EM Capital Flows

Another Taper Tantrum?

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Outline

Drivers of EM capital flows

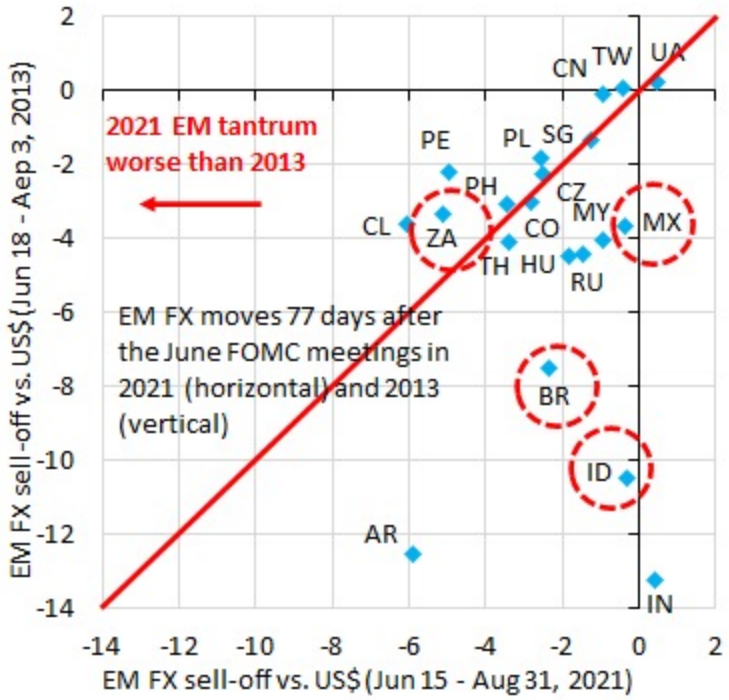
- We distinguish push versus pull factors.
- Push factors have been dominant in recent years.
- Fed QE tapering is a powerful “reverse” push factor.

Initial conditions: 2013 vs 2021

- EM outflows were very substantial in 2020.
- Currencies fell amid modest FX intervention.
- COVID-19 “stress test” was successfully passed.
- External financing gaps and REER levels look better.

Tantrum Risk

- US fiscal stimulus is a force for US yields higher.
- A 2021 taper tantrum hasn’t remotely begun.



