

EMERGING MARKETS

EMERGING MARKET MONITOR

A tale of two emerging market crises

August 2018

Anjeza Kadilli, Economist, Nikolay Markov, Senior Economist

Argentina and Turkey have been at the heart of the recent sell-off. Investors should look to policymakers and governments for clues as to where these markets are headed.

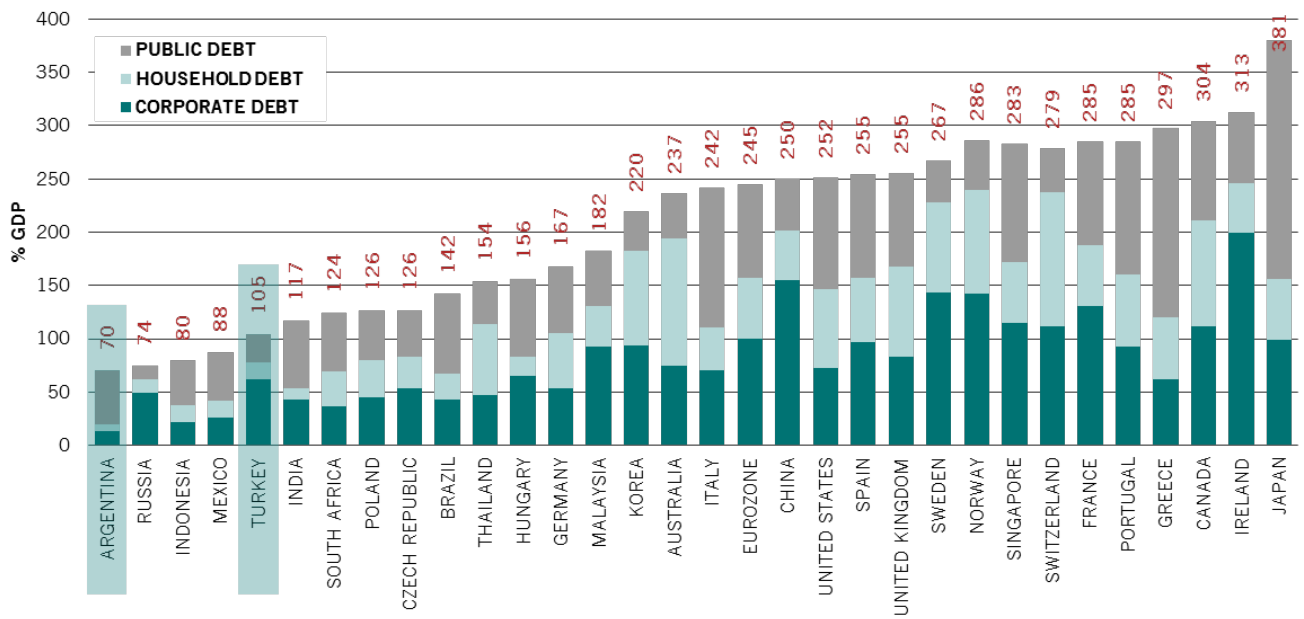
Debt not the main issue

Argentina and Turkey share large fiscal and current account deficits. That said, debt is not the main issue; as Figure 1 below shows, their debt relative to GDP is relatively low.

The main issue is that investors have lost confidence in their ability to control inflation.

