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"Business Opportunities in Emerging Markets: Which Country and Industry for Exporters?"

- In a post-Brexit world, businesses may decide to carefully reconsider their global investment and marketing plans. Even though growth prospects in emerging markets (EM) deteriorated perceptibly in 2014-15, the EM convergence story remains in place and these countries will offer important business opportunities for exporting companies in developed economies over the medium term.
- In this paper, we use our proprietary model to estimate the size of export markets five years out for a selected group of twelve EM countries. We focus on six sectors: cars, machinery, food, apparel, furniture and services. We provide a baseline scenario and two shock scenarios, one positive and one negative.
- China is going to be the biggest market for all industries and the one with the largest increase in absolute terms. Even under the negative-shock scenario, most sectors are likely to record good growth over the next five years.
- Russia and Mexico will have the second biggest markets, but are likely to record only moderate increases. Other emerging East-Asian countries like India, Indonesia, the Philippines, Thailand, and Vietnam will offer, in various industries, a very attractive market size. In Africa, the market size of imports in Ethiopia will record a remarkable catch-up in respect to South Africa.

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Executive Summary

Brexit may convince businesses to re-examine their global investment and marketing plans as the growth outlook of Western economies becomes more uncertain. One option on the table is to increase exposure to emerging markets (EM). However, the perceptible deterioration in EM growth prospects in 2014 and, in particular, in 2015, makes this choice far from obvious, because the business community is left facing high uncertainty about whether this slowdown represents a temporary shock or a "new normal".

We believe that recent pessimism is excessive and too generalized. EM is a heterogeneous group of countries, which includes a number of vibrant and dynamic members where the growth outlook remains positive. After all, even after last year's developments, economic expansion in emerging countries as a whole continues at twice the pace of advanced economies. Looking ahead, most forecasts indicate that growth is more likely to accelerate in EM than in developed countries; Brexit will probably contribute to this trend. Therefore, the EM convergence story remains in place, although with less impetus than we were used to.

The continuation of the convergence process in most of the EM world is likely to push a rising number of developing countries towards income thresholds that increase the propensity of households and firms to demand imported goods. This will open important business opportunities for exporting companies in developed economies.

In this paper, we provide an estimate of the size of these export markets for a selected group of twelve EM countries focusing on six sectors: cars, machinery, food, apparel, furniture and services. The time horizon of our estimates is five years.

We use our proprietary model to estimate the elasticity of imports of a specific category of goods with respect to GDP and population between 20-64 years old. We then apply the parameters of the model to the IMF forecasts of GDP and UN projections of population to forecast the value of imports. For each sector and country, we produce USD-denominated estimates to 2021, including also two risk scenarios that allow for a positive and negative growth shock vs. the baseline.

We find that China is going to be the biggest market for all industries and the one with the largest increase in absolute terms. Despite several medium-term challenges faced by this country, opportunities for exporters will continue to be very interesting. Even in the negative-shock scenario, most sectors are likely to record good growth over the next five years.

Russia and Mexico will have the second biggest markets, but are likely to record only moderate increases. However, our scenario for Russia may turn out to be too conservative as we do not take into consideration the lifting of sanctions that can happen at some point in the next five years, while Mexico represents an underexplored opportunity for European companies as their exports to this country are less than half those of the US. Turkey represents an important opportunity for European exporters given proximity and lower trade costs.

India is one of the fastest growing emerging economies, but the starting point of its income per-capita is low and its trade regulations are particularly restrictive. Hence, the size of its imports in 2021, even if growing, will not yet be comparable to those of China, Mexico and Russia. Other emerging East-Asian countries like Indonesia, the Philippines, Thailand, and Vietnam will offer, in various industries, a market size that is similar to India's, if not bigger. In Africa, the market size of imports in Ethiopia will record a remarkable catch-up in respect to South Africa.

European policy makers should notice that, in Asian and African markets, exporters from the EU have a stronger market penetration than the US, which is positive news given the strong growth that these markets will experience in the medium term. However, there is a large heterogeneity across European countries. Germany is the best placed across most industries and countries; whereas Italy needs to strengthen its penetration of Asian markets in industries such as "Food & Beverages", "Cars" and "Machinery".

Growth prospects in emerging markets: putting the slowdown into context

The last two years have seen the growth rates of developed and emerging markets move in opposite directions, as the former countries regained some traction following the damage of the European sovereign debt crisis, while the latter continued to decelerate. From a historical perspective, this pattern is unusual: we have to go back to the early 1990s to find two consecutive years of business cycle de-synchronization between advanced and developing economies. If we also consider that 2015 saw the slowest pace of EM expansion since the early 2000s (with the exception of 2009, the annus horribilis of the global economy), it may not be surprising that the investor and business community has grown increasingly cautious about the growth outlook for EM countries.

We believe that recent pessimism regarding the EM universe is excessive and too generalized. While in some BRICS economies such as Brazil, Russia and South Africa, short and medium-term growth prospects have deteriorated to a measurable extent, there are still a number of vibrant and dynamic EM countries where the GDP outlook remains positive. For example, this is the case of India and other frontier markets like the Philippines and Vietnam.

Overall, we see three main reasons to be constructive on the broad EM aggregate, especially in relative terms vis-à-vis the developed world.

First of all, as Fadi Hassan discusses in the UniCredit Global Themes Series of January 2016[1], we expect the three major shocks that hit EM countries in the last two years – commodity prices, capital outflows and China's slowdown – to have stabilized for the most part. Commodity prices, especially for oil, have already started to recover from their lows and while any further price increase will probably remain contained and far below past boom levels, the terms of trade of commodity-exporting EM countries should stop deteriorating from here. With the exception of China, net capital flows are expected to return to positive territory: the IIF forecasts a net inflow of USD 53bn to emerging markets in 2016 (excluding China). This is still far from the 2013 net inflows of USD 177bn, but represents an improvement in respect to both 2014 and 2015. Prospects for China's economic activity are the least encouraging. While the growth rate can hover around the new 6.5% target for the next couple of years, it would do so in a context of excessive leverage and overcapacity in a number of sectors. This raises uncertainty about China's financial stability and growth outlook on a three-to-five years' horizon.

Secondly, although the weakening of productivity is a global issue that also affects developing countries, especially China, we believe that this poses less of a challenge to emerging economies than to developed economies. The main reason is that emerging countries have large scope for catching-up, while developed countries need to move the frontier forward. For instance, China's total factor productivity is still only 13% that of the US (Zhu, 2012).

Thirdly, overinvestment does not appear to be a generalized problem across EMs. With an investment rate still well above 40%, China remains an outlier in this regard, while other emerging economies on average have an investment ratio of about 25% (2015).

[1] See "Global Challenges and Prospects for Emerging Markets: Commodity, China, and Capitals", UniCredit Global Themes Series No.30.

