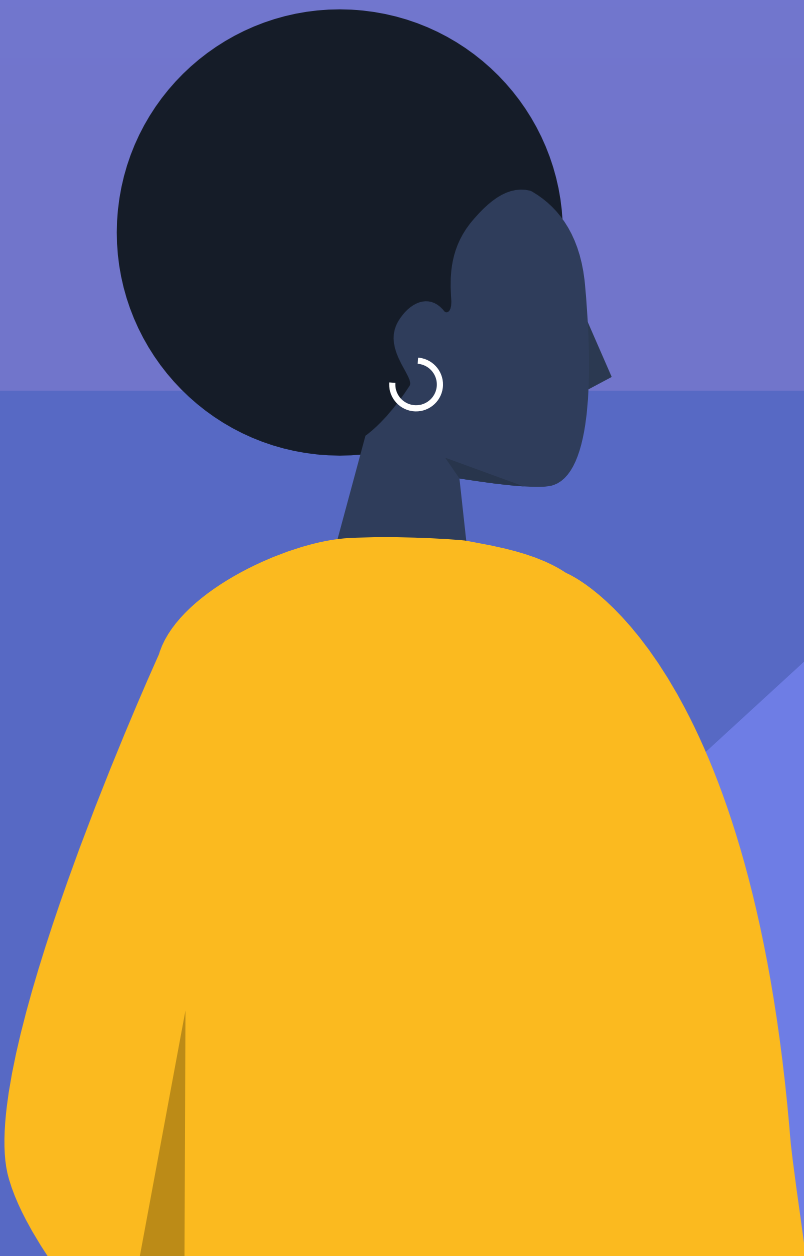
Brown Brothers Harriman

FOREIGN EXCHANGE

OUTLOOK FOR FOURTH QUARTER 2023



GLOBAL MONETARY TIGHTENING CYCLE:

An End In Sight

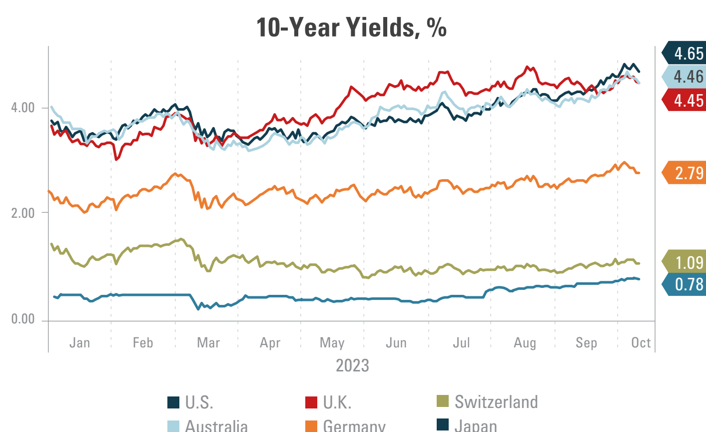
While a stronger dollar, higher yields, and lower equities seen in the last quarter will likely remain intact, we see several considerations for global markets in Q4.

