Monthly Comments – Emerging Markets

MacroFinance Research – November 2020

Key Messages

Country Focus – Indonesia: Out of economic tight spot in 2021H2, but structural problems to endure

Indonesia witnessed technical recession in 2020 due to the unprecedented impact of Covid-19 that forced stringent lockdown measures, a relaxation of which eventually did spike the infections in October only. Indonesia also faced elevated ex-ante vulnerabilities (existing prior to Covid-19) with subpar momentum of domestic demand, uncompetitive currency and increasing short-term debt levels, along with a populist regime with poor control of corruption. While these structural conditions have eroded, the monetary support by the Central Bank, the adequate forex reserves, and expected favorable global oil prices in 2021, should lead to an asymmetric V shaped recovery in 2021H2. However, going forward, despite the economic turnaround, the vulnerabilities that existed before Covid-19 will endure and could also be exacerbated, unless the government improves business and investment climate, addresses the twin (fiscal and current account) deficits and improves labor market flexibility.

Read more on page 2…

RiskWatch – Update of Debt Balance: low risk continues despite marginal deterioration

Our annual update of the Debt Balance reveals a slight deterioration in 2019 due to increase in external borrowings across most countries while inflows of foreign direct investments (FDI) receded. **China**, to a large extent, as well as most of the smaller countries (**Sub-Saharan Africa**) and commodity depended countries (**MENA**) have witnessed an increase in their external debt, while FDI have reduced. The **10 Key EM** have continued to attract a sizable portion of more stable FDI while their relative external borrowings remain manageable (barring **Turkey**). This unfavorable move on the Debt Balance shall significantly worsen in 2020 due to the unprecedented Covid-19 crisis that will heighten the external borrowings of most countries, while FDI inflows should substantially decrease, especially for medium and small economies.

View more on page 4…

Dashboard & Heatmap – Global Credit Risk, Covid-19 & Country Risk Premium Heatmap

Our updated Heatmap looks at performances and risks through each country's financial risks, growth sensitivity to the pandemic / health situation, and their ex ante vulnerabilities.

View more on page 7…

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

Completed on November 17, 2020.

Country Focus – Indonesia: Out of economic tight spot in 2021H2, but structural problems to endure

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Worsening Economic and Financial Risk

Over the past two years, Indonesia's Eco. & Fin. Risk ratings has steeply deteriorated (51-C in 2020Q3) because of the significant fall in our leading indicator for domestic demand, of an upward revision in external debt that has deteriorated the Debt and the Liquidity Balances, and of the persistent currency overvaluation. This deterioration in Eco. & Fin. Risk ratings, along with worsening Political Risk ratings (populist government of President J. Widodo's undermining the independence of institutions) is reflected in the elevated index of ex-ante vulnerability.

Indonesia: Country-Risk Assessment under Covid

Ex-ante Vulnerability,
Global Credit Risk and *Growth Sensitivity to Covid*
from 0 (best) to100 (worst)

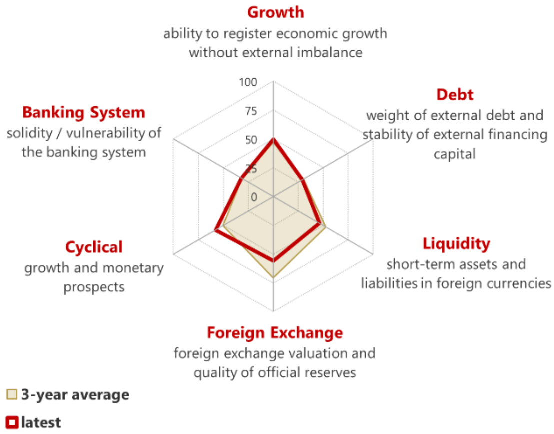
	Indonesia
Eco. & Fin. Risk rating	51
Political Risk rating	51
Ex-ante Vulnerability	**67**
Liquidity Risk	61
Fx Debt Risk	29
Corporate Risk	52
Sovereign Risk	49
Global Credit Risk	**48**
Covid Health Situation	60
Health Vulnerability	100
Stringency of lockdowns	34
International Trade - Supply chains	30
International Trade -Demand-side	34
Growth Sensitivity to Covid-19	**42**

Source: TAC ECONOMICS

Since the pandemic, Indonesia has entered technical recession (first time since the Asian Financial Crisis in 1998) even as the GDP contraction eased in 2020Q3 (-3.5% y/y after -5.3% in Q2) given a mechanic collapse in both demand and production directly related to stringent lockdown measures. In addition, our Global Credit Risk metric has deteriorated with increase in amortization (from 21bn$ to 74bn$ in 2020) worsening the Liquidity Risk, and an increase in external borrowings has elevated Sovereign Risk. Moreover, the epidemic itself is yet to taper significantly (despite recent favorable inflection), hence maintaining the economic recovery trajectory still uncertain.

