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Research Paper

Turkey, China and India: Is it time to rethink investing in emerging markets?

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ABSTRACT
As political and economic uncertainty increases globally, both economists and investors are forced to reevaluate the viability of emerging markets as investment opportunities. The 2000s saw a dramatic increase in the inflow of foreign capital into developing economies; however, the last decade saw a sharp trend reversal. This article uses secondary and tertiary data to create a comparison and analyze differences between three emerging economies that largely encompass the volatility and risk associated with such markets. Using such data, it concludes that the risk associated with emerging markets should not be a deterrent factor; however, investors must be cautious about the socio-political environment of such nations. The article further evaluates the future of emerging markets in light of the COVID19 pandemic and explores the possibility of investors shifting capital from stable emerging economies to younger ones, such as India. Lastly, the article argues in favour of prudence and conservatism as the global economic crisis is unprecedented and demands specific attention.

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Turkey, China and India: Is it time to rethink investing in emerging markets?

For several decades, emerging market economies have been seen as exceptional investing opportunities by foreign investors. The main reason behind this is the characteristic feature of these economies to grow at high rates and provide high return on investments. However, recent debacles in Turkey, Venezuela and several other countries have made investors rethink their strategies to invest in emerging markets. Along with this, uncertainty in the Indian, Chinese and other major Asian economies continues to confuse investors. This paper uses the aforementioned case studies to shed light upon the credibility of emerging markets and their ability to yield sufficient returns. It explores several factors that affect emerging market economies and act as indicators of the growth prospects offered by these nations.

I. INTRODUCTION TO EMERGING MARKETS

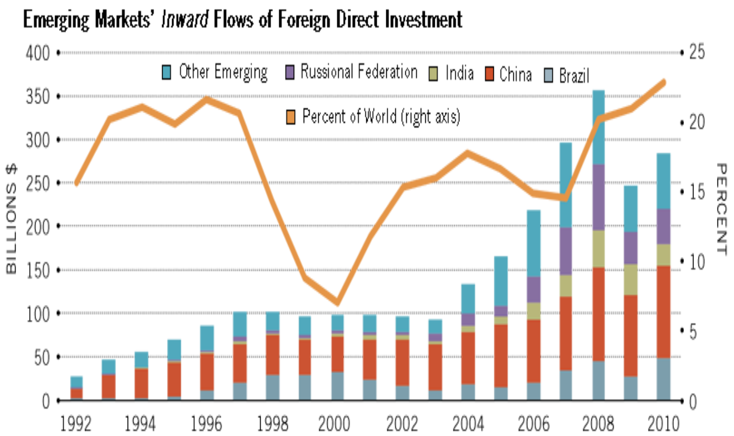
The textbook definition of an emerging market is a developing nation or economy which is on the path towards becoming a developed economy and hence offers very lucrative growth rates and investment opportunities. Most emerging markets indeed offer attractive return on investments, but this is coupled with risk and volatility. The instability of an emerging market economy makes it susceptible to geo-political disturbances. Emerging markets are typically viewed from two perspectives. One from a macro scale for development activities to be carried out and economic policies to be created. The other is the micro scale which is used by investors to analyze these markets before investing. This paper uses the International Monetary Fund analyses for an intergovernmental and macroeconomic viewpoint, and that of Morgan Stanley Capital International for an investment or microeconomic perspective. The following is a list of the current emerging market economies as classified by the IMF: Brazil, Chile, China, Colombia, Hungary, Indonesia, India, Malaysia, Mexico, Peru, Philippines, Russia, South Africa, Thailand and Turkey, Argentina, Bangladesh, Bulgaria, Pakistan, Poland, Romania, Ukraine and Venezuela. This paper focuses on the case studies of Turkey, China and India as part of its analyses and to discuss these nations as indicators of what emerging markets offer to investors. (Chappelow 2020)

II. INVESTING IN EMERGING MARKETS

There are an array of ways and instruments that investors and international organizations use to employ their wealth in emerging markets. These range from equity, to money markets, to government issued debentures or bonds, commodity stocks, currency and foreign direct investment. Several multinational corporations (Nestle, Coca Cola etc.) tend to invest large sums of money in emerging markets mainly through FDI. On the other hand, institutions such as MSCI, JP Morgan and various smaller hedge funds or investors prefer to invest through purchase of bonds or equity.

