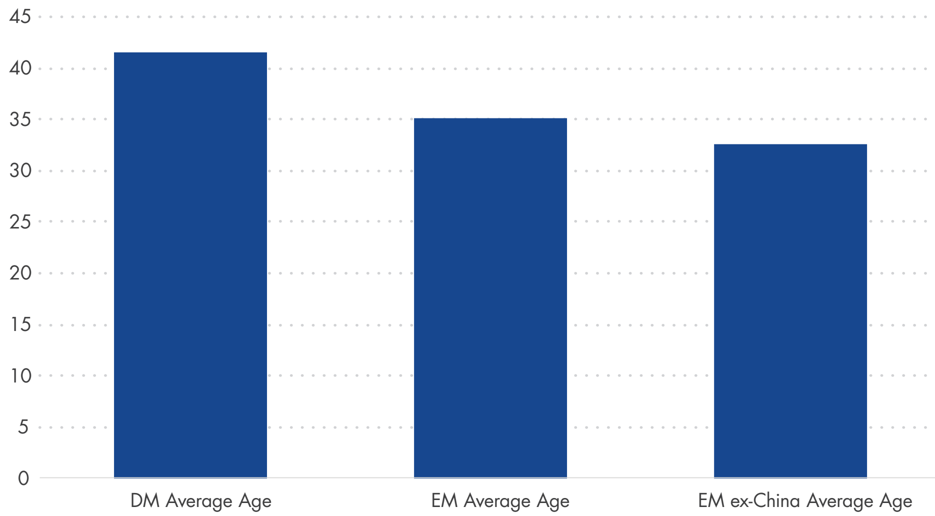
Exploring How COVID-19 Impacts Emerging versus Domestic Markets

By Eric Fine, Portfolio Manager, and the Active Emerging Markets Debt Team

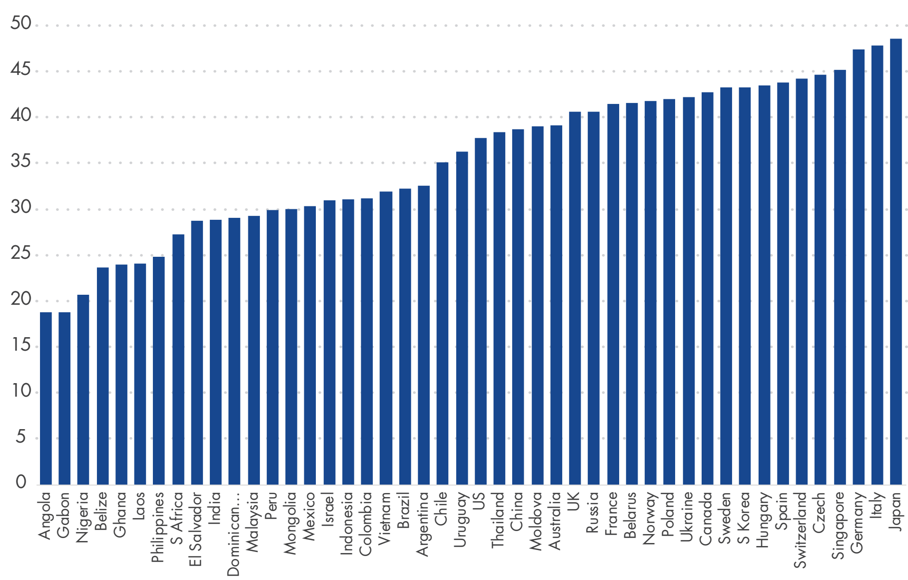
Portfolio Manager Eric Fine and the Active Emerging Markets Debt team share their favorite charts when analysing how emerging market reactions to the COVID-19 pandemic may differ from those in domestic markets.

Emerging Markets (EM) are younger, on average, than domestic markets.



Source: Bloomberg, VanEck.

