Post-covid developments in capital flows: what has changed?

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Կապիտալի միջազգային հոսքերի հետհամաճարակային զարգացումները. ի՞նչ է փոխվել

Քալանթարյան Հայկ Լ.
Միջազգային տնտեսական հարաբերություններ ամբիոնի ասպիրանտ,
Հայաստանի պետական տնտեսագիտական համալսարան (Երևան, ՀՀ)

Ամփոփագիր. Կապիտալի միջազգային հոսքերը և դրանց հաճախակի փոփոխվող օրինաչափությունները պահանջում են զգույշ և դինամիկ մոտեցումներ՝ տնտեսական աճի հեռանկարների և ֆինանսական խոցելիությունների գնահատման գործընթացում: Վերջին տարիներին, հատկապես Covid-19 համաճարակի սկզբից ի վեր, համաշխարհային տնտեսություններն ականատես եղան զգալի շոկերի և խոցելիությունների, որոնք բխում էին բարձր տնտեսական անորոշություններից, մատակարարման արժեշղթաների խափանումներից, էներգետիկ ճգնաժամից, գնաճի բարձր մակարդակներից, զարգացած տնտեսություններում դրամավարկային քաղաքականության խիստ պայմաններից և աճող աշխարհաքաղաքական ռիսկերից: Այս ամենը հանգեցրեց կապիտալի արտահոսքոսքերի որոշ EMDE-ներից՝ նպատակ ունենալով վերաուղղորդել կապիտալը դեպի ավելի ապահով ակտիվներ: Բացի այդ, զարգացած և զարգացվող տնտեսությունների միջև քաղաքականության տոկոսադրույքների տարբերության նվազումը հետագայում անդրադարձավ զարգացող տնտեսությունների գրավչությունը կապիտալի հոսքերի տեսանկյունից, թեև տարածաշրջանների և հոսքերի համապատասխան տեսակների միջև առկա էր տարասեռություն: Թեև կապիտալի միջազգային հոսքերում նկատվում են վերականգնման նշաններ, հաշվի առնելով կապիտալի հոսքերն ընդունողների մոտ տեղի ունեցող կառուցվածքային փոփոխությունները և համաշխարհային տնտեսության շուրջ անորոշությունները, EMDE-ներում ֆինանսական խոցելիությունը ռիսկերը կապիտալի հոսքերից և, մասնավորապես, կապիտալի հոսքերի հակադարձումից, մշտական մարտահրավերներ են ստեղծում:

Հանգուցաբառեր՝ կապիտալի հոսքեր, պորտֆելային հոսքեր, պարտք, բաժնետիրական կապիտալ, Covid-19, EMDE, ֆինանսական խոցելիություններ

Постковидные изменения в потоках капитала: что изменилось?

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Аннотация. Международные потоки капитала и их часто меняющиеся модели требуют осторожного и динамичного подхода при оценке компромисса между перспективами роста и финансовой уязвимостью. В последние годы, особенно после начала пандемии Covid-19, мировая экономика стала свидетелем эпизодов потрясений и уязвимостей, вызванных высокой экономической неопределенностью, сбоями в цепочках поставок, энергетическим кризисом, устойчиво высоким уровнем инфляции, жесткими условиями денежно-кредитной политики в странах с развитой экономикой и обострением геополитических риски. Это привело к оттоку капитала из нескольких стран с формирующимся рынком и развивающихся стран (EMDE) с намерением перенаправить капитал в безопасные активы. Кроме того, сокращение различий в процентных ставках между странами с развитой экономикой (AE) и странами EMDE еще больше повлияло на привлекательность развивающихся стран для потоков капитала, хотя между регионами и соответствующими типами потоков существовала неоднородность. Несмотря на то, что потоки капитала демонстрируют признаки восстановления, учитывая структурные изменения, происходящие с получателями потоков капитала, и неопределенность вокруг глобальной экономики, финансовая уязвимость в странах EMDE из-за потоков капитала и особенно из-за разворота потоков капитала постоянно создает проблемы.

