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Emerging and frontier markets: myths and realities

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Emerging and Frontier Markets: Impacts on Global Economy

International University of Monaco
Monaco

November, 2015

Dr. Marcus Goncalves

Business Experience

- President of MGCG, Inc., an international management consulting firm focused on global markets advisory services, international project and operations management, risk management, organizational development and international business ethics/FCPA.

Education

- Ph.D. (ABD) University of Saint Joseph, Macau, China - 2016
- Ed.D. Boston University, Boston-MA, USA
- Ms. CIS, Southwest University, Keen-LA, USA

Academic Experience

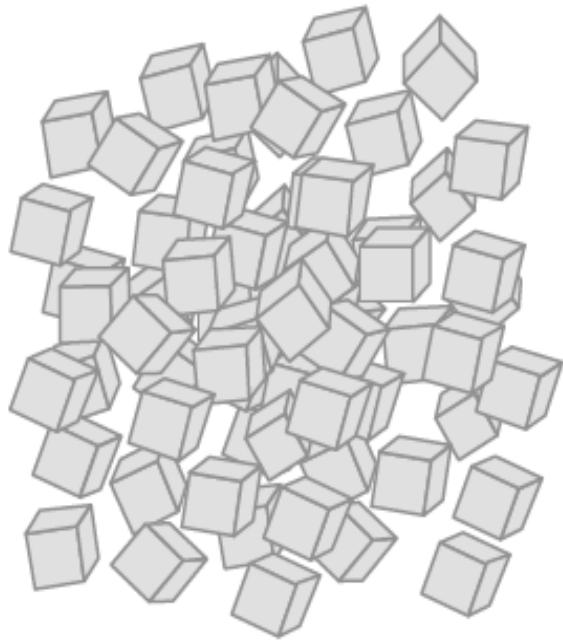
- Adjunct professor at Boston University - Graduate level courses in International Business Affair, Project and Operations Management
- Adjunct professor at Brandeis University – Graduate levels courses in International Business, Project and Knowledge Management
- Professor and Chair of International Business Program at Nichols College – teaching a variety of courses in ethics, international business, project management, marketing, and operations.



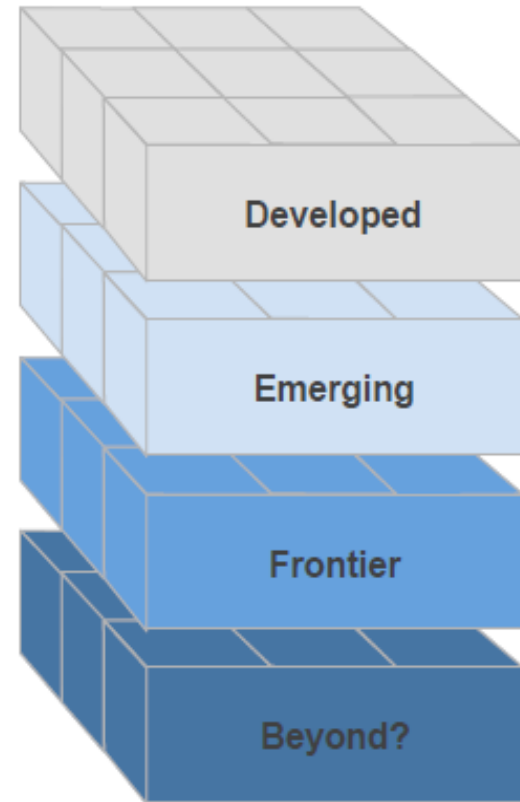
Emerging and Frontier Markets: Microeconomic Analysis and Opportunities



Sorting out countries and trading blocks



193 different countries...



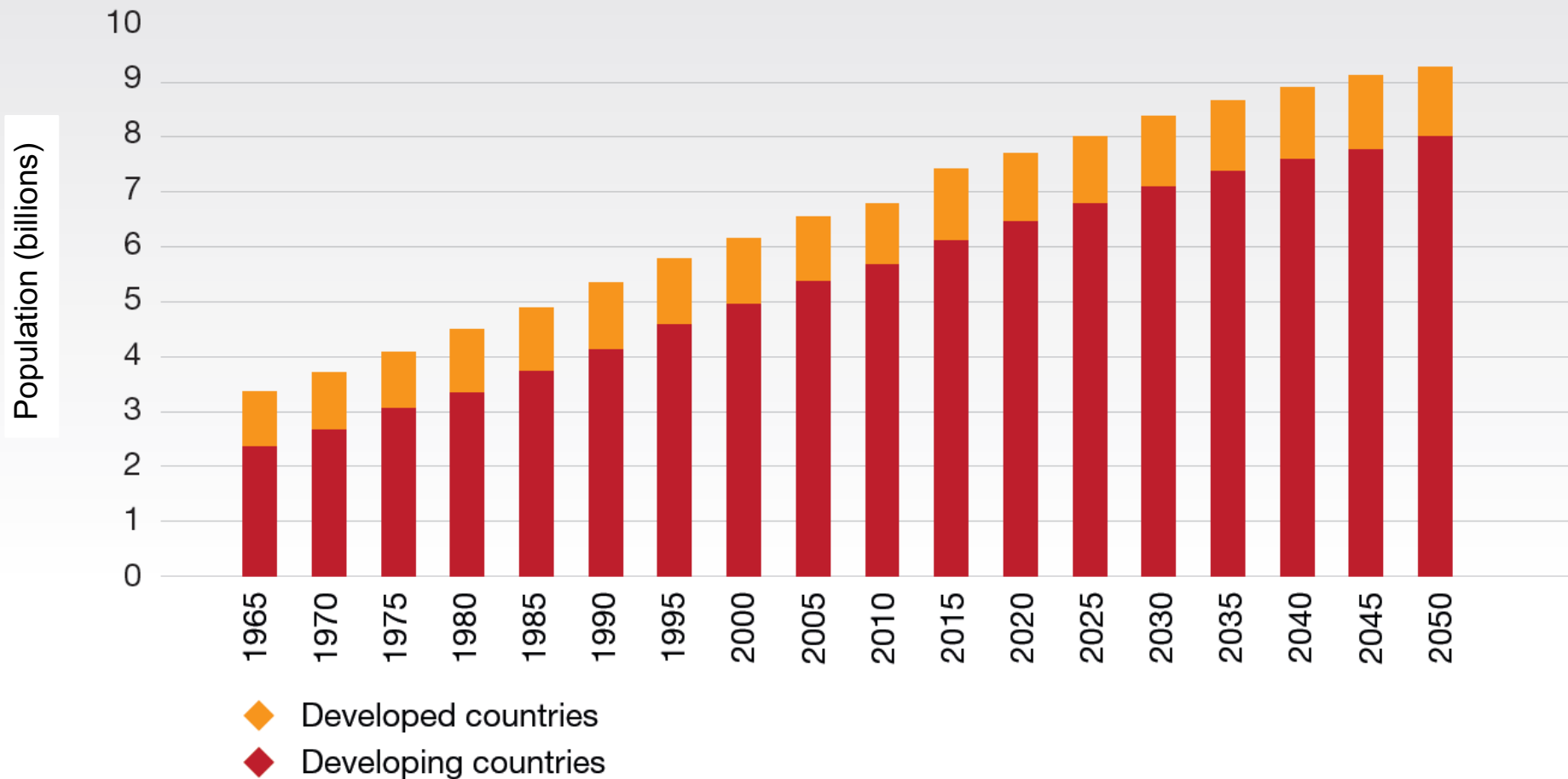
...Four neat categories

Danger everywhere you look... Really?



Source: The Reformed Broker

World population 1960-2050



Source: World Economic Forum Water Initiative, edited by D. Waughray (2010). *Water Security: The Water-Food-Energy-Climate Nexus*, based on United Nations Population Division, UN-DESA, UN Revision 2008

Population Drive

Top 10 largest cities in the World 2013

Emerging — Advanced	Population
10. Cairo, Egypt	19.6m
9. Sao Paulo, Brazil	19.8m
8. Shanghai, China	20.8m
7. Mexico City, Mexico	21.2m
6. Manila, Philippines	21.9m
5. New Delhi, India	22.2m
4. Seoul, South Korea	25.2m
3. Jakarta, Indonesia	28.0m
2. Chongqing, China	28.8m
1. Tokyo, Japan	35.1m

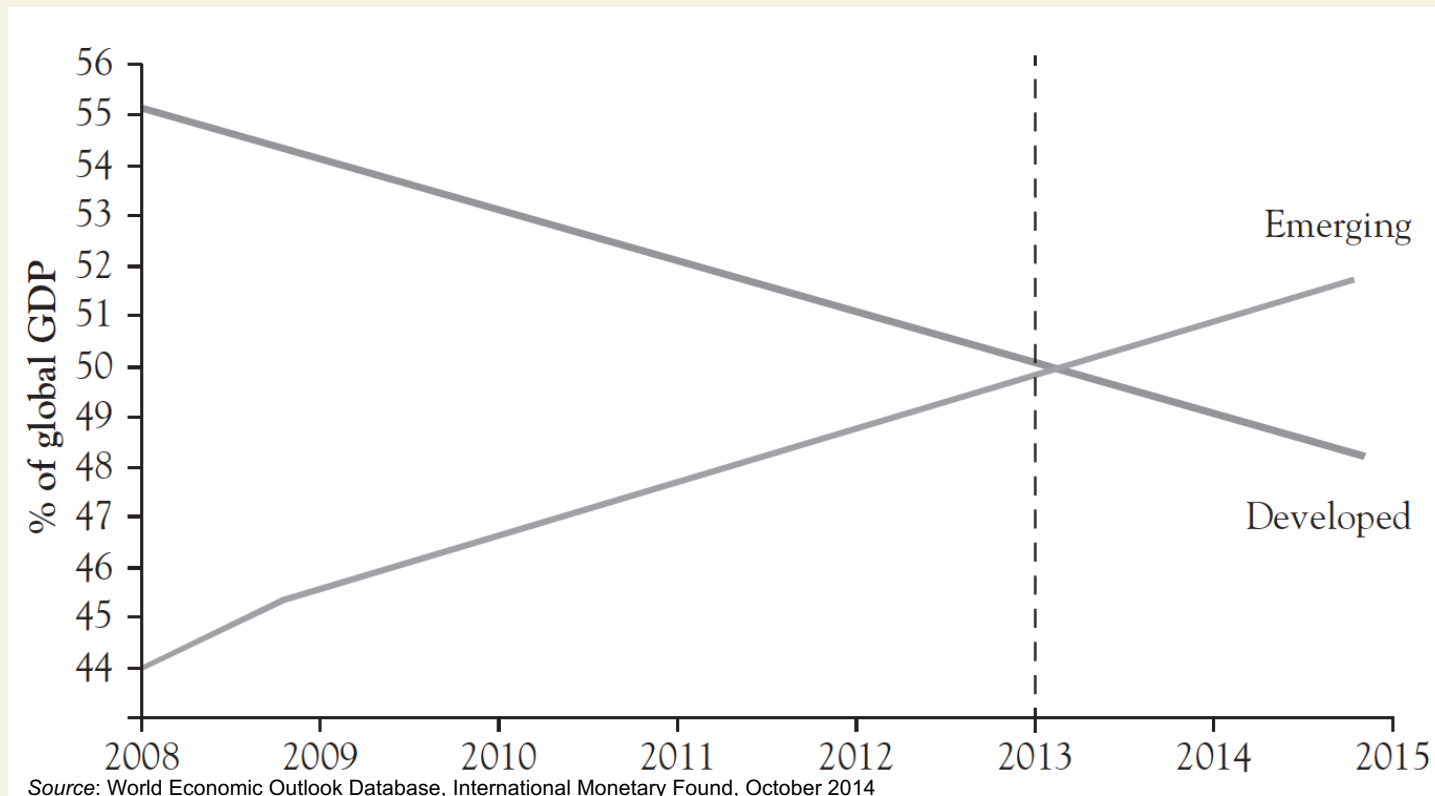
The impact and influence of emerging markets on advanced economies and global trade is impressive. **Today, these countries constitute over half of the world's population, with China and India accounting for over one third of it.** As a result of intense economic transformations many of these emerging economies are facing rapid urbanization and industrialization.

As of 2013 nine of the ten largest metropolitan areas in the world are located in emerging markets.



Advanced economies and emerging market share of global GDP

Emerging markets already account for about 50 percent of world's GDP and going forward, its contribution is expected to be higher than advanced economies. Not only are these economies enormous, but they are growing exponentially.

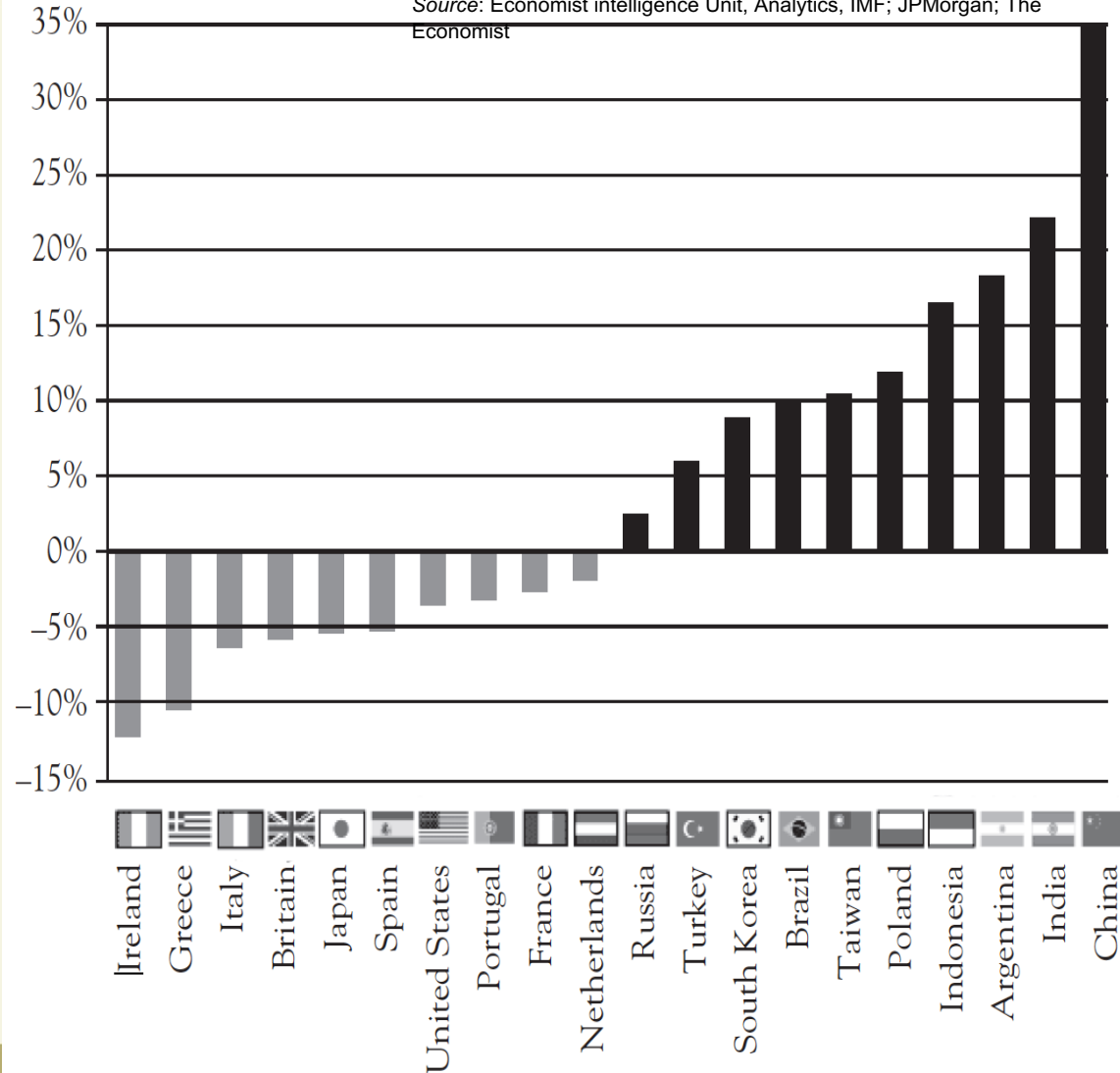


Source: World Economic Outlook Database, International Monetary Fund, October 2014



