Global Capital Flows in the COVID-19 Pandemic

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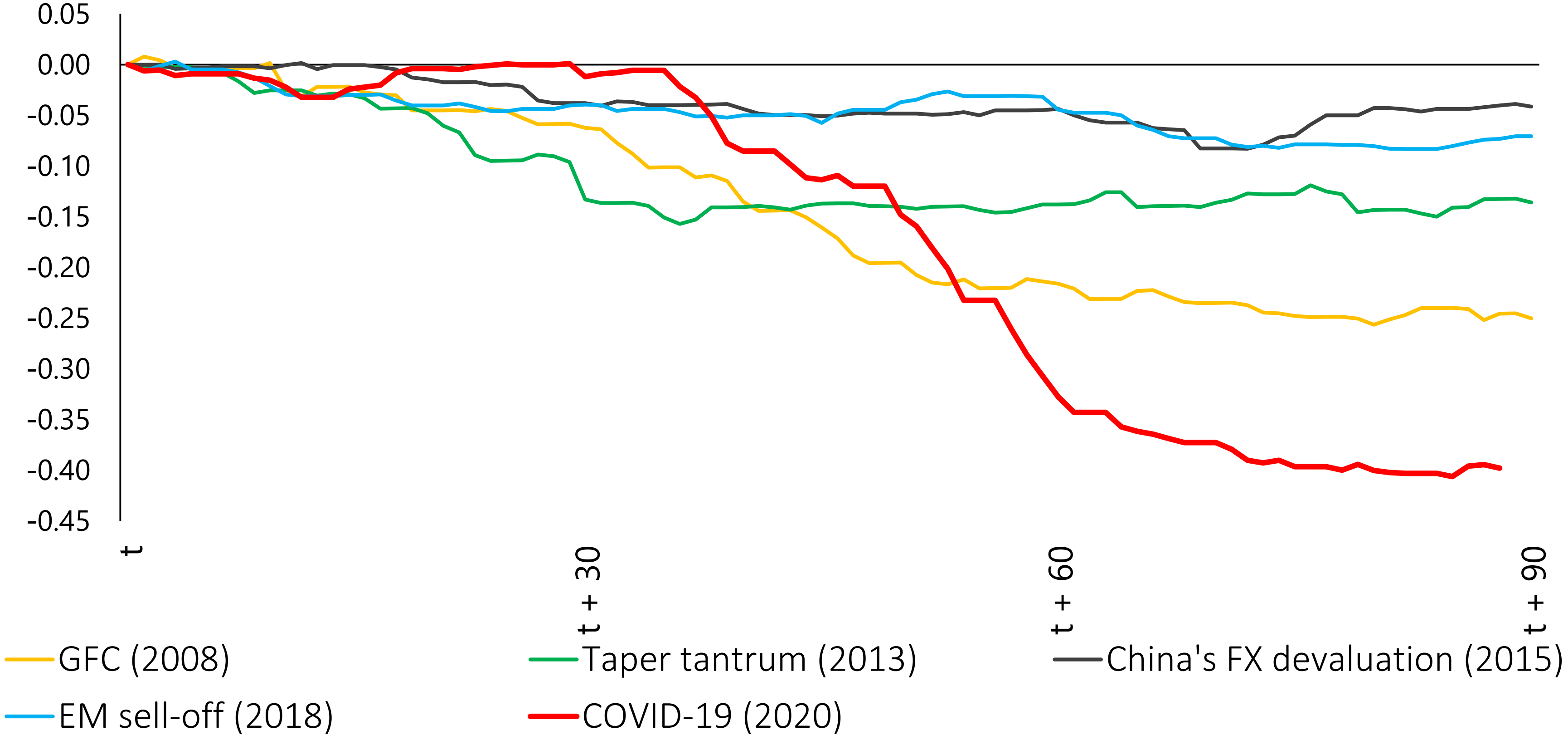
Emerging markets (EMs) experienced unprecedented portfolio outflows by non-residents in Q1:2020

The Covid-19 sell-off saw more than $90 bn of outflows with the speed of the reversal being the most notable since GFC (even after adjusting for GDP)

Cumulative nonresident Portfolio Flow to EMs
(Percent of GDP, based on daily observations)

