Capital Flows Report
The Fading COVID Inflation Shock

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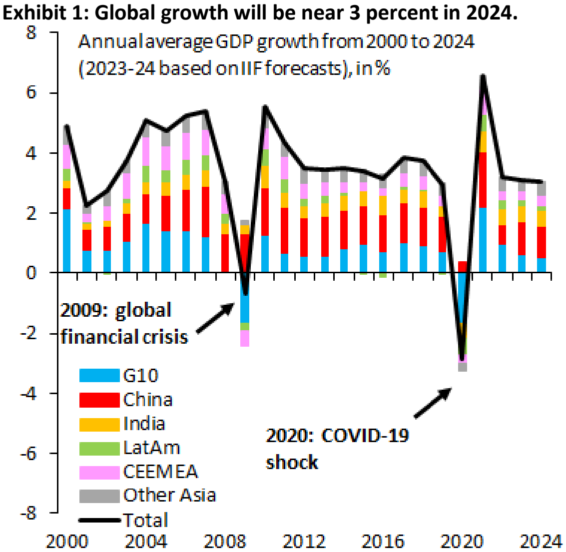
- We forecast solid – if unspectacular – global growth next year, ...
- with above-consensus forecasts for the US, Latin America and China, ...
- while the ongoing war in Ukraine puts us below consensus for the Euro zone.
- The biggest change from the Capital Flows Report one year ago is on inflation, ...
- where our certainty that the COVID inflation shock is finally fading has grown.
- The combination of solid growth and fading inflation is a positive one for EM.
- We forecast a substantial rebound in capital flows to non-China EM, ...
- even as geopolitical risk will continue to weigh on flows to China.

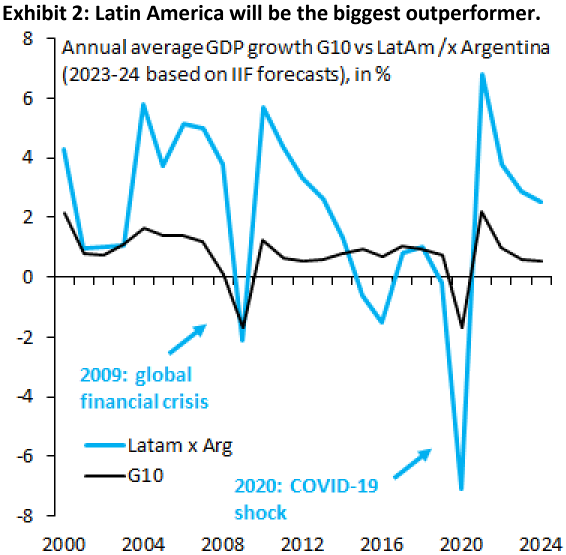
We laid out our global growth forecast in a ***Global Macro Views*** a few weeks ago. We forecast solid – if unspectacular – global growth next year. We are substantially above consensus for the US, Latin America and – to a lesser extent – China. In contrast, we are bearish on the Euro zone, where growth will continue to be weighed down by war in Ukraine, higher energy prices and limited fiscal space in periphery countries. The biggest change from the ***Capital Flows Report*** one year ago is on inflation, where our certainty that the COVID inflation shock is finally fading has grown. Early in 2023, we published work showing that lagged effects from COVID supply disruptions were important, which led us to forecast faster declines in inflation than consensus. We expect these disinflationary forces to keep operating well into next year, especially in Europe, where inflation declines have lagged the US. The combination of solid growth and fading global inflation paint a positive picture for capital flows to non-China EM, even as elevated geopolitical risk may continue holding back capital flows to China.

Exhibit 1: Global growth will be near 3 percent in 2024.



Source: Haver, IIF

Exhibit 2: Latin America will be the biggest outperformer.



Source: Haver, IIF

We expect global growth in 2024 to continue its gradual slowdown from its torrid pace in the immediate aftermath of COVID (Exhibit 1), but that should not be seen as a negative. Indeed, global growth around 3.0% is comparable to global growth in the decade before the COVID shock. In other words, activity is back to its pre-COVID trend. Our forecast therefore shares with the IMF and Bloomberg consensus that the post-COVID equilibrium – in terms of growth – is comparable to where we were pre-pandemic. Under the surface, however, there are big differences. Most important, we are substantially above consensus for Latin America, where – excluding the COVID shock – we forecast the strongest pace of growth in over a decade (Exhibit 2). This is partly because the region has many commodity exporters, who are benefitting from a positive terms-of-trade shock since Russia invaded Ukraine. It also reflects geography, given that Latin America is far removed from the rapidly increasing number of hotspots around the world.

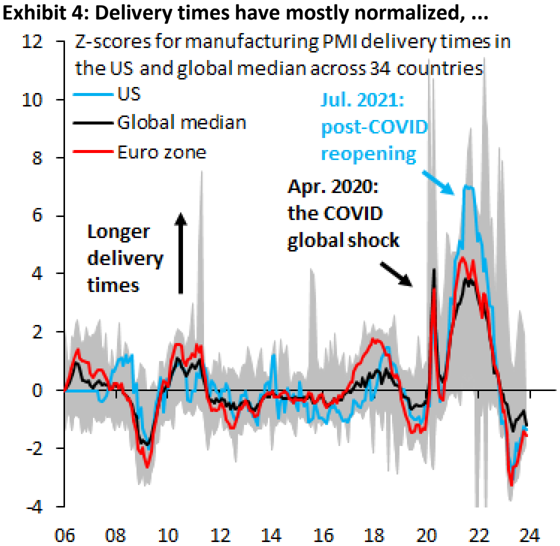
Excluding Argentina, we forecast 2.6% growth in 2024, substantially above Bloomberg consensus (1.9) and the IMF (1.9). For Argentina we forecast deep recession in 2024, as the needed fall in domestic demand pulls down GDP growth. Among the major economies, we are substantially above consensus for China, where we forecast growth of 5%, while we are – and have been – more bearish on Europe than the IMF or consensus (Exhibit 3). Risks to this forecast are balanced and linked mainly to geopolitics.

Exhibit 3. Global GDP Growth, in % y/y

	2019	2020	2021	2022	2023	IIF 2024	BBG 2024	IMF 2024
World (PPP weights)	**2.8**	**-3.0**	**6.4**	**3.2**	**3.0**	**3.0**	**2.5**	**2.8**
Mature Markets	**1.8**	**-4.3**	**5.6**	**2.6**	**1.4**	**1.3**	**0.9**	**1.3**
G3	**1.8**	**-3.9**	**5.4**	**2.4**	**1.5**	**1.4**	**0.9**	**1.3**
United States	2.5	-2.2	5.8	1.9	2.3	2.0	1.2	1.5
Euro Area	1.6	-6.1	5.9	3.4	0.4	0.6	0.6	1.2
Japan	-0.4	-4.2	2.2	1.0	2.1	1.2	0.9	1.0
EM	**3.5**	**-2.0**	**7.1**	**3.7**	**4.1**	**4.2**	**3.8**	**3.9**
EM x/ China	**2.2**	**-4.0**	**6.2**	**4.1**	**3.5**	**3.7**	**3.5**	**3.5**
Latin America	**-1.0**	**-7.0**	**6.8**	**4.0**	**2.2**	**2.1**	**1.5**	**2.0**
Latin America x/ARS	**-0.9**	**-6.6**	**6.3**	**3.9**	**2.8**	**2.6**	**1.9**	**1.9**
Brazil	1.2	-3.3	5.0	2.9	3.1	2.4	1.6	1.5
Mexico	-0.3	-8.7	5.8	3.9	3.4	2.7	2.0	2.1
Argentina	-2.0	-9.9	10.7	5.0	-2.2	-1.3	-1.6	2.8
Chile	0.7	-6.1	11.7	2.4	-0.1	2.5	1.9	1.6
Colombia	3.2	-7.3	11.0	7.3	1.2	1.8	1.8	2.0
CEEMEA	**2.2**	**-2.0**	**6.7**	**0.3**	**2.6**	**2.5**	**2.3**	**2.1**
CEEMEA x/RUB & UAH	**2.1**	**-1.4**	**7.6**	**4.3**	**2.1**	**2.3**	**2.7**	**2.7**
Russia	2.2	-2.7	5.6	-2.1	3.4	2.8	1.4	1.1
Ukraine	3.2	-3.8	3.4	-29.1	2.9	2.7	4.6	3.2
Turkey	0.8	1.9	11.4	5.5	4.2	2.5	3.0	3.0
Saudi Arabia	0.8	-4.3	3.9	8.8	0.5	5.4	3.4	4.0
South Africa	0.3	-6.0	4.7	1.9	0.5	1.0	1.2	1.8
Asia/Pacific	**5.2**	**-1.0**	**7.7**	**4.2**	**5.1**	**5.1**	**4.8**	**4.9**
Asia x/ China	**4.3**	**-4.8**	**6.4**	**5.8**	**5.0**	**5.3**	**5.2**	**5.2**
China	6.0	1.9	8.8	3.0	5.2	5.0	4.5	4.6
India (FY)	3.9	-5.8	9.1	7.2	6.4	6.4	6.3	6.3

