EM Strategy Monthly

CHINA FEARS ARE OVERDONE BUT MARKETS FACE A ROUGH PATCH AHEAD

Larry Brainard / EM Team

- **Risk:** We cut our call on EM risk to neutral owing to concerns about future Fed policy.
- **Brazil:** We maintain our positive call on equities because of the good reform prospects.
- **China**: We cut our call on equities to negative owing to the near-term economic slowdown.
- **Turkey**: We cut our call on equities to negative as the economic hard landing intensifies.

Asset Allocation View

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

This publication is part of our EM service. Click here for more details.

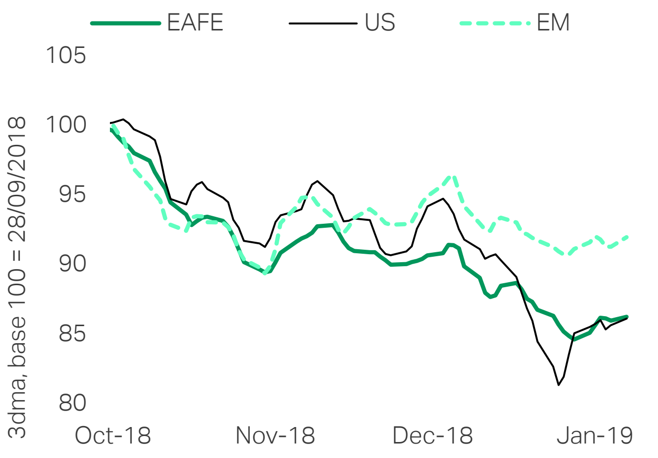
Notes on Portfolio Strategy

Below we explore in more detail the assumptions and judgments behind our current portfolio strategy recommendations.

China fears are overdone but markets face a rough patch ahead

Our positive call on EM risk last month played out well, at least relative to what happened in developed markets. As Chart 1 below illustrates, EM and DM equity markets moved roughly in lockstep from October to mid-November, falling roughly 8% on average. Thereafter, the aggregate MSCI EM index in dollar terms significantly outperformed DM indices, finishing the year unchanged over the last six weeks of 2018. Meanwhile, the respective MSCI DM equity indices (US and EAFE) fell another 7% over the period.

Chart 1: MSCI equity indices ($ terms)



Source: Bloomberg, TS Lombard.

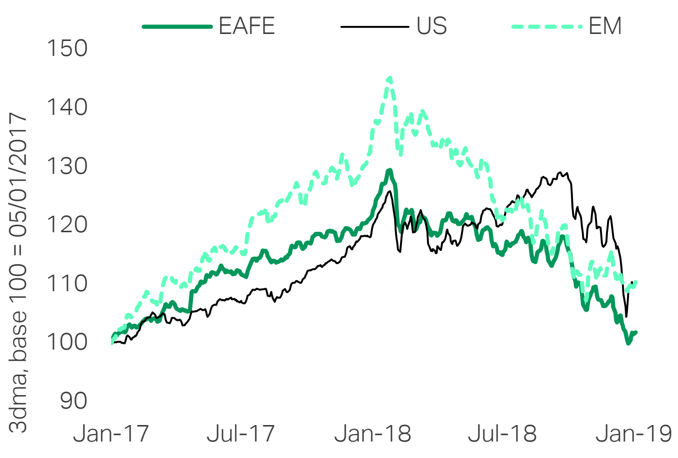
Chart 2: MSCI China vs. US ($ terms)

Source: Bloomberg, TS Lombard.

For the year as a whole, however, EM equities significantly underperformed US stocks, falling more than 16% vs a 7% decline for US equities. The difference is largely explained by the roughly 7% decline in EM equities in the four months from June through September and a corresponding rise in US equities of 8% over the same period; we anticipated EM weakness by moving to a negative call on EM risk in our Monthly Strategy of May 2018 before gradually raising it in October and December. Our decision to hike our call on EM risk to positive last month was based on our judgment that much of the bad news for EMs had been priced in by December; we did not anticipate a selloff in US markets at the time, but EM markets performed better than otherwise might have been expected.

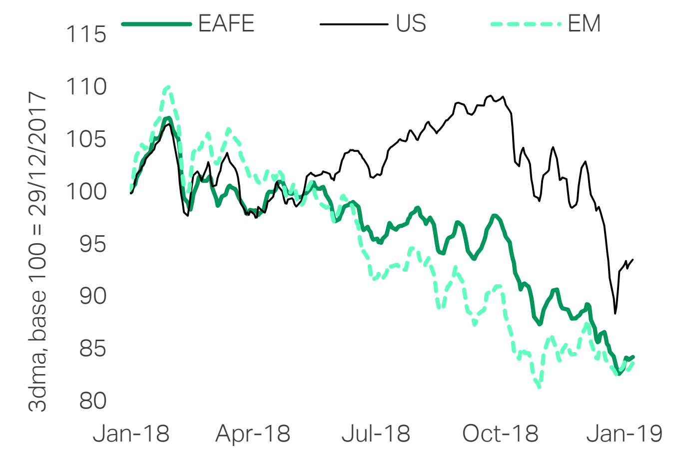
An interesting result highlighted by Charts 3 and 4 below is that EM equities finished last year with a performance almost identical to that of the EAFE Index (developed markets excluding the US and Canada). Moreover, on a two-year basis, EM equity performance is in line with US equities: both were up 9%, while outperforming the EAFE markets by some 10 percentage points.

Chart 3: MSCI equity indices ($ terms)



Source: Bloomberg, TS Lombard.

Chart 4: MSCI equity indices ($ terms)



Source: Bloomberg, TS Lombard.

We remain generally positive on the outlook for EMs in 2019, but several developments have led us to reduce our overall risk call to neutral. Foremost among them is the communications flip-flop by Fed Chair Jerome Powell over the past four weeks. We, along with most of the market, had expected a "dovish hike" at the 18-19 December FOMC meeting but instead got a more hawkish message that seemed to ignore markets signals that it was time for the Fed to pause its current rate-hiking cycle. In particular, the inversion of the yield curve at the short end and abundant signs of a slowing economy, led by weaker capex, should have set off alarm bells. Instead, we got a performance from Powell that appeared stage-managed by Fed economists running their models behind the scenes and oblivious to market realities.

Powell then went on to use comments at the American Economic Association meetings last Friday to spin a very different message to markets, namely that he is "flexible" and that the Fed may pause further tightening and possibly revisit plans to run down the Fed's balance sheet. My colleague Steve Blitz has provided a detailed analysis of Powell's flip-flop here.

Our takeaway from this episode is simply that Powell may be less attuned to markets than we had assumed. This creates uncertainty and is likely to fuel market volatility until the Fed makes clear that it will pause rate hikes. All we have now are "maybes", not certainties. This is the primary reason we have cut our call on EM risk to neutral and why we think a rough patch lies ahead for markets in the near term.

In terms of other positive factors that we highlighted last month when moving to a positive call on EM risk, the current outlook for China risk and the trade war gives us less concern. We had been highlighting the developing economic slowdown in China for some time, so the disappointing economic data released over the past four weeks were no surprise. We are now also seeing policymakers step up monetary and fiscal stimulus measures, as we anticipated and as they have always done in the past. As we note below in the China section, growth will ease to a projected 6.2% this year, down from 6.5% in 2018, thanks to these stimulus measures, which will likely begin stabilizing the economy in the next four to six months. We conclude that fears related to China are overdone.

Nonetheless, several aspects of China's economic slowdown are quite different from those seen in previous downturns and therefore deserve special attention. As China Research Director Bo Zhuang highlighted in recent reports (here and here) policymakers are unlikely to roll out across-the-board stimulus as they did in 2008 and 2015-16. Instead stimulus will be more limited, targeted at infrastructure investment and consumption but not property. Furthermore, the top leadership's commitment to cap rising debt levels will continue, albeit with an evident easing of pressure on firms and more determined efforts to open credit channels to SMEs, which have been adversely affected by the debt squeeze.

Other important changes reflect the effects of the trade war on China's economy. The first is the unavoidable slide of China's current account into deficit. Export growth, for example, will plummet in Q1/19 owing to the large-scale frontloading of export deliveries to the US in Q4/18, when firms expected Trump to escalate tariffs from 10% to 25% on a base of some US$200bn of products. US data from California's Port of Long Beach, for example, indicate record inventory levels of containers from China. Until such inventories are worked down, Chinese exports will slump, dragging down GDP growth in the current quarter and most likely increasing deflationary pressures on the yuan.

