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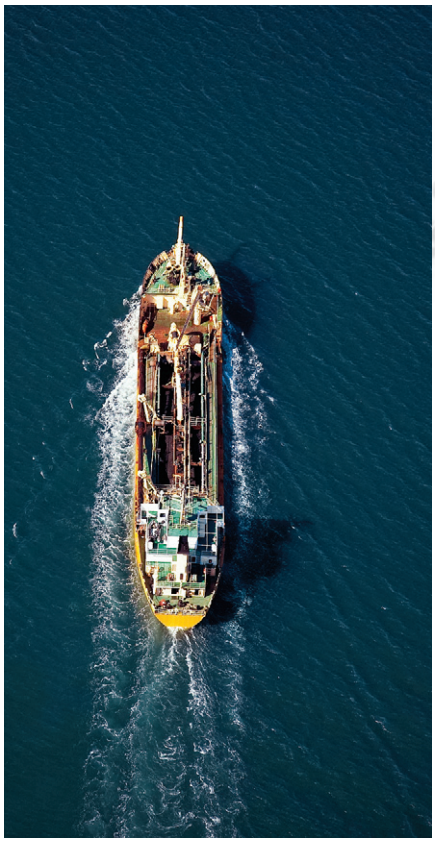

Investing in the Post-Recession World

Where companies should go for growth amid uncertainty

by Sage Newman, Courtney Rickert, and Ross D. Schaap

Opportunities for corporate growth in 2011 seem to be both everywhere and nowhere. The global recession is officially over, but it's still haunting much of the world. Government actions and contradictory economic trends further confuse the picture: Brazil is planning to spend while Australia is cutting back. Trade tensions are rising between the United States and China. Indonesia tempts inflation by keeping rates low.

Emerging market economies such as India are growing vigorously, offering hope for multinationals intent on expansion. Yet in virtually every country, negatives vie with positives, partly because of variation in how countries have managed the downturn. Are they stimulating their economies? Courting foreign direct investment? Imposing austerity?

Companies need a way to cut through the chaos and avoid pitfalls. Here we present a guide—based on an aggregation of political and macroeconomic factors—for determining where growth is likely, which governments are encouraging or impeding foreign investment, and which sectors in those countries provide the greatest opportunities.

Drawing on Eurasia Group's political analyses and on economic databases from sources such as the International Monetary Fund, we assigned scores to countries on the state of the macroeconomy (which affects issues such as consumer demand, labor unrest, and exchange rate stability) and on foreign investment policy (which affects multinationals' access to opportunities). We plotted the countries on a graph and divided them into four groups, ranging from least to most risky. Although other factors also matter to multinationals, we focused on those two issues because they are affected by political decisions, which can be difficult to comprehend and can change unexpectedly.

Some of the results are surprising. Chile, with its stability and transparency,

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A Global Map of Opportunity and Risk

Multinationals are emerging from the recession and beginning to look for opportunities to invest in global markets. But before targeting a specific country, managers need to understand the state of its macroeconomy and its friendliness toward foreign investment. This chart shows at a glance how various markets—emerging and developed—stack up. The arrows signal improvement or deterioration in countries' foreign-investment policy environments.

comes out ahead of perennial investment favorite Brazil. China has a more-favorable investment environment than India, but that gap is likely to close as India's government implements a variety of policy changes.

How We Assigned Scores

To assess a country's macroeconomic condition, we drew on data that correlate with economic conditions, including GDP growth, inflation, exchange rate volatility, government budget balance, current account balance, and foreign exchange reserves. To evaluate a country's policy environment, we used political data and analysis from Eurasia Group. We measured how hospitable the policy and regulatory environment is for foreign investment by assessing the extent to which government policies (such as regulation) and practices (such as corruption) inhibit economic activity. For both macroeconomic conditions and policy environment, we used scales of 1 to 10, with 1 representing the greatest degree of risk and 10 the lowest.

