Global Emerging Markets Outlook

Goldilocks for Emerging Market Debt to continue

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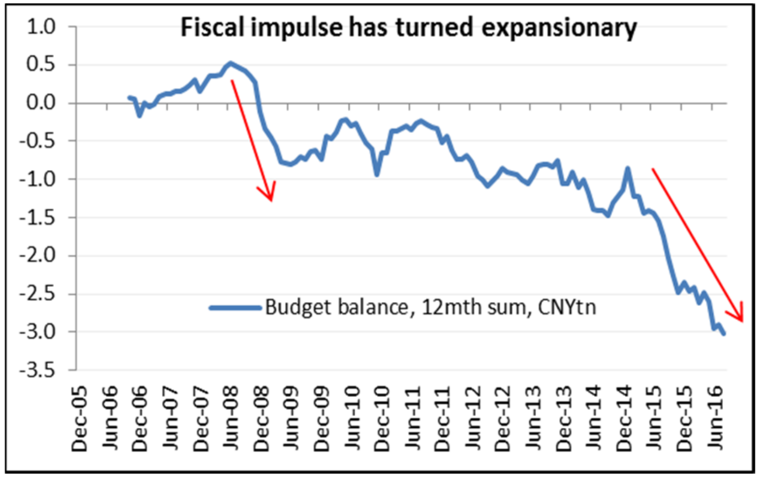
Key macro themes for the rest of 2016

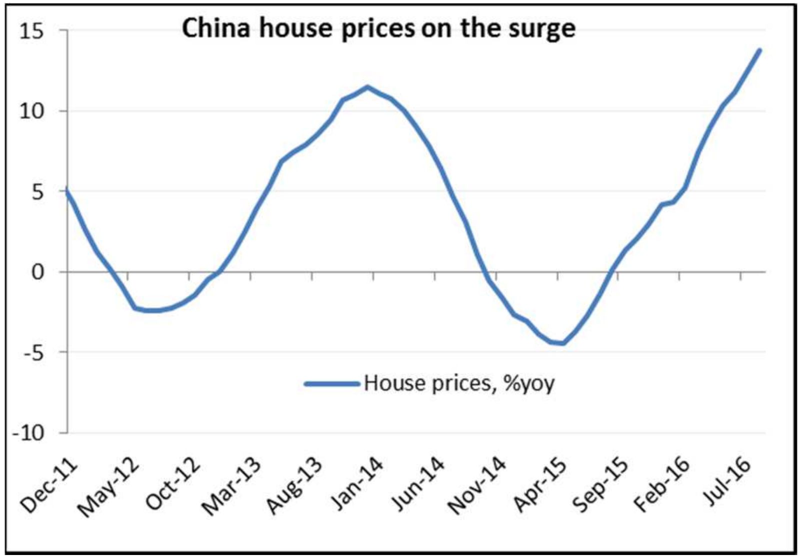
- China
  - Cyclical stabilisation to continue
  - Risks of leverage build-up persist
  - Downside risks to growth in 2017 from deleveraging, but sources of support are strong
- Fed
  - Market nervous about course of policy action, but Fed saddled with global concerns
  - Market may be under-pricing pace of hikes
  - But terminal rate pricing is arguably closer to fair
  - Sensitivity of EM assets to US rates is declining
- Trump
  - Increasingly uncertain US presidential election
  - A Trump presidency can be negative for EM given protectionist rhetoric
  - Could also lead to steeper curves if market thinks fiscal policy becomes looser

Source: Amundi

China: Cyclical stabilisation, long-term concerns, with structural defenses

- Macro indicators in China have stabilised this year
- Upside surprise to growth for 2016 is on the cards
- But leverage has continued to increase at a strong pace
- Domestic-dominated and quasi-dominated nature of debt provide sources of support for any deleveraging process in China

