Building a Slowdown BRIC by BRIC

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A Cooler Tenth Anniversary

It's been a decade since the coining of the term "BRICs" caused investors, economists and others to pay close attention to four key emerging markets: Brazil, Russia, India and China. Might the BRICs ride to the rescue of a weak global economy as they did back in 2009? That's sadly looking less likely due to recently reduced growth estimates for the individual members. While past is by no means prologue, investors should also bear in mind past differences in asset market performance—evidence that hearty growth, historically, has been more lucrative for equity and bond investors in some BRICs than others. Despite the tendency to group them rather mechanically, the four member countries actually differ significantly in many underlying respects.

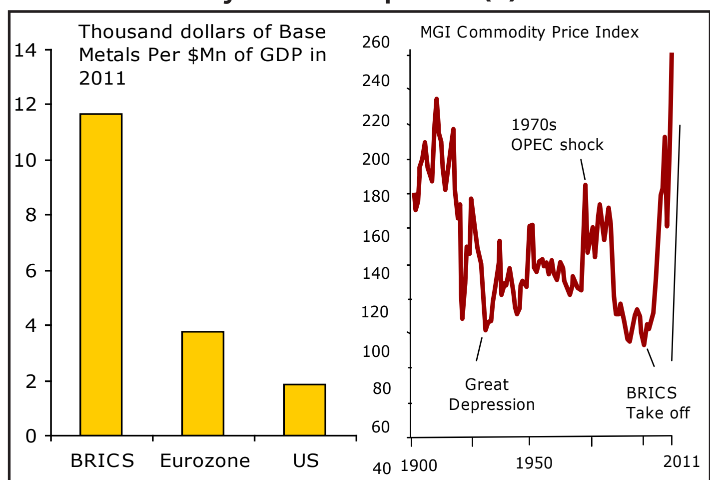
Whether measured in terms of country-level performance or the global economic landscape, the past decade has been an impressive one for the BRICs. The group's four members have accounted for nearly half of the rise in global GDP since the start of the millennium. Growth averaging a healthy 8% per year in the four members has helped to lift the emerging countries' share of the global GDP pie from 37% to 49% in this period. Per dollar of GDP, the four BRIC economies use six times the base metals and appreciably more crude oil than the US does (Chart 1, left). Their fast-paced economic development has, therefore impacted resource markets the most visibly. Real commodity prices, whether for food, energy or steel, fell more or less consistently for much of the twentieth century. Aided by the BRICs' expanding needs, that historical decline has been reversed in little more than a decade (Chart 1, right).

What for the most part has been impressive, if not always matching economic performance, masks deeper differences. China and India both have well diversified manufacturing sectors, complemented increasingly by tradeable services. Russia and Brazil continue, in contrast, to depend heavily on their historically important extractive and resource-processing sectors to pay their way internationally. Those sectors accounted for 74% and 68% respectively of their exports in 2010, tying their economies closely to the rhythms of the international business cycle.

Not All Growth is Created Equal

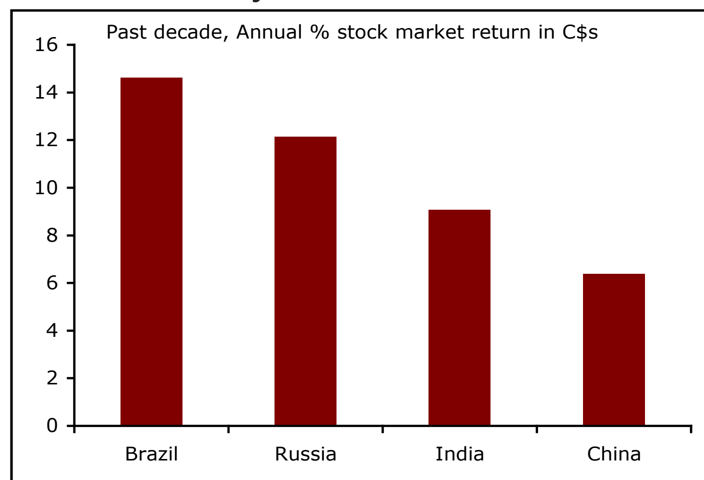
For investors, not all growth is created equal. While the BRICs as a class have been the investment community's darlings, particularly since the 2008 global crisis, fast-paced economic performance has rewarded investors in some countries more than others. Brazil's stock market has been the top performer in the last decade in Canadian dollar terms. Despite the strongest economic growth, China's market has had the lowest returns (Chart 2). Not

