

Financial Markets Annex

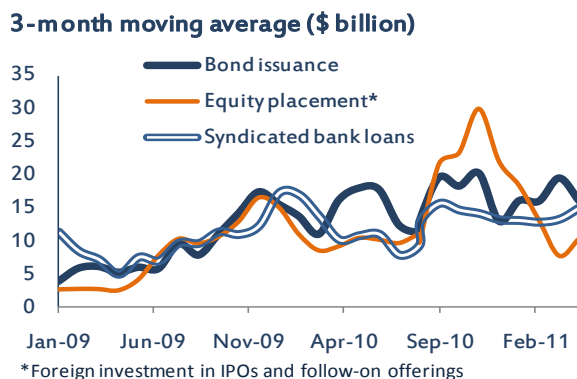
Recent trends in capital flows

International capital flows to developing countries have slowed since October...

Gross capital flows (international bond issuance, cross-border syndicated bank loans and equity placements) to developing countries totaled \$175 billion in the first four months of 2011, 24 percent less than the last four months of 2010 (figure FIN.1). Most of the decline was in equity placement (foreign investment in IPOs and follow-on offerings), which plummeted by 35 percent. There have been no major IPOs from developing countries this year, after the record breaking equity issuance of 2010. International syndicated bank-loans remained subdued compared with pre-crisis levels—although there was a modest rebound in lending to Europe and Central Asia (notably, Russia and Turkey) and Sub-Saharan Africa (Nigeria and South Africa).

In contrast to equity placement and bank-lending, international bond issuance by developing countries was strong in the first quarter, attaining the highest monthly level on record in January. A combination of relatively favorable pricing conditions and investor’s continued search for yield led to a near record pace of borrowing activity. Corporate borrowers

Figure FIN.1 Gross capital flows have eased since November



Source: Dealogic.

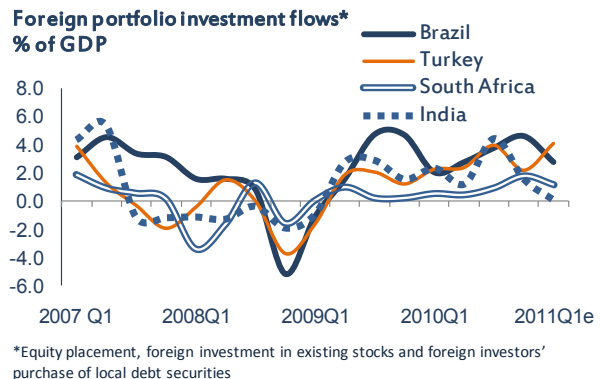
continued to dominate bonds with about 80 percent of year-to-date volume, with most issues coming from companies in China, Emerging Europe and Latin America. Chinese companies issued a record volume of international bonds in the first quarter of 2011, partly reacting to the increased cost and rationing of domestic finance following the government’s policies to curb credit growth. The pace of issuance has slowed considerably since January, partly reflecting the impact of increased uncertainty in global markets.

...as have the hot money flows, easing some of the pressures for currency appreciation.

Portfolio investment—equity placement, foreign investment in existing stocks and foreign investors’ purchase of local debt securities, also referred to as “hot money”—has eased since early 2011 (figure FIN.2). Most of the decline was in equity placements and foreign investment in stock markets, as there were considerable stock-market sell-offs during January and February, aside from the sharp fall in equity placement.

Growing concerns about sovereign debt in high-income countries, inflation, political turmoil in the Middle-East and North Africa, and high

Figure FIN.2 Hot money flows slowed down since October

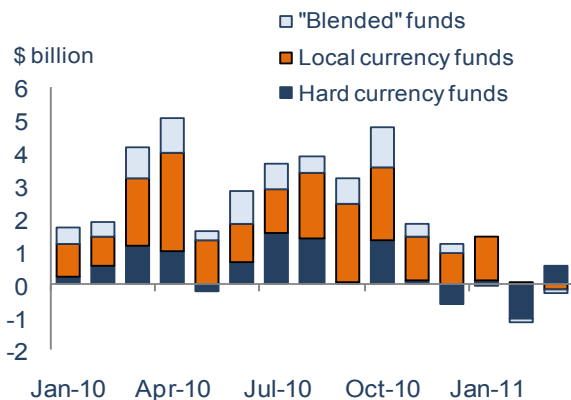


Source: Central Banks and World Bank.

