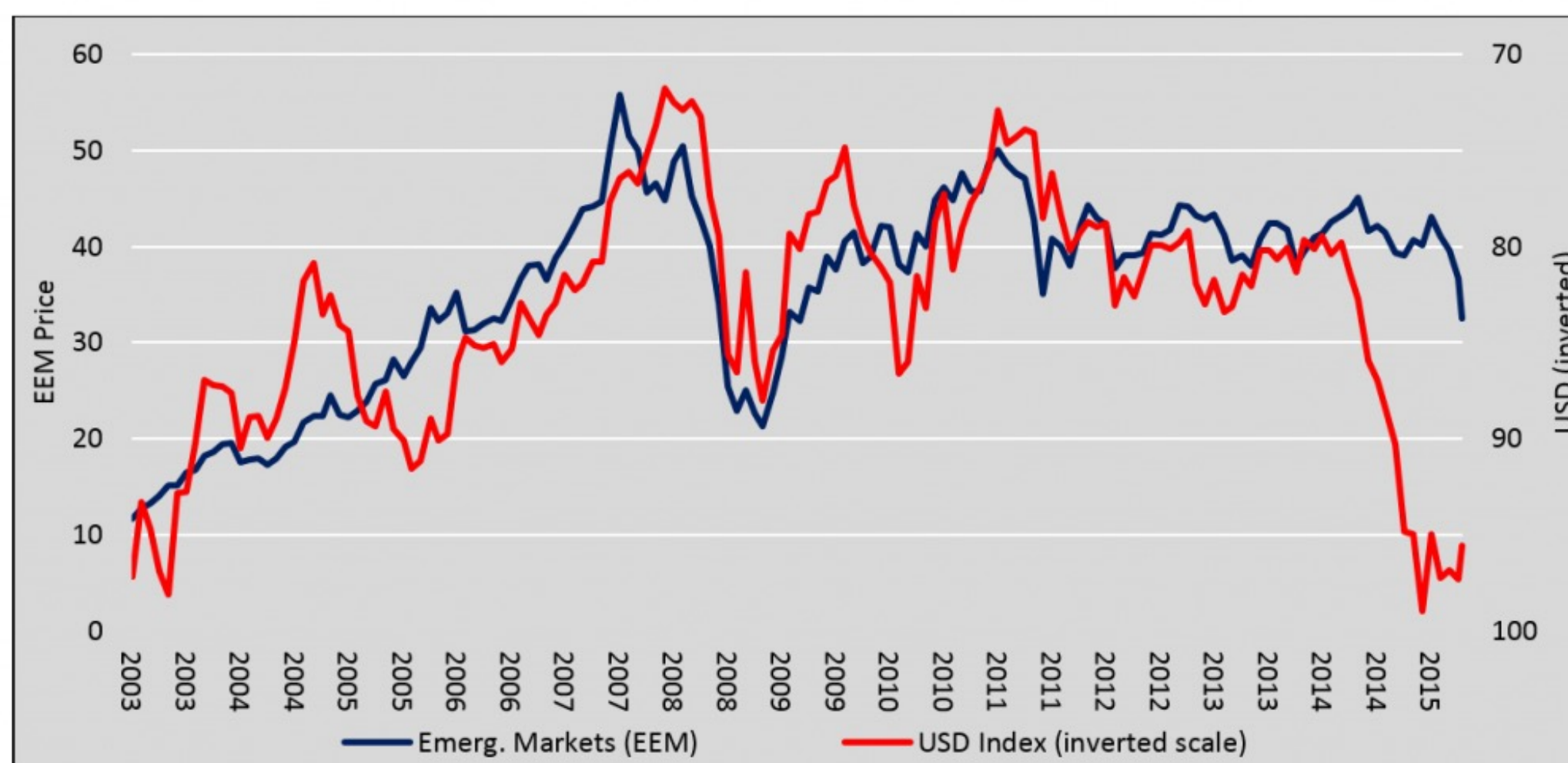


## Background

- U.S. interest rate adjustments can influence global capital flows, thus increasing borrowing costs and raising risk premiums, which can destabilize emerging market economies (EMEs)
- Stricter capital controls and floating exchange rates can buffer the effects of U.S. interest rate adjustments on emerging market stock performance

Correlation: USD Index versus MSCI Emerging Markets Index (EEM)



Data Courtesy Bloomberg, 720 Global

## Research Question

**To what extent do capital controls and exchange rate regimes moderate the effect of U.S. interest rates on stock market performance in emerging markets?**

## Hypothesis

- **CONTROLS** → Limit the flow of capital out of a country, reducing risk of foreign reserve depletion
- **REGIME** → Floating exchange rate, which is a rate is set by foreign exchange market, provides long term flexibility

## Literature Review

- The United States is a major player in the world economy, especially in the global financial sector and the commodities market, which is denominated in the U.S. dollar.
- EMEs are more involved in the global commodity market and are sensitive to foreign investment.
- Interest rate adjustments can lead to capital outflow from emerging markets and into the United States, which makes repaying debt more expensive and will depreciate foreign currency.
- More flexible exchange rate regimes allow for more flexible policy use as a response to resist against shocks.
- Economies with stricter capital controls are less financially sensitive.

## Methodology

$$\text{StockMarketReturnChange} = \beta_0 + \beta_1 * \text{InterestRate} + \beta_2 * \text{regime} + \beta_3 * \text{capitalControls} + \beta_4 * (\text{InterestRate} * \text{regime}) + \beta_5 * (\text{InterestRate} * \text{capitalControls}) + \epsilon$$

## Findings

Dependent variable:	
Stock Market Return Change	
Interest Rate	0.736 (0.492)
Exchange Rate Regime	-0.084 (0.335)
Capital Controls	-1.360 (1.536)
Observations	156
R2	0.022
Adjusted R2	-0.083
F Statistic	1.060 (df = 3; 140)
Note:	*p<0.1; **p<0.05; ***p<0.01

## Research Design and Analysis

- Data spans 12 adjustments from 2022 to 2024
- 13 countries are used to represent a wider array of emerging markets from diverse regions with strong economic ties to the U.S.
- Moderating variables are expected to capture the varying impact that the independent variable has in each condition
- No significant conclusions can be drawn from the analysis
- High variation amongst countries, who present a variety of reactions to interest rate adjustments
- The moderating variables showed no significance

## Limitations

- Possibility of not capturing a time lag
- Potential hedging strategies that result in a premature impact
- Limited observations

## Implications

- Guides investors on managing risks in volatile markets
- Emerging markets play a big role in global economy and can help better understand economic spillover and risks
- Helps design strategies to protect economies from U.S. monetary adjustments