Key Considerations for Global Markets in Q4

- **Higher global yields.** The rise in nominal yields is a global phenomenon but is being largely driven by the U.S. Both the 10-year yield traded at a new cycle high near 4.89% and the 30-year yield traded at a new cycle high near 5.05% before falling slightly. Due to a perfect storm of bond-negative drivers (huge supply of new UST issuance, strong growth and persistent inflation, and a hawkish Fed), a persistent 5-handle on all longer dated U.S. Treasuries now seems inevitable. As rates stay higher for longer, we expect a U.S. recession in 2024 but do not see a financial crisis developing.
- **Slower global growth.** As Q4 begins, the U.S. economy is the last man standing. Europe and the U.K. are slipping into recession, China's recovery remains lackluster, and global growth is set to slow in both 2023 and 2024 as global interest rates stay higher for longer. Most major central banks are not expected to cut rates until H2 2024, which means any stimulative impact won't be felt until 2025. The latest OECD forecasts see global growth at 3.0% in 2023 and 2.7% in 2024 vs. 3.5% in 2022. An extended period of slower growth and tighter global liquidity is of course very negative for risk assets, especially emerging markets.
- **Rising U.S shutdown risks.** Despite a last-minute deal to keep the government open through November 17, the ouster of House Speaker McCarthy is troubling. While shutdowns are typically quite short, the extreme dysfunction in the U.S. political landscape suggests unusually high risks of a protracted shutdown.
- **Widening U.S. labor strikes.** As we went to press, the auto strikes remain ongoing and are spreading as negotiations drag on and over 75,000 healthcare workers recently went on strike for higher wages. The longer and wider these strikes go, the bigger the risk to the U.S. economy.
- **Rising financial strains in China.** Stimulus efforts have been very modest so far and limited in large part to propping up the property sector. Policymakers may be able to muddle through for now but pumping more air into a rapidly deflating bubble is not a sustainable solution. China is facing down an old-fashioned EM debt crisis that it cannot grow its way out of. The only long-term solution we see is to undertake significant debt restructuring coupled with a banking sector bailout.

LET'S RECAP:

NOK was the only major currency to gain against the dollar in Q3 at 0.4%. GBP was the worst performer in Q3 (-4%), followed by AUD (-3.4%) and JPY (-3.4%). In EM, COP was the only currency to gain against the dollar in Q3 at 2.5%. ARS was the worst performer (-26.7%), followed by CLP (-10.0%), HUF (-7.3%), PLN (-7%), and CZK (-5.7%). In Q3, U.S. equity indices were down between 2-4% , while the U.S. 10-year yield rose 70 bp and the 30-year by nearly 80 bp.



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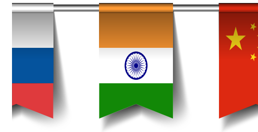


Higher for Longer

Global liquidity likely to remain tight into 2024

By Win Thin

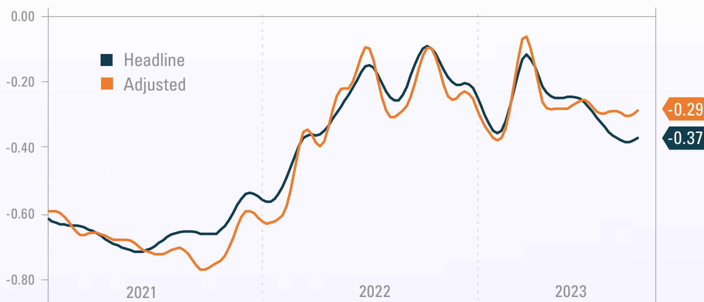
MONETARY POLICY OUTLOOK

The global monetary tightening cycle is nearing an end. While there are still one or two major central banks that may have a hike left in them, most rate hikes are behind us. However, rates are likely to remain at a high plateau well into 2024. The "higher for longer" mantra holds for virtually every major central bank so global liquidity is likely to remain tight until at least mid-2024.

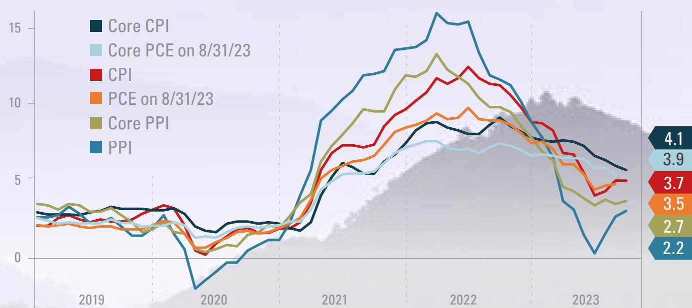
Here's our monetary policy outlook for developed markets.

Americas

We do not think the Fed is done. Financial conditions remain too loose despite Fed tightening to date. While the U.S. economy has grown at or above trend for most of this year, the Fed is aiming for sub-trend growth to get inflation lower. Chicago Fed's measure of financial condition were finally starting to tighten modestly at the end of September but remain as loose as they were right before the Fed started hiking in March 2022. This is very surprising considering how much U.S. yields have risen in recent weeks.

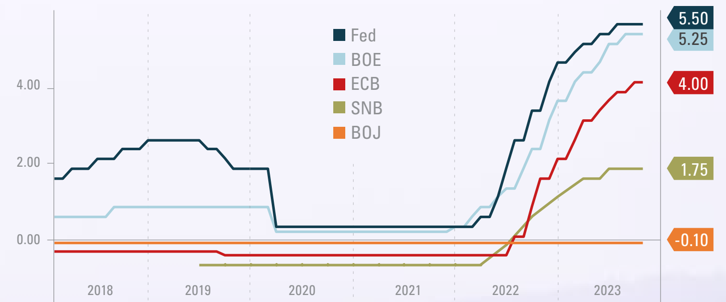


Rather, the Fed remains in skip mode. After hiking in May, it skipped in June, hiked in July, and skipped in September. Will it continue this pattern and hike next month? The market doesn't seem to think so as it sees only 10-25% odds of a hike in November. These odds rise and top out near 35-40% in December, which we believe are too low. Of note, the first cut is seen mid-2024 but market pricing has gone back and forth between June and July. Given our view that the tightening cycle is not yet over, we think the easing cycle will come later rather than sooner.



