

ON WINGS OF EAGLES

# The Next Emerging Giants Take Flight

By ALICIA GARCÍA-HERRERO





We have identified a special group of markets that we feel deserves closer investor attention. We call them EAGLEs, which stands for Emerging and Growth-Leading Economies.

**A**lthough we have heard much talk about “emerging economies,” we do not always understand what’s so special about them. The fact that we have dropped the pejorative adjective “undeveloped” in favor of the more positive-sounding “emerging” to describe these countries already hints at the key feature that distinguishes these economies today: high growth, especially when compared with the stagnant economies of the developed world. The higher growth rates of these countries are fast closing the gap that existed in relation to their developed counterparts. In addition, their populations are significantly larger, younger and growing faster than those of the developed world. Taken together, these factors augur budding business opportunities for investors.

But are these opportunities here to stay? Will these emerging markets deliver on their promise, or will they go the direction of other burgeoning countries, like Argentina, that begin well but falter along the path or lose their way entirely?

BBVA Research, which conducts economic analyses on various geographies for the international banking group, predicts important structural changes in the global economy in the medium to long term, in which a few emerging markets will lead the world economy.

Frankly, the population dynamics in these markets are much more favorable than in the developed world. Fast-growing urbanization and industrialization are driving ever greater investment in physical capital. And while investment in human capital is lower on average than in the developed world, this difference is narrowing rapidly, too. The same is true for expenditure on research and development, and the quality of these countries’ institutions.

Such factors, which had long explained the edge that the developed world maintained over the rest, further supports a quickening of the inexorable trend toward the eventual convergence of emerging and developed economies.

### A New Group Emerges

Countries used to be divided by ideology: communist or capitalist. In a similar way, economies are classified as developed or emerging. Experience shows, however, that such classifications do not make much sense: Just compare Greece’s situation with that of China.

This means that investors have to be much more careful when selecting countries to analyze their individual performances. Given the high cost of monitoring countries, investors may need to outsource such monitoring and rely on rigorously defined groupings of countries.

Grouping emerging countries is no easy task. The fact that a country has good macro-economic prospects is a necessary but certainly not sufficient condition to invest in a country. There is a wide variety of investor needs, and emerging countries differ more among themselves than do advanced economies. Investors have different goals and characteristics and, therefore, may be interested in different types of countries in terms of size and economic structure. A boutique-style company selling luxury goods or services, for example, may prefer to operate in a high-income country, or at least a country large enough to have a minimum number of wealthy clients. A large construction company may prefer large countries with underdeveloped infrastructures in order to exploit economies of scale. In addition, the rule of law and the stability of contracts will be more important the longer the engagement in a certain country.

Given these vital variations, BBVA Research has developed a rigorous and transparent methodology to select key countries not only for general investor purposes but also for special interests.

The general selection responds to the basic need to follow the economies that are going to generate the greatest business opportunities worldwide. Just as any company would have benefited from monitoring developments in



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the United States over the past few decades, we are simply attempting to detect potential opportunities and discern how the competition may behave in certain key markets.

We have identified a special group of markets that we feel deserves closer investor attention, given that the business opportunities there will be at least as great as those of the developed world. In addition to making a quarterly analysis, we review these key economies every year to take account of the rapidly changing global macroeconomic outlook. We refer to these countries as EAGLEs, which stands for Emerging and Growth-Leading Economies.

### Choosing the EAGLEs

The emerging world encompasses a large number of heterogeneous countries from which a subgroup needs to be selected to make monitoring feasible. There are two ways to do this: one is to do it subjectively, on an ad hoc basis; the other is to do it objectively and review it regularly.

## ■ EXECUTIVE SUMMARY

**Move over BRICS, Next 11 and CIVETS: The EAGLEs have landed.** A new formulation by BBVA Research, which conducts economic analyses for the international banking group, reveals a special group of markets that it feels deserves closer investor attention. The author refers to these countries as EAGLEs, which stands for Emerging and Growth-Leading Economies. These 10 emerging countries will contribute more to global growth than the G7 average in the next 10 years. On top

of this, this article identifies a dozen other countries to watch in the so-called EAGLEs' Nest. Though the opportunities for investors depend on many factors, there are two key areas that are common across all EAGLEs: the rise of the middle class, presenting opportunities for the retail and household service sector; and vast infrastructure needs, of special interest to construction companies in the developed world looking for new opportunities to boost their production capacity.

The first and best-known grouping of emerging countries – the BRIC countries of Brazil, Russia, India and China – follows the first approach. Coined by Jim O'Neill in 2001 when he was chief economist of Goldman Sachs, the term has become shorthand for describing how the global economic balance has tipped in favor of these four economic counterweights to the supremacy of the G7 club.

