Monthly Comments – Emerging Markets

MacroFinance Research – October 2020

Key Messages

Country Focus – India: Central bank navigating complex winds, able to keep the currency roughly stable

The Covid-19 pandemic has resulted in an unprecedented health, social, and economic shock, with acute contraction in activity and constrained recovery in 2021. Tensions on corporate and banking sectors will exacerbate, though adequate monetary management and likely recapitalization for public banks avoid systemic tensions. It would however further worsen the rapidly deteriorating public finances, with a possible downgrade by international rating agencies likely to trigger financial and currency volatility over the short- to medium-term. So far, India's long-term prospects of sustained economic growth are not substantially altered and should therefore be enough to keep public debt sustainable, while comfortable levels of foreign currency reserves allow the central bank to keep a rough stability in exchange rate over the next 18 months.

Read more on page 2…

RiskWatch – EM Growth Sensitivity to Covid-19: still challenging time

The objective of our tailored-made index of Growth Sensitivity to Covid-19 is to assess the vulnerability of Emerging Markets' (EMs) economic activity to Covid-19 related disruptions. The timing and amplitude of GDP contractions and recoveries in EMs will have massive influence on (higher) corporate and sovereign risk materialization; hence we have readjusted the weights of the 15 variables used in the construction of our index to better reflect the evolving situation, notably giving more importance to deaths' dynamic, instead of caseloads and reinforcing the role of trade in services and tourism. This allows highlighting the current dynamics in forward-looking risks on economic activity, with the Philippines, Turkey, Egypt, Mexico, Argentina and Malaysia appearing most at risk while China but also Poland, South Africa, Russia and South Korea able to show much more favorable metrics.

Read 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 6…

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

Completed on October 19, 2020.

Country Focus – India: Central bank navigating complex winds, able to keep the currency roughly stable

The Covid-19 pandemic has resulted in an unprecedented health, social, and economic shock, with acute contraction in activity and constrained recovery in 2021. Tensions on the corporate and banking sectors will exacerbate, though adequate monetary management and likely recapitalization for public banks should prevent any materialization of systemic problems. It would however further worsen the rapidly deteriorating public finances, with a possible downgrade by international rating agencies likely to trigger financial and currency volatility over the short- to medium-term. So far, India's long-term prospects of sustained economic growth are not substantially altered and should be enough to keep public debt sustainable, while high levels of foreign currency reserves allow the central bank to keep a rough stability in exchange rate over the next 18 months.

Revealing risks factors

Our approach to country-risk during this specific moment of global pandemic combine three angles: *(a)* an *Ex-ante Vulnerability* measured through our traditional country-risk premium;, *(b)* an assessment of *Global Credit Risk* focusing on overall financial risks and their foreign-currency (Fx) components, and *(c)* a measure of the economic *Growth's Sensitivity to Covid-19*, which looks at the impact through both domestic and international factors. All indicators are normalized on a scale from 0 (lowest risk) to 100 (highest risk).

The reading for India is straightforward:

(a) The *Ex-ante Vulnerability* was low, with a somewhat mediocre Political Risk Rating compensated by a favorable Economic & Financial Risk rating and no Early Warning for systemic shocks.

India: Country-Risk Assessment under Covid-19
from 0 (best) to100 (worst)

	India	*Average RM Countries*
Eco&Fin Risk Rating	39	*44*
Political Risk Rating	49	*54*
Crisis Signal / Watch List Indic.	--	
Ex-ante Vulnerability	**40**	***63***
Liquidity Risk	19	*51*
Fx Debt Risk	8	*39*
Corporate Risk	65	*43*
Sovereign Risk	25	*53*
Global Credit Risk	**30**	***46***
Covid-19 Health Situation	60	*58*
Health Vulnerability	100	*61*
Stringency Index	53	*53*
International (Supply-side)	40	*51*
International (Demand-side)	49	*62*
Growth Sensitivity to Covid-19	**55**	***57***

Source: TAC ECONOMICS

(b) The index of *Global Credit Risk* is also low: the global measure is indeed strongly pulled down by a favorable Fx position (low Fx debt, large Fx reserves), in striking contrast with a very high Corporate Risk component, more than 20 points above the average across all EMs.