Ключевые слова: Потоки капитала, потоки портфеля, долг, акционерный капитал, Covid-19, EMDE, финансовая уязвимость

Introduction

As the global economic environment changes so does the patterns of international capital flows. Since the beginning of globalization and particularly throughout the Great Moderation, capital flows have been recognized as an indispensable cornerstone for financial liberalization, deeper integration and economic growth [**18**]. Nevertheless, over time, the realization of potential risks deriving from capital flows, particularly if not accompanied by well-established institutional and macroeconomic environment, lead to a cautious approach both by policymakers and academia, shifting focus on analysing potential trade-offs from flows to the financial and real sectors and the overall economy in general. These risks are particularly tangible during times of sudden stops or reversals in capital flows, which was rather observed during the Global Financial Crisis (GFC) and the afterwards [**8**, pp. 239-240]. As a result, there is an everchanging pattern in how the capital flows across border, where it flows, who are the recipients and what are the type of capital they are receiving, which will determine the respective financial vulnerabilities derived from such flows (both inflows and outflows).

Such evolving patterns, as discussed, are as well observed in the aftermath of the GFC, particularly when referring to the type of capital flows and the magnitude. This necessitated a revision of IMF's "Institutional View on The Liberalization and Management of Capital Flows" in 2022 [**11**, p. 18], whereby the pre-emptive nature of capital flow management measures (CFMs) was acknowledged to contain the risks from capital flow vulnerabilities given that these measures do not substitute available institutional macroeconomic tools, including macroprudential policies. Moreover, not only the surges in flows and the following sudden stops are a subject to prudent risk approach, but also the stock of foreign capital, which can manifest into excessive financial vulnerabilities in times of heightened uncertainties.

López & Stracca (2021) [**16**, p. 13], while exploring the changing patterns of capital flows, acknowledge, among many, two noteworthy changes that were observed in post-GFC period. Firstly, there is rather a reorientation than a change towards the vulnerabilities associated with capital flows. Secondly, volume and the composition changes in capital flows after the GFC are rather expressed in declines of cross-border bank landings, and nowadays more capital flows through portfolio flows and non-financial corporations (NFC). Yet, the overall magnitude of capital flows has declined, which is well documented by McQuade & Schmitz (2019) who refer to the post-GFC years as the Great Moderation era in capital flows [**17**, pp. 5-8], expressed in smaller volumes and less volatility. Although the volatility may have declined after an extreme shock such is the GFC, in recent years, particularly with the onset of the Covid-19 pandemic, heightened global geopolitical environment and the monetary policy tightening cycle in advanced economies, certain volatility and behavioural changes have occurred in capital flows leading to financial vulnerabilities globally, particularly in Emerging Market and Developing Economies (EMDEs).

Discussion

The onset of Covid-19 pandemic resulted in elevated global uncertainty levels, supply chain bottlenecks, deteriorated consumer and investment sentiment, and, as a result, less funding and more capital flights were observed in EMDEs, affecting global liquidity levels due to outflows and/or sudden stops of capital flows. In the following years, world economy witnessed an extraordinary monetary policy tightening cycle, particularly in advanced economies, whereby global interest rates reached a 2-decade high and could stay as such higher for longer. Despite market anticipation towards a soft (or "soft-ish" as the IMF describes) landing scenario [**13**], particularly in the US, the high interest rates in AEs have been directing less capital to EMDEs. In post-pandemic era, almost third of global flows are directed to the US, whereas the share of EMs has declined significantly (China had its own fair share in this changing pattern).

These volatilities could indeed be observed when looking at the global uncertainty index, Chicago Board Options Exchange's CBOE Volatility Index, which the literature believes to be a significant determinant of global push factors for capital flows and a reliable predictor of perceived uncertainty [**3**]. Figure 1 allows us to immediately observe how the index witnessed a significant surge in early 2020 and since then has only eased moderately due to elevated geopolitical uncertainties, risk aversion and high country risk premiums in certain EMDEs, thus somewhat explaining the volatility in capital flows.

