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CEO of Petrobras Distribuidora

The BRAZILIAN ECONOMY

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Now that fears that the global financial crisis would have a heavy impact on Brazil have passed, credit in Brazil is undergoing a true revolution, reports Liliana Lavoratti in the cover story of this edition. Within 10 years the financial system's total loans to households and businesses could very well double from the current 45% of GDP. Certain signs — such as the unprecedented competition being driven by government-owned financial institutions — suggest that the current expansion reflects structural changes. But even though competitive pressure is already inducing a decline in the cost of money, Brazilians will pay dearly for bank loans for some time yet: of 130 countries surveyed recently by the World Economic Forum, Brazil has the highest bank interest rates.

The crisis has brought about also unprecedented banking competition in Brazil. Government-owned banks increased their lending significantly as part of a government strategy to mitigate the effects of the global crisis. As a result they have increased their share in a market that has been dominated by domestic and foreign private banks and the competition may finally be driving interest spreads down, despite increasing bank concentration from various mergers and acquisitions.

Beyond high interest rates, the return of external current account deficits is another reality Brazil must live with, and many have concerns about how these continuous and high negative balances affect the Brazilian economy. Analysts are divided. One side see no danger in using foreign savings to finance consumption and investment as long as Brazil's economic policies continue to be sound, as they have been for at least two decades, and the composition of external liabilities is favorable, with low foreign currency debt and high foreign direct investment. The other side is that in the long term the strategy of letting current account deficits build up represents a threat to continued growth and calls for intervention in the foreign exchange and capital controls to prevent excessive appreciation of the real against the dollar and reduce Brazil's external vulnerability. The underlying question, of course, is whether the world will continue financing Brazil's current account deficit.

Two myths about public accounts

The public sector accounts are constantly discussed in Brazil. One reason for this is that under successive governments of varying political shades, public spending has tended to increase above gross national product, and fiscal adjustment has been carried out by raising taxes rather than cutting expenses. Consequently, the tax burden has been increasing continuously. This apparent lack of fiscal discipline is a weak point in economic performance, which is otherwise quite positive in general terms.

The debate, however, has become slightly repetitive, probably in part because of the powerful political inertia that characterizes Brazil's public administration. Because the recommendations of fiscal experts for reformulating fiscal policy are ignored, they play the role of heralds, proclaiming over and over again the same diagnoses and criticisms. Familiarity closes the ears, and so Brazilians overlook the importance of the issue because the general feeling is that nothing is likely to change — not the conduct of the government, and not the criticisms.

The passionate urgings that public spending be curbed implies that the extremely popular model of a welfare state be reviewed and slowed down.

However, new approaches to the fiscal problems have emerged recently that go beyond the traditional diagnoses. These are ideas that can help provoke Brazilians into facing the crucial question of what features they want their government to have.

Two of these approaches are criticisms of two myths in the debate about public accounts in Brazil. The first relates to the possibility of improving fiscal performance by means of administrative shock therapy that would attack inefficiencies in the Brazilian government to bring about substantial savings. The second myth is that the only reason for low federal government investment is limited public resources because the lion's share of public revenue would simply be directed to current outlays.

Public expenditure evolution

Between 1999 and 2009 federal public spending (excluding interest payments), deflated by official consumer price inflation,[1] increased at an average rate of 7.3% a year, rising from 14% to 18% of GDP over the period. Without doubt this constitutes a significant expansive trajectory. However, showing that spending grew vigorously is not a sufficient basis for concluding that the expansion was extravagant or irresponsible. To understand the sources and causes of the expansion, we have to break down spending.

For this purpose National Treasury monthly expenditure reports are not very helpful. They break expenses down by personnel and social contributions, administrative and capital expenses, transfers from the Treasury to the Central Bank, and Central Bank expenses. Administrative and capital expenses are broken down further into four accounts: expenses

for the Workers' Support Fund, subsidies to the economy, welfare benefits, and other administrative and capital expenses.

"Other" expenses are a particularly mixed bag. The category covers important social expenses like grants to support poor families, Ministry of Health expenses with the National Health Fund, and Ministry of Education expenses with the National Education Development Fund (including books, school transportation, and nutrition). Spending for important government responsibilities like public health and school meals are lumped together with those for flight tickets and office supplies.

The analysis of public expenditure can be made clearer by introducing the concept of "restricted administrative expenditure," which consists of administrative spending after retirement pension benefits, grants to poor families, benefits for elderly and disabled adults, unemployment benefits, National Health Fund and National Education Fund expenses, and income transfers.

Expansion of the welfare state

The increase of 4.3 percentage points of GDP in federal public expenses between 1999 and 2009 can be broken down as follows: 1.7 percentage points of GDP for pensions; 1.3 for social expenses; 0.6 for investment; 0.6 for health and education expenses; and 0.4 for personnel expenses. Meanwhile, restricted administrative expenditure actually fell by 0.3 percentage points, from 2.1% of GDP in 1999 to 1.8% in 2009.

Restricted administrative expenditures include all the activities that administrative shock therapy would aim to cut: stationery, travel, consumption goods, and consultancy expenses, among others. Clearly, the relatively small amount of restricted administrative expenses is not sufficient to support a major fiscal adjustment and substantially raise savings. Not only is that the only category of public expenses showing a relative decline over the past decade, it hardly seems likely that the government machinery could function properly on less than 1% of GDP.

The evolution of spending since 1999 also provides evidence that a large part of the increase was due to the political mandate that the Brazilian people democratically conferred on their representatives, during first a center and then a center-left administration, to expand the Brazilian welfare state. This is illustrated by the doubling of social expenses, from 0.6% to 1.3% of GDP, and of education and health expenses, from 0.7% to 1.4% of GDP. Skyrocketing expenses like retirement pensions, which shot up from 5.5% to 7.2% of GDP, might be criticized, but undoubtedly they correspond to what the people want in terms of transfers and benefits guaranteed by the government.

The low implementation rate of government investment projects was related more to internal administrative failures than to such institutional factors as environmental requirements, audits by the Federal Audit Court, and strict procurement procedures.

It is evident, therefore, that the dramatic increase of federal public spending between 1999 and 2009 did not result from a wild spending spree in favor of a small group of beneficiaries orbiting the executive branch. Still, like the excessively generous pension scheme, there are huge distortions that deserve to be re-assessed. Generally speaking, however, the increased government spending over the decade tracked the implementation of projects offering society greater and comparatively better essential public services, accompanied by massive welfare

transfers to the elderly, the poor, civil servants, and all their families.

Thus the passionate urgings that public spending be curbed imply that the current extremely popular model of a welfare state be reviewed and slowed down. This is hardly an encouraging conclusion, but it is a vital issue in the discussion about what size government Brazilians want.

Low public investment

Whatever their political leanings, there is consensus among observers that low federal investment is a serious deficiency of current public policy. Total public investment in Brazil today proportionately is less than half what it was in the seventies, in spite of the enormous increase in the tax burden from about 25% to 35% of GDP.

Until a major effort is made to improve the organization and efficiency of government operations, the federal government will probably invest even less than the small resources it budgets and sets aside today.

Thus it is not surprising that both left and right urge the government to increase its investments, especially in infrastructure. Yet according to most observers, the main limiting factor for expanding public investment is the voracious rise in current public expenses.

In fact, if the federal government were to increase its investments substantially, it would eventually run out of resources and find itself compelled to confront such unpleasant options as raising taxes or cutting current spending. But an interesting study by Mansueto de Almeida, an economist at the Institute of Applied Economic Research, shows clearly that the government is far from reaching that point. Many investment projects for which resources had already been authorized are being held up by a variety of obstacles ranging from bureaucratic and administrative constraints ("red tape") to issues related to procurement and supervision by the Federal Audit Court.

The 2008 federal budget authorized investments amounting to R$54.97 billion (US$27.50 billion), but a mere R$28.3 billion (US$14 billion) was actually carried out that year, and R$18.3 billion of that consisted of payments on investments budgeted in previous years. Thus, actual investment was less than 60% of the amount budgeted.

Almeida's study revealed, surprisingly, that the low implementation rate of government investment projects was related more to internal administrative failures than to such institutional factors as environmental requirements, audits by the Federal Audit Court, and strict procurement procedures. Administrative, budgetary, financial and managerial were the categories ranked highest as constraints by project managers.

