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Capital Outflow from Emerging Markets, Role of IMF and Central Bankers

By Shodhan Babu, LLM Candidate, 2016 | October 16, 2015

The understanding in conventional economics that the free flow of capital to developing countries results in the increase in investment rates has come under review by the International Monetary Fund. In the past year emerging-markets have seen a net outflow of one trillion dollars. Emerging markets faced a similar collapse in 2008 and 2009 when the huge influx in 2006 and 2007 was followed by huge outflows. As a result of these outflows, financial instability in emerging countries has become more apparent as the value of the local currency drops drastically against the dollar. In turn, both the price of imports is rising substantially and the value of the debt in dollars is rising to unsustainable levels.

The reasons for the outflow is the prospect of the Federal Reserve raising interest rates from near zero percent for the first time in about a decade. The excess supply of oil has also resulted in the price of oil dropping which has adversely affected countries such as Brazil, Russia and Venezuela, which depend on oil exports. The Federal Reserve has cited the health of the US economy as the reason to increase the rate of interest but has not taken any decision with regard to the extent or the time of the rate hike. This uncertainty has resulted in foreign investors taking out money from emerging economies to find safer places of investment. While most governments have passed reforms and cut down on their foreign borrowings and abandoned fixed exchange rates, they have been unable to prevent domestic companies from foreign borrowings.

The scale of the issue at hand has called into question the ability of IMF to assist economies in any significant manner. The IMF is now calling for a coordinated effort on the part of Central Bankers to effect reforms to guard against capital volatility.