

# Emerging Markets Review and Outlook



## Economic and market review

Emerging markets rose in the fourth quarter, ending 2009 with the biggest annual gain on record, as generally positive economic news, healthy risk appetite and strong commodity prices continued to drive sentiment. Brazil's decision to tax foreign capital inflows, fears that Asian countries would impose similar capital restrictions and Dubai's debt problems dented sentiment temporarily, but the liquidity-led rally appeared to remain intact.

On the economic front, more countries emerged from recession, including Mexico, Chile and South Africa, which saw quarter-on-quarter improvements in third-quarter GDP. Brazil, India and China's economic growth accelerated, while the pace of contraction eased in Turkey, Hungary and Russia. Standard & Poor's raised the credit rating outlook for Hungary and Russia. Fitch upgraded Turkey's credit rating, citing the economy's resilience during the financial crisis. Conversely, Mexico's foreign-currency debt rating was lowered by S&P, although its outlook was kept stable.

Policymakers' commitment to maintain stimulus measures also proved critical in lifting market sentiment. Brazil extended tax breaks in the home appliance and construction sectors, and lowered sales taxes on furniture to boost demand. Thailand's Cabinet approved more projects to spur growth, while South Africa allocated additional funds for infrastructure.

As growth and inflation accelerated, Israel was compelled to raise interest rates yet again this quarter. It remains the only developing economy to have hiked rates so far since signs of global recovery emerged. India signalled a tighter policy stance by requiring lenders to increase bond reserves, even as the poor monsoon pushed food prices higher. Chinese regulators told banks to lend prudently amid escalating property prices. Elsewhere, however, inflation remained largely benign, with most central banks keeping interest rates steady.

Market performance seemed unmoved by developments on the political front. Trade tensions escalated between China and the US over key exports. Taiwan's ruling party lost two seats in local polls. Indonesian president Yudhoyono unveiled his new cabinet, but later came under attack for backing the bailout of local lender Bank Century. Meanwhile, the European Union's Lisbon Treaty was ratified following the Czech president's assent.

## Outlook

Emerging markets may rally further amid flush liquidity in the short term, but uncertainty and volatility are likely to persist. For now, policymakers appear to have decided that the withdrawal of extraordinary fiscal stimulus would be unwise, but this cannot continue indefinitely. The risk of asset bubbles could become more pronounced, if US interest rates stay low, restricting any recovery of the US dollar and prolonging the carrytrade. How developing countries will fare may depend on their ability to improve domestic demand, in the face of developed economies' tepid recovery.

Nevertheless, we feel the inherent potential for emerging markets remains undimmed. Our stock-picking approach is especially relevant, given that earnings visibility has been obscured by the one-off effects of cost-cutting and inventory restocking. Our holdings are well managed and financially sound, and should emerge stronger from the current headwinds.



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