



GLOBAL ECONOMIC OUTLOOK AND IMPLICATIONS FOR CAPITAL FLOWS TO ASIA

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Global activity strengthening, but uncertainty rising

- Global growth: uneven pick up
 - Advanced Economies (AE): improving performance, with upgrades primarily for the U.S. with growth in other countries sustained at sluggish rates
 - Emerging Market and Developing Economies (EMDE): near-term growth prospects revised up, primarily from China, but substantial weakening in a few large economies
- Uncertainty surrounding the policy stance of the new U.S. administration and its global ramifications, could lead to a dispersion of outcomes
- Recent data have been generally solid

Multiple forces and realignments shaping the outlook

Advanced Economies

- Changing policy mix
- Remaining post-crisis repair
- Fraying globalization consensus

overlaid on...

- Demographic headwinds
- Tepid productivity growth

EMDEs

- Rebalancing in China
- Tightening financial conditions
- Idiosyncratic shocks

overlaid on...

- Demographic trends
- Weakening productivity growth

Baseline assumptions

- Changing policy mix in the U.S. including near-term fiscal stimulus and a less gradual normalization of monetary policy
- Firming of oil and some other commodity prices
- Gradual return to growth in stressed economies
- Policy stimulus in China and gradual unwinding of credit boom and rebalancing

Growth projections: Advanced economies

(percent change from a year earlier)



World



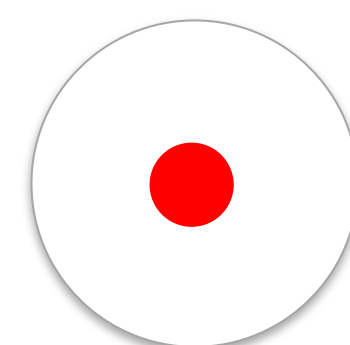
Advanced Economies



U.S.



U.K.



Japan



Euro Area



Germany



Canada



Other
Advanced
Economies

2016

3.1

1.6

1.6

2.0

0.9

1.7

1.7

1.3

1.9

2017

3.4

1.9

2.3

1.5

0.8

1.6

1.5

1.9

2.2

Revision
from Oct.
2016

0.0

0.1

0.1

0.4

0.2

0.1

0.1

0.0

-0.1

2018

3.6

2.0

2.5

1.4

0.5

1.6

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2.0

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Revision
from Oct.
2016

0.0

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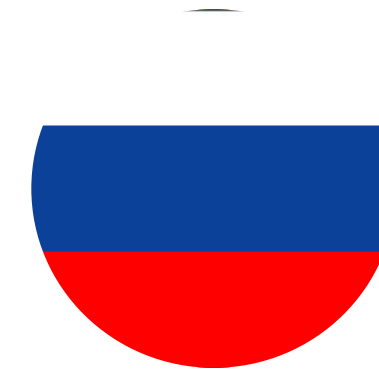
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Growth projections: Emerging markets and Asia

(percent change from a year earlier)



World

EMDEs

China

India

Brazil

Russia

ASEAN-5

EMDE
Asia

2016

3.1

4.1

6.7

6.6

-3.5

-0.6

4.8

6.3

2017

3.4

4.5

6.5

7.2

0.2

1.1

4.9

6.4

Revision from
Oct. 2016

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-0.1

0.3

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2018

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Revision from
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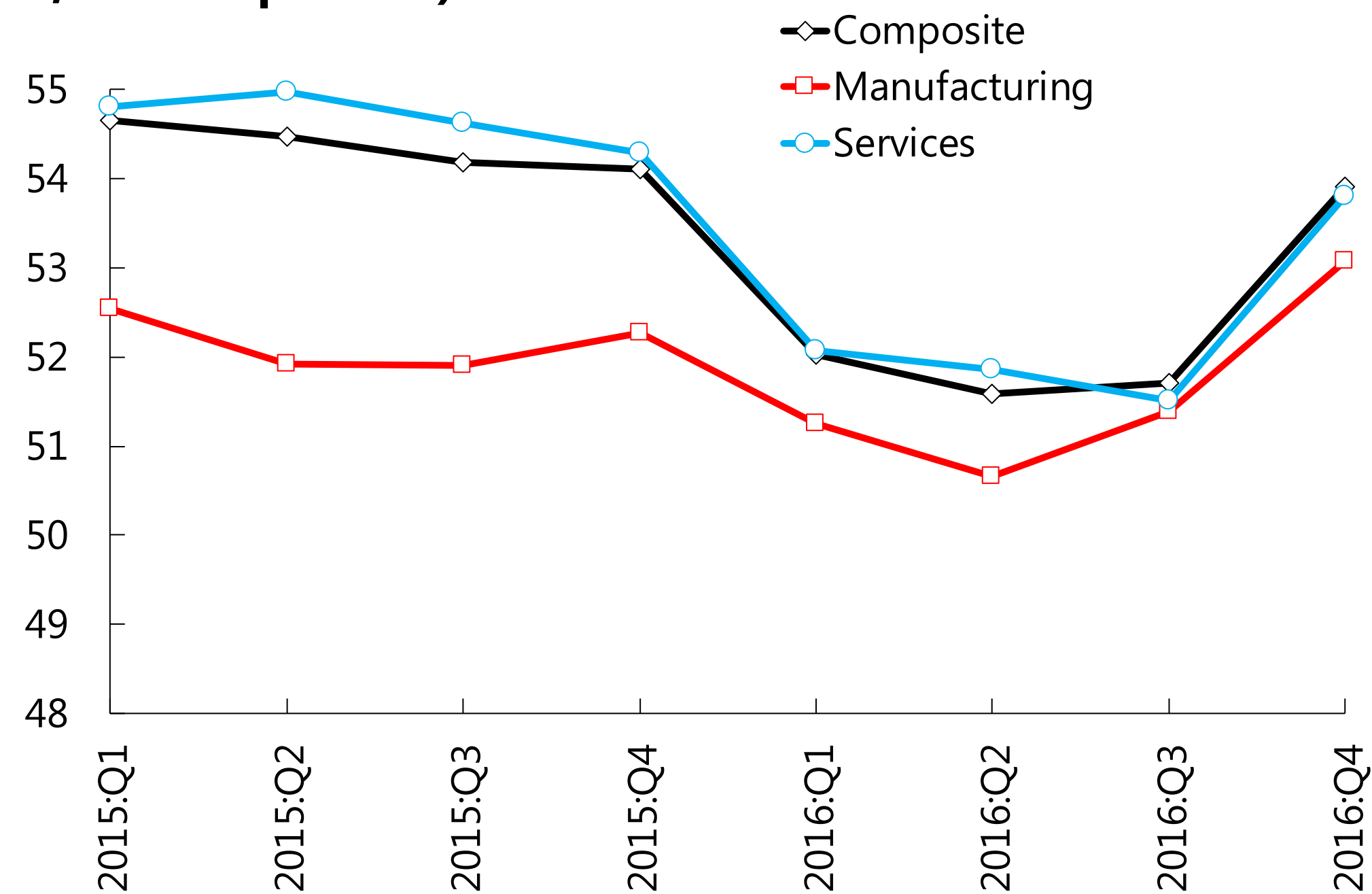
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Risks are two-sided, skewed to the downside

- **Stronger growth.** Support to activity from policy stimulus in the U.S. and China could turn out stronger than expected with possible positive confidence effects globally.
- **Protectionism.** Inward-looking policy approaches could harm trade and integration, leading firms to defer investment and hiring decisions.
- **Stagnation in AEs.** An extended period of weak demand could lead to persistently lower output and inflation. An unmooring of inflation expectations could raise real interest rates and weaken demand further.
- **China's transition.** China's rebalancing path could prove bumpier than expected. With continued reliance on credit and slow restructuring, the risk of an eventual disruptive adjustment is growing.
- **Financial threats to EMs.** Underlying vulnerabilities in some large EMs (high corporate debt, declining profitability, and weak balance sheets) together with the need to build policy buffers still leave EMDEs exposed to sudden shifts in investor confidence or surprises in U.S. monetary tightening.
- **Non-economic shocks.** Geopolitical risks and other factors ranging from droughts to terrorism could hurt sentiment. Climate change also presents a longer-term risk.

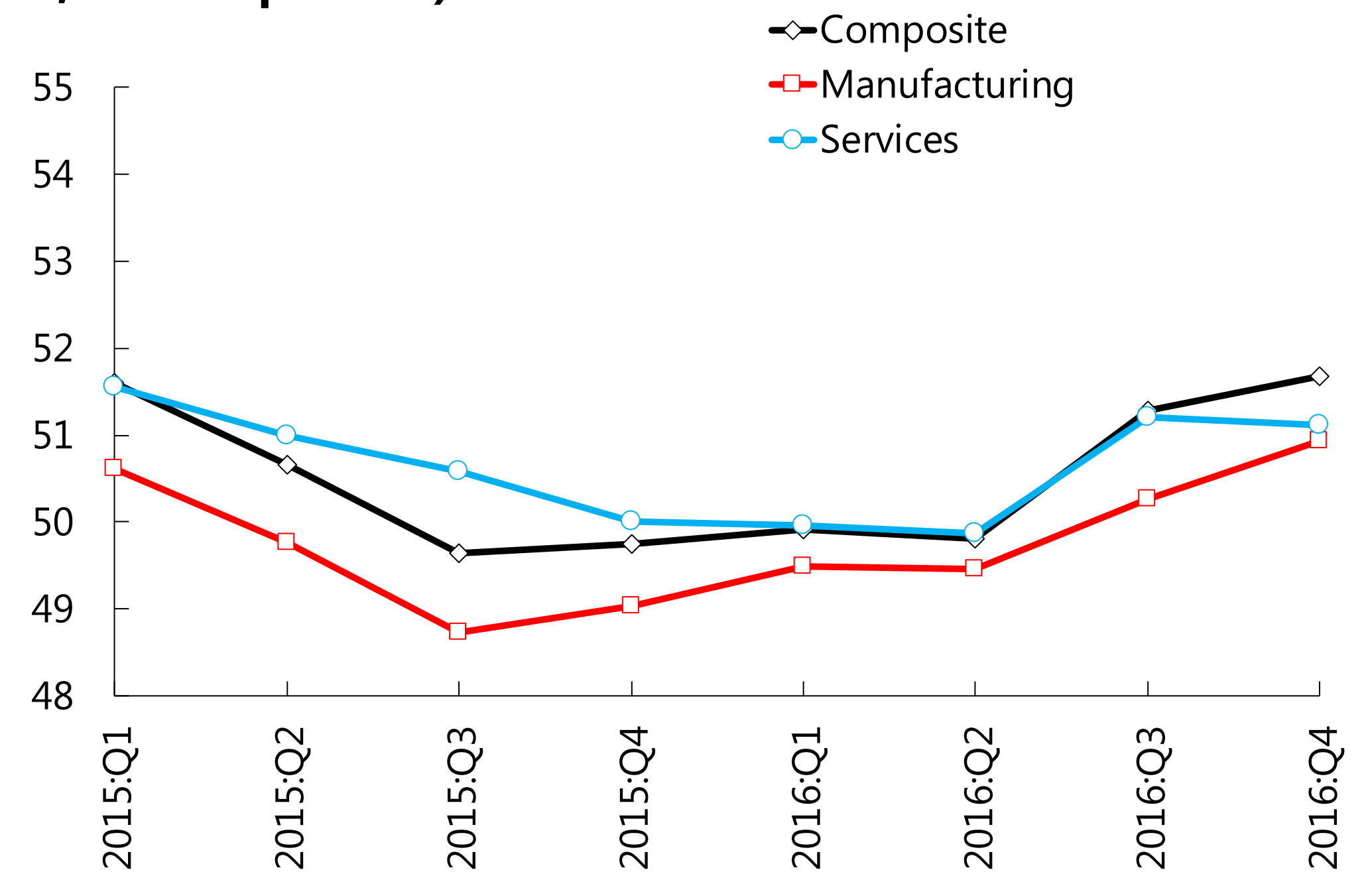
Near-term uptick on solid footing

**Developed Markets: Purchasing Managers' Index
(SA, 50+ = Expansion)**



Source: Haver Analytics.

**Emerging Markets: Purchasing Managers' Index
(SA, 50+ = Expansion)**

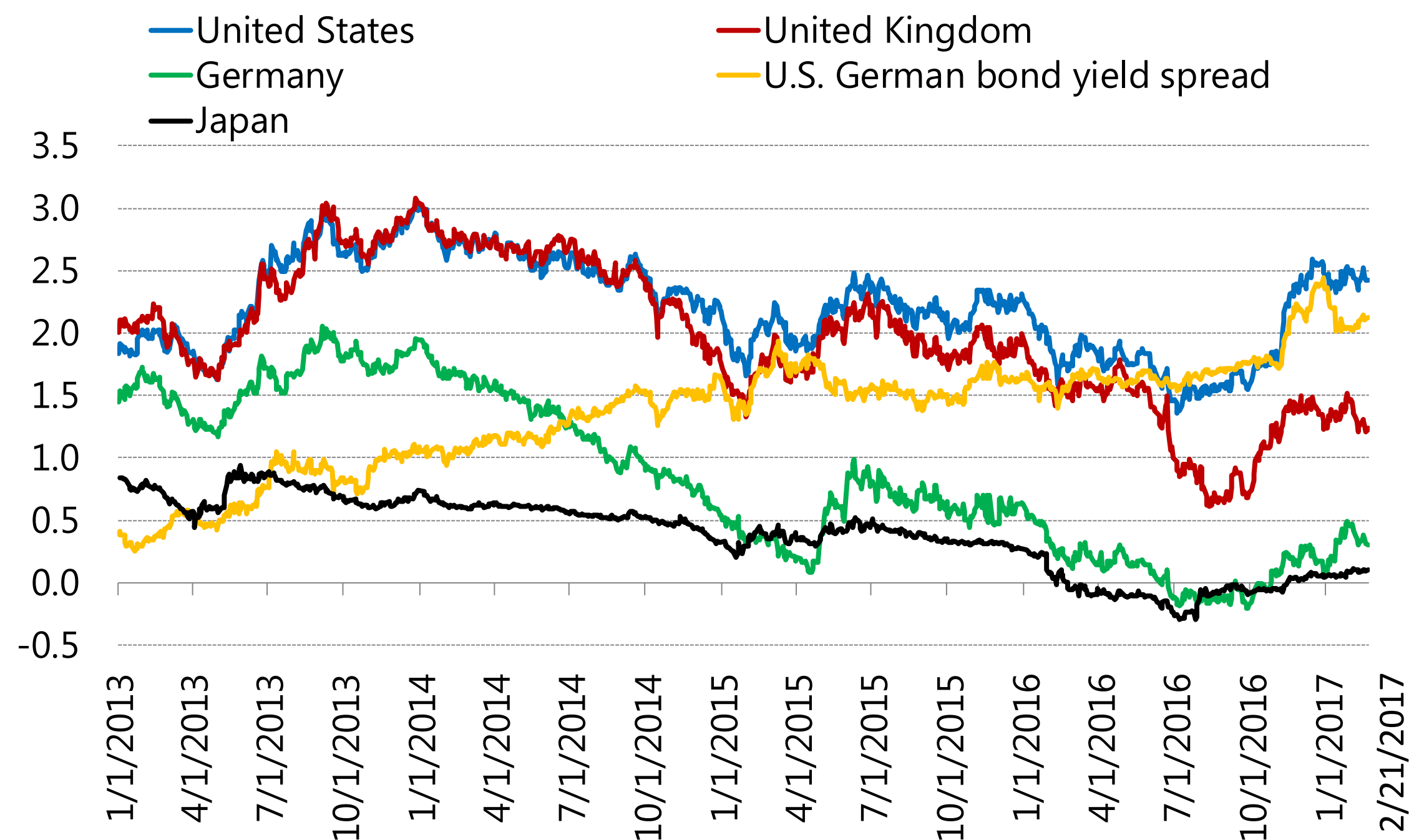


Source: Haver Analytics.

