Emerging Markets – The Comeback Story

By Vinika D. Rao , Executive Director, INSEAD Emerging Markets Institute

Uncertainty in the rich world and a new growth normal in developing economies add up to big changes.

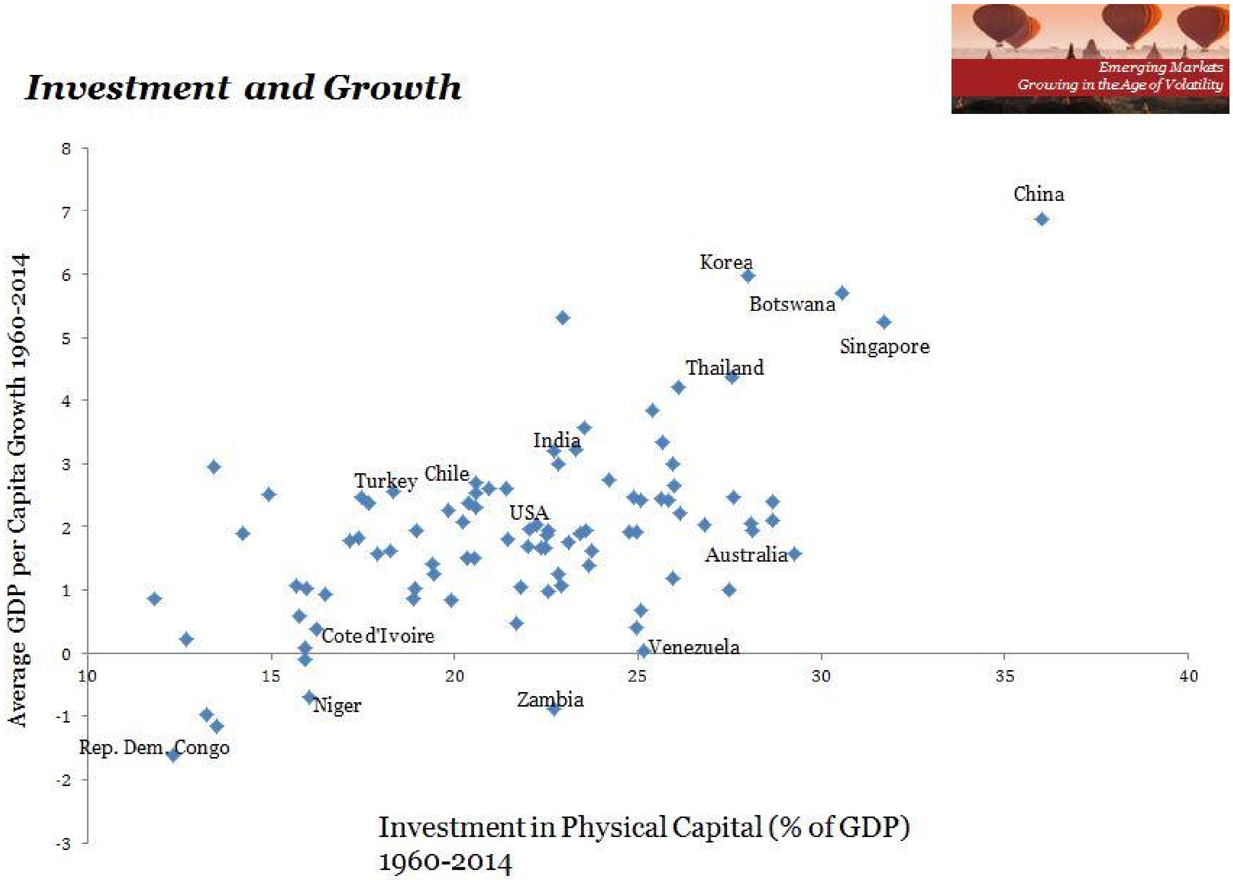
On 9 November 2016, as votes were being counted in the U.S. presidential election, Indian Prime Minister Narendra Modi announced that the country’s two largest denomination currency notes would cease to be legal tender effective at midnight. The aim – to pull the rug out from under black-marketeers – represented a surgical strike against the main scourge of countries seeking rapid growth: corruption. Unsurprisingly, international media attention was focused elsewhere. However, for a global economy seeking some haven of stability after the shocks of Brexit and the Trump win in leading developed economies, there were important reasons to watch this move carefully. It was another big step by a growth market towards creating the institutional and governance framework that has so far been the domain of so-called developed nations.

