

Ernst & Young Rapid Growth Markets Overview

Autumn 2011



Highlights

Rapid Growth Markets set to define the decade...

- The dynamics of the global economy has changed with a new set of fast-growing markets challenging the position of the established advanced economies. We have selected the top 25 of these 'Rapid Growth Markets' or RGMs which are becoming more important in terms of overall economic weight in the world economy and their global influence.
- Taken together, the RGMs have grown on average by 5.4% a year over the last decade, more than three times as fast as the advanced economies and this fast pace of growth is set to continue with growth in RGMs outpacing the advanced economies by nearly 3.5% points over the 10 years to 2020.
- RGMs will account for 50% of global GDP by 2020 when measured at purchasing power parity. They will also account for 38% of world consumer spending and 55% of world fixed capital investment.
- By 2020, we expect advanced economies to be exporting more than an estimated \$17600 billion of goods to RGMs, up from \$9280 billion today, and accounting for an estimated 33% of all exports from advanced economies.

...and can weather a renewed recession in advanced economies

- While the overall outlook for the RGMs is positive, one thing is certain: their progress will not be smooth. The RGMs have to address a number of challenges – for example, avoiding inflationary pressures arising from overheating; managing the impact of capital inflows on the competitiveness of their manufacturing industries; and ensuring that their infrastructure (physical and human) is sufficient to support their long-term growth potential.
- Right now, though, the main concern is about the global economic outlook, with the threat of a renewed recession in advanced economies and a renewed financial crisis.
 - The RGMs are far from decoupled from these risks. But our analysis shows that RGMs are well-placed to weather the economic storm. In the face of a disorderly Eurozone debt crisis that leads to recession in the US and eurozone in 2012, our analysis suggests that GDP growth would be cut to 2.7% across the RGMs in 2012 much lower than the 5.9% we currently expect but still the envy of most advanced economies.
 - Among the RGMs, Eastern Europe would be hit through their links with their neighbours. But oil and commodity exporters such as Russia, Brazil, and Chile would also be severely impacted as the value of their principal exports are hit by lower prices as well as weaker world demand. Those with greater trade and financial linkages such as Taiwan and Singapore would also be heavily hit. But we would expect countries such as China and India to be more modestly impacted, partly reflecting the scale of their domestic markets and the beneficial effects of lower oil & commodity prices.
- While not good news for RGMs, such a scenario would, however, even further increase their weight in the global economy, as the advanced economies decline. Moreover, we would expect such a scenario to be a temporary speed bump on the path to increased prosperity in RGMs – slowing growth in the near term but not undermining the supply side fundamentals that underpin the rapid growth we expect in RGMs over the next decade.



Rapid Growth Markets are the key drivers of global growth

The dynamics of the global economy have changed, with a new set of fast-growing 'emerging market' economies challenging the position of the established advanced economies. These economies – many of which are well past emerging, and which we therefore prefer to term Rapid Growth Markets (RGMs) - are becoming more important in terms of overall economic weight in the world economy and their global influence.

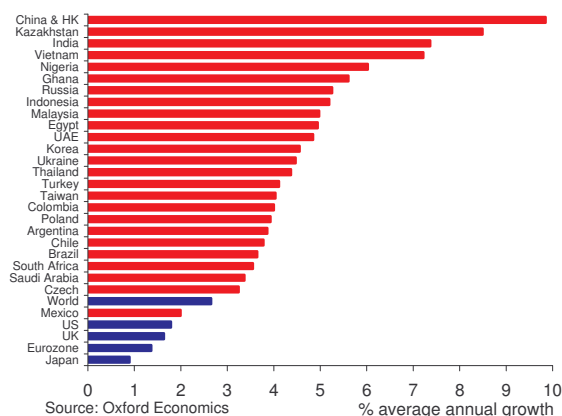
Who are the RGMs?

We define this set of 25 Rapid Growth Markets on the basis of three key criteria:

- Proven strong growth and future potential
- Size of the economy and population
- Strategic importance for business

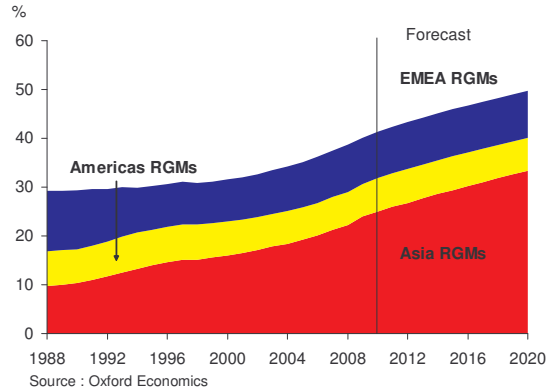
The chart below shows the GDP growth of our 25 RGMs over the last 10 years, comparing it with the leading advanced economies. Not surprisingly, China & Hong Kong top this league table, with India not far behind. But it is worth emphasizing that countries in both Emerging Europe and Africa have been among the world's fastest growing over the last 10 years. Taken together, the RGMs have grown on average by 5.4% a year over the last decade, more than three times as fast as the advanced economies.

Real GDP growth, 2000-2010



The strong expansion enjoyed by RGMs in recent years means that they already represent a significant proportion of the world economy. For example, they account for 31% of world GDP measured at market exchange rates and 40% of when measured in purchasing power parity (PPP) terms, which adjusts for differences in the relative cost of living. Clearly, the so-called BRIC economies – Brazil, Russia, India and China – are by far the largest of our RGMs. But out of our 25 RGMs, 17 would make it into the top 30 of the world's largest economies measured at PPP, including Mexico, Korea, Indonesia, Turkey, Poland and Taiwan within the top 20.

Share of World GDP in PPP terms

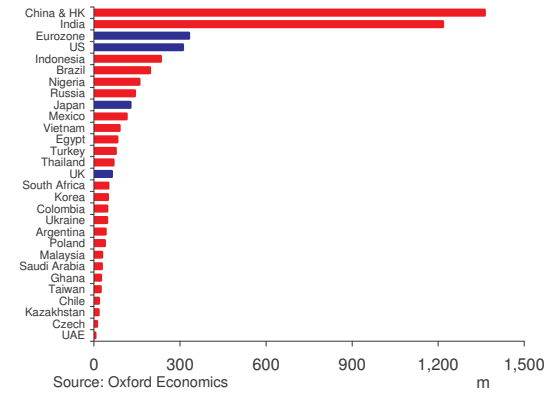


RGMs are, of course, even more significant in terms of their share of the world's population. Altogether, 4.2 billion people live in our 25 RGMs, over 60% of the world's population. That underlines both their potential and their strategic importance to business. They represent a massive pool of labour for production while the advanced economies age and also a source of rising demand for goods and services as the middle class in these countries develops.

