CITY OF LONDON
Investment Management Company Limited

Emerging Markets Quarterly Outlook

July 2023*

Overview

Focussing on Strategic Opportunities

EM equities continue to face challenges, but the broader index should benefit from targeted Chinese policy stimulus and a peak in the US terminal rate this year. Our country allocations continue to focus on fundamental value opportunities and strategic thematic drivers such as AI/advanced semiconductor demand and global supply-chain readjustment.

Global growth remained resilient in the first half of the year, but there was evidence of a loss of momentum going into 2H23. In June, the global PMI composite index decelerated to an above-trend 52.7, while the Citi global economic surprise index fell into negative territory. Regionally, economic activity was not uniform. The US data remained consistent with trend-like growth despite further tightening in monetary policy, while the eurozone recorded a mild recession. China's recovery showed signs of stalling following a significant run of weak data in recent months. We expect China will be able to achieve its growth target this year of "around 5%". However, depressed consumer confidence and continued weakness in the property sector will present challenges for next year's growth target without policy action. The July Politburo meeting is the most likely date for additional stimulus announcements to help stabilise activity. While China's growth is unlikely to materially exceed its growth target this year, its lower inflation and easier policy still leave it relatively well-placed to maintain trend growth compared to its DM peers.

Our broader EM equity view remains constructive despite ongoing challenges. Additional stimulus and stabilisation in China's growth momentum should support EM equities, which continue to trade at a low 12m forward P/E multiple of 12x. The US monetary cycle remains a headwind for EM assets, but we continue to expect a peak in the Fed's terminal rate this year. This shift should weaken support for the US dollar, providing some relief for EM. Furthermore, the recent AI focus is an added upside risk for EM equities, given its significant weighting to semiconductor stocks that are direct beneficiaries of generative AI.

Our country allocations continue to focus on key themes within the index. Growing demand for advanced chips and further evidence of a trough in global semiconductor sales favour EM Technology exposure. Taiwan remains our preferred overweight. Nearshoring or friend-shoring trends benefit ASEAN countries with robust earnings growth and lower geopolitical risk than China. We stay overweight Vietnam, Indonesia, and Malaysia within ASEAN. In addition, we upgrade Mexico to neutral from underweight, given the recent acceleration in foreign direct investment flows and still cheap valuations. India is also a beneficiary of a US supply chain readjustment; however, India's elevated P/E multiple leaves limited price upside. We therefore remain underweight. Finally, our broad commodity outlook is balanced, but we see better long-run prospects for Saudi Arabia (overweight) relative to South Africa (underweight), as explained in the country sections.

We continue to monitor major geopolitical events, given that EM equities are exposed to the strained US-China relations. US Secretary of State Blinken's recent visit to China may be an initial step towards some moderation in tensions, which may help reduce the geopolitical risk priced into Chinese equities. However, the US-China strategic rivalry will continue to drive US supply chain readjustment over the long run. In Russia, the recent 'coup' attempt is not an obvious driver of the MSCI EM Index, which now excludes Russia. Nevertheless, we are cognizant that greater instability within Russia does raise tail risks that could spread (e.g., an oil shock).

Market Strategy: Our EM allocations remain positioned to benefit from strategic themes (e.g., advanced semiconductor demand, nearshoring/friend-shoring) while focusing our conviction on countries where we see value. Relative to the previous quarter, we make the following adjustment to the existing country allocations:

- We upgrade **Mexico** to *neutral*. We continue to see risks to Mexico's earnings outlook. However, stronger FDI flows in Q1 suggest nearshoring trends may be gaining momentum. In addition, Mexico's valuation measures have improved relative to the broader EM index over the quarter. Overall, Mexico's risks have become more balanced.

EM Country Allocation

	Chg	-2	-1	0	+1	+2
Asia						
China	-		■			
South Korea	-			■		
Taiwan	-				■	
Malaysia	-				■	
Indonesia	-					■
Philippines	-		■			
Thailand	-		■			
Vietnam	-					■
India	-		■			
Latin America						
Brazil	-			■		
Mexico	↑			■		
Europe, Middle East and Africa						
Turkey	-		■			
Saudi Arabia	-				■	
South Africa	-	■				

Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarterly outlook. A dash indicates no change. *Source: CLIM*

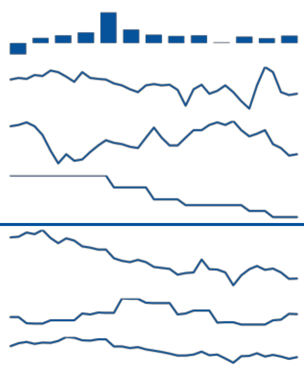
**The publication reflects asset performance up to 30 June 2023, and macro events and data releases up to 7 July 2023, unless indicated otherwise.*

Asia

China

Underweight

Chinese growth has failed to materialise, but valuations have become more attractive.