commodity prices have combined to slow the pace of portfolio equity inflows to developing countries. In addition, investors may also have considered that market equity valuations had reached maximum levels and started to take profits. During the first quarter of 2011, there was a net outflow of nearly \$25 billion from emerging market (EM) equity funds, compared with a net inflow of \$85 billion in 2010. Similarly, foreign investors' interest in emerging market bonds (both in local and other currencies) has also diminished considerably since October 2010 (figure FIN.3). And the EM fixed income funds registered a net outflow in February with a little improvement in March. Most of the decline was in flows to EM local currency funds, which have become quite popular in recent years, and experienced record inflows in 2010 (see box FIN.1: Domestic debt market developments in emerging markets). The outflows from both EM equity and fixed income funds do not necessarily imply a net outflow in terms of balance of payments financing, but highlights the easing in these types of flows to developing countries.

Country specific factors also played an important role in the slowing of capital inflows. South Africa (in November) and Turkey (in December and January) cut their policy interest rates—reducing the attractiveness of the carry-trade with these countries. The impact of the rate cuts turned out to be temporary in Turkey, however. After a slow down, foreign purchases of Turkish

Figure FIN.3 Inflows to EM fixed income funds have slowed down since October



Source: EPFR Global.

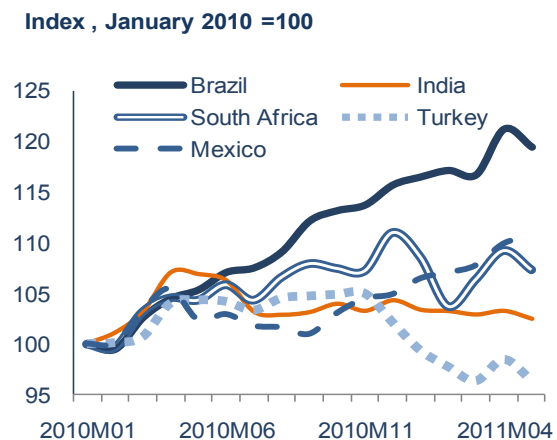
local debt securities rose to a record \$4.8 billion in March. While Brazil increased the tax on foreign investments twice in October, the fall-off largely reflected a drop in IPO activity following the record sale of Petrobras in September 2010 that attracted large foreign participation.

Several middle income countries experienced sharp appreciation of their currencies in 2010 following the surge in capital inflows. With the easing of these flows during the first quarter of 2011, the upward trend in real effective exchange rates also moderated (Thailand) or even reversed (South Africa and Turkey) (figure FIN.4). Brazil (due to large FDI inflows) and Mexico (flows into local debt securities) did not experience large depreciations. Consistent with the initial slowing of capital inflows, the pace of reserve accumulation among developing countries also slowed from 8 percent in 2010Q3 to 5 percent both in 2010Q4 and 2011Q1.

The fundamental conditions that underpin capital flows to developing countries remain strong...

Emerging markets entered 2011 with an improved risk profile, as well as higher growth prospects vis-à-vis the high income countries, and policy interest rates that were rising. Despite some recent increases (the ECB raised its

Figure FIN.4 Real effective exchange rate appreciation in selected economies

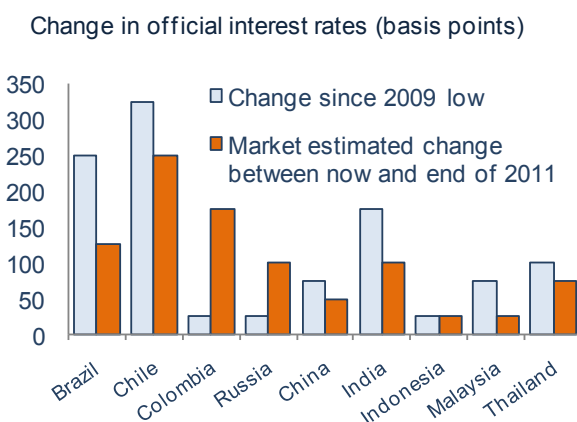


Source: International Monetary Fund.

official rate by 25 basis points (bps) to 2 percent in April 2011), policy interest rates in high-income countries remain low, while those in developing countries are rising. The rates in emerging economies are expected to go up further as these countries tighten monetary policy in the face of heightening inflationary pressures. This will likely increase interest rate differentials in favor of developing country assets—although this effect will be reduced if and when high-income countries begin withdrawing quantitative easing measures and tighten more traditional monetary policy.

