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Economics / Politics / Markets

EM Watch

WINNING THE TRADE WAR

Jon Harrison / EM Team

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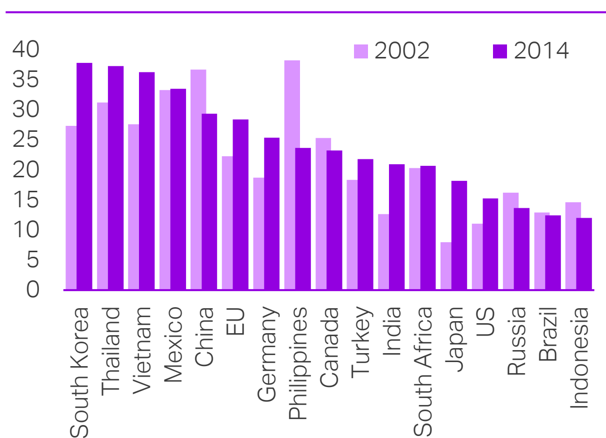
Import content of exports (%)



Sources: CPB Bureau for Economic Policy Analysis, TS Lombard.

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China: Fiscal policy will be contractionary

Lower budget deficit target, tighter scrutiny on PPP projects and LGFV financing, funding cost constraints for policy banks and expected lower land sales revenues mean that overall fiscal spending will be contractionary this year compared with 2017.

Brazil: Presidential door open for a novice

While a total of 11 parties have announced their pre-candidates for the presidential election, no candidate has gained traction in the polls, leaving the door open for a political novice. Most recently, Flávio Rocha of retail giant Riachuelo has indicated he might enter the race.

India: Tax compliance push will boost GST

The GST Council has decided to roll out the interstate electronic tracking e-way bill in an effort to shore up revenues, despite concerns about disruption to trade. At the same time, the Council extended the current tax return filing system until June. The GST remains a work in progress, with consequent risks for both the pace of economic recovery as well as fiscal slippages.

Russia: Tax change to reverse capital flight

Subordinated bond issuance from a significant privately-owned Russian bank last week highlights the theme of capital flight repatriation. The political spur of US and perhaps now also UK sanctions following the 'Skripal affair' is less important than new tax information exchanges. Macro effects may be felt more on the fiscal side than through the balance of payments. .

Mexico: NAFTA will survive despite Trump

Mexico's exemption from imports tariffs on steel and aluminium signed by President Trump last week confirms our long held view that NAFTA will survive. Meanwhile, Mexico's signing of the CPTPP Asia-Pacific deal reaffirms our view that trade diversification remains a policy priority.

Philippines: BSP will allow peso to weaken

Inflation surged in February to 4.5% on the old 2006 base year series, but remains within the Central Bank's 2-4% target range at 3.9% using the new 2012 series. BSP will likely maintain a dovish bias despite the weaker peso. We expect currency depreciation to trigger a rate hike later this year, but in the meantime the peso will fall further.

Global backdrop

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EM gain on limited US trade choices

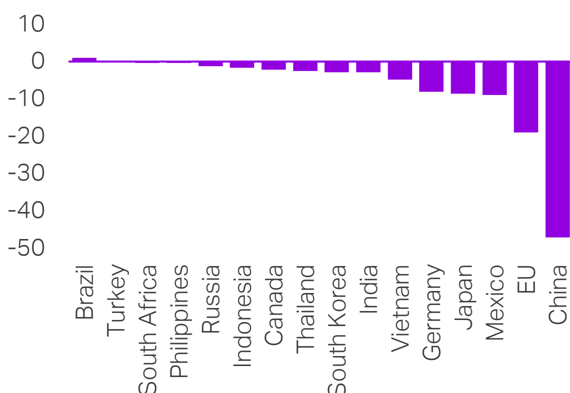
The implementation of the steel and aluminium tariffs looks set to fall short of worst-case fears, offering hope for global markets, and perhaps a template for future battles in the trade conflict. The administration's focus on the trade deficit puts the spotlight on China. The US may have the ammunition to fight a trade war with China, but realistic choices are limited. The path of least resistance will likely be US initiatives aimed at headlines, rather than the deficit. China will be unmoved on trade, but tensions will persist as the conflict on intellectual property develops. Other EM will continue to benefit from rising world trade and may gain from cheaper inputs, and even win market share from US exports. Unintended consequences remain a risk.

Investors remain nervous about the prospect of a trade war. The resignation of Chief Economic Advisor Gary Cohn last week rattled global financial markets as investors feared that the loss of one of the few voices opposing trade tariffs would lead to an escalation of protectionist measures. In the absence of dissenting opinions, the protectionist views in the administration may gain the upper hand. The growing influence of trade advisor Peter Navarro raises the risk of tension with China, while the roles of House Speaker Paul Ryan and Congress in curbing the worst excesses of the administration take on greater importance.

The tariff implementation is markedly softer than the initial announcement. Most importantly, the insistence that there would be no country-level exclusions has given way to the exemption of Canada and Mexico during the renegotiation of the NAFTA. This leaves open the possibility that tariffs will be imposed if the US decides to abandon the trade deal, but is nonetheless a better outcome than immediate tariff imposition. Exemptions for other countries and for specific product categories are probable too. Implementation will be less severe than the initial announcement, which is encouraging for the global economy, and offers a template for future US initiatives in which controversial announcements are simply negotiating gambits. We update our NAFTA view in detail in the Mexico section below.

