Capital Flows to Emerging Markets
Brighter Outlook

June 5, 2017

INSTITUTE OF INTERNATIONAL FINANCE

- Non-resident capital inflows to EMs are projected to increase by USD252 billion to USD970 billion in 2017
- We look for a notable moderation in resident outflows from China this year, helped by RMB stability
- Mixed prospects for FDI, but we see some improvement in banking flows as well as solid portfolio flows
- South-South investment makes up some 5% of total cross-border investment in EMs vs 2% a decade ago
- Key risks to our forecast include more aggressive Fed tightening—including rate hikes and balance sheet runoff—than is being priced in by markets. All else being equal, a USD500 billion decline in Fed Treasury holdings would be associated with a reduction of over USD50 billion in EM portfolio flows.
- Starting with this report, we have adopted the latest BPM6 presentation for the balance of payments.

CLOUDS LIFTING

The first months of 2017 have seen some potential headwinds for EM capital flows abate. In particular, efforts by Chinese policymakers to support growth and ensure RMB stability ahead of the autumn leadership transition should mean a less-volatile backdrop. At the same time, concerns about the impact of an "America First" orientation of U.S. trade policy have subsided—at least for the time being—as U.S. policymakers focus on the domestic agenda including healthcare and tax reform. Assuming ongoing improvement in global and EM growth and a gradual, well-communicated path of Fed tightening through 2018, we are now a bit more optimistic on EM capital flows. Total non-resident inflows to emerging markets should rise over 35% from 2016, reaching USD970 billion. Our first look at 2018 calls for non-resident inflows to top USD1 trillion—which would be the best year since 2014.

While the single biggest improvement we expect is a sharp decline in resident capital outflows from China, signs of a modest pickup in world trade and more stable commodity prices should underpin some improvement in banking flows and trade finance as well. South-South flows, particularly in cross-border banking flows and portfolio debt will make a growing—if still modest—contribution (See Box 1). We look for solid non-resident inflows to EM portfolio debt, supported both by still-attractive valuations and by rising demand from institutional investors (See Box 2).

Notable vulnerabilities remain. Downside risks to portfolio flows mainly relate to surprises in overall Fed policy, including balance sheet reduction (See Box 3). However, prospects for FDI are also mixed, and our economists highlight a range of domestic political and policy risks. But on the whole, 2017-18 prospects look better than they did back in January.

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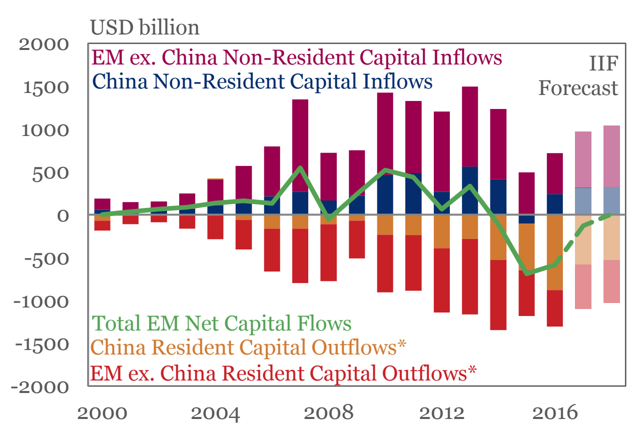

*Source: IIF. *In this chart, resident outflows include errors & omissions and net financial derivatives*

2017/18 Outlook for EM Capital Flows

Scott Farnham, Senior Research Analyst, Global Macroeconomics, sfarnham@iif.com, +1 202 857 3653

A BRIGHTER OUTLOOK FOR EM CAPITAL FLOWS

Given a more positive start to the year, and dissipating fears of a negative external shock from US policy, we now estimate that total non-resident inflows to emerging markets will rise to USD970 billion this year, from USD718 billion in 2016. Moreover, we look for inflows to break the USD1 trillion mark in 2018—for the first time since 2014 (Table 1, Chart 1). This marks a significant upward revision from our cautious forecast in February in the wake of the US election.

The firming in EM capital flows this year has been broadly driven by a strong rebound in equity and debt portfolio flows. As highlighted in our monthly Capital Flows Tracker, emerging markets attracted some USD100 billion of portfolio inflows in 2017Q1, marking the strongest quarter since 2014Q2 against the backdrop of robust institutional flows (See Box 3). We expect portfolio flows to increase from USD174 billion in 2016 to USD243 billion in 2017. While FDI flows are forecast to rise to USD520 billion in 2017 from a weak USD483 billion in 2016, this is still below 2014-15 levels. Moreover, our FDI forecasts for this year are still markedly lower in some countries (Russia, China, Mexico) than in the boom years of 2010-2014. Despite this more mixed assessment of FDI flows, we foresee a significant increase in the "other investment" component of the capital flows from USD61 billion in 2016 to USD207 billion in 2017, mainly reflecting some recovery in cross-border banking flows and trade credit as growth in global trade sees a modest pickup.

We are expecting resident capital outflows (a big factor in 2015-2016 weakness in net capital flows to EMs) to decline by USD141 billion to USD892 billion this year and fall a bit more in 2018. All of this moderation is due to China, which has used capital controls to clamp down on outward investment with some degree of success. That said, we expect a continued rise in South-South capital flows among emerging markets, particularly in the form of FDI and cross-border banking flows (See Box 1); China plays a big role in such flows.

With rising non-resident capital inflows and lower resident capital outflows, we have revised our 2017 forecast for net capital outflows (including errors and omissions) down to USD130 billion. This follows large China-driven net outflows in 2015-16. In our first look at 2018, we expect the first net capital inflows since 2013, as China net outflows moderate, and flows to EM ex-China continue apace. Moderation in net capital outflows should also prompt a rise in official reserves.

While most EMs should see improving non-resident capital inflows in 2017-18, we remain cautious on Brazil in the wake of a difficult political situation. We have revised up forecasts for Mexico (mostly FDI) to reflect less near-term concern over US policies. We foresee Saudi Arabia to become the fourth largest recipient of non-resident capital inflows in 2018, as the country continues to look for overseas investors to finance the large fiscal deficit.

Table 1: Emerging Markets – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**1,234**	**391**	**718**	**970**	**1,036**
Foreign direct investment	638	574	483	520	558
Portfolio investment	308	43	174	243	270
Equity	97	13	62	60	110
Debt	211	30	112	183	160
Other investment	287	-225	61	207	209
Resident Capital Flows	**-1,220**	**-837**	**-1,033**	**-892**	**-869**
Direct investment abroad	-386	-369	-338	-345	-347
Portfolio investment	-185	-191	-217	-249	-230
Other investment	-649	-277	-478	-297	-292
Financial derivatives, net	-13	-4	0	-4	-3
Capital transfers	-20	23	7	18	20
Reserves (- = increase)	-111	453	401	-68	-191
Net errors and omissions	-115	-241	-272	-205	-158
Net Capital Flows	1	-449	-314	75	164
Net Capital Flows plus Errors & Omissions	**-115**	**-690**	**-587**	**-130**	**6**
Memo:					
Current Account Balance	245	214	178	180	164

Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

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Macro backdrop

Ulrik Bie, Chief Economist, Global Macroeconomics, ubie@iif.com, +1 202 857 3651

GLOBAL ECONOMIC OUTLOOK: MOSTLY SUNNY

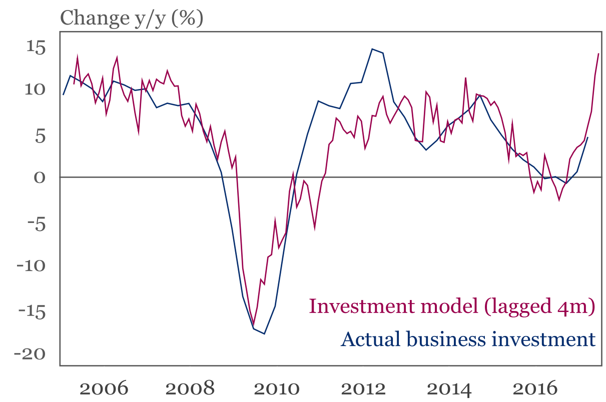
The improvement we expect in EM capital flows is supported by our growth outlook (see our latest Global Economic Monitor). We look for global growth to reach 3.1% in 2017 (up from 2.5%) in 2016, and edge slightly higher in 2018. In the mature economies, the US had a weak start to the year, but recent data suggest continued moderate growth, supported by both consumption and business investment (Chart 2). However, while the President's deregulation agenda is advancing, tax reform has been delayed by legislative hurdles, pushing back the timing to at least 2018 and possibly 2019 after the mid-term election. Given that, and as an infrastructure package may take some time to materialize, we have scaled back the expected contribution to growth from fiscal policy. However, we still expect the US economy to have enough momentum to carry growth north of 2% in 2017-18.

In Europe, a UK slowdown is becoming increasingly visible, while in contrast the euro area is gaining strength. German business sentiment reached its highest level since reunification in May, and the recovery is gaining momentum across sectors and countries. Some of this is based on temporary stimulus, but the improvement is also a dividend from painful structural reforms implemented in recent years—notably in southern Europe. Improvement in financial sector fundamentals should also provide support for the real economy—we see growth close to 2% for 2017-18.

Our EM Growth Tracker slipped in April after a strong run in recent months, but still points to healthy growth momentum (Chart 3). Indeed, the growth differential still favors EMs (Chart 4), with growth of around 4.7% this year and nearly 5% in 2018. EM Asia still has the brightest prospects, with India coming back strongly after temporary weakness following last year's demonetarization. Building on a slew of structural reforms, we expect growth in India to gain steam in both 2017 and 2018. In China, growth has tapered a bit as authorities continue a move from "growth-at-all-costs" to addressing financial sector risks via regulation--affecting everything from housing to equities. Financial conditions have been tightened—bond yields are higher and shadow finance is less available. Moreover, fiscal spending has been very front-loaded this year, at over 20% y/y in Q1. Thus, support from fiscal policy should fade in the second half of 2017.

