MARKET MATTERS

SIZING UP THE BRICS

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Twenty years ago in November 2001, Goldman Sachs economist Jim O'Neill coined the term BRIC, referring to Brazil, Russia, India and China. He argued that these four large emerging economies, that would grow rapidly and reshape the global economy and geopolitics, required increased global policy coordination and integration.

His paper spawned two somewhat unexpected children. Firstly, it became an investment 'megatrend'. Asset managers launched BRIC funds and investment banks jumped in with alternative combinations of emerging markets (like the MINTS and the CIVETS).

Secondly, and even more surprisingly, the four BRICs formed a formal political alliance in 2009. South Africa was generously invited to join in 2011, although it really is less of a BRIC and more of a briquette.

ODD ALLIANCE

The alliance is odd because these countries are so different. China and India have a history of armed border skirmishes. Russia is an energy superpower, while Brazil and South Africa compete as commodity exporters, with China as their main customer. China is a one-party state and no one believes Russia's pretences of democracy. South Africa, Brazil and India are imperfect democracies, though the latter two currently have leaders with authoritarian impulses. Russia is a former imperial power, while South Africa and India were part of the British Empire.

Even the pandemic experience was very uneven. Adjusted for population size, Brazil had by far the most deaths, followed by Russia. Where we stand today, China has vaccinated 85% of its population, Brazil 76% and India 56%. Despite developing its own vaccine, only 44% of Russians have been jabbed. South African lags even further behind, which is worrying given the new Omicron variant that seems to be driving the early stages of a fourth wave. This spooked not only local markets, but global markets too.

YOUNG AND OLD

Also consider demographics. China and India are the largest nations on earth with billion-plus populations. Brazil (212 million) and Russia (145 million) are the world's number six and nine respectively. South Africa is a relative minnow with 60 million people.

But the population growth profiles are very different.

Russia's population has started declining, apart from its dubious 2014 annexation of Crimea. China's now-abandoned one-child policy means population growth is very slow (its working-age population is shrinking).

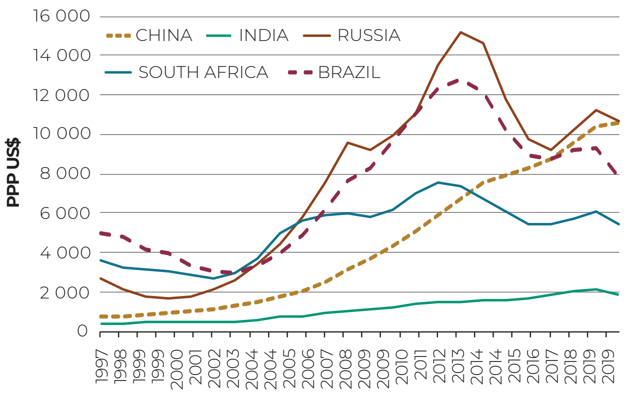
India and South Africa have young and growing populations. Brazil is somewhere in the middle. According to the UN, the median ages are as follows: Russia 40 years; China 38 years; Brazil 34 years; South Africa and India 28 years.

In comparison, Japan and Italy are the oldest countries on earth, with a median age of 48. At 15 years, the youngest country is Niger.

Having a young growing population should be a source of economic dynamism, partly because younger people spend more. But only if they have jobs. This is a challenge in India and especially South Africa.

Conversely a declining population is usually a drag on the economy, as the example of deflationary Japan suggests. However, Japanese people might not mind so much since they enjoy a very high standard of living. This is not true yet of any of the BRICS. A phrase commonly used in reference to China is that the country might grow old before it grows rich.

CHART 1: REAL INCOME PER PERSON IN US $



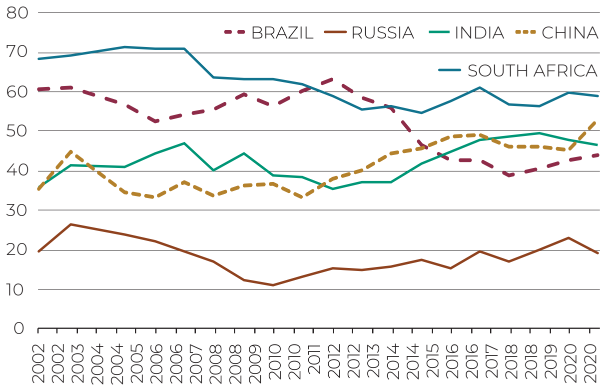
Source: World Bank

Despite its massive economy, the second biggest in the world, real income per person in China was only a sixth of the US in 2020 at $10 600 according to the World Bank (measured in purchasing power parity terms). Russia is at a similar level, with Brazil lower at $7 800 and South Africa even lower at $5 410. The World Bank categorises these four as upper middle income countries with income per head between $4 000 and $12 000. Income per person in Russia, Brazil and SA clearly followed the commodity cycle of the past two decades - which was in turn driven largely by China – rising in the first decade of the century and receding over the second.