Last but certainly not least, a fair comparison between EMs and mature economies should not miss the absolute (as opposed to relative) growth rates, which in developing counties remain of a totally different magnitude. For example, in 2015 the pace of GDP expansion in EM countries was still twice as fast as that in advanced economies (Chart 1). Therefore, although the pace of catch-up has slowed, especially in the wake of difficulties faced by commodity-exporting countries, the EM convergence story remains in place. For example, China's GDP per capita in PPPs is just 21% of that of the US, which is equivalent to Korea in 1977 or Japan in 1951 (Lin, 2016). Chart 2 shows emerging markets' GDP per capita as a percentage of advanced economies' one. For the whole EM universe, the margin for catch-up is still sizable and on a positive trend. Moreover, from a short-term cyclical perspective, it is encouraging to see that the latest data show improving GDP growth in EM. The EM Growth Tracker published by the IIF in May 2016 experienced the largest monthly advance in four years.[2]

GROWTH IN EMERGING MARKETS HAS SLOWED, BUT THE CATCH-UP CONTINUES

Chart 1: Real GDP growth rate emerging vs. advanced economies

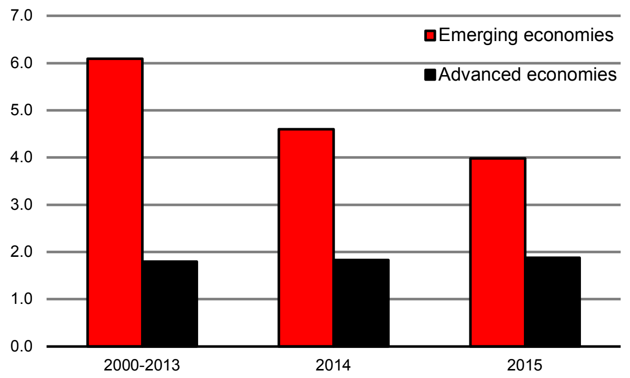
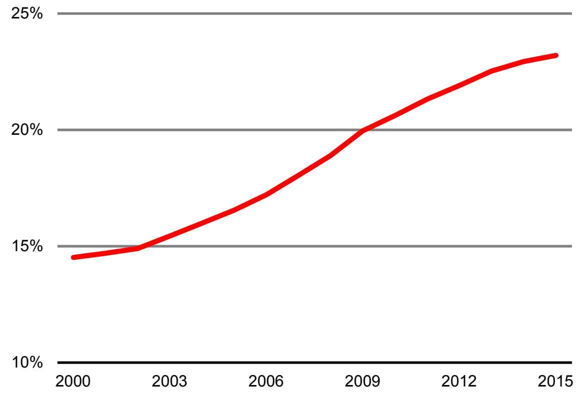


Chart 2: Emerging markets, per-capita GDP (% of advanced economies, PPP)



Source: IMF, UniCredit Research

Facts and figures about EM convergence

EM countries come from two decades of growth outperformance vis-à-vis developed economies that have significantly increased their role and stature in the global economy. Especially in the last ten to fifteen years, this convergence process has pushed the share of EM global economic output sharply higher.

In USD terms, the weight of EMs on total world GDP increased twofold from 20% in the early 2000s to about 40% in 2013 and has broadly stabilized thereafter. When adjusting for the difference in purchasing power, EMs now account for almost 60% of world GDP, from 40-45% fifteen years ago, and the trend still points upwards (Chart 3). Concurrently, EM output as a share of developed countries' GDP has climbed from about 25% to 65%. Since 2000, EM countries have contributed on average to 75% of global growth.

These relative GDP dynamics have also been reflected in world trade patterns. The share of EM imports on total world imports (measured in USD terms) has approached 40%, which is almost double the level of fifteen years ago. In the last two years, this convergence has flattened out primarily in the wake of large depreciation of EM currencies and reduced pace of EM growth outperformance (Chart 4).

[2] The IIF EM Growth Tracker estimates GDP growth on a 3m/3m saar basis. It accelerated to 4.3% in May 2016.

EMERGING MARKETS CONVERGENCE: HIGHER SHARE OF WORLD GDP AND OF INTERNATIONAL DEMAND

Chart 3: Emerging markets, share of world GDP (USD and PPP)

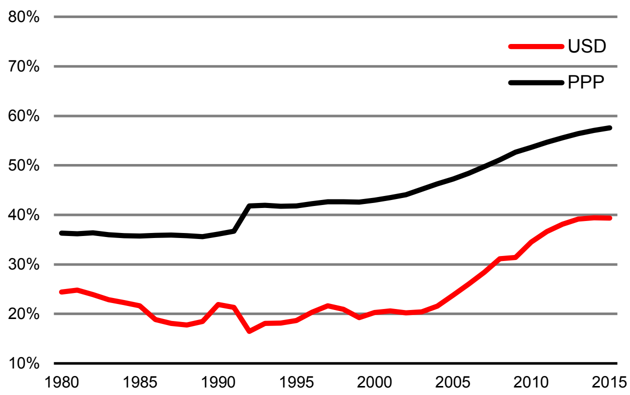
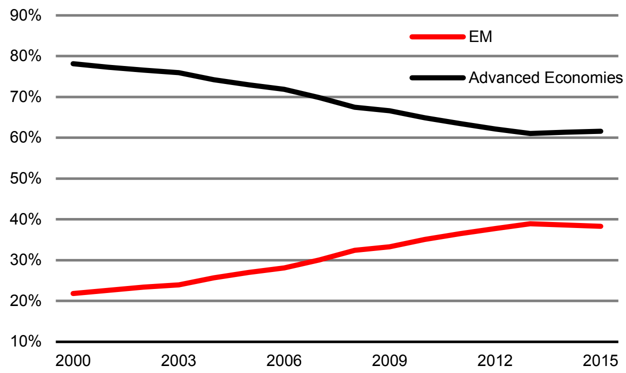


Chart 4: Share of world imports, emerging vs. advanced economies



Source: IMF, UniCredit Research

Nevertheless, the slowdown of the EM outperformance masks a heterogeneous picture. Chart 5 and 6 shows respectively real GDP growth and per-capita GDP for a selected group of EM countries: Brazil, China, Ethiopia, India, Indonesia, Mexico, the Philippines, Russia, South Africa, Thailand, Turkey, and Vietnam. Traditional emerging economies like Brazil, Russia and South Africa suffered a strong recession, but there are rising emerging economies like the Philippines, Vietnam and Ethiopia that are experiencing solid growth rates. Nevertheless, all these main frontier markets, even if very dynamic, fall within the lower income bracket and on average enjoy limited spending capacity (Chart 6). BRICS countries tend to predominantly position themselves in the upper income bucket (USD 8-10k), although they have representation also in the middle (South Africa) and lower (India) buckets.

