Emerging economy outlook: an uneven recovery

Emerging economies will experience a clear recovery in growth in 2021 and 2022. If we set aside China, a country with a different idiosyncratic dynamic which has already been analysed in this publication recently, the group of major emerging countries experienced a fall in GDP of 5.1% in 2020.[1] According to our latest projections, this decline will give way to growth of 4.8% in 2021 and of 3.8% in 2022. But the real key for the emerging world right now is not the recovery itself, but how unequal it is going to be. This asymmetry is going to produce winners and losers among emerging economies. Moreover, among the losers there will be a group of countries which, in addition to experiencing a loss of growth, will see their macroeconomic imbalances strained (we will call them the «fragile losers», to paraphrase the term «fragile emerging economies» which was widely used before the pandemic).

Pandemic outlook

The disparity in emerging countries' economic trajectory in 2021 and 2022 will depend on how the pandemic develops, how emerging economies are tied to the various global growth dynamics points of global growth and also their ability to deal with adverse economic shocks. Thus, the five most affected emerging countries relative to their population (Hungary, Brazil, Poland, Argentina and Chile) have more than twice as many infections as the average of the least affected emerging countries.

Furthermore, the outlook for the vaccination roll-out is vastly different among emerging countries. First of all, there is great disparity in the number of doses administered (for example, South Africa has vaccinated 0.5% of its population, while Hungary has reached 38%). More worryingly, however, the countries that are immunising the fewest people are also the ones that have ordered the lowest number of doses relative to their population.

It must be acknowledged, however, that there is some correspondence between the emerging countries that have been hardest hit by the pandemic and those which have guaranteed a greater number of doses. All in all, the outlook for the pandemic remains particularly sensitive in South Africa, Turkey, Indonesia, India, Malaysia, Colombia and Brazil.[2]

Emerging-economy ties with the engines of the global expansion

The second area that will generate asymmetry in emerging economies' recovery is the very nature of the global expansion. Given that in 2021 and 2022 the three major global economic engines (China, the EU and the US) are going to be operating at very different speeds, emerging economies will also see very different levels of foreign demand depending on the extent to which they are linked to these buying markets, in terms of exports of both goods (generally commodities) and services (most frequently tourism).

Emerging economies: pandemic and real channels

	Pandemic channel			Export channel [4]			Tourism channel [5]	Growth		
	Infection rate [1]	Population coverage [2]	Vaccination rate [3]	China	US	EU		2020	2021 (f)	2022 (f)
Turkey	54.0	33	15.8	0.4	1.2	8.0	11.3	1.6	4.0	3.4
Russia	32.1	500	7.8	3.2	0.8	8.3	5.0	–3.1	3.0	2.2
South Africa	26.5	50	0.5	2.7	1.8	4.7	9.0	–7.0	3.5	1.9
Poland	72.5	165	20.5	0.5	1.3	25.9	4.5	–2.7	3.7	4.3
Hungary	79.1	98	38	1.0	1.9	45.6	8.0	–5.1	3.9	4.0
India	12.0	23	8.7	0.6	1.9	1.5	6.8	–7.0	10.6	7.3
Indonesia	6.0	61	4.3	2.5	1.6	1.1	5.7	–2.0	4.3	5.8
Malaysia	12.0	10	2.4	9.2	6.3	5.1	5.9	–5.6	6.5	6.0
Brazil	67.0	133	12.9	3.4	1.6	1.7	7.7	–4.1	3.0	2.5
Mexico	18.0	102	9.4	0.6	29.5	1.6	15.5	–8.2	3.5	2.2
Argentina	62.5	73	14	1.5	0.9	1.5	9.8	–10.0	5.8	2.5
Chile	60.5	92	41.8	8.0	3.4	2.2	3.3	–5.8	6.1	3.8
Colombia	53.9	61	5.6	1.4	3.8	1.2	2.0	–6.8	5.1	3.6

