

# **The Natural Level of Capital Flows**

**John D. Burger**

Sellinger School of Business, Loyola University Maryland

**Francis E. Warnock**

Darden Business School, University of Virginia

NBER

**Veronica Cacdac Warnock**

Darden Business School, University of Virginia

October 2019

## **Summary**

This paper puts forward the notion that capital flows—specifically, gross portfolio flows—fluctuate around some natural level. Our particular measure of the natural level of capital flows, denoted by  $KF^*$ , is a theory-based time-varying supply-side factor, much like potential GDP is a theory based time varying supply side measure of economic activity. We construct  $KF^*$  for 184 countries and, for the subset of countries that have quarterly time series data of capital flows, we show that  $KF^*$  is a level to which flows converge in the medium term. That is,  $KF^*$  appears to help identify the underlying persistent component in gross portfolio inflows by differentiating between longer-term structural flows and short-term cyclical noise. Overall, we conclude that there is a natural level of capital flows that is well approximated by our measure of  $KF^*$ .