

IIF Capital Flows User Guide

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Frequently Asked Questions (pages 1-5):

1. What is a capital flow?
2. What does the IIF mean by “net private capital inflows to emerging markets”?
3. What data sources does the IIF use?
4. What is the IIF country sample of emerging markets?
5. Why do IIF data differ from IMF data?
6. How accurate and reliable are IIF data?
7. How does the IIF dataset treat intra-EM flows?

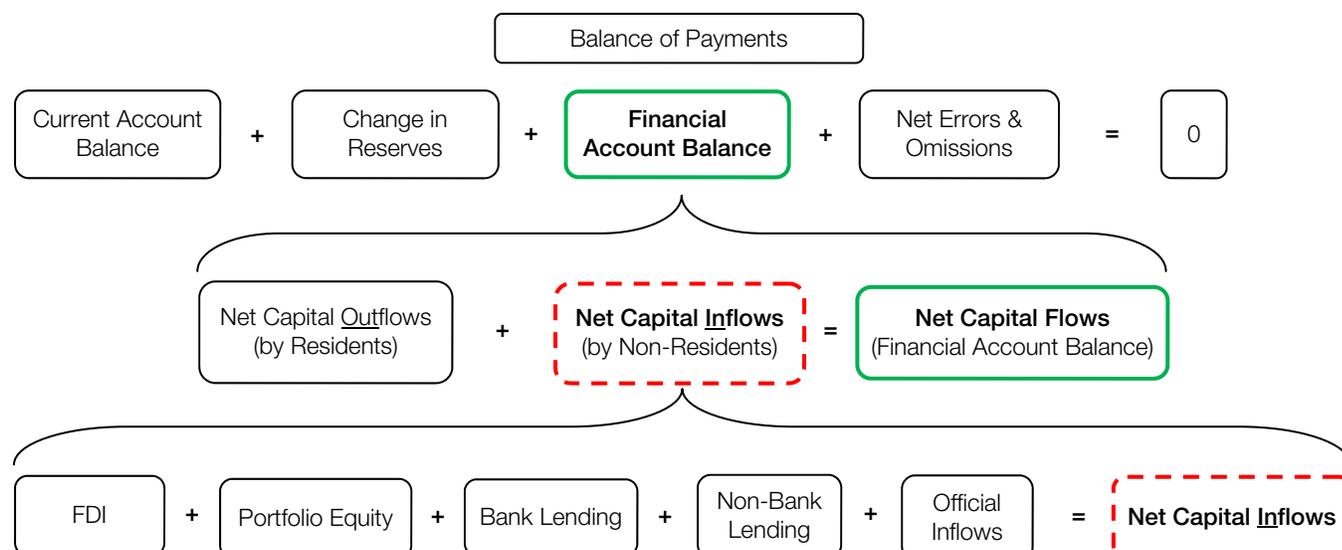
Capital Flows Manual (pages 6-9):

- Line-by-line explanation of all IIF capital flows time series
- Graphic illustration of IIF capital flows framework

1. What is a capital flow?

A capital flow arises through the transfer of ownership of a financial asset from one country to another. The assets involved in these transactions are typically equity and debt instruments. The transactions are recorded in the financial account of a country's balance of payments (Chart 1).

Chart 1:
Simplified Illustration of Capital Flows within the Balance of Payments



2. What does the IIF mean by “net private capital inflows to emerging markets”?

This refers to flows of capital (both equity and debt) from foreign private sector investors and lenders to emerging economies (Chart 2). “Net” means that foreign investors’ *withdrawals* of capital are subtracted. Not included in this measure are outward investments by EM residents (“capital outflows”) and inflows from official sector sources.

Capital inflows refer to flows from foreign investors and lenders

3. What data sources does the IIF use?

The IIF does not collect capital flow data directly from its members. Instead, we compile a dataset from both national and international data sources. This dataset is designed to reconcile stocks and flows from both creditor and debtor reporting systems in a way that our country experts find consistent and convincing. The single most important source is generally national balance of payments data. Since various EM countries may have their own reporting standards, we use a variety of other sources to ensure a consistent dataset across countries and regions. These additional data sources include, among others: IMF Balance of Payment Statistics, BIS cross-border banking data, World Bank debt data, Thomson Reuters (for bond purchases) and The Berne Union (for export credit). Our sources span different frequencies, including monthly, quarterly and annual data. We reconcile these different data frequencies by compiling a dataset at an annual frequency, which can be thought of as the least common denominator.

