Stirring positive change - Tipping points in emerging markets

Emerging Markets Outlook 2025

Triodos Investment Management

A great deal has occurred in the second half of 2024 that is impacting emerging markets. The US Federal Reserve has finally begun cutting interest rates, creating a positive sentiment around emerging markets. China's economy has managed to muddle through. However, global fragmentation persists, and protectionist pressures are rising, especially with Donald Trump's victory in the US presidential election. In 2025, we expect growth in emerging markets to slow somewhat, with inflation likely to rise modestly due to broad US tariffs on imports and weaker currencies.

Stirring positive change - Tipping points in emerging markets

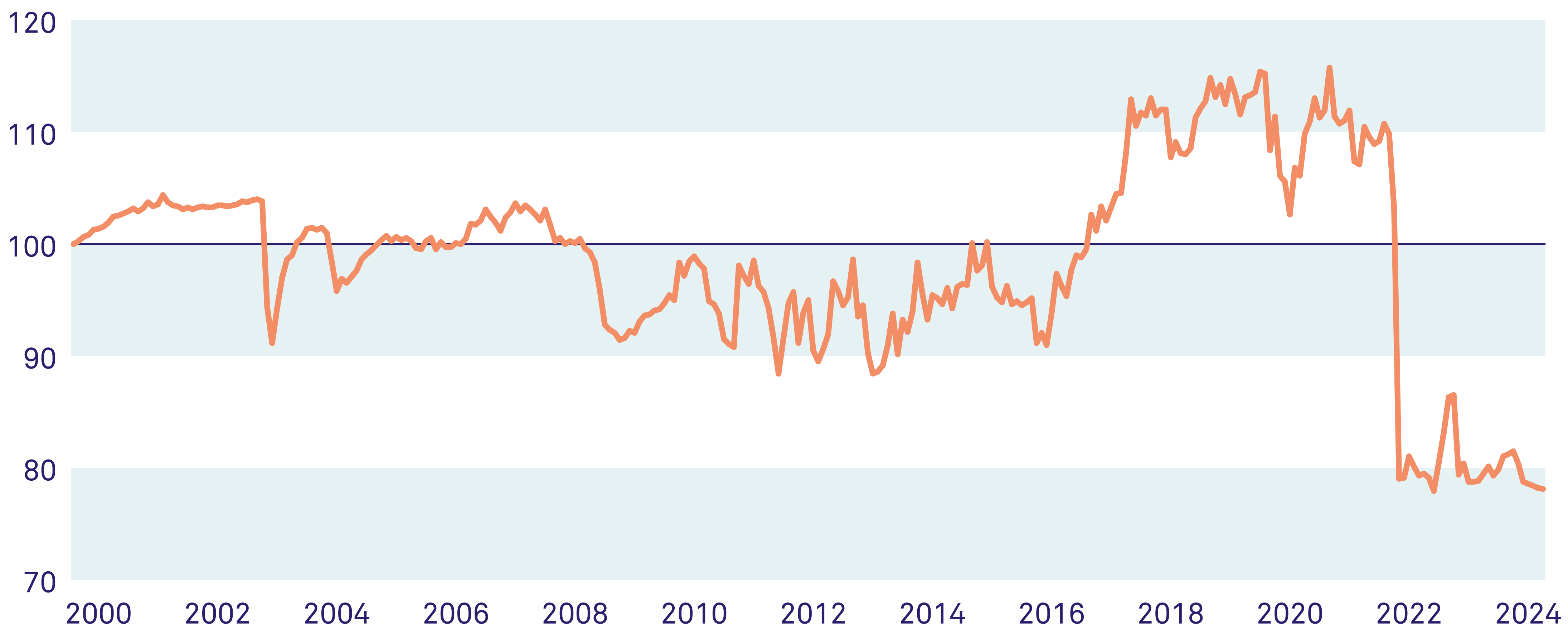
Risks have been shifting from inflation to global fragmentation. Emerging markets have been preparing for a more fragmented global landscape through alternative trade arrangements and are more resilient compared to past episodes of de-globalisation. In this outlook, we explore some game-changing developments that could lead to irreversible adjustments – tipping points. If steered in the right direction, these shifts could create a positive feedback loop for emerging markets, although the efforts required are large.

