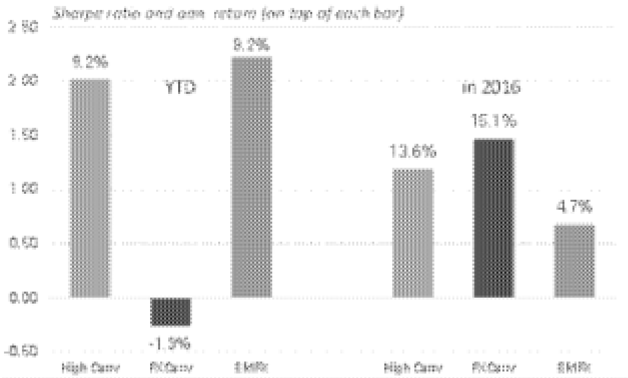
zero and they are ending the year in negative territory (chart). As we mentioned above the USD factor was not the sole driver of returns as idiosyncratic shocks were significant especially in Turkey and South Africa.

The year of the carry trade? Not really...




Source: Deutsche Bank, Bloomberg Finance LP.

## 2018: The boost of synchronized growth

We believe EM FX can perform well through 2018 but with total return just short of 5% (near 7% in LatAm, 4.5% in EMEA and 3% in Asia) absent the USD boost of 2017. We are constructive for several reasons:

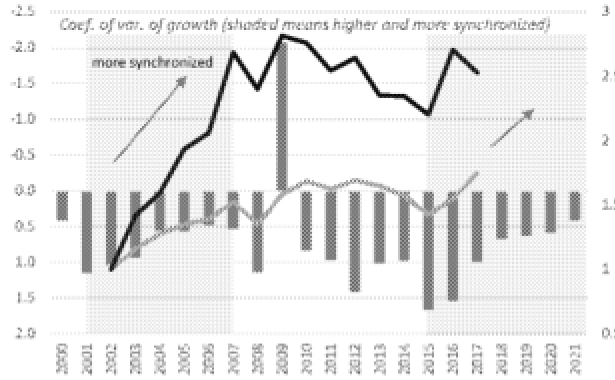
1. Global growth is turning more supportive and synchronized; Portfolio inflows are pro-cyclical on growth (particularly in equities);

2. EM FX valuations are attractive for the most part; as output gaps narrow and external vulnerabilities remain contained, monetary policy may tighten.

### 1. The boost from growth and flows

EM currencies tend to perform well during periods of global growth acceleration and synchronization. This is the pattern we expect to consolidate over the next year. Not only we expect global growth to inch up to a sound 3.9% (with EM up to 4.9%), but we also see reduced dispersion across the global economy. The shaded areas in the chart below mark periods of EM FX appreciation vs. the USD and they coincide with periods of increased growth with synchronization as we forecast for the coming year. After all this backdrop is associated with narrowing gaps, less stimulative monetary policies in EM, stronger trade and capital flows – all positive externalities for FX.

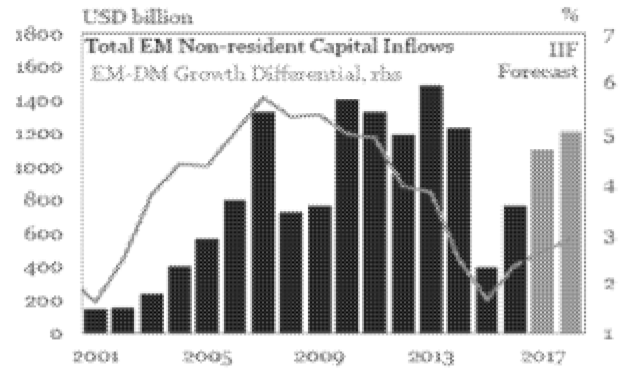
FX strengthens with faster and synchronized growth




Source: Deutsche Bank, Bloomberg Finance LP.

Higher growth spurs greater inflows into EM and boosts export cycles which benefit EM FX. As the chart below shows, higher EM growth relative to DM is associated with inflows into EM. This is particularly the case in LatAm, where the recovery has lagged the other EM regions but is set to accelerate in 2018.

EMEM inflows are pro-cyclical on growth




Source: Deutsche Bank; IIF

It is important to highlight that EM equity allocations are hovering near the lows of the past 12 years (according to EPFR). As we have discussed in related publications, EM inflows are most sensitive to the USD cycle and growth and the latter should tame the impact of tightening US liquidity on EM FX. In contrast with usual perceptions, the correlations between EM flows and core CB balance sheets or yields tend to be erratic and small for the most part. Also, the investment cycle seems to be gaining steam, which brings more global trade – another boost for currencies.