At BBVA Research, we prefer the second approach. Incidentally, Steven Radelet, of the Center for Global Development, adopted a similar approach in identifying 17 up-and-coming countries that he terms *Emerging Africa*, which is also the title of his book on that subject.

To make the selection as simple as possible, we use a single variable to select key emerging countries. This variable is incremental GDP, or how much a certain economy contributes to global growth. While most other groupings of emerging countries consider a 30-year time horizon, we forecast each country's economic growth for the next 10 years, so as to be able to pick up long-term trends without making too many futuristic predictions for which economists have no expertise.

To make our grouping as objective as possible, we need a cutoff point above which a country can be considered relevant enough in terms of its contribution to global growth. We use the average contribution to global growth over the next 10 years of these G7 countries – Canada, France, Germany, Italy, Japan and the United Kingdom – excluding the United States.

Based on these criteria, we find 10 countries that will contribute to global growth more than this average in the decade to come. These represent our EAGLEs.

Our grouping has several advantages over others, such as BRIC and the Next 11 of Goldman Sachs, or CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa) developed by the Economist Intelligence Unit and publicized by HSBC. See **Exhibit 1**.



China, the United States and India will lead the world over the next 10 years, although China is in a league of its own. By far, China will be the largest economy in the world by 2017.

First, ours is a forward-looking classification. It does not look at current measures of economic size but at the new business opportunities that are going to be created based on the concept of incremental growth. This is clearly more akin to a measure of market potential.

Second, EAGLEs is a dynamic concept, since the list of selected countries is revised every year based on our updated projections of economic growth. All other existing concepts are static, in the sense that the membership of a certain country is not put at stake through subsequent revisions. Indeed, doing so would ruin a neat acronym.

The key advantage of this approach is that it does not turn into a club of countries that is hard to enter and impossible to get left out of, even when economic prospects take a dramatic

turn for the worse. Instead, investors are made aware of “fallen angels.” Also, basing each country’s inclusion on a clear cutoff point makes it that much more transparent and justifiable.

### Who Are the EAGLEs?

Using this methodology and medium-term growth projections based on rigorous estimates of potential output, we identify 10 emerging countries that we believe will contribute more to global growth than the G7 average in the next 10 years.

Ranked from the largest to the smallest contribution, these countries are: China, India, Brazil, Indonesia, South Korea, Russia, Mexico, Egypt, Taiwan and Turkey.

During the next decade, we anticipate global GDP, adjusted for purchasing power parity (PPP), to grow \$41 trillion. Of this, the EAGLEs’ contribution will exceed 50 percent, whereas

## Comparing Concepts

EXHIBIT 1

THE EAGLEs GROUPING OFFERS SEVERAL ADVANTAGES OVER OTHERS.

BRIC	NEXT 11	CIVETS	EAGLEs
<b>Based on absolute size</b> <ul style="list-style-type: none"> <li>Bigger does not necessarily determine market potential</li> </ul>	<b>Based on population /GDP size</b> <ul style="list-style-type: none"> <li>Includes high population economies, which do not necessarily determine market potential</li> </ul>	<b>Based on young population</b>	<b>Based on absolute growth</b> <ul style="list-style-type: none"> <li>Large enough size plus fast-enough growth</li> </ul>
<b>Static concept</b> <ul style="list-style-type: none"> <li>Allows no anticipation: too much inertia</li> <li>Too long horizon: at least 20-25 years</li> <li>Why four countries? Subjective</li> </ul>	<b>Static concept</b> <ul style="list-style-type: none"> <li>Includes countries with political instability</li> <li>Too long horizon: between 20-45 years</li> <li>Based on absolute size</li> </ul>	<b>Static concept</b> <ul style="list-style-type: none"> <li>Missing key economies: Mexico, South Korea</li> <li>Several other large economies missing</li> <li>No clear horizon from 2020 onward</li> <li>Average growth above 4.5 percent over 20 years</li> </ul>	<b>Dynamic concept</b> <ul style="list-style-type: none"> <li>Anticipation</li> <li>Shorter horizon: next 10 years</li> <li>Flexible number of countries: club admission depends on performance</li> </ul>
<b>No clear cutoff</b>	<b>No clear cutoff</b>	<b>No clear cutoff</b>	<b>Defined cutoff: G7 (excluding U.S.)</b>





According to our projections, Indonesia and South Korea are expected to contribute more than Russia to global growth. This underscores the need to go beyond the narrow BRIC concept.

the G7 countries will barely represent an estimated 14 percent.