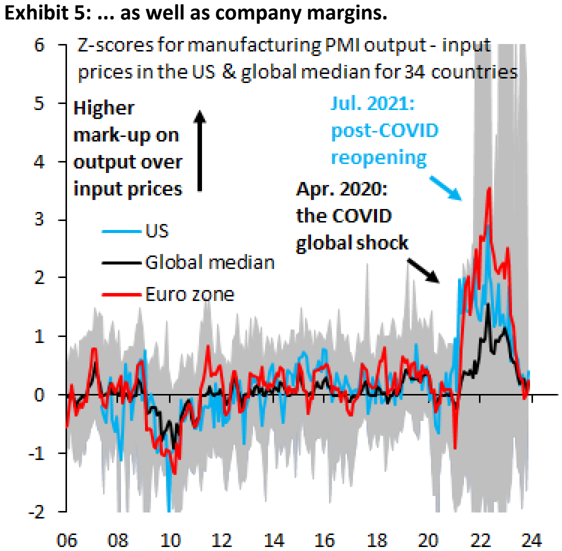
The inflation outlook has fundamentally changed from a year ago – for the better. Earlier this year, we developed an out-of-consensus view that supply disruptions at the height of COVID were still driving high inflation well into 2023, because lagged effects were playing an important role. This view has been borne out by data. Exhibit 4 shows Z-scores for US and Euro zone delivery delays from the global manufacturing PMI database. Delivery times normalized in the course of 2022, which caused some consternation because inflation remained high. However, as we showed earlier this year, mark-ups charged by firms only began to normalize with a considerable lag (Exhibit 5) and has further to run. As a result, the unwind of COVID supply disruptions will continue to pull inflation lower in 2024, especially in Europe where the fall in inflation has lagged the US.

Exhibit 4: Delivery times have mostly normalized, ...



Source: Haver, IIF

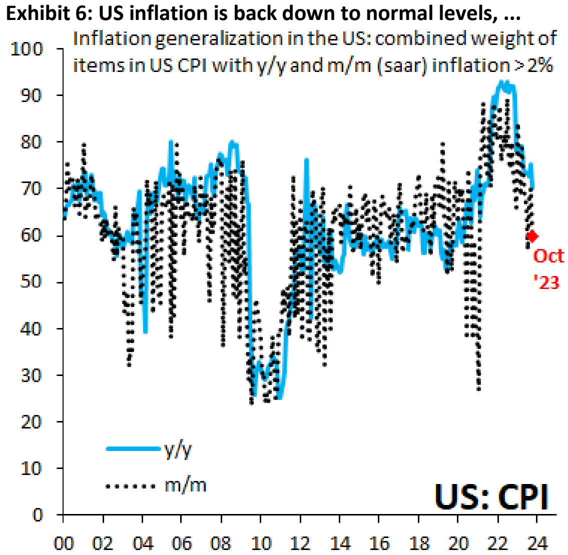
Exhibit 5: ... as well as company margins.



Source: Haver, IIF

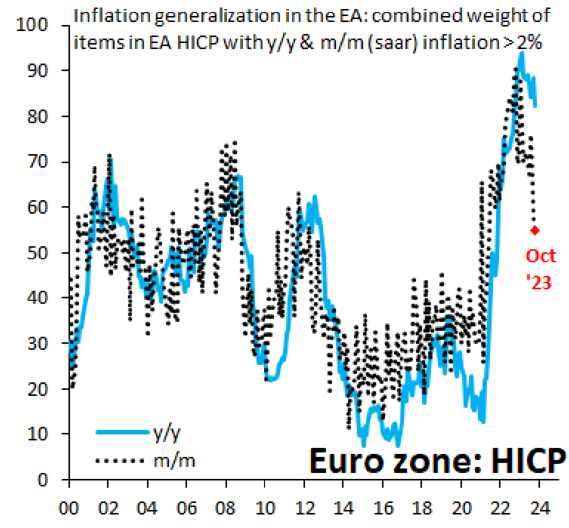
Indeed, our high frequency data tracking shows exactly this. We have paid close attention to our inflation generalization indices since mid-2022, which measure the combined weight of items with month-over-month inflation above 2%. For the United States (Exhibit 6), this generalization index began to show falling inflation pressure well over a year ago. The same is true – with a lag – for the Euro zone, where our inflation generalization index has registered sharp falls in recent months (Exhibit 7). Overall, what is clear is that the COVID inflation shock never really spilled over into broad-based inflation, as you would expect if there had been a strong demand-led component. Instead, it looks like supply factors were – in the end – the bulk of the story, so that *"Team Transitory"* is rehabilitated to an important degree.

Exhibit 6: US inflation is back down to normal levels, ...



Source: Haver, IIF

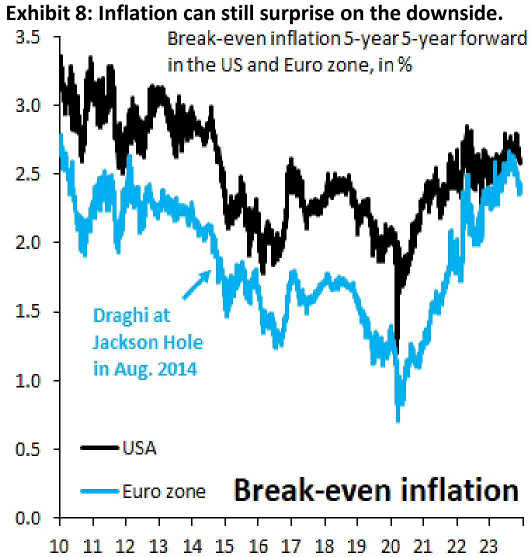
Exhibit 7: ... while Eurozone inflation registered sharp falls.



Source: Haver, IIF

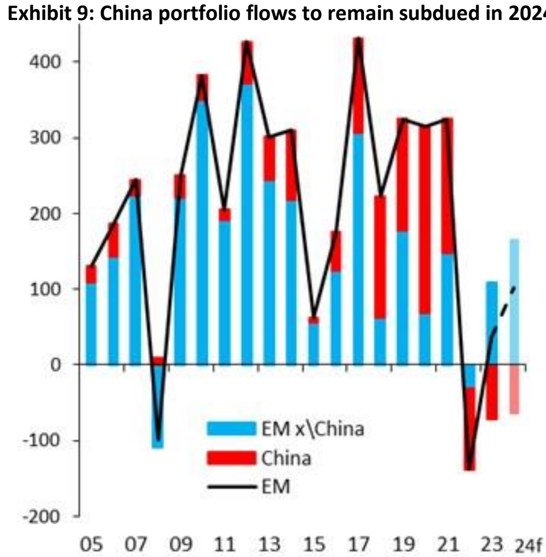
Given our benign view on inflation, we think there is still scope for inflation to surprise on the downside, especially for the Euro zone, where 5y5y forward breakeven inflation is still near US levels, a historical anomaly (Exhibit 8). Indeed, our solid – if unspectacular – global growth forecast combined with a benign inflation view bodes well for capital flows to emerging markets, where we see a bifurcation. Flows to non-China EM should benefit from the fall in global inflation, as advanced economy central banks turn less hawkish. Flows to China, however, will continue to be held back by elevated geopolitical risk. Our high-frequency tracking of global capital flows to EM picks up this bifurcation through Q4 2023, which we expect to continue. Overall, we project non-resident portfolio flows to EM x-China to run at $167 bn in 2024 (Exhibit 9), while China non-resident portfolio flows will remain subdued (outflow of $65 bn).

