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Ashmore

Where will global growth come from?

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As governments in developed economies scale back the easy monetary and fiscal policies, which fuelled much of their growth since 2008/2009, which countries are going to be the leading growth drivers in next five years?

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	10.2	–	1.69%
MSCI EM Small Cap	9.3	–	0.44%
MSCI Frontier	8.0	–	0.64%
MSCI Asia	10.8	–	1.64%
Shanghai Composite	8.6	–	1.65%
Hong Kong Hang Seng	7.2	–	1.74%
MSCI EMEA	8.6	–	1.46%
MSCI Latam	11.4	–	1.82%
GBI-EM-GD	6.44%	–	0.17%
ELMI+	5.58%	–	-0.05%
EM FX spot	–	–	0.11%
EMBI GD	6.52%	372 bps	0.94%
EMBI GD IG	4.84%	203 bps	0.42%
EMBI GD HY	8.47%	570 bps	1.48%
CEMBI BD	6.09%	338 bps	0.46%
CEMBI BD IG	4.92%	221 bps	0.23%
CEMBI BD Non-IG	7.72%	501 bps	0.75%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	14.3	–	2.90%
1-3yr UST	2.62%	–	-0.08%
3-5yr UST	2.62%	–	-0.31%
7-10yr UST	2.79%	–	-0.63%
10yr+ UST	3.10%	–	-0.98%
10yr+ Germany	0.25%	–	-0.55%
10yr+ Japan	0.01%	–	0.10%
US HY	7.05%	422 bps	0.69%
Barclays Ag	2.05%	-74 bps	-0.46%
VIX Index*	17.80	–	-0.39%
DXY Index*	96.34	–	0.72%
EURUSD	1.1368	–	-0.88%
USDJPY	109.61	–	-1.32%
CRY Index*	182.21	–	4.13%
Brent	62.5	–	5.92%
Gold spot	1279	–	-1.01%

Note: Additional benchmark performance data is provided at the end of this document. *See last page for index definitions.

Emerging Markets

Growth expectations always exert a powerful influence on market sentiment. However, growth rates of individual countries only impact growth on a global scale if a country is large. For example, an African country such as Ethiopia, which is expected to have racked up about 8.5% real GDP growth in 2018 according to the International Monetary Fund (IMF), is clearly fast growing, but Ethiopia's high growth rate hardly moves the dial in terms of global growth, since the Ethiopian economy is only the 68th largest in the world (0.4% of the size of the United States). In other words, to be a major contributor to global growth you need to be both fast growing and big.

The latest projections from the IMF suggest that real GDP growth in developed economies will slow from 2.4% in 2018 to 1.5% by 2023 as governments withdraw monetary and fiscal stimulus against a backdrop of still low productivity and high levels of debt. By contrast, Emerging Markets (EM) will see their growth rates accelerate moderately from 4.6% in 2019 to 4.8% by 2023, according to the IMF. The net effect of slowing growth in rich countries and stronger growth in EM means that global GDP growth will slow from 3.7% in 2018 to 3.6% by 2023. Against this backdrop, which regions and large countries are going to be the main drivers of global growth over the next five years?

Using regional GDP in current international Dollars for 2018 and IMF's forecasts for real GDP growth, Figure 1 shows estimated percentage contributions to global growth from the main regions and large countries in the world for the period from 2019 through 2023.

Fig 1: **Estimated contributions to real global GDP growth (2019-2023)**

	2019	2020	2021	2022	2023
EM	**69%**	**73%**	**74%**	**76%**	**77%**
Asia	49%	51%	52%	54%	54%
China	21%	20%	21%	21%	20%
India	9%	10%	11%	11%	12%
Eastern Europe	3%	3%	3%	3%	3%
Latin America	5%	6%	6%	6%	6%
Middle East	11%	11%	9%	8%	8%
Sub-Saharan Africa	3%	3%	3%	3%	3%
Advanced economies	**31%**	**27%**	**26%**	**24%**	**23%**
US	7%	6%	5%	4%	4%

Source: Ashmore, IMF.

