



## *China Leads the Emerging Market Recovery*

When the “Global Financial Tsunami” rolled from the US across the world, not surprisingly emerging markets were not immune to the adverse effects of the financial crisis. Investors very quickly pulled money from these markets as risk appetite dwindled and investors rushed to safer asset classes such as Government treasuries. Asian financial markets were severely impacted with both the Hang Seng and CSI indices losing 48% and 66% of their values respectively in 2008. In terms of a broader measure, the MSCI Emerging Market index also reported a 54% decline in 2008. It was clear that investors in emerging markets would have been the hardest hit as investments in those markets were perceived as being the quite risky.

China's story is no different despite the sheer size of its economy (over US\$7 trillion) and an average growth rate of 9.7% between 2000 and 2007. China witnessed a sharp and relentless shift from an overheating economy and threatening inflation to a sudden drop in growth and rise in company closures. However this picture should be tempered by the fact that the Government had previously been attempting to slow the economy for some time. The credit crunch being experienced by the US, China's main trading partner would have exacerbated the effect of these policies and hastened the subsequent cooling of the economy. The effect of all of this had been a consistent decline in the growth of China's trade surplus as both export growth fell precipitously as well as weakening domestic demand due to rising unemployment and falling consumer confidence.

However, several recent developments suggest that China is leading the recovery in emerging markets as the wider financial markets begin to show some signs of stability in 2009. China's policy response to its export-led slowdown has been timely and aggressive. The People's Bank of China (PBoC) cut rates a total of 216 basis points since last September and the government also put in place a 4 trillion Yuan (\$585 billion) stimulus package. This package is financed in part by a higher fiscal deficit and additional debt issuance, as well as increased lending by commercial banks. Tax cuts, export rebates, and government incentives for autos and consumer durables have also been a part of the stimulus program.

This series of actions is already providing a significant boost to domestic activity. Capital spending, in particular, has surged in recent months, with urban fixed asset investment now growing almost 40% year-over-year (y/y), reflecting strong growth in new projects. Industrial production growth is picking up, with the latest data showing strong y/y gains in the output of motor vehicles, steel products and cement, as well as improvements in crude, steel and electricity output. Incentives to purchase automobiles have supported a recovery in that market over the last few months, and the large easing in credit conditions should support consumption in the near-term. China's property market also appears to be benefiting from easier credit conditions, with prices in several key areas starting to rebound. China's economy is now projected to grow 7.5% in 2009 (previous 2009 forecast was 6%) down from 9.4% in 2008 and 11.4% the year before.

A second stimulus package is expected to be passed in 2009 and will focus on infrastructure projects. There is also expected to be an increase in social spending to try to persuade the Chinese public to spend rather than save. In contrast to the U.S. stimulus packages that have created much controversy, China's efforts look very promising. Sitting amid piles of cash, the country is fiscally strong enough to finance the anticipated expenditures. And as a country that is still in the middle of transforming itself into a more modern and industrialized nation, significant development is needed.

The market has responded positively to this news. Emerging market equity and bond funds have continued to see increasing levels of cash inflows; US\$26 bn over the last 11 weeks. This is greater than the inflows reported for the entire 2006 calendar year. Not surprisingly, emerging markets have rebounded remarkably in the second quarter of 2009 with the MSCI Emerging market up 32% for the year. Asian-based mutual funds such as the Templeton Asian Growth Fund (+50% year to date) and ETFs such as FXI (I-shares) (+24% year to date) have also reported similar impressive recoveries. Specific securities and ADRs which have also experienced similar performance figures include Petrochina (+38.25% ytd) and Aluminium Corporation of China (72% ytd)

	Past 11 Weeks (\$mn)	As at 05 June 2009 (\$mn)
<b>Total EM Inflows</b>	<b>26,327</b>	<b>26,060</b>
Global EM Funds	11,142	12,741
Asia	10,383	9,044
EMEA	653	(670)
LatAm	4,149	4,945
EM long only funds	11,356	10,200
EM ETFs	14,971	15,860

Source: Banc of America Securities- Merrill Lynch Calculations, EPFR Global

Still, the real challenge rests in the hands of the Chinese consumer. Stimulating domestic spending in an effort to plug the hole left by leaner export growth will be vital to ensuring further economic recovery and decoupling over the next couple of years. We believe that China possesses the cash necessary to spend its way out of this difficult time and with help from further stimulus packages remains well positioned to pull ahead of its emerging market peers

**Table 1: Regional Market Performance (as at 25 June 2009)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	779.12	-0.02	-1.31	-7.57	-32.22
All Trinidad	1,079.70	-0.03	0.01	-6.50	-27.95
JSE Index	81,325.06	-0.48	-1.09	1.46	-26.12
JSE Select	1,802.92	-0.58	-2.65	-9.16	-40.46
All Jamaica	66,686.46	-1.08	-1.45	-9.88	-39.62
BSE Composite	843.61	-0.02	0.07	-8.29	-21.71

**Table 2: International Market Performance (as at 25 June 2009)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	920.26	0.21	3.75	1.88	-30.39
Nasdaq Composite	1,829.54	1.21	8.13	16.01	-23.81
Dow Jones Industrial	8,472.40	-0.97	2.36	-3.46	-28.27
German Dax	4,800.56	-0.76	-2.40	-0.20	-27.46
FTSE 100	4,252.57	-0.66	-2.58	-4.10	-24.95
Nikkei 225	9,796.08	0.95	4.80	11.99	-29.17
Hang Seng	18,275.03	2.80	6.74	27.02	-19.26
DJ Eurostoxx	2,402.32	-0.50	-1.55	-2.01	-30.58

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