R&C Trendwatch

December 2013

Elections in key emerging markets heighten 2014 risks

Executive summary

- *Upcoming national elections in emerging markets may result in stalled decision-marking in the short term*
- *In certain markets new leadership may enact nationalistic or protectionist policies*
- *Global retail and consumer goods companies will want to consider potential political risks*

Introduction

A number of major emerging market countries will hold national elections in 2014, including Brazil, India, Indonesia, South Africa, and Turkey. The stakes are high for both consumer goods companies and retailers.

In several cases, such as in India and Indonesia, politicians seeking office may, if elected, enact protectionist or nationalist policies that discriminate against foreign firms. In other cases, such as in Brazil and South Africa, more business-friendly policies are expected. The next government in Turkey will probably fall somewhere in-between. Retail and consumer goods firms will want to be aware of what these electoral cycles mean for their prospects in both the short and medium term, and make their investment and risk management decisions accordingly.

Brazil

Post-election infrastructure investments likely

According to PwC's 16th Global CEO Survey, retail and consumer goods companies view Brazil as one of the top five markets most crucial for growth. President Dilma Rousseff is strongly favored to win reelection next October. According to a poll released in October, she leads among likely voters in all election scenarios.

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*This publication is produced in collaboration with **Eurasia Group (www.eurasiagroup.net)**. Eurasia Group is a leading political risk research and consulting company.*

Key emerging market elections in 2014

Country	Type	Date	Expected outcome	Effect on R&C policy
Brazil	Legislative; Presidential	October 5 (October 26 runoff)	• Ruling PT will maintain majority coalition in congress • Rousseff will be reelected as president	The government will muddle through with only limited economic reforms before the election, but the next government will tackle some of the economy's inefficiencies.
India	Parliamentary	By May 31 (Date TBD)	• Opposition BJP will win and lead a coalition government with Narendra Modi as prime minister	Policymaking will remain stalled ahead of the elections, and the current restrictive rules on FDI in multibrand retail are likely to persist under the new government, although it is likely to implement a watered-down GST.
Indonesia	Legislative; Presidential	April 9; July 9	• Opposition Golkar and PDI-P will likely win the most seats • A likely three-way race between Bakrie (Golkar), Megawati/Joko (PDI-P), and Prabowo (Gerindra coalition)	The government is likely to restrict imports and strengthen domestic sourcing requirements, although it may open the management of some infrastructure to FDI.
South Africa	Parliamentary	April-July (Date TBD)	• Ruling ANC will win with a smaller majority than they currently have • Zuma will likely remain president	Populist policies, including stronger affirmative action, will be implemented during the campaign, with more business-friendly policies likely after the election.
Turkey	Local; Presidential	March 30; July-August (Date TBD)	• Ruling AKP will win local elections • Erdogan will win the presidency	Broad policy continuity is expected, although the economic reform agenda will be stalled until the electoral cycle is concluded in 2015.

Sources: IMF World Economic Outlook, World Bank World Development Indicators

The election is also unlikely to significantly shift the balance of power in the legislature. If Rousseff wins, she is expected to retain a large governing coalition in the legislature. If an opposition candidate were to win, then Rousseff's coalition would probably fragment, and most of the centrist parties would pledge support for the new government in exchange for earmarks and jobs in the new administration.

With annual inflation at 5.8% and the government's gross debt-to-GDP ratio exceeding 60%, pressure is mounting for an economic policy adjustment. But with politicians focused on campaigning, major change will have to wait until after the election. Instead, the government will continue to muddle through without tackling structural issues such as high taxes and burdensome regulations that create economic inefficiencies.

Despite this outlook, there have been some limited policy reforms. These include the central bank's recent cycle of rate hikes intended to fight inflation, the government's plan to reduce subsidized lending from public banks to non-strategic sectors, and the aggressive turn to the private sector in transportation infrastructure projects. In the run-up to the election, the government is also likely to maintain tax incentives that encourage investment in housing, durable goods, and telecommunications infrastructure, as well as tax cuts related to labor costs in key industries including retail.

