Global Markets Research

ANCHOR REPORT

EM's struggle with 'America First' policies

27 January 2017

- We explain the challenges but illustrate in our risk scenario the peril of lumping all of EM together. Mexico's economy is the most vulnerable, but once starting positions and policy responses are considered, Turkey is the hardest hit. Asia is likely to be more vulnerable than most people think, but is cushioned by large fiscal stimulus. The only EM that could benefit is Russia.
- Prepare for major divergence in EM monetary policy this year. In our risk scenario we have five EM rate hikers, led by Turkey (400bp) and Mexico (175bp), and seven EM rate cutters, led by Brazil (-325bp), Russia (-150bp) and Colombia (-100bp).
- FX strategy: We expect broad USD strength amid higher volatility. We recommend long USD/CNH and short CNH versus an abridged CFETS basket, long CAD/MXN and short TRY/ZAR.
- Rates strategy: We prefer steepeners in Korea, Thailand, India and Singapore. We also like outright payers in HK IRS and Mexico; receive SGD IRS versus pay USD IRS.
- Check out the hot-off-the-press results of our investor survey.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

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Executive summary

There is new-found optimism in the air, notably in America, and it is spreading. But for EM, we are unconvinced that it will last. This week's souring of US-Mexican relations could be a taste of things to come. Yes, US fiscal stimulus is positive for EM, but we foresee two stronger counteracting forces that could have an earlier impact. One is a faster Fed hiking cycle and a strengthening USD, which exposes EMs – many of which have become heavily indebted since 2008 – to capital outflows and credit defaults. The other is the triumvirate of rising US trade protectionism, tougher immigration rules and a reassessment of US foreign policy positions, which seem to be at the heart of President Trump's 'America First' goal. EM, with its trade-orientated economies and delicate geopolitics, are much more exposed to this than developed markets. When we polled investors on whether increased trade protectionism can lead to rising geopolitical tension, the result was striking: 46% replied 'definitely yes' and 41% said 'probably yes'.

While we are cautious on EM, underlining this report is a warning against lumping all of EM together. EMs economic starting positions already vary greatly and Trumponomics stands to further widen this chasm. In Nomura's heat map of President Trump's 'America First' policies, Mexico unsurprisingly is deemed most vulnerable, while least vulnerable are Hungary, Israel, Russia and Peru. There are marked differences among regions too: 39% of Asia's heat map contains high-vulnerability red cells, while LatAm, even with Mexico's high exposure, has 30%, and EEMEA with 21% is the least vulnerable.

In a more quantitative exercise, against our baseline forecasts, we considered a downside risk scenario involving a tougher set of 'America First' policies, including greater US trade protectionism, tougher immigration policies, faster Fed rate hikes and more USD appreciation. In this risk scenario, Turkey's already very fragile economy is hit hardest and the wind is also taken out of the sails of the LatAm recoveries. In Asia, despite our heat map result, growth is only moderately weaker because the region utilises its fiscal space. There is only one EM with higher growth than baseline: Russia. The policy interest rate divergence remains stark. At one extreme, to defend their depreciating currencies, the central banks of Turkey and Mexico hike by 400bp and 175bp, respectively, this year, with higher rates also in Hong Kong, Singapore and the Philippines. At the other end of the spectrum, the big rate cutters are Brazil (-325bp), Russia (-150bp) and Colombia (-100bp), and four smaller rate cutters: China (-25bp), India (-25bp), Malaysia (-50bp) and Thailand (-50bp).

FX strategy: In our baseline view on the US macro, policy and political backdrop, USD/EM should be broadly supported in 2017. However, there are numerous risks that could lead to significant FX volatility, including a push for a weaker USD by team Trump and/or a reconciliatory stance on his campaign commitments. That said, in our risk scenario, there would be a forceful policy push from President Trump and the Fed would hike more aggressively, which would lead to more substantial USD strength. Considering our views on the global environment, local idiosyncratic factors and the skew of risks around President Trump's policies, our top EM FX trades are/remain long spot CAD/MXN with Mexico the most exposed to President Trump policy risks. We remain long USD/CNH and short CNH versus an abridged CFETS basket given local capital outflows, local macro/policy challenges and RMB overvaluation. Our short CNH versus basket position will help mitigate the risk of a softer USD. In EEMEA, we recommend short 1M TRY/ZAR as Trump/Fed hike risks could amplify domestic issues. Turkey's central bank remains reluctant to raise rates to support TRY and there are upcoming political risks. In contrast, SARB policy is ZAR supportive, positioning is limited and political risks are unlikely to intensify until later in the year. We are positive on RUB due to oil prices and a potential improvement in US-Russia relations. However, the risk is positioning and CBR FX intervention risk.

Rates strategy: We are biased towards steeper curves that should be driven by a rise in inflation in 2017and Fed tightening. That said, we look to take a differentiating approach to the EM complex. As US rates rise, we expect rates in most EM countries to rise. However, there will be differences in monetary policy. On one hand, we expect rate hikes in Turkey, Mexico and Philippines, while on the other, we forecast rate cuts in India, Malaysia, Korea, Thailand, Russia, Brazil and Colombia. In countries where we expect rate cuts, front-end rates should remain stable, while we expect rates further out on the curve to be affected by rising inflation and a rise in US yields. We like steepeners in Korea, Thailand, India and Singapore and outright payers in HK IRS and Mexico. We also like receive SGD IRS vs pay USD IRS.

High conviction trades

FX strategy

Long spot CAD/MXN (targeting 18.0 by end Q1): Mexico remains one of the most exposed to risks from President Trump's policies, while domestic imbalances are growing. This contrasts with Canada's economy, which seems to be stabilising at the margin, with terms of trade improving and imminent rate cuts unlikely.

Long USD/CNH (targeting 7.05 in spot, 2.3% total return by end-Q1) and short CNH versus an abridged CFETS basket (40% of USD/CNH notional): President Trump's policies and their implications for the Fed could add to RMB depreciation pressures. Locally, capital outflows, macro/policy challenges and RMB overvaluation remain intact. Short CNH versus an abridged CFETS basket provides a cushion against any temporary USD weakness.

Short 1M TRY/ZAR (S/L 3%, targeting 3.20 in 3-months, notional USD1mn): President Trump/Fed hike risks could amplify domestic issues in EEMEA. Turkey's central bank remains reluctant to raise rates to support TRY and there are upcoming political risks. In contrast, SARB policy is ZAR supportive, positioning is limited and political risks are unlikely to intensify until later in the year.

Rates strategy

Korea 2s5s (Target: 30bp; Reassess: 10bp) and THB 2s10s steepeners (Target: 120bp; Reassess: 80bp): We expect front-end rates to remain anchored by the weak domestic macro backdrop, while the long end should rise on global rates moves. We also expect expansionary fiscal policy to steepen the Thai curve. We target 30bp on Korea 2s5s and 120bp on THB 2s10s.

Pay HKD IRS 5yr (Target: 2.40%; Reassess 2.00%): This position is a good proxy for higher G3 yields and also offers cheap protection against a rise in China's risk premium. We believe slowing capital inflows should also lead to a reduction in liquidity and result in higher HIBOR fixings.

Receive SGD IRS 3yr vs pay USD IRS 3yr (Target: 0bp; Reassess: 30bp); SGD 3mfwd3s10s steepeners (Target: 94bp, Reassess: 64bp): In a rising US rates environment, we expect Singapore rates to outperform, as better liquidity in the banking system should keep SOR fixings stable. We also expect the combination of a stable front end and rising US rates to result in a steepening of the SGD IRS curve.

India 2s5s steepeners (Target: 40bp; Reassess: 20bp): We see a confluence of factors – a lack of open market operation purchases, end of easing cycle dynamics, a large state bond supply, the Fed hiking cycle and a potential pick-up in credit growth – to steepen the yield curve in India.

Pay Mexico 2yr TIIE (Target: 8.00%; Reassess: 7.15%): With formal NAFTA negotiations in the pipeline, macro conditions could continue to deteriorate as adverse conditions stemming from potential trade restrictions are imposed. Higher inflation should also lead to higher front-end rates.

Economic overview: A motley EM crew

President Trump's goal to make America great again entails policies that are likely to be overall negative for EM. True, US fiscal stimulus will provide some boost, but its impact is unlikely to be felt until late 2017 or 2018, and we expect two stronger, opposing forces that could have an earlier impact. One is a faster Fed hiking cycle and a strengthening of USD, which exposes EMs – many of which have become heavily indebted since 2008 – to capital outflows and credit defaults. The other is what is shaping up to be at the heart of team Trump's 'America First' policies and negotiating strategy: the triumvirate of rising US trade protectionism, tougher immigration rules and a reassessment of US foreign policy positions. In our assessment, EM – with its trade-orientated economies and delicate geopolitics – is much more exposed to this than developed markets.

However, the key message in this report is a warning against lumping all of EM together. We foresee big differences in economic performance. EMs have very different starting positions in terms of their ability to withstand external shocks. Also, their exposure to Trumponomics and their room for policy responses, vary greatly. In our baseline forecasts, we expect three central banks to hikes rates this year and seven to cut. China still has large room for fiscal stimulus, but others like Brazil and South Africa do not. This motley EM crew creates a rich environment for investing and, in the following chapters, our FX and rates strategists discuss their top trade recommendations.

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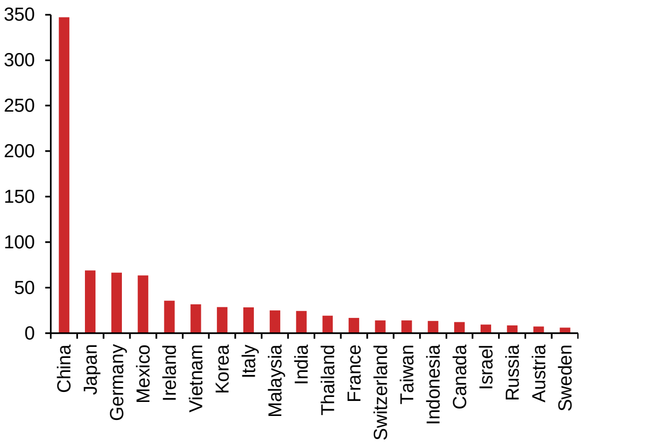
America First policies = EM last policies

It is clear from Nomura's league table – our attempt to rank 23 EM economies on their prospects for solid growth and fundamentals – that EM is generally starting from a weak position to fend off Trumponomics (Figure 3). Of the 23 EMs, there are only four in our Leaders camp (India, Indonesia, Philippines and Peru), while there are 12 Laggards and seven in the middle. In Asia, many economies already face stiff structural headwinds from late-stage credit cycles, shrinking workforces and a slowing China. Outside of Asia, many are fragile (e.g., Colombia, Mexico, South Africa and especially Turkey) because the slump in commodity prices in recent years and, in some cases, political turmoil.

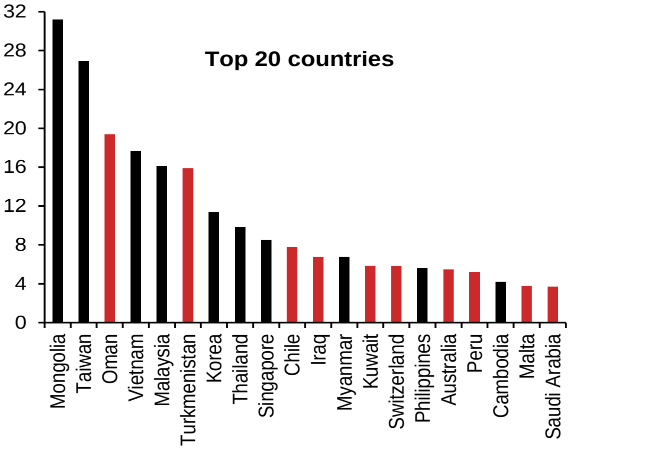
President Trump's immediate executive order to withdraw from the Trans-Pacific Partnership (TPP) and pledge to renegotiate NAFTA is a strong sign of the White House's determination to seek better trade deals. Next could include branding some EMs currency manipulators, sending home illegal immigrants, tightening visa requirements, import tariffs or border taxes, incentives for US firms to repatriate profits from overseas and penalties to encourage more onshore production. In our hot-off-the-press investor survey (see appendix), 67% of respondents believe it is either extremely likely or somewhat likely that the US will impose targeted tariffs on China. Mexico is singled out as the most exposed but, over time, we believe US trade protectionism could be strongest against Asia. Although the US trade deficit with China dwarfs that of Mexico (Figure 1), China also masks Asia's massive supply chain: a large share of the value-added in China's exports come from other Asian countries, which is reflected in the high share of China's imports in other Asian countries' GDP (Figure 2).

Fig. 1: US's top 20 bilateral trade deficit partners in 2016



Source: CEIC and Nomura.

Fig. 2: China's 2016 imports, scaled by source country's GDP



Note: Asian countries in black. Source: CEIC and Nomura.

Fig. 3: Nomura's EM league table

Leaders (strong growth outlook; sound fundamentals/ moving in that direction)

India: Demonetisation is negative in the short term but positive in the long term; solid fundamentals, 7.1% growth and progress on reforms sets the stage for rising potential growth.

Indonesia: Domestic-led growth to rise to 5.6% in 2017; there is space for fiscal stimulus and infrastructure implementation; external risks are motivating even more reforms to build resilience.

Philippines: Domestic demand is the strongest in Asia; healthy fiscal account, low leverage, and a young population; an investment boom is currently underway; the only Asia central bank we expect to hike in 2017.

Peru: It has the fastest growing economy (4%) in LatAm; new copper mines are starting production; BCRP on hold.

In the Middle

Brazil: Is exiting a recession, has falling inflation and we expect 475bp in rate cuts – while a fiscal reform agenda is pushed forward. But it is also very challenged by rising public debt, unemployment and continued unstable politics.

Czech: Stable growth and very low inflation; CNB does not want negative interest rates, so exit from EURCZK floor likely in Q3.

Chile: A modest growth recovery (1.9%); leveraged to copper prices; there is a focus on the November presidential election, as its outcome will determine the reform outlook.

Hungary: Fiscal stimulus should buoy growth (2.4%) but there is no scope for a rate cut (a rate hike also seems unlikely). High emigration brain drain is a concern.

Israel: Deflation to end in 2017, but the BOI is on hold and so a widening rate differential with the US should lead to a weaker ILS.

Romania: The economy risks overheating with expansionary fiscal policy and too-lose monetary policy; we expect 100bp of rate hikes but these will likely occur behind the curve.

Russia: Exits a recession (1.1% growth), biggest turnaround story in EEMEA; large fiscal tightening while easing inflation should allow 100bp of rate cuts.

Laggards (weak or deteriorating growth outlook; poor fundamentals)

China: Needs SOE restructuring and deleveraging but this will hurt growth. Beijing will do what it takes to keep growth at ~6.5%, but vulnerabilities are festering.

Colombia: Subdued growth (2%) as the government reins in its fiscal deficit; we expect 200bp of rate cuts, but the risk is less due to sticky inflation from the VAT hike.

Mexico: Most exposed to Trump protectionism, but the US has a lot to lose from extreme protectionism; expect Banxico to hike by at least 100bp.

Hong Kong: Property bubble, straightjacketed by HKD peg and political risks. Stuck between a rock (Fed hikes) and a hard place (slowing China).

Malaysia: Protectionism undermines exports and narrows the current account; large foreign bond holdings and limited FX reserves; political risk from elections clash with needed fiscal austerity.

Korea: Its large current account surplus is a symptom of demographics, high household debt; high political uncertainty, very exposed to Trump, little fiscal space.

Poland: Fiscal-led growth recovery (3.4%), but reform setbacks (pensions, SOEs) are a concern; political risks with a lingering constitutional crisis.

South Africa: Weak growth (1%) as politics supersede reforms; Zumxit unlikely in 2017; watch Zuma purge opponents in cabinet reshuffle in January/February.

Singapore: Unsuccessful in its bid to raise productivity; potential growth is slowing and the ultra-open economy is very exposed to myriad downside external risks.

Taiwan: Debt is high; cross-strait relations have deteriorated and could be left out of any new regional free trade agreements; US-Sino relations could indirectly impact its regional supply-chain.

Turkey: Switching to executive presidency; referendum likely April/May. Erdogan will try to stoke nationalism. Rising inflation, large CAD and 200bp in rate hikes.

Thailand: High household debt; large overcapacity; shrinking working-age population; lack of supply-side reforms, it is hampered further by politics under military rule.

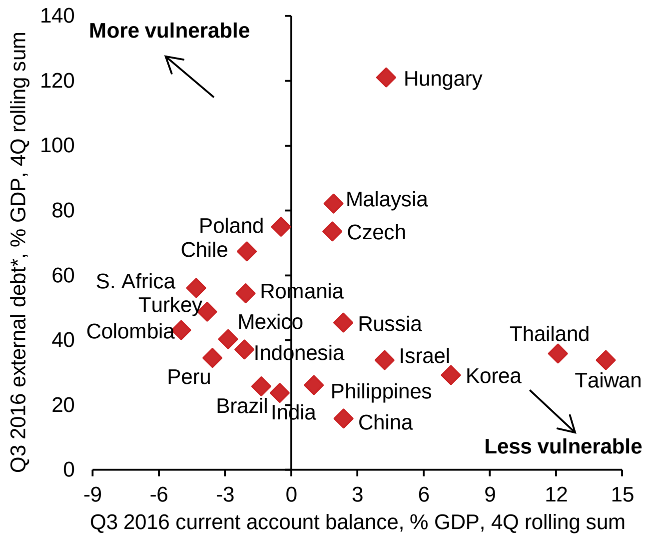
Source: Nomura.

Rising US trade protectionism and possible retaliatory measures could intersect with increased foreign policy tensions. Indeed, our investor survey asked whether increased trade protectionism can lead to rising geopolitical tension, and 46% replied 'definitely yes' while 41% said 'probably yes'. President Trump's actions already suggest the one-China policy could be on the table for negotiation. In EM, there is no shortage of potential flashpoints – the South China Sea, Korean peninsula, Taiwan Strait and Middle East – and markets have a nasty habit of not pricing in geopolitical risk until it is too late. On the other hand, a few in EM could benefit. President Trump's warmer tone towards Russia has increased expectations that sanctions may be lifted or relaxed, but we do not expect it to happen this year. India too could benefit as President Trump seems to believe that a nuclear India is the real check to Pakistan.

