ANDBANK RESEARCH

Global Economics &
Markets

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Working paper - 66

Some of the so-called "Fragile Five", are not so fragile

(Thus, the trigger for a massive sell-off must be sought elsewhere. I'm sorry)

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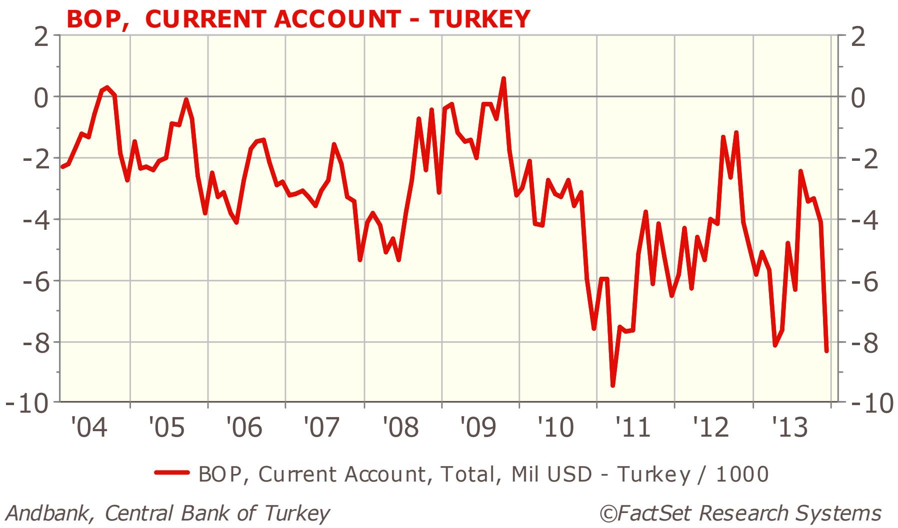
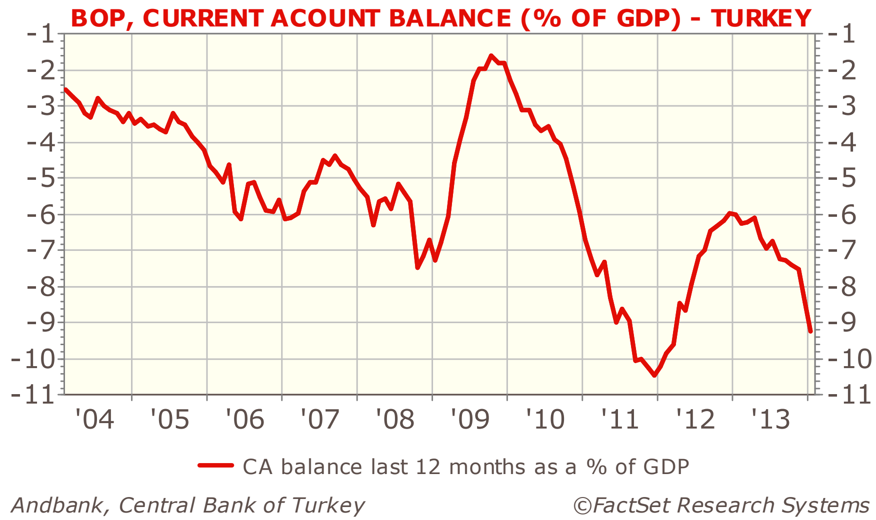
Turkey – Indeed, external imbalances are worsening but, in the fiscal front, things seem to remain clearly under control

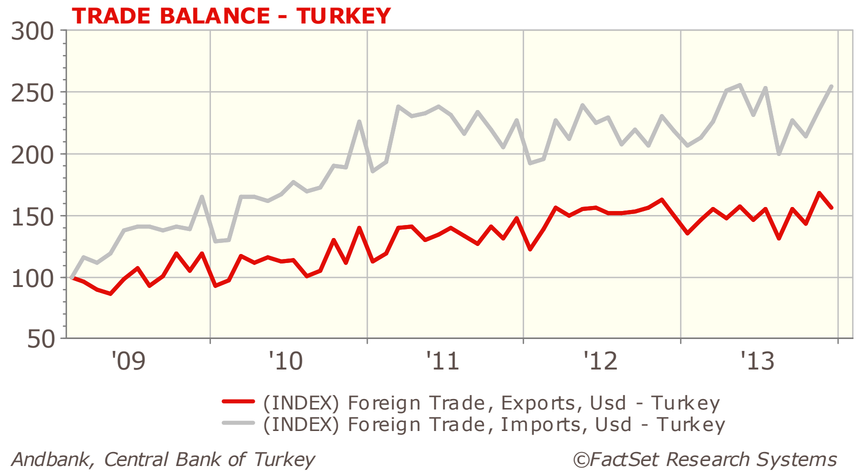
Turkey – Indeed, CA imbalances are worsening rapidly



