"Brazil will emerge from the crisis stronger"



Guido Mantega

Finance Minister

Klaus Kleber, from São Paulo

Because of its domestic market potential, and because inflation has been kept under control and the country's foreign accounts were unshaken, Brazil will emerge from the global crisis stronger, says Guido Mantega, the Brazilian Minister of Finance. He assures us that the third quarter started with growth already at about 4%, and year-end GDP will be positive, close to 1%. In 2010 the Minister expects that real Brazilian GDP will grow 4.5% to 5%: "There's a new world ahead." In this interview, Mantega reaffirms his criticism of private banks that charge high interest spreads and increase their provisioning for nonperforming borrowers: "The institution that charges higher interest rates also increases its risks. Down the line, default becomes an excuse to further raise interest rates." The appreciation of the real, in his opinion, is a consequence of the virtues of the Brazilian economy. Mantega also states unequivocally that the government will neither relinquish the floating exchange rate nor resort to capital controls.

The Brazilian Economy — **In a recent article the chief economist of the International Monetary Fund, Olivier Blanchard, suggests that the global economy is beginning to recover but that the process will be neither simple nor painless. The economic turnaround will be sluggish and will depend, to a great extent, on US exports and increased consumption by Asian countries, expressed in imports. What is your view?**

Guido Mantega — On a global scale, indeed, there are signs that the recovery has already started, not only in the US but also in some countries in Europe and in Japan after four or five quarters of negative growth rates. Unemployment in the US is receding after having crested at 9.5%. This does not mean that the more advanced countries will not confront many other troubles, such as trade imbalances and fiscal problems. And although activity may begin to intensify in the more developed countries from the third quarter of this year, their growth rates will continue to be low.

It is expected that the emerging countries will stand out, growing faster. China grew 7.9% in the second quarter of this year.

China is leading growth, but India has also performed very well during this transition period — it could grow as much as 5.4% this year. Russia, despite its dependence on oil, is starting to recover. As far as Brazil is

Foto: Credito das fotos

concerned, after two consecutive quarters of negative growth, the country is rapidly recovering; the first signs of the turnaround became clear in the second quarter of 2009, though pockets of poverty remain. Growth started in the third quarter at a pace of about 4%, and year-end GDP in Brazil will be positive, close to 1%. The perspective for 2010 is that real Brazilian GDP will grow 4.5% to 5%. There's a new world ahead.

You have mentioned the dynamism of the emerging countries. In a recent edition *The Economist* noted that Brazil has been spared the worst of the crisis because it is somewhat "backward" compared to the rest of the international financial system....

That is a joke. In fact, precisely because of the severe problems we had in the past, the Brazilian financial system is well regulated and sound; its institutions cannot and could not operate with the excessive leverage practiced by the international banks. We have not experienced the problems associated with subprime mortgages or toxic assets. We have public banks whose actions were decisive in overcoming the crisis.

In contrast, in the US, because of the systemic risks that threatened the financial system, the government was forced to at least temporarily nationalize banks and even companies like General Motors. In Brazil we acted swiftly, applying counter-cyclical measures such as reducing reserve requirements for banks and lowering interest rates. Tax exemptions were granted on home appliances and building materials; individual income tax was reduced with the introduction of a revised tax rate table; and the social contributions (PIS/Cofins) from motorcycles, wheat, flower, and bread were eliminated. All this was done without compromising the fiscal balance or cutting social programs. We have also extended the reduction of IPI (federal excise tax) to capital goods.

Furthermore, the Brazilian economy is diversified and dynamic; Brazilian agriculture is expanding, and R$107 billion has been directed to the 2009/2010 harvest plan. Industry can respond rapidly to the stimulus, as we see in the sales of automobiles and home appliances; and the retail sector is active and well-structured. In the 12 months leading to June, retail sales have shown an accumulated increase of 5.7% compared with the same period the previous year.

In addition to the stimulus to the domestic market, Brazil and other raw-material-exporting countries in Latin America have been helped by importing by China and other Asian countries.

