‘The Political Economy of Emerging Market Sovereign Bonds: Narrowing the policy space?”

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Abstract

While the role of international financial institutions in constraining domestic policy autonomy has been the subject of extensive analysis, the role of private financial market actors has been less studied, despite the fact that the majority of capital flows to developing countries now come through private rather than official channels. The mechanisms of policy constraint which are commonly written about in the International Political Economy literature are assessed, through trying to understand what factors actually determine financial markets’ allocation of resources to developing countries, and whether this allocation actually reflects country-specific fundamentals. Utilising extensive qualitative material, including over 41 interviews and two and a half months of participant observation among sovereign bond market participants in Hong Kong, it was found that ‘push’ factors external to the capital receiving country (including international liquidity, market sentiment, and international interest rates) were fundamentally more important than ‘pull’ factors (country-specific factors such as economic policy and economic performance), in influencing financial market resource allocation. This was not only because financial market investors explicitly based their investment decisions on push factors, but also because push factors exerted an important influence on investors’ interpretations of the pull factors themselves. How push factors influenced market participants’ interpretations of country fundamentals was further explored in depth through a case study of portfolio inflows to emerging market sovereign bonds during and after the recent financial crisis, between 2008 and 2013. It was found that despite country-specific fundamentals remaining constant during this period, investors’ interpretations of them changed dramatically according to changes in the push factors. If financial market prices do not reflect country specific policies in the first place, this means that it is less likely that they pose a constraint on government policy directly through the market mechanism as is implied in much of the literature on the topic. Furthermore, the findings of this paper problematise the rational actor models of financial market behaviour used by the International Political Economy and International Economics literatures. It is instead argued that alternative models of financial market behaviour, such as Keynesian and Economic Sociology approaches, should be integrated into the literature.