



# Morningstar Indexes Equity Annual Market Classification Review

May 28, 2024

## Changes under consideration

As part of Morningstar Indexes' annual equity market classification review, a few countries have been flagged as potential candidates for a change in market classification status. If adopted, these changes would impact the eligible universe for the Morningstar Global Markets and Target Market Exposure Index families, which only include countries classified as either developed or emerging markets. We would like to solicit feedback on these potential changes. Further details are included in this consultation.

## Markets under review

- **Egypt** – Potential reclassification to Unclassified from Emerging Market
- **South Korea** – Potential reclassification to Developed Market from Emerging Market
- **Turkey** – Potential reclassification to Unclassified from Emerging Market
- **Vietnam** – Potential reclassification to Emerging Market from Unclassified

## Submit your responses and questions

Responses to the Morningstar Indexes Equity Annual Market Classification Review can be submitted [here](#).

General questions about the consultation may also be sent to [indexes@morningstar.com](mailto:indexes@morningstar.com).

## Key dates

- **Consultation:** The consultation will be open for response from May 28 to July 31, 2024.
- **Decision announcement:** Final decisions will be announced by August 30, 2024.
- **Implementation:** Changes will be implemented at the June 2025 reconstitution.

## Egypt

Morningstar Indexes has classified Egypt as an emerging market since December 2014. Market accessibility had deteriorated due to difficulty repatriating capital, owing to limited foreign exchange liquidity. As a result, Egyptian securities were given special treatment in Morningstar Indexes, where index shares of Egyptian securities were frozen for non-mandatory events, causing the indexes to gradually become less representative of the market over time. However, conditions have improved following the country's move to a floating exchange rate.

## Lingering issues

Accessibility of the Egyptian equity market has deteriorated in recent years. Challenges include:

- **Low Liquidity in the Onshore Foreign Exchange (FX) Market** – It has been challenging to repatriate capital from Egypt due to severe shortages of foreign currencies in the Egyptian FX market since March 2023.
- **Macroeconomic Conditions** – Egypt has been experiencing high inflation and depleting foreign exchange reserves, leading to economic instability and market volatility.

### Improvements

Some of the significant improvements in Egypt over the past year include:

- **Floating FX Rate** – In March 2024, the Central Bank of Egypt moved the Egyptian pound to a floating exchange rate, resulting in a significant devaluation of the Egyptian pound, which has helped alleviate currency shortages.
- **Capital Inflows** – The IMF increased its lending support to Egypt; and ADQ, an United Arab Emiratesbased investment and holding company, announced plans to invest \$35 billion in the country.

### South Korea

Morningstar Indexes has classified South Korea as an emerging market since December 2014. Despite the large size of its economy and stock market, which is the 10<sup>th</sup> largest in the world by market cap), South Korea's foreign ownership restrictions and constraints on the convertibility of the Korean Won have kept the country limited to emerging market status. However, in recent years, South Korea has made significant improvements relating to currency trading hours, accessibility, information availability and corporate reforms.

### Lingering issues

Accessibility of the South Korean equity market has improved significantly in recent years. However, there are few challenges that persist, including:

- **Short-selling Ban** – Currently, South Korea has temporarily banned short-selling until June 2024.
- **Accessibility** – The lack of offshore trading for Korean Won still remains a concern.

### Improvements

Some of the significant improvements in South Korea over the past year include:

- **Currency Trading Hours** – Starting July 2024, the new trading hours will be from 9:00 AM until 2:00 AM the following day, providing greater overlap with trading hours in London and New York (5:00 PM GMT and 12 PM EST).
- **Clearing and Settlement** – The introduction of “omnibus accounts” to enable consolidated trading orders and settlements through a single account for foreign investors is a positive development.
- **Information Availability** – Listed firms with 10 trillion won (US\$7.62 billion) or more in assets will be required to make regulatory disclosures in English from the start of next year if 5% or more of their shares are owned by foreigners. Those with more than 2 trillion won but less than 10 trillion won in assets will be required to do the same when and if 30% or more of their shares are owned by foreign investors.

- **Corporate Reforms** – The "Corporate Value-up Program" seeks to correct a tendency for listed South Korean companies to have lower valuations than global peers due to factors such as low dividend payouts and the dominance of opaque conglomerates.
- **Foreign Ownership Limits** – The South Korean government is planning to ease regulations that limits foreign ownership in large companies deemed crucial to its economy. The government has identified 33 companies in telecom, aviation, broadcasting, media, and other key industries which earlier had restrictions.