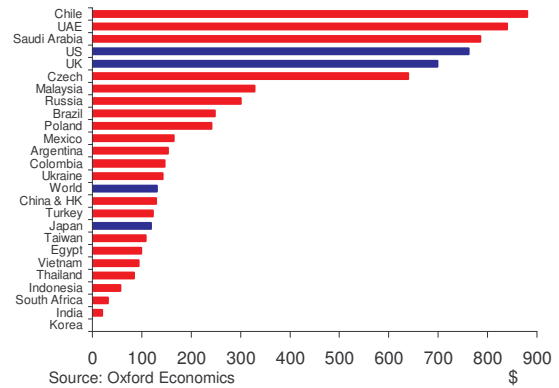
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Population level in 2010, millions



FDI inflows per capita in 2010, nominal



The economic success of RGMs reflects steps most have taken to liberalize their economies. Some of these countries - including, Korea, Thailand, Malaysia, Taiwan, Mexico and Saudi Arabia - are among the top 35 countries in the world for the ease of doing business as measured by the World Bank's 2011 *Doing Business* Report. Others are becoming more business friendly through better regulation and infrastructure, with Ghana and Kazakhstan, for example, among the top ten most improved economies over the past 5 years according to the World Bank.

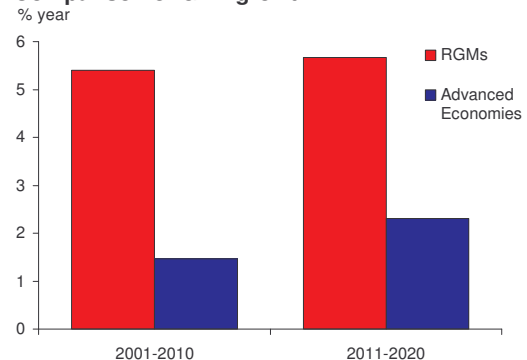
Not surprisingly, openness to trade is one of the defining characteristics of RGMs, particularly for many of the countries in Asia. Exports account for around 50% of GDP in the RGMs as a whole compared with 13% in the US or 41% in the euro area. And, likewise, many RGMs have been very successful in attracting foreign direct investment (FDI). FDI inflows to all RGMs have risen from \$210 billion in 2000 to \$445 billion in 2010, and they now receive 50% of global FDI inflows. Some countries have been particularly successful in attracting FDI inflows to spur their development – measured on a per capita basis, Chile, the UAE and the Czech Republic all stand out in this regard. But FDI is no longer a one way street - RGMs are themselves increasingly becoming major international investors in advanced economies, as their leading companies buy up western competitors.

That said, many challenges still remain for RGMs. These differ from country to country but most need to improve their infrastructure to support their rapid growth; many are struggling to meet the demand for talent given weaknesses within their education systems; and many have a very unequal distribution of income, which can create social tensions. Corruption is also a major issue in some RGMs, with Russia, Nigeria and Ukraine languishing around the bottom one-fifth of Transparency International's world rankings of perceived corruption.

The increasing economic importance of the RGMs

Our projections show RGMs continuing to grow rapidly over the next decade – with average growth in the RGMs expected to be even higher than over the last 10 years and again around three times faster than in the advanced economies.

Comparison of GDP growth





The strong prospective growth of RGMs means that their importance in the global economy will only increase over the next decade. By 2020, we expect them to account for 45% of world GDP at market exchange rates and 50% measured at PPP.

But that is only one part of the increasing significance of RGMs. By 2020, they will account for:

- 46% of world goods exports up from 37% in 2010
- 38% of world consumer spending and 55% of world fixed capital investment
- 72% of global employment and 60% of the world's population
- 52% of world demand for cars, and 34% for machine tools
- 48% of world production of consumer goods, 72% of iron and steel production and 42% of car production

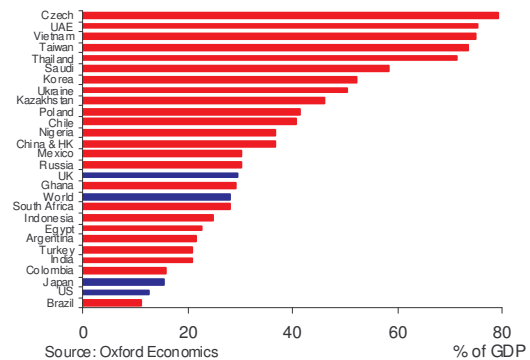
Critically, RGMs will also account for an even greater share of world demand for oil and other commodities by 2020. Already today, RGMs account for around 40% of oil demand and more than half of world demand for metals like copper, well in excess of their share of world GDP. And they account for over 70% of global demand for gold and over 60% of world food consumption.

The commodity-intensity of RGM economies, combined with their rapid growth, has been a major factor putting upward pressure on commodity prices in recent years. And, while both governments and companies in RGMs are seeking to become more resource-efficient, their impact on world commodity markets is likely to increase even further through this decade. For example, by 2030 we expect the US and the EU to account for less than a quarter of world oil demand, down from nearly a third now.

Rapid growth of RGMs is therefore not all good news for advanced economies. The continuing boom in RGMs is likely to keep oil and other commodity prices high in real terms. But the

pluses will more than outweigh the minuses. By 2020, given the rapid high growth and trade openness in RGMs, we expect advanced economies to be exporting more than an estimated \$17600 billion of goods to RGMs, up from an estimated \$9280 billion today, and accounting for 33% of all exports from advanced economies.

Exports as % of GDP in 2010



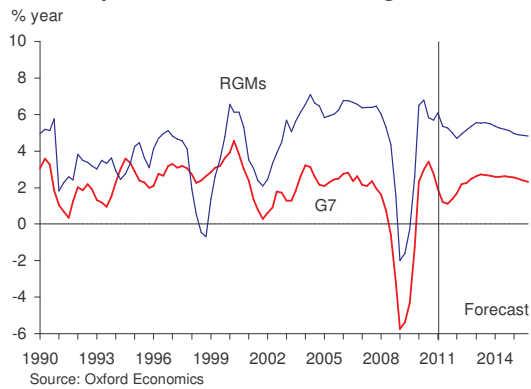
Why will RGMs remain rapidly growing?

The RGMs bounced back strongly from the global recession, with their GDP rising on average by 7.3% in 2010 – back to the boom rates that preceded the global financial crisis and much faster than growth had been prior to the mid-2000s. However, this rapid rebound – from a downturn that was mild in most RGMs compared with advanced economies – generated some rise in inflationary pressures. In part, these resulted from upward pressure that strong RGM demand put on oil, food and other commodity prices. But it also reflected domestic inflationary pressures as capacity utilisation rates rose to above-normal levels in many countries and strong demand for labour put upward pressure on wages.

