

# High Growth Markets

Insight and perspective on today's global economic hot spots

July 2015

## The Annual Outlook Issue

What's next for High Growth markets?

A look into the issues facing the emerging global economies over the coming years



cutting through complexity

# Pause for thought

No economy can enjoy uninterrupted, fast growth without the occasional hiccup, and recent events have highlighted the unpredictability in developing markets. Plummeting oil and commodity prices have exposed certain countries' over-dependence upon resources, while civil unrest, corruption and sanctions are testing the resilience of others. However, from challenge comes opportunity, as oil-rich states strive to broaden their industrial base and up-and-coming markets present themselves as alternatives to the established order.

With highly knowledgeable local experts, KPMG has its finger on the pulse of change at the country, regional and global level. Such deep insight enables us to continually assess and evolve strategies, whether it's evaluating new governments, sizing potential in frontier markets or singling out exciting new investment targets.

## In this issue

Fourteen years after the phrase 'BRIC' was first coined, scale remains a critical factor. In separate articles on pages 32 and 40, we consider the future of emerging trading blocs that bring collective strength. A single ASEAN market of 600 million consumers may be a mouth-watering prospect, but member nations need to preserve political and financial stability. Africa's Tripartite Free Trade Area (TFTA) also offers real hope of a more open trading environment across 26 countries.

Two giants that have suffered considerable setbacks are Russia and Brazil. In addition to falling resource income, the former must contend with punitive sanctions, while the latter is undergoing its worst ever corruption scandal. A profile of Russia on page 28 reveals the many inherent advantages of the world's largest nation, from a well-run corporate sector to a rapidly improving regulatory environment. Our page 38 feature on Brazil shows that, with companies undervalued and a number of assets for sale, there are some intriguing investment opportunities.

The election of a new government is always a time for both hope and reflection, and Nigeria is no exception. On page 21, we consider whether the new regime will bring much-needed reform by stamping out the twin evils of corruption and civil insurrection, while continuing to promote private investment.

One region determined not to fall victim to the 'resource curse' is the Arabian Gulf. Dubai, in particular, has successfully diversified its economy over the past few decades, with Abu Dhabi, Saudi Arabia, Kuwait and Bahrain all eager to follow suit. Read more about the growth of non-oil sectors on page 23.

Our article on page 48 takes a crystal ball to forecast what's in store for high growth markets over the coming years. Rather than treating all countries as a homogenous group, we argue for a segmented approach taking account of differing stages of development and differing characteristics.



Our regular 'Off the cuff' interview on page 56 is with Mr. BRIC himself, Jim O'Neill, the man who invented the concept. In this highly perceptive piece, he discusses the changes in high growth markets, plus a new challenge he's involved in: the growing threat of anti-microbial resistance. One of Jim's many solutions is to simply wash our hands more – which proves something we've suspected for some time: that some of the best ideas come from the bathroom!

**Mark Barnes**  
Global Lead Partner  
KPMG High Growth Markets



# HIGH GROWTH MARKETS

## THE ANNUAL OUTLOOK ISSUE 2015



### Global briefs

**Observations, trends and indicators:** The latest news and highlights from around the world 06

### Global view

**Emerging markets are dead, long live emerging markets!** By **Alexander Kazan**, Eurasia Group, Director and Practice Head – Emerging Markets Strategy 16

### Market insight

**A steady evolution:** Nigeria's new government and its agenda for reform 21

**Beyond energy:** How the Gulf States are accelerating efforts to diversify its industrial base 23

**The real Russia:** Investors take notice of the country's inherent strengths 28

**Stepping out of the shadows:** Investors are drooling over the prospects of a single ASEAN market 32

**Timing is everything:** Brazil may be suffering a downturn, but could this be an opportune moment to invest in the South American powerhouse? 36

**Looking beyond Brazil:** Colombia and Mexico 38

**Opening up the continent:** Africa's Tripartite Free Trade Area 40

**ASEAN Tigers:** Western brands and retailers look to establish a firm foothold in the ASEAN Economic Community 44

## Growth horizon

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### What next for High Growth Markets?

48

The speed of change in the world's growing markets has been unprecedented. In this article, we take a brief pause for breath and consider some of the issues that investors need to consider over the coming years

### Opinion: Constance Hunter,

54

KPMG's Chief Economist, answers the question: What's next for China?

### Off the cuff: BRICs and Bugs: Jim O'Neill

56

talks about the progress within HGMs, as well as the next rising threat that cannot be ignored

## The winner's circle

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**Great opportunities** are emerging in India

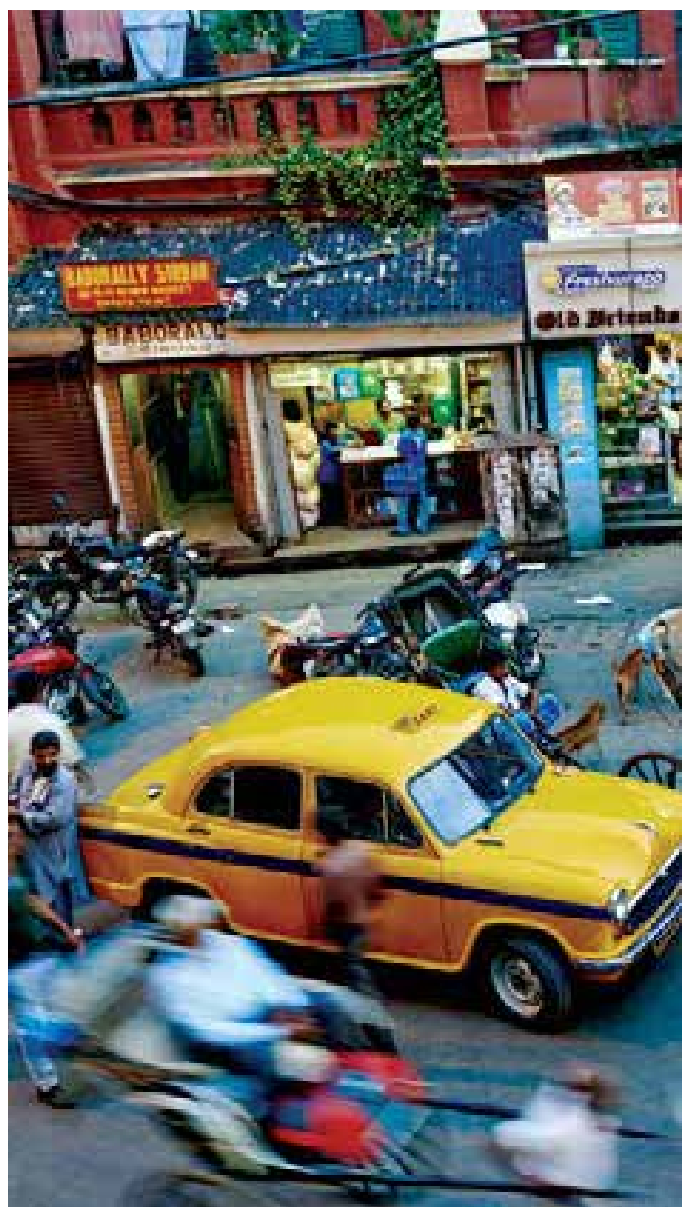
60

## Backstories

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**Heard around the world:** Quips and quotes from influencers, leaders and other market shakers

62





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# GLOBAL BRIEFS

Observations, trends and indicators

The battle for global manufacturing dominance, the rise of the robots, the power of bilateral trade and the growing role of private finance in the world's high growth markets.



## Global Manufacturing

### Battle of the BRICs

India and China outline their visions for manufacturing.

Hot on the heels of the 'Made in India' marketing campaign aimed at boosting the country's manufacturing sector, China is set to unveil its own, very different version. 'Made in China 2025' places a priority on innovation, research and development that will raise quality and contribute to more sustainable growth driven by domestic consumption. Incorporating ideas from Germany, the US and UK, China plans to create a manufacturing innovation center and boost sectors such as robotics, aerospace, e-vehicles, biopharma and medical devices.

In contrast, India's campaign is starting from a smaller base and emphasizes the appeal of its democracy, young and growing population and strong domestic demand. But if the country hopes to replace China as the world's next manufacturing powerhouse, India has a significant challenge in front of them. New Indian Prime Minister Modi recognizes the urgent need to improve skills, develop the country's fragile infrastructure and cut back on red tape in order to open up trade and business channels.

## Brunei Trade

### Brunei's doors opening wider

Acknowledging its place in the global community, Brunei is placing a renewed emphasis on free trade to ease the path for foreign investors, protect intellectual property and stimulate domestic growth. The Sultanate is already known for its stable political system and strong transportation, education and health infrastructure. In particular, Brunei aims to diversify an economy heavily dependent on oil and gas by developing its upstream petrochemicals industries, exporting halal food, pharmaceuticals and cosmetics, as well as building information, communications technology and high tech industries. By 2035, Brunei hopes that a steady 6 percent GDP growth rate will help it become one of the top 10 countries in terms of per capita income.



## Indonesia Development

An **expanding** urban footprint

In Indonesia, the island of Java dominates the country's economy, contributing 58 percent of the GDP. In an effort to spread growth and wealth more evenly across the country, Indonesia plans to build 10 new cities, starting by expanding the district of Tanjung Selor to create a new capital in the province of Kalimantan. Construction will play a central role in this regeneration, with an anticipated 14 percent growth in the sector during 2015. A number of Indonesian construction companies are also making inroads into nearby Myanmar, winning commercial, residential and healthcare projects.



## Myanmar Clothing

**Dressing** the world

Myanmar hopes to become another Asian powerhouse in garment manufacturing.

With 2014 apparel exports estimated at US\$1.5 billion, Myanmar expects a surge in trade with the European Union, Japan and South Korea. The government is streamlining investment processes and increasing employee training. These policies, along with low labor costs, have encouraged brands such as Hennes & Mauritz (H&M) and adidas to source their goods in Myanmar. However, concerns remain over labor conditions, especially over low pay and the use of child labor. In response, the garment industry is striving to bring practices up to Western standards, including the introduction of a voluntary code.

## Malaysia Environment

**Green** growth

In a bold bid to promote sustainable economic development, Malaysia's government is allocating US\$4 billion to introduce green technology. The country wants to improve productivity while using resources efficiently and minimizing pollution and is reaching out to the private and public sectors, as well as civilians, to buy into its vision for a greener future.

## Laos Hydropower

**Powering** Southeast Asia

An extensive new hydropower project is projected to produce power for Laos and possibly for neighboring Thailand, Vietnam and Cambodia. Mega First Corporation of Malaysia is developing the Don Sahong facility on the Mekong River in a 30-year concession. Laos currently has over 23 hydroelectric dams along the Mekong and expects hydropower to become a major revenue source by 2025.

## Philippines Banking

### Safe deposits

A World Bank review has applauded the Philippines' financial regulatory environment, and its determination to produce financially literate citizens. The Bank concluded that, "there is an impressive focus on consumer protection in the banking sector..." The study, which covers issues such as loans, e-banking, data protection and cross selling, also suggests some room for improvement, notably in clarifying the roles of the many entities involved in regulation.

## Thailand Furniture

### Top drawer

Prospects for Thailand's furniture industry could be looking up after a combination of competition, increased labor and material costs and trade barriers that contracted the sector in 2014. With improvements in key markets such as the US, as well as growing demand from middle classes in ASEAN, India and China, exports could rise by as much as 4 percent to approximately US\$1.25 billion this year. Manufacturers are placing more emphasis on design, and analyzing customer trends to access specific customer segments.

## Cambodia Development

### Branching out

Cambodia's government is seeking to end its dependence on garments, tourism, construction and agriculture, instead hoping to create a modern, diversified economy. This ambition is part of a wider plan to attract foreign and domestic investment, modernize small and medium enterprises, create an enabling regulatory climate, develop infrastructure and build workforce skills. The forecast for 2015 growth is currently 7 percent.



## Peru Industry

### Strengthening the base

According to Peru's latest government plans, manufacturing and infrastructure are the building blocks for the Peruvian economy. The country hopes to double its production of steel, refined metals and other products, aiming to reach US\$25 billion by 2025. Peru also hopes to drive to diversification beyond mining, oil and gas, which account for over two-thirds of export revenue. Leaders have signed a range of free trade agreements to ease the path to an export culture that cover 52 countries, including US, Canada, China and the EU.

A total of US\$19 billion in Peruvian infrastructure concessions are planned in the next decade. These concessions, which will be financed via public-private partnerships (PPPs), include extensions to Lima's metro system, the southern Peruvian natural gas pipeline, the port of Pisco and the Chinchero airport.





## Colombia and China

### Mutual relations

As the only South American country with coasts on both the Pacific and Atlantic oceans, as well as a favorable economic, political and business environment and free trade agreements with several nations, Colombia is becoming the first choice for Chinese companies eager to tap the Latin American market. Sino-Colombian trade reached US\$15.5 billion by the end of 2014, making Colombia China's fifth-largest trading partner in the region.

Chinese enterprises such as Sinopec Group, Sinochem Group, Huawei Technologies Co. and ZTE Corp have operations in Colombia, covering telecommunications, machinery and minerals industries, amongst others. The relationship is not just one-way, with Colombia gradually increasing its investment in China. Various discussions have eased the way, including the possibility of a bilateral free trade agreement.

## Chile Robotics

### Automatic success

As part of its shift towards becoming a knowledge-based economy, Chile is hoping to become a world leader in robotics. Currently heavily dependent upon resources, the government is increasing its R&D budget and calling on entrepreneurs and universities, along with financiers, to create an innovation culture. Chile's mining industry provides an opportunity to build a robotics industry that can be exported worldwide.

## Panama Canal

### Hub of activity

Widening the Panama Canal can create a major hub for logistics and manufacturing.

An increasing number of companies see the potential for Panama to become a center for distribution throughout Central America. As the canal nears completion of its US\$5 billion expansion, many are also considering relocating manufacturing to the country to be closer to their end customers. There is no shortage of facilities in the area, with the Panama Pacifico development containing almost 50,000 square meters of office, warehouse and factory space.

These sites are attracting a number of major businesses, including 3M, Cable & Wireless, medical equipment manufacturer Covidien, and computer maker Dell, which operates a shared-services center. A further advantage of Panama is its dollar-based economy, which simplifies customs procedures. These benefits, along with excellent air and road infrastructure and a planned mass transit system, are predicted to bring double-digit growth that could reach 11 percent by 2018.



## Egypt Growth

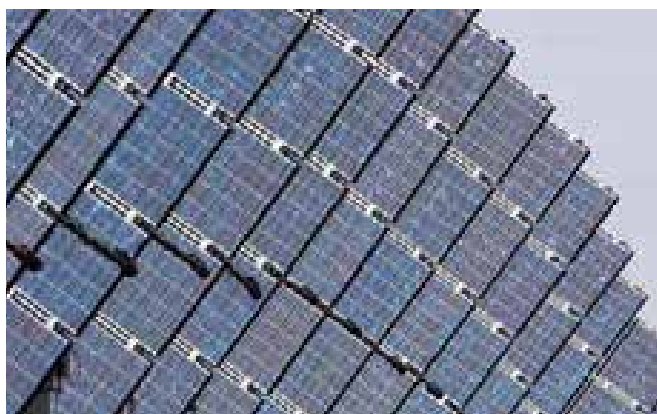
### Turning a corner?

After more than 4 years of upheaval, Egypt's economy is at last showing signs of a revival. A Reuter's poll predicts growth to reach 5.5 percent in 2016-17, although this is unlikely to be enough to reduce the double-digit unemployment that is adversely affecting the nation's youth. Egypt has been sustained by billions of dollars of aid from the Gulf States, helping the government restore growth, curb a swelling budget deficit and control inflation, which is forecasted to slow to 10 percent in 2015-16. Once inflation falls further, the central bank should have space to cut interest rates.

## Kuwait Solar Power

### Shining light

In the world's first example of its kind, pumps in a Kuwaiti oil field will be powered directly by solar energy. The new plant's 32,500 panels convert light into electricity at the Kuwait Oil Company's site in Umm Gudair, West Kuwait. The initiative is part of a wider goal to produce 15 percent of energy in Kuwait from renewable resources by 2030, with the plant reducing 250,000 tons of CO2 emissions over 25 years – enabling it to be registered with the UN to receive carbon credits.



## Kuwait Technology

### Investing in knowledge

The launch of IBM's first office in Kuwait is another step in the country's diversification, as it seeks to accelerate growth of its technology sector. Kuwait's advanced Information Technology (IT) sector is bolstered by one of the highest mobile and smart phone penetration rates in the Middle East, with total IT spending set to exceed US\$1.1 billion in 2015. IBM will offer a range of cloud, social media, mobile, Big Data and security solutions.



