Perspectives
Emerging Markets

SwissLife
Asset Managers

Fourth quarter of 2024

Key takeaways

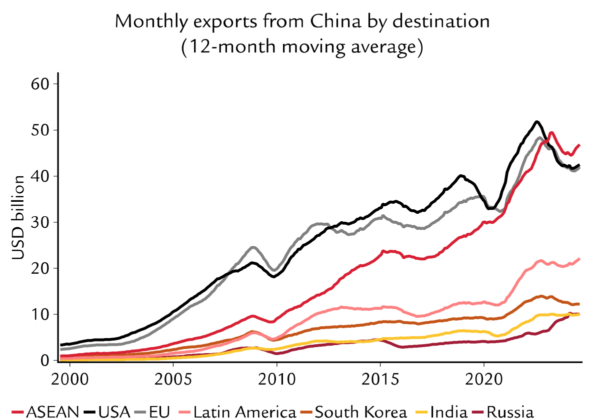
- Falling inflation and lower interest rates are supporting the robust domestic economy in emerging markets
- External tailwind is fading due to global growth fears
- China: The real estate crisis is closer to the end than the beginning, but downward pressure remains

Number in focus

5

India's GDP growth rate was above 7% for a full five consecutive quarters before falling slightly to 6.7% in the second quarter of 2024. India thus remains the fastest-growing major economy in the world. The main reason for the slight slowdown in growth was the presidential election in the second quarter, which led to a temporary halt in government spending. Consumption and investment, on the other hand, remained robust and should continue to be supported by diversification efforts that are diverting investors away from China.

Chart in focus



Given weak domestic demand due to the real estate crisis (see page 3), external demand has been a tailwind for China so far, but this is likely to ease somewhat with weakening demand from the US. However, China has diversified away from the US. Exports to Southeast Asia have surpassed those to the US, while those to Latin America are increasing rapidly. As a result, dependency on a single region has decreased significantly, which is one of the explanations for the country's robust export performance so far.

Strong emerging markets despite China's weakness

The economic resilience of the emerging markets is expected to continue in the fourth quarter of this year. Although inflation in the services sector remains somewhat more stubborn due to strong domestic demand, headline inflation in most economies is now within the target range of the respective central banks. With the exception of Brazil, which raised the key interest rate in September due to stronger-than-expected economic momentum and another slight increase in inflation expectations, most emerging markets can therefore continue with interest rate cuts. Latin America and the emerging markets in Europe have already made significant interest rate cuts since mid-2023. The interest rate cut by the US Federal Reserve also opens the door for the more cautious Asian region, where interest rate cuts will also follow. India, Indonesia and the Philippines in particular currently all have interest rates above 6%, which is considered restrictive and dampens economic momentum. These countries have scope to lower their interest rates. Lower inflation supports real disposable income and thus consumer spending, while lower interest rates will boost investment. In light of this, the outlook for domestic demand in emerging markets remains positive. The current trend shows that China is not the main driver of growth in emerging markets in the present environment. Despite China's current economic weakness, mainly due to the real estate crisis, other emerging markets are showing strong growth dynamics and demonstrating their resilience.

Support from external environment decreasing

While domestic demand remains stable in emerging markets, the external environment is becoming increasingly less supportive. This is already reflected in August's manufacturing Purchasing Managers' Index (PMI). While the PMI survey subcomponent for new orders remains above the 50 points mark, separating expansion from contraction and thus indicating solid domestic demand, the new export orders PMI has fallen below this threshold for the first time this year. One reason for this decline is the softening demand from the US, which is expected to decline further in the coming months. Mexico is particularly affected as it is heavily dependent on demand from the US, with exports to the US accounting for more than 25% of GDP. Although the recent 50 basis points rate cut by the US Federal Reserve is a positive first step in responding to the upcoming economic slowdown, growth fears and potential recession debates will reignite, making the overall risk sentiment more fragile. In addition, the forthcoming US election will create uncertainty, with a potential victory for Donald Trump being particularly negative for emerging markets due to his unpredictable policies and tariff threats. This is compounded by geopolitical uncertainty with the ongoing wars in Ukraine and the Middle East. Although we do not expect any war to escalate to a degree that would cause sustained upheaval in global financial markets, recent developments – such as Ukraine's invasion of Russian territory as well as the spread of war in Lebanon – are contributing negatively to the risk environment. In particular, vulnerable emerging markets that rely on fi-