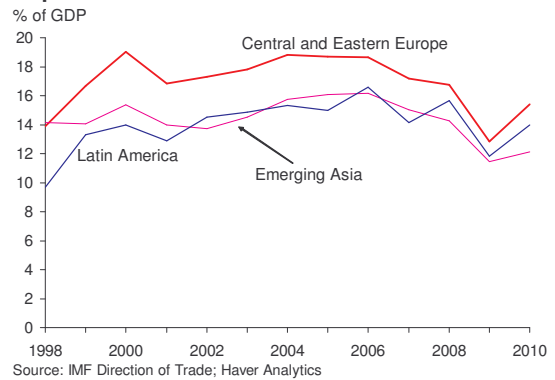
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G7 & Rapid Growth Markets: GDP growth



Exports to OECD



Policy-makers have responded to rising inflation risks by tightening monetary policy – both through higher interest rates and by raising the reserve requirements of banks. In addition, most RGM currencies have appreciated in real terms, as low interest rates and measures to boost liquidity in the advanced economies have encouraged substantial capital inflows (which some countries have sought to limit through various forms of capital controls). This tightening in monetary conditions, combined with the renewed weakness in demand in advanced economies, is expected to lead to a moderate slowing in growth in RGMs to 6% in 2011 as a whole.

The weak outlook for the advanced economies will inevitably continue to weigh on growth in the RGMs in 2012. The dependence of RGMs on trade with advanced economies has declined somewhat since the mid-2000s, reflecting both the relative decline of advanced economies and the strength of domestic demand growth in RGMs, which has fuelled greater inter-regional trade. But even so, exports from RGMs to advanced economies are still equivalent to almost 15% of RGM GDP.

Our forecast therefore shows average GDP growth in the RGMs edging just under 6% in 2012. Within the RGMs, both the American and Asian countries have seen the most marked slowing in growth, reflecting their dependence on trade and policy tightening in their largest economies. The picture in EMEA is more mixed, with some resource-rich countries such as Saudi Arabia and Ghana benefiting from high oil prices, while others like Turkey face a sharper downturn as credit conditions tighten.

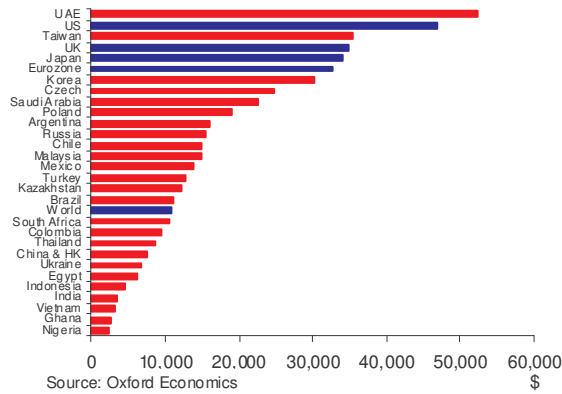
But it is important to see this slowdown in context. In part, it has been deliberately generated by RGM policy-makers to avoid a damaging inflationary spiral. It still leaves RGMs growing at a much faster rate than they have enjoyed by the standards of all but the very recent past. And – crucially - it does not alter the very positive longer-term prospect for RGMs.

There are many reasons to be optimistic about the growth potential of RGMs over the next decade:

- **Catch-up potential** – despite the rapid growth that RGMs have seen in recent years, average living standards are still way below those in advanced economies. For example, measured in purchasing power parity, GDP per capita in China is still only 16% of that in the US and in India it is only 7%. For RGMs as a whole, GDP per capita is still just 27% of that in the US and 39% of that for the Eurozone. This suggests that there is still considerable scope for RGMs to grow strongly as they emulate advanced economies.

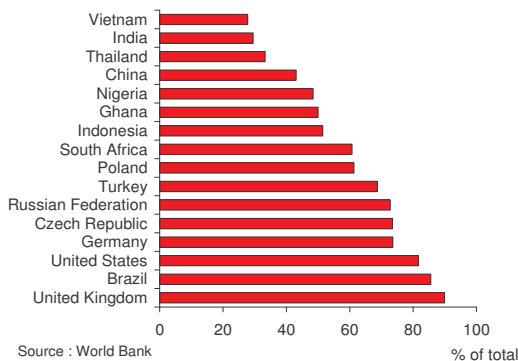


GDP\$ per capita at PPP, nominal in 2010



- Continued industrialisation and urbanisation** – related to the catch-up potential of RGMs, there are still massive populations in parts of Asia and Africa which are yet to move out of subsistence agriculture into the market economy. For example, 297 million people (22% of the population) in China still work in agriculture, 233 million in India (20%) and 42 million (18%) in Indonesia. This compares with just 0.3% of the population employed in agriculture in the US and 2% in the Eurozone. Similarly, increased urbanisation is likely to be associated with continued economic growth in RGMs particularly in Asia – currently, the proportion of the population that live in urban areas in India is less than half that in the US and Europe, while urbanisation in China is around two-thirds that in most advanced economies.

Urban populations: 2008

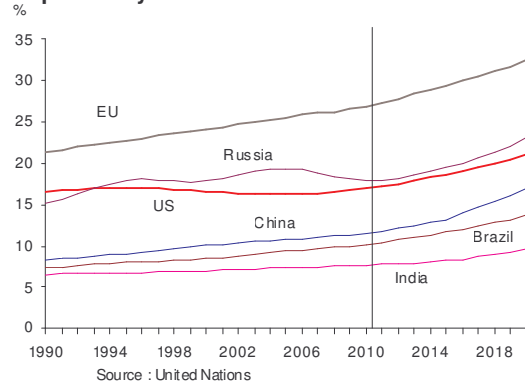


- Strong population growth** – the working age population across all RGMs is expected to increase by 268 million (9.4%) between 2010 and 2020. This increase will occur despite a

significant levelling off in the population of working age in China from the middle of this decade as the effects of the one-child policy hit the labour supply. Moreover, RGMs do not face the same pressures as advanced economies in funding an ageing population – dependency ratios (ie the number of children and retired relative to the size of the working age population) in most RGMs are only a fraction of those in Europe.

- High investment and savings rates** – It is not only strong labour supply growth that will drive the productive potential of RGMs higher. So too will their high rates of saving and investment. This is most marked in Asia, with China investing more than 40% of its GDP. Strikingly, even India – which historically had relatively low saving and investment rates – is now investing over a third of its GDP a year. Investment rates are typically lower in Latin America and Eastern Europe, but still much higher than in the advanced economies. Domestic investment is also likely to be supported by strong foreign domestic investment (FDI) flows, as Western companies continue to look for growth in RGMs in the face of weak home markets.

