

EMERGING MARKETS

EMERGING MARKET MONITOR

After Argentina and Turkey, where next?

September 2018

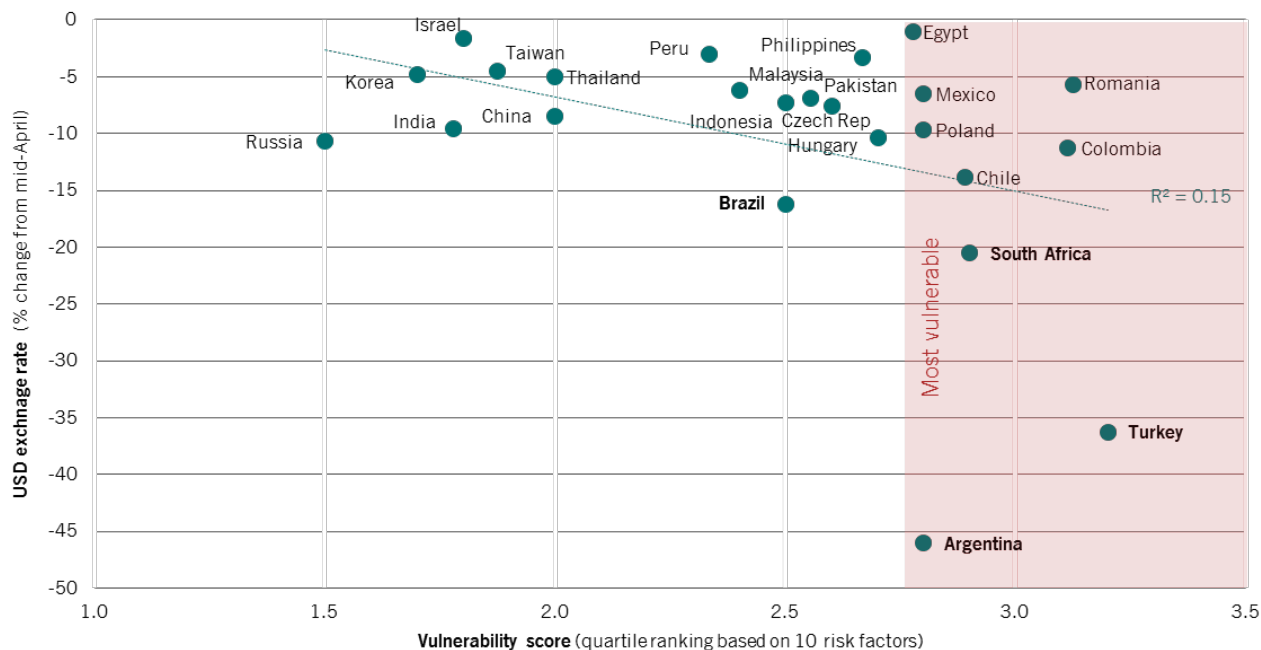
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Turkey and Argentina have dominated the headlines, but the South African rand and Brazilian real are the next worst performing currencies since the onset of the crisis. Is this justified?

The next to fall?

Our proprietary EM vulnerability score card shows that the correction may be justified for South Africa but less so for Brazil.

What is happening in these markets and should we expect more weakness from both currencies?



