The Two Components of International Portfolio Flows*

Shaghil Ahmed[a], Stephanie E. Curcuru[a], Francis E. Warnock[b,c,d,e], Andrei Zlate[a,f]
[a] Board of Governors of the Federal Reserve System
[b] Darden Graduate School of Business, University of Virginia
[c] Institute for International Integration Studies, Trinity College Dublin
[d] Globalization and Monetary Policy Institute, Federal Reserve Bank of Dallas
[e] National Bureau of Economic Research
[f] Federal Reserve Bank of Boston, Department of Supervision, Regulation and Credit

March 25, 2015 (PRELIMINARY)

Abstract

In empirical studies and policy discussions, capital flows are almost always described in terms that connote active portfolio reallocations. But measures of international portfolio flows, whether based on flows or changes in stocks, conflate two components. Flow-based measures conflate flows due to the placement of new savings (an income effect) with flows that actively reallocate between asset classes or countries (a switching effect). Portfolio-based measures combine a passive component (passive reallocations due solely to relative price changes) along with active portfolio reallocations. We form an easily constructed measure—relative weight—that isolates active portfolio reallocations and then, using a dataset on equity flows to EMEs and a set of simple graphs and regressions, show the importance of distinguishing between the active and passive components. The graphs suggest that the post-GFC surge of flows into EME equities was due more to the income effect and/or passive changes in portfolios rather than the active reallocations toward EMEs. The regressions suggest that analysis of the effects of QE and capital controls on EME capital flows depend importantly on the type of flow measure used. Different questions demand different measures of flows, but we must recognize that existing data typically conflate the focus of the researcher or policymaker (active decisions) with something more passive.

* The views in this ***DRAFT*** paper are solely the responsibility of the authors and should not be interpreted as reflecting the views of any other person associated with the Federal Reserve System. The authors thank McKinsey Global Institute for data on the size of global financial assets. We also thank for helpful comments Joshua Aizenman, John Burger, Marcos Chamon, Barry Eichengreen, Anton Korinek, Philip Lane, Alessandro Rebucci, Eric van Wincoop, and participants in seminars at Asian Development Bank, Bangko Sentral ng Pilipinas, BIS Asia Pacific Office, ECB and at Bank Negara Malaysia Conference on Monetary Policy in the New Normal, Board of Governors Workshop on Spillover Effects from Accommodative Monetary Policies since the Global Financial Crisis, CEMLA/World Bank/Banca d'Italia Conference on Macroprudential Policies, IMF Workshop on Capital Flows in Frontier and Emerging Markets, Tenth Annual Workshop on Macroeconomics of Global Interdependence, and the RBNZ Conference on Monetary Policy in Open Economies.