EMERGING MARKETS: A HETEROGENOUS

Chart 5: Real GDP growth, 2015

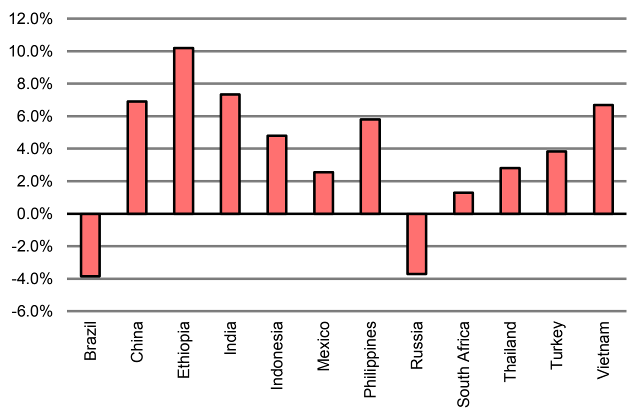
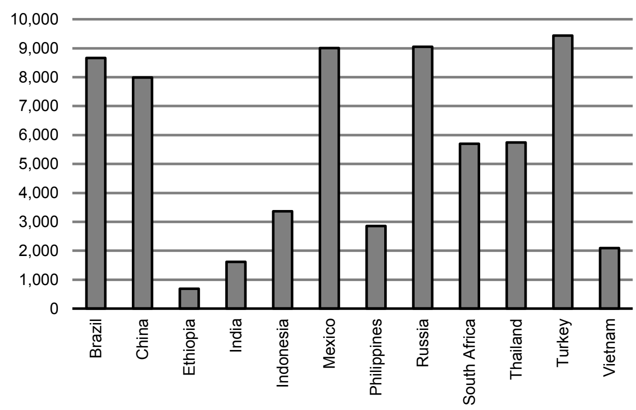


Chart 6: GDP per capita, 2015 (USD)



Source: IMF, UniCredit Research

What next?

When assessing future growth prospects for EM countries, it is key to disentangle the cyclical from structural drivers of the recent slowdown in economic activity. According to our calculations, potential output growth in EM as a whole remains robust, about 5% when factoring in the "new normal" for commodities, China and capital flows – what we label as "CCC-neutral potential output".[3]

The IMF seems to share most of our constructive assessment. In its April World Economic Outlook, the Fund predicts a reacceleration both in the pace of EM growth and in the EM outperformance vis-à-vis developed countries over the next five years, as EM growth improves progressively towards 5% while GDP expansion in mature economies is seen stabilizing at about 2% (Chart 7).

The IMF projections generally imply that the fastest growth rates will be recorded in low-income EM economies where the catch-up potential is largest, such as India, the Philippines and Ethiopia. In these three countries, per capita GDP (in USD terms) is expected to grow by a cumulative 55-60% over the next five years. China stands out as the country for which the IMF projects robust per capita growth despite the current comparatively high income levels, while South Africa and Brazil clearly lag behind (Chart 8).

MEDIUM-TERM OUTLOOK

Chart 7: Real GDP growth

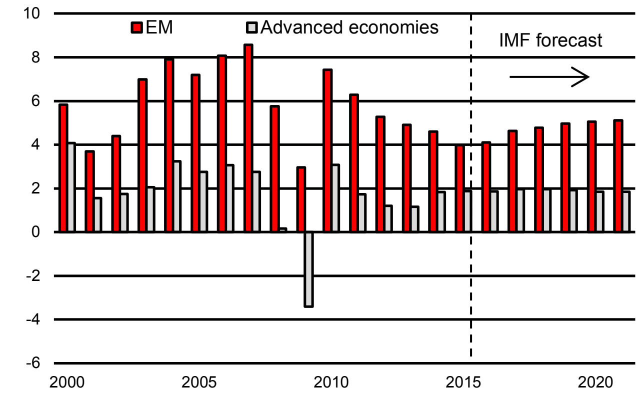
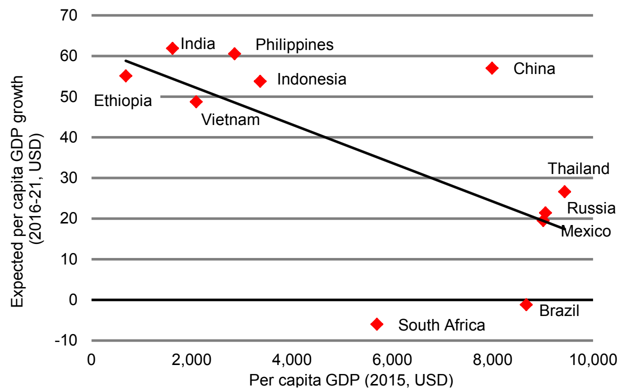


Chart 8: 2015 GDP per capita and expected growth through 2021



Source: IMF, UniCredit Research

All this has important practical implications. Although in a context of higher uncertainty, the continuation of the convergence process in most of the EM world is likely to push a rising number of emerging countries towards income thresholds that increase the propensity of households and firms to demand imported goods. This will open important business opportunities for exporting companies in developed economies. In the next section, we provide an estimate of the size of these new export markets from a sectorial perspective.

[3] For more detail, see "Global Challenges and Prospects for Emerging Markets: Commodity, China, and Capitals", UniCredit Global Themes Series No.30.

Forecasting export markets' size

We forecast the market size of exports to our selected group of EM countries focusing on six sectors: food, machinery, cars, apparel, furniture and services. The time horizon of our estimates is five years.

We follow a two-step process. First, we rely on our proprietary model to estimate the elasticity of imports of a specific category of goods with respect to GDP and population between 20-64 years old. Both imports and GDP are expressed in USD terms, while we choose the 20-64 age cohort because it includes the most active consumers. Secondly, given the parameters of the model, we employ the IMF forecasts of GDP[4] and UN projections of population to forecast the value of imports. For each sector and country, we produce USD-denominated estimates to 2021, which is the last year of the IMF forecast horizon.

We use trade data from the UN ComTrade database, which are currently available until 2015. The high granularity and timeliness of the database allow for a punctual, in-depth sectorial analysis, and it makes it possible to account for re-exports. However, ComTrade does not allow us to account for Global Value Chains and FDIs. Our estimates of the size of export markets should not be materially affected by the former, given that we focus on final products rather than on intermediate goods. Nevertheless, not accounting for FDIs underestimates the penetration that foreign products can have in local markets.

Our model allows us to account for the different stages of development of export destination countries. This is an important feature of our framework because the relation between imports and income per capita evolves during the development process. This can be better understood by looking at Charts 9 and 10. The first chart shows the example of furniture imports in Ethiopia. We can see that, even if income per capita started to grow rapidly since the mid-2000s, the imports of furniture started to increase only after income per-capita rose above USD 400. This contrasts with the case of Indonesia, which is at a higher level of development and where the relation between income and imports per-capita evolves more linearly.