## Qatar PPP

## Financing Qatar's **infrastructure**

With an ambitious national development plan that includes 12 iconic, eco-friendly stadiums for the 2022 FIFA World Cup, Qatar is investing heavily in infrastructure to support economic growth. PPPs are likely to play an increasing role in the expansion, offering essential finance for roads, rail, bridges, ports, airports, schools and hospitals.

PPPs enable governments to spread the cost over the lifetime of the asset and therefore avoid an upfront hit to the capital budget. Many Gulf nations, including Qatar, are looking for private sector partners not only to build, but also to help deliver public services and manage public assets. Qatar is aware that to build lasting relationships with private providers, it must deliver a strong pipeline of projects.





## Saudi Arabia Healthcare

### Healthy **growth**

Faced with a rising population and a sharp increase in diabetes and other 'lifestyle' related diseases, Saudi Arabia is growing its healthcare sector by about 9 percent a year up to 2020. This growth is being made easier by relaxed regulations and is being funded by a combination of public money, compulsory healthcare insurance and private investment. A number of foreign companies have shown interest in the Saudi market, including four from South Korea.







## Dubai Tourism

### Visitor **attractions**

Dubai is on track to receive 20 million tourists a year by 2020.

Despite challenging global economic conditions, the Emirate expects to continue its growth in visitor numbers. 2014 saw record 13.2 million tourists, including those staying with family and friends, as well as temporary visitors from cruise ships. Saudi Arabian, Indian and Omani travelers spend the most per trip, while there is growing interest from holidaymakers in China, Africa and South-East Asia.

Unfavorable exchange rates, along with a recovering Egyptian market, may have led some to choose Egypt over the more expensive Dubai, but this has not disrupted the overall upward trend. The lucrative meetings, incentives, conferences, and exhibitions market has also expanded by a healthy 10 percent this year. Dubai is increasing its stock of hotel rooms, with 46 new properties opening in 2014.



## UAE Japan Trade

### **Driving** exports

Japan's trade gap with UAE narrowed somewhat in 2014 on the back of increased demand for motor vehicles. With sales of more than US\$5 billion, cars and trucks constitute over half of all Japanese exports to the Gulf state, making it the fifth largest passenger car market for Japan, and its biggest in the region. Combined bi-lateral trade between the two countries surged to just over US\$51 billion, with mineral fuels making up the vast majority of UAE's US\$42 billion worth of exports to Japan.





## Kenya Economy

### Strong and resolute

In spite of a number of severe outbreaks of terrorism, Kenya has managed to maintain an impressive growth rate thanks to healthy investment in infrastructure and strong private sector consumption. The 2015 growth forecast of 6.9 percent makes Kenya the fifth fastest growing economy in Africa. For the first time in years, Kenya ranks above Rwanda in speed of growth and is due to surpass resource-rich Tanzania by the end of 2016. Only the Democratic Republic of Congo, Ethiopia, Cote d'Ivoire and Chad have expanded faster.



## South Africa Consumption

### Disposable incomes on the rise

Low inflation in South Africa is continuing to be beneficial to consumers, who are enjoying increased spending power, with disposable income up by over 3 percent year-on-year in March 2015. More people are moving into the middle and higher income categories, although new, higher personal tax rates will affect incomes to some extent. As long as fuel and food price rises remain low, the trend is likely to persist. Indeed, despite a small hike in food prices and a weakening rand pushing up the price of certain imports, inflation is forecasted to stay below 6 percent, which is below income growth rates.



*cutting through complexity*

## Great opportunities are emerging.

With High Growth Market economies such as Indonesia, now representing more than 50 percent of the world's GDP, they will continue to be an important long-term investment strategy for international businesses.

KPMG High Growth Markets has built on-the-ground expertise across the international investment corridors. We have firsthand knowledge of how to enter into a rapidly growing market, as well as how to expand regional operations, all while providing the greatest return on investment.

## Where will you invest?

## Emerging markets are dead, long live emerging markets!

**Sanctions and falling oil prices may have harmed the economy,** but investors should be alive to the country's inherent strengths.

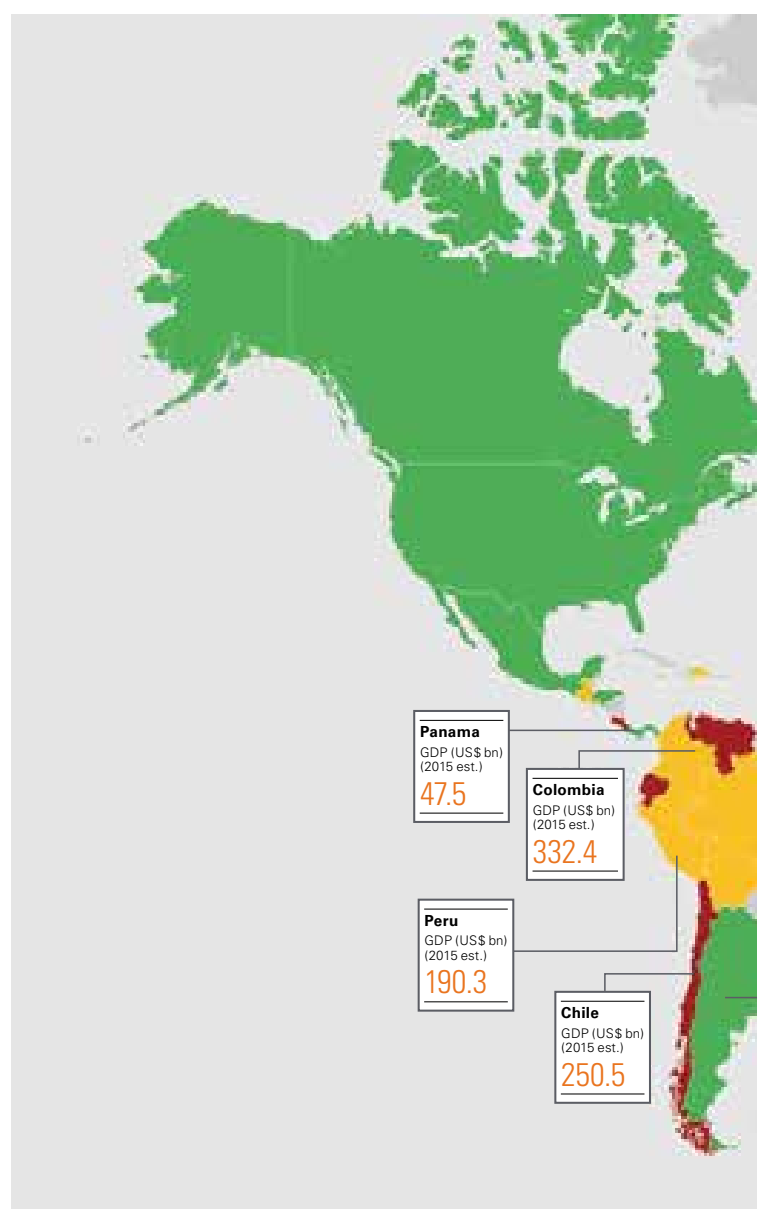
In recent years, slowing economic growth has raised real doubts about the fundamental case for investing in emerging markets: that more risk is compensated by high growth rates, increasingly open and competitive economies and the convergence of institutional quality toward developed country standards. Economic growth in EMs has now slowed for each of the past 5 years. This year, the IMF expects EM growth to slow again, to just 4.3 percent - and even less without China. Apart from India, Mexico and China, few EMs are pushing deep, productivity-enhancing economic reform. Meanwhile, corruption scandals from Latin America to Asia remind us that EM political institutions still have a long way to go.

### 24-Month Trajectories

Eurasia Group's (EG) Political Trajectories are indicators of the net impact of political factors on the macro business environment in a country over specific timeframes. For each country, Eurasia Group provides a short-term (6 months) and a long-term assessment (24 months).

The EM story isn't over, but it has changed. Instead of an across-the-board bull case, we now see a clear trend toward greater divergence. This differentiation is now visible in GDP growth, asset price performance, portfolio flows and foreign direct investment. The emerging world is increasingly dividing into winners and losers in the hunt for global investment dollars.

Basic economics explains some of this divergence – starting with China's rebalancing economy. Countries and regions have varying exposure to spillover from a slowing China; South America is most exposed, Mexico and EMEA less so, while emerging Asia has both winners and losers. Similarly, tightening global liquidity conditions and lower oil prices since mid-2014 also are driving differentiation through trade and financial channels.



POSITIVE NEUTRAL NEGATIVE



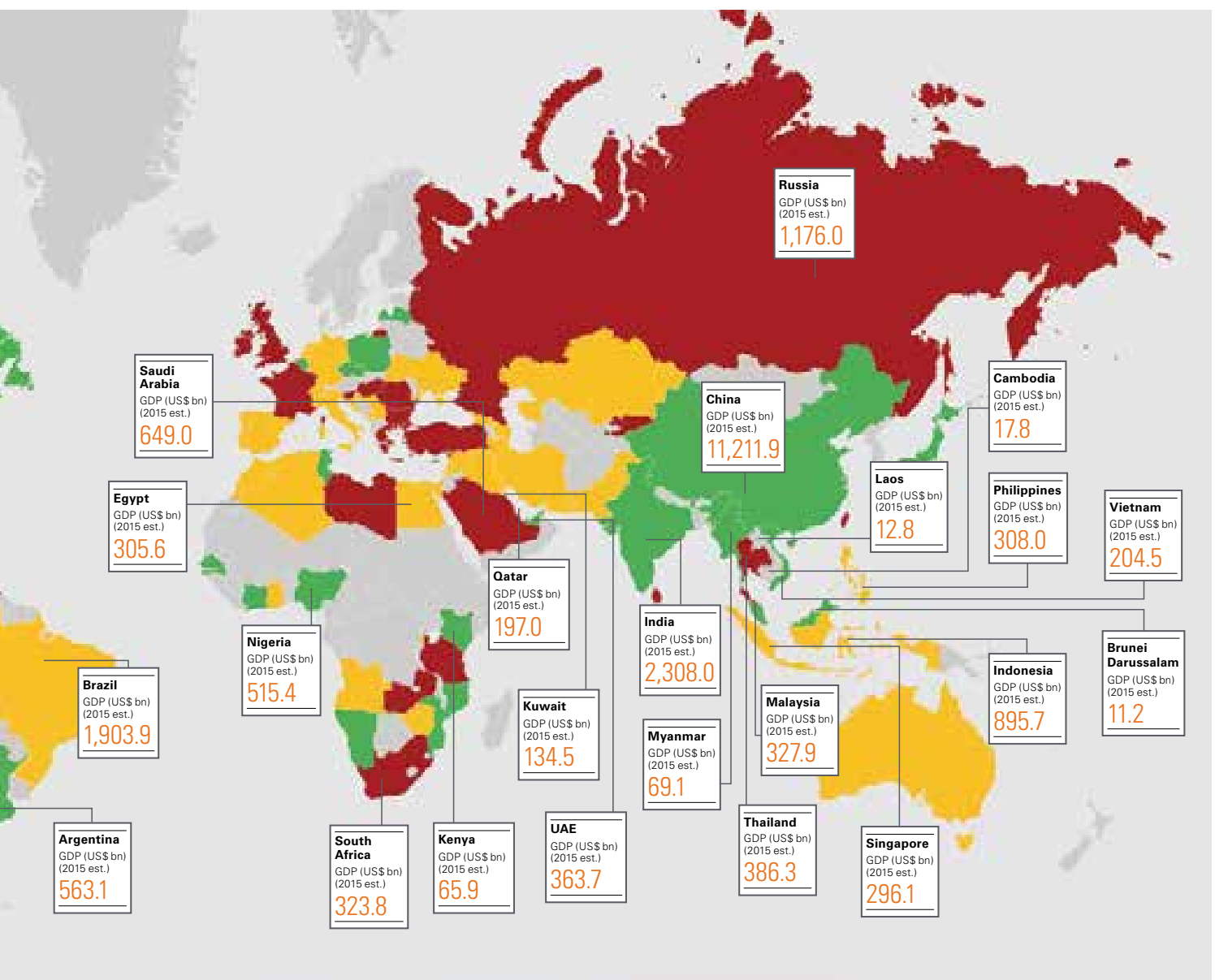
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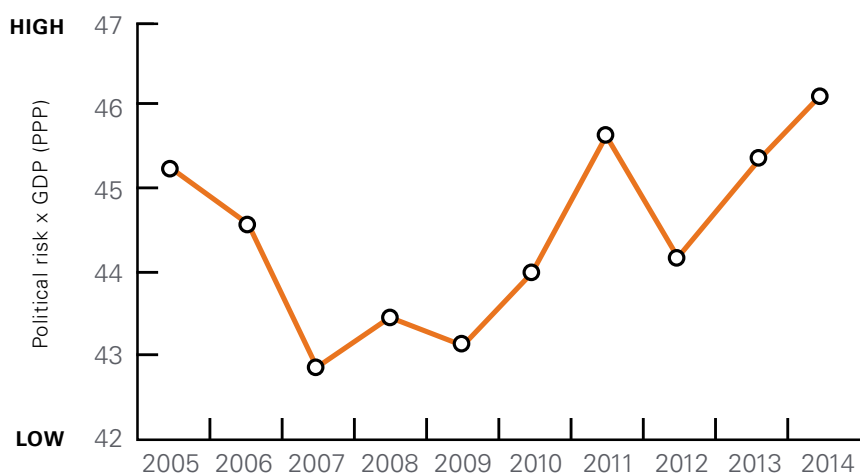
Alexander Kazan is Eurasia Group's lead emerging markets strategist and also directs the Firm's comparative research, including quantitative approaches to political risk. Alex led the development of the Political Risk Country Portfolio, a systematic comparative framework for analyzing the market pricing of political risk across emerging markets.

Before joining Eurasia Group in 2013, Alex led the Latin America equity strategy team at Goldman Sachs, where he developed and communicated the Firm's view on Latin American equity markets to internal sales and trading desks and institutional investors. He also has worked at Daiwa Asset Management as an economist and investment strategist and at Bear Stearns covering Latin America as part of the Global Emerging Markets equity strategy team.

Alex was born in San Francisco and lives in New York. He holds degrees from the University of California, Davis and Georgetown University.



Source: World Economic Outlook, International Monetary Fund website, accessed on 22 April 2015



Source: Eurasia Group Analysis, IMF World Economic Outlook

Global economy's exposure to political risk: rising in size and volatility since the 2008–2009 crisis

But politics are also playing a bigger role in driving economic and market outcomes. The long wars in Iraq and Afghanistan have reduced the willingness and ability of the US to pursue an activist foreign policy. American allies are focused on domestic challenges of their own, while China and other EMs aren't ready to fill the gap. This vacuum is leading to more frequent, intense and longer-lasting geopolitical conflicts. Eurasia Group's empirical measures of country-level political instability and volatility also point higher in recent years. It's not just headlines: the world really has become a less stable place.

It's also clear that global economic exposure to political risk is moving higher. In part, this simply reflects EM growth over the past 20 years – developing countries, which by definition riskier and less stable, are producing a larger share of global output. But something else is going on, too: actual levels of risk in EMs are higher and more volatile than at any point over the past 15 years.

Many EM governments are struggling to balance slower growth (and fewer fiscal resources) with more demands from newly-minted middle classes for more spending and investment. India, China and Mexico are pursuing real economic reform. But in Brazil, Turkey, South Africa, Chile and many other

places, these dual challenges are leaving governments weakened, playing defense and generally unable and unwilling to pursue the deep and often unpopular structural reforms required to raise productivity and revive growth. Weaker governments will also struggle to respond to external financial shocks – increasingly likely once the Fed raises rates – with decisive and effective policy responses. These trends are creating more volatile politics across EMs.

The diverging paths of India and Turkey this year highlight why getting the politics right matters so much. Both countries are large net exporters of energy; lower oil prices benefit both by easing pressure on the balance of payments, fiscal accounts and household finances. Despite roughly equal advantages on these metrics (which, if anything, are in Turkey's favor), Turkey hasn't translated these tailwinds into faster growth, more investment or better asset price performance, while India has. Politics have made the difference. In India, the new government led by Prime Minister Narendra Modi is taking advantage of popular and legislative support to liberalize restrictions on investment, make the tax system more efficient and boost infrastructure investment. In Turkey, despite the tailwinds from lower oil

prices, the politics are turning worse as President Tayyip Erdogan targets political rivals in a bid to consolidate power. In the process, he has undermined the independence and quality of many Turkish institutions, including the central bank, and caused serious damage to the investment environment.

