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DEMOGRAPHICS AS DESTINY

Mega Trends to Consider When
Planning Emerging Market Portfolios:

Urbanization



The
Economist

Intelligence
Unit

Most of the global shift to cities will occur in emerging economies in the coming years, with urbanization profoundly impacting their economic performance, social and political stability, and prospects for investment. How things play out will hinge largely on jobs growth, socially inclusive programs, and healthcare and infrastructure improvements—and the investment that does or doesn't follow.

Unmanaged, massive growth in urban populations will strain housing, transport and utilities infrastructure. But handled wisely, urbanization creates opportunity in those areas and others, as cities grow and new consumer markets take shape.

Demographics alone will not drive particular sectors, but with the right mix of rising incomes, investment, trade, and sound economic and social policies, they could transform emerging economies and open new markets for services and manufacturing. Countries that plan wisely should see demand rise in sectors associated with urbanization, such as housing and infrastructure.

These demographic changes are occurring at an astonishing pace. Western European countries passed through their demographic transitions in over a century; China will complete its transition in decades. Fast-growing economies have little time to prepare for the inevitable growth and unprecedented social changes coming their way.

The economic repercussions of urbanization will vary widely across sectors and countries. In Latin America and India, urban growth will only worsen already horrendous traffic congestion, hindering economic growth. New transportation infrastructure will be needed in bogged-down cities like São Paulo. In sub-Saharan Africa, surging migration and urbanization will likely boost demand for housing and office space but may strain water and food resources. But as efficiency, legal systems and corporate governance improve, investors will follow.

Better corporate governance in some countries is improving investment and job prospects. Among emerging markets, the former “tiger” economies of Southeast Asia, such as Thailand and Malaysia, lead the developing world in the quality of corporate governance, according to David Robinett, senior private sector development specialist on the World Bank's capital markets and corporate governance team. Those countries and new measures introduced after the Asian financial crisis of 1997 have helped close the gap with developed nations, he said. In some Eastern European countries, reforms were tied to their political transition process.

This paper, prepared by the Economist Intelligence Unit, will look at the leading urbanization trends shaping the less-developed markets in the next decade and beyond as the economic balance shifts towards emerging cities and demand rises for infrastructure, food, water and consumer goods.

MID-SIZE AND MEGA CITY GROWTH

The urbanization numbers are staggering; populations will be increasingly concentrated. Worldwide, just 440 emerging cities will contribute almost \$25 trillion to the world economy through consumption and investment in physical capital growth between 2010 and 2025, according to the McKinsey Global Institute, or roughly half of global GDP.

The bulk of this growth over the next 40 years will come from developing countries, according to the United Nations. By 2050, some 67% of the global population will live in urban areas, up from 52% in 2011.

Urban dwellers will be increasingly polarized between large cities of 1mn or more and sprawling megacities of 10mn or more, which will see the steepest gains, according to the United Nations report, “World Urbanization Prospects: The 2011 Revision.” That is a departure from today, with over half the global urban population living in small urban centers with fewer than half a million residents. Today, 3.6bn people live in settlements of varying sizes.

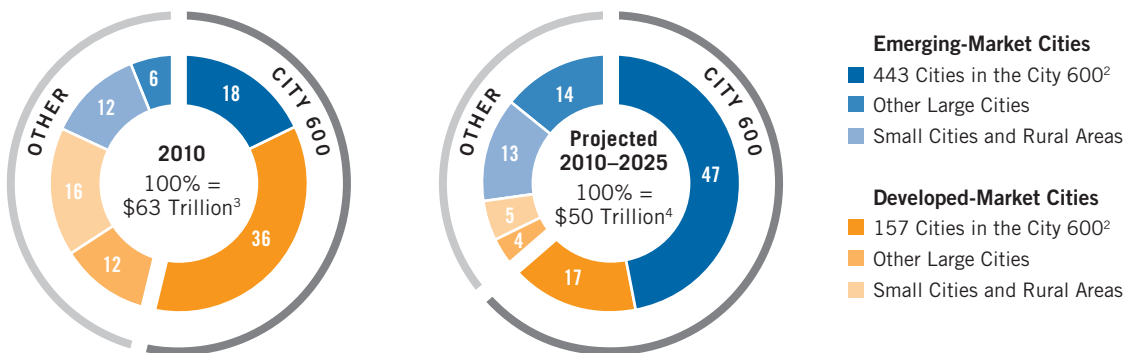
Africa and Asia are expected to urbanize more rapidly than the rest of the developing world, but in four decades they will still be less urbanized than the world’s more developed regions or Latin America and the Caribbean.

