

## CHARACTERISTICS OF THE EMERGING MARKET ECONOMIES - BRICS, FROM THE PERSPECTIVE OF STOCK EXCHANGE MARKETS

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**Abstract:** *Many international investors have realized that they cannot obtain profits as large, investing in mature markets as well as investing in emerging and developing countries. They want to obtain higher yields, of course assuming the extra risk, as the risk of liquidity or volatility of exchange rates, which are significantly higher than in developed markets. Studies on the BRICS economies are countless, researchers pointing that the development of these economies and their transition towards developed economies category is virtually inevitable (Nistor, 2011). In this article we propose a smooth approach on the state of the economies of the BRICS emerging countries and the stock exchanges markets. It is interesting to observe how, according to a forecast of the International Monetary Fund, in the year 2025 world supremacy from the economic point of view will belong still to the United States, but the discrepancies between the United States economy and China's economy subside until then. The same source, however, predict that by the year 2050, China's economy will bring forward the United States of America. However, should not be lost of sight the fact that China is part of the BRICS countries, with enormous development potential. As proof of those exposed earlier, sits the performance obtained from China's economy especially in times of crisis, when the vast majority of the world's economies recorded negative economic growth. Somewhat improperly said so, we were witnessing a world economic depression. The performance of China's economy is so, noteworthy, it received even in the toughest years of global financial and economic crisis, a positive value of economic growth. This also happened, within other BRICS emerging countries economies, having many similar economic meanings. With such a potential for economic growth, the economies of BRICS countries have brought into the spot light the operational stock exchanges. The interest of investors for investments in BRICS countries financial markets has increased considerably, mostly because they offer higher yields than the mature financial markets, of course with a slightly higher risk assumed.*

**Keywords:** emerging markets, stock market, market capitalization, BRICS economies.

**JEL classification:** G15, G01, G10.

### **1. Introduction**

Emerging countries are the countries whose economies are in a fast increase process, respective in transition phase to a market economy (Simon, 1997, p. 913). These countries have a higher capacity than the developed countries to provide investors with opportunities to achieve higher profits. According to Simon, the most important features of the emerging countries refer to:

- the small size of the economy,
- GNP/Capita much lower than in developed countries,

- a reduced opening for accepting foreign investors,
- a high volatility of the exchange rate which implies greater risk in trading.

It is considered that the biggest emerging economies are China and India.

When we refer to the phenomenon of transition economy, suppose that the transition is made from an emerging economy to a developed economy. There must, however, not lose sight of the reciprocal of this phenomenon, namely the transition can be made also vice versa, from developed economies to developing one. Of course, the transition to a developed economy is a wanted phenomenon, however it is the most widely-used usage of this notion, but it does not offer any guarantee that the converse is not true.

In Financial Markets Encyclopedia, Simon distinguishes between three distinct categories of emerging countries, considering a similar classification for stock exchange that operate within these countries. Thus, he talks about:

- the most advanced markets,
- narrow emerging markets,
- emerging markets (latent).

In the case of advanced emerging markets, Simon brings into question countries such as Malaysia, Mexico, South Korea, Taiwan, or Thailand whose inflation rates are quite low and in which there is some stability in the exchange rates. Financial and banking system are developed and have an opening to the international financial markets as shares and bonds, and trading system and financial securities settlement traded have a relatively sophisticated mechanism. These countries were not treated as developed countries category because it is considered that they are vulnerable to a possible volatility of the exchange rate and the stock market, a lot of local companies do not meet the conditions for listing, only companies that have exposure on the international market have passed listing of shares to the stock exchange.

Emerging markets generally narrow (as they called by Simon) does not provide an easy access of the investors on or of the international financial market, but this aspect belongs to the opening of each country belonging to this group. In the countries belonging to this group, the rate of inflation is high, the monetary and financial market is not developed enough to provide prospective investors optimal conditions for the conclusion of transactions. In these countries, the trading system of settlement of transactions requires major stabilization. It is not lost in sight of the fact that the spread between the poor and the rich is pretty emphasized. In this category we find emerging countries as: Argentina, India, Nigeria and the Philippines.

The third category proposed by Simon is that of emerging markets or latent markets. Their economic performances are quite poor and their access to international financial markets is very limited, and therefore the volumes of trading on these markets are greatly reduced. Of course, the performance of trading systems that dealt in securities settlement, is also reduced. Basically the economies of emerging countries are at the beginning of the road, they need capital to both support the entry on increasing trajectory and the financial institutions of market surveillance covering the investment on the stock exchange.

