FX Strategy
EM – NAVIGATING CHOPPY WATERS

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Emerging market growth in 2025 faces significant uncertainty, influenced by developments in the U.S. and China. Potential policy shifts in the U.S. could trigger a significant negative supply shock, impacting EM economies, as the new U.S. administration is likely to dampen EM growth prospects and constrain policy easing. Furthermore, with the dollar expected to stay strong in H1-25 and a slowdown in China's growth, we anticipate a challenging start to the year for the asset class as headwinds prevail. Considering these challenges, our baseline forecast projects EM growth (excluding China) to slow from 3.4% to 3.0% in 2025. Therefore, we begin the year with a cautious NEUTRAL stance, although risks remain tilted to the downside.

EM – Navigating choppy waters

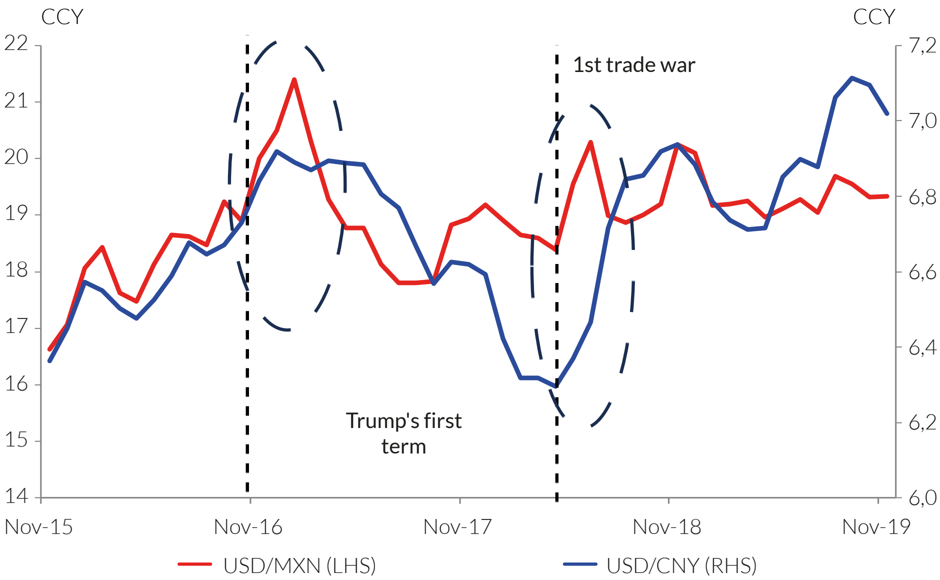
Emerging markets in 2025 are likely to face increased volatility compared to last year. The first Trump administration was a turbulent period for EM assets: following the November 2016 election, currencies like MXN and CNY depreciated by nearly 15%, bottoming out in early 2017 (**Figure 1**). A temporary relief rally followed as markets hoped the Trump policy agenda would be less aggressive, but those hopes were dashed.

In 2018, trade restrictions targeting China and others hurt business sentiment, capital expenditure, and EM assets. By the end of 2018, EM FX remained over 8% weaker against the USD compared to pre-2016 election levels, driven by higher U.S. rates and global uncertainty.

For 2025, we anticipate less of a delay in Trump's policy action compared to 2017 and we expect high volatility, driven by several potential U.S. policy shifts and their global ripple effects.

FIGURE 1.

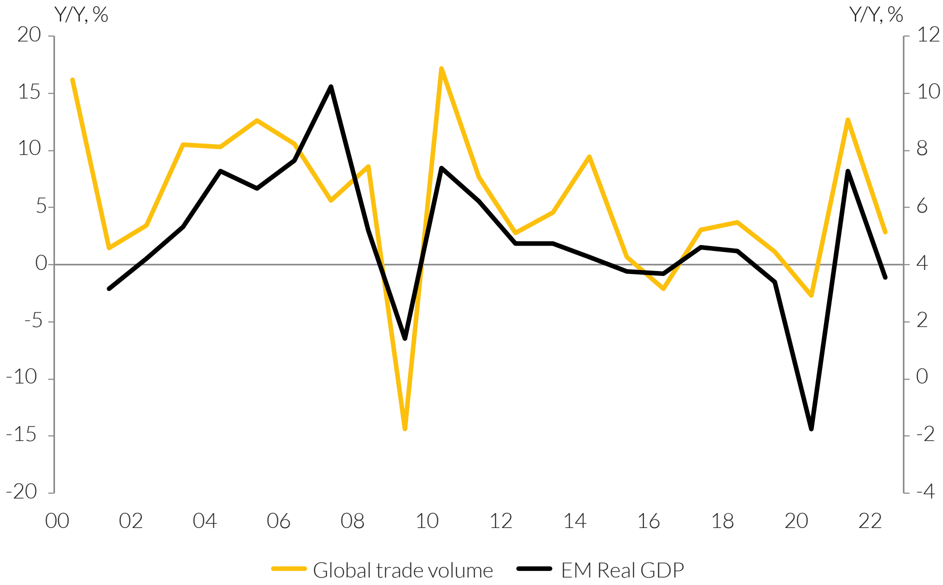
The 1st Trump administration was a turbulent period for EM currencies