It is even more pronounced when looking at the individual countries

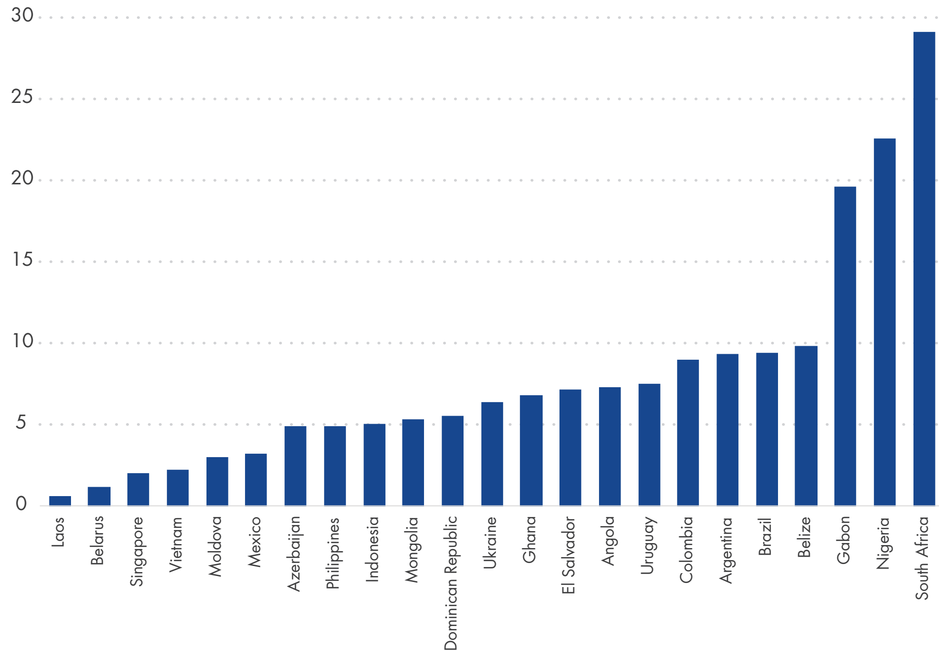


Source: Bloomberg, VanEck.

Credit Total Risk Score

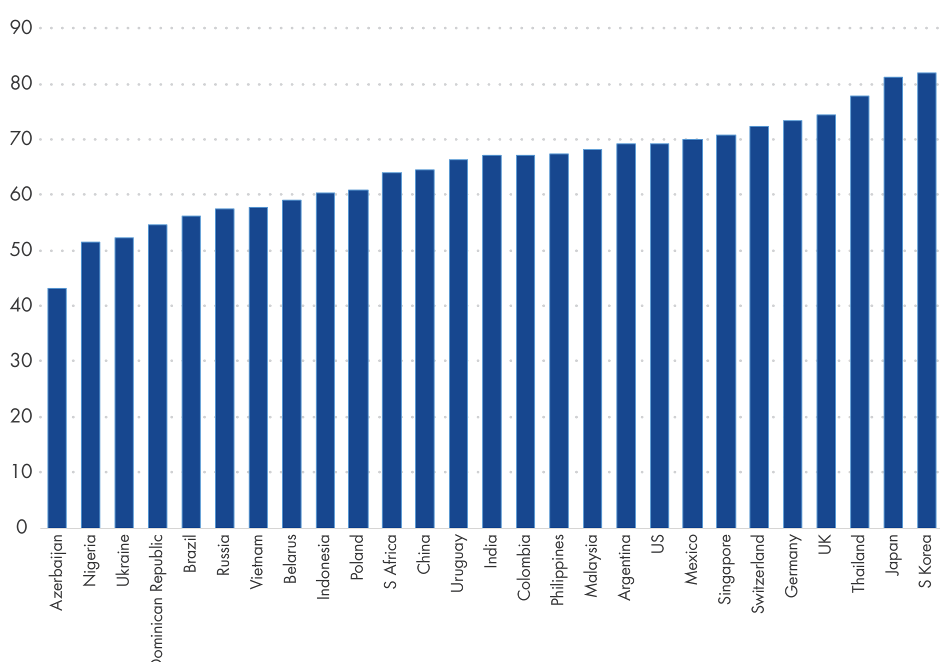
Unemployment could be a good screen. The higher it is, the more absorbable any high death rate is, however depressing that type of analysis; there's a lot of informal employment in Mexico and the Dominican Republic, which could counter their low-ish official unemployment as an issue, but on the true number, it could be mitigated.

Unemployment rate



COVID-19 is a test of health care systems; The below chart displays their quality, by country; though we caution, it is hard to judge on the quality of this data.

NUMBEO Healthcare Index (2020)

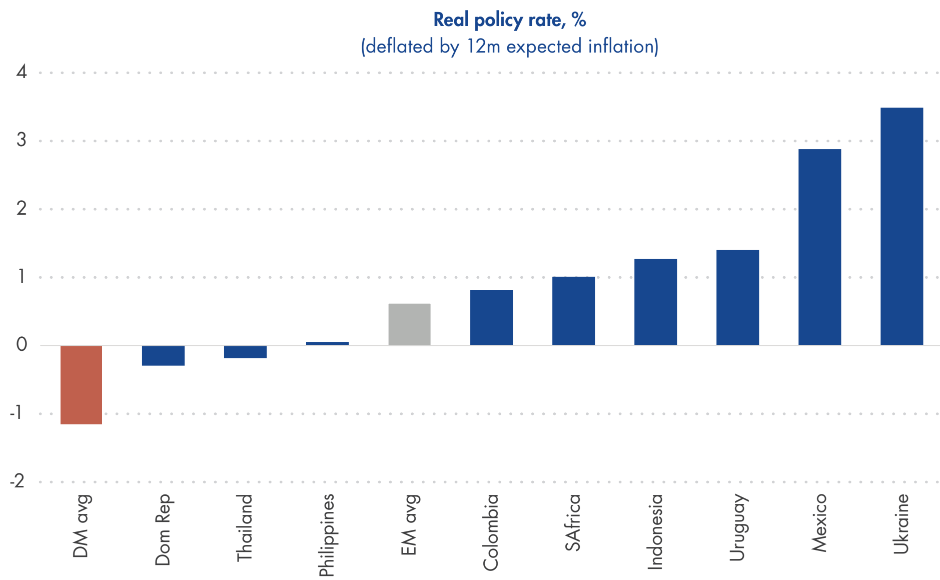


Source: Numbeo.

