Global Macro Views – How Big is the Rebound in Flows to EM?

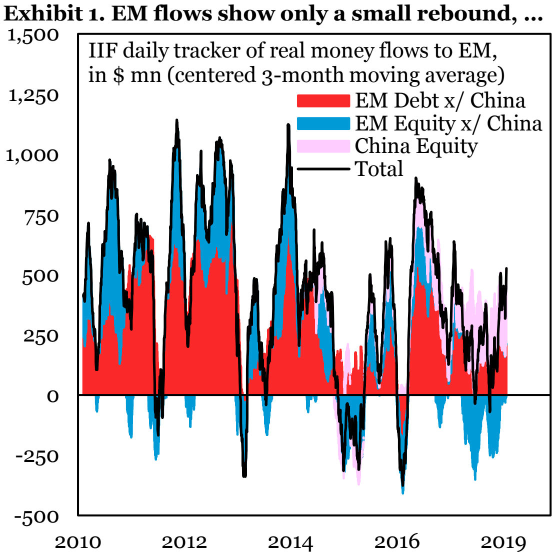
January 24, 2019

Robin Brooks, Managing Director & Chief Economist, rbrooks@iif.com, @RobinBrooksIIF
Jonathan Fortun, Economist, jfortun@iif.com, @EconChart
Greg Basile, Associate Economist, gbasile@iif.com, @GregBasileIIF

- Market sentiment has turned more constructive on EM, …
- amid anecdotes of a healthy rebound in emerging market flows.
- The IIF has a long history of maintaining high frequency flow trackers, …
- which in many cases give a daily reading of inflows to emerging markets.
- Our trackers do not point to a convincing pick-up in flows beyond China, …
- with flows to key emerging markets like India and South Africa quite weak, …
- even after sizeable and persistent outflows during last year's EM sell-off.

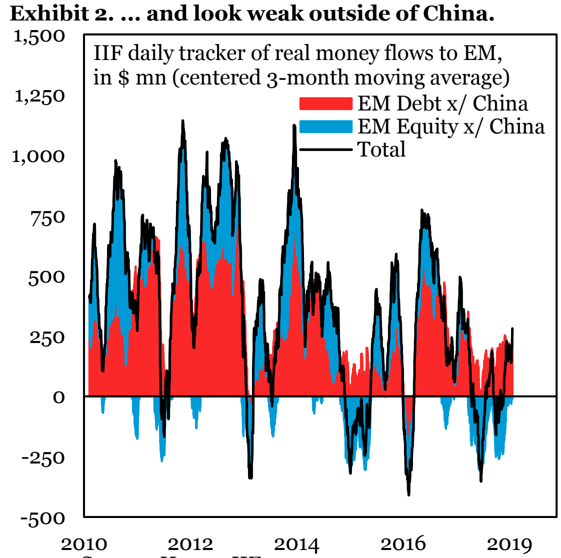
We have used recent ***Global Macro Views*** to lay out our key views for 2019, including a relatively upbeat outlook for global growth and a dovish Fed forecast, which foresees a prolonged pause (with two hikes in the second half of the year). Against the backdrop of the violent EM sell-off last year, which has left most emerging market currencies close to fair or significantly undervalued, the combination of solid growth and a cautious Fed should be positive for risk assets, including emerging markets. In this context, market sentiment has turned positive and there are many anecdotes of a rebound in EM non-resident portfolio flows. We review our capital flow trackers, which give a daily snapshot of flows to key emerging markets. We show that our trackers provide a comprehensive mapping into official BoP flows, which are published with an often-considerable lag. Our trackers fail to show a sizeable rebound in real money flows to EM beyond China, with flows to key emerging markets like India and South Africa remaining quite weak. The relatively anemic rebound in flows may be due to negative muscle memory from 2018 or – more likely in our view – reflect a broad positioning overhang in EM, after a decade of easy money and near-record inflows.

Exhibit 1. EM flows show only a small rebound, …



Source: Haver, IIF

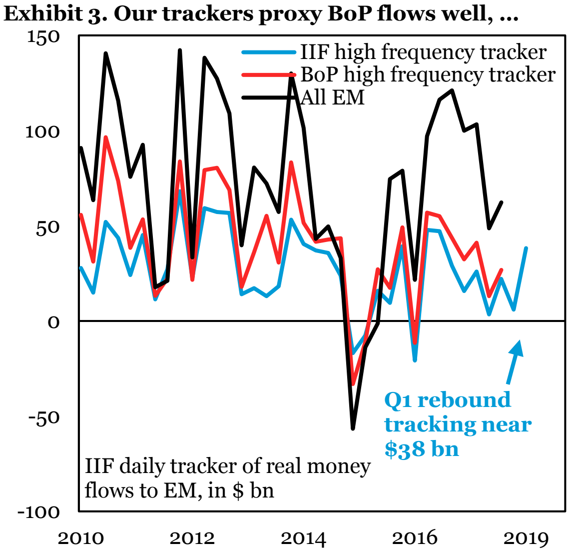
Exhibit 2. … and look weak outside of China.



