Perspective from
Franklin Templeton Fixed Income

Navigating uncertainty: The impact of the 2024 US elections on emerging markets

October 2024

Introduction

This has been an election-heavy year for emerging markets (EMs), thus far yielding some landmark results that are already affecting the policy outlook in several countries, including Mexico, South Africa and India. Indeed, roughly half of the global population is, or has been, directly impacted by an election this year. Still, we believe the election that's likely to have the broadest impact across the whole of the emerging markets universe, with some of the most consequential tail risk scenarios, is the US election.

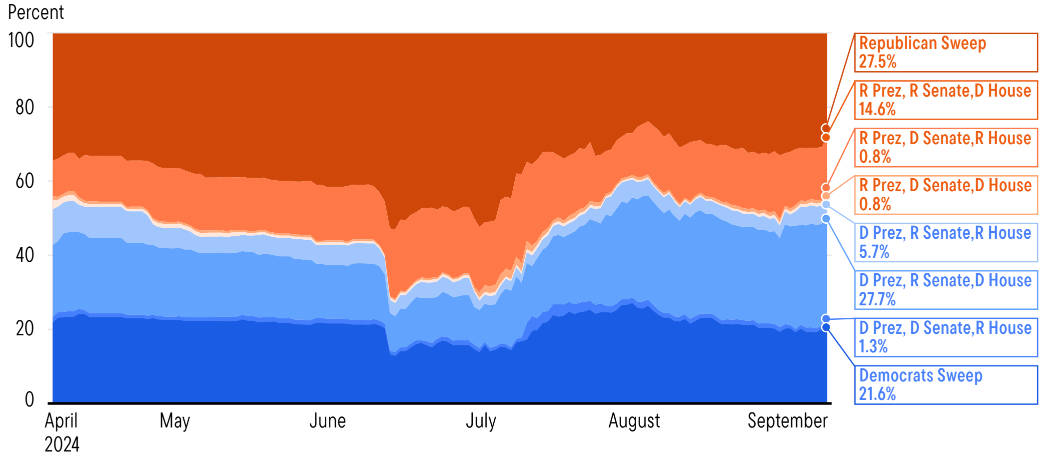
The potential return of President Donald Trump, and in particular the possibility of a Republican sweep in Congress, may mean a return to a policy agenda that prioritizes US protectionism and isolationism possibly to the detriment of free trade and international cooperation between the United States and its partners around the world. The precise policy mix is difficult to forecast, as are the implications, since policy priorities (in both parties) can have offsetting macro effects. On the whole, however, we see a much more difficult environment for emerging markets under Trump, especially with respect to long-term growth expectations, and especially in the event of a Republican sweep, whereas a Kamala Harris victory is more likely to represent a continuation of the status quo on issues relevant to EMs.

In the following sections, we'll cover four broad election outcome scenarios—Trump with a Republican Congress, Trump with a divided Congress, Harris with a divided Congress, and Harris with a Democratic Congress—and provide an overview of the potential implications of each for US trade policy, foreign policy and domestic policy, with a focus on some of the more extreme cases and their implications for emerging markets. Given the lack of clarity in polling and the uncertainty around policy implementation, it's extraordinarily difficult to make any sweeping predictions, but on the range of outcomes and potential scenarios, we can provide perhaps a bit of clarity.

US Election Risks

Exhibit 1: The Result Is Too Close to Call at the Moment

2024 US Election: Balance of Power



Sources: Polymarket, Macrobond, Franklin Templeton Fixed Income Research. As of September 23, 2024.

