TS Lombard

EM IN CHARTS

DISINFLATION & TRADE

**Jon Harrison**
January 2019

GLOBAL BACKDROP

- **We cut our view of overall EM risk to neutral from moderate positive**

- **The slowdown in the US and China will weigh on EM economies**

- **The lagged impact of the Trade War will continue to hit the US, China and EM**

- **In China, front loading unwind and delayed impact of stimulus will weigh**

- **The Fed will likely "soft ease", possibly backed by slowing the pace of QT**

- **China is shifting towards monetary and fiscal easing; the RMB is a policy tool**

- **A softer dollar benefits EM, but global slowdown and trade are negatives**

- **The transition of the Trade War to a Tech War will be less damaging for EM**

- **Disinflation from China will exacerbate downward price pressures in EM**

- **Many EM have seen changes in political direction and 2019 brings new risks**

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

DISINFLATION RETURNS TO CHINA

- **Front loading of exports ahead of tariffs is now set to unwind**

- **Chinese firms will turn to the domestic markets putting downward pressure on prices**

- **PPI has fallen below CPI for the first time since 2011, which will reduce profits**

- **Exported disinflation from China will exacerbate already falling inflation across EM**
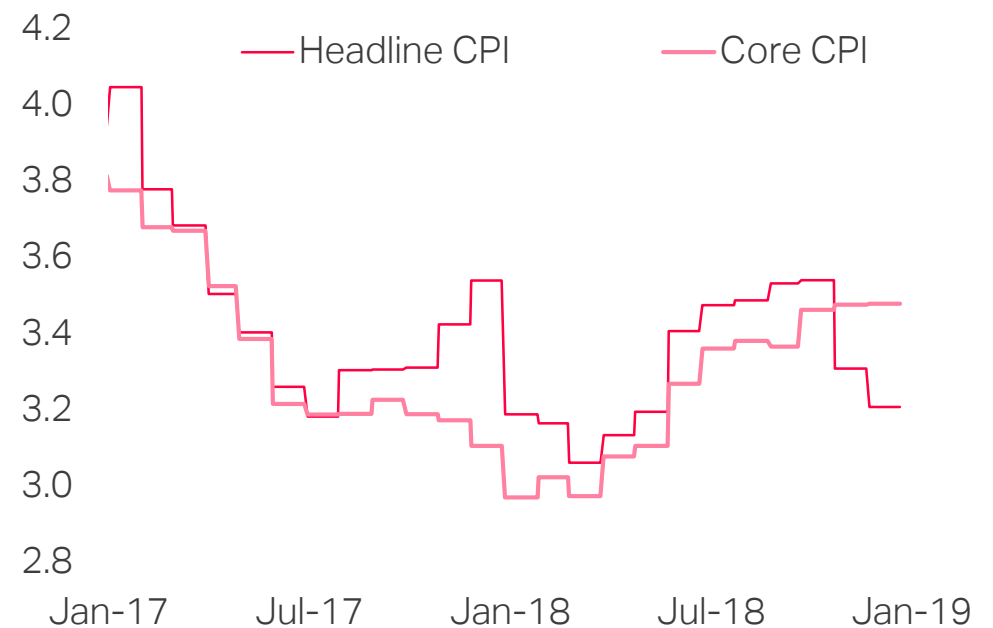
China PPI and CPI (%yoy)
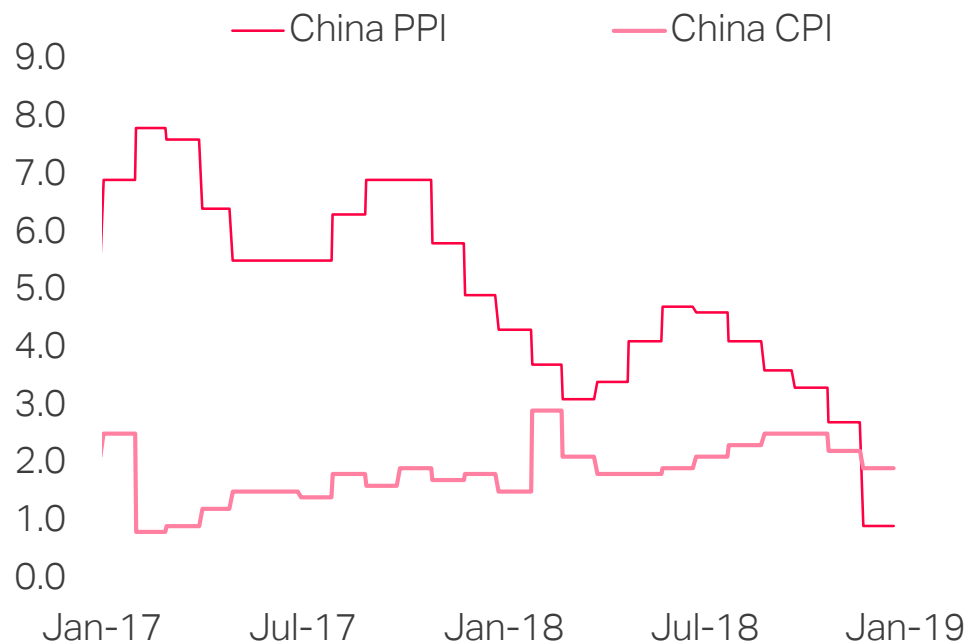
Sources: Bloomberg, TS Lombard.

EM headline and core inflation (%yoy)
(ex Turkey, Philippines)

Sources: Bloomberg, TS Lombard.

EM DISINFLATION IS BROAD-BASED

- **Headline inflation in many EM has been declining since November**

- **With few exceptions, notably Russia, EM inflation has turned lower**

- **Rising inflation in Philippines, Thailand and Turkey has now reversed**

- **The scale of the fall in inflation has persistently surprised analysts**

Monthly change in EM headline inflation
(ex Turkey)
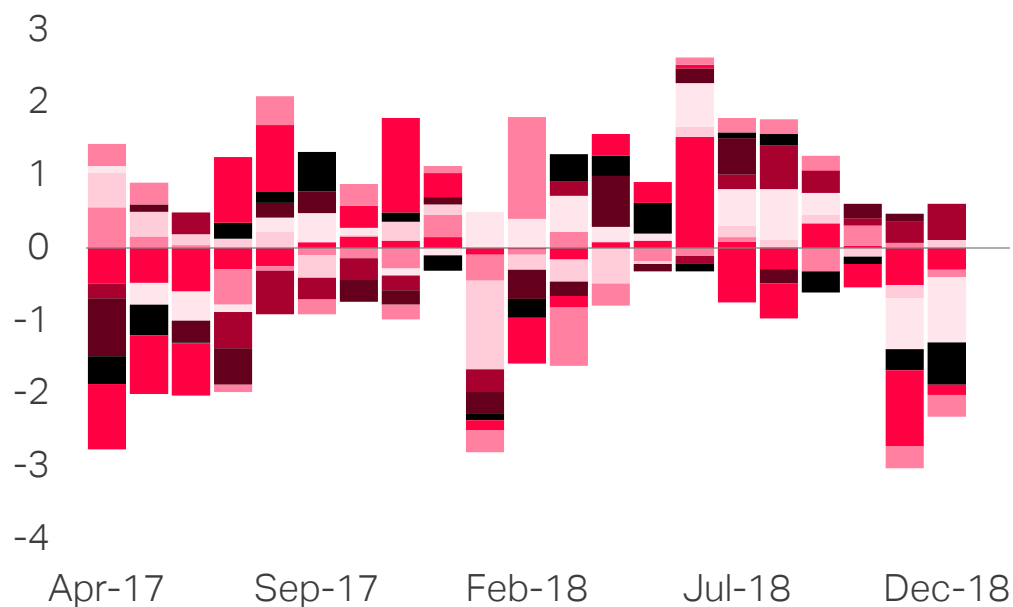
Sources: Bloomberg, TS Lombard.

EM inflation surprise
(ex Turkey, Philippines)

— Average EM inflation surprise
— Average EM inflation (RHS)
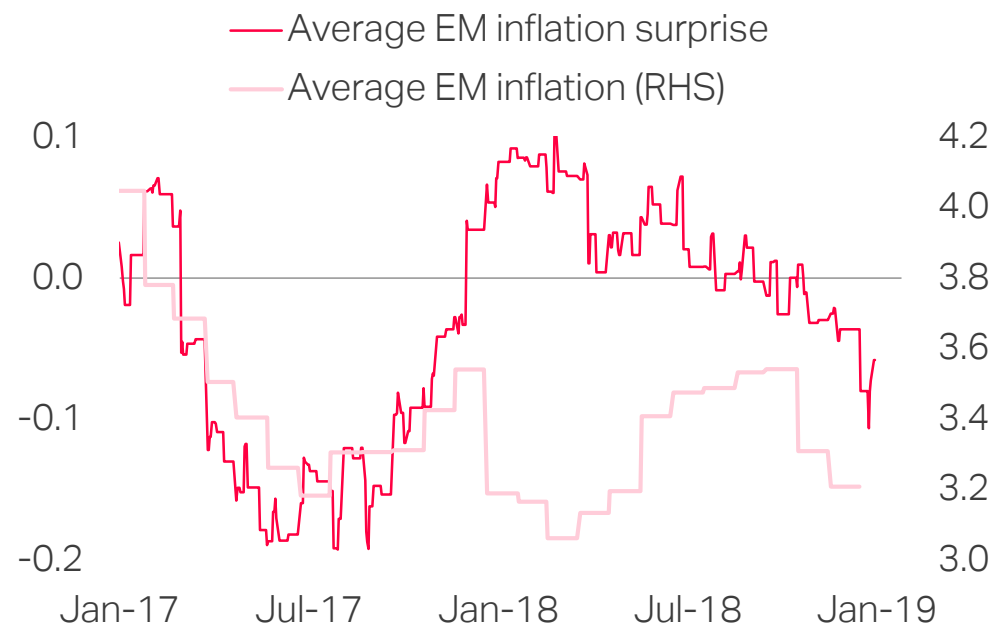
Sources: Bloomberg, TS Lombard.