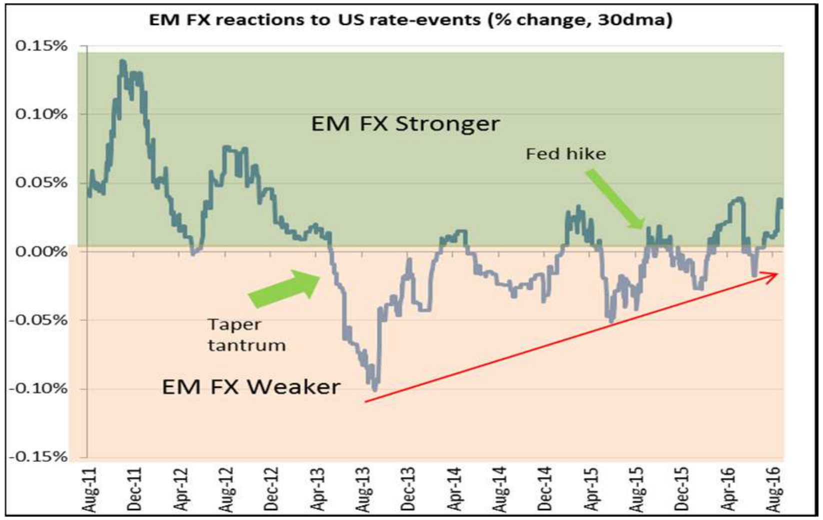


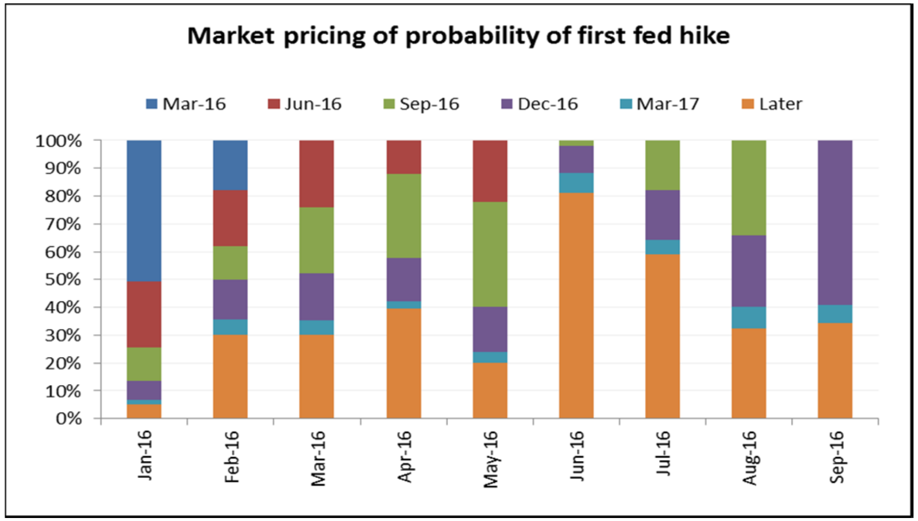


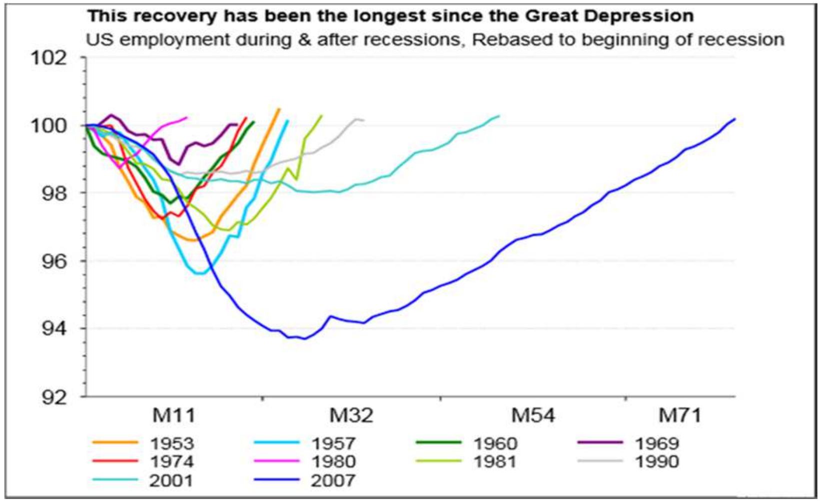
Source: Amundi, Thomson Reuters, Bloomberg, as at September 2016

Fear of the Fed: contained by global data dependence

- Fear of the Fed remains on market's mind
- But the Fed is increasingly constrained
- By global data and financial market reactions
- As well as by domestic data losing steam
- In any case, EM assets are becoming less responsive to Hawkish US rate surprises







