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2010-2011: The World Bounces Back with BRICs

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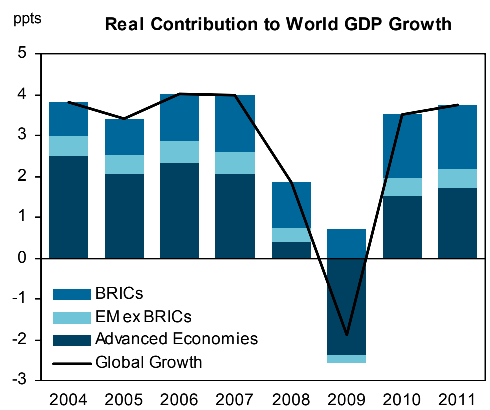
Earlier this month, we announced our updated forecasts and projections through 2011. We believe global growth will return to above trend in 2010 and 2011, led by strength in the emerging markets and, of course, in the BRICs in particular. Although we are bullish on growth, we expect inflation generally to remain in check.

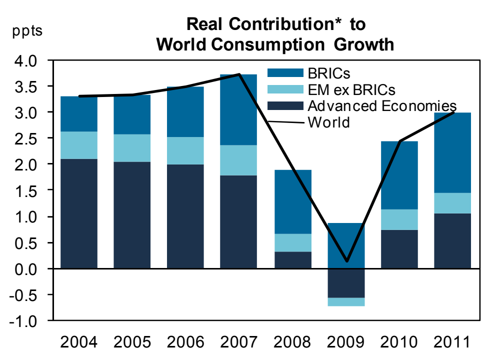
We are forecasting above-trend world growth in both 2010 (4.4%yoy) and 2011 (4.5%) on the back of strong growth from emerging markets, led by the BRICs. Consequently, the BRICs are likely to contribute more to world consumption growth than the advanced economies and other emerging markets in the next two years. The contribution to global investment growth should also be strong at 2.4ppt and 2.2ppt in 2010 and 2011, respectively.



Source: GS Global ECS Research.

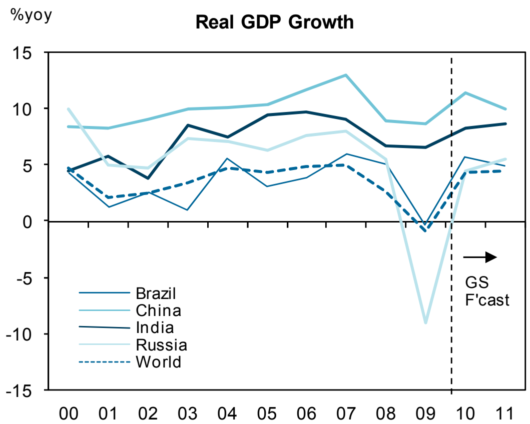
GDP growth in China and Brazil is forecast to accelerate in 2010 and then moderate in 2011 as domestic demand growth puts pressure on policymakers to tighten. Russia should see a steady recovery from 2010 into 2011, and we also expect India to see growth accelerate over the next two years.

Despite strong growth, we expect inflation to remain under control in the BRICs. Inflation should remain low in China and Brazil due to responsive monetary policy. In Russia, a strengthening currency and a wide output gap are likely to keep inflation low as well. India's inflation may see some acceleration in 2010-11 as supply-side inflation pressures build.



*Calculated from consumer expenditure for India, US, Japan, Euroland, and EM ex BRICs. Brazil and Russia use private consumption. China uses household consumption. Annual averages 2004-08, GS forecasts 2009-11. Source: GS Global ECS Research.

In terms of external balances, the current account deficit will likely widen in Brazil and India, while the current account surplus should fall in China and significantly improve in Russia. We expect import growth in BRICs to remain solid, mainly due to ongoing strong domestic demand growth from the regions. Similarly, recovery in external demand and the low base effect from 2009 should bring export growth safely back into positive territory.



