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Emerging markets are undergoing structural change

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Emerging markets can no longer be viewed as simply fast-growing developing countries with younger populations and many common characteristics, as was the case in previous decades. Structural changes have now made them far more heterogeneous. A more differentiated view is important and offers clear investment opportunities. At the same time, these structural shifts have also created risks that differ from traditional concerns of the past, such as high levels of external debt or significant current account deficits. The accelerated demand for supply-chain components used in artificial intelligence, particularly semiconductors, has led to a much higher concentration within the technology sector. As a result, the IT weighting in the MSCI Emerging Markets Index is now almost as high as that of the US equity market. This primarily affects Asia, whereas Latin America can be regarded as a commodity heavyweight and India is more dependent on domestic consumption.

The term "emerging markets" originated in the 1980s and was intended to distinguish emerging economies from the established industrial nations. For many years, emerging markets typically shared relatively homogeneous characteristics, such as increasing levels of industrialisation, younger populations, rising urbanisation and, as a particularly characteristic feature, faster or stronger earnings growth than in the established industrialised nations. However, it is now time to consider the structural changes taking place in emerging markets. These developments should lead investors to recognise the increasing differentiation within the emerging-market space and to acknowledge that it is less homogeneous than in the past. As a result, it may be more difficult to use emerging markets as a simple source of diversification relative to other equity and bond markets, particularly in light of the changes in sector and country weightings.

Fundamental factors have also changed since the 1980s and 1990s. Whereas emerging markets were often heavily indebted during those decades, many have since made great strides in this respect and have become less fiscally vulnerable than in the past. In particular, levels of indebtedness vis-à-vis industrialised nations have fallen considerably, as has the general dependence on US-dollar financing. Moreover, current account deficits have narrowed or have even been eliminated altogether, a fundamental improvement that is especially apparent in North Asia. A further fundamental change has been the improvement and increase in emerging markets' currency reserves, whereas currency crises were a frequent occurrence during the 1990s.

This development is also linked to improvements in inflation dynamics. Following the supply-chain disruptions caused by the COVID-19 crisis, emerging-market central banks began raising key interest rates more rapidly than those in industrialised nations. As a result, emerging-market central banks were able to reduce inflation and now have additional scope for interest-rate cuts, particularly in Latin America.

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In Asia, by contrast, we are witnessing a positive shift towards stronger earnings growth, as North Asia develops into a globally important centre for the artificial intelligence ecosystem. Emerging markets have become indispensable, particularly in the area of semiconductors (Taiwan, South Korea) and among hyperscaler companies involved in language models and software, as demonstrated by the launch of DeepSeek in China.

It should not be forgotten that China is a global leader in rare earths, which are crucial to the technology and electronics industries, as well as in robotics, sensors and battery manufacturing. Latin America, meanwhile, can leverage its vast resources of raw materials that are also in demand within the artificial intelligence ecosystem, for example globally important metals such as copper. In addition, Latin America is benefiting from efforts by the US to reduce its dependence on China and to relocate the production of industrial goods and supply-chain components away from Asia and towards geographically closer countries, a trend referred to as reshoring or friendshoring. Countries such as Mexico and Brazil stand to profit from these developments.

The structural changes taking place in emerging markets therefore create not only opportunities but also risks. Particular attention must be paid to the increased concentration of the technology sector within emerging-market equity markets, especially in South Korea and Taiwan. Technology now accounts for around 40% of the MSCI Emerging Markets Index, a weighting similar to that of the S&P 500 in the US.

Gérard Piasko

Gérard Piasko is Chief Economist and member of the investment committee.

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Maerki Baumann & Co. Ltd.
Dreikönigstrasse 6, CH-8002 Zurich
T +41 44 286 25 25, info@maerki-baumann.ch
maerki-baumann.ch