Macro Notes – The EM/FM Remittances Challenge

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Benjamin Hilgenstock, Economist, bhilgenstock@iif.com, @BHilgenstockIIF
Jonathan Fortun, Economist, jfortun@iif.com, @EconChart
Elina Ribakova, Deputy Chief Economist, eribakova@iif.com, @ElinaRibakova

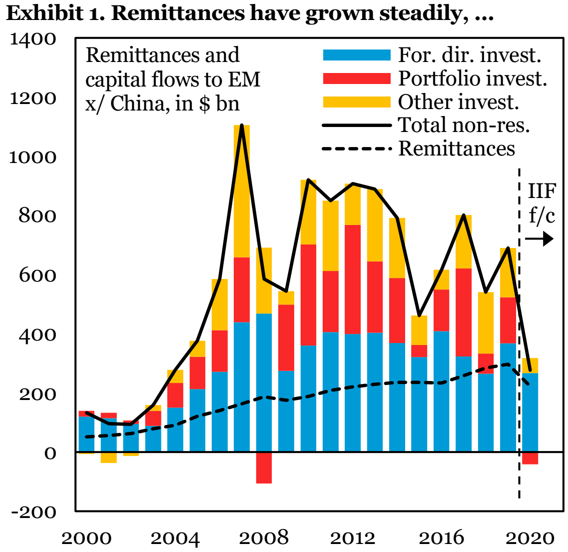
INSTITUTE OF INTERNATIONAL FINANCE

- Non-resident flows to emerging and frontier markets will contract sharply in 2020.
- Remittances have become an important, countercyclical, source of inflows for EM.
- In 2020, however, they will likely be much lower due to the global nature of shocks.
- High-frequency data show that the deceleration had already begun in the 1st quarter.
- Central America and the Caribbean, the Philippines, and Egypt are most exposed.

As we flagged in our recent ***Capital Flows Report***, we expect a sharp contraction in capital flows to emerging markets in 2020. While the IIF's high-frequency ***Capital Flows Tracker*** indicates a modest stabilization in non-resident portfolio flows in April-May, the COVID-19-induced sudden stop remains the most severe in recent history. In this ***Macro Notes***, we focus on another important source of external flows to emerging and frontier markets—remittances. Following the IMF's latest BoP manual, we define remittances as the sum of two current account categories: *"compensation of employees"* (income earned by migrant workers) and *"personal transfers"* (all current transfers between resident and non-resident individuals). Remittances are now as important as non-resident FDI as a source of FX inflows for emerging and frontier markets (Exhibit 1). They are also more stable than portfolio flows, which have historically been a critical source of external funding for these countries. Finally, remittances tend to be countercyclical. In 2020, however, they will likely be much lower due to the global and synchronized nature of shocks.

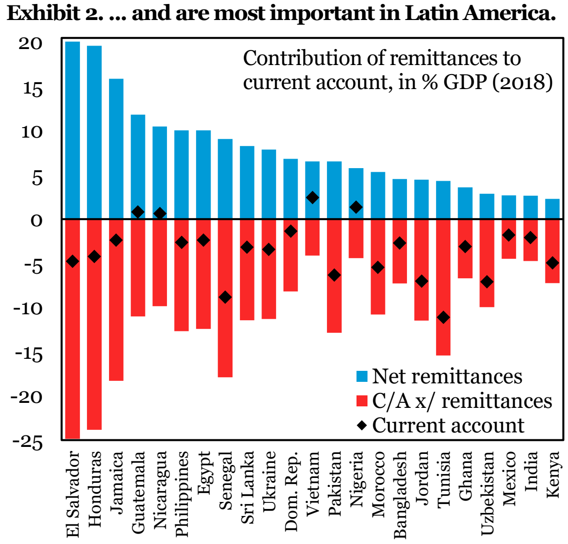
Remittances depend on migration, host- and home-country growth, exchange rate fluctuations, and the ability to transfer money across borders. In host countries, COVID-19 shutdowns have disproportionately affected sectors where migrants are more likely to be employed, for example certain services (food and hospitality, retail and wholesale trade, tourism, and transportation). Migrants also tend to be employed in sectors that may have stayed (partially) open, but where the infection risk is significantly higher (agriculture, food processing, and healthcare). Furthermore, migrants' ability to shift across sectors or gain access to government support is likely curtailed. Finally, while electronic cross-border flows can continue unabated by COVID-19 lockdowns, carrying cash is still the preferred method of remittance transfers in many cases.

