

Capital Inflows and Emerging Markets

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Presentation outline:

I) EMs as Recipient of Capital Inflows

Q1 - Do we observe co-movement in gross capital inflows?

Q2- Substitution or complementarity relationships across asset type?

Q3- What is driving this Global Financial Cycle (GFCy)?

Q4- Which EMs are more sensitive to changes in the GFCy? And Why?

Q5- Is the GFCy the main culprit of the variation in capital inflows to EMs?

II) EMs as Lenders (The case of cross-border banking flows)

Q6- Do EM banks play a significant role?

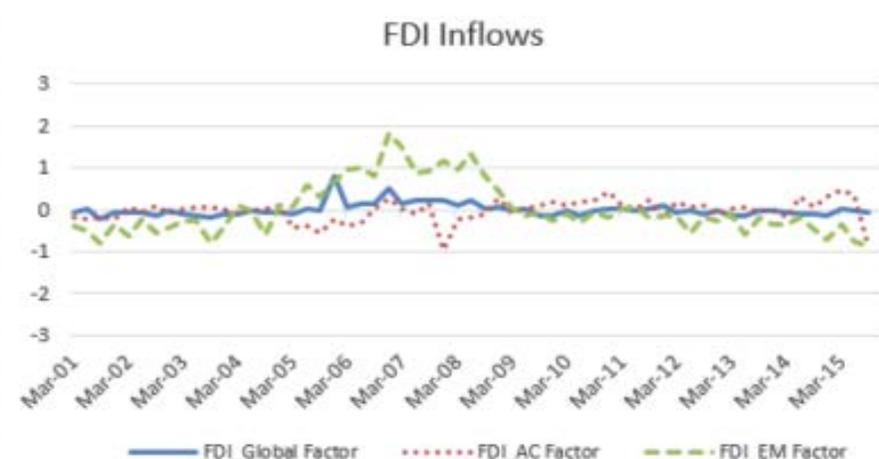
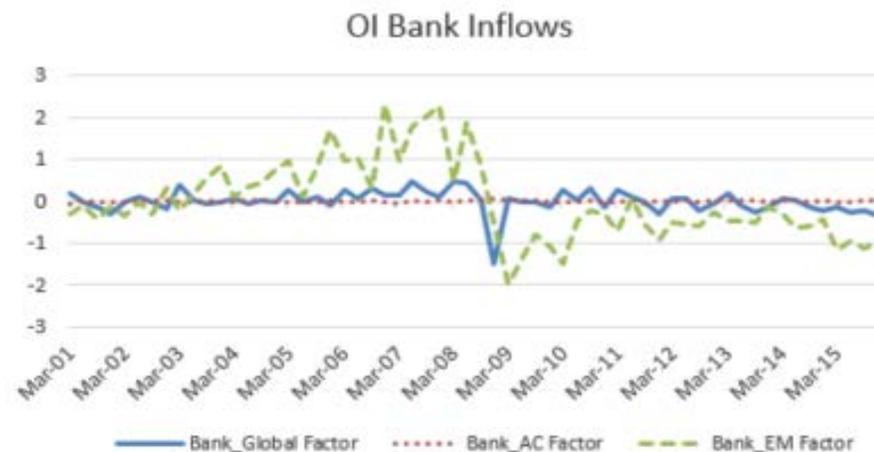
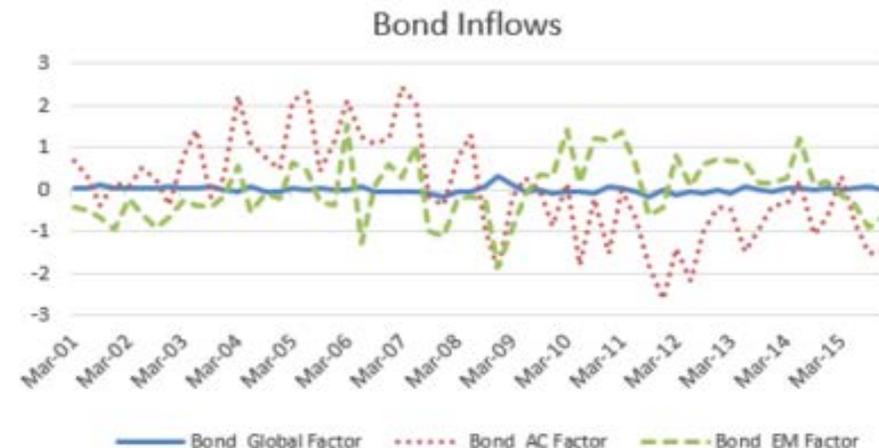
Q7- How do EM banks lend to EMDEs?

Q8- How important is EM bank lending for EMDEs?

III) Policy conclusions

Q1: Do we observe co-movement in gross capital inflows?

