JOHCM Funds

Emerging Markets Spotlight

"Borrowing in dollars is like playing Russian roulette, especially if you're borrowing relatively short term."
-Raghuram Rajan, governor of the Reserve Bank of India

"Interest rates are what shape inflation. If you keep the rates high, the inflation will be high too but if you cut it, inflation will also fall."
-Turkish President Recep Tayyip Erdoğan

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There are two emerging markets widely seen as being the main beneficiaries of the recent fall in the oil price. Both have struggled in recent years with high inflation and large current account deficits. In 2013, Turkey imported an estimated 661,000 barrels per day of liquid fuels, meaning that a US$ 50/bbl fall in the oil price will save Turkey US$ 12.1bn a year in oil imports (1.5% of GDP). For India, 2013 imports were an estimated 2.7m barrels per day, meaning that a US$50 decline in the price of a barrel of oil saves US$ 49.3bn (2.6% of GDP). Clearly, this is a huge macro-economic driver for Turkish and Indian assets.

We remain heavily exposed to Indian equities and zero-weighted Turkish equities for two other reasons. The first, as hinted above, is politics. India continues to see the effects of last year's election of a strongly reformist administration under Narendra Modi. Crucial reforms, previously considered impossible, are being delivered, with October's liberalisation of diesel and natural gas prices a landmark. Importantly, Prime Minister Modi has in Raghuram Rajan one of the world's best central bank governors. Previously chief economist for the IMF, he is a strong and capable governor who understands the risks that emerging markets face from a tightening cycle in US monetary policy.

By comparison, the AKP administration under newly-empowered President Erdogan displays a lack of commitment to international norms of corporate governance, conventional monetary policy and central bank independence. There is a significant chance that 2015 will see the Central Bank of Turkey (CBT) cutting interest rates despite sticky high inflation and a weakening currency. If the bond market were to lose confidence in the CBT's independence, the downside for all Turkish assets could be significant.

Additionally, as discussed previously, Turkey has seen a boom in borrowing and spending in the last ten years. Private sector credit-to-GDP increased by 53% of GDP in that period, the fastest growth rate in the emerging world. By comparison, Indian private sector credit-to-GDP increased by only 16% in that period, with low loan/deposit ratios and a lack of capital investment in recent years. Both countries have received a powerful positive exogenous shock, but Turkey has some very real endogenous risks to face this year.

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bbl is an abbreviation for oil barrel.

IMF is the abbreviation for International Monetary Fund.

AKP is the abbreviation for the Justice and Development Party, a Turkish political party.

GDP, or gross domestic product, is a measure of an economy which is defined as the value of all goods and services produced within a certain period of time.