Meanwhile, we think the ongoing trade negotiations between the US and China will eventually result in agreements on increasing Chinese imports of US goods, among them agricultural and energy products. The bottom line is that China's current account will move into deficit beginning in Q1/19.

A less obvious consequence of the lagged effects of the trade war is that the deflation of prices of Chinese manufacturers will mount. Facing existing tariffs and fearful of possible new ones, Chinese firms will aggressively move to reorient underused capacity to production for domestic markets, likely modifying products to meet domestic market preferences or even to produce new ones. Parallel efforts will undoubtedly focus on increasing sales elsewhere other than to the US, i.e. other EMs, Japan and Europe. The net result will be increasing deflationary pressures, not only in China's domestic market but potentially in other markets as well. Such deflationary pressures are likely to materialize for individual product lines rather than across the board. In the context of decelerating global growth, such developments could prove problematic for countries facing an economic slowdown. The return of China to exporting deflation will not be welcomed anywhere.

China's slide into deficit on the current account and rising deflationary pressures for manufactures should temper investors' optimism about current positive news on new stimulus measures.

The good news on the trade war front is that a less-damaging trade war is likely. As my colleague Jon Harrison argued in our 7 January 2019 EM Watch a pause in trade war frictions would be positive for EM assets. Our judgment is that Trump is in a serious bind owing to new domestic political pressures from the Democrat-led House of Representatives, last month's market turmoil and slowing US economic growth. Trump's braggadocio has at last been shown for what it is, namely empty words, and people are paying attention. In our view, US market volatility and the lack of any positive results from his trade war campaigns will rule out new tariff escalation. Instead, we think China's negotiators will offer concessions that will result in a long-running series of negotiations with limited market impact, i.e. they will offer Trump the opportunity to claim "victory". In this scenario, we expect Trump to shift his focus to imposing tighter controls on US exports of so-called emerging technologies; such initiatives will have a significant impact on US tech firms, but a more limited impact on the broader market.

Judging from the above anticipated developments, the adverse spillover from Trump's trade wars will likely be much broader and deeper than anyone thought a year ago. For example, steel tariffs, which were claimed to provide protection for US industry and led to an immediate rise in steel prices, have failed to deliver their promised benefits. US steel prices have dropped 21% since reaching their peak and are today below the levels before Trump announced the tariffs a year ago. There are multiple reasons for this outcome that go well beyond tariffs; but the lesson to draw from the past year is that steel is a globalized industry and tariffs cannot protect the US industry from global developments. More broadly, Trump's launch of protectionist trade policies in early 2018, at a time when the US economy was expanding strongly in the wake of major corporate tax cuts, led to increased uncertainty and was a factor in the slowdown of capex expenditures by US firms. US steel firms would likely have been better off with higher overall business capex and higher sustained US growth than with tariff protection.

Those with an optimistic bent of mind will be hoping that Trump has now become a prisoner of all the contradictions his reckless trade policies have created and that his ability to create more havoc will thus be limited. However, it is too early to make such a call; and markets will meanwhile have to get through the rough patch that lies ahead.

January Strategy Roadmap

Overview

- **Risk**: We cut our call on EM risk to neutral largely owing to concern about the direction of Fed policy. As we detailed in our Notes on Portfolio Strategy above, we were surprised by Fed Chair Powell's communication flip-flop from hawkish to dovish over the past four weeks. This has created market uncertainty and will most likely fuel volatility until the Fed makes clear it will pause rate hikes.

- **Asset classes**: This month we adopt positive calls on EM currencies and local rates. We maintain our negative call on credit as we think the prospects for spread tightening in the current environment are dim. At the same time, we cut our call on equities to negative owing mainly to concerns about slowing global growth.

Equities

- **China:** Targeted monetary and fiscal stimulus will limit the current downturn, but Q1/19 growth will weaken further before stimulus measures have an impact. Deflation of manufactures prices will keep headline inflation around 2% this year. Although we believe equities are currently oversold, we cut our call to negative because more positive economic data are unlikely before Q2/19.

- **Brazil:** The new government has hit the ground running with comprehensive reform plans. Meanwhile, benign inflation and rising economic confidence promise stronger growth for this year. We retain our positive call on equities.

- **India:** Ahead of the April-May national elections, fiscal stimulus programmes and cuts in the RBI's policy repo rate will likely support a near-term rally in stocks. We raise our call on equities to positive. The pay-back will come after the elections as the BJP faces the loss of its majority in the parliament.

- **Russia:** A squeeze on consumption and a growing risk of sanctions are in prospect. We maintain our negative call on equities.

- **Mexico:** Markets have settled down following approval of the government's conservative 2019 budget. We are positive on local rates, credit and the peso but believe stocks will lag following a strong 5% bounce last month. We maintain our negative call on equities.

- **Indonesia:** Sustained growth of around 5% and stable headline inflation in the 3-3.5% range are positive for the outlook. Political stability appears assured, too, since President Jokowi's ratings are well ahead of those of his leading opponent in the upcoming elections. We maintain our positive call on equities.

- **Philippines:** Falling inflation and strong economic growth are favourable for the outlook. We maintain our positive call on equities.

- **Thailand:** Very low inflation and improving growth are positive for the outlook. Foreign trade is increasingly affected by the redirection of exports away from China, but overall performance remains strong. We hike our call on equities to positive.

- **South Africa:** In the run-up to the national elections in May, President Ramaphosa has little to offer voters other than promises. Economic growth remains lacklustre amid slowly rising inflation. We maintain our negative call on equities.

- **Turkey:** Signs of the expected hard economic landing showed up in October data. Meanwhile, consumer confidence remains very weak, suggesting further GDP declines are likely in H1/19. Although the lira and local rates may continue to gain from oversold levels, we cut our call on equities to negative as we think the developing recession will be stronger than the consensus believes.

Note: Yields and rates are as of 09:00h GMT on 9 January 2019

Our next EM Strategy Monthly will appear on 1 February 2019

Asset allocation performance

Value added since our 4 December 2018 Asset Allocation View

The charts below illustrate the tactical value added over the past month of the asset allocation views presented in our 4 December 2018 EM Strategy Monthly.

EM equities have fallen by around 5% over the past month, compared with a similar loss on US equities. At the same time, an improving EM inflation outlook has driven a positive performance in many local debt markets, which is consistent with our overall view.

Our positive call on Brazil fared well across all asset classes. We believe that favourable sentiment for the new administration still has further to run. However, our overall asset allocation value added in equities was let down by an incorrect calls on China and Mexico.

Our asset allocation views generated positive value added in currencies, local debt and sovereign credit. Among our most successful views were the positive calls on the Mexican peso and on Mexican fixed income. Also, our negative call on Russian assets proved correct.

Chart 1: Equity value added (%)

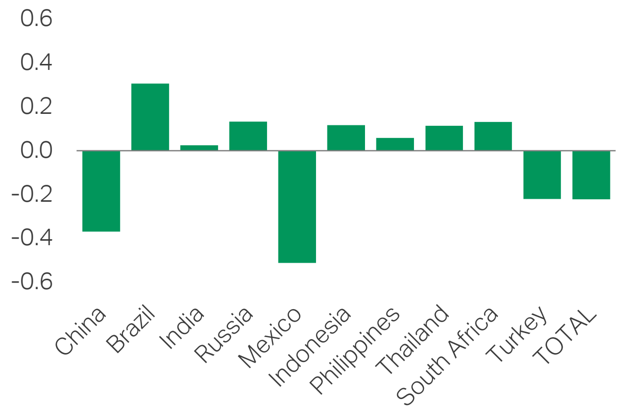


Chart 2: Currency value added (%)

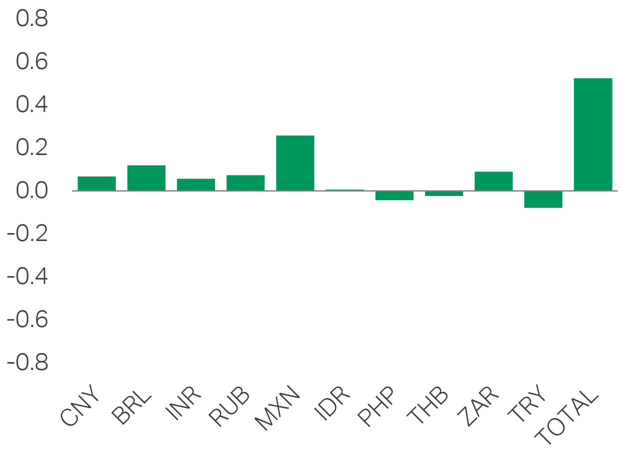


Chart 3: Local market value added (%)

