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These comments are based on the following paper:


To be precise, we assess the amount of portfolio (i.e., equity + bond) inflows that a country receives.

$K^*_{F}$ is computed as current period ROW private savings times a lagged portfolio weight (5yr moving average).
CAN WE PREDICT FUTURE PORTFOLIO INFLOWS?

F. Warnock, Insights from KF*

Quarterly, billions of USD
KF*, THE NATURAL LEVEL OF CAPITAL FLOWS, IS A STRONG PREDICTOR OF FUTURE FLOWS.

- Portfolio inflows oscillate around KF*.
- Deviations of actual flows from KF* are transitory.
  - Flows revert strongly to KF* over 1-2 year horizon.
  - The explanatory power of KF* is substantially greater than traditional push/pull factors.
- KF* predicts 6-quarters ahead sudden stops, as well as next year’s equity returns.
- Application to crises
  - KF*, at the eve of the GFC, predicted flows during the crisis.
  - KF*, at the eve of the pandemic, suggests sharp decreases in portfolio inflows will be short-lived.

F. Warnock, Insights from KF*
PORTFOLIO INFLOWS OSCILLATE AROUND KF*

It's apparent from the graphs, and we show empirically too.
FLOWS REVERT STRONGLY TO KF* OVER 1-2 YEAR HORIZON, AND THE EXPLANATORY POWER OF KF* IS SUBSTANTIALLY GREATER THAN TRADITIONAL PUSH/PULL FACTORS.

**Beta** = -1 means flows fully adjust to KF* in $h$ quarters.

$R^2$ of 0.15 would be considered good for push/pull factors.
**KF* PREDICTS 6-QUARTERS AHEAD SUDDEN STOPS, AS WELL AS NEXT YEAR’S EQUITY RETURNS.**

With these conditions

- gap between flows and KF* is large (1 stdev above its mean), and
- global growth is strong (1 stdev above its mean),

Probability of a sudden stop within 6 quarters is **38%**.

*Intuition: Strong ROW global growth means KF* is increasing. If actual inflows are increasing even more, high probability of a sharp decline in future flows.*

Same conditions (strong inflows relative to KF* and strong global growth) predict **13% decrease** in the country’s MSCI equity returns next year.

F. Warnock, Insights from KF*
Countries with a larger KF* gap/GDP in 2007 had larger declines during the GFC period (2008Q4-2009Q3).

At the eve of the pandemic, very few countries had positive KF* gaps.

Chile, Panama, Ukraine had the most positive KF* gaps in 2019. In Asia, most positive were Indonesia, China and Philippines (and all were just slightly positive).
**KF*, THE NATURAL LEVEL OF CAPITAL FLOWS**

- Portfolio inflows oscillate around KF*. Deviations of actual flows from KF* are transitory. Flows revert strongly to KF* over 1-2 year horizon, especially for EMEs and nonUMP AEs.

- KF* predicts 6-quarters ahead sudden stops, as well as next year’s equity returns.

- KF*, if applied at the eve of the GFC, predicted flows during the crisis.

- KF*, applied at the eve of the pandemic, suggests sharp decreases in portfolio inflows will be short-lived, because in 2019 very few countries had flows in excess of KF*.