

International Commentary — March 3, 2026

International

Downside Scenario: EM Vulnerabilities to a Sustained Geopolitical Shock

- Our base case scenario for Middle East events is still for a short-lived disruption to the global economy and financial markets ([Wells Fargo - The Conflict with Iran: FAQ with the Team](#)). But the downside scenario of a prolonged rise in geopolitical uncertainty and sustained markets volatility is increasingly more likely and needs to be evaluated. We assess this elevated geopolitical uncertainty shock scenario for emerging market economies and financial markets through a vulnerability lens.
- Most EMs have reduced vulnerabilities to a sudden stop in capital flows, especially the systemically important countries (e.g., China and India). However, in the event of a sudden stop, countries reliant on external financing with adverse sovereign debt profiles and inadequate FX reserves are most vulnerable. Those with elevated vulnerabilities can experience balance of payments crises, sharp economic slowdowns, or worse, sovereign default. Argentina and Turkey flag as most vulnerable, while Brazil and Mexico have only moderate vulnerability to a stop in capital flows.
- A sustained geopolitical shock can be another test to the resilience of EM FX. Over the last few days, EM FX has come under broad pressure, but market participants may show a renewed focus on fundamentals and valuations in a shock. Currencies associated with weak fundamentals and expensive valuations can see a sharp reversal (e.g., COP, MXN and ZAR). Countries associated with stronger FX fundamentals and more attractive valuations (e.g., TWD and KRW) can be more protected. At the same time, keep an eye on our framework's "max selloff" levels for whether a currency has become too misaligned or is detached from underlying FX fundamentals. "Buying" or "hedging" opportunities may become available should those levels be breached.
- A combined FX and inflation shock via elevated oil prices limits EM central banks' ability to cut policy rates further. Select central banks may still be able to cut as real interest rates are elevated and the shock hits less acutely (e.g., Brazil, albeit with less space). Others could see easing cycles end early as inflationary pressure builds from higher oil prices and FX pass-through, complicating already existing inflation pressures (e.g., Banxico). A few could restart tightening cycles even if growth prospects are damaged, as financial stability and containing inflation expectations becomes paramount (e.g., Reserve Bank of India).
- Should an affordability shock ensue from markets volatility and/or higher non-discretionary expenditures governments may be limited in their ability to respond via fiscal support. Public finance positions are already weak across EM, except for a select few. For certain governments, rising oil prices can generate increased revenues, boost growth prospects and offer new space to offset affordability issues. Administrations will need to weigh that dynamic against already wide fiscal deficits and large debt burdens (e.g., Colombia). But should governments without fiscal headroom ignore public finance limitations sovereign bond markets may turn volatile, and financing issues could follow.

Economist(s)

Brendan McKenna

International Economist | Wells Fargo Economics
Brendan.McKenna@wellsfargo.com | 212-214-5637

A sustained Middle East geopolitical shock could spark a “sudden stop” of capital flows into EM

Emerging markets have attracted capital inflows over the last 12-18 months, but should investor sentiment shift away from EM, economies reliant on external financing could experience crisis conditions. Argentina and Turkey are highly vulnerable, China and India are less sensitive, although most EMs have sources of vulnerability to a sudden stop scenario

	Overall EM Sudden Stop Vulnerability	Current Account Balance (% of GDP)	FX Reserve Adequacy (% of ST Debt)	Foreign Part. in LCY Debt (% of LCY Debt)	FX Denominated Debt (% of Gov't Debt)	FX Regime (Free, Managed Float or Crawl)
Argentina	Red	Yellow	Red	Red	Red	Red
Turkey	Red	Yellow	Red	Green	Red	Red
Indonesia	Yellow	Yellow	Yellow	Yellow	Red	Yellow
Colombia	Yellow	Red	Yellow	Yellow	Red	Green
Chile	Yellow	Yellow	Red	Yellow	Red	Green
Poland	Yellow	Yellow	Yellow	Yellow	Red	Green
Hungary	Yellow	Green	Red	Yellow	Red	Green
Peru	Yellow	Green	Green	Red	Red	Yellow
Philippines	Yellow	Red	Green	Green	Red	Yellow
South Africa	Yellow	Yellow	Yellow	Red	Green	Green
South Korea	Yellow	Yellow	Yellow	Red	Green	Yellow
Mexico	Yellow	Yellow	Yellow	Yellow	Yellow	Green
Brazil	Yellow	Yellow	Yellow	Yellow	Green	Green
India	Green	Yellow	Green	Green	Green	Yellow
Israel	Green	Green	Green	Green	Yellow	Yellow
Russia	Green	Green	Green	Green	Green	Red
Taiwan	Green	Green	Green	Green	Green	Red
China	Green	Green	Green	Green	Green	Red
Thailand	Green	Green	Green	Green	Green	Green

