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Econotes is a research publication available free on request. It is not a solicitation for business. It is devised and written by Dr. Andrew F. Freris based on 46 years of market experience which included senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well senior academic posts with universities in London and Hong Kong

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S.AFRICA, NIGERIA AND RUSSIA: COMMON ISSUES DIFFERENT OPPORTUNITIES

Summary

- All three economies share the common characteristic of commodities dependence and particularly on oil. The 12M outlook for the price of oil and gold, however, are basically flat.
- The current performance of S.Africa is more promising than that of Nigeria. which has a long way to go before its physical and human potential translates into earnings and stable currency, notwithstanding terrorist attacks. S. Africa, with the strikes behind it can look forward to a pickup in GDP growth.
- Russia will continue to depend on oil and gas but the Ukraine crisis left little impact on economic performance for now.

Investment Conclusions

- As all three economies are proxies for commodities their "investability" ranking must contain something more, such as consistency of economic and financial policies or trends
- All three currencies are strengthening and the rand may, slowly, reestablish favor as an interest differential investment now that the labor unrest abates
- Equity markets performance is modest in all three economies, and very dependent on forex movements for USD investors, with Russia being the cheapest and with strong recent performance which may continue for now.

Sharing some common characteristic

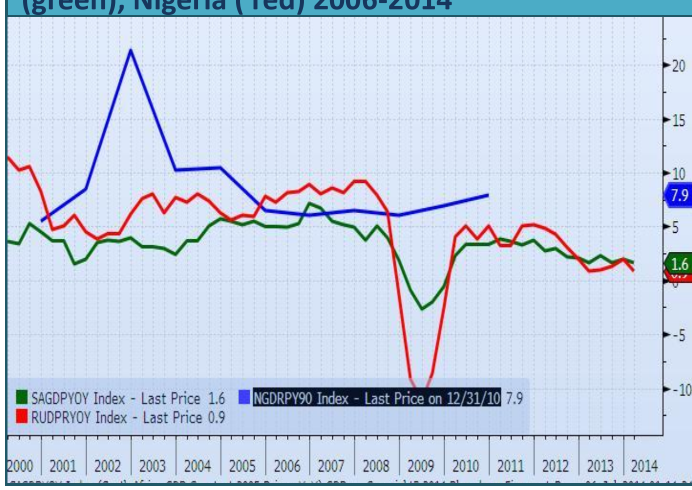
It is easy to exaggerate the dependence of these economies on commodities, but not so of Russia where exports of oil and gas accounted in 2013 for 58% of total exports, with the EU being the key buyer, especially of gas, accounting for 52% of the total exports. Russia is, in absolute terms, the biggest world exporter of oil and of natural gas. Nigeria on the other hand, strategically speaking, provided only 2.7% of world's oil capacity with oil output accounting for 11.0% of GDP, and now after the GDP revision, for about 8.0%.S.Africa is not the dominant gold producer, supplying only about a fifth of world output, but it is the dominant producer of platinum as it supplies about 77.0% of world total. In the case of gold, China is the biggest producer, followed by Australia and the US with S.Africa coming a distant sixth after Peru!

All these economies, however, owe primarily their relatively robust external balances to their commodities exports and Russia's potential in a large number of minerals, and in oil and gas in particular, is formidable.

Nigeria's recent revision of its GDP propelled it to the number one position in Africa, overtaking S.Africa, with the 2013 figure revised upwards by 89%.This revision on its own had little or no macro impact, except it has obscured, for now, the overal growth trend.In Chart 1 we show GDP growth only up to 2010.

The rebased numbers for 2012 were 6.7%, for 2013 7.4%(e) and a forecast 7.2% for 2014.In comparison, the GDP growth rates for Russia and S.Africa are modest **S.Africa's** GDP growth in 2013 registered 1.9% ,with 1Q.14 at 1.6% yoy likley to be further slowed down in 2Q.14 by the lenghty mining strikes. **Russia** clocked a 1.2% growth in 2013 and 0.9% in 1Q.14, likely to stay low in 2Q.14 as a result of the Ukraine crisis.

