

Tales From the Emerging World

# The Pandemic's Silver Lining

ACTIVE FUNDAMENTAL EQUITY | GLOBAL EMERGING MARKETS TEAM | MACRO INSIGHT | 2020

The shadow over emerging markets grew a bit thicker this month. The International Monetary Fund (IMF) revised its 2020 growth forecasts for developed economies upward, and emerging economies downward, based largely on the fact that richer countries are spending much more heavily on stimulus during the pandemic. This will only fuel widespread talk about the “end of convergence,” the idea that fast-growing emerging countries are destined to catch up with developed ones.

AUTHOR



**RUCHIR SHARMA**

*Head of Emerging Markets and  
Chief Global Strategist*

Moments like this are a reminder to stay calm in the rain. We have pointed out for years that convergence has always been difficult and rare; few emerging nations have ever caught up over the long haul. But hot decades are common, particularly after cold ones, as the economic cycles turn. The reasons to expect a good decade for emerging economies in the 2020s are numerous, particularly now that expectations are so low and sentiment so negative.

Digital revenue is growing much faster as a share of Gross Domestic Product (GDP) in emerging markets than developed markets.<sup>1</sup> Commodity producers cut so much excess supply over the last decade, global commodity prices are now poised for a rebound.<sup>2</sup> Even as global trade slows, a few emerging economies are still rising on the strength of export manufacturing. Emerging Market (EM) valuations are beaten down after a tough decade. And good decades are particularly likely after a crisis pushes nations to reform. The bigger the crisis, the greater the push. The underappreciated fallout of the pandemic is that it is forcing economic reform in many hard-hit developing nations.

<sup>1</sup> Statista, IMF. Data as of October 2020.

<sup>2</sup> MSIM.

One of the most powerful drivers of superior equity returns in emerging markets is a rising GDP growth differential.<sup>3</sup> When emerging economies are growing faster than developed economies, market returns have followed, historically. While the heavy spending on stimulus is currently easing the downturns in the developed world, the resulting increase in deficits and debt will slow growth going forward. Emerging countries are moving in the opposite direction: unable to borrow and spend, they are being forced to accelerate reforms, which will boost productivity and growth in the years ahead.

The depth and sweep of reform campaigns across the emerging world has been widely overlooked. One of the more striking examples is India, where Narendra Modi came to power in 2014, touted as a potentially radical reformer, but for the most part he has tinkered at the edges instead. Lately, however, with growth cratering, Modi's

government is feeling the heat and starting to take decisive steps.

After cutting corporate taxes last year, New Delhi has moved in recent months to ease controls on the sale, pricing and storage of agricultural goods, which have protected Indian farmers from market forces for decades. Along with many state governments it has also changed some of the most cumbersome labor laws in the emerging world.<sup>4</sup>

It's hard to know which reform campaign will provide the biggest boost to growth. Academic research is inconclusive about which types of reform have the biggest economic impact, and at times questions whether there is any impact at all. But anyone who has traveled in emerging economies has seen how an energized government with ambitious reform plans can fire up animal spirits in an economy. And we now see the ambition of EM reform plans growing.

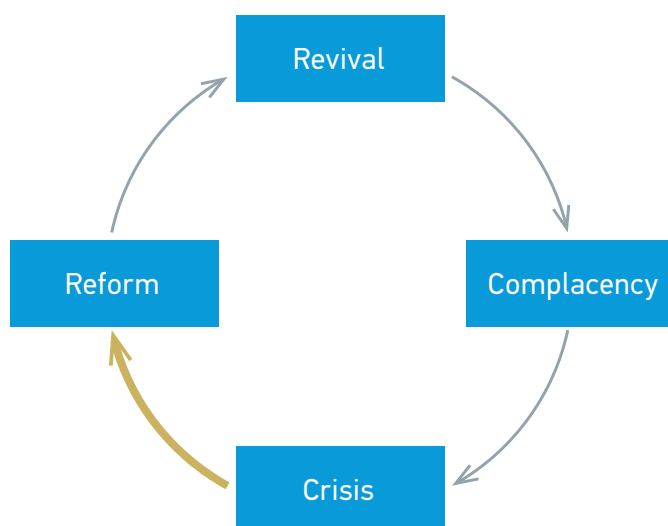
Under pressure from weak growth and rising debts, big emerging markets were making tough reforms even before the pandemic hit, and are still pushing ahead now. Going back to 2017, Indonesia had sharply cut fuel and energy subsidies, streamlined the paperwork hurdles to hiring foreign workers and set up a one-stop shop that processes new business licenses in three hours. Then last month, it topped all that when parliament, despite union protests, passed a bill with the stated aim of boosting investment and creating jobs through a sweeping reduction in red tape, easing labor laws, and cutting taxes on corporations and domestic dividends.<sup>5</sup>

