Perspectives
Emerging markets

Annual outlook 2025

Key takeaways

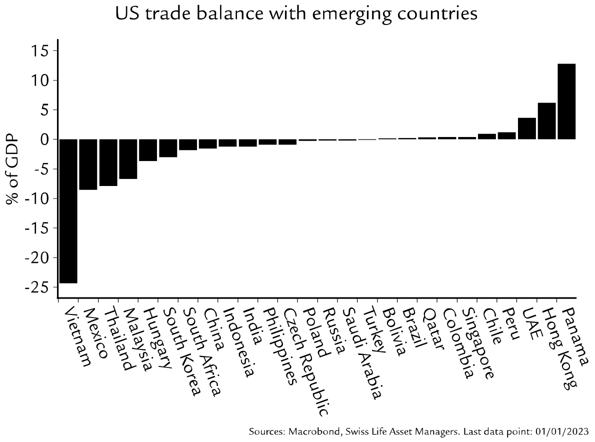
- The growth risks for China's economy are shifting from the real estate crisis to trade tariffs
- Emerging markets are affected to varying degrees by Donald Trump's trade barriers
- Geopolitical risks remain high and difficult to assess

Number in focus

60%

Trade tariffs will be Donald Trump's core instrument for policy making. The most drastic announcements for emerging markets include a 60% tariff for China and 25% for Mexico. However, we do not anticipate tariffs of this scope to be implemented. Instead, we think they are intended as a bargaining tool and not for pursuing the goal of an actual economic separation. Although such high tariffs are unlikely, there will be trade barriers put in place, which will impact economic activity. The threat in itself is already causing uncertainty and hindering investment.

Chart in focus



Emerging markets are affected to varying degrees by possible trade tariffs. Should Donald Trump not introduce any widespread tariffs for all the USA's trading partners as originally announced, but take the actual trade relations into consideration on a country-by-country basis, Latin America will have little cause for worry concerning direct trade tensions with the USA as the latter has a trade surplus with many countries in this region, the exception here being Mexico. Among the Asian countries, alongside China above all Vietnam could come under pressure.

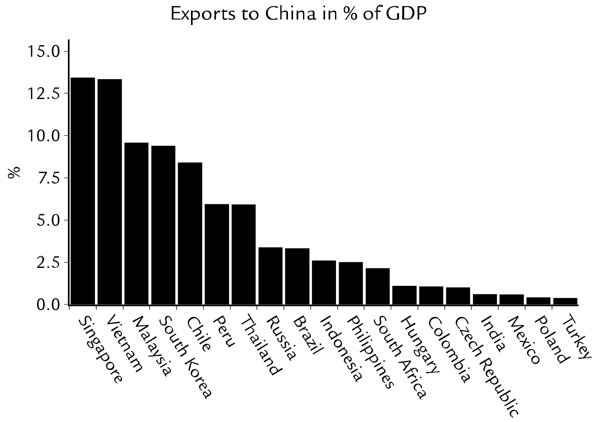
Emerging markets: external risks increasing

Following an extremely robust 2024, the economic prospects for emerging markets in 2025 are more subdued. While domestic demand should continue to support growth, the external underlying conditions are deteriorating. China in particular is coming under pressure due to the trade tariffs announced by Donald Trump which will slow down its economy. Lower demand from China will have negative repercussions for those emerging markets that maintain close trade relations with China. This applies particularly to Asian economies such as South Korea, Malaysia, Vietnam, Thailand and Singapore as well as to suppliers of raw materials from Latin America such as Peru and Chile (see Figure 1). Moreover, emerging market currencies are under pressure due to the economic policy uncertainties and trade tariffs. This has the positive effect of exports becoming more competitive and mitigating the negative effect of trade tariffs. However, too rapid a currency depreciation could at the same time cause uncertainty among investors and result in capital outflows. This poses a risk in particular for more fragile emerging markets dependent on external cash flows. However, not all emerging markets are equally affected by Donald Trump's agenda. The outlook for India, which is less dependent on global trade, remains robust. Assuming that Trump does not introduce any extensive tariffs for all the USA's trading partners as previously announced but takes account of the actual trade relations with each country individually, Latin America will also have little to fear with regard to direct trade tensions with the USA as the latter has a trade surplus with many countries in this region, Mexico being the prominent exception. With regard to monetary policy, the pressure on currencies will partially limit the scope for further interest rate cuts. However, the growing downside risks for economic growth, coupled with the fact that inflation in many emerging market countries already lies within the target range, will continue to enable emerging markets to reduce interest rates, which is set to remain a supporting factor for their domestic economies in the midst of this uncertain economic environment.