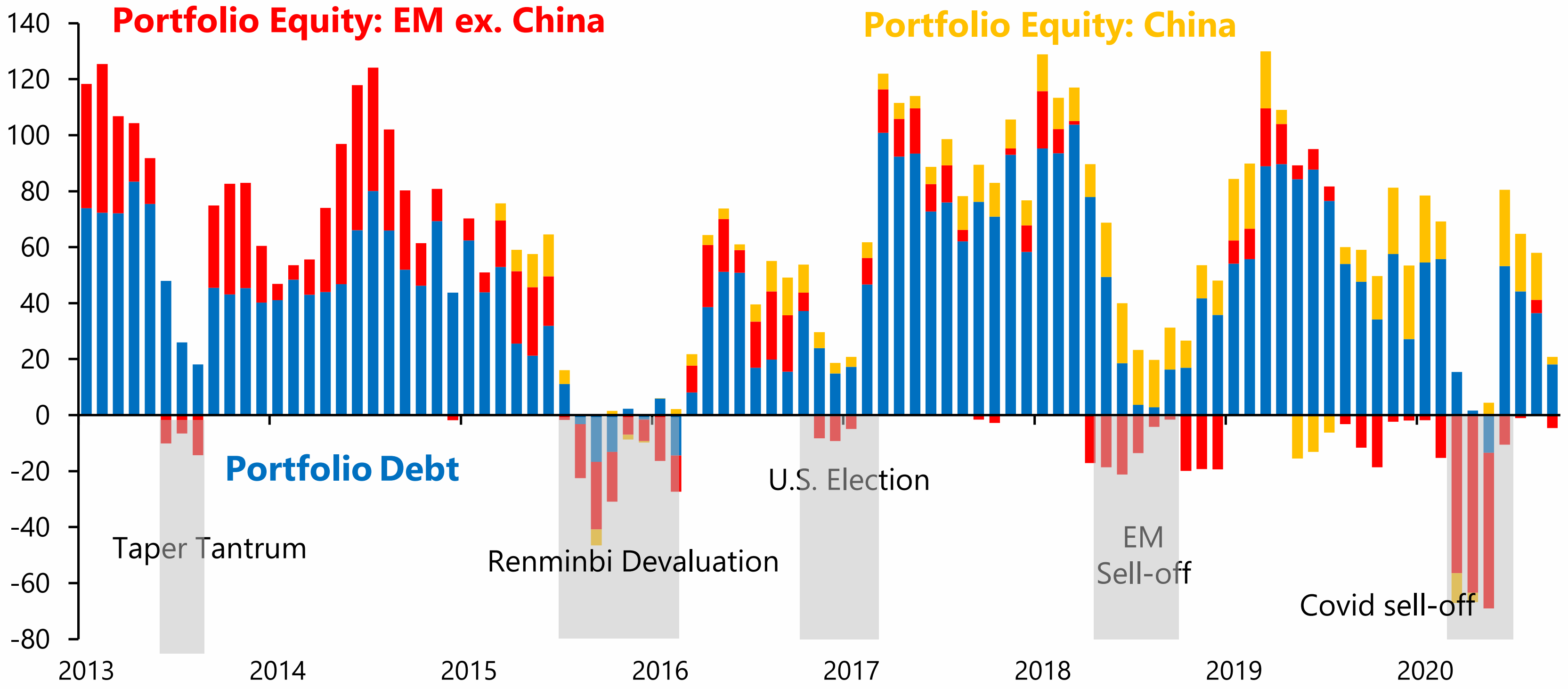


Sources: Bloomberg, IIF, IMF WEO

The portfolio flow reversal by non-residents was short-lived, though recovery remains uneven across EMs

The unprecedented portfolio outflows in March stabilized in June. Uncertainty due to US elections, and post COVID-19 recovery path marked the mixed dynamics of flows in September

Nonresident Portfolio Flows to EMs (incl. China)
($ billion, 3-month rolling sum; last observation: Sep 2020)