Indonesia: Risk-Scores on Fundamental Balances

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



Source: TAC ECONOMICS

Challenges on the road to recovery

The peak of the stringent lockdown measures that crippled economic activity is unlikely to be repeated despite resurgence of new Covid-19 cases peaking in early October 2020. Yet, business conditions remain subpar (Manufacturing PMI at 47.8 in Oct. 2020), the household confidence level remains mediocre, and slow implementation of policy support (fiscal package equivalent to 4% of GDP) indicate that a faster recovery would not materialize before 2021. Moreover, the Indonesian Rupiah, which is already significantly overvalued (about 20% against its main competitors) is expected to further strengthen next year (USD/IDR 13,500-13,700 in 2020Q2) due to more favorable global prices (but it will erode further its export earnings).

A recovery nonetheless

Even with the ample challenges, Indonesia enjoys a few strong fundamentals, along with some propitious factors that would help in an economic rebound in 2021. The strong foreign reserves (USD 130bn in Oct. covering close to 8 months of imports), contained inflationary pressure (+1.4% y/y in Oct.), well capitalized banking sector (capital adequacy ratio above 20%), an expected increase in global oil prices (65$/bl in 2021-end), faster than expected recovery of the Chinese economy, and Central Bank's liquidity injection (a cumulative 100bps cut in policy rate through the year, and bond purchases in the primary market) should facilitate an asymmetric V-shaped economic recovery. GDP contraction is expected reach only -2% y/y in 2020, a narrower contraction especially when compared to other G20 countries; it will be followed by +6% rebound in 2021.

However, this recovery does not obliterate the structural challenges that existed prior to Covid-19 crisis. The government needs to address its twin deficits, improve revenue generation, improve labor market flexibility and enhance its business climate to attract investment.

Revision of external debt data:

This month's RiskMonitor update incorporates new data on external debt for 2019 (cf. detailed analysis in the RiskWatch section, page 4), with significant upward revision on debt servicing for 2018-2025. Consequently, higher principal repayments lead entails mediocre degradation of Indonesia's trajectory on the Debt and Liquidity Balances, as well as upward move of the average Economic and Financial Risk ratings (to 50.8-C in 2020Q3 from 45.1-C in 2020Q2), pointing to some potential short-term financial vulnerability and tense external debt's sustainability.

RiskWatch – Update of Debt Balance: *low risk* continues despite marginal deterioration

*Our annual update of the Debt Balance reveals a slight deterioration in 2019 due to increase in external borrowings across most countries while inflows of foreign direct investments (FDI) receded. **China**, to a large extent, as well as most of the smaller countries (**Sub-Saharan Africa**) and commodity depended countries (**MENA**) have witnessed an increase in their external debt, while FDI have reduced. The **10 Key EM** have continued to attract a sizable portion of more stable FDI while their relative external borrowings remain manageable (barring **Turkey**). This unfavorable move on the Debt Balance shall significantly worsen in 2020 due to the unprecedented Covid-19 crisis that will heighten the external borrowings of most countries, while FDI inflows will substantially decrease, especially for medium and small economies.*

RiskMonitor's Debt Balance evaluates the medium-term foreign currency funding characteristics and performances. It is not designed to look at solvency issues for specific borrowers (for example, sovereign risk is examined in the Sovereign Balance) but observes whether a country can find a balanced way of funding its development with foreign currency resources. In particular, the structural quality of a country's external financing is combined with the ability to balance external debt with more stable inflows of foreign direct investment. Annual data on external debt up to 2019 published by the World Bank are incorporated here.

