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EMERGING COUNTRIES: WHAT ECONOMIC PROSPECTS? WHAT STOCK MARKET APPEAL?

"The difficulty lies not so much in developing new ideas as in escaping from old ones", John Maynard Keynes

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- **Should we invest in emerging stock markets?** Over several years, the economic growth differential is in favour of emerging countries, but the stock market performance differential is in favour of developed countries. So can a market catch-up be expected? Or is there a tangible explanation for this underperformance? Is not the convergence between emerging countries and developed countries an old idea from which we should try to escape? This is the aim of this report.

- **Emerging countries have succeeded in a fantastic catch-up in recent decades**. In 1980, they accounted for scarcely more than one-third of global GDP, and recently 52%. Some benefited from their commodity wealth, while others skilfully profited from a technological catch-up. Some of them, supported by a vast domestic market, have been able to attract investment by multinational firms. Many generate a growing current-account surplus which protects them in the event of a crisis. All have benefited from progress in the elimination of illiteracy, and from longer life expectancy.

- **However there are sharp contrasts between these countries**. To consider just the much-vaunted BRICs, China's GDP (with $12,300 billion in 2016 according to the IMF) is more than twice as large as the sum of the other three (India $2,400 billion, Brazil $1,900 billion and Russia $1,400 billion).

- **In recent years growth rates have been lower**, the catch-up effect has been somewhat exhausted, and political crises may have discouraged investment in some countries. In 2018, the OECD looks for 1.9% growth in Russia and Brazil, 6.6% in China and 7% in India. So growth in China and India remains high, in South Korea and Singapore it is satisfactory at around 3%, but nearly all these growth rates are well below the rates of the 1980s and '90s, and some large countries - Brazil, South Africa, Russia and Nigeria - have suffered recessions. The debt burden is far higher than it was a few years ago. This is true for households, in Thailand (78% of GDP) and in South Korea, and it is even more true for businesses, in India, China and Turkey and in many other countries.

- **What can be expected for the coming decades?** Among the positive factors for emerging countries note the potential for an improvement in productivity but not any further population growth. China, Russia, South Korea, Iran, Eastern Europe and many Latin American countries are hardly any different from Europe, and the strong population growth of India and Africa can sometimes be a problem. Among the positive factors for developed countries, progress in automation and the development of 3D printers will make it possible to keep or re-shore industries depending on cheap labour. If protectionism were to become more widespread, it would adversely affect “workshop” countries. Global warming, if it progresses, will adversely affect many emerging countries located in tropical regions. We may add to this picture the fact that the big Western multinationals have solid market shares in emerging countries and largely capture the growth of these economies. So, in terms of the long-term trend, the stock markets of developed countries still have advantages by comparison with stock markets of emerging countries, and the emerging countries will remain vulnerable to capital flows, positive in the past two years, negative in previous years and possibly again in the second half of 2018. Capital outflows weaken the currency, resulting in imported inflation, rising interest rates, a contraction of investment and hence a fall in the stock market.

China:

Since the start of the Industrial Revolution in the 18th century, China is indisputably the country that has seen the fastest spell of economic growth. In 2000 its GDP was only $1,000 billion; by the end of 2016 it exceeded $12,000 billion. The reason for this success is an incomparable investment rate, still more than 45% of GDP, boosted by a very high savings ratio and low consumption - less than 40% of GDP, which is half the percentage in the United States.

1. **Progress made:**

In 1990 China produced 5% of global GDP on a purchasing power parity basis, it now accounts for 18%. From 3% of global industrial production it has now grown to around one-quarter, and on this basis its per capita GDP is equivalent to that of South Korea in 1989. Even with growth slightly lower than 7%, half that of in the 1990s, China is the leading contributor to global growth, accounting for about one-third. Every year, its GDP increases by the equivalent of the GDP of Switzerland, and China is a unique example among emerging countries for the quality of its infrastructure. That said, this explosive growth should be put into perspective: per capita GDP, at one-fifth of US per capita GDP, ranks only 74th in the world, making China a middle-income country, and one that will remain so.