Exhibit 8: Inflation can still surprise on the downside.



Source: Haver, IIF

Exhibit 9: China portfolio flows to remain subdued in 2024.



Source: Haver, IIF

MODERATING COMMODITY PRICES

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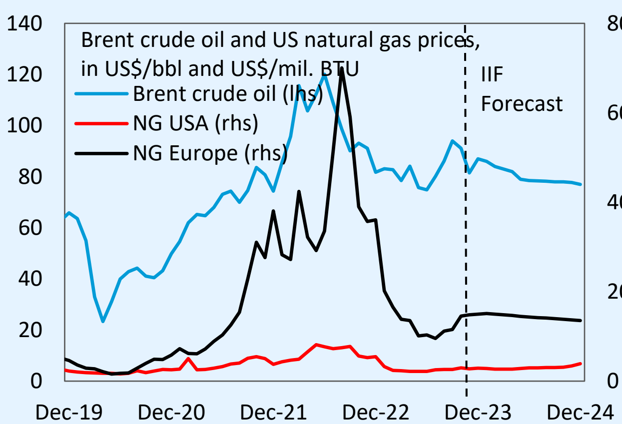
The impact of the war between Israel and Hamas on commodity prices has been limited. With the exception of gold, which is an attractive investment during periods of political and economic uncertainty, oil, food, and metal prices have remained broadly stable in recent months. Initially, oil traders were concerned that the conflict could widen into a larger regional war threatening oil supply. These fears have abated in recent weeks, with the market focused more on the OPEC+ November 30th meeting.

We are cautiously optimistic that Brent oil prices will average US$80/b in 2024 (as compared to an average of $83/b in 2023) (Exhibit 10). On November 30th OPEC+ agreed to cut an extra 1.2 million barrels a day (mb/d) of crude oil production, in addition to extending Saudi Arabia's voluntary cut of 1 mb/d through end-March of 2024. However, oil prices fell back to around $75/b as of December 6th, as traders were skeptical on whether the new agreement will be fully implemented. While the detailed breakdown of the agreed cuts was not available as of writing, it is expected that Russia will increase its voluntary reduction by 0.3 mb/d and the remaining 0.6 mb/d cut will be distributed among other major OPEC+ oil producers, particularly Iraq, the UAE, and Kuwait. Nonetheless, such cuts by OPEC+ could be offset by the continued production growth in non-OPEC+ countries, most notably in the USA, Brazil, Canada, and Guyana. Moreover, Iran, Libya, and Venezuela (the 3 OPEC members who are producing well below their quotas) are likely to increase their production further in 2024. On the demand side, we see the increase in global oil consumption decelerating from 2.2 mb/d in 2023 to 1.3 mb/d in 2024, with most of the increase driven by Asian emerging economies. Oil demand could be broadly flat in the USA and decline slightly in Europe and Japan. As a result, OECD oil inventories are likely to continue their recent increase. However, the range of uncertainty over the price of oil remains large. The upside risks include the potential for the war in Gaza spiraling into a prolonged regional war (low probability) that leads to a significant decline in global oil supply, particularly if Iran causes disruption in shipments of oil in the strait of Hormuz. In such a scenario, we expect oil prices between $90/b and $120/b in 2024, depending on the duration of the supply disruptions. Downside risks include the possibility that several major OPEC+ members, particularly Russia and Iraq, fail to comply with the recent OPEC+ agreement, which could also lead to an increase in oil production by Saudi Arabia, driving a larger fall in prices.

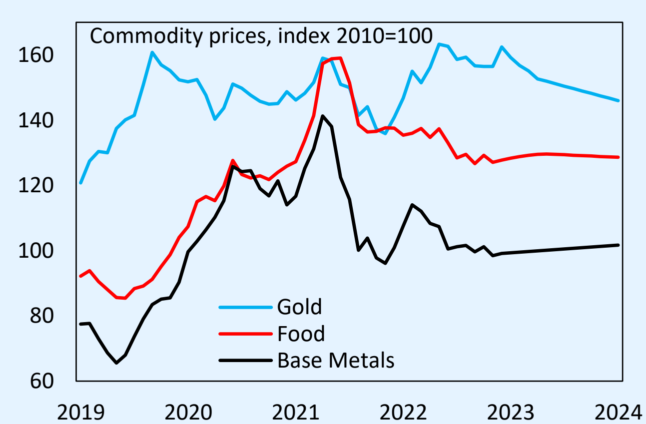
Food and base metal prices have weakened significantly in 2023 and are likely to decline marginally in 2024 (Exhibit 11). Food prices declined by 9% in the first 10 months of this year as compared with the corresponding period last year. Prices of all major food commodities except sugar and rice contributed to the decline. As a result of a robust supply response in the 2022-2023 season, wheat prices fell by 19%. Nonetheless, most food prices are still well above their average for 2015-2019. In this context, food security concerns prompted export restriction in India, which accounts for 40% of the market for rice. This has contributed to the 25% jump in rice prices. While wheat and soybean prices may decline slightly, rice prices could remain high into 2024, primary due to reduced yields and continued rice export restrictions in India. Base metal prices declined by 11% in the first 10 months of this year as compared with the corresponding period of last year, as China's real estate sector have weakened, which together with construction accounts for around 20% of global metal consumption. In 2024, China's robust demand for infrastructure is expected to offset the continued weaker demand for some metals for the residential construction sector. Global macro trends will be supportive of base metal prices beyond the short-term. Several base metals (especially aluminum, copper, and zinc) stand to benefit from the expected transition away from carbon-intensive energy towards green energy (including electric vehicles, wind turbines, solar power, and battery storage.

Exhibit 10. Oil prices decline further to $80/b in 2024.



Source: Haver, IIF

Exhibit 11. Food and base metal prices stabilize in 2024.



