“The role of BRICS in the global economy”

Address by Deputy Governor Daniel Mminele, at the Bundesbank Regional Office in
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1. Introduction

Good evening and thank you to Dr Andreas Dombret, member of the Executive Board of the Deutsche Bundesbank, and Ms Magarethe Müller, President of the regional office of the Deutsche Bundesbank for the opportunity to address you today on the topic of “The role of BRICS in the global economy”. Admittedly, this may have been a much easier topic a few years ago when the successes of the BRICS economies far overshadowed their weaknesses. As the challenges facing the BRICS economies have mounted, there are now many question marks over the economic power of the BRICS grouping and the ability to realistically challenge and change the global economic order to one which is more representative and fair.

Indeed, BRICS is not alone in the many challenges that it faces. Both advanced and emerging economies have slowed with each facing their own set of dynamics adversely impacting growth and which inter alia require bold actions in the implementation of much needed structural reforms.

It seems appropriate to be delivering this speech in the heart of Europe, a region which has vast trade linkages with the BRICS economies and where the economic influences are strong.

I would imagine that developments in Europe and the many challenges that this region has been confronted with lately, have occupied more of your attention than
BRICS matters have. European developments have certainly occupied the attention of policymakers in BRICS countries since, as we all know, we live in a highly interconnected and interdependent world with significant spill-overs across countries.

South Africa takes a keen interest in Europe, given large trade linkages and therefore significant implications for our economic prospects. The relationship between South Africa and Germany in particular, has been a long and fruitful one and certainly the contribution to South Africa’s development has not been insignificant. There are a large number of major German companies represented in South Africa, in particular in the automobile sector, as well as a number of small and medium sized enterprises. Approximately 600 German companies have operations in South Africa, employing over 90,000 workers. Such a presence contributes significantly to employment and skills-building, and no doubt, towards technological advancement in South Africa.

But let me turn to the topic of the speech. I will discuss BRICS in the South African and global context, more recent developments in terms of the slowdown in BRICS economic growth and focus on the successes of the BRICS countries. I will conclude with a brief update on economic developments in South Africa, which could be of interest to some of you.

2. BRICS and South Africa

The BRIC countries, as the grouping was initially known, admitted South Africa as a member to the club in December 2010. There were many criticisms levelled towards the inclusion of South Africa in this grouping, with the perception that South Africa’s economic size was just too small for it to have any benefits for the BRIC. However, if one considers the country’s large mineral resources; very well developed, deep and sophisticated financial markets; strong institutions and robust and expanding infrastructure programme, then surely South Africa’s presence in this grouping is not misplaced. In addition to South Africa being the only African member of the G20, its inclusion into the BRIC group provides it with a more representative structure and further emphasises the BRIC countries commitment to strengthening their presence

1 www.southafrica.diplo.de

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and engagement in Africa.\textsuperscript{2} Indeed, within the Sub-Saharan Africa (SSA) region, South Africa is the second largest economy, accounting for 21 per cent of SSA GDP. SSA is an important export market, and there are significant financial linkages in terms of foreign direct investment and a strong presence of South African firms in the South African Development Community\textsuperscript{3}.

South Africa’s trade with BRIC countries has expanded in recent years, as exports to BRIC countries grew from R20 billion in 2005 (EUR1 billion), to R154 billion (EUR9 billion) in 2013 (although this has since slowed to R147 billion (EUR8.5 billion) in 2015). Imports have similarly increased from R48 billion (EUR2.8 billion) in 2005 to R277 billion (EUR16 billion) in 2015.\textsuperscript{4} Much of the exports are destined for China, which accounts for 64 per cent of South Africa’s exports to BRIC, followed by India accounting for close to 30 per cent. The bulk of exports to BRIC countries consist of mineral products, although the percentage of mineral products in total exports in China, for example, has declined from levels of close to 80 per cent to 60 per cent in 2015. This most likely reflects to some extent the slowdown in China. In terms of imports from BRIC countries, China accounts for 72 per cent of South Africa’s imports from BRIC, followed by India with approximately 20 per cent. Most of the imports from China relate to machinery products and in India’s case, mineral products. Thus, while trade with BRIC countries has expanded, there has been a slowdown in export growth more recently, with a consequent increase in the trade deficit with BRIC countries.