Change in Real GDP per person (2014)

Source: Economist intelligence Unit, Analytics, IMF; JPMorgan; The Economist

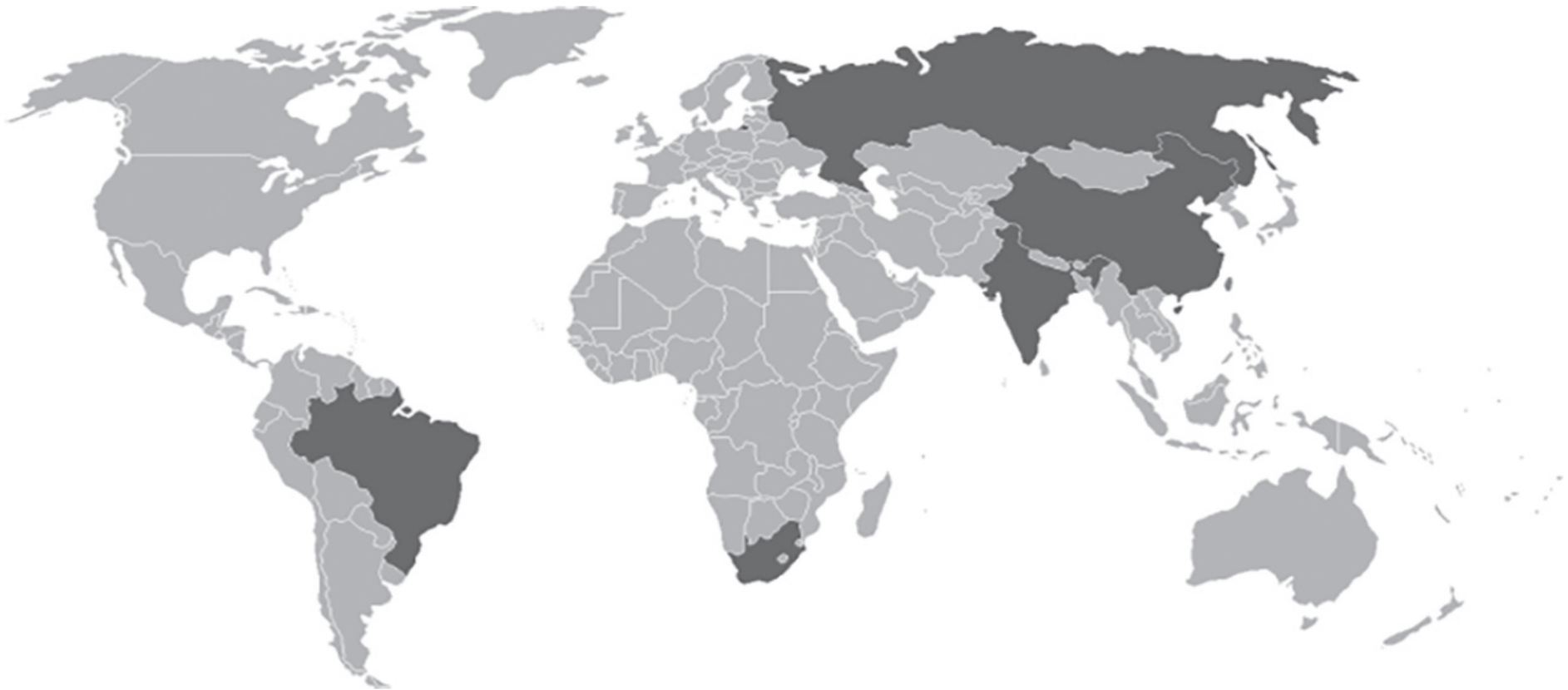


The change in real GDP per capita in emerging markets has surpassed advanced economies by far



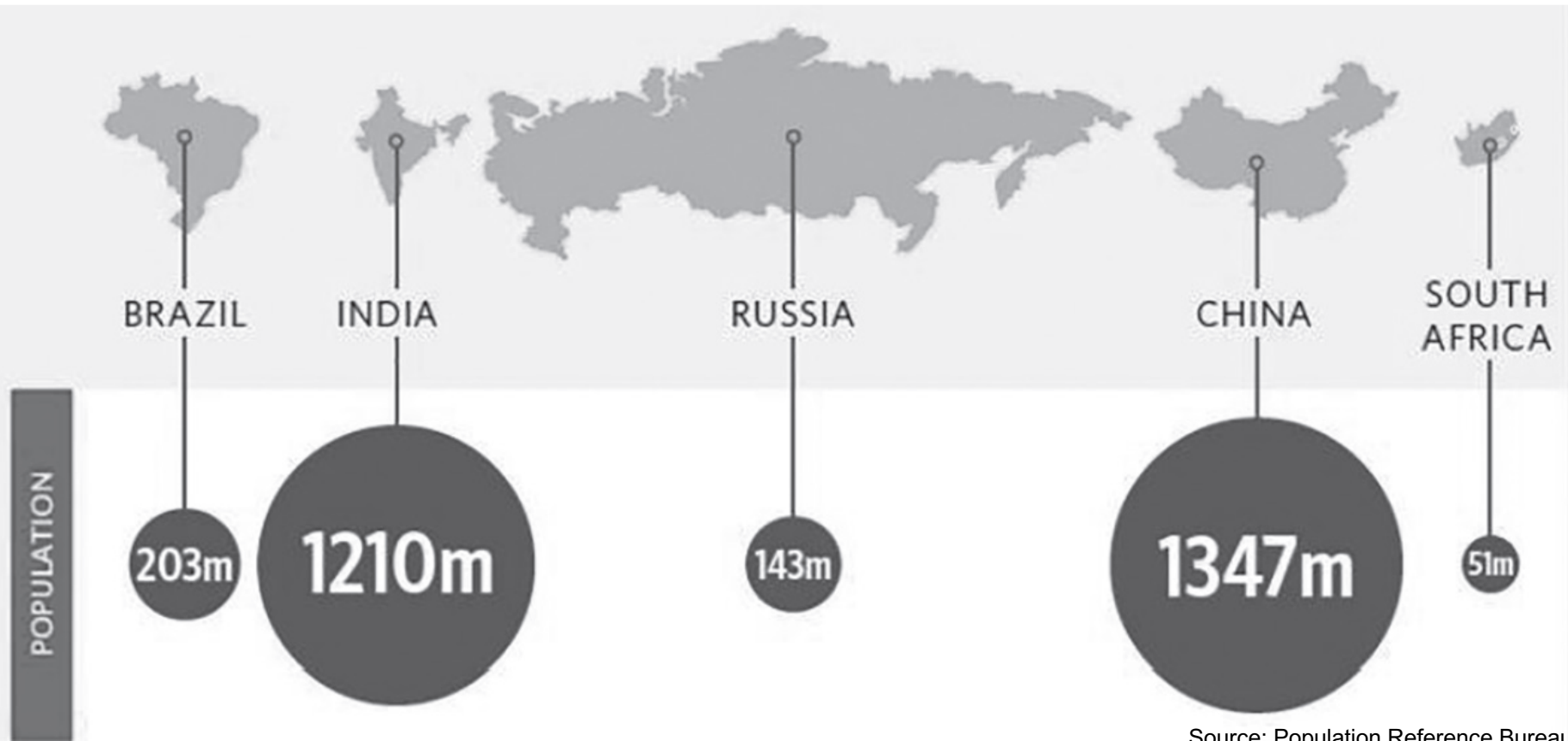
The BRICS Bloc

The original BRIC countries included Brazil, Russia, India, and China, then South Africa added in 2009. Jim O'Neill, a retired former asset manager at Goldman and Sachs, coined the acronym in 2001 in his paper entitled *Building Better Global Economic BRICs*.



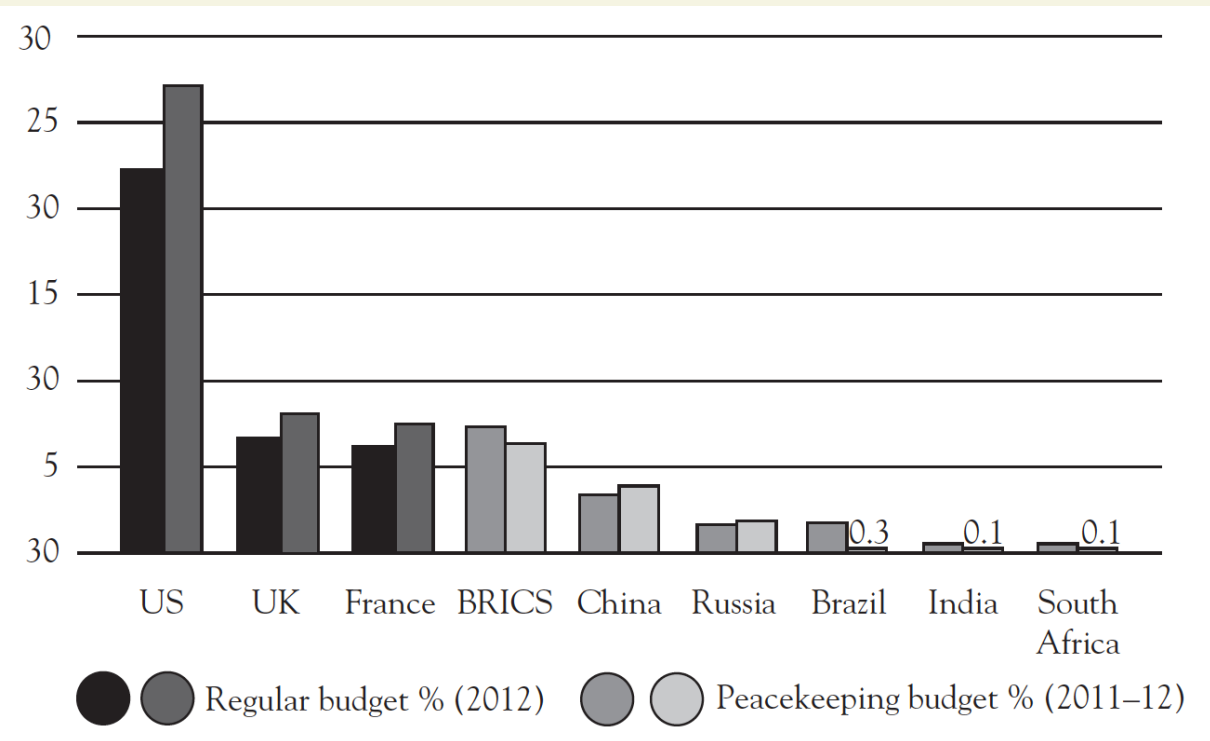
BRICS account for almost 50 percent of world population

Even as advanced economies recover from the recession, and emerging markets enter a period of slower growth, global economic growth will continue to be strongly influenced by emerging markets.



Source: Population Reference Bureau

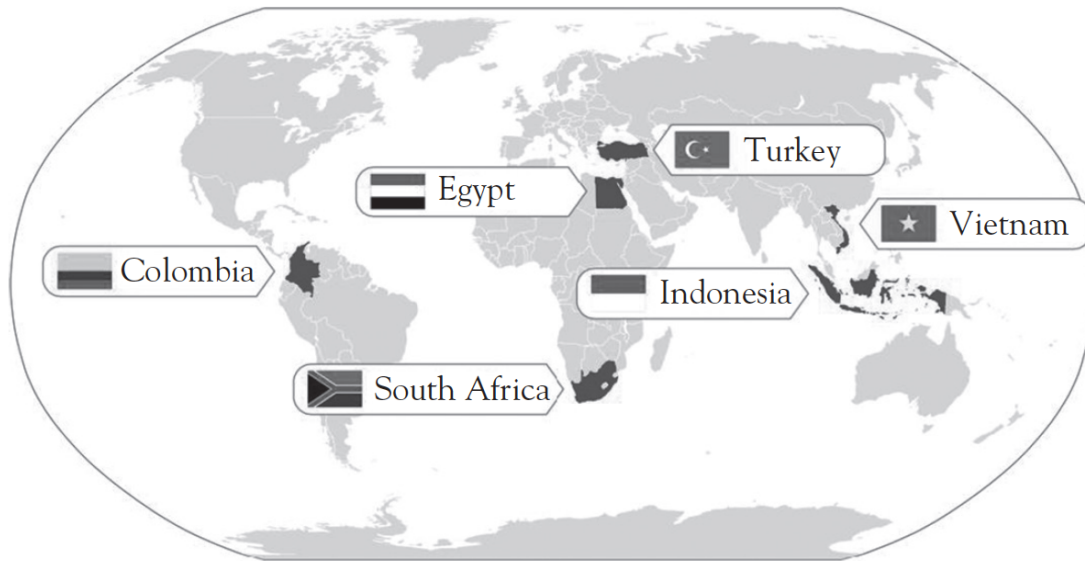
BRICS have increased their participation and contribution to UN budgets



Since its formation, it is clear the BRICS have been seeking to form a political club. According to a Reuter's article, the BRIC bloc has strong interest in converting "their growing economic power into greater geopolitical clout."



