EM MACRO OUTLOOK

By Chris Langner

After their worst year in several generations, the world's largest developing nations are poised for a strong recovery in 2021. As soon as vaccines are widely available, their economic recoveries could be very strong, given the record stimulus released in many of the large emerging economies this year.

Of course few of these nations are out of the woods yet. At the time of writing, Mexico, China and South Korea, just to name three countries, were dealing with a resurgence in virus cases. Some of the countries in the Northern Hemisphere had started to unveil new social-distancing measures threatening to curtail a nascent economic recovery.

With a few exceptions, central banks and governments have not spared any cash to fight the fallout of such lockdowns.

On a combined basis, the world's 10 largest developing economies have spent about 7% of their US$25.5 trillion in GDP, according to the International Monetary Fund on the effort.

The US$1.8 trillion or so in spending has more than compensated for the US$1.25 trillion in lost economic activity of these 10 countries recorded in the first two quarters of 2020.

The stimulus has not been equal across EM. Despite the rhetoric of its fiery left-wing President, Andres Manuel Lopez Obrador, Mexico has been the thriftiest of the 10 largest developed economies, having committed only 1.3% of its GDP to help the country recover as of December 2020.

Mexico was already reeling from a recession before the coronavirus crisis. The economy had contracted in the second quarter of 2019, was flat in the third quarter, and dropped again in the first quarter. None of that compares, however, to the 18.6% contraction in the second quarter of 2020. Growth was picking up thereafter, but the third quarter ended with a 8.6% year-on-year drop in activity.

The country is highly-connected to the US economy, however, and should benefit once the recovery picks up speed in the North. President-elect Joe Biden is also likely to be a lot friendlier to the left-wing government of Lopez Obrador than the Trump Administration was. Still, the President may have to open his purse.

Elsewhere in EM, Saudi Arabia committed only 2.8% of its GDP to help the recovery. In many ways, the country initially adopted an austerity program. It tripled its value added tax (VAT) to 15% in July, and that decision may have gone some way to neutralizing stimulus expenditure, although such initial thriftiness did come at a time of lower oil prices and global recession.

The country later rolled back some of the austerity, though, removing the VAT from property transactions, for instance. The nation's economy shrank 7% and unemployment rose to 15.4% in the second quarter.

Saudi Arabia's economy contracted 4.2% in the third quarter of 2020, according to a flash estimate from the Kingdom's statistics authority. The IMF's latest forecast was for Saudi GDP to end 2020 5.4% lower than the previous year.

There are green shoots in the Kingdom, though. The exclusion of property transactions from VAT, along with record low interest rates, had prompted the total amount of real estate loans to increase by 73% in the first 10 months of 2020. This could help stimulate non-oil GDP growth, and perhaps even support a return to rising real estate prices.

Near the other end of the spectrum stands Turkey, which used every possible tool to fight the recession. The country spent 12.8% of GDP on total monetary and fiscal stimulus, and a government-prompted lending campaign saw total loans in the banking system increase 26.4% (or by 764.7 billion Turkish lira) between the end of March and the last day of October. The country reportedly grew 15.6% in the third quarter of 2020, bringing its GDP back above pre-pandemic levels.

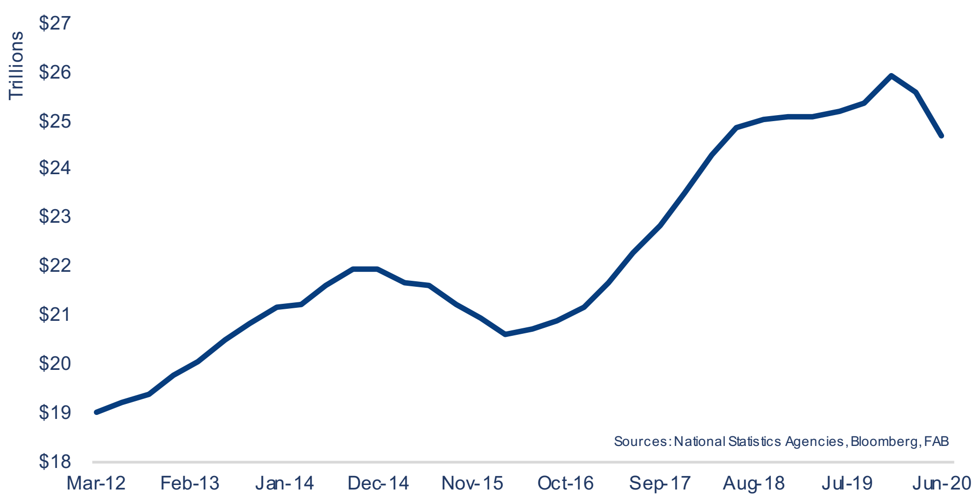
That, however, was done at the expense of stability. Inflation averaged 11.7% year-on-year in the period, one of the highest among major developing economies, with the exception of Argentina.

By mid-November, the country had also burned through more than US$17.9 billion in officially-stated foreign exchange reserves, or nearly a third of the total available at the end of March, as it tried to slow down the devaluation of its currency. Yet the lira still fell 12% in the same period. In fact, if adjusted for inflation and the fall in the currency, the country's GDP growth remained negative in the third quarter, despite the positive number reported in local currency.

India, the stimulus champion among large emerging markets, has seen some of the challenges of Turkey, but not to the same extent. Inflation spiked to 7.6% in October, from 4.6% at the same time in 2019. This is above the Reserve Bank of India's target of 6%, and has hampered the central bank's ability to cut the benchmark rate below the record low of 4% established in May.

The rupee was also 3.3% weaker for the year by the first week of December, but that pales in comparison to the nearly 24% loss recorded by the Turkish lira.

GDP of World's 10 Biggest Emerging Markets



Instead of the currency, the Indian economy seems to have borne the brunt of strict lockdowns. The economy contracted by a record 23.9% year-on-year in the second quarter, and by another 7.5% in the third quarter. India is on track for its worst recession in the modern era, and the government does not expect growth to pick up much beyond 8.5% in the next fiscal year, beginning 1 April, 2021.

Despite that, the country is on the verge of breaching the US$2,000 GDP-per-capita level, a threshold associated with accelerated growth and higher consumption. In fact, the Indian recovery and economic path could be a driver for growth in the rest of the developing world.

India is already the biggest consumer of palm oil and the third biggest importer of oil, globally. Crude imports have grown at a compound rate of 3.3% over the past decade, slower than the average compound GDP growth of 5.5%, partly because of the low GDP per capita. The jump into the 'middle economy' grouping will also likely stimulate the demand for commodities.

That, together with China's stimulus drive, could help broadly drive emerging market economies. Beijing has opened its purse sufficiently to restart the Chinese economy, and this has pushed the prices of some commodities, such as copper, much higher.

The total stimulus pledge for 2020 in China amounted to about 4.7% of GDP, with much of it focused on local provincial spending. However, the latest Chinese national plenum outlined a plan to spend roughly 500 billion yuan (US$76.5 billion) in infrastructure over the next five years to help sustainably boost economic growth. The amounts are similar to what China spent following the 2008 recession. In just over a decade since then, China's economy has grown an impressive 88.6%.

In conclusion, China and India will probably get lasting boosts from stimulus spending in the coming years, and that could buoy the broader EM universe. Although many of their currencies have been weak in recent years, this has made the largest developing economies more competitive. Lastly, a long period of relatively low rates in the US and Europe, as well as a potentially weaker dollar, have set the stage for higher growth in EM in coming years.