	3Y history	Latest	
GDP, % yoy		4.5	Q1
PMI, index		49.0	Jun
CPI, % yoy		0.2	May
Policy rate, %*		10.75	Jun
MSCI China**		-10.6%	Q2
EPS, % yoy		-3.5	Jun
12M Forward P/E		10.0	Jun

**Required Deposit Reserve Ratio for Major Banks.*
***US$ total return relative to MSCI EM.* *Source: Bloomberg*

The strong recovery following the reopening is now moderating. China now risks a phase of slower growth reinforced by poor consumer confidence. We are concerned by a sluggish Chinese economy, elevated indebtedness, ageing demographics, poor recent investments (particularly in property), growing distrust between China and the US, and the spectre of conflict over Taiwan.

However, the market has cheapened, and the potential outcomes are becoming more balanced. The Chinese government may seek to implement some form of stimulus, potentially at July's Politburo, to boost business and consumer confidence. Additional support is more likely to be targeted rather than broad-based – seeking to prevent the trend of saving rather than investing among households. The fact that Chinese inflation is negligible means that the PBOC has already been able to cut rates to stimulate the economy.

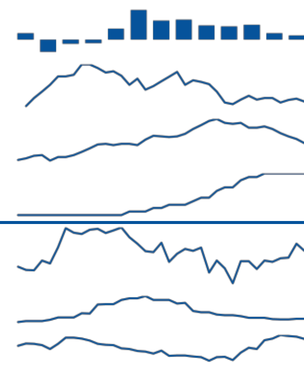
Despite these issues, China's economy is still forecast to grow close to target this year, just slower than previously expected. The economy has strengths in AI and related fields and leads in some areas of renewables and associated processes. If these areas continue to grow, Chinese firms could see earnings growth longer term in these critical industries.

Market Strategy: Chinese P/E multiples are low relative to the rest of the EM index and their historical trends. While the balance of risks has improved around current levels, the changing geopolitical dynamics mean that the multiple may remain discounted for longer. We stay *underweight* China.

South Korea

Neutral

Korea's high multiple might be justified if there is strength in the semiconductor sector.



	3Y history	Latest	
GDP, % yoy		0.9	Q1
PMI, index		47.8	Jun
CPI, % yoy		2.7	Jun
Policy rate, %		3.50	Jun
MSCI South Korea*		3.5%	Q2
EPS, % yoy		-22.5	Jun
12M Forward P/E		12.9	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Korea's equity market rose 4.4% in dollar terms during the three months to the end of June, outperforming the EM index. South Korea remains eligible for inclusion in the MSCI Developed Markets Index, which was estimated to provide net inflows into the index. However, the June review suggests an upgrade to the "monitor list" is not imminent.

South Korea's economy and stock market are cyclically exposed. The equity market's high weighting to semiconductors is a vulnerability if there is a recession in the US. The data shows that 2022 was the first year in two decades that Korea exported more to the US than China. However, South Korea's semiconductor exposure will be beneficial as the sector's downturn troughs and chip demand accelerates in response to AI-related growth. Korean equities depend highly on external factors, but the domestic economy is still influential. There is a growing probability that Korea might be able to achieve a soft landing as inflation moderates.

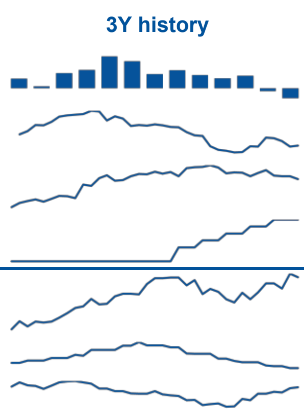
Market Strategy: Korean equities are trading at a high historical relative multiple, but there have been strong upward revisions to expected earnings in 2024. Korea's forward P/E multiple (12.9x forward earnings at the end of June) is justified assuming strength in the semiconductor sector. Global semiconductor sales remain in a structural uptrend; however, the pace of growth (-20% yoy) is only now starting to bottom.

The economic and financial conditions in Korea do not offer a convincing argument either way. We believe that the elevated multiples and exposure to a global slowdown offset the potential upsides of AI. We remain *neutral.*

Taiwan

Overweight

Taiwan is well-positioned to benefit from both AI and the end of the semiconductor downturn.



	Latest	
GDP, % yoy	-2.9	Q1
PMI, index	44.8	Jun
CPI, % yoy	2.0	May
Policy rate, %	1.88	Jun
MSCI Taiwan*	3.6%	Q2
EPS, % yoy	-22.4	Jun
12M Forward P/E	16.1	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Geopolitical tensions over Taiwan continue to make headlines. Still, while we cannot rule out the risk of further escalation, we do not think the US or China are incentivised to escalate tensions further ahead of the Taiwanese presidential elections in January 2024. The Taiwanese elections could produce a more Beijing-friendly Kuomintang (KMT) party if the Democratic Progressive Party (DPP) continues falling in the polls.