Rising long term yields and U.S. dollar strengthening

Advanced Economies: 10-Year Government Bond Yields

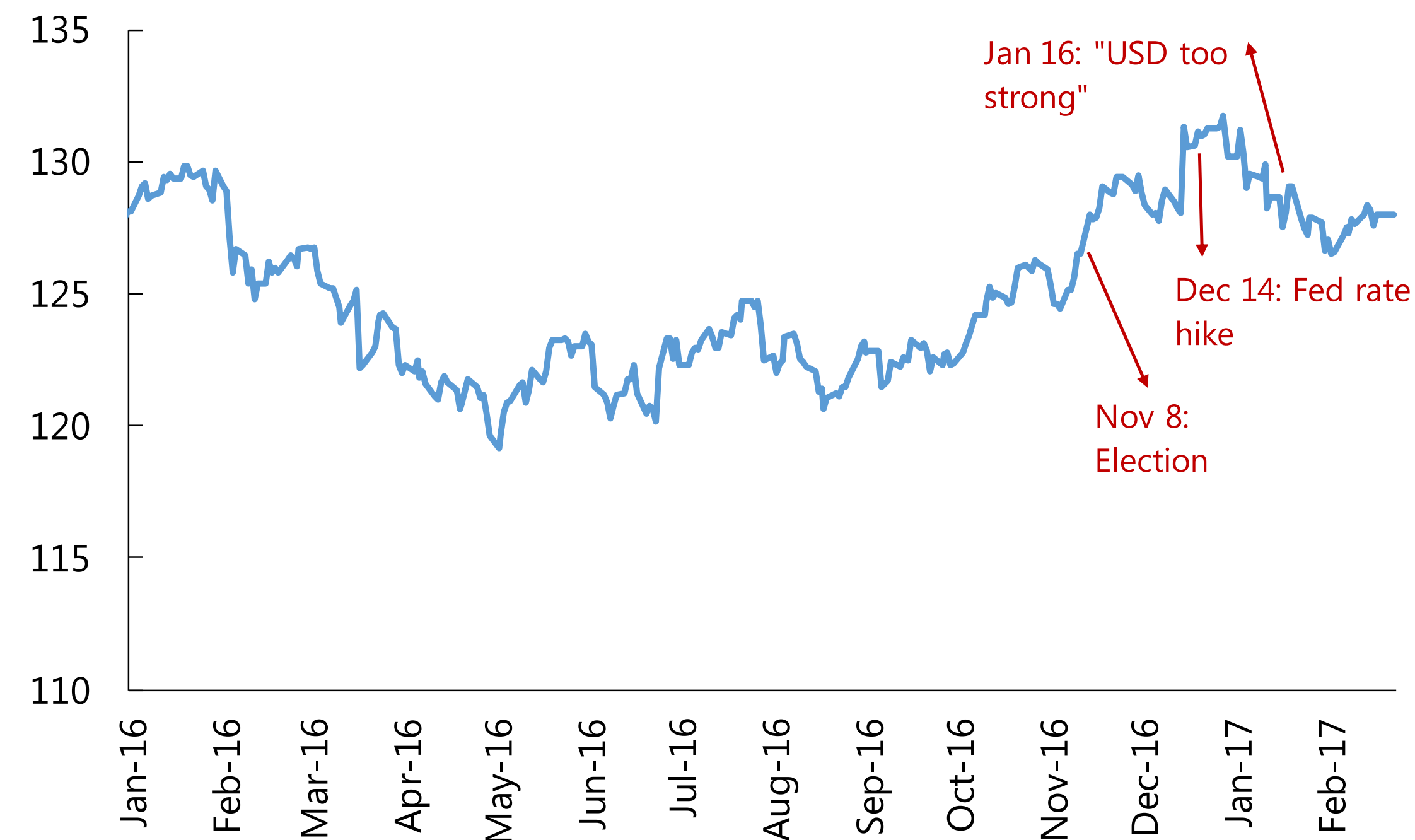
(In percent)



Source: Haver Analytics.

United States: Trade-weighted USD

(Index; against major currencies; 1/1/2013=100)

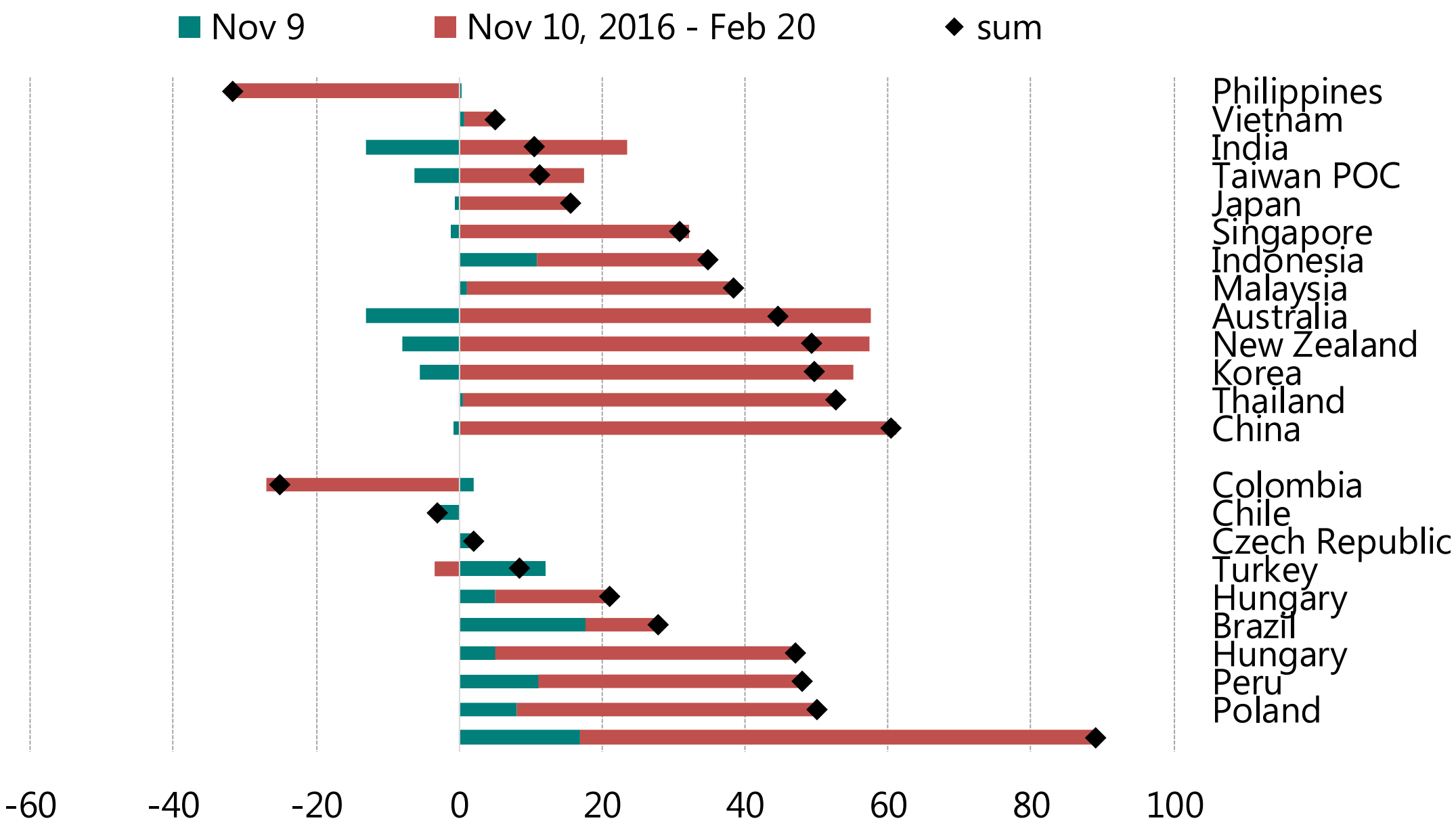


Source: Federal Reserve via Bloomberg.

Yields and exchange rates reacting to shift in U.S. policy

Selected Asia: 10 Yr Government Bond Yields

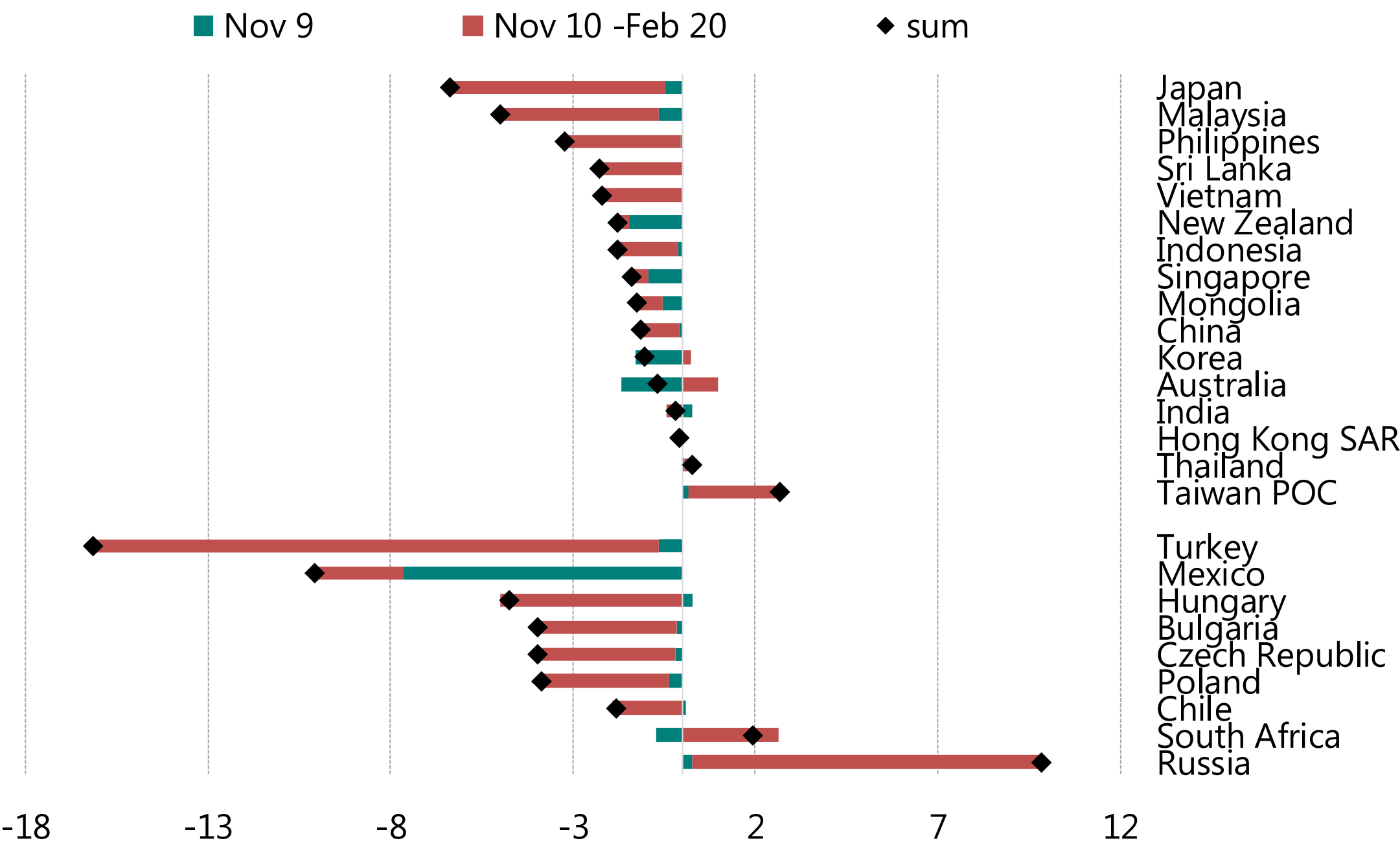
(Basis Points Change)



Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations.