More detailed analysis suggests that budget constraints mainly affect small-scale projects; they are not a limiting factor in the financing of large-scale projects for which resources have been authorized in approved budgets. At the same time there is evidence that obstacles to carrying out public investments are not limited to such notorious factors as environmental licenses, supervision by the Audit Court, and procurement procedures. Whether changing these factors would solve the problem of slow implementation of budgeted investments is not at all clear. Until a major effort is made to improve the organization and efficiency of government operations, the federal government will probably invest even less than the small resources it budgets and sets aside today.

[1] Published by the *Brazilian Institute of Geography and Statistics* (IBGE).

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Lubricated expansion



José Lima de Andrade Neto

President of BR Petrobras Distribuidora

Klaus Kleber, from São Paulo

Currently responsible for 39.7% of the distribution of fuel across the country, Petrobras Distribuidora (BR) already accounts for 5% of the results of the government oil holding company, Petrobras. The company is also investing to build its leadership in the field of lubricants. "Earlier this year we approved a plan to expand our lubricants plant in Duque de Caxias, near the Petrobras oil refinery," said José Lima de Andrade Neto, CEO of BR. When the project is completed in 2011, it should double current capacity. He assures us that the supply of ethanol, where there were problems in late 2009 and early 2010, should return to normal with this month's sugar cane crop. Andrade Neto believes that, given the rapidly growing importance of ethanol, both internally and externally, it is necessary to find ways to ensure market supply without seasonal fluctuations. Such mechanisms "may or may not include the formation of buffer stocks."

***The Brazilian Economy* — What share does Petrobras Distribuidora (BR) have in the market for fuel in Brazil?**

José Lima de Andrade Neto — In 2009 BR's share in fuel distribution was 38.6%. In February 2010 the company's market share rose to 39.7%. The company is a leader in the distribution of fuels and lubricants and currently has about 6,000 gas stations throughout the country.

How were BR's results in 2009?

For the calendar year BR recorded a net profit of R$1.462 billion (US$832 million) – 13.4% higher than in the previous year, which was about R$1.289 billion (US$734 million).

What percentage does BR contribute to the total profits of the Petrobras holding company?

The performance of BR produced 5% of Petrobras's results in 2009.

In your assessment, what was the extent of the decline in the supply of ethanol at the end of last year and early this year, and how did it affect gasoline and ethanol prices?

After a period of high prices in December and January, which had a significant impact on demand for ethanol, hydrous ethanol prices recorded a significant reduction. In the second half of January, the decrease was more

Foto: Crédito da foto

than 40%, which meant that the relationship between the prices of ethanol and gasoline, which had been unfavorable to ethanol, began to change in different regions of the country.

Gradually the supply of ethanol has normalized in other regions of the country. When do you believe that the supply will return to normal?
Currently, the states of São Paulo, Goias, Parana, Mato Grosso, Tocantins and Bahia already have good prices for ethanol.

When will this spill over into other states?
After the harvest season begins in April, this price movement will tend to expand to other states and reach even parts of the North and Northeast. The case of Bahia, where prices earlier this month were already favorable to ethanol, illustrates this movement. We faced less competitive prices due to a series of circumstances that weakened demand for the product, but in the last weeks of March and in early April ethanol prices moved back and ethanol became competitive again.

When do you think the addition of ethanol to gasoline can return to a rate of 25%?
The reduction in the proportion of anhydrous ethanol in the gasoline mix is valid until May 1st. It covered February, March, and April — the end of the intercrop season of 2009-10 to the start of the 2010-11 harvesting season. This measure proved to have been appropriate for market conditions, since consumption of ethanol has already recovered.

Is there a need to build buffer stocks to avoid shortages of ethanol additives for gasoline in the future?
Because the ethanol market has grown rapidly in importance, it is necessary to consider mechanisms to ensure supplies of the product without seasonal fluctuations. That may or may not include formation of buffer stocks.

What are the prospects for ethanol to become a commodity with international pricing?
We are moving in that direction, considering the strengthening and growth of this sector in Brazil and its repercussions in the rest of the world. But for this to actually become reality, it is essential that alternatives for ethanol supply be created worldwide, not only in Brazil.

Has Brazilian ethanol met many obstacles to its commercialization in the international market?
As major consumer markets like the United States and European countries realize that they cannot be dependent on only one source of energy, of course the opposition of these markets as reflected in their import barriers will be relaxed. Moreover, Brazil has recently announced a decision to reduce its import tax on ethanol to zero by the end of 2011. The measure is aimed to facilitate the international exchange of ethanol and is also a manifestation of good will, which can help contain protectionist initiatives in some countries.

What is happening with the project in which the BR would establish gas stations in Argentina and the Spanish oil and gas company (Repsol) would enter Brazil?
BR's operations are intended solely for domestic distribution and marketing of fuels. Those projects and other international initiatives are run by the Petrobras holding company.

For calendar year 2009 BR recorded a net profit of R$1.462 billion (US$832 million) — 13.4% higher than the previous year.

In the beginning the use of natural gas for vehicles was encouraged, but there were problems that could affect the supply. What is the situation now, particularly in Rio de Janeiro?

Among possible automotive fuels, compressed natural gas (CNG) is undoubtedly an important alternative, considering environmental issues. Over the past two years, the competition among fuels favored ethanol, which has shown exceptional growth. As a result, the conversion of vehicles to CNG has fallen substantially, despite policies for its intensive use, as in Rio de Janeiro.

Because the ethanol market has grown rapidly in importance, it is necessary to consider mechanisms to ensure supplies of the product without seasonal fluctuations.

BR recently opened in Macaé (Rio de Janeiro state) a distribution center for marine lubricants to supply offshore oil operations in the Campos Basin. Are other units of this type being planned, for example in Santos Basin (São Paulo state)?

Inauguration of the distribution center in Macaé included modernization and expansion of an existing facility. This area is strategically located within the port, where restructuring should ensure greater reliability and agility in meeting the demand of companies providing services to Petrobras in the Campos Basin and Rio de Janeiro. In other locations, such as Santos and Espirito Santo, we make use of existing lubricant distribution centers, such as Depot Supply House Victory (DeVito) and Terminal São Paulo (Tespa).

With expansion of the activities of Petrobras considering the findings in the pre-salt oil field, are there specific plans for expansion of BR?

We intend to have facilities close to or within the Petrobras offshore installations as soon as there is a final definition of the location of these facilities. BR is a leading offshore service lubricant provider and plans to consolidate its leadership by providing supplies with the greatest reliability and agility.

How many BR gas stations offer wind-powered energy?

At present, three stations use wind energy. The wind generator installed on each of them produces electricity from wind speeds above 8 mph.

What are other BR initiatives for energy efficiency, alternative fuels, and environmental protection?

We have several. In the area of energy efficiency, the introduction of electronic components and semiconductors in lighting our gas stations reduces power consumption. Our stations also wash vehicles with warm water heated by solar energy to reduce consumption of chemical products. We recycle washing water and we also use rainwater. Other measures that contribute to environmental protection are the recovery of steam at the service stations and obtaining certification for Sustainability Construction / Buildings (LEED) for eco-efficiency and the sustainability of service stations. We also have stations where all-electric and hybrid vehicles can recharge their batteries.

Is there collaboration between BR and the automotive industry on controlling emissions of carbon dioxide?

We are working with major automakers to develop products that meet the increasingly

Foto: Credito da foto

high standards of quality for gasoline and diesel engines to increase control of carbon dioxide emissions.

What expansion plans does BR have regarding lubricants?

At the beginning of the year we approved a plan to expand our lubricants plant in Duque de Caxias (Rio de Janeiro state), next to the Petrobras refinery. The project should be completed in 2011. It will double our current production capacity. This will allow for consolidation and expansion of our leadership in lubricants.

Are new lubricant products expected?

In general, BR is moving in the direction of synthetic lubricants that are biodegradable for the mining, offshore, and agriculture sectors, which integrate technology, high performance and respect for the environment.

In addition to fuels, lubricants, greases and chemicals, what are other BR products?

BR offers products and services for the asphalt industry, state governments, utilities, and construction of highways, clubs, and condominiums, among other segments that need fast and effective solutions in flooring. For this, the company has nine plants, two in São Paulo state and the others in Minas Gerais, Rio de Janeiro, Parana, Rio Grande do Sul, Bahia, Ceará and Maranhão states.

How many direct and indirect jobs does the BR provide?

The BR network has about 7,000 service stations that employ about 80,000 people. Considering the additional segments of maintenance, production, and technology that support the activity and distribution network operation, the number of indirect jobs is about 20,000. This represents a total of about 100,000 direct and indirect jobs that support the BR supply chain.

We are working with major automakers to develop products to increase the control of emissions of carbon dioxide. The BR network generates about 100,000 jobs, directly and indirectly.

In what social programs does the BR engage?