While the glory days of double-digit growth in emerging markets (EM) are certainly behind us, strategic moves like cancellation of large bills create hope for a comeback. Backed by the realisation that institutional inadequacies have to be addressed before growth ambitions can be realised, a new, slower and steadier growth normal is developing in these countries. In any case, recent surprises have demonstrated that the popular acronym VUCA – Volatility, Uncertainty, Complexity and Ambiguity – is now better applied to developed nations than to the emerging markets.

Improved fundamentals in emerging markets have led to an equity and debt rally in 2016. EM equities outperformed developed markets and EM debt has been among the best performing fixed income asset classes over the past 12 months. Analysts who dismissed these markets as no longer at the forefront of global growth are now talking about the yield they offer. But sustained recovery will require redoubled improvements in fundamentals and structural reforms.

Trends and challenges

At the 2nd annual **Emerging Markets Conference** held at INSEAD's Asia Campus, Dean Ilian Mihov, the Rausing Chaired Professor of Economic and Business Transformation at INSEAD, presented a framework summarising how economic success has been the result of providing the appropriate conditions (macroeconomic and institutional) for investment and, more generally, for business creation to take place.



Source: Dean Ilian Mihov

Mihov spoke about five major global trends that will influence growth potential in EMs:

1. Continued regulatory and institutional reforms: including political stability, government effectiveness, regulatory quality, rule of law and control of corruption

2. Productivity slowdown in advanced economies

3. Low real interest rates

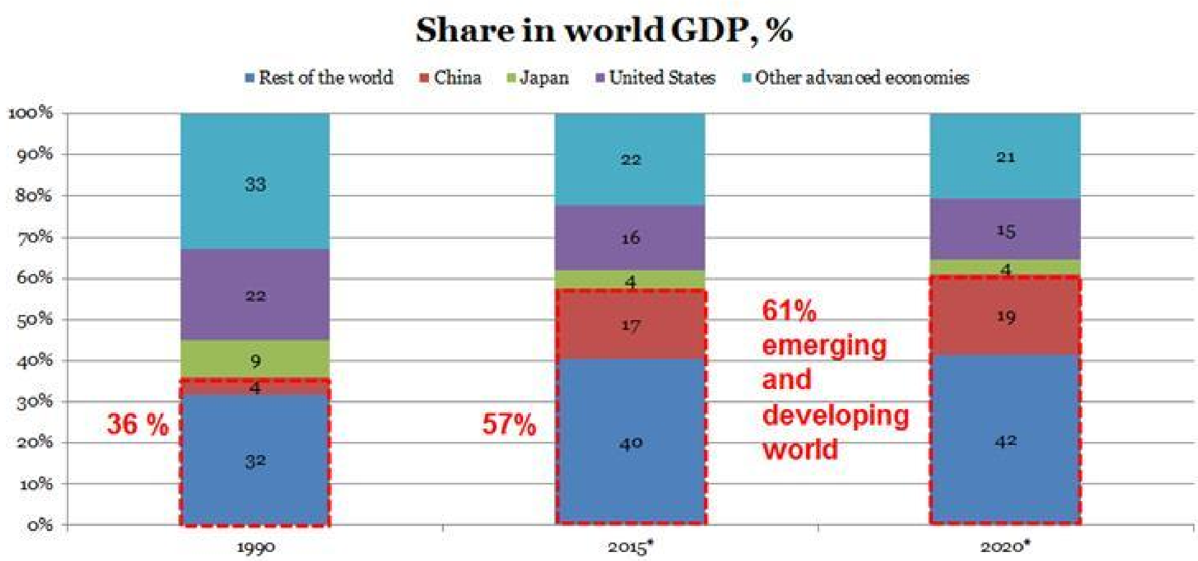
4. The rise of income inequality, populism and political instability