Source: Amundi, Thomson Reuters, Bloomberg, as at October 2016

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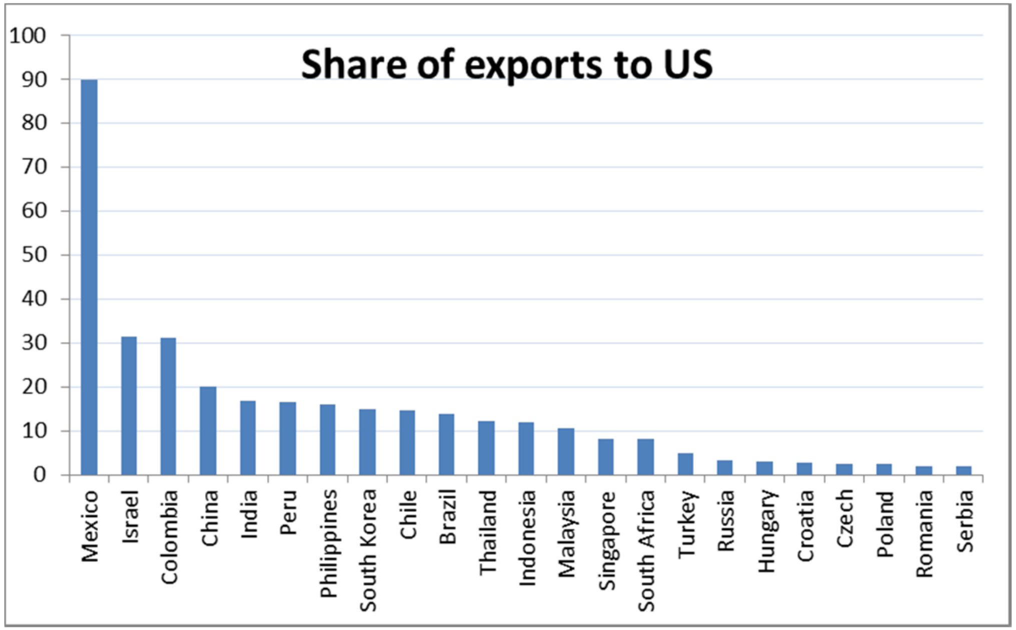
Trump and the rise of protectionism

- A Donald Trump victory increasingly unlikely
- But do not get too bearish on EM even if he wins
- Mexico and China-linked Asian countries will suffer
- But high yielders can benefit from delay in Fed hikes



Source: Amundi, CNN, Bloomberg, Thomson Reuters, as at September 2016

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EM has had a stellar year so far, but there's more left in the rally

- Inflows likely to remain strong
  - Global asset allocation is underweight EM – room for more structural inflows
  - Yield desert in developed markets – EM is the oasis

- Fundamentals
  - Growth has stabilised in EM. Differential vs. DM likely to widen
  - External vulnerabilities declining rapidly in EM amid reserve buildup
  - Current account balances at a multi-annual high in EM on average
  - Flexible exchange rates as a new automatic stabiliser for fundamentals in event of external shocks

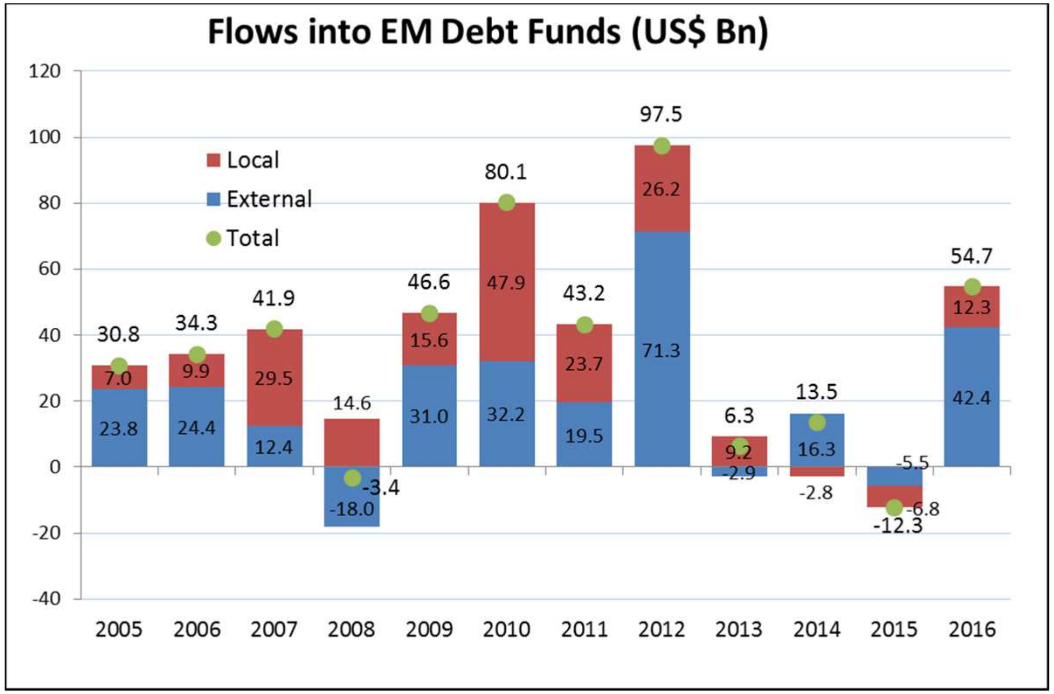
- Valuations
  - Valuations in EM are far from stretched
  - EM real yield differentials vs. DM are at multi-annual highs
  - Sovereign spreads have room for further tightening

