GlobalData. TS Lombard

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EM Strategy Monthly

CHINA STIMULUS & SOFT USD VS TARIFFS

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- Global growth dynamics have shifted but at least a softer dollar will boost EM
- China's stimulus will drive a cyclical upswing and support EM ex-China
- A slower pace of China equity gains should stem outflows from India and others

Global growth dynamics have shifted but we do not expect a US recession. The balance of global growth risks has turned decisively against the US. China has delivered on stimulus to drive growth (see our 5 March Quick Insight), while Germany is easing fiscal rules to fund infrastructure and defence (see our 5 March Quick Insight: Merz's 'whatever it takes' moment). Meanwhile in the US, the policy mix of the Trump administration is fuelling downside risks to growth and reigniting fears of recession. We do not buy into US the recession narrative (see our 7 March Quick Insight). Our base case is for continued US expansion this year and no further Fed easing, although there are risks around this view. In particular, aggressive escalation of tariff diplomacy could derail the US economic cycle, while the combination of relatively loose financial conditions and large fiscal deficits could fuel a renewed surge in inflation, pushing global yields higher (see our 10 March Global Macro Monthly). **We maintain our moderate positive view of overall EM risk.** EM economies will benefit from the recovery in China and to a lesser extent from that in Europe, but face risks if the US economy slows more than we expect or if there is resurgent global inflation. EM equities will be driven by the combination of a cyclical upswing in China and a softer dollar, supported by lower domestic interest rates in many EM and cheaper valuations.

EM Asset Allocation

	Equities ($)	Currencies	Local rates	Credit ($)		Scale
Overall risk	+1					
Asset class	+1	0 (-1)	+1 (-1)	-1 (+1)		
Relative country views						
China	+1 (+2)	0 (-1)	-1 (0)	n/a		+2
Taiwan	-1 (0)	-1 (+1)	0	n/a		+1
South Korea	+1 (-1)	+1 (-1)	-1	n/a		0
Brazil	0 (+1)	+1 (+2)	+1	+1		-1
India	+1	-1	0 (-1)	n/a		-2
Mexico	-1	-1	+1	-1		Last month
Indonesia	-1	0	+1	+1 (-1)		in brackets
South Africa	0 (-1)	+1	-1	-1 (+1)		

Source: GlobalData TS Lombard. The scores for our relative country views sum to zero in each column. See methodology.

See here for interactive heatmap.

EM sentiment will be supported by a softer dollar. The relative deterioration of the US growth outlook supports our view that US risk assets will underperform and favours further depreciation of the dollar, which remains overvalued vs historical averages (see our 5 March Macro Strategy). At the same time, many EM currencies are undervalued and, to take MXN vs USD as an example, could now be pricing in much of the tariff threat, contributing to us upgrading our relative asset class view of EM FX (see last week's EM Watch). A more favourable environment for EM currencies along with fears of a US slowdown will help lower the bar for EM central banks to ease monetary policy, which should shift the balance of risks in favour of EM local debt and against relatively safer sovereign credit.

China's fiscal expansion and ambitious growth target will support EM ex-China. A cyclical upswing in China will boost overall EM sentiment, raise demand for EM ex-China exports, and provide some support for commodity prices. Most EM economies have reduced their dependence on exports to China in recent years, except for Brazil and Indonesia, but China nonetheless remains an important trading partner for many (see our 18 February EM in Charts).

Markets are no longer complacent on tariffs, but escalation risks remain. The slow start to Trump 2.0 tariff diplomacy featuring easy wins, delays and a soft approach on China fuelled investor complacency that there would be negotiated settlements in place of the aggressive tariffs threatened during the election campaign. The repeated delay of tariffs on Mexico raises hopes that the worst impact may still be avoided, but the ratcheting up of measures targeting China puts an end to earlier investor complacency (see our 3 March EM Watch: Tariff complacency quickly unravelling). At the same time, the increasingly robust retaliation by China including tariff and non-tariff measures confirms that material trade disruption is probably inevitable, while the growing list of tariff threats indicate the likely direction of travel.

US efforts to close tariff back doors are key to watch. Since the escalation of US-China decoupling from 2018, China has avoided severe economic damage by a combination of re-directing exports to the US via third countries and growing export partners elsewhere. EM ex-China, especially Mexico and Vietnam, and other ASEAN manufacturers have benefitted from this transshipment and from international companies' reconfiguration of global supply chains. US efforts to pressure Mexico into imposing tariffs on its imports from China suggest that the administration could at last be aiming to close tariff back doors, while the imposition of global sectoral tariffs would greatly restrict tariff avoidance, piling pressure on China and EM ex-China (see our 10 February EM Watch: What if the tariff back doors are closed?).

