0%	3.2%	1.8%	0.9%	4.9%	5.0%	5.9%	6.7%
Middle East	0.1%	0.2%	3.4%	1.6%	1.6%	0.0%	0.1%	4.5%	2.9%	1.5%	1.3%	1.8%	1.3%	1.7%	1.1%	1.1%
Total EMF	1.1%	1.7%	2.6%	4.3%	4.0%	3.3%	4.1%	4.3%	2.5%	4.0%	3.6%	3.3%	3.2%	3.4%	4.4%	4.4%

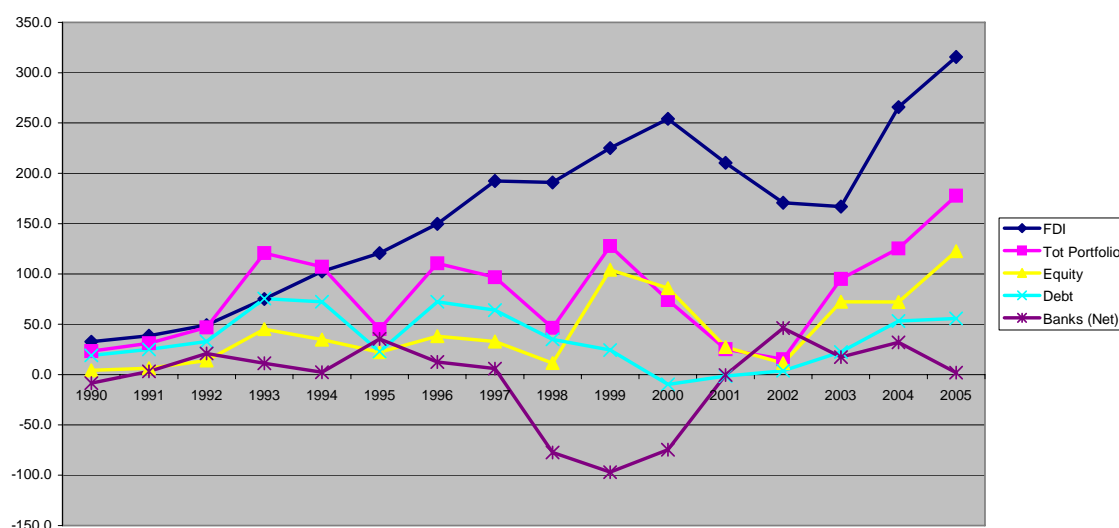
Sources: IMF's IFS and WB's WDI.

To fill in missing data, IMF's WEO, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Stats, CEIC, WB's Gl. Dev. Fin., UNCTAD, & Centennial Estimates. Hong Kong excluded before 1998, save FDI.

During 2003-2005, a cumulative \$1200 billion (4% of GDP) of private capital flowed into EMEs, compared to \$720 billion (3 % of GDP) during 2000-2002 (**Tables 1-2, and Charts 1-3**). The surge in capital inflows that began in 2002 continued through 2005. Since 2001, the shift away from bank-based capital inflows towards portfolio inflows seems to have accelerated, and the share of portfolio flows in total inflows has risen sharply to 34% during 2003-2005 compared to 16% in 2000-2002. Although the growth in portfolio debt has gathered momentum due to the coming on stream of a range of structural reforms in EMEs, the growth in portfolio equity has outpaced the growth in debt. While all regions have benefited from the revival of demand for EME assets, Emerging Europe and Asia have captured much of the recent growth in inflows.

Historic evolution of portfolio equity, portfolio debt, FDI, and bank financing by region (Americas, Asia, including central Asia, Middle East, Europe, and Africa) since 1990 are shown in billions of dollars and as percentage of GDP in **Tables 7-11 and Charts 4-8**. Asia continues to dominate in the amount of capital inflows – both FDI and Portfolio inflows -, with Europe and Latin America also showing significant revival since 2003, after several years of decline in inflows. Portfolio equity inflows in particular rose sharply in Latin America in 2005, while Europe experienced particularly sharp increases in portfolio debt since 2002. Both these regions have also shown strong recovery in FDI since 2002. Middle East and Africa also attracted both portfolio investment and FDI, but the size and growth of the flows was quite small relative to other regions. The recent sharp upsurge in oil prices seems to have led to increased private investment in oil export countries during the past few months but data to confirm this would be available only next year.

Chart 2: Capital Flows into Emerging Markets, by Type



In reviewing the historic evolution of capital flows, it is useful to focus on different sub-periods corresponding to different degrees of openness to capital flows into EMEs. Prior to 1990, only a few emerging markets were open to foreign investment. Roughly from 1991 to 1996, there was a progressive opening of equity markets by EMEs, resulting in large inflows during that period. There followed a period of crisis in 1997-98 in the aftermath of the devaluation of the Thai Baht. Finally, there is the current period (1999 onwards) of substantial opening and large capital flows into emerging markets in all regions.

Table 2: Index of Openness to Capital Flows For Selected Countries				
	1985-90	91-96	97-98	99-2000
Argentina	0.75	0.43	0.42	0.46
Brazil	1	1	0.88	0.85
Chile	1	1	1	0.923
Colombia	1	0.97	0.84	0.85
Ecuador	0.68	0.5	0.46	0.42
Mexico	0.92	0.84	0.83	0.84
Latin America				
Hong Kong	0.08	0.08	0.08	0.231
India	0.92	0.92	0.92	0.92
Korea	0.85	0.85	0.81	0.77
Malaysia	0.85	0.85	0.81	0.77
Philippines	0.92	0.88	0.85	0.85
Singapore	0.23	0.23	0.35	0.42
Asia				
Turkey	0.85	0.64	0.75	0.75
South Africa	0.86	0.89	0.84	0.84

A. Shifts in the Direction of Capital flows

The list of top ten recipients of total private capital inflows has changed significantly between 1994-95 and 2004-2005, with Thailand, Argentina, Indonesia, and Hungary dropping out, and Taiwan, Turkey, Russia, India, making the latest top ten (**Tables 2, 12-14**). The top ten list varies according to the type of inflow, with only a few countries being present among the top ten in more than one category of capital inflows (India in equity and bank financing; Hong Kong in FDI, Equity and bank financing; China in FDI and equity; Russia in FDI, Debt and Bank financing; Korea in equity and debt). European countries are among the top ten in both debt and bank financing. As an indicator of a reduction in the extent of concentration of capital inflows, the share of top three countries in total inflows has fallen significantly for all categories of capital flows. For example, the share of top three countries in global portfolio inflows into EMEs fell from 63% in 1994-95 to 33% during 2004-05.

**Table 3: Total Private Capital Inflow into EME
Top 10 Countries**

Total Capital Flows			
1994-1995		2004-2005	
Brazil	33.6	China, P.R.: Mainland	85.2
China, P.R.: Mainland	32.5	China, P.R.: Hong Kong	48.3
Thailand	16.9	Taiwan, China	27.4
China, P.R.: Hong Kong	16.3	Turkey	23.9
Korea	15.2	Korea	23.4
Argentina	14.4	Russia	23.3
Singapore	13.1	India	23.1
Indonesia	8.5	Singapore	21.9
Mexico	7.0	Mexico	19.5
Hungary	5.8	Brazil	19.4

For Banks and Portfolio, Hong Kong's 1993 data substituted for 1994.

Source: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, IMF Country Report 96/29, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.

B. Growth, Volatility, and Concentration of Capital Inflows

The long term trends in the size of various types of private capital flows is illustrated in **Tables 15-17** where inflows during various sub periods are presented for different EME regions. **Table** below presents long term trends in different types of capital inflows and their relative shares.

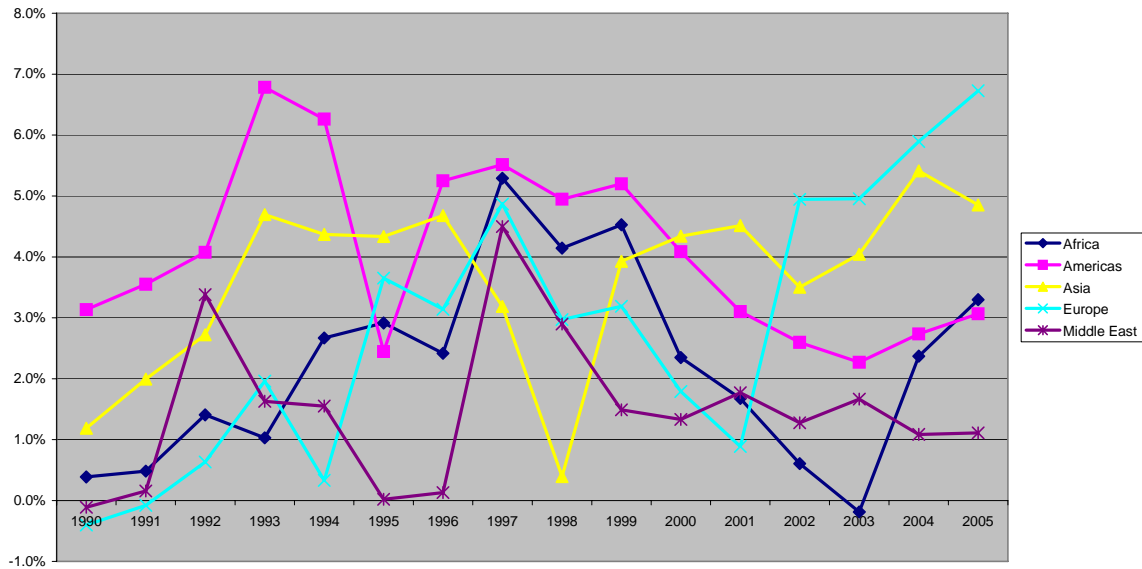
Table 4: Total Private Capital Inflows by Type. 1990-2005

EM Total	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
FDI	32.7	38.5	49.1	75.0	102.5	120.6	149.8	192.4	190.9	225.1	254.1	210.5	170.7	167.0	265.7	315.7
Tot Portfolio	23.4	31.3	46.8	120.7	107.1	45.1	110.5	96.8	46.5	127.6	74.0	25.2	15.3	94.9	125.4	177.8
Equity	4.3	6.3	14.0	45.1	34.7	22.2	38.2	32.8	11.4	104.2	85.8	27.4	11.5	72.4	72.1	122.7
Debt	19.1	24.9	32.8	75.6	72.4	22.9	72.3	64.0	35.1	24.3	-9.7	-1.6	3.9	22.6	53.3	55.7
Banks (Net)	-8.5	3.1	21.1	11.3	2.4	35.4	12.6	6.0	-77.4	-97.0	-74.6	-0.5	46.2	17.3	32.1	2.0
Total Capital Inflows	47.6	72.9	117.0	206.9	212.0	201.2	272.8	295.2	160.0	255.7	253.4	235.2	232.2	279.2	423.2	495.4

Sources: Sources: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates. Hong Kong excluded before 1998, save FDI.