2. **Geopolitical ambitions:**

History teaches us that China has not been an aggressive power towards the outside world. Even now, defence spending represents only 1.3% of GDP, a high amount in absolute terms ($140 billion), but one-quarter of Russia's percentage and a long way from the $620 billion of the US budget. China has only two aircraft carriers where the United States has ten, and it has 300 aircraft, i.e. one-third of the number in the United States. The main areas of tension are in the China Sea. China wants to assert its presence there, because it is the route travelled by one-third of global maritime trade and because, by extending its control to certain islands, it wants to obtain access to reserves of gas and rare minerals located offshore. Examples are the Spratly and Paracel islands, an archipelago of islets extending over several thousand kilometres south of China towards Vietnam, the Philippines and Taiwan, and the Scarborough Shoal, less than 200 kilometres from the Philippines, rich in gas reserves. We may add to this the

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ambitious Silk Road project, i.e. the determination to bring western China out of its isolation, to open up overland trade routes and enable Chinese building firms to offset the slowdown in the domestic market. But project execution is sometimes impeded by a determination to protect independence or not to offend India. For example, several countries, including Myanmar, Nepal, Pakistan and Kashmir, have refused the execution of dam projects that the Chinese said they were prepared to finance, provided that they could have ownership rights.

3. Ongoing reforms:

The reforms are **political**, including the fight against corruption, **economic,** with a determination to reduce overcapacity, and **strategic**, through the promotion of new technologies and automation. At its recent congress, the Chinese Communist Party decided to reassert the role of state-owned enterprises, establish large public-sector groups by facilitating alliances, and postpone the globalization of the yuan. There are numerous issues and challenges. Agricultural, because China has only 7% of the world's arable land, often polluted, to feed 17% of the world's population. Then demographic, due to ongoing urbanization. 250 million people are set to migrate from the countryside to cities between now and 2025.

4. Population ageing:

In 1960, the under-15 age group represented around 40% of the population, and in 2016 only 18%. The over-60 age group numbered 200 million in 2015, and this will rise to 450 million in 2050. To counter negative effects such as the recent decline in the labour force, the government has decided to push back the retirement age, but other measures will have to be taken.

5. Debt management:

According to the Bank for International Settlements (BIS), since 2008 the debt of the non-financial sector has increased from the equivalent of 60% of GDP to 260%. The problem is not so much household debt, which is moderate at less than 40% of GDP, as opposed to corporate and local government debt. This spiralling debt has resulted in significant overcapacity and lower returns on capital employed. For example, according to the IMF, whereas ten years ago $1.3 of credit generated $1 of GDP, the ratio is now four to one.

To curb the spiralling increase in local government debt, the central government has raised the official interest rate slightly to 2.5% and is stopping certain projects, such as the construction of a metro system, a project costing $4.6 billion, in a city of around three million inhabitants in Inner Mongolia. This example explains the slowdown in investment growth.

An improvement in the situation of the banks and in corporate margins is perceptible and could give fresh impetus to the rise of the stock market, currently driven by technology, and in particular Tencent

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which has a market capitalization exceeding $500 billion, and Alibaba, which at $475 billion is not far behind.

To conclude, let us repeat the expression used at the latest congress, the desire to have regained "by 2050, two hundred years after the Opium Wars, the leading position" which it had held. Is this credible? Certainly, but what is the sustainability of a growth model focused on investment but perverted by debt? How robust or how fragile is this single-party regime? It is hard to predict.

Russia:

1. **Relative decline**:

According to Angus Maddison's statistics, Russia accounted for 8.5% of global GDP on the eve of the 1914-18 war, 9.5% in the 1950s and only 2.8% now. Per capita GDP, again in 1914, exceeded that of Spain, whereas now it represents only one-third of Spanish GDP. Between 2002 and 2007, Russia's growth ranged between 6% and 9%. Now, in the wake of a recession, the expectation is for less than 2%.

2. **Demographic weakness**:

Russia is one-sixth of the planet, four-fifths of the area of the former USSR, and though, just over half of the USSR's population. But this apparent power conceals demographic weakness. Due to emigration (more than 350,000 in 2016) and insufficient births (100,000 in 2016), the country is being depopulated. From 145 million, the population could, according to some forecasts, fall to 110 million in 2050, unless there is a recovery in the birth rate. Putin, anxious to stop this population decline (by 0.3 million in 2017), is offering benefits to young parents for 18 months (€205 per month in Moscow, €150 in Saint Petersburg).