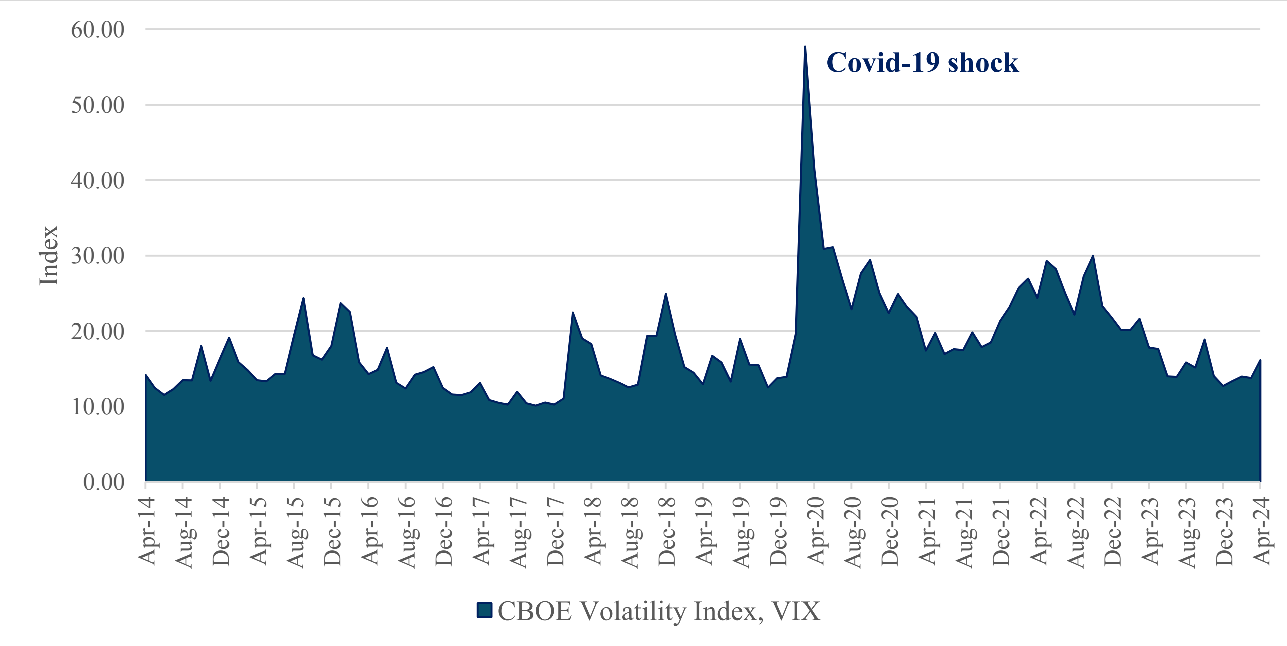

Figure 1: *CBOE Volatility Index: VIX, Index, Monthly, Not Seasonally Adjusted* [7]

Furthermore, the interest rate differentials between the US and EMDEs, captured by the difference between US 10-year treasury yields and the EMBI index, has been a crucial factor for redirecting capital flows towards the US and the broader AEs. The 10-year bond yields have been soaring to historic highs in recent years, thus narrowing the interest rate differential between AEs and EMDEs, affecting capital flows globally. This interest rate transmission channel is among the most documented within the literature, including but not limited to Ray (2013), Obstfeld (2015), Bruno & Shin (2012). This narrowing spread between the US 10-year bond yields and EMBI index indicates less premia and less incentive for investors to move capital to EMDEs. As a result, the interest rate differential pulled some capital out of certain EMDEs, making them more exposed to financial vulnerabilities stemming from capital outflows. However, a noteworthy phenomenon has been observed since the aftermath of the pandemic, whereby the EMDEs, especially in Latin America and Emerging Asia, despite witnessing capital outflows, have managed to contain these risks due to enhancements in institutional setting and macroeconomic fundamentals, [**12**] which made the respective financial systems rather resilient.