After the election, the new government will push harder on meaningful economic policy adjustments. This will be the case regardless of who wins, but an opposition candidate would be more likely to tackle these challenges more assertively. Infrastructure investment will remain an important priority regardless of who wins. The government aims to attract private sector investment to construct 10,000 kilometers of new rail lines, upgrade 7,500 kilometers of federal highways, auction airports to private investors, and overhaul Brazil's ports to boost capacity and improve logistics. If successful, these efforts would reduce costs for retailers and consumer goods firms operating in and sourcing from Brazil.

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India

Reforms benefiting foreign retailers still face internal hurdles

The outlook for multi-brand retail in the country remains cloudy. The next general election, which must be held by May, is likely to see Gujarat's controversial chief minister Narendra Modi and his Bharatiya Janata Party (BJP) leverage a plurality of seats to form a fragmented coalition government. If the BJP underperforms expectations, India will instead likely be led by a hodgepodge of regional parties in a so-called Third Front government.

Campaigning will heat up as the election approaches, subsuming the policy discourse in New Delhi. Long-pending reforms will likely continue to languish as the opposition BJP obstructs the ruling Indian National Congress party's legislative agenda. As a result, retail and consumer goods firms should not expect any substantive policy changes before May—or even after the election. In either election scenario, the resulting ruling coalition would likely prove too weak to push through many of the long-delayed economic reforms that would put the economy back on track. This is also likely to prolong the policy uncertainties that retailers currently face, as the BJP and many of India's regional parties have stymied the full implementation of two key reforms that could spur dramatic new retail expansion: the goods and services tax (GST) and FDI in multi-brand retailing.

Although India formally allowed 51% FDI in multi-brand retail operations in September 2012, strict conditions have seen the country fail to attract any such investment. Small retailers and traders make up a core BJP constituency, and the party has vociferously opposed any opening of the Indian market. But while the new government is unlikely to ease any of the major restrictions that have kept international retailers from opening stores, it is also unlikely to withdraw approval for multi-brand retail investment altogether, given the damage such a move would cause to India's already tattered investment reputation. As such, the status quo is likely to linger for at least several years after the election.

If implemented, a GST would substantially reduce compliance costs and sourcing delays for consumer goods producers and retailers alike, taking a notable step toward giving India a domestic common market. Although the BJP supports the GST in principle, a BJP-led government is likely to make a series of concessions to the states to grant them more independent revenue-raising autonomy, thereby diluting the impact on taxes and increasing the tax challenge for businesses, at least in the medium term. Concessions under discussion include allowing states to enact the reform at different times, apply it to different baskets of goods, or levy different tax rates.

Indonesia

No matter who wins, a protectionist agenda on non-energy imports is likely

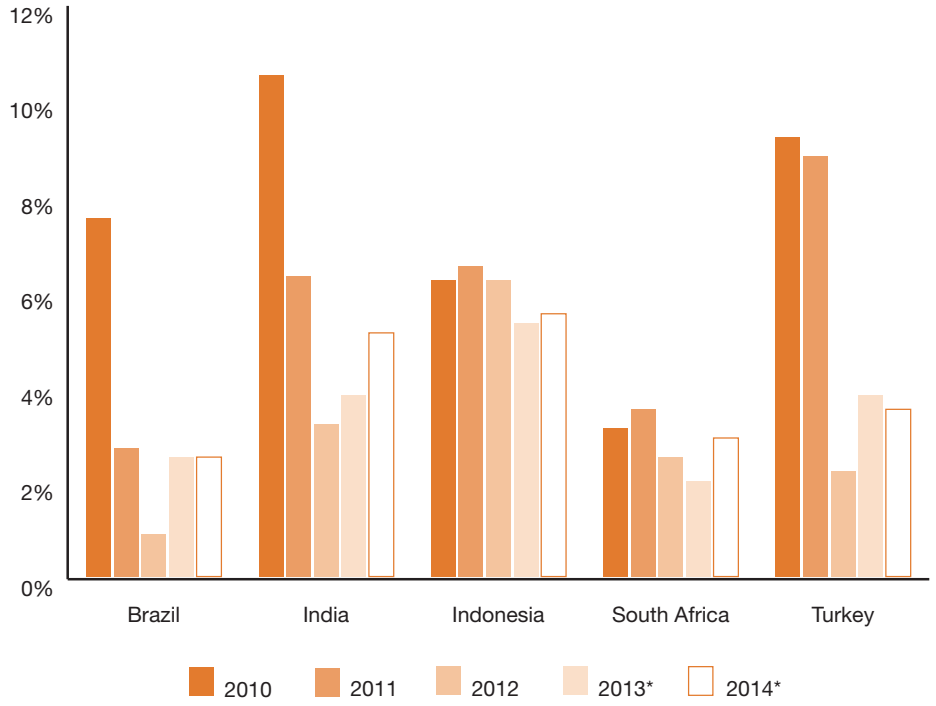
One of the world's fastest-growing consumer markets, Indonesia has both parliamentary elections in April and a presidential vote in July. The parliamentary elections are shaping up to be a contest among the four main parties, with the Golkar Party and the Indonesian Democrat Party-Struggle (PDI-P) likely to win more seats than President Susilo Bambang Yudhoyono's Democrat Party (PD) and the Gerindra party. The presidential election remains wide open, as formal nomination of candidates must await parliamentary election results.

