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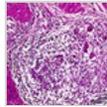
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ECONOMY | Updated March 7, 2012, 7:36 p.m. ET

# Emerging-Market Engines Falter

*Tempered Growth Outlooks in China, Brazil, Other Recent Drivers of Global Growth Spell Trouble for World Economy*

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By JOHN LYONS in São Paulo and BOB DAVIS in Beijing

Fresh signs of economic weakness in Brazil are adding to a growing worry for the global economy: that the emerging markets that have boosted growth in recent years are slowing.



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Agence France-Presse/Getty Images

Emerging markets are seeing slower growth. A Chinese steel mill, above.

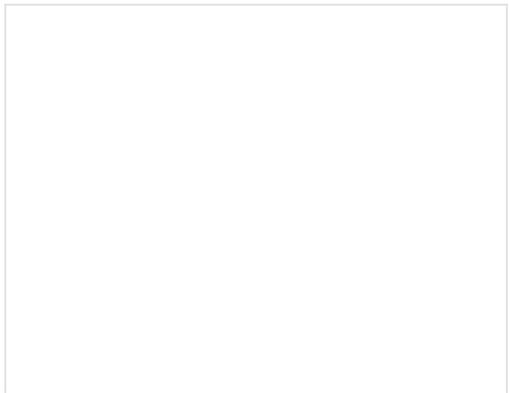
That is a big concern amid the drag of the European debt crisis and a sluggish U.S. recovery. Brazil, China, Russia, India and South Africa are among the dynamic economies that helped the world bounce back from the 2008 financial crisis.

This time around, they seem less likely to provide the same boost as they deal with problems such as strong currencies, inflation, deficits and real-estate bubbles.

Earlier this week, Brazil said its economy grew around 2.7% in 2011, less than half the rate the government predicted a year ago. And Wednesday, Brazil said industrial production fell 2.1% in January, the most since the 2008 crisis. Later, Brazil's central bank slashed its benchmark interest rate by three-quarters of a percentage point, a bigger cut than expected, to spur growth.

"The strain of carrying the weight of world growth on their backs has started to wear on the emerging market economies," said Cornell University economist Eswar Prasad, who has advised India and other emerging nations on economic policy. "The ability of emerging-market economies to contribute to a global recovery is being tested."

Growth forecasts are falling across the developing world. On Monday, China's Premier Wen Jiabao reduced the country's annual growth target to 7.5% after keeping it at 8% since 2005. Last week, India said its economy grew 6.1% in the final quarter of 2011, its slowest pace in two years. Economists expect South Africa's growth



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Soy harvested in Brazil.

to slow to 2.5% this year, a far cry from the 7% rate its central-bank governor, Gill Marcus, spoke of chasing just a year ago in order to dent high unemployment.

To be sure, most of the world's developing economies are still cruising faster than the U.S., Europe and Japan. Foreign investment in the regions is recovering, and rising commodity prices should help growth in resource-rich nations like mining giant South Africa and Brazil, a major exporter of iron ore, soy, beef and other goods.

"The emerging markets are still at the front of the train, but it's a slower-moving train," said Mohamed El-Erian, chief executive of Pacific Investment Management Co., which manages some \$1.3 trillion in bonds.

In 2009, he helped coin the term "new normal" to describe a global economy where emerging markets would consistently outpace developed world growth. Mr. El-Erian said his theory holds, though the onus is on European policy makers to resolve the region's debt crisis to prevent it from feeding into other regions.

But an important shift in the global growth mix has already happened. In 2010, economists spoke of a "two-speed recovery," where emerging-market economies zoomed ahead while rich ones stagnated. Now, both the haves and the have-nots are slowing. In January, the International Monetary Fund reduced its 2012 emerging-market forecasts from just three months earlier by 0.7% to 5.4%. The bloc grew 6.2% in 2011.

A collection of factors explain the slowdown. China is purposefully decelerating to a more sustainable growth rate. Export flows to Europe, and the U.S. are slowing, as are flows of commodities to China. In some poor nations, much-needed economic reforms stalled amid an expectation permanently higher growth rates had already been achieved.

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A slowdown in China—the biggest trade partner for Brazil, South Africa and other commodity exporters—will be felt across the globe. China buys iron ore and soy from Brazil; more iron ore plus magnesium, copper and other metals from South Africa, and ash and copper from India. Not to mention cars and luxury goods from the rich world.

China's economy grew at an average rate of 10% for 30 years—something no other country has ever accomplished. But the growth model relied heavily on three pillars that are each now under pressure: exports, investment in capital-intensive industries and real-estate appreciation.

The Japanese investment bank Nomura estimates China's February exports fell 15.2% compared with a year ago as markets in the U.S., Europe and Japan wobble. Apartment prices in China's biggest cities soared so much they are now out of reach for much of the population, undermining the boom and creating policy headaches for leaders.

Now, China's leaders are making clear that the years of 10%-plus growth are coming to a close. The idea is to shift to growth that depends more on domestic consumer demand. That could give China a sturdier foundation for growth well into the future. But managing the transition while still creating new jobs is tricky.

In Brazil, the government officials blame the U.S. and Europe for lowering interest rates, and sending a wave of speculative cash its way, overvaluing its currency and hurting its competitiveness.

But many of the country's problems are home-grown. High tax rates, poor roads, a

oversupply remains a problem.



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sprawling bureaucracy and endemic corruption make Brazil one of the most expensive places in the world to produce things.

The result is that Brazil's increasingly uncompetitive industrial sector is dying a slow death while its commodity exporters and service providers like restaurants and movie theaters are doing well. This is a troubling trend because manufacturing is where the good jobs are created in a poor undereducated population like Brazil's.

Brazil's biggest manufacturing group, the National Industry Confederation, issued a statement calling Brazil's economic outlook "alarming" this week. Brazil's industrial base is contracting: Production of durable goods fell 7.6% in January from a year ago.

The slowdown carries enormous political stakes for the government of President Dilma Rousseff, who campaigned on job creation through fast growth. In a Feb. 22 interview, Finance Minister Guido Mantega promised a range of measures to spur growth, from more lending to infrastructure spending and lower interest rates.

The 5.5% annual growth rates Mr. Mantega forecast for the future are no longer in the cards, many economists say. The consensus for 2012 is 3.3%. "Our goal is still between 4% and 5%," Mr. Mantega said.

India is also wrestling with the fallout from slower-than-predicted growth. Some analysts say it was caught off guard by its slowdown, which made expensive promises of social spending and fuel subsidies harder to afford. A year ago, India predicted it would notch 9% growth for the year ending March 2012, its fiscal year. Recently it cut the forecast to 7%.

The government will be hard pressed to pay for the subsidies without opening up wider budget deficits. But the government may be forced to go deeper into the red to fund more subsidy programs to maintain popularity.

"Here's a country that has potential to do a lot more, but because of government myopia and inaction it is suffering," said Rajeev Malik, senior economist at CLSA Asia-Pacific Markets.

South Africa is also slipping below its government's more optimistic forecasts of 4% annual growth made last year, hurt by its heavy reliance on Chinese commodity purchases. Mining production shrank by 13% in 2011, crimping growth to 3%. The declines complicate the nation's bid to provide jobs to a population facing a 24% unemployment rate.

"The immediate challenge we face is ensuring the current situation does not deteriorate," South Africa's Finance Minister Pravin Gordhan wrote in an op-ed in Wednesday's Business Day newspaper.

—Patrick McGroarty in Johannesburg and Amol Sharma in New Delhi contributed to this article.

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