Selected Asia: Bilateral FX Rate against USD

(Percent change; positive=local currency appreciation)

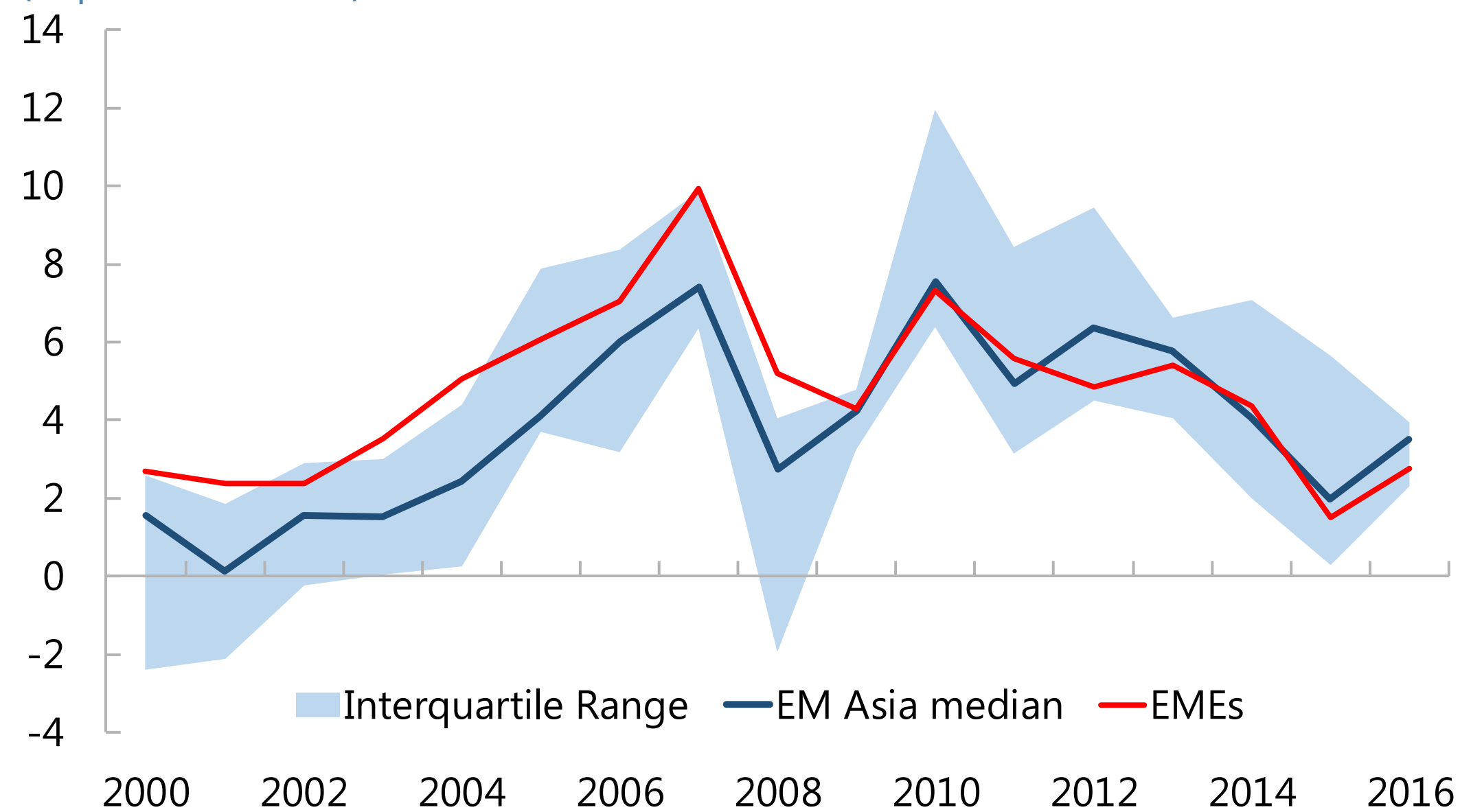


Sources: Bloomberg L.P.; Haver Analytics; and IMF staff calculations.

Capital inflows slowing

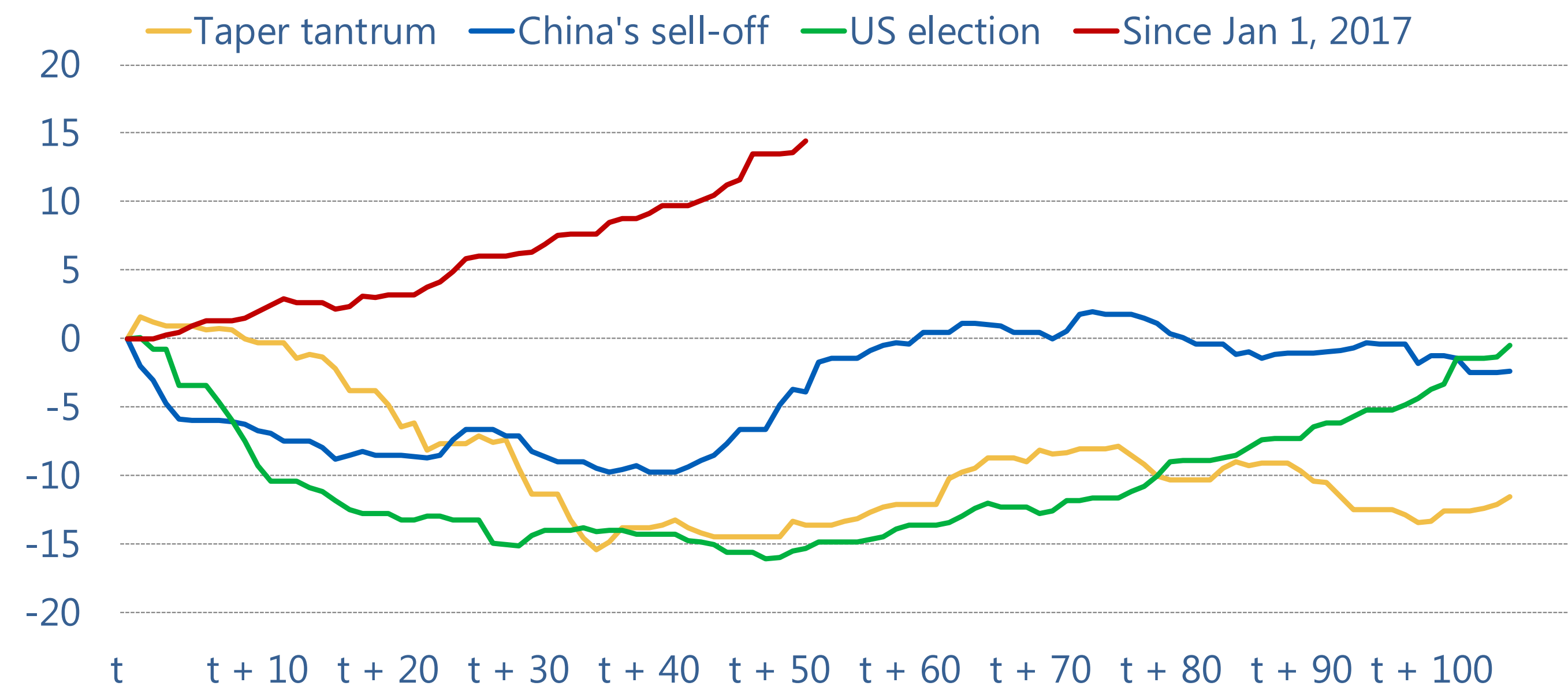
Gross Capital Inflows to EM Asia and EMEs

(In percent of GDP)



Asia: Cumulative Portfolio Flows

(In billion USD)



Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles.

Sources: Bloomberg L.P. ; Haver Analytics; and IMF staff calculations.

Note: Equities coverage: Indonesia, India, Thailand, Korea, the Philippines, Taiwan Province of China, Sri Lanka, and Vietnam; bonds coverage: Indonesia, India, Thailand, and Korea.

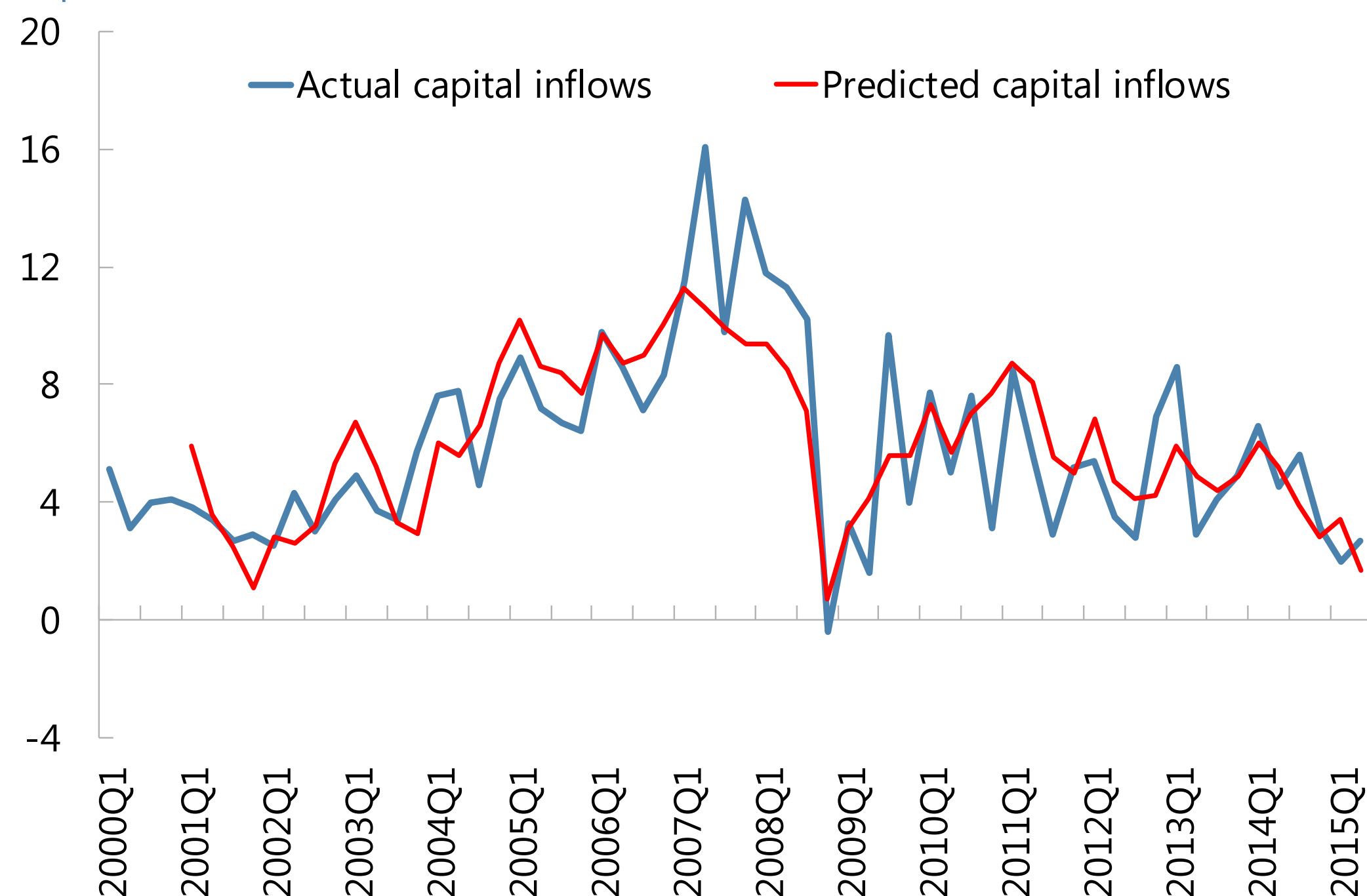
What global factors drive the capital inflows to EMDE?

- Growth and interest rate differentials between EMDEs and AEs
- Investors' risk appetite
- U.S. financial conditions
- Changes in oil prices

Declining inflows are closely linked to the shrinking growth differential...

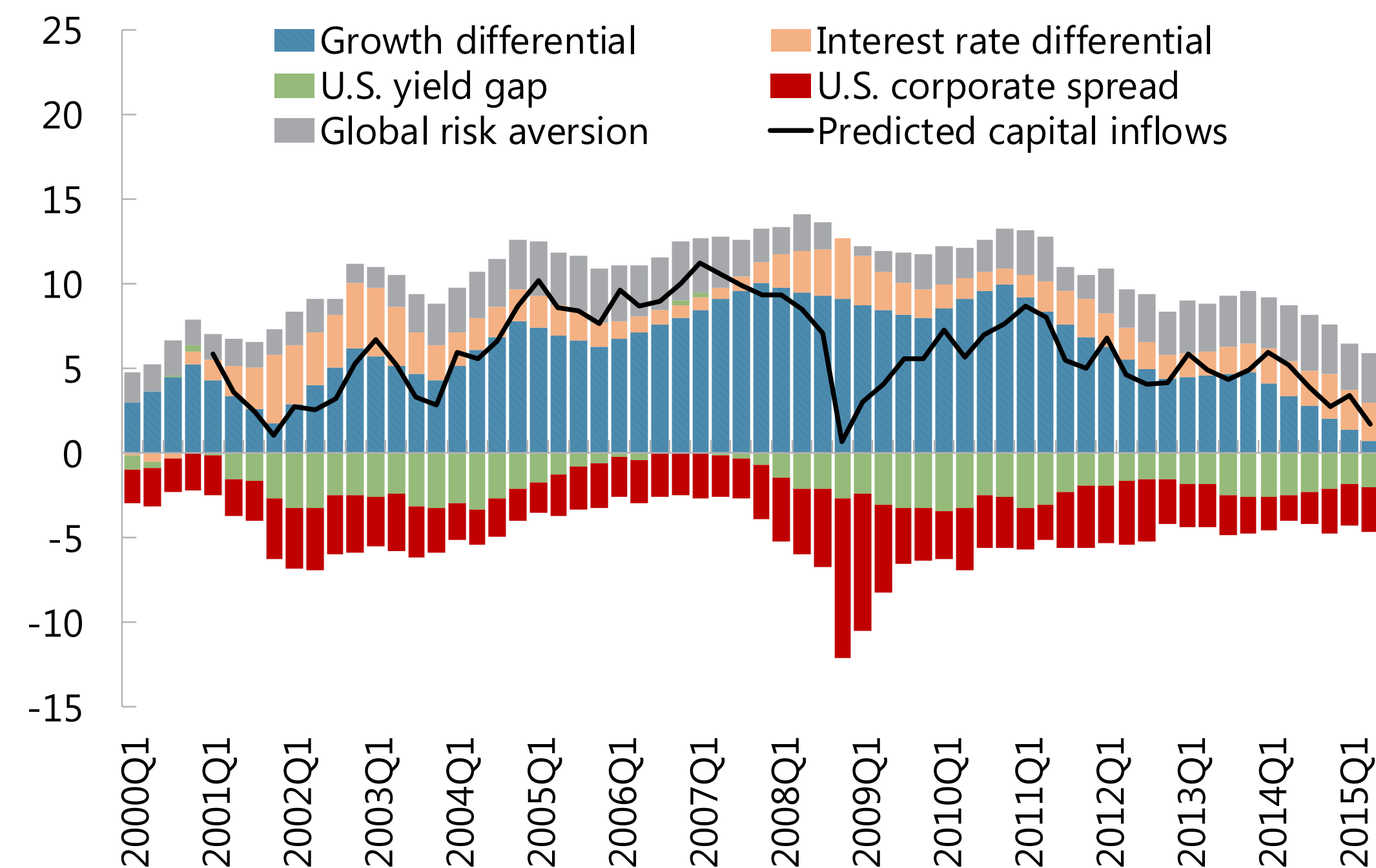
Actual and Predicted Capital Inflows

(In percent of GDP)



