Emerging Markets Quarterly – 2015/2

SwissLife Asset Managers

The external environment will remain a key factor for emerging markets in the second half of this year. While lower commodity prices and slowing demand from China, in particular for raw materials, dominated in past quarters, the impact of the upcoming US hiking cycle as well as the situation in Greece on emerging markets' capital flows is more in the focus today. As discussed in the previous edition of this paper, we do not expect the Fed to have a dramatic effect on these flows. Yet, the externally vulnerable countries, such as Turkey, South Africa, Brazil and Colombia, might suffer. Uncertainties regarding Greece affect the emerging world temporarily through a lower risk appetite. Direct and long-lasting impacts are however limited.

Rising dispersion

Individual countries are differently affected by these external developments. Some can be hurt considerably. Turkey, for example, is a weak spot regarding the Fed. Other countries, such as India, even benefit in the form of cheaper energy imports. These varying impacts will lead to more dispersion in economic activity across emerging markets. While this is not yet visible in growth rates, leading indicators have clearly diverged across countries over the last quarters. Therefore, differentiation should remain a key element for investors.

Still moderate growth rates

Growth rates remained moderate in the first quarter of 2015. Russia is in recession. Brazil most probably followed in the second quarter. In other parts of tormented Latin America there are however some positive signs. The acceleration of the US economy is supportive for Mexican exports. Moreover, private consumption is on an upturn. This is already visible in retail sales and backed by a strong labour market. Yet, stagnating confidence poses a risk. In Chile, sentiment is turning and in Peru, economic activity has been improving throughout 2015. Downside risks remain however due to the low copper price and lower Chinese demand as well as deteriorating business confidence and political uncertainty in the case of Peru. Regarding growth of the emerging world, we do not expect a substantial improvement for the rest of this year.

Ending monetary easing trend

An important theme for the second half of 2015 is the end of a monetary easing trend in the emerging world. The first half of this year marked the second largest easing cycle since the great recession. After a period of substantial monetary easing, there simply is less room left for further stimulus. Moreover, as soon as the US starts to hike rates, countries like South Africa, Mexico and Turkey are likely to follow in order to prevent a declining interest rate differential. Thus, stimulus will likely shift towards fiscal policy.

China – Stimulus should stop the slowdown, temporarily

The slowdown of the Chinese economy continued in the second quarter. The government reacted by adding again more fiscal and monetary stimulus. Thanks to these comprehensive easing measures, more signs pointing to a stabilisation for the third quarter are emerging. Moreover, there are some positive news from the real estate sector. In May, property sales entered positive territory on an annual change basis and house prices reached a turning point. However, construction activity still is weak due to a large inventory overhang. As the slowdown in China is structural and necessary we think the stabilisation will only be temporary.

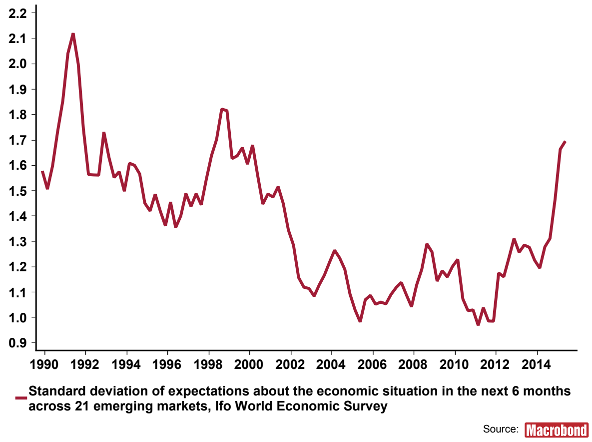
India – Some acceleration is finally visible

It was clear that expectations for India were exaggerated after Narendra Modi's election. Policy implementation indeed turned out to be gradual rather than aggressive. While the new GDP series showed an acceleration, this was not reflected in higher frequency data. However, over recent months, economic activity has gained momentum. Industrial production, in particular for capital goods, and car sales improved. Moreover, there is support from higher purchasing power due to lower fuel prices and more fiscal stimulus through the large infrastructure programmes ahead. Weather conditions pose an important downside risk as they can hurt rural consumption and push food prices up.

