



EMERGING MARKETS

Emerging Market Monitor - Hit by the Trump trade

February 2018

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With President Trump enacting protectionist campaign promises, we ask which emerging markets could suffer the most.

On 22 January, Donald Trump imposed steep tariffs on imported solar panels (30 per cent) and washing machines (20 per cent), clearly targeting China. These latest moves show he is committed to his campaign promise of tightening trade policy. We believe this will inflict damage on emerging markets - and not just China.

FIG.1 - SINCE TAKING OFFICE, TRUMP HAS ANNOUNCED A NUMBER OF TRADE MEASURES
The simple average import tariff applied across all goods by the US is 3.5% (see Fig.4)

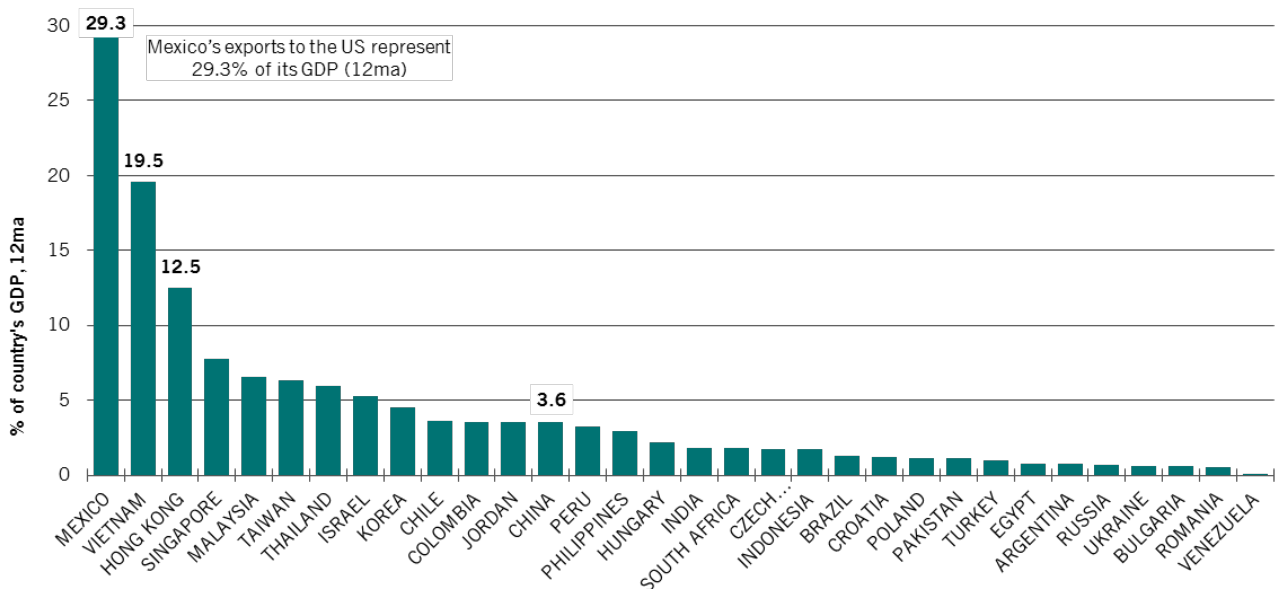
| | China Feb. 2017 | Canada Oct. 2017 | Canada Nov. 2017 | Canada Jan. 2018 | World Jan. 2018 | World Jan. 2018 |
|-----------------------|---------------------------------|----------------------------|------------------------|---------------------|--------------------|-------------------------|
| | Stainless steel products | Bombardier C-series | Softwood lumber | Paper | Solar panel | Washing machines |
| | | | | | | |
| tariff imposed | 63.9%-190.7% | 300% | 20.8%-23.8% | 10% | 20%-50% | 30% |

Source: Pictet Asset Management, South Morning China Post, BBC, CNN, US Department of Commerce, February 2018.

IS IT THE USUAL SUSPECTS?

By far the largest US trade deficit in nominal terms is with mainland China (-USD375bn)¹. However, the overall scale of China’s economy means US exports account for only 3.6 per cent of GDP. As Fig.2 below shows, Mexico for example is far more exposed to an escalation in US import tariffs.