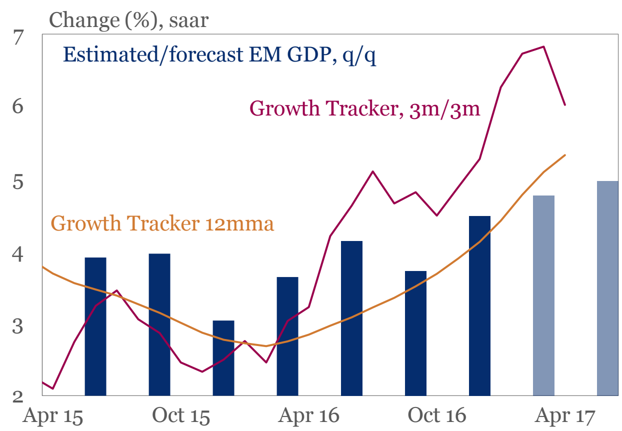
While we expect a broad-based pick up in EM growth, substantial political and policy risks remain headwinds across EM (Chart 5), particularly in key countries such as Brazil, Mexico, Turkey, South Africa and Nigeria (see regional pages below). These risks are mainly driven by domestic factors, although Mexico remains uniquely exposed to changes in US trade policy (see our EM Scorecard).

Chart 2: US indicators point to higher investment



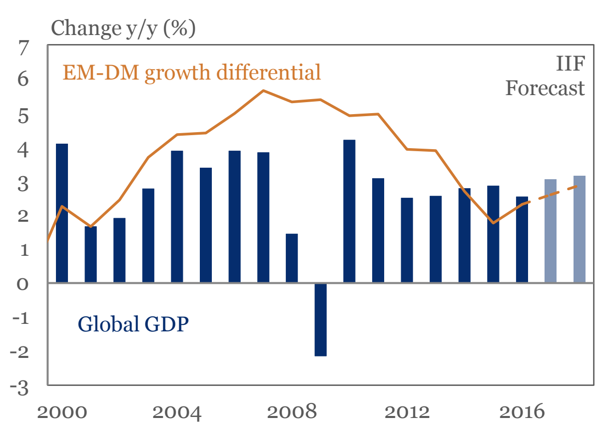
Source: Macrobond, IIF

Chart 3: Our *EM Growth Tracker* still points to strength



Source: IIF EM Growth Tracker

Chart 4: EM growth—still outpacing mature markets



Source: National sources, IIF

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OIL PRICES SET TO STAY RANGE-BOUND

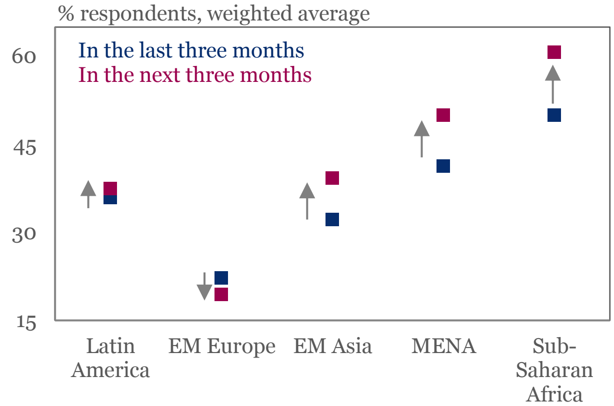
Lower commodity prices have been a drag on EM growth and capital flows in recent years. While many producers have pushed through reforms to cope with the lower price range, we do not expect prices to improve much. Despite the extension of OPEC production cuts for another nine months, uncertainty remains about future adherence to the agreement within OPEC (and participation by non-OPEC countries) if lower production is not matched by higher prices—and on whether the agreement will be extended in 2018.

Furthermore, higher production in non-OPEC countries including the US, Canada and Brazil has undermined the cuts, leading to less inventory drain than OPEC had hoped for. Going forward, as exploration cost in conventional oil projects have declined, we expect non-OPEC production to increase further. Most prominently, the price floor established by OPEC cuts has stimulated the US shale industry, with rig counts up nearly 40% this year and production on track to reach 9.4 mb/d by mid-year and 10 mb/d on average in 2018. We expect the energy sector to be one of the largest beneficiaries of President Trump's deregulation agenda. On balance, oil prices should average USD52 dollar per barrel this year and USD54 in 2018. Prices are likely to stay in a range of USD45-60 per barrel (Chart 6) while the OPEC cut is in effect, but downward risks will rise if it is not extended.

MATURE CENTRAL BANKS ON THE MOVE

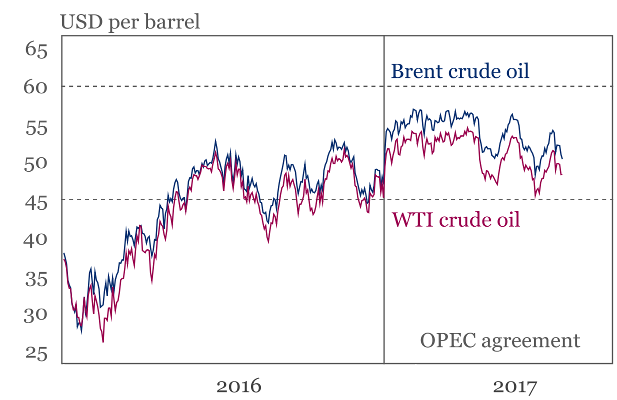
While the growth outlook across EMs is a positive factor for capital flows, changes in monetary policy in DMs over the next 18 months could be a major risk factor. Perhaps the most predictable (assuming moderate growth) is the path laid out by the Federal Reserve. Between now and end-2018 we expect the Fed to hike rates up to five times, taking the Fed funds rate to a maximum of 2.25% (Chart 7). At the same time, the Fed will begin reversing its balance sheet expansion through a slow (but increasing) runoff beginning in 4Q/2017. *In isolation*, our estimates suggest that US policy normalization will have a moderately negative impact on portfolio flows to EMs (See Box 3). However, the ECB and BOJ may be offsetting factors – at least until mid-2018. For the ECB, we expect a gradual scaling back of dovish comments in coming months, leading to a tapering announcement in September, implemented from January 1. When the QE program is terminated in mid-2018, we expect the deposit rate to be lifted to zero, but remain around that level for the foreseeable future. However, this also implies that the ECB will increase its balance sheet by EUR180 billion in 2018. We expect the BoJ to maintain an expansive policy until clear signs of reflation are seen, strengthening its communication strategy with forward guidance on top of yield curve control. Further out, the BoJ may taper its bond buying program with ordered and predictable policies.

Chart 5: EM banks expect domestic political risk to rise



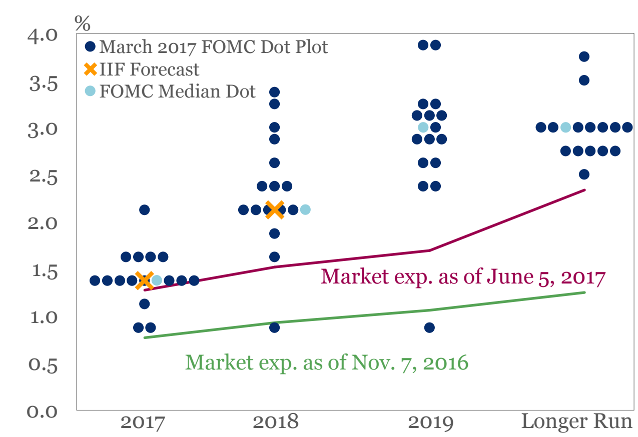
Source: IIF EM Bank Lending Survey

Chart 6: Oil prices to remain in range



Source: Macrobond, IIF

Chart 7: Fed looks ready to hike twice this year



Source: Federal Reserve, CME Group, IIF

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Box 1: *South-South Trade and Investment Flows*

Emre Tiftik, Deputy Director, Global Capital Markets, etiftik@iif.com, +1 202 857 3321
Khadija Mahmood, Research Analyst, Global Capital Markets, kmahmood@iif.com, +1 202 857 3309
Mahmoud Medhat, Policy Advisor, Global Capital Markets, mmedhat@iif.com, +1 202 857 3639

South-South Capital Flows—the Next Big Thing

A striking feature of the past decade has been the rise in financial integration among emerging markets. Despite relatively weak global trade and capital flows in the aftermath of the 2008 crisis, economic and financial linkages among EMs continue to grow, with a few key EM economies become increasingly important sources of lending and investment to other EMs. Over time, this could add a new dimension to the global economic and financial architecture, potentially reducing contagion risks stemmed from mature markets. To assess the degree of South-South integration across the 25 emerging market economies in our sample, we have focused on three major channels of integration: 1) trade flows; 2) remittances; and 3) cross-border capital flows.

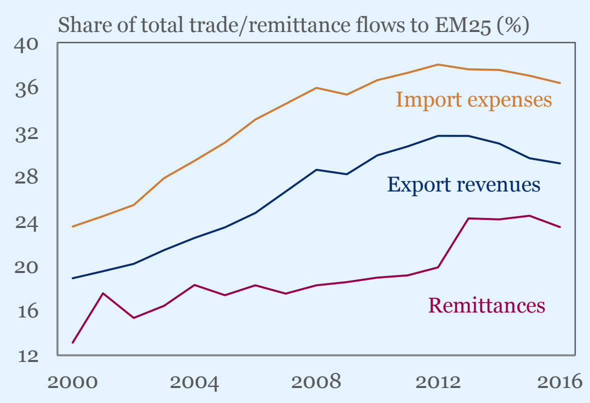
South-South trade is up 85% since 2006: *In the run-up to the financial crisis, a key driver of EM financial interconnectedness was the rapid growth in intra-EM trade linkages. While total South-South trade (measured as total exports and imports among our 25-EM sample) has contracted slightly in nominal USD terms in recent years as commodity price fell, it reached USD3.5 trillion at the end of 2016, up 85% from USD1.9 trillion a decade ago (Chart 1.1). Of note, China accounts for some 30% of total South-South trade.*

South-South remittances are growing faster than North-South remittances: *In line with the rise in South-South migration, the increase in remittance flows among EM countries has been particularly significant over the past 15 years, outpacing the growth of North-South remittances. Despite a modest decline in 2016, South-South remittances amounted to USD67 trillion in 2016, more than double the level of 2006. However, there is wide variance across countries: we estimate that the share of South-South remittances in total EM remittance receipts ranges from less than 1% for Mexico to more than 70% for Indonesia. Notably, Saudi Arabia and UAE have been the largest sources of South-South remittances, together accounting for more than 65% of total south-south remittances since 2010.*

South-South capital flows on the rise: *With outward investment and lending by EM residents exceeding USD1.0 trillion in 2016 (vs USD629 billion in 2006), available data suggest that a growing share of EM resident capital outflows has been directed towards other emerging markets (Chart 1.2).*