The BR has service stations under the Able Citizen Project for inclusion of individuals with special needs. The project currently operates in 13 service stations that employ over 30 people with physical disabilities. We also have service-station schools to promote training courses in lubrication, management of convenience stores, and service station operations. The project aims to encourage the first-time job seeker and income generation. The 13 BR schools have trained about 5,500 students, with 80% entering the job market. BR and Petrobras have also created the Follow Well Child Project, an initiative to combat sexual exploitation and work of children and adolescents on the roads. The project consists of campaigns to inform and sensitize truck drivers, trying to make them partners in rescuing children and adolescents living on the edge of highways.

What innovations are being developed?

BR is preparing to launch a new family of packages and to revise the presentation of its leading products, approaching the consumer with more modern visual communication that facilitates recognition of product quality.

Competition and CREDIT BOOM



Liliana Lavoratti, Rio de Janeiro

Credit in Brazil is undergoing a true revolution. The financial system's total loans to households and businesses could very well double from the current 45% of GDP in 10 years, according to estimates provided by banking institutions. Certain signs — such as the unprecedented bank competition being driven by government-owned financial institutions — suggest that the current expansion reflects structural changes. But despite the fact that the competitive pressure is already inducing a decline in the cost of money, Brazilians will still pay dearly for bank loans for some time yet: Brazil has the highest bank interest margin of 130 countries surveyed recently by the World Economic Forum.

The volume of credit in Brazil — about R$200 billion in 1994 — has soared to R$1.4 trillion (US$800 billion) today, increasing 16% just in the last year; Febraban, the Brazilian Banking Federation, estimates that it will increase by at least 20% in 2010. This trajectory could push the credit-to-GDP ratio to 53% in 2011, and possibly 72% in 2020, says Nilton Pelegrino, Bradesco Bank's director for credit and financing. "The expansion of economic activity combined with its decentralization to different regions increases credit opportunities to companies as well," says Altamir Lopes, head of the Central Bank economic department," adding that "the increase in income and formal employment seen in recent months is good news for personal credit."

Caixa Econômica Federal, the federal savings bank, intends to expand all credit lines by 30%, particularly mortgage credit. Real estate loans totaled R$8.5 billion in January and February alone — more than in the whole of in 2005. Caixa has now secured 82.3% of the home mortgage market, says Marcio Percival Alves Pinto, its vice-president for finance. At Banco do Brasil, the government commercial bank, which increased its credit portfolio by 33.8% in 2009 and registered the highest yearly profit ever by a Brazilian bank, credit growth is expected to increase 18% — 23% in 2010. Among the catalyzing factors are the good performance of the formal labor market, which reduces income fluctuations, and the 20% increase of investment, says Walter Malieni Jr., Banco do Brasil credit director. Malieni also cites the confidence of consumers and the business sector revealed in recent surveys as another positive factor for credit supply and demand in 2010. Banco do Brasil functions as loan agent for the Sustainable Growth Program, a credit line from the BNDES (Brazilian Economic and Social Development Bank), which charges corporations an end-user interest rate of 4.5% a year.

So far, however, expanded credit has been driven by household consumption, and has benefitted the retail sector over industry. In real terms, credit to individuals expanded 13.3% in January compared with January 2009, but credit to businesses fell by 1.4%, probably because of last year's economic stagnation and persisting guarantee requirements. From now on, however, credit expansion should be more balanced between individuals and corporations due to an increase in credit for logistics and construction, investment in infrastructure to support economic growth of 5%, and preparations for the Soccer World Cup and the Olympic Games.

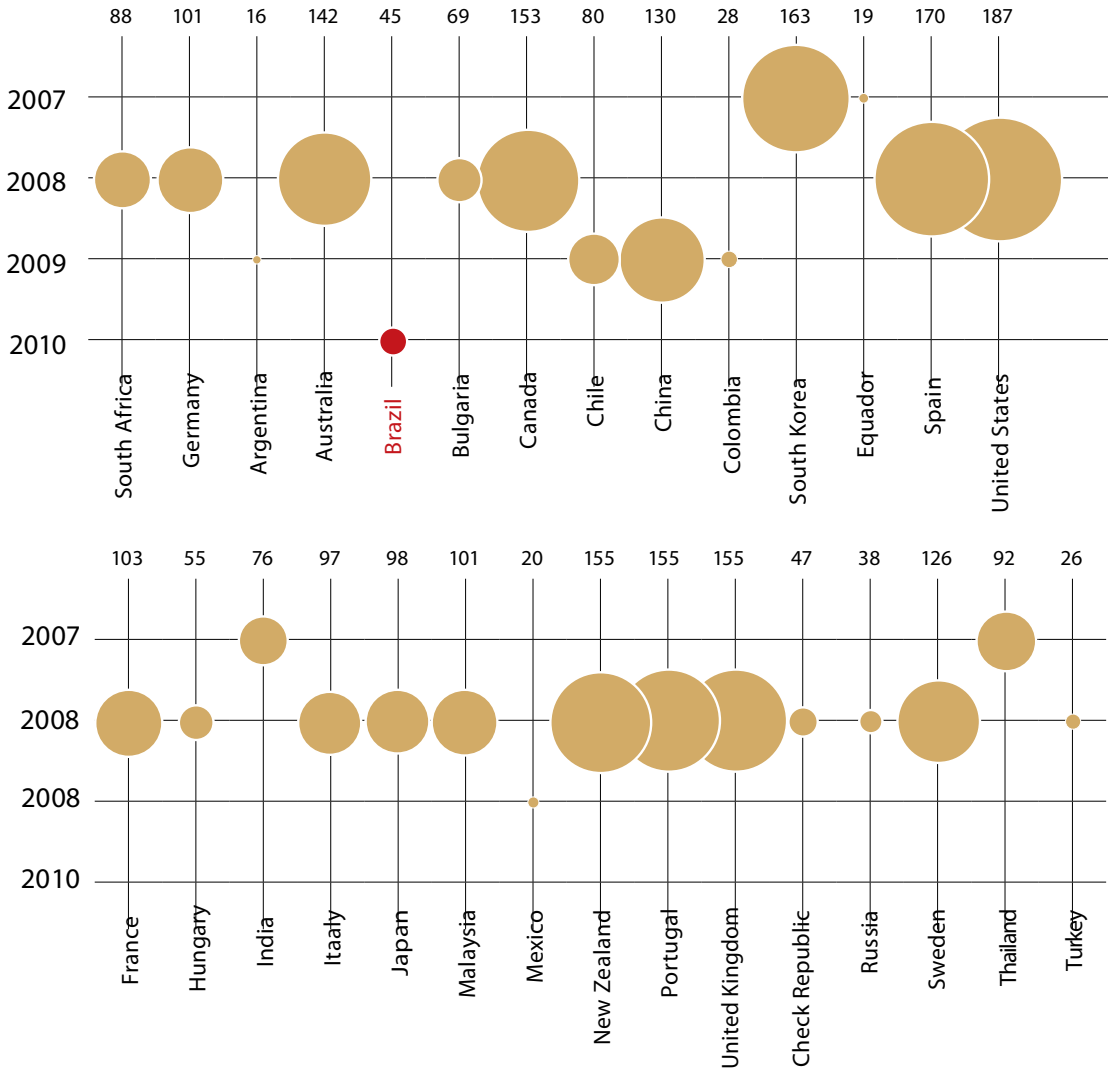
Supply and demand

Both supply and demand are fueling credit expansion in Brazil. "Banks have moved away from having the public sector as their sole client;

financing of the public deficit through acquisition of Treasury bills is no longer as attractive since interest rates and the total debt stock have declined," explains Bráulio Borges, chief economist at LCA Consulting. Here, the intervention of the monetary authorities to persuade government-owned banks to increase credit was fundamental. "Private banks have looked for and found a consumer ready to spend. That has generated feedback in the form of credit expansion," says Fábio Silveira, partner and director at RC Consulting.

Longer-term loans have also helped bring about change since they significantly reduce monthly payments. Five years ago the maximum term was 30 months. Because today a car can be financed over 84 months, many more

Credit-to-GDP ratio (% of GDP)



Sources: Credit Suisse, International Monetary Fund, and World Bank.

Brazilians can now fit a monthly car payment into their budget.

Another factor in the credit boom is innovative products, such as the consigned loans created in 2003, for which payments are directly debited from borrowers' salaries. They allow Brazilians earning at least the minimum wage (US$300) to obtain personal credit. "Today, the stock of consigned loans totals R$110 billion; in 2003, it was equal to zero," the Central Bank's Lopes reminds us. Consigned loans account for R$478 billion — 35% of all credit to individuals.

