What should be on Brazil's trade agenda

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The external outlook for boosting the Brazilian economy through exports is somewhat gloomy. In the euro zone, despite the devaluation of the euro against the dollar, the oil price fall, and the bond purchase program of the European Central Bank, in the first quarter GDP recorded only modest growth. Now Greece is again depressing investor confidence and threatening the EU recovery. In China, lower interest rates and the reserves required in June for banks pointed to the difficulty the government has had in containing the economy's slowdown to 7% growth. In the United States, at the last meeting of the monetary policy committee of the Fed, Chair Janet Yellen signaled that, although there is a possibility of raising the interest rate later this year, normalization of the U.S. economy will be more gradual than previously anticipated.

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At the IBRE seminar on economic analysis held in June, José Julio Senna, head of the IBRE Monetary Policy Center, noted that the downward revisions in basic interest rate projections of the US economy immediately reflected positively on prices for commodities exported by Brazil. "Markets are also accepting more risk, increasing demand for Brazilian bonds," he says. On the one hand, this outlook will improve capital inflows to Brazil, giving the economy more time to adjust; on the other, it sounds an alarm about weak external demand. "In the first quarter consumption was below disposable income, which indicates that Americans are not going shopping," he says.

Otaviano Canuto, former Executive Director of the World Bank, warns, though, that

Brazil should not wait for a more favorable international outlook to promote its exports. Canuto recommends that Brazil should consider the extent to which its economy may be too closed, noting that "In general, large countries have relatively lower imports and exports. However, in six larger economies than ours, trade (exports plus imports) accounted for 55% of GDP in recent years, compared with 27% in Brazil." Among Brazil's BRICS partners, trade accounts on average for 50% of GDP. Canuto suggests that Brazil's low trade numbers reflect the country's limited participation in global production chains: currently, the domestic value added to Brazilian manufactures is 93%, compared to 70% in Mexico and South Korea. "This shows that the division of the production process along transnational value-added chains—the second wave of globalization—has passed Brazil by," he says.

Brazil's exclusion from international trade reflects its economic and trade policies, says Canuto. To improve this situation, he argues that Brazil should address such old problems as its precarious logistics and the high costs involved in international trade, and prioritize macroeconomic management so that it does not hinder trade. "The temptation to let the exchange rate appreciate to bring inflation down should be avoided at all costs," he says. Protectionist policies should also be rolled back.

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Canuto believes the government's priorities now are to maintain a flexible exchange rate regime to balance external transactions, improve the country's business environment, and promote tax simplification. "It is possible that these changes will cause some companies in the production chain to disappear and be replaced by imported products. But companies that survive will be more competitive and produce better-quality goods," he says. Canuto argues that Brazil should maintain a trade-positive agenda with the United States and Europe to mitigate the potential negative effects of such trade agreements as the Transatlantic Partnership on Trade and Investment between the U.S. and Europe and the Transpacific Agreement. "These agreements will have costs for Brazil but they need not be disastrous," he says.