Economic Outlook for Brazil, India and China

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Our key global scenarios

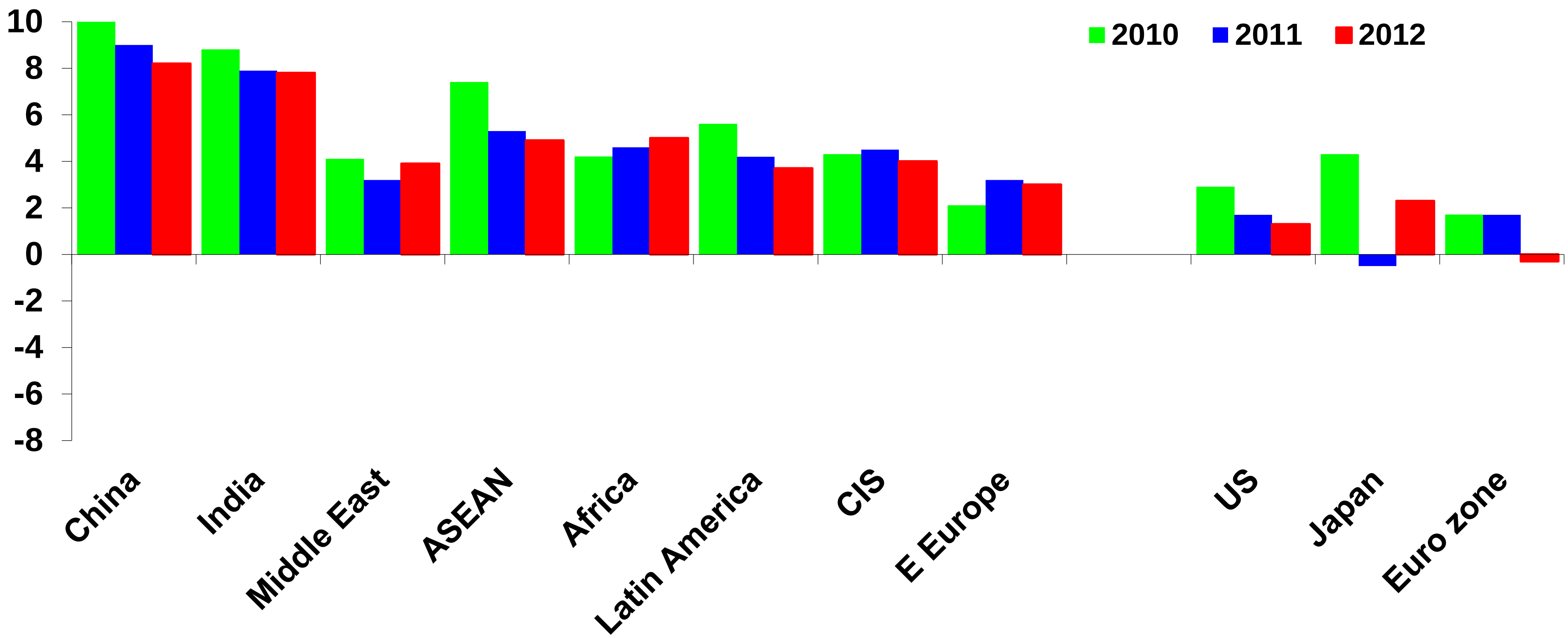
- Very slow, uneven growth
  - High unemployment, weak demand in developed countries
  - Euro zone will contract slightly in 2012
  - Less government spending, fiscal drag
  - Financial market volatility saps confidence
  - Banks under stress; little lending
  - BUT…US economy still growing
  - China, emerging markets are resilient
  - Not nearly as bad as 2008-09…yet

60%

- Global recession; we have raised the risk to…
  - Shocks (euro zone crisis, financial market panic) lead to plunging confidence, sharply reduced demand, less investment, hiring and liquidity freeze
  - Significant effect on emerging markets through trade channel

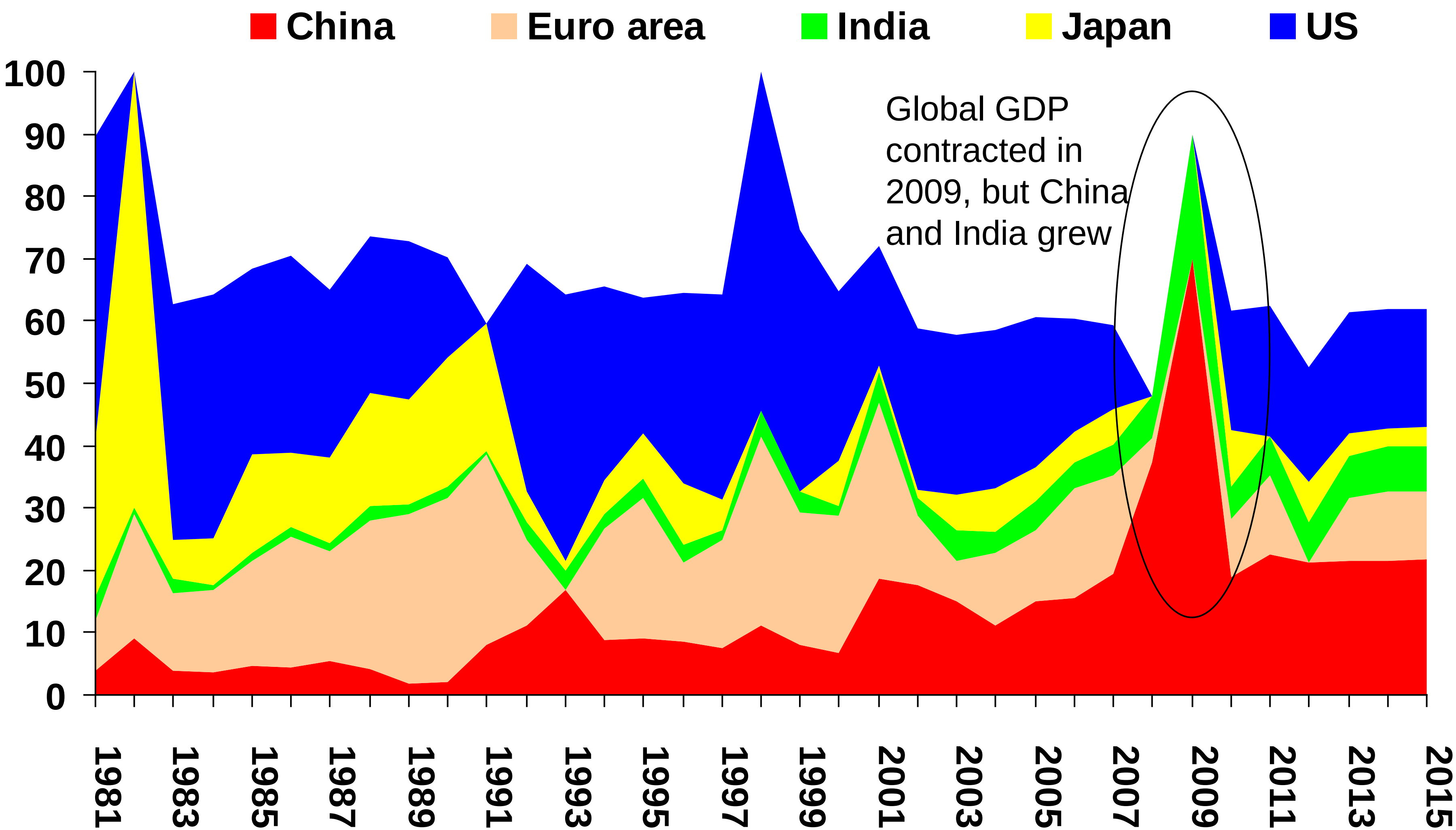
40%

Where's the growth?



Real GDP growth; % change, year on year. ASEAN = Association of South East Asian Nations. CIS = Russia, Ukraine etc.
As of October 2011. Source: Economist Intelligence Unit, CountryData.

China: Now the major driver of global growth



Contribution, in %, by each country/region to total real growth. Countries that contracted are assigned a zero contribution in that year.

Figures adjusted in years when global growth contracted. Source: EIU Country Data

Brazil...

Brazil – taking off…

Stable growth with relatively contained inflation (Brazil successfully weathered 2008-09 crisis, rebounding in 2010, with a 7.5% growth rate)

Sound macroeconomic policies

Favourable demographics with a growing middle class

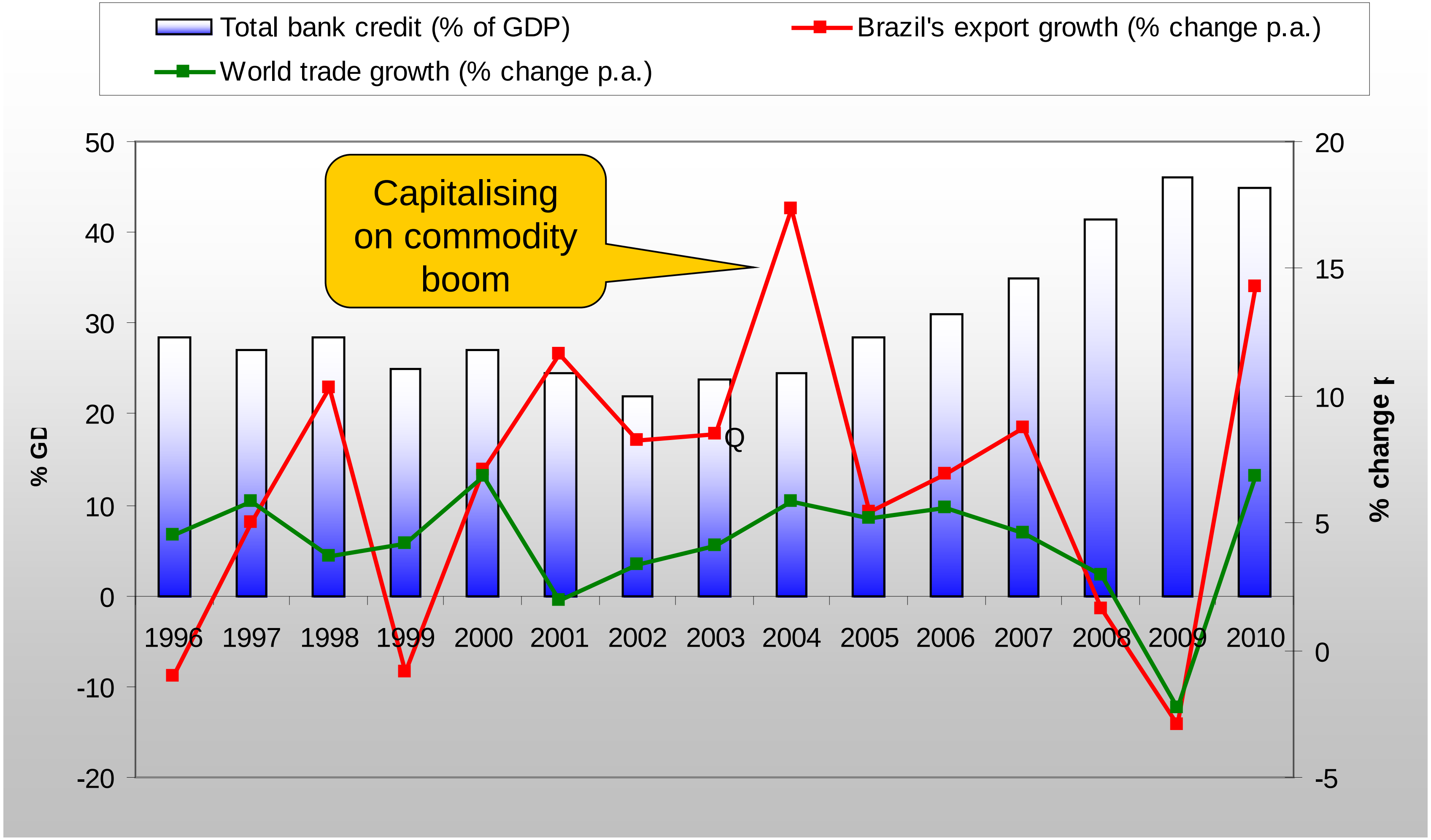
Abundance of strategic natural resources (including new oil reserves!) and diversified export markets and products

Record FDI inflows (US$50.5bn in 2011 up to Sept)

Lowest unemployment rates to date (6% in Sept)

