Monthly Comments – Emerging Markets

MacroFinance Research – January 2021

Key Messages

Country Focus – Brazil: A narrow window of opportunity in 2021!

Even though Brazil entered the new year with a series of negative figures and bad news, this should not overturn the positive economic outlook for 2021, illustrated by a rare "alignment of stars" for Brazil, notably the exceptional combination of a significantly better external environment and policy support to domestic demand, while interest rates remain low and the currency is highly competitive. Overall macro performances will therefore be favorable in 2021, with strong economic growth, a firming currency and the absence of external financial pressures. However, our country-risk metrics and the dissipation of the previous alignment of stars converge in suggesting that 2022 will see higher risk materialization, notably for indebted corporates, and questions on medium-term fiscal sustainability will come back to the fore.

Read more on page 2…

RiskWatch – Growth Balance: temporary plunge into high risk area with highly differentiated performances pointing to structural resilience capabilities

In this monthly report, the annual update of the Growth Balance shows the substantial impact of the global pandemic crisis, with a massive decline in economic growth and a lowering external balance. After a modest deterioration in 2019, the exceptional but temporary deepening of the average trajectory of 100 Emerging Markets and Developing Economies (EMDEs) into the high-risk area will lead to rising multi-faceted materialization of country risks, notably political and social tensions, sovereigns' liquidity and solvency issues, interconnection of challenging corporate and banking situations. Despite significant global uncertainties and progressively disappearing ability to engineer large supportive economic policies, 2021 performance on the Growth Balance will mechanically show a major improvement, with the most pressing question on the sustainability of such recovery postponed to 2022 when the legacy burdens will have to be tackled.

At regional level, economic growth has systematically weakened, while the dynamic of external balance has similarly been more unfavorable, at the noticeable exception of Asia. EMs in MENA and Sub-Saharan Africa are now on average inside the high-risk area, while the three other regions moved deep into an intermediate-risk area where external accounts remain correct but economic growth is clearly insufficient to meet the development challenges. Idiosyncratic factors continue to exert major influence on an individual country's performances on the Growth Balance despite the common nature of the pandemic-related shock, clearly highlighting very different resilience capabilities, a critical indication of future risks.

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

Completed on January 19, 2021.

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2020: A year of colossal (negative) figures and sharp cyclical swings

Brazil emerges with the world's 3rd largest number of Covid-19 infections and 2nd largest number of deaths (8.5mn cases and 210,000 deaths as of Jan. 18, 2021). Restrictions to movements of persons have remained modestly stringent, though confidence issues and the rapid deterioration in international trade led to a massive -9.1% y/y GDP contraction in 2020Q2, with a 30% depreciation against the USD during 2020H1. In turn, this induced an unprecedented policy reaction: massive fiscal effort (14% of GDP spread over 2020 and 2021), further declines in central bank's SELIC rate to a historic low of 2%, coupled with multiple interventions in foreign exchange market (using USD 44bn of Fx reserves). The impressive rebound in 2020Q3 (GDP +10.3% q/q) was, supported by positive contribution from external trade (large drop in imports, current account surplus) and booming confidence; it was associated with a sharp revival in manufacturing (PMI above 60 since Aug. 2020, +2.7% y/y for industrial production in Nov.2020).

A rare alignment of stars in 2021, however!

The new year started in Brazil with visible challenges: increasing Covid-19 infections, difficulties in vaccine distribution, increase in food price, rising social tensions, and many adverse political noises. These have kept markets worrying and pushed the USD/BRL exchange rate from 5.05 mid-Dec.2020 to 5.49 on Jan.12, 2021.