Our single most important source is generally national balance of payments data

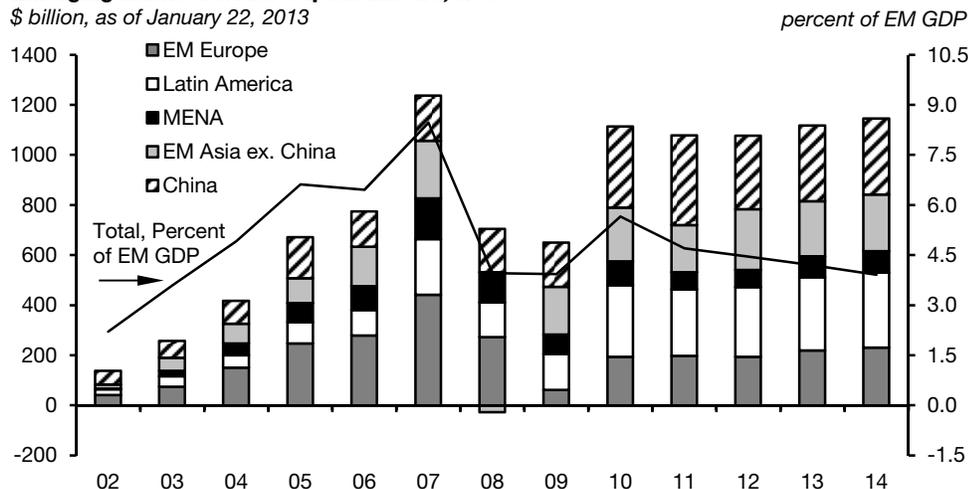
4. What is the IIF sample of EM countries?

Our sample of emerging markets comprises the following 30 countries: Argentina, Brazil, Bulgaria, Chile, China, Colombia, Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, Korea, Lebanon, Malaysia, Mexico, Morocco, Nigeria, Peru, Philippines, Poland, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine, UAE, Venezuela.

Chart 2

Emerging Market Private Capital Inflows, Net

\$ billion, as of January 22, 2013



5. Why do IIF data differ from IMF data?

When comparing data from different data sources, it is critical to look at them on the same basis. This is particularly true for capital flows data, which are often analyzed using a range of closely related, but different concepts. For example, a country's net capital flows (the sum of flows by residents and non-residents) should not be confused with net capital inflows (by non-residents). Similarly, it is important to distinguish between private sector capital flows and official sector flows.

When compared on the same basis, IIF and IMF capital flows data are quite similar in terms of aggregate inflows to our sample of 30 major EM economies. This is true for both equity and debt flows (Charts 3 and 4). For most countries and components, the data from the two sources are not identical, however, and in some cases the discrepancies can be quite large. The main reasons for discrepancies between IIF and IMF data on capital flows are:

Definitions: In some cases, the definitions for IIF and IMF data differ. For example, IIF data on foreign direct investment (FDI) excludes intercompany loans, since these are considered debt rather than equity flows. Another example is flows by banks, which appear in a single category in the IIF's dataset ("Commercial Banks"), but are split into two categories in the IMF's data (under "Portfolio Debt" for banks' bond purchases and "Other Debt Instruments" for bank loans). Note that there is a statistical break in the IMF's dataset (in years 2005-2008) resulting from methodological changes implemented in 2012.

Data sources: Our experts make use of a wide variety of data sources in an effort to provide the most accurate picture of capital flows (see FAQ 3). By contrast, the IMF's dataset relies on data provided by national statistical agencies.

Country sample: Aggregate capital flows data may differ because the IIF's sample of EM countries differs from that of the IMF. Our sample includes a geographically diverse group of the 30 largest EM countries, which account for the vast majority of global capital flows to emerging markets. In addition, the classification of certain countries may differ, (e.g. Korea, which is part of our sample of emerging markets but which is not part of the IMF's group).

