



## Talking point



### BRICs as emerging international financial powers

January 27, 2010

The international financial position of the BRIC countries (Brazil, Russia, India and China) has improved beyond recognition, reflected largely in their large official FX reserves. However, as of 2008, only China and Russia were creditors in terms of their net international investment position. China is already the world's second largest net creditor, trailing only Japan. On current trends, China will not only replace the US as the world's largest economy over the course of the next two decades, but it will also replace Japan as the world's largest net international creditor.

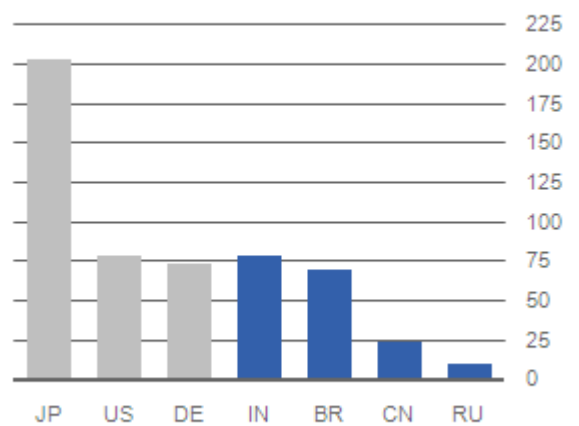
Rapidly rising G-3 government indebtedness has cast into sharp relief the financial rise of the BRIC countries, according to many commentators. While the G-3 governments are struggling to rein in record fiscal deficits and the rapid increase in debt, BRIC government debt has barely budged and fiscal policies remain, by and large, sustainable. While Brazil's and India's government debt levels are similar to those of the G-3, China's and Russia's public debt is much lower (see chart). Russia's debt might rise tangibly should the government be forced to deplete its reserve funds, but China's debt is poised to remain low for the foreseeable future.

But what about the BRICs' international financial position? Besides Japan, Taiwan, Korea and Hong Kong, the BRICs are the largest holders of official FX reserves. Combined BRIC FX reserves exceed USD 3 tr (equivalent to 1/3 of the world total). Holding USD 2.4 tr, China accounts for the bulk of BRIC reserves. The Chinese government is also the single largest holder of US government and agency debt. Underpinned by large current account surpluses, China's FX reserves will continue to grow rapidly – and much more rapidly than the reserves of the other BRICs. It is not surprising that 44% of Americans believe that China is the world's leading economic power.

Nonetheless, the exclusive focus on official FX reserves does not fully capture a country's international financial position. While reserve assets in emerging markets often account for the bulk of external assets, as they do in China and India where they account for 2/3 or more of total international assets, they make up less than 50% of Brazilian and Russian external holdings. Once both liabilities and non-reserve assets are taken into account, a more nuanced picture emerges.

#### G3 vs BRIC-4

Gross general government debt, % of GDP, 2009F



Source: Fitch



First, including equity liabilities and assets, only China and Russia enjoy a net positive international investment position (see chart). Amazingly, China's USD 1.5 tr net positive position only ranked second to Japan's net USD 2.5 tr and ahead of Germany's USD 0.9 tr. Russia, whose net position only turned positive in 2008, has a comparatively small USD 0.25 tr in net international assets. Both Brazil and India have a negative net international investment position.

Second, excluding equity liabilities and assets, the BRICs are either net international creditors or have only negligible net international liabilities (Brazil). This is almost also true if the external assets held by the private sector are excluded from, and the external liabilities of the private sector are included in, the calculation. This represents a very dramatic change compared with the situation in the 1990s and early 2000s when Brazil, India and Russia suffered major external debt and/or balance-of-payments crises due to a very weak net

international financial position. The much improved external position is the main reason why the BRICs weathered the global financial shock relatively unscathed from an external sustainability point of view.

Third, in spite of large FX reserves, total BRIC gross external assets remain small compared to most advanced economies. US international assets amount to USD 20 tr; Germany and France both hold USD 6 tr of international assets. By comparison, China's assets amount to USD 3 tr and Russia's to a mere USD 1 tr, while Brazil and India hold less than USD 0.5 tr of international assets. BRIC external holdings may be growing rapidly, but compared with the advanced economies they remain small.

No doubt, the BRIC countries' international financial position has improved beyond recognition during the course of the past decade. However, with the exception of China, they cannot claim international financial "great power" status yet. The BRIC governments' net international creditor position provides them with the ability to extend sizeable official credit to other governments (or countries) in pursuit of economic, financial and political objectives. It also allows them to lend support to domestic companies' outward investment strategy. Nonetheless, neither the size of their gross foreign assets (relative to the advanced economies) nor the size of their net international assets (relative to Japan and Germany, at least) qualifies them as financial great powers yet – China, again, excepted.

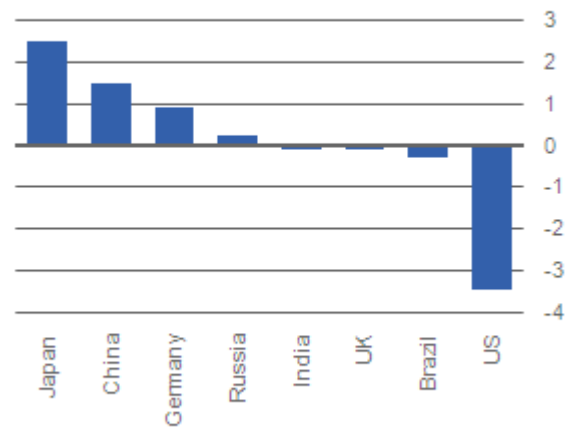
Recent trends in net external asset accumulation paint a very similar picture. In 2009, China's current account surplus, though smaller in dollar terms than in 2008, is set to be larger than the combined surplus of Germany, Japan, Norway and Russia. It will account for a full 1/3 of global net capital exports (up from 1/4 in 2008). Both Brazil and India are running, and will continue to run, current account deficits. Meanwhile, Russia's net capital exports are not only significantly smaller than China's, but their sustainability heavily depends on continuously high international energy prices. China's net capital exports appear substantially more sustainable, international criticism of its exchange rate policy and the risk of protectionism notwithstanding. Leaving aside valuation changes, China's net international position will continue to improve at a dramatic speed over the next couple of decades.

China is an economic and financial superpower in the making. It will still be a few years before China replaces Japan as the world's largest net creditor. However, on current trends and barring a major "accident", China will have replaced both the US as the world's largest economy by the middle of the next decade and Japan as the world's largest net international creditor even earlier than that. The other BRICs will undoubtedly play a more important international financial role in the coming years. But China will remain the primus inter pares until it emerges as the supremus mundi sometime around 2025.

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### China only trailing Japan

Net IIP, USD tr, 2008



Source: IMF



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