EDITORIAL

INERTIA

Over the past few months, the equity markets of the main emerging financial centres have shown a little more optimism. They are betting on a recovery in growth in China after the lifting of health restrictions, on the positive effect of the drop in commodity prices for importing countries and on the impact of US monetary tightening and the appreciation of the dollar to be less severe than expected. The first two arguments are uncertain and must be put into perspective. The financial shock is probably behind us. But its negative impact on investment will continue this year. Likewise, the acceleration of inflation in 2022 could have diffuse effects on household consumption, even if wages were to catch up.

Since October, stock prices in the main emerging markets have recovered, even though economic indicators (PMI, exports) remained depressed until December and the main financial institutions (IMF, World Bank) expect a sharp slowdown in growth or even a recession in 2023. The stock market recovery is limited for the time being, as the MSCI index has just returned to its 2019 level. However, it reflects the bet on a recovery in China after the lifting of health restrictions, the positive effect of the drop in commodity prices for importing countries, and a less severe impact than expected from US monetary tightening. Does it make sense ?

A recovery in Chinese activity should indeed occur by the end of the first quarter through a simple catch-up effect. However, uncertainty remains high about the development of the pandemic, especially if the elderly population is not being vaccinated very quickly.

Commodity prices have indeed fallen significantly since spring 2022 (-20% between March and December for the aggregate index of 69 commodities tracked by the IMF), but their level remains at a record high. In December 2022, the median increase was still 40% compared to the 2019 level and 22% of commodities had a price that was at least 80% higher than the 2019 level.

More generally, the shift in inflation rates, generally presented year on year, should not make us forget that price levels have continued to rise. For two-thirds of emerging countries, year-on-year changes in consumer price indices did indeed fall by 1.3 points in median terms in November or December from their high point in 2022, but the monthly increase was still 0.6% (also in median terms) in Q4 2022.

The question is whether wages will have caught up with the cumulative price increase of 2021-2022 in 2023. The indications in this respect are rather positive, although the data is still incomplete: for half of the countries for which wage statistics are available until the end of Q3 2022 or the beginning of Q4, a catch-up has already taken place.

Regarding changes in anticipation of the severity of US monetary tightening,, net portfolio investments in emerging countries have recovered significantly since August (+USD 69.6 billion between August and December, according to IIF estimates, compared with -USD 35.9 billion between January and July). As a result, the depreciation of emerging currencies against the dollar slowed sharply (-1% in median terms in H2 2022 compared to -7% in H1) and CDS premiums fell or remained stable in H2 (with the exception of Pakistan and Tunisia).

The financial shock of US monetary tightening and a stronger dollar is thus probably behind us. But, the consequences in terms of activity are still to come as stressed by the IMF director who announced at the beginning of the year that a third of economies are likely to experience a recession, particularly in Europe.

Companies in emerging countries will have to deal with the drop in external demand at least over the first part of the year and, for those

EMERGING COUNTRIES: EQUITY MARKETS AND ACTIVITY

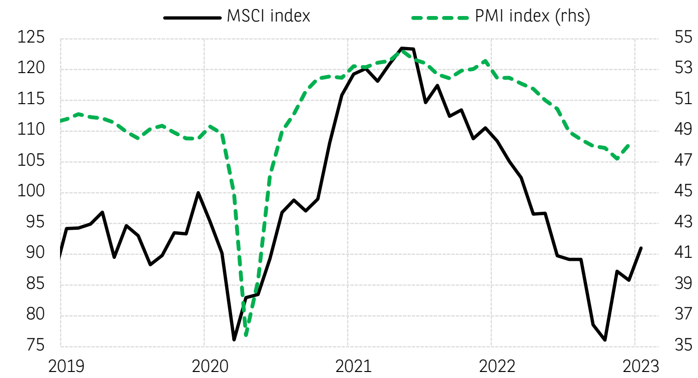

CHART 1 SOURCE: MSCI, S&P GLOBAL, BNP PARIBAS

operating in the commodities sector, with a deterioration in the terms of trade. In addition to these factors, there is an increase in financing costs. With a few exceptions, the cost of borrowing in dollars for large companies is currently significantly higher than in recent years (by at least 200 basis points compared to the pre-pandemic period), with the rise in the country risk premium adding to that of US government bond yields. Domestic interest rates are also well above their pre-pandemic level and small and medium-sized companies will probably not be able to pass on the cost of commodities to their selling prices.

As a result, in a context of uncertainty about demand, companies could follow a wait-and-see policy in terms of investment, even if, adjusted for consumer price inflation, real interest rates may seem attractive. According to the World Bank, investment growth in emerging countries outside China will slow again in 2023 to around 3% from around 4% in 2022 and almost 10% in 2021.

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