3. **BRICS in the global context**

Increased globalisation has meant that BRICS has become an important source of global growth and political influence. BRICS economies have grown rapidly with their share of global GDP rising from 11 per cent in 1990 to almost 30 per cent in 2014. BRICS account for over 40 per cent of the world population, hold over US$4 trillion in reserves and account for over 17 per cent of global trade.

\textsuperscript{2} \url{www.brics5.co.za}, South Africa in BRICS

\textsuperscript{3} World Bank 2016 Global Economic Prospects: Sub-Saharan Africa

\textsuperscript{4} All figures in EUR quoted at exchange rates prevailing at the time.

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Financial markets in the BRICS countries have similarly expanded in a rapid manner. For example, in the 20 years until 2010, Brazil’s market capitalisation increased from a very low 4 per cent of GDP to 74 per cent, India from 12 per cent to 93 per cent, Russia and China from almost zero to 70 per cent and 81 per cent, respectively. In South Africa, market capitalisation has more than doubled from 123 per cent to 278 per cent. According to S&P Global Market Intelligence global bank rankings, banks from these five countries figured among the top 100 banks in the world, with the top 4 banks headquartered in China.

It therefore comes as no surprise then that these economies became the new engines of global demand. Having been victims of the global financial crisis, and suffering the impact of large and volatile capital flows and what Mohamed El Erian has referred to as “tourist dollars”, the BRICS countries were propelled into a common objective of reforming the international financial and monetary system, with a strong desire to build a more just, and balanced international order that reflects the dynamics of today’s global economy and serves the interests of all in a fair manner. To this end, the five countries in the BRICS community play an important role in the G20, in shaping global economic policy and promoting financial stability.

4. The future role of BRICS

Following an impressive performance in the aftermath of the global financial crisis, BRICS countries have recently started to slow. In this respect, there seems to be an awful lot of doom and gloom bandied about the BRICS in some quarters. Some have referred to the BRICS bubble bursting, others have noted that BRICS “instead of propelling the global economy into calmer waters, now risk capsizing it” and others question “why the mighty BRICS nations have broken?”

This slowdown has been reflected in a number of areas. Exports from BRICS to developed markets and investments into their respective economies have declined, while the collective contribution to global growth has fallen from a peak of nearly 50 per cent in 2013 to around 36 per cent in 2015. Real GDP growth of BRICS, which

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5 Whitman Lecture, What Lies Ahead for the Global Economy, A BRICS Perspective, October 2014
6 BRICS New World Order is now on Hold, Wall Street Journal, Davos 2016

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was over 8 per cent in 2010 declined to just over 4 per cent in 2015. In addition, the local currencies of BRICS, with the exception of China, has experienced varied levels of volatility following the onset of the global economic crisis.

As Christine Lagarde noted in a recent speech⁷ there have been three particular challenges confronting the global economy and also the BRICS countries. First is China’s growth transition and the rebalancing of its economy from industry to services, from exports to domestic markets, and from investment to consumption. In the short run, this will lead to slower growth with spill over effects through trade and lower demand for commodities. Global trade, which fell to 20 per cent below its pre-crisis trend, was driven by sluggish growth in advanced economies, and the maturation of global value chains which has further reduced the elasticity of trade flows to economic activity and exchange rate changes. Furthermore, higher capital requirements and tightened financial regulations have reduced banks’ willingness to extend trade finance, and the pace of trade liberalization slowed. Secondly, declining commodity prices has placed many commodity-exporting emerging economies under severe stress with very large currency depreciations in some cases and has set back growth in commodity-exporting BRICS. Third, asynchronous monetary policies has contributed to an appreciation of the U.S. dollar, putting considerable strain on emerging market currencies. Meanwhile, net capital flows to BRICS have undergone significant bouts of volatility, which have weighed on investment growth.

