Mizuho Economic Outlook & Analysis

December 2, 2015

The Risks of the Materialization of Concerns over the EM Economies

- keep a close eye upon the "Risky Four" -

< Summary >

- Triggered by the slowdown in the Chinese economy, an increasingly pessimistic view on the emerging market (EM) economies has spread in the market. In this report, we conducted a cross-regional analysis to uncover the risks these countries now face.

- As a result, Venezuela, Argentina, Turkey and Brazil, or the "Risky Four," appeared in our list of countries with relatively higher risks, followed by Indonesia, Russia, South Africa, Malaysia and Vietnam.

- Although we believe there is little chance of crises materializing immediately in these countries, it is important to keep a close watch on their development.

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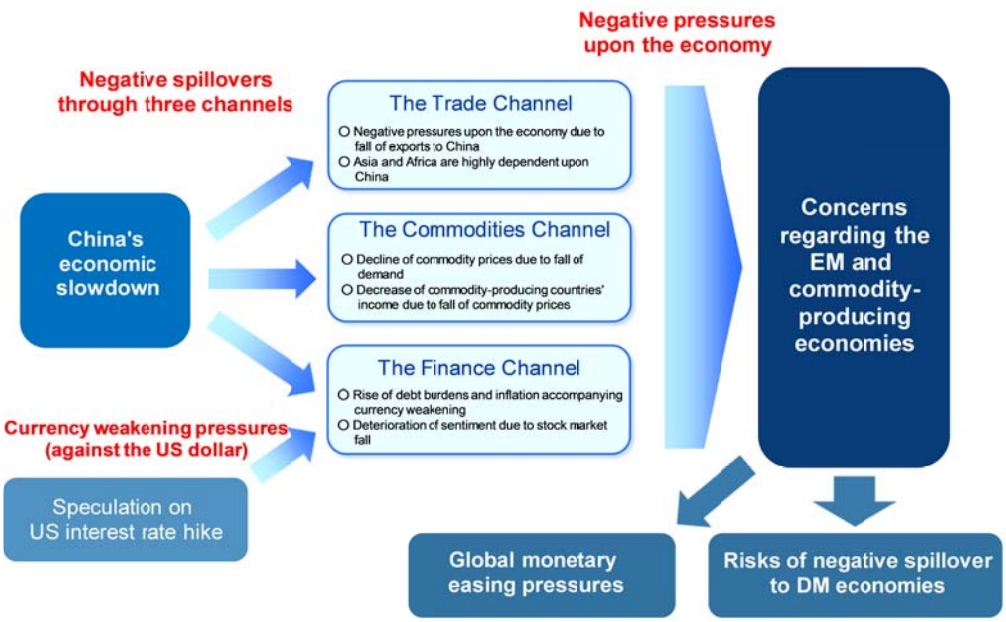
1. Rising concerns over the EM economies

The emerging market (EM) economies, which have served as the main engine of global economic growth since the Lehman Shock, are now facing sluggish economic growth. The deceleration of China's economy, in particular, is raising concerns regarding the EM and commodity-producing economies by exerting negative pressure on exports to China as well as on commodity prices, and through movements to avert risk in the financial market (**Chart 1**).

The EM currencies plummeted in response to China's devaluation of the yuan against the US dollar in August, amid heightening speculation surrounding the US interest rate hike. With some EM currencies falling to the level recorded in 1998 immediately after the Asian Financial Crisis, worries arose of another currency crisis in the making. But later on, as excessive concerns over China eased and speculation over the US interest rate hike receded, many of the currencies of the EM economies began to recover. Nonetheless, given the high probability of a US interest rate hike and the uncertain outlook on the Chinese economy, we need to maintain a cautious stance regarding the EM currencies.

Chart 1: Channels through which China's slowdown is spilling over to the EM economies



Source: Made by MHRI.

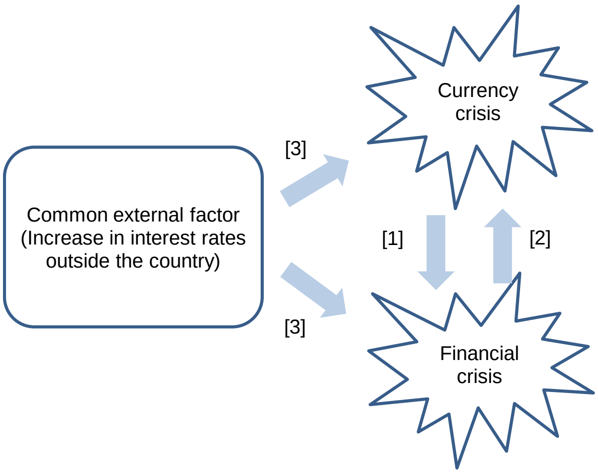
Meanwhile, we should also pay attention to the rising pressure on the balance sheet adjustment in the EM economies. Economic growth in the EM economies, which served as a driving force behind global economic growth after the Lehman Shock, accompanied a sharp rise in debt. Mizuho Research Institute (MHRI) holds that the global balance sheet adjustment has entered a third phase, placing new focus on the debt problem in the EM economies. In the first phase (2007-2008), excessive private-sector debt in the developed market (DM) countries led to various financial crises, such as the subprime loan crisis and the collapse of Lehman Brothers, triggering the bankruptcy of financial institutions and restraints on loans, and ultimately culminating in the global economic downturn. In the second phase (2009-2012), fiscal deficit in the DM countries became the focal point, leading to the Greek Shock and the European debt crisis. In the current third phase (2015-), we see potential risks that may bring about a financial crisis in the EM economies.