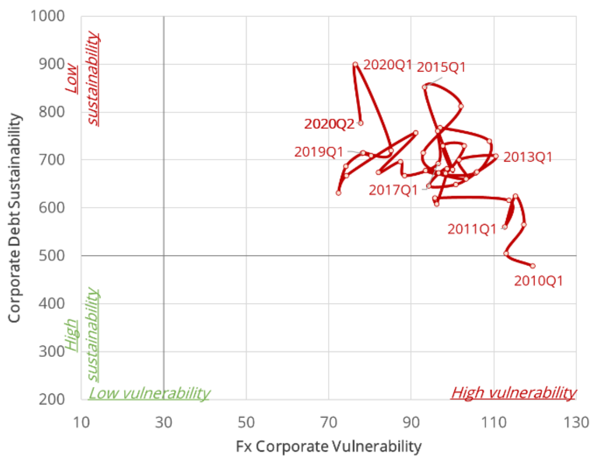
However, Brazil will benefit from a rare alignment of stars in 2021: (1) The worldwide exit from the pandemic, though irregular, will create a sharp improvement in international trade and firmer commodity prices; (2) anchored inflation expectations, "low for long" interest rates and persistent fiscal support will combine with strong levels of confidence to induce a large recovery in domestic demand, resulting in an expected +4.2% annual GDP growth. (3) BRL depreciation in 2020 has created a large competitive advantage (20%+ undervaluation in our tools), at a moment of ultra-low US interest rates and a weak USD, coupled with a comfortable short-term foreign exchange position (Fx reserves at USD 351bn in Dec. 2020); our quantitative models suggest that this combination would imply large capital inflows and a BRL appreciation towards USD/BRL 4.75 at the end of 2021.

Increasing risks expected in 2022

2022 will be characterized by normalization in trade and financial conditions, less supportive policies in Brazil, and the re-emergence of the country's structural weaknesses (low investment, poor business environment, social and political polarization, expensive banking intermediation). Higher prospective risks are consistent with the observed deterioration in our Economic & Financial Risk rating prior to the pandemic.

The key risks when getting into 2021 would include political and social risks as well as financial risks for Brazilian corporates. Despite a sharp increase and a too-high level of public debt (100% of GDP end-2020), medium-term questions on sustainability will rise, though the very low share of Fx denominated public debt and the prospects of longer-lasting low levels of interest rates will push the challenge later in the decade. Conversely, the corporate sector appears more sensitive to the expected deterioration in risk conditions in 2022, with a large FX vulnerability (horizontal axis on the chart below) associated with rapidly deteriorating debt sustainability (vertical axis), suggesting more acute difficulties.

Brazil: Corporate Balance



Source: TAC ECONOMICS

RiskWatch – Growth Balance: temporary plunge into *high risk* area with highly differentiated performances pointing to structural resilience capabilities

In this monthly report, the annual update of the Growth Balance shows the substantial impact of the global pandemic crisis, with a massive decline in economic growth *and a lowering* external balance*. After a modest deterioration in 2019, the exceptional but temporary deepening of the average trajectory of 100 Emerging Markets and Developing Economies (EMDEs) into the* high-risk *area will lead to rising multi-faceted materialization of country risks, notably political and social tensions, sovereigns' liquidity and solvency issues, interconnection of challenging corporate and banking situations. Despite significant global uncertainties and progressively disappearing ability to engineer large supportive economic policies, 2021 performance on the Growth Balance will mechanically show a major improvement, with the most pressing question on the sustainability of such recovery postponed to 2022 when the legacy burdens will have to be tackled.*

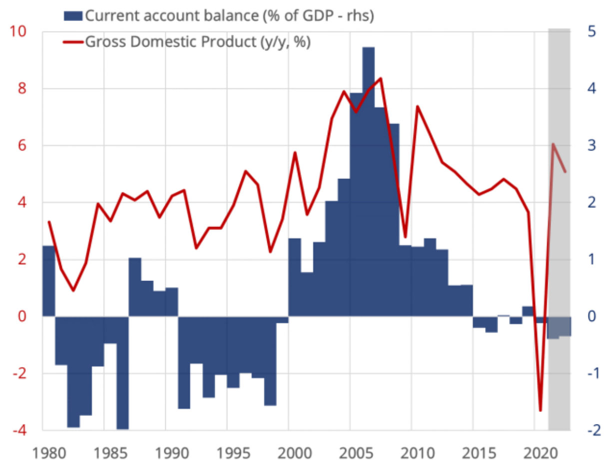
At regional level, economic growth *has systematically weakened, while the dynamic of* external balance *has similarly been more unfavorable, at the noticeable exception of **Asia**. EMs in **MENA** and **Sub-Saharan Africa** are now on average inside the* high-risk *area, while the three other regions moved deep into an* intermediate-risk *area where external accounts remain correct but economic growth is clearly insufficient to meet the development challenges. Idiosyncratic factors continue to exert major influence on an individual country's performances on the Growth Balance despite the common nature of the pandemic-related shock, clearly highlighting very different resilience capabilities, a critical indication of future risks.*

