Chatham Wealth Management

Falling BRICS…

By John Lui – March 2014

BRICS as in Brazil, Russia, India, China and South Africa, which represented the fastest growing emerging markets over the last few decades, have recently seen their economies decelerate and their stock markets and currencies suffer. While most have blamed the US Federal Reserve's tapering of quantitative easing (QE), it is China's decelerating growth that is the primary culprit.

Firstly, the Fed tapering is not tightening, but represents a recognition that the US economy is strengthening and is no longer in need of as much bond buying support. I have in the past, compared this to a doctor tapering the steroids given to a patient because the patient is recovering and getting better. An improving US economy should lead to more imports to the US, which would be stronger exports for emerging market economies. In addition, the Fed taper is more than offset by accommodative monetary policies from the EuroZone and Japan. So overall, Fed tapering due to a stronger US economy is not the main cause of all the problems for emerging market economies.

Rather than look West to the US for the answer, you have to look East to China, where their new leadership is attempting to curb their credit-fueled boom to avoid a bust. While the Fed's QE injection of liquidity did not fuel an infrastructure and business investment boom in the US, loose monetary policies and lax credit standards have in China. The Chinese are tightening and attempting to shut down their "shadow banking system", which is why their economy has slowed from mid-teens growth to the mid-to-high single digit level. In addition, the Chinese want to rebalance their economy away from infrastructure and business investments toward consumer spending and services. This slowdown and transition of the Chinese economy is hitting all the commodity-exporting emerging markets economies very hard, as they are now seeing lower volume and lower prices for their commodity exports to China.

It does not look like there will be a recession in China as they have the financial resources to sustain growth and rebalance their economy, leading to a more sustainable growth model, much like South Korea. Investors should be cautious about emerging market economies that have high commodity-export exposure to China as they will have some short-term pain adjusting to China’s changes.