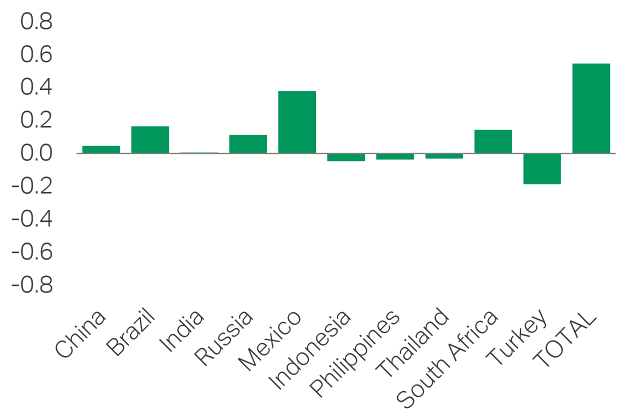
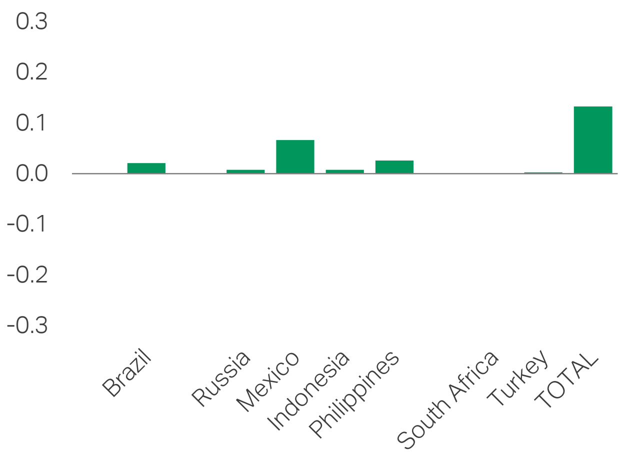


Chart 4: Sovereign credit value added (%)



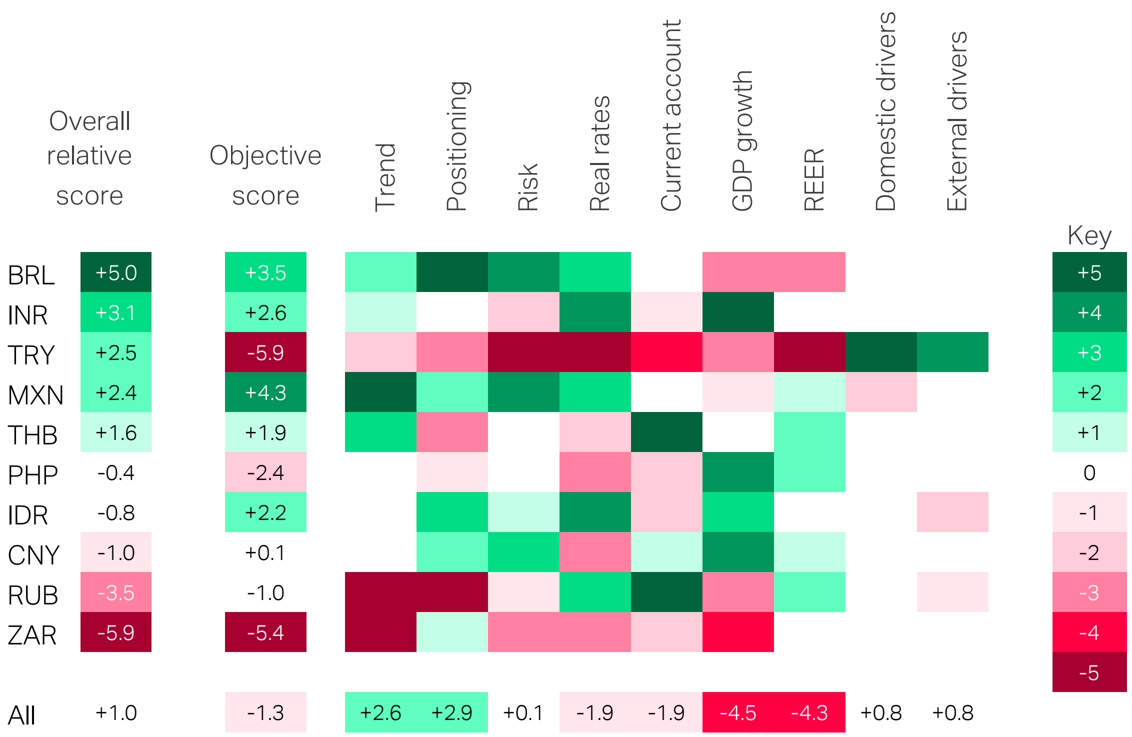
Sources: Bloomberg, TS Lombard.

FX Scorecard

We are positive on BRL, INR, TRY and negative on CNY, RUB, ZAR

The figure below presents our latest FX Scorecard. We last updated the FX Scorecard in our 4 December 2018 EM Strategy Monthly. For further explanation, see our methodology.

FX Scorecard: Relative scores for EM currencies



CNY

We maintain our negative view of the renminbi. The depreciation of the renminbi last year has helped drive a recovery in export growth by raising China's competitiveness at the expense of regional peers. We continue to believe that the authorities are committed to deleveraging or at least to not allowing leverage to increase further. The economy, therefore, is likely to slow in Q1/19 before stimulus measures, including targeted tax cuts, begin to have an impact. Indeed, the latest RRR cuts mark the start of a gradual shift towards prioritizing growth (see our 7 January 2019 Daily Note). The renminbi will remain an important policy tool and the gradual depreciation prevailing for the past six months will likely continue. A more substantial depreciation is likely if the next round of US tariffs goes ahead, as threatened, at the beginning of March or if the Q1/19 slowdown is deeper than expected. Our central scenario, however, remains that US tariff escalation will likely be delay to allow talks to continue.

INR

We have turned more positive on the rupee. Among EM economies, India is one of the most vulnerable to higher oil prices, which weigh on the current account deficit, the budget deficit and inflation. The collapse of oil prices has driven inflation to its lowest level since June 2017 and will reduce pressure on the rupee. Investor focus on the Chinese economic slowdown will likely benefit the rupee at the expense of the renminbi.

At the same time, the replacement of RBI Governor Patel with Shaktikanta Das is likely to herald a more dovish monetary policy that focuses on falling headline inflation (see Chart 1 below). Indeed, the new governor has already shown an easier regulatory stance by allowing small companies to restructure stressed debt. The combination of a less hawkish central bank and further populist policies from the government, including loan waivers, is likely to boost the economy and markets ahead of the April/May national election. The chances are that the election will return Modi to power, but the opposition challenge has intensified to a greater extent than previously expected (see our 7 January 2019 EM Watch).

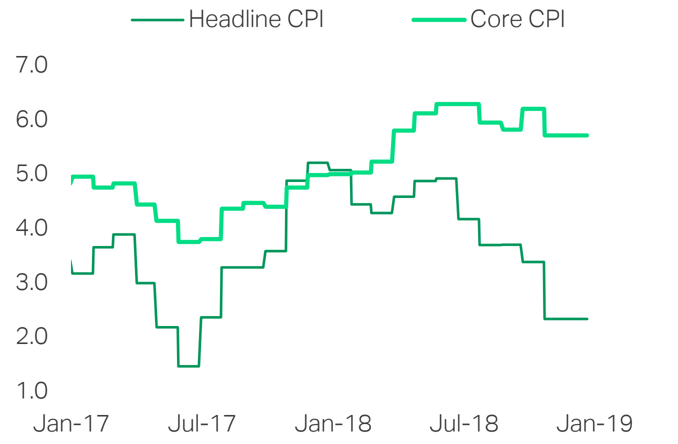
THB

We have become more positive on the baht. The Bank of Thailand finally raised interest rates in December, citing uncertainty global financial markets. Inflation risk nonetheless remains to the downside, and the central bank has signalled that it will likely pause the tightening cycle, despite higher global and regional interest rates. The baht will benefit from higher interest rates, while government stimulus aimed at boosting the economy ahead of the February general election– including infrastructure spending and measures to help the agricultural sector – will provide support for assets. The small open Thai economy is likely to be hit further as global trade slows, although the latest data support our view that exports to ASEAN neighbours and directly to the US will pick up at the expense of those to China.