IMPORTS AND STAGE OF DEVELOPMENT: INCOME THRESHOLDS MATTER

Chart 9: Ethiopian imports of furniture and GDP per-capita

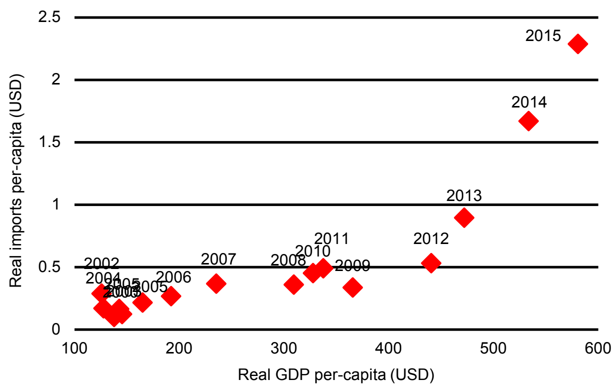
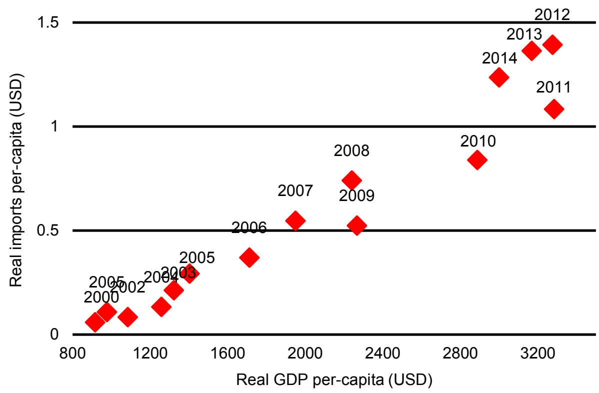


Chart 10: Indonesian imports of furniture and GDP per-capita



Source: ComTrade, World Bank, UniCredit Research

[4] As from the April World Economic Outlook, which is not updated to the post-Brexit scenario. We expect that Brexit is going to have some limited impact on EM in the short run and a marginal one over a five-years horizon.

Moreover, thanks to the use of country fixed-effects, our model is able to account for the fact that income and demographic elasticity differ across countries according to consumers' preferences for domestic vs. foreign goods (home bias), the traditional strength of local production, and the accessibility of local markets to foreign exporters due to cultural and linguistic barriers.

Our forecasts critically hinge on the IMF's GDP predictions through 2021, which is the reference year for our simulations. IMF estimates are expressed in USD terms, therefore they are exposed to two main sources of risk: **1.** The growth risk, which refers to the pace of economic activity denominated in local currency, and **2.** The FX risk, which stems from local currencies' fluctuations vis-à-vis the USD. 2015 showed that the FX risk in EM can materialize to a large extent.

Given the high uncertainty surrounding any medium-term estimates, as a robustness check we look at two alternative scenarios where the GDP levels for 2021, implied by the IMF forecasts, are subject to a +/-33% shock. This is a large shock that, on the downside, can account for a combination of currency devaluation and growth deterioration of about the same magnitude of that recorded in Brazil and in Russia in 2014-15.

In order to test the validity of our model and understand what can potentially bias our predictions, we run out-of-sample forecasts where we predict the 2015 market size of our six sectors in the selected group of twelve EM countries using data until 2010. Table 1 shows the average forecast error by country.

TABLE 1: ON AVERAGE, GOOD MATCH BETWEEN MODEL PREDICTIONS AND ACTUAL DATA

Difference between actual and predicted market size in 2015, across-sector average (absolute value)

	Actual vs. Predicted	Notes
Brazil	10%	
China	13%	
Ethiopia	8%	
India	20%*	*5.3% when excluding automotive (outlier)
Indonesia	6%	
Mexico	12%	
Philippines	7%	
Russia	17%*	*predictions affected by the embargo
South Africa	9%	
Thailand	7%	
Turkey	10%	
Vietnam	19%*	*5.6% when excluding automotive (outlier)

Source: BIS, Comtrade, Haver, UniCredit Research

Most of our predictions are within a 10% difference from the realized outcome, with Russia, Vietnam and India recording the largest prediction errors. Forecasts for Russia have been negatively affected by the embargo following the Ukraine crisis, while forecasts for India and Vietnam are strongly biased by overestimates in the car industry; excluding this sector, the forecast error falls to a much more benign 5%. Such an overestimate in the automotive industry is due to an increase in tariffs after 2009.

These results show that our model performs reasonably well, with the main source of error being commercial shocks like change in tariffs or embargos. Moreover, our model cannot account for structural changes in the relation between imports and overall GDP growth that may stem from future specific trade agreements, such as the Trans-Pacific Partnership (TPP). The TPP should come into force in 2018 and would affect Vietnam and Mexico among the countries in our sample. This means that our export market forecasts can be conservative in these two countries. Nevertheless, the simulations that we have run show that, unless major regulatory commercial shocks occur, our model is able to forecast with accuracy the market size of exports over a five-year horizon.

Export market by industry, a five-year outlook

We present forecasts of the value for exports by sector in 2021. Unless otherwise specified, the baseline year of our forecast is 2015. All results are expressed in real 2015 US dollars and we show both the absolute value of the market size and its share relative to GDP.

We also show the percentage increase of the market size between 2015 and 2021. The most interesting market opportunities are going to arise from markets that: **1.** Are big and **2.** Record a strong growth rate. This is simply to say that a market of USD 50bn is more promising than a market of USD 20bn; and that a market of USD 12bn that is expected to rise by 5% offers fewer opportunities than a market of USD 12bn that is seen growing by 50%.

Moreover, we discuss the results under the two alternative growth scenarios of +/- 33% relative to the IMF forecasts. The negative shock scenario delivers very low estimates for Brazil, Russia, and South Africa, as such a shock would imply a GDP level in 2021 that is lower than the current one. This seems a conservative scenario, given the large economic deterioration and currency depreciation that these countries have already experienced in the last couple of years.

Finally, we map the market penetration of European, UK, American, Japanese, and Chinese exporters in 2015. This allows us to identify the markets where countries need to focus their export policy in order to improve their performance relative to competitors. Nevertheless, we have to consider that we are not accounting for FDIs as a measure of export penetration.