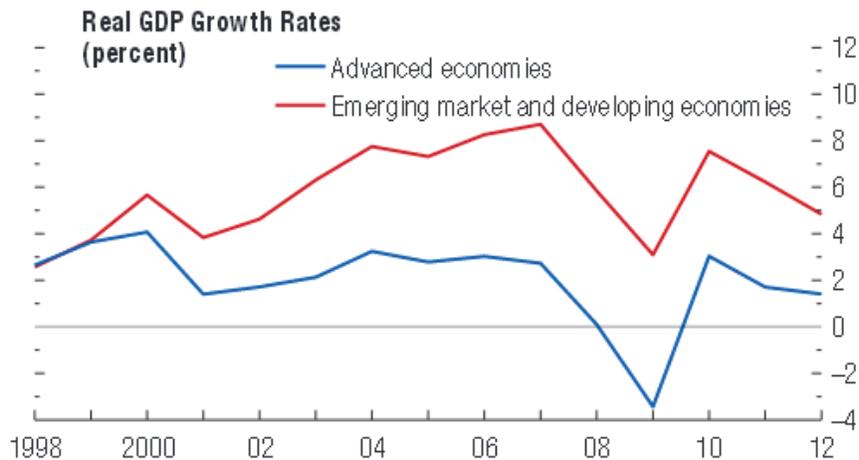
## **2. Overview of the economies of emerging countries**

Regarding investments in emerging markets from the perspective of stock markets, we consider that these requires higher risks than in the case of investments made on a mature market. Thus, the most important risk associated with the financial investment on such markets is their price volatility, which can be observed in a given period of time. Volatility as risk associated with investments in the stock market is a result of the manifestations of risks of the most diverse: political risk, change of the exchange rate,

inflation rate, respectively, of all measures adopted by the authorities of the local currency, but also the information in the market likely to disturb (both in negative and in positive sense) in the normal course of securities listed. However, according to the principle of high risk-high profit, investors who assume the risks of investing on such markets, have the opportunity to earn more than on mature markets, the volatility supplement commitments being offset by a supplement to the profitability of investments made. For international investors, investing in such savings is basically an opportunity to diversify their portfolios, especially because most emerging markets are rather weak correlated with developed markets. According to a report from the International Monetary Fund (IMF, 2012), considered countries with an economy in transition in July 2012 are: Argentina, Brazil, Bulgaria, Chile, China, Colombia, Estonia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Romania, Russia, South Africa, Thailand, Turkey, Ukraine and Venezuela.

Many economists believe that the economies of emerging countries will be those that will boost the world economy and that they will be the new force in the world, in a specified time-frame. The same IMF report makes an analysis of the evolution of the global economy as a whole and separating performance of developed economies, from those of emerging economies and in the developing world.

It can be seen from the following figure that the performances achieved by the developing countries are higher than those of developed markets, both for the period of crisis and for the year 2012. These are the practical element that maintains the world economy on positive economic growth rates.



**Figure 1.** The evolution of economic growth in emerging countries in the developing world and for developed countries

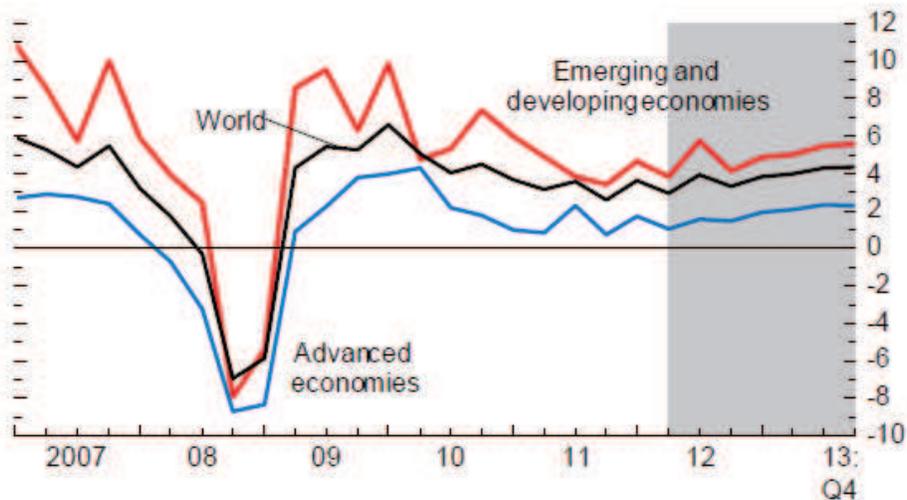
Source: World Economic Outlook. April 2014, the International Monetary Fund (IMF, 1986, p. 114)

The previous figure shows trends in the rates of increase in real gross domestic product for the emerging countries in the developing world and in developed countries.