THE RENMINBI IS A POLICY TOOL

- **Further China export weakness is already baked in and will weigh on current account**

- **The latest RRR cut marks the start of a shift to prioritise growth**

- **Stimulus will target infrastructure and consumption, but not property**

- **The renminbi remains a policy tool; renewed depreciation will hit wider EM FX**

USD/EM FX correlation vs USD/CNY
(3 month, daily changes)
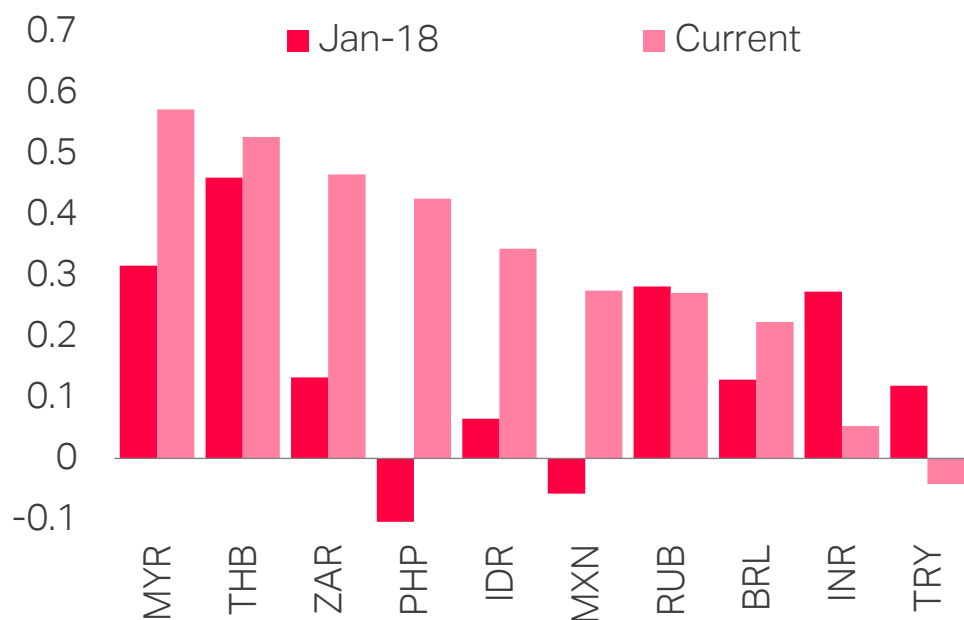
Avg EM FX correlation vs USD/CNY
(3 month, daily changes, ex-LatAm, Turkey)

Sources: Bloomberg, TS Lombard.

Sources: Bloomberg, TS Lombard.

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EM DISINFLATION TREND

- **A softer dollar and EM FX recovery has reduced inflation pass through risk**

- **Falling breakevens support a more benign inflation view**

- **Disinflation from China will exacerbate downward price pressures on EM**

- **A weaker RMB and loss of export competitiveness are risks for EM**

EM inflation pass through vs 3 months ago

Legend:
- Range of inflation impact
- Worst case as of Oct-18

X-axis: South Africa, Russia, Brazil, India, China, Mexico, South Korea, Indonesia, Philippines, Malaysia, Thailand
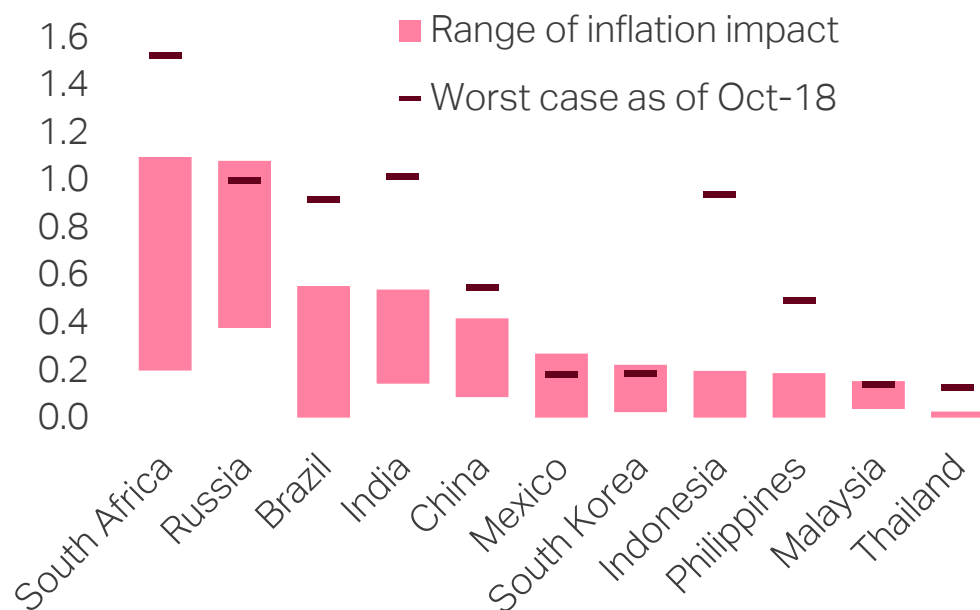
Sources: Bloomberg, TS Lombard.

EM breakeven inflation

Legend:
- EM avg. breakeven inflation (8 countries, ex-Turkey)
- USD vs EM FX (simple avg.)

X-axis: Jan-17, Jul-17, Jan-18, Jul-18, Jan-19
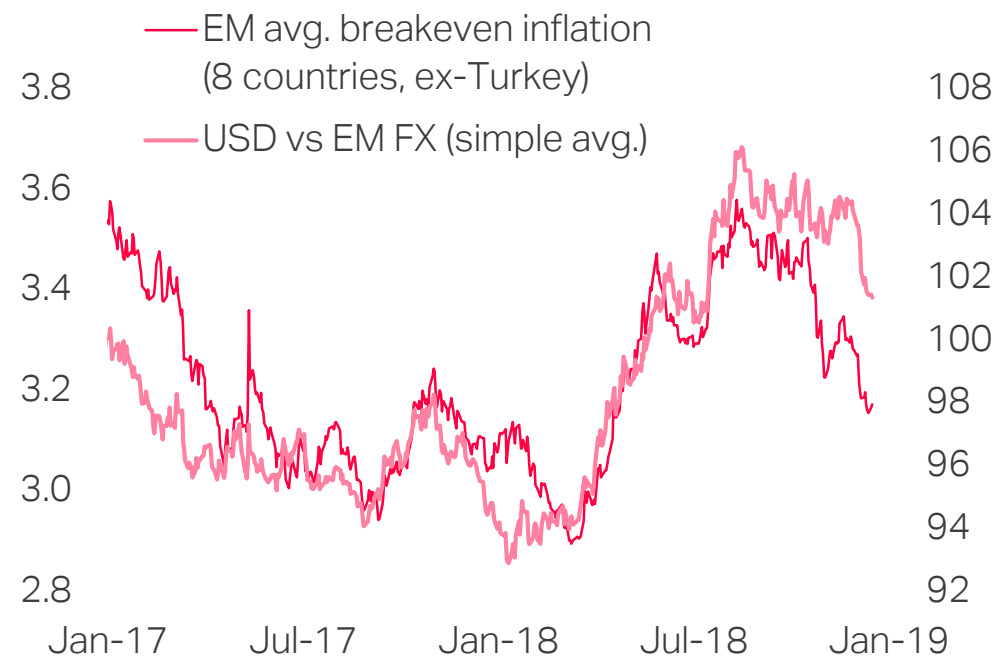
Sources: Bloomberg, TS Lombard.

