

# Emerging Markets Review and Outlook



## Economic and market review

Emerging markets fell in the three months to the end of June, the first quarterly retreat in over a year as concerns over sovereign debt contagion in Europe and policy tightening in China dominated sentiment. Worries that fiscally challenged peripheral European economies might default on their debt and harsh austerity measures announced across the Continent unsettled markets. In particular, Hungary's hasty comments that it might face a Greek-like debt crisis sent markets reeling. Confidence was dented further by fears that aggressive tightening in China would stall the global recovery. In contrast, Beijing's politically motivated pledge to reintroduce exchange rate flexibility provided markets some respite.

Economic data generally continued to improve. First quarter GDP rose in Brazil, Mexico, Turkey and various parts of Asia, while elsewhere manufacturing activity maintained momentum. A devastating earthquake in Chile initially sent the country's industrial production tumbling, but output stabilised in May. Nevertheless, doubts over the strength of the recovery remained as manufacturing output and GDP growth moderated towards period end.

Inflation quickened, especially in Asia. India's central bank raised interest rates and reserve ratios, and indicated it will gradually remove monetary stimulus.

China also increased reserve requirements and widened measures to curb property speculation. Brazil's central bank became the first in Latin America to increase borrowing costs in over a year. In contrast, still challenging conditions prompted central banks elsewhere to trim rates further.

In other policy news, China and Taiwan agreed to lower tariffs on goods and open their services markets further. Beijing also cancelled its export tax rebate, which is expected to help rebalance the economy. Meanwhile, India passed new regulations requiring listed companies to increase their free floats to 25% by at least 5% annually, while Indonesia lifted its foreign ownership limit in certain sectors.

The quarter also saw political challenges. Poland's president and central bank governor both died in a tragic plane crash; at the time of writing, Bronislaw Komorowski from the ruling party was narrowly elected the new president. Hungary's opposition won a landslide victory and later announced plans to freeze state spending and impose a tax on financial institutions to reduce deficit. In Asia, Thailand's political unrest dragged for two months, climaxing in a bloody showdown between the army and anti-government protestors.

## Outlook

Investors are increasingly worried. In the West, deteriorating leading indicators have intensified fears of a double-dip, splitting opinions about whether or not stimulus should be maintained. While some favour extending stimulus, Europe's burgeoning debt problems have increased the call for fiscal discipline and austerity. However, this comes at a time when final private demand is still anaemic and risks derailing the increasingly vulnerable global recovery. Adding to these concerns are rising inflation and overheating worries in many emerging economies, which policymakers are also seeking to address.

Emerging markets will not escape a renewed weakness in global trade, with volatility likely to remain high. However, we are focused on the long-term attributes of the asset class, namely, its robust finances, sound businesses and fast-growing middle class, rather than the short-term pressures, and will look to buy when opportunities present themselves.

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