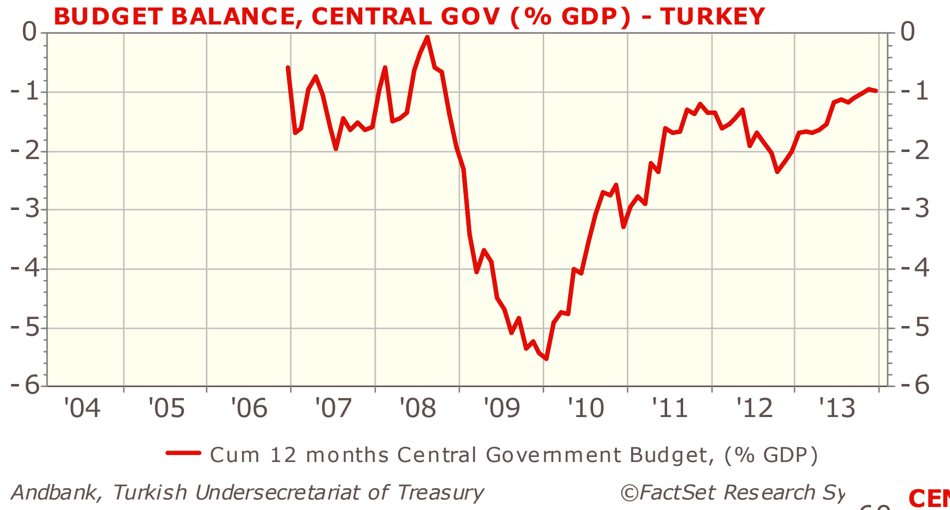


Indeed, such a deterioration in CA deficit is a concerning development but …

… it has been primarily due to a sharp rise in imports (suggesting that domestic dynamics are strong enough)

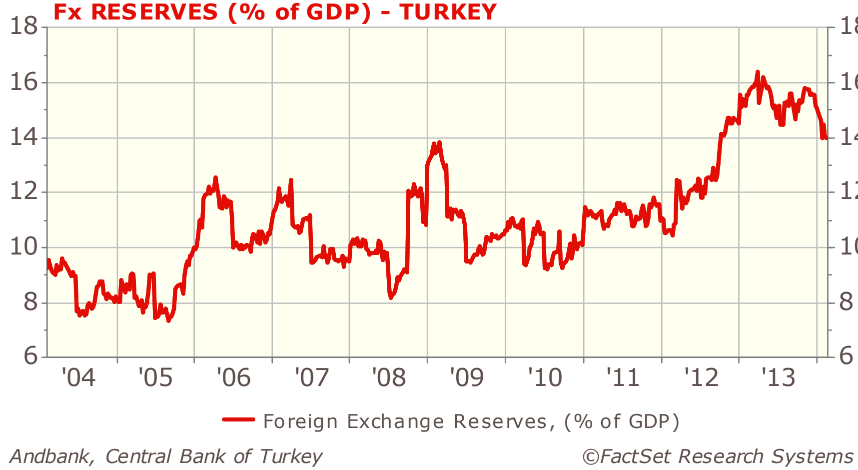


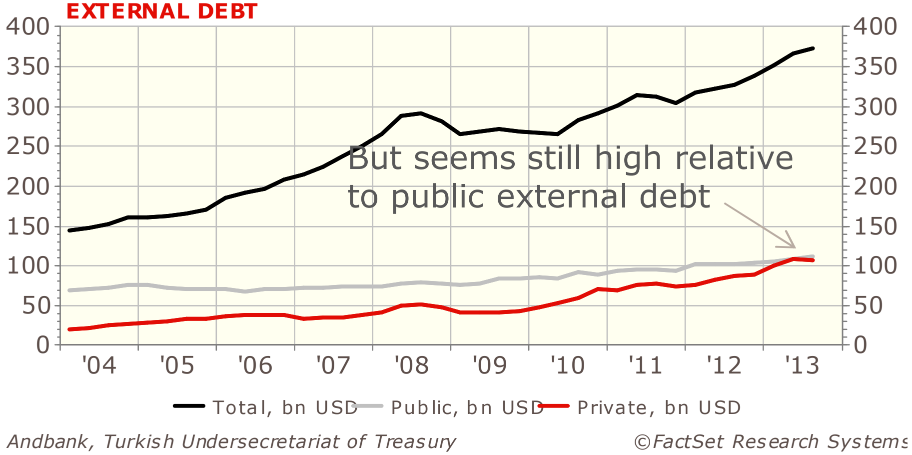
Turkey – But in the fiscal front, things seem to remain clearly under control

