Perspectives
Emerging markets

Swiss Life Asset Managers

Third quarter 2024

Key takeaways

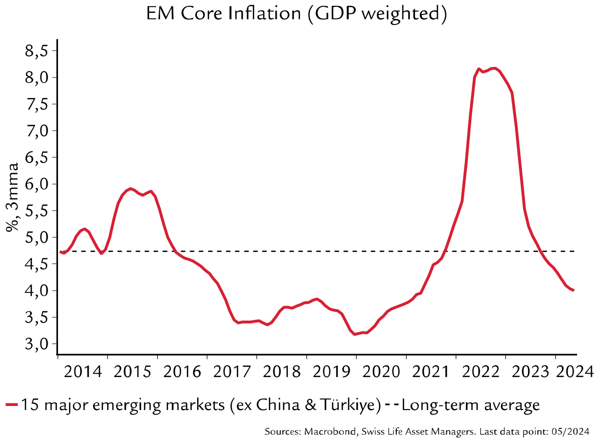
- Economic momentum remains strong in emerging markets, focus shifts towards political risks
- China: alongside a weak real estate sector, further trade tariffs create challenges for its economy
- Economic outlook unchanged despite surprising election results in South Africa, India & Mexico

Number in focus

100%

Global trade barriers are increasing. The Biden administration has imposed tariffs on a number of Chinese goods, including a 100% tariff on the import of electric vehicles. At the same time, the EU Commission has announced an average additional tariff of 21% on Chinese electric vehicles. In the medium term, this will complicate, but not hinder, China's efforts to use high-tech products as growth drivers. In addition, trade barriers necessitate greater localisation, which is more costly and supports our assumption of a higher inflation environment compared to the pre-pandemic period.

Chart in focus



Inflation in emerging markets continues to decline, and in some cases has already reached the inflation target of the respective central banks. The aggregate core inflation rate, which excludes volatile food and energy prices, has already returned to pre-pandemic levels for the 15 leading emerging markets (see "Chart in focus"). We have excluded China and Turkey from this aggregation due to the exceptional situation in these countries with regard to inflation.

Domestic economy continues to grow

In the first half of 2024, domestic activity in the emerging markets contributed strongly to growth. In particular, consumption surprised positively in Southeast Asia and large parts of Latin America. This is due to favourable labour market conditions and falling inflation, which has increased real disposable income. In addition, lower inflation rates have enabled central banks in emerging markets to cut interest rates ahead of the US Federal Reserve, thus creating an investment-friendly environment. As a result, the Purchasing Managers' Index for both manufacturing and the services sector rose overall in the emerging markets, significantly exceeding the 50-point mark that separates growth from contraction. Following the surprisingly strong GDP growth rates in the first quarter, these developments bode well for the second quarter GDP data, which is yet to be published.

China: even more trade tariffs

China's economy faces significant challenges. Although various incentives for the real estate sector were introduced in May – including a further cut to mortgage interest rates, more relaxed capital adequacy requirements and a call for local governments to purchase unsold property stocks – real estate market indicators are continuing to decline from an already low level. In the first five months of this year, real estate investments fell by more than 10% while real estate sales declined by more than 30% compared to the previous year. Despite these challenges, our forecast for GDP growth this year remains relatively constructive at 4.9%. This is supported by the resilience of certain sectors. Infrastructure investments remain a key pillar of growth. In addition, the surge of investment in high-tech manufacturing as a new growth driver has delivered strong results. However, this sector is currently threatened by trade barriers. The US has imposed tariffs on a wide range of Chinese products, including semiconductors, lithium-ion batteries, solar cells and electric vehicles. Tariffs on electric vehicles are particularly high at 100%, which effectively excludes these products from the US market. At the same time, the European Commission has announced an average additional tariff of 21% on electric vehicles. While these tariffs will slow the growth of China's electric vehicle sector, they will not stop it. Chinese car manufacturers, which sell their products in Europe at significantly higher prices than domestically, can reduce their prices to absorb some of the impact of the EU tariffs. They will also increasingly relocate their manufacturing operations to their target markets in order to avoid tariffs and further increase their market share. However, increasing trade conflicts and the shift towards local manufacturing will lead to an increase in their cost structure, which supports our assumption of a higher inflation rate compared to the pre-pandemic period.

Chart 1: Purchasing Managers' Indices point to continued robust economic growth

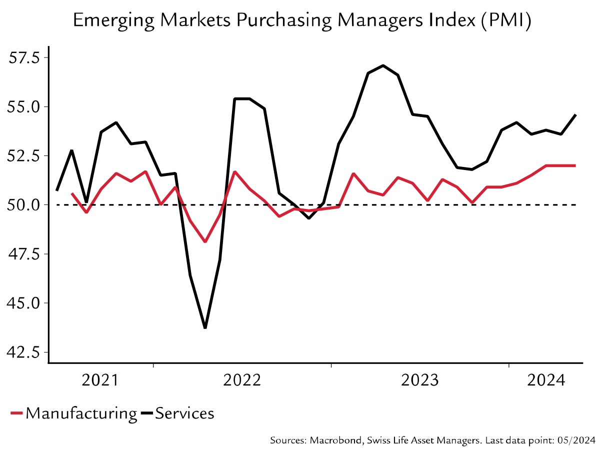
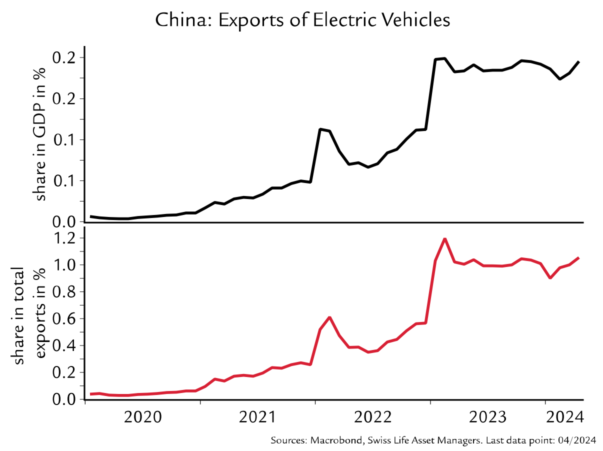


