Economic Views – EM Balance of Payments Nowcasts

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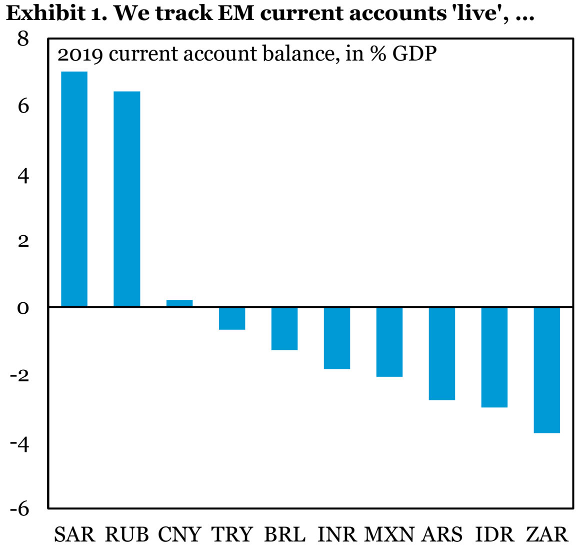
- We assess EM current accounts systematically, ...
- through the lens of our BoP Nowcast framework.
- Deficits in Turkey and Argentina will shrink, ...
- but Turkey's financing needs will remain high.
- South Africa will have the largest deficit in EM.
- Reserve levels are comfortable in most countries, ...
- but buffers are limited in Turkey and South Africa.

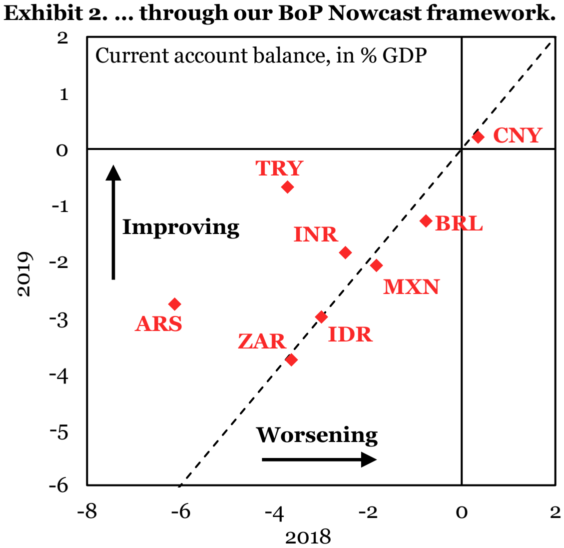
In a series of recent publications, we scanned the EM universe through the lens of two of our analytical frameworks — FX fair value and investor positioning. We found that countries like South Africa and Indonesia remain overvalued in FX terms and look over-positioned. Heavy positioning is a broader EM phenomenon that we think explains why EM currencies have been generally weak, despite a dovish Fed and easing US-China trade tensions. We complement these work streams by using our BoP Nowcasts to analyze EM current accounts in 2019. Unlike a year ago, we do not see gaping current account deficits among major EMs, as Turkey and Argentina experienced large external adjustments. However, vulnerability remains particularly high in Turkey due to still large external amortization. We project current account deficits to remain fairly large in South Africa and Indonesia. India's deficit is set to narrow, mitigating vulnerability. Most EMs have ample reserves relative to gross external financing needs, but buffers remain limited in countries such as South Africa.

Exhibit 1. We track EM current accounts 'live', ...



Source: Haver, IIF

Exhibit 2. ... through our BoP Nowcast framework.



Source: Haver, IIF

Our ***BoP Nowcasts*** provide "live" tracking of the complete balance of payments for systemic EMs, with special emphasis on the role of commodity prices (Exhibits 1 and 2). A slight decline in average oil prices in 2019, is one of the factors that will help India's current account deficit narrow. The current account deficits of Turkey and Argentina will improve drastically in 2019 due to import compression. South Africa's and Indonesia's current accounts will remain roughly unchanged from 2018, making them the widest deficits among systemic EMs. We complement the current account nowcasts with external amortization projections by sector to have a full picture of external financing needs relative to reserve buffers (Exhibits 3 and 4). Buffers are adequate or even ample in most EMs but remain limited in South Africa and Turkey. In the latter, high private sector external debt will keep financing needs and vulnerability high, despite a large swing in the current account (Exhibit 5). On this metric, Argentina looks better than Turkey because the IMF program topped up international reserves.