Notes: *1. Thousands of cases per million inhabitants, April 2021. 2. Percentage of the population that can be vaccinated according to the quantity of doses ordered, March 2021. 3. Percentage of the population that has received at least one dose, April 2021. 4. Exports of goods as a percentage of GDP, in US dollars, 2019 5. Contribution to GDP, 2019 or latest year available. (f) indicates forecast. The shaded cells indicate weakness or vulnerability in the area in question and, in the case of growth, lower GDP growth.*
Source: *CaixaBank Research, based on data from DOTS-IMF, WEO-IMF, national sources, the WHO and the World Travel & Tourism Council.*

1. This set of countries is made up of Turkey, Russia, South Africa, Poland, Hungary, India, Indonesia, Malaysia, Brazil, Mexico, Argentina, Chile and Colombia.
2. In the case of Brazil, whilst in nominal terms the quantity of vaccines ordered provides relatively good coverage of the population, it has idiosyncratic difficulties (of a logistical and institutional nature) which justify considering it a country with a fragile health outlook.

In this sphere, we consider countries that export a lot to China or the US, or those with a relatively lower exposure to tourism (or whose market of origin is Asia or North America), to be in a better position. As a result, the list of potential countries with the most worrying outlook includes Turkey, Russia, Poland and Hungary.

Macroeconomic imbalances, economic policy margin and vulnerability to adverse shocks

Finally, the third area that could generate asymmetry is that of macroeconomic imbalances, and in particular whether the «legacy» of the COVID-19 crisis includes an increase in these imbalances which leaves countries vulnerable to potential adverse shocks. As we have done previously, we will first identify the sensitivity of the reference group of emerging economies to an adverse shock, before looking at the asymmetries of each country in more detail.

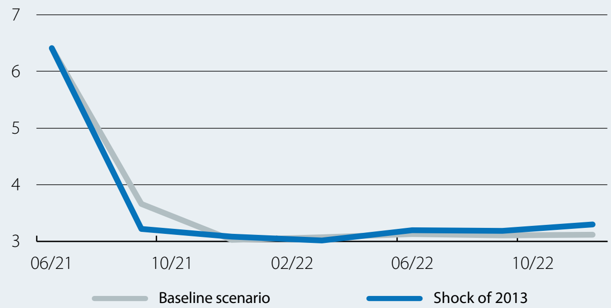
What potential shock currently poses the biggest risk to emerging economies? Given that the emerging-economy growth cycle of recent years has very clearly benefited from highly accommodative global financial conditions which have favoured significant capital inflows, a tightening of these conditions would represent a considerable shift that could potentially hinder the outlook for this group of economies. Such a situation could arise, for instance, if recovery in the US were much stronger than expected and there were a monetary policy adjustment that strengthened the dollar and led to a rise in the interest rate. This set of factors could reduce flows of capital into emerging economies and lead to a tightening of financial conditions.

To further refine the assessment of the impact that a tightening of financial conditions could have on emerging-economy growth, we analysed the impulse-response functions of an SVAR model in an episode marked by a notable increase in these conditions, namely the taper tantrum of 2013. This is an illustrative exercise, and it is indeed reasonable to expect that the type of revival we see after the pandemic could end up having characteristics that distance it from the historical precedents. However, as can be seen in the chart, the growth of the major emerging countries is highly sensitive to global financial conditions, especially in the short term, suggesting that it is important to consider whether there may be certain emerging countries in a more vulnerable situation than the rest.

In this context, in order to identify which countries are particularly vulnerable, we pose two more specific questions: i) how can measures of country risk be expected to evolve in the major emerging countries in 2021 and 2022, and ii) which emerging countries combine a relatively high level of imbalances with a smaller margin to absorb potential negative shocks?

Growth of the emerging economy in different scenarios of thightening of global financial conditions

Year-on-year change (%)



Note: *A 4th-order SVAR is estimated, which includes quarterly data for a representative set of emerging economies on GDP, foreign debt, public debt and inflation, as well as a global financial conditions index. The baseline scenario represents CaixaBank Research's current forecasts.*
Source: *CaixaBank Research.*

To answer the first question, we used historical data to estimate the credit score that would correspond to the main macroeconomic variables and we compared it with the current score.[3] This exercise indicates that there are two countries, namely Indonesia and Colombia, whose macroeconomic developments suggest greater pressures on sovereign solvency, and another larger group of countries whose situation suggests some cause for concern (South Africa, Russia, India, Brazil, Mexico, Chile and Malaysia).