Major findings

The major findings of our analysis are:

- China is going to be the biggest market for all industries and the one with the largest increase in absolute terms. Despite the several challenges faced by this country in the medium term, opportunities for exporters will continue to be very interesting. Even in the negative-shock scenario, most sectors are likely to record double-digit (cumulative) growth over the next five years.
- Russia and Mexico are the countries with the second biggest markets, but they will only record moderate increases in the next five years. Therefore, in general they will hardly provide growing opportunities for exporters both on the extensive and intensive margin.
- Our scenario for Russia may turn out to be too conservative, as we do not take into account the lifting of sanctions that can happen at some point in the next five years. Russia’s economic deterioration and ruble devaluation have been particularly severe in the last few years and imports may need some time to pick up even after the sanctions are lifted.
- Despite overall modest growth potential for its markets, Mexico can represent an underexplored opportunity for European companies as their exports to this country are less than half those of the US. US proximity, as well as economic and socio-demographic connections, can explain the gap. Nonetheless, given the size of this market, Mexico could offer good opportunities to European exporters.
- India is one of the fastest growing emerging economies, but the starting point of its income per-capita is low and its trade regulations are particularly restrictive (see Box 1). Hence, the size of its imports in 2021, even if growing, will not yet be comparable to those of China, Mexico and Russia.
- Other emerging East-Asian countries like Indonesia, the Philippines, Thailand, and Vietnam will offer, in various industries, a market size that is similar to India’s, if not bigger.

- In Africa, the market size of imports in Ethiopia will record a remarkable catch-up in respect to South Africa. This may provide excellent opportunities for exporters interested in East Africa, especially in the furniture and machinery industries.
- Turkey represents an important opportunity for European exporters given proximity and lower trade costs.
- The export of services will be growing very fast in most countries, but the size of this sector will not be comparable to the more traditional tradable industries.
- Exporters from EU 14 have a stronger penetration than American ones in Asia and Africa. This can offer a strategic advantage to Europe in the medium term as those markets are facing rapid expansion.
- Among EU countries, Germany is the better placed across most industries and countries. If we look at Asian markets, Italy has a surprisingly weak penetration in "Food and Beverages", "Machinery", and "Cars"; whereas it is relatively well placed in terms of "Apparel" and "Furniture". This suggests that Italy should be pro-active in the former sectors, taking the latter sectors as examples of success.

After Box 1, we provide a more detailed analysis by industry.

BOX 1: INDIA'S RESTRICTIVE TRADE REGIME

India has passed relatively unscathed through the last two years of EM turmoil. Given its high growth rate and huge population of 1.3bn people, the country deserves attention for the opportunities it can offer to exporters.

Despite recent reforms aimed at opening the country to economic integration with the global economy, India's trade regime and regulatory environment remain restrictive. Exporters to India still face sizeable tariff and non-tariff barriers. Among the latter, quantitative restrictions, mandatory testing and certification for a wide range of products, import licensing, and complicated and lengthy customs procedures play an important role.

EU merchandise exports to India in 2015 were EUR 38bn, 2% of total extra-EU exports. The Free Trade Agreement negotiations that were launched in 2007 between the EU and India were intended to increase bilateral trade flows as well as investment and access to public procurement. However, talks have stalled since 2013 as parties failed to reach a compromise on the key areas of negotiation. On the one hand, the EU is pushing for a drastic cut in duties on automobiles, wines and spirits: EU exporters currently face Indian import duties of up to 100% on cars and car parts, and up to 150% on wines and spirits. On the other hand, India's main demands regard data security status (crucial for India's IT sector to conduct more business with EU firms) and easier temporary movement of skilled professionals.

Cars

In our forecast for cars (Table 2), Chinese imports are projected to reach a stunning USD 100bn. After China, Indonesia and the Philippines offer the most interesting opportunities in East Asia with both countries expected to climb above USD 4bn and continue rising rapidly. The market in Russia is expected to recover from the low level of 2015 and increase by USD 3bn, getting close to USD 10bn, which is a conservative estimate as it is still below the 2010 level. The market size of Indian imports is particularly small when compared to the size of the economy. This is partly driven by the role of the "Make in India" program, which aims to favor FDIs for local production over imports.

TABLE 2: FORECASTS FOR THE CAR INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-21	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Upside shock, +33% GDP Forecast (Real USD mn, 2015)	Downside shock, -33% GDP Forecast (Real USD mn, 2015)
Brazil	5,361	5,020	7%	0.33%	0.28%	8,867	1,854
China	100,048	59,700	68%	0.63%	0.54%	134,866	65,230
Ethiopia	697	414	68%	0.74%	0.67%	954	441
India	1,253	228	450%	0.04%	0.01%	2,396	110
Indonesia*	4,294	1,480	190%	0.34%	0.17%	6,670	1,918
Mexico	12,404	9,460	31%	0.95%	0.83%	16,515	8,292
Philippines	4,062	2,320	75%	0.86%	0.79%	5,291	2,831
Russia	9,787	6,490	51%	0.68%	0.49%	15,963	3,610
South Africa	4,269	4,040	6%	1.47%	1.29%	5,621	2,918
Thailand	2,076	1,280	62%	0.46%	0.32%	3,347	804
Turkey	10,276	9,230	11%	1.16%	1.26%	14,690	5,861
Vietnam*	922	379	143%	0.34%	0.20%	1,488	357

*Baseline year 2014. Import classification SITC 781. Source: UniCredit Research

Table 3 shows the market penetration by country. EU exporters have the largest market share with the exception of India, the Philippines, Ethiopia, and South Africa, where Japan has the highest penetration, as well as Mexico where the US is the clear leading exporter. Among EU countries, Germany has the highest market share. Italy and France have an extremely low penetration in emerging markets. In some cases, like Brazil, this can be explained by the presence of foreign factories of French and Italian producers, but in most cases this simply reflects an insufficient export strategy for these markets. The UK has a relatively high penetration in key markets such as China, Russia and Turkey. Being home to many car producers drives this, but this advantage may change if after Brexit some carmakers will consider changing the location of production.

TABLE 3: CARS – EXPORT SHARE BY COUNTRY, 2015

Country \ Exporter	Italy	Germany	France	EU14	UK	US	Japan	China
Brazil	0.1%	8.1%	0.4%	12.6%	5.3%	3.9%	6.5%	0.6%
China	1.1%	27.2%	0.4%	33.1%	14.7%	26.0%	15.6%	–
Ethiopia	0.1%	1.5%	0.5%	2.7%	0.3%	1.0%	54.6%	2.2%
India	0.8%	8.7%	0.0%	9.8%	1.8%	1.3%	25.7%	0.0%
Indonesia*	5.9%	49.7%	0.0%	64.9%	12.8%	2.9%	3.3%	0.6%
Mexico	0.3%	7.8%	0.9%	14.9%	1.3%	33.5%	14.5%	0.1%
Philippines	0.4%	2.1%	0.2%	3.0%	0.6%	2.3%	12.6%	0.4%
Russia	0.2%	22.5%	0.1%	29.0%	9.8%	12.3%	31.5%	1.3%
South Africa	1.6%	21.2%	0.1%	23.2%	7.0%	3.0%	31.9%	1.1%
Thailand	1.2%	39.1%	3.2%	60.0%	7.6%	2.1%	1.6%	0.1%
Turkey	0.1%	17.5%	0.5%	19.1%	6.7%	9.2%	24.5%	0.5%
Vietnam*	1.3%	25.8%	1.3%	34.6%	7.9%	7.5%	11.5%	0.1%

*Baseline year 2014. Import classification SITC 781 Source: Comtrade, UniCredit Research

Machinery

The machinery industry offers a quite heterogeneous range of opportunities across countries. We take into account an extensive set of machineries: specialized machineries, power-generating machinery, and metalworking machinery, with specialized machinery representing the largest fraction of imports in all countries.