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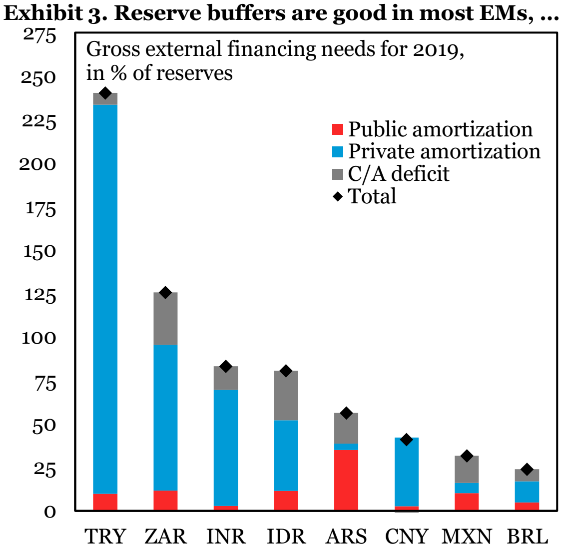
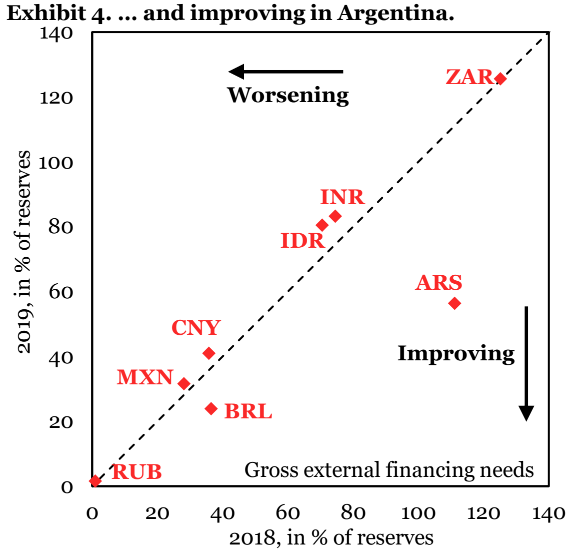
Exhibit 3. Reserve buffers are good in most EMs, …



Source: Haver, IIF

Exhibit 4. … and improving in Argentina.

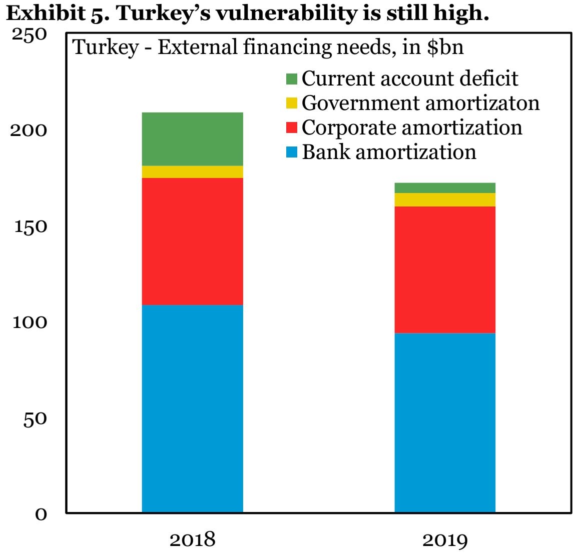


Source: Haver, IIF

South Africa's high external debt poses vulnerability on two fronts. First, it weighs on the current account deficit, more than offsetting a benign trade balance (Exhibit 6). Second, it is at the core of heavy positioning and high external amortization relative to reserves. This particular risk is partly mitigated by large external assets in the private sector, which could serve as a source of inflows in the event of a large depreciation due to regulatory caps on locals' foreign holdings. However, the ongoing fiscal deficit issue and a potential downgrade to junk status could further worsen external vulnerability. We project Indonesia's current account deficit to remain fairly wide, but significantly below South Africa's. Strong imports were behind the widening deficit in 2018, but we expect the recent slowdown in import growth to persist, keeping the current account roughly unchanged in 2019.