3. **A cyclical upturn:**

The recession (-3.5% in 2015, -0.2% in 2016) has ended, growth is expected to reach 1.7% in 2017, the official unemployment rate is 4.9%, public debt remains low at 10% of GDP, the recent rise in the oil price above $60/barrel and the increase in exports to a record level of 5.2 million bpd all make it possible to balance the budget, offering Vladimir Putin some leeway to consolidate an election success next year. But traces of some difficulties remain. Admittedly, of the various members of the BRICS, Russia, according to the World Bank's statistics, is by far the richest in terms of per capita GDP, with $24,000 compared with $15,000 in Brazil, $14,000 in China and $6,000 in India. But, at the trade-weighted exchange rate of 2016, GDP in 2016 just exceeded $1,400 billion, roughly the GDP of Spain, which is three times less populous, and far lower than the $2,200 billion of 2013. Real income declined by around 6% in 2016, following a drop of more than 3% in 2015, and the number of Russians below

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the poverty line increased to around 20 million, or 14% of the population. A positive factor is lower inflation, which allowed several interest rate cuts. But the growth of the Russian economy is hampered by the austerity of thirty months of sanctions imposed by the United States, and the recent weakening of the currency is possibly in anticipation of further sanctions.

4. **Structural weaknesses:**

With half of the government's revenues derived from oil and gas production and with one-third of GDP accounted for by oil and gas exports, Russia has the features of a rent economy. And this rent is insufficiently used for infrastructure development and is devoted excessively to financing a defence budget which amounts to $70 billion, or 5.5% of GDP. The rent is insufficiently devoted to productive investment, which amounts to not even 20% of GDP. In the new 2018 budget, Vladimir Putin reduces spending on roads and education, and increases by more than 30% defence spending, which accounts for 30% of the national budget. According to Fitch, household income has declined by 11% since 2013.

More fundamentally, the growing control of the economy by the state and state-owned enterprises is somewhat regrettable. The liberalization which prevailed until 2005, reducing the public sector's weight to 35% of GDP, was followed by a reverse trend, and at present three-quarters of GDP comes from the public sector. Additionally, we are forced to face the facts: on the eve of 1914, Russian industry was equivalent to that of Germany, whereas it now represents not even one-third of it, and it is hard to find strengths outside the defence industry.

Persisting large capital outflows testify to a lack of confidence among the major economic players, undermined by insufficient protection of property rights, discouraged by bureaucracy and penalized by low competitiveness. To reverse the trend, some of the reforms recommended by Alexei Kudrin ought to be applied: diversifying the economy, investing in new technologies and encouraging private business start-ups.

5. **Politically :**

Russia has asserted its presence on the international stage, carrying out numerous actions in Syria, the Baltic and the Donbass, strengthening its presence in the Kurils, resolving to set up military bases in the Arctic, and above all overlooking Yeltsin's 1992 veto of a resolution of the Russian parliament bringing into question the handing over of Crimea to Ukraine. In short, a lot of money spent (not forgetting the $7 billion for the construction of a bridge between Crimea and Russia), but few signs of a resolution of the crisis in these various theatres of operation and a relative diplomatic isolation.

Regarding the twelve countries of the CIS (Commonwealth of Independent States), Yeltsin's commitment to respect territorial integrity has been flouted twice, in Georgia in 2008 and in Ukraine in 2014, and Russia’s ally Kazakhstan fears an annexation of the northern part of the country with a Russian-speaking majority.

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- In China, previously smaller in terms of GDP and now nine times larger, the alliance is ambiguous, since the country represents less than 15% of Russia's trade, the sale of anti-missile systems by Russia and cooperation in the field of energy are not guarantees of a lasting friendship and, with the expansion of the Silk Road, Russia will find it hard to contain a Chinese alliance with Russia's former allies.

