



The Impact of Foreign Portfolio Flows on Emerging Market Volatility: Evidence from Thailand

by

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Abstract:

We conduct an analysis of the impact of foreign portfolio flows on the volatility of emerging markets, using a unique dataset consisting of aggregate daily trading by foreign investors in the Thai stock market between 1995 and 2002. We find that the effect of foreign flows on the volatility of daily and weekly returns in the market comes primarily from the unexpected shocks to foreign flows. The predictable component of flows, which is attributable to positive feedback trading, has a negligible impact on the local market volatility. Our analysis reveals that the extraordinarily high volatility during the Asian financial crisis is associated with domestic selling, as foreign investors are net buyers, and thus liquidity providers, during that period. Moreover, foreign flows also play an instrumental role in promoting market liquidity.

Keywords:

FOREIGN PORTFOLIO FLOWS; EMERGING MARKET VOLATILITY.

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