# THE BRAZILIAN ECONOMY

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**Brazil's foreign trade**

Agenda and agreements

**Interview**

Director of Planning of the National Bank of Economic and Social Development (BNDES)

## FINANCIAL SYSTEM CHALLENGES

# The BRAZILIAN ECONOMY

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The BNDES is the only financial institution offering long-term investments in industrial and infrastructure projects. The Bank's Chief Planning Officer says that while other banks may participate in simple operations, those involving higher risk should remain within a stable institutional structure. By Liliana Lavoratti (page 4).

### Financial system: Long-term challenges

The banking system has recorded major structural advances in the past 15 years, such as the privatization of state-owned banks, an inflow of foreign capital, and mergers and acquisitions. This has resulted in a solid and profitable sector whose credit portfolios have low risk. However, credit is predominantly short-term, and Brazil has the highest spread and interest rates in the world. It may take some time before the system is providing long-term financing to infrastructure and industrial undertakings. By Liliana Lavoratti (page 10).

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The advances achieved by the Brazilian financial system in the past 15 years are obvious. Privatization of public banks, government aid programs to restructure private and state-owned banks, foreign capital inflows, adoption of Basel prudential regulations, and mergers and acquisitions have produced a sound, albeit concentrated system, with a credit portfolio of relatively low risk. Thus, systemic risks are minimal, as was evidenced during the recent world financial crisis.

Yet there are some less positive aspects to the Brazilian financial system: it has the highest spread and interest rates in the world, and credit — despite the boom recorded in the past two years — is mainly short-term, expensive, and available mostly to consumers rather than businesses. Analysts are unanimous in predicting that it will take some time before the national banking system becomes a significant participant in Brazil's development through long-term financing for infrastructure and industrial projects; so far these have been financed only by the National Bank for Economic and Social Development (BNDES), sometimes with subsidized funds.

This is the main challenge for the banking sector at this moment: to support investments in energy, transportation, communication and such areas, so as to sustain the economic growth rate at over 6% a year. But the game has a new element: an expansion in loans by public banks at lower interest rates, which points to closer competition with private banks, something that was not that evident two years ago.

The feature story in this edition shows how private banks can finance the country's growth, as well as discussing the role of public banks within a new context of increased competition.

# Credit outlook is for longer-term investment



## *João Carlos Ferraz*

Chief Planning Officer of the Brazil's National Bank for Economic and Social Development

**Liliana Lavoratti,** from Rio de Janeiro

So far practically alone in making long-term investments in industrial and infrastructural projects in Brazil, the government's National Bank for Economic and Social Development (BNDES) is preparing to reduce its presence in the Brazilian credit market. "Simpler, shorter-term transactions constitute the space that other banks could occupy. In higher-risk areas, such as innovation or infrastructure investments maturing in 20 or 30 years, however, maintaining a more stable institutional structure is in the country's best interests," says BNDES Chief Planning Officer João Carlos Ferraz. Recognizing the need to expand transactions with maturities that exceed 10 years so as to sustain economic growth, and considering the criticism of granting National Treasury resources to private investors, the bank is leading a discussion with the Brazilian Banking Federation (Febraban), the stock market, and other financial agents to convince them of the importance of having a long-term vision for the credit market.

***The Brazilian Economy* — How will the BNDES operate amid the new wave of industrial and infrastructural investments?**

**João Carlos Ferraz** — We must consider the bank as a vehicle in the process initiated in 2006. In 2006, investments started to increase ahead of gross domestic product (GDP), and larger and more complex projects started to come up. There has been steady growth in production capacity, especially in infrastructure, which has not been affected by the crisis. Because most of these projects take so long to mature, they are less affected by external factors, such as the world crisis. The last survey the bank conducted suggests that gross fixed capital formation will grow three times as fast as GDP between 2010 and 2013. Currently, expectations for investment in industry and infrastructure are greater than before the crisis — the total expected for the period from 2009 to 2012 is R$859 billion (US$477 billion), against R$781 billion (US$390 billion) invested during the similar four-year period that ended in August 2008. Including the civil construction sector (homes, commercial buildings, sports facilities, and prefabricated structures), the total rises to R$1.3 trillion (US$735 billion).

Foto: Credito das fotos

**What is the profile of these investments?**
Most recently they have focused on the energy area, especially oil and gas. What is remarkable is that investment in areas to ease bottlenecks, such as railways and ports, will increase by 20% in the next three to four years. The current projections represent a 55% increase over the period of 2005-2008. For 2014 and 2015, economic experts are projecting GDP growth of about 5.5% a year, on the back of strong investment — unlike today when Brazil's economic growth largely depends on family consumption.

**Who will finance these long-term investments?**
Brazil has an anomalous structure, with interest rates still heavily dependent on the short term, a vestige of those times of high inflation. Our culture is still tied to the short term. Undoing this behavior will not be easy; there are no magic solutions. Yet only a few changes are needed, such as stimulating the market for debentures, lowering the tax burden on long-term maturities, and increasing the benefits offered to the capital market.