Steady growth in a turbulent environment

In 2024, economic growth in emerging markets has so far exceeded market watchers' expectations, hovering around 4%. This despite the uncertainty around China's economic slowdown. To reach its 5% GDP growth target, China's leadership this year focused on targeted stimulus to support the property market and on boosting export growth. The most recent support is a USD 1.4 trillion fiscal package, mainly aimed at restructuring the finances of local governments. This will reduce their cost of financing, but it is unclear how this additional stimulus will help households. This explains why China-watchers are expecting more support once the new US trade policy is rolled out. But there is some urgency in China's rebuilding consumer confidence (see Figure 1). Social welfare must improve, and more jobs must be created – particularly in the services sector with its low carbon footprint. Emphasising sustainable growth in the services economy could help drive China's long-term stability and reduce environmental impacts.

Additionally, a record number of elections in emerging markets have taken place this year, reshaping political landscapes, including in India and South Africa. Meanwhile, elevated geopolitical risks are changing the global trade landscape, which is becoming more fragmented, with rising protectionism. Flexible exchange rates and credible emerging markets' central bank policies have helped in tackling inflation (see Figure 2). Inflation in these markets has largely stabilised this year after a rapid decline over the past two years, although significant regional disparities persist. Emerging Asia, including countries like Indonesia, the Philippines, Pakistan and Sri Lanka, has made notable progress toward central bank inflation targets. In several African countries, by contrast, reducing inflation has proven more challenging. Double-digit inflation persists in Zambia, Sierra Leone, Nigeria and Ghana. In these countries, food prices have been the primary driver of inflation.

Figure 1 China NBS consumer confidence (index, January 2000 = 100)



