



Emerging Markets Quarterly – 2016/4

After the difficulties in the year 2015 and the beginning of 2016, the fundamental situation of emerging countries has strengthened during the course of this year: They have mostly digested the shock of lower commodity prices. Political tensions have peaked in many countries. The situation in China has stabilised. The most important question after Donald Trump's election is, whether his presidency will undo the recovery.

Growth – A “tamed” Trump does not undo the recovery

After the election of Donald Trump, many uncertainties regarding his future policies remain. Yet, we expect him to implement less extreme measures than what he announced during the campaign. His rhetoric changed after the election. Moreover, checks and balances will “tame” the President-elect. Such a “tamed” Trump should not prevent the growth recovery of emerging markets, which has started in early 2016. The recovery is mostly driven by the bottoming out of the recession in Brazil and Russia. These two major economies were hit by big shocks: the fall of commodity prices and severe political tensions. The fading out of these shocks provides a relief to growth of emerging markets. Thus, the situation becomes “less bad” rather than “better”. A “tamed” Trump is not as big of a shock to overall emerging markets growth as one of the most severe recessions in Brazil and Russia as well as a commodity price fall. Therefore, we do not expect Donald Trump to undo the recovery. Yet, we have always anticipated a slow recovery as many problems remain, such as low commodity prices, political and structural issues. A Trump presidency will certainly add more difficulties.

Donald Trump – How does he affect the emerging world?

Overall, the victory of Donald Trump is clearly bad news for emerging markets. Yet, the magnitude of the impact on individual countries varies significantly. There are four main channels: First, external vulnerability is back in focus. As in 2013, US interest rates are rising and the Dollar is strengthening. This pressures countries with large current account deficits and external debt, such as Turkey or South Africa. Second, potential protectionist measures would weigh on countries with strong trade links to the US, such as Mexico or China. Third, the security situation of Eastern Europe depends on the role of the US in NATO. Finally, there is also a positive impact: metals prices have surged in anticipation of US infrastructure projects. Copper and iron ore exporters benefit.

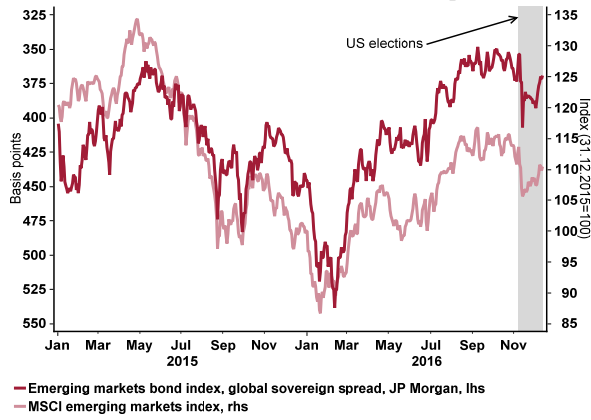
US rates – How exposed are emerging markets?

The rapid rise of US long-term interest rates and more hawkish anticipations regarding the Fed are a reminder of 2013. It is an environment, in which countries with external imbalances, such as Turkey, South Africa or Colombia, are under pressure. A number of countries are less vulnerable today than in 2013 as they have reduced their current account deficits. India, Brazil and Indonesia, for example, have made considerable progress and their current account deficit is not a big concern anymore. The improvement is not due to wise policies but rather a consequence of commodity price moves, currencies and, in case of Brazil, the recession. While the situation in Turkey and South Africa also has improved, it remains vulnerable. In Colombia, the current account deteriorated considerably due to the oil price fall. Since 2013, current accounts have generally improved in the emerging world. Overall, inflation is lower, but there are exceptions in Latin America. Yet, there has been no progress of fiscal balances. In contrast, the situation has deteriorated in many countries.

China – “Tamed” slowdown in 2017

The Chinese government successfully stabilised growth. This shows that authorities indeed have the means to stop the slowdown if necessary. The stabilisation is however not sustainable as it was driven by the old-style model of debt creation, infrastructure spending and a revival of the real estate sector. The underlying forces pushing Chinese growth lower remain: The economy experiences a healthy downsizing after the stimulus driven years in the wake of the great recession. China is becoming richer and hence grows at a slower pace. Finally, demographics look less favourable. Thus, the slowdown will continue in 2017. The government will however “tame” the deceleration upfront to the important congress in autumn. The authorities have two overarching goals: rebalancing and growth. Since late 2015, the latter has priority. While we expect less stimulus in 2017 than in 2016, we do not believe that the focus shifts back to reforms. The strength of the Dollar after the US elections has put a lot of pressure on the Yuan. Capital outflows are resurging. The central bank tries to counter a too strong depreciation by using for example foreign reserves to support the currency. The goal of a controlled and gradual depreciation is still in check. Yet, the more the Dollar appreciates, the higher is the risk that it becomes too costly for the central bank to counter the depreciation pressures.