China: new growth risks

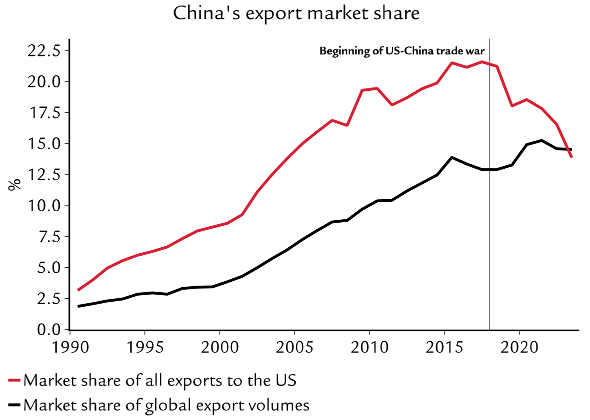
The challenges for China's economy are shifting. Although the real estate sector remains a burden, it no longer poses the greatest risk to growth. Demand for real estate has hit rock bottom and sales are stabilising at a low level. While this is not sufficient to boost investments in new projects, which will decline further, this stabilisation will make growth risks from the real estate sector more manageable. The greatest growth risk is now resulting primarily from external factors. Trade tariffs will place a burden on exports and are impairing business sentiment, which is negatively impacting investments. However, the impact on economic growth in 2025 will depend greatly on how high the tariffs actually prove to be, when they enter into force and whether diverting trade via other countries will continue to be tolerated. We are not anticipating the worst-case scenario in which the Trump administration levies a broad tariff of 60% on all Chinese goods. We nevertheless expect a gradual introduction of tariffs that could potentially already be imple-

Figure 1: Countries with close trade relations with China affected by low Chinese demand



Sources: Macrobond, Swiss Life Asset Managers. Last data point: 01/01/2023

Figure 2: China's share of exports to the USA is falling, while its global share of exports is growing



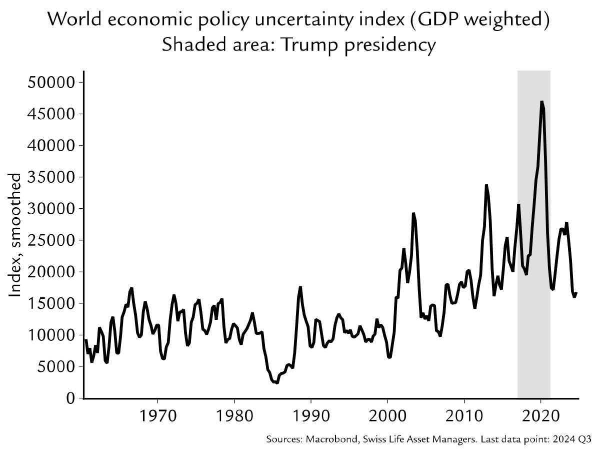
Sources: Macrobond, Swiss Life Asset Managers. Last data point: 2023 mented shortly after Donald Trump's inauguration. As China's exports to the USA account for around 3% of Chinese GDP, these trade restrictions will have a negative impact on its economy. However, there are various factors to offset the negative effect. For a start, exports are being brought forward before the tariffs come into effect. Moreover, the depreciation of the Chinese yen will offset some of the impact of tariffs, which will not only benefit trade flows to the USA but also to other parts of the world. China has already diversified its trading partners. Since 2023, it has no longer been exporting primarily to the USA but to Asia. Furthermore, exports to Latin America and Russia have increased rapidly in recent years, while those to the USA have fallen. These efforts to diversify trading partners are being stepped up. Finally, we expect China, as in the initial trade war, to remain open to negotiations, which should prevent an escalation of the trade tariffs. The so-called Phase One trade deal between the USA and China during Trump's first term in office was not fully implemented, as China fell far short of the agreed import targets. However, certain efforts were made, with imports of the products contained in the agreement exceeding 2017 levels, while imports of those products not covered by the agreement remaining significantly below it (see Figure 3). This enabled Trump to declare it a success and ease trade tensions. It is likely that a second term for Donald Trump could bring more such superficial agreements. We have accordingly revised China's GDP growth forecast for 2025 moderately down-wards from 4.5% to 4.1%.

Geopolitics remains in focus

Geopolitical risks will remain in focus in 2025. As well as trade disputes, the ongoing wars in Gaza and Ukraine are shaping the geopolitical environment. There is barely any doubt that under Trump negotiations will take place regarding the Ukraine war. However, it remains unclear what a possible deal could look like. Even if such a deal were to bring the hostilities to an end and generate directly positive economic momentum through the rebuilding of Ukraine, it remains questionable whether it could restore the security architecture in place before the war and secure a stable peace in the long term. An imminent end to the Gaza war likewise does not appear within immediate grasp. Donald Trump could steer the developments in the Middle East in both directions: on the one hand his non-reflective and harsh rhetoric and maximum pressure on Iran could fuel regional tensions. On the other hand, his dual strategy of maximum pressure and openness to dialogue could also create opportunities for diplomatic solutions as he has demonstrated in the past with the Abraham Accords. Geopolitical risks will accordingly not only remain high in 2025, but also difficult to assess.

Figure 3: Although not fully implemented, the Phase One trade deal defused the conflict

Figure 4: Donald Trump will once again cause increased economic policy uncertainty



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