EMERGING COUNTRIES: BETWEEN IMPROVING FINANCIAL CONDITIONS AND A SLOWDOWN IN CHINA

Growth in emerging markets held up fairly well until the spring of 2024, partly thanks to the easing of monetary policies since mid-2023. The imminent one in the United States should make it possible to extend or even strengthen it. In the most likely scenario of a soft landing of the US economy, the main risk for emerging economies is a sharper-than-expected slowdown in the Chinese economy. The slump in the real estate sector is spreading through the fall in commodity prices. On the one hand, most emerging countries will gain in disinflation. But, on the other hand, commodity-exporting countries of which China is the main customer will suffer. Above all, the risk of contagion lies in the implications of the Chinese authorities' strategy of supporting growth through foreign trade. Chinese companies are gaining export market share thanks to a very aggressive pricing policy facilitated by a competitive renminbi, not only vis-à-vis advanced economies but also emerging economies. The positive point of this trade strategy for emerging countries is that Chinese companies are intensifying their direct investments there.

At its meeting on 17 and 18 September, the Federal Open Market Committee is expected to kick off the monetary easing widely anticipated in the US. Markets are anticipating a cumulative fall in the Fed Funds rate of at least 200 basis points. Usually, monetary easing in the US gives a shot in the arm to the financial markets of emerging countries. Firstly, the US dollar weakens or stops appreciating, except against currencies of high-inflation economies (Argentina, Egypt, Turkey). With the exception of the Mexican peso, the main emerging currencies have appreciated against the USD since the end of June (+2% as a median)[1]. Secondly, central banks see an opportunity to ease monetary policy, if permitted by internal inflationary pressure and the position of their economy in the cycle. Thirdly, bond and equity markets benefit from an influx of portfolio investment, which strengthens dollar liquidity and financing conditions (lower risk premiums on external debt and domestic bond interest rates).

In addition, US monetary easing will take place against a backdrop of downward pressure on commodity prices and therefore on domestic inflation, which facilitates action by the central banks. As a result, our macroeconomic scenario anticipates a further fall in key interest rates in Latin America, with the exception of Brazil, and in central European economies. We should remember that monetary policy easing in these two regions began in mid-2023. A cautious approach to easing is also expected to be adopted by central banks in Asian countries, which had remained at the ready up until now (with the exception of China)[2]. In summary, financial conditions for emerging economies are expected to improve by the end of 2025.

Economic growth in emerging countries has so far held up well at a rate of around 1% per quarter up to spring 2024. Can alignment of the financial planets be enough to maintain this growth? In principle, yes, provided that the US economy does not experience a hard landing, but above all, provided that the slowdown in growth in China is not more pronounced than expected (-0.4 percentage points in 2025 after -0.3 points in 2024, which would bring annual growth back to 4.5% compared to 5.2% in 2023).

The Chinese real estate sector continues to suffer, and in the wake of this, heavy industries such as the steel sector are reducing their production capacity, with mass redundancies.

The deterioration in the labour market, combined with falling real estate prices – the mainstay of Chinese household wealth – is restricting private consumption. Stagnation in the construction sector also explains downward pressure on the prices of commodities used by the sector (especially metals). On the one hand, most emerging countries will gain in disinflation. But, on the other hand, commodity-exporting countries of which China is the main customer (Chile, Peru) are obviously very exposed to this twofold drop in demand in terms of volume and in prices.

But the risk of contagion of the Chinese slowdown lies mainly in the implications of the authorities' strategy of buoying economic growth through foreign trade. Chinese companies are gaining market share in exports thanks to a very aggressive price policy facilitated by a renminbi that has remained competitive (since 2021, the Chinese currency has depreciated as much against the dollar as the median of the principal emerging countries, i.e., by around -10%). Export prices have fallen significantly since mid-2023 (-7% year-on-year in July). This strategy of gaining market share concerns an ever broader range of products, including high value-added goods. In other words, in macroeconomic terms, China is exporting its growth slowdown (some would say its unemployment) through the dumping of its industry.

This strategy is mainly applied to the US and European markets, which has led to several rounds of tariff increases since 2018 by the US and, more recently, on the European side on electric vehicles. But an increasing number of emerging countries competing with China have also raised tariffs on steel (Brazil, Chile), basic textiles (Indonesia) or photovoltaic panels (South Africa).

However, emerging economies will be less affected than developed economies. In fact, Chinese companies are intensifying their direct investment in emerging economies, either to circumvent US sanctions (the case of Chinese investment in Mexico and Southeast Asia), or to gain access to a free trade zone and benefit from low or non-existent tariffs (Trojan horse strategy as in Hungary and Turkey).

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1 Depreciation of the Mexican peso is linked to the challenge of judicial reform and not to economic or financial developments.
2 including the Central Bank of Indonesia, which had to raise its key rates at the end of April to stabilise the rupiah.