China is still going to be the biggest market (Table 4). Even if the country is transitioning from investment-led to consumption-led growth, we estimate that imports of machinery will rise by USD 27bn between 2015 and 2021. This would lift machinery imports to USD 93bn, which is 56% higher than the 2015 level but below the 2011 peak. Moreover, compared to the current level, the share of machinery imports to GDP would decline slightly (see Box 2 for further analysis).

India and Indonesia enjoy the most interesting outlook after China, with imports rising by more than 50% and reaching a value above USD 20bn. Also the Philippines and Ethiopia are on a steep upward trend and will offer very good opportunities in the longer term.

TABLE 4: FORECASTS FOR THE MACHINERY INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-21	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Upside shock, +33% GDP Forecast (Real USD mn, 2015)	Downside shock, -33% GDP Forecast (Real USD mn, 2015)
Brazil	13,002	12,700	2%	0.79%	0.72%	16,106	9,898
China	93,685	66,400	41%	0.59%	0.60%	117,552	69,818
Ethiopia	4,154	2,660	56%	4.39%	4.32%	5,333	2,976
India	22,763	14,300	59%	0.69%	0.68%	28,219	17,306
Indonesia*	21,164	13,800	53%	1.66%	1.55%	27,729	14,599
Mexico	33,262	30,200	10%	2.54%	2.33%	44,724	21,799
Philippines	6,218	3,540	76%	1.31%	1.21%	8,728	3,707
Russia	19,026	15,300	24%	1.32%	1.15%	25,555	12,497
South Africa	5,386	5,280	2%	1.85%	1.69%	6,759	4,014
Thailand	15,371	12,400	4%	3.39%	3.07%	20,116	10,626
Turkey	17,944	15,100	9%	2.02%	2.06%	22,815	13,074
Vietnam*	12,809	9,220	9%	4.76%	4.96%	15,887	9,730

*Baseline year 2014. Import classification SITC 71, 72, 73.

Source: UniCredit Research

Table 5 shows a strong prevalence of EU exporters in respect to the US across most key countries. However, Japan turns out to have an even higher penetration in China, India, the Philippines and Turkey. Among European exporters, the German machinery industry is clearly the best positioned one. Relatively speaking, Italy is better placed in Indonesia, Vietnam and Thailand, but needs to strengthen its position in key markets like China and India.

TABLE 5: MACHINERY – EXPORT SHARE BY COUNTRY

Country \ Exporter	Italy	Germany	France	EU14	UK	US	Japan	China
Brazil	7.5%	12.0%	2.8%	30.8%	1.6%	31.5%	6.6%	11.9%
China*	3.5%	18.0%	3.0%	30.4%	1.9%	14.6%	24.2%	–
Ethiopia	4.9%	4.1%	1.1%	17.1%	2.6%	16.0%	4.3%	33.1%
India	3.2%	7.7%	0.8%	16.1%	1.0%	5.7%	23.9%	24.4%
Indonesia*	6.4%	13.4%	1.9%	27.3%	3.1%	11.3%	11.2%	23.5%
Mexico	3.2%	9.2%	1.3%	19.5%	1.3%	48.9%	6.9%	7.1%
Philippines	1.1%	9.3%	0.5%	14.6%	2.1%	6.0%	22.2%	17.7%
Russia	8.4%	18.0%	2.4%	39.1%	3.5%	8.4%	5.0%	14.4%
South Africa	1.8%	6.4%	1.0%	13.8%	5.5%	7.3%	31.4%	23.6%
Thailand*	11.4%	20.6%	5.0%	47.5%	7.8%	5.4%	5.9%	12.3%
Turkey	2.1%	5.7%	0.4%	9.8%	1.0%	4.0%	22.7%	33.1%
Vietnam*	9.8%	14.0%	3.8%	38.3%	4.8%	13.8%	6.2%	16.0%

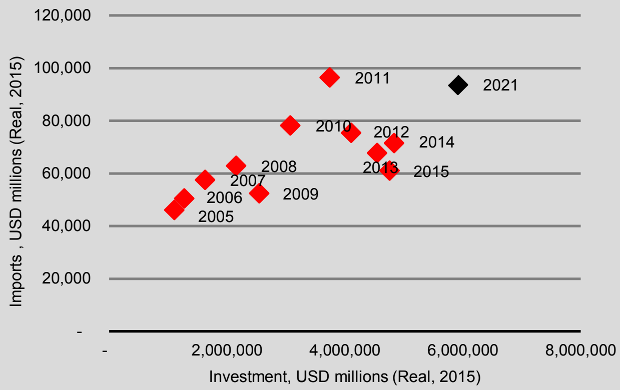
*Baseline year 2014. Import classification SITC 71, 72, 73.

Source: Comtrade, UniCredit Research

BOX 2: CHINA'S CHANGING GROWTH MODEL AND MACHINERY IMPORTS

China's growth model is changing, as authorities in Beijing pursue slower and more balanced expansion favoring a reduction in the weight of investment relative to consumption. This obviously raises questions about the increase in machinery imports predicted by our model. Chart 11 looks at the relation between the absolute level of investments and machinery imports in real terms. Even though the IMF expects China's investment rate to decline to a historical low in 2021 (37% of GDP), the absolute level of investment in real terms will hit a historical high. Nevertheless, we forecast that the level of imports will remain below the 2011 peak.

Chart 11: Investment will be at a historical high, but imports will be below peak



Source:. Comtrade, Haver, UniCredit Research

Food Industry

Imports of food and beverages by emerging countries are a multi-billion market that is rising rapidly. Here, we focus on processed food and beverages both for industry and household consumption. Table 6 highlights a strong increase in all East Asian countries with the exception of the Philippines. China provides the biggest opportunities with a market size expected to approach USD 60bn. India, Indonesia and Thailand are on a strong positive trend with a valuable market size of around USD 8bn. The forecast for Russia does not take into account a possible lifting of the ban on imported food from Europe that was imposed in August 2014. Nevertheless, imports in 2021 are expected to be around USD 15bn, which is close to the 2007 level.

