

## EMERGING AND DEVELOPING COUNTRIES: HOW WILL THEY WEATHER THE ENERGY SHOCK?

As in 2022, the energy shock will affect emerging and developing economies. Today, as in the past, this shock is a negative-sum game between importing and exporting countries. Furthermore, although this is basically a supply shock, central banks in emerging economies may tighten their policies if they need to counter downward pressure on exchange rates, in order to prevent inflation from rising too sharply. However, compared to 2022, there are mitigating factors: 1/ the absence of a shock to agricultural commodity prices so far; 2/ AI, which is an external growth driver for Asian countries in particular; and 3/ the Fed is expected to adopt a more accommodative stance than in 2022 in response to the anticipated rise in inflation. In terms of the solvency and liquidity of public finances and external accounts, emerging economies are no more vulnerable than in 2022. However, some developing countries still face vulnerabilities. The impact on energy balances is putting pressure on interest rates and exchange rates, although this pressure remains limited for now.

Almost exactly four years after Russia's military intervention in Ukraine in 2022, emerging economies will suffer the consequences of a new external shock of a similar kind: a spike in oil and gas prices combined with a disruption to supplies from the Gulf states. The stagflationary shock will depend on both the scale of the price rise and the duration of the conflict. Beyond a few weeks of tensions, what will be the impact on growth and inflation for emerging economies? How will their financial conditions be affected? Are emerging economies more or less vulnerable than they were in 2022?

### A STAGFLATIONARY SHOCK

Whether the scenario entails a moderate but sustained rise in oil prices or a very sharp but temporary rise, macroeconomic simulations show that the negative impact on growth for netimporters far outweighs the positive impact for net-exporters countries. In the first scenario, there would be no positive impact for exporting countries whatsoever. Indeed, a commodity price shock is never a zero-sum game. As a matter of fact, in 2022, growth in emerging and developing countries reached 4.3% compared with 7% in 2021, whereas in October 2021 the IMF had forecast a slowdown of just 1.5 percentage points (from 6.4% to 5.1%).

Compared with 2022, there are three moderating factors. First, the spike in hydrocarbon prices has not spread to the prices of key agricultural commodities (wheat, maize, cotton, rice). Second, although Asian countries are experiencing direct impacts from supply disruptions, they are benefiting more than other EMs from the development of artificial intelligence. Such a growth driver did not exist in 2022. Third, even if inflation picks up again, monetary tightening in the United States on a scale comparable to that of 2022 is unlikely.

However, three risk factors are worth mentioning. First, hydrocarbon prices have driven up the costs of petroleum-derived materials used in fertilisers. This poses a risk that these increased costs will spread to agricultural commodity prices through the rising cost of production inputs. Second, if the conflict were to drag on, supply disruptions would affect all sectors of activity in Asia, where, with the exception of China, crude oil stocks do not exceed two months, and even less in Africa (in South Africa, the ratio is just two weeks). Third, faced with rising inflation and pressure on exchange rates, central banks in emerging economies may opt to tighten their monetary policies.

The initial adverse effect on inflation will stem from various factors that may partly offset one another. However, unlike the impact on growth, the rise in energy costs is likely to affect both exporters and importers.

The direct impact on inflation will depend on: i) the share of energy in price indices; ii) fluctuations in the exchange rate relative to the US dollar; and iii) the introduction (or strengthening) of mechanisms to mitigate the rise in energy prices for consumers or producers. Furthermore, the overall effect of the shock will be determined by its spillover to the broader price level: it will be more significant the higher the inflation rate and/or the further along the economy is in the economic cycle.

For emerging economies, the share of energy in consumer price indices varies from 7% to 13%. The direct impact of rising hydrocarbon prices would therefore be quite substantial<sup>1</sup>.

Most emerging economies have reached the intermediate phase of their business cycle. They are therefore neither at the lowest nor at the highest point of the cycle (output gaps are either moderately positive<sup>2</sup> or moderately negative). The spillover effects on overall prices would not be exacerbated by an overheating situation. Furthermore, exchange rate depreciation remains contained (median of -1.5% against the USD since 27 February). Finally, many countries have mechanisms in place to limit price rises (China) or are reintroducing compensation systems through tax cuts or increased subsidies (Croatia, Hungary, Indonesia, Türkiye). Some countries have even introduced rationing measures to limit fuel consumption. These compensatory measures will mitigate the negative impact of the shock on inflation and household consumption, albeit at the expense of a deterioration in public finances or to the detriment of refining companies.

### OVERALL, FINANCIAL CONDITIONS REMAIN LARGELY UNAFFECTED

The shock has put pressure on domestic interest rates. In Asia, the rise has been moderate (35 basis points [bp] or less, except for the Philippines (+70 bp). It has also been moderate in Brazil and Mexico (+40 bp). The countries most affected are those in Central Europe and South Africa, with rises of between 55 and 70 bp (with Hungary at the higher end) and, above all, Türkiye at +135 bp. The markets are therefore anticipating a surge in inflation, followed by a faster tightening of monetary policy than in Asia, mirroring trends observed in 2022.

<sup>1</sup> For instance, Türkiye exhibits all the characteristics of an economy that is highly sensitive to energy price shocks. Its central bank estimates that a sustained increase in oil prices of 10% would result in an additional 1 percentage point (pp) of inflation within a year. Estimates by local economists range from 4 to 6 pp, based on assumptions that the price of Brent crude will stabilise at USD 85 or USD 100 for at least a year, even taking into account the mechanism designed to cushion price rises, which is very generous to consumers (up to 75%).

