

Economic Views

BRICs

February 2012

View from the top

We expect the BRIC economies to continue to drive world economic growth in 2012. Nevertheless, the growth prospects for these economies are expected to moderate in the short-term due to trade exposure to the Eurozone, and a slowdown in domestic demand following a period of rising inflation and interest rates in 2011. Unlike developed economies, the authorities in the BRICs have greater capacity to provide monetary and fiscal support. In particular there has been a reversal in the interest rate cycle, with Brazil leading the way. The positive impact from the rate cuts is expected to take effect in the second half of 2012. Stable FDI flows into these economies suggest that the medium to long-term outlook remains optimistic.

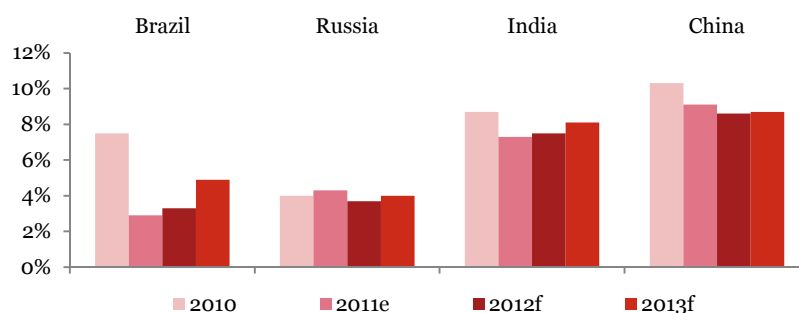
Key opportunities

- Easing of inflationary pressures and interest rate cuts
- Government reforms to support the domestic economy
- Stable long term foreign capital inflows to continue

Key threats

- Moderation in economic growth compared to 2010 on account of domestic and external factors
- Equity outflows and vulnerable exchange rates
- Political uncertainty with upcoming elections in Russia

Real GDP forecasts for BRIC economies



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Source: IBGE, Russian Federal State Statistics Service, Indian Central Statistical Organisation, National Bureau of Statistics of China; PricewaterhouseCooper's estimates (e) and forecasts (f)

Forecasts are updated regularly online at economics.pwc.com

BRICs – have they hit the wall?

The BRICs have witnessed robust growth in 2010 and the first half of 2011. However, recently they have been faced with slowing demand growth raising concerns over their ability to support a weak global economy this year as many have hoped for.

Going forward, BRIC economies will face challenges from:

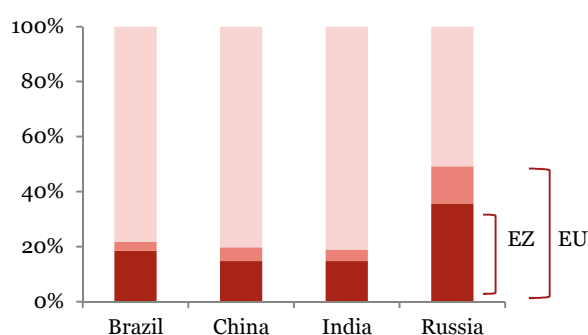
- a deteriorating global economy, particularly in Europe;
- a reversal of investor risk appetite moving capital from the BRICs (and other emerging markets) to safe havens; and
- a loss of confidence at home.

As a result, we expect a moderation of growth in 2012. However, the authorities in these economies have plenty of scope to loosen monetary policy and provide fiscal support so we expect policy measures to provide a boost in the second half of 2012.

Trade exposure to Eurozone

With a high probability that the Eurozone will enter into a recession this year, the export position of the BRIC economies is likely to take a hit due to their exposure to this region. **Chart 1** below shows that the European Union makes up at least a fifth of total exports for these countries, and that Russia is particularly exposed.

Chart 1: Share of total exports to European Union and Eurozone (2010)



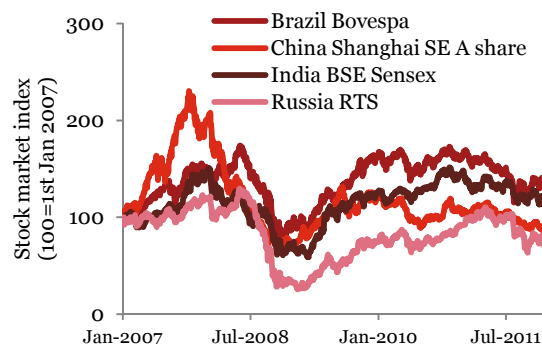
Source: UNCTAD

Short-term capital is exiting the BRICs

Over the past decade, the BRICs have been the world's favourite investment destination with mutual funds pouring money into these countries. However, in 2011 uncertainty in the global economy resulted in equity outflows and stock market falls.