China

The pace of equity gains may slow but fiscal expansion and an ambitious growth target will drive a cyclical upswing. The much-anticipated stimulus included an ambitious growth target of about 5% and a fiscal stimulus of 1.6% of GDP, taking the deficit to a new high. The fiscal expansion fell slightly short of what we had expected, but combined with the strong growth target, supports our view that the authorities remain committed to stabilising growth (see our 5 March Quick Insight). The stimulus measures include a pivot to domestic consumption as well as further steps to underpin the property sector and investment in infrastructure (see our 6 March China Watch). In the short term, however, there could be a sell-on-the-news period of consolidation for China's equity markets, although we believe that stimulus will be sufficient to drive a cyclical upswing in the economy. The PBoC has shown an increasing willingness to intervene to stabilise the exchange rate, while the prospect of an economic recovery should reduce the need for monetary easing. We maintain our view that much of the down move to record low yields was driven by rebalancing out of poorly performing equity markets, while a more favourable medium term equity outlook will fuel outflows from local debt. Extreme tariff escalation remains a tail risk, although China is well prepared and has the resources to protect the economy as well as having made material progress in growing export markets outside the US (see, for example, the decoupling tracker charts in our 18 February EM in Charts).

Taiwan

Exports remain strong but equities are under pressure from rotation out of US tech, while the tariff threat and geopolitics weigh. The trade balance continues to increase amid strong export growth and solid global chip demand. The worst of the rotation out of US tech may now be over but there could still be further downside and spill over into Taiwan's equities. The CBC's hawkish bias will provide some support for the currency, but equity outflows will likely dominate (see the 11 March edition of The GRID). The new investments into the US announced by TSMC could help win support from the Trump administration, but the threat of global tariffs on the semiconductor sector remains. Furthermore, Trump has raised doubts about US willingness to defend Taiwan and is pressuring the country to spend more on defence. At the same time, China has intensified reunification rhetoric and will likely increase grey zone warfare, which could start to impact markets if exports are disrupted. Local debt yields will likely remain stable but face upward pressure from external and domestic inflation risks, including possible utility price hikes.

South Korea

Receding political risks will set the stage for new elections and fiscal expansion that is not yet priced into equity markets. The delay in the Constitutional Court ruling on the impeachment of President raises the uncertainty facing markets, but our base case remains that the impeachment will be upheld and that new elections will be called. The opposition DPK is well placed to win elections that would open the way to fiscal expansion aimed at boosting growth. Equity markets will likely start to price in this positive scenario sooner rather than later. The rate cut at the end of last month and the probability of further easing next month is a further support for equities. In the longer term, however, a sustainable equity rally will depend on the Value-Up initiative, of which there is little sign of material progress. South Korea is exposed to the tariff threats against the semiconductor and auto sectors, especially the latter in which the country has made material gains in US import share in recent years (see our 3 March EM Watch). The won should benefit from improved political sentiment and equity inflows despite lower interest rates. Local debt yields have diverged from USTs since Q4/24 and could face upward pressure from still relatively high global yields, despite monetary easing, while the prospect of a bond funded stimulus package is a further risk factor.

Brazil

Equities face growing risks from Lula's populist pivot, although medium term reforms and potential election upside remain in place. Opinion polls suggest that the collapse of President Lula's popularity may not have bottomed out. In an effort to rebuild support the President has turned to populist measures (see our 27 February report Lula takes action as his approval sinks). Lula's decision to appoint Congresswoman Gleisi Hoffmann as coordinator of relations between government and legislature is unlikely to improve governability and is further evidence that the President is ceding more power to the left of his party (see our 6 March report Lula opts for loyalty over governability). The government's populist pivot reduces the chance of spending cuts and hinders efforts toward fiscal sustainability and will weigh on equities. At the same time, however, the possibility that Lula may decide not to run for re-election offers the prospect of material upside for markets (see our 18 February Chart Story: 2026 election starts to drive the market). A further 100bp rate hike is a near certainty this week and we expect at least another 50bp in May and probably a further 25bp after that (see our 14 March report Banco Central to remain hawkish). High interest rates will drive further appreciation of the real. Much of the anticipated further rate hikes are priced into local debt markets, although there could still be some upside risk to yields while inflation expectations remain unanchored. We maintain our positive view of local debt, justified by high yields and by a more favourable external environment for EM local debt markets. Sovereign credit faces risks from faltering investor sentiment and failure to effectively reduce government spending, but nonetheless appears attractive in comparison with higher rated Mexico given the country's lesser exposure to tariff risks.

