

BRICs Monthly

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Is this the 'BRICs Decade'?

The last decade saw the BRICs make their mark on the global economic landscape. Over the past 10 years they have contributed over a third of world GDP growth and grown from one-sixth of the world economy to almost a quarter (in PPP terms). Looking forward to the coming decade, we expect this trend to continue and become even more pronounced.

The last decade saw the 'arrival' of the BRICs story. Here, we take a look at the next chapter—at how the BRICs and their relationships with the rest of the world will change in their second decade. We expect many of the trends we have already seen to continue and become even more pronounced. Our baseline projections envisage the BRICs, as an aggregate, overtaking the US by 2018. In terms of size, Brazil's economy will be larger than Italy's by 2020; India and Russia will individually be larger than Spain, Canada or Italy.

In the coming decade, the more striking story will be the rise of the new BRICs middle class. In the last decade alone, the number of people with incomes greater than \$6,000 and less than \$30,000 has grown by hundreds of millions, and this number is set to rise even further in the next 10 years. These trends imply an acceleration in demand potential that will affect the types of products the BRICs import—the import share of low value added goods is likely to fall and imports of high value added goods, such as cars, office equipment and technology, will rise.

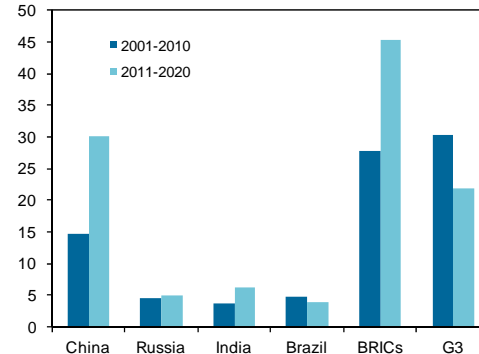
In the past decade, BRIC equity markets outperformed significantly because the strong growth of these economies surprised many and the BRICs themselves came into focus. At the same time, valuations were low relative to many major markets in 2000. Now that the BRICs story is better known, expectations are higher and the valuation gap is much smaller, the same degree of outperformance seems much less likely, even if the BRICs deliver solid returns.

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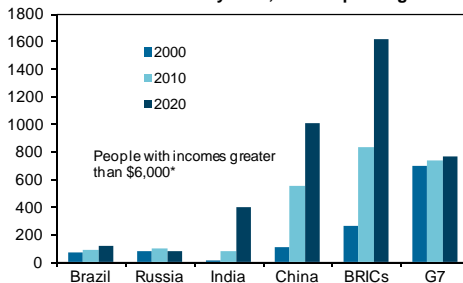
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BRICs Will Contribute Twice As Much To Global Growth As The G3 In The Next Decade

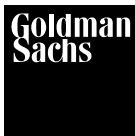


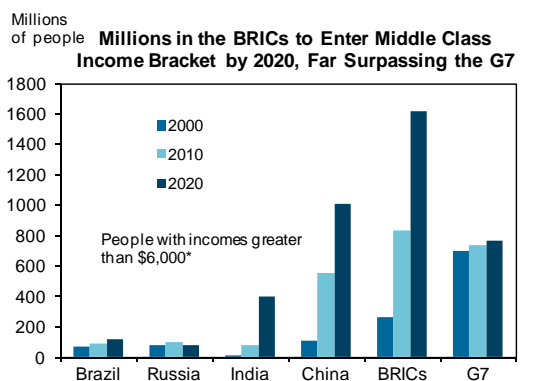
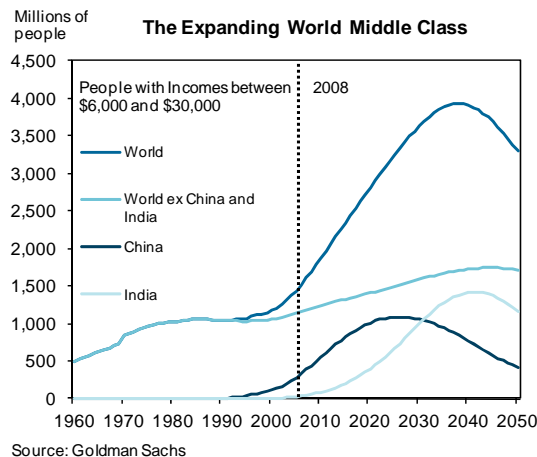
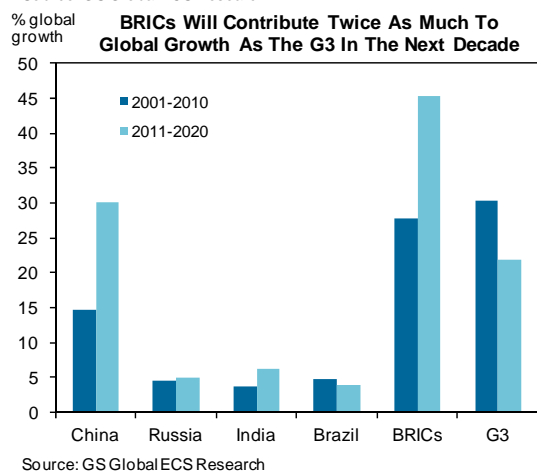
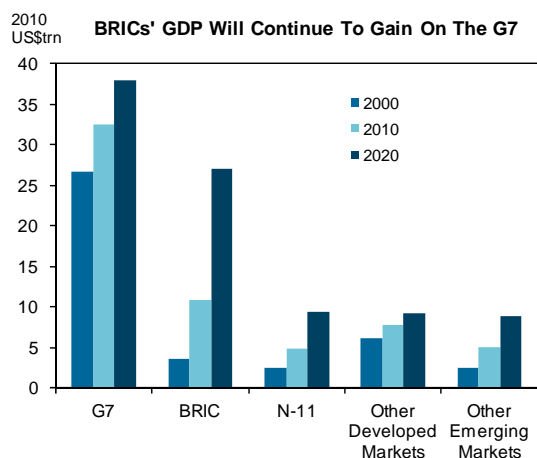
Source: GS Global ECS Research