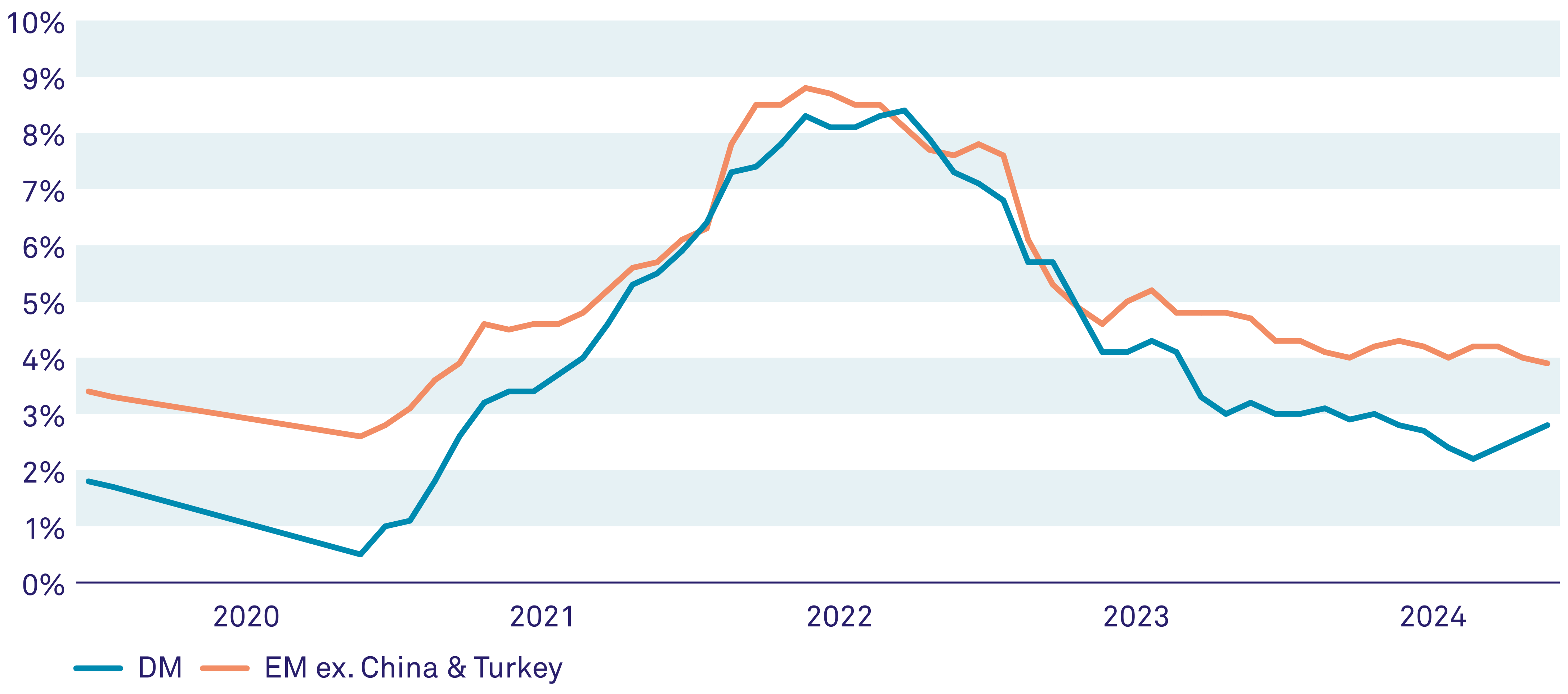
Source: LSEG Datastream

Favourable investor sentiment

Investor sentiment towards emerging markets has generally improved, bolstered by expectations of rate cuts from the major central banks, which would reduce borrowing costs and strengthen local currencies against the US dollar. However, not all factors align with these expectations. Tensions in the Middle East escalated in September and the US elections in November increased financial market volatility. Consequently, the US dollar has strengthened as a safe-haven currency, muting the anticipated boost to emerging markets from lower rates and a weaker dollar.

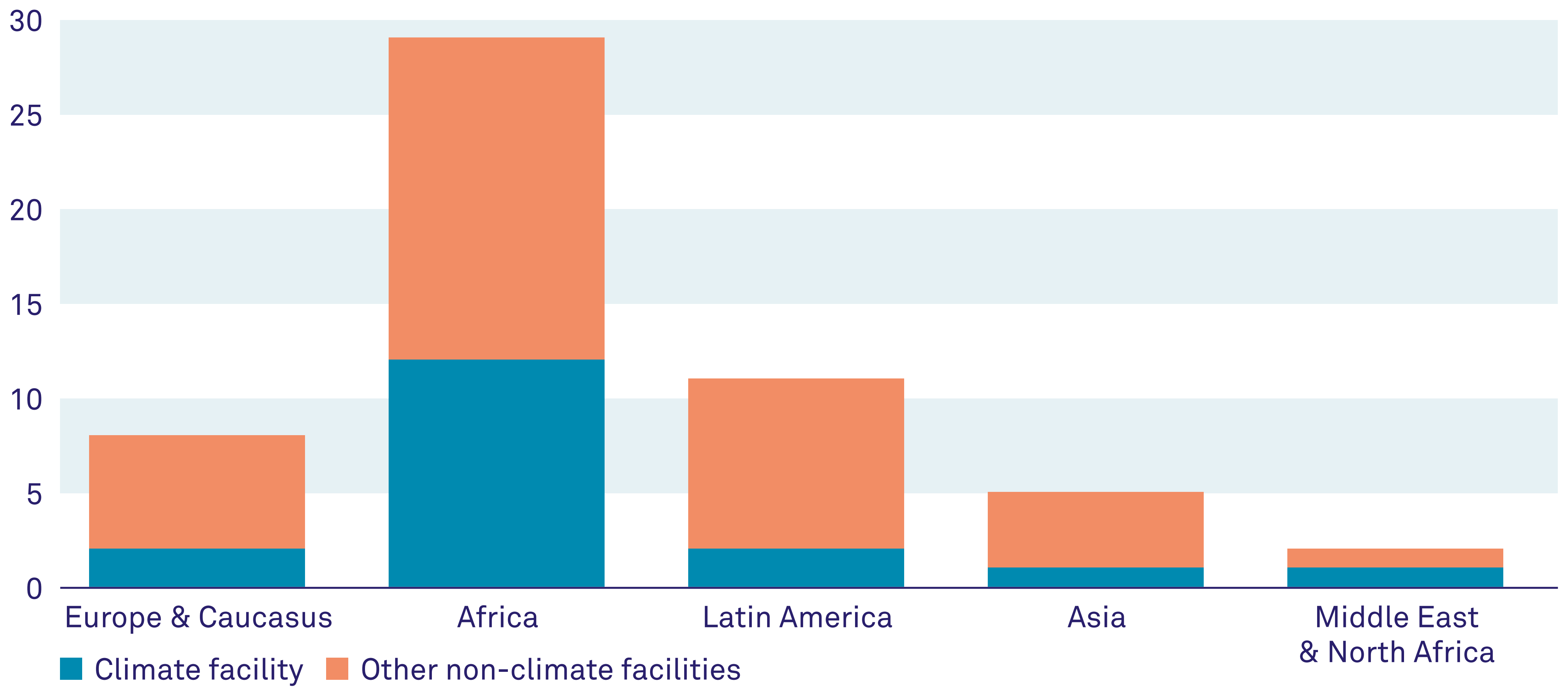
Despite these challenges, emerging markets, including Brazil, India and Romania, have continued to attract steady inflows of private capital, albeit primarily short-

