Capital Flows to Emerging Markets

Alvaro Ortiz Vidal-Abarca, PhD
Turkey and Big Data Chief Economist
BBVA Research

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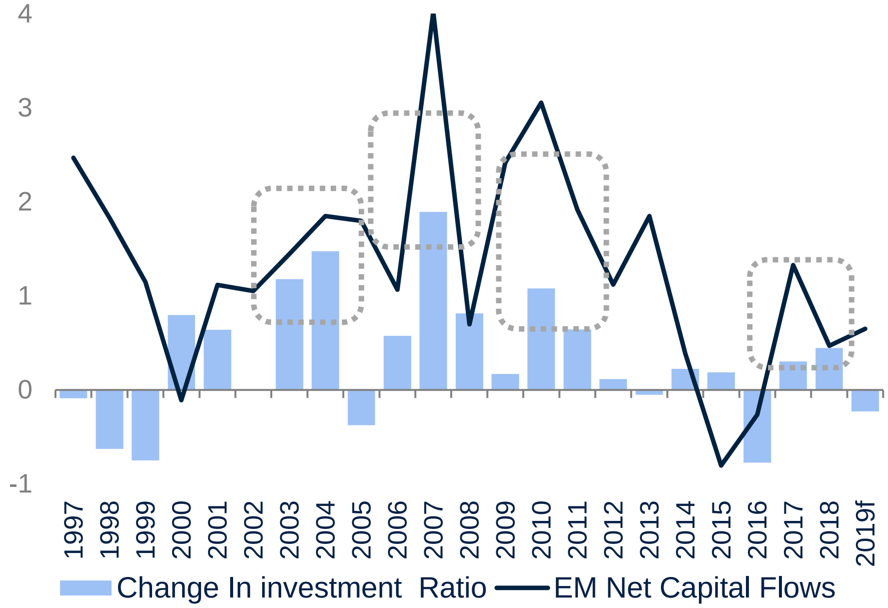
The Capital Flows "Booms" to Emerging Markets (EMs) are normally associated to positive consequences…

NET CAPITAL FLOWS & CHANGE IN INVESTMENT IN EMS
(% GDP)