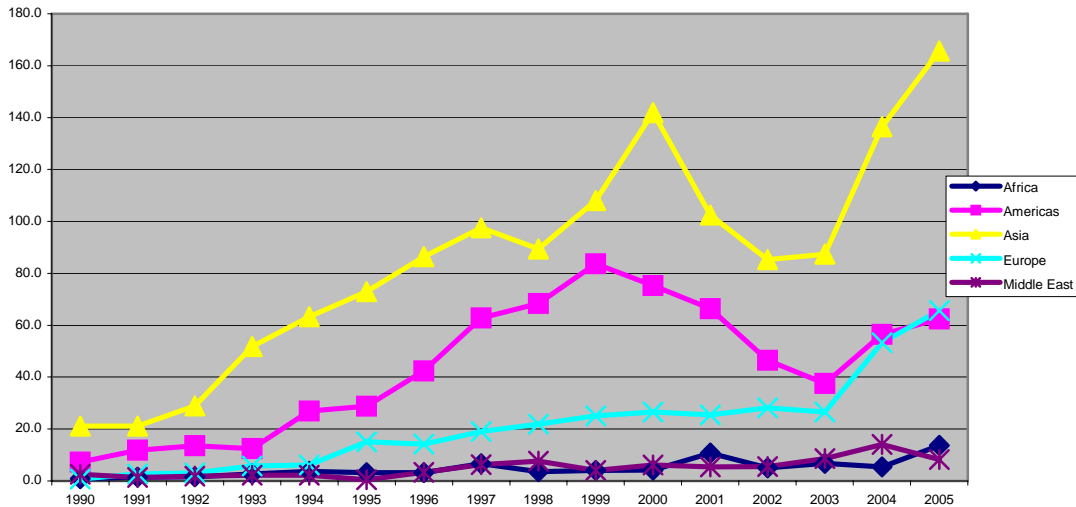
Chart 3: Total Capital Inflows as % GDP, by EM Region



Sources: IMF's IFS and WB's WDI. To fill in missing data, Taiwan's, India's, & Indonesia's Central Banks, Singapore Dept. of Stats, CEIC, WB's Gl. Dev. Fin., UNCTAD, IMF Country Reports, IMF's WEO, & Centennial estimates. Hong Kong excluded before 1998, save FDI.

FDI inflows nearly doubled during 2003-2005, with Asia and Europe absorbing most of the growth in inflows. Several years of declines in FDI inflows in Latin America was mostly reversed in the last two years. Africa too witnessed a significant expansion in FDI, although from a small base. Recent FDI growth was driven in particular by investments in oil rich countries (Russia, Kazakhstan, and Azerbaijan), and in EU accession countries (Czech Republic, Poland, Hungary) .Nevertheless, Asia continued to dominate, with China alone absorbing 25 % of total FDI inflows in 2005, reflecting in part increases in foreign investments in the banking sector. South Africa recorded nearly five fold increases in direct investment, mainly due to large acquisitions in the banking and mobile phone sectors. Growth in FDI in India was modest in 2005, returning to the level reached in 2002, with its share in global FDI flows falling slightly.

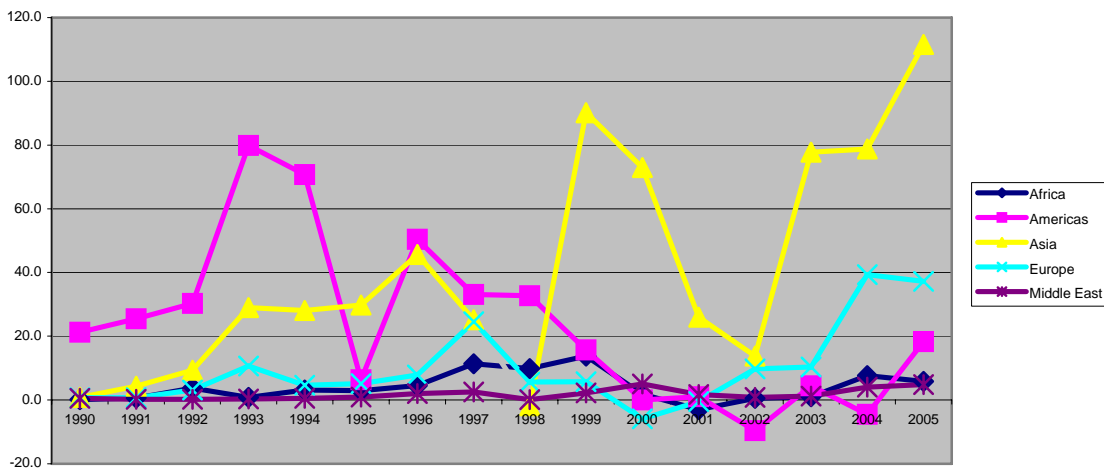
Chart 4: FDI



Source: IMF's IFS. To fill in missing data, Taiwan's & India's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.

Portfolio capital inflows recovered strongly after the Asian crisis to a high of \$127 billion (2 % of GDP) in 1999. It declined to an all time low of \$15 billion in 2002 in the midst of the global equity price collapse. Since then it has recovered strongly to a new peak of over \$178 billion in 2005, with Asia contributing to most of the recent growth. A near tripling of equity inflows into Europe, and a return of foreign investments into the local equity markets in Latin America also played an important role. Despite the volatility of these flows, their share in total private capital flows seems to be on the rise.

Chart 5: Total Portfolio

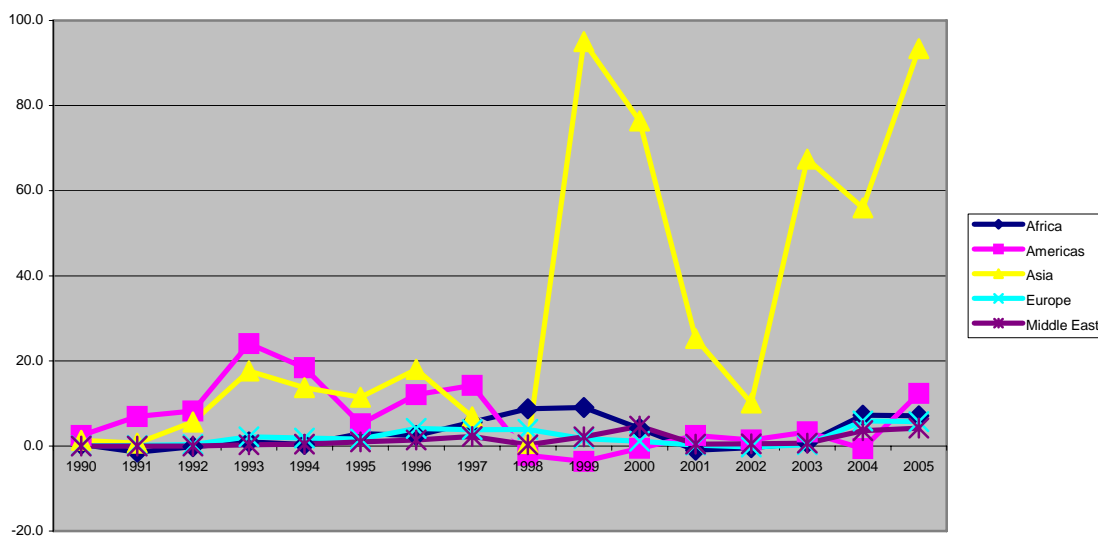


Source: IMF's IFS. To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, & Centennial Estimates. Hong Kong data missing before 1998.

Portfolio inflows as well as bank inflows exhibit substantial volatility, with FDI flows remaining relatively stable.

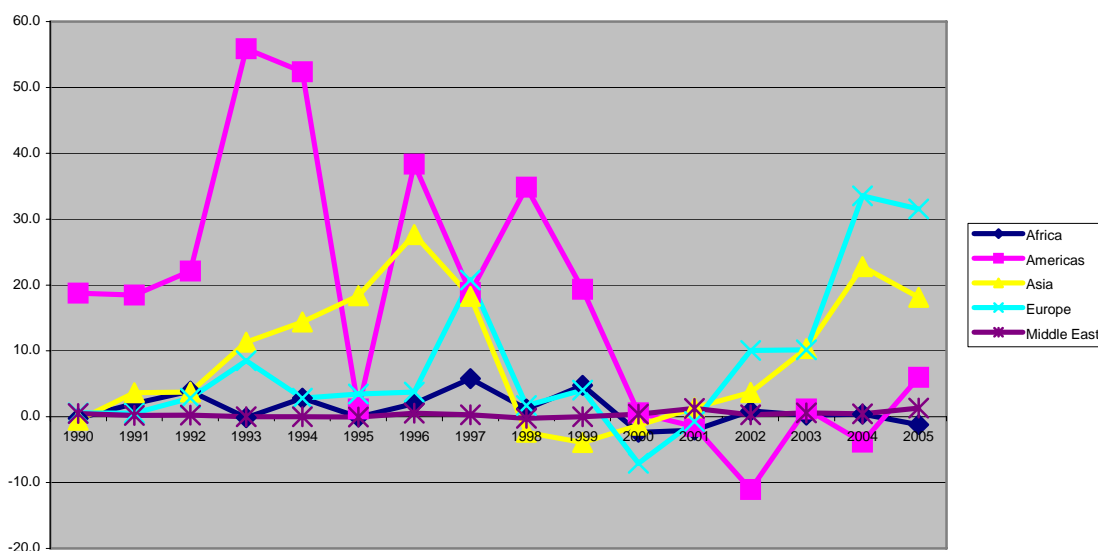
While the volatility of portfolio debt inflows and that of FDI declined in the recent years of increased openness, those of portfolio equity and Bank financing have remained high. For portfolio debt, in particular, there is some evidence that widespread adoption of active debt management by issuers and financial innovations in the EME debt markets together could reduce debt market volatility- in terms of both financing volumes and risk spreads. Continued reforms of local equity markets should also lead to more resilient and less volatile portfolio equity flows to in due course.