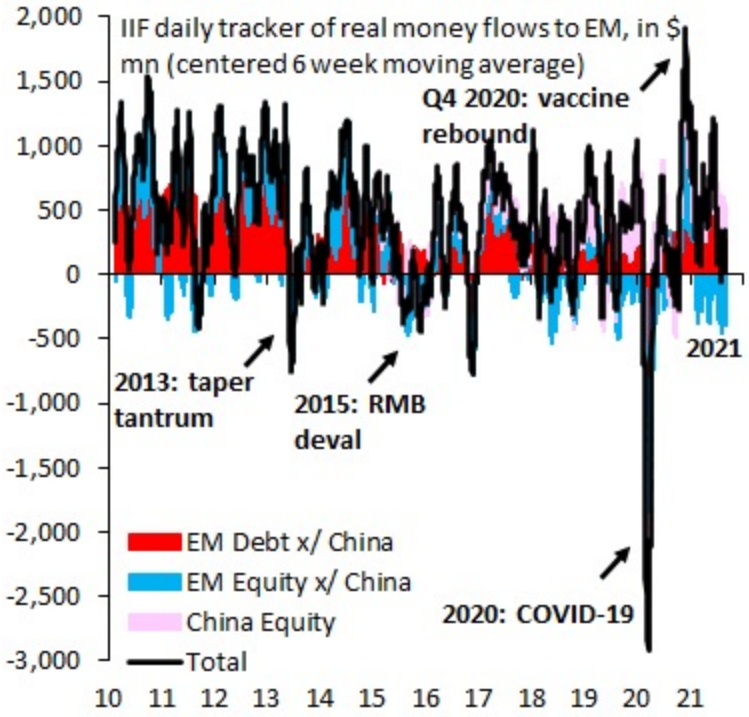
Capital Flows

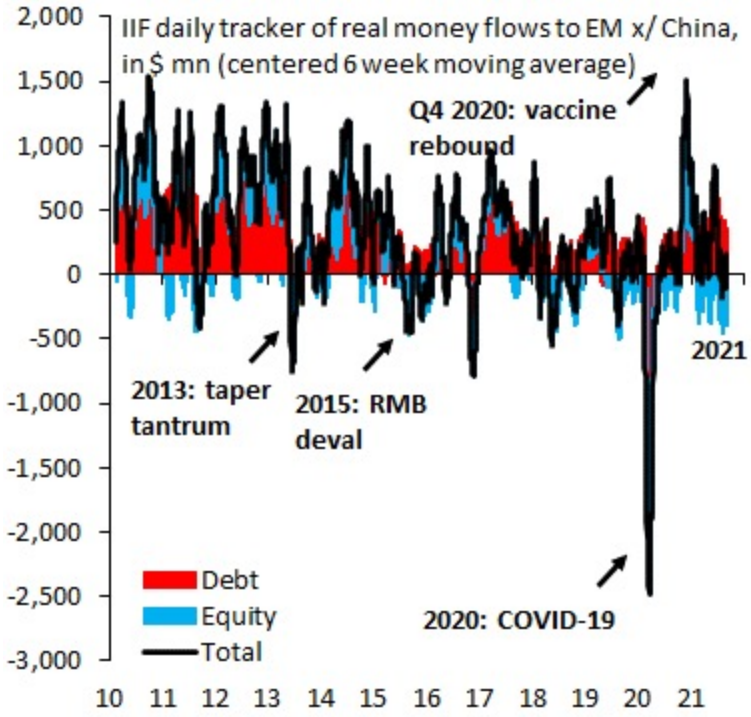
- Academic literature distinguishes between external *"push"* factors and domestic *"pull"* factors.

Push factors	Pull factors
• Risk appetite in markets • Federal Reserve policy • Global activity picture • Commodity prices • Past performance	• Macro fundamentals • Asset market performance • Investor positioning • Risk premia • FX regime
Factors that drive capital flows to EM & push investors to change exposure	*Factors that attract foreign investors to EM & depend on country characteristics*

Capital Flows

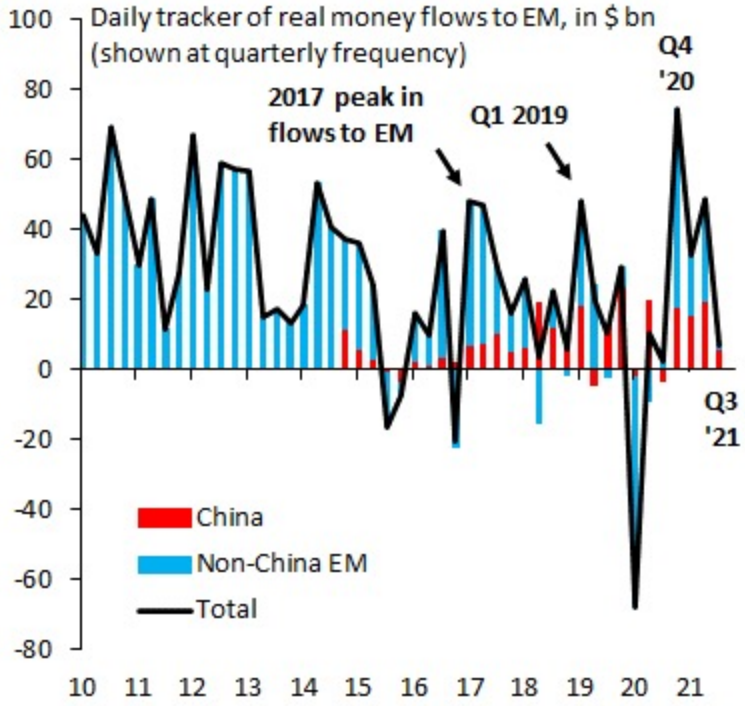
- We track daily flows to 14 emerging markets.
- Flows to non-China EM have gone slightly negative.

