



Have We Witnessed the Failure of the Emerging Markets Growth Model?

Description

Could it be true that the massive expansion in global economic growth that was triggered by the rapid modernization of a number of emerging markets has come to a sharp and disappointing end?

This is the claim of some economists as they survey the damage that the collapse in economic growth of some of the world's fastest-growing emerging economies has left behind. If true, it would certainly have a sharp impact not only on Canada's economy, but on some of Canada's biggest listed companies.

Now what?

Way back in 2001, the then chairman of Goldman Sachs coined the term BRICS to describe the emergence of Brazil, Russia, India, China, and South Africa as the most important emerging markets and drivers of global economic growth. Since then almost all have encountered significant economic problems that have had a ripple effect throughout the global economy—the most significant being the sharp collapse in commodity prices caused by a slowing China.

This has caused the prices of a number of commodities including iron ore, crude, and coal to collapse. This has had a marked impact on emerging economies that are dependent on these commodities as key drivers of economic growth.

Brazil, Latin America's largest economy, has fallen into its worst economic downturn since the Great Depression as a range of structural issues and weaker commodity prices have been weighing heavily on its economic outlook.

You only need to look at Colombia, one of the more resilient emerging economies and an important growth market for **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)), to see the impact of sharply weak commodity prices. The country is highly reliant on crude as key export and driver of economic growth.

Prior to the sharp collapse in oil prices, its 2015 GDP was forecasted to grow by 4.2%, but over recent months this has been slashed to 2.8%. It has also caused the Colombian peso to plunge by about 40% against the U.S. dollar, adding to inflationary pressures.

Then you have the Fed's recent rate hike, which will also roil emerging markets.

Higher U.S. interest rates will trigger a flight of capital from these economies, exacerbating the impact of weak commodity prices on economic growth.

This is because it will create a shortfall in capital and reduce liquidity in economies that are highly dependent on foreign investments as an important growth lever. It will also add inflationary pressures to economies that already suffer from volatile inflation, and a stronger U.S. dollar makes imports more expensive.

Meanwhile, emerging market companies, such as Brazil's **Petroleo Brasileiro SA** ([NYSE:PBR](#)), that have gorged themselves on U.S. dollar-denominated debt will face increasing pressure. The rate hike coupled with a stronger U.S. dollar makes this debt more costly, and it has been estimated that the corporate default rate in emerging markets could climb to over 5% for 2015, 2% higher than it was in 2014.

So what?

The outlook for emerging economies is growing bleaker as the collapse in commodity prices weighs heavily on their outlook. Emerging markets have further to fall yet, highlighting that they are no longer the engines of global economic growth that they were once thought to be.

With emerging economies among some of the largest consumers of commodities, this will weigh heavily on commodity prices, particularly metals and metallurgical coal. This makes miners such as **Teck Resources Ltd.** ([TSX:TCK.B](#))([NYSE:TCK](#)), **First Quantum Minerals Ltd.** ([TSX:FM](#)) and **HudBay Minerals Inc.** ([TSX:HBM](#))([NYSE:HBM](#)) unattractive investments.

CATEGORY

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2. NYSE:HBM (Hudbay Minerals Inc.)
3. NYSE:TECK (Teck Resources Limited)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:FM (First Quantum Minerals Ltd.)
6. TSX:HBM (Hudbay Minerals Inc.)
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