Perspectives
Emerging markets

Annual outlook 2023

Key messages

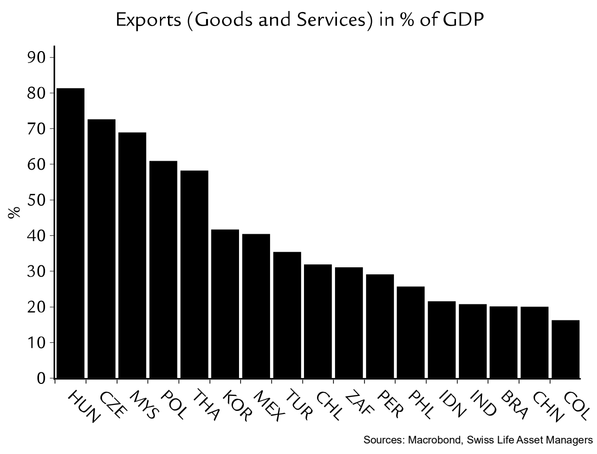
- Easing of monetary policy in individual emerging markets as soon as the Fed ends the interest rate hike cycle
- China heralds the end of its "zero-Covid" policy: cyclical upswing from the second quarter of 2023
- No de-globalisation but "China plus 1" as the predominant diversification strategy

Number in focus

3.9%

According to International Monetary Fund forecasts, emerging and developing economies will grow by 3.9% year-on-year in 2023. This is slightly above this year's growth forecast of 3.7%, but well below the historical growth rates for this part of the world. There are, however, major regional differences: solid growth of over 5% is expected for Asia, while emerging markets in Europe are bringing up the rear with a growth forecast of 0.6%. Further details on the growth dynamics of the various regions follow on page 2.

Chart in focus



High inflation, rising interest rates and the energy crisis are weighing on the economy in the US and the eurozone, which are both heading towards — or are already in — a recession. Meanwhile, the slowdown in global demand is clearly noticeable in emerging markets. Countries heavily dependent on exports (see "Chart in focus"), such as those in Eastern Europe, South Korea and Mexico, are already experiencing a slowdown in their exports. Other emerging markets, such as India and Indonesia, are more inward-looking and less affected by negative global dynamics.

Uneven growth prospects for 2023

The growth prospects of the emerging markets for 2023 vary greatly from region to region. The IMF's growth forecasts for Asia, for example, are constructive at around 5%. There are a number of reasons for this solid outlook in an environment of slowing global growth. On the one hand, inflation remained lower compared to other emerging markets. This in turn enabled the central banks to initiate more moderate interest rate hikes. As a result, domestic demand remained resilient and is additionally supported (outside China) by a sustained post-pandemic recovery. Moreover, several Asian economies with a relatively low export share as a percentage of GDP are less vulnerable to negative global demand dynamics. At the same time, the expected reopening of China from the second quarter of 2023 onwards could give the region a further boost, even if China will not be the major growth engine this time – China's economic growth is likely to be lower than that of the other emerging Asian markets for the first time since 1990 (see Figure 1). In Latin America, the outlook is somewhat less optimistic. Rising inflation rates have forced central banks to raise interest rates significantly, which will weigh on domestic demand, while countries such as Mexico will feel the lower demand from the US. In addition, political uncertainty in the region remains high with new populist governments in various countries. Eastern Europe is particularly fragile under the current economic and political conditions. This is not only due to its proximity to the war, which is perpetuating the geopolitical uncertainty. The Eastern European countries are very dependent on the growth path of Western Europe, where some countries are in recession. Moreover, with double-digit inflation rates, price pressure in the region remains significant despite sharp interest rate hikes by the respective central banks and is weighing on the domestic economy.

Scope for monetary easing

The central banks of the emerging markets have done a good job in the current high-inflation environment. They anticipated the rate hikes by the US Federal Reserve and significantly raised interest rates in the course of 2022. For some of them, there is an opportunity to end the rate hike cycle, and the first countries may be able to reverse some of the rate hikes in 2023. This is particularly true for Latin American economies. Above all Brazil, whose central bank has raised interest rates to above 13% and whose real interest rates (inflation-adjusted nominal interest rates) exceed 7%, may be in a position to make a first rate cut, especially as inflationary pressures continue to fall. However, other countries, will have to be more cautious. Eastern Europe is reporting double-digit inflation rates, although interest rates have risen significantly, leaving real interest rates deep in negative territory. In Asia, central banks have been reluctant to raise interest rates in a significant manner and therefore have only limited scope to maintain interest rates at current levels or even lower them, especially while the Fed continues to raise interest rates. However, as soon as the Fed reaches its peak, the first Asian countries, such as India or Indonesia, may also be able to loosen their monetary policy.