Historic shock on economic growth

Looking at the average GDP growth for EMDEs in a long-term perspective highlights the severity of the pandemic-related shock. Indeed, domestic lockdowns on a worldwide scale have created a unique combination of collapse in demand (domestic and through international trade) and constraints on supply (supply-chains disruptions) resulting in an aggregate GDP contraction of -3.3% for all EMDEs in 2020: this is the worst performance seen during the past 40 years, with a much sharper decline in activity than during the global financial crisis of 2008-09.

Beyond the sobering human and health implications, this has major consequences in terms of aggregate employment as well as rising poverty, with more than 100 million people pushed back into extreme poverty.

Emerging Markets and Developing Economies GDP Growth and Current Account Balance



Sources: TAC ECONOMICS, IMF/WEO, UNCTAD

In comparison, EMDEs' external accounts have not deteriorated significantly. The aggregate reading is partly misleading, as it largely reflects China's exceptional trade dynamic: its current account surplus increased from USD 141bn in 2019 to USD 253bn in 2020, while the other EMDEs collectively registered a visible deterioration. Overall, the aggregate current account deficit amounted to -0.1% of EMDEs' GDP in 2020, and should worsen further in 2021, i.e. a performance equivalent to 2015-2016 and much closer to balanced external accounts than in the 1990s or 1980s, two periods characterized by a large number of financial difficulties and foreign debt restructurings.

Trade in both goods and services dropped in 2020 (about -10% and -20% y/y respectively for EMDEs). However, the overall contraction in merchandise-export volumes in 2020 was much less severe in EMDEs than in mature economies, while conversely the contraction in imports was massive because of sharply declining domestic demand. Workers' remittances declined (-7% in 2020 for low and middle-income countries) but proved more resilient than trade in goods. One component of the current account balance that was massively affected by the pandemic was tourism (international tourist receipts down by -60% y/y year-to-date for 27 largest EMDEs destination).

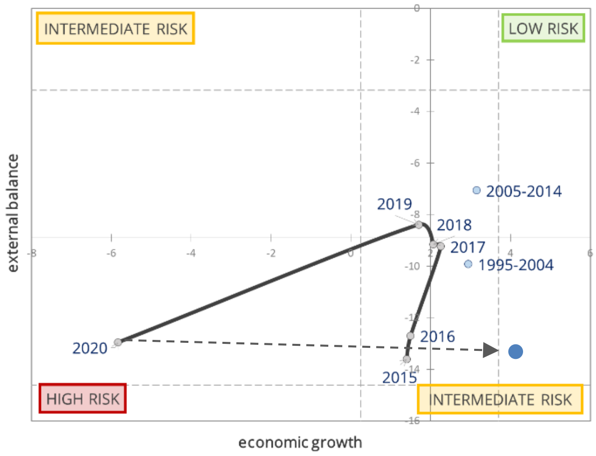
Double degradation pushes EM world further into *high-risk* area of the Growth Balance

The Growth Balance identifies whether countries can sustain their economic development without triggering excessive external deficits.

The Balance uses an indicator of *economic growth* (horizontal axis), which also incorporates changes in population and a time-dynamic component, hence amplifying the move when it is both very large and very abrupt, as for 2020; combined with an indicator of *external balance* (vertical axis), which is based on the current account balance. The next chart presents the annual update of the average (unweighted) trajectory for 100 EMs.