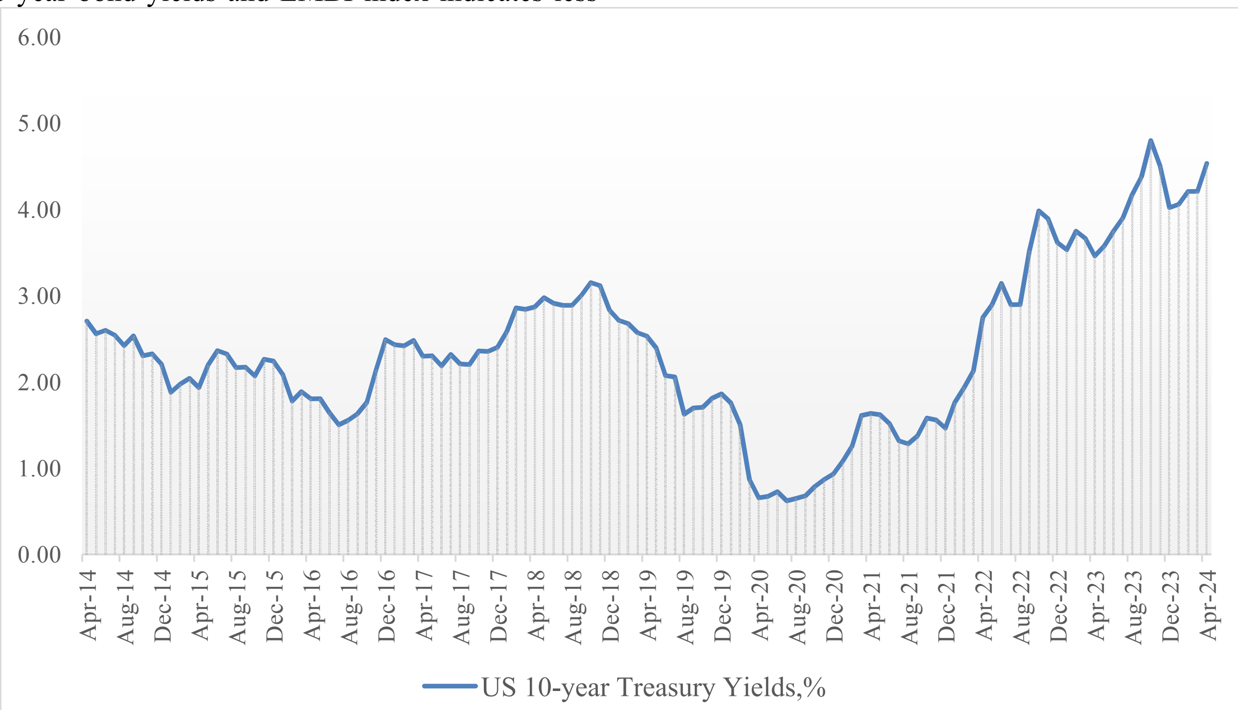

Figure 2: *US 10-year Treasury bond yields* [**7**]

Figure 3 (*[IIF's Capital Flow Tracker]* *captures capital flows data for selected major EMDEs on a monthly basis*) plots non-resident capital flows to selected EMs starting from mid-2000s and contains 3 notable episodes. First, the GFC, when capital flows to EMs declined drastically, second, the 2015 sudden stop episodes due to the global commodity price fluctuations in 2015 [**16**, p. 4]. Lastly, after regaining momentum throughout 2021, the monetary policy tightening cycle and further heightening of global economic and geopolitical uncertainties, observed also by the VIX index, decreased the magnitude of capital flows significantly. This was particularly worrisome from financial instability perspective as the rather loose financial conditions before this episode resulted in capital flights as shock manifested itself. Moreover, the massive stocks of accumulated debt levels by Chinese property developers and the concerns about potential defaults since 2021 [**15**] fuelled further uncertainties around the economic outlook and required more caution by investors who direct capital to China. It is worth noting that in the past 10 years or so a major portion of capital flows was directed to the Chinese economy.

