CITY OF LONDON
Investment Management Company Limited

Emerging Markets Quarterly Outlook

July 2017

Overview

A Tipping Point for Emerging Markets?

Advanced economies are in the thrall of central banks dialling back the wheels of monetary accommodation. While not coordinated, most central banks across the G10 are responding to similar economic conditions, albeit to varying degrees. The Fed has raised interest rates four times in the current tightening cycle, promising one more move in 2017 and three in 2018. What is more, it has laid out plans to shrink its bloated balance sheet, perhaps commencing as soon as late 2017. Together, these actions put pressure on both short and long term interest rates, the latter being of importance for those emerging markets (EM) depending on foreign financing. The Bank of England has also halted its QE program and has begun to debate rate increases, although its Council remains divided on the issue in the face of the uncertainties relating to Brexit. In turn, the ECB has stepped down the pace of its asset purchases and will likely further reduce its activities in 2018 as its economy gathers momentum, the deflation threat appears to wane and its purchases face increasing market constraints. It has not debated rate increases, but it is well known that several of its members are opposed to the negative deposit rate. Only the Bank of Japan (BoJ) appears set to continue its decades-long effort to reflate its economy, prolonging both its asset purchases and its recently adopted "yield curve control" policy.

Could these developments end the impressive rally in EM equities, which gained 6.2% in Q2 and close to 20% in H1? We have previously argued that emerging market balance sheets have improved considerably over the past decade and again, in many cases, since the 2013 'taper tantrum'. But EMs could nevertheless be affected by higher US rates as they drive the US dollar up and spur capital outflows. Yet, the outlook is less dire than it may appear. Rate increases everywhere will likely be gradual and rise to a lower terminal rate than in previous cycles. What is more, considerable uncertainty remains over the pace of tightening as (a) inflation pressures remain largely absent, (b) the focus appears to be on creating room for manoeuvre and "insuring" against future recessions as well as on (c) safeguarding financial stability (preventing asset market bubbles). Accordingly, US markets price in only an 8% chance of a Fed hike in September and just 40% for a December hike. Janet Yellen's apparent backtracking in her recent Congressional testimony quickly gave emerging markets a boost. What is more, when emerging economies grow along with the US, this typically minimizes the narrowing of rate differentials, keeping currencies stable. In turn, this can act to deter capital outflows and the start of a vicious debt cycle. A third element is that a reversal of the volatility suppression that QE achieved could reduce Sharpe ratios and thus render EM investments less attractive. While this remains true, emerging market investors are typically accustomed to higher rates of risk in return for greater rewards and a rise in volatility also opens up new opportunities.

Finally, there is a sectoral aspect to bear in mind. Since hopes for a boost to construction and healthcare sectors thanks to President Trump's planned policies have faded, investors have increasingly turned to the technology sector, which is less exposed to policy interference. The interest in tech has also pervaded emerging markets: the share of technology in the MSCI EM has doubled over the past five years to over 25%, overtaking the share of the energy sector which declined to some 12% over the same period. A breakdown of index performance by sector shows that it has primarily been led by the technology and consumer discretionary sectors since early 2016.

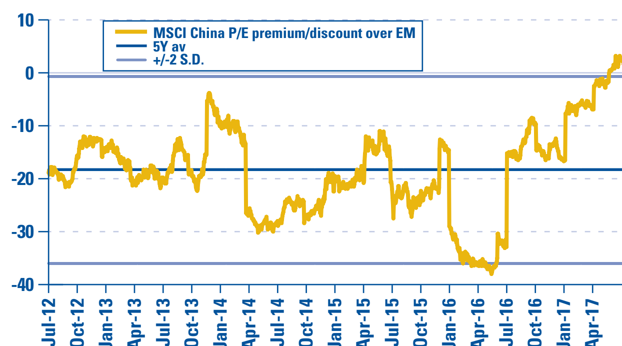
Market Strategy

The prominence of the technology sector and a burgeoning middle class which is spending on consumer goods are characteristics typical of Asian economies. These countries thus remain at the core of our allocation. However, we are also wary of the rapid rise of technology stocks as they have driven earnings expectations for the year to new heights (14.5% yoy).

On balance, risks for EMs are rising, even if there is no clear 'tipping point' approaching. The implication is that high-beta high markets may do less well in the months ahead. That is why we maintain our *underweight* in Turkey (the top performer during Q2 though it retains many vulnerabilities) and our *underweight* in Brazil, where political risk remains high. Conversely, India may undergo a temporary setback if the introduction of the GST encounters hiccups, but continues to represent a good defensive choice in a less risk friendly environment. We keep our *overweight* there.

The key change to our allocation is the move to *underweight* of China. Valuations for China have reached extremes according to our metric (a P/E premium to the market two standard deviations from its 5yr average), while the debt burden has kept rising. This may not lead to a bust, but represents a burden on the economy, which suffers overcapacity, declining productivity and misallocated resources to inefficient SOEs. What is more, the recent rally may partly owe to the announcement that mainland shares will be included in the MSCI EM index from June 2018, an effect that is likely to fade.

Chart 1: China Valuations, %



Source: City of London Investment Management, Bloomberg

Asia

China

Underweight (↓)

There is little upside for the Chinese economy as policymakers struggle to reconcile their growth objectives with widening internal imbalances.

Policymakers have been successful in maintaining growth at a solid level, while permitting a gradual slowdown. If Q4 growth exceeded expectations with a 6.8% yoy gain, Q1 2017 did so again as GDP expanded 6.9% yoy. What is more, recent activity indicators point to ongoing steady growth. Industrial production grew at an unchanged 6.5% yoy in May, while FAI growth slowed only marginally, to 7.9% yoy in May from 8.3% in April on the back of softer infrastructure and real estate investment growth. Retail sales remained unchanged at 10.7% yoy in May. More recently, the NBS manufacturing PMI beat market expectations in June, rising to 51.7 from 51.2 in May, while the non-manufacturing PMI increased to 54.9.

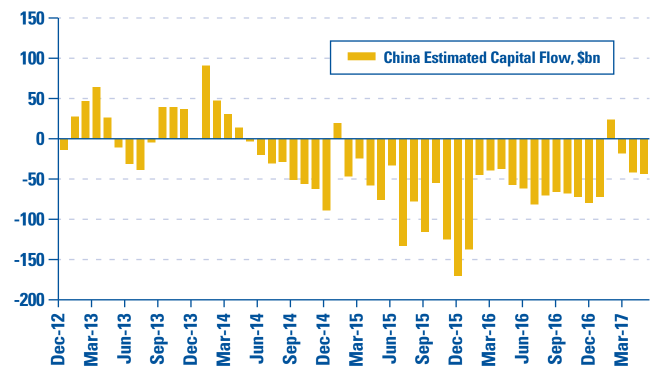
The housing market has held up well this year, as transactions in cities without tightening measures more than offset the weak activity in cities that did tighten housing market policies. NBS data show national house prices rising an average 9.7% yoy in May, only slightly down from a 9.9% yoy gain in April. However, housing transaction growth has begun to slow and real estate investment growth eased to 7.4% yoy in May from 9.8% in April as a result. The second half of the year could witness a slowdown in headline growth as the fiscal stance is less expansionary than in 2016 and much of the expenditures for infrastructure projects this year have been frontloaded to H1.