As an example, an analysis of Spain's macroeconomic conditions reveals deterioration in several variables in the past year. For instance, the unemployment rate increased from 18% in 2009 to an estimated 19.9% in 2010. The exchange rate volatility of the euro also increased over this period, which decreases the stability of the macroeconomic environment. In addition, Spain's real GDP growth is slow in comparison with that of other countries: The IMF estimates that Spain's economy contracted 0.3% in 2010 and will grow only 0.7% in 2011. The government's policies have not helped Spain's macroeconomic condition: In January 2010 the government introduced austerity measures that included a decrease in public sector wages, increases in the value-added tax, and income taxes on high-income earners. Although the government is implementing austerity to appease bond investors, these policies limit consumer demand, while spending cuts keep public expenditures from rising to offset the decrease in demand. Thus Spain's macroeconomic score decreased over the past year. A variety of market indicators corroborate the deterioration in Spain's macroeconomic environment, including a 5.3% decline in the country's equity markets and a 16% increase in the government bond yield year-on-year to October 2010.

In the following pages, we will take you through a selection of emerging and developed markets where there is a potential for policy change or where our findings may contradict conventional wisdom.

Turn the page for a country-by-country analysis of risks and opportunities.

Forge Ahead

Multinationals investing in these countries can feel confident: Governments are promoting foreign investment, and the relatively strong economies mean that domestic demand will probably be substantial and labor unrest will be limited.

In the Asia-Pacific region, Australia's economy will continue expanding. In Europe, both Germany and Poland are expected to have positive macroeconomic and policy environments, but growth in Germany is expected to slow in 2011.

These countries are the most obvious choices for foreign investors, so competition for opportunities will be intense.

	Macroeconomics	Foreign investment	Sectors
Australia	Despite the expiration of stimulus measures, Australia's economy is projected to grow by 3.5% in 2011, aided by booming commodity exports. Investment and consumer spending are slowly rebounding, but currency appreciation is a concern for exporters.	Foreign investment will continue to play an important role. Contrary to popular perception, Canberra has not rejected any of China's 200 investment bids in the past three years. Australia is also exploring trade agreements with most Asian economies.	Although the investment environment is generally positive, an unclear carbon policy outlook clouds the prospects for the electricity and industrial sectors. And a proposed tax on coal- and iron-ore-mining companies could limit new mining investments.
Chile	Chile's economy continues to recover swiftly from the global financial crisis and the February 2010 earthquake. Growth is expected to be 6% in 2011. Inflation is predicted to remain low, at 3%, which gives the central bank room to raise rates gradually without threatening the recovery.	Chile remains one of the most open economies and may have the most predictable policy environment in Latin America, a situation that is unlikely to change anytime soon. The stability and transparency of Chilean institutions attract foreign investors.	The government raised taxes on most large corporations in 2010 to finance $8.4 billion in postearthquake reconstruction, which is likely to provide opportunities for infrastructure investment. Chile's currency appreciation hurts the competitiveness of exporters, especially in agriculture.
Germany	During the recession, Germany had the resources to stimulate its economy, and so its recovery has been stronger than those of other EU members. Growth is projected at 2%, but the country's eurozone trade partners are implementing austerity, which will constrain demand for German exports.	Reliable contract and competition enforcement makes Germany a stable investment destination. The tax regime is complex, but the government may simplify the corporate tax code in 2011. Labor costs are competitive, despite somewhat rigid labor-market regulations.	The government plans to increase spending on education and research to 7% of GDP by 2015, in part through grants to domestic and foreign businesses. In addition, the government is financing research and development in energy technologies, such as offshore wind farms.
Mexico	The Bank of Mexico estimates 2011 GDP growth of 3.2% to 4.2%. There are signs that internal demand is recovering, but inflation is high, at an estimated 4.4% for 2010.	Owing to the government's push for antimonopoly measures, Mexico will continue to attract multinationals. But organized crime makes it a riskier place for investment than other countries in the Americas. There were 12,000 drug-related deaths in 2010.	The government recently promoted telecommunications investment by allowing cable companies to provide phone services. In the energy sector, a 2008 law gives companies cash bonuses for technological transfers and timely contract fulfillment.
Poland	Poland's economy, forecast to grow by 3.7% in 2011, remains one of the strongest in the EU. Inflation remains in check, at 2.7% in 2010. The government will seek to avoid measures that would dampen consumer demand.	Foreign firms have strong positions in a range of sectors because of Poland's competitive corporate tax rates and substantial domestic demand. The government would like to implement additional market-friendly reforms but will wait until after the 2011 elections.	In preparation for hosting the 2012 European soccer championship, Poland has accelerated investments in stadiums, roads, hotels, and rail lines. State-controlled commodity firms are likely to look for foreign partners to help their technological development.
United States	It is expected that growth will be below 3% until 2012 and that inflation will remain too low to be healthy. Consumers are likely to stay cautious as they cope with high unemployment and a decline in household wealth.	Although trade tensions with China will continue through 2011 and policy makers are reworking the corporate tax system, there is little risk that the United States will turn sour on foreign investment.	President Obama's upcoming budget will seek to make permanent an R&D tax credit, which is most beneficial for high-tech industries. However, such tax credits are likely to be incremental rather than permanent, as policy makers focus on deficit reduction.