Figure 2 Headline inflation (%, year-on-year)



Source: National statistics

Figure 3 Number of countries with active IMF programmes (October 2024)



Source: IMF, some countries have more than one type of funding facility

term investments. In the first half of the year, India in particular benefitted from investor caution toward China amid rising risks, leading to a surge in its equity markets. Overall, foreign investment in emerging markets has been largely short-term, with limited patient capital inflows.

One indicator of resilience in emerging markets is a decrease in IMF financing facilities in 2024 compared to the previous two years. Progress towards IMF targets has generally been positive, and there have been no sovereign defaults reported so far this year. Many countries are increasingly seeking multilateral support to address climate change challenges, with Africa hosting the largest number of active IMF climate programs through the Resilience and Sustainability Facility (see Figure 3).

Overall, emerging markets have performed exceptionally well, given the complex global landscape. Humanitarian crises are unfolding in the Middle East, the war in Ukraine is intensifying and tensions have escalated with the involvement from both North and South Korea. Geopolitical fragmentation has been expanding but has not yet hurt global trade volumes because alternatives are being sought. A second term for President Trump will certainly have implications for emerging markets. Fortunately, many countries are now better prepared to handle shocks with stronger buffers and more flexible currency systems.

Outlook: steady but not transformative

Our base scenario for 2025 anticipates no recession in advanced economies. However, we expect emerging markets' GDP growth to decelerate slightly, while inflation edges up. Both growth and inflation are likely to vary more widely across emerging markets, reflecting persistent global tensions that are creating negative feedback loops.

Several key factors are dampening the growth outlook in emerging markets. First, the escalating wars in Ukraine and the Middle East, alongside intensifying trade and security tensions between China and the West, are deterring patient capital. Second, the new Trump administration will likely reshape US policies on migration, trade and development finance, pressuring inflation in emerging markets via weaker currencies and impacting growth through reduced remittances and external support. Finally, as advanced economies redirect budgets toward defense and adapt to more protectionist trade structures, less foreign capital would be available to support vulnerable countries with high financing needs.

These forces are straining the global rules-based order and there is a risk of this order being pushed towards a negative tipping point, with destabilising feedback effects. There are alternatives, however, to leverage positive tipping points and forging a path toward resilience and sustainable growth.

Reducing the risk of negative tipping points

Creating the conditions for lasting opportunities with positive spillover effects for emerging markets requires multiple transformations. There is no single solution to reach a positive tipping point. But steering change in the right direction is a good begin. Decisions made by the US, the EU and China have significant global repercussions. All three must consider broader implications, incorporating the perspectives of other regional players to build sustainable solutions. Without such inclusivity, geopolitical fragmentation could become entrenched, imposing high societal costs and delaying critical transitions, such as the shift to renewable energy. While imbalances persist across many areas, addressing a few key ones can help trigger the change that eventually leads to positive tipping points.