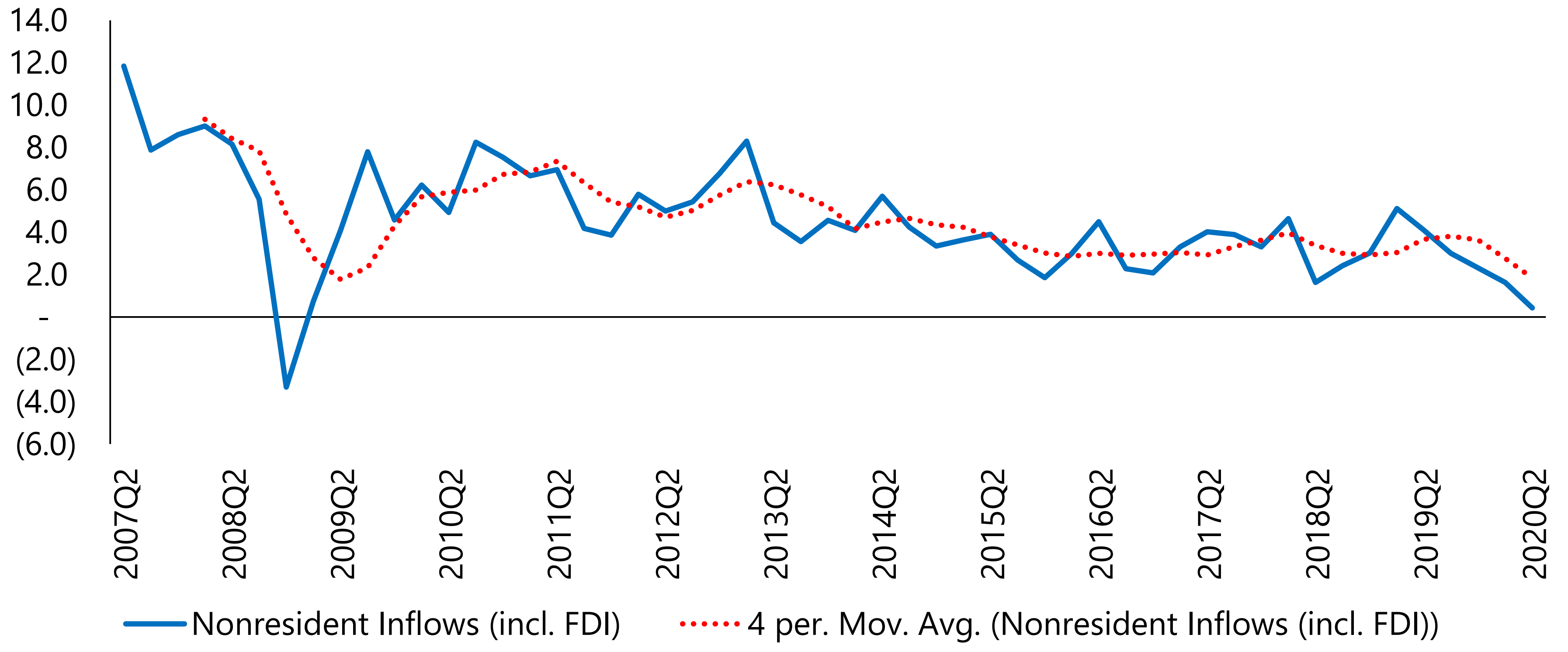


Source: IIF, IMF MCM Capital Flows Tracker

However, aggregate non-resident inflows continued to decline in Q2:2020…

Nonresident flows declined sharply in Q2, to 0.4%of GDP, vs 1.6% in Q1 and average of 4.4% in the last decade.

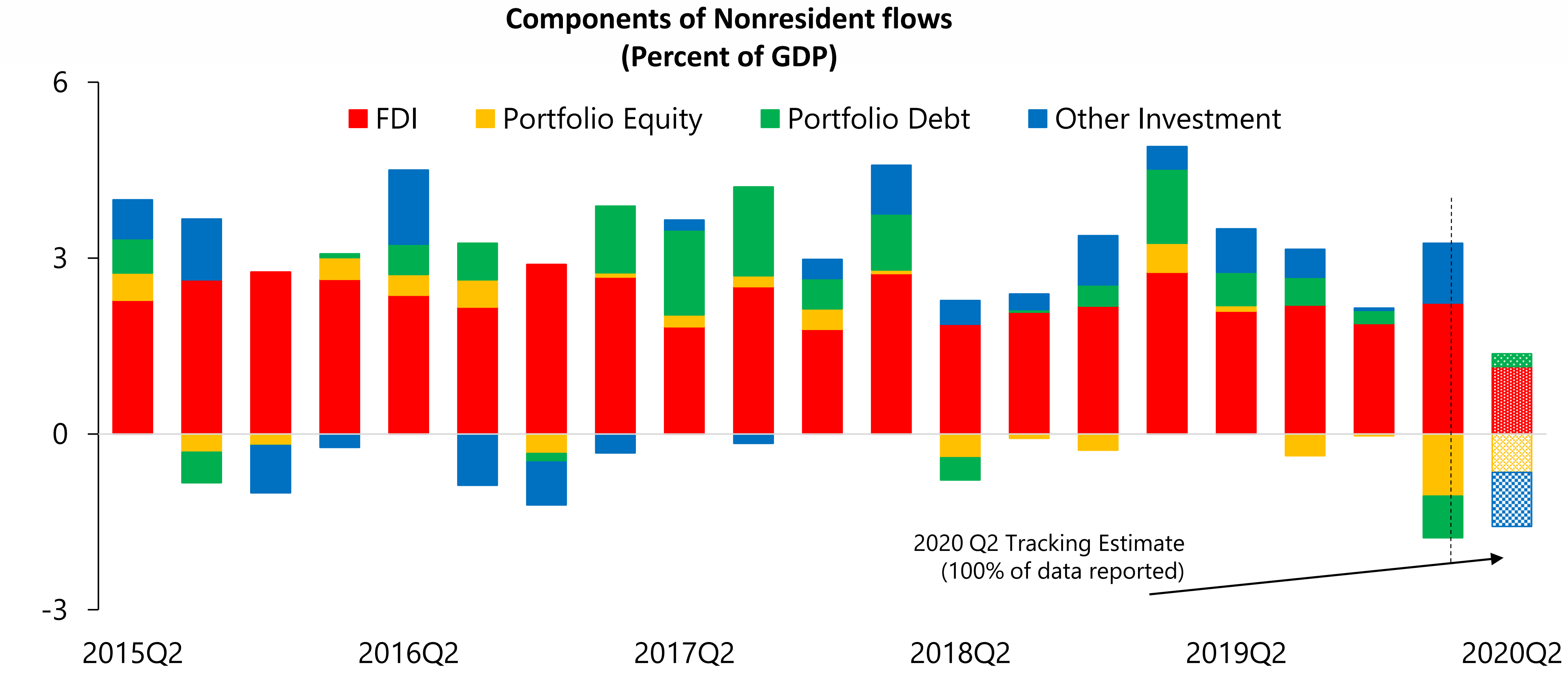
Nonresident Flows to EMs
(Percent of GDP)



Source: Haver, National Authorities, IMF MCM Capital Flows Tracker

...due to weakness in FDI and banking inflows

While non-resident portfolio inflows improved from Q1 levels driven by debt flows, FDI flows declined to historical lows, and other investment flows declined sharply as well.