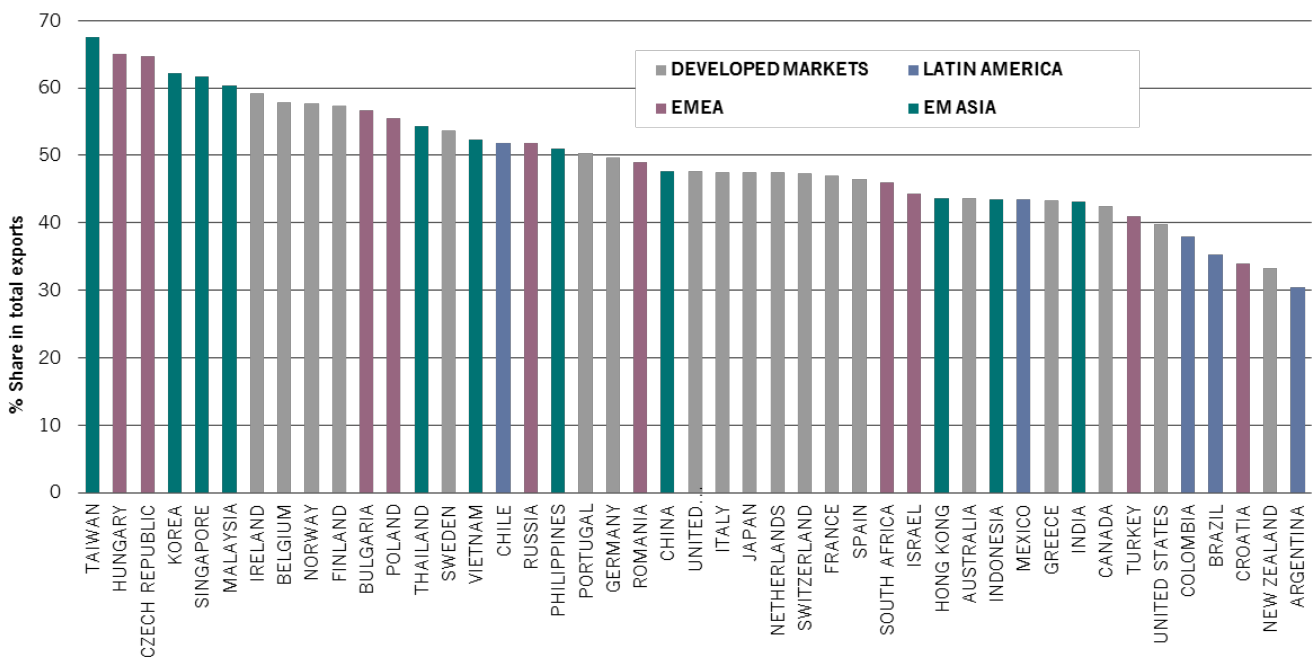
FIG.2 - EMERGING MARKETS' BILATERAL TRADE EXPOSURE TO THE US SHOWS MEXICO IS MOST VULNERABLE
Exports to the United States as a share of GDP



Source: Pictet Asset Management, CEIC, Datastream, February 2018

However, we think we can get better insight by looking at those economies most enmeshed in the global value chain (see Fig.3). This captures all goods going back and forth between nations during their manufacturing process.

FIG.3 - HIGHEST GLOBALISED ECONOMIES TO BE HIT THE MOST BY MORE GLOBAL TARIFFS MEASURES
Global value chains participation rate*



Source: Pictet Asset Management, CEIC, Datastream, February 2018.