The other challenge for EM is the risk of an outbreak of US inflation from tighter immigration policies (higher wages), trade protectionism (higher import prices) and more expansionary fiscal policy, all when the US economy is approaching full employment. This could result in faster-than-expected Fed hikes and further USD appreciation, a combination to which EM is arguably more exposed than in previous episodes, for there is no doubt that, since 2008, QE in the advanced economies contributed to an extraordinary build-up of debt in many of these EMs. Thus, EMs with high external debt and large current account deficits are particularly exposed to capital flight and currency depreciation pressure (Figure 4). It could also be the spark – perhaps from FX debt mismatches or the evaporation of market liquidity – that ignites a wave of EM corporate defaults and domestic financial stress, particularly in Asia where credit to the private non-financial sector in many countries has risen to a very high share of GDP (Figure 5).

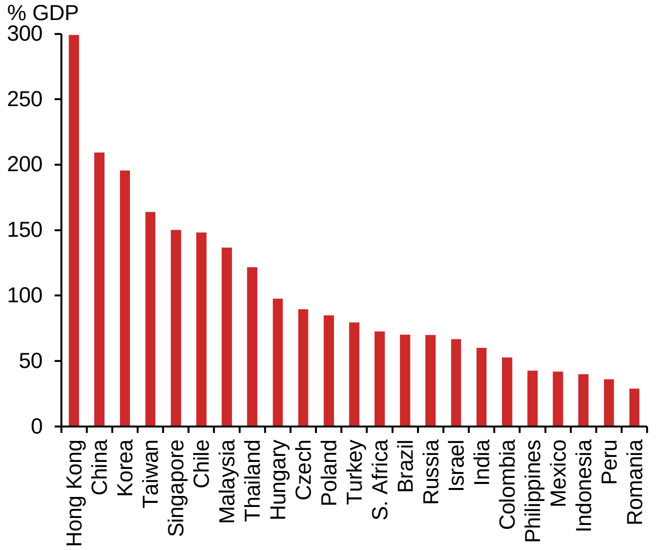
In admittedly a more qualitative exercise based on bold assumptions of equal weightings, we summarise our assessment of the overall impact of 'America First' policies on 21 EMs, in the form of a heat-map (Figure 6). The black cells, denoting low vulnerability, count for 68 out of 168 cells; but there are a high number of high-vulnerability red cells (53) and medium-vulnerability grey cells (47). The least vulnerable countries with the highest number of black cells are Hungary (7), Israel (6), Russia (6) and Peru (6), while unsurprisingly Mexico has the most red cells (6). There are striking differences by region: Asia is dominated by high-vulnerability red cells (39% of total cells), reflecting the region's high exposure to US protectionism and foreign policy confrontation, as well as higher rates and USD appreciation. On the other hand, LatAm, even with Mexico's high exposure, has 30% share of high-vulnerability red cells, while EEMEA appears the least vulnerable region of all with 21% of red cells.

Fig. 4: Current account balance versus external debt



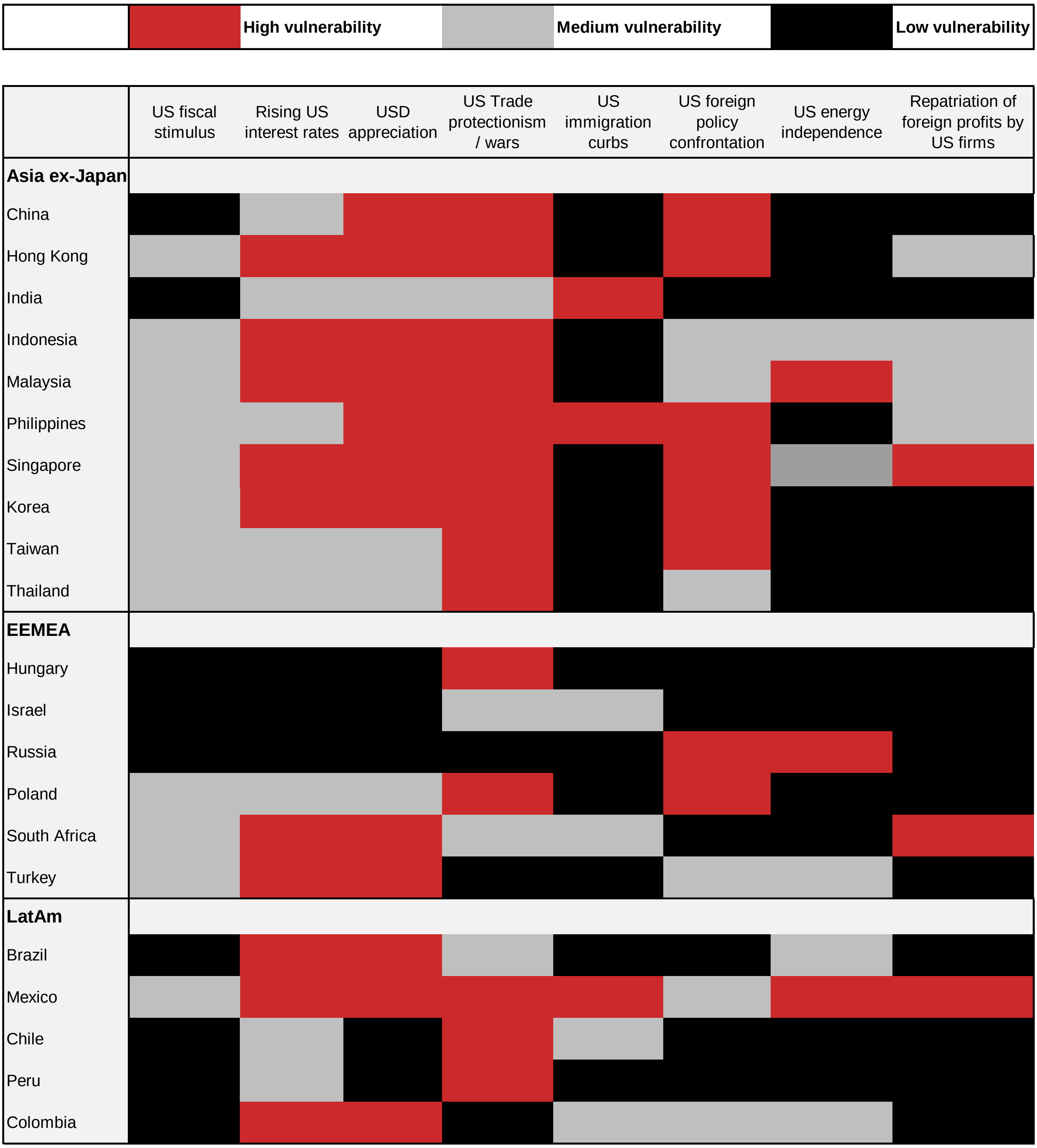
Note: *We include our estimate of so-called hidden external debt: EM companies that use their offshore subsidiaries to issue debt. Source: BIS, CEIC and Nomura.

Fig. 5: Credit to private non-financial sector in Q2 2016



Source: BIS, IMF and Nomura.

Fig. 6: Nomura's heat map assessing the relative vulnerability of EM to Trumponomics



Note: Vulnerability to US fiscal stimulus refers to the inability of an economy to benefit from US fiscal stimulus. High vulnerability here reflects an economy that enjoys little or no benefit from US fiscal stimulus while low vulnerability reflects significant benefits.
Source: Nomura.

Our baseline forecasts and a downside risk scenario

Our baseline house view around Trumponomics assumes a moderate US fiscal stimulus (an annualised impulse of 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year (June and December); low-scale US trade protectionism and tighter immigration policies; further USD appreciation (USD/JPY120 and EUR/USD1.00 by end-2017); and Brent oil averaging around current levels.

As highlighted in Figure 7, our assumptions around Trumponomics, as well as regional and country-specific factors, gives us a baseline forecast of GDP growth slowing in 2017 across most of Asia, but picking up in LatAm (except Mexico) and EEMEA. We expect CPI inflation to rise (from low levels) in Asia, but fall (from higher levels) in LatAm (except Mexico) and EEMEA. In our baseline forecasts, 2017 will be a year of monetary policy divergence in EM. We expect sharp rate hikes in Turkey (200bp) and Mexico (100bp) because of currency depreciation-induced inflation and moderate hikes in the Philippines (demand-driven inflation), and a rise in interbank rates in Hong Kong and Singapore (these latter two import Fed policy, as their currencies are respectively fixed and managed against the USD). By contrast, we forecast rate cuts in India, Malaysia, Korea, Thailand, Russia, Brazil and Colombia.

Of course, there is very high uncertainty over the US policy outlook, and a full gamut of alternative scenarios could play out, ranging from a massive, early US fiscal stimulus and a revival in animal spirits feeding through to private business investment, to the other extreme of an outbreak of US inflation, a major tightening of US financial conditions, trade wars and geopolitical turmoil.

As explained, we judge that the risk to our baseline for EM is skewed to the downside, and hence we have come up with a downside risk scenario based on the following assumptions: 1) the same US fiscal stimulus as in the baseline, but greater inflation pressures forces the Fed to hike four times this year; 2) USD appreciates to USD/JPY 130 and EUR/USD 0.95 by end-2017; 3) medium-scale US trade protectionism and tighter immigration policies (these may include, among other things: a) exiting or renegotiating free-trade agreements; b) imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; c) incentives to US firms to repatriate their overseas profits; and d) deportation of illegal immigrants and reducing the inflow of new ones) are quickly implemented, which leads to some retaliation; 4) a noticeable rise in geopolitical tensions; and 5) a moderate decline in the Brent oil price to average USD45-50/bbl this year.

We go into more detail in the individual country pages below, but in terms of the big picture, the major changes to our forecasts (Figure 7) in this risk scenario relative to the baseline are:

GDP growth: Turkey's economy would be hit the hardest, with growth slowing to 0%, 2.5 percentage points (pp) lower than baseline, reflecting its weak starting position and punishing rate hikes to defend TRY. The wind is also taken out of the sails of the LatAm recoveries, with growth lower in Mexico (-1.0pp), Colombia (-0.8pp) and Brazil (-0.6pp). In Asia, there is less of a negative impact because it has more room for policy responses. The biggest hits are in the more open economies of Singapore (-0.5pp), Hong Kong (-0.4pp) and Malaysia (-0.4pp). China's growth is 0.3pp lower than the baseline, while India (-0.1pp) would be least affected. Only one EM would experience a positive growth impulse: Russia (+0.2pp).

CPI inflation: Notwithstanding lower growth and oil prices, inflation rises sharply from the baseline in Turkey (+1.1pp), Mexico (+1.1pp), Colombia (+1.0pp), Korea (+0.7pp), Taiwan (+0.5pp) and Brazil (+0.4pp), chiefly because of sharp currency depreciation (for details see the section, FX outlook: Trump impact on EM FX).

Current account: Despite more currency depreciation and lower oil prices, Asia's current account surpluses mostly shrink, because of the region's high exposure to trade disruptions, with the Philippines joining India and Indonesia with current account deficits. By contrast, Turkey's current account deficit narrows sharply as a result of the outsized depreciation of TRY and an economic recession causing import compression.

Fiscal policy: In the risk scenario, we would expect Asia to respond with a large fiscal stimulus, led by China with a budget deficit of 5% of GDP in 2017. In LatAm and EEMEA, the scope for a fiscal response is more constrained.

Monetary policy: The policy interest rate divergence in our baseline becomes even more distinct in the risk scenario, largely because of exchange rate moves. At the one extreme, to defend their depreciating currencies, the central banks of Turkey and Mexico hike by 400bp and 175bp, respectively, this year, with higher rates also in Hong Kong, Singapore and the Philippines. At the other end of the spectrum, the big rate cutters are still Brazil (-325bp) and Colombia (-100bp), although they cut less than in the baseline because of weaker exchange rates, while Russia, with a resilient exchange rate, now cuts by a bigger 150bp. China (-25bp) now joins the other Asian rate cutters of India (-25bp), Malaysia (-50bp) and Thailand (-50bp), whereas, compared to baseline, we now have Korea on hold as we would expect more KRW depreciation.

Fig. 7: Baseline vs risk scenario forecasts

	Real GDP growth, % y-o-y			CPI inflation, % y-o-y			Current account balance, % GDP			Fiscal balance, % GDP			Policy rate, end-period, %		
	Baseline		Risk scenario	Baseline		Risk scenario	Baseline		Risk scenario	Baseline		Risk scenario	Baseline		Risk scenario
	2016	2017	2017	2016	2017	2017	2016	2017	2017	2016	2017	2017	2016	2017	2017
Asia ex-Japan															
China	**6.7**	6.5	6.2	**2.0**	2.6	2.4	2.2	2.1	1.9	**-3.8**	-4.0	-5.0	**1.50**	1.50	1.25
Hong Kong	1.5	0.5	0.1	**2.4**	1.5	1.0	3.2	1.8	1.5	0.5	0.3	-0.2	**1.00**	1.40	1.90
India	7.1	6.9	6.8	**4.9**	5.3	5.1	-0.8	-1.3	-1.2	-3.5	-3.0	-3.0	**6.25**	6.00	6.00
Indonesia	**5.2**	5.6	5.4	**3.5**	4.4	4.4	-2.2	-2.9	-3.1	-2.5	-2.6	-2.8	**4.75**	4.75	4.75
Malaysia	4.1	3.7	3.3	**2.1**	2.8	2.3	1.8	1.2	0.9	-3.1	-3.0	-3.3	**3.00**	2.50	2.50
Philippines	**6.9**	6.3	6.1	**1.8**	3.3	3.1	1.3	0.5	-0.1	-2.2	-2.7	-3.0	**3.00**	3.50	3.50
Singapore	**1.8**	0.7	0.2	**-0.5**	0.5	0.3	23.0	23.0	20.0	0.8	0.5	-0.5	**0.97**	1.55	1.85
Korea	**2.7**	2.0	1.8	**1.0**	1.3	2.0	7.3	6.8	7.0	0.1	0.8	-0.2	**1.25**	1.00	1.25
Taiwan	**1.4**	1.1	0.9	**1.4**	1.5	2.0	14.2	12.1	13.2	-0.5	-1.5	-2.0	**1.38**	1.38	1.38
Thailand	**2.8**	2.8	2.5	**0.2**	1.0	0.8	10.6	7.8	6.0	**-2.7**	-2.7	-3.7	**1.50**	1.00	1.00
EEMEA															
Russia	-0.6	1.1	1.3	**5.4**	4.5	4.2	3.0	3.5	3.0	-4.5	-3.0	-3.0	**10.00**	9.00	8.50
Turkey	2.2	2.5	0.0	**8.5**	8.4	9.5	-4.1	-5.1	-3.4	-1.1	-1.6	-2.2	**8.00**	10.00	12.00
LatAm															
Brazil	-3.3	1.0	0.4	**6.3**	4.8	5.2	**-1.3**	-1.5	-1.3	-9.5	-9.0	-9.5	**13.75**	9.50	10.50
Colombia	1.8	2.0	1.2	**5.8**	5.0	6.0	-4.8	-4.0	-4.5	-4.0	-3.3	-3.8	**7.50**	5.50	6.50
Mexico	2.2	1.7	0.7	**3.4**	4.9	6.0	3.0	3.0	2.8	-3.0	-2.9	-3.2	**5.75**	6.75	7.50

Notes: Numbers in bold are actual values. "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6 percentage points of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to 120 USD/JPY and 1.00 EUR/USD by end 2017; and the Brent oil price averaging around USD50-55 this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: same US fiscal stimulus as baseline but greater inflation pressure forces the Fed to hike four times this year; stronger USD appreciation to 130 USD/JPY and 0.95 EUR/USD by end 2017; quick implementation of medium-scale US trade protectionism and tighter immigration policies and some retaliation (they could include, among others, exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives for US firms to repatriate their overseas profits; deportations of illegal immigrants and reducing the inflow of new ones), a noticeable rise in geopolitical tensions and a moderate decline in the Brent oil price to average USD45-50 this year. Source: Nomura Global Economics.

FX outlook: Trump's impact on EM FX

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Returns from our pre-Trump inauguration trade recommendations (10 January) of long CAD/MXN and long USD/CNH have fluctuated, with USD/CNH slightly negative and CAD/MXN close to flat currently (see *FX Insights - EM FX: Winners and losers*, 10 January 2017). Recent developments include: 1) additional FX action by the Chinese authorities to support RMB (see *Asia Insights - USD/CNY fix: A look into the PBoC's toolkit*, 17 January 2017); 2) reduced market confidence in President Trump's ability to deliver on his pre-election pledges in the near term (especially fiscal); and 3) adjustments to long USD positions by market participants (see *Asia FX Positioning Indices - Using options, implied yield and equity flow data to determine positioning*, 16 January 2017).

At this juncture, as we believe the impact from these three factors has played out to a degree in EM FX, we are inclined to maintain our trade recommendations. However, we still see some risks, such as the Trump administration possibly seeing the need for a weaker USD or signs that President Trump might take a more reconciliatory stance on his pre-election commitments. These risks are difficult to predict, but at least on USD, recent statements by US Treasury Secretary nominee Steven Mnuchin (from the 'Senate Finance Committee' and 'Questions for the record' publication) suggest that a stronger dollar remains in the best interests of the US.

That said, as we highlight in this report, Nomura's baseline view for 2017 still looks to be for a stronger broad USD. Specifically, US fiscal stimulus is expected to support growth in H2 2017, the Fed is expected to hike twice this year and US protectionism is expected to emerge (mainly against Mexico and China). However, weighing the risks ahead, Nomura Economics sees a possible adverse risk scenario in which, along with US fiscal stimulus, inflation rises more than expected, the Fed hikes up to four times (25bp each time) this year, USD strengthens further (USD/JPY at 130 and EUR/USD at 0.95 by end-2017 vs. our baseline forecasts of 120 and 1.0 respectively), and protectionism as well as geopolitical tensions worsen. We believe this scenario would increase the negative pressures on EM FX, even though there would be some relative outperformers. Within EEMEA, we still believe President Trump's policies (particularly protectionism) will have less of an impact, but there are numerous domestic issues in some countries that could be exacerbated because of Fed/ECB monetary policy risks and Eurozone political risks.