Dependency Ratio



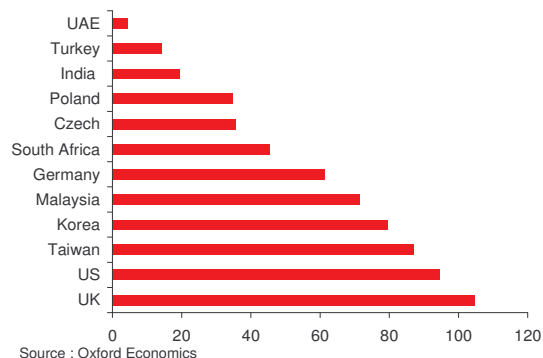
- Improved economic management and political stability** – A key to the recent success of RGMs is improved macroeconomic management and enhanced political stability. This is most striking in the case of a country, for example, like Brazil, which persistently underperformed through the post-War period, experiencing repeated crises and even

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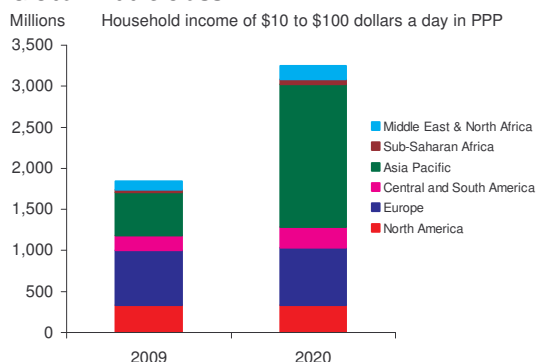
hyperinflation. But macro policy reforms that began over a decade ago have generated not only more stable growth but contributed to Brazilian GDP significantly outpacing world GDP growth in recent years. A similar pattern has been seen across sub-Saharan Africa also. And it is to be hoped that the 'Arab spring' will lead to a similar transition in countries such as Egypt. More generally, the full economic benefits of greater economic freedom across RGMs – and further reforms that are in the pipeline - have still to come through, which will boost efficiency and productivity.

Household liabilities as a % of GDP: 2010



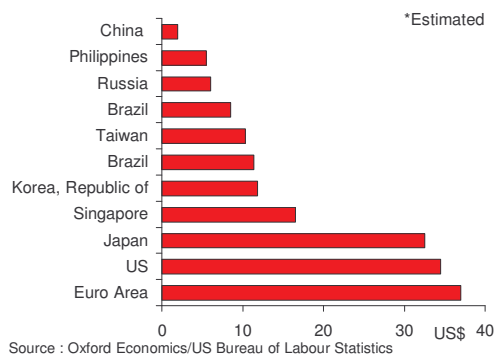
- The avoidance of high debt** – A key advantage that RGMs now have over advanced economies is that they avoided the excesses of the financial bubble. As a result, typically neither households nor governments are struggling under the high debt burdens faced by most advanced economies. This is particularly important in giving governments scope to use active fiscal and other measures to support their growth if necessary, and we would expect to see some fiscal stimulus introduced in many RGMs in 2012 in the event of a further downturn in trade with advanced economies. There are exceptions, though, among the RGMs. For example, some countries such as Poland have a relatively high government deficit, which gives less scope for expansive fiscal policy. And household debt is higher relative to incomes in South Korea and Taiwan than it is in the US, which constrains their potential for consumer-led growth.

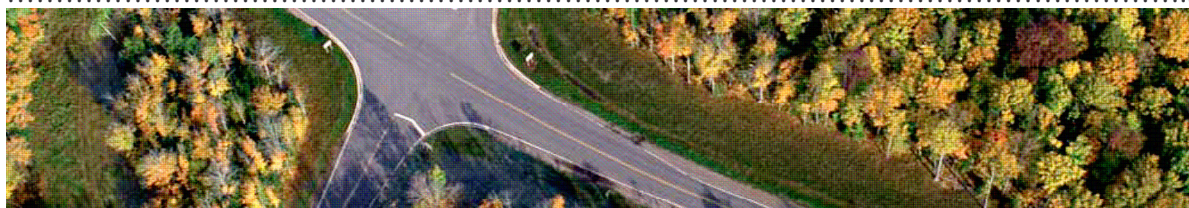
Global middle class



- Growth of the middle class** – Many RGMs have traditionally had an export-led model of growth. However, as they have become richer, this has led to the emergence of a substantial middle class, which is creating domestic consumer markets of critical mass. The middle class population in RGMs, particularly in Asia, is expected to reach significant proportions. For example, the number of households with an income in PPP terms of between \$10 and \$100 dollars a day in Asia is expected to triple from 2009 to 2020 to 1740 million. As a result, demand for consumer goods and services (including foreign holidays and financial services, as well as cars, electronics and other luxury products) is expected to boom. To illustrate, the number of international tourists travelling from China is forecast to almost double from 32m in 2010 to 59m by 2020.

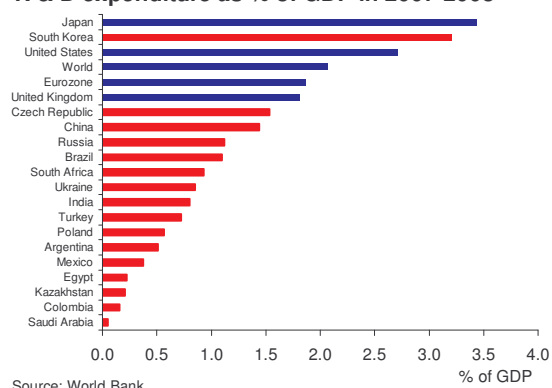
All Employees: Hourly compensation costs in U.S dollars in manufacturing in 2010*





- Competitiveness and moving up the value chain** – Many RGMs have developed initially by offering a low-cost production base for manufacturing, and this is likely to remain critical to the growth of many such economies particularly Mexico and Vietnam. But as wage rates rise, some RGMs are looking to move up the value chain into higher value-added activities. This is, for example, an explicit intention of the Chinese in their new five year economic plan. But, more generally, we are seeing a shift up-market across RGMs. One clear indication of this is their increased investment in R&D. South Korea invests more in R & D as a proportion of GDP than the US, and the Czech Republic and China now invest over 1.5% of their GDP in R&D, not far behind that for the UK and the Eurozone average.

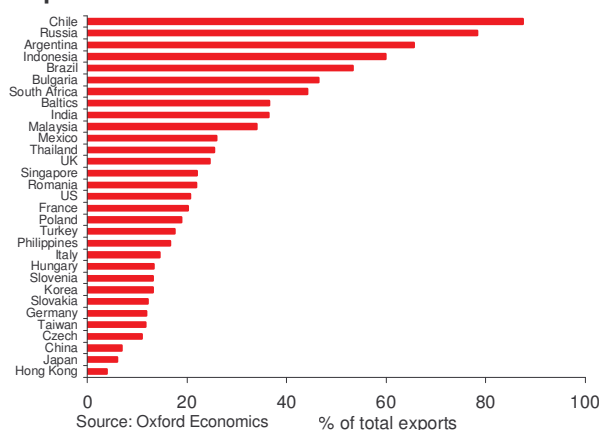
R & D expenditure as % of GDP in 2007-2008



- High real commodity prices** – A number of the RGMs are very dependent on exports of oil and other commodities. With countries such as China and India – which are big net commodity importers - expected to continue to grow rapidly, and new sources of supply likely to be limited for oil and most metals, we expect commodity prices to remain high in real terms over the next decade and beyond. This means that countries such as Russia, Kazakhstan, Saudi Arabia, Chile and Nigeria will benefit from continued strong export revenues. And some RGMs who have more recently begun to exploit significant commodity assets – for example off-shore oil in Ghana, palm oil plantations in Malaysia, and coal deposits in Indonesia - will also benefit. The challenge for such economies is

to avoid the so-called ‘resource curse’ and ensure healthy development of their non-resource economies as well.