India scrapes into the lower middle-income category with income per head of $1 900. This is slightly above where China was when it started its growth explosion in 2001 (more on this below). This begs the question of whether India can be the "next China" and become a globally dominant economy, and whether India will ever have a similar demand for resources. In most major commodity markets, China today accounts for about half of demand.

Long-term economic forecasts put India as the world's number three economy at some point in the 2030's, but any such projection needs to be taken with a grain of salt. On the one hand, it is quite possible given a young population, high savings rate and large diaspora that can recycle capital and know-how. On the other hand, China's growth has been incredibly investment-intensive. No other country has ever sustained an investment share of GDP above 40% as long as China has. Nor should they try. It has had a devastating environmental impact while also leading to much waste and misallocation.

CHART 2: CONTROL OF CORRUPTION INDICATOR RANK (HIGHER IS BETTER)



Source: World Bank

THE CHINA SHOCK

A few weeks after the Goldman Sachs paper was released, China became a member of the World Trade Organisation. This moment formally announced what was to be one of the most amazing transformations of the world economy since the Industrial Revolution in Britain in the 18th century and the rise of America in the early 20th.

China became the world's factory, transforming itself and the global economy in the process. From then on, most supply chains would run through China, something that we are only too acutely aware of these days.

This had a number of implications. Environmentally it has been a disaster, both in China where pollution levels are severe, and beyond since the country is now the world's largest carbon emitter (though the Chinese would point out that per capita emissions are about half that of the US). For the Chinese people, living standards have risen at an unprecedented pace and hundreds of millions were lifted out of deep poverty in the countryside thanks to stable urban jobs. But the flipside is that industrial workers in the West suddenly faced stiff competition, as average wages in China were substantially lower, even when adjusted for skill levels and transport costs. In addition, millions of workers from India and the former Eastern Bloc countries joined the global economy in the early 1990s, while the 1994 Nafta agreement saw Mexican workers compete head-on with their neighbours to the north. MIT economist David Autor has highlighted how this "China shock" had a very concentrated regional impact on the US, decimating cities and regions that specialised in particular types of industry, and that these areas were more likely to vote for Donald Trump in his surprise 2016 presidential win.

While some workers lost, global consumers gained. The cost of manufactured goods declined substantially. This kept a lid on overall inflation. As technology continues to improve, globalisation has not just shifted manufacturing jobs to lower cost countries, but also service jobs like call centres.

There is much of talk of "deglobalisation", but so far limited evidence. Trump's trade wars did little to simulate manufacturing or dent the US consumer's appetite for imported goods (Joe Biden has kept most of Trump's tariffs on China in place). Some firms are diversifying operations away from China towards other emerging markets such as the likes of Vietnam and Bangladesh (with a combined population of 260 million people). But so far very few companies have shut low-cost production in emerging markets to relocate completely back to America or Europe.

Therefore, beyond the current (upward) dislocation of prices, globalisation and technology are likely to continue to place downward pressure on inflation. Raise your prices or wages too far, and there is someone from a far-off place that will steal your customers.

This is one of many factors complicating life for central banks, as they look to normalise policy in the year ahead, at least in the case of the US Federal Reserve.

This in turn can lead to a tricky time for many emerging markets, including some of the BRICS. India, Brazil and South Africa were considered part of the fragile five (along with Indonesia and Turkey) back in 2014 when the Fed's previous hiking cycle was about to kick off. These countries faced weaker currencies and upward pressure on local interest rates. They are less exposed today, being somewhat less dependent on capital flows, but not immune.

HOW SOUTH AFRICA COMPARES

From a South African point of view, there are two other illuminating comparisons with our BRICS peer group.