The largest shift from rural and other areas to towns and cities will occur in Asia, with about a third of the rise in the global urban population in the years ahead coming from China and India. Asia is expected to add 1.4bn people, followed by Africa, with nearly 1bn, and Latin America and the Caribbean, with 0.2bn. Half of Asia’s population is projected to live in urban areas by 2020, while half of Africa’s population will reach that level by 2035.

Between 2011 and 2025 particularly high growth rates are expected in Lagos, Dhaka and Karachi—all of which are expanding at well above 2% annually. Megacities such as Delhi, Calcutta, Mumbai, Shenzhen, Beijing, Guangzhou, Shanghai and Manila are also expected to expand rapidly, outpacing the growth of megacities in Egypt and Turkey.

Approximately 440 Emerging Market Cities Are Poised to Deliver Close to Half of Global GDP Growth

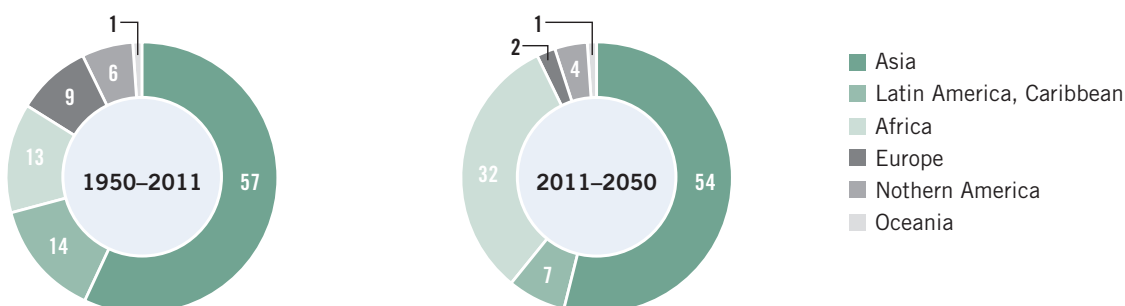
Cities’ Contribution to Global GDP and GDP Growth¹ (% , Real Exchange Rate)



Source: “Winning the 30 trillion decathlon: going for gold in emerging markets,” McKinsey & Co, p. 25.

- >2,600 cities, including large cities as well as smaller cities and rural areas.
- The top 600 cities by their contribution to global GDP growth 2010–2025.
- Reflects market exchange rate.
- Prediction based on difference in per capita GDP growth rates of countries relative to the growth of US per capita GDP.

Increase in Urban Population by Major Regions (% of Total Urban Increase)



Source: United Nations, Department of Economic and Social Affairs, Population Division: *World Urbanization Prospects, the 2011 Revision*. New York, 2012.

BURGEONING CONSUMER MARKETS

Urbanization and rising incomes will help grow the globe's consumer base, set to nearly double to 4.2bn by 2025 from today's 2.4bn according to the McKinsey Global Institute. Already, emerging markets account for more than half the global consumption of most commodities, world exports and inflows of foreign direct investment, *The Economist* reported.

For a sense of the opportunity look to basic goods and services. Consumer spending on laundry care products between 2010 and 2025, for example, is expected to be highest in São Paulo, followed by Beijing and Rio de Janeiro, according to the McKinsey Global Institute.