FIG.1 - ARGENTINA AND TURKEY AMONG THE LEAST INDEBTED MARKETS IN TERMS OF GDP

Total debt by sector for developed and emerging economies



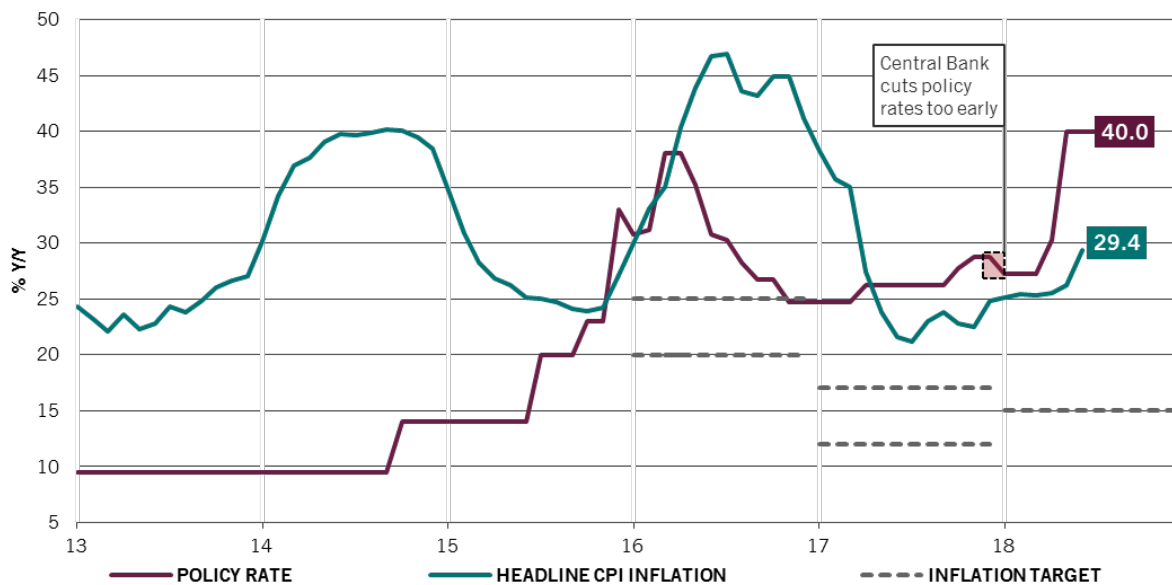
Source: Pictet Asset Management, BIS, CEIC, Datastream, based on data available as at 31.07.2018

Glass half full

In Argentina, the Macri administration cut policy rates in late 2017, hopeful it would succeed in reducing inflation and mindful of 2019 elections. But it acted too early and caused loss of investor confidence in the central bank, which was forced to raise rates by around 13 percentage points to stem the currency's decline.

FIG.2 - ARGENTINA'S CENTRAL BANK CUT POLICY RATES TOO EARLY

Argentina's CPI inflation, target range and policy rate



Source: Pictet Asset Management, CEIC, Datastream. Data as at 31.07.2018

This, together with other policy mistakes, cost the governor of the central bank his job, and saw the country burn through significant foreign currency reserves. Growth forecasts have almost halved since, and Argentina had to request to be bailed out by the IMF.

However, we believe that the worst is over if the government commits to fighting inflation over the medium term. In our view, necessary **fiscal reforms** are justified but will require political stamina to implement, especially as they will in themselves be inflationary.