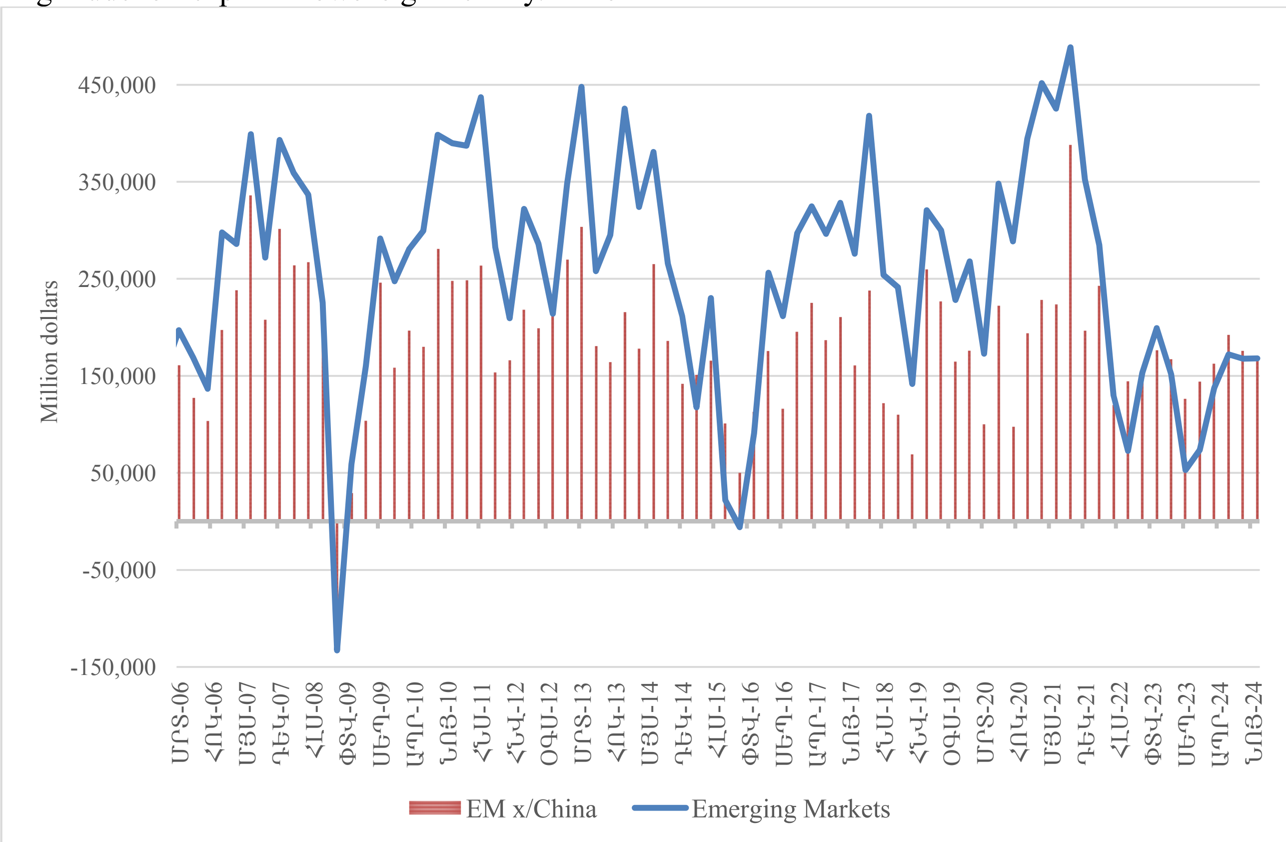

Figure 3: *Non-Resident Capital Flows to EMs, in $ mln* [**14**]

While discussing capital flows and vulnerabilities derived from its volatilities, it is widely common to consider disaggregate flows based on their type. Given the highly volatile nature of portfolio flows as opposed to other types of flows, particularly the FDIs, [**6**, pp. 24-28] as well as the common belief that these flows are greatly affected by global push rather than pull factors [**9**, p. 24], I shift the focus on such flows. As discussed by Cleassens & Ghosh (2013) [**4**, pp. 98-99], surges in capital flows (both inflows and outflows) in EMs are rather characterized by global "push" factors, because for these economies financial integration is about seeking more funding from external sources, whereas, in AEs, with the deeper integration in financial markets, capital flow surges are rather about risk-sharing.

According to the Figure 4, in the wake of the global pandemic's onset, net portfolio flows to selected EMDEs recorded a significant decline from a 13 bln USD in January of 2020, to 160 bln USD in April, followed by a rather volatile path along the recovery. One might have assumed that this was due to decline in capital inflows to EMDEs, but looking at the outflow data it is clear that there was a 2-side story, whereby, to certain degree, the stop in flows was accompanied by a reversal in capital flows. Another key pattern was that, unlike the GFC period, where shocks were mainly transmitted through the banks and cross-border bank lending [**5**,

p. 10], the episodes of recent outflows are showing sign of being driven by non-banks and/or non-financial institutions**.** However, less turbulent outlook was observed this time compared to the GFC (acknowledging the differences in the shocks observed), which could, among many, be explained by the gradual decline of the role of global push factors and the accelerating influence of domestic economic factors as a more pronounced driver of capital flows**.** This somewhat moderated the vulnerabilities for those EMDE who have heavily invested in regulatory and institutional adjustments to balance vulnerabilities from capital flows.