Growth Balance since 1995

Unweighted average for the 100 RiskMonitor countries



Source: TAC ECONOMICS

The pandemic-related leftward movement of the global EMDEs' path aptly reflects the exceptional magnitude of the economic contraction as well as its suddenness. We note however that the deterioration comes after few years of mediocre performances, with EMDEs' *economic growth* indicator remaining on the primary risk threshold since 2015, below the decennial performances observed in 1995-2004 and 2005-2014. Similarly, the (contained) deterioration in our *external balance* seen in 2020 comes after a couple of years of modest improvement post 2015, though the 2020 metric for the index is akin to that of 2015.

Looking further ahead, complex interrelations between persistent health uncertainties (level of infections and containment policies, roll out of vaccinations), a progressive exhaustion of fiscal and monetary support, increased levels of total debt for both corporates and sovereigns, and rising social and political tensions, will create a lasting post-Covid legacy. However, as our index of *economic* growth incorporates an accelerator / decelerator effect, the expected 2021 recovery in GDP will push the aggregate EMDEs path back above the risk threshold, with limited improvement (probably a mere stability) in external accounts, therefore bringing the trajectory close to the 1995-2004 average position: an undisputable improvement compared not only to 2020 but also to the 2015-2019 period. The key question is whether this more favorable position expected for 2021 can be sustained over a longer post-recovery period.

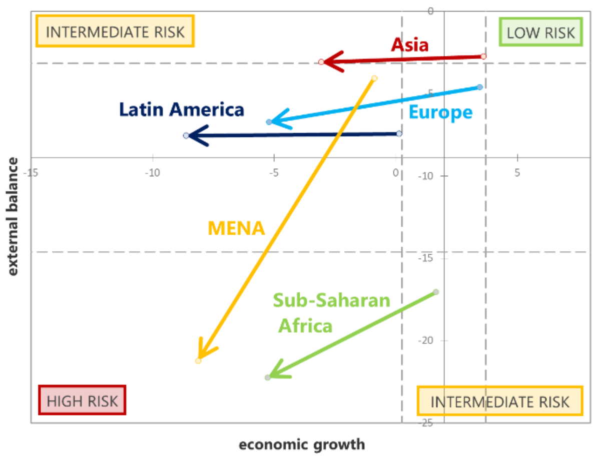
All regions deteriorate: MENA and Sub-Saharan Africa drop into the *high-risk* area, Asia outperforms

All five regions registered a significant decline in *economic growth* to abysmal levels, though the unfavorable move appeared slightly lower for **Asia** and **Sub-Saharan Africa**, and larger for **Europe** and **Latin America**.

The contraction in GDP was limited in Asia (-1.7% y/y in 2020, according to IMF latest projections), notably thanks to China's positive output; conversely, GDP plunged very deeply in Latin America (-8.1%) and recorded intermediate performances in other three regions (between -3.0% and -5.0%). In parallel, the negative impact on trade flows and balances has been sharper in **MENA** and **Sub-Saharan Africa**, as most countries depend on oil and other commodities for export revenues. Thus, the former joined the latter in the *high-risk* area of the Growth Balance. Indeed, the HeatMap constructed by regions to monitor the changes in the Growth Balance (cf. page 6) corroborates this regional degradation: all but four EMs in SSA and three in MENA (out of 30 and or 15 respectively) are henceforth positioned into the *high risk* area.

Growth Balance by region

(2019 → 2020)

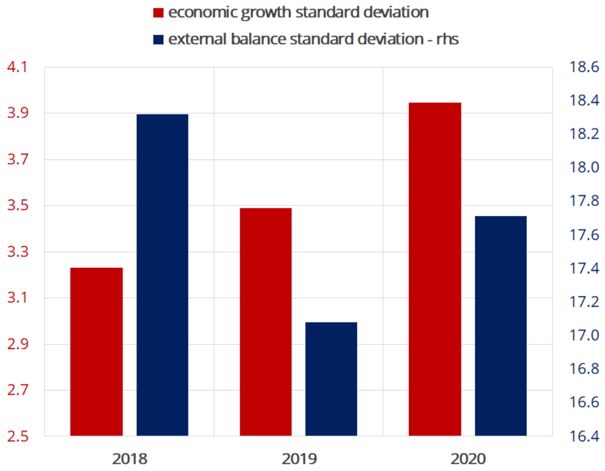


Source: TAC ECONOMICS

Increasing dispersion of performances despite the worldwide nature of the pandemic-related shock

The common nature of the shock affecting worldwide economies in 2020 impacted all EMDEs, but it is highly revealing that idiosyncratic risks or country-characteristics remain very substantial, as suggested by the increase in dispersion of performances seen between 2018-2019 and 2020 on both indicators (*economic growth* and, to a lesser extent, *external balance*), and even more visibly by the respective positions of all EMDEs on the Growth Balance.