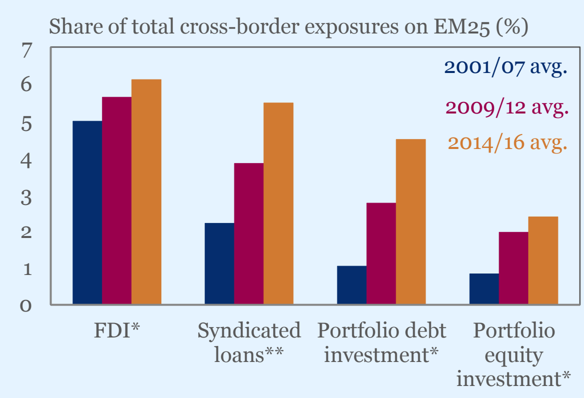
- ***South-South FDI accounts for 6% of the total stock of EM FDI :*** *While a significant portion of FDI stock in EMs still originates from mature markets, the share of South-South FDI in total EM FDI flows has been rising since the early-2000s.*
- ***South-South bank lending continues to grow:*** *Cross-border banking flows to EMs—most originating in mature economies—have been weak and volatile in recent years compared to the pre-crisis period. Deleveraging by mature market banks have been an important driver of this retrenchment. However, data on cross-border synidicated loan activities suggest that some EM banks are stepping in to fill the gap, highlighting the increasing importance of South-South banking flows for many emerging markets.*
- ***South-South portfolio investment makes up 3.6% of total cross-border portfolio investment in EMs:*** *The rise in South-South portfolio flows in recent years has been mostly in the form of portfolio debt, which has risen from some 1% of total EM portfolio debt to some 4.5% in 2016 (Chart 1.2). This ratio stands at 2.4% for portfolio equity investment*

Chart 1.1: South-South Trade and Remittances



Source: Haver, World Bank, IIF

Chart 1.2: South-South Financial Exposures



*Source: IMF, Thomson One, IIF. *based on stock data; **based on issuance data.*

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Market backdrop

Sonja Gibbs, Senior Director, Global Capital Markets, sgibbs@iif.com, +1 202 857 3325

MARKET DRIVERS: HAVE WE HIT "PEAK EM?"

After months of rising stock prices, tightening spreads and some rebound in EM currencies (particularly for commodity importers—Chart 8), many question whether the current enthusiasm for emerging markets will hold up in the face of challenges ahead. China risk remains a potential headwind, oil and commodity prices are not expected to see much improvement, and there is a wide discrepancy between market pricing of U.S. interest rates and what the Fed itself says it will do (see our new Global Macro Views). However, while we agree that a degree of caution is warranted, we continue to believe that relative valuation is attractive and investors are still broadly underweight EM (see below). With RMB stability high on the agenda for Chinese policymakers (see our recent China Spotlight) and U.S. protectionism seen as more of a medium-term threat, the overall market backdrop for EM flows could stay relatively benign for some time.

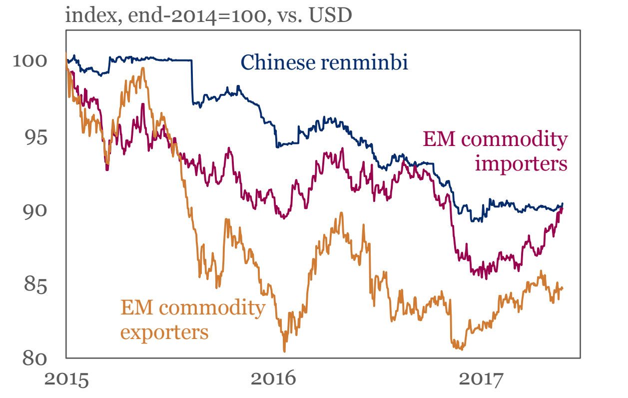
The case for EM equities

Assuming a relatively gradual, predictable path for Fed rate hikes and no major disruption from China, EM equity market valuations do not look overly stretched. Using forward price-earnings ratios, emerging markets at around 13x are less than 10% above their long run average. In contrast, mature market are 18% higher and U.S. stocks in particular are more than 20% overvalued on this metric. However, adjusting for the economic cycle (using cyclically-adjusted price-earnings ratios modeled on Cape Shiller PE), mature markets are only slightly overvalued—and emerging markets are deeply undervalued (Chart 9).

Much though will depend on whether earnings growth forecasts are realized. After five years of flat or minimal growth, EM earnings are expected to rebound 20-25% this year, and more than 15% in 2018, with particular strength in the materials, IT and energy sectors. While earnings gains in the EM financial sector are expected to be more subdued—up 8-10% over the next year—the cyclical pickup in economic growth should permit an increase in dividends. Profitability has also improved—after dipping below that of mature market firms in 2014-16, ROE for EM firms is now close to 12%.

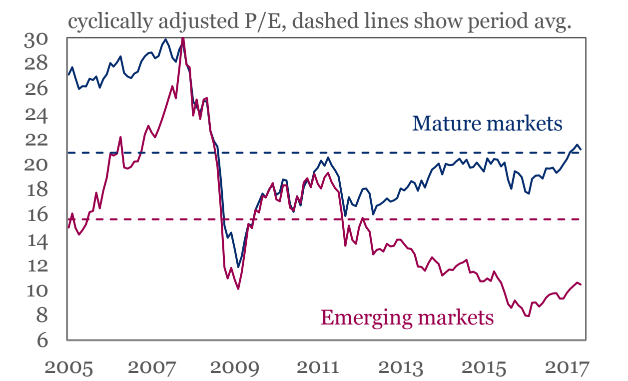
By region, earnings estimates have been revised up more in Latin America (though the expected turnaround in Brazil could be a risk—see below) and EM Europe (thanks to Russia). Earnings in EM Asia ex China—which have been more stable—are expected to be up over 10-15% this year. In China, after a drop of more than 8% in in 2016, analysts are expecting earnings growth of 15% this year, albeit with a significant degree of uncertainty given concerns about the prospects for China's highly indebted corporate sector (see our take on China's growing debt burden here).

Chart 8: Soft USD has been supportive for EM currencies



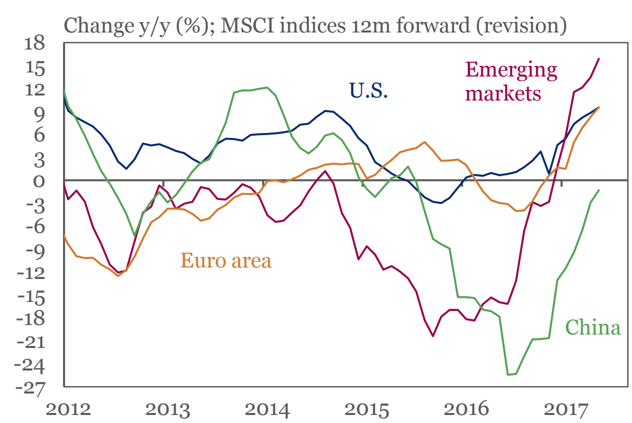
Source: Bloomberg, IIF

Chart 9: Cyclically adjusted, EM stocks look cheap



Source: Bloomberg, IIF

Chart 10: Growing optimism about EM earnings



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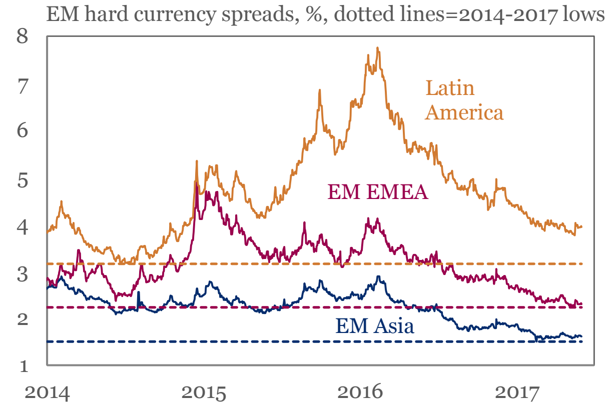
EM bonds—favorable outlook, with caveats

EM fixed-income, which has received sizeable inflows this year (driven primarily by institutional investors—See Box 2) has seen significant tightening in hard currency bond spreads, with both EMEA and EM Asia near their narrowest since 2014 (Chart 11). The EMBI global bond index has gained nearly 5% year to date, easily outperforming high-yield bonds (+2% ytd). EM local currency bonds (GBI-EM) have done better still, with gains of over 10% year to date, helped by improving inflation trends in a number of key markets (e.g. Brazil, Russia, South Africa, India). While EM local currency yields have fallen 100bp or so this year, the carry-to volatility ratio remains attractive for many key emerging markets. In addition, EM currencies in aggregate are some 20% below long-run average levels in terms of real effective exchange rates, implying scope for appreciation as growth differentials with mature markets widen (see Chart 4 above). For corporate bonds, which now represent over 40% of the EM bond universe, we expect some cyclical improvement in credit risk as economic fundamentals improve and commodity prices stabilize. Corporate governance reforms in many EM countries have also been bearing fruit (see also here). Overall corporate default rates are expected to fall from a peak of close to 4% last year towards 3% by end-2017.

Reflecting improved investor sentiment towards EM over the past year or so, mutual fund and ETF portfolio allocations to EM bonds have risen significantly, and are now much closer to an effectively neutral weight of just over 11% (Chart 12), while EM equities remain well underweight on this measure. Nonetheless, with portfolio allocations to U.S. bonds (63% of total global bond allocations) notably overweight (see Portfolio Allocation Trends) and little prospect of higher yields in the euro area and Japan any time soon, EM bonds should continue to see strong interest.

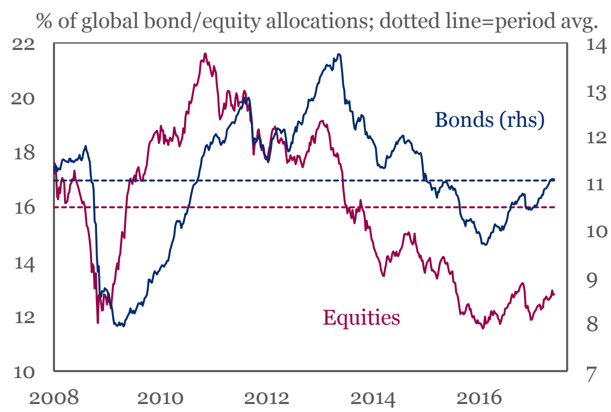
All that said, valuations are less compelling for bonds than for equities in most EM countries, particularly given the risk of global bond market turbulence in the event of a faster-than-expected rise in U.S. interest rates. Fed balance sheet reduction could also weigh on EM flows (See Box 3). Moreover, as noted our Global Debt Monitor, refinancing risk remains high, with over $1.8 trillion in EM bonds and syndicated loans coming due through 2018. Rising leverage in many EM countries remains a source of vulnerability. While issuance in recent years has been increasingly in local currency (meaning less risk of currency mismatch), the sheer volume of debt taken on—notably in the corporate sector in countries including Korea, Malaysia, Chile, Hungary and Thailand (Chart 13), and of course China (>165% of GDP)—may be a differentiating factor in EM bond market performance, particularly during stress periods.