Hence, we now face the potential risk of two crises – one involving currencies and the other related to the financial system – with the added danger that the two may occur simultaneously (**Chart 2**).[1] Firstly, when a currency devalues sharply, it can cause the bankruptcy of companies due to a surge in debt burden denominated in a foreign currency. It may also lead to the outflow of deposits denominated in the local currency, increasing bad debts and slashing liquidity in the banking sector, triggering a financial crisis (**Chart 2 [1]**). Secondly, as the financial system becomes increasingly dislocated, public funds are injected into the system to bail out both banks and depositors, creating the risk of heavier downward pressure on the local currency through a worsening fiscal balance (**Chart 2 [2]**). And thirdly, when interest rates outside the country rise as a common external factor, capital begins to flow outside the country, and this can lead to the simultaneous outbreak of a financial crisis and currency crisis (**Chart 2 [3]**).

In this report, we conducted a cross-regional analysis from the above perspective to discover the economic risks that exist in each EM country. More specifically, based on this perspective, our study focuses on (1) the economic fundamentals and political situation, (2) resilience to a currency crisis, (3) the degree of urgency of the financial crisis, and (4) vulnerability to the slowdown in China's economy, which is one of the original factors causing concerns in the EM economies. In addition, we also examined if there is (5) flexibility for additional policy implementation to avert risk (**Chart 3**). We used the same criteria of (1) through (5) for each country to finally determine which countries carry the highest risks.

[1] The description in this paragraph refers to Eiji Ogawa (1998), "*Stability of the International Monetary System*."

Chart 2: Relationship among the various risks



Source: Made by MHRI.

Chart 3: Items monitored and analysis criteria

Items	Analysis criteria
(1) Economic fundamentals and political situation	Growth rate, inflation, current account balance, political situation
(2) Resilience to a currency crisis	Coverage of the import and short-term external debt by foreign exchange reserves
(3) Urgency of the financial crisis	Debt level, repayment burden
(4) Vulnerability to the slowdown in China's economy	Estimated impact based on a time series model
(5) Flexibility for additional policy implementation to avert risk	Flexibility to implement monetary and fiscal policies

Source: Made by MHRI.

2. Economic fundamentals and political situation as the basis of evaluation

When assessing the risks of the EM economies, the most important criteria are the economic fundamentals and political situation of the country in question. In this section, we evaluated each country using basic elements such as economic trend, inflation rate, current account balance and political situation.

(1) Evaluation of the economic trend in each country

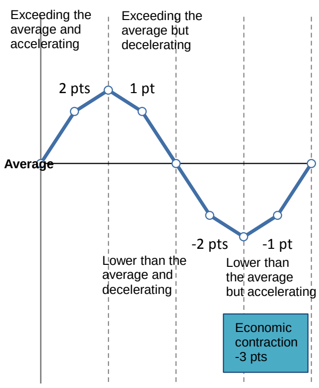
Market investors always try to evaluate a country's risks based on various factors. If a nation's economy is slowing down, and has little growth potential, there is no choice but to evaluate the nation harshly. When the economic trend is negative, the market will project more downward pressure on the local currency, prompting the sale of the country's currency and triggering the start of balance sheet adjustment in the domestic market. The difficulty in evaluating the economic trend stems from differences in the standard of growth rate neutral to the economic condition. For example, looking at China's economy, although the current growth rate is significantly lower than the 10% level registered in the past, China is still growing at a faster pace than the world's average, and its economic growth rate belongs to the top group compared even with the EM economies. Nonetheless, few people would probably judge that the Chinese economy is "good" given its current slowdown.

This time, we evaluated the economic growth rate of each country by comparing the

5-year average growth rates. Our evaluation also took into account near future projections and current growth rates; more specifically, we incorporated the IMF forecast into our evaluation process since it is a widely accepted consensus in the market. We then analyzed where the current growth rate and forecast for the next year would appear in the economy map of **Chart 4** and evaluated each country's economic trend using a 4-level scale from A to D derived from the total score.