LAGGED TRADE WAR IMPACT

- **EM exports have been slowing faster than EM imports**

- **EM imports are adjusting lower but current account risks have increased**

- **China's imports have collapsed and will likely slow further**

- **EM exports will suffer more short term pain**

EM avg export and import growth (%yoy)

Export growth (3m ma %yoy)

Import growth (3m ma %yoy)
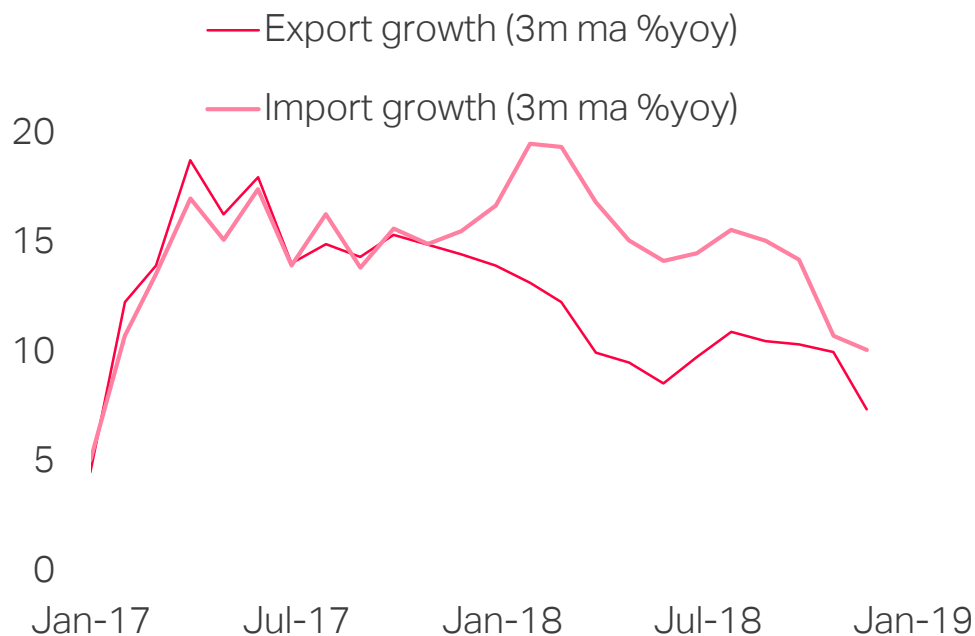
Sources: Bloomberg, TS Lombard.

EM export and China import growth (%yoy)

EM export growth (yoy, 3m ma, simple avg.)

China import growth (3m ma yoy)
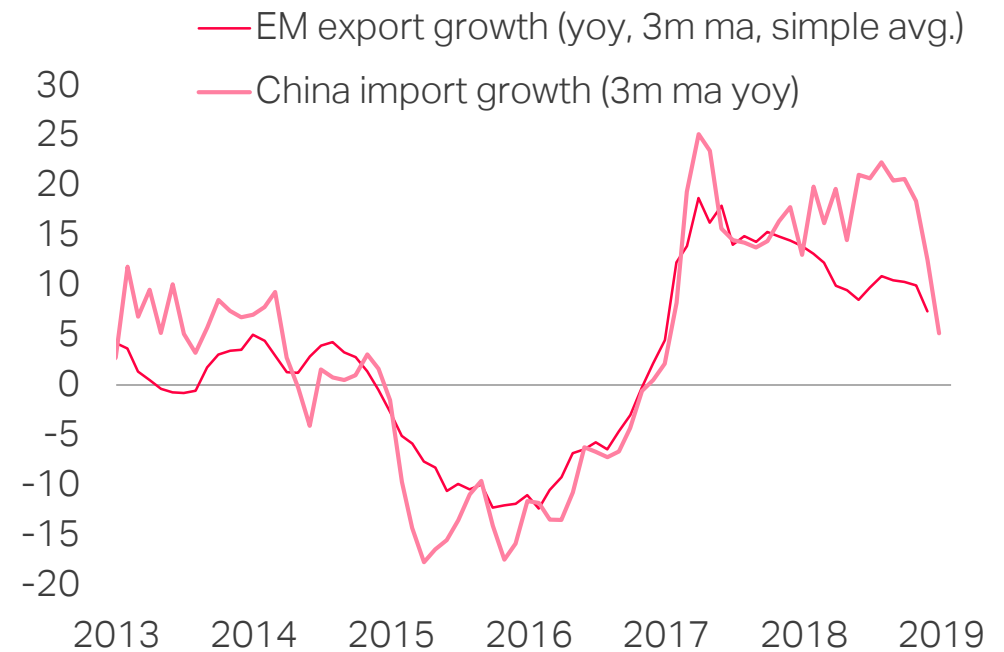
Sources: Bloomberg, TS Lombard.

TRADE WAR IMPACT

- **Short term: Lower overall world trade volumes and loss of competitiveness vs China**
- **Short term: Supply chain disruption will cut exports to China**
- **Longer term: Growing regional trade linkages will raise exports to other Asia**
- **Longer term: Rising imports from China will strengthen regional trade links**

Thailand export growth (November, %yoy)

	World	ASEAN	China	US	Japan	EU
Total	-0.9	+4.9	-9.0	+11.9	+4.3	-2.0
Machinery (16%)	-4	+1	-19	+4	+12	-9
Electrical (14%)	-6	-2	-10	-3	-12	-2
Vehicles (12%)	-6	+2	-32	-7	+42	+5
Rubber (6%)	-6	-13	-18	+14	-13	+7
Plastics (6%)	+4	+8	+6	+31	+9	+6
%Total exports		28%	12%	12%	11%	8%

Sources: Bloomberg, TS Lombard.

Thailand import growth (November, %yoy)

	World	ASEAN	China	US	Japan	EU
Total	+14.7	+14.6	+15.1	+6.0	+14.0	-6.8
Electrical (18%)	+6	-1	+12	+7	-1	+8
Machinery (12%)	+11	-4	+26	+38	+6	-4
Vehicles (4%)	+15	+1	+45	-19	+22	-1
Plastics (4%)	+11	+8	+22	+2	+13	-1
%Total imports		18%	21%	6%	14%	8%

Sources: Bloomberg, TS Lombard.

EM PRICING A TRADE COLLAPSE

- **EM export growth has slowed but EM equities have collapsed**

- **EM equity loss in 2015/16 coincided with a contraction of exports**

- **EM equities are more than pricing in a further slowdown in export growth**

- **Our model based on freight costs suggests moderation of the export slowdown**

EM export growth and equity return

—EM export growth (yoy, 3m simple avg.)
—EM equity rtn (yoy, RHS)

EM export growth vs freight cost

—EM export growth (yoy, 3m simple avg.)
—Model (China Freight + Baltic Dry)

Source: Bloomberg, TS Lombard.
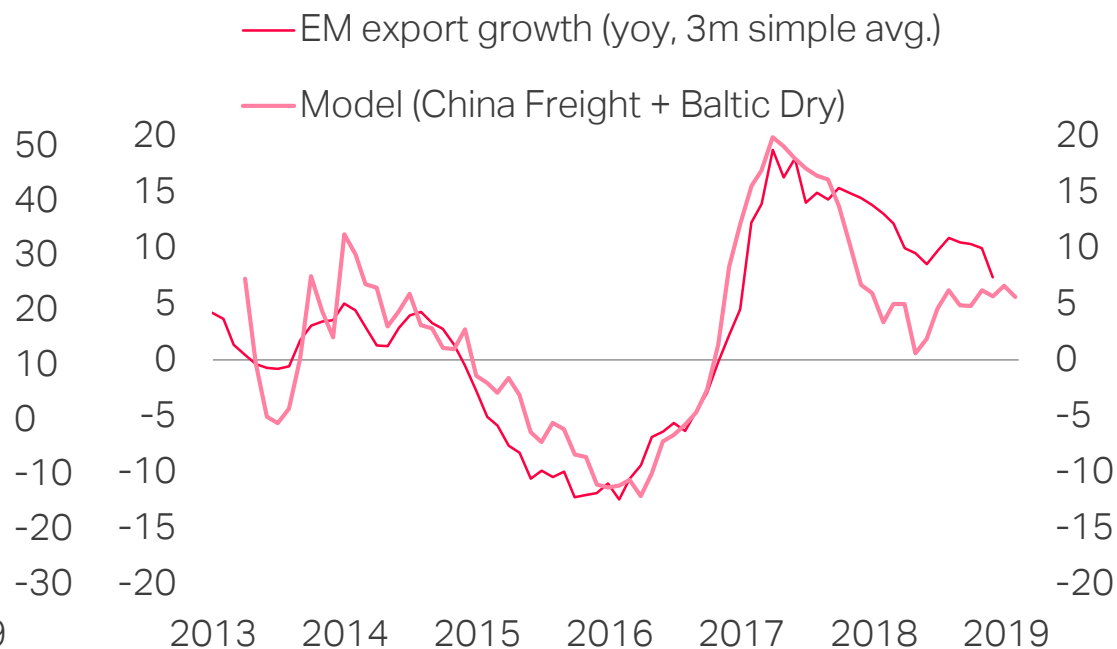
Source: Bloomberg, TS Lombard.

EM FUNDAMENTALS REASSERT

- **EM economies can be organised (very broadly) along lines of vulnerability**

- **Growth/commodity prices, liquidity and trade all impact EM economies**

- **High beta assets will outperform in the current favourable risk conditions**

- **But fundamental resilience will become more important as liquidity tightens**

Organising EM economies
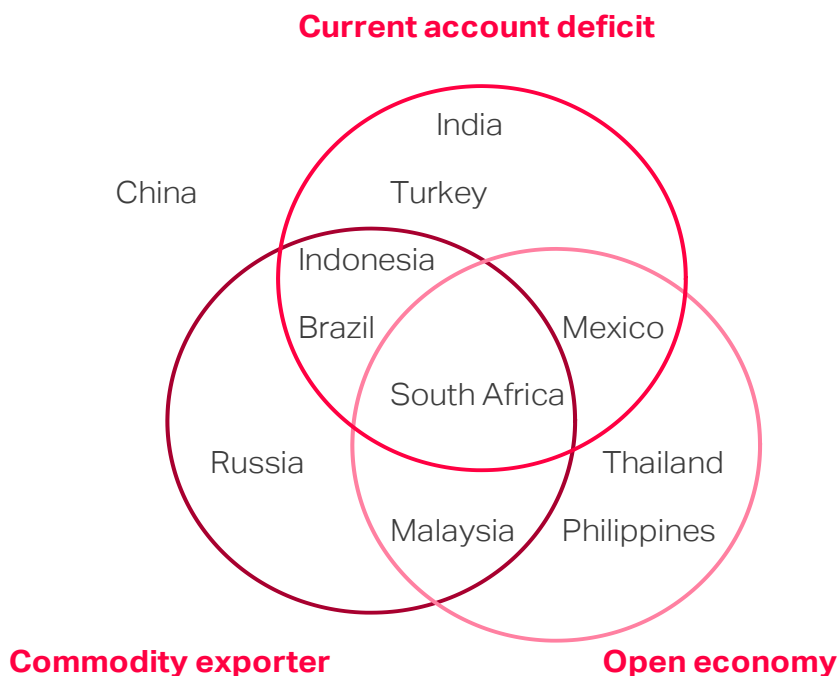
Source: TS Lombard.

