

Global Macro Views – The FDI Shortage in EM

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- Last year we unveiled a new measure of genuine FDI flows to EM, ...
- which strips out reinvested earnings to focus only on “true” FDI flows.
- This measure of “true” flows has fallen to its lowest level in 20 years, ...
- a global FDI shortage that impacts emerging as well as frontier markets.
- Brazil, Colombia and Chile continue to get the most FDI relative to GDP.

The re-escalation of the China-US trade war is making life more difficult for emerging markets, which were already laboring under a positioning [overhang](#), whereby – after a decade of low G-3 policy rates – investor enthusiasm for more exposure in EM stocks and bonds is limited. FDI is one source of more stable external funding, which is why we developed a new measure of these flows almost a year [ago](#). Our measure isolates “true” FDI flows, by splitting out reinvested earnings, which are not a capital flow in any event and may, in some cases, reflect restrictions on repatriating earnings. This measure of “true” flows has fallen to its lowest level in 20 years, encompassing emerging as well as frontier markets. Relative to the size of their economies, resource-rich countries like Brazil, Chile and Colombia are the biggest recipients of “true” FDI, while China – controlling for reinvested earnings – gets very little.

Exhibit 1. FDI flows to EM have been falling, ...

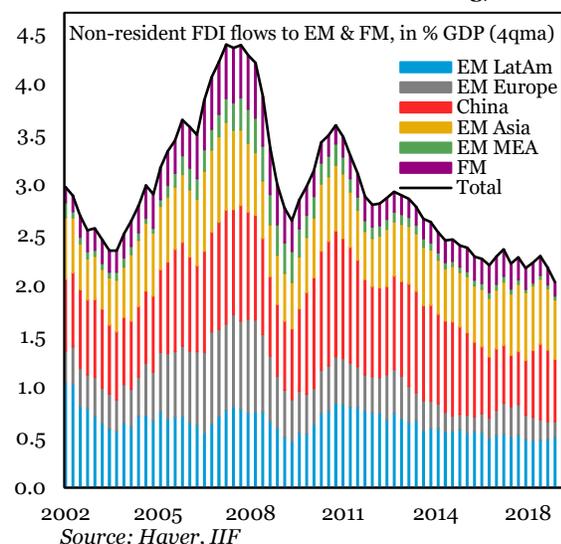


Exhibit 2. ... especially the “true” flow component, ...

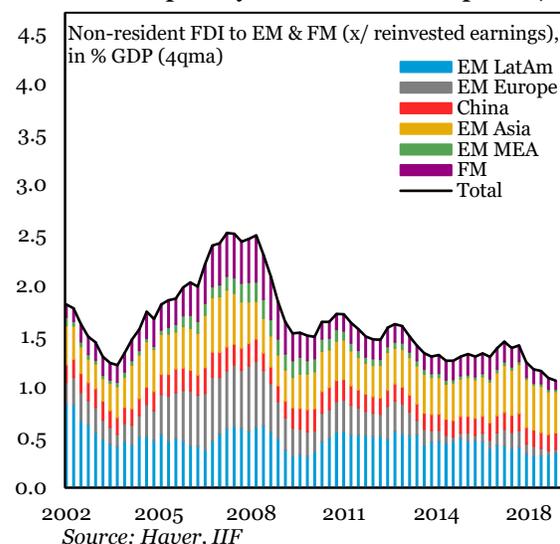


Exhibit 1 shows FDI flows to emerging (EM) and frontier (FM) markets, which encompass genuine inflows and reinvested earnings that in some cases, notably China, reflect restrictions on repatriation that skew the overall picture. We have therefore developed a new measure that excludes reinvested earnings, which shows that the “true” magnitude of FDI flows to EM and FM is only half the headline number (Exhibit 2). Countries in Latin America and emerging Asia are the biggest recipients of these inflows, while reinvested earnings are especially prevalent in China (Exhibit 3). Our data allow us to track which countries get the biggest inflow relative to GDP (Exhibit 4). Brazil stands out as the largest recipient, though other resource-rich economies in Latin America – including Colombia and Chile – also get a lot. Controlling for the large role that reinvested earnings play in China, genuine inflows are near the bottom of the spectrum across emerging markets (Exhibit 5).