Can Modi deliver on his reform agenda? The end result of the current debate over tax reform will send an important signal here. Mexico continues to make enormous strides on labor, tax, competition, energy and other big reforms – all of which should enhance productivity and potential growth in the years ahead. And while China's rebalancing has negative spillovers for many EMs, it's also associated with one of the most transformative reform efforts now underway anywhere, with the government moving ahead on SOE, environmental, financial and capital markets reform.

The EM world is increasingly dividing into two tracks, and politics will play a central role in separating the winners from losers.



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# MARKET INSIGHT



# A steady evolution

**Although elected on a reform agenda,** Nigeria's new government is likely to build on, rather than replace, the economic policies of its predecessor.

General Mohammed Buhari's victory in the February 2015 Nigerian general election ended 16 years of power by the ruling People's Democratic Party (PDP). Many voters had become disillusioned with the PDP's inability to root out corruption and tackle the scourge of terrorism from the Islamist Boko Haram group.

Despite a clear resolve to address these two pressing issues, as well as deliver a number of other much-needed reforms, the new All Progressives Congress (APC) government is expected to continue with the private sector-led policies that have done much to drive the economy forward under the previous incumbent Goodluck Jonathan. Among the PDP's successes were the privatization of the power sector and significant improvements to agriculture, with private investment into seeds and fertilizers, more efficient distribution and a move into processing of foodstuffs, which brings higher margins.

Public-private partnerships (PPPs) should also remain as an essential means of funding Nigeria's large and expanding infrastructure gap, helping to build roads,

rail and energy networks. Falling oil revenues saw capital expenditure as a proportion of the total national budget fall from 33 percent to 24 percent between 2013 and 2014,<sup>1</sup> leaving little option but to harness the power of private finance. Examples of PPPs include the US\$600 million 1.6 km second Niger Bridge, which connects northern and southern Nigeria,<sup>2</sup> the US\$130 million Lekki-Epe Expressway near the capital Lagos,<sup>3</sup> and the US\$1.4 billion Lekki Deep Seaport,<sup>4</sup> which is set to be the second deepest seaport in Africa.

But it's not just foreign money pouring into Nigerian capital projects; domestic investors are also showing faith in the economy and financing a number of PPPs and other business initiatives. Aliko Dangote, Nigeria and Africa's richest businessman, has invested over US\$11 billion in an oil refinery, petrochemical and fertilizer plant.<sup>5</sup>

## A time for change

New president Buhari is no stranger to power. As a military leader he was temporarily head of state between 1983

and 1985 following a coup. This army background gave voters belief in his party's ability to defeat a Boko Haram group that has murdered thousands of citizens and soldiers, as well as infamously kidnapping 200 schoolgirls.

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The new government is expected to continue with the private sector-led policies that have done much to drive the economy forward.

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Buhari and his government are also less tainted by the corruption that has haunted Nigeria for decades. Nigeria currently ranks 136th out of 175 countries surveyed for Transparency International's Corruption Perceptions Index,<sup>6</sup> and many feel that the previous PDP regime failed to live up to its promise to halt the corruption that has impacted every level of society.

Reform of the oil industry is high on the new government's agenda, particularly the removal of controversial fuel subsidies that cost the government billions of dollars, but are considered

<sup>1</sup> *Economic Update – Nigeria: Analysis Of 2014 Budget*, Proshare, accessed 23 April 2015.

<sup>2</sup> *Financing infrastructure through public-private partnership*, Nigeria Infrastructure Advisory Facility, 7 August 2014.

<sup>3</sup> *Lekki-Epe Expressway concession buy-back: Begging posers*, Vanguard, 26 November 2013.

<sup>4</sup> *Nigerian government approves construction of Lekki deep sea port for N200 billion*, Premium Times, 4 December 2013.

<sup>5</sup> *Africa's richest tycoon adds another \$2bn into Nigeria refinery*, Financial Times, 14 December 2014

<sup>6</sup> *Transparency International Corruption Perceptions Index*, 2014..



unaffordable given the drop in world commodity prices. Nigeria's many joint ventures with multinationals account for almost half of its oil output, and these are being scrutinized. The Governor of the Central Bank has called on the incoming administration to consider selling off 30 percent of its majority stakes in these joint ventures, suggesting that this could raise as much as US\$75 billion to invest in important infrastructure projects.<sup>7</sup>

The new administration also has its sights on trimming down the bloated public sector, following a 2015 report by a committee led by former senior civil servant Stephen Orasanye, which recommends the scrapping and merger of some government agencies.<sup>8</sup>

Tax is another issue that has perplexed successive governments, with billions of dollars lost every year through evasion and inefficient collection processes. The national tax revenue to GDP ratio is 12 percent, which, when oil revenue is excluded, drops to just 4 percent. More training in tax and transfer pricing is urgently needed to improve standards, along with efforts to institutionalize a 'tax culture'.<sup>9</sup>

The 2013 privatization of the state electricity monopoly was a big step

### The new administration has pledged to reform the oil and power industries and trim down the bloated public sector.

towards improving the country's inadequate power network, but there is still much to be done. Over 50 percent of Nigeria's 160 million people receive no electricity at all, with South Africans consuming 55 times more energy per person. Lack of power is estimated to restrict annual economic growth by as much as US\$130 billion, or a quarter of GDP.<sup>10,11</sup> The country's transmission network, still publicly-owned, remains the weakest link with a limited capacity and an inability to reach the entire nation. President Buhari's new government has pledged to press forward with transmission privatization plans that had stalled under his predecessor.

### Diversification is a key to future strength

Initial reactions to the election results have been positive, with the country's capital markets enjoying their largest ever daily single gain of more than

8 percent, as well as the appreciation of local currency,<sup>12</sup> calming any fears that the outcome might spark civil unrest. The main oil producing states, which stayed loyal to the PDP, also appear to have accepted the outcome and there are signs that they are prepared to work with the new regime.

With oil prices unlikely to regain their former heights, the country's future is dependent on a diversified economy that includes agriculture and wider agro-businesses, manufacturing and services. Already, the cement industry is a major and growing contributor to GDP. The domestic film sector, known as "Nollywood" is another big business, contributing 1.2 percent to Nigeria's GDP and employing more than a million people.<sup>13</sup>

The successful diversification program that began under the outgoing government is expected to be continued under new President Buhari, adding a layer of stability that will reassure both domestic and foreign investors. If this progress can be combined with greater security and transparency, then Nigeria has every chance of fulfilling its undisputed potential as a future economic powerhouse.

<sup>7</sup> Reactions trail 30% joint venture divestment proposal, Daily Independent, 23 April 2015.

<sup>8</sup> Nigeria: Govt Urged to Implement Orasanye's Committee Report, All Africa, 26 March 2015.

<sup>9</sup> Nigeria's tax revenue ratio to GDP drops, Okonjo-Iweala says, Premium times, 22 April 2015.

<sup>10</sup> Nigerian power breakthrough provides new hope for millions, The Guardian, 14 October 2013.

<sup>11</sup> World Bank data, 2015.

<sup>12</sup> Nigerian Economy Reacts Positively To Buhari's Election, Leadership, 6 April 2015.

<sup>13</sup> Nigeria's film industry: Selling BlackBerry Babes, The Economist, 22 November 2014.

# Beyond energy

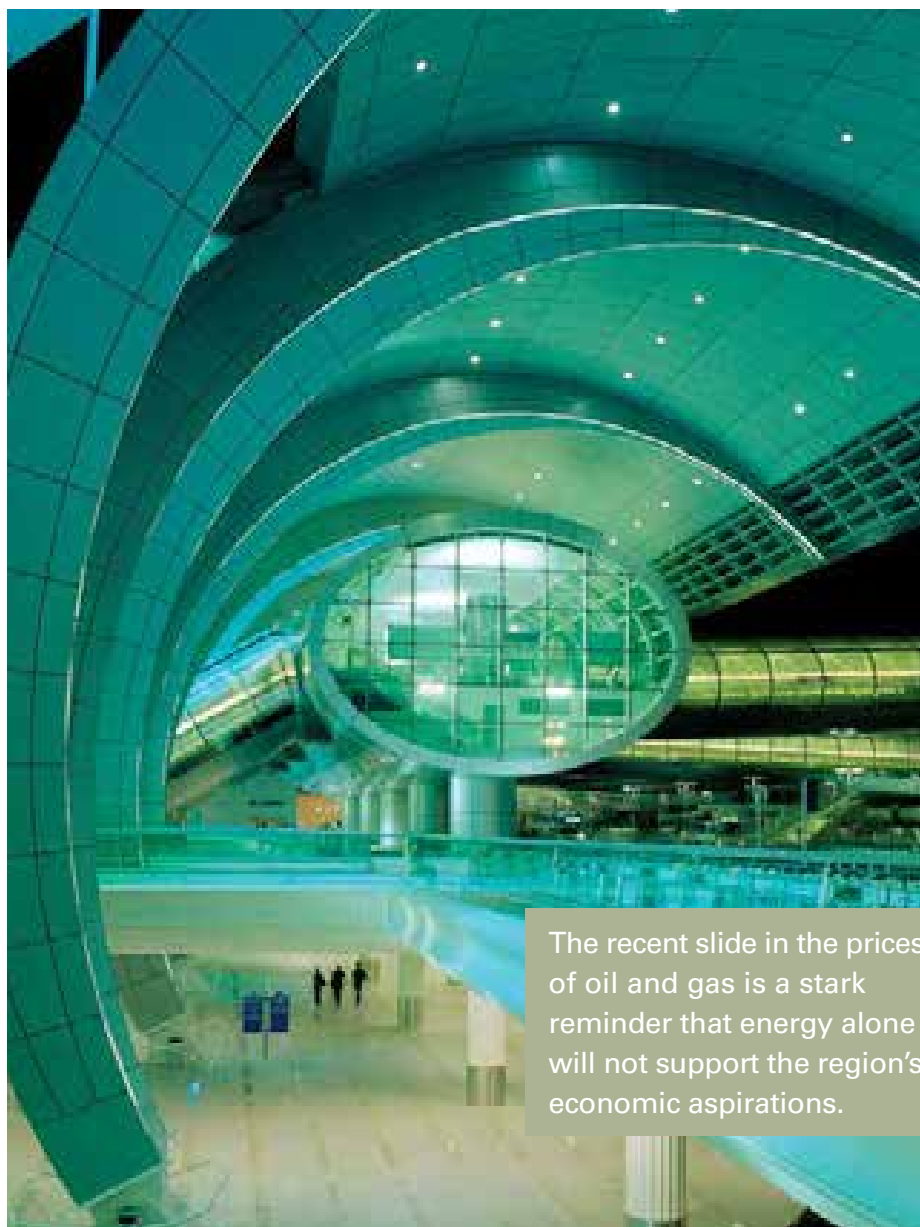
**With oil prices close to US\$65 a barrel,** the Gulf States are accelerating efforts to diversify their industrial bases and reduce dependence on fossil fuels.

Approximately 70 million travelers pass through Dubai International Airport every year, making it the world's busiest airport and a crucial hub for global business travelers. It is also a shining example of progress in a region that was once known purely for oil and gas, but is now diversifying into a wide range of sectors to build sustainable economic foundations.

The Gulf States have become extremely wealthy thanks to huge natural resources spread across modest-sized populations. Qatar tops the world rankings for gross domestic product (GDP) per capita, with four other Gulf nations – Kuwait, United Arab Emirates (UAE), Saudi Arabia and Bahrain – all making the top 12.<sup>1</sup>

The recent slide in the prices of oil and gas, however, is a stark reminder that energy alone will not deliver the types of lifestyles to which citizens of these countries have become accustomed – nor support their aspirations.

Under the visionary leadership of Sheikh Rashid, Dubai was a regional pioneer for the development of infrastructure and a diversified economy, transforming the city-state from little more than a fishing village in the early 1960s into the global metropolis of today. A key starting



The recent slide in the prices of oil and gas is a stark reminder that energy alone will not support the region's economic aspirations.

<sup>1</sup> World Economic Outlook Database, International Monetary Fund, 14 April 2015.



point was the 1972 opening of the deep water Port Rashid, followed by the construction of Jebel Ali, now the largest man-made port in the Middle East and the biggest between Asia and Europe, with revenue accounting for roughly a quarter of Dubai's GDP. Its current expansion plan will make it the largest port in the world.<sup>2</sup>

Further investment in roads, bridges, schools and hospitals, allied with a

business-friendly environment, has enabled thriving trade, tourism, hospitality, financial services, education, healthcare and retail sectors. The throngs of shoppers flocking to Dubai Airport Duty Free spend about US\$1 billion a year – more than in any other global airport.<sup>3</sup>

Although Dubai's energy wealth is not insignificant, it pales against the enormous reserves of its neighbor Abu Dhabi, where the rate of change

has been relatively slower. Oil and gas represents 55 percent of Abu Dhabi's GDP.<sup>4</sup>

### Picking winners

Much of the region's wealth is concentrated in the hands of a few family-owned businesses. Small-to-medium-sized enterprises, or SMEs, contribute 33 percent to Saudi Arabia's GDP and employ a quarter of its local workforce. In the UAE, the figure is higher, with SMEs making up 30 percent of GDP and a significant 86 percent of its working population.<sup>5</sup>

With education still lagging behind more sophisticated Western nations, children of these dynasties are routinely educated in some of the world's best universities in the US and Europe, returning with enlightened economic ideas and bold ambitions for expansion.

Dubai may be the most diversified economy in the Gulf, but others are swiftly following suit. The region has excellent links to the key emerging markets in China, India, Southeast Asia and Africa, while also attracting significant tourist trade from Europe. A number of Gulf states are utilizing this favorable location, along with modern tourism facilities, to hold international conventions. Dubai has been chosen to host the World Expo trade convention in 2020, providing an invaluable showcase for its many assets.

Abu Dhabi is striving to emulate the success of Dubai's Emirates airline with its own Etihad brand, while Qatar's eponymous air carrier is also making headway as a global player. The 2022 World Cup represents a massive coup for a small nation like Qatar with a population of only two million, and is set to be an important marketing vehicle for attracting inward investment, given that oil and gas still constitutes over half of its economy.<sup>6</sup> The soccer tournament



Dubai may be the most diversified economy in the Gulf, but others are swiftly following suit.

<sup>2</sup> Dubai: the UAE's hedge against oil, beyond Brics, Financial Times, 3 February 2015.

<sup>3</sup> ibid.

<sup>4</sup> Dubai enters top five ranked fastest growing economies, The National, 22 January 2015.

<sup>5</sup> Small and Medium Sized Enterprises in the GCC: Can Private Equity Capital Fill the Financing Gap? MENA Private Equity Association, February 2013.

is one of the main drivers behind the country's US\$1.7 billion Orbital Highway motorway, which connects the new port at the Qatari capital Doha with Ras Laffan, the gas-producing industrial city in the north.

Manufacturing is another success story across the Gulf. Aluminum exports from the UAE are expected to rise in coming years to become one of the key non-oil contributors on the back of the region's infrastructure expansion.<sup>7</sup> Abu Dhabi aims to establish itself as a world class engine maintenance hub and has a joint-venture between the government-owned Mubadala Aerospace and GE, which also extends to healthcare.

Bahrain is setting the pace in the fast-growing Islamic finance sector, being named the GCC's leading Islamic finance market (and second out of 92 countries worldwide) in 2014.<sup>8</sup> The kingdom is home to the largest concentration of Islamic financial institutions in the world, including 32 Islamic banks and related firms.<sup>9</sup>

Demand for schooling is opening up opportunities for private operators, the biggest of which is GEMS, a global company originating in Dubai, which aims to create 40,000 new school places by 2017, primarily in UAE, Saudi Arabia and Qatar, a number of which will cater for the children of expatriates.<sup>10</sup>

## A race to improve infrastructure

Gulf Cooperation Council states (consisting of all Arab states of the Persian Gulf, with the exception of Iraq) are investing heavily in infrastructure, particularly for road and rail transport. Additional mega projects include the US\$86 billion



King Abdullah Economic City in Saudi Arabia, Qatar's US\$70 billion 2022 World Cup-related infrastructure and the UAE's US\$20 billion Masdar City development.<sup>11</sup>

One interesting inter-state initiative is the proposed Gulf railway linking Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. Covering almost 2200 km and hosting 200 km/hour high-speed trains, the near-US\$200 billion project should be complete by 2018, with the cost shared by the six GCC countries.<sup>12</sup>

In Saudi Arabia, the capital Riyadh hopes to tackle chronic congestion and air pollution through its US\$22.5 billion Metro, featuring electric, driverless trains, plus a new bus network and park-and-ride services. Qatar has similar plans with its new Metro for the capital Doha.