Chart 11: EM bond spreads are tight—bar LatAm



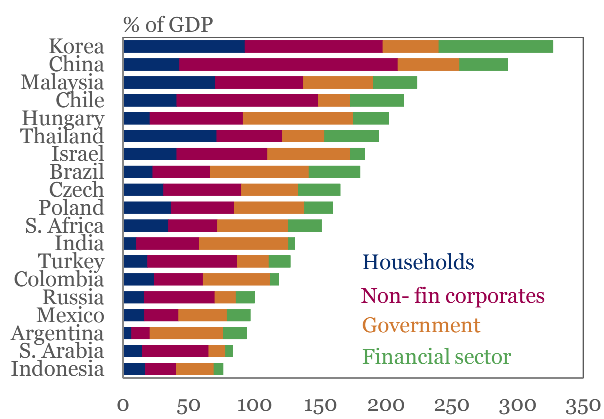
Source: IIF, Bloomberg, MSCI. Government bonds only.

Chart 12: Portfolio allocations to EM bonds--neutral



Source: IIF, EPFR; includes mutual funds and ETFs

Chart 13: Rising debt—a key vulnerability for many EMs



Source: IIF Global Debt Monitor

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Box 2: *A New Breakdown of Portfolio Flows by Investor Type*

Emre Tiftik, Deputy Director, Global Capital Markets, etiftik@iif.com, +1 202 857 3321
Mahmoud Medhat, Policy Advisor, Global Capital Markets, mmedhat@iif.com, +1 202 857 3639

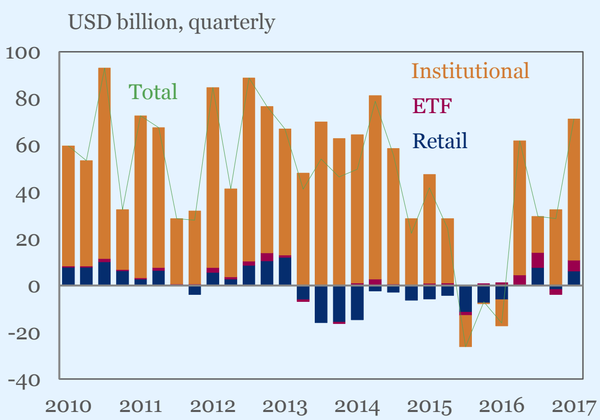
Getting More Granular

Responding to requests from our members, we have put together estimates of portfolio flows by investor type—a database we do not believe is publicly available elsewhere. To get the most accurate breakdown, we have consolidated data from multiple sources, including official balance of payments (BoP) data, the IIF Portfolio Flows Tracker, and EPFR's fund flows statistics. This short box describes briefly our proxy for the portfolio flows by investor type—retail, ETF and institutional.

- ***Cross-border retail portfolio flows*** *are computed by adjusting EPFR retail flows database (ex-ETFs) for the origin of the flows. In other words, we exclude resident investing in onshore funds that are exposed to domestic assets—e.g. a Turkish resident investing in a Turkey-domiciled fund that holds Turkish securities. EPFR categorizes fund shares as "retail" if fund shares are not assigned to institutional investors and the minimum investment amount in the fund is less than 100k.*
- ***Cross-border ETF-based flows****—for which there has been a real lack of granular data—are treated separately, as they encompass both retail and instituation investment. As with retail flows, we calculate cross-border ETF flows by adjusting EPFR's ETF data for the origin of the flows.*
- ***Cross-border institutional portfolio flows*** *are then computed by taking the difference between BoP based portfolio flows and the sum of the computed cross-border retail and ETF flows. To adjust for the lag in BoP data, we use the IIF Portfolio Flows Tracker as a proxy for portfolio flows.*

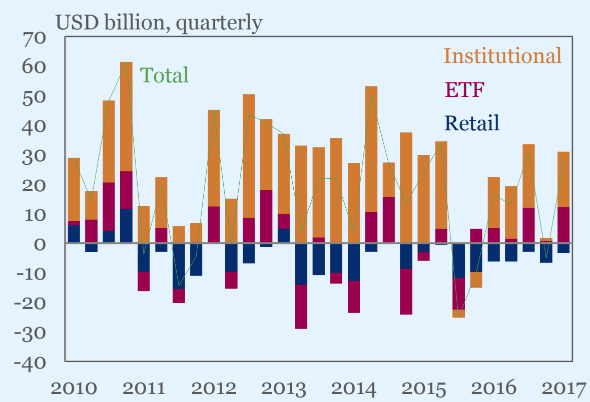
Using our new measure, the pickup in EM portfolio flows for Q1 2017 appears to have been driven mainly by institutional investors, who accounted for some 80% of non-resident portfolio inflows. While retail investors were net buyers of EM fixed income securities in Q1 (Chart 2.1), our estimates suggest that they reduced exposure to EM stocks (Chart 2.2). However, we would underscore that a significant portion of EM equity flows in Q1 was via ETFs--probably related to a broader trend towards the use of ETFs for equity investment, rather than mutual funds

Chart 3.1: EM debt flows, by investor type



Source: IIF, EPFR, national sources

Chart 3.2: EM equity flows, by investor type



Source: IIF, EPFR, national sources

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Box 3: *Fed Balance Sheet and EM Portfolio Flows*

Emre Tiftik, Deputy Director, Global Capital Markets, etiftik@iif.com, +1 202 857 3321
Celso Nozema, Financial Economist, Global Capital Markets, cnozema@iif.com, +1 202 682 7451

How Might Fed Balance Sheet Reduction Affect EM Portfolio Flows?

As the Fed contemplates how much and how quickly it will reduce the size of its balance sheet, we revisit our earlier work on key drivers of portfolio flows to emerging markets. For this purpose, we estimate a simple econometric model by using monthly data from the IIF Portfolio Flows Tracker. Our sample period is January 2009 to December 2016. The results are reported in Table A, providing a unique early attempt to quantify the impact of changes in the size of Fed's balance sheet. Our key findings include:

- ***U.S. shadow rates matter:*** *Changes in the shadow Fed Funds rate have a statistically significant and economically important impact on portfolio flows to emerging markets. Broadly, a one percentage point decline in the shadow rate is associated with a USD9 billion increase in portfolio flows to EMs. Conversely, as shadow rates rise with the Fed removes liquidity from the system, portfolio flows to EMs are likely to decline on a similar order of magnitude. Of note, we find that the impact of the ECB shadow rates on EM portfolio flows are less strong than the Fed's (See Table A –Model 1 and 2).*
- ***Fed rate expectations and changes in holdings of U.S. Treasuries matter most:*** *Our estimates suggest that while there may not be a strong relationship between the size of the Fed's overall balance sheet and EM portfolio flows, changes in the Fed's holdings of U.S. Treasuries do have an impact (model 3). In contrast, there is less evidence that a change in the Fed's MBS holdings would impact EM portfolio flows. Our findings suggest that a cumulative USD65 billion decline in the Fed's UST holdings would be associated with a USD6.8 billion reduction in EM portfolio flows—roughly the same as a 25bp increase in market expectations for the Fed funds rate two years forward. Since USD425 billion of Treasuries in the Fed's portfolio will mature in 2018, this would suggest over USD22 billion reduction in EM portfolio flows (assuming the Fed reinvests 50% of maturing Treasury securities).*
- ***Reduced secondary market liquidity would also weigh on EM flows:*** *We find that secondary market liqudity (as measured by dealers' corporate bond inventories) is a statistically significant driver of EM portfolio flows. We assume that underlying liqudity problems—such as reduced willingness of dealers to act as "shock absorbers" in a more stringent regulatory environment--have been partly masked by the plentiful Fed liquidity and ultra-low interest rates. Our results suggest that low secondary market liqudity could be a particular challenge for EM capital flows as the Fed begins to reduce its balance sheet (model 4).*

Table A: EM Portfolio Flows and Fed's Balance Sheet

	Model 1	Model 2	Model 3	Model 4
Constant	10.76***	10.334***	8.654***	10.365***
	(2.159)	(2.206)	(2.292)	(2.245)
MSCI EM/MM (stock market performance)	1.288**	1.672***	1.047*	1.229**
	(0.580)	(0.574)	(0.564)	(0.540)
Risk aversion (EMBIG Spread)	-0.203***	-0.177***	-0.278***	-0.274***
	(0.054)	(0.054)	(0.057)	(0.054)
Fed shadow rate	-10.529***			
	(4.365)			
ECB shadow rate		-5.030		
		(4.913)		
U.S. rate expectations			-0.280***	-0.266***
			(0.073)	(0.068)
Fed's U.S. Treasury holdings (t-1)			0.105**	0.094**
			(0.050)	(0.048)
Fed's MBS holdings (t-1)			-0.044	-0.052
			(0.047)	(0.045)
Secondary market liquidity (t-2)				0.530***
				(0.165)
Flows (t-1)	0.381***	0.414***	0.398***	0.382***
	(0.081)	(0.081)	(0.076)	(0.072)
Adjusted R^2	0.41	0.38	0.49	0.54

Note: Standard errors are shown between parentheses below the correspondent coefficient and asterisks indicate significance at the 10%, 5% and 1% level for 1, 2, 3 asterisks, respectively. Asterisks denote significance at the 10%, 5% and 1% level for 1, 2, and 3 asterisks, respectively. Standard errors are in parentheses. Models were estimated using monthly data for January 2009 to December 2016. Functional forms are based on standard stationarity tests for all variables (Augmented Dickey-Fuller tests). For portfolio flows, the dependent variable is non-resident portfolio debt and equity inflows to EMs as reported by the IIF portfolio flows tracker. Flows(t-1) is the lagged dependent variable. MSCI EM/MM is the monthly return differential (in percentage points) between the MSCI EM stock market index and the MSCI World Index (developed markets). EMBIG Spread is the change from the prior month in the yield (in basis points) of the J.P. Morgan Emerging Markets Bond Index Global (EMBIG). U.S. rate expectations refer to the change in the federal funds futures contract two years into the future. The Fed balance sheet measures changes in securities (U.S. Treasuries and MBS) held by the Federal Reserve and are expressed in USD billion. Secondary market liquidity is the change in U.S. primary dealers' corporate bond inventories in USD billion terms.