Predicted Capital Inflows and Contributions

(In percent of GDP)

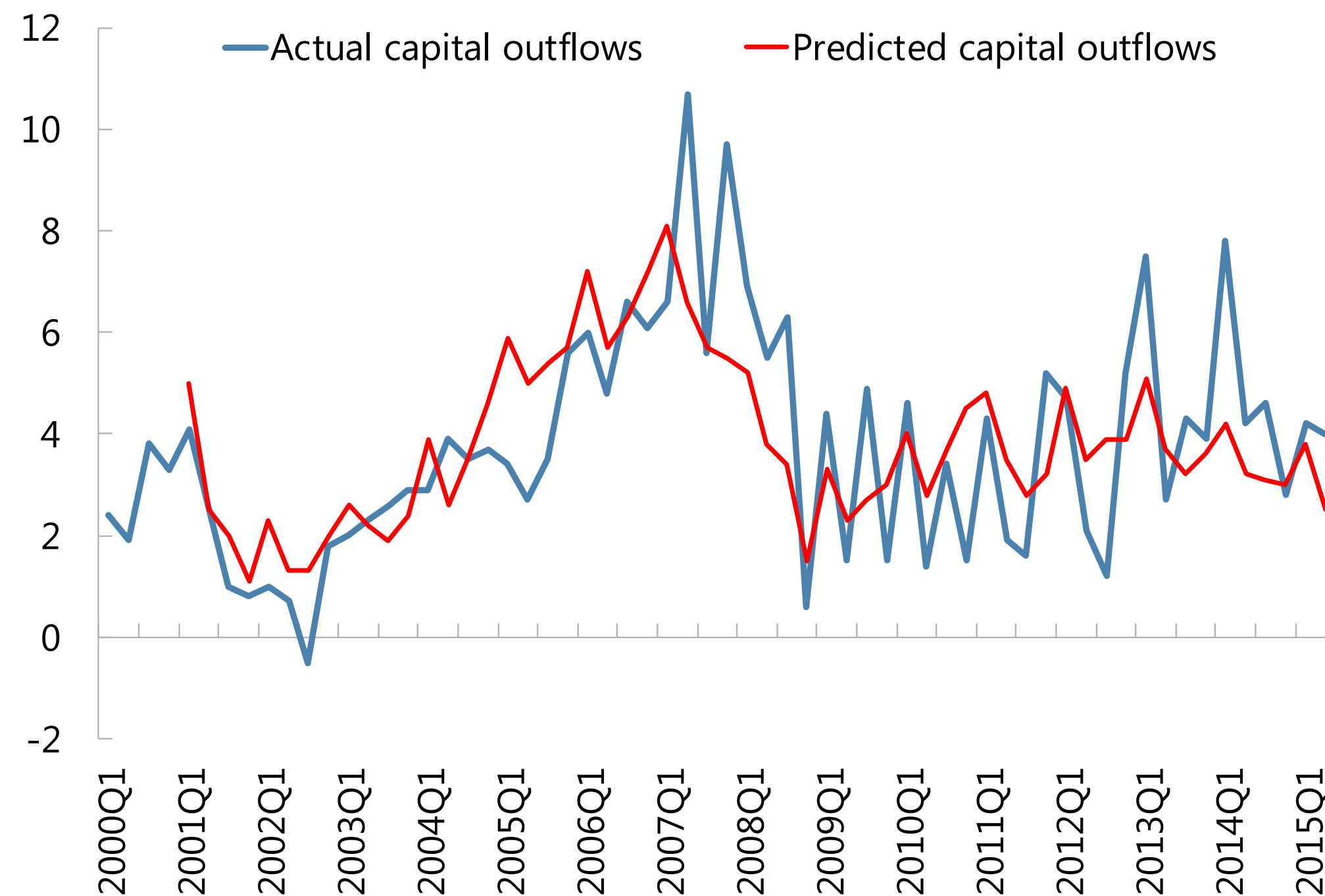


Sources: CEIC Asia database; CEIC China database; Fernandez and others 2015; Haver Analytics; IMF, *Balance of Payments Statistics*; IMF, *International Financial Statistics*; Standard & Poor's; World Bank, *World Development Indicators* database; World Bank, *World Governance Indicators*; and IMF staff calculations.

...but outflows remain more difficult to track.

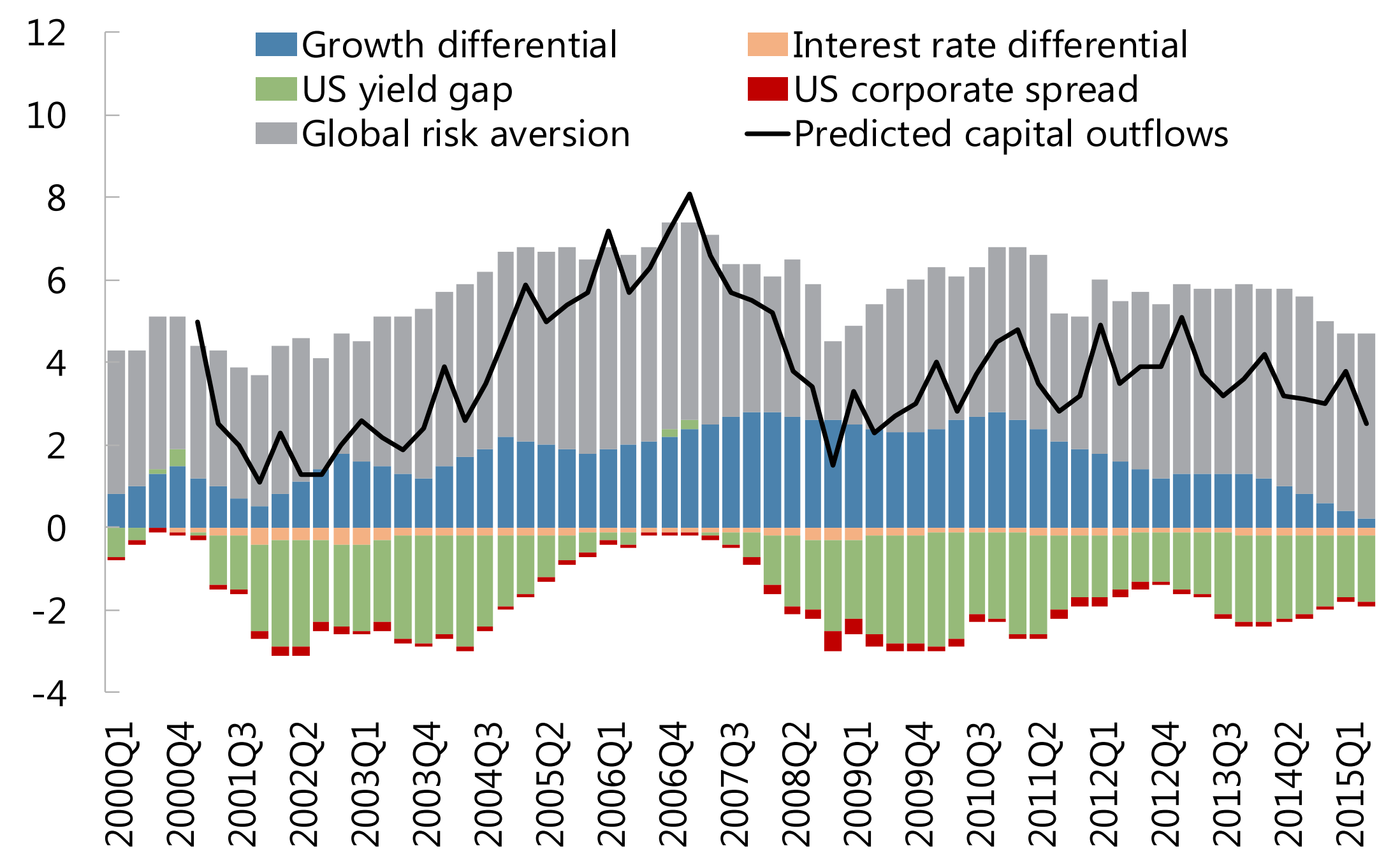
Actual and Predicted Capital Outflows

(In percent of GDP)



Predicted Capital Outflows and Contributions

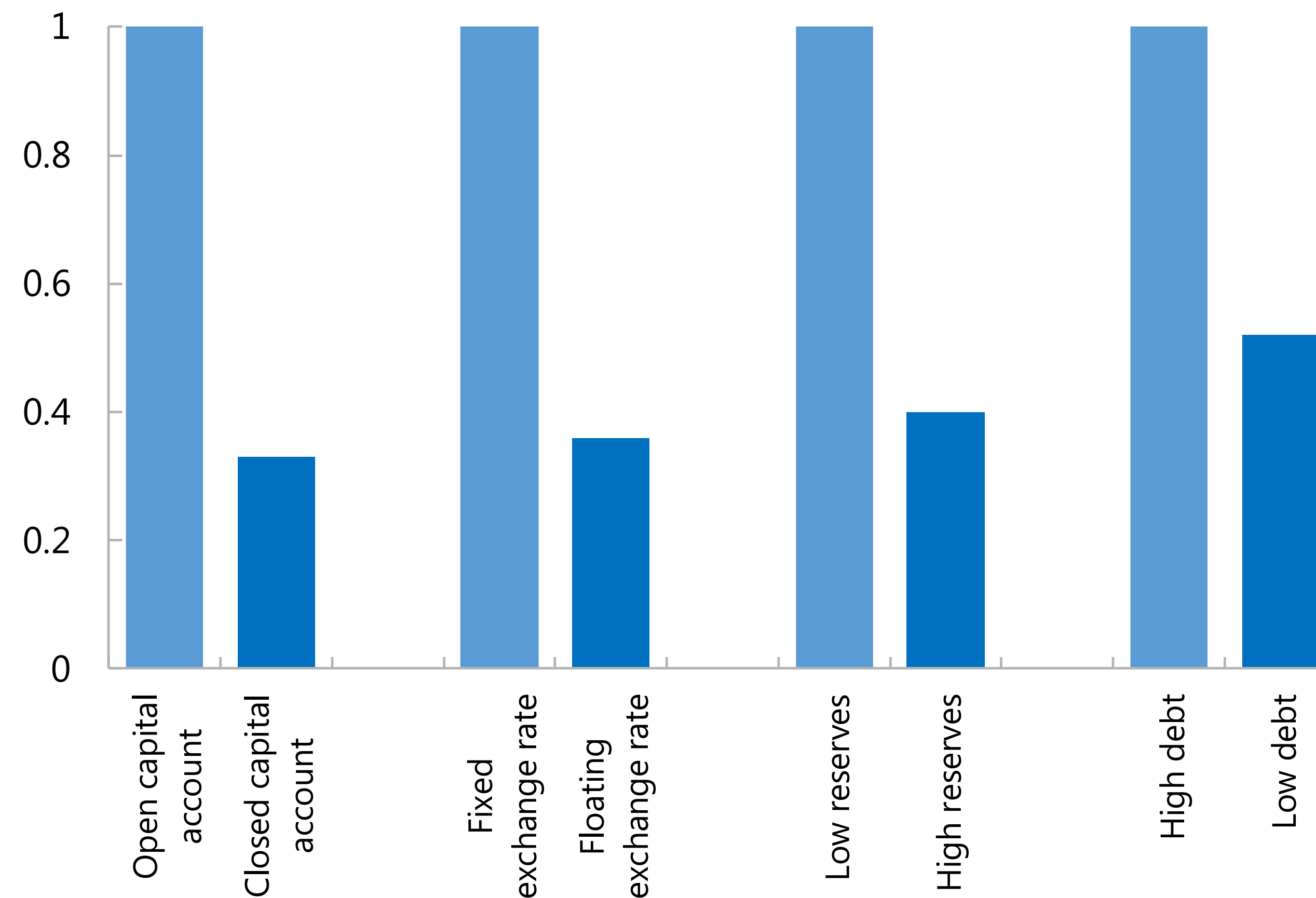
(In percent of GDP)



Global factors matter less in countries with floating exchange rates, higher reserves, and lower debt...

Share of Variation in Gross Capital Inflows Explained by Global Factors

(2000-2015)

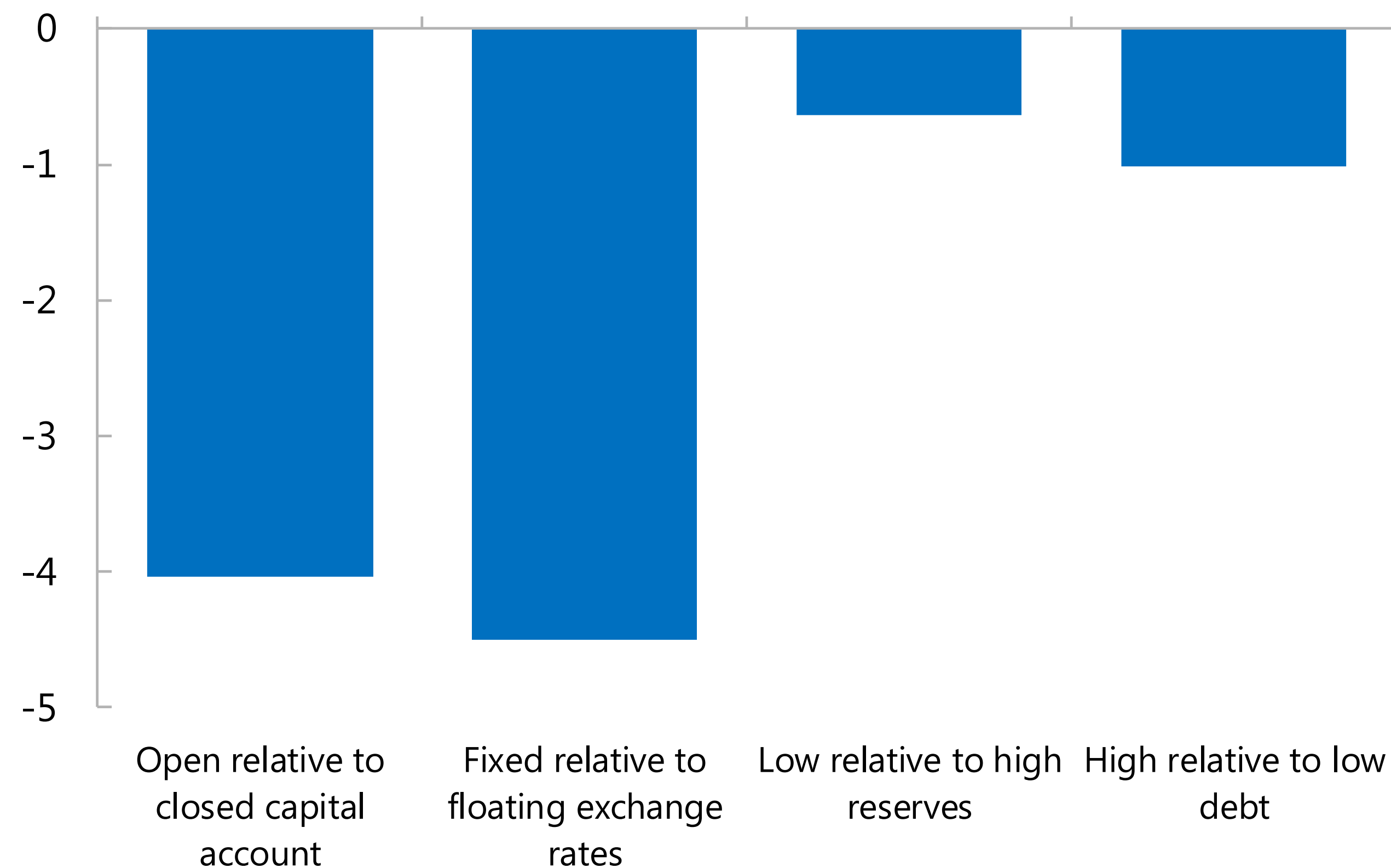


Sources: CEIC Asia database; CEIC China database; Fernández and others 2015; Haver Analytics; IMF, Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER); IMF, Balance of Payments Statistics; IMF, International Financial Statistics; World Bank, World Development Indicators database; and IMF staff calculations.

