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Emerging Nation Debt: Which Countries Are Less Resilient to External Risks?

Turkey is the most serious. Note also Colombia, Chile and Hungary

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Summary

- Against the backdrop of rate hikes by the U.S. Federal Reserve (FRB) and the strengthening of the dollar, there are concerns about the resilience of emerging nations to changes in the external environment. The impact of FRB rate hikes varies depending on the size of each country's current account deficit, the type of external financing, whether there are industries that attract FDI, whether or not to raise funds denominated in the national currency, the level of foreign currency reserves, and the exchange rate regime. Looking at the heat map, no other major emerging nations have seen an imminent balance of payments crisis, unlike Tunisia and Sri Lanka which requested assistance from the IMF in 2022. However, some countries need attention.

- For example, Colombia and Chile have high external debt to GDP, and their current account deficits expanded significantly in 2022. In both countries, portfolio investments account for a relatively high proportion of the current account deficit as a financing instrument. Furthermore, sizable nonresident holdings of government bonds tend to make capital flows volatile upon risk aversion. Since Latin American countries have high U.S. dollar-denominated debt ratios held by government, non-financial institutions, and financial institutions, attention should be paid to the increase in the burden of debt repayment due to the strong dollar.

- Next is Hungary. Against the backdrop of the conflict between right-wing Prime Minister Alban and the EU, there is a possibility that disbursement from EU funds and reconstruction funds will be suspended. Although the large size of FDI and the low ratio of debt denominated in US dollars are reassuring factors, it could induce a sharp decline in the Hungarian forint if the EU oppose the release of funds. Hungary's reserves are already below the safety level and thus warrant attention. And finally, Turkey is risky in that it has a large current account deficit and a large amount of bank borrowing as a means of financing it. Since the ratio of U.S. dollar-denominated liabilities in financial institutions is high at around 70%, there is a tendency for foreign exchange risk to increase. It would be highly desirable to strengthen external buffers.

Attention
This report is a summary translation. The official document is only in Japanese.

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