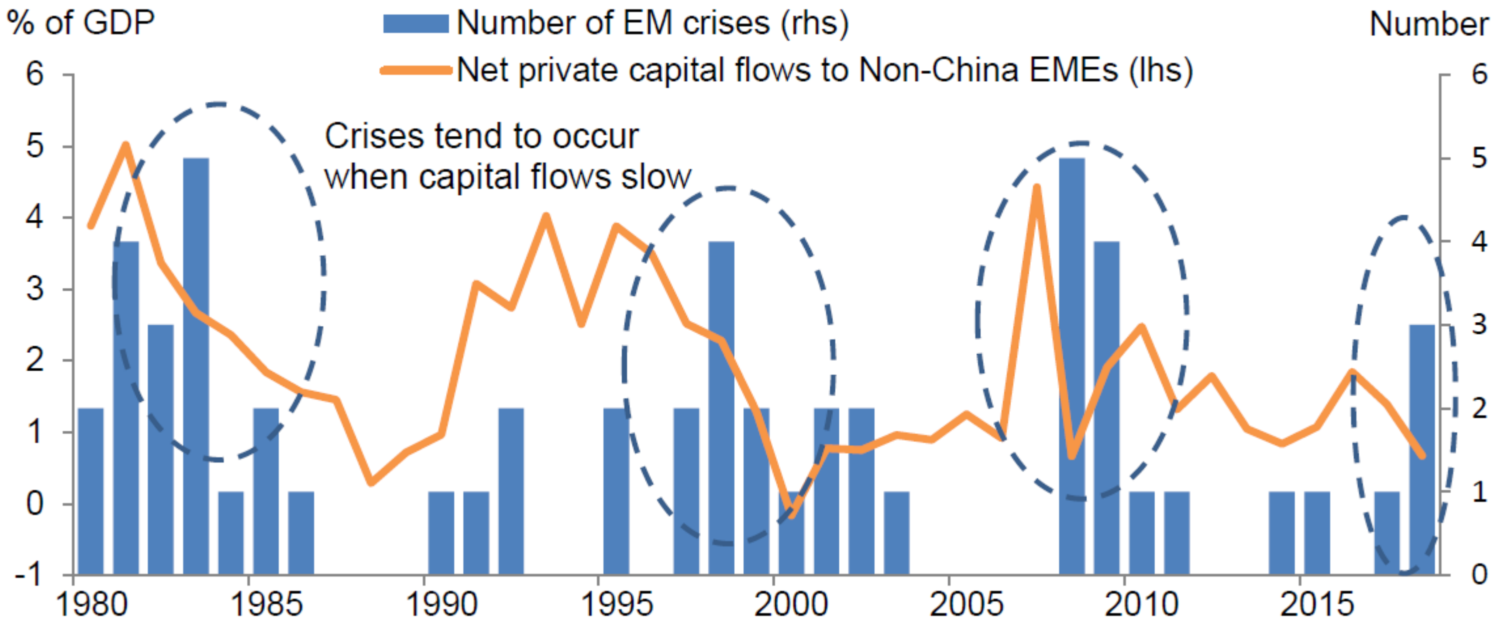


Source: IMF

- Increase in Aggregate Demand…
- Lower levels of unemployment
- Boost in financial assets
- Real exchange rate appreciation
- And in some cases increase in productivity and potential growth

… But unfortunately can have perverse effects when they slow down or suddenly stop…

NET CAPITA FLOWS EX CHINA & CRISIS IN EMs
(% GDP)



Source: Carney (2019) Jackson Hole Symposium 2019

A simple model of "Pull & Push" factors can be useful to understand the driver behind the capital flows to EMs in the past & the future…

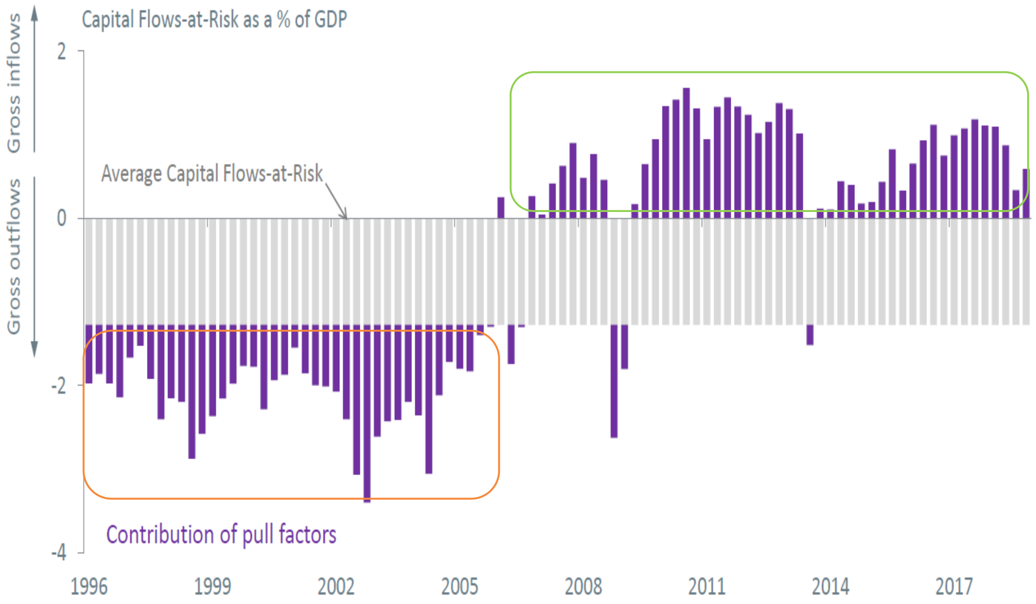
DETERMINANT OF CAPITAL FLOWS: "PULL", "PUSH" AND "STRUCTURAL" FACTORS

Push & Pull	Global "Push"	Structural
Growth Differential Interest Differential	Commodity prices Global Risk Aversion Global Liquidity	Population Trade Openness FX Regime Institutional quality Doing Business Capital openness Financial development