- In Europe, exports have almost halved since 2012, to €120 billion, and imports have fallen from €120 billion to about €70 billion. Europe is still the leading economic partner, accounting for 40% to 50% of trade, but political relations are on hold.
- In the United States, the love affair with Trump turned out to be merely an illusion.
- In the Middle East, diplomacy with Turkey is not easy, the past history of thirteen wars is a heavy burden, and rivalry between Turkey and Iran, two countries with similar populations and living standards, cannot be ignored for long, since each country dreams of asserting its presence in the region. Regarding Syria, it is hard to see how Bashar al-Assad could legitimately stay in power after so many massacres.

6. **The market's relative attractiveness:**

The market valuation is attractive compared with that of the other emerging countries. One feature, and a differentiating factor, is the weight of energy stocks, representing about half the market capitalization. This resulted in underperformance when oil prices were low, and is a factor in the expected upturn at present.

Paradoxically, the currency weakened recently even when the oil price had gained 15% relative to its low in October.

India:

1. **This is above all a story of fantastic population growth:**

Just think that in 1845, before Queen Victoria became Empress of India (1876), India had only 130 million inhabitants. It now has ten times more. This population boom is a recent phenomenon: the 1950 census reported less than 380 million inhabitants. And this expansion, a major difference with China, is set to continue, so that by 2030 India's population will exceed that of China.

A comparison with the median ages of Russia and China is edifying. India is only at 28, Russia at 39 and China at 37, and ageing rapidly.

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This youth is both an asset and a challenge. A challenge because it will be necessary to finance education for a country which still has a 30% illiteracy rate (versus 5% in China) and which devotes only 2.7% of its GDP to education. Admittedly, since 1980 the percentage of children not attending school has fallen from 50% to 10%, but, except for the elite, the quality of education and teachers is mediocre, teacher absenteeism is high, as is that of pupils, and the country therefore runs the risk of wasting its demographic asset. A challenge, because it will be necessary to create 12 million jobs each year, something completely unprecedented in a country which, in recent years, has created less than half that number and in which labour force participation rates, especially those of women, are very low. A challenge, because with 60% to 70% of the population employed in a relatively unproductive agricultural sector which generates less than 15% of GDP, numerous restructuring operations and redundancies can be expected. A challenge, because although the service sector accounts for more than 50% of GDP, it provides only 28% of jobs. A challenge, because the rate of urbanization is still only 35% to 40%. A challenge, because the expansion of the middle classes will have a formidable impact on pollution. Just consider that India has only about thirty cars per thousand inhabitants, whereas China has close to 100 and the United States has more than 760.

2. **Handicaps: the weakness of industry, of infrastructure and of corporate finances.**

In 1750, India accounted for one-quarter of global industrial production, while on the eve of the 1914-18 war the figure was 1.3%. At the same time, the colonial power, England, had seen its share increase from 2% to 13.5%. More recently, from the start of the 1990s, India's weight in global GDP measured in purchasing power parity terms has increased from slightly more than 3% to 7%.

Today, manufacturing activity accounts for only 16% of GDP, way below the 30% level observed in China. There are not many flagship sectors, apart from petrochemicals and pharmaceutical generics. Tourism, with less than 10 million visitors each year, is still not very developed; this is one-third of the number for China, and just a quarter in revenue terms.

Today, research and development spending does not exceed 1% of GDP, half that of China, and one-quarter of the South Korean level. Not surprisingly, India does not even register 1% of international patents, very far from the 5% level of China.

Indian industry currently suffers from the small size of its companies. Whereas, in China, half of the companies have more than 200 employees, the figure in India is only 10%. A study by McKinsey estimates that only 270 companies have revenues exceeding $125 million, whereas there are around 7,700 such companies in China, around 3,500 in Russia and 1,300 in Brazil.

India is still not a very open economy: it exports only 20% of its GDP, accounts for only 2% of global trade and slightly more than 3% of trade in services, and although its current-account deficit is less than

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the 5% level posted a few years ago, it is nevertheless close to 2% of GDP. One of the causes is the importing of 80% of the oil consumed, and good quality coke.