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China

Gene Ma, Chief Economist for China, gma@iif.com, +1 202 857 3305

SMALLER CAPITAL OUTFLOWS AHEAD

China has experienced massive net capital outflows in the past two years--USD640 billion in 2016 and USD647 billion in 2015 if including errors and omissions (Chart 14). In these two years, capital outflows of some USD1.3 trillion, declining foreign exchange reserves (USD833 billion) and weakening RMB (10%) reinforced each other. Though supporting the export industry, this vicious cycle weakened economic confidence and heightened domestic financial risks. The PBoC and the SAFE have attempted to break this cycle first by currency intervention, then tighter capital controls, and lately by introducing the "counter-cyclical factor" in the RMB morning fixing rate.

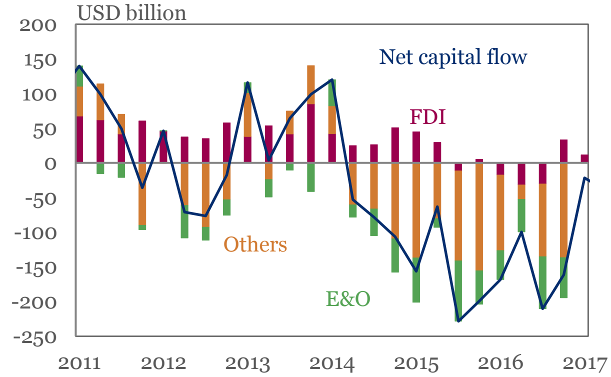
Excluding error & omissions, the non-resident capital flows reversed back to an inflow of USD173 billion in 2016H2 after the record outflow in 2015Q3. The outflow by non-residents is limited by the assets they owned onshore. Moreover, non-residents increased their holdings of onshore financial assets last year--thanks to more opened financial markets. On the contrary, residents took USD418 billion abroad through the financial account in 2H2016. Thus, net capital outflows have been mainly driven by residents (Chart 15).

There are many reasons behind the capital outflows—the needs by wealthier Chinese households to diversify their assets, the diminishing investment returns at home, the unrelenting anti-corruption campaign, and the expectation of Fed hike, etc. However, we find the most important driver of all is the expectation of the RMB exchange rate.

Regression results show that the above-mentioned measurement of capital flows can be 70% explained by the RMB expectation priced in NDF. Adding other explanatory variables such as dollar index and CNY spot rate only improve the regression results marginally. Whether to exclude FDI in capital flows does not change the result much, as intra-company loans and reinvested profits in FDI are also highly sensitive to exchange rate expectation (Chart 16).

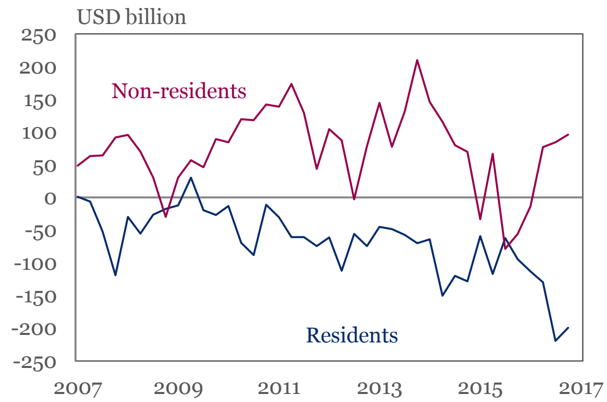
The regression result shows that one can still expect USD33~USD85 billion of outflows a quarter if the market still expects 2%~3% depreciation in a year. Capital control measures may curb outflows but only partially and temporarily, as people will eventually find ways to circumvent the barriers. Part of the reasons behind the surprisingly small current account surplus in 2016 (only 1.8% of GDP) could be capital outflows hidden in current accounts. In view of the tighter capital controls, "Belt & road" initiatives, re-anchoring of RMB, likely Fed hikes and credit downgrades, we expect persistent, albeit much smaller, net capital outflows of around USD270 billion in 2017.

Chart 14: Net capital flow, including errors & omissions



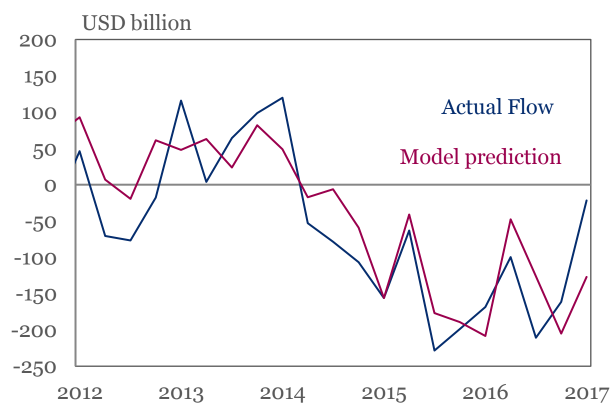
Source: SAFE, Haver, IIF

Chart 15: Net capital flow: residents vs. non-residents



Source: SAFE, Haver, IIF

Chart 16: Net capital flow: actual vs. predicted



Source: SAFE, Haver, IIF estimates

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Bejoy Das Gupta, Chief Economist for Asia/Pacific, bdasgupta@iif.com, +1 202 857 3649

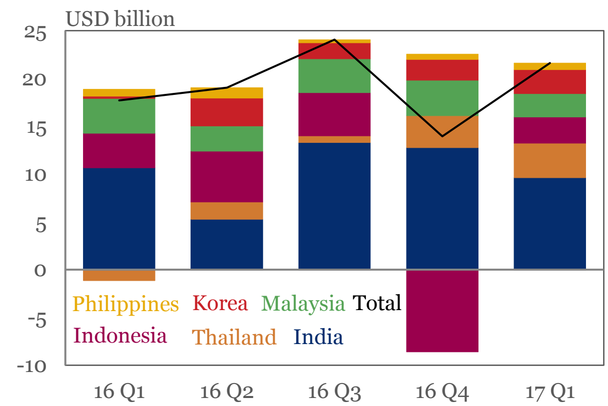
NON-RESIDENT CAPITAL FLOWS REBOUNDING

Non-resident capital flows to the Asia Six, comprising India, Indonesia, Korea, Malaysia, Philippines and Thailand, are turning up. While there are divergences and headwinds, the region is benefitting from better growth prospects, solid macro fundamentals, advancing of reforms and strong external positions, accompanied by lowering of domestic political uncertainties. One positive sign is rising foreign direct equity investment early this year (Chart 17). Another is the region benefitting from greater global appetite for EM assets, led by a sharp increase in portfolio flows to India and Korea so far this year (Chart 18). Overall, we project non-resident inflows to the Asia Six to surge to USD200 billion this year and next from around USD100 billion in 2016 (Chart 19). Downside risks stem from possible inward-looking policies and macro missteps in the US, along with spillover through the finance channel should volatility return to global markets.

With Prime Minister Modi's government advancing a slew of reforms, including the GST, momentum from recent state election victories and ending of the drag from the demonetization shock, India should receive inflows exceeding USD100 billion a year, after dropping to only USD66 billion in 2016 when around USD20 billion in Non-resident Indian (NRI) deposits matured. These deposits were contracted when the government turned to NRIs to shore up the external position in late 2013 in the wake of the taper tantrum. Non-resident capital inflows to Indonesia are also set to rise to USD35 billion this year and next from only USD12 billion in 2016. Foreign direct equity inflows are reviving from last year's weakness when the tax amnesty scheme ended round-tripping, while attractive yields and positive fundamentals are lifting foreign portfolio purchases, especially bonds.

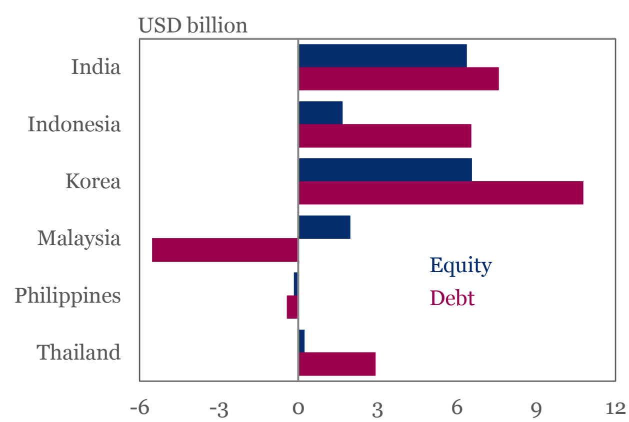
The turnaround in Korea should also be dramatic, shifting from non-resident capital outflows of around USD11 billion in 2015 to inflows exceeding USD30 billion this year and next. Although there is a lot of work to be done, portfolio inflows have responded positively to the recent election of President Moon, which ended the protracted political uncertainty, supported by his pledge to seek to rejuvenate the economy and calm tensions with the North. Thailand is also benefitting from greater foreign purchases of domestic bonds and is on a path of gradual economic recovery, so that capital inflows increase to USD12-15 billion a year from only USD2 billion in 2016. In Malaysia, after several challenging years, the economy is being lifted by the success of fiscal reform, return to positive non-resident portfolio equity inflows this year, and ending of the retrenchment in domestic debt outflows from April after greater onshore hedging flexibility was allowed, so that total annual inflows should be around USD15 billion. Positive annual inflows of around USD10 billion should also be sustained in the Philippines.

Chart 17: Foreign direct equity investment



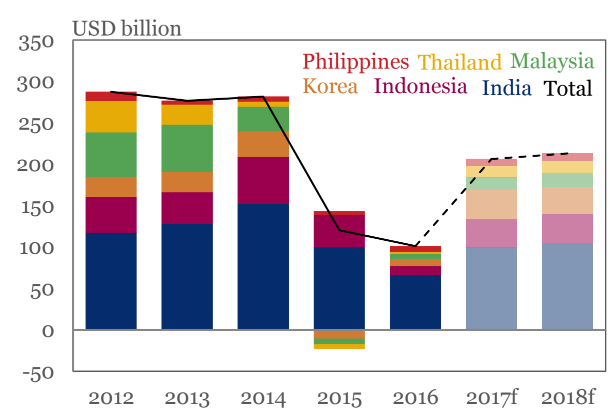
Source: National sources, Haver, IIF

Chart 18: Net foreign purchases of domestic securities, January-April 2017



Source: National sources, Bloomberg, Haver, IIF estimates

Chart 19: Non-resident capital inflows



Source: National sources, Bloomberg, Haver, IIF. f= IIF forecast.

