Monthly Comments – Emerging Markets

MacroFinance Research – April 2020

Key Messages

Country Focus – South Korea: Covid-19 cuts into the already feeble economic growth

South Korean economy was facing economic slowdown with lowest GDP growth rate in the decade due to fall in its exports and contraction in its semi-conductor and electronic industry affected by the heightened uncertainties in global trade war between China & US and regionally between South Korea & Japan. The Covid-19 pandemic thus came at a time of massive economic vulnerability heightening uncertainties on domestic consumption and external trade. South Korea's integration in the global value chain and its high infection rates place the economy on elevated levels of sensitivity to Covid-19. However, the economy enjoys only moderate ex ante vulnerabilities, which makes the economy resilient and better capable of policy absorption. In addition, the swift measures taken by the government in controlling the spread of Covid-19 (extensive testing and contact tracing) has flattened its infection curve at a faster rate. Hence along with the heavy fiscal stimulus and appropriate monetary policies announced, the economy is likely to still register positive GDP growth in 2020H2 although at a lower rate than expected earlier.

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RiskWatch – Surging impact of Coronavirus on EMDEs

In this monthly report, we provide a deeper investigation into the potential impact of the Covid-19 pandemic on country-risk levels for Emerging Markets and Developing Economies (EMDEs) through an analytical approach combining health situation and challenges, policy responses, transmission channels and ex-ante vulnerabilities. The global negative impact will be unprecedented for peace-time periods, with acute economic contraction in the short-term followed by an asymmetric recovery during 2020H2; associated with persistent risk-aversion and capital outflows, the collapse in activity will magnify any pre-existing financial risks, on both external and domestic credit. Among the largest EMDEs, the analysis highlights Argentina, Turkey, Malaysia, UAE, South Africa and to some extent Poland as most vulnerable, with implications on risks for exchange rates, but also capital controls, debt renegotiation or defaults.

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Dashboard & Heatmap – Summary of quantitative changes and key metrics

View more on page 7…

As always, readers are most welcome to come back to us for further details or clarifications.

Completed on April 17, 2020.

Country Focus –South Korea: Covid-19 cuts into the already feeble economic growth

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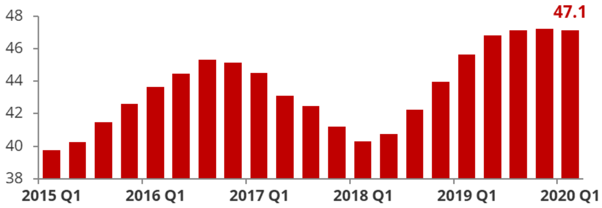
Global pandemic at a time of low growth

When the first case of Covid-19 was confirmed in South Korea in late Jan. 2020, the economy had barely stepped out of the poor economic performance of 2019. Our Economic & Financial Risk ratings for South Korea have been worsening for the last six consecutive quarters (47.2-C) and with a two-year time lead on the ratings, subpar economic performance was anticipated for the next couple of years. In addition, the economy on our WatchList Indication for Economic Activity (2018Q3-2020Q2) indicating a looming business cycle shock.

South Korea – Economic & Financial Risk Rating History
from 0 (lowest) to 100 (highest)



Source: TAC ECONOMICS

Risk ratings for South Korea have been on the rise predominantly due to an eight-quarter precipitous fall in our leading indicator of economic activity (*real economic pressure*) on the Cyclical Balance, which despite is recent upturn, continues to remain at an unfavorable level. Moreover, the economy has had increasing proportion of speculative capital flows reducing its *foreign reserve quality* (Foreign Exchange Balance) and *financial stability* (Debt Balance). Indeed, our calculation (cf. Monthly Comments, Aug. 2019) revealed that there has been a massive capital outflow of USD 208bn (between 2016-2018) by international investors revealing a weaker appetite for Korean assets.

The year leading to Covid-19 was particularly challenging for South Korea: GDP at +2.0% y/y in 2019 was the lowest in a decade, caused by China-US trade war and South Korea's specific trade conflict with Japan, which contracted its exports (-10%y/y in 2019), severely affecting its semiconductor electronics industry (largest contributor to exports for last few years). Moreover, private investment contracted (by -6.0%), annual inflation at 0.4% remained much below the Central Bank's target (+2.0%), all of which are reflective of weakening domestic consumption and reducing consumer confidence.

