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Emerging Markets Spotlight

A mixed picture for Emerging Markets

An assessment of Emerging Markets reveals uneven performance and identifies opportunities in domestic-driven economies

KEY POINTS

- South Korea and Taiwan, two of the largest and most open emerging economies, have been negatively impacted by the global economic slowdown, with a sharp decline in their exports and industrial production
- China has seen an improvement in its PMIs, but its exports were down 6.8% YoY in the first two months of the year, indicating further regional weakness
- Central Europe appears less alarming, with flat or positive YoY growth in exports and positive PMIs and industrial production data
- Mexico continues to perform strongly, with record exports in January and ongoing industrial expansion, leading to positive earnings revisions for Mexican companies

In July 2022, we wrote a piece assessing what macro-economic and market data from Emerging Markets could tell us about the global economic cycle. After several months of broad optimism, followed by a far less positive mood last month, we decided to revisit the topic. Followers of our strategy will know that we feel a subset of emerging markets are well exposed to the strength of the global economy and whose economic data can give visibility into aggregate demand.

Korea and Taiwan in East Asia are two of the largest and most open emerging economies. As well as being highly open to trade, they are major exporters of manufactured goods, including vehicles and materials. China, meanwhile, has a sizeable domestic sector but remains the world's largest exporter. All three of these countries are investment grade bond issuers with significant and sustained current account surpluses, meaning they have limited sensitivity to global market risk but high sensitivity to the global economic cycle.

South Korea's exports in the year to February fell 7.5%. This number was an improvement on a more bearish consensus. While the same measure for Taiwan was down 17.1%, and Taiwanese export orders fell 19.3% to January. In the same period, Korean industrial production was down 12.7%, and industrial production fell a considerable 20.5% for Taiwan - PMIs in both

countries remain firmly below 50. Given the weight of exporters in these two economies and their equity markets, revisions to earnings expectations for MSCI Korea and MSCI Taiwan are sharply negative.

The developing post-covid bounce in the economy heavily skews Chinese data. PMIs have moved to very strong levels, but its exports were down 6.8% YoY in the first two months of the year, indicating further regional weakness.

The situation in the export-heavy economies of Central Europe looks less alarming. Polish exports were near flat YoY in December, and Hungarian exports were up 6.1%. PMIs and industrial production data show past weakness turning to a more positive outlook, particularly Hungary's February manufacturing PMI print of 56.5.

Another significant emerging market exporter is Mexico. Mexico continues to perform strongly as an economy, including in the external sector. Exports in January were a record USD 586.9bn, up 18.3% YoY, while remittances from citizens living overseas (predominantly in the US) were up 12.5% YoY. Manufacturing PMIs (Mexico has two versions) show ongoing industrial expansion, supported by positive industrial production and manufacturing production growth. Mexican companies are benefiting from this environment, seeing ongoing earnings revisions.

Overall, the picture is mixed, with the ongoing strength of the US economy, a weak recovery in Europe, and an ongoing slowdown in the Asian regional economy. We continue to see a significant opportunity in Emerging Markets in more domestically driven economies like Indonesia and India, and in domestic sectors of export and commodity economies like Brazil, Mexico, and South Africa. The strategy is heavily underweight Korea and Taiwan and has zero-weight central Europe but has a favorable outlook for Mexico as its largest overweight in the Emerging Markets.

Source for all data JOHCM/Bloomberg (unless otherwise stated)

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