- YES. Co-movement among capital inflows occurs largely among EMs. Not much across AEs
- Mostly on Equity, Bond, and Bank inflows, but not FDI

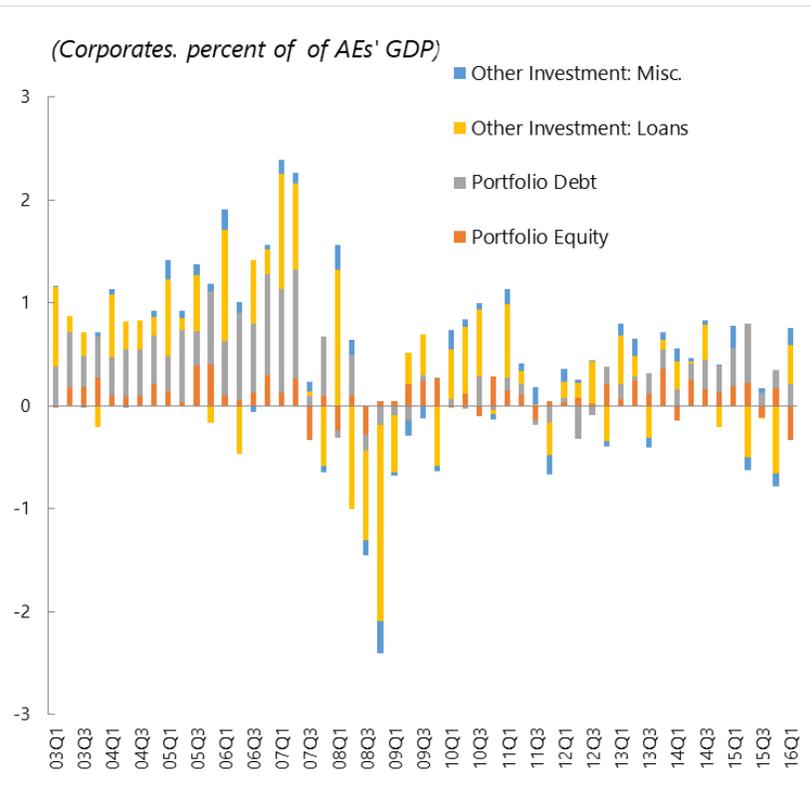


Source: Cerutti, Claessens, Puy (Forthcoming JIE)

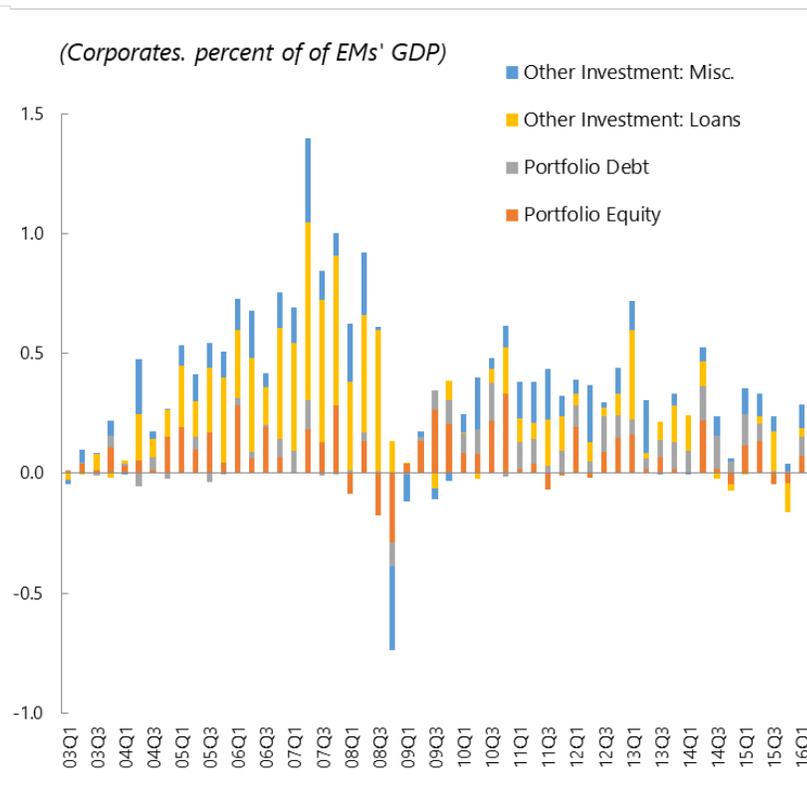
Q2: Substitution or complementarity relationships across asset type?

