Flash Comment

Reflections on EM after Trump presidential victory

- Donald Trump was confirmed as the winner of the US presidential election yesterday. As outlined in our presentation sent out yesterday, Donald Trump as US President - the economic and financial implications, we think this will mark a significant policy shift in the US in many policy areas, such as fiscal, trade, foreign and monetary policies, which could potentially have a large impact on emerging markets.

- After an initial sell-off in EM currencies, most of them recovered during the day (see figure below). A natural question is whether the US election is just like Brexit, where a significant negative knee-jerk reaction gave way to a significant market rally.

- It is too early to say the exact bearing the Trump presidency will have on emerging markets. Although Trump struck a more conciliatory tone in this acceptance speech yesterday, it is hard to predict how tough Trump’s foreign and trade policy will turn out to be. We will probably only know in the coming days or weeks as the new administration begins to take shape with the key appointments of the finance minister and head of state.

- The Trump administration is likely to present a much bigger challenge for emerging markets than Brexit: (i) the US economy is far more important for emerging markets than the UK economy and (ii) the Trump administration is highly likely to target (selected) EMs, while Brexit is mainly about UK relations with the rest of Europe with little bearing on EM. In addition, uncertainty about US relations with traditional allies such as NATO and possible closer ties to Russia could weigh on eastern European currencies.

![Modest market reaction for EM currencies in response to the Trump victory yesterday](chart)

Note: one-day change in currencies versus the USD.

Source: Macrobond Financial, Danske Bank Markets

Chief Analyst
Jakob Ekholt Christensen
+45 3058 4714
jokc@danskebank.dk

Senior Analyst
Vladimir Miklashevsky
+358 (0)10 546 7522
vladimir.miklashevsky@danskebank.com
However, it is not all doom and gloom for emerging markets. The expected fiscal expansion planned by the Trump administration has the potential to raise US growth at least in the medium term (although EM may benefit less if their access to the US market is constrained). Certainly, the prospect of a significant rise in US infrastructure spending gave way to higher copper prices. This will benefit mining-heavy EM countries such as Chile and Peru in LATAM, along with African and CIS countries.

Hence, following the election outcome in the US, these are our immediate thoughts on the different currencies:

- **The Mexican peso** will remain under close market scrutiny until we know more about the concrete stance of the Trump administration on trade policy. The currency saw a sharp sell-off yesterday morning with the USD/MXN rising to 20.7 to the USD (a bit short of our call of 21.5) although it recovered to 19.5 per USD fairly quickly. Three factors probably lent support to the currency (for the time being): (i) a general improvement in market sentiment, (ii) profit taking on stretched short MXN positions, (iii) expectation of Banco Mexico intervention to prevent excessive currency weakness leading to higher inflation (although central bank Governor Agustín Carstens toned down the need for supporting the MXN).

- With exports to the US amounting to 30% of GDP (see figure below), MXN is highly susceptible to reduced market access for Mexican exporters to the US market. Sizable remittances may also be at risk if the Trump administration makes good of the promise to tighten immigration rules and/or deport illegal immigrants. Although the Mexican peso looks very cheap fundamentally in real effective terms compared with long-run averages, finding alternative export markets may be difficult in the short run as other LATAM economies have imposed tariffs on Mexican goods and European markets are far away. On a positive note for the MXN, Mexican policy institutions (like the ministry of finance and the central bank) are generally strong and prudent.

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Source: Macrobond Financial
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Large differences in emerging market exports to the US (% of GDP)
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Source: Macrobond Financial, Danske Bank Markets
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• **The big question is where MXN will trade when the dust settles.** We think it is too early to say until Trump’s stance on trade with Mexico becomes clearer. If relatively benign, we think the peso may well strengthen from current levels but that it is likely Trump will pursue a stricter trade regime vis-à-vis Mexico, in which case MXN will weaken from current levels while the Mexican economy will fall into recession with a permanently weaker MXN.

• We also remain cautious on other LATAM and Asian currencies with sizeable trade exposure to the US. About 20% of China’s exports go to the US. However, as we pointed out yesterday (Flash comment: What Trump means for China, 9 November), there might be reasons why the Trump administration will be less hawkish against China, including the threat of retaliation by China and its significant leverage against the US through its holdings of US treasury securities. In the LATAM space, note Brazil and Argentina’s relatively limited size of US exports in percentage of their GDP.

• **As expected, eastern European currencies** (PLN and HUF) have been relatively unaffected by the Trump win. The main reason is very limited trade exposure with less than 3% of total exports going to the US market. These economies are far more dependent on western Europe, notably Germany. As long as we do not enter a global trade war, they should maintain their export levels. Investors may still weigh in geopolitical concerns about warmer Trump-Putin relations and possible frictions within NATO but it is too early to say how this will turn out.

• **The Russian rouble** has turned out to be a win-win EM asset, weakening the least on the US election result as we expected, rebounding by the end of the trading session in Moscow. However, being closely linked to oil price, the RUB seems to be slightly overvalued as long as the crude stays in the current territory. While the market will be speculating on sanction relief with a more pro-Russia stance in the US administration, we are cautious on this point given significant concern in the Republican party with regard to Russia. OPEC has a meeting later this month and we will wait to see the Fed’s stance in December. They will be the major drivers for the Russian currency while carry traders continue to like the RUB as if nothing has happened

• **The Turkish lira** has entered the perfect storm as internal woes are fortified by the global EM turbulence. Yet again, the Fed’s stance in December will be the key factor for the lira, which has calmed down. The macro side is not inspiring though in order to bring the USD/TRY back under 3.00 as it was in September. There is a question about what Trump will do to Turkish preacher Fethullah Gülen, who lives in the US as Barack Obama has refused to extradite him back to Erdogan. We follow this with interest.

No doubt, the next days, weeks and months will prove very interesting for emerging markets and we will learn more about the Trump administrations plans. In addition, we have the Fed upcoming meeting, where we still expect a rate hike followed by two hikes in June and December next year. The Fed will certainly also ponder the outlook for the US economy and monetary stance following the possible sea of change in US politics.
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Date of first publication
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