## The rising importance of sovereign wealth funds

Across the Gulf, tax revenue is typically low due to zero or minimal personal and corporate income tax rates. As governments race to improve infrastructure, they are aware that dwindling oil revenues alone will not fund the huge range of projects in the pipeline.

Sovereign wealth funds may be the key to filling the funding gap. An estimated US\$2 trillion sits in the region's coffers – around 40 percent of all funds globally – with Gulf states providing four of the top 10 largest funds.<sup>13</sup> Although most of these funds initially concentrated on overseas investment, they are now turning towards domestic development in infrastructure, real estate, education and healthcare.

<sup>6</sup> Qatar's economic growth edges up to 5.7 y/y pct in Q2, Reuters, 30 September 2014.

<sup>7</sup> Aluminium industry to become key non-oil contributor, Thomson Reuters Zawya, 14 April 2015.

<sup>8</sup> ICD-Thomson Reuters Islamic Finance Development Indicator (IFDI), September 2014.

<sup>9</sup> Bahrain tops GCC in Islamic finance, Gulf Daily News, 5 September 2014.

<sup>10</sup> Schools Operator GEMS Plans Rapid Middle East Expansion, The Wall Street Journal, 29 January 2014.

<sup>11</sup> Sovereign Wealth Funds – Riders through the storm, KPMG International, 2014.

<sup>12</sup> GCC rail network to connect the 6 Gulf states by 2018, American Journal of Transportation, 15 April 2015.

<sup>13</sup> Sovereign Wealth Fund Institute figures, April 2015.



Private businesses are also benefiting and the huge Kuwait Investment Authority (KIA) fund, (to name just one), has been heavily involved in a number of industries. Having injected billions into propping up domestic capital markets following the global crisis, the KIA now has holdings in several banks and is the single largest investor in many of the country's investment companies. The KIA also invests in commercial real estate and holds equity stakes in several prominent telecommunications, building materials and food and beverages companies. Technology is a further priority, in the form of the National Technology

Enterprises Company (NTEC), which uses its US\$360 million capital base to help foster life sciences, energy, water, cleantech and information and communication development.<sup>14</sup>

Foreign investment by Gulf sovereign wealth funds can have a positive impact on domestic economies by encouraging reciprocation. The Middle East's geographical proximity to Africa makes the two regions natural partners, and the inaugural West Africa Investment Forum in Dubai in 2014 forged some promising links, with African countries securing an estimated US\$19 billion from UAE investors across numerous infrastructure projects. One

sovereign wealth fund – Investment Corporation of Dubai (ICD) – has put US\$300 million into West Africa, and total Gulf investment in the African continent is believed to be more than US\$30 billion.<sup>15</sup>

As well as being heavily dependent on the Gulf's oil, China is becoming a major investor in and trading partner with the region, building on the area's strong financial, trade and logistics capabilities. Total China-UAE trade is expected to reach close to US\$100 billion by 2015. There are over 2,000 Chinese companies registered in Dubai alone, while major Chinese banks have branches in the Emirate,

<sup>14</sup> *Emerging trends in the Sovereign Wealth Fund landscape, Middle East*, KPMG International, May 2013.

<sup>15</sup> *Sovereign Wealth Funds – Riders through the storm*, KPMG International, 2014.



which is also home to approximately 200,000 Chinese, primarily business expatriates.<sup>16</sup>

### The future is diversified

Political unrest and conflict has, regrettably, become a fact of life in the wider Middle East region, and the Gulf is by no means immune. Bahrain experienced an uprising in 2011 as part of the Arab Spring and there were lower-level protests in Oman during the same period. Amidst the news of war in Syria and Iraq, progress with Iranian nuclear negotiations could introduce a new era in trade, opening up a market of almost US\$80 million,

providing a tremendous boost to surrounding economies.

Gulf states have avoided the so-called 'Resource Curse' that has impacted a number of energy-rich countries around the world through a combination of strong, central leadership and a recognition that the citizens have to receive a reasonable share of their nations' wealth. This philosophy is fueling the push for diversification, as governments seek to avoid the plight experienced by countries such as Russia, whose over-dependence upon oil and gas revenue has seen its economy slide and Ruble depreciate.

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An estimated US\$2trillion sits in the region's sovereign wealth funds – that's around 40 percent of all funds globally.

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As the world adjusts to lower oil and gas prices, while also investing in renewables such as wind and solar, the need for a broad-based economy is greater than ever. The shrewd investment policies demonstrated by Dubai – and replicated around the Gulf – should help cement the region's role as a major commercial center on the future global stage.

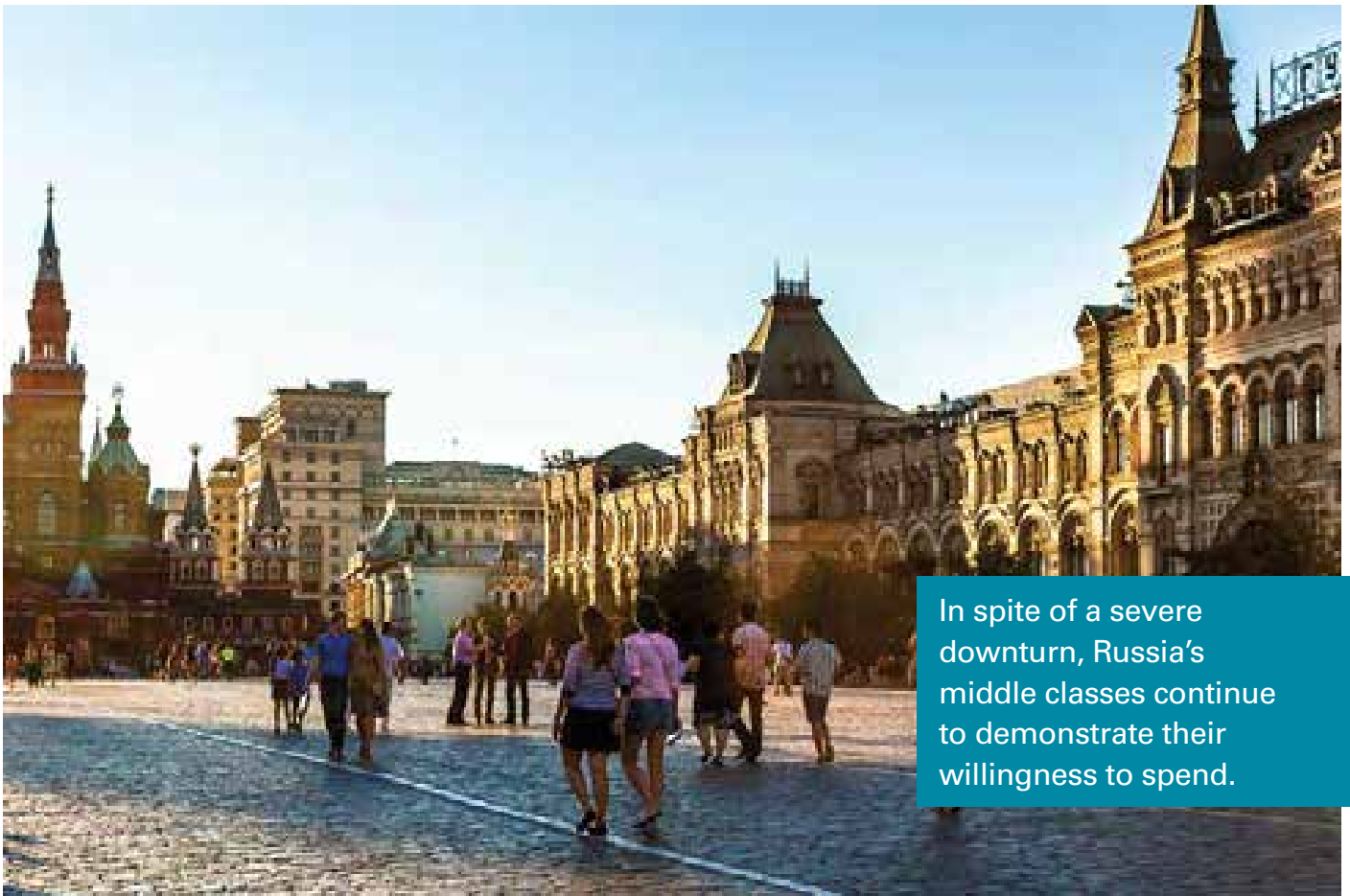
<sup>16</sup> *China and the Middle East: More Than Oil*, The World Financial Review, 26 November 2014.

# The **real** Russia

**Sanctions and falling oil prices may have harmed the economy,**  
but investors should be alive to the country's inherent strengths.







In spite of a severe downturn, Russia's middle classes continue to demonstrate their willingness to spend.

With recent Hollywood blockbusters such as 'A Good Day to Die Hard,' 'The Avengers' and 'Jack Ryan, Shadow Recruit,' which all feature Russian villains, one could think the Cold War never ended. And while no serious investor would admit to be influenced by a movie, the prevalence of so many stereotypical Russian bad guys does, in a small way, highlight a wider lack of understanding of this vast and diverse country.

Even the 2014 Sochi Winter Olympics failed to improve outside impressions, with the unrest in Ukraine overshadowing what could have been a prime opportunity for Russia to promote itself to the wider world.

The collapse in global commodity prices, along with sanctions over alleged support of separatist militants in eastern Ukraine and the annexation of the

Crimean peninsula, has had a dramatic impact upon Russia's economy. With corporates effectively locked out of international capital markets, Russian banks have had to extend loans to avoid defaulting on an estimated US\$100 billion of foreign debt. This comes at a price, with central bank rates reaching a massive 17 percent by the end of 2014. These rates will remain in double figures in 2015 while banks become forced to cut lending to smaller businesses.<sup>1</sup> Foreign direct investment has also suffered a calamitous decline, down 70 percent in 2014 on the previous year.<sup>2</sup>

Yet, despite these and other structural challenges, the underlying potential of the world's largest nation (by geographical size) remains strong. For European investors in particular, Russia represents by far the biggest 'near' market. When combined with Armenia, Belarus,

Kazakhstan, and, shortly, Kyrgyzstan, the Eurasian Economic Union numbers some 180 million consumers in total.

Russia's middle classes have certainly demonstrated their willingness to spend. As the ruble collapsed during 2014, many citizens recalled a similar devaluation in the 1990s, when Soviet-era rubles became virtually worthless, casting many into poverty. This time around, the first sign of a currency fall sent shoppers rushing to the malls and car dealerships. Between June and December 2014, when the ruble dropped from 35 per US dollar to 54 per US dollar, consumer spending actually rose slightly year-on-year.<sup>3,4</sup> And, although overall automobile sales were down 10 percent in 2014, luxury brands such as Mercedes, Porsche, Lexus and Jeep all saw significant rises.<sup>5</sup>

<sup>1</sup> *Russian banks rush to rescue credit-starved large corporates*, Reuters, 30 January, 2015.

<sup>2</sup> *China Trumps U.S. for Foreign Investment*, Wall Street Journal, 29 January 2015.

<sup>3</sup> *Russia Consumer Spending Forecast*, Trading Economics, accessed 12 May 2015.

<sup>4</sup> *Rouble suffers worst fall since 1998 crisis*, Financial Times, 4 December 2014.

<sup>5</sup> *Association of European Businesses Automobile Manufacturers Committee data*, 15 January 2015.

## Russia's productivity rate is less than half that of Germany and just 28 percent of the US.

While these minor successes pale against the severe challenges facing the Russian economy – the World Bank predicts a 3.8 percent contraction in 2015<sup>6</sup> – they do show that, ultimately, Russia is a place that serious investors cannot afford to ignore.

### Casting off the Soviet legacy

Many of Russia's acknowledged structural weaknesses are a throwback to the former Soviet Union, foremost of which is a chronically low productivity rate that is less than half that of Germany and just 28 percent of the US.<sup>7</sup> Much of this can be attributed to 'mono cities' based around a single industry, often in remote locations. In many other

parts of the world, when business gets tough, the owners simply close up shop or move to different location. In Russia, however, both government and business owners have been reluctant to take such tough decisions, not wishing to abandon the population to market forces. Lately, however, there is a growing recognition that such a situation cannot continue to be allowed, with President Putin ambitiously pledging to improve the country's productivity by 50 percent between 2012 and 2018.

Russia's biggest automaker, AvtoVAZ, based in the city of Tolyatti, 870 kilometers south-east of Moscow, is up to the task. Between 2009 and the end of 2014, the firm, which is 51 percent owned by Renault and Nissan, shed half its workforce, slashing 53,000 jobs in a bid to become profitable.<sup>8</sup>

Like a number of other energy-rich countries, Russia has a narrow industrial

base, making it extremely dependent upon volatile oil and gas prices. Taxes from the oil industry account for about half of the government's budget, and the economy urgently needs to diversify to protect it from external shocks.

Another factor hindering industrial and commercial efficiency is the bureaucracy, which involves significant form-filling and long waits for permits and other approvals. Admittedly, Russia has moved up the World Bank Ease of Doing Business ranking, leaping from 112th in 2012 to 62nd by 2015, but there are some stark variances in results. The good news? Russia is positioned 34th in terms of starting a business, 12th in registering property, and 14th in enforcing contracts. In contrast, the country ranks 156th in dealing with construction permits and 143rd in getting electricity.<sup>9</sup> Russia's goal is to reach the rank of 20th overall by 2018.

Decades of centralized economic control have also served to repress the entrepreneurial spirit, leaving Russia with a far smaller proportion of small and medium-sized enterprises (SMEs) than other major powers. While SMEs account for more than 50 percent of gross domestic product (GDP) in the US and close to 70 percent in many parts of the EU, they account for only about 20 percent of Russian GDP, employing around 30 percent of the workforce.<sup>10</sup> It is hoped that the millennial generation, inspired by the example of young tech billionaires in other countries, can spur a new era in enterprise and cast off the 'nanny state' mentality. Reducing some of the aforementioned bureaucracy should also accelerate the growth of start-ups.

Finally, one has to go back over 70 years to the Second World War to trace the source of Russia's relatively low population, which has left the nation short of that most vital of resources:



<sup>6</sup> Oil price fall and sanctions affect Russian property market, Financial Times, 14 April 2015.

<sup>7</sup> Russian Government Sets Up Four-Year Plan to Boost Productivity, The Moscow Times, 13 July 2014.

<sup>8</sup> RUSSIA: AvtoVAZ cuts "difficult" but productivity up: Bo Andersson, Just Auto, 5 September 2014.

<sup>9</sup> Doing Business 2015, World Bank, 2015.

<sup>10</sup> SMEs Powering Global Competitiveness, St. Petersburg International Economic Forum Foundation (SPIEF), 24 May 2014.



people. The Soviet Union suffered like no other during the conflict, losing tens of millions of its citizens, the majority of them male. Despite an increase in post-war birth rates, Russia is still playing catch-up. From the collapse of the Soviet Union in 1991, the new Russia had to wait until 2013 to record its first year of natural population growth.<sup>11</sup>

### Keeping the faith

Many smart investors have chosen to look beyond the current economic downturn and longer-standing structural inefficiencies to focus on the strong fundamentals of the Russian market. In spring 2105, veteran US financier Jim Rogers argued that the time was ripe to invest in Russia – and not just to take advantage of bargain basement stock pickings. Speaking to Reuters, he observed that: “Something has happened over in the Kremlin. The old ways of doing things in Russia have changed in my view.”<sup>12</sup> Another renowned US investment expert, Mark Mobius, is equally optimistic over longer-term prospects. His Franklin Templeton

fund has several Russian holdings, and he has commented that Russian companies are “...very well-run and have excellent management.”<sup>13</sup>

German car giant Volkswagen has also expressed a commitment to Russia. Despite scaling back production at its site in Kaluga due to a fall in demand, it has confirmed its belief in the future by announcing its intention to invest US\$1.3 billion in the country by 2018.<sup>14</sup>

Sanctions notwithstanding, national and regional governments are striving to make life easier for foreign investors, with special economic zones offering incentives for industrials, technology, transport and logistics and tourism and recreation sectors, with dedicated regional advisory teams to offer assistance. The way that investors are handled is also monitored for best practice.

Amidst all this change, there is one aspect of Russian culture that may take longer to shift: the ‘slow-slow-quick’ tempo of business life. In a country that experiences long, harsh winters,

the people have, over centuries, grown accustomed to a form of hibernation followed by a frantic race to grow, harvest and store crops in the spring and summer months. These habits still persist, so investors need to remain patient during slower periods, expect cyclical up and downturns, and be assured that, when the moment comes, Russians will move quickly to achieve their goals. In the build-up to the Sochi Winter Olympics, there were fears that the facilities would not be ready in time, yet Russia delivered. By showing faith in the ability of this huge, remarkable and often-misunderstood nation to continue to deliver, shrewd investors should see their patience vindicated.

