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Evidence shows that the transmission of global shocks to domestic financial conditions was significantly stronger during the period of high foreign participation (2014–2022) and weakened after 2023 as foreign holdings declined.

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Approach

This paper analyzes how the participation of foreign investors in Colombia's local sovereign debt market became, particularly after 2014, a key channel for transmitting global financial risk to domestic financial conditions. It describes episodes of capital inflows and outflows following Colombia's increased weight in the J.P. Morgan GBI-EM Index, the effects of higher foreign participation on yields, liquidity, and debt structure, and the role of investor composition in amplifying external shocks. In addition, the study uses the IDOAM Index developed by Banco de la República (the Central Bank of Colombia) and a VAR model estimated by subperiods to assess how the sensitivity of domestic financial conditions to global factors has changed between 2011 and 2025.

Contribution

The paper synthesizes existing empirical evidence on the effects of foreign participation in emerging markets and presents specific results for Colombia, showing that the entry of investors after 2014 lowered yields, broadened the investor base in local currency, and improved liquidity, but also increased the country's exposure to changes in global financial conditions. Furthermore, it highlights that the effects depend on investor composition: mutual funds and index-driven agents react strongly to global factors, whereas long-term institutional investors respond mainly to domestic fundamentals. The analysis using the IDOAM Index and the VAR model contributes to understanding how this sensitivity varies according to the level of foreign participation.

Results

The findings show that during 2014–2022, a period of high foreign participation, global shocks had a rapid and significant impact on domestic financial conditions, as evidenced by the response of the IDOAM Index to increases in the global risk indicator. Before 2014, when foreign participation was low, the transmission of these shocks was practically negligible, whereas after 2022, with the reduction in foreign holdings, sensitivity declined but remains relevant. The VAR model applied to 10-year TES yields confirms that global shocks raise financing costs across all periods, with differences in magnitude and speed depending on the level of foreign participation and fiscal conditions. These results are complemented by previous evidence linking foreign participation to effects on credit, volatility, and the structure of the local market.