Based on the global backdrop, local idiosyncratic factors and the skew of risks around President Trump's policies, our top EM FX trades are/remain:

MXN: difficult to spot value until the dust settles

- **Long spot CAD/MXN (10 January entry at 16.33, targeting 18.0 by end Q1).**

In our *EM FX: Winners and losers* report, 10 January 2017, we highlighted Mexico as the most exposed to risks from President Trump's policies, while domestic imbalances were growing. This stood in contrast to Canada's economy, which seemed to be stabilising at the margin, with terms of trade improving and imminent rate cuts unlikely.

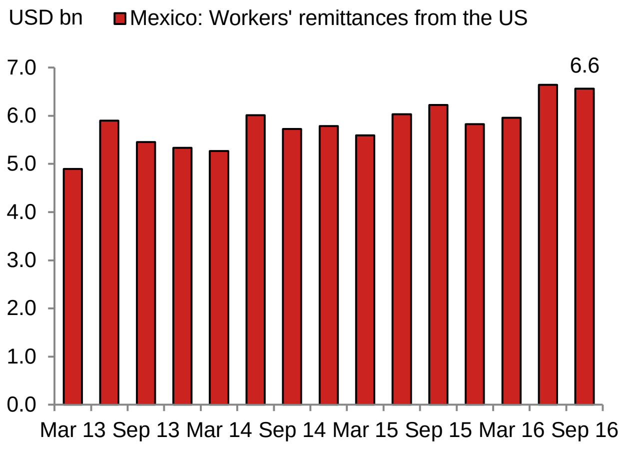
Since the President Trump's inauguration, the focus of the US administration has been on the renegotiation of NAFTA, with Mr Trump seeking a "better" deal with Mexico. Specifically, President Trump has stated that the US will crack down on violations of trade agreements and fight for tougher trade deals to support US manufacturing. Although what the final topics of discussion will be and how far the US, Mexico and Canada are willing to negotiate remain unclear, we believe that it may be a bumpy road for MXN and CAD. Mexico's worst fears are a complete negation of this trade agreement (Figure 8), but currently, we believe a deep and tough negotiation looks more likely at this point. Indeed, this week, team Trump fired the opening salvo, announcing that the US will build a border wall and floated the idea of imposing a 20% tax on imports from Mexico to pay for it, prompting Mexican President Enrique Peña Nieto to cancel his scheduled meeting with President Trump.

Fig. 8: Mexico's relationship with its NAFTA partners

Mexico linkages to	United States		Canada	
	USDbn	% (within each cat.)	USDbn	% (within each cat.)
MX nominal GDP (4Q to Q3 2016)	917	-	917	-
Exports (12M to Aug 2016)	294	74.6%	27	6.9%
Imports (12M to Aug 2016)	196	46.2%	11	2.6%
Total Trade (12M to Aug 2016)	490	71.2%	38	2.9%
Inward FDI (liabilities, cumulative flow since '99)	210	45.9%	27	5.9%

Source: Bloomberg, CEIC, Nomura.

Fig. 9: Flow of labour remittances from the US into Mexico



Source: Banco de Mexico, Nomura.

Although MXN recently caught a small respite after weakening into President Trump's inauguration, it may still be too early to say that this will be sustained, given the extent of these negotiations and the risks to Mexico's external accounts. Aside from trade, additional information on immigration-related action has been limited, and this is key given the risk to flows of labour remittances into Mexico that currently total about USD25bn per year (Figure 9). Indeed, we believe adverse news on immigration policies is still not fully priced into MXN.

Thus, given the combination of US policy risks with our view that the domestic situation is still one of deteriorating growth, increased political risks and potential foreign portfolio outflows, we prefer a short MXN position against CAD. We also believe that, in the risk scenario proposed by Nomura Economics, MXN underperformance would be even more evident and we estimate it could depreciate against USD by 17%.

This view is generally consistent with our 'EM investor survey: What's next from President Trump' (see page 36), where MXN is expected to be among the worst performing currencies in 2017 (19% chose MXN as one of the worst three performers in EM). That said, this may not be an extremely strong consensus view as there was also a relatively large group of investors who expected MXN to be one of the top three FX performers in EM in 2017 (9% of those surveyed chose MXN).

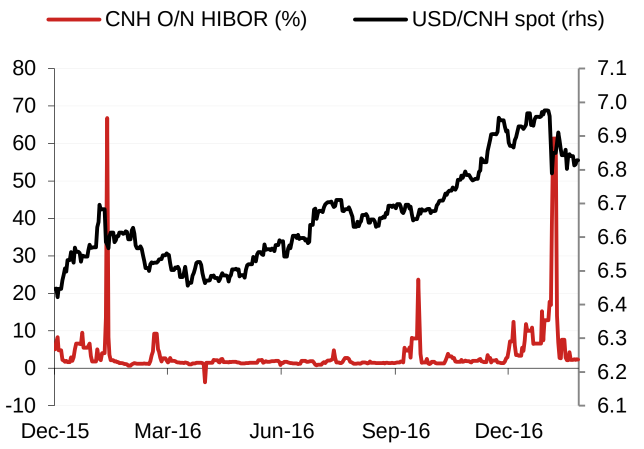
RMB: depreciation trend intact, but near-term headwinds

- **Long USD/CNH (targeting 7.05 in spot or around 2.3% total return by end Q1)**.
- **Short CNH versus basket[1] (40% of USD/CNH notional)**

Spot USD/CNH has fallen by around 90bp since 10 January, when we published our *EM FX: Winners and losers* article, as a result of FX intervention and liquidity squeezes (Figure 10), tightening of regulations on outflows and a capping of the USD/CNY fixings when the broad USD has strengthened (see *Asia Insights - USD/CNY fix: A look into the PBoC's toolkit*, 17 January 2017). Although these measures have been successful in curbing short RMB positions, we remain concerned with the sustainability and implications of these policies (strengthening RMB TWI, lower FX reserves, liquidity concerns etc). The potency and near-term sustainability of these measures are unquestionable, as they would undoubtedly delay/push out our forecast of RMB depreciation. However, given local capital outflows (Figure 11), global policy/political risks, China macro/policy challenges and RMB FX overvaluation, we still expect medium-term RMB depreciation.

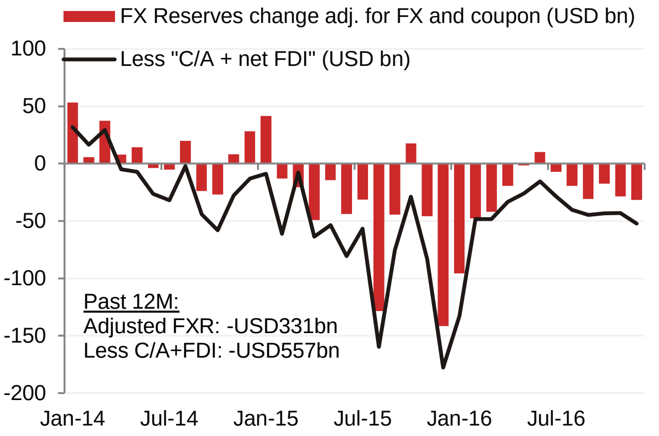
[1] In our 12-currency abridged CFETS basket, we have USD (25.6%), EUR (18.7%), JPY (13.2%), HKD (4.9%), GBP (3.6%), AUD (5.0%), SGD (3.7%), CAD (2.5%), MYR (4.3%), RUB (3.0%), THB (3.3%) and KRW (12.3%).

Fig. 10: Overnight CNH HIBOR and USD/CNH spot



Source: Bloomberg, Nomura.

Fig. 11: Substantial capital outflows



Source: Bloomberg, CEIC, Nomura.

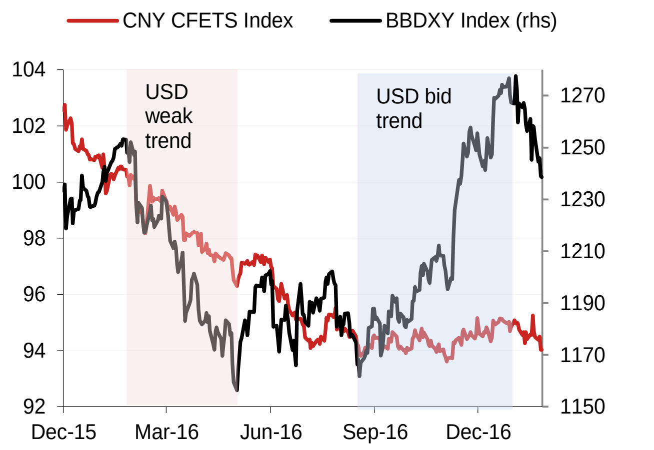
Indeed, concerns over growth prospects into year-end could increase, especially after the hike (24 January) in the Marginal Lending Facility (MLF) rate. Since late 2016, there has been a broad consensus view that the government will sustain growth at elevated levels ahead of major political changes at the 19th National Congress of the Communist Party of China (around October/November 2017). However, following the MLF rate hike, there could be a shift in growth expectations, as the government is expected to increase its focus on reducing leverage. We view this as a positive step over the long term, but the risk in the near term is that it could raise economic/financial concerns and sustain local resident outflows (Figure 12).

Fig. 12: China capital flow simulation (select components)[2]

all figures in USD bn	2014	2015	2016(f)	2017(f)
Net trade settlement	348.1	-37.9	185.9	271.8
Net FDI	145.0	62.1	-129.2	-258.6
Net debt flows	31.9	-41.8	3.7	97.7
Total inflow	525.0	-17.6	60.4	110.9
Services	-172.4	-182.4	-236.2	-299.1
Loans	138.3	-281.8	46.5	106.6
Errors & Omissions	-108.3	-188.2	-176.0	-163.4
Total outflow	-142.3	-652.4	-365.7	-355.8
Net flow	**382.7**	**-670.0**	**-305.3**	**-245.0**

Source: Bloomberg, BIS, CEIC, Nomura.

Fig. 13: CNY CFETS index and broad USD trend



Source: Bloomberg, Nomura.

Combining these factors, we continue to expect CNH depreciation and maintain our end-2017 USD/CNH forecast of 7.30. The risk to this forecast emanates from authorities remaining very active in FX markets, which would come at a cost as mentioned above.

[2] Net trade settlement (from November 2016) are based on Nomura Economics trade forecasts and use the 2016 realised average ratio of goods FX settlement against exports (50.4%) and imports (57.2%) in 2016 and a reversion to the trailing 3y average for exports (56.4%) and imports (61.7%) in 2017. Net FDI (from Q4 2016), on FDI liabilities, uses the average year-on-year growth rate over two quarters of -47%. On FDI assets, we used the average year-on-year growth rate over two quarters of 37%. For 2017, uses 5y average y/y growth rate of -7% on liabilities and 45% on assets. Debt inflows (from Q3 2016) include: 1) the average quarterly net outflow over the past three years of USD1.0bn; 2) reserve manager allocation at 2/3 of the average linear interpolated allocation in 2016 (10Y around USD779bn) and a full allocation of USD77.8bn in 2017; 3) CGB inclusion by JPM GBI-EM in 2017 (USD2bn/month). Services (from Q4 2016), on service credit uses the average year-on-year growth rate from the past two years of 5.9%. Debit uses average year-on-year growth rate from past two years of 20% with an acceleration of this growth rate by 1.33x. Loans (from Q3 2016), uses the quarter-om-quarter growth rate of 3.2%, which is a half of the loan growth rate in the 10y to Q1 2015. Errors & omissions (from Q3 2016) uses linear trend estimate of E&O outflows from past two years.

Also, a softening of broad USD would make it challenging for USD/CNH to move significantly higher. Thus, we recommend short CNH versus an abridged CFETS basket to help offset the risk of a softer broad USD (Figure 13).

However, if the risk scenario proposed by Nomura Economics materialises (especially regarding Fed hikes, increased protectionism and an even stronger broad USD), we see risks of more RMB depreciation as part of the solution to challenges from slower growth and capital flight. In the risk scenario, we estimate USD/CNH could rise to 7.45 by end-2017. In particular, one of President Trump's policies that could lead to this scenario is the imposition of tariffs on Chinese goods. If this policy were implemented, we would see a notable risk of retaliation from China, and one possible domestic policy response would be increased fiscal stimulus and a more flexible exchange rate (see *Asia Insights - China's potential reactions to protectionist measures/geopolitical risks from US*, 20 January 2017).

According to our survey, a plurality of those surveyed (41%) expect the first policy implemented by President Trump that affects China would relate to trade and the imposition of tariffs, while expectations of Chinese retaliation are high at 75% (out of those who chose trade protectionism as the first policy action by President Trump). Respondents viewed targeting China's purchases of US goods as the most likely form of retaliation (36% of those who chose trade protectionism), while only 13% expected China to respond by shifting its FX policy. Notably, our survey showed that there was strong conviction CNH will underperform in EM this year (even in the regional breakdown). However, we do not believe the market is positioned this way following the recent and consistent FX-related policy actions by the authorities. Note that offshore spot USD/CNH was around 448pips below onshore spot USD/CNY, as of the official close on 26 January (before the lunar new year holiday).

Relative value in EEMEA

• **Short 1M TRY/ZAR (S/L 3%, targeting 3.20 in 3-months, notional USD1mn)**.

As highlighted in *Economics Insights - EEMEA 2017 outlook: External risks magnifying domestic risks* (29 December 2016), we see President Trump as one of the most significant risks for EEMEA in the early part of 2017. This vulnerability is not so much from his direct policy actions, but more from the implications for the Fed. Combined with concerns over a monetary policy shift in Eurozone and political risks, these could amplify domestic issues in parts of EEMEA.

For Turkey, Nomura's economist, Inan Demir, sees several risks from President Trump including US reflation and changes to the FOMC outlook, focus on countries with dual deficits and vulnerability/funding (Figure 14), as well as a stronger USD.

Locally, there are a few risks ahead for Turkey, including constitutional amendments for the switch to an executive presidency system, which the public will vote on no later than the third week of April (see *Economics Insights - Turkey: Constitutional amendments come to the parliament floor*, 9 January 2017). The main risk until then is that President Erdogan tries to shore up support among nationalists and conservatives by taking an aggressive stance against Kurds and in Syria. The other concern for TRY is that, despite being slightly more hawkish in its 24 January monetary policy meeting statements, the TCMB remained reluctant to deliver conventional rate hikes after leaving its o/n borrowing and 1-week repo rates unchanged (Nomura forecast +50bp for both rates; see *First Insights - Turkey: TCMB hopes to ride this wave out*, 24 January 2017). Nomura still views the TCMB's tool of liquidity tightening as TRY supportive, but this measure is unlikely to change the trend (Figure 15).

Unlike the TCMB, we believe the SARB continues to support its currency in the near term. In particular, the SARB has stated that it is concerned about potential ZAR weakness from "both domestic and external shocks", which suggests that it will not be shifting to an easing bias anytime soon[3]. In addition, our economist, Peter Attard Montalto, believes that still-high inflation adds to a likely hawkish bias of the Bank (see *First Insights – South Africa: MPC to keep the faith*, 17 January 2017). Indeed, the SARB left rates unchanged on 23 January in line with market expectations. This contrasts with

[3] 23 January SARB statement

the TCMB, which left the benchmark lending rate unchanged against market expectations for a 50bp hike.

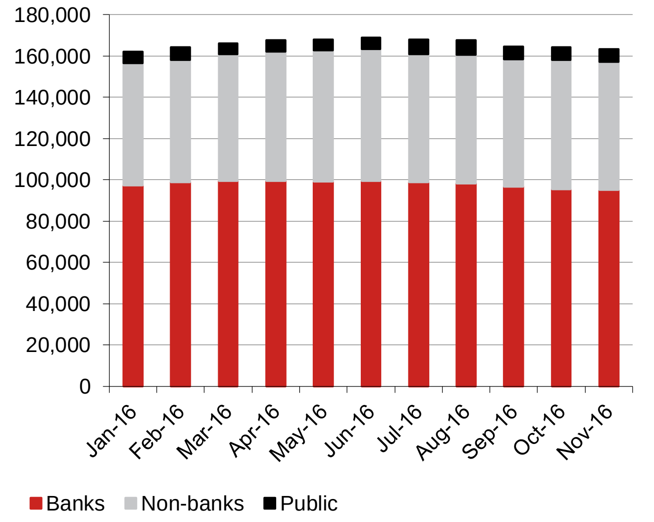
We expect domestic politics to remain a risk for both TRY and ZAR. In South Africa, the ANC will likely be focussed on the five-yearly elective conference that occurs in December (see *Global Economic Outlook Monthly - Waiting for US policy direction*, 11 January 2017) while, as mentioned above, Turkey's political risks could intensify as it progresses towards the executive presidency referendum by the third week of April. We also note that further ZAR strength would be consistent with the currency's fundamental undervaluation, while other financial variables (CDS spreads lowest since July 2015, equities +5.9% YTD) suggest the same. Finally, we do not believe long ZAR is a consensus trade, and this is reflected in our survey, which showed that only 7% of investors expect ZAR to be among the top three performers in EM this year.

Regarding RUB, the positives are well known from OPEC support for crude oil prices, an orthodox central bank that remains focussed on bringing down inflation and growth having bottomed out. We believe the CBR's preference is still to keep monetary policy relatively tight, real rates high and allow RUB appreciation as long as the assumptions in the budget are not threatened (3.0% deficit; USD40/bbl oil; CPI 4% at year-end).

Externally, the potential improvement in US-Russia relations is supportive of RUB, but any signs of a lifting of the sanctions would provide a substantial boost to the currency. The media already highlighted the positive relationship between Secretary of State Rex Tillerson and Vladimir Putin, as well as the possibility of President Trump relaxing sanctions "if Russia is really helping us..." (*Wall Street Journal*, 14 January 2017).

Fig. 14: Turkey short term external debt

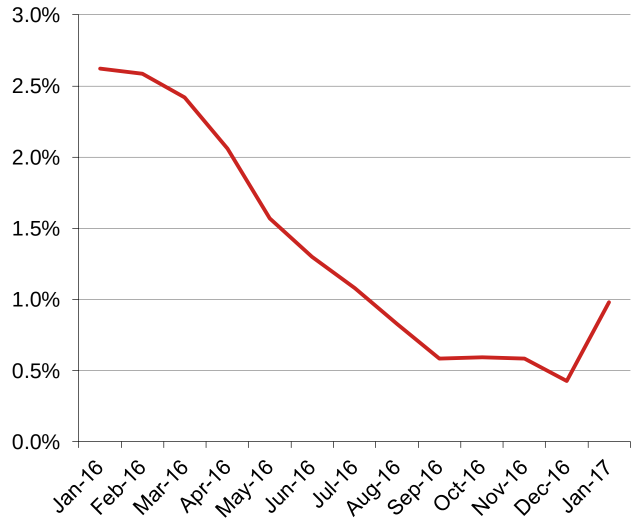
External debt maturing in next 12 months (USD mn)



Source: TCMB.