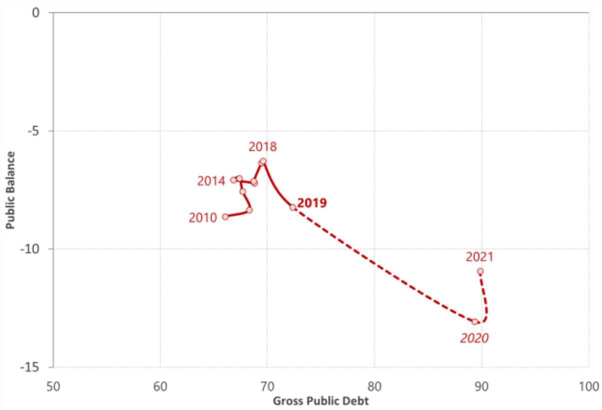
(c) The overall index of Growth Sensitivity to Covid is high, at par with the EM average. This is mostly related to the persistent health vulnerability, coupled with poor administrative capacity. The early and strict lockdown (from March 23 to May-end) failed to prevent a surge in new infections (multiplied by more than 10 over the last three months, to 7.4 mn and 110,000 deaths at mid-October). Despite a low international transmission factor, economic activity remains then highly affected.

Acute shock on corporates and banks

The economic contraction of 2020Q2 was unprecedented (GDP: -23.9% y/y). With local extensions of restrictive measures (transportation, workplaces and schools) continuing to weigh on domestic demand recovery, the impact on corporate's financial situation and by extension on banks' balance-sheets is due to be large… at a time when pre-existing vulnerabilities of both corporate and banking sectors were substantial despite a long-lasting period of sustained economic growth (GDP: +6.7% on average during 2015-2019).

In banks, non-performing loans (NPLs) were elevated (8.2% of gross loans as of end-2019), and profitability was abysmal (RoE & RoA close to 0). As problems are concentrated at Public Sector Banks (PSBs)s, the much-needed support will be met by public finances.

India: Public Finances
(Central and States Governments, % of GDP)



Source: IMF/WEO

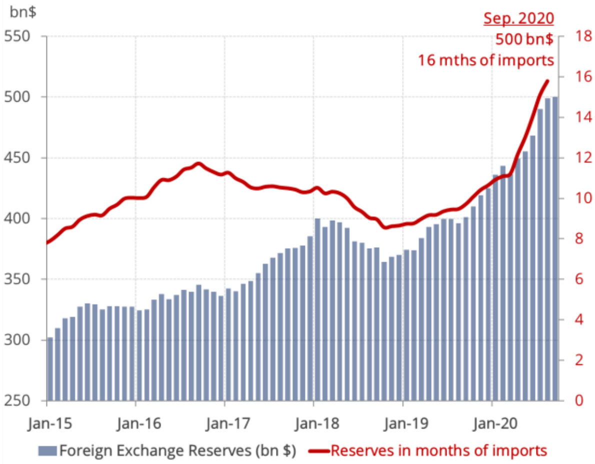
Although the announced additional spending in response to the Covid-19 crisis represent less than 2% of GDP in 2020, the extension of borrowing limits for Central and States governments suggest a consolidated public deficit of about -13% of GDP and a surge in public debt (to almost 90% of GDP in 2020 and 2021), even before the full-fledge recapitalization requirements for PSBs (see chart next page).

While this negative pattern of public debt will be very similar to many other emerging markets, a plausible downgrade by international rating agencies could prove an additional blow to economic and financial performances, notably fx and equity markets.

The Central Bank (RBI) has to tread a delicate balance between the dire need to support demand through easing measures, credibility questions as inflation has so far remained elevated (+7.3% y/y in Sept. 2020, above the upper limit of the target range of 3%-6%), and potential turbulences on the foreign exchange market.

The RBI has stopped its monetary easing in May 2020 (repo rate cut by -40bps to 4.0%) and is likely to keep rates unchanged from now on; it will however continue to resist any restrictive stance even at moments of Fx turbulences, using its large and increasing foreign exchange reserves (USD 500bn in Sept. 2020) to keep the Indian Rupee in a broad range of [USD/INR 70-75] over the next few quarters.