Taiwanese GDP data has been weak so far in 2023; falling to a below trend pace of -2.9% yoy in Q1. Exports, particularly to the US have been a major factor in this. If we move into a deeper global slowdown, there is a risk that semiconductors (a cyclical commodity), and consequently Taiwan, will suffer. Despite the weakness in the GDP numbers, the equity market has held up well in anticipation of future earnings. The MSCI Taiwan Index gained 4.5% in dollar terms in Q2.

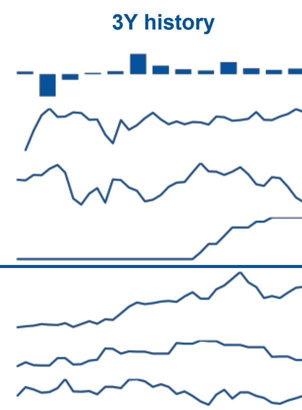
Given that Taiwan's equity market has a large weighting to semiconductors, it will benefit when the sector moves out of its post-Covid downturn. Furthermore, given the advanced nature of the Taiwanese chip industry, it looks likely to prosper if investment in AI continues to grow rapidly. If, as it seems, we are approaching terminal policy rates, particularly in the US, then any subsequent rate cuts should support Taiwan's long-duration tech stocks.

Market Strategy: Taiwan remains exposed to geopolitical risks and the wider global economy, but Taiwan's unique position in the semiconductor industry offers strategic exposure to AI growth. The market is priced at a P/E multiple close to its historical average and has seen upgrades to its earnings expectations. We remain *overweight* Taiwan.

India

Underweight

India remains expensive relative to other emerging markets.



	Latest	
GDP, % yoy	6.1	Q1
PMI, index	57.8	Jun
CPI, % yoy	4.3	May
Policy rate, %	6.50	Jun
MSCI India*	11.3%	Q2
EPS, % yoy	-4.7	Jun
12M Forward P/E	20.5	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

India has many attractive qualities. It has excellent demographics and recently surpassed China as the most populous country. Prime Minister Modi was also recently involved in what appears to have been a successful trip to the US. In addition, the equity market has seen a sharp rise in forward earning expectations.

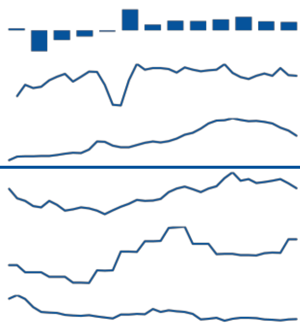
Yet, India's market fundamentals are not attractive at current levels. Across various valuation measures, India ranks as the most expensive emerging market, and is expensive relative to many developed economies. Although there are potential upsides, for example increased trade with the US, the equity multiple already reflects a significant degree of optimism. As it stands, we would not anticipate increasing our allocation at current levels. Both earnings and multiples remain vulnerable.

There are also some shorter-term economic headwinds. Central bank hiking has tamed inflation, but also looks likely to slow growth. Tight monetary and fiscal policies are expected to weigh on domestic demand and thus profits. Capital expenditure will likely fall if profits drop much further – imports of capital goods have already fallen. Bank lending rates may continue to rise due to poor bank liquidity. Meanwhile, low wage growth and a lack of job creation hamper household finances.

Market Strategy: India has several factors supporting its case as an attractive long-term investment, but currently the economic conditions coupled with rich valuations mean that there are more attractive opportunities elsewhere. We remain *underweight* India.

ASEAN

The nearshoring trend underway and cheap valuations should continue to support most ASEAN equities.



	3Y history	Latest	
GDP, % yoy*		4.6	Q1
PMI, index		51.0	Jun
CPI, % yoy		3.6	May
MSCI ASEAN**		-5.3%	Q2
EPS, % yoy		22.4	Jun
12M Forward P/E		13.1	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Low geopolitical risk and attractive valuations mean that we maintain our ASEAN tilt in our allocation to gain exposure to the global supply chain readjustment. In the near term, the global slowdown and China's disappointing recovery are headwinds to the region's all-important export sector. Inflationary pressures continue to trend down while the Fed is close to reaching peak rates, allowing central banks to start cutting rates. Vietnam's central bank has already unwound policy by 150bps this year. One risk to the inflationary outlook is the potential hit to food supplies from El Niño, given the large weight of food in CPI baskets.