* Foreign value added used in a country's exports (backward participation) + value added supplied to other countries' exports (forward participation)

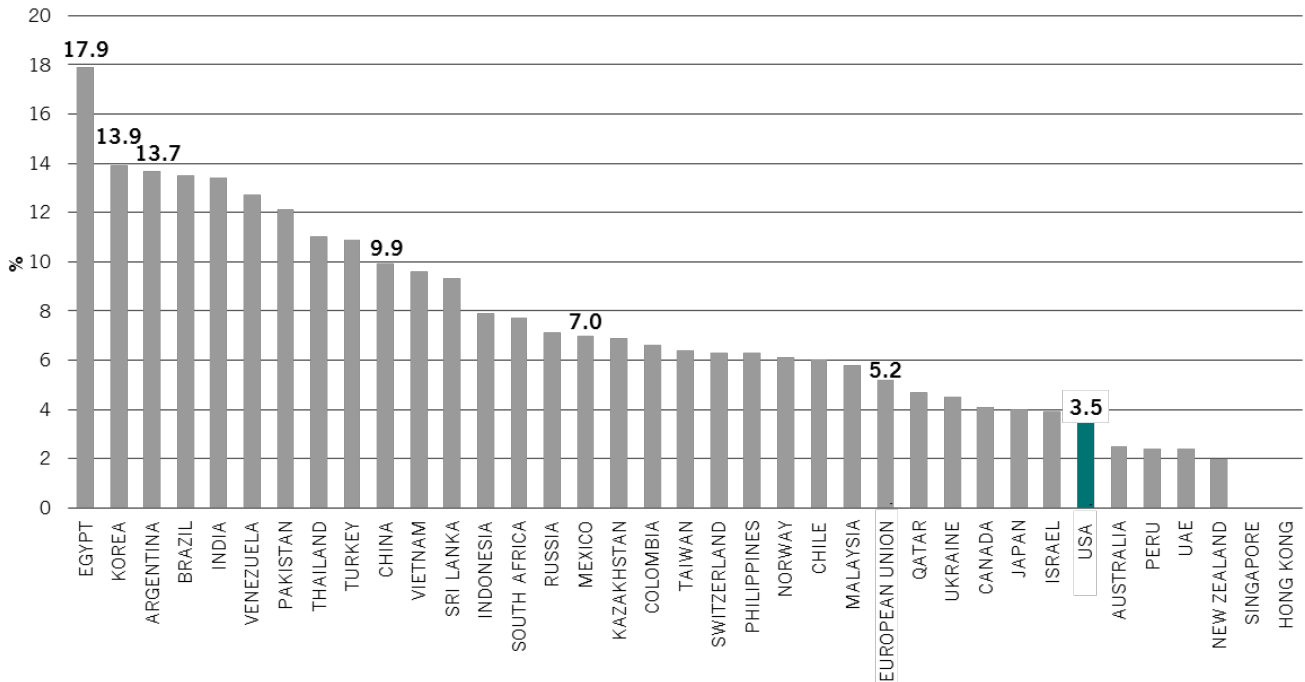
Using this measure, Taiwan is top with 67 per cent of its exports part of a value chain². Other Asian countries feature prominently, closely followed by Emerging European markets. China is in the middle, while Latin America would be the least impacted.

How likely is a further escalation in Trump's trade policy?

We think quite likely. Compared with other populist economic policies such as tax or immigration which need to be passed by Congress, Trump has more scope for action when it comes to trade policy. The President has the power to impose tariffs or quotas on imports.

Valid or not, the perception of Trump's voters is that the US has lost its manufacturing sector leadership due to unfair competition from China and other leading trade partners³. It should also be acknowledged, as Fig.4 shows, that **US tariffs on imports under the World Trade Organization are lower than other countries**. In other words, further upside is possible.

FIG.4 - THE UNITED STATES HAVE VERY LOW IMPORT TARIFFS RELATIVE TO THE REST OF THE WORLD
Simple average import tariffs applied