¹ Red indicates "High vulnerability"; Orange indicates "Moderate vulnerability"; Green indicates "Little vulnerability"

Source: IMF, IIF Wells Fargo Economics

A shock can test the resilience of EM FX. Which currencies are vulnerable and which can be more protected?

Markets are likely to focus on relative fundamentals and valuations in a downside shock. Underlying FX fundamentals are most fragile in Argentina, Colombia and Turkey, but strongest in Peru, Taiwan and China. COP, CLP, MXN, ZAR, IDR, BRL and ILS screen as overvalued, while TWD and KRW valuations appear more attractive

	Current Exchange Rate (Level vs. USD)	Max FX Depreciation (Level vs. USD)	Unrealized Max FX Depreciation (% vs. USD)	Q1'2026 FX Vulnerability ^{1 2}	Current Account Balance (% of GDP)	Real Int. Rate Diff. With U.S. (%)	Import Cover (Months)	Political Risk Indicator
Argentina	1,411	1,524	(6.4%)	High	High	High	High	High
Colombia	3,790	4,239	(10.1%)	High	High	Low	High	High
Turkey	43.98	46.80	(5.5%)	High	High	Low	High	High
Chile	909.50	1,003	(8.7%)	High	High	High	High	High
Hungary	336.66	371.08	(8.7%)	High	Low	High	High	High
Mexico	17.72	20.15	(11.6%)	High	High	High	High	High
South Africa	16.54	18.52	(10.1%)	High	High	High	High	High
Indonesia	16,872	18,953	(10.5%)	High	High	High	High	High
South Korea	1,488	1,596	(6.1%)	High	Low	High	High	High
Philippines	58.43	66.17	(11.3%)	High	High	High	High	High
Poland	3.71	4.10	(9.0%)	High	High	High	High	Low
Thailand	31.45	36.39	(13.4%)	High	Low	High	High	Low
India	91.48	100.38	(8.3%)	High	High	High	High	Low
Brazil	5.29	6.03	(11.9%)	High	High	Low	Low	High
Israel	3.10	3.61	(14.1%)	High	Low	High	Low	High
Peru	3.40	3.72	(8.3%)	Low	Low	High	Low	High
Taiwan	31.63	32.02	(1.1%)	Low	High	High	Low	Low
China	6.92	7.61	(9.0%)	Low	Low	High	Low	High

FX Vulnerability as of 3/3/2026

¹ Red indicates "High vulnerability", Orange indicates "Moderate vulnerability", Green indicates "Low vulnerability"

² "High vulnerability" represents maximum peak-to-trough 20% depreciation, "Moderate vulnerability" represents maximum peak-to-trough 15% depreciation, "Low vulnerability" represents maximum peak-to-trough 10% depreciation

Source: IMF, Bloomberg Finance L.P. and Wells Fargo Economics

An FX and inflation shock means central banks monetary policy space for additional rate cuts would narrow sharply

Should the downside scenario for FX depreciation and an inflation shock via higher oil prices materialize, all EM central banks (ex-PBoC) would lose space to ease monetary policy. A select few may have room for easing (e.g., Brazilian Central Bank), others would likely end the easing cycle (e.g., Banxico), while certain institutions may shift to rate hikes (e.g., Reserve Bank of India)