Source: Haver, IIF

Table 1. Global Growth Forecasts

Real GDP Growth, change y/y (%)	2015	2016	2017	2018	2019	2020	2021	2022	2023f	2024f
World (PPP weights)	**3.5**	**3.4**	**3.7**	**3.6**	**2.8**	**-3.0**	**6.4**	**3.2**	**3.0**	**3.0**
Mature Markets	**2.3**	**1.7**	**2.4**	**2.2**	**1.8**	**-4.3**	**5.6**	**2.6**	**1.4**	**1.3**
G3	**2.3**	**1.6**	**2.3**	**2.2**	**1.8**	**-3.9**	**5.4**	**2.4**	**1.5**	**1.4**
United States	2.7	1.7	2.2	2.9	2.5	-2.2	5.8	1.9	2.3	2.0
Euro Area	2.0	1.9	2.6	1.8	1.6	-6.1	5.9	3.4	0.4	0.6
Japan	1.6	0.8	1.7	0.6	-0.4	-4.2	2.2	1.0	2.1	1.2
Emerging Markets	**4.5**	**4.6**	**4.7**	**4.7**	**3.5**	**-2.0**	**7.1**	**3.7**	**4.1**	**4.2**
Emerging Markets x/China	**3.2**	**3.5**	**3.6**	**3.6**	**2.2**	**-4.0**	**6.2**	**4.1**	**3.5**	**3.7**
Latin America	**-0.1**	**-1.4**	**1.0**	**0.7**	**-1.0**	**-7.0**	**6.8**	**4.0**	**2.2**	**2.1**
Argentina	2.7	-2.1	2.8	-2.6	-2.0	-9.9	10.7	5.0	-2.2	-1.3
Brazil	-3.5	-3.3	1.3	1.8	1.2	-3.3	5.0	2.9	3.1	2.4
Chile	2.2	1.8	1.4	4.0	0.7	-6.1	11.7	2.4	-0.1	2.5
Colombia	3.0	2.1	1.4	2.6	3.2	-7.3	11.0	7.3	1.2	1.8
Mexico	2.7	1.8	1.9	2.0	-0.3	-8.7	5.8	3.9	3.4	2.7
Venezuela	-6.2	-17.0	-15.7	-19.6	-37.0	-21.4	3.8	7.7	3.3	4.8
Emerging Europe	**1.2**	**1.7**	**4.1**	**3.4**	**2.3**	**-1.6**	**7.2**	**-0.2**	**0.5**	**0.5**
Czech Republic	5.4	2.5	5.2	3.2	3.0	-5.5	3.6	2.4	-0.4	1.5
Hungary	3.7	2.2	4.3	5.4	4.9	-4.5	7.1	4.6	-0.6	1.9
Poland	4.4	3.0	5.1	5.9	4.9	-2.0	6.9	5.2	0.3	2.8
Russia	-2.0	0.2	1.8	2.8	2.2	-2.7	5.6	-2.1	3.4	2.8
Turkey	6.1	3.3	7.5	3.0	0.8	1.9	11.4	5.5	4.2	2.5
Ukraine	-9.8	2.4	2.4	3.5	3.2	-3.8	3.4	-29.1	2.9	2.7
Asia/Pacific	**6.5**	**6.8**	**6.3**	**6.4**	**5.2**	**-1.0**	**7.7**	**4.2**	**5.1**	**5.1**
China	7.0	6.9	6.9	6.8	6.0	1.9	8.8	3.0	5.2	5.0
India*	8.0	8.3	6.8	6.5	3.9	-5.8	9.1	7.2	6.4	6.4
Indonesia	4.9	5.0	5.1	5.2	5.0	-2.1	3.7	5.3	5.0	5.1
Malaysia	5.0	4.5	5.8	4.8	4.4	-5.5	3.3	8.7	4.0	4.3
Philippines	6.3	7.1	6.9	6.3	6.1	-9.5	5.7	7.6	5.2	5.9
South Korea	2.8	2.9	3.2	2.9	2.2	-0.7	4.3	2.6	1.3	2.3
Thailand	3.1	3.4	4.2	4.2	2.1	-6.1	1.5	2.6	2.4	3.7
Africa/Middle East	**3.0**	**3.4**	**1.5**	**1.8**	**1.0**	**-1.9**	**3.8**	**5.4**	**2.0**	**3.3**
Algeria	3.7	3.2	1.4	1.2	1.0	-5.1	3.4	3.2	3.0	2.8
Egypt	4.4	4.3	4.2	5.3	5.5	3.6	3.3	6.7	4.0	3.3
Iran	-1.4	8.8	2.8	-1.8	-3.1	3.3	4.7	3.7	1.9	2.6
Lebanon	0.5	1.6	0.9	-1.9	-6.9	-25.9	-10.0	1.8	-0.6	-0.3
Nigeria	2.7	-1.6	0.8	1.9	2.2	-1.8	3.6	3.3	2.5	3.1
Qatar	4.8	3.1	-1.5	1.2	0.7	-3.6	1.5	4.3	0.6	2.5
Saudi Arabia	4.7	2.4	-0.1	2.8	0.8	-4.3	3.9	8.8	0.5	5.4
South Africa	1.3	0.7	1.2	1.6	0.3	-6.0	4.7	1.9	0.5	1.0
UAE	6.8	5.6	0.7	1.3	1.1	-5.0	4.4	7.9	3.8	3.2

Source: IIF. Aggregates calculated using previous year's nominal GDP in $ as weights unless otherwise noted.
**India real GDP growth reported in calendar year; country notes and databases report in fiscal year.*

Note: Our full country database can be downloaded from our website.

Table 2. Emerging Markets excl. China – Capital Flows

$ bn (+ = inflow of capital, - = outflow of capital)	2019	2020	2021	2022	2023f	2024f
Non-resident Capital Flows	**820**	**604**	**1034**	**670**	**622**	**794**
Foreign direct investment	457	450	480	370	307	379
Equity	396	324	380	307	259	301
Debt	61	126	100	63	48	78
Portfolio investment	177	68	148	-31	108	167
Equity	31	-33	-29	-5	34	66
Debt	147	101	177	-26	74	101
Other investment (largely banking related flows)	186	85	405	331	207	248
Resident Capital Flows	**-708**	**-705**	**-854**	**-875**	**-537**	**-591**
Direct investment abroad	-292	-297	-323	-216	-182	-235
Portfolio investment	-143	-181	-281	-136	-150	-130
Other investment (largely banking related flows)	-273	-227	-250	-522	-206	-226
Financial derivatives, net	3	-3	1	6	-3	-2
Capital transfers	14	19	14	-1	6	8
Reserves (- = increase)	-136	-58	-287	71	-58	-209
Net errors and omissions	-29	20	-29	-22	-10	0
Net Capital Flows	115	-104	181	-200	82	200
Net Capital Flows plus Errors & Omissions	**86**	**-84**	**152**	**-222**	**72**	**200**
Memo:						
Current Account Balance	-46	-135	-136	-156	11	-1
Official Flows	-1	33	80	53	67	63

Source: IIF. See annexes 1 and 2 for guidance on how to interpret these data and country coverage

Table 3. Emerging Markets – Capital Flows

$ bn (+ = inflow of capital, - = outflow of capital)	2019	2020	2021	2022	2023f	2024f
Non-resident Capital Flows	**1111**	**1195**	**1717**	**649**	**486**	**739**
Foreign direct investment	644	703	824	550	312	409
Equity	558	545	681	467	274	328
Debt	86	159	144	83	39	81
Portfolio investment	325	315	325	-139	36	102
Equity	76	47	54	30	39	51
Debt	249	268	271	-168	-2	51
Other investment (largely banking related flows)	142	176	568	238	137	228
Resident Capital Flows	**-989**	**-1346**	**-1577**	**-1060**	**-697**	**-1011**
Direct investment abroad	-429	-451	-501	-366	-362	-415
Portfolio investment	-233	-332	-406	-310	-260	-270
Other investment (largely banking related flows)	-328	-563	-669	-384	-76	-326
Financial derivatives, net	1	-14	11	0	-12	-12
Capital transfers	14	19	14	-2	6	8
Reserves (- = increase)	-116	-86	-475	-25	19	92
Net errors and omissions	-158	-139	-164	-112	-60	-80
Net Capital Flows	123	-165	151	-411	-223	-285
Net Capital Flows plus Errors & Omissions	**-36**	**-304**	**-13**	**-523**	**-283**	**-365**
Memo:						
Current Account Balance	-149	-383	-489	-558	-280	-277
Official Flows	-2	32	80	52	66	62

Source: IIF. See annexes 1 and 2 for guidance on how to interpret these data and country coverage

China

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AN ARDUOUS RECOVERY

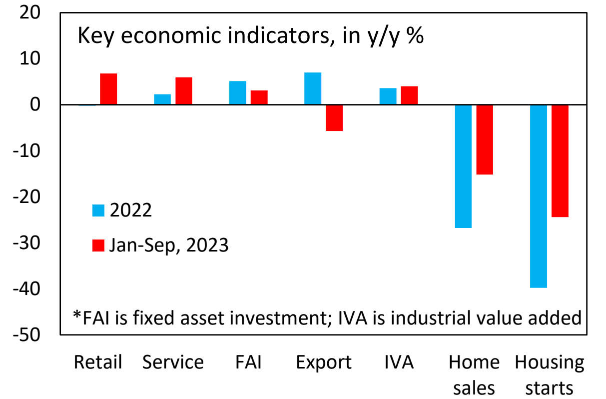
China's economy experienced a bumpy post-Covid recovery in 2023, facing significant strains due to a housing recession negatively affecting activity in related sectors such as consumer durables and local government finances. Moreover, the post-Covid shift in global consumer spending from goods to services weighed on China's exports (Exhibit 12). However, supported by substantial household savings, pent-up consumer demand, especially in service sectors, provided a lift to economic activity, contributing to an estimated increase in real GDP growth of 5.2% in 2023 from 3% in 2022.