Policy interest rates for a number of developing countries have been raised since mid-2009 as strong economic activity has signaled a rapid closing of output gaps and inflation has been moving up. As the inflationary effects of higher oil prices are more evident, policy makers will undoubtedly look toward tightening monetary policy. This is especially likely in Asia and Latin America, where central banks are already grappling with higher inflation amid stronger growth and record food prices. Market-estimated changes in policy rates point to further hikes in official rates for most of emerging market countries this year (figure FIN.5). Rising inflation rates have been pushing real yields down in countries with increasing inflation. Real yields turned negative in several emerging

Figure FIN.5 Accelerating inflation could lead to a further monetary tightening



Source: Bloomberg and World Bank staff calculations.

markets, including Russia and Thailand, making local bond less attractive—though yields remain positive in real terms if adjusted for the expectation of currency appreciation.

...and developing countries continue to struggle with mitigating the impact of high capital flows.

In an attempt to limit the high levels of capital inflows and currency appreciation, Turkey reduced its policy interest rate twice in December 2010 (by 50 bps) and later in January 2011 (by 25 bps) bringing the rate to an all time low. While this move surprised the markets and led to portfolio equity outflows in December and January, cross-border flows to local debt markets remained strong. Nevertheless, Turkey's real effective exchange rate eased by 7 percent between December and April 2011. Similarly, South Africa lowered its policy rate by 50 bps on November 13th, with some impact on portfolio investment and the real exchange rate. Both countries will find it difficult to maintain low rates however, as they are facing increasing inflationary pressures.

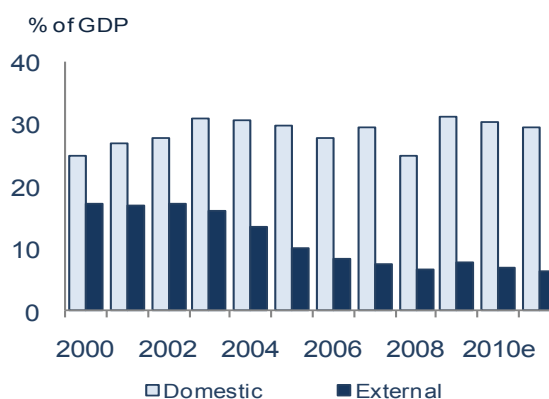
Other policy responses to mitigate the short-term impacts of hot money flows have included the introduction of capital controls, higher foreign currency reserve requirements for banks, minimum holding periods, or withholding taxes on foreign investment in order to discourage inflows; and improvements in the enforcement of existing restrictions on cross-border inflows. For example, Brazil raised its financial operations (IOF) tax on foreign investment in fixed income securities twice in 2010. The impact of these hikes was limited and short-lived, and they were followed by a further increase in April. Brazil also announced that it will extend the high tax rate on the renewal of foreign loans with maturities of up to a year, while a reintroduction of a 15 percent withholding tax on federal securities is under consideration.

Indonesia imposed a 1-month minimum holding period on central bank money market certificates in July 2010, and introduced new regulations on the net foreign exchange positions of

Box FIN.1. Domestic debt market developments in emerging countries

Domestic debt markets in developing countries have grown markedly over the past decade as many countries shifted from external to local currency financing to lower the volatility of their debt service given their more flexible exchange rate regimes. This shift is particularly true for government bond issuers as domestic public debt now accounts for more than 80 percent of the total public debt for developing countries (box figure FIN.1). In recent years, local-currency bond markets have expanded considerably in several countries—among them Brazil, Colombia, China, India, Malaysia, Mexico, South Africa, and Turkey (World Bank 2009). Growing interest from local investors—particularly from pension funds—has played a key role in the development of domestic debt markets in developing countries.

With extraordinarily easy monetary policy in the high-income countries, international investors are also increasingly drawn to emerging market local currency bonds, with higher yields and prospects of capital gains arising from currency appreciation. As a result inflows to fixed-income funds focusing on developing countries reached a record \$65 billion in 2010, with the overall allocation biased toward local currency funds (figure FIN.3 in the text). Despite the recent fall-off, foreign purchases have continued in Latin America, with Mexico posting record \$12 billion inflows through March this year.