Legislative improvements have also been important, says Rubens Sardenberg, Febraban's chief economist. The bankruptcy law (No. 11,101 of 2005) now excludes the financing for real estate projects from a bankrupt company's assets, and it is now easier to repossess real estate from defaulters. Before those institutional changes in 2003, real estate financing represented no more than 1.5% of GDP. Today it has doubled to about 3%, though that is still far below averages of 10% to 15% of GDP in emerging countries and up to 100% in Europe and the US.

Professor Pedro Cavalcanti Ferreira of the FGV Graduate School of Economics comments that "The lower-middle-class market expanded after the rules on risks became more transparent for both parties to a contract. Today, anyone earning five times the minimum wage (US$1,500 a month) can finance a home." LCA Consulting's Borges agrees: "The next step after buying or trading in a car is financing a home or improving existing property."

To do so the expansion of wages is essential because it gives the consumer the confidence to purchase real estate. An additional push is the federal government's My House, My Life Program, which subsidizes home purchases by low-income households otherwise ineligible for traditional bank financing.

Bradesco's Pelegrino suggests another reason the financial system may be expanding the supply of housing credit: about 32 million Brazilians have in the last five years risen from the very-low- into the lower-middle-income class: "This represents more people than the combined populations of Paraguay, Chile, and Uruguay. It is a lot of people aspiring to purchase or furnish their homes or to buy cars." As a result, the credit-to-GDP ratio has soared from 20% in 2003 to 45% today.

The financial system's total loans to households and businesses could very well double from the current 45% of GDP in 10 years.

Corporations

Recently credit to corporations, a structural problem for the Brazilian economy, has also been on the rise, although more slowly than credit to individuals. The crisis is over, the economy has taken off, but the problem persists. "The world is making capital available, and conditions in Brazil are positive; this does not mean, however, that life has been made any easier for the business community," says Humberto Barbato, Chairman of Abinee, the Brazilian Association of the Electric and Electronic Industry. Julio Cesar Gomes de Almeida, a former secretary for economic policy at the Ministry of Finance and now professor at the

So far expanded credit has been driven by household consumption, and has benefitted the retail sector over industry.

University of Campinas, agrees that "The explosion of credit . . . has yet to reach industry."

Thus it is still difficult to be an entrepreneur in Brazil. Barbato says, "The high cost of working capital, about 20% a year, and the low level of external competitiveness because of exchange rate appreciation leads to the sad conclusion that the bank ends up pocketing the bulk of the profits generated by industrial activity." He believes it is impossible for a small or micro-enterprise to operate with bank rates of 50% – to 60% a year for working capital: "No company is that profitable."

Whereas credit to the retail sector grew 6% and to agriculture 2%, credit to industry retracted by 0.9% in January this year compared with January last year, Gomes de Almeida notes. But he believes this disparity will disappear during the year as production recovers.

Milton Bogus is director of the Department for Micro-, Small- and Medium-sized production companies at the São Paulo Industrial Federation (Fiesp). He says, "Banks keep insisting on looking into the past rather than the present and the future before deciding to approve loans." Although aware that small- and medium-sized enterprises carry higher risk, he feels that assessment of repayment capacity should be based less on last year's reduced sales and more on increases in orders: "Industrial production fell by 5.5% last year, but it will be in very good shape in the medium term."

Gomes de Almeida says that though credit programs and guarantee funds are important, credit is actually built on a relationship of trust. "The financial system must know the company's situation before lending money to it. A pattern of relationship between businesses and the banks was developing, but it was interrupted when the crisis broke out," he explains.

Last August, recognizing the possibilities in the credit market opened up by the revival of investment, Banco do Brasil launched the FGO (Operational Guarantee Fund), making R$2.7 billion available to micro- and small-sized enterprises in the next five months rather than a planned R$1 billion. "By ensuring up to 80% of the value of the loan and by replacing the collateral, the FGO reduces financial costs and stimulates lending," Maliene says. Banco do Brazil also recognizes that medium- and small-sized businesses require more time to pay off debts and has extended its loan terms from the customary 180 days to a full year.

Bradesco Bank is also paying more attention to businesses. Its strategic plan projects growth of 21%–25% in its credit portfolio in 2010, triple the 2009 figure. "From now on, the growth of credit to individuals and to corporations will be more balanced," Pelegrino says. The bank has opened branches in all municipalities and has been creating products to support local production. It has earmarked R$750 million for 25,000 micro-enterprises.

Corporate credit in Brazil has run into issues similar to those in other countries: a growing economy, competition between resource suppliers, and a capital market that is still developing. It all

depends, says Rubens Sardenberg, chief economist at Febraban, on "maintenance of a stable macro-horizon, where institutions are preserved, and where the rules of the game remain unchanged." The high cost of registering a company is another hindrance to starting up businesses.

Long-term investment credit is in practice dominated by the BNDES; all other banks grant credit only for a maximum of three years. Besides the fact that large businesses absorb most of its resources, BNDES lacks a structure to meet the demand generated by its own programs — "which, incidentally, are successful" — Abinee's Barbato notes. "The release of working capital is slow, and the other banks, acting as financial agents for BNDES, end up pushing their own credit lines to businesses which, although more expensive, win through due to speedier procedures," he says. That is why FGV professor Cavalcanti Ferreira proposes a more aggressive BNDES stance toward medium-sized enterprises.

The ability to access BNDES credit is what produces the divide between businesses that enjoy low-cost investment — the same large enterprises that have access to capital markets — and medium-, small-, and micro-sized enterprises, points out Gomes de Almeida. The difference in interest rates is enormous, he says: "The average cost of investment funding in the general market is 26.5% a year, whereas BNDES credit lines, even when made available through financial agents, do not exceed 10% a year."

The head of BNDES Economic Research, Ernani Torres, says that its client base "is the face of Brazil, and includes all types and sizes of businesses that invest." However, "good projects with real guarantees are submitted to us. And it is the large corporations that invest in infrastructure, which happens to be our primary area of activity. Financing a piece of equipment is one thing; building a power plant is something else." Of the 304,000 loans BNDES made in 2009, only 1,500 involved large corporations; the rest were to micro-, small-, and medium-sized enterprises.

LCA's Borges says that "BNDES alone will not be able to meet the country's entire credit demand for physical investment. Private banks will have to grant much longer-term credit lines compared to what is offered today." A Chinese bank, which recently opened in São Paulo, is already doing that in order to secure a share of investments in areas China considers strategic: ore, oil and gas, and agriculture).

