Emerging markets signal confidence

Corrections in the emerging markets might well present a buying opportunity for investors in the months ahead, notes **Stefan Hofer**.

Every autumn, the board of governors of the IMF and World Bank convene meetings with various stakeholders across emerging and developed markets to discuss a range of policy issues and the global economic outlook. This year, policymakers met in Istanbul and provided investors with insights on how the environment for emerging markets had changed in the wake of the global recession and financial crisis. Topping the list of issues was the timing of the so-called exit strategies that central banks and governments around the world arguably need to carry out as economies return to more solid footing.

The sentiment in Istanbul was that central banks, including the Federal Reserve and European Central Bank, will tighten policy only when conditions that are consistent with their respective mandates warrant action. In other words, while fora such as the G-20 will continue to call for unified action on many fronts, the case for a synchronised exit is less compelling than synchronised stimulus. In early October, the Reserve Bank of Australia's surprising 25-basis-point hike added to the argument that exit strategies are a national, and not an international or regionally-coordinated, exercise.

On fiscal policy, the IMF's view was that the premature removal of fiscal stimulus was one of the greatest risks facing the global economy. As such, the acute budgetary pressures confronting (mostly developed) economies are a challenge to be dealt with once the global recovery appears more pronounced. Experts on US fiscal policy discussed the idea that taxes will indeed need to rise in 2010. This rise may include the introduction of a value-added tax. Further, the fiscal costs related to the aging population in advanced economies was raised again, highlighting that even without the financial system bailout, major reforms are needed for the longer term.

That said, the IMF's fear of a sudden reversal of fiscal stimulus was partly predicated on the idea that emerging markets have not decoupled from advanced-economy demand for their exports. Therefore, disappointing growth in the G3 over 2010-2011 would undermine the G-20's overall recovery. The IMF also conceded that the US consumer's role in the global economy has probably suffered a permanent shock, thus sustaining the reliance on fiscal support for some time. Rather than the heavy focus on China as an engine of consumption in the future, the IMF also argued that the US should derive more growth from net exports.

The widespread enthusiasm among investors for Brazil was reinforced at the IMF meetings. Expert speakers on Brazil highlighted the longer-term policy accomplishments and the relatively resilient performance throughout the global recession. Overall, emerging market policymakers came across with a new sense of confidence that, despite having suffered sharp contractions in recent quarters, strong V-shaped recoveries had taken hold, especially in emerging Asia. On China, some experts raised the idea that reforms were needed to boost disposable income (i.e. lower taxes) and nurture domestic demand, which would contribute to addressing the global imbalances. At the same time, though, China's healthy government finances leave policymakers there in a position to boost spending should growth decelerate again in the months ahead.

So where does this leave investors? One possible message from the annual meetings is that the global fiscal and monetary environment may remain fairly benign for risky assets, emerging markets included, for some time to come. Given the strong performance of emerging market assets this year, the prospect for shorter-term profit taking remains very real. That said, the medium-term outlook remains robust, as evidenced by the speed of the ongoing recoveries taking hold across emerging markets, and corrections in asset prices may well be attractive buying opportunities.

__The writer is a research analyst at Bank Julius Baer.__