BBVA Research

Cross-Country Emerging Markets Analysis

Economic Watch

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Economic Analysis

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Should South Africa be a BRIC?:

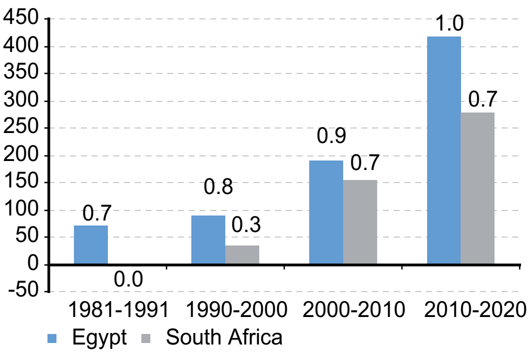
Not really: rather Egypt or – even better - Indonesia

- **After China's invitation, is South Africa worthy of BRIC status?** Our EAGLEs concept offers an objective approach to this question.
- **South Africa's expected contribution to global growth is only 2/3 of Egypt's** South Africa is the largest economy in Africa but we estimate it would be overtaken by Egypt by 2013.
- **South Africa would need to grow by around 6% in the next 10 years to get EAGLE status, versus our current forecast of 4%.** Not impossible, but not easy.
- **No country in Africa can be compared with the BRICs**
- **Indonesia is the next economic giant in the emerging markets, closely followed by Korea.** Both are in our view more relevant than the smallest BRIC, Russia.

The BRIC acronym has gained such prominence that South Africa's proposed participation in political meetings of the group has stirred up the debate about what BRIC status entails and how to measure the importance of emerging markets in the world stage. We think the controversy about South Africa being a BRIC is indeed a good example of the shortcomings of the concept years after its creation. Our own country group, the EAGLEs or "Emerging and Growth Leading Economies" attempts to overcome some of these limitations, offering a more objective criterion in this debate.

Chart 1

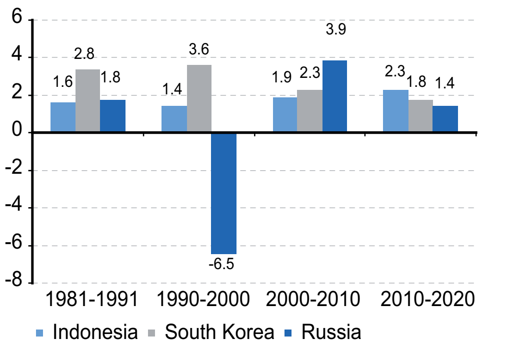
Why not Egypt?*



* Change in Gross Domestic Product. PPP USD billions Figures above columns = contributions to world growth (percent).
Source: IMF and BBVA Research

Chart 2

Or better still: Indonesia*



* Change in Gross Domestic Product. PPP USD billions Figures above columns = contributions to world growth (percent).
Source: IMF and BBVA Research

The EAGLEs concept

EAGLEs stands for "Emerging and Growth-Leading Economies" and the group includes all the emerging markets whose contribution to global growth is expected to be larger than that of the average G6 economy (ie. the G7 excluding the US) in the next ten years. There are actually 10 countries – i.e. ten EAGLEs – which fulfill this requirement. Ranked by their contribution to global growth, these economies are China, India, Brazil, Indonesia, Korea, Russia, Mexico, Egypt, Turkey and Taiwan. Notice that the EAGLEs methodology emphasizes dynamic measures (ie. changes in GDP, what we call "incremental GDP") versus more static or inertial variables (like GDP or population, which tend to dominate in existing emerging countries' groupings). South Africa serves as a good test of our methodology and how it differs from other approaches.

Why not Egypt?

South Africa is the largest economy in the African continent, closely followed by Egypt and much larger than Nigeria. Our current forecast for South African growth over the next 10 years is at around 4%, which would imply a continuation of the pace observed over the past decade. Given its size and growth, we expect South Africa's economy to contribute around 0,7% of global demand between 2010 and 2020 (chart 1, previous page). This is indeed a respectable figure (higher than Italy's or France's, in fact), but it falls short of our forecast for the average G6 economy. Accordingly, South Africa is not considered an EAGLE but is included in the "nest", or the list of countries that could actually get EAGLE status if their growth prospects improve in coming years. To be more precise, we estimate that it would take growth of around 6% to ascend into the EAGLEs group. While feasible, achieving this growth will not be easy, in our view, particularly taking into account poor demographic prospects and the structural difficulties in improving the functioning of the labour market.

Within the EAGLE group, the only African country which appears is Egypt, with an expected contribution to global growth of 1%. We expect faster growth in Egypt, which in fact has outperformed South Africa consistently for the last 30 years (and spectacularly so during the global crisis). Accordingly, our projections – which are in any event very close to consensus – expect Egypt will overtake South Africa as Africa's largest economy as early as 2013, measured in PPP terms.

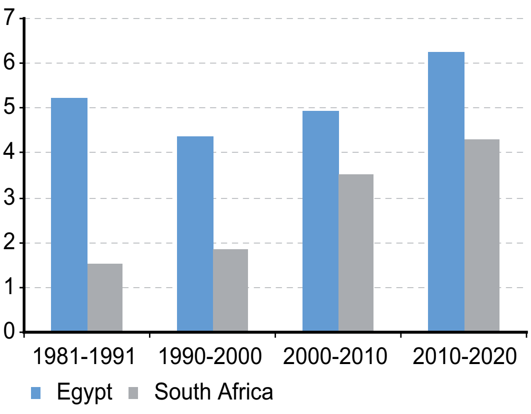
Another important takeaway from the comparison between South Africa and Egypt refers to the use of dollar values of GDP. Most analysts in this debate are focusing on the dollar value of GDP, which is clearly higher for South Africa. So much so, in fact, that South Africa would actually be contributing as much to world growth as Egypt even after considering its lower growth rate. However, using dollar measures of GDP does not seem warranted as it introduces unwanted volatility; particularly when the experience of the last 30 years shows the longer term trend in relative GDP is the same regardless of fluctuations in nominal exchange rates, even if the pace may be lower. Furthermore, exchange rates tend to converge to equilibrium, which for high-growth countries are bound to be stronger than current levels.