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**Volkswagen intends to invest US \$1.3 billion in Russia by 2018.**

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<sup>11</sup> *Russia Reverses Birth Decline – but for How Long?* The Moscow Times, 22 June 2014.

<sup>12</sup> *US financier Rogers says now may be time to invest in Russia*, Reuters, 6 April 2015.

<sup>13</sup> *How to embrace risk in a volatile world*, Fortune, 1 March 2015.

<sup>14</sup> *VW to Reduce Russian Output*, The Wall Street Journal, 21 March 2015.

# Stepping out of the shadows

**Investors may be drooling over the prospects of a single ASEAN market**, but there could be a few bumps in the road in the form of territorial disputes and political and financial instability.

With 600 million consumers and a combined GDP of US\$2.4 trillion, ASEAN (The Association of Southeast Asian Nations) is a force to be reckoned with. Comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam, this economic zone – which ranks as the world's seventh largest economy – should enable members to finally step out of the shadows of China and India.

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Many multinational companies recognize the potential of ASEAN as a regional production hub for parts and components in global manufacturing supply chains.

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Following the 1997-98 Asian financial crisis, many countries in the region struggled to match their previous high growth rates, with the added challenge of competition for investment dollars from a resurgent China. The AEC (ASEAN Economic Community), set to be implemented by the end of 2015, gives Southeast Asia an expanded, single market on a scale that the individual nations alone could never achieve. With collective strength comes greater bargaining power to develop





One advantage that ASEAN can claim over China is its favorable demographics, with 60 percent of its population below the age of 35.



further free trade agreements with other parts of the world. In addition, sectoral cooperation can help to transfer knowledge to narrow the gaps between the various member countries.

Free from restrictive tariffs and regulations, intra-regional trade can blossom, helped by bilateral agreements that avoid double taxation and a common approach to fair competition. Those thinking of setting up a business in ASEAN can now take the best that each nation has to offer, whether it's the low-cost labor of Myanmar and Vietnam, the complex engineering skills in Thailand and Malaysia or high-end R&D expertise from Singapore.

A possible portent is the success of the Greater Mekong Sub-Region (GMS), which in the past two decades has brought closer integration to

Cambodia, Laos, Myanmar and Vietnam, as well as the two southern-most provinces of China – Yunnan and Guangxi Zhuang. These participants have enjoyed the benefits of regional manufacturing and agricultural hubs, rich natural resources, big consumer markets and tourist attractions, all of which has attracted foreign direct investment. Consequently the International Monetary Fund (IMF) expects these economies to be the fastest growing in ASEAN up to 2017.

Many multinational companies recognize the potential of ASEAN as a regional production hub for parts and components in global manufacturing supply chains. After the 2011 Fukushima nuclear disaster, Japanese firms in particular are diversifying outside their domestic shores to mitigate

future risks, with ASEAN one of their chosen destinations.

## Reclaiming the spotlight from China

With Chinese wages rising to an average of US\$28 per day, foreign industrial groups that shifted their portfolios towards China are now taking a second look at ASEAN. A worker's daily salary in Indonesia and Vietnam is around US\$9 and US\$7 respectively, and these countries, along with Myanmar and the Philippines, are becoming more popular for manufacturing and assembly.

An easing of restrictions on foreign ownership and a widening of permitted sectors only adds to the attraction, along with increased investment protection and improving registration procedures. Indonesia's new 'one-stop integrated services' aims to make life much easier for investors, cutting red tape and increasing transparency.

Political tensions between Japan and China, along with rising production costs and increased difficulty in managing factories in China, is also causing Japanese companies to turn toward ASEAN's cheap labor and open economies.

Another advantage that ASEAN can claim over China is its increasingly favorable demographics. Sixty percent of ASEAN's population is below the age of 35, and high fertility rates can only increase the size of the workforce relative to China, which is struggling to replenish its proportion of working-age people in the face of its one-child policy. ASEAN already boasts the world's third largest labor force. Rapid urbanization will usher a larger share of people to more productive sectors, with the proportion living in cities predicted to rise from 36 percent to 45 percent by 2030.

## Rising fortunes for the Philippines and Myanmar

After decades of underperformance, for very different reasons, these two nations



The South China Sea is a potential flashpoint, with competing territorial claims from China, Vietnam, the Philippines, Malaysia and Brunei.



are in the midst of dynamic expansion, with both economies set to grow faster than China. Once infamous for sub-par infrastructure, political instability and widespread corruption, the Philippines' revival is based upon good governance and a stable economy.

Foreign direct investment levels have tripled since 2010, and infrastructure spend is expected to be close to US\$13 billion in 2015 – around 4 percent of GDP. One of its sunshine industries is a rapidly growing business process outsourcing sector. Foreign investors, however, should be aware of the country's low transparency rankings and shareholding laws that restrict them to just 40 percent ownership of local firms.

Myanmar's transition from military dictatorship to democratic government has been well-documented, paving the way for economic reforms and the easing of sanctions. A 2014 growth rate of 7.8 percent (forecasted to rise to 8.3 percent in 2015) has been achieved on the back of trade liberalization, a focus on the private sector and increasing access to finance.

Strong performance in telecommunications and manufacturing contributed to a December 2014 foreign direct investment figure of US\$6.2 billion, with many regional and international institutions lining up to establish operations in one of the world's fastest growing economies. Myanmar is strategically well-located between China and India, making it a natural trading hub as well as a key supplier of minerals, natural gas and agricultural produce.

Sustained growth is dependent on continued reforms, improved infrastructure and a cooling down of damaging ethnic conflicts.

### **Adjusting to the new power balance in southeast asia**

Given its abundant energy and raw materials reserves, vital sea lanes, huge manufacturing facilities and vast economic potential, Southeast Asia is a region in which all the world's major

powers feel they have a stake. After a period of relative peace and stability following the Vietnam War, tensions have once more arisen, with a newly-powerful China joining the US and Japan in asserting its interests, and, to a lesser extent, India and South Korea.

The South China Sea is a potential flashpoint, with competing territorial claims from China, Vietnam, the Philippines, Malaysia and Brunei. China has occupied some parts of the Spratly Islands, with the apparent aim of building military facilities, which could alter the balance of power in the area.

Concerned about such developments, the US is increasing its deployment of forces in the region. Japan is equally keen to preserve its access to vital resources and protect its significant investments in Southeast Asia, and has sympathized with Vietnam and the Philippines in the latter's disputes with China.

Although such developments give cause for concern, China and the ASEAN countries recognize the need for a secure South China Sea, and are making some, albeit slow, progress at cooperation. It could also be argued that a healthy balance of multiple forces acts as a check against any aggression by any one country. In addition, all the nations in the area see each other as trading partners; a dependency that should, hopefully,

prevent any dangerous escalation of claims.

### Overcoming political and financial uncertainty

At a national level, certain members of ASEAN have an inherent volatility that could undermine their participation in the bloc. After almost 10 years of political turbulence, including two military coups, and violent protests, Thailand must hope that a new constitution and 2016 elections can return some stability.

Myanmar is also looking forward to a smooth election in late 2015 to cement the transfer of power from the army to a popularly elected government. Ceasefires and formal peace talks to end decades of insurgencies involving ethnic minorities are also gaining momentum. Another country moving towards a 2016 presidential election is the Philippines, with some uncertainty over a new incumbent's ability to drive forward further economic reforms, improve the economy's competitiveness, and finally resolve a major insurgency in the south of the country.

The region's financial stability is also vulnerable to a rising US dollar and expected interest rate hike in the US, which puts pressure on currencies and domestic interest rates, and could lead to a tightening of liquidity and capital outflows. This development is worrying,

given the increased debt taken on by many businesses and individuals across ASEAN, and the current account deficits held by countries such as Indonesia.

However, the competent fiscal record of most ASEAN central banks and policymakers, who have maintained low inflation and limited deficits, gives cause for confidence in riding any financial storm. Exchange rates are managed fairly soundly and less susceptible to speculative pressures, while most nations have built up a reasonable buffer of foreign exchange reserves. Banking systems are also better capitalized and rigorously supervised.

Infrastructure remains a big priority, and there are signs that many ASEAN economies are reversing a long period of under-investment. Nevertheless, the Asian Development Bank estimates the region's infrastructure needs at US\$60 billion a year from 2010-2020, which is a significant commitment.

ASEAN integration is essentially a marathon, not a sprint, and, like the European Union, will take decades to evolve. However, the speed of economic progress in this fascinating, diverse region has been nothing short of breathtaking, and this pace, energy and resolve should give investors confidence that the many, formidable challenges can be overcome, to produce an important player on the global stage.



# Timing is everything

**Brazil may be suffering a downturn,** but could this be an opportune moment to invest in the South American powerhouse?

The perfect storm engulfing Brazil combines economic malaise with commercial and political scandal. As commodity and oil prices plummet, GDP growth, which had ground to a halt in 2014, is expected to decline slightly in 2015. A dramatic depreciation of the reais (R\$) has impacted spending power, while unemployment, which has been on a steady downward trend, has soared to 6.4 percent.<sup>1</sup>

As if to add further distress on a already-troubled nation, Brazil is in the grips of arguably its worst ever case of alleged corruption, known locally as 'Carwash,' which touches both the

country's private and public institutions. More than a dozen major Brazilian construction companies stand accused of paying bribes to secure million and billion-dollar contracts with the part-state-owned energy conglomerate Petrobras, as well as forming a cartel to keep prices artificially high.

Unsurprisingly, government approval ratings have hit rock bottom, with the country's credit ratings downgraded.

Turn the clock back 5 years or so, and the scene looked very different, with investors strongly attracted to Brazil. The economy was booming, the ranks of the middle classes were

swelling with new consumers eager to spend and with the FIFA World Cup and Olympics on the horizon, opportunities appeared limitless.

2010, however, also bore the hallmarks of a classic bull market, as companies were traded at inflated prices, sometimes without robust business plans to justify the sky-high values. Those who bought into Brazil at that time are now suffering from the premiums they paid, and in a downturn are struggling to recover a fraction of their initial investments.

## Interesting pickings

As the dust settles on a shocked Brazilian economy, shrewd investors are starting to see some intriguing opportunities emerge. In the face of more realistic valuations, the same people and groups that may have held back from transactions a few years ago have now returned. The devaluation of the reais gives considerably greater purchasing power for buyers holding US dollars (US\$). In October 2010, for example, one dollar was worth R\$1.6; at the time of writing it's almost double that figure at more than R\$3.

Petrobras is set to dispose of as much as US\$13.7 billion of assets this year in a bid to reduce debt and protect



<sup>1</sup> Brazil Unemployment Rate, Trading Economics, accessed 21 May 2015.

cash, fearing that some assets could possibly be frozen as part of the bribery investigation. The company also needs to raise funds to forge ahead with its huge, 5 year, US\$221 billion capital spending plan to focus on deep-water exploration, as it seeks to access oil reserves lying up to seven kilometers under the surface of Brazil's southeast coast.

A range of businesses will go on sale – quite possibly at favorable prices – including gas distribution, thermo-electric facilities, onshore reserves, non-deep-water reserves and refineries, including some companies in Africa and elsewhere.<sup>2,3</sup>

Another victim of the fall-out from the 'Carwash' scandal is engineering company OAS, also urgently in need of cash. OAS is contemplating selling its 24.4 percent stake in infrastructure company Invepar, which holds some attractive road, rail, airport, shipyard, soccer stadium, waterworks, oil and gas and housing project concessions. These include Guarulhos international airport just north of São Paulo and part of the Rio Metro.<sup>4</sup>

## A strong focus on infrastructure

Despite being the world's sixth-largest economy, Brazil ranks only 114th out of 148 countries in the World Economic Forum's infrastructure quality tables.<sup>5</sup> According to the national development bank BNDES, Brazil expects infrastructure investments in 2015-18 to be 30 percent higher than in 2010-13, at US\$202 billion.<sup>6</sup>

Like many nations, both emerging and mature, Brazil lacks the finance to push ahead with essential projects and has been turning to the private sector to fund both existing and new assets, with



a growing concession program that now extends to hospitals, educational facilities and prisons, many of them involving public-private partnerships (PPPs). The state of Minas Gerais, north of Rio, is considering PPPs for education and health, while Amazonas in the northwest has signed a prison PPP.<sup>7</sup>

The country's ports were put up for tender in 2013, and a number of northern, northeastern and central states are considering privatizing power distribution to improve efficiency and service.<sup>8</sup> With five airports already run by the private sector, there are plans to open up two more to PPPs: the international airports of Espírito Santo state capital Vitória and Ceará state capital Fortaleza.<sup>9</sup>

These various opportunities notwithstanding, Brazil remains a dynamic market with strong fundamentals. Its middle classes now make up over half of the 200 million population and they have shown that they like to spend. Demand for consumer

goods, healthcare, telecommunications, technology and automobiles is likely to pick up, given the nation's young, aspirational demographic profile. Its natural resources may have generated less income in recent years, but will continue to be an important sector.

And, in spite of lingering concerns over corruption, Brazil remains an established democracy with robust institutions – exhibited by the open manner in which the 'Carwash' scandal is being tackled. In Brazil, foreign investors are treated fairly and private capital is openly welcomed. The present government, in particular Finance Minister Joaquim Levy, is showing that it's not afraid to make tough, unpopular decisions to reduce the fiscal deficit and cut waste in public spending. Combined, these factors should reassure those thinking of investing in Brazil, where the bear market may just provide solid opportunities for buyers prepared to do their homework.

<sup>2</sup> Petrobras to sell \$13.7 billion in assets in 2015 and 2016, Reuters, 2 March 2015.

<sup>3</sup> Petrobras finds itself in deep water, Financial Times, 29 December 2104.

<sup>4</sup> Brazil's OAS attracts foreigners in billion-dollar asset sale, BN Americas, 16 January 2016

<sup>5</sup> Solving the Infrastructure Challenge in Brazil through Public-Private Partnerships, International Affairs Review, The Elliott School of International Affairs at George Washington University, 24 February 2015.

<sup>6</sup> Brazil's multibillion infra investments forecast to rise 31% in 2015-18, BN Americas, 4 March 2015.

<sup>7</sup> Infra PPP, Infrastructure/PPP News in Brazil, 26 March 2015.

<sup>8</sup> Brazil Said to Mull Goiás Utility Sale in Expanded Privatization, Bloomberg, 27 March 2015.

<sup>9</sup> Brazil mulls offering more airports to private sector, BN Americas, 26 March 2015.



# Looking **beyond** Brazil

**As one of the four BRICs**, Brazil has received much of the spotlight in the central and southern America region. However, Colombia and Mexico have not gone unnoticed and both are enjoying good growth rates and generating increasing interest from investors.

## **Colombia: Latin America's fastest-growing economy**

For a country that was once associated primarily with violence and drug trafficking, Colombia has made impressive strides. As the third largest economy in Latin America, GDP growth in 2014 was 3.7 percent, with per capita GDP rising almost 3 percent to US\$4,376 – and doubling since 2003. Unemployment, which was in the double digits for most of the 2000s, has also decreased steadily, standing at less than 9 percent in March 2015.<sup>10,11</sup> Relatively low inflation has boosted purchasing power.

Sensing that Colombia's time has arrived, a number of foreign brands are moving into a market currently dominated by independent and specialist retailers. Starbucks and Tommy Hilfiger have recently arrived on the scene, Portugal's largest retailer Jeronimo Martins has opened five discount stores in different cities and another household name, Krispy Kreme, is looking to launch 25 franchised outlets over the next few years.

Colombian shoppers are also showing increasing sophistication, opening the doors to several premium-price segments. A growing trend towards healthy lifestyles is pushing up demand for organic, low-fat and low-sugar foods. People are also prepared to pay more for higher quality products such as craft beers. And as consumers adopt busier working lives, they are open to convenience foods that take less time to prepare.

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**As the third largest economy in Latin America, GDP growth in 2014 was 3.7 percent, with per capita GDP rising almost 3 percent to US\$4,376 – and doubling since 2003.**

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Housing demand from aspirational locals, as well as a growing band of foreigners, has helped the surge in the country's real estate markets. High-end properties in the capital Bogotá have grown by an average 10 percent a year since 2011, with rents keeping pace. Venezuelans make up the single biggest

group of foreign buyers, followed by Spanish, Portuguese, Japanese and Americans, all keen to take in the wonderful climate, expanding economy and international lifestyle – and to benefit from the strong US dollar.

