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Economic Views

BRICs

October 2011

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View from the top

One of the main challenges confronting the BRIC economies is accelerating inflation which has been largely driven by rising food and commodity prices. Despite a series of interest rate hikes by the respective central banks, inflation continues to run well above the comfort level for policy makers – Brazil (7.2%), Russia (9.5%), India (9.2%) and China (6.2%).

The higher interest rates are slowing the pace of industrial growth. The BRIC economies grew at a softer pace in the first half of the year on account of this ongoing monetary tightening. However, robust domestic demand on the back of sustained consumer spending and investment is expected to drive economic growth going forward.

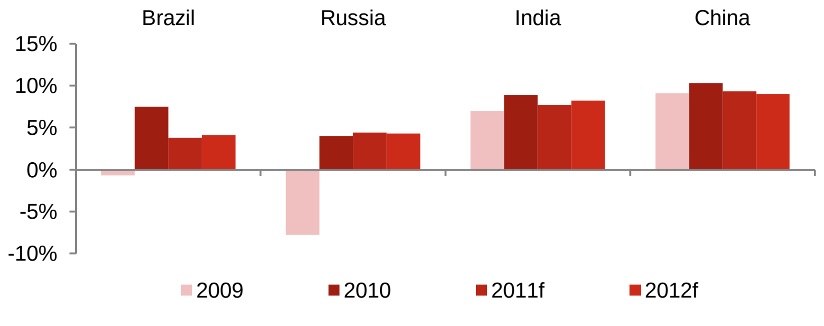
Key opportunities

- Strong domestic demand
- Strong capital inflows
- Large infrastructure spending plans
- Rising middle-class and urbanisation

Key threats

- Strong inflationary pressures
- Monetary tightening
- Reliance on export-led growth
- Government red tape

GDP forecasts for BRIC economies



Yael Selfin
yael.selfin@uk.pwc.com
+44(0)20 7804 7630

Himani Gupta
himani.z.gupta @uk.pwc.com
+44 (0)20 7804 5475

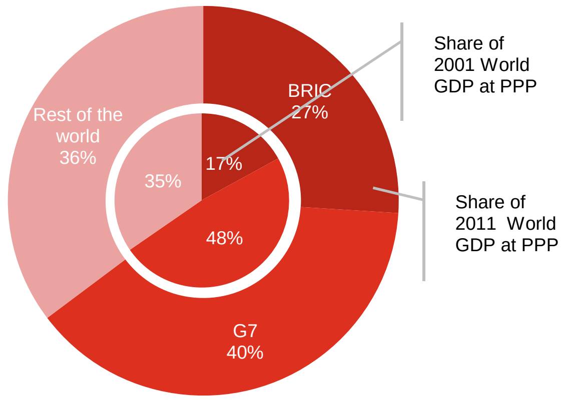
Source: IBGE, Russian Federal State Statistics Service, Indian Central Statistical Organisation, National Bureau of Statistics of China; PricewaterhouseCooper's forecasts (f)

Forecasts are updated regularly online at *economics.pwc.com*

BRICs – a decade later

The BRICs concept was developed a decade ago to describe the growing potential of Brazil, Russia, India and China. These countries have witnessed robust growth over the last ten years and recovered briskly from the global crisis. Chart 1 below shows the shift of global economic power to these countries, with their share in world GDP rising over the last ten years.

Chart 1: Share of world GDP at PPP exchange rates

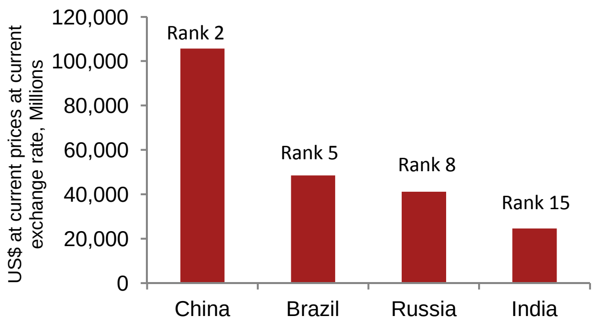


Source: International Monetary Fund, PwC forecasts

Opportunities

One of the common characteristics of the growth of the BRIC economies is the rise in capital inflows to these economies. BRICs accounted for a third of all emerging market mergers and acquisition (M&A) deals last year and a tenth of global M&A deals[1].Chart 2, top-right, shows the level of gross foreign direct investment (FDI) that flowed into these economies in 2010. FDI inflows to China topped US$ 100 billion last year and Brazil climbed up the global rankings, jumping from 15th in 2009 to 5th last year. The improving business environment and government policies such as encouraging joint ventures and partnerships have supported these investment inflows.