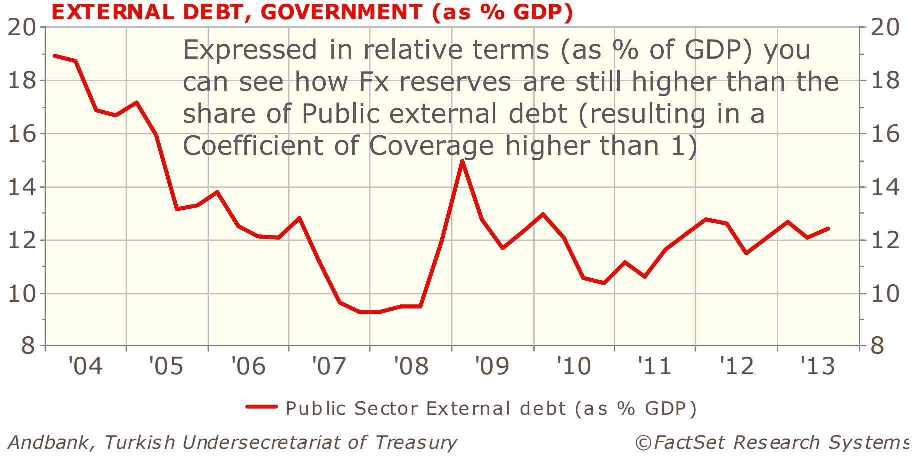


Certainly an enviable situation!

And, although Fx reserves are dangerously declining …







... there is no strain in the coverage coefficient yet (although admittedly, a continuity of Fx outflows could cause serious problems)

	Russia	Indonesia	Turkey	Argentina
GDP (bn usd)	2.200	894	841	461
Fx Reserves (% GDP)	22%	11.2%	14%	5.8%
Public Debt (as % GDP)	12%	24%	36%	41%
Public External Debt - PED (as % GDP)	2.8%	12.8%	12.4%	12%
National External Debt - NED (as % GDP)	32.4%	26.9%	44.3%	29%
Coverage Coefficient in PED (Fx Reserves / Public Ext Debt)	**7.85x**	**0.88x**	**1.13x**	**0.48x**
Coverage Coefficient in NED (Fx Reserves / National Ext Debt)	**0.68x**	**0.42x**	**0.32x**	**0.20x**

This is still a healthy level

India – Recent resilience … likely not a one-off

India – Significant improvement in CA balance

- India's current account deficit narrowed to a more than four-year low of 1.2% of GDP in Q4, having been as high as 6.5% at one point in 2012.

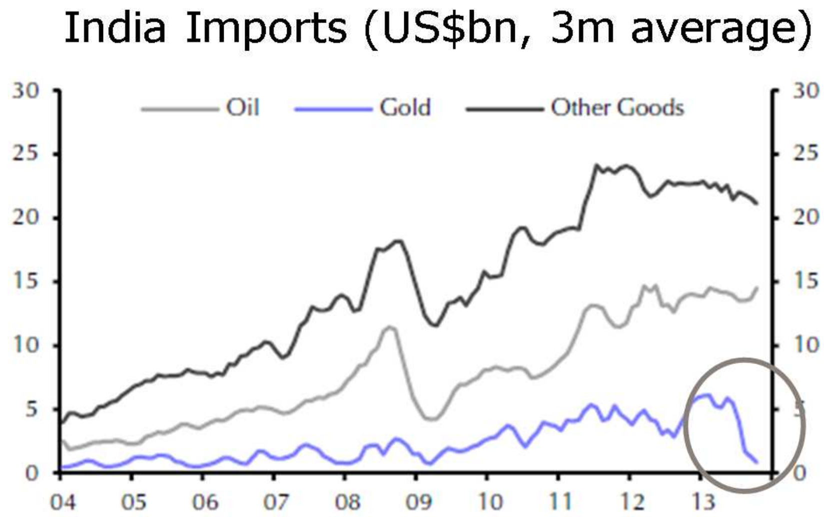
- Like in Indonesia, an increase in exports and a fall in imports have been the drivers for the general improvement in the external balance. Behind exports' improvement has been a stronger external demand and a more competitive. In addition, weak domestic sentiment, rate hikes, and currency weakness have all held back imports.