Box figure FIN.1 External and domestic public debt in developing-countries

Source: JP Morgan.

commercial banks. And Thailand implemented a 15 percent tax on interest income and capital gains earned by foreign investors. And rather than new measures, China announced that it will intensify enforcement of the existing measures on capital inflows.

The IMF published a report in April 2011 providing a framework for managing the impact of high capital flows (IMF, 2011a). The report suggests that, if possible, countries should first respond to higher capital inflows by letting their exchange rates appreciate, easing monetary policy and tightening fiscal policy. If that is not possible, countries are urged to first use controls that do not discriminate between foreign and domestic investors, for example limits on foreign currency borrowing by local banks or minimum holding periods. According to the framework, measures that discriminate against foreign investment, such as taxes on foreign capital inflows imposed by Brazil, should be a last line of defense. At the same time, the report recommends that the use of controls should be proportional to the economic risk, that they

should be withdrawn when they are no longer needed; and importantly, that countries should bear in mind the costs of using them.

FDI inflows have gained momentum since the last quarter of 2010...

Foreign Direct Investment (FDI) inflows gained momentum in the last quarter of 2010 (figure FIN.6). FDI flows in early part of 2010 were likely restrained by uncertainty concerning the global recovery. This uncertainty has since eased—especially concerning growth in developing countries—and cross-border mergers and acquisitions (M&A) transactions (which react more quickly to changing economic conditions than greenfield investment) in developing countries accelerated in the second half of the year.

FDI inflows to developing countries increased by 24 percent in 2010, a relatively modest gain (less than the rise in other capital flows to developing countries) considering its 36.5 percent decline in 2009. The rebound in FDI

inflows in 2010 was much stronger than the World Bank’s January estimate of 15 percent growth (Global Economic Prospects 2011a), mainly because of large revisions by China to its historic and 2010 FDI numbers (box FIN.2). For developing countries excluding China, the rebound in 2010 was slightly above 10 percent.

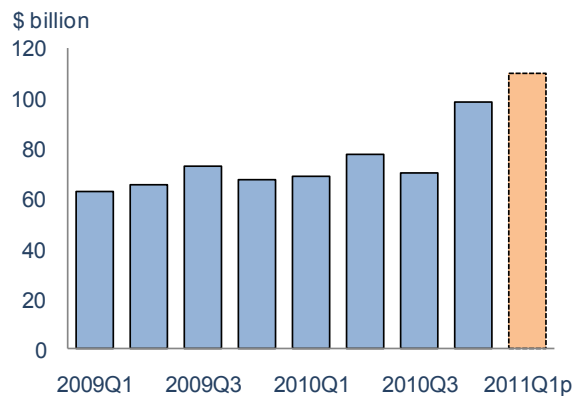
Most of the increase in FDI inflows in 2010 came from higher reinvested earnings. Income generated by FDI projects in developing countries increased 26 percent in 2010, compared to its level in 2009. Multinationals invested 30 percent of this income back into developing country operations in 2010, accounting for 35 percent of FDI inflows. FDI was also supported by increased South-South flows—particularly from Asia. With the sharp decline of FDI outflows from high-income countries since the crisis, investment from other developing countries rose to 34 percent of total inflows in 2010, up from 25 percent in 2007.

Cost of borrowing is on the rise

Long-term yields in developing countries are facing pressures from rising long-term rates in high-income countries...

The implicit yield on emerging market sovereign bonds (EM spread + U.S. 10 year treasury yield) has risen 50 bps since September 2010, mainly due to upward movements in high-income country long-term sovereign yields (figure FIN.7). Long-term interest yields for government bonds rose since early September 2010 in the United States (60 bps), Japan (25 bps) and the European Union (74 bps), reflecting rising government debt, higher inflationary expectations and perhaps reduced demand as the impact and extent of quantitative easing slows.

Figure FIN.6 FDI inflows for selected economies



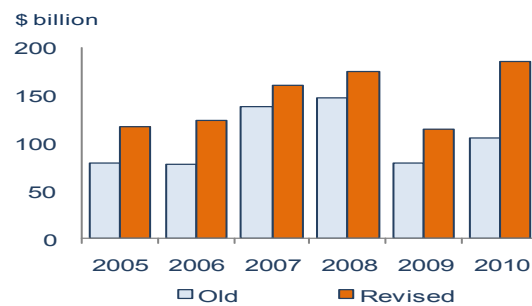
Source: The World Bank.

