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MarketWatch

Emerging Markets Report

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Emerging markets rate cuts offer hope for stocks

By Myra P. Saefong, MarketWatch

SAN FRANCISCO (MarketWatch) — A new round of interest-rate cuts by central banks in emerging markets, as developing countries respond to stalling global growth and try to tame currency appreciation, could benefit the broader economy and help stock markets recover, say analysts and fund managers.

"Rate cuts are clearly designed to provide monetary stimulus domestically," said Michael Bechara, managing director at risk-management firm Granite Consulting Group.

Fed ponders next move

The recent bad economic news raises the odds that the Federal Reserve will take additional steps to spur growth and hiring. Jon Hilsenrath explains on The News Hub.

"It's difficult to say exactly where this money will go, but generally low interest rates and cheap money flow into risk assets such as equities, so we may see some boost to stock markets globally."

Chile, Mexico, Israel and Peru are also "seriously" considering rate cuts, he said.

Last week, Brazil's central bank unexpectedly slashed the benchmark interest, or Selic, rate to 12% from 12.5% and earlier in August, Turkey also announced a surprise cut to its benchmark one-week repurchase rate to 5.75% from 6.25%. The central banks cited worries about a global economic slowdown. Read about Brazil's unexpected rate cut.

U.S. stocks have given up all of their year to date gains, and European markets have suffered double-digit percentage declines from the end of last year, as debt concerns in the euro zone intensified and recent economic data pointed to slowing global growth. The S&P 500 Index (SNC:SPX) on Tuesday logged its worst September start in its five-decade history. Read more on U.S. stocks.

These stock drops have coincided with more doubts that U.S. and European policy makers, hampered by deepening regional and partisan differences and fewer unused tools to stimulate growth, will be able to jump start their economies anytime soon. Some relief, however, could come from policy actions in emerging markets.

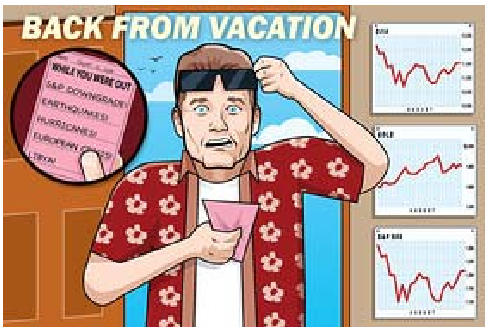
"If ministers in these emerging markets make the proper fiscal and monetary moves to control mounting inflation without restraining growth too much, this could prove beneficial not only to emerging market investors, but also to the global economies [that] are growing more dependent on the buying power of emerging markets," said Kevin Mahn, president and chief investment officer of Hennion & Walsh Asset Management.

Balancing act

But it's a tricky balance.

Until last week, "Brazil's government was debating its course of action because of the combination of inflation and a cooling economy at home and turmoil abroad," said Usha Haley, professor of international business at Massey University in Auckland, New Zealand. And "similar concerns are also causing other emerging market countries to debate policies, often behind closed doors."

At the same time, emerging market economies are trying to maintain their surpluses with developed markets in Europe and the U.S., said Bechara.



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"As demand has slowed in the developed world, this has caused significant anxiety amongst exporters," he said. "In response, the usual grab bag of interventions has been brought out and they are being implemented in predicable fashion."

And "rates are being cut by central banks across the globe in order to devalue their currency in the hope that their exporters's goods will maintain a price advantage over others," said Bechara.

Brazil's real (ICAPC:USDBRL) has gained 12% against the U.S. dollar in the past 12 months, though the Brazilian currency has lost some ground in the third quarter.

"Currency appreciation in emerging economies has been a byproduct of two things: increasing interest rates, especially against very low nominal rates in developed economies, and stronger balance sheets and fiscal spending positions relative to developed governments," said Paul Herber, co-portfolio manager of the Forward Frontier Strategy Fund (MFD:FRONX) (MFD:FRNMX) .

That currency appreciation in emerging markets has actually acted as a "shock absorber" for developed markets as it stimulated an export-led recovery through weaker currencies, helping to offset some of the economic weakness in the developed world, he explained.

Developing nations are striving for financial stability and continued economic growth. But not all industrialized economies may benefit from their efforts.

Europe's problems are "rooted deeply in its own debt and there is little role for emerging markets to play" there, said Matt Lasov, director of global research at Frontier Strategy Group. In the U.S., however, "bad debt is less of a concern and growth in emerging markets is likely to become the key driver of corporate profitability in the medium term."

Gauging options

In the end, it may just be all about having choices.

Overall, "emerging markets simply have more policy options. They can cut rates or issue stimulus," said Lasov. "Both policies are off the table for over-leveraged western markets in near-zero interest rate environments."

Brazil's move to cut rates "will be seen as leadership among emerging markets and will likely be the precedent for additional cuts," he said, pointing out that central and Eastern Europe is the region with the "most imminent need to cut rates because of its links to Western Europe."

Still, there are some analysts who believe that most emerging markets are still too small to make too much of a difference in economies of the developed world.

"Emerging economies are still too small relative to the developed world to make a dramatic improvement in these much larger economies," said Forward Frontier Strategy Fund's Herber.

"Any associated economic stimulus in the emerging markets would likely be felt by a select group of countries, primarily the commodity exporters such as Australia, Canada and Norway," he said, and these have "largely avoided the worst of the economic troubles in the last few years primarily due to the beneficial effects of emerging markets."

Besides, with the exception of China which is still tightening, monetary stimulus in emerging markets are simply not large enough to effect the world economy, said William Gamble, president of Emerging Market Strategies.

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