Chart 6: Equity



Source: IMF's IFS. To fill in missing data, Taiwan's & India's central banks, CEIC, WB's Global Dev. Fin., & Centennial Estimates. Hong Kong Data missing before 1998.

Chart 7: Portfolio Debt by Region (\$ billion)

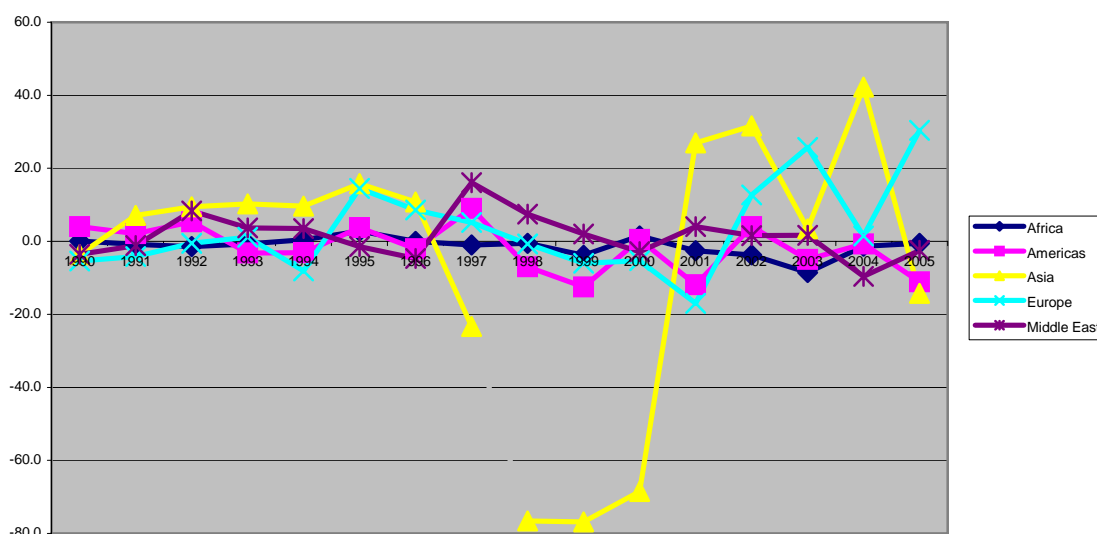


Source: IMF's IFS. To fill in missing data, Taiwan's & Indonesia's central banks, CEIC, & Centennial Estimates. Hong Kong data missing before 1998.

Both portfolio capital flows and FDI tend to be concentrated regionally, although some shifts in regional shares are surfacing, reflecting greater global competition for resources and broader adoption of policies to enhance access to foreign capital (**Tables 18 - 28**). Subsequent to the Asian crisis, a progressively larger share of portfolio capital inflows has been drawn into Asia, in part reflecting both improved macroeconomic fundamentals as well as structural reforms to strengthen capital markets, with the share in Latin America falling until 2004. The share of Europe in portfolio capital has recovered particularly strongly following several years of declines. Nevertheless the dominance of PR China, Hongkong and Taiwan together is striking. These three economies are on the top ten list and account for 34.5 % of total portfolio capital flows into EMEs in 2005.

Gross syndicated **bank lending** to developing countries rose by about 74% in 2005, and by 64 % in net (of amortization) terms to, according to World Bank's GDF 2006 report, with significant expansion reported in Europe and Asia. For the EMEs considered in this paper, and using the measure of net bank financing flows (net inflows of bank financing into EMEs minus net outflows of bank financing from the EMEs, including resident outflows) net bank financing declined in 2005 after a rapid rise in 2004. The decline in 2005 was on account of large net outflows from the banking system in China, Hongkong, Taiwan, Malaysia, Mexico, Czech Republic, and Israel) which offset large inflows of bank financing into Europe (Russia, Hungary, Romania, Bulgaria, Croatia, Turkey, Ukraine), other Asia (India, Korea, Kazakhstan) and Saudi Arabia.

Chart 8: Banks (Net)



Source: The IMF's IFS, and to fill in missing data, Taiwan's Central Bank, the Singapore Dept. of Statistics, & CEIC. Hong Kong data missing before 1998.

In sum, in the period since 1999 developments in Private capital inflows show the following patterns of behavior:

- Significant shifts in regional and country composition of private capital inflows
- A massive growth in volumes, particularly since 2002

- Significant volatility historically, with many structural factors that could dampen volatility seems to be emerging in recent times
- Substantial concentration of flows both among regions and within regions
- Growing importance of portfolio capital relative to other forms of capital inflows.

III. Developments during 2005

During 2005, our group of EMEs saw a record amount of private capital inflows totaling US\$ 495 billion equivalent to 4.4% of GDP. This represented an increase of US\$72 billion or 17% over 2004. The increase is even more impressive in the three relatively more stable sources of private finance -- FDI, portfolio equity and debt flows --, while bank lending showed a sharp drop in net outflows from US\$32 billion in 2004 to only US\$2 billion in 2005, for the reasons mentioned above. Total FDI flows reached US\$315 (an increase of US\$50 billion or 19%). Total equity portfolio flows were US\$122.7 (increase of 98% over 2004). And, portfolio debt flows reached US\$55.7 billion (compared to US\$53.3 billion in 2004).

Within these totals, Asia remained by far the largest recipient region with total flows of US\$263 billion (4.9% of GDP), of which FDI accounted for US\$165 billion, portfolio equity US\$93 billion, and portfolio debt US\$18 billion. Asia's total capital inflows, however, were only 1% above 2004 (US\$257 billion) because of net outflows of bank loans totaling US\$14 billion. Emerging Europe had the second largest capital flows totaling US\$133 billion, which represented a 41% increase over 2004 (US\$94 billion); net flow of bank financing rose to US\$30.3 billion compared to only US\$1.5 billion in the previous year. Emerging Market Economies in Latin America showed a healthy increase of 36% and came third at US\$70 billion. Africa attracted US\$19 billion and Middle East US\$10.6 billion.

IV. Determinants of Portfolio Equity Flows

Many of the macro-economic and structural determinants that led to increased demand for EME assets since 2002 - discussed in the Capital Flow Report for the 2005 EMF - continue to hold in 2005 and early 2006, while some of the so called "push factors" are weakening. Nevertheless, the on going structural reforms and financial innovations in many EME capital markets have the potential to attract strategic investors, minimize excessive capital flow volatility, while building efficient defenses against inevitable volatility that will remain. Adoption of such reforms in a broader range of countries would enhance the efficiency of financial globalization process.

Key factors influencing the size and direction of capital inflows can be categorized as follows.

A. Factors affecting relative investment returns and risk–return mix.

These factors include prospects for growth, expected exchange rate changes, and relative yields on various instruments, taking into account corporate profitability (for equity instruments) and monetary policy stance (for debt instruments). So long as the overall macro-level indicators are promising, the issue will be one of profitability and

financial soundness of actual companies they invest in. The soundness of the financial sector also needs to be factored in along side the purely macroeconomic indicators to form a view on risks to macroeconomic performance and the sustainability of returns. Such factoring in of financial stability considerations in country risk assessments is particularly important in an increasingly globalized setting of many EMEs. In addition to macroeconomic and macro prudential factors, factors like earnings growth, return on equity, and other measures of corporate soundness and profitability are also key considerations for global investors. Shifts in sovereign credit ratings, as a summary measure of credit risk derived from the country fundamentals and other factors, affect investor sentiment.

In addition a range of **structural factors affecting the investability in EME assets** also play a key role. These include:

- Openness to various forms of capital flows
- State of development of capital markets and the related financial market infrastructure
- Structural changes in the sources of supply of capital

First, a country's policies to open up and enhance the access of foreign investors to the equity and debt of its companies is a necessary first step to attract global investors seeking diversification and new opportunities for returns (see section 3.2 for further details)

Second, several structural factors governing security market infrastructure play a critical role in shaping the perceived returns and riskiness of investing in EMC equity securities. These include:

- **Corporate governance and transparency:** The Asian financial crisis highlighted the crucial importance of good corporate governance, transparency of management and majority shareholders actions affecting companies that foreigners invest in, and the accuracy of financial accounts presented to the investment community. The creation of effective regulatory and supervisory institutions and the formulation of appropriate policy framework for good governance in EMCs have been important factors in attracting portfolio equity in particular. {{There is some evidence, though not a whole lot, that foreign mutual funds investments in emerging markets are significantly linked to security-market infrastructure, shareholder rights, and quality of accounting standards (see Aggarwal, Klappen and Wysocki (2003)².)}}
- **Market liquidity:** This has also become an important determinant of flows of portfolio capital into EMC equities. Global investors typically seek investments in which there are significant amounts of daily trading enabling them to buy and sell these assets without moving the price against them and also ensuring that they can enter and exit these investments easily as and when they desire to. Market liquidity is influenced by both the size and pattern of ownership of listed securities, and the microstructure of the markets, including the trading systems.