Above average sensitivity to Covid-19 and policy measures

South Korea was one of the first countries to be affected by the pandemic, partly due to large tourist flows with China. The country's heightened sensitivity to Covid-19 arises from the large scale spreading of the infection; a tight integration in the global value chains, and important domestic stringency in controlling Covid-19 spread.

Covid-19 Sensitivity Index
from 1 (best) to 5 (worst)

		South Korea
Domestic	Covid-19 Health Situation	2.5
	Health Vulnerability	1.0
	Stringency Index	5.0
International	Supply-side	3.5
	Demand-side	2.2
Overall Index		**3.6**

In the month of February and early March, when infection was spreading rapidly in South Korea, implying strong adverse impact on domestic demand and production, the Korean Won registered a significant depreciation (-10% against the USD until March-end).

To combat the downward spiral of the economy, the government approved a massive fiscal stimulus package (0.8% of the GDP for cash transfers, employment retention support, consumption coupons) along with various tax benefits. The Bank of Korea (BoK) provided monetary policy support through a steep cut in its interest rate (by 50bps to 0.75%).

In addition, thanks to the early domestic measures of extensive testing, contact tracing and sensible social distancing, South Korea has been one of the few countries to flatten the infection curve faster (10,613 infected and 229 death as of April 17, 2020). This has also enabled the country to avoid the severe restrictions on movement of people that has brought other economies to a grinding halt.

As a result of all these measures, some restrictions have already been slightly relaxed. Moreover, since the end of March, the Korean Won (with some volatility) has regained some ground (+4% against the USD), while the swap line provided by the US Fed too has helped in restoring investors' confidence

Rapid, but low economic recovery after Covid-19

Government's handling of the pandemic has been widely approved, which led the ruling Minjoo (Democratic) Party of President Moon Jae-in to win a landslide (180 of the 300 seats) victory in the Parliamentary elections on April 15. Indeed, South Korea has been one of the few countries to hold elections during the pandemic, where 66% voted, the highest in a parliamentary election since 1992.

The time-dynamics of our synthetic index reveals that South Korea is moving rapidly towards lower levels of sensitivity, as there was relaxation in confinements (although at the time of writing this paper, a few new cases were detected).

Indeed, South Korea's moderate ex ante vulnerabilities (pre-existing economic and financial imbalances), reveals relative economic resilience that will help in policy absorption and the economy will also be aided by early (weaker) recovery by China (which has also reported some new cases recently). This is likely to result in an asymmetric recovery, as the initial rapid recovery will not be large enough to offset the losses due to Covid-19.

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Global context and economic scenario

Specific characteristics of the Covid-19 pandemic lead to a disproportionate economic impact (related to lockdowns and confinements), with persistently high uncertainties and strong financial volatility. For China and (later) for most mature economies, our central scenario is one of a short duration for the economic collapse (massive recession in 2020Q1 and especially Q2), followed by a subsequent recovery starting in Q3. This would translate into an asymmetric V-shape cyclical trajectory, i.e. a rapid rebound not strong enough to compensate fully for the acute loss in economic activity during the worst of the crisis.

Beyond the sudden short-term shock on EM's financial performances in March 2020, financial turbulences, prolonged risk-aversion and flight to safety are likely to remain substantial over the next two quarters, with persistent pressures on currencies, equity and credit markets. In parallel, authorities in mature economies are conducting ultra-low policy and government bond rates along with massive injection of liquidity worldwide (i.e. non-conventional policies) and huge fiscal support.

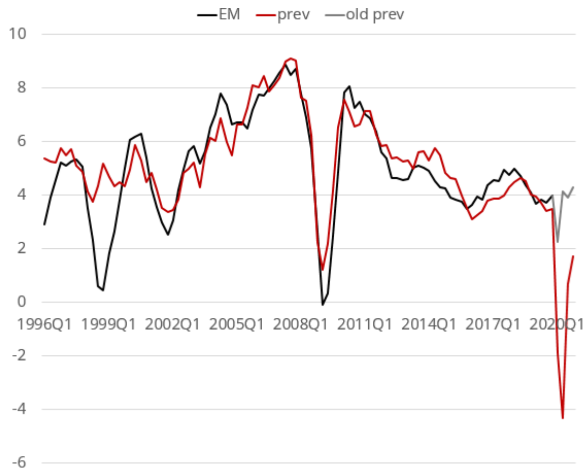
The dual impact of the transmission from the global recession and of domestic containment measures on EM economic growth can be analyzed though a comprehensive approach of epidemiologic, economic and financial factors.