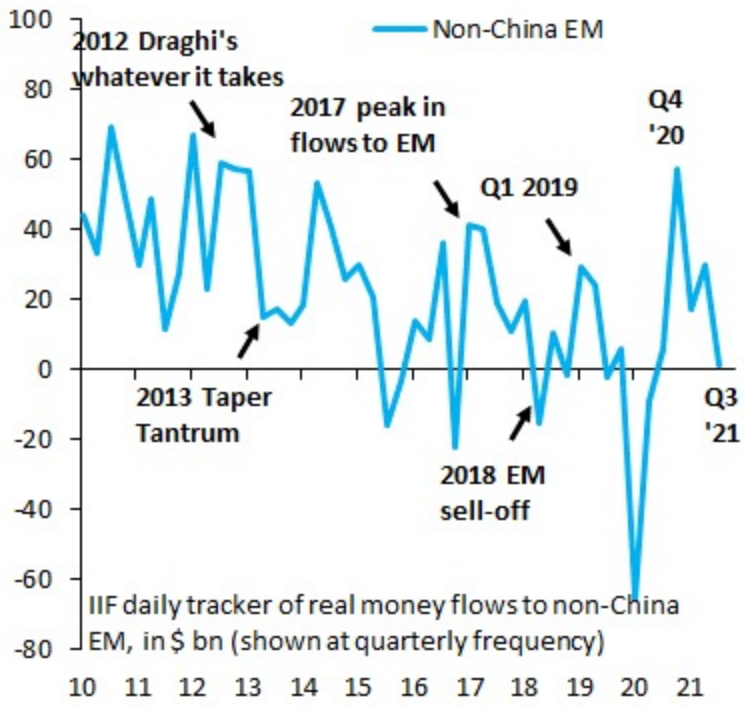




Capital Flows

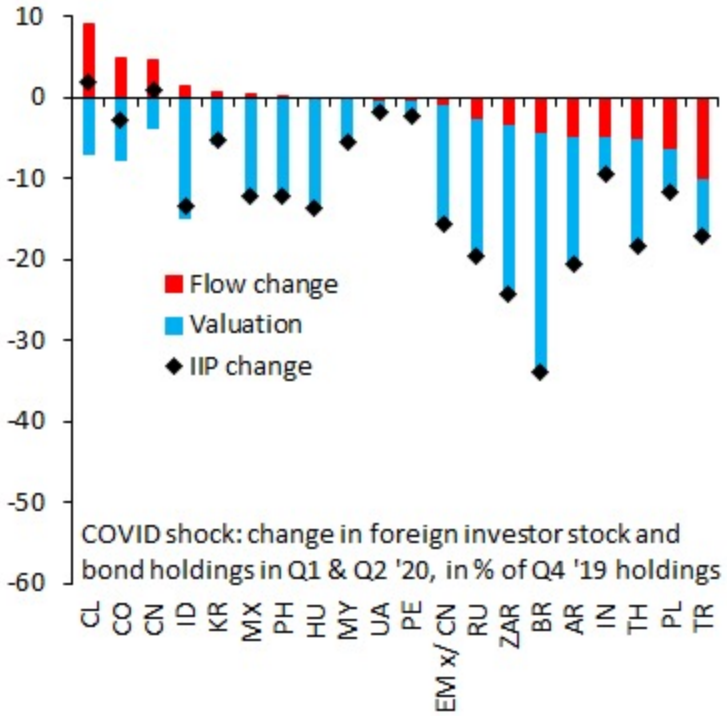
- Flows to non-China EM have trended lower for many years.
- This coincides with gradual financial opening by China.