Bank of Canada has paused for the second time this cycle. The first pause came at the March 8 meeting, when rates were kept steady at 4.5%. Rates were also kept steady at the April 12 meeting, but the bank then restarted the tightening cycle June 7 with an unexpected 25 bp hike to 4.75%. After hiking 25 bp in July it signaled a likely pause which was confirmed at the September 6 meeting, when rates were kept steady at 5.0%. The market saw 35% odds of a hike at the next meeting October 25, rising over time to top out near 80% in Q1, which we think seems about right. The market sees the first cut in Q4 2024, which also seems about right.

Interestingly, the market has more conviction of a BOC hike than a Fed hike. Inflation has picked up in recent months while the labor market remains firm. With economic integration still deepening, Canada should be viewed as a mini-U.S. as the two ride the same business cycles. If Canada is struggling to limit inflation and needs to hike more, a similar dynamic may be seen in the U.S.



Europe

The European Central Bank (ECB) tightening cycle has ended. At the last meeting in September, the ECB hiked rates 25 bp, suggesting rates were high enough to get inflation back to the 2% target. President Lagarde was reluctant to call an end to the cycle at her press conference. Since then, the doves have seized control of the narrative as the incoming data supports their stance.

More ECB officials have said current rates are the peak, whilst stressing that they may have to stay higher for an extended period. Despite a few hawkish holdouts, the discussion has clearly shifted from how high to how long. The market sees no odds of any more hikes, which we agree with. The timing of the first cut has been moved forward, with nearly 50% odds of a cut April 11 and nearly priced in for June 6. This seems too early but suggests that markets see a deteriorating economic outlook for the eurozone.

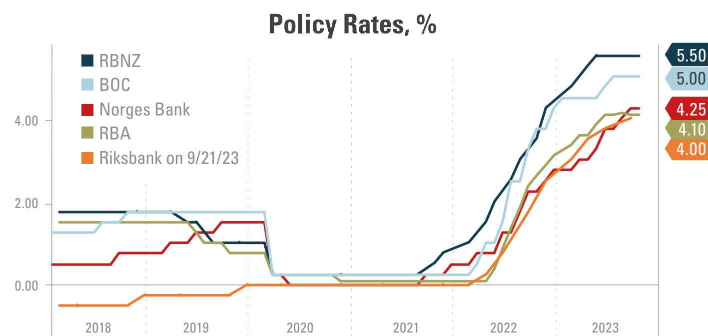
Bank of England delivered a dovish hold in September. It kept the policy rate steady at 5.25% by a 5-4 vote but said further tightening may be required if inflation persists, adding that policy must be restrictive enough for a "sufficiently long" period. The statement noted that BOE policymakers saw the September PMI readings that were released the next day. These turned out very weak and acknowledged that underlying growth in H2 will likely be weaker than the 0.25% seen in August. Updated macro forecasts will be released at the November 2 meeting.

Overall, the message was very dovish as the BOE didn't even try to signal a November hike. Indeed, we think we may have already seen the end of the tightening cycle. The market sees 30% odds of a hike November 2, rising to top out near 55% in Q1, which we believe are too high. The first cut is seen in H2 2024, which seems about right.

Swiss National Bank unexpectedly kept rates steady at 1.75% in September. A 25 bp hike was expected. The SNB said "From today's perspective, it cannot be ruled out that a further tightening of monetary policy may become necessary to ensure price stability over the medium term." The market sees only 15% odds of another hike in Q1, which seems about right. The market sees easing in Q4 2024, which seems about right.

Norges Bank hiked rates 25 bp to 4.25% in September, as expected. Inflation is falling but the economy is holding up rather well, helped by high oil prices. The market sees no odds of a hike November 2 but rise to top out near 45% December 14. We think these odds are about right. The market sees the first cut in H2 2024, which seems about right.

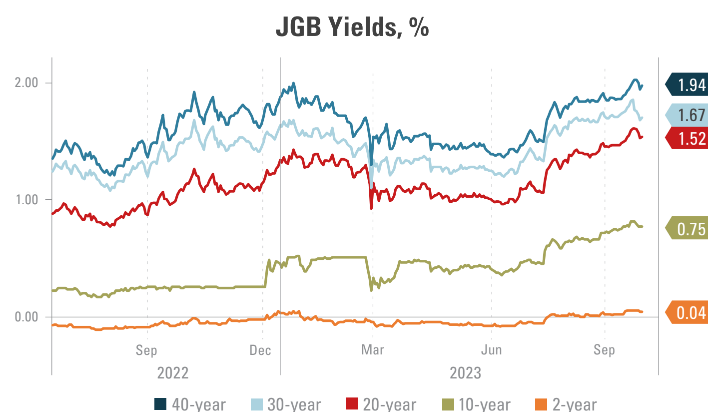
Riksbank hiked rates 25 bp to 4.0% in September, as expected. It said rates could be raised further but the expected rate path was little changed. It now sees the policy rate peaking at 4.10% in Q3 2024 vs. 4.05% in Q2 2024 in the June forecasts. However, inflation is expected to fall sharply in September for the second straight month, bringing the need for more tightening into question. The market sees 55% odds of a hike November 23, rising to nearly 60% in Q1. We think these odds are a little on the high side, especially if recent krona strength continues. The market sees the first cut in H2 2024, which seems about right.