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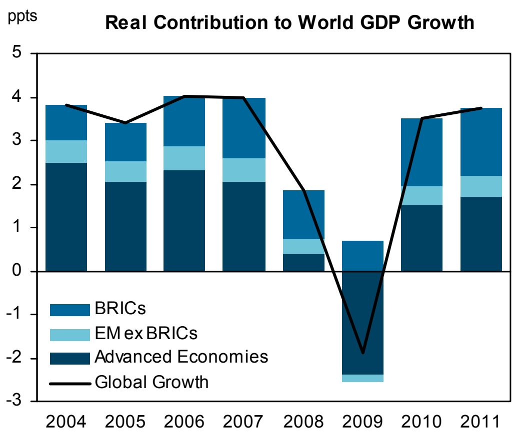

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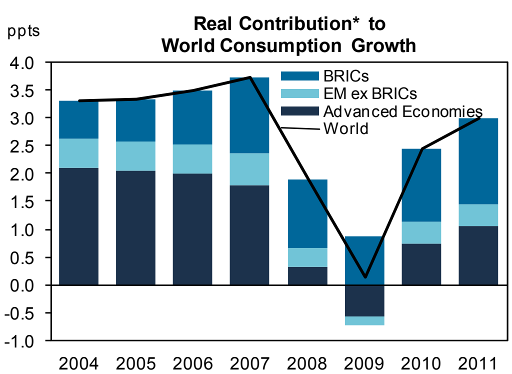

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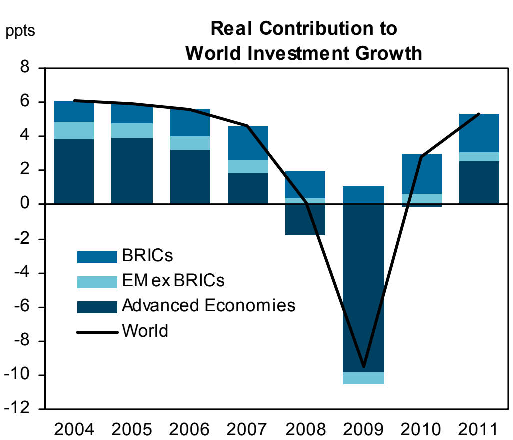


Source: GS Global ECS Research.

BRICs to Drive World Growth Forward

- Earlier this month, in *Global Economics Weekly 09/43, "*The Outlook for 2010/11: Exciting, with Risks!", we announced our updated forecasts and projections through 2011. We are forecasting above-trend world growth in both 2010 (4.4% yoy) and 2011 (4.5%). We believe this strong global growth will derive mostly from strength in the emerging markets, led by the BRICs, as opposed to the US, which we expect to recover more slowly. On a dollar-weighted basis, our forecasts see the BRICs contributing more to global growth in the next couple years than the rest of the emerging world.

- China should continue to lead the BRICs in GDP growth, with a strong 11.4% growth in 2010 slowing to a more modest 10.0% in 2011. Slower growth would come from tighter financial conditions and an unwinding of the fiscal stimulus. Investment will likely remain the main driver of growth, although private investment will replace public investment further. Private consumption growth should also be strong as real income continues to increase.

- While we expect domestic demand to slow slightly in China, India's should continue to increase notably. GDP growth is set to accelerate in India into 2010-11, to 8.2% and 8.7% respectively, due to expanding investment and consumption demand and a recovery in exports.

- For Brazil, we forecast 5.8% growth in 2010, boosted by strong domestic demand. Part of the demand will stem from public stimulus, as we see fiscal policy remaining expansionary before the elections later in the year. This may put strain on public finances and threaten price stability as the output gap quickly closes. Thus, growth may slow modestly in 2011.

- Russia, after suffering one of the more spectacular GDP slowdowns in 2009, is set for a steady recovery in 2010 and 2011. Russia's economy is more stable than a year ago, and we see private investment and consumption growth driving GDP up 4.5% next year and 5.5% the year after.

- Consequently, the BRICs should contribute more to world consumption growth than the advanced economies and other markets in the next two years. On a dollar-weighted basis, the BRICs are expected to contribute 1.3 percentage points (ppt) and 1.55ppt to world consumption growth in 2010 and 2011, compared with 0.8ppt and 1.1ppt in advanced economies. The contribution to global investment growth will also be strong at 2.4ppt and 2.2ppt in 2010 and 2011, compared with –0.2ppt and 2.6ppt in advanced economies, and 0.6ppt and 0.51ppt in emerging markets.

Robust Growth While Inflation Stays In Check

- Interestingly, while we believe GDP growth will be strong in the BRICs, we also think that inflation will remain largely under control. Inflation has come down significantly during the global recession and we expect it to stay relatively low, particularly in Russia.

- In Russia, a strengthening currency coupled with a wide output gap could bring inflation to under 5% by 2010Q2 for the first time in post-Soviet history. Meanwhile, monetary policy should keep inflation low in both Brazil and China, although inflationary pressures will build as output gaps close relatively quickly. India should experience some acceleration in inflation in 2010-11, and as pressure here is from the supply side, we see risks to the upside.