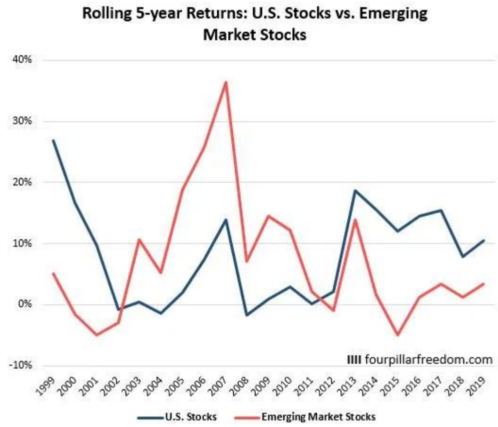
Emerging markets can be extremely profitable investment opportunities, and this is what attracts investors. These economies are usually developing nations moving towards becoming rich and developed. In order for any economy to grow, an investment in infrastructure is crucial. Along with this, generating employment, setting up industries and attracting FDI are also some of the aspects the governments of these nations focus on. These factors lead to high GDP growth rates and consequently, a growth in money markets as governments and several other private corporations start issuing debentures and bonds in order to obtain funds to fuel growth and development. This also leads to a growth in the equity market, as both local and foreign investors start becoming more optimistic and lenient with their investment. Since these economies are predicted to grow consistently and provide high return on investment, investors are lured to these nations and that is with good reason.

However, many times, emerging markets tend to become victims of the volatility and instability that are unavoidable in any growing nation. This is what forces investors to carefully analyze the future growth prospects and the geo-political stability of such nations into account before investing. Despite careful and extensive analyses, the extent to which investors can make safe decisions is limited. This is because, often factors such as poor fiscal discipline on the part of the government, unforeseen changes in administration, geo-political disturbances, and cultural volatility tend to affect the emerging market economies. Since these factors are largely out of investors' control, they have no choice but to take the risk in the hope of receiving profitable RoI. (Wheatley 2019)



The risk associated with investing in emerging markets is why individual investors find it difficult to invest their money into their markets. This is why the major chunk of FPI, FII and FDI entering emerging market economies come from large investment firms, MNCs, and hedge funds.

Global investors increasingly started to move towards investing in emerging markets economies in the 2000s. This was the time period when most emerging market economies grew at record rates and the risk factor reduced considerably. However, 2011-2012 was when the emerging markets became increasingly volatile and economies started to slow down. Some countries were able to survive the slow down and still yield high returns, others became unstable economies.

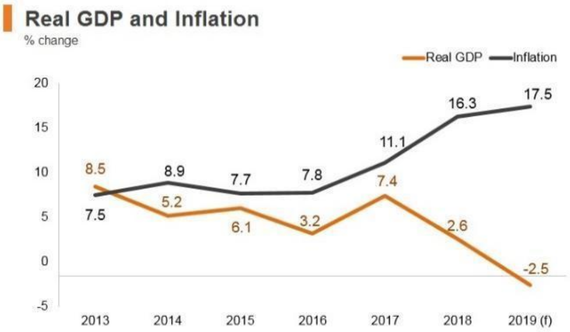


This paper analyses several crucial case studies of emerging market economies to compare the return on investment and growth potential of such economies.

III. TURKEY

The Turkish economy is probably one of the best indicators of the volatility and instability an emerging market can foster. With a strong GDP growth rate of 7.4% in 2017, Turkey was considered to be one of the most promising emerging market economies. However, January of 2018 saw a turn of events which led to the Turkish Lira crashing and investors pulling their investments from Turkish bonds and money markets.

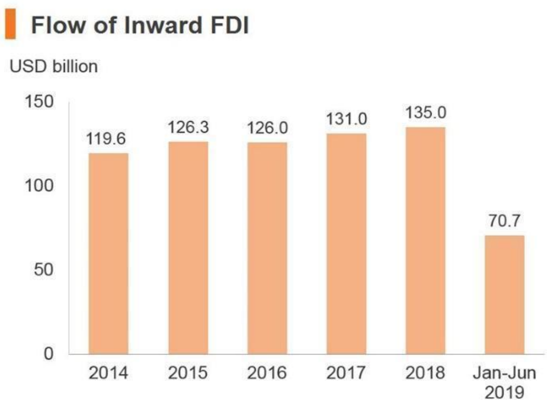
The factors for this crash were varied; however, the two main reasons behind this nosedive are both political as well as economic: Firstly, the decision by the US president Donald Trump, to raise tariffs on steel and aluminum imports gave rise to a minor trade battle with Turkey, who retaliated by raising tariffs on imports such as tobacco, alcohol and passenger cars from the US. This made investors cautious and led them to retract their wealth. Along with this, investors were also worried that Turkish companies would not be able to repay the high debts accumulated by them as the fall of the Lira translated into higher payable debt. Investors were skeptical about President Erdogan's increasing involvement in the functioning of the Central Bank and framing of the monetary policy. This period also saw inflation growing to unprecedented rates and unemployment rapidly increasing which led to a series of economic turmoil for Turkey. However, despite this economic slump, investors continue to have confidence in the Turkish economy. This is mainly rooted in the belief that an economy as dynamic and young as that of Turkey is bound to grow and provide returns.