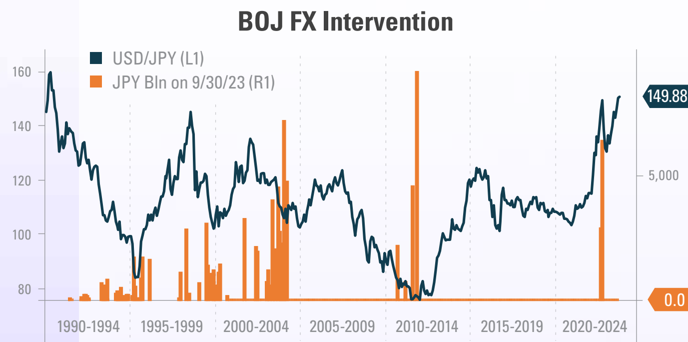
Asia

The Bank of Japan delivered a dovish hold in September. Governor Ueda said: "Because we aren't in a state where inflation accompanied by wage growth - sustainable and stable inflation - is in sight, we're patiently continuing with monetary easing under the current framework." However, the summary of opinions from that meeting suggest more and more BOJ board members believe the 2% target is nearing.

Updated macro forecasts will come at the October 30-31 meeting and should provide more clues to the timing of a pivot. The market sees no odds of a rate hike at that meeting, but the odds rise to 15% December 19 and further to become fully priced in April 26. We think these odds are about right. However, the expected tightening cycle is seen as very shallow, with 20 bp of hikes over the next twelve months, another 30 bp over the subsequent twelve months, and another 25 bp in the twelve months after that. This seems too dovish a rate path.



We could see Yield Curve Control end in Q4, though we lean more towards Q1. JGB yields are rising along with the rest of the world so maintaining YCC for much longer makes no sense. With monetary policy divergences still in play, the yen should continue to weaken. The market is on alert for FX intervention but so far, there's been nothing except jawboning. The October drop in USD/JPY was unlikely tied to intervention but we won't know for sure until monthly intervention data are released in early October.



Like the Bank of Canada, the Reserve Bank of Australia also tried to pause this year. It hiked rates 25 bp to 3.6% March 7 but admitted that it was considering a pause.

That pause came at the April 4 meeting, but Governor Lowe warned that it didn't mean hikes were over. This was prescient as the RBA then delivered a hawkish surprise at the very next meeting May 2 with a 25 bp hike to 3.85%. It delivered a second hawkish surprise in a row June 6 with another 25 bp hike to 4.10%. It kept rates steady July 4 and warned of potential hikes ahead but delivered a dovish surprise August 1 with no hike vs. 25 bp expected. The RBA then kept rates steady at 4.10% October 3 and again warned that further tightening may be required.

This was Deputy Governor Michele Bullock's first meeting having taken over September 18 for a seven-year term as Governor. Not surprisingly, she favored continuity and did not rock the boat. However, inflation has started to pick up again and GDP growth is holding up well. The market sees around 5% odds of a hike November 7, rising to 25% December 5 and topping out near 40% in Q1. We think these odds are about right. The market sees no easing until 2025, which seems too hawkish.

Reserve Bank of New Zealand was the first major central bank to hike back in October 2021. After an aggressive tightening cycle, the RBNZ hiked rates one last time in May and signaled the end of the cycle whilst leaving the door open to another hike.

Governor Orr said: "All of the committee were comfortable with the forward path that had interest rates holding around 5.5%", but "there was still that tightening bias." GDP growth has picked up and inflations remains stubbornly high. The market sees 30% odds of a hike November 29, rising to 60% February 28 and top out near 75% April 10. We think these odds are about right. The market sees no easing until 2025, which seems too hawkish.

A Long Road Ahead for Emerging Markets

Following a period of tight monetary policy and volatile rate hikes, Emerging Markets have a long way to go. As markets look to restabilize in Q4, there are several considerations ahead.

Emerging Markets are starting to emerge from a period of tight monetary policy. Over the course of 2021 and 2022, Emerging Market central banks hiked rates aggressively, often long before the Fed and other Developed Market central banks started to hike. In H1, the best performers in EM vs. USD were COP (16.3%), MXN (13.9%), BRL (10.3%), HUF (9.3%), PLN (7.7%), and CLP (6.1%). All of them are high yielders and attracted investor interest.

However, since Q3 began, aggressive monetary easing has become one of the largest weights on EM FX. This is likely to continue in Q4 and beyond. Hungary was the first to cut aggressively (May), followed by Chile (July), Brazil (August), Poland (September), and Peru (September). All of their currencies are paying a price. It's no coincidence that after ARS (-26.7% vs. USD), the worst EM performers in H2 so far are CLP (-13%), TRY (-6.2%), HUF (-6.2%), CZK (-5.8%), BRL (-5.2%), PEN (-5.2%), and PLN (-4.7%). With the exception of Turkey, all are already cutting or about to cut rates.

This crystalizes the dilemma that many central banks face. Inflation remains elevated but their economies are slipping into recession. Hungary, Poland, and others cutting rates have prioritized growth but at a cost of higher inflation and weaker currencies, which in turn feed back into even higher inflation. Others such as Colombia and Mexico are being more cautious but even their currencies are coming under pressure from the broad dollar rally. This too should continue in Q4.