Source: Haver Analytics, ANIMA Research

FIGURE 2.

We expect EMX[1] aggregate GDP to slow down in 2025, driven by trad



Source: Haver Analytics, ANIMA Research

1 – 2025 EM Growth outlook: mixed bag as growth slows.

EMs' growth set to slow in 2025. We project EM growth (excluding China) to decrease from 3.4% in 2024 to 3.0% in 2025 (**Table 1**). The impact of a potential "Trade War 2.0" under Trump will be crucial for EMs, with varying effects across countries depending on retaliatory and counter-cyclical policies.

Additionally, we expect high uncertainty over the EM outlook to persist. EMs will likely face considerable uncertainty in 2025, caught between major policy shifts in China and the U.S. The latter's policy changes could trigger a significant negative supply shock with widespread ripple effects across EM. In our baseline, we assume U.S. tariffs on imports from China will rise throughout 2025-26 to an average effective rate of 60% (up from 20%), with product-specific variations to limit the impact on U.S. consumer prices. We expect similar-sized tariffs on trans-shipment exports from other Asian countries such as Malaysia and Vietnam.

Trade should be the most relevant macro-driver of risk. As trade is central to many EM economies (**Figure 2**), driving both consumption and investment, any disruptions are likely to visibly hurt EM growth, impacting capital flows, inflation, and fiscal and monetary policies. While weaker EM currencies might offset some growth effects through depreciation, trade uncertainty could suppress business sentiment and investment. Additionally, excessive currency depreciation might lead to higher domestic inflation, potentially forcing central banks to scale back anticipated rate cuts more than initially planned.

1 - EMX = EM ex China and Turkey

- **In China, we tentatively estimate that trade tariffs will reduce growth by around 1.5-2.0 percentage points**, partially offset by fiscal policy, monetary policy, FX, and industrial measures, resulting in a net growth drag of 0.5-1.0pp. This would lower China's growth from 4.8% in 2024 to 4.0-4.4% in 2025.

- **Elsewhere, EM Asia excluding China will see the largest impacts on manufacturing exporters** like Malaysia and Vietnam, while India and Korea will face more modest effects.

- **In Latin America, Mexico's growth may be constrained by trade uncertainty surrounding the 2026 USMCA review**, potentially dampening its recent investment momentum.

The second most relevant macro driver will be the U.S. In our baseline, we anticipate U.S. growth to slow from 2.8% in 2024 to 2.3% in 2025, but how Trump's agenda will unfold throughout 2025 remains unclear at this stage. In our view, aggressive inward policies like trade curtailments or deportations could result in a severe global supply shock, materially affecting EMs. Conversely, deregulation and tax cuts might boost U.S. growth but with limited spillovers to EM. Under adverse scenarios, commodity exporters (such as Brazil and South Africa) and EM Europe may face less severe effects. In fact, despite anticipating Brent crude to average $70/bbl from $80/bbl this year, China's focus on commodity stockpiling and friend-shoring could benefit those countries.

At this stage we don't rule out some positive macro surprises among EMs. Overall, despite headwinds, EM fundamentals— improved fiscal outlook (Table 2), robust private sector balance sheets, and cautious policies—remain supportive, leaving room for potential upside surprises in EMs' macro performance.

TABLE 1.

