BRICS' Painful Adjustment

Amid the global economic slowdown, BRICS nations still have tools at their disposal By Zhang Maorong

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Since the outbreak of the global financial crisis in 2008, emerging economies, especially the BRICS nations—Brazil, Russia, India, China and South Africa—have become the major engine of global economic growth. Amid these changes, the U.S. Federal Reserve at one point signaled its intention to discontinue the long-running quantitative easing policy midway through the country's economic recovery, but ultimately chose not to. Some BRICS economies including India, Brazil and South Africa are now mired in worsening financial turmoil, with their economic growth rates falling sharply. These developing economies are facing an uphill battle in the ongoing pursuit of structural reform.

Tarnished BRICS

In recent years, the current accounts of India, Brazil and South Africa have been on a path of constant deterioration. These countries are increasingly relying on short-term foreign capital to make their current account deficits look less dismal. With growing expectation of a U.S. liquidity contraction, the direction of global capital flow has reversed. The three countries' currencies are depreciating on a large scale. Since May, the Indian rupee's exchange rate against the dollar hit a series of record lows, exhibiting a trend of currency crises with the depreciation soaring to over 20 percent.

The Brazilian real depreciated to its lowest point in the last four years, with depreciation peaking at 18 percent. The South African rand and Russian ruble's sharpest depreciation reached 14 percent and 7 percent, respectively. Capital flight from India and Brazil once triggered a twin slump in the stock and bond markets, creating a string of financial turbulence. Moreover, poor trade and investment conditions in these countries caused a sharp decline in their economic growth rates, erasing hopes for an economic recovery in the short term. The International Monetary Fund released statistics in July showing that in 2012, the growth rates of China, India, Brazil, Russia and South Africa were 7.8 percent, 3.2 percent, 0.9 percent, 3.4 percent and 2.5 percent respectively, down 1.5, 3.1, 1.8, 0.9 and 1.0 percentage points from the year before. China's economic growth rate has dropped to its lowest point since 1999, while India's has fallen far below its annual average in recent years. In addition, Brazil lost its status as the world's sixth largest economy to Britain.

Now in 2013, the trend of decline among BRICS economies is self-evident. In the second quarter, Russia's economy grew just 1.2 percent more compared to the same period in 2012—its worst performance since 2009. Russia has lowered growth expectations twice in the past four months, from the original 3.6 percent to 1.8 percent. According to statistics released by the Indian Government in early September, growth in the second quarter slid to 4.4 percent—the worst quarterly performance since 2009—due to the country's shrinking mining and processing industries.

International opinion has thus moved toward a belief that BRICS countries have already seen their golden growth period and are now entering a slowdown due to structural problems.

Deep troubles

Caught up in unprecedented prosperity brought on by rapid economic expansion, BRICS countries had little incentive to conduct economic and social reforms during the past 10 years. They neglected or failed to adequately address problems related to economic development, which has slowed the momentum of economic growth. Developed economies, on the other hand, are regaining vigor after five years of painstaking reforms. The West, especially the United States, is once again the engine pushing global economic growth. Now is the time for the BRICS to reflect and begin solving these deep-rooted structural problems in their own economic systems.

The BRICS economies are in need of transformation. Sliding competitiveness and insufficient domestic demand, in addition to falling demand from developed countries and increasing global trade protectionism, have damaged BRICS economies. The shoddy economic growth figures in recent years show that they are in urgent need of economic transformation from a type of development characterized by low-end processing industries and raw material export to another format based on high value-added production and expanding domestic demand. Due to their overreliance on oil, natural gas and mining exports, the Brazilian, Russian and South African economies are vulnerable to fluctuations in international commodity prices. Price falls will continue to affect Brazil and Russia in following years.

The economic growth pattern of BRICS

INCREASED CAPACITY: A jet sits on the tarmac nearby as construction continues on Terminals 3 and 4 at the Sao Paulo/Guarulhos Governor Andre Franco Montoro International Airport in Guarulhos, Brazil, on October 21

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countries currently lacks a sufficient level of technological innovation and efficiency. In other words, their value-added industries are not adequate. Currently, the industrial value-added output of China is less than 30 percent, and about 20 percent in India—far below that of the U.S. figure of over 45 percent. The BRICS' poor performance in global innovation reflects their shortcomings. In Brazil, labor increasingly flows to service industries from the industrial sector, as service jobs are comparatively easy and high paying. This not only inhibits the country's industrial competitiveness, but also increases inflation risks. Statistics from HSBC show that China, India and Brazil all received fewer processing orders in July. In addition, BRICS countries' domestic demand is not sufficient. In 2012, domestic consumption contributed 51.8 percent to China's GDP growth, and about 55 to 65 percent in India and Russia, which were far below the global average of 70 percent. The average rate in developed countries is actually as high as almost 80 percent.

The BRICS must find ways to adjust to new forms of development. China's banking sector is overleveraged; housing prices are stuck at a high level; and its manufacturing capacity is already in excess. Brazilian enterprises bear heavy tax burdens, which lifts production cost and thus shrinks the manufacturing industry. India has an unbalanced industrial structure, high inflation, high budget deficit, and high public debt. Moreover, poor governmental management leads to corruption and a poor business environment. Banks are reluctant to loan to enterprises or consumers due to the country's poor macroeconomic environment. Russia, Brazil and India all exhibit woefully inadequate infrastructural investment. Russia has not extended its road network since 1994. Not until 2018, when Russia hosts the FIFA World Cup, will there be a highway between Moscow and St. Petersburg. The World Economic Forum released a 2013-14 global economic competitiveness report on September 4. India ranked 60th among the 148 economies, its worst position in recent years, with the report noting that the country's infrastructural facilities, such as roads, IT networks and energy grids, are unable to match its economic development potential.

BRICS' advantages

BRICS economies on the whole perform adequately while maintaining strong safeguards against risk. They have robust economies and solid foreign exchange reserves, modified financial systems and perfected current accounts. These advantages allow for greater flexibility in policy choices and a better ability to defend against financial risks—such as the Asian financial crisis in the 1990s. Their long period of robust economic growth has freed these economies from the negative influences brought by the U.S. economic slowdown. Currently, BRICS countries' capital flow is healthier than in the 1990s. Moreover, they adopt floating exchange rates to provide a buffer against capital flow reversion. For example, China has a large foreign exchange reserve of $3.5 trillion. The financial turbulence in emerging markets has not brought a great deal of damage to the Chinese economy. Its stock market and foreign exchange market operate smoothly, and its economic growth is stable. China's GDP now accounts for about 40 percent of the total of emerging economies. A stable Chinese economy and steady exchange rate of the yuan are significant for maintaining the steadiness of BRICS economies. China's GDP is expected to see an increase of 7.5 percent this year, continuing its position as a backbone of the emerging markets.

With a wide international market and tremendous potential domestic demand, the BRICS countries still possess development advantages. The huge domestic market affords a flexible status in the slow global economic recovery. In the future, their education, social welfare investment and infrastructural construction will provide powerful stimuli for domestic demand. Russia, with its vast territory, will undergo a new round of development in its Far East regions. And lastly, as a leader of regional economic cooperation in Africa, South Africa will benefit from its growing market and emerging middle class. ■

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