Box FIN.2 China revised up capital account numbers for 2005-2010.

China’s State Administration of Foreign Exchange (SAFE) revised the capital account in their balance of payments report following implementation of a new accounting method. Much of the adjustment is in FDI inflow numbers, which are revised up between 20-75 percent for the period 2005-2010 (see Box figure). SAFE cited better accounting for reinvested earnings by multinationals as the main reason for the upward revision. This portion of FDI does not cross the border, and hence may not be fully recorded in government reports.

According to the new estimates, FDI inflows to China rebounded strongly by 62 percent in 2010, reaching \$185 billion. The largest increase was in the financial sector (300 percent) followed by the real estate sector (78 percent), reaching \$12 billion and \$21 billion, respectively. Nonetheless, the manufacturing sector remains the main recipient of FDI inflows to China. Manufacturing received \$70 billion in 2010, 50 percent more than in 2009. With the revisions, China now accounts for 30 percent of total FDI inflows to developing countries, compared to an estimated one-fourth in previous statistics.

Box figure FIN.2 FDI inflows to China



Source: China’s State Administration of Foreign Exchange.

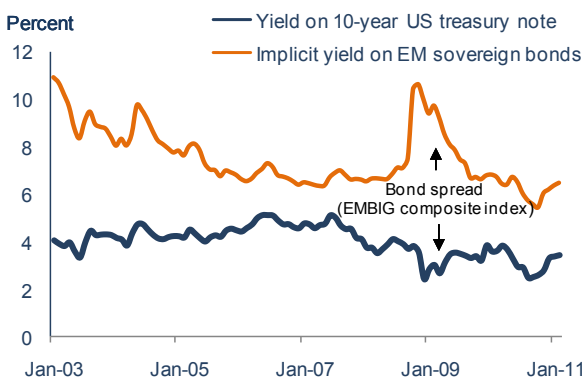
Developing country spreads have remained in a tight range despite ongoing geopolitical unrest and economic uncertainties. The events in the Middle East and North Africa region led to a widening in spreads only within the region and among the most affected countries. Credit risk (as reflected in 5-year CDs spreads) for Egypt, Bahrain and Saudi Arabia widened between 50-150 bps immediately after the turmoil in late January and February, but most stabilized in March. Meanwhile, concerns related to the European debt crisis reemerged in early March, when International Credit Rating Agencies downgraded ratings of Greece, Spain and Portugal, citing worries about their ability to reach their fiscal adjustment targets, in some cases linked to political stability concerns. CDs spreads for these economies rose following the downgrades.

While Japanese stocks plummeted following the March 11 earthquake, the impact of the crisis on world financial markets has been limited. Developing countries were little affected by increases in risk aversion owing to the difficulties in Europe and Japan—sovereign bond spreads for the emerging markets as a group remained within a tight range through the end of April 2011 (figure FIN.8).

...and are expected to go up further.

Going forward, emerging market yields are expected to increase amid rising long-term yields

Figure FIN.7 The implicit yield on EM sovereign bonds is up



Source: JP Morgan.

in high-income countries. Spreads for developing countries might also widen, as the trend decline in risk premiums partly reflects the very low policy rates and quantitative easing in high-income countries (Hartelius et al 2008). These easy monetary conditions have suppressed the price of risk in both high-income and developing countries, and prompted a search for yield similar to that observed in the pre-crisis period. Developing country spreads are sensitive to U.S. Treasury yields. A jump in Treasury yields, for example because of a sudden phase-out of quantitative easing, could spark a sharp widening of spreads on emerging market debt. A more gradual policy tightening is likely to result in a more modest and short-lived widening of spreads.

Tighter financial regulation may also contribute to higher long-term interest rates, and will likely increase the cost of capital, potentially hindering trade finance in the medium term.

