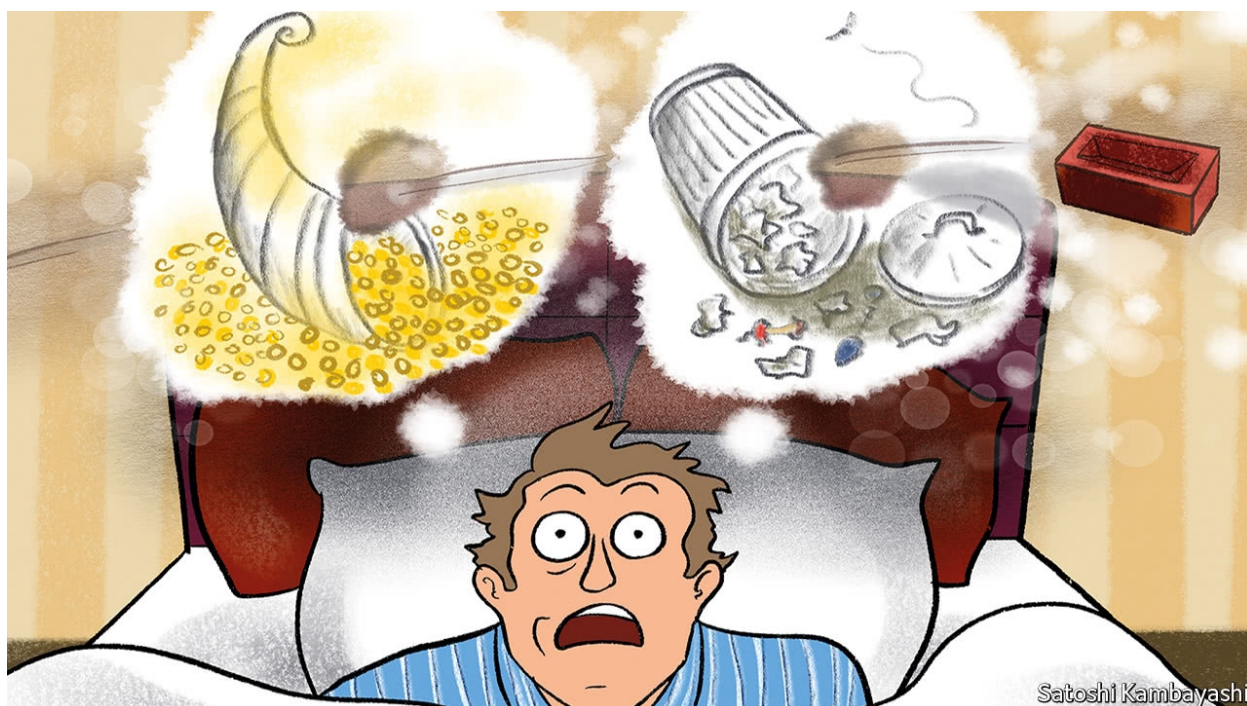


Awaking with Brics

Four BRICs don't quite make a wall

Brazil, Russia, India and China have done even better than forecast—thanks mainly to China



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EMERGING markets have been through a lot over the past four years. The “taper tantrum” in 2013 (prompted by fears of a change in American monetary policy); the oil-price drop in 2014; China’s botched devaluation of its currency in 2015; and India’s botched “demonetisation” of much of its own currency in late 2016 (removing high-value banknotes from circulation). But 2017 has started more brightly. Indeed, for the first time in two and a half years, the world’s four biggest emerging economies (Brazil, Russia, India and China, known as the BRICs) are all growing at the same time.

Russia's GDP bottomed out at the end of 2015 (using seasonally adjusted figures) after the longest recession since the 1990s. It has expanded at a gathering pace for the past three quarters. Higher oil prices have helped, though Russia cannot profit fully from the improved market by ramping up sales without violating the production limits that caused the market's recovery.

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During the collapse of the rouble in late 2014 and early 2015, it was easy to forget some of Russia's economic strengths, such as its consistent trade surpluses and its substantial foreign-exchange reserves (which never fell below \$300bn). As Russia has regained its footing, the rouble has rebounded, gaining 15% against the dollar over the past 12 months, making it one of

the world's best-performing currencies.

Brazil's torment has been even more prolonged. Its economy contracted for eight consecutive quarters as commodity prices tumbled, a president was impeached and a corrupt political class was impugned. Brazil's political scandals remain far from resolved, but at least the weather has improved. Generous summer rains in states like Bahia contributed to a bumper harvest of soyabeans and corn in the early months of the year. That helped Brazil's GDP expand by 1% in the first quarter (an annualised pace of over 4%). Since bumper harvests cannot be repeated every three months, some economists fear GDP may shrink again in the second quarter, but many forecasters believe growth will be positive for 2017 as a whole.