US Elections

Exhibit 2: Scenario Analysis by Polymarket Probabilities

President	Trump	Trump	Harris	Harris
Congress	Republican	Divided/Democrat	Divided/Republican	Democrat
Likelihood	28%	16%	37%	20%
Trade Policy	Tariffs very likely but uncertainty remains around timing, level, and scope. Our base case is for China tariffs to move to 50%-60% from 25% and ROW to increase to 10%. For Mexico, the USMCA is renewed with tweaks.	Tariffs likely. Base case is for China tariffs to increase, but unlikely to move to 50%-60% from 25% and ROW to increase to 10%. Timing could be impacted by passage of domestic policies.	A continuation of the Biden administration (e.g. Section 301, 100% on EVs, steel, aluminium, batteries), but non-tariff measures could become more stringent under Harris (e.g. country of origin labeling).	A continuation of the Biden administration (e.g. Section 301, 100% on EVs, steel, aluminium, batteries), but non-tariff measures could become more stringent under Harris (e.g. country of origin labeling).
Foreign Policy	The end of Pax Americana? Trump threatens withdrawal from NATO but stops short of pulling out. Reduced support for Ukraine and Taiwan. Strongly anti-Iran and more support for Israel and stronger relations with authoritarian regimes. Sanctions likely to be used willingly to further trade agenda with China a likely target.	Pulling out of NATO requires a two-thirds majority in the Senate, which seems unlikely. Sanctions possibly used to pressure China. Likely to be more support for Israel and stronger relationships with authoritarian regimes.	Continued support for Ukraine (gradually dwindling) and status quo regarding support for Taiwan with a firm stance against Chinese aggression. Continued strong support for international bodies such as NATO. Sanctions on China unlikely to be broadened unless in response to aggression.	Expect continued support for foreign partners with further deepening of relations with key allies. A firm stance on China and Russia. Increase prominence of climate change and human rights considerations in foreign policy. Sanctions unlikely unless in response to aggression.
Domestic Policy	Up to a full extension of the Trump Tax cuts set to expire in 2025, offset in part by higher tariff revenues. Deficits increase and both inflation and growth expectations deteriorate. On immigration a much tighter policy constrains potential labor force growth and output growth by extension, offsetting some gains from expansionary fiscal policy, while the impact on inflation is more balanced.	Partial extension of the Trump tax cuts offset by an increase in tariff revenue, with net impact on deficits less clear. Tariffs are net negative for growth and pose upside inflation risks. Tighter immigration policy constrains labor force growth and output growth, with a neutral effect on inflation.	Status quo likely, with some Trump-era tax cuts extended on lower income workers. Some social benefits, such as a higher Child Tax Credit, could find bipartisan legislative support. Deficits rise marginally. No major changes to immigration policies.	Trump tax cuts expire on high earners and higher corporate taxes are introduced, along with new taxes on the very wealthy. New spending on social programs more than offsets the revenue effects, pushing deficits higher. No major changes to immigration policies.
Market Impact	In the US, we expect a stronger US dollar and higher US Treasury yields, leading to tightening financial conditions. Weaker growth expectations could impact commodities further, although China tariffs are partially offset by a weaker currency and supply-chain reorganization. EM-EM trade seen increasing, with some deflationary implications for Southeast Asia.	A continuation of loose fiscal policy in the United States will most likely keep inflation elevated and constrain the Fed in its easing efforts. US interest rates will have a higher floor, which will be negative for global fixed income markets in the long run. This should mean continued strength of the US dollar.	A Harris victory would likely be positive for risk assets in the short term. This outcome will allow the Fed to stay on track with its easing cycle; however, medium term we expect inflation to remain elevated with loose fiscal policy and therefore US rates to have an elevated floor.	Anticipate a relief rally across global markets as the outcome would imply "political continuity." This outcome will allow the Fed to stay on track with its easing cycle, however, medium term we expect inflation to remain elevated with loose fiscal policy and therefore US rates to have an elevated floor.
Implications for EMD Positioning	Short duration US-dollar denominated EMD outperforms local currency, which suffers from the stronger US dollar pressure. Weaker EM credits are potentially more vulnerable to refinancing risk in this environment of tighter financial conditions and Central American countries with heavy reliance on remittances are vulnerable. US-dollar-denominated corporates in China underperform moderately due to sanctions risk. Economies that have stronger domestic demand dynamics potentially outperform.	Ukraine and China likely to be most vulnerable within the EM space with risks of funding cuts and sanctions weighing on their performance. Immigration policy could have negative implication on remittances for Central American countries. A stronger US dollar will mean EM foreign exchange is likely to weaken and the limited room for the Fed to cut could also mean that EM central banks are limited in their ability to cut rates.	EMs that would most likely benefit from this outcome include Ukraine, where financial support will remain in place under Harris. Furthermore we could see the pricing out of a more aggressive policy toward China, with Chinese assets outperforming. The US dollar would likely be less strong than under the Trump scenarios, supporting local currencies.	EMs that would most likely benefit from this outcome include Ukraine, where financial support will remain in place under Harris. Furthermore we could see the pricing out of a more aggressive policy toward China, with Chinese assets outperforming. In the near term, we could see the weaker US dollar trend continue to the benefit of local currency.