Until 2013, the slowdown was predominantly driven by external factors, however, the role of domestic factors has increased in the past two years and have come to the forefront as the predominant forces behind slowing growth in BRICS. This reflects declining potential growth, compounded by a deterioration in fiscal positions of BRICS and political dynamics which have dented confidence and increased pressure.

The question then is, does BRICS still matter and should it occupy so much of our attention? BRICS account for about two-thirds of emerging market GDP. The World Bank has estimated that in the event that growth in BRICS economies fell one

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⁷ The Role of Emerging Markets in a New Global Partnership for Growth, By Christine Lagarde, Managing Director, International Monetary Fund, University of Maryland, February 4, 2016

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percentage point below expectations, this would knock 0.8 percentage points off growth in other emerging markets over a period of two years and reduce global growth by 0.4 percentage points. The effects of a BRICS slowdown on other emerging markets and the global economy are significantly worse if one assumes that financial sector turbulence will also accompany the slowdown. These effects are a result of unintended knock-on effects, in the form of financial, trade and economic spill-overs. In this context, the BRICS are at an important juncture and the question is how does BRICS emerge from the current dismal conjuncture? It should be noted that the slowdown of BRICS hampers the scope for a speedy recovery of the world economy given the much greater weight of BRICS in the global economy.

As we have heard time and again, a combination of proactive countercyclical policies and structural reforms are needed to reinvigorate domestic economies and economic growth. While the recipe for success are of course not the same for all, the ingredients for success are mostly the same and include *inter alia* encouraging greater private sector investment, labour market reforms, stronger protection for intellectual property rights, and addressing infrastructure bottlenecks, amongst others. Given the sheer size, vast resources and youthful populations of the BRICS countries, the potential of this grouping for both domestic and global outcomes is beyond question. Indeed, recessions in Brazil and Russia and slower growth in South Africa are expected to bottom out this year, while China may experience only a modest slowdown and India continues to expand at a robust pace.

This brings me to the next point of my speech, which is the progress that BRICS has made in terms of collaborating and setting up institutions to help address common challenges and risks that lie ahead.

5. **The achievements of BRICS**

The BRICS grouping have achieved much since the first political dialogue in September 2006 and the first BRIC Summit which took place in June 2009. In the seven years since the first Summit, the BRICS countries have established the New Development Bank (NDB), and the Contingent Reserve Arrangement (CRA),

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amongst other initiatives. In my view, these are quite significant achievements in a relatively short period of time. For the purposes of this talk, I would like to focus on these two initiatives.

The establishment of the BRICS NDB marked a milestone in BRICS co-operation and as mentioned by some analysts is a testament of the “coming of age” of these countries in the world of development finance. Others have mentioned that the NDB was established to challenge the post-Second World War international economic order, that is, the Bretton Woods System. However, as has been indicated previously by many other BRICS colleagues, one of the objectives of the NDB is to promote South–South co-operation and to better serve the needs of developing countries through the promotion of infrastructure and sustainable development. Against this background, the NDB should rather be seen as a complement to, rather than a challenge or as competition to existing Bretton Woods institutions. In the future, the World Bank and the NDB may look to co-operate and by so doing, enhance the international development financing system.

The NDB is well under way in mobilising resources for infrastructure development projects. The NDB has appointed its first President and has a fully functioning Board of Governors and Board of Directors. The NDB has already disbursed its first funds for renewable energy projects in all five BRICS nations, while the NDB Board has also approved the first five year Yuan bonds. The NDB is in the process of seeking an international rating where after issuance on international markets will be pursued.