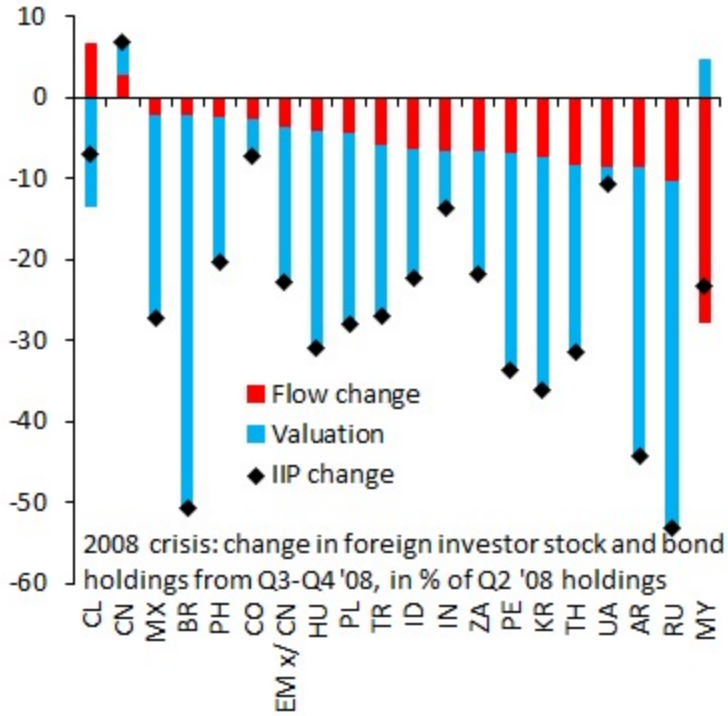




Initial Conditions: 2013 vs 2021

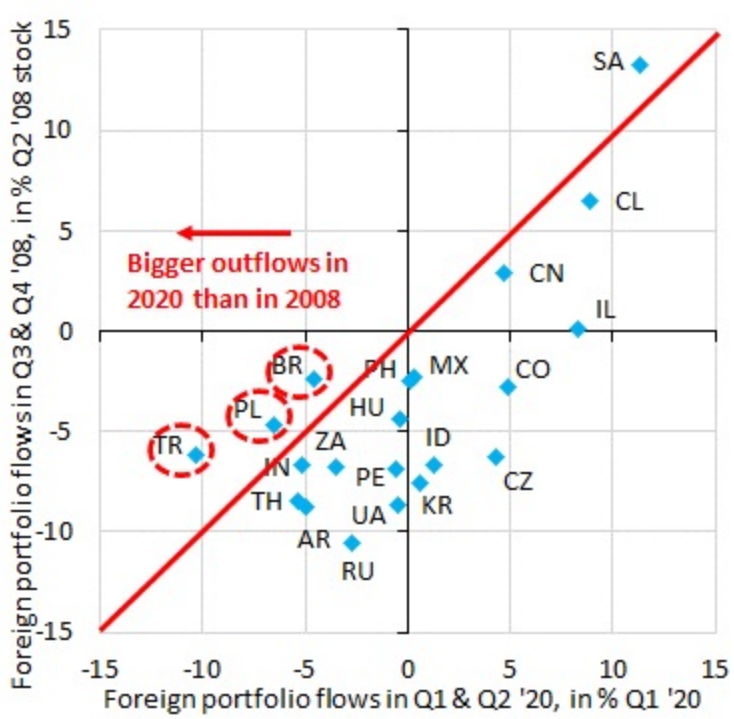
- We scale flows by the stock of foreign holdings from the IIP.
- This allows us to compare Q1 & Q2 2020 to Q3 & Q4 2008.