- There is evidence of substitution between banking inflows and portfolio debt for AEs' corporates, AEs' sovereigns, as well as EMs sovereigns (before 2008)!
- Complementarity relationships for EMs' corporates and EMs sovereigns (after 2008)

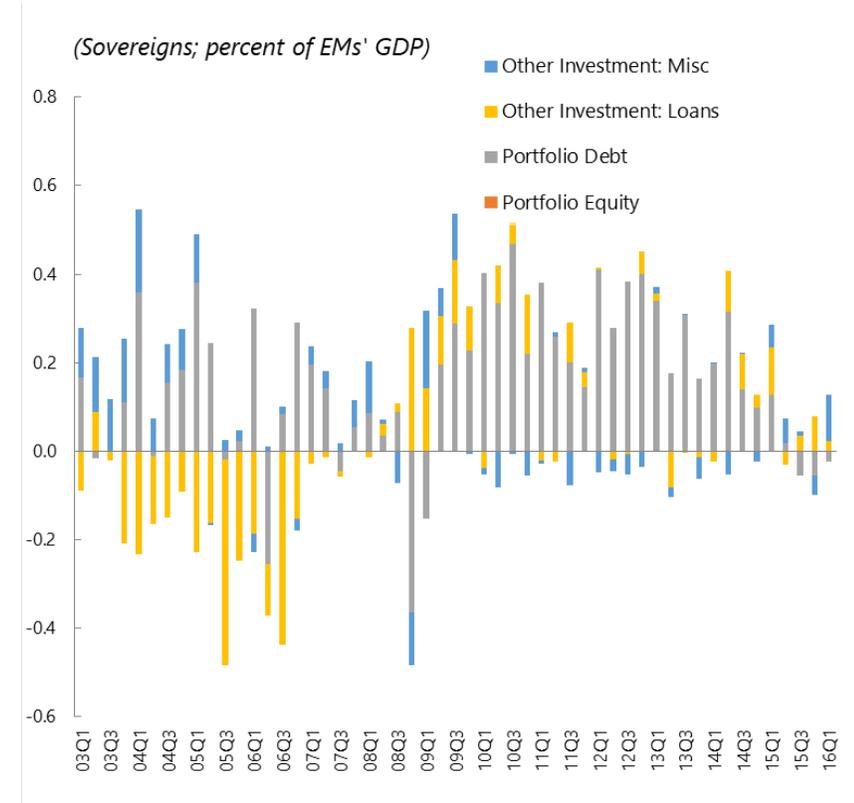
AE Corporates



EM Corporates

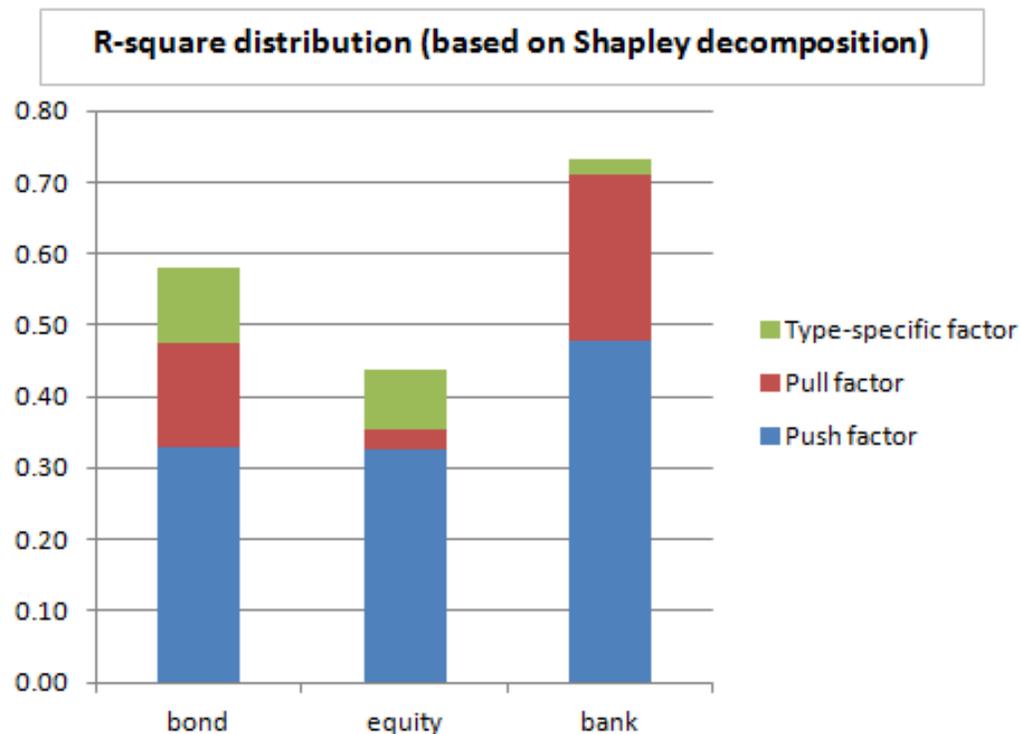


EM Sovereigns



Q3: What is driving this Global Financial Cycle (GFCy) for EMs?