- However, the biggest swing factor has been the effectiveness of curbs on gold imports. These restrictions were tightened progressively last year to contain the deficit (and halt the rupee's slide).

- Nonetheless, some officials have called for these restrictions to be relaxed (due to some strains caused by the domestic gold shortage, local jewelers have lobbied against the curbs, concerns about rising gold smuggling).

- Given the ongoing jitters in EM financial markets, it is likely that India will relax curbs but only gradually, to help keep the CA deficit low. It is expected the CA deficit to remain at 2% in 2014.

- The reductions in the CA deficit in India will prove to be more than fleeting, making that the recent resilience shown in this currency is not a one-off.



Thomson Datastream, CE

Indonesia – Healthy Fx reserves, low debt, and improvement in external balance

BI decides it is no longer necessary to defend the Rupiah

- **Bank of Indonesia (BI) decided not to follow the lead of other deficit countries including Turkey, South Africa and India (all of them having hiked rates in recent weeks), and left interest rates on hold for a third consecutive month.**

- **BI's decision reflects the fact that the country has reduced its external vulnerabilities. This idea is reinforced by watching how some factors have developed recently.**

1. ***Resilience of the IDR:*** By no hiking rates in 3 months, the BI stopped to defend the rupiah in part due to the resilience of the currency in the most recent sell-off (after falling 21% in 2013, it has appreciated a 3% in 2014, being the best of the EM currencies).

2. ***Healthy Fx reserves:*** With no intervention, the recent appreciation has come as a result of an increase in Indonesia's Fx reserves. The country has reached the US$100bn level (after the US$5bn bond issue, with demand for US$17.5bn). Public external debt is US$123bn (12.8% of GDP), meaning that the Public Coverage Coefficient is 81%.

3. **Low debt that will be even lower:** The total government debt represents 24% of GDP. Still healthy according to international standards and showing clear signs of continuing to decline.

4. ***Improving CA deficit:*** CA balanced has improved from 4.2% in Q3 to just 2% in Q4 with exports rising sharply and imports falling. Some analysts suggest that the recovery in exports seen in December can be explained by a front-loading of mineral ore exports ahead of a ban that came into effect on January. We doubt it. Exports of copper and nickel increased sharply but combined account for only 3% of total exports. A much more important factor was a recovery in exports of manufactured goods, supported by an upturn in the global economy in 4Q13 and last year's sharp fall in the rupiah. Behind lower imports are (1) tighter MP weighting on domestic demand, (2) a reduction in fuel subsidies, and the weaker currency pushing up price of imports. Tight monetary policy (no hikes but no cuts, keeping the refi rate at 7.5% after a cumulative 175bp raise since May 2013) ensures that CA deficit continues its downward trend in 2014. We expect it to stay at around 2% of GDP.

Indonesia – Still a healthy GDP projection

- **Growth to remain at 5.5% in 2014 and 2015 (indeed below 6% but still healthy) and unlikely to accelerate. Why?**

  1. ***Consumer spending unlikely to accelerate:*** due to (1) temporary high inflation, resulting from fuel subsidies removal, will probably eat into the purchasing power of consumers in the next months, and (2) wage growth has slowed.

  2. ***Investment spending unlikely to accelerate*** due to (1) tighter monetary policy resulting from the BI defense of the Rupiah, (2) lower commodity prices globally and (3) political impasse arising from presidential elections in 2Q.

  3. ***Public spending will continue being tamed*** since government remains stick with its target of reducing deficit to just 1.7% of GDP in 2014 (it was 2.3% in 2013)

  4. ***Exports will remain fairly stable.*** Admittedly, faster growth in DM will boost manufactured exports (33% of total) but "slower" demand from China, and new law banning exports of some raw materials) will keep commodity exports subdued (50% of total)

- **Considered all, and after arguing with some analysts familiar with this topic, we set a no-acceleration-no-deterioration-of-GDP-pace as our central scenario for this economy, with the tightening cycle probably over (and a cut in rates as the most likely step in the next monetary policy decision)**

Indonesia - Inflation will decline sharply, dissipating risks for the currency and government bonds

- **Despite weakness in the currency (that is starting to feed through import prices: 17% y/y in December), this will not be passed onto CPI since**

  1. Indonesia is a relatively closed economy with imports barely representing 25% of GDP

  2. Government subsidizes a range of goods, most notably fuel, meaning that is the government who bears the escalation in import prices.