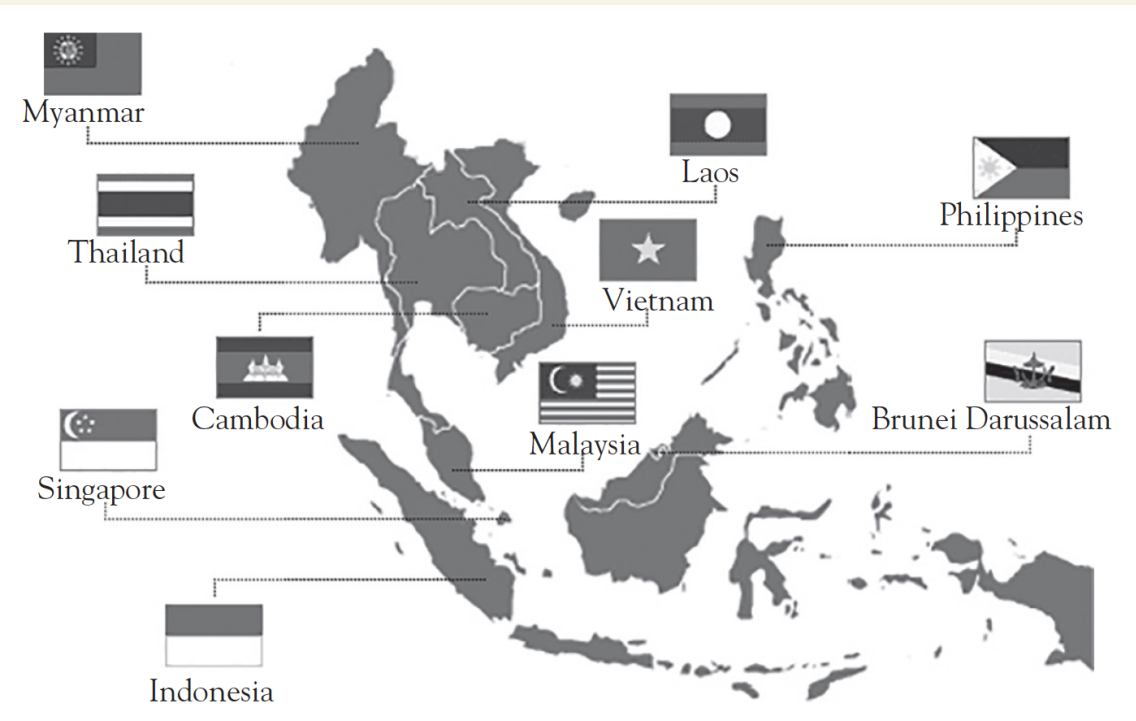
The CIVETS Bloc



The CIVETS bloc is about 10 years younger than the BRICS with similar characteristics. These countries are growing very quickly and have relatively diverse economies. They offer a greater advantage over the BRICS, as they don't depend as heavily on foreign demands. They also have reasonably sophisticated financial systems, controlled inflation, and soaring young populations with fast-rising domestic consumption.


















The ASEAN Bloc



The Association for South East Asian Nations (ASEAN) is an organization of countries located in the Southeast Asian region that aims to accelerate economic growth, social progress, and cultural development among its members and to promote regional peace



ASEAN Countries GDP

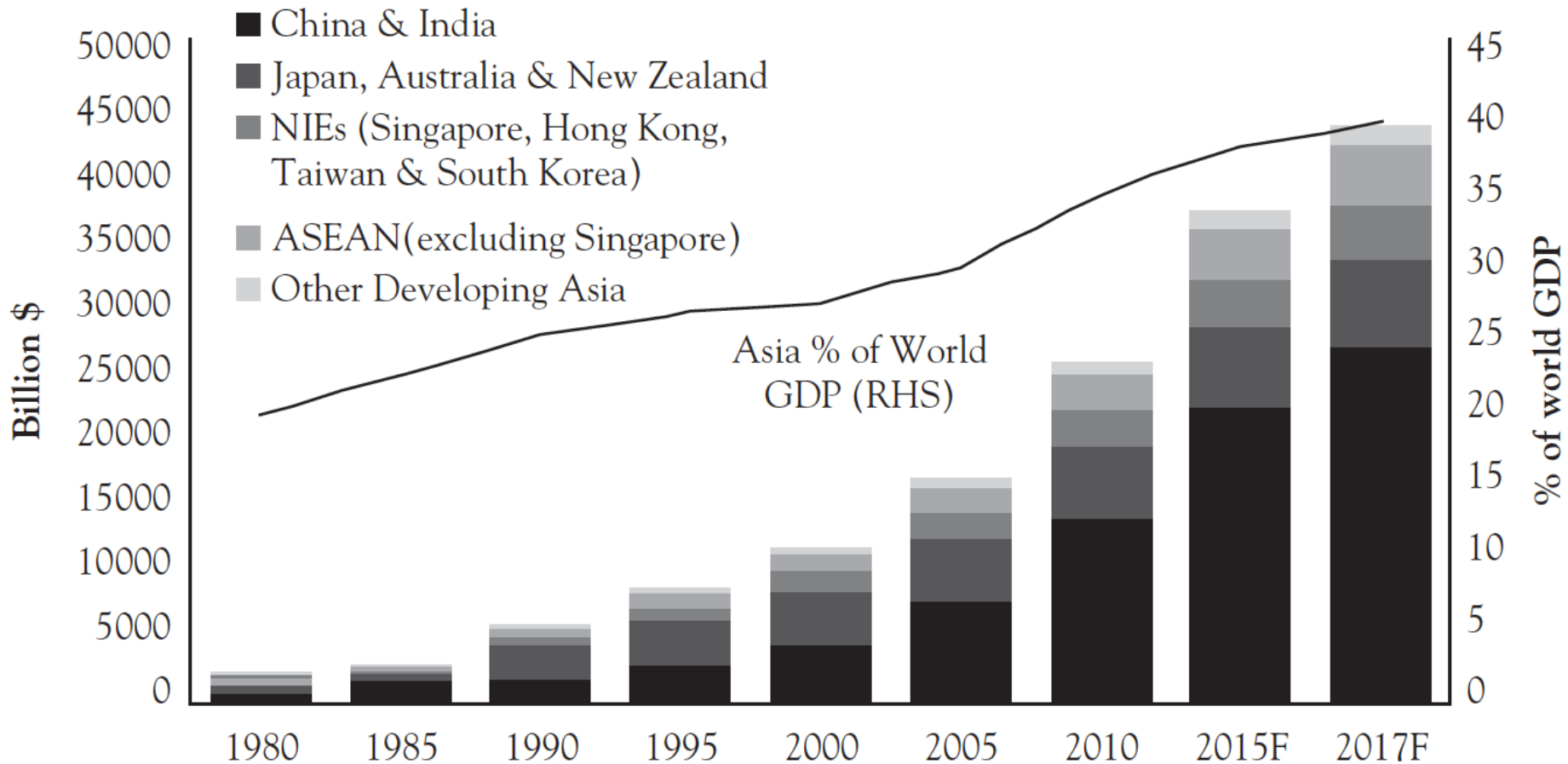
Rank ↕	Country ↕	Population in millions ↕		GDP Nominal millions of USD ↕		GDP Nominal per capita USD ↕		GDP (PPP) millions of USD ↕		GDP (PPP) per capita USD ↕	
—	<i>World</i>	7,013.42		71,707,302		10,200		83,140,055		11,850	
—	 <i>European Union</i>	502.56		16,584,007		32,518		16,092,525		32,021	
—	 United States	314.18		15,684,750		49,922		15,684,750		49,922	
—	 China	1,354.04		8,227,037		6,076		12,405,670		9,162	
—	 Japan	127.61		5,963,969		46,736		4,627,891		36,266	
—	ASEAN	615.60	100.0	2,305,542	100.0	3,745	100.0	3,605,602	100.0	5,857	100.0
—	 South Korea	50.01		1,155,872		23,113		1,613,921		32,272	
1	 Indonesia	244.47	39.7	878,198	38.1	3,592	95.9	1,216,738	33.7	4,977	85.0
2	 Thailand	64.38	10.5	365,564	15.9	5,678	151.6	651,856	18.1	10,126	172.9
3	 Malaysia	29.46	4.8	303,527	13.2	10,304	275.1	498,477	13.8	16,922	288.9
4	 Singapore	5.41	0.9	276,520	12.0	51,162	1,366.1	326,506	9.1	60,410	1,031.4
5	 Philippines	95.80	15.6	250,436	10.9	2,614	69.8	424,355	11.8	4,430	75.6
6	 Vietnam	90.39	14.7	138,071	6.0	1,528	40.8	320,677	8.9	3,548	60.6
7	 Myanmar	63.67	10.3	53,140	2.3	835	22.3	89,461	2.5	1,405	24.0
8	 Brunei	0.40	0.1	16,628	0.7	41,703	1,113.5	21,687	0.6	54,389	928.6
9	 Cambodia	15.25	2.5	14,241	0.6	934	24.9	36,645	1.0	2,402	41.0
10	 Laos	6.38	1.0	9,217	0.4	1,446	38.6	19,200	0.5	3,011	51.4

The ASEAN economy is set to double by 2020**

2020**

** - According to Arno Maierbrugger from Investvine

Asian Economic GDP growth based on purchasing power parity
(Current International Dollar Billion)*



*An International dollar has the same purchasing power over GDP as the U.S. dollar has in the United States Source: International Monetary Fund, World Economic Outlook, October 2012; Australia

The MENA Bloc

MENA countries include Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Qatar, Saudi Arabia, North and South Sudan, Syria, Tunisia, United Arab Emirates (UAE), Yemen, West Bank, and Gaza.

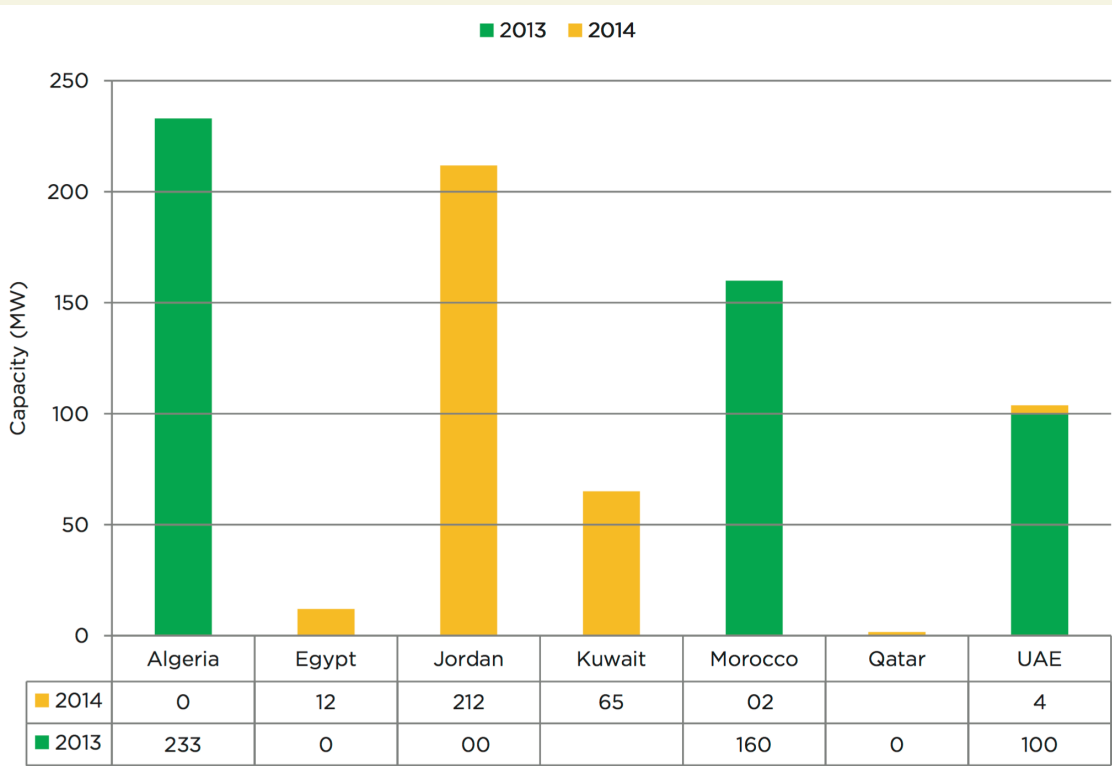


MENA solar energy may power the world

- According to a new study reported in the Dubai-based Khaleej Times, **sunny region and its associated countries could solar power the world three times over.**
- If such projections ever become reality, poverty may have a chance to be eradicated in the region.
- Countries that move fast, the study suggests, could have the competitive advantage.
- MENA countries, especially ones located on the Arabian Peninsula, as well as others like Jordan, Lebanon, and Israel are well positioned to take the lead in this industry.



MENA solar energy may power the world



In 2015, we will see the solar market in MENA reach a new level of growth, with over 1,500MW worth of solar projects expected to be tendered over the next 12 months

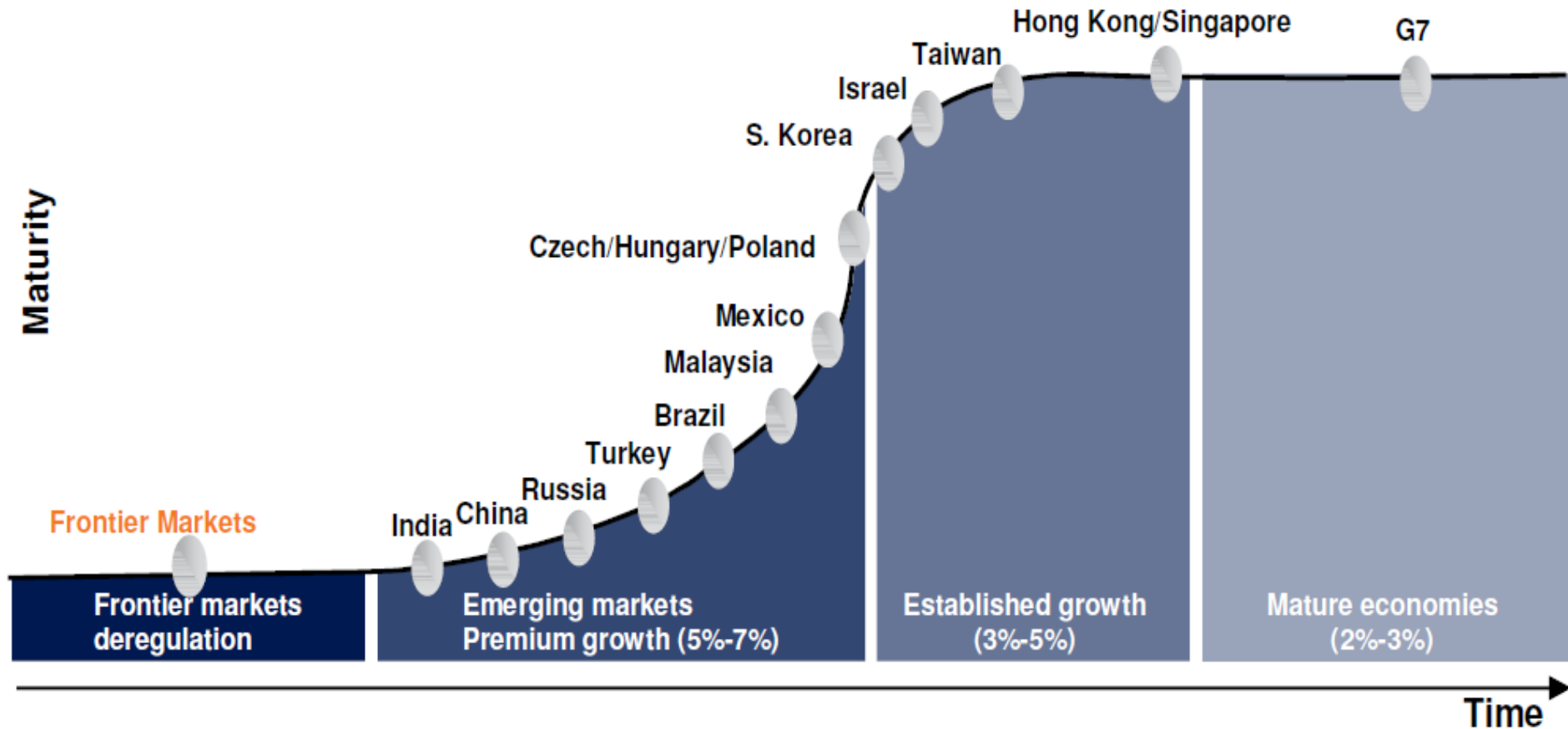


An Overview of Frontier Markets



Frontier markets at early stage of development, prone for faster growth

Emerging markets stages of development



But, the taxonomy leaves markets to big to ignore: the Asian example



But, the taxonomy leaves markets to big to ignore: the African example



Share of Banking assets held by foreign banks (%)

The low financial integration indicators partly explain why Africa escaped both the sub prime and banking crises. No African country announced a bank rescue plan at the scale observed in many developed countries.