As a result of this analysis (**Chart 5**), we classified Brazil and Russia, whose economies are expected to contract in 2015 and in 2016, as "significantly weak" (evaluation D). For China, whose economy continues to expand at an annual rate of 6%, we classified its economy as "weak" (evaluation C). Since the Chinese economy is now understood to be moving to the "new normal," the economic growth rate is expected to hover at a level lower than its previous average.

Chart 4: Evaluation criteria of the economic trend



Evaluation		Points
Good	A	4
		3
Relatively good	B	2
		1
		0
Weak	C	-1
		-2
		-3
Significantly weak	D	-4
		-5
		-6

Note: We scored (1) the current growth rate and (2) the IMF forecast, respectively, and evaluated the economic trend using a 4-level scale (A to D) derived from the total score.
Source: Made by MHRI.

Chart 5: Views on the EM economies

	GDP global share (market rate)	GDP growth (latest) (Y-o-y ch)	2016 IMF projections)	Evaluation
Brazil	3.0	-2.4 (15/06)	-1.0	D
Russia	2.4	-4.5 (15/06)	-0.6	D
Venezuela	0.3	-2.3 (14/09)	-6.0	D
Argentina	0.7	1.9 (15/06)	-0.7	D
Taiwan	0.7	0.8 (15/06)	2.6	D
South Africa	0.5	1.2 (15/09)	1.3	D
China	13.4	6.9 (15/09)	6.3	C
Turkey	1.0	4.2 (15/06)	2.9	C
Malaysia	0.4	4.7 (15/09)	4.5	C
South Korea	1.8	2.7 (15/09)	3.2	C
Indonesia	1.2	4.7 (15/09)	5.1	C
Thailand	0.5	2.9 (15/09)	3.2	C
India	2.7	7.0 (15/06)	7.5	B
Mexico	1.7	2.6 (15/09)	2.8	B
Philippines	0.4	6.0 (15/09)	6.3	B
Vietnam	0.2	6.0 (14/12)	6.4	B

Note: Qualitative assessments have been added to some countries in view of temporary fluctuations in the GDP growth rate.
Source: Made by MHRI based upon statistics of the relevant countries, IMF.

(2) "High inflation" and "current deficit" as factors impeding stable growth

When judging the economic condition, we evaluated not only the growth rate but also the inflation rate, because a high inflation rate may impede economic growth. High inflation runs the risk of restraining real income growth and may weaken growth in personal consumption as well. Hence, we can predict the occurrence of such risks through an evaluation of the inflation rate. Also, since the inflation rate is a target of monetary policy, a high inflation rate may place downward pressure on the economy through monetary tightening. On the other hand, we also downgraded our assessment when the inflation rate is too low. We assessed "disinflation" (evaluation B) where the inflation rate is between 2% and -1%, and where we saw signs of "clear deflation," our assessment was evaluation D, the same evaluation given under "significantly high inflation," because deflation may exert negative pressure on the economy and prolong the balance sheet adjustment period. In the assessment this time, although no country corresponded to "clear deflation," countries undergoing "significantly high inflation" included Venezuela, Russia, Argentina and Brazil (**Chart 6**).

In addition, we also assessed the current account balance that is emphasized as an important risk factor in predicting a currency crisis. The most basic theory on the outbreak of a currency crisis explains that mounting external debt through repeated current account deficits is a primary cause of a currency crisis, and therefore investors and lenders monitor the current account balance as an index to measure a country's vulnerability to a currency crisis. In this analysis, we assessed the condition to be "relatively good" (evaluation B) when the current account deficit to GDP is below 2%, "weak" (evaluation C) when in the 2% to 3% range, and "significantly weak" (evaluation D) when above 3%. More specifically, Turkey, South Africa and Brazil fell under evaluation D (**Chart 7**).

(3) Political situation is critical when evaluating the EM economies

In addition to looking at the economic fundamentals, we also focused on political

Chart 6: Evaluation of inflation

	Inflation rate (%) (yr/mo)	Evaluation
Venezuela	68.5 (14/12)	D
Russia	15.6 (15/10)	D
Argentina	14.4 (15/09)	D
Brazil	9.9 (15/10)	D
Turkey	7.6 (15/10)	C
Indonesia	6.2 (〃)	C
South Africa	4.6 (15/09)	A
India	4.4 (〃)	A
Malaysia	2.6 (15/09)	A
Mexico	2.5 (〃)	A
China	1.6 (15/09)	B
South Korea	0.9 (15/10)	B
Philippines	0.4 (〃)	B
Vietnam	0.0 (15/10)	B
Taiwan	-0.4 (〃)	B
Thailand	-0.8 (15/10)	B

Note: Part of the above evaluation takes into account our qualitative assessment.
Source: Made by MHRI based on statistics of the respective countries and the CEIC.