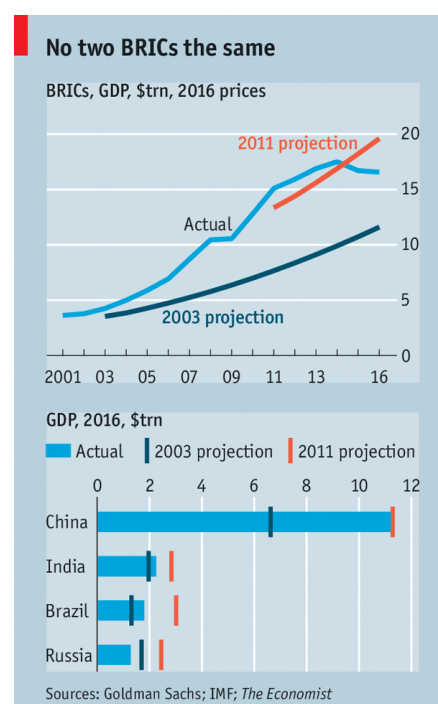
Faster growth has not jeopardised price stability. Rather, inflation has eased in Brazil, just as in Russia and India. Whether lower inflation will allow Brazil's central bank to make further big interest-rate cuts partly depends on a new political furore engulfing Michel Temer, the president. If that prevents the government from reforming social security and curbing fiscal excess, the central bank may be loth to soften its stance dramatically, lest fiscal indiscipline and monetary easing combine to weaken the currency and push up prices.

If inflation has been too high in recent years in Brazil, it has been too low in China. Thanks to downward pressure on prices and the currency, China's economy actually shrank in dollar terms in 2016 for the first time in 22 years. But the deflationary threat has since receded and the yuan has strengthened this year against the greenback, as capital outflows have been tamed. Indeed, China's central bank may have resumed adding to its foreign-exchange reserves, which increased by \$24bn in May, having declined by about \$1trn since their peak in 2014 as capital fled.

Will the resumption of growth in Brazil and Russia (and the return of "dollar growth" in China) breathe new life into the BRICs brand? The term was coined by Jim O'Neill, when he was chief economist of Goldman Sachs, and took on a life of its own. The countries' leaders began holding an annual summit, inviting South Africa to join as an additional member. They also set up a development bank, with its headquarters in Shanghai but headed by an Indian, which now has operations in all five countries, having approved its first loan to Brazil in April. (Lord O'Neill has always felt that South Africa, a country of only 56m people with a GDP of less than \$300bn, was too small to stand alongside his original quartet. And so far this year, the fifth member's fortunes have diverged from the others', as South Africa's economy slipped into a recession in the first quarter.)

Having christened the BRICs in 2001, Goldman Sachs later sketched out their futures over the next five decades in a paper entitled "Dreaming with BRICs", published in 2003. The investment bank then upgraded those growth projections in 2011 in light of the BRICs' strong performance over the previous decade. That proved to be a mistake. Of the four economies, only China's dollar GDP has kept pace with those optimistic 2011 projections (see chart). The others have fallen short of them by a combined \$3trn.

A similar disappointment befell stockmarket investors. The BRIC equity index compiled by MSCI has lost 40% since its 2007 peak. In October 2015



Goldman Sachs folded one of its BRIC equity funds, meant for American investors, into a broader emerging-market product (“a more holistic solution in emerging-markets equity”, in its words). These setbacks seemed to vindicate the curmudgeonly sneer cited by Peter Tasker, of Arcus Investment, dismissing the BRICs as a “Bloody Ridiculous Investment Concept”.

But if the BRICs have not sustained the euphoria of 2011, they have amply fulfilled the original “dream”, as articulated by Lord O’Neill in 2001 and quantified by his team two years later. Even after their recent tribulations, their combined GDP (\$16.6trn) remains far greater than the Goldman team envisaged back in 2003 (\$11.6trn). Only Russia has failed to live up to those early expectations. China has easily surpassed them. In Brazil, growth was slower than Goldman Sachs projected but the country’s real exchange rate appreciated further than they imagined, boosting its GDP in dollar terms.

Moreover, at some point after 2015, the BRICs became unmodish enough to count once again as good investments. Since Goldman Sachs closed its fund, the BRIC stockmarket index has gained almost 20%.

The trickiest problem for the BRIC concept may be its final consonant. China contributed about half of the club’s GDP in 2001 and now accounts for fully two-thirds of it. China is also home to most of the group’s biggest companies. Eight out of the ten largest stocks in the MSCI BRIC index are from China, including Alibaba, Baidu and Tencent (a tech trio that have their own acronym, BAT). As its markets grow and open up to capital inflows, China seems destined to become an asset class in its own right, one that is hard to contain in a “holistic” emerging-market fund, let alone a narrower four-country vehicle. The biggest threat to the BRIC idea may not be the quartet’s economic shortcomings but the singular success of its largest member.

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