Countries	Share of Banking assets held by foreign banks (%)	Largest Foreign Banks	Home country
Angola	53	Banco BPI	Portugal
Botswana	77	Barclays Bank	UK
Mozambique	100	Banco Commercial Portugues	Portugal
Swaziland	100	Standard Bank	SA
Uganda	80	NetBank	SA
Zambia	77	Standard Bank	SA
Ghana	65	Barclays Bank	UK
Cote d'Ivoire	66	Standard Chartered Bank	UK
Madagascar	100	Standard Chartered Bank	UK
Cameroun	63	Barclays Bank	UK
		Société Générale	France
		Calyon	France
		Bank of Africa	Benin
		BFBP	France

Sovereign wealth funds by country (billions of US dollars) mid-2008

The accumulation of reserves following the commodities boom has supported the expansion of sovereign wealth funds in Nigeria and Botswana and the creation of new ones in Libya, Algeria, Sao- Tome and Principe and Sudan. While these funds represent only 2% of the sovereign funds' global assets, the accumulated volume amounted to more than USD 124 billion, before the 2008 financial crisis.

Country	Nonpension	% Africa
Libya	50	40 %
Algeria	47	38 %
Nigeria	17	14 %
Botswana	7	6 %
Gabon	0.40	
Sudan	0.10	
São Tomé and Príncipe	0.02	
Africa	124.42	100 %
World	2975.00	
<i>Africa, % of World</i>	4.1	

Impact of the financial crisis on markets: stimulus *exporting inflation*

Region/Country	Currency name	Benchmark 07/31/2008	Value at end of Week (13/02/2009)	Rate of depreciation
Algeria	<i>Algerian Dinar</i>	63.0	73.7	-14.5
Angola	<i>New Kwanza</i>	75.2	75.2	0.0
Benin	<i>CFA Franc</i>	429.2	520.1	-17.5
Botswana	<i>Pula</i>	6.5	8.1	-19.8
Burundi	<i>Burundi Franc</i>	1,191.5	1,233.5	-3.4
Cape Verde	<i>Escudo</i>	71.8	87.1	-17.6
Comores	<i>Comoros Franc</i>	316.9	381.9	-17.0
Congo. Dem. Rep. of	<i>Congolese Franc</i>	437.0	712.8	-38.7
Djibouti	<i>Djibouti Franc</i>	178.7	179.6	-0.5
Egypt	<i>Egyptian Pound</i>	5.4	5.6	-4.3
Ethiopia	<i>Birr</i>	10.0	11.2	-10.8
Gambia, The	<i>Gambian Dalasi</i>	21.5	26.6	-19.3
Ghana	<i>New Cedi</i>	1.2	1.4	-15.1
Guinea	<i>Guinea Franc</i>	4,653.6	4,868.6	-4.4
Kenya	<i>Kenyan Shilling</i>	68.7	83.0	-17.2
Lesotho	<i>Loti</i>	7.5	10.1	-25.6
Liberia	<i>Liberian Dollar</i>	64.0	65.0	-1.5
Libya	<i>Libyan Dinar</i>	1.2	1.3	-8.5
Madagascar	<i>Ariary</i>	1,612.9	2,018.6	-20.1
Malawi	<i>Kwancha</i>	144.0	143.8	0.2
Mauritania	<i>Ouguiya</i>	234.5	263.5	-11.0
Mauritius	<i>Mauritius Rupee</i>	27.6	34.2	-19.3
Morocco	<i>Dirham</i>	7.4	8.6	-14.5
Mozambique	<i>New Metical</i>	24.1	25.6	-5.9
Namibia	<i>Namibian Dollar</i>	7.6	10.2	-25.6
Nigeria	<i>Naira</i>	118.9	149.1	-20.3
Rwanda	<i>Rwandan Franc</i>	556.5	578.4	-3.8
São Tomé & Príncipe	<i>Dobra</i>	14,773.4	14,661.9	0.8
Seychelles	<i>Seychelles Rupee</i>	8.0	16.9	-52.4
Sierra Leone	<i>Leone</i>	2,997.7	3,093.9	-3.1
Somalia	<i>Somali Shilling</i>	1,450.9	1,448.5	0.2
South Africa	<i>Rand</i>	7.4	10.0	-26.1
Sudan	<i>Sudanese Pound</i>	2.1	2.3	-6.8
Swaziland	<i>Lilangeni</i>	7.4	9.9	-25.1
Tanzania	<i>Tanzanian Shilling</i>	1,187.6	1,341.6	-11.5
Tunisia	<i>Tunisian Dinar</i>	1.2	1.4	-16.3
Uganda	<i>Uganda Shilling</i>	1,671.0	1,978.5	-15.5
Zambia	<i>Zambian Kwacha</i>	3,588.9	5,398.6	-33.5
Zimbabwe	<i>Zimbabwe Dollar</i>	353,950.0	37,456,777.0	-99.1
OTHERS				
Europe	<i>Euro</i>	0.6	0.8	-17.5
Japan	<i>Yen</i>	108.1	90.2	19.7

There are three distinguishable immediate effects of the crisis:

- The contagion effects on financial markets
 - The rise of sovereign debt spreads – cost of external debts increased
- Foreign exchange markets
 - Zambian Kwacha exchange rate to the US dollar depreciated sharply, 50% (2008)
- Commodity markets
 - Huge drop in prices.



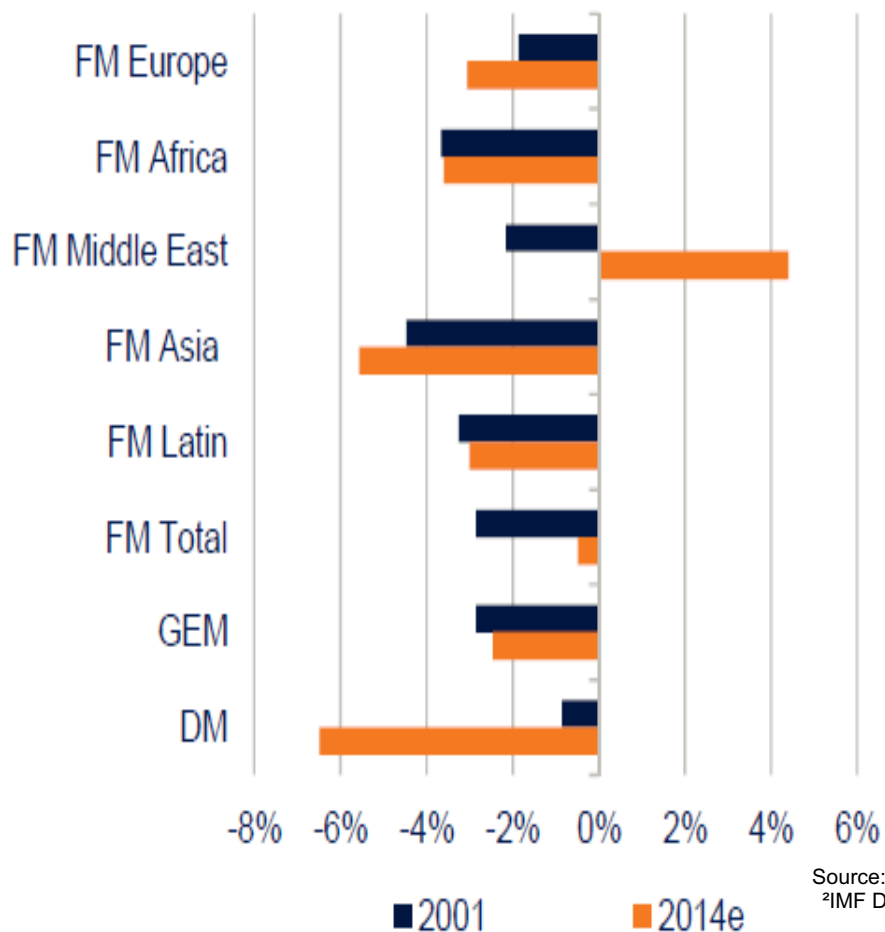
The fall of commodity prices

The crisis has taken a heavy toll on countries that are highly dependent on natural resources, especially those relying on copper, oil, timber and diamonds. The fall in copper prices resulted in a significant drop of export receipts for Zambia and a considerable reduction in its foreign exchange reserves.

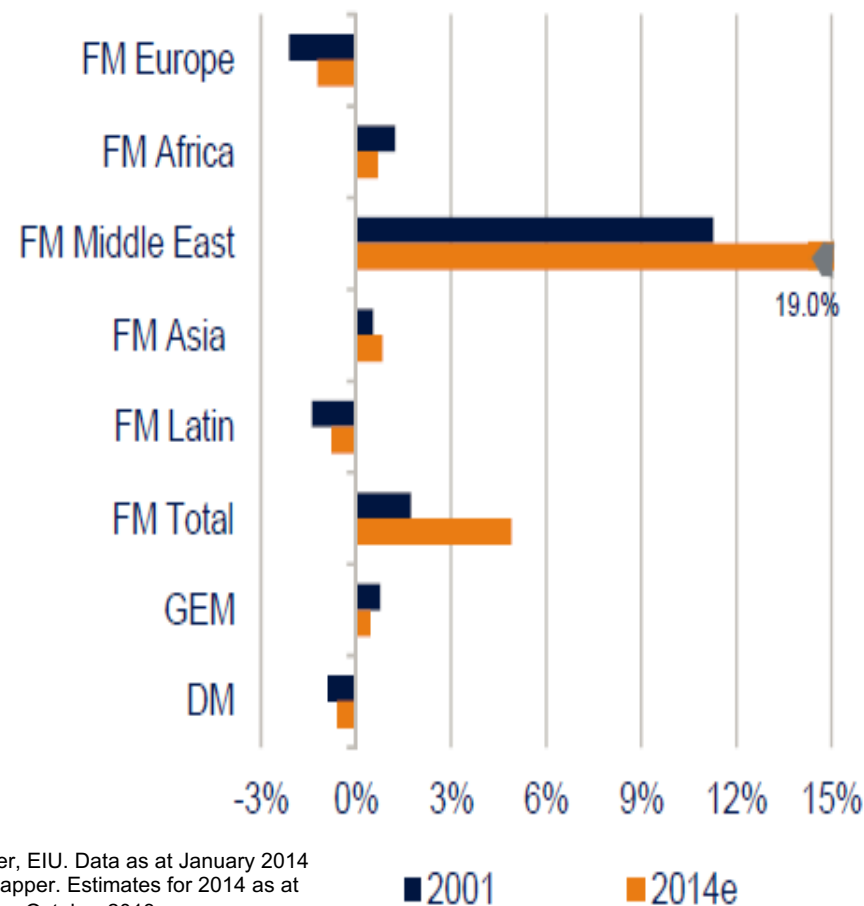
Commodity	Unit	Benchmark 07/31/2008	Value at end of Week (13/02/2009)	% Change Index
Crude Oil (Brent)*	<i>US\$ per barrel</i>	125.73	44.09	-64.93
Gold	<i>US\$ per Troy Ounce</i>	918.00	935.50	1.91
Silver	<i>US\$ per Troy ounce</i>	17.48	13.37	-23.51
Platinum	<i>US\$ per Troy ounce</i>	1,758.00	1,055.00	-39.99
Cotton, N° 2 Future	<i>USd/lb.</i>	49.71	45.22	-9.03
Cocoa beans	<i>US\$ per tonne</i>	2,908.50	2,682.12	-7.78
Coffee, Arabica	<i>US cents per pound</i>	131.10	99.00	-24.49
Coffee, Robusta	<i>US cents per pound</i>	115.09	81.75	-28.97

But, fiscal balance and current account picture better than advanced and emerging markets