Yet, amidst its efforts to rebalance the economy towards a greater reliance on domestic consumption, the government has had to repeatedly return to policy stimulus to ensure a smooth growth slowdown. In turn, this has resulted in the build-up of record leverage and run-away house price inflation. From 156% of GDP in 2008, China's domestic debt exploded to 268% of GDP by 2016, twice the EM average and only just below the DM average measure. The majority of it is owed by corporates (61%), over half of which are SOEs. While China has so far been able to stave off a crisis thanks to the domestic nature of the debt, its high growth and savings rates as well as some technical adjustments, the heavy burden is nevertheless weighing on the economy and preventing a more efficient allocation of resources. In particular, it has led to a decline in investment efficiency, the build-up of overcapacity and to excessive lending, some 60% of which go towards servicing existing debt. These problems will likely continue to cast a shadow over the economy, spur capital outflows and weigh on the currency until the government makes more fundamental changes to the SOE and banking sectors.

Inflation, meanwhile, recovered from its lows earlier in the year and CPI rose to 1.5% yoy in May, from 1.2% in April as food prices stabilized. But overcapacity, softening demand and weak commodity prices meant that PPI dropped once again, easing from 7.6% yoy in March to 5.5% yoy in May. With CPI well below the official 3% target and PPI having peaked in February, the PBoC will likely keep benchmark policy rates and the RRR unchanged for the year. Nevertheless, it has tightened wholesale liquidity conditions and strengthened prudential regulations recently, with the aim of cracking down on shadow banking transactions.

FX reserve data suggest continued, but moderate capital outflows. In June, reserves edged up to $3.1 trn, bringing the year-to-date rise to $46 bn. Exports have remained strong amid softening imports, driving a recovery in the trade surplus. Together with tighter capital controls, this has lessened the need for FX intervention by the PBoC and allowed foreign reserves to rebuild.

Chart 2: China Estimated Capital Flow, $bn



Source: Bloomberg

Market Strategy: Sentiment towards Chinese equities was buoyed by MSCI's decision in June to include mainland China A shares in its EM index from June 2018 with an estimated weight of 0.7%. Having been rejected twice previously, improved investor access to mainland shares via the Stock Connect programme, which links the Hong Kong Stock Exchange with the Shanghai and Shenzen exchanges, persuaded MSCI to include 222 A-share large cap stocks. This is more than the 169 stocks initially suggested, but still less than half of the total of 448 large cap stocks in the MSCI China A International index.

Partly as a consequence, the MSCI China had another strong quarter with a 10.6% return in Q2, bringing year-to-date performance to 25% and the rise from February 2016 to ca. 60%. At the same time, it has boosted China's valuation. While its 16.3 P/E is only just above the 15.9 EM average, the 2% premium it implies is a long distance from the traditional 18% discount, putting it two standard deviations above the 5yr average. As the economy continues to slow and the debt burden weighs on potential growth, further market upside becomes increasingly limited. We shift our allocation to *underweight* as a result.

South Korea

Overweight

Confidence in the economic outlook is improving, following the decisive election victory of Moon Jae-in in the May presidential elections.

In line with the opinion polls, Moon Jae-in of the Democratic Party (DPK) comfortably won the presidential election held on May 9th. He secured a landslide 41% of the vote, while his conservative challenger Hong Joon-pyo garnered just 24% of the votes. The election had been brought forward from December, following the impeachment of former president Park Geun-hye in March. As a result, there was no transition period and Moon assumed office immediately. Yet, his election is likely to have only a limited impact on Korea's economic outlook as the DPK lacks a majority in parliament and Moon's policy proposals are moderate in scale. In particular, the much awaited supplementary budget amounted to just 0.7% of GDP and faces stiff opposition in parliament.

Korea's economy began 2017 on a strong note, with GDP growth ticking up to 2.9% yoy in Q1, from 2.4% yoy in Q4. The pick-up was led by a rise in investment growth and private consumption also strengthened. Export growth rebounded, but a sharp rise in import demand meant that net exports were a drag on growth.

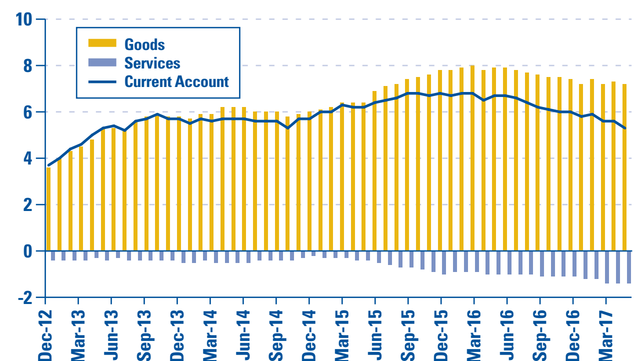
More recently, the reduction in political uncertainty has led to an improvement in consumer and business confidence. Consumer optimism reached a five-year high in June. This likely reflects the government's promises to increase support for childcare and the elderly, support job growth, as well as the rise in equity prices. While industrial production disappointed with a mere 0.1% yoy gain in May (down from 1.8% yoy in April and 3.3% yoy in March), this reflected adverse base effects while on a monthly basis IP witnessed a modest gain, reversing the April drop. On the other hand, manufacturing PMI rose to 50.1 in June, above the expansion threshold for the first time since July last year, reflecting growing confidence in improving demand conditions.

Headline consumer prices declined to 1.9% yoy in June from 2.0%. Weaker commodity prices put downward pressure on the headline rate but last year's weak readings will likely lead to higher markings in H2. However, core inflation has been steadily trending lower over the past year.

The Bank of Korea (BoK) has continued to leave its policy rate unchanged at 1.25% in June and is unlikely to move the needle in 2017. Importantly though, the economy appears to be on the mend and the BoK raised its forecast for 2017 growth from 2.6% to 2.8%. If the government's fiscal stimulus program is approved by parliament, this could provide a further boost to growth. Conversely, there is little need for the BoK to track the Fed as it inches interest rates up, given that Korea's large current account surplus puts it in a strong position to deal with any capital outflows.

Exports continue to decelerate from their February peak, which had marked the end of a recovery that started in mid-2016. But growth remains robust, buoyed in particular by sales of naval vessels. However, service exports continue to slow as a result of China's restriction on arranged travel tours to Korea. Meanwhile, the current account surplus bounced back in May, after declining consecutively for the previous three months.

Chart 3: South Korea Current Account Balance, % of GDP



Source: Bloomberg

Market Strategy: The decisive election victory of Mr. Moon and the promise of pro-growth policies have bolstered consumer and business sentiment, supporting economic momentum. Stronger domestic demand and credit growth should also boost financial sector earnings. Rising external demand is likely to support Korea given its high gearing to the technology sector and the upcoming new product launch cycle.

South Korea was one of the top equity performers in Q2, with a 10.2% return, equivalent to 3.9% index outperformance. Yet, its P/E ratio remains a low 12.9, a 19% discount to EM. This is low even relative to its usual (5yr average) 14% discount. We thus retain our *overweight* allocation.

Taiwan

Overweight

A slowdown in H1 is set to give way to growth acceleration in H2 amid healthy global demand and the new smartphone cycle commencing.

Taiwan's GDP expanded by 2.6% yoy in Q1, down slightly from 2.8% in Q4 as exports and investment slowed. A further deceleration is expected in Q2, indicated by weaker manufacturing PMI data. The Q2 monthly average was 53.6, still in expansionary territory (above 50) but down from 55.4 in Q1. However, the favourable global demand backdrop and the start of a new smartphone cycle in H2 is expected to support a rebound in growth. Consensus estimates for 2017 growth have been pushed higher to 2.3% currently, up from 1.8% at end-2016.

Tech exports already began to accelerate in Q2, with electronics exports up by 19.0% mom in June and that of telecoms rising by 8.6% against a 4.8% rise in total exports. This follows three months of contracting tech exports. Meanwhile, the steep contraction in capital goods imports (-20.3% mom in June) could be a growth counterbalance as it is typically an indicator of capex, suggesting lacklustre investment ahead.