EM MONETARY POLICY OUTLOOK

Latin America

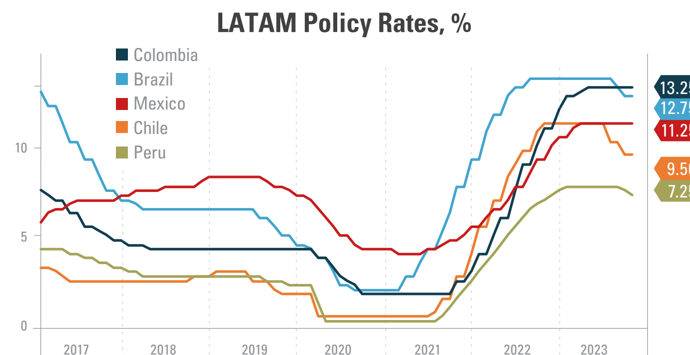
Chile's tightening cycle continues. Chile started its tightening cycle in July 2021. After beginning its easing cycle with 100 bp, it then cut rates 75 bp to 9.5% in September and said: "In the short term, the MPR will continue the path outlined in the previous meeting." The bank has previously said the policy rate should end the year between 7.75-8.0% and with meetings October 26 and December 19, that implies two more 75 bp cuts. The market agrees and is pricing in a year-end rate near 8.0%.

Brazil was amongst the first to hike rates back in March 2021 and amongst the first to cut rates. After starting the easing cycle in August with a dovish surprise of 50 bp, Brazil then cut rates another 50 bp to 12.75% in September and said: "Committee members unanimously anticipate further reductions of the same magnitude in the next meetings. This pace is appropriate to keep the necessary contractionary monetary policy for the disinflationary process." Next meetings are November 2 and December 13, which would imply a year-end rate of 11.75%. The market is also pricing in 50 bp cuts at the January 31 and March 20 meetings.

Peru started its tightening cycle in August 2021. It began its easing cycle with a 25 bp cut to 7.5% in September. Governor Velarde tried to manage easing expectations by noting Peru can't cut rates as fast as other countries despite following up with another 25 bp cut to 7.25% in October. While Bloomberg consensus sees the policy rate at 6.75% by year-end, 6.0% by the end of Q1, 5.25% by the end of Q2, and 4.75% by the end of Q3 – this seems too aggressive and would surely invite further sol weakness.

Banco de Mexico started its tightening cycle in June 2021. Since its last hike in May, the bank has kept rates steady at 11.25%. However, bank officials are hinting that a rate cut is expected in 2024 as market is pricing in steady rates over the next three months followed by some odds of a 25 bp cut over the subsequent three months.

Colombia started its tightening cycle in September 2021. After hiking rates to 13.25% this April, it has kept rates steady. Having recently delivered a hawkish hold as minutes showed it "acknowledged that the fight against inflation is not over, they agreed on the need to maintain the current restrictive stance of monetary policy, until they see convincing signs of the convergence of inflation toward its target." The market is pricing in 25 bp of easing over the next three months followed by 75 bp over the subsequent three months. It's worth noting that Colombia was the last in Latin American to stop hiking and will likely be the last to start easing.

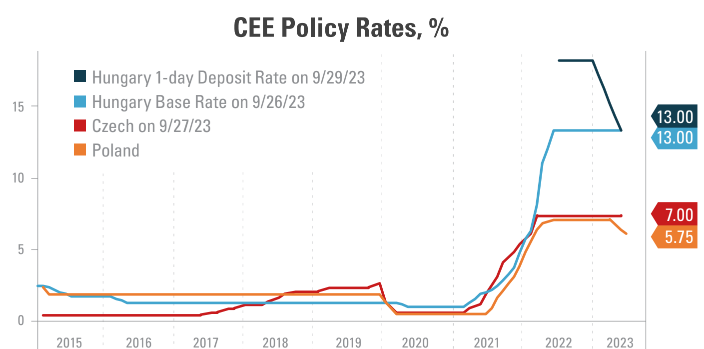


EMEA

Hungary started its tightening cycle in June 2021. With the forint remaining under pressure, it introduced the 1-day deposit rate as the new benchmark at 18% in October 2022, replacing the base rate that stood at 13%. The bank was the first to cut rates in EM with a 100 bp cut to the new policy rate in May and has followed up with monthly 100 bp cuts until it matched the base rate at 13% in September. With the two rates united, the bank is likely to cut monthly going forward and the swaps market is pricing in 150 bp of easing over the next three months followed by another 150 bp over the subsequent three months.

Poland's central bank, despite high inflation, cut rates 75 bp to 6.0% vs. the expected 25 bp. A senior aide to Prime Minister Morawiecki said the currency had weakened beyond the "optimal" level, (estimated in the 4.40-4.60 range against the euro). He added that the central bank should consider the zloty impact of future policy decisions, an acknowledgment that the dovish surprise was ill-considered. The next cut was only 25 bp and the market is pricing in 25 bp of total easing over the next three months followed by another 50 bp over the subsequent three months.