Chart 2: Gross FDI inflows (2010)

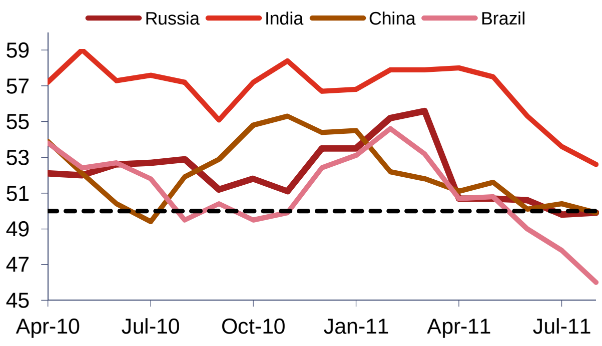


Source: UN

Threats

One of the main challenges confronting the BRICs is accelerating inflation, which has been mainly driven by food and commodity prices, and is running well above the comfort level for policy makers - Brazil (7.2%), Russia (9.5%), India (9.2%) and China (6.2%). Central banks have responded by tightening monetary policy but the rising interest rates are slowing the pace of industrial growth. Chart 3, below, suggests a moderation in manufacturing growth in BRIC economies since April 2011 as indicated by the Manufacturing Purchasing Mangers' index (PMI). The index suggests that whilst growth in the manufacturing sector has slowed in India, the sector's output is contracting in Russia, China and Brazil.

Chart 3: Manufacturing Purchasing Managers' Index (PMI)



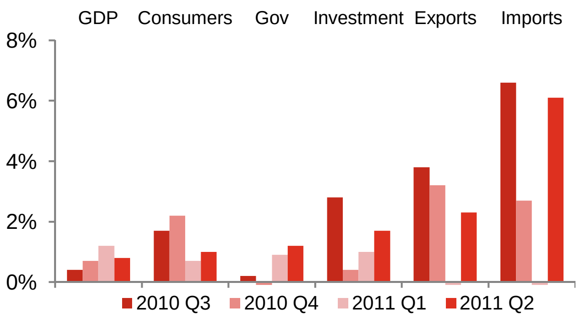
Source: Markit

[1] Source: Thomson Reuters

Brazil

After witnessing strong growth of 7.5% last year, Brazil's economy grew at a softer pace in the first half of this year, as the strong currency dampened exports and together with high interest rates slowed industrial activity. GDP expanded by 0.8% quarter-on-quarter (q-o-q) in Q2 2011, down from 1.2% in Q1 2011 (see Chart 4below).

Chart 4: The Brazilian economy, quarter-on-quarter growth rates



Source: IBGE

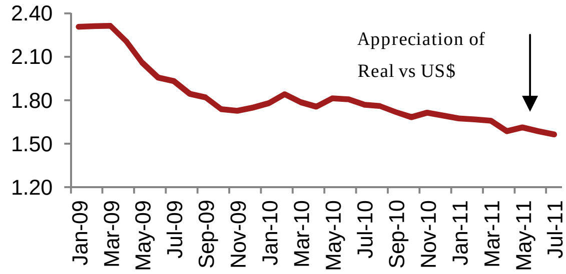
The central bank's dilemma: Rising inflation and an appreciating real

In a move to fight inflation, Brazil's central bank has raised the benchmark Selic interest rate by 375 bps since April 2010 to 12.5% in August 2011. In addition, in order to rein back accelerating credit growth, the government has cut the funds it provides the Brazilian development bank to US$27 billion in 2011 from US$ 105 billion in 2010.

Despite these measures, inflation has surged to 7.2% in August 2011, the highest level in the last six years, on account of rising food prices and expanding credit.

The central bank is currently in a tight spot with the responsibility to manage both inflation and capital inflows. Rising interest rates have not only slowed industrial activity but are also hurting the trade balance by putting upward pressure on the real. The currency has appreciated by more than 30% against the dollar since January 2009 (see Chart 5 top-right).

Chart 5: Real vs US$



Source: Thomson Datastream

To limit the currency appreciation and reduce capital inflows, monetary authorities are continuously intervening in the money market. The central bank introduced permanent cash reserve requirements on banks' foreign exchange positions. The government tripled the tax on foreign purchases of its bonds to 6%, imposed a 1% tax on some currency derivates, raised the cost of foreign borrowing by local companies and restricted banks' positions against the real. These measures have so far not been able to prevent the real from strengthening.

