Opinion **The FT View**

Shaky emerging markets watch the US and China

Welcome investor discrimination may not survive a serious shock

THE EDITORIAL BOARD

As the Fed tightens its monetary policy, emerging markets are on alert. Turkey and Argentina have already been affected and South Africa and Brazil face trickier conditions © FT montage; Dreamstime

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Whenever emerging market assets or economies start falling into widespread trouble, there is an inevitable tendency to look towards episodes in the past. Is this like the summer of 2015 and early 2016, a sharp sell-off in equities sparked by problems in China which nonetheless had little lasting impact? Is it like 2008, with relatively innocent middle-income countries swept up in a global crisis that emanated from the developed economies? Or is it like the 1990s, when the Asian crisis was characterised by rapid contagion from one vulnerable current-account deficit country to another?

As in previous eras, current worsening external conditions have a lot to answer for. The US Federal Reserve's tightening of monetary policy has hurt governments and companies borrowing in dollars. Higher oil prices have pushed up inflation and damaged current account positions for net energy importers. And goods exporters are looking nervously at the prospect of a generalised trade war damaging supply chains.

The weakness in emerging market assets has been widespread. Yet so far there are, happily, clear signs that investors are distinguishing between countries that have serious — and largely homegrown — problems, and those that have sounder fundamentals.

Very firmly in the first camp are Turkey and Argentina, both of which have been running large current account deficits, though with different domestic counterparts. In Turkey it is the private sector that has been borrowing heavily from abroad. In Argentina, although the government of President Mauricio Macri has committed itself to economic orthodoxy, the legacy of incontinent public finances has caught up with the economy. The perennial crisis country has, as often in its history, felt itself forced to call in the IMF.

Yet elsewhere, the movements in asset markets so far look like a correction and reflection of specific market conditions rather than headlong capital flight. There is not much sign of a generalised worsening of overall financial conditions. Although there have been big falls in bond prices in some countries — including Brazil, beset by political uncertainty, as well as Turkey and Argentina — they have held up better in others. Nor has there been a sharp worsening in gross domestic product growth, which has slowed but is certainly not heading towards recession for most EMs.

The main risks for market volatility turning into something a lot more serious are the possibilities of significant slowdowns in the US or China. Both would suck demand out of the global economy, further threatening growth for export-dependent nations. They could also cause a generalised rise in risk aversion which would pull money out of emerging markets in a less discriminatory fashion than seen so far.

Those countries that have worked to reduce their external vulnerabilities, improving their current account positions and limiting borrowing in dollars, can feel somewhat pleased that they have insured themselves against a worsening in external conditions. A few may have room to respond by loosening policy, as has China this year. Less well-prepared governments with inflation problems will have to ride out any shock and indeed raise interest rates to shore up falling currencies.

The troubles of most emerging markets, apart from the few that have actively inflicted harm on themselves, presently look more like the market shake-outs of recent years than the global crisis of a decade ago or the contagion of the 1990s. Whether the skies turn darker is out of most emerging markets' hands. They will be watching events in China and the US with even more than the customary vigilance.

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