In 2024, several factors look set to support output growth. The housing sector is expected to stabilize next year and reduce the drag on the economy after a two-year housing recession. Additionally, exports are poised to contribute positively to growth with moderate global goods demand recovery alongside an upswing in the tech cycle. Furthermore, policy support, particularly those initiated in late 2023, will continue to support economic growth in 2024. We expect government spending to pick up in the last quarter (Exhibit 13). Additionally, at least half of the proceeds from the additional ¥1tn central government bond issued in 2023Q4 are allocated to finance government spending in 2024. This allocation alone is projected to boost real GDP growth by more than 0.4 pp in 2024. We forecast 5% real GDP growth in 2024, slightly above consensus and providing robust momentum to lift the economy away from deflationary pressures.

We project continued net outflows of non-resident capital from China in 2024 (Exhibit 14). After significant outflows in 2023, net outflows of non-resident portfolio debt are projected to remain substantial at $45bn in 2024. Despite the Fed's halted rate hikes, the wide USD-CNY yield spread will likely persist due to the PBoC's dovish stance. We forecast the non-resident portfolio equity flows to shift to outflows in 2024, reflecting poor earnings, and lingering concerns over market regulation and corporate governance. Our projection suggests that FDI will reach only $30bn, following the stagnant inflows in 2023. This subdued outlook reflects a few factors, such as: i) Chinese companies' overseas IPOs will likely remain difficult; ii) the retained earnings may remain low due to low profitability and more repatriation; and iii) PE/VC investments will take time to recover. Chinese residents will likely continue diversifying their portfolios with foreign investments. Residents' outbound FDI will likely hold up at $180bn in 2024 as Chinese companies seek to establish offshore production bases and secure minerals for the green industry.

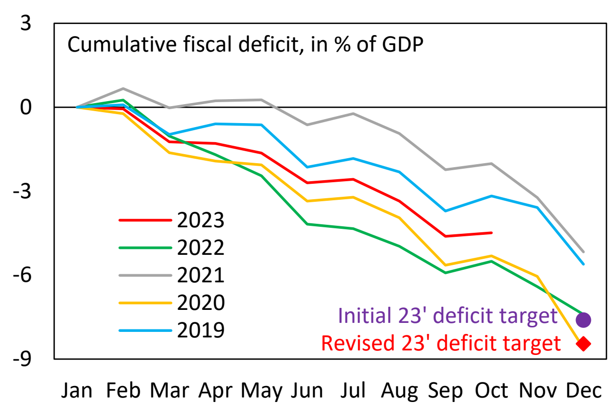
A deterioration in China's relations with the West remains a main downside risk. Concerns about de-risking, re-shoring, and technology embargoes persist, which will weigh on capital flows to China in 2024. Another downside risk is the housing sector recovery, which may take longer than we expect.

Exhibit 12. Housing and exports weighed on 2023 growth.



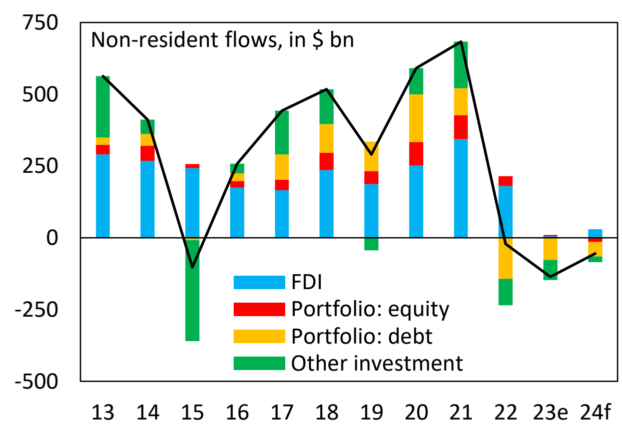
Source: Haver, IIF

Exhibit 13. Fiscal policies in '23Q4 will lift activity in '24.



Source: Haver, IIF

Exhibit 14. Nonresident outflows will likely persist in '24.



Source: Haver, IIF

Argentina

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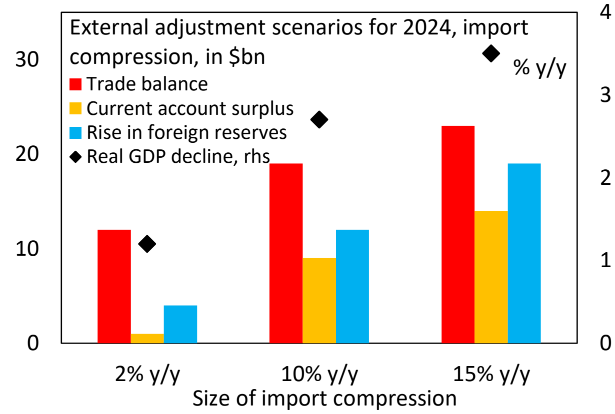
PAINFUL ADJUSTMENT

The new administration will face the daunting task of adopting tough upfront measures to address mounting imbalances that put Argentina close to a full-blown crisis without much political support (Exhibit 15). Populist policies have driven further deterioration in economic conditions this year, exacerbated by the impact of a severe drought on agricultural output. A pre-election fiscal stimulus of about 2% of GDP, financed by central bank peso printing, and tightened FX controls have pushed inflation above 150% y/y amid a wide gap between the parallel and official exchange rate. Despite weak activity, the current account deficit rose to almost 3% of GDP in 2023, leading to massive reserve losses.

The outlook hinges on the new authorities' ability to tighten policies significantly. Against a harsh external financing backdrop, including debt payments to the IMF and bondholders for $4.4bn in Dec.-Jan., the new administration aims to pursue a front-loaded stabilization plan (Exhibit 16). This entails: i) spending cuts to tackle a fiscal deficit of 5% of GDP; ii) IMF program renegotiation; and iii) central bank normalization, including FX adjustment to replenish foreign reserves. After years of misguided policies, the recent political change has initially sparked enthusiasm. The centrist party's support has provided some political muscle and policy expertise, helping moderate the new government's most controversial plans. However, no matter what policy framework prevails in 2024, we project a recession and still-high inflation, given unavoidable FX and fiscal adjustment. We forecast a real GDP contraction of 1.3% in 2024. Import compression and a grain export rebound should help shift the current account to surplus, facilitating foreign reserve accumulation. Argentina's global capital market access will likely remain restricted in 2024. Even so, we expect net borrowing from official creditors and slower resident capital outflows to limit foreign reserve drawdowns, easing pressure on the currency.

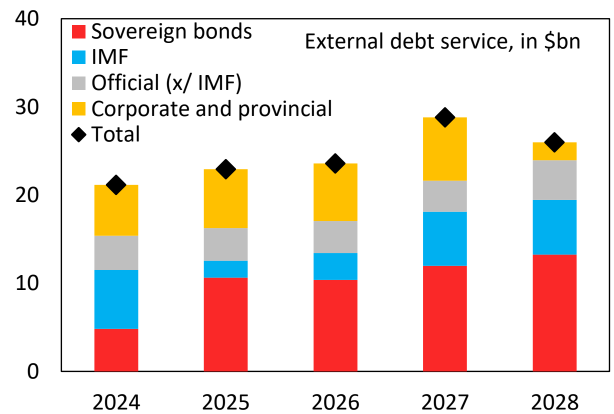
Risks to the outlook are significantly tilted to the downside. Executing an ambitious pro-market reform agenda and strict austerity measures amid a limited legislative base and fragile economic and social conditions will require skillful political leadership. Looming dollarization risk – a bold proposal that has been postponed, lacking dollars to put it in place – could erode confidence, weighing on stabilization efforts. Without enough political backing, policy implementation challenges could result in social tension and governability problems later on. Unlike the 2018 crisis, when Argentina's participation in global debt markets was significant, turmoil should not affect the rest of LatAm (Exhibit 17). In most LatAm countries, stable policy frameworks, robust commodity-linked activities, and increased nearshoring opportunities should lift private capital flows next year.

