



Are the BRICs strong enough?

As the global slowdown deepens and developed economies slip into recession, there is increased speculation about the impact on the 'BRIC' economies and the validity of the 'decoupling theory'. BRIC, an acronym for the economies of Brazil, Russia, India and China, is a term that was first used in a 2003 Goldman Sachs report which speculated that by 2050, the BRIC economies would be stronger than most of the current major economic giants. With the US economy currently experiencing a full-blown recession, economic growth in the BRIC countries has been slowing, defying the 'decoupling' theory which assumed that the performances of the emerging economies especially, will no longer be dependent on the United States, to the extent they did in the past.

The International Monetary Fund (IMF) projects that the output in advanced economies will contract but that growth in major emerging markets will still allow the global economy to grow by 22% in 2009, compared to 3.9% in 2008. Critics argue that the only thing the BRIC countries have in common is that they are all big emerging markets and that there are no political or economic ties between them. Already, the BRIC countries account for more than 15% of global economic output which raises the question of whether this large contribution is due to their geographical size or wealth. In terms of population, they account for around 42% of the world's population with China at the top, followed by India, Brazil, and Russia respectively.

The BRIC countries are highly connected to the world in terms of goods flows, with each country heavily dependent on trade flows from the advanced economies, most of which are in recession. This translates into lower demand for products from China, dampened even further by the recent contaminated milk scandal. It also means lower demand for services from India and commodities from Brazil and Russia.

In China, after double digit growth of 13% in 2007, GDP growth slowed to 9% in 2008 and is projected to slow even further in 2009. With China contributing almost 19.5% to global growth, as estimated by the IMF in 2007, the impact on the global economy will be significant. China's domestic demand is also waning as the 2.8% decline in exports, one of the biggest declines since 1999, is triggering factory closures and increasing job losses. In India, GDP slowed to 7.90% y-o-y and 7.60% y-o-y in the third and fourth quarters of 2008 respectively, and the government is forecasting growth to slow to between 6.5% and 7% in the current fiscal year, marking the weakest growth level since 2003. Like China, India's exports have also fallen off, lowering output levels and increasing job losses as employers shed costs. In Brazil, where commodity exports account for two-thirds of external sales, the pull back seen in commodity prices, coupled with the slowdown in global demand, all resulted in a weakening of the country's economic position. Brazil's growth is forecasted to slow to 3%

in 2009 from 5.2% in 2008. Meanwhile in Russia, the world's second largest oil producer, after Saudi Arabia, economic growth is expected to shrink 0.2% this year due to falling demand for energy and metals, the country's main exports.

The BRIC currency markets have also taken a beating over the past few months as volatility persisted in the foreign exchange market. The Russian ruble and Indian rupee each operates under a managed float system against the US Dollar. Both lost around 19% and 23% in value, respectively, against the US Dollar for 2008. The Brazilian real, which is an independent free-floating currency, lost around 30% in value against the US Dollar for the same period. The Chinese yuan, which is pegged to a basket of currencies, gained around 7% in value against the US Dollar and is believed to be heavily controlled by the central bank. China's reserves are the world's largest at US\$1.95 trillion, allowing the country enough room to prop up its currency if needed.

Monetary policies in the BRIC countries have started to follow that of the US, as the focus shifted from inflation control to more economic growth stimulus. In Brazil, the Banco Central do Brasil cut their Selic target rate by 100 basis points to 12.75%, the largest cut since December 2003. In China, interest rates across the board have been cut as trade growth tumbled due to recessions in the advanced economies. China, like the US, is intent on increasing economic activity within the country as seen from the US\$584 billion stimulus package revealed in November 2008 which focused on infrastructure. In India, rates have also been cut as inflation has retreated by more than half of the 12.91% high seen in August 2008 opening the window for even more cuts. Since October 2008, the bank's benchmark rate has been reduced by 350 basis points to its current level of 5.5% and is expected to come down further. In Russia, the central bank has been busy trying to stabilize the local currency, the ruble, as investments in the country decline. Investors are estimated to have withdrawn \$245 billion from Russia since August 2008 given the fall-off in oil prices. This fall-off, along with the geopolitical risks seen in Russia's war with Georgia and the disruption to gas exports, exacerbated the negative impact of the global financial crisis on the country. These have all caused significant fluctuations in the ruble calling on the Central bank to use the country's reserves, the world's third largest, to buy local currency in the market to help spur demand and push up the price of the currency. These efforts resulted in a reduction in the country's reserves to US\$171.6 billion from US\$426.5 billion seen in August 2008.

Are the BRICs strong enough to stand alone and withstand the slowdown in developed economies? While the emerging markets are not heavily exposed to the problems in US subprime mortgages with regards to asset backed securities, it is evident that the goods flows play a major part in determining the well-being of the respective economies. Most of these BRIC countries once thrived on an extremely favorable global economy – booming commodity prices, strong liquidity conditions and buoyant global demand. It also meant that they became very trade-dependent, on both exports and imports. Now that all of these conditions have been reversed, these BRIC countries will be severely affected.

All countries are connected in some way especially through globalization and more specifically, through trade. What do we as investors do during these times? It is evident that as risk aversion increases, investors still flock to the US as a safe haven, which was clearly seen from the recent rally in the US Dollar and US Treasuries, which has sent Treasury yields to unprecedented lows. Are all monetary policies from all countries tied to each other in some way? Can the BRIC survive the volatility of the foreign exchange market and the general panic and flight to quality sentiment? Will the decoupling theory hold true by 2050?

The BRIC countries are emerging markets and definitely hold significant weighting when it comes to the world's population and economic output. Even as the advanced economies contract, it is the growth of the BRIC countries that is acting as the main support to global growth. Critics argue that the BRIC acronym should be longer and include other countries such as Mexico and South Korea which also have strong levels of GDP growth comparative to those of the BRICs. Each of the BRIC economies has their Achilles' heel and as the slump in the advanced economies worsens and more countries declare a recession, the latest victim being Britain, we cannot expect to see a recovery in the BRICs in the near future. As long as investors remain risk averse and continue to flock to the safe haven assets, foreign direct investment and flows to the emerging markets will continue to take a beating. With both of these components expected to slow, the road to recovery for the BRIC countries will be a rough one.

FINANCIAL & ECONOMIC INDICATORS

As at 22 January, 2009

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	88.91	89.84
Euro	1.30	1.31
Jamaica	84.20	82.53
Guyana	203.90	205.50

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	43.67	35.40
Natural Gas (US\$/mmbtu)	4.69	5.23
Gold (US\$/Troy Ounce)	857.00	817.80

Eurobond Indices (As at 22-January-09)

Lehman Brothers Global Aggregate Index (Return % YTD)	-2.61
JP Morgan EMBI+ (Basis points)	662
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	3.69

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0-0.25	0-0.25
Euro Zone	2.00	2.00
Japan	0.11	0.10
Brazil	12.75	13.75
Trinidad	8.75	8.75
Jamaica		17.00
Barbados	3.00	3.00

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.10	0.11
US 10-Yr Treasury	2.59	2.17
3-month UK Libor	2.20	2.27
Japan 90-day T-Bill	0.37	0.38
Brazil 90-day T-Bill	12.20	13.19
TT 90-day T-Bill		7.00
Jamaica 90-day T-Bill		22.01
Barbados 90-day T-Bill		4.86

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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