India

Less extreme valuations, monetary easing and a moderation of rebalancing to China should support equities despite tariff risk. The surge in China's equity markets this year has largely been driven by foreign investors and has coincided with outflows from India as well as some other large EM equity markets (see our 24 February EM Watch). If as we expect there is a period of consolidation in China's equity market in the aftermath of the stimulus announcement, outflows from India should moderate. At the same time, policy rates will almost certainly be cut in April with further easing in subsequent months, while equity valuations are now relatively more attractive. In addition, equities have faced pressure owing to a liquidity crunch that the RBI is now starting to take steps to alleviate (see our 3 March report Markets face liquidity and growth crunch). We expect the RBI to continue to target growth, which will require a weaker currency to boost competitiveness. Indeed, the central bank appears to have become more tolerant of a weaker currency in recent months (see our 19 February Chart Story: Rupee's bounce back is temporary). Local debt markets should benefit from monetary easing, although some of this is likely already priced in and renewed equity inflows could prove negative for bonds. India is exposed to the planned US reciprocal tariffs. The government has already reduced multiple tariffs in response to the US threat but appears increasingly resistance to further adjustment raising the risk of escalation, which could be especially damaging to the pharmaceutical sector.

Mexico

Tariff delay offers some hope for equities, but risk of escalation remains amid ongoing deterioration of the growth outlook. In our view, the depreciation of the peso over the past few months is more or less pricing in the 25% tariffs that have been delayed until next month (see last week's EM Watch). There would likely be a strong rebound in the peso and equities if a US-Mexico deal was somehow agreed or if the tariff threat was rendered non-credible by repeated delays. For the moment, however, we expect some tariffs to be imposed next month even if these turn out to be temporary, with negative consequences for the currency. US efforts to prevent transshipment via Mexico are a further risk to markets. At the same time, the growth outlook continues to deteriorate despite monetary easing and the prospect of further rate cuts to come. The central bank's focus on growth should continue to benefit local debt, although extreme tariff scenarios would of course undermine sentiment. Slowing growth will add to the risks facing sovereign credit.

Indonesia

Equities will remain fragile as fiscal and sovereign wealth fund uncertainty weigh on sentiment despite a soft dollar and recovery in China. Headline deflation in February was driven by a once-off cut in electricity prices, while core CPI edged higher. Bank Indonesia will remain cautious in the pace of monetary easing. The central bank will continue to focus on exchange rate stability and will intervene if needed to limit rupiah weakness. A stable currency and prospect of lower policy rates should support local debt markets. Indonesia is among the larger and more liquid EM ex-China local debt markets and should benefit from more favourable global conditions for the asset class. Lower interest rates should ultimately support equity markets, but growing fiscal concerns linked to government spending plans and the creation of a sovereign wealth fund financed by a combination of budget cuts and SOE dividends raise risks for equities. In addition to fiscal risks, the wealth fund is expected to control firms that make up as much as 20% of the major equity index at a time when investors are increasingly concerned about liquidity. Sovereign credit spreads have widened in recent months and could now be pricing in the near term fiscal risks, although much depends on the success of government plans to raise GDP growth.

South Africa

Equity markets will benefit from the China recovery and a soft dollar, but still high interest rates, slow growth and Trump clash are risks. We upgrade equities to neutral from moderate negative as correlation with China should provide support, while the prospect of a softer dollar will boost high beta currencies, including the rand. Inflation increased in January and SARB governor Kganyago has warned of upside risks owing to external conditions, which will likely delay monetary easing until May. Relatively high interest rates will further support the currency, while local debt yields could rise owing to inflation risks and central bank caution. South Africa is not directly in the firing line of US tariff diplomacy over trade but has faced criticism from both Trump and Musk over its land expropriation law as well as allegations that Black empowerment laws raise barriers to international companies doing business in the country. The US decision to suspend federal funding marks a deterioration in US-South Africa relations that could weigh on investor sentiment. The wrangling over the annual budget highlights tension within the ruling coalition and growing problems in stabilising public finances, while lack of fiscal space is a risk to already weak growth. On balance we downgrade sovereign credit, given tension with the US and failure to boost growth.

ASSET ALLOCATION PERFORMANCE

Value added since our 17 February Asset Allocation View

The charts show the tactical value added of the views in our 17 February EM Strategy Monthly.