The major advantage of the emerging countries in the developing world is that including the period of the crisis, they have recorded positive economic growth. Of course, the year 2009 was marked by a severe decline in the pace of economic growth in these countries, however, economic growth in 2009 is maintained at approximately + 3%. You may also have noticed the steep decline of the indicator for developed countries, in the most affected year of the crisis. At that time, the vast majority of developed economies have seen a regression of the real GDP, unable to speak of a positive economic growth. The year 2010 has brought a greenbelt area in both the developed economies that have been

able to re-enter on the territory of positive economic growth, as well as for emerging economies in the developing world.

In mid-2012, the IMF made a forecast for world economic growth to the end of 2012. This prognosis was + 3.5%, this being achieved by developed countries for which contribution it was estimated an increase of 1.4% but especially emerging countries for which estimated an increase of 5.6% at the end of 2012. Statistics show that by the end of 2012, the average economic growth of developed countries was about 1.5%, while the average economic growth of emerging countries in the developing world was approximately 5%. Also in mid-2012, the IMF has expanded its forecast for the end of 2013, according to which the world economy was supposed to achieve a 3.9 percent advance developed countries generated with 1.9% and economic growth in emerging countries of 5.9%, as in the following figure.

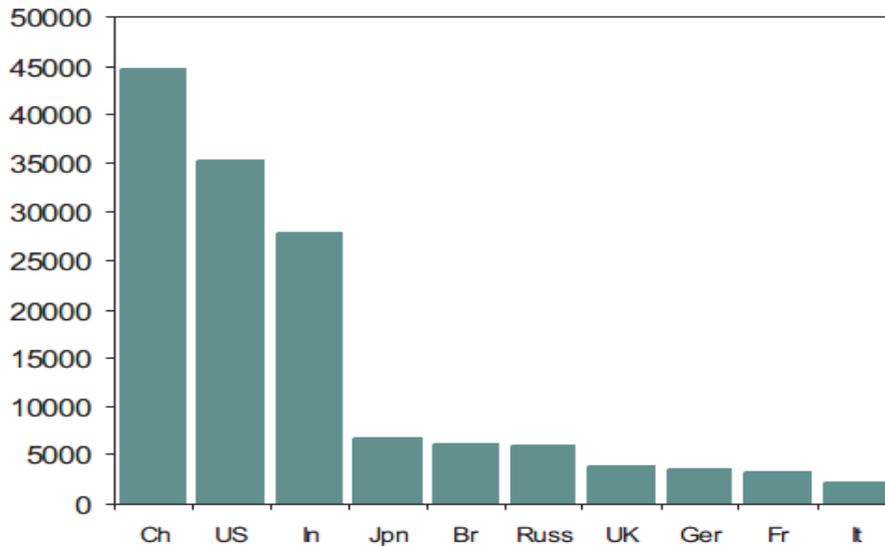


**Figure 2.** The IMF forecast of economic growth for the end of 2013  
Source: World Economic Outlook. International Monetary Fund (IMF, 2012)

We conclude therefore that the emerging markets have brought an extra touch of interest from investors in the financial market, and the IMF forecasts encourages trading on these markets as long as the forecast is for growth of these economies.

The four BRIC countries, as they've been named by Jim O'Neill: Brazil, Russia, India and China are the ones that will dominate the world economy. Their importance is underlined in many analyses of Goldman Sachs, who believes that by the year 2050, China will bring forward the economy of the United States of America. Research carried out by Goldman Sachs (Goldman Sachs, Dreaming with BRICs. The Path to 2050, 2003) forecasts a growth of the most important economies of the world by 2050, as follows:

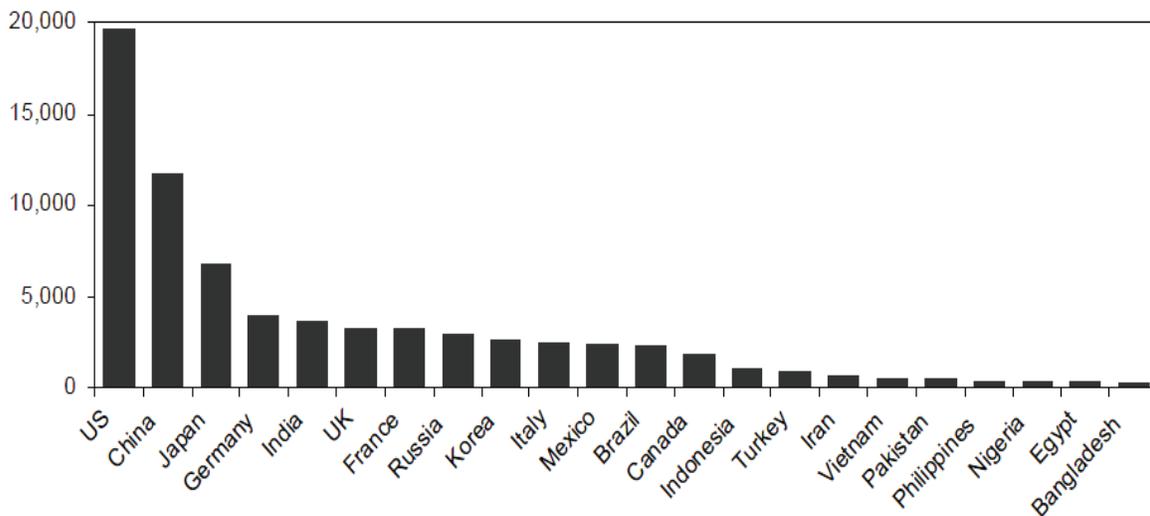
GDP-billions of dollars



**Figure 3.** Forecast rankings of the most important economies in 2050  
 Source: (Goldman Sachs, *Dreaming with BRICs. The Path to 2050*, 2003)

According to forecasts made by Goldman Sachs, the U.S. economy will be in second place in the world, followed by that of India. Brazil's and Russia's economies will seriously compete with Japan's economy in the year 2050. In a subsequent analysis of Goldman Sachs (Goldman Sachs, 2005), it shall revise forecasts trends in BRIC countries thanks to the strongest increases registered by them in relation to initial forecasts, from the moment of the first analysis. Thus, according to Goldman Sachs, top countries in terms of gross domestic product in 2025 will look like the following figure:

