2019 Outlook_Emerging Markets

Richard Edgar: [00:07]

Hello, emerging markets made many of the investment headlines in 2018, and not always for the right reasons.

Will they be at the centre of things in 2019, as trade battles become wars, debt piles mount up, and easy money from central banks dries up?

Well, with me in Fidelity's Hong Kong studio, our equity portfolio managers, **Hyomi Jie**, who specialises in China and Taiwan, and **Teera Chanpongsang**, who covers wider Asia.

Thank you both very much indeed for joining me now.

Teera, let's start with you and Asia in 2018 - good fundamentals, but it still ended up being a very tough year. Why is that?

Teera Chanpongsang: [00:43]

If we look back at 2018, on the back of 2017, we came into the year with low expectations after a year returning 42 per cent in Asia as a whole - meaning 2018 would be very difficult to gain from that peak.

In 2018, we started with high expectations at the beginning of the year, and saw a strong market for the first two months,

Then began the concerns that US interest rates were rising and the US dollar was very strong. Currencies in Asia had been weak and then you had the headlines of Turkey and Argentina, and then you come to the trade disputes between China and the US that caused a lot of market concern, especially from Asian countries.

These factors form the backdrop of the weak market performance in 2018, both from high expectations and the fundamental issue of the trade dispute.

Richard Edgar: [01:44]

So you've painted a broad picture there of some of the problems - we will come back to a number of them over the next few minutes - but how do you expect 2019 to develop, looking at the region as a whole?

Teera Chanpongsang: [01:56]

We have much lower expectations to begin with, as the valuation of the market is much cheaper than at the beginning of 2018 - but the volatility and uncertainty will continue to be there.

Richard Edgar:	[02:10]	Okay. Well let's move from the individual stocks and steer to the region's largest economy. Hyomi, everywhere seems to take its lead in Asia from China, how do you expect the trade war with the US to continue in 2019. And what impact would it have?
Hyomi Jie:	[02:29]	I think the trade war between the US and China is going to be a more normal and longer-term reality to both countries, and also to the wider economy globally. I think the impact to the region as a whole will be pretty significant in a way. First of all, if we think about some of the key sectors that China has been exporting to the global market, let's say tech, then its supports the whole global supply chain. While you have manufacturing bases in China, they import components from other regional markets including Korea and Taiwan. When the manufacturing base can ultimately diversify from mainly focused in China, towards ASEAN countries or Taiwan, how the supply chain will all move together remains a big uncertainty. So I think the impact will not just be limited to China, but will spread to the wider region.
Richard Edgar:	[03:32]	So looking at sectors in particular, it's not just going to be the exporters, as you explained, but also about how might that spread out to other sectors as well?
Hyomi Jie:	[03:40]	One obvious area would be general consumption sectors. Now I think it's more sentiment-driven because, frankly speaking, there has been a lot of talks about how things will evolve in terms of this China-US trade war. Nothing has really happened yet, until the first tariff was levied in late September, so we are only going to see that impact from here on.
Richard Edgar:	[04:07]	So we haven't seen anything yet. And which are the sentiment-driven sectors that you're thinking of?
Hyomi Jie:	[04:12]	I think consumption in general, especially discretionary spending, as it is highly related towards consumer confidence. So when the consumers have confidence about their future income growth and also employment robustness, they are more willing to spend on discretionary items. But when things are uncertain, you don't know whether things will slow down or if they are going to be stable, so you will wait and see.

Richard Edgar:	04:42	But Teera, in the past, when there've been shocks to the Chinese economy, the government has been able to take stimulus measures to try and turn things around and that's actually been to the benefit, not just to China, but the region and indeed the world. Have they got the capacity to do that again?
Teera Chanpongsang:	04:58	There is a lot of discussion among the Chinese government but nothing has been implemented yet. That's more of the discussion, but I think it's more towards the particular sector. If I look at the trade dispute, if the tariff comes to full impact, I would expect that the Chinese government will give a tax refund to exporters to help reduce their operating costs.
Richard Edgar:	05:26	Would that be enough, Hyomi? Would that change how you feel about things? Are you still worried, or do you think that this sort of intervention would help?
Hyomi Jie:	05:34	No, I agree with Teera that this sort of intervention or stimulus will definitely help to restore consumer confidence, but people will only believe it when they see the results coming in.
Richard Edgar:	05:49	Let's talk about something else which often feels intangible, which is debt in China, which has just grown and grown in recent years. It's now three times GDP, is that sustainable?
Hyomi Jie:	05:59	I think that there are two ways to think about debt. First, where is this debt going? The traditional area has been fixed asset investments and also property markets. I think that's largely driven by the government's policy. If they believe that the debt will continue to stimulate fixed-asset investment and property investment, which is a big part of GDP, I think with the blessing of government that the debt can continue to increase at a manageable rate. The other part is consumer debt, which has been largely ignored until 2010, 2011. So you can see that the absolute level of non-mortgage debt in the consumption space in China is lower than the US, but the speed of the debt expansion has been very, very rapid.
Richard Edgar:	07:05	That could be destabilising in itself, couldn't it?

Hyomi Jie:	07:08	Exactly. So, in my view, that's one risk area that we all need to watch very carefully because the expansion of consumer debt has been very, very fast over the past five to seven years.
Richard Edgar:	07:21	Do you agree, Teera? Does this spread throughout the region?
Teera Chanpongsang:	07:23	One good thing is that when I compare this with the Asian financial crisis in 1997, the Chinese debt was more towards domestic debt. In 1997, Asian countries saw huge foreign capital inflows come to the countries. When the currency depreciated, you saw huge outflows - this is what caused the Asian financial crisis.
Richard Edgar:	07:48	Okay. So, you already touched at the beginning on some of the destabilisation we've seen in places like Turkey, as the US cycle changes and the impact that it has many, many thousands of miles away in places like Turkey. How are things going to develop in 2019 as the US continues its tightening cycle? As you say, the foreign inflows of debt are not quite the same as they were - is it going to be contained or should we be reassessing the risk in emerging markets?
Teera Chanpongsang:	08:20	Comparing 1992 to 1997, five years before the Asian financial crisis, you will see Thailand, Malaysia, Indonesia, Philippines, all had huge current account deficits, between five to ten per cent. This is the same backdrop with Turkey and Argentina now, both with huge current account deficits. But when you look at foreign debt-to-GDP, all the Asian economies are very low compared with the past, 50 per cent lower than the past, and with current account deficits in many countries that are positive. Therefore, we have to look at the region on a country-by-country basis. If you look at corporates in the past, 200 per cent net gearing was acceptable. Today you don't have any company more than 100 per cent, or even 50 per cent, because corporates got burnt out 20 years ago and they have learned from their experience. And second, if you talk about corporates in Asia, almost 80 per cent is domestic debt, which offers an element of stability.