

Local Capital Markets

Emerging Market Investment Opportunities

Executive Summary

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Global Financial Environment

Where We Stand: 1999-2007

The growth rate of EM countries averaged $6\frac{1}{2}$ percent; That of advanced countries was $2\frac{3}{4}$ percent

Inflation of 5 percent in the EM countries approached convergence with that of industrial countries

Mature economies net savings: negative $1\frac{1}{4}$ percent of GDP
EM countries net savings: positive $4\frac{1}{2}$ percent

EM and mature economy current account balances mirrored net savings balances

Global Financial Environment

Where We Are Headed

EM current account surpluses will narrow and mature economy current account deficits will decline:

Reduced global liquidity and imbalances

EM domestic spending catching up with income

Mature economy savings catching up with income

Global Financial Environment

Where We Are Headed

Implications:

Spotlight on EM country-specific and asset-specific value in face of tighter global credit and liquidity conditions

Increased emphasis on countries that have successfully implemented appropriate economic policy and active asset/liability management

EM local capital markets and sovereign wealth funds will continue to grow in importance with both local and global consequences

Local Capital Markets

Current Environment Leaves Limited Options for Private Sector Financing

EM capital markets for the private sector continue to be dominated by banks and are characterized by short-term lending and illiquidity (especially in Latin America)

Although bond markets have achieved a significant increase in volume, most of it is accounted for by government paper

Private sector bond and stock markets show a high degree of concentration in both supply and demand and lack adequate liquidity

While AAA corporations can access the capital markets externally, or in some cases domestically, mid-sized companies have limited options

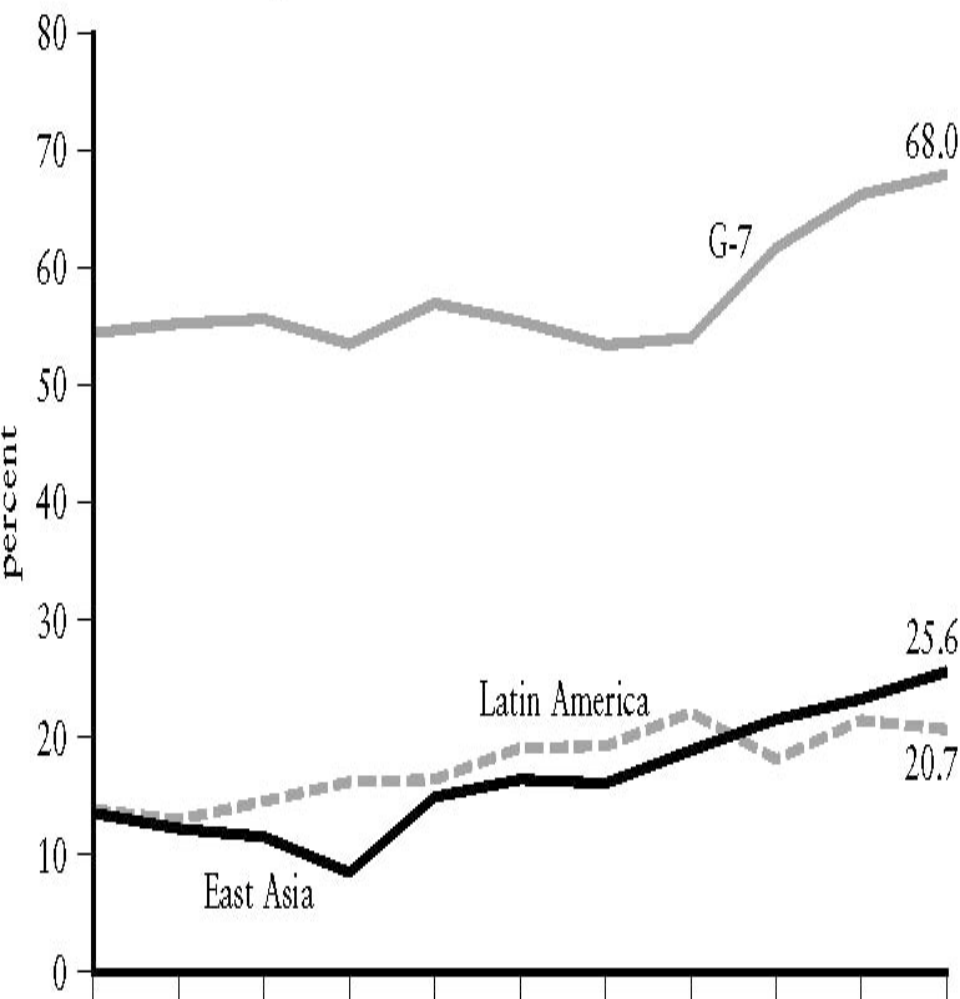
EM Domestic Markets Are Still Relatively Underdeveloped

