2017.1.10

Concerned Outflow of Money from Emerging Economies in 2017

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With the Trump shock and recent and anticipated rate hikes rate hike in the US, concerns over a critical capital outflow from emerging economies are rising. According to the International Institute of Finance (IIF), capital outflow from emerging economies[1] amounted to $24.2 billion in November 2016, the largest in the last three and a half years.

In May 2013, the currencies of emerging economies sharply fell triggered by the statement of the US Fed Chairman Ben Bernanke on the possible tapering of its quantitative easing policy, causing a so-called Taper Tantrum where a large amount of money flowed out of emerging economies**.** As there had been an overheated investment in emerging economies after the global financial crisis with a continuous shift of money from advanced economies to emerging world, the capital outflow from these countries at a time of Taper Tantrum was so massive as if the excessive money that had flowed in there was instantly disgorged back. However, the large scale of outflow that took place last November had a different dimension from the one seen at the time of Taper Tantrum. Since 2015, some of the emerging economies had experienced a gradual outflow of capital as their economic growth was decelerated affected by a slower economic growth in China and falling resources prices. So the recent outflow of capital may represent a more fundamental problem of weakening of emerging economies and it may be too optimistic to see it as a temporary outflow of excessive funds that had flowed into these countries earlier.

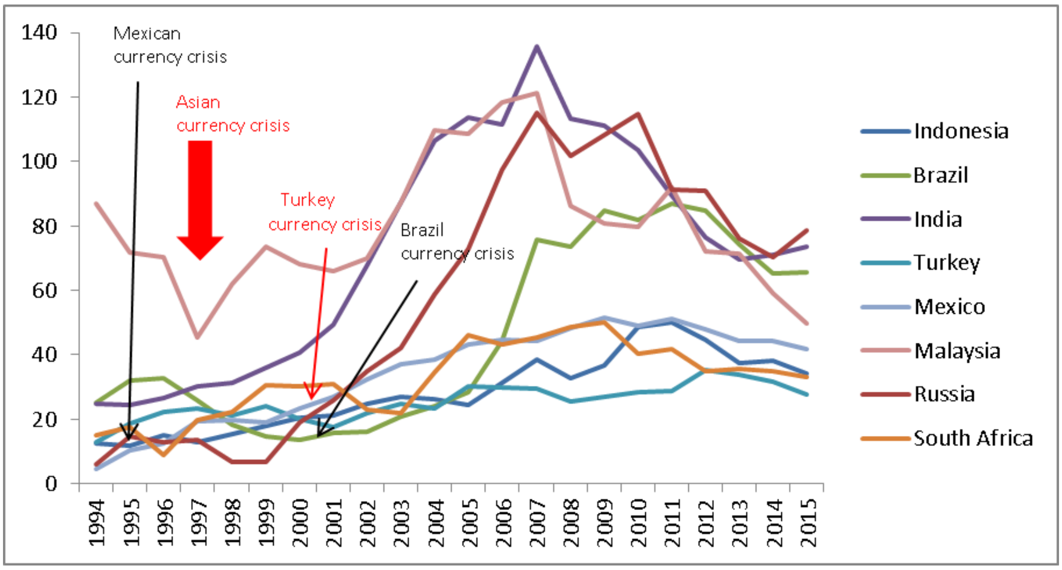
Further, at a time of Taper Tantrum, although the US economy had been recovering from the global financial crisis, its growth rate was rather anemic and the Fed postponed the tapering until December in 2013. Then the Fed terminated the expansion of quantitative easing in October 2014 and started to raise the policy rate in about a year later, which prompted a massive outflow of capital from emerging economies. On the other hand, the Fed quickly decided to raise the policy rate in the next policy meeting after a large scale of capital outflow from emerging economies took place in the backdrop of a rising dollar after the election of the next

[1] They refer to Brazil, Chile, China, India, Indonesia, Mexico, Poland, Russia, South Africa and Turkey

president Mr. Trump in November and following rise in the US long-term interest rates. The Fed has indicated a possibility of three hikes of its policy rate in 2017 taking into consideration a possible higher inflation caused by the fiscal policies of the Trump administration but there is also a possibility of more accelerated rate hikes. If the Fed takes a path of rate hike at once a year pace as was seen in recent year, emerging economies will be able to endure the impact, but close attention will be needed to a possibility of more rapid pace of monetary tightening.

Emerging economies have been struggling to control continuous outflows of money associated with currency depreciation, by adjusting interest rates and adopting capital controls. Learning from the lessons of currency crises that occurred in Asia and Central America, they have been reinforcing preparatory measures for currency depreciation, by trying to improve current account balances, building up foreign exchange reserves, and reducing external debts. Yet, the ratio of external debt outstanding to foreign exchange reserves is approaching in some countries like Turkey and Malaysia to their low levels reached at the time of currency crisis, showing little room in their foreign exchange reserves used for protecting their currencies (Chart 1). So in 2017, more cautious attention than in last year should be given to a concern of rapid capital outflow from emerging economies and their capacity to endure such external shocks.

Chart1 Ratio of External Debt Outstanding to Foreign Exchange Reserves[2] in Emerging Economies (%)



(Source) World Bank

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[2] The ratio for China is excluded here because its values are too big. It remained under 100% in the 1990s, but gradually increased to reach 1300% in 2010 to be followed by a downward trend to 240% in 2015