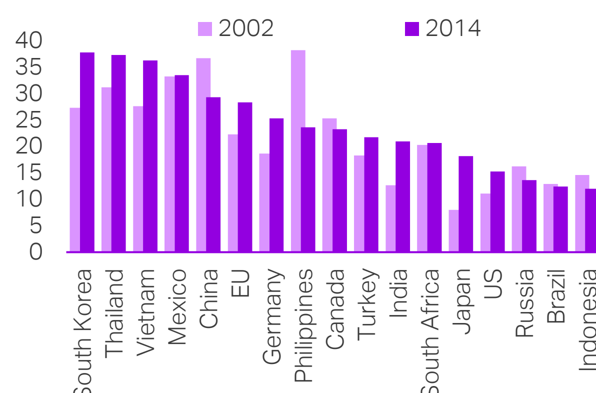
The US administration nonetheless mounted a robust defence of the principle of tariffs, and there is little chance that Trump will reverse the protectionist dynamic. The President cites the trade deficit as a motivating factor, which puts China in the firing line, as well as the EU and Mexico (see chart below), but the structure of US trade leaves few realistic choices.

US merchandise trade balance (%)



Source: US Census Bureau, TS Lombard.

Import content of exports (%)



Source: OECD, TS Lombard.

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Trump's assertion that trade wars are easy to win is false. We wrote in last week's EM Watch about the declining leverage of the US over China in steel and aluminium as well as in high-tech manufacturing. The US nonetheless retains one advantage in that the import content of US exports is relatively low (see chart above). The US in theory has more freedom to impose tariffs on imports without damaging its own exports. With the exceptions of Mexico and Canada, US imports from most trading partners (including China) contain less than 5% of US content. Even for the US, however, supply chains are becoming more complex and unintended consequences are difficult to avoid. Furthermore, the US may import more goods than does China, but Chinese imports are growing more rapidly, and US companies will lobby hard to gain their share.

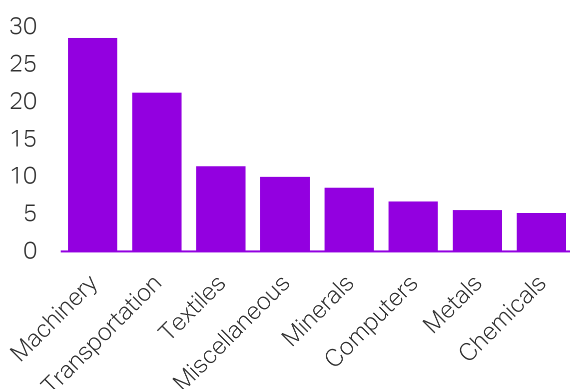
The structure of the US trade deficit means there are few easy choices to secure a trade victory (see chart below). Metals and chemicals feature heavily in the list of allegations of unfair trade at the US ITC, but contribute little to the deficit. Transportation, particularly cars from the EU and Japan, offers a better alternative, though tariffs could be hard to justify on grounds of national security. An easier path may be to encourage manufacturers to relocate production to the US, as many have already done. Machinery is an obvious target, and will likely be the subject of specific measures, as already seen in solar cells and washing machines. But widespread price hikes in high-tech consumer goods would be unpopular with US consumers; and US machinery imports extend throughout the value chain, raising the risk of damage to US exporters.

US escalation to Textiles, Furniture and Footwear appear less complicated choices for tariffs. We would not rule out targeted trade measures in these product categories, but broad-based tariffs are unlikely. The poorest US consumers would be worst hit by higher prices, and there is risk of retaliation by China in aircraft, cars and soybeans, in which the US has a surplus (see chart below). India too would be hit if the US raises tariffs on textiles.

The path of least resistance will likely be US trade initiatives that are finely targeted, aimed at generating headlines, but with little impact on either the US deficit or on Chinese trade. US-China tensions will, however, persist as the conflict on intellectual property develops. We explore the IP issue in this week's forthcoming China Watch.

EM economies will continue to benefit from rising world trade. The tariff choices facing the US are limited, suggesting that world trade volumes will continue to expand. Moreover, the prospect of cheaper steel will help support infrastructure programs in South East Asia; and Brazil will benefit from any global retaliation against US agriculture (see last week's EM Watch).

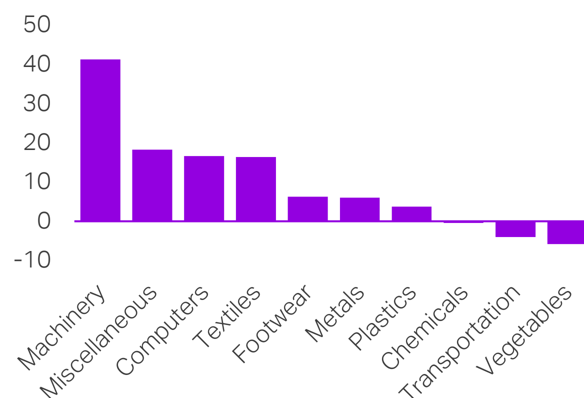
Structure of US trade deficit (%)



Source: UN Comtrade, TS Lombard.

In the charts above "Machinery" excludes Computers.

China trade balance with US (%)



Source: UN Comtrade, TS Lombard.

"Miscellaneous" is 60% Furniture; "Vegetables" is 80% Soybeans.