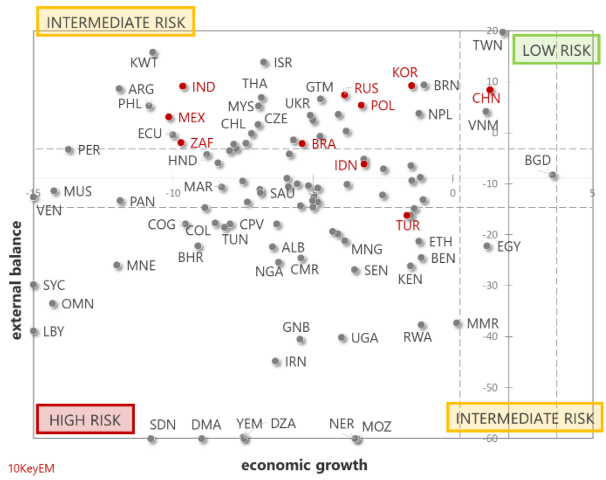
Economic Growth **and** ***External Balance***
Dispersion across 100 RM countries



Source: TAC ECONOMICS

Among the 100 EMDEs plotted in the Growth Balance below, only **Bangladesh** still exhibits a favorable *economic growth* in 2020 (i.e. above the main risk threshold), which is combined with a neutral index of *external balance*, thus making the country the only one still in the *low risk* area in 2020. Countries that have suffered less in terms of economic activity also include China, Taiwan, Vietnam, and Egypt.

Growth Balance - 2020



Source: TAC ECONOMICS

Among the **10 Key EM** (in red on the chart above), China has undoubtedly the most favorable combination, registering only a growth slowdown (+2.3% in 2020) and increasing its current account surplus; Turkey is the only one among the 10 Key EM to have kept a worrying *external balance*, as the current account balance moved back into deficit in 2020 (USD -33bn after USD +9bn in 2019). The other 8 Key EM show larger economic contraction associated to favorable *external balances*, with India, Mexico, and South Africa suffering from much larger economic damages.