Changes in the financial regulatory landscape that have been implemented, and that are being discussed both at the national and global level, would tend to raise the cost of bank lending and should be reflected in higher long-term interest rates. In the United States, the June 2010 Dodd-Frank bill forbids future government bailouts of banks; places limits on risk-taking by financial institutions, and introduces new clearing and

Figure FIN.8 EMs spreads have remained in a tight range despite the rising geopolitical risk



Source: JP Morgan.

trading requirements for CDS markets. A revised international agreement (Basel III) seeks to strengthen banks' resilience to systemic stresses, by raising capital requirements and imposing stricter definitions of what constitutes bank capital. While the proposals incorporate a generous phase-in period, with capital ratios to be raised gradually, and linear phasing out of ineligible securities between 2013 and 2019, there remains uncertainty related to the implementation of these requirements across countries. The impact of Basel III on trade finance is expected to be significant (box FIN.3 Impact of Basel III: Trade finance may become a casualty).

Higher borrowing costs could reduce both the level and the growth of GDP.

Higher capital costs due to increased long-term interest rates and less abundant capital are likely to cause firms to invest less, which will reduce the amount of capital employed in the economy and lower GDP levels from what they would have been had capital costs remained low. During the transition period from a high capital usage regime to a lower capital usage regime, the

rate of growth of potential output in the economy will slow.

Simulations suggest that higher capital costs could lower developing country GDP growth by between 0.2 and 0.7 percentage points over a period of between 3 and 5 years. Global Economic Prospects 2010 estimated that the substitution away from capital intensive techniques would reduce potential output in developing countries over the medium term by between 3 and 5 percent and potentially by as much as 8 percent—depending on how much long-term interest rates rise.

Developing countries can mitigate the costs of the tightening of global financial conditions through strengthening regional and domestic institutions.

Inefficiency of domestic financial sectors resulting from corruption, weak regulatory institutions, poor protection of property rights, and excessive limits on competition can make borrowing costs in developing countries 1,000 bps higher than in high-income countries. Improvements in the policies and institutions

Box FIN.3. Impact of Basel III: Trade finance may become a casualty

The Basel Committee on Banking Supervision, which sets rules that national banking regulators implement, announced a comprehensive reform package in September 2010 that raises capital requirements and, for the first time, sets global standards for overall borrowing, known as leverage, and liquidity. The "Basel III" rules are designed to make banks more resilient and prevent a repeat of the financial crisis, but several provisions combine to make trade finance, already a low-margin business, much less profitable. Basel III's implementation could have unintended consequences for trade financing through the proposed leverage ratio, which would require banks to set aside 100 percent of capital for any off-balance-sheet trade finance instruments, such as letters of credit. This is five times more than the 20 percent credit conversion ratio used for trade finance in Basel II. New capital regulations would also require banks to set aside capital for one year for any instrument, even though that security may carry a maturity of under a year. Most trade finance instruments have maturities of about 90 days: this would triple the capital cost of such instruments.

Such higher capital requirements are likely to depress trade finance. According to Standard Chartered Bank, the new regulations would lead to trade finance becoming 15 to 37 percent more expensive, with volumes falling by 6 percent—which implies a \$270 billion a year reduction in global trade and a 0.5 percent fall in global gross domestic product. Developing countries would be particularly affected by a fall in trade finance. Trade finance is an important source of working capital, particularly for small and medium-sized enterprises. And developing countries rely heavily on international banks for trade finance. In 2010, the largest rebound in capital flows was in short-term debt, which reached \$122 billion, and was for the most part trade finance (World Bank 2011).

There is some question as to whether this rise in capital requirements is necessary for trade finance, which is usually collateralized and has low default risk. The International Chamber of Commerce has published a study that examined the trade finance activity of nine global banks from 2005 to 2009, which together arranged 5.2 million transactions accounting for \$2.5 trillion. It found that only 1,140 of those transactions defaulted. Of the 2.8 million transactions arranged during the crisis in 2008 and 2009, only 445 defaulted (0.02 percent).

governing the financial sector can thus have a significant impact on domestic borrowing and capital costs in developing countries. Such changes have the potential to outweigh any negative effect of higher costs for internationally sourced capital. Simulations suggest that if developing countries continue to improve policies and other fundamentals, so that their interest spreads fall by an average of 25 bps a year, they would more than offset the long-term effects of the financial crisis—potentially yielding a 13 percent increase in long-term potential output and increases in potential output growth of about 0.3 percent per year by 2020. Developing countries may also further increase domestic savings by following closely their comparative advantages in their industrial upgrading and diversification (Lin 2007).