Source: Pictet Asset Management, CEIC, Datastream

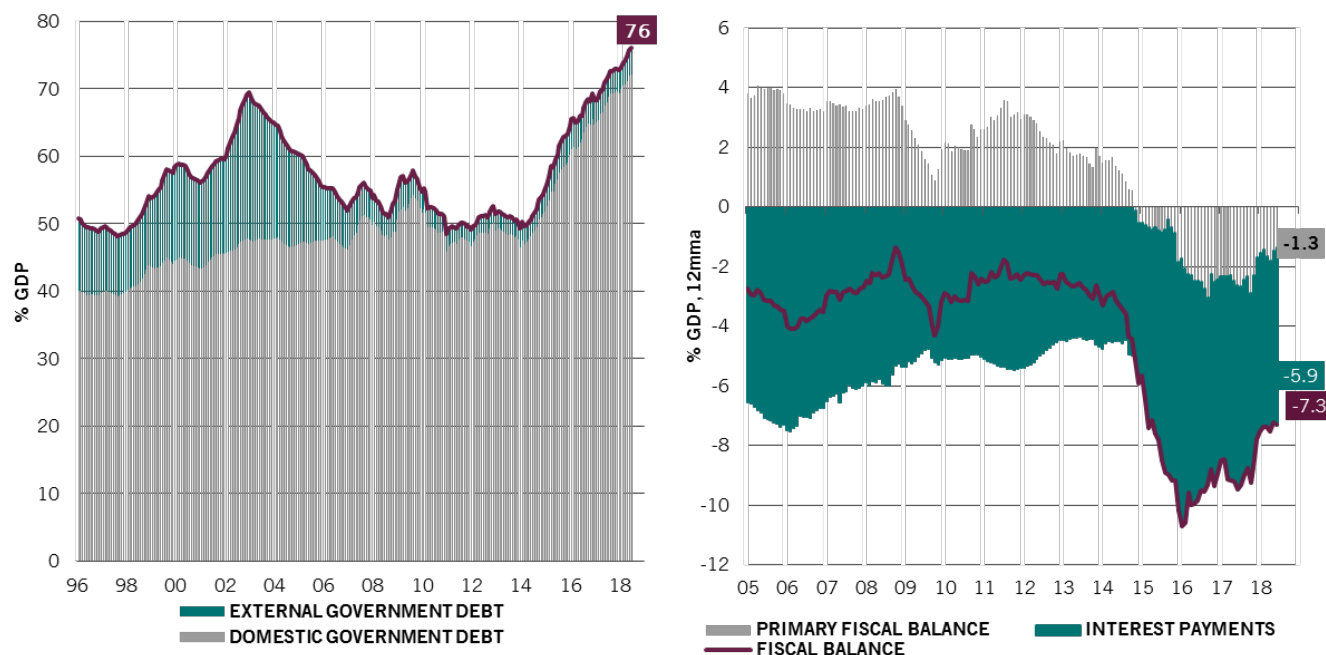
Brazil: fighting fit

Between the four markets, Brazil seems in best economic health. Whilst Argentina, Turkey and South Africa have significant current account deficits, Brazil's is relatively narrow. Meanwhile, it has significant foreign currency reserves (USD370 bn) equivalent to 27 months of imports to defend its currency.

More of an issue is public debt of 76% of GDP (the second largest in EM after Egypt), which is expected to rise for a couple of years even in the most optimistic scenarios.

The mitigating factor is that roughly 95% of public debt is owned by domestic holders, who are more captive due to a range of factors, and therefore less volatile than debt owned by overseas investors.

FIGURE 2 LEFT CHART: BRAZIL'S PUBLIC DEBT DECOMPOSED BY DOMESTIC & EXTERNAL (% GDP) / RIGHT CHART: BRAZIL'S FISCAL BALANCE (% GDP)



Source: Pictet Asset Management, CEIC, Datastream

Elections take centre stage

It appears Brazil's vulnerability is largely due to the uncertain outcome of next month's elections (the first round is on the 7th October, the second on the 28th).

Candidates span the political spectrum. At this stage the two front-runners are Fernando Haddad (official candidate of the Workers Party backed by jailed former President Lula) and right wing Jair Bolsonaro, who was recently stabbed in the street whilst on the campaign trail.

“Brazil's vulnerability is due to the uncertain outcome of next month's elections.”

We believe that regardless of who wins, the public debt issue will be addressed. The depth of the reforms will depend however on the political and personal profile of the winner.