A City-Specific Lens Can Reveal Urban Areas with the Highest Growth Potential in a Given Market

Top 20 cities by Growth in Given Market, 2010–2025

Rank	Elderly Higher-Income ⁵ Consumers (aged 65 and over)	Young Entry-Level ⁶ Consumers (aged 14 or under)	Consumer Spending on Laundry Care Products ⁷	Demand for Commercial Floor Space ⁸	Municipal Water Demand
1	Shanghai	Lagos	São Paulo	New York	Mumbai
2	Beijing	Dar es Salaam	Beijing	Beijing	Delhi
3	Tokyo	Dhaka	Rio de Janeiro	Shanghai	Shanghai
4	Tianjin	Ouagadougou	Shanghai	Los Angeles	Guangzhou
5	Mumbai	Khartoum	Mexico City	Tokyo	Beijing
6	São Paulo	Ghaziabad	Moscow	Washington, D.C.	Buenos Aires
7	Osaka	Sanaa	Bangkok	Dallas	Kolkata
8	Chongqing	Nairobi	Istanbul	São Paulo	Khartoum
9	Delhi	Luanda	Manila	Guangzhou	Dhaka
10	Nanjing	Baghdad	Johannesburg	Chicago	Istanbul
11	Guangzhou	Kampala	Belo Horizonte	Houston	Dallas
12	New York	Ibadan	Porto Alegre	Tianjin	Pune
13	Seoul	Lusaka	Buenos Aires	Moscow	Las Vegas
14	Hong Kong	Kinshasa	Tianjin	Atlanta	Karachi
15	Wuhan	Kano	Tehran	Miami	São Paulo
16	Kolkata	Abidjan	New York	Hong Kong	Hyderabad
17	Shenyang	Abuja	Foshan	Mexico City	Lagos
18	Los Angeles	Bamako	Santiago	Shenzhen	Moscow
19	Toronto	Chittagong	Shenzhen	Phoenix	Wuhan
20	Ahmedabad	Port Harcourt	London	Istanbul	Manila

Source: McKinsey Global Institute analysis.

Emerging regions are indicated in bold.

5. With household income >\$20,000 at purchasing-power parity.

6. With household income of \$7,500–\$20,000 at purchasing-power parity.

7. Based on city-level market-demand-growth model.

8. Includes replacement floor space.

AFRICA A New Class of Consumers

Africa is often overlooked as an end market globally. But the region has the highest urban growth rate in the world, and its total population is expected to more than double by 2050, to about 2.2bn, as its people live longer.

The jump from today's 40% estimated urbanization rates to 50% in 2040 will increase opportunities in cities due to shorter transport times and improved efficiencies, among other factors, said Wolfgang Fengler, The World Bank's lead economist for Kenya, Rwanda, and Eritrea.

These gains coupled with rising urban incomes will create a new class of consumers who will stoke demand for new products and services, according to the Economist Intelligence Unit. Over 34% of Africans, or 326mn people are in Africa's new middle class, up from 27% in 2000, *The Economist* reported last year.

The African Development Bank defines the middle class as anyone who spends between \$2 and \$20 a day in purchasing-power parity terms. Across Africa, personal disposable income doubled to \$164.7bn in 2009, from \$82bn in 2000, and is forecast to soar to \$287.9bn by 2017, according to the Economist Intelligence Unit. Meanwhile, lower income consumers are already buying more soap, packaged goods, appliances and cleaners.

In some countries sales of some of these basic staples have doubled or more in a decade; sales of higher priced items are projected to double, again.

Nigeria Market Demand

Basic Staples Sales in Millions (US\$)

	2011	2012	2013	2014	2015	2016	2017
Electrical Appliances and Houseware ⁹	\$146,5	\$174,6	\$200,1	\$226,9	\$253,3	\$283,8	\$314,2
Footwear ¹⁰	\$18,3	\$20,8	\$22,6	\$24,4	\$25,9	\$27,6	\$29,3

Source: Economist Intelligence Unit.

LATIN AMERICA Retrofitting Sprawl

Latin America's urbanization and high population growth phase has largely passed; the focus is now on improving life in cities. The region has the most highly urbanized population in the developing world today, with some 79% of its people in cities, up from 41% in 1950. Today Latin America's population growth rates are low compared to those of Africa and Asia.