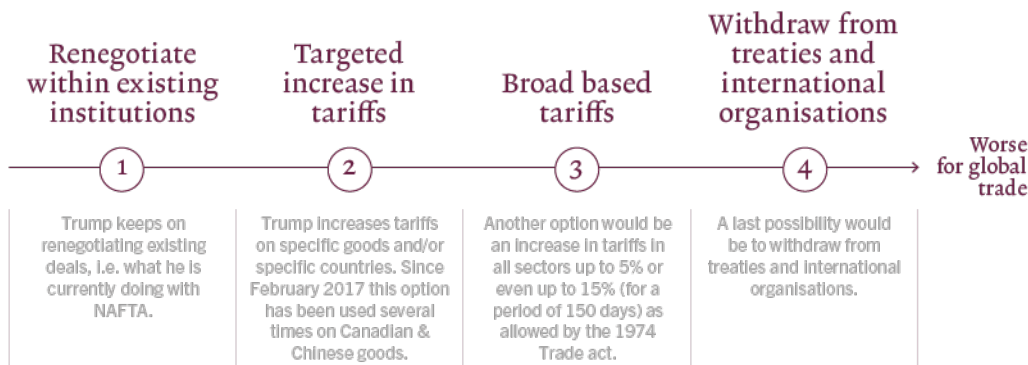


Source: Pictet Asset Management, CEIC, Datastream, February 2018.

What scenarios can we expect?

Trump has four options to modify trade policies.

FIG.5 - TRUMP HAS FOUR OPTIONS, EACH WITH A DIFFERENT IMPACT ON GLOBAL TRADE



Source: Pictet Asset Management, February 2018.

Given Trump's preference for bilateral agreements, we believe the most likely scenario is a continuation of the first two options. In this context, emerging markets most at risk would be those whose exports to the US account for the highest proportion of their GDP (Fig. 2), Mexico, Vietnam and Hong Kong in particular.

In the unlikely event that scenarios three and four materialise, this would be more disruptive on a global scale and would hit emerging countries with the highest participation rate in the global value chain (Fig.4). In this case, Taiwan would be most at risk, closely followed by Hungary and the Czech Republic.

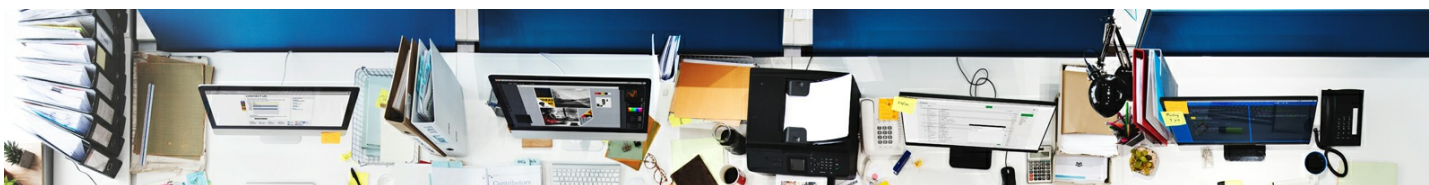
[1] Source: Pictet Asset Management, CEIC, Datastream; bilateral trade deficit with the US in 2017.

[2] This figure includes both the imports used in Taiwan exports (backward participation) and the Taiwanese exports that are used in other countries' exports (forward participation).

[3] US manufacturing employment share in total employment has been on a structural decline since WWII (source: Pictet Asset Management, Datastream). The US has lost 5 million manufacturing jobs since 1995 (Source: Bureau of Labor Statistics).

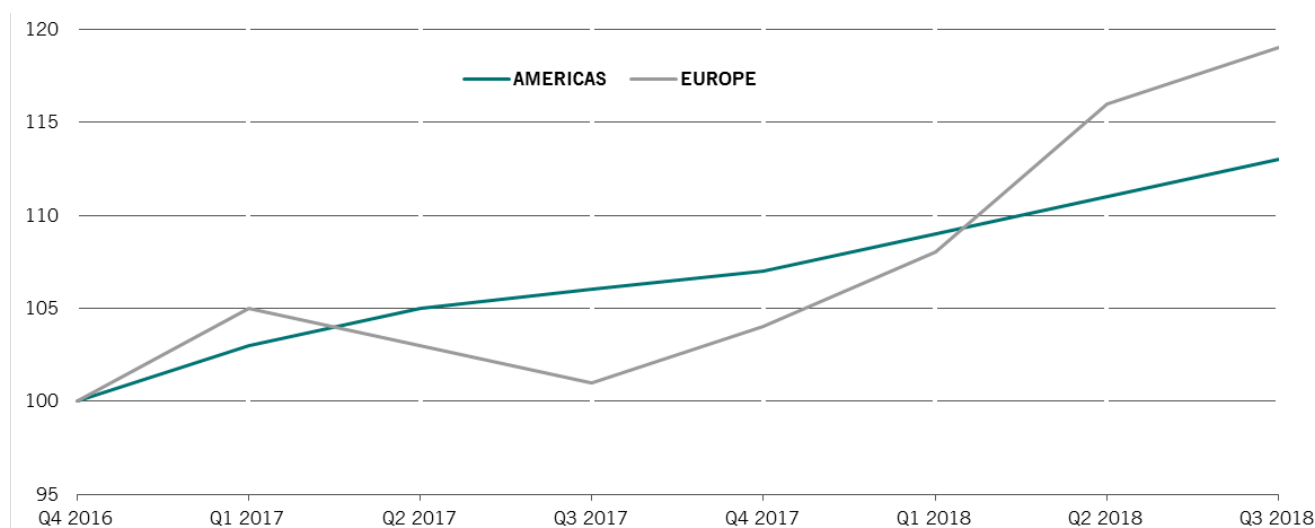
THE VIEW FROM OUR EMERGING MARKET EQUITY TEAM