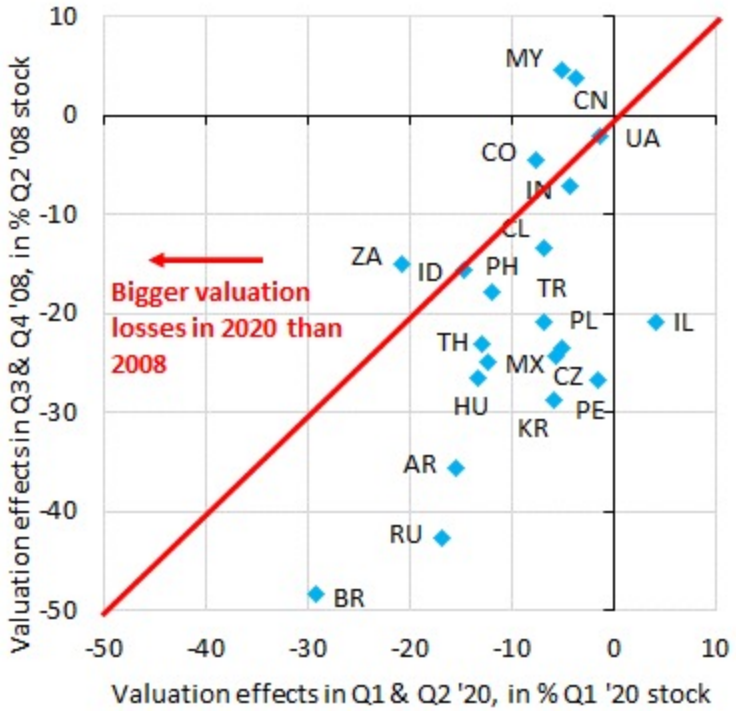




Initial Conditions: 2013 vs 2021

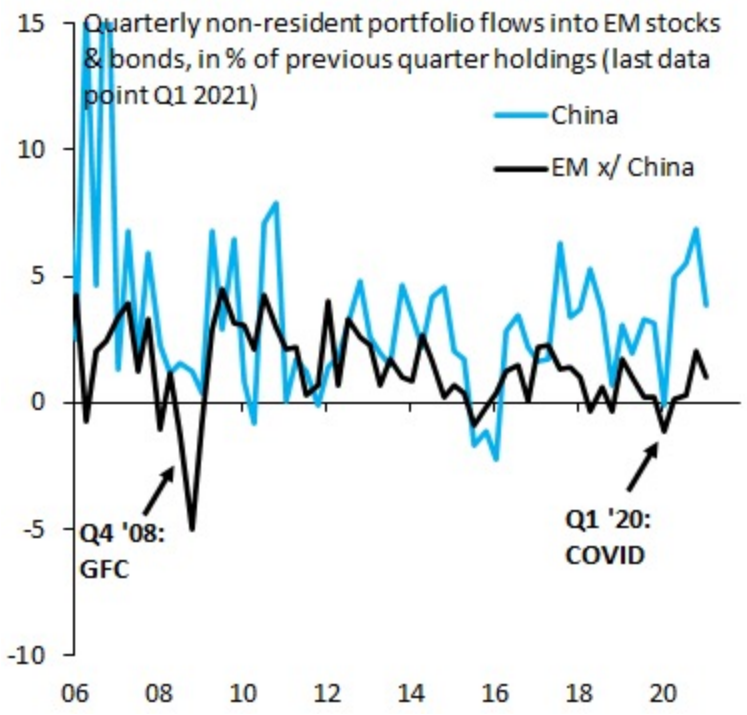
- Outflows were 4% of assets in 2008 versus 1% in 2020.
- Turkey, Poland and Brazil were hit harder than in 2008.

