Dreaming with BRICs

What do BRICs mean?

In recent years, new terms have emerged to describe the largest developing countries such as **BRIC** and, even more recently, studies are conducted for **BRIMC** that stand for **Brazil, Russia, India, Mexico and China**. These countries do not share any common agenda, but experts believe that they are enjoying an increasing role in the world economy and on political platforms.

How Solid are the BRICs?

■ Since the beginning of the term BRICs, each country has grown more strongly than the initial projections. The updated forecasts of GS suggest **the BRICs can realize the 'dream'** more quickly than we would have thought about 5 years ago.

■ The case for **including the BRICs directly in global economic policymaking** is now **overwhelming**.

■ We introduce a **Growth Environment Score (GES)**, which aims to summarize the overall structural conditions and policy settings for countries globally. **Improving long-term foundations** is key **to converting potential into reality.**

■ Encouragingly, the BRICs themselves are all in the top half of the rankings for developing countries. While the BRICs are generally progressing, there is a **need for considerable further policy improvement in each.**

The latest specialized papers discuss how the BRICs countries have progressed. We also look at how "BRIClike" other large population countries are, and present a measure to show how these, the BRICs and all the world's economies score in terms of sustaining a healthy environment for growth. The BRICs economies do seem to be ahead of many other developing economies, both large and small.

For all countries, BRIC-like or otherwise, the key to converting potential into reality continues to be progress in strengthening key long-term conditions for growth (macroeconomic stability, political institutional development, trade and investment openness, and education).

Dreams and Reality[1]

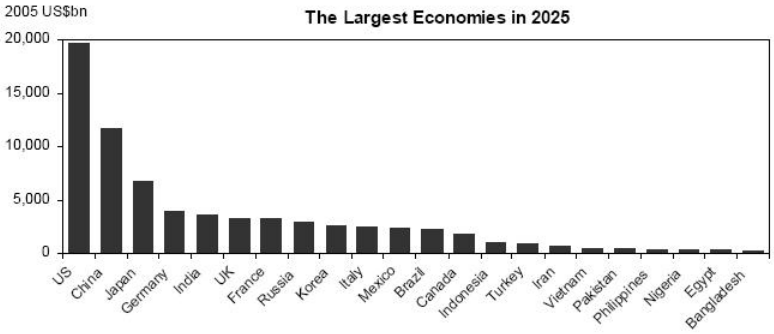
Two themes have come up repeatedly while projecting the BRICs 2050 scenarios:
Will the BRICs make it? And who else might join them?
There is a major distinction between the BRICs *potential* and the *reality.* **The key** to turning one into the other relies largely on **the BRICs finding and keeping in place the *conditions* for growth**. Without these improvements, the BRICs potential will not be fulfilled. Demographic advantage is not sufficient. As showed, **"miracle conditions" are not necessary, but a basic set of powerful conditions is crucial**.
We try to capture the progress and current state of growth conditions in an index that called **the Growth Environment Score**. A good question should be: **why just Brazil, Russia, India and China?** As a simple reason, specialists think they represent the group of countries that have both **the potential** to become important (largely because of their size) and **a reasonable chance of meeting the criteria**.
The case for China and India is especially straightforward, simply on the basis of their massive populations. Brazil and Russia were not included purely because the acronym would fail to be made if we left them out, as we have repeatedly and amusingly heard. Experts genuinely believed, and still do, that these two economies, along with China and India, have *the potential to be among the most interesting global economic stories and investment themes for many years to come*. In addition, they now believe even more strongly **that optimal economic policymaking cannot be undertaken without including *all* of the BRICs countries at the highest level.**

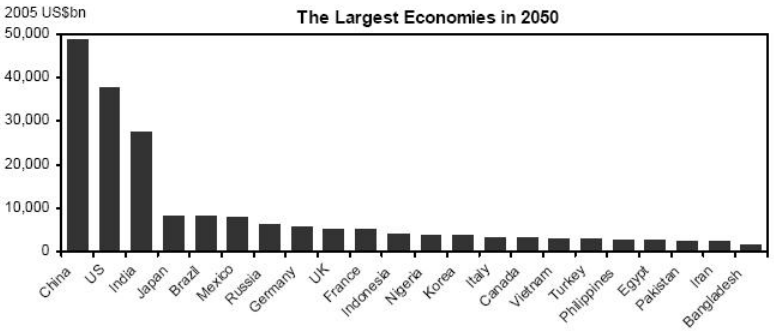
[1] This study was based on the Goldman Sachs Working Papers: www.gs.com

Separating Myth from Reality in the BRICs Theory

The global BRICs analysis made a clear distinction between **potential** and **reality**. Rather than **forecasting** that China **will** become the largest economy in the world by 2041 and that India **will** become the third-largest by 2035 or that the combined BRICs GDP size **will** become bigger than the G6 (G7 minus Canada) by 2041, we **suggested** that, if everything went right, then China **could** become the largest economy in the world by 2041, India the third-largest by 2035, and the combined BRICs GDP **could** exceed the G6 by 2041. The **capacity of the BRICs to influence global dynamics turns on their ability to set and maintain growth-supportive policy settings**.