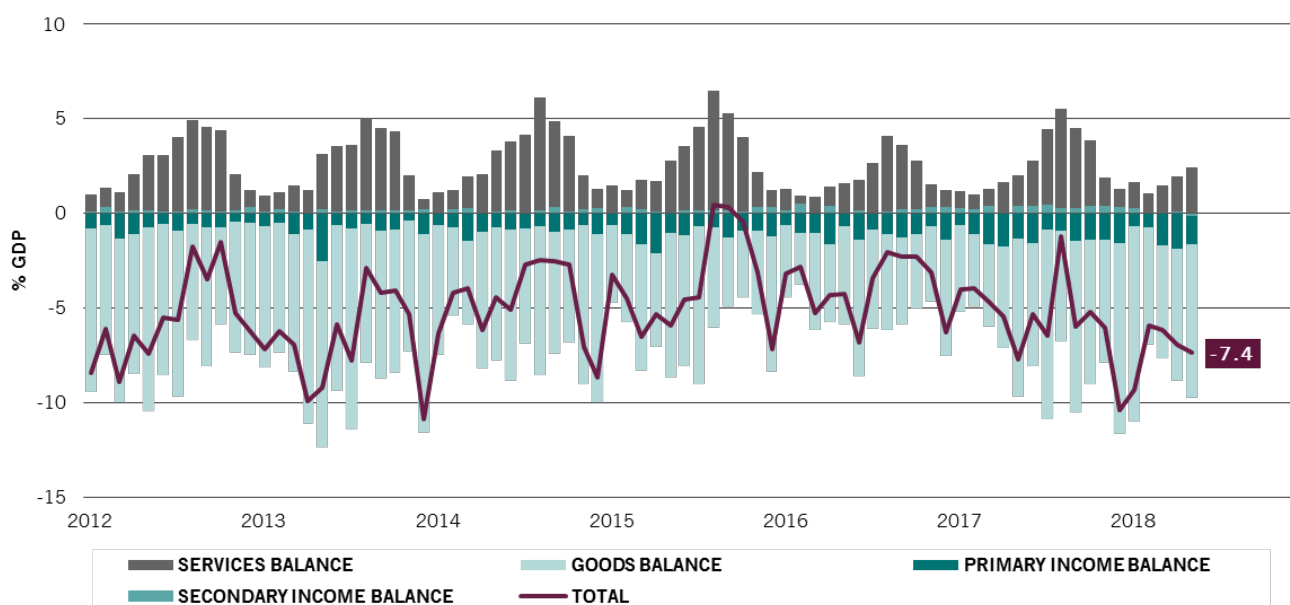
We also believe they need to establish a more credible target range for inflation, higher than their current 15%.

Glass half empty

We are a lot less optimistic about Turkey under the rule of re-elected President Erdogan.

Firstly, as the chart below shows, there is a large and chronic current account deficit. Turkey's private sector (both households and corporates) is highly leveraged due to high domestic consumption and a low savings rate. The country has no choice but to finance its current account deficit mainly through foreign investments, and in USD, EUR or JPY as external investors' confidence in the lira has plummeted.