...these factors also mitigated the 2010-2015 decline in inflows.

Differences in Contribution of Global Factors to Gross Capital Inflows

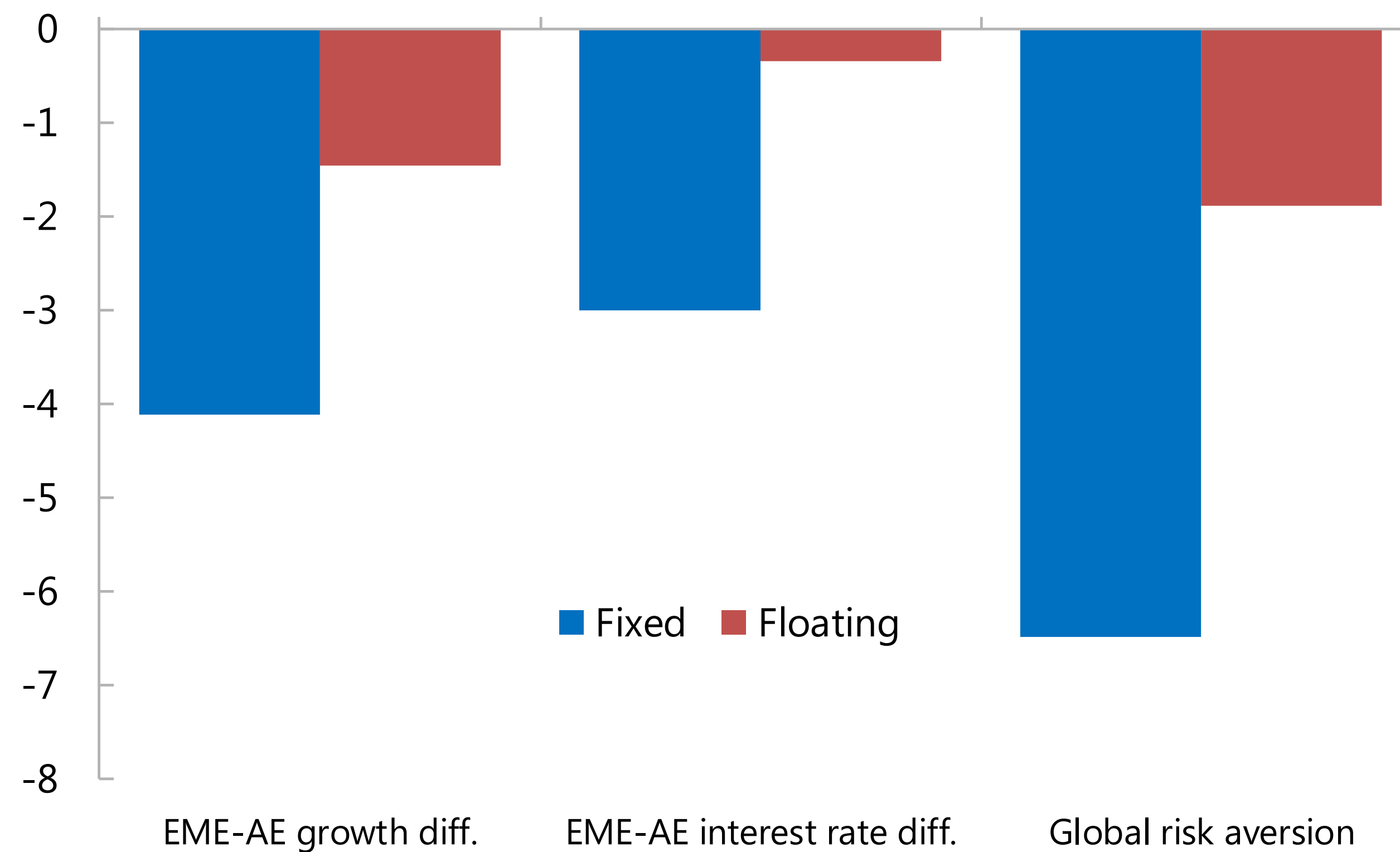
(Percent of GDP)



Exchange rate flexibility also dampened the effects of key global factors.

Contribution of Global Factors on Gross Capital Inflows

(Percent of GDP)

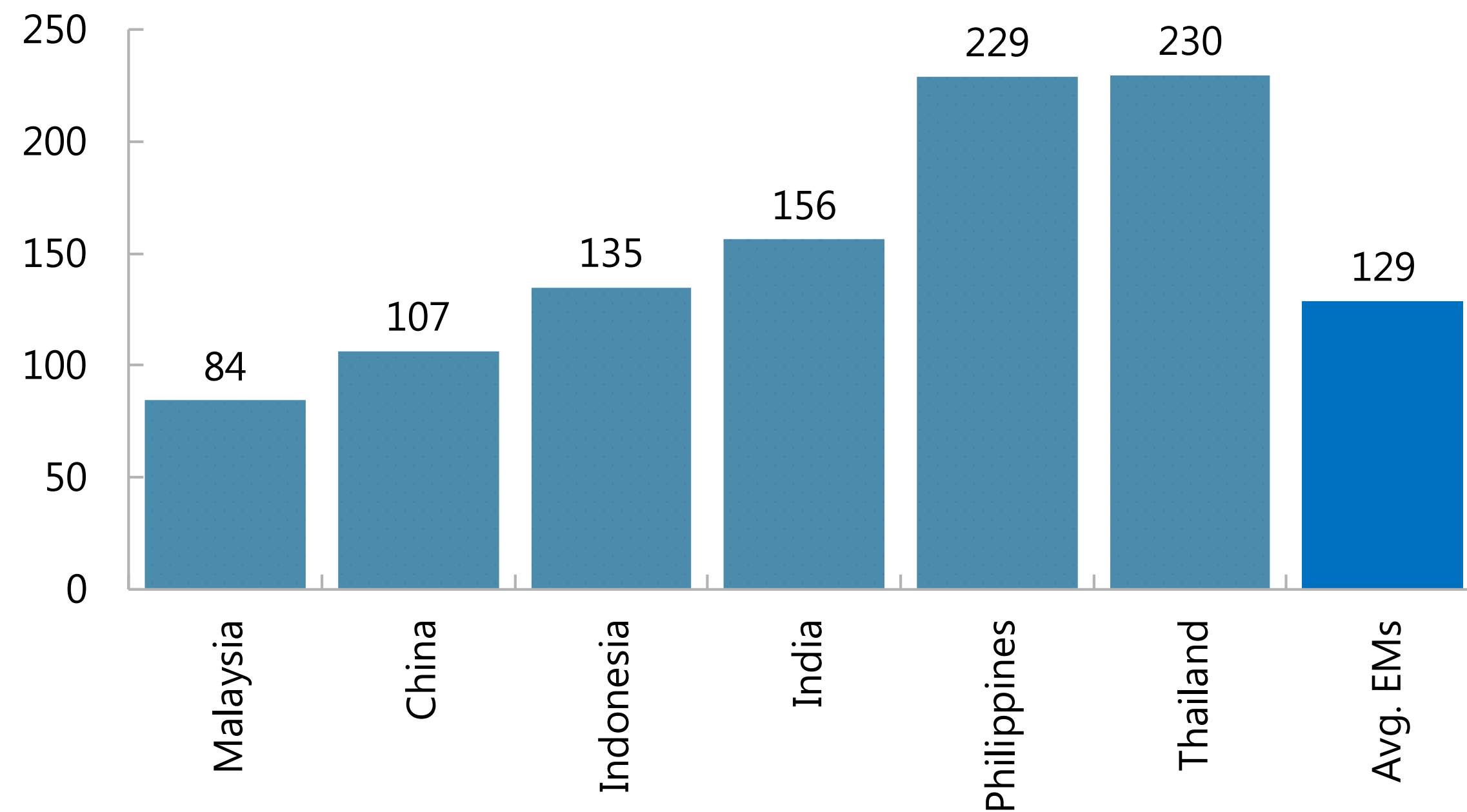


Source: IMF staff calculations.

Asia EMs appear well prepared to deal with slower inflows...

Reserves as percent of ARA metric

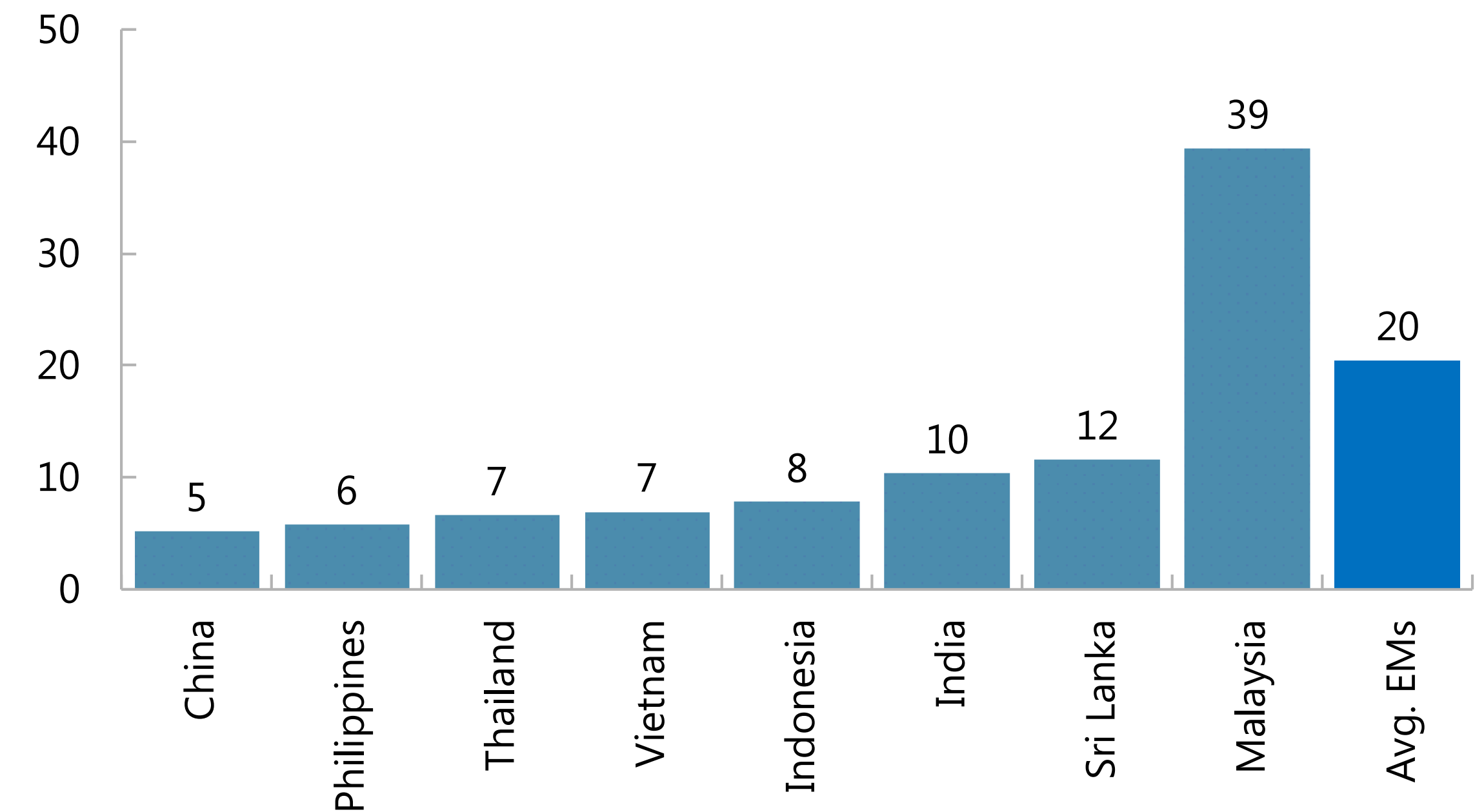
(In percent)



Sources: IMF Vulnerability Exercise Database; and staff estimates.
1/ Reserve coverage without capital controls