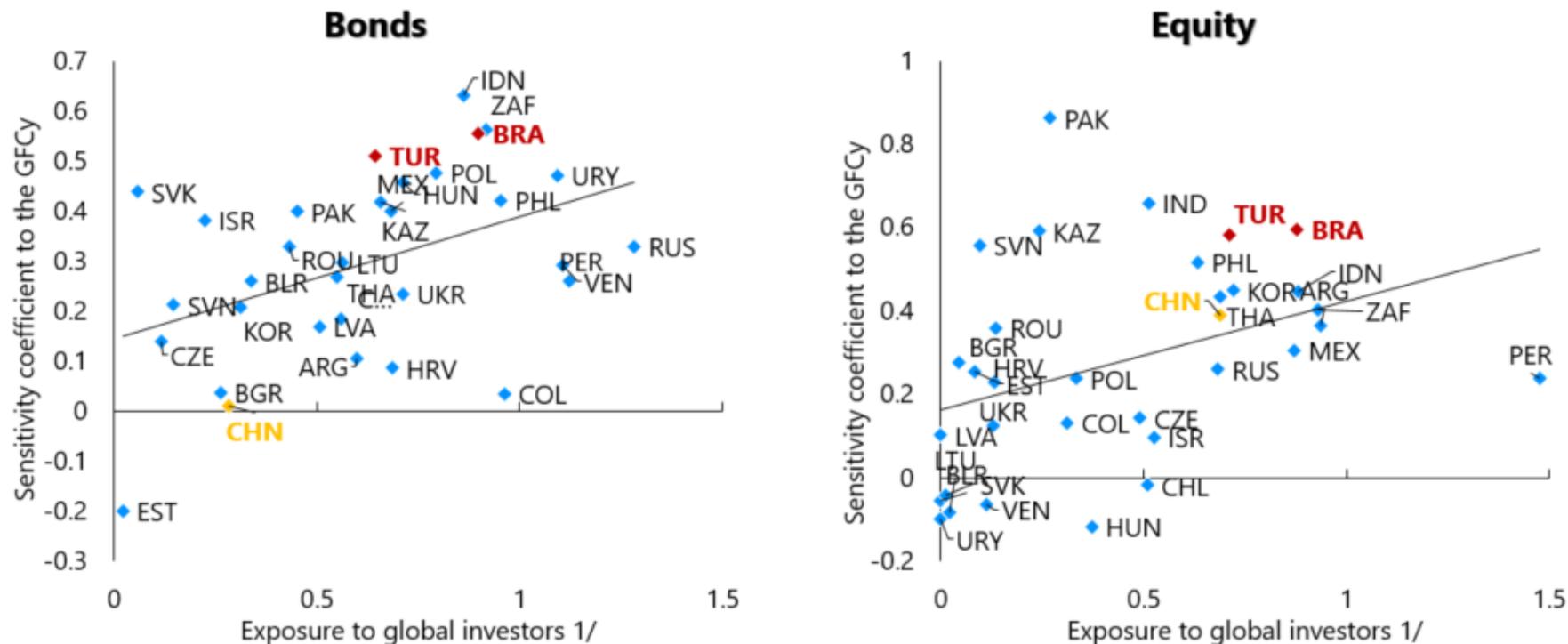
- EM common dynamic explained mostly by push factors in core countries
- The relative importance of push factors varies across type of flows
- Pull variables somewhat more important for bond and bank flows (but as function of commodity prices, so not really an EM internal driver)



Source: Cerutti, Claessens, Puy (2015, IMF WP/15/267)

Q4: Which EMs are more sensitive to changes in the GFCy? Why?

- Much heterogeneity. Some countries very sensitive across all assets (e.g. Brazil, Turkey)
- Why? Market characteristics rather than institutional/macro fundamentals
- Why? Composition of the foreign investor base (reliance on global investor funds) plays a key role in the case of bond and equity flows