There are still several investment firms such as MSCI who have become bearish on Turkey and have gradually started to retract their investment. This is because they feel that if the current government continues in Turkey, they could be looking at an economic recession in years to come.

IV. CHINA

The Chinese economy has been one of the greatest success stories of emerging markets. Till the 1980s, China was a conservative and socialist nation. It was Deng Xiaoping who first revolutionized China's economy and set up the roadmap for what China is today. China saw a boom in FDI through the 1980s and 1990s as the government started liberalizing the economy and creating special economic zones such as Shanghai, Shenzhen and Xiamen. Before the liberalization of the economy, China was growing at a dull rate of 5-5.4%; however, as the country opened up to foreign investment and created its own financial markets, it started to grow at a rate of 7.4%, and in 2010 it recorded a growth rate of 10.4%. China's GDP per capita rose from a modest $205 in the 1980s to a towering $8827 in 2017. Over the last three decades, China has also amassed massive sums of foreign exchange which has enabled it to emerge as an economic powerhouse and maintain a stable economy. From reserves of a nominal $2262 in 1980, China has accumulated $3 trillion worth of foreign exchange reserves in 2019. Another crucial way through which China attracts foreign investment is the issue of bonds. China and several Chinese companies raise massive debts to fuel infrastructure projects, growth and development.

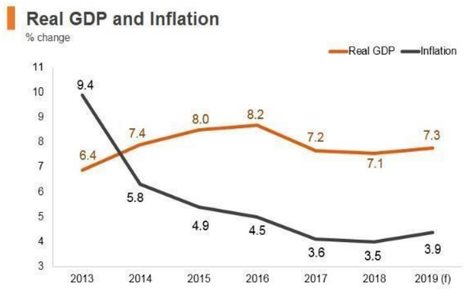


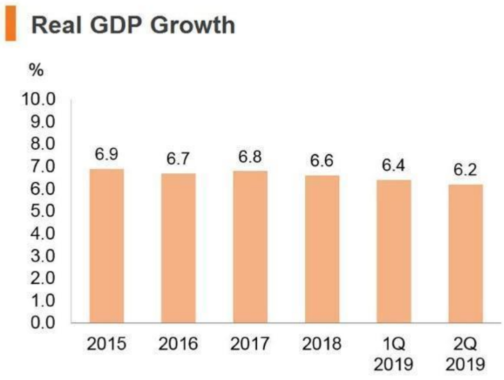
Since 2010 onwards, China has started to move towards being a developed economy and with its GDP being more that $14 trillion, the growth rate of China's economy has reduced and the government has also started to reduce the number of foreign investment opportunities available. China has also been increasingly involved in trade wars with the United States with both economic giants retaliating by raising tariffs on imports from each other's country. This has further led to a decline in the equity and bond markets as foreign investors are worried about the impact of such trade wars with the United states. Most importantly, the outbreak of the COVID19 pandemic and the Chinese Government's handling of it have forced all stratas of investors, especially foreign direct investors, to look at alternate investment opportunities. As global companies start to reevaluate their SOPs post the crisis, finding alternated manufacturing nations has become the top priority.

Therefore, as an investment opportunity, China will probably be substantially downgraded in the years to come. This is primarily due to the growing distrust in the Chinese authorities and prioritization of health and safety. However, the void this will create will be an appealing opportunity for other emerging markets.

V. INDIA

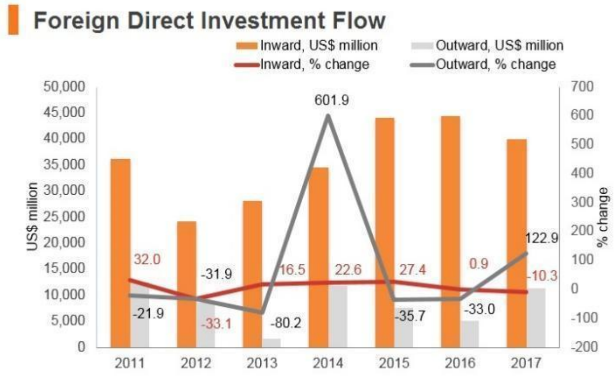
India has been considered as being one of the most stable emerging market economies by several reputed investors. With a consistent growth rate of more than 8% from 2008-2009, when the world saw an economic recession, India continued to project itself as a lucrative investment opportunity. India had considerably relaxed its FDI and FPI norms and made it easier for investors to enter Indian markets. This is why the nation saw towering FDI and FPI inflow from 2014 – 2017. This was also the time India saw a GDP growth rate of more than 7% which further attracted investors. However, there were several factors which led to the markets falling and GDP growth slowing down. One of the major factors was the NBFC crisis that Indian markets faced in 2018. This was the time when liquidity was very low in the market and investors started to grow increasingly cautious of their investments. Along with this the budget of 2019-2020 came as a disappointment to global investors as the government decided to raise taxes on Foreign portfolio investments which meant that the return on investment for foreign investors would further reduce.





