THE ROLE OF THE INTERNATIONAL CAPITAL MOVEMENT & FINANCIAL CRISES

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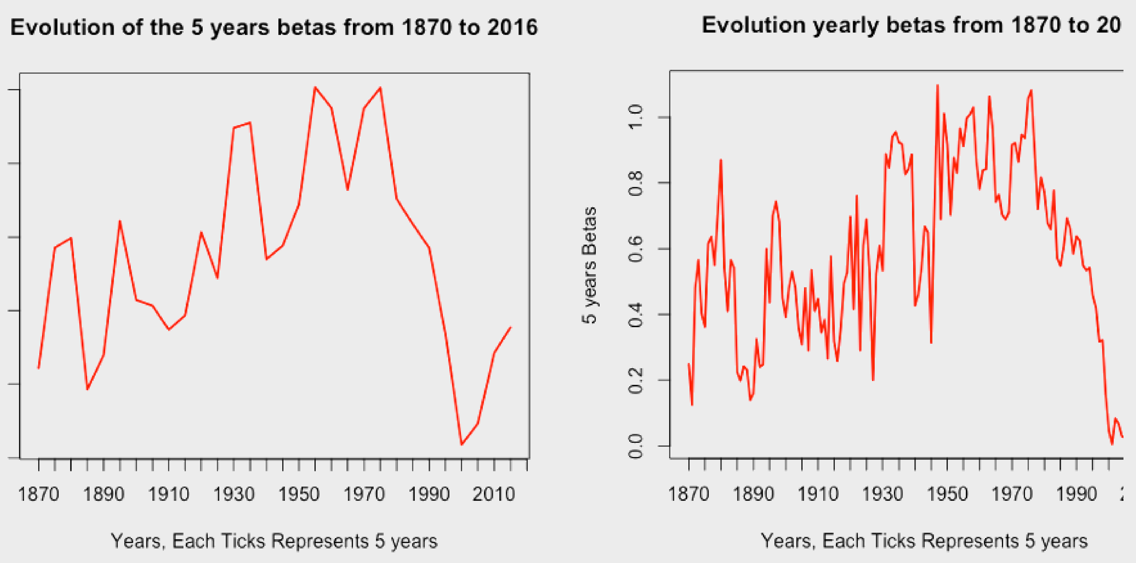
INTRODUCTION & HYPOTHESIS

The Great Depression and the Great Recession are often compared. Nevertheless, the role of international capital is almost always overlooked. This essay intends to take an in-depth look.

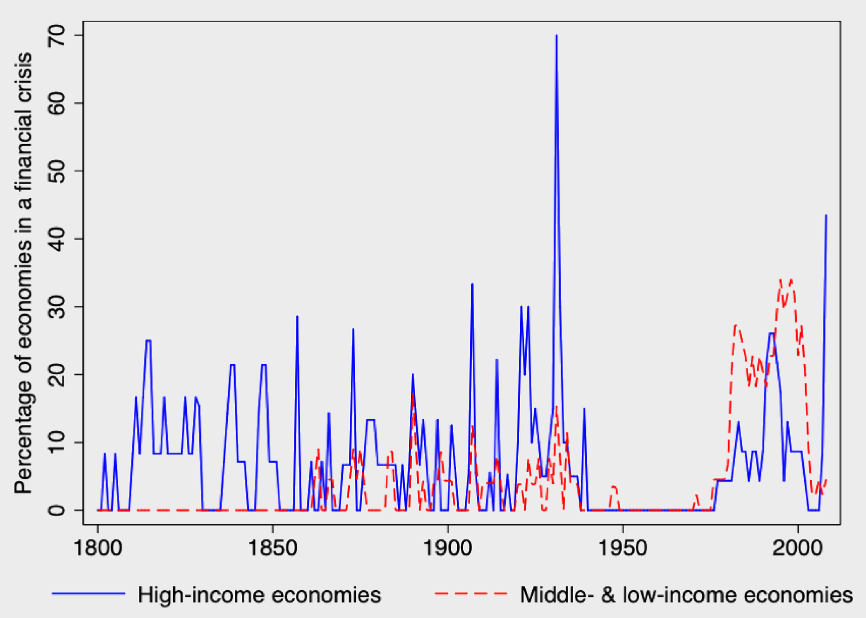
The hypothesis that this work tries to prove is that **capital movement will create bubbles through credit expansions**. This work takes into account the idea of Bernanke (2005) of the Global Saving Glut and Borio (2011) of excess financial elasticity.