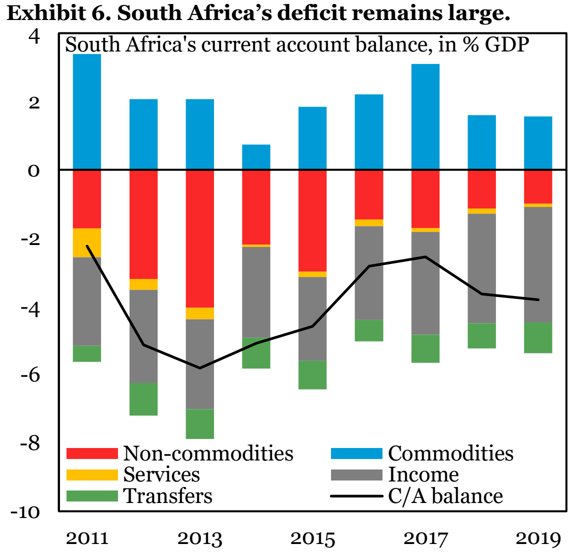
Our FX fair value, investor positioning, and BoP Nowcast frameworks allow us to scan EM for vulnerabilities systematically and helped us flag risk in Turkey and Argentina early on last year. According to our BoP Nowcasts, import compression will shrink Turkey's current account deficit, but high amortization will keep vulnerability elevated. We identify South Africa as the EM facing a combination of a somewhat overvalued currency, heavy positioning, and a sizeable current account deficit. Indonesia faces a similar set of issues, although vulnerability is lower than in South Africa. Elsewhere in EM, we project moderate current account deficits or surpluses, but heavy positioning in markets like Mexico remains a source of vulnerability (Exhibit 7).

Exhibit 5. Turkey's vulnerability is still high.



Source: Haver, IIF

Exhibit 6. South Africa's deficit remains large.



Source: Haver, IIF

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Exhibit 7. BoP Nowcasts

C/A balance, in $ bn	2017	2018	2019f
Argentina	-31.6	-28.0	-11.6
Commodities	-3.2	-2.3	-1.4
Non-commodities	-2.2	0.3	12.8
Brazil	-7.2	-14.5	-24.7
Commodities	47.2	61.0	65.1
Non-commodities	16.9	-7.4	-20.9
China	195.1	49.1	31.7
Commodities	-234.9	-312.1	-320.1
Non-commodities	710.8	707.2	714.9
India	-39.0	-64.9	-50.8
Commodities	-98.4	-123.7	-126.9
Non-commodities	-49.8	-63.2	-53.0
Indonesia	-16.2	-31.1	-32.6
Commodities	15.7	16.8	17.9
Non-commodities	3.1	-17.2	-22.8
Mexico	-19.4	-22.2	-26.0
Commodities	-18.3	-23.2	-28.7
Non-commodities	7.3	9.3	10.8
Russia	33.2	113.8	103.4
Commodities	189.2	252.9	237.1
Non-commodities	-73.8	-58.7	-68.1
Saudi Arabia	10.5	72.3	57.0
Commodities	170.2	231.6	226.9
Non-commodities	-71.8	-61.1	-67.5
South Africa	-8.9	-13.4	-14.0
Commodities	10.8	5.9	6.1
Non-commodities	-6.0	-4.2	-3.7
Turkey	-47.3	-27.8	-4.8
Commodities	-54.3	-59.4	-59.3
Non-commodities	-4.6	17.8	36.0

Source: Haver, IIF

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