The world's three biggest economies – China, the United States and India – will lead the world over the next 10 years, although China is in a league of its own. Its contribution is expected to represent 30 percent of all global growth, or \$12.6 trillion. This is twice the aggregated contribution of all G7 countries and nearly 2.4 times that of the other three BRIC economies combined. By far, China will be the largest economy in the world by 2017.

Perhaps more surprising to some observers, India's incremental GDP, amounting to \$3.6 trillion, is expected to match that of the United States. Both will contribute around 8.6 percent to global growth. While the U.S. economy will still be larger than India's, it is worth noting that

most of India's GDP will derive from new, incremental growth opportunities.

According to our projections, Indonesia and South Korea are expected to contribute more than Russia to global growth. This underscores the need to go beyond the narrow BRIC concept.

Moreover, the recent decision taken at a summit of leaders from Brazil, Russia, India and China to admit South Africa into the BRIC fold, officially amending the acronym to BRICS, does not seem to be based on purely economic criteria, since in our estimation South Africa will contribute less to global growth than any of our EAGLEs. If the purpose was to include a country from Africa, our analysis shows that Egypt would have been a better choice in terms of future business opportunities. Obviously, this hinges on how things pan out for Egypt in the future – as it does for South Africa – which is why we commit to revise our ranking every year and modify it accordingly.

Brazil, Indonesia and South Korea's contribution to global growth – \$1.1 trillion, \$942 billion and \$739 billion respectively – will be larger than Japan's. Similarly, Mexico's contribution will be higher than Germany's, while Egypt, Turkey and Taiwan will surpass Canada, France, Italy and the United Kingdom.

As such, these 10 countries seem much more worthy of general investor attention. See **Exhibit 2**.

### The EAGLEs' Nest

As previously mentioned, EAGLEs is a dynamic concept. In fact, changes in growth prospects for the next 10 years could result in a country dropping out of the EAGLEs group entirely.

This is more likely to occur if the country is smaller, and therefore closer to the cutoff point, or if there is a large downward revision of a country's growth projections relative to G7 projections.

Meanwhile, there are countries that don't yet make the cut but are contributing quite sub-

### ■ ABOUT THE AUTHOR

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Prior to BBVA, she was part of the Asian Research Program of the Bank for International Settlements in Hong Kong. From 2001 until 2006, she was head of the International Economy Division of the Bank of Spain. She was also a visiting professor at Johns Hopkins University and Carlos III

University of Madrid.

She was a member of the Counsel to the Executive Board of the European Central Bank (1998-2001), head of Emerging Economies at the Research Department at Banco Santander as well as associate professor at the Autonomous University of Madrid (1997-1998) and worked as an economist at the International Monetary Fund (1994-1997).

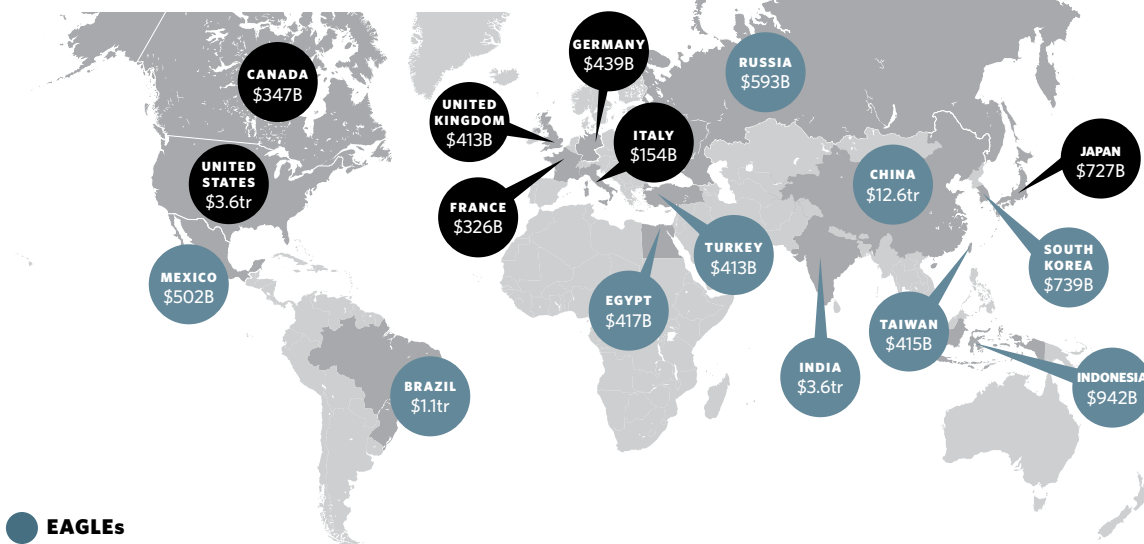
She holds a Ph.D. in Economics from George Washington University. Many of her papers have been published in reference journals and books. She has also been a research fellow at the Bank of Japan and the Bank of Finland.



