Global Asset Management

BlueBay Asset Management

Inequality – The Elephant in the Room

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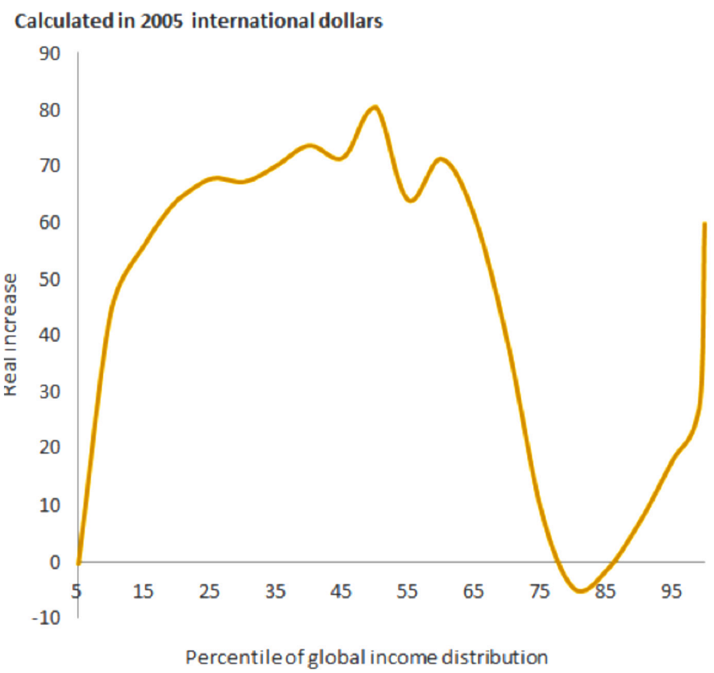
Investors must navigate rising political and policy risks in the developed world

From the Brexit vote to the rise of Donald Trump, the unequal distribution of the benefits of globalisation, we believe, is fueling populism and disenchantment with the status quo in the 'Western' world. It is also eroding support for the unconventional monetary policies pursued by central banks since the global financial crisis that are perceived to disproportionally favour the wealthy asset rich. Political and policy risk, so long associated with investing in emerging market assets, is becoming a predominant feature of developed markets.

Exhibit 1

Change in real income between 1988 and 2008 at various perentiles of global income distribution



Note: The vertical axis shows the percentage change in real income, measured in constant international dollars. The horizontal axis shows the percentile position in global income distribution. The percentile positions run from 5 to 95, in increments of five, while the top 5% are divided into two groups: the top 1%, and those between 95th and 99th percentiles.
Source: Global Income Inequality be the Numbers: in History and Now, Branko Milanovic November 2012

The winners and losers from globalisation is summarised by the famous 'elephant chart' below, described as "the most important chart for understanding politics today"[1], based on the seminal analysis of global household income by World Bank economists Branko Milanovic and Chrisoph Lakner.[2] It shows the change in real income between 1988 and 2008 at various percentiles of the global income distribution. The unusual shape of the curve gives rise to its 'elephant chart' nickname with the trunk pointed up on the right, the location of the richest households.

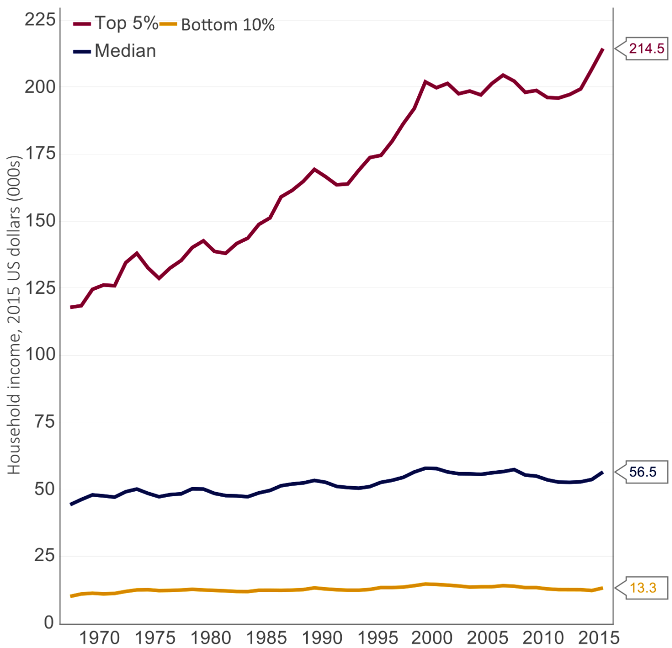
The chart shows that the greatest gains over the period following the collapse of the Berlin Wall in 1989 accrued to the 'emerging global middle class' – the elephant's hump – dominated by the rise of China and other major emerging economies such as India, Indonesia and Brazil. Along with the global top 1% in the rich world economies (the tip of the trunk), these are the winners of globalisation. The losers are shown by the bottom of the trunk – the middle-income households in rich countries whose incomes stagnated.

A recent analysis of the Milanovic and Lakner data by a UK think tank, the Resolution Foundation, showed that after taking into account the differential population growth across countries, the incomes of the rich world working/middle class as a whole did rise during the globalisation era.[3] Nonetheless, the elephant shape remains and income dispersion in 'Western' countries is profound even though globalisation has reduced global inequality.

The backlash in developed markets against stagnant incomes and rising inequality is made more acute by the economic disruption and legacy of the global financial and eurozone crises. The consequence is a surge in public support for populist, anti-establishment and anti-globalisation (and migration) political movements. From the UK's vote to leave the EU, Donald Trump's challenge to the Republican Party and Washington establishment, Marie Le Pen's National Front in France and the far-left Podomos in Spain, the status quo is creaking under the pressure.

[1] https://www.washingtonpost.com/news/wonk/wp/2016/01/13/this-may-be-the-most-important-chart-for-understanding-politics-today/
[2] 'Global Income Inequality by the Numbers: in History and Now', World Bank Policy Research Working Paper 6259, November 2012
[3] 'Examining an elephant: Globalisation and the lower middle class of the rich world', Adam Corlett, Resolution Foundation, September 2016

Exhibit 2
U.S. Household Income Dispersion: 1967 to 2015



Source: U.S. Census Bureau; data at 13 September 2016

Yet the gains from globalisation do not have to be abandoned but shared more evenly through more imaginative fiscal and monetary policies, economic and political reforms and broadening educational opportunities. Last week, data from the US Census Bureau reported a 5.2% rise in the real income of the median US household, the first statistically significant increase since 2007, albeit still lower than before the financial crisis.

Navigating the political uncertainties and policy shifts is becoming ever more important for investors to preserve capital and exploit the opportunities presented. The times are changing though not inevitably for the worst.

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