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Fed Policy Expectations and Portfolio Flows to Emerging Markets

Robin Koepke¹

Abstract: The empirical literature has long established that U.S. interest rates are an important driver of international portfolio flows, with lower rates “pushing” foreign capital to EMs. On this basis, it is often argued that Fed tightening is likely to weigh on EM portfolio flows in coming years. This paper offers a different interpretation of the literature and provides empirical evidence that it is mainly the surprise element of monetary policy that affects EM portfolio inflows. A shift in market expectations towards easier future U.S. monetary policy leads to greater EM portfolio inflows, while an upward shift in interest rate expectations reduces such flows.

JEL Classification Numbers: E43, F32, F41, F42, G11

Keywords: Capital Flows, Emerging Economies, U.S. Monetary Policy, Market Expectations, Push and Pull, Taper Tantrum

Short bio: Robin Koepke is an economist in IMF's Monetary and Capital Markets Department, where he contributes to the Global Financial Stability Report and supports the IMF's market surveillance efforts. Previously, he was a senior economist in the Global Macroeconomic Analysis Department at the Institute of International Finance, where he served as an expert on international capital flows. He expects to get his PhD in Economics from the University of Wuerzburg, Germany, in late 2016. In addition, he holds a Master's degree in International Economic Relations from The American University in Washington, DC, and Bachelor's degree from the University of Passau, Germany.

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