India: Foreign Exchange Reserves



Sources: TAC ECONOMICS, Datastream

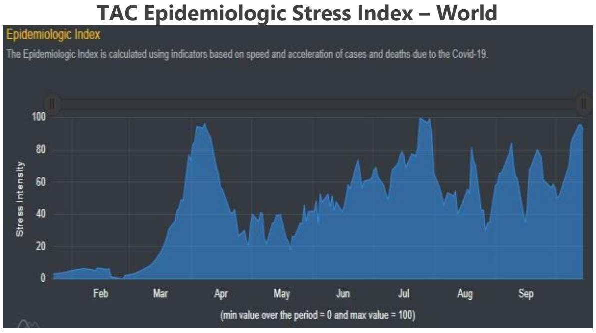
RiskWatch – EM Growth Sensitivity to Covid-19: still challenging time

The objective of our tailored-made index of Growth Sensitivity to Covid-19 is to assess the vulnerability of Emerging Markets' (EMs) economic activity to Covid-19 related disruptions. The timing and amplitude of GDP contractions and recoveries in EMs will have massive influence on (higher) corporate and sovereign risk materialization; hence we have readjusted the weights of the 15 variables used in the construction of our index to better reflect the evolving situation, notably giving more importance to deaths' dynamic, instead of caseloads and reinforcing the role of trade in services and tourism. This allows highlighting the current dynamics in forward-looking risks on economic activity, with the Philippines, Turkey, Egypt, Mexico, Argentina and Malaysia appearing most at risk while China but also Poland, South Africa, Russia and South Korea able to show much more favorable metrics.

Persistence of Covid-19 pandemic

Our Epidemiologic Stress Index (ESI) has again hit the maximum level (100) mid-October 2020 when observed at worldwide level. The current phase is characterized by acute instability (between 30 and 100 since August 2020), highlighting a complex combination of second waves in countries having already been through the first one (e.g. Europe) and highly asynchronous health developments in EMs.

TAC Epidemiologic Stress Index – World



Source: [TAC ECONOMICS]

We still assume that there will not be generalized and strict lockdown measures even if we hit the maximum ESI levels, though recourse to stringent but localized measures becomes more frequent. Hence, our central scenario of a global asymmetric V-shape recovery remains on track in mature and emerging economies.

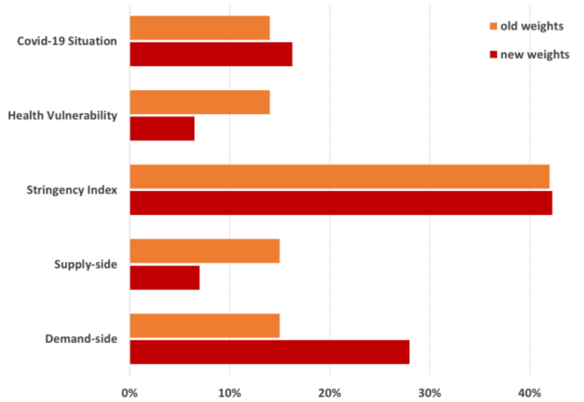
Despite the differentiated recovery profile – faster and stronger in China -, global EM economic activity would contract by an historic -2.1% y/y in 2020 (after +3.6% in in 2019). Except in China, recoveries will not be enough to bring back the levels of production (hence, of employment and profitability) to the trajectories expected prior to the pandemic before the end of 2021 or early 2022, pointing therefore to long-lasting impact on political risk as well as on debt levels and sustainability, at sovereign and corporate levels.

Index of Growth Sensitivity to Covid-19: 3rd revision

Our synthetic index summarizes the different facets of growth vulnerability, with a dual focus on the domestic situation and international transmission. The former includes variables on the health situation (number of infections, deaths, acceleration / deceleration of the pandemic, ability of health systems to cope with increasing number of cases), and on the severity of restriction and lockdown measures; international transmission is a view on potential supply-side constraints (high sensitivity when highly dependent on complex supply chains with critical upstream inputs) and demand-side pressures (international trade, commodity prices, tourism). All indicators are normalized on a scale from 0 (lowest sensitivity) to 100 (highest sensitivity).