External Financing Requirement

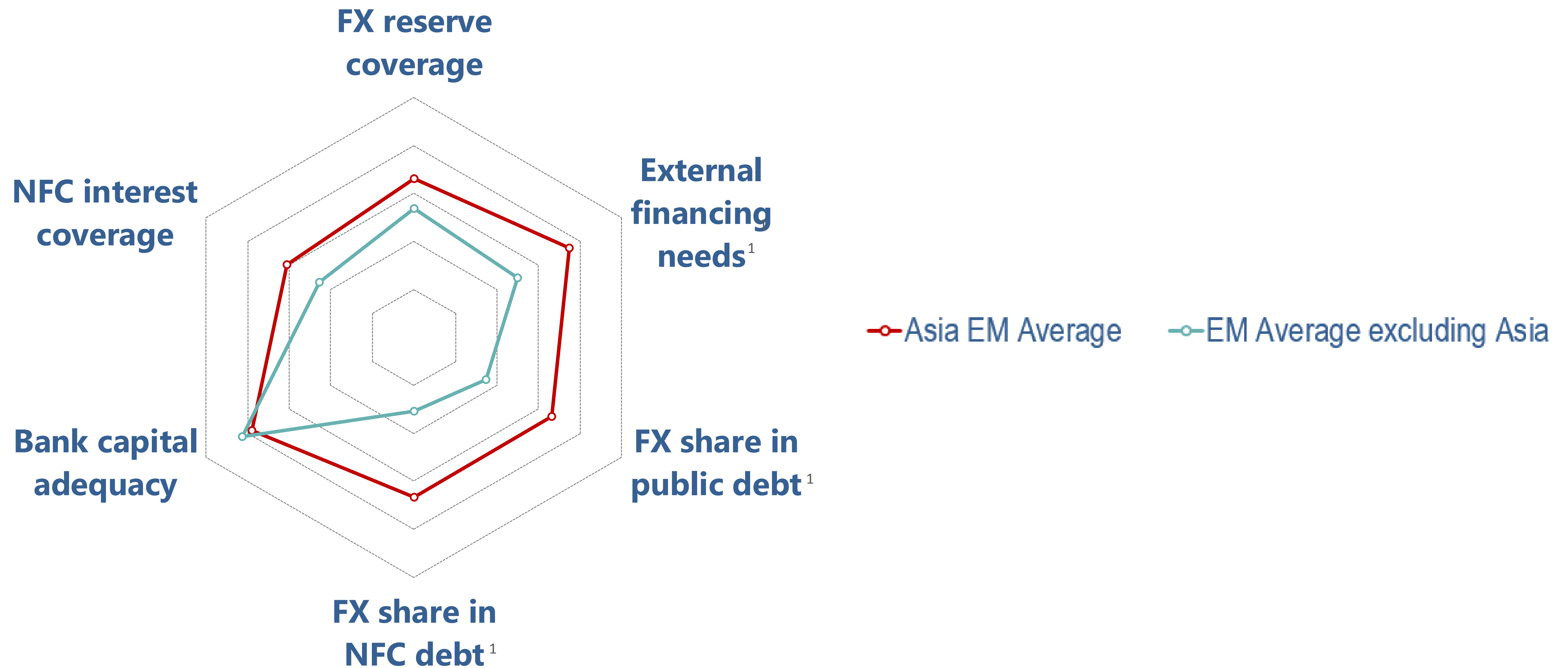
(In percent of GDP)



Sources: IMF WEO database; and staff calculations.

Note: External financing requirement is the short-term debt plus the long-term amortization paid plus the current account balance in percent of GDP.

...and look relatively less vulnerable from a global perspective.



Sources: IMF Vulnerability Exercise Database; and staff estimates.

1/ Inverted axis with values decreasing from center to periphery.

Note: The values are staff estimates for end-2016 as of January 2017 except for NFC interest coverage ratio, which reports actual figures for end-2015.

Takeaways

- The EMDE-AE growth differential shows a close association with capital inflows to EMDEs, and can explain the bulk of the 2010-15 slowdown.
- Country characteristics and policy choices also matter:
 - Common factors explain less of the variation in capital inflows in EMEs with more flexible exchange rates, higher reserves and lower debt.
 - Flexible exchange rates have helped mitigate the slowdown associated with a declining growth differential.

Thank you



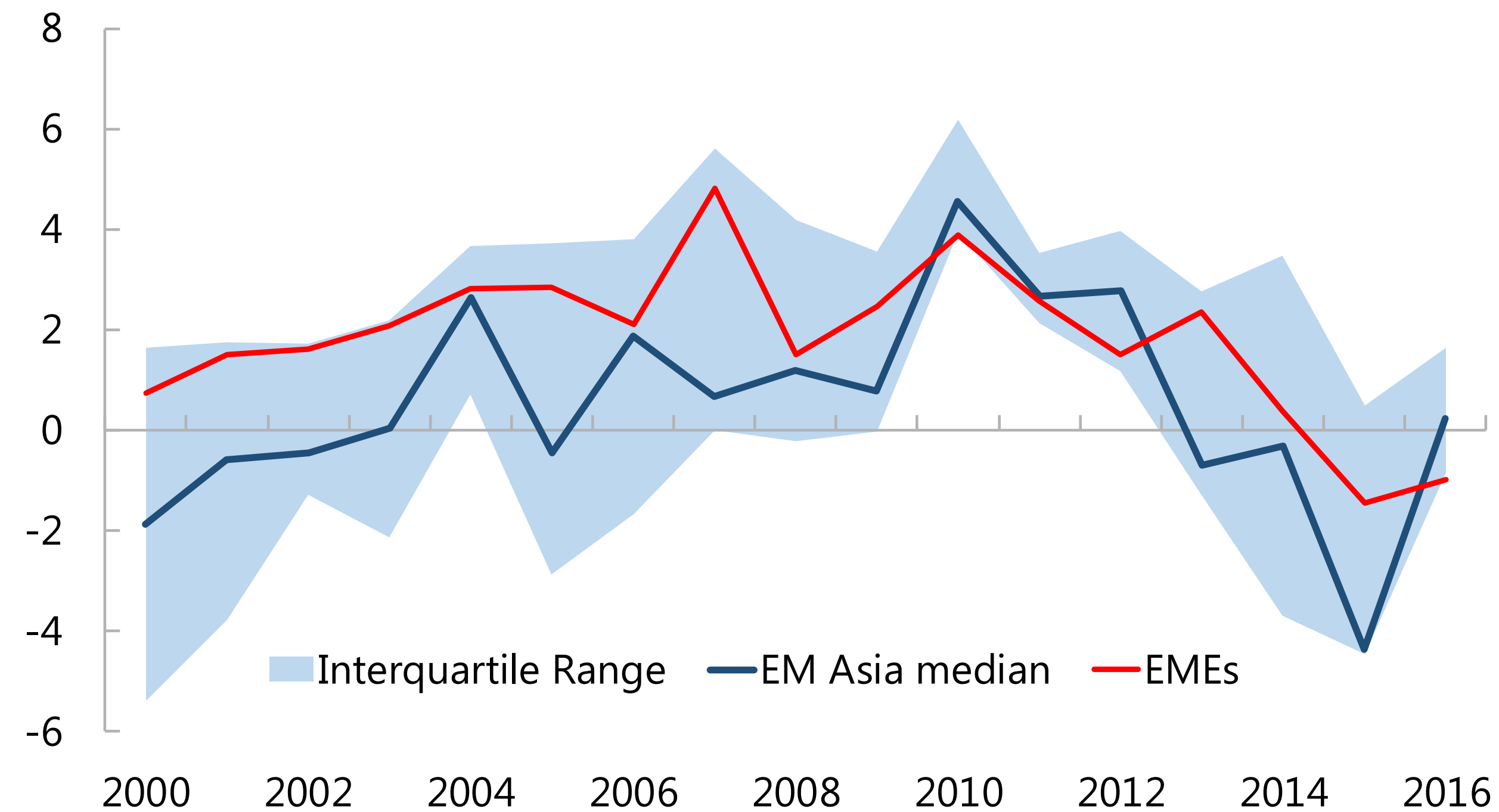


SUPPLEMENTARY SLIDES

Net Capital Inflows

Net Capital Inflows to EM Asia and EMEs

(In percent of GDP)



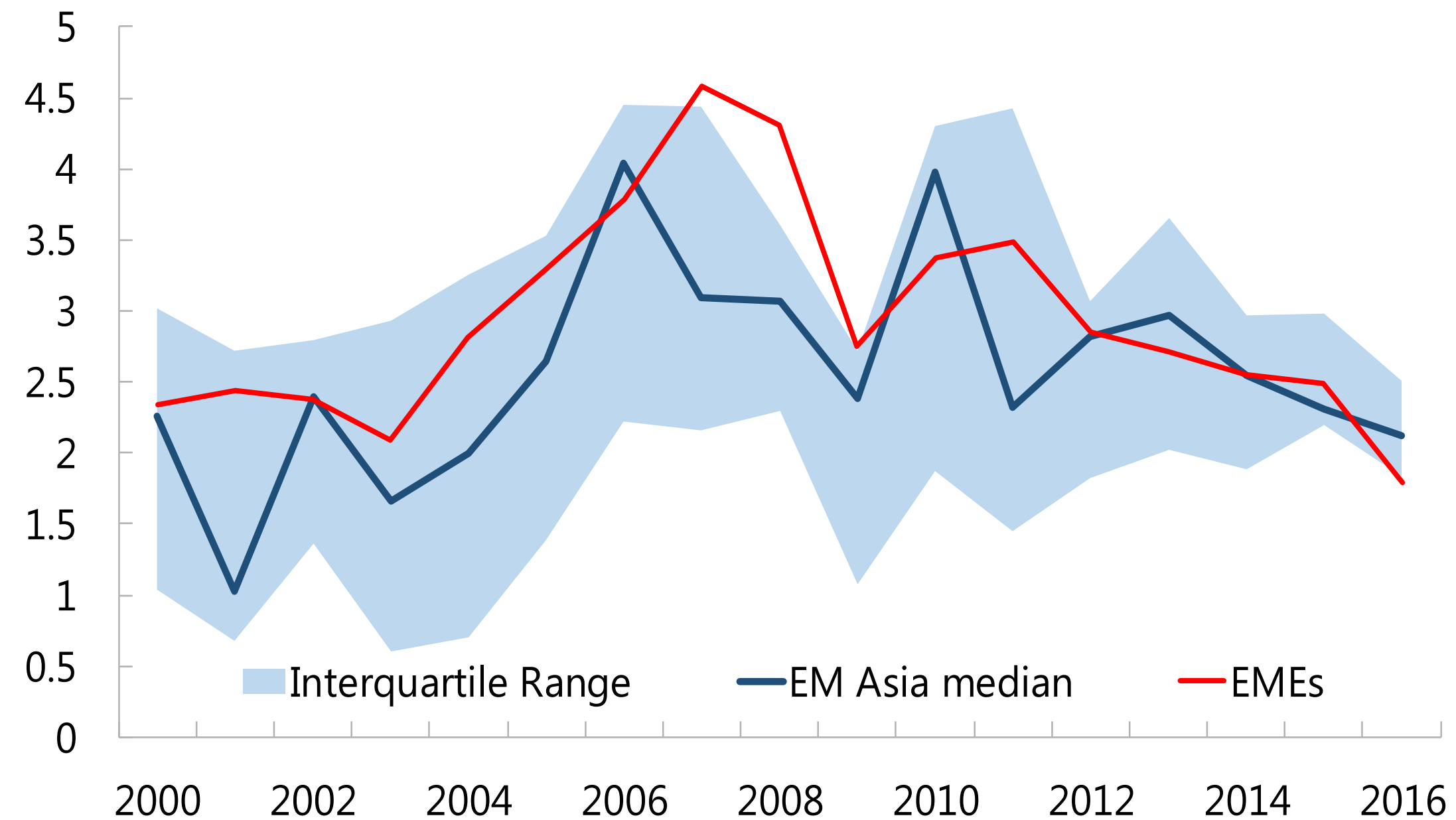
Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles.

Capital Inflows by Asset Type

Foreign Direct Investment Inflows to EM Asia and EMEs

(In percent of GDP)

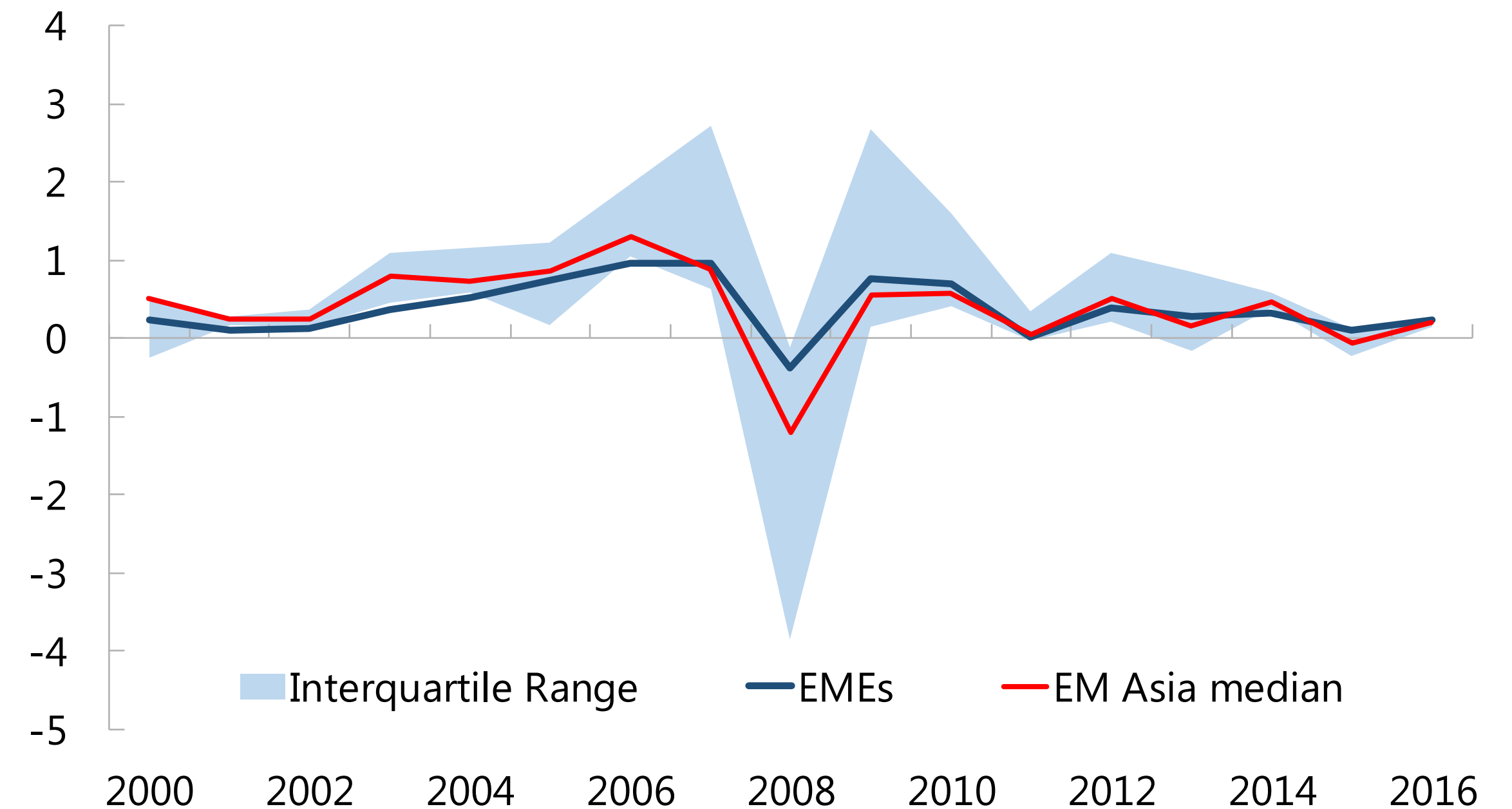


Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: EM Asia includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam. 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles of EM Asia.