Fig. 15: Turkey real policy rate

O/N lending rate, ex ante



Source: TCMB. Turkstat, Nomura.

That said, the risks against RUB appreciation are rising. The first is the significant long RUB market positioning, with our analysis of real money managers tracking the JPM EM GBI index being notably overweight RUB FX and Russia bonds (by allocation). This view is also reflected in our investor survey, which shows that a large 20% of those surveyed expect RUB to be an outperformer in EM this year. The other risk is the potential start of FX USD buying intervention from February onwards. Although the purchase amounts discussed are not big enough to significantly impact the market, it could still put a ceiling on RUB.

Rates outlook: Steepening bias

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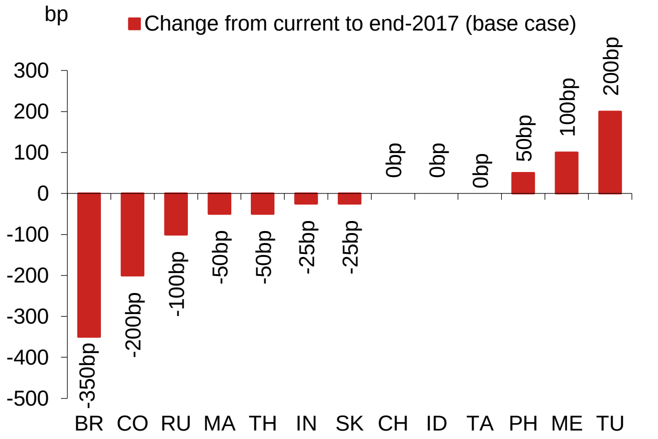
We are biased towards steeper curves that should be driven by a return of the rise in CPI inflation theme in 2017and Fed tightening (see *Asia Economic Outlook - Asia 2017 outlook: Sailing into the storm*, 8 December 2016). That said, we look to take a differentiating approach to the EM complex (see *2017 Rates Outlook - Dawn of a new era?*, 22 December 2016). As US rates rise, rates are expected to rise in most EM countries. However, there will be differences in monetary policy.

Our economics team, led by Rob Subbaraman, expects different monetary policy responses within EM. On the one hand, we expect rate hikes in Turkey (200bp) and Mexico (100bp) because of currency depreciation-induced inflation and more moderate hikes in the Philippines (demand-driven inflation), while on the other, we forecast rate cuts in India, Malaysia, Korea, Thailand, Russia, Brazil and Colombia (Figure 16). In the countries where we expect rate cuts, stable monetary policy should ensure that front-end rates remain stable, while we expect rates further out the curve to be affected by rising inflation and a rise in US yields (Figure 17). In Mexico and Hong Kong we do not expect a stable front end and therefore believe outright payers are a better way to express the rising inflation view.

In the current environment these are our recommended trades:

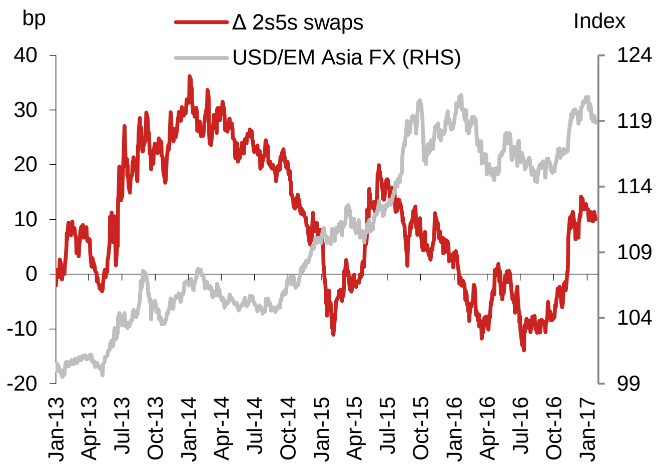
- Korea 2s5s swap steepeners
- Thailand 2s10s swap steepeners
- Pay HKD IRS 5yr
- Receive SGD 3yr vs USD 3yr IRS; SGD 3s10s steepeners
- India 2s5s swap steepeners
- Pay MXN 2yr TIIE

Fig. 16: Change from current policy rate to Nomura end-2017 forecast (base case)



Source: Nomura estimates, Bloomberg.

Fig. 17: Yield curve dynamics in EM Asia rates

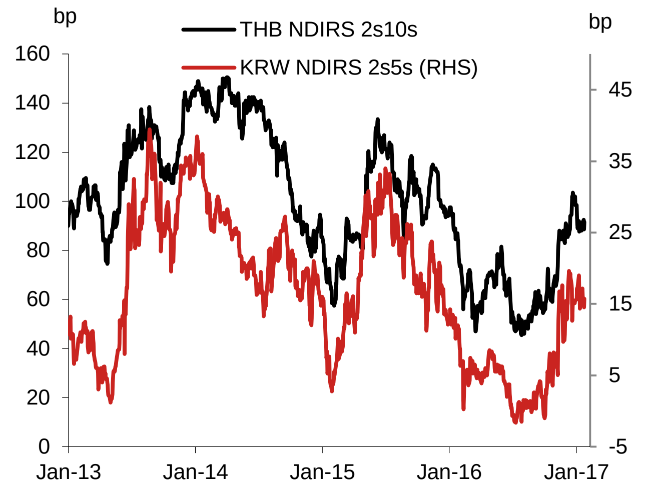


Note: The 2s5s swaps are tracked as the average change in bp across the swap curves of EM Asia (China, Hong Kong, India, Malaysia, South Korea, Singapore, Thailand and Taiwan; for Indonesia we use the 2s5s spread for bonds) since 1 January 2013. Similarly, USD/EM Asia FX are indexed to 100 on 1 January 2013 and the average percentage change in Asia EM FX since then is used to generate the USD/EM Asia FX series. Source: Nomura, Bloomberg.

Korea 2s5s swap steepeners (Target: 30bp; Reassess: 10bp): We expect front-end rates to remain anchored by the weak domestic macro backdrop while the long end remains sensitive to global rates moves. If the risk scenario materialises, we expect KRW NDIRS 2s5s (Figure 18) to steepen further despite the likelihood of a Bank of Korea rate cut diminishing as the 5yr part of the KRW NDIRS remains sensitive to global rates (see *Asia Insights - Asia Rates Monthly: Monetary policy divergence and China receiver*, 20 January 2017).

Thailand 2s10s swap steepeners (Target: 120bp; Reassess: 80bp): THB NDIRS 2s10s has been under steepening pressure since July (Figure 18) and we expect this to continue. Valuations of the 10yr part of the curve are unattractive with a 23bp spread between 10yr THB swaps and USD swaps. This leaves limited cushion for the longer end. Also, being a low yielder, foreign demand for Thailand bonds is expected to remain subdued in a rising core rates environment. At the same time, we expect front-end rates to remain stable as faced with weaker growth and high debt levels the Bank of Thailand is far from hiking rates. These factors make us comfortable with our 2s10s steepener position. In our risk scenario, we expect THB 2s10s to bear steepen as the faster pace of Fed hikes can be expected to induce term premia. We also note that the potentially expansionary fiscal policy is expected to steepen the Thai curve (see *Asia Insights - SGD and THB swaps: Steepeners and front-end receivers* , 20 January 2017).

Fig. 18: KRW NDIRS 2s5s and THB NDIRS 2s10s



Source: Nomura, Bloomberg.

Fig. 19: HKD IRS 5yr and SGD IRS 3yr vs US IRS 3yr

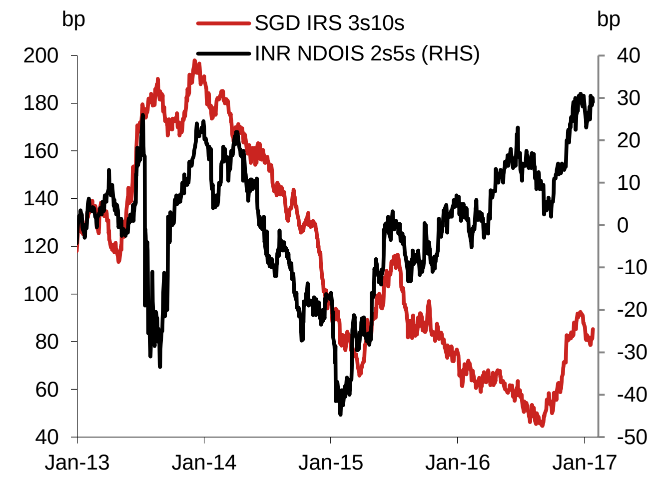
Source: Nomura, Bloomberg.

Pay HKD IRS 5yr (Target: 2.40%; Reassess 2.00%): We believe that pay HKD IRS 5yr positions (Figure 19) are a good proxy for higher G3 yields and, at the right levels, may also offer cheap protection against a rise in China's risk premium. Local factors are also supportive of slowing capital inflows in 2017. Examples include restrictions on mainland purchases of savings-related insurance products, an increase in the residential property stamp duty and a focus on local politics ahead of the March chief executive election. We believe slowing capital inflows will also benefit pay HKD IRS 5yr positions as they should lead to a reduction in liquidity and hence likely resulting in higher HIBOR fixings. We expect this trade to perform better in the risk scenario as a faster pace of Fed hikes will not only push global rates higher but may also exert capital outflow pressure (see *Asia Insights - Asia Rates Monthly: Monetary policy divergence and China receiver*, 20 January 2017).

Receive SGD IRS 3yr vs pay USD IRS 3yr (Target: 0bp; Reassess: 30bp); SGD 3mfwd3s10s steepeners (Target: 94bp, Reassess: 64bp): We recommend receive SGD IRS 3yr vs US IRS 3yr positions (Figure 19). In a rising US rates environment, we expect Singapore rates to outperform as better liquidity in the banking system should keep SOR fixings stable. Indeed, improving incremental deposit versus credit growth has been one of the key drivers of better banking system liquidity (see *Asia Economic Outlook - Asia 2017 outlook: Sailing into the storm*, 8 December 2016). In the risk scenario, we believe that the move higher in rates will be driven by US rates. In previous Fed hiking cycles SGD rates have outperformed US rates, which provides comfort in holding our receive SGD IRS 3yr against a pay position in US IRS 3yr as a strategic trade in a Fed hiking cycle. We also believe the combination of a stable front end and rising US rates is likely to steepen the SGD IRS curve. Therefore, we like SGD 3mfwd3s10s steepeners (Figure 20; see *Asia Insights - SGD and THB swaps: Steepeners and front-end receivers*, 20 January 2017).

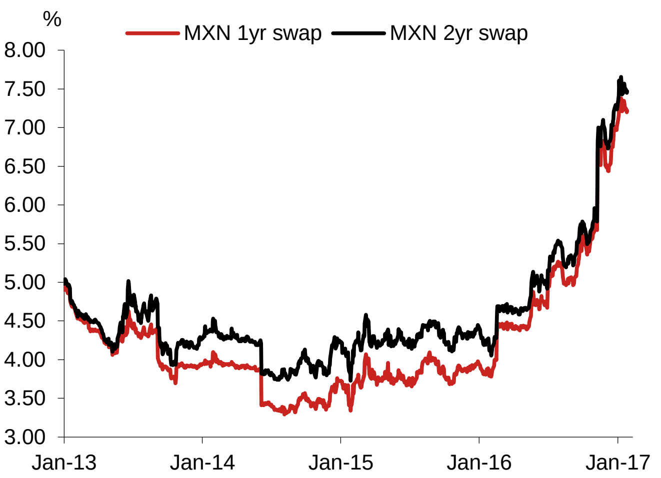
India 2s5s steepeners (Target: 40bp; Reassess: 20bp): We see a confluence of factors – a lack of open market operation purchases, end of easing cycle dynamics, a large state bond supply, the Fed hiking cycle and a potential pick-up in credit growth – that could steepen the yield curve in India. In swaps, we express our steepening view through 2s5s NDOIS steepeners (Figure 20). Should the rate cut that we expect in February materialise, we believe 2s5s will break through the upper bound of the current 20-30bp range that it has been operating in since November 2016 (see *Asia Insights - India rates: Foundations for steeper curve*, 19 January 2017).

Fig. 20: SGD IRS 3s10s and INR NDOIS 2s5s



Source: Nomura, Bloomberg.

Fig. 21: Mexico 1yr, 2yr swaps



Source: Nomura, Bloomberg.

Pay Mexico 2yr TIIE (Target: 8.00%; Reassess: 7.15%): Mexico's markets are likely to remain under the spotlight, particularly with formal NAFTA negotiations in the pipeline. Under a reasonable number of scenarios, we believe rates could still move higher across the board. Overall macro conditions could continue to deteriorate as adverse conditions stemming from potential trade restrictions are imposed. Domestic inflation conditions may also deteriorate.

The front-end of the curve (up to 2yr) has been underperforming longer tenors. At the moment, it is difficult to gauge a pivoting of the yield curve shape in either direction, given the risks that exist. That said, we are relatively confident that most of these risks should lead to higher rates. Although we believe longer-term yields still have some catching-up to do, we remain uncertain of just how much higher the combination of monetary policy and a decompressing US term premium can pull them. Under most scenarios we believe the 1yr to 2yr (Figure 21) sector should remain under pressure and thus we remain better payers (see *2017 Rates Outlook - Dawn of a new era?*, 22 December 2016).

China: Non-trivial risk of a trade war

While our baseline sees 6.5% GDP growth in China in 2017, we see a non-trivial risk of a trade war with the US, which could shave as much as 0.3pp off growth.

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Economy's starting position (neutral): China's economy ended Q4 2016 with real GDP growth of 6.8% y-o-y, slightly higher than the 6.7% in the previous three quarters (see *China: We expect a modest slowdown in Q1 after a higher growth in Q4*, 20 January 2017). Growth was mainly underpinned by the services sector, the "other" services sector in particular, while the property market cooled and the financial markets remained sluggish. Production and investment growth both moderated in December. The fiscal policy stance was more expansionary last year, with the fiscal deficit widening to 3.8% of GDP from 3.4% in 2015. We think the People's Bank of China's (PBoC) novel use of a "temporary liquidity facility" to inject liquidity in January reflects its desire to ease market concerns over rising PPI inflation and tighter liquidity and expect the PBoC to maintain a truly neutral liquidity environment (see *China: PBoC applies novel measure to smooth liquidity conditions*, 20 January 2017).

Vulnerability to Trumponomics (high): Our baseline scenario already sees China's GDP growth slowing this year, but we do see a rising risk of a trade war breaking out which threatens to do significant harm to China's economy. The key transmission channels, in our view, will be trade and capital flows. Although the importance of the US as an export destination has fallen in recent years, it remains a major trading partner (accounting for 18.2% of direct exports in 2016) – China's USD251bn trade surplus with the US (~2.2% of China's GDP) accounts for almost half of its total trade surplus of USD511bn. Moreover, capital outflows may continue as uncertainty around the new US administration's policies remains. Escalating geopolitical risk in East Asia, as a result of a strategic plays by both parties in deal-making, is also likely to raise risk premia and prompt capital outflows from the region.

In our view, possible policy responses by China to a trade war could include: stronger fiscal stimulus, a more flexible exchange rate, pursuit on closer regional trade and cooperation, and greater efforts on the "One Belt One Road" strategy. However, we expect China to make some friendly gestures, such as maintaining gradual RMB depreciation instead of fast or one-off devaluation against USD, and further opening of its domestic market to foreign companies.

Baseline and risk scenario: Under our more adverse risk scenario, 2017 GDP growth could fall by 0.3pp to 6.2% from our baseline of 6.5%; inflationary pressure would be milder on weaker growth and lower commodity prices. A shrinking of the trade surplus would also further narrow the current account. Fiscal policy would become more expansionary to offset some of the shocks from strong US protectionism. We also add one interest rate cut in the risk scenario as the PBoC could turn accommodative against a backdrop of a faster slowdown.

Fig. 22: China forecasts: Baseline and downside risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**6.7**	6.5	6.2
CPI inflation (% y-o-y)	**2.0**	2.6	2.4
Current account (% of GDP)	2.2	2.1	1.9
Fiscal balance (% of GDP)	**-3.8**	-4.0	-5.0
Policy rate (end-period, %)	**1.50**	1.50	1.25
USD/CNY (end-period)	**6.95**	7.29	7.44

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Hong Kong: Heavy blow to the housing market

An acceleration of Fed monetary tightening and a stronger effective HKD would increase the risk of a rapid housing market correction and massive net capital outflows.

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Economy's starting position (Weak): Some of Hong Kong's fundamentals remain solid (e.g., improved FX and fiscal reserves, a low bank loan-to-deposit ratio and a flexible domestic price-adjustment mechanism), but others (e.g., credit-driven property market overvaluation, heavy exposure to China, highly leveraged financial system) are causes for concern. We expect GDP growth to slow sharply to 0.5% in 2017 from 1.5% in 2016, given the city's vulnerability to weaker Chinese growth, higher US interest rates and a strong effective HKD. We believe house prices will fall 25% by 2018 (see Box 7 in our *Asia Economic Outlook - Asia 2017 outlook: Sailing into the storm*, 8 December 2016). Inbound tourism is likely to remain sluggish, especially with mainland tourists tightening their belts as growth in China slows and as HKD strengthens against CNY. The government announced policies for 2017 that it plans to increase infrastructure spending, such as on sports facilities and a smart city, but we believe fiscal stimulus will not be enough to offset external headwinds.

Vulnerability to Trumponomics (High): Hong Kong is an entrepôt for a significant amount of business between China and the US. Declining trade volumes would be negative for local business in packaging, container ports and trans-shipments. If concerns over US protectionism and a deteriorating relationship with China spark global financial turmoil for any extended period, this would be hugely detrimental to Hong Kong's large financial services sector and property markets, which together account for 25% of GDP. Moreover, because HKD is pegged to USD, faster monetary tightening in the US would lead to a significant rise in local interest rates in Hong Kong, which would likely have a serious effect on Hong Kong's overvalued housing market.

