



Review of emerging markets

December 2012, with a focus on Latin America

Highlights of the month

- Emerging market equities advanced in December. Global risk appetite improved as announcements by the Bank of Japan underlined the commitment of policymakers across the globe to pro-growth monetary policy.
- In the larger emerging markets, Indian equities underperformed during the month. The MSCI India declined by -0.05%, compared to a rise of 4.78% in the wider MSCI Emerging Markets.
- Economic data and official comments pointed to improving conditions in China and Brazil.
- Domestic demand remains strong across the fast-growing economies of South East Asia, particularly in Thailand and Indonesia.

Economic Data

Overview of the IMF's World Economic Outlook projections				
(percentage change, year over year)	2010a	2011a	2012p	2013p
Output				
Advanced Economies	3.0	1.6	1.3	1.5
United States	2.4	1.8	2.2	2.1
Euro area	2.0	1.4	-0.4	0.2
Japan	4.5	-0.8	2.2	1.2
UK	1.8	0.8	-0.4	1.1
Emerging Market and Developing Economies	7.4	6.2	5.3	5.6
Central and Eastern Europe	4.6	5.3	2.0	2.6
Russia	4.3	4.3	3.7	3.8
Developing Asia	9.5	7.8	6.7	7.2
China	10.4	9.2	7.8	8.2
India	10.1	6.8	4.9	6.0
ASEAN-5 ⁽¹⁾	7.0	4.5	5.4	5.8
Latin America and the Caribbean	6.2	4.5	3.2	3.9
Brazil	7.5	2.7	1.5	4.0
Mexico	5.6	3.9	3.8	3.5
Middle East and North Africa	5.0	3.3	5.3	3.6
Sub-Saharan Africa	5.3	5.1	5.0	5.7
South Africa	2.9	3.1	2.6	3.0
World Trade Volume (goods and services)				
Imports				
Advanced Economies	11.4	4.4	1.7	3.3
Emerging Market and Developing Economies	14.9	8.8	7.0	6.6
Exports				
Advanced Economies	12.0	5.3	2.2	3.6
Emerging Market and Developing Economies	13.7	6.5	4.0	5.7
Consumer Prices				
Advanced Economies	1.5	2.7	1.9	1.6
Emerging Market and Developing Economies	6.1	7.2	6.1	5.8

(1) Indonesia, Malaysia, Vietnam, Thailand, Philippines

Source: Overview of the IMF's World Economic Outlook projections, World Economic Outlook, October 2012, p2.

Market Data

Stock Market Indices (US\$)	Dec-12	1 Month		3 Months	6 Months	12 Months
MSCI Emerging Markets	1,055.20	4.78%	▲	5.24%	12.57%	15.15%
MSCI Eastern Europe	206.11	6.27%	▲	3.55%	12.78%	13.21%
MSCI Russia	807.53	6.16%	▲	2.07%	11.27%	9.60%
MSCI Arabian Markets ex Saudi Arabia	523.38	0.07%	▲	-1.48%	4.08%	3.93%
MSCI Latin America	3,797.81	6.07%	▲	3.35%	7.85%	5.43%
MSCI Brazil	2,727.71	7.05%	▲	2.22%	6.66%	-3.50%
MSCI Asia	447.40	3.46%	▲	5.83%	14.02%	18.15%
MSCI China	62.85	4.81%	▲	12.84%	17.32%	18.97%
MSCI India	430.03	-0.05%	▼	0.28%	15.24%	23.93%

Sources: Bloomberg/ MSCI/Barra

Global emerging markets in December

As the table above indicates, emerging equity markets generally performed well during December as investor sentiment continues to improve. This was partly due to a continued stabilisation of the eurozone debt crisis, where yields on peripheral government bonds continued to fall. In addition, the Bank of Japan announced an 'enhancement' of its 'aggressive monetary easing' on 20 December. The central bank moved to expand its purchase of Japanese Government Bonds and Treasury Bills and will lend at low rates to Japan's banks. Worries over the well publicised 'fiscal cliff' (i.e. a combination of potential tax increases and spending cuts) in the United States did not have a significant impact on emerging markets as investors correctly took the view that an agreement will ultimately be reached in Congress.

From an economic perspective, in its latest *World Economic Outlook*, the International Monetary Fund (IMF) projects robust growth in the emerging world over the coming year, despite ongoing problems in the developed world. Growth in the majority of the larger emerging markets is expected to accelerate in 2013. In many cases, this is being driven by an increasing contribution from domestic demand rather than exports as countries such as China continue to move away from a model of export-led growth.