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Emerging Markets

Two clear conclusions emerge from Figure 1. First EM, already the main global growth engine, will become even more so over the next five years. EM countries already account for 69% of all global growth and this share will rise to 77% by 2023. This is an astonishingly large figure. Within EM, India's contribution will rise from 9% to 12% of global growth, while China will continue to contribute about one fifth of all growth on Planet Earth. Despite the ongoing slowdown in Chinese growth, which is already factored into IMF's numbers – the IMF is forecasting Chinese growth to slow from 6.5% this year to 5.6% by 2023 - China's contribution to global growth remains high and stable throughout the forecast period, because of the enormity of China's economy and still strong relative growth rates. Elsewhere, Latin America will also contribute marginally more to global growth, while Middle East will contribute less. Sub-Saharan Africa's contribution to global growth, including the contribution from Ethiopia, will remain low mainly because African countries are still so small in economic terms.

The second conclusion from Figure 1 is that the contribution of advanced economies to global growth will decline to just 23% in 2023 from 31% this year. Despite accounting for about half of the global economy, rich countries only contribute a fifth to growth on account of their low growth rates. The contribution of the United States shrinks to just 4% of global growth by 2023 from 7% this year. Or to put this slightly differently, by 2023 India will be three times more important than the US in terms of its global growth contribution.

Investors and policy-makers need to pay close attention to these numbers. Both risks and opportunities are closely tied to growth. It is unrealistic to expect growth rates in developed economies to improve much in the coming years. Their economies are mature, which naturally limits their ability to grow. In addition, they have largely squandered the years of hyper-easy monetary policies since 2008/2009 by failing to reform and by building up more debt. To make matters worse, their economic policies are increasingly becoming more populistic, which does not bode well for productivity.

In comparison, EM countries are far less indebted and many have undertaken meaningful reforms in recent years. EM countries also weathered serious external shocks in recent years, including a sharp Dollar rally, capital flight, falling commodity prices and higher borrowing costs. The main ingredient required for EM growth to accelerate meaningfully from here is greater access to financing, which is likely to be forthcoming as investors re-allocate back to EM countries as the big distortions in financial markets caused by Quantitative Easing policies are unwound. Financing is an extremely potent growth driver, because most EM countries face binding financing constraints (EM countries are about 50% of global GDP, but only 22% of global bond markets, for example).

- China: There are growing signs that the Chinese economy is stabilising. Overnight, new macroeconomic data was on balance stronger than expected. The Chinese economy expanded at a rate of 6.4% yoy in Q4 2018 and 6.6% yoy for 2018 as a whole, which was in line with expectations, but higher frequency data beat expectations. Fixed asset investment stopped declining and retail sales as well as industrial production improved outright relative to last month. Moreover, credit turned positive in December in a sign that policy easing is beginning to support the economy. For example, new loan growth was CNY 1080bn in December versus CNY 825bn expected and the yoy rate of broad money supply inched up to 8.1% in December from 8.0% in November. Aggregate financing was also higher in December than in November (CNY 1590bn versus CNY 1524bn, respectively). The improvements in credit, retail and industrial production are timely, since exports and imports both fell sharply in December due to the effects of Trump's trade war. As far as financial reform is concerned, China continues to move forward. The government announced last week that the Qualified Foreign Institutional Investor (QFII) programme will be doubled in size to USD 300bn ahead of the inclusion of Chinese bonds into the Barclays Aggregate bond index in April of this year.

- **Brazil:** Both core and broad retail sales beat expectations in November. Core retail sales increased 2.9% mom, while headline retail sales increased by 1.5% in November. Economic output also expanded at a rate of 0.29% mom in November, which was up from 0.02% mom in October and higher than expected (0.16% mom). Brazil growth may well triple in 2019 relative to 2018, in our view. Stronger economic performance is currently sitting alongside softer inflation, a pleasant combination. The yoy rate of CPI inflation (known as IPCA in Brazil) eased significantly to 3.75% in December from 4.05% yoy in November. Inflation is therefore running below the central bank's target for the second year in a row. Indeed, there is talk in market and in policy circles that Brazil's neutral interest rate may be coming down in which case bonds may have further upside.

- India: Trade and inflation improved in November and December. The trade deficit narrowed sharply to USD 13.1bn from USD 16.7bn in November, while the market had expected a wider deficit of USD 14.5bn. The rate of CPI inflation eased to 2.2% yoy in December from 2.3% yoy in November.