Source: Franklin Templeton Fixed Income Research. Note: ROW stands for Rest of the World; HoR stands for House of Representatives. There is no assurance that any estimate, forecast or projection will be realized. As of September 23, 2024.

Trade outlook

Growth

Tariffs would threaten both US and global growth by disrupting trade and investments, raising production costs and curbing economic output. Empirical evidence shows that tariffs have a sizeable negative effect on output growth, with detrimental effects persisting over years.[1] Trump's proposed 60% tariff on Chinese imports and 10% global tariffs would likely reduce US trade volumes significantly and hit US growth as a result. Higher input costs would fuel producer and consumer price inflation and reduce disposable income, especially for lower-income households.[2] This would likely weaken consumer spending and force businesses to raise prices or cut investment and production, further hindering US growth.

Globally, export-reliant economies would face reduced trade volumes, with currency depreciation offering only partial relief. Globally, export-reliant economies would face reduced trade volumes, with currency depreciation offering only partial relief. Asia looks to be most vulnerable, especially since the region that excludes China and Hong Kong has seen a notable increase in exports to the United States since 2017 (Exhibit 3). The potential impact of a Chinese slowdown, given an expected reduction in trade volumes to the United States, is likely to add further pressure on the region. Drilling into country specifics, markets like Vietnam, where US trade makes up 22% of gross domestic product (GDP), Costa Rica (10%), Thailand (9%) and Malaysia (9%) would be particularly disrupted by Trump's global tariffs (Exhibit 4). A rollout of broad tariffs may also push companies to shift from nearshoring to onshoring, further fragmenting global supply chains and disrupting corporate activity. This would erode business confidence and slow capital investments, both vital for growth across EMs. China, already weakened by the 2018-2019 trade war when GDP fell from 6.9% to 5.8%, and with a frail economy still trying to resolve the issues in its property sector, would face added pressure. While devaluing the renminbi might cushion some impact,[3] it wouldn't fully offset the potential rise in tariffs from around 20% to 60%, and hence some reduction in trade volume seems unavoidable, especially given that the incremental impact may not be uniform across all exports. Second-order effects loom, as corporate investment in China fell sharply from 9.4% to 2.7% during the previous trade war.

In Latin America, Mexico could face growth challenges under Trump, particularly in the automotive and agriculture sectors, given that 79% of its exports go to the United States (ca. 27% of GDP) (Exhibit 5). However, we believe Mexico remains shielded under the USMCA trade pact at least until the 2026 renegotiation when stricter non-tariff barriers like rules of origin will likely come into play. Conversely, some countries will benefit. During Trump's first term, shifts in competitive pricing and the building of new alliances resulted in increased demand from China for agricultural products out of Brazil.

A Republican Sweep Could Reintroduce Aggressive Protectionist Policies, Potentially Hurting US and Global Growth

Exhibit 3: US Imports Have Been Rerouted to Broader Asia
Exports to the United States (% of Total Exports, 12-Month Trailing)

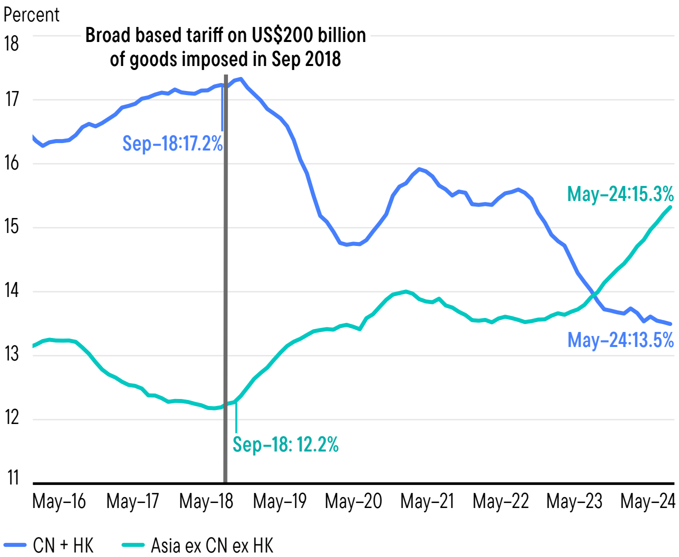
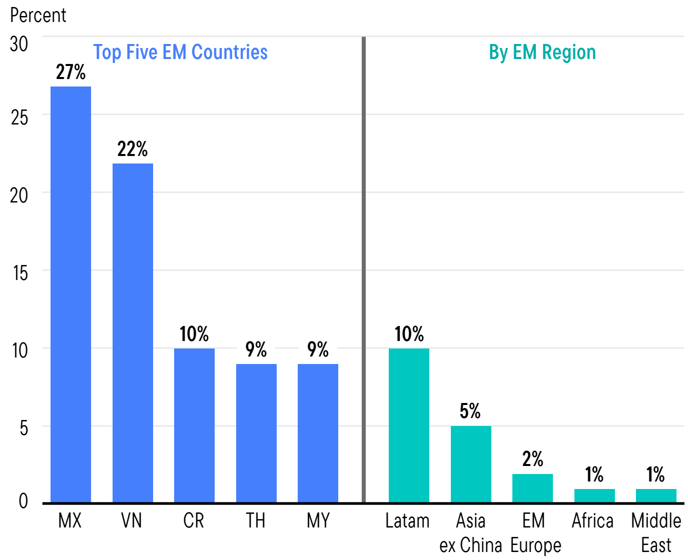