Chart 7: Evaluation of current account balance

	Current account balance (To GDP, %)	Evaluation
Taiwan	12.4	A
South Korea	7.1	A
Thailand	6.2	A
Russia	5.0	A
Philippines	5.0	A
China	3.1	A
Malaysia	2.2	A
Vietnam	0.7	C
India	-1.4	B
Argentina	-1.8	B
Indonesia	-2.2	C
Mexico	-2.4	C
Venezuela	-3.0	C
Brazil	-4.0	D
South Africa	-4.3	D
Turkey	-4.5	D

Note: We evaluated each country based partly on our qualitative assessment of the IMF forecast in 2015.
Source: Made by MHRI based on the IMF.

stability because a stable political situation is the basis of economic management in all nations. MHRI evaluated each country's political stability based on such factors as relative strength of the government base and the presence of insurgencies. For example, although China is not a democratic nation, the Xi Jinping administration under one party rule of the Communist Party is stable, in contrast to the opaque political landscape in Brazil, where the possibility of President Rousseff's impeachment is surfacing. In Venezuela, the political situation has grown unstable with violent clashes between the supporters of the ruling party controlled by President Maduro, who succeeded former president Hugo Chavez, who died in 2013, and the opposition parties.

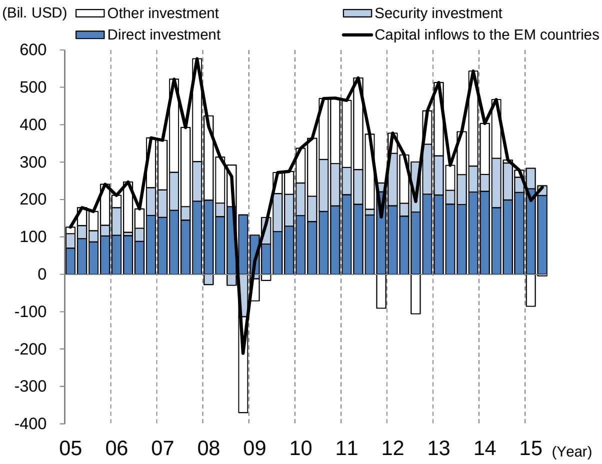
3. Risk of currency and financial crises

(1) Resilience to a currency crisis from the viewpoint of foreign exchange reserves

It is critical when assessing the risk of a currency crisis to look at the country's "resilience" to the crisis. When a nation's currency decline is persistent and the market judges that the country lacks "resilience" to a currency crisis, the country's assets will continue to be sold, driving down the value of the currency and possibly trapping the country's economy in a vicious cycle. In the worst case scenario, economic agents of the EM country may become unable to procure foreign currency, running the risk that overseas investors and lenders may not be able to extract their capital. As the EM economies continue to slow down, capital inflows have already begun to decline (**Chart 8**), which may be a sign that investors are already aware of the rising risk to their capital brought on by a potential currency crisis. If companies and financial institutions in the EM economies are no longer able to procure foreign currency in the market, then the central banks are expected ultimately to provide foreign exchange reserves as the last lenders. Hence, it is a general practice in the market to examine the level of foreign exchange reserves to see whether a country has enough "resilience" to a currency crisis.

In this section, we assessed each country's "resilience" to a currency crisis by evaluating to what extent the foreign exchange reserves owned by each country can cover the value of short-term external debt and import amount covering three months (**Chart 9**). It should be noted that in the "resilience" test this time, we also considered whether the foreign exchange reserves exhibit a clear increasing or decreasing trend. In other words, if the value of foreign exchange reserves is on a declining trend, we downgraded our initial evaluation based on the foreign currency reserve coverage ratio only. As a result, the EM economies running short of foreign exchange reserves include Venezuela, Argentina, Turkey, South Africa and Malaysia.

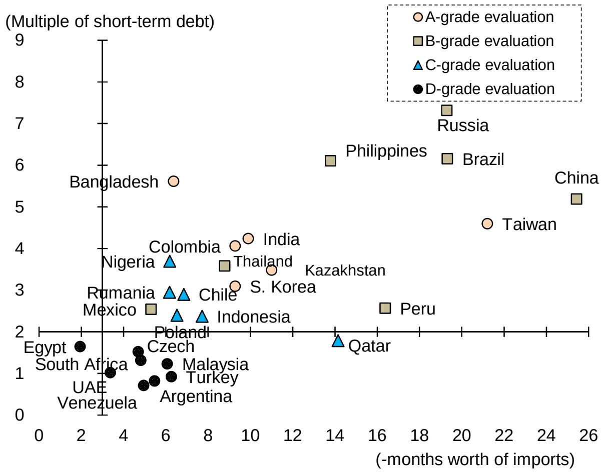
Chart 8: Capital inflows to the EM countries



Note: Total sum of credit flows to China, India, South Korea, Hong Kong, Singapore, Indonesia, Malaysia, Philippines, Thailand, Argentina, Brazil, Chile, Columbia, Mexico, Uruguay, Poland, Romania, Bulgaria, Croatia, Czech Republic, Hungary, Turkey, Russia, Ukraine and Republic of South Africa.