Exhibit 15. Dollarization would entail deeper recession.



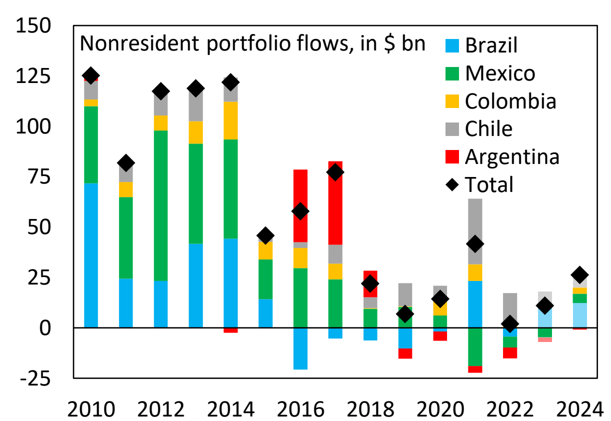
Source: Haver, IIF

Exhibit 16. Sizable external financing needs in 2024.



Source: Haver, IIF

Exhibit 17. Regional spillovers to remain contained.



Source: Haver, IIF

Turkey

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ADVANCING EFFORTS TO WOO INVESTORS

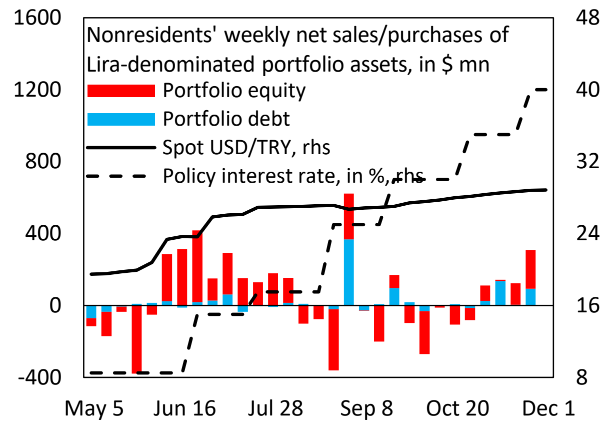
Since the May elections, investor sentiment has improved, thanks mainly to Turkey's shift to orthodox economic policies. This shift centered around hikes in the central bank's key policy interest rate and gradually simplifying macroprudential restrictions within the banking system. The central bank's rate hikes (from 8.5% in May to 40% in November) led to significantly higher yields on Lira-denominated assets, which are now offering quite attractive terms to investors (both domestic and foreign). Even so, concerns persist for foreign investors over the expected transition from a managed-floating to a free-floating exchange rate regime. Investors appear cautious to re-engage more actively with Turkish assets due to concerns about the potential impact of this transition on the Lira exchange rate (Exhibit 18).

The near-term outlook depends on how easily and at what cost Turkey will be able to roll over its maturing external liabilities. Since May, Turkish borrowers have been quite successful in increasing external debt rollover ratios, with figures exceeding 100% for banks and other sectors, indicating net inflows of nonresident capital to Turkey (Exhibit 19). The continuation of this success will play a vital role not only in determining the Lira's near-term performance but also shaping Turkey's growth and investment prospects into 2024. We expect robust market access for rolling over external debt for both public and private sector borrowers. This expectation mainly reflects improved foreign creditor sentiment since May, following changes in the economic management team and the adoption of significantly tighter policies.

The signs of enhanced investor confidence are evident in Turkey's growing FX reserves and declining CDS spreads, which have narrowed from around 700bps in late May to approximately 340bps in early December (Exhibit 20). We expect orthodox policies will be maintained, and higher interest rates will help Turkey attract sufficiently large capital flows to finance a smaller current account deficit of 3.2% of GDP in 2024, down from an estimated 4.5% of GDP in 2023. We project such tight policy stance and external financing scenario to align with a slowdown in real GDP growth to 2.5% in 2024 (which compares to a consensus growth forecast of 3% for 2024), from an estimated 4.2% in 2023.

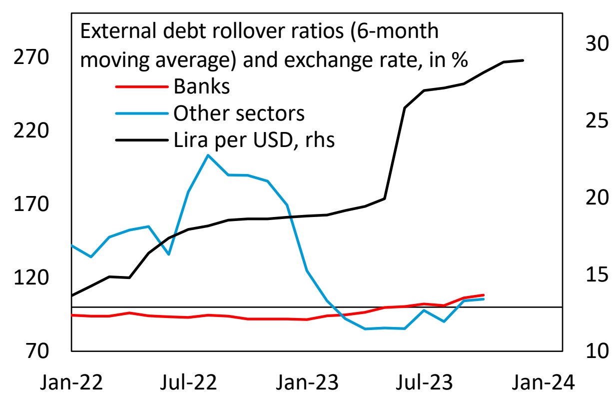
The main downside risk to our baseline forecast is Turkey's inability to attract sufficiently large capital inflows. Regulatory pressures on banks to increase lending before the scheduled March 31 municipal elections, or changes in the economic management team would deteriorate market sentiment markedly. Populist fiscal policies introduced at a large scale ahead of the municipal elections would counteract the positive impact of tight monetary policy, hindering efforts to mitigate Turkey's vulnerabilities, such as high inflation and a large current account deficit. This, in turn, would deteriorate confidence and restrict net inflows of nonresident capital to Turkey, clouding the outlook.

Exhibit 18. Net inflows would improve Lira's outlook.



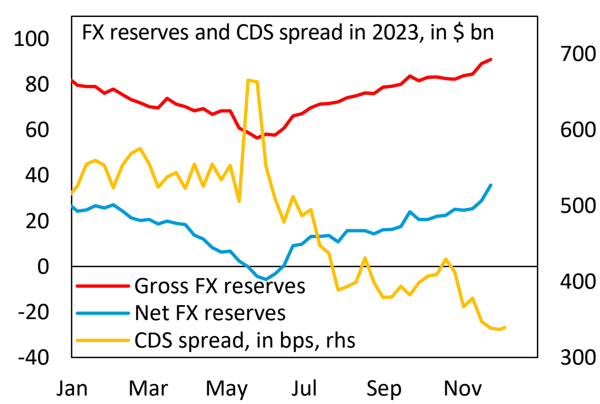
Source: Haver, IIF

Exhibit 19. Rollover ratios have risen since May.



Source: Haver, IIF

Exhibit 20. CDS spread narrows as FX reserves rise.



Source: Haver, IIF

South Africa

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TWIN DEFICITS AND POLITICAL UNCERTAINTY

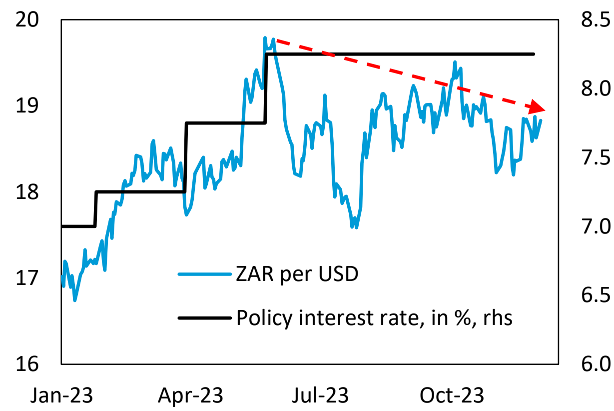
Since mid-2023, South Africa managed to mitigate some of its idiosyncratic risks. These included resolving allegations around arms supply to Russia, improving the reliability of electricity supply, and implementing a reasonable, albeit partial, reallocation of budget resources to alleviate fiscal pressure – all of which helped ease depreciation pressures on the Rand (Exhibit 21). Moreover, the central bank hiking its key policy interest rate by 100 bps to 8.25% not only helped stabilize the Rand but also facilitated a downward trajectory in inflation.

