InvestSense

April 2023

Look both ways before you cross the BRICS Road

The ongoing shift in economic and political influence from the West, represented by the United States and the G7, to the East, represented by China and the BRICS bloc of nations, has been grabbing headlines over the past few years. While this East versus West divide has seen periodic flare-ups, such as the Trump-inspired trade wars in 2018, South Africa has managed to stay out of the spotlight. Unfortunately, this is no longer the case, with South Africa increasingly in global news headlines due to its stance regarding the ongoing Russian invasion of Ukraine.

In this commentary, we will evaluate why South Africa increasingly finds itself in a compromised position, why it matters, and what the consequences would be for investors of a clear shift towards either the East or the West.

Setting the Scene

To understand South Africa's position in the current global economy, it is important to identify the key players in this arena.

There are two primary groups, referred to as the 'West' and the 'East'. The West typically includes countries with a history of Western European cultural and political influence, such as the United States, Canada, Australia, Western Europe, and other countries with similar worldviews and political systems. On the other hand, the term East, as it is used today, refers to countries with a history of influence from Eastern cultures, such as China, India, Russia, and Korea. These countries often have different worldviews and political systems (capitalism vs communism).

Although the West has long operated collectively through organizations like the G7 and NATO[1], the East, under China's leadership, has gradually embraced a more cohesive approach and established a distinct trade group in the past decade. This cohesive entity, commonly referred to as BRICS, is an abbreviation for Brazil, Russia, India, China, and South Africa. BRICS represents a formal alliance of four significant emerging economies worldwide, in addition to South Africa, encompassing nearly half of the global population and approximately 30% of the global GDP. It is important to note that BRICS does not imply an equivalence to the entire East, but rather reflects a specific grouping within the East.

The origins of BRICS can be traced back to 2001 when the acronym BRIC was first coined by Jim O'Neill, who was then the chairman of Goldman Sachs Asset Management. The BRIC countries recognized the need for a formal platform to enhance their cooperation and coordination on issues of mutual interest. As a result, the formalisation of BRIC took place on June 16, 2009, when the first BRIC summit was held in Russia. South Africa is aligned to the East, having formally joined BRIC (to make it BRICS) on December 24, 2010, becoming the fifth member of the association. The decision to include South Africa was based on the country's strategic importance in Africa and its potential to contribute to the growth and development of the BRICS economies. Importantly, being part of BRICS does not preclude South Africa from interacting with Western nations. During the 3rd BRICS summit in 2011, the countries agreed to create a new global governance model that reflects the changing economic landscape of the world. They also agreed to cooperate on a wide range of issues, including trade, finance, energy, and climate change. The 15th BRICS summit is set to take place in South Africa in August 2023.

Why does this all matter for South Africa?

While South Africa has been a member of BRICS since 2010, it has so far been able to trade relatively freely, facing only two minor disagreements with the US over agricultural exports in 2015 and aluminium tariffs in 2020. However, as the conflict between China and the US has intensified, so the tension between East and West has reached levels last seen during the Cold War. This could potentially strain South Africa’s ability to trade from this point forward.

South Africa is considered a small open economy, which means that it relies heavily on international trade to support its economy, rather than having a large enough internal market to be self-sustaining. For comparison, only three regional economies, namely the US, Europe, and China, would meet the self-sustaining criteria. Given South Africa’s reliance on trade, any restrictions on it would have a severe impact on the economy. Fears about potential sanctions are not unfounded, as recent cases involving Russia, Turkey, and Iran have seen their ability to trade curtailed by the West through economic sanctions.

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Which trade agreements are at risk?

