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Frontier Sovereigns 2023: Navigating Treacherous Waters

Macroeconomic And Sovereign Ratings Outlook

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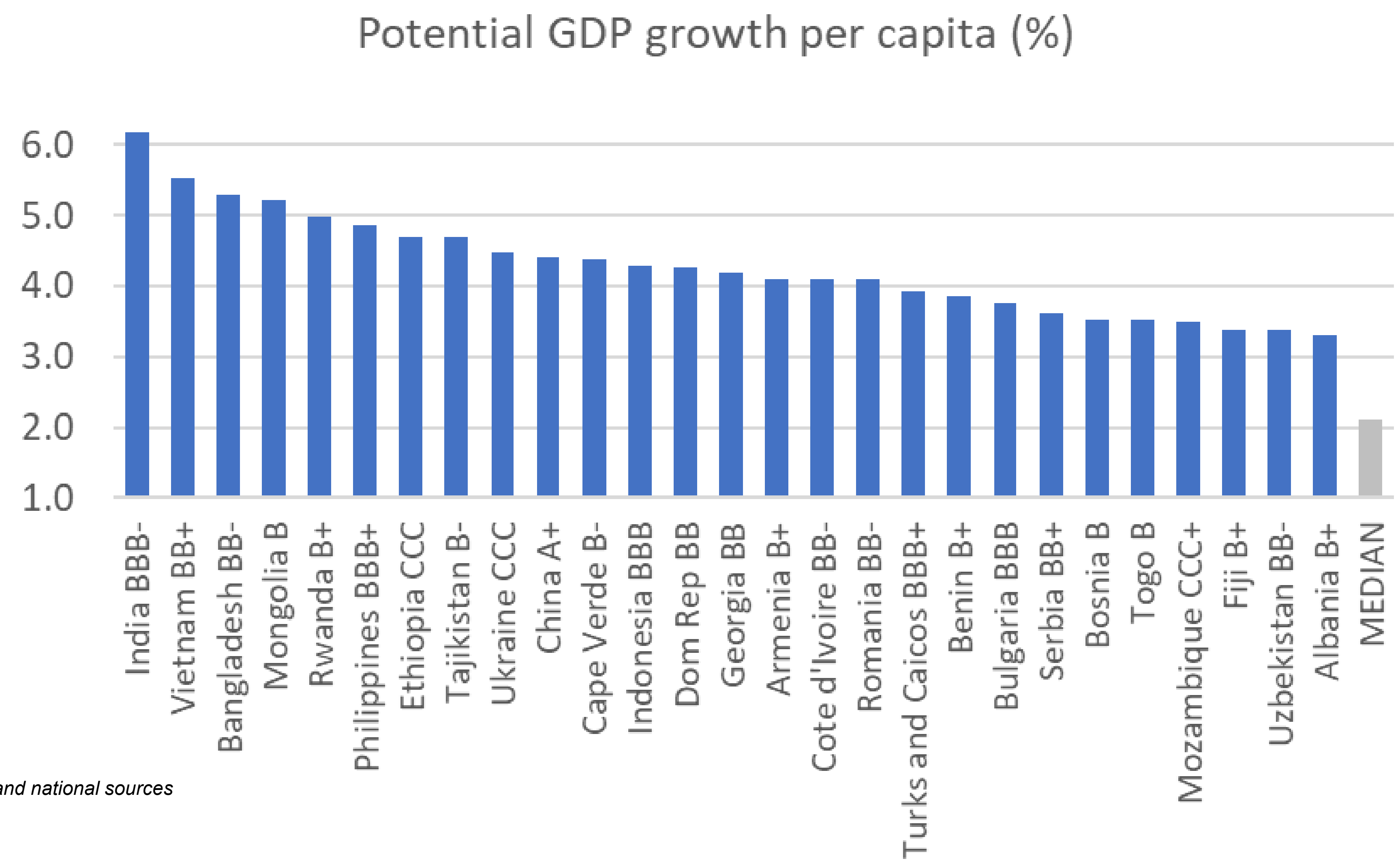
Potential Growth in Frontier Markets: High



