IIF Capital Flows Tracker
Looking Through the Turbulence

June 4, 2018

Emre Tiftik, Deputy Director, etiftik@iif.com, +1 202 857 3321
Scott Farnham, Senior Analyst, sfarnham@iif.com, +1 202 857 3653
Sonja Gibbs, Senior Director, sgibbs@iif.com, +1 202 857 3325

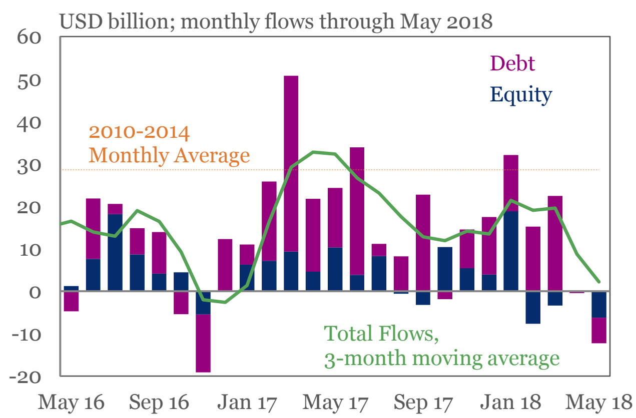
- Non-resident portfolio outflows from emerging markets accelerated to $12.3 billion in May from $0.3 billion in April
- EM debt and equity markets saw evenly split portfolio outflows of around $6 billion, led by outflows from EM Asia
- However, our broader measure of net capital flows[1] to EMs remained robust at around $32 billion in April
- China, Turkey and Mexico saw the largest net inflows in April, while flows to Argentina and India turned negative
- Key downside risk: a 10% USD appreciation would cut annual net capital inflows to emerging markets by some $95 billion

EM portfolio outflows accelerated in May

We estimate that emerging markets saw net non-resident portfolio outflows[1] of $12.3 billion in May, split evenly between debt and equity markets (Chart 1). This cuts year-to-date portfolio flows to some $46 billion—a sharp slowdown from $134 billion during the same period in 2017. Regionally, outflows in May were concentrated in EM Asia (-$8.0 bn) and Africa/Middle East (-$4.7 bn). Our daily flows dataset shows that outflows persisted throughout May, as the Flows Alert triggered by outflows at end-April is still in effect. This marks the second longest Alert we have on record following the seven-week period of outflows after the U.S. election in November 2016.

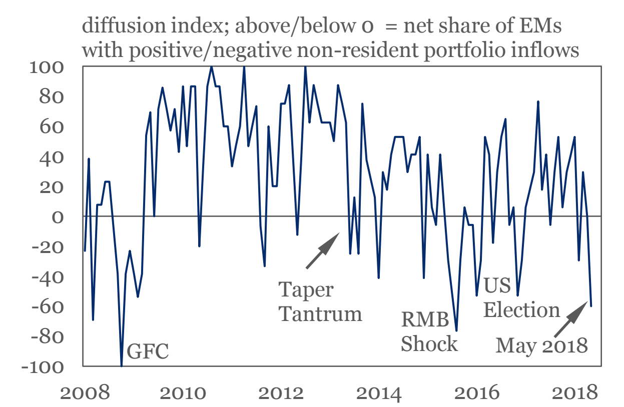
No single driver of outflows from EM assets stands out. Instead, a combination of factors appears to be at work: idiosyncratic domestic strains such as funding pressures in Argentina and Turkey or the truckers' strike in Brazil (which has underscored the government's challenges in implementing reforms); renewed U.S. tariff threats and retaliatory actions; and political uncertainty in Italy and Spain (which implies more risk of upward pressure on the USD—see our latest Weekly Insight). Moreover, against a backdrop of higher U.S. yields and a stronger dollar, a monthly diffusion index of flows to countries in our sample shows a recent broadening of outflows, suggesting that the risk-off environment is affecting a greater range of EM countries (Chart 2). However, as noted in our latest Capital Flows Report, there are reasons to look beyond the recent turmoil, despite the more challenging landscape. The outlook for EM growth—led by a resilient China—remains strong. Valuations have also become more attractive as asset prices come down; on the equity side, rising earnings estimates have pushed EM forward P/E ratios to their cheapest since early 2016. Moreover, while medium-term forecasts for global rates remain deeply divided, the drop in U.S. 10yr bond yields since mid-May should provide more solid footing for EM portfolio debt and equity inflows in the near term.