## Turkey

Morningstar Indexes has classified Turkey as an emerging market since December 2014. However, in recent years, Turkey has experienced major headwinds related to a ban on short selling, which has been partially lifted since, and government interventions on currency convertibility, resulting in currency depreciation and inflation.

### Lingering issues

Accessibility of the Turkish equity market has deteriorated in recent years. Challenges include:

- **Macroeconomic Risks** – Turkey is currently experiencing high inflation, a large current account deficit and depleting foreign exchange reserves. Recent elections and political uncertainty have further added volatility to macro-economic risks.
- **Lira Depreciation and Institutional Intervention** – The Turkish Lira has continued to depreciate despite interventions by the Central Bank of Turkey to support the lira by purchasing lira selling US dollars. Additionally, the Central Bank of Turkey has directed the lenders to put portions of their lira required reserves into restricted accounts, thus pushing up interest rates and cutting the size of some banks loans, hurting liquidity.
- **Ban on Short Selling and Stock Lending** – The Turkish equity market was adversely impacted by the introduction of short selling and stock lending bans in 2020, which was gradually lifted for BIST 30 and BIST 50 index securities on the Istanbul Stock Exchange, but short selling is still banned for all other securities listed on this exchange.
- **Information Availability** – Not all regulations are available in English. Stock market information is not always complete and is not always disclosed in English.

### Improvements

There was a significant improvement in Turkey over the past year:

- **Capital Flows** – Turkish securities have experienced positive capital flows from foreign investors for the first time in 6 years due to improving sentiment following recent policy changes, including gradual interest rate increases, allowing Turkish lira to depreciate, terminating an FX-protected deposit scheme, increasing VAT, hiking tax on fuel and constraining government spending.

## Vietnam

Vietnam currently receives an unclassified market status, but it is a candidate for reclassification as an Emerging Market. Vietnam's development over the past 30 years has been remarkable. Economic and political reforms have spurred rapid economic growth, transforming what was then one of the world's poorest nations into a lower middleincome country. This country has two stock exchanges: Ho Chi Minh stock exchange and Hanoi stock

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exchange with the former as a major stock market exchange. It had an aggregate market capitalization of around USD \$246 billion as of December 2023.

### Lingering issues

- **Clearing and Settlement** – Vietnam does not meet the “Settlement Cycle (DvP)” criterion due to the market practice of conducting a pre-trading check to ensure the availability of funds prior to trade execution.
- **Restricted Foreign Ownership** – Foreign ownership is limited to 49% in most sectors, but that limit is as low as 30% for key sectors like banks.
- **Information Availability** – Information is still not readily available in English.
- **Low Liquidity** – The liquidity of many stocks listed in Vietnam remains low, as foreign investors remain cautious.
- **Ban on short-selling and stock lending.**

### Improvements

Some of the significant improvements in Vietnam over the past year include:

- **Centre Counterparty Model** – Vietnam Securities Depository & Clearing Corporation has been established to improve regulations related to depository, clearing and settlement of transactions.
- **New Trading Platform** – A new trading platform, KRX, is in final stages of launch and should be fully operational by May 2024. This should help facilitate the deployment of new products and services on the stock market.
- **Relaxed Settlement Process** – Following a practice from China, Vietnam is planning to launch a new stock trading system that would allow brokers to vouch for foreign investors when they buy shares, thereby giving foreign investors two days to settle transactions after they purchase shares instead of the current requirement where they must settle the transaction on the same day, which can be challenging.
- **Credit rating upgrade** – Fitch upgraded Vietnam's sovereign credit rating to BB+ from BB in December 2023.

### Consultation questions

Please answer the below questions and provide your feedback and reasoning:

1. Should Egypt be changed to Unclassified status from Emerging Market and be dropped from Morningstar equity indexes?
  - a. Yes
  - b. No
2. Do you have any other comments or feedback regarding the potential reclassification of Egypt?
3. Should South Korea be reclassified as a Developed Market from Emerging Market?
  - a. Yes
  - b. No

4. Do you have any other comments or feedback regarding the potential reclassification of South Korea?
5. Should Turkey be changed to Unclassified status from Emerging Market and be dropped from Morningstar equity indexes?
  - a. Yes
  - b. No
6. Do you have any other comments or feedback regarding the potential reclassification of Turkey?
7. Should Vietnam be reclassified as an Emerging Market from Unclassified and added to Morningstar equity indexes?
  - a. Yes
  - b. No
8. If Morningstar Indexes includes Vietnam as an Emerging Market, do you prefer the inclusion of stocks listed on Ho Chi Minh stock exchange and Hanoi stock exchange or ADRs trading on eligible US stock exchanges?
  - a. Listings in Vietnam
  - b. ADRs
  - c. Both
  - d. Other, please explain.
9. Do you have any other comments or feedback regarding the classification of Vietnam?
10. Are there any other markets Morningstar Indexes should monitor for future addition to or removal from the investable equity universe?