Exhibit 4: Trade-Reliant Economies Are Most Exposed to Tariffs
Exports to the United States (% of GDP)



Sources: UN, IMF, Morgan Stanley, Franklin Templeton Fixed Income Research. As of end December 2023.

A Harris presidency with a divided Congress would likely safeguard US growth by ensuring trade stability while favoring targeted (but less strict) non-tariff measures with limited economic implications for EMs. By upholding agreements like USMCA and CAFTA-DR, among others, she would reduce supply-chain disruptions, control trade-related inflation, and sustain consumer spending, leading to steady US growth. Globally, this approach would likely minimize supply chain issues, benefiting emerging markets like China, Southeast Asia, and Mexico. Harris's policies would be more supportive for investments and capital flows in EMs. This strategy would sustain global economic momentum while keeping the US competitive in sectors like technology and clean energy, ensuring broad benefits across domestic and global markets.

Inflation and foreign exchange (FX)

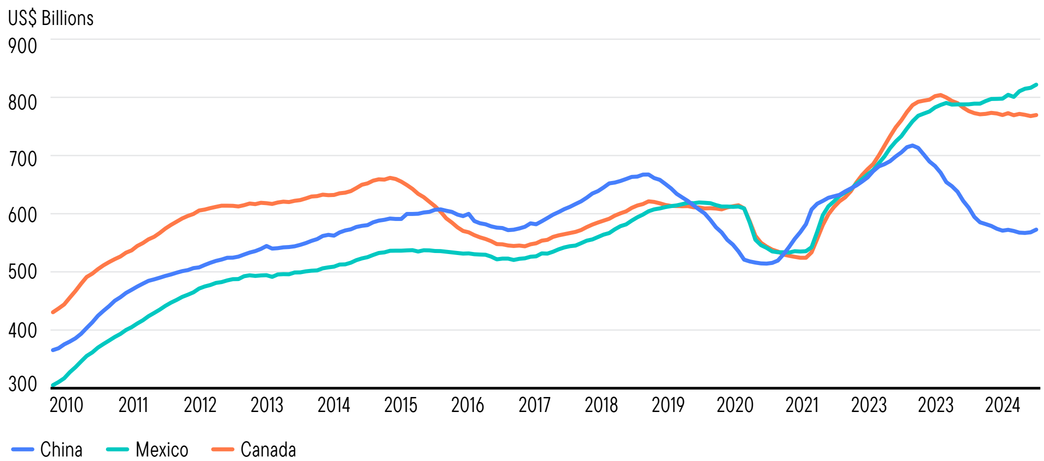
During the 2018 steel and aluminum tariffs, prices initially spiked but stabilized within a year, leading to only a small impact on the US consumer basket. Some producers could absorb these costs, and weaker EM FX helped to partially mitigate price increases. The Federal Reserve (Fed) previously estimated that the 2018 tariffs caused a modest 0.2% rise in core personal consumption expenditures index inflation, showing limited long-term effects.[4] This time around, a Trump presidency seeks to propose extending tariffs to all Chinese imports (14% of US imports). This requires Congressional support to revoke China's Permanent Normal Trade Relations (PNTR) status. A red sweep outcome would therefore see elevated risks to inflation, potentially slowing domestic growth even further. In contrast, we expect a Harris presidency or Trump presidency with a divided Congress would be able to avoid broad tariffs of this magnitude, keeping inflation low for producers and consumers.