EM resilience
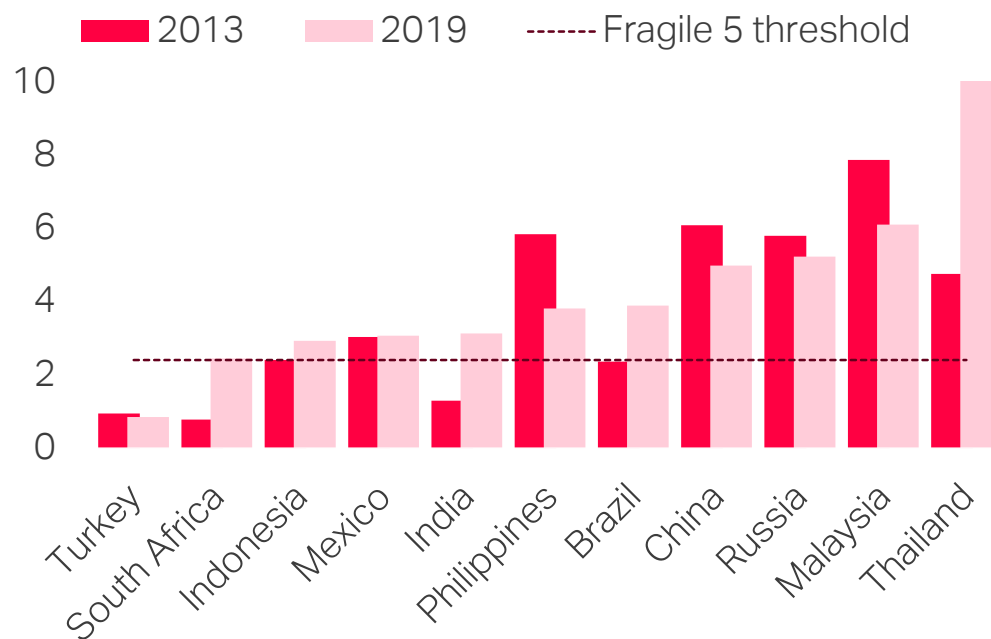
Source: Bloomberg, TS Lombard.

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EM COMBINED RISK INDICATOR

- **We combine resilience with our assessment of political/geopolitical and trade risk**

- **We have scored risks likely to emerge in H1/2019 more highly than longer-term risks**

- **We have scored the risk of a shock more highly than gradual deterioration**

- **The transition of the Trade War to a Tech War will be less damaging for EM**

EM combined risk indicator
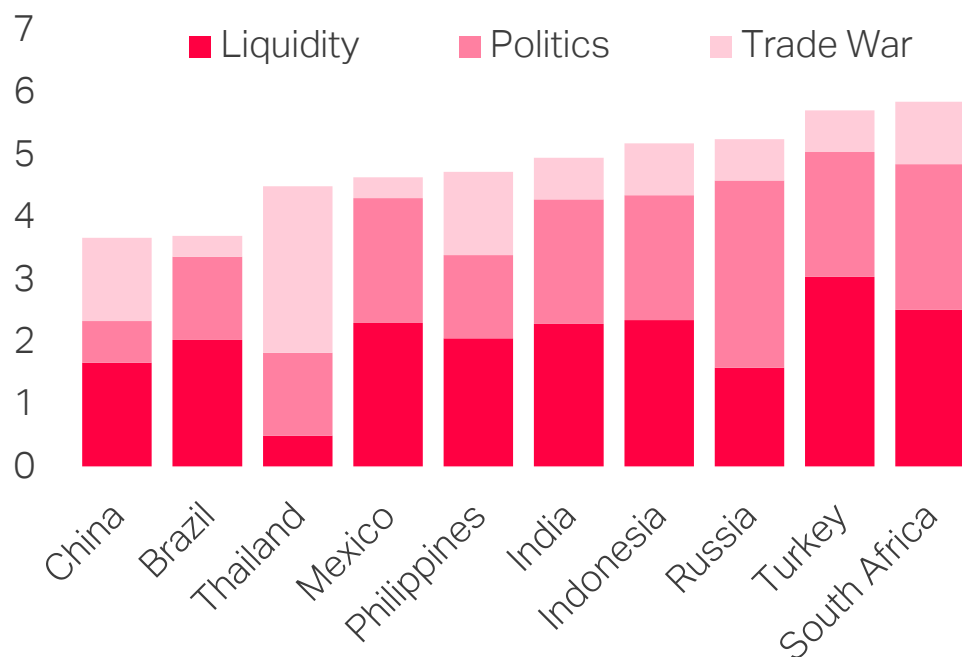
Source: Bloomberg, TS Lombard.

EM combined risk indicator
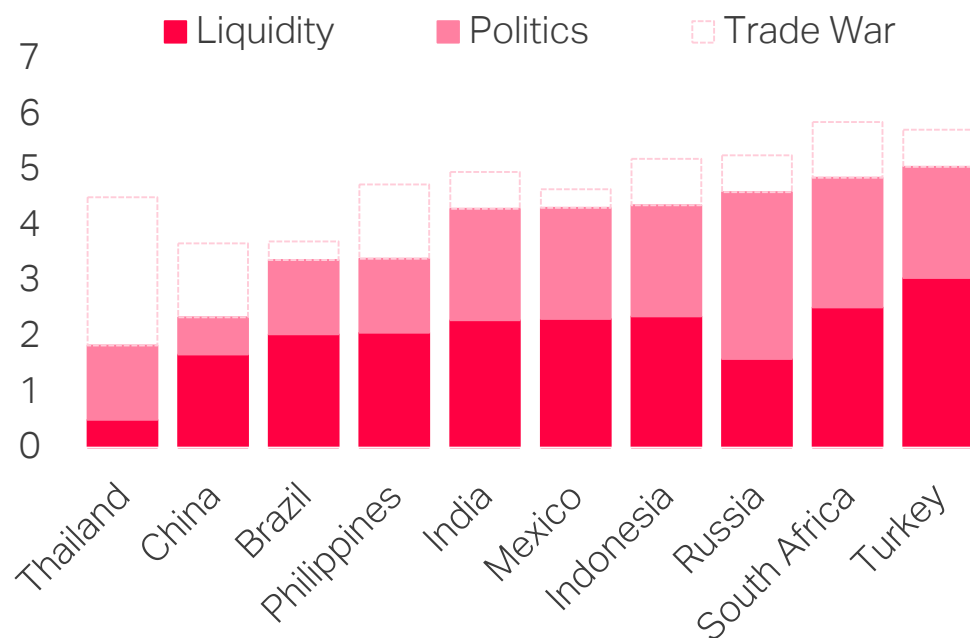
Source: Bloomberg, TS Lombard.

EM ASSET ALLOCATION

EM COUNTRY VIEWS

- **China**. Weak exports and slow growth before stimulus kicks in

- **Brazil**: Rising confidence drives markets but not yet backed by economic data

- **India**. Lower policy rates increasingly likely; oil price is key.

- **Russia**. VAT hike may raise inflation but sanctions, Ukraine main drivers

- **Mexico**. Sound budget will help but AMLO struggles to rebuild sentiment

- **Indonesia**. Trade War disruption raises current account risk

- **Philippines**. Inflation has peaked, but current account threat to peso

- **Thailand**. Baht to benefit from rate hike; election could boost sentiment

- **South Africa**. Troubled SOEs and weak growth could feed populist threat

- **Turkey**. Short term boost from pre-election stimulus and higher exports

EM ASSET ALLOCATION

Risk	0 (+1)			
	Equities ($)	**Currencies**	**Local rates**	**Credit ($)**
Asset class	-1 (+1)	+1 (-1)	+1	-1

Relative country views				Scale
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.

EM ABSOLUTE 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	194	-1.3%
Brazil	Local debt	Long	7-Jan-19	%	7.68	7.72	+0.2%

Date/time 16-Jan-19 08:39

Source: Bloomberg, TS Lombard.

Table 2: Closed Absolute Views

Asset		Long Short	Date Opened	Date Closed	Open Level	Close Level	Total Return
South Africa	Local debt	Long	10-Nov-16	3-Feb-17	9.27	9.08	+9.7%
Turkey	Sovereign credit	Long	27-Jul-16	7-Mar-17	322	311	+2.1%
Russia	Equities	Long	8-Dec-16	12-Jun-17	576.0	528.5	-8.3%
Turkey	Local debt	Long	15-May-17	11-Sep-17	10.69	10.71	+7.6%
Indonesia	Equities	Long	5-Apr-17	20-Nov-17	495.1	522.6	+5.6%
Russia	Sovereign credit	Long	16-Oct-17	16-Apr-18	140	204	-2.0%
Thailand	Equity	Long	22-Jan-18	18-Jun-18	20.22	18.35	-9.3%
Russia	Equity	Long	18-Jun-18	23-Jul-18	578.1	596.4	+3.2%
CNY/IDR		Short	30-Jul-18	7-Jan-19	2,115.0	2,055.5	+5.3%

Source: Bloomberg, TS Lombard.