PHP

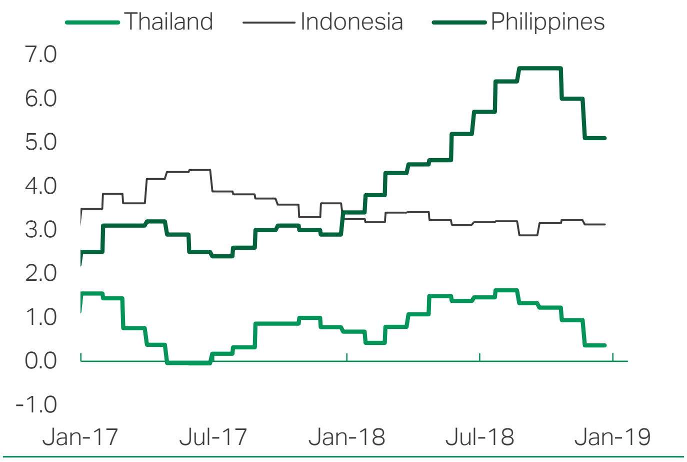
We have become more negative on the Philippine peso. Inflation has at last started to decline after rising rapidly for the whole of 2018 (see Chart 2 below). Falling inflation will put downward pressure on interest rates, although further rate hikes cannot be ruled out. Lower rates will reduce the attractiveness of the peso, although the most important driver will likely be the deteriorating current account balance. The government will continue to give priority to infrastructure, which will boost imports at a time when exports are already under pressure as a result of falling world trade volumes (see our 17 December 2018 EM Watch). Unpredictable comments by President Duterte aimed at bolstering his standing among the local electorate remain an ongoing risk to international investor sentiment; they will likely increase ahead of the June midterm elections, which will be seen as a test of the President's popularity.

Chart 1: India: Headline and core CPI



Sources: Bloomberg, TS Lombard.

Chart 2: Southeast Asia inflation



Sources: Bloomberg, TS Lombard.

Fixed Income Scorecard

We are positive on local debt in Brazil, Mexico, Turkey and negative on Indonesia, Russia, South Africa

The figure below presents our latest Fixed Income Scorecard, last updated in our 4 December 2018 EM Strategy Monthly. For further explanation, see our methodology.

Fixed Income Scorecard: Relative scores for EM local debt

	Overall relative score	Objective score	Trend	Yield vs risk	CPI surprise	FX	CPI forecast	Yield/inflation	Domestic drivers	External drivers
Brazil	+5.5	+5.0								
Mexico	+4.6	+5.3								
Turkey	+2.3	-3.0								
China	+0.7	-3.8								
Thailand	+0.1	-2.4								
India	-0.8	+4.8								
Philippines	-1.8	-1.6								
Indonesia	-2.4	+1.4								
Russia	-3.3	-0.8								
South Africa	-5.5	-4.8								
All	-0.3	+1.7	+2.9	-0.8	+5.9	-1.3	+4.7	-3.7	+1.4	-2.7

Key
+5
+4
+3
+2
+1
0
-1
-2
-3
-4
-5

Turkey

High interest rates and the disinflationary economic slowdown will benefit local debt. The government is likely to introduce stimulus measures ahead of the end-March local elections, but for now we expect the Central Bank to hold off from cutting interest rates prematurely (see our 7 January 2019 EM Watch). Inflation fell slightly in December but remains around 20%. The recovery of the lira, however, has significantly improved the outlook for inflation expectations (see Chart 1 below), while low oil prices and the economic slowdown will add further to the downward pressure on prices. Furthermore, the lira remains relatively undervalued in real effective exchange rate terms. The combination of improved export competitiveness and weak demand for imports has boosted the current account balance, reducing the risk to markets.

Russia

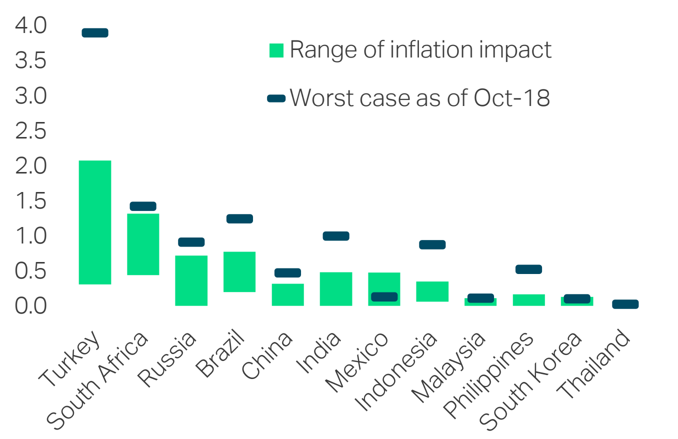
The outlook for local debt has deteriorated even ignoring the impact of possible sanctions. Inflation has been rising steadily for the past six months and there is a risk of further upward pressure on prices owing to the uncertainty over second-round effects from the increase in VAT that went into effect on 1 January (see Chart 2 below). The VAT hike will weigh on consumer demand at a time when low oil prices have already hit disposable incomes.

The prospect of US sanctions remains the most important negative driver of Russian assets. In the worst case, the US could sanction Russia's sovereign debt or target state-owned banks. The potential for reduced tension in Ukraine could ultimately present a buying opportunity. The Ukraine presidential election due to be held on 31 March will likely result in a more pragmatic government than that currently in place, which could provide a positive boost to markets (see our 7 January 2019 EM Watch)

South Africa

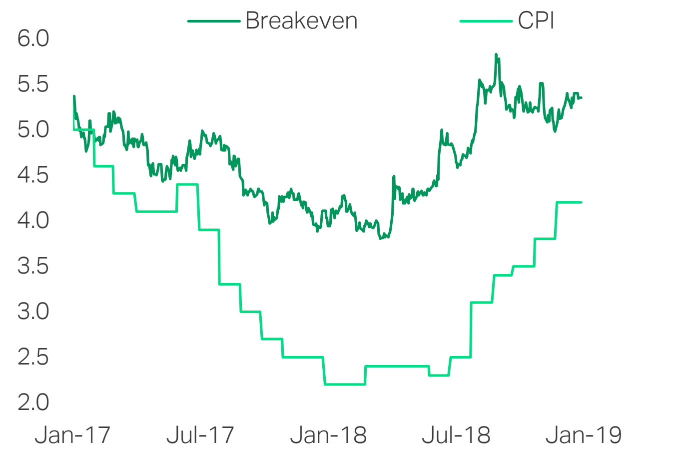
We maintain our negative view of the rand and local debt. South African markets are among the highest beta to EM risk appetite; the scaling back of Fed rate hike expectations in recent weeks has therefore benefitted both the rand and local debt. At the same time, the inflation outlook remains relatively benign, which under different circumstances could provide a favourable backdrop for local debt markets. We believe, however, there is a growing risk that South Africa's credit rating will be downgraded. The outlook for GDP growth remains weak: we forecast just 1-1.5% growth in 2019, and the government has little fiscal room for manoeuvre ahead of the national elections due later this year. The financial difficulty facing state-owned electricity producer Eskom and the risk of renewed power cuts this year is another risk to debt to GDP dynamics.

Chart 1: EM inflation impact of FX depreciation



Sources: Bloomberg, TS Lombard.

Chart 2: Russia: Breakeven inflation and CPI



Sources: Bloomberg, TS Lombard.

Absolute Views

The table below presents our high-conviction total return market views

Table 1: Current Absolute Views

Asset		Long Short	Date Opened	Units	Open Level	Current Level	Total Return
Mexico	Sovereign credit	Long	12-Jun-17	bp	149	197	-1.4%
Brazil	Local debt	Long	7-Jan-19	%	7.68	7.66	+0.1%

Date/time 9-Jan-19 08:36

Source: Bloomberg, TS Lombard.

The list of closed views is published at the end of our weekly EM Watch. 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.