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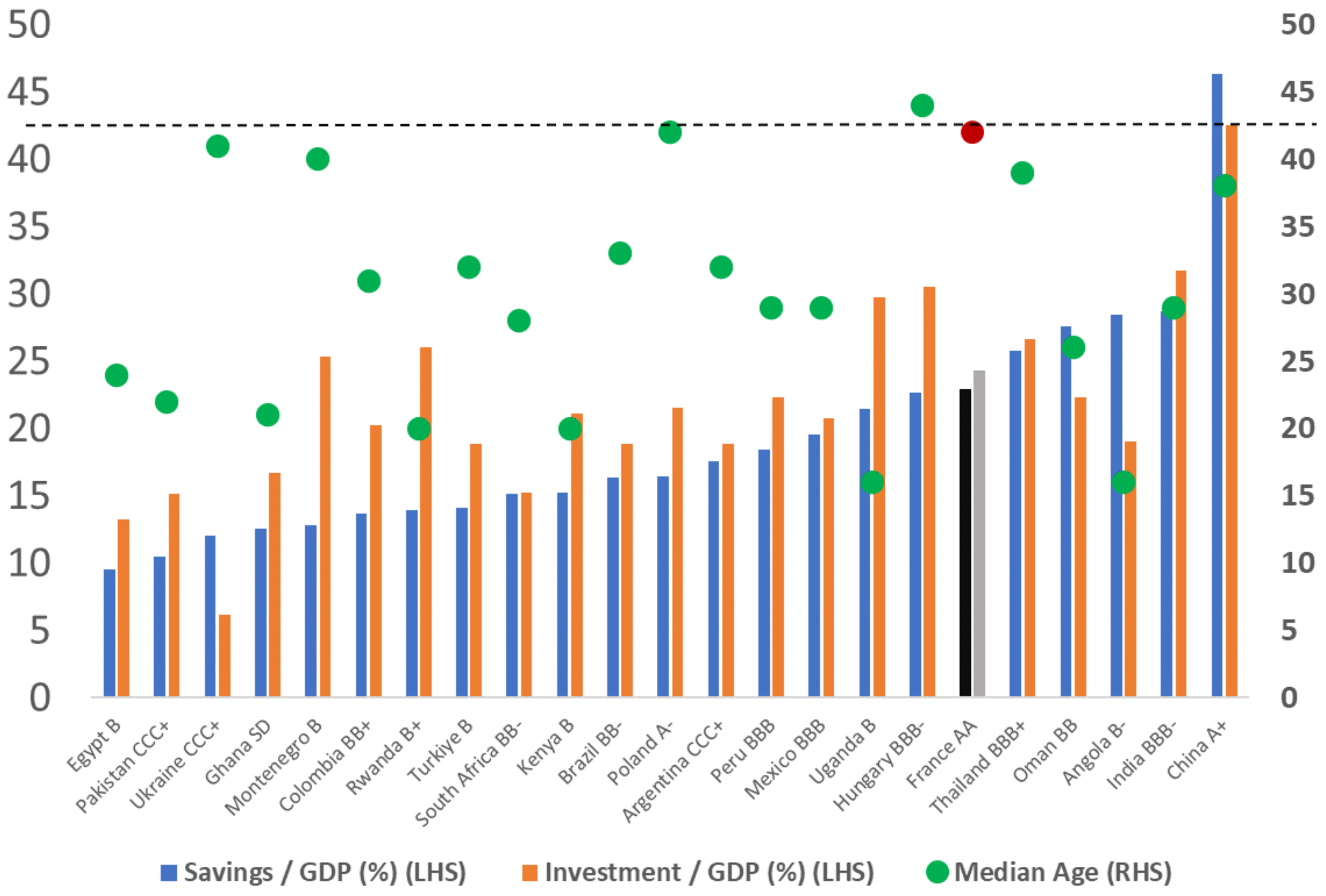
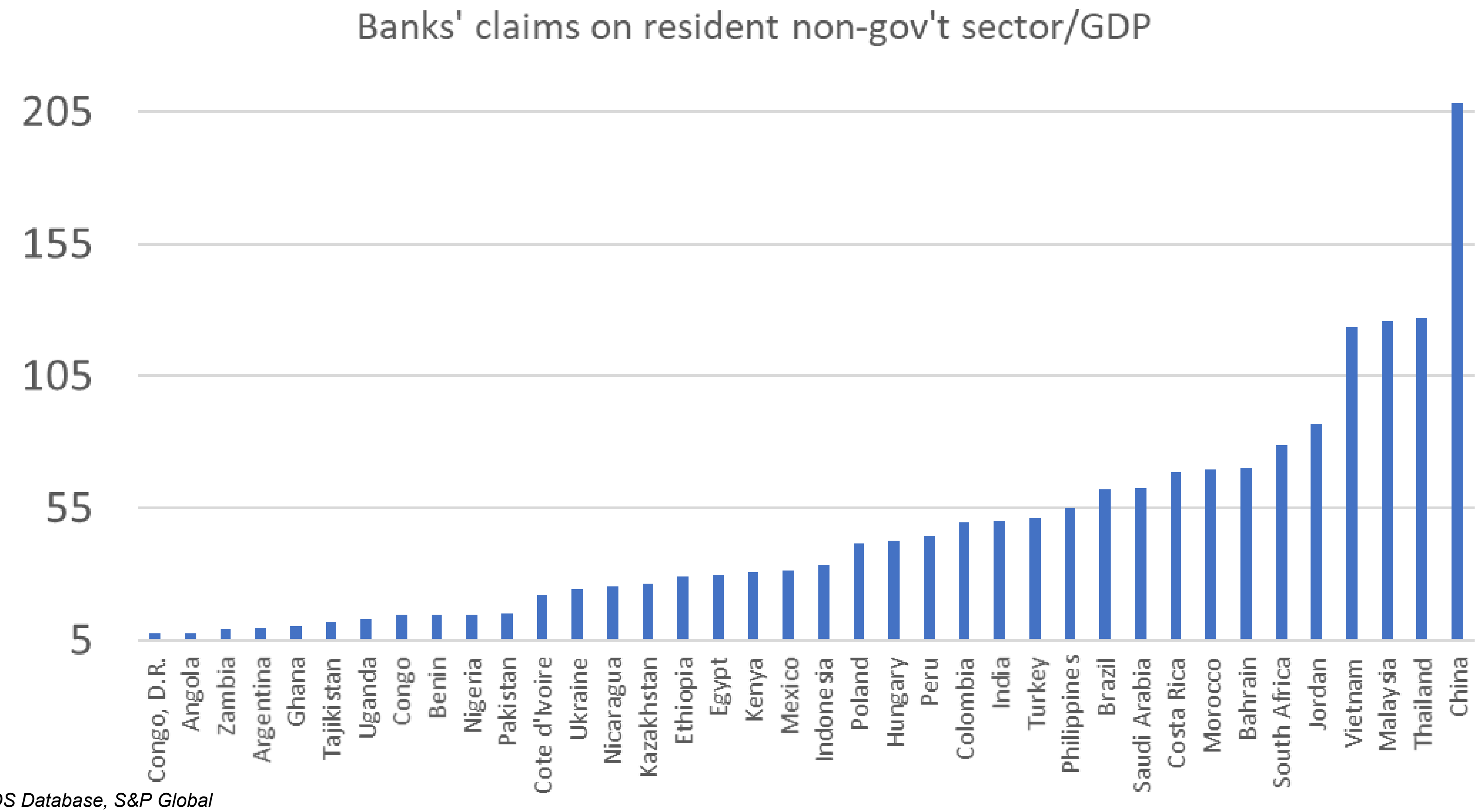
What is an Emerging Market? A Low Savings Economy



- One classic definition of an Emerging Market is a Low Savings Economy, where investment demand exceeds domestic capacity to generate savings.
- Large dissavings are features of low income economies Egypt, Pakistan, Ghana, but also middle income economies Montenegro, Turkey, Brazil. China's savings exceed 45% of GDP. India's savings are near 30%.
- High Savings generally imply domestic financing capacity, even when fiscal debt is elevated (India).
- The story of Emerging Market distress in 2020-2022 was principally focused on low savings economies with limited domestic financing capacity, and hence high outstanding stocks of foreign currency debt.