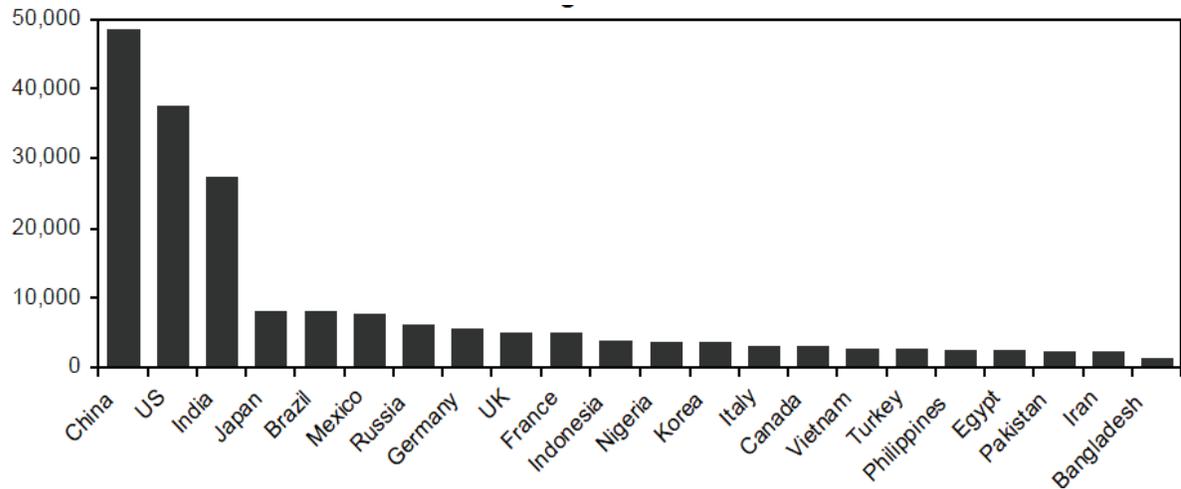
GDP-billions of dollars



**Figure 4.** The largest economies in 2025  
 Source: (Goldman Sachs, *How solid are the BRICs?*, 2005)

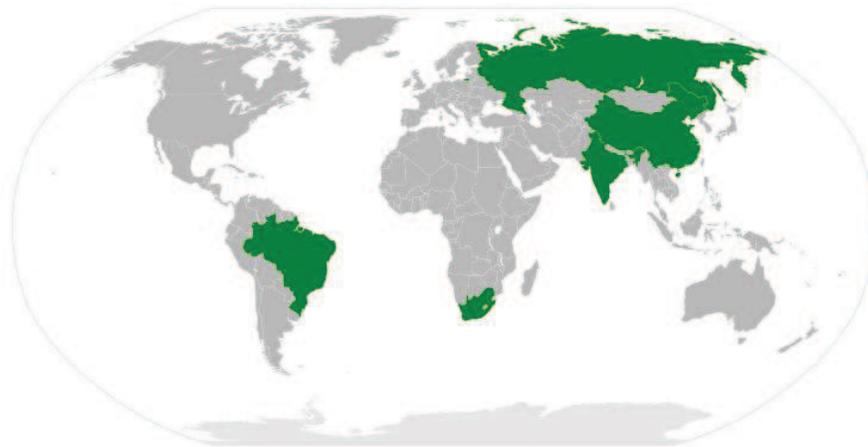
According to the same analysis, after 2025, respectively, by 2050, this will bring: first China, Germany will be brought forward from Russia, Mexico, Brazil and India. The standings will look like:

GDP-billions of dollars



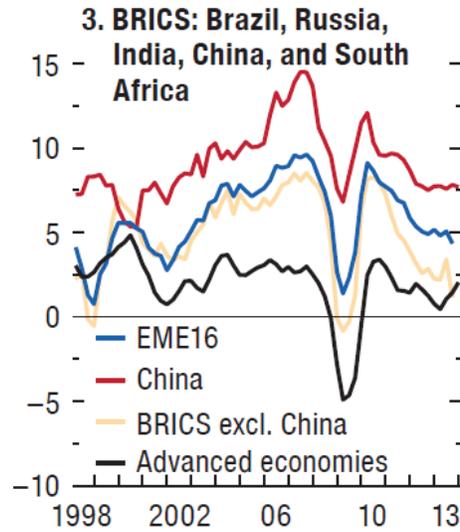
**Figure 5.** The largest economies in 2025  
 Source: (Goldman Sachs, How solid are the BRICs?, 2005)

In 2010 South Africa joined the BRIC countries and so was taking birth the BRICS Association. South Africa has the same coordinates as well as major economic countries from BRIC. The location on the globe of the five emerging countries as members of the BRICS are as follows:



**Figure 6.** The location on the globe of the BRICS countries  
 Source: (www.wikipedia.org, 2014)

The following figure shows the evolution of the average economic growth for BRICS countries without China's economy (pink line), compared with the average economic growth for the 16 emerging economies (blue line) and China's economic growth (red line).