<sup>2</sup> With the exception of Asian countries that are benefiting from the AI boom, such as Taiwan.



Türkiye has been the most impacted because of the significant structural exchange rate pass-through<sup>3</sup> and the contagion effect on other prices.

By contrast, risk premiums have reacted very little, including for the Gulf countries, with the exception of Bahrain<sup>4</sup>. In those countries where risk premiums have risen, CDS spreads have typically widened by less than 15 basis points<sup>5</sup>. During the first two months of the year, governments successfully issued international debt without facing significant challenges. However, the risk of a flight to quality cannot be ruled out, as portfolio investments remained significant until February 2025.

## THE VULNERABILITY OF EMERGING AND DEVELOPING COUNTRIES COMPARED WITH THE PREVIOUS SHOCK OF 2022

The vulnerability of emerging economies to external shocks is gauged by the creditworthiness of their governments and the resilience of their external accounts. However, are emerging and developing countries more vulnerable than they were in 2022?

### Sovereign solvency has deteriorated only marginally

In a sample of 43 emerging economies (including industrialised Asian countries and Central European eurozone members and excluding Ukraine), public debt-to-GDP ratios rose by 5 percentage points, or even more in 25% of cases. However, the interest burden relative to income has risen significantly in only six countries (by 5 percentage points or more). In a strict sense, the creditworthiness of governments has deteriorated only marginally, despite the rise in indebtedness.

Furthermore, although non-resident portfolio investment flows remain strong, the share of local currency sovereign debt held by non-residents has declined since 2022 in most countries. Exposure to exchange rate risk has also fallen, with foreign currency debt (as a percentage of GDP) having risen by more than 5 percentage points of GDP in only five countries, which may account for the moderate increase in CDS spreads.

Based on these indicators, Egypt and Pakistan emerge as the most vulnerable countries in our sample. Egypt's vulnerability stems from a sharp increase in its debt burden, which absorbs more than half of the country's revenue. Pakistan's situation is similarly precarious due to an increase in the interest burden, coupled with a possible rise in subsidies that could jeopardise IMF support.

In Argentina, public finances remain the weak link among emerging economies. This is not due to a deterioration in the government's creditworthiness – quite the contrary – but because of insufficient foreign exchange reserves relative to the repayment of its US dollar-denominated debt (a dollar liquidity issue).

The risk of default associated with a deterioration in creditworthiness mainly affects low-income countries. Indeed, these countries have often seen a sharp rise in their public debt, including foreign-currency debt, resulting in a surge in interest payments (which were already high in 2022). This situation is evident in Bangladesh, Nigeria and, in particular, Senegal.

### Resilience of external accounts, except for low-income countries in deficit

At first glance, the resilience of a country's external accounts depends on the magnitude of the shock's impact on the energy balance, the size of the energy balance itself, as well as the size of the current account deficit and the foreign exchange liquidity available to central banks.

For the emerging economies in our sample, energy balances (oil, gas and petroleum products) are in deficit in Central Europe and Türkiye (between -1.5% and -3.6% of GDP), but also in Asia (between -1.4% and -5.9% of GDP). Assuming a conservative estimate of a 40% average rise in hydrocarbon prices this year compared with the 2025 average (with the price per barrel held at USD 100), the increase in the energy bill would amount to between 0.8 and 2.3 percentage points of GDP for Asian countries, and between 0.5 and 1 percentage point of GDP for Central European countries and Türkiye. However, for countries with the highest energy balance deficits, current account balances are either in surplus (South Korea, Thailand) or below the 5% of GDP warning threshold (which is the case for most Central European countries, with Romania being the notable exception). In our sample of 43 countries, the percentage of countries with a current account deficit of 3% or more is the same in 2025 as in 2022. In Latin America, the energy balance is even in surplus in Argentina, Brazil and Colombia, while the deficits in other countries are relatively minor.

The foreign exchange reserves held by central banks in emerging markets were generally higher at the end of 2025 compared to the end of 2022. When considering the months of imports of goods, services and other current payments, these reserves have, at best, remained stable. However, as a general rule, the ratios exceed five months.

For emerging economies, the risk of a balance of payments crisis associated with a spike in energy costs is, in principle, low. Nevertheless, Argentina, Egypt, Pakistan and Ukraine require support from financial institutions and major international banks to service their external debt. Pakistan is particularly vulnerable due to its foreign exchange reserves being insufficient from this viewpoint. Conversely, for countries with a high current account deficit, the rising energy bill may exert downward pressure on their exchange rates.

Low-income countries are more vulnerable to the energy price shock, either because their energy deficit is very high (Cambodia, Laos) or because their foreign exchange reserves are insufficient relative to their external debt servicing requirements (Sri Lanka). Furthermore, many sub-Saharan African countries rely heavily on imports from Gulf states and have no oil reserves of their own.

François Faure

<sup>3</sup> Currently, the Turkish lira has held up better than Central European currencies (-0.4% against the US dollar since 27 February) due to interventions by the Central Bank. However, the pass-through coefficient stands at 0.4, in contrast to the range of 0.1 and 0.2 for the main Central European countries and South Africa.

<sup>4</sup> Except for Bahrain (+35bp).

<sup>5</sup> Alongside Bahrain, the other exceptions are Egypt (+46bp), Argentina and Türkiye (+25bp each).