The weakening domestic outlook and global uncertainties resulted in a surprise 50 bps cut in the Selic rate on 31st August 2011, reversing the cycle of interest rate hikes that began in April 2010. Overall, we expect inflation to remain high this year at 6.4% and gradually ease off to 4.6% in 2012.

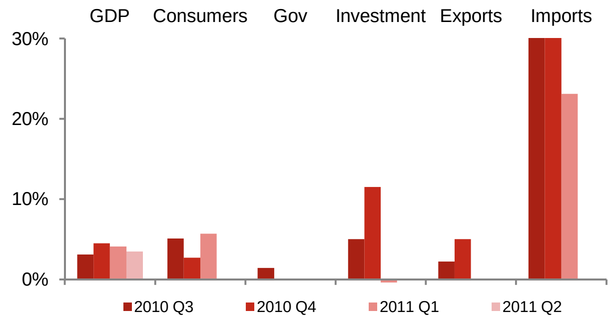
Growth Outlook

The new government under Dilma Rousseff, who took office in January 2011, has been taking steps to control inflation and government spending. The government plans to cut the 2011 budget by US$ 30 billion to cool off inflationary pressures. However, these cuts would not impact the Growth Acceleration Programme –a plan to invest US$526 billion over the next four years with the help of the private sector. Favourable government policies such as the promotion of public-private partnerships, strong FDI inflows and planned infrastructure spending for the World Cup in 2014 and Olympics in 2016 should see the Brazilian economy growing relatively strongly at 3.9% in 2011 and 4.1% in 2012.

Russia

The Russian economy grew by 3.4% year-on-year (y-o-y) in Q2 2011, down from 4.1% in the previous quarter (see Chart 6 below). Whilst the breakdown of growth in Q2 2011 is not yet available, figures show consumer spending remained strong in the year to the first quarter. Retail sales also grew at a healthy rate of 15.4% in the first half of 2011. However, investment activity underwent a contraction in the year to the first quarter of 2001, as rising interest rates dampened investor sentiment.

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



Source: Federal State Statistics Office, breakdown of GDP not yet available for Q2 2011.

Inflation eases off slightly

Monetary tightening earlier in the year, accompanied by measures such as banning grain exports and selling grain domestically at discounted prices, have helped to ease off inflation to 8.2% in August 2011 compared to 9.6% in January 2011. Going forward, we expect inflation to average 8.3% in 2011 and 7% in 2012.

The on-going sovereign debt crisis has seen investors fleeing to 'safe havens', which negatively impacted Russia, with the finance ministry and the central bank offering to place a US$ 5 billion credit line to domestic banks in order to avert a possible liquidity crunch.

Threats to fiscal position

Russia is aiming for a balanced budget this year, while the forecast for next year's deficit is 1.5% of GDP. These targets are based on an average annual oil price of US$ 105/barrel this year and US$ 95/barrel in 2012. However, weakening global demand and a volatile oil price pose some risks to the targeted budget deficit. In addition, improving the effectiveness of public expenditure is likely to be a challenge during the election period in 2011 and 2012.

Growth outlook

The moderation in the Index of Industrial Production (IIP), which has grown at 4.9% in the year to Q2 2011 compared to 10.9% in the same period last year, and a downward trend in the Manufacturing PMI, suggest that industrial activity is likely to remain sluggish for the rest of the year. However, government spending is likely to pick up ahead of the parliamentary election this year and presidential election next year. Overall, the Russian economy is expected to expand by 4.4% and 4.3% in 2011 and 2012 respectively, driven largely by consumer and government spending.

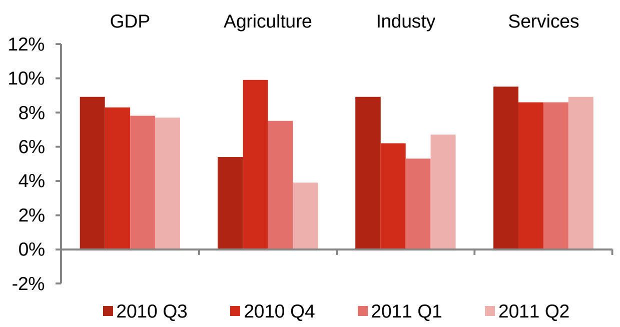
India

The robust growth momentum in India over 2010 moderated in the first half of this year. GDP expanded at 7.7% in the year to Q2 2011, the slowest pace for six quarters. On the demand side, consumer spending growth cooled down to 6.2% in the year to Q2 2011 compared to 8% in the previous period. The government's commitment to cut its fiscal deficit resulted in government spending growth moderating to 2.1% in the year to Q2 compared to 4.9% previously. Fixed investment growth was more encouraging and stood at 7.9% in the year to Q2 2011.