Strong foreign reserves coverage and favourable terms of trade

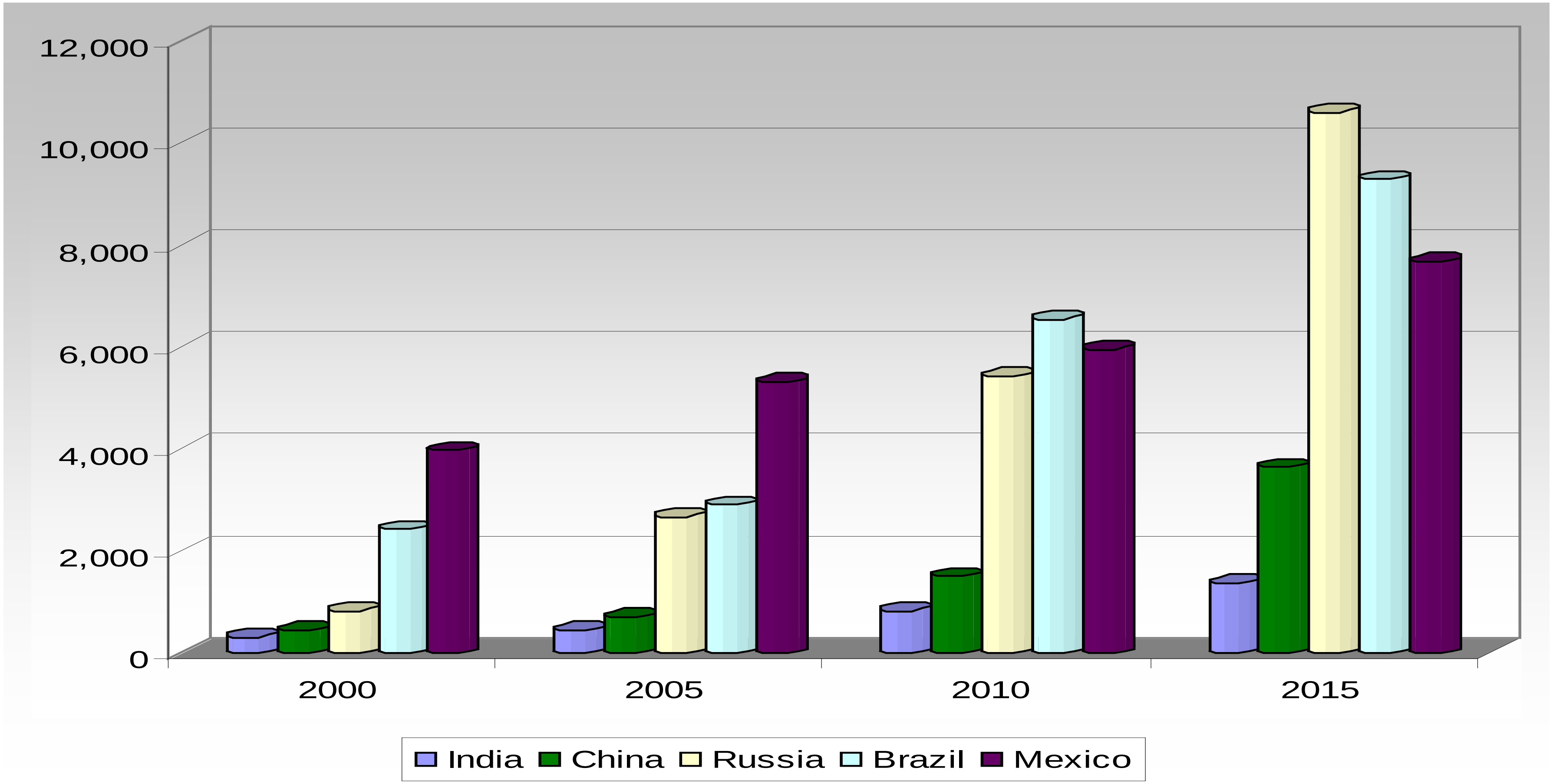
Firing on many cylinders



Source: Economist Intelligence Unit, CountryData.

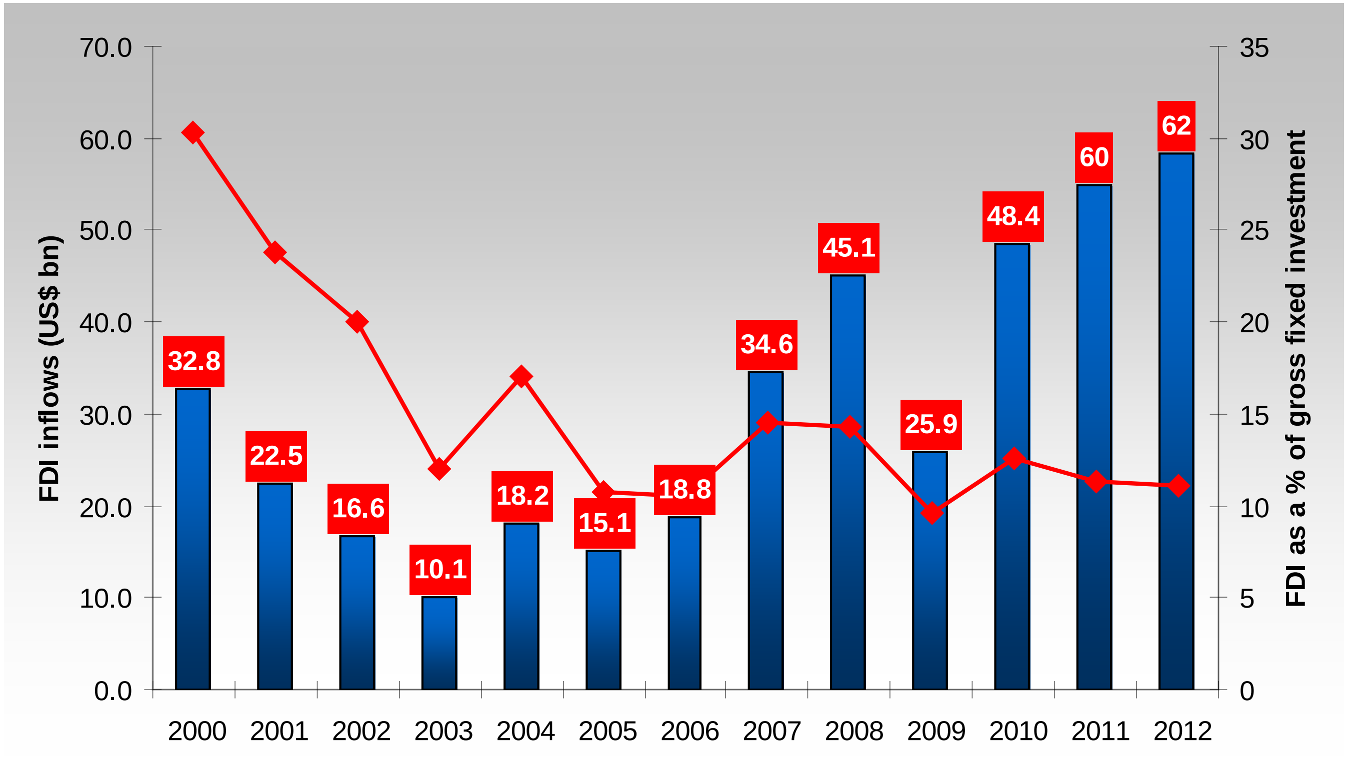
Domestic demand is picking up

Household consumption per head (US$)



Source: Economist Intelligence Unit, CountryData.

Attractive FDI destination



Source: Economist Intelligence Unit, CountryData.

Energy powerhouse

Oil and gas powerhouse

Huge reserves of oil and gas, which will turn the country into a top ten oil exporter (and self sufficient) by 2025

The major offshore oil and gas discoveries in the pre-salt layer in ultra-deep waters off the coast of the state of Espírito Santo down to Santa Catarina might increase the country's reserves to up **to 80bn barrels** (from 12.6bn barrels in 2009).

Renewable energy powerhouse

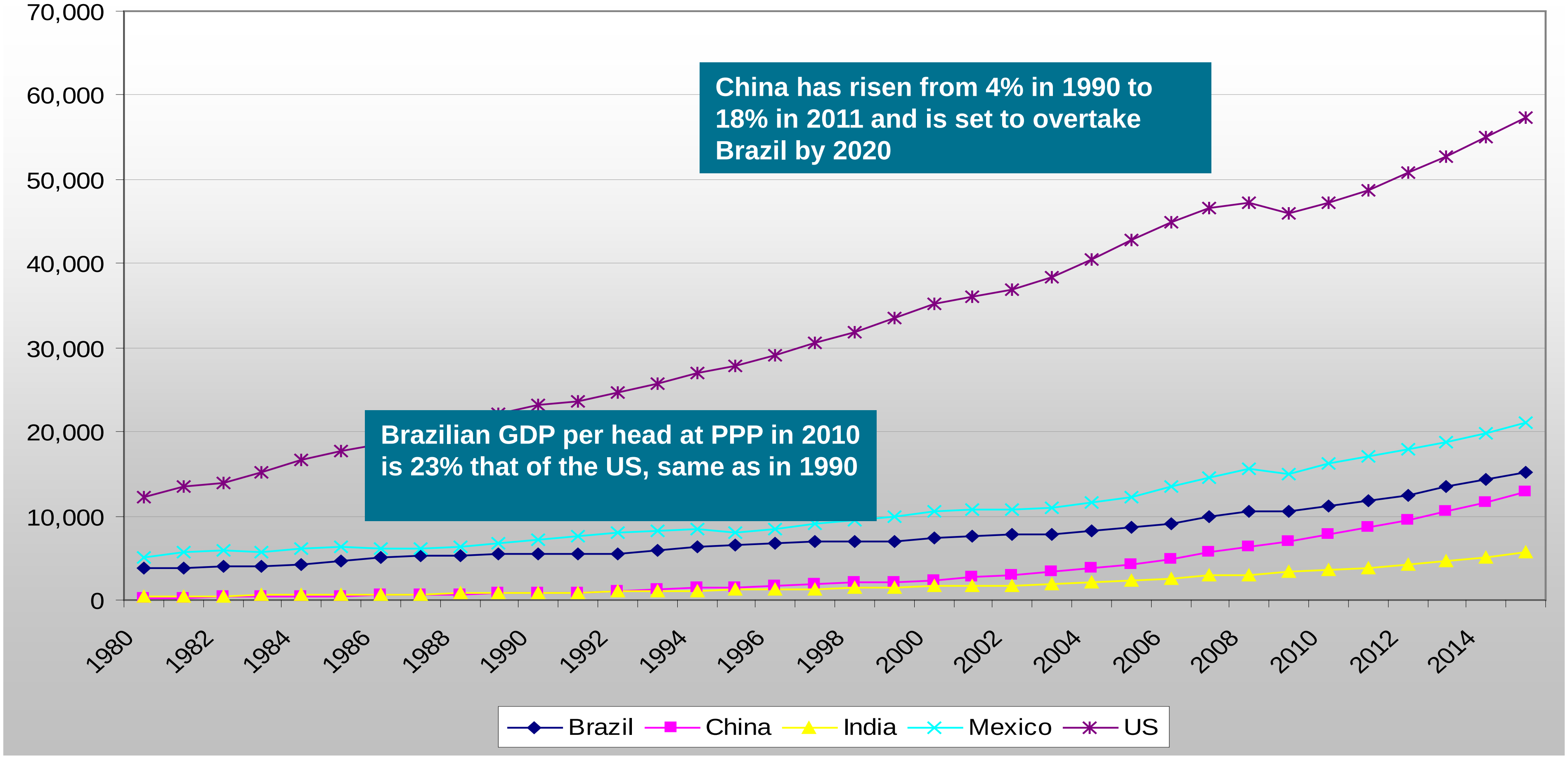
Energy mix dominated by renewable energy – hydro, bio fuels

Second-largest producer and largest exporter of ethanol in the world

One of the world's biggest producers of hydropower; and has wind potential

So, all good news?

