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Slowing Global Recovery, Geopolitical Concerns Top Worries at IMF Fall Conference

By: *Emerging Markets Debt* | November 15, 2022

Boston - The October fall meeting of the IMF in Washington, D.C. revealed a bleaker global economic outlook than in April, underscoring the protracted strains of global inflation and the Russia-Ukraine War. Multi-decades high inflation, elevated debt, rising food and energy security risks, persisting supply-chain and trade disruptions, tightening financial conditions, and growing capital flow and exchange rate volatility, are posing increased fragmentation risks.

Meanwhile, positive prospects exist across regions, such as Inflation potentially stabilizing in some Latin American countries, and IMF staff-level agreements and financing developments in several countries including Sri Lanka, Tunisia, Egypt, and Mozambique.

The strength of the dollar, at its mightiest since at least the early 2000s, is a significant obstacle for many emerging markets. The spike appears to be fueled mostly by fundamental forces such as tightening U.S. monetary policy and the energy crisis.

The following are regional observations from the emerging markets debt team:

Macro

Everyone expressed a bearish tone for growth, including investors, policy makers, and IMF representatives.

The U.S. dollar is strong but not overvalued, reflecting changes in its fundamentals.

Central banks around the globe are likely to remain hawkish, amid widespread concern of rising inflation.

China, a major lender to EM countries, was absent at these meetings as they coincide with 20th National Congress of the Communist Party of China (CPC). Moreover, there is concern that China is disengaging.

The IMF is eager for "wins" and is willing to be more flexible, a stance that was positively perceived.

G10 Countries

Heavy discussion about the United Kingdom during the week was sparked by recent market volatility amid concerns over economic growth and monetary policy tightening from central banks.

Monetary Policy

The real economy in the U.S. is still pretty hot, even as small- and medium-size businesses are struggling with elevated cost pressures.

Many central banks seem untroubled about the stronger dollar. The question often arose in investor meetings, and central banks frequently noted that trade-weighted exchange rate had depreciated less than the U.S. dollar.

Fiscal Policy

The dollar bloc is consolidating significantly. Inflation is the main worry in these countries. The governments do not want to be perceived as the cause behind higher inflation.

Some European countries are consolidating, while others are moving in the wrong direction. The European Union commission is concerned about broad-based fiscal packages which could aggravate the inflation problem.

Political

There won't be any new Euro-area issuance in the near-future. The EU commission wants to prioritize using leftover COVID-19 funds.

Energy

There's disagreement within Europe over energy and economic policy. Prior to Putin's Feb. 24 invasion of Ukraine, the EU obtained nearly 40% of its natural gas from Russia. Now, less than 10% is coming from Russia.

Asia

Sri Lanka reached a staff-level agreement with the IMF for a \$2.9 billion loan. Board approval by the end of the year is unlikely, but approval is more likely in Q1 2023.

Latin America

More Latin American central banks are ceasing prolonged cycles of rate hikes or hinting that they may soon as inflation is starting to turn. These nations are very aware of the U.S. dollar and how it's behaving.

Brazil held policy rates at its most recent monetary policy meetings. Brazil straddles a narrow path between over-tightening and not tightening enough. Brazil's spending cap may be abandoned/reformulated even after Luiz Inácio Lula da Silva, known as Lula, defeated Brazil's far-right president, Jair Bolsonaro. However, fiscal deterioration in 2023 appears limited. Bolsonaro was more eager to privatize public companies.

There's a positive take on Honduras despite the new government initially financing the budget with reserves. The new government stepped into office in February with sharp rhetoric and blunt instruments for quickly achieving the country's political and economic objectives. An IMF program could come online soon.

Political uncertainty swirls in Peru and could hit the economy, but the country's fundamentals and policies are solid and boast a strong track record. The central bank governor doesn't think there is political room for another pension fund withdrawal.

EMEA

A few countries in Central and Eastern Europe and central Asia have been benefitting from the flow of Russian people and money fleeing the Russia-Ukraine War, a topic that arose after Putin announced Russia's first mobilization since World War II in September.

IMF projections don't include the latest flow of people and money and don't make an assumption on how long the war is going to last. Policymakers are treating these flows as temporary.

Armenian authorities and IMF staff reached a staff-level agreement on a three-year precautionary arrangement. Armenia's central bank expects to achieve growth of about 13 % in 2022, bolstered by large inflows of external income, capital, and labor into the country.

Georgia is forecast to grow 7% in 2022. The outlook is fueled by a , surge in inbound money transfers, and immigration.

IMF staff and the Tunisian authorities have reached a staff-level agreement to support a loan in an effort to restore macroeconomic stability, strengthen social safety nets and tax equity, and expedite reforms that foster inclusive growth and sustainable job creation.

IMF staff and Egyptian authorities have reached a staff-level agreement to bolster Egypt's macroeconomic stability and debt sustainability with a loan of \$3 billion. Egypt was hit hard by inflation and skyrocketing wheat prices because of the Russia-Ukraine War.

Buoyed by higher hydrocarbon prices, the GCC region is expected to report strong twin surpluses in 2022 and continue over the medium term.

Saudi Arabia is on course to be one of the world's fastest-growing economies this year, boosted by sweeping pro-business reforms and a spike in oil.

Oman reduced debt-to-GDP from 63% to about 45% year-over-year displaying prudent fiscal policy.

Africa

Financing needs persist across the continent. A common question in the meetings was about country's eligibility for IMF's Resilience and Sustainability Trust (RST). It's particularly interesting as it does not count for "Exceptional Access" in terms of IMF lending limits and allows a country to borrow up to 150% of quota. Rwanda became recently the first country to reach a staff-level agreement for this facility in Africa.

Zambia, which attracted significant interest from investors during the meetings, defined its perimeter of debt relief as most of its external debt, including bilateral loans from official creditors, Eurobonds, and other commercial loans, but excluding non-resident holdings of domestic debt. In its proposal to creditors, the country seeks a 49% debt relief in net present value terms, but they are willing to negotiate and optimistically see a deal with creditors happening by Q1 2023.

Mozambique's debt is sustainable with or without ongoing liquefied natural gas (LNG) projects. If projects materialize, Mozambique would produce one-third of Qatar LNG output. Security has improved, with regional forces stationed in the LNG project area.

Chad is set to become the first country to reach a debt restructuring agreement under the Common Framework mechanism created by the G20.

Bottom line: The global economy faces mounting threats as negative impacts of global inflation and the Russia-Ukraine War persist. However, valuations across EMD are compelling and seem to be pricing in these risks more aggressively than other asset classes. Additionally, there are pockets of hope with funding agreements and regional growth spikes across continents.

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