Tread Carefully

	Macroeconomics	Foreign investment	Sectors
Brazil	Brazil's economy is forecast to grow by 4.1% in 2011, with moderate inflation of approximately 4.6%. Growth will be driven by domestic consumption as credit markets expand for the country's ascendant middle class.	The government recently passed a measure allowing domestic companies to be favored in government contracting. And if the Brazilian real continues to appreciate, the government will face pressure to intervene again in currency markets—possibly by imposing additional capital controls.	The government has vowed to increase public investment in transportation and energy infrastructure—a commitment that will only increase as the country prepares to host the 2014 World Cup and the 2016 Olympics. Those areas are attractive opportunities for foreign investment.
China	Consumer demand benefited from China's stimulus spending. The country's economic growth, forecast at 9.6% in 2011, will let policy makers guide the overheated property market to a soft landing. Rising domestic consumption and exports will drive expansion.	Foreign investment continues to be a priority, but the government fails to protect intellectual property rights and limits market access for foreign firms in order to boost domestic ones.	The government unveiled a plan to make China the world leader in the electric vehicle market, earmarking $14.7 billion in investment over 10 years. The proposal has drawn criticism for favoring state companies while marginalizing foreigners and China's private sector leaders.
Colombia	Colombia's economy is expected to grow by 4.6% in 2011. Inflation has remained comfortably within the central bank's target and is expected to hold steady at around 2.6% throughout 2011. Consumer demand, especially in the retail sector, has been strong.	The center-right government of President Juan Manuel Santos is likely to continue pursuing market-friendly economic policies aimed at attracting and retaining FDI, especially in the burgeoning oil and gas sector.	Colombia is rising in the ranks of Latin America's oil and mineral producers, thanks to a recent surge in FDI. The country's improved security situation and favorable investment terms will continue to drive interest in oil, gas, and mineral exploration.
India	India's economy is expected to continue growing robustly in 2011, at 8.4%, according to the IMF. Meanwhile, the central bank has begun raising interest rates to slow core inflation, a measure that will dampen consumption and investment.	Given India's limits on foreign equity ownership, capital controls, and extensive licensing requirements, the investment environment can be difficult for foreign companies. However, the government may reduce corporate tax rates for foreign investors.	The government is poised to ease FDI restrictions in the retail and insurance sectors. India's use of public–private partnerships to expand and improve the national highway system creates opportunities for foreign investment in infrastructure.
Indonesia	Indonesia's surprisingly strong growth in 2010 is expected to continue in 2011, with expansion forecast at 6.2%. Growth will give the government more resources to invest in infrastructure, but domestic consumption, which has been the economy's main engine, could be hurt by resurgent inflation.	Private investment is a critical element of the government's growth strategy. President Susilo Bambang Yudhoyono has embarked on an ambitious three-year effort, including restructuring and privatization, to reform Indonesia's inefficient state-owned enterprises.	The government is promoting investment in utilities, especially electricity. Another growth area is green industries, particularly geothermal energy. The government is planning $20 billion of investment in this sector by 2025 and has improved regulations to attract other investors.
Saudi Arabia	Saudi Arabia's macroeconomic outlook is generally positive, with growth forecast at around 4.5% for 2011. Inflation, projected at 5.3%, is likely to continue exerting pressure but will probably not have a significant impact on consumer demand.	Although Saudi Arabia's business environment ranked 13th in the world in 2010, it placed 140th on contract enforcement. Progress on judicial reform is critical. King Abdullah has pushed to clarify and codify the Saudi legal system, but his eventual successor could disrupt reforms.	Saudi Arabia recently implemented a five-year, $385 billion development plan in a bid to diversify its economy and place Saudis in skilled positions currently held by foreigners. The plan offers opportunities in engineering, architecture, and other industries involved in infrastructure and construction.