FIG.3 - TURKEY'S CURRENT ACCOUNT
Breakdown by % GDP

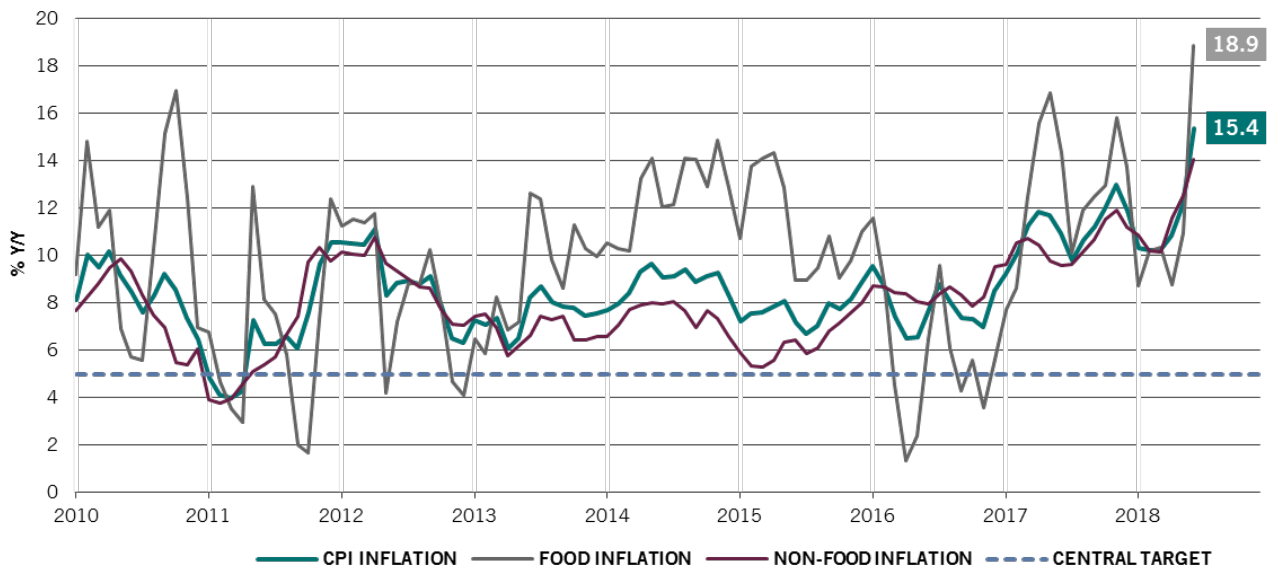


Source: Pictet Asset Management, CEIC, Datastream. Data as at 31.07.2018

In addition to this external imbalance, the major domestic shortcoming is high inflation (see Fig.4 below), above 15 percent, and on a very steep trend. This is due to the lira's chronic weakness (down 56 percent against the dollar year to-date¹) as well as rising energy prices.

With inflation expected to rise further, as the lira continues to depreciate, tighter monetary policy is urgently needed. However the Central Bank (CBRT) has disappointed by refraining from raising rates at its July meeting.

FIG.4 - TURKEY'S MAJOR DOMESTIC SHORTCOMING IS HIGH INFLATION
Turkey's headline CPI, food & non-food inflation



Source: Pictet Asset Management, CEIC, Datastream. Data as at 31.07.2018

Unlike in Argentina, we have limited confidence in Turkey's political regime to make the right calls for the economy. A focus on growth-enhancing measures instead of inflation control appears to be undermining monetary policy.

What's more, the decision by President Erdogan to appoint his son-in-law to head the new finance & treasury ministry raises concerns about the independence of the central bank.

In conclusion we think Turkey's macro vulnerabilities, coupled with political concerns, put the country close to a breaking point. In our view, all the macro ingredients are now present for a full-blown balance of payments crisis.

[1] Source: Bloomberg, data as at 10.08.2018

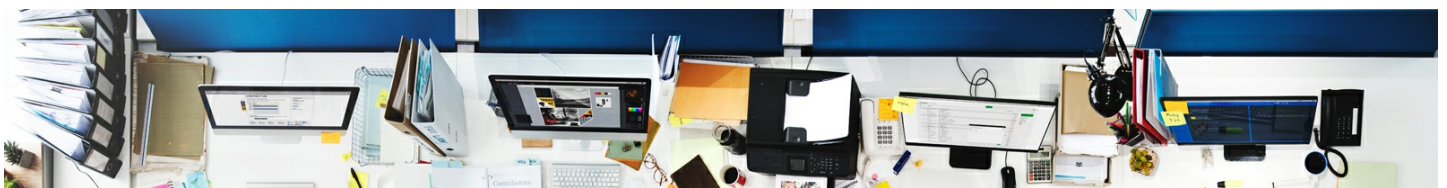


CHART FROM OUR EMERGING CORPORATE BONDS TEAM

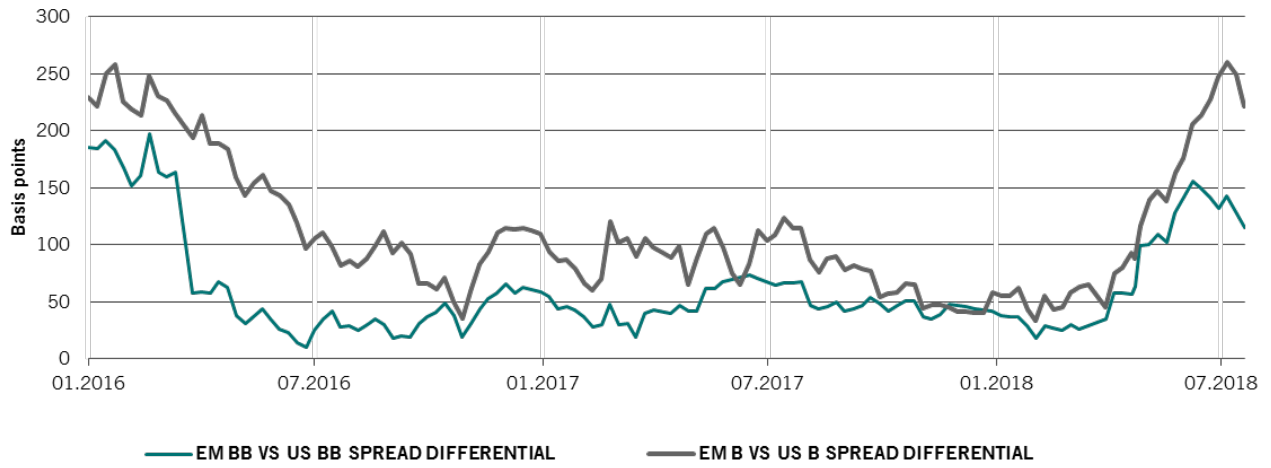
By Karen Lam, Senior Client Portfolio Manager