CNY/IDR

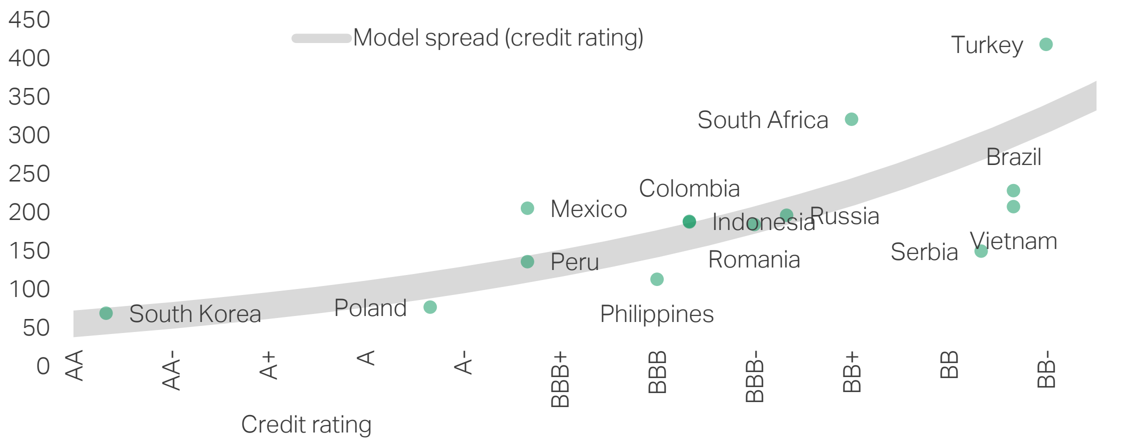
As of 7 January, we closed our short CNY/IDR position, which we had opened in our 30 July 2018 EM Watch, with a total return of 5.2% (see our 7 January 2019 EM Watch). Indonesian exports contracted by more than 3% yoy in November, following three successive months of sub-5% growth as a result of the slowdown in global growth and disruption to world trade. Exports represent a smaller share of GDP than they do for some other countries in the region, but the deteriorating trade balance will hit the current account and weigh on the rupiah. Government efforts to reduce imports have started to have an impact – import growth slowed to 12% yoy in November from 24% in October – but the improvement in trade dynamics may be too little, too late for the currency. The authorities will struggle to maintain rupiah stability amid slowing global growth and the deteriorating trade outlook.

Mexico

We maintain our positive view of Mexican sovereign credit, which opened in our 12 June 2017 EM Watch. Sovereign credit spreads tightened by around 10bps over the past month in a mixed environment for EM credit. Over the past few months, Mexican sovereign credit has widened to price in multiple rating downgrades that we do not expect to be realised (see Chart 1 below). At the same time, inflation risks have subsided and the stability of the peso will likely ensure that inflation expectations remain well anchored.

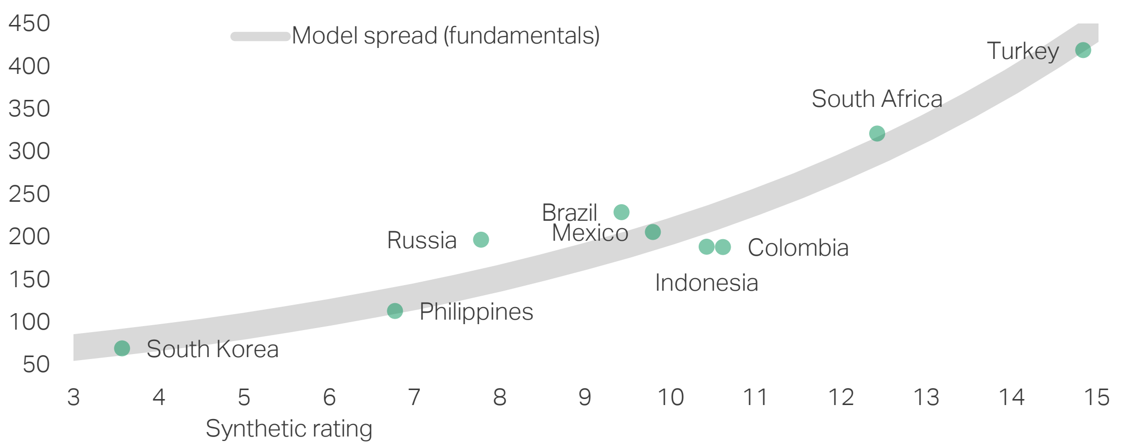
Fiscal policy is likely to be supportive, too. The 2019 budget bill appears fiscally reasonable and contains few headline surprises. Our model of credit spreads vs economic fundamentals, based on GDP per capita, budget balance, external debt to GDP and inflation, suggest that spreads remain broadly in line with comparable peers, despite recent tightening (see Chart 2 below). The AMLO government nonetheless still has an uphill battle ahead to regain investor trust after a series of missteps beginning with the public consultation on the new Mexico City airport (see our 19 December 2018 report Mexico: A closer look at the 2019 budget).

Chart 1: Sovereign credit spread vs credit rating



Sources: Bloomberg, TS Lombard. See our sovereign credit methodology.

Chart 2: Sovereign credit spread vs fundamentals



Sources: Bloomberg, TS Lombard. See our sovereign credit methodology.

Brazil

As of 7 January, we added a long Brazil local rates position (see our 7 January 2019 EM Watch). The yield on the Bloomberg Barclays Brazil Local Bond Index is currently around 7.65%, compared with inflation at 4%. Inflation expectations have fallen sharply in recent months owing to global factors and the stability of the currency. We see potential for real interest rates to decline further, perhaps by 50-100bp, if the Bolsonaro administration is able to deliver on its market-friendly privatization plan and make progress on pension reform. The new administration appears to understand the necessity to make progress on reform quickly in order to take advantage of the honeymoon period (see our 4 January 2019 report Brazil: Bolsonaro's honeymoon begins). At the same time, the Real is relatively undervalued vs its REER over the past year.

China

	Latest	Next 3-6 months
Inflation yoy%	2.2	Deflation of manufactures prices will keep overall CPI around 2%
GDP growth%	6.5	After weak Q1/19, stimulus will limit decline to 6.2% for entire year

The current economic slowdown is mostly due to the government's policy priority of putting a cap on rising leverage. The popular narrative that recent disappointing economic data reflect policymakers' failures to prevent sharp economic deterioration is wrong. The top leadership has understood for some time that an economic model based on ever-rising debt levels is not only unviable, it is also a potential risk to the political foundations of the regime – a lesson the authorities drew from the demise of the Soviet Communist Party back in the late 1980s. This is why they elevated deleveraging to a top policy priority in 2016-17 and have stuck to that stance, albeit with an easing of pressure on firms since mid-2018.

However, all has not gone well in the transition to a less debt-dependent economic growth model. The squeeze on shadow banking activity has been evident, but commercial banks have been reluctant to make up the shortfall in credit, especially for SMEs, despite various official incentives. Buoyed by some initial successes of this campaign, fiscal policy was set excessively tight at the beginning of 2018, which forced a sudden shift to fiscal easing in mid-year after growth and investment unexpectedly slowed in H1/18. Although local analysts whom we visited in Beijing last October criticized government policy for its fixation on deleveraging, we do not expect the leadership to abandon its focus on debt. Accordingly, we expect the government to continue pursuing various targeted fiscal stimulus measures, especially tax cuts and significantly higher quotas for local government special bonds to boost FAI in infrastructure. Meanwhile, monetary policy has shifted towards easing, with cuts this month in RRRs and the creation of a new funding facility for loans banks make to SMEs. Policymakers will be quick to step up stimulus should it be required, thus limiting the extent of the current slowdown.

Since September the policy response to Trump's trade war has downplayed retaliation and taken a wait-and-see posture. China appears willing to make concessions on trade and protection for intellectual property, but will continue to resist US demands to alter its state-directed growth strategy. By opting to wait and see, China's leadership believes that market and political pressures on Trump will lead him to accept a more limited deal than that which his hawkish advisors are urging. In our view, US market turmoil last month and mounting evidence of the adverse effects of Trump's trade policies on US capex and hence on growth will rule out further tariff escalation. Instead, we expect to see multiple deadline extensions turning the talks into a series of long-running negotiations with limited market impact. Meanwhile, Trump is likely to shift his focus to imposing controls on exports of emerging technologies, which will pose significant risks for US technology companies but have limited broader market impact.