Impact and transmission on EM economic growth

Dominant and synchronic effects of mature and China economic scenario, coupled with critical challenges regarding the pandemic (expansion, public healthcare services and containment measures) will have a collapsing impact on global economic growth for EM.

Using a robust econometric model on aggregate EM GDP growth based on the latest central scenario for GDP growth in US, Eurozone and China, and global oil prices, we find that the shock could be equivalent to an average GDP contraction of -1.0% y/y in 2020 (after +3.9% in 2019) with a quarterly trough slightly below -4.0% in Q1. The consequent reduction in per capita income on average in EM world in 2020 is unprecedented.

TAC ECONOMICS EM GDP Growth Projection



Source: TAC ECONOMICS

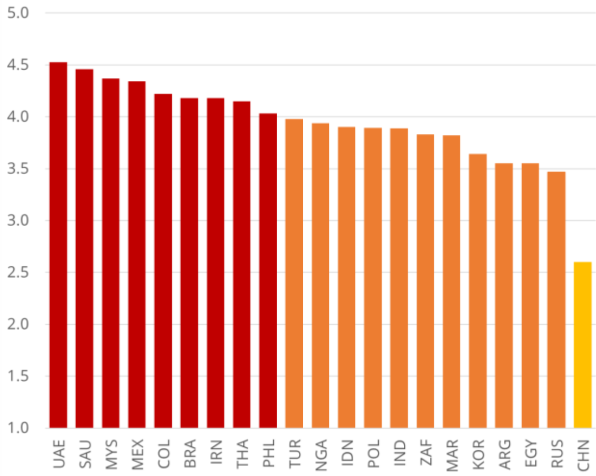
An additional challenge for EM arises from the role of informal sector (30 to 60% of labor force in EM) with generally much less safety nets (healthcare services, and unemployment benefits) and higher difficulties to face stringent containment measures (high density residential population, limited savings). Fall in economic opportunities and extensions of strict restrictions could trigger social and humanitarian crisis, as well as bouts of political tensions, that must be also averted.

Insights into the country-per-country implication for economic activity are derived from a composite index of overall **Covid-19 Sensitivity Index**, which combines domestic factors related to the pandemic and international transmission [1]. The tool is implemented on our whole list of 100 EM.

Among the most affected EM according to our Covid-19 Sensitivity Index are several large commodities producers (e.g. Saudi Arabia, UAE, Oman, Kuwait, Mozambique, Peru, Dem. Rep. of Congo, Qatar) and few countries highly integrated in international trade and supply chains (e.g. Vietnam, Hungary, Malaysia, etc.). On the opposite, China has already witnessed a reduction in its Covid-19 Sensitivity Index (from 3.4 to 2.6) thanks to satisfactory control of the epidemic and gradual lifting of containment measures. Similarly, Taiwan and to a lesser extent South Korea are now showing declining negative effects from the domestic health situation.

Covid-19 Sensitivity Index

From 1 (best) to 5 (worst)



Source: TAC ECONOMICS

EM relative financial vulnerabilities

We aim at assessing the potential macro-financial impact of Covid-19 pandemic through a **Global Credit Risk**, which combines several aspects of financial risks for EMDEs, namely short-term Fx liquidity challenges, overall burden of external debt, overall sustainability and vulnerability of the corporate, and of the sovereign borrowers.