China has played a fundamental role in this process and it must be stressed the Chinese — even before the eruption of the crisis — had adopted measures to stimulate domestic demand and investment in production. Because demand increased in the Asian countries, particularly in China, our exports were not hit as severely due to good revenues from commodity trade. Our sales to the Chinese market expanded by 60%. By virtue of its domestic market potential, and because inflation has been kept under control and the country's foreign accounts have remained unshaken, Brazil will emerge from the crisis stronger.

In connection with the fiscal balance you mentioned that the primary surplus in the

In the medium term, the central bank policy rate could fall to 7% yearly, which corresponds to a real rate of about 3%, if inflation remains under control.

12-month period leading up to June was 2.04%. Is this year's 2.5% target still valid?

Yes. It is obvious that the tax exemptions we granted as part of the countercyclical policy and the ensuing decline in revenues had to bring the primary surplus down. Moreover, the positive operating results of Petrobras (the state oil company) have recently been excluded from the primary surplus calculations. Petrobras accounts for 0.5% of GDP. However, even excluding Petrobras we intend to achieve our 2.5% target in 2009, and we are counting on the economic recovery bringing us increased tax revenues in the second half of the year. For 2010 the primary surplus target is 3.3%. We should keep in mind that the US only recently started its stimulus program for purchasing automobiles. Brazil started granting excise tax breaks for purchasing automobiles in December last year and the program is still on. It is also worth pointing out that the five-point reduction in the central bank interest rate — from 13.75% yearly in December last year to the current 8.75% — is reducing domestic public debt service. Also, Brazil has a sovereign fund that represents 0.5% of GDP in primary savings.

In the present circumstances, reserves tend to grow. They could very well end up at about US$250 billion or higher.

Despite all this, the business community is discontented. With a 12-month inflation projection of 4.07%, the real base interest rate is 4.50%. Businesspeople, as well as some economists, consider this real interest rate too high when compared with rates in other countries. With inflation at about 4%, the policy rate could be lowered to 7%, which would mean a real rate of about 3%. How do you see this issue?

For many years Brazil had to live with excessively high interest rates, be it the central bank policy rate or the effective rates on bank loans. That is no longer justified. Within the next 18 months we will be able to move our base interest rate close to that in other emerging countries. In the medium term the central bank policy rate could fall to 7% yearly, which corresponds to a real rate of about 3%, if inflation remains under control. This is about the same level as Mexico's under normal circumstances. We are heading in that direction.

As far as public banks are concerned, what exactly was their concrete influence during the crisis?

Some results can already be celebrated, namely the reduction in the cost of credit to businesses and individuals borrowing from public banks, which operate in line with the government's direction. They also play a very important role in carrying out countercyclical policy. Starting in September 2008, with the crisis deepening, the credit operations of public banks increased by 25.2%, significantly above national private banks (19%) and foreign banks (2.6%). The share of public banks in the total balance in the national credit system reached 38.6% in June this year.

Banco do Brasil, Caixa Econômica, and the other public banks have reduced their spreads, which the private banks believe to be a reckless measure considering the default rates. Commercial banks, on the other hand, have been raising their provisioning for nonperforming loans. Have the risks increased or decreased today?

Banco do Brasil's loan default rate is low, and operations are conducted according to strict technical criteria. Inexpensive credit is easier

to repay. By increasing the supply of credit and making it cheaper, the public banks help to inject oxygen into the economy and business in general. Their margin is lower, but the banks make more money on a greater volume of loans. It is obvious that when a bank raises provisioning and interest rates for fear of default, it is increasing the nonperformance risk. In other words, banks that do so are fuelling default, and when it happens, that gives them another excuse to raise interest rates further.

Exporters, particularly those exporting manufactured goods, often complain about the exchange rate. The Central Bank's market report, "Focus," projects the exchange rate of the real against the US dollar to be R$1.85 by year-end, which would render sales impossible. What measures could the government take in this situation?

