INSIGHT

Tide turns

Nicholas Spiro says while recent investor flight from emerging markets is unlikely to become a rout, it is worrying that the sell-off has been this disorderly – before any 'tapering' by the US Fed

"Only when the tide goes out do you discover who has been swimming naked." Warren Buffet's famous phrase rings especially true for the financial turmoil that has engulfed emerging markets since the US Federal Reserve hinted in late May that it planned to scale back, or "taper", its programme of quantitative easing.

Developing economies with large external imbalances or whose prospects for growth have deteriorated (or both) have been hit the hardest in a disorderly sell-off which shows no signs of abating. Last week was particularly brutal, with US$2 billion gushing out of emerging markets bond funds – the 14th consecutive week of outflows – and US$4 billion pouring out of emerging markets equity funds, according to data provider EPFR.

While emerging markets whose underlying fundamentals are relatively strong have not been immune from the sell-off, those with large current account deficits which need to be financed by money from abroad have been penalised by investors. While the list of vulnerable emerging markets is extensive, India, Turkey, Indonesia, Brazil and South Africa have all taken a beating.

These "deficit" countries – as opposed to the surplus ones such as China, the Philippines, Hungary and Kazakhstan – are the most vulnerable to the shift in capital from developing economies to developed ones. While Fed tapering fears were the trigger for the deterioration in sentiment towards emerging markets, the sharp rise in benchmark US Treasury yields has shone the spotlight on weaknesses within the emerging market asset class.

Three failings in particular stand out. The most conspicuous one is the inability – or unwillingness – of policymakers to stop the rot. Instead of raising interest rates to a sufficiently high level to stabilise their currencies and stem capital outflows, Indian and Turkish policymakers have been dithering and tinkering at the edges for fear of endangering growth. While this is understandable, their lack of resolve is now a major contributing factor to the sell-off.

The second major weakness is structural. The emerging markets which are suffering the most right now are the ones whose reform agendas are the most incomplete. Economic, regulatory and institutional shortcomings in many were never meaningfully addressed by policymakers and were masked by the surge in capital flows to emerging markets over the past several years. The "hunt for yield" on the part of investors eclipsed long-standing country-specific weaknesses.

The third big risk is external. A toxic combination of rising US interest rates and geopolitical risks stemming from possible US military intervention in Syria is further souring sentiment towards emerging market assets and boosting demand for "safe haven" investments, such as the Japanese yen. Policymakers in emerging markets have been putting pressure on the Fed to be more mindful of the market dislocations caused by the central bank's exit from quantitative easing.

Still, fears of a repeat of 1994, when emerging markets suffered a full-blown crisis after the Fed stunned markets by raising interest rates aggressively, are way overblown.

Firstly, the emerging market asset class as a whole is better placed to manage the fallout from the sudden shift in US monetary policy. Most emerging markets now have investment-grade credit ratings, operate flexible exchange rate regimes and have much lower levels of foreign-currency-denominated debt. Indeed, risk perceptions have changed significantly since the 2008 global financial crisis, with many emerging markets enjoying higher credit ratings and lower credit default swap spreads – a gauge of the cost of insuring against a debt default – than several developed economies.

Markets which benefited the most from the liquidity are experiencing the sharpest sell-offs

Secondly, investors have become more discerning and are adopting a more discriminating approach this time. Even within the "deficit" group of countries, markets whose external imbalances are smaller and whose underlying economic fundamentals are stronger, such as Poland and Mexico, have fared relatively well since the financial turmoil erupted in late May. While investors were not discriminating enough when emerging market equity and bond markets were buoyant, they are more selective now – and have by no means thrown in the towel on emerging markets.

Much of the foreign capital that has left emerging markets over the past three months or so has been retail and high-net-worth individual money. Large institutions, or so-called "real money" investors, have sat tight and maintained their exposure (although there are indications that even these investors are having second thoughts when it comes to the most vulnerable markets). This is not a fully fledged retreat, at least not for the time being.

The big question is whether the current sell-off will eventually turn into a full-blown rout. The fact that markets which benefited the most from the ample liquidity provided by central banks are now experiencing the sharpest sell-offs suggests that this is a correction as opposed to a financial meltdown.

However, much hinges on the Fed's exit from quantitative easing. That it has proved this disorderly even before the Fed begins to taper its asset purchases, to say nothing about increasing interest rates, is cause for serious concern.