Source: Made by MHRI based on the IMF.

Chart 9: Evaluation of the level of foreign exchange reserves



Note: Evaluated on a scale of A to D on the basis of forex reserves as a multiple of short-term debt), in terms of imports) and the change in forex reserves.

Source: Made by MHRI based upon statistics of each of the countries, World Bank, CEIC.

(2) Urgency of the financial crisis from the perspective of private-sector debt

In the EM countries, private-sector debt has been swelling since 2008 (**Chart 10**), and the time for balance sheet adjustment has now arrived. This is a result of the EM country efforts to support their economies through aggressive credit expansion, as seen in China's economic stimulus plan worth 4 trillion yuan, since the collapse of Lehman Brothers. Looking back on the past, the DM countries - whose private-sector debt had been growing rapidly from around 2005 - were hard hit by the subprime loan crisis in 2007 and the Lehman Brothers debacle in 2008. The current expansion of private-sector debt in the EM countries also carries the risk of triggering a similar financial crisis.

In this report, as the first leading indicator of a financial crisis, we focused on deviations from the trend of outstanding private-sector debt in the non-financial sector (to nominal GDP ratio). This is in line with the approach taken by the Bank for International Settlements[2]; and if the ratio surpasses the trend by over 10% point, the possibility of the outbreak of a financial crisis heightens, and if the ratio exceeds the trend by over 2% point, the supply of credit is considered to be excessive relative to the actual economic activities.

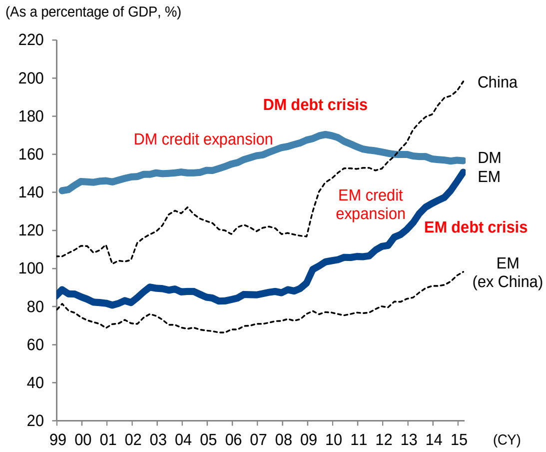
As the second leading indicator of a financial crisis, we selected deviation from the

[2] BIS (2015), *BIS Quarterly Review*, September. The reason for focusing on deviation from the trend of outstanding private-sector debt (to nominal GDP) is to eliminate the structural change of financial deepening.

past average of the debt service ratio (ratio of principal repayment and interest payment of private-sector debt to gross national income). This also follows the BIS methodology; and if the ratio is over 6% point from the past average, the possibility of a financial crisis heightens, and if the ratio exceeds the past average by over 4% point, caution is required on future developments in the financial market.

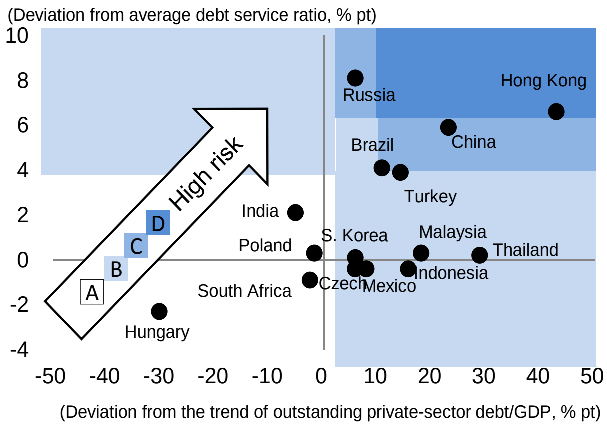
Looking at the two indicators, with the exception of Hong Kong, where the financial sector represents a significant part of the overall economy, China, Russia, Turkey and Brazil in particular are seeing their private-sector debt accumulate and their debt service ratio rise (**Chart 11**). In Thailand, Malaysia, Indonesia, Mexico, Czech Republic and South Korea, although their outstanding debt balance is rising, thanks to restrained interest rates, debt burden measured by the debt service ratio is not increasing very much. The rise of private-sector debt in India, Poland, South Africa and Hungary remains subdued, a situation that reflects the sluggishness of their economies.

Chart 10: Rising EM private-sector debt



Note: "EM" refers to the total of China, India, Hong Kong, South Korea, Singapore, Thailand, Malaysia, Indonesia, Brazil, Russia, South Africa, and Turkey.
"DM" refers to the total of the US, eurozone, UK and Japan.
Source: Made by MHRI based upon BIS.