Sprawl continues, but slums are less common. Slum dwellers fell from 35% of the urban population in 1990 to 27% in 2005, according to the UN. More developed urban areas are growing faster than slums, thanks to more

In South Africa, for example, demand for soaps and cleaners more than doubled to \$3.4bn in 2009 from \$1.4bn in 2000 and is expected to soar to \$9bn by 2017, according to the Economist Intelligence Unit. Retail sales of food also more than doubled to \$70bn last year from \$30.3bn in 2000, and are forecast to grow to \$83.4bn by 2017.

Nigeria, with Africa's largest population, is also a focus market for many companies. Demand for electrical appliances and housewares there could double to \$314mn by 2017, up from \$147mn in 2011, while footwear demand is projected to reach \$29mn from \$18mn over the same period.

To bring staples to these markets, Africa's agriculture sector has enormous potential for growth because it is starting from a low base. Food systems have been stifled by corruption and the break-up of large farms. Unlike Asia and South America, where per-capita agricultural production has risen dramatically over several decades, Africa only recently returned to 1970s output levels, according to a report by the U.S. National Intelligence Council, "Global Trends 2030: Alternative Worlds." To address food insecurity and stabilize prices, which remain astronomically high for many Africans, agriculture will have to become more efficient and large-scale.

The drive to boost food security will also bring opportunity in supply chains and transport. Many African countries, hobbled by weak governance, lack infrastructure to transport seeds and fertilizer inland from ports.

progressive policies promoting inclusive governance and access to basic services, such as water and sanitation.

In Chile and Mexico, alternatives to slums are now an option in low-to-medium income housing projects far from urban centers. The availability of large, inexpensive tracts of land made this possible, according to the Inter-American Development Bank.

For these reasons, India and Sub-Saharan Africa can learn much about healthy urbanization from Latin America and the Caribbean, according to George Martine, a Brazil-based population and environmental consultant.

9. Total market demand for electrical appliances and housewares such as electric space heaters, electric blankets, electrical bathroom and kitchen appliances; excludes retail and wholesale mark-up.

10. Total market demand for footwear, excludes retail and wholesale mark-up. Includes leggings, gaiters and footwear from leather, fabrics and other materials except footwear made wholly of wood or almost entirely of vulcanized or moulded rubber or plastic.

THE INFRASTRUCTURE CHALLENGE

The most critical need cities face is in infrastructure. New road, rail, telecommunications, airport and electricity systems meet fundamental urban needs, and open the door to new markets and other opportunities.

There is a yawning need for better transportation in many countries. Buses and trains are overwhelmed by growing urban populations in some cities. These are crucial building blocks of economic development which must be carefully planned.

The midsize Indian city of Hyderabad, for example, is densely populated and growing rapidly. But bottlenecks abound from commuters using private vehicles to travel to the city center from nearby fast-growing areas. To ease traffic flow, the city has undertaken road projects—overpasses, interchanges, flyovers. In recent years, authorities opened an eight-lane expressway encircling the city and an elevated corridor—the

longest in the country—linking Hyderabad to an international airport outside the city. Despite these investments, congestion persists. This underscores the importance of integrated, inclusive urban planning.

Africa's urban infrastructure needs are enormous. In Kenya's highly urbanized port city of Mombasa, for example, government and international agencies have poured funds into road, airport and shipping improvement projects to spur regional trade. Weak infrastructure and delays, poor handling of goods and corruption at the port had contributed significantly to the decline of the manufacturing sector in Kenya, according to the World Bank. Kenya's Transport and Infrastructure ministry plans to focus its 2013-2014 budget spending on completing key highways and the expansion and modernization of the city's port to handle larger-capacity vessels.

INDIA The Next Colossus

Though China has garnered most headlines in recent years, attention on India as an urban growth market should increase. India's population of 1.3bn is growing three times as fast as China's in a land area only about one-third the size. India will overtake China as the world's most populous country by 2021 and accounts for about 22% of global population growth annually today.

Urbanization is occurring at a breakneck pace in India. As the least urbanized of the BRIC economies, India has the greatest potential for growth, analysts say. In about 30 years, India will be predominantly urban—a milestone China reached early last year.