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China

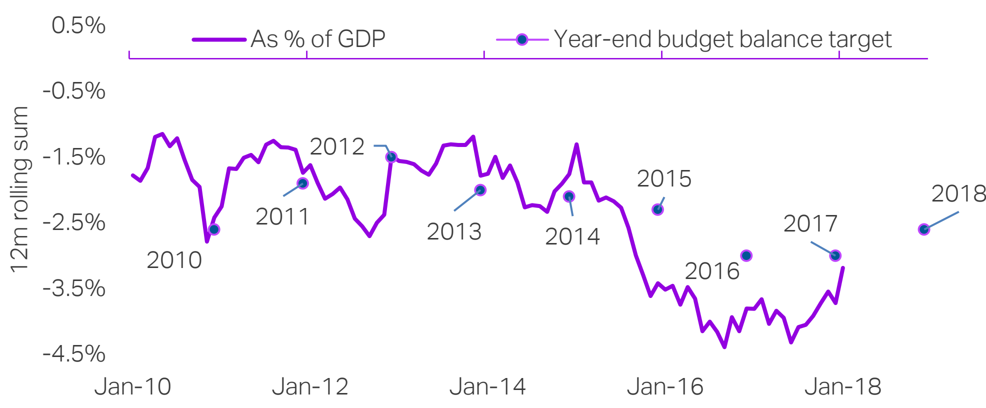
Overall augmented fiscal spending will be contractionary in 2018

Lower budget deficit target, tighter scrutiny on PPP projects and LGFV financing, funding cost constraints for policy banks and expected lower land sales revenues mean that overall fiscal spending will be contractionary this year compared with 2017. We estimate that the augmented fiscal deficit – including quasi-fiscal tools – will shrink by about 1-1.5% of GDP in 2018.

As Beijing holds its annual legislative Congress – at which, among other things, political changes will be discussed and the new government approved – major economic targets have been announced in the Government Work Report (GWR). As we expected, the report sets a growth target of "around 6.5%" for 2018, despite earlier rhetoric about shifting the focus from the speed of growth to the quality of growth. The undertaking in the 2017 government report to "try to achieve a better result" than the target has been removed in this year's GWR. That provides some room to tolerate a moderate slowdown in 2018 to 6.5% from 6.9% last year.

Although the GWR retained the wording of "proactive fiscal policy", the general budget deficit target has been lowered to 2.6% of GDP from 3.0% in the previous two years; resilient economic growth for fiscal revenue was cited as the reason for the reduction. In absolute terms, the deficit is projected at RMB2.38trn in 2018 vs the actual RMB3.07trn in 2017. The lowered budgetary deficit implies the government's determination to contain the public debt risk, which supports our cautious view on infrastructure spending this year. In addition to an increase in the general public budget, the quota for local government special bonds was lifted from RMB800bn last year to RMB1.35trn this year, along with RMB1.7-1.8trn in expected local government bonds issuance in 2018 to complete the local debt swap scheme. According to the 2018 GWR, the increasing local special bond financing will be used mainly for projects under construction.

Budget deficit



Sources: CEIC and GWR.

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Despite a significant expansion of the 2018 local government special bonds quota, quasi-fiscal spending is likely to decline. In recent years, much of China's fiscal stimulus has been through quasi-fiscal channels including policy banks, PPP projects and LGFV borrowings. Under the government's recent prioritization of containing leverage, PPP projects and LGFV financing will face tighter scrutiny. Meanwhile, the ability of policy banks to finance long-term infrastructure projects will be constrained by rising funding costs because the 10-year yield of China Development Bank's financial bonds has increased from a mere 3% in late 2016 to more than 5% in January 2018.

We estimate that the augmented fiscal deficit – including quasi-fiscal tools – will shrink by about 1-1.5% of GDP in 2018. Together with expected lower land sales revenues, overall fiscal spending will be contractionary this year compared with 2017. Overall, we expect infrastructure investment growth to slip below 12% in 2018 – the lowest growth rate in more than a decade. The official infrastructure investment growth targets listed by the 2018 GWR reflect a tighter fiscal policy with planned investment in railway construction set at RMB732bn this year (vs actual amount of RMB801bn in 2017) and that for highway and waterway investment at RMB1.8trn (vs actual amount of RMB2.3trn in 2017).

Brazil

Candidates crowd into the race as a fickle electorate remains undecided

While a total of 11 parties have announced their pre-candidates for the presidential election, no candidate has gained traction in the polls, leaving the door open for a political novice. Most recently, Flávio Rocha of retail giant Riachuelo has indicated he might enter the race.

While the anxious market waits for clues, the electorate remains on the fence. With the presidential election less than seven months away, the Brazilian electorate has offered few indications of what it is looking for in a candidate. Despite the growing discussion about this October's race among opinion makers, there have been surprisingly few changes in the poll data over the past six months. And with the exception of far-right candidate Jair Bolsonaro, all of the main contenders have seen their voter intentions remain stable within the margin of error of plus or minus 2.2 pp since February 2017, according to the CNT/MDA poll released last week (see Chart 1 below).

New candidates still could join the race, but they need to join a party by 8 April. With no candidate inspiring the confidence of the electorate, the race remains open for new candidates to throw their hats into the ring, in the hopes of gaining the support of undecided voters. In this context, the next important electoral milestone to monitor is the 8 April deadline for party affiliation. Political novices who are considering trying their luck in the October election will need to join a party by 8 April if they want to enter the race. Although TV personality Luciano Huck is now very unlikely to join a party, other potential contenders should be monitored. One possible candidate is the former Chief Justice of Brazil's highest court (STF) Joaquim Barbosa, who has high approval ratings, but has no political experience. Although it is still possible he will join the race, negotiations with the Brazilian Socialist Party (PSB) have reportedly fizzled out, reducing the likelihood he will be a candidate.