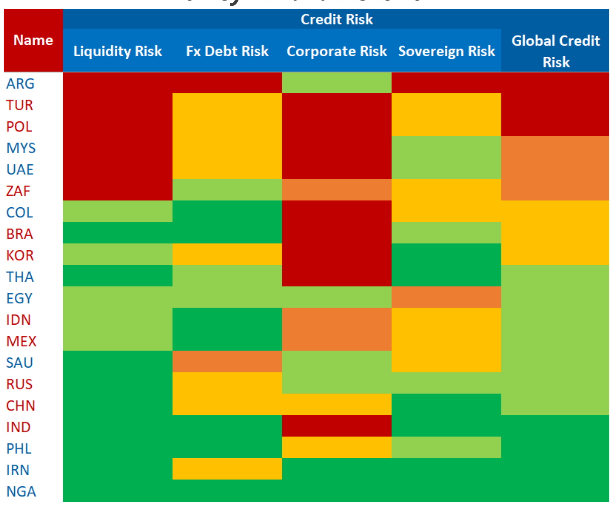
The Global Credit Risk looks at financial risks on businesses, partners (clients and suppliers) or assets for investors/asset managers. As EMDEs – and China notably – had stockpiled debt and accentuated financial risks since the Global Financial Crisis (GFC) in 2008, the extraordinary context of global recession and surging global risk aversion (with massive capital / portfolio outflows) induces a substantial increase in financial vulnerabilities. Indeed, capital outflows have doubled when compared to the GFC (0.4% of global GDP in 2020, against 0.2% in 2008), with sizeable negative impact on EMDE exchange rates; currencies in arbitrage markets like Mexico, South Africa, Brazil, Russia or Turkey have depreciated by at least 15% against the US Dollar in March 2020.

When looking at the 100 EM, **Liquidity Risk** (short-term external debt and principal amortization in 2020 as a ratio of forex reserves) and to a lower extent **Fx Debt Risk** (external debt and stability of external financing) are the key contributors to high Global Credit Risk (like in Montenegro, Venezuela, Mongolia, Tunisia, Qatar, Argentina and Czech Rep.)

When looking at largest EM (**10 Key EM** and **Next 10** in next table), the Liquidity Risk is similarly important, but coupled with much stronger concerns on **Corporate Risk** (aggregate leverage and fx vulnerability), denoting significant pre-existing companies' financial imbalances. On the contrary, the **Sovereign Risk** is less predominant for large EM (except for **Argentina**). Therefore, surging risk of corporate default clearly impose higher discrimination among counterparties for industrial and financial investors.

TAC ECONOMICS Global Credit Risk

10 Key EM** and **Next 10

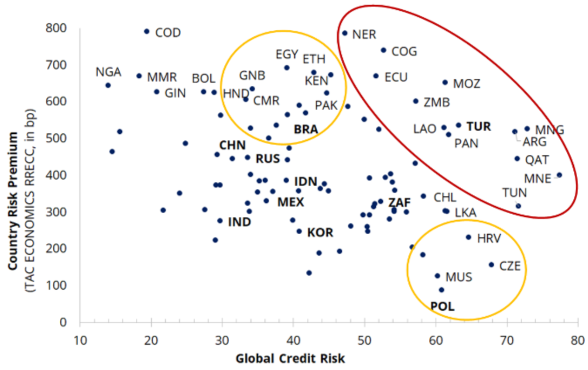


Source: TAC ECONOMICS

In a last step, we cross each country's aggregate score for Global Credit Risk with our overall country risk measure (Risk-Related Extra Cost of Capital, RRECC) expressed in basis points and illustrating the overall *ex ante* situation prior to the Covid-19 pandemic.

[1] Domestic factors: epidemiologic situation (prevalence of Covid-19 cases, fatalities and acceleration/deceleration in infection), health preparedness and stringency of restrictions on movements and activities; International transmission factors: international trade, (forward and backward) integration in global value chains, share of travel and tourism in GDP, oil and commodities exports.

Global Credit Risk and Country Risk Premium



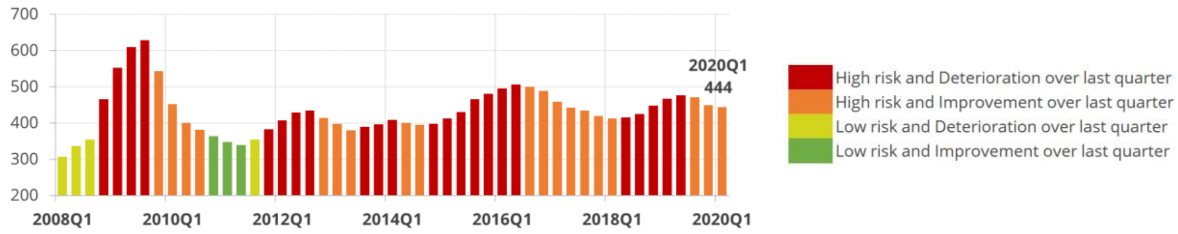
Source: TAC ECONOMICS

Countries in the upper-right area combine high ex ante vulnerability with high Global Credit Risk will face major difficulties ahead to handle together the financial shock and the Covid-19 pandemic. **Turkey**'s position appears extremely vulnerable, especially given the mediocre public management of the Covid-19 crisis.