Source: Hannah (2017) and BBVA Research

The “Pull Factors” improved dramatically since the last EM crisis as most of the EMs did their “homework” and the strategy did "pay-off"

CAPITAL FLOWS TO EMERGING MARKETS: ROLE OF PULL FACTORS

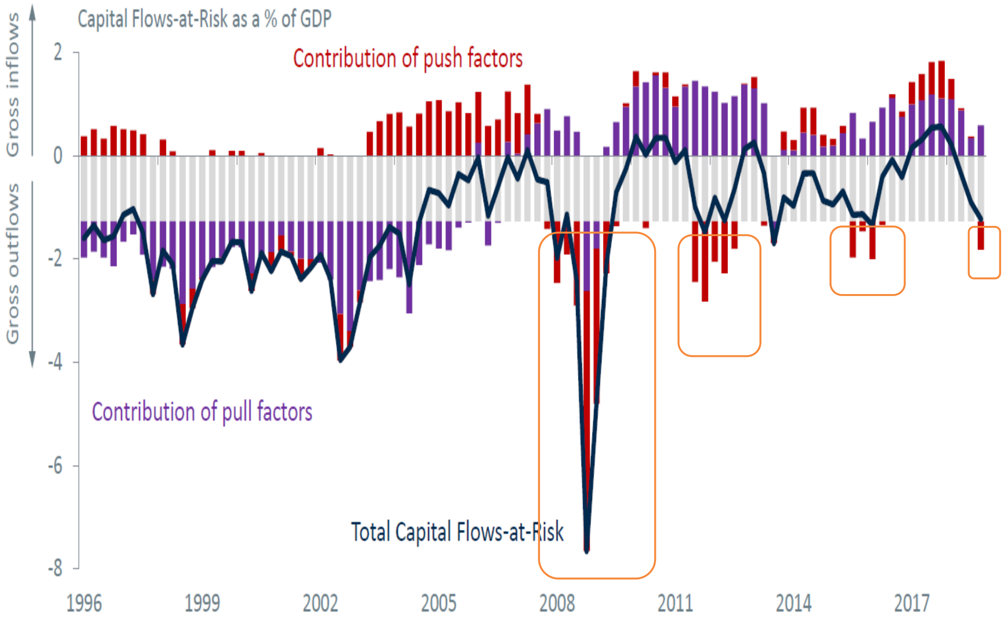


Source: Bank of England

- Inflation targeting regimes abated hyperinflation
- Fiscal Sustainability replaced fiscal frugality
- Flexible Exchange rates provided flexibility to absorb shocks
- FX denominated debt by households was reduced (but not in Corporates!!!) reducing the “fear of floating”

But global "Push" factors have revealed as an important destabilizing factor since the Global Financial Crisis…