Although the objective of the index has remained the same since the onset of the Covid-19 crisis in China, we have revised its content to reflect the evolution of the pandemic. In February and March, the index looked at the usual (trade and financial) channels of international transmission from China, South Korea, and Italy, as they accounted then for most total Covid-19 cases. The present set of variables used in the index was integrated in early April 2020 to incorporate the rapid transformation into a worldwide pandemic. With the complex but visible unfolding of combinations of health / lockdown policies, we have revisited our computation and adjusted to reflects the on-going evolution.

Growth Sensitivity to Covid-19: weight of factors



Source: TAC ECONOMICS

In the *domestic issues* or factors included in the index, we changed the **Covid-19 Situation** by increasing the importance of number / acceleration of deaths against number of cases because of difficulties and huge country-variations in testing capacities and coverage and because a vast majority of cases are asymptomatic. In parallel, the weight of the **Health Vulnerability** ("Physical exposure to epidemics") has been reduced since immediate and evolving pandemic management revealed to be almost equally critical to control infections than pre-existing healthcare capability. **Stringency Index** (equal weights for School closing, Workplace closing, and Restrictions on internal movement) remains the most critical input in the overall computation of Growth Sensitivity.

Finally, we adjusted the various components of the *international transmission*, by reducing the importance of **Supply side** risks as the functioning of global value chains appear to be back to quasi-normal; within **Demand side** factors, we reduced the importance of overall trade in goods while reinforcing the trade in services and tourism..

Reading of Index

The revised metrics for all 100 EM are available in the Heatmap (following pages), and we concentrate here on highlighting the "extreme" (most sensitive, least sensitive) among the 20 larger EMs, while providing a table showing the largest changes in the index when compared to the previous version.

Among the 20 larger EM (our 10 Key EM and Next 10), 6 show high (i.e. above 60) index of Growth Sensitivity to Covid-19, pointing therefore to substantial costs in terms of aggregate economic activity and constraints for recovery: Philippines, Turkey, Egypt, Mexico, Argentina and Malaysia.

Conversely, China, but also Poland, South Korea and maybe more surprisingly South Africa and Russia show a sensitivity index below 45.

Comparing this revised version of the Index with the previous one (see table opposite), Colombia, South Africa, Nigeria, Cameroon, Indonesia and India are registering noticeably better readings, suggesting that management of the pandemic might not have the desired health-control outcome but is sufficient to avoid a worsening of economic conditions. Symmetrically, Jordan is the country by far most negatively affected by the revision (mostly because of a very large upward change in Demand-side / tourism in the aggregate Index); smaller but negative revisions are noted also for Morocco, the Philippines, Turkey, Egypt and Sri Lanka.

Growth Sensitivity to Covid-19 Index
10 Key EM & Next 10

	Domestic Issues			International Transmission			
Country	Covid-19 Situation	Health Vulnerability	Stringency Index	Supply-side	Demand-side	**Growth Sensitivity to Covid-19**	Index (old weights)
PHL	80	80	74	70	78	**76**	73
TUR	80	80	82	60	61	**74**	70
EGY	60	20	82	50	64	**67**	65
MEX	60	60	67	100	61	**66**	79
ARG	90	40	67	20	63	**64**	65
MYS	52	60	48	100	72	**60**	70
SAU	60	60	56	20	67	**57**	67
UAE	70	60	29	60	89	**57**	67
IND	60	100	53	40	49	**55**	71
NGA	52	100	60	30	40	**54**	72
BRA	80	80	50	30	42	**53**	59
COL	60	80	56	30	43	**53**	75
IRN	90	80	40	20	48	**52**	61
THA	32	60	32	90	78	**51**	59
IDN	60	100	46	30	34	**47**	64
KOR	62	20	39	70	41	**44**	48
RUS	80	20	31	40	49	**44**	52
ZAF	70	40	22	50	58	**43**	63
CHN	48	80	31	40	48	**42**	51
POL	80	20	20	70	50	**42**	50