Chart 1: Domestic demand remains robust, export orders are dwindling

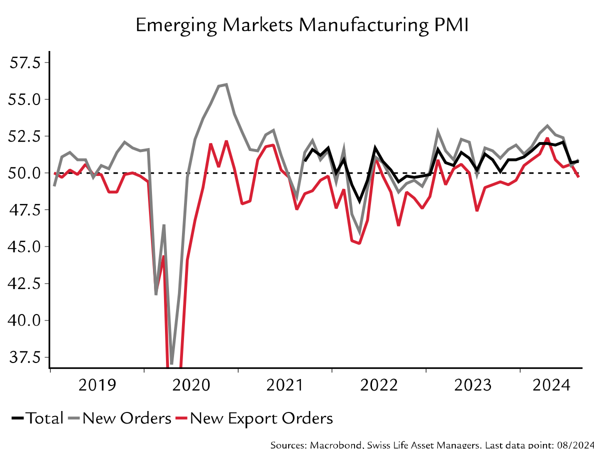
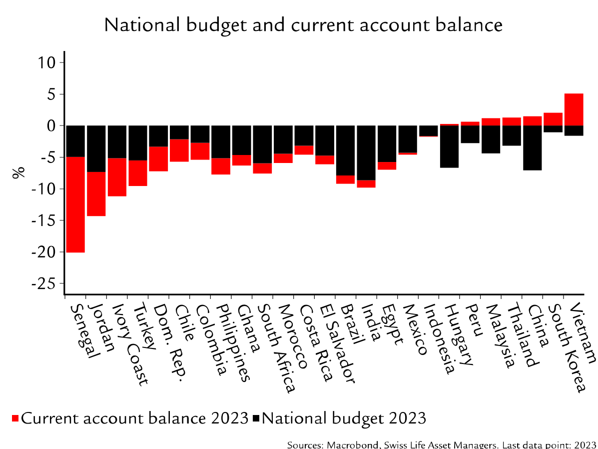


Chart 2: Fundamentally weak economies under increased pressure



nancial flows from abroad – i.e. those with large current account and budget deficits – will be quickly hit by a less friendly risk environment. On the other hand, the fundamentally more robust countries, mainly Asian economies, are more resilient (see Chart 2).

China's real estate crisis: is the end in sight?

China's domestic economy remains weak. Especially in the consumer sector, economic indicators, such as retail sales, fell well below expectations over the course of the year. The trigger for this weak demand is the ongoing real estate crisis, which is keeping consumer confidence at a record low. The crisis began three years ago with the financial difficulties of the Evergrande Group. Evergrande, once one of China's largest real estate developers, ran into significant financial trouble as regulators introduced measures to limit the leverage of real estate developers. These measures led to liquidity bottlenecks and subsequent payment defaults. Three years after the start of the crisis, the question is how long we will have to wait for the trend to turn around. While an exact timing cannot be predicted, recent indicators suggest that we are closer to the end than the beginning of the crisis. On the one hand, the downward trend in seasonally adjusted monthly property sales this year was much flatter than in the past three years, and the latest August data has stabilised compared to the previous month (see Chart 3). In addition, the financial analysis group Gavekalestimates that real estate purchases by households will decline to around 6% of GDP in 2024, which is in the range of 5% - 7.5% from before the real estate boom and is considered the standard internationally. Any further decline from this significantly more moderate level of real estate sales will be less significant than the previous downward correction. However, there are several reasons why we do not yet expect a reversal of the downward trend. One is that the public is sceptical about the financial ability of real estate developers to deliver sold but not yet completed real estate projects. Indeed, the gap between the cumulative number of pre-sold but unfinished homes and the completions of these homes has steadily widened. The completion and delivery of real estate projects remains extremely sluggish. In August, they declined by more than 23% compared to the previous year. As long as this trend continues, investor appetite for pre-sold properties will remain low. In addition, the further fall in real estate prices puts potential buyers in a holding pattern as they wait to see how far prices will fall. Although we are closer to the end than the beginning of the crisis and the downside moves will be less pronounced, a trend reversal is not yet in sight.

Chart 3: China: Downward trend in real estate sales flattening

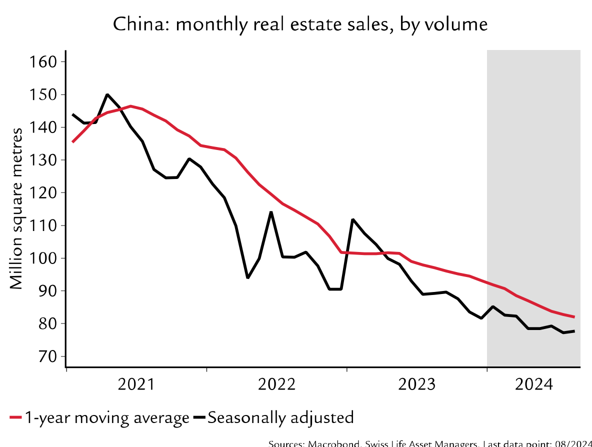
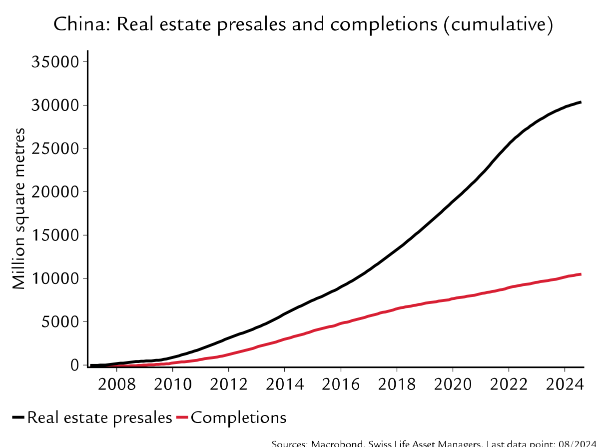


Chart 4: China: Gap between real estate presales and completions is widening



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