Businessman Flávio Rocha of clothing retailer Riachuelo is also reportedly mulling a bid for the presidency. The most recent potential candidate who is receiving attention from the press is Flávio Rocha, the CEO of Brazil's third-largest clothing retailer Riachuelo. Rocha, who has been increasingly his media profile in recent months, has now indicated that he too might be interested in entering the race. We believe that Rocha could be a serious contender, since he would tick many boxes for the Brazilian electorate. First of all, as a native of northeastern Pernambuco state, Rocha could attract voters from that region, which differentiates him from other centre-right candidates. Likewise, Rocha could easily be billed as a political outsider, despite the fact that he has some experience in politics, having served two terms as a Congressman in the late 1980s and early 1990s. Rocha also has the advantage of being very wealthy, with a fortune estimated at roughly $1.3 bn, and he could therefore help finance his own campaign.

Upcoming polls will be key to monitor. Although Flávio Rocha's candidacy is still in its early stages, if his name continues to get attention from the media, it will be important to monitor whether he can gain any traction in the polls. It will also be important to follow how he weathers the media attention and whether any dirt begins to surface about him or his company. Regardless, the growing attention that Rocha is receiving is an indication that the race still remains open to an outsider and that changes to the field of candidates are still possible. However, once the 8 April deadline for party affiliation passes, it will be harder for an outsider to throw his or her into the ring. This means that by next month, we will have a slightly clearer view of the field of candidates.

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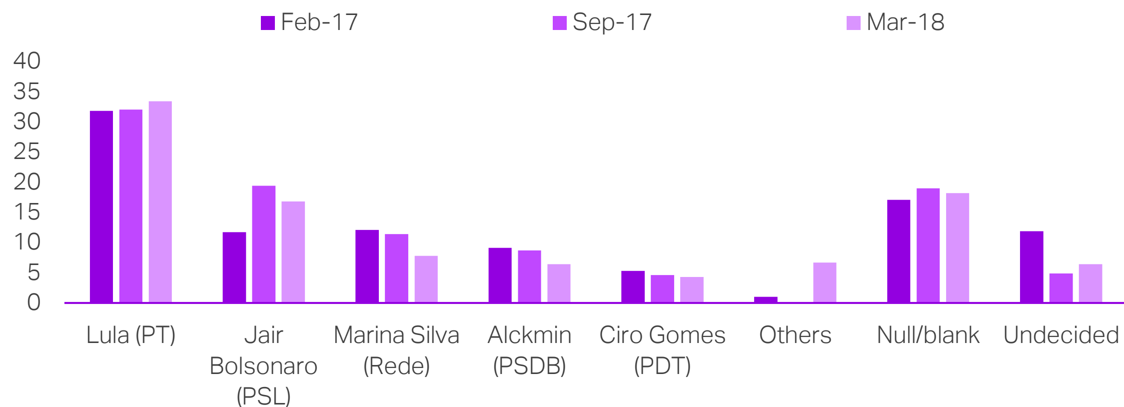
Chart 1: First-round voter intentions (with Lula in the race)



Source: CNT/MDA.

India

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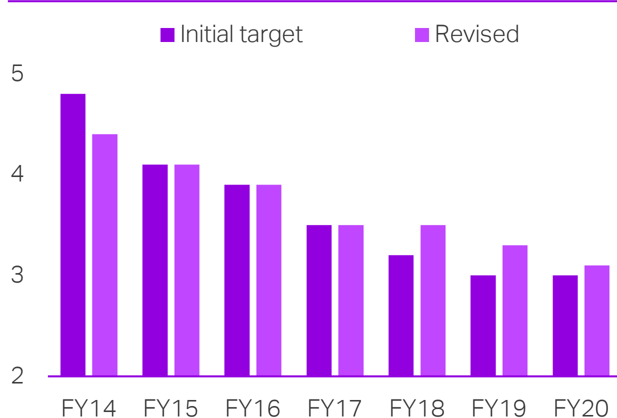
Government aims to plug tax evasion to shore up GST revenues

The Goods and Services Tax (GST) Council decided to roll out the interstate e-way bill that will electronically track the shipment of goods across state borders from 1 April despite concerns about disruption to trade as it is worried about the revenue leakages through tax evasion. At the same time, the Council extended the current tax return filing system until June as a new simplified system was not considered robust enough to check tax evasion, and has allowed exporters and small businesses an additional 3-6 months of exemptions. The GST remains a work in progress, with consequent risks for both the pace of economic recovery as well as fiscal slippages.

