Perspectives
Emerging Markets

SwissLife
Asset Managers

Third quarter 2020

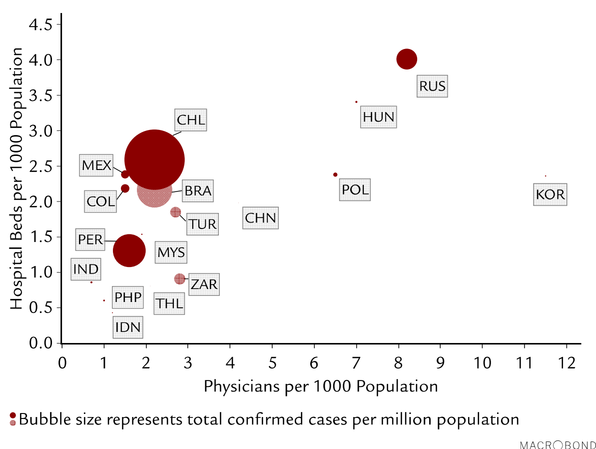
Key messages

- China's economic recovery takes up speed as the government steps up its stimulus measures
- Latin America falls into deep recession as it struggles to get the pandemic under control
- Limited room for monetary and fiscal support as interest rates approach zero and fiscal positions deteriorate

Number in focus

Thailand reported zero tourism receipts in April and May, since not a single foreign tourist spent vacation in the holiday paradise. The country has successfully reined in the spread of the pandemic as it implemented strict lockdown measures and banned inbound travel from early April on. This comes, however, at a high economic cost with tourism accounting for a fifth of economic output. As demand for international travel will likely remain subdued even after travel restrictions in Thailand are eased, the country will suffer a sharp economic loss.

Chart in focus



Latin America as well as South East Asia are ranking low on healthcare capacities, measured by the availability of physicians and hospital beds, while confirmed coronavirus cases per capita are highest in Latin America. Particularly in regions with strained healthcare conditions the fear factor is pronounced and although lockdown measures are being eased, consumers will remain reluctant to get back to their usual consumption patterns. Therefore, the path of economic recovery will likely be a bumpy one in countries that struggle to get the spread of the coronavirus under control.

Not a second, but a never-ending first wave

Other than in the developed world, emerging markets are not threatened by a second wave, but are struggling to control the never-ending first wave of coronavirus cases. Especially in Latin America new coronavirus cases are rapidly on the rise, with Brazil, Mexico, Chile, Colombia and Peru reporting exponential growth of new infections. GDP proxies for the month of April have shown that economies on the South American continent have been hit strongly and indicate a sharp economic contraction in the second quarter this year (see Chart 1). Peru's economy plunged the deepest, contracting by 40.5% in April, as the country implemented by far the strictest containment measures to control the pandemic. Although the country reacted swiftly by putting in place strict stay-at-home measures already in mid-March, Peru has been unsuccessful in reining in the spread of the virus. This demonstrates the difficulty that many emerging markets face, as lockdown measures that have proved successful in the developed world work less efficiently in countries where people live much closer together, where working at home is not an option, and where a substantial part of the population works in the informal sector and is forced to leave their homes to earn a salary. By comparison, Brazil's economic output dropped much less sharply, contracting by "only" 15% in April, as the containment policy has been much more loose, with President Bolsonaro still neglecting the severity of the health crisis. Nevertheless, given that Brazil is now facing one of the most rapid surges in new cases, it is likely that the recovery will also be quite tepid. First, the fear of getting infected as new coronavirus cases are steeply on the rise could derail the resumption of usual consumption patterns. Second, labor market conditions deteriorated sharply and are not expected to improve swiftly. And third, investments will likely be delayed, as besides the pandemic also the political environment causes uncertainty and dents investors' confidence.

Room for monetary policy easing getting tighter

Central banks in emerging countries have cut interest rates by more than 20 percentage points over the last four months. This includes countries such as Brazil and Mexico reducing rates by 200 basis points (bps), Turkey and South Africa slashed rates 250 bps, while India reduced its policy rate to 4% from 5.15% in March. As consumer prices across the emerging world are expected to dip further given the outlook for ongoing weak demand, central banks have some more room to provide even more support for their collapsing economies. This is especially true for high yielding countries, such as Brazil, Russia, Indonesia and Mexico. Others however have already cut rates to near zero and exhausted their scope of easing. As the room for further rate cuts is getting tighter, more and more emerging market central banks are refraining from further rate cuts. Meanwhile, quantitative easing has reached emerging markets too and a number of emerging market central banks have started to buy government bonds in order to keep borrowing costs for the state low. Indeed, for emerging countries with trustful monetary and fiscal authorities quantitative easing can be a useful tool to stimulate economies. However, for those where central bank independence is less well established or that heavily depend on borrowing in foreign currency (such as Turkey or Argentina), it creates a certain risk. Investors might lose faith in the central