- **Inflation is high currently because of subsidy cuts of gasoline in 2012. Gasoline price raised 44% bringing headline CPI to 8% (from 4.5%) but inflation should fall sharply from July once the low base drops out.** On the two occasions that government hiked fuel prices (2005 and 2008), inflation was lower a year later than it was before the increase.

- **The economy is going to expand at 5.5% pace during 2 years, which is a non accelerating inflation level.**

Indonesia - The three main risks

1. **The uncertainty over the pace of tapering (Although it is already fully priced in a 10 bn cut per FOMC).**

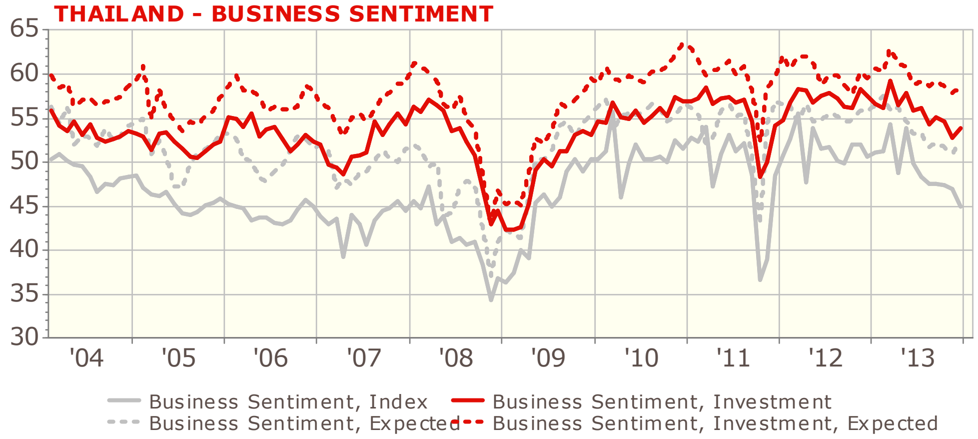
2. **The uncertainty over an hypothetical rise in Fed's rates. Indonesia is highly sensitive to Fed fund's rate.**

3. **Low pace in teaming CA deficit (due to the law banning some exports). We have seen how CA deficit has been lowered to 1.8% of GDP (from 4.4%)**

Thailand – An economy that is not included in the box yet … it may be the true "fragile"

Thailand - The unresolved political crisis is already being felt

- Thailand's economic growth eased to 0.6% q/q from a revised 1.4% in Q3.
- For 2013 as a whole, growth came in at 2.9%, down from 6.4% in 2012.
- Business sentiment have slumped. There are reports showing that companies are putting their expansion plans on hold
- The weakness came from all areas of the economy, but **primarily** from a slump in **investment** growth and **private consumption**.
- Although February's general election proceed as scheduled, voting went ahead only in 89% of polling stations, meaning that will not be enough to deliver a new government (the constitution requires that 95% of seats in parliament are filled). Therefore, it can be said that protestors succeeded in blocking candidate registration in enough constituencies.
- A best case scenario is that by-elections (partial) are now conducted to fill empty parliamentary seats **but it could be months before a new government can be formed**.



Andbank, Bank of Thailand *©FactSet Research Systems*

Thailand - In the meantime the ongoing protest will further damage the economy.

- Foreign investors have been pulling funds out of Thai markets since November
- Pace in tourism arrivals have declined to 6.7% growth (versus almost 20% for the whole 2012). International arrivals in the two main gateways to Bangkok (Don Muang and Suvarnabhumi) were even weaker (2% pace y/y)
- Fiscal disbursements have been interrupted by the temporary closure of many state agencies (as a result of protest)
- Investment applications have also been stalled due to restrictions on the actions to be taken by caretaker governments. Large public infrastructure investments are unlikely to begin soon enough to lift growth in 2014.
- There is even a risk that the tabling of the budget for FY2015 (starting October 2014) will be hampered by delays
- The longer the power vacuum lasts, the worse it will be for the Thai economy. **It is doubtful that Thai GDP in 2014 can exceed 3%, and downside risks are rising fast.**
- **Thailand is immersed in a "political trap":** With fiscal policy effectively paralyzed, the central bank must take the burden of responsibility for supporting the economy, meaning that it will probably cut rates at its next meeting in March. However, it's a question of time that international investors starts attacking the currency and then the CBT will have to choose between defending the currency (hiking rates) or focusing on growth (keeping rates low). **Whatever the decision, we will witness further strain in some area of the economy.**

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