- **The role of geopolitics in triggering change.** Emerging markets are increasingly aligning within geopolitical blocs, as the recent BRICS summit shows. This summit gathered Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia and the United Arab Emirates, with many more countries expressing interest in joining, although so far expansion has been limited. The countries represented at the BRICS+ summit share one major concern: their prosperity largely depends on access to foreign markets. According to the IMF, fractured trade would impact emerging markets twice as much as advanced economies. Meanwhile, Western nations are moving towards common ground on trade protectionism and stricter migration controls, downgrading their commitments to development finance, including efforts in poverty alleviation and climate action. As countries seek to mitigate the impact, trade between the BRICS+ has been increasing, while the blocs' trade with the US and EU has been declining. The problem is that the BRICS+ only offer a partial framework to replace the conventional financial system. The US dollar is far from being replaced.

  There is a pressing need to redefine a more inclusive multilateral system – one that empowers a wider range of countries to participate in decision-making, rather than leaving a few to determine what is best for all. Challenges like climate change and migration are global in scope; if fragmentation becomes the norm, it could have devastating consequences. Economic ties have historically fostered additional foreign direct investment, knowledge sharing, innovation and even peace between countries. The alternative will make the world weaker.

- **The role of China in triggering change.** As the world's second-largest economy, China is a key player in the global power balance, its choices carrying worldwide consequences. China took the path of innovation over the past few years, but this has not created positive spillovers. Rather, trade partners have seen this as a risk to security. For China to ignite a positive cycle both domestically and internationally, several elements need to align, including the recognition that enduring international relations are built on partnerships, even with competitors. So far, China has largely focused on competition and its best interests, like the other leading powers. There is still uncertainty around China's role if President Trump successfully dismantles the Inflation Reduction Act, which has supported the US clean energy transition in recent years. Should that happen, China could gain a critical edge in the global clean technology race in emerging markets. The country is in a position where well-conceived choices could generate positive spillover effects globally.

- **The role of renewable energy in triggering change.** For emerging markets, the renewable energy transition makes economic sense and can initiate a positive feedback loop. Not only does renewable energy make power more affordable and accessible for the poorest households, it also creates demand for complementary clean technologies, such as energy storage batteries, heat pumps and other sustainable infrastructure. It also spurs innovation. The scramble for lithium has stimulated research into sodium-ion batteries. These interconnected advancements are fueling a "multi-level" positive cycle, driving the rapid global growth of clean energy. India, for instance, has **shown strong ambition** to double its capacity of renewable energy by 2030. Other countries, including Brazil and regions like the Middle East and North Africa, are pursuing similar goals. When we cross the tipping point and renewables become the new normal, we will enter a carbon-free society.

Key role for investors

However, this is easier said than done. Countries need adequate financing to help low-income households shift to renewable energy, ensuring no one is left behind. Without support, households that cannot afford to invest in renewable energy will have to stay on the old energy grid – with prices rising, as fixed costs will have to be borne by a smaller group of consumers. Chile and Pakistan have been confronted with this unintended development. Additionally, the current preference for trade blocs increases the economic costs of the clean energy transition, as supply chains become fragmented and knowledge sharing declines.

To drive positive tipping points, countries, particularly major economies like the US and China, should avoid acting in isolation. Unilateral approaches will only heighten global fragmentation, potentially triggering a negative tipping point with undesired feedback loops. At the same time, investors are critical in providing the financing to steer change in the right direction, including in the areas of trade, renewable energy and poverty reduction. Together these areas offer the right path forward to start a meaningful transformation.