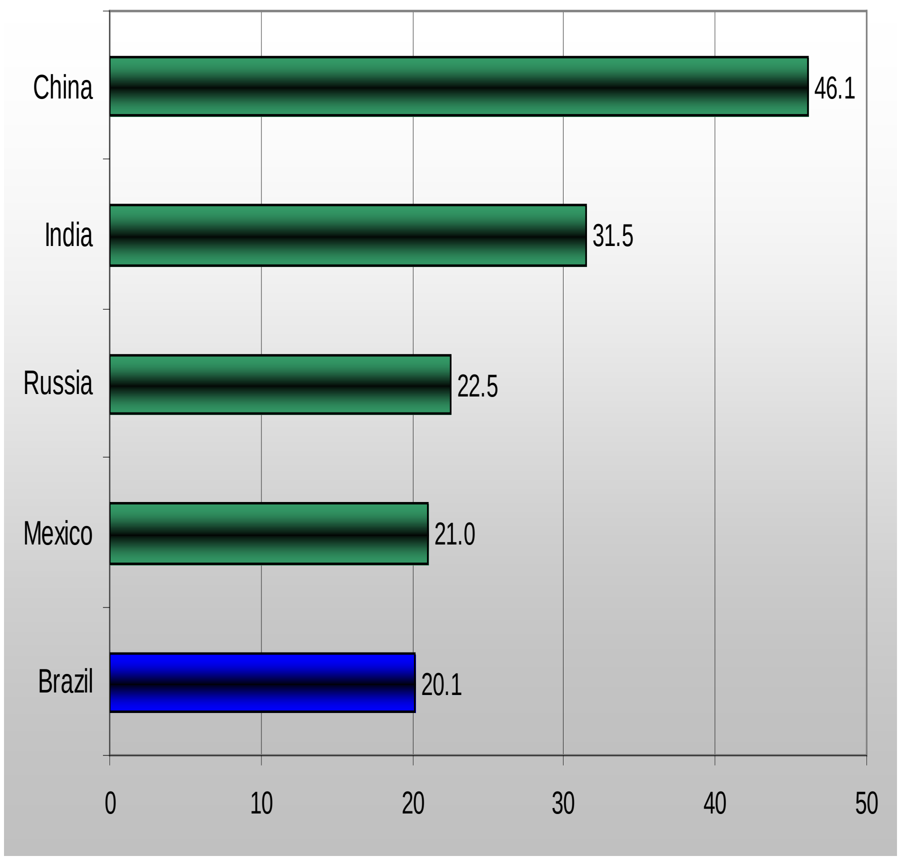
Really catching up with US income per capita?



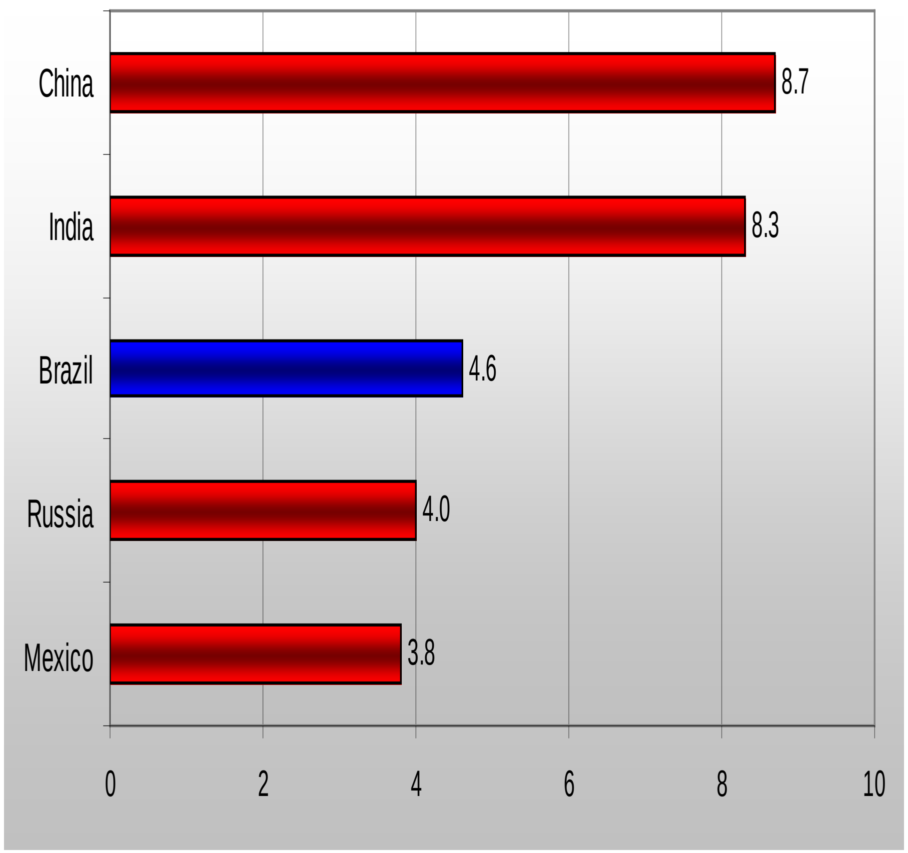
GDP per head at PPP as % of US GDP per head at PPP
Source: Economist Intelligence Unit, CountryData.

Really catching up?

Investment/GDP (%)



GDP growth (%)

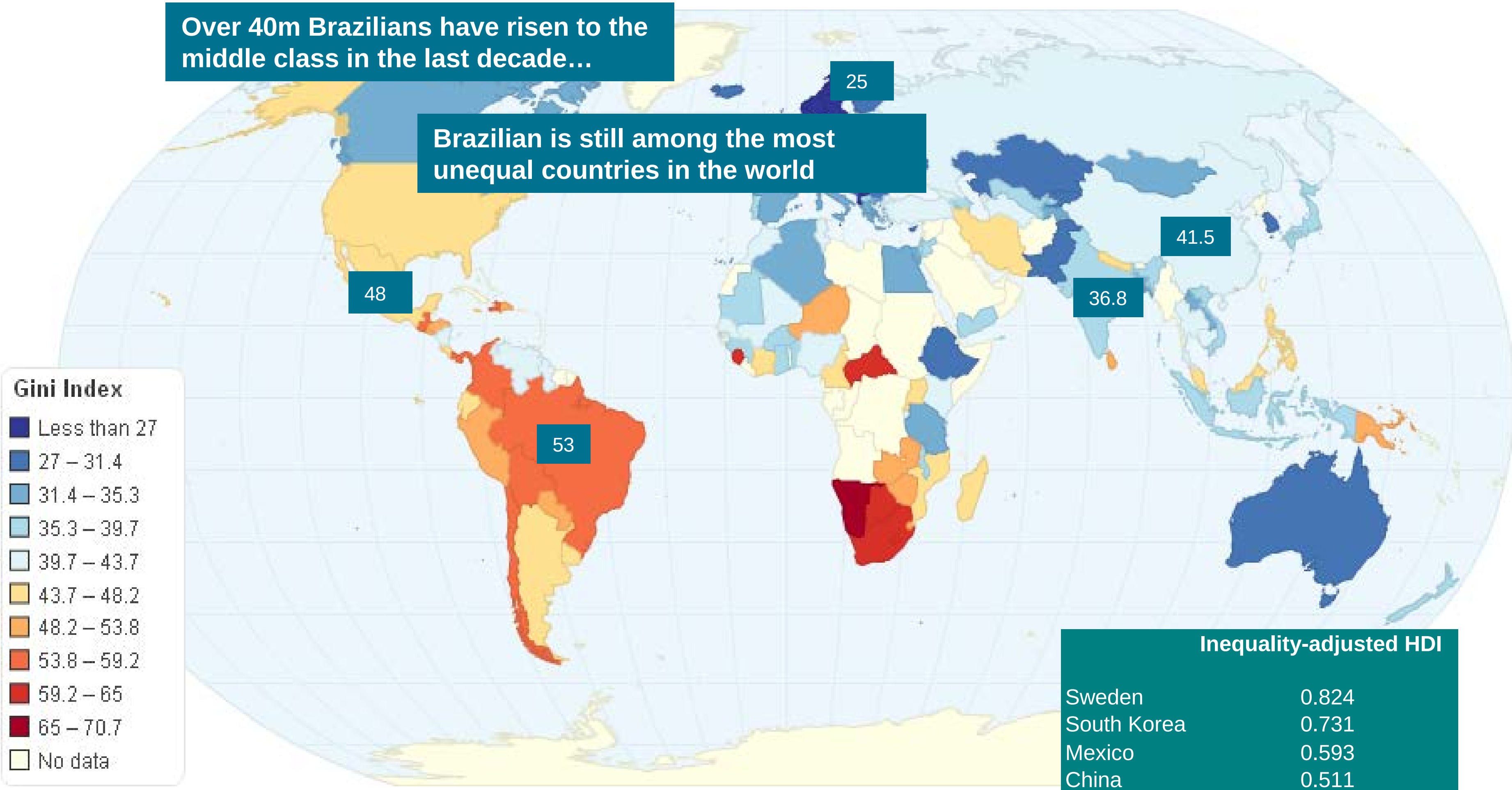


Annual average (2010-15)
Source: Economist Intelligence Unit, CountryData.

Really catching up?

Over 40m Brazilians have risen to the middle class in the last decade…

Brazilian is still among the most unequal countries in the world

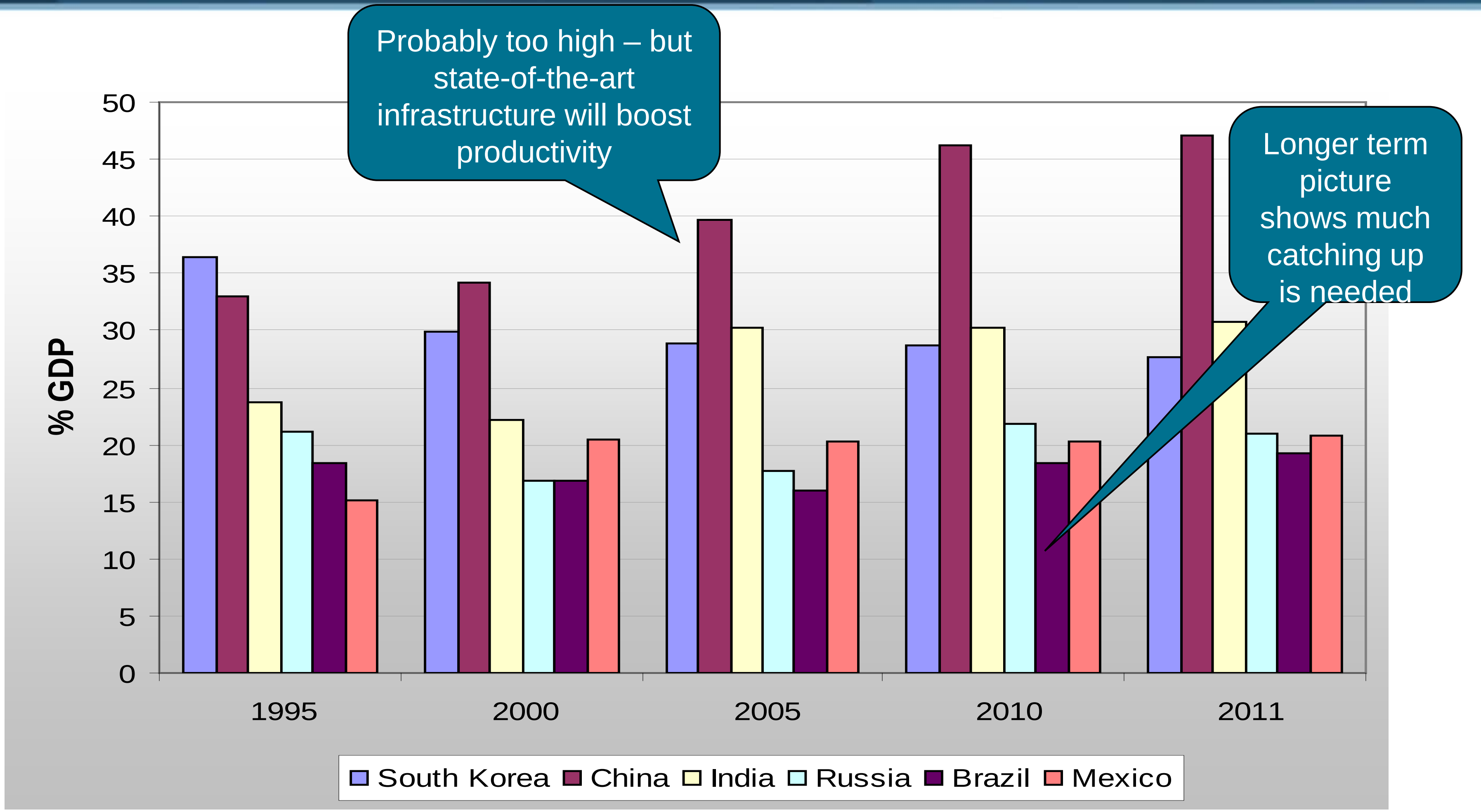


Inequality-adjusted HDI	
Sweden	0.824
South Korea	0.731
Mexico	0.593
China	0.511
Brazil	0.509
India	0.365

Source: ChartsBin, 2011.

A few weak spots...

Weak spot 1: Investment rates still far too low



Source: Economist Intelligence Unit, CountryData.