Robust tech exports are expected to support a continued large current account surplus, forecast to be 12.6% of GDP this year. Three quarters of this is set to be accounted for by Taiwan's trade surplus. In addition, policies aimed at attracting tourists from outside China have compensated for the 42% yoy fall in Chinese tourists in Q1.

Meanwhile, inflation has remained muted. Headline and core CPI both rose by 1.0% yoy in June, up from 0.8% and 0.9%, respectively, a year earlier. The 9.3% yoy rise in the real effective exchange rate is likely to keep downward pressure on inflation and the headline rate around 1.0% for 2017 as a whole. After the central bank eased its policy rate by 25bps to 1.375% in H1 2016, growth has accelerated and with inflation tepid there is unlikely to be any change in policy in H2. The Bank stated after leaving the policy rate unchanged at its June meeting that "domestic inflationary pressures and inflation expectations are both mild."

Market Strategy: MSCI Taiwan outperformed EM by 2.3% in Q2 and 9.1% over the past year. However, Taiwan stocks still offer value in our view since they trade at a 4% trailing P/E discount to EM against a five-year average of a 21% premium. The expected growth acceleration in H2 and robust current account surplus at a time of tighter global monetary policy are also supportive for returns, so we maintain our *overweight*.

Malaysia

Overweight

Fiscal expansion is set to counteract slowing growth, while prudent FX policies have aided ringgit resilience.

Malaysia posted Q1 GDP growth of 5.6% yoy, almost a full percentage point above expectations. This is a marked acceleration from the pace in Q4 (4.5%) and puts the economy above its potential growth rate of 4.5-5.0%. The Q1 expansion was broad-based, aided by robust investment (12.9% yoy), government (7.5%) and household spending (6.6%). Overall GDP growth is expected to accelerate to 4.6% this year, up from 4.2% in 2016.

Meanwhile, the fiscal deficit widened to 4.3% of GDP in Q1, meaning that fiscal tightening will be required to meet the government's 3% target for 2017. This occurred last year when government spending fell from 22.9% of GDP in H1 to 19.6% in H2. The burden is likely to fall on areas like universities and development expenditure. Spending is most focused on raising pay for civil servants ahead of the general election, which may be called this year but must be held by 28th August 2018.

Meanwhile, inflation has been well behaved. Consumer prices rose by 3.9% yoy in May, down from 5.1% in April, and look set to be in line with BNM's forecast of 3-4% this year. Some of the fall in inflation this year has been due to lower fuel prices, but we see upside risks due to healthy domestic demand. BNM may therefore become more hawkish in H2.

Trade data improved towards end of Q2, suggesting an upturn in the tech cycle. Capital goods imports have also accelerated year to date (ytd), suggesting robust investment in H2. Some of this has been driven by FDI from China, with the East Coast Rail Link, worth $13 bn (4.5% of Malaysia GDP) and due for completion in 2024, a key project. Overall, the current account is set to remain in surplus (3.0% of GDP estimated for 2017 from 2.6% in 2016).

Prudent FX policies have improved the resilience of the ringgit to tightening global monetary conditions. Since April, exporters have been required to convert 75% of export revenues into ringgit. This has aided FX reserves, which rose to $94.6 bn in May, the highest since 2015. It also supported the currency, which has risen by 3% against the US dollar since the policy was introduced.

Market Strategy: The market trades at a 5% premium to EM, 1.5 standard deviations below its long-term average. Fiscal expansion is likely to counteract slowing growth in H2, while improving external buffers should support the ringgit, so we stay *overweight*.

Indonesia

Overweight

The economy remains steady, benefitting from stronger commodity prices and a likely increase in government spending, while withstanding rising US rates.

Increased government spending and higher commodity prices will likely boost income this year, but GDP has so far disappointed, with a mere 5.0% yoy gain in Q1. This was similar to the 4.9% yoy recorded in Q4 and indeed broadly in line with the quarterly readings over the last two years. Yet, vehicle sales and consumer confidence are rising and growth is likely to pick up in the latter half of the year, even though commodity prices (coal and palm oil) have begun to soften again. The government typically ups capital expenditures towards the end of the year and unlike in 2016, when it had to cut spending in order to meet its 3% of GDP budget deficit target, it benefits from windfall gains from the tax amnesty this year. The amnesty yielded declarations close to IDR 4.9 trn (36% of GDP) which, assuming a 25% tax rate on the income generated by these assets, could boost tax revenues by 0.6-0.8% of GDP.

Inflation has risen successively from 3.0% yoy in December 2016 to 4.4% yoy as of June, partly as a result of a rise in administered fuel prices, as the government aims to phase out subsidies. A planned rise in administered electricity tariffs could further lift headline inflation up to 4.8% yoy in Q3. Yet, core inflation has remained broadly stable at 3.1-3.4% yoy this year and will likely be affected only little by the adjustment which is relatively narrowly focused. Nevertheless, as headline inflation approaches the top of Bank Indonesia's 3-5% yoy target range, it will likely remain on hold (at 4.75%) after it cut rates six times last year in order to support growth.

Indonesia's external balance has continued to improve as its current account deficit runs at less than 2% of GDP following the government's stabilization efforts. What is more, strong foreign inflows have allowed the basic balance to move into a small surplus. This supported reserve growth and kept the currency stable in the face of Fed rate hikes.

S&P recently upgraded Indonesia's foreign currency government debt rating to investment grade, following Moody's move in 2012. Indonesia has one of the lowest debt levels in the region at 30% of GDP and demonstrated its strong commitment to fiscal rectitude in 2016 when it undertook dramatic spending cuts.

Market Strategy: Economic improvements fuelled gains of 8.5% for Indonesia during Q2, outperforming the index by 2.2%. With a P/E of 19.4, Indonesia's premium remains below its average 5yr premium and we thus retain an *overweight* allocation.

Philippines

Neutral

Growth is expected to slow and though inflationary pressures are muted, BSP is likely to remain vigilant.

Growth in the Philippines is set to slow to 6.4% this year from 6.9% in 2016. This would be below the government's 6.5-7.0% target and match the Q1 outturn, which came in below expectations of 6.7%. The secondary sector was a key drag, with mining output contracting by 20%. On the expenditure side, government consumption and investment slowed markedly, while private consumption also decelerated.

The slowdown may have moderated in Q2. Manufacturing PMI has remained in expansionary territory (above 50), but the Q2 average rose from 53.4 in Q1 to 53.8 in Q2. The business confidence index rebounded from 39.4 in Q1 to 43.0 in Q2. However, vehicle sales growth slowed to 14% in June, down from 32% in March, suggesting lacklustre household consumption. The consumer confidence index for the next three months in Q2 fell to its lowest in a year.

However, slowing activity has thus far not led to a deceleration in credit expansion. The ytd monthly average growth of commercial loans outstanding was 17.1%, up from 15.2% in the same period last year. Bangko Sentral ng Pilipinas (BSP) Governor Nestor Espenilla, who started his six-year term in July, has said the Bank will be monitoring credit growth closely. The central bank could therefore have a more hawkish tilt in H2, even though, at 2.8% yoy in June. CPI remains close to the midpoint of the central bank's 2-4% target range.

The tax reform bill approved in the House of Representatives in May, which aims to broaden the VAT base, is expected to push CPI up by 0.5-1.5 percentage points over the next few years. Over the medium-term, this may contain the budget deficit to below 3.0% of GDP, but may also leave BSP with a hawkish tilt.