Bond Market Development in Selected Regions

1990-2004

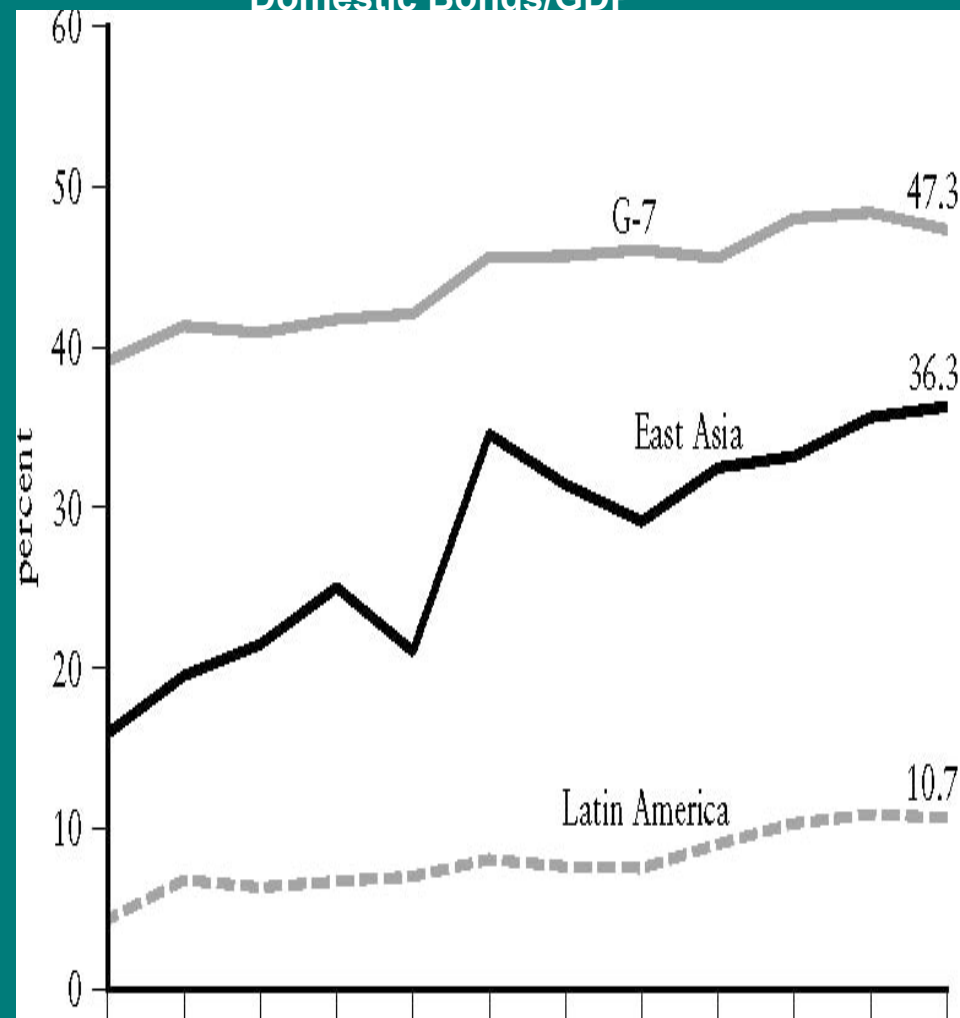
Amount Outstanding of Public Sector

Domestic Bonds/GDP



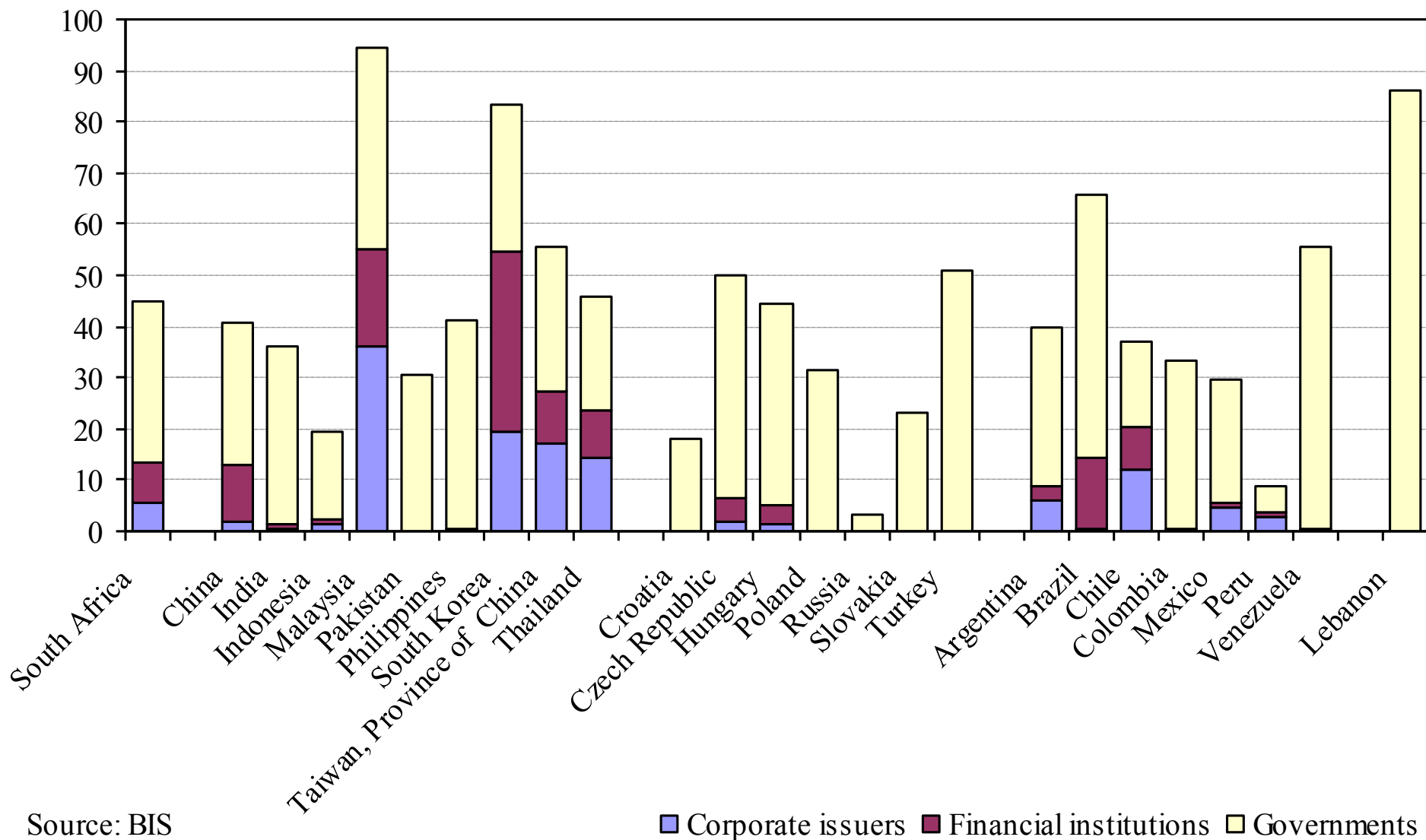
Amount Outstanding of Private Sector

Domestic Bonds/GDP



Large Proportion of Corporate Domestic Issues Taking Place in Malaysia, South Korea, Taiwan, and Thailand

