Cross-Country Emerging Markets Analysis

Economic Watch

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Economic Analysis

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BBVA EAGLEs

As world growth rotates towards the emerging markets, focus should shift from BRICs to EAGLEs

- **We introduce the EAGLES:**
  Emerging and Growth-Leading Economies. This group will include any country which will contribute more to global GDP growth than the average of the largest developed economies during the next ten years.

- **We identify ten BBVA Eagles, ordered from the largest to the smallest contributor to global growth:**
  China, India, Brazil, Korea, Indonesia, Russia, Mexico, Turkey, Egypt and Taiwan.

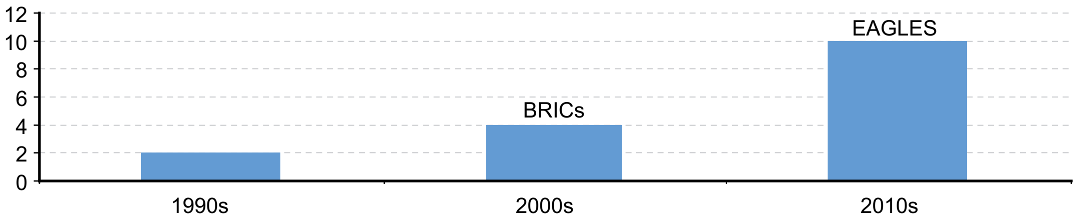
- **There are another eleven economies which will contribute more to global growth than the smallest contributor of the G7, Italy**
  Ordered by decreasing contribution to global growth: Nigeria, Poland, South Africa, Thailand, Colombia, Vietnam, Bangladesh, Malaysia, Argentina, Peru and the Philippines.

- **We believe that the EAGLEs concept is more accurate than the established BRIC grouping:**
  First, it focuses on incremental GDP rather than absolute size. Accordingly, it includes countries that will be larger in this dimension than some of the BRICs. In fact, Korea and Indonesia will contribute more to global growth than Russia during the next 10 years. Also, the non-BRIC EAGLEs alone will be more relevant for incremental growth than some of the largest industrial economies.

  Second, it is dynamic. The number of countries included and the countries themselves can change over time depending on their growth prospects. This is why having a watch list of countries which may eventually become EAGLEs – a nest - is all the more attractive.

Chart 1

From BRICs to EAGLEs. Number of countries whose contribution to global GDP growth exceeds the G6 average



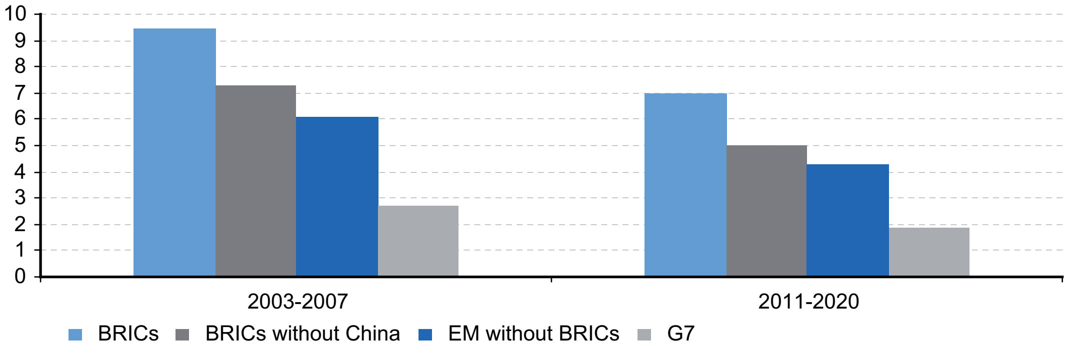
Source: BBVA Research

1. What is EAGLEs and what are the deliverables?

In this note we are introducing to you the EAGLEs concept, as developed by the BBVA Research Department. The concept of EAGLEs incorporates a selection of countries that merit particular attention because their individual contributions to world growth in the next 10 years are expected to match or exceed that of the six largest developed economies (excluding the US). Hence, the acronym: EAGLEs stands for Emerging and Growth-Leading Economies.

Chart 2

Slower, but still differential growth. GDP growth



Source: BBVA Research

Our methodology has several advantages. First, it is based on objective measures of performance, which allows for separating facts from fads. Second, it is a dynamic concept: some countries may become an EAGLE in the future, while others may drop out of the group. In order to narrow down the group of emerging countries which may become EAGLEs we shall determine a watch list of emerging countries that are large and dynamic enough to be in the EAGLEs' nest.