Revisions of past data:

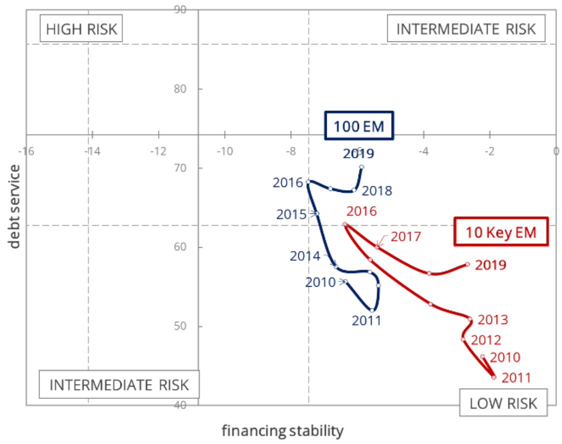
Along with new data on external debt for 2019, World Bank's International Debt Statistics database integrates some revisions for past data. Large downward change has been observed for Myanmar (total external debt down by -30% in 2013-2018 to USD 11bn in 2018), while UAE (+37%), Comoros (+34%), Guinea (+52%), Guinea-Bissau (+29%), Libya (+73%), Mozambique (+24%) have registered major upward revisions, with generally negative impact on their debt service indicator.

Debt Balance in 2019: lingers in *low risk* area

In 2019, the average position for the 100 EMs remained in the *low risk* area despite the marginal increase in the *debt service*, while the *financial stability* roughly stabilized around the 2018 level. Nevertheless, the inching of the trajectory closer to the primary (horizontal) threshold indicates that any further increase in external debt (a very likely outcome of the Covid-19 crisis in 2020) will lead to an entry into the *intermediate risk* area of the Debt Balance. Meanwhile the 10 Key EMs fair better with improved *financing stability* (increased inflow of FDI) and with modest increase in *debt service.*

Debt Balance

10 Key EM and 100 RiskMonitor countries

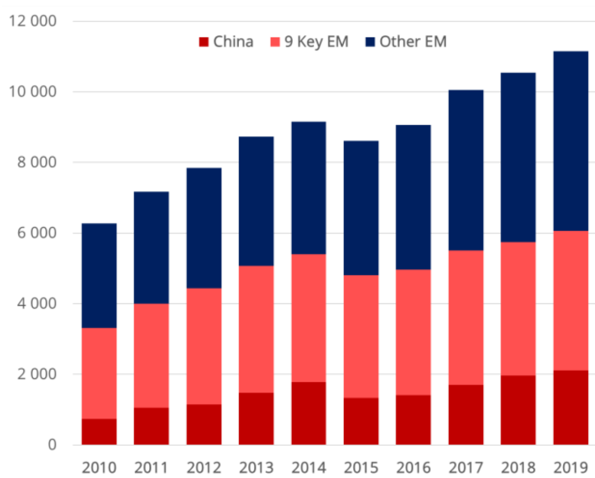


Source: TAC ECONOMICS

Increasing external debt in EM

External debt for 100 EMs has modestly increased in 2019 (+6%) with an overall uptick in cross-border borrowings across all countries, especially small and/or commodities dependent economies (Africa and MENA). In parallel, Chinese external debt remains the largest among all the EMs (18% of the total stock in 2019).

EM External Debt Stocks (USD bn)



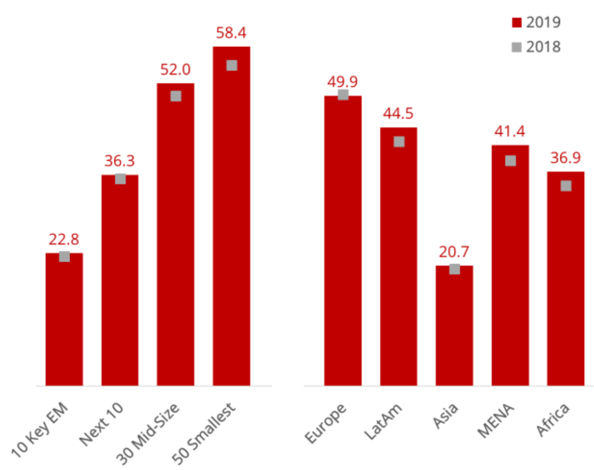
Sources: World Bank, TAC ECONOMICS

Meanwhile, international trade conditions degraded in 2019 (-4% y/y for 100 EMs) because of the persistent trade tensions between US and China. However, going into 2020, most of the data and its analysis in 2019 would dwarf in comparison to the jolt to the international trading system and the likely skyrocketing of external debt by the EMs to combat the unprecedented impact of Covid-19. Corporates and sovereigns would be highly challenged and their debt sustainability will be tested, especially for the medium and small economies (**Chile**, **Colombia**, **Ukraine**, **Ivory Coast**, **Niger**, **Mali**, **Senegal**) that already have sizeable borrowings from multilateral institutions.

