Dean Newman: Middle class boom to drive economies

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THE emergence and growing importance of the middle class is a key investment theme for Latin America.
In our view, growth in the number of middle-income consumers should strengthen the dynamics of the domestic economies as well as boosting the region's development. With the average person living longer and becoming wealthier, we are witnessing a significant expansion of purchasing power.

The growth of the middle class has been an underlying driver behind Latin America's improved economic performance over the past decade. According to a variety of sources, the middle class now accounts for about half the total population of the main countries in the region.

This phenomenon, which has been particularly evident in Brazil, has been supported by strong regional GDP growth in recent years. The implementation of sound macroeconomic policies, resulting in an important reduction in inflation across the region, together with government initiatives to cut poverty levels, has also played an important part.

Before we take a closer look at what we believe could be the beneficiaries of the growth of the middle class, we need to define this socioeconomic classification. According to Fundacao Getulio Vargas, the middle class in Brazil begins at a yearly family income of US$8,000.

Only when this income level rises above US$34,000 does it merit an upgrade to class B from C. Families in class C normally have just bought their first home, run an economy car, have internet access and own white goods such as washing machines and refrigerators. Those aspiring to become middle class tend to live in smaller apartments in less attractive neighbourhoods and make do with basic furniture.

Citigroup Global Markets estimates that between 2003 and 2009 approximately 30 million Brazilians joined the middle class. With this figure set to increase as the country's economic success filters even further down the income chain, the housing sector is likely to reap benefits. Reflecting a favourable demographic profile, strong pent-up demand and growing access to affordable mortgage credit, we believe the long-term outlook for homebuilding in the country is positive. Affordable housing has been a key policy initiative, firstly in Mexico, and more recently in Brazil. Lower interest rates and improved mortgage financing terms have made home ownership feasible for a wider spectrum of potential homebuyers.

The average number of occupants per household is changing too as a result of smaller family sizes and urbanisation. According to a recent study by Ernst & Young, there were 3.1 persons per household in 2007.

The projection for 2030 is that this will fall to only 2.4 persons per household, which is likely to increase demand for dwellings.

With living standards rising and a greater number of people working, demand for financial products is also likely

to grow. Banks are likely to benefit from acceleration in growth for mortgages and other forms of consumer credit. Greater wealth should also provide opportunities for insurance companies to increase the depth and range of private pensions. With disposable income levels rising and income inequalities being further reduced, the outlook for providers of savings and investment-related products is likely to improve.

Another indicator of changing lifestyles is an increasing propensity to travel. In Latin America, passenger traffic is concentrated in Brazil and Argentina, with Chile, Peru and Colombia being smaller markets. After being adversely impacted by the global economic slowdown of 2008-09, we believe that personal travel and tourism is likely to resume a healthy growth rate. This should benefit airlines, airport operators and car rental companies.

Health and wellbeing are other areas that may prosper with a population that is growing older and richer. This could be in the form of enhanced hospital services, including increased spending on pharmaceutical products, or more people taking out private healthcare schemes such as dental plans. In 2010, Brazil spent about US$56 billion on health-related goods and services. According to projections from market research firm Euromonitor, this figure could easily double by 2020. To put it in perspective, medical spending in Germany, Europe's largest economy but with about half the population of Brazil, was US$90bn last year.

Cosmetics is another industry that is doing very well in the region, and one that could do even better as consumer spending powers growth. Already, Brazil is the third largest market in the world for toiletry and beauty products, behind America and Japan. According to forecasts from Euromonitor, Brazil could overtake these to become the biggest market globally in less than ten years' time.

We can see how consumption behaviour is likely to change as individuals move up the income ladder. We believe this is a positive development for the countries involved and one that strengthens the long-term investment appeal of the region.

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