News release

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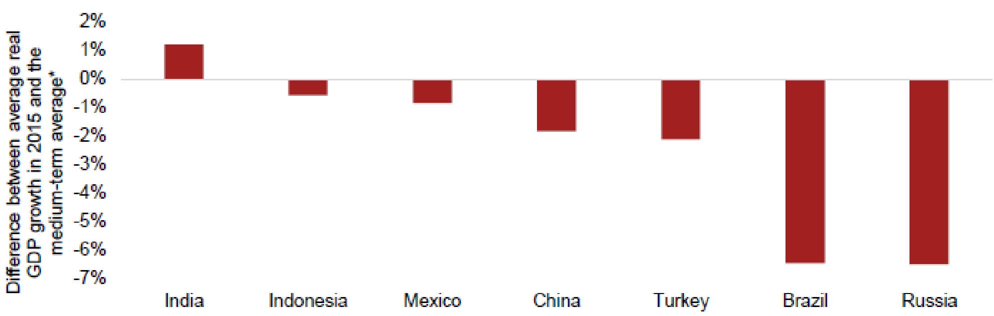
How concerned do you need to be about emerging markets?

Strong dollar, low commodity prices and slower-growing China pose threats to some large emerging markets, warn PwC economists

Once again the global economy faces a dangerous cocktail of risks including slowing growth in China, a strong dollar, and low commodity prices.

But this time, the emerging market economies look the most vulnerable, while advanced economies are still struggling to escape the low economic growth environment almost a decade on from the global financial crisis, say PwC economists.

Fig 1: Emerging economy growth is slowing down – of the E7, only India enjoyed faster growth in 2015 compared to its medium-term average



*Medium-term average defined as 2010-2014, growth measured on a quarterly basis in year-on-year terms
Note: Due to data availability, the growth data for India and Indonesia starts from 2012 Q2 and Q1 2011 respectively
Sources: PwC analysis, Datastrean, National Statistical Agencies

Figure 1 above shows that economic growth has slowed in six of the seven largest emerging markets (the 'E7') compared to previous trend growth rates. Only **India** grew faster in 2015 than its medium-term average rate. **Brazil** and **Russia** are contracting.

So what has driven this deterioration in their economic outlook?

China's economy is slowing and commodity price projections are falling:
After growing at above 8% from 2000 to 2011, the Chinese economy slowed down to just under 7% growth last year and PwC economists expect this to decline further to around 6% in 2017.

"Even though some of this trend was expected, the slowdown has been faster than most commentators anticipated a couple of years ago," says Richard Boxshall, Senior Economist, PwC. "Risks remain weighted to the downside even though, according to our latest CEO Survey, Chinese CEOs remain more confident than their US counterparts on their own companies' future revenue growth."

The main, direct effect of China's slowdown in growth is being felt through trade. **Brazil** and **Indonesia** remain the most exposed to China here. For example, the direct impact of a 10% decrease in Indonesia's goods exports to China would be to lower its GDP by around 0.2 percentage points. The slowdown in China is also having an indirect impact on other emerging economies through lower commodity prices as Chinese demand falls. **Russia**, **Indonesia**, **Brazil** and, to a lesser extent, **Mexico** are all net primary commodity exporters and as such have suffered from this effect.

Foreign currency debt is a source of weakness for some emerging economies:
The strength of the US dollar coupled with the scale of dollar denominated debt continues to be an area of concern for some emerging market businesses, households (and to a lesser extent governments), as shown in Figure 2 below. PwC's economists conclude that:

- **Brazil** has joined **Turkey** in being classed as 'highly vulnerable' as far as its foreign debt position is concerned

- **China's** external debt continues to remain relatively insulated from the effects of a strong dollar because foreign-currency denominated debt makes up a small proportion of its overall economy, although some individual Chinese enterprises are more exposed here.

- **Indonesia**, **Mexico**, **Russia** and **India** which are four of the world's seven largest emerging economies, fall somewhere in the middle and so present a mixed picture in terms of their exposure to the dollar –though the first three of these have other exposures here relating to commodity prices and/or reliance on exports to China as noted above. India seems more secure and currently looks to be the strongest of the large emerging economies.

Fig 2: For most of the E7, the strong dollar still poses a significant risk

Countries	Vulnerability	Foreign currency external debt (% of GDP)	Jun 14 – Jan 16 currency movement (%)	Current account balance (% of GDP)
Turkey	High	53%	-29.5%	-4.5%
Malaysia	High	61%*	-25.9%	2.2%
Chile	High	59%	-23.4%	-0.7%
Colombia	High	38%	-42.5%	-6.2%
Brazil	High	37%*	-44.7%	-4.0%
South Africa	High	21%	-34.8%	-4.3%
Peru	Medium	36%	-18.7%	-3.7%
Indonesia	Medium	35%*	-14.4%	-2.2%
Argentina	Medium	25%	-40.2%	-1.8%
Mexico	Medium	25%	-28.1%	-2.4%
Russia	Medium	36%	-55.8%	5.0%
Thailand	Medium	27%	-10.1%	6.2%
India	Medium	16%	-11.2%	-1.4%
Philippines	Low	25%	-7.7%	5.0%
China	Low	13%*	-6.3%	3.1%

* Number shows total external debt as a % of GDP
Sources: PwC analysis, World Bank, IMF, Datastream

Policymakers do have some space to provide support to the economy:

PwC's analysis shows that:

- Some of the E7 have fiscal space as they have relatively small budget deficits and a low level of relative debt. Even in **Mexico** and **Russia**, where the deficit is over the 3% of GDP threshold, public debt is below 60% of GDP. Policymakers could use fiscal stimulus to boost demand if economic growth continues to slow

- Things are less clear cut with monetary policy as inflation remains high in **Brazil**, **Russia** and **Turkey** for example, but is below target in **China**. However, with interest rates in the emerging economies not as low as in the advanced economies –the lowest policy rate in the E7 is in **Mexico** at 3.25% –policymakers do have the room to provide monetary stimulus to the economy if they so decide.

PwC's Richard Boxshall concludes: "Overall, the short term economic outlook for the emerging economies has deteriorated even though many retain considerable long-term potential. We therefore recommend that our clients stress test their business plans against a lower-than baseline growth scenario for major emerging markets over the next few years."

For more details, please see this month's Global Economy Watch at www.pwc.com/gew.

Notes:

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