Meanwhile, BSP expects the current account to be in small (0.2% of GDP) deficit this year, unchanged from 2016, as domestic demand raises imports. Overseas foreign workers' remittances should continue to counterbalance this and have risen by a monthly average of 4.5% ytd. This should prevent a significant further depreciation of the peso, which has fallen by 6.3% ytd in trade-weighted terms.

Market Strategy: Valuations for the Philippines are at a 40% premium to EM, one standard deviation below its long-term average. However, slowing growth and a hawkish central bank mean we keep our *neutral* weight.

Thailand

Neutral

Q1 GDP growth accelerated significantly, but is set to fall back below potential for full-year 2017, keeping inflation low and the BoT on hold.

GDP growth in Thailand more than doubled to 5.2% quarter-on-quarter (qoq) saar in Q1, from 2.0% in Q4. The expansion was driven by consumption (5.3%), bolstered by households and non-residents, and exports (16.3%) amid healthy external demand conditions. However, headwinds in H2 are likely as tourist numbers are hampered by King Bhumibol's cremation in October, during which time tourists have been recommended to avoid Bangkok. Domestic spending is also set to be hampered by zero real wage growth, down from double digits in 2015. GDP growth is projected to rise to 3.4% in 2017 from 3.2% in 2016, still short of the Bank of Thailand's (BoT) estimate of potential growth of 4.0-4.5%.

Fiscal spending could provide a boost, which it has done over the past year. The military junta have outlined infrastructure spending plans in a variety of areas including airports, roads and high-speed rail as part of the development of the Eastern Economic Corridor. Incentives are also being given to raise investment in the digital economy. However, attracting foreign capital could prove difficult under military rule. Although elections are set to take place in 2018, unrest has risen after more than three years under the junta and this may further delay elections.

Meanwhile, CPI inflation has fallen to zero, comfortably below the BoT's 2.5% +/- 1.5% target range and down from a recent peak of 1.6% yoy in January. Below potential growth suggests inflation should remain contained and this is likely to mean that the BoT keeps its policy rate at 1.5%. Moreover, lacklustre growth has led to a rise in NPLs, from 2.2% of outstanding loans in 2014 to 2.9% in March. Banks have thus been tentative in extending loans, stymying credit and justifying a continued loose policy stance.

BoT has expressed its concern over the rise in NEER (+5.0% yoy) and the authorities have been trying to manage the appreciation by buying foreign currency, with FX reserves rising to a five-year high of $176 bn (equivalent to over a year of imports). This provides a strong buffer to external shocks, as does the large current account surplus (11.3% of GDP in 2016), which in turn has been supported by an expanding trade surplus.

Market Strategy: The P/E of the MSCI Thailand trades at a discount to EM and is nearly two standard deviations below its long-term average. Combined with strong external accounts, this should provide some downside protection. However, the lacklustre growth and earnings outlook lead us to keep our *neutral* weight.

India

Overweight

Both growth and inflation decelerated ahead of the introduction of the GST, the next test for Modi's government.

Following last year's surprise demonetization experience, India is now embarking on another landmark policy move, the introduction of a nationwide Goods and Services Tax (GST), as of July 1st. The GST replaces a plethora of central, state and local taxes with a single, uniform tax for goods and services, effectively creating a common Indian market. This should boost trade and reduce transactions costs, but the tax design is not as efficient as originally envisioned: there are significant exemptions for various products and it is based on five different rates instead of the simpler, original structure. A scheme of such complexity and reach is likely to create some implementation problems.

The new tax structure was designed to be revenue-neutral, with effective tax rates on goods falling while those on services are rising. While the government remains committed to a fiscal deficit of 3.2% of GDP for 2017-18, it faces uncertain tax revenues as a result of the GST reform, higher-than-budgeted rent allowances and the farmer loan waivers announced by various state governments.

GDP growth for the first quarter of 2017 (last quarter 2016-17 fiscal year) surprised sharply to the downside. What is more, revisions to earlier quarters indicate that the economy was already slowing before the demonetization experiment. Q1 growth recorded 6.1% yoy, down from 7.0% yoy in the previous quarter and much below expectations. Upward revisions to previous quarters meant that full year growth for 2016-17 was still a solid 7.1% but much of the growth was propped up by agriculture and government spending while the private economy began to slow as early as mid-2016. The latest release puts the headline figure more in line with the signals received from the high frequency indicators - which had been weak long before the demonetization - as well as the falling inflation readings.

This trend has continued beyond Q1. IP growth in April printed slightly above expectations at 3.1% yoy, but declined from the previous month and remains below its pre-demonetization levels. May PMI fell from 52.5 to 51.6. While it is difficult to discern how much of the growth slowdown is due to demonetization, deceleration is likely to continue. With a normal monsoon, agricultural growth would halve relative to last year. Together with tightening fiscal policy and a banking system that is cleaning up its balance sheet investment growth will likely be kept at bay. Only export growth holds some promise after a strong start to the year.

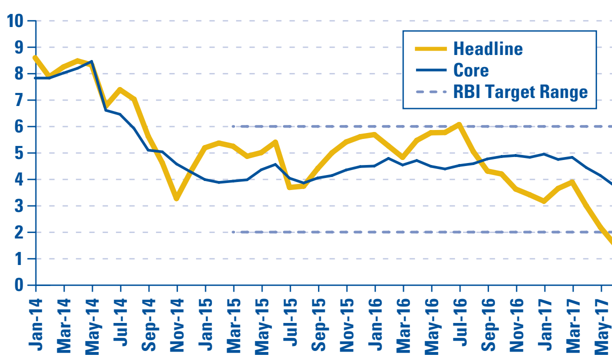
Inflation firmed slightly in February and March (to a high of 3.9% yoy), but decelerated sharply subsequently, dropping to 3.0% yoy in April and 2.2% yoy in May. The sharp fall in the headline

rate owed primarily to the deceleration in food prices as well as favourable base effects. It is not clear how permanent lower food prices will be, but CPI could at least temporarily drop below 2% in the near term. This is also evident in wholesale prices, which have contracted month-on-month during the last three readings. Core CPI also moderated to 4.0% yoy in April and May from 4.5% yoy previously and is now in line with the Reserve Bank of India's (RBI) inflation target.

Already before the May CPI print was released, the RBI had cut its inflation forecasts by some 175bps for the first half of this fiscal year (April-March) and by 100bp for the second half. This resulted in a new forecast range of 2.0-3.5% for the first half and 3.5%-4.5% for the second. Nevertheless, the RBI has remained on hold throughout the year. But with inflation expectations near historical lows, capacity utilization below 75% (suggesting a large output gap), this year's monsoon forecast and both oil prices and the rupee stabilizing recently, the central bank could yet decide to ease. With questions remaining over the durability of the disinflation trend any easing, if it materializes, would likely be modest though.

Meanwhile the trade deficit widened sharply in both April and May, to the highest level in over two years. This partly reflected higher gold and silver imports, but the bulk of the widening stemmed from other categories, perhaps reflecting the rupee's recent real appreciation.

Chart 4: India Inflation, % yoy



Source: Bloomberg

Market Strategy: The Indian economy stands out as a high growth, reform-oriented economy backed by political consensus. But it also faces ongoing challenges as growth slows, inflation drops precipitously and the GST introduction could turn out to be disruptive. In Q2, its market underperformed the index by 3.4% points with a 2.9% return. We regard this as a sign of India's low-beta nature and a reflection of its high valuation. With a P/E of 22.3, it appears high relative to the average 15.9 P/E of the index. However, this is in fact less than its typical 47% premium over the market. As a result, we maintain our *overweight* and regard the exposure as defensive in case of a market downturn.

Latin America

Brazil

Underweight

While inflation and interest rates plumb new depths, the economy decelerated again as ongoing political ructions weigh on consumer and business sentiment.