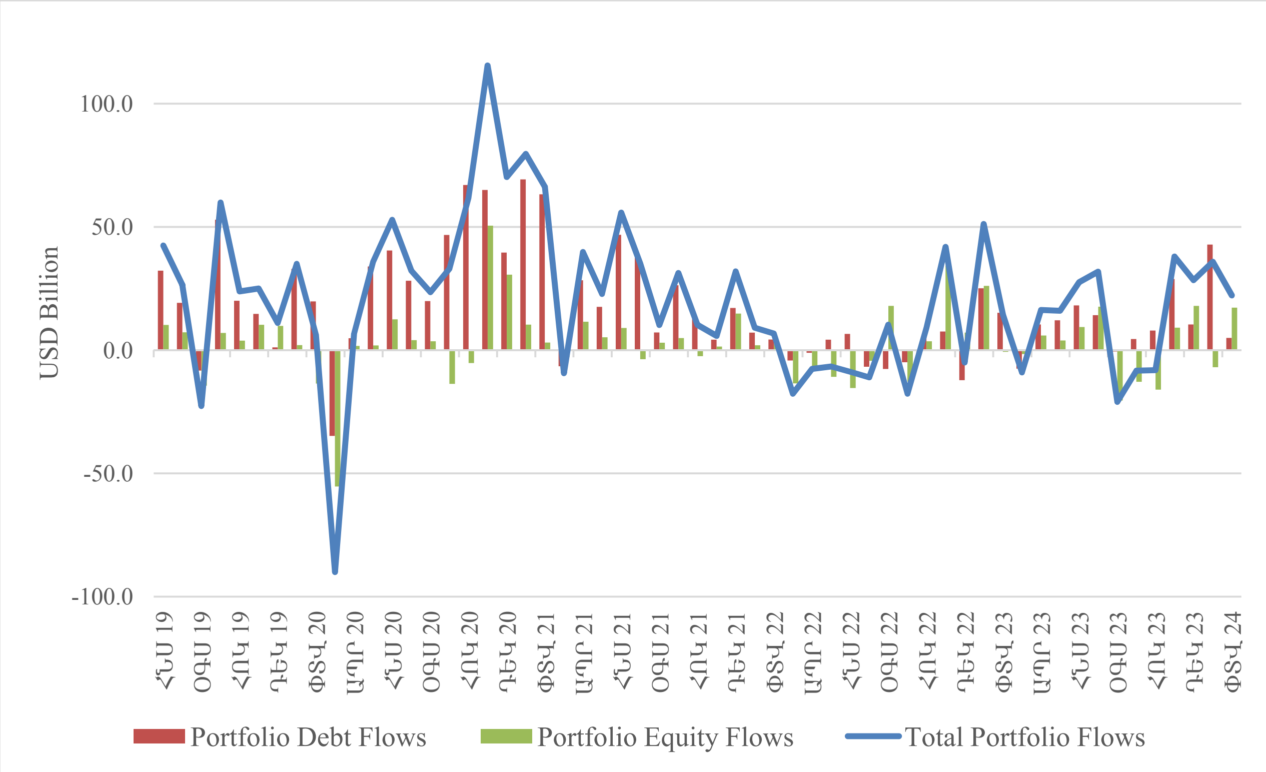

Figure 4: *Net non-resident purchases of EM stocks ("portfolio equity flows") and bonds ("portfolio debt flows") in USD billion. Proxy for portfolio flows as measured in the balance of payments* [**14**].

