# The Search For New Emerging Markets

## Africa: the next economic tiger?

If you are looking for some good cheer in a pretty gloomy world, consider the growing consensus among some of the world's smartest money that the next big emerging market may be Africa.

Above all, that is great news for Africans: As we have seen across so much of Asia, economic growth has accomplished what decades of well-meaning development efforts failed to do, lifting hundreds of millions out of poverty. If that happens in Africa, the world will be transformed.


This case for Africa as the world's new economic tiger is made forcefully in "The Fastest Billion: The Story Behind Africa's Economic Revolution," a data-packed collection of essays published under the aegis of Renaissance Capital, an investment firm with Russian roots and global ambitions.

The consensus view among many students of the global economy is that investment decisions are about choosing, in the words of Mohamed A. El-Erian, chief executive of the fund manager Pimco, "the cleanest dirty shirt": The United States faces a fiscal cliff and political gridlock, Europe is tenuously poised between years of painfully slow growth and outright collapse, and even go-go China is slowing.

## Lions on the move: The progress and potential of African economies

By contrast, Africa is on a tear. It is the only region in the world where growth is accelerating. If you strip out South Africa, the rest of the region is actually growing very, very quickly.

Renaissance Jennings  says he believes Africa is following the path to economic development that has been trod in recent decades by countries like Brazil, China and India – only in Africa the transformation is happening even faster.

The chances are this will be like Asia and this will go on for the next 30 years.It is helpful to remember where Asia was in the early 1970s. Then, most of the wars were in Asia, the lowest GDP and life expectancy were in Asia. People thought that was Asia's lot.

We hold those same prejudices, only more deeply, when it comes to Africa. But, quietly, Africa has been remaking itself. You have this very broad-based, Asia-like process of modernization."

Take for instance that Kenya had halved infant mortality in five years, an improvement it took India 25 years to achieve, predicts that within a generation, Africa's place in the world will be utterly changed. By 2050, Nigeria will be the most populous country in the world and the African economy will be bigger than that of the United States and Europe combined.

Two years ago, McKinsey, the management consulting firm, put a savanna spin on the emerging market cliche in a report titled, "Lions on the move: The progress and potential of African economies."

Foreshadowing "The Fastest Billion," this report painted a picture of an Africa whose economic pulse "has quickened," with gross domestic product rising 4.9 percent per year from 2000 to 2008. "While Africa's increased economic momentum is widely recognized, less known are its sources and likely staying power," the McKinsey study argued. "Our analysis suggests that Africa's long-term economic prospects are quite strong. Global businesses cannot afford to ignore the potential."

An obvious source of Africa's new might is the surge in commodity prices, and both reports acknowledge the impact of natural resources. But they also have a shared conviction that domestic factors are at play. The predictable one is improved governance.

Less predictable is the joint celebration of Africa's excellent demographics. Not so long ago, Africa's tragedy was its children – now that is why the global elite think Africa may be a strong bet. This is just the beginning of a revolution in our thinking about babies and the economy: The Industrial Revolution transformed children from a family's labor force to its luxury good. That is still the case; but for the national economy, babies are becoming the most precious resource of all.

But it is worth challenging one optimistic assumption, particularly because of its wider implications.

That is the view that in Africa, economic growth and democracy will go together. Their synonymity is a comfortable belief. But in Africa, as in other emerging markets like China, Russia and even Turkey, it may not be true.

## Question Mark ?

We might argue that in countries that are cracking down on freedom of the press, like Ethiopia, economic growth deflects attention from growing authoritarianism rather than undermining it.

This is the Putin model, or the Beijing model – forget about ephemeral concepts like free speech and pluralism in exchange for a swiftly increasing GDP. It is not just impoverished domestic electorates that are tempted by this siren song. Western investors and many Western governments find it equally convincing. But for the emerging market lions – as well as for the tigers and the Siberian bears – it is important to ask the question on how long authoritarian growth can be sustained.

## Ghana and Uganda offer promise for brave investor

*Political stability, an economy growing at more than 14% the rise of mobile technology, oil discoveries and a growing middle class are piquing the interest of investors. But risks remain.*

Ghana, however, is located in the western part of Africa, a vast continent often portrayed as troubled and unstable, and therefore the nation has received less attention from investors than its assets might justify.

Ghana and Uganda — a landlocked country in East Africa — exemplify the seismic changes under way across large parts of sub-Saharan Africa. Extended periods of peace, stable political structures, ubiquitous mobile-phone networks and the rise of mobile technology have transformed their societies. The discovery of oil in both countries holds the promise of huge profits. These changes have helped spark the birth of a middle class eager to spend its hard-earned money on the trappings of modern society.