Conversely, countries in the lower-right area (Croatia, Czech Rep, Mauritius, Poland) will register a very large financial shock but with more favorable absorption / resilience capabilities.

RiskMonitor Dashboard

Country Risk Premium (bp)



Eco & Fin Risk Rating

from 0 (lowest risk) to 100 (highest risk)

	q/q	level
Total		
100 EM	-0.2	44.7
By Country's Size Group		
10 Key EM	+0.2	44.3
Next 10	+0.3	43.8
30 Mid-Size	-0.5	46.7
50 Smallest	-0.3	43.7
By Region		
Asia	+0.2	45.2
Europe	-0.5	45.5
Latin America	-0.4	45.9
MENA	+0.2	47.3
Sub-Saharan Africa	-0.5	41.7
By Type of Risk		
Activity	-0.1	46.1
Exchange Rate	-0.1	45.6
Payment	-0.2	42.9
By Horizon		
< 1 year	-0.1	46.4
1 – 3 years	-0.2	44.4
3 – 5 years	-0.2	43.8

Crisis Signals

Strong probability of a significant shock during the following periods:

Country	Type	Period
Libya	Activity	2020Q3 - 2024Q3
Myanmar	Activity	2018Q4 - 2023Q2
Seychelles	Payment	2019Q4 - 2024Q3
Sudan	Activity	2019Q2 - 2023Q2
Yemen	Activity	2018Q4 - 2021Q4

Eco & Fin Risk Rating

Top 5 Improvement	rating	q/q	Top 5 Deterioration	rating	q/q
Niger	49.8	-3.6	Montenegro	59.0	+4.5
Congo	44.4	-3.6	Comoros	32.6	+3.1
Burkina Faso	36.0	-3.5	Qatar	60.5	+2.9
Argentina	51.7	-3.3	Rwanda	40.9	+2.8
Tunisia	44.1	-2.8	Laos	59.1	+2.7