Macro views

Politics	US-China trade talks appear to be moving forward
Economics	Growth is slowing, but targeted stimulus is being rolled out

Markets

Equities	-1(+1)	Concerns about slowing growth are likely to dominate sentiment
Currencies	-1	Further depreciation is likely given slowing growth
Local rates	+1(-1)	Easing monetary policies and falling rates lie ahead

Brazil

	Latest	Next 3-6 months
Inflation yoy%	4.0	Inflation likely to remain around 4% through H1/19
GDP growth%	1.3	Upsurge in confidence likely to push up GDP by 2.5-3% in H1/19

Confidence has strengthened on the improved reform outlook under the new government. When Jair Bolsonaro was sworn in as President last week, he reiterated his goal of pursuing an ambitious economic reform programme. Economy Minister Paulo Guedes appears keenly aware of the need to capitalize on the new administration's positive approval rating and to present difficult measures to the Congress as quickly as possible to improve the chances of their being passed. In this vein, Guedes plans to present his pension reform proposal this week with the goal of submitting it to the Congress in early February.

The window for reform is open. Despite legitimate concerns about the difficulties of passing unpopular structural reforms through the highly fragmented legislature, there have been some positive indications of progress on this front. Last week, Bolsonaro's Social Liberal Party (PSL) agreed to support the re-election of Lower House Speaker Rodrigo Maia, a move followed by the PSDB. Maia is a strong proponent of pension reform and his re-election will help the government to push its agenda forward. While the election of the Senate President is still up in the air, we believe the probability of pension reform being passed this year remains high. This is in large part because Bolsonaro has the popularity and legitimacy that the Temer administration lacked. But it is also because the Temer government successfully communicated the need for pension reform to the public and the issue was central to the pre-election debate. Approval of pension reform this year would send a positive message to both local and international investors, paving the way for stronger growth and a market rally. But it remains unclear to what extent the reform will be watered down to secure passage through the Congress.

Low inflation and concession auctions will likely help sustain positive market sentiment. The administration should also benefit from the short-term economic outlook. Inflation surprised on the downside at the end of 2018, aided by falling oil and electricity prices; and we expect it to remain low through H1/19. This will allow Roberto Campos Neto, the new Banco Central president, to keep rates lower for longer. For its part, short-term market sentiment will be boosted by upcoming airport, port and railway auctions, which were structured during the Temer administration. Furthermore, incoming Infrastructure Minister Tarcísio Gomes de Freitas has promised to continue to push ahead with an aggressive privatization programme. Likewise, Mines and Energy Minister Bento Albuquerque said that he plans to move ahead with the process of reducing the government's stake in Eletrobras – a statement that has further bolstered sentiment.

Macro views

Politics	February elections of Lower and Upper House Speakers key for reform agenda
Economics	Recovery likely after the extended period of recession and lacklustre growth

Markets

Equities	+1	Advance of the reform agenda to sustain rally in the near term
Currencies	+1	Foreign inflows to support the Real in the next three to six months
Local rates	+1	Weak inflationary pressures to keep rates lower for longer
Credit	+1	Positive sentiment on fiscal reform to support recovery in credit

India

	Latest	Next 3-6 months
Inflation yoy%	2.3	Slumping food prices likely to keep headline inflation below 4%
GDP growth%	7.1	Remaining in 7-7.5% range for FY19

Ahead of the April-May national elections markets are preoccupied with the risk of the ruling BJP failing to win a majority and the likelihood of new populist measures before the vote. A nationwide opinion poll released over the weekend highlighted that Prime Minister Modi is likely to fall short of a majority in the elections. In assessing these findings, India Research Director Shumita Deveshwar concluded that the elections are shaping up as a close contest with the balance of power likely to be held by regional parties. The poll found 37% support for the BJP, 30% for the Congress-led coalition and a significant 33% for regional parties. Foremost among the regional parties are the Trinamool Congress in West Bengal and the Samajwadi Party and Bahujan Samaj Party in Uttar Pradesh, which have announced a pre-poll alliance despite years of bitter rivalry. Regional parties are positioning themselves in order to play off the two major parties against each other, which will likely result in a significant future erosion of discipline on government spending.

Modi's strategy for dealing with his apparent loss of support is not yet known, but a raft of populist spending projects will likely be rolled out before the election. This week markets were rife with rumours of a major farm relief package at the national level, which resulted in upward pressures on interest rates on sovereign bonds. A number of states have already introduced farm debt waivers, but new cash handouts to farmers from the national budget would result in significant fiscal erosion. The attention being paid by politicians to distress in rural India reflects the widespread decline in farm incomes owing to falling prices of staple foodstuffs. New income support measures are unlikely to make much progress in alleviating rural poverty, but both major parties are likely to promise more money for farm families in order to gain votes.

Rising fiscal erosion led to a change at the top of the RBI. The December exit of Governor Urjit Patel and his replacement with retired bureaucrat Shaktikanta Das sparked a brief equity rally as markets expect the latter to introduce easier monetary policies and be more lenient on struggling state-run banks. Although Patel said he quit for personal reasons, a more likely scenario was that he felt pressured by the government to compromise the RBI's autonomy by transferring an unacceptably large amount of the central bank's reserves to government coffers. Patel's last MPC meeting in December opted for a "wait and see" stance with five of the six members reiterating their support for continuing the "calibrated tightening" stance favoured by Patel. A week later headline CPI was confirmed at just 2.3% yoy, well below consensus expectations. The low inflation reading, largely reflecting falling food prices, will likely provide the basis for a cut in the RBI's 6.5% repo rate when the MPC reconvenes under Das on 6 February.

Macro views

Politics	National elections will be a close contest; regional parties will be kingmakers
Economics	Growth continues on a 7-7.5% trajectory amid weak inflation pressures

Markets

Equities	+1(-1)	Fiscal stimulus and rate cuts likely to be positive for stocks
Currencies	+1(-1)	Low oil prices to support strength of the rupee
Local rates	-1	Further upward pressures on rates likely owing to higher spending

Russia

	Latest	Next 3-6 months
Inflation yoy%	4.2	Rising to 4.5-5% due to 2pp VAT hike in January
GDP growth%	1.5	Modest growth of around 1.5% likely to be sustained

A squeeze on consumption will be the main damper on overall growth. The increase in VAT from 18% to 20% on 1 January is expected to erode both real incomes and consumption especially in H1/19, in part because consumers have front-run the tax hike. Year-on-year growth comparisons will also be adversely affected owing to base effects: personal incomes were boosted this time last year by various pre-election wage and pension hikes, and there will be no such effects this year. Russian Research Director Christopher Granville noted that sales of consumer durables accelerated sharply before yearend, especially for TV sets, which were up nearly 100% in December. But most food products and consumer staples were unaffected by the VAT hike; however, their weight in overall consumption is relatively small. For the full year, we expect growth to average 1.5%; this is roughly where it ended 2018 but well below earlier hopes of sustaining expansion at more than 2%.

At the same time, ambitious government plans to boost infrastructure spending and investment have been unveiled. The Central Bank and the government drew up plans last year to channel an increasing share of total credit into priority investments; this has the potential to frontload investment-led growth in project finance and housing. The initiative, which is known as "stimulatory credit regulation" (details here), is designed to use macroprudential regulations alongside targeted government resources to create a new investment-led growth model. So far, the main progress can be seen in housing finance, where a radical overhaul and expansion of credit support is being supported by securitization. Official funding for the initiative will come from MoF domestic bond issuance of 0.5% of GDP – the so-called structure deficit. Meanwhile, the CBR plans to inject liquidity into markets via FX sales from Q2/19 onwards in order to provide market liquidity to facilitate the placement of the bonds.

The sanctions environment is likely to deteriorate further now that Democrats have taken over the US House of Representatives. Rank-and-file US legislators from both parties are targeting various actions against President Trump and Russia for alleged election interference, the use of chemical weapons in the alleged Skripal assassination attempt and Russia's actions against Ukraine. Draft legislation in Congress is targeting new Russian government bond issuance as well as Russian state-owned banks. Whether and when new sanctions are enacted is uncertain and will be caught up in Congressional efforts to implicate Trump himself. In any case, Russia is unlikely to escape new sanctions.

Macro views

Politics	New US sanctions appear highly likely
Economics	Lacklustre growth in prospect amid the emerging squeeze on consumers

Markets

Equities	-1	Sanctions risk is both high and uncertain
Currencies	-1	Lower oil prices are negative for the ruble
Local rates	-1	Upward pressure on rates will come via increased MoF bond issuance
Credit	-1	Less attractive owing to lower oil prices

Mexico

	Latest	Next 3-6 months
Inflation yoy%	4.7	Falling gradually to around 4.2-4.4% at end of H1/19
GDP growth%	2.5	Slowing to 1.7-2% for 2019 as a whole

The passage of a conservative 2019 budget late last month and the successful buyback of US$1.8bn of Mexico City Airport Bonds have buoyed market sentiment. President Lopez Obrador opted to ring in the New Year by sending positive market signals on the fiscal front, after sparking a market rout in Q4/18 with his cancellation of Mexico City's new airport. In one positive sign, new tax incentives for the northern border region – which took effect on 1 January – have been granted to selected sectors in 43 municipalities for an initial two-year period, but the limited scope of the plan will minimize losses to the Treasury. In another encouraging signal, the government not only maintained but increased the fuel tax in January in order to take advantage of current low world oil prices. In addition, despite provocations, the President has stayed conspicuously silent thus far on nearly all issues related to President Trump's border wall campaign. This helped the peso rally 5% since mid-December.

