8th February 2016

Developing Markets Insight

www.blackfriarsam.com
+44 (0) 20 7332 2270

Market Review

January saw continued weakness in world equity markets, with the GEM universe declining 6.5%. A small crumb of comfort was the rally in the final week, pulling the index back from an otherwise appalling 13.3% tumble.

Asia was the weakest market, slipping 7.3%, dragged down by China's 12.7% retreat. The country has been at the forefront of investors' concerns, as 2015 GDP slowed to 6.9%, marking the weakest gain in 25 years.

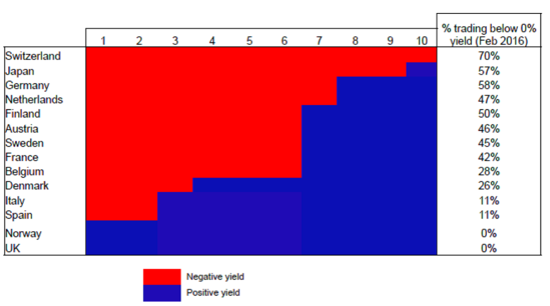
Latin America lost 4.6%, with the usual culprit being Brazil, as it slipped another 7.3%. The failure of the Central Bank to increase rates was viewed as undermining its independence.
EMEA gave up 4.2%. It contained the month's worst market, with Greece's 21.2% collapse. However it was held up by advances in Turkey and Hungary, and relative resilience in South Africa.

All sectors receded. Financials was the laggard, losing 9.2%, hit especially by Indian and Chinese banks. Telecommunications was the most resilient, only shedding 2.2%.

Global conditions

Late last year, after the long awaited rise in the Fed funds rate, there was much discussion on the pace of rate hikes in 2016. Now, following the market moves in January, talk is more about what options are available to central banks if easing is required. As the chart below shows, many places around the world are already exhibiting negative interest rates.

Government Bond Yields

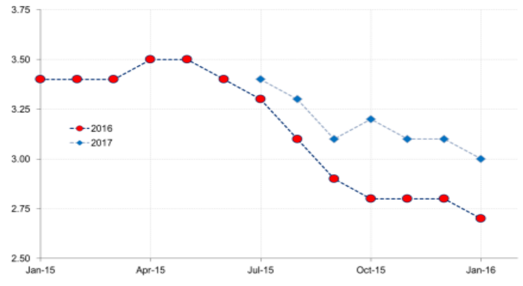


Source: Bloomberg Finance LP, DB Global Markets Research

In our view, the key sticking point for markets at the moment is global growth or rather the lack of it.

Growth expectations for this year and next have been falling since the middle of last year. It will be difficult for emerging markets to make much progress until this trend reverses or at least flattens.

Global GDP Growth forecasts



Source: Citi Research (Jan 2016)

One key driver of the outlook for global growth is the strength of the Chinese economy. As discussed in this month's Asia Insight, the likelihood is for continued moderation. During January there were announcements relating to the closure of capacity in both steel and coal, neither of which will be sufficient to address the current oversupply situation. More is clearly needed, and in other industries too, and the worry here is that the authorities will be reluctant to act because of the impact on employment. The multi trillion RMB stimulus in 2008/9 – now generally regarded as a mistake – was in response to a sharp rise in unemployment post GFC. The situation now is somewhat different though.

The conditions generating unemployment are mainly domestic and more tightly focused (in NE China) giving the authorities much better visibility and allowing them to manage the situation more effectively. Further, the government is more secure than in 2008, Xi Jinping has consolidated power effectively. Lastly, the jobs market is very different now to 2008. In the three years leading up to the end of 2008, China's working age population grew by 18 million; in the three years to the end of 2015 it fell by over 10 million. Recent work by Bernstein shows that average wages continue to rise in China which is at odds with the notion of unemployment being an issue. It also suggests that there may not be as much pressure on the government to depreciate the RMB (to restore competiveness) as is perceived.

The precipitous fall in the price of oil is regarded by many as a symptom of the weakness in global growth. Markets rise and fall in line with the oil price. While this might make sense for oil producing nations, for the rest of the world, including China and most emerging markets, a weaker oil price represents a major windfall and should, over time, provide an economic boost.

The Indonesian 4Q15 GDP numbers released today were a positive surprise showing a modest acceleration which was driven by growth in fixed investments, an area which had been a disappointment. The GDP numbers from the Philippines were also good and ASEAN remains an area where we see good opportunities despite the difficult global picture. *AL, BR & TH*