Because of the dynamic nature of our concept, as opposed to other existing ones such as BRIC, BBVA Research commits to providing investors with quarterly reports on economic developments: the BBVA EAGLEs Outlook. We shall also provide an annual evaluation report where growth prospects for the next 10 years will be reassessed, taking into account any developments that might influence them: BBVA EAGLEs Long-Term Updates. This yearly report will serve as the basis for reviewing the countries that remain in EAGLEs as well as new countries on the list. It will be supported by local knowledge of economic think-tanks in the countries involved.

In this initial note, we set out our view on three key questions using a full revision of our forecasts for the next ten years: (i) How fast can we expect the emerging world to grow compared with the developed economies? (ii) Which countries are more likely to reach economic significance in the global stage? (iii) How safe are these forecasts?.

2. Emerging markets' growth will outperform the G7 by 3-4 percentage points, even excluding China

As the developed world pays the toll for years of financial excess, emerging markets are moving ahead with a strong recovery. Some of this difference is purely cyclical but not all. In fact, beyond cyclical differences, investors still have to come to grips with some defining features in the growth potential of emerging markets and how it is likely to compare with the developed world. First, we envisage slower trend growth across the board: a reduction of GDP growth of around 1 percentage point (pp) for the average G7 country and a reduction of about 2pp for emerging markets versus the pre-crisis decade. The larger reduction for emerging markets takes care of the previously mentioned cyclical differences in today's growth rates. However, emerging markets will still maintain a positive growth differential versus the developed markets of around 4pp per year. Second, even excluding China, the difference in growth rates remains very large: about 3pp per year. Finally, when one excludes China, the growth rates of Brazil, India and Russia are not that different from the average emerging market outside the selective BRIC club.

Table 1

Size and incremental demand for the EAGLEs.
Gross Domestic Product (USD PPP 2010 trillions, constant valuation)

Country	2010	2020	Incremental demand: absolut change
China	10.1	22.7	12.6
India	4.0	7.6	3.6
Brazil	2.2	3.3	1.1
Indonesia	1.0	1.8	0.7
Korea	1.5	2.2	0.7
Russia	2.2	2.8	0.6
Mexico	1.5	2.0	0.5
Egypt	0.5	0.9	0.4
Turkey	1.0	1.4	0.4
Taiwan	0.8	1.2	0.4
EAGLEs average	**2.5**	**4.6**	**2.1**
Japan	4.3	4.9	0.6
Germany	2.9	3.4	0.4
UK	2.2	2.6	0.4
Canada	1.3	1.7	0.3
France	2.1	2.5	0.3
Italy	1.8	1.9	0.2
G6 average	**2.4**	**2.8**	**0.4**
United States	14.6	18.2	3.6
G7 average	**4.2**	**5.0**	**0.8**

Source: BBVA Research

3. The list of key economies expands: EAGLEs will lead incremental demand in the world economy

As the rotation of global growth towards emerging markets continues, the question is: how will countries change their economic relevance in the global context? To answer this question, we strongly advocate looking at incremental growth, rather than GDP size. Why? Conceptually, size per se is too inertial and allows no anticipation of long term trends. Moreover, incremental demand is more relevant for new business opportunities. Finally, lackluster activity across the world offers a premium on those countries which are growing, even if their size is still not fully developed.

Using this criterion, the relevant figures in our forecasts are as follows. We anticipate world GDP measured in PPP terms to grow by around 40 trillion (from around 70 trillion) in the next 10 years. Out of these figure, the US will add additional GDP of 2.8 trillion while the remaining countries in the G7 (which we term the G6) will add about 2.4 trillion, implying an average of 400 billion each. On the other hand, according to our forecasts, there will be 10 emerging economies which will add more additional demand than the average G6 country: China, India, Brazil, Korea, Indonesia, Russia, Mexico, Turkey, Egypt and Taiwan. These ten economies constitute the BBVA EAGLEs.

Table 2
Strong growth offers large cushion. GDP growth rates

Country	Average GDP growth rates between 2010-2020	Reduction in country's growth to match Italy's contribution	Consensus
Brazil	4.6	-3.9	4.6
China	8.6	-8.5	8.4
Egypt	6.2	-3.5	6.6
India	6.8	-6.5	7.8
Indonesia	5.5	-4.2	6.2
Korea	4.2	-3.3	4.1
Mexico	2.9	-2.1	4.7
Russia	2.5	-1.9	4.5
Taiwan	4.3	-2.6	5.4
Turkey	4.0	-2.6	4.4

