PICTET
Asset Management

EMERGING MARKETS

EMERGING MARKET MONITOR

A tale of two emerging market crises

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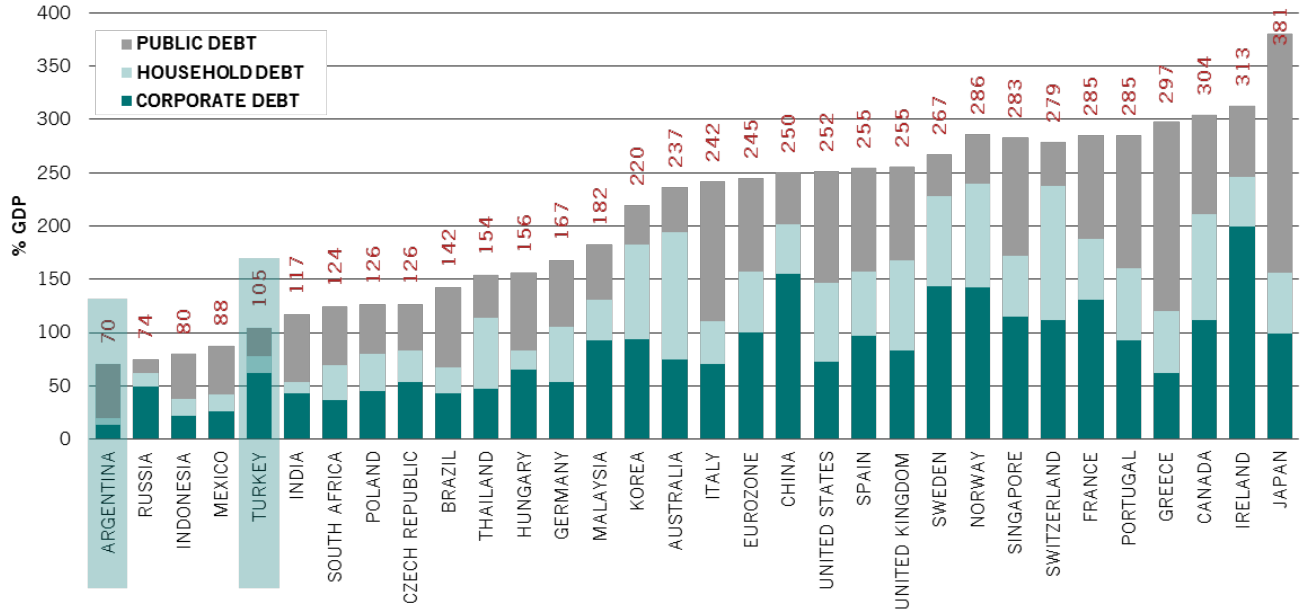
Argentina and Turkey have been at the heart of the recent sell-off. Investors should look to policymakers and governments for clues as to where these markets are headed.

