GLOBAL EMERGING MARKETS: IN TRUMP'S WORLD

"At least in the near term, the outcome of the U.S. presidential election may create economic headwinds around the world. President-elect Trump's economic plan will likely lead to higher U.S. rates and a stronger U.S. dollar, the combination of which will continue to be a negative shock for many emerging nations."

– David Woo, head of Global Rates, FX, and EM Fixed Income Strategy and Economics

Our view

A binary year

We are cautious in the near term because of high volatility in interest rates and low liquidity. Buying opportunities could emerge once U.S. real rates stabilize and fundamentals in the emerging markets improve. For the year, we forecast economic growth of 4.7 percent in the emerging markets, up from 4.1 percent. That's better than in the U.S. and the rest of the developed world.

India leads the way

Once again, we expect India to be at the head of the pack in economic growth; Indian GDP should increase 7.6 percent in 2017. And we foresee China's bellwether economy as expanding by 6.6 percent. Overall, emerging Asia should grow by 6.2 percent, and we look for Eastern Europe, the Middle East and Africa (EEMEA) to rise 1.9 percent. Latin America should rebound with growth of 1.5 percent, after a drop in 2016.

Mexico, a surprise winner with Trump

Although we believe the election of Donald Trump will be negative for LatAm, Mexico could do relatively well in the Trump era. Higher U.S. spending on construction and infrastructure, along with any revival in American manufacturing, could be good for Mexico, too. Brazil may be affected negatively, though, since its strategy to gradually reduce its budget deficits depends on low global rates, capital inflows and stronger domestic growth.

Speed bumps ahead for EM corporates

Given the outcome of the U.S. election, we expect lower total returns of 1.5 percent to 2 percent for emerging market corporates, along with higher volatility. The result could be total returns of 1.3 percent for investment-grade bonds and 1.9 percent for high yield. Country selection will be critical, though. Overall, we expect an improvement in credit fundamentals and default rates and a drop in net supply. Investors may be nervous about Mexico and China, due to possible currency volatility and trade issues with the U.S.

Shadow on EM sovereign debt
U.S. rates, commodity pricing, trade policies and possible move to isolationism are among several drivers of return on emerging market sovereign debt in the coming year. For 2017, we forecast emerging market returns of about 2.6 percent for external debt and only 0.7 percent for local debt.

Key calls

- **Bullish calls** – We recommend the U.S. dollar over the weaker Chinese yuan. Our top contrarian pick in Latin America: Mexico's currency over Brazil's. The peso looks oversold and the real could be vulnerable, as the paths diverge between Brazil's easing cycle and the Federal Reserve's tightening. We're bullish on Russia's ruble against the euro and South Africa's rand. Russia could benefit from OPEC production cuts and sanction relief.
- **Corporate bond outlook** – We are overweight Latin America, underweight Asia and market weight Eastern Europe, the Middle East and Africa (EEMEA). Our top country picks are Brazil, Turkey and Indonesia. Meanwhile, we are underweight Mexico and South Korea.
- **External debt** – We expect the best performance from lower-quality bonds, due to higher yields and more potential for spread tightening. With U.S. rates expected to increase around 30 basis points, high-quality, low-yielding bonds have little carry to offset the decline in prices.