By Prashant Kothari, Senior Investment Manager



As Patrick's research has shown, India is not one of the countries most at risk from tighter US trade policy. However, certain sectors are more at risk than others and the Indian IT services sector has received a lot of negative press, precisely because of potential US protectionist measures.

FIG.6 - INDIAN IT SERVICES SECTOR GROWTH RELYING LESS ON AMERICAS
Indian IT services revenues rebased to Q4 2016

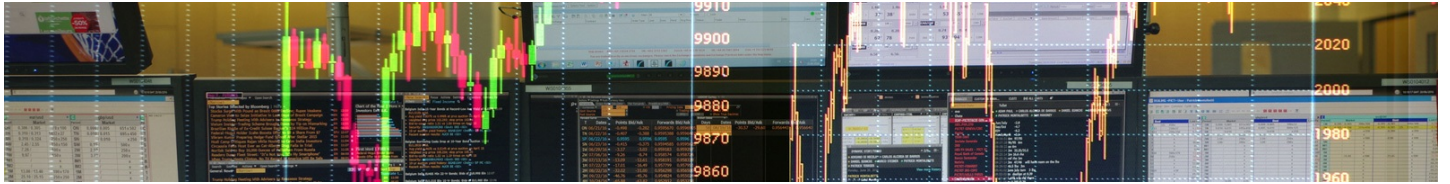


Source: company data, Goldman Sachs Research, February 2018

While the environment is undoubtedly challenging, we believe it is a nimble sector that benefits from broad-based revenue sources. As the chart above shows (Fig.6), revenue growth attributed to Europe has been significantly increasing since Q4 2016. We expect this trend to strengthen and exceed Americas-led revenue growth, thus compensating for potentially tighter US import tariffs.

The sector's ability to make operational changes is also key. This can be seen through an increase in the proportion of local hires by Indian companies in the US. It can also be seen through more activity being conducted in India itself, i.e. offshoring. We think worries about the Indian IT sector are not justified.