Scores on Fundamental Balances

Top Improvement and Deterioration in latest data

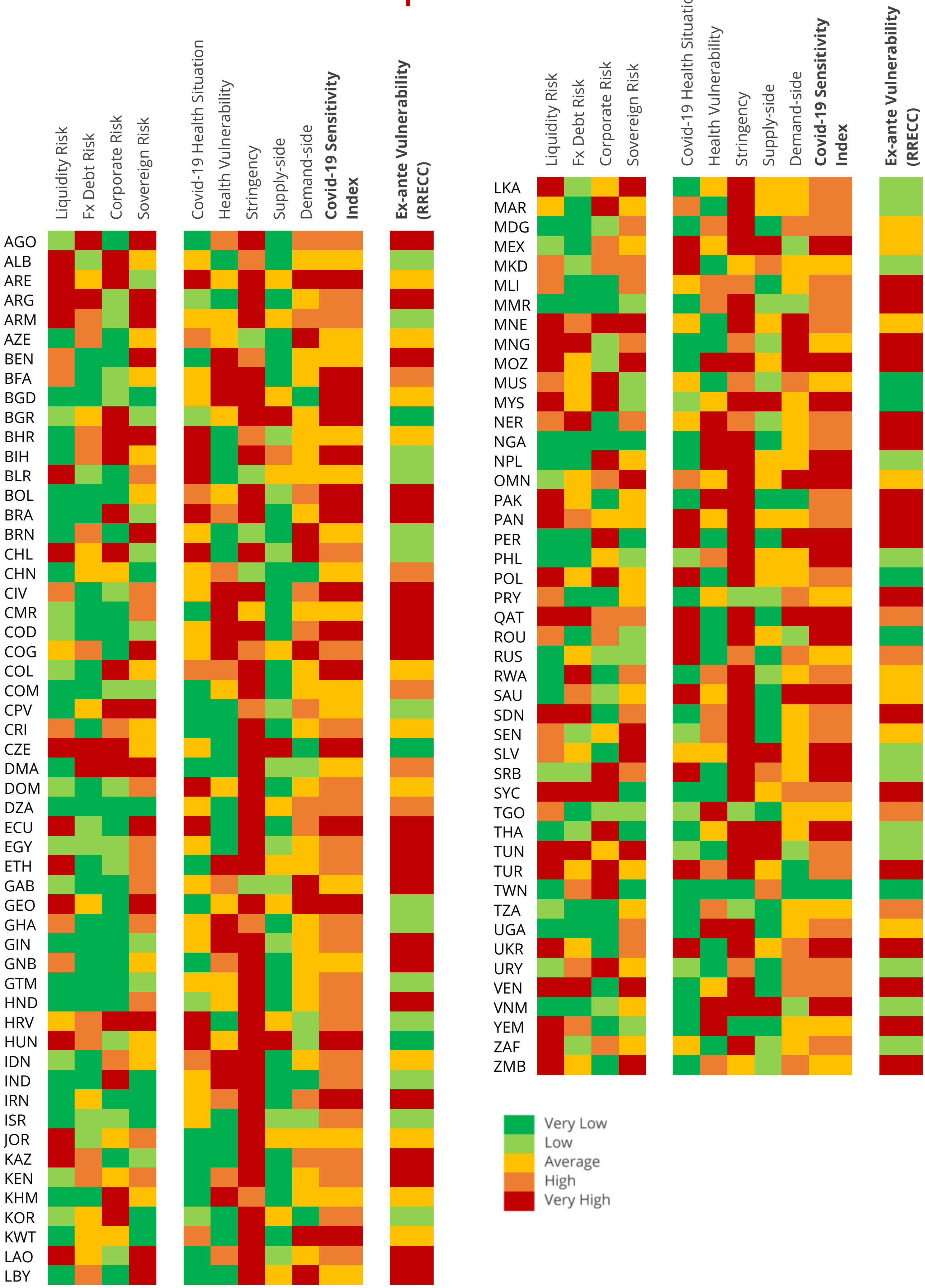
Foreign Exchange Balance	score	q/q	position
Albania	60	+16.0	Liquidity Risk
Benin	62	+16.5	Unsustainable Overvaluation
Burkina Faso	59	+17.3	Liquidity Risk
Ecuador	81	+35.8	Ecuador
Madagascar	67	+14.3	Liquidity Risk
Montenegro	23	-28.7	Positive Undervaluation
Mozambique	22	-22.1	Positive Undervaluation
Tunisia	4	-22.1	Positive Undervaluation

Watch List Indications

Vulnerability to a significant shock during the following periods:

Country	Type	Period
Angola	Activity	2019Q3 - 2021Q2
	Exchange Rate	2020Q3 - 2022Q3
Brazil	Exchange Rate	2019Q1 - 2021Q2
China	Exchange Rate	2018Q3 - 2021Q2
	Activity	2020Q2 - 2022Q2
Kazakhstan	Payment	2020Q1 - 2022Q2
Korea	Activity	2018Q3 - 2020Q2
Libya	Activity	2018Q4 - 2022Q3
Mongolia	Payment	2021Q4 - 2024Q1
Montenegro	Payment	2018Q2 – 2022Q2
Turkey	Exchange Rate	2018Q2 - 2020Q4
	Payment	2019Q4 - 2021Q4
Ukraine	Payment	2019Q4 - 2021Q3
Venezuela	Activity	2017Q2 - 2024Q2
	Exchange Rate	2018Q4 - 2020Q3

Credit risk & Covid-19 Heatmap



Appendices

Appendix 1: List of 100 countries monitored by region

Eastern & Central Europe, CIS (19)			
ALB	Albania	KAZ	Kazakhstan
ARM	Armenia	MNE	Montenegro
AZE	Azerbaijan	MKD	N. Macedonia
BLR	Belarus	POL	Poland
BIH	Bosnia	ROU	Romania
BGR	Bulgaria	RUS	Russia
HRV	Croatia	SRB	Serbia
CZE	Czech Rep.	TUR	Turkey
GEO	Georgia	UKR	Ukraine
HUN	Hungary		

Latin America (18)			
ARG	Argentina	SLV	El Salvador
BOL	Bolivia	GTM	Guatemala
BRA	Brazil	HND	Honduras
CHL	Chile	MEX	Mexico
COL	Colombia	PAN	Panama
CRI	Costa Rica	PRY	Paraguay
DMA	Dominica	PER	Peru
DOM	Dominican Rep	URY	Uruguay
ECU	Ecuador	VEN	Venezuela

