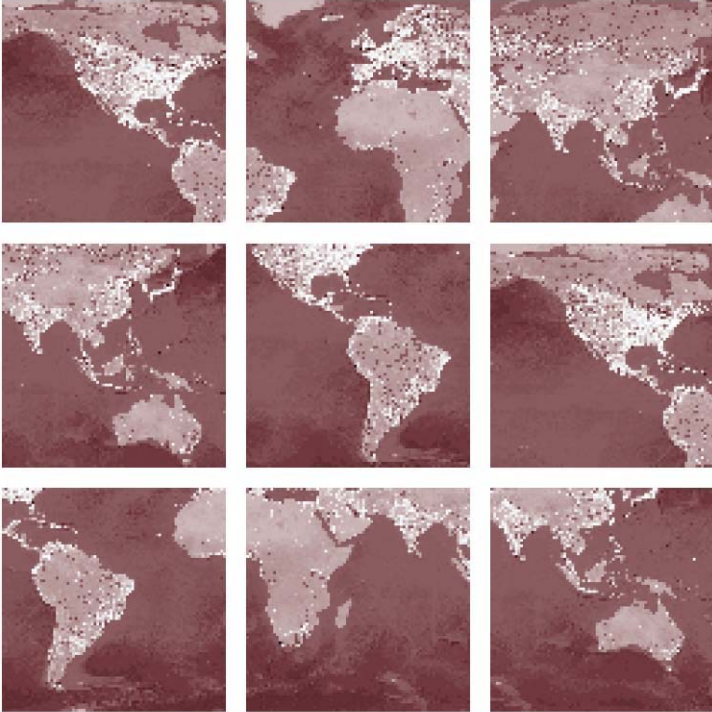


CHAPTER TWELVE

CURRENT ANSWERS (AND QUESTIONS) ABOUT BRICS AND THE N-11

July 2007





CURRENT ANSWERS (AND QUESTIONS) ABOUT BRICs AND THE N-11

Where We Stand on BRICs and the N-11

The BRICs story continues to be one of the most, if not the most, important investment themes of our generation, with more and more financial market movements influenced by these countries' economic progress and their actions. Linked to this, and judging from the many questions we receive, the N-11 'concept' also seems to be also gaining increasing traction in the investment community. Let us restate some key aspects of our long-term structural thinking to lay the ground, before answering some of the many questions we receive.

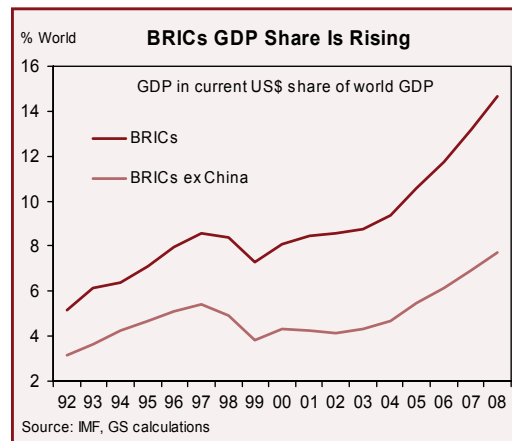
We first mentioned the term 'BRIC' back in Autumn 2001 (*Global Economics Paper 66: 'Building Better Global Economic BRICs'*) and argued that by the end of this decade, the share of the BRICs countries (Brazil, Russia, India and China) in global GDP would rise sufficiently to make it clear that the global governance of the world economy would need to change radically in order to incorporate them.

At the time, we presented four alternative scenarios of how the world might evolve up to 2010. In the event, the relative rise of the BRICs economies has been stronger than even our most optimistic scenario had envisioned. By mid-2007, they are already around 13% of global GDP in current US Dollar terms.

We have never suggested that the combined GDP of the four will *definitely* overtake the size of the G7. Our famous 2003 paper (*Global Economics Paper 99: 'Dreaming With BRICs: The Path to 2050'*) highlighted the fact that this is *possible* if the BRICs countries achieve their productivity potential. The possibility that the BRICs exceed the G7 in size before 2050 does seem a reasonable 'working model' for business, and the likelihood that they will do so appears to be growing.