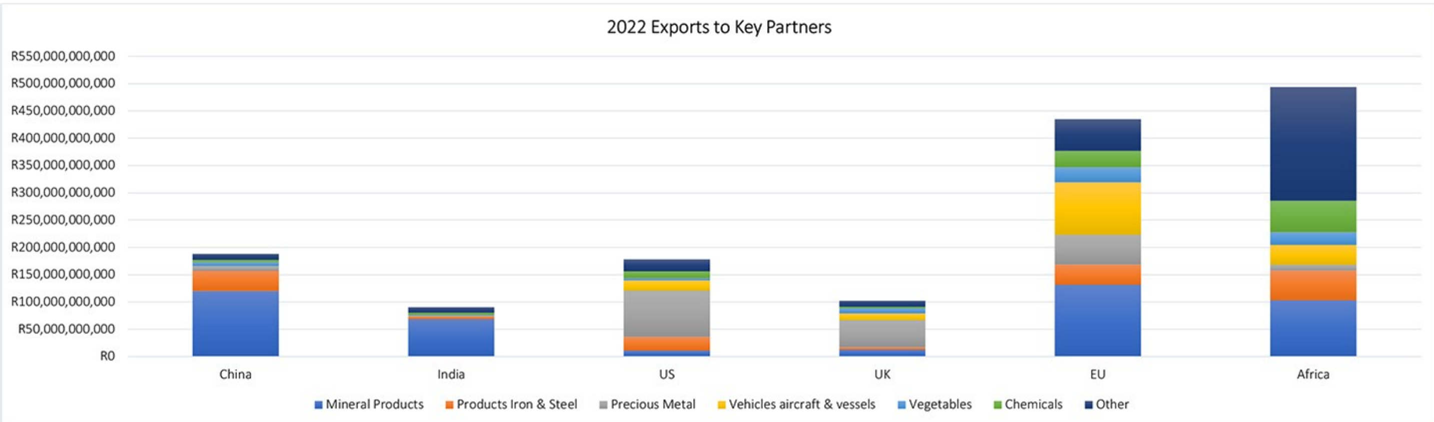
South Africa has several trade agreements, with the majority being within Africa. However, there are a few that may be at risk if South Africa takes an opposing stance to the West. These agreements include the African Growth and Opportunity Act (AGOA), which is a trade agreement between Sub-Saharan countries and the US that allows for duty-free exports from Africa to the US. South Africa exported roughly R41bn worth of goods to the US under this agreement in 2019 (this represents around 20% of total US/South Africa trade volumes). Additionally, there are three free trade agreements between South Africa and the European Union, Canada, and Japan respectively. Another agreement that could be affected is the Trade & Investment Framework Agreements (TIFA), which is a platform that facilitates bilateral trade discussions rather than covering any actual trade.

It is important to note that there are no formal, binding free trade agreements directly between the United States and South Africa. The primary risk from the United States would therefore be sanctions, which would restrict the flow of goods and reduce employment. Over 600 American businesses operate in South Africa, and many of them use South Africa as a regional headquarters.

Who do we trade with?

South Africa's largest bilateral trade[2] partner is China, with over R555bn of goods traded between the two countries in 2022. This is almost double the size of the next largest country, being the United States. If we look at this information on a broader regional level and focus on exports-only, then Africa accounts for around 25% of total exports. This, somewhat surprisingly, makes them the largest single group destination for our exports. Chart 1 shows the breakdown of trade for some key partners (BRICS represented by China & India, G7 represented by the US, UK & EU) in 2022. While these point-in-time values are interesting, the trend in trade values is far more interesting as presented in Chart 2.

Chart 1: Export Values to Key Partners in 2022



Source: South African Revenue Services

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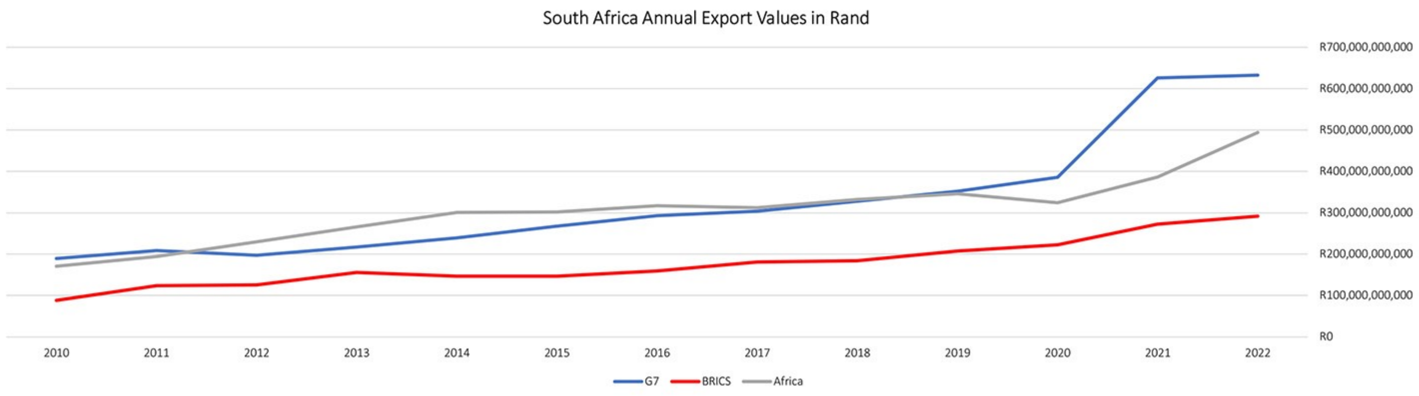
Chart 2: Annual Export Values for Key Groups