Commercial property is fetching high prices, with multinationals such as insurance company AIG, beer and soft drinks giant SAB-Miller, Twitter and ride-hailing service Uber all choosing Bogotá to host their regional headquarters. Two million tourists visited Colombia in 2014, up 14 percent on the previous year. In response, hotel chains Marriott, Hyatt, Sheraton and Four Seasons have all opened hotels or announced new projects.

The prospects of a permanent peace deal between the Colombian government and the leftist rebel FARC group could provide a further lift to the economy. However, investors should be aware of the country's reliance on oil and coal, which are susceptible to price volatility that has impacted other resource-rich nations.

<sup>10</sup> Colombia GDP Growth Rate, Trading Economics, accessed 22 May 2015.

<sup>11</sup> *A Dynamic Bogotá Attracts Foreign Buyers and Businesses*, The New York Times, 20 March 2015.



## Mexico's ambitious infrastructure agenda

As Latin America's second largest economy, Mexico is taking strides to speed up its growth. A 2015 report from the Organization for Economic Co-Operation and Development (OECD) praised Mexico for embarking: "...on a bold package of structural reform to break free from three decades of slow growth, low productivity, pervasive labor market informality and high income inequality."<sup>1</sup> These reforms cover areas such as competition, the financial sector, labor, infrastructure, telecommunications and tax.

The government is certainly thinking big. Its National Infrastructure Program 2014-2018 pledges to invest US\$590 billion in 743 programs covering energy, land development, transport and communications, healthcare and tourism. Some of the landmark projects include a 1000 kilometer (km) gas pipeline, power plants, the capital's new, state-of-the-art Peña Nieto airport, high-speed and urban rail developments and nationwide fiber optic cable networks. Government is expected to cover 63 percent of the

costs, with the remaining 37 percent coming from private investment.<sup>2</sup>

Mexico is also in the midst of bids for exploration, exploitation and production of oil and gas fields. Two-thirds of bidders for these contracts are foreign.

Infrastructure private finance is nothing new to Mexico – the real estate and private equity sectors provide much of the liquidity – but the country has less of a track record when it comes to bigger projects. Pension funds have recently been permitted to invest in alternative assets such as infrastructure, introducing a valuable new source of capital. However, the secondary market is still in its relative infancy, and lacking in liquidity, so local and federal government, plus multilateral or development banks, are urgently needed to plug the funding gap.

Since 2012, Mexico also encourages unsolicited proposals from the private sector, which, if agreed, are put forward for tender, enabling companies to forge robust, well-scoped projects.

Mexico is becoming an increasingly international market that welcomes overseas businesses. Most major

Spanish construction companies have significant operations in the country, and the big Mexican banks have expanded to become part of the global financial community. As the burdens of protectionism, regulation and lack of transparency are slowly released, the prospects for infrastructure investors should not be overlooked.

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**Mexico's National Infrastructure Program 2014-2018 pledges to invest US\$590 billion on 743 projects.**

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**Some of the insights in this piece were taken from a discussion on "Infrastructure opportunities in the Mexican Energy Sector" at the World Economic Forum (WEF) on Latin America, 6-8 May 2015. The session, which was moderated by John Scott, KPMG Deputy Chairman, considered how to increase the country's appeal to infrastructure investors, especially in energy, including oil, gas and electricity.**

<sup>1</sup> OECD Economic Surveys: Mexico, January 2015.

<sup>2</sup> Mexico Update: Infrastructure Plans Unveiled, Americas Society/Council of the Americas, 9 October 2014.

# Opening up the **continent**

**Africa's Tripartite Free Trade Area (TFTA)** is set to create a huge market of more than 600 million consumers across 26 countries.



Of the many challenges to doing business in Africa, trade barriers are among the most frustrating. Sizeable export, import and associated costs can push up the cost of goods, while customs and transit bureaucracy – which differs from country to country – add time and expense to the movement of goods across borders and makes business travel inconvenient.

With long anticipated launch of the Tripartite Free Trade Area (TFTA) agreement in Sharm El Sheikh Egypt on 10 June 2015, such concerns may eventually become a thing of the past. The agreement establishes a vast economic bloc stretching from Egypt in the north to the tip of southern Africa, with a combined gross domestic product (GDP) of US\$1.2 trillion and 625 million aspirational consumers.<sup>1</sup> This exciting initiative is the culmination of 10 years of negotiations between the Common Market for Eastern and Southern Africa (COMESA), East African Community (EAC) and Southern African Development Community (SADC).

An enlarged market with duty-free trading and simplified, harmonized customs, transit and visa procedures should greatly aid the cross-border movement of goods, services and business people to level the commercial playing field for businesses based in the 26 member states. Such improvements can play a critical role in the development of these economies, opening up new markets

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**The Tripartite Free Trade Agreement should stimulate infrastructure development, industrialization and free movement of goods and people, and encourage foreign direct investment.**

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and encouraging essential foreign investment in industry, commerce and infrastructure. Indeed, one of the pronounced aims is to encourage joint planning and implementation of infrastructure programs such as road, rail, border posts, seaports, air transport, telecommunications and energy.

The TFTA is also a major step towards the ultimate goal of a fully inclusive African economic community.

### **A new level of cooperation**

Of course, collective trade agreements are nothing new in Africa. COMESA, EAC and SADC are just three of many such groupings, of varying degrees of sophistication. What makes TFTA different is its sheer scale.

This wide, geographic coverage brings together economies with different characteristics that can benefit mutually from each other's strengths. In southern Africa, for example, many countries rely heavily on extractive minerals, and neighbors within SADC have relatively less need to purchase such commodities from each other, except during times of occasional shortage. It's a similar story in eastern Africa, where agriculture and coffee production predominates, whereas in the north there is a greater emphasis on oil.

By combining these three groups, TFTA gives businesses and consumers greater access to a much wider range of goods and services, many of which may not be readily available in their existing trading zones. Commodities producers, who have traditionally suffered through an inability to add value to basic extracted materials, now have a much larger target audience within Africa. This offers an incentive to horizontally integrate into processing, which should generate higher prices for more developed forms of gold, diamonds and nickel.

Being part of a larger bloc also enhances the negotiating power with other global trading zones, notably the European Union (EU). After a decade of talks, the EU finally reached 'Economic Partnership Agreements' with EAC and SADC in 2014 in a bid to usher in improved trade reciprocity. This agreement (which also includes COMESA), provides a solid foundation for a wider agreement for the whole of TFTA. The European Parliament has openly stated that TFTA is an "important" development that could achieve a fairer access to markets for both EU and TFTA countries.<sup>2</sup>

### **Benefiting both domestic and foreign businesses**

Once the TFTA has been fully implemented, companies with manufacturing and other operations within the TFTA area should have a significant competitive advantage thanks to almost complete duty free access to all the 26 countries, which brings down the cost of goods and makes it easier to transport products between member states. And with a growing market of hundreds of millions of consumers within reach – especially the rising middle classes – they can also plan more confidently for the future.

One key issue to be ironed out is the concept of 'rules of origin' of goods. The three participating trade areas have different definitions of what constitutes a locally-produced item, so these rules will have to be aligned. At the Tripartite meeting in February 2014 in Malawi, it was agreed that where rules of origin among the three free trade areas are common or identical, these will be adopted as Tripartite rules – while acknowledging that further discussions on this topic are necessary.<sup>3</sup>

<sup>1</sup> *Tripartite summit now set for June*, Southern Times, 30 March 2015.

<sup>2</sup> *Launch of Tripartite FTA now set for June*, International Centre for Trade and Sustainable Development, 8 April 2015.

<sup>3</sup> *ibid.*

Foreign investors thinking of setting up operations in the zone should therefore ensure that they are up to speed on any regulation, or risk their output being deemed as 'foreign-made,' if it has insufficient local input in terms of materials and/or labor.

Overseas investors can also expect a high degree of scrutiny over tax. The Africa Tax Administration Forum (ATAF) is a pan-continental force for combatting tax evasion and avoidance, promoting efficiencies in tax collection and enabling the exchange of taxpayer information. With 36 country members, the forum is keen to root out individuals or businesses seeking to gain advantage through transfer pricing driven tax base erosion and profit shifting.

Customs duty is a valuable source of revenue for African countries, many of which lack sophistication in their collection of personal and corporate tax. With the advent of free trade zones such as TFTA and the expected subsequent fall in import and export

revenues, the tax authorities are likely to be especially vigilant in maximizing revenue from other sources.

A coordinated, Africa-wide tax strategy, including engagement with the relevant national and pan-regional tax bodies, can help larger companies create more certainty over their future tax burdens and also help influence other aspects of the agreement.

### **Taking a long-term view**

Despite the obvious advantages of TFTA, the path towards a unified region will inevitably take time – potentially several years. After all, the EU didn't happen overnight and continues to evolve after several decades. COMESA, EAC and SADC are all at different stages of development, which will also impact the pace of change.

Disputes are bound to arise and when they involve a strategically-important organization with strong political clout, the domestic government is likely to support its own businesses, adding

to the complexity. Security is another big worry, so the member countries will want to gain some assurance that they're not opening up their borders to drugs, arms and disruptive groups of insurgents or terrorists.

At the time of writing, 24 of the 26 countries covered by the TFTA had signed the Declaration for the establishment of the TFTA. A deadline has been set to complete all outstanding negotiations by 2017. Most, if not all, ambitious international businesses have an 'Africa strategy,' and will be following developments closely to ensure that they are part of this unique opportunity to advance the continent's undoubted potential.

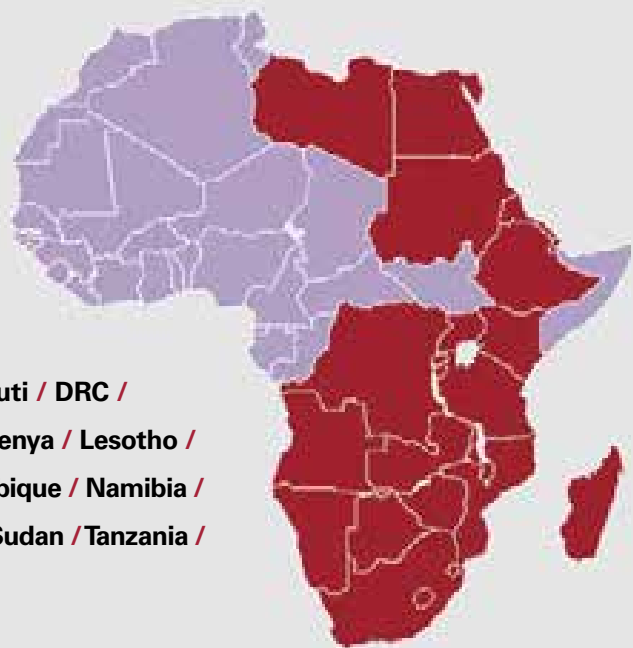
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**Being part of a larger bloc also enhances the negotiating power with other global trading zones, notably the European Union (EU).**

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## **AREA COVERED BY THE TFTA**

**Angola / Botswana / Burundi / Comoros / Djibouti / DRC /  
 Republic of Congo / Egypt / Eritrea / Ethiopia / Kenya / Lesotho /  
 Libya / Madagascar / Malawi / Mauritius / Mozambique / Namibia /  
 Rwanda / Seychelles / Swaziland / South Africa / Sudan / Tanzania /  
 Uganda / Zambia / Zimbabwe**



**Source:** *The Tahir Institute for Middle East Policy*, July 2015



*cutting through complexity*

## Great opportunities are emerging.

One would be hard-pressed to deny the growing influence of the High Growth Markets. Massive consumer growth, increasing prosperity, greater rule of law and young populations all create significant opportunity for those able to execute a successful HGM strategy.

To better understand the challenges and opportunities, we conducted an in-depth survey of more than 300 senior executives across developed markets. What we found was a high-level of optimism, increasing investment and great promise for areas like Africa, the Middle East and ASEAN.

To read more, visit [kpmg.com/GlobalHGMOutlook2015](http://kpmg.com/GlobalHGMOutlook2015)

## Where will you invest?



## ASEAN Tigers:

# Western brands and retailers look to establish a firm foothold in the ASEAN economic community

*As featured in KPMG's ConsumerCurrents18: Issues driving consumer organizations*

When WHSmith was launching a new store in the ASEAN region at Kuala Lumpur airport in 2012, the company's International Director had his own view on which books should be stocked. "We need some Joseph Conrad," Louis de Bourgoing told Bison, WHSmith's local joint-venture partner. "He wrote a lot about Malaysia." For De Bourgoing, Conrad's novels set in the Malay Archipelago would be perennial sellers, much as Wilfred Thesiger's *Arabian Sands* was the company's most popular book in Oman. That granular attention to detail is one of the keystones of success in the ASEAN region.

Ten countries comprise the Association of Southeast Asian Nations (ASEAN)—Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. By the end of 2015, ASEAN aims to have created a single economic market, to be known as the AEC, built on a collective

population of around 625 million and a GDP worth about US\$2.4 trillion.

It's easy to be dazzled by the figures. By 2020, Nielsen estimates, 400 million people in ASEAN will belong to the middle class, more than in Brazil, France, Germany, the UK and the US combined. GDP in the region is expected to rise by 6 percent per annum between 2011 and 2016. The demographics favor ASEAN, too: in the coming decades, it will have more prime-age adults (between 25 and 54) than ever before. Add in the optimism that pervades consumers in many of these countries and you can see why some companies might overlook the very real challenge posed by the region's cultural, legal, political and economic diversity.

The 10 ASEAN countries harbor vast differences in wealth (Singapore, the richest, is more than 50 times wealthier than the poorest, Myanmar); in population (Indonesia's 248 million dwarfs Brunei's 420,000); in religion (Myanmar is predominantly Buddhist,

Indonesia is mainly Muslim, the Philippines is largely Roman Catholic); and in political and economic systems (democracies and dictatorships, communism and capitalism are in close proximity). Understanding these differences is important to any business operating in the region.

### Nuanced strategy

The old-school approach for multinationals looking to tap into the ASEAN market was to set up an HQ in Singapore and assume the challenge was sorted. Yet Ian Thornhill, Advisory Director at KPMG in Thailand and Myanmar, says that brands need a much more nuanced strategy if they are to flourish across the region. "Companies need to study the subtleties of consumer demand. Some international brands will acquire, or work with, a local partner to understand different markets and grasp the balance of quality and price the customer is looking for," Thornhill said.

“For example, they need to consider prices and the size of the products they’re selling. In some poorer markets, they might be better off selling sachets.” One advantage for Western brands, according to Thornhill, is that they are perceived as being of higher quality than local ones, “yet they still need to be affordable. For example, one globally famous premium ice cream brand effectively withdrew from the Philippines market after 12 years.”

As critical as price points can be in ASEAN, they aren’t the only conundrum that consumer goods companies must face. “Distribution and access to market can be a challenge,” said Yasuhide Fujii, Managing Partner at KPMG in Myanmar. “Local supply chains can be quite complex and it can be difficult to access certain parts of the country.”

Some markets are more open than others, which is why WHSmith has opted for a joint venture in Malaysia and appointed IDP as a franchise partner in Indonesia. “Many people like to think that going direct is the best answer in the long term,” says De Bourgoing,

“and they may be right. But running a joint venture can be effective because there are always things you don’t understand and it is an interesting challenge to have to agree – and align – with a partner. You provide the expertise and the best practice and they have the local knowledge to help you make fewer mistakes.”

One mistake Western brands can make is to extrapolate the factors that drive their developed markets to the ASEAN region. Omnichannel is a troubling reality in most Western retail markets, yet it is not so important in Southeast Asia, according to Terry O’Connor, CEO of the furniture, electrical and IT retail giant Courts Asia. “In some countries, shopping is seen as an irritation; in ASEAN it is a pastime,” he said. “In Singapore, the mall is a social anchor, with food courts, cinemas and kids’ theaters. E-commerce accounts for [only] around 1.1 percent of retail in Singapore, less in Malaysia and Indonesia.”

O’Connor is not arguing that the ASEAN consumer market is protected

by some kind of exceptionalism. The group has just revamped its online offering, eCourts, and he believes e-commerce can help the company move into new territories. But he is also convinced that the region’s shopping culture gives retailers such as Courts longer to adapt than equivalent companies in the West.

On its homepage, Courts makes much play of its promise to the community. Corporate social responsibility statements are familiar in the West but have particular resonance for Western brands looking to move into ASEAN. “It is important that companies show that it’s not entirely about their own business,” said Fujii. “American companies investing in Myanmar, for example, have set a high standard for responsible business conduct, working with partners and NGOs to improve the quality of life for the Myanmar people.”