² Aggarwal, Rena, Leora Klappen and Peter D. Wysocki 2003 "Portfolio Preferences of Foreign Institutional Investors" Policy Research Working Paper 3101, WB, Washington, D.C. July.

The creation of a liquid security market with efficient trading arrangements is thus important to attract both domestic and foreign investment. {{There is evidence that equity-market liberalization, involving an opening up to foreign shareholders, is associated with significant increase in share prices and reduction in cost of capital (Henry and Lorentzen (2003) Also, more protection of shareholders is strongly associated with the size, efficiency and stability of equity markets (see Henry and Lorentzen (2003))^{3, 4}}}

- **Legal Infrastructure:** While transparency, good governance and market micro-structure are also important for developing debt markets, certain infrastructure components such as insolvency regimes, trust and securitization laws require proper attention in order to develop corporate debt markets. In addition the development of government securities market calls for a conducive and an effective framework for public debt management.
- **Macro stability and Macro prudential surveillance:** Several broad structural features that affect the macroeconomic and financial stability policy frameworks, such as the sustainability of exchange rate regime, the perceptions of financial system stability, including the debt-equity ratio of companies, public debt sustainability, efficiency and soundness of financial intermediation etc. will also shape the overall perceptions of costs, risks and returns of investing in EMCs.

Third, structural changes in the sources of foreign capital can be critical. For all types of institutional investors in industrial countries, the share of foreign assets in their total portfolio is rising, reflecting a growing strategic focus of these investors on EMEs (Global Financial Stability Report, September 2005 and Global Development Finance 2006). This could reinforce the impact domestic capital market development policies in enhancing the depth and liquidity of local financial market.

Finally, there are **special factors** such as privatizations, mergers, and other country or region specific one-off factors (e.g. initial impact of accession to EU) that influence the type and level of capital flows.

B. Factors affecting risk-adjusted returns

The regional variations in growth and annual real exchange rate change in various EME regions are shown in **Tables 5-6**. Strong global growth and low inflation witnessed in 2005, despite further jumps in oil and non-oil commodity prices, are expected to continue in 2006, according to various official forecasts. Emerging Markets have faced unusually favorable external conditions, characterized by strong global demand, large terms of trade improvements, and easier access to external financing. These circumstances were reflected in strong growth, large current account surpluses, and moderate inflation in EMEs generally. In addition, stable or generally appreciating nominal or real exchange rates during in recent years –partly in response to the strong inflows of capital--added to the returns to foreign investors on EME assets. The number

³ Pietro Garibaldi, Nada Mora, Ratra Sahay, and Jeromin Zettlemeger, What Moves Capital to Transition Economies? In IMF Staff Papers May 2002, vol 48, Special Issue (IMF, Washington, D.C.).

⁴ Peter Blair Henry and Peter Lombund Lorentzen. "Domestic Capital Market Reform and Access to Global Finance: Making Markets Work." The Future of Domestic Capital Markets in Development Countries ed. By Robert E. Litan, Michael Pomerleane, and V. Sundararajan (editors) Brookings Institution Press(2003 Washington D.C.).

of upgrades of sovereign ratings by rating agencies far exceeded number of downgrades, contributing to strengthened external demand for EME assets, and continued downward trend in credit spreads.

In the presence of such strong fundamentals that led to attractive relative returns, the beginning of monetary tightening in the US in 2004 has had only a limited impact on risk perceptions. However, the synchronized tightening among industrial countries now underway, and the prospective adjustments in the pattern of global current account imbalances, all seem to pose more significant downside risks for the global economy. This was already evident in the second quarter of 2006, when global financial markets experienced increased volatility and a sharp correction in the price of riskier assets. Some emerging market asset prices declined sharply, particularly in some of the more liquid local equity markets and in those currency markets that had appreciated the most. In Debt markets, however, there was only a slight upward adjustment in the credit spreads, which have been at historic lows already. Thus the impact of recent turbulence seems well contained and transitory (See **Box 1** on the next page for a further discussion of turbulence in emerging markets.)

Emerging markets in particular are expected to sustain the robust growth achieved in 2005, current account surpluses are expected to be broadly maintained, with an increase particularly in the Middle East region on account of oil price increases, and inflation is expected to remain moderate in most EMEs. The relatively subdued reaction of inflation so far to commodity price shocks, the greater role of EMEs in sustaining global demand, and generally favorable financial conditions of the corporate sector, both financial and non-financial, are some of the factors that would contribute to continued strong macroeconomic performance globally and in EMEs in 2006.

The EME performance has also benefited from improvements in the financial soundness of both banks and non banks (BIS (2006), GFSR (April 2006)). Banking systems in EMEs have generally strengthened overall (in terms indicators such as Capital adequacy ratios, ratio of non-performing loans, etc.) as a result of economic recovery and reforms, while debt –equity ratios of non- financial firms has declined. Capacity for making macroeconomic and financial policy adjustments in response to various shocks impacting on the financial system has improved in many EMEs, which have built up their macro -prudential surveillance capabilities. {As an indicator of their capacity for macro prudential surveillance, 24 emerging and developing countries have started, over the last few years, issuing Financial Stability Reports to complement their monetary policy related reports}.

Box 1: Global Imbalances, Risk Aversion, and Recent Turbulence in Emerging Markets

While emerging market fundamentals and demand for EME assets remain strong, the effects of concerted monetary tightening in industrial countries on the demand for EME assets remain unclear. Also the recent sell off by global investors, which affected some EME markets particularly sharply, has raised the issue whether this presages a generalized risk aversion leading to outflows of portfolio investment, or simply reflects transitory one-off adjustments in relative risk exposures.

An increase in risk aversion due to the perceived risks –uncertainty and shifts in inflation and exchange rate expectations, and possibly lower growth and corporate profitability, owing to possible downturn in economic activity in countries where monetary policy is tightening—could raise risk premiums, affect investor positioning in specific markets where investors feel over exposed. At the same time, large terms of trade improvements and continued moderate inflation in most EMEs may help to sustain strong growth and continued strong fundamentals overall.

The sell-off by global investors in the spring of 2006 was concentrated in local emerging markets, particularly equities and currencies, and to a limited extent in local currency debt markets; some of the EME equity prices that had risen sharply in 2005 witnessed sharp declines. Some of the higher yielding currencies that had been favored by investors for carry trades saw significant sell off (IMF (2006b).)This helped to reverse the sharp nominal and real appreciations in these currencies in 2005.A sell-off of portfolio local currency debt partly reversed the significant inflow into local currency debt markets in 2005, with sharp corrections in prices.

The evidence presented in IMF (2006b) and BIS (2006), suggest that the recent sell off in emerging market capital markets was modest relative to large inflows that had already occurred, and that recent increase in emerging market spread was small relative to the pronounced declines in spread that occurred since 2002. [Table on EME stock price increases in selected countries]. A recent analysis of the determinants of EME debt market spreads examines the time series evolution of spreads as a function of country fundamentals (measured by various country risk ratings) and external perceptions of global financial risk (measured by 3-month future Fed funds rate and its volatility). The analysis suggests that the EME spreads are well anchored in fundamentals, and that even sizeable increases in global risk may offset only slightly the reductions in the spread so far due to country fundamentals. This finding, combined with the evidence of significant structural improvements in local currency debt markets (see section – of text), including public debt management framework, and the prospects for continuation of strong fundamentals, all seem to suggest that the recent turbulence seems a one-off adjustment rather than a precursor of global risk aversion.

In the future, perceptions of risks in EME investments could increase due to the uncertainties associated with the policy adjustments and market reactions to the current and prospective global imbalances (and the associated shifts in inflation and exchange rate expectation). Nevertheless, the strength of fundamentals in many EMEs, and the recent structural changes in the EME capital markets, together have the potential to stabilize the capital inflows to the EMEs with strong fundamentals.

In summery, the prospective continuation of strong fundamentals in EMEs could serve to maintain broadly the risk adjusted returns on EME assets at attractive levels seen in recent past, and thereby sustain the foreign investor appetite for these assets.

B. Structural and special factors affecting Investibility and Capital Flows

While the continued strength of macro economic fundamentals in EMEs clearly played a role in shaping the expected returns and perceptions of risk in all forms of EME assets, a range of structural forces have also been in play in shaping the demand for different categories of private capital inflows.

A large number of countries have opened up their capital markets to foreign investors during the last decade, both by allowing access of residents to foreign financial markets, and by strengthening access of non-residents to domestic financial markets. As noted in Miniane (2004), the degree of capital account restrictions have been eased substantially, though at varying paces, in a wide range of countries during 1985-2000. The trend toward greater openness seems to continue as highlighted in AREAER (2005) For example, in addition to relaxing non resident's access to local money and securities markets, several countries have eased access of residents to foreign securities as part of policies to cope with strong inflows.. These developments have allowed for a greater competition among countries for foreign investments, and contributed to a reduction in concentration of capital inflows among countries noted earlier.

The local equity and debt markets have developed significantly in many EMEs on account of a range of structural reforms and supportive macroeconomic environment. Various measures of market development -- such as market capitalization to GDP ratio, bonds outstanding to GDP ratio, and stock market turnover -- have improved over the past decade. Although markets in many EMEs remain shallow, requiring further institutional development, overall EME equity markets have provided attractive opportunities for risk diversification (GFSR, June 2002) to global investors. The on-going innovations and reforms in local and international debt markets for EMEs have also provided risk diversification opportunities (BIS 2006). Some of these innovations such as growing use of credit derivatives, strengthened public debt management arrangements, innovations in structured finance to design Islamic fixed income securities (see Box 2), all have raised the attractiveness of EME debt.