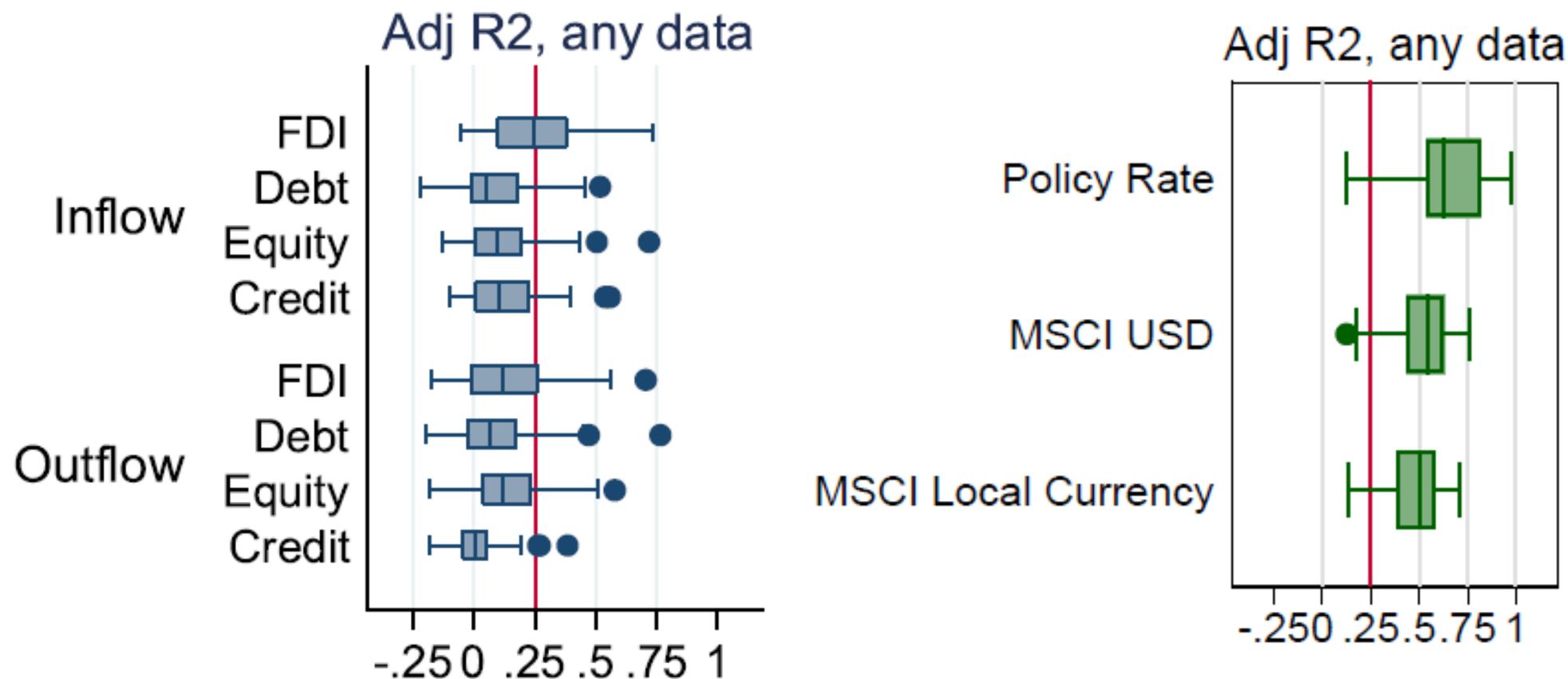


1/ A weight above (below) one implies that the country was over- (under-) represented in global investor flows relative to total BOP flows. Peru is an outlier in terms exposure to global investors in equity markets due to the peculiar incorporation in offshore markets of Peru's largest domestic bank holding company and a large Peruvian mining company.

Source: Cerutti and Obstfeld (2018, IMF WP/18/253) based on Cerutti, Claessens, Puy (Forthcoming JIE)

Q5: Is the GFCy the main culprit of all the variation in capital inflows?

- Not really. GFCy not that important in understanding capital flows
- Potential impact of the GFCy present in other variables (e.g. domestic asset prices and credit)



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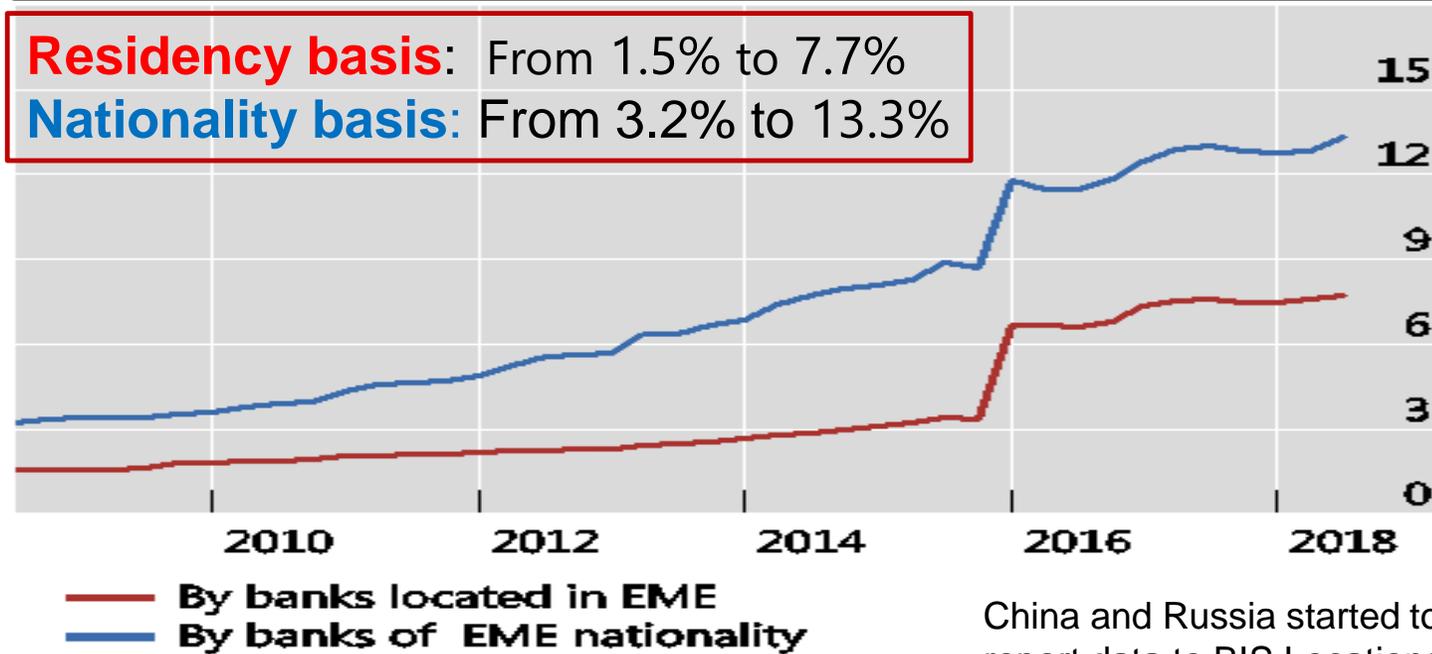
III) Policy conclusions

