Perspectives
Emerging Markets

SwissLife Asset Managers

Third quarter 2023

Key takeaways

- Emerging markets posted robust growth in the first quarter
- China's economic upswing already seems to be losing momentum again
- Various emerging markets should be able to benefit from the "friendshoring" trend

Number in focus

15%

The Turkish central bank raised its key interest rate from 8.5% to 15% in mid-June. Although this was a smaller rate hike than previously expected, it nevertheless symbolises a first step towards a more sustainable monetary policy. After winning re-election at the end of May, President Erdogan appointed a new economic team, including a new governor of the central bank. President Erdogan is a self-proclaimed opponent of higher interest rates as a tool in the fight against inflation (39.6% YoY in May). We must therefore wait and see how sustainable this development is. The recent collapse of the lira shows that the markets have their doubts.

Chart in focus

Inflation in China remains at a very low level. Year-on-year consumer price inflation stood at 0.2% in May. Lower consumer goods inflation and falling transport costs are the main drivers of this decline, while food prices rose sharply in May. Producer price inflation has also fallen sharply and was once again in deflationary territory in May. The low price pressure does not indicate an overheating Chinese economy and means that China is currently exporting deflation rather than contributing to global price pressure as feared.

China's recovery already faltering

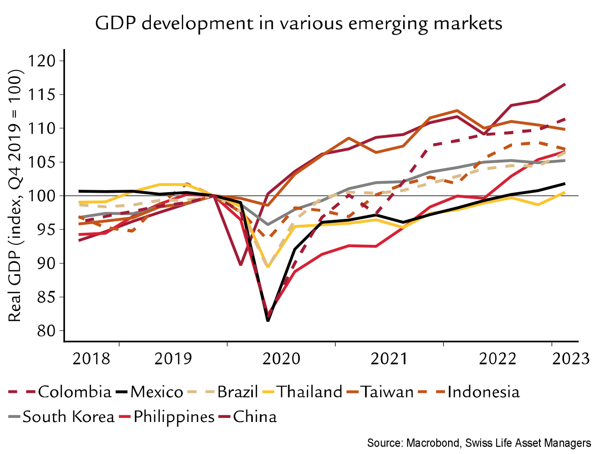
After economic data for April already came in significantly weaker than expected, May data also suggest that the recovery is already faltering again. Foreign trade figures for May again surprised significantly on the downside. Exports in particular fell sharply in May compared to the previous year. Imports were also falling again. After industrial production in April was significantly lower than expected, May data were in line with expectations, but the latter were scaled down. Also in May, the official purchasing managers' index for the manufacturing sector remained below the growth threshold of 50 for the second month in succession. At 48.8, it is at its lowest level since December 2022. The services index also recorded its second consecutive decline in May, although at 53.8 it is still well above the 50 threshold. Private consumption remains robust. Retail sales continued to grow strongly. However, some base effects due to last year's lockdown measures are still playing a role here. The government has already reacted to these weak data. Surprisingly, China's central bank cut its key interest rate by 0.1 percentage points in mid-June. The low inflation is giving the central bank some room for manoeuvre. Similarly to activity data, China's inflation rate surprised strongly on the downside. Consumer price inflation stood at 0.2% in May, while producer price inflation at -4.6% remained clearly in deflationary territory. The weak data have also refuelled speculation about possible government stimulus packages. However, we currently consider the likelihood of a significant package, especially in the infrastructure or real estate area, to be low.

Robust first quarter in the emerging markets

In addition to China, the other emerging markets also posted robust growth in the first quarter. However, this was not so much due to positive spillover effects from China, but rather to country-specific factors. In Latin America, Mexico and Brazil in particular posted stronger-than-expected growth. The Brazilian economy grew by 4% in the first quarter compared to the previous year. This was mainly due to the agricultural sector, which experienced strong growth due to rich harvests. In Mexico, the strong services sector was the main driver of robust growth of 3.9% in the first quarter. In Asia, by contrast, economic growth in the first quarter was somewhat below expectations, with the exception of Indonesia. The Asian economies benefited less from the Chinese upswing than previously expected. In contrast to previous growth episodes, the Chinese economy this time was mainly driven by a recovery in the services sector, which reduced the positive spillover effects to the rest of the world. Nevertheless, gross domestic product is back above pre-pandemic levels in all countries of the region. Although the emerging markets are set to feel the impact of the weakening global economy, we expect growth in these countries in the second half of 2023 to continue to remain somewhat more resilient compared to developed economies. Headline inflation in the emerging markets saw a sharp decline. While, as in the developed economies, core inflation also remains somewhat more stubborn here, we expect it to gradually normalise in the second half of the year.