Malaysia

(Overweight)

We still think Malaysia's prospects are positive, as the slowdown in exports is likely to be offset by the China-led recovery in tourism and the relative resilience of domestic demand. In addition, MSCI Malaysia's defensive tilt (25.9%) leaves it well-placed against a global slowdown.

Helped by generous subsidies, inflation continues to edge down; however, core disinflation has been slow. El Niño weather impacts and an eventual switch to more targeted fuel subsidies mean inflation risk is skewed to the upside. The latter will be needed if the government aims to achieve its target of reducing its fiscal deficit of 3.2% by 2025. Following a surprise rate hike in May, the Bank Negara Malaysia (BNM) has likely completed its tightening cycle. But given the BNM considers the current stance "slightly accommodative", another 25bps of rate hikes cannot be ruled out if growth or inflation data beat expectations.

Market Strategy: Valuations for Malaysia's stock market are still attractive, with its forward P/E premium to EM over one standard deviation below its five-year average. Earnings are projected to grow by 6.1% yoy in 2023, a sharp pick-up from last year's 0.2% yoy. Therefore, we keep our *overweight* to Malaysia.

Indonesia

(Overweight)

We maintain our optimistic structural view on Indonesia as the country moves up the metals value chain. In the short-term, softer external demand and the sharp drop in coal prices should be partly offset by tourism sector normalisation and campaign spending ahead of the general election in Q1. A key risk to the outlook is whether the election produces a president that maintains the current government's pro-business agenda. In the past, Indonesia recorded foreign equity outflows a year before the election, but a more robust current account backdrop should minimise outflows.

The Bank Indonesia (BI) is likely to start cutting the policy rate in Q4 as the disinflation trend has been broad-based and foreign ownership of government bonds is low at c.15%, affording the BI monetary policy space. A repricing in the Fed funds rate would push back the start of the easing cycle.

Market Strategy: Indonesia's equity market valuations have become more expensive but still appear attractive, while earnings growth is projected at 25.6% yoy this year. Polls show incumbent-party-backed candidates ahead, which points to a continuation of the reform agenda. We stay *overweight*.

Philippines

(Underweight)

The Philippines is one of the few exceptions to our overall positive view on the ASEAN region, given the constraints of its twin deficit problem and cyclical-tilted equity market (39.3% of the index). Following a solid outturn in Q1, domestic demand is set to abate as high inflation and interest rates bite, and the country's budget deficits limit the fiscal policy space to support the economy.

Headline inflation should continue to ease to within the policy target by the end of the year. Still, a current account deficit means the Bangko Sentral ng Pilipinas will take the Fed's lead on easing policy. Moreover, minimum wage hikes and the expiry of the government's reduced import duties on food staple imports at the year's end are upside risks to inflation.

Market Strategy: Like its ASEAN peers, the Philippine stock market continues to screen cheap, with the forward P/E premium to EM two standard deviations below its five-year average. But the dividend yield of 2.3% is lower than EM's 3.0%. With no clear positive catalyst in sight, we keep our *underweight*.

Thailand

(Underweight)

The positive outlook based on the tourism sector revival is tempered by political uncertainty and a hawkish Bank of Thailand (BoT). Indeed, the rebound in arrivals, notably those from China, means spill over benefits to domestic demand and an improvement in the current account balance. However, following the landslide win of the opposition party, Move Forward Party (MFP), in May, government formation has been held up. As such, the 2024 fiscal budget is likely to be delayed. Opposition by the military dominated Senate to an MFP-led government could risk stoking public protests, weighing on sentiment.

The BoT is likely to look through recent disinflation and tighten policy as it noted a "continuation of gradual policy normalization to be appropriate" at its meeting in May. In addition, the recovery of the tourism sector and the government-elect's fiscal stance mean that inflation could rise again.

Market Strategy: Valuations for the MSCI Thailand Index have not changed over the past three months and appear in line with its five-year average. Moreover, its forward P/E multiple of 17.2x leaves it exposed to derating if political uncertainty drags on. We keep our *underweight*.

Vietnam

(Overweight)

Vietnam is still a key beneficiary of supply chain readjustment away from China over the medium term. Therefore, despite the near-term headwinds of slowing external demand, we maintain our positive view on Vietnam. Meanwhile, there are early signs that the property downturn may have reached a trough. Indeed, there was an increase in new project approvals and a rebound in housing transaction volumes in Q1.

With inflation moderating and comfortably within the State Bank of Vietnam (SBV) target, the SBV has space to extend its easing cycle. Along with tax cuts, relaxation of property laws and the return of Chinese tourists, this should help balance the weakness in the export sector.

