TCW Investment Perspectives

Uncertainties Loom over IMF's Spring Meeting

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Anisha Goodly: Welcome to the TCW Investment Perspectives Podcast.
I'm Anisha Goodly, head of the Emerging Markets Portfolio Specialist Team at TCW.
The IMF spring meetings brought together an unusually large contingent of EM debt investors to learn about the global policy outlook at a time of heightened geopolitical tensions, a marked shift in Fed expectations compared to late 2023, and continued loose fiscal policy across the world. Today I'm here with Blaise Antin, head of TCW's EM Sovereign Research Team, and Brett Rowley, our Senior Sovereign Analyst responsible for the Middle East and Africa. Brett and Blaise are just back from the IMF World Bank meetings, and today we're going to spend some time on their key takeaways. Blaise, Brett, thank you for joining us today.

Blaise Antin: It's great to be with you.

Brett Rowley: Good to be back, Anisha.

Anisha Goodly: So Blaise, let's kick off and give us some background about the meetings. Who attends, what's the purpose, and who did the team meet with?

Blaise Antin: So the annual meetings of the IMF are in October, and the spring meetings are in April every year. Typically, the annual meetings are attended by huge numbers of investors from all over the world, as well as policymakers. The spring meetings were especially large this year because there's a lot of uncertainty on the macro side, and there's also the fact that last fall's annual meetings were in Morocco, and attendance at that one was quite a bit smaller than it is when they have these meetings in Washington. So huge turnout, investors, policymakers, bankers, a lot of conversations as a team. I think we met with more than 40 countries, senior officials from 40 countries. We had as a group probably 200 plus meetings over the course of the week. It was a pretty thorough and comprehensive set of discussions on a whole range of issues, ranging from global macro to regional macro and country-specific developments. Geopolitics was a central theme in the discussions. There's a lot of risk out there in the world right now, and people are very interested in how to invest around that. And then, of course, a lot of opportunity for market participants to talk with each other and exchange ideas, and how they think about the different trades that are out there in this complicated environment.

Anisha Goodly: Well, thanks, Blaise. That's certainly a lot. 200 plus meetings across 40 different countries. Now if you can, can you give us a few of your takeaways? What was the tone? What did you come away with? And Brett, I'd like to have you answer that as well afterwards.

Blaise Antin: I think the first thing I would say is, in the very short term, the IMF has actually slightly upgraded its global growth forecast for this year, incremental from 3.1% to 3.2%. That's not great. It's still below the long-term averages we've seen, if we look back over the last 30 years period of globalization. But nevertheless, a slight upgrade for this year, driven largely by continued resilience in the U.S. economy, and also some better than expected Chinese growth numbers in the first months of 2024. Obviously, the big change from a few months ago is Fed expectations and dollar funding costs, which has a huge impact on investor sentiment all over the world. And so, I think that was really very much the focus of investors. How do we navigate around this high-for-longer environment? And what kind of EM exceptionalism or differentiation is there going to be against this backdrop?

Anisha Goodly: Well, thanks, Blaise. And I'm going to pivot over to Brett, because Brett, your trip was bookended by Iran and Israel exchanging in direct attacks. So, talk to us a little bit about that, your latest thoughts and what the tone was like.

Brett Rowley: Yeah. Thanks, Anisha. I mean, it was interesting going into that weekend, just like when we talked about the weekend before I went to Morocco, right? Was when all of this erupted. So maybe I shouldn't go to these IMF meetings. No, but it was interesting because the context behind these attacks was clearly a change in the rules of engagement. It was the first time that Iran had directly attacked Israel. And so, basically, the early part of the week, people were just wondering, OK, what is Israel going to do? How are they going to respond? And the international community is really trying to press Israel for restraint.
But I think the big takeaway from both the attacks, whether it was Iran launching the 300 missiles and drones toward Israel or Israel's response to that, both of them seemed very calibrated not to escalate the situation into a direct hot war between both countries that could potentially draw in others from the rest of the region.

Anisha Goodly: Well, thanks, Brett, on geopolitical risk. And talking to that, Blaise, I want to circle back to you. You talked a little bit about how China's been surprising to the upside in terms of the data. But what were some of the things that you came away with on US-China tensions, especially leading into an election?

Blaise Antin: Yeah, it's a very difficult situation right now. I think the globalization story was obviously, in large part, the integration of China into the global economy, supply chains, and ultimately into some integration in terms of financial markets. It's hard to classify whether we've entered a period of de-globalization or whether globalization is maybe just going to flatline for a period of time. Clearly, geopolitical tensions are at the root of this.
The US made a bet in the 1990s and early 2000s that by integrating China into Western and global supply chains that China would become more like us over time. And that has clearly not happened politically and geopolitically, and there doesn't seem to be any likelihood that it will happen going forward. So it's really now we've gone to a place where officials on both sides - Washington, Beijing, and other major players, whether they're in Tokyo or in Europe - are thinking about how to think about China going forward.