	Pre-Iran 2026 Monetary Policy Space	2026 Monetary Policy Space ^{1 2}	Real Int. Rate Diff. With Fed (%)	Inflation From CB Target (%)	Economic Growth Momentum	FX Performance vs. USD (Last 3 months)
Hungary	Green	Yellow	Green	Green	Green	Red
Thailand	Green	Yellow	Yellow	Green	Green	Red
Poland	Green	Yellow	Yellow	Green	Green	Red
Israel	Green	Yellow	Yellow	Green	Yellow	Red
Chile	Green	Yellow	Yellow	Green	Yellow	Red
Brazil	Green	Yellow	Green	Yellow	Green	Red
China ³	Yellow	Yellow	Red	Green	Green	Red
South Africa	Yellow	Red	Yellow	Yellow	Yellow	Red
Philippines	Yellow	Red	Red	Yellow	Yellow	Red
Mexico	Yellow	Red	Yellow	Red	Green	Red
Turkey	Yellow	Red	Green	Red	Yellow	Red
Colombia	Yellow	Red	Green	Red	Red	Red
India	Red	Red	Red	Yellow	Yellow	Red
South Korea	Red	Red	Red	Yellow	Yellow	Red
Indonesia	Yellow	Red	Red	Red	Red	Red
Peru	Yellow	Red	Red	Red	Red	Red
Argentina	Red	Red	Red	Red	Yellow	Yellow

¹ Green indicates "Adequate Monetary Policy Space", Orange indicates "Limited Monetary Policy Space", Red indicates "No Monetary Policy Space"

² Adequate Monetary Policy Space represents scope for >50 bps of rate cuts, Limited Monetary Policy Space represents scope for 25-50 bps of rate cuts, No Monetary Policy Space represents scope for 0 rate cuts

³ People's Bank of China 7 Day Reverse Repurchase Rate

Governments may need to offset affordability hits, but can they offer fiscal support without bond market volatility?

Administrations have floated the idea of financial support should affordability issues become apparent. But only a few have fiscal policy space to deliver (e.g., Chile and Peru). Those without fiscal headroom (e.g., Brazil, South Africa and Colombia) risk instability and economic downturns, or if resources are deployed anyway, local bond markets could turn volatile

Country	2026 Fiscal Policy Space ¹	Primary Balance (% of GDP)	Interest Expense (% of GDP)	Bond Maturities* (% of GDP)	Gross Gov't Debt (% of GDP)	Auto. Debt Dynamics (Rates-Growth)
Chile	Green	Yellow	Green	Green	Green	Green
Peru	Green	Yellow	Green	Green	Green	Yellow
Russia	Yellow	Yellow	Green	Green	Green	Red
Czech Republic	Yellow	Red	Green	Green	Green	Yellow
Turkey	Yellow	Yellow	Red	Green	Green	Green
Indonesia	Yellow	Yellow	Yellow	Green	Green	Yellow
Korea	Yellow	Red	Green	Green	Yellow	Yellow
Philippines	Yellow	Yellow	Yellow	Yellow	Yellow	Green
Thailand	Yellow	Red	Green	Yellow	Yellow	Yellow
Argentina	Yellow	Green	Yellow	Red	Red	Green
Poland	Yellow	Red	Yellow	Yellow	Yellow	Yellow
Mexico	Yellow	Green	Red	Yellow	Yellow	Red
China	Yellow	Red	Green	Red	Red	Green
Israel	Red	Yellow	Yellow	Yellow	Red	Yellow
Hungary	Red	Red	Red	Yellow	Red	Red
India	Red	Red	Red	Red	Red	Green
Colombia	Red	Red	Red	Yellow	Yellow	Red
South Africa	Red	Yellow	Red	Red	Red	Red
Brazil	Red	Yellow	Red	Red	Red	Red

¹ Green indicates "Adequate Fiscal Policy Space", Orange indicates "Limited Fiscal Policy Space", Red indicates "No Fiscal Policy Space"

* Wells Fargo Estimate

Economics Group

Tom Porcelli	Chief Economist	212-214-6422	Tom.Porcelli@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Aroop Chatterjee	Senior Economist	212-214-8819	Aroop.Chatterjee@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Azhin Abdulkarim	Economic Analyst	212-214-5154	Azhin.Abdulkarim@wellsfargo.com
Anagha Sridharan	Economic Analyst	704-410-6212	Anagha.Sridharan@wellsfargo.com
Andrew Thompson	Economic Analyst	704-410-2911	Andrew.L.Thompson@wellsfargo.com

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