Source: TAC ECONOMICS

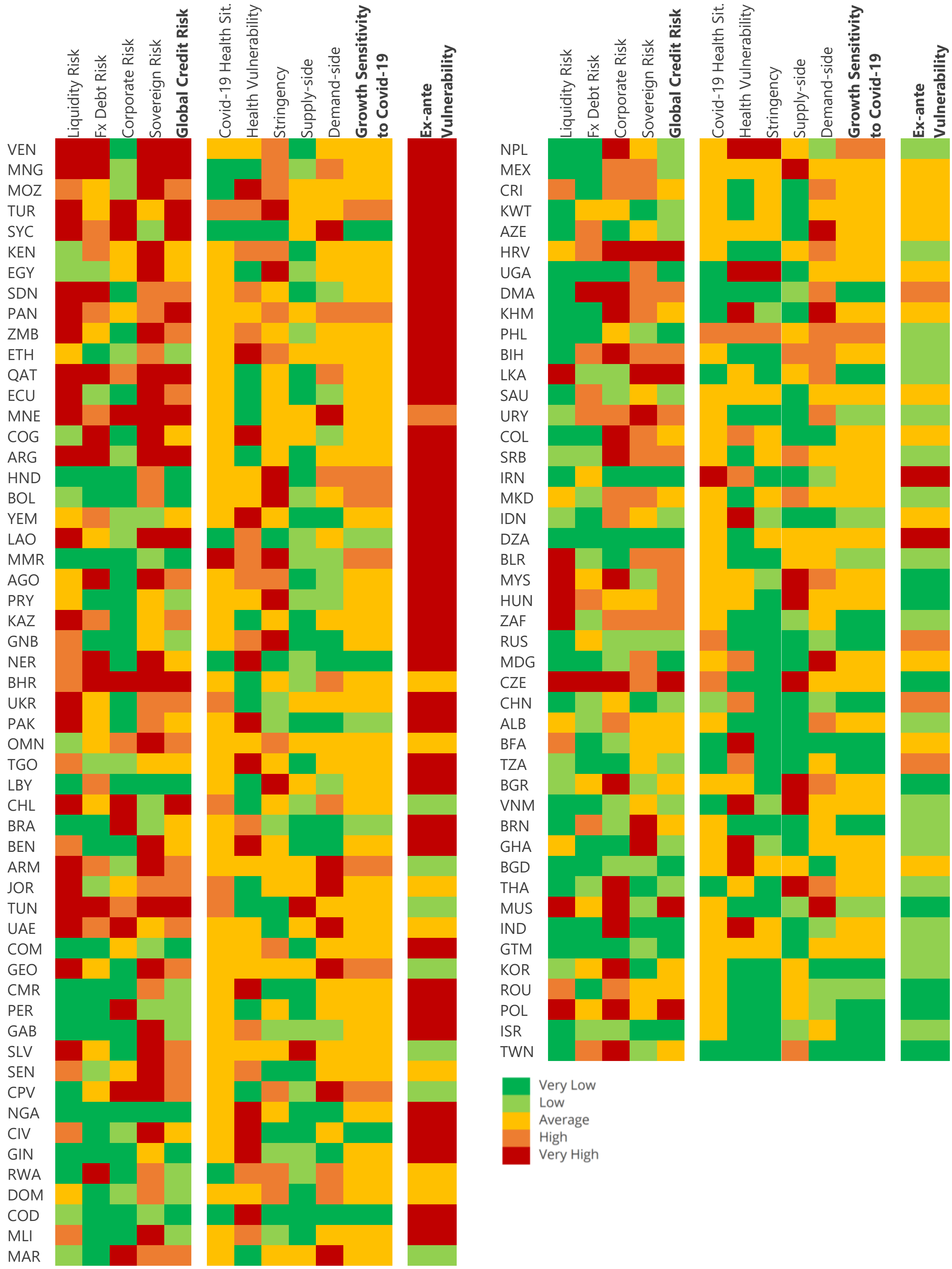
Revision in Growth Sensitivity Index – Largest changes against previous version

Top 15 Improvements		**Deteriorations (13)**	
Colombia	-22	Jordan	+17
South Africa	-20	Seychelles	+5
Congo	-19	Morocco	+5
Nigeria	-19	Myanmar	+5
Costa Rica	-18	Belarus	+4
Cameroon	-17	Turkey	+4
Indonesia	-17	Philippines	+3
Burkina Faso	-16	Mauritius	+3
Libya	-16	Panama	+2
India	-16	Montenegro	+2
Hungary	-15	Egypt	+2
Guinea	-15	Sri-Lanka	+1
Venezuela	-15	Armenia	+0
Azerbaijan	-15		
Viet Nam	-14		