The one is our sophisticated financial markets. China unsurprisingly has the biggest financial markets, with the A-share equity market valued at almost $8 trillion according to the Datastream index (though this is still a minnow compared to the US at almost $48 trillion).

Still, this is impressive given that the Shanghai Stock Exchange was only re-established in 1990. Though it dates back to the late 1860s, the market was closed first by Japanese invasion in 1936 and then the communist revolution in 1949.

Similarly, Russia had no stock market under communism and the adjustment to capitalism in the 1990s was rough. In 1998 it became one of the few countries to have defaulted on local-currency denominated bonds (most defaults happen when there isn't enough hard currency to repay foreign lenders).

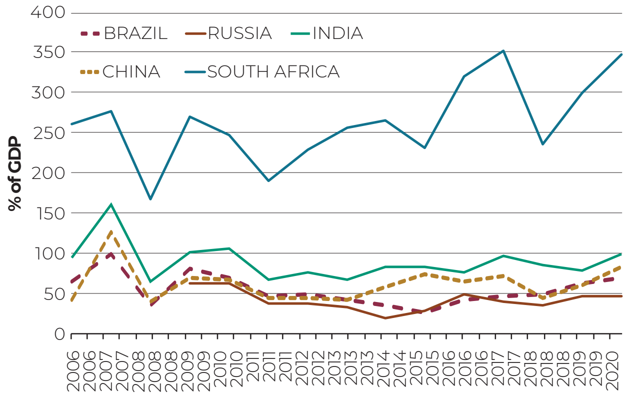
Somewhat similarly, Brazil's history of hyperinflation in the 1980s and 1990s has played havoc on its capital markets. Today, the market value of its stock exchange is only equivalent to 50% of GDP.

In contrast, South Africa's stock market value is more than 300% of GDP, well ahead of even the US or UK.

The Johannesburg Stock Exchange was founded in 1887 to fund gold mines and the capital intensive nature of mining explains its massive relative size from the start. These days however, the main reason is simply that it is dominated by global companies that have little to do with the domestic economy (Prosus, Richemont, BAT, BHP).

South Africa's foreign exchange market is even bigger relative to the size of the economy. This is a blessing and a curse. Sophisticated capital markets mean savers can put their money to work without taking undue risks, while borrowers don't need to look abroad for funding. However, it also means that foreign investors can potentially destabilise the domestic economy by moving "hot" money in and out.

CHART 3: EQUITY MARKET CAPITALISATION RELATIVE TO DOMESTIC ECONOMY, %



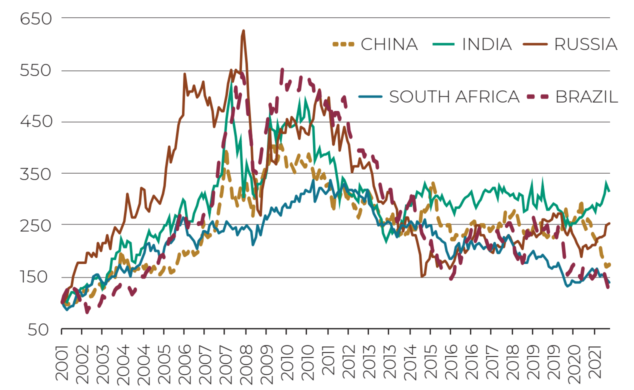
Source: World Bank

The second interesting comparison is on corruption, which is not as bad in South Africa as in the other BRICS, according to international measures such as the World Bank's Governance Indicators and Transparency International's Corruption Perceptions Index. This is not to say South Africa does not have a corruption problem, but the bigger problem is arguably incoherent polices and incompetent implementation.

NOT ALL STORIES HAVE HAPPY ENDINGS

Finally, a quick investment lesson. O'Neil's paper focused on how global governance would need reforming post 9/11, not on identifying investment opportunities. But marketers saw a gap and BRICS became a flavour of the month investment megatrend. Initially this worked very well, and all four countries (plus South Arica) outperformed global equities as exchange rates appreciated, credit flowed freely, commodity prices boomed and, importantly, a narrative took hold: these were the countries of the future.

CHART 4: BRICS EQUITY RETURNS RELATIVE TO WORLD EQUITIES IN US $



Source: Refinitiv Datastream

But as chart 4 shows, the future didn't arrive and by around 2011 the strong upward trend turned and the BRICS started underperforming the rest of the world as the dollar appreciated, commodities weakened and growth slowed. And of course, America's West Coast tech giants saw their share prices exploding higher.