Source: Haver, IIF

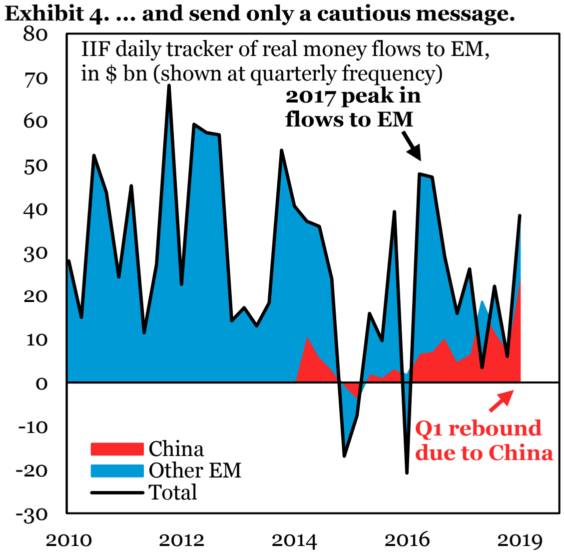
Our capital flows trackers span around twenty of the world's key emerging markets, including China, Brazil, India as well as Turkey, and provide an often-daily reading on real money flows into EM stocks and bonds. Exhibit 1 shows the recent history of this tracker, breaking out flows into EM stocks (blue) and bonds (red), in addition to flows into Chinese equities, which we keep separate due to the difference in scale. We track flows using a centered 3-month moving average, where the *"centering"* is important because it reduces the backward-looking bias. The last datapoint, for example, spans the six-week period through early December and is therefore a good yardstick by which to judge the rebound in flows to EM. Exhibit 2 shows the same thing excluding China, i.e. focusing on what might be considered genuine EM flows. The picture is that the rebound in flows to EM is anemic, especially if you consider the depth of the 2018 sell-off. Of course, there is the question how representative our trackers are versus official BoP data, which lag but have the advantage that they should cover all transactions between resident and nonresidents. The good news is that our trackers are a useful *"real-time"* proxy for BoP non-resident portfolio flows to EM. Exhibit 3 compares our tracker, where we have aggregated it up to a quarterly frequency (blue), to official BoP data (red) for the same set of countries. The measurement error is small and declining over time. Perhaps more important, the subset of countries in our tracker is a good proxy for the broader EM universe (black), although the amplitude of swings across the full EM spectrum is greater. Exhibit 3 extrapolates data for January through all of Q1, showing that real money flows to EM are running at a pace of around $38 bn currently. This is relatively healthy, but there is a twist. Much of the rebound in our tracker reflects flows to China (Exhibit 4), while the rebound to the rest of EM is best described as weak.

Exhibit 3. Our trackers proxy BoP flows well, ...



Source: Haver, IIF

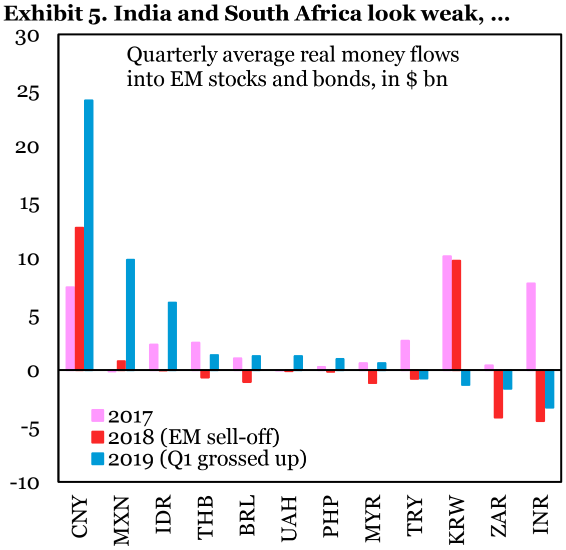
Exhibit 4. ... and send only a cautious message.



Source: Haver, IIF

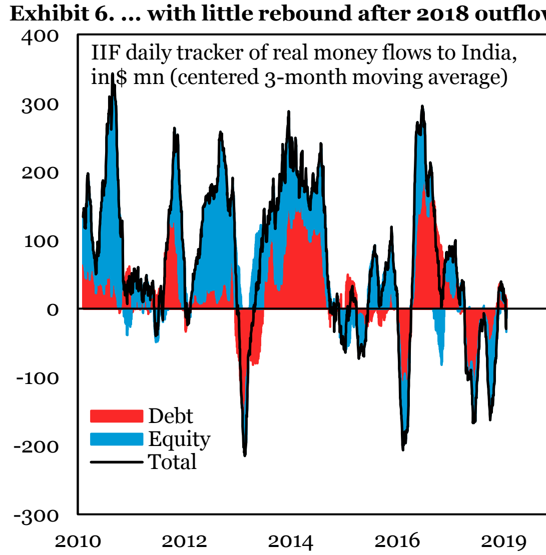
Exhibit 5 tries to give some perspective on the anemic rebound in flows outside of China. It compares the quarterly pace of inflows in 2017 – a good year for EM – to the quarterly pace of flows during the EM sell-off last year and then our tracking of flows in Q1, grossing up flows for January-to-date for Q1 as a whole. Non-resident flows to China are clearly running at a strong pace compared to history, but this is not true for the broader EM universe. In particular, key emerging markets like India and South Africa are seeing a weak flow picture. The only positive exceptions are Indonesia and Mexico. Exhibit 6 zeros in on India, where our centered 3-month moving average is barely positive, even following large outflows last year. Part of the explanation for the anemic rebound may be muscle memory from 2018. But we suspect that a continued positioning overhang after years of easy money and record flows to EM is really to blame.

Exhibit 5. India and South Africa look weak, ...



Source: Haver, IIF

Exhibit 6. ... with little rebound after 2018 outflows.



Source: Haver, IIF