MIND THE GAP

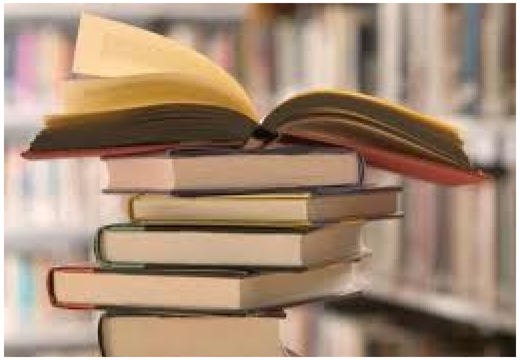
Weak spot 2: Mind the skills gap!

- According to a Fundação Dom Cabral survey, 92% of firms in Brazil have difficulties in recruiting suitably qualified professionals. Situation is particularly problematic in the South East, where economic activity is concentrated

- Among the most problematic obstacles in hiring staff: the scarcity of skilled and trained professionals (81%), the lack of experience (49%) and deficiencies in basic skills (42%)

- Among the sectors suffering the acutest difficulties: civil construction, the naval industry, automotive, railway, furniture, metallurgy, steelmaking, transport and the services sector. The oil and gas sector can be added to this list as development of the sub-salt reserves begins.

- Among the professional categories more difficult to fill: technicians (with 45% of businesses reporting difficulties), mechanical engineers (34%), project managers (29%), production operators (24%), electrical engineers (23%), administrators (22%) and human resources professionals (22%).



Source: Fundação Dom Cabral, 2010 and 2011.

Weak spot 2: Mind the skills gap!

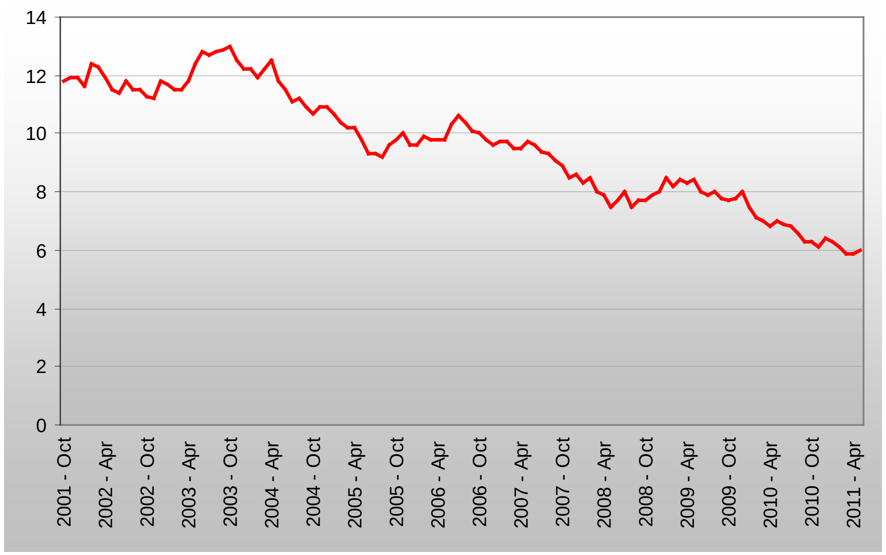
Much of the problem lies in the poor state of Brazil's public education system:

- Time in school, the nature of the curriculum, pedagogic styles, teacher absenteeism and grade repetition (an average of 19%, the highest in Latin America and one of the highest in the developing world)!
- Low completion rates (only 42% for secondary education)
- Wide regional disparities with high drop-out rates especially in the North East
- Brazilian 15-year-olds scores significantly lower than the OECD average in reading, maths and science (Brazil came 53rd of the 65 countries tested) in the 2009 Programme for International Student Assessment (PISA)

PLUS

Tight labour market: unemployment levels are at historical lows:

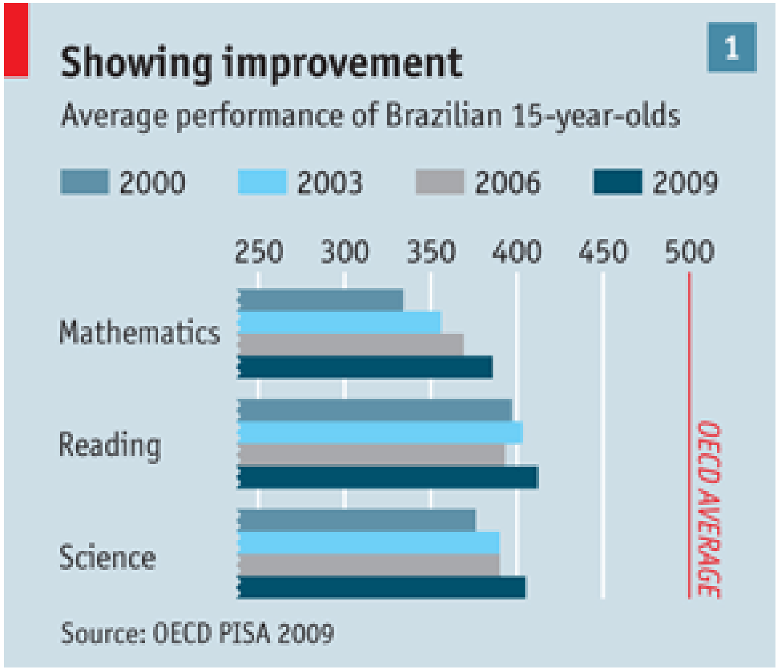
Recovery led to the net creation of over 2.1m formal-sector jobs in 2010. A further 1.5 net formal jobs were created in January-Sept 2011.



Weak spot 2: Mind the skills gap!

BUT ON THE GOOD SIDE:

- Enrolment rates have improved significantly (especially for secondary education)
- In latest PISA, the average performance of 15-year-olds showed solid gains in all three subjects tested
- The political economy of public education is favourable: the emerging Brazilian middle class will increasingly put pressure on political parties to deliver improvements in education.
- Plano Nacional de Educação (PNE 2011-20, the National Education Plan) envisages US$38bn in additional spending over the next ten years
- Pronatec – govt vocational training program



MIND THE GAP

Weak spot 3: Mind the infrastructure gap!

A rate of investment of 4-5% of GDP in infrastructure is required to sustain 5% growth rates in Brazil

Brazil currently invests around 3% of GDP, as compared to 10% and 6% in China and India and Chile respectively – due to bureaucratic delays, fiscal constraints,etc.

Among main infrastructure bottlenecks: rickety transportation and logistics, antiquated cargo rail network, overburdened and inefficient ports and airports

MIND THE GAP

Weak spot 3: Mind the infrastructure gap!

Brazil is making progress but still a long way to go to catch up with international best practices

Quality of Infrastructure Index

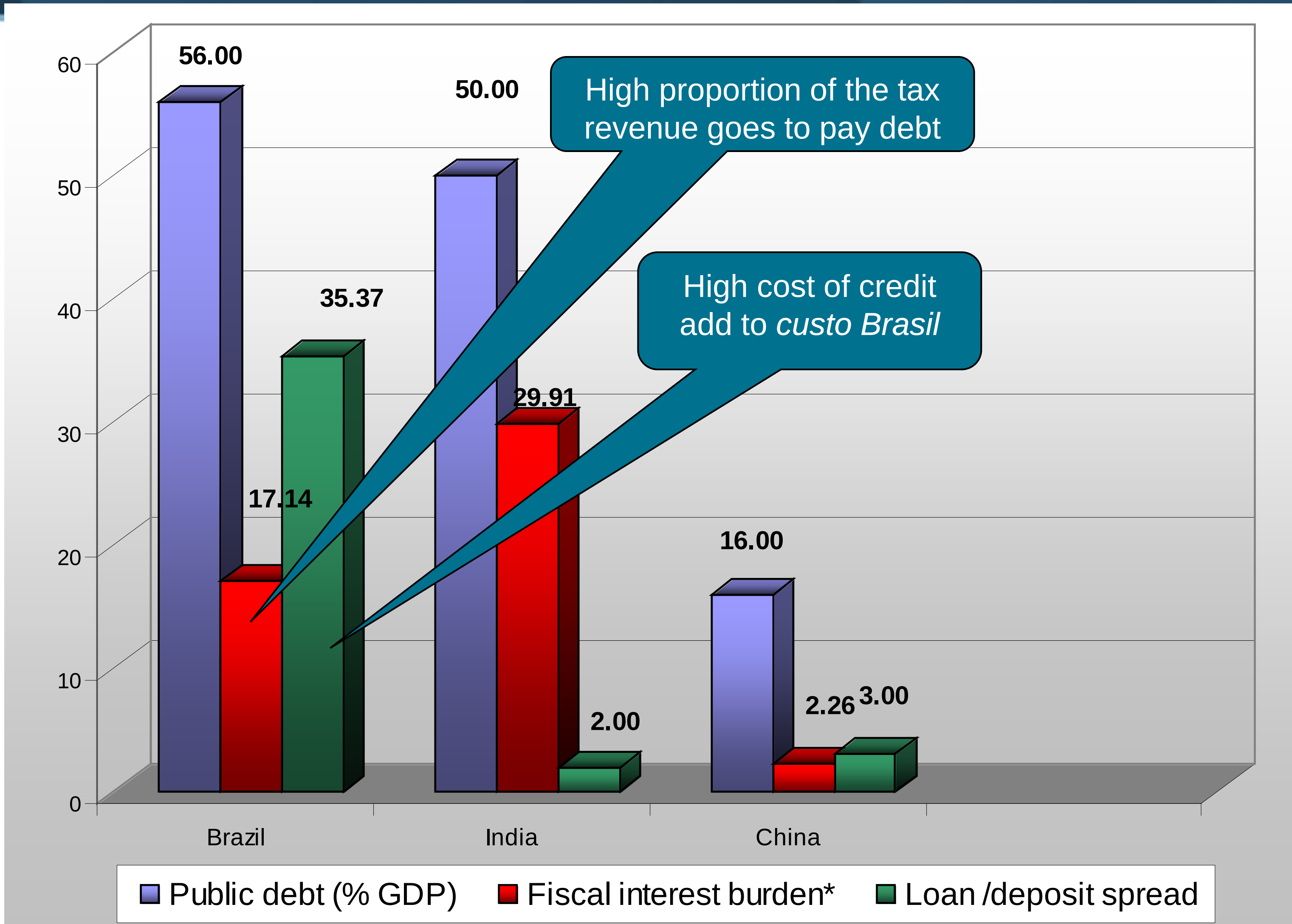
	2011-15		2006-10		
	Score	Rank	Score	Rank	Rank change
Denmark	9.58	1	9.58	2	1
US	9.44	4	9.30	6	2
France	9.44	4	9.30	6	2
South Korea	7.75	27	7.89	24	-3
Chile	7.61	29	6.63	35	6
Poland	7.47	31	7.05	32	1
South Africa	6.63	44	6.63	35	-9
China	6.48	46	5.64	52	6
Brazil	6.48	46	5.50	56	10
Turkey	6.34	52	5.64	52	0
Argentina	6.34	52	6.20	45	-7
Mexico	6.20	55	5.64	52	-3
Peru	5.92	60	4.80	66	6
Colombia	5.78	61	4.94	61	0
Venezuela	5.78	61	6.06	46	-15
Egypt	5.08	70	4.80	66	-4
Vietnam	4.94	71	3.67	76	5
Indonesia	4.80	72	4.23	72	0
India	4.66	75	4.09	74	-1
Nigeria	2.97	80	2.41	81	1

Source: Economist Intelligence Unit

Brazil: infrastructure investment prospects
(R bn)

	2005-08	2010-13	% change
Infrastructure total	199	310	55.6
Electricity	67	98	45.2
Telecommunications	66	67	2.1
Sanitation	22	39	76.5
Railways	19	56	195.3
Highways	21	36	73.0

Weak spot 4: Public finances



A lot on Dilma's plate…what about the structural reforms?

PTC

Ten-party ruling alliance is unwieldy, preventing Ms Rousseff from passing any radical measures

PP

PSB

PTB

Progress on comprehensive structural reforms to flexibilise labour markets, improve government efficiency, cut corruption and make the fiscal system more sustainable among others is unlikely

PSC

PRONA

PR

PT

Instead, we expect her to focus on simplifying the tax system and on infrastructure/programme implementation and making smaller, gradual improvements to the business environment.