What is an Emerging Market? Low Domestic Financing Capacity



IMF/World Bank SDDS Database, S&P Global

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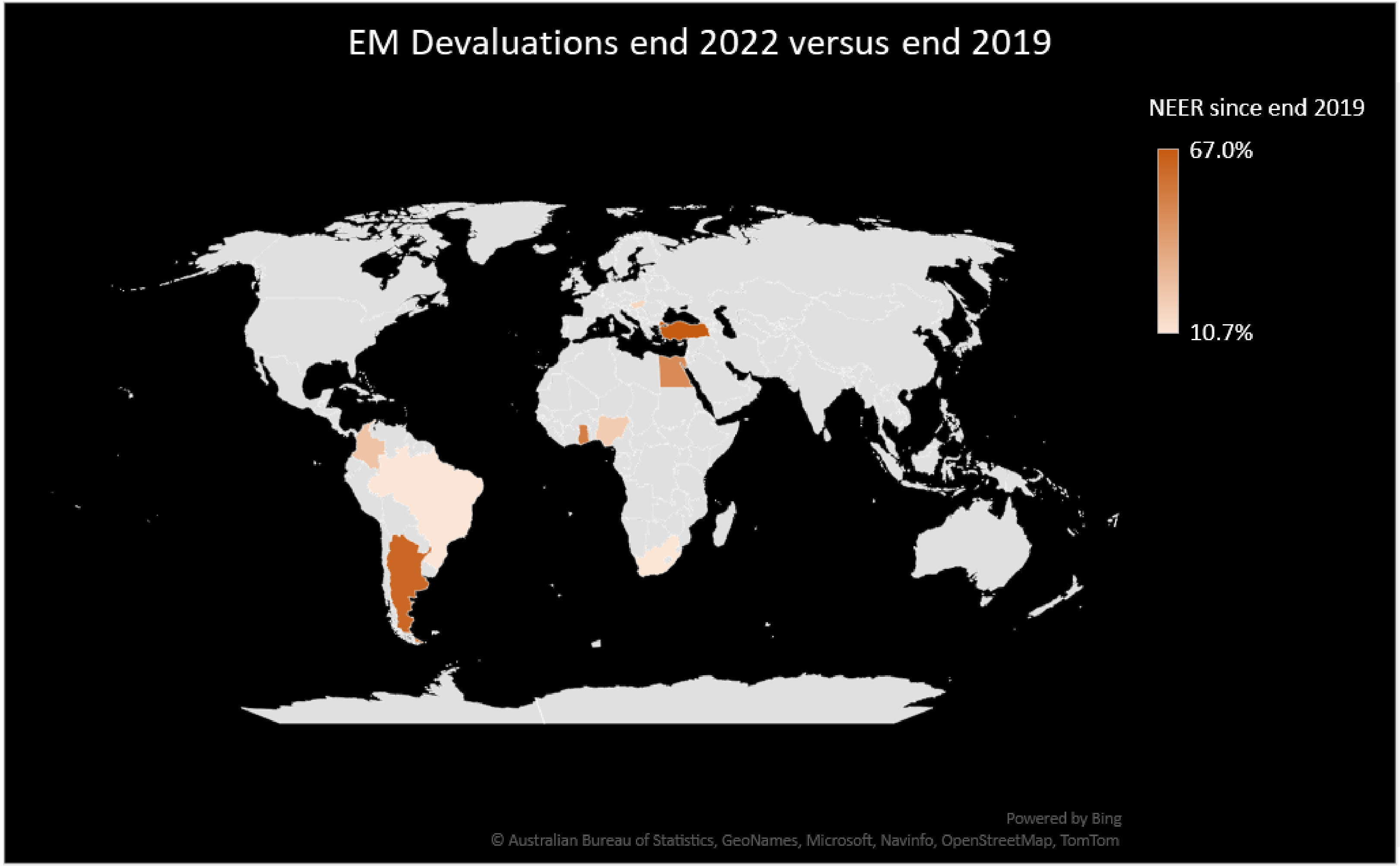
What is an Emerging Market? Currency Pressures end 2022 vs 2019



2022 versus 2019 saw large currency devaluations in Argentina, Turkey, Ghana, Egypt, Colombia and Nigeria, despite many of them being net energy exporters.

High global inflation, driven by processed fuels and elevated food prices. This may be coming to an end, but the uncertainty around the war, China's reopening still persist.

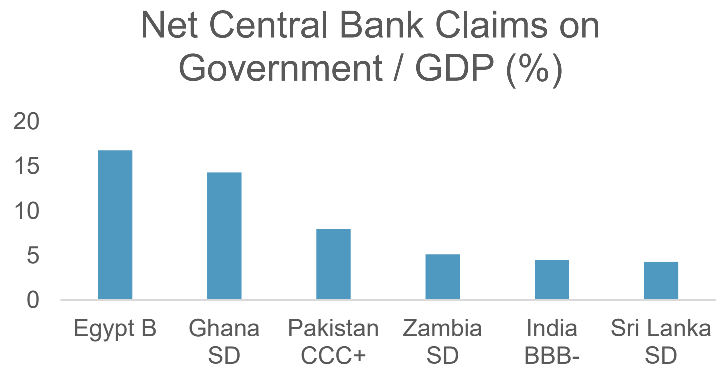
Where the share of foreign currency debt exceeds 50% of government debt, currency pressures fed immediately into balance sheet shocks (Egypt, Ghana, and Turkey, but not Brazil).