Chart 1: The stronger the lockdown measures, the sharper the economic slump

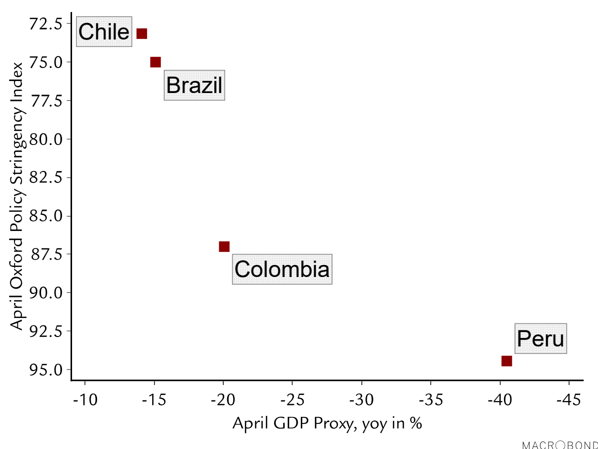
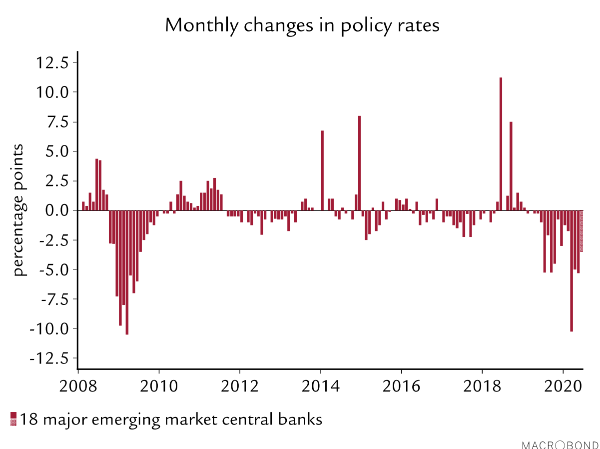


Chart 2: Room for more rate cuts gets limited as a lot has already been done



bank's ability to keep prices stable and might dumb the local currency, which then leads to depreciation followed by a spike in inflation.

South Africa: on the brink of a sovereign debt crisis

South Africa is hit particularly hard by the pandemic, as one of the world's strictest lockdown measures that have been implemented already in mid-March have been unable to get the spread of the virus under control. Despite the still fast rising infection rate, the country has seen itself forced to start easing lockdown measures to avoid an even sharper hit to its economy, which increases the risk of a prolonged health crisis. As the economy is expected to contract sharply, also the country's finances are deteriorating. South Africa's fiscal position has been in a bad shape already before the current crisis, as loss-making state-owned companies such as the electricity provider Eskom received bailout payments. Amid the current recession, the fiscal situation is expected to get much worse. The finance minister warned that the country is at the brink of a sovereign debt crisis, with public debt expected to surpass 80% of GDP and the fiscal deficit to widen to above 15% this year. Therefore, the country announced in an emergency budget update significant spending cuts, tax increases and a redirecting of spending to help finance a COVID stimulus package. The country's financial strains mean that capacity to support the economy is limited – another factor that will weigh on the country's recovery path. Besides South Africa a number of other emerging countries, such as Argentina, Brazil or India, entered the crisis with elevated debt levels, and fiscal constraints limit their stimulus capacity. This has also been reflected in emerging markets' relatively smaller stimulus packages compared to the developed world.

China: government stimulus to the rescue

Since China has been the first country to be affected by the coronavirus, it has also been the first one to significantly ease its lockdown measures and is now leading the economic recovery progress. In recent months, the government has stepped up its stimulus measures to support the economy. The country's broad credit measure accelerated to a growth rate of 12.5% in May (see Chart 4) supported, among others, by the issuance of special local government bonds that are mainly used for infrastructure projects. As a result, infrastructure investments have recovered rapidly and surpassed year-ago levels in May. Chinese consumers however seem more prudent. While sales of cars and furniture picked up above last year's levels, catering services remain in deep contraction. The resurgence of new coronavirus cases in Beijing has been a reminder that the risk of a second wave is still present. Although we do not believe that another round of nationwide lockdown measures will be implemented, it still means that existing social distancing measures will not be further eased any time soon, which could further protract the consumption recovery. Moreover, political risk remains elevated. China is rushing to implement a national security law in Hong Kong, which would allow it to increase its grip over Hong Kong citizens. This move will likely spark an upsurge in social protests in Hong Kong and deteriorate the already worsening US-China relations.

Chart 3: South Africa's fiscal situation to deteriorate sharply

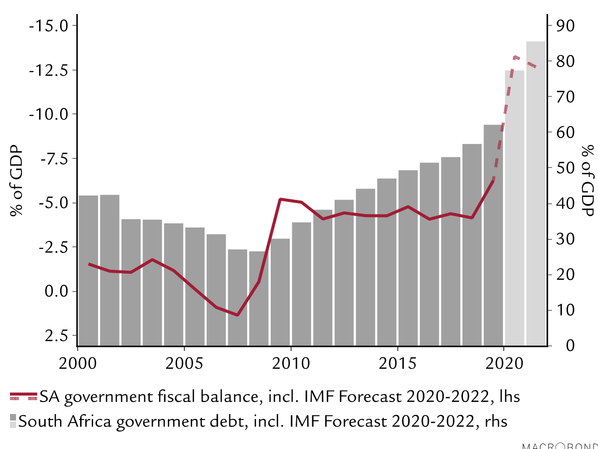
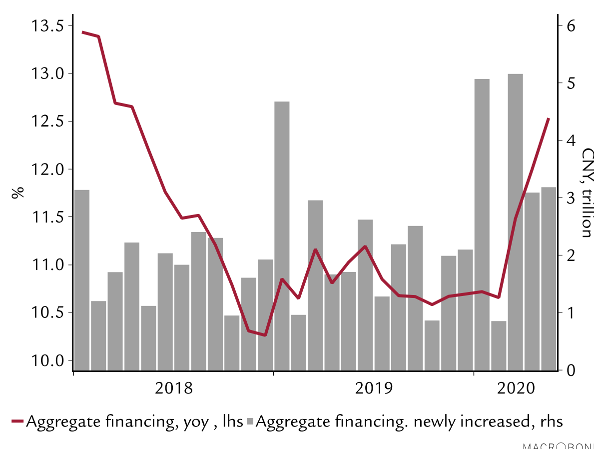


Chart 4: China's broad credit measure accelerates, as the government steps up its stimulus effort



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