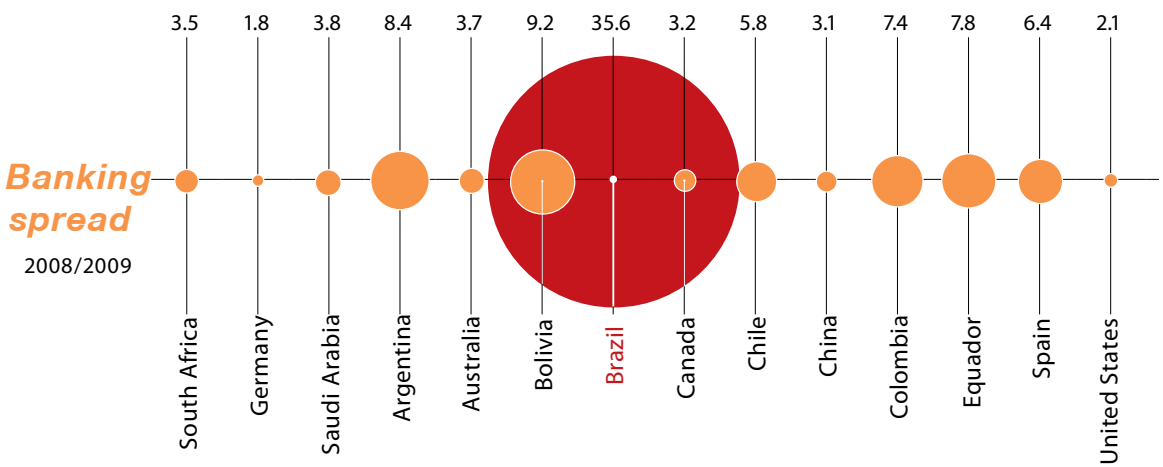
The future

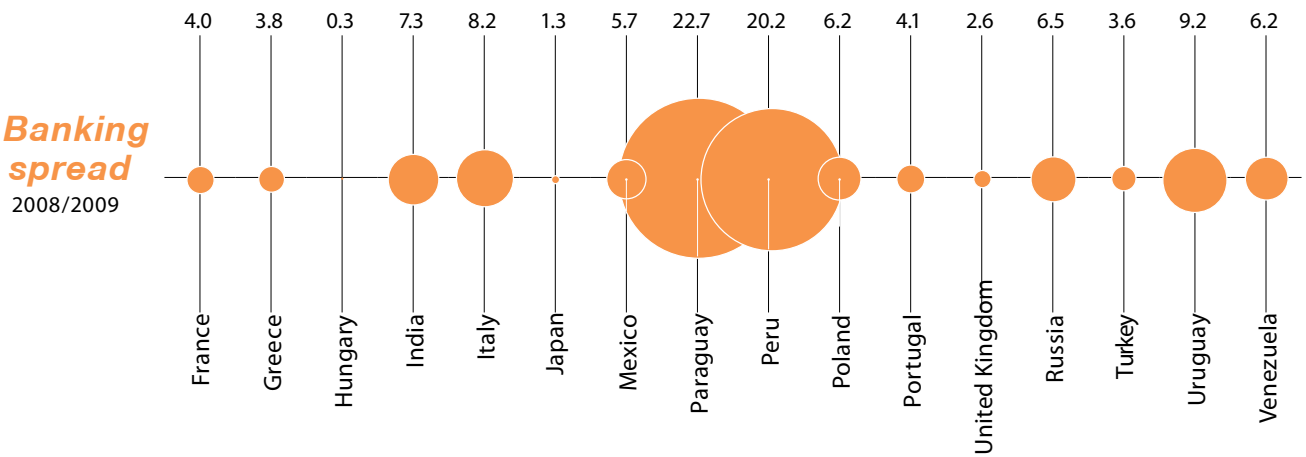
What are the prospects for the credit market? As people borrow to purchase or remodel their home or to trade in their car, says Borges, it is "perfectly feasible that within the next decade credit will reach 80 to 90% of GDP."

But the transition will not necessarily be smooth. The major challenge is the spread — the difference between what banks pay for funds and the rates they charge when they lend the funds to

The spread of Brazilian banks averages 40 percentage points; the world average is 7 percentage points.

borrowers. Though default rates explain about one third of the spread, "No one can explain why, after a decade of sound economic policy, after six years of sound growth and falling interest rates, bank spreads in Brazil remain so high," Borges says. A World Economic Forum survey in 130 countries last September ranks the Brazilian spread next to worst — ahead only of Zimbabwe. The average spread for Brazilian banks is 40 percentage points; the world average is 7. Taking into account variables that help explain disparities in spread in the countries surveyed — protection of property rights and independence of the judiciary, the public deficit, inflation, and taxes on profit — the spread could be reduced by two-thirds, an LCA Consulting study suggests. If the risk built into its interest rates fell to international levels, the Brazilian credit market could grow to 80% of GDP by 2020.





Source: The Global Competitiveness Report 2009-2010, World Economic Forum.

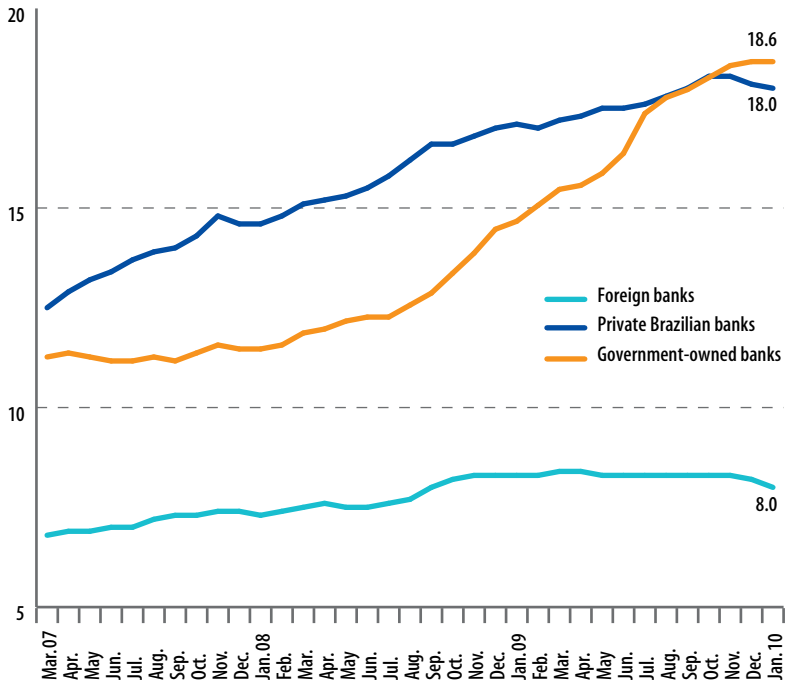
Although Febraban's Sardenberg does not believe the spreads of public banks are much lower than that of private banks — "in similar operations, the rates are quite compatible; however, sometimes the results are distorted because different things are being compared" — he agrees with Borges that the economy's inefficiencies weigh on the cost of money and the laws related to business activity carry a high cost.

The loan default rate does not explain much, Borges says: "The US has a higher default rate than Brazil, but the US spread is infinitely lower." After a record high of 5.9% in July 2009, 90-day past due loans declined to 5.3% in February and should fall further as income again grows. According to the Central Bank, lower default rates have helped stabilize the average interest rate at 34.5% a year. Official data from February confirm a slight reduction in the average spread from 24.3% to 24.1%.

In addition to the increased competition among private financial institutions triggered by the entry of the government-owned banks into the market, and favorable economic developments and institutional changes, other microeconomic measures may reduce the cost of money. One of the measures the National Congress is considering is a data bank of personal and corporate loans and their payment history. "This measure would have a tremendous effect on the spread," Borges says. Current practice is to send only the names of bad payers to the Credit Protection Services; the data bank would allow banks to also identify good payers and could lead to their being granted lower interest rates.

Also, although it was authorized by the National Monetary Council in 2006 with a view to fostering competitiveness between banking institutions, the transferability of credit — transferring a financial commitment from one bank to another offering more attractive services and rates — is still underutilized and is in fact little known to consumers.

Credit to the private sector (% of GDP)



Source. Central Bank of Brazil.

It is impossible for a small or micro-enterprise to operate with bank rates of 50% to 60% a year for working capital.

Dilemmas raised by the external deficit

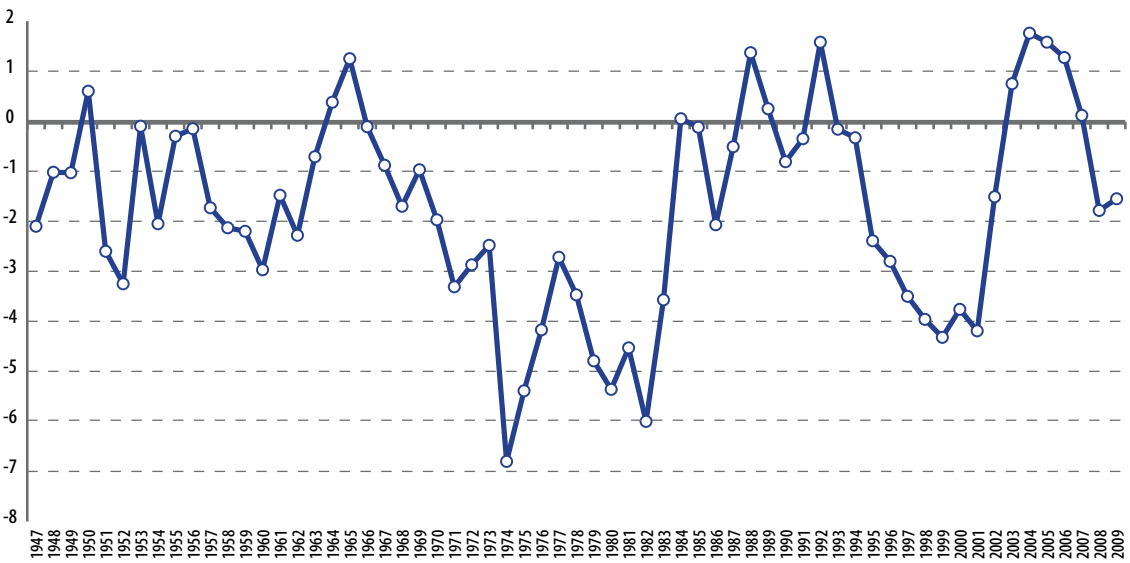
Liliana Lavoratti, Rio de Janeiro

The return of external current account deficits is a reality Brazil must live with, but there are concerns about the possible effects of these continuous and high negative balances on the Brazilian economy. During a seminar on "Current Account Deficits: Opportunity or Threat?" presented by the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation (FGV), panelists Affonso Celso Pastore, Marcio Holland, Pedro Cavalcante, and Samuel de Abreu Pessoa demonstrated how the issue divides analysts.