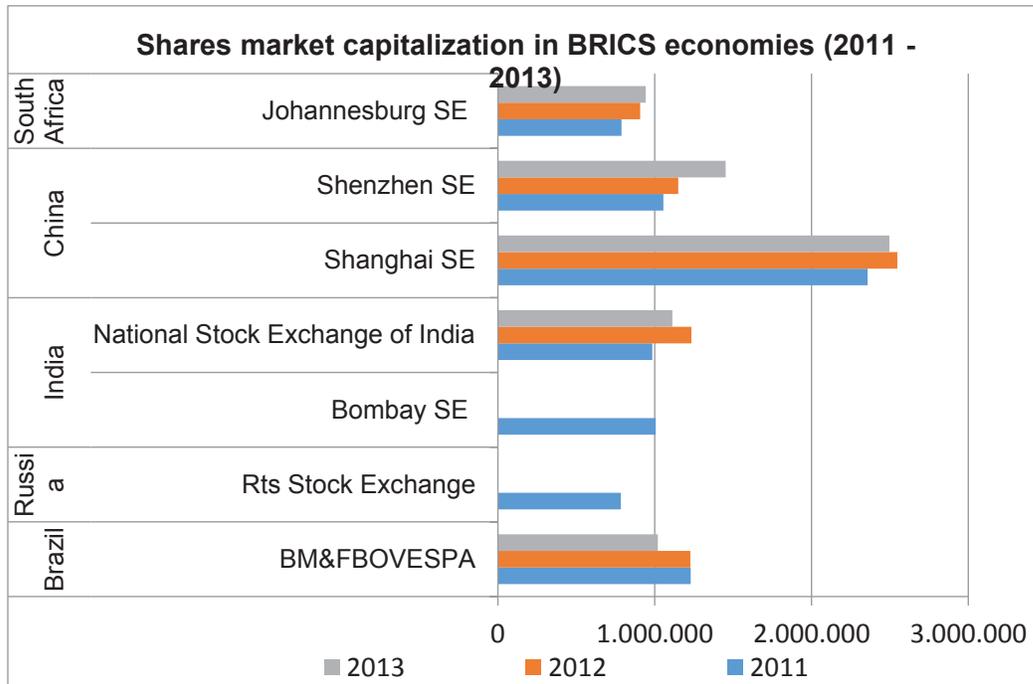


**Figure 7.** Evolution of the average economic growth for BRICS countries in comparison with the average of developed economies.  
 Source: World Economic Outlook. April 2014, the International Monetary Fund (IMF, 2014, p. 137)

In the previous figure, China's economy was dealt with somewhat distinct from the other BRICS countries economies because it is the most dynamic of these, it is basically the engine of the global economy, during the crisis. BRICS countries average in terms of economic growth, not taking into account China's economic performance, gets even in the negative territory most affected crisis year- 2009.

### 3. Characteristics of the stock exchange in emerging BRICS countries.

We propose a comparison of market shares in the five member states of the BRICS. The following figure shows that the market size operations are comparable between themselves, like many indicators of macro-economic nature of these states.



**Figure 8.** The market capitalization of the shares market of the BRICS countries within 2011-2013

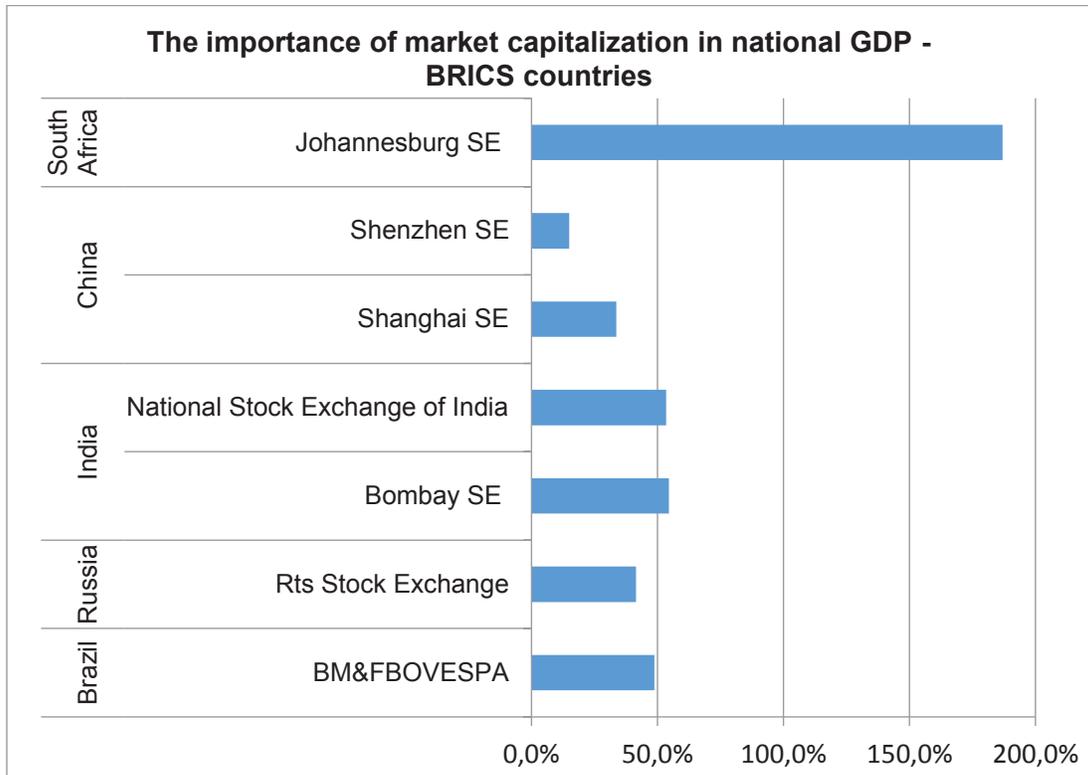
Source: after processing statistical data provided by the WFE ([www.world-exchanges.org](http://www.world-exchanges.org), 2014)