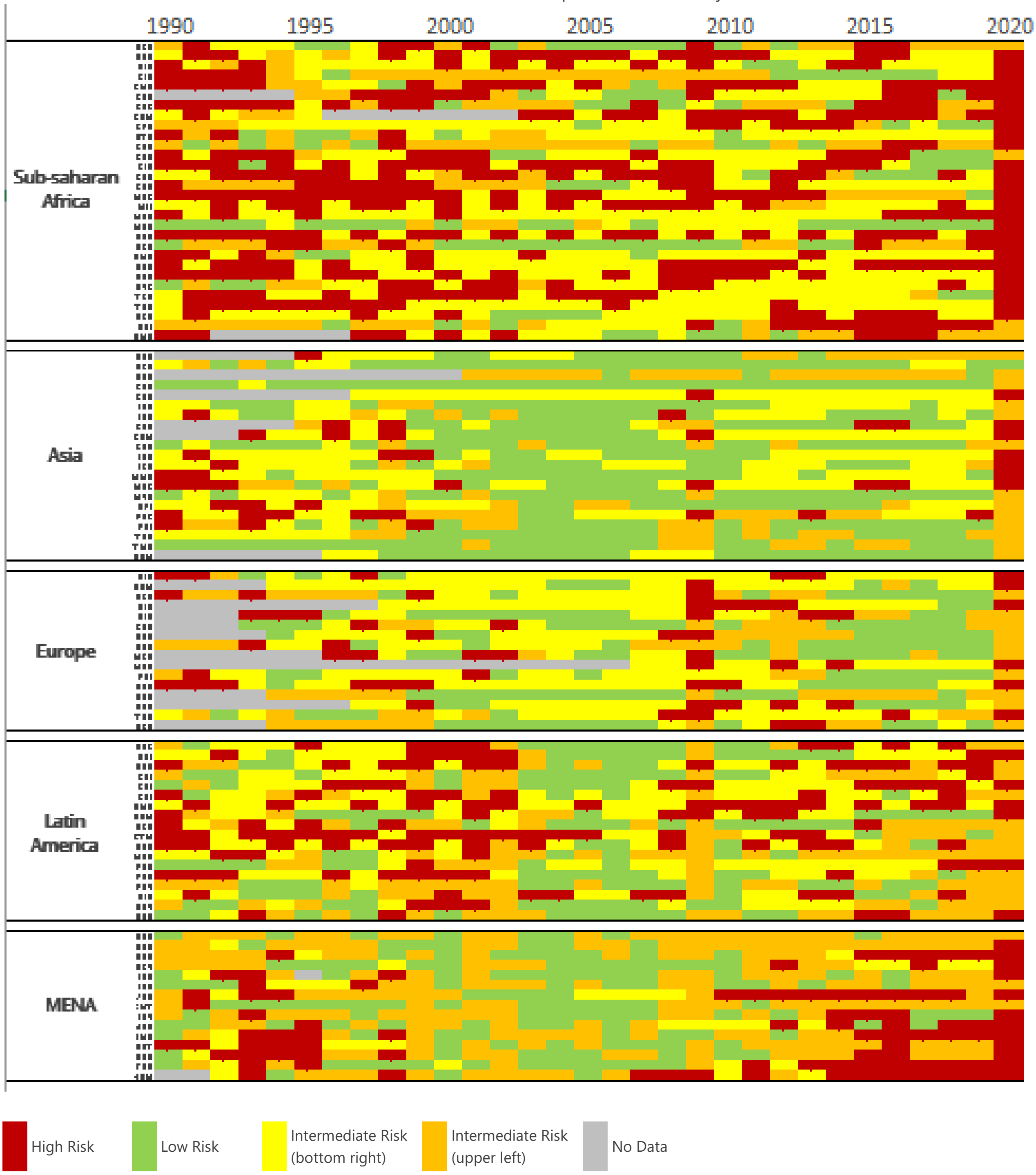
Noticeably, the proximity in positions for countries for which perceptions may be highly different is a very useful thought provoker: Oman being close to Venezuela or Libya and the tremendous difference with positions of other GCC countries tells a lot about the constraints facing the country; Algeria (noted DZA) at the bottom of the chart alongside Sudan, Mozambique, Niger or Yemen also sends a clear signal of the upcoming (political) difficulties; the Philippines in the *intermediate risk* area not far from Argentina, Ecuador or Peru and much further from other ASEAN countries is also revealing of increasing complexity in policy-making.

Finally, the HeatMap shows countries (grouped by regions) and columns are years since 1990; color codes refer to the positions in the Growth Balance (green for *low risk*, red for *high risk*, and yellow for *intermediate risk*, here with a differentiation between the *bottom right* area, i.e. sufficient economic growth associated with unfavorable external performances, and the *upper left* area, indicating favorable external accounts coupled with insufficient economic development).

The HeatMap clearly confirms that the situation is worse than during the Global Financial Crisis in 2009, except in **Europe** where more EMDEs were more severely affected then (ten in *high risk* area versus six in 2020). In **Asia**, out of the four EMs in *high risk* area in 2009, Cambodia, Georgia, and Mongolia have reverted to this least favorable quadrant in 2020, met this year with Kazakhstan, Laos, Myanmar, and Sri Lanka because of the unprecedented crisis. In addition, fewer **Latin American** countries (6) are located in *high risk* area than during the 2000-2002 period when 10 registered excessive external deficit and poor *economic growth*.

100 RiskMonitor Countries' position on Growth Balance

From 1990 to 2020, each row represents one country



Source: TAC ECONOMICS

Appendix 1: List of 100 countries monitored by alphabetical order of ISO3 Code

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
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

ISO 3 Code	Country Name
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
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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