economist SPECIAL

neptune

an emerging global picture

December 2008

With emerging markets having been hard hit by the financial crisis, does this signal the end of the story for the BRIC economies? James Dowey, Economist at Neptune Investment Management, explains why he thinks categorically not.

The credit crisis in the developed world is not the end for emerging markets. On the contrary, it is the mother and father of buying opportunities.

It is true that collateral damage to emerging stock markets this year has been severe. Amid unprecedented levels of financial turmoil, global investors have been forced to deleverage and de-risk – which has meant taking money out of emerging market equities. The result has been sharply falling equity markets across the emerging world.

huge discount

The long-term fundamentals of the key emerging economies have not been affected. The rise of the BRIC economies, which together account for more than 40% of the world's population, is a far greater force than the credit crisis. It is the economic event of our lifetime. The stock market falls these countries have experienced merely present a chance to purchase the long-term growth that they offer at a huge discount.

Emerging economies have low capital stocks and hordes of labour occupied in unproductive agricultural jobs. When you add capital to the economy in these conditions, the return on each factory, each piece of machinery and each mile of rail track is very high. When technology and ideas imported from the developed world flow to Shanghai and Mumbai to meet labour migrating from the Chinese and Indian countryside, the result is rapid economic growth. This has been the case in China since the late 1970s and in India since the early 1990s. This pattern of development is not new – it is an established course.

turning point

We are, however, currently at an important turning point. Emerging economies, many of which have relied on exports to the developed world for a large portion of their growth in the early stages, are now reaching the size at which they become growth poles in their own right. They are now adding significantly to the demand side of the global economic equation, not just the supply side.

This year Russia overtook Germany as the largest consumer market in Europe. India now has a middle class of 200 million people, leading lives recognisable to the Western consumer. Around 10 million middle-class Indians can afford the world's most expensive brands while another 50 million can buy the cheapest in the range, and 140 million in between can aspire to Levi's jeans and iPods. In China, the authorities have stated an objective to help rebalance economic growth from exports towards domestic consumption. With a potential market of ultimately 1.3 billion consumers, this is a huge development for the global economy.

Moreover, consumption in emerging economies is growing rapidly because wages in those countries are growing rapidly. This is in stark contrast to the West over the past decade, where consumption has grown in line with debt.

timing

We are still in the midst of the financial crisis, as Western policy makers scramble to fix the battered banking sector and to ensure their economies do not lose momentum altogether. While the Western financial system is still in crisis, further falls in emerging markets are likely. Indeed, it will be difficult to find the bottom in emerging markets, but for those looking for long-term growth emerging markets look very attractive at this point.

The current crisis in the west is acting to accelerate the shift in global economic weight towards the emerging economies. Long-term investors should take note and act.

The opinions expressed here represent the views of the author at the time of preparation, may change and should not be interpreted as investment advice.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Selestia Investment Solutions investment platform gives you access to an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, Collective Retirement Account and Collective Investment Bond provided by Selestia Life & Pensions Limited and an Offshore Collective Investment Bond distributed by Skandia MultiFUNDS Limited for Old Mutual International (Guernsey) Limited.

Skandia fund platform gives you access to MultISA and MultiFUND provided by Skandia MultiFUNDS Limited and to products provided by Skandia Life Assurance Company Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited, Skandia Investment Management Limited and Selestia Life & Pensions Limited are registered in England & Wales under numbers 1363932, 1680071, 4227837 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359, 208543 and 207977. VAT number for all above companies is 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Businessn (Bailiwick of Guernsey) Law 2002. Registered number 2424. Registered Office at Fairbairn House, PO Box 121, Rohais, St Peter Port, Guernsey GY1 3HE, Channel Islands.