



Impact of large international capital flows on currency crises

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ABSTRACT

We follow Forbes and Warnock (2012) to define four types of large international capital flows, namely, capital flight and capital retrenchment of domestic residents, and capital surge and sudden stop of foreigners. Using data from 56 countries from 1985 to 2017, we find that only the sudden stop would likely increase the probability of a currency crisis. Then, based on the significant results of the sudden stops, we further investigate which type of large capital inflows combined with the sudden stop would increase the probability of a currency crisis. We argue that the large capital inflows, including capital surges and capital retrenchments, are driven by different entities, which may affect the impact of sudden stop on currency crises. We find that a capital surge followed by a sudden stop would increase the probability of a currency crisis, but the capital retrenchment followed by a sudden stop does not.

Keywords: capital flight, capital retrenchment, capital surge, sudden stop, currency crisis

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