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The quiet revolt

Alice Wu looks at how the use of two simple words that pack a big punch could well transform Hong Kong's bickering political scene

Dr York Chow Yat-ngok, former health minister and now head of the Equal Opportunities Commission, seems to have found a new voice after leaving government. The softly spoken man has proved many people wrong – and surprised the public – not only with his willingness to weigh in on issues, but also with his frank views.

On his first day at the commission, he spoke on voting rights and the need for Hong Kong to comply with the International Covenant on Civil and Political Rights, thereby pitting himself against some political heavyweights and dispelling critics' doubts about his "watchdog" credentials.

And by urging caution on government rules to limit sales of milk powder in Hong Kong, he showed he was not afraid to question the work of his former colleagues when needed. When his critics got personal – making assumptions about him based on his religious beliefs – he proved them wrong, too. And so the public learned an important lesson about not making assumptions.

Chow taught us another lesson last week. When asked to comment on the controversial suspension of Yu Cheuk-man, former head of cardiology at the Prince of Wales Hospital, Chow offered his considered view. Given his previous positions as health minister and chief executive at Queen Mary Hospital, he seemed perfectly entitled to do so, and his words should carry weight.

Whether the suspension of the heart specialist revealed management and teamwork issues within the hospital, as Chow suspects, that is something the Hospital Authority's independent investigation committee should look into. Meanwhile, Chow urged all parties to "shut up"; it was time for serious work to be done and the bickering to stop.

And this got me thinking about the history of the "shut up" in politics. It's not every day that one hears public figures telling people to "shut up". Those words surprised some in Australia last month, when opposition leader Tony Abbott phrased a historical put-down against his opponent, Prime Minister Kevin Rudd, with "Does this guy ever shut up?" during a debate in Brisbane.

Earlier that month, on the eve of the US Senate's August recess on the other side of the world, US senator and majority leader Harry Reid told chatty senators to "sit down and shut up". The "Great Communicator" Ronald Reagan fought back against political hecklers when he was US president with "Oh, shut up!" more than once.

"Shut up" – two simple words that pack a big political punch – has been used, quite effectively, to taunt, rebuke, win debates and hit back at hecklers. Chow might just have been aiming his comment at the war of words over Yu's suspension controversy but, certainly, others can learn from his "shut up" dictum.

A few things come to mind, but as today is the first day of school for many children, this summer's curious case of foul-mouthed teacher Alpais Lam Wai-sze stands out. If only she had held her emotions in check, there wouldn't have been the subsequent war of words and the verbal diarrhoea of those who just won't shut up. And, as our legislators prepare to return to work, Chow may have happened upon a possible solution to the rowdiness within the chamber's walls.

Alice Wu is a political consultant and a former associate director of the Asia Pacific Media Network at UCLA

The ICAC has been politicised, though not by our chief executive

Mike Rowse says the high-profile complaint against Franklin Lam was but a smear campaign

There has been a lot of talk recently about "politicisation" of the Independent Commission Against Corruption.

Much of the commentary has been very wide of the mark and, in some cases, the logic of the situation has been turned completely upside down.

Let me begin by setting out the credentials which I believe allow me to speak with some authority. I arrived in Hong Kong in 1972, at which time corruption was rampant within the public service and in particular the police force. During 1973 and 1974, while working as a reporter for a tabloid newspaper, I specialised in writing stories about corruption.

When the ICAC was established and advertised for recruits, I joined the Operations Department in the first wave and was a proud member of Induction Course 1A. I stayed for three years in operations and also spent three years in the Corruption Prevention Department.

Because the forces of darkness were perceived to be all powerful, a priority in those years was to persuade the public at large to report at all. They were afraid of retribution and the new organisation had first to earn credibility. Most of the early reports were anonymous. Hence, the emphasis right from the outset was on protecting the identity of informants.

Bit by bit as the ICAC won its spurs, the situation improved and gradually the proportion of those making reports who were prepared to identify themselves crept up. They are now very much the majority.

But confidentiality remains vital to the organisation's work. There is, of course, still a need to protect informants, partly to improve the prospects of success by keeping the facts of investigation and key details secret, and partly to protect the reputation of those subject to false or malicious reports who are later found to be innocent.

In effect, Lam was innocent, but this was reported as 'not enough evidence to prosecute'

This last aspect has been totally overlooked in recent years. In fact, the pendulum has swung completely the other way. There are some in our community who think nothing of making reports to the ICAC in a very high-profile way, sometimes actually turning up with camera crews and busloads of reporters and photographers in attendance.