Chart 11: Private-sector debt and debt service burdens of EM countries (March 2015)



Note: Debt service ratios of EM countries included in the BIS *Debt Service Ratio* database. The trend of outstanding private-sector debt (as a % of nominal GDP) is calculated by MHRI based upon BIS (2015).
Source: Made by MHRI based upon BIS, *Debt Service Ratio, Credit to the non-financial sector.*

4. Vulnerability to a "China Shock," which may trigger a crisis, and flexibility to address such a crisis through policy implementation

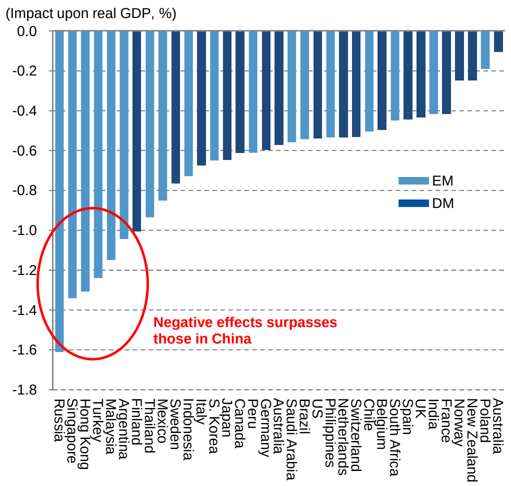
(1) The market is closely watching for countries vulnerable to a China Shock

Concerning the EM economies whose fundamentals are considered to be vulnerable, we focused on the pressure of currency devaluation and balance sheet adjustment, and sorted out and evaluated the EM economies under such pressures. One of the factors with the high possibility of triggering such an adjustment is a further slowdown in the Chinese economy, which will exert a downward pressure on the economies of the EM countries.

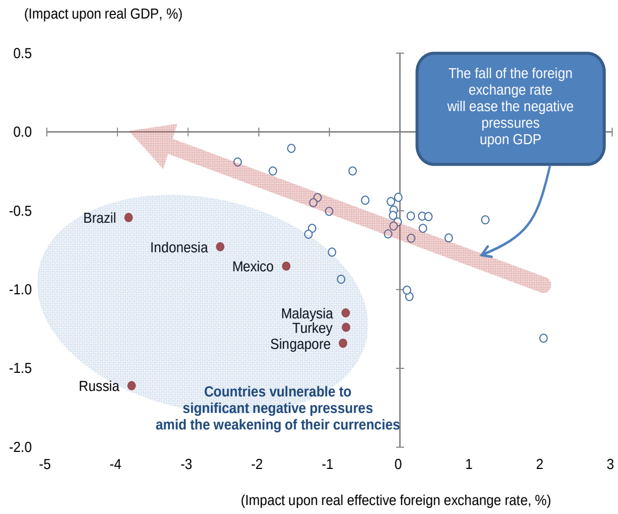
For this reason we studied which countries are most vulnerable to a further downturn in the Chinese economy. The routes through which China's economic slowdown will influence the EM economies include the three channels indicated in **Chart 1** at the beginning of this report. We estimated the impact of China's economic slowdown on the respective countries by using the Global VAR model (GVAR model) whose variables comprise each country's GDP as well as the major demand components, commodity market situation such as crude oil prices, foreign exchange rates and prices. The results of our estimate are shown in the left column of **Chart 12**.

Chart 12: The impact of China's economic slowdown (an approximately 1% slowdown in growth) on the global economy

The impact on the real GDP growth rate (one year following a "China Shock")



The impact of a "China Shock" on the real effective exchange rate and real GDP



Note: Cumulative impact one year following the "China Shock". The size of the "China Shock" assumes that China's GDP is subject to a one-standard-deviation negative impact (China's GDP falls by approximately 1% one year on).

Source: Made by MHRI based upon Smith, L.V. and A. Galesi (2014),"GVAR Toolbox 2.0" (https://sites.google.com/site/gvarmodelling/gvar-toolbox), L. Gauvin and C. Rebillard (2015) "Towards Recoupling? Assessing the Global Impact of a Chinese Hard Landing through Trade and Commodity Price Channels".

The left column of **Chart 12** presents our estimate of how much an approximately 1% point decline in China's economic growth rate would impact each country's economic growth rate. Attention should be paid to the fact that among the listed EM countries, some will see their economies shrink by over 1% point, or at a pace faster than China's, which is the source of the slowdown.

When a country is affected by the downturn in China's economy, price competitiveness of exports may improve with the depreciation of its local currency due to currency sales through the financial channel, as indicated in **Chart** 1. This may actually have a positive impact on the country's economy as downward pressure on the real GDP is alleviated, as shown in the right column of **Chart 12**. Nonetheless, for some EM countries such as Russia, our estimates suggest that the positive effect may prove difficult to see. In the case of Russia, where crude oil prices have a significant impact on the economy, the negative impact of China's economic slowdown may grow larger through the commodities channel, as indicated in **Chart 1**.