Decision-making is likely to stall ahead of the elections, with candidates for legislative seats starting their campaigning in early January. The most important exception could be a decision to allow foreign companies to manage Indonesia's airports and ports. Even though foreign firms would still be precluded from owning such facilities, allowing foreign managers could improve Indonesia's struggling transportation networks. This would help retailers and consumer goods firms by reducing supply chain bottlenecks that are common throughout the country.

Other policies needed to ensure sustainable economic growth, such as further cuts to fuel subsidies, are unlikely ahead of the elections. Instead, given the government's concerns over a growing current account deficit, which is being driven by increasingly expensive fuel imports, it is possible that authorities will attempt to clamp down on non-oil and gas imports. This move could exert pressure on them to require greater domestic manufacturing or import-substitution. Either result could dramatically hike the operating costs for companies in Indonesia.

It is unlikely that such nationalistic policies will be tempered after the election, regardless of who wins, as most possible presidential candidates have espoused both nationalist and populist policies to some degree. Indonesia's elites generally agree that the country should attempt to move up the value chain, so the government will likely push for growth in domestic manufacturing. Companies in the electronics sector will be at particular risk, as consumer demand for these products continues to rise.

Economic growth forecast to pick up as elections approach



*Forecast data
Source: IMF World Economic Outlook, October 2013

South Africa

ANC internal strife resulting in negative policy environment

South Africa remains the traditional entry point for investment in sub-Saharan Africa and is now becoming a conduit to the large and growing consumer class on the continent. But elections that will be scheduled between April and June could drive anti-business initiatives because the ruling African National Congress (ANC) is in its weakest position since coming to power in 1994.

The ANC will win the elections, but the party's share of the vote will probably fall. The passing of Nelson Mandela should provide a burst of nostalgic support for the party, but it will still lose (mostly urban) votes to opposition parties, including the liberal (and historically white-led) Democratic Alliance and the new, ultra-populist Economic Freedom Fighters, led by former ANC youth leader Julius Malema.

The ANC and its allies, including the Congress of South African Trade Unions (Cosatu), are suffering from deep internal schisms. To keep Cosatu in its camp, the ANC government will appease labor in the lead-up to elections. Although initiatives like the youth employment tax incentive are positive for firms, the government will also implement policies that hurt businesses—such as restricting contract workers and punishing affirmative action violations.

Factionalism within the ANC and its labor allies will continue to drive indecisive, and in some cases injurious, policies. An example is the recent round of revisions to the Broad Based Black Economic Empowerment code, a set of affirmative action policies that applies to all firms operating in South Africa and is intended to increase black ownership, management, and employment. These will be implemented over the next 12 months and will likely cause many companies to incur significant costs to meet the new criteria and maintain their current status.

The outlook for after the elections, however, is more promising for the business environment. Although statist factions within the ANC will continue their efforts to hobble structural change, basic reforms and more effective capital expenditures will be easier for the ANC to pass after the elections, creating a moderately improved economic outlook for late 2014 and 2015.

Turkey

A large, affluent consumer market, but needed reforms unlikely until 2015

Turkey's large and increasingly affluent population has made it a promising market for retail and consumer goods companies. Despite recent social unrest, it appears that the ruling Justice and Development Party (AKP) is well-placed to win all upcoming elections.