Source: Amundi

Inflows likely to be sustained

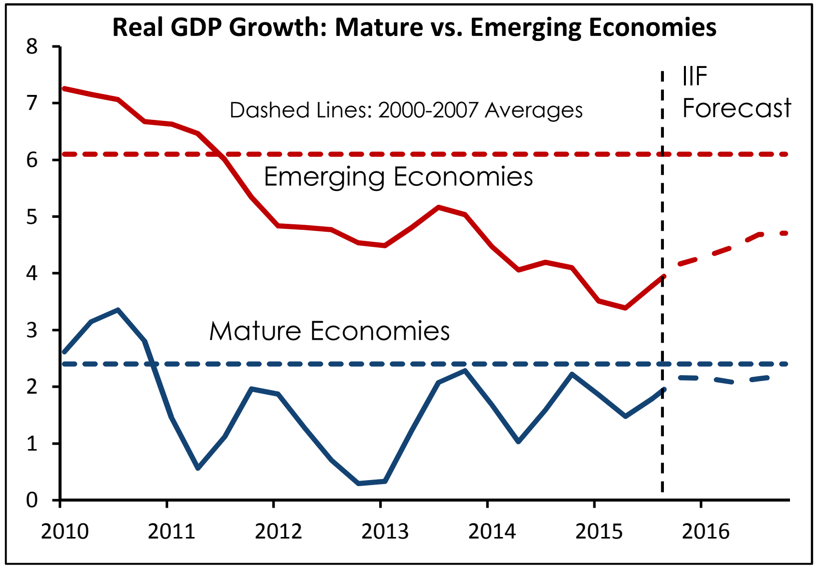
- Global asset allocation is underweight EM
- Negative Yielding Assets pushing flows away from DM
- Post-Brexit environment can be similar to Greek crisis period

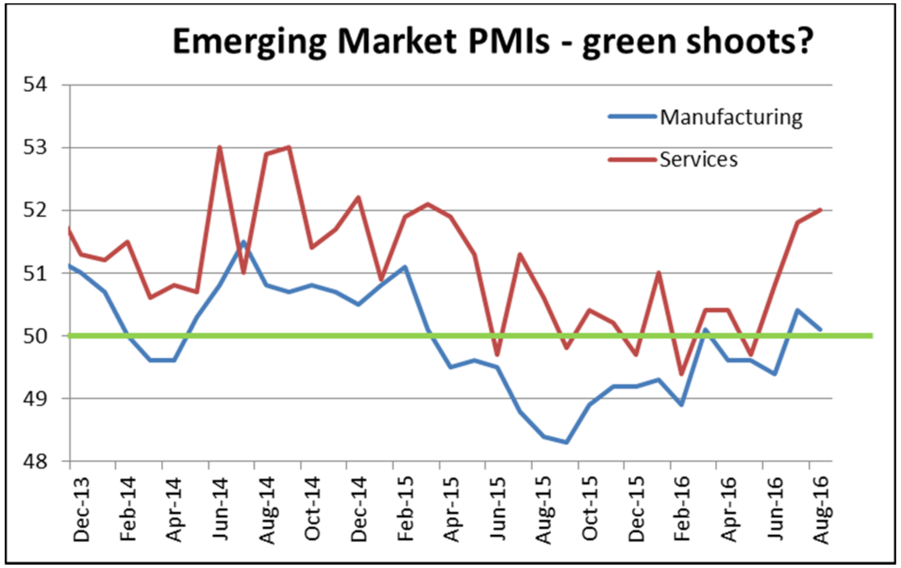
Maturities	GBI Broad	EMU	EUR Credit
1-3	33%	37%	55%
3-5	25%	25%	25%
5-7	18%	18%	14%
7-10	19%	17%	7%
10+	5%	4%	-
Total	28%	51%	53%



EM growth showing signs of stabilisation

- Growth in EM has been surprising to the upside for first time in 5 years
- The EM-DM output growth differential expected to start widening again
- No sign of negative knock-on effect on EM growth from Brexit
- But no surge in growth either amidst slowing China