Linked to this growing influence, **we see the BRICs as much more than a new emerging market theme**. The BRICs are a **key aspect of the modern globalised era**. What distinguishes the BRICs from any other story of EM growth is **their ability to influence, and be influenced by, the global economy and global markets in a broad fashion**. The current and prospective outlook for globalisation has the BRICs nations at its core and the interplay between the BRICs economies and the G7 is a critical aspect of globalisation and interdependence. The varied composition among the BRICs, the balance between resource-abundance and resource-dependence within the BRICs, and the global demographic tilt towards the BRICs allows these economies the chance to participate in an integral way in the world economy.



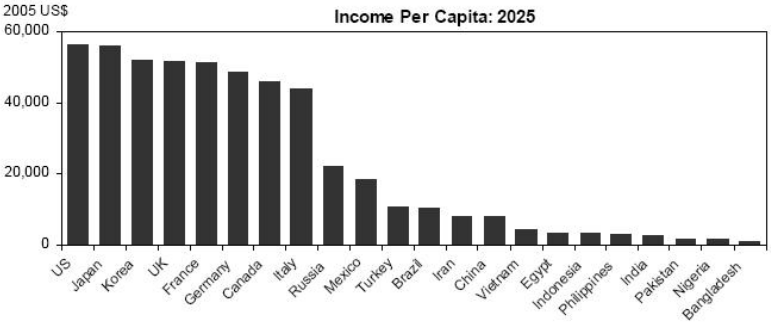


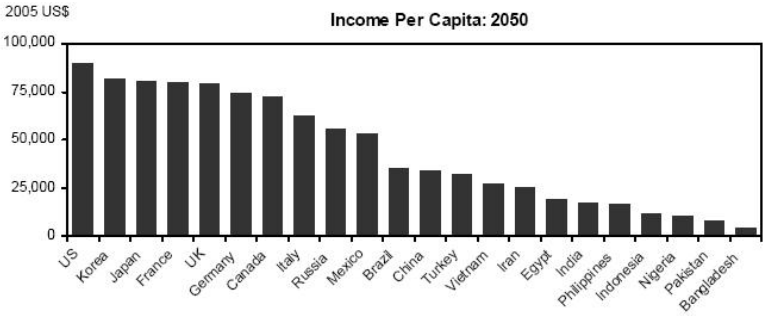
Bigger BRICs, Bigger Impact

Since they were first published (2003) **BRICs 2050 scenarios**, the BRICs have grown significantly better than we assumed. The regional economists. forecasts show that the BRICs should continue to exceed the projections in the next couple of years, suggesting that in the near term our approach is proving conservative. Of course, global economic and financial conditions have been favorable, although the BRICs economies themselves have been central to these developments.
The BRICs. impact on the global economy has continued to grow over the last few years, through a wide range of different dimensions:

Growth and Trade

Over the past decade, the BRICs contributed roughly 28% of global growth in US dollar terms, and 55% in Purchasing Power Parity (PPP) terms. **Their share of global trade continues to climb at a rapid rate**. At close to 15% currently, it is now *double* its level in 2001. Trade *among* the BRICs has also accelerated, with intra-BRICs trade now nearly 8% of their total trade compared with 5% in 2000. There have been **numerous signs of developing trade relationships**, including the *sharp increase in Brazilian trade with China and Chinese investment commitments in Brazil*. **India (in intellectual property)** and **Brazil (in agriculture)** have also **illustrated their policymaking leadership among developing countries through the WTO negotiation process.**





Capital Flows

The BRICs have played an important part in global financial developments. Latest estimates suggest that **the BRICs now hold more than 30% of world reserves**. China is the dominant contributor, but Russia, India and Brazil have all accumulated substantial reserves also. Despite this reserve accumulation, **real exchange rates in each country have appreciated over the last few years.** *Real exchange rate appreciation was and remains an* ***important part of the projected paths out to 2050.***

BRICs' current accounts continue to be in **healthy surplus**, reflecting the **group's key role in the global savings supply.** *The BRICs are increasingly important counterparts to the US current account deficit.*

BRICs. share as a destination for global FDI also continues to rise (now 15% of the global total, nearly three times higher than in 2000). What is even more striking is that BRICs. FDI *outflows* have also picked up (to more than 3% of the global total, a sixfold increase since 2000) as BRICs companies expand their own global presence.