PV

The opportunities and challenges ahead

Opportunities - Much more than soccer

- Increasing global players emerging in many sectors: at the forefront of *multilatinas*

- Banking sector (including banking the expanding middle class)

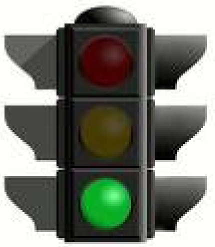
- Manufacturing (aircraft, automotive)

- Renewable energy and oil

- Agribusiness and mining

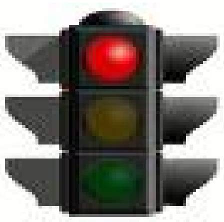
- Tourism: the World Cup and the Olympics ahead

Investment grade credit pro and cons



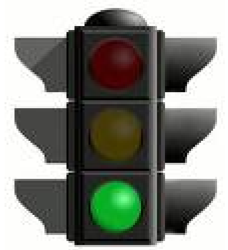
- Fairly stable growth and mild inflation
- Strong reserves coverage/ net ext creditor
- Diversified export markets and products

= greater resilience to global woes

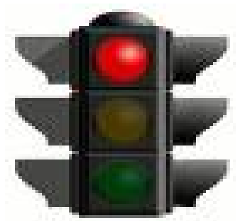


- High public debt burden
- Heavy fiscal burden of debt service
- Little prospect of fiscal reform

Investment pros and cons



- Prudent fiscal and monetary policies
- Huge and growing domestic market
- Heavy investment in infrastructure
- An advanced banking system
- A dynamic private sector
- Deeper south-south trade and investment links



- A shortage of skills
- Rigid labour market
- Crime and corruption
- Inefficient bureaucracy
- *Custo Brasil*
- Underdeveloped infrastructure

Brazil faces a challenging 2012…

- The economy is already slowing...3% in 2011
  - (dragged down by industry)
- Inflation is high 7% (October)

- Contagion from euro zone woes?
  - Trade/ banking/ confidence
  - And via China…(terms of trade)

- And Brazil's policy mix…
  - Government's desire to use global woes to "rebalance" Brazil's skewed policy mix
  - Is Central Bank easing - too risky?
  - How much room for stimulus; will fiscal policy remain prudent in 2012?

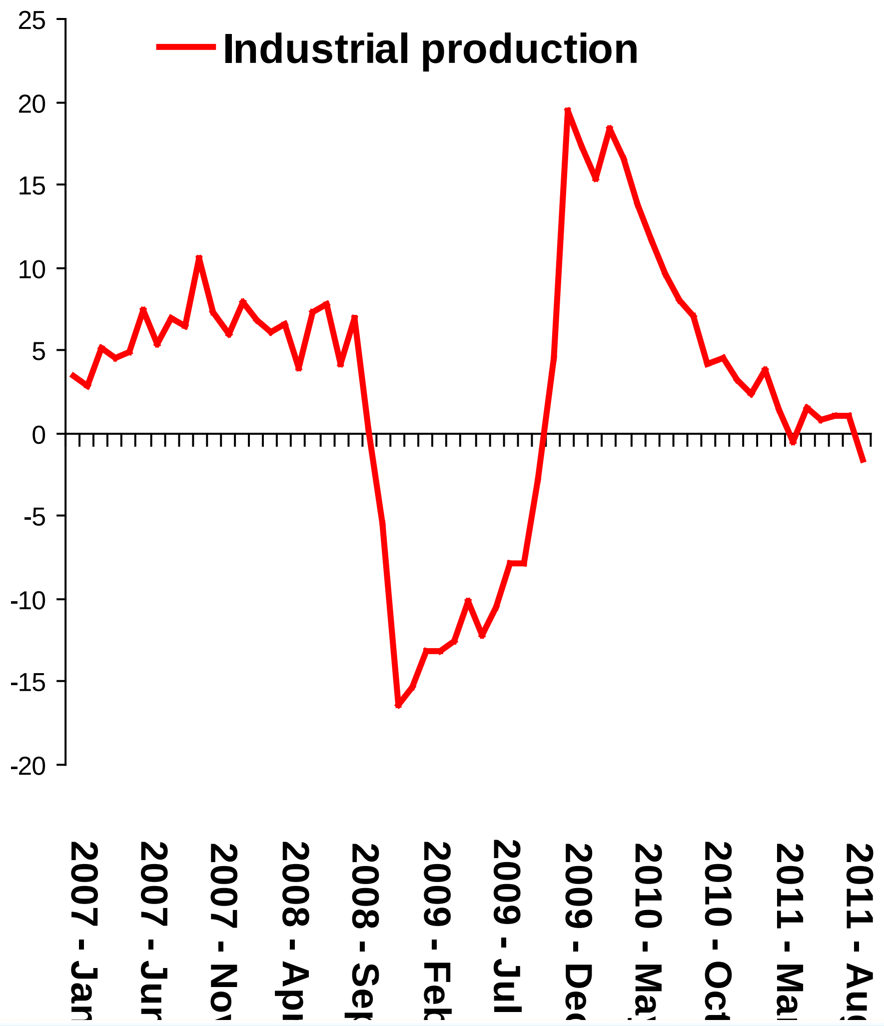
- Creeping protectionism…

Brazil: Manufacturing has been struggling

- Industrial output dropped in September. Why?
  - Strong real; imports surging
  - Weaker overseas demand
  - Slightly slower consumer spending
  - Inventory adjustments

- Manufacturing competitiveness problems
  - High taxes
  - Rapidly rising wages; near double digits
  - Rickety infrastructure

- Government taking protectionist measures to protect jobs
  - Tax hike on auto imports
  - Easier to apply for dumping duties



% change, YoY. Source: Haver Analytics

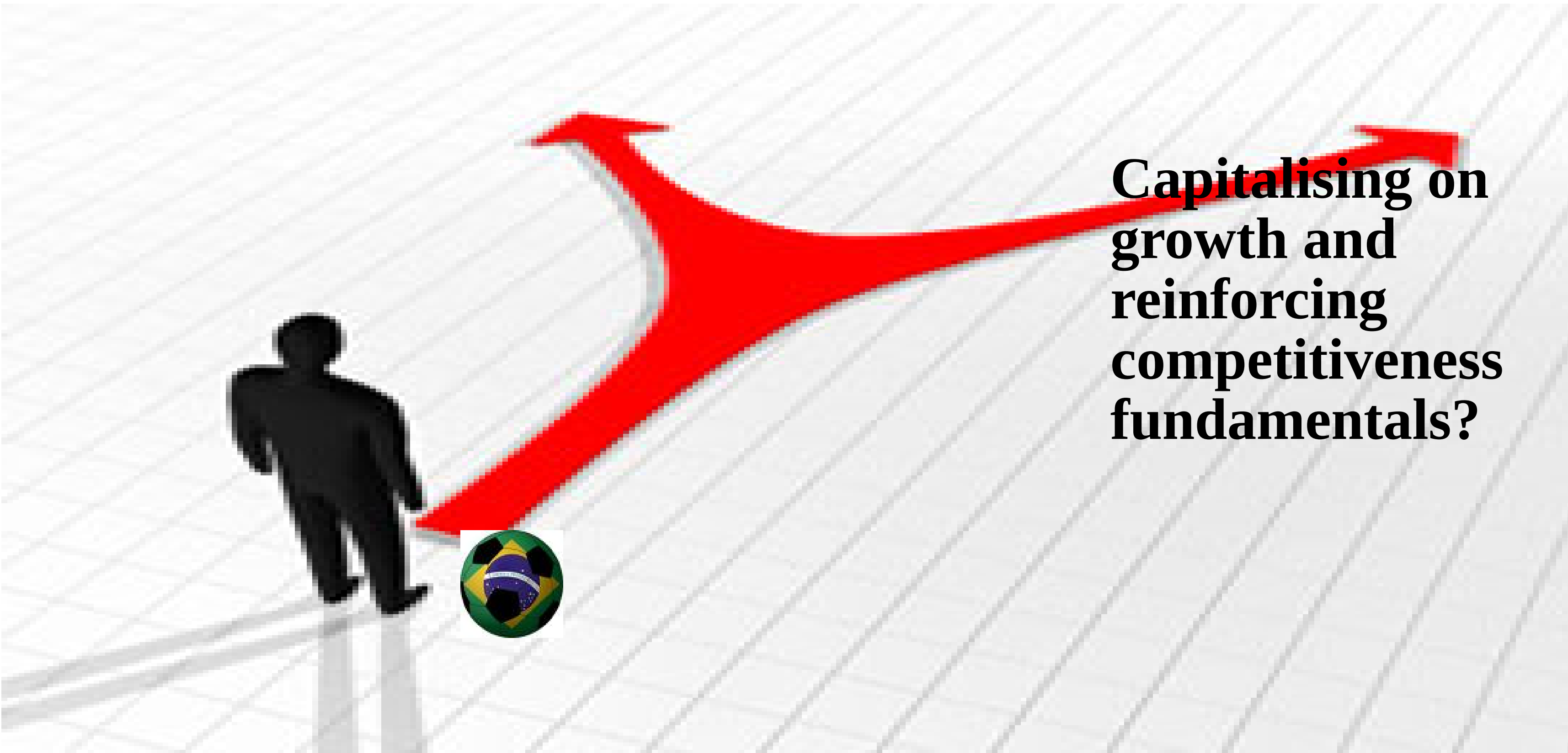
Brazil – Forecast summary

- Ms Rousseff has a majority in Congress, but retaining the unity of the multiparty and ideologically diverse alliance will prove increasingly challenging, especially as more corruption cases emerge.
- Policy tightening earlier in 2011 and weaker global growth will slow GDP growth to 3% this year, with little improvement in 2012 despite policy easing.
- An investment and electoral cycle will lift GDP growth to 5% in 2014, before growth eases in 2015 after the elections.
- If risks to the global economy materialise, namely that of a US recession or a full-blown euro zone debt crisis (or both), and hit external credit lines, Brazil's large reserves cushion will help to mitigate the shock.
- The real will weaken against $

(% change, unless indicated)	2011	2012	2013	2014	2015
Real GDP growth	3.0	3.5	4.5	5.0	4.3
Industrial production growth	3.0	3.5	4.0	4.5	4.5
Agricultural production growth	3.4	3.5	3.8	4.0	3.8
Inflation	6.5	5.5	5.0	4.8	4.7
Money market interest rate	11.7	10.6	10.9	11.0	11.5
Public sector balance (% GDP)	-2.7	-2.7	-2.5	-2.4	-2.1
Exports of goods fob (US$ bn)	254	266	281	309	347
Imports of goods fob (US$ bn)	-233	-259	-285	-318	-364
Current-account bal (US$bn)	-53	-73	-92	-97	-115
Current-account (% of GDP)	-2.2	-2.9	-3.5	-3.4	-3.8
External debt (US$ bn)	409.4	462.5	518.1	574.3	640.5
Exchange rate R:US$ (yr end)	1.74	1.83	1.89	1.94	1.99

The way ahead

Overheating/entrenched inflation/overvaluation
Deindustrialisation?



Capitalising on growth and reinforcing competitiveness fundamentals?