EM equity returns were close to zero over the past month, but outperformed the US by a considerable margin, consistent with our moderate positive view of overall EM risk. We expect China's stimulus and a softer dollar to support EM risk appetite in the coming month.

Among our most successful equity calls were our strong positive view of China and our moderate negative on South Korea. Elsewhere, however, equities in Brazil continued to lag contrary to our view, while we were premature in our positive view of India.

In EM currencies, among our most successful calls was our negative view of KRW, while our positive TWD and negative MXN views fared less well. In the coming month, we expect a softer dollar to support high beta EM currencies, including BRL and ZAR.

In local markets our positive view of Mexico was successful, but India's local debt outperformed contrary to our expectation.

Chart 1: Equity value added (%)

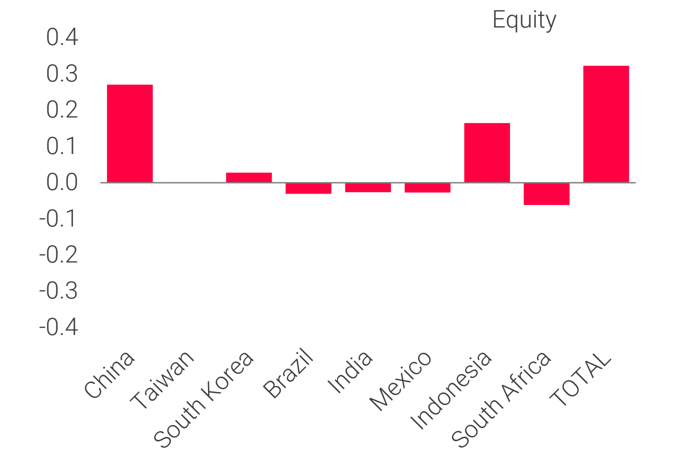


Chart 2: Currency value added (%)

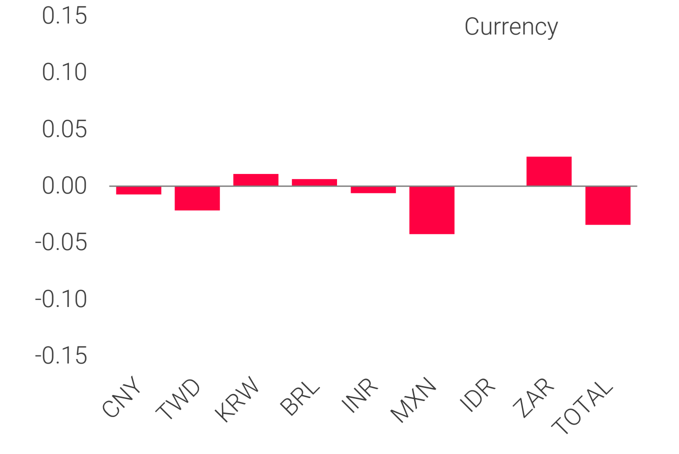


Chart 3: Local market value added (%)

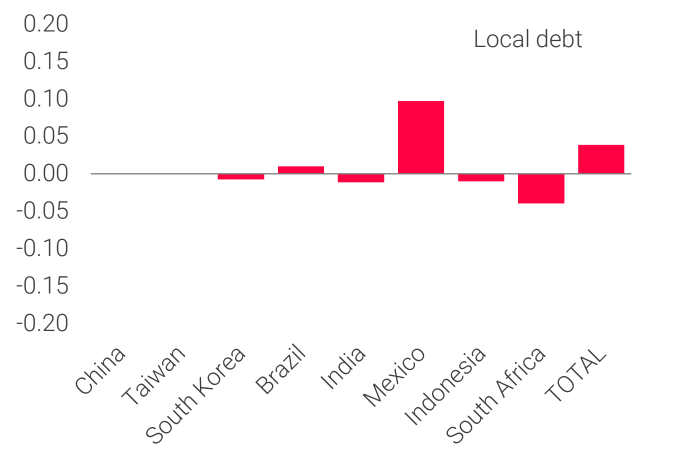
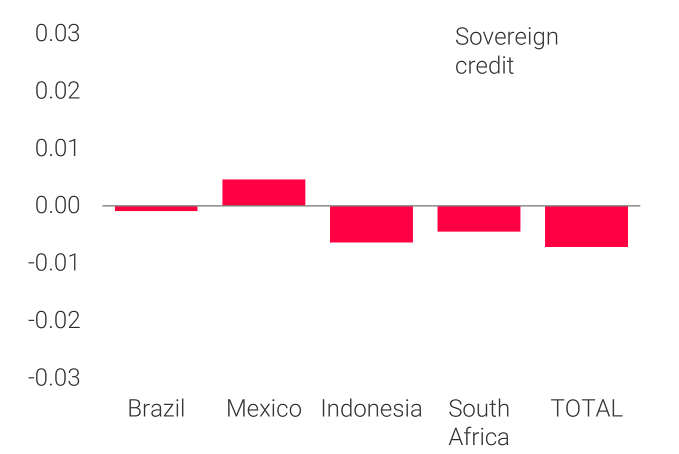