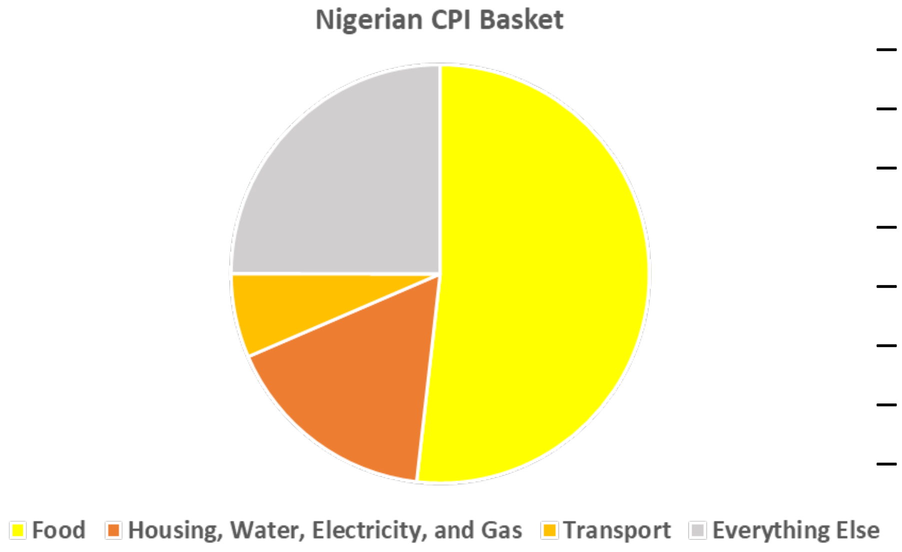
Weak currencies forced many EM central Banks to tighten policy beyond what underlying demand perhaps required.

Rated EM Sovereigns Operating Double Digit Inflation (30 VS 6)

2019

- Angola B-
- Argentina CCC+
- Egypt B
- Nigeria B-
- Turkey B
- Uzbekistan BB-





2022

- Argentina CCC+
- Bosnia B
- Botswana BBB+
- Bulgaria BBB
- Burkina Faso CCC+
- Chile A
- Colombia BB+
- Congo DRC B-
- Egypt B
- Ethiopia CCC
- Georgia BB
- Ghana SD
- Honduras BB-
- Hungary BBB-
- Jamaica B+
- Lebanon SD
- Montenegro B
- Mozambique CCC+
- Nigeria B-
- North Macedonia BB-
- Pakistan CCC+
- Poland A-
- Romania BBB+
- Rwanda B+
- Serbia BB+
- Sri Lanka SD
- Suriname SD
- Turkiye B
- Uzbekistan BB-
- Zambia SD

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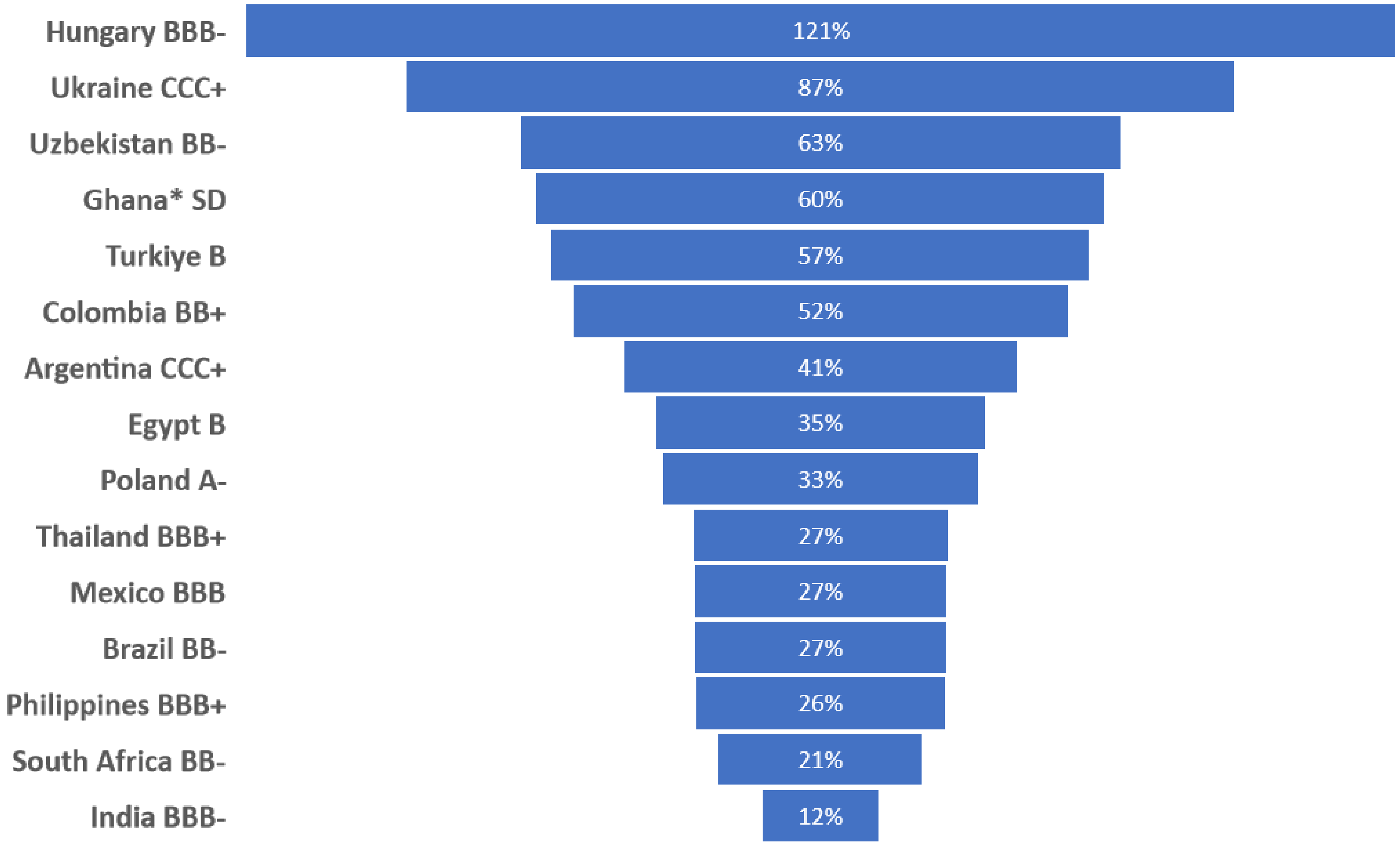
What is an Emerging Market? Original Sin (Foreign Currency Debt as % of GDP)



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Cost of Duel Shocks to Emerging Markets?