Chart 1: Net non-resident portfolio inflows to EMs



Source: National sources, IIF

Chart 2: Portfolio outflows seen across more EMs



Source: IIF. Partial data through May 2018

[1]Non-resident portfolio flows are a subsection of overall net capital flows, which include all types of flows from both residents and non-residents covering portfolio flows, banking flows, direct investment, and other components of the financial account in a nation's balance of payments. Portfolio flows, while similar, should not be confused with fund flows.

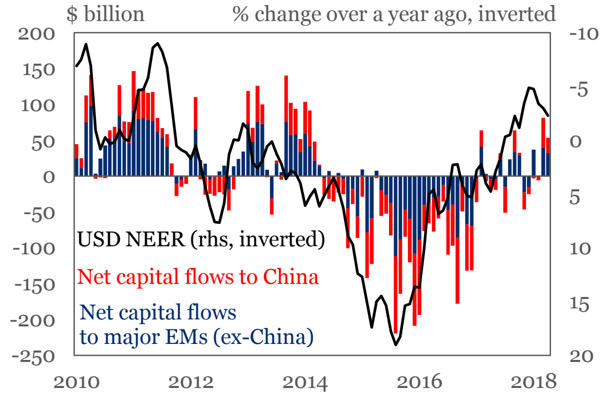
Net capital inflows held up well in April

Despite increased volatility in non-resident portfolio flows this year, our broader measure of capital flows[1] still suggests solid investor appetite for emerging markets through April. We estimate that EM net capital flows came in at $32 billion in April—well above the average inflows of $7 billion per month in 2017. This brings net capital inflows to some $110 billion for the first four months of 2018–vs. just $37 billion during the same period in 2017. This divergence between portfolio flows and net capital flows suggests that *non-portfolio* flows have been particularly strong this year, largely offsetting the negative impact of the sharp retrenchment in portfolio debt flows.

Although the stronger U.S. dollar has raised concerns about a potential slowdown in net capital flows, the USD has gained only about 1.5% on a trade weighted basis year to date—an important factor behind the resilience in net capital inflows to EMs in recent months. Looking ahead, much will depend on how the global trade landscape evolves, as an escalation in tensions could well boost demand for USD-denominated assets. While the projected deterioration in U.S. twin deficits should limit further USD strength, our estimates suggest that a 10% appreciation in the trade-weighted U.S. dollar would slash annual net capital inflows to emerging markets by some $95 billion.

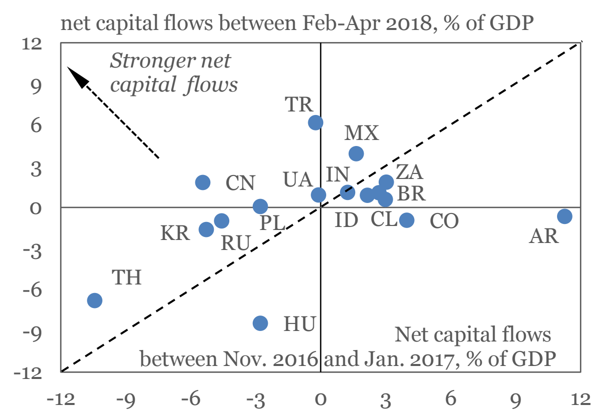
Compared to previous stress episodes, China's resilience to swings in global risk sentiment has been an important factor supporting broader flows to emerging markets (Chart 4). China saw more than $21 billion of net inflows in April, bringing total inflows to over $53 billion this year. This reflects both stricter enforcement of capital controls and improved investor appetite against the backdrop of declining corporate sector indebtedness in China. Net flows to Turkey amounted to some $10 billion in April. At $8 billion, net flows to Mexico were at their highest pace since January 2015, though flows to Brazil were muted. In sharp contrast, flows to Argentina and India turned negative for the first time since May 2017 and February 2016, respectively.

