MoneyMarketing

The middle ground

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The growth of the middle classes in emerging countries is driving performance of domestic economies

To combat concerns about economies overheating and to help calm food and energy price inflation, most central banks in emerging markets countries have already embarked on a series of interest rate hikes.

Policymakers have learned from the past and now appear to be better equipped to with-stand potential inflation spirals. The main worry now is that the purchasing power of consumers, particularly the poor who suffer disproportionately from inflation as wage increases lag price rises, will be eroded.

While this may have an adverse impact on shortterm consumption patterns, we do not believe this will derail one of the key invest-ment themes within developing markets - the emergence and growing impor-tance of the middle class.

In our view, growth in the number of middle-income consumers over the long term should strengthen the dynamics of the domestic emerging economies. The average person is living longer and becoming wealthier. The growth of the middle class has been an underlying driver behind the improved performance of emerging market economies over the past decade.

This phenomenon has been particularly evident in Brazil. Just to focus on how big the explosion in this social stratum has been, Citigroup Global Markets estimates that between 2003 and 2009, about 30 million Brazilians joined the middle class. According to research from Brazilian university Fundacao Getulio Vargas, published in March 2011, the middle class in Brazil begins at a yearly family income of US$8,000 for social class C and this rises to US$34,000 for upper middle class B. Social class C now accounts for 94.9 million people, 50.5 per cent of the population.

This new middle class has 46.2 per cent of Brazil's consumer purchasing budget, more than the top two social classes put together.

With the number of consu-mers within emerging markets growing in size and affluence, we believe this will provide attractive investment oppor-tunities. For example, health and wellbeing is an area that may prosper.

This could be in the form of enhanced hospital services, including increased spending on pharmaceutical products, to more people taking out private healthcare schemes such as dental plans.

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, we believe the outlook for providers of savings and investment-related products is likely to improve.

Another indicator of chan-ging lifestyles is an increasing propensity to travel.

Although this was 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.

We believe that the best way to gain exposure to these opportunities lies in investing in the companies based in emerging countries as opposed to Western multinationals.

By focusing on the underlying investment themes, we can be more stock specific when selecting companies for inclusion in our portfolios.
Currently, we favour mid-cap stocks as we believe that many of these offer great long-term potential and are supported by impressive local management teams.

Dean Newman is head of emerging markets equities at Invesco Perpetual

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