Millions in the BRICs to Enter Middle Class Income Bracket by 2020, Far Surpassing the G7



*We generally consider Middle Class as those with incomes >\$6,000 and <\$30,000. But, to compare BRICs to the G7, we included estimates for all people >\$6,000 - i.e. both the middle and upper class.
Source: Goldman Sachs





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Source: Goldman Sachs

The 'BRICs' Decade'—Behind Us or Ahead?

- Since we coined the acronym in 2001, BRICs has become well-known worldwide, and investors, politicians and many others have shifted their focus to these countries. As we look back on the last decade, it's clear that the BRICs have already begun to play a more significant role in the global economy and on the world political stage. The BRICs contributed 36.3% of world GDP growth in PPP terms (or 27.8% in USD) during the first decade of the century. They have also steadily increased their share of global output. Currently, they make up about a quarter of the global economy (in PPP).
- We expect many of the trends we have already seen to continue over the coming 10 years and become even more pronounced. Our baseline projections, underpinned by demographics, a process of capital accumulation and a process of productivity catch-up, envisage that the BRICs, as an aggregate, will overtake the US by 2018. In terms of the size of the economy, by 2020, Brazil will be larger than Italy; and India and Russia will be individually larger than Spain, Canada or Italy. By 2020, we expect the BRICs to account for a third of the global economy (in PPP terms) and contribute about 49.0% of global GDP growth.

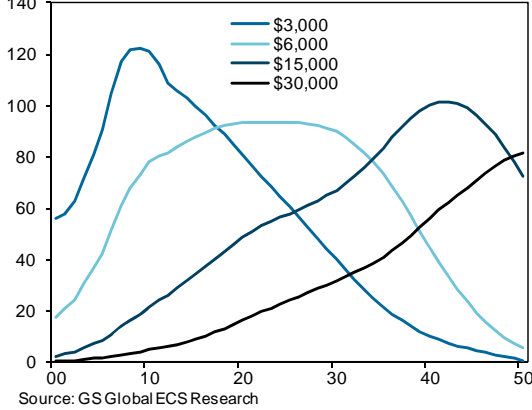
Will This Be The Decade of the New Middle Class?

- Although the BRICs' growth story developed in the last decade, one of the major effects of their growth is likely to play out over the next decade. That is, rising incomes in the BRICs will create a massive new middle class, as we first detailed in *Global Economics Paper 170*: "The Expanding Middle: The Exploding World Middle Class and Falling Global Inequality". We have already seen falling poverty rates and rising income equality over the last decade, and these trends are set to continue.
- In fact, the middle class as we define it (people with incomes greater than \$6,000 and less than \$30,000) has already grown by hundreds of millions in the last decade alone, and is set to grow even more in the coming decade. Growth in the middle class will be led by China, where we expect the number of people entering the middle class to peak during this decade. Meanwhile, middle class growth in India will accelerate throughout this decade. As China and India are the world's two most populous countries, rising incomes there will have much greater impact on global demand than any other countries could.