Portfolio equity inflows benefited in particular from expanded investor base, including a growing presence of retail investors through emerging market stock funds, in addition to strong growth in valuations (with emerging market stock prices performing exceptionally well during the past three years) As a result, both international equity placements by EME issuers, as well as foreign investment in local stock markets, performed well. A significant part of equity issues during 2005 was driven by IPO's, notably in China (World Bank (2006)).

Strong growth and reduced volatility of **portfolio debt inflows** into EMEs was attributable to the cumulative impact of a variety of structural factors affecting EME debt markets. These include: 1) Growth in euro market for EME debt; 2); Growth in credit derivatives applied to EME debt, allowing better risk diversification, and hence stronger demand (and finer pricing) for EME debt; and 3); Strengthened institutional arrangements for more active and effective public debt management, facilitated by a deepening of local currency debt markets and a widening of investor base for EME bonds.

Strengthened Public Debt Management policies and structural demand from foreign investors have contributed to resilient markets for EME debt. For examples, several EMEs have reduced currency mismatches and lengthened the maturities by strengthening local currency debt markets. Such markets have thus evolved into a major source of long-term finance in many EMEs.

In addition, a rise in allocations to EME assets by institutional investors in developed countries (Pension Funds, Insurance Companies, and Mutual Funds) has contributed added depth and liquidity to many Emerging markets Active debt management to achieve desired tradeoffs between cost and risks has played a key role in shaping the portfolio debt inflows. The specific measures to manage the trade offs included: debt buy backs, pre-financing of borrowing needs to take advantage of liquid markets, and quick actions to stabilize the markets when markets faced selling pressures. These factors have improved the debt dynamics and contributed to reducing the spreads on EME debt.

Bank financing inflows to EMEs, mainly syndicated bank lending, was dominated by oil and gas projects and oil import financing. The strong growth recorded inflows of syndicated bank lending in some countries, noted in GDF 2006, being offset by outflows of bank financing from EMEs in many countries.

FDI inflows, which last year accounted for US\$316 billion or 64% of total private capital inflows to EMEs (compared to US\$167 billion in 2003), appear to be driven by a combination of traditional and new factors. The macro-economic and structural reforms as well as efforts of many countries to enhance private sector role in the economies have made the countries much more attractive to international companies; these companies are often investing large amounts to catch up. In high growth countries with large domestic markets – China, India, Russia, Brazil – the multinational companies are increasing their exposure to exploit market opportunities; indeed, many multinational companies realize that to remain a major global player they can not afford not to be present in fast growing EMEs, particularly the so called BRICs. In addition, most multinationals are investing in EMEs to source products at lower costs. Unlike the past, such investments now often go beyond investments in plants and include mergers and acquisitions of existing domestic players. And, finally, since the recent sharp rise in commodity prices, there has been a surge in investments in resource rich countries EMEs and other developing countries.

V. Summary and Issues For Discussion

Surge in private capital flows to emerging markets, particularly since 2002/2003 continued in 2005, but some of the factors that led to the buoyancy of capital flows have been in retreat in recent months. The synchronized tightening of monetary policy in

industrial countries, and the increases in commodity prices, particularly energy prices, have led to a cyclical build up of risk aversion and inflation expectations. Despite recent turbulence, both portfolio equity flows, and foreign direct investment seems to have risen in 2006, but private debt inflows may have declined somewhat in 2006 from a peak level reached in 2005. This reflected in part pre-financing by many sovereign and private borrowers in 2005 and early 2006 in anticipation of a future tightening of liquidity conditions in the financial markets.

Recent developments highlight several key issues in managing capital flows:

1. Despite the buoyancy of capital inflows on account of the favorable combination of sound macro economic performance, unusually accommodative monetary policies in major OECD economies, strengthened terms of trade, and strong demand for EME assets, portfolio flows remain volatile as seen in the recent sell-off of equity positions in emerging markets. Nevertheless, the changes in debt management practices and greater depth and resilience of local debt and equity markets seemed to have limited market volatility. In particular, debt market volatility seems to have fallen relative to what was observed in recent years. Bank financing continues to remain volatile. These observations in turn point to two key issues:
 - *What are the likely consequences of the potential unwinding of global imbalances on the size and volatility of private capital inflows to emerging markets? What are the likely implications for financial soundness, macro economic stability and economic growth in EMEs?*
 - *Does the recent turbulence and sell-off in emerging markets reflect one-off adjustments in relative risk exposures or presage more fundamental shift in risk perceptions generally on account of global uncertainties?*
 - *Do emerging markets have adequate macro-prudential surveillance framework to monitor adequately the impact of global imbalances and of the shifts in capital flows on domestic financial soundness?*
2. The continued strong growth in FDI in 2004 and 2005 was accompanied by some diversification of FDI among regions. FDI expanded strongly in resource rich countries, which benefited from energy and commodity price increases, in some European countries, which benefited from the improved investment opportunities and confidence deriving from the initial impact EU accession, and in Africa due to two large acquisitions in South Africa. Thus a lot of FDI flow in these regions seems related to special circumstances, FDI remains concentrated in Asia, and regional differences remain important. East Asia, in particular China, continues to dominate.
 - *What are the lessons of recent experience for the strategy to improve and broaden access to FDI inflows?*
3. There is evidence that appropriate structural reforms to develop domestic financial markets can promote stable capital flows to finance long-term growth, and limit the impact of volatility on financial soundness: This observation raises several issues:

- *What is the appropriate scope and sequencing of reforms to build domestic capital markets?*
 - *Can capital market development strategies with an emphasis on asset securitization facilitate private finance of infrastructure development, which is a critical need in many emerging markets?*
 - *As the share of strategic investors grows, how could countries position themselves to attract larger shares or retain their relative shares?*
 - *What are the implications of growing importance of local currency debt markets for the relative shares of debt inflows to EMEs?*
4. While private capital flows have been characterized by substantial concentrations by regions and countries, recent shifts in the structure of global imbalances due to oil price increases may have implications for the type and patterns of capital flows. In particular, the growing surpluses of oil exporting countries particularly in the Middle East seems to have led to increased demand for *Islamic securities*, a form of structured finance transaction linked to ownership in tangible assets and equity claims, as a means to finance infrastructure and sovereign financing needs. However, legal and institutional infrastructure for Islamic finance is still evolving. (See **Box 2** on next page for a discussion of Islamic securities)
- *Would the sovereigns and firms issuing such securities play a key role in recycling oil surpluses?*
 - *What can be done to strengthen the infrastructure for issuing Islamic securities?*

Centennial Group
September 2006

Box 2: Middle East Surpluses and Islamic Securities

Recent analysis of financial market implications of growing surpluses in the middle-east region - on account of energy price increases - conclude that current concentration of investments of oil funds in dollar assets, particularly offshore dollar bank deposits, could continue and only a slow diversification into other asset classes, including those denominated in other currencies, is likely to take place (IMF (2006) a Global Financial Stability Report).

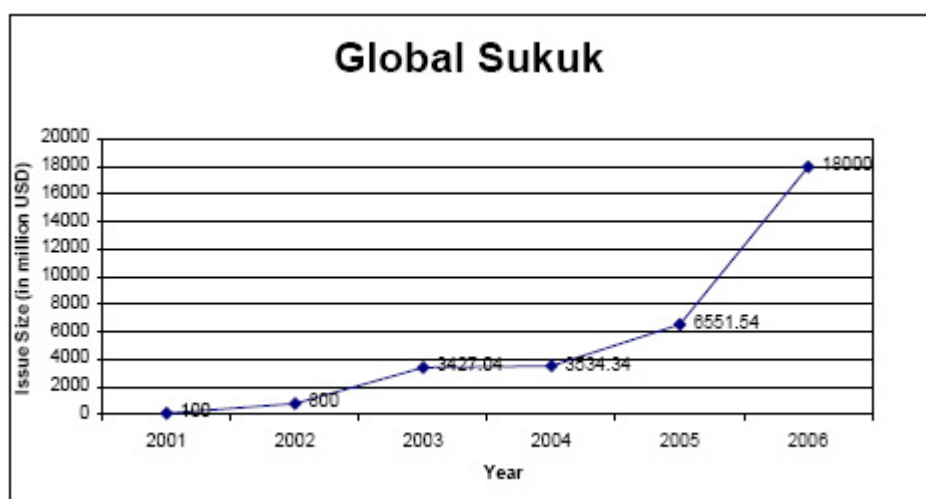
The importance of Islamic Finance, particularly in the countries of the middle -east raises the issue of whether the increase in oil surpluses could spur the demand for Islamic securities and Islamic investment products generally, and whether such securities could become a source of diversification for the investments of petrodollars.

Islamic financial instruments are financial contracts issued in accordance with the principles of Islamic Commercial Jurisprudence (Shariah principles). Some of the key principles include: prohibition of interest, sharing of risks to justify return, not incurring “avoidable” or “excessive” risks, avoidance of financial support to products and activities prohibited by Islam, transparency of contracts, etc.... Institutions offering Islamic Financial Services (IIFS) typically employ a Shariah Board of Shariah scholars to seek ex -ante approval for the products and services to be offered in order to provide assurances that these are Shariah-compliant. The opinions/ rulings (also referred to as fatwas) of Shariah Boards are further reviewed (and subject to approval) by a National Shariah Board in some jurisdictions (e.g. Malaysia, Indonesia), and are left to market forces in others (Saudi Arabia, Dubai). Regardless of the institutional arrangements for the harmonization and implementation of Shariah rulings and standards, banking regulators will typically oversee the adequacy of the systems and controls in an IIFS to ensure Shariah compliance.

