Emerging Markets Spotlight

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"Higher oil prices could be a game changer for Asia's trade-gap trio"

Reuters, April 26, 2018

The first four months of 2018 have a more challenging global environment for emerging markets, notably a rising oil price alongside a strengthening US dollar and higher global bond yields. This combination of drivers exposes both countries with external financing needs, i.e. those with large and/or persistent current account deficits, and those with significant oil import bills. And the main way that those weaknesses come through is in currency movements. Emerging market currencies have generally been weak against the dollar so far this year, but an analysis of the two drivers mentioned above shows some distinct patterns. Overall, three groups of countries emerge.

The first, which have been the main point of focus in commentary, are the current account deficit oil importers. The Reuters article from which the above quote comes focuses on India, Indonesia and the Philippines, but the worst hit emerging currencies year-to-date have been the Turkish lira (down 11.0% against the US dollar at the time of writing), and the Argentine peso (down 17.9%). Both countries are expected to have current account deficits in excess of 5% of GDP this year and both are now facing the prospect of severe monetary policy tightening to limit currency weakness.

India, Indonesia and the Philippines also all run current account deficits and are substantial net oil importers. In the first quarter of 2018, crude oil imports costs rose year-on-year in India by US$5bn, in Indonesia by US$1bn and in the Philippines by US$130m. Correspondingly, these countries have all seen currency weakness year-to-date, but so have several other emerging markets. Overall, the group of Argentina, Turkey, India, Indonesia, the Philippines, Pakistan, Brazil, Chile, Peru and South Africa have an average forecast current account deficit of 2.7% of GDP, will see that worsen by 0.4% of GDP for each US$10 increase in the crude oil price, and have seen average currency move of -5.9% against the US dollar year-to-date.

The second group are the oil importers whose current account balances are so strong that they are, for now, able to weather the rising oil price. Exclusively in emerging Asia, this group comprises South Korea, Taiwan, Malaysia and Thailand. These countries have an average forecast current account surplus of 7.1% of GDP, will see that worsen by 0.5% of GDP for each US$10 increase in the crude oil price, but have seen average currency move of +0.8% against the US dollar year-to-date.

The third group are the pair of Mexico and Colombia. Each produces about 600k barrels of oil equivalent per day more than they consume, and so although they run current account deficits, a US$10 increase in the crude oil price improves their current account balances by an estimated 0.2% and 0.7% of GDP respectively; both currencies have strengthened against the US dollar so far this year as a consequence. Building on our comments of last month, this is another reason to be more positive about Mexican assets in the run-up to July's presidential election.

Finally, the above analysis does not mention one important country. Russia produces an annual 2.9bn barrel annual oil surplus, so oil's move from the 2017 average of US$54 per barrel to the current US$77 is worth an extra US$67bn to Russia, or 4.3% of GDP, while Russia's forecast current account surplus is already 3.1% of GDP. At this oil price, Russian assets should be performing very strongly, yet the Russian ruble has fallen 7.8% against the US dollar year-to-date. Politics notwithstanding, if there is one emerging market that most benefits from this environment, it is Russia.

Sources for all data: Bloomberg

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