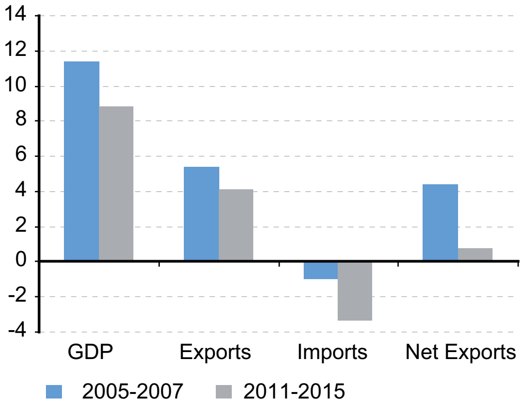
Source: BBVA Research

Some striking results come from focusing on incremental GDP. First, while many observers already expect China to match the US in PPP size by the end of the decade, our approach puts into focus the fact that this requires that China's additional demand to be around 4 times larger in China than in the US. India will actually match the US contribution. To us, this implies that China and, to a lesser extent, India's weight in global economic matters will be even larger than what their GDP size suggests. But there are some very interesting insights looking outside the BRICs. For example, Korea and Indonesia will each add more growth than Russia, despite not having BRIC status. In fact, the combined GDP of the 6 EAGLEs who are not in the BRICS is now around 50% of the G6 aggregate. However, the change in GDP in the next ten years will be about 40% larger.

4. On a relative basis, the EAGLEs are safer than usually thought

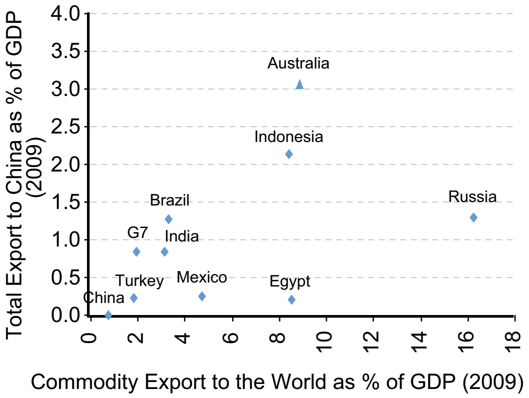
Our forecasts are obviously subject to a wide set of uncertainties and criticisms, as any economic forecast is. The relevant issue for investors is one of relative risks, however. On that basis, EAGLEs have clear advantages when compared with their own past or with the developed economies.

Chart 4
External demand gradually less important. China's Demand Components Contribution to Growth



Source: BBVA Research

Chart 5
External demand gradually less important. Weight of China and commodity exports over GDP



Source: BBVA Research

First of all, the growth differential between the EAGLEs and the largest developed economies is so large that there is ample room for error. EAGLEs could grow by about 2pp less than what we envisage and still have larger incremental demand than a country like Italy. Second, the overall message does not depend on PPP valuation. Using USD to measure GDP reduces the growth gap but it does not disappear. Furthermore, over the medium term, we expect appreciation of emerging countries' currencies so that USD and PPP GDP figures will get much closer.

No matter how robust the results are to growth changes, it is still interesting to ask what the key risks to our growth forecasts are. One key risk is a sudden reduction in external demand. In reality, our forecasts are not very dependent on external demand from developed countries but rather rely a continuation of South- South trade. Furthermore some countries, as important as China, have imbedded in their projections an almost null contribution of net external demand over the next 10 years. This is because we envisage a significant slowdown of exports to the developed world, but an acceleration of imports from China. Such increase in imports from China explains, at least partially, our forecasts of growing South-South trade. Another related risk in the geographical concentration of exports, but it is not radically different in most EAGLE countries when compared to the US.

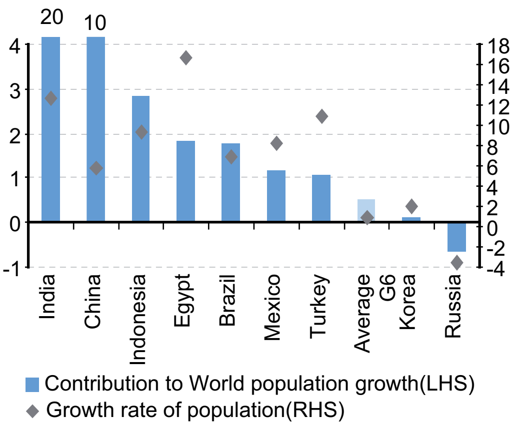
Our estimates of potential GDP growth are based on a detailed analysis based on the production function approach (as in Domenech, Estrada and Gonzalo-Calvet (2008)). Our methodology takes into account demographic trends –corrected to account for structural changes in working age population and participation rates– and capital accumulation (based on forecasts of investment rates). This decomposition allows estimating total factor productivity as a residual, which we then model using time series and adjust based on two main dimensions: 1) institutional quality; 2) impact of the crisis on each country's growth model. We take advantage of the expertise of our local economist teams to do these adjustments.