- Pakistan: Amidst prospects of a greater than expected package of funding from Saudi Arabia and China, the government has decided not to seek IMF funding for the time being. In addition to providing balance of payments support, Saudi Arabia is rumoured to be funding a major refinery in the same deep-water port, which China is financing as part of the Belt & Road Initiative.

- Venezuela: The US government is weighing further sanctions against members of the Venezuelan military and the oil industry. The US government is also considering recognising Juan Guaido, the current head of the National Assembly, as the country's legitimate leader. The Maduro Administration has gone so far down the

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Emerging Markets

road of expropriation, economic mismanagement, rampant corruption and human rights abuses that the most realistic way to change direction is regime change. Investing in defaulted Venezuelan bonds can therefore be thought of as an option on regime change. Greater US pressure on Maduro allies within important economic sectors and the military increases the likelihood of regime change, although it is impossible to say when change will happen. Maduro is not in power because of his endless charm. Rather, his power rests on his ability to pay for support. The presidential election last year was widely regarded as illegitimate – unlike previous Venezuelan elections. This difference may prove crucial. Whereas in the past it was difficult to justify the unseating of Venezuelan presidents, because they had won power in reasonably fair elections, this time things may be different.

Snippets:

- Argentina: The rate of inflation continues to decline. Headline inflation declined to 2.6% mom in December from 3.2% mom in November.
- Colombia: The government is considering the sale of an 8% stake in EcoPetrol, the state oil company. The sale would improve the public finances against the backdrop of a disappointing tax reform. A resurgence in bombing by the ENL rebel group is raising concerns for the Peace Process.
- Indonesia: Bank Indonesia left the policy repo rate unchanged at 6.00% in line with expectations. The trade deficit narrowed to USD 1.1bn in December from USD 2.0bn in November.
- Peru: Real GDP growth handsomely beat expectations in November as the economy expanded at a yoy rate of 5.3% versus 4.7% yoy expected. The economy expanded at a 4.2% yoy rate in October.
- Romania: Headline inflation eased by 0.1% to 3.3% yoy in December.
- Russia: Weekly inflation slowed to 0.2% wow in the week to 14 January from 0.5% wow in the previous week.
- Singapore: Non-oil domestic exports dropped 5.1% in December relative to the previous month on lower Chinese imports of intermediary inputs. This decline can be attributed to US President Donald Trump's tariffs on Chinese goods. A similar effect is evident in South Korean exports – see below.
- South Africa: The pace of retail sales accelerated to 3.1% yoy in real terms in November from 2.1% yoy in October. The central bank left the policy rate unchanged at 6.75%.
- South Korea: Exports in the first twenty days of January were 14.6% lower than in the same month of 2018. This slowdown is due to US President Donald Trump's trade war and shows that the implicit assumption behind Trump's China tariffs that manufactured goods are made in just one country are extremely misguided.
- Sri Lanka: The IMF stands ready to support Sri Lanka amidst a political crisis in the country. Sentiment improved following the government's repayment of a USD 1bn loan. Bank of China offered Sri Lanka a loan and the government indicated the intention to tap global bond markets.
- Turkey: The monetary policy committee left the policy repo rate unchanged at 24% in line with expectations.

Global backdrop

The two main English-speaking countries in global financial markets continue to supply by far most of the risk to investors. The US government remains shut with no sign of resolution and the longer this goes on the greater the drag on the US economy. Meanwhile, the UK is writhing in self-inflicted agony as the Brexit clock continues to run down. UK markets are clinging to the hope that Parliament will find some last-minute solution after the massive defeat of Theresa May's Brexit deal last week. There are just over two months to Brexit and so far no deal. A benign outcome cannot be ruled out if, say, a majority of members of parliament vote in favour of some amendment, which either buys time or amends the terms of the deal with Europe. However, this would require a majority in Parliament, which in turn would require one of four things to happen:

1. The ideological Hard Brexit rebels within the Conservative Party vote in favour of diluting Hard Brexit, which is their ultimate objective just as it moves within reach;
2. The opposition Labour Party agrees to support a deal, which in effect extends the life of the Theresa May's government, its arch-enemy;
3. The European Union (EU) grants UK major concessions;
4. The Labour Party whip fails to prevent a major rebellion within the ranks of Labour MPs to enable them to form a very rare cross-party coalition in Parliament to pass the necessary legislation to avoid a Hard Brexit.