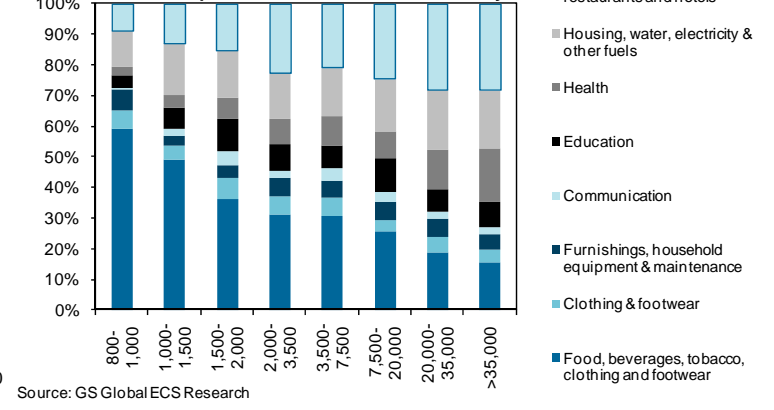
- The other BRICs (and other emerging markets) will also see a rising middle class in the next decade, and should also see a rising 'upper class' (incomes higher than \$30,000).

- With the explosion of the middle classes, spending patterns are likely to change (see next section), leading to competition for resources. Environmental pressures may become even more acute, as the demand for energy increases. We have already seen many of these effects begin to take shape, and we expect these patterns to intensify as the decade progresses.

Millions of people **Number of People Crossing Different Income Thresholds in BRICs Annually**



share of consumption **As the Middle Class Grows, Consumption Becomes More Discretionary**



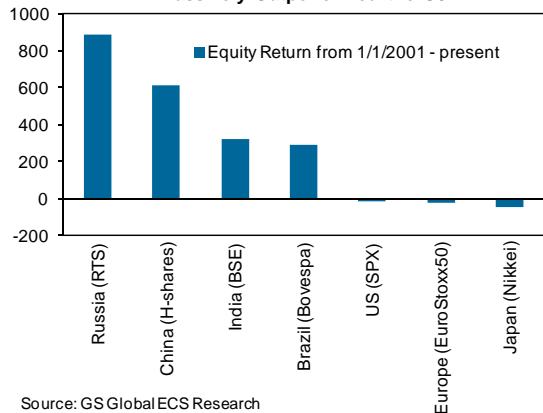
Middle Class Growth in the BRICs Will Drive Global Consumption

- As countries pass through industrialisation and GDP per capita rises to around US\$1,000-\$3,000, savings and investments typically rise. On the flipside, consumption (as a share of GDP) usually falls during this period. Over the past decade, China and India have for the most part stayed within this lower income range, characterised by a low share of consumption and high savings.
- We believe the annual rate for the number of people with income rising above US\$3,000 has peaked. That is, China and India are at an inflection point. The income of tens of millions of people is rising above this key threshold every year. As we discussed in our *Global Portfolio Strategy* piece “The BRICs Nifty Fifty,” these trends imply an acceleration in demand potential. This will impact the types of products the BRICs import—the import share of low value added goods will fall and imports of high value added goods, such as cars, office equipment and technology, will rise. In a recent *Global Economics Weekly (GEW 10/13, “Emerging Markets Gaining Prominence in Global Trade”)*, we showed that the share of exports to the BRICs is increasing in both developed and emerging countries, and this trend is likely to continue as demand from BRICs consumers rises in the next decade.

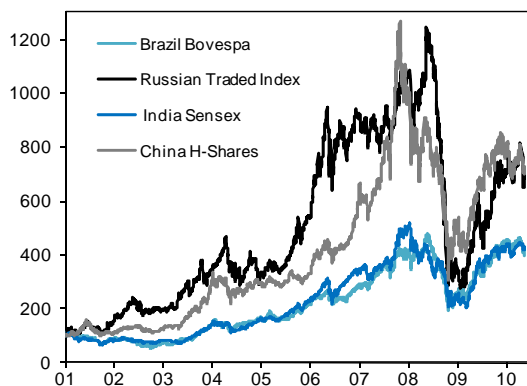
Will the BRICs’ Equity Outperformance Continue?

- The last decade was a BRICs’ decade for stocks: the Russian traded index rose by a sizeable 884%, followed by China H-Shares (610%), the BSE in India (319%), and the Bovespa in Brazil (294%). While BRICs equity markets may continue to do well, some factors that led to this extraordinary outperformance are less clear now.
- On the one hand, if one believes in the immense potential of rising consumer demand in the BRICs, particularly from the middle-income section of the population, this may help to support market performance over the next decade, both in the BRICs and other countries that can take advantage of increased demand. Our near-term growth views are also stronger than consensus across the BRICs.
- On the other hand, markets generally tend to reward growth stories most when they are much better than expected or are in markets that are out of vogue. In the past decade, BRIC equity markets outperformed significantly because the strong growth of these economies surprised many and the BRICs themselves came into focus. At the same time, valuations were low relative to the very frothy valuations that existed in many major markets in 2000. Now that the BRICs story is better known, expectations are higher and the valuation gap is much smaller, the same degree of outperformance seems much less likely, even if the BRICs deliver solid returns.

