



De La Salle University – Dasmariñas

**CAPITAL INFLOWS AND REAL EXCHANGE RATE IN
SELECTED DEVELOPING COUNTRIES**

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ABSTRACT

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Foreign capital inflows to carry substantial benefits, impulsive investment, and economic growth into the recipient developing economy; as it helps emerging economies end the technology gap with the advanced economies. However, despite these foreign capital inflows, large surge of these inflows may also bring undesirable outcomes in macroeconomics.

Generally, this paper focused on the effect of capital inflows on real exchange rate across five developing countries such as Brazil, China, India, Mexico, and the Philippines. The study also presented capital inflows – remittances and foreign direct investment, and real exchange rate movements in 1980 to 2011. Afterwards, effects of these inflows on real exchange rate in each country were also explained through the multiple OLS regression. Lastly, panel regression was used to determine the effect of remittances and foreign direct investment on real exchange rates in all the selected countries.

The research provided three models for: model 1: remittances, model 2: foreign direct investment, and model 3: total capital inflows that were regressed separately. In Model 1, remittances cause real depreciation for India and Mexico



and real appreciation for the Philippines. In Model 2, foreign direct investment was found to be insignificant in all countries. Finally, in Model 3, total capital inflows showed to be significant in China and the Philippines at 10 percent. Moreover, the panel regression provided no significant key explanatory variables in the model.

Since the study hypothesized that these capital inflows cause appreciation of real exchange rate which was reflected in the Philippines, this paper also provided an elaboration of the detection of Dutch disease in the Philippines – that the Philippines has been experiencing Dutch disease since the mid-2000s, as its exports of goods and services declined along with the increase in remittances that causes real appreciation. Although the Philippines had the Dutch disease phenomenon, it is not hurting the economy, given that real GDP per capita happens to be increasing over time.



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