EDITORIAL

DOUBLE WHAMMY

Excluding China, activity in emerging countries was stagnant in Q2 2022 and business and household confidence surveys indicate that the economic slowdown will continue. Inflation continues to rise and is being accompanied by new decisions of monetary tightening, including by central banks in Asia. The deterioration in external demand and tighter domestic financial conditions have combined with the monetary tightening in the United States and USD appreciation to trigger the slowdown in activity. This is a double whammy for emerging countries. But developing countries, which are also facing the food crisis and a situation of over-indebtedness, are in a more worrisome situation.

ECONOMIC GROWTH SLOWDOWN CONFIRMED

Signs of a slowdown or contraction in activity have been confirmed since the spring and have become more numerous over the summer. China started the ball rolling with a 2.6% fall in its GDP in Q2 compared to Q1. Excluding China, real GDP of our sample of the 26 main emerging countries stagnated. It even contracted in some of them (South Africa, India, Poland, Taiwan). Including China, real GDP fell by 1% in Q2 2022 compared to Q1. Over the course of the summer, the opinions of manufacturers about their order books continued to worsen, particularly for large exporter countries in Asia (China, South Korea, Taiwan) and in Central Europe (Hungary, Czech Republic). Global trade is slowing, oil and metal prices have turned around since mid-June and the Baltic Dry Index (benchmark price index for maritime transport and leading indicator for trade) has normalised after its rise in 2021.

In a number of countries, consumer confidence has fallen back to its spring 2020 level. The main reason is the acceleration in inflation. Inflation exceeds 15% year-on-year in most central European countries; it is between 8% and 14% in Latin America (excluding Argentina) and is now spreading in Asia (with the exception of China, Hong Kong and Taiwan) in a range between 4% to 8%. As a result, monetary policies are continuing to tighten, including in Asia.

DOUBLE WHAMMY

The deterioration in external demand and tighter domestic financial conditions (inflation and rise in key policy rates) have combined with the monetary tightening in the United States and the appreciation of the US dollar to trigger the slowdown of activity. Yet, according to the Institute for International Finance (IIF), bond portfolio investment flows to emerging countries excluding China have been rather resilient; they amounted to USD 75 bn over the nine first months of the year. In other words, sovereign debt yields in local currency have not suffered a double whammy (i.e. the effect of the rise of the US interest rates + the effect of investment withdrawals by non-residents).

However, emerging countries are inherently more sensitive than advanced countries to the tightening of US financial conditions. Firstly, the US dollar and commodity prices are generally negatively correlated and changes in the latter are often stronger than those in the US currency, with the result that commodity exporting countries suffer a loss of purchasing power. Secondly, the appreciation in the value of the US dollar increases the burden of external debt. Finally, financing costs in US dollars are rising, all the more so as risk premiums tend to widen.

According to IIF estimates, the share of non-bank sector debt (i.e. States + companies + households) denominated in dollars has risen sharply in Turkey and Latin America (Chile, Colombia, Mexico).

USD-DENOMINATED DEBT OF THE NON-BANK SECTOR

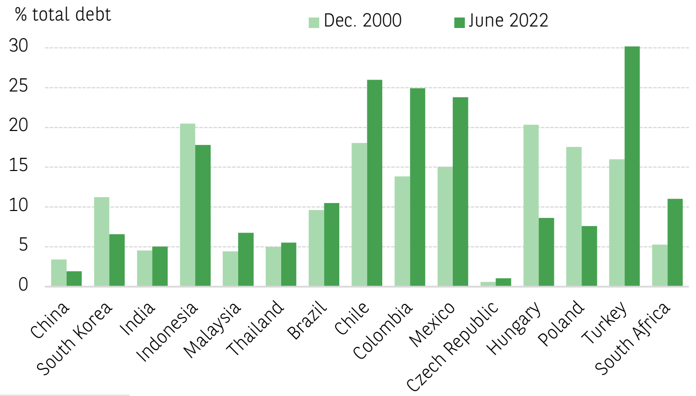

CHART 1 SOURCE: IIF, BNP PARIBAS

For the other emerging countries, this share has remained stable and moderate (chart 1). The dollar effect should therefore not be overestimated or generalised. Furthermore, the risk premiums on foreign-currency bond debt of sovereign borrowers classified as "investment grade" (mainly emerging countries) have remained stable since the beginning of the year.

However, many developing countries, which are much more fragile, have financed themselves on the international bond market and have obtained funding from China. The share of USD-denominated public debt in those countries has risen sharply over the past decade. They are also countries in the speculative grade category whose risk premiums have widened considerably.

Moreover, developing countries are also faced with another double whammy. According to the Global Report on food crisis, 45 countries totalling 180 million people are at risk of, or are already, facing a food crisis because of external or internal conflicts, weather conditions or economic shocks such as the Covid pandemic. According to the IIF, of 35 countries facing a food crisis, around half of these (mainly in Africa) are experiencing major difficulties in repaying their debt servicing costs (debt distress situation), which will amount to over USD 10 billion in 2023. In these circumstances, calls from countries to renegotiate their debt can only increase.

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