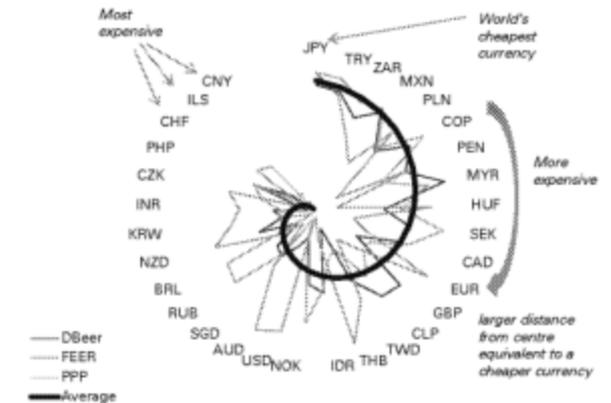


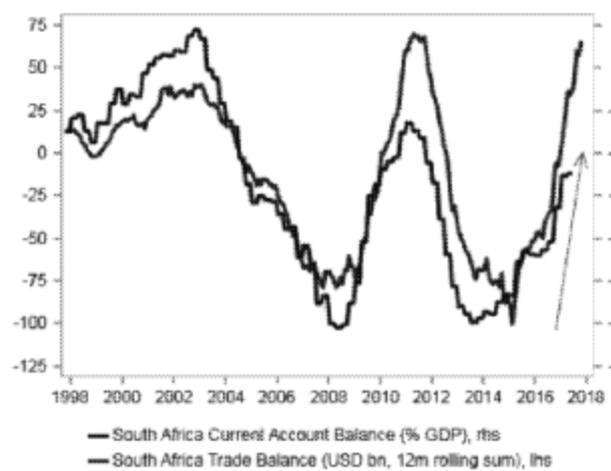


ZAR is one of the cheapest currencies in the world on the aggregate of our three valuation metrics



Source: Deutsche Bank

South Africa's trade balance has moved to a record-high surplus, compressing the current account deficit



Source: Deutsche Bank, Macrobond

Which EM currencies will lag?

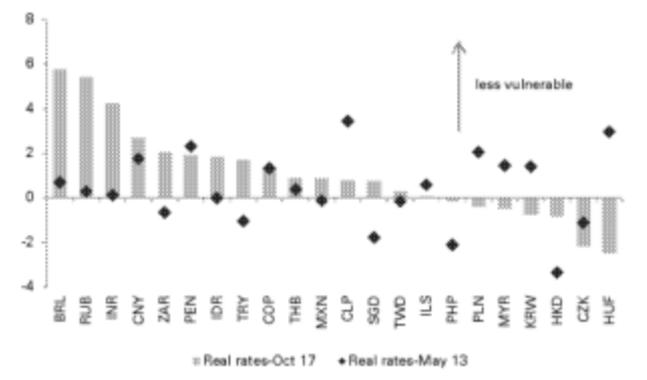
The main risks to EM FX are USD strength (and FX-hedging induced by a surge in US rates) and a more dramatic slowdown in China. In terms of timing, although dovish current pricing could trigger some bouts of rates repricing earlier in the year, we expect inflation and policy risks to build in the latter part of the year and especially in 2019 when output gaps will be much narrower. Bear in mind that QE unwinding will be very gradual with net core CB purchases until 2019.

On China, our economists expect growth to slow in the first half of 2018 due to property and financial sector tightening (which is already underway). However, despite an expected slowdown from current elevated

levels, growth is forecasted to remain above 6% in H1; moreover, it is expected to then rebound back towards 6.5% later in the year on renewed policy loosening. As such it is unlikely to derail EM FX appreciation.

A repeat of "tantrum" seems very unlikely and we see the possible bouts of repricing as comparable to those of 2017. EM real rates have improved this year and they will likely continue to improve in 2018. Compared to 2013, for example, real rates are higher, external imbalances reduced and FX reserves are greater. Further, real rates could rise next year for a number of EMs as there is less room for accommodation in 2018. Asia is where tightening begins, but across most EM the easing cycles are coming to a close.

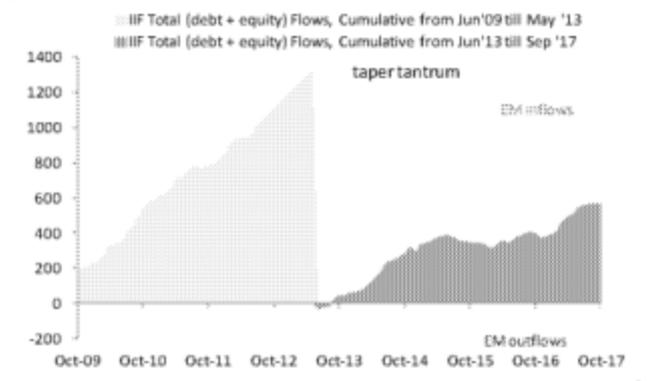
Higher real rates vs. 2013, especially for high-yielders



Source: Deutsche Bank

Also, despite recent inflows, positioning remains a lot lighter when compared with pre-GFC and pre-tantrum levels (chart). Local markets (and equities, in particular) have yet to refill as EM grows.

EM flows: Only a partial refill post-tantrum



Source: Deutsche Bank, IIF.

When we narrow the focus on domestic developments, valuations or external vulnerabilities we believe that COP, INR, and ILS will lag. LatAm is naturally most exposed to a China slowdown (less so MXN in this case).