Perspectives
Emerging Markets

SwissLife
Asset Managers

First quarter 2020

Key messages

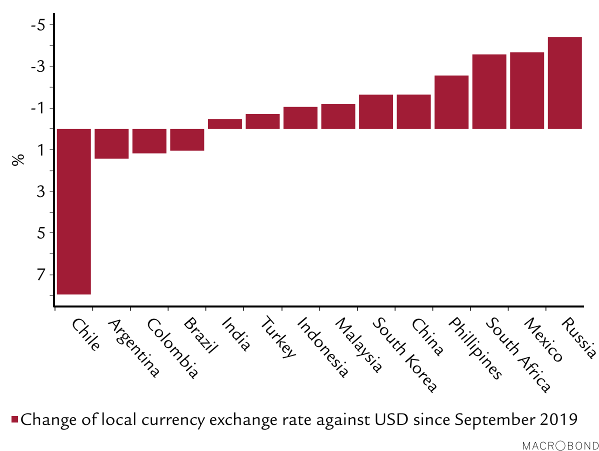
- Economic downturn to bottom out in the first quarter 2020 amid monetary and fiscal support
- Ongoing political uncertainties and a structural slowdown in China to hamper substantial rebound
- Latin America: social unrest in Chile and Colombia to hit economies

Number in focus

1000

This year the Turkish central bank delivered rate cuts of a total of 1000 basis points. Loose monetary policy coupled with fiscal support and a stabilising currency helped to move Turkey out of recession, with third quarter GDP expanding by 0.9% from a year ago. However, a swift rebound of growth in 2020 is unlikely as (geo)political risks remain elevated. The government is targeting a 5% growth rate next year and the stimulus package needed for this, is likely to create fundamental vulnerabilities.

Chart in focus

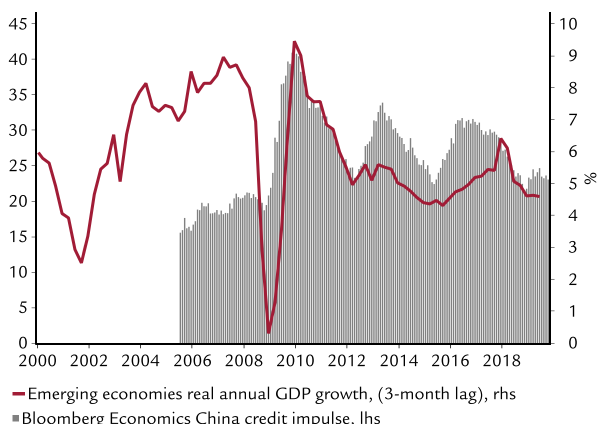


Major Latin American currencies tumble as social unrest is spreading across the continent, most recently in countries such as Chile, Colombia, Ecuador and Peru. While protests have been kindled by unique domestic issues, contagion has pushed down the currencies in the region. Central banks in Chile and in Brazil have started to sell dollars in order to prevent a sharper depreciation. Social turmoil that is here to stay will likely lead to a sharp downturn of economic activity.

Emerging markets growth to stabilise at low levels

After a broad-based economic slowdown since end of 2018 and over the course of this year, economic activity in emerging markets is expected to stabilise in the first quarter 2020. Fiscal and monetary policy have been supportive as emerging market central banks across the board delivered multiple rate cuts this year, in order to foster the sluggish growth momentum. As inflation rates in many emerging markets are at or even below the inflation target, there is still some room for monetary policy easing. This is especially true for high yielding economies that still have some interest rate buffer, such as Indonesia, Russia, Mexico and Brazil. Given that political risks do not intensify, especially concerning the US-China trade relation, we expect a delayed pass-through of those stimulus measures to support a stabilisation of economic activity. Nevertheless, we expect economic growth only to stabilise at low levels but not to rebound. Political uncertainties are to remain elevated: the threat of a renewed intensification of US-China trade relations will linger, and the protests in Hong Kong as well as the social unrest that has spread across various South American countries, particularly Chile and Colombia, are unlikely to be resolved any time soon. Furthermore, other than in past down-cycles, where China lifted emerging market growth rates with a substantial credit boost, China's policy makers are emphasising on growth quality over quantity and are ready to tolerate a gradual slowdown of the economy. Hence, the credit stimulus from China, a good leading indicator for emerging countries' economic expansion, is unlikely to boost economic activity in 2020.

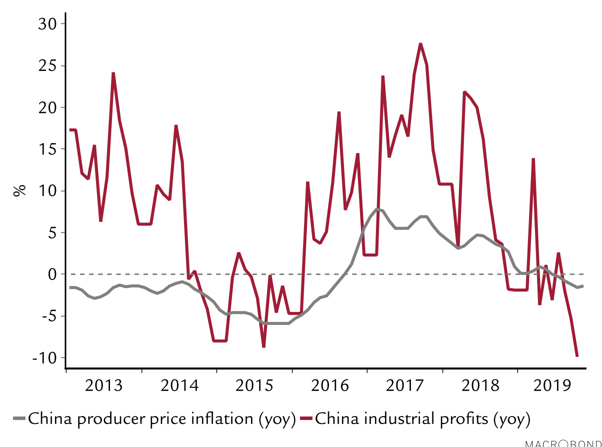
Chart 1: Emerging markets not to be lifted by China as credit stimulus remains prudent



