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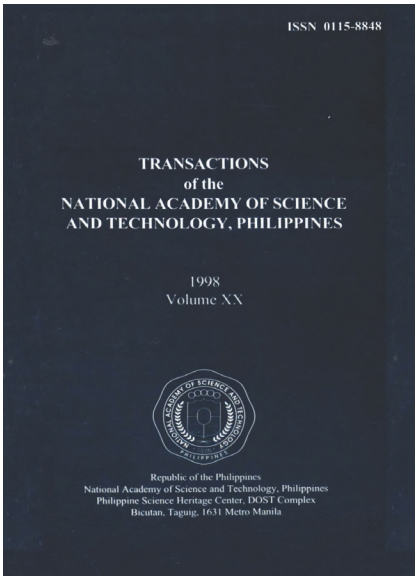


# Capital Flows and the Integration of International Financial Markets

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# CAPITAL FLOWS AND THE INTEGRATION OF INTERNATIONAL FINANCIAL MARKETS

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## ABSTRACT

As financial markets become more integrated, factors other than purely domestic policies will affect macroeconomic performance. This study attempts to empirically assess how capital flows have affected domestic interest rates, real money demand, real consumption demand, and real investment demand in the Philippines using quarterly data from 1982 to 1995. Dynamic simulations are used to obtain the time paths of interest rates and money demand assuming no inflows, which are then compared to the actual. Incorrect attributions of changes in these variables to capital flows could lead to incorrect policies. The possible effects of capital flows on real consumption demand and real investment demand are examined, distinguishing between real FDI flows and real portfolio flows.

***Key words:*** Capital flows, financial integration, macroeconomic performance, dynamic simulations