As for the implications for the US dollar (USD), a renewed Trump presidency would likely strengthen the USD as tariffs increase US inflation, leading to tighter monetary policy. Additionally, tariffs slow growth in exporting countries, prompting looser policies and weaker currencies, further boosting the USD as a safe-haven asset. Markets would anticipate a stronger monetary policy response from central banks, particularly in Latin America, where there is more room for easing compared to Asia. A stronger dollar could lead to capital outflows from EMs, weakening their currencies. Mexico could face added currency depreciation pressures due to the uncertainties surrounding the upcoming USMCA renegotiation. In contrast, a Harris presidency would likely bring more stability to the dollar by avoiding broad tariffs and minimizing trade disruptions. Trade stability under Harris would reduce the need for aggressive monetary easing in emerging markets, supporting stronger EM FX, boosting investor confidence, and moderating capital outflows, fostering a stable global economic environment.

A Harris Presidency Could Reduce Supply-Chain Disruptions, Benefiting China, Southeast Asia and Mexico

Exhibit 5: Mexico Has Overtaken Both Canada and China as the US' Largest Trading Partner

Trade (Exports + Imports)



Sources: CEIC, HSBC, Franklin Templeton Fixed Income Research.

Foreign policy

On foreign policy, the outlook hinges primarily on the presidential race,[5] with a Harris presidency expected to align with Biden-era policies[6] while a Trump presidency could deviate substantially on key issues.[7] The balance of power in Congress will have implications for foreign aid, with a blue sweep more likely to yield further support for Ukraine and less support for Israel at the margin, while a red sweep might yield the opposite.

Intervention in foreign conflicts

We expect Trump to push for a swift end to the war in Ukraine, being more transaction-led than optimizing the outcome for Ukrainians. He has suggested that he would withhold military aid from Ukraine unless it enters peace negotiations with Russia, and reports suggest that he'd take a similar approach with Russia, threatening increased aid to Ukraine if Russia fails to negotiate.[8] Challenged on whether he would like to see Ukraine "win the war," he has equivocated.[9] The shape and scope of a Trump deal isn't entirely clear but could involve, as a base case, a freezing of territory at the frontline and a promise from Ukraine not to join NATO. A peaceful equilibrium that retains Ukraine's sovereignty should be good for investors in the region, but we shouldn't dismiss the potential for adverse outcomes in a forced negotiation. Harris, on the other hand, is likely to continue supporting Ukraine and may push for further funding, although if she faces a divided Congress, she may struggle to get it and may need to lean more on NATO allies for support.

In Gaza, priorities are somewhat reversed. Trump has offered conflicting messages on the war, saying that he would "get that settled and fast,"[10] but he has also cultivated close ties with the Israeli Prime Minister, Benjamin Netanyahu, and has a history of siding with Israel. Under a Trump presidency, we would expect a higher likelihood of escalation in the conflict, potentially drawing in Hezbollah and Iran. Iran itself is likely to face pressure similar to what it faced under Trump's previous presidency, further escalating tensions. A spillover into the wider region would be a challenge for investors in Middle Eastern credits, but the impacts may be much more broadly felt depending on the full scale of the conflict. Harris, we expect, will seek to simultaneously retain Israel as an ally in the region while also remaining critical of Netanyahu's approach to the war in Gaza. That balancing act risks further eroding a long-standing alliance between Israel and the United States.

Use of sanctions

Under Trump, sanctions policy is set for a potentially volatile and incoherent realignment. China and Chinese companies are likely targets, as they were during his first term. Trump is especially likely to go after Chinese companies that seek to circumvent US tariffs via alternative trade channels. He's also more likely to enact sanctions as part of his anti-immigration efforts, with Venezuela a possible target, although he could just as well take the opposite tack with Venezuela President Maduro to win his cooperation. As for Harris, we expect policy continuity. The past few years have seen a growing skepticism within the Democratic Party about the utility of broad economic sanctions[11] with some effort to be more targeted in the imposition of sanctions, as we've seen in Venezuela.[12] We would expect Harris to adopt the same approach.