**The EAGLEs Have Landed**

EXHIBIT 2

THE INCREMENTAL GDP PPP FOR THESE 10 EAGLEs WILL EXCEED 50 PERCENT OF GLOBAL GDP, WHEREAS THE G7 COUNTRIES WILL ONLY REPRESENT AN ESTIMATED 14 PERCENT.



● G7 ● EAGLEs

SOURCE: BBVA Research (based on November 2010 forecast)

stantially to the global economy. In the interest of being as forward-looking as possible, we have also created a separate watch list of other countries that are close to becoming EAGLEs. We call it the EAGLEs' Nest.

As before, we need some cutoff point to determine which countries are in the nest. We choose the expected contribution to global growth of the least contributing country of the G7 – namely, Italy – for the next 10 years.

In this way, we identify 13 economies that will contribute to global growth less than the \$400 billion average of the G7 (excluding the United States), but more than Italy's \$154 billion.

In descending order, these are: Thailand, Nigeria, Poland, Iran, Colombia, South Africa, Malaysia, Vietnam, Pakistan, Bangladesh, Argentina, Peru and the Philippines. However, given the United Nations sanctions that Iran faces, we have chosen not to include that country.

As a whole, the EAGLEs' Nest is expected to contribute 8 percent to global growth, which is approaching that of the United States. See **Exhibit 3**.

**The Opportunities**

The changing shape of global growth dynamics has far-reaching implications for investment

opportunities, which cannot be ignored. However, these potential opportunities vary according to different types of investors.

For corporate investors, the growing role of emerging markets implies the creation of new market opportunities that will undoubtedly benefit those players able to enter these markets as early and decisively as possible.

Although difficult to quantify, creating significant market opportunities is bound to be easier in economies where demand is growing, rather than in countries where it is not, no matter their size. That's because additional demand creates room for expansion without necessarily having to fight incumbents for existing business. Also, fixed entry costs make markets with larger absolute increases in demand more attractive destinations.

That said, the challenges for corporations from the developed world cannot be underestimated. There are huge differences in competitive conditions, including regulations and public confidence, as well as keener competition from local players.

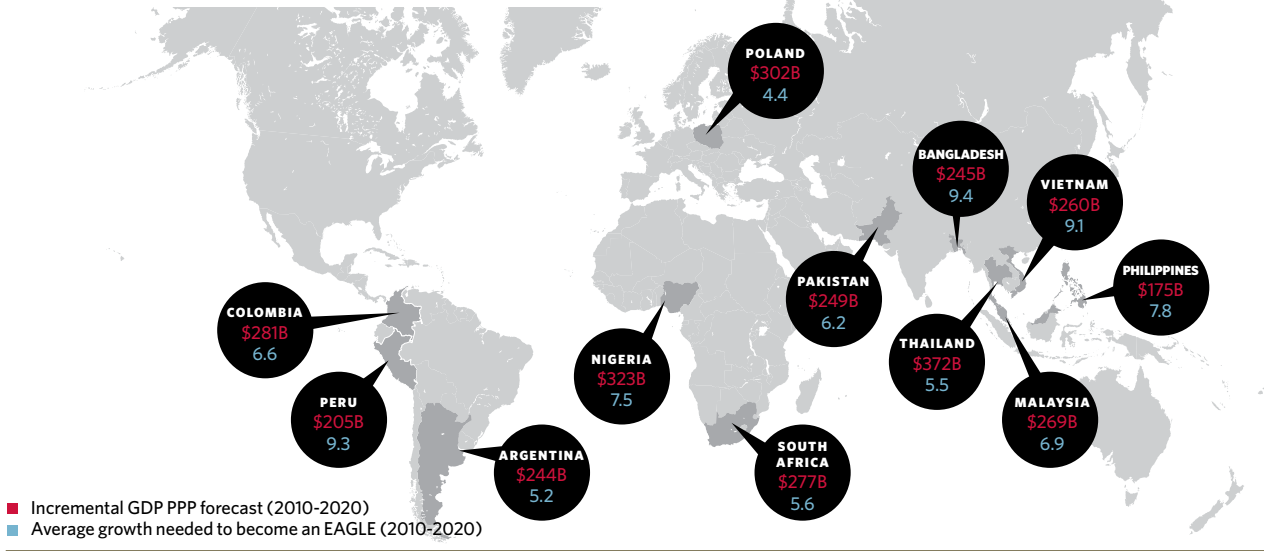
In addition, as developed markets push for greater openness in emerging markets, they need to make sure their own markets



**Economies to Watch**

EXHIBIT 3

THESE ADDITIONAL COUNTRIES ARE EXPECTED TO CONTRIBUTE 8 PERCENT TO GLOBAL GROWTH, WHICH IS APPROACHING THAT OF THE UNITED STATES.