Prospects

Despite their recent moderation, international capital flows to developing countries are projected to rise further over the forecast period.

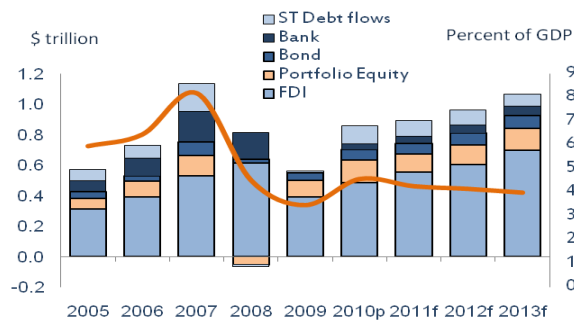
Cross-border flows to developing countries are projected to increase further in nominal terms over the medium-term, but at a slightly slower pace than GDP growth, reaching \$1.1 trillion (3.8 percent of GDP) by 2013 (figure FIN.9). Much of the increase is expected to be in FDI inflows. FDI inflows to resource rich economies and to developing countries with rapidly expanding domestic markets are expected to recover more firmly in 2011. Bank flows might also rise as the deleveraging cycle has largely

come to an end. However, bank lending is expected to remain lower than pre-crisis levels due to approaching regulatory changes.

Other capital inflows that led the initial rebound in 2010 have started to stabilize (or even decline) as the expected monetary tightening in high-income countries and inflationary pressures in emerging markets dampens demand for emerging market assets. Short-term debt and portfolio investment flows in particular, may face considerable weakening or sudden reversals (table FIN.1). When quantitative easing in advanced countries is phased out and global liquidity conditions begin to tighten (or risk aversion rises), developing country local bond markets could be adversely affected, as carry-trade related flows to developing countries slow. Similarly, there may be a contraction in short-term debt flows by 2013 with speculative flows falling, and with trade-related portion hindered by regulatory changes.

Downside risks for the outlook are still considerable, however. First and most immediate is the European debt crisis. While its impact on developing countries has been limited and temporary so far, an unexpected or disorderly resolution of the debt problem might prompt broad-based risk-aversion in global financial markets driving capital flows toward safe-haven assets. This could lead to a sharp reversal in capital flows to developing countries, with a potentially disproportionate impact on countries in developing Europe and Central Asia, whose economies are more closely tied to those in high-income Europe. Second, international capital flows are sensitive to the policy stance in high-income and developing countries. If high-income countries shift toward tighter policy more quickly, or if markets become increasingly concerned by the buildup of debt and central bank liabilities, longer-term interest rates may begin to rise quickly—raising the cost of capital for developing countries and likely weakening flows faster than expected. In fact, a recent IMF study shows that an unanticipated 5 bps rise in U.S. real interest rates might cause a 1/2 percentage point (pp) reduction in net flows (inflows minus outflows) in the first quarter and

Figure FIN.9 Further increase in capital flows



Source: The World Bank.

1.25 pps cumulative reduction in two years (IMF 2011b). The impact is projected to be larger in countries with higher financial linkages with United States.

With higher oil prices and increased debt-financing requirements, several oil importing economies will remain vulnerable to sudden changes in global markets

Although the impact on credit risk was limited, the events in the Middle East and North Africa resulted in a sharp increase in oil prices. And many oil importing countries now face higher

import bills and current account deficits. In addition, developing countries issued international bonds valued at \$180 billion in 2010, and entered 2011 with \$855 billion in short-term debt. As a result, external financing needs (current account projections and amortization of external debt) for developing countries increased from \$0.8 trillion (3.5 percent of GDP) to \$0.9 trillion (3.9 percent of GDP).