Figure 1: Growth prospects for Asia are constructive, but China no longer a growth driver

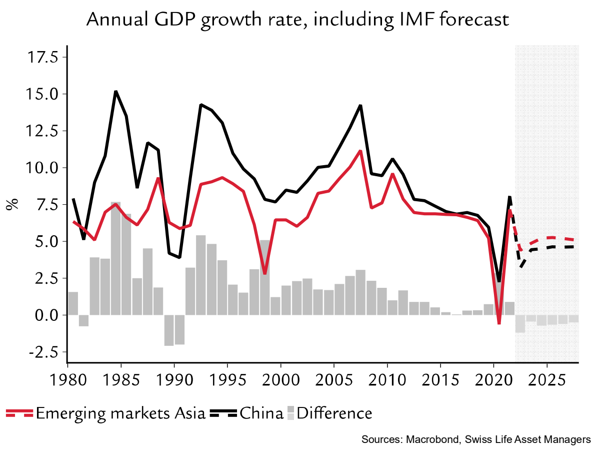
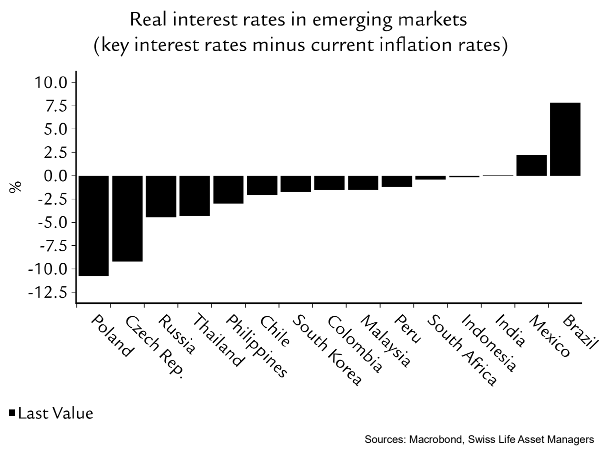


Figure 2: Scope for interest rate cuts in Brazil due to high real interest rates and falling inflation



Zero-Covid policy is obsolete

The Chinese government has announced a significant easing of Covid measures, which shows that its zero-Covid policy to contain the virus has become obsolete. This means that city-wide lockdowns and daily PCR testing of millions of people are a thing of the past. These easing measures were introduced much earlier and are more widespread than expected, thus bringing forward the timing of an economic recovery. We therefore expect the economy to experience an upturn from the second quarter of 2023. However, the transition to this economic recovery will be bumpy. Firstly, only 40% of the population aged over 80 have received a booster vaccination. The target of getting 90% of this age group to receive at least the first two vaccinations or a booster vaccination by the end of January seems very ambitious. Given the poor level of immunisation among the population, it remains to be seen how quickly local authorities will be able to ease the restrictions if an increase in cases puts a strain on the country’s healthcare system. Secondly, while the easing of Covid restrictions will boost the domestic economy, the external environment remains difficult and is likely to weigh on the country's export performance. For this reason, we are only raising our GDP forecast for 2023 slightly, from 4.7% to 4.9%.

"China plus 1" not de-globalisation

The pandemic has shown how crucial sustainable and diversified supply chains are. In addition, tensions between the US and China, as well as the greater political risk in doing business in China have triggered fears of increasing de-globalisation and onshoring (the relocation of the production of goods and services back to the country of origin). For some critical components, such as semiconductors, some efforts are already being made in this direction. On a broader level, however, there are no signs of de-globalisation. World trade is continuing its upward trend and China's exports to the world also remain at a very high level. Nevertheless, survey data and anecdotal evidence show that more and more companies want to shift investments from China to other countries. Although we do not anticipate a mass exodus of companies from China, we do anticipate an increasingly diversified footprint. A "China plus 1 strategy" is therefore likely to be the predominant path in the future. Recent experiences from the trade war between the US and China may provide an indication of where trade from China could shift to. Since 2018, when trade tariffs were introduced on Chinese goods, China has lost around 3 percentage points of market share for US imports. This in turn has benefited other countries, most notably Vietnam (see Figure 4).

Figure 3: China’s mobility will recover further thanks to Covid easing measures

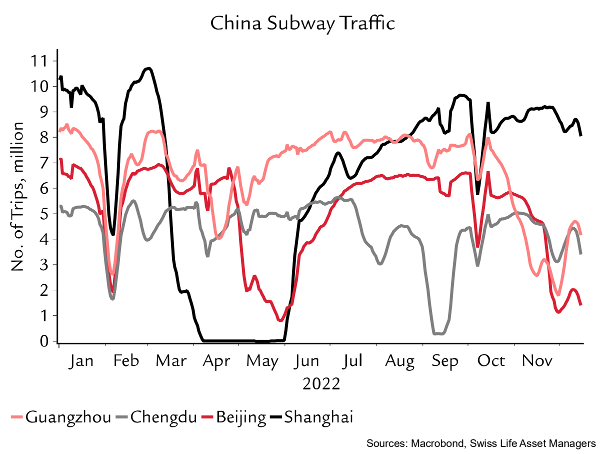
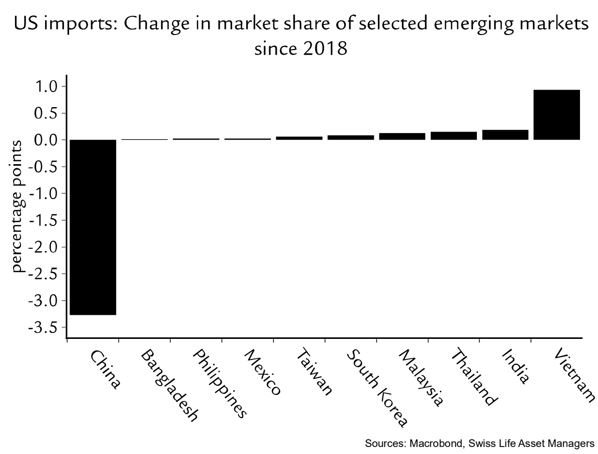


Figure 4: Diversification away from China benefits other Asian economies



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