Consistent with the Shariah principles, Islamic finance instruments are either equity-like (based on various forms of profit sharing contracts, including partnership arrangements) or asset-based (based on purchases and resale of goods, ownership and leasing of assets, or forward purchases of goods for delivery, etc.) A range of Islamic investment products, such as non tradable Profit Sharing Investment Accounts (PSIA)--based on profit sharing and loss -bearing contracts, known as Mudarabha --provided by IIFS, or tradable equity securities and mutual funds that meet specified screening criteria set up by Shariah boards, have existed for a long time. PSIA are fixed term products which provide returns linked to the profits of the overall asset portfolio of the IIFS (Unrestricted PSIA) or to a specific investment portfolio (Restricted PSIA). These are in principle similar to mutual funds, but are not tradable, and constitute a significant source of funding for Islamic banks. The size and share of Shariah compliant stocks have also grown rapidly in recent years. A large number of indexes —currently more than 40 under the Dow Jones Islamic Market Indexes (DJIMI) umbrella, and several indexes under the FTSE Global Islamic Index Series—are available to monitor Shariah compliant stocks in many jurisdictions. Globally, nearly 250 Islamic mutual funds operate managing about \$300 billion in assets. However the availability of globally acceptable fixed income securities consistent with Shariah principle (known as Sukuks, or Islamic Bonds) is more recent (IOSCO (2004)). In particular, design of Shariah-compatible short-term (money market) securities or government securities that yield a fixed income stream has been a major challenge in Islamic finance, owing to the Shariah prohibition of trading in debt; and this has constrained liquidity risk management by IIFS and liquidity management by central banks in jurisdictions with significant presence of IIFS.

Recent innovations in Islamic Asset securitization have begun to overcome these limitations and the issuance of Islamic fixed income securities (known as sukuk) particularly for project financing, has accelerated in recent years. Historically, many governments, notably Malaysia and Bahrain, have promoted Islamic bonds in their national jurisdictions. However, issuance of globally acceptable Islamic bonds has gathered momentum particularly since 2001, when IDB, and some national governments began securitizing Islamic contracts, particularly lease contracts (known as Ijara contracts).

Islamic Bonds or Sukuks are “trust certificates” or “participation certificates” that grant an investor a share of an asset along with the cashflows and risks commensurate with such ownership. Sukuks represent “certificates of equal value representing undivided shares in ownership of tangible assets, usufruct, and services, or (in the ownership of assets of particular projects or special investment activity....” AAOIFI, Shariah Standard No. 17). Sukuks are classified according to the underlying Islamic contracts that underpin the securitization (Ijara Sukuk, Musharakha Sukuk, etc...). Issuance of Sukuk involves creation of a Special Purpose Vehicle (SPV) to own, service and operate specified assets, issue Sukuks, pass on the proceeds to the originator and enter into income generating contracts using the assets (e.g. leasing or trading, building and operating, etc...). Thus, ideally Sukuk issuance requires strong secured asset laws and trust laws to ensure true sale and bankruptcy remoteness of SPV in order to safeguard investor interests. In practice most Sukuks until recently have involved “purchase undertaking agreements “by the originator, so that the underlying risks are related to the credit rating of the originator, rather than the quality of the underlying assets and SPV governance. (Moody (2006)). Recent developments in global issuance of Sukuks, many issued for financing infrastructure projects are shown in the chart below. This includes one of the largest issues - \$3.5 billion - by Dubai Ports World to finance capital expenditures. The strong growth in issue activity in the Gulf region reflects both the boom in business investment and the availability of savings on account of energy price increases (Financial Times, July 11, 2006, P 17). Reported Sukuk Issues in the first half of the year was about \$12 billion, almost five times the \$2.6 billion closed in the same period of 2005. While Malaysia remained the leading issuer, issue activities by Gulf countries including Bahrain, CAE, Kuwait and Saudi Arabia seem to be taking off. The innovations in Islamic finance, thus, augur well for efficient recycling of petrodollars.



Source: Liquidity Management Center, www.lmc Bahrain.com, lists a total of 77 issues since September 2002, with a current outstanding value of about 18 billion. Adding staff estimates for issues in the remainder of 2006, total outstanding could rise to about \$36 billion, mainly on account of what appears to be a huge surge in issuance in 2006.

List of Emerging Market Countries

There is some debate as to how to define emerging market economies and therefore which countries should be included in any list of EMCs. For purposes of this paper, we have used a relatively broad definition to include countries which are both of most interest to international investors at this time and which compete with each other in attracting international private capital flows. The list we have chosen corresponds to the list and definitions of EMCs used by international investors and also by journals such as the Economist. While most of these countries are middle or upper middle countries developing countries in Asia, Europe and Latin America, we also include some low middle income and low income countries (e.g. China, India, Vietnam, Kenya, Nigeria, Bolivia etc.) which are capable of attracting significant capital flows as well as the so called “tiger” countries in Asia spawned the original club of the EMCs and whose economic policies are both emulated in and intertwined with the rest of Emerging Asia

Latin America

Argentina
Bolivia
Brazil
Chile
Colombia
Costa Rica
Ecuador
Mexico
Peru
Uruguay
Venezuela

Europe

Bulgaria
Croatia
Czech Republic
Hungary
Poland
Romania
Russia
Serbia and Montenegro
Slovak Republic
Turkey
Ukraine

Middle East

Egypt
Thailand
Bahrain
Iran
Israel
Jordan
Kuwait
Saudi Arabia
United Arab Emirates

Asia

Bangladesh
China
Hong Kong, China
India
Indonesia
Korea, Rep.
Malaysia
Pakistan
Philippines
Singapore
Sri Lanka
Taiwan (China)
Vietnam
Kazakhstan

Africa

Algeria
Morocco
Tunisia
Cote d'Ivoire
Ghana
Kenya
Nigeria
South Africa
Uganda

Data Sources & Definitions

1. Foreign Direct Investment (FDI) inflows are taken from line 78 bed of IMF International Financial Statistics (IFS) yearbook (various issues); It is referred to in IFS tables as “Direct Investment in Representative Economy, not included elsewhere (nie)”, and represents increase in net inward investment by non-residents and includes equity capital, reinvested earnings, other capital and financial derivatives associated with various intercompany transactions between affiliated enterprises.
2. Portfolio Debt net inflows is taken from line 78 bnd of IMF, IFS yearbook (various issues)”. It is referred to in IFS tables as “portfolio investment liabilities ,nie, debt securities” and covers nonresident purchases of bonds, debentures, notes, etc... and money market and negotiable debt investments.
3. Portfolio Equity net inflows is taken from line 78 bmd. Of IMF, IFS yearbook (various issues); It is referred to in IFS tables as ”portfolio investment liabilities, n.i.e., equity securities” and covers non-resident acquisition of shares, stocks, participation and similar documents (e.g. depository receipts) that usually denote ownership of equity.
4. Net Bank financing is calculated as the sum of line 78 bud (other investment liabilities, n.i.e., banks) and line 78 bqd (other investment assets, n.i.e., banks) and represents transactions with non-residents in currency, and deposits, bonds, and trade credits through the banking system.
5. Data for 2005 are staff estimates based on partial quarterly data reported in IFS and country publications.
6. Data reported here differ from other commonly cited sources- World Bank’s Global Development Finance, IMF’s Global Financial Stability Report and World Economic Outlook --due to
 - differences in country coverage
 - a. differences in the definitions and sources used in compiling portfolio debt and bank inflows.

For example, data in portfolio debt based on IFS definition in this document roughly corresponds to net bond financing data used in World Bank’s GDF (DT.NFL.PBND.CD, DT.NFL.PNGB.CD). For Bank inflows, we use net inflows from Banks plus net outflows to Banks as defined in IFS. As our list of EMEs include major financial centers, there can be massive recorded inflows that are offset by large outflows reflecting international inter bank activity. Therefore net figures are used to avoid distortions in measuring the true extent of inflows through the banking system. That is, resident outflows through the banking system are also deducted from net inflows, in addition to on lending and carry trade activities; As a result, net figures tend to be lower than the syndicated bank lending and other long-term net lending reported in GDF (DT.NFL.PCBK.CD, DT.NFL.PNGC.CD).

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Table 5: Average Weighed Annual GDP Growth Rates

Weighed Av An Real GDP Growth Rates	91-96	97-98	99-04	2005-2007 (projected)
Africa	2.0%	2.5%	3.5%	4.8%
Americas	3.5%	4.0%	1.9%	4.1%
Asia	8.1%	3.4%	6.8%	7.5%
Europe	-2.9%	1.8%	4.4%	4.9%
Middle East	5.3%	3.7%	3.9%	5.7%
Total EMF	4.3%	3.3%	4.7%	6.1%

Source: WB's WDI and IMF's WEO.
Taiwan excluded, Serbia no data 1990-1992, and Kuwait no data 1990-1991.

Table 6: Real Effective Exchange Rate (Weighed by GDP)

Weighed REER	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	114.1	112.7	119.8	118.8	104.1	100.0	96.9	90.4	96.3	101.2	103.7
Americas	97.1	98.3	105.4	106.1	102.0	100.0	102.2	95.2	87.8	88.5	92.2
Asia	93.8	100.6	105.0	105.5	100.7	100.0	103.2	101.3	95.0	92.5	92.7
Europe	99.7	115.1	123.5	112.7	93.2	100.0	113.6	115.8	114.8	121.6	132.4
Middle East	93.4	95.9	100.3	102.1	97.5	100.0	100.8	95.7	88.7	83.1	81.3
EM Total	98.1	105.2	111.0	108.4	99.3	100.0	104.6	102.8	99.0	100.0	103.9

Source: IMF's IFS, World Bank's WDI, and to fill in missing data IMF's WEO.

Table 7: Foreign Direct Investment by Region 1990-2005

FDI (bn\$)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	0.9	1.5	1.6	2.7	3.7	3.2	3.2	6.7	3.5	4.1	4.2	10.8	5.1	6.8	5.4	13.7
Americas	7.3	11.9	13.6	12.5	27.0	28.8	42.5	62.8	68.3	83.6	75.3	66.4	46.5	37.5	56.5	62.4
Asia	21.1	21.1	28.9	51.8	63.3	73.0	86.5	97.5	89.4	108.1	141.9	102.4	85.3	87.4	136.5	165.7
Europe	0.8	2.7	3.1	5.8	6.2	15.1	14.3	19.1	21.9	25.2	26.6	25.4	28.2	26.6	53.2	65.6
Middle East	2.6	1.4	1.9	2.2	2.3	0.5	3.3	6.3	7.7	4.1	6.1	5.4	5.6	8.7	14.1	8.3
EM Total	32.7	38.5	49.1	75.0	102.5	120.6	149.8	192.4	190.9	225.1	254.1	210.5	170.7	167.0	265.7	315.7

Sources: IMF's IFS. To fill in missing data, Taiwan's & India's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.