The moral of the story is to be careful of blindly extrapolating trends and avoid getting sucked in by stories.

As seen over the past few days with the news of the new variant, emerging markets including South Africa and the BRICS tend to get the short end of the stick when global risk appetite declines. Omicron is a reminder that the pandemic is still very much with us, but until we have more information on how it affects people and responds to vaccines, nothing has fundamentally changed yet. Investors should therefore avoid making rash portfolio changes based on news headlines and recent market moves. Just as vaccination is still the best defence against Covid-19, appropriate diversification and patience remain investors' best defence against uncertainty and market volatility.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	3 132.0	-2.73%	-1.35%	16.43%	20.93%
United States	S&P 500	US$	4 595.0	-2.19%	-0.22%	22.34%	26.58%
Europe	MSCI Europe	US$	1 980.0	-4.49%	-4.53%	7.61%	12.44%
Britain	FTSE 100	US$	9 396.0	-3.24%	-5.17%	6.42%	10.54%
Germany	DAX	US$	1 621.0	-5.37%	-5.09%	-5.11%	9.45%
Japan	Nikkei 225	US$	253.6	-2.78%	0.09%	-9.31%	-0.37%
Emerging Markets	MSCI Emerging Markets	US$	1 223.0	-3.62%	-3.32%	-5.27%	-0.57%
Brazil	MSCI Brazil	US$	1 422.0	-0.49%	-0.42%	-24.20%	-16.35%
China	MSCI China	US$	87.8	-3.61%	-4.48%	-18.98%	-18.64%
India	MSCI India	US$	821.1	-4.81%	-2.37%	21.64%	33.07%
South Africa	MSCI South Africa	US$	413.0	-8.43%	-9.43%	-8.22%	-3.73%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	68 615.0	-2.50%	1.70%	15.50%	18.46%
All Share	All Share (Total Return)	Rand	11 125.0	-2.50%	1.72%	20.05%	23.34%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	27 184.9	-4.17%	-2.34%	17.25%	20.83%
TOP 40/Large Caps	Top 40	Rand	10 075.0	-2.29%	2.64%	19.34%	22.43%
Mid Caps	Mid Cap	Rand	18 037.0	-4.22%	-5.29%	18.92%	22.83%
Small Companies	Small Cap	Rand	24 764.0	-3.97%	-4.39%	44.22%	49.53%
Resources	Resource 20	Rand	4 882.9	-1.12%	1.72%	19.49%	30.32%
Industrials	Industrial 25	Rand	19 021.0	-1.75%	6.20%	20.83%	17.95%
Financials	Financial 15	Rand	8 431.0	-6.87%	-6.87%	11.71%	15.95%
Listed Property	SA Listed Property	Rand	1 510.3	-4.30%	-1.16%	22.79%	35.09%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	533.3	-0.03%	-0.28%	-4.56%	-3.05%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	790.1	-2.46%	-0.68%	4.11%	5.70%
Government Bonds	BESA GOVI	Rand	780.0	-2.42%	-0.66%	4.01%	5.69%
Inflation Linked Bonds	BESA CILI	Rand	299.0	-1.87%	-0.11%	10.33%	12.96%
Cash	STEFI Composite	Rand	480.5	0.07%	0.30%	3.42%	3.79%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	72.7	-7.87%	-13.48%	39.77%	51.42%
Gold	Gold Spot	US$	1 793.0	-2.87%	0.56%	-5.33%	-1.27%
Platinum	Platinum Spot	US$	956.0	-7.54%	-6.55%	-10.65%	-0.93%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	16.30	-3.44%	-6.44%	-9.88%	-6.76%
ZAR/Pound	ZAR/GBP	Rand	21.71	-2.49%	-3.92%	-7.51%	-6.49%
ZAR/Euro	ZAR/EUR	Rand	18.46	-3.79%	-4.76%	-2.76%	-2.00%
Dollar/Euro	USD/EUR	US$	1.13	0.00%	2.30%	8.14%	5.31%
Dollar/Pound	USD/GBP	US$	1.33	0.79%	2.71%	2.71%	0.46%
Dollar/Yen	USD/JPY	US$	0.01	-0.58%	-0.58%	9.73%	8.75%

Source: I-Net, figures as at 26 November 2021

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