While international debt market conditions have been robust so far in 2011, high external financing needs make countries vulnerable to

**Table FIN.1 Net capital flows to developing countries
\$ billions**

	2004	2005	2006	2007	2008	2009	2010e	2011f	2012f	2013f
Current account balance	195.2	318.8	450.3	469.1	440.6	284.4	264.5	219.6	159.9	163.1
as % of GDP	2.4	3.3	4.0	3.4	2.6	1.7	1.4	1.0	0.6	0.6
Financial flows:										
Net private and official inflows	342.2	502.9	656.3	1132.1	771.1	633.8	930.2			
Net private inflows (equity+debt)	366.3	567.0	725.9	1132.1	743.3	557.4	857.8	892.7	963.5	1065.3
Net equity inflows	243.6	379.2	497.0	664.9	561.2	498.1	633.2	674.1	733.9	839.8
..Net FDI inflows	206.7	311.7	389.3	529.8	614.4	390.0	485.4	555.0	603.6	696.2
..Net portfolio equity inflows	36.9	67.5	107.7	135.1	-53.2	108.2	147.8	119.1	130.3	143.6
Net debt flows	98.6	123.8	159.3	467.2	209.9	135.6	297.0	218.6	229.6	225.5
..Official creditors	-24.1	-64.0	-69.6	0.0	27.8	76.4	72.4			
....World Bank	2.4	2.7	-0.2	5.2	7.3	17.7	19.3			
....IMF	-14.7	-40.2	-26.7	-5.1	10.0	26.5	16.3			
....Other official	-11.8	-26.6	-42.6	0.0	10.6	32.2	36.8			
..Private creditors	122.7	187.8	228.9	467.2	182.1	59.2	224.6	218.6	229.6	225.5
....Net M-L term debt flows	69.8	113.3	145.0	283.0	196.1	52.8	104.1			
.....Bonds	34.3	48.3	31.7	88.2	24.1	51.1	66.5			
.....Banks	39.7	70.3	117.9	198.5	176.8	3.2	37.6			
.....Other private	-4.1	-5.3	-4.7	-3.7	-4.8	-1.6	0.0			
....Net short-term debt flows	52.9	74.5	83.9	184.2	-14.0	6.4	120.5			
Balancing item /a	-137.5	-406.9	-458.6	-509.5	-733.5	-271.1	-524.4			
Change in reserves (- = increase)	-399.9	-414.8	-647.9	-1091.7	-478.2	-647.0	-670.3			
Memorandum items										
Net FDI outflows	46.1	61.6	130.5	148.7	207.5	153.9	210.0			
Workers' remittances	159.3	191.8	226.3	278.2	325.0	307.6	324.7	348.6	374.5	
As a percent of GDP										
	2004	2005	2006	2007	2008	2009	2010p	2011f	2012f	2013f
Net private and official inflows	4.3	5.3	5.8	8.1	4.6	3.9	4.8			
Net private inflows (equity+debt)	4.6	5.9	6.4	8.1	4.4	3.4	4.4	3.9	3.8	3.8
Net equity inflows	3.0	4.0	4.4	4.8	3.3	3.1	3.3	3.0	2.9	3.0
..Net FDI inflows	2.6	3.3	3.4	3.8	3.7	2.4	2.5	2.4	2.4	2.5
..Net portfolio equity inflows	0.5	0.7	1.0	1.0	-0.3	0.7	0.8	0.5	0.5	0.5
..Private creditors	1.5	2.0	2.0	3.3	1.1	0.4	1.2	1.0	0.9	0.8

Source: The World Bank

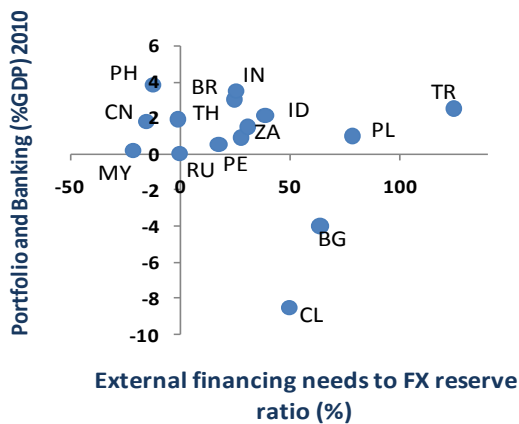
Note:

e = estimate, f = forecast

/a Combination of errors and omissions and transfers to and capital outflows from developing countries.

sudden reversals in capital markets and to a possible increase in borrowing costs. Countries such as Russia, Brazil, Indonesia and Turkey are susceptible to these types of risks (the first three because of high debts, the last because of its high debt and large current account deficit). These risks are further accentuated when a large share of external financing comes in the form of relatively volatile portfolio equity and debt flows (Brazil, Indonesia, and Turkey) (figure FIN.10).

Figure FIN.10 External vulnerability



Source: International Monetary Fund and World Bank.

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