**Composition of Emerging Market Outstanding Domestic Debt
(Percent of GDP, end 2005)**



Source: BIS

Corporate issuers Financial institutions Governments

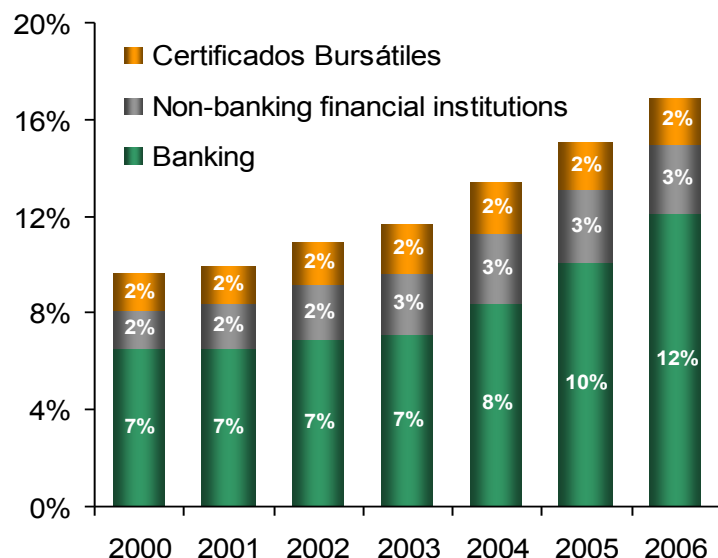
In Latin America, Even Mexican Private Capital Market Has Yet to Deepen Significantly, with Limited Options for Private Financing

Corporate Debt: Challenges and Opportunities

This lack of financing through capital markets is also evident from the firms' perspective. Capital markets represent a small share of total financing and corporate resources come mainly from suppliers and commercial banks credit.

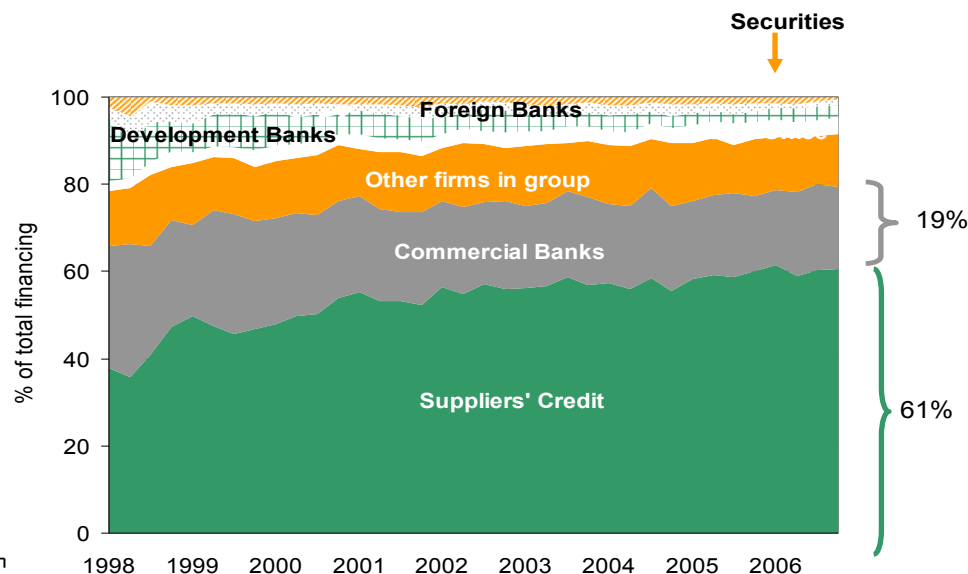


Credit to the Private Sector
(% of GDP)



