

EMs' Vulnerability to Rising Food Prices and Political Instability

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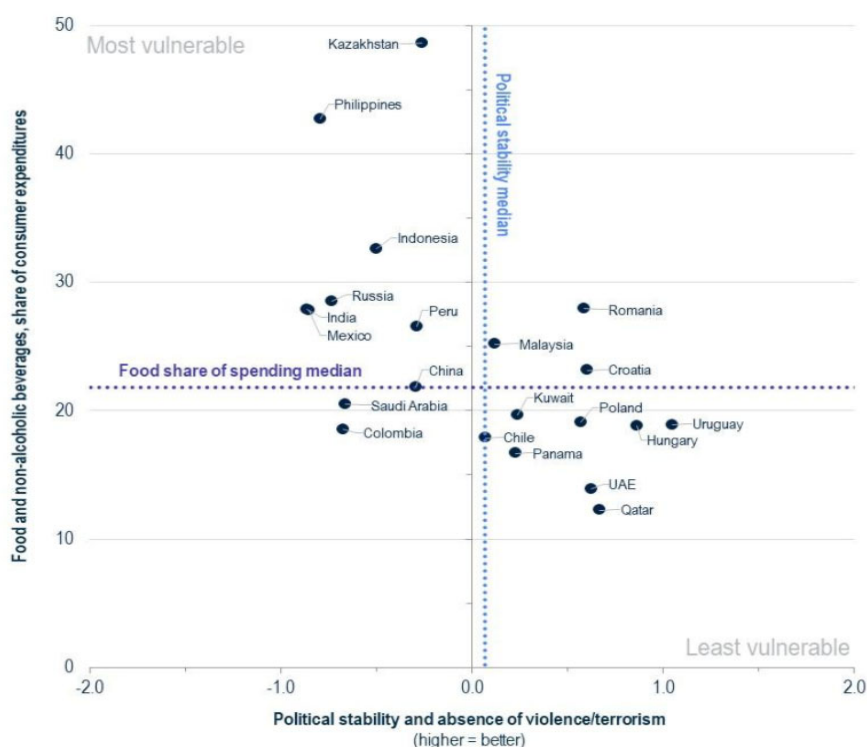
Since our blog post five months ago about emerging markets' vulnerability to inflation, commodity and food prices have continued to skyrocket. In this follow-up piece, we focus on variations in food spending among countries and examine the potential social and political consequences of higher food prices across EMs.

Food items typically have a larger weight in the consumer price index (CPI) basket of emerging markets. Therefore, food price increases might require policy action on the part of central banks if they become a major source of inflation. Politically, food price increases can also cause social discontent if they rise significantly. There are plenty of examples in recent history of political crises sparked by rampant food inflation, from Egypt in 1977 to Argentina in 1989 and Venezuela in 2016 and 2017. At times, unrest has become so widespread that it has resulted in leadership changes; in other cases, food riots were resolved through the granting of subsidies and a general increase in the fiscal largesse of governments. The recent runup in food commodity prices has disproportionately hurt real incomes, and one cannot rule out the possibility of a new bout of social and political instability that, in turn, could affect both the capacity and willingness of EM governments to repay their external debts.

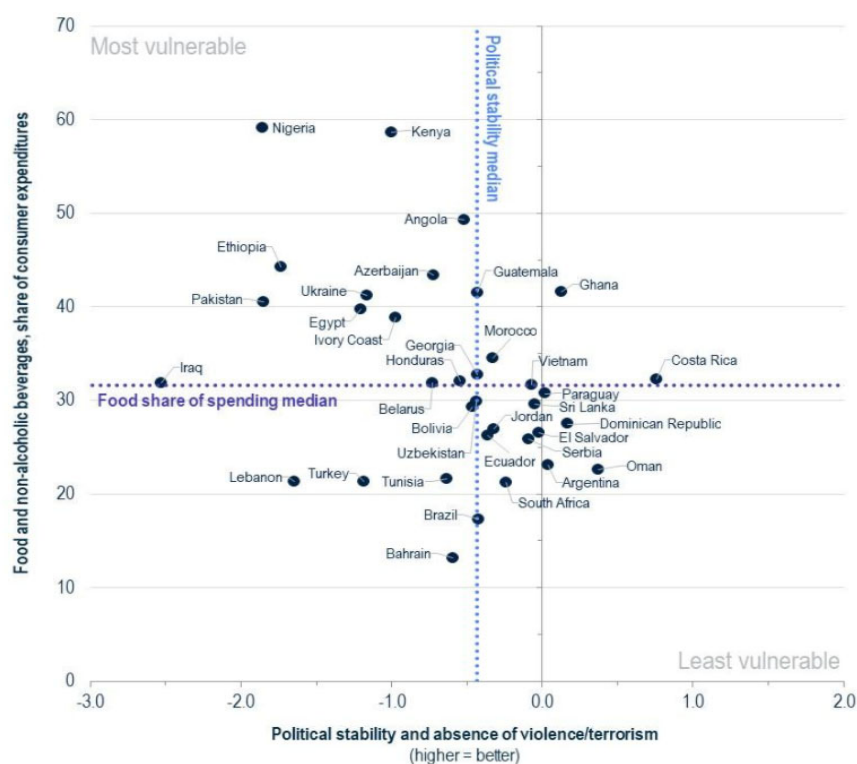
We conduct our analysis on two variables. First, we look at how much individual EM countries spend on food and non-alcoholic beverages as a share of their total expenditure, using data from the U.S. Department of Agriculture, with the understanding that price pressures have more outsized socioeconomic effects on citizens who spend disproportionately more on food. Second, we use the World Bank's Political Stability & Absence of Violence/Terrorism indicator to assess each country's vulnerability to social unrest. For this variable, a higher value reflects higher political stability.

Finally, we divide our sample of the component countries in JP Morgan's Emerging Markets Bond Index (EMBIGD) into two sub-samples: investment grade (IG) credits and high yield (HY) credits. The rationale for this separate analysis is two-fold: First, HY credits include lower-income countries, which generally spend more on food as a share of their total consumption; second, institutions are generally more established among IG countries than HY, thus increasing the likelihood of a more effective government response to food inflation.

The results of our analysis are reported in Figure 1 and Figure 2 for IG and HY credits, respectively.

FIGURE 1: Vulnerability to Food Prices and Political Instability: IG Credits

Source: U.S. Department of Agriculture, World Bank, Haver, PGIM Fixed Income as of February 2022.

FIGURE 2: Vulnerability to Food Prices and Political Instability: HY Credits

Source: U.S. Department of Agriculture, World Bank, Haver, PGIM Fixed Income as of February 2022.

Using these variables, our findings show that Kazakhstan and the Philippines are the most vulnerable credits in the IG universe.¹ The massive protests that broke out in Kazakhstan earlier this year in response to soaring commodity prices serve as confirmation of our analysis, and it bears watching what happens in the Philippines as the May elections approach. On the least vulnerable side, higher-income countries, including Hungary and Uruguay, unsurprisingly fare better. Meanwhile, HY credits are much more dispersed. Kenya and Nigeria appear to be the most vulnerable, and the months leading up to the Kenyan general election in August could be a volatile period, as they have in past elections. The least vulnerable HYs, from Serbia to Sri Lanka, are very diversified from a geographical point of view. It is somewhat reassuring that Brazil, a continental giant holding elections in October, is not in the most vulnerable group. We will continue to monitor these vulnerabilities closely as part of our credit selection process.

¹ This analysis serves as a partial study of a country's creditworthiness and must be complemented by other analysis for investment purposes.

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