Chart 1: GDP growth YoY %, Russia (red),S.Africa (green), Nigeria (red) 2006-2014



Source: Bloomberg

Markets and investment opportunities

The **S.African** rand has long been a favored for carry trades because of S.Africa's high rates. Three months deposits rates are now 6.6% while the 2Y govies yield 6.2%.The forex rates however registered a continuous weakness since 2012 and only since the start of 2014 has the rand trended stronger. The end of the strikes will help GDP recovery and may rekindle carries.(Chart 2)

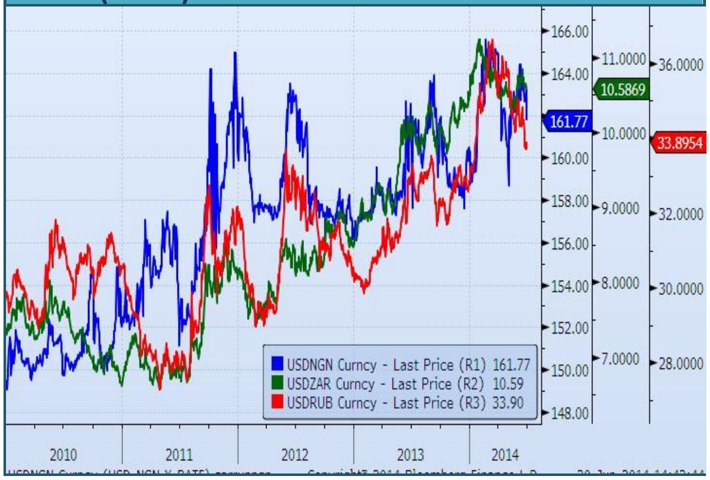
The **Russian** ruble has had a much more volatile history, but, clearly the imposition of sanctions by th EU and the US as a result of the Ukraine crisis had little impact on the overall recovery of the unit since the start of the year. Similar strengthening trend has been registered on the **Nigerian** naira.(Chart 2)

The equity market in Russia bottomed in April this year and then put on a steep rise confounding the concerns over the effects of the sanctions, registering a 16% rise in ruble terms with the ruble appreciating during the same period by 5.0%.The market, however, is less than 1.% ytd, but it is quite cheap at a 12M forward P/E of 5.5.In comparison the Nigerian stock market is up ytd in naira terms by 3.3% with a forward P/E of 11.8 while the S.African market is up by 13.0% ytd in rand terms but expensive at 15.7 forward P/E. Market rates and govies yields in Russia spiked during the crisis but are down again, while S.African rates are trending up.

FACTBOX : Nigeria and the reality of strife

The current concern over the Muslim insurgency in the north of the country should take into consideration three aspects of Nigeria's history. First, Nigeria experienced a vicious secessionist civil strife, the Biafra War, in 1967-70 which killed more than1.0 ml.and involved a whole region trying to secede. The central authorities won. Second, guerilla movements become a threat to central authorities when they transcend regionalism and cultural or religious adherences. Organized armies invariably win over narrowly focused guerillas. Lastly Nigeria has enough resources to dominate, eventually, economically Africa, if the mismanagement of its economy ceases.

Chart 2: Forex to USD, Ruble (red), Rand (green) Naira (blue) 2010-2014



Source: Bloomberg

Focusing and summarising

As we indicated in the opening remarks, trends in commodity prices are very important for these economies, but investors may seek a little more rather than commodity proxies.

We believe that the steady and slow recovery of the US, the glacial recovery in the EU and the false promise of Japan (See Econotes No.4) will not push oil prices past the highs achieved recently, especially as the impact of the lifting of US export restrictions is still uncertain.

Gold prices will be capped by the near certainty of higher UST yields. Hence the macros of these economies will be helped but not driven by this neutral commodities environment.

Hence our modest proposals of re-examining the rand as a carry instrument and the Russian equity market with the caution that the ruble has been more volatile than the rand.

Nigeria remains under observation as a very long term opportunity, but could be given a boost if the guerilla threat dissipates.

(Completed 5-7 July 2014)