

Ready for a BRIC Century

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In the business of economics and investment, there are plenty of people who profess to have crystal balls through which they glean the shape of the future. But I have never owned a crystal ball and have always been skeptical of the consensus view.

Looking back at the first six months of 2011, we have experienced the Arab Spring, the ongoing drama of the euro zone, the tragedy in Japan, the slowdown in the world economy, and China overtaking Japan to become the second-largest economy in the world. These are unpredictable times, and from my 30 years in the financial markets, I have learned that people fear the worst when there is uncertainty.

For me, uncertainty over the direction of markets means that we have to focus our attention on where the pockets of value still remain given the big-picture macro themes we believe in. The story of the growth markets remains central to my near- and long-term thinking. It's interesting to look back to the Maastricht criteria and see what countries within the euro zone currently satisfy it and compare that with the world's growth markets. Within the euro zone, only one country meets Maastricht — Finland. Meanwhile, the BRIC countries and the four

other growth markets of Mexico, Indonesia, South Korea and Turkey all satisfy the original criteria. How long will it take investors to accept that the growth markets are actually fiscally more prudent and financially in better shape than in the Western world?

The BRICs are already among the 10 biggest economies in the world and could represent four of the world's five largest economies by 2050. Together with the four other growth markets, they could contribute 60 percent of the world's gross domestic product. From this perspective, it seems crazy that so many in the Western world obsess about Greece. This year alone, China will create new GDP growth of more than \$900 billion, which is three times the entire size of Greece's economy, and its import growth is likely to be as big as the entire Greek economy.

In terms of the current loss of momentum for the world economy, the main factors behind it are the recent increase in commodity prices and the disruption in the supply chain following the Japanese earthquake. There are some signs that the negative impact of these events is now dissipating. A more fundamental question is whether a strong recovery can be sustained once these factors go away, particularly given the fiscal tightening in the growth markets.

Looking ahead to the second half of the year, Chinese inflation seems to me the single most important issue. This year, China's growth momentum has softened, and the policy of the Chinese government is now explicitly about the quality rather than the quantity of growth. Most significantly, during his recent trip to Europe, Chinese Prime Minister Wen Jiabao struck an optimistic note on inflation. Beyond the cyclical benefits in controlling inflation, China's moderation could also provide relief for commodity markets, both in the near and long term, and improve the outlook for equities.

In the so-called developed world, the United States has been hit by continued uncertainties about the state of the labor market, housing and the budget. Financial conditions are likely to remain at very accommodating levels in the United States. As a result, we can expect higher inflationary pressures. The key structural challenge for the United States is domestic consumption. The simple fact is that the U.S. consumer cannot support growth — domestic or global — to the extent that it has done in the past. But while domestic consumption has decreased in importance for the United States, there has been a rapid rise in the share of growth markets in U.S. exports. If this rise is sustained, it is not inconceivable that the improvement in its current account could partly offset the decline of the domestic consumer.

Given the medium-term challenges facing the United States, the global relevance of the growth markets has never been greater to the world economy. Regarding the big picture, the challenge for all of us is to remove ourselves from a home-market bias and try to see the world for what it really is — a world in which the growth markets underpin every major investment theme and opportunity. Understanding and responding to that new world is a challenge that goes way beyond the second half of 2011.

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