



Talking point



EM capital markets growth prospects after the global crisis

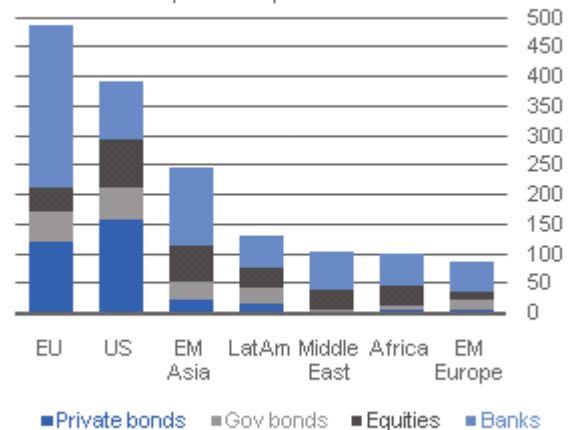
August 20, 2010

The global crisis has further enhanced the relative growth prospects of emerging markets (EM) capital markets. Advanced economies' capital markets will continue to make up the bulk of global financial assets, developed markets (DM) deleveraging and EM leveraging notwithstanding. Emerging Asia has not only the largest capital markets, but also the most developed markets in the EM space. From the perspective of global investors and, even more so, financial services providers, some (segments) of the rapidly growing EM financial markets can only be accessed with some difficulty and tapping into their growth requires a well-thought-out, focused strategy. This fact notwithstanding, the "opportunity costs" of not building exposure to – or a platform in – the EM will be increasing over time.

The stock of EM financial assets (bonds, bank assets, equities) grew from USD 15 tr in 2002 to USD 29 tr in 2008, after taking into account exchange rate and valuation effects. As a share of global financial assets, EM assets grew from 10% to 16%, while, as a share of global GDP, they rose from 47% to 57%, according to the IMF. The global crisis has further enhanced the relative growth prospects of EM capital markets. The crisis can arguably be interpreted as a Kooan-type "balance sheet recession". The term originally described companies seeking to minimise debt rather than maximize profits following Japan's financial bust. Today's situation is somewhat different in the sense that it is banks and households that suffer from excess leverage and seek to minimise debt, thereby generating extra-low interest rates, weak consumer demand and weak private sector investment. Private-sector deleveraging in the major advanced economies will lead to a significant rise in public debt over the next few years, similar to what happened in Japan after the bust.

Scope for greater EM "leverage"

Financial assets, % of GDP, 2008



Source: IMF

Most advanced economies will experience only modest financial asset growth (ex-government debt). While most EMs are "under-leveraged", many advanced economies are "over-leveraged". As of 2008, domestic debt (excluding government liabilities) averaged 400% of GDP in the EU and 250% in the US, but only 100% in the EM. Improved economic and financial stability, continued solid economic growth prospects and rapid per-capita growth will drive solid EM asset growth, not only in dollar terms but also as a share of total global assets and global GDP. Add to this the prospect of higher returns on the back of higher underlying growth and improved EM risk relative to the DMs, and it is not difficult to understand why global investors and financial services providers are allocating a larger share of their capital and investment to EMs.

This optimistic-sounding prediction comes with a few caveats, however. First, advanced economies' capital markets will continue to make up the bulk of global financial assets for the foreseeable future, DM deleveraging and EM leveraging notwithstanding. At present, the G-3 (EU, Japan, US) make up 80% of global financial assets, while the EMs account for slightly more than 15% of the total. To illustrate the same point: EU financial assets are 2.5 times larger than all EM assets combined. By extension, the bulk of capital markets-related revenues remains highly concentrated in the DMs, even if revenue growth is bound to be greater in the EMs.



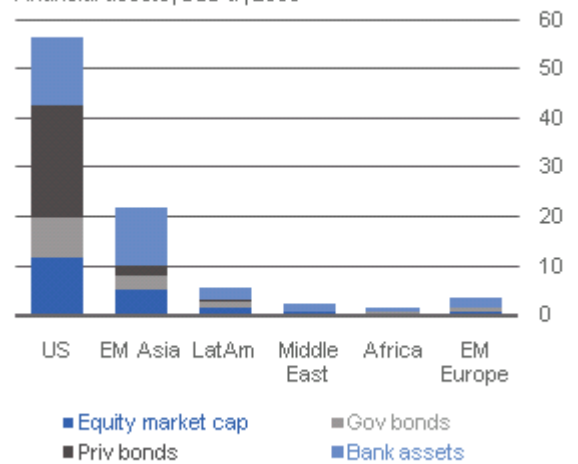
Second, the bulk of EM assets is concentrated in Emerging Asia. Not only is EM Asia larger in terms of GDP, but the financial-assets-to-GDP ratio is significantly higher than in the other EM regions. This holds true for total financial assets and it is true in each capital markets segment. Both equity market capitalisation and the stock of private-sector bonds are around twice as large as the other EM regions combined. To a large extent, this reflects differences in regional savings rates and macroeconomic stability.

Third, EM capital markets are relatively bank-centred, while private bond markets are quite under-developed, with some notable exceptions (e.g. Korea, Malaysia). Equity markets are relatively large, Eastern Europe excepted. The size of individual market segments does not generally say much about the sophistication and liquidity, nor about the risk-reward prospects. Generally speaking, however, EM Asia is more advanced than the other EM regions, especially as regards local bond, derivatives and equity markets.

International financial services providers and investors seem to be pushing into the EMs in general and Emerging Asia in particular –pulled by EM economic and financial prospects and much-improved financial stability and pushed by less than buoyant DM prospects. However, it is important to bear in mind that EM financial markets are growing from a low base. Some important markets can only be accessed with great difficulty; or foreign financial institutions face more or less extensive restrictions and – and this will become an increasingly important theme – intensifying competition from increasingly sophisticated local financial institutions. These caveats notwithstanding, the EMs, and particularly Emerging Asia, have a huge development and growth potential. Tapping into this growth will not be easy and will undoubtedly require a very focused and well-thought-out strategy. Nonetheless, the potential “opportunity costs” for financial services providers of not creating a solid, focused business platform, and for global investors of not building substantial exposure to the EMs will certainly be increasing over time.

EM Asia dominant among EM

Financial assets, USD tr, 2008



Source: IMF



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