

Global Capital Flows

Recovering risk appetite drives capital flows to EMs

In a search-for-yield environment, a higher risk appetite is likely to drive global capitals to emerging markets (EMs). As EMs economy may rebound more quickly in 2020 and central banks in US, EU and Japan all joined the easing wave, we are positive on EMs and expect the flow of fresh funds to EMs to recover this year. Meanwhile, foreign investors were selling off US Treasuries, and Japan remained the largest holder of US government debt as a result of its low-yield environment domestically. We believe US equities and agency bonds are still attractive to global funds in the near term.

- **EMs attracted US\$51bn capital flows in Nov and Dec 2019.** During the last two months of 2019, when major central banks joined the global monetary-easing wave and US-China trade talks were progressing, risk appetite got improved and investors were returning to EMs. Global portfolio managers allocated about US\$20.3bn and US\$30.7bn into EMs in Nov and Dec 2019 respectively, with a sum of US\$17.3bn to stocks and US\$33.7bn to bonds. This year-end rebound is seen as a positive sign for further improvement, especially after global investors fled EMs stocks in May and Aug 2019 as trade war heated up then.
- **Improving risk appetite and a faster rebound in EMs economic growth may continue to drive capital flows to EMs.** Total capital flows to EMs in 2019 (US\$310bn) were well above that of 2018 (US\$194bn), but fell short of the amount of 2017 (US\$375bn). Looking ahead, the outlook for capital flows to EMs will depend on how the US-China relations, EMs financial stability and other risk factors will play out. We see global growth only recovering mildly and hovering around 3% in 2020. EMs growth, in our view, is likely to rebound faster than developed economies, which would drive capital flows to EMs and the asset performance there.
- **China's holdings of US government bonds continued to fall and Japan remained the top holder of US debt.** Net long-term portfolio flowed to US by US\$10.8bn, 4.3bn and 6.8bn from Sep to Nov 2019. Agency bonds were the most attractive long-term securities while foreigners were selling off US Treasury bonds for four straight months as of Nov 2019. Instead, foreign holdings of all-denominated short-term US securities and other custody liabilities continued to increase by US\$9.1bn in Nov 2019.
- **The landscape of global capital flows is undergoing significant changes, making tracking cross-border investment more meaningful.** EMs had a dismal performance over the past decade. But this story is likely to change given a low-growth low-yielding developed world in 2020s. Compared to FDI, portfolio investments are more sensitive to the impact of idiosyncratic global shocks. Tracking cross-border capital flows gives investors the most updated and direct information about the market trends.

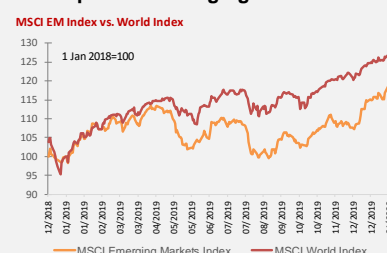
Global portfolio inflows to Emerging Markets (US\$ bn)

| | Aug 19 | Sep 19 | Oct 19 | Nov 19 | Dec 19 | Jan 20E |
|--------------------------|--------|--------|--------|--------|--------|---------|
| Portfolio inflows to EMs | -13.8 | 37.7 | 22.5 | 20.3 | 30.7 | 38.5 |
| Equity inflows | -14.1 | 10.3 | 1.2 | 4.4 | 12.9 | 16.0 |
| Debt inflows | 0.3 | 27.6 | 21.3 | 15.9 | 17.8 | 12.5 |

Source: IIF, CMBIS

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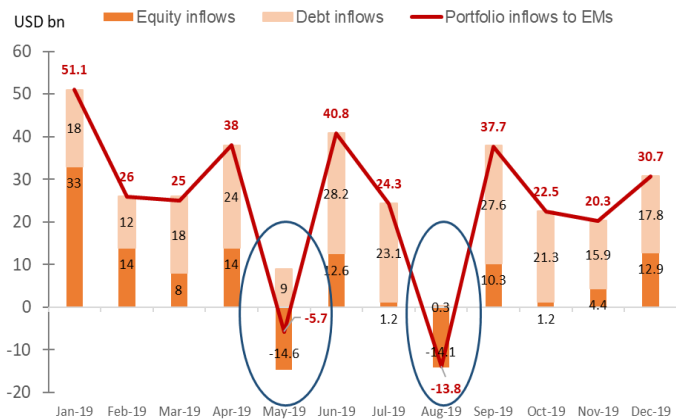
Equity market performance of developed and emerging markets