Chart 2 below shows the movement of major stock markets in these economies with indices falling to almost the same level as during the recession in 2008-2009. BRIC funds recorded US\$15 billion outflows last year.¹ These outflows are also putting downward pressure on BRIC currencies.

Chart 2: Stock market movement in the BRICs



Source: Thomson Reuters Datastream

Confidence disrupted

Compounding these problems is the loss of momentum in domestic activity. A particular concern is the declining confidence of businesses, which could undermine investment plans for some of the biggest firms in the BRICs in 2012. PwC's 15th Annual Global CEO Survey² indicates that business leaders' short-term confidence in the BRIC economies has fallen sharply in the last year (see **Table 1** below).

Table 1: Short-term confidence for BRICs

	Brazil	Russia	India	China
2008	33	30	70	29
2009	50	53	57	68
2010	55	61	88	72
2011	42	48	55	51

Source: PwC 15th Annual Global CEO Survey

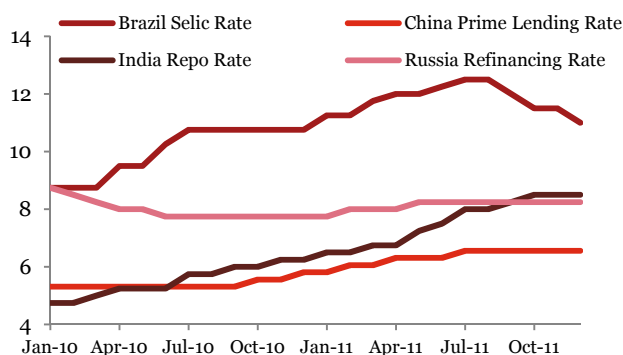
¹ Source: EPFR Global data

² Source: <http://www.pwc.com/gx/en/ceo-survey/index.jhtml>

Authorities have policy space to support their economies

After a long period of interest rate tightening, there are signs of a reversal in the interest rate cycle with Brazil and China leading the way. Brazil's central bank has already cut its key policy rate by 150 bps since September 2011 (see [Chart 3](#) below), while the Chinese monetary authorities reduced the banks' reserve requirement ratio policy by 50 bps in December 2011. Moderating growth and easing inflation are expected to create room for interest rate cuts in Russia and India this year. The positive impact of rate cuts on economic growth is expected to take effect in the second half of the year.

Chart 3: BRICs key interest rates

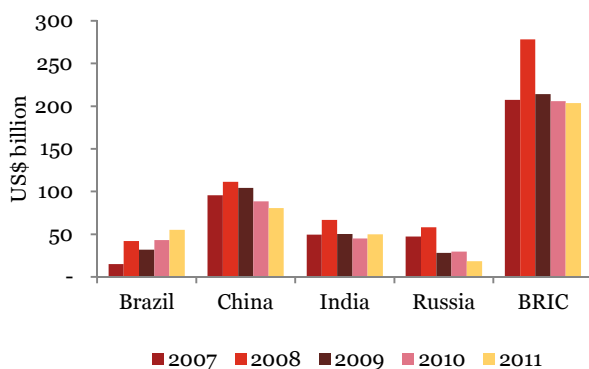


Source: BRICs central banks

Long-term investment continues to flow into the BRICs

The flow of stable, long-term foreign capital in the form of foreign direct investment (see [Chart 4](#) below), appears to have been largely unaffected by the short-term concerns. This supports a favourable medium to long-term outlook for the BRIC economies.

Chart 4: Foreign Direct Investment to BRICs

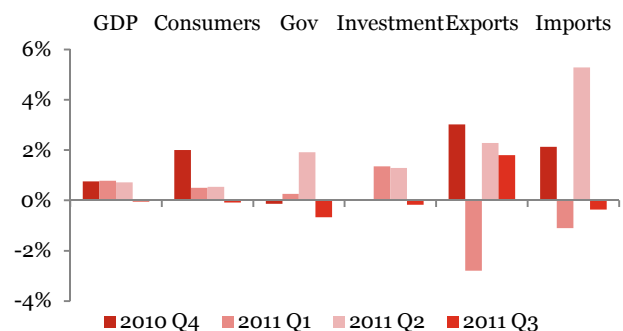


Source: FDI markets

Brazil

For the first time in more than two years, Brazil's economy contracted marginally in the third quarter of last year (see [Chart 5](#) below). High interest rates, high inflation and controls on foreign capital all contributed to stalling consumption and investment in the third quarter of 2011. We now estimate GDP growth for 2011 will come in at 2.9% compared to 7.5% in 2010.