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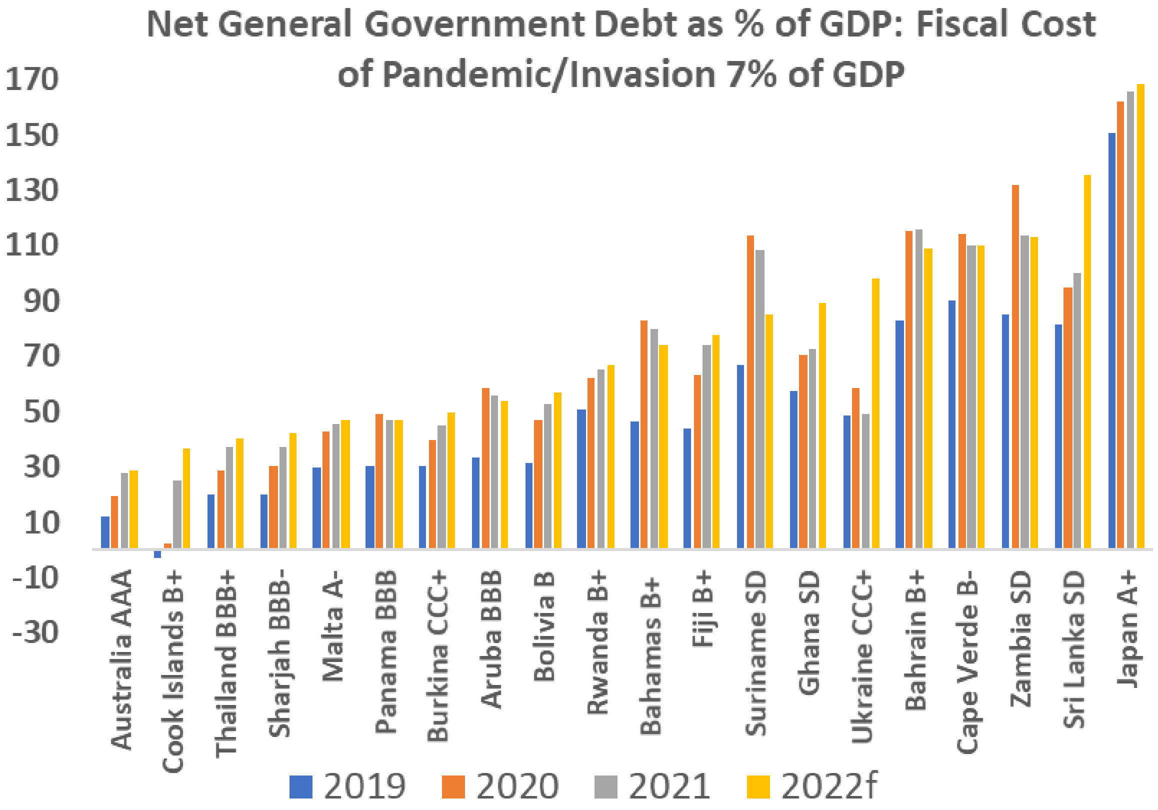
More government debt…



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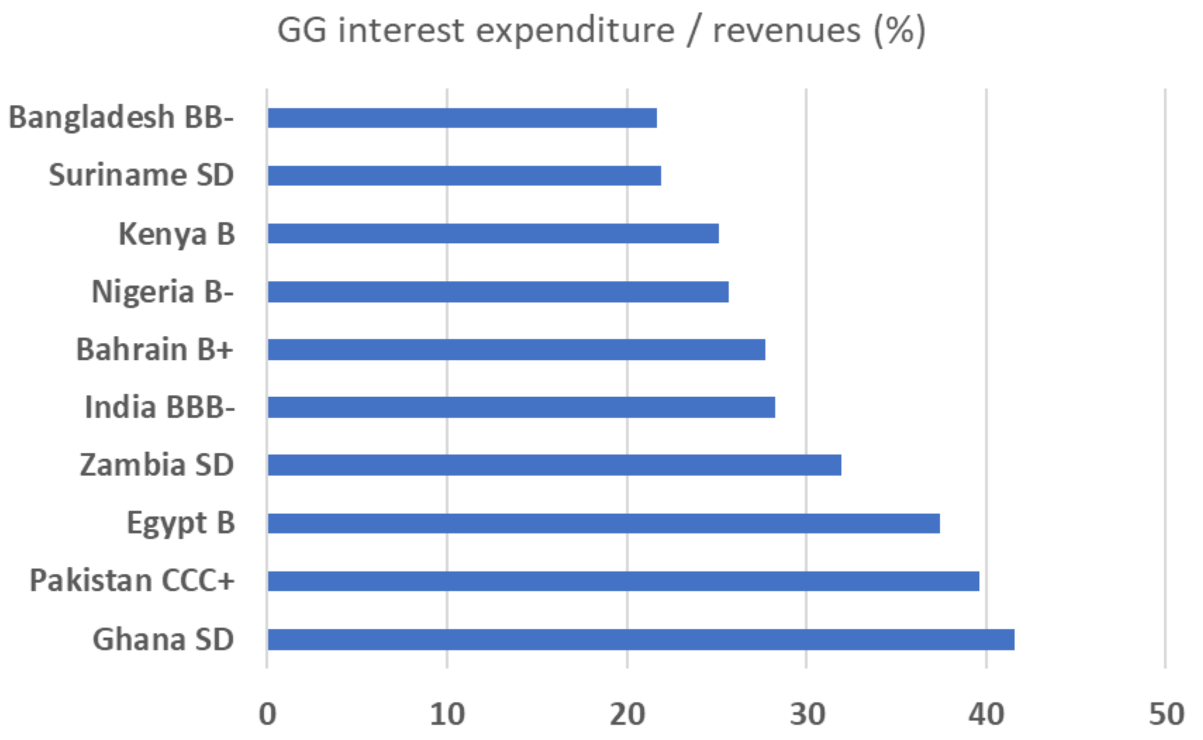
More expensive debt (2022 estimates)…