## Gold rush mentality

Western brands would also be foolish to overlook the political uncertainties that affect such key markets as Myanmar and Thailand. Even so, the opening up of Myanmar has been spectacular, with 15 US companies – including Gap – investing there in the past year. Most recently, Colgate-Palmolive acquired a local toothpaste maker. But what some analysts see as a gold rush mentality has sent real estate costs rocketing and prompted some potential entrants to wait for the market to cool down. “The growth is coming, but Myanmar is a long-term play,” said Fujii. “In the short term, you may see better growth from other ASEAN countries that are starting from a higher base.”

So it may be no coincidence that these markets are the priorities both for WHSmith, a global retailer making inroads into ASEAN and the Singapore-based Courts. The latter is already the second largest player in its sector in

Malaysia but O’Connor says the company is determined to keep expanding. “We aim to grow our footprint in Malaysia by an average of six stores a year,” he tells ConsumerCurrents. “On top of that, we have just entered the Indonesian market with our largest ever ‘big-box’ megastore in Bekasi.

“Indonesia is a very exciting market,” he added. “The consumer segment has seen a very strong emergence as there are about 135 million middle-class consumers. We’re looking forward to being a long-term player in the country. There is a lot of scope for players like us to bring something different to the market.”

WHSmith has targeted the same markets in the same order, but using different models: Malaysia through a joint venture with Bison, followed by Indonesia through franchisee IDP. Though De Bourgoing is instinctively reticent when asked strategic questions, the modus operandi seems clear. Get a foot in an ASEAN market, learn the right

lessons, and then, when it is stable and the moment seems right, look for the next market. “The good thing about retail,” he told ConsumerCurrents, “is that you can test, adapt and react.”

## Huge achievement

Whereas Courts covers more sectors as a retailer, WHSmith is something of a specialist. In ASEAN, its focus is on travel essentials – from neck pillows (its bestseller) and soft drinks to books and magazines – yet the strategy for growth is not dissimilar. Courts, which opened its first store in Singapore 40 years ago, moved into Malaysia then Indonesia. The Philippines and Vietnam are now of particular interest.

This is also effectively the strategy noted by Fujii: “Given the differences in consumer tastes across the region – and the challenges supply chains can pose – many companies look to establish a hub and export, or move into, neighboring markets.”



Conventional wisdom suggests that, for multinationals, it can take a long time to profit from emerging economies. Yet De Bourgoing says WHSmith's first store at Kuala Lumpur airport – a photograph of which hangs on his wall in his London head office – was trading profitably from day one. The company's international division is now 5 years old – he previously spent a decade building up a similar business for Lagardère – and is growing fast. This is not, he added, due to any particular genius on his part: "If you're selling travel accessories at an airport in Malaysia, where traffic is growing by 12 percent a year, all you have to do is get on the train."

Will the single ASEAN market help that train accelerate? O'Connor is cautiously optimistic. His company saw revenue increase by 4.6 percent in the year to March 2014, although profits fell by 31.6 percent due to increased costs – in particular, the credit difficulties of

some customers. "Confidence levels across the region are robust," he said. "Being realistic, 2015 is the first step on a journey but if it brings down barriers, makes the ASEAN market more open and encourages investment, it can only help the expected economic expansion."

By the end of 2015, ASEAN aims to have created a single economic market, to be known as the AEC, built on a collective population of around 625 million and a GDP worth about US\$2.4trn.

O'Connor's optimism is shared by the respondents to the Economist Corporate Network's survey in 2013. When asked whether ASEAN will build a true single market by 2015, only 6 percent said yes. But a further 89 percent expect it to be completed eventually. As Pushpanathan Sundram,

Managing Director for Asia of EAS Strategic Advice, said: "Remember that the goals for the ASEAN Economic Community are very bold. Even if they only achieve 70 percent of their targets by 2015, that will still be a huge achievement."

If ASEAN were a country, it would be the world's fourth largest economic power. With most members expected to enjoy growth rates that would leave developed countries dollar-green with envy, ASEAN offers an opportunity that seems too good to resist for many Western brands and retailers. Yet multinationals eyeing the region could do worse than heed De Bourgoing's advice: "Be organized. Be patient: there are complexities that will take time to resolve. And be optimistic: these are dynamic markets with a lot of resources, people and potential."





# GROWTH HORIZON





# What's next for High Growth Markets?

**The speed of change in the world's growing markets** has been unprecedented. In this article, we take a brief pause for breath and consider some of the issues that investors need to consider over the coming years.

## Markets are not homogenous

When the concept of emerging markets and BRICs first began to take off, there was a tendency to lump these countries together as a single collection of fast growing economies with seemingly unlimited potential. Today, with growth stalling in some nations such as China, and even negative in others like Brazil and Russia, a more selective approach is called for – one that takes into account the differing rates of growth and varied economic characteristics.

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A selective approach to High Growth Markets is called for, taking into account differing rates of growth and varied economic characteristics.

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Markets can be grouped in a number of ways, including: oil and commodity exporters (e.g. Brazil, Russia); oil exporters (e.g. UAE, Qatar, Venezuela); non-oil commodity exporters (e.g. South Africa, Indonesia, Malaysia, Peru); oil importers (e.g. India, China, Indonesia); food producers (e.g. Kenya, Brazil, Turkey); exporters of manufactured

goods (e.g. China, Thailand, Korea, Czech Republic); and consumption-driven economies (e.g. India, Singapore, Brazil).

Falling oil and commodity prices have laid bare the over-dependence on a single source of revenue for countries such as Brazil, Russia and Venezuela. At the same time, cheaper energy imports have enabled countries like Indonesia and India to slash their huge fiscal deficits, freeing up capital to fund bold structural forms.

Some countries have clearly managed to achieve a faster pace of growth over a considerable time period, and are distinguished by heavy investment in infrastructure, more sophisticated regulatory environments and tax incentives to foreign investors. Many states have yet to establish clear strategies for growth that offer competitive advantage, while others could still be described as frontier markets, including Myanmar, Mongolia and Cuba.

## Established models of success may need a rethink

Many 'tiger' economies have expanded rapidly through the export of

manufactured goods based upon low-cost labor. As consumption in developed markets stabilizes, newly emerging markets such as Myanmar need to consider the most appropriate national business models. Will their success be based solely upon manufacturing? Or should they be thinking about alternatives such as intellectual capital?

Sustainability is also taking on much greater importance, as High Growth Markets seek to create more resolute, inclusive societies. This represents a huge opportunity for investors, particularly multinational companies, to develop more efficient operations that use less power and water and reduce waste, and contribute to society as responsible employers.

## The continuing talent dilemma

Despite the vast numbers of individuals entering the working population across the world's emerging markets, many key skills remain elusive. At a more senior level, organizations are crying out for experienced talent in a range of professions as well as in general management. Perhaps even more pressing is the dearth of 'technocrats'

in the form of tradespeople and factory workers, which can slow down the pace of change and add frustration to daily life.

All governments are aware of the value of education, but the cost and quality of schooling, universities, apprenticeships and on-the-job training remains a barrier. The most successful corporations recognize the value of cross-fertilizing talent by moving their best workers around the world to create a global, multicultural pool of expertise and experience that can pass on knowledge to local employees.

But it's not just skills that are in short supply. The innovation culture that has powered some of the world's leading companies is noticeably lacking in countries like China and India, which tend to excel at reengineering and cost-efficient operations but have yet to come up with consistent, world class breakthroughs in technology, healthcare and industrials.

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Despite the vast numbers of individuals entering the working population across the world's emerging markets, many key skills remain elusive.

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## Technology changes the game

Although playing catch-up in many traditional industries, High Growth Markets have the potential to become leaders in new, exciting and technology-powered sectors. Mobile financial services are developing quickly in countries where large portions of the population do not have bank accounts. Tele-health is another promising area, especially in more remote, rural regions where access to traditional medical services is limited.

These and other innovations can help to leapfrog traditional approaches favored in mature nations and lead to lower-cost

provision that is less dependent on expensive facilities. The high proportion of young citizens in the developing world should also accelerate the adoption of technology, as this group is typically faster to embrace all things new.

## Low cost of capital can fund growth

The abundance of cheap money in mature markets – designed to stimulate flagging economies post-recession – offers an excellent opportunity for companies in emerging markets to invest in growth and productivity and for their governments to fund infrastructure. Although borrowing would raise debt levels and increase exposure to exchange rate fluctuations, it is a risk worth considering, given the current low cost of capital.

## A new set of risks

Investors in High Growth Markets are no strangers to risk, and are familiar with challenges such as resource nationalism, undeveloped regulatory regimes, weak talent pools, poor logistics, lack of transparency and restrictive bureaucracy. They must now address additional questions before making tough strategic choices on where to expand and locate facilities.

With tax authorities coming down on any activities perceived as avoidance, most notably through BEPS (base erosion and profit shifting), the relative attractiveness of countries for extraction, processing, manufacturing and distribution can change. And as production processes become increasingly automated, low labor costs take on less importance.

Companies must also ask themselves how much capacity to build in any one location. On the one hand, they need the flexibility to ramp up to meet a surge in demand. But on the other, rapidly changing tastes are shortening product life cycles, which can quickly lead to redundant capacity.







# OBSERVATIONS FROM AROUND THE GLOBE

**Our regional experts** take a quick look at the prospects in certain key countries and regions.

## **Southeast Asia**

One of the more interesting global economic forecasts is that, by 2025, more than half of the world's consumers will live within a five-hour flight of Myanmar. Statistics like this show the immense strategic importance of Southeast Asia and the ASEAN free trade bloc (discussed in greater detail on pages 42-45 of this publication), which should, over time, make it much easier to do business in the region, thanks to common regulations and reduced import and export duties. Singapore is already an important center for financial services and industrial innovation, and acts as a hub for entry into Indonesia, Malaysia, the Philippines and Myanmar.

However, the region could benefit greatly from greater financial integration. Most banks and other financial institutions operate primarily on a national basis, with national regulations, which restricts their ability to borrow and lend across markets, depriving governments and businesses of much-needed capital.

## **Africa**

Africa's size, diversity and youth offer a fascinating mix of 54 countries at various stages of development. Public-Private Partnerships (PPPs) are on the rise, funding infrastructure, healthcare and education, while free trade initiatives such as the Africa Tripartite Agreement are opening up the

movement of goods and people. This is a welcome development. Africa's biggest trading partner is Africa, yet in some instances goods have to be shipped out of the continent to France and then back to Africa to overcome restrictive customs regulations.

A number of countries are benefiting from foreign direct investment from the US, Europe, China and India and China, although investors are keen to see improvements in ease of doing business and transparency.

## **China**

Fears of an imploding property market and declining growth levels should be placed in the wider context of China's



enormous potential. The People's Republic is still registering annual GDP growth of around 7 percent, and with rapidly improving infrastructure, a strong manufacturing base and the world's largest consumer market, no multinational company can afford to be without a China strategy.

One issue yet to be determined is whether China can continue to be the world's workshop. As living standards rise, the country can no longer claim to be the low-cost manufacturer of choice. How effectively and quickly it moves towards higher-value sectors will have a big impact on its precise role on the future global stage. One thing is for sure: as a centralized, command-and-control economy, China has the ability to swiftly implement necessary changes.

## India

Narendra Modi's election as Prime Minister has revived hopes of an Indian renaissance, with promises of a more business-friendly environment to stimulate growth and the easing of restrictive regulations and incentives in many sectors. The current attitude is very much one of 'wait and see,' as the new government beds in and strives to implement its bold reforms.

The buying power of a fast-growing, young and aspirational middle class is a big factor in India's favor. Technology is at the center of people's lives, with a strong interest in online retail and social networking, which is likely to influence marketing and distribution strategies. E-commerce giant Flipkart was recently valued at over US\$15 billion, making it one of the world's most valuable privately-held start-up companies.<sup>1</sup> Airtel is the largest telecommunications company in India and the third largest in the world, operating in 20 countries across south Asia and Africa.

One sector to keep an eye on is defense. As it seeks to modernize its armed forces, India is set to become possibly the world's biggest defense spender, much of which is likely to come from domestic manufacturers. India is also trying hard to enter the ranks of the world's leading innovators, with a strong focus on mathematics and technology in the education system and an increasing number of multinationals locating R&D and knowledge centers in the country.

Infrastructure, for so long a hindrance to doing business, is slowly improving, with the emergence of major freight corridors that should reduce transport costs and times. Industrial townships should spring up around these regions. India's main weakness is manufacturing, which represents just 17 percent of GDP.<sup>2</sup> The current 'Made in India' campaign may be a useful starting point, but there is a long way to go before this sector can start to rival the services sector in terms of economic importance.



<sup>1</sup> Flipkart Valued at \$15 Billion After Latest Funding, Wall Street Journal, 19 May 2015.

<sup>2</sup> Manufacturing, value added (% of GDP), World Bank Data, accessed 3 June 2015.



# Opinion

**Constance Hunter**, KPMG's Chief Economist, answers the question: What's next for China?



China is home to the world's best performing stock market. The Shanghai stock exchange is up 130% over the past 18 months. Is China's equity market a leading indicator of future robust growth? Forecasts from respected institutions such as the IMF and the OECD suggest growth will likely slow slightly as China gradually becomes a middle income country that sees more and more of its economy come from the service sector. Meanwhile, some China watchers are betting that China will experience what economists call a hard landing brought about by a reversal in the price of collateral backing debt that has risen by 150% of GDP since 2007.<sup>1</sup> What outcome is likely to be correct?

A recent IMF Paper entitled *China's Growth: Can Goldilocks Outgrow Bears?*<sup>2</sup> takes a look at some the challenges China faces in the next phase of its development. Growth in economies dependent on fixed asset investment to support manufacturing and export-led growth is faster than more mature economies that have a greater portion of their growth attributable to the service sector. This type of growth, fueled by domestic and foreign investment in fixed assets, has propelled China's growth at an average of 10 percent for the past 25 years. However, it's not sustainable. As manufacturing know-how improves, economies strive for a higher value-added component of manufacturing. This, combined with labor shortages, usually leads to wage increases that over time push the lower skilled manufacturing jobs to other countries. In the case of China, a working age population of over 900 million people means this phase of development could go on for quite a long time as its pool of seemingly inexhaustible new workers moved from rural to manufacturing jobs and wage growth occurred at a relatively slow rate.

For the past decade, China's leaders have stated that evolving to an economy with a greater service sector that propels greater domestic demand (as compared to fixed asset investment led growth) is a primary goal. Getting there is not easy, especially when the default stimulus lever is encouraging fixed asset investment. Had the global financial crisis not occurred, China would have been unlikely to have engaged in the world's largest stimulus program; one that was dominated by fixed asset investment not programs to spur a services economy. Nevertheless, important changes are starting to occur. One important sign of change is that employment in the service sector has risen at a faster rate in 2014 than any previous year.

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**This type of growth, fueled by domestic and foreign investment in fixed assets, has propelled China's growth at an average of 10 percent for the past 25 years.**

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Transitioning to a services economy will mean slower growth rates in the years to come. Part of this has to do with a change in the structure of the economy and part of it has to do with the fact that China will be growing from a higher base, so while China will experience large changes in absolute growth it will be recorded as less staggering year-over-year changes due to the higher base. The big question surrounding the current slower growth rate is assessing how much of the slower pace is cyclical and how much is structural. That is to say, how much is due to the fall in property prices, which could lead to further deterioration in the collateral backing the recent run up in debt levels, and how much is merely due to China transitioning to a

more service-led economy. The answer to the question is important because the first would likely illicit a policy response to stimulate growth whilst the second would not. Further stimulus, if it comes in the form of encouraging more fixed asset investment, would only stall China's transition to a more mature economy. It would also likely exacerbate some of the imbalances that hinder the pace at which this transition takes place.

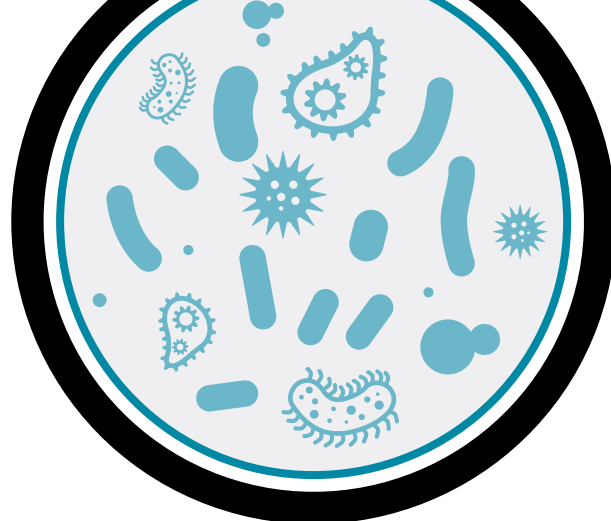
The IMF paper finds that China is near the peak of a powerful financial cycle and adjustment from this cyclical factor is both likely and needed to bring the economy closer to equilibrium.<sup>3</sup> It also notes that some of the current and anticipated future slowdown in growth is structural. The pace at which China converges towards a growth trajectory seen in more developed economies depends on the pace and manner in which structural reforms are implemented. Structural reforms have been implemented with varying degrees of success and failure in both emerging and developed economies over the past several decades. Even largely successful measure can be met with missteps and China is likely to make some mistakes and swing the pendulum too far in some cases.

