Economic Views – EM Asia & LatAm Growth under COVID-19

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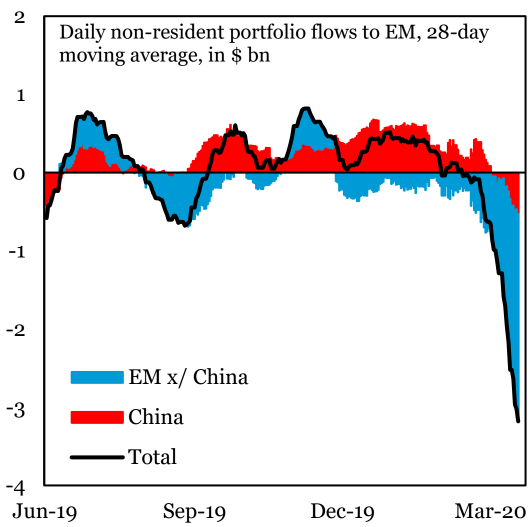
- We see the global economy in recession this year, …
- as low oil and financial stress add to the Covid shock.
- The shock hits EM after years of already subpar growth.
- We project recessions everywhere in Latin America, …
- and the lowest EM Asia growth since the 1997-98 crisis.

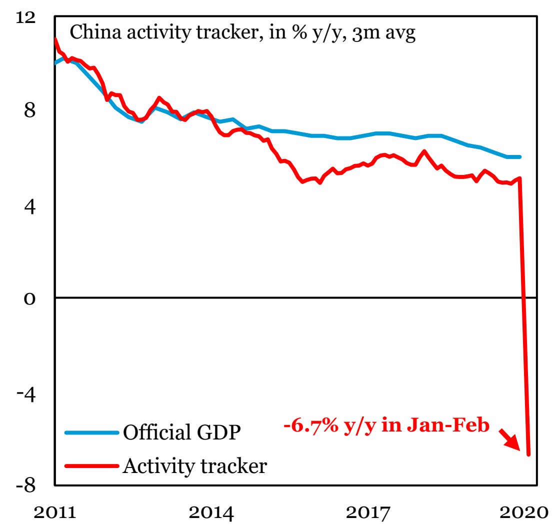
We downgraded our global growth forecast in the early stages of the COVID-19 outbreak but initially expected a relatively swift recovery before the summer. Since then, shutdowns to contain the virus, a sudden stop in global capital markets, and outsized outflows from EM have changed the outlook fundamentally (Exhibit 1). Given these developments, yesterday we cut our global growth forecast, which now sees global activity falling 1.5% in 2020. We downgraded US and Euro Area growth to -2.8% and -4.7%. Downside risk to our forecast remains significant, as we work under the assumption of normalization of daily life and positive growth in H2. This note is the first of a series of publications this week on the regional details of our updated EM forecast. COVID-19 and market stress hit the emerging world in the context of persistently low growth and weak investment, which we have characterized as EM secular stagnation. We expect growth in EM Asia and Latin America to suffer heavily from the combination of low commodity prices, financial dislocation, and recession in key trading partners. As in DMs, we project a recovery in the second half of 2020, but see some long-lasting output losses due to the impact of tight financial conditions. While we do not expect a recession in EM Asia, we are forecasting the lowest growth rate since the Asian financial crisis of 1997-98, in part due to a major slowdown in China. Latin America, a region that has struggled to grow relative to others, will be in deep recession in 2020.

Exhibit 1. Sudden stop in capital flows.