Baseline and risk scenario: In our downside risk scenario (e.g., a much faster Fed's rate hiking cycle), we would expect Hong Kong GDP growth of only 0.1% in 2017, as we see a risk of a disorderly unwinding of Hong Kong's outsized financial cycle of excessive domestic credit and highly elevated property prices. Also in this scenario, the HKMA would face a dilemma between maintaining its peg with higher interest rates (which could cause a collapse in asset prices) and adopting a new FX policy regime that allows for HKD depreciation (which would erode Hong Kong's key feature as a financial and business hub in Asia). Norman Chan, chief executive of the HKMA, said on 20 January 2016 that, "The IMF's long-standing support for the Linked Exchange Rate System reaffirms the importance of the system to our financial stability", which echoed comments that there are no plans to sever the USD peg and that this may still be the more optimal FX regime. Thus, we believe Hong Kong is committed to its USD/HKD peg and, in order to maintain the peg, the HKMA can only allow the currency board system to operate freely (i.e., allow Hibor rates to rise to much higher levels than USD Libor to mitigate net capital outflows).

Fig. 23: Hong Kong: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	1.5	0.5	0.1
CPI inflation (% y-o-y)	**2.4**	1.5	1.0
Current account (% of GDP)	3.2	1.8	1.5
Fiscal balance (% of GDP)	0.5	0.3	-0.2
HIBOR (end-period, %)	**1.00**	1.40	1.90
USD/HKD (end-period)	**7.76**	7.80	7.84

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

India: Immigration policy is the main risk

Tighter immigration norms and trade protectionism are the main source of vulnerability for India. Elsewhere, the impact is largely neutral.

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Economy's starting position (strong): India is fundamentally in a strong position due to sharply lower fiscal and current account deficits since the taper tantrum, lower inflation and more sustainable growth prospects due to continued productivity enhancing reforms instituted by the Modi government. Compared to most other EMs, India's economy is more internally driven, and less exposed to trade. However, the government's decision to demonetise higher denomination notes in November 2016 has led to a cash crunch, which is set to slow growth sharply in Q4 2016 and Q1 2017. Still, we expect this growth hit to be only transitory, not long lasting, as remonetisation, wealth re-distribution and lower lending rates should result in growth returning to above 7% from H2 2017. On the policy front, both fiscal and monetary space is limited because of a high general government deficit (~6.5% of GDP) and a stiff inflation target (4% by March 2018).

Vulnerability to Trumponomics (neutral): Immigration restrictions are the main source of India's vulnerability. President Trump plans to raise H-1B minimum salaries, give preference to Americans over those from abroad, limit green cards for foreign workers and scrap H-1B extensions. Indian nationals comprised 86% of H-1B visas issued for technology firms in 2014. The viability of the offshoring model of Indian software firms would be at risk. Remittances from the US (~16% of total inflows in 2015) would also likely moderate, widening the current account deficit. Increased US trade protectionism will also hurt India, but more indirectly, as India is not a part of the TPP. The US accounts for ~15% of India's goods exports, while India is just 2% of US imports. A border tax or an across-the-board tariff increase could hurt India's major export products to the US (pharmaceuticals, textiles, gem & jewellery and auto products). Geopolitically, India stands to benefit as President Trump seems to believe that a nuclear India is the real check to Pakistan. Finally, higher US rates and a stronger dollar will undoubtedly slow portfolio flows, but given the preponderance of equity over debt flows into India, the impact should be relatively less than in other EM economies.

Baseline and downside risk scenario: We currently project GDP growth to slow to 6.9% in 2017 from 7.1% in 2016, largely reflecting a weak Q1 owing to demonetisation, followed by a sharp V-shaped recovery in H2 2017. In our risk scenario, we would expect growth to slow only marginally to 6.8%, mainly due to weaker trade volumes and tighter financial conditions. Lower oil prices will moderate inflation and reduce subsidy expenditures, but we doubt there will be any policy response, because inflation should remain above the Reserve Bank of India's target of 4% and the government will use the subsidy savings on other programs. Finally, under the risk scenario, we expect any benefits to the current account from lower oil prices to be partially offset by weaker exports and lower remittance inflows from the US.

Fig. 24: India forecasts: Baseline and downside risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	7.1	6.9	6.8
CPI inflation (% y-o-y)	**4.9**	5.3	5.1
Current account (% of GDP)	-0.8	-1.3	-1.2
Fiscal balance (% of GDP)	-3.5	-3.0	-3.0
Policy rate (end-period, %)	**6.25**	6.00	6.00
USD/INR (end-period)	**67.9**	70.2	71.6

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Indonesia: External risks motivate reforms

Trumponomics should negatively impact growth but, at the same time, the associated external uncertainty is prompting more domestic reforms to build resilience.

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Economy's starting position (strong): Indonesia's fundamentals have noticeably improved since September 2015 due to President Jokowi's reform agenda, which has focussed on reducing bureaucratic barriers to business and boosting public capital spending. We expect these reforms to continue, as authorities view them as a necessary support to growth, which is on a recovery path, but also to build resilience against elevated external risks. There is room for the government to increase the fiscal deficit to the 3% of GDP legal limit (from the budgeted 2.4%), but it is instead emphasising better execution on infrastructure projects and an improvement in the overall quality of spending by further reducing energy subsidies. As Bank Indonesia's (BI) cutting cycle has ended, it is now focussed on the transmission of previous rate cuts and enhancing operations under the new corridor framework that began in August 2016.

Vulnerability to Trumponomics (high): With the current account deficit likely to increase, capital outflows triggered by Fed rate hikes are a key source of near-term vulnerability, as foreign investors still hold a large 37.8% of total Indonesian government bonds. A weaker currency also has important implications for private sector spending and could therefore constrain consumption and investment. Trump's protectionist policies are a potential obstacle to further improving ties with the US, which could also undermine FDI inflows. Lastly, a drop in commodity prices would still have significant terms-of-trade effects, given Indonesia remains a net energy exporter.

Baseline and risk scenario: Under our baseline, GDP growth accelerates to 5.6%, supported by a sustained pickup in domestic demand. Under the risk scenario, we would expect GDP growth to slow by 0.2pp to 5.4%, with capital outflows likely increasing and slowing exports – the US accounts for a significant 11% of total exports – but this would be partly offset by some fiscal stimulus. Consequently, we see a wider current account deficit under the risk scenario. We expect similar headline inflation under both baseline and risk scenarios (average of 4.4%) given Indonesia's current mechanism to set fuel prices is more ad-hoc than fully market determined. These factors should continue to discourage BI from implementing further rate cuts and, therefore, we expect the policy rate to remain unchanged at 4.75% under the risk scenario. However, BI has scope to use macroprudential measures such as cuts in the primary reserve requirement and a relaxation of loan-to-value / downpayment restrictions on mortgages and other loans.

Fig. 25: Indonesia forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**5.2**	5.6	5.4
CPI inflation (% y-o-y)	**3.5**	4.4	4.4
Current account (% of GDP)	-2.2	-2.9	-3.1
Fiscal balance (% of GDP)	-2.5	-2.6	-2.8
Policy rate (end-period, %)	**4.75**	4.75	4.75
USD/IDR (nominal, end-period)	**13473**	14150	14433

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Malaysia: From resilient to vulnerable

Malaysia has derived much of its recent economic resilience from US demand for its manufactured exports, but protectionist US policies would threaten this.

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Economy's starting position (neutral)*:* A key source of Malaysia's economic resilience over the past two years has been US demand for its manufactured exports, which helped support employment and therefore private consumption even with the implementation of the goods and services tax in April 2015 (see *Asia Insights – Malaysia: The remarkable resilience of private consumption*, 30 March 2016). Fiscal policy will likely continue to consolidate, with the government targeting a further reduction in its fiscal deficit to 3.0% of GDP in 2017 from 3.1% in 2016, implying little support for the economy. Partly for this reason, we believe Bank Negara Malaysia (BNM) is biased to ease monetary policy further although the extent of rate cuts will be limited by financial stability concerns and FX pressures given external debt levels at a fairly elevated 71.8% of GDP (Q3 2016).

Vulnerability to Trumponomics (high)*:* The prospect of protectionist US policies could threaten US demand of Malaysian manufactured exports, in effect turning a source of resilience into one of vulnerability. The US accounts for about 10.3% of Malaysia's merchandise exports and 10.5% of foreign direct investment inflows. Protectionism could also indirectly hurt Malaysia's exports of intermediate goods to China. Higher US rates and a further weakening of MYR could also spur greater capital outflows, especially as foreign investors still hold a substantial 47.1% of Malaysian government securities.

Baseline and risk scenario: Under our risk scenario, 2017 GDP growth could fall by another 0.4 percentage points to 3.3% from our base line expectation of 3.7%, which is already below the official 4-5% forecast range. In addition, lower oil prices would hit liquefied natural gas exports just as export volumes are likely to come under pressure from greater competition. This would likely further narrow the current account, which would then force the government to slow the pace of public sector investment and capital goods imports to keep the current account balance in surplus, undermining domestic demand. We believe the government will recalibrate its budget to allow fiscal policy to support growth, though it is unlikely to revise its fiscal deficit target significantly above its current target of 3.0% of GDP in a bid to preserve the country's sovereign credit rating. Combined with our baseline view that elections will be held in Q2 2017, this could imply a similar situation as seen last year when fiscal targets were overshot in H1. The resultant sharp fiscal tightening in H2 could coincide with the timing of some inward-looking US policies in the risk scenario, exacerbating pressures on growth. With inflation likely to remain low at 2.3% rather than rising to 2.8% under our base case, we would still expect BNM to cut its policy rate by 50bp to support growth – additional rate cuts may be difficult in the face of a likely spike in FX volatility.

Fig. 26: Malaysia forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	4.1	3.7	3.3
CPI inflation (% y-o-y)	**2.1**	2.8	2.3
Current account (% of GDP)	1.8	1.2	0.9
Fiscal balance (% of GDP)	-3.1	-3.0	-3.3
Policy rate (end-period, %)	**3.00**	2.50	2.50
USD/MYR (end-period)	**4.49**	4.76	4.86

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Philippines: Navigating the rough seas

Geopolitics poses the biggest risk. Other channels, such as outsourcing receipts and worker remittances, are important but can be offset by large fiscal stimulus.

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Economy's starting position (strong): The Philippine economy remains on solid footing, with a strong growth outlook and falling unemployment rates. This is supported by structural reforms that are boosting investment spending which, in turn, is pushing potential growth higher to 6.2% (see *Asia Special Report - Philippines: Beyond words*, 20 October 2016). We think reforms will continue under the new government of President Duterte, particularly on reducing corruption and red tape, and implementing tax reforms designed to support an ambitious infrastructure agenda. FDI inflows are also rising, supported in part by a full liberalisation of the foreign ownership in the banking sector.

Vulnerability to Trumponomics (high): There are a number of channels through which the Philippines could be affected. The Philippines runs a merchandise trade surplus with the US of 0.7% of GDP. If the US tightens its immigration policies – which leads to fewer migrant workers – this could impact remittances inflows back to the Philippines. The US is host to 34.5% of the total overseas Filipino population, which we estimate comprises about 31% of total worker remittances. Trump's commitment to bring jobs back to the US may also affect the increasingly important BPO sector, which caters mostly to US corporates. FX revenues from the BPO sector are projected to equal total worker remittances (about 9% of GDP) in the next few years. Most importantly, regional security issues related to the South China Sea puts the Philippines on the front line. The potential for further disputes between China and the Philippines may have eased with the Duterte government seeking stronger economic ties with China. However, while President Trump's stance on this issue remains unclear, his cabinet nominees have said "China should not be allowed access to [those disputed] islands."[4]

Baseline and risk scenario: In our baseline, we expect some moderation in GDP growth this year to 6.3% from 6.9% in 2016, as the boost from the 2016 presidential election fades but is partly mitigated by more progress on infrastructure spending under President Duterte. Under the risk scenario, we would expect growth to slow more sharply to a still relatively resilient 6.1% amid increased fiscal stimulus, with the government running a larger fiscal deficit. We think the current account could also dip into a deficit, as both revenues from the business process outsourcing sector and worker remittances could slow. Headline inflation will likely ease marginally relative to our baseline, given mildly lower global oil prices, but will nevertheless remain above the mid-point of the central bank's (BSP) 2-4% headline inflation target. Therefore, we would still expect 50bp of cumulative BSP policy rate hikes this year.

Fig. 27: Philippines forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**6.9**	6.3	6.1
CPI inflation (% y-o-y)	**1.8**	3.3	3.1
Current account (% of GDP)	1.3	0.5	-0.1
Fiscal balance (% of GDP)	-2.2	-2.7	-3.0
Policy rate (end-period, %)	**3.00**	3.50	3.50
USD/PHP (nominal, end-period)	**49.6**	51.5	52.8

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

[4] See "Trump White House vows to stop China taking South China Sea islands," *Reuters*, 24 January 2017.

Singapore: Another unwelcome headwind

Trumponomics severely exacerbates an already long list of headwinds facing the economy, underscoring our cautious outlook.

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***Economy's starting position (weak)**:* While recent activity data have been better than expected, we remain cautious of its sustainability given a host of headwinds, including political risks in Europe and from Brexit, rising domestic interest rates, high levels of household and corporate leverage, and weakening property and labour market conditions. These factors exacerbate an already downbeat medium-term outlook, given lacklustre labour productivity growth and unfavourable demographics (see *Asia Special Report: Singapore's productivity conundrum*, 23 October 2015). Rising inflation pressures – we expect core inflation to rise to 1.5% in 2017 from 0.9% in 2016 – limit scope for policy easing and supports our base case in which the Monetary Authority of Singapore (MAS) keeps the slope, centre and width of the S$NEER policy band unchanged in April, rather than easing via a downward re-centring of the band (30% probability). There is plenty of fiscal space, but we expect the government to run another small fiscal surplus in FY17 because of the balanced budget rule.

Vulnerability to Trumponomics (high): For ultra-open Singapore, any increase in trade protectionism will likely be highly negative for its growth outlook, because it harms not only Singapore's already struggling manufacturing sector but also its services sector (e.g., port and transport services). Singapore's exposure to the US is substantial – the US accounts for about 9.5% of non-oil domestic exports, 11.9% of services exports and 19.7% of FDI. Singapore's exports of intermediate goods could also be hurt by protectionist policies affecting other parts of Asia, especially China. Higher US interest rates and a stronger USD would likely push Singapore's domestic rates higher, raising debt servicing burdens when both household and corporate debt are high at 76.8% and 153.2% of GDP, respectively. This should, in turn, pressure the slowing property market further.

Baseline and risk scenario: Our forecast of GDP growth slowing to 0.7% in 2017 from 1.8% in 2016, below the official 1-3% forecast range, would be subject to further pressure and could fall to 0.2% under a more adverse risk scenario, dragged by weaker exports and FDI, and a faster rise in domestic interest rates. We expect weaker demand-pull inflation pressures and lower oil prices to reduce 2017 headline and core inflation by 0.2 percentage points from our baseline of 0.5% and 1.5%, respectively. This should open the door to further FX policy easing by the MAS, likely via re-centring lower of the S$NEER policy band. We would also expect more expansionary fiscal policy in FY17, although the balanced budget rule would likely preclude any large deficits.

Fig. 28: Singapore forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**1.8**	0.7	0.2
CPI inflation (% y-o-y)	**-0.5**	0.5	0.3
Current account (% of GDP)	23.0	23.0	20.0
Fiscal balance (% of GDP)	0.8	0.5	-0.5
3m SIBOR (end-period, %)	**0.97**	1.55	1.85
USD/SGD (end-period)	**1.45**	1.50	1.56

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

South Korea: Troubled waters to get choppier

We would expect the economy to be negatively affected by trade protectionism and by a rise in geopolitical risks surrounding the Korean peninsula.

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Economy's starting position (weak): The combination of elevated household debt and an ageing population is curbing private consumption, while a number of manufacturing sectors (e.g., shipbuilding) are struggling with overcapacity. A potential early presidential election after domestic political scandals further increases uncertainty, which is negative for business investment. One silver lining is that Korea's external balance has improved since 2008, as its net international investment position hit a record-high USD234bn (17% of GDP) in Q2 2016, supported by a series of sizable current account surpluses. Korea's short-term external debt has trended lower as FX hedging demand has declined. S&P raised Korea's sovereign credit rating to AA from AA- in August 2016.

Vulnerability to Trumponomics (high): In June 2016, Mr Trump criticised the free trade agreement with South Korea (effective in 2012), saying it had doubled US trade deficits with Korea and destroyed nearly 100,000 American jobs. Korea's exports to the US were equivalent to 5% of its GDP in 2015, one of the highest in the region. Over 2012-15, Korea's merchandise trade surplus with the US averaged USD21.6bn annually, versus USD9.4bn over the 2008-11 period. Potential punitive tariffs of 45% and 35% on imports from China and Mexico, respectively, would hurt Korean manufacturers (which are exporting goods to the US) in these countries as well. We would expect the US to intensify its monitoring of KRW movements and see a risk that South Korea, in addition to China, is declared a currency manipulator. Mr Trump has also committed to forcing South Korea to meet the full cost of its US-provided security guarantees. When South Korea, disappointed with China's lack of action against North Korea's nuclear threat, turned to the US to consult on the Terminal High Altitude Area Defence (THAAD) system for its own national security, China was reportedly infuriated as it sees THAAD as a threat to its security. Similar episodes would be negative for Korea's trade with China.

Baseline and downside risk scenario: In our base case, we forecast GDP growth to slow to 2.0% in 2017 from 2.7% in 2016 due to lacklustre exports, weaker construction investment and sluggish private consumption. Under the risk scenario, we would expect 2017 GDP growth to slow further to 1.8%, but CPI inflation to rise to 2.0%, suggesting that scope for further rate cuts has narrowed and the likelihood of a larger fiscal stimulus has increased. As a result, we would expect a sizable FY17 supplementary budget (1% of GDP) and no further policy rate cut. We do not expect the Bank of Korea to hike policy rates to defend KRW as a weaker KRW would support exporters and we would not expect CPI inflation to rise much above the 2% target. If USD/KRW surges, we would expect the government to ease macroprudential measures, such as raising the limit of FX derivatives contracts or reducing the withholding tax on bonds held by foreign investors.

