

GMV – The EM Flows Recovery

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- Our view has been that a COVID-19 vaccine would be good news for EM, ...
- because a vaccine is a positive boost to global demand and commodity prices, ...
- with the resulting terms of trade shock lifting most emerging market currencies.
- This dynamic has been playing out following positive COVID-19 vaccine headlines.
- Capital flows to EM are the strongest since immediately after the Great Recession.

Earlier this year, at the height of the COVID-19 shock, we [recorded](#) large capital outflows from EM. In the months that followed, the recovery in non-resident portfolio flows to EM was tepid, unlike after the global financial crisis, when flows to EM rebounded quickly. We [explain](#) this divergence with the lack of a 2009-style China stimulus, which boosted global demand and commodity prices, lifting many EM currencies and especially those of commodity exporters. We see positive news on COVID-19 vaccines as the modern-day equivalent of the 2009 China stimulus, allowing the world to return to the status quo before the virus, i.e. delivering a powerful boost to global demand. Markets have been trading positive vaccine headlines along these lines. We are recording the strongest pace of non-resident portfolio flows to EM in many years. Factoring in robust offshore bond issuance, Q4 is the strongest quarter since Q1 2012.

Exhibit 1. Flows to EM are recovering, ...

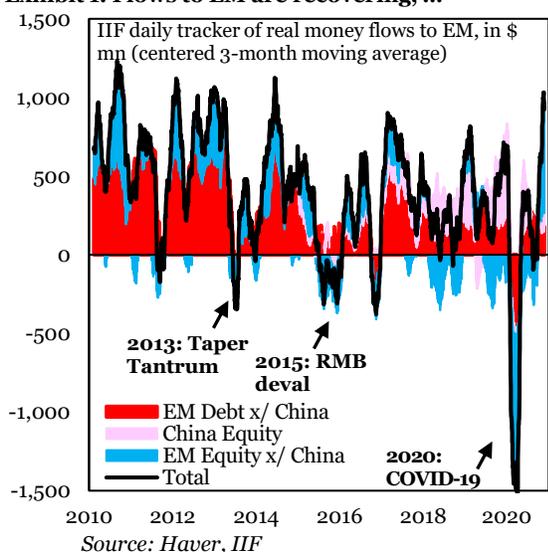
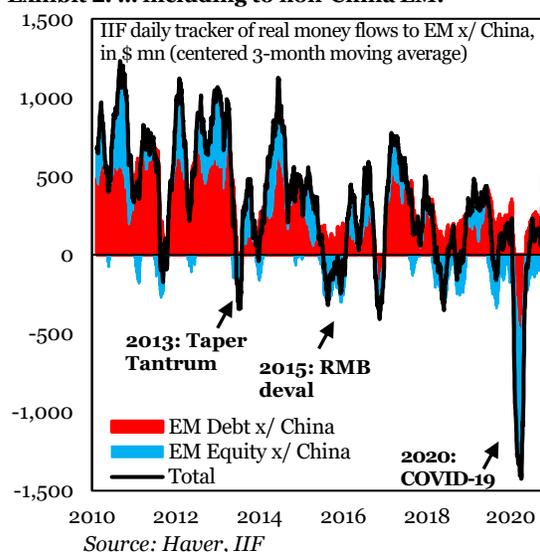
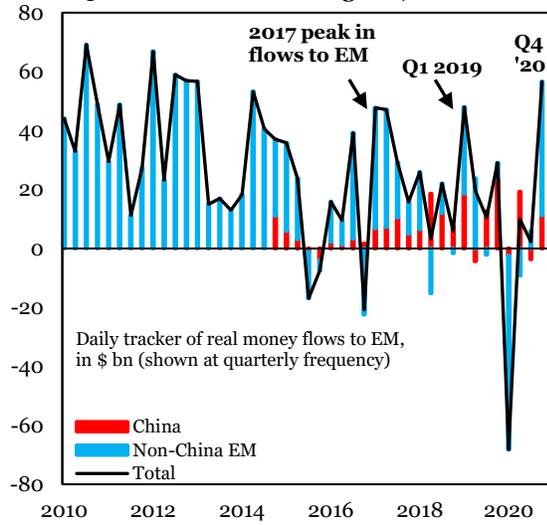


Exhibit 2. ... including to non-China EM.