Having lodged their "complaint", they then come out and make statements to the press naming the individuals and giving details of the allegation. The same media representatives then rush round to the person who is the subject of the complaint and demand a response. He in effect does a "perp walk" and the public are left with a very negative impression.

A common response might be to the effect that there's no smoke without fire: presumed guilty unless and until you can prove your innocence.

Why do the complainants – all active in political affairs – do this? Because it is an easy way to generate good publicity for themselves and smear their opponents, or those associated with them.

They are, in short, using the ICAC as a political weapon, knowing as they do that the organisation is obliged by law to investigate every complaint.

Reporting the outcome of investigations has also been politicised. When the ICAC, on the advice of the Department of Justice, decide not to prosecute, this might be for a range of reasons stretching from "did something dodgy, but just short of breaking the law" or "not quite enough evidence" right through to "report was erroneous, the accused is innocent".

For example, in a recent case, it was established that Franklin Lam Fan-keung had put two residential properties on the market prior to his appointment as an executive councillor. It was therefore quite false to claim that following his appointment he had taken advantage of inside knowledge to unload the properties in a hurry, fearing the impact of proposed new housing measures.

In effect, then, he was innocent, but this was reported in the media as "not enough evidence to prosecute" alongside quotes from his original accusers insisting on their own interpretation.

When Chief Executive Leung Chun-ying suggested that, in such cases, the accusers might care to apologise, he was accused of politicising the ICAC.

This is utter nonsense. The politicisation began with the original accusation.

Whether Leung was wise to say what he did is another matter. He could have waited for someone else to make the point on his behalf. Someone, perhaps, who had himself been subject of a false report and would therefore write with feeling about the subject.

Like this.

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Innovation holds the key to healthy, growing economies

Lord Hunt says growth must nonetheless rely on sustainable resource use

Following a recent meeting between Asian Development Bank president Takehiko Nakao and Chinese Finance Minister Lou Jiwei (樓繼偉), the bank has pledged its support for green and inclusive growth in China by providing US$4.21 billion in the next two years for urban development, water supply and sanitation, and transport projects aligned with the current 12th five-year plan.

The announcement comes as the "green growth" approach is receiving growing support at the expense of an alternative "green economy" paradigm, which is increasingly viewed as politically unacceptable, largely because it will probably mean lower standards of living for many in the developing world.

Green growth, by contrast, implies rising consumption of resources, food and energy – and thus higher standards of living. However, implicit in this approach is that developing countries must also introduce fundamental changes in patterns of consumption, technology and agriculture to ensure a sustainable future for their growing populations.

The importance of sustainability for economic growth was illustrated during the 2011 intense floods in Thailand, which disrupted the country's car industry, with knock-on effects for international supply chains. And in Asia, this year, there have been several examples of severe air pollution in cities spreading over hundreds of kilometres. This disrupted both economic activity and affected the health of millions, underlining the urgency of speeding up measures to protect the atmosphere.

Despite its popularity, green growth also poses extraordinary challenges, nowhere more so than in China. One example is choosing appropriate policies, which can be controversial. China, for instance, is promoting online shopping and local delivery centres "on every street corner". However, critics question whether the global shipping of consumer goods will not massively increase air pollution emissions.

Green growth implies rising consumption of resources ... thus higher standards of living

It is clear that for more people to enjoy better standards of well-being, while promoting sustainability, enhanced innovation is needed to reduce consumption of physical materials and damage to sensitive ecologies and resources. Some small states and cities in the developing world are showing the way, with world-class, low-emission transport, low-energy housing, agriculture with low energy and minimal water use, and bio-energy.

At a continental scale, developing countries have a record of establishing innovative energy and water networks, although transport and trade networks have emerged more slowly. Buckminster Fuller's vision of a world electricity network is becoming closer as Europe, Russia and China are linking together, and other Asian nations plan to join. This is a key part of green growth and will bring significant benefits.

For the developed world, a key challenge is how best to share knowledge about green growth with developing countries and, just as important, how to convince more decision-makers that economic development needs to be based on optimum long-term use of natural resources.

It is clear that green growth represents a key, emerging development paradigm, and that China will probably be the crucial test bed. Whether this approach is widely adopted and proves successful will have vital implications not just for the developing world, but also for global environmental sustainability.

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