Q6: Do EM banks play a significant role?

- Increasing role of EM banks in the international banking system
- Chinese banks represent 64% of total EM bank-to-EMDE borrower activity

Cross-border claims by EME reporters

Share in % of total (excl. BH, BS and JE)

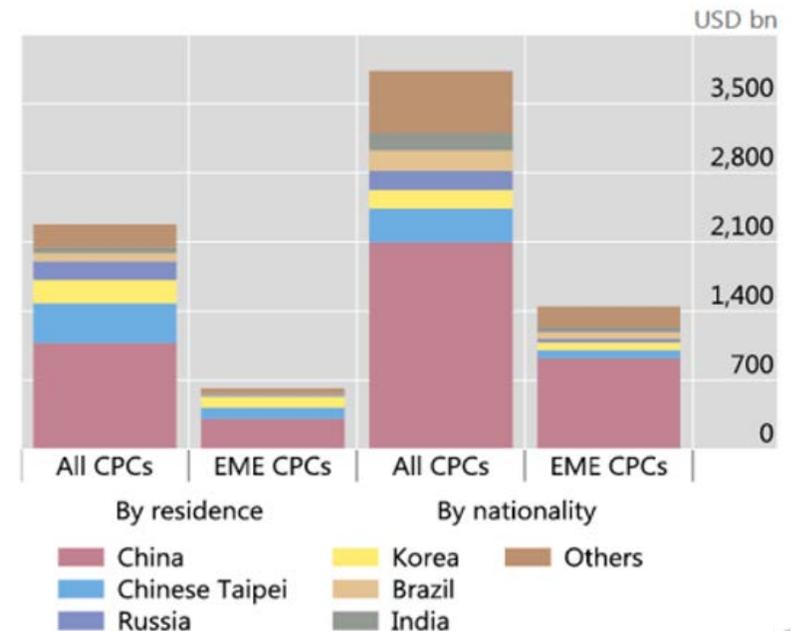


China and Russia started to report data to BIS Locational Statistics from 2015Q4

BIS Cross-border bank claims

As of end-June 2018

Amount outstanding, by EME lender¹



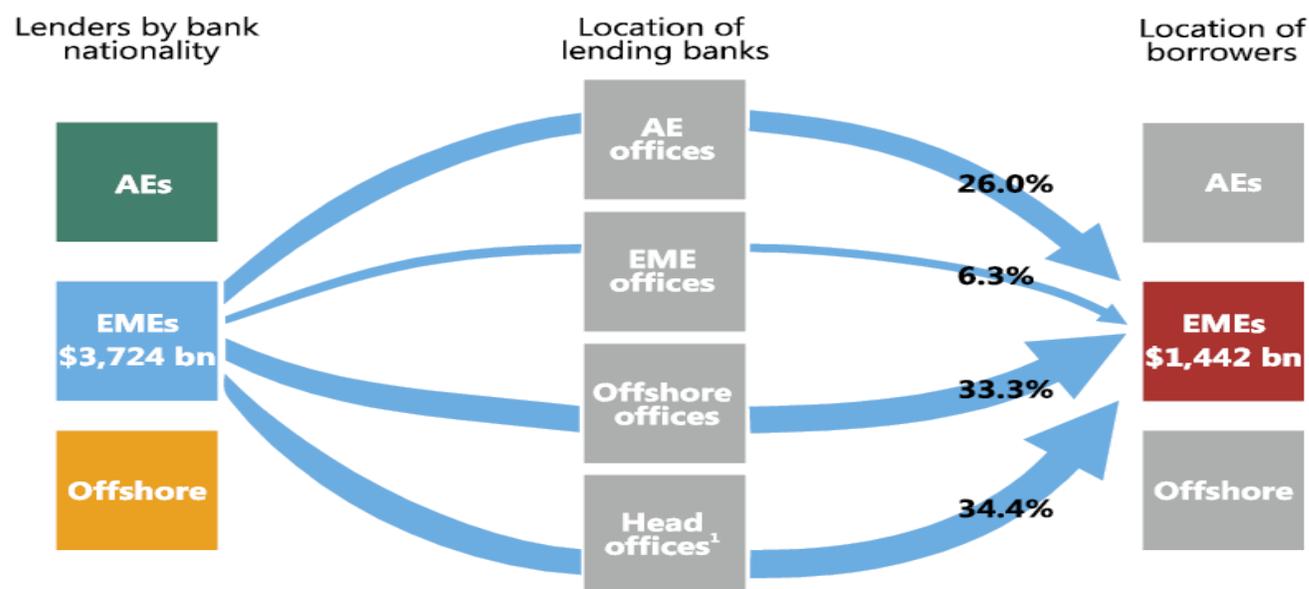
Q7: How do EM banks lend to EMDEs?