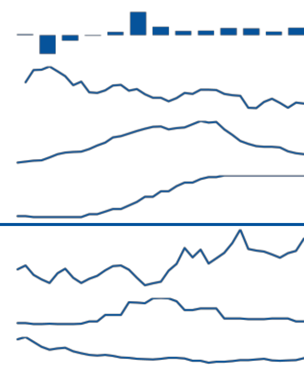
Market Strategy: The recent strength in Vietnamese stocks has led to a deterioration in valuations, with the forward P/E returning to its five-year average. The rally was driven by the tentative return of retail investors. Nonetheless, with the equity market providing value to longer-term investors due to friend-shoring trends, we maintain our *overweight* allocation.

Latin America

Brazil

Neutral

Despite recent strength, we are wary of Brazil's longer-term risks.



	3Y history	Latest	
GDP, % yoy		4.0	Q1
PMI, index		46.6	Jun
CPI, % yoy		3.9	May
Policy rate, %		13.75	Jun
MSCI Brazil*		19.8%	Q2
EPS, % yoy		-18.9	Jun
12M Forward P/E		7.8	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Brazilian equities performed well in Q2; the MSCI Brazil Index is up 20.7% in the three months to the end of June in dollar terms. A major factor in this outperformance is that policymakers have managed to control inflation and inflation expectations, stabilising the economy, and thus raising the likelihood of interest rate cuts.

There are some encouraging economic narratives in Brazil, with positive economic data surprises, and signs that profits might be beginning to improve. There is also a push for reforms that would simplify the current convoluted tax code, boosting productivity. Yet we fear that some of these attributes may have already passed their peak or, in the case of tax reform, a long process towards implementation may take up to a decade to translate into earnings growth.

Against this backdrop though there are several hurdles for the Brazilian economy. It remains unduly dependent on a relatively small range of commodities, it has poor infrastructure, and its debt-to-GDP ratio is a cause for concern. A strong labour market is needed to reduce poverty in the country, which has risen sharply since the beginning of the pandemic. Given the spending that is required and that which has been proposed, it will be hard for the government to limit spending, potentially worsening their indebtedness.

Market Strategy: Despite recent strength the Brazilian equity market, it remains cheap relative to the wider EM index and its history. Despite this discount, we remain sceptical about the country's long-term prospects. We remain *neutral* on Brazil.

Mexico

Neutral (↑)

An expected US slowdown remains a headwind, but nearshoring opportunities will remain a positive driver of equities.

	3Y history	Latest	
GDP, % yoy		3.7	Q1
PMI, index		50.9	Jun
CPI, % yoy		5.8	May
Policy rate, %		11.25	Jun
MSCI Mexico*		4.7%	Q2
EPS, % yoy		0.0	Jun
12M Forward P/E		11.9	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

We are upgrading our allocation to Mexico from underweight to neutral, as we are cautiously optimistic on the nearshoring trend and valuations screen cheap, despite outperformance. Existing trade agreements with the US and Canada and competitive wages mean that Mexico is well-placed to benefit from the reallocation of supply chains. Nevertheless, an overreaching government, ongoing USMCA tensions and the weak rule of law are some factors that could limit Mexico from achieving the full benefits of nearshoring.

The ruling MORENA party is well-placed to win next year's presidential election after winning the all-important State of Mexico in recent state elections. But the 2021 mid-terms produced a divided congress, which should keep the government in check.

The risk of a US slowdown looms over Mexico's economic outlook. As such, domestic demand will drive growth, which should find some support from the tight labour market. However, prior monetary tightening and a slowdown in remittances will keep a lid on household spending.

The disinflation process appears to have taken hold, as evidenced by the ongoing falls in headline and core inflation. Therefore, the Bank likely concluded its hiking cycle at its March meeting. If inflation continues to fall at its current pace, the Banxico will likely start cutting rates before the end of the year to keep the real policy rate stable, as priced in by the market.

Market Strategy: The rally in Mexico's equity market outpaced the broader EM benchmark for the fourth consecutive quarter. Nonetheless, with a 12m forward P/E multiple below its five-year average and earnings projected to grow by 21.7% this year, valuations are still very cheap. Therefore, we close our underweight position as we currently assess the equity market risks as more balanced. We upgrade Mexico to *neutral*.

Europe, Middle East and Africa

Turkey

Underweight

The gradual but painful readjustment process to drag on activity.

	3Y history	Latest	
GDP, % yoy		4.0	Q1
PMI, index		51.5	Jun
CPI, % yoy		38.2	Jun
Policy rate, %		15.00	Jun
MSCI Turkey*		-11.6%	Q2
EPS, % yoy		146.4	Jun
12M Forward P/E		5.0	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

The end of political uncertainty and hopes of a return to conventional policymaking meant that Turkish equities rallied after President Erdogan secured a new five-year term in May. Nonetheless, the sharp depreciation in the lira, partly due to FX controls being relaxed, eroded the stock market's performance in US dollar terms.