In our most recent detailed study (*Global Economics Paper 153, 'The N-11: More Than an Acronym'*), we projected even more optimistic growth paths for the BRIC economies, in which China could overtake the US by 2027 and the BRICs combined could overtake the G7 by 2032. The box on page 155 has more details of our current projections.

As for the N-11, the main goal in introducing this concept was simply to study whether the next group of large developing countries with large populations had the potential to become 'BRIC-like'. We also sought to explain why we had selected only the original countries as BRICs—a question we have frequently been asked. In 2005 we had suggested that, of the N-11, only Mexico had the potential to be as big as the BRICs. However, our most recent paper (published in March) suggests that Indonesia may



Current Answers (and Questions) About BRICs and the N-11

also—at least in concept—given its very large population. Importantly, as we discuss below, the N-11 grouping is much more diverse than the BRICs, and in this way it is much more of a ‘typical’ emerging market investment theme.

Finally, it is important to recognise that even if the BRICs countries do achieve our most optimistic projections, the world’s wealthiest nations today will still be the wealthiest in 2050. As we have shown, helping the BRICs and N-11 countries to achieve their potential raises their wealth significantly—and ours too. Globalisation, in the aggregate, is a win-win game.

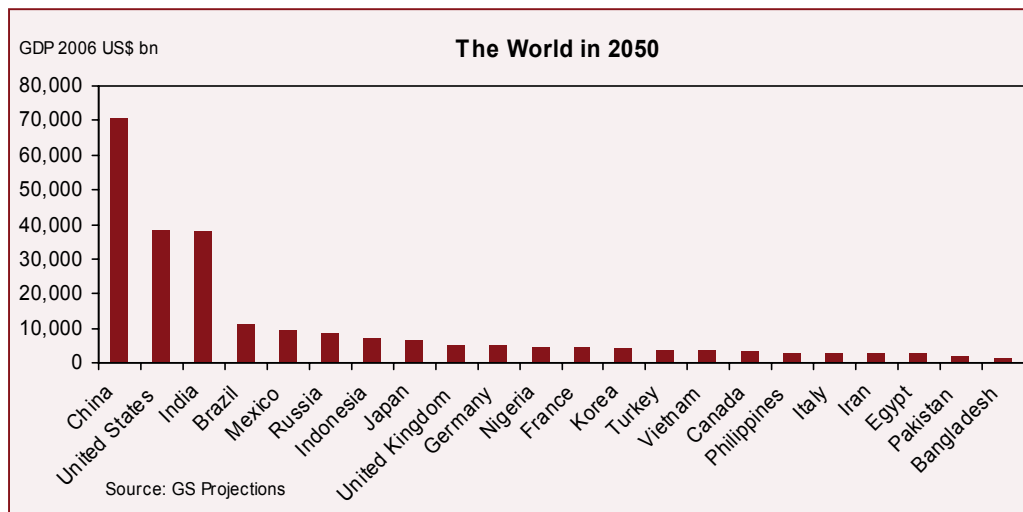
What Is the Latest With the BRICs?

The BRICs phenomenon remains probably the most important economic and investment theme of our generation. Contrary to the tone of some of the questions we now are asked, we have not introduced the N-11 as a ‘new theme’ because we have ‘tired’ of the BRICs!

In terms of economic growth, BRICs GDP growth generally continues to rise more quickly than we had assumed in even the most optimistic case in 2001. China recently revised up its 2006 real GDP growth to 11.1%, and last week reported Q2 growth at an 11.9% pace, stronger than expected. In Q1, its 11.1% growth pace actually meant that, for the first time in modern history, China contributed more to world GDP than did the US. (In current US Dollar terms, China is now around 6.5% of global GDP, while the US is just above 30%.)

Brazil is often regarded as the ‘least justified’ BRIC country, and we have heard much scepticism over the years about our decision to include it. But Brazil is now in the early stages of an accelerating growth phase where real GDP may expand between 4%-5% annually for some time. Brazil remains our current favourite among the BRIC equity markets, and the Bovespa is one of our live 2007 Top 10 macro trades.

China is poised to overtake Germany to be the world’s third-largest economy within the next few quarters. Brazil, India and Russia have all risen to around \$1 trillion in size; each is about 2% of world GDP, ranking somewhere between 9th and 12th largest in the world.