Table 8: Portfolio Capital Inflows (Debt Plus Equity) by Region 1990-2005

TotPort In (bn\$)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	0.1	0.6	3.8	0.8	3.1	2.9	4.5	11.4	9.9	13.8	1.8	-3.0	0.5	1.0	7.7	5.8
Americas	21.2	25.4	30.3	79.9	70.8	6.4	50.4	33.1	32.7	15.7	0.0	1.0	-9.6	4.5	-4.5	18.3
Asia	0.8	4.3	9.3	29.0	28.1	29.8	45.7	25.1	-1.8	90.2	73.0	25.9	13.8	77.8	78.8	111.5
Europe	0.7	0.7	3.2	10.7	4.7	5.1	7.9	24.6	5.6	5.7	-5.9	-0.5	9.8	10.4	39.4	37.2
Middle East	0.5	0.2	0.2	0.3	0.5	0.9	2.0	2.5	0.1	2.2	5.1	1.8	0.8	1.3	4.0	4.8
EM Total	23.4	31.3	46.8	120.7	107.1	45.1	110.5	96.8	46.5	127.6	74.0	25.2	15.3	94.9	125.4	177.8

Sources: IMF's IFS. To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, & Centennial Estimates.
Hong Kong excluded before 1998.

Table 9: Portfolio Equity Inflow by Region, 1990-2005

Equity In (bn\$)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	0.4	-1.4	-0.1	0.9	0.3	3.0	2.5	5.6	8.7	9.0	4.2	-1.0	-0.4	0.7	7.3	7.0
Americas	2.5	6.9	8.2	24.0	18.4	5.2	12.1	14.3	-2.2	-3.6	-0.6	2.5	1.4	3.3	-0.6	12.3
Asia	1.3	0.6	5.6	17.6	13.7	11.4	18.0	6.9	0.6	95.0	76.4	25.3	10.1	67.4	56.0	93.4
Europe	0.1	0.1	0.4	2.2	1.9	1.6	4.1	3.8	3.9	1.7	1.2	0.2	-0.3	0.3	5.8	5.7
Middle East	0.0	0.0	0.0	0.3	0.5	1.0	1.4	2.2	0.3	2.2	4.7	0.5	0.5	0.6	3.6	4.2
EM Total	4.3	6.3	14.0	45.1	34.7	22.2	38.2	32.8	11.4	104.2	85.8	27.4	11.5	72.4	72.1	122.7

Sources: IMF's IFS. To fill in missing data, Taiwan's & India's central banks, CEIC, WB's Global Dev. Fin., & Centennial Estimates.
Hong Kong excluded before 1998.

Table 10: Portfolio Debt by Region, 1990-2005

Debt In (bn\$)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	-0.2	2.0	3.9	-0.2	2.8	0.0	2.0	5.8	1.2	4.8	-2.4	-2.0	0.9	0.2	0.4	-1.2
Americas	18.7	18.5	22.1	55.9	52.4	1.2	38.3	18.8	34.8	19.4	0.6	-1.5	-11.1	1.2	-3.9	6.0
Asia	-0.5	3.7	3.7	11.3	14.4	18.4	27.7	18.3	-2.4	-3.9	-1.3	1.3	3.7	10.4	22.8	18.1
Europe	0.6	0.6	2.8	8.5	2.8	3.5	3.7	20.8	1.7	4.1	-7.1	-0.7	10.1	10.1	33.5	31.5
Middle East	0.5	0.2	0.3	0.0	0.0	0.0	0.6	0.3	-0.2	0.0	0.4	1.3	0.3	0.6	0.4	1.3
EM Total	19.1	24.9	32.8	75.6	72.4	22.9	72.3	64.0	35.1	24.3	-9.7	-1.6	3.9	22.6	53.3	55.7

Sources: IMF's IFS.
To fill in missing data, Taiwan's & Indonesia's central banks, CEIC, & Centennial Estimates.
Hong Kong excluded before 1998.

Table 11: Net Flow of Bank Financing by Region, 1990-2005

Banks (bn\$)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Africa	0.0	-0.8	-1.4	-0.7	0.4	2.8	0.0	-1.0	-0.6	-3.8	1.4	-2.6	-3.7	-8.6	-1.4	-0.5
Americas	4.1	2.1	5.3	-3.2	-3.1	3.8	-2.0	9.1	-6.9	-12.5	0.5	-11.9	4.0	-4.9	-0.7	-11.1
Asia	-3.6	7.1	9.4	10.3	9.7	15.8	10.8	-23.3	-76.6	-76.8	-68.5	27.0	31.6	3.4	42.2	-14.2
Europe	-5.4	-4.1	-0.6	1.1	-8.1	14.5	8.6	5.2	-0.7	-6.0	-5.3	-16.9	12.7	25.7	1.5	30.3
Middle East	-3.5	-1.1	8.3	3.7	3.5	-1.4	-4.7	16.1	7.5	2.0	-2.8	4.0	1.6	1.7	-9.6	-2.5
EM Total	-8.5	3.1	21.1	11.3	2.4	35.4	12.6	6.0	-77.4	-97.0	-74.6	-0.5	46.2	17.3	32.1	2.0

Sources: IMF's IFS.

To fill in missing data, Taiwan's Central Bank, the Singapore Dept. of Statistics, & CEIC.
Hong Kong excluded before 1998.

**Table 12: Total FDI Inflows into EMEs
Top 10 Countries**

FDI				
1994-1995			2004-2005	
China, P.R.: Mainland	34.8		China, P.R.: Mainland	67.0
Mexico	10.2		China, P.R.: Hong Kong	35.0
Singapore	10.1		Singapore	18.6
China, P.R.: Hong Kong	7.0		Mexico	18.0
Argentina	4.6		Brazil	16.7
Malaysia	4.3		Russia	15.0
Brazil	4.0		Poland	10.3
Indonesia	3.2		United Arab Emirates	10.0
Hungary	3.0		Czech Republic	8.0
Peru	2.9		Chile	7.2

Source: IMF's IFS.

To fill in missing data, Taiwan's Central Bank, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, India's Central Bank, & Centennial Estimates.

**Table 13: Total Portfolio Inflows into EMEs
Top 10 Countries**

Total Portfolio			
1994-1995		2004-2005	
Brazil	29.0	Taiwan, China	24.1
Korea	11.7	China, P.R.: Mainland	17.2
China, P.R.: Hong Kong	8.9	Korea	16.1
Argentina	8.1	Poland	12.9
Indonesia	4.0	Turkey	12.0
India	3.5	India	10.9
Thailand	3.4	Mexico	8.1
South Africa	2.9	Malaysia	7.2
Taiwan, China	2.8	Hungary	6.5
Hungary	2.3	China, P.R.: Hong Kong	6.5

For Hong Kong, 1993 data used for 1994-1995.

Source: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, IMF Country Report 96/29, & Centennial Estimates.

**Table 13a: Debt Inflows into EMEs
Top 10 Countries**

Debt			
1994-1995		2004-2005	
Brazil	24.0	Poland	11.4
Korea	7.7	Korea	9.8
Argentina	5.2	Turkey	8.5
Thailand	2.4	Mexico	7.7
China, P.R.: Mainland	2.3	Hungary	5.8
Indonesia	2.3	Malaysia	4.7
Hungary	2.3	Czech Republic	2.8
Philippines	1.8	Ukraine	2.4
South Africa	1.4	Indonesia	2.2
Taiwan, China	1.0	Russia	1.8

Hong Kong excluded for 1994-1995.

Source: IMF's IFS.

To fill in missing data, Taiwan's & Indonesia's central banks, CEIC, & Centennial Estimates.

**Table 13b: Equity Inflows into EMEs
Top 10 Countries**

Equity			
1994-1995		2004-2005	
Brazil	5	Taiwan, China	24.5
Korea	3.9	China, P.R.: Mainland	15.6
India	3.5	India	10.9
Argentina	2.9	South Africa	6.8
Mexico	2.3	China, P.R.: Hong Kong	6.4
Taiwan, China	1.8	Korea	6.3
Indonesia	1.7	Brazil	4.3
South Africa	1.5	Israel	3.7
Thailand	0.9	Turkey	3.5
Czech Republic	0.9	Singapore	3.5

Hong Kong excluded for 1994-1995.

Sources: IMF's IFS.

To fill in missing data, Taiwan's & India's central banks, CEIC, WB's Global Dev. Fin., & Centennial Estimates.

**Table 14: Net Banks Flows into EMEs
Top 10 Countries**

Net Banks			
1994-1995		2004-2005	
Thailand	11.9	China, P.R.: Hong Kong	6.9
Singapore	3.1	India	6.8
Russia	2.5	Russia	6.5
Korea	2.2	Turkey	5.7
Saudi Arabia	2.1	Hungary	3.3
Czech Republic	1.9	Bahrain	3.2
Argentina	1.7	Romania	3.1
South Africa	1.7	Kazakhstan	2.3
Philippines	1.7	Croatia	2
Indonesia	1.2	Taiwan, China	1.6

For Hong Kong, 1993 data used for 1994-1995.

Source: IMF's IFS

To fill in missing data, Taiwan's Central Bank, the Singapore Dept. of Statistics, CEIC, IMF Country Report 96/29.