Services sector remains resilient

Whilst there are signs of easing in agriculture and industrial activity, the services sector remained resilient in Q2 2011 largely across the board (see Chart 7 below).

Chart 7: The Indian economy, year-on-year growth rates



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

Persistent Inflation

Containing high and sticky inflation has emerged as the most pressing concern for Indian policymakers. Despite the eleven interest rate hikes by the Reserve Bank of India since March 2010, inflation has averaged 9.5% for the first seven months of this year. Food and fuel prices are the biggest factors unpinning the rising inflation. The government procures food grains to be prepared against adverse weather conditions and meet unforeseen demand patterns. A record food grain procurement of 65 million tons in July 2011, significantly above the 35 million tons buffer usually stocked by the government, and the ongoing monetary tightening, should see inflation ease slightly to 9.1% this year and gradually come down to 6.2% in 2012.

Government reforms and growth outlook

As rising inflation stalls consumer spending and fiscal tightening restricts government spending, robust investment growth is likely to drive economic growth going forward. Strong foreign capital inflows are also expected to foster rising investment activity.

The government is under pressure from a series of corruption allegations and is looking to speed up the reform process in order to get the economy back on a growth trajectory and to improve its reputation. The Economic Advisory Council has proposed allowing the share of FDI to reach 49% in most industries, as well as the acceleration of the implementation of the goods and services tax, and the removal of constraints on land acquisition and environmental clearances. The government recently approved a US$ 7.2 billion deal between Reliance Industries and BP Plc, which is one of the largest foreign direct investments into India to date.

Opening up FDI in retail with a ceiling of 51% is also being discussed. However, certain conditions are likely to be imposed as the retail sector is opened up to foreign investors, such as possibly requiring half of all jobs created to be in rural areas, sourcing at least 30% of their input requirements from medium and small enterprises, and commiting at least US$ 100 million in investment.

However, despite this potential boost to investment, slowing industrial growth is likely to see more moderate economic growth of 7.7% in 2011 with a slight pick up to 8.2% in 2012.

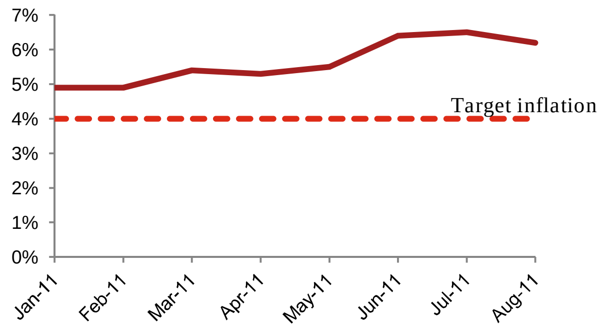
China

The Chinese economy grew by 9.6% in the year to Q2 2011, not far off the 9.7% expansion in the year to the previous quarter. Services and manufacturing continued to grow at a robust pace of 9.2% and 11% respectively in the year to Q2. Consumption remained vibrant, with retail sales growing at 17.2% in the year to Q2 2011 in nominal terms.

Rising food and property prices

However, inflation is starting to bite. It hit a three-year high of 6.5% in July 2011 before easing slightly to 6.2% in August (see Chart 8 below). Food prices remained the key driver of inflation - in particular pork prices, which form a big part of Chinese consumers' food basket.

Chart 8: Chinese inflation



Source: Chinese National Bureau of Statistics

To stave off the threat of overheating, the Chinese central bank has increased the one-year benchmark lending rate three times this year to 6.56% in August and has increased cash reserve requirements six times this year to cool the money supply. As inflation remained outside the comfort zone for the first half of the year, it is expected to remain the top priority of the policy makers. We expect that monetary intervention will bring inflation down to 5.6% in 2011 and 4.6% in 2012.

Government measures to ease house price inflation seem to have taken effect with more cities reporting lower or unchanged property prices in August 2011. The latest efforts to curb property prices included local government establishing new home price control targets, based on economic growth and increases in disposable income, as well as imposing home purchase restrictions in second and third tier-cities. The government has also announced that it will build 36 million affordable housing units between 2011 and 2015 in a move to curb property prices.