Source: TAC ECONOMICS

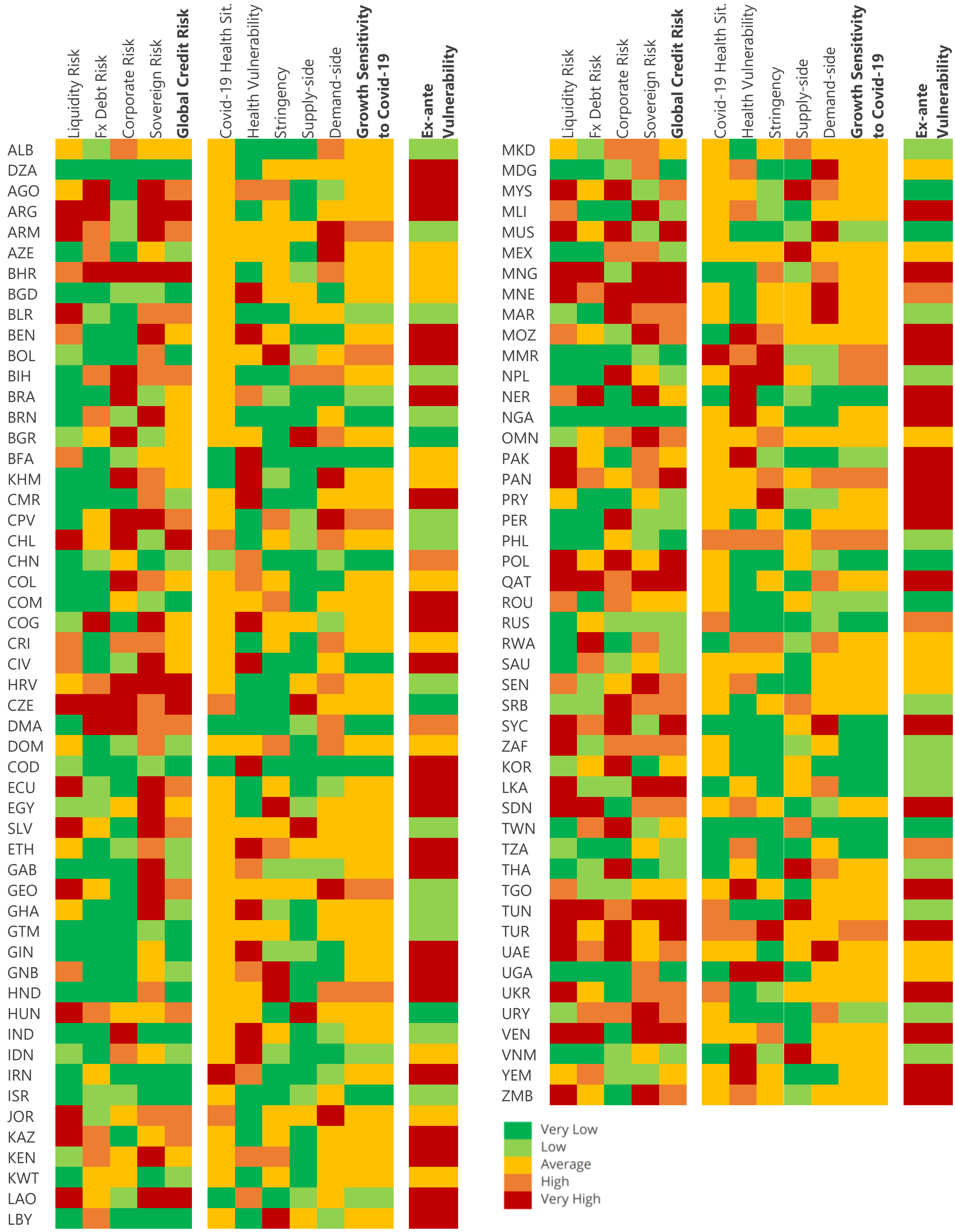
Global Credit Risk, Covid-19 & Country Risk Premium Heatmap

From highest risks (Global Credit Risk, Growth Sensitivity & Ex-ante vulnerability average) to lowest risks



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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