- EM banks book the majority of their cross-border lending to EMDEs at their foreign affiliates.
- This is not followed by AE bank peers, or EM bank lending to AE borrowers.

Cross-border lending to EMEs by EME banks

By nationality of lender, as of end-June 2018

Graph 2



As of end-June 2018, EME banks held cross-border claims worth \$3.7 trillion vis-à-vis all borrowers, extended from all their offices in BIS reporting countries. Of that total, \$1.4 trillion had been provided to borrowers in EMEs. The blue arrows indicate the split of this total intra-EME lending by location of loan originator. For instance, 33% of these claims held by EME lender banks on EME borrowers have been extended from their offices in offshore centres as reported by BIS member countries.

¹ Refers to the reporting offices of a bank headquartered in the respective home country.

Source: BIS locational banking statistics (by nationality).

Source: Cerutti, Koch and Pradhan (2018, December 2018 BIS Quarterly Review)

Q8: How important is EM bank lending for EMDEs?

- EM banks are the major providers of cross-border credit to non-bank EMDE borrowers in Asia and Africa

Relative importance of EME lender banks for EME non-bank borrowers¹

By region of borrower in counterparty country, as of end-June 2018

Table 2

Borrowing region ²	Share of borrowing counterparty countries ³ (as % of number of countries in respective region)		
	EME credit >25%	EME credit >50%	EME credit >75%
Europe	56.3	18.8	6.3
Latin America and Caribbean	55.6	18.5	3.7
Africa and Middle East	63.5	49.2	23.8
Asia-Pacific	74.4	53.8	33.3

¹ Banks with controlling parents in EME countries. ² Numbers of counterparty countries included in each counterparty group: 16 for emerging Europe; 26 for Latin America and the Caribbean; 60 for Africa and the Middle East; and 36 for Asia-Pacific. ³ Individual counterparty countries in different regions borrow from different bank nationalities (advanced, emerging and offshore). Taking, as an example, the 16 counterparty countries in emerging Europe (all sectors, all currencies): 56.3% of these borrower countries (ie nine out of 16 countries in the region) receive more than 25% of their total credit from EME banks, and 18.8% (or three out of 16 countries) receive more than 50% of their total credit from EME banks.

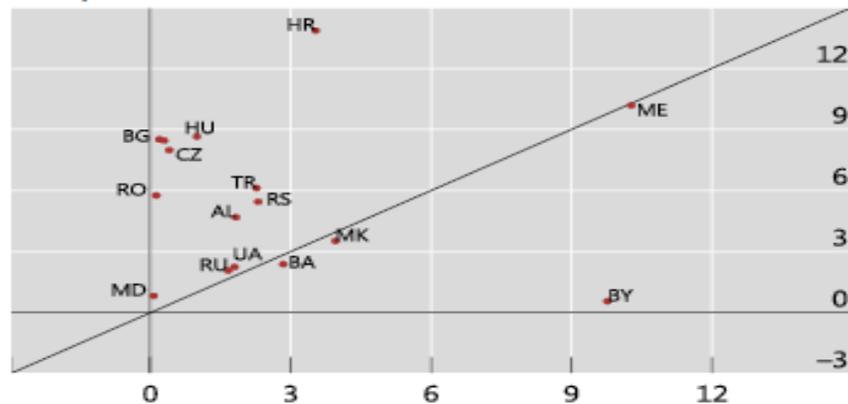
Sources: BIS locational banking statistics by nationality; authors' calculations.