Last Decade, the BRICs’ Equity Performance Massively Outperformed the G3

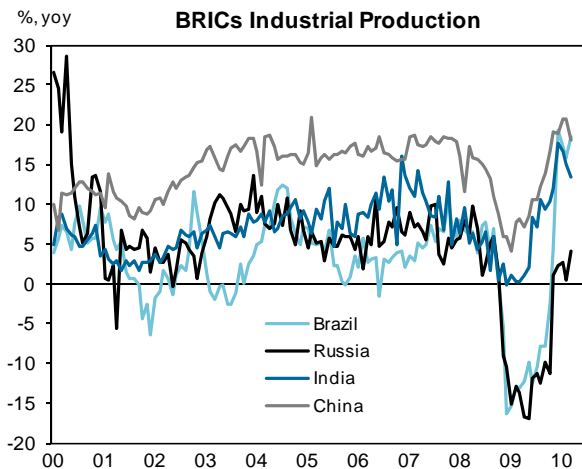


BRICs Equity Indices

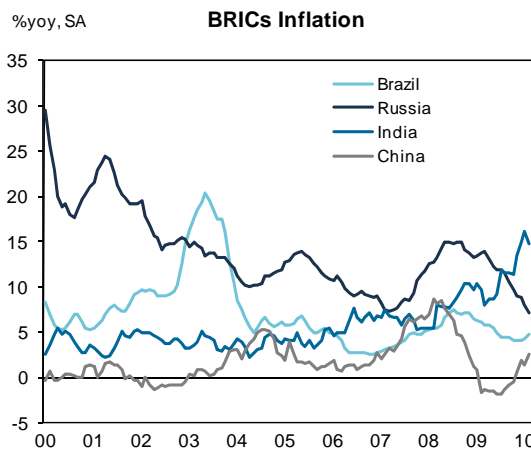


Economic Activity in the BRICs

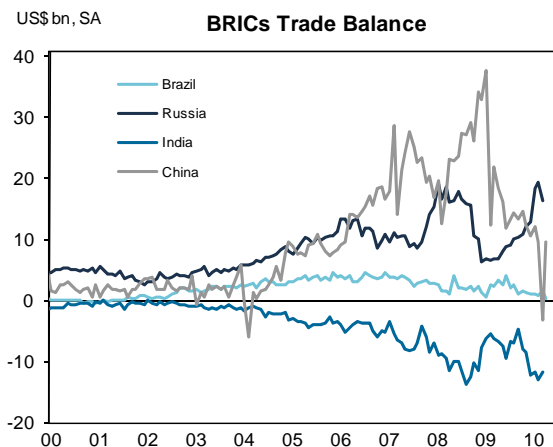
Industrial production in China and India moderated in March, while IP in Russia and Brazil both came in higher in yoy percentage terms.



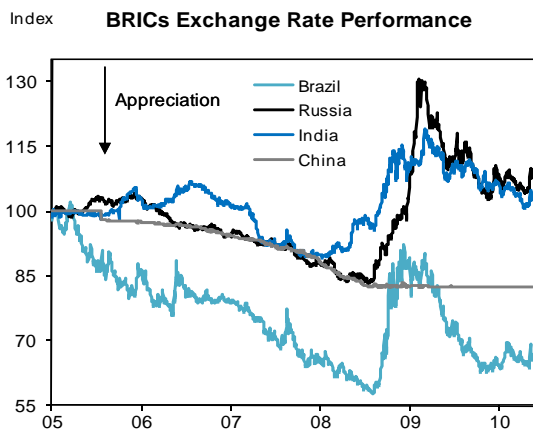
CPI inflation picked up in China to 2.8%yoy in April. Inflation also rose in Brazil, reaching 5.5%yoy, while it continues to moderate in Russia.



In China, the trade balance turned to a deficit in March due to distortions from the Lunar New Year, but the trend of a declining trade surplus is clear.



Over the past month, the BRIC currencies have all depreciated vs the USD except for the CNY. The BRL depreciated 3.0%, the RUB 5.0% and the INR 2.5%.



We, Dominic Wilson, Swarnali Ahmed and Alex Kelston, hereby certify that all of the views expressed in this report accurately reflect personal views, which have not been influenced by considerations of the firm's business or client relationships.

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