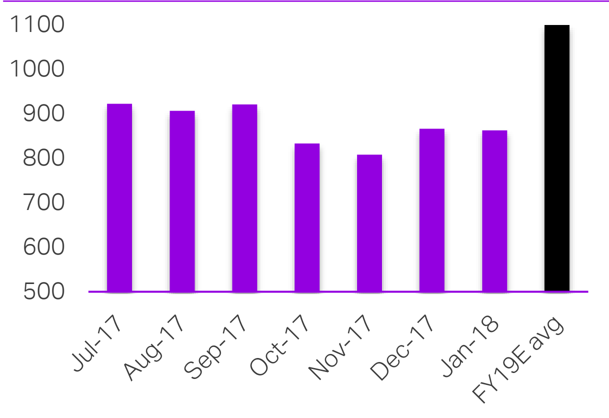
The federal indirect tax body's meeting this weekend that came amid concerns of revenue shortfalls as India's economy continues to adjust to the new tax regime decided to take aggressive action to shore up collections. As we highlighted in our 9 March note GST: Done but not yet dusted, the low tax compliance levels as evident from the lower-than-expected revenues have raised concerns about further fiscal slippage after the government missed its FY18 budget deficit target and cut itself some slack in the FY19 deficit target as well. The chart on the right below shows revenue collections dipping after the first few months of the GST's implementation. This makes the government's assumption for the monthly tax revenue for FY19 appear unachievable.

Initial vs revised fiscal targets



Sources: Budget documents, Bloomberg.

GST receipts (Rs bn)



Sources: Ministry of Finance, TS Lombard.

Technical glitches had forced the GST Council to defer the e-way bill rollout from the initial February 2018 deadline, and there was some doubt over whether it will stick to the revised 1 April date as businesses fear there will be teething problems similar to the GST's implementation in July 2017. The Council said that the introduction of the e-way bill for interstate movement of goods will be conducted in a staggered manner but will be complete by June at the latest. With many other issues still pending, such as the simplification of tax returns, we believe that it will take another 6 months at the very least for the economy to adjust to the GST and the real economic benefits of the new tax system to begin to be felt.

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That said, the large organised sector is already benefiting from the GST that seeks to unify and formalise India's economy, and firms are reporting margin expansions as a result of input tax credits and efficiencies in warehousing and storage. As the GST further pervades the economy, the expectation is for margins to expand further. The improvement in India's GDP growth also indicates that the economy is reviving (see our 5 March EM Watch). However, the pace of economic recovery is uneven as smaller firms continue to grapple with the new tax regime, forcing the government to provide them more leeway for meeting their filing requirements.

Russia

US/UK politics plus tax cooperation help reverse some capital flight

Subordinated bond issuance from a significant privately-owned Russian bank last week highlights the theme of capital flight repatriation. The political spur of US and perhaps now also UK sanctions following the 'Skripal affair' is less important than new tax information exchanges. Macro effects may be felt more on the fiscal side than through the balance of payments. .

The repatriation of private flight capital may be increasing in scale. A significant case history emerged last week in the form of a bond issue by Sovkombank, which, along with Alfa and Moscow Credit, is in the top rank of domestic commercial banks still in private hands. The bank successfully placed through the Moscow Exchange on 5 March two dollar denominated subordinated bond issues for US$250 million with coupons of 8.25-8.75%. The subordinated status allows the proceeds to count towards the bank's Tier 1 and Tier 2 capital. Two interesting details jump out:

- There was no urgent need for the bank to replenish its capital since according to its 9mo17 IFRS financial statements, its capital adequacy ratio was 250bps above the 10% minimum requirement
- In the internally run book-building process, the offering was directed initially towards the bank's beneficial owners and clients.

Sovkombank has tapped its owners' and clients' wishes to return wealth to Russia. The Bank's CEO Dmitry Gusev said that the choice of domestic FX-denominated bonds as an instrument stemmed from the trend of wealthy clients returning their funds from abroad into Russian banks. An idea of the scale of this demand may be gauged by the initially planned US$150 million size of the bond offering reflecting known demand from investors returning their money to Russia, with the increase to the actual US$250 million probably resulting from institutional investor interest over and above that core.

There is a political angle to this trend, also confirmed by Sberbank's wealth management division last month, of private money flowing back into Russia from abroad. Since late 2017, the political catalyst has been the US Treasury's "Kremlin List" of "regime-connected" officials and business owners mandated by the latest US sanctions law ("Countering America's Adversaries Through Sanctions Act"). The Finance Ministry declared its readiness to issue FX-denominated domestic bonds aimed at Russians wishing to repatriate funds in anticipation of that threat. At the latest of his periodic meetings with oligarchs in December, President Putin endorsed this "*beryozki*" bond plan (while taking care to point out that the initiative here had been taken by the business community rather than the government).

The *beryozki* bond plan has yet to materialize, though new impetus may now come from the threat of UK sanctions. Russians with substantial assets in the UK may face sanctions as part of the official UK response to suspected Russian state involvement in last week's poisoning of Sergey Skripal, a former Russian military intelligence offer who spied for Britain, where he has been living since 2010. The UK government could use for the purpose "unexplained wealth orders" – a new power granted under legislation enacted last year.

The most important stimulus for reversing capital flight is not politics but information exchanges between tax authorities. Probably much more important than all such headline-grabbing sanctions stories is the effect of the Automatic Exchange of Information on Financial Accounts. This initiative under OECD auspices allows participating countries' tax administrations to exchange information about the foreign bank accounts of each other's tax residents. Russia joined this initiative in 2016 and the information exchange process with several important partner countries (including the UK and Switzerland) went live in January this year. Since Russian tax residents can no longer be certain of keeping their financial affairs abroad hidden from the Russian Tax Service, repatriating capital at the 13% flat rate of income tax is clearly becoming an attractive option for some.