The corruption probe in Brazil continues to expand its reach and has led to the investigation of one third of the government cabinet, one third of Senators and numerous lower house deputies. Most recently, former Finance Minister and Chief of Staff Palocci was convicted to 12 years in jail for orchestrating the bribery network under Presidents Lula and Rousseff. In May, it was revealed that a tape recording by Joesley Batista, co-owner of meat exporter JBS, showed President Temer approving the payment of bribes in order to keep jailed former speaker of the lower house, Eduardo Cunha, quiet. President Temer, whose approval rating has reached a low of 7%, has himself been indicted by the Prosecutor General in late June. However, before the Supreme Court can take up the case, it has to be approved by the Constitutional Committee of the lower house as well as the full floor with a 2/3 majority. President Temer will likely be able to muster the necessary support of 1/3 of the deputies to keep him in office. But the episode is likely to perpetuate the gradual erosion of the government's political capital, making it increasingly difficult to garner the 3/5 majority needed to pass the pension reform. If the pension reform is not passed, the constitutional spending cap would be breached by 2022 and public debt would quickly enter an unsustainable path, heading towards 100% of GDP (all else equal).

Meanwhile, the separate trial under way by the Electoral Court for alleged illegal financing of the 2014 Rousseff-Temer election campaign was resolved in favour of the president and this risk is now defused. However, another scandal has emerged regarding the use of a private jet and it was thus no surprise that in the wake of such cumulating allegations, the reform process eventually hit a stumbling block. In June, the labor reform bill, which allows greater temporary work and outsourcing in both the private and public sector, failed a vote in a senate committee, having already passed through the Lower House and another Senate committee. It may yet come unstuck, but the episode demonstrates the increasing difficulties the government is likely to face in passing critical reforms.

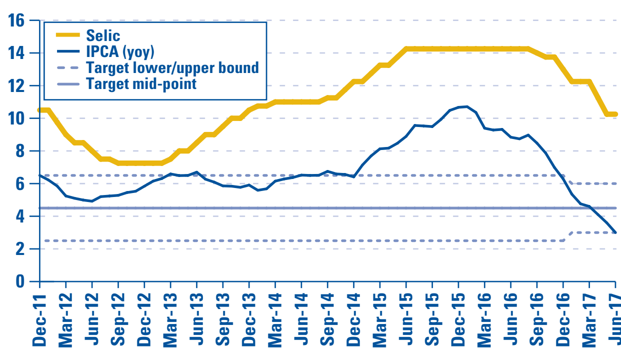
After a sharp 0.5% qoq (-2.5% yoy) contraction in Q4, GDP bounced 1.0% qoq in Q1, reducing the annual contraction to 0.4% yoy. But while this was the first positive quarter since Q2 2013, it may be too soon to declare the recession over. On the supply side, most of the gain owed to the agricultural sector, whereas on the

demand side activity was entirely driven by inventory accumulation. As such, this development does not appear to be sustainable and a relapse into the red appears possible in Q2 and perhaps even Q3. Still for the year as a whole, favourable base effects will likely combine for a positive growth outcome.

Inflation continued to surprise on the downside, with the May IPCA recording 0.3% mom or 3.6% yoy, down from 4.1% in April. The deceleration mainly owed to lower food prices and as a result core inflation registered a higher 4.6% yoy for the month. In light of the precipitous fall in inflation, the Copom did not hesitate to trim interest rates further, cutting 100bps each in April and May and bringing the Selic rate to 10.25%. In its June Inflation Report, the central bank updated its inflation forecasts, lowering its forecast for Q2 2019 inflation to 4.3% and perhaps paving the way for a lowering of the 2019 inflation target to 4.25% from 4.5% in 2018. In its latest minutes, the central bank continues to stress the need to approve reforms and points to the risks surrounding its baseline scenario. Against this backdrop, it also suggested that a reduction in the pace of easing would be appropriate.

The trade balance reached a new high in May, suggesting a strong outcome for the full year. In turn, this could allow the current account deficit, currently just above the 1% of GDP mark, to fall below that threshold for the full year.

Chart 5: Inflation and Selic Rate, %



Source: Bloomberg

Market Strategy: Disappointing growth, a widening corruption probe and the stuttering of the reform agenda in Congress undermine much of the upside that had been priced into the Brazilian market when President Temer replaced ousted President Rousseff. With a 6.7% loss in Q2, Brazil underperformed the index by almost 13%. This has reduced Brazil's P/E to 17.7, more closely in line with the average EM P/E of 15.9. We nevertheless retain our *underweight* allocation as we see political risk as far from dissipating and even if President Temer is not brought down by the investigations and survives the lower house vote, the resulting loss of political capital will cast a shadow over the remainder of the reform program.

Mexico

Neutral

The economy continues to recover as external threats appear to recede. But domestic political risks loom on the horizon for 2018.

Having governed it for the past 90 years and being the home state of President Pena Nieto, much was at stake for the PRI in the June gubernatorial elections in the State of Mexico. After having lost ground at state level recently, the PRI scraped by with just 34% of the votes, half the share obtained in past elections. The Morena party of presidential hopeful Andrés Manuel López Obrador (AMLO) came in a close second, despite it being its first major state election. This makes AMLO a serious contender for next year's presidential election, all the more so if Morena formed an alliance with the PRD as has been mooted. Yet, a PAN-PRD alliance appears more likely, having been successful elsewhere at state level. Such a combination could relegate the long-dominant PRI to third place in the election. An AMLO victory is widely feared by financial markets given his hard-left rhetoric, even though he has so far often been pragmatic in office.

Meanwhile, a moderation of the anti-Mexico rhetoric by US President Trump could benefit the PRI further. The issue of the border wall appears to have slipped down the list of priorities, while NAFTA appears increasingly unlikely to be scrapped wholesale and instead will likely be subject to tweaks and updates that could be mutually beneficial. At the same time, the economy continues to hold up well as survey data strengthened markedly in May and are now back to the levels prior to Trump's election victory in November. The IMEF surveys showed the non-manufacturing component surge to a three-year high of 52.3 in May, up from 48.7 in April while the Markit manufacturing PMI also rose in May, to 51.2 from 50.7 the month prior. Yet, industrial production fell 0.3% mom in April, illustrating that despite gains in the rest of the economy, persistent weakness in the mining sector weighs on overall activity.

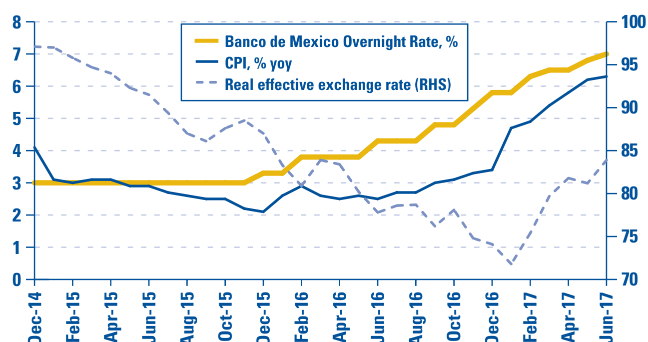
This builds on continued GDP growth, which expanded at a 0.7% qoq pace in Q1, boosting the headline rate to 2.8% yoy from 2.3 % yoy in Q4 2016. The uptick benefited from a strong 3.1% yoy gain in consumption and a 9.1% yoy boost to exports. On the other hand, gross investment was unchanged from the previous year. Despite the strength of exports, moderating investment plans and softening consumption could mean a weaker Q2.