Asia (18)			
BGD	Bangladesh	MNG	Mongolia
BRN	Brunei	MMR	Myanmar
KHM	Cambodia	NPL	Nepal
CHN	China	PAK	Pakistan
IND	India	PHL	Philippines
IDN	Indonesia	LKA	Sri Lanka
KOR	Korea	TWN	Taiwan
LAO	Laos	THA	Thailand
MYS	Malaysia	VNM	Vietnam

Middle East & North Africa (15)			
DZA	Algeria	MAR	Morocco
BHR	Bahrein	OMN	Oman
EGY	Egypt	QAT	Qatar
IRN	Iran	SAU	Saudi Arabia
ISR	Israel	TUN	Tunisia
JOR	Jordan	UAE	UAE
KWT	Kuwait	YEM	Yemen
LBY	Libya		

Sub-Saharan Africa (30)			
AGO	Angola	MDG	Madagascar
BEN	Benin	MLI	Mali
BFA	Burkina Faso	MUS	Mauritius
CMR	Cameroon	MOZ	Mozambique
CPV	Cape Verde	NER	Niger
COM	Comoros	NGA	Nigeria
COG	Rep. of Congo	RWA	Rwanda
COD	DR Congo	SEN	Senegal
CIV	Cote d'Ivoire	SYC	Seychelles
ETH	Ethiopia	ZAF	South Africa
GAB	Gabon	SDN	Sudan
GHA	Ghana	TZA	Tanzania
GIN	Guinea	TGO	Togo
GNB	Guinea Bissau	UGA	Uganda
KEN	Kenya	ZMB	Zambia

Appendix 2: List of 100 countries monitored by size group

10 Key EM			
BRA	Brazil	MEX	Mexico
CHN	China	POL	Poland
IND	India	RUS	Russia
IDN	Indonesia	ZAF	South Africa
KOR	Korea	TUR	Turkey

Next 10			
ARG	Argentina	NGA	Nigeria
COL	Colombia	PHL	Philippines
EGY	Egypt	SAU	Saudi Arabia
IRN	Iran	THA	Thailand
MYS	Malaysia	UAE	UAE

30 Mid-Size			
DZA	Algeria	MAR	Morocco
AGO	Angola	MMR	Myanmar
BGD	Bangladesh	OMN	Oman
CHL	Chile	PAK	Pakistan
CRI	Costa Rica	PAN	Panama
CZE	Czech Rep.	PER	Peru
DOM	Dominican Rep	QAT	Qatar
ECU	Ecuador	ROM	Romania
ETH	Ethiopia	LKA	Sri Lanka
GTM	Guatemala	SDN	Sudan
HUN	Hungary	TWN	Taiwan
ISR	Israel	UKR	Ukraine
KAZ	Kazakhstan	URY	Uruguay
KEN	Kenya	VEN	Venezuela
KWT	Kuwait	VNM	Vietnam

50 Smallest			
ALB	Albania	GNB	Guinea-Bissau
ARM	Armenia	HND	Honduras
AZE	Azerbaijan	JOR	Jordan
BHR	Bahrain	LAO	Lao P.D.R.
BLR	Belarus	LBY	Libya
BEN	Benin	MKD	N. Macedonia
BOL	Bolivia	MDG	Madagascar
BIH	Bosnia	MLI	Mali
BRN	Brunei	MUS	Mauritius
BGR	Bulgaria	MNG	Mongolia
BFA	Burkina Faso	MNE	Montenegro
KHM	Cambodia	MOZ	Mozambique
CMR	Cameroon	NPL	Nepal
CPV	Cape Verde	NER	Niger
COM	Comoros	PRY	Paraguay
COG	Congo, Rep.	RWA	Rwanda
COD	DR Congo	SEN	Senegal
CIV	Côte d'Ivoire	SRB	Serbia
HRV	Croatia	SYC	Seychelles
DMA	Dominica	TZA	Tanzania
SLV	El Salvador	TGO	Togo
GAB	Gabon	TUN	Tunisia
GEO	Georgia	UGA	Uganda
GHA	Ghana	YEM	Yemen
GIN	Guinea	ZMB	Zambia

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