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Emerging Europe

Ondrej Schneider, Chief Economist for EM Europe, oscheider@iif.com, +1 202 857 3635
Ugras Ulku, Deputy Chief Economist for EM Europe, uulku@iif.com, +1 202 857 3617

CAPITAL INFLOWS LIKELY TO REMAIN ROBUST

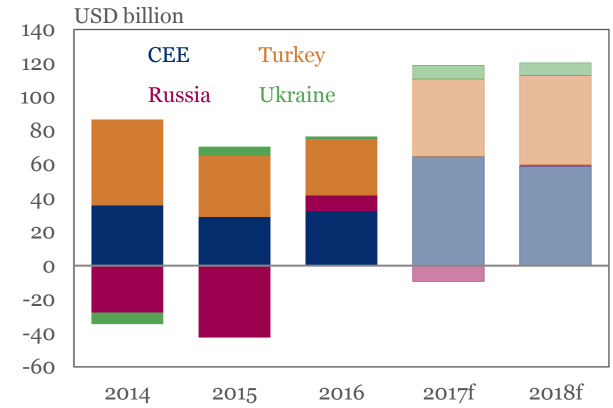
A sharp reversal of outflows from Russia and still sizable inflows to Turkey led non-resident capital inflows to Emerging Europe to surge from USD28 billion in 2015 to USD77 billion in 2016. Strong inflows continued in 2017Q1 with nonresident capital inflows rising sharply to USD54 billion from USD30 billion in 2016Q4. The 2017Q1 increase, however, was mainly driven by a surge in inflows to the Czech Republic, in anticipation of the Czech central bank's abandoning a longstanding cap on the CZK/EUR exchange rate in early April. Non-residents stepped up their purchases of koruna-denominated government bonds to all-time high of USD16 billion in 2017Q1. Should the Fed rate hikes occur at a gradual pace and in line with market expectations, capital inflows will moderate during the remainder of 2017, which should leave annual inflows to Emerging Europe to increase to USD109 billion this year and further to USD120 billion in 2018 (Chart 20).

Resident capital outflows from Emerging Europe slowed to USD31 billion in 2016 from USD82 billion in 2015, thanks mainly to smaller outflows from Poland and Turkey as well as a sharp reversal to inflows in Hungary. However, resident outflows remained broadly unchanged from a quarter before at USD28 billion in 2017Q1, mainly driven by outflows from Russia, Poland and Turkey. We project that annual resident capital outflows will increase from USD31 billion in 2016 to USD36 billion in 2017 before slowing to USD24 billion in 2018.

After Emerging Europe's total FX reserves increased by USD50 billion in 2016 (a sharp increase from only USD6 billion reserve accumulation in 2015), the rise in FX reserves continued in 2017Q1, thanks mainly to the reserve accumulation of USD44 billion by the Czech National Bank. FX reserve accumulation should increase to USD77 billion this year before gaining further momentum to USD84 billion in 2018, driven mainly by the Czech Republic, Russia and Poland (Chart 21).

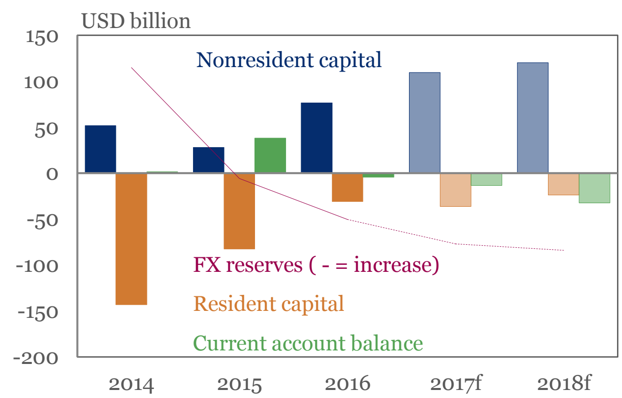
Downside risks to non-resident capital inflows to Emerging Europe remain substantial, especially if the Fed's tightening leads to a broad selloff of emerging market assets. Turkey is the most vulnerable in the region to such a broad global selloff given its reliance on short-term capital inflows to finance a widening current account deficit. Capital flows to/from Russia will remain dependent on the financial sanctions levied on Russia since 2014. As we expect no sanction relief this year, we estimate that non-resident capital inflows will probably turn negative in the second half of the year when the external debt repayments will ramp up again (Chart 22).

Chart 20: Emerging Europe: Non-resident capital inflows



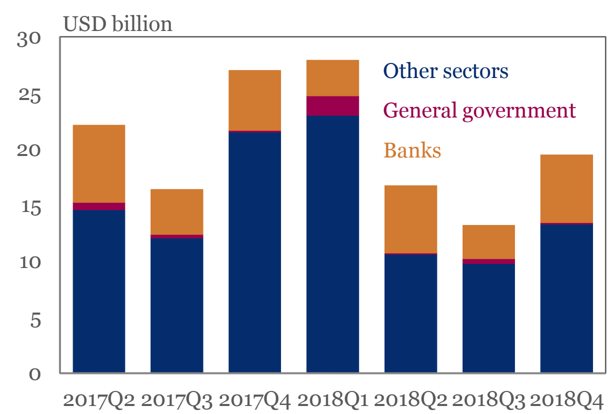
Source: Haver, IIF

Chart 21: Emerging Europe: Net capital inflows



Source: Haver, IIF

Chart 22: Russia: External debt repayments through 2018



Source: Bank of Russia, IIF

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Latin America

Ramón Aracena, Chief Economist for Latin America, raracena@iif.com, +1 202 857 3630
Martín Castellano, Deputy Chief Economist for Latin America, mcastellano@iif.com, +1 202 857 3641

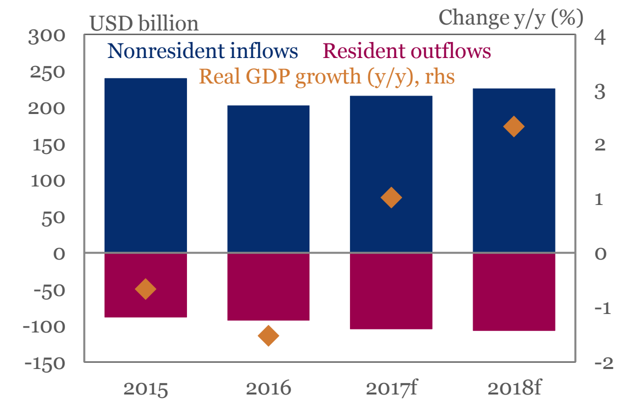
SIZABLE DOWNSIDE RISKS

As Latin America moves on from a two-year recession, we forecast private nonresident capital inflows to gradually increase in 2017 and 2018 (Chart 23). Significant uncertainty over the degree of the U.S. policy shift has been recently compounded by domestic challenges in key countries, clouding the outlook for capital flows to the region. In Brazil, a new wave of political turmoil stemming from President Temer's alleged involvement in the longstanding corruption probe has led to a deep market selloff. Nonetheless, non-resident portfolio equity inflows have held up thus far, suggesting that demand for local assets by foreign investors searching for yield could become a key market stabilizer (Chart 24). This has helped the central bank achieve an orderly FX adjustment despite increased financial turbulence. Even though we project an upturn in capital inflows to the country this year and next, the uneasy unfolding of the corruption scandal could challenge the ongoing policy realignment, which is critical to lifting growth.

In Mexico, the *peso* has gained ground against the dollar in recent months due to tighter monetary conditions and some moderation in the tone of trade protectionism talks by US officials. Although portfolio equity inflows by foreign investors slowed in 2017Q1, they remained relatively resilient. Foreign holdings of local currency bonds have recently declined amid sizable downside risks to the growth outlook linked to major near-term challenges such as doubts about future relations with the US and the 2018 presidential election (Chart 25). The US administration has already kicked-off the formal process to renegotiate NAFTA, yet considerable uncertainty over the timing and size of the changes to the current trade framework will likely weigh on inward FDI in 2017 and 2018. With left-leaning presidential hopeful Andrés Manuel López Obrador leading the latest polls ahead of next year's election, we also expect political noise to trigger large resident dollar outflows this year and next.

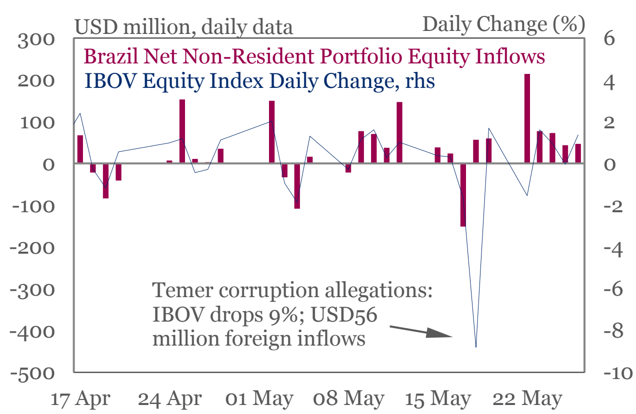
Other countries in the region could be vulnerable to spillovers (e.g. increased FX volatility, higher financing costs) from Brazil's corruption scandal. Argentina has relied heavily on dollar debt inflows this year to finance sizable borrowing requirements, reflecting a policy strategy of significant monetary tightening and limited fiscal consolidation. Public and private sector entities issued USD13 billion of new debt in global capital markets in 2017Q1. This has resulted in steady real exchange rate appreciation, hindering inward FDI and boosting resident dollar outflows. While the *peso* has adjusted to recent developments in Brazil, a forceful reduction of the fiscal deficit is needed to achieve a more balanced policy mix and reduce the country's exposure to swings in investor sentiment.

