EDITORIAL

LOSS OF MOMENTUM

The recovery in economic activity that began at the end of the spring continued through the summer, with China leading the way, and oil and metals prices have picked up. But doubts are emerging as the pace of the recovery seems to be slowing, as reflected by exports recent loss of momentum. Above all, there are currently worries regarding the persistence of the pandemic and the risk of lockdown extensions or even new lockdowns in several countries. There are, however, some factors of support: continued easing of monetary policies, market tolerance of rising budget deficits and a reduction in the debt of the most vulnerable countries by official lenders. However, the effect of these factors should not be overstated.

Over the summer, emerging economies bounced back as had been prefigured by business surveys from April onwards. The growth tracker published by the Institute for International Finance (IIF) shows annualised moving average growth over three months of 5.3% in August, from -1.3% in June. The recovery seems fairly solid, as the three components of the index (activity indicators, business surveys and financial indicators) have all contributed since July. In China, GDP has returned to pre-crisis levels and the recovery has become more broadly based.

However, for a large majority of other countries, activity indicators such as industrial production, exports and retail sales had not returned to their end-2019 levels by July. By region, Latin America still lags behind Asia and the EMEA zone, with the IIF indicator down 2.2% in Latin America, but up by 8.1% in Asia including China and 5.1% in the EMEA region.

Disparities between countries and a lack of information means that it is not possible to say whether the recovery is being driven by internal or external factors. In general terms, the recovery in exports seems to be in advance of that in imports, but on the face of it industry can run down inventories to meet demand, whether domestic or external. We might just note that for Brazil, Turkey and central European countries, the recovery has largely been based on household consumption boosted by public transfers (in Brazil and Turkey) or the resilience of the labour market and wages (in central Europe).

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Once the mechanical rebound in activity is over, might the recovery run out of steam? Many observers fear so, for various reasons.

The recovery in exports has now stalled in many countries. The year-on-year trend in exports (that is, comparing to pre-Covid times) remains negative. In particular, the very negative gap, which between the low point in March/April and June started to close rapidly, is now proving harder to address. The possibility of a lasting slowdown in international trade due to a reorganisation of value chains and the relocation of businesses remains a major unknown for the recovery scenario.

Several countries have decided to extend or reintroduce lockdowns across the whole country (Israel) or in urban areas (Argentina, Indonesia). Latin America still faces the highest ratios of victims to total population (Brazil, Chile, Mexico, Peru). But the spread of the pandemic seems to be slowing. However, new cases are still on the rise in India, whilst the curve of new cases in several EMEA countries has got significantly steeper. Lastly, only Asian countries have succeeded so far in tackling the first wave and introducing measures to shorten the second wave.

The recovery in portfolio investment seen from the end of May to mid-July has fizzled out. Between mid-July and mid-September, net outflows came to USD 13 billion (USD5 billion excluding China) according to IIF figures. This withdrawal of investors was particularly noticeable in Brazil and Turkey.

A FEW SUPPORTIVE FACTORS

A reversal of activity in Q4 and in 2021 is not the most likely scenario. With the notable exception of Mexico, PMI indices for August had regained or exceeded their Q1 levels. Over and above these advance indicators, there are factors of support, even though these are fragile and the likely impact is limited.

Some 40 countries have applied for the G20's DSSI initiative to suspend repayments of public external debt due to bilateral creditors. The potential amount covered by this deferral of debt payments is USD 11.5 billion between October and December 2020, with an extension of the initiative to December 2021 representing an additional reduction of USD 16.6 billion. The Chinese government seems to be playing an active part, as indicated by the restructuring of Angola's debt. It is also worth noting the agreement Argentina has reached with its private international creditors. This helps provide the breathing space needed to avoid a multiplication of sovereign defaults.

Commodity prices have firmed up although the scale of their recovery is limited due to high inventory levels. Oil and gas prices have benefited from OPEC+ members respecting production quotas, whilst metals prices have been bolstered by China's measures to promote infrastructure and construction investment.

Meanwhile, monetary easing has continued in a dozen emerging nations, such that interest rates on sovereign debt in local currencies have continued to fall, at least in Asia. The markets are still not reacting negatively to the sharp increases in budget deficits. Elsewhere, the withdrawal of non-resident portfolio investments has in particular affected equity markets, but had little effect on local-currency sovereign debt markets.

The two exceptions are Turkey and, to a lesser extent, Brazil. The lira and the real have not gained ground against the US dollar, despite the fact that the former has weakened against major currencies since July. The Turkish central bank has been forced to tighten monetary policy, resulting in a significant increase in the government's borrowing costs.

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