## Appendix: Supporting Information

### Appendix 1: Country Inclusion Framework

Morningstar Indexes maintains a watch list containing markets under consideration for a possible change in their classification and carries out an annual review for all such countries, in consultation with clients. The Morningstar Index Operations Committee reviews all potential changes. Notifications of changes are provided, at least 90 days in advance, where possible. This framework considers three main criteria:

- Degree of economic freedom
  - A score of 50 or above from the Index of Economic Freedom
- Country Income
  - A high- or middle-income country classification from the World Bank
- Depth of equity markets
  - More than \$5 billion in market capitalization
  - Ratio of market capitalization/GDP must be among the top 80%

### Index of Economic Freedom

The Index of Economic Freedom is a joint study by the Heritage Foundation and The Wall Street Journal that measures countries according to 10 factors of economic freedom:

- Business freedom
- Fiscal freedom
- Monetary freedom
- Financial freedom
- Freedom from corruption
- Trade freedom
- Government size
- Investment freedom
- Property rights
- Labor freedom

### World Bank Country Classification

For operational and analytical purposes, the World Bank's main criterion for classifying economies is gross national income, or GNI, per capita. The bank's analytical income categories (low, middle, and high) are based on the bank's operational lending categories (civil works preferences, International Development Association eligibility, etc.). These operational guidelines were established three decades ago based on the view that since poorer countries deserve better conditions from the bank, comparative estimates of economic capacity needed to be established. GNI, a broad measure, was considered the best single indicator of economic capacity and progress; at the same time, it was recognized that GNI does not, by itself, constitute or measure welfare or success in development. GNI per capita is therefore the bank's main criterion for classifying countries.

## Country Market Capitalization and Country Market Capitalization/GDP Ratio

The size of a country's equity markets should be material, or above \$5 billion. The market should exhibit financial depth; that is, the ratio of the size of the country's equity markets to its gross domestic product should be high. Countries that fall into the bottom 20% are ineligible for the index.

## Additional Country Inclusion Criteria

The following criteria are taken into account when determining country eligibility:

- The country's allowance of foreign investors to easily enter and exit the market, as well as to repatriate capital and dividends
- Accuracy and availability of real-time and historical market data
- The level of interest attracted by the market from international investors

## Developed- and Emerging-Market Classification

Countries are classified as developed if they meet all the following criteria:

- Annual per capita GNI falls in the high-income category, as defined by the World Bank, for the most recent three years
- The country must not have any broad-based discriminatory controls against nondomiciled investors for the most recent three years
- The country's stock markets must exhibit these characteristics:
  - Transparency
  - Market Regulation
  - Operational efficiency
  - Absence of broad-based investment restrictions

Countries that do not meet all the above criteria fall into the emerging-markets economic segment. For example, a country may be classified as high-income by the World Bank, but because of a lack of transparency within local markets, it falls into the emerging-markets economic segment.

## Appendix 2: Market Classification Status (Current)

### Developed Markets

Australia	Austria	Belgium	Canada
Denmark	Finland	France	Germany
Hong Kong	Ireland	Israel	Italy
Japan	Netherlands	New Zealand	Norway
Poland	Portugal	Singapore	Spain

Sweden	Switzerland	United Kingdom	United States
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### Emerging Markets

Brazil	Chile	China	Colombia
Czech Republic	Egypt	Greece	Hungary
India	Indonesia	Kuwait	Malaysia
Mexico	Peru	Philippines	Qatar
Saudi Arabia	South Africa	South Korea	Taiwan
Thailand	Turkey	United Arab Emirates	United Arab Emirates

### About Morningstar Indexes

Morningstar Indexes has been designing modern solutions for 20 years, but what makes us truly unique has been more than three decades in development. Our rich history began in 1984, when Morningstar was founded on a promise to empower investors with data and research that is independent and objective. Over time, our collection of data has expanded considerably—and so has its application. Today, Morningstar Indexes draws on unique IP to unlock an extensive range of emerging opportunities for investors of every kind, while providing a robust institutional beta platform for core investing.

### Contact Us

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