

# Fitch: Emerging Markets Resilient, Monetary Policy Vigilance Needed

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Fitch Ratings-London-12 June 2006: Fitch Ratings today said that emerging markets should be able to ride out the tighter global monetary policy environment and associated re-assessment of risk appetite with their credit fundamentals intact. Nevertheless with inflation concerns having risen across the globe, emerging markets will need to demonstrate their capacity for sound monetary policy management to maintain investor confidence. Fitch noted in its June 2006 Sovereign Review, released today, that the world economy remains strong in 2006. The US has bounced back from the Katrina-affected slowdown in Q405, Japan's economy continues to fire on all cylinders and a German recovery is on its way. Meanwhile China continues to defy expectations of an investment led growth slowdown. World GDP will expand by 3.5% in 2006, above its long run trend. "Rapid GDP growth and the accompanying rise in energy and metals prices have focused global monetary policy makers squarely on inflation risks," said Brian Coulton, Senior Director in Fitch's Sovereign Group in London. "We are entering a synchronised phase of monetary tightening by the world's three largest central banks the likes of which has not been seen since 1979. Along with the continuing drag to real incomes from high energy prices, macro policy tightening will lead to a moderation in global growth in 2007 back towards 3%." The US will lead the adjustment as the consumer retrenches in the face of a weakening housing market and rising debt service costs. The impetus to consumption from the huge scale of mortgage equity withdrawal since 2002 will diminish sharply as US household balance sheets are squeezed from both sides. But thanks to structural economic improvements in Germany and Japan the spill-over effects from a US slowdown should be contained at a global level, resulting in a welcome rebalancing of global growth. This should help limit further increases in the US current account deficit and hence concerns about the dollar. "Nevertheless the changing monetary policy environment and growth outlook seems to have sparked a re-assessment of risk in global financial markets which could dent capital flows to emerging markets, said Fitch's Coulton. "The latter have recently been running at post-1998 highs with the composition having shifted towards portfolio investment in local currency assets (debt and equity) and towards private sector recipients." Tighter global liquidity and lower risk appetite will expose emerging market borrowers with large external financing needs. In the presence of increased foreign investor participation in local currency asset markets it could also see adverse inflation surprises punished severely by the markets. Monetary policy regimes introduced in a previously more benign climate of global disinflation could come under greater scrutiny. Recent market volatility in Turkey partly reflects inflation shocks and perceptions of lagging policy responses. But the improvements in overall emerging market sovereign creditworthiness since 2003 look set to remain intact. Strengthened external finances, falling fiscal deficits and improved macroeconomic policy regimes have underpinned continued improvements in ratings. High commodity prices have boosted the terms of trade for many countries and the recent run up in metals prices seems likely to be sustained, benefiting export receipts in a number of speculative grade sovereigns. The pace of upgrades may be waning, but the ratio of Positive to Negative Outlooks remains 2:1. Political risk has, however, come back onto radar screens in all regions including Latin America, where heterodox policies and nationalism have re-emerged in a number of countries. Meanwhile the threat of a geopolitical shock resulting in a renewed surge in oil prices remains a key risk to the global outlook. The full Sovereign Review will be available at [www.fitchratings.com](http://www.fitchratings.com). Contacts: Brian Coulton, London, Tel: +44 20 7862 4097; Paul Rawkins, London, Tel + 44 20 7417 4239; Roger Scher, New York, +1 212 908 0240; James McCormack, Hong Kong, + 852 2263 9925. Media Relations: Jon Laycock, London, Tel: +44 20 7417 4327. Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, [www.fitchratings.com](http://www.fitchratings.com). Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest,

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