TABLE 6: FORECASTS FOR THE FOOD INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-21	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Positive shock 2021, +33% GDP Forecast (Real USD mn, 2015)	Negative shock 2021, -33% GDP Forecast (Real USD mn, 2015)
Brazil	4,990	4,930	1%	0.30%	0.28%	5,614	4,367
China*	57,548	36,900	6%	0.36%	0.34%	71,055	44,043
Ethiopia	2,380	1,450	4%	2.52%	2.35%	2,991	1,771
India	8,135	5,680	43%	0.25%	0.27%	9,431	6,840
Indonesia*	7,759	5,910	31%	0.61%	0.66%	9,541	5,979
Mexico	13,685	12,600	9%	1.05%	0.97%	19,006	8,365
Philippines	5,210	4,730	10%	1.10%	1.62%	5,695	4,725
Russia	15,464	13,400	15%	1.07%	1.01%	19,387	11,542
South Africa	3,198	3,090	3%	1.10%	0.99%	4,557	1,840
Thailand*	7,987	5,640	42%	1.76%	1.39%	11,737	4,238
Turkey	4,264	3,350	27%	0.48%	0.46%	4,765	3,764
Vietnam*	7,099	4,350	3%	2.64%	2.34%	9,468	4,731

*Baseline year 2014. Import classification BEC12.

Source: UniCredit Research

If we look at export penetration, Table 7 shows that, among European exporters, France is the best positioned in the markets that will experience the strongest growth. Whereas, surprisingly, Italy has a lower penetration than Germany and the UK in key Asian markets. Finally, Mexico, which is expected to be the third biggest market within EM, shows a very low presence of European exporters, as it is mostly a market for US companies.

TABLE 7: FOOD AND BEVERAGES – EXPORT SHARE BY COUNTRY, 2015

Country \ Exporter	Italy	Germany	France	EU14	UK	US	Japan	China
Brazil	3.3%	2.2%	2.2%	23.7%	2.6%	5.1%	0.1%	5.0%
China*	1.3%	4.0%	6.0%	21.6%	0.9%	13.0%	0.8%	–
Ethiopia	1.4%	0.5%	2.5%	8.0%	1.9%	3.6%	0.0%	0.6%
India	0.6%	0.5%	0.8%	5.1%	3.8%	1.5%	0.0%	1.1%
Indonesia*	0.4%	1.4%	3.2%	9.8%	0.3%	12.8%	0.5%	6.8%
Mexico	0.7%	0.5%	0.9%	6.5%	1.6%	71.9%	0.1%	2.3%
Philippines	0.3%	2.8%	2.3%	12.9%	0.6%	13.2%	0.7%	9.2%
Russia	4.4%	4.7%	3.2%	21.4%	2.0%	1.5%	0.2%	4.2%
South Africa	3.1%	4.4%	4.9%	27.2%	8.0%	2.7%	0.1%	5.1%
Thailand*	0.9%	1.5%	3.4%	11.5%	3.5%	11.3%	4.0%	11.1%
Turkey	4.5%	6.7%	2.2%	29.0%	3.5%	4.7%	0.0%	1.6%
Vietnam*	0.3%	1.9%	2.8%	11.3%	0.8%	16.5%	2.1%	5.4%

*Baseline year 2014. Import classification BEC12.

Source: Comtrade, UniCredit Research

Apparel

In the apparel industry (Table 8), the value of imports in China should more than double in respect to 2015, approaching USD 12bn. Also Russia provides good business opportunities, with imports expected to rise by more than USD 1bn and approach a total size of USD 7bn. Among other emerging countries, Vietnam and India offer the most interesting opportunities to exporters: their market size is still below USD 2bn, but it is rising rapidly.

TABLE 8: FORECASTS FOR THE APPAREL INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-21	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Upside shock, +33% GDP Forecast (Real USD mn, 2015)	Downside shock, -33% GDP Forecast (Real USD mn, 2015)
Brazil	2,716	2,710	0%	0.16%	0.15%	2,775	2,656
China	11,919	5,740	108%	0.08%	0.05%	17,024	6,812
Ethiopia	790	441	79%	0.84%	0.72%	1,222	358
India	1,216	672	81%	0.04%	0.03%	1,363	1,068
Indonesia*	854	536	59%	0.07%	0.06%	1,127	581
Mexico	4,232	3,790	12%	0.32%	0.29%	6,008	2,455
Philippines	717	420	71%	0.15%	0.14%	821	612
Russia	6,840	5,590	22%	0.47%	0.42%	8,839	4,840
South Africa	1,927	1,710	13%	0.66%	0.55%	2,320	1,534
Thailand	1,237	938	32%	0.27%	0.23%	1,716	759
Turkey	3,534	3,020	17%	0.40%	0.41%	4,745	2,322
Vietnam*	1,694	797	113%	0.63%	0.43%	2,669	721

*Baseline year 2014. Import classification SITC 84. Source: UniCredit Research

Table 9 shows the export penetration for the apparel industry. In this sector, the country ranking should be taken with caution as many western brands have their production located in China and they export directly from that country. In fact, China has the highest export share in all countries by a high degree: this reflects a mix of Chinese products and foreign goods produced in China. Among EU countries, Italy has the strongest export penetration, reflecting both its traditional comparative advantage in this sector and the fact that the higher-end of Italian apparel is more likely to be produced domestically.

TABLE 9: APPAREL – EXPORT SHARE BY COUNTRY, 2015

Country \ Exporter	Italy	Germany	France	EU14	UK	US	Japan	China
Brazil	0.9%	0.0%	0.1%	2.2%	0.0%	0.4%	0.1%	58.4%
China	17.6%	0.3%	2.3%	23.8%	0.9%	0.7%	1.7%	–
Ethiopia	0.2%	0.1%	0.0%	0.4%	0.2%	0.3%	0.0%	71.1%
India	1.3%	0.5%	0.3%	5.4%	0.3%	0.7%	1.3%	38.9%
Indonesia*	4.0%	0.5%	0.7%	12.6%	2.0%	1.7%	0.1%	35.5%
Mexico	2.0%	0.1%	0.2%	5.4%	0.1%	11.0%	0.0%	37.1%
Philippines	0.4%	0.2%	0.6%	5.4%	0.5%	2.3%	1.1%	41.6%
Russia	5.6%	0.7%	0.5%	8.7%	0.2%	0.2%	0.0%	43.8%
South Africa	4.7%	0.5%	2.0%	9.7%	0.5%	1.2%	2.3%	51.8%
Thailand	5.3%	1.1%	0.5%	10.7%	0.7%	0.4%	0.1%	29.1%
Turkey	1.5%	0.6%	0.5%	3.1%	0.2%	1.7%	6.8%	51.7%
Vietnam*	1.0%	0.1%	0.2%	1.9%	0.3%	0.5%	0.0%	53.2%

*Baseline year 2014. Import classification SITC 84. Source: Comtrade, UniCredit Research

Furniture

The market size of furniture is lower than other industries, but is rapidly rising and still sufficiently sizable to provide interesting opportunities (Table 10). China and India are going to double their import size in the next five years, reaching USD 4.1bn and USD 1.6bn. Russia is the market to watch for. Imports of furniture have collapsed by 45% between 2014 and 2015, from USD 3.2bn to USD 1.7bn; we forecast a rebound to USD 2.2bn by 2021, but this is possibly an underestimate.