Structural constraints will continue to weigh on South Africa's growth and investment prospects. Despite investments in alternative energy sources that led to better-than-expected activity in early 2023, signs of a slowdown emerged in the second half of 2023. Overall, we forecast real GDP growth of 0.5% for 2023. Expectations of a sustained decline in inflation and easing monetary policy in 2024H2 should support household spending, while capital expenditure will likely remain robust. Taken together, we project growth to pick up to 1% in 2024, which is slightly below the consensus growth forecast. In terms of external balance, the trade surplus is projected to narrow due to softer commodity prices, decreased demand from China, and logistical challenges at Transnet, resulting in the current account deficit widening from an estimated 1.3% of GDP in 2023 to 2.2% in 2024. Net inflows of non-resident capital are showing signs of recovery as South Africa-specific risks have gradually diminished. Portfolio debt flows recovered after significant outflows in May, while FDI inflows have remained healthy. Most of the projected increase in non-resident capital inflows is expected to stem from FDI, driven by investments in renewable projects (Exhibit 22).

The underlying fiscal position is forecasted to deteriorate in FY23/24 and remain weak in FY24/25 due to lower revenue, overspending, higher interest costs, SOE bailouts, and social spending pressures. Overspending is the main risk for the fiscal outlook. Due to challenges in financing the fiscal deficits solely from the market, the National Treasury expanded its funding strategies as presented in the October Medium-Term Budget. To address some of the state's funding needs, there is consideration of accessing the gross foreign exchange reserves account (which reflects valuation effects of FX reserves) amounting to around R500bn (~ USD26bn) or ~7.2% of GDP.

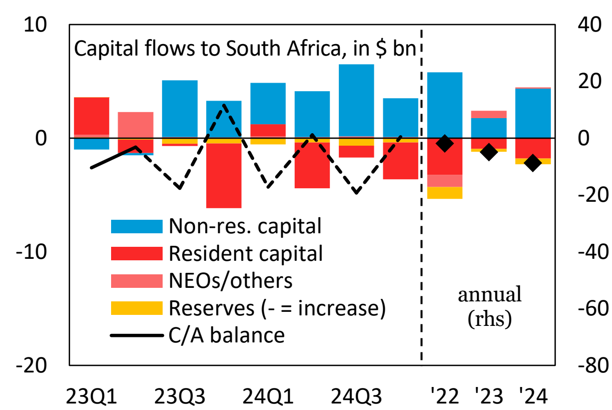
The growing twin deficits will likely keep risk premiums at elevated levels (Exhibit 23). The first half of 2024 presents significant risks, with the National Budget in February and the May elections being key events to watch for investors. Our primary scenario assumes the ruling party's retention of power. In an attempt to secure such an election outcome, the ruling ANC government could ramp up pre-election spending in early 2024, which would increase the government's borrowing needs, and lead to a renewed depreciation pressures on the Rand.

Exhibit 21. The Rand rebounded from its lows in May.



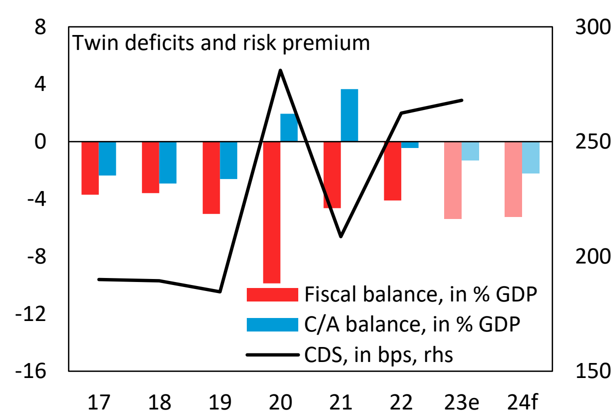
Source: Haver, IIF

Exhibit 22. Capital flows should pick up modestly in '24.



Source: Haver, IIF

Exhibit 23. Twin deficits will weigh on risk premium.



Source: Haver, IIF

Saudi Arabia

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PROSPECTS REMAIN FAVORABLE

The economy continues to benefit from the implementation of large infrastructure projects, which are largely funded by the PIF (the Saudi Sovereign Wealth Fund). Driven in part by PIF's ongoing capital spending, we project non-oil real GDP to grow 4.5% in 2023. However, overall real GDP growth is estimated at less than 1%, due to a substantial decrease in oil production that is weighing down the overall activity.

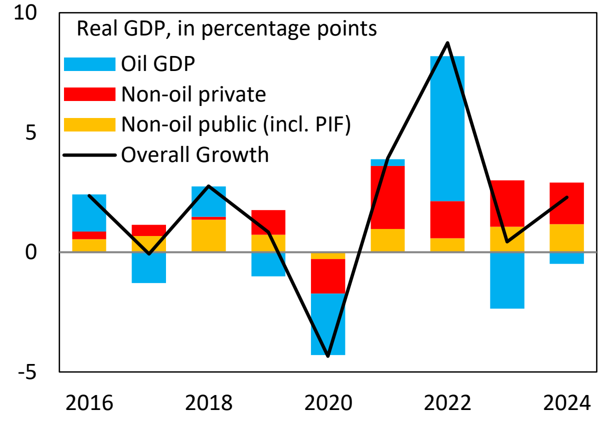
The outlook will continue to depend heavily on the direction of oil prices. We see non-oil growth remaining robust at around 4% in 2024 (Exhibit 24). High frequency indicators (PMI index, consumer spending, and credit to the private sector) suggest that economic activity has remained strong. As oil prices remain well above $70/b, the impact of tighter monetary policy in Saudi Arabia on non-oil real GDP growth will be negligible. However, we project overall real GDP growth of 2.3% for 2024 (below consensus forecast of 3.5%), under the assumption that Saudi Arabia rolls over the 1 mb/d voluntary production cuts through end-March 2024 in the context of the November 30th OPEC+ agreement. In this case, average oil production would decrease from 9.7 mb/d in 2023 to 9.4 mb/d in 2024.

Under the assumptions of oil prices averaging $80/b and a small decline in exports volume of oil, the current account surplus will narrow from 4.5% of GDP in 2023 to 1.2% in 2024 (Exhibit 25). Our estimates show that the external breakeven oil price, which balances the current account, is $75/b, while the fiscal breakeven oil price is $94/b for 2024. The projected modest current account surpluses in 2023 and 2024 will continue to be more than offset by outflows on the financial account, leading to a marginal decrease in official reserves managed by the central bank.

We expect private non-resident capital inflows to increase further in 2024, driven largely by the issuance of international bonds. FDI remains limited, accounting for less than 1% of GDP despite the significant improvement in the business environment in recent years. Higher portfolio and other investment inflows will be driven by the increase in financing needs by sovereigns, in the context of widening fiscal deficits. Corporate issuance to finance existing loans and bonds that mature in 2024 will also remain sizeable. Saudi authorities are encouraging green finance and investment in sustainable projects as part of their efforts to diversify the economy away from oil. Resident capital outflows from Saudi Arabia will continue to exceed nonresident capital inflows (Exhibit 26), despite the narrowing of the current account surplus. As in previous years, investments abroad by the PIF continue to drive resident capital outflows. Outward FDI continues to exceed inward FDI.

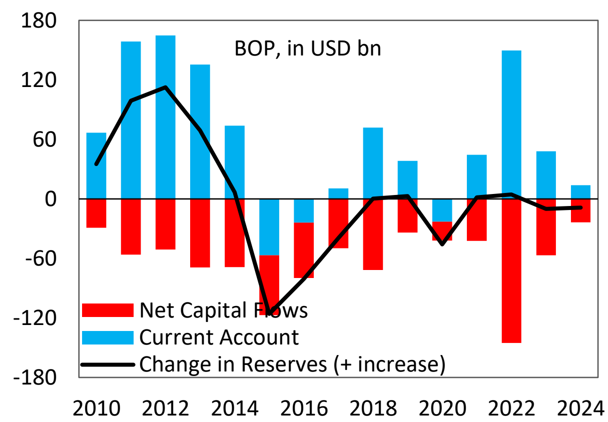
Risks to the outlook are balanced. On the upside, the kingdom could terminate its voluntary production by February or March 2024 if Russia, Iraq, and other oil producers fail to comply with the November 30th agreement. On the downside, lower oil prices and slower implementation of the reform agenda would reduce potential non-oil real GDP growth.