Exhibit 1. Remittances have grown steadily, …



Source: Haver, IIF

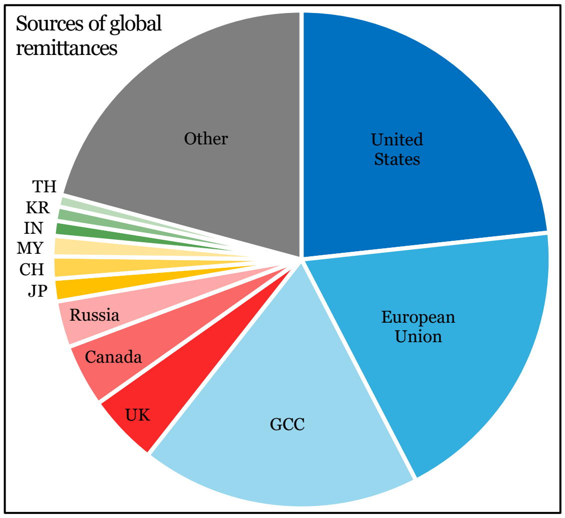
Exhibit 2. … and are most important in Latin America.



Source: Haver, IIF

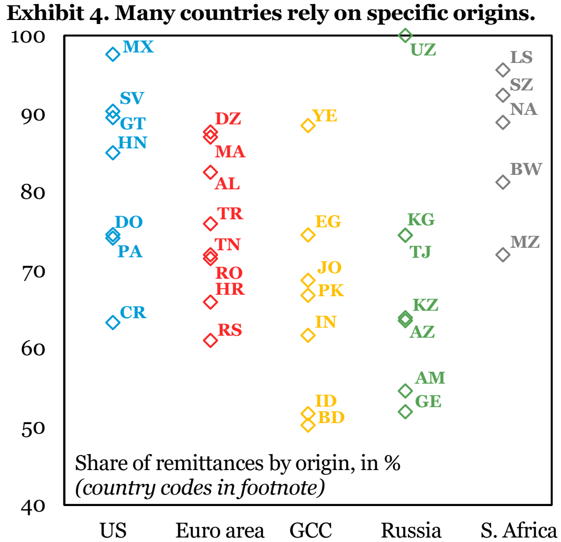
During the global financial crisis (GFC), remittances fell by about 5%. As the COVID-19 recession affects even more countries simultaneously, especially host countries in the EM universe, a drop of 20-30% seems possible. A recent study by the World Bank expects remittances to low- and middle-income countries to fall by about 20% in 2020, with only a moderate recovery in 2021. This will be particularly challenging for countries with high external funding pressure where remittances help reduce otherwise large current account deficits, including most of Central America, Caribbean nations, as well the Philippines and Egypt (Exhibit 2).

Exhibit 3. Few countries account for the bulk of flows.



Source: Haver, IIF

Exhibit 4. Many countries rely on specific origins.