Still, there is ample uncertainty ahead for the domestic economy in H1/19. The myriad policy changes spearheaded by AMLO dovetail with investor worries about a US economic slowdown. Business confidence for the manufacturing industry contracted in December for the fourth consecutive month; and although confidence edged up for the construction and retail industries, their readings remain below 50, on balance signalling pessimism. Export growth slipped in November to 2.8% yoy, dragged down by slowing auto exports as well as lower oil exports, while imports jumped 10.4%. As a result, the trade deficit for the first 11 months rose to US$15.5bn, up 41.7% yoy. To add to the headwinds, Banxico raised its benchmark rate 25bps last month to a 10-year high of 8.25%, citing ongoing policy uncertainty. Although a stronger peso and lower global energy prices would help the inflation outlook, the minimum salary hike of 16.2% that took effect on 1 January (save for the northern border region, which saw its minimum salary doubled) is likely to offset part, if not all, of those gains. Another wild card to watch is the fuel supply shortage in at least six states after AMLO ordered key fuel pipelines to be shut down in a bid to stop fuel theft. That move could push up inflation.

While credit is tightening and consumer NPLs are on the rise, populist spending initiatives will likely aid domestic consumption of basic goods. Alongside the minimum salary hike, such initiatives include the doubling of pension pay-outs to those who are 68 and older and a new programme to aid 2.6mn youths. Other developments that should boost sales of consumer staples are record-high remittances: through November US$30.5bn of inflows were registered, surpassing the record full-year total in 2017.

Macro views

Politics	AMLO tilts towards a conservative 2019 budget
Economics	Growth is easing at the margin to slightly below 2%

Markets

Equities	-1	Upside is limited after the recent strong rebound
Currencies	+1	Positive fiscal intentions will support the peso for now
Local rates	+1	A rate hike cannot be ruled out but is less likely after December's hike
Credit	+1	Spreads are now compelling after the fiscally realistic 2019 budget

Indonesia

	Latest	Next 3-6 months
Inflation yoy%	3.1	Remaining in the 3-3.5% range
GDP growth%	5.2	Sustained growth of around 5%

In 2018 Indonesia recorded its lowest fiscal deficit in six years. Finance Minister Sri Mulyani Indrawati said the estimated deficit was 1.7% of GDP, narrower than the initial government target of 2.2%. The primary balance was US$283mn in surplus. Strong growth in budget revenues supported by high oil prices and a weaker rupiah was the main reason for the deficit reduction. Government spending will likely see a boost ahead of general elections in April, but we expect the fiscal deficit to remain below 2% of GDP as the government aims to tighten fiscal policy to support investor sentiment and sustain portfolio inflows into domestic bonds.

The trade deficit widened in November but import growth decelerated as government control measures proved effective. Imports grew 11.7% yoy, the slowest growth rate since March 2018, owing to a 2.1% yoy decline in imports of capital goods, which reflects the government postponing big infrastructure projects. The growth of customer goods imports decelerated to 6.8% yoy, down from 20.1% the previous month, aided by hikes in import tariffs in Q3/19. Exports fell 3.2% yoy vs 3.6% growth in October owing to a 6.5% yoy decline in manufacturing shipments driven by trade war uncertainties and weak export sales of palm oil due to lower prices. The trade deficit was the widest in more than five years (US$2.1bn) but we expect it to narrow this year as government measures continue to reduce imports and exports potentially benefit from recent government foreign trade deals. The main risk to the export outlook are lower commodities prices associated with slowing global growth.

The tightening cycle is nearing its end. At its December meeting, Bank Indonesia kept its policy rate at 6%, as widely expected. The bank continues to focus on currency stability but its pronouncements appear less hawkish than earlier. Given that the current account is still under pressure and the external environment remains volatile, it is too early to call the end of the tightening cycle; however, it is clearly not far off. We think BI will increase policy rates this year only in anticipation of a Fed rate hike in an effort to maintain interest rate differentials – a Fed pause would lead to a similar deferment of BI rate hikes.

Ahead of the 17 April elections, the government will increase cash handouts for poor families. President Jokowi said that outlays under the Family Hope Programme – a government initiative that offers a basic payment of US$130/year for nearly 10 million families – will increase to US$2.4bn from US$1.3bn in 2018. The government also plans to increase the number of households benefiting from the scheme. These moves further increase the odds of Jokowi's re-election. Latest polls show that he has a wide lead over his main opponent, Prabowo Subianto.

Macro views

Politics	Jokowi will likely win the presidential election in April this year
Economics	Economic growth is relatively strong and inflation stable

Markets

Equities	+1	Positive fiscal and political trends will buoy stocks
Currencies	-1(+1)	Narrowing of CAD will be pushed back owing to weak exports
Local rates	-1(+1)	Likely to lag following recent strong portfolio inflows
Credit	0(-1)	Narrowing budget deficit is a positive

Philippines

	Latest	Next 3-6 months
Inflation yoy%	5.1	Gradually easing to 4%
GDP growth%	6.1	Strong growth of 6.5% will be driven by infrastructure spending

Inflation continues to decline. December headline inflation came in at 5.1% yoy, down from 6% in November, well below the 5.6% market consensus. Easing food inflation was the primary driver, decelerating to 6.7% yoy in December vs 8% in November. Food prices, which account for 38.3% of the CPI basket, slowed their upward trajectory owing to the recent good harvests and increased imports of rice. Transport inflation eased, too, thanks to lower oil prices. Moreover, the drop in core inflation, to 4.7% from 5.1% in November, suggests that the underlying dynamics will bring about further declines in inflation. According to the Central Bank's officer-in-charge, Diwa Guinigundo, inflation could return to 2-4% target band as early as the end of Q1/19.

Bangko Sentral is unlikely to tighten this year. Following hikes totalling 175bps in 2018, the BSP decided at its 13 December Monetary Board meeting to maintain the policy rate at 4.75%. The main reason for the decision was falling inflation, which has dropped even further since the meeting. The bank's rate hiking cycle is over for now. Indeed, in making its interest-rate decisions, BSP was focused mainly on fighting inflation – unlike Indonesia, where currency stability has been central bank's main concern. Moreover, this year the BSP will likely return to its policy of cutting the reserve requirement ratio, actions that were put on hold last year in order to avoid sending the markets conflicting policy signals.

The current account deficit will remain large, thus exerting downward pressures on the peso. October imports rose 21.4% yoy, driven not only by a larger oil bill but also by purchases of capital goods and raw materials, reflecting the government's public infrastructure push. Exports remained lacklustre, growing just 3.3% yoy. Electronic shipments, which account for 53.2% of total exports and were a bright spot for most of 2018, grew just 0.6% yoy in October. The overall trade deficit was US$4.2bn – the widest in 2018 reported to date.

November trade data (due this week) will likely show lower oil imports owing to falling global oil prices. Nonetheless, we think the trade balance will remain under pressure this year: imports will continue to grow strongly, driven by import-intensive public infrastructure projects, while export growth will likely remain sluggish amid slowing economic growth in the Philippines' main trading partners (the US, China and Japan). In addition, overseas workers' remittances will likely suffer from slower global growth. We forecast the current account deficit will widen from the 2% of GDP shortfall that we estimate for 2018, maintaining downward pressure on the currency.