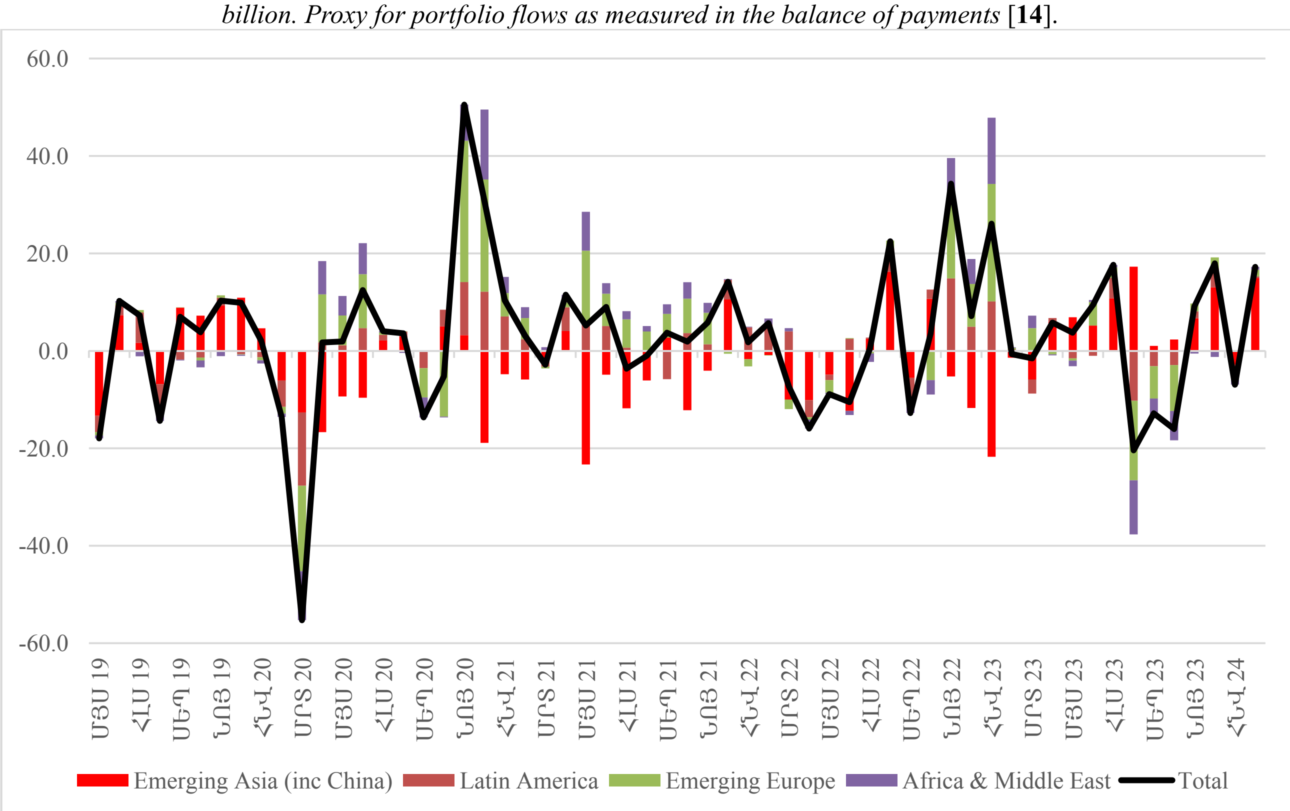

Figure 5: *Net non-resident purchases of EM stocks ("portfolio equity flows") and bonds ("portfolio debt flows») by region, in USD billion* [**14**].

Exploring the data on regional level in Figure 5, it is observed that the initial decline in portfolio flows to EMs was particularly prominent in Latin American countries (Chile, Argentina, Brazil) and rather prevalent in debt flows. While certain uptick was preserved in the aftermath, capital flows became more volatile and oriented towards advanced economies as the monetary policy tightening cycle began mid-2022, which was rather aggressive and policy rates are still assumed to be staying higher for longer, affecting both capital inflows and outflows through the interest rate channel. After the pandemic shock, investors started to rebound flows, but they were more cautious given the vulnerabilities in world economies. López & Stracca (2021) [**16**, p.12] note that a major portion of recovery was attributed to China and Eastern European economies and was more pronounced in debt flows.

Another vulnerability observed was due to issuance of debt by several EMDEs, especially in foreign currencies. This was explained first by lack of liquidity in certain markets and second, the expansionary fiscal policies that were designed to stimulate the economy, adding to concerns over unsustainable debt levels. Looking at the BIS International Debt Securities statistics [**1**], I observe that bank credit to non-banks in EMDEs, after years of robust annual growth rates, first started to flatline and wes followed by a path of a sharp decline, similar to the GFC period, yet at a smaller magnitude. This, consequently, narrowed the credit available in respective economies and more debt issuance was needed to meet liquidity demands, especially by the non-banks and non-financial corporates, raising further concerns about financial vulnerabilities. Global debt levels have already been soaring in recent years and debt issuance by NFCs, particularly offshore debt, has risen concerns over its financial stability [**2**]. Given the lack of literature on such debt and flows as well as the difficulties to track such data from official statistics such as the BOP, further financial vulnerabilities are rising. The debt levels are further worrisome given their dominance in FX, raising USD index and elevated global interest rates that affect EMDE's attractiveness for capital flows. IMF also notes that "External liabilities are riskiest when they generate currency mismatches—when external debt is in foreign currency and is not offset by foreign currency assets or hedges" [**10**].

