



Present:

**ECONOMIC-FINANCIAL REPORT n. 6 Latin America  
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**America Latina Area Director: Mr. Antonio Curia**

## **Brazilian Economy growth up to 0,20% in 2009, from a report of Focus magazine**

SÃO PAULO – the Banco Central (BC) managers expect a growth of 0,20% for the Brazilian economy in 2009, a little bit more positive than the last expectations of 0,18%. For the next year, the *Produto Interno Bruto* (PIB) of the *país* will be 4,83% and not 4,80% how previously reported.

About the last commercial balance, the Focus Report, by the BC, released on Monday, brought the projected surplus of \$ 25.5 billion, lower than the U.S. \$ 26 billion surplus envisaged in the report month.

The forecast for industrial production in this calendar was also revised, with a fall of 7.57% for a decline of 7.70%.

## **Late in, first out**

### **Brazil is the first Latin American country to emerge from recession**

Brazil is the first Latin American country to emerge from recession—and one of the earliest among the G-20 countries to have done so—following a 1.9% quarter-on-quarter expansion in economic activity in the April-to-June period. Whereas the global environment remains difficult and the export sector therefore continues to struggle, the strength of domestic demand has propelled the economy to the start of a recovery.

The second-quarter rebound came after two consecutive quarters of shrinkage (1% in the first three months of 2009 and 3.4% in the last three months of 2008), which had put Brazil into a technical recession. This relatively short recession was the first for Brazil since 2003. The quick economic rebound is attributable to the strength of domestic demand, particularly household expenditure, which grew by 2.1% in the second quarter. Exports of goods and services grew by 14.1%, while imports rose by 1.5%, government consumption grew barely, at 0.1%, while gross fixed investment was flat quarter on quarter.

### **Year-on-year shrinkage**

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On a year-on-year basis, the economy still contracted, by 1.2%, in the second quarter of 2008, though this was at a slower pace than the 1.8% shrinkage recorded in the first quarter. Private consumption increased by 3.2% year on year (up from just 1.3% in the first quarter). However, government spending rose by just 2.2%, the smallest increase for more than three years. Investment continued to fall back, with gross fixed capital formation down 17% on a year earlier (the sharpest such contraction since the data series began in 1996). Exports of goods and services fell by 11.4%, easing from the 15.2% decline of the first quarter. However, imports fell more steeply, by 16.5% compared with a drop of 16% in the first quarter.

**Domestic drivers**

Still, the finance minister, Guido Mantega, highlights the fact that Brazil was one of the last major economies to fall into recession in 2008, and one of the quickest to bounce back. This is testament, he says, to Brazil's strong macroeconomic fundamentals and effective fiscal and monetary policies. He expects the recovery to speed up in the third and fourth quarters; whereas GDP shrank by 1.5% year on year in the first half of 2009, he expects it to grow by 3.5% in the second. This would bring full-year growth to 1%.

The second-quarter result was somewhat stronger than the Economist Intelligence Unit had been expecting. As a result, we now see GDP growth finishing the year closer to zero, rather than our most recent projection of a 1% contraction. Brazil's growth rate will strengthen in 2010, assuming a mild global recovery, reinforced by the boost to household expenditure from monetary easing and lower inflation. This will also help investment to stage a (partial) recovery in 2010, supported also by a turn in the inventory cycle. Public spending will pick up with the approach of the October 2010 presidential election. We presently forecast that real GDP will expand by 3.3% in 2010, although this is below the Mr Mantega's current expectation of 4% or better.

**Fairly resilient**

The mildness of Brazil's recession—which is especially notable considering the high base of comparison—also reflects the high degree of diversification of the economy and trading partners, as well as the solidity of the financial system. The latter cushioned Brazil from the fallout of the global financial crisis that hit last year. And even though exports are down significantly from a year earlier, they account for just 13% of GDP—a much smaller share than in China, Japan and Germany (where exports reach around 40% of GDP). Consequently, the impact of the global demand downturn has been more muted for Brazil.

Indeed, various banks and credit-risk agencies have pointed to Brazil's resilience to external shocks as the reason to maintain its relatively positive credit ratings. Standard & Poor's and Fitch Ratings both assign an investment-grade rating to Brazil's sovereign debt, and Moody's is considering to upgrade its rating to the same.