CAPITAL FLOWS TO EM: NEGATIVE PUSH FACTORS INCREASE

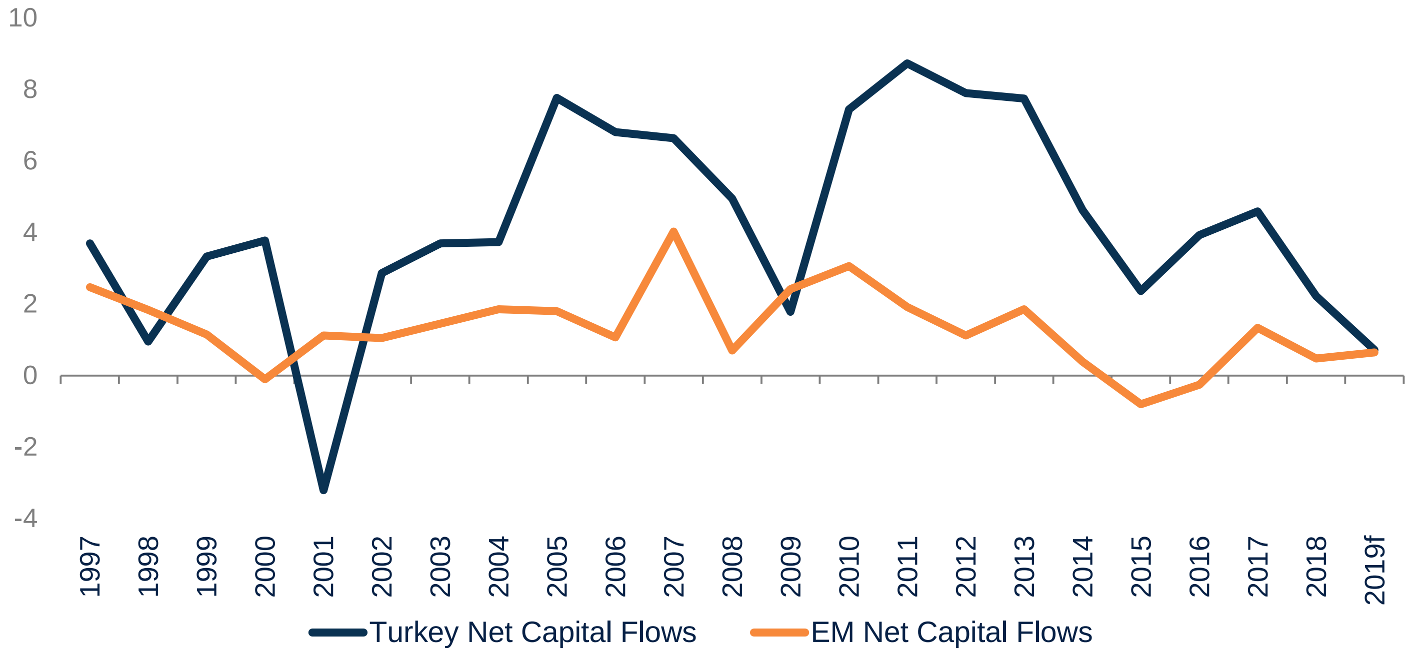


Source: Bank of England

- The Economic Rebalancing has not matched by a Financial Transition
- The US Dollar Dominance is well alive
- The Global Financial Crisis (and the policy responses) have increased the Volatility of Hot Flows…
- …and the periodicity of Risk On-Off periods..
- Global safety net has diminish notably

In the case of Turkey, Net Capital Flows have been higher and more volatile than the rest of EMs during most of the last two decades…

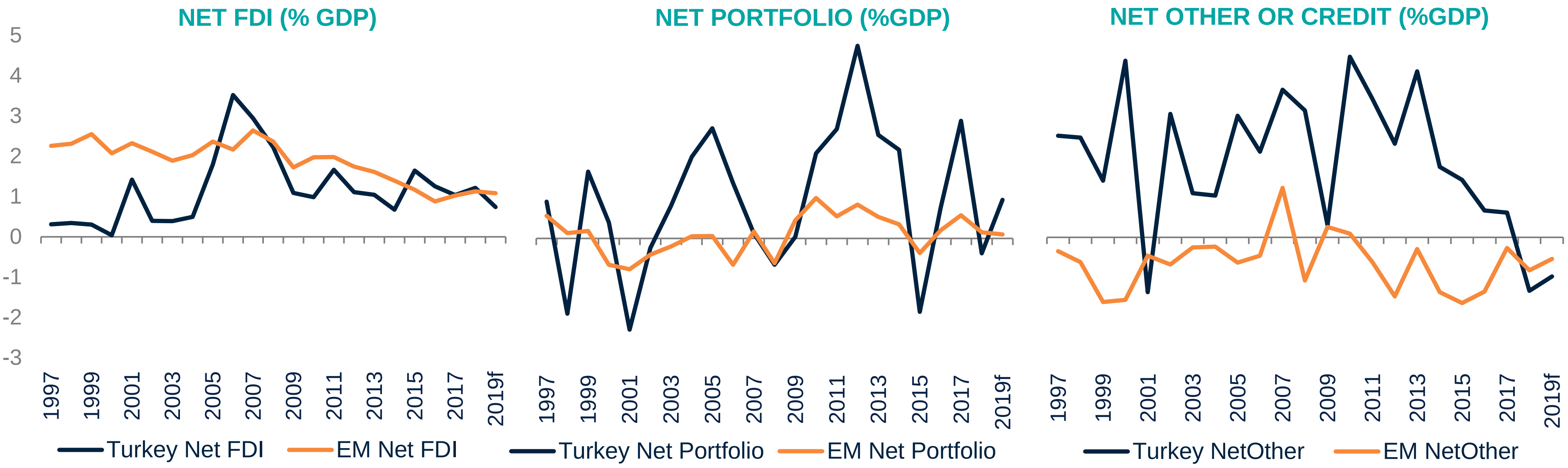
NET CAPITAL FLOWS TO EMERGING MARKETS AND TURKEY
(% OF GDP)