Portfolio Equity Inflows to EM Asia and EMEs

(In percent of GDP)



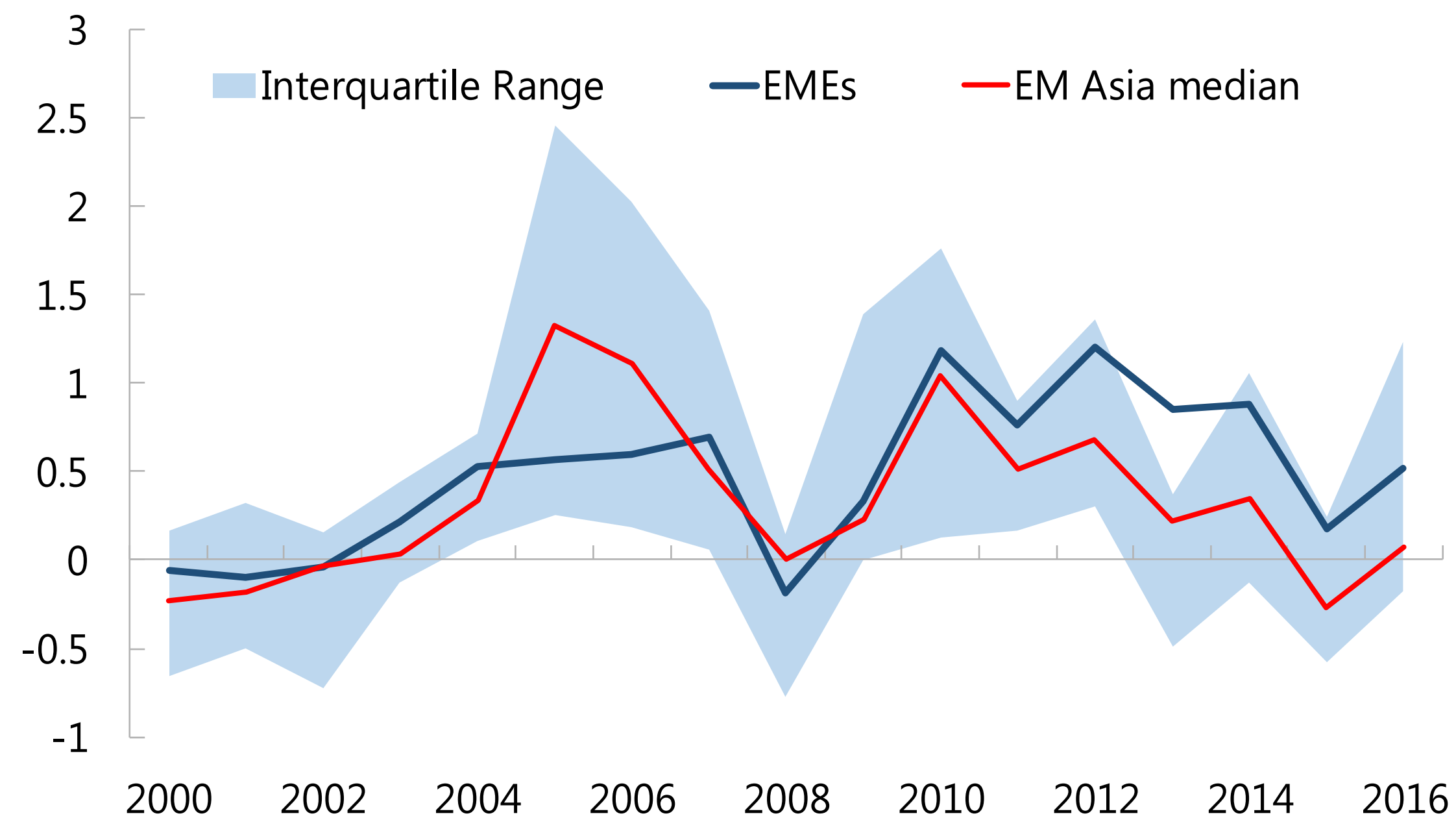
Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: EM Asia includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam. 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles of EM Asia.

Capital Inflows by Asset Type

Portfolio Debt Inflows to EM Asia and EMEs

(In percent of GDP)

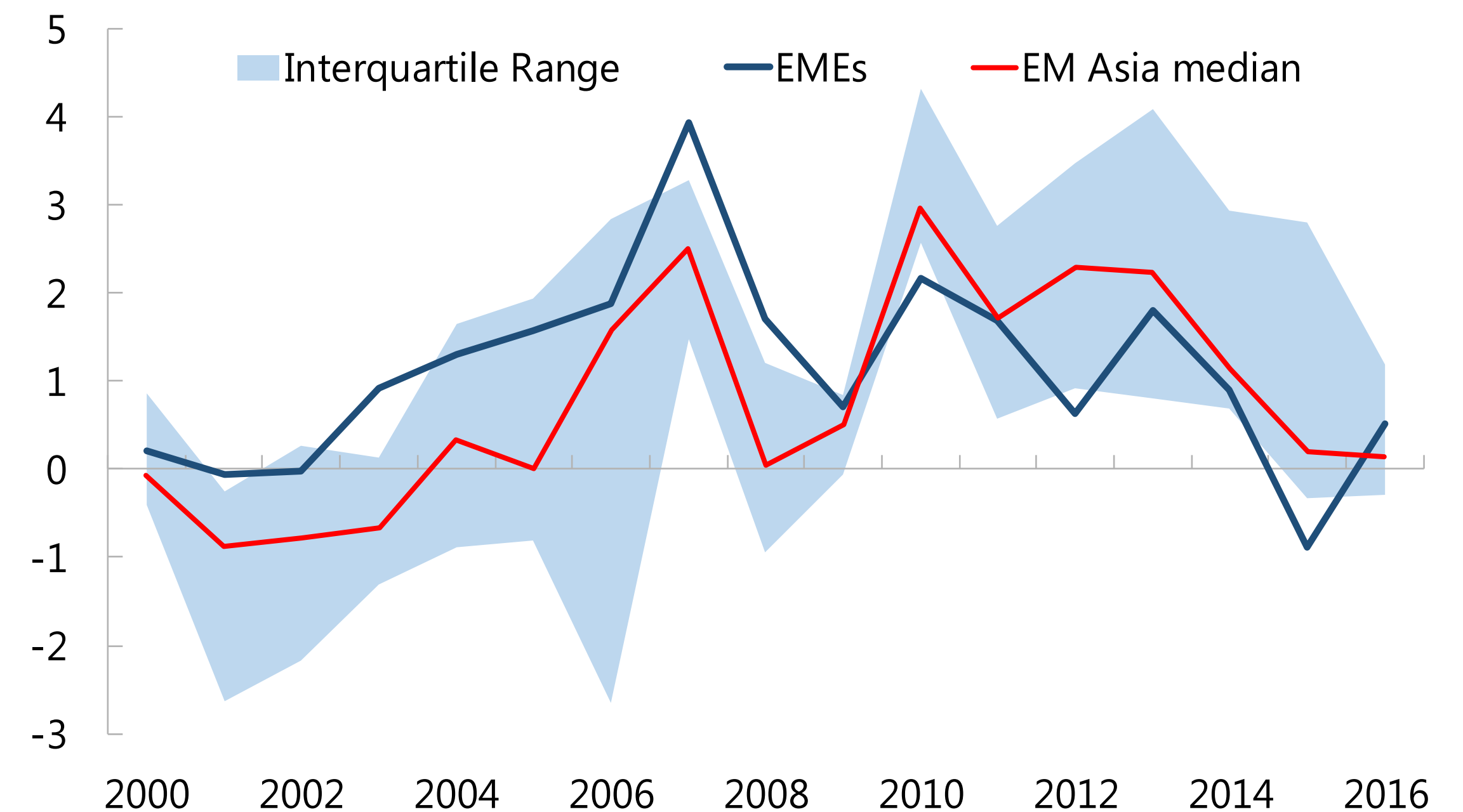


Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: EM Asia includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam. 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles of EM Asia.

Other Investment Inflows to EM Asia and EMEs

(In percent of GDP)



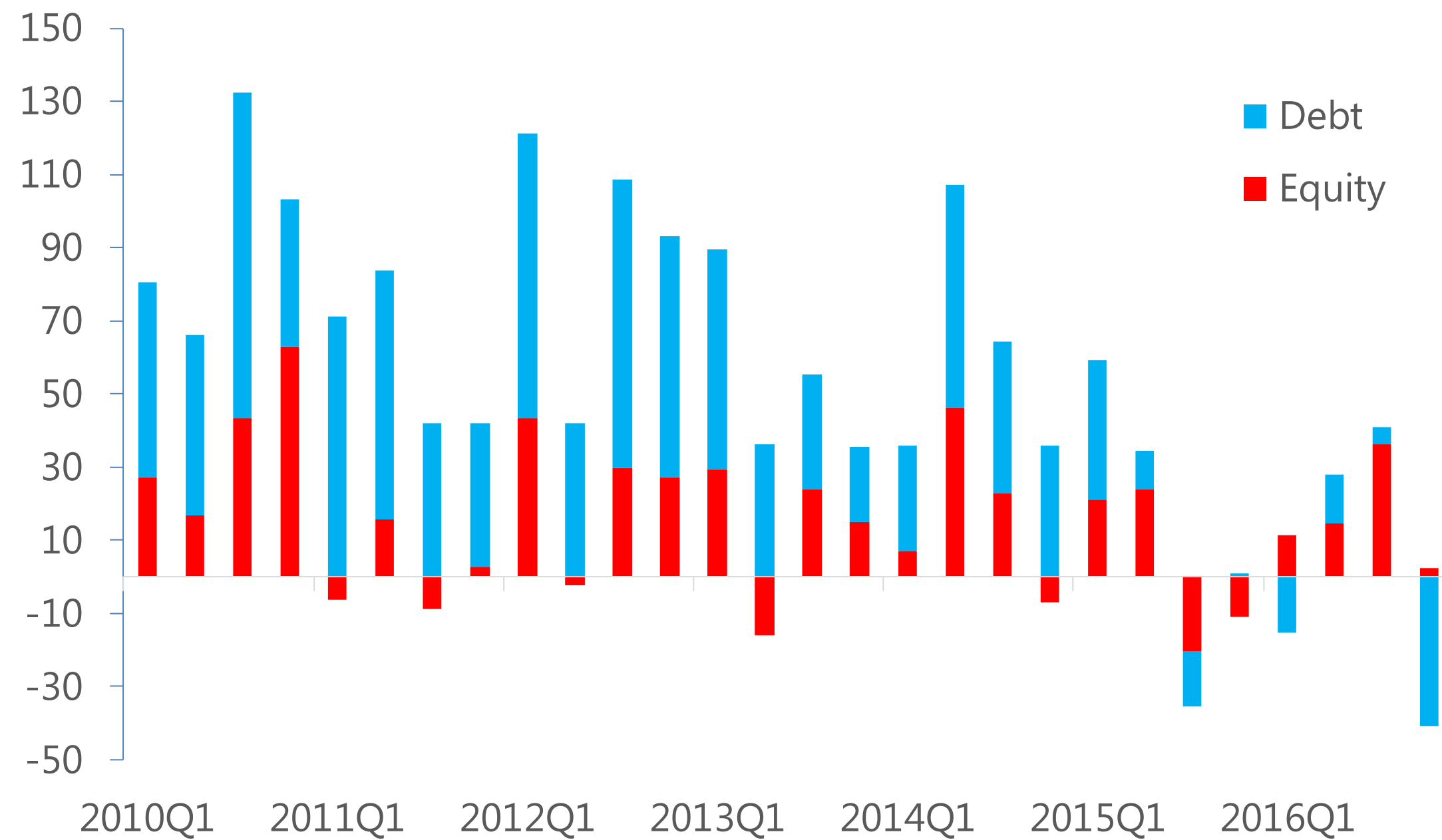
Sources: IMF *Financial Flows Analytics* database and staff calculations.

Note: EM Asia includes China, India, Indonesia, Malaysia, Philippines, Thailand, and Vietnam. 2016 number is the average of 2016Q1-Q3 data. Interquartile range is in the 25th and 75th quartiles of EM Asia.