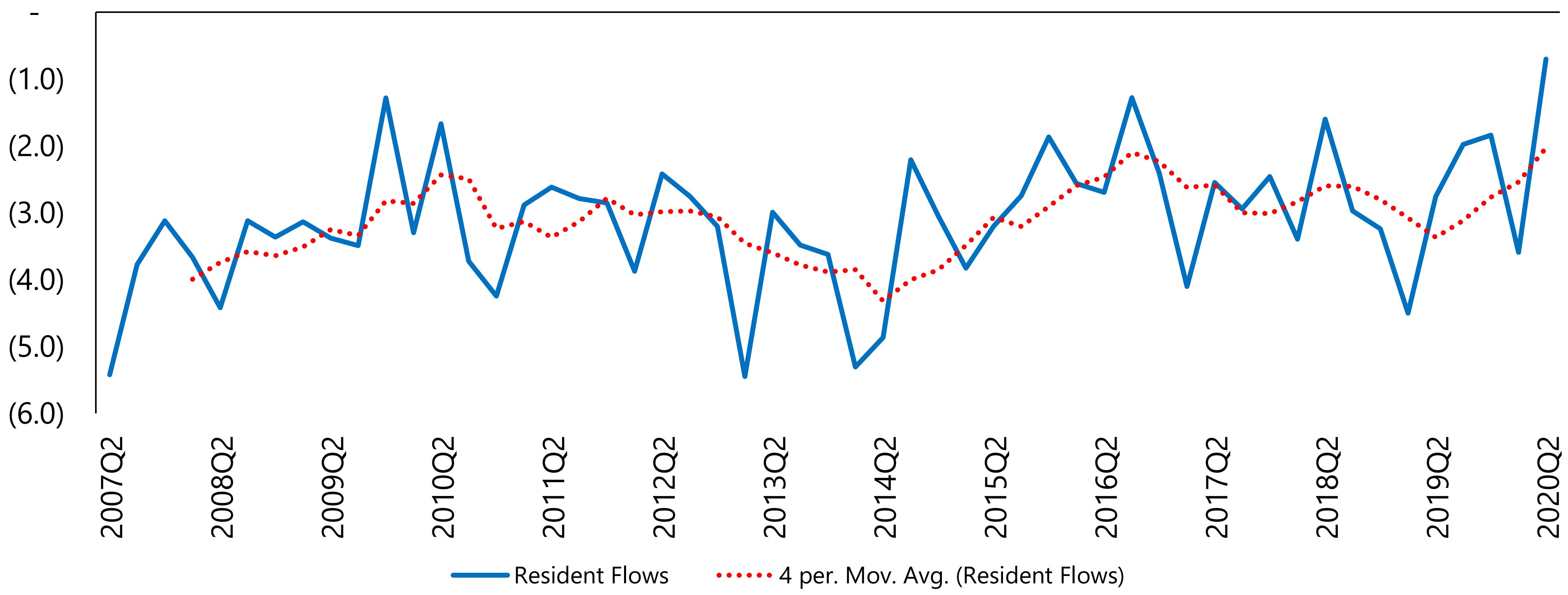


Source: Haver, National Authorities, IMF MCM Capital Flows Tracker

Resident outflows played a stabilizing role

Resident outflows were 3.6% of GDP in Q1 2020, a sharp decline from 4.6% in 2019 Q1, and fell further to 0.7% of GDP in Q2 2020

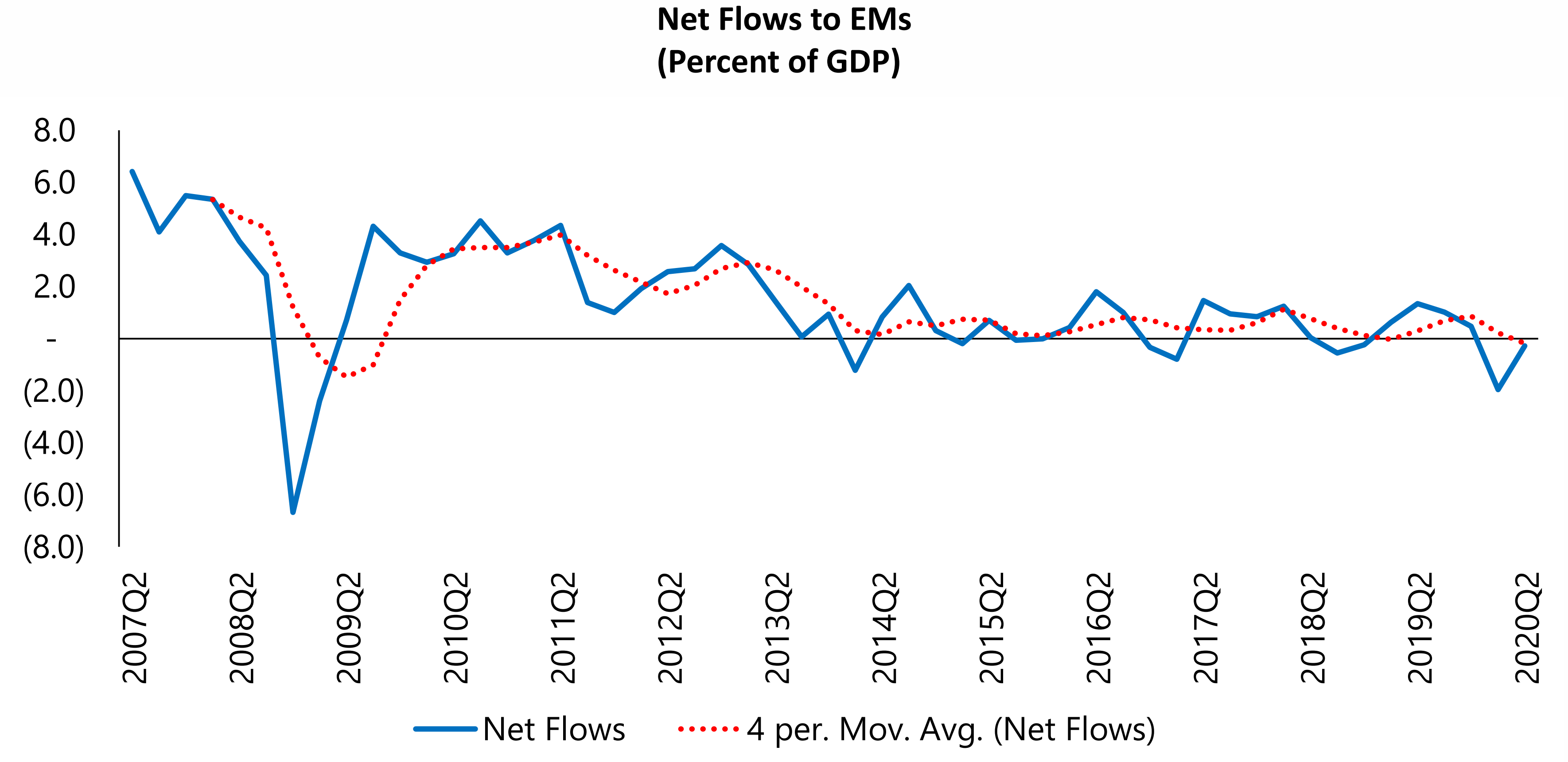
Resident Flows to EMs
(Percent of GDP)