None of these options is easy. If no shift occurs, the UK will crash out of the EU on 29th March 2019 with catastrophic implications, especially for trade.

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Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	5.45%	5.45%	5.45%	-14.92%	16.14%	3.68%
MSCI EM Small Cap	2.85%	2.85%	2.85%	-19.41%	8.56%	1.65%
MSCI Frontier	3.67%	3.67%	3.67%	-18.50%	9.19%	0.81%
MSCI Asia	4.28%	4.28%	4.28%	-15.22%	14.44%	5.53%
Shanghai Composite	4.10%	4.10%	4.10%	-23.46%	-1.67%	7.71%
Hong Kong Hang Seng	5.06%	5.06%	5.06%	-15.45%	13.86%	4.88%
MSCI EMEA	6.99%	6.99%	6.99%	-14.82%	17.02%	-0.67%
MSCI Latam	11.88%	11.88%	11.88%	-3.29%	24.81%	1.73%
GBI EM GD	2.61%	2.61%	2.61%	-6.71%	7.90%	-0.25%
ELMI+	1.41%	1.41%	1.41%	-3.76%	5.19%	-0.41%
EM FX Spot	2.13%	2.13%	2.13%	-9.46%	0.65%	-6.36%
EMBI GD	2.65%	2.65%	2.65%	-1.95%	6.68%	5.15%
EMBI GD IG	1.79%	1.79%	1.79%	-0.40%	5.38%	4.50%
EMBI GD HY	3.55%	3.55%	3.55%	-3.57%	8.14%	5.65%
CEMBI BD	1.62%	1.62%	1.62%	-0.21%	6.00%	4.51%
CEMBI BD IG	1.03%	1.03%	1.03%	0.51%	4.21%	3.98%
CEMBI BD Non-IG	2.42%	2.42%	2.42%	-1.06%	9.01%	5.13%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	6.63%	6.63%	6.63%	-2.66%	14.67%	9.98%
1-3yr UST	-0.08%	-0.08%	-0.08%	1.68%	0.79%	0.78%
3-5yr UST	-0.33%	-0.33%	-0.33%	1.76%	0.74%	1.37%
7-10yr UST	-0.57%	-0.57%	-0.57%	1.75%	0.56%	2.48%
10yr+ UST	-1.14%	-1.14%	-1.14%	-0.55%	0.92%	4.93%
10yr+ Germany	0.23%	0.23%	0.23%	7.54%	3.48%	7.19%
10yr+ Japan	0.48%	0.48%	0.48%	2.93%	3.21%	4.40%
US HY	3.84%	3.84%	3.84%	1.01%	9.59%	4.40%
Barclays Ag	0.12%	0.12%	0.12%	-1.57%	2.50%	1.03%
VIX Index*	-29.98%	-29.98%	-29.98%	57.94%	-33.31%	38.31%
DXY Index*	0.17%	0.17%	0.17%	6.36%	-2.75%	18.79%
CRY Index*	7.31%	7.31%	7.31%	-6.80%	14.50%	-34.55%
EURUSD	-0.86%	-0.86%	-0.86%	-7.29%	4.54%	-16.17%
USDJPY	0.07%	0.07%	0.07%	1.20%	7.38%	-4.84%
Brent	16.13%	16.13%	16.13%	-8.93%	113.61%	-41.46%
Gold spot	-0.30%	-0.30%	-0.30%	-4.14%	16.12%	3.00%

*VIX Index = Chicago Board Options Exchange SPX Volatility Index. *DXY Index = The Dollar Index. *CRY Index = Thomson Reuters / CoreCommodity CRM Commodity Index.

Source: Bloomberg, JP Morgan, Barclays, Merrill Lynch, Chicago Board Options Exchange, Thomson Reuters, MSCI, total returns.
Figures for more than one year are annualised other than in the case of currencies, commodities and the VIX, DXY and CRY which are shown as percentage change.
Data as at 21 December 2018.

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