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# Forecasting Financial Crises in Developing Countries: Revisiting the Roles of External Financing and Exchange Rate Stability

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## Résumé

This paper investigates the effects of external financing and exchange rate stability on the likelihood of financial crises (banking, currency and twin) in 67 developing countries between 1972 and 2011. We begin by developing a two-period theoretical model of banking, including two different sources of financing (FDI and external debt). Then, in the empirical investigation, we estimate three prediction logit panel models (fixed-effects, random-effects and population-averaged) and include several tests to check the robustness of the results. Our main findings are the following: i) foreign direct investment reduces the likelihood of financial crises occurrence but external debt increases it; ii) exchange rate stability within a flexible regime decreases the occurrence of financial crises, whereas exchange rate rigidity increases it. Therefore, developing countries should control the composition of their external financing by favoring FDI over debt and consider an intermediate currency regime rather than extreme exchange rate policies.

**Mots-Clés:** financial crises, FDI, debt, panel logit models, political decision, making, economic policy

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