Emerging markets assets – Suffered surprisingly little after the election of Donald Trump



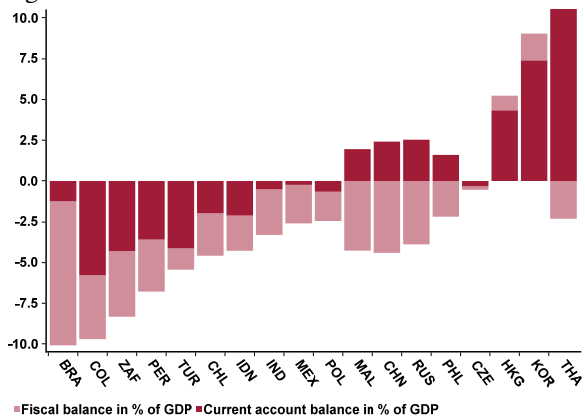
Source: **Macrobond**

Growth – The slow recovery should unfold despite Donald Trump’s election



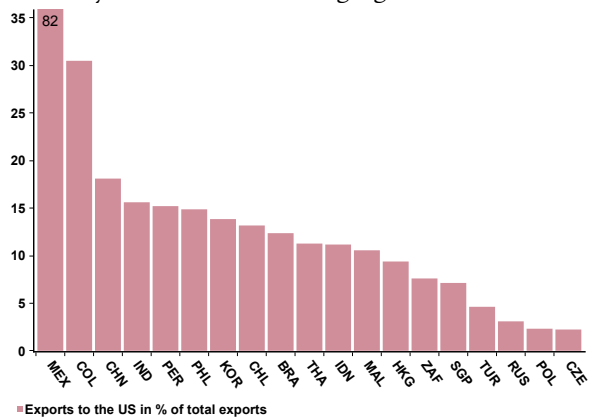
Source: **Macrobond**

Twin deficits – Some countries are vulnerable to higher US interest rates



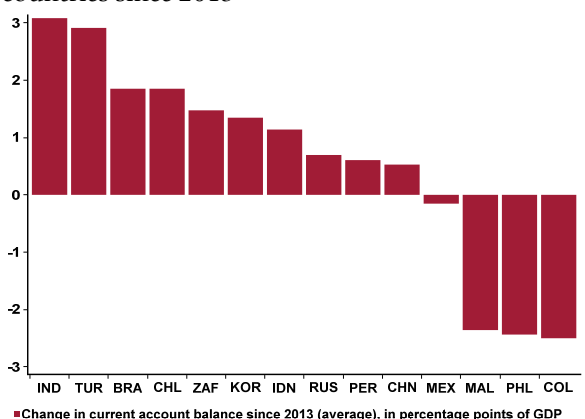
Source: **Macrobond**

Trade – The US is an important export destination for many but not for all emerging countries



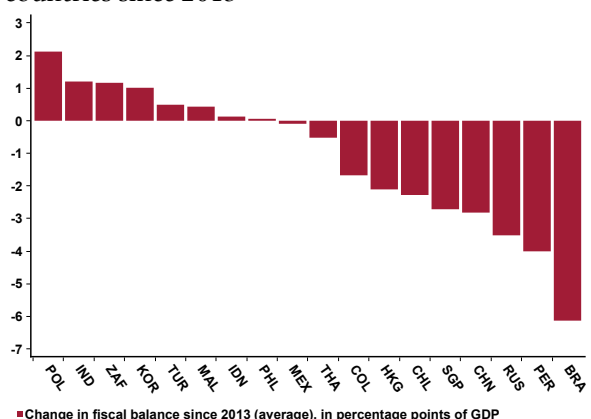
Source: **Macrobond**

Current account balances – Improvement in many countries since 2013



Source: **Macrobond**

Fiscal balances – Deterioration in a number of countries since 2013



Source: **Macrobond**

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