Exports of commodities - 2009



Clearly, there are also factors that will constrain growth in RGMs, and also risks to the economic outlook that will impact their development, which we discuss in the next section. But even taking these into account, our forecasts show the level of real GDP in US\$ terms rising across the RGMs by 76% between 2010 and 2020, equivalent to average growth of 6.0% a year.

Within the RGMs, Asia will lead the way, with GDP up 95% by the end of this decade (average growth of 7.1% pa). But Latin American RGMs are expected to expand by 48% by 2020 (4.3% pa), RGMs in the Europe, Middle East and Africa region by 55% (4.5% pa).

What could go wrong for the RGMs?

While the overall outlook for the RGMs is positive, one thing is certain - their progress will not be smooth. As highlighted already, the RGMs have to address a number of challenges to fulfil their potential. The boxes highlight some of the domestically-generated risks facing economies in different regions within the RGMs.

Right now, though, the main concern is about macroeconomic risks, in particular as a result of the concerns about the strength of the recovery in advanced economies, the escalating Eurozone sovereign debt crisis and the associated financial turmoil.

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RGMs are very exposed to a severe downturn in advanced economies for a number of reasons:

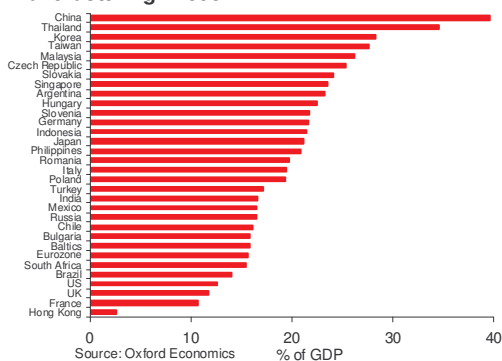
(i) Trade links are still large

As already highlighted, exports to advanced economies still account for one-sixth of RGMs' GDP. That means that, for example, a 5% fall in exports to advanced economies would cut GDP growth in RGMs directly by around 0.75% points.

But RGMs exposure to a downturn in trade with advanced economies is even greater than such figures imply. That is because RGMs are generally very dependent on the most volatile components of international trade, ie:

- **Manufacturing** – industrial production is much more cyclical than the service sector, in particular because of the impact of big swings in inventory holdings. For most RGMs – especially those in Asia and Eastern Europe – manufacturing is a much bigger share of their GDP than it typically is in advanced economies.
- **Investment goods** – within manufacturing, the investment goods cycle is generally much more marked than that for, say, consumer goods, since it is driven by 'big-ticket' purchase decisions which companies can quickly put on hold when economic conditions deteriorate. Again, many RGMs have significant reliance on investment goods production, due to their dependence on the electronics or motor vehicles sectors.

Manufacturing - 2009



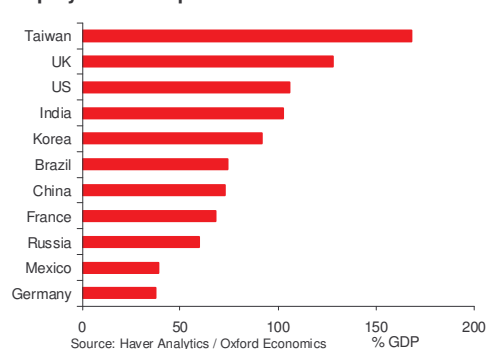
A downturn in advanced economies is therefore likely to have a magnified impact on RGM trade, which is likely to knock on to trade within RGMs given their highly inter-connected supply chains.

(ii) Financial linkages are also substantial

Financial markets in RGMs are obviously closely coupled to those in the advanced economies. The recent collapse in equity markets in advanced economies has been broadly mirrored in most RGMs. Similarly, concerns about the stability of the financial system and access to credit, which has driven swings in yields on both government and corporate bonds in advanced economies, are also impacting on interest rates for RGMs.

While RGMs are generally less sensitive to the financial sector than advanced economies, such effects still matter. For example, equity market capitalisation is higher relative to GDP in Taiwan than in the US and UK. And it is higher in India, Korea, Brazil and China than it is in France and Germany.

Equity market capitalisation



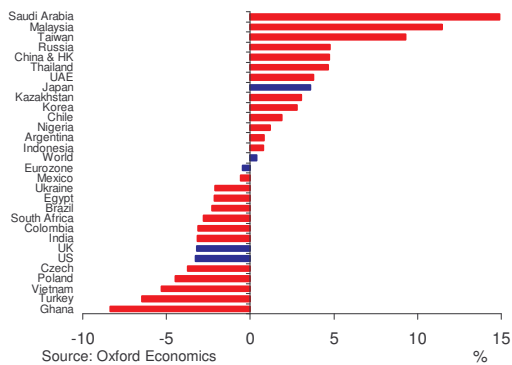
In addition, a collapse in financial markets in advanced economies is normally associated with a fall in FDI flows to emerging markets. And an increase in risk aversion generally triggers a reversal of more speculative flows into RGMs, which further destabilises their financial markets and can trigger sharp currency swings. Such a shift would be very dangerous at present for an economy like Turkey, for example, which is reliant on external financing to fund its extremely large current account deficit.

(iii) Consumer and business confidence is influenced by global events



Similarly, consumer and business confidence in RGMs is impacted when there is increased uncertainty about prospects in the advanced economies. This leads to more cautious behaviour by consumers and businesses, who delay spending decisions until prospects are clearer. This effect is most marked currently in Eastern European RGMs, where there has been a particularly marked decline in confidence measures in recent months, reflecting the exposure of those economies to the troubles in the Eurozone.

Current account as % of GDP in 2010



(iv) Oil & commodity price impacts

The effect of a downturn in advanced economies on oil & commodity prices has mixed impacts on RGMs. For those that are net exporters, it obviously worsens their terms of trade. But for net importers, it can help mitigate the impact of weaker trade and financial flows. Strikingly, however, the recent concern about a renewed downturn in advanced economies has done relatively little so far to bring down commodity prices. This in turn underlines that demand for most commodities is now driven primarily by RGMs.

An alternative scenario – the RGMs in the face of a Eurozone crisis

As highlighted in the E & Y Eurozone forecast Autumn 2011, the Eurozone sovereign debt crisis shows no sign of abating and there is a significant probability that the Eurozone slips back into recession. A severe escalation of the Eurozone sovereign debt crisis would likely lead to a renewed recession in advanced economies, and as a result, have a significant impact on the Rapid Growth Markets. We have used Oxford

Economics' Global Model to highlight the international repercussions of a severe escalation of the Eurozone sovereign debt crisis.