When comparing data from different data sources, it is critical to compare them on the same basis

Chart 3
Total Emerging Market Equity Inflows: IIF vs. IMF Data
\$ billion, IIF sample of 30 major EM economies

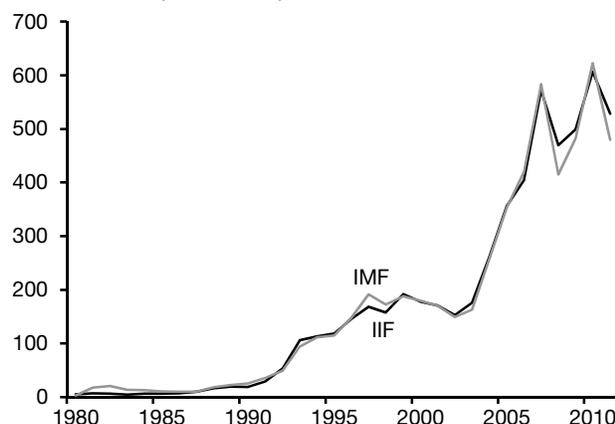


Chart 4
Total Emerging Market Debt Inflows: IIF vs. IMF Data
\$ billion, IIF sample of 30 major EM economies

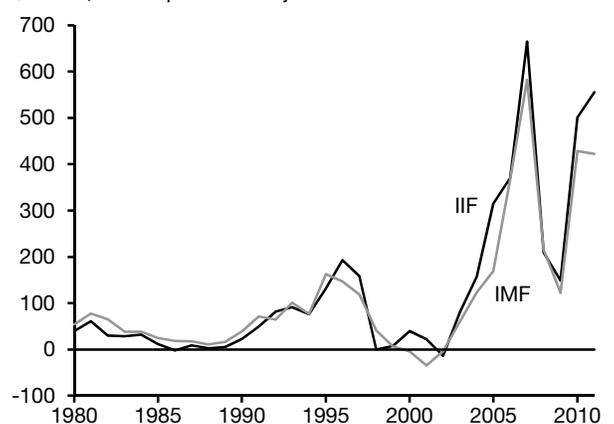
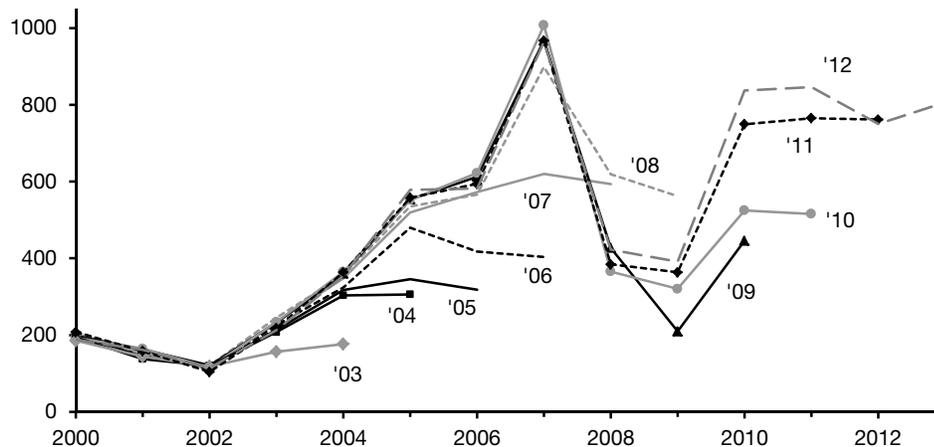


Chart 5
Net Private Capital Flows to EMs: History of IIF Estimates (Old Measure*)
\$ billion, data as of October of year indicated by the label



*Old IIF Measure: equity flows by EM residents are subtracted from net private capital inflows

6. How accurate and reliable are IIF data?

In order to interpret IIF forecasts of capital flows, it is useful to know how accurate our projections have proven in the past. Over the past decade, we predicted the direction of flows correctly in most years (i.e. whether flows were going to increase or decrease), but not necessarily the magnitude. Looking at the last capital flows cycle, it appears that we were too pessimistic in good times and a little too optimistic in bad times (Chart 5). In particular, during the 2003-2007 global expansion, we repeatedly revised our forecasts up. During the turmoil of fall 2008, we made large downward revisions to our forecasts, though the actual drop turned out to be even bigger. A possible explanation for the apparent downward bias during the 2003-2007 expansion is that our forecast may have taken into account the small probability of a collapse in capital flows during these years (which ultimately became reality in the fall of 2008).