Table 15: Total Capital Inflows, Long Term Trend

Total Capital Inflows, Av.	85-90	91-96	97-98	99-04	2005
Africa	0.6	5.3	15.0	6.6	19.0
Americas	6.1	67.0	99.5	57.9	69.6
Asia	14.6	89.0	55.2	163.3	263.0
Europe	-3.4	15.1	37.8	42.6	133.2
Middle East	-1.9	4.0	20.1	9.4	21.5
Total EMF	16.1	180.5	227.6	279.8	506.3

Source: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Stats, CEIC, IMF's BoP, WB's Gl. Dev. Fin., UNCTAD, & Centennial Est.
Hong Kong excluded before 1998, save FDI.

Table 16: Total Capital Inflows, Long Term Trend

Total Capital % GDP, Av.	85-90	91-96	97-98	99-04	2005
Africa	0.26%	1.86%	4.73%	1.85%	3.30%
Americas	0.76%	4.75%	5.23%	3.34%	3.07%
Asia	1.25%	3.98%	1.86%	4.34%	4.85%
Europe	-0.69%	1.65%	3.97%	3.98%	6.73%
Middle East	-0.49%	1.02%	3.72%	1.42%	2.25%
Total EMF	0.52%	3.44%	3.41%	3.69%	4.52%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Stats, CEIC, IMF's BoP, WB's Gl. Dev. Fin., UNCTAD, IMF's WEO, & Centennial Est.
Hong Kong excluded before 1998, save FDI.

Table 17: Capital Inflows By Type, Long Term Trend

By Type, Av.	85-90	91-96	97-98	99-04	2005
FDI	22.2	89.2	191.6	215.5	315.7
Tot Portfolio	4.9	76.9	71.6	77.1	177.8
Equity	1.1	26.8	22.1	62.2	122.7
Debt	3.9	50.2	49.5	15.5	55.7
Banks (Net)	-11.2	14.3	-35.7	-12.8	2.0
Total Capital Inflows	15.9	180.5	227.6	279.8	495.4

Source: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.
Hong Kong excluded before 1998, save FDI.

Table 18: Capital Inflows By Type, Long Term Trend, Period Averages, % of GDP

By Type % GDP, Av.	85-90	91-96	97-98	99-04	2005
FDI	0.72%	1.70%	2.87%	2.84%	2.82%
Tot Portfolio	0.16%	1.47%	1.07%	1.02%	1.59%
Equity	0.03%	0.51%	0.33%	0.82%	1.10%
Debt	0.13%	0.96%	0.74%	0.20%	0.50%
Banks (Net)	-0.36%	0.27%	-0.53%	-0.17%	0.02%
Total Capital Inflows	0.52%	3.44%	3.41%	3.69%	4.42%

Sources: IMF's IFS and WB's WDI

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, IMF's WEO, & Centennial Estimates.

Hong Kong excluded before 1998, save FDI.

Table 19: Foreign Direct Investment, Long Term Trend, Period Averages

FDI, av.	85-90	91-96	97-98	99-04	2005
Africa	0.8	2.7	5.1	6.1	13.7
Americas	6.0	22.7	65.6	61.0	62.4
Asia	13.4	54.1	93.5	110.3	165.7
Europe	0.4	7.9	20.5	30.9	65.6
Middle East	1.5	1.9	7.0	7.3	19.2
Total EMF	22.2	89.2	191.6	215.5	326.6

Source: IMF's IFS.

To fill in missing data, Taiwan's & India's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, & Centennial Estimates.

Table 20: Foreign Direct Investment, Long Term Trend, Period Averages, by % GDP

FDI % GDP, Av.	85-90	91-96	97-98	99-04	2005
Africa	0.34%	0.93%	1.61%	1.70%	2.38%
Americas	0.76%	1.61%	3.45%	3.52%	2.75%
Asia	1.15%	2.42%	3.16%	2.93%	3.06%
Europe	0.08%	0.86%	2.15%	2.88%	3.31%
Middle East	0.40%	0.49%	1.30%	1.12%	2.01%
Total EMF	0.72%	1.70%	2.87%	2.84%	2.92%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's & India's central banks, Singapore Dept. of Statistics, CEIC, WB's Global Dev. Fin., UNCTAD, IMF's WEO, & Centennial Estimates.

Table 21: Total Portfolio Inflows, Long Term Trend, Period Averages

TotPort, av	85-90	91-96	97-98	99-04	2005
Africa	-0.4	2.6	10.6	3.6	5.8
Americas	2.6	43.9	32.9	1.2	18.3
Asia	2.0	24.4	11.7	59.9	111.5
Europe	0.6	5.4	15.1	9.8	37.2
Middle East	0.0	0.7	1.3	2.5	4.8
Total EMF	4.9	76.9	71.6	77.1	177.8

Source: IMF's IFS.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, & Centennial Estimates.

Hong Kong excluded before 1998.

Table 22: Total Portfolio Inflows, Long Term Trend, Period Averages, by % GDP

TotPort % GDP, av.	85-90	91-96	97-98	99-04	2005
Africa	-0.15%	0.92%	3.36%	1.02%	1.01%
Americas	0.32%	3.11%	1.73%	0.07%	0.81%
Asia	0.18%	1.09%	0.39%	1.59%	2.06%
Europe	0.13%	0.58%	1.58%	0.92%	1.88%
Middle East	0.01%	0.18%	0.24%	0.38%	0.51%
Total EMF	0.16%	1.47%	1.07%	1.02%	1.59%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's, India's, & Indonesia's central banks, Singapore Dept. of Statistics, CEIC, IMF's WEO, & Centennial Estimates.

Hong Kong excluded before 1998.

Table 23: Equity Inflows, Long Term Trend, Period Average

Equity, Av.	85-90	91-96	97-98	99-04	2005
Africa	-0.1	0.9	7.2	3.3	7.0
Americas	0.5	12.5	6.0	0.4	12.3
Asia	0.7	11.2	3.7	55.0	93.4
Europe	0.0	1.7	3.9	1.5	5.7
Middle East	-0.1	0.5	1.3	2.0	4.2
Total EMF	4.3	26.8	22.1	62.2	122.7

Source: IMF's IFS.

To fill in missing data, Taiwan's & India's central banks, CEIC, WB's Global Dev. Fin., & Centennial Estimates.

Hong Kong excluded before 1998.

Table 24: Equity Inflows, Long Term Trend, Period Average, by % GDP

Equity % GDP, Av.	85-90	91-96	97-98	99-04	2005
Africa	-0.05%	0.30%	2.26%	0.92%	1.22%
Americas	0.07%	0.88%	0.32%	0.02%	0.54%
Asia	0.06%	0.50%	0.13%	1.46%	1.72%
Europe	0.00%	0.19%	0.41%	0.14%	0.29%
Middle East	-0.04%	0.13%	0.24%	0.31%	0.44%
Total EMF	0.14%	0.51%	0.33%	0.82%	1.10%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's & India's central banks, CEIC, WB's Global Dev. Fin., IMF's WEO, & Centennial Estimates.

Hong Kong excluded before 1998.

Table 25: Debt Inflows, Long Term Trend, Period Averages

Debt, Av.	85-90	91-96	97-98	99-04	2005
Africa	-0.2	1.8	3.5	0.3	-1.2
Americas	2.0	31.4	26.8	0.8	6.0
Asia	1.3	13.2	7.9	5.5	18.1
Europe	0.6	3.7	11.2	8.3	31.5
Middle East	0.2	0.2	0.0	0.5	1.3
Total EMF	3.9	50.2	49.5	15.5	55.7

Source: IMF's IFS.

To fill in missing data, Taiwan's & Indonesia's central banks, CEIC, & Centennial Estimates.

Hong Kong excluded before 1998.

Table 26: Debt Inflows, Long Term Trend, Period Averages, by % GDP

Debt % GDP	85-90	91-96	97-98	99-04	2005
Africa	-0.10%	0.62%	1.10%	0.09%	-0.21%
Americas	0.26%	2.22%	1.41%	0.05%	0.26%
Asia	0.11%	0.59%	0.27%	0.15%	0.33%
Europe	0.12%	0.40%	1.18%	0.78%	1.59%
Middle East	0.05%	0.04%	0.01%	0.08%	0.14%
Total EMF	0.13%	0.96%	0.74%	0.20%	0.50%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's & Indonesia's central banks, CEIC, IMF's WEO, & Centennial Estimates.

Hong Kong excluded before 1998.

Table 27: Net Bank Flows, Long Term Trend, Period Averages

Net Banks, Av.	85-90	91-96	97-98	99-04	2005
Africa	0.2	0.0	-0.8	-3.1	-0.5
Americas	-2.5	0.5	1.1	-4.2	-11.1
Asia	-0.9	10.5	-50.0	-6.9	-14.2
Europe	-4.4	1.9	2.2	1.9	30.3
Middle East	-3.6	1.4	11.8	-0.5	-2.5
Total EMF	-11.2	14.3	-35.7	-12.8	2.0

Source: IMF's IFS.

To fill in missing data, Taiwan's Central Bank, the Singapore Dept. of Statistics, & CEIC.
Hong Kong excluded before 1998.

Table 28: Net Bank Flows, Long Term Trend, Period Averages, by % GDP

Net Banks % GDP, Av.	85-90	91-96	97-98	99-04	2005
Africa	0.08%	0.01%	-0.24%	-0.87%	-0.09%
Americas	-0.32%	0.03%	0.06%	-0.24%	-0.49%
Asia	-0.08%	0.47%	-1.69%	-0.18%	-0.26%
Europe	-0.89%	0.21%	0.23%	0.18%	1.53%
Middle East	-0.94%	0.35%	2.18%	-0.08%	-0.26%
Total EMF	-0.36%	0.27%	-0.53%	-0.17%	0.02%

Sources: IMF's IFS and WB's WDI.

To fill in missing data, Taiwan's Central Bank, the Singapore Dept. of Statistics, IMF's WEO, & CEIC.
Hong Kong excluded before 1998.



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