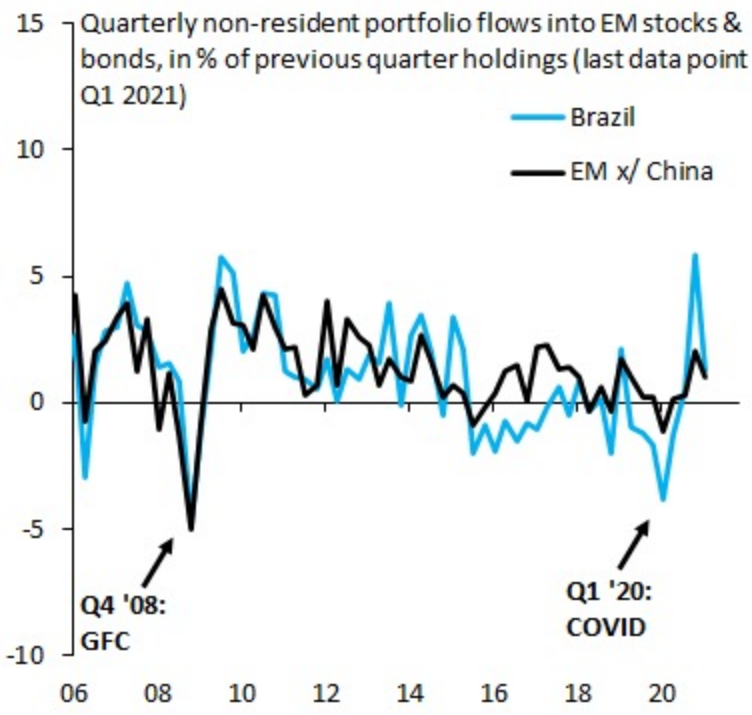




Initial Conditions: 2013 vs 2021

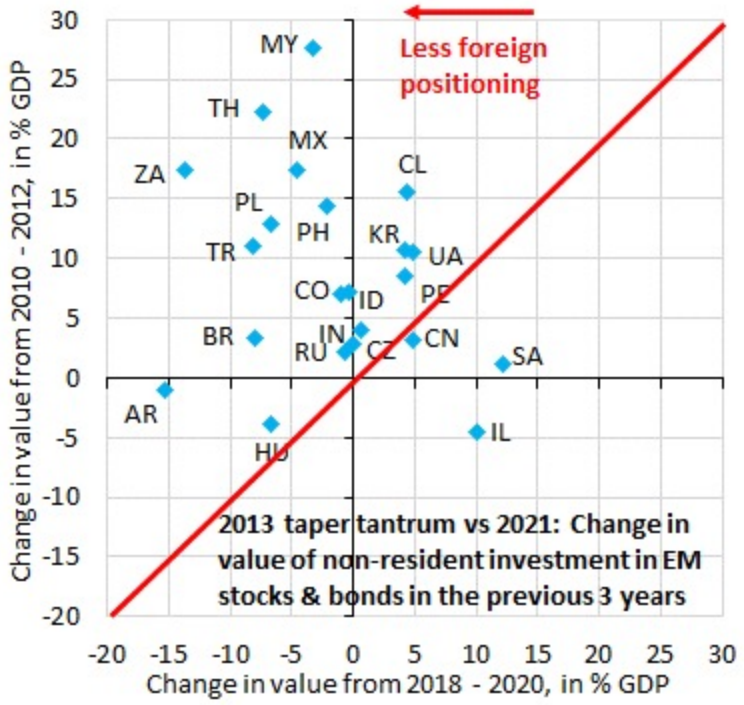
- China is a big drag on the rest of EM.
- Its financial opening is diverting capital away from others.