Chart 5: The Brazilian economy, quarter-on-quarter growth rates



Source: IBGE

A swift response from policymakers

With indications of weak growth continuing in Q4 2011, and an outflow of portfolio capital which contributed to a weakening of the currency – the real to US\$ stood at 1.84 in December 2011, having reached 1.59 in June – policy makers have taken measures to stimulate domestic demand and encourage more inward investment. The measures include:

- a 150 bps cut in base rates since September 2011;
- a lowering of the financial transaction tax to attract more foreign capital; and
- a package of fiscal measures to support consumption and spur construction.

Domestic demand is expected to drive growth in 2012

Collectively we expect that these measures will see domestic demand growth pick up in the second half of 2012. Consumer spending is likely to get a further lift from the planned 14% rise in minimum wage at the start of the year and the “13th month salary”. The government's Growth Acceleration Programme – a plan to invest US\$526 billion over the next four years with the help of the private sector – is expected to drive investment going forward.

We expect growth of 3.3% in 2012 and 4.9% in 2013. A slower rate of growth over the next two years compared to 2010, along with a stabilisation of the Real in 2012, is expected to ease inflation to 5.3% in 2012 and 5% in 2013 from 6.6% estimate for 2011.

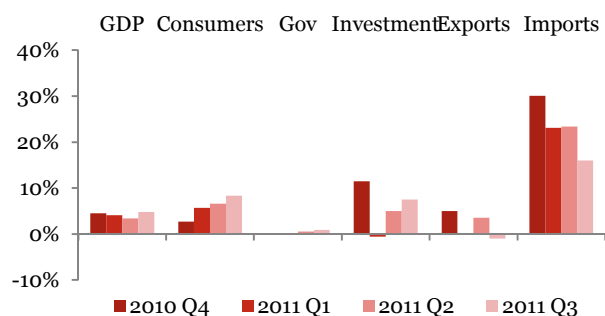
Russia

Unlike the other BRIC economies, Russia's economic output has continued to accelerate in 2011, expanding by 4.3% compared to 4% in 2010. However, signs of a slowing manufacturing sector, the exposure of Russia's trade balance to a slowdown in the Eurozone, and the reliance on oil prices which may soften in 2012 as global demand slows, suggest growth could moderate slightly this year.

Growth holding up

Russian GDP growth remained resilient in Q3 of 2011 – growing by 4.8% year-on-year (y-o-y), up from 3.4% (y-o-y) in the previous quarter. This has been driven by strong consumption and investment activity and a slowdown in import growth (see [Chart 6](#) below). The combination of accelerating consumption growth and slowing import growth suggests that the Russian economy may be going through a period of import substitution.

Chart 6: The Russian economy, year-on-year growth rates



Source: Federal State Statistics Office

Inflationary pressures may pick up again in 2012

A sharp jump in the agricultural output last year along with monetary and fiscal measures taken in early 2011 has helped to ease inflation from 9.6% in January 2011 to 6% in December 2011. But with parliamentary elections in March 2012, we are anticipating an increase in government spending. Together with possible rate cuts, we are expecting inflation to pick up again and average 6.9% this year and 7.5% next year.

These measures will also support GDP growth and help sustain the consumption and investment momentum – we expect the Russian economy to grow by 3.7% and 4% in 2012 and 2013 respectively. However, Russia is vulnerable to a downturn in the Eurozone (forming 35% of its total exports) and a possible fall in oil prices.

Spotlight: Russia's accession to the World Trade Organisation (WTO)

After 18 years of negotiations, Russia has been formally accepted into the World Trade Organisation (WTO). Some estimates suggest Russian membership will give the economy a boost equivalent to 1% of GDP per year.

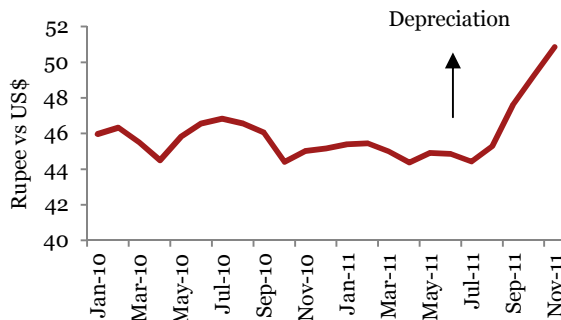
Russia is Europe's third largest export market. Compliance with WTO rules will open the market for a range of services, including legal, insurance and telecoms. And although overall foreign participation in the banking system will be limited to 50%, 100% foreign-owned banks will be allowed to open in Russia for the first time. Tariff reductions on imported equipment will reduce costs and increase profitability in industries such as telecommunications and steel manufacturers.