On one side are those who see no danger in using foreign savings to finance consumption and investment as long as Brazil continues to have sound economic policies, as in the last two decades, and the composition of external liabilities is favorable, with low foreign currency debt and high foreign direct investment. In that case, foreign savings simply complement domestic savings, which probably will remain low. Proponents of this position admit, however, that there are uncertainties that can affect their favorable scenario.

The opposite view is that, in the long term, the strategy represents a threat to continued growth and calls for intervention in the foreign exchange and capital controls areas to prevent excessive appreciation of the real against the dollar and thus reduce Brazil's external vulnerability.

External current balance (% of GDP)



Source: Central Bank of Brazil.

Despite their differences, all agree on two points: Brazil is returning to its historical pattern of external current account deficits, a structural problem whose root is the low level of domestic savings. In February the balance of external transactions was the worst since 1947, leading the Central Bank to revise its projection for the 2010 current account deficit from US$40 billion (2.5% of GDP) to US$49 billion (4%). For the first time in nine years, the inflow of direct investment was not enough to counterbalance outflows, so the country had to depend on short-term loans to fill the external current account gap. That has not happened since 2001.

Multiplier effect — Sound economic policies and sustained growth reduce the risk of using foreign savings to finance excess domestic absorption (private and public consumption and investment). According to this reasoning, which takes into account the preferences of Brazilian society and the political system, foreign savings represent an opportunity to accelerate growth by increasing the investment rate. "The inflow of foreign capital causes the real exchange rate to appreciate, leading to increased investment, and the multiplier effect of that causes an expansion in income and consumption and a reduction in net exports. Thus there appears the current account deficit," explained former Central Bank governor Affonso Celso Pastore.

Brazil has low domestic savings, so investments require foreign savings, imported through current account deficits. According to Pastore, national accounts data show that whenever external current account deficits grow, so does investment. "The conclusion is that foreign savings are predominantly used to raise production capacity, not consumption, which contributes to economic growth," he emphasized.

To give up external resources, Brazil would have to radically change its economic policy and aim to increase domestic savings — starting with the public sector, cutting current expenditures and income transfers that stimulate private consumption. As the government is not contemplating any such strategy, it is unlikely that Brazil will follow the Chinese way: domestic savings of almost 50% of GDP, low public spending on social security, and high private savings. Brazil's domestic savings fell last year to 14.6% of GDP, the lowest level since 2001.

"The inflow of foreign capital causes the real exchange rate to appreciate, leading to increased investment, and the multiplier effect of that causes an expansion in income and consumption and a reduction in net exports."

Affonso Celso Pastore

Samuel de Abreu Pessoa, head of the IBRE Center for Economic Development, believes that economic policy should not be directed against current account deficits but should clarify the limits, consequences, and risks of this option. He believes that economic policy should induce a structure of external liabilities that do not cause problems for the country. For example, for a long time Australia has survived high external current account deficits due to an economic model that has protected the country from external shocks, despite high foreign currency debt.

"If we do our homework, we are not likely to go through a balance of payments crisis because there will be no shortage of external financing," Pessoa said. In his view, Brazil today can sustain economic growth even with high current account deficits:

"The question is whether the world will continue financing Brazil's current account deficit."

Luiz Guilherme Schymura

"If we do our homework, we will hardly go through a balance of payments crises because there will be no shortage of external financing."

Samuel Pessoa

"Unlike the past, when external liabilities were predominantly in US dollars, the proportion of external liabilities denominated in the real has increased, and this creates favorable momentum for Brazil. It is helped by robust foreign exchange reserves and the fact that the country is a net external creditor."

The structure of Brazil's external liabilities in the last 14 years has changed: the share of loans and debt financing fell while foreign direct investment and equity investments increased. At the end of 2009, together investments and the purchase of shares accounted for 72% of total external liabilities, compared to only 29% in 1995.

The economic and institutional mechanisms to operate safely on the path of external financing, Pessoa said, should include, beyond control of inflation, fiscal balance, and the floating exchange rate, government action to discourage companies borrowing in foreign currency without hedging, to make it clear that the public sector does not offer hedging protection. "This is all you can do," he said, "because policy choices that will lead us to a long period of external current account deficits have already been made." Among those choices are the expansion of programs of income redistribution and the population's preference for consuming in the present rather than saving for the future.

For Pedro Cavalcanti Ferreira, professor in the FGV School of Graduate Studies in Economics, there is no doubt that the safest policy would be to increase domestic savings, thus eliminating the risk of not being able to finance the external deficit and creating the conditions for devaluation of the exchange rate. But, he added, "This is neither feasible nor likely in the short and medium term, as there are in place none of the conditions necessary to reverse the external current account deficit except in the long term." Moreover, the evidence that exchange rate overvaluation has a negative impact on economic growth is not robust. Exchange rate revaluations in 2002–08 did not have a big impact on industry and advanced technology sectors, he said, so he has no concerns about future current account deficits affecting growth in the long term.

However, Cavalcanti warned, external financing leaves Brazil vulnerable to shocks that can disrupt capital inflows. In this sense, the large foreign exchange reserves and a floating exchange rate, combined with an appropriate composition of external liabilities where there is little mismatch between assets and liabilities in dollars, could help the economy to make the necessary adjustments.

Threats and vulnerabilities — On the other side of the debate are those who see current account deficits as a threat, due to the potential vulnerabilities they carry and their negative implications for economic growth in the long term. The main concern here is that the deficits make it more likely that there will be balance of payments crises similar to those experienced in the past. This view holds that even assuming the continuity of sound economic policy, capital inflows could reverse abruptly due to changes in the international economy beyond Brazil's control, making it difficult to finance current account deficits. An external crisis could

quickly contaminate the country's economy, and exchange rate flexibility would be insufficient to accommodate the shock — or might even aggravate it, because a sharp devaluation could disrupt the domestic economy.

"All the projections for the external current account deficit are being revised up. Soon it will affect growth, and the familiar history will repeat itself," said Márcio Holland, professor of economics at FGV São Paulo. He advocates more policy intervention in the exchange rate in the short run to prevent excessive appreciation of the real. Among the fears raised by the overvaluation of the real — one of the most volatile currencies in the world — are the possibility of de-industrialization, which would make the economy less dynamic, push up remittances of profits and dividends, and worsen trade deficits.

Holland, too, argues for an increase in domestic savings. While agreeing that low domestic savings are a result of the expansion of social rights in the Constitution of 1988, he thinks the situation can be reversed with a strong fiscal adjustment in government spending and some constitutional changes. For example, the public sector invests around 2.5% of GDP, but spends 3% on death benefits. In the countries of the Organization for Economic Cooperation and Development, average death benefits are only 0.5% of GDP.

Parallel discussions — Other risks are the inevitable rise in international interest rates on capital flows to Brazil, the effects of developments in world trade on Brazilian exports, and increased competition from Chinese products in markets traditionally supplied by Brazilian industry. "Perhaps the question should be whether it's worth letting the situation reach a threatening deficit," said IBRE economist and seminar coordinator Regis Bonelli. He suggested that "Since it is impossible to know in advance if exchange rate flexibility will be sufficient to cushion the effects of negative changes in the external scenario without harmful consequences for the domestic economy, it would be wise to adopt policies that avoid the unnecessary exchange rate volatility that would arise from excessive capital inflows today, followed by disorganized capital outflows tomorrow."

IBRE director Luiz Guilherme Schymura, raised one more problem: huge institutional advances are occurred in Brazil, facilitating production and changing the economic structure, yet the state of the post-crisis world remains unclear. Recovery is slow in developed countries and is especially bad in Greece, Portugal, and Spain, which are fighting high debt as well as slow economic growth. "The question is whether the world will continue financing Brazil's current account deficit," he said. "What is clear so far is that we have low domestic savings and excess consumption in addition to increasing social spending and the current spending of government. One scenario is continuing foreign capital inflows; the other is that the worsening global situation will interrupt them."

Pastore is not so concerned that the foreign resources now being invested in Brazil will leave any time soon to migrate to other countries. "Investment opportunities in the rest of the world do not seem plentiful," he said, "so there is a lot of money to put in Brazil."

