

## Global growth could be the best in over a decade; emerging markets will likely benefit



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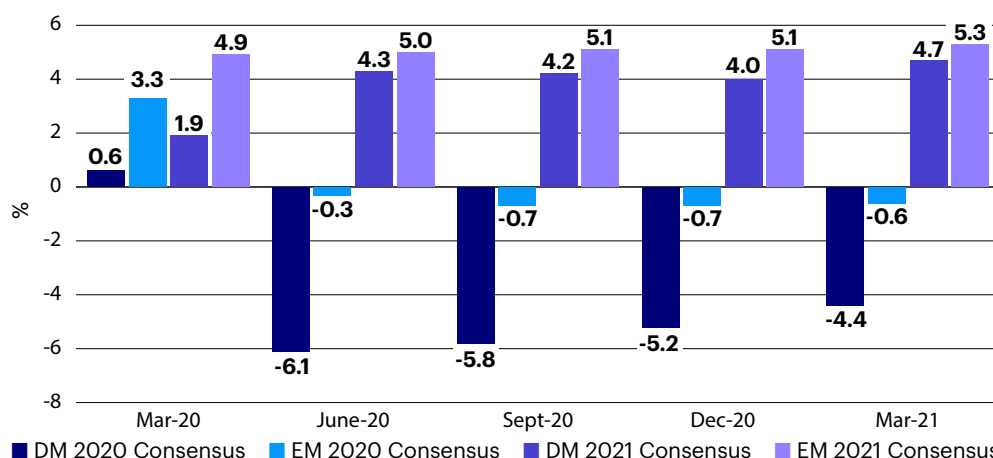
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### Overview

- Our estimate for global growth is at the top of our forecast range, but inflation should remain tempered.
- We expect emerging market central banks to become less accommodative, but any changes should not exceed market expectations.
- We maintain a cautious view on Peru's rates and currency due to its uncertain election outlook and economic challenges posed by the pandemic.

A global recovery is well under way with 2021 growth estimates being raised across global regions. Our own estimates for the US, eurozone and selected emerging market countries are near the upper end of our economists' forecast ranges. This indicates our growing confidence that this year's global growth could be the highest in over a decade. While the initial upswing is likely to be led by China, followed by the US and emerging markets, especially Asia, Europe could rebound in the second half of the year, extending the recovery to a truly global reflationary boom. These improved global growth forecasts would, however, still leave the global economy below its trend output until 2022. Inflation, therefore, should be tempered and not of significant concern. While recent inflation has been dominated by goods prices, the coming boom is likely to be services-led, where the output gap is still too large to result in any near-term inflationary concerns.

**Figure 1: GDP consensus forecasts – developed markets versus emerging markets**



Source: Bloomberg L.P. Data from March 30, 2020, to March 22, 2021. EM is emerging market. DM is developed market.

We continue to expect emerging market central banks that were providing extraordinary stimulus to become less accommodative. This change should be limited and unlikely to exceed market expectations already priced in. We believe the path of rate increases will be key to extracting excess returns from markets.

In emerging markets, mainly due to recency bias, there is a persistent apprehension that global growth will lead to policy responses that will result in negative asset performance. We believe this relatively pervasive apprehension has kept emerging market term premia elevated, and will allow them to be extracted within our investment horizon of nine to 18 months. The emerging markets of today are not the emerging markets of 2013. Their external accounts have meaningfully improved, currencies remain at compelling valuations, in our view, and capital flows, though negative in 2020, have turned moderately positive.

The theme underlying our investment strategy in the short and medium term will remain reflation and growth. Additionally, in the absence of tightening financial conditions, all growth will likely be "good" growth for reflationary assets.

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## Market Pulse

The absolute April performance of the benchmark (JPM GBI-EM Global Diversified Index) was driven by stronger emerging market currencies, somewhat lower interest rates, with the balance from income.<sup>1</sup> From a high-level perspective, we favor the front end of some rates curves (Mexico, Czech Republic, Colombia), specifically around the five-year point, given its attractive carry and roll potential, while we are cautious on the long end, as fiscal pressures continue. The main change during the month was in Russia, where we have become more cautious based on fundamental macro performance (growth and inflation) and the possibility of more severe sanctions by the Biden administration. In currencies, we favor Asia and are cautious on Latin America.

Except for Russia and Ukraine, central banks have been on hold, either looking through high and rising inflation and/or benefiting from a pause in the upward march of higher US interest rates and steeper yield curves. After hiking 25 basis points in March, the Russian central bank hiked by 50 basis points in April. The bank's hawkish message solidified the market's expectations of a front-loaded cycle spurred by demand-driven inflation pressures - not only in food but in core inflation too, fueled by growing wage pressures. The bank's hawkish message was supported by its new policy rate forecast range, showing a midpoint benchmark rate of 5.1% for 2021 and 5.8% for 2022.<sup>2</sup> Assuming the central bank tightens by 25 basis points at its next two meetings, the 2021 average rate would reach the 2021 midpoint. The bank's hawkish tone continues.

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## Country spotlight: Peru

From the start of the year, Peru has been one of the few countries we have viewed negatively from both a rates and currency perspective. Our early bearish view was predicated on politics and the difficult electoral dynamics in a discordant social and institutional environment made worse by the pandemic. The pandemic has had a lasting negative impact on Peru's population and its economy. While Brazil received most of the negative headlines about the pandemic, Peru has one of the lowest ratios of ICU beds per capita in Latin America. The lack of vaccines and preparedness by the current administration led to a severe third wave of the virus. In our view, the impact of the recent third wave could delay Peru's economic recovery until the second half of 2021. One of the government's major responses was to allow for early pension withdrawals. At the beginning of April, the congress approved the third round of withdrawals but it was vetoed by the president and may take months to settle, putting further pressure on the country's yield curve and exchange rate. In addition to the renewed health crisis, Peru held the first round of its presidential elections on April 11. Pedro Castillo of the leftist Free Peru party finished first in the voting, in what seemed to be the voters' response to the poor handling of the pandemic by the government. Castillo will now face a second-round runoff against the more moderate, but highly controversial, Keiko Fujimori of the Popular Force party. In our view, Castillo's stated policies are quite radical, and could impact the long-term recovery and investment thesis in Peru. We maintain a cautious view on Peru's rates and currency heading into the June 6 second-round runoff. Castillo holds a lead with a large number of undecided votes, and so heightened political instability is a risk factor.<sup>3</sup>

1. Source: Bloomberg L.P. Data from April 1, 2021 to April 30, 2021.
2. Source: Central Bank of Russia. Data as of April 23, 2021.
3. Source: JPM. Data as of May 12, 2021.

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When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

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All data as of April 30, 2021, unless otherwise stated. All data is USD, unless otherwise stated.

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