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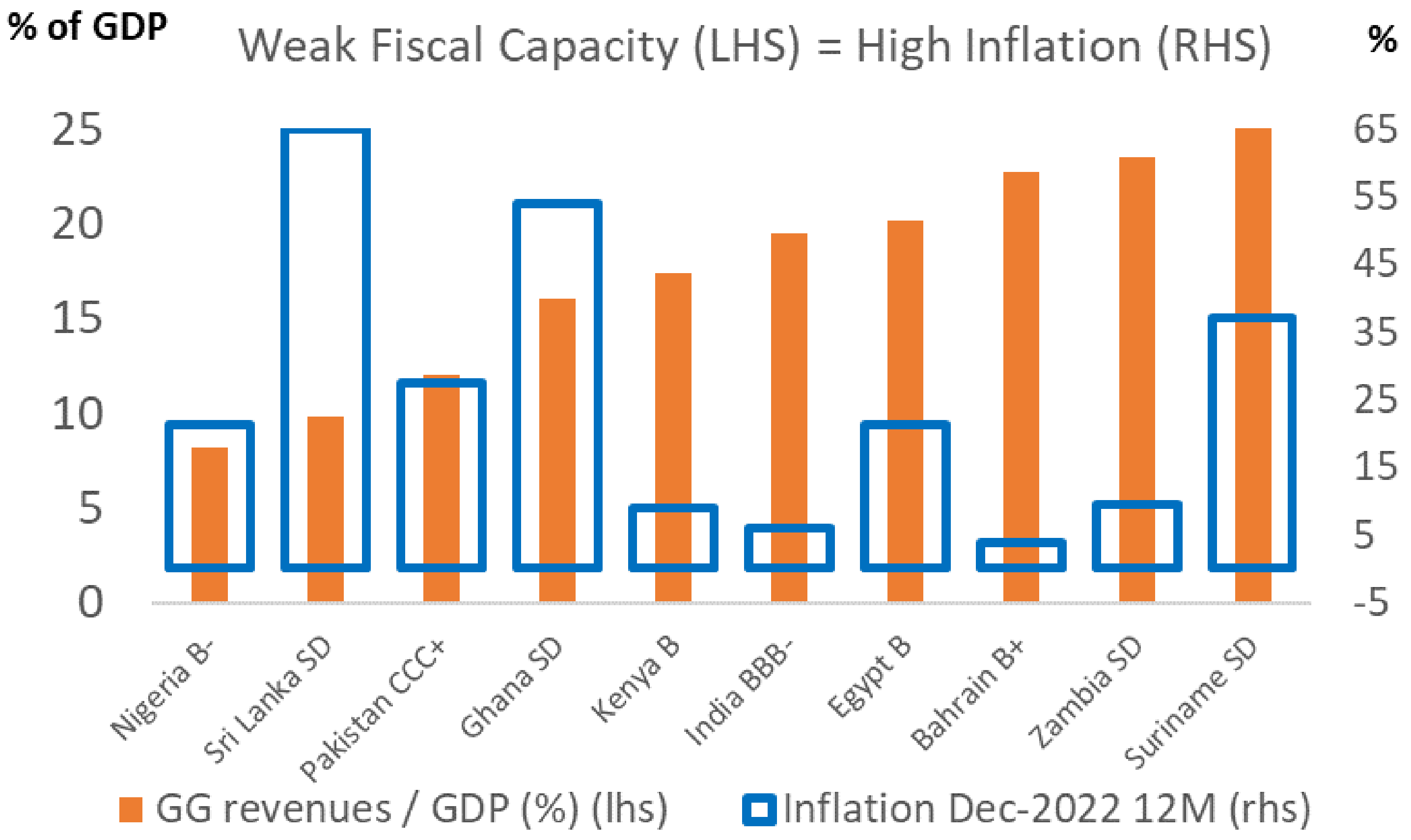
What is an Emerging Market? Low Fiscal Capacity

“Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.” Milton Friedman (1970)



- 10 EMs with the highest cost of debt as measured by interest/revenues.
- Where tax pressure is lower, typically inflation has been higher.
- Monetary financing in these sovereigns.
- High inflation/strong $ drove currency devaluations across weaker EMs last year, especially large food and energy importers.
- External conditions have improved lately, as energy and food prices ease, and visiblity on FED policy is les opaque.