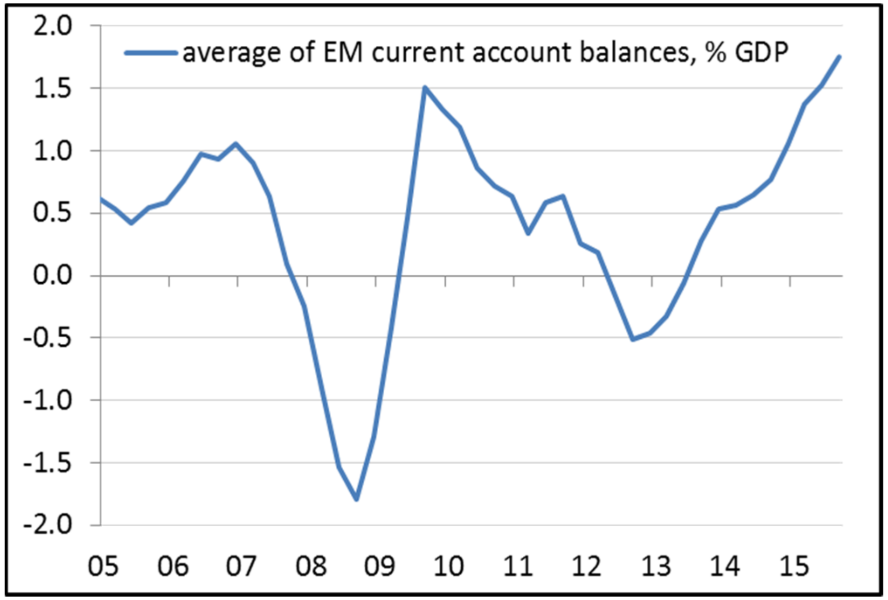


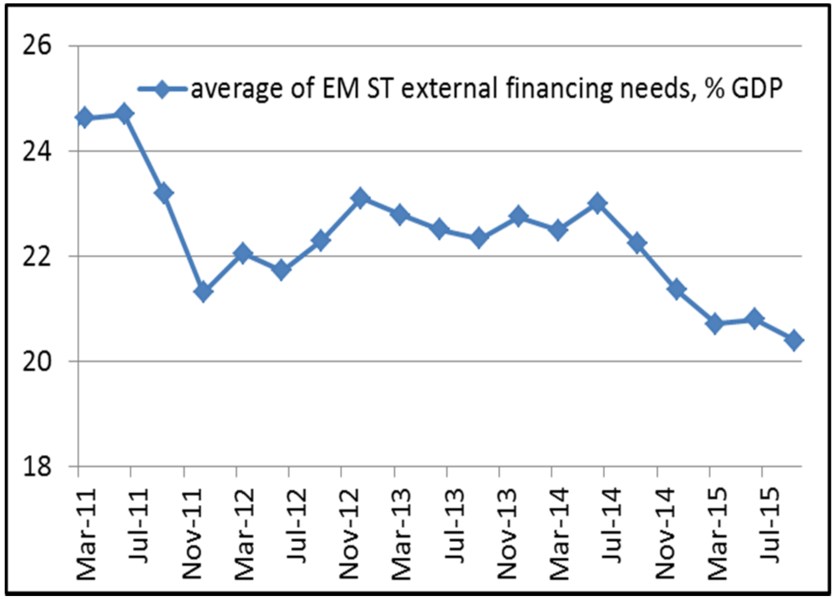


Source: Amundi, Thomson Reuters, IIF, IMF, as at October 2016

Fundamentals looking healthier – lower external vulnerabilitiy

- Current account balances on improving trend, *despite* negative shock to terms of trade
- Short-term external financing needs on declining path in EM