For 2013, it is somewhat noted the Shanghai Stock Exchange (China) with a market capitalization of two times higher than the average of BRICS, the conditions under which, the capitalization of the stock exchange has increased by over 1000% in the last 10 years. After 1990, when stock market capitalization has totaled just over 11 billion dollars, Brazil stock exchange, BM & FBOVESPA had a spectacular rise due to the successful implementation of a new trading system that offered new perspectives for investors on this market, but also because of a policy to promote financing opportunities through stock exchange which has attracted numerous IPOs on the exchange market. The two representative stock exchanges of India, National Stock Exchange of India and Bombay Stock Exchange seem to be in a close competition, at least at the national level, in 2011 their stock market capitalisation were about 1,000 billion dollars each. The reason we did not take into account the market capitalisation of the market shares for the stock exchange in Bombay in the year 2012 and 2013, lies in the fact that the World Federation of Exchanges no longer provides statistical data about this stock exchange in 2012.

The BRICS countries, Russia and South Africa's stock exchange have the lowest market capitalization of just over \$ 780 billion, at the end of 2011. For Russia's stock exchange, World Federation of Exchanges no longer provides statistical data starting the year 2012. The market capitalisation of the stock market by the end of 2013 for the Johannesburg Stock Exchange can be compared to that of the Brazil Stock Exchange (BM & FBOVESPA), both being around 1,000 billion dollars.

In an interesting study about who influences more the development of stock exchanges in BRICS member countries, the United States or Japan (Jeyanthi, 2010), based on calculations, Jeyanthi came to the conclusion that, at least in the short term, the development of stock exchanges in India is influenced to a large extent of developments in the United States of America stock exchange, those in Russia are influenced more by

the evolution of stock exchanges in Japan, member states and the other BRICS are not influenced either by the U.S. or Japan stock exchanges. With regard to the importance of market capitalization in the GDP of each country, by the end of 2011, in the BRICS countries, the situation looks like the following:



**Figure 9.** The importance of market capitalisation in the GDP of the BRICS countries  
Source: after processing statistical data provided by the WFE ([www.world-exchanges.org](http://www.world-exchanges.org), 2014)

By far the highest percentage of market capitalization in the country's GDP, by the end of 2011, belong to the stock exchange in Johannesburg (South Africa), 187%, therefore market capitalization exceeds the GDP of the country. Of note is that this stock exchange is the only one on the African continent that counts on the world map, the stock exchanges of other countries have very small stock capitalization. For the other BRICS countries, market capitalization accounts for approximately half of the gross domestic product of each state in which they operate.

In the last decade, many companies that have their headquarters in the BRICS countries have chosen to list their shares on the stock exchange in America or Europe (Wójcik & Burger, 2010). The best 'host' for international listings was the United Kingdom (London Stock Exchange) and the United States of America, for which international listings in 2006 accounted for approximately 60% of the total.

#### 4. Conclusions

The most powerful emerging economies, as the authors call them in a work under the aegis of the Romanian Academy (Oehler-Şincai, Ghibuţiu, Laghari, Miru, Bah, 2010 &) is like through a series of characteristics such as: massive natural reserves as both volume and diversity, competitiveness is more visible in the industrial sector and the agriculture and consumer markets are robust. The distinctions that they bring into question on the

same spot refer to the endowment with factors of production or the predominance of different sectors in the national economy.

We find interesting the analysis done on the evolution of stock exchanges capitalization in the BRICS countries, even if it is done in a short period of time, in 2011 to 2013. We are of the opinion that one important aspect linked to the development of stock exchanges in emerging BRICS countries is that of innovation and of financial engineers in this area. Of course, the starting points of financial innovation are developed economies and its stock markets. Access to financial innovations within these economies is essential, but the opening of the emerging BRICS countries stock exchange have is a proper aspect of each of these. Tied to the opening of markets in emerging countries, financial innovation has created for the investors, new instruments so that the investment process can achieve transfer of risk between various market participants.

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