In local polls to be held in March, the key battle between the AKP and the main opposition Republican People's Party (CHP) will be the municipal elections in Istanbul, which the ruling party is likely to win. Next summer, the still-popular Prime Minister Recep Tayyip Erdogan is likely to win the presidential election if he runs. And the AKP is also likely to win the June 2015 parliamentary elections given that the opposition parties remain extremely weak and uninspiring. Policy continuity, therefore, is generally expected to prevail after the elections.

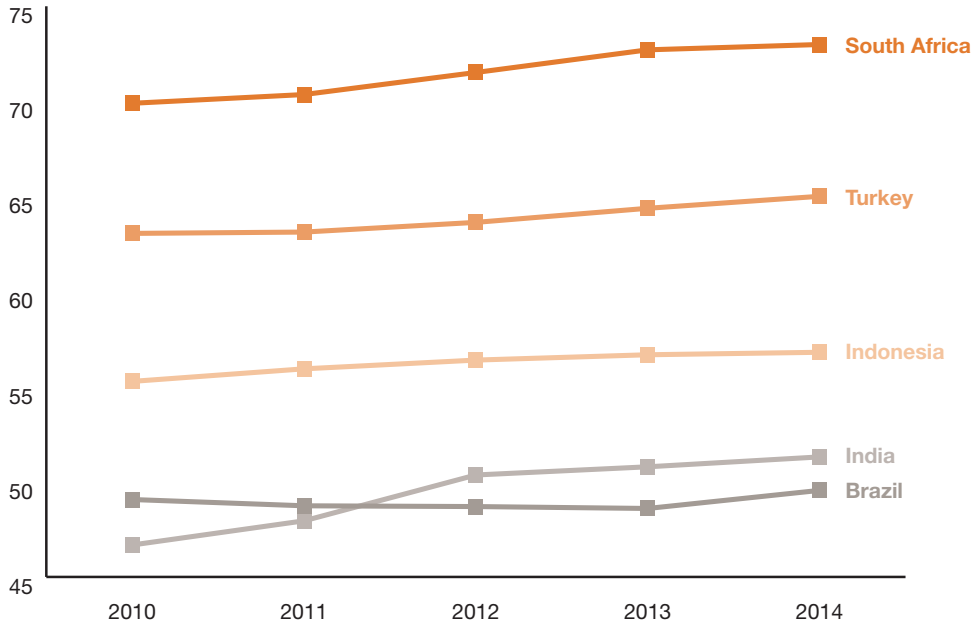
Despite the government's strength, however, political risks are set to escalate through the end of the electoral cycle in mid-2015, mainly because of Erdogan's increasingly authoritarian and uncompromising

manner. In addition, the extended period of campaigning means changes that are needed to improve the political and economic climate in Turkey are likely to be sidelined. Most importantly, a new, consensus-based constitution will not be adopted, with the AKP and the CHP instead potentially agreeing on very limited revisions to the existing constitution. Reforms to tackle the economy's structural problems, such as restricting the informal economy, boosting R&D and the savings rate, increasing flexibility in the labor market, and improving value-added domestic production, are also likely to be shelved. Foreign companies operating in Turkey should not expect any vast improvement in the business operating environment any time soon.

On the other hand, one important, near-term, economic policy initiative will advance: slowing the rate of loan growth in order to reduce the current account deficit. In October, the government adopted a set of measures to curb demand for imported products and limit consumer credit growth levels. These measures included higher risk weightings for credit card loans and consumer loans. Furthermore, consumer financing firms will be subject to the same reserve requirement ratios as banks, and credit card limits will be capped at 400% of monthly income. Additional measures against consumer loans may emerge in the coming months, such as introducing down payments. Limiting consumer credit will likely constrain consumer spending in 2014.

After the elections, the policy environment in Turkey is likely to improve, and Erdogan's populist rhetoric is expected to moderate. At the same time, Erdogan's dominant position in the political system is likely to weaken if he is elected president, because without a constitutional change, he will have less power than he currently does as prime minister. As a result, his ability to intervene in domestic politics is likely to be somewhat constrained.

Business environments are slowing improving



Note: An economy's score is on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the best performance.
Source: World Bank Doing Business 2014

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