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International capital flows expanded strongly before the global financial crisis, and current account imbalances accumulated in key economies. The crisis triggered a contraction in capital flows, which often forced a painful adjustment on countries running high external deficits. This special issue of the Journal of International Money and Finance consists of seven papers that offer novel empirical and theoretical perspectives on the implications of increasing financial integration for international capital flows, and for asset prices and real activity, in the context of both the global economy and the euro area. The financial crisis and the euro crisis figure prominently as potential watershed moments, in the studies collected here. All papers were presented at a conference held at the European Commission in Brussels on December 6e7, 2013, organized by the Journal of International Money and Finance, the European Commission, CEPR, ECARES, Tilburg University, the University of British Columbia, the University of Southern California and the University of Wisconsin.

The first paper, by Shagil Ahmed and Andrei Zlate provides an empirical analysis of the determinants of foreign capital flows to emerging market economies (EME). Those flows were sizable before the global financial crisis, fell sharply during the crisis, but then recovered rapidly. The authors find that growth and interest rate differentials and global investors' risk appetite are key drivers of capital flows to EMEs. US unconventional monetary policy easing contributed to the post-crisis rebound of capital flows to EMEs, but was only one among other important drivers. EME capital controls were effective at dampening capital flows to EMEs.

Joshua Aizenman and Yothin Jinjarak document a significant and robust positive association of real estate price growth with current account deficits and with domestic credit growth. That relationship holds both for developed and emerging market economies, and both before and after the global financial crisis. Current account deficits and credit growth are significant predictors of future real estate price growth. Large current account deficits may thus serve as a warning signal for real estate bubbles and financial crises.

Martin Evans presents a theoretical framework that links a country's net foreign asset assets (NFA) to current and expected trade flows and to expected future returns on foreign assets and liabilities. The author's empirical analysis, based on data for developed and emerging economies, suggests that changing expectations about trade flows far into the future contribute significantly to NFA variations, while near-term expectations about trade flows are much less relevant. Except for the US, expected financial conditions are markedly less important drivers of external positions.

The remaining papers focus on euro area external balances. Alexandr Hobza and Stefan Zeugner construct a novel database of annual bilateral gross financial flows between euro area countries and major non-euro area economies. The authors document that the geography of financial flows differs significantly from that of goods flows. Before the financial crisis, the core euro area surplus countries financed the current account deficits of euro area periphery countries, and also intermediated financial flows from the rest of the world to the euro area periphery. The crisis then led to a sharp collapse in intra-euro area financial flows, and in the current account deficits of periphery countries.

Jan in't Veld, Robert Kollmann, Beatrice Pataracchia, Marco Ratto and Werner Roeger analyze the joint dynamics of the trade balance, asset prices and real activity in Spain, the largest of the euro area countries that received sizable capital inflows in the run-up to the global crisis, and then experienced a sudden stop. Using an estimated New Keynesian model with a housing sector, the authors argue that the Spanish boom before the crisis was fuelled by a loosening of collateral constraints for Spanish households and firms, and by a fall in the interest rate spread between Spain and the rest of the euro area. During and after the crisis, falling house prices and a tightening of household collateral constraints contributed to a sharp drop in capital inflows and to a persistent slump in Spanish real activity.

Filippo di Mauro and Francesco Pappadà analyze the role of the real exchange rate in euro area external adjustment. The authors construct a three-country model, with heterogeneous firms. Using new micro data, the authors show that the distribution of firm-level productivity is less dispersed and right-skewed in euro area periphery countries than in the core countries. The authors show that this implies that the extensive margin (firm entry/exit) is relatively unimportant for external rebalancing by the periphery, i.e. rebalancing requires a stronger terms of trade adjustment.

Patrick Hürtgen and Ronald Rühmkorf document that the correlation between the fiscal balance and the current account is positive, for euro area countries. Importantly, the empirical correlation between the 'twin deficits' is weaker at high sovereign debt levels. To explain this finding, the authors develop a non-linear model of an open economy with the possibility of sovereign default. At high sovereign debt, an adverse shock to the fiscal balance triggers a rise in domestic precautionary saving (due to greater default risk), which dampens the current account deterioration induced by the fiscal shock.