Consumer prices continued to rise and recorded a 6.2% yoy high in May, up every month since the December 3.4% yoy reading. The two driving forces behind high inflation are the persistent pass-through from a weak currency and a rise in agricultural prices. Both forces now seem to be subsiding, allowing core CPI gains

to moderate and PPI to ease since the start of the year. Yet a drop in the headline rate will likely have to await the start of next year.

The central bank took the bull by the horns and hiked its policy overnight rate 125bps this year, most recently with a 25bps move in June, which took the interest rate to 7%. This brings the cumulative tightening since end-2015 to 400bps and also likely heralds the end of this cycle. Indeed, despite tightening its policy rate, Banxico's statement was couched in a fairly dovish tone even though inflation had risen for 10 consecutive months and is unlikely to have peaked yet. But the peso sell-off reversed this year, appreciating by almost 20% against the US dollar to date and thus also reversing its effect on domestic prices. Agricultural prices also seem to have peaked while the risk of a major trade dispute with the US appears to recede. Finally, given the scale of the tightening cycle, Mexican monetary policy has effectively delinked from the US and the monetary stance is now neutral, if not tight, given the state of the economy.

Chart 6: Mexico Inflation Dynamics



Source: Bloomberg

Market Strategy: The Mexican market performed broadly in line with the wider market, recording a 7.2% gain in Q2, just 0.9% ahead of the index. The downside from domestic and external political risks seems broadly balanced against the economic recovery and the likely deceleration of inflation. But with a P/E of 22.4, Mexico is one of the most expensive markets, even if that 43% premium is lower than its 73% average. On balance, we maintain a *neutral* allocation for now.

Emerging Europe and Africa

Russia

Neutral

Amidst a gathering recovery, inflation picks up and the external imbalance widens, but the central bank remains in easing mode.

Russian activity recorded its second positive headline growth in Q1, as GDP posted a 0.5% yoy gain, following a 0.3% yoy advance the previous quarter. After two years of recession, this confirms its end amidst rising oil prices. The economy has maintained strong momentum since, with April and May data recording robust gains. Industrial output grew a strong 5.7% yoy in May as both mining and manufacturing fared well in Q2. Retail sales remain weaker overall but are improving and surprised to the upside, with a 0.9% yoy advance in May. Meanwhile, sentiment indicators point to improving confidence in the recovery. PMI rose to 56.0 from 55.3 in May, with the manufacturing component jumping from 50.8 the previous month to 52.4 and services PMI rising to 56.3 from 56.1.

Inflation broadly continued its descent, but picked up to a surprise 4.4% yoy in June (from 4.1% yoy previously) as some food prices jumped on account of cold weather. Yet, underlying inflation remained well-behaved, with core CPI decelerating to 3.4% yoy in June, from 3.8% yoy previously.

The CBR eased rates again in June, but reverted to a slower 25bps pace, following a 50bps cut in April. This brings the current interest rate to 9.0%. Weakening oil prices and the new sanctions imposed in February likely prompted the central bank to adopt a more cautious stance. Similarly, recent ruble weakness, the negative inflation surprise and a possible VAT hike could keep the central bank on hold for now. Nevertheless, it has upgraded its growth forecast for 2017 from 1.0%-1.5% to 1.3%-1.8%.

Russia's current account balance dipped into the red in Q2, from a $23.3 bn surplus in Q1. The deterioration came mostly on the back of weaker commodity prices, but non-commodity net exports deteriorated as well. While the goods balance remained in surplus, it was ca. $10 bn below the Q1 outcome. Meanwhile, both services and the income balance slid further into deficit as foreign travel increased and net investment income dropped. As the domestic recovery gathers pace, the current account could deteriorate further in coming quarters, although rising net FDI flows led to an improving 'basic balance'.

Market Strategy: The Russian market continued to give up its Q4 gains, incurring a 10% loss in Q2, equivalent to 16.3% underperformance. As the market remains cheap with a P/E of just 7.4, the risk of a snapback leads us to maintain a *neutral* allocation.

Turkey

Underweight

Economic conditions improve as growth picks up and lira stabilization supports a decline in inflation.

Turkey enjoyed a strong second quarter, both from a market perspective (as the top performer in EM equities) and in terms of economic performance. GDP growth surprised to the upside, posting a strong 5.0% yoy increase in Q1 after a mere 3.5% yoy gain in Q4 and far outpacing expectations. Activity surged on the back of a rebound in exports (strong gains in tourism receipts) and solid consumption, both private and public. The former benefitted from improving sentiment and the latter from government stimulus measures. Indeed, the central bank's tightening and lira stabilization played a key role in supporting consumer sentiment. Nevertheless, investment remained weak and detracted from overall growth. More recently, industrial production surged to a 5.9% yoy pace in May, from 2.5% yoy in April.

Inflation performance continues to benefit from lira stabilization. In addition, strong base effects and a decline in food prices helped CPI decline to 10.9% yoy in June, from 11.7% yoy the month before. As the impact of lira weakness in 2016 begins to fade, core CPI also remains benign and headline inflation looks on track to end the year below the 10% mark. Despite the strong performance, the central bank will likely maintain a cautious stance as CPI readings still remain far from its 5% target and economic activity is gathering steam.

While Turkey's current account deficit has generally been on the mend over the past five years, it has undergone a gradual deterioration since mid-2016. In particular, the May current account deficit widened to $5.2 bn, bringing the 12-month moving sum to ca. 4.3% of GDP. Gathering EU demand and a recovery of tourism receipts, following the lifting of the Russian travel ban boosted exports. But rising gold and oil imports more than compensated. What is more, imports are set to expand further as domestic demand recovers. Strong capital inflows more than covered the external deficit and debt repayments.

Market Strategy: Turkey's market bounced back strongly during Q2, with a 19.3% return equivalent to 13.1% points outperformance, following a long period of underperformance. While domestic politics are ready to reignite at any time, the economy is stabilizing in the wake of last year's coup attempt. With a P/E of 10.2 and a 36% discount, the Turkish market is attractive from a valuation standpoint. But a rising current account deficit represents a vulnerability as global monetary policy becomes less accommodative. Therefore, we maintain our *underweight* allocation.

Romania

Neutral

Robust GDP growth is being driven by fiscal expansion, leaving upside risk for inflation and the twin deficits.

Q1 GDP expanded by 5.7% yoy, up from 4.8% in Q4. Household consumption was key, contributing 4.8 percentage points as real wages rose by a post-crisis high of 18% yoy in Q1. Economic conditions are set to remain favourable amid ongoing fiscal expansion and low inflation, with GDP forecast to expand by 4.0-4.5% this year.

Romanian consumer prices have moved up ytd, emerging from 18 months of deflation due to VAT cuts. However, the 0.6% yoy rise in CPI in May is still muted and comfortably below the National Bank of Romania's (NBR) 2.5% +/- 1% inflation target range. Core inflation is also muted (1.1%) and is only marginally above the May level when the impact of the VAT cut is excluded. This is despite growth above the estimated potential of 3% and suggests that the NBR could keep its key policy rate unchanged at 1.75% in Q3. However, as the NBR acknowledges, inflation risks are "tilted to the upside" for 2018 so the Bank is likely to have a somewhat hawkish bias in H2.

Political changes within the PSD-led government have continued. Delays in implementing policy led to the dismissal of Prime Minister Sorin Grindeanu in June and his replacement by Mihai Tudose, who was endorsed in a parliamentary vote. Tudose is expected to maintain the planned fiscal expansion, with an emphasis on raising wealth distribution to labour. To this end, the public wage law approved in June includes salary increases of 25% for public sector workers in January 2018. Other measures proposed under the new government include a reduction in income tax from 16% to 10% and a near 40% rise in the minimum wage. This is set to widen the budget deficit from 3.0% of GDP 2016 to 5.0% next year, according to J.P. Morgan estimates.