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

For further explanation see our methodology.

FX SCORECARD

	Overall relative score	Objective score	Trend	Positioning	Risk	Real rates	Current account	GDP growth	REER	Domestic drivers	External drivers
BRL	+5.0	+3.5									
INR	+3.1	+2.6									
TRY	+2.5	-5.9									
MXN	+2.4	+4.3									
THB	+1.6	+1.9									
PHP	-0.4	-2.4									
IDR	-0.8	+2.2									
CNY	-1.0	+0.1									
RUB	-3.5	-1.0									
ZAR	-5.9	-5.4									
All	+1.0	-1.3	+2.6	+2.9	+0.1	-1.9	-1.9	-4.5	-4.3	+0.8	+0.8

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

For further explanation see our methodology.

FIXED INCOME SCORECARD

	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

For further explanation see our methodology.

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SOVEREIGN CREDIT VS FUNDAMENTALS

- **Fundamental model based on GDP/capita, external debt/GDP, fiscal balance, inflation**

- **Russia is cheap to fundamentals, but sanctions are the driver**

- **Fundamentals are improving in Brazil**

- **South Africa is "fair value" but credit risks are increasing**

Sovereign spread vs fundamentals

Model spread (fundamentals)
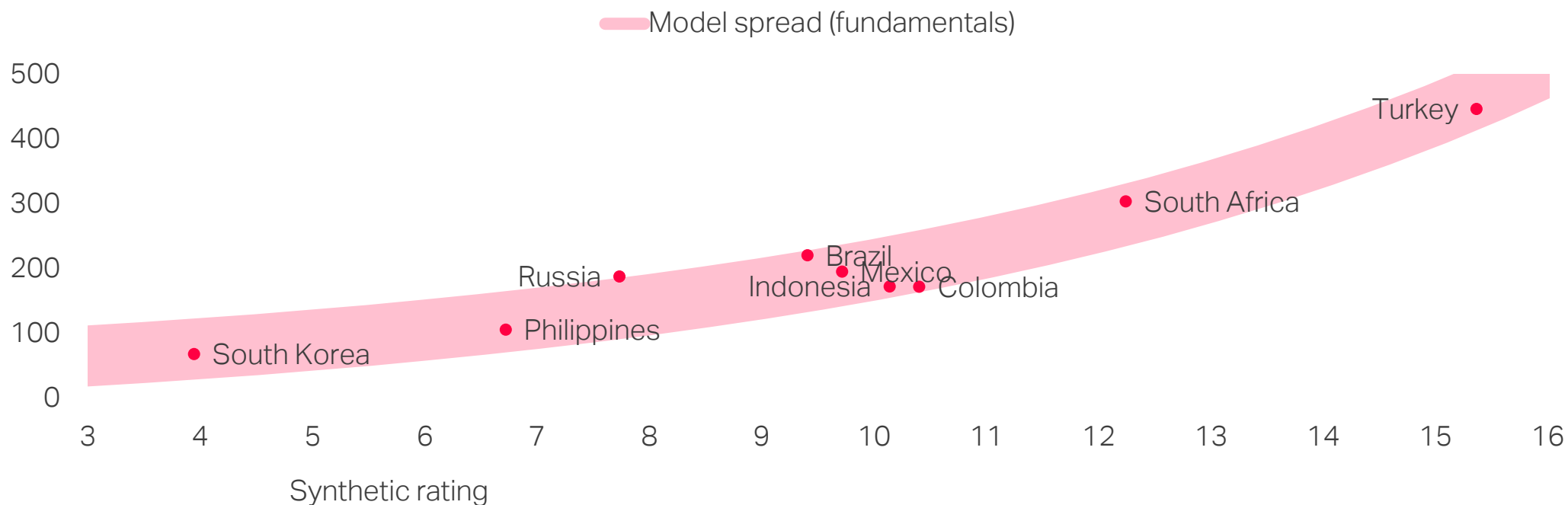
Source: Bloomberg, TS Lombard. For further explanation see our methodology.

SOVEREIGN CREDIT VS RATING

- **Our spread vs credit model includes an adjustment for duration of each index**

- **Mexico is pricing in downgrades to BB+ which appears overdone**

- **Turkey is also pricing multiple rating downgrades**

- **Russia is trading at "fair value" despite sanctions risk**

Sovereign credit vs rating + duration

SUPPLY CHAINS

SUPPLY CHAIN WAKE-UP CALL

- **A pause in hostilities reduces the urgency of relocating production away from China**

- **Supplier diversification still makes sense but could take many years**

- **Section 301 submissions by US companies favour low cost China alternatives**

- **AmCham China surveys show tentative signs of supply chain reconfiguration**

US importers' China alternatives (%)

Bar chart categories: Mexico, India, Vietnam, South Korea, Taiwan, Thailand, Canada, Japan, Indonesia, Russia, Malaysia, Germany, Italy, France, Brazil, Spain, Turkey, Philippines
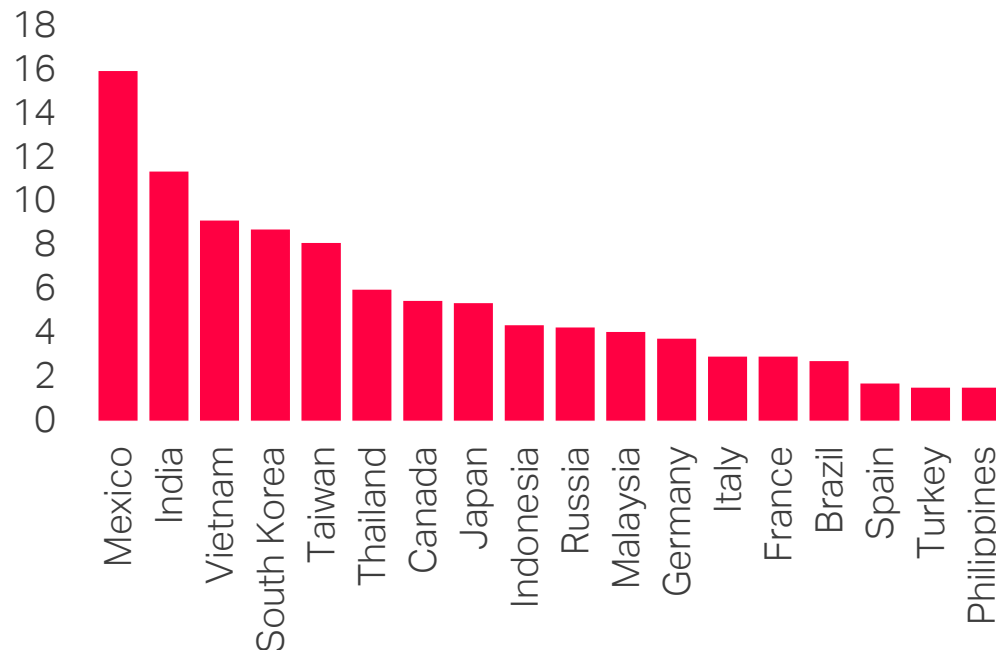
Source: USTR, TS Lombard.

Economic complexity vs GDP/capita ($k)

Labelled points: China, Mexico, Malaysia, Thailand, Philippines, Turkey, Russia, India, Vietnam, Brazil, Indonesia, Colombia, South Africa
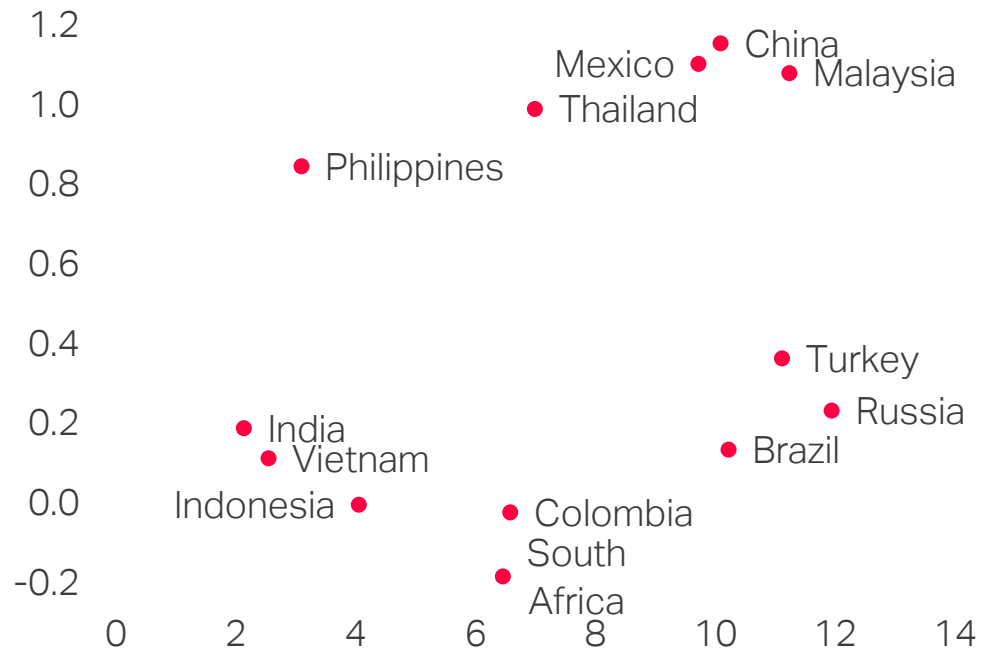
Source: IMF, Atlas of Economic Complexity, TS Lombard.