This is a consequence of the Brazilian economy's virtue, and a problem that existed before the crisis. With the sound fundamentals of the Brazilian economy and with the quality of the adjustments made, we have the potential to grow at about 5% a year, in contrast with other developed or developing countries. Brazil is an attractive destination for new foreign investment, be it direct investment, stock exchange investment, or to a lesser degree investment in government bonds; the country's foreign accounts are in good order. Exports will decline this year, but they should remain between US$158 billion and US$160 billion, generating a trade surplus of US$23–US$25 billion. The current account external deficit is estimated to be about US$15 billion, which could be covered easily by foreign revenues of about US$50-US$60 billion, allowing for an increase in official international reserves.

In 2008, according to the Growth Acceleration Program (PAC), the federal government invested 0.9% of GDP and Petrobras 1.3%. In 2009, the federal government will invest 1.2% of GDP and Petrobrás 1.7%.

Could the government introduce any changes to the current exchange policy?

One thing is certain: We will not abandon the floating exchange rate policy and will not resort to artificial measures like capital controls. What we can offer exporters are incentives to enhance competitiveness, better credit conditions, and a substantial improvement of infrastructure, which in Brazil accounts for significant costs. When our foreign trade stagnated, infrastructure became secondary. Today, this is no longer acceptable. We need to modernize our infrastructure substantially to remain competitive in international markets.

Excessive accumulation of foreign reserves, which as of early August were about US$213 billion, has also met with criticism, because it puts pressure on domestic public debt which according to market projections could reach 42.5% of GDP at the end of this year.

In the present circumstances, reserves tend to grow. They could very well end up at about US$250 billion or higher. Foreign exchange reserves will certainly be higher than precrisis levels. We are vigilant to avoid an increase in the debt-to-GDP ratio, which by the end of the year could be about 39.5%. But we are projecting a declining path: From 2010 onward, this ratio should fall to 36.5% and should be at most 33.4% in 2011 and 30.1% in 2012. It must be noted that the net debt-to-GDP ratio in other countries is

much higher than in Brazil, something which was aggravated by the crisis.

To sustain growth without inflationary consequences, investment in increasing capacity is needed, which most companies still hesitate to carry out, at least for the moment. Can this trend be reversed?

If foreigners see opportunities, Brazilian businesspeople will also know how to take advantage of them. A survey conducted by the Getulio Vargas Foundation found that the confidence index in industry, which sank to its lowest level in the last few months of 2008, is now rising, as is capacity utilization in industry. The National Bank for Economic and Social Development (BNDES) today has US$80 billion available for investment, four or five times more than the World Bank, and applications for disbursements are increasing. On the other hand, the government has been investing all it can of its own as well as Petrobras resources. In 2008, according to the Growth Acceleration Program (PAC), the federal government invested 0.9% of GDP and Petrobras 1.3%. In 2009, the federal government will invest 1.2% of GDP and Petrobrás 1.7%.

Will investments be led by the building sector?

Construction activity, both small and large projects, is already expanding. In addition to the PAC investments, R$28 billion in subsidies and R$60 billion in investment is projected for the housing program, My House My Life. The contribution of this segment will therefore be significant. The effects are already visible in employment. According to the latest data from the General Registry of Employed and Unemployed Persons (CSGED), the formal labor market created 138,400 new jobs in July, mostly in construction and industry. In industry, the segment most severely affected by the crisis due to the fall of manufactured good exports, 17,300 jobs were created, which indicates that a recovery is underway.

By our estimates, 600,000 to 700.000 new jobs will be created in 2009, which in a year marked by the crisis is certainly positive.

What is your projection for job creation this year?

By our estimates, 600,000 to 700,000 new jobs will be created in 2009, which in a year marked by the crisis is certainly positive. Starting in the fourth quarter of the year, the figures will be even more encouraging because the economy will be much more vibrant.

What lessons can Brazil draw from the crisis?

Brazil has been through a real stress test, and the economy has proved to be solid. We have also shown that we have the capacity to conduct countercyclical policies. In previous crises, the measures were procyclical. It is interesting that the last countercyclical set of policies conducted in Brazil in previous decades was the second National Development Plan (II PDN), launched in 1974. During the current crisis, we have been able to conduct an expansionist monetary policy, reducing base interest rates significantly. And government fiscal policy has been proactive. The Brazilian economy was put to the test and has overcome the obstacles.