When looking at stock of external debt as a percentage of GDP, we observe:

1) There is a large divergence among EMs based on their size. The **50 Smallest** and the **30 Mid-Size** have significantly larger share of external debt to GDP than the **10 Key EM** and the **Next 10**. Smaller EMs will tend to have less developed domestic debt markets and higher share of funding from multilateral financial institutions.
2) External debt to GDP ratios have increased in LatAm, Africa and MENA regions, but have remained relatively stable in Europe and Asia, the latter being much less exposed to non-resident creditors.

External Debt Stock (% of GDP)
by region and by country's size

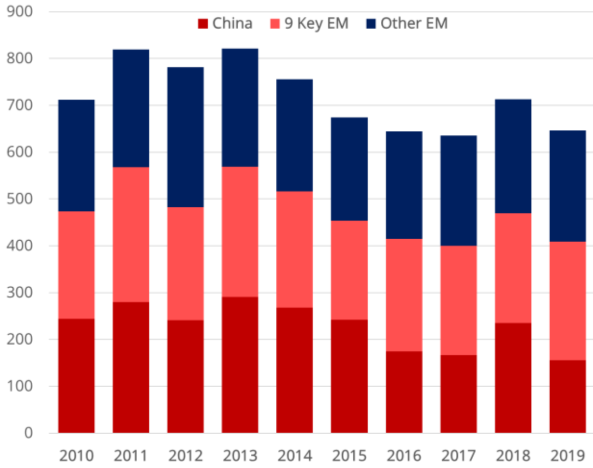


Source: TAC ECONOMICS

FDI inflows dwindled, mainly on China's account

The rebound in FDI witnessed in 2018 was reversed in 2019 predominantly due to the contraction in FDI flows to China (-33%) given the uncertainties surrounding the trade war with the US. While direct investments into the 9 Key EMs improved marginally (8%), FDI inflows in intermediate and smaller EMs, especially in Africa, contracted. This falling trend in global FDI to EMs will be significantly exacerbated in 2020 due to the unprecedented economic impact of Covid-19 crisis.

FDI Inflows in EM (USD bn)



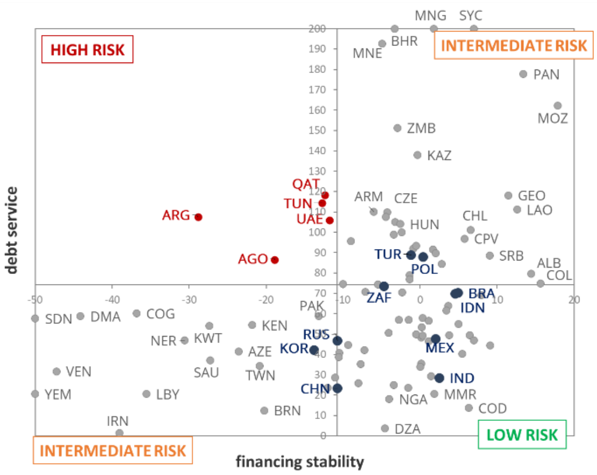
Sources: World Bank, TAC ECONOMICS

Wide dispersion among EMs and rocky path ahead

The following graphs present a snapshot of 100 EMs' latest position on the Debt Balance, and decennial trend for each group and region. Some noticeable observations that emerge are:

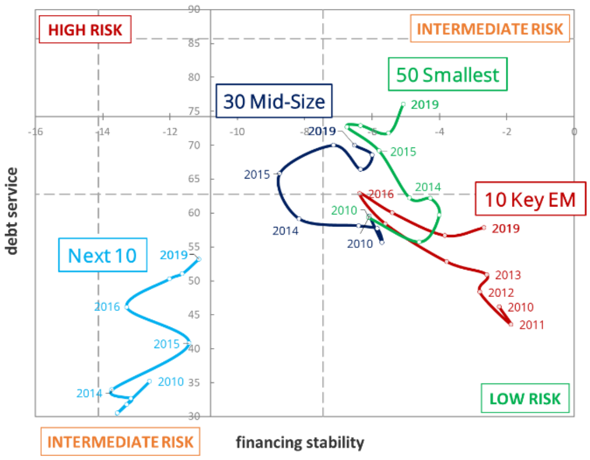
1) Five countries (**Angola**, **Argentina, Qatar**, **Tunisia**, and **UAE**) are located in the *high risk* quadrant in 2019, with only Tunisia entering the most unfavorable area due to degradation of *financing stability* to an insufficient level.
2) On the bottom-left *intermediate risk* quadrant, countries witnessing persistent (geo)political tensions (**Libya**, **Iran**, **Venezuela**, **Yemen**) exhibit low levels of external debt and also unsurprisingly fail to attract FDIs inflows.
3) Most of the **10 Key EM** continue to be best placed in *low risk* quadrant (or closed to main risk threshold like **South Korea**, **Poland**, and **Turkey**) given the fact they attract considerable FDI inflows and retain manageable external debt levels.
4) Meanwhile among the EM groups; *debt service* in **MENA** countries (most of which are commodity dependent) has been on the raise over the years while *financing stability* remained subpar.
5) **Europe** remained in the *intermediate risk* area on average, due to combination of excessive external indebtedness and strong *financing stability*.
6) While **Asia**, **Sub-Saharan Africa** and **Latin America** are all placed in *low risk quadrant,* Asia has the most favorable move with improving *financing stability* and still comfortable level of *debt service*.