Macro views

Politics	The May mid-term elections will be a test of Duterte's public support
Economics	Economic growth will remain strong; we expect 6.5% in 2019 as a whole

Markets

Equities	+1	Easing inflation will boost investor sentiment
Currencies	-1(+1)	Widening CAD will exert downward pressure on the peso
Local rates	-1(+1)	Although inflation is easing, real interest rates remain negative
Credit	-1	Trading at very tight spreads relative to risk owing to strong local bid

Thailand

	Latest	Next 3-6 months
Inflation yoy%	0.4	Gradually moving up to around 1%
GDP growth%	3.3	Growth set to rise to 4%

Tourist arrivals bounced back in November, growing 4.5% yoy compared with the 0.5% decline in October. The rebound was driven by visa-on-arrival fee exemptions for the period 15 November 2018 to 30 April 2019 and robust non-Chinese arrivals (especially from Malaysia and India). Meanwhile, Chinese arrivals declined 14.6% yoy vs the nearly 20% drop in October. We expect the recovery in Chinese tourism to continue, albeit at a sluggish pace given the official discouragement of tourist travel in package tours by Beijing.

Exports weakened in November. Customs-cleared exports declined 1% yoy, vs the 8.7% increase in October, owing weaker shipments of agricultural products, cars & parts and electronics. The negative impact of the trade war can be seen not least from the decline in exports to China of 8.9% yoy, especially products reprocessed by Chinese firms for export to the US, including rubber, electrical machinery and car parts, all of which saw double-digit contractions. But the decline was partly offset by shipments to Vietnam and Japan, which may be a result of supply chain reconfigurations. Moreover, exports to the US continued to accelerate, recording 11.9% yoy growth. This partly reflects stronger shipments of computers & parts, rubber and plastics that are substitutes for similar Chinese products.

The Bank of Thailand hiked its policy rate in December but further tightening in H1/19 is unlikely. At last month's MPC meeting, members voted five to two to hike the policy rate by 25bps to 1.75%. The decision reflected concerns about financial stability risks and the BoT's desire to create policy space to be able to cut rates in the event of a future economic downturn. Given the expected slowdown in Thailand's main trading partners, the trade war uncertainties and the fact that headline inflation fell from 0.9% in November to 0.4% in December (below the BoT's 1-4% target range), we do not expect further hikes anytime soon.

The announcement of the King's coronation ceremony triggered worries that the general elections will be postponed. The date of the coronation of Rama X has been scheduled for 4-6 May, which led to suggestions by Deputy Prime Minister Wissanu Krea-ngam that post-election events could disrupt the rituals ahead of the ceremony. Last year, the election date had been provisionally set for 24 February, but last week the government failed to issue an official decree committing to that date. According to the constitution, the elections need to take place before 9 May. We think the ballot will not be postponed beyond the end of March, thereby meeting the constitutional deadline and limiting any disruption ahead of the coronation ceremony. Delaying the elections would damage the political climate and market sentiment.

Macro views

Politics	We expect the elections to be held in Q1/19
Economics	An export slowdown will be a drag on growth in 2019

Markets

Equities	+1(-1)	Confirmation of the election date will be positive for equities
Currencies	+1(-1)	The large current account surplus will support the baht
Local rates	+1(-1)	Reduced policy-rate hike risk and weak inflation are positives

South Africa

	Latest	Next 3-6 months
Inflation yoy%	5.2	Rising toward 5.5%, but remaining below SARB's 6% target ceiling
GDP growth%	1.1	Continuing positive but very weak growth of 1-1.5% this year

The economy is no longer in recession but growth is not expected to improve significantly in the near term. The economy exited recession in Q3/18 with 2.2% qoq growth, after a drop of 0.4% in Q2/18. This was largely driven by expansion in the agricultural sector (+6.5% qoq) as a result of the drought coming to an end. Retail and wholesale trade improved, too. Additionally, there were base effects at work in the third quarter owing to an inventory build-up; previous quarters had experienced constraints on consumption, which lagged after VAT had been to hiked 1pp to 15% effective as of April 2018. The manufacturing PMI for January was 49 (previously 48.2), the sixth consecutive print below 50. The marginal improvement is attributable to the low base and somewhat higher new orders stemming from anticipated increases in consumption, which were also likely aided by declining fuel prices. This does not, however, signal a renewed or improved growth trajectory: capital spending and economic investment – key factors for a meaningful improvement in the growth outlook – remain absent. Furthermore, both global headwinds and domestic factors have reduced the 2019 real GDP market consensus from 2% (as of June 2018) to the current 1.5%. Moreover, significant power outages in Q4/18 raise further concerns about the growth recovery, particularly in the manufacturing sector.

Where are the jobs? The weaker economy in 2018 contributed to worsening unemployment, which is now at 27.5%. Consensus is expecting that figure to move higher this year. Job creation is not looking promising, not least owing to noise from the CEO of Edcon, one of the largest apparel retailers in South Africa, about store closures and retrenchment as part of its plan to stay afloat, which does not bode well for the labour market. The state-owned power company Eskom is restructuring and retrenching in order to reduce its bloated wage bill; job cuts are inevitable. Other SOEs similarly taking a long, hard look at their own performance may find themselves too with the need to reduce staff as productivity remains low owing to high staff numbers and wage bills.

Elections loom. Voters remain frustrated with the lack of headway in improving growth and indebted households face significant constraints to service debts. This leaves the ANC and President Ramaphosa in a tight spot, having little to offer supporters other than promises ahead of May's elections. As we mentioned last month, the President's hands remain tied amid few real policy options as he focuses on unifying the party and thus retaining the voter base. This will leave the economy adrift in H1/19 with many of the same trends evident as in the past six months and with global headwinds blocking much-needed relief.

Macro views

Politics	Ahead of elections, Ramaphosa will provide promises but little of substance
Economics	Slow growth trajectory to continue amid a worsening labour market

Markets

Equities	-1	Little remains in the form of a catalyst for revenue growth
Currencies	-1	The rand remains vulnerable to growing twin deficits
Local rates	-1	A weakening bias is likely ahead of February's budget speech
Credit	-1(0)	Less compelling in the absence of fiscal improvements

Turkey

	Latest	Next 3-6 months
Inflation yoy%	20.3	Continuing to fall but at a slower pace; 17-18% by mid-year
GDP growth%	1.6	Negative growth over next 6 months; zero average for 2019

Financial stabilization has been sustained amid a developing economic slump. Despite weakness after the New Year, the lira has remained in the TRY5.30-5.50/US$ range since early December. This means the currency is 20% stronger than before the belated 625bps hike in the Central Bank's policy rate in early September, but markets are clearly concerned that the CBRT may cut rates prematurely. Headline inflation in December fell to 20.3% yoy, down from 21.6% the previous month, but the mom decline was just 0.4% vs 1.4% in November. Headline inflation is likely to fall gradually to around 17.5% by midyear and 15% at yearend. The lira and local rates will benefit from this trend, but gains will be more limited than in the previous three months.

GDP managed a positive 1.6% yoy advance in Q3/18, but a negative outcome is likely for Q4/18 when figures are released in March. Signs of the economy's slide into recession are seen in October data: industrial production dropped 5.7% yoy and retail sales volume plummeted 7.5%, the sharpest drop since recordkeeping began in 2010. The diffusion index of business confidence is still negative overall – at 91.5 in December (nsa) – but up from its 87.6 low in October thanks to strong export orders. Consumer confidence remains depressed: the December reading, at 58.2, is little changed from the 57.3 October low and well below July's 73.4. Manufacturing PMI data have remained in the 43-44 range over the past four months.

The mayoral elections on 31 March are being preceded by populist policies to boost support for Erdogan's AKP government. Indeed, recessionary pressures in the economy are likely to be strongest in Q1/19. The government has announced measures to ease the burden of credit card debt and to wave utility payments for households on social benefits. Further such initiatives are in the pipeline. Finance Minister Berat Albayrak announced at New Year that VAT and special consumption tax breaks targeting housing, white goods, furniture and cars that were in effect during Q4/18 and set to expire on 31 December will be extended for another three months. In other comments, Albayrak said the government was working on a package of measures to support the real estate sector and that talks with banks were ongoing to seek ways to reopen credit channels for businesses. Meanwhile, the long-anticipated assessment of the financial soundness of domestic banks, which was undertaken by the Banking Regulation and Supervision Agency, concluded on 27 December that the current capital structure of banks is "sufficient to manage the risks likely to arise through asset quality issues". In the absence of details on individual banks, markets will treat these assurances with caution.

Macro views

Politics	March local elections are likely to bring losses for Erdogan's AKP
Economics	The hard landing is now biting and negative growth is likely through Q2/19

Markets

Equities	-1(+1)	Accelerating decline of economic growth will be negative for stocks
Currencies	+1	Falling inflation should sustain further, albeit gradual, gains for lira
Local rates	+1	Short rates set to follow inflation down
Credit	+1	Bad economic news is priced in; relative value attractive

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