Fiscal Balance as % of GDP¹

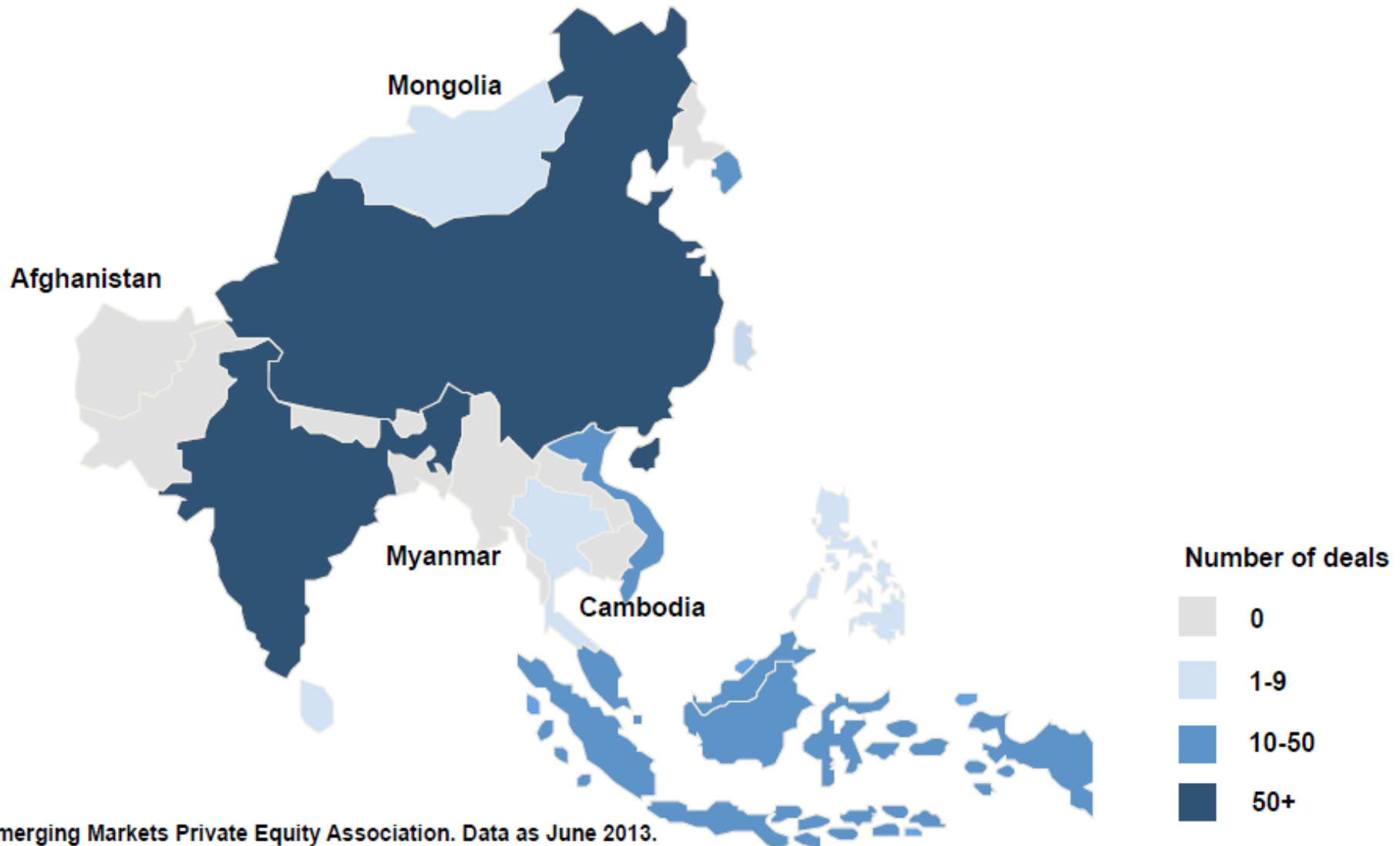


Current Account as % of GDP²

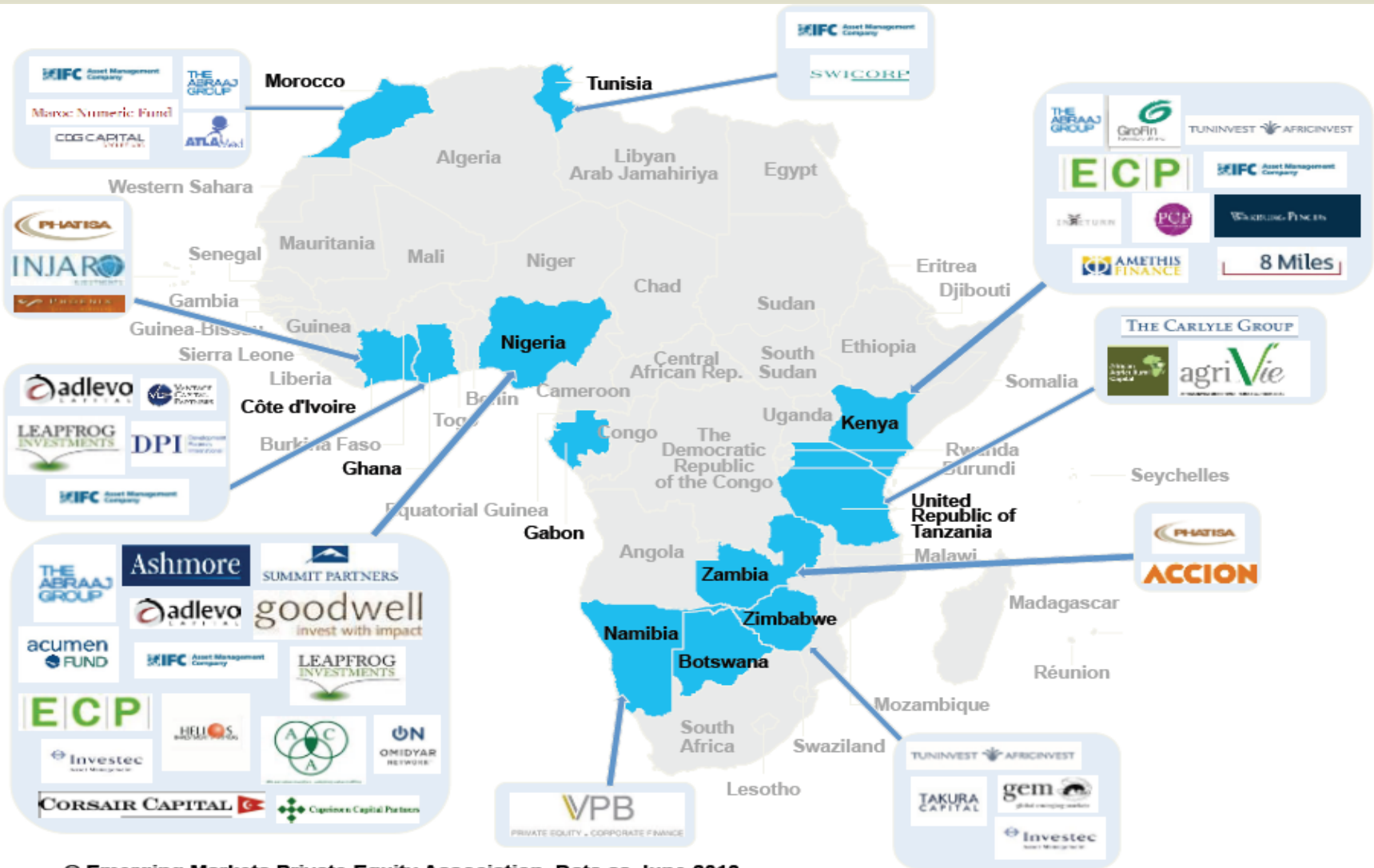


Source: ¹Haver, EIU. Data as at January 2014
²IMF Data Mapper. Estimates for 2014 as at October 2013

Private equity deals in Asia through Q2 of 2013



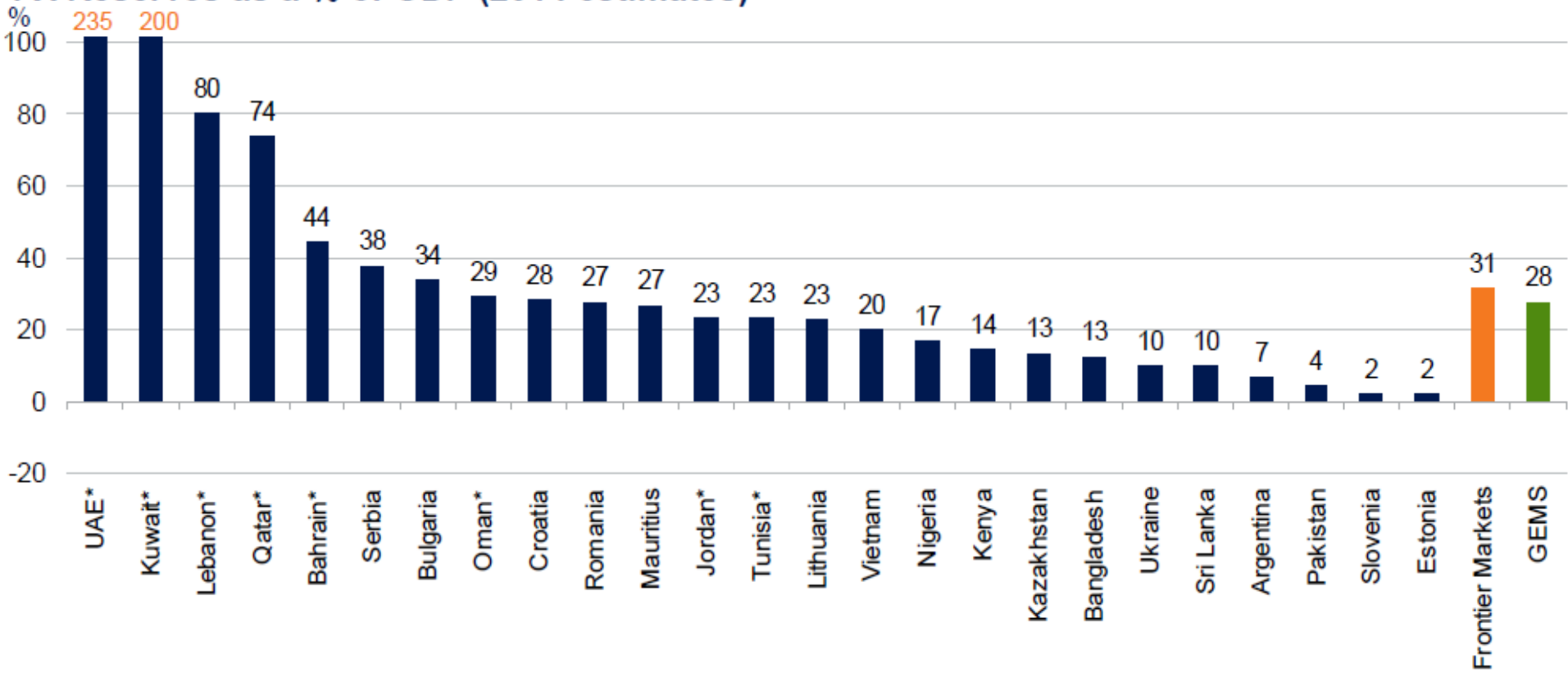
Private equity deal-makers in Africa through Q2 of 2013



Despite being less developed, Frontier countries have strong reserves

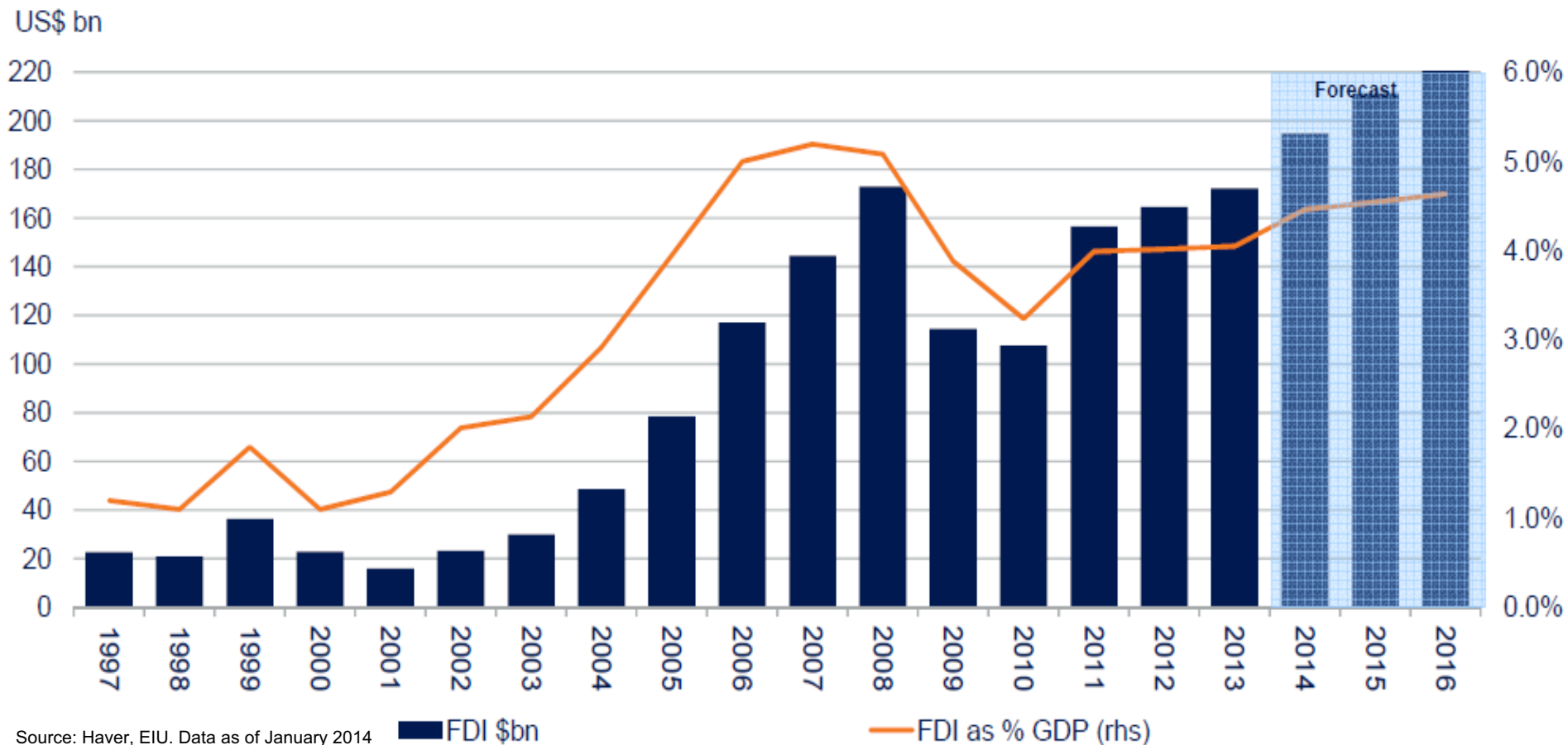
FX Reserves

FX Reserves as a % of GDP (2014 estimates)