RESULTS

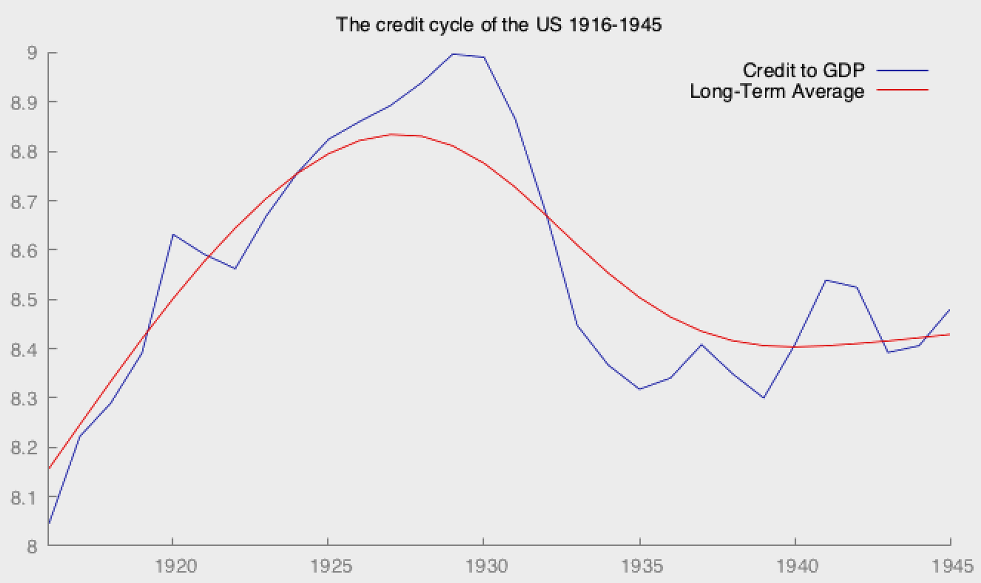
1 Graph 1: Evolution of capital movement using Feldstein Horioka approach

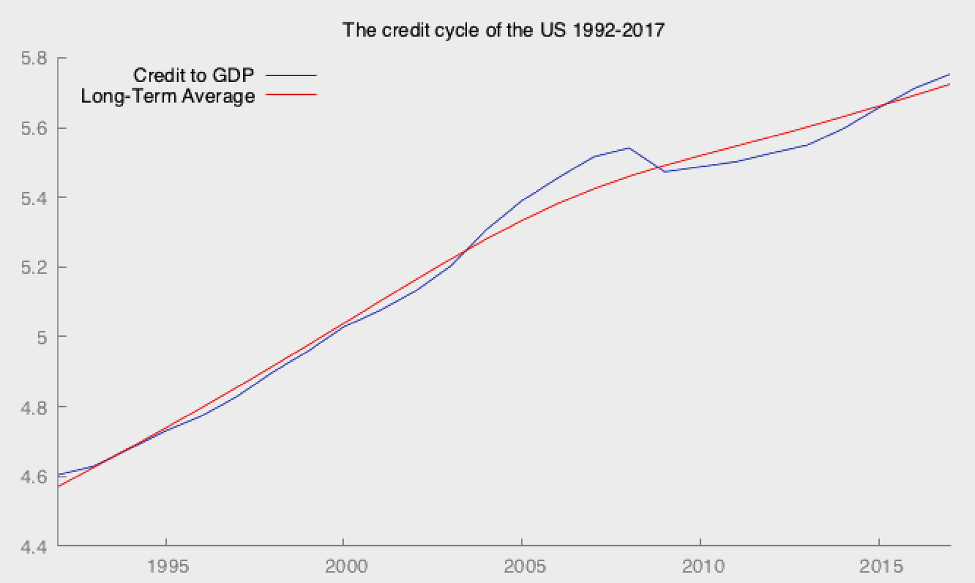


2 Graph 2: Frequencies of financial crises from 1800 to 2010



3 Graph 3: The credit cycle using Hodick-Prescott Filter





4 Graph 4: APT approach for Stock Price (1920's) and Housing (2000's)

$$\mathrm{Stock\ Price} = \alpha + \beta_1 \mathrm{EG} + \beta_2 \mathrm{IR} + \beta_3 \mathrm{CA} + \beta_4 \mathrm{CPI} + u_i$$

	OLS of Stock Price		
	Coefficient	Std. Error	P-Value
Const	8.173***	0.905	0.0001
Long Term Interest Rates	-1.081***	0.248	0.0049
Economic Growth	0.024	0.016	0.1908
Foreign Capital (CA)	1.067***	0.228	0.0034
Inflation (CPI)	-0.035*	0.017	0.0901
R2	0.79		
R2 adjusted	0.65		
Dependent Variable	Log of Stock Price		

$$\mathrm{House\ Index} = \alpha + \beta_1 \mathrm{EG} + \beta_2 \mathrm{IR} + \beta_3 (-\mathrm{FA}) + \beta_4 \mathrm{CPI} + u_i$$

	OLS of Housing Price		
	Coefficient	Std. Error	P-Value
Const	5.239***	0.246	1.28e-07
Long Term Interest Rates	-0.075	0.050	0.432
Economic Growth	-0.014	0.017	0.182
Foreign Capital (CA)	0.085**	0.028	0.021
Inflation (CPI)	-0.050	0.053	0.381
R2	0.82		
R2 adjusted	0.73		
Dependent Variable	Log of Housing Index		

CONCLUSIONS

- Using the Feldstein-Horioka puzzle,we observe that there are changes on the capital mobility across the three modern periods: The Gold Standard, Bretton Woods and the Modern Financial International Order. Hence, proving the point of view of Caludio Borio (2011).
- It seems that the frequency of the financial crises and capital mobility has a negative relationship but further studies are needed.
- Capital mobility might have fuelled credit booms (and subsequently asset bubbles) thus increases the likelihood of financial crises. The main factor of capital movement is the push factors and thus proving the point of view of the Global Saving Glut (Bernanke, 2005).

MAIN BIBLIOGRAPHY

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- Basco, S. (2011). Globalization and Financial Development: A Model of the Dot-Com and the Housing Bubbles.
- Bernanke, B. S. (2005). *Remarks by Governor Ben S. Bernanke.*