Looking over the longer term, the supply-side economics behind our forecasts seem safer than for many developed economies. Most EAGLEs can rely on significant population growth versus a relative stabilization or decline in the G7 countries. This bodes well for their domestic demand. Taking such population trends into account, our estimates for capital accumulation and total factor productivity (TFP) are generally not too demanding. In fact, our projections of medium term growth which lead to the EAGLEs classification include a declining estimate of TFP in most countries.

As for country risk, macroeconomic fundamentals are clearly stronger in the EAGLEs than in the developed world. Debt is lower, fiscal imbalances more contained and external positions generally better. BBVA Research econometric models for sovereign risk suggests that, based on macro variables alone, emerging markets should actually be trading 80pb below the G7 average. In a world where developed economies can no longer rely on markets to ignore their macro fundamentals, we interpret this result as a strong indication that a significant fraction of the spread compression between emerging and developed economies recently observed could be structural.

Chart 6

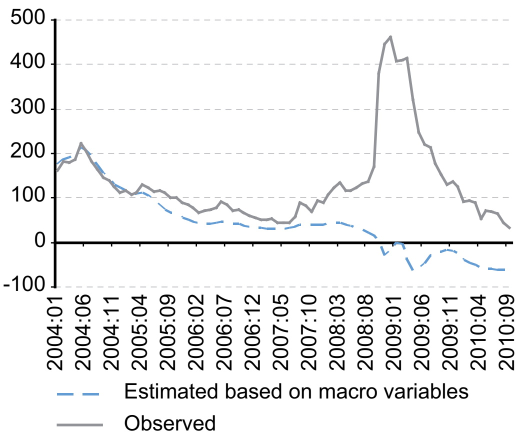
Strong demographic bonus in EAGLEs. Population prospects



Source: BBVA Research

Chart 7

A risk rotation too. Sovereign CDS spread Emerging vs. Developed Economies



Source: BBVA Research

Who is in the nest? Countries which could get EAGLE status

There are many other emerging countries which are worth being followed closely by investors. In fact, there are as many as eleven countries whose contribution to global growth is expected to be larger than that of Italy in the next ten years. That implies that each of those economies will generate short but close to 400 bn. USD in new business. These eleven countries, which are in the nest of the EAGLEs, are (ordered from the largest to the smaller contributor): Nigeria, Poland, South Africa, Thailand, Colombia, Vietnam, Bangladesh, Malaysia, Argentina, Peru and the Philippines.

The economic importance of Asia not only shows up in the EAGLEs (5 out of 10 are Asian countries) but also in the watchlist, where still five out of eleven are Asian. In decreasing relevance, these countries are Thailand, Vietnam, Malaysia, Bangladesh and the Philippines. All in all, Asia implies 81% of total new business stemming from Eagles and their nest. Excluding China and India, this figure falls to 40% but the other Asian countries remain leaders in terms of their contribution.

Latin America stands out as second most important emerging region, not only because it has two EAGLEs out of ten but also because it has three countries in the watchlist out of eleven, namely Colombia, Argentina and Peru. All in all, Latin America implies 10% of the new business from Eagles and the nest, but 30% when China and India are excluded. As for Africa, South Africa and Nigeria make it into the watchlist, which adds to the only African Eagle: Egypt. All in all, Africa accounts for 4% of total new business. Finally, Emerging Europe only has one country in the nest, namely Poland, which adds to the two European Eagles: Russia and Turkey. All in all, Emerging Europe accounts for 5% of total new business.

The EAGLEs' nest is clearly a more heterogeneous group in terms of its risk assessment. There are some cases where external dependence is strong (particularly in Asia) as they would be hit hard by a slowdown in China. Others are quite dependent on commodity prices. However, their macroeconomic situation is generally sound and their longer-term fundamentals also benefit from stronger population growth, in line with our assessment for the EAGLEs.

Table 3

GDP Growth

Country	Average growth needed to become an EAGLE (2010-2020)	The difference between required and forecasted growth
Poland	4.1	0.6
Nigeria	7.2	0.7
Thailand	5.2	1.1
South Africa	5.3	1.1
Colombia	6.3	1.6
Argentina	5.0	1.7
Malaysia	6.6	1.9
Vietnam	8.7	2.1
Bangladesh	9.0	2.2
Philippines	7.5	3.1
Peru	8.9	3.3

Source: BBVA Research

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