Schroders Quickview: India and Brazil's future growth reliant on reform

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Latest GDP figures show the contrasting performance of Brazil and India, but both economies require reforms.

Brazilian GDP data reinforces need for reform

Brazilian GDP contracted 0.2% year on year in the third quarter, compared to a 0.9% contraction recorded in the second quarter. On a quarterly basis, GDP managed to grow 0.1%, ending the country's technical recession. The figures demonstrate the need for reforms aimed at revitalising investment.

A breakdown of the figures showed weakness coming through in investment, which contracted 8.5% year-on-year in the third successive quarter of declines. Meanwhile, consumer spending, previously a mainstay of growth for Brazil, contracted 0.3% quarter on quarter and barely grew in year-on-year terms, expanding only 0.1%. The main growth supports came from net exports and government spending. Reliance on the latter is a cause for concern given the need to reduce government spending.

High frequency data in the fourth quarter has been generally weak, with industrial production numbers and PMI prints pointing to continued contraction in the manufacturing sector, while retail sales are essentially treading water. The fourth quarter will likely be slightly weaker, capping a disappointing year for Brazilian growth.

In terms of the medium-term outlook, we were of the opinion that growth next year would be weak whoever won in October's elections – reforms take time and can be painful – and so the election result prompted no change to our 2015 forecast.

The longer term outlook, however, is gloomier, as we are sceptical of Dilma's commitment to reform. Nonetheless, should Dilma's cabinet propose, and be allowed to implement, credible reform plans, the growth picture for 2016 will improve. For now, corporates are still expressing reluctance to invest, waiting for clarity before they do so. Clarity can come only if reform plans are kept to despite economic pain. Consequently, if reforms are enacted and, importantly, not rolled back by the second half of 2015, investment should pick up. Today's numbers only emphasise how badly this is needed

India growth provides positive surprise

Indian GDP expanded 5.3% year-on-year in the third quarter of 2014, slower than the 5.7% expansion in the second quarter but beating City, and our, expectations. Though growth was stronger than expected, it was supported by government expenditure and private consumption. Investment and net exports were both much weaker than in the previous quarter, and this is a negative development in an economy with significant infrastructure needs and a recurrent current account problem. The reliance on government spending is also a concern given the tighter fiscal deficit targeting to come.

Higher frequency data has been reasonable in India and we expect growth to hold up in the final quarter. Presently, 2015 looks marginally stronger thanks to oil price weakness, and we expect some success on reforms to lead to greater investment, picking up momentum going into 2016. However, India still has supply-side bottlenecks (particularly in power and transport infrastructure) and a relatively poor investment environment, and recent export weakness is concerning.

The reform agenda remains the key to Indian growth hopes, and while there have been some moves forward, political obstacles remain. Prime Minister Modi has not had the free rein some expected given his strong mandate. The latest worry is that state governments are pressing for exemptions from the Goods and Services Tax (GST), a key piece of taxation reform. If too many items are excluded from coverage by this tax, it will lose its transformational value. Parliament reconvened on 24th November for its month-long winter session; its success in implementing economic reforms in this time, including the GST, will have significant implications for sentiment and prospects.