Our Revised BRICs Projections

Earlier this year we revised our BRICs projections for the latest information on the GES and the closer links between conditions and convergence speeds.

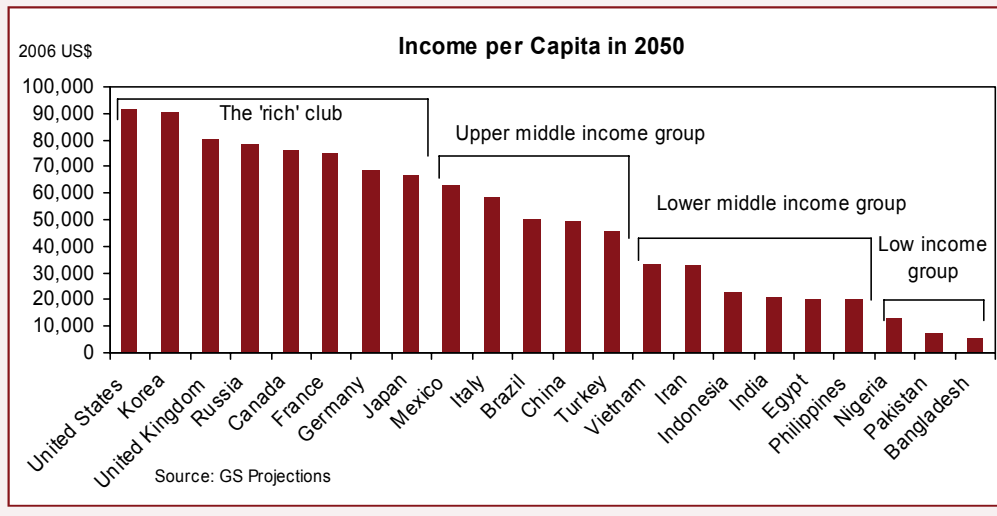
In general, the new projections show the BRICs as a group growing more rapidly than before. As a result, China could surpass the US earlier (2027 vs 2035) and overtake more dramatically than before (by 2050 it is projected to be 84% larger rather than 41% before). India too essentially could catch up with the US by 2050, where before it was projected only to reach 72% of the US economy. Projections for both Russia and Brazil are also somewhat higher.

The BRICs as a group now might pass the G7 in 2032 rather than 2040. Stronger recent performance, the recent upward revisions to Brazil's GDP (which show its economy now around 11% higher than previously recorded) and somewhat more optimistic assumptions about productivity growth are the main contributors.

Although the BRICs projections have become more optimistic as a result, our regional economists—at least for China and India—continue to produce work that suggests that their growth paths (at least over the next ten or 20 years) may still not be optimistic enough. For instance, Tushar Poddar's latest work on India suggests that the economy's sustainable growth rate might be around 8% until 2020 (not the average of 6.3% in our projections) and that India could overtake the US before 2050 (see *Global Economics Paper* No. 152 'India's Rising Growth Potential', January 22, 2007).

Our projections could be seen as conservative, as our country economists for both China and India currently believe. However, over a time span as long as the one we have used, there will likely be surprises in both directions. As a broad cross-country comparison, it is also important to stick to a transparent and consistent framework across the different groups.

The advantage of this approach is that it makes results clear and comparable. The disadvantage is that no simple framework will ever take into account all the specific factors that a country expert might see. Looking at those specific factors, our 'official' Chinese and Indian *forecasts* from our economists for the next decade or two would likely be higher than our BRICs projections. Our goal is not to provide explicit forecasts (a task we leave to our country economists), but rather to provide a reasonable way of benchmarking potential across a large group of economies.



Equities and Companies

In equity markets, while China and Brazil have been enjoying strong performances this year, India and Russia have taken a ‘rest’ (although in the past fortnight, India has started to move up again). Occasionally, some people ask whether the BRIC markets have become a ‘bubble’, but apart from generally modest valuations, broader analysis suggests this is far from the case.

In their recent regular presentation of the world’s top 500 companies by market capitalisation, the *Financial Times* magazine included 31 from the BRIC economies in total. Interestingly, they were evenly split, with eight each from China, India and Russia, and seven from Brazil. Of these 31, 12 companies were new to the list, and 12 had risen in the rankings since 2006.