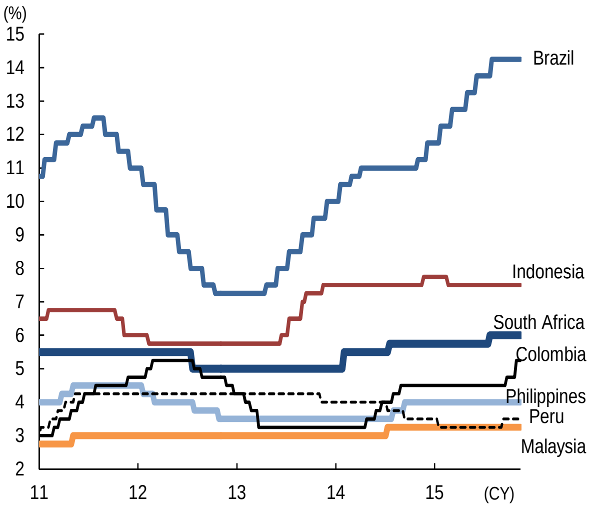
Based on the estimates, we evaluated that some Asian countries and commodity-producing countries are more susceptible to the slowdown in the Chinese economy (evaluation D), since their economies are expected to contract more than the Chinese economy, which is the source of the slowdown. For other countries also, we evaluated that the slowdown may have a certain impact (evaluation C), with the exception of India (evaluation B), whose economy is not overly affected by China's economy.

(2) Is there flexibility for the EM countries to avert risk through policy implementation?

If the economies of the EM countries are actually affected negatively by a further deceleration of China's economy, it is important to examine what measures these countries can exercise in response to the crisis. For example, if a country can implement monetary easing to boost its economy, it may be able to avert a sudden balance sheet adjustment in the domestic market. Nevertheless, while some EM countries have already lowered their interest rates, other countries find it difficult to reduce interest rates in response to currency depreciation and inflationary pressure (**Chart 13**), and some have little flexibility in terms of further interest rate cuts, having already adopted a low interest rate policy. We lowered our assessment of such countries based on the criterion of having room to maneuver in terms of implementing additional monetary measures.

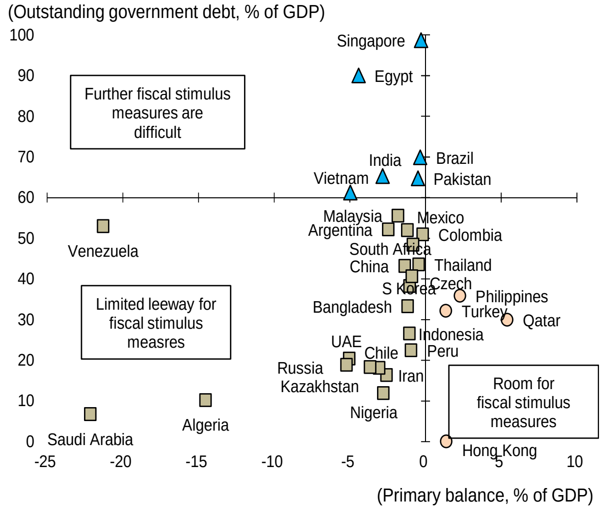
Furthermore, we also evaluated whether a country has flexibility for implementing fiscal policies because such policies can be effective in reducing downward pressure on the economy, even when taking additional monetary measures is difficult (**Chart 14**). To

Chart 13: Policy interest rates of EM countries



Source: Made by MHRI based upon Bloomberg.

Chart 14: Fiscal conditions of EM countries



Source: Made by MHRI based upon IMF.

be more specific, we evaluated that room for adopting fiscal policies is limited when the country's primary balance lies in negative territory and when the size of government debt is massive.

We comprehensively assessed the flexibility to implement monetary and fiscal policies. As a result, we evaluated little flexibility for policy implementation (evaluation D) for Brazil, and limited room for policy implementation (evaluation C) for Venezuela, Argentina, Indonesia and South Africa.

5. Comprehensive evaluation – keep a close eye upon the "Risky Four" -

A comprehensive evaluation of our analysis results (**Chart 15**) points to Venezuela, Argentina, Turkey and Brazil as the "Risky Four" (comprehensive evaluation D) with relatively high risk. These countries are followed by Indonesia, Russia, Republic of South Africa, Malaysia and Vietnam (comprehensive evaluation C).

Concerning Venezuela, over 90% of the nation's exports and 40% to 50% of government revenue depend on crude oil, and the decline in crude oil prices is causing economic dislocation. The insufficiency of foreign exchange reserves has also become serious, creating the risk of default on government bonds and state-run oil enterprises. In the upcoming parliamentary election (December 6), the opposition party is expected to make gains, so caution over the rise of political confusion is required, as well.