Brazil is overhauling its crippling expensive pension system, aiming to cut spending by more than \$140 billion over 10 years, in part by raising the retirement age for both men and women.<sup>6</sup> In traditionally insular Saudi Arabia, the government is granting new rights to foreigners, including the right to own 100 percent of publicly traded companies in sectors from real estate to health and education, and to obtain (for a hefty fee) permanent residency permits, which include legal authority to purchase property and hire housekeepers. It has also implemented fiscal reforms to compensate for the collapse in oil revenues.<sup>7</sup>

All these efforts represent the kind of wrenching change that governments rarely contemplate unless their backs are up against the wall. Since the pandemic hit, more than 80 countries—the vast majority being frontier markets like Pakistan and Nigeria—have sought financial relief from the IMF. Even though the IMF is waiving its usual demands for reform as a condition of aid, some key frontier markets have continued pushing ahead anyway. Egypt has sharply cut fuel and energy subsidies, bringing the deficit under control and stabilizing its currency, with no sign that it will lose discipline during the pandemic.<sup>8</sup>

## DISPLAY 1

### Bigger Crises Inspire Bigger Reforms



Source: MSIM Global Emerging Markets Team.

<sup>3</sup> MSIM, Bloomberg, FactSet, Haver.

<sup>4</sup> CSIS, BBC, Reuters, as of September 2020.

<sup>5</sup> OECD July 2019, Financial Times, as of October 2020.

<sup>6</sup> Mercer, as of December 2019.

<sup>7</sup> PricewaterhouseCoopers, Reuters October 2019, Gulf Business, as of March 2020.

<sup>8</sup> Bloomberg as of June 2019, IMF, MSIM.

Pakistan has cut government spending and reduced subsidies to lower its deficit, and devalued the rupee to make it more competitive.<sup>9</sup> Several others are still rising as export powers, despite the decline in global trade, and the rise in trade barriers. The leading example is Vietnam, which recently closed a landmark trade deal with the European Union.

In developed countries, massive stimulus is providing a growth sugar rush. The United States, in particular, seems increasingly complacent, confident that it can print enough money to spend its way out of a downturn, without long term consequences. Emerging countries don't have that luxury. They are being forced to reform, to solidify national finances, streamline government and be

open to global market forces in ways that could help sustain faster growth for many years. Economic reform is the pandemic's silver lining: It is not the only reason to expect that the 2020s could be a stronger decade for many emerging economies, but it is one of the most overlooked.

**Risk Considerations:** There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g. natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g. portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks. In general, **equities securities'** values also fluctuate in response to activities specific to a company. Investments in **foreign markets** entail special risks such as currency, political, economic, and market risks. The risks of investing in **emerging market countries** are greater than the risks generally associated with investments in foreign developed countries. **Stocks of small- and medium-capitalization companies** entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies. **Derivative instruments** can be illiquid, may disproportionately increase losses and may have a potentially large negative impact on the portfolio's performance. **Illiquid securities** may be more difficult to sell and value than public traded securities (liquidity risk). **Non-diversified portfolios** often invest in a more limited number of issuers. As such, changes in the financial condition or market value of a single issuer may cause greater volatility.

## About Morgan Stanley Investment Management<sup>10</sup>

Morgan Stanley Investment Management, together with its investment advisory affiliates, has 729 investment professionals around the world and approximately \$715 billion in assets under management or supervision as of September 30, 2020. Morgan Stanley Investment Management strives to provide outstanding long-term investment performance, service and a comprehensive suite of investment management solutions to a diverse client base, which includes governments, institutions, corporations and individuals worldwide. For more information, please visit our website at [www.morganstanley.com/im](http://www.morganstanley.com/im). This material is current as of the date specified, is for educational purposes only and does not contend to address the financial objectives, situation or specific needs of any individual investor.

<sup>9</sup> Bloomberg as of June 2020, Bloomberg as of November 2018, MSIM.

<sup>10</sup> Assets under management as of September 30, 2020. Morgan Stanley Investment Management ("MSIM") is the asset management business of Morgan Stanley. Assets are managed by teams representing different MSIM legal entities; portfolio management teams are primarily located in New York, Philadelphia, London, Amsterdam, Hong Kong, Singapore, Tokyo and Mumbai offices. Figure represents Morgan Stanley Investment Management's total assets under management/supervision.