Source: IMF, IIF and BBVA Research

… However, there are important differences between FDI (moderating), portfolio (high volatility) and credit flows (high & volatile)…

CAPITAL FLOWS TO EMERGING MARKETS AND TURKEY (% GDP)



Source: IMF and IIF

Reforms paid-off but a new round is needed…

…Volatility in Portfolio is Twice higher ..

… high dependence of external credit…

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What to expect for Capital Flows next year ?

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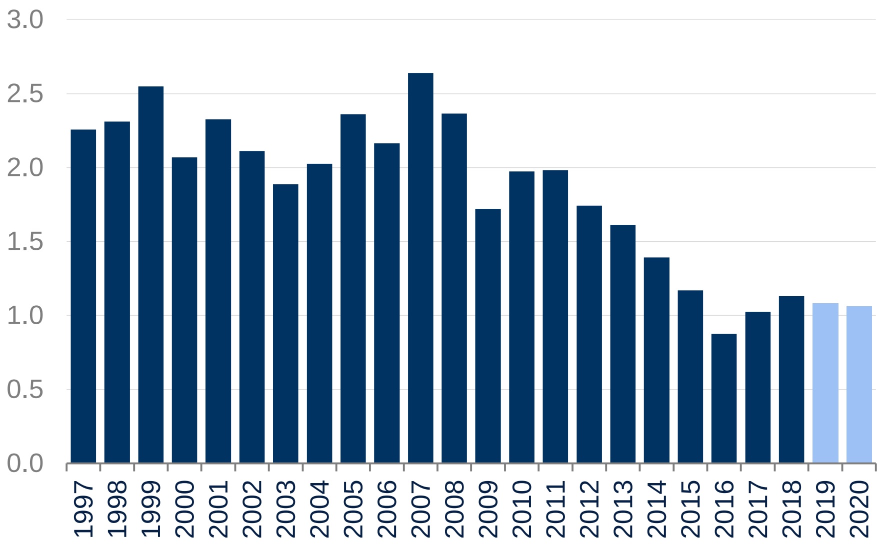
FDI flows will maintain low but at stable levels of near 1% of GDP until uncertainty on world economy and trade dissipates

NET CAPITAL FLOWS TO EM
(% GDP)