Exhibit 24. Non-oil growth will remain robust.



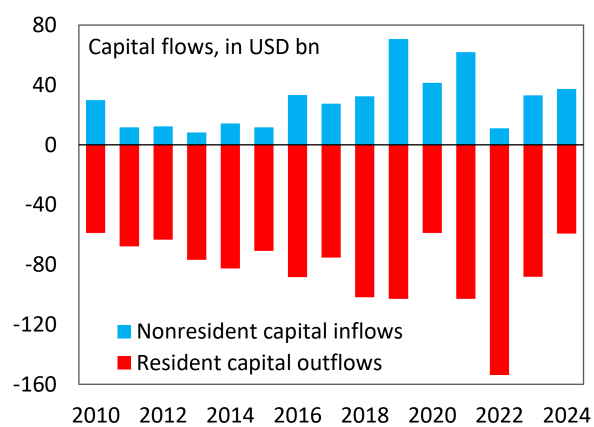
Source: Haver, IIF

Exhibit 25. The CA surplus will decline further in 2024.



Source: Haver, IIF

Exhibit 26. Capital outflows exceed inflows.



Source: Haver, IIF

Egypt

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REGIONAL RISKS ADD TO DOMESTIC TROUBLES

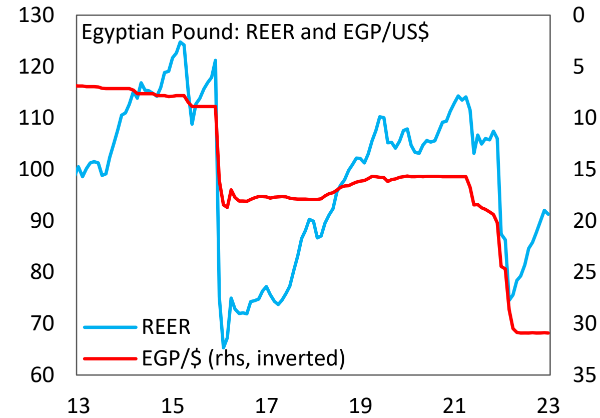
Egypt's economic situation remains delicate. Persistent current account and fiscal deficits, postponement of the IMF program, high debt amortization, low portfolio flows, and a large net foreign liability position of the banking system have constrained Egypt's external financing options, leading to a heavy reliance on FDI and official lending. The decline in capital inflows led to a drain in FX reserves, which have put serious pressure on the Pound. Despite a large devaluation in January 2023 (Exhibit 27), the spread between the black-market exchange rate and the official rate is now at around 40%. Weaker domestic demand (caused by high inflation) and difficulties in sourcing foreign exchange led to a significant import contraction. This, combined with strong tourism and transportation receipts, significantly reduced the current account deficit to -1.2% of GDP in FY2022/23.

We forecast real GDP will grow by 3.3% in FY2023/24 (below consensus forecast of 4%). Surging inflation, FX shortages, supply bottlenecks, and the war in Gaza will all weaken private consumption and exports. Hydrocarbon exports will decline in FY2023/24, due to export restrictions imposed during the summer months to meet strong domestic energy demand and because of the impact of the war in Gaza on Israeli imports of natural gas, which are re-exported by Egypt. While October tourist data remained strong, we expect to see tourism revenues to fall in 2023Q4. Falling hydrocarbon exports, declining service receipts, and a modest recovery in imports are expected to widen the current account deficit to 3.2% of GDP in FY2023/24(Exhibit 28).

We estimate a financing gap of around $7bn in FY2023/24, with that gap primarily financed by FDI and official inflows (Exhibit 29). Our baseline scenario assumes the resumption of the IMF program early next year, after the presidential elections in January, with another major devaluation and movement to a flexible exchange rate regime following suit. The resumption of the IMF program should pave the way for the authorities' privatization plans (with $5bn in privatization proceeds expected by end FY2023/24) as well as for official lending from GCC partners. While Egypt's external funding picture would remain difficult, with large external amortizations due in the next two years, the additional IMF funding would help avoid a further decline in official reserves.

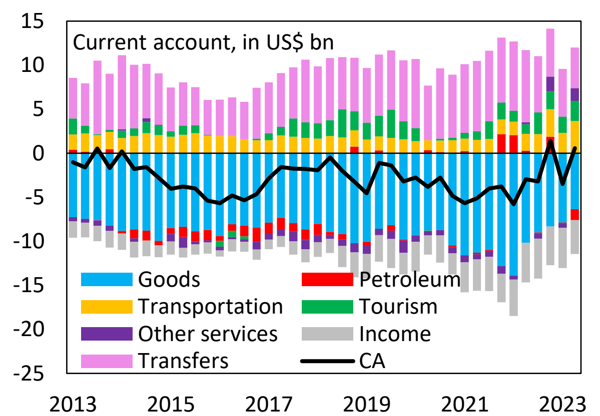
Risks to our baseline are tilted to the downside, with the main risks stemming from a failure to reach an agreement with the IMF and a prolonged war in Gaza. If these risks materialize, they could result in a wider current account deficit and inadequate external financing, leading to FX reserves falling to critical levels. In such a scenario, Egypt could muddle through by forcing additional import contraction on capital goods, much as it did in FY2022/23, and relying on limited flows from smaller privatization proceeds, bi-lateral financing, and market issuances.

Exhibit 27. The currency imbalance is not sustainable.



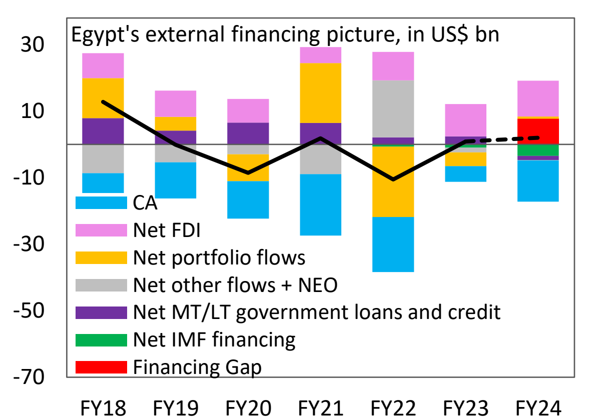
Source: Haver, IIF

Exhibit 28. Trade deficit offset by services and transfers.



Source: Haver, IIF

Exhibit 29. Financing will depend on privatization .



Source: Haver, IIF

Annex 1. IIF capital flows data

Capital flows arise through the transfer of ownership of assets from one country to another. When analyzing capital flows, we care about who buys an asset and who sells it. If a foreign investor buys an emerging market asset, we typically refer to this as a non-resident capital flow (or inflow) in our terminology. We report capital flows on a net basis. For example, if foreign investors buy $10 bn of assets in a particular country and sell $2 bn of that country's assets during the same period, we show this as a (net) capital inflow of $8 bn. Note that non-resident capital flows can be negative, namely if foreign investors sell more assets of a country than they buy in a given period.

Correspondingly, if an investor from an emerging market country buys a foreign asset, we call this a resident capital flow (or outflow). Resident capital flows can also be positive or negative.

Annex 2. IIF Capital Flows Report Country Sample (25)

Emerging Europe (6)	***Latin America (6)***	***Africa/Middle East (6)***	***Emerging Asia (7)***
Czech Republic	*Argentina*	*Egypt**	*China*
Hungary	*Brazil*	*Lebanon*	*India**
Poland	*Chile*	*Nigeria*	*Indonesia*
Russia	*Colombia*	*Saudi Arabia*	*Malaysia*
Turkey	*Mexico*	*South Africa*	*Philippines*
Ukraine	*Venezuela*	*United Arab Emirates*	*South Korea*
			Thailand

**For India and Egypt, annual data and forecasts are represented on a fiscal year basis*

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