Source: Haver, National Authorities, IMF MCM Capital Flows Tracker

Therefore, despite the sharp decline in nonresident flows, net flows improved in Q2 2020

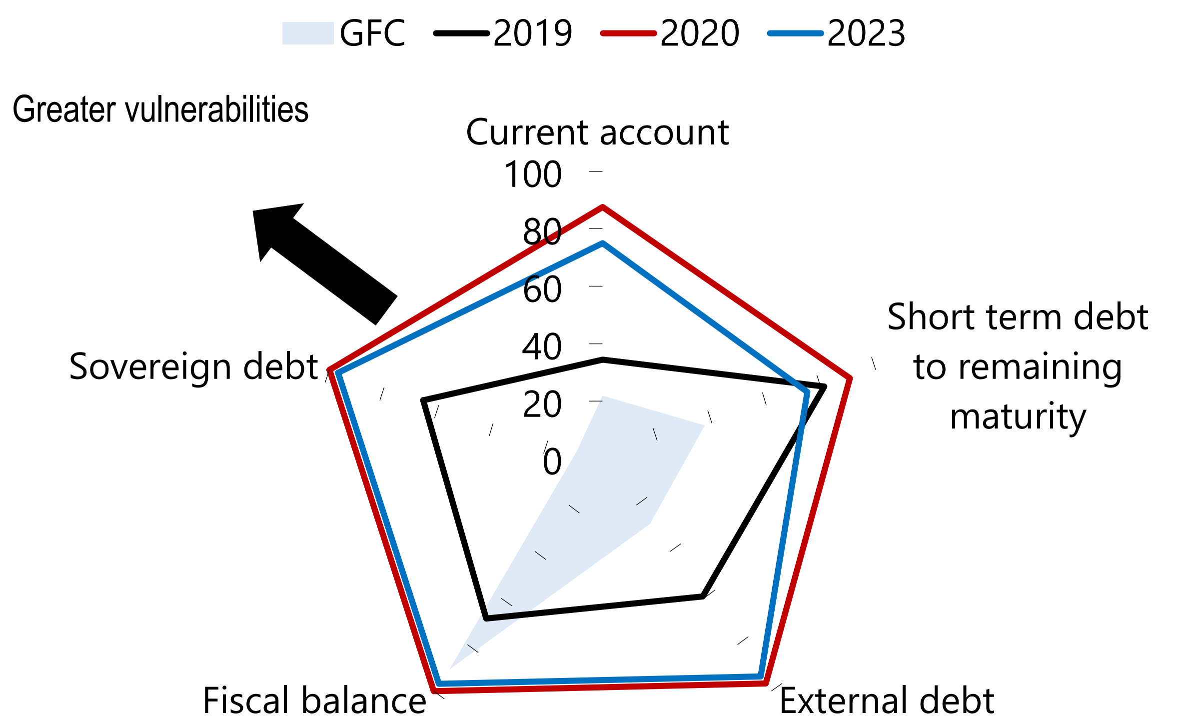
Despite the sharp decline in nonresident flows, net flows improved sequentially from -2% in Q1 to -0.3% in Q2



Source: Haver, National Authorities, IMF MCM Capital Flows Tracker

The COVID-19 pandemic has exacerbated existing vulnerabilities, which are likely to remain elevated

