EMERGING MARKETS DEBT

Inflation Concerns Eclipse COVID-19 at Washington IMF Meetings

By: Emerging Markets Team | November 11, 2021

Boston - At the October meeting of the International Monetary Fund (IMF) in Washington, the concerns of the participants reflected a significant shift from their last gathering in April —worries about inflation nudged aside COVID-19 as their main focus.

To further emphasize just how prevalent of a macro topic inflation was during the meetings, the Eaton Vance emerging markets (EM) team observed that during EMEA (Europe, Middle East, Africa) regional meetings, "inflation" was mentioned on average six more times than "COVID" was. The EM team was in virtual attendance and offers these highlights.

The headline economic news reflected steady global growth —world GDP was revised down marginally by 0.1 point to 5.9% for 2021, while the 2022 growth forecast stayed at 4.9%. In developed economies, the main drag on growth stemmed from supply chain disruptions, while developing countries were held back more by worsening pandemic dynamics in the form of slower vaccination rates and less policy support. In both developed and developing countries, the increase in commodity prices partially offset the detractors, resulting in steady growth.

On the inflation front, a divergence in outlook between IMF officials and country policymakers became apparent. IMF officials still lean toward the belief that the inflation surge is transitory, while a growing number of policymakers are taking the view that supply shocks may last for a while. There was a broad consensus on the importance of monitoring inflation expectations — if these strengthen, the price surge could be "stickier."

The buzzword of the meetings centered on the prospect of "regime changes" in China and the U.S. Notably, China's policy shifts to tighten control over private enterprises ahead of next year's elections have already started to take effect. Meanwhile, U.S. midterm elections in 2022 are on the horizon.

Following are regional highlights:

Latin America
Most of the region experienced strong growth, to a large degree spurred by trade ties with the U.S. and its ongoing recovery. However, inflation and supply chain disruption have hindered progress, and central banks have been slow to tighten, hesitating to move past the transitory view.

The IMF has been active in the region, willing to engage with anyone seeking assistance. In the wake of the pandemic, it has stopped insisting on fiscal consolidation as a prerequisite, as it has in prior years. Many countries, like Argentina, are seeking new IMF programs or extensions. Negotiations with Argentina center on the country addressing its torrid inflation — at around 50% to 60% — through changes to its foreign exchange policy.

Asia
In contrast to Latin America, most Asian countries don't have the appetite for IMF programs even though the Fund is ready to engage. Policymakers are bullish, with a strong focus on the supply side.

However, the IMF does have its hands full with a few problem areas in the region, like Sri Lanka, whose sovereign debt is in severe distress and where the market is pricing in a restructuring. The country is now resisting a deal with the IMF and will likely hold out until its economic crisis worsens. The IMF and Pakistan also are trying to salvage a deal, which is under the shadow of the country's recent confrontational geopolitical style, including anti-U.S. comments from its prime minister.

China is in a category by itself, with its own strategic vision, in which the IMF does not play much of a role. The country is seeking to establish its own international financial architecture, not looking to fit into the current global order. Its stance has made it less relevant at IMF meetings.

Central and Eastern Europe
Growth in the region is expected to increase rapidly in 2021 and 2022, with mostly upward revisions to forecasts. Inflation is accelerating as well, but central banks are adopting orthodox monetary policies to combat inflation.

For example, Russia and the Czech Republic are aggressively tightening, as are Hungary and Romania while also trying to balance the risks to recovery and growth. Romania is notable for being extremely slow in its vaccination progress. As large exporters of cars and machinery, the Czech Republic, Poland and Hungary have been particularly hit by supply chain issues.

Middle East and Northern Africa
The pace of recovery in the region has been uneven, with Turkey and Iraq projected to be the best performers for the year.

Iraq has benefited from the uptick in oil prices, while Turkey got a boost from healthy tourism and strong demand for manufacturing exports, helped by depreciation of the Turkish lira. On the negative side, Turkey has had the largest revision for inflation in the region, and the currency depreciation was a factor in that. President Erdogan's contrarian view of monetary policy has played out in multiple rate cuts this year, with the most recent cut at the end of October sending the lira to new all-time lows.

Bottom line: As emerging markets grapple with the changing dynamics of the pandemic and inflation, there is a wide dispersion in the outlooks for EM countries. The need for an investment strategy backed by in-depth, proprietary fundamental research has never been more important — an approach the EM team has practiced for decades.

Emerging Markets Team
Eaton Vance Management

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