Markets

BRICs' share of oil demand is moving steadily higher, with an estimated **18% share**, projected to rise further this year and next. This dynamic still has a long way to run, with the next decade in particular the likely point of maximum pressure on energy and other natural resources.

BRICs stock markets have also generally performed very strongly since 2003, with Brazilian, Russian and Indian indices all up by around 150% over that period. China is the one exception, where the idiosyncrasies of the local market have seen very lacklustre performance continue into this year. China provides a warning that the local market may not be the best investment vehicle for the local growth story.

BRICs **market capitalisation continues to climb**, **currently** at close to **4% of the global total**. Current success is obviously no guarantee of future performance, but it is encouraging that the BRICs have so far grown faster than we envisaged. The updated projections take into account the recent economic data and the latest demographic projections, rebasing the figures to 2005. **China would now overtake the US by 2040, while India would overtake Japan by 2033.**

Getting Conditions Right—the Growth Environment Score (GES)

There is no doubt that the BRICs are currently performing well and the near-term outlook looks quite favourable. The **big question** is **whether they can keep growing over the longer horizon that our projections map out.**

In the original projections, it was argued that getting the *conditions* for growth in place and keeping them there was critical to whether the scenario we described would in fact occur. It was showed that **running the same model from 1960 would have accurately predicted growth for the developed economies**, and **some key emerging Asian economies** (**except India**), but not others.

It helps to think of a country.s growth performance as a combination of its potential and its conditions. In general, developed countries have lower potential (they are already developed), but the chances of meeting that modest potential are good. **Developing countries have much higher potential for rapid growth**, but the difficulty is to achieve and sustain the conditions that allow that potential to be realised.

Specialists often question the ranking of the BRICs and assessment of their prospects of staying on the projected path. Taking into account several researches we resorted to a number of ways to tackle this challenging question, but largely stuck with a ***qualitative assessment of the growth environment****, identifying the most probable risks the BRICs might face in the future. We try to answer this question now in a more fundamental way.*

In order to rank countries. **abilities to meet their growth potential** more formally and to monitor growth conditions over time, the **Growth Environment Score (GES)** was developed that aims to **summarise the overall environment in an economy, emphasising the dimensions that are important to economic growth.** Relying on the large body of research on the determinants of economic growth, the GES was constructed using 13 sub-indices, which can be divided into five basic areas:

- **Macroeconomic stability**
  Inflation; government deficit; external debt
- **Macroeconomic conditions**
  Investment rates; openness of the economy
- **Technological capabilities**
  Penetration of PCs; phones; internet

■ **Human capital**
Education; life expectancy
■ **Political conditions**
Political stability; rule of law; corruption

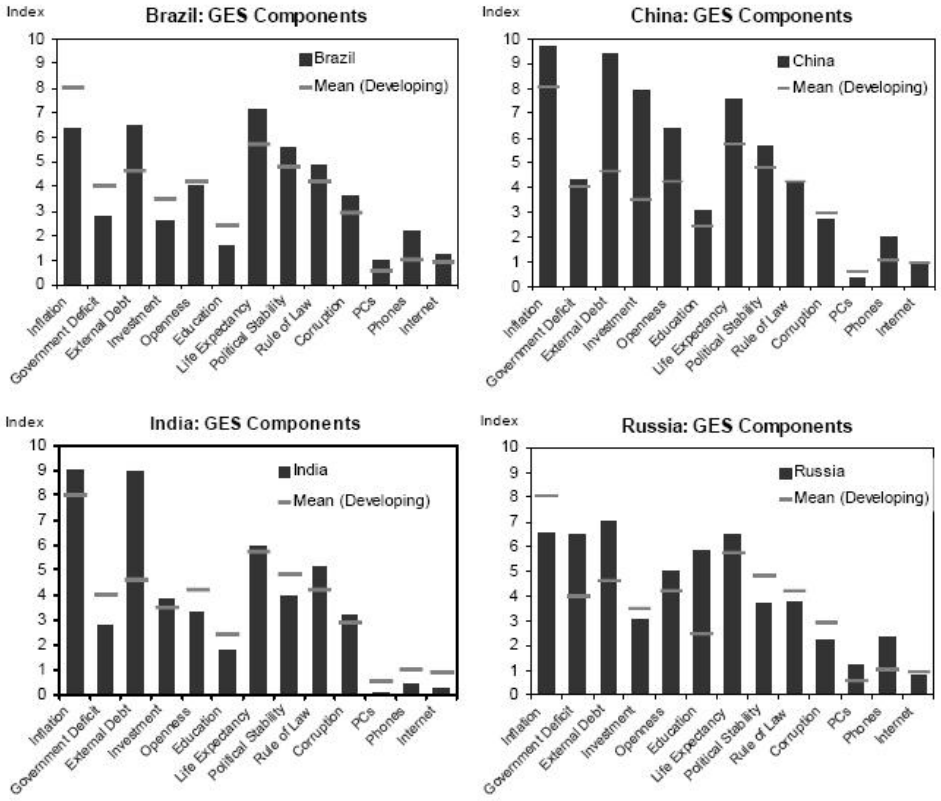
A country's performance is ranked on each measure on a 0-10 scale and create an overall score, the GES, which also ranges from a possible minimum of 0 (poor conditions) to a possible maximum of 10 (perfect conditions). The GES is consistent across countries and over time, can be easily updated and tracked on an ongoing basis, and is based on hard evidence.

