Emerging Markets Spotlight

Remittances Fueling the Engine of Foreign Capital

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KEY POINTS

- Remittances have been the largest source of external finance flows to developing countries excluding China. In 2023, remittance flows to developing countries are estimated to have increased by 3.8% to $669 billion USD.
- Major emerging markets are poised to benefit from the size and stability of remittances, providing a reliable funding source for countries including India, Mexico, China, Egypt, and the Philippines.
- Differing levels of incoming remittances differentiate between emerging markets that necessitate a top-down, country-driven approach to equity investing.

Investment in emerging economies is significantly funded by money flowing in from exports, or more precisely, from the provision of goods and services to the rest of the world. This includes physical goods — from crude oil to semiconductors — and services such as software, tourism, and call centers. Yet, much of what's fueling the engine of foreign capital flows from remittances sent by citizens making their living overseas.

We have previously written about the importance of remittances to Mexico (March 2024: Trade Exports $50.8 Billion, Remittances $5.0 Billion), but a new report from the International Organization for Migration offers deeper insight into the role remittances play in emerging markets.

Since 2015, remittances have served as the largest source of external finance flows to developing countries, ex-China. In 2023, remittance flows to developing countries increased an estimated 3.8% to $669 billion USD. Remittances are roughly three times the volume of official development aid and are now larger than foreign direct investment (FDI) flows.

In general, the poorest developing countries rely on remittances most. The Top 3 countries with the highest remittances to GDP include Tajikistan (51%), Samoa (44%) and Lebanon (36%), but none of these have equity markets suitable for investment.

Within the group of investable emerging markets, these capital flows take on critical importance. In 2023, the Top 5 developing countries receiving remittance inflows included India ($125 billion USD; 3.4% of GDP); Mexico ($67 billion USD, 3.7% of GDP); China ($50 billion USD, but only 0.3% of GDP); the Philippines ($40 billion USD, 9.2% of GDP); and Egypt ($24 billion, 6.1% of GDP). With India and the Philippines expected to run account deficits this year of 1.2% and 2.5% of GDP respectively, these remittances remain a vital funding source.

Remittances are generally stable, offsetting the economic volatility these countries often display. During the height of the pandemic in 2020, remittances fell 13.7% from the 2019 average in their worst month.

Meanwhile, exports plunged by 52.8%. Because remittances are determined by the currency of the host nation, their value increases in weak economies, providing added financial cushion in volatile times.

Consumers still contend with the costs of sending remittances. Despite a UN Sustainable Development Goal to reduce remittance transactions to 3% of the transfer, costs remain in the 5-6% region. For emerging market banks, however, 5-6% of the $669 billion USD in remittances provides a lucrative revenue stream, even as the quest to lower fees opens powerful opportunities for new players in emerging market financial services.

Yet, we are reminded that not all emerging markets are cut from the same cloth. The unique profile of the Arabian Gulf, for example, showcases remittance outflows for Saudi Arabia, the UAE, Qatar, and Kuwait totaling more than $110 billion USD in 2022, the latest figures available, and in turn, material to lower-income countries across South Asia and the Middle East. (Egypt alone receives $8 billion USD in remittances each from Saudi Arabia and the UAE).

These differences highlight the diversity of income levels, development models, and growth drivers within emerging markets, providing yet more evidence for a top-down, country-driven approach to emerging market equity investing.

Source: Bloomberg/MSCI/JOHCM. ñThe Impact of Remittances.ò KNOMAD, 2024. https://knomad.org/data/remittances. International Organization for Migration. ñWorld Migration Report 2024.ò 2024. https://worldmigrationreport.iom.int/.

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