TABLE 10: FORECASTS FOR THE FURNITURE INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-2021	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Upside shock, +33% GDP Forecast (Real USD mn, 2015)	Downside shock, -33% GDP Forecast (Real USD mn, 2015)
Brazil	744	735	1%	0.05%	0.04%	840	648
China*	4,145	2,600	59%	0.03%	0.01%	5,481	2,809
Ethiopia	459	242	90%	0.49%	0.39%	781	137
India	1,588	838	89%	0.05%	0.04%	2,188	987
Indonesia*	641	366	75%	0.05%	0.04%	882	400
Mexico	3,144	2,820	11%	0.24%	0.22%	4,548	1,739
Philippines	569	250	128%	0.12%	0.09%	804	333
Russia	2,210	1,760	26%	0.15%	0.13%	2,989	1,431
South Africa	537	503	7%	0.18%	0.16%	678	397
Thailand*	843	533	58%	0.19%	0.13%	1,338	348
Turkey	1,130	821	38%	0.13%	0.11%	1,554	705
Vietnam*	259	183	42%	0.10%	0.10%	312	206

* Baseline year 2014. Import classification SITC 82.

Source: UniCredit Research

Table 11 shows that the export penetration of Chinese furniture is particularly strong in countries with a relatively small market like Vietnam or South Africa, reflecting a preference for products of cheaper quality. European exports are stronger in the richest markets like China and Russia, whereas the US has the strongest presence in Mexico. Among EU exporters, Italy and Germany share the highest export penetration in key markets, although Germany lags behind in Turkey.

TABLE 11: FURNITURE – EXPORT SHARE BY COUNTRY, 2015

Exporter / Country	Italy	Germany	France	EU14	UK	US	Japan	China
Brazil	4.7%	3.2%	2.7%	16.7%	0.6%	14.2%	2.6%	36.9%
China*	13.2%	15.4%	2.5%	37.0%	3.4%	8.7%	6.0%	–
Ethiopia	2.1%	0.3%	0.3%	4.2%	2.2%	2.2%	0.0%	24.3%
India	1.0%	2.7%	0.2%	5.4%	0.5%	1.2%	9.2%	58.2%
Indonesia*	6.0%	8.2%	0.5%	16.6%	2.2%	4.7%	1.7%	47.8%
Mexico	3.4%	2.6%	0.6%	9.5%	0.2%	50.6%	1.3%	22.1%
Philippines	1.4%	1.2%	0.4%	4.6%	0.5%	3.9%	5.5%	55.9%
Russia	10.8%	6.5%	1.1%	23.4%	1.4%	2.9%	1.4%	23.9%
South Africa	2.1%	3.8%	0.8%	9.0%	0.5%	2.9%	9.7%	58.2%
Thailand*	10.4%	9.6%	4.0%	29.4%	1.5%	2.1%	1.5%	33.4%
Turkey	12.1%	3.5%	0.2%	17.5%	0.3%	0.8%	5.3%	32.2%
Vietnam*	3.9%	9.5%	1.0%	18.4%	1.6%	1.7%	0.6%	48.7%

*Baseline year 2014. Import classification SITC 82.
Source: Comtrade, UniCredit Research

Services

The market of services presents few opportunities for exporters as the size of emerging market imports is on the order of USD tens of millions (Table 12). This is not surprising given the non-tradable nature of services. Obviously, the service sector itself is going to be rising strongly in emerging markets, but opportunities in this sector can probably be better seized through FDIs in the local market than through exports.

TABLE 12: FORECASTS FOR THE MACHINERY INDUSTRY

Country	Market Size of Imports, 2021 (Real USD mn, 2015)	Market Size of Imports, 2015 (Real USD mn, 2015)	% Change 2015-21	Import Share 2021 (% GDP)	Import Share 2015 (% GDP)	Upside shock, +33% GDP Forecast (Real USD mn, 2015)	Downside shock, -33% GDP Forecast (Real USD mn, 2015)
Brazil	68	67	1%	0.004%	0.004%	78	58
China	953	470	103%	0.006%	0.004%	1,352	554
Ethiopia	7	5	40%	0.008%	0.007%	9	5
India	257	120	114%	0.008%	0.006%	389	124
Indonesia*	44	30	47%	0.003%	0.003%	54	35
Mexico	37	32	16%	0.003%	0.002%	41	33
Philippines	44	24	83%	0.009%	0.008%	58	29
Russia	102	88	16%	0.007%	0.007%	126	77
South Africa	17	16	6%	0.006%	0.005%	21	12
Thailand	58	51	14%	0.013%	0.013%	69	47
Turkey	29	23	26%	0.003%	0.003%	40	19
Vietnam*	24	16	50%	0.009%	0.009%	31	17

*Baseline year 2014. Services, IMF BoP.
Source: UniCredit Research

Concluding Remarks

Even after the last two problematic years, emerging markets still offer thriving business opportunities for exporters in developed countries. This paper provides an analysis about the most promising countries and sectors over a medium-term horizon. Moreover, the paper highlights the current export penetration for different countries, highlighting the markets where a competitive advantage can be found and those where a poor performance may call for policy makers to adopt specific policies aimed at supporting exporters.

On aggregate, China emerges as the biggest market for all sectors, even under a negative-shock scenario. Other Asian countries like the Philippines, Indonesia, Thailand, and to some extent Vietnam will provide very interesting opportunities to Western exporters. These markets should be viewed very positively.. India, despite being the fastest growing EM economy, will offer fewer opportunities than one might expect, due to the current low level of income per-capita and to the high level of tariffs and regulation that characterize some sectors.

Among the BRICS, Brazil, Russia, and South Africa are likely to offer limited opportunities for exporters, although in the case of Russia the normalization of trade relations with the removal of sanctions may brighten the picture. Mexico is a very large and relevant export market, but it has very low import penetration from European exporters and is mainly a target of US.

Our forecasts confirm the shift of the center of gravity of trade towards East Asia. In this context, European exporters seem better positioned than American ones in the sectors we have analyzed. However, the picture is not homogeneous. While German exports to Asian countries show strength across most sectors, Italy and France need to improve their penetration of the key markets of this promising region.

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