



EMERGING MARKETS

EMERGING MARKET MONITOR

Should we worry about emerging market debt levels?

June 2018

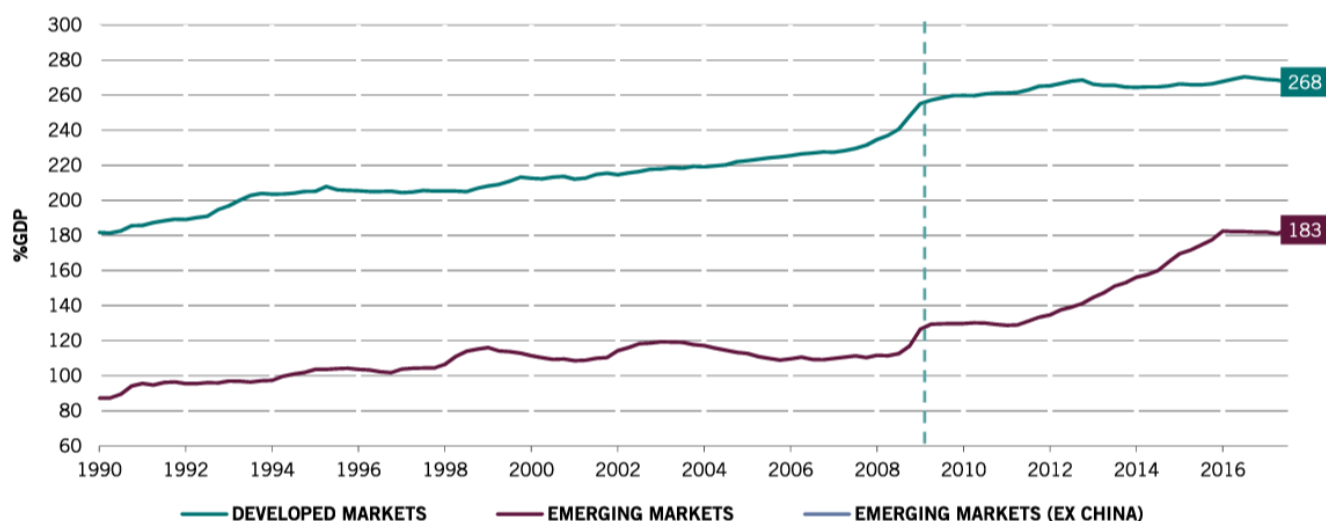
Patrick Zweifel, Chief Economist

How does EM debt in 2018 compare to 2009?

Rising indebtedness?

Emerging markets continue to have lower levels of debt than developed markets as a percentage of GDP. But as the chart below shows, from 2009 emerging markets have increased their levels of indebtedness to reach 183% of GDP according to latest available figures. What has driven this increase?

FIG.1 - TOTAL DEBT BY MAIN REGION (% GDP)
1990-2018

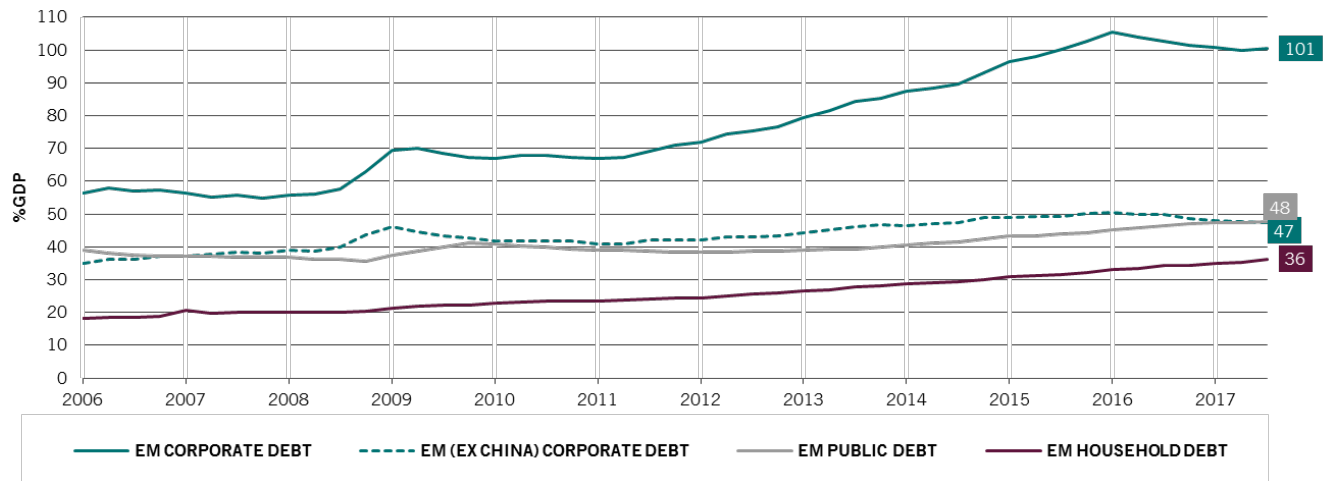


As is often the case, the answer is China. Strip it out and the level of indebtedness of emerging markets has barely budged for 20 years. This is a positive fundamental consideration for investors.