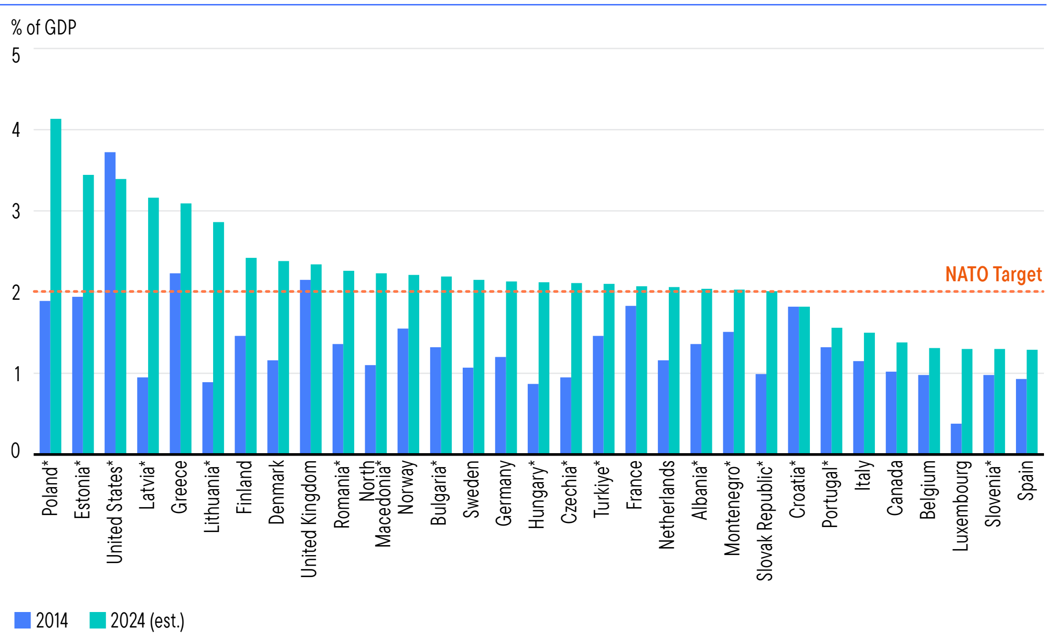
NATO and foreign bilateral relations

NATO has long been the subject of Trump's ridicule.[13] Pulling out of the alliance requires a two-thirds majority vote in Congress, so leaving isn't an option under any reasonable scenario. However, Trump may exert pressure on NATO members that fall short of their commitments to defense spending. Notably, most EM NATO members are expected to be in compliance with the 2% of GDP target this year, sparing them the fiscal implications of a potential defense spending pressure campaign from Trump.

In general, we believe a Trump presidency would likely erode US relations with traditional allies in favor of stronger ties with authoritarian leaders (and the like). Russia, Turkey, Saudi Arabia, Hungary, Serbia, Albania, Argentina, El Salvador and others might benefit to some degree from a Trump administration.

Most NATO Members Are Expected to Meet the 2% Defense Expenditure Target in 2024

Exhibit 6: EM Nations (*) Are on Track to Reach a Higher Rate of Compliance than Developed Markets this Year



Sources: NATO Public Diplomacy Division, Franklin Templeton Fixed Income Research. There is no assurance that any estimate, forecast or projection will be realized.

Domestic policy

Much can be (and has been) written on the implications of another Trump term for US domestic policy and its potential economic impact. We'll keep our focus narrow and address in broad strokes the outlook for fiscal policy and immigration, and we'll consider the effects on inflation, US rates, and the USD.

Fiscal policy

There is no scenario in which a significant fiscal contraction appears especially likely. A sweep for either party could invite some fiscal expansion, with a Democratic sweep coming with expanded benefits (ca. 1% of GDP) offset by a modest increase in taxes aimed at the high-income segment of the population and corporations (ca. 0.4% of GDP),[14] while a Republican sweep may come with a full extension of the Trump-era tax cuts (ca. 1.3% of GDP)[15] offset in part by an increase in tariff revenues (ca. 1% of GDP).[16] A split Congress would likely mean very little progress on expenditure reform but there would likely still be some agreement on a partial extension of tax cuts beyond their expiration in 2025. We consider sweeps to be more fiscally expansive, while splits yield more constraints, but are unlikely to yield a meaningful contraction in the federal deficit.

Given the bias to expansionary fiscal policy, especially in sweep scenarios, we expect upward pressure on long-term interest rates in the event of a red or blue sweep, while a split result is less clear.[17] We would also expect the USD to strengthen under Trump with the imposition of new tariffs, while under Harris the status quo of an easing Fed and slowing growth would likely be a net negative for the USD over the medium term. The key risk for EMs is in the Republican-sweep scenario, where we see a steeper rates curve and a stronger USD amid growth-limiting tariffs, an environment in which EMs face recession risk and potentially damaging retaliatory policy responses to US tariffs.