MARKET WATCH




| EQUITIES | 1 mth / YTD (%) | 3mths (%) | 1 yr (%) | 3 yrs ann. (%) | 5 yrs ann. (%) | 10 yrs ann. (%) |
|---------------------------------------|------------------------|------------------|-----------------|-----------------------|-----------------------|------------------------|
| MSCI EM | 8.33 | 12.45 | 41.01 | 11.83 | 5.74 | 3.88 |
| MSCI EM Value | 8.72 | 12.43 | 33.16 | 9.45 | 3.12 | 2.86 |
| MSCI EM growth | 7.95 | 12.37 | 48.91 | 14.11 | 8.27 | 4.80 |
| MSCI AC Asia ex Japan | 7.56 | 11.17 | 43.54 | 12.51 | 9.18 | 6.15 |
| MSCI Brazil | 16.84 | 18.40 | 30.95 | 14.74 | -0.18 | -0.77 |
| MSCI China | 12.49 | 16.43 | 62.29 | 16.38 | 11.61 | 6.76 |
| MSCI India | 3.44 | 7.73 | 37.55 | 7.16 | 8.54 | 2.40 |
| MSCI Russia | 12.57 | 19.70 | 18.75 | 24.41 | -0.54 | -3.28 |
| MSCI EM Europe | 10.16 | 16.04 | 30.48 | 13.78 | -1.73 | -2.92 |
| MSCI World | 5.28 | 9.02 | 25.83 | 11.83 | 11.68 | 6.42 |
| BONDS | 1 mth / YTD (%) | 3mths (%) | 1 yr (%) | 3 yrs ann. (%) | 5 yrs ann. (%) | 10 yrs ann. (%) |
| JPM EMBI Global Diversified | -0.04 | 0.74 | 8.64 | 6.77 | 4.85 | 7.20 |
| JPM GBI-EM Global Diversified | 4.48 | 8.39 | 17.72 | 3.92 | -0.83 | 3.86 |
| JPM ELMI+ | 2.88 | 5.53 | 12.68 | 4.13 | -0.16 | 1.32 |
| JPM CEMBI Broad Diversified Composite | 0.07 | 0.41 | 6.71 | 6.03 | 4.54 | 6.55 |
| JPM Jade Broad Asia Diversified | 1.46 | 4.94 | 10.85 | 3.10 | 1.91 | - |
| Chinabond composite | 3.88 | 5.64 | 10.34 | 2.88 | 3.65 | - |
| JPM GBI-EM Global Latin America | 5.96 | 5.74 | 15.73 | 2.94 | -0.81 | 4.40 |
| JPM EMBI Global Diversified Europe | 0.08 | 1.16 | 8.49 | 7.76 | 4.87 | 7.12 |
| JPM Global All Mats | 1.32 | 2.77 | 7.27 | 2.19 | 0.88 | 2.73 |
| COMMODITIES | 1 mth / YTD (%) | 3mths (%) | 1 yr (%) | 3 yrs ann. (%) | 5 yrs ann. (%) | 10 yrs ann. (%) |
| S&P GSCI TR | 3.42 | 9.48 | 10.95 | -4.02 | -12.32 | - |
| S&P GSCI WTI TR | 7.42 | 19.04 | 15.53 | -9.62 | -17.57 | - |
| S&P GSCI Brent Crude TR | 3.88 | 15.44 | 23.79 | -2.51 | -15.01 | - |
| LBMA Gold pm | 1.74 | 5.90 | 10.90 | 2.19 | -4.18 | - |
| CURRENCIES | 1 mth / YTD (%) | 3mths (%) | 1 yr (%) | 3 yrs ann. (%) | 5 yrs ann. (%) | 10 yrs ann. (%) |
| USD/BRL | 4.74 | 3.30 | -0.68 | -5.36 | -8.88 | -5.68 |
| EUR/BRL | 0.97 | -3.40 | -13.84 | -8.43 | -7.30 | -4.04 |
| USD/RUB | 3.37 | 3.47 | 8.20 | 7.66 | -11.65 | -7.84 |
| EUR/RUB | -0.35 | -3.24 | -6.13 | 4.17 | -10.12 | -6.24 |
| USD/INR | 0.35 | 1.84 | 6.67 | -0.88 | -3.51 | -4.68 |
| EUR/INR | -3.26 | -4.77 | -7.46 | -4.10 | -1.84 | -3.02 |
| USD/CNY | 3.51 | 5.34 | 9.33 | -0.21 | -0.23 | 1.33 |
| EUR/CNY | -0.22 | -1.49 | -5.16 | -3.45 | 1.50 | 3.10 |
| USD/ZAR | 4.26 | 19.10 | 13.53 | -0.69 | -5.53 | -4.49 |
| EUR/ZAR | 0.51 | 11.37 | -1.51 | -3.91 | -3.90 | -2.83 |

 Top performer among the EM indices or currencies shown in this table, for the corresponding period.

 Worst performer among the EM indices or currencies shown in this table, for the corresponding period.

 Developed markets.

 Source: Datastream, Bloomberg, data as at 31.01.2018 and in USD. Equity indices are quoted on a net dividend reinvested basis; bond and commodity indices are quoted on a total return basis. The currency rates evolution is treated as a performance calculation based on FX rates.

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