India…

India: the outlook

India will remain one of the world's fastest-growing economies

Weathered the 08/09 global crisis better than peers, better than expectations… resilience

GDP growth to average over 8.2% pa in next 5 fiscal years; overtaking China's annual rates

Investment to remain higher than **business environment** would suggest

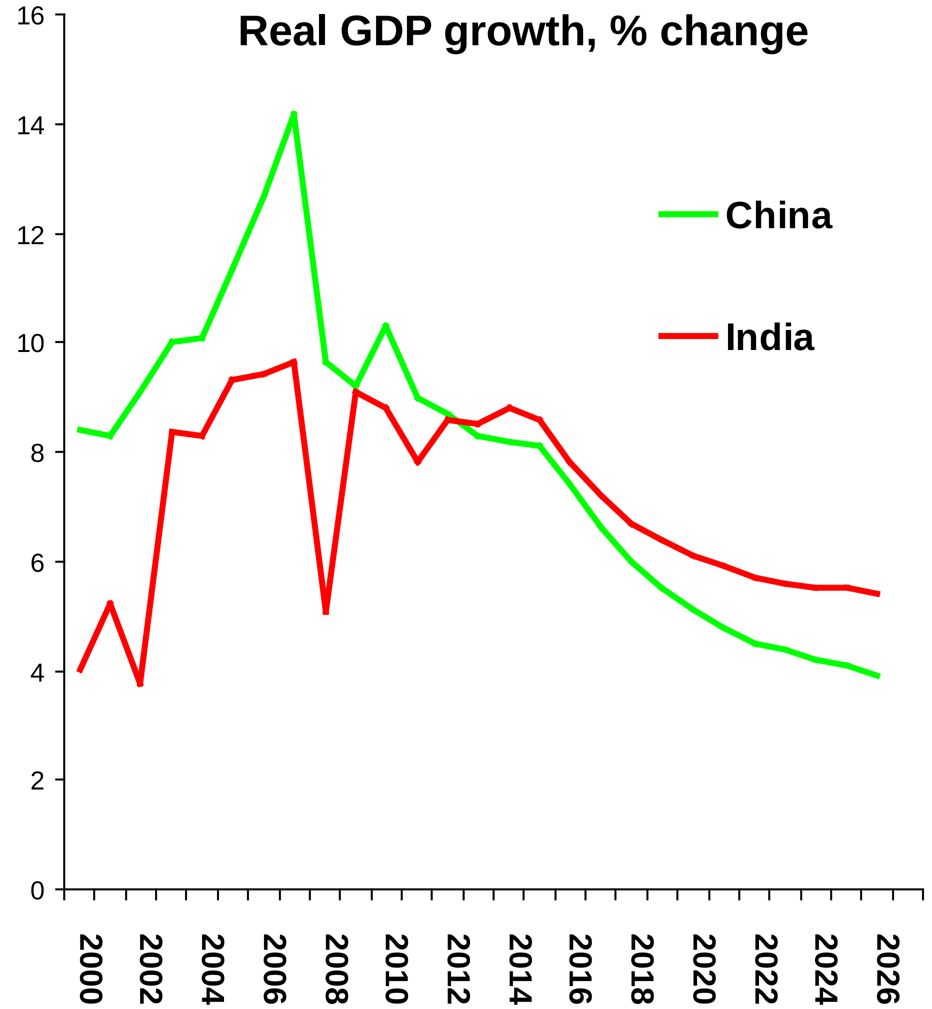
Policy, operational risks persist…

India: Step change in last decade, and more to come

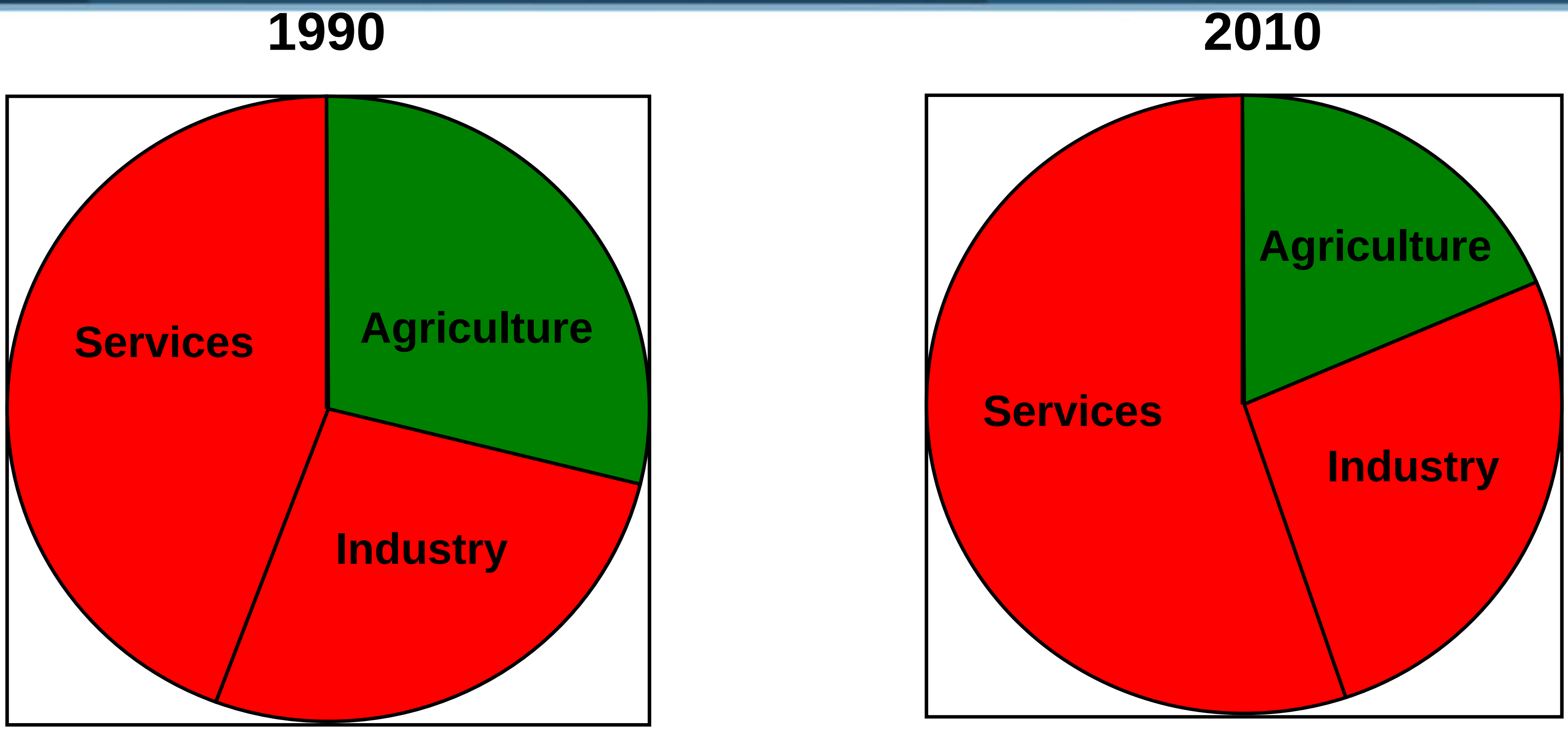
- India has doubled growth rate in last decade
  - High saving and investment rates
  - Young population
  - Fast labour force growth
  - Rapidly expanding middle class
  - Well-established manufacturing sector (but with quality issues)

- Steady economic performance; little year to year volatility

- But considerable risks
  - Stubbornly high inflation
  - Appalling infrastructure
  - Weak fiscal regime

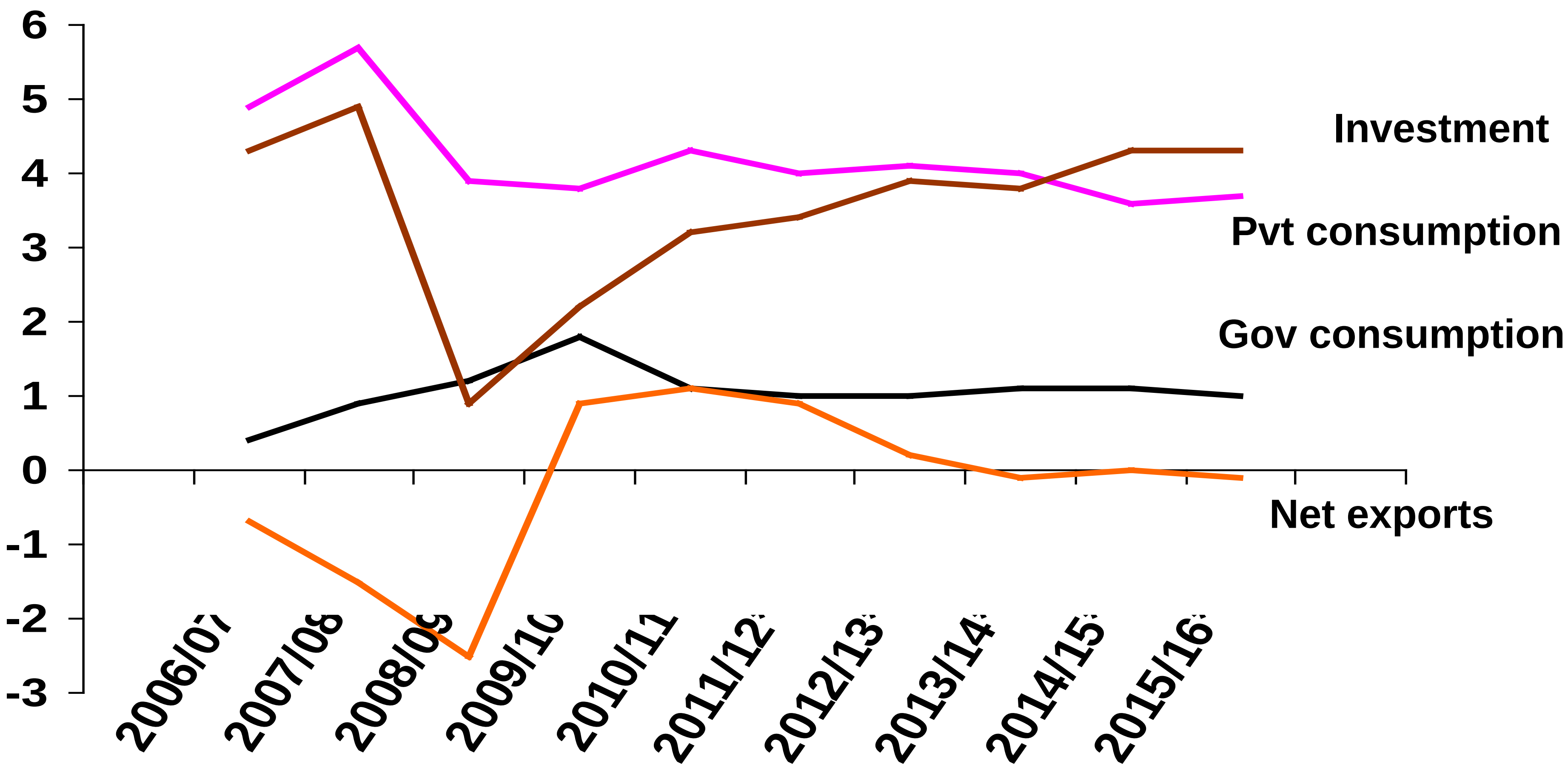


Structural movement



Share of GDP, %

The drivers: look inward



Contribution to growth, % points

Holding pattern?

The government's 2011/12 budget:

- Optimistic macro assumptions
  - 9% GDP growth
  - Fiscal consolidation
  - c/a deficit reduction
  - Moderating inflation

- Higher spending: agriculture, infrastructure…

- Reform: still waiting !
  - No corporate tax changes
  - FDI liberalisation: "discussions underway…"
  - Privatisation plans scaled back

Disappointing business environment rankings - 0 to 10 (Best)

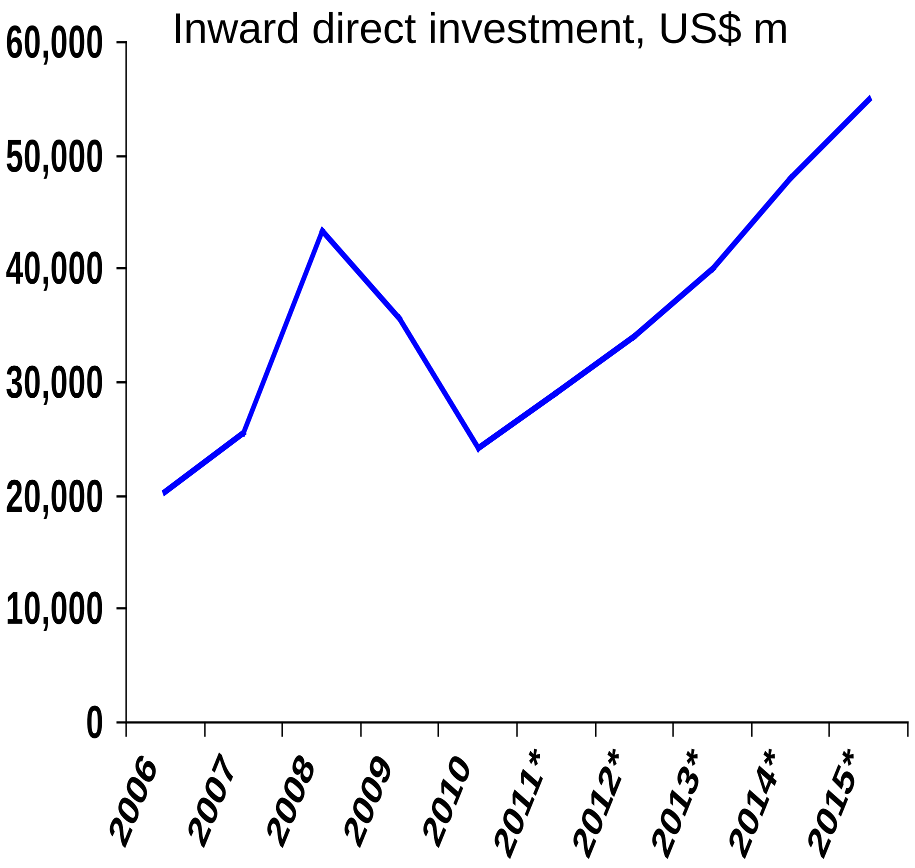
	INDIA	ASIA AND AUSTRALASIA	RANK IN ASIA AND AUSTRALASIA
Market opportunities	7.8	6.0	3
Policy towards foreign investment	6.9	7.0	8
Political environment	5.3	6.1	9
Policy towards private enterprise	6.0	6.2	10
Financing	5.5	6.1	13
Macroeconomic environment	6.9	7.1	13
The labour market	6.1	6.4	13
Taxes	6.0	6.9	15
Infrastructure	4.7	6.2	15
Foreign trade & exchange controls	6.0	7.6	16
OVERALL POSITION	6.1	6.6	12