Today, the investment rate is only 28% whereas emerging countries generally devote more than 35% of their GDP to investment. But India suffers from a shortfall in local savings, less than 30% of GDP, and has problems attracting foreign investors. The $50bn to $60bn in foreign direct investment each year, barely equivalent to 2% of GDP, represents less than 3% of international flows, while foreign investment stocks represent only 13% of GDP, or on average half the percentage of other emerging countries. This low level of investment explains why the country is lagging behind in infrastructure. Another reason for this lag is the fact that railway companies struggle to invest, because they keep prices too low and try to compensate for this by increasing freight prices, which diverts traffic to the road and saturates the network. Many electricity companies are not profitable, because they still provide smallholder farmers with electricity free of charge.

The financial position of businesses and banks is another problem. Businesses are heavily indebted, they allocate more than one-third of their operating profits to the payment of interest and bank charges, and they seem to give priority to debt reduction as compared with investment. For the banks, non-performing loans exceed 15% of their total loans, and the percentage is far higher for loans to local businesses. The total amount exceeds $140 billion, which is why the government recently approved a recapitalization of public-sector banks by more than $30 billion within two years, as they account for 70% of bank loans. In the meantime, private investment has stagnated recently, and this is not offset by the stimulus of public investment in port, road and rail infrastructure.

3. **Another handicap is the persistence of administrative barriers.**

In various rankings regarding the business environment, India always has low scores. Of 190 countries, India ranks 79th for the level of corruption, and 130th according to the World Bank rankings for ease of doing business! Many infrastructure projects are held up by the difficulty of expropriation, and labour regulations are an obstacle to layoffs. These two reforms appeared in Narendra Modi's election programme but have not been implemented.

4. **A less favourable economic environment despite ambitious reforms.**

Modi's government has undeniably made reforms benefitting the economy to reduce bottlenecks. We note the reduction in petrol price subsidies which has enabled the state to generate a capacity for investment in infrastructure, the permission for foreign interests to acquire up to 49% of the capital of insurance companies, railway infrastructure or cable networks, the policy of increasing the number of taxpayers liable to income tax (currently around 1%) and broadening the tax base, which represents barely 15% of GDP, i.e. a percentage less than the average for emerging countries and among the lowest in the world. Finally, note the introduction of VAT in July 2017. This is a major tax reform, although its

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application is rather complicated, with four rates between 5% and 28%, a dozen exemptions and a lot of forms to be filled in.

GDP growth is expected to reach 5.7% this year, a flattering figure but well below the 7% posted in recent years, although admittedly in a context of sharply falling oil prices which had previously boosted growth by 1 to 2 percentage points. This can be blamed on the removal from circulation of around 80% of bank notes, which penalized the underground economy and growth in a country in which around 60% of households do not have a bank account, and where the underground economy is estimated at more than 20% of GDP. Fortunately, falling inflation has made it possible to cut interest rates, and this will boost lending and investment. Also fortunately, two good monsoons have increased income and in the last quarter industrial production growth recovered to 7%.

By way of a **conclusion**, from the economic, stock market, monetary and geopolitical viewpoints, take note that India is no China. Their populations are fairly similar, with India set to exceed China by 2030, but India's GDP is five times smaller. China's foreign exchange reserves alone, amounting to $3,100 billion, exceed India's GDP. From a stock market viewpoint, at more than 20x projected earnings, the market is expensive. From the monetary viewpoint, Moody’s more favourable opinion regarding Indian risk has meant a reduction in the interest-rate spread and a 4.5% appreciation of the currency against the US dollar this year. From a political viewpoint, relations with Trump's America are unclear, with Putin's Russia they are impeded by Russia's policy of moving closer to China and selling it arms, and lastly with China, apart from the eternal border dispute in Kashmir, relations remain handicapped by Chinese aid worth around $60 billion provided to Pakistan for the development of a trade lane on the Silk Road.

Africa: "He believes that he knows, he doesn't know that he believes", Jean Rostand

Africa has 51 countries and covers an area equivalent to the Europe, the United States, China and India combined. So it is hard to speak of it as a block. In the 1980s and '90s, the situation in Africa was a constant concern. Since the year 2000, the opposite feeling prevails. Is this justified? We shall endeavour to be less clear-cut, bearing in mind Rostand's ironic remark about a dogmatic scientist.

