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MARKET COMMENTARY

Is Greece an Emerging Markets country?

By Jan Dehn

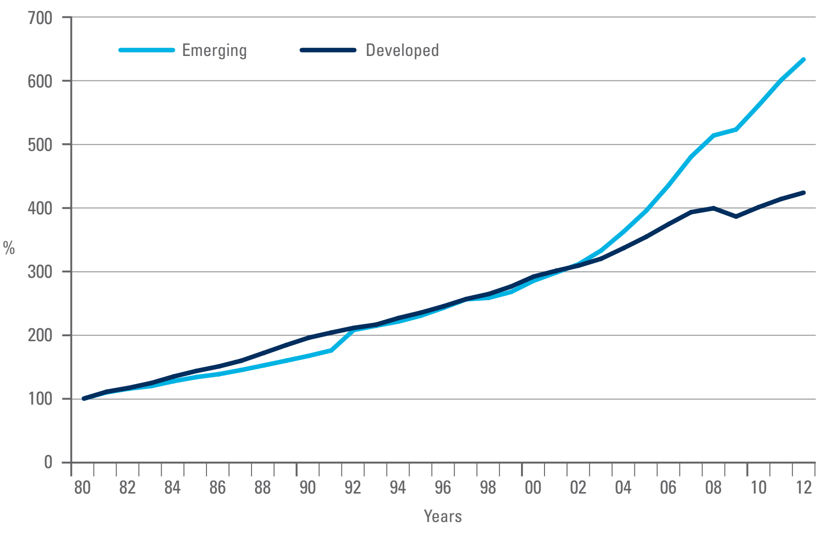
A large US fund manager recently reclassified Greece as an Emerging Markets country (*"Greece Reclassified as an 'Emerging Market'",* CNBC, Holly Ellyat, March 4, 2013).

Greece is not an Emerging Markets country, because it is too rich and its financial system is too developed. Greece is simply a bad credit. The example of Greece illustrates a basic fundamental principle of investing that all countries are risky and all countries can become bad credits. Regardless of whether they are 'developed' or 'emerging'.

The view that countries should be regarded as 'emerging' if they become bad credits is both widespread and completely misguided, quite aside from being deeply offensive. It reveals a profound lack of understanding of what it means to be 'emerging' and it completely fails to distinguish between the processes whereby countries turn into bad credits – which can happen to all countries – and the processes of rapid economic and financial catch-up, which is a characteristic specific to Emerging Markets.

Specifically, countries in Emerging Markets have (a) relatively lower income per capita and (b) relatively less developed capital markets. These conditions tend to dispose Emerging Market countries to grow faster than rich countries. Higher growth rates in turn mean that Emerging Markets countries tend to 'catch up' with richer countries over time. This is an entirely natural economic process with strong theoretical foundations in growth theory. Economists call the process 'convergence'.

GDP per capita (rebased 1980=100)



Source: IMF WEO

Of course, convergence is not a given. During the Cold War period many Emerging Markets countries fell behind rich countries rather than catching up. Many had terrible governments, which could – and did – act with impunity as long as they remained loyal to a Superpower of choice. As a result, policy conditions were truly horrific in some countries and their growth potential remained untapped. The prejudice that leads some to confuse being 'emerging' with being bad credits undoubtedly stems from this period.

It is about time that the old prejudices about Emerging Markets give way to objectivity. The Cold War ended nearly a quarter of a century ago. The economic and political improvements which took hold across Emerging Markets in the decades after the Cold War ended have had profound effects. Emerging Markets are today the powerhouses of the global economy, with far stronger fiscal balances, far lower levels of debt, far higher growth rates, and far larger stocks of foreign exchange reserves.

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