China's corporate debt is the main factor

Digging into the composition of emerging market debt unveils a similar insight: most of the increase has come from corporate debt in China. By contrast, public (sovereign) debt or household debt has remained fairly flat.

FIG. 2 - TOTAL EMERGING DEBT BY SECTOR (% GDP)
2006-2018

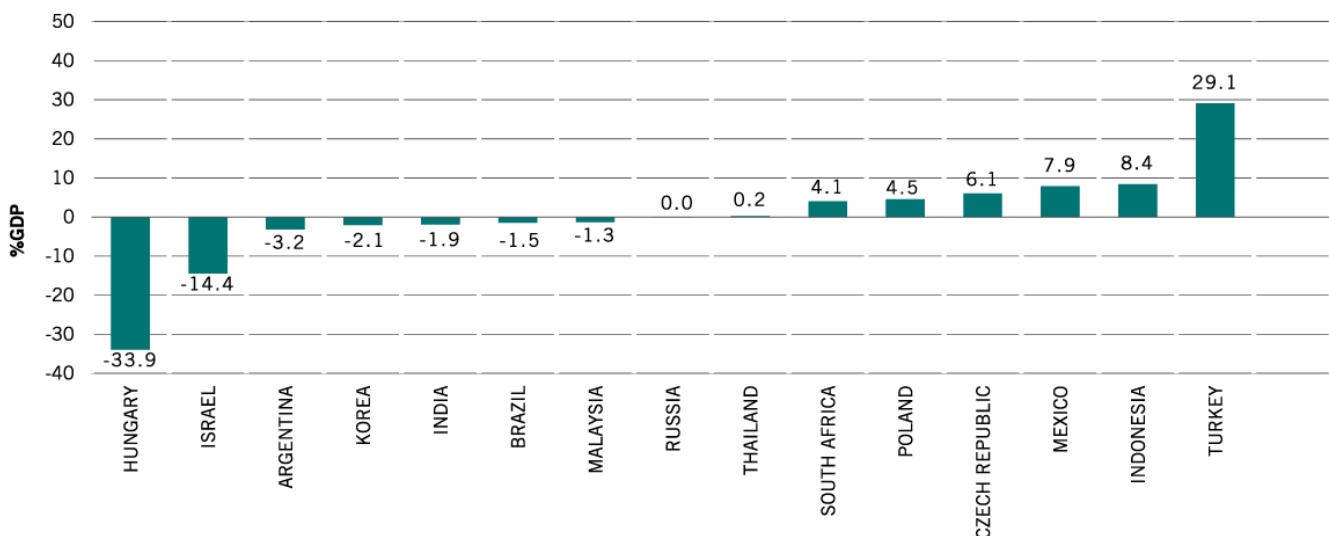


Source: Pictet Asset Management, BIS, CEIC, Datastream

Should we be concerned?

The wave of Chinese corporate debt issuance over the past decade is observable in the chart below. The only market that has come close over this period is Turkey.

FIG. 3 - EM CORPORATE DEBT CHANGE BY MARKET
Q2 2009-Q3 2017



Source: Pictet Asset Management, BIS, CEIC, Datastream

Is this a problem? Although the size of China's corporate debt sector has been noted as a source of systemic global risk by policymakers, we do not feel the bubble is likely to burst. Firstly, excess corporate debt aside, China's macroeconomic

fundamentals are broadly in good health. We expect an orderly, managed corporate deleveraging over a period of years, which will admittedly weigh on overall growth. Second, much of the debt is issued by state-owned enterprises (**SOEs**), which are quasi-sovereign and can be considered as being bank-rolled by the Chinese government.



THE VIEW FROM OUR EMERGING CORPORATE BONDS TEAM

Karen Lam, Senior Client Portfolio Manager

In the Chinese corporate market, we feel our investment opportunities are mainly in the external (US dollar denominated) space. That's not to say we don't occasionally look at renminbi debt, but we do not currently have any RMB corporate bond exposure in our portfolios.

As shown below, China is expected to remain a significant contributor to gross issuance in external debt in 2018.