In Argentina, the ongoing foreign exchange intervention to avert a sharp depreciation of the peso has caused an acute decline in the nation's foreign exchange reserves.

Chart 15: Overall evaluation of EM risks

	Overall evaluation	GDP share (2014)		Business conditions	Inflation rate	Current account balance	Political conditions	Foreign exchange reserves	Debt burden	Negative spillover from China's slowdown	Leeway for policy maneuver
		(Market rate)	(PPP basis)								
Venezuela	D	0.3	0.5	D	D	C	D	D	-	-	C
Argentina	D	0.7	0.9	D	D	B	C	D	-	D	C
Turkey	D	1.0	1.4	C	C	D	C	D	C	D	B
Brazil	D	3.0	3.0	D	D	D	C	B	C	C	D
Indonesia	C	1.2	2.5	C	C	C	C	C	B	D	C
Russia	C	2.4	3.3	D	D	A	B	B	C	D	B
South Africa	C	0.5	0.7	D	A	D	B	D	A	C	C
Malaysia	C	0.4	0.7	C	A	A	C	D	B	D	C
Vietnam	C	0.2	0.5	B	B	C	B	D	-	-	C
Mexico	B	1.7	2.0	B	A	C	B	B	B	D	C
Thailand	B	0.5	1.0	C	B	A	C	B	B	D	B
China	B	13.4	16.6	C	B	A	B	B	C	-	B
Taiwan	B	0.7	1.0	D	B	A	C	A	-	-	B
South Korea	B	1.8	1.6	C	B	A	B	A	B	C	B
Philippines	B	0.4	0.6	B	B	A	B	B	-	C	B
India	B	2.7	6.8	B	A	B	B	A	A	B	C

Note: Overall evaluation based upon evaluations of each of the factors. Evaluated on a four-pt scale of (A) good, (B) relatively good, (C) weak (concerns), and (D) significant weakness (significant concerns). Evaluations on “debt burden” were withheld for countries whose private-sector debt burdens could not be analyzed due to data limitations. Likewise, evaluations on “negative spillover from China’s slowdown” were withheld for countries which could not be incorporated in the GVAR model due to data limitations.
Source: Made by MHRI based upon statistics of each of the countries, IMF, World Bank, BIS, Bloomberg, CEIC.

On the other hand, Argentina voted for a change in government from the left-wing Kirchner administration to the center-right Macri administration (inaugurated on December 10), and the new government is expected to promote reforms aimed at reexamining foreign exchange controls and returning to the international financial market. While such a transition in policy can be viewed as a positive development for Argentina’s economy, in the long-term we need to watch out for negative short-term side effects, such as hyperinflation caused by currency devaluation.

For Turkey, the largest concern is its small foreign exchange reserves. Thanks to the ruling party having regained majority control in the general election held on November 1, the political situation has become more stable and expectations are heightening on the development of future policies. However, attention should be paid to the rising geopolitical risks. Turkey continues its struggle against the “Islamic State (IS),” which is extending its influence in neighboring Syria, and the vulnerability of the Turkish economy has intensified after Turkey’s shooting down of a Russian military aircraft flying missions against the IS in Syria. This incident has caused Russia to posture for economic sanctions against Turkey.

In Brazil, amid deepening stagflation, the nation’s fiscal balance is deteriorating and it runs the risk of heightened pressure caused by capital outflows due to the additional downgrade of its credit rating. It should be pointed out, however, that Brazil has strengthened its resilience to currency devaluation backed by higher foreign exchange reserves and a reduction in foreign currency denominated debt owned by the government

(95% of the debt is denominated in local currency). And despite increasing private-sector debt, the country continues to maintain a stable banking system.

For China meanwhile, we judged its risk to be relatively low. Although we need to maintain a vigilant watch on the rising pressure on China's balance sheet adjustment due to its swelling private-sector debt, the country still has sufficient room to implement monetary and fiscal policies as well as strong resilience against external risk, thanks to its current account surplus and abundant foreign exchange reserves. Such factors serve as advantages for China relative to other EM countries; but as shown in **Chart 1**, since China itself is the source of the slowdown in the EM economies, we should pay attention to the development of China's economy in view of its spillover effect in other EM countries.

Even though our analysis this time classified certain countries as high-risk countries, we do not believe that such risks will materialize immediately. Our basic stance in the MHRI forecast calls for a soft landing of the EM economies, including China. And the sense of crisis derived from the presence of various risks may urge each country to take appropriate measures to respond to such risks. It is imperative that we continue monitoring the development of each country to see whether there will be downward pressure on the basic scenario, bringing about a risk scenario, or whether the policy response of each country will take effect and ease such risks.