JOHCM Funds

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Emerging Markets Spotlight

James Syme
Senior Fund Manager

Paul Wimborne
Senior Fund Manager

We have written at length about what the move in global commodity prices means for emerging market commodity exporters (both companies and countries), and the opportunity we feel that presents for investors. This piece is both an update on that, as well as a highlight of the hidden export strengths of two of our favourite markets, India and Mexico.

Commodity price strength continues, with the hydrocarbon energy complex at the heart of it. As well as the upward pressure in natural gas prices as a demand recovery overwhelms supply in Europe and Asia, the oil price continues to press on towards USD 90/barrel. In addition, high refining margins mean the price change for end-users of refined products is even sharper.

January saw a new component to this trend that, we feel, is not receiving remotely enough attention. Like crude oil, natural gas is used not just as an energy source but also as a feedstock for the production of various chemicals, most notably as the first step in the ammonia-urea-ammonium nitrate fertiliser production chain. The prices of ammonia and urea have exploded in recent weeks, and shutdowns of production capacity (for example, in China and Ukraine), and export restrictions (for example, Russia) suggest that the price spike is likely to last for some time. The implications of this for farmers, and then for agriculture output and food prices globally are significant. Inflation may not be transitory.

Still, for commodity exporters, times are good. Russia's oil and gas exports in the first ten months of 2021 were USD 122bn, up 52.5% on a year earlier, and have pushed the trade balance back towards historic highs. Brazil and South Africa have also seen commodity exports soar on higher prices and volumes.

By comparison, India is an economy that is famously short of many basic commodities, with vulnerabilities to both the current account balance and to inflation. However, India has another strength that is providing a great boost to the economy at present: IT and software service exports.

India is a global powerhouse, with some of the largest software and IT services companies in the world, including Tata Consultancy, HCL Technology and Infosys. Industry-specific data is difficult to obtain, but the central bank conducts a highly detailed annual survey, the results of which show that total computer service exports (computer services, like IT services and software product development, and IT enabled services, such as BPO services and engineering services) have grown from USD 62.6bn in fiscal year 2013 to USD 133.7bn in fiscal year 2021. Because the large, listed IT companies make up such a large part of the market, it is possible to predict how that export value will grow in future: based on consensus revenue estimates for the twenty largest Indian IT companies, India can be expected to have IT export revenues of USD 160bn in the current fiscal year and USD 204bn in fiscal year 2024.

With oil prices at their current levels, India's oil import bill for the current fiscal year is likely to exceed USD 200bn, suggesting a net deficit of the two combined, but still far smaller than the USD 103bn by which oil imports exceeded IT exports in fiscal year 2013. India is not immune from oil price shocks, but the steady growth of its key export service industry gives it far lower risks. In addition, IT services have held up much better through Covid than the tourism revenues which many other emerging markets depend on to support their current account balances.

India also has significant remittance income, the flows of capital back into India from non-resident Indians. Remittance income has exceeded USD 80bn/year in recent years; in addition, the component of remittances from the Arab Gulf has some leverage to oil prices creating some degree of natural hedge. This further reduces India's oil vulnerability.

Similarly, remittances income is a major support for the Mexican economy. Here, the dominant geographical source is the US, but even in the difficult calendar year of 2021, remittances into Mexico were USD 51.6bn, up 30.4% on a year earlier. This reflects a continuation of recent years' strong growth – remittances have more than doubled since 2015 when USD 24.8bn was transferred. As well as supporting the trade balance (Mexico ran a merchandise trade deficit of USD 11.5bn in 2021), the remittances typically go straight to household budgets, supporting domestic demand more directly than merchandise trade exports do.

With wage growth remaining strong in the US, and with a tight labour market in sectors such as restaurants and hospitality, construction and logistics, 2022 is likely to be another strong year for remittances into Mexico.

Despite concerns about inflation and central banks tightening monetary policy, a stronger global economy and higher export prices and volumes (including hidden surpluses such as remittances and service exports) are highly supportive for some emerging markets. We feel that investors may be overlooking these strengths and continue to seek opportunities where we see the best top-down conditions.

Source for all data JOHCM/Bloomberg (unless otherwise stated)

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