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## ICI VIEWPOINTS

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# The IMF Is Entitled to Its Opinion, but Not to Its Own Facts

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Part of a [series of ICI Viewpoints](#) about problems in the IMF's analysis of the asset management industry.

On Wednesday, the International Monetary Fund (IMF) released its latest [Global Financial Stability Report](#) (GFSR), including a chapter on the asset management industry and financial stability.

The IMF argues that regulated funds domiciled in developed countries may amplify shocks to emerging markets, thus destabilizing those markets. It implies that this risk is growing because regulated funds and their investors are piling into high-yield and emerging market debt. In [Figure 3.6](#) of the GFSR, the IMF claims that bond funds globally held \$2.9 trillion in emerging market bonds in 2014. [These holdings](#) have supposedly surged by \$900 billion over the past two years. Unfortunately, the [Wall Street Journal](#) has already reported these figures as facts.

As the late senator Daniel Patrick Moynihan said, "You are entitled to your opinion. But you are not entitled to your own facts." In reality, the IMF's figures overstate by a wide margin both the level and growth in the emerging market bonds held by regulated funds domiciled outside of emerging market economies. And the overall message of risk posed by emerging market funds is also inflated.

Fact: Regulated fund holdings of emerging market debt are significantly smaller than the IMF claims and have been steady the past two years.

One way to see the problem is through the IMF's own data on international investment positions. Those data show that *all foreign investors combined* held \$1.76 trillion in emerging market debt at the end of 2013, *less* than the \$2.14 trillion that the IMF estimates were held just by bond funds in 2013.

Even within the GFSR, the IMF's figures are inconsistent. Figure 3.6 suggests that regulated bond funds held \$2.14 trillion in emerging market debt in 2013. But Figure 3.1.1 in the annex to the GFSR indicates that regulated funds held just \$1.5 trillion (5 percent of \$30

trillion) in emerging market debt at the end of 2013.

In yet another section of the GFSR, the IMF bases its empirical analysis on third-party data from EPFR Global. According to EPFR Global data, bond funds globally held just \$526 billion in emerging market bonds at the end of 2014. Yet the IMF doesn't reconcile how Figure 3.6 reports assets five times greater.

Some of these discrepancies may be explained if the IMF's figures for bond funds reflect holdings by investors and funds domiciled in an emerging market of their own country's debt—e.g., a Brazilian resident investing in a Brazilian-domiciled bond fund that holds Brazilian debt. But if home-country owners of debt are included in the numbers, those data hardly apply to any claim of risk imposed on emerging markets by cross-border investments from regulated funds in developed countries.

The IMF's Figure 3.6 also appears to overstate growth in bond funds' holdings of emerging market debt. Recall that the GFSR states that bond fund holdings of emerging market bonds grew by \$900 billion—or 44 percent—over two years. According to EPFR Global, however, those holdings grew by only \$43 billion from 2012 to 2014—less than 10 percent. And much of the increase in EPFR Global's measure reflects the fact that EPFR Global has improved the coverage of its database in the past two years, notably by adding funds domiciled in Japan and India. The data do not indicate that purchases of emerging market debt by regulated funds domiciled in the United States and Europe have increased in the past two years.

Fact: Regulated funds are not the dominant investors in emerging market capital markets.

Regulated fund holdings of emerging market securities remain a small portion of the total value of the stocks and bonds of emerging market countries. In 2013, regulated funds held just 4.3 percent of outstanding debt and 8.5 percent of the stock market capitalization of emerging market countries, and [these shares](#) have not changed much since 2012. Other market participants—especially emerging markets' own residents and domestic institutions—remain the dominant investors in emerging market equity and fixed-income markets.

Fact: Regulated funds are more stable than other foreign portfolio investors.

The IMF possesses a lot of data to assess the relative stability of regulated funds compared to other foreign portfolio investors, but continues to repeat hypothetical concerns about regulated funds' flows to emerging market economies. ICI analysis of regulated fund flow data and IMF portfolio flow data show that fund flows tend to be [a stable source of financing for emerging economies](#).

While regulated funds represent a sizable part of the foreign investor base in emerging market countries, they are a stable investor base. Moreover, regulated funds are not the primary source of the variability of portfolio capital flows to emerging markets. As of 2013, regulated funds held more than half of the emerging market equities held by foreign investors and almost 30 percent of emerging market bonds held by foreign investors. But on average, regulated funds accounted for less than 15 percent of the variance of foreign portfolio capital flows to emerging markets from 2005 to 2013.

Fact: Fund investors *respond* to returns, but do not *drive* emerging market bond returns.

The IMF bases its claim that bond fund flows are destabilizing in emerging markets on the

notion that fund flows drive returns in these markets.

But monthly returns on emerging market securities are explained by factors other than funds' net purchases of emerging market stocks and bonds—most significantly by capital flows from other (non-fund) foreign investors. In particular, statistical analysis in a recent [ICI Global research paper](#) demonstrates that a broader measure of all foreign investor flows dominates net purchases by regulated funds. Thus, when this broader measure is included in the analysis, it shows that regulated funds' net purchases have *no* effect on monthly returns of emerging market securities.

Also, regulated funds' net purchases of emerging market securities do not drive future returns. Weekly data show that while net purchases respond with a lag to returns on emerging market securities, those purchases do not have a persistent, or statistically significant, effect on future returns.

Fact: Non-fund foreign investors have dramatically increased emerging market bond holdings in the past five years.

In its examination of financial stability, the IMF's misplaced focus on regulated funds has caused it to ignore risks that potentially are significantly more serious. For example, risks might arise from non-fund foreign portfolio investors' purchases of emerging market bonds, a topic not discussed in the GFSR chapter at all. From 2009 to 2014, emerging markets received bond inflows of roughly \$1 trillion. Of that flow, ICI analysis of regulated fund flow data shows that regulated funds can account for less than 15 percent.

All of these facts suggest that regulators should focus on portfolio capital flows to emerging market countries from *all* foreign investors, rather than narrowly focusing on flows from regulated funds. A more holistic approach to financial stability would also focus on activities across the financial system, instead of particular entities. In the opening to its chapter on asset management, the IMF states that it has indeed come around to ICI's view that an activities-based approach to regulation is preferable to an entity-based approach. Now if only they can get their facts in line.

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