The latest capital amnesty has been extended for a year, and other lures are in the works. The Sovcombank bond issue indicates that capital repatriation can happen of its own accord, regardless of any new instruments (such as *beryozki*) or other policy initiatives. Nevertheless, some active facilitation measures are likely. One such has already materialized – a one-year extension until March 2019 of a capital amnesty programme that started in March last year (following a similar initiative in 2015-16). This is an opportunity for people to return funds from abroad with a one-off payment of 13% on the total with 'no questions asked' about previous tax evasion. Another initiative now in the State Duma aims to attract flight capital into FDI by relaxing restrictions on investments from certain offshore jurisdictions into Russian sectors and companies defined as being of strategic importance.

In the macroeconomic perspective, the common thread here is to prevent returning flight capital from exerting unwelcome upward pressure on the ruble exchange rate. This thinking is evident in the FX-denominated *beryozki* bond scheme. The main macro effect from the prospective reduction in net private capital outflows (now forecast by the CBR at US$16-17 billion this year) may therefore come on the fiscal side rather than through the balance of payments.

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Mexico

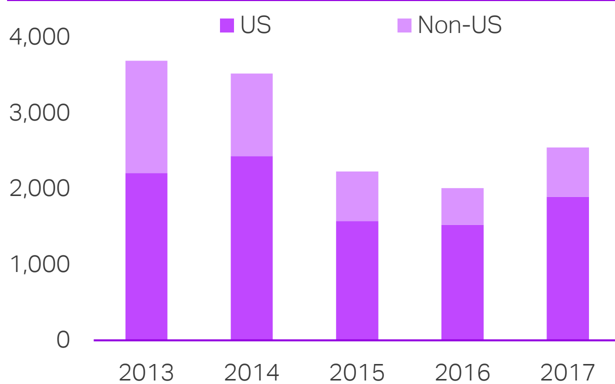
NAFTA goes on, despite Trump's trade tirade

Mexico's exemption from imports tariffs on steel and aluminium signed by President Trump last week confirms our long held view that NAFTA will survive. The 8th round of NAFTA talks is expected to take place at the end of March. Meanwhile, Mexico's signing of the CPTPP Asia-Pacific deal reaffirms our view that trade diversification remains a policy priority.

President Trump's imports tariff of 25% on steel and 10% on aluminium signed last week excluded Mexico. This exemption signals willingness of US and Mexico's government officials to carry on with the NAFTA renegotiation, which 7th round of talks concluded one week ago. While the fundamental, underlying motivations for excluding Mexico from the tariffs were not disclosed, we outline some arguments which reaffirm our view (see our 2 February NAFTA note) that Trump's trade tirade will not prevent NAFTA from being preserved and modernized.

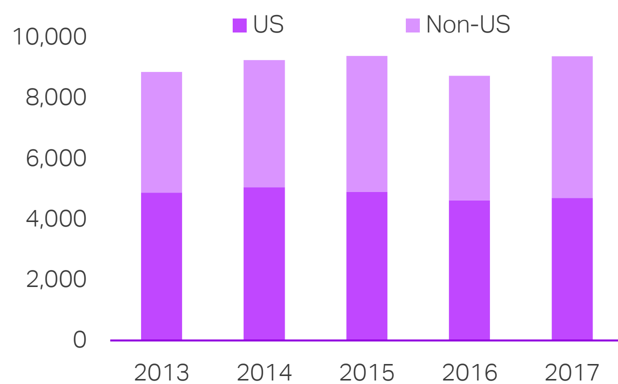
Trade patterns between Mexico and US reveal how vulnerable the US steel industry is to imports tariffs. For starters, Mexico's exports of raw iron and steel to the US reached US$ 1.9 bn last year (see Chart 1), according to available data from ITC Trade Map. However, Mexico's imports of manufactured articles of iron and steel from the US are more than twice the size of its exports of these raw materials to the US (see Chart 2).

Chart 1: Mexico's exports
Raw iron and steel, USD mn



Sources: ITC Trade Map, TS Lombard

Chart 2: Mexico's imports



Sources: ITC Trade Map, TS Lombard

The growth of supply chains across the NAFTA region has made it harder to disentangle the value added content of trade into foreign and domestic products. What this means for companies in the US is that an imports tariff on raw steel materials from Mexico could be easily passed on to the final export product to the same country. But this could invite companies operating in Mexico to reduce the share of final steel products bought from the US in favour of non-US countries. Although Mexico exports 75% of raw steel products to the US, it nonetheless imports less than 50% of steel articles from its northern neighbour.

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In a less constructive scenario, such a move would accelerate the ongoing process of trade diversification launched by the Mexican government in the wake of US trade protectionism. The situation could deteriorate if Mexico decided to hit back with an import tariff on final steel products from US. But this reaction seems unlikely as it would also affect Mexico's own markets, given the industry interlinkages mentioned above.

Instead, the bottom-line for Mexico's trade strategy appears to be the gradual diversification of its trade basket. By doing so, Mexico is both increasing its leverage ahead of the 8th round of NAFTA talks that will take place at the end of March while also hedging itself from an unexpected departure of the US from NAFTA. This has become evident from the efforts made by the Mexican government in reaching out to EU and Asia-Pacific countries.

Mexico's signing of the CPTPP (formerly TPP-11) trade deal last week is another step in the same direction. The deal is expected to come into effect by 2019, once the treaty is ratified in Congress by at least six of the eleven signing members. Mexican products would have access to six new markets (Australia, Brunei, Malaysia, New Zealand, Singapore and Vietnam) which together add over 150 million potential consumers. Moreover, the opening of the Japanese agri-food market will likely add to the ongoing efforts made by the Mexican government to increase trade in this space with South American nations.