The focus in the near term will be on whether the appointment of more orthodox policymakers, which includes a new central bank governor, will result in credible adjustments to address the country's growing macroeconomic imbalances. For a start, the central bank will need to raise interest rates sharply to bring real rates in line with Turkey's EM peers and into positive territory. Second, the central bank must replenish its international reserves and unwind financial repression measures. Finally, the budget deficit, which ballooned at the start of this year due to pre-election giveaways and disaster relief, will need to be contained. The smaller-than-expected rise in the key rate at the first central bank meeting under new leadership suggests that policy recalibration could be more gradual than required, potentially expending any post-election positive investor sentiment.

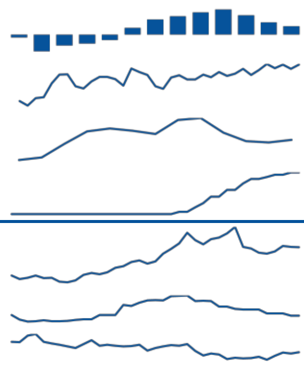
On the macroeconomic front, recent lira depreciation, wage and pension increases, and delayed tax hikes suggest that inflation will likely rise again. Meanwhile, economic activity will lose traction as monetary policy is tightened.

Market Strategy: Lira weakness weighed on MSCI Turkey's performance in Q2. Turkey is one of the cheapest EM equity markets, reflecting weak earnings projections for this year. With the economic readjustment process underway, we see more downside to the economy and the stock market. Thus, we remain *underweight*.

Saudi Arabia

Overweight

We continue to see value in the equity market as the Kingdom progresses in diversifying its economy.



	3Y history	Latest	
GDP, % yoy		3.8	Q1
PMI, index		59.6	Jun
CPI, % yoy		2.8	May
Policy rate, %		5.75	Jun
MSCI Saudi Arabia*		5.4%	Q2
EPS, % yoy		-5.2	Jun
12M Forward P/E		16.5	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Saudi Arabian equities held up over the quarter, despite softer oil prices. While estimates for growth this year have been revised down in response to Saudi Arabia's lone oil output cut decision, we hold a positive view of the country on the back of the Vision 2030 structural reform programme.

Efforts to diversify the economy away from hydrocarbons are starting to bear fruit. The unemployment rate fell from 11% in 2021 to 8% in 2022, while the female employment participation rate has already breached the Vision 2030 target of 30%. The non-oil economy is expected to maintain momentum this year and remain the main driver of domestic demand, as evidenced by the PMI reading above 50 in June.

Although the budget balance will likely tip into a deficit due to lower oil prices and higher spending, the shortfall will be modest. The success of Vision 2030 partly relies on fiscal prudence. Additionally, the Kingdom's low debt levels and ample reserves mean it can weather a further dip in oil prices. Similarly, the current account is projected to narrow but remain in a surplus.

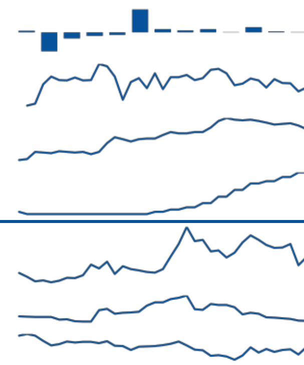
Robust economic activity has not fed into inflationary pressures, which have been contained. Nonetheless, the dollar-peg requires the Saudi Arabian Monetary Authority (SAMA) to hike rates higher in line with the Fed. The relative currency stability afforded by the dollar-peg should limit inflationary spikes.

Market Strategy: Despite the outperformance in Q2, Saudi Arabia's stock market continues to screen attractive. We continue to see value in Saudi Arabia's reform process, and there is scope for rerating, especially as EPFR data show that fund managers are still underweight Saudi Arabian equities relative to the benchmark. Thus, we remain *overweight*.

South Africa

Underweight

Ongoing power outages plague the economic outlook and earnings.



	3Y history	Latest	
GDP, % yoy		0.2	Q1
PMI, index		48.7	Jun
CPI, % yoy		6.3	May
Policy rate, %		8.25	Jun
MSCI South Africa*		-5.8%	Q2
EPS, % yoy		-22.6	Jun
12M Forward P/E		9.9	Jun

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Ongoing power outages, upside inflation risks and rising geopolitical tensions suggest that there is scope for South African equities to derate further. As such, with the trough in valuations yet to be reached, we maintain our bearish view. Domestic activity continues to be curtailed by load-shedding, therefore GDP is likely to stagnate this year. South Africa's medium-term economic outlook depends on the speed of reforms at Eskom, the primary electricity supplier.

Geopolitical risks have risen recently over South Africa's relations with Russia, leading to growing tensions with the US. There have been calls for South Africa to not host the AGOA Forum and BRIC Summit later this year.