Macroeconomic conditions in these countries are good, but the political environments are less favorable for foreign companies.

In South America, Colombia is more eager for foreign investment than Brazil, which is enacting policies to favor domestic firms. In Asia, both India's and Indonesia's investment environments are improving.

To penetrate these markets, multinationals may want to establish partnerships with local firms.

Pursue Opportunities

Macroeconomic conditions are weak in these countries, but governments are implementing policies that are favorable for foreign investors; external investment could eventually improve domestic demand.

Compare Bulgaria and Spain: They have similar policy scores, but Bulgaria gets demerits for corruption and opaque policy making, whereas Spain's score is partly a result of its slow response to fiscal problems.

With friendly policies and relatively inexpensive labor and other inputs, these countries may represent attractive sourcing locations.

	Macroeconomics	Foreign investment	Sectors
Bulgaria	Bulgaria is recovering slowly from the global financial crisis. The economy is expected to grow by 2% in 2011, and domestic demand will likely remain subdued. Inflation is forecast at 2.9%.	Low tax rates (10%) and labor costs have attracted many investors from Western Europe, notably Italy. However, corruption remains a significant impediment to doing business. In addition, a lack of transparency surrounding the government's budget and the country's halting efforts on health care reform will continue to cloud the policy environment.	The government has recently shown interest in green initiatives, raising funds from European investors to develop renewable-energy projects and announcing the creation of a green building code that will require international expertise. Experts have identified Bulgaria's potential for wind power, and the government hopes to promote opportunities for foreign investment in that area.
Hungary	The IMF projects that Hungary's economy will grow by just 2% in 2011, which is below expected regional growth of 3.1%. Household spending will be constrained by austerity measures and onerous mortgage payments on foreign-currency-denominated loans.	The economy is generally open to foreign investment, but the current government's hostility toward FDI in certain sectors has dampened the policy environment. Politicians have criticized previous governments for giving away too much to foreigners and have adopted a populist, antimarket tone.	The most notable bright spot has been the auto industry; Audi and Opel recently announced new investments. Banking, by contrast, provides fewer opportunities: The government imposed a temporary 0.6% tax on bank assets through 2012. Telecom, energy, and retail were also recently targeted for a 50% tax rate on profits through 2012.
Ireland	Ireland faces mounting challenges in 2011, including costly bank bailouts, a strict austerity budget, and a probable election in early 2011. Although GDP growth is projected at 2.3%, inflation is forecast at negative 0.5% in 2011, indicating weak consumer demand.	Ireland's low corporate tax rate of 12.5%, intended to woo foreign investors, has come under EU pressure. The government is unlikely to increase the rate in 2011, but the high budget deficit may force officials to reconsider.	The government's recently unveiled strategy for promoting investment and trade is intended to generate 150,000 jobs in manufacturing, tourism, and trade-related services through 2015. Officials will encourage foreign investment by removing anticompetition regulation in the professional services, transport, and energy sectors. Existing incentives include a 25% tax credit for R&D.
Spain	The IMF projects real GDP growth of just 0.7% in 2011, and the government is cutting social spending. Elevated unemployment and household debt, as well as reduced government expenditures and tax hikes, undermine consumer demand and the outlook for economic growth.	The government perceives foreign investment as important for economic growth but will likely remain averse to foreign takeovers of strategic sectors such as utilities. Despite labor reform in 2010, high labor costs and complex wage agreements are likely to continue limiting efficiency.	The government prioritizes private sector R&D and continues, despite recent austerity measures, to fund programs that promote research. Spain provides financing, technical support, and identification of partners for domestic and foreign firms in innovative sectors—particularly health, automotive, renewable energy, and information and communications technology.