Exhibit 3. ... after taking out reinvested earnings.

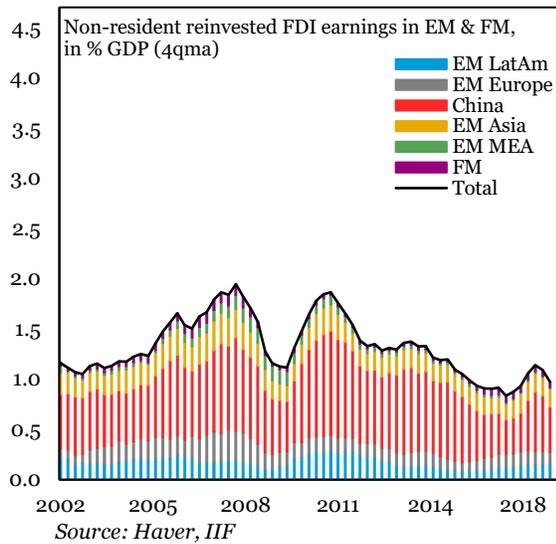
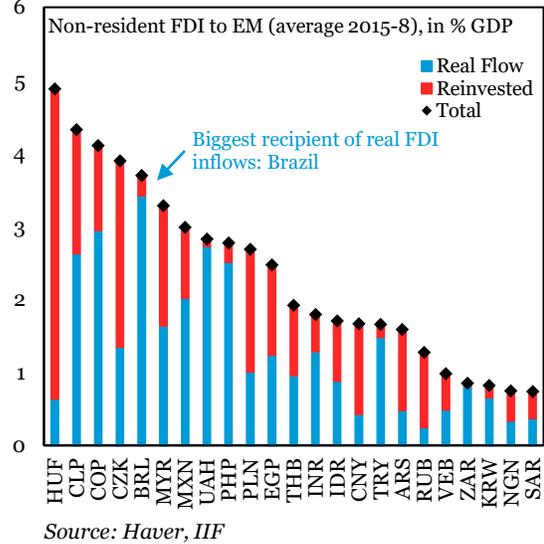


Exhibit 4. Brazil gets lots of FDI relative to GDP, ...



One reason that emerging market currencies have struggled, despite the remarkable dovish Fed shift, is that low G-3 interest rates pushed a “Wall of Money” to EM over the last decade, so that there is now a positioning overhang. One lens through which to look at this overhang is the relative size of FDI versus non-resident portfolio inflows in recent years, where the latter are sometimes called “hot money.” Exhibit 6 makes this comparison and shows that Brazil stands out as having received the biggest FDI inflow, while at the same time attracting essentially no portfolio inflows. This is one reason why we have been calling Brazil the least positioned emerging market out there.

Exhibit 5. ... while China gets a smaller amount.

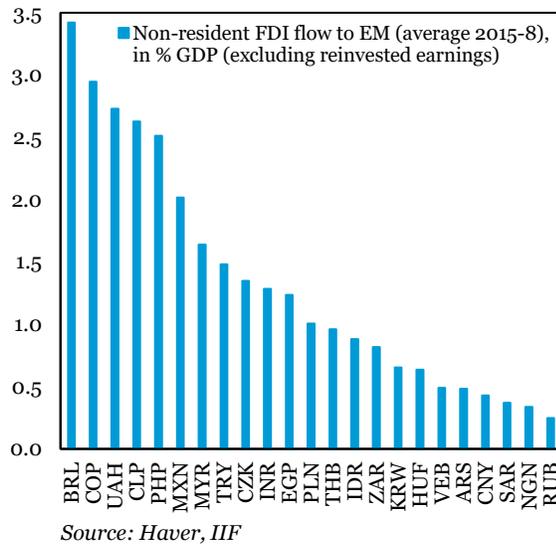


Exhibit 6. Brazil looks least positioned across EM.

