FLASH NOTE

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Navigating through Emerging Markets with selectivity and cautiousness

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What happened so far?

Emerging markets have been hit hard by the Covid-19 sell-off, suffering large outflows, more than in any crisis of the past 15 years*, and this despite not being as hard hit as developed countries with lower official death rates and less severe restrictions.

Policy support

In April, global markets enjoyed a stimulus-fuelled rally on evidence that the Covid-19 outbreak is getting contained. Emerging markets have also stabilised on growing evidence the pandemic's impacts will be less severe, along with improving dollar liquidity averting a dollar squeeze/debt crisis so far.

Economic uncertainties persist

Although very early and difficult to assess and quantify the full impact of Covid-19, the second-order economic effects from lockdowns, shuttered tourist industries and weakened external and domestic demand are still a headwind for Emerging markets.

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Big picture view

The current crisis is mostly reinforcing previous trends of slowing global growth, and dispersion of economic performance between countries. If liquidity injections, monetary and fiscal stimulus from advanced economies and a possible weaker dollar can provide further support to Emerging markets, medium-term outlook remains uncertain, therefore **selectivity will remain key to navigate through this volatile and fragile environment**

Diverging conditions

A clear separation seems to be operating among Emerging countries:

Deteriorating outlook for oil exporting countries and those needing US dollar fundingthat could be hurt by dollar-squeeze further down the line.
Constructive outlook for oil importing countries and namely Asian countriesthat have decent fundamentals, stronger relative growth and have managed to navigate the crisis better than the western world.
China clearly stands out as the good handling of crisis & economy could make it come out stronger from the crisis in relative terms.

The Chinese case

Economic activity is gradually picking up as it is the first country out of lockdown.
China has so far eschewed large-scale government support, with a more targeted approach. Instead of pumping credit indiscriminately (like they would have done in the past), they engineered a slowdown and directed credit towards key sectors for economy (Technology, Artificial Intelligence, Healthcare, Electric Vehicles).
Improving fundamentals & current account surplus, benefiting from lower commodity prices & shutdown of tourism for a prolonged period.

*Source: Carmignac, Bloomberg, Gavekal research, 07/05/2020

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