Immigration

The official platform for the Republican party lists as its two top priorities the full cessation of "the migrant invasion" at the border and the execution of the "largest deportation operation in American history."[18] The Democratic platform differs significantly in its appeal to migrants already living illegally in the United States and tends to prioritize a more targeted border control policy and a focus on voluntary returns rather than active removals.[19] In practice, both parties have been similarly active in immigration enforcement actions, deporting unauthorized migrants and pushing for cooperation from governments in Central and South America (Mexico and Panama in particular). That's likely to continue whether Harris or Trump wins in November.

Immigration Has a Profound Impact on both US Labor-Force Growth and Remittance Flows to EMs

Exhibit 7: US Labor-Force Growth under Trump and Biden

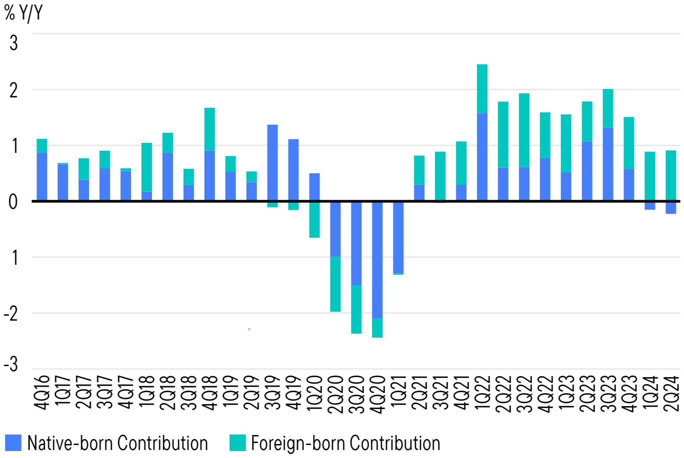
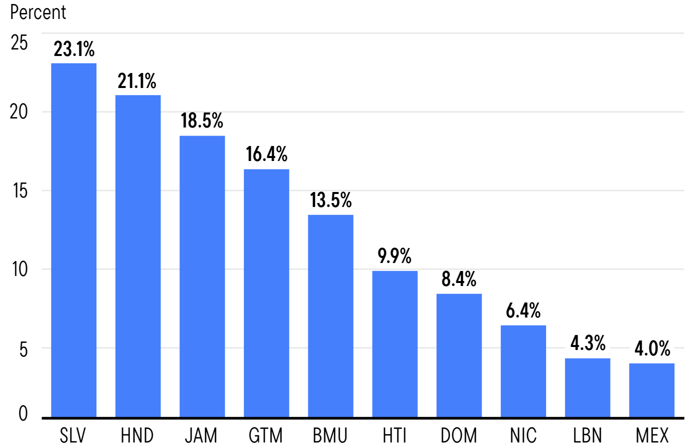


Exhibit 8: 2021 EM Remittance Flows from the United States (% GDP)[20]



Sources: US Bureau of Labor Statistics, KNOMAD, WB Bilateral Remittance Data, Franklin Templeton Fixed Income Research.

We believe Trump is likely to resume the efforts of his first term in limiting immigration to the United States, whether by rhetorical hostility to foreign nations or executive orders designed to discourage new entrants. That hostility poses a particular threat to labor-force growth in the United States, which has been recently fueled in large part by an influx of foreign-born labor. Under Trump, we expect the immigration issue to weigh on real growth expectations, at least temporarily. With respect to the inflation outlook under tighter immigration policies, the impact is ambiguous with offsetting demand and supply effects in the aggregate.

As for the impact on EMs, a weaker growth story in the United States is a net negative for EM broadly, and while a loss of immigrants in the United States may be another country's gain, the effect isn't likely to be offsetting and certainly won't be evenly distributed across EMs. Central America in particular is likely to face political pressure and rising violence in the short run, but some countries may benefit in the long run from a larger labor force under the right policy mix.[21] Remittances could also come under pressure over the long run, with El Salvador, Honduras, Jamaica and Guatemala particularly vulnerable as the top four beneficiaries of bilateral remittance flows from the United States as a share of their GDP. Granted, remittances have historically shown resilience to changes in immigration and US growth shocks, but restrictions on remittance flows have some precedence in the United States (Cuba has been subject to such policies) and Trump has suggested targeting remittances in the past (as a means of paying for the construction of a wall at the US-Mexico border).