SUPPLY CHAIN WINNERS (1)

- **US imports from China in which countries are top 5 revealed comparative advantage**

- **Derived from top 100 4-digit HS codes accounting for 80% of US import from China**

- **Mexico and Southeast Asia will be the main beneficiaries**

- **A China-centred Asian trading bloc is likely to emerge**

Potential supply chain reconfiguration gain ($bn)

Source: UN Comtrade, TS Lombard.

Who has comparative advantage if not China? (major low cost economies, HS2 codes)

Category	Countries	
Electrical	Philippines, Vietnam, Malaysia, Mexico, Thailand	
Machinery	Thailand, Mexico, Philippines, Malaysia, Turkey	
Furniture	Vietnam, Mexico, Turkey, Malaysia, Indonesia	
Clothing	Vietnam, Turkey, India, Indonesia, Philippines	
Toys	Vietnam, Mexico, Thailand, Indonesia, Philippines	
Plastics	Thailand, Turkey, Malaysia, Mexico, India	
Vehicles	Mexico, Turkey, Thailand, South Africa, Brazil	
Footwear	Vietnam, Indonesia, India, Brazil, Turkey	
Iron or steel	Turkey, India, Thailand, Mexico, South Africa	
Instruments	Mexico, Malaysia, Philippines, Thailand, Vietnam	
Textiles	India, Turkey, Vietnam, Mexico, Philippines	
Chemicals	India, Indonesia, Thailand, Malaysia, South Africa	
Leather	Vietnam, India, Philippines, Indonesia, Thailand	

% US imports from China

(x-axis: 0, 5, 10, 15, 20, 25, 30)

Source: UN Comtrade, TS Lombard.

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Who has comparative advantage if not China? (major low cost economies, HS4 codes)

Category	Countries
Telephone apparatus (8517)	Vietnam, Mexico, Malaysia, Thailand, Philippines
Computers & digital readers (8471)	Philippines, Mexico, Thailand, Malaysia, Vietnam
Office machines (8473)	Philippines, Thailand, Malaysia, Vietnam, Mexico
Models & toys (9503)	Vietnam, Indonesia, Mexico, Thailand, Malaysia
Furniture (9403)	Vietnam, Malaysia, Turkey, Indonesia, Mexico
Monitors (8528)	Mexico, Turkey, Malaysia, Vietnam, Philippines
Seats (9401)	Mexico, Vietnam, Turkey, Indonesia, Thailand
Motor vehicle parts (8708)	Mexico, Thailand, Turkey, Philippines, India
Light fittings (9405)	Mexico, Turkey, Philippines, Malaysia, Vietnam
Trunks & cases (4202)	Vietnam, Philippines, India, Indonesia, Thailand
Printers (8443)	Philippines, Malaysia, Vietnam, Thailand, Indonesia
Transmission apparatus (8525)	Thailand, Vietnam, Malaysia, Indonesia, Mexico
Games (9504)	Mexico, Philippines, South Africa, Malaysia, Russia
Electrical transformers (8504)	Philippines, Mexico, Thailand, Vietnam, Turkey
Heaters (8516)	Turkey, Malaysia, Thailand, Mexico, Indonesia
Footwear (6403)	Vietnam, Indonesia, India, Turkey, Brazil
Storage devices (8523)	Malaysia, Mexico, Thailand, Philippines, India
Plastic articles (3926)	Mexico, Thailand, Vietnam, Malaysia, Turkey
Clothing (6110)	Vietnam, Turkey, Indonesia, Philippines, India
Footwear (6404)	Vietnam, Indonesia, Turkey, India, Brazil
Wires & cables (8544)	Philippines, Mexico, Vietnam, Turkey, Indonesia
Gym equipment (9506)	Thailand, Vietnam, Mexico, Philippines, India
Household articles (3924)	Turkey, Thailand, Vietnam, India, Mexico
Footwear (6402)	Vietnam, Indonesia, Brazil, Turkey, India
Taps & valves (8481)	Mexico, India, Brazil, Philippines, Turkey

US imports from China ($bn) — axis: 0, 10, 20, 30, 40, 50, 60, 70, 80

Source: UN Comtrade, TS Lombard.

Who has comparative advantage if not China? (major low cost economies, HS4 codes)

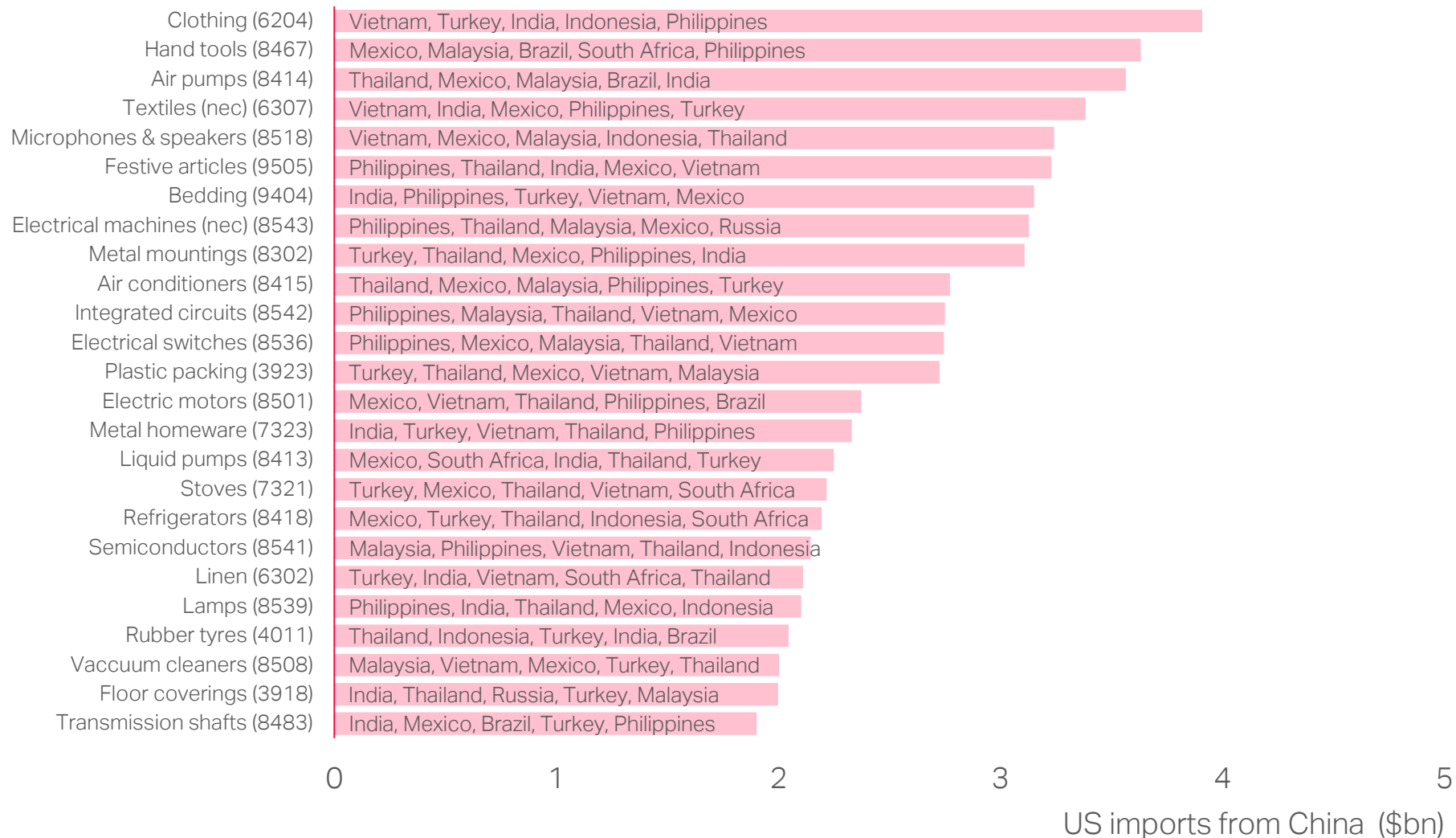| Category	Countries
Clothing (6204)	Vietnam, Turkey, India, Indonesia, Philippines
Hand tools (8467)	Mexico, Malaysia, Brazil, South Africa, Philippines
Air pumps (8414)	Thailand, Mexico, Malaysia, Brazil, India
Textiles (nec) (6307)	Vietnam, India, Mexico, Philippines, Turkey
Microphones & speakers (8518)	Vietnam, Mexico, Malaysia, Indonesia, Thailand
Festive articles (9505)	Philippines, Thailand, India, Mexico, Vietnam
Bedding (9404)	India, Philippines, Turkey, Vietnam, Mexico
Electrical machines (nec) (8543)	Philippines, Thailand, Malaysia, Mexico, Russia
Metal mountings (8302)	Turkey, Thailand, Mexico, Philippines, India
Air conditioners (8415)	Thailand, Mexico, Malaysia, Philippines, Turkey
Integrated circuits (8542)	Philippines, Malaysia, Thailand, Vietnam, Mexico
Electrical switches (8536)	Philippines, Mexico, Malaysia, Thailand, Vietnam
Plastic packing (3923)	Turkey, Thailand, Mexico, Vietnam, Malaysia
Electric motors (8501)	Mexico, Vietnam, Thailand, Philippines, Brazil
Metal homeware (7323)	India, Turkey, Vietnam, Thailand, Philippines
Liquid pumps (8413)	Mexico, South Africa, India, Thailand, Turkey
Stoves (7321)	Turkey, Mexico, Thailand, Vietnam, South Africa
Refrigerators (8418)	Mexico, Turkey, Thailand, Indonesia, South Africa
Semiconductors (8541)	Malaysia, Philippines, Vietnam, Thailand, Indonesia
Linen (6302)	Turkey, India, Vietnam, South Africa, Thailand
Lamps (8539)	Philippines, India, Thailand, Mexico, Indonesia
Rubber tyres (4011)	Thailand, Indonesia, Turkey, India, Brazil
Vaccuum cleaners (8508)	Malaysia, Vietnam, Mexico, Turkey, Thailand
Floor coverings (3918)	India, Thailand, Russia, Turkey, Malaysia
Transmission shafts (8483)	India, Mexico, Brazil, Turkey, Philippines