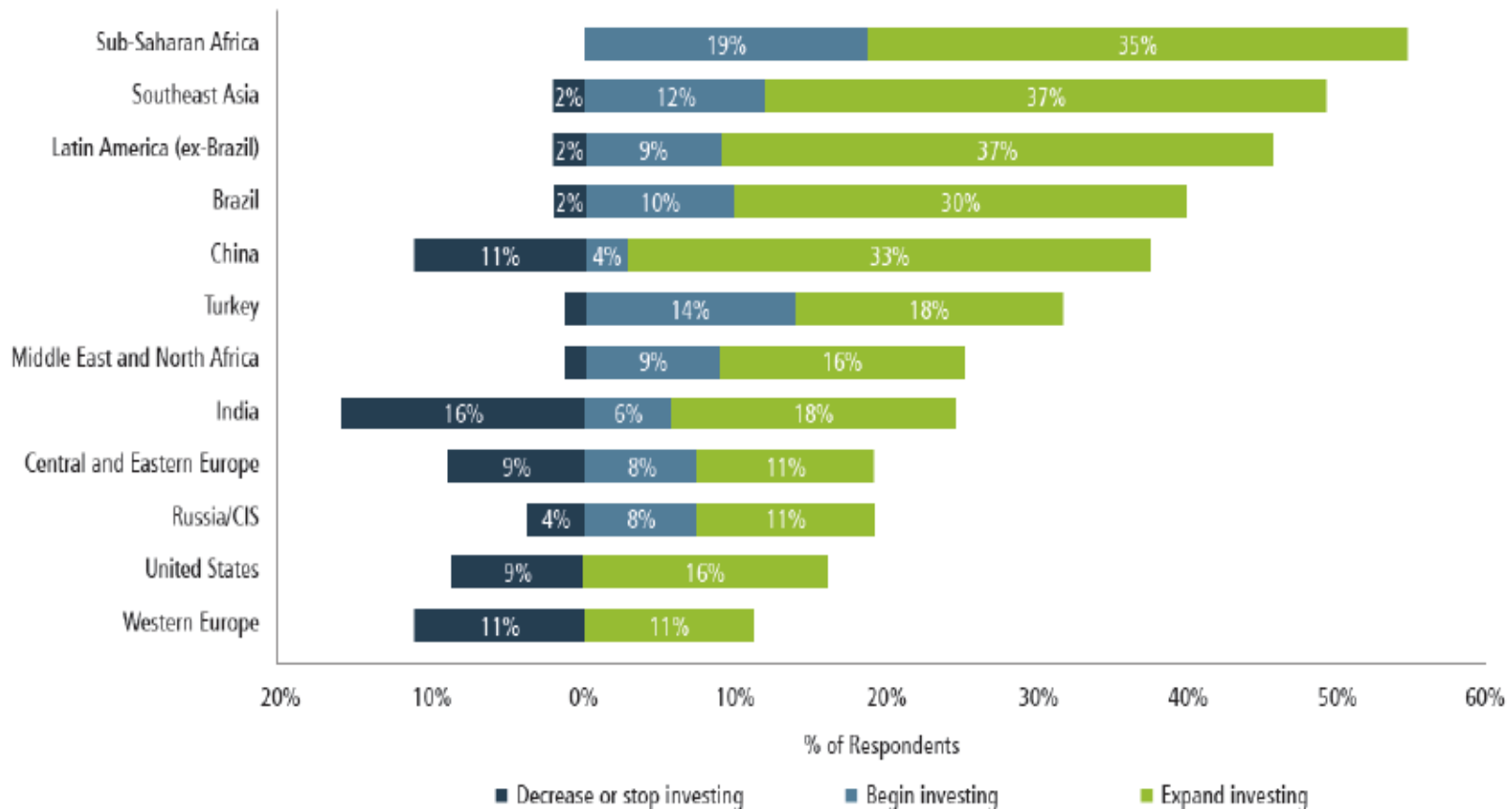
Rising FDI will support economic growth and development

Foreign Direct Investment into Frontier Markets

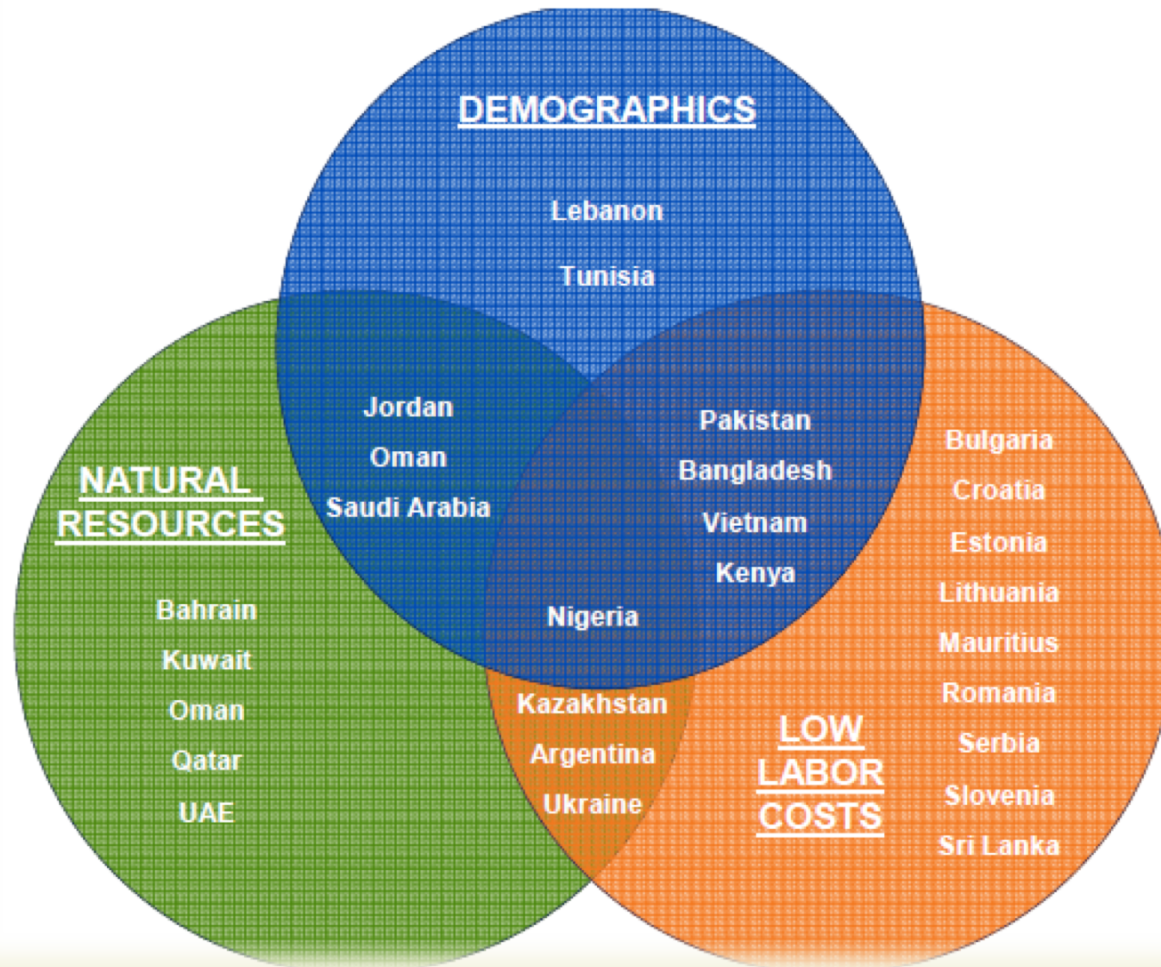


Growing interest in frontier markets, particularly sub-Saharan Africa

Planned Changes of EM PE Investment Strategy through 2015



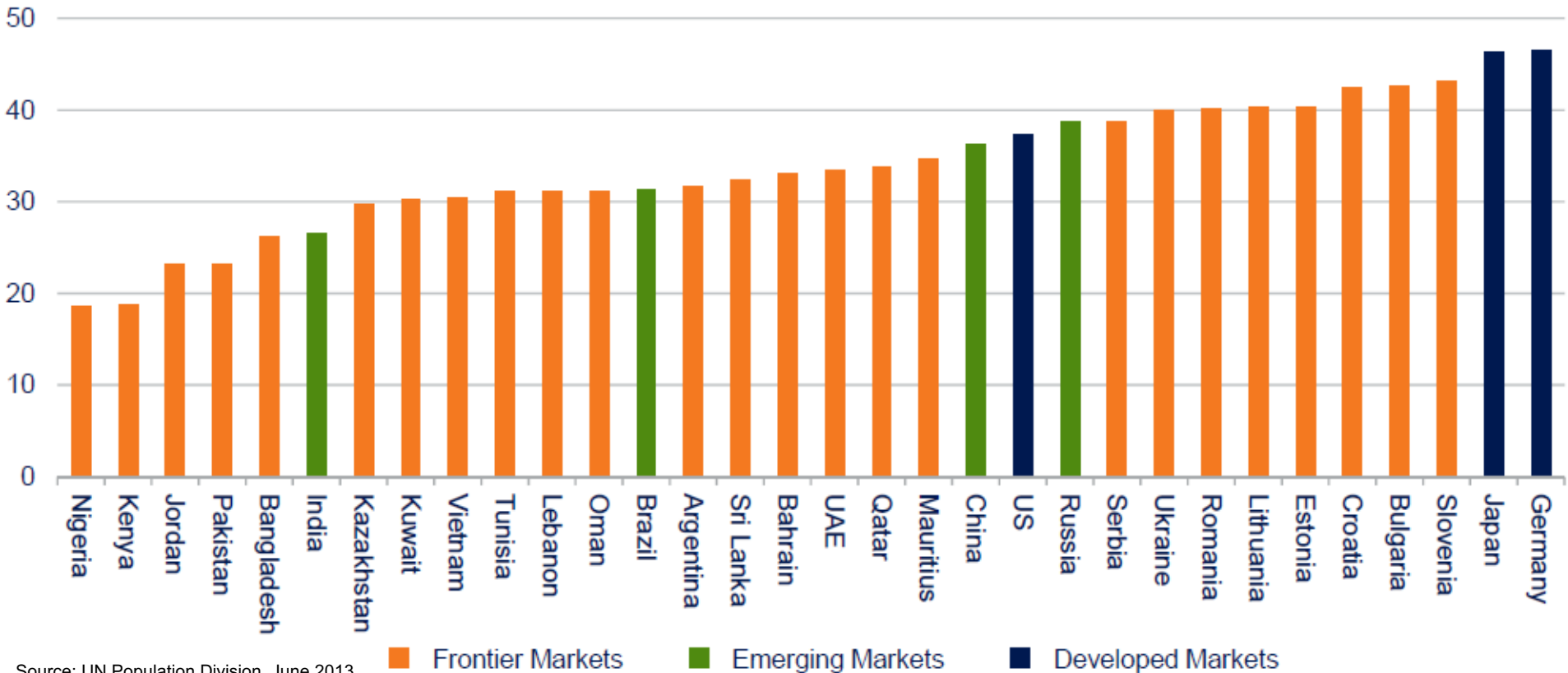
Diverse Competitive Advantage



Frontier countries tend to have relatively young populations...

Demographics

Median age in years



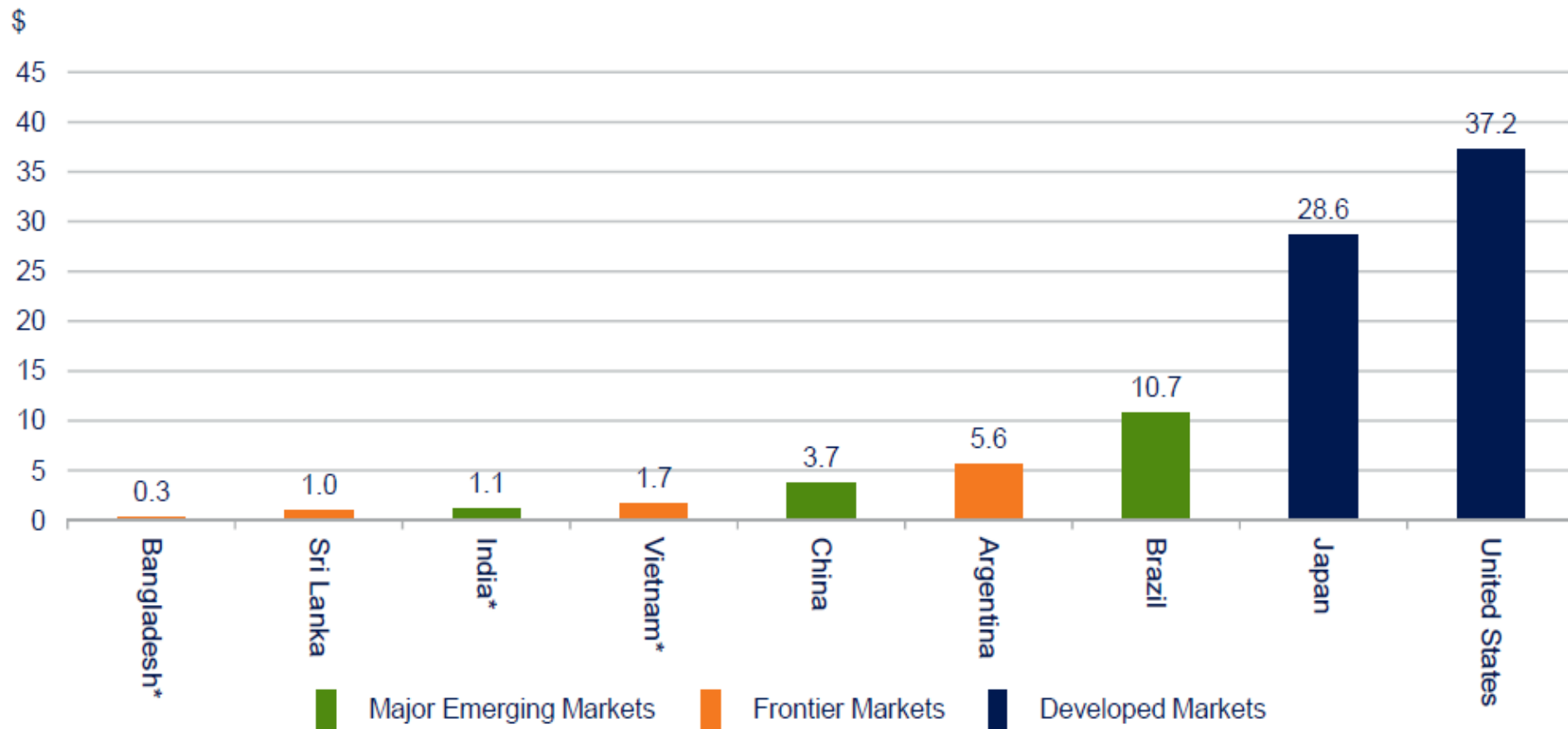
Frontier Markets benefit from very competitive labor costs

Labor costs per hour (in US\$)