Cross-border claims, in all currencies on the non-bank sector, by borrower region

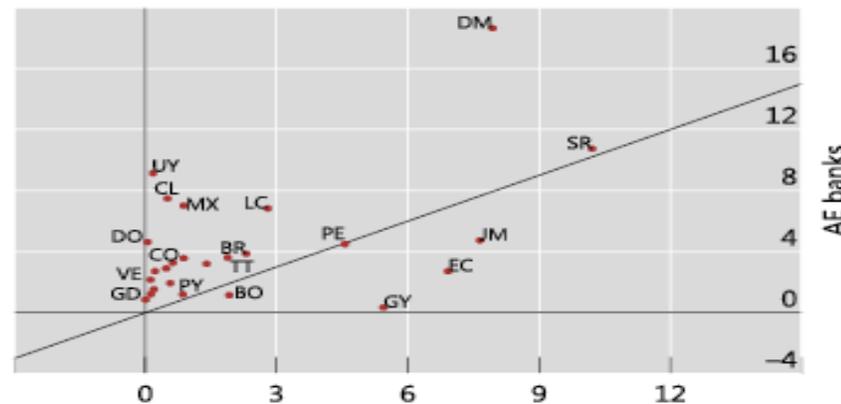
By nationality of lending bank, as of end-2017; as a percentage of GDP

Graph 4

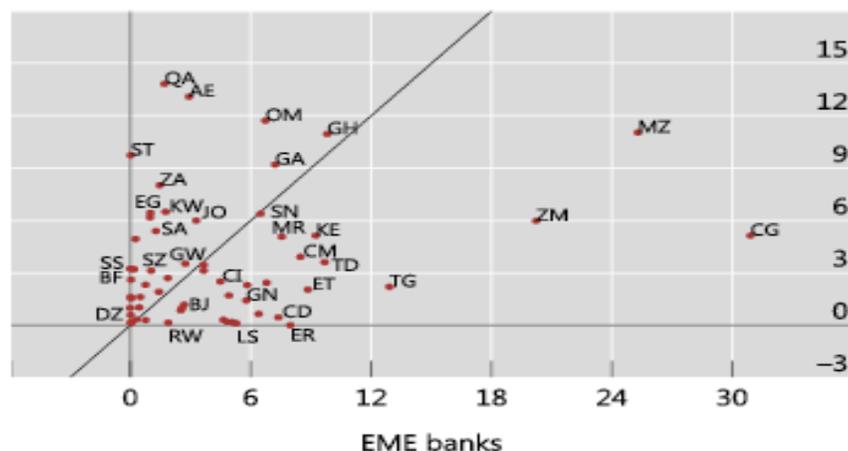
Europe



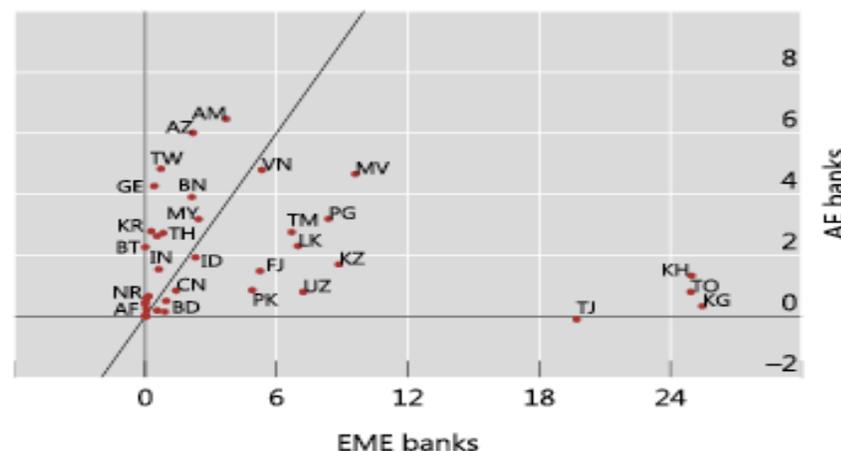
Latin America and Caribbean¹



Africa and Middle East²



Asia-Pacific³



EMDE countries borrowing more than 25% of their GDP from EM banks are:

- Djibouti (58%)
- Laos (45%)
- Congo (31%)
- Mozambique (25%)
- Cambodia (25%)
- Kyrgyz Republic (25%)
- Tonga (25%)

The dots denote the total of cross-border claims on the non-bank sector as a share of the counterparty country's GDP that is borrowed from EME banks (horizontal axis) and AE banks (vertical axis), respectively.

¹ Excludes Belize (6, 83) and St Vincent and the Grenadines (1, 81). ² Excludes Cabo Verde (4, 44), Djibouti (58, 1), Liberia (53, 631) and the Seychelles (38, 89). ³ Excludes Laos (45, 2), the Marshall Islands (3,405, 13,987) and Mongolia (9, 19).

Sources: IMF, *World Economic Outlook*, October 2018; BIS locational banking statistics (by nationality).

Conclusions

- Summary of key findings:

- Disaggregated BOP data is important to better understand capital inflows to EMs
- Interlinkages among EMDEs have grown rapidly in recent years and have given rise to extensive interdependencies

- Policy implications:

- A better understanding of the relative differences in the impact of the GFCy into quantities (e.g., capital flows) and prices (e.g., asset prices), as well as the transmission channels (e.g. investor base) is necessary before reaching final policy conclusions on the potential reach of, and remedies to, the GFCy
- Even though the growing footprint of EM banks has lessened EMDEs' dependence on AE banks, EM banks are now new sources of contagion and propagator of stress