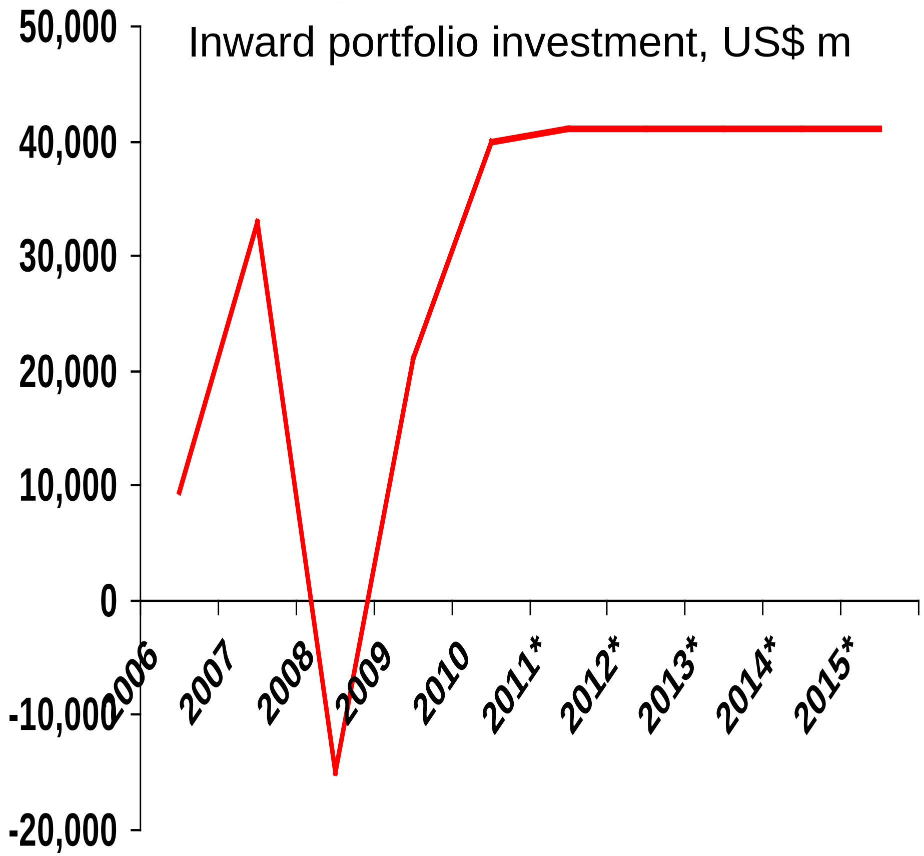
Business environment quality score out of 10, when 10 means high quality environment.

Scores for 2011-15

Regional rank out of 17 countries

Rising foreign investment





** Economist Intelligence Unit forecast*

India: key themes

Stellar economic performance to continue

- Economy has shown resilience
- Rapid growth at a sustainable rate
- Growth has solid foundations

But double-digit GDP growth rates not achievable due to:
infrastructure bottlenecks; skilled labour shortages;
difficulties shifting out of low-productivity agro

Challenges abound…

…but these present the greatest potential opportunities !

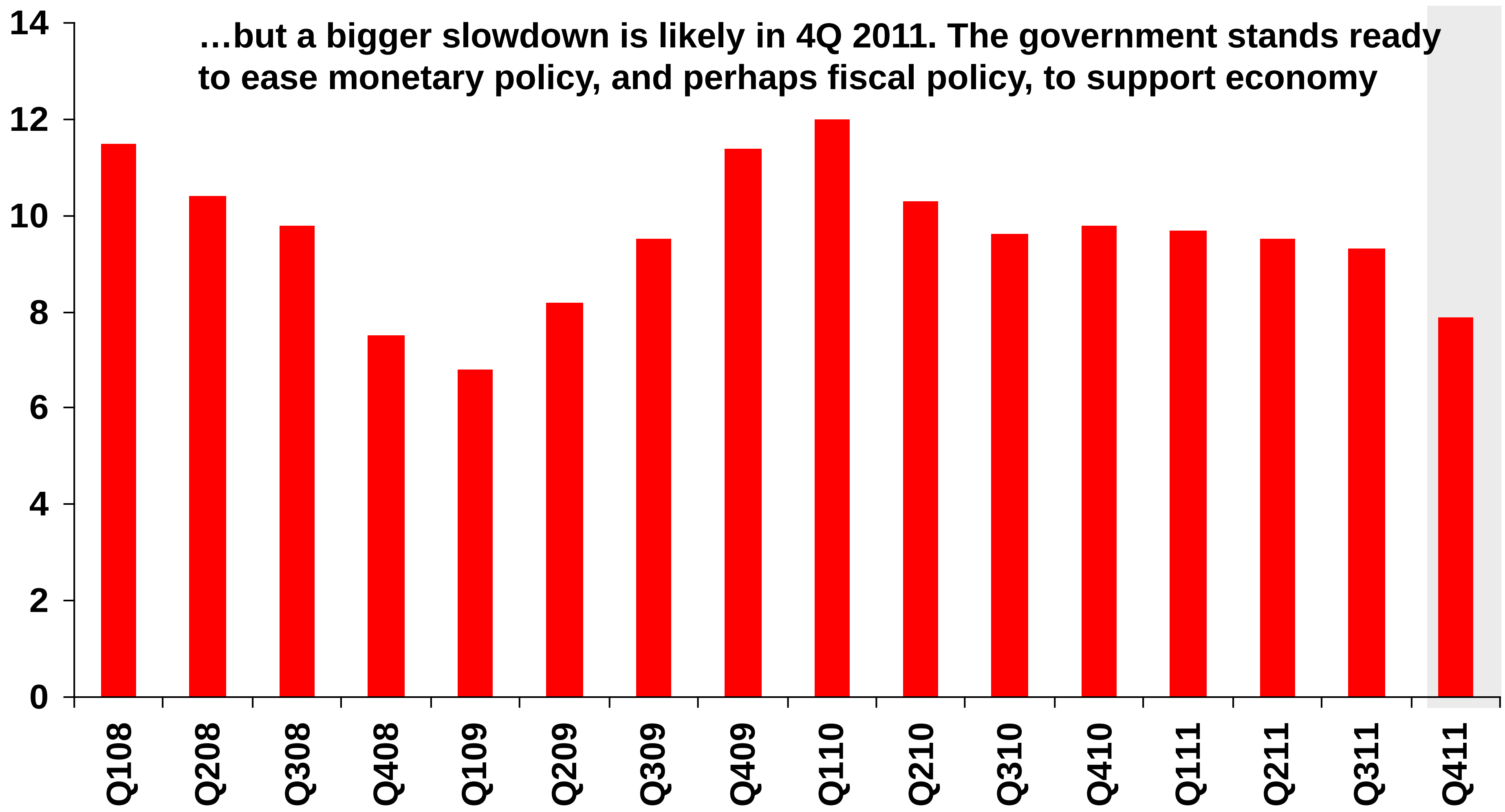
India – Forecast summary

- The Indian National Congress-led United Progressive Alliance coalition government is likely to complete its five-year term, which ends in 2014, but its political standing is low, owing to corruption and high inflation.
- High-profile anti-corruption protests have highlighted the graft issue, but also the government's mishandling of the situation. But the issue will not impair political stability.
- The government will make only lacklustre efforts at structural reform, partly because it lacks a reliable parliamentary majority.
- The government's fiscal deficit target of 4.6% for 2011/12 (April-March) will be missed. The deficit will narrow to 4.2% by 2015
- Real GDP is forecast to expand by 7.9% in 2011/12, and 7.8% in 2012/13, compared with growth of 8.8% in 2010/11. Growth will then average 8.4% annually.
- Inflation will decelerate from 8.3%

(% change, unless indicated)	2011	2012	2013	2014	2015
Real GDP growth	7.9	7.8	8.3	8.4	8.4
Industrial production growth	4.3	6.0	7.5	7.9	7.9
Agricultural production growth	4.9	3.5	3.0	4.0	3.5
Unemployment rate (av)	9.8	9.8	9.6	9.3	8.9
Inflation (end-period)	7.3	8.2	8.2	7.8	7.1
Short-term interbank rate	9.6	9.6	8.9	12.0	11.8
Government balance (% of GDP)	-4.9	-4.8	-4.6	-4.9	-4.2
Exports of goods fob (US$ bn)	306	353	401	470	570
Imports of goods fob (US$ bn)	-465	-530	-607	-697	-819
Current-account balance (US$ bn)	-74	-84	-90	-86	-70
Current-account balance (% of GDP)	-3.7	-3.7	-3.4	-2.8	-1.9
Total foreign debt (US$ bn)	273	284	298	313	334
Exchange rate Rs:US$ (yr end)	47.0	47.8	47.6	46.6	45.3

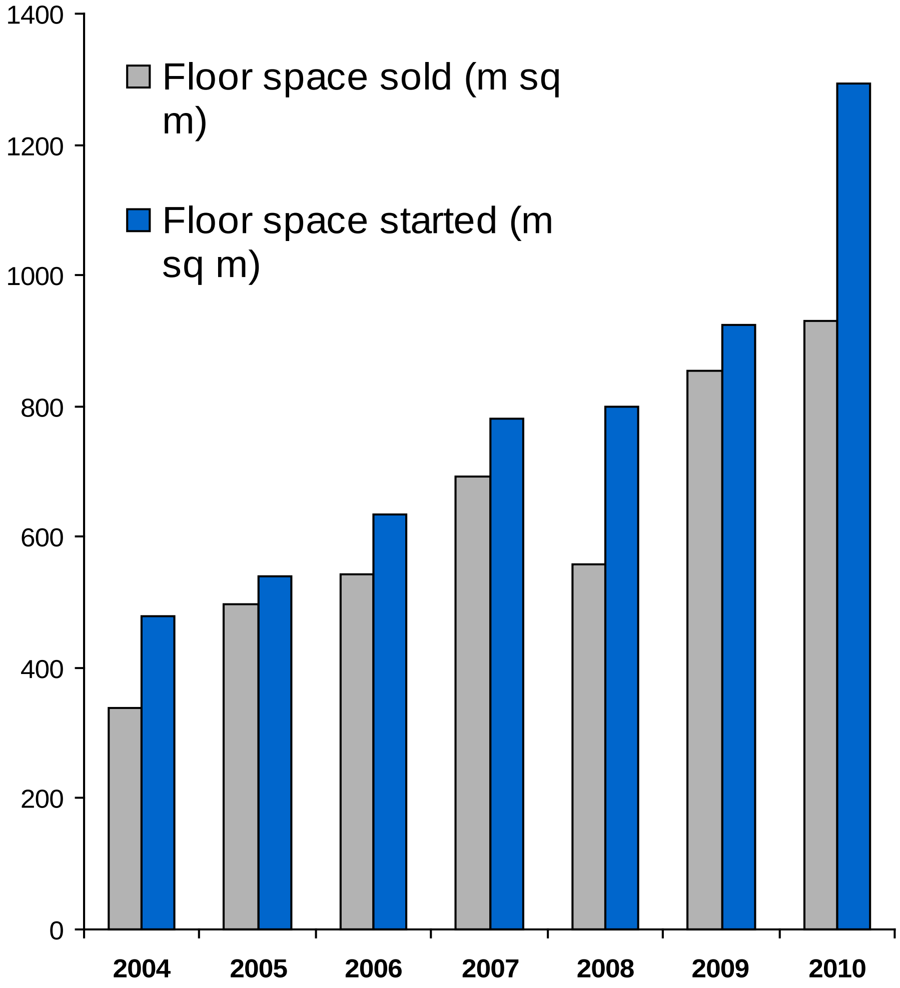
China...

China: Shocking slowdown? Not so far…



Real GDP growth, %; Sources: National statistical agency; EIU forecast

We should worry about China in the short-term



Why are investors worried?