Source: Banxico and CNBV

Firms' financing resources
(% of total financing)



Source: Banxico (2006). Credit market survey

EM Domestic Capital Markets Have Significant Room to Grow

	% of Global GDP	% of Global Bond Market		% of Global GDP	% of Global Bond Market
US	20.1%	34.8%	China	15.4%	0.1%
Japan	6.4%	17.7%	India	5.9%	0.0%
Germany	4.1%	10.3%	Asia (other)	5.8%	2.6%
France	3.0%	6.1%	Brazil	2.6%	0.0%
Italy	2.7%	5.1%	Mexico	1.8%	0.5%
Spain	1.8%	3.1%	LatAm (other)	3.0%	0.1%
Euro (other)	3.2%	9.1%	Russia	2.6%	0.2%
UK	3.0%	5.1%	CIS (other)	1.2%	0.0%
Canada	1.8%	2.7%	Central Europe	3.3%	0.2%
Advanced (other)	6.2%	0.6%	Middle East	2.8%	0.1%
supranational	0.0%	1.3%	Africa	3.3%	0.4%
	52.3%	95.9%		47.7%	4.1%

Source: IMF World Economic Outlook 2006; Lehman Brothers Global Aggregate Index

Local Capital Markets

Public Policy Goals

The G8's recent "Action Plan for Developing Local Bond Markets in Emerging Market Economies" calls for:

- More efficient and robust market infrastructure
- Improved public debt management practices
- Broader and diversified local investor base
- Development of derivatives, swaps, and securitization
- Improving local bond market databases
- Promoting regional development of bond markets where appropriate
- Improved and better coordinated technical assistance by IFIs and improved dialog between emerging and G8 market participants

Local Capital Market

Private Sector Opportunities Opportunities

Limited financing availability for private sector and tighter global liquidity encourages investor focus on:

Strong EM country environment

Financing opportunities where notable gaps exist, such as for mid-sized companies

Event-driven mid-sized enterprise in strong asset class

➤ Take enterprises to “next level” through refinancing or new capital injection

Local expertise and diverse investment strategies

Emerging Market Investment Opportunities

Strong EM Country Environment

Investors should look for strong country environment:

- Low sovereign political risk
- Maintain control over fiscal policy after accounting for strong commodity price exports; Declining public debt
- Monetary policy priority is low inflation
- Active asset and liability management
- Deepening domestic capital markets
- Strong legal infrastructure
- Open capital account market
- Favorable corporate tax structure
- Good labor relations with low costs

Local Capital Markets

Opportunities for Private External Financing

External financing opportunities where notable gaps exist in capital availability for private sector

- Corporate mezzanine loans
- Senior and subordinated loans
- Private equity investments
- Mortgage backed securities
- Structured financial instruments/structured finance to enhance risk/returns

Emerging Market Investment Opportunities

Event-driven Enterprise in Strong Asset Class

Take advantage of:

- Sector leader in country, including energy, infrastructure, financial services, real estate, communications
- Public-private partnerships that give stability of capital base with future liquidity options
- Enterprises gaining from no-strings government equity as part of capital markets incentive program
- Enterprises gain competitive advantage through refinancing/ new capital; Turnaround situation after capital injection
- Broadened capital availability avoids asset-liability mismatches

Local Capital Markets

Confluence of Public and Private Sector Interests

Public policy goal of deepening local markets aided by external financial interests:

- Virtuous cycle of deepening local capital markets and broadening investor base
- Growing institutional investor participation shifting towards strategic investors
- Increasing role of strategic investors contributes to improved geographic diversification, stability of investor base and governance
- Broader investor base enabling EM debt managers to use increasingly sophisticated portfolio management techniques to better manage risks
- Investors gain new opportunities for hedging financial and exchange rate risks
- Both investors and EMs gain from more stable financial markets