This shift to cities is already underway. India added 50mn people to its urbanized areas in seven years, growing from an estimated 290mn in 2001 to an estimated 340mn in 2008, according to a McKinsey Global Institute report, "India's urban awakening: Building inclusive cities, sustaining economic growth." That figure is expected to climb to 590mn by 2030.

Though the demographic shift will boost demand for jobs, housing and infrastructure, urban poverty remains a challenge in India and its neighboring countries. In 2001, 42% of Asia's 1.3bn urban residents lived in slums, according to a 2011 United Nations report, "Population Distribution, Urbanization, Internal Migration and Development: An International Perspective." In fact, India and Pakistan accounted for nearly three-quarters of the slum population in Southern Asia.

Water shortages are also an important issue. Insufficient clean water is threatening industrial and farm output growth in India, which treats only 20% of its sewage. With conglomerates such as Tata and Adani facing water shortages, India plans to double its spending on water management to \$20bn over the five years ending in March 2017, according to Bloomberg.

PREPARING FOR URBAN GROWTH

Attempts by policymakers to stop urbanization are futile, said George Martine, lead author of the United Nations Population Fund report, “State of World Population 2007: Unleashing the Potential of Urban Growth.” Instead, governments must prepare to avoid worst-case-scenarios. “Preparation for the land and housing needs of the poor makes a huge difference,” he said. Without this, he added, impoverished populations will live on or near the least desirable plots of land with few prospects for land price appreciation, on tracts that are “degraded or subject to floods or landslides, or exposed to toxic waste.”

Slums should be avoided. They bring on a host of problems because they are the outgrowth of unfettered urban expansion. As slums grow, their inhabitants become disconnected from jobs, services and other urban benefits, he said. Moreover, without social amenities and acceptable environmental conditions, investment also lags.

Congestion is also likely. Failing to address transportation needs can bring traffic jams like those in São Paulo which some days stretch hundreds of kilometers back. To stem sprawl and bottlenecks, governance efforts on land use, sanitation, transportation and public safety are critical, he said.

CONCLUSION

Globally, countries can benefit or suffer from demographic shifts. The impact of urbanization will largely depend on how it is managed. Countries can plan for rising urbanization by improving infrastructure, healthcare, housing and transportation. They can develop socially inclusive policies, and spur job growth. Many complex pieces of the puzzle need to come together to generate and capture the opportunity.

AFRICA Infrastructure Opportunity

Africa will have to make major investments in infrastructure to realize its full potential. More than 60% of the continent’s urban inhabitants lived in slums as of 2005, according to United Nations estimates, a portion expected to remain stable, experts say. More high-rises and better mass transportation systems will thus also be needed, said Wolfgang Fengler, The World Bank’s lead economist for Kenya, Rwanda, and Eritrea. High rise shortages and poor mass transit have led to urban sprawl and environmental degradation, said Fengler. Stronger institutions can help cities like Nairobi manage sanitation and water services which have much room for improvement.

Road systems also leave much to be desired. Traffic congestion has plagued Nairobi, Dar es Salaam, Kampala and other cities due in part to rapid growth. “Investment in roads—not just building more roads but managing traffic flows and putting in new mass urban transit systems—that agenda has just lagged,” said Roland White, lead urban specialist in the Africa region at the World Bank.

Unfettered urban growth in already dense areas could also set the scene for destabilizing political movements. There, large income gaps are often apparent, making it easier to marshal a critical mass of potentially disgruntled groups through social media. “It’s going to be a challenge because of the political aspect—unrest, riots,” said Joseph Chamie, former director of the United Nations Population Division. “You can mobilize people more easily because they’re denser. If you look at the Arab Spring, all the riots were in cities, not rural areas.”

Africa has more time than other regions to address these issues. Most of Sub-Saharan Africa’s young people will come of age around 2045 or 2050, giving governments ample time to improve employment opportunities, institutions and education. But its population will grow tremendously, complicating planning efforts. For those that do, the payoffs could be substantial.

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