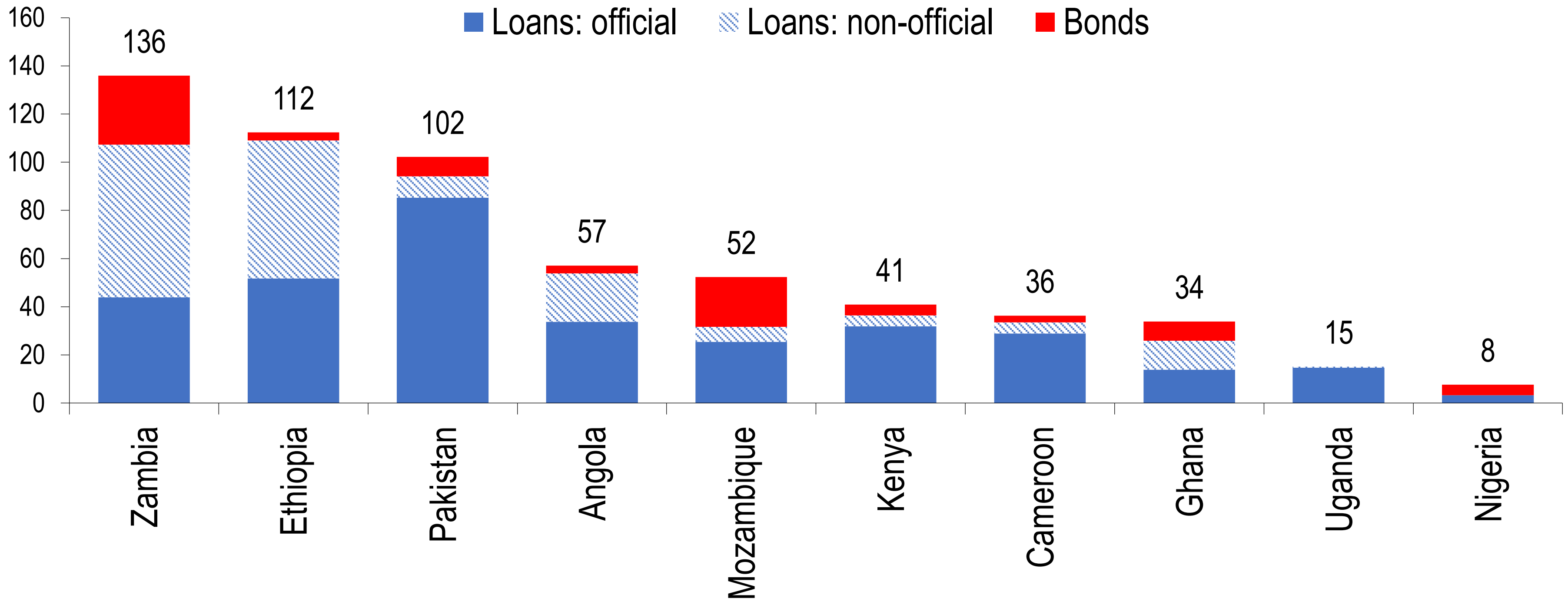
Evolution of Sovereign Debt and External Financing Requirements for EMS
(Percentile Rank since 1990)



Source: IMF Global Financial Stability Report

Market access for many EMs – especially frontier and lower-rated EMs has been materially impacted

External Debt Service through the End of 2021
(Share of foreign reserves, percent, as of July 2020)



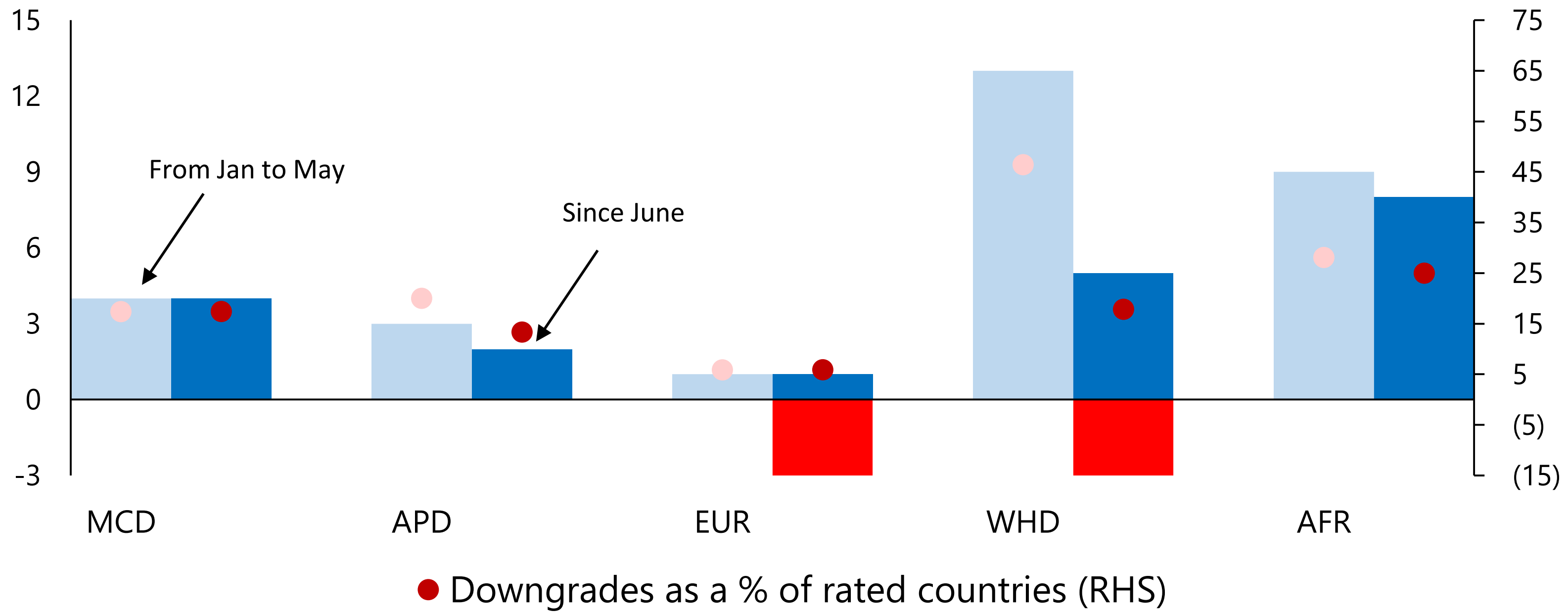
Source: Bloomberg Finance L.P.; World Bank Debtor Reporting System; IMF Global Financial Stability Report

Many countries have seen ratings downgrades

Net downgrades continued in all regions since April with 8 Sub-Saharan African countries downgraded by one or more rating agencies.