China: downward pressure not abating yet

China's November manufacturing purchasing managers indices improved considerably as the country's private survey reading climbed up further to 53.2, while also the official NBS reading surpassed the 50 points mark that separates expansion from contraction. However, hard data show that downward pressure on the sector remains elevated. Industrial profits have slumped sharply as producer prices are edging lower, which is a negative signal for companies' capacity to invest and hire. November producer price inflation, an indicator for corporate profitability, contracted by 1.4%, the fifth consecutive contraction this year. Moreover, exports contracted by 1.1% compared to a year ago. A regional breakdown shows that the major contributor to the export slump were exports to the US that contracted by 23%. Therefore, the imposed tariffs on a total of 360bn USD of Chinese products remain a big headwind. This implies that it is getting increasingly important for China to reach a deal with the United States that clears off the trade spat that has led to a downturn in global trade and investments. Nevertheless, it does not suggest that trade negotiations will get any easier, as the ongoing drag on exports means that a substantial removal of existing tariffs will be a key demand for a potential trade deal from the Chinese side. Meanwhile, Beijing has stepped up its easing measures to support the economy. It cut the capital requirement ratio for infrastructure projects, brought forward 1 trillion yuan (140bn USD) of the 2020 local government special bonds quota (used for the financing of infrastructure projects) and implemented incremental interest rate reductions. However, Beijing will likely remain reluctant to implement broad stimu-

Chart 2: persistent downward pressure in the Chinese industrial sector as industrial profits slump



lus measures, amid financial risks given the already very elevated debt burden, high housing prices and soaring inflation. Inflation has increased sharply over the course of the year, reaching 4.5% in November as pork prices, that account for 2.4% of the inflation bucket, doubled. The Chinese consume 50 million tons of pork each year and the African Swine Fever erased half of the country's pork herd. As it remains difficult for China to compensate this tremendous amount via imports, pork prices and hence inflation is likely to continue to rise.

Latin America: Social unrest hits economies

Many South American economies suffer from high inequality, high crime and an ineffective governance – the main source of the recent social unrest that has spread through the continent. Protests in Chile and Colombia have been among the largest. In Chile more than 2 million people joined the demonstrations countrywide, accounting for more than 10% of the country's population. Chile's relatively low deficit and moderate debt level allowed the government to announce additional fiscal spending measures, promising spending on pensions and healthcare. Moreover, the country agreed to overhaul its constitution that dates back to the dictatorship of Pinochet. While this has been a major demand of protesters, the government will likely need to announce more specific measures to address inequalities in order to calm the situation. Meanwhile the demonstrations have hit the country's economy. Chile's economic activity index, a proxy for GDP, has dropped sharply to -3.4%, down from a 3% expansion before. The central bank slashed its economic growth forecast for 2020 to 0.5% – 1.5%, from 2.75% - 3.75% previously. In Colombia protests were kindled by a tax reform proposal but turned into a general anti-government movement. Just as Chile, Colombia also announced fiscal spending measures, such as a large tax cut plan in order to calm the movement. However, as Colombia's fundamentals are less solid, with a more elevated fiscal deficit and debt level compared to Chile, these measures put the country at risk of a rating downgrade.

India: shadow banking crisis to hamper recovery

India's economy is slowing sharply, expanding by only 4.5% in the July to September quarter, 0.5 percentage points below the previous quarter. This is the sixth straight quarter of deceleration amid weak global demand, a fragile banking system and a slump in domestic consumption. After the fallout of IL&FS - hj a large non-bank lender - in September 2018, a wave of defaults among shadow banks has led to a liquidity squeeze, making it difficult for businesses and consumers to get funding. There is a considerable risk that the shadow banking stress leads to contagion, as default rates among highly leveraged companies that are struggling to raise funds are increasing sharply. India's central bank has cut rates five times this year but surprised with a pause of its easing stance at its latest central bank meeting in December due to a pickup in inflation. The government has launched various stimulus measures to support economic activity, such as corporate tax cuts, support for car purchases and a recapitalisation of public-sector banks. However, any recovery is likely to be weak, as the country's shadow banking crisis has led to a deeper slowdown than expected.

Chart 3: Chile's economy hit strongly by social unrest

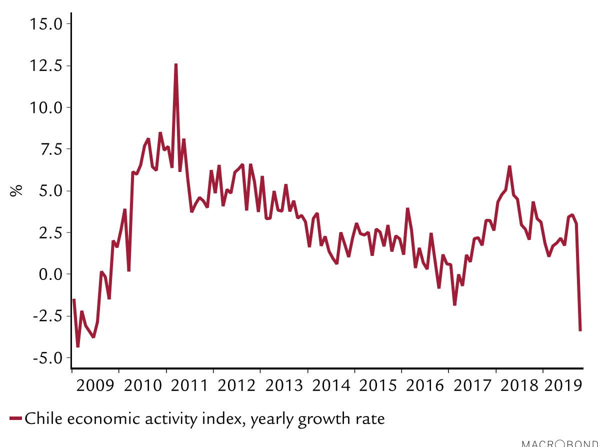
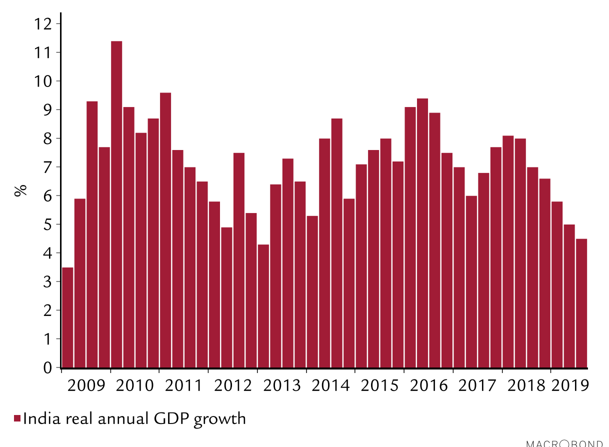


Chart 4: India's economic growth decelerates for a sixth consecutive quarter



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