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

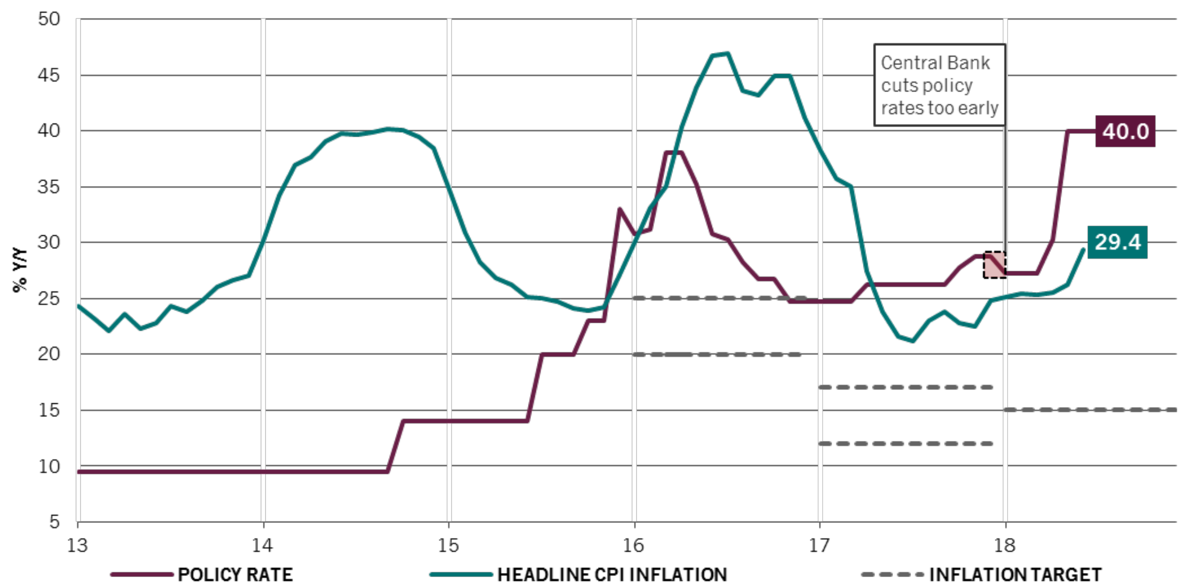


Source: Pictet Asset Management, BIS, CEIC, Datastream, based on data available as at 31.07.2018

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.

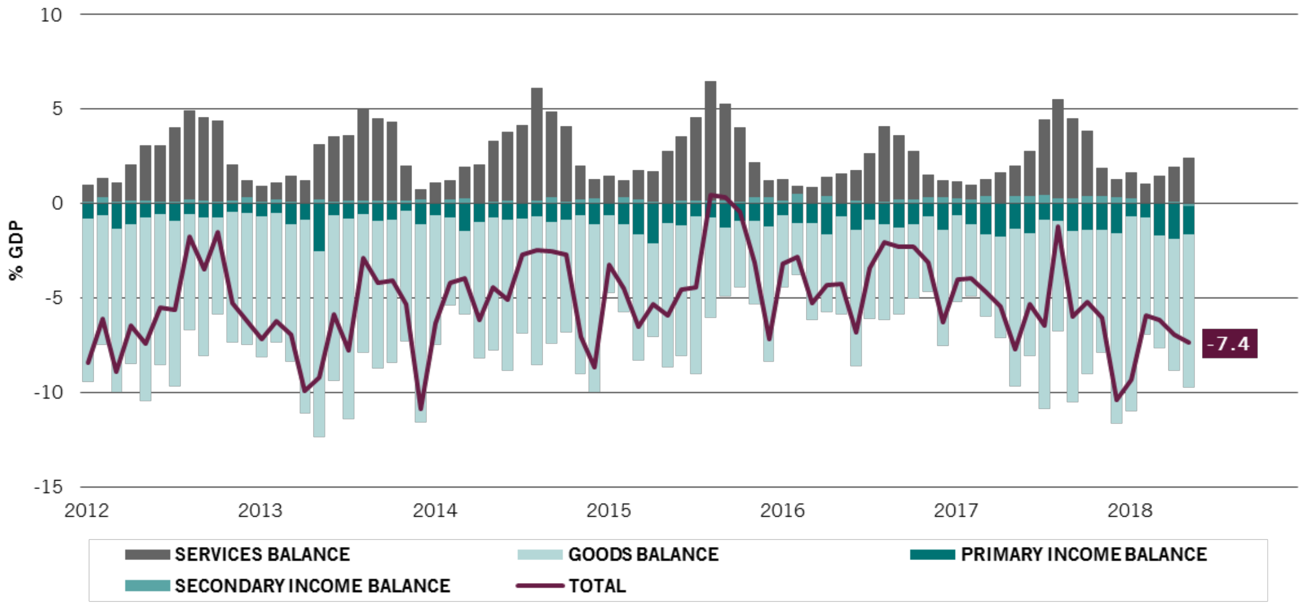
We also believe they need to establish a more credible target range for inflation, higher than their current 15%.

