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## COMMENTARY

# Emerging markets: A silver lining amid the haze?

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Looking out my window at the hazy sky as I pen this article, I cannot help but feel that the recent haze in Singapore mirrors the doom and gloom surrounding developed countries, now in a quandary from having too much debt and too little economic growth.

Competitiveness in these countries has dwindled over the years. The bastion of global growth has now been taken over by the emerging economies. These countries have a younger and hungrier population and, in many cases, are blessed with natural resources and cheaper labour. Not only are these emerging economies a source of global manufacturing and resources, they are also a source of demand in their own right. A prime example is China, the world's factory, which also has a strong demand for raw materials.

It is not only the abundance of manpower and raw materials that are driving these economies. Over the last few years, there has been a slow but steady shift to services as well. New financial hubs in Asia have emerged from the ashes of the financial meltdown in the West as new centres for capital reallocation. The labour force has also become more skilled and

sophisticated – just take a look at the number of “emerging economy” students pursuing advanced tertiary degrees in developed markets.

It used to be the case that people from Asia would look for opportunities to migrate to the West for a “better life” – but strangely enough the children of these migrant families are now looking to Asia for employment opportunities. I remember reading an article late last year which showed that the highest-paid investment bankers were from Sao Paulo, and not from New York or London.

What is clearly happening is a shift of financial powers from the West to emerging economies. With the benefit of hindsight, I think the Asian financial crisis was a blessing in disguise – albeit a very tough lesson. Since the crisis, policymakers have reduced debt levels, built up reserves and reduced the reliance on foreign capital. Local capital markets were developed and many emerging economies in Asia and Latin America now have deep and active local capital markets that domestic companies and governments can tap into.

Therefore, should global growth slow down, and I believe it will, emerging-market

policymakers are now in a position to better manage it. They can expand fiscal policy to increase spending and lower interest rates to reduce the cost of borrowing. The same cannot be said of developed economies whose interest rates are already low or zero and fiscal situation is dire. The only emerging market region where there is more risk is Eastern Europe, where debt levels are higher and monetary policy has tightened.

## OPPORTUNITIES IN EMERGING MARKETS

Analysed from a different viewpoint, in an environment with zero interest rates, capital will eventually be put back to work and, so, where else better than the emerging market economies? As we speak today, inflows into emerging market bond funds have remained positive.

But wait, will the emerging market economies not get hit too if the situation in developed markets gets worse? My short answer to this question is a definite “yes”. Emerging-market growth will slow but is still likely to perform markedly better than the developed markets for the reasons I mentioned above.

That said, in the short term, because of the market uncertainty over the developed

markets, the spillover effects will render performance of emerging market assets more difficult to predict. After all, they are, by nature, a risk asset. Therefore, in times of distress and risk aversion, they will likely underperform and we have already seen underperformance in some segments of emerging-market assets, mainly foreign exchange, high yield and risk corporate bonds.

My own strategy for navigating my clients' monies through the current haze is to steer investments to longer-duration, better-quality sovereign and quasi-sovereign debt. Investors are likely to invest in such products in the event of more bad news coming out. I have also reduced corporate and high yield exposure as well as keep some cash as “ammunition”.

When the haze will clear for developed countries is anyone's guess. But emerging-market assets may provide a silver lining for investors who are looking for buying opportunities to counter the anaemic deposit rates and to take advantage of the recent correction in emerging-market assets. ■

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