5. Monetary worries: Is unwinding of QE riskless?

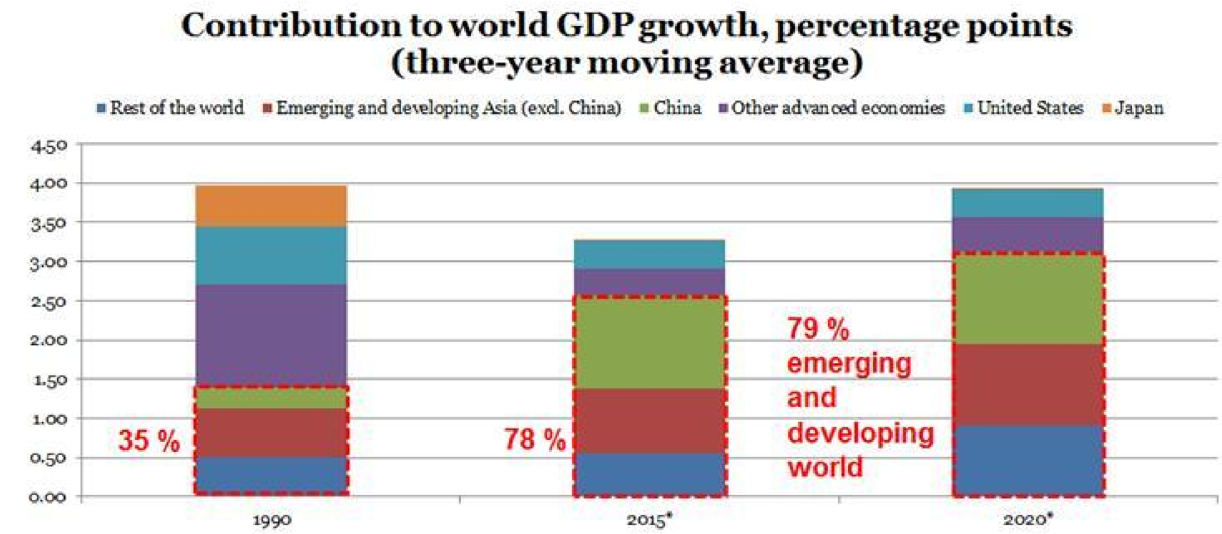
From *The Economist*, Andrew Staples, Director of Corporate Network, Southeast Asia, spoke about the return of political risk around the world, in the form of anti-establishment issues (Brazil and Philippines), long-running disputes (North Korea and South China Sea) and populism (Brexit and

Trump). South Asia will remain the fastest-growing region, with growth driven by strong private consumption and investment. But growth could be stunted by inward-looking growth strategies and protectionist regulations. Globalisation is now on the back foot.

Jennifer Blanke, Chief Economist, World Economic Forum, described how the distribution of world GDP has shifted with emerging markets becoming drivers of world GDP growth. The uncertainty in advanced economies is in large part responsible for the sluggish projected 3 percent global growth figure for 2016. Emerging markets, on the other hand, are once again at the frontier of growth.



