The Composition Matters: Capital Inflows and Liquidity Crunch during a Global Economic Crisis

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Summary

This paper studies whether the volume and composition of capital flows affect the degree of credit crunch during the 2007-2009 crisis. Using data on 3823 firms in 24 emerging countries, we find that, on average, the decline in stock prices was more severe for firms that are intrinsically more dependent on external finance for working capital. Interestingly, while the volume of capital flows per se has no significant effect, the composition matters a lot. In particularly, greater dependence on non-FDI capital inflows before the crisis worsens the credit crunch during the crisis, while exposure to FDI alleviates the liquidity constraint.