SOURCE: BBVA Research (based on November 2010 forecast)

are equally open to competition. Erecting protectionist trade barriers would be a self-destructive move, since retaliation by emerging economies would ultimately block access to where the greatest opportunities lie, serving only to worsen the situation of the developed world.

Each emerging country offers a specific set of opportunities depending on its individual characteristics, growth model, geographic location and actual level of development. Still, there are two key areas that are common across all EAGLEs.

First is the rise of the middle class, which will shift growth opportunities toward consumption expenditure – particularly relevant for retailers.

Second, infrastructure remains one of the biggest bottlenecks to increased productivity and, consequently, potential growth. The infrastructure needs of EAGLEs should be of special interest to construction companies in the developed world looking for new opportunities to boost their production capacity.

**Middle Class Consumers**

Some countries in our EAGLEs group, such as India, are huge in terms of their absolute popu-

lation, but their citizens have very low purchasing power. Income per capita, despite being an important measure of purchasing power, is not sufficient, since it ignores income inequality. A skewed income distribution will, in fact, reduce the size of the middle class.

In order to assess EAGLEs in terms of their opportunities for the retail and household service sector, we have made estimations of the middle class for the next 10 years.

We define “middle class” as the number of people whose income is expected to be at least \$800 a month, or \$9,600 a year, which is considered the reasonable amount required to generate demand for durable goods and financial services.

When estimating “middle class,” several factors apply. For developed countries, the main driver is population growth, as income per capita is already quite high, and most percentiles of income distribution lie above the threshold.

For emerging markets, the determining factors are income per capita, how skewed income distribution is, along with the growth rate of income per capita. Countries with more egalitarian income distributions and higher starting incomes per capita will usually see more consumers above the \$800 mark.



Each emerging country offers a specific set of opportunities. The rising middle classes and infrastructure needs should be of special interest to companies in the developed world.

According to our 10-year forecasts, more than 250 million people will enter the status of “middle class” in the EAGLEs. This is seven times the number expected for G7 countries.

More than half that total will come from China, making it the uncontested leader. India, despite its low starting point in terms of income per capita, benefits from its relatively egalitarian distribution of income and large initial population. Russia’s middle class is projected to shrink, once again elevating the relevance of Mexico.

Only Egypt falls short of the G7 economies, mainly because of its low initial income per capita. The consequences of low or even negative population growth in developed countries are clearly felt in the lack of additional middle-class consumers in many of these economies.

### Infrastructure Needs

Another source of opportunities is related to EAGLEs’ inadequate supply of infrastructure in comparison with G7 countries. EAGLEs are particularly interested in improving the quantity and quality of their infrastructure, in order to boost their competitiveness.

With the exception of South Korea and Taiwan, the gap in general infrastructure between the EAGLEs and the G7 economies is quite clear. Although Turkey, India and China have closed the gap with Italy in terms of the quality of their transport infrastructure, there is still a long way to go for the rest of the EAGLEs to match the quality of the roads, railroads, ports and air transport infrastructure of the other G7 economies.

There is also room for improvement in the quality of electricity and telephony infrastructure, although, again, Taiwan and South Korea fare better than the rest.

Clearly, there are plenty of opportunities for companies specialized in infrastructure projects to invest in the EAGLEs. Of course, before investing, other factors must be taken

into account, such as the quality of a country’s social institutions, especially its judiciary system, and public confidence in and respect for the rule of law.

Pursuing these opportunities can be a daunting task – certainly for large corporations, and even more so for smaller companies. Yet, in spite of the challenges, it seems clear that most of the future growth opportunities are going to be in the EAGLEs, albeit with some variation across countries and sectors. Managers need to be following these developments closely to find new opportunities that will help their companies soar to new heights. □

### ■ TO KNOW MORE

- García-Herrero, A., D. Navia and M. Nigrinis. “BBVA EAGLEs.” BBVA Research. Find regular market updates at [www.bbvaesearch.com](http://www.bbvaesearch.com) and [www.bbvaeagles.com](http://www.bbvaeagles.com)