Philippines

Peso will fall further amid dovish Central Bank bias

Inflation surged in February to 4.5% on the old 2006 base year series, but remains within the Central Bank's 2-4% target range at 3.9% using the new 2012 series. Rising food and beverage prices and higher price of crude oil were the main drivers. BSP believes that higher inflation is transitory and will likely maintain a dovish bias despite the weaker peso. We expect currency depreciation to trigger a rate hike later this year, but in the meantime the peso will fall further.

Headline inflation increased in February to 4.5% (2006 base). The increase was led by surging prices of food and beverages as well as rising crude oil prices. The Tax Reform for Acceleration and Inclusion (TRAIN) reform undoubtedly contributed to the higher inflation reading. The new PHP 6-12 per litre sugar tax inflated the price of soft drinks and juices, the excise tax on tobacco increased to 7.7% and an additional tax of PHP 2.5 per litre of diesel was introduced. Robust domestic demand helped raise core inflation (2006 base) to 4.4%.

The Statistic Authority changed the CPI base year from 2006 to 2012. The weights in the customer basket used for CPI calculation are revised every 6 years and are based on the Family Income and Expenditure Survey (FIES). The most important change this time is the weight of food and non–alcoholic beverages in the basket, which dropped from 40 % to 38.3 %. One of the main drivers of inflation recently has been food prices, meaning that using the new base lowers the CPI reading (see chart below). Indeed, CPI using the 2012 base was only 3.9%, still within BSP target range.

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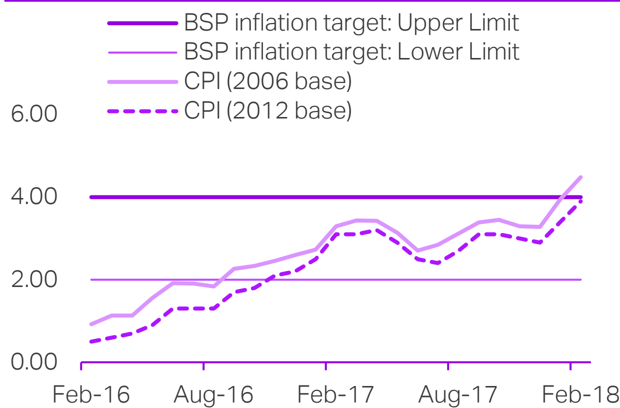
Bangko Sentral Ng Pilipinas (BSP) appears reluctant to hike the policy rate. BSP believes that rising inflation as a transitory effect and expects CPI to increase further but then to return to its target range in 2019. Governor Nestor Espenilla dampened speculations of a rate hike in March by communicating that the effect of the rate hike lag and would be seen only next year. The peso is one of the worst performing EM currencies this year and depreciation pressure is likely to increase while interest rates remain relatively low (see chart below).

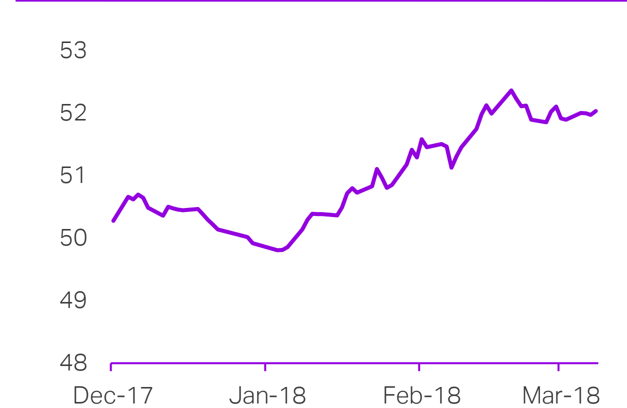
A weak peso will support exports and stimulate domestic demand through increased remittances, but the import of capital goods for infrastructure projects requires a stronger currency. Export growth in January was only 0.5% yoy while imports grew 11.4% yoy. A weaker peso will help stimulate exports and boost GDP growth this year. It will also encourage remittances, which will support domestic demand. Infrastructure investment, however, remains the political priority. A stronger currency would reduce the cost of imports of capital goods and raw materials. We do not believe that BSP will hike rates at the 22 March meeting, but could face heightened political pressure if it allows peso depreciation to continue throughout the year. We expect at least one hike later in 2018.

Inflation



Source: CEIC, TS Lombard

USD/ PHP



Source: Bloomberg, TS Lombard

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India: GST teething troubles set to continue

The faster-than-expected recovery in India's Q3/FY18 GDP growth – to 7.2% yoy – signalled a waning of the negative effects from the rollout of the new Goods and Services Tax and the earlier cash ban. Shumita Deveshwar explains that benefits from the new tax regime have started to show for the large organized sector: many firms are reporting margin expansions. Input tax credits and cost savings on warehousing and efficiency in transportation will help further improve margins in FY19. But the rollout of the e-way bill, which will electronically monitor the movement of goods and is needed to check tax evasion, will cause further short-term disruption to business. See our 9 March report India GST: Done but not yet dusted.