Chart 1—**BRICs Resource Intensive (L), Real Commodity Prices Snap Back (R)**



Source: McKinsey & Co, CRU, IMF

Chart 2—**Better Payoff in Some BRICs**



Source: MSCI, CIBC

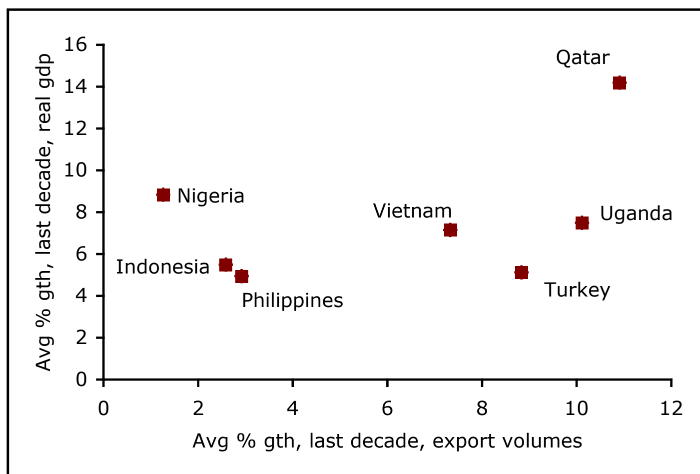
putting all your eggs in one basket is a sensible policy. From a diversification perspective, Brazil and Russia's markets have had the highest degree of correlation with Canadian stocks, a not altogether surprising finding given the resource-intensity of both economies. Those in China and India have had the weakest relationship.

Imitation is, of course, the sincerest form of flattery. One reason the BRICs don't stand out in the economic crowd to the degree they once did is the success of a growing number of other countries in copying the same export-oriented formula. Outside the BRICs, import substitution policies were popular in emerging markets a decade or two ago. Now from Ankara to Ho Chi Minh City, "tomorrow's BRICs" are pursuing an export-oriented path to faster economic and business development, seeking to secure future prosperity through greater interaction with the world's other economies (Chart 3).

That said, no country is an island. The BRICs' elevated trade dependence, while a *plus* in good times, is a *negative* in more difficult ones. We expect weaker export demand owing to the global economy's softer performance to help hold BRIC growth to a sub-7% pace in 2012 after an average increase of well over 8% in the two preceding years.

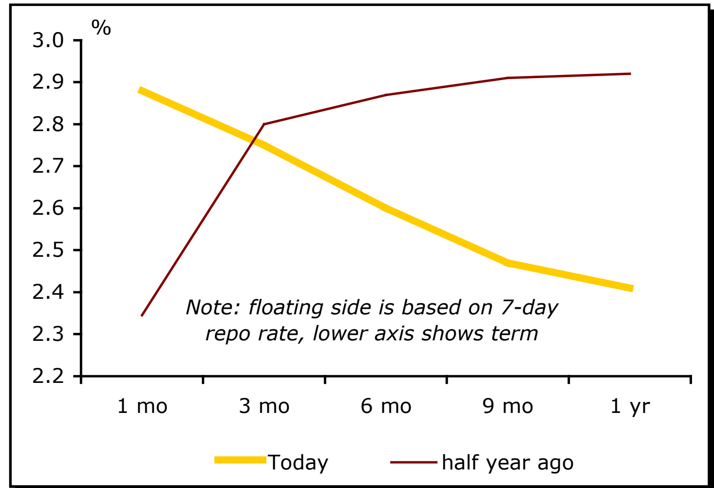
China has been the most dynamic of the world's major economic players in recent years, but fast growth has brought problems of its own. To curb high inflation and property speculation, the PBOC hiked interest rates five times and the banks' reserve requirements nine times between the fall of 2010 and the middle of 2011. While policy there is now showing signs of tilting back toward a pro-growth orientation (Chart 4), the drag from past braking actions should contribute to a downshift in growth to a rate of just under 8½% in 2012. Declining housing prices and credit restraints are also threatening to slow activity in the housing sector, whose share of GDP is two-to-three times what it was in the US during that country's property boom (Chart 5, Table 1).