Chart 23: Latin America capital flows and growth



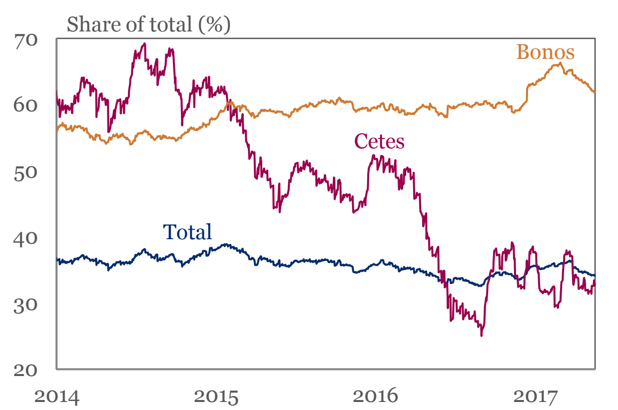
Source: National sources, IMF, IIF

Chart 24: Brazil market turmoil and nonresident flows



Source: BM&FBovespa, Macrobond, IIF

Chart 25: Mexico foreign holdings of local currency debt



Source: Central Bank of Mexico, IIF

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GCC and Egypt

Garbis Iradian, Chief Economist for MENA, giradian@iif.com +1 202 857 3304

RAPID INCREASE IN CAPITAL INFLOWS

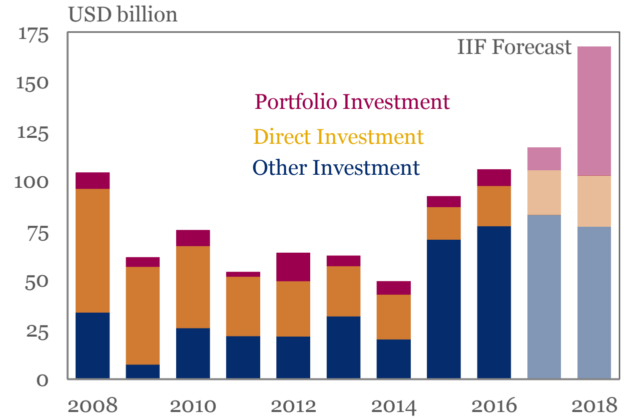
Non-resident private capital flows to the GCC countries (Saudi Arabia, the UAE, Qatar, Kuwait, Oman and Bahrain) are expected to increase to USD117 billion in 2017 driven largely by the issuance of international bonds (Chart 26). A large portion of the fiscal deficit for this year (USD94 billion, 6.5% of GDP) is expected to be financed from foreign funding, taking advantage of the low global interest rate environment and seeking to ease liquidity conditions in local banks. We expect foreign borrowing to slightly exceed USD40 billion in 2017 compared to USD37 billion in 2016. The sharp increase in 2018 capital flow forecasts is mainly due to the projected proceeds of USD50 billion from the sale of 5% of the state-owned oil giant Aramco, which the authorities say is worth about USD2 trillion.

Capital outflows from the GCC remained large in the past two years despite the shift in the current account balance from a surplus of USD240 billion in 2014 to deficits of USD45 billion in 2015 and USD10 billion in 2016 (Chart 27). While official reserves fell substantially, mainly in Saudi Arabia, the resident non-government sector continued to accumulate assets abroad. Both portfolio and other investment outflows continued to rise. Gross public foreign assets of the GCC, which peaked at USD2.7 trillion in 2014, have declined to USD2.4 billion in 2016 (170% of GDP), two-thirds of which are managed by sovereign wealth funds with diversified portfolios of public equities, fixed income securities, and minority shares in global companies. The rest is official reserves, mostly of Saudi Arabia, and is invested in liquid assets.

While the sharp depreciation of the Egyptian pound, and the tight monetary (key policy rates are up by 500 bps in the past six months) and fiscal policies have been painful, they were critical steps to restore competitiveness and macroeconomic stability, rebuild reserves, and alleviate investor uncertainty over pound valuation. Consequently, capital inflows in Egypt have increased sharply since the agreement with the IMF in November 2016, and are projected to peak at USD32billion in 2017 on the back of higher FDI, disbursement of loans from multilateral organizations, and issuance of Eurobonds (Chart 28). The authorities have recently raised another USD3 billion in Eurobond sales, about twice as much as targeted and at lower cost than the bonds sale of January 2017.

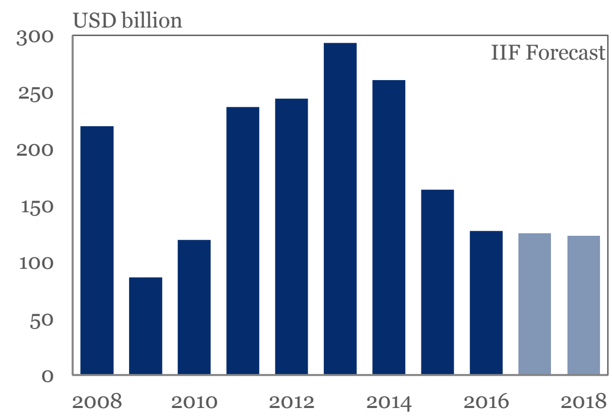
Portfolio investment in Egypt is projected to shift to a net inflow of USD7 billion in the current fiscal year ending June 2017, as compared with a net outflow of USD1.3 billion in the previous fiscal year. Foreign investors held the equivalent of USD6.7 billion in Egyptian government securities as of end-May, as compared to less than USD1 billion in the previous five years combined.

Chart 26: Non-Resident Capital Inflows to the GCC



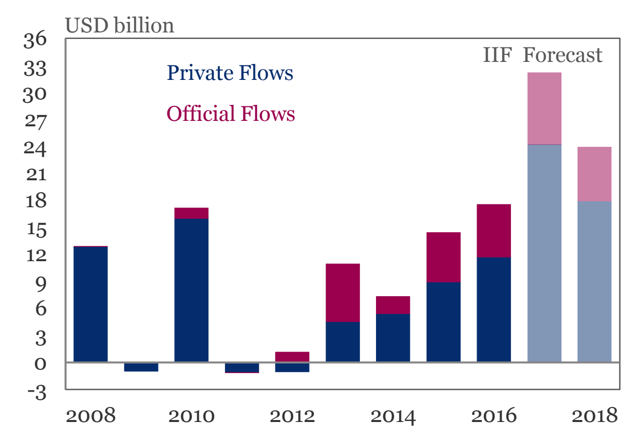
Source: National sources, IIF

Chart 27: Resident Capital Outflows by the GCC



Source: National sources, IIF

Chart 28: Capital Inflows to Egypt



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Sub-Saharan Africa

David Hedley, Chief Economist for SSA, dhedley@iif.com, +1 202 857 3605

TENSE TIMES AHEAD

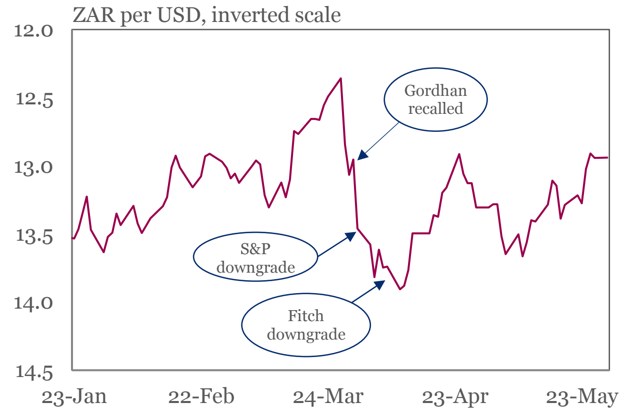
South Africa and Nigeria, which attract the bulk of capital inflows, are struggling against a background of heightened political tensions and policy uncertainty. This is weighing heavily on investor sentiment and is likely to dampen inflows going forward. Flows to other countries in the region tend to be small by comparison, and mostly in the form of ODA. Although multilateral agencies provide a steady flow of funds, China has become an increasingly important source of finance, especially for infrastructure projects. Eurobond issuance has slowed and is likely to become more sporadic as countries reduce FX exposure and stabilize their debt ratios.

South Africa has so far weathered the storm that was triggered by President Zuma's bombshell decision in March to sack his highly respected finance minister, which in turn prompted both S&P and Fitch to downgrade the country's foreign currency rating to sub-investment grade. After an initial kneejerk reaction that saw the exchange rate fall sharply, the FX market stabilized and the rand has now regained much of its lost ground (Chart 29), supported by renewed buying of domestic bonds by non-residents (Chart 30). The path forward may not be as smooth, however, and we expect markets to be volatile and capital flows to be subdued.

There are three critical events on the horizon that pose major risks. The first is Moody's upcoming ratings review. Their current rating is two notches above sub-investment grade. We think the rating will be cut, but by only notch, which means that investment grade will be kept—at least for now. However, if they do cut to sub-investment grade, this would likely precipitate significant capital outflows as some institutional investors may be forced to close their positions in domestic bonds for fiduciary reasons. The second important event to watch for is this month's ANC policy conference, which sets the policy agenda for the next five years. The third is the ANC leadership contest in December. The outcome of both these meetings will likely have a major bearing on foreign investors' attitude toward South Africa going forward.

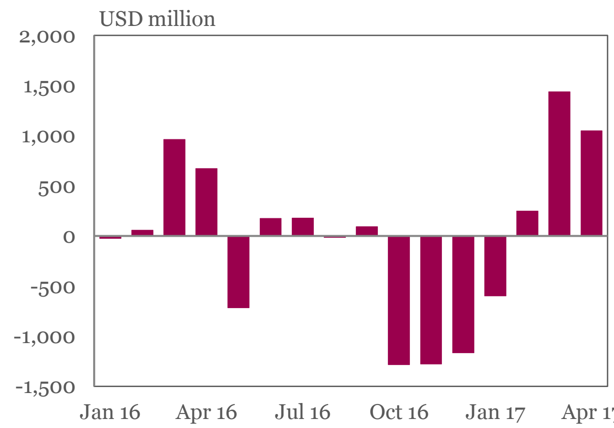
FX shortages persist in Nigeria due to ongoing de facto capital controls. Liquidity has improved a bit this year as oil production and prices have picked up and Nigeria has successfully tapped the international bond market. However, we think that a material improvement in capital inflows is unlikely until further reforms to the interbank foreign exchange market are implemented to allow for transparency and price discovery. Unless all FX controls are removed, the spread between official and parallel exchange rates will likely persist and foreign capital will remain on the sidelines (Chart 31).