On the external front, softer commodity prices are a headwind. The soft global backdrop and pick-up in imports on the back of investment in alternative energy sources suggest a widening current account deficit. This implies further downside for the rand, which has declined nearly 10% YTD. Regarding fiscal policy, lower government receipts and higher public sector pay mean that the Treasury's optimistic budget deficit target of 4.0% for FY23/24 is unlikely to be met. Moreover, the ruling ANC could be tempted to spend ahead of the 2024 elections, given its loss of public support.

Inflation remains sticky, with currency weakness and the higher costs associated with load-shedding complicating the disinflation process. Therefore, the South African Reserve Bank (SARB) will likely deliver one more 25bps rate hike.

Market Strategy: MSCI South Africa's valuation remains cheap, while earnings growth projections of 13.7% for this year appear optimistic, given the deteriorating macroeconomic environment. Therefore, we keep our *underweight*.

KEY ECONOMIC AND FINANCIAL INDICATORS

	Emerging Market	Annual GDP Growth*	Industrial Production*	Consumer Price Index*	Trade Balance*	Current Account Balance*	Foreign Reserves 2023 Latest*	Foreign Reserves 2022 Year ago	Currency vs $ 2023 Latest*	Currency vs $ 2022 Year ago	Short-Term Interest Rates*	Sovereign Rating S&P*	% S&P/EM Frontier Super Composite BMI	Stock Market Index S&P/EM Front. Super Comp. BMI US$	Change since 12/30/22 US$	Change since 12/30/22 Local Currency	2023 P/E Forecast*	EBIT Margin 2023 Forecast*	6 month Stock Market Index Estimate (Front Super Comp. BMI) US$*	3 month Currency vs $ +/-*
		Macroeconomic Data											Market Data							
		% change on year ago			Latest 12 months								Performance				Forecast (Bloomberg)†			
		%	%	%	$ Bn	$ Bn	$ Bn	$ Bn			%		Jun. 30, 2023	Jun. 30, 2023	%	%		%		
Overweight	INDONESIA	5.0	1.2	3.5	51.2	15.6	130.6	122.3	15183.0	14980.0	4.0	BBB	2.1	1442.0	6.6	2.7	15.2	24.2	1482	+
	VIETNAM	4.1	2.8	2.0	20.0	6.5	85.8	109.0	23648.0	23380.0	5.7	BB+	0.3	219.6	13.1	13.2	13.9	16.8	231	+
	SAUDI ARABIA	3.8	n.a.	2.8	35.8	17.7	427.6	415.7	3.8	3.8	5.8	A	3.6	169.6	10.3	10.1	17.7	29.2	166	uc
	TAIWAN	-2.9	-15.7	1.8	50.7	88.7	564.8	549.0	31.3	29.8	1.5	AA+	14.6	508.5	20.2	21.8	18.0	9.9	518	+
	MALAYSIA	5.6	-3.3	2.8	55.1	11.3	102.9	103.0	4.7	4.4	2.7	A-	1.6	328.0	-9.0	-3.6	13.8	20.3	344	+
	QATAR	8.0	n.a.	2.6	96.7	62.6	42.6	37.4	3.6	3.7	n.a.	AA	0.8	294.3	-2.3	-2.3	9.7	n.a.	290	uc
Neutral	BAHRAIN	4.1	n.a.	0.7	n.a.	n.a.	4.4	4.3	0.4	0.4	6.3	B+	0.1	313.7	19.4	19.4	n.a.	n.a.	315	uc
	BRAZIL	4.0	1.9	3.9	73.3	-48.5	312.2	315.3	4.9	5.3	8.5	BB-	5.5	765.0	20.9	10.9	8.0	20.6	796	+
	CHILE	-0.6	-4.5	7.6	12.0	-20.9	35.3	44.5	804.5	949.9	11.5	A	0.5	431.6	11.4	4.9	8.8	15.6	473	-
	COLOMBIA	3.0	-3.0	12.4	-13.7	-19.3	52.8	52.7	4243.9	4383.6	13.2	BB+	0.2	4409.6	3.7	-10.2	5.0	37.8	4350	-
