GMV – The COVID-19 Sudden Stop

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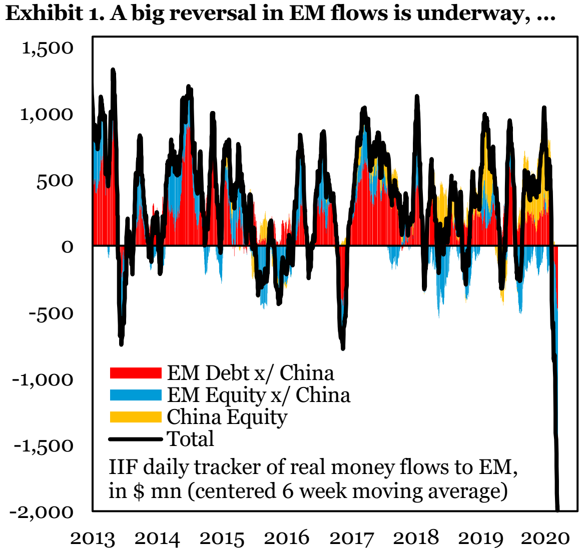
- We last week revised down growth forecasts for this year, ...
- with global growth potentially approaching 1 percent in 2020.
- We have written a lot about *"sudden stops"* in emerging markets, ...
- when foreign capital inflows halt and force drastic declines in activity.
- The multitude of shocks in the system now risks a global *"sudden stop,"* ...
- as falling oil prices potentially accelerate mounting credit stress in the US.
- Vulnerable emerging markets are already seeing large outflows, ...
- with another *"sudden stop"* building on that front.

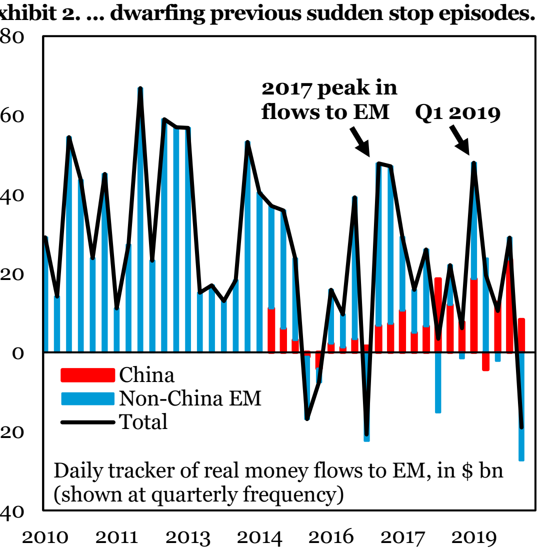
We last week downgraded our global growth forecast, which may potentially approach 1 percent in 2020, the weakest pace of growth since 2009. The epicenter of our down revisions is China, where we expect GDP to fall 1 percent quarter-on-quarter in Q1, followed by a recovery of 2 percent quarter-on-quarter in subsequent quarters, bringing annual average growth down to below 4 from 6 percent previously. Our US forecast was also cut, with the economy flat-lining in Q2 as the potential brunt of the COVID-19 shock hits. The sharp drop in oil prices since then has changed the landscape, raising the risk of credit stress in the US and moving our US forecast closer to recession territory. We worry a global *"sudden stop"* in financing is beginning to emerge, with COVID-19 the underlying driver. Monetary and fiscal easing measures are a welcome palliative, but in the end only a concerted response in terms of testing and containment will be able to mitigate the *"fear factor"* in markets and jump-start global demand. Our high-frequency tracking of non-resident portfolio flows to EM is a useful gauge of risk appetite and points to a large *"sudden stop"* on that front as well. We fear that 2020 will be another challenging year for growth across EM.

Exhibit 1. A big reversal in EM flows is underway, ...



Source: Haver, IIF

Exhibit 2. ... dwarfing previous sudden stop episodes.



Source: Haver, IIF

Our tracking of non-resident portfolio flows to EM provides a representative snap-shot that is available on a daily basis. At key turning points in markets, this flow metric provides insight into risk appetite and foreign investor positioning. Our tracker is currently the most negative ever (Exhibit 1), with outflows exceeding the 2013 *"taper tantrum"* and the 2008 global financial crisis. On an aggregated quarterly basis, flows to China have remained positive (Exhibit 2), obscuring what is quite a negative picture elsewhere. If we take this flow picture as a possible representation for what is happening to risk assets more broadly, a global *"sudden stop"* is in the making, one that could present substantial downside risk to our forecasts. What worries us especially is that a decade of extraordinary monetary policy stimulus has – by design – steered lots of flows into high-beta assets, including emerging markets. Exhibit 3 documents how foreign investor holdings in EM stocks and bonds have grown in the past decade, with South Africa a stand-out along with Mexico and Chile. We worry especially about places where the underlying flow has driven this rise, as opposed to valuation gains (Exhibit 4).