With regard to the second question, when analysing the macroeconomic imbalances and the margin offered by economic policy to absorb shocks (see the second table), we identify a group of countries that are in the precarious position of showing higher imbalances. In particular, the central imbalance at present is that of indebtedness, which can take different forms. It can be mostly public or private, and more or less dependent on external financing (and, by extension, on global financial conditions). Moreover, in some cases, the problem is exacerbated by a more stressed liquidity situation. When a precarious position on these fronts is combined with less margin for manoeuvre, the names that appear are Turkey, South Africa, Indonesia and, albeit with a somewhat different balance of vulnerabilities, Malaysia, Brazil and Russia.[4]

3. We use a model estimated using ordinary least squares which allows a credit rating to be assigned to each country based on the evolution of a set of macroeconomic variables. More specifically, these variables are GDP per capita, public debt, inflation, GDP growth forecast for the next four quarters, volatility of GDP growth over the last three years, and a binary variable equal to 1 if there was a drop in the rating in the previous quarter.
4. Due to its particular circumstances, Hungary would probably be excluded from this group despite its vulnerabilities. The opposite is the case for Russia, as its high exposure to geopolitical risk intensifies a balance of vulnerabilities which, on the face of it, is somewhat less adverse than that of other fragile emerging countries.

Let us recap the above analysis. When we review the three areas that could lead to asymmetry in emerging countries' economic recovery, we identify three large groups of emerging countries. The first group is that of the «winners» – countries that benefit from a fairly good health outlook, have closer trade connections with the countries or regions that are going to grow the most, and have few imbalances. This category includes many emerging countries, especially those in Asia. The second group is that of the «losers», which, at least in relative terms, are enduring a more difficult health situation and have closer ties with less buoyant markets. This category would include Europe's emerging countries. But the third group, that of the «fragile losers», is the most concerning. This group comprises those emerging countries which are not only worse off in terms of the pandemic and looser connections to the pull of the most buoyant economies, but also show more pronounced macroeconomic imbalances. In this unfortunate situation are the countries already mentioned above (Turkey, South Africa, Indonesia, Colombia, Brazil, Russia and Malaysia).

In short, the emerging world, which entered the COVID-19 crisis relatively in sync, is going to experience a recovery at different speeds, which in turn will generate differentiated risks. While it may not be immediately obvious, there is a positive side to this development. Whereas practically all emerging economies appeared to be in a vulnerable position just a few months ago, the idiosyncratic situations have now changed.

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Emerging economies: vulnerabilities and margin for manoeuvre

	Latest Data	Change since Q2 2013 (pps)	Five worst countries
Internal and external imbalances			
Current account balance (% of GDP)	1.16	3.43	Colombia, Turkey, Brazil, Argentina and Peru
Foreign debt (% of GDP)	48.22	9.13	Chile, Hungary, Argentina, Malaysia and Poland
Foreign debt s/t (% of GDP)	34.63	2.77	Malaysia, Turkey, Argentina, Hungary and South Africa
Inflation (%)	5.86	0.60	Argentina, Turkey, India, Russia and Brazil
Credit-to-GDP gap (% vs. trend)	3.19	0.01	Chile, Malaysia, Saudi Arabia, Argentina and Brazil
Mitigating factors for an adverse shock			
Foreign currency to s/t foreign debt ratio	3.28	–0.91	Saudi Arabia, Russia, Brazil, India and Indonesia
Government balance (% of GDP)	–5.92	–4.30	Hungary, Russia, Argentina, South Africa and Indonesia
Public debt (% of GDP)	54.77	18.83	Argentina, Brazil, Hungary, South Africa and Malaysia
Intervention rate (%)	5.26	–0.05	Argentina, Turkey, Mexico, Russia and India

Note: *The data correspond to the simple average of the variables calculated for a sample of emerging countries, consisting of Turkey, Russia, South Africa, Poland, Hungary, Saudi Arabia, India, Indonesia, Malaysia, Brazil, Mexico, Peru, Colombia, Argentina and Chile.*
Source: *CaixaBank Research, based on data from Refinitiv, the BIS and the IMF.*