As the chart below shows, high yield spreads in emerging markets have widened whilst in the US they continue to grind tighter.

To us, brewing crises in Argentina and China have caused indiscriminate selling in the EM bloc. This creates opportunities for investors to buy the high yield credits of emerging markets that have suffered unduly, at particularly attractive levels compared with US high yield.

FIG.5 - EM HIGH YIELD LOOKS GOOD VALUE?

EM B & BB differential with US B & BB (OAS differential, bps)



Source: Bank of America Merrill Lynch, Pictet Asset Management analysis. Data to 27.07.2018.



MARKET WATCH

MARKET WATCH DATA
31.07.2018

EQUITIES	1 mth (%)	3mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
MSCI EM	2.20	-5.52	-4.61	4.36	8.94	5.25	2.87
MSCI EM Value	4.05	-6.08	-3.72	3.04	6.80	3.20	1.92
MSCI EM growth	0.45	-4.93	-5.46	5.47	10.97	7.21	3.74
MSCI AC Asia ex Japan	0.84	-5.27	-3.96	5.20	9.69	7.96	5.99
MSCI Brazil	11.82	-14.27	-7.51	0.45	11.76	-0.01	-3.97
MSCI China	-2.49	-5.89	-4.20	8.56	10.30	10.65	5.48
MSCI India	6.51	1.69	-1.49	5.30	6.95	10.99	5.16
MSCI Russia	3.95	5.51	6.82	25.80	14.60	1.43	-3.61
MSCI EM Europe	3.66	-2.30	-5.02	5.04	6.45	-2.01	-4.61
MSCI World	3.12	3.72	3.57	11.88	8.95	9.49	6.85

BONDS	1 mth (%)	3mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
JPM EMBI Global Diversified	2.55	0.38	-2.81	0.07	5.34	5.43	6.91
JPM GBI-EM Global Diversified	1.90	-5.94	-4.67	-2.50	3.49	-0.92	2.15
JPM ELMi+	0.87	-3.14	-2.57	-0.25	2.58	-0.61	-0.15
JPM CEMBI Broad Diversified Composite	1.45	0.32	-1.47	0.51	4.46	4.86	6.42
JPM Jade Broad Asia Diversified	0.04	-4.01	-4.46	-1.16	2.67	1.85	-
Chinabond composite	-1.88	-5.32	0.20	3.55	0.45	2.31	-
JPM GBI-EM Global Latin America	3.96	-4.84	-1.95	-4.62	5.36	-0.38	2.52
JPM EMBI Global Diversified Europe	1.49	0.31	-2.32	0.26	5.52	5.28	6.98
JPM Global All Mats	-0.55	-1.78	-1.47	-0.50	2.34	0.99	2.33

COMMODITIES	1 mth (%)	3mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
S&P GSCI TR	-3.53	-0.81	6.47	19.95	-0.59	-10.92	-
S&P GSCI WTI TR	-5.28	2.98	18.27	39.56	-2.13	-16.97	-
S&P GSCI Brent Crude TR	-6.02	0.71	15.65	50.31	4.19	-12.42	-
LBMA Gold pm	-2.36	-7.02	-5.43	-3.68	3.59	-1.47	-