Brazil: The presidential race remains wide open

The latest poll highlights the rising risk of volatility in the October election: more than 60% of voters say they are undecided or will cast null/blank votes. Elizabeth Johnson and Grace Fan explain the current state of play now that former President Lula – the current frontrunner – is more likely to end up behind bars than on the ballot. There is no guarantee of a favourable outcome for markets. Market favourite São Paulo Governor Geraldo Alckmin remains level in the poll, underscoring the risk that more extreme candidates will advance to the runoff round. See our 9 March report Brazil: The left eyes alternatives to Lula

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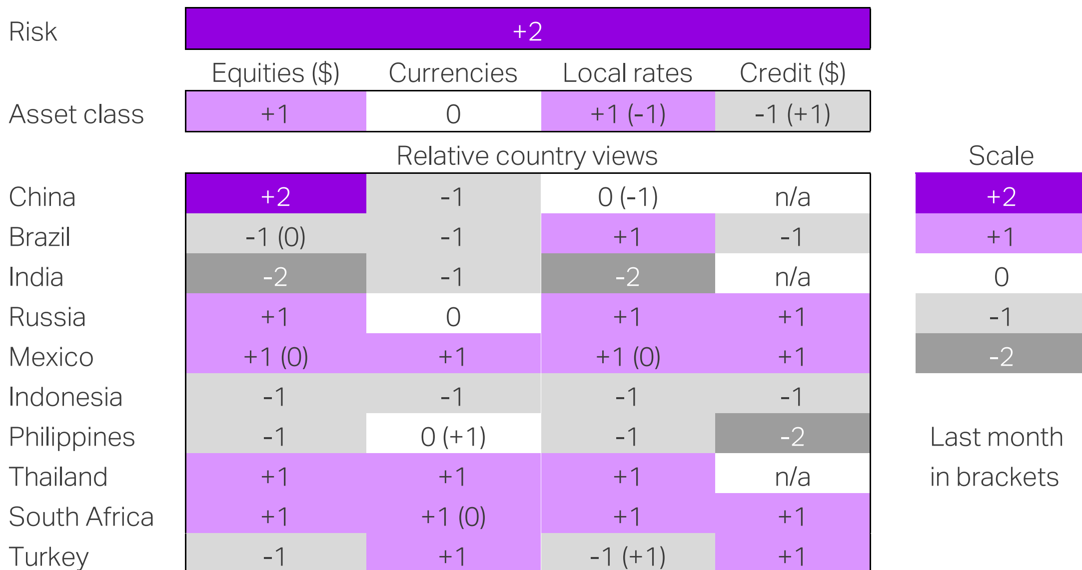
We present below our EM asset allocation views which are updated once per month, most recently in our 1 March EM Strategy Monthly.

We will publish our next Asset Allocation view in our EM Strategy Monthly on 4 April.



	Equities ($)	Currencies	Local rates	Credit ($)
Risk	+2			
Asset class	+1	0	+1 (-1)	-1 (+1)
Relative country views				
China	+2	-1	0 (-1)	n/a
Brazil	-1 (0)	-1	+1	-1
India	-2	-1	-2	n/a
Russia	+1	0	+1	+1
Mexico	+1 (0)	+1	+1 (0)	+1
Indonesia	-1	-1	-1	-1
Philippines	-1	0 (+1)	-1	-2
Thailand	+1	+1	+1	n/a
South Africa	+1	+1 (0)	+1	+1
Turkey	-1	+1	-1 (+1)	+1

Scale
+2
+1
0
-1
-2

Last month in brackets

The scores for our relative country views sum to zero in each column.

For further explanation see our methodology.

Absolute Views

Table 1 below presents our high-conviction total return market views

Table 1: Current Absolute Views*

Country	Asset	Market view	Units	Date opened	Open level	Current level	Performance to date
Mexico	Sovereign credit	Positive	bp	12-Jun-17	149	144	+2.0% (+5 bp)
Russia	Sovereign credit	Positive	bp	16-Oct-17	140	131	+1.7% (+9 bp)
Thailand	Equity	Positive	USD	22-Jan-18	20.22	20.63	+2.0%

Date/time 12-Mar-18 07:36

*The legacy EM sovereign bond indices that we were using to monitor fixed income views have been discontinued by Bloomberg; the opening and current levels have been updated to use the replacement Bloomberg EM bond indices.

Source: Bloomberg, TS Lombard.

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Closed views are in Table 2, below. Intra-day prices used for views that are opened or closed on the date of publication are modified to the close of business prices in subsequent reports. For further explanation see our methodology.

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Levels are for London close of business, obtained from Bloomberg.

Table 2: Closed Absolute Views

Country	Asset	Market view	Units	Date opened	Date closed	Open level	Performance to close
Russia	Equities, energy	Positive	USD	18-Sep-15	12-Jan-16	596.6	-17.7%
Brazil	Equities	Negative	USD	30-Jan-15	5-Feb-16	1,711.0	+42.6%
Brazil	10-yr local debt	Positive	%	7-Apr-16	7-Sep-16	14.24	+34.9% (+224 bp)
Philippines	Equities	Positive	USD	17-Jun-16	7-Sep-16	28.36	-1.5%
South Africa	Local debt	Positive	%	10-Nov-16	3-Feb-17	9.27	+9.7% (+19 bp)
Turkey	Sovereign credit	Positive	bp	27-Jul-16	7-Mar-17	322	+2.1% (+11 bp)
Russia	Equities	Positive	USD	8-Dec-16	12-Jun-17	576	-8.3%
Turkey	Local debt	Positive	%	15-May-17	11-Sep-17	10.69	+7.6% (-1 bp)
Indonesia	Equities	Positive	USD	5-Apr-17	20-Nov-17	495.1	+5.6%

Source: Bloomberg, TS Lombard.

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For further explanation see our methodology.

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