International Capital Flows, External Assets, and Output Volatility

Mathias Hoffmann
Deutsche Bundesbank

Michael Krause
University of Cologne

Peter Tillmann
University of Giessen

Abstract

Cross-sectional evidence for 119 developing, emerging, and developed countries shows over the last three decades that countries with an on average higher volatility of output growth experience more procyclical capital outflows over the business cycle than those countries with the same growth rate but a more stable output path. This stylized pattern shows up in addition to the recently established fact that countries with higher macroeconomic uncertainty tend to accumulate higher external asset positions. To explain this finding we present an open-economy real business cycle model with stochastic growth rates in which higher uncertainty of the expected income stream increases the precautionary savings of households. We show that the combination of income risk and the precautionary savings motive leads to both more procyclical capital outflows in the shorter run and a higher long-run external asset position.