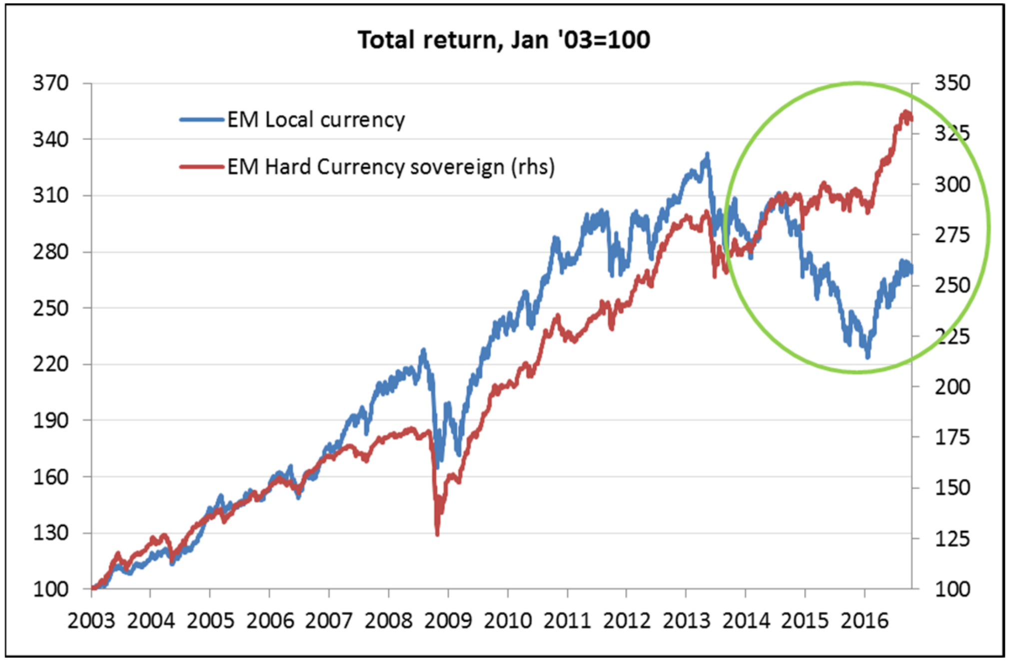


Source: Amundi, Thomson Reuters, IIF, IMF, as at September 2016

EM Fundamentals have a new source of resilience: Flexible exchange rates

- The divergence between EM credit and EM currencies has been unprecedented since the oil price collapse started in mid-2014
- EM Currencies have acted as the adjustment valve – increasing number of currencies in free float
- Currency sell-off has allowed for macro stabilisation

  ⇒ prevented exaggerated weakness in current account and fiscal balances
- Only GCC currencies have not adjusted in 2014/2015, making credit in the region more vulnerable



Source: Amundi, Bloomberg, JPMorgan as at May 2016

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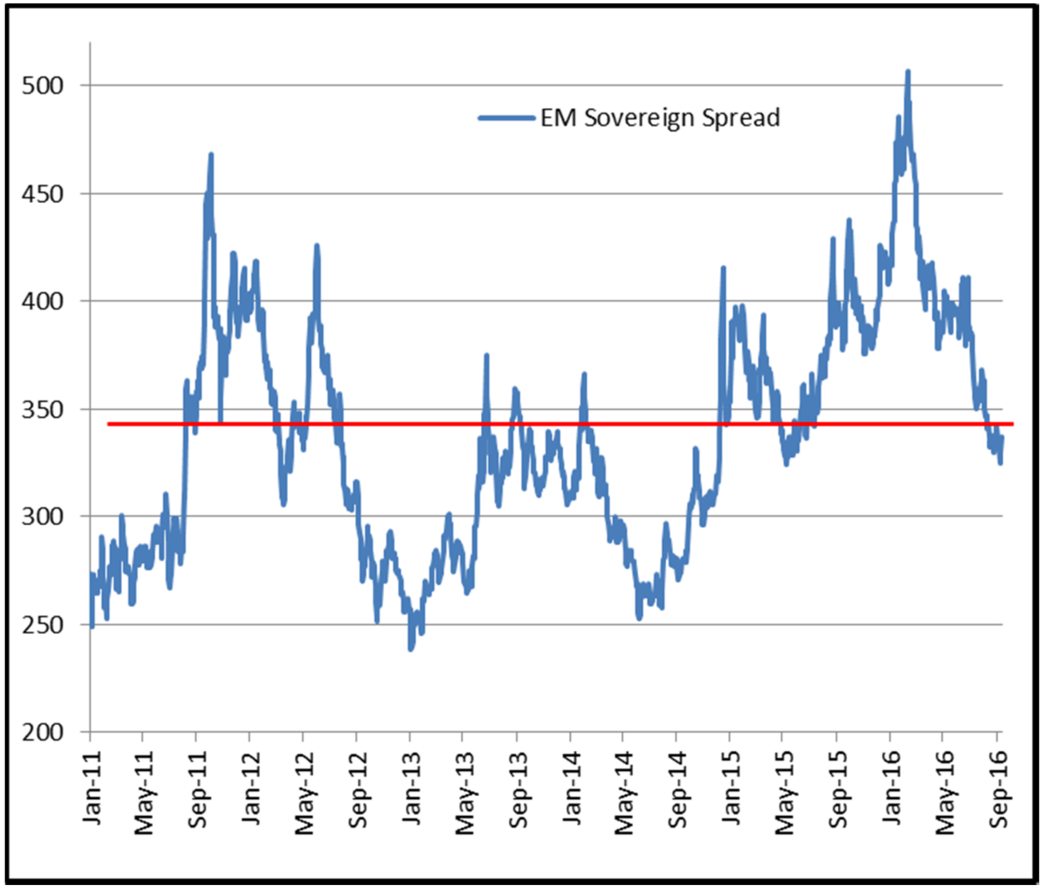
Valuations: Spreads still wide given improved fundamentals

- Sovereign spreads have tightened, but remain 100bps wider than taper tantrum episode, despite reduced vulnerabilities



