

Emerging Markets Update

Argentine contagion risk remains limited

SUMMARY. Argentina's stocks fell 38% and its currency slumped 30% against the US dollar to a record low on 12 Aug after a surprise primary election result. Investors may feel more jittery than usual about the possibility of contagion to the rest of Emerging Markets. We believe the cross-country spillover risk remains moderate but the turmoil is hitting to general EM investor sentiment. Currently, global easing tide stands to help EM, but growth of many EM is trending down and recession risks loom due to US protectionism and geopolitical tensions.

- **Argentine election shock roils markets.** Results of Argentina presidential primary showed that, the left-wing populist opposition leader Alberto Fernández (48%) was 15-point ahead of the President Macri (32%) unexpectedly. The upset, widely seen as a preview of Oct's presidential vote, suggested that a more protectionist government is very likely to take power in Dec. Argentina's markets now are in the panic mode in fears of losing market-friendly agenda and returning to interventionist economics. Moreover, Fernández plans to renegotiate the agreement with IMF, from which Macri received US\$57bn loan in exchange for tough fiscal commitments, raising the risks of default on short-term debt.
- **Macroeconomic instability and fears for crisis fuel risk aversion.** The panicked market reaction gives rise to the fears of a full-blown financial crisis in Argentina once again coming rushing to the fore. In recent years Argentina is battling recession, double-digit inflation and rising poverty levels. President Macri has made some progress saving Argentina's economy, including reaching a trade deal with EU recently. Now, policy uncertainties are mounting. Implied default probability based on 5-year CDs spiked to 80%. Further FX depreciation will pose risks to solvency. According to our EM crisis framework, economic cycles and non-market risks are the most important factors explaining the current Argentine turmoil (other two factors are global financial environment and amount of earlier capital inflows). As the populist leader is likely to win the election, investors are moving away from riskier assets, adding support to Yen and gold prices, which scaled highest to US\$1,523 per ounce (as of 13 Aug).
- **Cross-country contagion risk remains moderate.** The key market concern now is the threat of financial contagion from Argentina turmoil to emerging markets in Asia and beyond. Among the four factors of our contagion-mechanism, heightened awareness and herd behavior are the main channels for contagion now, which means that other EM can do more to release positive signals and stabilize markets' expectations, such as adjusting monetary policies quickly. This is why we think the contagion risk of the current Argentine turmoil remains modest.
- **Global easing tide stands to help EM, but risks loom amid US protectionist measures and geopolitical tensions.** More dovish stance by major central banks including Fed and ECB is alleviating pressure on EM currencies and supporting capital flows. That said, outlooks for many EM have been weakened quickly such as South Korea due to global headwinds. We have assessed the resilience of EM using multiple groups of data including external debt/GDP, leverage ratio, fiscal deficit ratio, etc. and we identify Turkey, Argentina, Venezuela and South Africa as the most vulnerable.

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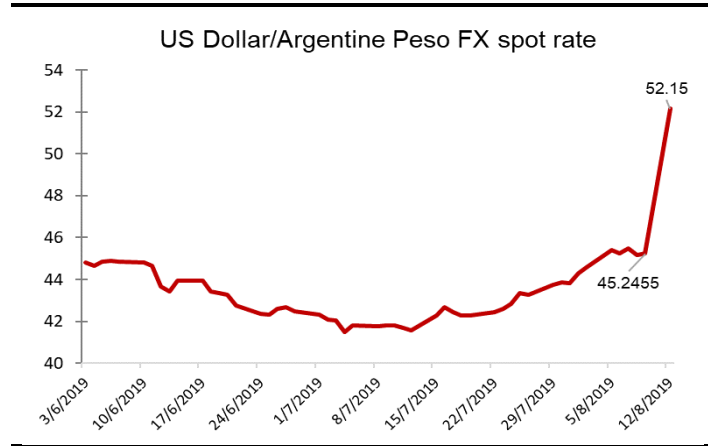
Focus Charts