Chart 3—**The BRICs of Tomorrow?**



Source: IMF, CIBC

Chart 4—**China: Inverted Swap Curve Shows PBoC Easing Expectations**

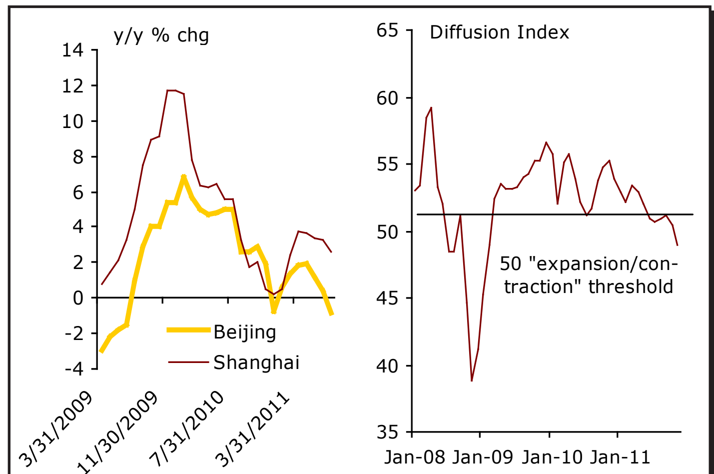


Other Not So Solid BRICs

Although China is important owing to its economic heft, other BRIC economies are, if anything, showing clearer signs of deceleration, albeit from fairly decent earlier levels, reducing the danger of outright recession.

After the best performance in 25 years in 2010, Brazil's rate of GDP growth stalled in Q3. Raising concerns about the short-run growth outlook, the loss of altitude, due largely to the household sector's weaker performance,

Chart 5—**Price of Existing Residential Buildings (L), Manufacturing PMI (R)**



Source: National Bureau of Statistics, China Federation of Logistics & Purchasing

Table 1—**Real GDP Growth Rates**

	2003-7 Avg.	2008A	2009A	2010A	2011F	2012F	2013F
World*	4.8	2.8	-0.7	5.1	3.8	3.2	3.8
Brazil	4.0	5.2	-0.6	7.5	3.8	3.6	4.2
Russia	7.5	5.2	-7.8	4.0	4.3	3.5	3.8
India	8.6	6.2	6.8	10.1	7.8	7.0	7.2
China	11.6	9.6	9.2	10.3	9.2	8.3	9.0