Egypt beats South Africa's growth record

Egypt's GDP expected to catch up with South Africa by 2013, and on track for matching its dollar size

Chart 3

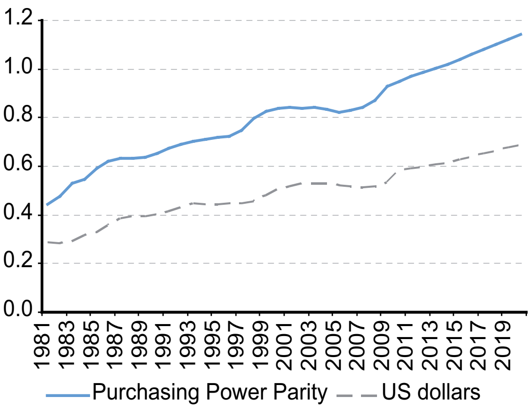
GDP growth rates



Source: IMF and BBVA Research

Chart 4

Egypt's GDP relative to South Africa. PPP and US Dollars



Source: IMF and BBVA Research

To summarize, we think South Africa is an attractive economy that could make it into EAGLE status with adequate policies but it is still somewhat far from being an EAGLE, let alone a BRIC. Like most observers, we are concerned about the evolution of its current account and the challenges posed by demographics and the labor market. Egypt's situation is not easy either: it has an uncomfortably high level of public debt so that it would be important to see faster reduction of its fiscal deficit. The recent bombing of a Christian church highlights the extent of religious conflict, and the questions about political transition remain. However, its contribution to world growth makes it more relevant for global economic trends and inside the EM universe. In view of this, while South Africa has other potential advantages in its developed financial markets and its democratic track record, we consider the proposal of including it in the BRIC universe to be more geopolitical than based on economic reasons. We have recently written about China's strategy for its partnership with Africa (see our Economic Watch "Africa forgotten: certainly not for China!") and South Africa's invitation looks like a step in that strategy.

The reality is that no economy in Africa has enough economic potential to compare with the BRIC group. We do not actually see compelling reasons for sticking with the BRIC reference, but If we had to choose just one single economy for inclusion, that sweet spot would go to Indonesia.

Better still: choose Indonesia

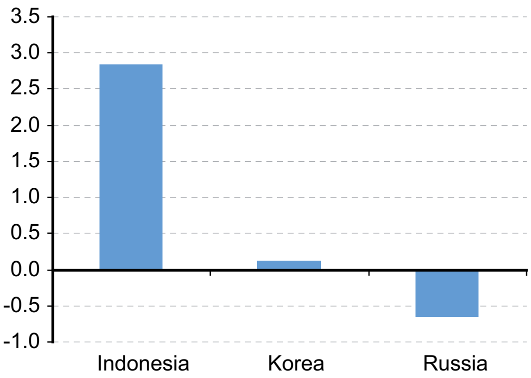
We have long held a positive view about Indonesia's growth potential and risk profile (see our Economic Observatory "Indonesia, a star performer" for a recent update). We estimate its average growth rate for the next 10 years at around 5.5%. Given our pessimistic view about Russia on account of demographic headwinds and institutional challenges, these forecasts would imply that Indonesia's contribution to world growth would be around 50% larger than Russia's, placing it as the fourth most relevant emerging market in terms of its dynamics (chart 2, first page of this document). South Korea would also surpass Russia's contribution to world growth. Even looking at GDP levels Indonesia looks like a very good candidate: we expect it to reach about 70% of Russia's GDP in 2020, making it large enough to exert significant influence in global economic trends and politics. As discussed when we launched the concept, we think incremental GDP should offer a better handle on investment opportunities and global relevance, particularly in a world where the relative stagnation of developed economies puts "extra" growth at a premium. That is why we would also advocate Indonesia before South Korea, even if it is a close call. Moreover, its underlying growth fundamentals, particularly population dynamics, look more robust than either Korea's or Russia's (chart 5). Its exposure to a double shock in China and commodities is high, but lower than for either of these two countries (chart 6). Market concerns about its inflation are overdone and should not affect the long term prospects of Indonesia. Since we agree with the view that the country should receive its investment grade credentials soon, the relative risk/reward profile in Indonesia looks particularly attractive.

Indonesia's growing population is a plus for internal demand

And its trade relationships are less exposed to China/ commodities shocks

Chart 5

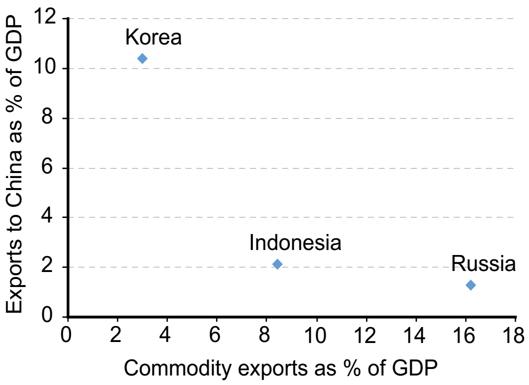
Contribution to growth of world population (%)



Source: UN and BBVA Research

Chart 6

Exports to China and commodity exports as a % of GDP



Source: UN, IMF and BBVA Research

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