If the BRICs’ 13% share of global GDP were reflected in this list, then there should have been something closer to 65 companies, i.e. more than twice the actual number. China alone would warrant more than 30 if the list were to reflect its share of world GDP. Given that we expect a relative growth acceleration in the BRICs, we may well see a significant shift in the composition of this list in the years ahead.

Of course, other markets are increasingly dominated by the BRICs. The growth of sovereign investment funds and the Chinese acquisition of nearly 10% of Blackstone are the latest of many examples. In foreign exchange, 2007 has seen the INR join the BRL in enjoying considerable nominal trade-weighted appreciation. There are also very recent signs that the pace of CNY appreciation is accelerating, and we are now forecasting nearly 8.5% further appreciation over the next 12 months. There are even some signs that the RUB is joining the currency party!

To be sure, the BRICs theme remains the biggest thing in town.

Are the BRICs Becoming More Involved in Global Policy Setting?

Unfortunately, only at a snail’s pace.

It has now become a regular custom for the G7 and G8 to invite the BRIC countries, and South Africa, to join some of their meetings. At June’s G8 Heads of State Summit, they were elevated to the dubious grouping of ‘outreach countries’—something many of them may regard as a bit of an insult. On a slightly more encouraging tone, the OECD has announced that it has started dialogue with the BRIC nations about how they can become integrated into the OECD umbrella—which is more than can be said for the IMF.

As we said when we first wrote about the BRICs, their rapidly rising significance makes it imperative that they assume a bigger representative position in all areas of global governance. Whether it be global warming, energy demand and pricing, global imbalances or sovereign investment funds, the optimal global solutions to global challenges both today and in the future require their equal presence. The more time that passes without a faster change in global governance, the greater the likelihood of major policy errors.

FT Global 500: BRICs Companies

| Global rank | | Company | Country | Market value \$bn |
|-------------|------|---|---------|-------------------|
| 2007 | 2006 | | | |
| 6 | 10 | Gazprom | Russia | 245.91 |
| 9 | n/a | Industrial and Commercial Bank of China | China | 224.79 |
| 23 | n/a | Bank of China | China | 165.51 |
| 35 | n/a | China Construction Bank | China | 128.53 |
| 41 | n/a | China Life Insurance | China | 116.28 |
| 50 | 48 | Petrobras | Brazil | 105.88 |
| 53 | n/a | Sinopec | China | 104.01 |
| 68 | n/a | Rosneft | Russia | 88.50 |
| 74 | 117 | Vale do Rio Doce | Brazil | 86.14 |
| 95 | 76 | Lukoil | Russia | 73.49 |
| 103 | 232 | Sberbank of Russia | Russia | 70.48 |
| 131 | 234 | Unified Energy System | Russia | 58.10 |
| 152 | 94 | Surgutneftegas | Russia | 51.33 |
| 166 | n/a | Bank of Communications | China | 47.07 |
| 182 | 284 | Reliance Industries | India | 43.87 |
| 187 | 158 | Oil & Natural Gas | India | 43.21 |
| 196 | n/a | Ping An Insurance | China | 41.67 |
| 205 | 205 | Bradesco | Brazil | 40.85 |
| 208 | 222 | Banco Itau | Brazil | 39.72 |
| 239 | 376 | MMC Norilsk Nickel | Russia | 35.36 |
| 244 | 266 | Ambev | Brazil | 34.73 |
| 257 | 443 | Bharti Airtel | India | 33.29 |
| 265 | n/a | China Merchants Bank | China | 32.44 |
| 313 | 286 | National Thermal Power | India | 28.41 |
| 319 | 367 | Tata Consultancy Services | India | 27.72 |
| 331 | 362 | Banco Brasil | Brazil | 26.90 |
| 345 | 414 | Infosys Technologies | India | 25.83 |
| 469 | n/a | Reliance Communications | India | 19.76 |
| 475 | n/a | Mobile Telesystems | Russia | 19.61 |
| 487 | n/a | Itausa | Brazil | 19.30 |
| 500 | 430 | Wipro | India | 18.69 |

Source: Financial Times Magazine 30 June / 1 July 2007

Market values as of 30 March 2007.