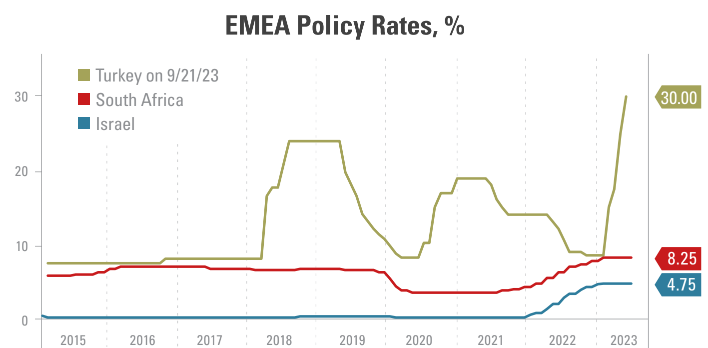
Czech National Bank Governor Michl is pushing back against rate cut bets. To differentiate from its counterparts in Hungary and Poland, both of which have started aggressive easing cycles despite high inflation, he said: "Inflation is still extremely high… Don't expect at all that we will cut in September, October or something like that… We will keep restrictive monetary policy until we are certain that inflation will be around 2% not only in the first half of 2024 but also later."



Turkey is the only one hiking rates in EM but was late to the game. After previous Governor Şahap Kavcıoğlu cut rates to 8.5% at a time when inflation was high and rising, new Governor Hafize Gaye Erkan took the reins June 9 and delivered two dovish surprises in a row in June and July. Followed by two hawkish surprises, the latest one in September. Erdoğan said his economic team is "implementing measures of monetary and credit tightening to attain price stability. These steps will channel our resources to productive areas and aim to attain high, sustainable and balanced economic growth." Erdoğan's about-face, coupled with a recent 500 bp hike and the accompanying hawkish message from the central bank, has had an impact on market expectations as the market is now pricing in a peak policy rate near 40% vs. 36% previously. With inflation at 59% and still rising, a policy rate of 40% still wouldn't do the trick in terms of lowering inflation and stabilizing the lira. However, it's better than nothing.

There are no words to describe the shocking attack by Hamas on Israel that began on October 7. Military operations are ongoing and 300,000 IDF reservists have been called up but there is no telling how long this situation will last. As of this writing, thousands of Israelis and Palestinians have been reported killed, numbers likely to rise sharply when Israel conducts a ground assault on Gaza. Concerns of regional instability are running high, and Israeli assets are coming under pressure. The Bank of Israel announced a $45 billion support plan for the shekel, consisting of $30 billion in direct FX intervention and $15 billion in FX swaps. If shekel weakness leads to higher inflation, the central bank will likely respond with rate hikes.

South Africa just delivered a hawkish hold in September with a 3-2 vote (the two dissents in favor of a hike). The Reserve Bank's model sees the policy rate at 8.25% by end-2023 vs. 8.03% previously, at 7.57% by end-2024 vs. 7.41% previously, and at 7.31% by end-2025 vs. 7.17% previously. This path suggests rates will be higher for longer, with no cuts implied until H2 2024.

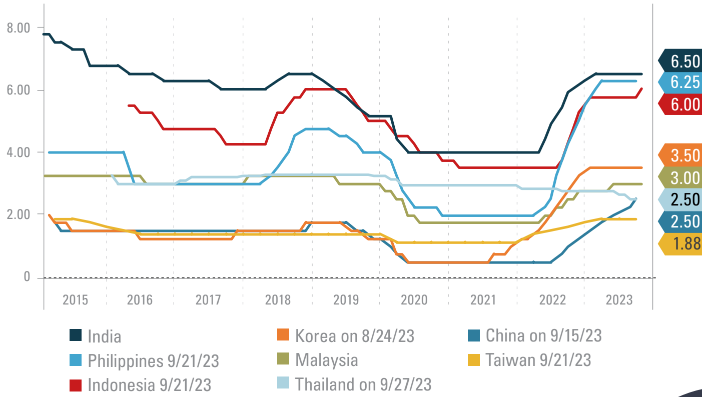


Asia

China stands out for remaining in easing mode this entire global cycle having cut policy rates and reserve requirements several times. More easing is expected in the coming months and should put further downward pressure on the yuan. This is one of the greatest monetary policy divergences right now.

Indonesia and Malaysia have stopped hiking rates. However, they have not signaled any intent to cut. Indonesia is quite aware of the need to keep local interest rates high enough to attract capital and prevent rupiah weakness. After five straight moves to tighten policy, the Monetary Authority of Singapore is now on hold. If the economy continues to suffer from the regional slowdown, we expect easing in 2024.

The Philippines, India, and Korea have paused and while highlighting risks of further hikes. In particular, the recent spike in inflation led Philippine central bank Governor Remolona to warn "A rate hike is on the table for November. How big it will be will depend on the data." He added "So if we raise in November, then I expect rates to stay at that level for the early part of next year." Thailand recently hiked rates 25 bp and signaled a pause. However, it may have to restart the cycle if the recently announced fiscal stimulus fans inflationary pressures.



Bloc Gets Six New Members

With the addition of six new countries in January 2024, BBH's Jay Foraker assesses the opportunity of deeper trade integration across the expanded bloc.

The expansion of the BRICS (Brazil, Russia, India, China and South Africa) bloc to 11 members in January next year has the potential to shape geopolitics in the coming decades.

