Rising Food Prices Threaten Emerging Markets

According to the World Bank, food prices will probably remain elevated through 2024. In developing countries, where consumers spend a greater portion of their income on food, the pressure is rising.

In 2011, soaring food prices contributed to violent protests in Egypt, Tunisia, Libya, Yemen and Syria. Today, we find pronounced examples of food-related hardship in Egypt, Indonesia, Peru and Sri Lanka.

Given the strong historical relationship between high food prices and social unrest, we see potential for large-scale protests in the near term. Should high prices persist, emerging market equities could start to underperform their developed market peers. Emerging market currencies are reflecting heightened political concerns.

This edition of Global Insights explores the relationship between rising food prices and social unrest in emerging economies.
Emerging markets are reeling from higher food and energy prices. According to an International Monetary Fund (IMF) forecast, in 2022, global consumer prices will have climbed at the fastest pace in nearly three decades. Many emerging markets, meanwhile, have also been struggling with low vaccination rates. The dual crosswinds of COVID-19 and inflation could complicate the growth outlook for emerging markets and should give investors pause.

**High food prices can hurt equity markets.** At the turn of the 20th century, American writer Alfred Henry Lewis declared “there are only nine meals between mankind and anarchy.” We worry that equity and currency markets have downplayed this risk. The global pandemic and ensuing supply chain disruptions laid the foundation for higher food prices, but Russia’s invasion of Ukraine caused them to skyrocket (see Exhibit 1). This is especially true for key staples such as rice, wheat and corn, with prices jumping 8.2%, 38.3% and 29.9%, respectively, over the past three months (see Exhibit 8).

**Exhibit 1: Food Prices Hit Record Highs in March**

![Graph showing food prices](image)

Note: World Uncertain Emerging Economies Index is a smoothed one-year average.
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 31, 2022

Historically, one of the biggest risks facing emerging market investors has been political instability. In the past, price spikes, especially in key staples, have led to social unrest in developing economies. Should prices remain elevated, food-related protests will likely follow. There is an obvious corollary between recent events and the lead-up to the 2011 Arab Spring uprisings. We think it is useful to revisit the impact on economic activity and markets to look for clues to the range of possible outcomes.

**Arab Spring Uprisings.** Soaring food prices contributed to violent protests in Egypt, Tunisia, Libya, Yemen and Syria in 2011, roiling global markets. Over this period, the VIX Index averaged 30, a level that exhibits heightened volatility compared to the 20-year average of 19.5. Additionally, real growth declined across the region (see Exhibit 10). According to a 2016 United Nations report, conflict across the Middle East and North Africa resulted in a net loss of $613.8 billion of economic activity in the four years that followed. Further, the events of the Arab Spring resulted in a significant decline in foreign direct investment (FDI). FDI—a driver of economic growth—had already decreased in the aftermath of the 2008 Great Financial Crisis, with some regions arguably becoming uninvestable. In a worrying development, for many of the impacted countries FDI has not returned to its 2005-2009 highs (see Exhibit 2).

**Exhibit 2: Foreign Direct Investment Collapsed During the 2011 Uprisings**

![Graph showing foreign direct investment](image)


Egypt, one of the largest wheat importers in the world, was hit hard by the 2011 food crisis, resulting in mass social unrest. As a result, its stock market closed for 55 days, and the MSCI Egypt Index lost nearly half its value. With that in mind, we are surprised that the Index has only declined 3.8% since the start of Russia’s invasion of Ukraine, even with the price of wheat settling near an all-time high.

In the years following the Arab spring, as its economy fell into recession, Egypt accepted a $12 billion loan from the IMF to stave off collapse. A key feature of the agreement was liberalization of the exchange rate. The Central Bank of Egypt devalued the Egyptian pound by nearly 50% versus the US dollar. More recently, in response to the economic fallout from Russia’s invasion of Ukraine, Egyptian officials requested support from the IMF again. The Egyptian pound slid, and it has declined nearly 15% against the dollar over the past month (see Exhibit 3).
Emerging markets are more vulnerable to food price shocks. As seen during the Arab Spring, high food prices can weigh on economic activity. Looking at emerging markets broadly, we believe investors should avoid economies characterized by higher rates of consumer spending on food relative to income. For example, in the US, food represents 13.3% of the Consumer Price Index (CPI) basket, which is moderately higher than the median 9% for 12 developed markets that we measured (see Exhibit 4). The data for emerging markets is more concerning, in large part because they are more dependent on food imports. For example, Egypt, Indonesia, and Turkey are among the world’s largest wheat importers, with most of those imports coming from Russia and Ukraine. Unsurprisingly, they have also seen a good deal of unrest.

