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Should emerging markets worry investors?

Q: The turmoil we say in the emerging markets is not specific to Asia but it has been in India, Indonesia, Turkey and South Africa. All as a result of what has been going on with the Fed talking about tapering. Is this a crisis yet for the emerging markets? Are you expecting this to reach the sort of proportions we saw more than 10 years ago in the Asian financial crisis.

Not at all. This is nothing like it. The reaction of emerging markets is purely because of people getting over excited in the short term. People believe tapering is going to happen very fast. I don't think that is going to happen. It's going to be taper-lite with a lot of dovish comments. The whole reaction has been because of money outflows from the countries which have a BOP deficit.

Q: So this is not a underlying fundamental problem with these economies. This is more about outflows as people chase better returns on the dollar?

Yes. In general, this is not an emerging market crisis. Specific countries obviously have individual problems namely India and Indonesia; and they will find it more difficult to come out of this as a result of the outflow. The world is connected no matter what you say.

Q: We have the Jackson Hole meeting of the great and good in the central banking world. There were calls for central bankers to take into consideration more of what their actions mean internationally, i.e., when Ben Bernanke talks about tapering, emerging markets take a hit. Are central bankers going to worry about what goes on beyond their borders? I mean it is all about what is happening in their own patches.

I completely agree. They didn't worry about it when QE started and there is no reason why will worry about it when QE tapers. This is a good call to be made because this is going to be impact on the emerging markets obviously, but they are more worried about how domestic economies react to their individual policies.

Q: We are going to see tapering, maybe as early as next month, and certainly by the middle of next year probably be heading towards the end. What is that going to mean for the emerging markets over that period. Do you think it there is an initial shock and things will die down or we will continue to see this outflow?

The reaction to tapering has been far too violent. A 100 basis point rise in the long bond yield is not justified. Tapering is going to be at best taper-lite, and it is going to be accompanied by a lot of dovish comments. Tapering does not mean that monetary policy is tightening and interest rates are going up. We will see a loose monetary policy for a long time to come, which means that, yes, money outflow will be there from emerging markets, but not a huge rush out. It will stabilize after a period of time. Countries such as India and Indonesia need to reform their domestic economies to take account for that, because they have been living with the inflow to finance their BOP deficits for a long period of time; and that does mean they have to take the pain as this goes on.

Q: So what advice would you give to investors now who are looking at emerging markets?

Global growth is still relatively stable. It is not led by the US anymore. It is Europe, Japan and China that are now stabilizing it. So, we are still in favor of equities over bonds. The only thing is that focus has to shift from growth led in the U.S. to a value based strategy of Europe and Japan where valuations are cheaper. And within Asia, I don't think everything is the same. North Asia, which is much more geared to developed markets, and has smaller external financing requirements, is still very good. South Asia does have problems - India, Indonesia and Thailand. And there you have to buy into hard currency bonds because people have thrown out the baby with the bath water. There is some value to be had in the hard currency bonds where the currency risk doesn't exist.

Q: Let's stick on the equity side for a moment. You mentioned Japan. You are reasonably bullish on Japan even though there are questions about whether Abenomics can get out of the 'third arrow' and there will be reforms.

I think people under-estimate the resolve this point, of the politicians to get the economics right. Obviously the third arrow they are starting now is more difficult than the first two. And the real test of that this will happen is whether they will be able to raise consumption tax over the coming months.

Q: And you think they will?

I think they will, but they won't do it as aggressively as had been planned. They won't go from 5% to 8%in one go. They might do 1% at a time. What they do not want to do is to raise the consumption tax to balance the fiscal side, and then go back to the quagmire they were in in the last decade.

Q: Yes, they have been there and done that in the 1990s.

Indeed.

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