Robust growth outlook

The strong jump in imports in August 2011 points at continued health in domestic demand. With early signs of rebalancing and reduced dependence on exports, we expect the Chinese economy to expand at 9.3% this year and 9% in 2012, with domestic demand expected to remain robust, driven by consumer spending and investment.

Brazil's recent performance and forecasts

	2008	2009	2010	2011[f]	2012[f]
Real growth (annual % change)					
GDP	5.1	-0.7	7.5	3.8	4.1
Consumer spending	5.4	4.2	7.0	5.0	4.6
Government	5.4	3.9	3.3	2.4	1.9
Investment	5.6	-10.3	22.0	8.3	17.1
Exports	-0.8	-10.2	11.5	4.4	11.0
Imports	18.5	-11.5	36.2	13.6	24.1
Contribution to growth (%)*					
Consumer spending	3.2	2.5	4.4	3.1	2.9
Government	1.3	0.9	0.8	0.5	0.4
Investment	2.3	-1.9	3.7	1.6	3.4
Exports	-0.1	-1.2	1.3	0.5	1.3
Imports	-2.0	1.4	-4.0	-1.9	-3.7
Domestic demand	6.8	1.5	8.9	5.3	6.7
Net exports	-2.1	0.2	-2.7	-1.4	-2.4
Economic structure (% of GDP)*					
Consumer spending	59.6	62.6	62.3	63.0	63.9
Government	22.9	24.0	23.0	22.7	22.2
Investment	18.4	16.6	18.9	19.7	22.4
Exports	12.0	10.9	11.3	11.5	12.9
Imports	12.3	11.0	13.9	15.2	20.0
Inflation					
CPI (annual % change, average)	5.7	4.9	5.0	6.4	4.6

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

Size of the economy

	2008	2009	2010	Share of 2010 world total
Population (millions)	190	191	193	2.8%
GDP, current prices (US$ billions)	1,655	1,601	2,090	3.3%
GDP, PPP terms (International $ billions)	1,996	2,002	2,172	2.9%
GDP per capita, current prices (US$)	8,728	8,360	10,816	
GDP per capita, PPP terms (International $)	10,528	10,453	11,239	

Source: IMF

Russia's recent performance and forecasts

	2008	2009	2010	2011f	2012f
Real growth (annual % change)					
GDP	5.2	-7.9	4.0	4.4	4.3
Consumer spending	10.8	-7.7	4.0	4.9	5.0
Government	2.8	2.0	0.9	1.0	1.2
Investment	10.4	-15.7	5.7	7.8	8.0
Export	0.6	-4.7	11.0	7.0	8.8
Imports	14.8	-30.4	20.5	14.0	16.1
Contribution to GDP growth (%)*					
Consumer spending	6.5	-4.9	2.5	2.4	2.5
Government	0.4	0.3	0.1	0.2	0.2
Investment	2.5	-4.0	1.3	1.7	1.7
Export	0.2	-1.6	3.9	2.3	3.0
Imports	-5.8	13.0	-6.6	-2.8	-3.5
Domestic demand	9.4	-8.6	4.0	4.3	4.5
Net exports	-5.6	11.4	-2.8	-0.5	-0.5
Economic structure (% of GDP)*					
Consumer spending	63.0	63.1	63.1	49.7	50.0
Government	14.2	15.8	15.3	18.3	17.7
Investment	25.7	23.5	23.8	21.8	22.6
Export	34.2	35.4	37.7	34.1	35.6
Imports	42.8	32.4	37.5	22.0	24.4
Inflation					
CPI (% change, annual average)	14.1	11.7	6.9	8.3	7.0

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

Size of the economy

	2008	2009	2010	Share of 2010 world total
Population (millions)	142	142	140	2.0%
GDP, market rates (US$ billions)	1,660	1,222	1,465	2.3%
GDP, PPP rates (International $ billions)	2,277	2,118	2,223	3.0%
GDP per capita, market rates (US$)	11,700	8,614	10,437	
GDP per capita, PPP rates (International $)	16,042	14,927	15,836	