Non-resident Portfolio Inflows to EMEs

Non-Resident Portfolio Flows to Emerging Markets

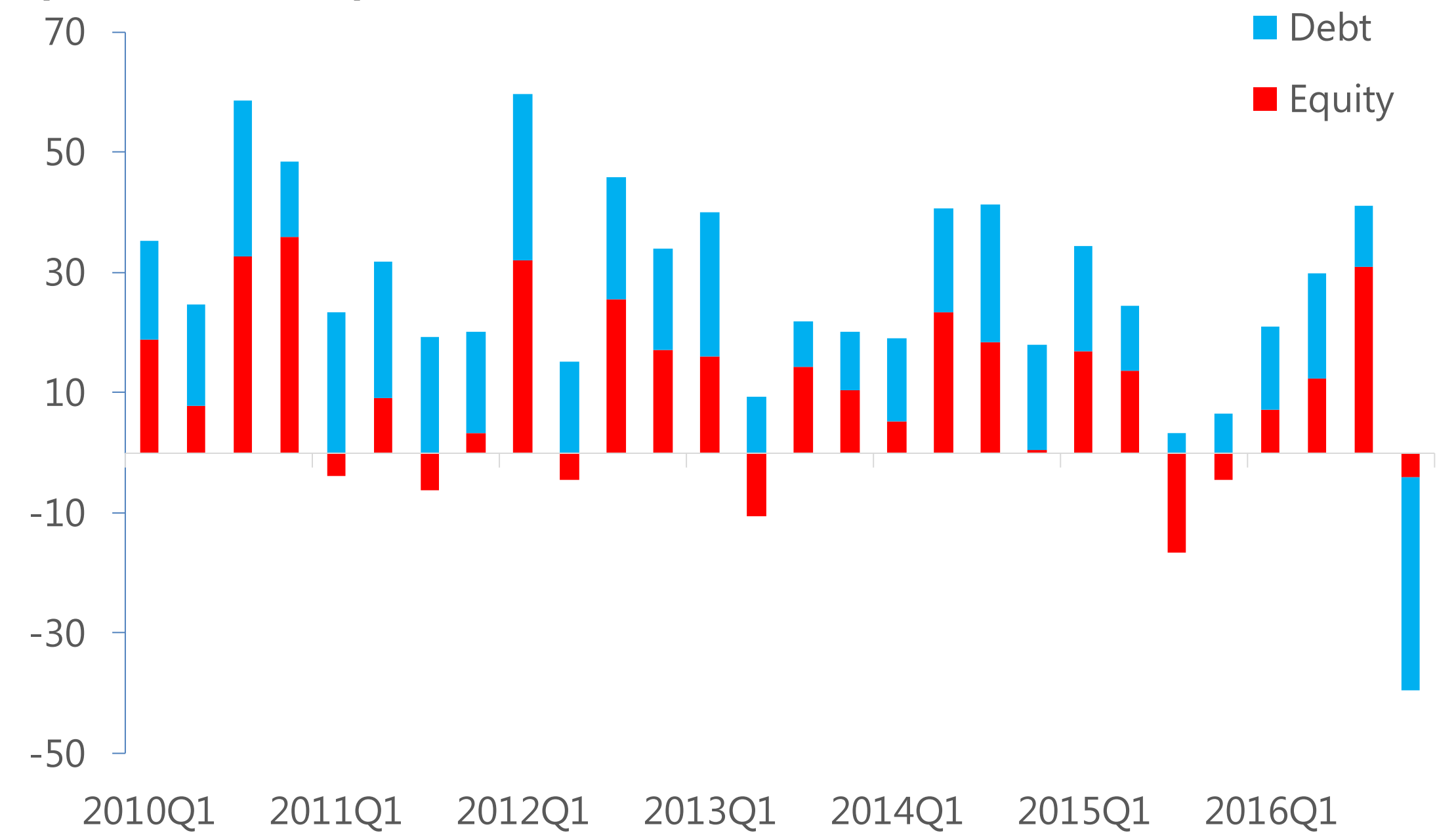
(Billions of U.S. dollars)



Sources: Haver Analytics; and IIF.

Non-Resident Portfolio Flows to Emerging Asia

(In Billion USD)

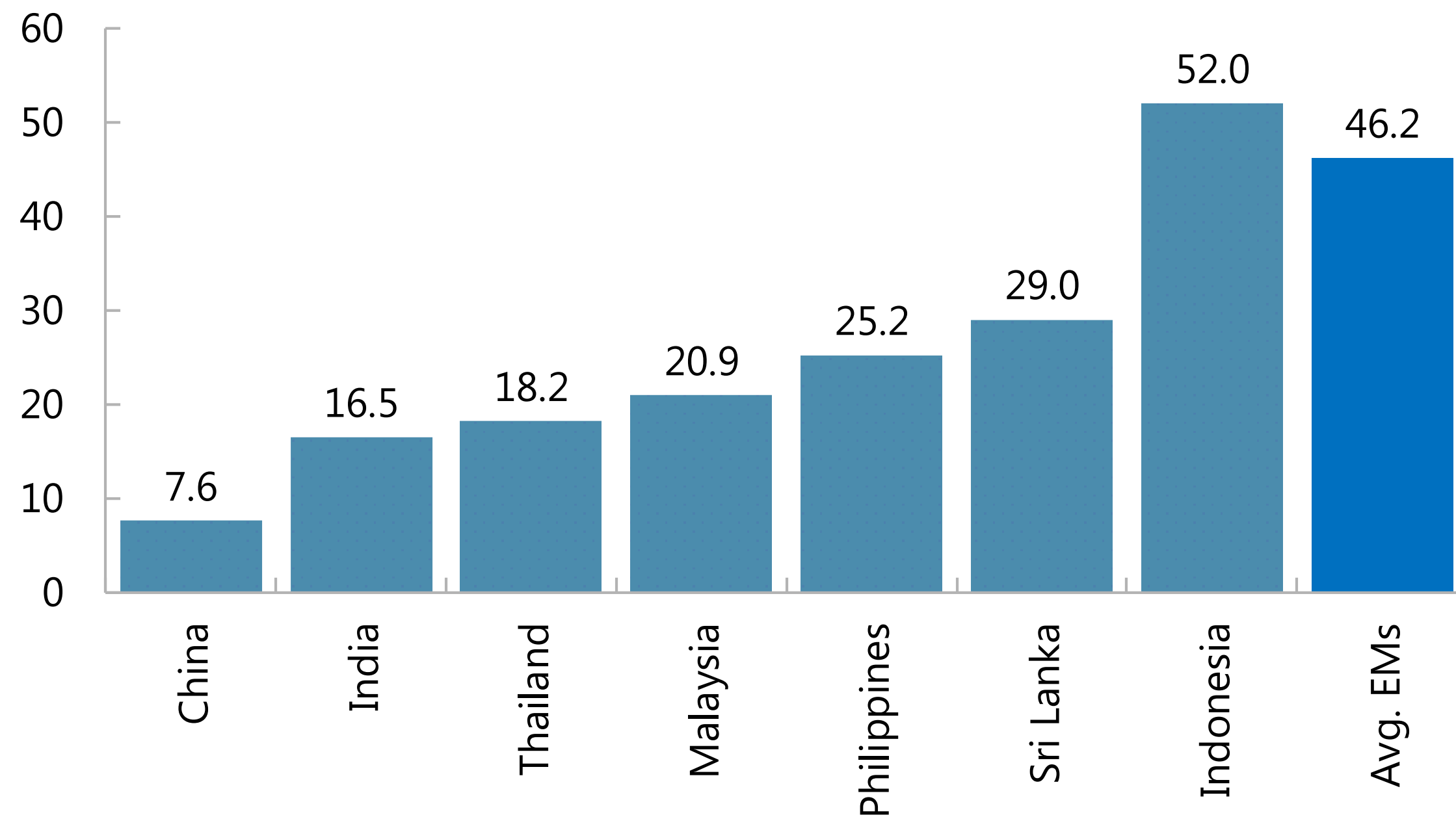


Sources: Haver Analytics; and IIF.

Additional Slides

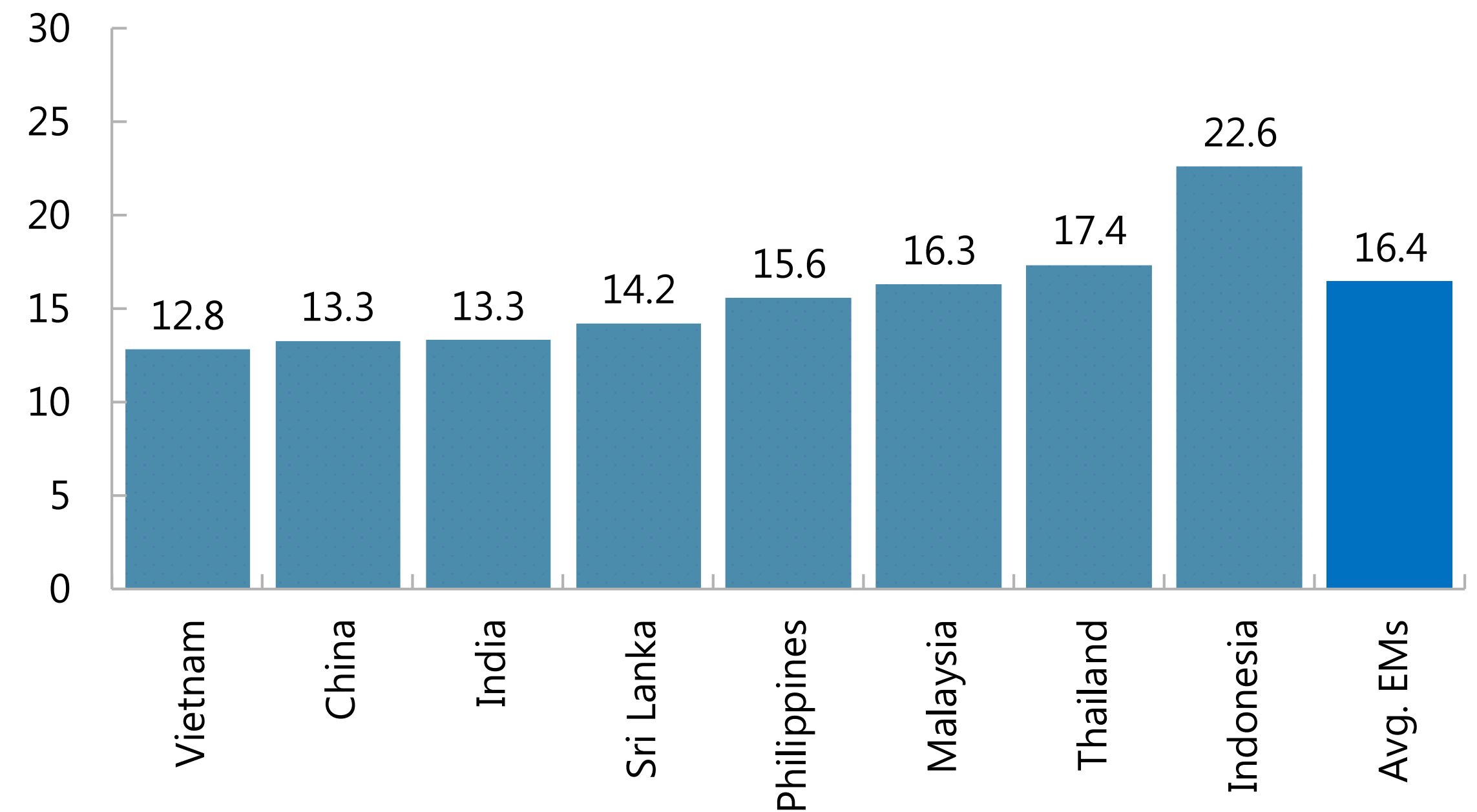
FX share of NFC debt

(In percent)



Capital Adequacy Ratio

(In percent)

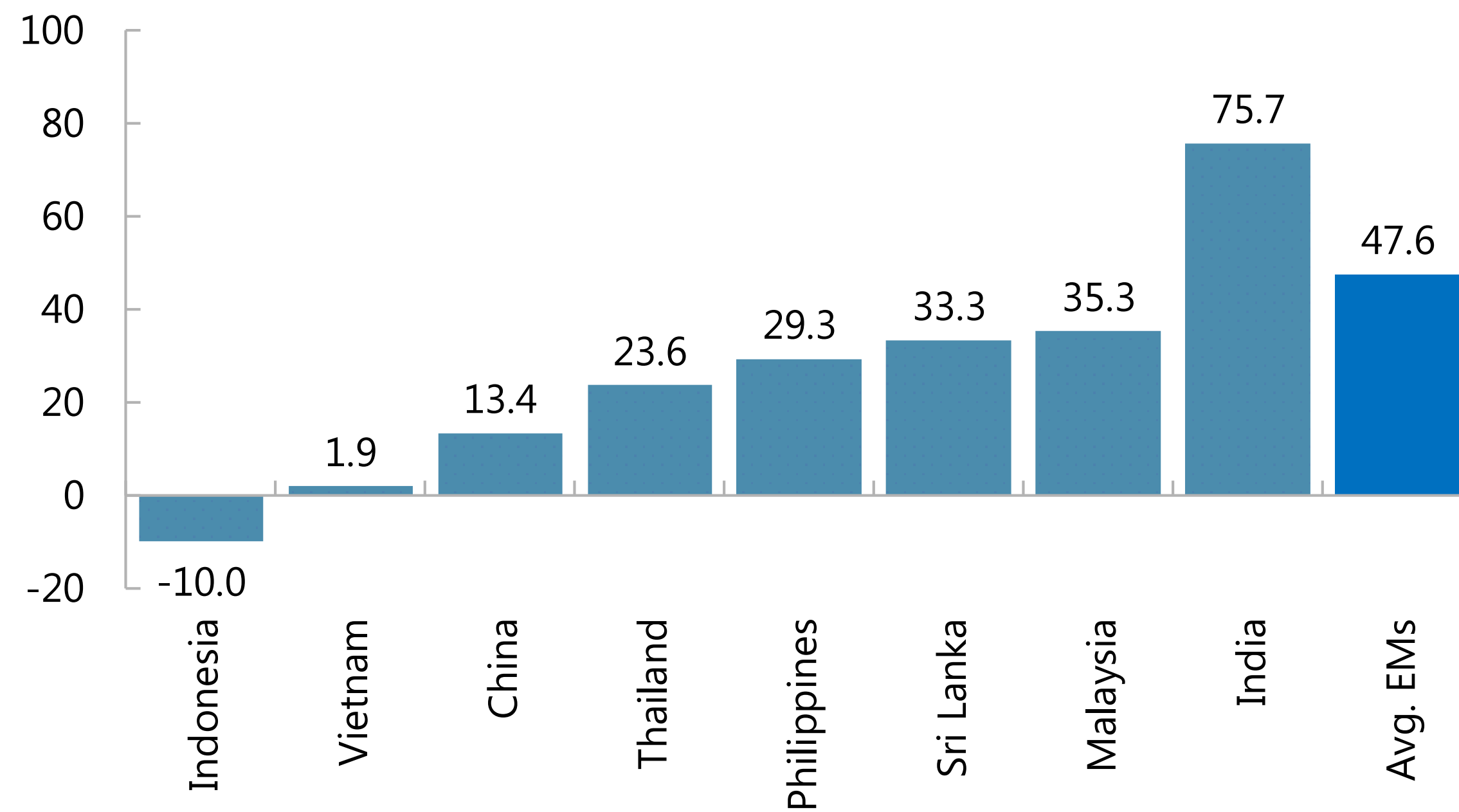


Sources: IMF Vulnerability Exercise Database; and staff estimates.

Additional Slides

Interest Coverage Ratio

(In percent)



Sources: IMF Vulnerability Exercise Database; and staff estimates.