

COMMERCE

Can China rescue economies of Russia, Brazil?

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Ritz-Carlton Moscow

By JOE MCCARTHY

As Russia remains marooned in the West and Brazil's economy enters intensifying turbulence, China is lending a hand, further flexing its diplomatic might.

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Two countries that depend on the oil industry, Russia and Brazil have been hit hard by plunging prices. Add to that economic isolation and a weak ruble for Russia and corruption and social unrest for Brazil, and both economies begin to lose the luster of the emerging nation status they were afforded several years ago as part of the elite BRIC club.

"Both economies are so dependent on natural resources and exports," said Milton Pedraza, CEO of [Luxury Institute](#), New York.

"It's very tricky for a country because of the swings and dislocations that price changes can have," he said. "They both need to get off commodity addiction and into other areas that are futuristic and create jobs that are high value.

"They need something that has more upward mobility for their citizens."

Tightrope

Russia has the fifth largest economy in the world and is the largest producer of oil and

natural gas. Excluding the global economic crisis, the economy has grown steadily for the past decade, building a solid middle class.

In 2015, though, it is expected to contract 4 percent.

Several factors including rising inflation, falling oil prices, a crackdown on civil liberties and a prevailing ethos of cronyism would have all led to a slowdown eventually, but the invasion of Ukraine and the subsequent sanctions accelerated this dip.

The fraught relationship between the West and Russia has teetered for years. Although the mayhem in Kiev and the Crimean annexation roiled the world, the grating tenor of the ensuing diplomacy came from deep-seated distrust ([see story](#)).

With the United States at the helm, Western countries joined together to punish Russia with a series of sanctions targeting financial transactions, personal assets and exports and imports, among other things.



Breguet in Moscow

Since then, Russia has been fishing for an economic friend. The country is working on an international investment bank, it has set up a \$100 billion reserve fund to aid BRIC nations and it generally wants to reduce the supremacy of Western economic institutions, especially with the Trans-Pacific Partnership looming.

Recently, as the West protested Russia's annual World War II commemoration, president Xi Jinping of China sat alongside president Vladimir Putin, a symbolic gesture of the countries' growing interdependence.

Trade between Russia and the EU dwarfs trade between Russia and China, with more than five times as much money exchanged in 2012, but China wants to gradually close the gap.

In addition to guaranteeing purchases of expensive military arms, China is encouraging its banks to lend to Russia to make up for the vacuum caused by the West and plans to purchase upwards of \$400 billion of natural gas beginning in 2018 for 30 years.

Comparatively, the Europe imports well over \$100 billion in energy annually from Russia.

China has also signed trade deals covering infrastructure, agriculture and transportation with Russia.

However, the increased warmth between the countries should not be mistaken for an egalitarian relationship. China holds the upper hand and Russia ultimately wants to avoid becoming a sort of vassal state orbiting the Chinese economy.

"It's not long-term relevant," Mr. Pedraza said. "Chinese resources are not enough to compensate for European countries and their united boycotts and restrictions.

"The ones who are suffering are the everyday consumers who have nothing to do with the global poker," he said.

Where does this all leave Russia right now?

Ian Ivory for the Financial Times **writes** that the situation is not as dire as many assume, especially in Moscow where economic activity appears somewhat vibrant. In fact, solidarity among the public and media and an unstinting belief in the government's ability to navigate economic difficulty may act as a buoy.



Four Seasons in Moscow

Also, Western sanctions are not exactly crippling, being far more specific than those foisted onto Iran and North Korea.

Consequently, companies, especially luxury brands, doing business in Russia may not be facing as hostile an environment as expected.

In CBRE's latest report on retail expansion, Moscow ranked as one of the hottest cities in the world (**see story**). Of course, extrapolating Russia's economic situation from Moscow would be like using New York as the bellwether for the U.S.

Sprawling

In the other half of the hemisphere, China is offering assistance to a struggling South American economy, the seventh largest in the world: Brazil.

An economy traditionally fueled by oil and other commodity exports, Brazil slowed down

as prices fell and demand, especially from China, dried up.

For a few years, especially during the World Cup, Brazilians have taken to the streets to protest poor wages, shoddy public services, income inequality, bureaucratic corruption and other issues.



Hublot was a partner of the World Cup

Social unrest exploded when the public learned of the pervasive corruption at state-owned oil company Petrobras. Essentially, the oil giant paid kickbacks to droves of politicians, all the way up the political ladder, for attractive contracts.

"While the Petrobras scandals may have damaged Brazil's perception among investors, robust domestic consumer spending and on-going economic and political reforms mean the country's economy is strong enough to withstand these destabilizations," said William Palley, expert on Brazil and head of strategy and insights at [MindBodyGreen](#), New York.

"Marketers often overlook the fact that the interior and Northeast regions of Brazil are becoming the major engines of economic growth," he said. "Cities like Fortaleza and Recife in the Northeast are burgeoning economies with a rapidly expanding middle class.

"Considered as a whole, this growing consumer cohort represents billions of dollars of demand, as it comes to grips with newfound spending power and is eager to purchase premium products and services."

The government is seeking to placate the people by coming clean, while also taking tough austerity measures to stabilize the economy.

Around \$23.3 billion is expected to be cut from the federal budget, and economic growth is expected to slow to .9 percent this year.

"President Dilma Rousseff's government is also pushing ahead with reforms in response to recent protests," Mr. Palley said.

"She underscored her commitment to reforms in her victory speech this October and has been somewhat true to her word," he said. "This has played out well with Brazilian consumers, quelling discontent and fostering more positivity about the government and

the economy.

"Considered together, the growing spending power of the emerging middle class, combined with on-going political reforms and investment in infrastructure, will propel the Brazilian economy away from a deep depression."

China is also helping Brazil avert this depression.

The powerhouse country signed a deal May 19 promising a slew of agreements such as a deal for a railway system, the lifting of bans on certain Brazilian products and a \$1 billion dollar purchase of passenger jets.

Overall, the agreements will total around \$9 billion, bringing a needed infusion.

Chinese companies are also planning to build factories and begin infrastructure projects ranging from freight railroads, electricity and telecommunications networks.

"Brazil has been looking to reduce its dependence on the U.S. for some time now, and China's recent aid will expedite this process, helping to bolster the country's economy," Mr. Palley said.

"Particularly after the Snowden revelations that the U.S. was spying on Brazilian politicians, the Brazilian government has been looking to lower its reliance on the United States and establish closer ties with other major global economies," he said. "China's recent aid is one of several parts of a pivot away from the U.S. and toward Asia.

"For instance, earlier this year, President Dilma Rousseff announced that Brazil would join as a founding member of the Asian Infrastructure Investment Bank, a China-based institution that some people see as a rival to the World Bank."

Final Take

Joe McCarthy, staff reporter on Luxury Daily, New York

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