- Inflationary asset price bubble

Government also worried about:

- Poor allocation of capital
- Inflation causing social ills

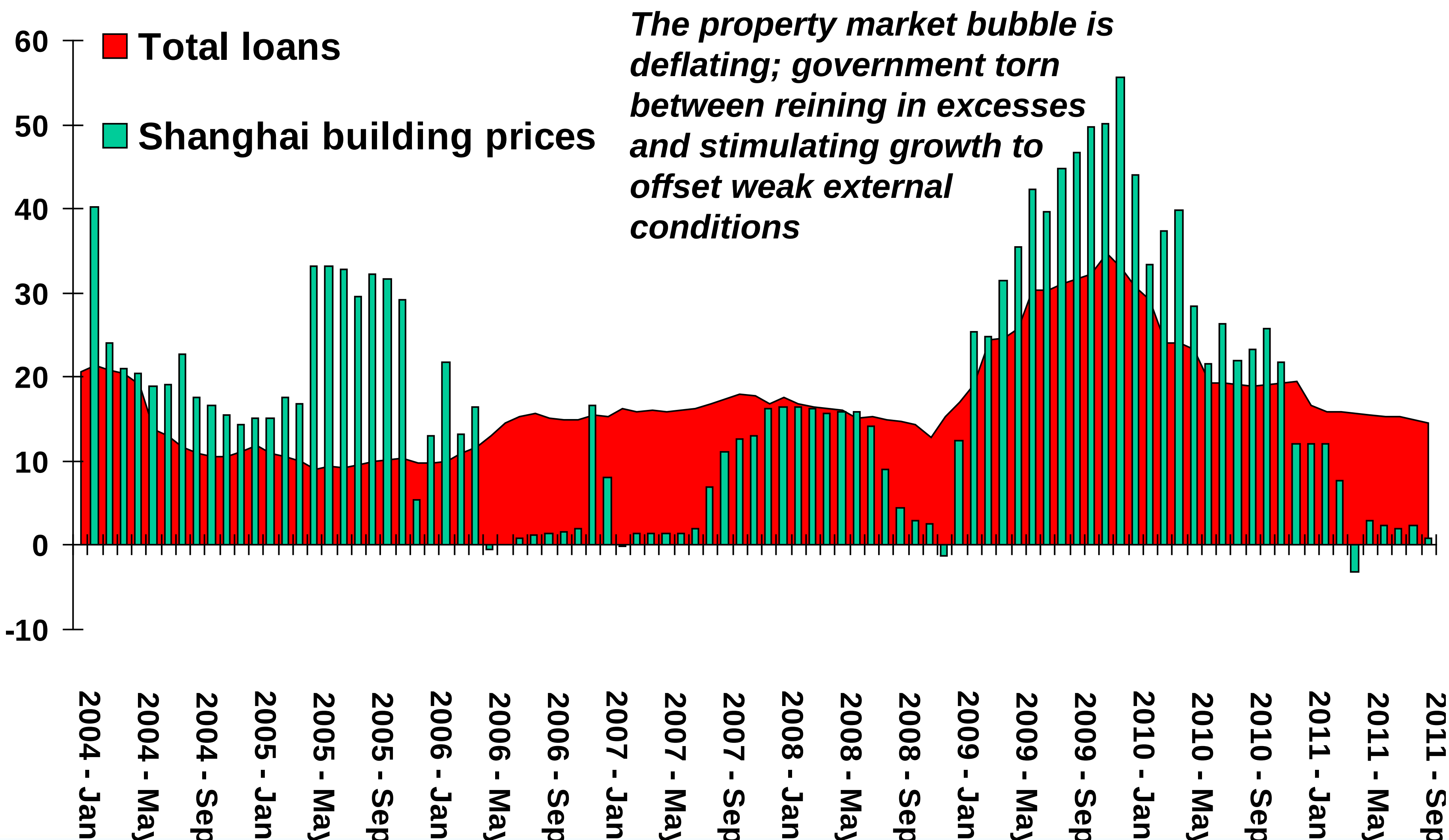
Government has reacted

- Will the brakes go on too hard?

We have increased our risk probability of a crash to moderate

Source: CEIC

China: Loan growth leveling off; property prices flat



% change, year on year; total loans by the banking system and Shanghai building prices. Source: Haver Analytics

China has a serious debt problem, but....

- Grey loans?
- Local government debt is a problem
- We do not know how big it is – 8 trillion RMB is CBRC initial estimate. Moody’s has it at over 14 trillion.
- - but we know its backed by the central government which has plenty of money and more if it needs to find it.
- Local government debt ***cannot*** cause a US style financial crisis.
- In the late 1990s the central government paid for 1.4 trillion RMB in bad bank loans.
- Not all loans will go bad. Central government revenue is around 10 trillion a year and growing fast.

Locked in the past

- Renminbi appreciation to be modest vs US$ in 2012-13
- Real appreciation faster owing to inflation differentials

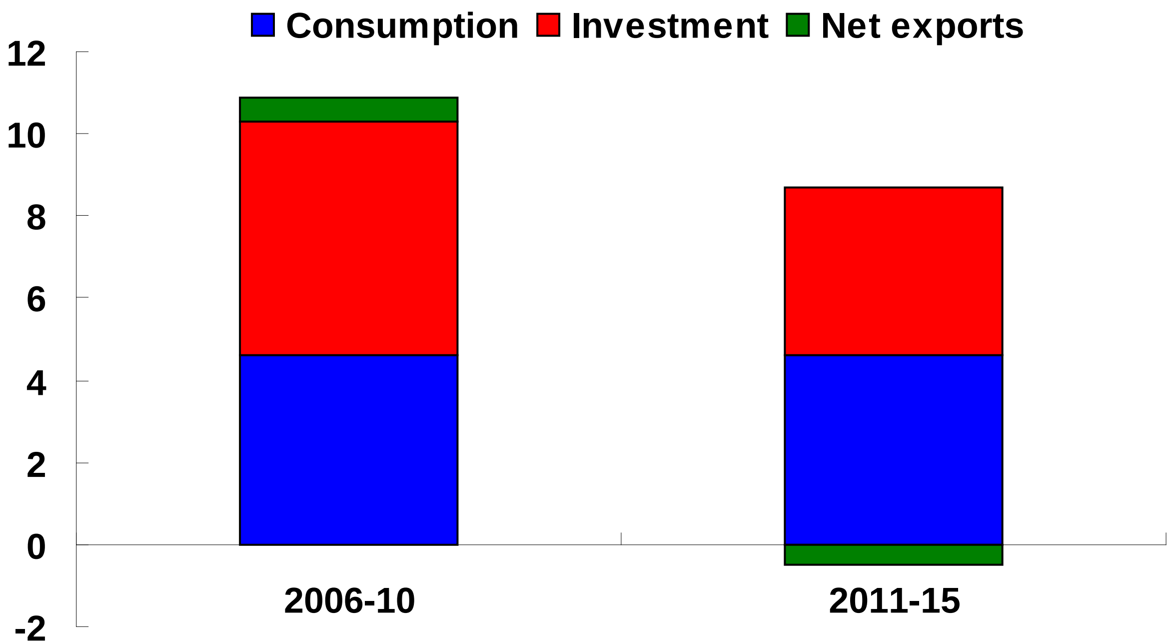
Nominal Rmb appreciation, %

	2012	2013	2014	2015
USD	3.4	3.3	1.7	2.7
€	8.5	6.9	6.2	-1.1
JPY	-0.3	7.5	4.2	5.2

- Government committed to exchange rate liberalisation. CNH and NDF markets pricing in depreciation. Depreciation requires fundamental market rethink on Rmb & implications.
- The renminbi cannot become a leading global reserve currency until China runs a capital-account deficit

Rebalancing…?

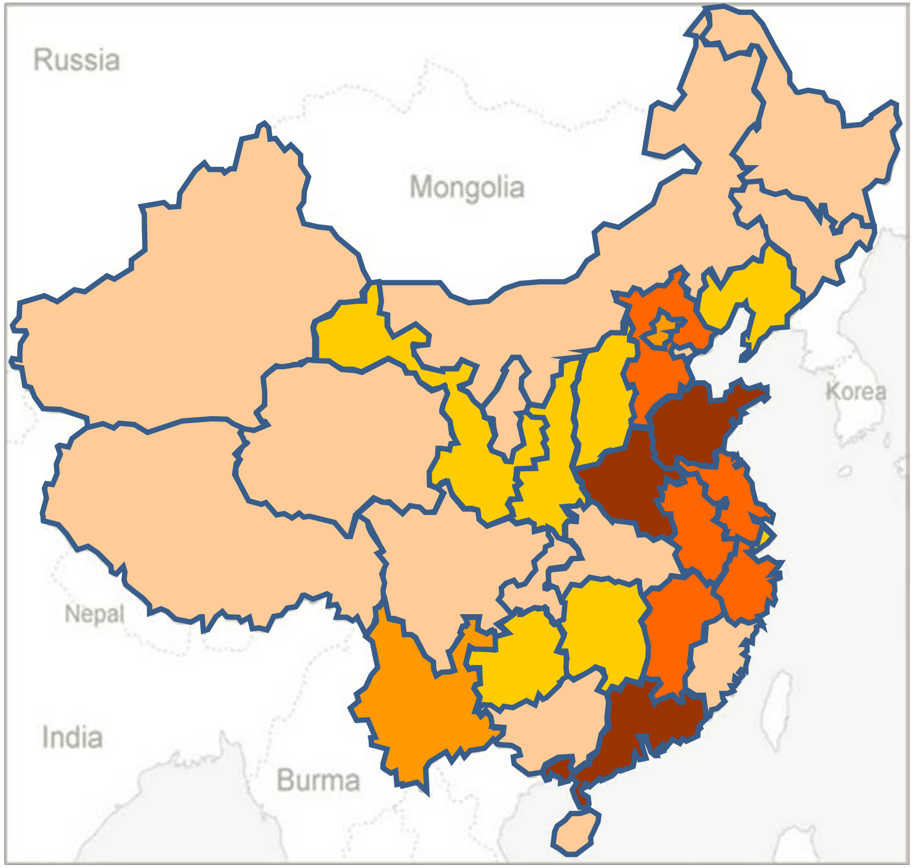
Percentage point contribution to average annual GDP growth



- The primary theme of the govt’s 2011-15 plan is rebalancing. Less dependence on exports, more focus on consumption rather than investment.
- In practice, it will be tough to rebalance investment vs consumption without a significant economic slowdown

- The handover of power to a younger generation of leaders in 2012-13 will slow reform during that time, but the new administration is likely to try to make its own mark on economic and political policy
- GDP growth is estimated at 9.1% in 2011, easing to 8.2%. owing to the weaker outlook for the EU and US economies.
- Higher interest rates and the slowing rate of expansion of the workforce will bring average annual GDP growth in 2013-16 down further, to 8%. Rapid wage growth will help to support private consumption, but growth in investment, notably in the property sector, will decelerate.
- Amid a weaker global outlook, global commodity prices will fall in 2012, cooling CPI, but it will remain a major issue as firms pass on rising input costs.
- The renminbi is expected to appreciate steadily against the US dollar as current account suprlus narrows

(% change, unless indicated)	**2011**	**2012**	**2013**	**2014**	**2015**
Real GDP growth	9.1	8.2	8.5	8.0	8.0
Industrial production growth	13.0	12.5	12.0	11.7	11.1
Agricultural production growth	2.6	3.0	2.7	2.8	2.8
Unemployment rate (av)	6.5	6.4	6.6	7.0	6.3
Inflation (end-period)	4.4	4.3	4.3	3.9	3.8
Short-term interbank rate	6.6	7.1	7.3	7.6	7.6
Government balance (% of GDP)	-1.8	-3.1	-2.5	-2.2	-1.9
Exports goods fob (US$ bn)	1,906	2,089	2,337	2,587	2,927
Imports goods fob (US$ bn)	1,680	1,878	2,125	2,400	2,743
Current-account balance (US$ bn)	275	248	240	211	196
Current-account balance (% of GDP)	3.9	3.0	2.5	1.9	1.5
External debt (US$ bn)	642	710	799	899	1,030
Exchange rate Rmb:US$ (yr end)	6.33	6.18	5.96	5.96	5.67



- By 2025 around 1bn living in China's cities
- By 2025 15 cities with 25m+ population
- By 2025 200+ cities with 1m+ population
- By 2025 170 new mass transit systems built
- By 2025 40bn sq m of floor space built
- By 2014 China's urban population increases by 80m

China urban inflows, 2010-20. Denser colour=greater inflows Source: China Regional Forecasting Service, Economist Intelligence Unit.

Q & A