Source: World Economic Outlook , International Monetary Fund, October 2015



Source: World Economic Outlook , International Monetary Fund, October 2015

East Asia/Pacific drives almost 40% of global growth; improvements over the last decade

India leads South Asian economies, rising to 39th with all-round improvements

South Africa is stable but must upgrade infrastructure and education, institutions

Brazil declines, hit by lower commodity prices and diminished confidence

The most competitive economy in MENA, the **United Arab Emirates**, is also the most diversified

How the BRICS stack up

Global Competitiveness Report 2016-2017	Global rank*
China	28
India	39
Russian Federation	43
South Africa	47
Brazil	81

How the MINTs stack up

Global Competitiveness Report 2016-2017	Global rank*
Indonesia	41
Mexico	51
Turkey	55
Nigeria	127

Source: Global Competitiveness Report, September 2016, World Economic Forum

Blanke highlighted that EMs face a number of competitiveness challenges:

• Productivity and output growth have been declining while income inequality is rising or stagnant.

• Commodity prices have fallen, trade growth has stalled.

• New technologies and the 4IR (fourth Industrial Revolution) have the potential for leapfrogging or being left behind.

• Improving competitiveness and making the growth process more inclusive will be critical.

Ones to watch

Meanwhile, the next wave of EM activity will feature a new set of players. Among the hotspots that are on investor watch-lists are Myanmar, Nigeria and Argentina.

Ye Min Aung, managing director of both the Myanmar Agribusiness Public Corporation and Ayeyar Hinthar Group, said that with a projected GDP growth rate of 8.6 percent, Myanmar is the world’s fastest-growing economy. In close proximity to India and China and thus to almost 40 percent of the global population, the country boasts a population of 54.1 million people, 60 percent of whom are relatively young. The Yangon Stock Exchange was established in December 2015 and various economic reforms have been introduced in Myanmar.

Political risks are still prevalent, however. Aung suggests working with a good local partner, establishing links with the Union of Myanmar Federation of Chambers of Commerce and Industry (UMFCCI) and the Myanmar Investment Commission (MIC), as well as investment advisory services at foreign banks and practicing “transparent and responsible investments”. Singapore is among the largest foreign investors in the country and many foreign investors are finding it useful to use the city-state as their hub for investing in Myanmar.

Tonye Cole, co-founder and executive director of the Sahara Group, which was founded in 1996 and now has an annual turnover of more than US$12 billion, said that the “attractiveness of [Nigeria] depends on who you are talking to”. To invest in Nigeria, Cole says, it’s essential to experience first-hand its vibrancy and spirit of entrepreneurship. “Everyone is hungry for something in Nigeria.” He advises to look beyond the country’s reputation for corruption and political instability, especially as these factors ensure relatively low competition and high margins. Oil and gas continues to be a major area. Nigeria has 185 trillion cubic feet of proven gas reserves, representing an estimated US$55 billion worth of investment opportunities. The Sahara Group owns the largest power plant in Nigeria, producing about 40 percent of the country’s current output. But this is a fraction of what the country actually needs.

Sergio Fogel, co-founder of dLocal and Astropay, emphasised how fast things can change for the better. In 2015, Argentina was in dire straits – the GDP was crashing, inflation was out of control, exports were down, infrastructure was crumbling and even "the national soccer team was performing badly!" But in April 2016, Argentina re-entered the bond market with the largest emerging-market debt sale ever. Though hurt by taxes and foreign exchange controls, Argentina's agribusiness continues to do well, and the energy, mining, forestry and raw materials sectors are also flourishing. The nation's embrace of innovation has made it a world leader in the bitcoin market.

According to Sergio, "volatility has its value" as it brings great opportunities to those who aren't afraid of risks. Argentina offers access to talent, sophisticated consumers, innovative solutions and raw materials, and provides a gateway to LATAM countries.

Overall, the common theme among the successful EM entrepreneurs – hungry, combining astuteness with a dash of audacity – is their ability to look for the opportunities behind the chaos and instability.

The new crop of emerging markets is distinguished by concrete efforts to improve their institutions, infrastructure, talent and information.

Once these countries start getting it right, they promise growth rates that will outstrip anything we're likely to see in the developed world anytime soon.

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