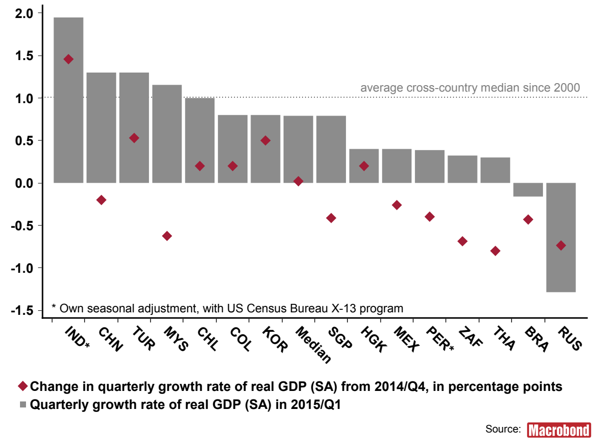
(Limited) Support from global demand

Accelerating demand in the developed world should support many emerging countries. In particular, currently disappointing export activity in Asia is bound to brighten up in coming quarters, thanks to improving demand in G3 and a stabilisation in China. Nevertheless, we should not expect the upswing in global demand to lift the emerging world as it used to do. World trade is still weak and the elasticity of trade to growth decreased in recent years.

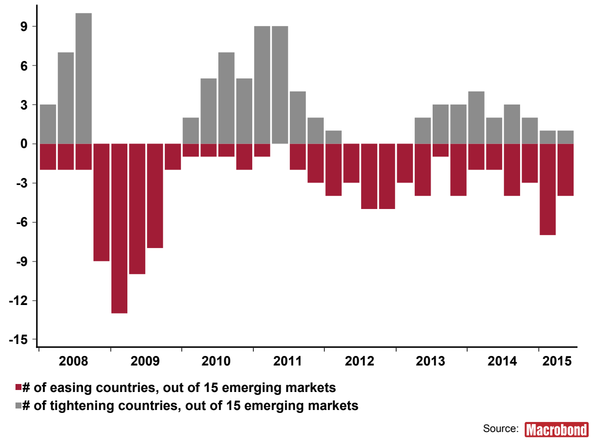
More divergence – Dispersion in expectations about the economic situation is as high as in 1998



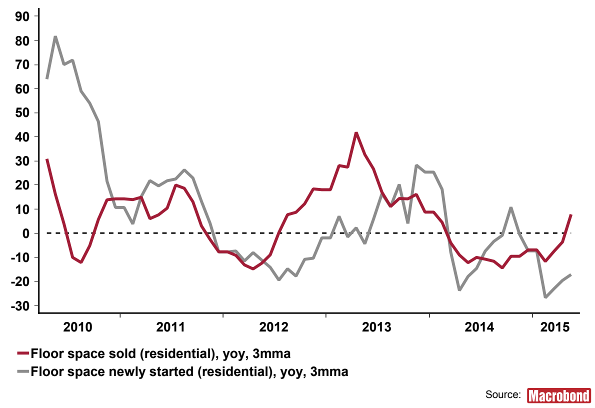
Growth in 2015/Q1 – Still below average and more weakening than strengthening countries



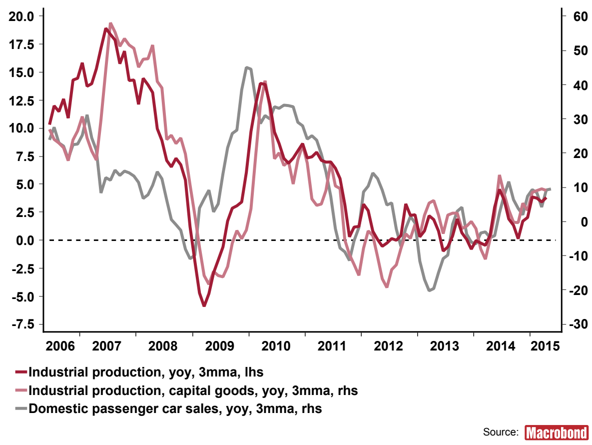
Monetary stimulus – Aggressive monetary easing in the first half of 2015



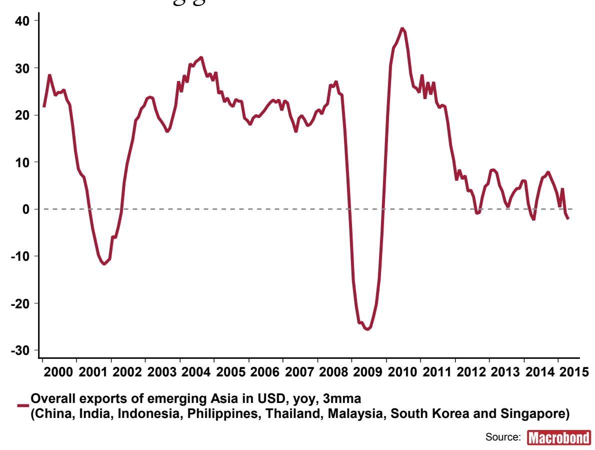
China –Property sales are improving but elevated inventories still weigh on construction activity



India – Slowly gaining momentum



Asian exports – To detach from depressed levels thanks to rising global demand



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