US imports from China ($bn)

Source: UN Comtrade, TS Lombard.

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Who has comparative advantage if not China? (36 countries, HS4 codes)

| Category	Countries
Telephone apparatus (8517)	Vietnam, Slovakia, Mexico, Czech Rep, Netherlands
Computers & digital readers (8471)	Philippines, Czech Rep, Mexico, Thailand, Malaysia
Office machines (8473)	US, Philippines, Thailand, South Korea, Netherlands
Models & toys (9503)	Czech Rep, Denmark, Vietnam, Hungary, Poland
Furniture (9403)	Vietnam, Poland, Denmark, Italy, Romania
Monitors (8528)	Slovakia, Mexico, Hungary, Poland, Czech Rep
Seats (9401)	Poland, Romania, Czech Rep, Mexico, Slovakia
Motor vehicle parts (8708)	Romania, Czech Rep, Mexico, Hungary, Slovakia
Light fittings (9405)	Mexico, Austria, Poland, Hungary, Denmark
Trunks & cases (4202)	Vietnam, Italy, France, Philippines, India
Printers (8443)	Philippines, Netherlands, Malaysia, Vietnam, Singapore
Transmission apparatus (8525)	Thailand, Vietnam, Japan, Netherlands, Hungary
Games (9504)	Poland, Austria, Spain, Japan, Czech Rep
Electrical transformers (8504)	Philippines, Austria, Denmark, Sweden, Hungary
Heaters (8516)	Romania, Turkey, Malaysia, Hungary, Poland
Footwear (6403)	Vietnam, Indonesia, Italy, Romania, India
Storage devices (8523)	Malaysia, Singapore, Czech Rep, Poland, Ireland
Plastic articles (3926)	Czech Rep, Austria, Poland, Slovakia, Hungary
Clothing (6110)	Vietnam, Turkey, Denmark, Italy, Indonesia
Footwear (6404)	Vietnam, Indonesia, Belgium, Czech Rep, Italy
Wires & cables (8544)	Romania, Philippines, Mexico, Hungary, Vietnam
Gym equipment (9506)	Austria, Czech Rep, Thailand, Italy, Netherlands
Household articles (3924)	Turkey, Poland, Denmark, Italy, Hungary
Footwear (6402)	Vietnam, Slovakia, Romania, Indonesia, Belgium
Taps & valves (8481)	Italy, Denmark, Germany, Czech Rep, US

US imports from China ($bn)

ESG SPECIAL EDITION

EM ESG – EM WATCH: SPECIAL EDITION

- **Late last year we published an <u>EM Watch: ESG Special Edition</u>**

- **Please get in touch if you have any feedback or would like access to the report**

- **The following slides are only a small part of our analysis**

- **ESG performance is correlated with GDP per capita**

Macro-ESG index vs GDP/capita
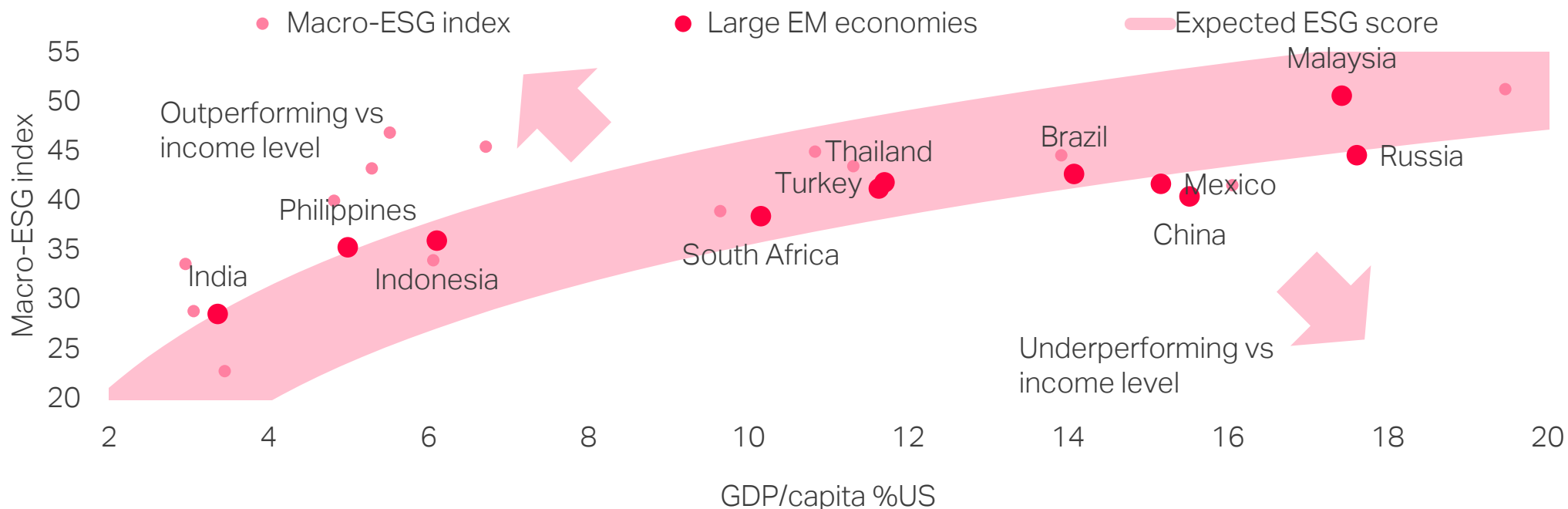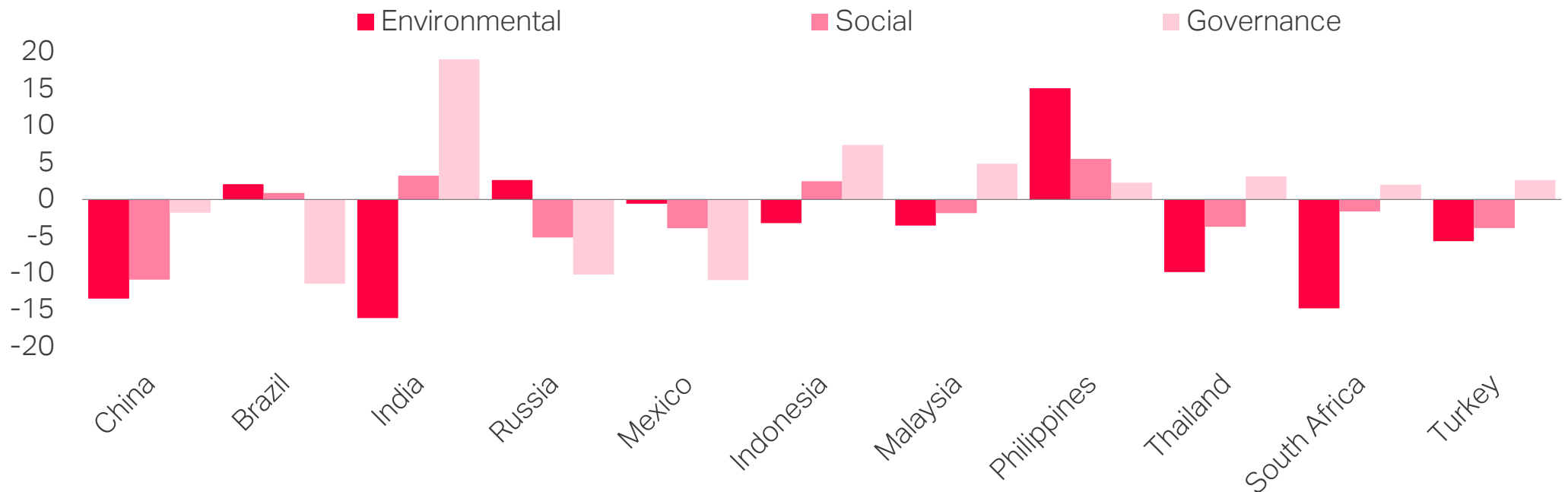

Source: IMF, TS Lombard.