Recent flare-ups of unrest are worrying. The historical relationship between high food prices and social unrest is notable (see Exhibit 6) and could lead to large-scale protests in the near term. We are already seeing some developments. For example, in Indonesia, the rising cost of basic goods has led to mass demonstrations. Sri Lanka has declared a state of emergency as it deals with its worst economic downturn since its independence. In Peru, politicians have announced 24-hour curfews in response to protests against fertilizer and fuel prices. It has become apparent that with millions of tons
of grain unable to be transported from besieged areas of Ukraine, food staples will remain scarcer than usual. Investors should be on watch for further escalation and economic deterioration in vulnerable markets.

Exhibit 6: Food Price Spikes Track Social Unrest

Investment Implications

Although higher food prices are being felt globally, emerging markets will bear the brunt of increases. Investors should avoid economies that are experiencing above-average food inflation and low vaccination rates. Flare-ups in Sri Lanka, Peru and Indonesia, in particular, are cause for concern. Egypt’s request for IMF assistance could be the canary in the coal mine. Although emerging market foreign currencies (EMFX) markets have weakened amid higher food prices, equity markets have traded in line with developed markets. Should high prices persist, emerging market equities could start to underperform their developed market peers (see Exhibit 7).

Exhibit 7: Emerging Market Strength May Waver Versus Developed Markets Amid High Food Prices

Note: There were 26 food-related riots in 2008. The chart is truncated at 10 for display purposes.

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of May 3, 2022
Charts You Can't Miss

Exhibit 8: Wheat, Corn and Rice Prices Have Accelerated at a Pace Not Seen Since 2008

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 31, 2022

Exhibit 9: EM Equity Bulls Come Charging Back Following Russian Invasion of Ukraine

Source: Haver, Morgan Stanley Wealth Management Global Investment Office as of March 31, 2022

Exhibit 10: The Economic Consequences of the Arab Spring

<table>
<thead>
<tr>
<th>Country</th>
<th>Real GDP Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>5.1 1.8 2.2 1.8</td>
</tr>
<tr>
<td>Jordan</td>
<td>2.3 2.6 2.8 3.5</td>
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<tr>
<td>Libya</td>
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<tr>
<td>Tunisia</td>
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</tr>
<tr>
<td>Yemen</td>
<td>7.7 -12.7 2.4 6.0</td>
</tr>
</tbody>
</table>


Exhibit 11: High Food Prices Could Cause Greater Currency Volatility

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of April 26, 2022
As consumers grapple with higher food prices, farmers around the global face tighter margins from higher fertilizer costs. Over the past year, common crop inputs have surged faster than food prices due to energy supply shortages, shipping costs, tariffs, extreme weather and geopolitical issues. This dynamic could put additional pressure on food supplies as farmers are pressured to lower production. Reactions to more expensive fertilizer have included demand destruction, hoarding and government subsidies for potash and phosphates. In addition, bilateral agreements, with the goal of covering input shortfalls and securing crop production, are starting to be made. Going forward, fertilizer could become an increasingly important part of strategic planning for agricultural nations. – Brad Fulton
GLOBAL INSIGHTS

Disclosure Section

Index Definitions

MSCI EMERGING MARKET CURRENCY INDEX measures the total return of 25 emerging market currencies relative to the US Dollar where the weight of each currency is equal to its country weight in the MSCI Emerging Markets Index.

UN FOOD AND AGRICULTURE WORLD FOOD PRICE INDEX is a measure of the monthly change in international prices of a basket of food commodities.

WORLD UNCERTAINTY EMERGING ECONOMIES INDEX compares the level of uncertainty across countries.

For other index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealthinvestmentsolutions/wmir-definitions

Glossary

Important note regarding economic sanctions

This report may involve the discussion of country/ies which are generally the subject of selective sanctions programs administered or enforced by the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”), the European Union and/or by other countries or multinational bodies. The content of this presentation is for informational purposes and does not represent Morgan Stanley’s view as to whether or not any of the Persons, instruments or investments discussed are or may become subject to sanctions. Any references in this presentation to entities or instruments that may be covered by such sanctions should not be read as recommending or advising on any investment activities involving such entities or instruments. You are solely responsible for ensuring that your investment activities in relation to any sanctioned country/ies are carried out in compliance with applicable sanctions.

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Investing in foreign markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. Investing in currency involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions. In addition, international investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets and frontier markets, since these countries may have relatively unstable governments and less established markets and economies. Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond’s maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies. Technology stocks may be especially volatile. Risks applicable to companies in the energy and natural resources sectors include commodity pricing risk, supply and demand risk, depletion risk and exploration risk. Health care sector stocks are subject to government regulation, as well as government approval of products and services, which can significantly impact price and availability, and which can also be significantly affected by rapid obsolescence and patent expirations.

Rebalancing does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

The indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

The indices selected by Morgan Stanley Wealth Management to measure performance are representative of broad asset classes. Morgan Stanley Wealth Management retains the right to change representative indices at any time.

Disclosures

UN FOOD AND AGRICULTURE WORLD FOOD PRICE INDEX

WORLD UNCERTAINTY EMERGING ECONOMIES INDEX