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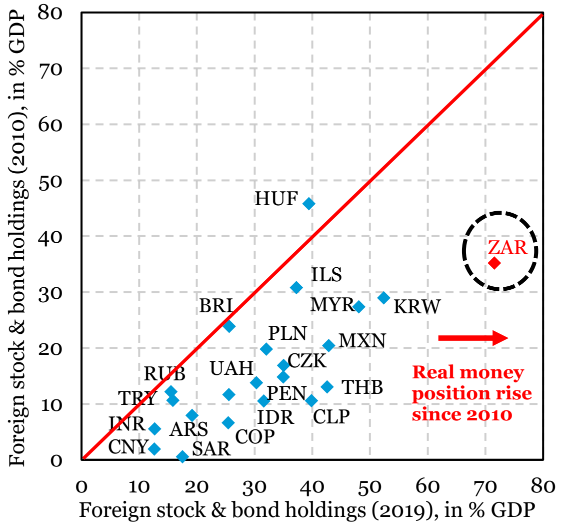
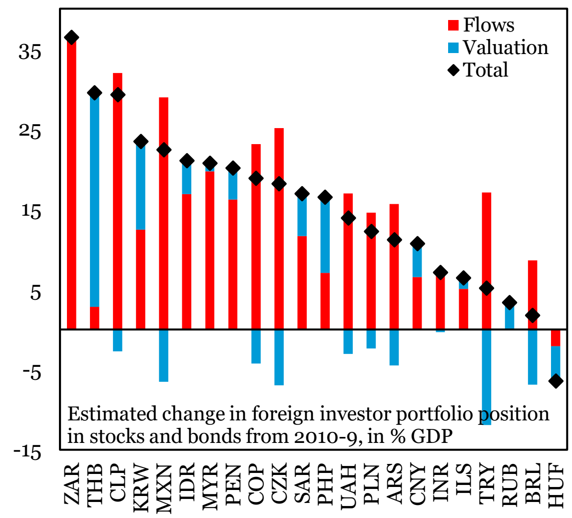
Exhibit 3. Positioning across many EMs is heavy, ...



Source: Haver, IIF

Exhibit 4. ... following years of QE-related inflows.



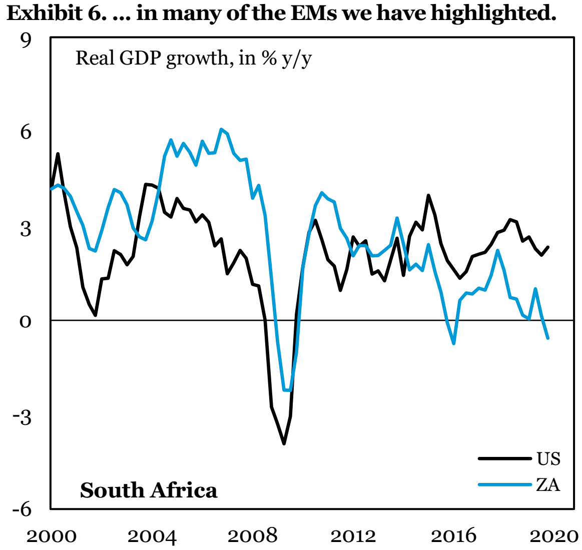
Source: Haver, IIF

Turkey and Argentina showed in 2018 just how negative *"sudden stops"* can be for economic activity, with the reversal in foreign financing leading to a shut-down in investment from which both countries have yet to recover. We worry that the unfolding *"sudden stop"* now has a similar potential, just on a more global and systemic level. We have documented negative growth momentum in many emerging markets even before the COVID-19 shock, including in Mexico (Exhibit 5) and South Africa (Exhibit 6), so that the initial conditions in many places are weak and vulnerability to a persistent pull-back in foreign financing material.

Exhibit 5. This sudden stop will weigh on growth, ...

Source: Haver, IIF

Exhibit 6. ... in many of the EMs we have highlighted.



Source: Haver, IIF

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