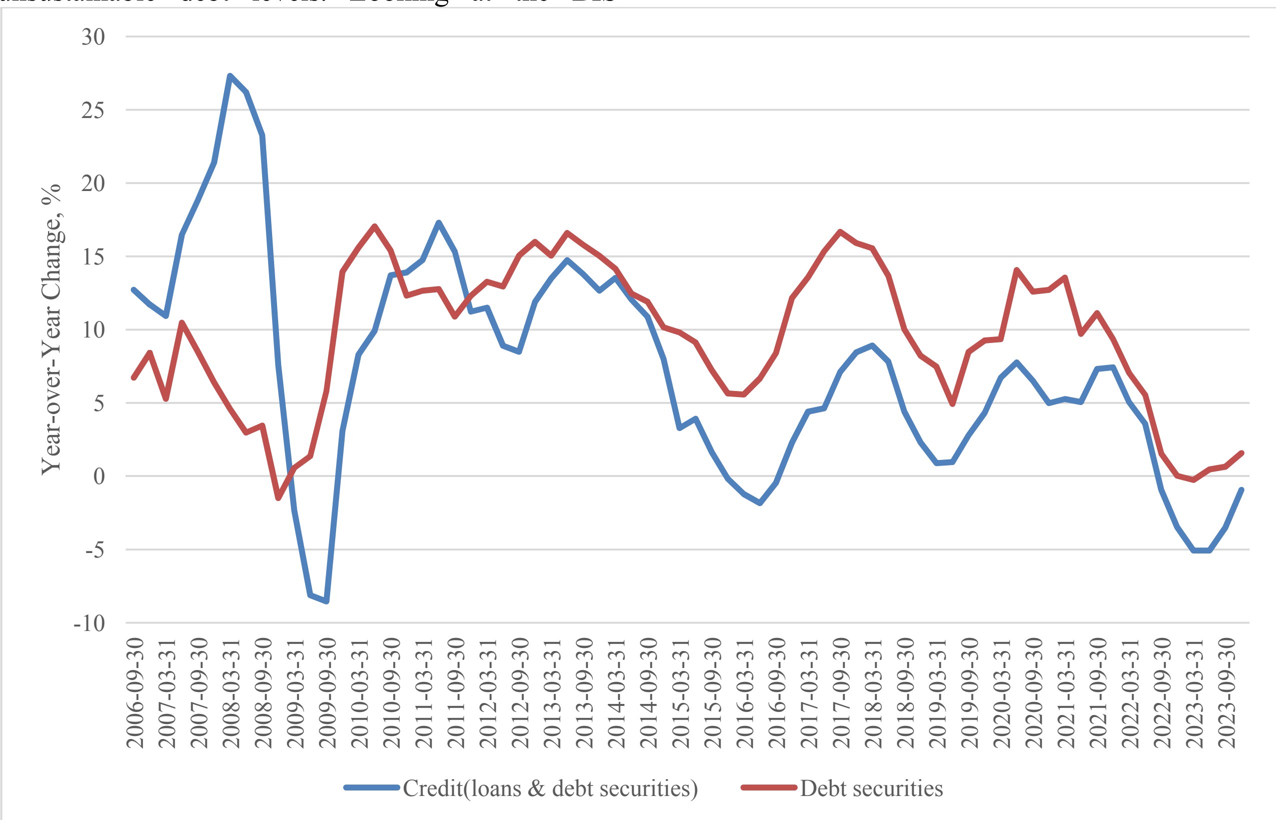

Figure 6. *Cross-border & local in fcy credit vis-a-vis non-banks, in EMDEs, in terms of credit (loans & debt securities), in USD* [**1**].

Conclusion

To conclude, during the post-pandemic era, additional vulnerabilities deriving from capital flows rose. Elevated uncertainty levels amidst the Covid-19 shock, which later was translated into supply chain disruptions globally, directed less capital in and more capital out of EMDEs on a high-frequency basis, adding to global liquidity concerns.

This was rather observed in portfolio debt flows and more prevalent in Latin American economies. Following this, elevated and persistent inflation levels in AEs necessitated an extraordinary monetary policy tightening cycle, leading to decreased interest rate differentials between AEs and the EMDEs, thus making AEs more attractive for directing capital towards. Furthermore, after the GFC, further vulnerabilities have derived from the increasing role of non-banks and/or non-financial institutions in international capital flows and debt issuance. Given that the world still experiences mounting uncertainties around higher for longer interest rates, unsustainable debt levels in the US and other economies as well as uncertainties around neutral interest rate levels and geopolitical risks, financial stability risks in EMDEs from capital flows and particularly from reversals of capital flows are persistent.

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