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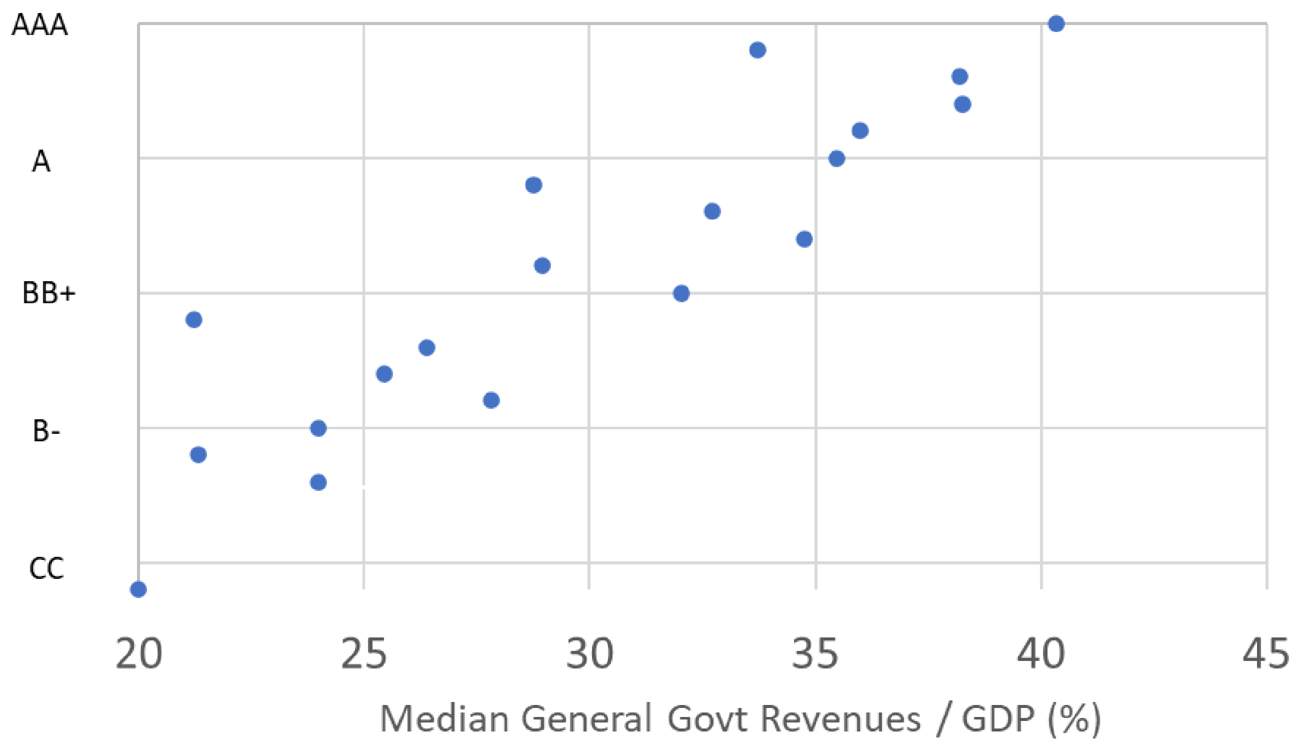
Strong Relationship Between Creditworthiness and Tax Pressure

How Taxable is GDP?



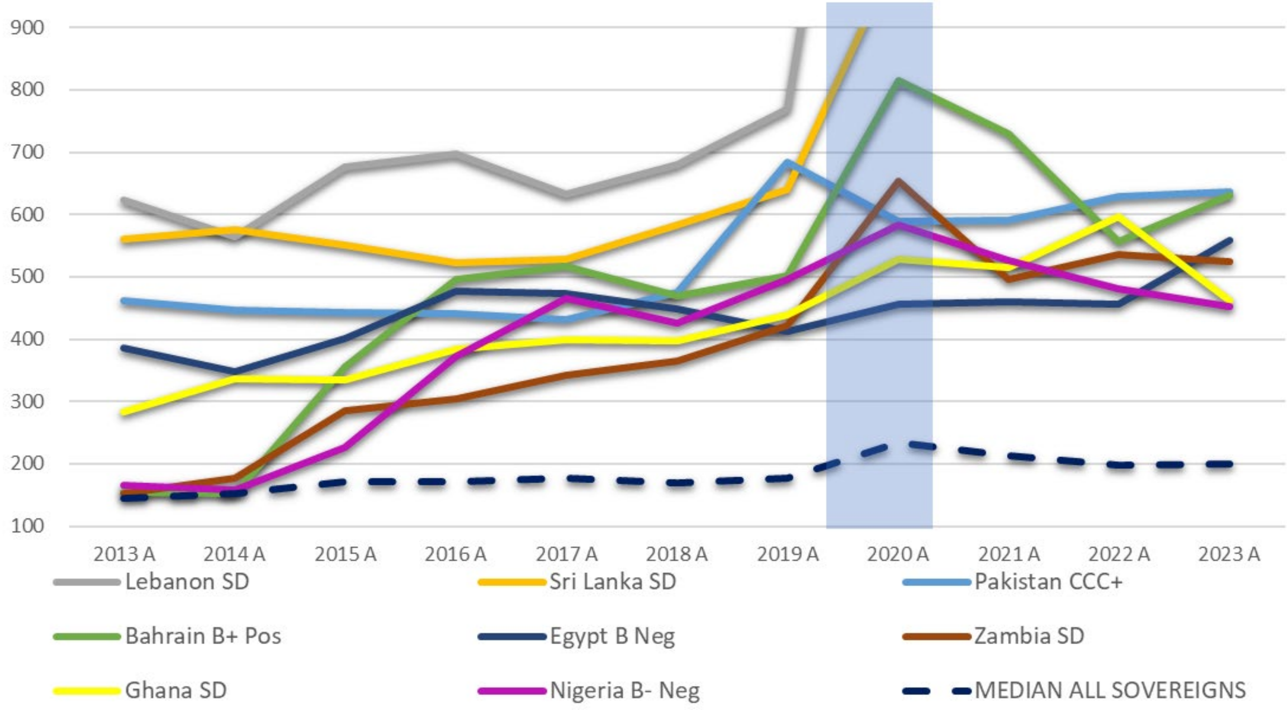
- The ability to finance spending by taxing domestic economic activity is a key determinent of creditworthiness.
- S&P Global looks at the level, and the reliability of tax earnings by the general government to service debt.
- There is a strong relationship between tax pressure and Sovereign ratings.
- Tax pressure is also closely correlated to per capita GDP and institutional assessments, although there are considerable differences across different states.