CURRENCIES	1 mth (%)	3mths (%)	YTD (%)	1 yr (%)	3 yrs ann. (%)	5 yrs ann. (%)	10 yrs ann. (%)
USD/BRL	2.42	-7.16	-11.70	-16.81	-3.16	-9.48	-8.37
EUR/BRL	2.20	-4.13	-9.38	-16.18	-5.00	-7.16	-5.70
USD/RUB	-0.16	-1.15	-8.72	-5.92	-2.04	-11.92	-9.38
EUR/RUB	-0.37	2.07	-6.32	-5.20	-3.89	-9.66	-6.73
USD/INR	-0.10	-2.69	-6.94	-6.47	-2.22	-2.38	-4.66
EUR/INR	-0.31	0.48	-4.49	-5.75	-4.07	0.12	-1.87
USD/CNY	-2.95	-7.06	-4.61	-1.43	-3.11	-2.13	0.01
EUR/CNY	-3.15	-4.03	-2.10	-0.68	-4.94	0.37	2.93
USD/ZAR	4.64	-4.70	-5.49	0.72	-1.24	-5.43	-5.67
EUR/ZAR	4.42	-1.59	-3.00	1.49	-3.11	-3.00	-2.92

- Top performer among the EM indices or currencies shown in this table, for the corresponding period.
- Worst performer among the EM indices or currencies shown in this table, for the corresponding period.
- Developed markets.

Source: Datastream, Bloomberg, data as at 31.07.2018 and in USD. Equity indices are quoted on a net dividend reinvested basis; bond and commodity indices are quoted on a total return basis. The currency rates evolution is treated as a performance calculation based on FX rates.

Important legal information

This marketing document is issued by Pictet Asset Management. It is neither directed to, nor intended for distribution or use by any person or entity who is a citizen or resident of, or domiciled or located in, any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation. Only the latest version of the fund's prospectus, the KIID (Key Investor Information Document), regulations, annual and semi-annual reports may be relied upon as the basis for investment decisions. These documents are available on assetmanagement.pictet.

This document is used for informational purposes only and does not constitute, on Pictet Asset Management part, an offer to buy or sell solicitation or investment advice. It has been established on the basis of data, projections, forecasts, anticipations and hypothesis which are subjective. Its analysis and conclusions are the expression of an opinion, based on available data at a specific date. The effective evolution of the economic variables and values of the financial markets could be significantly different from the indications communicated in this document.

Information, opinions and estimates contained in this document reflect a judgment at the original date of

publication and are subject to change without notice. Pictet Asset Management has not taken any steps to ensure that the securities referred to in this document are suitable for any particular investor and this document is not to be relied upon in substitution for the exercise of independent judgment. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. Before making any investment decision, investors are recommended to ascertain if this investment is suitable for them in light of their financial knowledge and experience, investment goals and financial situation, or to obtain specific advice from an industry professional.

The value and income of any of the securities or financial instruments mentioned in this document may fall as well as rise and, as a consequence, investors may receive back less than originally invested. Risk factors are listed in the fund's prospectus and are not intended to be reproduced in full in this document.

Past performance is not a guarantee or a reliable indicator of future performance. Performance data does not include the commissions and fees charged at the time of subscribing for or redeeming shares. This marketing material is not intended to be a substitute for the fund's full documentation or for any information which investors should obtain from their financial intermediaries acting in relation to their investment in the fund or funds mentioned in this document.

EU countries: the relevant entity is Pictet Asset Management (Europe) S.A., 15, avenue J. F. Kennedy, L-1855 Luxembourg

Switzerland: the relevant entity is Pictet Asset Management SA , 60 Route des Acacias – 1211 Geneva 73

Hong Kong: this material has not been reviewed by the Securities and Futures Commission or any other regulatory authority. The issuer of this material is Pictet Asset Management (Hong Kong) Limited.

Singapore: this material is issued by Pictet Asset Management (Singapore) Pte Ltd. This material is intended only for institutional and accredited investors and it has not been reviewed by the Monetary Authority of Singapore.