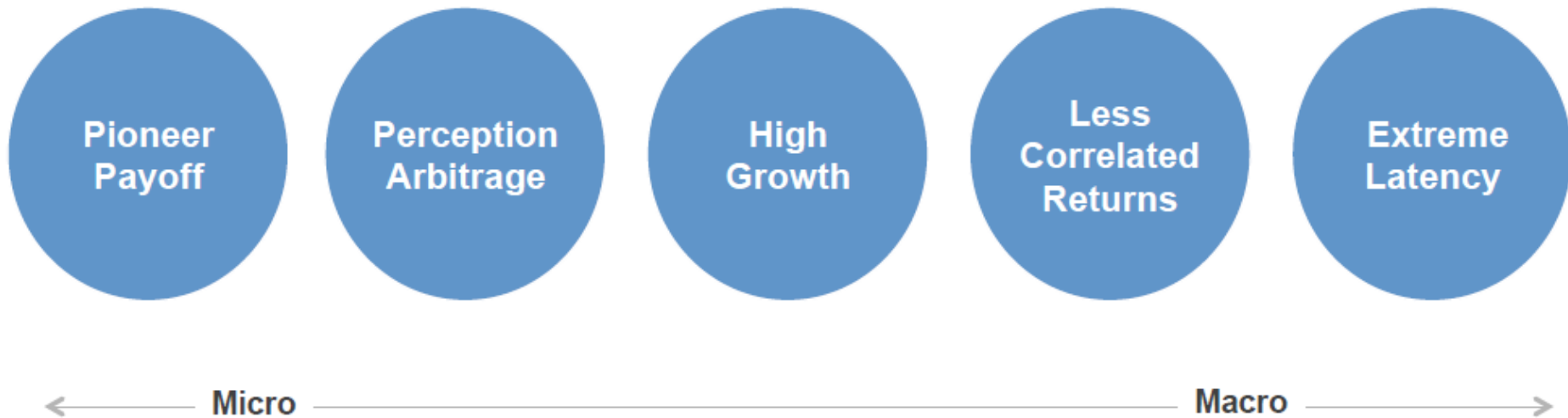
Asia and Latin America

Source: Haver, EIU. 2014 estimates as at January 2014

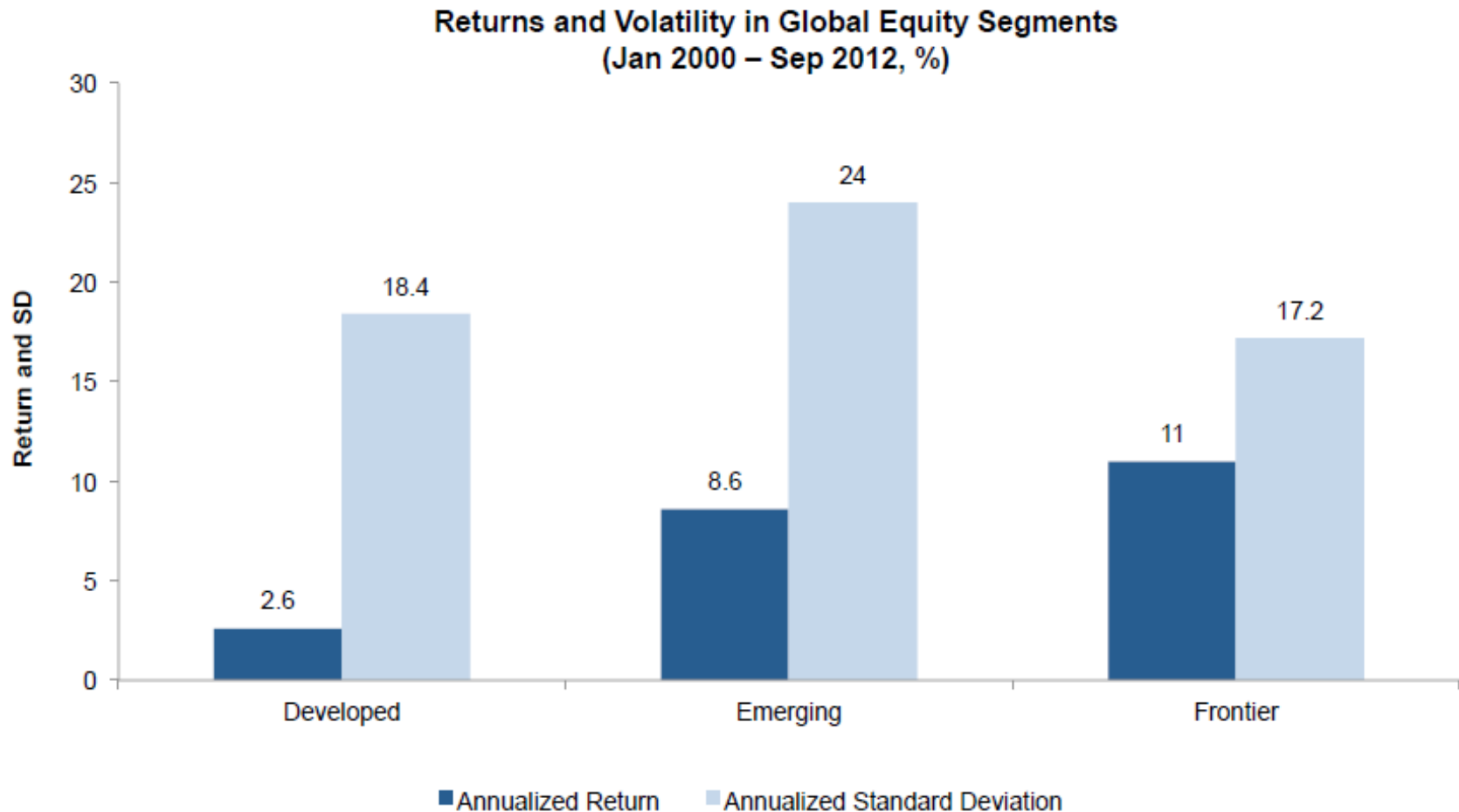
*UBS/ILO estimates as at June 2011



A Five Factor FDI Thesis for Frontier Markets

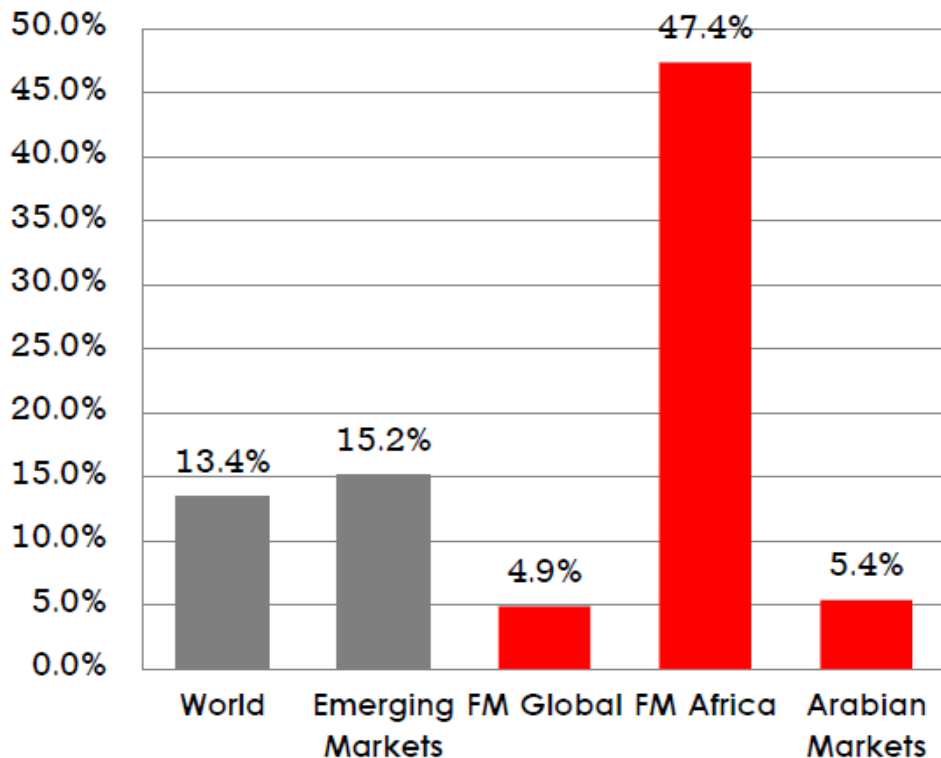


Frontier Markets have experienced strong growth in last decade

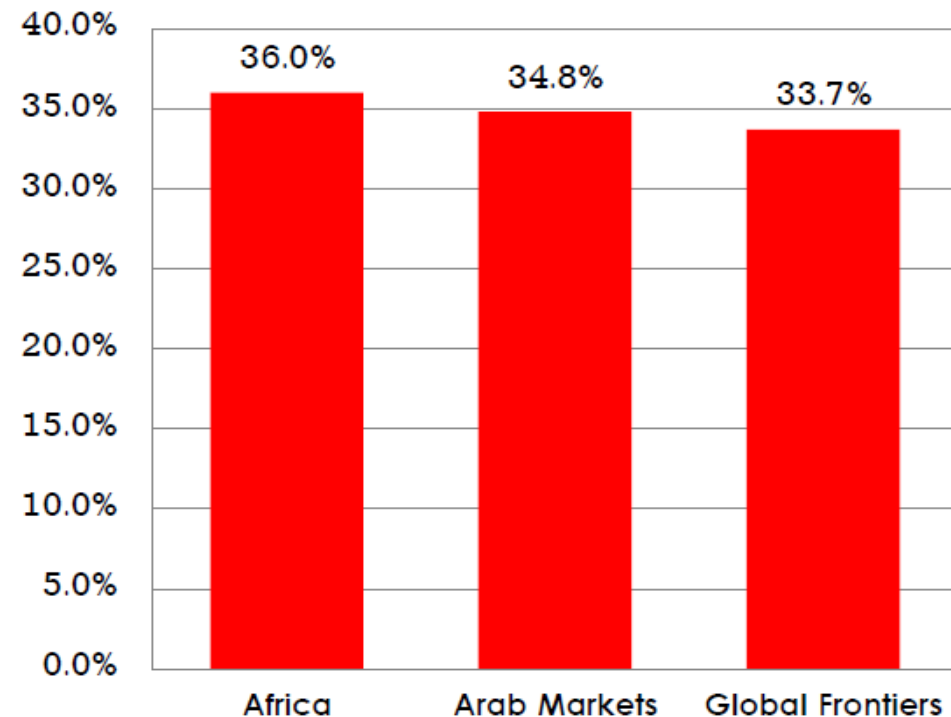


Strong Economic development among Frontier Markets

2012 Returns (USD)



2013 Bottom-up targets (USD)



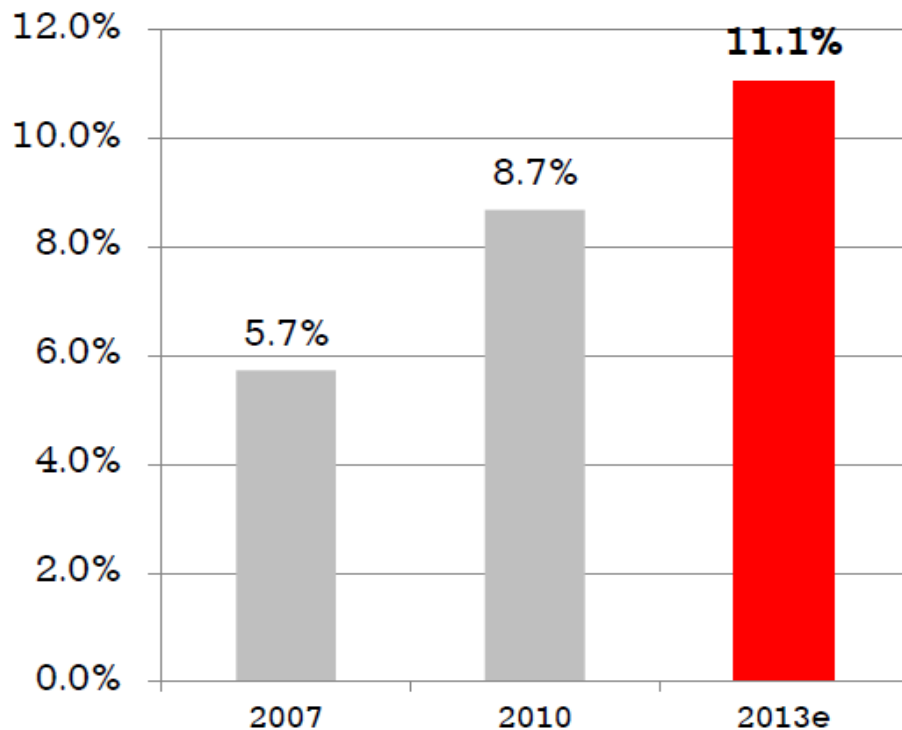
- African markets were the best performing frontier markets in 2012
- Fundamentals support 30%+ returns across regions in 2013

The case of “unloved” FM regions is strong

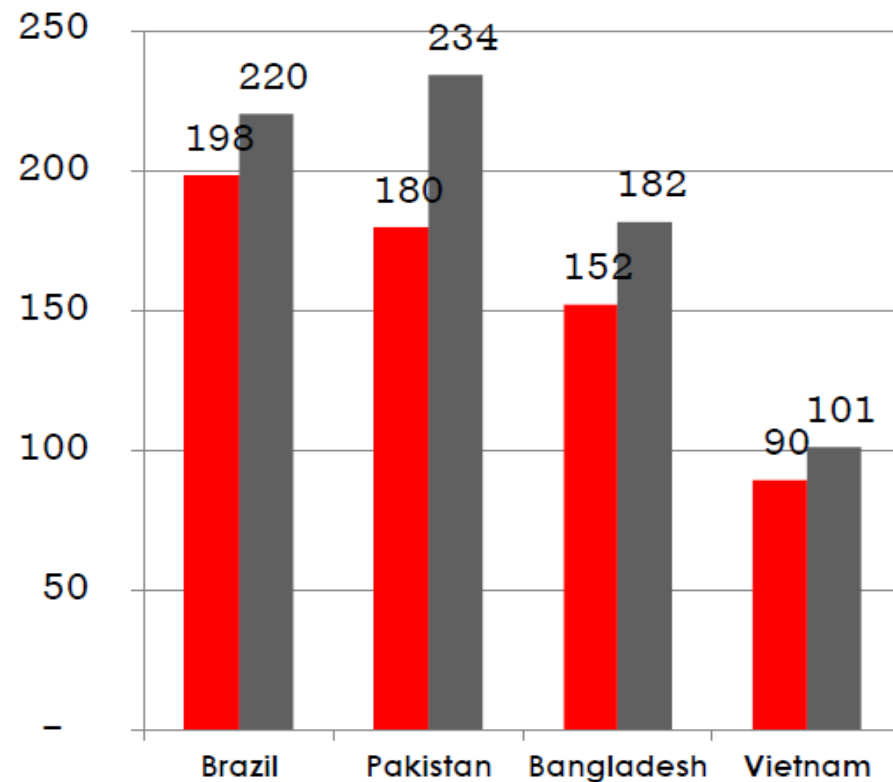
The Arab region is resilient during a period of global downturn and local upheaval. The region has also succeeded in strengthening its global hub position which allowed Arab companies to thrive.

With the exception of Vietnam, Frontier Asian countries are not well covered. 2013 may see a reverse with more attention to their economic potential driven by their consumer base.