Fiscal Capacity a Key Determinent of Ratings

– Debt to Revenues

Debt to Revenues (%)

Source: S&P Global, national sources



Foreign Currency Public Sector Debt as % of GDP

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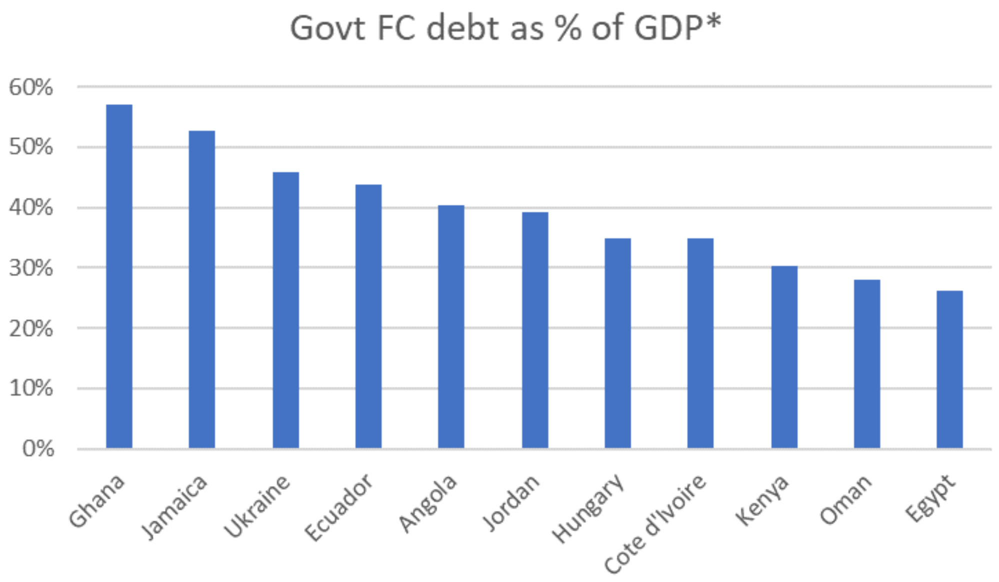

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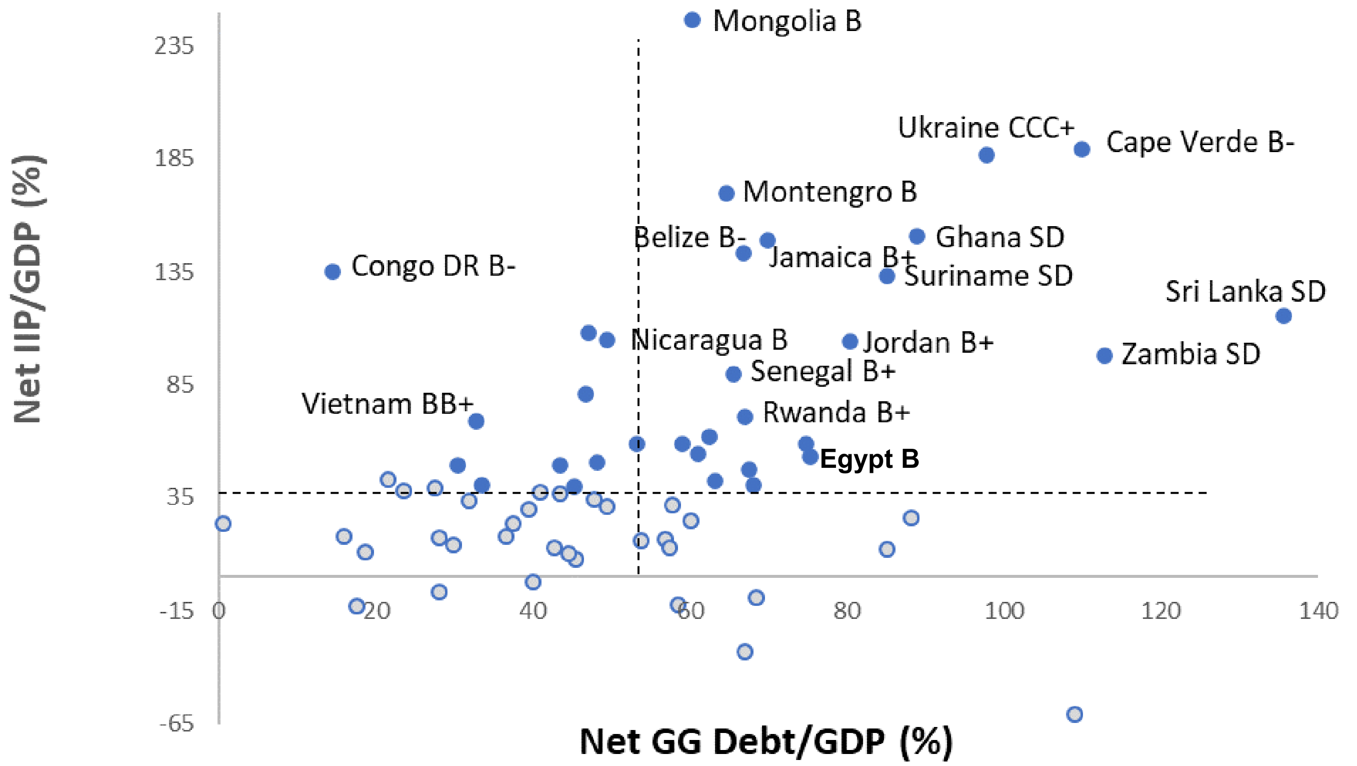
Fiscal Imbalances Can Drive External Ones

NET EXTERNAL LIABILITIES AS % OF GDP VERSUS NET GOVERNMENT DEBT AS % OF GDP



- A large external liability position often reflects that the stock of domestic savings is low, and vulnerability to external financing conditions is high.
- How can Emerging Markets grow and develop without dissavings? There are a few EM sovereigns (for example Vietnam) with a large net external liability but low public debt. But this is exceptional.
- Sub-saharan Africa combines high external and fiscal liabilities, low savings, and low fiscal receipts. The absence of lending to the private sector may reflect crowding out/unpredictible governance/or completely unrelated factors.
- The analysis of default is complicated: Argentina has been a net external creditor for decades.

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