J O Hambro Capital Management Group

News

Remember Remittances

Remittances have been the largest source of external finance flows to developing countries ex-China



James Syme   Paul Wimborne   Ada Chan

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The development processes in emerging markets are significantly funded by money flowing in from exports, or, more precisely, from the provision of goods and services to the rest of the world. That includes physical goods, from crude oil to semiconductors; it includes services such as software, tourism and call centres; it also can be thought to include remittances from citizens working overseas. We have written previously about the importance of remittances to Mexico (March 2024: trade exports USD 50.8bn, remittances USD 5.0bn), but the publication of the World Migration Report 2024 [https://worldmigrationreport.iom.int/] allows a review into the wider role of remittances to emerging markets.

Since 2015, remittances have been the largest source of external finance flows to developing countries ex-China. In 2023, remittance flows to developing countries are estimated to have increased by 3.8% to reach USD 669 bn. Remittances have been about three times the volume of official development aid and are now larger than foreign direct investment (FDI) flows. In general, it is the poorer developing countries for whom migration and remittances are most important. The three countries with the highest remittances to GDP are Tajikistan (51%), Samoa (44%) and Lebanon (36%), but none of those have equity markets suitable for investment.

Within the group of investable emerging markets, these capital flows can also be important. In 2023, the top five developing countries for receiving remittance inflows were India (USD 125 bn, 3.4% of GDP), Mexico (USD 67 bn, 3.7% of GDP), China (USD 50 bn), the Philippines (USD 40 bn, 9.2% of GDP), and Egypt (USD 24 bn, 6.1% of GDP). Given that, for example, India and the Philippines are expected to run current account deficits this year of 1.2% and 2.5% of GDP respectively, these remittances are extremely important.

Remittances are also generally very stable, offsetting the economic volatility that these countries often display. For example, in the covid-hit year of 2020, the worst month of remittances was down 13.7% on the 2019 average, whereas the worst month of exports was down 52.8%. Because remittances are effectively determined in the currency of the host nation, weakness in emerging market currencies increases the local currency value of remittances, also providing support in difficult times.

An interesting fact from the report is about the cost of sending remittances. Despite a UN Sustainable Development Goal target to reduce the cost of a typical remittance transaction to 3% of the transfer, costs remain in the region of 5-6%. Although that is a significant friction for consumers, 5-6% of USD 669bn is a huge revenue source for emerging market banks, while the quest to lower those fees is a powerful opportunity for new players in emerging market financial services.

One group of emerging markets that have a very different profile are the countries in the Arabian Gulf. For 2022, the latest year available, the remittance outflows for Saudi Arabia, the UAE, Qatar and Kuwait totalled over USD 110bn and are in turn material to lower-income countries in South Asia and the Middle East (Egypt alone receives over USD 8bn of remittances a year from each of Saudi Arabia and the UAE). These differences are a reminder of the diversity of income levels, development models and growth drivers within emerging markets, and yet more evidence for a top-down, country driven approach to emerging market equity investing.

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