Chart 3: Strong net capital flows to EMs through April



*Source: IIF; *Major EMs include Argentina, Brazil, Chile, Colombia, Czechia, Hungary, India, Indonesia, Korea, Mexico, Poland, Russia, South Africa, Thailand, Turkey and Ukraine*

Chart 4: Net capital flows: this time has been different



Source: IIF

Table 1: Net Capital Flows* (including E&O)

$ billion	*Argentina*	*Brazil*	*Chile*	*China*	*Colombia*	*Czech Rep.*	*Hungary*	*India*	*Indonesia*	*Korea*	*Mexico*	*Poland*	*Russia*	*S. Africa*	*Thailand*	*Turkey*	*Ukraine*
2017H1	*22.4*	*8.1*	*0.0*	*-39.2*	*6.6*	*45.3*	*-6.2*	*37.1*	*12.2*	*-34.7*	*8.4*	*-9.6*	*-5.5*	*3.2*	*-12.7*	*18.9*	*2.2*
2017H2	*23.1*	*6.4*	*1.3*	*-34.1*	*5.1*	*0.0*	*-3.1*	*39.6*	*16.8*	*-39.4*	*8.4*	*-6.3*	*-7.0*	*7.3*	*-9.4*	*20.3*	*2.6*
Feb. 2018	*1.2*	*2.9*	*-0.1*	*-5.9*	*-0.1*	*0.1*	*-2.3*	*2.8*	*-0.6*	*-3.8*	*2.6*	*0.8*	*2.9*	*0.9*	*-5.5*	*4.3*	*-0.2*
Mar. 2018	*1.1*	*1.0*	*-0.1*	*41.2*	*-0.6*	*-1.1*	*0.0*	*6.0*	*-1.1*	*-4.0*	*1.0*	*3.8*	*-4.7*	*-0.1*	*-2.8*	*0.0*	*0.4*
Apr. 2018	*-3.3*	*1.4*	*0.7*	*21.3*	*-0.1*	*-2.4*	*-1.1*	*-1.2*	*3.9*	*1.3*	*8.2*	*-4.6*	*-2.6*	*0.8*	*-0.5*	*10.2*	*0.1*
Jan-Apr. (2018)	*6.6*	*10.4*	*-0.2*	*53.4*	*-1.6*	*-5.3*	*-4.7*	*20.4*	*5.5*	*-7.8*	*17.2*	*-1.6*	*-7.9*	*3.9*	*-5.0*	*25.8*	*-0.3*
Memo:																	
Jan-Apr. (2017)	*18.2*	*11.1*	*-0.1*	*-32.2*	*5.1*	*42.9*	*-2.6*	*16.6*	*9.4*	*-22.3*	*9.5*	*-10.5*	*-8.7*	*2.1*	*-7.8*	*4.3*	*1.6*
2017	*45.5*	*14.5*	*1.3*	*-73.3*	*11.6*	*45.3*	*-9.3*	*76.7*	*29.0*	*-74.1*	*16.8*	*-15.9*	*-12.5*	*10.5*	*-22.0*	*39.1*	*4.8*
IIF 2018 forecast	*41.9*	*41.1*	*7.7*	*-76.1*	*13.7*	*9.3*	*-9.6*	*40.4*	*20.5*	*-77*	*15.2*	*4*	*-36.4*	*12.9*	*-22.6*	*51.3*	*6*

*Source: IIF. *Net capital flows = financial account balance excluding reserves*