Recently, the government retracted the FPI surcharge and reduced the long term and short-term capital gain taxes which encouraged investors to return to India. However, it is too soon to know if these moves would actually attract the lost foreign investment or not. India was one of the few countries which was not affected by the fall of the Lira and this proved the stability of India's economy.

India still remains a popular destination among foreign direct investors as, despite the slowdown, FDI inflow only reduced by 1% in 2018-2019. FDI inflow fell from 44.8 billion US dollars in 2017-2018 to 44.4 billion US dollars in FY 2018-2019. The fiscal prudence of Indian governments and low inflation is what continues to keep investors bullish on India's growth prospects. However, the economy is showing troubling signs, the Indian economy indicated an impending recession, and several rating agencies have reduced GDP growth forecasts to below 100 basis points. On a brighter note, in light of the COVID19 pandemic, investor confidence in China has substantially reduced and a large number of international companies are looking optimistically at India as the next manufacturing centre. This creates a crucial opportunity for India to fight the economic recession and emerge as a global leader in the long run.



VI. THE PATH FORWARD

The last few years in emerging markets, especially India and Turkey, have been volatile and the future remains unpredictable. After the economic slowdown and crisis in India and Turkey respectively, investors finally hoped for a return to a period of high growth. This would mean increase in FDI inflow into developing nations and consequent stimulus for increase in economic activity.

However, in a factor common to both, and to the world economy as a whole, the outbreak of Covid-19 has been a major setback for global economic growth: the IMF has officially declared that the world economy has entered a recession. In a situation where the global economy was struggling and finally nearing a bottom, the outbreak of a pandemic has pushed us years, if not decades, back. It is due to this that FDIs, FIIs, and FPIs have become increasingly conservative, and have started to withdraw their investments from several emerging markets. In the above case studies, it was evident that in both, India and Turkey, foreign investment inflow was directly proportional to economic growth; therefore, an outflow of foreign investment from these economies translates into yet another period of prolonged slowdown.

In a situation specific to India, ineffective governance and a series of financial frauds have effectively crippled the economy, and have muted economic growth. The banking sector - which is one of the pillars of an economy - is facing a series of challenges. The banks have large exposure to both telecom and airline firms, such as Vodafone Idea and Spicejet, both of whom are facing a viability crisis. Furthermore, the collapse of the private lender, Yes Bank, has strained the system even more. These, along with an elongated period of slowdown, have forced global agencies to revise their growth projections for India. Nonetheless, as stated previously, the pandemic might propel India towards a crucial economic juncture, and this might resume India's growth trajectory.

Hence, in the short run, the trends for global growth seem to be timid and unimpressive. However, in the long run, investors can expect to see a sharp recovery in global growth led by emerging markets, as seen after the 2008 financial crisis. This is, perhaps, why investors have good reason to follow emerging markets as lucrative investment opportunities. Despite this, in times where millions are at risk of getting infected, being financially prudent is of paramount importance and conservatism is probably the most rational approach.

VII. CONCLUSION

The three aforementioned examples indicate the various trajectories emerging markets follow and how geo-political instability affects such economies. While Turkey teaches us to be conservative and extensively analyze our investments, China compels us to analyze economic growth in unison with transparency and governance, and India teaches us to be patient with our investments. These examples themselves reflect the variations in the types of emerging markets and the factors affecting them. Political will and control was one of the main reasons behind China's success and plausible downfall, and it also led to an economic crisis in Turkey and a slowdown in India.

Emerging market economies will continue to be lucrative for those investors willing to take a risk and be patient with their investments. What investors must realize is that the volatile and unstable nature of emerging markets is common amongst all growing individuals, companies or any entity for that matter. Emerging markets are like an adolescent striving for success and like a parent must be patient with them, we must be patient with emerging markets. Governments shall come and go but the real growth lies in the hands of the common man and while we support him, there is no reason why he cannot achieve success.

The more faith we invest in such nations and its people and the more wealth we employ, more are our chances to earn profits. Hence, in conclusion, I would like to quote the investing pioneer Benjamin Graham, when he said, “successful investing is about managing risk, not avoiding it”

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