In this scenario, the Eurozone authorities' incremental management of the sovereign debt crisis becomes insufficient and a wildfire of financial contagion ensues. The harsh fiscal measures announced for peripheral Eurozone countries prove to be intolerable leading to bigger and less orderly defaults in Greece, Portugal and Ireland, with heightened fears about Italy and Spain. This would not only hit banks hard in the crisis countries but also across the Eurozone, particularly in Germany and France, with uncertainty about asset quality resulting in a large rise in counterparty risk – similar to that seen in the global financial crisis. Global equity markets would also fall further. The consequent increase in borrowing costs and plunging consumer and business confidence would push the Eurozone back into recession. Financial stress would affect the US to a much more limited extent, but even so the economy would be likely to fall back into recession in 2012.

Table 1 on page 15 below shows the implications of this scenario for the RGMs. It shows:

- GDP growth would be cut to just under 2.7% across the RGMs in 2012 but would still be the envy of most advanced economies.
- Among the RGMs, Eastern Europe would be hit through their links with their neighbours. But oil and commodity exporters such as Russia, Brazil, and Chile would also be severely impacted as the value of their principal exports are hit by lower prices as well as weaker world demand with Russia nearing recession. Those with greater trade and financial linkages such as Taiwan and Singapore would also be heavily hit. But we would expect countries such as China and India to be more modestly impacted, partly reflecting the scale of their domestic markets and the beneficial effects of lower oil & commodity prices.

The impact of such a scenario on RGMs would be cushioned by the policy response we would anticipate in many of these economies. With

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fewer financial overhangs from the recent global crisis, we would expect to see a reversal of the recent monetary policy tightening implemented in many countries. And, indeed, many could also raise government spending and/or cut taxes to support demand.

While not good news for RGMs, such a scenario would, however, even further increase their weight in the global economy, as the advanced economies decline. Moreover, we would expect such a scenario to be a temporary speed bump on the path to increased prosperity in RGMs – slowing growth in the near term but not undermining the supply side fundamentals that underpin the rapid growth we expect in RGMs over the next decade.

Conclusions

The global economic outlook is very uncertain, with the risks of a renewed recession in advanced economies and widespread financial crisis growing.

The RGMs are far from decoupled from these risks. But our analysis shows that RGMs are well-placed to weather the economic storm. These countries are increasingly developing their own critical economic mass and most have the financial means, if necessary, to help support growth and protect their banking sectors.

There are also domestically-generated challenges that RGMs must face – for example, avoiding inflationary pressures arising from overheating; managing the impact of capital inflows on the competitiveness of their manufacturing industries; and ensuring that their infrastructure (physical and human) is sufficient to support their long-term growth potential.

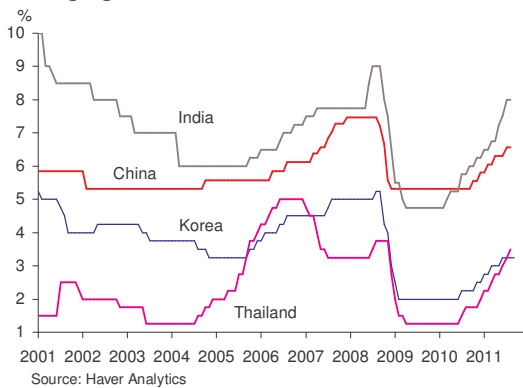
Nevertheless, our projections show RGMs accounting for 50% of world GDP measured at PPP by 2020. We expect advanced economies to be exporting more than an estimated 17 600 billion of goods to RGMs, almost twice the level today. These new reports will map out the progress of RGMs along this path and highlight the opportunities and challenges for Western companies in doing business with RGMs.



Box: Growth potential and risks for Asia’s Rapidly Growing Economies

Urbanisation, productivity catch-up and rising prosperity will continue to drive strong growth in Asia. But for its potential to be fulfilled, particularly as the external engine of growth from Europe and the US sputters, the continent will need to tap into the high level of household savings and generate sustained consumption growth. Many savings rates in Asia are in excess of 25% with China’s overall savings rate closer to 40%. In order to rebalance these economies towards greater consumption and a higher standard of living, government policy will need to be directed towards greater public provision of social safety nets to reduce precautionary saving. For many of these countries, greater financial sector development is also needed with a higher return to savings and a wider range of financial instruments for households to save for their old age.

Emerging Asia: Short-term interest rates

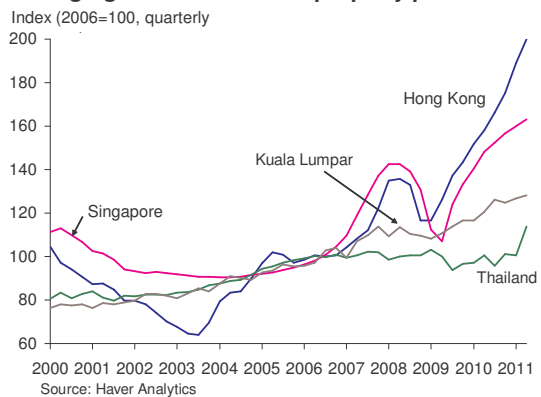


For strong productivity growth to be maintained, many countries will need greater infrastructure development, accompanied by a number of reforms to ease the cost of doing business, in order to attract more long-term investment flows. Indonesia has made significant improvements in its macro management and with the current level of government debt to GDP very low at 26%, it is hoping to achieve investment grade status this year. However, a reliance on short-term flows increases the vulnerability of the emerging Asian countries to any global market turmoil. Indonesia is gradually attracting longer term investment and less short term flows and foreign direct investment rose by almost 17% to US\$2.9bn in Q1

2011, up from US\$2.48bn whilst foreign portfolio investment decreased. Greater political stability should provide a boost to Thailand and Malaysia’s new ten year plan is focused on attracting greater FDI inflows.

The success of Asian economies has also led to a rising inflation pressures, particularly in India where inflation in July has 8.9%. Central banks across Asia have increased interest rates (and reserve requirements in many cases) to tackle these pressures and we expect inflation in the region to moderate. But strong demand and capital inflows have also contributed to rising asset prices, particularly in commercial property in Asia. Property prices in Hong Kong have risen sharply, buoyed by strong demand from the Mainland as investors seek a wider range of financial assets and to circumvent tighter restrictions on property investment in Mainland China. Singapore has introduced several measures to cool the housing market but whilst the pace of inflation has slowed, prices continue to rise. In Kuala Lumpur, house prices rose by 7.1% on the quarter in Q1 while overall mortgage loans in Malaysia have almost doubled in the last five years.

Emerging Asia: Residential property prices



Property prices in many cities in Asia could fall quite quickly if overcapacity or the global gloom leads to a reversal of investment flows. This would have knock-on effects on confidence, household wealth and the liabilities of banks. But high foreign reserves, low fiscal deficits and scope to loosen monetary policy provide plenty of ammunition to counter the affects of any bursting in asset prices bubbles.