India

India's economic prospects took a turn for the worse in summer 2011. The rupee dropped 15% against the dollar, industry output growth halved and GDP growth slowed to 6.9% in Q3, its slowest rate in two years. However, the main challenge for policy makers in 2012 will be to bring inflation under control. Until inflation is on a downward path it will be difficult for the central bank to cut interest rates to support slowing growth.

The rupee was one of the worst performing currencies in 2011

The rupee depreciated by 15% against the US dollar between August and November 2011, making it one of the worst performing currencies in Asia (see [Chart 7](#) on the following page). The underlying causes of this slowdown were the weak domestic environment, high fiscal and current account deficits, and a reduced risk appetite by investors.

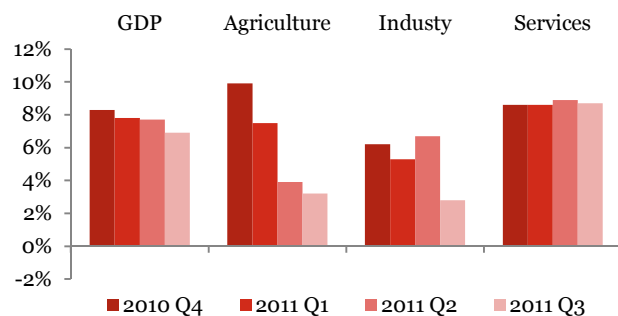
Chart 7: Falling rupee against US\$

Source: Reserve Bank of India

In response to capital outflows and the depreciating rupee, the Reserve Bank of India (RBI) reduced restrictions on foreign capital inflows. The RBI increased the limits on foreign investment in government and corporate debt, increased the amount of interest payable on non-resident deposits, and increased the amount domestic companies can borrow from abroad.

Services sector remains resilient

There has been a significant slowdown in the industrial sector mainly driven by the slack in manufacturing and mining activities. However within industries, electricity, gas and water supply expanded at a healthy pace. The services sector remained resilient in 2011 (see [Chart 8](#) below).

Chart 8: The Indian economy, year-on-year growth rates

Source: Ministry of Statistics and Programme Implementation, GDP measure is at factor cost

On the demand side, while consumer spending decelerated, investment contracted. Exports grew by 27.4% in the year to Q3 2011, supported by the weaker rupee.

Government reforms to boost investment should provide business opportunities in 2012

The Government is likely to undertake reforms this year which could include the introduction of a goods and service tax to reduce tax evasion. A hike in the FDI limit in the insurance sector from 26% to 49% has also been under discussion together with the

speeding up of the delivery of key energy projects, and allowing up to 51% FDI in multi-brand retail (a policy that was announced and then delayed last year).

Bringing inflation under control will be the key to robust economic growth in 2012

Inflation remains the main challenge facing the Indian economy. Averaging 9.4% in 2011, it is well above the central bank's comfort zone. On account of monetary tightening and slowing growth, we expect inflation to moderate to 7% this year and to 5.8% in 2013.

High interest rates are expected to constrain private investment and consumer spending in the first half of 2011. However, if inflation eases, as we anticipate, then the central bank will have room to reverse the interest rate cycle later in the year. In the mean time, we are expecting government spending to pick up in Q1 2012 on account of upcoming state elections. We project the economy to expand by 7.5% in 2012 and 8.1% next year.

China

The Chinese economy experienced a moderation in growth to 9.2% in 2011 on account of slowing services and manufacturing sector. We expect this moderation to continue into 2011 with growth falling below 9% for the first time since 2001.

The key risks to China's economic outlook are from its trade exposure to the slowing growth in Europe and a sharp correction in property prices that is already underway, but the authorities have plenty of ammunition to respond if a sharper slowdown becomes evident.