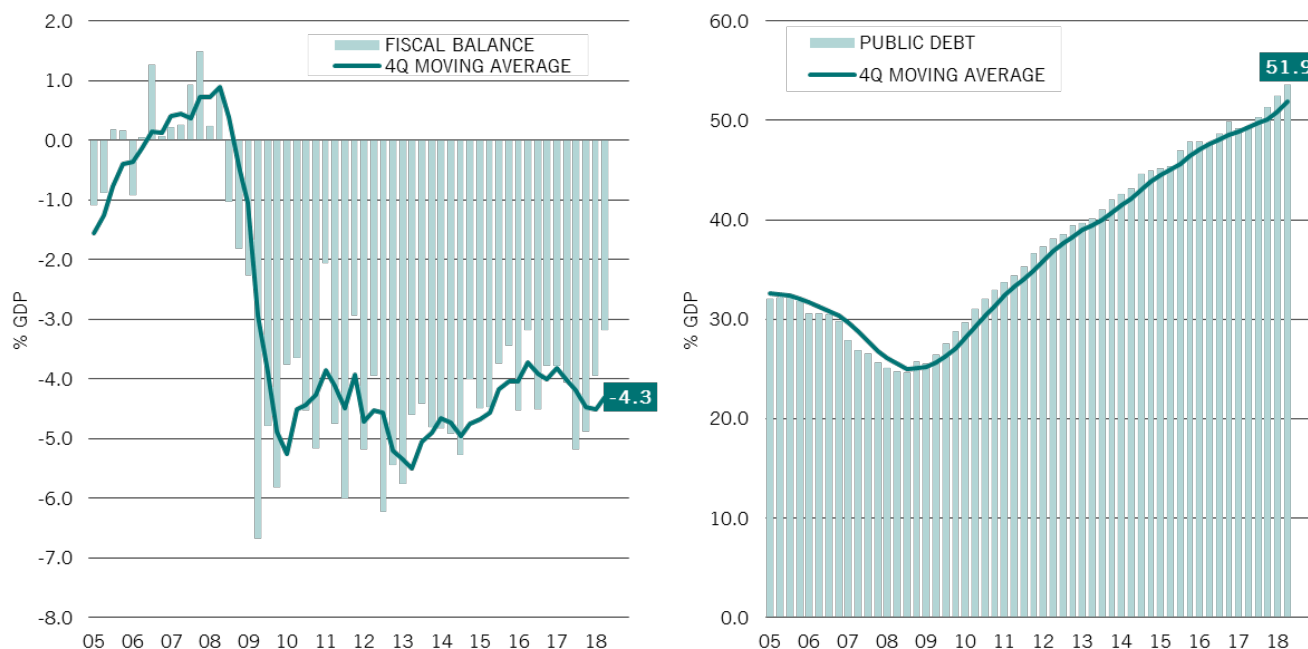
South Africa: running out of steam?

Across the Atlantic, South Africa is arguably more vulnerable than Brazil to global developments due to its weak macro fundamentals and volatile political environment.

The honeymoon period President Ramaphosa enjoyed after his February election is now over and the currency has weakened again. South Africa technically entered recession in Q2 for the first time since 2009. The rand was also hit by concerns that a change in the constitution later this month could result in Zimbabwe-style land seizures.

On the domestic side, the fiscal deficit is significant. Announced tax increases are unlikely to curtail spiralling public sector expenditure exacerbated by struggling state owned enterprises (SOEs).

FIGURE 3 LEFT CHART: SOUTH AFRICA GOVERNMENT FISCAL BALANCE TO GDP RATIO / RIGHT CHART: SOUTH AFRICA GOVERNMENT DEBT TO GDP RATIO



Source: Pictet Asset Management, CEIC, Datastream

On the external front, the current account deficit remains high. This reflects weaker demand and is financed by volatile portfolio flows (stocks and bonds) prone to changes in global financing conditions and sovereign credit ratings. The depreciation of the rand is likely to push up inflation, which is already close to its upper target range. This would limit the central bank's scope for more accommodative monetary policy.

Final thoughts...