Forecast table- emerging economies selected countries

	GDP growth (% yoy)			Inflation (CPI, % yoy avg)			Government debt/GDP (%)			Government balance/GDP (%)			Current account/GDP (%)		
	2023	Forecast 2024	Forecast 2025	2023	Forecast 2024	Forecast 2025	2023	Forecast 2024	Forecast 2025	2023	Forecast 2024	Forecast 2025	2023	Forecast 2024	Forecast 2025
Belarus	3.9	3.2	2.8	5.0	5.4	4.1	30.5	31.1	31.7	0.8	1.5	1.7	-3.2	-4.3	-4.4
Bolivia	3.1	1.8	2.2	2.6	3.7	3.6	90.7	93.9	95.7	-10.3	-8.9	-10.0	-2.5	-4.0	-4.5
Brazil	2.9	3.0	2.5	4.6	4.0	3.8	79.0	79.2	79.5	-8.9	-8.8	-8.0	-1.0	-2.0	-2.3
Chile	0.3	2.4	2.6	7.6	4.2	3.4	28.6	26.9	25.4	-2.4	-1.3	-1.9	-3.5	-2.9	-3.4
China (mainland)	5.2	4.9	4.6	0.2	0.4	1.5	30.7	31.9	33.0	-4.6	-4.4	-4.8	1.5	0.9	0.4
Colombia	0.6	1.6	2.7	11.7	6.7	4.3	27.3	25.0	23.0	0.0	-5.3	-4.7	-2.5	-3.7	-4.5
Ecuador	2.4	-0.2	1.4	2.2	1.8	2.1	45.6	45.6	45.0	-3.5	-3.7	-3.1	1.7	3.1	2.3
India	8.1	6.8	6.6	5.7	4.7	4.7	52.6	50.5	49.1	-6.1	-3.7	-4.8	-0.8	-0.5	-1.6
Indonesia	5.0	5.1	5.1	3.7	2.5	2.8	42.3	40.8	39.2	-1.4	-2.7	-2.9	-0.2	-0.8	-0.8
Ghana	2.9	4.9	4.5	39.2	22.1	14.4	61.0	58.0	55.0	-4.9	-5.0	-4.1	1.8	-2.2	-2.2
Kazakhstan	5.1	4.1	4.4	14.7	8.8	7.3	25.7	25.8	25.5	-2.4	-2.9	-2.8	-3.3	-1.9	-1.7
Kenya	5.6	5.0	5.4	7.7	4.7	3.7	62.2	60.2	58.2	-5.8	-4.4	-3.6	-4.0	-4.5	-5.7
Mexico	3.2	1.4	1.4	5.5	4.8	4.3	36.4	36.2	36.0	-3.4	-5.5	-3.7	-0.3	-0.2	-0.6
Pakistan	0.0	2.5	3.3	30.8	13.0	6.6	85.3	87.9	86.2	-7.7	-7.5	-7.5	0.2	-1.9	-1.8
Peru	-0.5	2.8	2.8	6.3	2.5	2.3	34.7	34.4	33.8	-2.8	-3.2	-2.2	0.8	1.7	1.1
Philippines	5.6	5.8	6.0	6.0	3.2	2.9	52.7	51.1	49.8	-6.2	-5.7	-4.8	-2.6	-1.6	-1.1
Poland	0.1	3.1	3.9	10.9	3.9	4.4	58.1	56.8	55.4	-4.8	-5.7	-5.5	1.5	0.6	-0.4
Russia	3.6	4.0	2.5	5.9	8.5	6.9	22.9	14.1	6.6	-2.3	-0.2	0.0	2.5	0.4	3.6
South Africa	0.7	1.1	1.8	5.9	4.5	3.8	76.6	75.1	73.8	-4.3	-3.9	-3.4	-1.6	-1.7	-2.0
South Korea	1.4	2.4	2.1	3.6	2.4	2.0	53.4	54.0	54.6	-1.5	-2.2	-1.7	1.9	3.8	3.7
Thailand	1.9	2.7	3.2	1.2	0.7	1.3	54.2	54.0	54.4	-2.8	-3.1	-3.2	1.9	1.4	2.1
Turkey	5.1	3.6	2.6	53.9	58.3	28.1	25.4	24.9	24.5	-5.2	-3.9	-3.7	-4.0	-1.5	-1.5
Uzbekistan	6.0	6.5	5.3	10.0	9.0	6.5	41.0	41.6	40.4	-5.5	-5.4	-5.0	-8.6	-7.3	-6.9

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Investing in positive change

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