We expect EMX GDP to slow down in 2025, below potential

	Real GDP % y/y			
	2023	*2024*	*2025E*	*Potential*
Emerging Markets	4,2	4,1	3,4	4,5
China	5,2	4,7	4,3	5,5
EM ex. China	3,3	3,4	3,0	3,5
Emerging Asia	5,0	4,8	3,9	5,0
Latin America	1,9	1,8	2,2	2,0
EMEA	2,6	2,6	2,0	2,5

Source: Haver Analytics, ANIMA Research

TABLE 2.

We expect the aggregate EMX fiscal outlook to improve in 2025

	Fisical Balance (% of GDP)		
	2023	*2024*	*2025E*
Emerging Markets	-4,4	-4,0	-4,1
EMX	-4,9	-5,0	-4,3
Emerging Asia	-4,3	-3,7	-4,0
Latin America	-5,7	-6,0	-5,5
EMEA	-4,0	-4,3	-3,1

Source: Haver Analytics, ANIMA Research

2 – 2025 EM Inflation outlook: decelerating.

EM inflation is projected to slow in 2025 as services inflation moderates, although goods prices may experience a temporary boost from tariffs and FX depreciation. Headline inflation for EM (excluding China and Turkey) is expected to decline from 4.1% at the end of 2024 to 3.4% by the end of 2025. The reason for this is twofold.

1. The primary driver of disinflation will be the continued moderation in services prices, though regional disparities will emerge due to differing labour market conditions and economic slack. Economies with weaker domestic demand and rising unemployment, such as those in EM Asia, are already seeing significant inflation reductions. Meanwhile, regions like Latin America and Central and Eastern Europe (CEE), with tighter labour markets and elevated wage growth compared to pre-pandemic levels, are experiencing slower inflation moderation.

2. Services price inflation, currently at 5.3% y/y for EM, is on a downward trajectory, anchoring broader disinflationary trends in 2025 (**Table 3**, **Figure 3**). However, divergences among countries are expected to widen throughout the year, contributing to variations in inflation outlooks across EMs.

3 – Monetary Policy Outlook: room for more easing ahead.

Monetary easing is expected to be the major positive driver to EMs' growth in 2025. As emerging market inflation is projected to slow due to easing services inflation, EM central banks will have room to cut rates (**Figure 4**), while navigating shifting U.S. financial conditions. They will need to balance financial stability concerns against the adverse effects of weakening sentiment and slowing global trade. Despite softer domestic growth, ample rate buffers are expected to provide room for cautious monetary easing in 2025, supporting growth. Nonetheless, if the Fed induces a tightening of global financial conditions, EM currencies could weaken, and inflation could rise, limiting monetary easing and ultimately curbing demand.

TABLE 3.

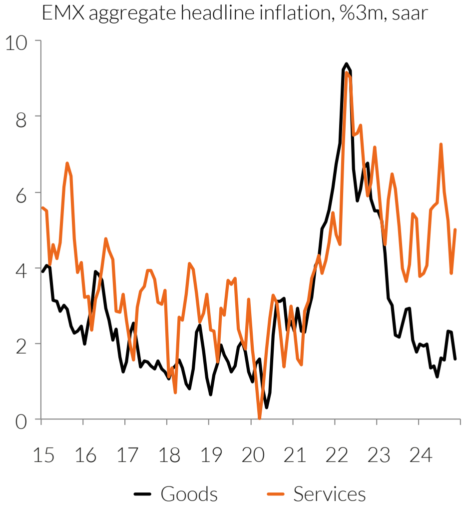
EMX inflation set to steadily cool down in 2025

	Inflation % Y/Y		
	2023	*2024*	*2025E*
Emerging Markets	3,7	3,4	2,8
China	0,3	0,2	0,5
EMX	6,9	5,6	4,4
Emerging Asia	2,6	1,6	1,4
Latin America	4,9	4,4	4,1
EMEA	17,2	13,3	8,4

Source: Haver Analytics, ANIMA Research

FIGURE 3.