Announced at the 2023 BRICS Summit in late August, the bloc will add six new countries that are established commodities exporters: Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the UAE. The trade integration between these nations is expected to deepen in the coming years to further a strategic power on the geopolitical stage.

This expansion also brings to the fore several themes that emerging economies have long espoused.

- The de-dollarization of trade. While not explicitly named as a goal in the 2023 Summit Declaration, it can be inferred as a top priority given concern over "unilateral" sanctions against Russia following its invasion of Ukraine.[1] USD is involved in nearly 90% of all FX transactions,[2] making de-dollarization of world trade a tall order.
- Although creation of a common BRICS currency has been discussed, it was not on the Summit agenda. Challenges include the need for banking union, fiscal union, and macroeconomic convergence. However, the Summit Declaration stressed "the importance of encouraging the use of local currencies in international trade and financial transactions between BRICS as well as their trading partners."[3] For perspective, concrete steps toward creation of the European common currency (EUR) began in the early 1970s, with the Euro being fully established in the beginning of 2002.
- The BRICS expansion is another example of the continued trend toward stronger regional trade integration. Although the focus of BRICS is "trade, not aid", one clear message of BRICS expansion is that many countries seek alternatives to the established post-Cold War unipolar world.

Since BRICS' formation in 2010, it's existed as a geopolitical grouping and to finance development projects in emerging Brazil, Russia, India, China and South Africa.[4] BRICS member countries each committed capital in 2015 to establish the New Development Bank (NDB) as an alternative to the World Bank for financing development projects within the five countries, which to date have included the issuance of green bonds. Mutual assistance (e.g. COVID relief) and trade integration have remained priorities of BRICS members.

Enter Russia's February 2022 invasion of Ukraine and subsequent U.S. sanctions of the Russian economy, the freezing of USD transactions involving Russia have reoriented global trade flows, particularly in energy and agricultural commodities.

The expanded BRICS will represent nearly half of the world's population and nearly one-third of both world trade and nominal GDP *(see Figure 1)*.

The 2023 Summit Declaration tasked member countries' foreign ministers with developing a country-partner model and list of prospective members in advance of the 2024 summit (which will be hosted by Russia).[5] That said, the August 2023 BRICS expansion announcement is growing influence having been attended by the UN Secretary General.[6]

Figure 1: World Trade, GDP and Population across BRICS, G20 and G7 (2022)

	% of World				
	Trade	GDP (Nominal)	Population	Members	Recent Developments
BRICS	35%	29%	46%	Argentina, Brazil, China, Egypt, Ethiopia, India, Iran, Russia, Saudi Arabia, South Africa, United Arab Emirates	Expansion from 5 to 11 members; NDB recently issued first ZAR bonds.
G20	85%	55%	54%	Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, South Korea, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, African Union, European Union	India chaired 2023 G20 summit; African Union (55 member states) was added as a member.
G7	67%	60%	15%	Canada, France, Germany, Italy, Japan, United Kingdom, United States, European Union	Under pressure to lead reforms of World Bank, IMF and UN Security Council.

Sources: World Trade Organization, International Monetary Fund and CIA World Factbook 2022.

1. *XV BRICS Summit Johannesburg II Declaration,* 2023, pp 2-3.
2. Maronoti, Bafundi. "Revisiting the international role of the US dollar." *BIS Quarterly Review,* Basel: December 2022
3. *XV BRICS Summit Johannesburg II Declaration*, 2023, p. 14.
4. BRICS - Wikipedia
5. *XV BRICS Summit Johannesburg II Declaration*, 2023
6. https://www.reuters.com/world/brics-poised-invite-new-members-join-bloc-sources-2023-08-24/

Figure 2: USD Value of Bilateral Merchandise Trade, 2021 ($ billions)

	Brazil	Russia	India	China	South Africa	Argentina	Egypt	Ethiopia	Iran	Saudi Arabia	United Arab Emirates
Brazil	—	7.8	12.0	163.5	2.2	24.3	2.6	0.0	2.0	3.9	3.4
Russia	7.8	—	13.6	146.5	1.0	1.4	4.8	0.2	4.0	1.5	5.2
India	12.0	13.6	—	110.6	17.1	5.2	6.3	0.8	1.7	35.9	68.5
China	163.5	146.5	110.6	—	32.8	19.7	11.3	4.1	14.8	41.2	60.9
South Africa	2.2	1.0	17.1	32.8	—	0.7	0.2	0.1	0.0	4.5	4.1
Argentina	24.3	1.4	5.2	19.7	0.7	—	2.1	0.0	1.2	1.2	1.1
Egypt	2.6	4.8	6.3	11.3	0.2	2.1	—	0.1	0.0	8.3	3.1
Ethiopia	0.0	0.2	0.8	4.1	0.1	0.0	0.1	—	0.0	0.6	0.7
Iran	2.0	4.0	1.7	14.8	0.0	1.2	0.0	0.0	—	N/A	6.9
Saudi Arabia	3.9	1.5	35.9	41.2	4.5	1.2	8.3	0.6	N/A	—	33.9
United Arab Emirates	3.4	5.2	68.5	60.9	4.1	1.1	3.1	0.7	6.9	33.9	—

Sources: The World Bank: World Integrated Trade Solution database 2021.

Opportunities for deeper trade integration

From an investment perspective, deeper trade integration should provide short term stimulus for BRICS economies and boost their currencies, while the proliferation of an additional, integrated geopolitical pole of influence will contribute to volatility in the longer term.