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

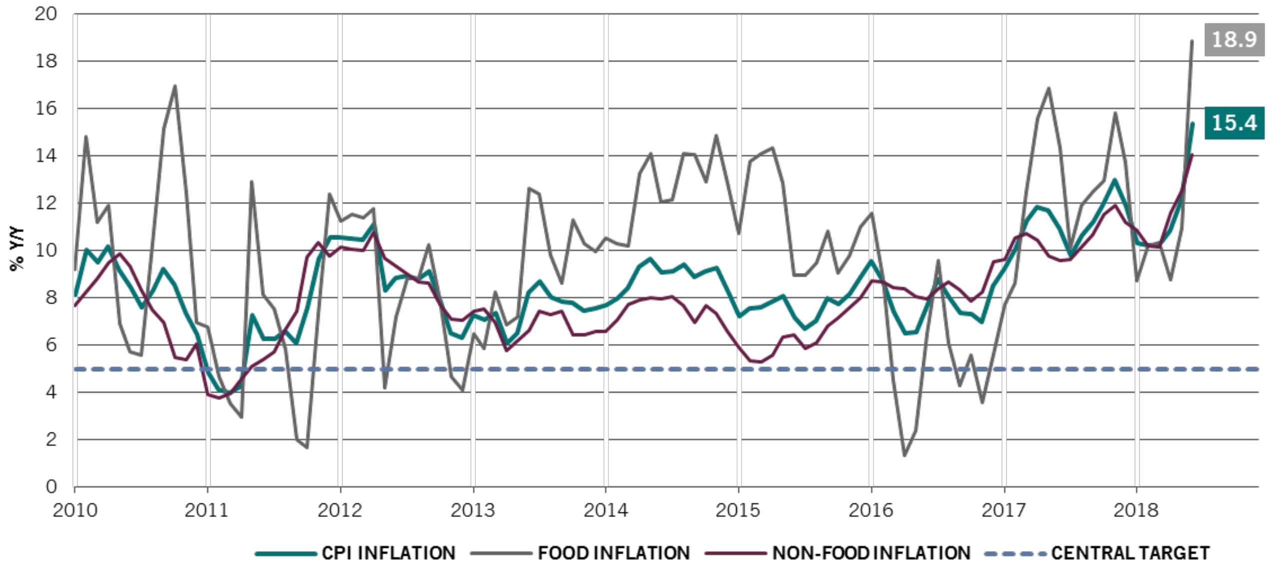


Source: Pictet Asset Management, CEIC, Datastream. Data as at 31.07.2018

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-date[1]) 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

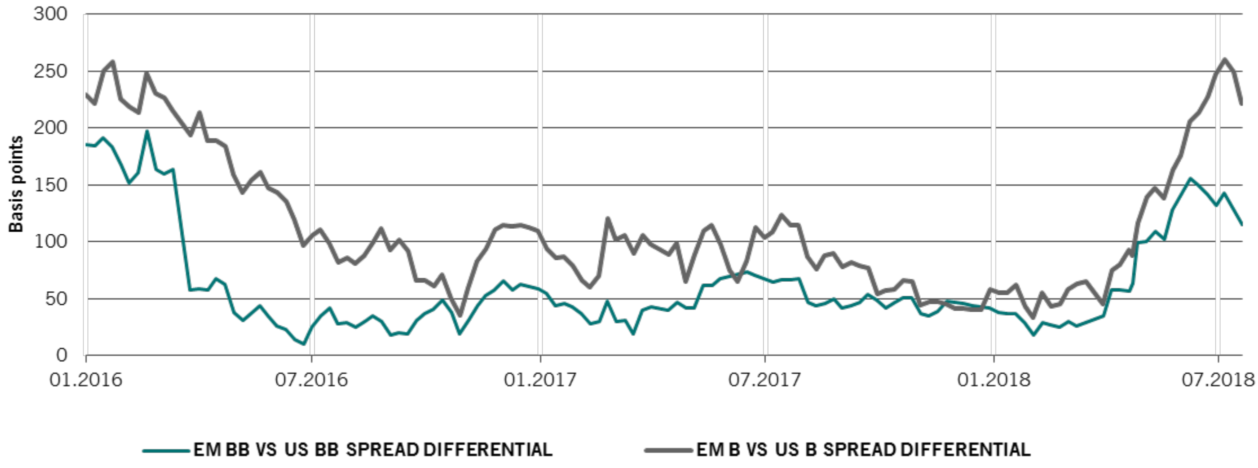
By Karen Lam, Senior Client Portfolio Manager

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.