Chart 4: Sovereign credit value added (%)



Sources: Bloomberg, GlobalData TS Lombard.

Chart 5: Cumulative equity value added (%)

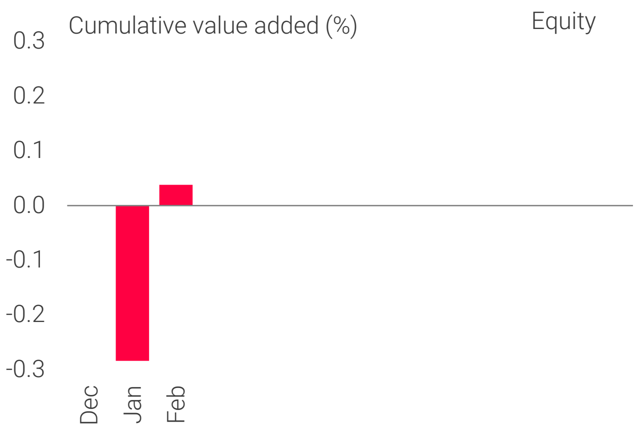


Chart 6: Cumulative currency value added (%)

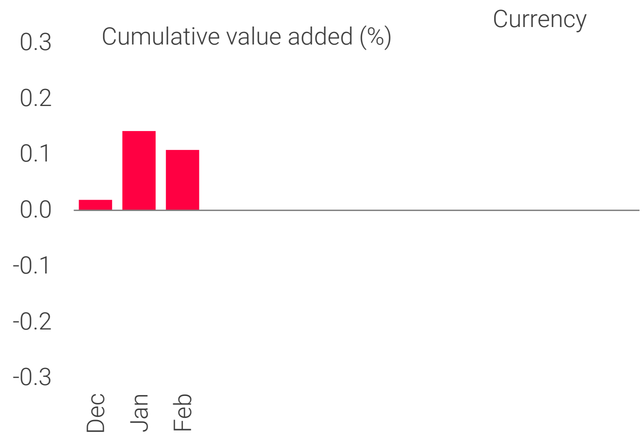


Chart 7: Cumulative local debt value added (%)

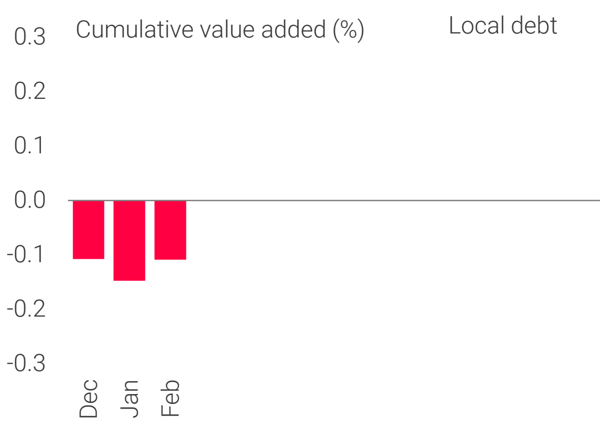
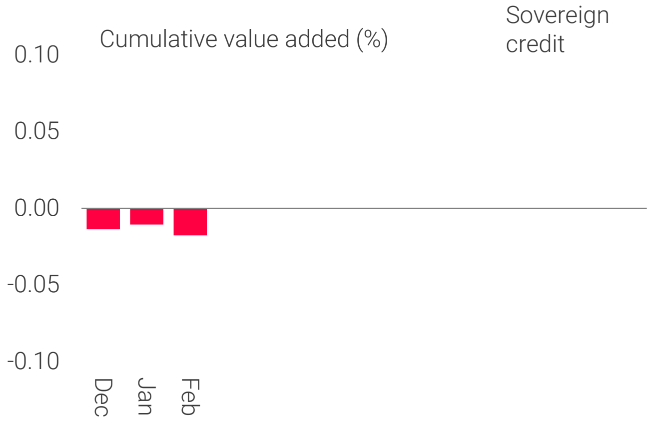


Chart 8: Cumulative credit value added (%)



Sources: Bloomberg, GlobalData TS Lombard.

