GLOBAL EMERGING MARKETS: PARTING THE WATERS

"The promise of economic and market recovery failed to materialize in 2014. Will 2015 be different? Diverging monetary policies in the United States, Europe and China could increase volatility and create challenges for the emerging markets."

– Alberto Ades, Co-head of Global Economics Research and Head of Global Emerging Markets Fixed-Income Strategy

Our view

In all modesty: Economic growth in emerging markets should reach 4.5% next year, up slightly from a disappointing 4.2% in 2014 (but below the consensus call of 4.9%). Increasing growth in the United States should help, as should rebounds by Brazil and India from historically low growth levels. We also expect a modest rise in overall growth because of lower energy prices.

Steadiness on inflation and rates: The 30% fall in energy prices should exert downward pressure on what is an already low average inflation rate. Overall, we forecast average inflation unchanged at 4.5% in 2015. And, as the U.S. Federal Reserve raises interest rates, we see 13 central banks hiking moderately; the median increase should be only 0.25%.

India's pending emergence: We expect India will benefit from moderate easing and stronger investment spending as confidence improves. The next five years should be much better than the previous five. India's GDP growth rate should reach 6.3% in 2015, up from 5.3% this year, and overtake China's in 2016. China's growth rate should dip to 7.1% from 7.2% in 2015.

Russia steps back: While the consensus calls for growth in Russia, we expect the country will slip into recession, with the economy shrinking by 1.5%. Sanctions and lower oil prices should take their toll.

Caution on debt – again: Look for returns of roughly 2.3% for external sovereign debt, 1.6% for local currency debt and 1.1% for foreign exchange. That would make 2015 the second straight year that hard-currency debt outperforms local bonds.

Key calls

- **Bullish calls:** We're more bullish on 2015 growth than the consensus for Venezuela (as likely macroeconomic adjustments should bring some relief) and Hungary, which benefits from lower energy prices and borrowing costs and has a better employment picture. Favorable political change is likely in Argentina next year.

- **Top bond and currency picks**: We continue to favor long 10-year bonds in India. Among currencies, we are relatively bullish on the Chinese yuan, Mexican peso and Indonesian rupiah; bearish on the Peruvian nuevo sol; and, on the dips, would buy the U.S. dollar against currencies of Eastern Europe, the Middle East and Africa.