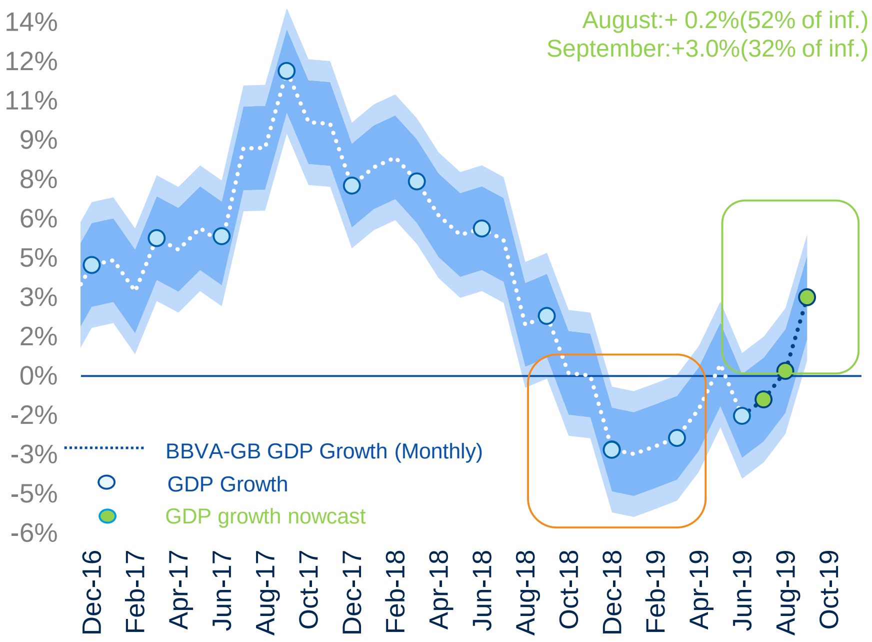


Source: IMF

- World Economic uncertainty
- Global Subdued investment
- World Trade Instability
- Lack of dynamism in Regional Trade & Investment Agreements
- Some potential for New Sustainable and infrastructure Investment

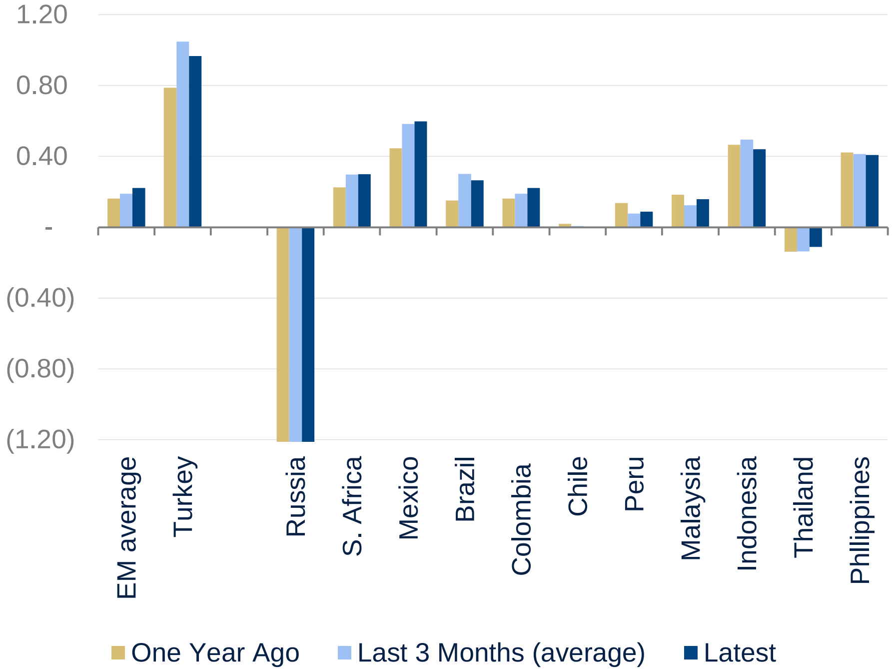
The Local Push factors will be supportive as growth accelerates and interest rate differential remains attractive…

TURKEY: BBVA-GB GDP MONTHLY INDICATOR
(% YOY, 3M MOVING AVG.)