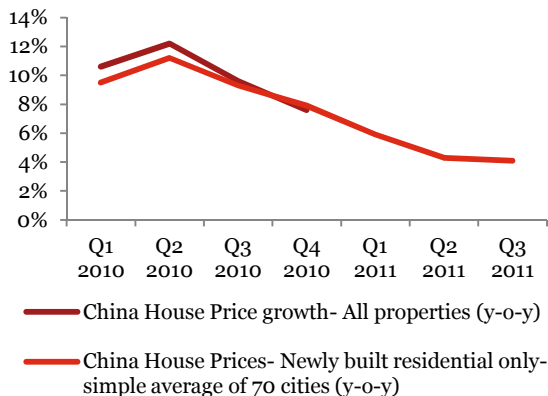
Overheating property market

One of the problems facing China's economy is overheating in the property market. The cause of this can in part be linked to the effects of the 4 trillion yuan government stimulus package announced in 2010 coupled with continued strong demand fundamentals and ongoing market speculation in the market.

The government has responded by imposing purchase restrictions, requiring higher mortgage down payments, restricting the number of houses owned, and introducing a property tax in some cities.

This has resulted in a sharp correction in the real estate market (see [Chart 9](#) below). Given the Government's commitment to bringing down property prices, this trend is likely to continue into 2012.

Chart 9: Chinese property market, year-on-year growth rates



Source: Chinese National Bureau of Statistics, PwC Analysis, All property series has been discontinued since 2011. We have calculated the newly built residential index based on a simple average of 70 city indices

Growth may fall below 9% for the first time since 2001

China's inflation rate fell to 4.2% in November last year after peaking at 6.5% in July on account of the easing food prices and monetary tightening measures undertaken earlier in 2011. The central bank had increased banks' reserve requirement ratio (RRR) six times and the benchmark rate three times in 2011 to combat above-target inflation. However with inflation back on a downward trend, the central bank had a 50 bps reversal in the RRR in December 2011.

Given the deteriorating global economic outlook and China's trade exposure to Europe, we are expecting growth to moderate to 8.6% in 2012 and 8.7% in 2013, and we expect inflation to average 3.9% in 2012 and 2013.

Brazil's recent performance and forecasts

	2010	2011 ^e	2012 ^f	2013 ^f
Real growth (annual % change)				
GDP	7.5	2.9	3.3	4.9
Consumer spending	6.9	3.9	3.2	5.1
Government	4.2	2.1	2.0	4.0
Investment	21.5	5.4	8.9	15.3
Exports	11.5	4.5	8.4	10.0
Imports	35.9	10.1	11.6	19.1
Contribution to growth (%)*				
Consumer spending	4.3	2.5	2.0	3.2
Government	1.0	0.5	0.5	0.9
Investment	3.7	1.1	1.8	3.2
Exports	1.3	0.5	1.0	1.2
Imports	-4.1	-1.5	-1.8	-3.2
Domestic demand	9.1	4.0	4.2	7.3
Net exports	-2.9	-0.9	-0.8	-2.0
Economic structure (% of GDP)*				
Consumer spending	62.1	62.7	62.7	62.8
Government	23.0	22.8	22.5	22.3
Investment	19.6	20.0	21.1	23.2
Exports	11.4	11.6	12.1	12.7
Imports	14.5	15.5	16.7	19.0
Inflation				
CPI (annual % change, average)	5.0	6.6	5.3	5.0

Source: INDEC; PricewaterhouseCoopers estimates (e) and forecasts (f) *Component shares of GDP may not add up to 100% owing to stockbuilding and statistical discrepancy.

Size of the economy

	2010	2011 ^e	Share of 2011 world total
Population (millions)	193	195	2.8%
GDP, current prices (US\$ billions)	2,090	2,518	3.6%
GDP, PPP terms (International \$ billions)	2,179	2,309	2.9%
GDP per capita, current prices (US\$)	10,816	12,917	
GDP per capita, PPP terms (International \$)	11,273	11,846	

Source: IMF

Russia's recent performance and forecasts

	2010	2011 ^e	2012 ^f	2013 ^f
Real growth (annual % change)				
GDP	4.0	4.3	3.7	4.0
Consumer spending	3.0	6.4	6.0	6.2
Government	1.4	0.8	1.1	1.4
Investment	6.1	5.6	7.9	8.0
Export	7.1	2.2	5.8	7.5
Imports	25.6	17.7	13.7	15.0
Contribution to GDP growth (%)*				
Consumer spending	1.5	3.2	3.0	3.2
Government	0.3	0.1	0.2	0.2
Investment	1.3	1.2	1.7	1.8
Export	2.3	0.7	1.9	2.5
Imports	-4.3	-3.6	-3.1	-3.7
Domestic demand	3.0	4.5	4.9	5.2
Net exports	-2.0	-2.8	-1.2	-1.2
Economic structure (% of GDP)*				
Consumer spending	49.5	50.6	51.7	52.8
Government	18.9	18.3	17.8	17.4
Investment	21.1	21.4	22.3	23.1
Export	33.3	32.7	33.4	34.5
Imports	20.1	22.8	25.0	27.6
Inflation				
CPI (% change, annual average)	6.9	8.5	6.9	7.5

Source: Federal State Statistics Service; International Monetary Fund; PricewaterhouseCoopers estimates (e) and forecasts (f) *Component shares of GDP may not add up to 100% due to stock building and statistical discrepancy.