***at purchasing power parity**

Source: IMF, CIBC

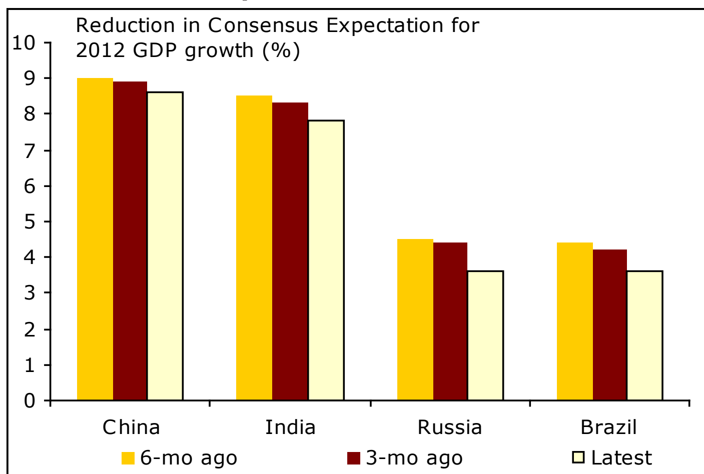
came despite a still fairly solid showing on the net export side. That offset is unlikely to be sustained in the face of deteriorating conditions in key export markets like Europe. The recent downshift appears to be, in part, an outgrowth of restrictive measures brought in earlier in the year to cool inflation, that have since been lifted. Even so, the latest developments suggest GDP is unlikely to tip the scales at much over 3½% in 2012 after a gain of 3.8% in 2011. That's just half the tempo attained in 2010 (Chart 6).

A larger, increasingly affluent population has also helped make India another darling of investors in recent years. India's demographic distribution is more favourable than China's, with more potential labour force entrants, fewer nearing retirement age. Although that contributes to a positive medium-to-longer term economic picture, the Reserve Bank of India has had to hit the policy brakes hard to bring inflation down from its recent double-digit levels.

Now, unexpectedly soft macroeconomic data has also cast a shadow lately over India, pointing to a significant downshift in the economy's performance over the next 12-18 months. Alongside the faltering factory sector

Chart 6

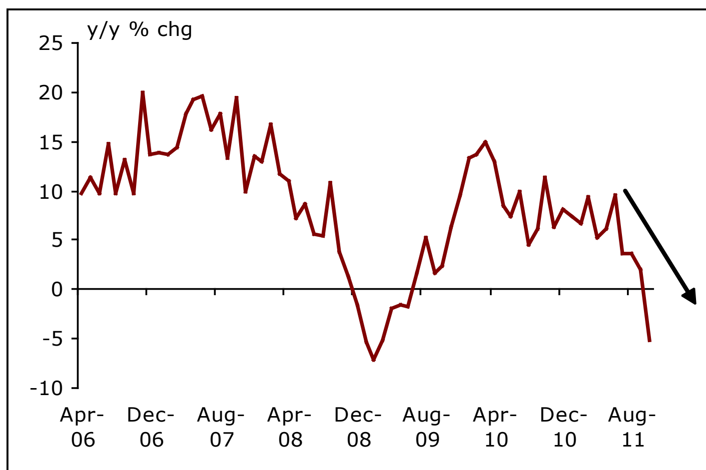
Not as Great Expectations



Source: FocusEconomics

Chart 7

Indian Industrial Production: A Sudden Chill



Source: Central Statistics Office

(Chart 7), GDP advanced at its slowest pace in two years in the third quarter and a growing number of observers expect a rise of 7% or less in 2012.

When it comes to the business climate and economic prospects, Russia is "a riddle wrapped up in an enigma", to paraphrase Churchill's famous dictum. Strong growth in the last two years has merely reversed the precipitous drop experienced in 2009, when the economy was hit by a dramatic drop in demand for its exports. Until recently, the coming year had been expected to see further improvement, abetted by still-elevated energy prices. It's too early to judge the full impact of the uproar over the contested December 4th election. But even before that vote, capital flight, a 1990's problem had re-emerged. That threatens to undo recent modest progress in attracting more foreign investment, hampering efforts to wean the economy from its unhealthy dependence on natural resources.

The BRICs have been the world's economic all-stars for much of the last decade. But even good teams can play inconsistently on occasion. Strong growth has brought challenges from rising inflation in some countries, to renewed political uncertainty affecting the investment environment in others, such as Russia. While the BRICs are likely to continue to grow wealthier in the longer term, offering opportunities on the export side, they may not provide the same lift to the world economy that they did in 2008-09 as they grapple with a number of short term issues. That's one more reason to continue to tilt portfolios away from sectors that are highly dependent on rapid global growth.