These economic “New Tigers” of Africa are poised to grab a bigger share of the continent’s growth and — for some investors — offer an alternative to the traditional powerhouses Nigeria, South Africa and Kenya.

There are risks. Uganda’s president, the aging Yoweri Museveni, has held power for 26 years and shows no signs of loosening his tight grip. A destructive war in Congo rumbles threateningly on the country’s southwestern border. Ghana has just completed an election but the declared loser has refused to concede defeat. Bureaucratic hurdles to investing are high, currency volatility and low liquidity in local stock markets pose significant barriers.

## Underappreciated

Still, some investors are taking advantage of what they see as underappreciated opportunities in these markets.

The biggest theme for all of Africa, including Ghana, is the rise of the middle class. Ghana’s stock market is small and relatively illiquid, but opportunities can be seen in the banking and consumer-products sectors.

such as  Unilever Ghana and there are several banks  among them Ghana Commercial is a large local bank, somewhat sleepy but awakening. There are also some foreign global banks that have local subsidiaries such as Standard Chartered.

Ghana sees a rapidly growing economy partly fueled by oil discoveries that were made in 2007 and production started in late 2010. The public spending that results from higher oil revenues is creating quite a lot of activity in construction, retail, consumer goods and so on.

Look for ways to get exposure to the consumer story, noting that Ghana Commercial Bank and Fan Milk, a producer of milk, yogurt and ice cream, are two attractive equities to achieve that.

Buoyed by the beginning of oil production, Ghana’s gross domestic product expanded by an estimated 14.4% in 2011, according to the International Monetary Fund. It’s projected

to exceed 8% this year.

## Golden opportunities

Mark Mobius, the veteran emerging-markets investor, lauded Ghana’s “golden opportunities” in a post on his blog. http://mobius.blog.franklintempleton.com/2012/05/

“Ghana has abundant natural resources, including timber, oil, silver and manganese, but perhaps most important are cocoa and gold, two prized commodities for which Ghana is a key producer” .

Several companies listed in the West offer exposure to Ghana’s resources sector. One of them is Tullow Oil PLC, a London-based energy company that operates the Jubilee oil field — with estimated recoverable resources of up to 1 billion barrels — located off the coast of Ghana. Tullow is also active in Uganda.

In the gold-mining sector, companies with operations in Ghana include AngloGold Ashanti , Gold Fields Ltd.  and Newmont Mining Corp .

## Investing in Ghana certainly comes with risks.

One of them is the very low liquidity in the local stock markets, especially compared with the developed world. Average daily turnover in 2011 was only $330,000 in Ghana, while in Nigeria the daily turnover is between $15 and $20 million a day, according to data from Insparo Asset Management's Stock. In Uganda, average equity turnover is $50,000 a day.

Aside from liquidity, policy and political unpredictability also poses risks.

For foreign investors, this uncertainty is unwelcome and a formal legal challenge of the results by the NPP is likely to keep political tensions elevated. If that happens, "economic activity will slump, more forex will be withdrawn from banks, major investment decisions by companies for 2013 companies will be delayed, and the Ghanaian cedi may come under speculative attack.

## and Uganda's challenges present even more risks.

Uganda's appeal for investors is declining, because the policy environment has become very murky. President Museveni has been in power for 26 years and has shown no inclination to even begin to groom a successor, let alone cede any power.

Relations between the president and foreign investors in the oil sector have worsened. Museveni is withholding approval of Tullow, Total and Cnooc's development plan due largely to a dispute over whether to export crude or refined products, with the president insisting on developing a petroleum-products industry, while the companies prefer to build a small refinery to satisfy local consumption. Total  is the French oil major, and Cnooc  is an oil company controlled by the Chinese state.

Disputes between the president and parliament have also led to delays in critical oil-sector legislation. All these issues mean that oil production will likely be postponed until late 2017 at the earliest.

Another issue is that corruption has become increasingly evident and prompted some countries including the United Kingdom to suspend aid. Following allegations of misuse of public funds in Uganda, the World Bank's Kampala office said in mid-November that it was reviewing its development assistance to the country. -see story [http://www.guardian.co.uk/world/africa-blog/2012/oct/01/uganda-oil](http://www.guardian.co.uk/world/africa-blog/2012/oct/01/uganda-oil) -

These developments come as economic growth has slowed. Facing a difficult outlook in late 2011, Uganda contained rampant inflation by tightening monetary policy, but that in turn lowered its growth rate to around 3% in the current fiscal year from nearly 7% previously. While oil was recently discovered, agriculture — especially the production of coffee and tea — is the most important economic sector.

At a given point the yields can be very high. At one point, one-year T-bills were yielding around 18%. But you only capture that return if the exchange rate is stable. Yields have now come down and we don't see them as particularly attractive right now.