Source: IMF

India's recent performance and forecasts

	2008	2009	2010	2011f	2012f
Real growth (annual % change)					
GDP	7.5	7.0	8.9	7.7	8.2
Agriculture	0.4	0.5	4.9	4.8	4.0
Industry	5.7	5.6	9.6	6.5	8.3
Services	10.0	9.1	9.6	8.7	9.1
Contribution to growth (%)					
Agriculture	0.1	0.1	0.7	0.7	0.6
Industry	1.2	1.1	1.9	1.3	1.7
Services	6.2	5.8	6.2	5.7	6.0
Economic structure (% of GDP)*					
Agriculture	15.9	14.9	14.4	14.0	12.7
Industry	20.3	20.1	20.2	20.0	21.8
Services	63.8	65.0	65.4	66.0	65.5
Inflation					
WPI (annual % change, average)	8.7	2.4	9.6	9.0	6.3

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

Size of the economy

	2008	2009	2010	Share of 2010 world total
Population (millions)	1,182	1,199	1,216	17.7%
GDP, market rates (US$ billions)	1,258	1,268	1,537	2.4%
GDP, PPP rates (International $ billions)	3,382	3,644	4,060	5.5%
GDP per capita, market rates (US$)	1,065	1,058	1,264	
GDP per capita, PPP rates (International $)	2,861	3,039	3,339	

Source: IMF

China's recent performance and forecasts

	2008	2009	2010	2011f	2012f
Real growth (annual % change)					
GDP	9.6	9.1	10.3	9.3	9.0
Agriculture	5.4	4.2	4.3	3.5	3.5
Industry	9.9	9.9	12.2	10.4	9.7
Services	10.4	9.3	9.5	9.1	9.3
Contribution to growth (%)					
Agriculture	0.6	0.4	0.4	0.3	0.3
Industry	5.4	5.4	6.7	5.8	5.4
Services	3.7	3.3	3.4	3.2	3.3
Economic structure (% of GDP)*					
Agriculture	10.0	9.5	9.0	8.5	7.1
Industry	54.3	54.7	55.6	56.1	57.1
Services	35.6	35.7	35.4	35.4	35.7
Inflation					
CPI (annual % change, average)	5.9	-0.7	3.3	5.6	4.6

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

	2008	2009	2010	Share of 2010 world total
Population (millions)	1,328	1,335	1,341	19.6%
GDP, current prices (US$ billions)	4,520	4,990	5,878	9.3%
GDP, PPP terms (International $ billions)	8,218	9,057	10,085	13.6%
GDP per capita, current prices (US$)	3,403	3,738	4,382	
GDP per capita, PPP terms (International $)	6,188	6,778	7,518	

Source: IMF

PwC Macro Consulting Services

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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. Our analysis takes into consideration our worldwide macro views and leverages our proprietary data on demand and supply trends in different regions and sectors. Using a mix of primary and secondary research, modelling, forecasting, benchmarking and gap analysis, we answer the following questions for our clients:

- What economic goals are realistic?
- Who are our main competitors?
- How we compare against the competition?
- What should we do to improve our global standing?

Geographical market selection

We assist growing multinational companies to assess opportunities in new geographical markets. This is done through bespoke econometric analysis using in-house models that project demand and supply dynamics. Typically we forecast demand in potential new markets as measured by revenue. To this we can add projections of costs and other risks that affect market attractiveness.

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 through the following techniques:

- Revenue forecasting, using econometric models that link our economic forecasts and industry indicators to revenue;
- Stress-testing key business metrics by creating and applying upside and downside macroeconomic risk scenarios; and
- Price elasticity analysis, pointing at a product's optimal price in a given market and estimating its impact on key business metrics.

Economic impact analysis

We assist clients in demonstrating the value they bring to their host economies in the context of wider economic trends. Our findings are typically used for media profile-raising as well as to support government relations, and comprise estimates of a company or industry's impact on GDP, employment and long-term productivity growth, as well as other wider socio-economic benefits.

For more information about our services please contact one of the members of the Macro Consulting team below:

Yael Selfin	Head of Macro Consulting	+44 (0)20 7804 7630	yael.selfin@uk.pwc.com
Richard Boxshall	Consultant	+44 (0)20 7213 2079	richard.boxshall@uk.pwc.com
Richard Snook	Consultant	+44 (0)20 7212 1195	richard.snook@uk.pwc.com
Douglas Niven	Senior Associate	+44 (0)20 7804 2775	douglas.r.niven@uk.pwc.com
Himani Gupta	Senior Associate	+44 (0)20 7804 5475	himani.z.gupta@uk.pwc.com
Danny Chan	Associate	+44 (0)20 7804 3872	danny.chan@uk.pwc.com
Robert Vaughan	Associate	+44 (0)20 7212 2521	robert.p.vaughan@uk.pwc.com

economics.pwc.com

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