



CAPITAL & ECONOMICS

Are The Emerging Markets Still Emerging?

September 8th, 2015

OVERVIEW

Throughout the world's long recovery from the 2007-2008 global financial crisis, the fortunes of emerging markets have attracted close attention. As most of the developed world entered recession, real GDP growth continued across much of the developing world. Innumerable papers and articles analyzing the reasons for the difference have suggested that this heralded a fundamental change to the global economic order.

Eight years on, and much of the developed world is still struggling to fully recover from the downturn. However, things could be looking up. The International Monetary Fund's July 2015 Global Economic Outlook projected developed market growth of 2.1 percent in 2015, up from 1.8 percent in 2014. Meanwhile, growth in the developing markets is set to slow from 4.6 percent in 2014 to 4.2 percent in 2015.

Is the world beginning to return to its pre-crisis norms? Some of the biggest boom markets of the post-crisis period seem to be struggling. Brazil has entered recession, low oil prices and sanctions continue to threaten Russia, and reports of slowing growth in China have increased following its summer 2015 stock market crashes and August 2015 currency devaluation. At the same time, many of the regulatory problems that have long characterized developing markets have yet to be overcome. Are the emerging markets still a good opportunity for business growth, or is it time to refocus on the post-crisis developed world?



IN DEPTH

As businesses looked for safe bets while the West remained in turmoil following the 2007-8 financial crisis, high growth in developing markets began to seem an ever more appealing opportunity for business. The BRICS (Brazil, Russia, India, China and South Africa) were rising as more mature economies were falling, promising new markets as well as new investment opportunities. As of early 2015, the world's four biggest companies were all Chinese, while in 2007 none made it into the top 40. Meanwhile, the ongoing uncertainties in the Eurozone continue to threaten a fresh crisis for the hyperconnected developed world.

This is why some claim that to consider China and India as “emerging” shows outdated thinking – by nominal GDP, China is the world's second largest economy, India the ninth. By Purchasing Power Parity, the IMF and World Bank's 2014 figures both place China at number one and India in third place, while Brazil and Russia are also still in the top 10.

High-growth economies also have an impact on the wider world economy. As their wealth increases, so does demand for raw materials and, with the rise of newly wealthy middle classes, for high-end products like Western cars and technology – Apple is selling more iPhones in China than the U.S. for the first time in the first quarter of 2015. Equally, while Western overseas investment declined during the financial crisis, booming Chinese and Indian companies began to invest abroad more than ever before, a trend likely to continue.

So there's potential competition, but also increased opportunities to take advantage of the goods and services available from these markets. Even the smallest companies in developed markets have the opportunity to outsource work or to buy commodities and products that originated in the developing world, reducing costs and increasing efficiencies in a time of ongoing economic uncertainty.

Signs of trouble?

Despite this, today the economic outlook for the BRICS seems mixed. Brazil is in its deepest recession in 25 years, while South Africa is potentially also on the edge of recession. Russia's economy has been hit by sanctions over Ukraine and, although opinions are mixed on the impact, falling oil prices. China's growth is slowing and its July 2015 market crash has raised questions about its economic stability – as well as having a negative impact on neighboring economies. While India's growth seems strong, questions have been raised about the reliability of the official figures, and recent figures show a marked contraction in both imports and exports.

This is why attention has begun to turn to another group of emerging economies, dubbed the MINTs – Mexico, Indonesia, Nigeria and Turkey. They in turn have been grouped within another set of countries, the “Next Eleven,” identified by investment bank Goldman Sachs as having “high potential,” and made up of Bangladesh, Egypt, Iran, Pakistan, the Philippines, South Korea and Vietnam as well as the MINTs.

With many developing economies blessed with growing, youthful populations, the potential for further economic growth in these markets and others in the developing world is immense.

A question of trust

However, despite the potential for growth there are also still many potential pitfalls. The key concerns for businesses operating in the developing economies remain transparency, predictability and regulation. In emerging markets, legal systems are often less robust, corruption more common, and political situations less stable.

The Petrobras scandal in Brazil has rocked the government and the economy, but has also had an impact on the reputation of Brazilian business. In China, high-profile antitrust cases against foreign companies have led to settlements in the hundreds of millions of dollars, and its sweeping new national security law has been seen by some analysts as another sign of a tightening of control over the economy as well as society, making some wary of the potential uncertainties of operating within the market. In a similar if more overt way, Russia has introduced legislation to target “undesirable” foreign non-governmental organizations, which could include businesses seen as competing with state-owned firms. Meanwhile, concerns over the reliability of India’s revised GDP figures are matched by uncertainties about its rapidly-changing regulatory landscape.

With most emerging markets eager to be seen to reform regulatory and legal systems to attract foreign investment, the landscape is shifting constantly. Though their economies may now be among the biggest in the world, their regulatory systems have yet to catch up. Indeed, one recent survey of risk management and compliance executives at 150 multinationals found that 83 percent of respondents had suffered significant losses in emerging markets through regulatory, bribery and fraud, or reputational issues.

With so many unknowns across the world’s emerging economies, the big picture can only tell us so much. While some countries may be hit by falling commodity prices, for others this can prove a boon as supplies for key industries become cheaper. This is why it is so important for any business with current or future links to any emerging market to take a more detailed view. There may be trouble ahead, but there may also be fresh opportunities.

TALKING POINTS



“Global manufacturers, retailers and their logistics service providers need to remain cognizant of the shifting dynamics if they are to exploit the significant opportunities which exist” – John Manners-Bell, CEO, Transport Intelligence



“Blindly lumping emerging economies together under a single banner is a risky strategy for any investor. Don't adopt a 'bulk buy' approach, rather think of emerging markets as a pick 'n' mix investment opportunity – selectivity is key.” – This Is Money



"It is often unclear why one country has been awarded emerging status while another merits a developed tag. Chile has a bigger economy, a bigger population, less debt and lower unemployment than Portugal but is classed as emerging, whereas the European nation remains part of the developed world."

– The Financial Times



"China... could drag global growth below 2 percent, a threshold many would agree is equivalent to a world recession. If Singapore is any guide, it may already be under way." – Bloomberg View



"The era of 'easy' GDP growth driven by a massive army of young workers is ending. Emerging economies must face the resulting growth challenge head-on, by pursuing sweeping changes in policies, incentives, and established practices to boost productivity." – Martin Neil Baily, Brookings Institution,

and Jaana Remes, McKinsey Global Institute, Project Syndicate

FURTHER READING

- Emerging markets are in trouble – Business Insider, August 13, 2015
- Why emerging-market weakness is not a replay of the 1997 financial crisis– The Economist, August 23, 2015
- The crack in the BRICS – The World Economic Forum, July 9, 2015
- Why The China Stock Crash Matters – Forbes, July 10, 2015
- How to survive and thrive in emerging markets – The Canadian Trade Commissioner Service, July 21, 2015
- A Framework for Strategists Assessing Emerging Markets – Harvard Business Review, July 2, 2015
- Emerging markets: special focus – Euromoney, ongoing series
- In Depth: Redefining Emerging Markets – Financial Times, ongoing series
- Political Risk Map 2015 – Aon's interactive guide to global political risk
- Market Views & Analysis – Aon's weekly global market report archive