Net Rating Downgrades by Region

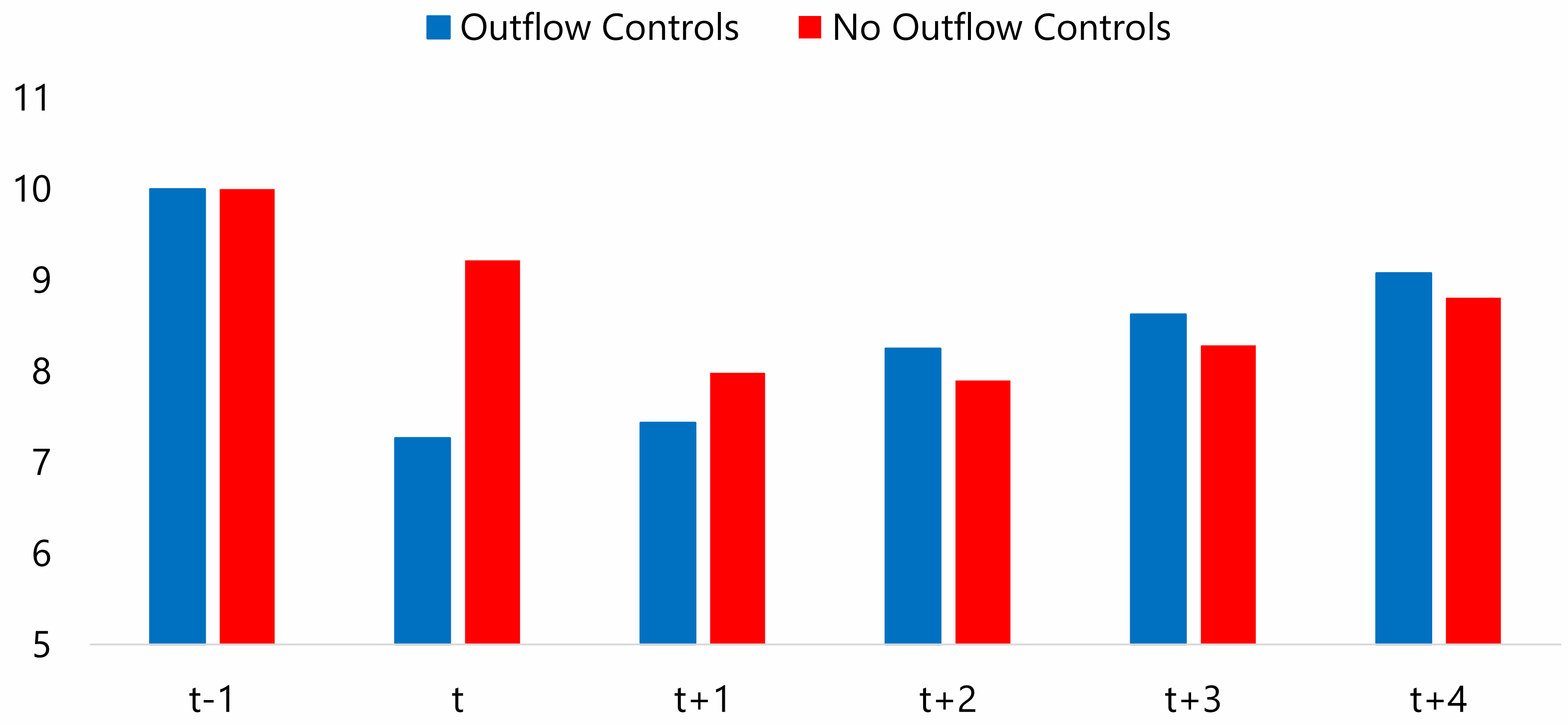
(Number on LHS; as a percent of total rated countries on RHS; Positive bars imply net downgrade, while negative bars are net upgrades)



Source: Bloomberg, IMF MCM EM Ratings Monitor

Sovereign ratings tend to remain depressed for years after a crisis, irrespective of whether outflow controls are used

Average Rating of Countries with and without Outflow Controls Introduced in Crisis Year t[2]

