FINANCIAL AID TO DEVELOPING COUNTRIES: CHINA IS THE MAGIC WORD

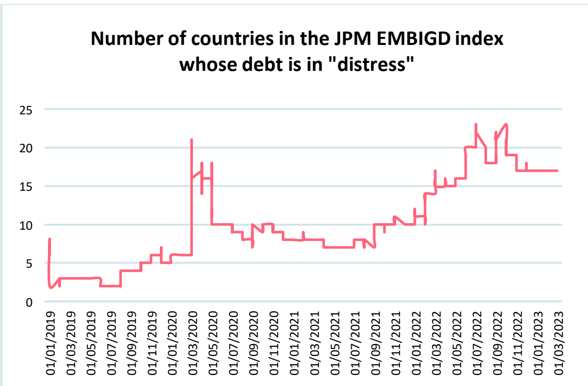
After 3 years of absence due to the Covid-19 pandemic, China is making a strong comeback on the international scene, notably in the G-20's common framework for renegotiating the debt of developing countries created in 2021. What are the stakes and implications in terms of investment strategy?

Strategist viewpoint

Zouhoure Bousbih

Emerging Markets Strategist

Zambia, Ethiopia, Ghana, Sri Lanka and Pakistan have been waiting for several months for the disbursement of IMF financial assistance. The reason: the choices made by China. Under the G-20 common framework for renegotiating the debt of developing countries created in 2021, the China guarantee is a prerequisite for the disbursement of IMF financial support. Since the start of the pandemic, the number of emerging countries with "distressed"* debt has increased significantly, as shown in the chart below.



Sources JP Morgan, Bloomberg –March 10, 2023

17 countries are involved in the JPM EMBIGD index. These countries have the characteristic of being highly indebted. The large expenditure linked to the pandemic and the sharp rise in their borrowing costs in dollars have accentuated the deterioration of their public finances by excluding them from the capital markets. It is to help them that the common G20 debt renegotiation framework was created in 2021, also including China. Indeed, China has become

the first creditor in the world, within the framework of the "Belt and Road Initiative". Ethiopia is indebted to 17% of its GDP, 23% for Zambia, 11.6% for Pakistan and nearly 10% for Sri Lanka.

At the last G20 summit, China followed in the footsteps of other creditors by drastically reducing the debt burden of several countries. Thus, the Chinese authorities recently announced a moratorium on Sri Lanka's debt, prior to the release of the IMF rescue plan of 2.9 billion dollars. For Pakistan, the Chinese banks granted 2 billion dollars, also paving the way for a rescue plan of 1.2 billion dollars. These are positive elements that should give budgetary leeway to these countries in order to return to economic growth. This should result in a compression of risk premia. These countries must also accelerate structural reforms in order to achieve long-term sustainable growth. Improving governance is a key element. Thus, Sri Lanka is currently passing a law to fight against corruption, one cause of social tensions in the country

** « distress » : a country with a spread higher than 1.000 bps*

Portfolio Manager viewpoint

Brigitte Le Bris

Head of Global Fixed income and Emerging Debt Management

China's return to the negotiating table is indeed excellent news: this confirms one of the points of our confidence in emerging debt, namely the support for the countries most in financial difficulty, from multilateral lenders, the IMF, the World Bank, etc. and China. The market was quite confident although it took a while.

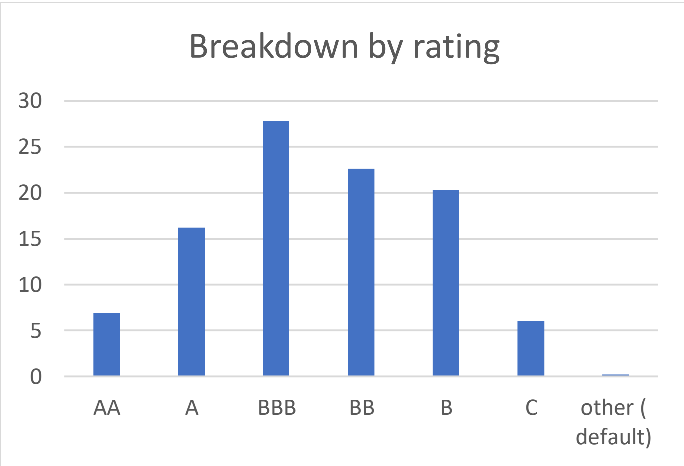
But this news should not suggest that all emerging countries need help. It is important to keep in mind that 50% of the Emerging Debt universe is Investment Grade

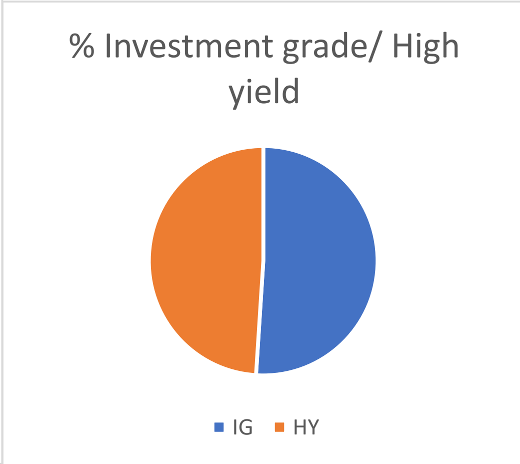
The number of Distress countries in our management universe may have increased since the pandemic, but it has also started to decrease and above all it is essential to put this number into perspective with the weight importance of these countries in our universe!

Indeed, the five countries mentioned (Zambia, Ethiopia, Ghana, Sri Lanka, and Pakistan) represent barely 2% of our universe!

In total, the CCC countries (i.e., close to payment default) and in default represent a little less than 4% of our index. With a high rate of return sometimes close to 20%, they remain attractive provided of course that you choose them correctly in order to avoid payment accidents; Our dual approach integrating both fundamental and technical elements as well as ESG criteria should precisely help us do this.

In the end, this news is important, but we must not be mistaken: it concerns the developing countries, which are dimly represented in the Emerging Debt management universe, even if these countries represent investment opportunities that should not be underestimated.





Sources JP Morgan, Bloomberg – February 28, 2023

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Additional notes

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