Current Account to Widen in Brazil and India

- We expect the current account deficit to widen in Brazil and India, and the current account surplus to fall in China and improve significantly in Russia. Import growth in the BRICs should remain solid at an average of 22%yoy in each of 2010 and 2011, mainly due to ongoing strong domestic demand growth from the regions. Similarly, a recovery in external demand and the low base effect from 2009 should bring export growth safely back into positive territory.

- In Russia, the current account surplus should improve significantly from 3.4% of GDP in 2009 to 7.1% in 2010 and 6.5% in 2011, thanks to the improvement in export growth from -38.7%yoy in 2009 to 45.2%yoy in 2010—the biggest rebound among the BRICs. The expected rise in oil prices will likely play an important role in the export recovery.

- The current account deficit should widen in India and Brazil due to the strength of domestic demand growth. Additionally, in Brazil, the rebound in profit and dividend remittances, as well as a large outflow of net services, will be factors. A combination of these forces will likely widen the US$23.8bn deficit in 2009 to US$55.0bn in 2010 in Brazil.

- In China, export growth should gradually improve in 2010 and 2011, but at a slower pace than in previous cycles, reflecting the sluggish recovery in the US on this occasion. The slowdown in domestic demand growth will reduce the current account surplus from 6.4% of GDP in 2009 to 5.5% and 5.6% in 2010 and 2011, respectively. The recovery in export growth will also contribute to the decrease in surplus.

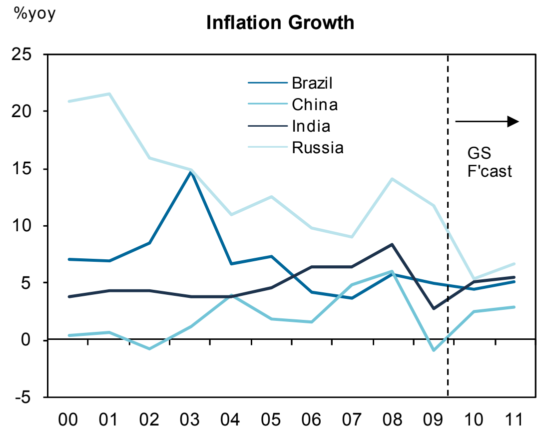
Mixed Performance in BRICs Currencies

- We expect the BRL to weaken, the CNY and RUB to remain flat, and the INR to appreciate slightly on a 12-month horizon.

- Despite growing foreign pressure on China to resume CNY appreciation, we think top policymakers will keep the currency policy unchanged. The Chinese government remains concerned over the weakness in export growth and the potential risk to asset prices from hot money inflows.

- Although the current account deficit will widen in India, strong capital inflows due to both growth and rate differentials should easily finance the deficit and put upward pressure on the INR.

- The RUB should appreciate in the next 3 months on higher oil prices, but weaken over 12 months due to our expectation of USD strength against the EUR. Similarly, the BRL will appreciate in the next 3months given large capital inflows, but weaken in 12 months as the CA deficit widens rapidly.



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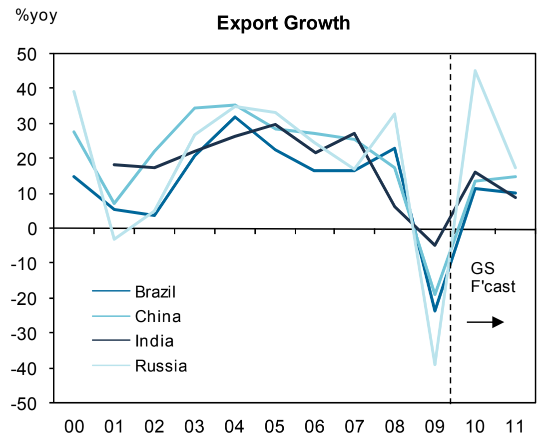

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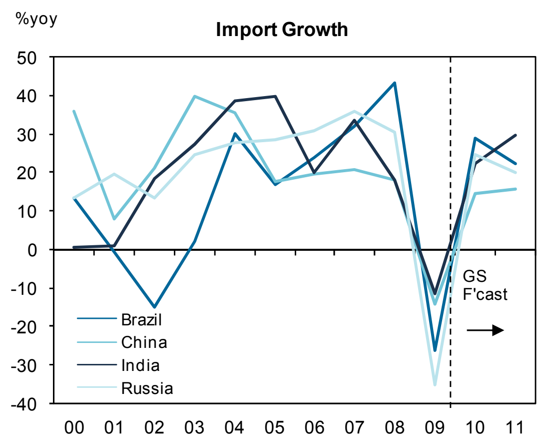