Does it make sense to have so much of the critical component of globalization coming from a country that is very different politically and has different geopolitical interests? I think that struggle is likely to play out for an extended period. Now, we had Secretary of State Tony Blinken go to China last week, had very high-level meetings including with Xi. I think at the top line, there is an effort underway from both sides right now to try to do some de-escalation in the short term. I think that probably serves the Biden administration's needs going into the elections, for example. But the reality is on the ground, we see increased tariffs on steel coming from the US towards China. We see increased pressure on the EV sector coming from both the US and Europe on China. And of course, last week when Congress passed the huge foreign aid bill for Ukraine and others, there was an outright TikTok ban in there. And Biden has signed that legislation, which has set the clock running on a large cultural integration vehicle, if I can describe social media company TikTok in that way. I think there's a lot of uncertainty going forward. I think the main takeaway is the relationship is unlikely to get better and probably will get worse over time. But it's more of a managed decline than, or they're attempting to have a managed decline here rather than to avoid outright confrontations, especially on the military side, anytime soon. But I think a year from now, two years from now, there's a good probability the relationship will be worse than it is today.

Anisha Goodly: And Brett, what does that mean for your region? Because certainly China is a big lender to many of these countries. The frontier segment of the market isn't a large part of the market, but it is a really interesting part of the market right now as it's turning around. How do you think about these relationships when you're looking and analyzing these countries? Yeah, absolutely.

Brett Rowley: China is particularly important when it comes to lending and Africa, right? And so although African issuers face significant challenges still, I think one thing that was important that set these meetings apart from what we've had over the past couple of years is this year, high yield generally and Africa specifically has outperformed the broader index across the board.

Anisha Goodly: Right. Triple C's alone are up 20% or so.

Brett Rowley: Right, right. And, you know, that's as distress stories are reaching restructuring agreements, but also we're starting to see some of the single B's being able to access the market. So that set a much more constructive tone overall for the meetings with policy makers as well as IMF staff. I think the shortcomings of the common framework, we've talked about those in the past. It seems like comparability of treatment is the recent moving target that's proving difficult to hit in some of these restructuring engagements. And China is certainly at the center of those, with the official creditors having to reach terms and agree that private creditors have provided debt relief on comparable terms as official creditors. But we are seeing things moving ahead. Generally, two steps forward, one step back. Zambia is pretty much at the finish line, which has raised hopes that Ghana and Ethiopia and some of those that are currently in default will be able to move forward and reach an agreement with private creditors this year.

Anisha Goodly: Last time we spoke, you talked about how you did expect medium to long term that the situation would remain contained, that multiple parties, the Middle East, the US, even Iran, they want this to remain contained. In light of the attacks recently, has your base case changed?

Brett Rowley: Yeah, I would say our base case has not changed in the sense that it will primarily remain in a regional conflict. But clearly, as I mentioned earlier, the rules of engagement has changed. The fact that they have gone to doing direct attacks, I don't think they can walk that back. And so the risk of miscalculation from all parties involved is now higher. And so we can't ignore that. I would also add that it probably increases the likelihood that this lasts for several more months. International parties are really working hard to deescalate. And there's still daily headlines about ceasefire agreements and hostage exchanges. But, you know, the gap does still seem to be fairly wide in terms of, you know, what the duration of the truce should be and how many hostages are going to be required to strike a deal. So it seems like we still think it's going to be relatively contained within the region. But the risks of miscalculation have certainly increased. And it's probably going to be a much more protracted conflict probably lasting through the U.S. election.

Anisha Goodly: And Blaise, let me ask you something about China again. So you talked a little bit about how Chinese growth has been surprising to the upside, fairly low expectations. Now, what does that mean for global inflation? Because that's certainly a concern for investors.

Blaise Antin: That's a great question. I mean, I think everyone recognizes inflation became a huge problem during and after COVID with all the stimulus. There's been a lot of disinflation, but most central banks are still struggling with inflation rates above their targets. Obviously, that's true here in the U.S. with the Fed. And it's why market expectations for Fed easing have really changed. I mean, late last year, we were pricing six Fed rate cuts at one point in 2024. Now, we're basically pricing one. And obviously, that's had a big market impact. The good news here, since a lot of the Chinese growth we saw in Q1 in particular was export-led, and while that does ruffle feathers politically and geopolitically, it does mean that China's exporting deflation to the rest of the world, because it's basically dumping more goods at lower prices in order to clear inventory. That may actually prove helpful, to the extent those goods flow into Western consumers' pocketbooks and garages. I think that could help, over time, get inflation lower, get the Fed easing cycle brought forward somewhat, and maybe help the ECB with its easing cycle, as well. So, it remains to be seen. But I think at a macro level, Chinese deflation exported to a global economy where there's too much inflation is going to be helpful.

Anisha Goodly: Blaise, Brett, let me try to put some of this together, because I want to really talk about now your EM outlook. But if you step back, you've talked about U.S. economic resilience faster than expected Chinese growth, the potential for exported deflation out of China to give some relief on the inflation front. Brett, you've talked about your continued base case view that the geopolitical conflict between Israel and Hamas would remain contained. How do you think about the EM outlook in that context, and maybe where are you finding the best opportunities in your regions?