For further explanation of the calculations see methodology.

MUST READ

The GRID: The fundamental guide to Emerging Markets

In the 11 March edition of The GRID, our EM team explain that China's fiscal expansion and ambitious growth target will support improving confidence. In Taiwan, investment in the US could delay tariffs but risks remain amid rising China tensions, and in South Korea, political risks are easing, setting the stage for a fiscal push later this year. The RBI's dovish pivot in India and upcoming income tax cuts should help raise sentiment, while in Brazil, political uncertainty has increased as high interest rates drag on growth and in Mexico, growth is still slowing amid domestic policy uncertainty and delayed tariff risk.

Brazil: Banco Central to remain hawkish

Mixed sectoral data for January suggest that the economic slowdown expected this year could be more gradual than anticipated. Wilson Ferrarezi and Elizabeth Johnson explain that weaker does not change Banco Central's roadmap for rate hikes in the coming months; we continue to forecast the Selic rate at 15% by mid-2025. See our 14 March report Banco Central to remain hawkish.

ASSET ALLOCATION

We will publish our next Asset Allocation view on 17 March.

EM Asset Allocation

	Equities ($)	Currencies	Local rates	Credit ($)		Scale
Overall risk	+1					
Asset class	+1	0 (-1)	+1 (-1)	-1 (+1)		
	Relative country views					
China	+1 (+2)	0 (-1)	-1 (0)	n/a		+2
Taiwan	-1 (0)	-1 (+1)	0	n/a		+1
South Korea	+1 (-1)	+1 (-1)	-1	n/a		0
Brazil	0 (+1)	+1 (+2)	+1	+1		-1
India	+1	-1	0 (-1)	n/a		-2
Mexico	-1	-1	+1	-1		Last month
Indonesia	-1	0	+1	+1 (-1)		in brackets
South Africa	0 (-1)	+1	-1	-1 (+1)		

Source: GlobalData TS Lombard. The scores for our relative country views sum to zero in each column. See methodology.

See here for interactive heatmap.

ABSOLUTE VIEWS

Table 1: Current Absolute Views

Asset	Asset class	Long/ Short	Date Opened	Units	Open Level	Current Level	Total Return ($)
USD/INR	Currency	Long	3-Feb-25		87.19	86.83	-0.7%
BRL/MXN	Currency	Long	3-Feb-25		3.506	3.475	-0.5%
Brazil	Equity	Long	24-Feb-25		1,306	1,333	+2.0%
EM ex-China vs China	Local debt	Long	24-Feb-25		0.763	0.770	+0.9%

Date/time 17-Mar-25 08:36

Source: Bloomberg, GlobalData TS Lombard.

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

CLOSED VIEWS

Table 2: Closed Absolute Views

Asset	Asset class	Long/ Short	Date Opened	Date Closed	Open Level	Close Level	Total Return ($)
EM ex-China	Local debt	Long	12-Aug-24	7-Oct-24	145.6	148.6	+2.1%
EM HY vs EM equity	Credit vs Equity	Long	23-Sep-24	7-Oct-24	106.54	105.04	-1.4%
Brazil	Equity	Long	8-Jul-24	3-Feb-25	1,455	1,320	-9.3%
USD/IDR	Currency	Short	27-Aug-24	3-Feb-25	15,495	16,448	-4.9%
MX credit vs USD/MXN	Credit vs FX	Long	2-Sep-24	3-Feb-25	100.00	97.52	-2.5%
EM energy vs index	Equity	Long	14-Oct-24	3-Feb-25	100.00	96.64	-3.1%
IN, BR vs MX, KR	Equity	Long	11-Nov-24	3-Feb-25	100.00	97.60	-2.4%
TW, BR, ID vs MX, KR, IN	Currency	Long	9-Dec-24	3-Feb-25	98.54	100.21	+1.7%
EM credit vs local debt	Credit vs local debt	Long	11-Nov-24	10-Mar-25	100.00	99.12	-0.9%
China vs EM ex-China	Equity	Long	3-Feb-25	10-Mar-25	2.196	2.606	+18.4%

Source: Bloomberg, GlobalData TS Lombard.

Levels are for London close of business, obtained from Bloomberg. Intra-day prices used for views that are opened or closed on the date of publication are updated to the close of business prices in subsequent reports.

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