Source: Garanti BBVA Research

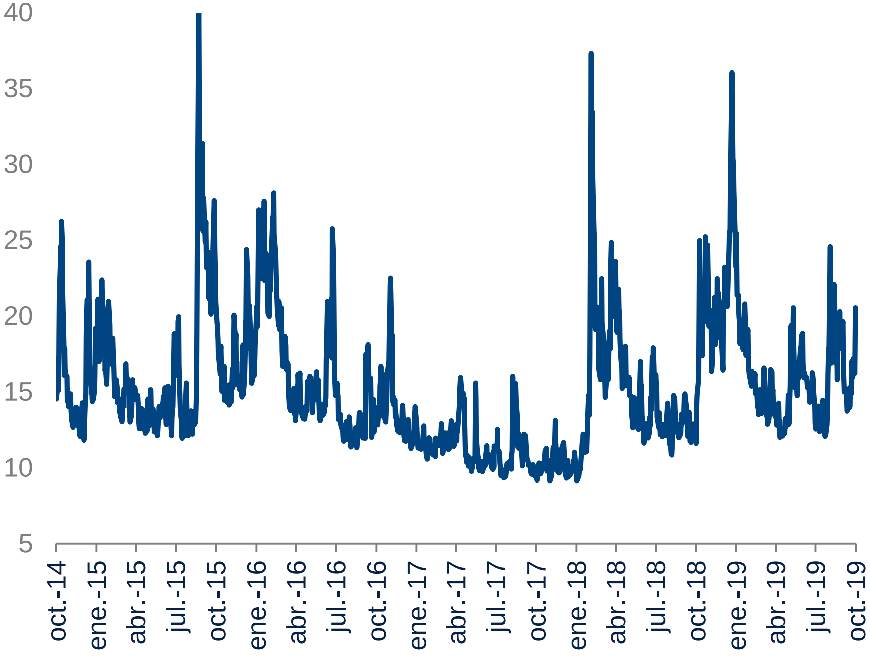
EM: RISK ADJUSTED DIFFERENTIAL
(POLICY RATE DIFFERENCTIAL / 1M CURRENCY VOLATILITY)



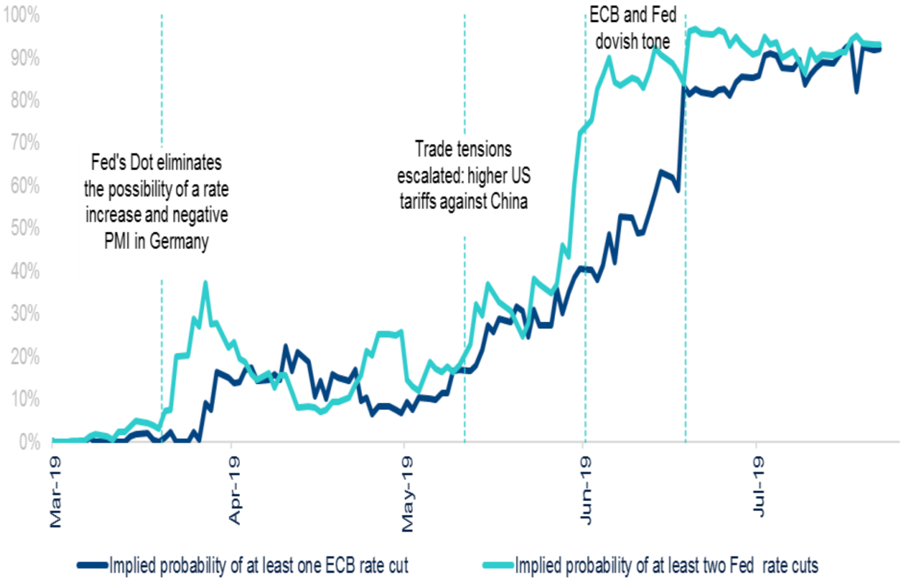
Source: Bloomberg & Garanti BBVA Research

…However the Global "Push" factors as Global Risk Aversion remain a key factor to monitor despite the new Big Central banks support round…and volatility in portfolio flows can persist..