Fig. 29: South Korea forecasts: Baseline and downside risks scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**2.7**	2.0	1.8
CPI inflation (% y-o-y)	**1.0**	1.3	2.0
Current account (% of GDP)	7.3	6.8	7.0
Fiscal balance (% of GDP)	0.1	0.8	-0.2
Policy rate (end-period, %)	**1.25**	1.00	1.25
USD/KRW (end-period)	**1205**	1240	1290

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Taiwan: Stuck in the middle

The US exit from the TPP should hamper President Tsai's agenda to diversify export markets beyond China. US-Sino relations could have a large indirect impact on Taiwan.

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Economy's starting position (weak): Taiwan has a large current account surplus (10% of GDP in 2009-15), which results in a very strong external balance; its net international investment position was USD1054bn (202% of GDP) in 2015. Foreign investor positioning data show that capital flows in Taiwan are less vulnerable to higher global interest rates or stronger USD than in other Asian countries. However, we expect Taiwan GDP growth to slow to 1.1% for 2017 from 1.5% for 2016, as we believe the slowdown in electronics parts exports will weigh on growth. Also, the house price index in December 2016 was 13.6% below its peak in April 2015 which, along with stagnant wages, is likely to constrain private consumption. We see room to increase fiscal spending in response to weaker growth. At the end of last year, President Tsai hinted that the government could unveil infrastructure investment proposals to boost domestic demand.

Vulnerability to Trumponomics (high): Taiwan's exports are more exposed to China and less exposed to the US than other Asian manufactures. As a result, we believe that the US Treasury would exert less pressure on Taiwan than on China or Korea when it comes to currency manipulation issues. Regardless, Taiwan's supply chain in the region (notably China) could be hurt by international trade protectionism. The US exit from the Trans-Pacific Partnership (TPP) should hamper President Tsai's agenda to diversify export markets beyond China. If Trump wants to erode China's power in the region, the US could increase its support for Taiwan to raise its international profile. Indeed, Trump recently seems to strengthen diplomatic ties with Taiwan. In this case, Taiwan's exports to mainland China may be affected negatively.

Baseline and risk scenario: In our downside risk scenario, we forecast only 0.9% GDP growth in 2017, as macro policy responses would partly offset the negative impact of Trump's policy on exports. We believe Fed monetary tightening should reduce the chance of further monetary easing by the Central Bank of China (CBC) as CPI inflation would rise to 2.0% in 2017 due to weaker TWD. Also under this scenario, we expect more aggressive fiscal stimulus, such as an increase in infrastructure spending, to result in a larger fiscal deficit of 2.0% of GDP in 2017, compared to 1.5% in our base case.

If capital outflow pressures increase substantially, we would expect the CBC to intervene in the currency market by selling USD to ensure orderly TWD depreciation. Taiwan's FX reserves (USD434bn at end 2016) are large enough to keep its currency market stable. Selling USD can give Taiwanese authorities a valid argument against any US Treasury claims that Taiwan has engaged in persistent net foreign currency purchases in the 12 months through June 2016. We assign almost a zero probability to the CBC hiking policy rates to defend the currency in 2017, as Taiwan's inflation is acceptable, domestic demand is not strong and, more importantly, a weaker TWD will help exports.

Fig. 30: Taiwan forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**1.4**	1.1	0.9
CPI inflation (% y-o-y)	**1.4**	1.5	2.0
Current account (% of GDP)	14.2	12.2	13.2
Fiscal balance (% of GDP)	-0.5	-1.5	-2.0
Policy rate (end-period, %)	**1.375**	1.375	1.375
USD/TWD (end-period)	**32.3**	33.1	34.1

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Thailand: Staying sub-par

Although the economy is less vulnerable to Trumponomics, it remains on a sub-trend growth path owing to structural domestic constraints, which are unlikely to be addressed.

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Economy's starting position (weak): The Thai economy has suffered from a multi-year slowdown driven by cyclical and structural factors. Highly leveraged households, over-capacity in the manufacturing sector, an ageing population and poor labour productivity at a time of political uncertainty have weighed on domestic demand. The government has policy space to push growth and has indeed started to implement short-term stimulus measures. With public debt to GDP at 42.4%, well below the self-imposed ceiling of 60% of GDP, the government has more fiscal room for manoeuvre.

Vulnerability to Trumponomics (low): The US was Thailand's biggest trading partner in 2016, accounting for 11.5% of total exports. So the risk of increased US protectionism may weigh on overall Thai exports, which have shown some signs of recovering in recent months. That said, the current account surplus has increased, reflecting weak domestic demand, but also the influx of tourists, led by visitors from China, which we do not expect to be affected by Trumponomics. Capital outflow risks are also relatively limited as a result of faster Fed hikes. Foreign holdings in government bond and equity markets are relatively low at 14.8% and 33% respectively. We continue to view that Thailand's main weaknesses mainly stem from the abovementioned long-term domestic concerns that remain unaddressed.

Baseline and risk scenario: Our baseline scenario is for growth to remain sub-par at 2.8% in 2017. In the risk scenario, we forecast growth to weaken to 2.5% with weaker exports partly offset by an increased fiscal stimulus. We expect this additional fiscal spending to be focused on providing cash hand-outs to farmers, tax breaks for consumers and more shovel-ready projects. We also expect weaker export growth to lead to a narrower current account surplus of 6.0% of GDP versus our baseline of 7.8%, but remain large nonetheless. The increase in headline inflation should be more modest given our oil price assumptions, averaging 0.8% versus our baseline of 1%, but nonetheless remaining below the BOT's 1-4% headline inflation target. This, we believe, will provide the BOT with room to deliver a cumulative 50bp in rate cuts similar to what we have pencilled into our baseline.

Fig. 31: Thailand forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	**2.8**	2.8	2.5
CPI inflation (% y-o-y)	**0.2**	1.0	0.8
Current account (% of GDP)	10.6	7.8	6.0
Fiscal balance (% of GDP)	**-2.7**	-2.7	-3.7
Policy rate (end-period, %)	**1.50**	1.00	1.00
USD/THB (nominal, end-period)	**35.8**	36.5	37.0

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Russia: Time for a reset?

Russia would be the main beneficiary of the Trump era if US sanctions are eased early, but potential US energy independence policies would hurt oil prices.

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Economy's starting position (neutral): The severe recession of 2015 that was triggered by the drop in oil prices and sanctions has given way to a more modest decline in GDP of 0.6% in 2016. The economy looks set to return to positive growth in 2017, though weak potential growth limits the extent of recovery. Inflation decelerated to 5.4% at the end of 2016, after having peaked at close to 17% in early 2015. This has allowed total policy rate cuts of 700bp since the emergency hike of late 2014, though only 100bp of these cuts occurred in 2016. More recently, the recovery in oil prices after the OPEC agreement late last year underpins expectations of a growth recovery, an improvement in the current account and consequently currency appreciation.

Vulnerability to Trumponomics (neutral): Russia is not meaningfully exposed to any moves by the US towards trade protectionism as exports to the US make up around 4% of total Russian exports. So the focus has been on geopolitical aspects of the transition to the Trump administration and market expectations have centred on sanctions. Based on President Trump's warmer tone towards Russia, expectations that sanctions may be lifted or relaxed soon have strengthened. We think this is unlikely to happen in the near term. First, a bill to limit the President's room for manoeuvre to lift sanctions unilaterally seems to have bipartisan support in US Congress. Second, after so much publicity on Russian intelligence interference in the US Presidential election, the "optics" of the newly-elected President Trump moving swiftly to ease sanctions would be very unfavourable. So, the sanction regime would be more likely to remain unchanged through 2017. The other channel through which the Trump administration can have an impact on Russia is on energy independence policies. If these result in increased oil production by the US and drive oil prices lower, Russia stands to suffer. Again, the time frame for this remains very much uncertain. Even if the measures to boost US production go into effect right away, the effects on production volumes and prices would not be visible before the second half – and perhaps the final quarter – of the year. Moreover, there are other moving parts; it is difficult to know, for example, how OPEC would respond to such a development. So it would be premature to reach conclusions as to how big the impact will be or if it will outweigh the impact of an easier sanctions regime.

Baseline and risk scenario: In our baseline, we see Russian economy growing by 1.1% in 2017. We expect further disinflation, though at a slower pace, to bring headline inflation to 4.5% by year-end. We think this outlook will allow rate cuts of 100bp while the Central Bank of Russia (CBR) aims to keep USD/RUB stable around current levels. We see USD/RUB at 60 at year-end. In our risk scenario, given our assumption of a relatively modest decline in oil prices, we focus more on the positive scenario that could be triggered by earlier easing of sanctions. This would ease the funding costs for Russian banks and corporates, supporting growth. However, due to potential output constraints we see GDP growth accelerating only slightly to 1.3%. The improved capital account picture, would lend support to RUB, though we expect CBR to lean against excessive appreciation in this scenario and see USD/RUB flat. We think the means to prevent appreciation will be FX purchases and larger rate cuts in this scenario.

Fig. 32: Russia forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	-0.6	1.1	1.3
CPI inflation (% y-o-y)	**5.4**	4.5	4.5
Current account (% of GDP)	3.0	3.5	3.0
Fiscal balance (% of GDP)	-4.5	-3.0	-3.0
Policy rate (end-period, %)	**10.00**	9.00	8.50
USD/RUB (end-period)	**61.27**	60.00	60.00

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Turkey: Large external funding requirement against a less-friendly global backdrop

Turkey does not stand to suffer from protectionism or immigration restrictions, but higher US yields and a stronger dollar would hurt Turkey via the external financing channel.

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Economy's starting position (weak): The Turkish economy slowed sharply in Q3 2016, posting its first year-on-year contraction since 2009 as the failed coup took its toll on economic activity. Indicators for Q4 2016 show some recovery, but domestic demand is held back by uncertainties posed by the extent of the post-coup purge and sharp depreciation of TRY that weighs on consumer/business confidence and wreaks havoc with the balance sheets of corporates that run a short FX position of USD213bn (25% of GDP).

Vulnerability to Trumponomics (high): Turkey is not too exposed to risks of increased US trade protectionism (exports to US make up less than 5% of total) or immigration restrictions. A more important source of vulnerability is the external financing channel. If the moderate fiscal impulse that we expect from the Trump administration leads to higher US yields and a stronger dollar, Turkey stands to suffer. The impact of higher yields is reasonably straightforward: Turkey's external debt maturing in the next 12 months is USD163bn (19% of GDP), and higher core yields will make it more costly to refinance this. Less visible but equally – if not more – important is the impact of the stronger dollar. 57% of Turkey's external debt is denominated in dollars whereas only 42% of export revenues is denominated in dollars. In a world where the dollar is strengthening against the major currencies, Turkey would be in the unenviable position of trying to service dollar-denominated debt by generating export receipts denominated in other currencies. The impact of potential geopolitical shifts is less clear-cut. On the one hand, there are high hopes in Turkey that the US-Turkey relationship will improve under President Trump which could help improve the Turkey narrative internationally. On the other hand, an isolationist US policy regarding the Middle East could embolden Turkey to act unilaterally, which might escalate Turkey's internal tensions.

Baseline and risk scenario: In our baseline, we see Turkish banks and corporates rolling over their maturing debt while the current account deficit is financed mostly by a combination of net errors/omissions flows and reserve loss. This, in our view, would allow growth to muddle through at 2-2.5% levels. The downward pressure on the currency would continue because of the challenging external financing outlook, but we would expect moderate rate hikes that push the 1-week repo rate gradually to 10% to slow the pace of depreciation. Relative stability of the currency in the second half of the year would help bring inflation down to 8.4% at year-end, after peaking in double digits in Q2 2017.

Under the risk scenario, higher US yields and a stronger dollar may intensify the pressure on TRY and political constraints on the TCMB may preclude meaningful and timely policy support. This could push the currency to lows that would strain corporate balance sheets, leading to insolvencies that would hurt capitalisation of the banking system. Growth would suffer from this combination while exchange rate pass-through pushes inflation higher, leading also to a higher terminal policy rate.

Fig. 33: Turkey forecasts: Baseline and risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	2.2	2.5	0.0
CPI inflation (% y-o-y)	**8.5**	8.4	9.5
Current account (% of GDP)	-4.1	-5.1	-3.4
Fiscal balance (% of GDP)	-1.1	-1.6	-2.2
Policy rate (end-period, %)	**8.00**	10.00	12.00
USD/TRY (end-period)	**3.52**	4.00	4.25

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Brazil: A lot to fix internally

Fundamentals remain marked by recession and dismal debt dynamics, but fiscal reform is being pursued while improvement is visible in inflation and in the external accounts.

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Economy's Starting Point (weak)*:* The growth picture remains poor, with the long-standing recession still ongoing and poised to improve only marginally in 2017. A cyclical recovery is expected to take place and, in combination with lower interest rates (as the BCB continues to deliver on what should be a long-cutting cycle), is likely to lead to positive growth this year. However, the said recovery is set to be underwhelming. In a scenario of: still rising unemployment, falling income, weak corporate financial standing and the necessity for the government to restrain fiscal expansion, there are no clear strong growth drivers on the short-term horizon. In addition, we also add that, even in a non-Trump scenario, risks to our growth estimates in the near term would already be to the downside.

Vulnerability to Trumponomics (neutral)*:* The clearest Brazilian vulnerability to possible Trump policy seems to be a form of significantly weaker BRL levels that add pressure to inflation and, despite a still negative (wide) output gap, constrain how much the BCB is able to cut rates (see *Trumping LatAm: Macro Risks Under New Normal*, 2 December 2016). In a downside scenario, interest rates would remain significantly above neutral levels (see *Brazil: Where Is the Neutral Rate?*, 1 August 2016), standing in the way of a better activity environment just as Brazil attempts to exit a long recession – and with few drivers available, as we have expressed above. Alternatively, we do not see high risks stemming from – trade with the US, remittances from Brazilian workers abroad, the level of the current account deficit and FDI flows. In this sense, Brazil is not as exposed to external accounts risks as other regional peers.

Baseline and risk scenario: We highlight that Brazil is in a position of improving (or not) its outlook based on domestic policymaking in 2017. In particular, we highlight the (upside and downside) risks associated with its fiscal reform agenda, most importantly social security reform, set to be discussed in Congress this year. In a Trump downside risk scenario, we see a combination of weaker BRL and slightly higher inflation that lead the BCB to halt its cutting cycle in above-neutral levels. That, in combination with heightened uncertainty and lower confidence levels, would bode poorly for a recovery in growth. We highlight that the biggest risk – as in any downside risk scenario in Brazil for the next several years – stems from the continued rise in government debt levels. Stabilization of GDP/ratios requires lower expenditures, stronger revenue and GDP growth going forward – a combination that requires domestic reform but will also be harder to achieve in a downside Trump-induced scenario.

Fig. 34: Brazil forecasts: Baseline and downside risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	-3.3	1.0	0.4
CPI inflation (% y-o-y)	**6.3**	4.8	5.2
Current account (% of GDP)	**-1.3**	-1.5	-1.3
Fiscal balance (% of GDP)	-9.5	-9.0	-9.5
Policy rate (end-period, %)	**13.75**	9.50	10.50
USD/BRL (end-period)	**3.25**	3.60	3.80

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Colombia: Limited threats but weak starting position

Its negative trade balance with US cushions it from protectionist policies, but it is vulnerable to tight financial conditions as it needs foreign inflows to finance its current account deficit.

LatAm Research

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***Economy's starting position (weak)**:* The start of Trump's administration finds the Colombian economy (still) on an adjustment path after the terms-of-trade shock suffered, following the sharp drop in oil prices in 2014 and 2015. In particular, the economy is still in the process of reducing a significant current account (CA) deficit that should finish 2017 close to 4.0% of GDP. Recall that the CA deficit reached 6.4% of GDP in 2015. Despite the advancement on this front, we think the country remains vulnerable to a slowdown in the CA financing sources (FDI and portfolio inflows).

***Vulnerability to Trumponomics (neutral)**:* We believe Colombia's vulnerability is low to Trump's policies related to trade and immigration. Nevertheless, given its dependence on external flows (FDI and portfolio inflows) for financing its CA deficit, the country is exposed to a tightening of external financial conditions.

On the low exposure related to trade and immigration policies, we note the following. The collapse in oil prices back in 2014 triggered a negative trade balance between Colombia and the US. Such a negative trade balance reduces the impact of any announcement related to either new tariffs or potential changes to the free trade agreement signed between Colombia and the US. Likewise, we do not foresee major effects on the remittances side should there be policies directed to stop the flows sent from illegal immigrants in the US. Indeed, the proportion of illegal Colombian immigrants in the US is low (approximately 20% of total, see *LatAm: Trumping LatAm: Macro Risks Under New Normal*, 2 December 2016). In any case, it is also important to note that remittances represent 1.8% of GDP which is a sizable amount given the meaningful current account deficit that the country is facing.

Although the country seems shielded on the trade and immigration front, its main vulnerability comes from a worsening of external financial conditions. Such a worsening could be triggered by a faster-than-expected pace of hikes by the Fed on the back of the fiscal stimulus provided by the new administration. Tighter external financial conditions could be translated into lower portfolio inflows to the country, complicating the CA deficit financing schedule. Finally, we note that an additional source of risk for the country comes from the likelihood of seeing lower oil prices due to policies directed to boosting the shale oil production in the US.

Baseline and downside risk scenario: In our base-case scenario, we expect Colombia's economy to grow 2% y-o-y in 2017 and the CA deficit to reach 4.0% of GDP. Under our downside risk scenario a reduction in portfolio inflows would force a faster than expected close of the CA deficit which would be translated into additional deceleration of domestic absorption and therefore deceleration of economic growth. Under such scenario the economy would grow 1.2% y-o-y and the CA deficit would reach 4.5% of GDP.

Fig. 35: Colombia forecasts: Baseline and downside risk scenario

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	1.8	2.0	1.2
CPI inflation (% y-o-y)	**5.8**	5.0	6.0
Current account (% of GDP)	-4.8	-4.0	-4.5
Fiscal balance (% of GDP)	-4.0	-3.3	-3.8
Policy rate (end-period, %)	**7.5**	5.5	6.5
USD/COP (end-period)	**3,002**	3,400	3,650

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Mexico: Trumping NAFTA

Mexico seems particularly vulnerable to protectionist policies from the US. In our view, MXN depreciation is the main valve of adjustment, but it is likely to accelerate inflation.