Source: South African Revenue Services

Chart 2 provides total export values in Rand to G7 nations as well as Africa and the BRICS nations. We focus on exports as these are at higher risk than imports if sanctions are implemented. The trend is surprising with G7 growth far outstripping BRICS growth despite the stronger ties engendered by the BRICS collective. If we dig deeper, we find that much of the rise in G7 export value has come from rising precious metals[3] prices from 2019 to present rather than growth in volumes of exports. With these rising prices precious metals now constitutes close to 50% of export value to G7 nations, up from roughly 30% in 2010. The world is currently reliant on South Africa's platinum group metals (PGM) supply, especially given that the other large global supplier of PGMs is Russia. This reliance is not necessarily enduring given the current drive to move towards electric vehicles.

The trend demonstrated in Chart 2 suggests that a pro-BRICS stance from South Africa is risky. If South Africa lost its ability to export to G7 nations, it would require exports to BRICS nations to more than double from their current levels to retain the status quo level of total exports. The wild card in this equation is Africa, if South Africa could improve their ability to export into Africa, then this reduces reliance on both the G7 and BRICS.

How would a clear shift in alignment impact investors?

Currently South Africa sits in a proverbial 'sweet spot', with both the Chinese-led BRICS grouping and the US-led G7 happy to engage and trade with us as a strategic partner and potential gateway to Africa. This position is becoming increasingly tenuous, with Western leaders speaking out against South Africa's actions, with a particular focus on our interactions with, and support of, Russia.

In this increasingly polarized world, we face headwinds from both sides. On the one hand, to continue to align more closely with BRICS, the country risks the cancellation of free trade agreements and sanctions being employed. In 2016 Madagascar was suspended from AGOA, following this it is estimated that their exports to the US declined by 42% and that 20,000 jobs were lost. If we simplistically apply this scenario to South Africa then this represents closer to R16bn in lost exports from this trade agreement alone. The number of lost jobs would be far greater than 20,000 for South Africa.

If this was taken a step further and sanctions were put in place there is evidence from both Russia (in 2018 and 2022) and Iran (in 2019) that this would have far-reaching consequences. This would have a negative impact on all asset classes, particularly our government bonds and the Rand.

The impact would not be felt equally, with those companies whose revenue is more exposed to Western nations (car exporters, precious metals miners) being heavily impacted in the short-term, while those with strong links to China (processed steel & base metals producers) would likely be better off. Ultimately, the hope would be that the demand for products from Western nations would eventually be replaced by that from the fast-growing East. This will take time to manifest, and as we have seen with Russian oil,

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we would likely have to sell goods below general market prices.

On the other hand, to stray too far from the prevailing BRICS 'kraal' could result in unilateral decisions by China and her allies to alienate South Africa. This was done to Australia in the mid-2010s during a trade dispute between the two nations. This resulted in an estimated 40% decline in Australian exports to China and an estimated R790bn cost to the Australian economy over a period of three years. Given that China is currently our largest single-country trade partner (comprising 65% of all exports to BRICS nations), and that BRICS is expected to comprise more than 50% of global GDP in the coming years, this severely curtails South Africa's future growth potential.

Neither of these outcomes is ideal, with severe impacts on both the real and financial economy being potential consequences. It is not out of the realm of possibilities for South Africa to be replaced by Mexico as the supplier of cars to Europe, or by Brazil as the supplier to China for their iron ore needs. Therefore, it is concerning that South Africa increasingly finds itself in a conflicted position between East and West. Changes in foreign policy can have an outsized impact on investment markets. South Africa experienced the positive impact of this post-Apartheid when its investment markets were essentially re-opened to the world.

Ultimately, South Africa’s relatively narrow drivers of export trade leave us vulnerable to global turf wars. There is significant opportunity within developing economies such as Africa and China, and they are already amongst our largest customers. However, the relative stability and financial clout offered by the G7 means they are a stable partner we need to keep on side to ensure our economic growth path delivers on its potential.