GLOBAL RISK AVERSION: VIX VOLATLITY INDEX (%)



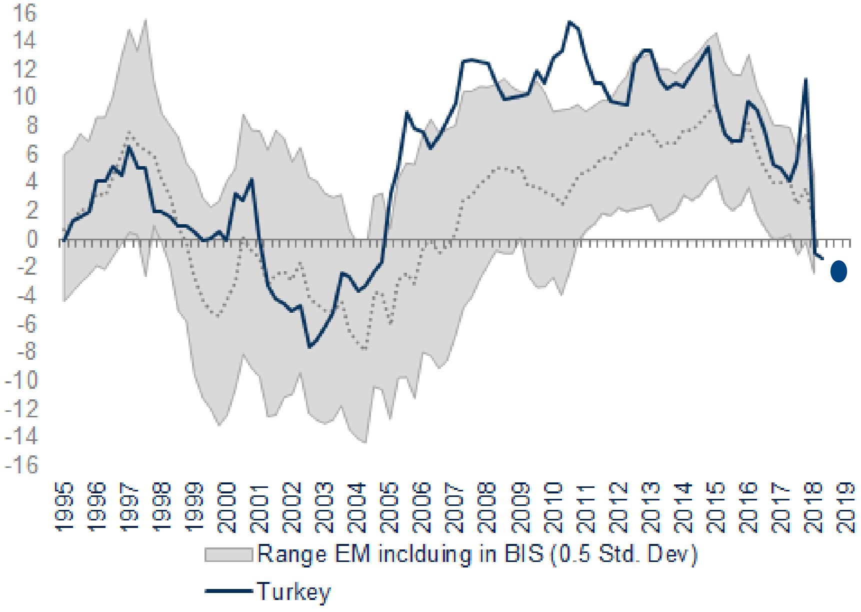
PROBABILITY OF RATE CUTS BY THE FED AND THE ECB (*) (%)



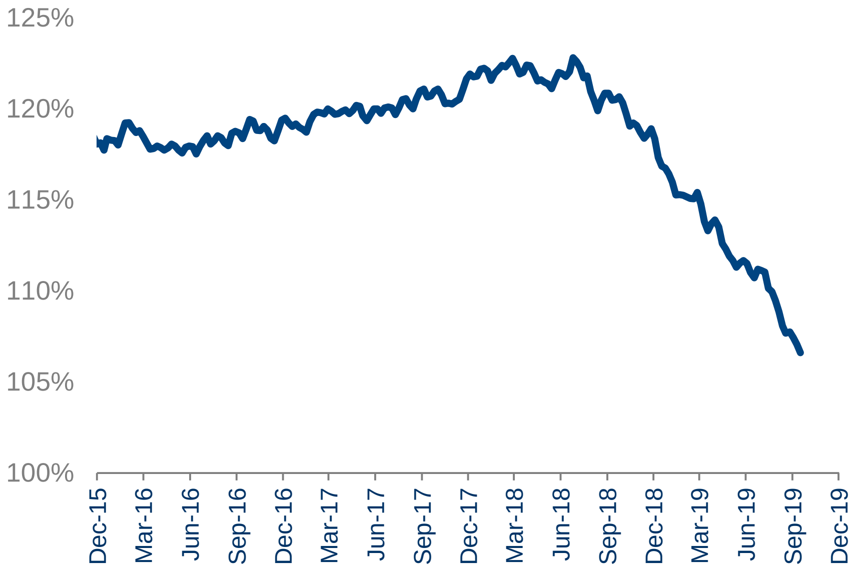
(*) According to financial markets, as of July 22, 2019.
Source: BBVA Research and Bloomberg

Banking flows can improve in Turkey after the sharp correction this year.. but will not boom due to lower demand and global banking woes

BIS CREDIT GAP: EM BIS COUNTRIES VS TURKEY
(% DEVIATION FROM TREND)



TURKEY: LOAN TO DEPOSIT RATIO
(%)



Source: Garanti BBVA Research

Summing Up

- Despite the new round of global monetary policy support, **Net Private capital flows to EMs will remain moderate until the world economic & trade uncertainty dissipates and global risk aversion moderates**
- **Net Private Capital Flows to Turkey will recover some ground** after the sharp adjustment of the current account this year
- **Global "Push" factors will remain important source of capital flows volatility** and this is out of control of EMs. **Caution should prevail!!**
- **EMs policymakers should focus in what they control :** Implementing **"sound" policies**, enhancing **economic reforms** and **reduce "amplifiers"** (excess flows and exposure the FX debt)

Source: Garanti BBVA Research

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