Figure 1: Argentine election shock roils equity market



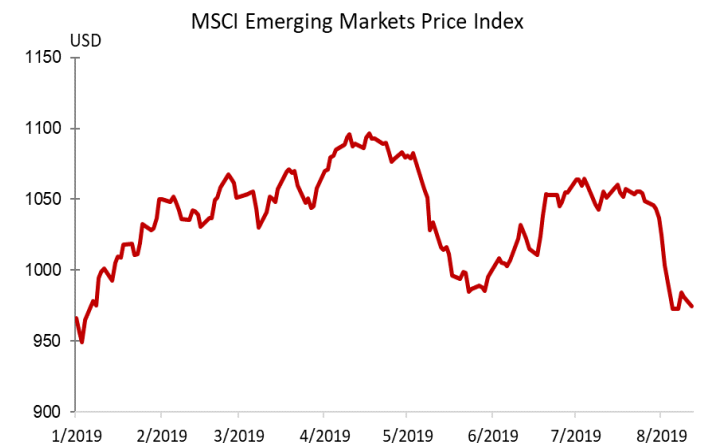
Source: Thomson Reuters Eikon, CMBIS

Figure 2: Argentine currency (Peso) slumped 30% against the dollar to a record low



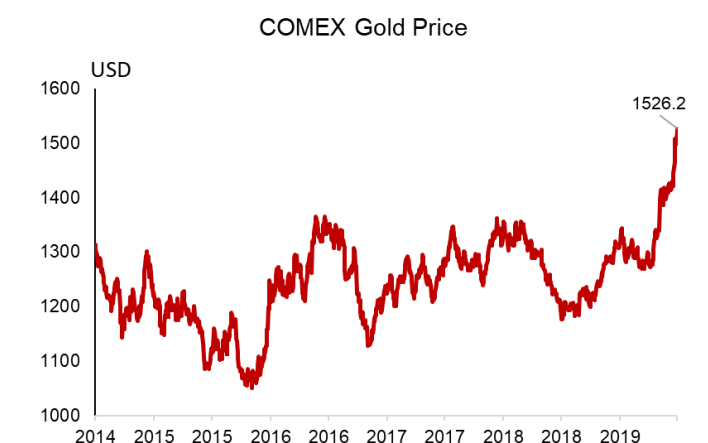
Source: Thomson Reuters Eikon, CMBIS

Figure 3: MSCI Emerging Markets Price index has corrected sharply as trade battle flares



Source: Thomson Reuters Eikon, CMBIS

Figure 4: Argentine turmoil fuels risk aversion, sending gold price to record high



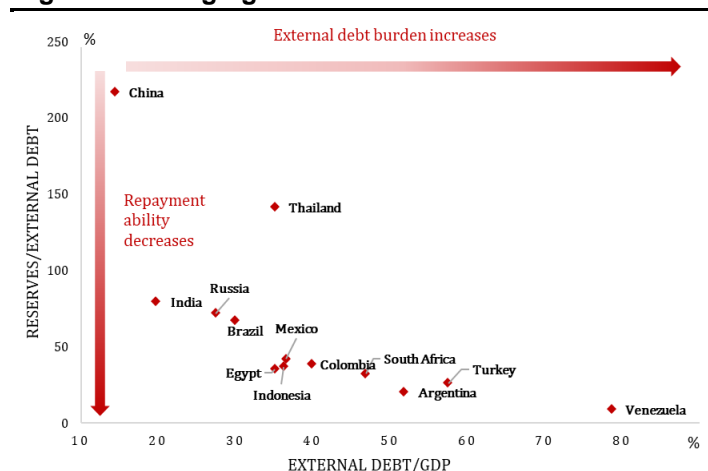
Source: Thomson Reuters Eikon, CMBIS

Figure 5: Emerging markets risk assessment

	Real GDP growth rate(2018)	Macro economic conditions	Crisis resilience	Non-market risks	Overall risks
Venezuela	-18	Red	Red	Red	Red
Argentina	-2.5	Red	Red	Red	Red
Turkey	2.6	Red	Red	Red	Red
Egypt	5.3	Red	Red	Red	Red
South Africa	0.8	Red	Red	Yellow	Red
Colombia	2.7	Yellow	Red	Red	Red
Brazil	1.1	Red	Yellow	Yellow	Red
Russia	2.3	Yellow	Yellow	Red	Red
India	7	Yellow	Yellow	Yellow	Yellow
Thailand	4.1	Grey	Yellow	Red	Yellow
Indonesia	5.2	Yellow	Yellow	Yellow	Yellow
Mexico	2	Yellow	Yellow	Yellow	Yellow
Chile	4	Yellow	Yellow	Yellow	Yellow
Poland	5.1	Grey	Yellow	Yellow	Yellow
China	6.6	Grey	Yellow	Yellow	Yellow
Czech Republic	2.9	Grey	Yellow	Yellow	Yellow

Source: IMF, CMBIS (Red: high risks; Yellow: moderate risks; Grey: low risks)

Figure 6: Emerging markets resilience assessment



Source: CEIC, CMBIS

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