Errors and omissions (E&O) are also useful to assess the explanatory power of our data. Conceptually, the current account balance is equal to the sum of all capital inflows and outflows (see page 7). Practically, however, there is a discrepancy between the two. This residual is called “errors and omissions”, which comprises (1) statistical errors that arise from the difficulty to reconcile different sources of data and (2) transactions that are not recorded. Unrecorded transactions tend to increase during times of severe financial stress, when people attempt to withdraw funds from a troubled country without the knowledge of the authorities (“capital flight”). An example is Argentina’s crisis in 2001, which saw a large amount of capital flight (Chart 6, next page). Russia is another country where errors and omissions have been an important component of the balance of payments in the last decade.

Historically, errors and omissions have been large relative to the identified flows in our dataset. In the late 1990s, E&O averaged around 40% of total net private capital inflows to emerging markets (Chart 7, next page). This means that a significant portion of aggregate

Over past decade, we predicted the direction of flows correctly in most years but not necessarily the magnitude

Errors and omissions are the residual between the current account balance and total capital inflows and outflows

Chart 6
Argentina and Russia: Errors and Omissions

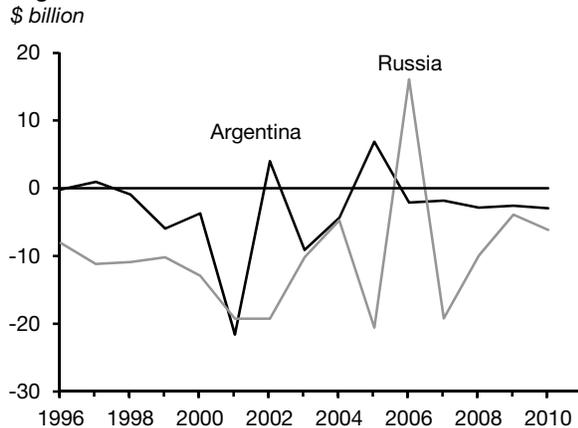
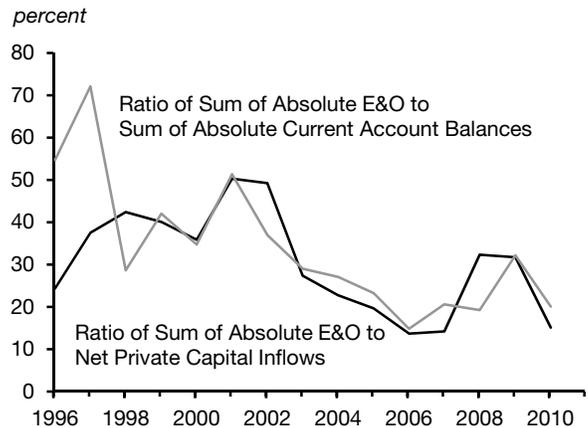


Chart 7
IIF EM 30: Errors & Omissions



flows were not captured by our calculations and projections (In our forecasts, we assume that errors and omissions are zero). Since the early 2000s, however, errors and omissions have declined relative to measurable capital flows. The main reason behind this is probably an improvement in balance of payments accounting standards and practices.

7. How does your dataset treat intra-EM flows?

Intra-EM flows (i.e. flow from one EM country to another) also count towards our aggregate estimate of net private capital flows to emerging markets. The reason is that we look at emerging markets on a country-by-country basis. This means all capital inflows from non-residents of a particular country are taken into account, regardless of whether investors/lenders are located in a mature economy or in another emerging economy. A notable trend in recent years has been the increase in investment and lending between emerging market economies.

MANUAL FOR IIF CAPITAL FLOWS DATA

The following is a line-by-line explanation of the time series used in the standard tables of our capital flows report (Table 1). All measures are on a “net” basis. This means non-residents’ *withdrawals* of funds from EM countries are subtracted from the total of funds they send to those countries. For example, if U.S. portfolio investors buy Brazilian stocks of \$10 million (positive inflow) and sell Brazilian stocks of \$3 million (negative inflow), the resulting net inflow is \$7 million. Outward investments by EM residents (“capital outflows”) are considered separately.

“Net” flows means that foreigners’ *withdrawals* of funds from EMs are subtracted from the total of funds they send to those countries

Capital Inflows**Total inflows, net**

Comprises the sum of all private and official capital flows by non-residents.

Private inflows, net

Comprises the sum of all equity and debt inflows from private sector sources.