Implications for Emerging Market Debt (EMD) positioning

The extreme difference in the two parties' policies and the conjunction of economic and geopolitical challenges make this US election of particular relevance outside of the United States. The shared narrative of prioritizing America provides risks across emerging markets but by far the largest risk, we believe, is of a Republican sweep, where a second Trump presidency would have full control to inflict harsh trade, economic and foreign policy without much consideration of second order effects. In all other probable scenarios, the lack of alignment across Congress and the White House makes downside scenarios much shallower and could allow for some relief to EM assets from current levels given the removal of the worst-case scenario.

In truth, the lack of specific detail on policy and the very large effects of multiple policies, acting concurrently across the globe make forecasting the exact impact nearly impossible. For example, the potential path of the USD, a key determinant in much of this analysis, is far from clear given the contradictory policy being discussed by candidates and the influence of how the US trading partners are likely to react to these policies. Adding to this uncertainly is the fact that the contest itself is extremely close to call.

Despite this uncertainty, the following observations are drawn: while the worst-case scenario of a Republican sweep is most damaging for emerging markets, we believe the declining probability of this scenario means the outlook for EMs is more balanced than initially thought, and while the return of executive orders delivered via social media will mean a more volatile global environment, there will be EM countries that stand to gain either through geography or political alignment such as Mexico, Central America and Hungary. China, meanwhile, is clearly the most at-risk country, which in extreme scenarios will have negative feedback onto the broader asset class. By and large, EM policymakers have maintained relatively tight monetary and fiscal policy ahead of the US election, and the expected nascent easing cycle from the Fed also allows them considerable policy space to react if needed.

Outside of the red-sweep scenario, expectations for a further controlled slowdown in the US economy and more measured policy under the new administration will likely leave room for EM assets to tighten in the short term.

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Endnotes

1. Source: Furceri, D., Hannan, S. A., Ostry, J. D., & Rose, A. K. (2020). "Are tariffs bad for growth? Yes, say five decades of data from 150 countries." Journal of Policy Modeling, 42(4), 850-859. The paper finds that a 3.6pp tariff increase can reduce output by 0.4% over five years due to labor inefficiencies, rising production costs, and currency appreciation.
2. The Tax Policy Center estimates that these tariffs could reduce after-tax income by 1.9% overall, with a more severe 4.1% hit for low-income groups, further weakening consumer spending.
3. Between the second-quarter 2018 and fourth-quarter 2019, the CNY dropped 10.9% against the US dollar, offsetting approximately 60% of the tariff impact. Source: "Asia Economics: The Viewpoint: How US elections could affect Asia." Morgan Stanley. July 2, 2024.
4. Source: "US Election Implications for Emerging Markets." Morgan Stanley Global Research (2024).
5. Source: "US Foreign Policy Powers: Congress and the President." Council on Foreign Relations. March 17, 2017.
6. Source: Council on Foreign Relations, Kamala Harris's Positions.
7. Source: Council on Foreign Relations, Donald Trump's Positions.
8. Source: "Trump threatens to cut US aid to Ukraine quickly if reelected." Politico. June 26, 2024.
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10. Source: "Where Do Trump and Harris Stand on Israel-Gaza Conflict?" The New York Times. September 11, 2024.
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12. Source: "Trump in final parting shot hits Venezuela with sanctions." PBS News. January 19, 2021.
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15. Source: "Budgetary Outcomes Under Alternative Assumptions About Spending and Revenues." Congressional Budget Office. May 2024.
16. Source: Tax Policy Center Model Estimates. August 15, 2024.
17. Source: "The Economic Effects of Long-Term Fiscal Discipline." Brookings Research. December 17, 2022.
18. Source: 2024 Republican Party Platform. Brookings Research. July 8, 2024.
19. Source: 2024 Democratic Party Platform. Brookings Research. July 8, 2024.
20. SLV=El Salvador, HND=Honduras, JAM=Jamaica, GTM=Guatemala, BMU=Bermuda, HTI=Haiti, DOM=Dominican Republic, NIC=Nicaragua, LBN=Lebanon, MEX=Mexico; Table excludes countries with GDP less than US$ 5 billion.
21. As an example, the estimated impact of Venezuelan migration on Colombian GDP is between 0.4 and 0.5 percent. Source: World Bank Group.

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