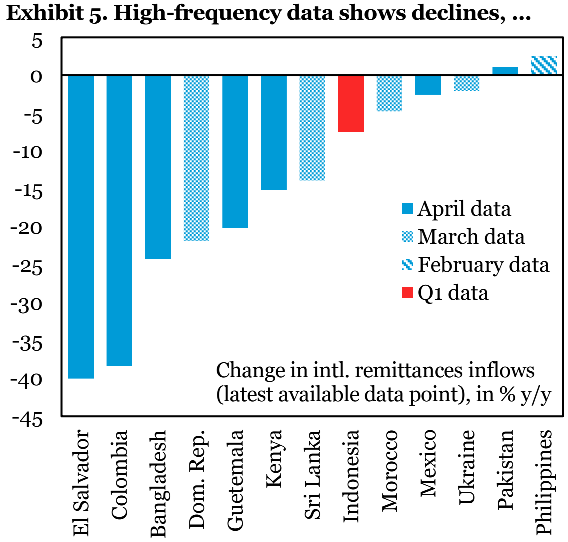


Source: Haver, IIF

Economies that account for the bulk of global remittances flows are among the most-exposed to the COVID-19 and oil price shocks (Exhibit 3). Not surprisingly, the US accounts for most of the flows to Latin America (Exhibit 4 shows the share of a country in percent of total remittances flows to a recipient country). Europe is an important source of remittances for Africa and Eastern Europe, and workers based in the GCC send money to home countries in Africa and Asia. Finally, more regional patterns exist with regard to Russia, which is an important source of transfers for CIS countries, and South Africa, which accounts for a large share of remittances to its neighbors. Among key recipient countries, important emerging markets such as India, China, Mexico, the Philippines, Egypt, and Nigeria account for close to 40% of all remittances in dollar terms.

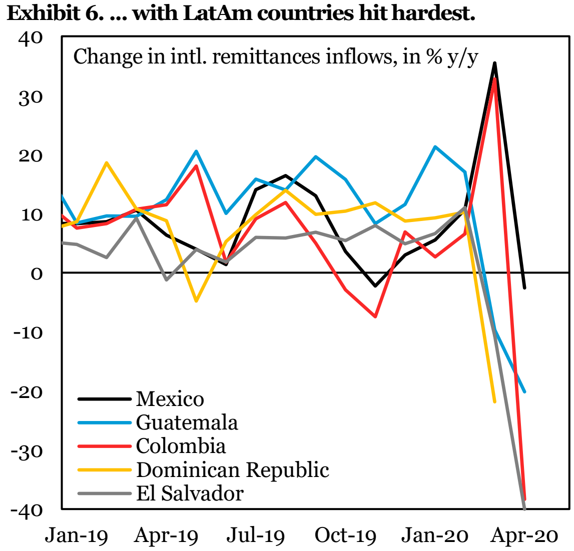
Data for January-April already show a sharp decline in remittances for many Latin American and Caribbean countries as well as Bangladesh, Kenya, and Sri Lanka—in some cases by as much as 40% y/y (Exhibit 5). Interestingly, remittances in March increased significantly for Mexico and Colombia (subsequently reversing in April; Exhibit 6). It appears migrants sent more money to home countries to help cope with the COVID-19 shock, making use of accumulated savings, and also took advantage of the weakness of both the Colombian Peso and Mexican Peso, which had depreciated sharply in March (by 16% and 19%, respectively). However, the effect is likely to be temporary. 2020Q1 also does not reflect the full effect of travel bans and economic shutdowns.

Exhibit 5. High-frequency data shows declines, ...



Source: Haver, IIF

Exhibit 6. ... with LatAm countries hit hardest.



Source: Haver, IIF

Country codes: AL - Albania, AM - Armenia, AZ - Azerbaijan, BD - Bangladesh, BW - Botswana, CR - Costa Rica, DO - Dominican Republic, DZ - Algeria, EG - Egypt, GE - Georgia, GT - Guatemala, HN - Honduras, HR - Croatia, ID - Indonesia, IN - India, JO - Jordan, KG - Kyrgyz Republic, KZ - Kazakhstan, LS - Lesotho, MA - Morocco, MX – Mexico, MZ - Mozambique, NA - Namibia, PA - Panama, PK - Pakistan, RO - Romania, RS - Serbia, SV - El Salvador, SZ - eSwatini, TJ - Tajikistan, TN - Tunisia, TR - Turkey, UZ - Uzbekistan, YE - Yemen