Equity investment, net

Net inflows of direct and portfolio equity capital, including reinvestment of earnings on equity investment.

Table 1
Emerging Market Economies: Capital Flows
\$ billion, as of January 22, 2013

| | 2011 | 2012e | 2013f | 2014f |
|--------------------------------------|--------------|--------------|--------------|--------------|
| Capital Inflows | | | | |
| <i>Total Inflows, Net:</i> | <u>1145</u> | <u>1113</u> | <u>1173</u> | <u>1209</u> |
| Private Inflows, Net | 1084 | 1080 | 1118 | 1150 |
| Equity Investment, Net | 528 | 572 | 616 | 646 |
| Direct Investment, Net | 524 | 499 | 517 | 536 |
| Portfolio Investment, Net | 4 | 73 | 99 | 110 |
| Private Creditors, Net | 556 | 508 | 502 | 504 |
| Commercial Banks, Net | 177 | 143 | 152 | 175 |
| Nonbanks, Net | 379 | 365 | 351 | 329 |
| Official Inflows, Net | 61 | 33 | 55 | 59 |
| International Financial Institutions | 17 | 0 | 18 | 22 |
| Bilateral Creditors | 44 | 33 | 37 | 37 |
| Capital Outflows | | | | |
| <i>Total Outflows, Net</i> | <u>-1445</u> | <u>-1427</u> | <u>-1390</u> | <u>-1359</u> |
| Private Outflows, Net | -721 | -975 | -1016 | -1026 |
| Equity Investment Abroad, Net | -221 | -314 | -342 | -371 |
| Resident Lending/Other, Net | -499 | -661 | -675 | -655 |
| Reserves (- = Increase) | -666 | -378 | -374 | -333 |
| <i>Memo:</i> | | | | |
| <i>Net Errors and Omissions</i> | <u>-58</u> | <u>-74</u> | <u>0</u> | <u>0</u> |
| <i>Current Account Balance</i> | <u>300</u> | <u>314</u> | <u>217</u> | <u>150</u> |

Foreign direct investment, net

Net flows of direct equity capital, including reinvestment of earnings on direct equity investment. Equity investment is considered “direct” when the investor has a degree of managerial control over the firm in question. The threshold for this is usually set at 10% of ownership. Below this threshold, the investment is considered “portfolio” investment.

Portfolio investment, net

Net inflows of portfolio equity capital, including reinvestment of earnings on portfolio equity investment.

Private creditors, net

Sum of commercial bank lending and lending from non-bank sources.

Commercial banks, net

Net disbursements from commercial banks (excluding credits guaranteed or insured under credit programs of creditor governments). This generally includes bond purchases by commercial banks.

Nonbanks, net

Net external financing provided by all other private creditors. This includes flows from non-bank sources into bond markets, as well as deposits in local banks by nonresidents other than banks. It also includes credit by suppliers (excluding credits guaranteed or insured under credit programs of creditor governments), identified private placements of debt securities, and other financial securities issued in local or foreign currencies. Finally, it includes estimated interest payments due but not paid, and estimated payments flows with private creditors other than commercial banks resulting from discounted debt transactions.

Official inflows, net

Sum of financing provided by international financial institutions and bilateral creditors.

International Financial Institutions

The sum of net external financing provided by the IMF, the IBRD, and other multilateral creditors.

Bilateral creditors

Net external financing from bilateral creditors including credits guaranteed or insured under credit programs of creditor governments, direct government-to-government credits, rescheduled interest, and other official bilateral credits, and including estimated interest payments due but not paid or rescheduled.

Capital Outflows**Total outflows, net**

Sum of private outflows by residents and change in official reserves.

Private outflows, net

Sum of resident net lending abroad and equity investment abroad by residents.

Equity investment abroad, by residents, net

Net outflows of direct and portfolio equity capital, including reinvestment of earnings on equity investment.

Resident lending/other, net

Transactions in financial assets other than equity, held abroad by residents, excluding official reserves (valuation changes are excluded). Includes export financing, and changes in deposit money banks and other non-reserve assets.

Reserves (negative number denotes increase because it constitutes an outflow)

Transactions in official international reserves excluding gold, but including foreign exchange, SDRs, and the reserve position in the IMF. Valuation changes are excluded.