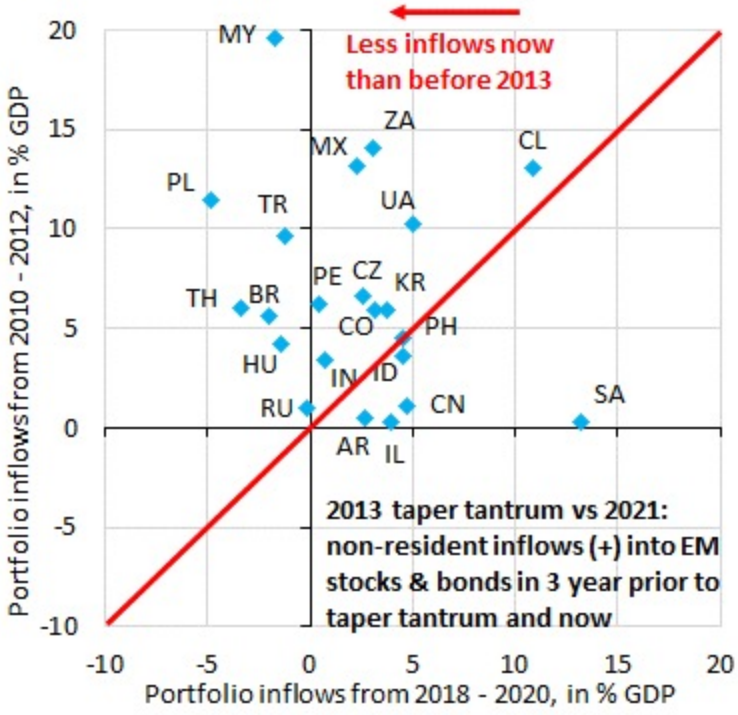




Initial Conditions: 2013 vs 2021

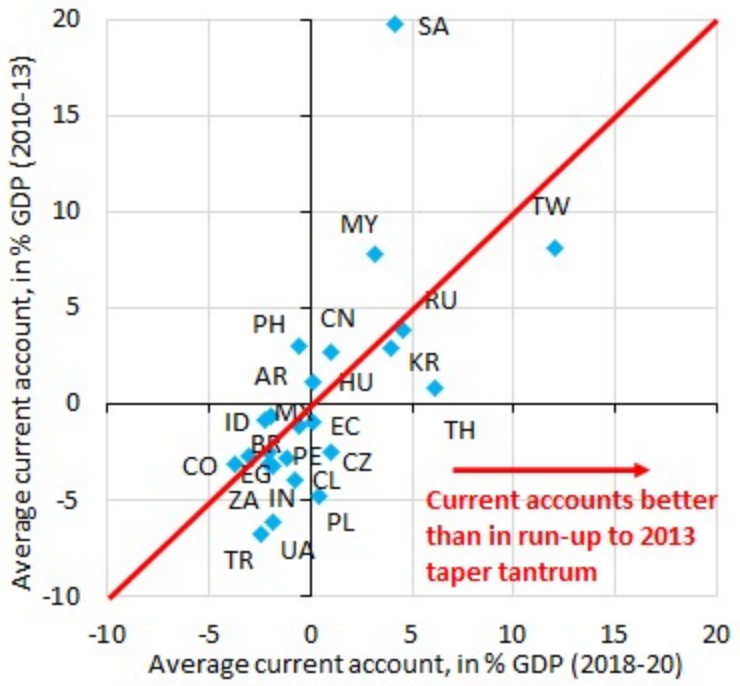
- Look at rise in positioning and inflows ahead of 2013 vs now.
- With exception of China & Saudi, inflows are now much less.