1. **A demographic challenge:**

In the space of 65 years, life expectancy in Africa has increased by more than 20 years, to 57, but the fertility rate is still extremely high at 4.7 children per woman, far above the figures for Asia and Latin America, at 2.1 and 2 respectively.

In 1980 Africa had 10% of the world's population. By 2050, the figure will be 25%, and by 2100, some estimates suggest 40%. In concrete terms, from 1.2 billion at present, the population will reach 2.5

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billion in 2050, and the population of Nigeria will increase from 190 million to more than 400 million. Two-thirds of growth in the global labour force by 2050 will be in Africa, which means that it will be necessary to create 450 million jobs over the next twenty years - definitely a challenge. How can one imagine rapid economic development of a country such as Niger where the number of children per woman amounts to 7.5 and where the population doubles every 22-24 years?

Admittedly, population growth means the opportunity of new markets, but it also means challenges such as job creation, education (because millions of children do not attend school), urbanization and pollution.

2. **Contrasting economic results:**

There are clear contrasts from one country to another and from one region to another, because East Africa has seen more rapid growth than West Africa. Some countries such as Ethiopia still post a growth rate of close to 10%, while others, such as Nigeria and South Africa, are in recession or just coming out of it.

As a percentage, the proportion of the population that is poor decreased from 56% to 43% between 1990 and 2012, but in absolute terms there has been an increase in the number of poor people, from 280 million in 1990 to 345 million in 2015.

Agriculture employs 70% of the population but it is insufficiently productive and the good lands are often acquired by foreigners.

Indebtedness was one of the major components of recent growth and, in a recent study, the IMF points to debt servicing which accounts for 12% of government revenues, versus 5.4% as recently as 2011. The public debt of the 18 countries of Sub-Saharan Africa followed by Fitch amounts to 52% of GDP, almost double the 28% recorded in 2011. Of the major countries, South Africa exceeds this level, with a debt ratio of 54% of GDP, while Nigeria is still far behind, at 20%. Of the small countries, Mozambique should be watched, with a ratio of 90%.

3. **Political instability:**

Admittedly democracy is spreading. From four countries in the early 1990s, the continent now has 25 democratic countries out of a total of 54. But it is estimated not only that one-quarter of the population of the countries of Sub-Saharan Africa live in regions of conflict, but also that more than one-third of the conflicts on the planet in the past fifty years have occurred on this continent which has only 15% of the world's population. About twenty countries are very vulnerable. Some states, such as Niger for example, with few savings, are forced to spend 6% to 7% of their GDP on defence, often to no good purpose. The state is often weak, not very capable of ensuring the rule of law, and so-called Islamic State and other organizations find fertile breeding grounds there.

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4. **Obstacles to economic development:**

Corruption is widespread. Infrastructure is very insufficient and the construction of railway lines is too costly. More than 600 million people do not have access to electricity. The banking sector is often not very active in lending. The manufacturing sector accounts for scarcely more than 10% of GDP. Africa accounts for only 1.5% of global industrial production, half less than forty-five years ago, and what's more, this production is heavily concentrated in South Africa and Nigeria. Some countries, such as Angola and Sierra Leone, are rich in commodities but are unable to exploit them profitably.

5. **A mirage?**

Let's not be mistaken. Per capita GDP in Sub-Saharan Africa has indeed doubled in the last twenty-five years, to $3,700, but in the meantime China's GDP has been multiplied by sixteen. Africa represents less than 5% of energy consumption worldwide. Sub-Saharan Africa represents barely the GDP of France. And again, we must be cautious regarding the published figures. Was it not Nigeria that revalued its GDP by 90% in 2013, decreeing that it exceeded $500 billion? Rapid economic expansion? Admittedly the last decade has been positive, but looking at the list of the thirty poorest countries in terms of per capita income, we find that 26 of them are in Sub-Saharan Africa, and in 2016 per capita GDP declined by more than 1%. What role in the process of globalization? Is it simply as a supplier of agricultural or mining commodities? Where is the value added? Where will essential job creations be found? China invests in Africa, but one-quarter goes to the mines, without any great benefit for the local economies.

There is often talk of the emergence of a middle class of 300 million people which is considered to be a fantastic opportunity for the big multinational firms. But this is to overlook the fact that most of this middle class has only $2 to $4 per day, nothing to enable it to allocate money to superfluous spending.