Chart 1: China's exports, especially to the ASEAN region, have plummeted

Chart 2: GDP in the emerging markets is again significantly above pre-pandemic levels



"Friendshoring": winners and losers

The term "friendshoring" means the restriction of trade to friendly countries. China in particular is negatively affected by this trend. A certain amount of diversification of supply chains away from China has been observed since the pandemic. We have already written about the so-called "China Plus 1" strategy in this publication. "Friendshoring" is now making it a little clearer which emerging markets could benefit from this. A frequently mentioned potential profiteer is India. The government of India recently launched an initiative to attract international industrial enterprises (see next section), which has already had some success. However, we do not expect India to experience a major industrial boom due to "friendshoring", but instead see steady growth as more likely. In Southeast Asia, Vietnam is likely to continue to benefit. The country has already significantly increased its share of global exports since the pandemic. Outside Asia, we see Mexico in particular as a country that could benefit from diversification, especially with regard to investments from the US. Mexico already has a long-standing trade agreement with the US. Its geographical proximity and low wage costs are also an advantage. However, political planning security in Mexico has declined in recent years. For example, private investment in various sectors, such as renewable energy, has been hampered by the Mexican government. This could be a barrier to more significant investment in Mexico.

India: the next China?

India recently overtook China as the world's most populous country. Since then, there has been renewed discussion about when India will also overtake China economically. There are several factors which speak for a positive development of India. The average age of the Indian workforce is very low. The government has invested heavily in the country's infrastructure in recent years, especially in the transport sector and digitalisation. For an emerging market, India's economy is very heavily dependent on its services sector. Therefore, as already mentioned, the government has launched a large-scale initiative to attract international industrial enterprises. While initial successes have been achieved, certain obstacles remain. Confidence in the stability of politics remains low. The Indian government's focus on so-called domestic "champions" could discourage investment. This risk of an unequal competitive environment for domestic and foreign firms could explain why gross foreign direct investment has slowed down. We therefore do not expect India to experience an industrial boom, but instead consider continuous growth to be likely.

Chart 3: The share of US imports from Vietnam has already increased significantly

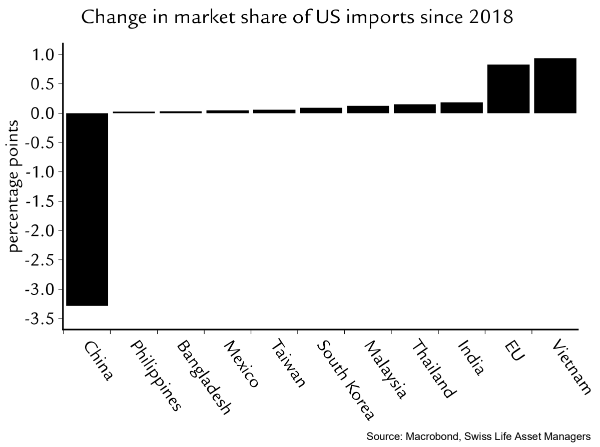
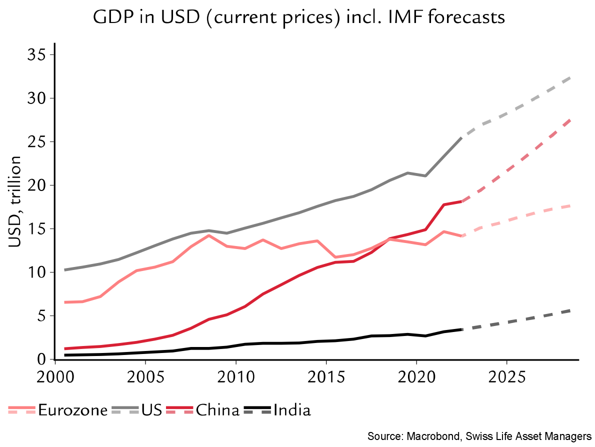


Chart 4: An industrial boom is unlikely to occur in India



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