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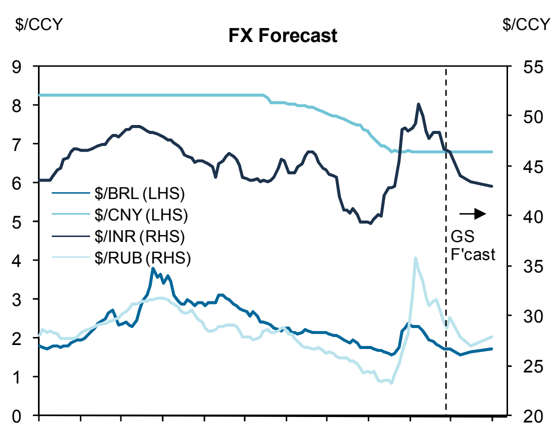
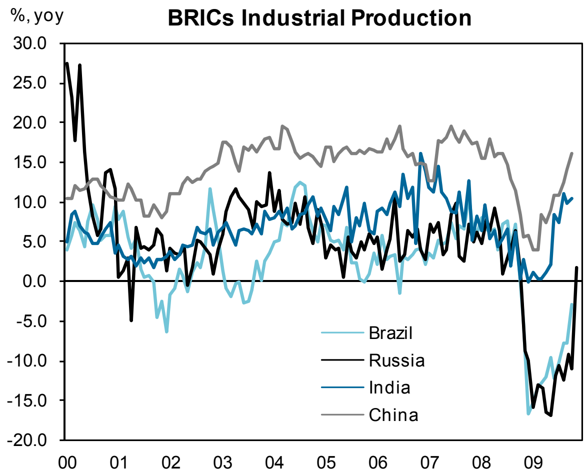


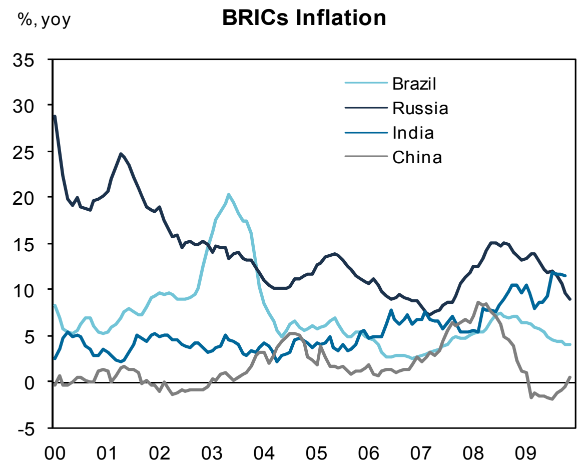
Source: GS Global ECS Research

Economic Activity in the BRICs

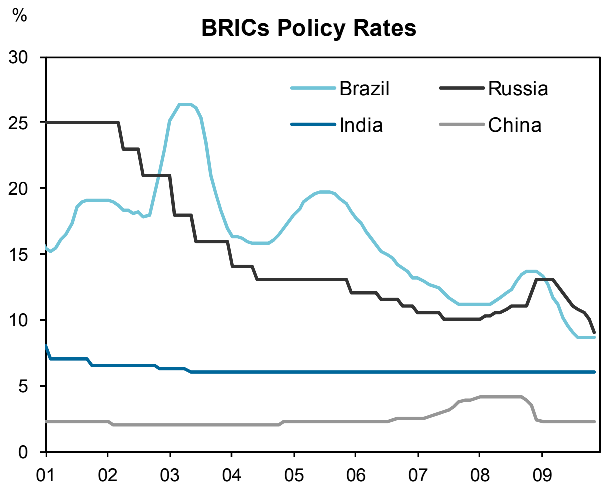
Russia's IP rose significantly in November, registering 1.7%yoy. However, much of this was due to the low base effect from November 2008.



China's CPI emerged from negative territory in November, rising 0.6%yoy. At the same time, inflation in Russia continued to fall.



Russia's refinancing rate continued to fall in November: it was down 1 percentage point from the previous month.



Equity markets in the BRICs have all fallen so far this month, led by the Bovespa, which is down 4.0%. The Russian Traded Index has fallen just –0.3%.