Think Long Term

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	Macroeconomics	Foreign investment	Sectors
Nigeria	The economy is expected to grow by 7.4% in 2011, buoyed in part by a moderate uptick in oil production. Fiscal policy, however, will be challenged by growing pressure from state governments to draw down funds in an oil windfall account, as well as by election-related spending.	Nigeria has pursued liberal economic policies to attract investment, but obstacles such as multiple taxation, power shortages, and overlapping levels of bureaucracy impede foreign investment. Strict local-content rules in the hydrocarbons sector are likely to tighten.	It is unclear whether Nigeria's new oil-sector legislation will be sufficient to reinvigorate industry enthusiasm for the deepwater oil sector. The power sector may provide more opportunities—a proposed reform would privatize generation and construct a new transmission network.
The Philippines	Private sector investment, exports, and consumption will drive economic growth, projected to be 4.5% in 2011. Unlike other Southeast Asian countries, the Philippines depends on exported services (such as business process outsourcing and temporary workers abroad), which have been resilient.	The government's reforms will focus primarily on reducing the red tape constraining foreign investment. However, the current administration's strong ties to domestic businesses argue against significant liberalization in many of the country's major sectors.	Infrastructure—particularly toll roads and power—and mining could be among the major growth sectors as related policies stabilize. Much of the improvement will be due to increased domestic investment in those sectors by influential local players, which will lead to demands for better and more-predictable regulation.
Russia	Russia's economy is continuing to recover; the IMF forecasts GDP growth of 4.3% in 2011. Inflation was projected to hit 8% to 9% in 2010 and is expected to remain high in 2011. But domestic consumption is strong, supported by solid growth in disposable income.	Improving the investment environment—in particular, focusing on corporate governance, stemming corruption, and upholding the rule of law—is a top priority for President Dmitry Medvedev. Rhetoric notwithstanding, it is unlikely that there will be significant material improvement in the medium term.	The government has announced a broad but vaguely defined program to diversify the economy by, for example, increasing investment in knowledge-based industries. The government's focus is on the renewable energy, IT, communications, biomedical, and nuclear sectors.
Ukraine	Ukraine's economy is expected to continue recovering from the worldwide downturn. The 4.5% growth in 2011 forecast by the IMF depends on external demand for steel and other exports. Higher natural gas and food prices are boosting inflation, potentially decreasing consumer demand.	The government has taken few steps to advance its goal of improving the investment environment, leading to concerns about the government's commitment to such policies. A reformed tax code (including reduced corporate-profit taxes), going into effect in early 2011, may help, but businesses are not happy with some changes.	The government has sought outside investment for infrastructure projects for the Euro-2012 soccer tournament, as well as for boosting energy efficiency. Direct budgetary and regulatory support has been minimal, however. Improved Ukrainian–Russian relations will lead to further Russian investment, possibly in telecommunications, aerospace, and chemicals.
Vietnam	The IMF estimates that Vietnam's 2011 growth will be 6.8%, but the economy's expansion will depend on the global recovery. Much of the growth will come from greater trade and private investment. The government's challenge is to create a favorable environment without stoking inflation.	The government will continue its efforts to improve the climate for foreign investment. But progress will be uneven, in part because of the maneuvering between reformists and conservatives, who believe that slower reform will prevent shocks for domestic sectors and local interests.	Reform of state-owned enterprises and a public investment program will be among the most critical changes in 2011. The near bankruptcy of the country's largest shipbuilder and frequent power outages have strengthened the push for reforms. Export industries will also continue to receive positive treatment from the government.

Investing in these countries, where macroeconomic conditions are poor and government policies largely discourage foreign investors, involves taking on more risk.

Russia and Ukraine face some of the same uncertainties: Economic growth in both depends in part on external demand for their commodities—hydrocarbons and steel, respectively. But neither government is likely to substantially improve its foreign investment environment. The government of the Philippines is making slow progress toward improving the foreign investment environment.

There may be strategic advantages to entering these markets now in pursuit of long-term opportunities.

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