EM countries in general can't afford to shut down their economies. So we believe they will just bear it, but not suffer as much economically. Only rich economies can (or think they can) emphasize a purely public health response over a response that incorporates economic impact. Employment and inflation will be the economic ways of measuring that tolerance, in addition to the financing availability we note in the country-by-country paragraphs below.

We believe Some countries may actually benefit. It is troubling to look at it this way, of course, but South Africa stands out as a winner, as a lot of the vulnerable population is unemployed but on health benefits. I asked DB's economist on this and she said unequivocally that it will lead to reduced health care costs. This can be challenging to quantify.

Most countries will see a decline in inflation. This will raise real interest rates and thus increase room for rate cuts; here they are for our countries.



Source: VanEck.

When we look at our countries through the COVID-19 lens, the initial take would be the following:
There are only six thousand cases in the entire continent of Africa and most are in Egypt. Some are speculating (it is not evidence, just speculation from Indian medical officials in particular, among others), that smallpox vaccination (ubiquitous in Africa, India and many poorer countries) somehow reduces risks. Also, having dealt with Ebola and other diseases, there are established medical institutions and protocols. Youth is also a likely factor, of course.

The group of African Finance Ministers just asked for financing for the stimulus measures they are planning. They repeated their request for relief on US$44B in debt service, floating the idea of creating a special purpose vehicle (SPV) to handle them. It looks like G20 countries and multilaterals would put money into the SPV, maybe in exchange for some kind of IOU and that money would then be used to service their own debts along with those of eurobond holders—we believe that's the equivalent of a temporary G20 guarantee on eurobond payments. The IMF's Executive Board just approved a US$221M disbursement to Senegal under the emergency instruments. Senegal is, though, not the point, the point is the speed and scale of assistance and that the assistance is designed to finance payments on bonded private market debt. We only own Angola and a small Gabon position, as well as South Africa.

- **Mexico:** We believe It benefits the most from any U.S. rebound and the U.S. is doing the most fiscally and monetarily. It also has high real rates and benefits directly from the Fed's USD swap lines. There is a lot of labor outside the formal sector, so the costs should be to individual health, not economic health. Health costs could decline there, but we are doing calls on that, so don't know for sure yet. According to the health care system metric we found, the country's is pretty good. That sounds counter-intuitive, but not really to us.

- **Argentina:** There is very high unemployment. The outcomes there are more about the debt deal than the economic crisis. It is preserving reserves using capital controls. Low growth from COVID-19 dramatically reduces imports.

- **El Salvador:** Also high unemployment and a very reformist government with access to multilateral support if it asks for it.

- **Indonesia:** This could be a tough one. Poor health infrastructure, though it has seasoned disaster responses due to the weather and earthquake history. A key mitigating factor there is that it can easily get multilateral funding and a headline just crossed our screens saying it is asking for multilateral financing that will cover its entire "2%-of-GDP" fiscal response. Unemployment is also not low.

- **Ukraine:** It has an IMF program that it is doubling as of yesterday's surprise quick approval of land and other reform. Unemployment is also high and Ukrainians could return from Poland easily if labor shortages arise. Health care in former-Soviet countries favored quantity over quality, so I would expect it to be in the positive camp, relatively, for this type of crisis. I think the former Soviets have 4x the doctors per person than Western countries.

- **South Africa:** This one could be a problem, despite what I say above about the reduction in health spending. This is because AIDS is concentrated among miners. I assume their vulnerability to COVID-19 is significant and could hit mining production. The government has put the country on lockdown as of last week and maybe that slows things down. For what it's worth, so much bad news was priced in there that it has outperformed since the lockdown and since the Moody's downgrade last Friday. Bonds rallied. It also benefits a lot from low oil prices. It also has what we view as easy access to multilateral support when/if it wants it. Unemployment is very high, but a lot of it is unemploy-ability (albeit hard to measure).

- **Angola:** It has the youngest population in our chart above. It also has high smallpox vaccination rates (whether fully legitimate as an argument or not). It has started border controls nonetheless and is restricting movement. Of the $8B coming due this year, $1.5B was prepaid to the IMF and can be re-accessed, $4.5B is to China and should be termed out if it sees a future there and the IMF/IBRD is the remaining $2B. The JP Morgan economist we spoke to just got off with the Africa teams at the IMF, and they are very keen to be forgiving to smaller, poorer countries, without requiring defaults on bonded private debt (the stuff that trades). The country is running huge primary surpluses (7% of GDP) with a big reform commitment and the IMF tries to be very flexible in situations like this.

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666 Third Avenue | New York, NY 10017
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