Debt Balance by Country - 2019



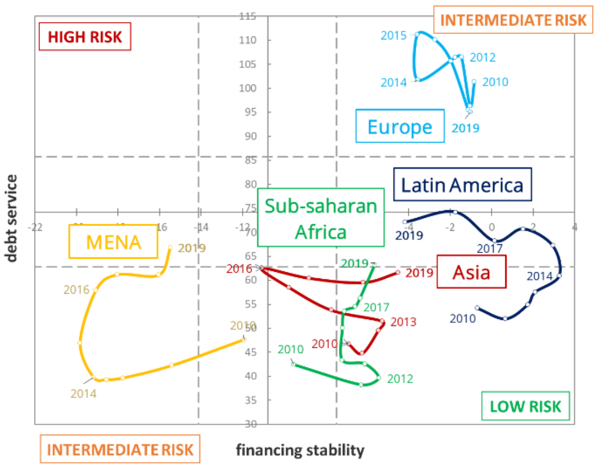
Source: TAC ECONOMICS

Debt Balance by Group



Source: TAC ECONOMICS

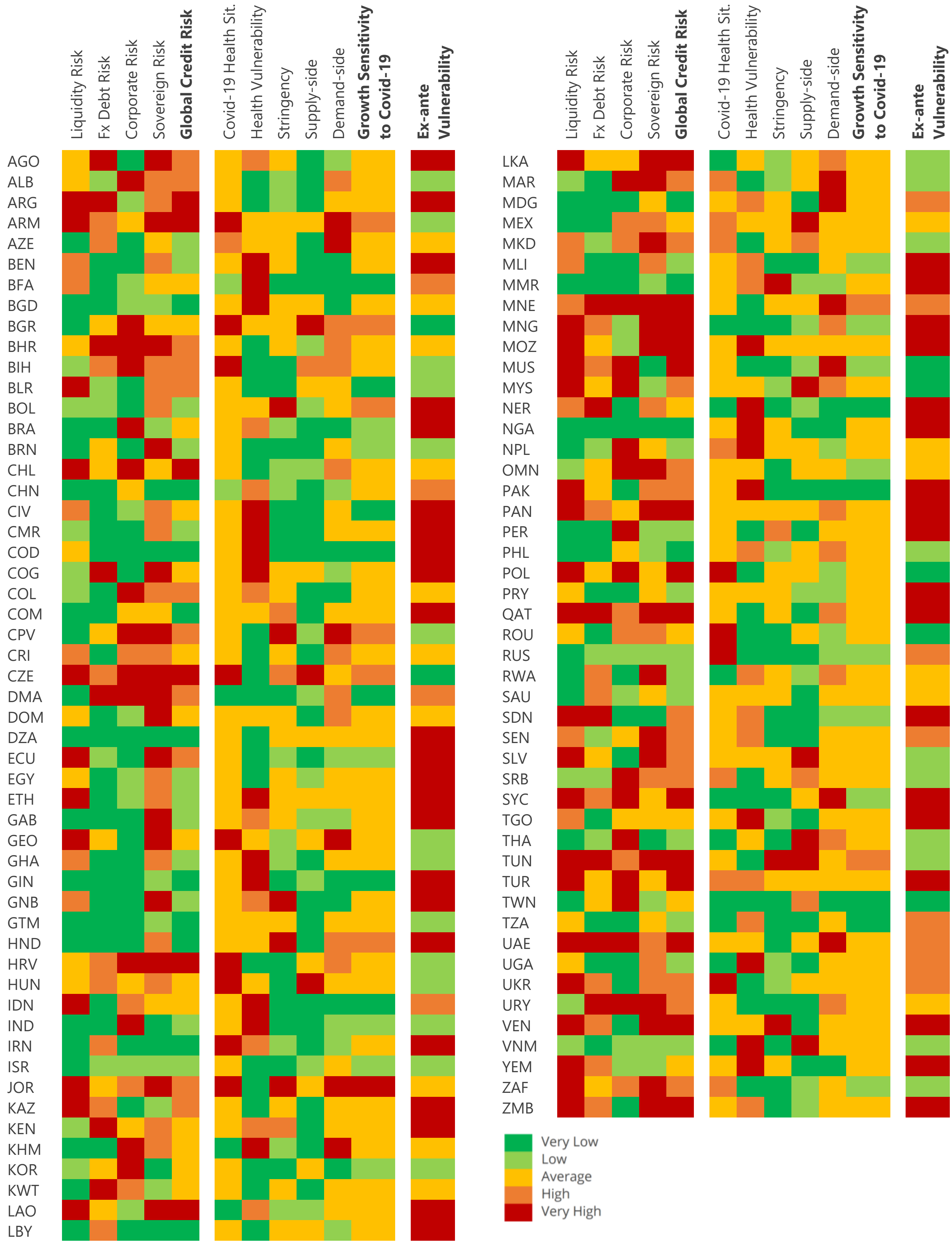
Debt Balance by Region



Source: TAC ECONOMICS

Global Credit Risk, Covid-19 & Country Risk Premium Heatmap

List of 100 countries by ISO3 Code alphabetic order



Appendices

Appendix 1: List of 100 countries by ISO3 Code alphabetic order

ISO 3 Code	Country Name
AGO	Angola
ALB	Albania
ARG	Argentina
ARM	Armenia
AZE	Azerbaijan
BEN	Benin
BFA	Burkina Faso
BGD	Bangladesh
BGR	Bulgaria
BHR	Bahrein
BIH	Bosnia
BLR	Belarus
BOL	Bolivia
BRA	Brazil
BRN	Brunei
CHL	Chile
CHN	China
CIV	Cote d'Ivoire
CMR	Cameroon
COD	DR Congo
COG	Rep. of Congo
COL	Colombia
COM	Comoros
CPV	Cape Verde
CRI	Costa Rica
CZE	Czech Rep.
DMA	Dominica
DOM	Dominican Rep
DZA	Algeria
ECU	Ecuador
EGY	Egypt
ETH	Ethiopia
GAB	Gabon
GEO	Georgia

ISO 3 Code	Country Name
GHA	Ghana
GIN	Guinea
GNB	Guinea Bissau
GTM	Guatemala
HND	Honduras
HRV	Croatia
HUN	Hungary
IDN	Indonesia
IND	India
IRN	Iran
ISR	Israel
JOR	Jordan
KAZ	Kazakhstan
KEN	Kenya
KHM	Cambodia
KOR	Korea
KWT	Kuwait
LAO	Laos
LBY	Libya
LKA	Sri Lanka
MAR	Morocco
MDG	Madagascar
MEX	Mexico
MKD	N. Macedonia
MLI	Mali
MMR	Myanmar
MNE	Montenegro
MNG	Mongolia
MOZ	Mozambique
MUS	Mauritius
MYS	Malaysia
NER	Niger
NGA	Nigeria
NPL	Nepal

ISO 3 Code	Country Name
OMN	Oman
PAK	Pakistan
PAN	Panama
PER	Peru
PHL	Philippines
POL	Poland
PRY	Paraguay
QAT	Qatar
ROU	Romania
RUS	Russia
RWA	Rwanda
SAU	Saudi Arabia
SDN	Sudan
SEN	Senegal
SLV	El Salvador
SRB	Serbia
SYC	Seychelles
TGO	Togo
THA	Thailand
TUN	Tunisia
TUR	Turkey
TWN	Taiwan
TZA	Tanzania
UAE	UAE
UGA	Uganda
UKR	Ukraine
URY	Uruguay
VEN	Venezuela
VNM	Vietnam
YEM	Yemen
ZAF	South Africa
ZMB	Zambia

Appendix 2: 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

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