One can find potential when breaking down existing trade activity amongst current and new BRICS members. Each of the five current BRICS members has a significant existing trade relationship with the other members, and most have established energy and/or commodity-centric trading relationships with the six new members *(see Figure 2).* The total $900 billion in bilateral merchandise trade among these 11 countries constitutes 3% of $32 trillion total world trade and is expected to grow in the coming years.

Further, each new BRICS member is a significant economic and/or trading power – either globally or regionally – in its own right.

- Argentina is the second largest economy in MERCOSUR and a leading global agriculture exporter.
- Egypt is the largest economy in continental Africa as well as a member of the African Continental Free Trade Area (AfCTA) and a key energy and agricultural exporter.
- Ethiopia, also a member of AfCTA, is one of the fastest growing economies in Africa.
- Iran is the world's third-largest oil and second-largest natural gas reserve holder (as of 2021).[7]
- Saudi Arabia and UAE, similarly, are leading oil and gas exporters actively participating in other multi-lateral groups including the Gulf Cooperation Council (GCC) and the Shanghai Cooperation Organization (SCO).

Underscoring the commodities-centric nature of these trading relationships is the fact that post-expansion, BRICS will include three of the thirteen OPEC member countries (Iran, Saudi Arabia, and the UAE).

Regardless of whether this deeper trade integration ultimately proves to be forward-looking or reactionary, data shows that world trade is gradually reorienting across geopolitical lines. According to the WTO's 2023 World Trade Report, trade between blocs has grown on average 4% to 6% slower than trade within blocs since the beginning of the war in Ukraine in 2022.[8] In addition, WTO research shows that the projected welfare loss from trade decoupling can be as large as 12%, with that loss impacting lower income areas due mostly to the loss of technology spillovers from higher income countries.[9] Hence the range of countries by income represented by the expanded BRICS, specifically higher per-capita GDP countries like Saudi Arabia and UAE, mitigate the potential welfare loss from trade decoupling.

7. U.S. Energy Information Agency: https://www.eia.gov/international/analysis/country/IRN

8. *World Trade Report 2023.* Geneva: the World Trade Organization, p.32.

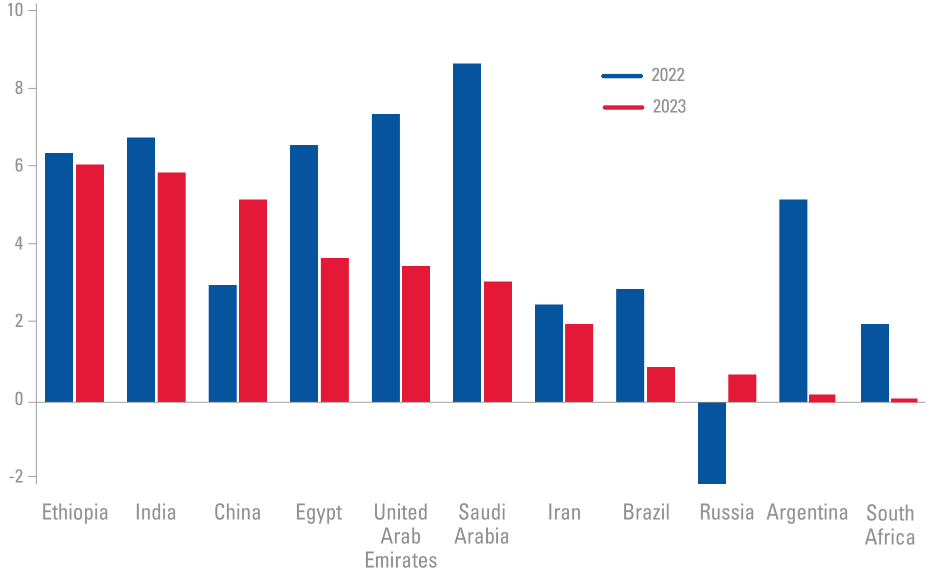
9. Goes, C. and Bekkers, E. (2022), "The Impact of Geopolitical Conflicts on Trade, Growth, and Innovation", WTO Staff Working Paper ERSD-2022-09, p.33.

Highlighting divergent priorities and interests

Despite the practical nature of the trade integration, the expanded BRICS bloc comprises countries with divergent priorities and interests. This includes South Africa's need to obtain new energy sources to address electricity shortages, Russia's need for new export markets and sources of investment in the wake of U.S. sanctions, and a push by Saudi Arabia and the UAE to establish more independent foreign policy positions.[10] There is also the dichotomy of Iran and Saudi Arabia belonging to the same bloc, given recent tensions and the fact that the two countries only reestablished diplomatic ties in March 2023 following a deal brokered by China.

One may question the durability of this expansion given the divergence of interest among the soon to be eleven members. Regardless, there is significant potential for material trade integration within the expanded bloc, which could be a net positive for the world economy, as well as for the members, given their varying growth rates at present *(shown in Figure 3)* per the IMF.[11]

Figure 3: Real GDP growth (Annual % change)



Source: International Monetary Fund 2022, 2023.

With 2023 GDP growth slowing markedly in most BRICS countries, observers should watch for signs of whether integration keeps these economies in growth mode during 2024 and beyond.

10. S&P Global Market Intelligence, July 18, 2023
11. IMF Data

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