Middle East share of global airlines capacity

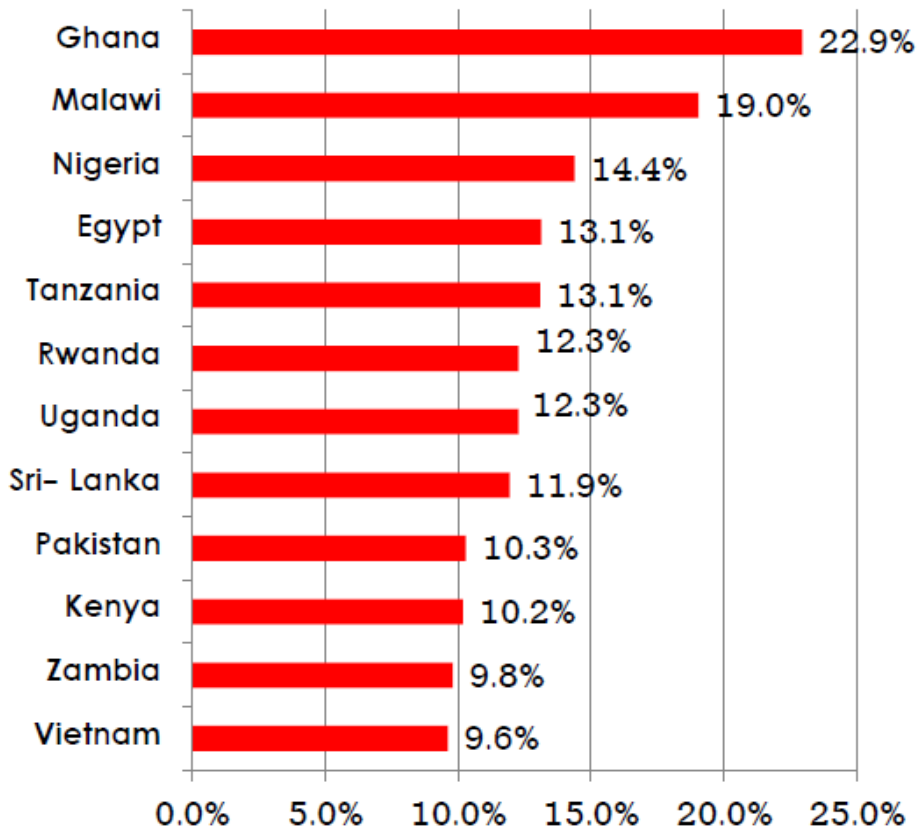


Population (x Million)

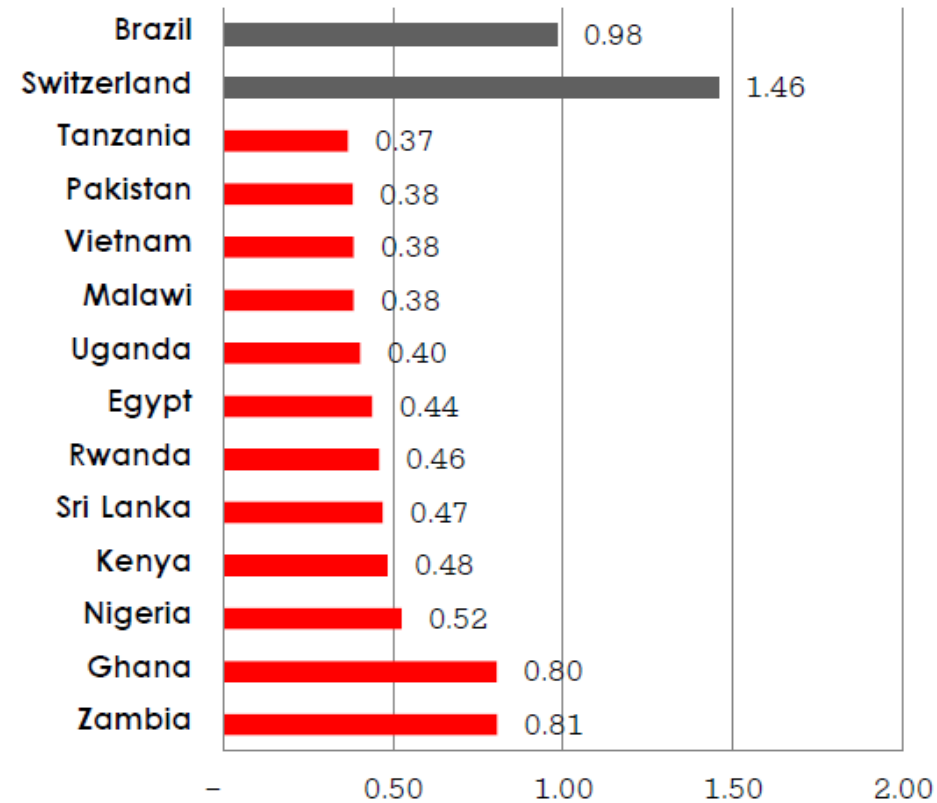


Local currency appreciation tells the story

Indicative 1-2 Yrs Yields



PPP Conversion Levels vs. USD (%)



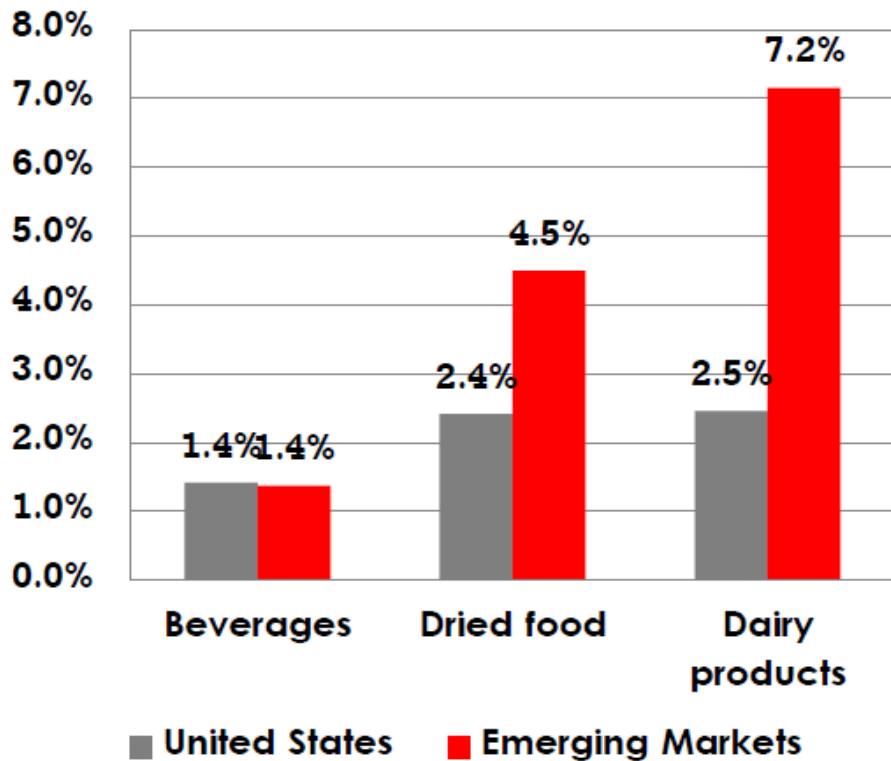
- Rich local currency yields across a range of 10 to 20%+
- Long term undervaluation of currencies is clearest when assessing PPP conversion levels

African food services prone to grow over 10x in the next decade.

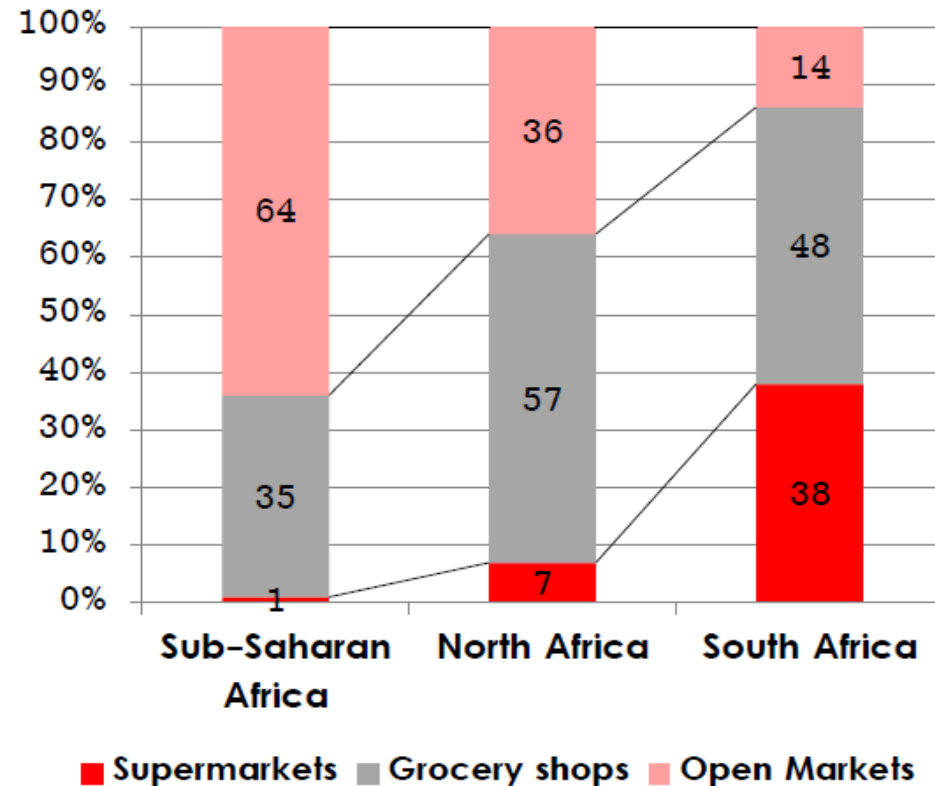
Food consumption in Africa can grow 40x to achieve US and 20x to achieve EM level

Development of the modern retail sector will be a significant catalyst

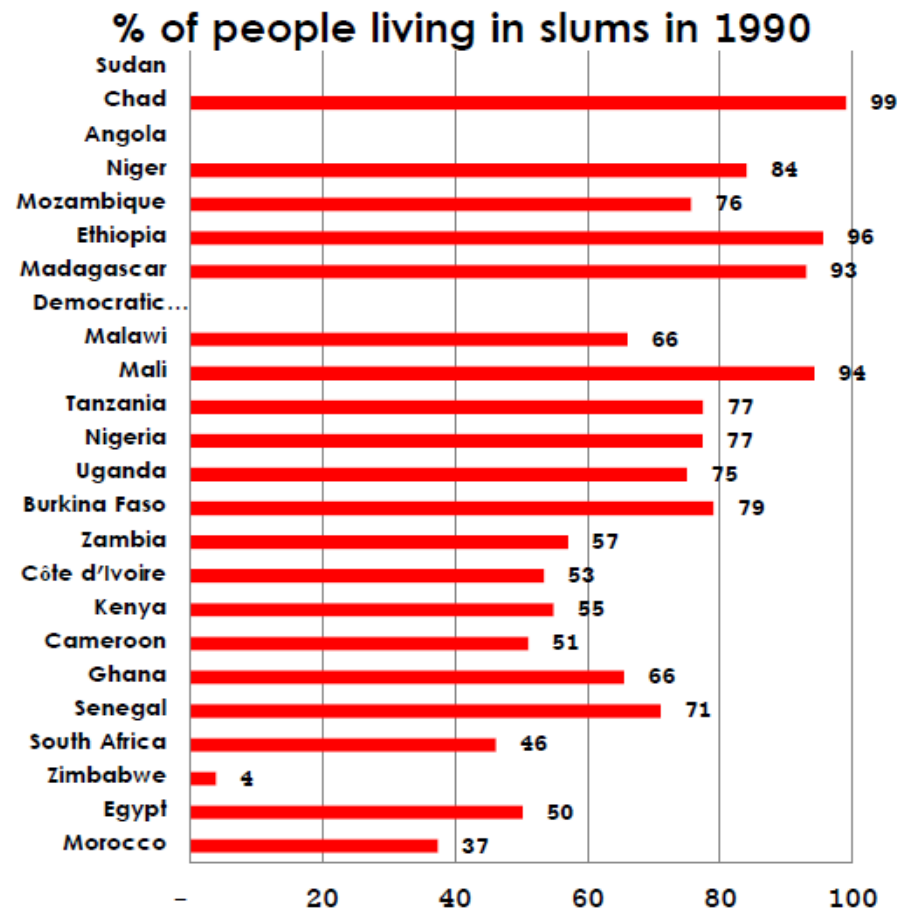
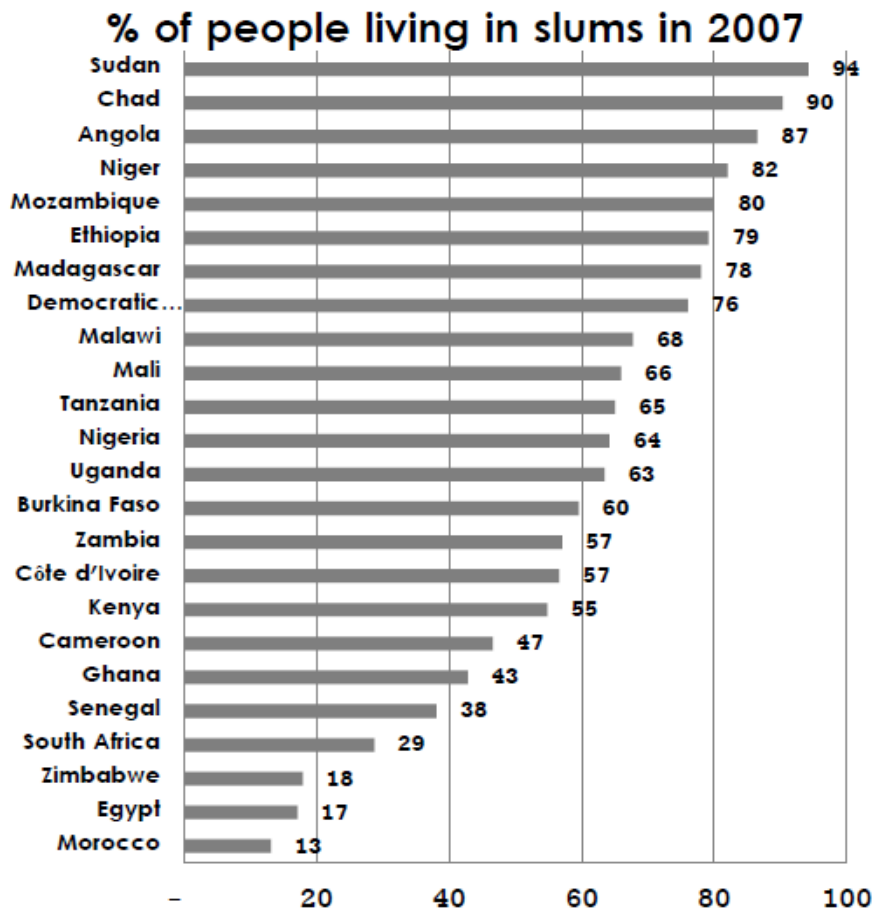
Per capita consumption in Sub-Saharan Africa vs. US & EM



Breakdown of Food sales channels



Africa is in the process of eradicating slums



- Over 100m housing units are needed to be built in coming 10 years to eradicate slums
- As in China, a focus on construction could spur local and global GDP growth

Frontier Market Challenges

Frontier Market Country-Level Difficulties

Any investments is always a joint bet on a country and company, but particularly in these markets:

- **Country Risks:** Macro instability, currency risk, physical risk, idiosyncratic factors (difficult to price and hedge)
- **Country Challenges:** Poor infrastructure, limited human capital, lack of financial partners

These factors also create opportunities for investors

Frontier Market Firm-Level Difficulties

Investment Entry

Transaction Costs

- Initial fixed cost to understand country and opportunities
- Information asymmetry and lack of transparency requires more due diligence
- Costly to acquire political risk insurance or other hedging mechanisms

During

Counter-Party Risk

- Public sector not reliable partner or offtake

Execution Risk

- More hands-on operational expertise required
- More exposed to “outside forces”

Investment Exit

Risk in realizing returns

- Possible expropriation
- Strategic sales easily deterred by headlines (such as election cycles)
- Limited or no exit to public markets
- Currency risk
- Limited minority position protections

Q&A