Turkey is case in point in this regard. On 18 December, the central bank announced a 0.25% reduction in interest rates to 5.50%. The central bank noted that 'domestic demand follows a moderate pace, while exports continue to increase despite weakening global activity.'

Elsewhere, comments from policymakers in Thailand and Indonesia further confirmed that domestic demand remains strong across the fast-growing economies of South East Asia. Bank Indonesia, for instance, said on 11 December that it expects the Indonesian economy to grow apace, driven by 'private consumption and investment, while a slowdown in exports continues.' On 28 December, the Bank of Thailand also remarked favourably on recent economic trends. 'Private spending, both consumption and investment, remained the key drivers of growth, while merchandise exports also picked up, all of which led to a (notable) improvement in manufacturing production. In addition, growth in the tourism sector remained robust. ... Unemployment was low and headline inflation moderated primarily (thanks to) fresh food prices.'

December also saw the Reserve Bank of India (RBI) publish its Mid-Quarter Monetary Policy Review. The RBI opted to keep policy settings unchanged, leaving interest rates at 8.0% and its Cash Reserve Ratio at 4.25% (i.e. the portion that must be held as cash with the RBI).

The RBI commented that economic growth in India slowed to 5.3% in the third quarter of 2012. Positive signs are, however, beginning to emerge as industrial activity increased sharply in October, although the RBI notes that this is in part ‘...due to a low base and festival-related demand which propelled the growth of both consumer durables and non-durables into double digits. Significantly, capital goods production recorded a growth of 7.5% after 13 successive months of decline.’

The RBI is cautiously optimistic about the outlook for inflation, which has been a major challenge for India. ‘Though consumer price inflation remains stubborn, the pace of moderation in wholesale price inflation has been faster than anticipated. With food and manufacturing prices expected to edge down further, inflationary pressures may ease somewhat in the coming months.’

A highlight of the month was fresh evidence that the implementation of pro-growth policies in China is having a positive impact on growth in Asia’s largest economy. On December 31, HSBC said that its purchasing manager’s index (PMI) for China’s manufacturing sector rose from 50.5 in November to 51.5 in December, the highest level since May 2011 (a figure of more than 50 represents an increase in activity). Hongbin Qu, HSBC’s Chief Economist for China, noted that the rise in the PMI was due to new business for manufacturers and ‘an end to destocking.’ He suggested that ‘momentum is likely to be sustained in the coming months, when infrastructure construction (moves to) full speed and property market conditions stabilise.’

In Eastern Europe, HSBC noted that its PMI for Russia’s services sector fell from 57.1 in November to 56.1 in December. Overall activity in the sector remains strong, however, with employment growth at a 19 month high. Meanwhile, HSBC’s PMI for the Russian manufacturing sector declined from 54.6 to 50.6, the lowest level since September 2011.

Region in focus: Latin America

Latin American equities delivered strong gains in December with the MSCI Latin America Index rising by 6.07% in US dollar terms. While investors have been concerned over the health of the Brazilian economy – the largest economy in the region and the largest weighting in the index – recent data releases point towards an improvement in the overall picture here. Indeed, HSBC

noted in early December that its composite PMI for Brazil (covering both the manufacturing and the services sectors) rose from 50.7 in October to 53.0 in November. This suggests that Brazil’s private sector is expanding at its fastest pace for eight months.

Looking ahead, we believe that Brazil’s exporters should continue to benefit from a stabilisation of growth in China. The government’s initiatives to boost infrastructure investment should also have a positive impact on overall growth in the country, with President Dilma Rousseff – herself formerly Energy Minister – indicating that the development of the country’s electricity network remains an important priority. However, it remains to be seen whether investment in advance of, and related to, the 2014 World Cup and the 2016 Olympics actually materialises.

Elsewhere in the region, conditions in the important manufacturing sector in Mexico continue to improve, with HSBC’s PMI rising from 55.5 in October to 55.8 in November. Mexican manufacturers have benefited from ‘the fastest new order growth since April 2011.’ Looking ahead, we believe newly elected President Enrique Peña Nieto is likely to pursue pro-business reform measures in order to boost productivity and private sector investment. We also expect reform with regard to taxation and the Energy sector, including the opening up of state-owned oil company Pemex to investors.

We believe the Andean region (Peru, Chile and Colombia) continues to be the least susceptible to external shocks and these economies remain well placed to deal with any further negative external shocks. From an investment perspective, we see particular potential in companies that have cross-regional reach and can therefore benefit from the growth of domestic demand across the region.



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