EM ESG - OBJECTIVES

- **Our objective is to provide a country-level diversified macro input to investors' emerging market ESG asset allocation process**

- **We first construct a Macro-ESG Index that compares ESG factors between economies relative to their respective level of GDP per capita**

- **This allows us to quantify the effectiveness of governments and institutions in delivering a favourable ESG landscape in which companies operate, while taking account of countries' differing levels of development**

- **We construct our Macro-ESG Index using established third-party indices as proxies for the underlying drivers of the ESG landscape, we supplement this with insights from our country economists and political analysts, to assess the ESG outlook within each EM economy**

- **We aim to assess client interest in EM macro-ESG and lay the ground work for further analysis of ESG factors in the regular publications of our EM service**
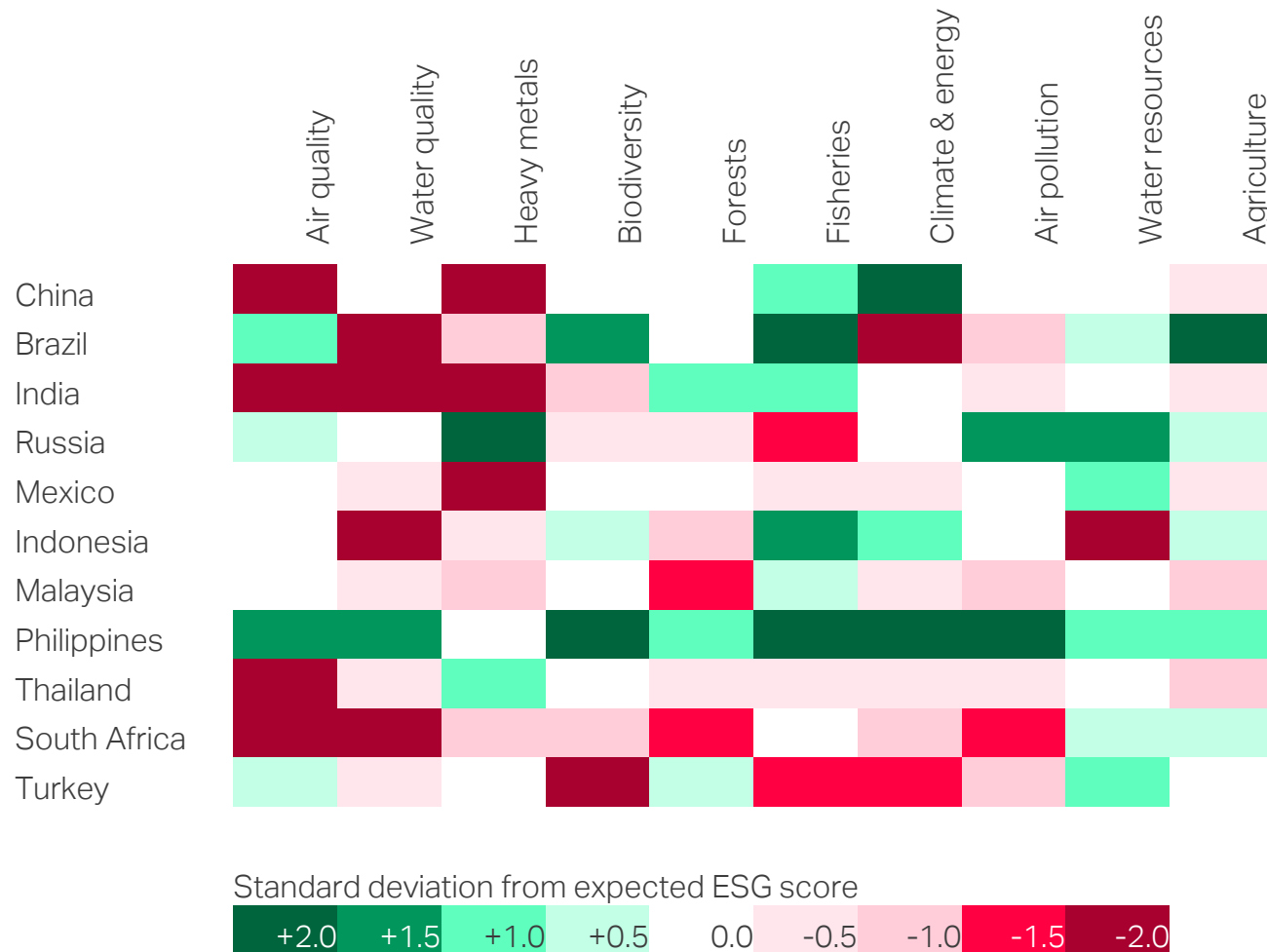
EM ESG PERFORMANCE

- **China: Limited by poor reporting and regulation**

- **Brazil: E and S may suffer amid anti-corruption fight**

- **India: Targeting S and G at the expense of E**

- **Russia: Sanctions blow to the ESG environment**

Macro-ESG index vs benchmark

Source: TS Lombard

ENVIRONMENTAL

Standard deviation from expected ESG score

+2.0 +1.5 +1.0 +0.5 0.0 -0.5 -1.0 -1.5 -2.0

Source: Yale University and Columbia University with World Economic Forum, TS Lombard.

SOCIAL

Source: The Social Progress Imperative, TS Lombard.

GOVERNANCE
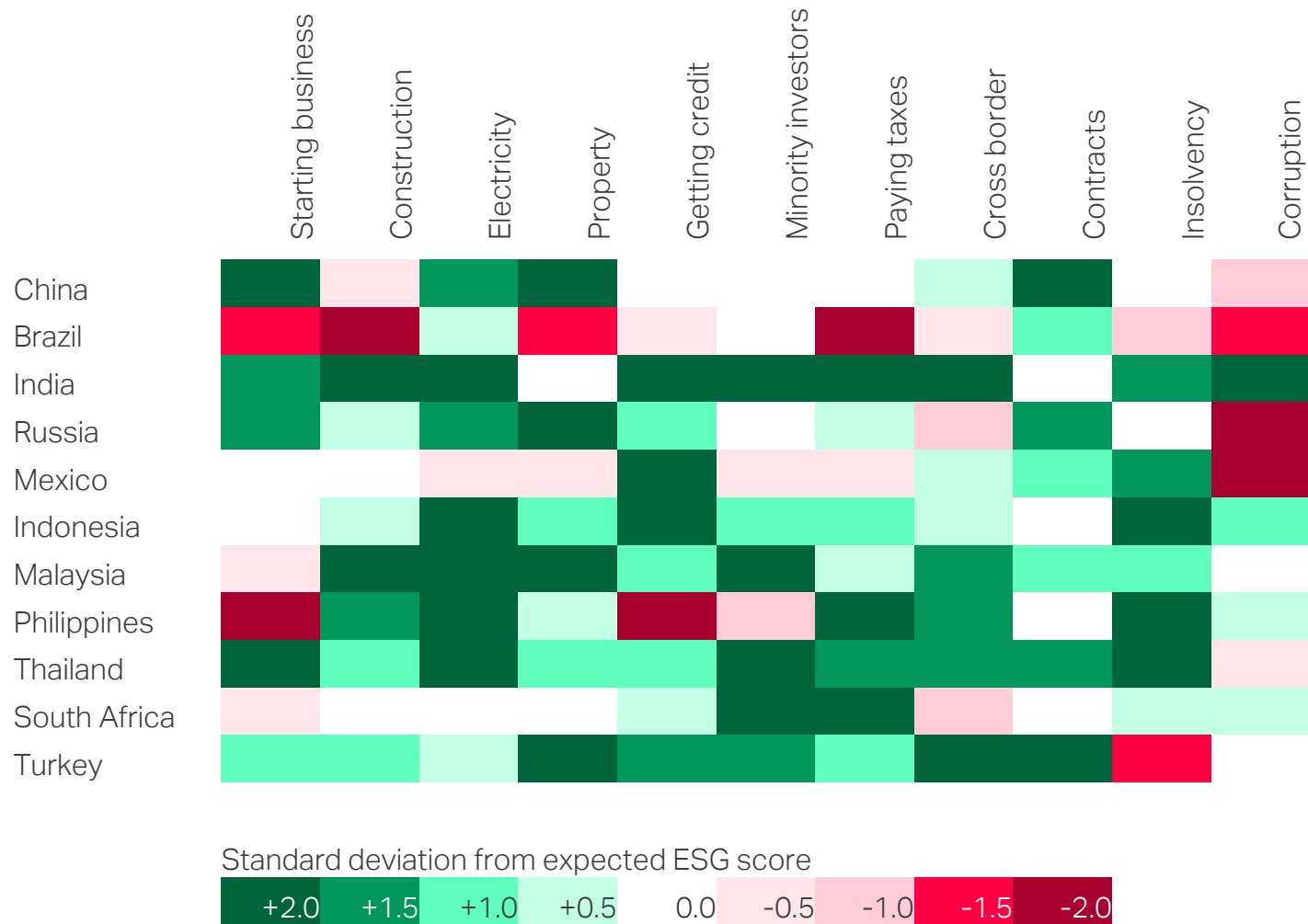
Source: The World Bank, Transparency International, TS Lombard.

Global

Global Macro

Daily Note

Macro Picture

Global View

Global Leading Indicators

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Global Political Drivers

Strategy

Asset Allocation

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India

Russia

LatAm

EMEA

SE Asia

Strategy

EM Strategy Monthly

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