Is the N-11 as Good an Investment Theme as the BRICs?

As discussed above, we created the N-11 concept simply to describe the next set of large countries from the developing world, and to analyse their own BRICs ‘potential’. They are *not* to be regarded in the same light as the BRICs. This is not least because two of them, Korea and Mexico, are already OECD members. On a large number of measures, Korea is as developed as many of the most developed economies. For example, its 2006 GES (our Growth Environment Score), was 6.9—the same level as the United States.

The N-11 countries are a very diverse group in terms of their stages of economic development and wealth. They are geographically diverse, with six in Asia, three in the Middle East and Africa, and one each in Europe and Latin America. Indeed, the group is so diverse than in terms of a diversified approach to emerging markets, they probably represent a very suitable basket of countries.

In this sense, it is not surprising to see the emergence of N-11 investment funds. These arguably have better diversification properties than many others. As we have argued on many occasions, we would not regard the BRIC countries as typical ‘emerging markets’ in the truest sense of the phrase. They are a rising and integral part of the modern globalised economy, while at least for now, most of the N-11—except Korea and Mexico—are more ‘typical’ EMs.

N-11 2006 Economic Snapshot

| | GDP (US\$bn) | 2001-06 Average GDP Growth Rate (%) | GDP Per Capita (US\$) | Population (mn) | Trade openness (% GDP) | GES |
|-------------|-------------------------|--|----------------------------------|-------------------------|---------------------------------------|------------|
| Bangladesh | 65 | 5.7 | 427 | 144 | 45.8 | 3.2 |
| Egypt | 101 | 4.2 | 1,281 | 72 | 58.9 | 3.7 |
| Indonesia | 350 | 4.8 | 1,510 | 222 | 58.1 | 3.4 |
| Iran | 212 | 5.7 | 3,768 | 70 | 54.5 | 4.4 |
| Korea | 887 | 4.5 | 18,484 | 48 | 72.5 | 6.9 |
| Mexico | 839 | 2.3 | 7,915 | 104 | 56.6 | 4.6 |
| Nigeria | 115 | 5.6 | 919 | 150 | 71.0 | 2.7 |
| Pakistan | 129 | 5.3 | 778 | 155 | 39.4 | 3.1 |
| Philippines | 118 | 5.0 | 1,314 | 87 | 101.0 | 3.6 |
| Turkey | 403 | 4.6 | 5,551 | 73 | 55.1 | 4.0 |
| Vietnam | 61 | 7.6 | 655 | 84 | 143.2 | 4.5 |

Source: IMF, World Bank, UN, GS

Aren't Some of the N-11 Countries Risky?

Of course, some of the N-11 countries are risky! The GES scores for some (Bangladesh 3.2, Nigeria 2.7 and Pakistan 3.1) rank towards the lowest among all the 170 countries that we monitor. Iran is of course a country that invokes particular surprise, but if you look at its GES scores, it scores a relatively high 4.4. Other N-11 countries have higher scores. In addition to Korea's high score (it ranks higher than all the BRICs as well as the rest of the N-11), Vietnam scores a relatively high 4.5 and Mexico 4.6.

This diversity helps to give the N-11 some considerable attractions as a 'basket' of low and high risks. Moreover, it goes without saying that modest steps towards reform in some of the least developed would raise their potential attractiveness considerably.

In some ways, Nigeria is especially interesting. It is Africa's largest country by population, about three times the size of South Africa. It is interesting that Nigeria's current leadership has embraced our N-11 research as part of its goals to become one of the world's top 20 nations by 2020. What an achievement it would be for Nigeria and for Africa if that were to be the case.

At its broadest level, the N-11 theme relates centrally to the future of globalisation. In all the growing and complex debates about globalisation, it is surely appropriate that some of the world's largest populations develop their economies successfully enough to dramatically raise their living standards. If globalisation cannot help deliver this, then it is right to be challenged. We are highly encouraged that many of the N-11 countries have shown a positive response to our research about their future potential, since it is only by adopting reforms and raising their GES scores that they can they achieve the economic size and wealth that their population sizes should allow for.

Jim O'Neill
July 25, 2007