Source: Haver, IIF

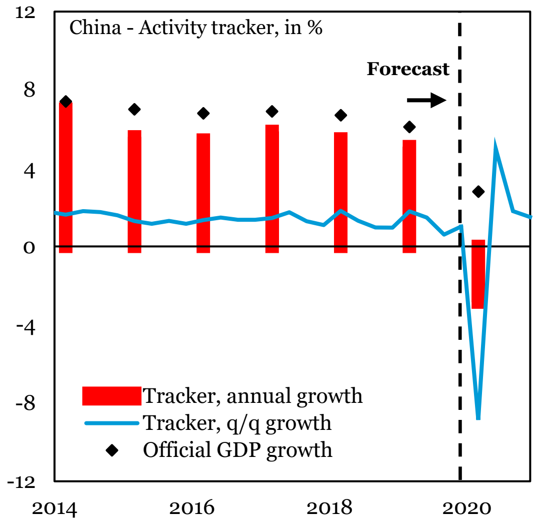
Exhibit 2. Sharp slowdown in China, …



Source: Haver, IIF

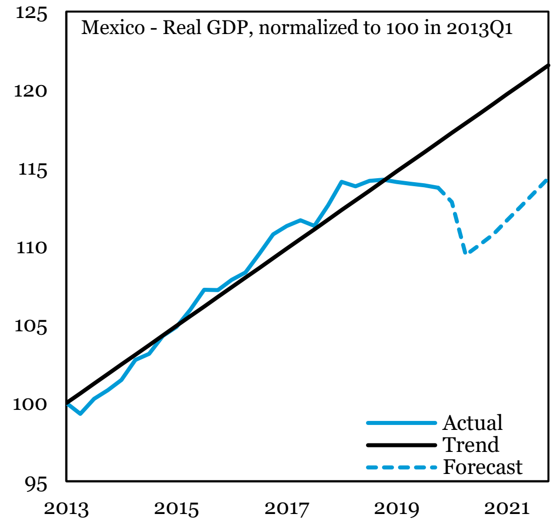
China's high-frequency data for January-February showed activity tanking, highlighting the risk that other countries implementing major virus containment measures experience sharp contractions. As always, we read China high-frequency data through the lens of our activity tracker. It is based on the structural relationship between monthly data and official GDP up until 2015, when the latter becomes oddly stable. We think the activity tracker picked up the 2015-16 slowdown and the impact of deleveraging and tariffs in 2018-19 in a timelier fashion than official GDP. Data for the first two months of the year point to an extraordinarily sharp contraction in underlying economic activity in 2020Q1 (Exhibit 2). Even under a strong rebound in the second quarter and beyond, underlying activity in China will be very weak for the year (Exhibit 3). As in past stress episodes, we expect official GDP growth to show less variability than underlying activity and pin our 2020 forecast at 2.8%. We expect the spillovers from low growth in China to the rest of EM to be strong, especially for commodity exporters. Elsewhere in EM Asia, we expected a gradual recovery in growth before the COVID-19 outbreak but now revise our forecast down from 4.5% to 1.6%. Countries like Indonesia enter the shock with some growth momentum but others like Thailand were already slowing in 2019. Global turmoil will be especially challenging for India. A domestic financial shock led to a growth slump last year that adverse global conditions and virus containment measures will aggravate. We project growth to fall to 2.6% in FY21, from an already underwhelming 5.0% in FY20.

Exhibit 3. … followed by a rebound in Q2.



Source: Haver, IIF

Exhibit 4. Mexico struggles with low growth.



Source: Haver, IIF

Latin America has underperformed EM peers for a long time, partly due to poor productivity growth. With many commodity exporters in the region and generally limited fiscal space, we expect the impact of the COVID-19 shock to be sharp even if the virus does not spread widely in the region. We downgrade our regional forecast from +1.1% to -2.7%, a contraction larger than in the global financial crisis. We project recessions in all the countries we cover. In cases like Mexico, the shock hits under poor starting conditions after years of disappointing growth. Even under a strong recovery in 2021, output will remain well below trend (Exhibit 4). Brazil is in a similar situation, as we think there was already a lot of spare capacity in the economy in 2019. In Argentina, we project a third year of deeply negative growth, which will complicate any normalization of economic and financial conditions (Exhibit 5).

Exhibit 5: IIF Global Growth Forecasts

Real GDP Growth, change y/y (%)	**2016**	**2017**	**2018**	**2019**	**2020 Oct**	**2020 Mar**
World	**2.7**	**3.2**	**3.1**	**2.6**	**2.6**	**-1.5**
Mature Markets	**1.6**	**2.2**	**2.2**	**1.6**	**1.5**	**-3.3**
Emerging Markets	**4.3**	**4.7**	**4.5**	**3.8**	**4.2**	**1.1**
EM x/China	**3.0**	**3.4**	**3.2**	**2.3**	**3.1**	**0.0**
Latin America	**-1.2**	**1.3**	**0.7**	**-0.1**	**1.2**	**-2.7**
Argentina	-2.1	2.7	-2.5	-2.4	-1.6	-3.1
Brazil	-3.3	1.3	1.3	1.1	2.0	-1.8
Chile	1.7	1.3	4.0	1.2	3.2	-2.3
Colombia	2.1	1.4	2.7	3.3	3.3	-0.4
Mexico	2.9	2.1	2.0	-0.1	1.2	-2.8
Asia/Pacific	**6.5**	**6.3**	**6.1**	**5.5**	**5.5**	**2.4**
China	6.7	6.8	6.6	6.1	5.8	2.8
India	9.0	6.6	6.8	5.3	6.7	2.9
Indonesia	5.0	5.1	5.2	5.0	5.1	2.7
Malaysia	4.2	5.9	4.7	4.5	4.2	1.1
Philippines	6.9	6.7	6.2	5.9	6.2	2.6
South Korea	2.9	3.1	2.7	2.0	2.3	-0.8
Thailand	3.4	4.0	4.1	2.4	3.3	-1.6