> Increasing domestic savings "is neither feasible nor likely in the short and medium term, so there are none of the conditions necessary to reverse the external current account deficit, except in the long term."
>
> Pedro Cavalcanti

What Kind of Recovery?



Barry Eichengreen

The economic tea leaves are increasingly difficult to read. Although the United States shed 36,000 jobs in February, it is unclear whether those losses should be blamed on the snowstorms that blanketed the country that month or taken as signaling the underlying weakness of the economy. In Europe, growth all but stalled out in the fourth quarter of 2009 — the latest flash numbers show EU GDP growth at 0.1 per cent, down from 0.3 per cent in 2009 Q3. But again, it is not clear whether this reflects exceptional factors like the problems of Greece, where GDP shrank by 0.8 per cent in 2009 Q4, or a more fundamental malaise. No one knows for sure whether recent reports represent the beginning of a double dip — but they clearly amplify the volume of double-dip talk.

While the short-term prospects may be unclear, one thing is glaringly obvious: who was right and who was wrong in the debate over the speed of recovery. On one side of that debate, you may recall, were adherents to the Zarnowitz Rule, named after business-cycle researcher Victor Zarnowitz of the National Bureau of Economic Research. Zarnowitz famously argued that the deeper the recession, the faster the recovery. In deep recessions, he observed, firms liquidate inventories with a vengeance. But once demand stabilizes, they start producing for inventory again. The faster the inventory liquidation, the stronger will be the boost the ramped-up production imparts. That alone will be enough to goose growth rates significantly.

In the current recession, moreover, housing starts

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collapsed to virtually zero in the US, Spain, and elsewhere. Even a modest resumption of residential construction starting from such a low base would constitute a significant increase in investment activity. This was another reason, the optimists observed, to believe that the current recovery would follow the Zarnowitz Rule.

On the other side of the debate were those who believed that recoveries from recessions caused by financial crises are slower and shallower than recoveries from other types of recession. Carmen Reinhart and Ken Rogoff in a series of influential papers and now a book document this opinion. Small firms and households, neither of which can access nonbank sources of finance like the bond market, are a drag on recovery from financial crisis-linked recessions. That is exactly what we are seeing now: with banks still repairing their balance sheets, the advanced countries are experiencing credit-less recoveries. Consumption growth is minimal. Small firms, finding it hard to access credit, are slow to ramp up production, or hiring.

And of course the main engines of growth in the last upswing — not just residential construction but also commercial real estate and the financial sector itself — are still sputtering. Sustaining the recovery will require new engines. Everyone hopes that "green industries" can be the new driver of economic expansion. But mortgage brokers and bond traders cannot be retrained overnight as designers and fabricators of wind turbines. Growth is more difficult when it involves structural change.

It is now clear that the current recovery violates Zarnowitz's Rule and that the pessimists were right. Double dip or not, recovery in the US and Europe will be slow by historical standards. Yet one of Zarnowitz's key insights remains valid: at the end of a recession you get an inventory bounce. In fact the inventory bounce explains why growth toward the middle of 2009 looked as good as it did. But without sustained support from final demand, the bounce remains only a bounce. Without new customers firms will eventually stop adding to inventories. This is why growth slowed again toward year-end.

If the other arguments of the pessimists are not enough, there is also the fact that the effects of fiscal stimulus have now peaked. The weakness of the recovery in the United States and Europe creates an economic argument for additional stimulus. But no matter what the economic merits, another stimulus is not going to happen. Rightly or wrongly, fears about fiscal sustainability are widespread. With 2010 a midterm election year in the United States, members of Congress are reluctant to take responsibility for larger deficits. It is an interesting commentary on who shapes the terms of public debate that people in Congress seeking reelection worry more about being accused of fiscal irresponsibility than about doing too little to combat unemployment.

Worries about debt sustainability may be excessive, but they are an economic as well as a political fact. If deficit spending is to do more good than harm, it must avoid exacerbating such fears. This means that

deficit spending now must be accompanied by credible plans to balance budgets in the future. Only credible plans by US and European governments will reassure those worried about rising debt. And surpluses in the future will mean lower borrowing costs not just then but also now, through the term-structure relationship. This will be helpful if and when the recovery gathers steam and borrowing costs begin to rise.

The challenge lies in making the commitment to future surpluses credible. The Obama Administration's two big ideas for doing so are health care reform and a bipartisan commission to identify and endorse painful but necessary spending cuts. Health care reform that successfully bends the cost curve would make a significant difference to the medium-term budgetary outlook. But as the health care debate sputters to an underwhelming conclusion, there is little curve-bending in sight. Meanwhile, Congress has refused to pass a bill establishing a bipartisan fiscal commission and committing itself to consider the latter's recommendations, so the president has been forced to create the commission by executive fiat. A commission would make a difference if both political parties bought into the process and if Congress was bound to accept or reject its recommendations in a single up-or-down vote. Alas, neither is true.

In Europe, fears about debt sustainability are even greater, not just because inherited levels of debt are higher but because demographic trends are less favorable. Slower-growing labor forces and more rapidly rising old-age dependency ratios make for less debt-bearing capacity, as investors well realize. But the optimal response, as in the United States, is not to withdraw stimulus now but to make credible commitments to fiscal consolidation later. Europe seems to be proceeding in exactly the opposite direction.

Circumstances in Latin America and emerging Asia are, of course, different. In both regions, growth is surging. The preoccupation is with the danger of overheating, not with stagnation or a double dip. It is appropriate for emerging-market central banks to begin tightening, but if I am right to worry about unusually slow recovery in both the US and Europe, then it is important for Latin American and emerging Asian central banks not to overreact. They should avoid tightening too quickly, because export growth is likely to slow. They can rely on the US and Europe to help solve — if that is the right word — their overheating problem. ■

Restrictions to intellectual property rights and public policy

Rafael Pinho Senra de Morais

We are experiencing interesting times in Brazil today. When Lula was first elected president, the markets feared the worst: annulment of concession contracts, a review of the privatization process and possible renationalization; control of royalties transferred abroad; violation of intellectual property rights; and so on. As the administration tackled this lack of confidence, it has waned through President Lula's two terms.

The situation today is unprecedented. Never before have had foreign investors had so much confidence in Brazil. According to IBGE (Brazilian Institute of Geography and Statistics), we have the best economic environment in Latin America: January 2010 data indicated a 7.8 index for Brazil compared to the average of 5.6 for the region. Our growth indicators are sound: the OECD has cited Brazil as the only one of its 26 member countries to be spared by the crisis; and ahead of us there is the Soccer World Cup and the Olympic Games, with all the infrastructure projects they imply.

Yet Brazil is now ready to restrict and even revoke the intellectual property rights of corporations or individuals residing in the US; that is the aim of the Presidential Provisory Measure No. 482/10 (02/10/2010). This could discourage investments in Brazil because of unfavorable investor perceptions of the certainty of our laws and the quality of the business environment.

Trade retaliation

The provisory measure was issued because the US has not complied with the rulings of the WTO Dispute Settlement Body rulings in a complaint Brazil filed in 2002 concerning US government subsidies to cotton producers (dispute WT/DS 267). The Brazilian government seems not be satisfied with retaliating by simply increasing customs duties on US products. Its plans to act on US intellectual property rights would affect compensation for inventive work involved in, for example,

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Never before have had foreign investors had so much confidence on the Brazil. ... . Yet, Brazil is ready to restrict and revoke intellectual property rights whose holders are US corporations or individuals.

computer software, films, books, chemical products, and pharmaceuticals.

This is a case of "cross-retaliation," a situation where the object of the reprisal is not directly related to the wrongful practice that originally caused damages. If Brazil applies restrictions on intellectual property, it would constitute the first case of cross-retaliation in international trade.[1]

We should praise the transparency of the process and the proposal for dialogue on this that our Foreign Trade Chamber (CAMEX) has advanced. Through Resolution No. 16 (published in the Official Gazette on 03/15), CAMEX opened a public consultation procedure "on the measures of suspension of concessions or the country's obligations concerning intellectual property and other rights," to give civil society the opportunity to express its position within 20 days. Now parties affected, as well as researchers and experts on the subject, need to come forward.

The central issue is whether we should retaliate by restricting or revoking patents, and if so which patents should be targeted. Should we leave the choice to the discretion of public officials, who could be influenced by natural political pressures? Or should the choice be guided by public policy-based criteria?

My proposal here is partial, but follows the lines of the one CAMEX advanced regarding which US products should be subjected to increased import duties. The list excludes, for example, equipment and machines, because Brazil does not want to increase their cost to our production sector. It generally includes products considered to be luxury goods, such as motor boats, luxury automobiles, motorcycles, and perfumes. Setting aside the debate on whether wheat should be included, the list in general terms has great social appeal and expresses a concern for avoiding increasing prices to the poor.

