

INFLATION TRENDS IN EMERGING COUNTRIES: BUCKLE YOUR SEAT BELT

Emerging countries have truly delivered phenomenal economic growth in recent years. Their share of the global economy has grown impressively and until recently, they had managed to maintain strong economic discipline. However, economic stress is beginning to develop in the emerging world. In this edition of the Marker, we review the situation and highlight signposts to monitor in coming months.

A KEY DRIVER OF RECENT GROWTH EXPERIENCES STRESS

The developing world has contributed and benefited immensely from the health of the global economy over the past decade. Much has been written about the ability of emerging countries to export their way to new heights of wealth and create better standards of living for their denizens. It is noteworthy that emerging countries have contributed to global surpluses in labour and savings while adding to pressure on supply of agricultural and basic materials, including energy. In doing so, they have helped keep inflation low for the past 10 years; yet, they may be becoming one of the key drivers in mounting global inflation pressures. One thing is for certain, developing countries are now feeling the effects of inflation. As the two charts on this page illustrate, several developing economies now need to compose with very high inflation, which in turn leads to unsustainably high nominal GDP growth. One critical difference between emerging and developed world trends is the fact that wages appear to have moved into upward spiral mode in many emerging countries. This is a central banker's greatest fear as it indicates consumers have determined the inflation threat is real and here to stay.

MARKETS TAKE NOTICE

Wage and price spirals have not gone unnoticed by central banks. With monetary growth in excess of 10% in several countries, no less than 24 central banks have tightened monetary policy since the start of 2008. Emerging economies are forced to deal with a cocktail of threats to economic stability. Inflation is moving up at an accelerating pace, driven by food and oil price increases and higher wages. To make matters more complicated, many of these countries have seen real estate prices increase rapidly on the back of easy financing, and owners are made to face pressure from higher interest rates. Stock markets certainly have begun to react. ISI Group has recently reported that a number of markets had retreated significantly from their peaks. These include China (-54%), India (-30%), and Vietnam (-66%).

INFLATION		
		Latest Y/Y %
Latvia	CPI	17,9%
India	WPI	11,5%
Indonesia	CPI	11,3%
South Africa	CPI	11,1%

NOMINAL GDP	
	Latest Y/Y %
Saudi Arabia	25,0% e
China	22,3%
Vietnam	20,5%
Lithuania	11,5%

Source: ISI Group

NATCAN WEEKLY MARKER

Emerging countries have been key contributors and benefactors of globalisation and of the strong economic growth of the past decade. They are now faced with an elevated inflation risk. Investors have reacted by marking down some of the most speculative markets and stocks. A global economic slowdown may be required to assist these important economic players in taming the inflation monster while avoiding disastrous outcomes. Greater market volatility needs to be expected from these quarters in the coming months.

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FINANCIAL MARKETS

RETURNS AS AT JUNE 27, 2008 (%)	MTD	QTD	YTD	RATES AS AT JUNE 27, 2008	
S&P/TSX	-2.18	8.25	5.17	CAD/USD	1.01
S&P 500	-6.93	-4.36	-10.55	CAD/Euro	1.59
S&P/TSX Small Cap	-1.45	3.61	-0.59	US Treasuries yield 10-yr/30-yr	3.99/4.54
Russell 2000	-4.91	0.24	-6.72	GOC bond yield 10-yr/30-yr	3.70/4.06
MSCI EAFE	-7.11	-4.23	-9.30	Fed Fund Rate (target)	2.00
MSCI World	-6.73	-3.47	-8.74		
DEX Universe Bond	0.11	-0.56	2.38		

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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