Meanwhile, external accounts have deteriorated as robust domestic demand meant that the rise in imports has outpaced that of exports. Romania's trade deficit widened to 6.1% of GDP in the year to April, from 5.7% in the previous 12 months. The deterioration is expected to continue this year and the current account deficit is projected to widen to 3.0% of GDP in 2017 from 2.5% in 2016.

Market Strategy: Romanian valuations are cheap (the trailing P/E is at a 34% discount to EM compared to a long-term average of 9%). However, we believe that this is counterbalanced by risks from the country's widening twin deficits and upside risks to inflation. We therefore keep our *neutral* weight on a six to nine month view, acknowledging that market outperformance could continue on a shorter horizon.

South Africa

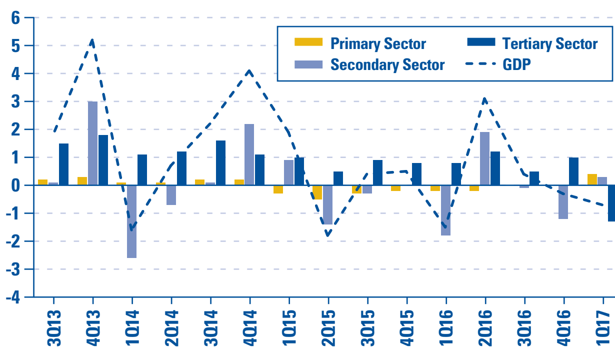
Underweight

Recessionary conditions are adding economic woes to ongoing political dysfunction.

GDP in South Africa fell for a second consecutive quarter in Q1 (-0.7% qoq), pushing South Africa into technical recession. The contraction was driven by a broad-based 2.0% fall in services sector output, which outweighed the 0.7% rise in mining production. Real wage growth also fell to zero, compared to a rise of 1.7% last year, and with household consumption approximately 60% of GDP, this is set to be a drag on economic activity this year. Following the data release, consensus GDP growth forecasts for 2017 fell from 1.0% to 0.7%, which would not be much of an improvement from last year's 0.3% outturn.

Data so far this year has provided evidence that political ructions are beginning to impact economic decisions, despite the resilience of the services sector in post-crisis slowdowns and contractions so far (see Chart 7 below). In Q1, output in all services sub-sectors contracted. However, the data does not include the impact of the cabinet reshuffle on March 31st and the sovereign rating downgrade in April by S&P to non-investment grade. Available data for Q2 suggest a slowdown ahead, with manufacturing PMI moving into contractionary territory (below 50) in June and at its lowest level since April 2016. Moreover, business confidence was at a post-crisis low in Q2 and manufacturing production fell by 4.1% yoy in April, the steepest fall in nearly three years. This could be counterbalanced somewhat by improved retail sales, which expanded by 1.5% yoy in April. Overall, we expect 2017 growth estimates to be downgraded further in H2.

Chart 7: South Africa GDP, %-Point Contribution to qoq Growth



Source: Statistics South Africa

Headline and core inflation have declined in sync and significantly ytd, the first time this has happened since the global financial crisis. Core price rises have decelerated by 1.1 percentage points ytd to 4.8% yoy in May and the headline figure has fallen by 1.3 points to 5.4%, within the South African Reserve Bank's (SARB) 3-6% target range for the first time since 2015. This and the benign inflation outlook are largely due to rand strength, with the real effective exchange rate up by 29% since January 2016.

This backdrop has led the SARB to keep its policy rate unchanged at 7.0% this year, with the last move a 25bps hike in March 2016. However, the Bank has become more dovish in recent months, downgrading its 2017 headline inflation forecast from 5.9% to 5.7% at its May meeting, while that for core inflation was reduced from 5.4% to 5.0%. Monetary easing could commence in H2 if inflation undershoots expectations amid continued food price deflation and pass-through from rand strength, especially given ongoing political uncertainties.

These factors are counterbalanced to some extent by the risk that more hawkish rhetoric from G10 central banks could trigger capital outflows. At the same time, policy risk emanates from the ruling African National Congress (ANC) seeking to influence the Bank's policies in recent months, with the Public Prosecutor proposing a change in the constitution so that the SARB targets growth rather than inflation. Although the ANC proposal to nationalise the Bank should not impact decision-making, it is indicative of government intervening in an area that should be independent.

Meanwhile, the current account deficit widened to 2.1% of GDP in Q1, from 1.7% in Q4, though this was mainly due to reduced dividend repatriation. The trade surplus rose marginally to 1.3% of GDP and this could rise further in H2 as the weaker growth outlook compresses imports and vehicle exports rise as production comes back online. Overall, the current account shortfall is set to narrow to 3.0% of GDP this year, from 3.3% in 2016.

Political clouds continue to hover over South Africa as policy becomes increasingly populist. A new mining charter was introduced in June which forces firms to have at least 30% black ownership, up from 26%, even if black investors decide to sell their holdings. The companies would also have to pay 1% of annual turnover to black owners, which in 2016 would have amounted to ZAR5.8 bn of the total ZAR5.9 bn paid in dividends. Additional populist policies are expected in H2 as President Jacob Zuma seeks to shore up support for his candidate ahead of ANC leadership elections in December.

Market Strategy: MSCI South Africa underperformed EM by 2.7% in Q2, after 7.1% underperformance in Q1. The market trades at a 22% P/E premium to EM, below the long-term average of 28%. Given the ongoing power struggle in the ANC amid a slowing economy, there is a heightened risk of policy errors that in our view are not accounted for in valuations. We stay *underweight*. ◆

Michael Hart and Lyndon Barreto, CFA, July 2017

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KEY ECONOMIC AND FINANCIAL INDICATORS