What makes the NDB a “new” development bank. Firstly, it has new financing sources in that the financing will come from the world’s major developing economies, within the framework of new South–South co-operation. Secondly, the financing is largely devoted to meeting the needs of developing countries for infrastructure development. This is different because MDBs are largely devoted to reducing global and regional poverty along with many other priorities, which limits the finance available for infrastructure development. Thirdly, it has new financing mechanisms which focuses on a more equal and balanced development partnership in the relations between major developing countries and with their smaller developing counterparts. The NDB plans to use market-oriented operations to reduce loan costs

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and provide innovative loan facilities so that developing countries will have a more robust, flexible and customer-oriented development finance service.\(^9\)

The CRA Treaty of the BRICS countries was signed in July 2014 and came into effect a year later with the finalisation of all the operational requirements pertaining to the Treaty. The CRA is basically a self-managed contingent reserve arrangement to forestall short-term balance of payments pressures, provide mutual support and further strengthen financial stability. Once again, as with the establishment of the NDB, the CRA is not meant to replace any financing arrangements under the IMF, but is rather a complement to existing international monetary and financial arrangements and in the main helps to strengthen the global financial safety net. The arrangement is important because it provides the possibility to quickly obtain additional liquidity in the event of a crisis. As yet, none of the BRICS countries have had a need to call upon the CRA.

There are a number of new initiatives being discussed under the BRICS agenda, with a view to furthering the work already undertaken and cementing the progress that has been made to date.

Allow me now to briefly touch on recent economic developments in South Africa, before I conclude my address today.

**Recent economic developments in South Africa**

The South African economy has slowed in recent years, from growing by almost 6 per cent prior to the global financial crisis, to a mere 1,3 per cent in 2015. In the first quarter of 2016, growth contracted by 1,2 per cent. South Africa has been buffeted by a number of negative developments, namely, the slowdown in China and reduction in commodity prices; weak demand in advanced and emerging market economies, as well the deterioration in growth prospects for the Sub-Saharan Africa region; policy uncertainty; and suffering one of the worst droughts on record during 2015/2016. According to the SARB’s most recent forecast the economy will only grow by a meagre 0.6 per cent in 2016. However, the Bank expects that the first

\(^9\) BRICS Insight Paper 2, New South-South Co-operation and the BRICS New Development Bank, by Zhu Jiejin

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quarter GDP number represents the low point, and a slow upward trend is expected going forward. This view is consistent with the favourable developments in a number of indicators, such as the Barclays Purchasing Managers Index for the manufacturing sector and an increase in the real value of non-residential building plans passed. A modest recovery is expected in the next two years, with growth forecast at 1.3 per cent and 1.7 per cent respectively.

Amidst a worsening growth outlook, the inflation outlook has also deteriorated with an extended breach of the 3 – 6 per cent inflation target expected, while inflation expectations remain at uncomfortably high levels. The exchange rate remains one of the biggest risks to the inflation outlook and highly sensitive to domestic political developments and the ever-changing risks associated with US monetary policy. Brexit is a further factor whose full impact on South African financial markets and the economy is still unknown. South Africa’s policy rate has been adjusted upwards by 200 basis points since January 2014, in line with rising inflation risks. However, it is quite obvious that the Monetary Policy Committee (MPC) faces a policy dilemma as reflected by the inflation and growth dynamics. The South African Reserve Bank operates within a flexible inflation targeting framework, and this requires carefully calibrated policy decisions. These decisions need to appropriately take account of the evolving international and domestic economic and financial markets environment. They also need to protect the credibility of the framework in managing inflation expectations. And while policy decisions need to be sensitive to growth dynamics, they also need to take into account that monetary policy cannot address structural deficiencies holding back the economy.

**Conclusion**

Let me then conclude by saying that the challenging times we face as the BRICS are by no means unique to us. Indeed, the entire global economy is at a difficult juncture at present. While we may have emerged from the global financial crisis, the recovery has by no means been as robust as one would have liked.

The challenges we face need to be tackled decisively and provide us with the opportunities to implement meaningful reforms, which ultimately can lead to strong,

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sustainable and balanced growth. Such efforts are well underway. What has been broken can certainly be fixed, and I have no doubt that the BRICS, along with the rest of the global economy, through better co-ordination and collaboration will emerge stronger.

Thank you.

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