Further, while the government has implemented counter-cyclical fiscal policies, the cost of these has not been very large. According to Mr Mantega, they have cost the equivalent of 1-1.5% of GDP, as opposed to 13% of GDP for China and 6.7% of GDP for the US. The stimulus measures have included seven consecutive months of interest-rate cuts that put the benchmark rate at a record low of 8.75% (an easing cycle that seems to have ended for now); tax breaks for purchases of cars, consumer durables and household appliances; and enhanced credit supplied by state development banks.

Given the relatively low cost of the stimulus package, Brazil's economy and fiscal situation will be in better shape than those of many other G-20 countries next year. Mr Mantega believes that the current fiscal stimulus will have run its course by the end of this year, by which time the economy will have its own growth momentum and will not need renewed fiscal support.

Brazil's quick recovery also will be good news for other neighbouring Latin American countries, whose economies are closely integrated with that of South America's behemoth. Argentina, in particular, could see expanded demand for its exports. Brazil's automotive sector, for instance, is

tied to that of Argentina, and has been experiencing healthy performance in recent months.

*(from The Economist, Oct 09)*

## **Tax that will drain Brazil's precious onshore liquidity**

*From Mr Marcelo Giufrida.*

Sir, Your editorial "[Fatal attraction](#)" (October 22) rightly points to the challenges faced by a successful Brazil. We agree that the government is wise to worry about the impact of excess global liquidity before it is too late. But we could not disagree more with your conclusion that a 2 per cent tax on portfolio inflows is a sensible policy response.

While in theory such a tax has the potential to put sand in the wheels of hot money inflows, the harsh reality is simply that it has not worked in the past.

In sharp contrast, its lasting damaging effects are potentially significant, in particular working against the goal of building liquid, deep and strong local capital markets.

The reality is that a successful Brazil is attracting the attention of global investors because it is fully integrated financially into the world. If asset bubble pressures are global, it is hard to imagine that Brazil will be the exception simply because it has a 2 per cent tax on portfolio inflows. More important, the tax does not apply to investors trading in Brazilian ADRs (American Depositary Receipts) in New York. Thus, the actual impact of the tax will be solely to divert trading away from the local markets, draining precious onshore liquidity. There are also sizeable costs. The additional premium in the long end of the yield curve is serious discouragement for the development of a genuine and liquid local debt markets.

Now we are moving in reverse at exactly the time when Brazil's tested robust regulation and financial infrastructure makes the country a potentially relevant financial hub in the region. More importantly, Brazil's capital markets are increasingly fulfilling their role as an effective tool for financing badly needed investment.

As you say, Brazil will have to live with a strong real. Weakening its local capital markets without palpable benefits hardly seems a good recipe to facilitate that process.

*(From Marcelo Giufrida)*

*President,*

*ANBIMA - Brazilian Financial and Capital Markets Association*

SÃO PAULO - Considered one of the main thermometers in investor confidence in the Brazilian economy, the EMBI +, calculated by JP Morgan Chase Bank, closed today for 212 points, 2,3% less than last week that was 217 points.

### **On the EMBI + Brazil**

The Emerging Markets Bond Index - Brazil is an index that reflects the behavior of Brazilian foreign debt securities. Corresponds to the weighted average of premiums paid for those securities for securities of equivalent term U.S. Treasuries, considered the most solvent country in the world, from virtually zero risk.

The indicator measures the surplus to be paid for the return of bonds guaranteed by the U.S. government. Means that every 100 points expressed by Brazil risk, the securities of the country pay a surcharge of 1% on the roles of the U.S..

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*(Research dept)*

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Basically, the USA market the EMBI + to measure the ability of a country meet its financial commitments. The interpretation of the investors is that the higher the score indicator of risk, is applied in the most dangerous country. Thus, to attract foreign capital, the government considered "risky" to offer high interest rates to persuade outside investors to finance its debt - to what is called the risk premium.

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More infos to be required at [brasile@lawandbusiness.it](mailto:brasile@lawandbusiness.it)

Best regards

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