	Emerging Market	Macroeconomic Data: % change on year ago: Annual GDP Growth	Industrial Production	Consumer Price Index	Latest 12 months: Trade Balance	Current Account Balance	Foreign Reserves 2017 Latest	Foreign Reserves 2016 Year ago	Currency vs $ 2017 Latest	Currency vs $ 2016 Year ago	Short-Term Interest Rates	Sovereign Rating S&P	Market Data: Performance: % S&P/EM Frontier Super Composite BMI	Stock Market Index S&P/EM Front. Super Comp. BMI US$	Change since 12/31/16 US$	Change since 12/31/16 Local Currency	Forecast: 2017 P/E Forecast	EBIT Margin 2017 Forecast	6 month Stock Market Index Estimate (Front. Super Comp. BMI) US$	3 month Currency vs $ +/-
		%	%	%	$ Bns	$ Bns	$ Bns	$ Bns			%		Jun. 30, 2017	Jun. 30, 2017	%	%		%		
Overweight	INDONESIA	5.0	6.4	4.4	12.0	-14.6	119.10	97.86	13363.00	13096.00	6.3	BBB-	2.23	1450.06	12.44	11.22	17.5	22.5	1429	-
Overweight	MALAYSIA	5.6	4.2	3.9	19.1	5.9	94.57	93.88	4.30	3.99	2.9	A-	2.40	372.69	16.21	11.20	16.6	19.6	360	-
Overweight	INDIA	6.1	3.1	2.2	-121.7	-15.2	349.06	339.03	64.77	67.28	6.3	BBB-	10.45	995.13	25.07	19.14	17.8	14.0	995	-
Overweight	SOUTH KOREA	2.9	0.1	2.0	88.1	93.0	367.08	363.45	1147.27	1147.83	4.6	AA	15.60	513.16	27.37	20.76	9.7	11.7	484	+
Overweight	TAIWAN	2.6	0.8	0.6	46.1	69.1	440.25	433.43	30.45	32.19	0.7	AA-	11.83	263.26	21.06	14.30	14.5	8.2	255	+
Neutral	ARGENTINA	0.3	2.7	14.3†	-0.3	-16.8	40.94	24.86	16.62	15.01	18.6	B	0.60	616.33	38.43	45.28	15.9	18.2	636	+
Neutral	BAHRAIN	1.1	n.a.	0.7	n.a.	n.a.	2.65	3.08	0.38	0.38	2.3	BB-	0.13	142.43	12.37	12.45	n.a.	n.a.	160	uc
Neutral	CHILE	0.1	0.1	2.6	4.2	-5.0	38.00	38.86	664.90	656.71	2.9	AA-	1.23	472.69	14.32	13.45	17.7	13.7	482	-
Neutral	COLOMBIA	1.1	-6.8	4.4	-10.7	-11.9	45.21	45.59	664.90	656.71	5.7	BBB	0.56	5703.44	7.69	9.59	13.5	n.a.	5814	+
Neutral	CZECH REP.	3.0	-2.5	2.4	18.3	2.1	137.55	73.72	22.90	24.29	0.1	AA-	0.15	780.13	19.38	6.70	13.3	n.a.	705	-
Neutral	EGYPT	4.3	12.9	29.7	-33.4	-19.4	23.77	12.27	18.01	8.88	16.8	B-	0.19	1313.09	10.34	10.27	14.2	n.a.	1265	-
Neutral	GREECE	0.4	1.0	1.2	-18.8	-1.3	1.63	2.25	1.14	1.12	0.1	B-	0.44	33.69	31.34	22.53	28.1	17.9	26	-
Neutral	HUNGARY	4.2	2.5	2.1	10.7	6.3	25.96	27.79	271.13	284.30	0.0	BBB-	0.27	503.83	18.25	9.44	11.5	n.a.	424	-
Neutral	KENYA	4.7	n.a.	9.2	-9.2	-45.9	8.57	8.01	103.80	101.15	7.1	B+	0.12	662.06	18.42	19.84	10.7	23.6	581	-
Neutral	KUWAIT	1.8	n.a.	2.7	57.2	5.9	31.22	30.75	0.30	0.30	1.5	AA	0.50	70.29	9.03	8.33	12.2	n.a.	77	+
Neutral	MEXICO	2.8	-4.4	6.2	-9.8	-26.5	166.56	170.71	18.15	18.39	7.4	BBB+	3.16	472.43	25.17	10.08	17.7	14.7	425	-
Neutral	MOROCCO	3.8	8.9	0.3	-18.3	-7.5	23.51	23.73	9.66	9.78	3.2	BBB-	0.26	593.78	10.77	5.69	19.2	27.6	528	-
Neutral	PAKISTAN	5.7	10.5	3.9	-33.0	-3.6	17.71	17.52	104.83	104.71	4.5	B	0.34	998.90	-4.29	-3.87	11.6	n.a.	1048	-
Neutral	PERU	2.1	3.1	2.7	3.6	-3.8	61.00	59.28	3.25	3.28	0.5	BBB+	0.45	1674.76	10.37	9.80	13.6	n.a.	1649	-
Neutral	PHILIPPINES	6.4	5.9	3.1	-26.9	-0.4	72.47	73.96	50.56	46.86	3.5	BBB	1.32	875.60	13.17	14.87	19.4	22.8	854	+
Neutral	POLAND	4.0	9.1	1.5	0.8	0.5	106.85	95.35	3.71	3.98	1.6	BBB+	1.23	349.08	33.76	18.87	12.3	14.6	314	-
Neutral	QATAR	2.5	n.a.	0.1	25.3	-8.3	33.34	35.05	3.76	3.64	2.0	AA-	0.59	227.75	-9.80	-9.33	11.9	n.a.	269	uc
Neutral	ROMANIA	5.7	5.5	0.6	-11.5	-26.0	38.34	35.90	4.00	4.05	0.5	BBB-	0.11	109.37	24.07	15.10	9.8	21.1	102	-
Neutral	RUSSIA	0.5	5.6	4.1	0.1	35.4	326.66	319.82	58.95	63.84	8.9	BB+	3.19	391.50	-9.97	-12.19	6.3	15.6	473	+
Neutral	SLOVENIA	5.3	7.8	0.9	0.8	3.0	0.32	0.29	1.14	1.11	0.2	A+	0.05	391.63	18.03	9.15	12.1	11.9	352	-
Neutral	SRI LANKA	3.8	-1.0	6.1	-9.7	n.a.	4.07	5.08	153.55	146.35	11.7	B+	0.08	298.45	11.65	14.44	12.2	13.7	261	-
Neutral	THAILAND	3.3	1.4	-0.1	31.8	43.0	175.81	167.38	33.98	35.04	1.5	BBB+	2.37	1098.41	9.51	3.90	14.8	11.6	1111	-
Neutral	UAE	3.8	n.a.	2.6	68.3	11.5	87.49	80.45	3.67	3.67	1.4	AA	0.76	121.93	2.63	2.63	11.1	n.a.	126	uc
Neutral	VIETNAM	5.7	8.6	2.5	-3.6	8.5	36.17	27.88	22720.00	22308.00	4.8	BB-	0.32	155.32	17.30	17.09	17.6	18.8	154	-
Underweight	CHINA	6.9	6.5	1.5	458.9	169.5	3053.57	3191.74	6.79	6.66	1.1	AA-	25.09	764.90	21.89	22.52	13.5	11.7	720	-
Underweight	BRAZIL	-0.4	-4.5	3.6	57.1	-18.1	367.89	354.83	3.31	3.25	7.2	BB	5.90	587.81	3.80	5.66	11.8	18.1	689	-
Underweight	SOUTH AFRICA	1.0	-4.1	5.4	2.5	-32.1	38.87	39.06	13.10	14.56	7.3	BB+	5.53	713.85	7.11	2.63	15.5	11.3	724	+
Underweight	NIGERIA	-0.5	n.a.	16.3	1.6	4.5	30.75	26.62	314.75	282.50	10.6	B	0.24	189.25	39.90	39.80	9.5	-11.9	137	-
Underweight	TURKEY	3.1	6.7	10.9	-59.4	-33.2	85.95	96.54	3.53	2.90	11.7	BB	1.15	427.29	30.67	30.85	9.1	13.4	347	+
	OUT OF INDEX																			
	SAUDI ARABIA	-0.5	n.a.	-0.7	43.4	-1.2	490.38	570.07	3.75	3.75	1.7	A-	0.00	115.04	5.48	5.44	14.1	n.a.	112	uc

Note: All data shown are as at 30 June 2017 unless stated otherwise. †Unofficial estimates suggest annual inflation is between 30% and 40%. UC is unchanged (currency versus US dollar). S&P credit rating shown is long-term foreign currency rating. UAE sovereign rating shown is for Abu Dhabi. Data for countries in the Middle East and North Africa region are the latest available, but in certain cases relate to periods more than one year ago. The 34 countries shown in the table accounted for 98.9% of the S&P/EM Frontier Super Composite BMI on 30 June 2017. An additional 24 countries accounted for the remaining 1.9% of the index on the same date. These countries, which can be accessed via City of London's Frontier Markets strategy, are: Bangladesh, Botswana, Bulgaria, Cote d'Ivoire, Croatia, Cyprus, Ecuador, Estonia, Ghana, Jamaica, Jordan, Kazakhstan, Latvia, Lebanon, Lithuania, Mauritius, Namibia, Oman, Panama, Slovakia, Trinidad & Tobago, Tunisia, Ukraine and Zambia.

Source: Bloomberg, City of London Investment Management

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