Broad disinflationary trend still in place among EMs



Source: US customs, Haver Analytics, Anima Research

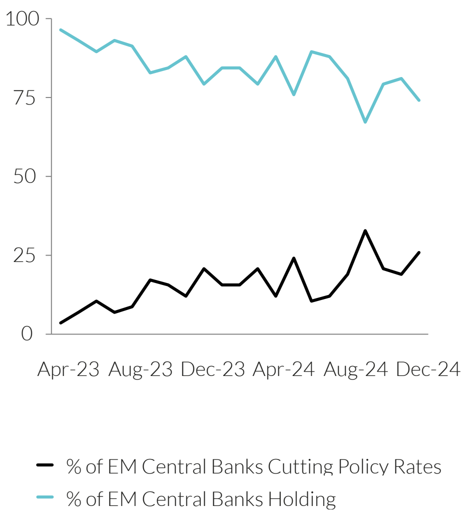
4 – Dollar: ongoing headwind for EMs

We expect the USD to remain strong, with further upside possible if US disinflation stalls. Trade policies, tariffs and fiscal dynamics remain crucial to our bullish USD outlook. On one hand, the Federal Reserve may decelerate rate cuts as recent developments ease growth concerns and indicate slowing deflation. On the other hand, subdued global growth outside the U.S. and expectations for a higher Fed terminal rate are likely to support a strong USD stance through at least Q1 2025, pending full implementation of the Trump administration's policies.

From a market perspective, a historical review of the past 20 years highlights a correlation between USD strength and EM equity performance (**Figure 5**). Historically, a stronger USD has coincided with weaker EM equities, which have declined by a median of 2% for each 1% increase in the broad USD index. Conversely, a weaker USD has generally aligned with stronger EM equities, which have risen by a median of 3.5% for each 1% decline in the broad USD index.

FIGURE 4

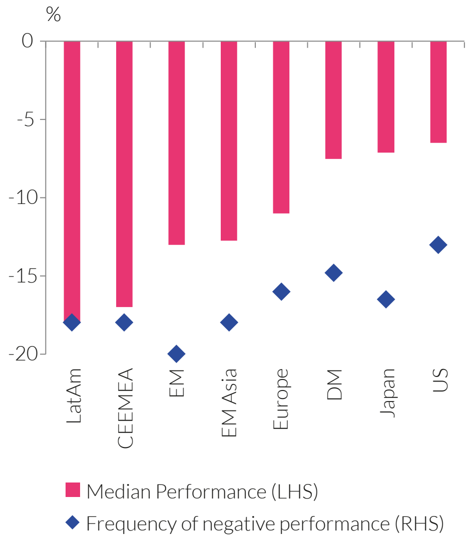
EM Central Banks have room to ease further



Source: Haver Analytics, ANIMA Research

FIGURE 5.

Periods of USD strength don't bode well for EM equity markets



Source: Haver Analytics, ANIMA Research

5 –EMs offer no safe bets: out stance remains NEUTRAL

In summary, we believe that the EM outlook at the start of the year is fraught with uncertainties, particularly due to developments in the U.S. and China as potential policy shifts in the U.S. could trigger a significant negative supply shock, impacting EM economies. Considering that no EM region is a safe bet at this stage, with each area presenting both pros and cons (**Table 4**), we choose to start the year with a cautious NEUTRAL approach. Among macro-regions, we slightly prefer Emerging Asia over EMEA and Latin America.

TABLE 4.

We maintain a neutral stance on the asset class due to idiosyncratic risks present in every macro-region

Emerging Asia	EMEA	Latin America
Neutral/+	Neutral/=	Neutral/-
Despite resilience in 2024, the region faces actual challenges from a US-China trade war in 2025, which could slow Em. Asia GDP growth below 4%. The inflationary outlook is not a concern. Nonetheless, impact from trade dynamics remains uncertain, as depreciating Asian currencies in response to tariffs may reignite inflation. Furthermore, tighter global financial conditions may limit monetary easing.	On the one hand, growth will continue but at a slower pace, with downside risks primarily stemming from weaker Eurozone demand rather than shifting sentiment . On the other hand, limited trade links with the US or China suggest limited indirect impacts from US tariffs. Rate cuts are delayed in several countries due to persistent core inflation and rising global uncertainties.	GDP growth in 2025 is expected to marginally improve and South American commodity exporters may benefit from China's stockpiling and reduced US agricultural exports. At the same time, most governments aim for fiscal consolidation, as debt-to-GDP ratios remain high and domestic fiscal challenges outweigh external risks. Mexico risks a sovereign downgrade due to fiscal and trade concerns as it faces risks from USMCA review uncertainty. Central banks should remain cautious as inflation remains way above target in the region driven by tight labor markets and weak currencies. Interest rates will remain above neutral, supported by fiscal consolidation efforts, especially in Brazil despite ongoing medium-term fiscal risks.

Source: ANIMA Research

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