	CZECH REP.	-0.5	-1.6	11.1	-2.6	-13.7	131.5	162.7	22.0	24.4	7.1	AA-	0.1	1475.0	25.1	20.4	11.5	n.a.	1577	+
	EGYPT	6.6	-10.1	32.7	-31.6	-10.5	23.8	27.2	30.9	18.9	18.3	B	0.1	1266.8	-1.9	22.5	7.2	n.a.	60	-
	GREECE	2.1	4.2	1.8	-38.0	-17.9	4.4	2.9	1.1	1.0	0.0	BB+	0.5	51.9	40.3	37.5	6.1	8.7	605	+
	HUNGARY	-0.9	-4.6	20.1	-5.3	-12.6	33.3	28.0	356.7	396.7	14.5	BBB-	0.2	578.1	28.8	17.4	6.0	n.a.	613	+
	KENYA	5.3	n.a.	7.9	-13.3	-70.2	6.5	8.4	141.0	118.1	7.7	B	0.0	479.3	-23.3	-12.6	6.9	22.4	484	-
	KUWAIT	8.2	n.a.	3.7	n.a.	63.2	45.9	41.6	0.3	0.3	3.2	A+	0.8	137.4	-3.4	-3.0	15.9	n.a.	130	n.a.
	MEXICO	3.7	0.7	5.1	-24.4	-66.0	180.7	179.5	17.3	20.6	11.5	BBB	2.3	636.7	27.1	12.1	12.3	17.1	693	+
	MOROCCO	3.5	0.8	7.1	-16.8	-4.7	32.1	29.4	9.8	10.2	2.9	BB+	0.2	616.1	14.7	8.6	15.8	25.6	618	n.a.
	NIGERIA	2.3	n.a.	22.4	5.6	1.3	30.1	32.7	750.1	423.7	9.0	B-	0.1	159.1	-9.7	50.0	8.2	n.a.	312	+
	PAKISTAN	-1.3	-24.9	29.4	-27.9	-14.3	4.8	8.9	276.4	207.4	16.6	CCC+	0.0	302.6	-16.6	4.6	3.3	n.a.	2276	n.a.
	PERU	-0.4	0.3	6.5	11.0	-7.2	68.7	71.9	3.6	3.9	0.1	BBB	0.2	1991.7	12.9	12.4	10.3	n.a.	2098	+
	POLAND	-0.3	-3.2	11.5	-11.5	-7.8	152.5	135.6	4.1	4.7	7.5	A-	0.8	336.0	25.4	16.3	8.5	12.0	351	-
	ROMANIA	2.4	-4.6	10.6	-34.3	-25.4	54.9	39.2	4.6	4.9	6.4	BBB-	0.1	194.9	13.4	11.2	4.9	29.0	210	+
	SOUTH KOREA	0.9	-7.3	2.7	-63.2	7.6	402.2	425.1	1305.9	1297.5	3.8	AA	12.6	567.0	14.2	19.0	17.3	6.6	160	+
	UAE	7.4	n.a.	2.3	79.0	48.0	151.6	122.5	3.7	3.7	5.3	NR	1.3	171.7	0.7	0.7	10.0	n.a.	170	uc
Underweight	INDIA	6.1	4.2	4.3	-276.7	-68.4	520.9	531.2	82.7	79.1	6.0	BBB-	16.8	1705.1	7.1	6.2	22.2	13.4	1793	+
	SOUTH AFRICA	0.2	3.4	6.3	5.6	-20.6	47.0	42.9	19.1	16.7	9.4	BB-	2.8	689.4	-7.1	3.1	10.9	21.0	684	+
	CHINA	4.5	3.5	0.2	944.2	398.1	3204.8	3119.7	7.2	6.7	1.1	A+	26.2	714.9	-5.3	-4.0	10.8	12.8	740	+
	PHILIPPINES	6.4	8.1	5.4	-59.1	-18.1	86.9	91.6	55.6	56.0	6.3	BBB+	0.7	723.9	1.4	0.4	13.1	21.0	757	-
	THAILAND	2.7	-3.1	0.2	5.4	-10.4	203.6	221.8	35.2	36.1	1.8	BBB+	1.9	1176.1	-11.7	-9.7	17.8	9.7	1218	+
	TURKEY	4.0	-1.2	38.2	-122.2	-57.8	55.7	53.6	26.1	17.3	20.0	B	0.7	361.9	-22.5	7.8	5.2	11.8	387	+
	ARGENTINA	1.3	-13.3	114.2	1.0	-8.5	27.5	32.3	260.3	126.6	92.3	CCC-	0.8	1111.7	40.2	103.2	8.2	17.3	1119	-

Note: All data shown are as at 7 July 2023 unless stated otherwise. UC is unchanged (currency versus US dollar). S&P sovereign rating shown is long-term foreign currency rating. 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 32 countries shown in the table accounted for 98.9% of the S&P/EM Frontier Super Composite BMI on 30 June 2023. An additional 24 countries accounted for the remaining 1.1% 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, Estonia, Ghana, Iceland, Jamaica, Jordan, Kazakhstan, Latvia, Lithuania, Mauritius, Namibia, Oman, Panama, Slovakia, Slovenia, Sri Lanka, Trinidad & Tobago, Tunisia and Zambia.
†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.
**Key Criteria*
Source: Bloomberg, CLIM

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