Brazil:

1. **Long-term growth in real per capita GDP is structurally low**, which can be explained by a low investment rate (less than 20% of GDP, whereas in China it is close to 45% of GDP), itself attributable to insufficient domestic savings. The country is emerging from recession and the IMF expects 0.7% growth this year, but per capita income, in real terms, has declined by around 10% since 2013. Official interest rates are still high, and this is holding back lending.

2. **A poorly exploited demographic asset**: With around 200 million inhabitants, Brazil is the fifth largest country in the world by population, behind China, India, the United States and Indonesia. It is a young country, because the over-65 age group represents scarcely more than 10% of the working population aged 15 to 64. This is a plus, compared with European countries where this figure is close to or exceeds 30%, and especially compared with Japan.

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And yet, since pensions are generous, the cost (13% of GDP) exceeds that in Europe and Japan. It is understandable that there is a political will to change this situation.

3. **Indisputable economic strengths which are often poorly exploited**: Brazil is a major producer and a big exporter of agricultural products, whether it be meat, soya beans, sugar, coffee or oranges, and for the last three products it is by far the leading producer in the world. These are basically low value-added products. Agriculture is important for the economy, but rural poverty persists. It is the leading industrial country in Latin America and it is virtually independent for energy. Thanks to a recovery in the prices of some commodities, the current-account deficit has been very substantially reduced since 2015.

4. **Political clarification which will have to wait until the October 2018 election**: The recent political crisis has discredited the various political parties. Although the Temer government has been able to approve the idea of a limit on spending, it will be difficult to comply with this rule as long as the social security reform has not been enacted. Given the combination of political uncertainty, the increase in the public debt to 75% of GDP this year and more than 80% in 2018, and the persistence of a primary budget deficit equivalent to 2.6% of GDP, S&P has downgraded the country's rating to BB - and will probably not upgrade it again until after the election.

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Conclusion: **Convergence? "Do not hope for what cannot be hoped for", Pythagoras**.

Since 2007, GDP growth in the United States has been 14%, greater than that of Russia, which did not exceed 7%, and well below the rates for India and China, which more than doubled their GDP. And yet, it is the United States which had the best stock market performance and China the worst, where the market actually declined!

Admittedly, emerging countries account for 52% of global GDP, a level far greater than the 35% of 1980, but most of the increase is attributable to China, a more moderate proportion results from India's growth, while the weight of the other countries is stable. Convergence is an aspiration but often proves to be an illusion, a dream in both senses of the term, positive and negative, so that, in **Kant's** formulation, **"Progress is a consoling hypothesis"**, the word "progress" should be replaced by "convergence".

From an economic standpoint, it is indisputable that the emerging countries are better managed than before the 1998 crisis. The positive current-account balance reflects less vulnerability to global capital flows, although some large emerging countries such as Mexico and Brazil have extremely low gross savings ratios, at less than 20% of their GDP, which make them dependent on international capital. It is also true that, as a percentage of GDP, the total debt of emerging countries is far smaller than that of the developed countries, but it has nevertheless increased rapidly in recent years. The technological catch-up effect has undeniably favoured a positive growth differential for emerging countries, but this will play a smaller role in the future. The effect of growth in the banking sector, with easier access to credit, is behind us, and loan/deposit ratios are now similar to those of OECD countries. Female work is still often not very widespread compared with developed countries, and this is a factor for optimism.

From a stock market viewpoint, the size of emerging markets' capitalization has increased hugely since 1990, and that could lend credibility to the belief that these markets are very attractive, but, as **Balzac** would have said, **"Hope is a lie based on the future"**, and three corrections are required. Firstly, initial public offerings often account for a substantial fraction of the increase in the market capitalization. Secondly, although the total capitalization of emerging markets seems large, the capitalization of emerging markets based on the free float represents only one-quarter of the global market capitalization, because the free float is often small. This is because many large companies are mostly state-owned. Finally, if the market capitalization represents only 40% of these countries' GDP compared with 100% in developed countries, this is because many of these markets do not yet have the depth of developed markets in terms of the number of listed companies, and because the governance of these companies is still sometimes deficient.

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