Chart 29: The Rand Hits Turbulence



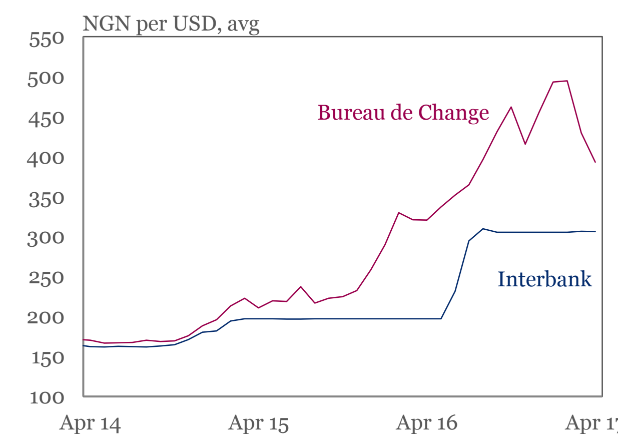
Source: Haver, IIF

Chart 30: Purchases of South African Bonds



Source: South African Reserve Bank, IIF

Chart 31: Nigerian Exchange Rates



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Tables and Annexes

Scott Farnham, Senior Research Analyst, Global Macroeconomics, sfarnham@iif.com, +1 202 857 3653

Table 2: China – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**411**	**-102**	**242**	**315**	**323**
Foreign direct investment	268	242	171	181	185
Portfolio investment	93	7	41	74	75
Equity	52	15	19	20	19
Debt	41	-8	22	54	55
Other investment	50	-352	30	59	63
Resident Capital Flows	**-463**	**-330**	**-654**	**-421**	**-416**
Direct investment abroad	-123	-174	-217	-191	-191
Portfolio investment	-11	-73	-103	-97	-91
Other investment	-329	-82	-334	-133	-133
Financial derivatives, net	0	-2	-5	-5	-5
Capital transfers	0	0	0	0	0
Reserves (- = increase)	-118	343	444	46	-35
Net errors and omissions	-67	-213	-223	-156	-109
Net Capital Flows	-51	-434	-417	-112	-98
Net Capital Flows plus Errors & Omissions	**-118**	**-647**	**-640**	**-268**	**-207**
Memo:					
Current Account Balance	236	304	196	222	242

Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

Table 3: Emerging Asia ex. China (Asia Six) – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**282**	**120**	**101**	**206**	**213**
Foreign direct investment	91	94	82	104	113
Portfolio investment	66	-14	25	67	58
Equity	18	-22	22	30	24
Debt	48	8	3	38	33
Other investment	125	40	-6	35	43
Resident Capital Flows	**-272**	**-189**	**-165**	**-231**	**-223**
Direct investment abroad	-71	-62	-47	-72	-73
Portfolio investment	-56	-54	-70	-84	-74
Other investment	-145	-74	-47	-74	-76
Financial derivatives, net	-5	3	4	-1	-2
Capital transfers	0	0	0	0	0
Reserves (- = increase)	-79	-38	-56	-71	-68
Net errors and omissions	3	-11	-6	0	0
Net Capital Flows	5	-66	-60	-25	-11
Net Capital Flows plus Errors & Omissions	**8**	**-76**	**-66**	**-25**	**-11**
Memo:					
Current Account Balance	71	115	122	96	79

Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

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Table 4: Emerging Europe – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**52**	**28**	**77**	**109**	**120**
Foreign direct investment	73	51	58	61	68
Portfolio investment	-4	-11	12	10	19
Equity	-8	-3	-3	-2	5
Debt	4	-8	16	12	14
Other investment	-17	-12	6	39	33
Resident Capital Flows	**-143**	**-82**	**-31**	**-36**	**-24**
Direct investment abroad	-81	-41	-21	-25	-23
Portfolio investment	-29	-34	2	-10	-7
Other investment	-33	-7	-12	-1	6
Financial derivatives, net	-5	-6	-1	1	0
Capital transfers	-22	21	7	17	20
Reserves (- = increase)	116	-6	-50	-77	-84
Net errors and omissions	1	7	3	0	0
Net Capital Flows	-97	-60	45	74	97
Net Capital Flows plus Errors & Omissions	**-95**	**-53**	**47**	**73**	**97**
Memo:					
Current Account Balance	1	38	-4	-13	-32

Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

Table 5: Latin America – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**370**	**240**	**202**	**215**	**226**
Foreign direct investment	170	156	140	139	152
Portfolio investment	127	48	64	56	49
Equity	23	16	23	9	13
Debt	104	32	41	47	36
Other investment	73	36	-2	20	25
Resident Capital Flows	**-153**	**-82**	**-92**	**-105**	**-107**
Direct investment abroad	-53	-47	-20	-27	-29
Portfolio investment	-17	11	-4	-10	-12
Other investment	-83	-46	-68	-68	-65
Financial derivatives, net	-4	0	3	2	3
Capital transfers	0	1	0	0	0
Reserves (- = increase)	-32	21	-20	-10	-12
Net errors and omissions	-22	-25	-4	0	0
Net Capital Flows	213	157	113	112	122
Net Capital Flows plus Errors & Omissions	**191**	**132**	**109**	**112**	**122**
Memo:					
Current Account Balance	-159	-153	-89	-103	-110

Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

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Table 6: Africa & Middle East – Capital Flows

USD billion (+ = inflow of capital, - = outflow of capital)	2014	2015	2016	2017f	2018f
Non-Resident Capital Flows	**119**	**106**	**96**	**124**	**155**
Foreign direct investment	36	30	32	35	40
Portfolio investment	26	13	32	35	70
Equity	12	6	2	3	48
Debt	14	7	30	33	22
Other investment	56	62	32	54	45
Resident Capital Flows	**-190**	**-146**	**-90**	**-98**	**-100**
Direct investment abroad	-58	-43	-32	-30	-31
Portfolio investment	-72	-35	-39	-48	-46
Other investment	-60	-68	-19	-21	-22
Financial derivatives, net	2	0	-1	0	0
Capital transfers	1	1	1	1	1
Reserves (- = increase)	4	136	83	43	8
Net errors and omissions	-31	-7	-42	-49	-49
Net Capital Flows	-70	-40	6	26	55
Net Capital Flows plus Errors & Omissions	**-101**	**-47**	**-36**	**-23**	**6**
Memo:					
Current Account Balance	96	-90	-47	-20	-15

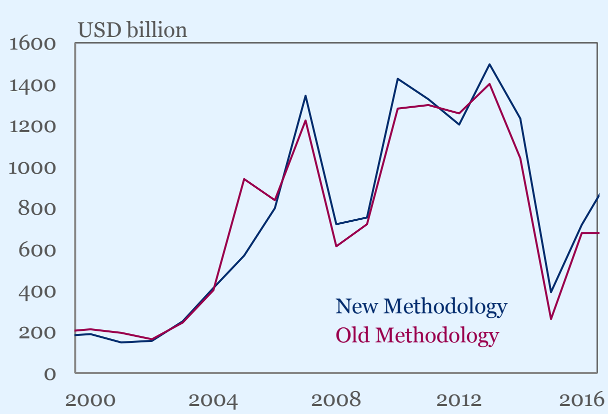
Source: IIF. See annexes 1-3 for guidance on how to interpret these data and country coverage

Annex 1: An update of our capital flows methodology

As part of our recent economic database update, we have adopted the latest IMF presentation (BPM6) for the balance of payments starting with this report. We have thus moved away from our traditional creditor based approach to track capital flows to emerging markets. As in the past, we continue to split capital flows into non-resident (liabilities) and resident (assets) flows. Unlike official BPM6, we continue to utilize a simple approach to the sign of our flows, where by a negative (-) sign indicates a net outflow of capital from the EM country and a positive (+) sign indicates a net inflow of capital (see Annex 2 below). In addition, and in order to enhance analysis, we now subdivide non-resident FDI and portfolio flows into equity and debt so that we can reconcile debt-creating capital flows with changes in the stock of external debt, using a valuation model. We no longer provide flows data for international financial institutions, official bilateral creditors and commercial banks, which are now aggregated into "other investment".

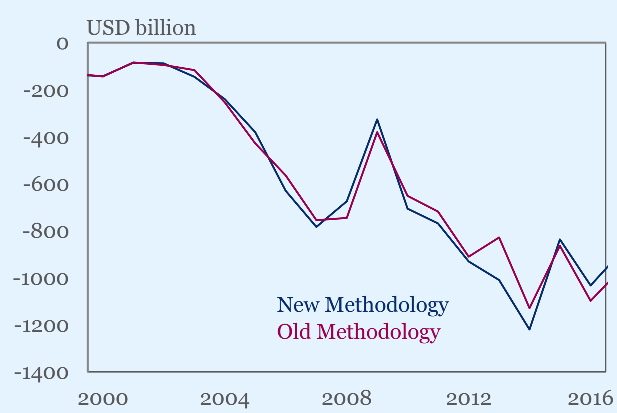
Despite the change in methodology, major headline figures remain consistent with the previous methodology (Charts A1 and A2). You can find the updated annual and quarterly capital flows databases here on our website. Please email info@iif.com with any questions.

Chart A1: Non-Resident Capital Inflows



Source: IIF

Chart A2: Resident Capital Outflows



Source: IIF

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Annex 2: IIF capital flows data – a layman's guide

Capital flows arise through the transfer of ownership of assets from one country to another. When analyzing capital flows, we care about who buys an asset and who sells it. If a foreign investor buys an emerging market asset, we typically refer to this as a non-resident capital flow (or inflow) in our terminology. We report capital flows on a net basis. For example, if foreign investors buy $10 billion of assets in a particular country and sell $2 billion of that country's assets during the same period, we show this as a (net) capital inflow of $8 billion. Note that non-resident capital flows can be negative, namely if foreign investors sell more assets of a country than they buy in a given period.

Correspondingly, if an investor from an emerging market country buys a foreign asset, we call this a resident capital flow (or outflow). Resident capital flows can also be positive or negative.

Annex 3: IIF Capital Flows Report Country Sample (25)

Emerging Europe (6)	***Latin America (6)***	***Africa/Middle East (6)***	***Emerging Asia (7)***
Czech Republic	*Argentina*	*Egypt*	*China*
Hungary	*Brazil*	*Lebanon*	*India*
Poland	*Chile*	*Nigeria*	*Indonesia*
Russian Federation	*Colombia*	*Saudi Arabia*	*Malaysia*
Turkey	*Mexico*	*South Africa*	*Philippines*
Ukraine	*Venezuela*	*UAE*	*South Korea*
			Thailand

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Contributors

GLOBAL MACROECONOMICS

Robin Brooks, Managing Director and Chief Economist
Ulrik Bie, Chief Economist
Peter Nagle, Economist
Scott Farnham, Senior Research Analyst
Jonathan Fortun, Research Analyst

AFRICA/MIDDLE EAST

David Hedley, Chief Economist, Sub-Saharan Africa
Garbis Iradian, Chief Economist, MENA
Giyas Gökkent, Senior Economist
Boban Markovic – Research Analyst

EM EUROPE

Ondrej Schneider, Chief Economist
Ugras Ulku, Deputy Chief Economist
Yorbol Yakhshilikov, Economist
Yalcin Oney, Research Analyst

CHINA

Gena Ma, Chief Economist
Phoebe Feng, Research Analyst

EM ASIA/PACIFIC

Bejoy Das Gupta, Chief Economist
Kevin Sanker, Economist
Yuanliu Hu, Research Analyst

LATIN AMERICA

Ramon Aracena, Chief Economist
Martin Castellano, Deputy Chief Economist
Maria Paola Figueroa, Senior Economist
Brent Harrison, Research Analyst
Tariq Khan, Research Analyst

GLOBAL CAPITAL MARKETS

Hung Tran, Executive Managing Director
Sonja Gibbs, Senior Director
Emre Tiftik, Deputy Director
Celso Nozema, Financial Economist
Mahmoud Medhat, Policy Advisor
Fiona Nguyen, Senior Research Analyst
Khadija Mahmood, Research Analyst

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