Chart 2: Exports of electric vehicles are rising rapidly, but are still a small part of the economy



Surprising election outcomes in Mexico, India and South Africa

The election year has been quite eventful so far, with unexpected outcomes in the elections in India, Mexico and South Africa. Despite a volatile transition period during which the new governments will set their final course, our medium-term view on these countries remains unchanged. *In India*, Prime Minister Modi's BJP failed to win an absolute majority in parliament. Nevertheless, the BJP-led NDA coalition will continue to rule, albeit from a weakened position. In the short term, there is a risk that the party will shift its focus towards populist spending measures in order to improve its standing amongst the population, which would weigh on the budgetary situation. However, the composition of the new cabinet indicates a high degree of political continuity, with most ministers, including the four top ministers, remaining unchanged. This suggests that the main axes of reform will be continued. This includes expanding the infrastructure and improving manufacturing facilities to take advantage of the opportunities arising from the friendshoring trend. These factors contribute to our positive growth forecast for the fastest growing major economy in the world. *In South Africa*, the ANC party, which has been in power for the last 30 years, lost its majority for the first time, winning only 40% of the vote. This result reflects the party's inability to effectively address the country's economic problems. South Africa is struggling with an unemployment rate of over 30% and sluggish GDP growth averaging 1% over the past decade due to lack of investments, frequent power outages, widespread corruption and crime. The country's political parties have agreed to form a governing coalition consisting of the ANC, the main opposition and pro-market DA, and three other smaller parties. In an optimistic scenario, the market-oriented DA could fuel momentum for reform. However, ideological differences may make decision-making within the coalition more difficult. We remain correspondingly cautious regarding the country's economic prospects. *In Mexico*, Claudia Sheinbaum of the ruling left-wing Morena party won an impressive victory, securing a two-thirds majority in the lower house of Congress and being only a few seats away from that in the Senate. The strength of her mandate carries the risk that her party could pass the constitutional reforms demanded by President Lopez Obrador, including a controversial reform of the judiciary, which could weaken the country's institutional framework. Nevertheless, there are signs that Sheinbaum, a climate scientist, will adopt a more technocratic approach than her predecessor. She has promised to handle finances responsibly, keep the respected finance minister in office and encourage private investments. This promise seems credible, considering that in her former role as Mayor of Mexico City, she promoted public-private partnerships. The short-term risks therefore arise from the institutional aspects, while in the medium term the President's stance could have a positive impact.

Chart 3: The Indian government will continue to promote investments in its infrastructure

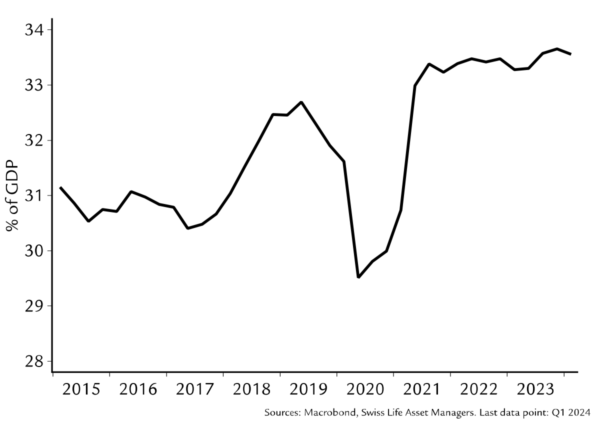
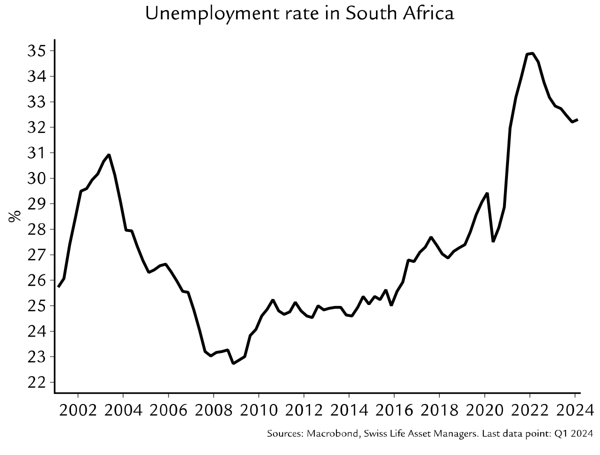


Chart 4: South Africa's new government faces a slew of economic challenges



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