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[1] The north Atlantic Treaty Organisation is a political and military alliance formed by North American and European countries to promote collective defense and security.
[2] Bilateral Trade is the sum of exports and imports.

[3] Gold and platinum group metals.

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data provided by Refinitiv

MARKET REPORT

30/04/2023

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	-0.2%	8.7%	12.6%	20.2%	10.0%	10.9%	16.9%	14.3%
FTSE/JSE SA Listed Property	ZAR	1.0%	0.0%	3.3%	17.6%	-4.5%	1.2%	27.0%	21.7%
SA All Bond Index (ALBI)	ZAR	-0.7%	2.2%	6.4%	9.8%	6.8%	6.8%	8.0%	8.0%
SA Cash Index (SteFI)	ZAR	1.7%	2.3%	6.2%	4.8%	5.8%	6.2%	0.4%	0.4%
Balanced Benchmark	ZAR	1.4%	8.2%	11.9%	14.7%	9.6%	10.3%	11.7%	9.7%
SA Inflation (1 month lag)	ZAR	1.7%	2.1%	7.1%	5.5%	5.0%	5.1%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity (Datastream World)	USD	2.5%	9.8%	3.7%	13.6%	8.7%	9.3%	18.1%	14.6%
Emerging Markets Equity (Datastream EM)	USD	-4.7%	2.9%	-6.1%	4.7%	-0.7%	2.2%	18.9%	17.0%
Global Property	USD	-6.0%	2.7%	-14.3%	4.9%	3.0%	3.6%	18.4%	15.4%
Global Bonds (Barclays Global Bond Index)	USD	0.2%	3.5%	-2.3%	-3.9%	-0.9%	0.0%	8.5%	7.4%
Global Cash	USD	1.2%	1.6%	3.8%	1.4%	1.8%	1.2%	0.4%	0.4%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	-0.2%	8.7%	12.6%	20.2%	10.0%	10.9%	16.9%	14.3%
Global Equity (Datastream World)	ZAR	7.6%	18.0%	19.9%	13.5%	17.3%	17.3%	16.8%	15.5%
Emerging Markets Equity (Datastream EM)	ZAR	0.0%	10.5%	8.6%	4.6%	7.2%	9.7%	14.0%	13.6%
Global Property	ZAR	-1.3%	10.4%	-0.9%	4.7%	11.2%	11.2%	18.1%	15.8%
SA All Bond Index (ALBI)	ZAR	-0.7%	2.2%	6.4%	9.8%	6.8%	6.8%	8.0%	8.0%
Global Bonds (Barclays Global Bond Index)	ZAR	5.1%	11.2%	12.9%	-4.1%	6.9%	7.3%	15.2%	13.7%
COMMODITIES									
Gold (US Dollars)	USD	3.2%	9.6%	4.3%	5.3%	8.7%	3.1%	14.0%	14.7%
Gold (Rands)	ZAR	8.3%	17.8%	20.6%	5.1%	17.3%	10.7%		
CURRENCIES									
Rand / Dollar	ZAR	-4.9%	-7.5%	-15.6%	0.1%	-7.9%	-7.4%	15.8%	15.0%
Rand / GBP Pound	ZAR	-7.1%	-12.3%	-15.7%	0.3%	-6.0%	-5.1%	14.0%	14.7%
Rand / Euro	ZAR	-6.6%	-11.2%	-21.0%	-0.1%	-6.0%	-5.5%	13.9%	13.4%

Spot Rates		28-Apr-23	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	18.3	17.7	15.8	12.5	9.0	7.3
Rand/GBP	Rand	23.0	21.9	19.8	17.2	14.0	11.6
Rand/EUR	Rand	20.2	19.3	16.7	15.1	11.8	8.1
RATES							
Libor 6m $	US$	5.4	5.3	1.9	2.5	0.4	1.3
Repo Rate	Rand	7.75	7.75	4.25	6.50	5.00	13.50
Prime	Rand	11.25	11.25	7.75	10.00	8.50	17.00
All Bond Index Yield	Rand	10.2	10.0	11.6	8.8	6.8	9.7
COMMODITIES							
Gold ($/oz)	US$	1 990.4	1 976.5	1 908.5	1 313.2	1 467.6	338.3
Platinum	US$	1 074.0	981.0	932.0	905.0	1 507.0	603.0
Oil (Brent Crude) $	US$	79.5	79.8	107.8	75.0	101.6	23.7
INFLATION							
SA Inflation	%	7.1	7.1	5.9	4.6	5.9	9.4

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