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Monthly review of emerging markets

September 2012, with a focus on Latin America

Highlights of the month

- Policy announcements in the developed world – particularly in Europe, the US and Japan – led to a marked improvement in investor sentiment in September.
- This buoyed demand for riskier asset classes such as emerging equities with the MSCI Emerging Markets Index returning 5.8% in US dollar terms.
- In the emerging world, investors reacted favourably as the Reserve Bank of India moved to boost liquidity in the banking sector by cutting the cash reserve ratio.
- There were, however, further concerns of a slowdown in the Chinese economy, particularly in the export-oriented manufacturing sector.
- In South East Asia, the Organisation for Economic Co-operation and Development commented on the positive long-term outlook for Indonesia.
- Activity in the Mexican manufacturing sector continues to grow apace due to rising domestic consumption and strong export demand from the neighbouring US economy.

Statistical summary

Stockmarket Indices (US$)	Sep-12	1 Month		3 Months	6 Months	12 Months
MSCI Emerging Markets	1,002.66	5.84%	▲	6.97%	-3.72%	13.88%
MSCI Eastern Europe	199.05	5.64%	▲	8.91%	-7.46%	12.86%
MSCI Russia	791.13	5.31%	▲	9.01%	-9.42%	13.90%
MSCI Arabian Markets ex Saudi Arabia	531.25	3.91%	▲	5.65%	-1.71%	2.90%
MSCI Latin America	3,674.66	3.79%	▲	4.35%	-10.54%	9.96%
MSCI Brazil	2,668.42	2.71%	▲	4.34%	-16.49%	1.61%
MSCI EM Asia	422.74	7.08%	▲	7.74%	-1.19%	15.16%
MSCI China	55.70	6.02%	▲	3.97%	-4.07%	13.92%
MSCI India	428.83	14.55%	▲	14.92%	3.16%	5.86%

Sources: Bloomberg/MSCI/Barra

Emerging markets in September

Emerging market assets performed strongly in September as investors reacted positively to policy moves from several global central banks.

In Europe, the announcement that the European Central Bank (ECB) would now be willing to directly support the Spanish and Italian government bond markets was welcome news. Investors took the view that a disorderly default by these governments was, as a result of the ECB's decision, extremely unlikely.

Investor sentiment was also buoyed by the announcement of further quantitative easing measures in Japan, while in the US the Federal Reserve also positively surprised markets by its apparent commitment to engineer a substantial recovery in the domestic economy.

Against this improving backdrop, emerging equity markets performed strongly with the wider MSCI Emerging Markets Index rising by 5.8 % in US dollar terms. Indian equities led the way, registering double-digit gains in the month. At its mid-quarter review, the Reserve Bank of India kept interest rates unchanged at 8.0%, although it did move to cut the cash reserve ratio (the minimum reserves banks must hold by way of customer deposits) for commercial banks in a bid to boost liquidity in the Indian banking sector. This was widely seen as providing a useful boost to economic growth in Asia's second largest economy.

The Indian central bank also indicated that recent reform measures have had a positive impact on curbing inflationary pressures. In this regard, the government has reduced fuel subsidies and sold stakes in public enterprises, while steps taken to increase foreign direct investment should lead to capital inflows and higher productivity over the long-term.

There were, however, further concerns of a slowdown in the Chinese economy, most notably in the export-oriented manufacturing sector. On 1 October, HSBC reported that its Purchasing Manager's Index (PMI) for the Chinese manufacturing sector stood at 47.9 in September (a figure less than 50 represents a decline in activity). This now means that operating conditions in the sector have now declined for 11 consecutive months with new export orders falling at the sharpest rate in three-and-a-half years.

The PMI compiled by the China Federation of Logistics and Purchasing (CFLP) moved from 49.2 in August to 49.8. Although this indicates that overall activity is still shrinking, the CFLP suggested that government policies have worked to stabilise economic activity.

Elsewhere in the Asia ex Japan region, there were encouraging signs of the long-term growth in domestic consumption across South East Asia. In its review of Indonesia's economy, the Organisation for Economic Co-operation and Development (OECD) highlighted the ongoing growth story of South East Asia's largest economy. The country has '…improved its macro-economic and structural policies over the last 15 years. Its economy, with strong and stable growth rates of 5-6.6%, is catching up with other countries in the region and allowing Indonesia to focus on its development agenda.' Looking ahead, the OECD noted that '…the government's challenge now is to boost productivity, reduce energy subsidies and raise tax collection to finance key infrastructure, social and environmental programs.'

In Eastern Europe, the Czech National Bank (CNB) moved to reduce interest rates by 25 basis points to a record low of 0.25%. CNB Governor Miroslav Singer said that interest rates may be lowered even more and cautioned that the central bank may even intervene in foreign exchange markets going forward. Hungary also announced an interest rate cut in the month with the Magyar Nemzeti Bank lowering its key policy rate by 25 basis points to 6.50%.

In contrast, the Bank of Russia increased interest rates by 25 basis points to 8.25%. The central bank remains concerned about inflation which, at 6.3%, is above its target. 'The observed worsening of the food market conditions in Russia and globally combined with this year's crop harvest estimates remains the (most) important source of inflation risks.'

There were several high-profile offerings of financial institutions in emerging markets during the month. The Russian government raised US$5.2bn through its sale of a 7.6% stake in Sberbank. Following the transaction, the government will retain a stake of 50% plus one share in Sberbank. Sberbank has a 46% market share in terms of deposits, and a nationwide network of 19,000 branches. The deal may be followed by other privatisation sales by the Russian government. Elsewhere, Spanish banking group Santander raised US$4bn through the sale of around one quarter of its subsidiary in Mexico. The transaction was the largest initial public offering to have taken place in Mexico.

Region in focus: Latin America

Latin American equity markets registered robust performance in September with the MSCI Latin America index returning 3.8% in US dollar terms.

From an economic perspective, Mexico's manufacturing sector continues to benefit from rising domestic demand and strong export demand from the neighbouring US.

While HSBC's latest PMI for the Mexican manufacturing sector fell from 55.1 in August to 54.4 in September (a figure more than 50 represents an increase in activity), activity is still increasing and Sergio Martin, HSBC's Chief Economist for Mexico, expects that the '…manufacturing sector will maintain its positive momentum.'

Chile stands out as another country in the region where domestic consumption has remained remarkably robust, notwithstanding the weak external environment. In terms of policy moves, the Central Bank of Chile opted to keep interest rates unchanged at 5.00% in September, noting inflation remains below 3%.

There are early signs that activity may be picking up in Brazil's manufacturing sector. At the beginning of October, HSBC noted that its PMI for the sector had increased from 49.3 in August to 49.8 in September, pointing to a 'fractional' decline in activity. However, manufacturing production actually increased in the month, '…whereas new orders and new export orders both fell, companies depleted backlogs to support production.' As we have noted in past editions of the Emerging Markets Review, policymakers in Brazil have aggressively cut interest rates in a bid to boost economic activity in Latin America's largest economy.

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Version 08/SD

Complied: 4 October 2012