Both emerging markets need to be watched closely. But we believe South Africa is most likely to feel the heat in coming months. It is more globally exposed than Brazil, and vulnerable to trade issues and wider tensions between China and the US (its second and third trading partners respectively). We also feel uncertain political governance could increase the strain on its already weak fiscal position.



MARKET WATCH


EQUITIES	1 mth (%)	3 mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
MSCI EM	-2.70	-4.70	-7.18	-0.68	11.42	5.04	3.45
MSCI EM Value	-2.11	-3.42	-5.76	-1.25	9.66	3.04	2.46
MSCI EM growth	-3.28	-5.93	-8.56	-0.30	13.06	6.95	4.35
MSCI AC Asia ex Japan	-1.02	-4.98	-4.94	2.76	13.15	8.07	6.64
MSCI Brazil	-11.34	-9.11	-18.00	-16.23	12.97	-1.97	-4.13
MSCI China	-3.80	-11.09	-7.83	0.22	13.49	9.27	5.97
MSCI India	0.96	6.49	-0.54	7.12	10.63	13.77	5.38
MSCI Russia	-6.99	-2.96	-0.64	8.22	14.06	0.04	-2.78
MSCI EM Europe	-7.57	-4.76	-12.22	-8.91	6.38	-3.08	-4.00
MSCI World	1.24	4.35	4.85	13.10	11.92	10.23	7.13

BONDS	1 mth (%)	3 mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
JPM EMBI Global Diversified	-1.73	-0.42	-4.49	-3.37	5.05	5.61	6.64
JPM GBI-EM Global Diversified	-6.09	-7.04	-10.47	-10.05	3.24	-1.33	1.88
JPM ELMI+	-3.02	-3.77	-5.51	-4.22	2.69	-0.90	-0.10
JPM CEMBI Broad Diversified Composite	-1.08	-0.07	-2.53	-1.52	4.63	4.88	6.25
JPM Jade Broad Asia Diversified	-0.20	-3.14	-4.64	-2.07	3.81	2.50	-
Chinabond composite	0.01	-4.61	0.21	1.58	1.11	2.42	-
JPM GBI-EM Global Latin America	-6.83	-4.31	-8.65	-11.89	5.32	-0.70	1.94
JPM EMBI Global Diversified Europe	-2.00	-1.08	-4.27	-3.34	4.49	5.27	6.70
JPM Global All Mats	-0.05	-0.88	-1.51	-1.68	2.16	1.05	2.50

COMMODITIES	1 mth (%)	3 mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
S&P GSCI TR	1.08	-1.17	7.61	22.19	-0.34	-11.32	-
S&P GSCI WTI TR	2.76	7.95	21.54	52.72	-2.15	-17.02	-
S&P GSCI Brent Crude TR	4.34	0.68	20.66	56.14	4.83	-12.66	-
LBMA Gold pm	-1.52	-7.88	-6.86	-8.33	1.94	-2.92	-

CURRENCIES	1 mth (%)	3 mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
USD/BRL	-8.82	-9.61	-19.49	-23.63	-4.03	-10.42	-8.84
EUR/BRL	-8.31	-9.32	-16.91	-21.96	-5.22	-8.15	-6.67
USD/RUB	-7.74	-8.28	-15.78	-13.48	-0.73	-13.33	-9.63
EUR/RUB	-7.22	-7.98	-13.08	-11.59	-1.96	-11.14	-7.48
USD/INR	-3.30	-4.86	-10.01	-9.87	-2.14	-1.41	-4.68
EUR/INR	-2.75	-4.55	-7.12	-7.90	-3.36	1.09	-2.41
USD/CNY	-0.05	-6.28	-4.65	-3.41	-2.26	-2.17	0.01
EUR/CNY	0.52	-5.97	-1.59	-1.30	-3.48	0.31	2.39
USD/ZAR	-10.60	-13.56	-15.50	-11.29	-3.26	-6.91	-6.25
EUR/ZAR	-10.09	-13.28	-12.79	-9.35	-4.47	-4.55	-4.02

- 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 31.08.2018 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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