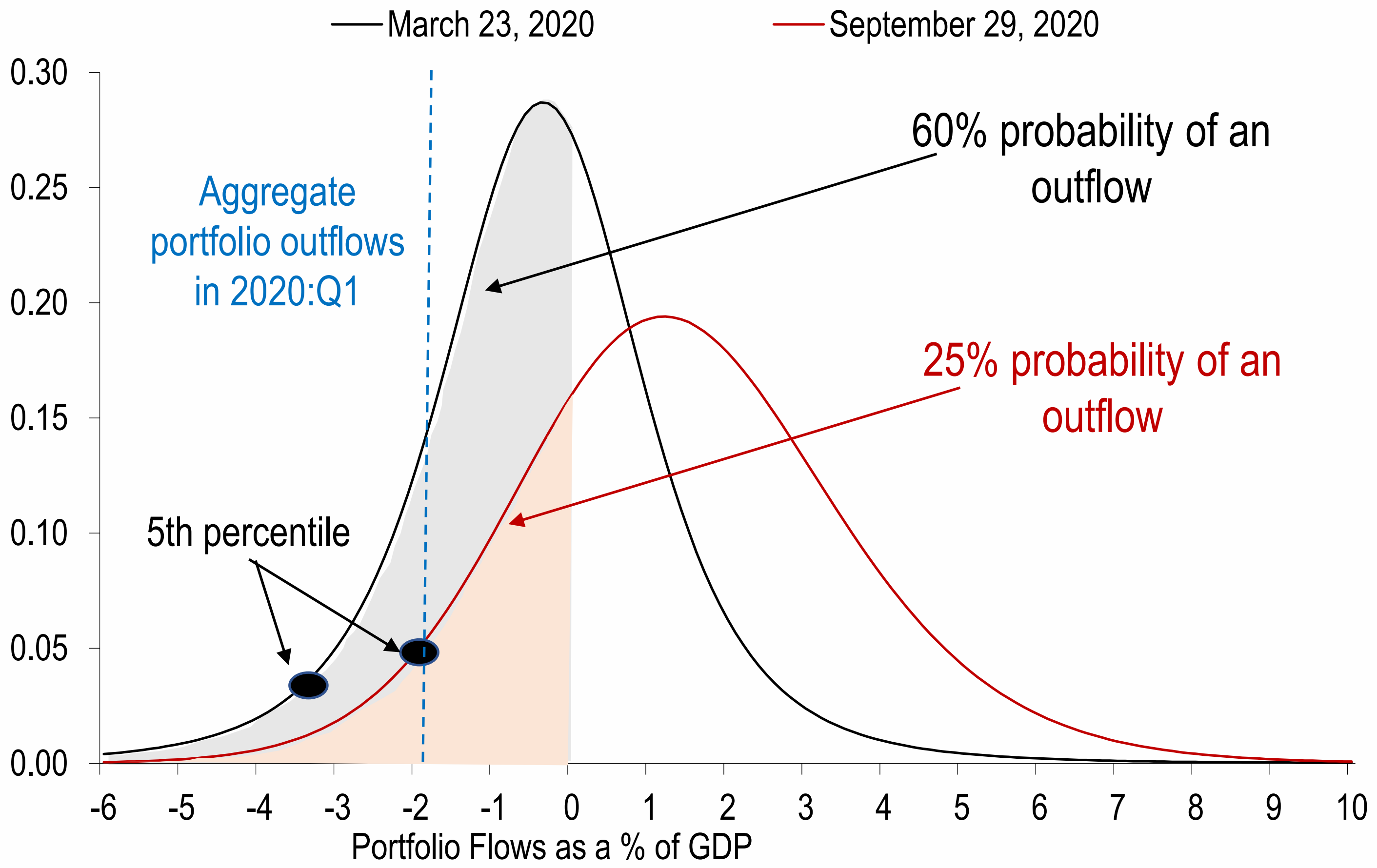


[1] Panel shows the average S&P sovereign debt foreign currency rating (ranging from 1 for default to 22 for AAA), rebased at value 10 the year before the crisis year t.

Source: Bouis et al. (forthcoming)

The outlook for portfolio inflows remains challenging, with nearly 25 percent probability of outflows next year

Capital Flows at Risk: Near-term Portfolio Flow[1] Forecast Densities (Probability Density)



[1] denotes net nonresident portfolio (debt and equity) flows.

Source: IMF Global Financial Stability Report; Bloomberg; IMF WEO

EMs used a range of policies to mitigate stress

- To mitigate stress in local bond and currency markets, many emerging market central banks:
  - lowered policy rates,
  - Released macroprudential buffers
  - used FX interventions and,
  - for the first time, asset purchases

- Despite exceptionally large capital outflows, the COVID-19 crisis did not trigger a wide-spread introduction of capital controls.
  - However, some EMs liberalized inflow controls

Uncoordinated responses to global shock can lead to spillovers

- Spillovers from Foreign Exchange Intervention (FXI) that are well-crafted to improve financial conditions— are likely to be on the net, benign
  - However, FXI used to resist warranted exchange rate depreciation, may be a precursor to protectionist policies and could delay the global recovery.

- For EMDEs with underdeveloped financial systems, outflow CFMs could help stabilize their economies, and on balance, be helpful to trading partners
- However, the use of outflow CFMs by a major economy could potentially trigger capital outflows from other economies
- Widespread adoption of CFMs could impede global recovery

Multilateral cooperation can improve global outcomes

- Multilateral cooperation can reduce the need to use FXI or impose CFMs and, in the recovery, the need to accumulate foreign exchange reserves
- Swap lines by the Federal Reserve and other major central banks
- The expansion of existing and creation of new IMF lending facilities:
  - Doubled access to Rapid Credit Financing and Rapid Financing Instruments facilities
  - Short-term Liquidity Line (SLL): a new, revolving and renewable backstop for member countries with very strong policies
  - Approvals under Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL)
- Debt relief under the Catastrophe Containment and Relief Trust (CCRT)
- Calls for bilateral debt relief
- Multilateral cooperation on allocation of SDRs and coordinated debt-service suspension by the private sector could also improve global outcomes

Thank you!