FIG. 4 - EM CORPORATE EXTERNAL BONDS
2018 supply forecast by region

US \$ BN	ASIA	EM EUROPE	LATAM	ME&A	GLOBAL EM	CHINA	ASIA EX-CHINA
Gross issuance	268	48	79	47	442	193	75

Source: JP Morgan 09.05.2018

China now accounts for 42% of short-dated EM credit issuance compared to 18% five years ago. Most of this is focused on two sectors: real estate and financial services.

In our view, short-dated credits issued in the former are not attractive. This is because China real estate developers have been willing to pay up to get their debt issued, given their refinancing needs and time limits on regulatory approval, which in turn has put pressure on the secondary market. In relative terms, we therefore prefer select short-dated Chinese credits in financial services when the bottom-up fundamentals stack up.



MARKET WATCH

EQUITIES	1 mth (%)	3mths (%)	QTD (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
MSCI EM	-3.54	-5.76	-3.97	-2.61	14.03	6.17	4.52	1.62
MSCI EM Value	-4.81	-5.85	-3.97	-2.42	10.08	3.68	2.45	0.69
MSCI EM growth	-2.26	-5.66	-3.97	-2.80	17.77	8.55	6.51	2.45
MSCI AC Asia ex Japan	-1.32	-2.12	-0.62	0.04	17.27	7.43	7.96	4.98
MSCI Brazil	-16.37	-21.19	-19.71	-9.78	6.86	7.44	-3.43	-6.03
MSCI China	1.84	-1.54	1.81	3.66	30.85	6.93	11.67	5.18
MSCI India	-3.59	-3.23	0.37	-6.61	6.68	5.79	7.71	3.01
MSCI Russia	1.13	-9.89	-6.39	2.39	20.74	9.86	0.37	-6.37
MSCI EM Europe	-5.19	-13.98	-9.69	-7.83	6.54	2.93	-3.52	-6.33
MSCI World	0.63	-0.44	1.78	0.48	11.57	7.65	9.40	5.38
BONDS	1 mth (%)	3mths (%)	QTD (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
JPM EMBI Global Diversified	-0.94	-2.10	-2.38	-4.08	-0.56	4.50	4.34	6.67
JPM GBI-EM Global Diversified	-4.98	-6.85	-7.79	-3.69	1.01	2.53	-1.66	2.74
JPM ELMI+	-2.38	-3.55	-4.21	-1.80	2.21	1.82	-0.69	0.22
JPM CEMBI Broad Diversified Composite	-0.70	-1.54	-1.35	-2.46	0.48	3.78	4.01	6.17
JPM Jade Broad Asia Diversified	-1.09	-0.92	-2.39	-1.55	3.45	2.75	1.34	-
Chinabond composite	-0.73	0.99	-0.36	5.06	11.77	2.37	3.17	-
JPM GBI-EM Global Latin America	-7.34	-8.72	-10.18	-4.53	-1.42	2.68	-1.90	2.55
JPM EMBI Global Diversified Europe	-0.63	-1.70	-1.66	-3.23	0.27	5.29	4.24	6.81
JPM Global All Mats	-0.95	-1.25	-2.75	-0.64	1.77	2.72	1.26	2.48
COMMODITIES	1 mth (%)	3mths (%)	QTD (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
S&P GSCI TR	1.45	8.92	6.56	8.89	25.84	-4.83	-9.61	-
S&P GSCI WTI TR	-1.97	9.55	3.74	12.58	36.89	-11.80	-15.55	-
S&P GSCI BrentCrude TR	4.37	22.05	13.48	19.85	59.92	-2.69	-10.48	-
LBMA Gold pm	1.74	-0.95	-1.40	1.11	3.09	3.09	-1.31	-
CURRENCIES	1 mth (%)	3mths (%)	QTD (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
USD/BRL	-6.35	-12.76	-10.75	-10.93	-12.92	-5.00	-10.55	-7.93
EUR/BRL	-3.06	-8.85	-5.97	-8.37	-16.11	-6.97	-8.66	-5.25
USD/RUB	-0.56	-9.46	-7.28	-8.18	-9.82	-5.52	-12.73	-9.26
EUR/RUB	2.92	-5.41	-2.31	-5.54	-13.13	-7.47	-10.88	-6.63
USD/INR	-1.10	-3.46	-3.35	-5.42	-4.39	-1.82	-3.50	-4.53
EUR/INR	2.37	0.87	1.83	-2.70	-7.89	-3.85	-1.46	-1.76
USD/CNY	-0.88	-1.08	-1.71	1.73	6.56	-1.07	-0.85	0.81
EUR/CNY	2.60	3.36	3.56	4.66	2.66	-3.11	1.25	3.74
USD/ZAR	-1.43	-6.80	-6.44	-2.25	4.12	-1.33	-4.50	-4.93
EUR/ZAR	2.02	-2.62	-1.43	0.56	0.30	-3.37	-2.48	-2.17

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 31.05.2018 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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