Size of the economy

	2010	2011 ^e	Share of 2011 world total
Population (millions)	143	142	2.1%
GDP, market rates (US\$ billions)	1,480	1,885	2.7%
GDP, PPP rates (International \$ billions)	2,231	2,376	3.0%
GDP per capita, market rates (US\$)	10,356	13,236	
GDP per capita, PPP rates (International \$)	15,612	16,687	

Source: IMF

India's recent performance and forecasts

	2010	2011 ^e	2012 ^f	2013 ^f
Real growth (annual % change)				
GDP#	8.7	7.3	7.5	8.1
Agriculture	4.9	4.7	3.5	4.0
Industry	9.2	4.7	7.0	8.0
Services	9.5	8.7	8.5	9.0
Contribution to growth (%)				
Agriculture	0.7	0.7	0.5	0.5
Industry	1.8	0.9	1.4	1.6
Services	6.2	5.7	5.6	6.0
Economic structure (% of GDP)*				
Agriculture	14.4	14.1	13.5	13.0
Industry	20.2	19.7	19.6	19.6
Services	65.4	66.3	66.9	67.4
Inflation				
WPI (annual % change, average)	9.6	9.4	7.0	5.8

Source: Indian Central Statistical Organisation; Indian Office of the Economic Adviser; PricewaterhouseCoopers estimates (e) and forecasts (f). #GDP at factor cost for Calendar year. . *Component shares of GDP may not add up to 100% owing to statistical discrepancy.

Size of the economy

	2010	2011 ^e	Share of 2011 world total
Population (millions)	1,191	1,207	17.6%
GDP, market rates (US\$ billions)	1,632	1,843	2.6%
GDP, PPP rates (International \$ billions)	4,058	4,470	5.7%
GDP per capita, market rates (US\$)	1,371	1,527	
GDP per capita, PPP rates (International \$)	3,408	3,703	

Source: IMF

China's recent performance and forecasts

	2010	2011 ^e	2012 ^f	2013 ^f
Real growth (annual % change)				
GDP	10.3	9.2	8.6	8.7
Agriculture	4.3	4.5	4.0	4.0
Industry	12.2	10.6	9.0	8.7
Services	9.5	8.9	9.2	9.7
Contribution to growth (%)				
Agriculture	0.4	0.4	0.3	0.3
Industry	6.7	5.9	5.0	4.9
Services	3.4	3.2	3.3	3.5
Economic structure (% of GDP)*				
Agriculture	9.0	8.6	8.2	7.8
Industry	55.6	56.2	56.2	56.3
Services	35.4	35.2	35.6	35.9
Inflation				
CPI (annual % change, average)	3.3	5.4	3.9	3.9

Source: National Bureau of Statistics, Bloomberg; PricewaterhouseCoopers estimates (e) and forecasts (f);

*Component shares of GDP may not add up to 100% owing to stockbuilding and statistical discrepancy.

Size of the economy

	2010	2011 ^e	Share of 2011 world total
Population (millions)	1,341	1,348	19.6%
GDP, current prices (US\$ billions)	5,878	6,988	10.0%
GDP, PPP terms (International \$ billions)	10,120	11,316	14.4%
GDP per capita, current prices (US\$)	4,382	5,184	
GDP per capita, PPP terms (International \$)	7,544	8,394	

Source: IMF

PwC Macro Consulting

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The team works with businesses and governments to identify and assess strategic opportunities and external risks. The team's consulting services combine strategic analysis of macro trends with strong quantitative techniques across four broad categories outlined below:

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We work with cities, regions and countries to create or update their economic vision blueprints and strategies.

Geographical market selection

We assist growing multinational companies to assess opportunities in new geographical markets.

Business scenario analysis

We use our knowledge of macro trends and our econometric toolkit to help companies understand the risks and opportunities in their business.

Economic impact analysis

We assist clients in demonstrating the value they bring to their host economies in the context of wider economic trends.

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