Blaise Antin: I think the EM outlook is mixed. I think there is a lot of differentiation out there, and it really varies from region to region, and also from country to country. Obviously, those countries where you either have the best macros in terms of solid fiscal and prudent monetary policy combined potentially with sort of a relatively lower debt stock coming into all of this.

Anisha Goodly: And you would say the fiscal and EM on the whole is better.

Blaise Antin: For sure. For sure. I mean, there was a lot less EM fiscal stimulus pumped into the system, pumped into economies during COVID and the aftermath than we saw in developed market economies, so debt levels much, much lower. And, you know, we've seen a lot of easing already by EM central banks, you know, beginning last year, continuing into this year. How much further that easing can go will depend a little bit on what happens with the Fed and the ECB in the coming quarters. But I do think we'll see continued easing by EM central banks. I think the one thing I would just maybe add on the globalization theme we discussed earlier, the concepts of near-shoring and friend-shoring have been discussed quite a bit, and they were very much in discussion in Washington during the spring meetings. You know, they don't mean the same thing. Friend-shoring is working with your allies. Near-shoring is working with countries you like that are close to you. And so, there are winners and losers depending on one's interpretation of that. Turkey sits on the doorstep of Europe. South Africa much further removed from major economies geographically. That's a factor that investors will have to think about going forward regarding potential growth in the medium to long-term. So, I think we're opportunistically constructive. Countries like Brazil, Turkey, some really good stories unfolding there. Some of the distress space that Brett can talk to, and has talked to a little bit, also with some good opportunities as well. So, you know, it's a mixed market, but we're also in a high-for-longer environment where carry is quite a bit higher than it was in the years, certainly during COVID and preceding COVID. So, the investment landscape has its attractions at this point. There's no denying that.

Brett Rowley: Yeah, and I would say, you know, maybe just starting with the Middle East, you know, with the conflict continuing, clearly there's a premium in oil prices. You know, the experts say about a $5 to $10 a barrel premium in oil prices currently. So, to the extent that if we do get a ceasefire agreement, or some kind of truce, or see some de-escalation, there could be some upside for some of the Middle East credits that have suffered during this. And thinking, you know, specifically Lebanon and Jordan, some of those that have felt the pain of the regional crisis more than others. Obviously, the oil producers with prices being higher, that benefits them to some degree, but then you get into the discussion more about supply and demand of oil. So far, the conflict has actually not had much of an impact on oil supply. If, for whatever reason, there's an escalation where it does impact oil supply, the straight and foremost is, you know, they try and close that. Or Iran starts to attack, or some of its proxies start to attack oil infrastructure, you know, throughout the region. Then we could see a significant spike in oil prices.

Anisha Goodly: And if that were to happen, would you expect, you know, countries like China to also verbally step in and try to shut that down?

Brett Rowley: Yes, they have clearly, even so far, with what we've seen in the Red Sea, China has, you know, made their opinions well known that they would like the Houthis to step down and try and restore some order with shipping, just because of how much it's raised shipping prices to China, for example. So clearly, I think the international community is trying to keep this situation contained as much as possible. But we've said the risk of calculations can be high. I would say within Africa, though, particularly on the frontier, I would expect, you know, high yield generally to continue to outperform. And specifically, within Africa, I would look for the countries that are undertaking reforms that are in IMF programs that are moving ahead in the restructuring process. You know, that's where I would place my bets. We've seen with the successful transactions in Kenya, Ivory Coast and Benin earlier this year, that's really reopened the market for some of these single B issuers, which could be opportunities later this year. And then the one thing that I would say, some of the turnaround stories that we talked about last time, Nigeria and in Egypt, for example, they've significantly devalued their currencies. They've hiked interest rates aggressively. And so there's some really interesting local currency opportunities that we haven't seen in years in the frontier.

Anisha Goodly: Blaise, do you want to jump in on that?

Blaise Antin: Yeah, there's one thing I think should be addressed, which was very much on investors minds in Washington and very much front and center in discussions was obviously there's a big U.S. election coming up in November. And, you know, depending on what particular issues one is looking at, there's some binary potential outcomes. I think on China, no matter who wins, it's going to be tough going between you and U.S.-China relations. But I think investors really are uncertain if there is a second Trump administration, what that would mean for a number of key international institutions and what it would mean for U.S. policy, foreign policy and economic, international economic policy. A lot of questions from investors on that. And a lot of Trump advisors and former advisors were meeting with investors trying to explain how to think about a potential Trump scenario. And I think there were no firm conclusions because there really probably can't be any at this point. But that's, I think, as we get closer to November, going to be a very big factor for investors in the U.S. as well as global emerging markets.

Anisha Goodly: Blaise and Brett, thank you so much. That's all that we have time for today. This is very productive, very thorough. I really enjoyed hearing your comments. For more information on TCW strategies, please visit our website at TCW.com. Thanks for listening. And we'll pick up next time exploring the trends and opportunities shaping global markets.