Source: Amundi, Bloomberg, JPMorgan, as at October 2016

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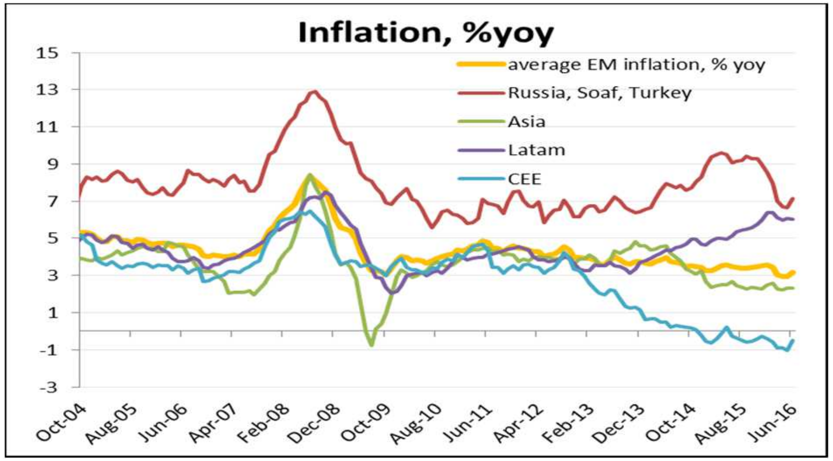
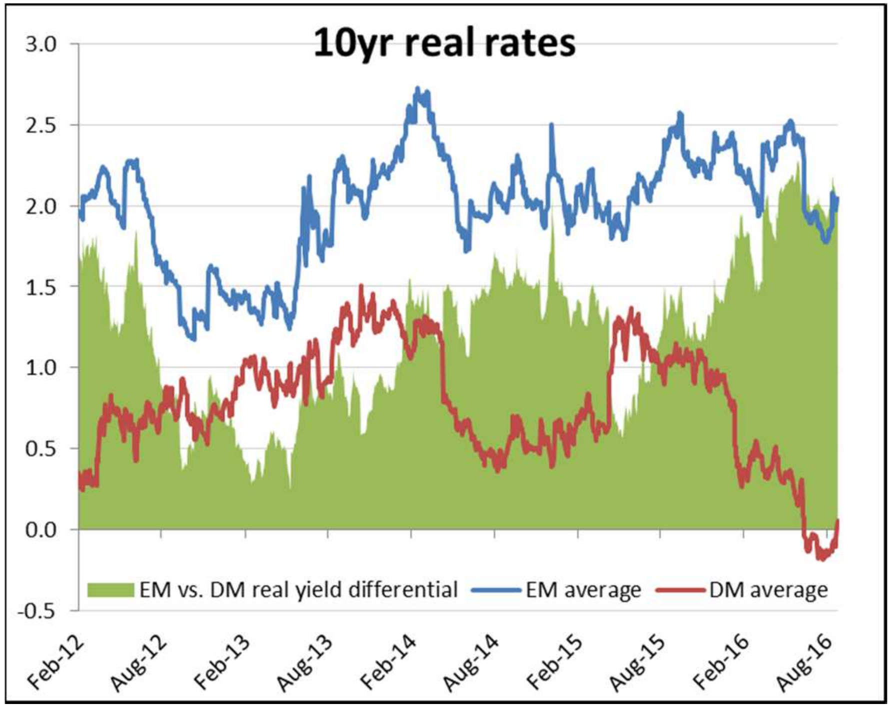
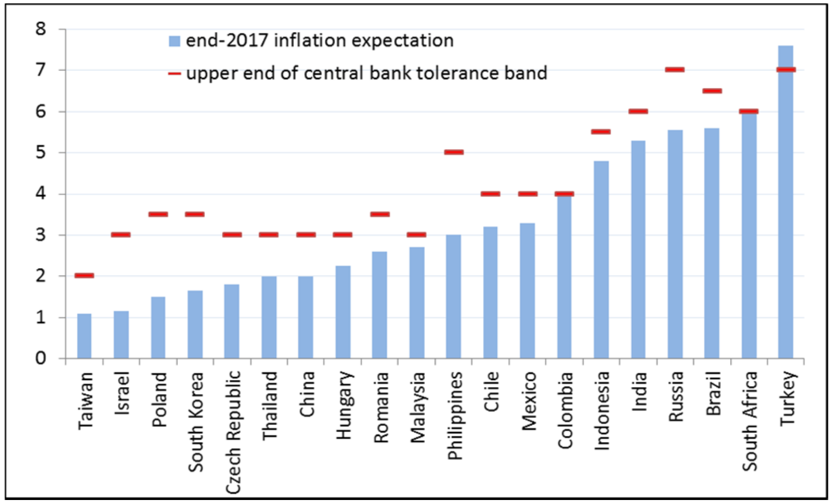
Valuations: Inflation contained, higher real rates, room for more accommodation

- Valuations in EM rates and credit remain attractive, despite the recent rally
- Real rates in EM are at multi-annual wides vs. DM – significantly higher than during taper-tantrum episode