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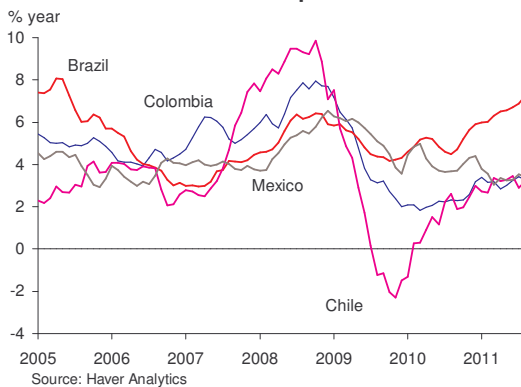


Box: Managing inflation and capital inflows in Latin America

Most of the rapidly growing economies in the Americas have been tightening monetary policy over the past 12 months in order to tackle rising inflation. Mexico suffered a much deeper recession in the aftermath of the financial crisis and as result, with capacity utilisation much lower, its central bank has kept rates on hold at 4.5% during 2011. But more recently, with the weakening in the global outlook, we have seen a pause in rates, notably for Chile and Columbia with Brazil even lowering its rate by 50 basis points in a surprise move at the end of August to 12%.

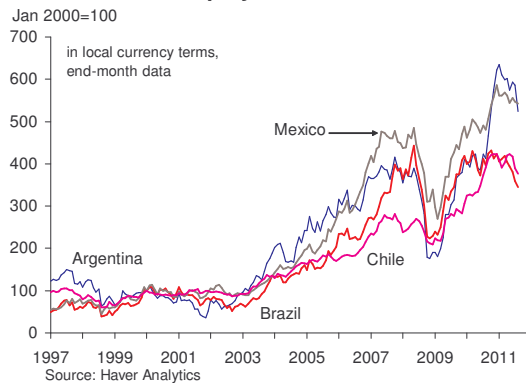
Brazil has tried to tackle this through capital controls, with limited success. In the medium term, much more of the burden of the fight against inflation in Brazil needs to be carried by a structurally tighter fiscal policy, which would allow lower interest rates and in turn reduce the upward pressure on the BRL. At the same time, many countries in the Americas need to improve their competitiveness through a variety of supply side reforms, improving the workings of the labour market, boosting their infrastructure and reducing the complexity of their tax systems.

Latin America: Consumer prices



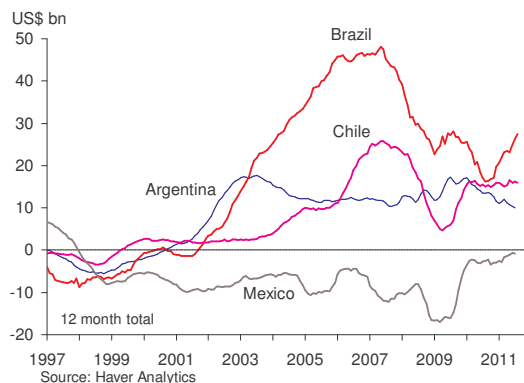
Despite the threat of renewed recession in advanced economies, inflation is still of concern for some of the Latin American economies, notably Brazil where headline CPI rose to 7.2% in August. During 2010 and 2011 H1, with strong growth and relatively high rates of return, there has been a significant rise in capital inflows into these economies since 2010. While much of this is welcome and is a signal of the higher potential growth in these economies, it also put upward pressure on the value of their currencies. The Brazilian Real and the Chilean peso were given a further major impetus from the surge in commodity prices since 2009. Argentina and Mexico saw sharp rises in their equity prices over the same period, adding to concerns over asset price bubbles. While some of these pressures have abated in recent months with financial market volatility and a flight from risk, the prospect of renewed QE3 poses additional dilemmas for some economies in Latin America.

Latin America: Equity markets



Improving infrastructure investment and ensuring the right skill levels of the labour force will be important to ensure production and exports are broad-based and less reliant on energy and other commodities. This in turn will help to attract more sustainable and diversified FDI flows and to ensure that the region is not vulnerable to the swings in market sentiment which have led to debt and currency crises in the region in the past.

Latin America: Trade balance

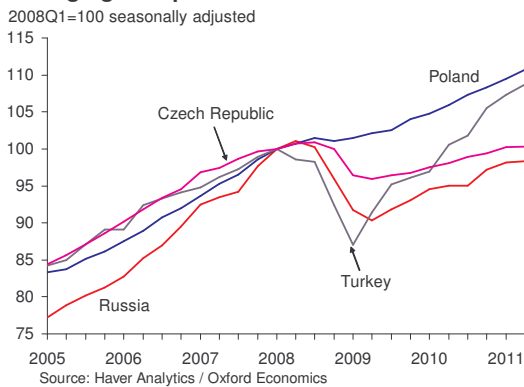




Box: Recovery and risks in Emerging Europe

Compared to the recoveries in emerging Asia and Latin America since the global financial crisis, that in Emerging Europe for the most part has been lacklustre. Many countries have yet to regain 2008 peak levels of activity and this largely disappointing performance continued in 2011 Q2. The recovery in Poland and Turkey has been more robust, relative to its peers. With Turkey recovering rapidly since been more severely affected in late 2008 while Poland only had a mild recession and a steady recovery. But for many, the economic environment has become more difficult in Q3, with the financial market turmoil triggered by the deepening Eurozone debt crisis and the sluggish nature of growth in the US.

Emerging Europe: Real GDP

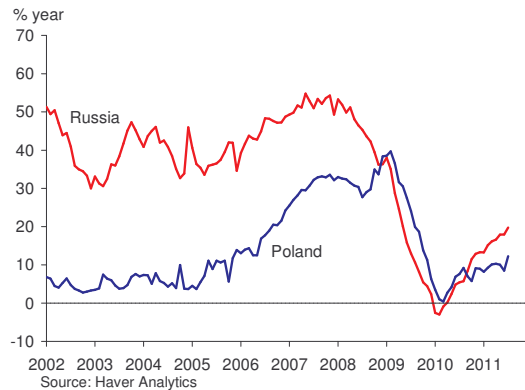


On a seasonally adjusted basis Russian GDP increased by just 0.2% on the quarter in Q2, with reasonably recovery in domestic demand according to monthly indicators. Moreover with global oil prices little different from those in May and June, the impact of the recent global financial turbulence on Russia's export prospects have been modest compared to other Emerging Europe economies who rely on selling manufactures to the EU. In addition, with inflation now moderating (8.2% in August), real wage growth is now running at a much healthier pace than earlier in the year, while the recent loosening of fiscal policy will also support consumer spending in 2012. Finally bank lending growth is also growing at a robust pace, up 19.7% year-on-year in July. As a result these factors suggest that Russia should be reasonably well-placed to withstand the impact of weaker global growth, with growth likely to exceed 4% next year. The major risk is if the developed

economies slumped back into recession and caused a sharp fall in the oil price – which would quickly undermine Russia's fiscal and external positions.