**DEFINITIONS: Gross Domestic Product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period. It includes all private and public consumption, government outlays, investments and net exports.

**IMPORTANT DISCLOSURES:** The views and opinions are those of the author as of the date of publication and are subject to change at any time due to market or economic conditions and may not necessarily come to pass. Furthermore, the views will not be updated or otherwise revised to reflect information that subsequently becomes available or circumstances existing, or changes occurring, after the date of publication. The views expressed do not reflect the opinions of all portfolio managers at Morgan Stanley Investment Management (MSIM) or the views of the firm as a whole, and may not be reflected in all the strategies and products that the Firm offers. Forecasts and/or estimates provided herein are subject to change and may not actually come to pass. Information regarding expected market returns and market outlooks is based on the research, analysis and opinions of the authors. These conclusions are speculative in nature, may not come to pass and are not intended to predict the future performance of any specific MSIM product.

Certain information herein is based on data obtained from third party sources believed to be reliable. However, we have not verified this information, and we make no representations whatsoever as to its accuracy or completeness. The information herein is a general communications which is not impartial and has been prepared solely for information and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The material contained herein has not been based on a consideration of any individual client circumstances and is not investment advice, nor should it be construed in any way as tax, accounting, legal or regulatory advice. To that end, investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

**Past performance is no guarantee of future results.**

This communication is not a product of Morgan Stanley's Research Department and should not be regarded as a research recommendation. The information contained herein has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

There is no guarantee that any investment strategy will work under all market conditions, and each investor should evaluate their ability to invest for the long-term, especially during periods of downturn in the market. Prior to investing, investors should carefully review the strategy's/ product's relevant offering document. There are important differences in how the strategy is carried out in each of the investment vehicles.

**DISTRIBUTION:** This communication is only intended for and will only be distributed to persons resident in jurisdictions where such distribution or availability would not be contrary to local laws or regulations.

**Ireland:** Morgan Stanley Investment Management (Ireland) Limited. Registered Office: The Observatory, 7-11 Sir John Rogerson's Quay, Dublin 2, Ireland. Registered in Ireland under company number 616662. Regulated by the Central Bank of Ireland. **United Kingdom:** Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA. **Dubai:** Morgan Stanley Investment Management Limited (Representative Office, Unit Precinct 3-7th Floor-Unit 701 and 702, Level 7, Gate Precinct Building 3, Dubai International Financial Centre, Dubai, 506501, United Arab Emirates. Telephone: +97 (0)14 709 7158). **Germany:** Morgan Stanley Investment Management Limited Niederlassung Deutschland, Grosse Gallusstrasse 18, 60312 Frankfurt am Main, Germany (Gattung: Zweigniederlassung (FDI) gem. § 53b KWG). **Italy:** Morgan Stanley Investment Management Limited, Milan Branch (Sede Secondaria di Milano) is a branch of Morgan Stanley Investment Management Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), and whose registered office is at 25 Cabot Square, Canary Wharf, London, E14 4QA. Morgan Stanley Investment Management Limited Milan Branch (Sede Secondaria di Milano) with seat in Palazzo Serbelloni Corso Venezia, 16 20121 Milano, Italy, is registered in Italy with company number and VAT number 08829360968. **The Netherlands:** Morgan Stanley Investment Management, Rembrandt Tower, 11th Floor Amstelplein 1 1096HA, Netherlands. Telephone: 31 2-0462-1300. Morgan Stanley Investment Management is a branch office of Morgan Stanley Investment Management Limited. Morgan Stanley Investment Management Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom. **Switzerland:** Morgan Stanley & Co. International plc, London, Zurich Branch Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-115.415.770. Registered Office: Beethovenstrasse 33, 8002 Zurich, Switzerland, Telephone +41 (0) 44 588 1000. Facsimile Fax: +41(0)44 588 1074.

**U.S.:** A separately managed account may not be appropriate for all investors. Separate accounts managed according to the Strategy include a number of securities and will not necessarily track the performance of any index. Please consider the investment objectives, risks and fees of the Strategy carefully before investing. A minimum asset level is required. For important information about the investment manager, please refer to Form ADV Part 2.

**Please consider the investment objectives, risks, charges and expenses of the funds carefully before investing. The prospectuses contain this and other information about the funds. To obtain a prospectus please download one at [morganstanley.com/im](http://morganstanley.com/im) or call 1-800-548-7786. Please read the prospectus carefully before investing.**

Morgan Stanley Distribution, Inc. serves as the distributor for Morgan Stanley Funds.

**NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A BANK DEPOSIT**

**Hong Kong:** This document has been issued by Morgan Stanley Asia Limited for use in Hong Kong and shall only be made available to "professional investors" as defined under the Securities and Futures Ordinance of Hong Kong (Cap 571). The contents of this document have not been reviewed nor approved by any regulatory authority including the Securities and Futures Commission in Hong Kong. Accordingly, save where an exemption is available under the relevant law, this document shall not be issued, circulated, distributed, directed at, or made available to, the public in Hong Kong. **Singapore:** This publication should not be considered to be the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under section 304 of the Securities and Futures Act, Chapter 289 of Singapore ("SFA"), (ii) to a "relevant person" (which includes an accredited investor) pursuant to section 305 of the SFA, and such distribution is in accordance with the conditions specified in section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. In particular, for investment funds that are not authorized or recognized by the MAS, units in such funds are not allowed to be offered to the retail public; any written material issued to persons as aforementioned in connection with an offer is not a prospectus as defined in the SFA and,

accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply, and investors should consider carefully whether the investment is appropriate for them. This publication has not been reviewed by the Monetary Authority of Singapore. **Australia:** This publication is disseminated in Australia by Morgan Stanley Investment Management (Australia) Pty Limited ACN: 122040037, AFSL No. 314182, which accepts responsibility for its contents. This publication, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

**Japan:** For professional investors, this document is circulated or distributed for informational purposes only. For those who are not professional investors, this document is provided in relation to Morgan Stanley Investment Management (Japan) Co., Ltd. ("MSIMJ")'s business with respect to discretionary investment management agreements ("IMA") and investment advisory agreements ("IAA"). This is not for the purpose of a recommendation or solicitation of transactions or offers any particular financial instruments. Under an IMA, with respect to management of assets of a client, the client prescribes basic management policies in advance and commissions MSIMJ to make all investment decisions based on an analysis of the value, etc. of the securities, and MSIMJ accepts such commission. The client shall delegate to MSIMJ the authorities necessary for making investment. MSIMJ exercises the delegated authorities based on investment decisions of MSIMJ, and the client shall not make individual instructions. All investment profits and losses belong to the clients; principal is not guaranteed. Please consider the investment objectives and nature of risks before investing. As an investment advisory fee for an IAA or an IMA, the amount of assets subject to the contract multiplied by a certain rate (the upper limit is 2.20% per annum (including tax)) shall be incurred in proportion to the contract period. For some strategies, a contingency fee may be incurred in addition to the fee mentioned above. Indirect charges also may be incurred, such as brokerage commissions for incorporated securities. Since these charges and expenses are different depending on a contract and other factors, MSIMJ cannot present the rates, upper limits, etc. in advance. All clients should read the Documents Provided Prior to the Conclusion of a Contract carefully before executing an agreement. This document is disseminated in Japan by MSIMJ, Registered No. 410 (Director of Kanto Local Finance Bureau (Financial Instruments Firms)), Membership: the Japan Securities Dealers Association, The Investment Trusts Association, Japan, the Japan Investment Advisers Association and the Type II Financial Instruments Firms Association.

**IMPORTANT INFORMATION: EMEA:** This marketing communication has been issued by Morgan Stanley Investment Management Limited ("MSIM"). Authorised and regulated by the Financial Conduct Authority. Registered in England No. 1981121. Registered Office: 25 Cabot Square, Canary Wharf, London E14 4QA.

Any index referred to herein is the intellectual property (including registered trademarks) of the applicable licensor. Any product based on an index is in no way sponsored, endorsed, sold or promoted by the applicable licensor and it shall not have any liability with respect thereto.

Charts and graphs provided herein are for illustrative purposes only.

The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the applicable European or Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

MSIM has not authorised financial intermediaries to use and to distribute this document, unless such use and distribution is made in accordance with applicable law and regulation. Additionally, financial intermediaries are required to satisfy themselves that the information in this document is appropriate for any person to whom they provide this document in view of that person's circumstances and purpose. MSIM shall not be liable for, and accepts no liability for, the use or misuse of this document by any such financial intermediary.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without MSIM's express written consent.

All information contained herein is proprietary and is protected under copyright law.

Morgan Stanley Investment Management is the asset management division of Morgan Stanley.

Explore our site at [www.morganstanley.com/im](http://www.morganstanley.com/im)