Errors and omissions

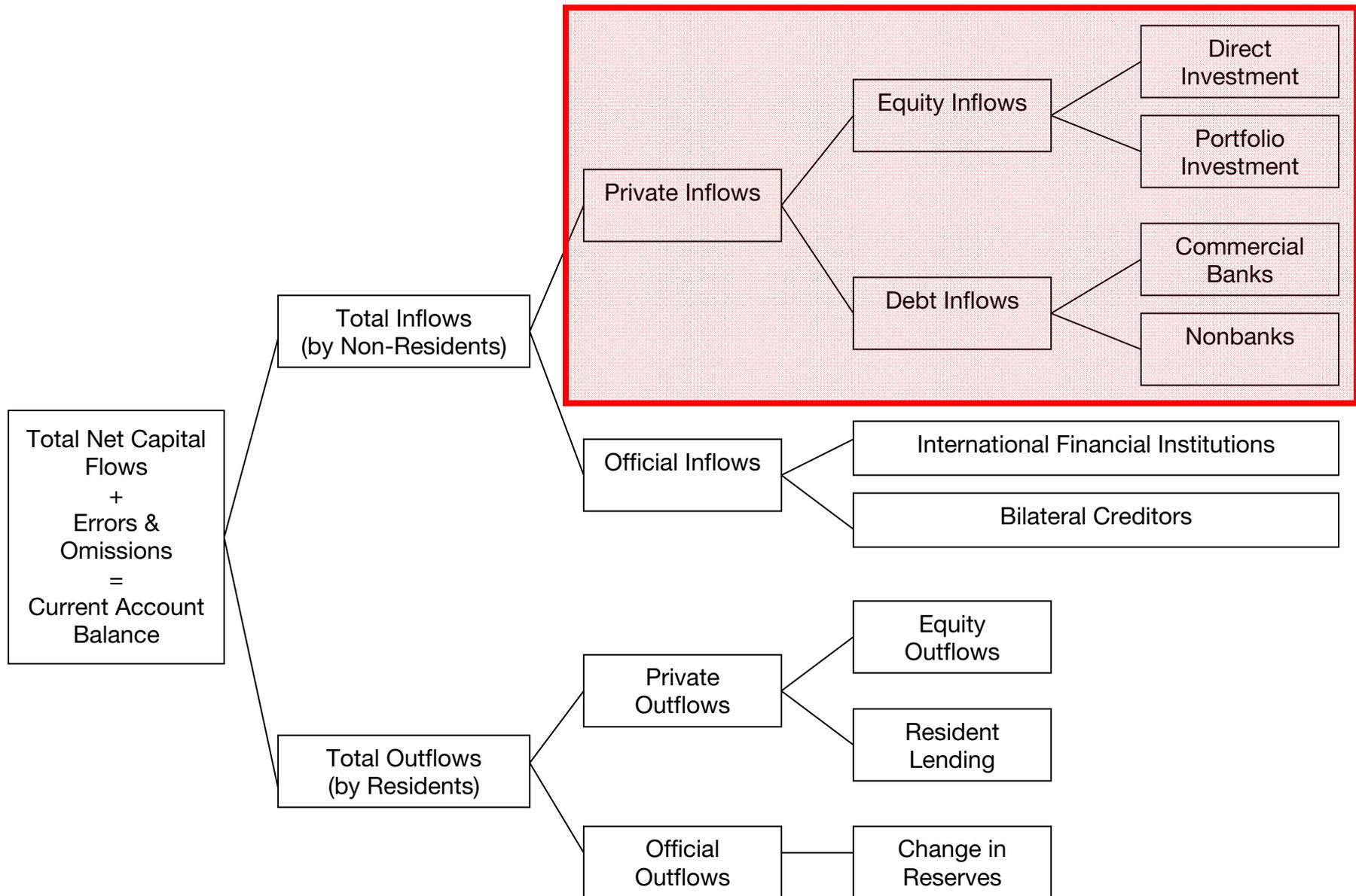
The residual between the current account balance and net capital flows (including reserve accumulation). This residual comes from statistical errors that arise from the difficulty to reconcile different sources of data as well as from transactions that are not recorded.

Current account balance

The sum of the trade balance and the balance on services, income and transfers.

IIF Capital Flows Taxonomy

IIF Focus



Note: All flows are on a “net” basis, i.e. withdrawals of flows within the same category are subtracted.