The GES sub-components highlight the strengths and weaknesses of each of the BRICs, and where there is room for improvement:

■ **Brazil** scores relatively well on measures of political stability, life expectancy and technology adoption, but quite poorly on investment, education levels, openness to trade and government deficit.

■ **Russia** also scores well in terms of education, fiscal position, external debt position, openness to trade, technology adoption and life expectancy, but it does less well in terms of political measures (political stability, corruption), investment rates and inflation.

■ **India** scores relatively well in terms of rule of law, external debt and inflation, but quite poorly in terms of levels of secondary education, technology adoption,fiscal position and openness.



■ **China** ranks well above the mean on macro stability, investment, openness to trade and human capital. Its rankings on technology adoption are more mixed (PC usage is still quite low) and corruption measures are also a little worse than the mean.

The BRICs: A Lasting Global Theme

Three **key points** emerge from our research:

■ Since the beginning of their rise, the **BRICs' impact on the world has grown substantially across a broad range of areas**. Given their importance to a wide range of global economic issues, the case for including them more actively in policy-making is overwhelming.

■ Other economies **may be able to share in a "BRICslike" story**, but (Mexico aside, perhaps) the probability of their having a similar impact is small, at least as individual markets. **Strong regional growth themes may emerge**. Brazil and Mexico in Latin America for instance; China, India, Korea and Vietnam in Asia; or possibly India, Pakistan and Bangladesh in South Asia. But **the BRICs are likely to remain the only ones at the core of truly global growth themes.**

■ There is quite wide variation in setting the conditions that should allow countries to stay on course for the "dream" projections we set out. The BRICs are generally doing a reasonable job now, but there are clear weaknesses in each case. Dealing with them remains critical.

The **BRICs theme** continues to have **major implications for investments in local markets**. It does not (and never did) necessarily follow that due to the BRICs' potential, investing in the BRICs stock markets is the best investment theme. However, **BRICs equity markets have performed extremely well**, *except for China*. Even after strong recent performances, on current P/E ratios, the BRICs markets do seem cheap relative to their more developed competitors. **If BRICs. potential is fulfilled, then local stock markets *will* probably continue to be good investments over the long haul. So will their currencies, probably**.

The 2050 projections, and the specific dramatic forecast that **the BRICs' GDP will exceed the G6 by 2041**, depend on an assumption of real FX appreciation for one-third of the potential. While there are some fast-growing economies of the past 40 years that did not see real currency appreciation, the fastest-rising of them all, Japan, did. Specialists think the case for further appreciation in BRICs currencies is very good, if their strong growth continues.

Local market opportunities are only a small part of the story. In fact, **what distinguishes the BRICs theme from an "emerging markets" story is that they appear to be a crucial driver of markets and investment opportunities *outside* those countries also**. The **ongoing bull run in commodities is the most striking example of global trends being driven in part by BRICs. growth**.

The interplay between the four BRICs economies, especially in terms of commodities, has been, and is increasingly likely to be during the next decade, the critical aspect of developments in the energy and commodity markets. Just as commodity investments have been an excellent BRICs-related theme, investing in other non-BRICs located companies might become a more rewarding experience in the near future, such as **the luxury goods market leaders of today or the big consumer products areas**. Earlier reports showed that the natural sequence of opportunities is likely to move from basic materials to consumer products to services, but there will be plenty of variation around that broad trend.

There are a multitude of risks to all of these projections, as we continually point out. But with the BRICs continuing to grow in importance and their interrelationship with each other and the world still rising, we think they will remain a critical factor in the global investment theme of today and for many years to come.