However, while China is sure to hit some bumps in the road, it is still home to 1.3 billion people, many of whom are seeing their incomes rise and their opportunities expand. Potential GDP growth of between 5.5-7 percent over the next 5 years seems highly likely. This, combined with China's sheer size makes it a viable market, even if the near-term outlook presents challenges.

<sup>1</sup> McKinsey Global Institute, February 2015

<sup>2</sup> Working paper by Wojciech Maliszewski and Longmei Zhang, published by IMF, May 27, 2015

<sup>3</sup> IMF



# Off the cuff: BRICs and bugs

**Famous for coining the phrase 'BRICs,'** Jim O'Neill talks to us about progress in high growth economies, as well as another critical global issue: the rising threat of drug resistance.

## **BRIC has become a household phrase. How would you describe the impact of the concept?**

It's extraordinary. I never dreamt how dramatically influential the phrase would become as a symbol of a changing world. I suppose it just caught the right timing, where these countries' leaders were setting ambitious growth policies and multinational corporations were starting to sense the potential for serious investment. It wasn't that investors had been unaware of the possibilities in high growth markets, but there was a tendency to view them as exotic and slightly dangerous and fraught with compliance and legal risk. By quantifying the sheer scale of opportunity, the notion of the BRICs helped change the thinking of many internationally minded businesses, and made them more determined to be a part of this global growth phenomenon.

## **Since 2001, when you first introduced the acronym, how have the four BRICs performed against your expectations?**

Despite some well-publicized recent setbacks, by May 2015 each of the four

BRICs, in US dollar terms, is still way bigger than any of our initial scenarios. The first decade in particular was spectacularly successful, even for Brazil, which was considered the weakest of the bunch. However, the two resource-dependent countries, Brazil and Russia, are having a disappointing few years. Both are struggling to prove that their growth is due to anything more than beneficial commodity prices. China, though, is in a league of its own. It is one-and-a-half times the size of the other three put together. Even if India grows faster than China in the next 10 years or so, China will have effectively created three new Indias in the same period. The other exciting development is the new development bank, which also includes South Africa. Together with the Asian infrastructure bank, this is symbolic of changing governance in the world economy.

## **Talking about China; how soon could it be before the People's Republic is no longer considered a high growth market?**

That's an interesting question to ask investors. By the end of 2016, Apple expects to sell more iPhones in mainland China than in the US. If the world's

biggest company sees China as its largest market, then the lines between developed and developing are becoming increasingly blurred.

## **Do you think that the focus on BRICs has been at the expense of other high growth markets? Or has it benefited them all?**

Very much the latter. I think it has opened up minds to attractive markets everywhere, including the MINTs (Mexico, Indonesia, Nigeria and Turkey), which all have young populations and favorable geographical locations.

## **So, could any of these become future BRICs?**

It is important to remind ourselves of the original requirements of a BRIC, which is to have the potential to reach 5 percent of global GDP. With the possible exception of Indonesia and perhaps Mexico, no other country could achieve the critical mass needed to reach this goal. Outside of the big four, only Mexico has a GDP of more than a trillion US dollars. If Africa started to behave as a true economic unit, and really boosted its intra-continental trade, then there could be an argument for seeing it collectively as a contender.

The big unknown is Nigeria, which has spectacular demographics (its population is forecast to exceed that of the US by 2050), but has yet to overcome some deep structural and cultural challenges.

### **Have mature markets anything to fear from the rise of the BRICs? For example, in terms of rising demand for scarce resources?**

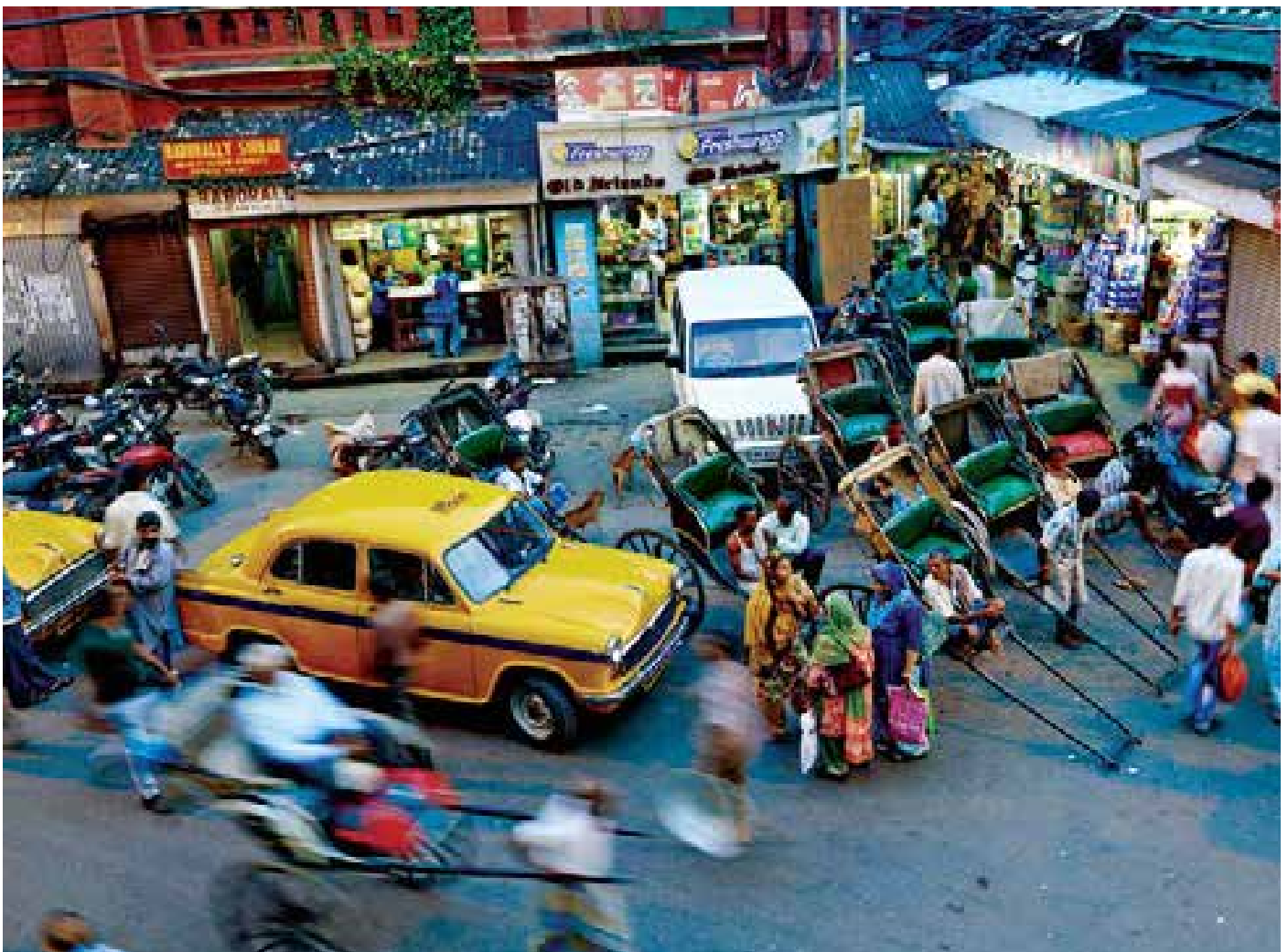
Rather than worry about the competitive threats, governments and corporations should embrace the incredible opportunities. Witness the UK government's eagerness to sign up to the BRIC investment bank. The last 12 months have seen a renewed focus in China on quality of growth over quantity, which is likely to result in a bigger consumer market for foreign firms to target.

### **What can established markets learn from BRICs?**

There are a number of lessons to be gained. Firstly the willingness to invest in infrastructure to fuel the future economy. China, in particular, is far more relaxed about using state money to fund critical projects. Every time I go there, I'm staggered at the progress they're making with rail, roads and airports. London's Heathrow airport, by contrast, is bursting at the seams, while in New York, you can't even get a train from JFK to Manhattan. Then there's the role of financial systems, which in the BRICs seem to act far more in the national interest. As we saw during and after the financial crisis, many mature societies are still struggling to define the role of banks and other financial institutions. Rather than supporting growth, they appear to be more preoccupied with quarterly returns for

anonymous shareholders. And thirdly, the US and the UK could emulate India and learn to deal with a disparate political environment and create some harmony, to replace the adversarial atmosphere that holds back sensible decision-making.

The BRICs can also gain by studying each other. China has been focused on investment to the detriment of consumption, whereas in India the reverse is true. China is now striving to boost its domestic expenditure, while the new government in India is making noises about creating a more investor-friendly environment. As China opens up, it could also try to emulate the way in which India manages a highly diverse population, with more emphasis upon personal freedom, which should spur innovation.





# Jim O'Neill's **10-point plan** to combat anti-microbial resistance (AMR)



- 1 Wash our hands more.**
- 2 Embark on a massive global PR exercise.**
- 3 Stop using antibiotics for animal growth promoters.**
- 4 Explore the scope for using vaccines.**
- 5 Improve dramatically surveillance of resistance.**
- 6 Utilize state-of-the-art diagnostics.**
- 7 Improve the numbers and pay of those studying AMR.**
- 8 Create a global innovation fund.**
- 9 Make AMR a priority for China's G20 leadership.**
- 10 Develop some big new drugs.**

## You've recently turned your attention to the challenge of drug-resistance and its effect on the world economy. How did you get involved in this area?

I was approached out of the blue, really, and asked to lead a review on anti-microbial resistance (AMR), reporting to the British Prime Minister. To be honest, I knew very little about AMR, but I was soon convinced that it was arguably the biggest threat to world health over the next 30 years. My team's task is to help find a set of solutions by September 2016. Resistance cannot be solved without the BRIC countries, given their vast populations and important place in the world. China has an incredibly timely opportunity as it chairs the G20 in 2016, and I'm in discussions with relevant policymakers, as well as those in India, to try to elevate AMR as a major focus. This is an historic moment that we can't afford to miss.

## Could you quantify the scale of AMR?

A recent report, involving findings from the review team and produced by KPMG predicts that drug-resistant infections

could cost the world 10 million extra deaths a year and up to US\$100 trillion in lost output by 2050. This will be hugely damaging to all economies, but especially so in lower income regions struggling to improve living standards. The worst case scenario for Africa, for instance, is a loss in GDP of US\$2.9 trillion by 2050; that's a fifth of the continent's total economic output.

## You've already come up with some suggestions on addressing the problem. Talk me through some of them.

On the supply side, there are simply not enough new drugs coming through, and we're becoming increasingly resistant to the ones we have. So we need some radical new ideas to ramp up early stage research. A global innovation fund would be a good starting point to fund research and start-ups. Governments and multilateral agencies can't be expected to shoulder the entire burden, and the pharma industry needs to put up a fair share of the cash. We estimate that 10 new drugs could be developed within a decade at a cost of US\$25 billion. To put this figure into perspective; that's just 0.03 percent of global GDP.

Tackling demand is arguably even more important. There has to be a massive PR and education program to convey the seriousness of the challenge, stop antibiotics being treated like sweets and make sure that patients take their full course of tablets. Diagnostics can play a big part, so that doctors and medical practitioners can stop guessing, and start prescribing more accurately. I call this "Google for doctors" – installing state-of-the-art technology in surgeries. When I was in India recently, I met some fantastic diagnostics companies which process blood samples from some of London's leading hospitals, and get results back faster than can be done within the UK. We have invited the CEO of one of these businesses to be on our advisory board.

The AMR challenge is frightening, but in many ways, perfect for me. It's relatively short-term in its scope, it's global and it's all about economics. I hope I can sit here with you in 5 years' time and report on significant progress.







# THE WINNER'S CIRCLE

Great opportunities are emerging in India

Prime Minister Modi envisions a stronger nation taking its place at the top table of the world's economic powerhouses.

The news that India's growth rate had climbed to 7.3 percent in the year to March 2015 must have been music to the ears of the new premier, who has promised to rejuvenate the country's ailing performance. International Monetary Fund head Christine Lagarde even called India "a bright spot" on an otherwise fairly "cloudy global horizon."

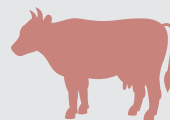
The administration's first budget eased restrictions on foreign investment in defense, insurance and construction, and pledged to secure US\$34 billion and US\$20 billion respectively from Japanese and Chinese investors, as well as reduce corporate tax from 30 to 25 percent.

These measures seem to be paying off, albeit with the benefit of a favorable, falling oil price. Although the new government is attracting foreign investors, it need to accelerate economic growth and job creation by embracing majority ownership, as well as make good on its promise to establish a common goods and services tax to replace the existing complex system that holds back domestic production.

India is the second most populous country globally and the world's fourth largest economy. Its diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries and a multitude of services. Economic growth following the launch of economic reforms in 1991 and a massive youthful population are driving India's emergence as a regional and global power.



70% of the world's spices come from India.



The world's largest producer of milk, India recently overtook the European Union with production reaching over 132.4 million tons in 2014.



India is the world's largest producer of tea and dried beans, such as kidney beans and chickpeas. It also leads the world in banana exports.



India has the world's third largest road network at 1.9 million miles. It also has the world's second largest rail network, which is the world's largest civilian employer with 16 million workers.

**Population:**

**1.236**  
billion

**Demographics:** 28.5% (0–14 years); 65.7% (15–64 years); 5.8% (65 years and over)

**Major cities:** New Delhi (24.95 million); Mumbai (20.74 million); Kolkata (11.77 million); Bangalore (9.72 million); Chennai (9.62 million); Hyderabad (8.67 million)

**Regions:**

**29 states**  
Seven union territories

**Local currency:** Rupee (INR)

**GDP:** GDP in 2014 was

**US\$7.2 trillion**

and is expected to grow by 6.4 percent annually from 2014–18, partly owing to acceleration in investment spending.

# BACKSTORIES

Heard around the world

// Talent used to flow one way. We sent in the talent to get these investments going. But now we're also developing a **global talent pool**, a two way flow of high potential people with a great background in international business. You might take an executive from China or India and move them to (Western Europe) or the U.S. where the **knowledge exchange** is two way. //

**Senior executive** at a large technology company

// **95%** of the GROWTH coming from the ENERGY sector is in High Growth Markets. //

**Mark Barnes** at KPMG's Global Energy Conference in Houston, May 2015

Follow Mark @markbarnes\_KPMG

// Our survey of **539 senior #consumer execs** reveals that this year's top priority is expansion and top line growth. //

**Willy Kruh**, Chairman, KPMG's Consumer Markets

Follow Willy @WillyKruh\_KPMG

// Our entire company was founded on **emerging markets**. Many of our customers are MNC's themselves with operations around the world. They have an interest in seeing us having **resources** in all locations where they are operating. So our move into China was driven by our largest customer. They wanted us to have a presence in China to **serve their Asian operations**. //

**Chief Financial Officer** at a global software engineering and development company

// The anti-corruption drive in **Brazil** is likely to work and to help Brazil's economy **improve meaningfully**. **Mexico** will become the next developed state in the world. //

**Ian Bremmer**, Eurasia Group on Geopolitics in an unstable world

Follow Ian @ianbremmer

// It is clear that the world's investing community is now fully focused on Africa and our investment into facilitating Market Entry into the continent is paying off. The days of talking about Africa's potential are behind us and it is now time for

**ACTION.** //

**Bryan Leith**, COO, KPMG in Africa

// Good to see India tracking **#growth**.

However it's important the govt. take 5 large projects and make them & the MNC's successful for impact. //

**Richard Rekhy**, CEO, KPMG in India

Follow Richard @richardrekhy

// We're only in 10 countries (11 if you include the US), including Mexico, Chile, Brazil, Hong Kong, China, Singapore, Malaysia, Indonesia and India – yet, **we cover half of the world's population.** //

**Chief Executive Officer** of a global financial group

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IN OUR NEXT ISSUE

## The Middle East: The oil states diversify

For foreign investors, the time has never been better to invest into the Gulf States, who are diversifying their economies and attracting new business sectors and industries. Our next issue will examine the global importance of this region and where the most lucrative opportunities exist.