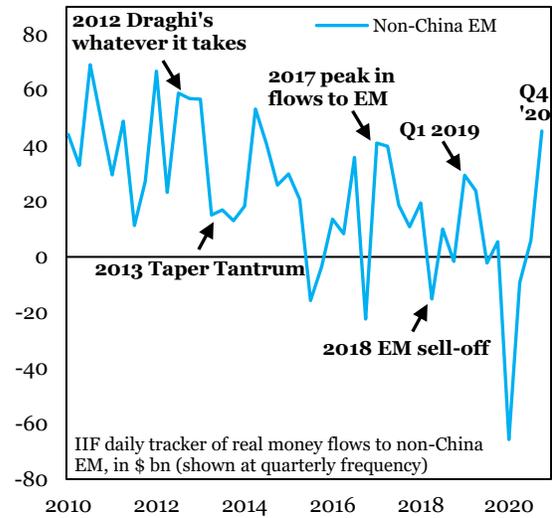
Our daily tracking of non-resident portfolio flows to EM gave us an [early](#) read on the severity of the COVID-19 shock. Outflows in March exceeded anything on record in our tracking (Exhibit 1), especially when looking at EM excluding China (Exhibit 2). However, recent headlines on potential vaccines have changed this picture and we are now tracking the strongest pace of EM inflows in many years. When we aggregate our data up to a quarterly frequency, to reduce the amount of noise and focus on underlying trends, Q4 2020 is likely to be the strongest quarter for EM inflows since Q1 2013, i.e. since just before the “taper tantrum” (Exhibit 3). Excluding China, non-resident portfolio flows to EM are at their strongest pace since Q2 2014 (Exhibit 4), i.e. since just prior to the fall in commodity prices that pulled down the terms of trade in many emerging markets, causing their currencies to depreciate.

Exhibit 3. EM inflows are the highest, ...



Source: Haver, IIF

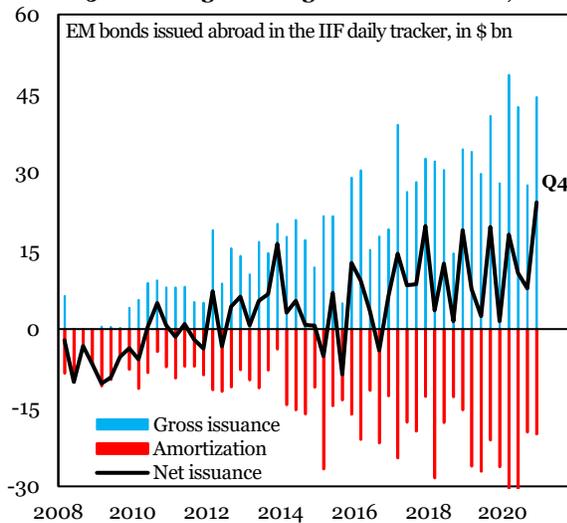
Exhibit 4. ...they have been in many years.



Source: Haver, IIF

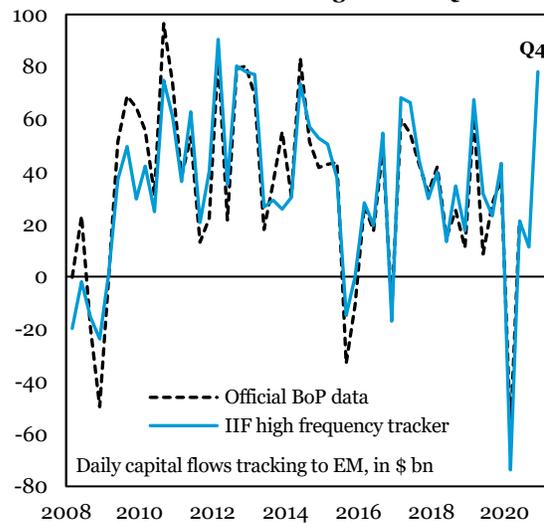
One thing not captured in these flows is offshore issuance of bonds, where the gross and net issuance picture has been robust throughout 2020, a big difference from the global financial crisis. If we extrapolate strong issuance in October and November to Q4 overall, it suggests the highest level for EM net issuance ever (Exhibit 5). Putting this issuance picture together with our high-frequency tracking of flows paints a picture of strong recovery, with flows returning to their strongest level since Q1 2012 (Exhibit 6), i.e. since just before the escalation of the Euro zone debt crisis and in the immediate aftermath of various Fed QE programs. Overall, the exodus of capital from emerging markets is now firmly in the rearview mirror and robust inflows look set to continue. As last week's *Global Macro Views* flags, substantial [undervaluations](#) remain in place for the Brazilian Real, Colombian Peso, Chilean Peso and Russian Ruble, in addition to a structural undervaluation of China's RMB.

Exhibit 5. Factoring in strong offshore issuance, ...



Source: Haver, IIF

Exhibit 6. ... flows are the strongest since Q1 2012.



Source: Haver, IIF