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Economy's starting position (neutral): The economy should continue to grow at a below-potential rate (we estimate potential growth at around 2.3-2.6% y-o-y). We think the anti-NAFTA policies pose serious headwinds to Mexico's economic outlook. Before the US election, we had forecast 2017 growth at 2.5%, but now expect 1.7%. With exports plus imports comprising more than two-thirds of the economy, we think the main adjustment valve against potential anti-NAFTA policies remains MXN depreciation.

Vulnerability to Trumponomics (high): In our opinion, Mexico is one of the EM countries most exposed to the Trump administration's likely protectionist policies. Mexico's current account deficit used to be around 1.5% of GDP (past 10-year average), but it has doubled since 2015 as oil production plummeted. This week, diplomatic tensions with the US have clearly escalated, but there are strong arguments to believe the threat of completely abandoning NAFTA is unlikely to fully materialize. The reasons include the high level of integration between the US, Mexico and Canada in the supply chain for manufactured goods, that 40 cents on the dollar of US imports from Mexico have US content, and that US exports to Mexico are sizable (US$211bn in January-November 2016 according to the US Census). The Mexican government recently opened up the energy sector (oil/electricity/gasoline/gas), which was not part of NAFTA, to foreign investment – a potentially very profitable opportunity for US companies, in our view. On immigration, there are 11mn illegal aliens in the US, 56% of them from Mexico (as of end-2014; *Migration Policy Institute*). Together, illegal and legal Mexico-born aliens in the US send almost 2.5% of GDP in remittances every year, which are key to limiting the current account deficit. In Mexico, threats to NAFTA could slow or delay FDI. Annual FDI accounted for 2% of GDP and is vital in financing the current account deficit. Portfolio inflows, which are also needed to finance the current account, could suffer because of anti-NAFTA policies, but also in an environment of high US Treasury yields.

Baseline and risk scenario: We expect 2017 inflation to be about 5%, due to the liberalization of gasoline prices and FX pass-through, but to fall to 3.5% in 2018. We estimate a current account deficit in 2017 and 2018 of around 3% of GDP, with net FDI inflows of 1.5-2.0% of GDP. We see MXN at 20-21 throughout the year. While we still see a possibility of MXN trading at 25-28, we now think there are too many uncertainties to have a strong conviction about strong depreciation or appreciation. The main tool to limit the impact of FX depreciation on inflation expectations is monetary policy. We expect Banxico to implement further rate hikes, despite rates being around neutral (which we estimate at 5.50%) and the economy running a negative output gap. Mexico has some fiscal cushion including potential transfers from Banxico to the finance ministry due to the revaluation of international reserves worth about 2.5% of GDP and savings in its oil stabilization fund worth 0.5% of GDP, and it has hedged its oil revenues for 2017.

Fig. 36: Mexico

	Baseline		Risk scenario
	2016	2017	2017
Real GDP growth (% y-o-y)	2.2	1.7	0.7
CPI inflation (% y-o-y)	**3.4**	4.9	6.0
Current account (% of GDP)	3.0	3.0	2.8
Fiscal balance (% of GDP)	-3.0	-2.9	-3.2
Policy rate (end-period, %)	**5.75**	6.75	7.50
USD/MXN (end-period)	**20.72**	21.00	25.00

Notes: "Baseline" is our current house view around Trumponomics which assumes a moderate US fiscal stimulus (an annualised impulse of around 0.6pp of GDP) starting to boost growth from Q3; two Fed hikes this year; low-scale US trade protectionism and tighter immigration policies; further USD appreciation to USD/JPY120 and EUR/USD1.00 by end-2017; and Brent oil averaging USD50-55/bbl this year. There is lots of uncertainty around our baseline, and as discussed in the Overview there are many other plausible scenarios that could play out. Overall, we judge that of the risk to our baseline for EM is skewed to the downside, and hence we have come up with a "Downside risk scenario" based on the following assumptions: the same US fiscal stimulus as in the baseline, but greater inflation pressures force the Fed to hike four times this year; USD appreciation to USD/JPY130 and EUR/USD0.95 by end-2017; quick implementation of medium-scale US trade protectionism, tighter immigration policies and some retaliation (which may include, among other things: exiting or renegotiating free-trade agreements; imposing an across-the-board tariff, or targeted tariffs on specific imports, or border taxes; incentives to US firms to repatriate their overseas profits; deportation of illegal immigrants (and reducing the inflow of new ones); a noticeable rise in geopolitical tensions; and a moderate decline in the Brent oil price to average USD45-50/bbl this year. Numbers in bold are actual values. Source: Nomura Global Economics.

Investor survey: What next from President Trump?

Asia FX Strategy

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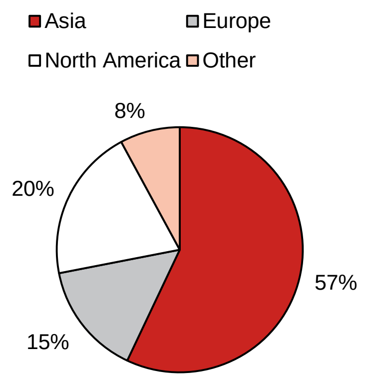
Over 23-26 January, we conducted a survey of global EM investors to gauge expectations of policy under the Trump administration and its impact on EM (Figure 37). Specifically, we were interested in investor views on policies most likely to be pushed through, expectations for Fed rate hikes and USD, EM FX performance and its drivers, and action on China and China's potential responses.

Overall, investors saw more risks for EM FX ahead amid broad USD strength and were confident there would be measures on trade. 72% of respondents expect USD to appreciate by end-2017, with an average DXY gain of 3.7%, and 91% expect two or more Fed rate hikes. 60% see more downside risks for EM FX in 2017. 41% expect protectionist measures to be taken as the first policy action by the US on China, which could lead to some form of retaliation (75% of respondents). Finally, the lion's share (87%) of respondents expects trade protectionism to lead to increased geopolitical tension.

Potential policy steps

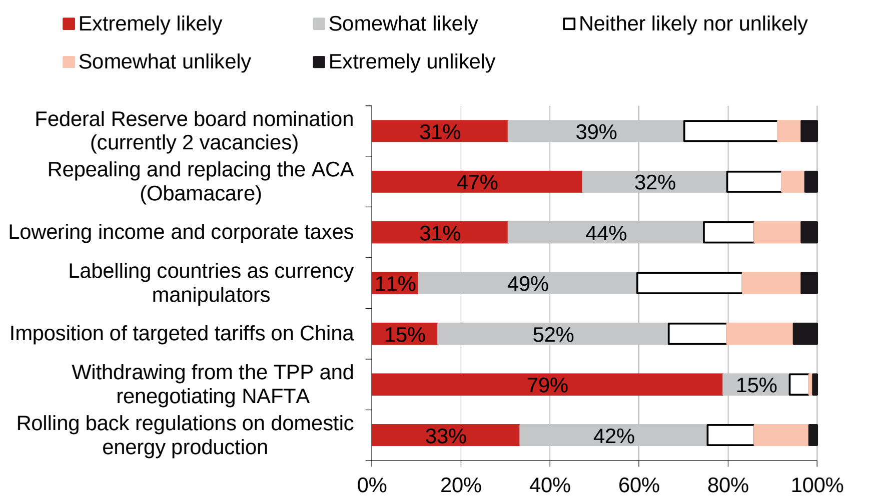
To assess investor expectations around specific policies under the Trump administration, we asked them to assess the likelihood of a number of potential policies in H1 2017. An overwhelming number of respondents (94%) saw it as extremely, or highly, likely that the US withdraws from the Trans-Pacific Partnership (TPP) and renegotiates NAFTA, while 79% expect a repeal and replacement of the Affordable Care Act (ACA, or "Obamacare"; Figure 38). 75% of respondents expect a rolling back of regulations on domestic energy production, with 33% seeing it as extremely likely. Similarly, 75% of respondents expect a lowering of both income and corporate taxes; 31% view this as extremely likely. On China, 67% expect the imposition of targeted tariffs (15% see this as extremely likely) while 60% expect countries (likely including China) to be labelled as currency manipulators. Finally, a significant 70% expect the incoming administration to nominate members to the Federal Reserve Board, where there are currently two vacancies, with 31% seeing this as extremely likely. Respondents also suggested "other" policy measures could include: building the southern border wall, a border adjustment tax, infrastructure focus and deregulation.

Fig. 37: Where are you based?



Source: Nomura

Fig. 38: The incoming administration has highlighted a number of "Top issues" that include energy, foreign policy, jobs and growth, rebuilding the military, law enforcement and trade. How do you view the likelihood of the following:



Source: Nomura

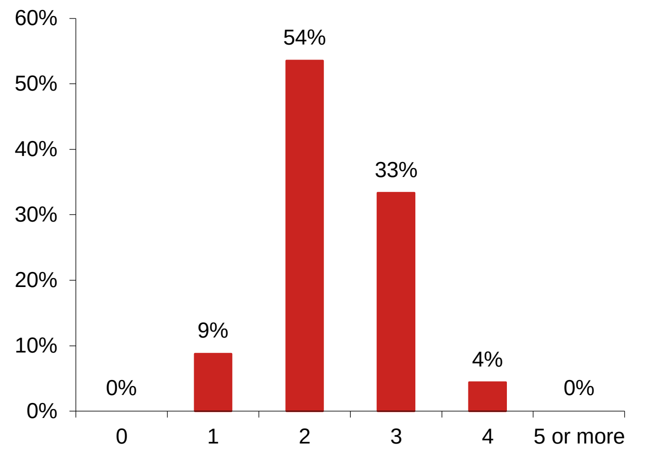
US monetary policy and broad USD expectations

Our next questions focused on the Fed, broad USD expectations and potential drivers. Most respondents (91%) expect the Fed to hike rates twice or more, while 72% expect the broad USD (DXY index) to appreciate by year-end (Figures 39 & 40). Respondents who expected a positive move in USD (72%) on average expect a gain of 3.7% while those who expect USD depreciation expect a move of -3.1% on average. Overall, respondents expect an average broad USD move of 1.8% with a median move of 2.0% (Figure 40).

Within the group of respondents who expect USD appreciation, more aggressive Fed rate hikes are expected to be an important driver of USD strength according to 32% of these respondents, while 26% expect America First trade policies to support USD (Figure 41). Other drivers of USD strength mentioned by respondents included a fiscal stimulus, leading to improved sentiment towards growth, inflation and higher policy rate expectations. Capital flows into USD due to higher expected returns, the Homeland Investment Act (HIA), US growth prospects, and comparatively loose monetary policy in other developed markets were also mentioned as potential factors.

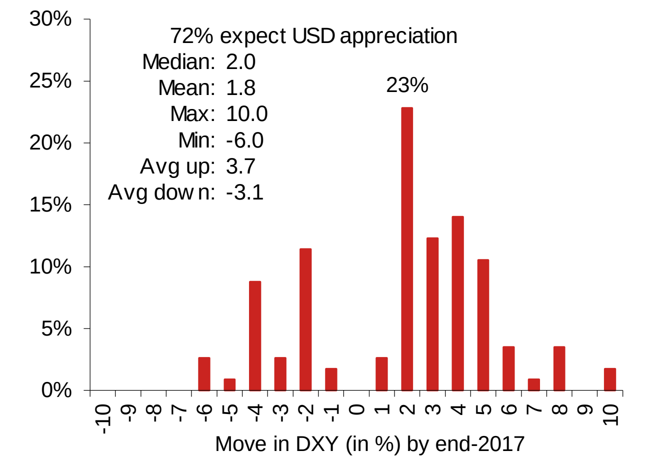
On the other hand, within the group of respondents who expect USD depreciation, 33% of those respondents saw stretched long USD market positioning as a driver of weakness, while 27% see a risk that the Fed hikes rates less than, or in line with, current market expectations (around two hikes for 2017; Figure 42). Other potential factors for USD weakness include: the risk that policies on taxes and fiscal stimulus take longer than investors currently expect, as well as a potential weak USD policy against countries with a large trade surplus with the US and Trump's stated objective of bringing manufacturing jobs back to the US. Similarly, verbal intervention, the risk of a Plaza Accord-style deal, the relatively high level of USD versus EUR and other currencies were listed as potential factors.

Fig. 39: How many hikes (25bp each) do you expect from the Fed this year?



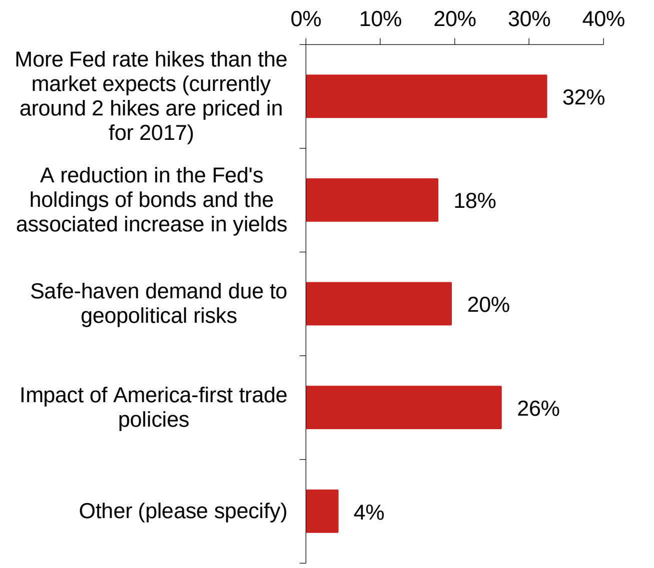
Source: Nomura

Fig. 40: How much do you expect the broad USD (DXY Index) to move by end-2017?



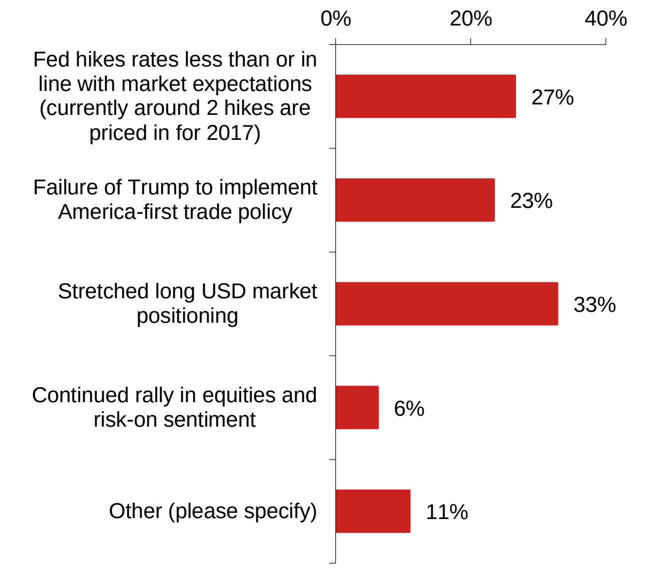
Source: Nomura

Fig. 41: What do you believe will be the most important drivers of USD strength?



Source: Nomura

Fig. 42: What do you believe will be the most important drivers of USD weakness?

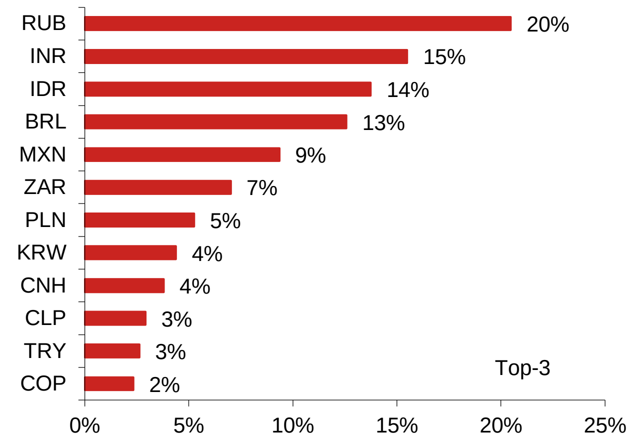


Source: Nomura

Relative performance in EM FX

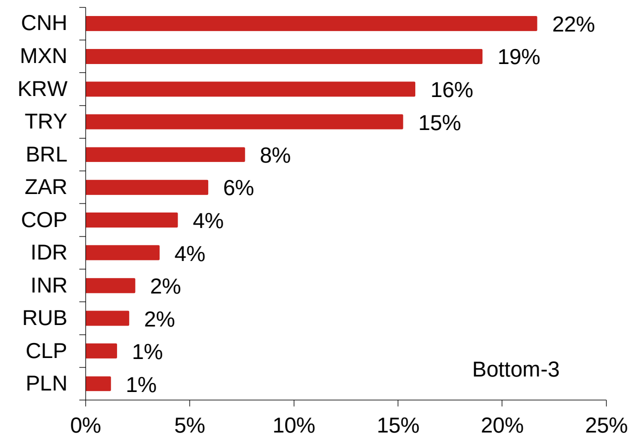
From a selection of currencies across the EM space (Asia: CNH, KRW, INR, IDR; EMEA: TRY, PLN, ZAR, RUB and LatAm: BRL, MXN, COP, CLP), respondents were asked to choose their top and bottom three performers (Figures 43 and 44). RUB (20%), INR (15%) and IDR (14%) were the most commonly occurring in the top three outperformers, with BRL only slightly less so at 13%. CNH was the most commonly selected bottom three performer (22%), followed by MXN (19%) and KRW (16%), with TRY a close fourth at 15%. By region, we note that respondents from Asia were more likely to choose INR and IDR among their outperformers, while RUB and BRL were somewhat more popular in North America and Europe as outperformers instead of INR and IDR. That said, CNH was consistently chosen as an underperformer across regions while Asia respondents appeared slightly more bearish than others on MXN (Figure 45).