Source: Amundi, Thomson Reuters, IIF, IMF, Bloomberg, JPMorgan, as at October 2016

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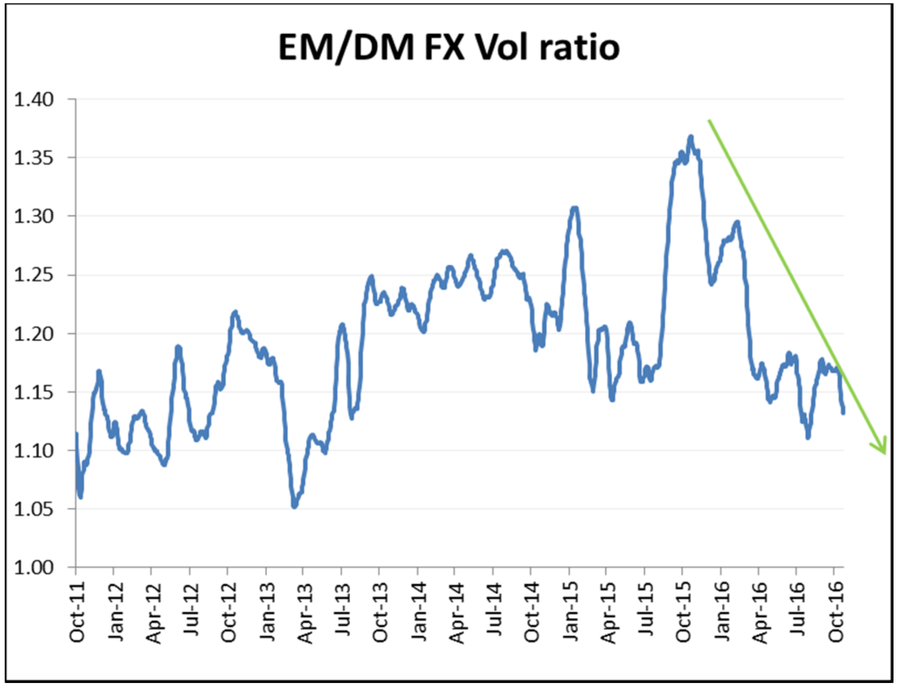
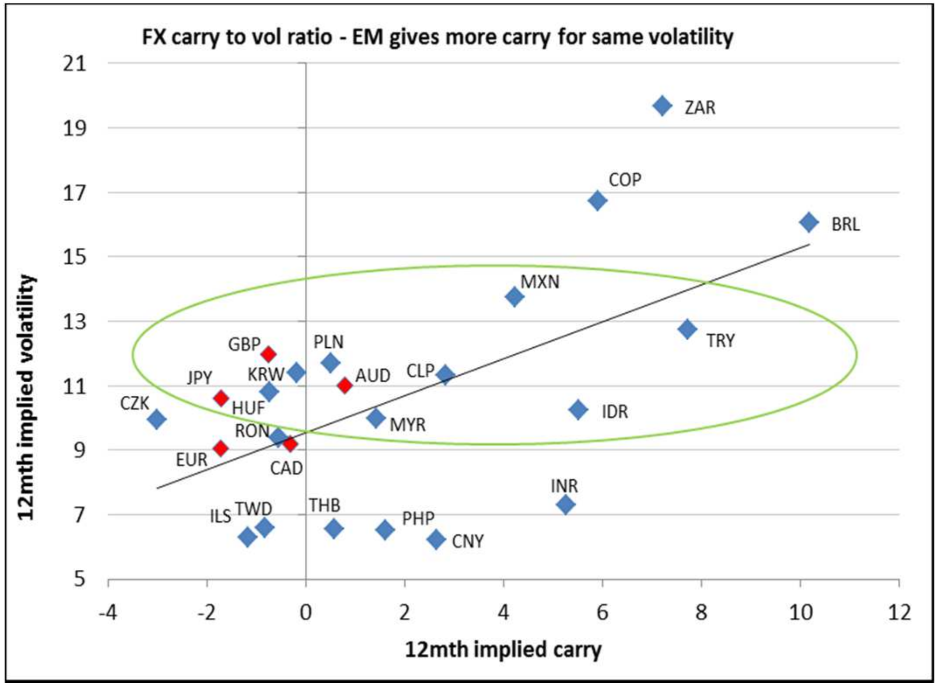
The lower volatility of EM currencies compared to G10: reflective of broader trends

- Volatility of EM currencies falling compared to G10
- EM currencies offer much better volatility-adjusted levels of yield compared to G10





Source: Amundi, Thomson Reuters, IIF, IMF, Bloomberg, JPMorgan, as at October 2016

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