## Three Uganda sectors set to benefit from oil boom

With an estimated 3.5 billion barrels of oil lying beneath the lush forests of Uganda's Albertine Rift, the anticipation of wealth hangs heavy in the air of the country's capital.

But speculation is rife about who exactly will benefit from this East African country's black gold, particularly since the oil is slow in coming; the Ugandan Ministry of Energy said in May it could be another three to five years before commercial production gets under way.

Much will depend on how the Ugandan government spends future oil revenues, and so far its intentions have been far from transparent. But, judging from the experiences of other oil rich African nations, there are several sectors in Uganda that are poised to grow.

### Construction

The most obvious comparison is Ghana. Ghana has a new resource boom and it is changing the landscape of the largely rural nation. According to a report by the BBC, expensive new homes and apartments are already transforming the coastal Ghanaian town of Takoradi, rich in offshore oil. Many have been built in anticipation of economic growth, which is projected to more than double.

One sure thing is that where there is oil, there is a great need for hotels.Uganda is already fitted out with a modest number of these, mostly aimed at tourists, but the legions of oil executives and engineers expected to descend on the country will certainly demand more.

Nor will the construction boom stop there. New and better roads will also be needed between the capital and the oil-rich western region. But the main driver of growth will be in overall increase in demand.

There shall be an increase in the incomes of people, which will increase aggregate demand for non-tradable goods in the economy. This will include things like new homes, as well as other investment projects including shopping malls.

Leading construction companies in Uganda include closely held National Housing and Construction Company, and Roko Construction, which also operates elsewhere in the region.

## Services

One stark example of how a sudden oil boom can affect a poor country's service sector can be seen, in Angola. Damaged by decades of poverty and conflict, Angola has been focusing on oil since the end of its civil war in 2002, though commercial production in the area dates back to the 1950s. Today the Angolan capital, Luanda, is consistently ranked among the most expensive cities in the world. With the resource boom, demand for offices, accommodation and international restaurants shot up, and all were in short supply. The result was stratospheric inflation and prices that, in the eyes of new arrivals, can seem obscenely high.

Uganda is coming into its oil after a decade of strong economic growth, so the rise in demand, and in prices, isn't likely to be as precipitous. But the service sector will boom. There shall be a need for hotel services and restaurants in the oil areas, but all over the country such things will come up because of revenues from the oil.

In Uganda, the service sector already leads the economy, and it is growing. There is even a danger that with the advent of oil, services and construction could undermine other mainstays of the Ugandan economy, such as agriculture and fisheries, as capital and labor are concentrated elsewhere. The agricultural industry is already experiencing labor shortages as young people choose the "quick returns" of work in the service sector. With oil revenues and rising demand for services, this problem could well be compounded.

Growth in construction and services – nontraded goods – could eventually damage the country's manufacturing sector as well, according to a paper published last year by the Bank of Uganda. Because traded goods can be imported, paid for by the oil-induced flood of foreign exchange, the structure of production in the Ugandan economy will shift toward nontraded goods with potentially damaging long term consequences, including unemployment and poverty.

At the moment, the luxury hotel industry in Uganda is dominated by international chains like Starwood Hotels & Resorts Worldwide's, Sheraton and TPS Eastern Africa's Serena Hotels, which trades on the Nairobi Stock Exchange under the symbol TPSE. More are expected to pour in to accommodate wealthy executives once the oil begins to flow. Other players in the sector include telecom companies, such as France Télécom's Orange, South Africa's MTN and Uganda Telecom, which is jointly owned by the Libyan government's investment fund and the Ugandan government.

## Hydropower

One question looming over Uganda's nascent oil industry is what effect it will have on the critical power situation in the country itself. There are no easy answers to this; how the sector fares will depend on how the government chooses to invest its revenues.

But if past promises are anything to go by, one sector that should receive a badly needed cash injection is hydropower. According to the World Bank, a hefty chunk of the royalties so far paid by foreign oil companies to the Ugandan government — totaling around $400 million — have been earmarked for future investment in energy generation, most of which, in Uganda, comes from dams. Chief among these is the long-anticipated Karuma Dam, whose projected 600 megawatt capacity should be a boon both to the energy sector and to an economy groaning under the strain of power cuts.

Hydropower companies in Uganda include South Africa's Eskom, which currently operates the Nalubaale Hydroelectric Station near Jinja, and Bujagali Energy Company, which runs the newly opened Bujagali Dam. The Karuma Dam is still in the early stages of construction, and it remains to be seen which company will be charged with its operation.

It is anticipated that Uganda should benefit from oil, but only if it is managed properly. With the country's oil projected to last only 30 years, a frenzy of spending and an overreliance on oil revenues could leave Uganda with nothing. But investment in industries like hydropower could provide a sustainable boost to power supplies not only in Uganda, but in the region as a whole.