Competition

I believe we can also use this cross-retaliation instrument to promote good public policy. Why subsidize some sectors through state-owned financial institutions, if I can revoke a patent? From a microeconomic perspective, subsidies distort competition whereas revoking patents encourages competition by eliminating a barrier to entry in a sector that generates great market power and distorts prices.

Let us consider pharmaceuticals. The argument is simple: Someone has decided that it is desirable to invest in pharmaceuticals.[2] Let us then make this investment less expensive to society. It is definitely less costly to use the opportunity provided by cross-retaliation to restrict intellectual property rights than to promote industrial policies

that have a cost to the treasury and distort competition.

Another very controversial issue is the timing of the eventual suspension of cross-retaliation, which is by nature temporary. If the US lifts the cotton subsidies, will we have to reinstate the intellectual property rights that applied before the retaliation? On this, even WTO's interpretation is somewhat ambiguous in terms of whether retaliation is simply dissuasive, or whether it also has a compensatory aspect associated with the damages caused.3 Nonetheless, even if we are forced to proceed to an immediate withdrawal of the sanctions if the US complies with the WTO ruling, even if there has not been enough time to produce the pharmaceuticals locally, revoking the patent would already have paid off by allowing cheaper imports.

The question then would be which pharmaceutical patents to suspend. The first part of the answer has to do with whether there are available in the international market generic products of proven quality that we can import legally. The second has to do with not discouraging pharmaceutical research on diseases that are particularly prevalent in poor countries.

I have argued elsewhere that there is a need for greater incentives to research and development (R&D) in pharmaceuticals to combat neglected diseases (malaria, Chagas disease, leishmaniasis, dengue, cholera, etc.). I have also argued that developing countries should together commit to not using mandatory licensing for patents in those areas. Thus, if we end up retaliating by restricting intellectual property rights, we should focus on pharmaceuticals that are useful in fighting diseases that affect rich as well as poor countries, pharmaceuticals for which the markets in poor countries are less important. There are cases in which revoking patents will have minimal negative impact on the incentives to innovation while favoring access for millions of poor patients to expensive medicines.

With some basic public policy criteria, it should be possible to reconcile with international rules, widening access to good and cheap pharmaceuticals.

If we act cautiously, there is much to gain from applying intellectual property retaliation in pharmaceuticals. But we should make it clear to the world that for neglected diseases intellectual property rights will be strictly enforced in Brazil. And we will not import such pharmaceuticals produced in violation of intellectual property rights in other countries, or of doubtful quality. With some basic public policy criteria, it should be possible to reconcile trade retaliation with international rules, widening access to good and cheap pharmaceuticals and retaining incentives to R&D related to neglected diseases..

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[1] On two other occasions WTO has allowed the use of cross–retaliation, but in both cases the retaliation did not materialize because the parties came to an agreement.

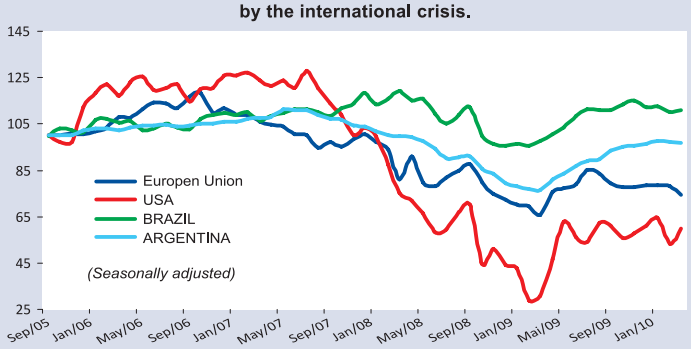
[2] Pharmaceuticals have been included in the list of four strategic sectors in the industrial development policy of the Lula administration.

[3] Visit the institution's site: www.wto.org/english/res_e/booksp_e/analytic_index_e/dsu_08_e.htm#article22B

Consumer confidence stable

After hitting the bottom in December 2008, consumer confidence has recovered quickly since the second quarter of 2009, rising by November to near the pre-crisis level. Since November the index has fallen slightly, partly reflecting the end of the fiscal measures to boost consumption and an acceleration of inflation rates. In comparison with other countries and the European Union, in Brazil consumer confidence has been much less affected by the international crisis that broke out in 2008.

Consumer confidence in Brazil was the least affected by the international crisis.

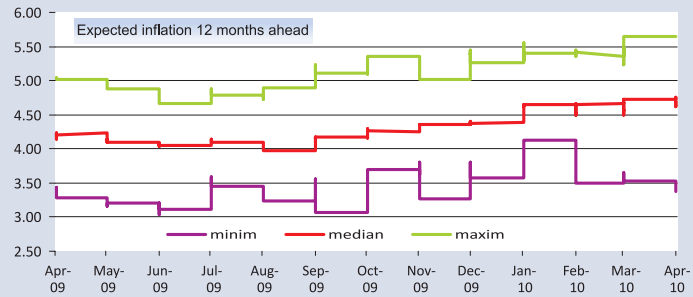


Sources: IBRE-FGV, (Brazil), Conference Board (US), European Commission (EU), and Centro de Investigacion en Finanzas (Argentina).

Inflation on the rise

Inflation expectations have been rising steadily since September 2009. The latest Central Bank weekly survey showed that inflation expectations for 2010 have risen 3 basis points to 5.3%, the thirteenth consecutive increase. Expectations of real GDP growth also increased, from 5.6% to 5.8%, after healthy economic activity was reported last week. Acceleration of growth in emerging countries, particularly China, has caused international commodity prices to rise. The increase is being gradually passed on to final prices. The Central Bank in its late March inflation report now projects inflation of 5.2% for 2010.

Inflation expectations have been rising steadily since September 2009.

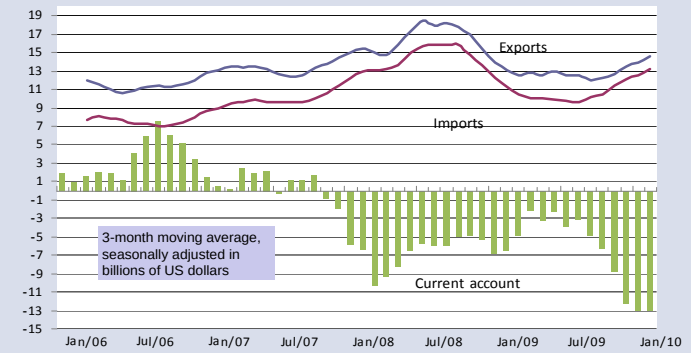


Source: Central Bank of Brazil.

External current account widened

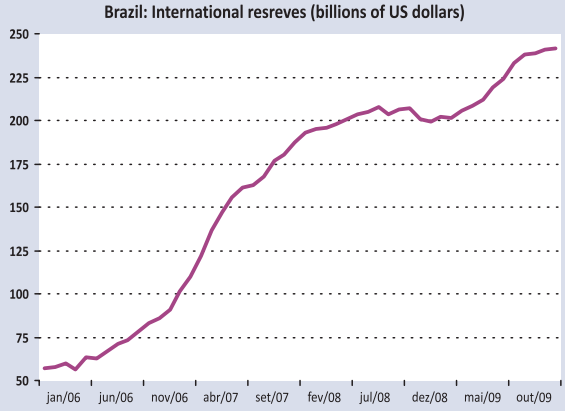
Despite a gradual recovery starting in June of last year, Brazilian exports are still 20.8% below their highest level, recorded in May 2008. Imports were less affected by the international crisis because of the strength of the Brazilian domestic market. As a result, the external trade balance, which averaged US$2 billion a month in 2008 and 2009, fell to US$1.4 billion in February 2010, causing the external current account to widen.

External current account has widened, as exports remain low and imports strong



Source: Central Bank of Brazil.

Brazil: International resreves (billions of US dollars)



Source: Central Bank of Brazil

Excess reserves?

Despite the increase in the external current account deficit, the inflow of foreign currency for financial applications and direct investment caused the exchange rate to appreciate in the second half of 2009. To avoid excessive appreciation, the Central Bank has sterilized these inflows of resources, building up international reserves to US$241 billion, which represent about 15% of Brazilian GDP and more than 100% of Brazilian foreign debt. The cost of carrying these reserves — the difference between domestic and international interest rates — is estimated at US$17 billion a year (1% of GDP). The high cost has triggered a debate on whether there is still a need to continue accumulating reserves.