As has been the case since 2008, Poland was the star performer among the Emerging Europe economies in 2011Q2, with GDP rising by 1.1% on the quarter, a pace also achieved in three of the previous four quarters. Moreover this expansion was broad based, with consumer spending increasing by 0.9%, investment by 1.9% and export volumes up 4.5%. However, the intensification of the external headwinds will inevitably slow growth over the next year even if the economy is much less reliant on exports than most of its neighbours. The level of seasonally adjusted industrial output in July was lower than the average in Q2, while August's manufacturing PMI was the second-weakest since January 2010, albeit still in expansion territory. In addition retail sales also slipped in July (though were still over 4% up on the year). Notwithstanding these developments, we still expect Polish growth to average over 3% growth in 2012. Moreover, if the external environment becomes much worse, the central bank has the scope to cut interest rates if necessary (having raised them 100bp to 4.5% earlier in 2011), although the scale of the adjustment would be influenced by the performance of inflation and the exchange rate (which has dropped over 8% against a weak Euro since the end of July).

Emerging Europe: Bank lending



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Table 1: Alternative scenarios for Ernst and Young's 25 Rapidly Growing Economies: Autumn 2011

Alternative GDP growth forecasts				
	2010	2011	2012	2013
Oxford Forecast				
US	3.0	1.7	2.3	3.1
Eurozone	1.7	1.6	1.1	1.7
Brazil	7.5	4.3	4.8	4.7
China	10.3	8.8	8.2	9.2
India	9.0	7.3	8.4	9.4
Russia	4.0	4.7	4.3	3.9
RGEs	7.3	6.0	5.9	6.7
World	4.5	3.7	3.9	4.5
Eurozone disorderly debt crisis				
US	3.0	1.4	-0.6	0.9
Eurozone	1.7	1.2	-2.1	-1.2
Brazil	7.5	3.5	0.6	3.5
China	10.3	8.4	5.2	7.0
India	9.0	6.6	6.3	8.4
Russia	4.0	4.1	0.0	2.0
RGEs	7.3	5.5	2.7	4.9
World	4.5	3.3	0.9	2.1



**Table 2: Outlook for Ernst and Young's 25 Rapidly Growing Economies:
Autumn 2011**

Real GDP growth						
	2010	2011	2012	2013	2014	2015
Americas	6.5	4.3	4.4	4.8	4.5	4.0
Argentina	9.1	7.1	4.5	4.0	4.0	3.2
Brazil	7.6	3.8	4.5	4.9	4.4	4.1
Chile	5.1	6.4	4.1	4.8	4.5	4.4
Colombia	4.3	4.7	4.6	4.7	4.2	4.0
Mexico	5.4	3.8	4.3	5.1	4.8	4.0
EMEA	4.2	4.8	4.2	5.2	4.8	4.6
Czech Republic	2.2	2.0	2.1	3.4	3.1	2.8
Egypt	5.1	1.0	3.0	5.5	5.8	5.5
Ghana	7.7	14.0	8.3	6.9	5.6	4.9
Kazakhstan	7.3	6.5	6.5	7.0	7.5	7.1
Nigeria	7.9	7.1	7.0	6.5	6.1	5.1
Poland	3.8	4.1	3.4	4.2	4.1	3.7
Russia	4.0	4.0	4.4	4.3	3.6	3.5
Saudi Arabia	3.3	7.2	5.8	4.7	4.4	4.2
South Africa	2.8	3.4	3.5	4.9	4.7	4.7
Turkey	9.2	6.7	2.4	6.2	6.0	5.6
Ukraine	4.2	4.8	5.9	7.5	6.5	6.3
United Arab Emirates	1.4	4.4	4.7	5.6	5.3	4.9
Asia	9.1	7.1	7.1	7.9	7.5	7.1
China & Hong Kong	10.1	8.7	8.0	9.0	8.6	8.1
India	8.9	7.2	8.1	9.5	8.9	8.2
Indonesia	6.1	6.3	6.4	6.7	6.0	5.7
Korea	6.2	3.6	4.3	4.7	4.5	4.2
Malaysia	7.3	4.7	5.0	5.1	4.8	4.6
Taiwan	11.1	4.8	4.1	4.0	3.8	3.7
Thailand	7.9	3.8	4.8	5.0	5.0	4.9
Vietnam	6.8	5.4	6.3	7.3	7.0	6.6
TOTAL	7.3	6.0	5.9	6.7	6.3	6.0

Ernst & Young Rapid Growth Markets Forecast Autumn 2011



**Table 3: Outlook for Ernst and Young's 25 Rapidly Growing Economies:
Autumn 2011**

CPI Inflation						
	2010	2011	2012	2013	2014	2015
Americas	4.9	5.4	4.8	4.2	3.9	3.6
Argentina	10.4	10.3	11.0	8.0	5.8	4.1
Brazil	5.0	6.4	4.7	4.2	4.0	4.0
Chile	1.4	3.2	2.9	3.0	3.0	3.0
Colombia	2.3	3.2	3.3	3.5	3.5	3.3
Mexico	4.2	3.5	3.9	3.6	3.4	3.0
EMEA	6.3	6.4	6.1	5.1	4.5	4.4
Czech Republic	1.5	1.8	3.0	2.7	2.6	2.5
Egypt	11.3	11.5	9.2	7.7	6.3	5.5
Ghana	10.7	8.9	8.1	6.9	5.8	5.0
Kazakhstan	7.1	8.6	7.0	6.3	5.9	5.5
Nigeria	13.7	10.5	9.8	8.8	8.0	8.0
Poland	2.7	4.1	2.6	3.3	2.9	2.5
Russia	6.9	8.7	8.0	6.1	5.2	5.3
Saudi Arabia	5.3	4.8	4.5	3.7	3.3	3.0
South Africa	4.3	4.8	5.4	5.0	4.8	4.8
Turkey	8.6	5.9	6.3	4.8	4.2	4.0
Ukraine	9.4	10.2	8.8	6.7	5.5	5.5
United Arab Emirates	0.9	1.1	2.8	3.0	3.0	3.0
Asia	4.6	5.6	3.7	3.3	3.2	3.2
China & Hong Kong	3.3	5.5	3.3	3.0	3.0	3.0
India	12.1	8.4	5.6	4.8	4.4	4.1
Indonesia	5.1	5.6	5.9	5.4	5.0	4.9
Korea	3.0	4.3	3.0	2.8	2.7	2.6
Malaysia	1.8	3.2	2.7	3.0	3.0	3.0
Taiwan	1.0	1.4	1.8	1.8	1.8	1.8
Thailand	3.3	3.9	2.6	2.2	2.5	2.6
Vietnam	8.9	19.2	10.5	7.5	5.7	4.8
TOTAL	5.1	5.8	4.5	3.9	3.6	3.5