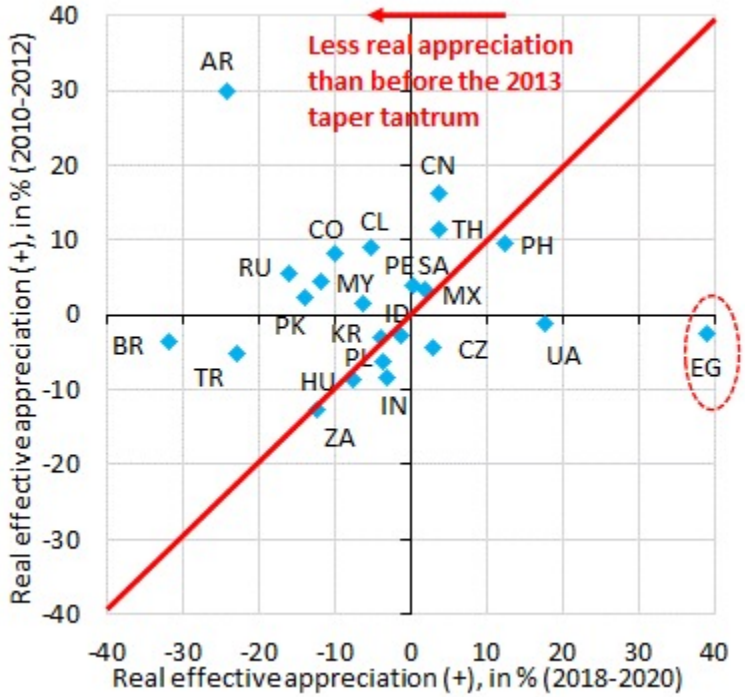




Initial Conditions: 2013 vs 2021

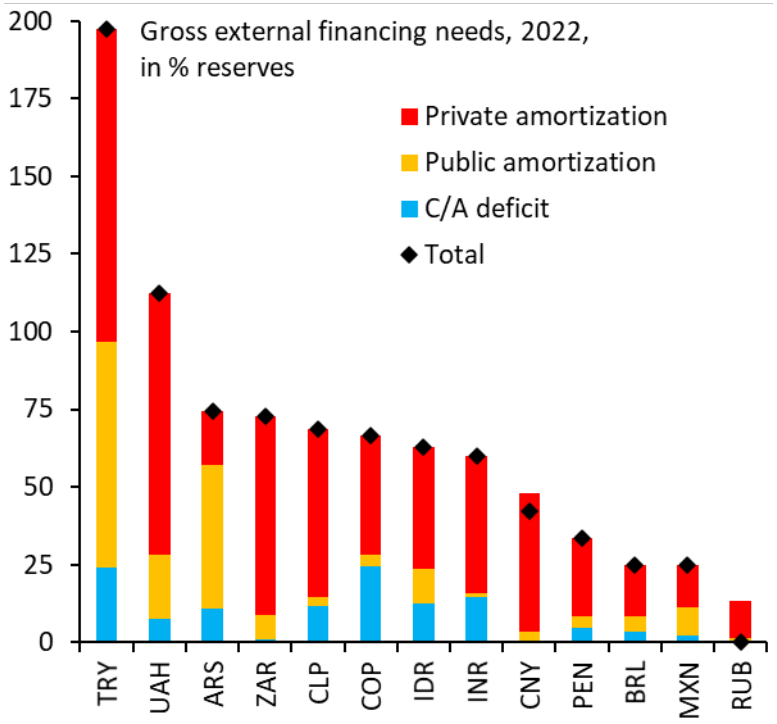
- Initial conditions are more favorable now than 2013.
- Current accounts are healthier and REER levels are better.

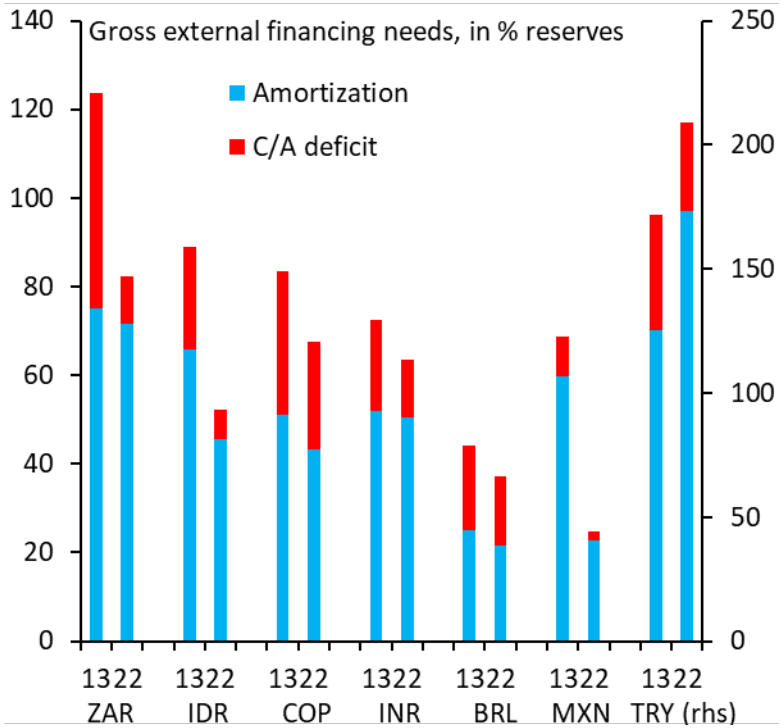




Initial Conditions: 2013 vs 2021

- External financing needs are smaller than in 2013.
- Foreign exchange reserve buffers are generally good.





Tantrum Risk

- The goal of tapering is to lift longer-term real rates.
- If that doesn't work, the Fed will need to hike sooner.