Fig. 43: Top three performers in EM FX in 2017



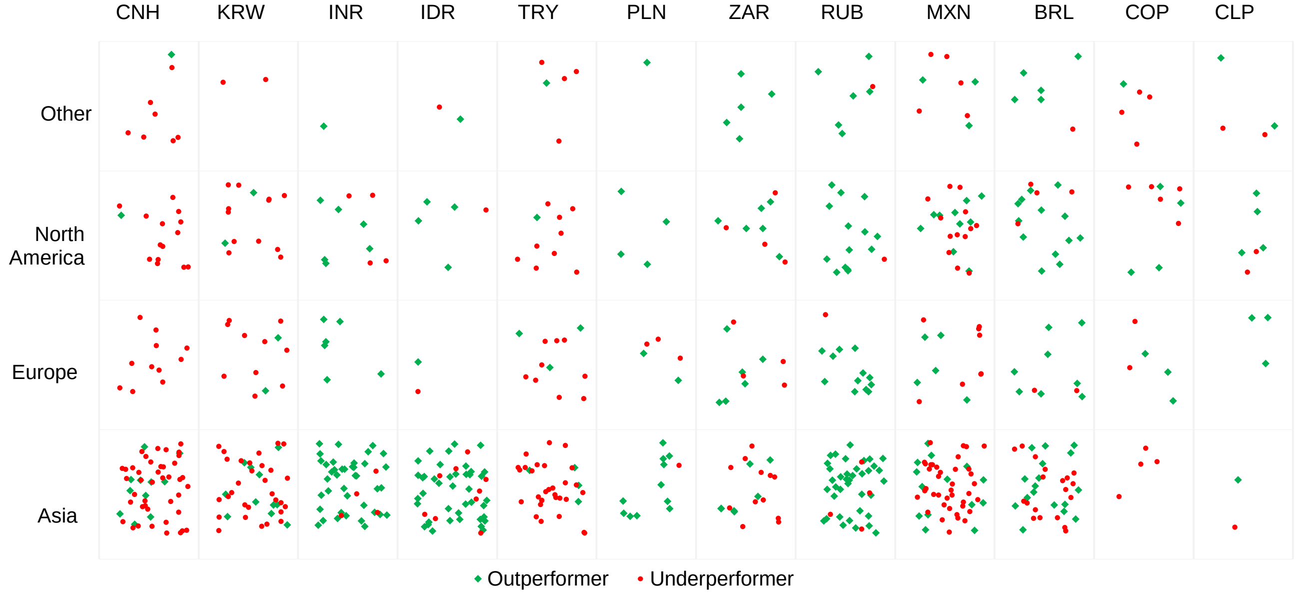
Note: The percentage indicates the number of times each currency occurred in all top-three selections as a proportion of all currency selections. Source: Nomura.

Fig. 44: Bottom three performers in EM FX in 2017



Note: the percentage indicates the number of times each currency occurred in all bottom-three selections as a proportion of all currency selections. Source: Nomura.

Fig. 45: Currency outperformers and underperformers by region of respondent



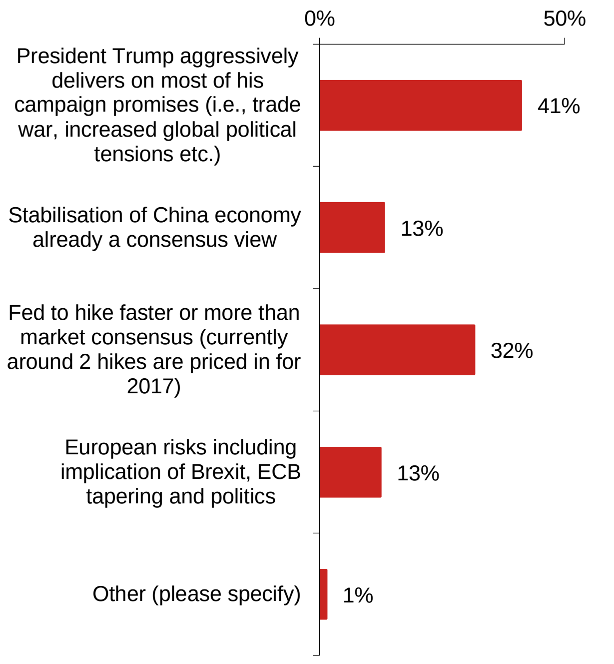
Source: Nomura. Note: each green and red dot corresponds to the inclusion of each currency in a top-three or bottom-three basket respectively.

Prospects and drivers for broad EM FX

Respondents were then asked for their views on risks to broad EM FX and potential positive and negative drivers. On balance, respondents were more pessimistic on prospects for EM FX in 2017, with 60% seeing more downside risks versus USD. The respondents who saw more downside risks to EM FX expect an aggressive delivery of campaign promises to drive EMFX weakness (41%) while a faster pace of Fed hikes was also a concern (32%; Figure 46). A relative minority of 13% saw the consensus nature of economic stabilisation in China as a negative driver, while the same proportion saw European risks percolating into EM FX weakness. Other potential negative drivers listed by respondents include: Uncertainty over Trump's sabre rattling (however, with limited delivery) and the HIA.

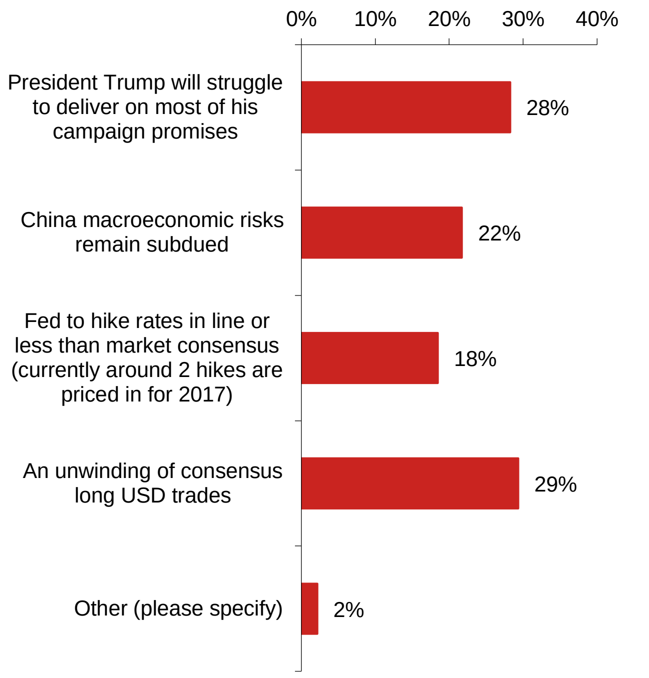
Among respondents who expected more upside risks, the main drivers were an unwinding of consensus long USD trades (29%) and the belief that President Trump will face difficulties delivering on his campaign promises (28%; Figure 47). 22% of respondents suggested diminished China macroeconomic risks while 18% expect EMFX risks to be diminished by Fed rate hikes in-line with or less than current market expectations. Other positive drivers mentioned include: the global capex cycle, an over-valued USD, for which a correction could become a consensus view.

Fig. 46: What are the most important negative drivers for EM FX in your view (select two)?



Source: Nomura

Fig. 47: What are the most important positive drivers for EM FX in your view (select two)?



Source: Nomura

Policies towards China and potential responses

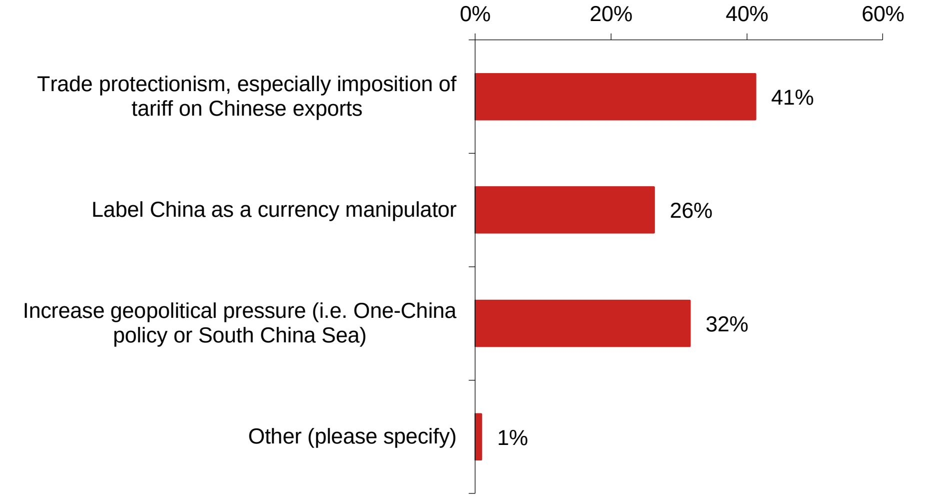
In this section, respondents were asked for their thoughts on what policies Trump would first implement towards China, and how China might respond. A plurality of those surveyed (41%) expect the first policy implemented that affects China to be the imposition of tariffs (Figure 48) and expectations of some form of Chinese retaliation are high at 75% (out of those who chose trade protectionism as the first policy action; Figure 49). Respondents judged that the main form of retaliation would be to target China's purchases of US goods (36% of those who chose trade protectionism), while 13% saw a shift in China's FX policy as a likely form of retaliation.

The next largest group (32%) expect that the first policy will be to increase geopolitical pressure on China. Similarly, expectations of Chinese retaliation are high at 70% (out of those who chose increased geopolitical pressure as the first policy action; Figure 50), and the main form of retaliation would be for the Chinese to disrupt development of the Sino-US relationship and cooperation on key areas (42%). Interestingly, only a small

11% believes that China will take strong action, including a potential military clash, under this scenario.

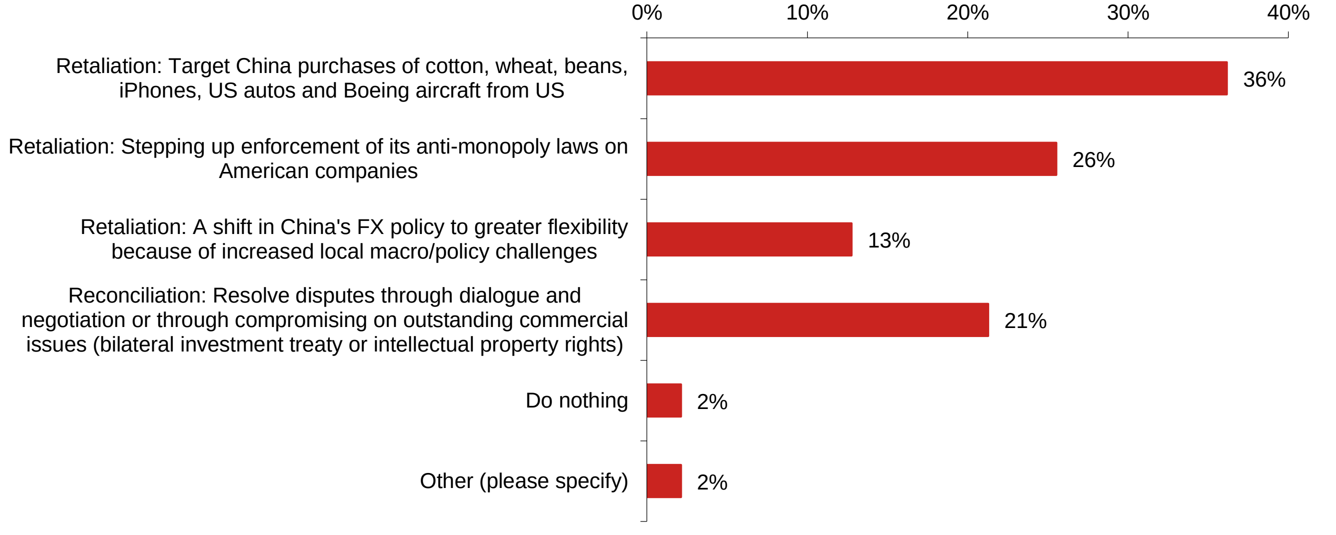
The smallest group (26%) expect the first policy to be labelling China as a currency manipulator. Compared to the first two groups (which expect trade protectionism or increased geopolitical risk), a significantly larger proportion (30%) of those who chose labelling China as a currency manipulator as the first policy action believe that China would do nothing against this particular action (Figure 51). Expectations of Chinese retaliation to being labelled a currency manipulator are relatively low at 57%, but still represent a significant risk. Interestingly, our respondents judged the main form of retaliation would be for China to shift its FX policy to greater flexibility (27%).

Fig. 48: What policy do you expect President Trump to first implement on China?



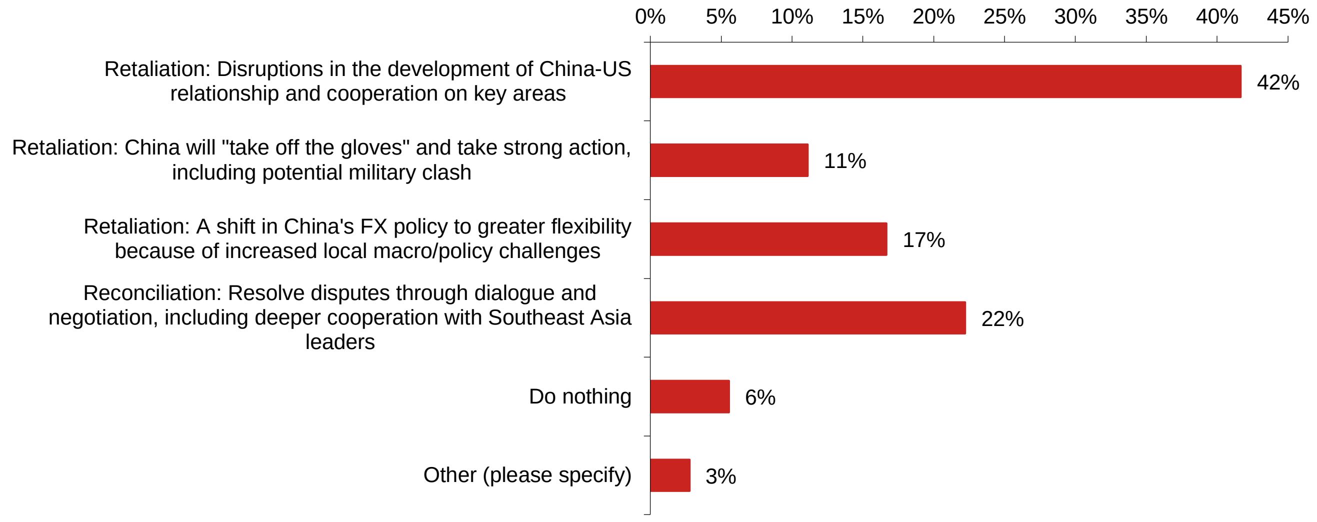
Source: Nomura

Fig. 49: Trade protectionism: How would China most likely respond?



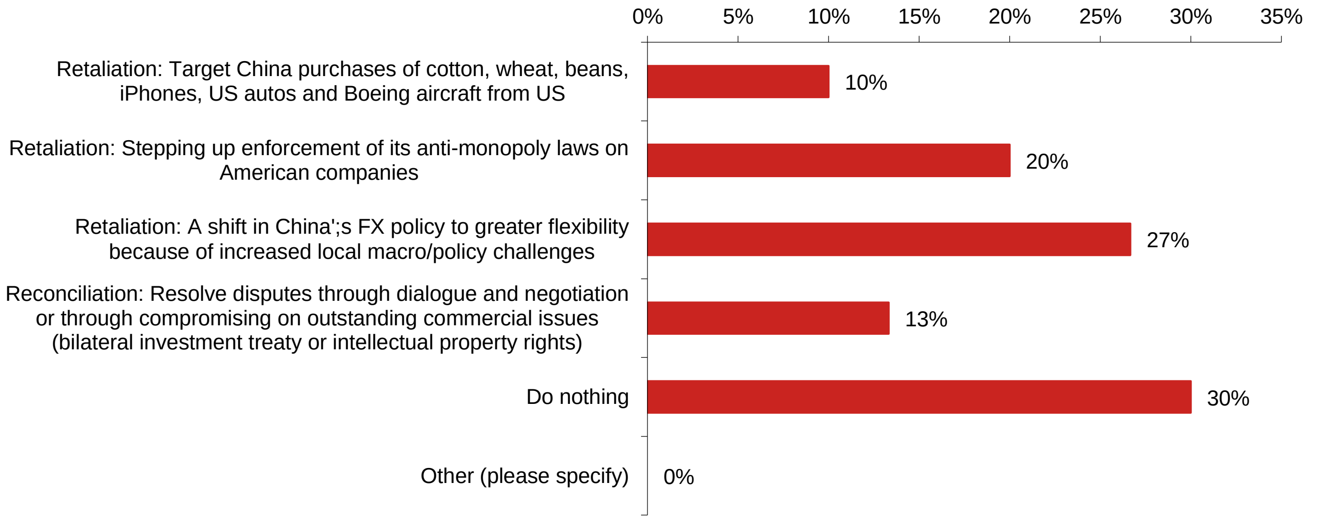
Source: Nomura

Fig. 50: Geopolitical pressure: How would China most likely respond?



Source: Nomura

Fig. 51: Currency manipulator: How would China most likely respond?

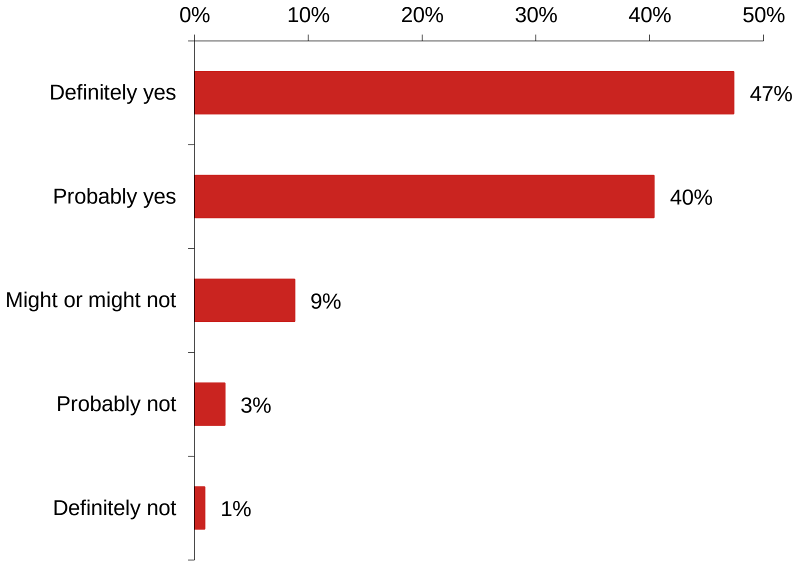


Source: Nomura

Impact of trade protectionism on geopolitics

Finally, respondents were asked if they believed increased trade protectionism could lead to higher geopolitical tensions. An overwhelming majority of respondents (87%) believed they could (Figure 52).

Fig. 52: Do you think increased trade protectionism can lead to rising geopolitical tensions?



Source: Nomura

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