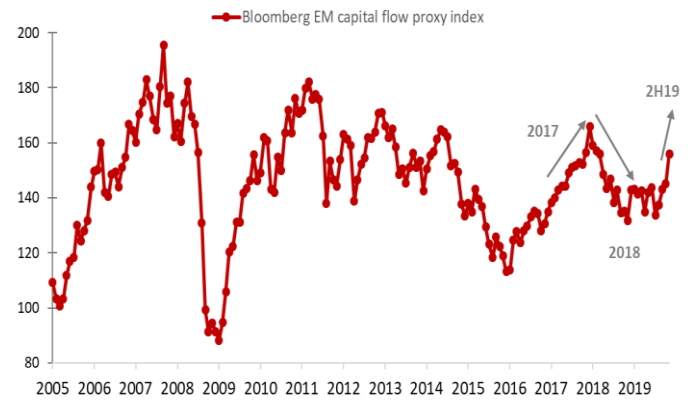
Source: Bloomberg, CMBIS

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Figure 1: Trade jitters brought nightmares to EMs in May and Aug 2019
Portfolio inflows to EMs


Source: IIF, CMBIS

Figure 2: Capital flows to EMs rebounded in 2019 but still lower than 2017
EM capital flow proxy index


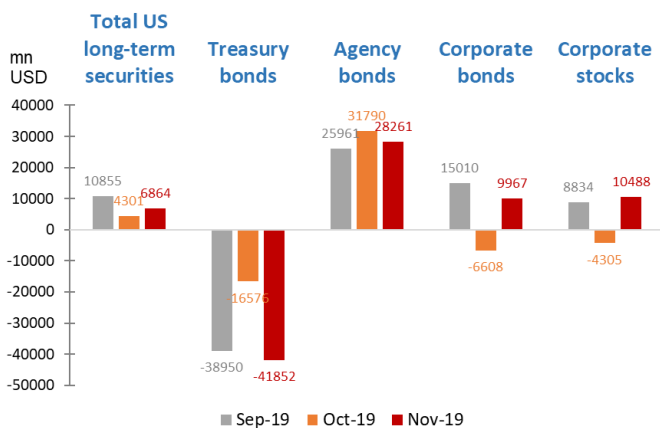
Source: Bloomberg, CMBIS

Figure 3: EMs stocks fell in May and Jul 2019, followed by a strong rebound in Dec 2019
MSCI Emerging Markets Index

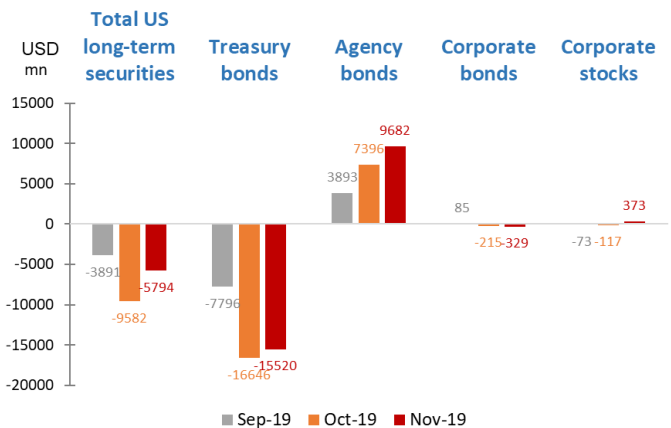

Source: Bloomberg, CMBIS

Figure 4: Japan has surpassed China to be the top holder of US Treasury Securities
China vs. Japan: holding of US Treasury Securities


Source: Bloomberg, CMBIS

Figure 5: Foreign net purchases of US long-term securities increased and of Treasury bonds decreased further in Nov 2019
US Foreign Net Purchases of US Long-term Securities


Source: US Department of Treasury, CMBIS

Figure 6: China was selling US Treasury bonds while purchasing agency bonds
Mainland China's Net Purchases of US Long-term Securities


Source: US Department of Treasury, CMBIS

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