**For the time being, the BNDES is the only institution able to raise long-term funding.**
BNDES's funding structure relies on the Workers' Support Fund (FAT), whose resources are remunerated not by the Central Bank's benchmark rate (SELIC) but by the TJLP — a long-term interest rate benchmark established by the National Monetary Council. Despite being much lower than the SELIC rate, the TJLP has been kept higher than inflation, and it is used to calculate the remuneration of FAT and as a reference for BNDES loan transactions. Under the Brazilian Constitution, the FAT is the basis for BNDES funding, and 40% of its resources are directed to the bank. Our mission as a development bank is fulfilled with a spread of less than 1.2% a year. This allows the BNDES to charge relatively low interest rates. This has been the situation since the BNDES was created in 1952.

**In recent years the BNDES has begun to lend subsidized public resources to companies.**
In the past two years the National Treasury granted two loans to the Bank, one for R$100 billion (US$56 billion) and the other for R$80 billion (US$44 billion). Interest rates on loans granted to companies out of the R$100 billion were partially based on the TJLP, while rates on loans out of the R$80 billion were totally based on the TJLP. The difference between what the government pays to raise funds by issuing public securities (SELIC) and what the National Treasury charges on fund transferred to the BNDES (TJLP) is expected to reach R$1 billion a year. Estimating this subsidy involves more than subtracting the TLJP from the SELIC rate because the BNDES pays taxes and dividends, which also must be considered in calculating the actual cost of the funds the National Treasury conveys to BNDES for corporate loans.

**Many analysts seem concerned about the transparency of these operations, as well as about their tax implications.**
There is a subsidy, but we must consider how

*Brazil has an unusual structure, with interest rates still heavily dependent on the short term, a vestige of those times of high inflation.*

much society is willing to pay to finance long-term projects. One thing is the government providing a subsidy for specific purposes; another is what has been done: expanding Brazil's production capacity.

**Does the reduction of subsidies depend on a drop in the SELIC rate?**

We are not expecting that the TJLP rate will equal the SELIC rate for at least 30 years but when it does, the subsidy will disappear. Let us suppose, however, that in times of crisis — or even without a crisis — the financial system becomes unable to lend money at interest rates relatively close to international reference rates; that would mean a reduction in investments. Without financing, investments would fall behind, and the country would have to pay much more in investment costs. These must be considered as well, so the R$1 billion subsidy would actually be much less. Thus, the main focus should be on how much society is willing to pay for long-term financing.

*This year, we expect to disburse R$130 billion in loans, which is less than the R$137.4 billion disbursed in 2009.*

**Some economists consider that the presence of BNDES, which can offer subsidized loans, restricts the expansion of private long-term credit.**

During the 2008–09 crisis, it was said that the decision of the National Treasury to make the R$100 billion loan to BNDES was necessary. In the future, this choice will be seen as the best option at the time. While the entire financial system was retrenching, the measure signaled to markets that there would always be credit for investment in quality projects. After that loan, government financial institutions such as Banco do Brasil (BB) and Caixa Econômica Federal (CEF) entered the scene, and a certain minimum amount of credit in the economy was maintained.

In September I talked to an economist at a private bank who offered two different viewpoints. As a bank economist he said: "We are looking at the Basel II prudential rules." However, as a Brazilian economist he pondered: "While banks have their eyes set upon this indicator, the credit offer will not move forward. But when other agents enter the market and offer credit, the banks will start to be concerned with their market shares and will once again make resources available." In this sense the movements especially of BB and CEF helped. After they entered the market more aggressively, market share started to matter [to their competitors]. This is what we see now with the expansion of consumer credit, which has again reached a level considered normal for the size of the economy.

**Those who think that the BNDES presence in the market for credit is excessive argue for a BNDES withdrawal.**

We have already withdrawn from the working capital segment; we did take up an enormous amount of shares during the crisis, but then we sold them. This year, in spite of the growing demand, we expect to disburse R$130 billion (US$72 billion) in loans, which is less than the R$137 billion (US$76 billion) we spent in 2009.

Our historical passion for investment remains, though. In April last year, when

Folha Credito das Folha

the economy started to stabilize, we thought it was time for investments to lead growth again, so we decided to push the infrastructure and industrial projects forward. Investments tend to slow down in times of crisis; while GDP may take a year to recover, investments take two years. Once the crisis hit, by July 2009 BNDES's credit line for machinery and equipments (FINAME) daily disbursements had dropped to R$60 million, compared to R$153 million in September 2008, so we launched the Investment Sustaining Program (PSI). The PSI is a credit line with low interest rates of only 4.5% a year. Since the PSI was launched, requests for FINAME loans have quadrupled.

**Aren't infrastructure and industrial needs getting much more complex?**

They certainly are. The Madeira River and Belo Monte hydroelectric power plants, for instance, require different financial plans, with completely different guarantee systems and maturity terms. The argument that the BNDES must step back and leave it all to the market is simplistic.

The BNDES is one of the few institutions that are experienced in long-term financing. Some analysts say incorrectly that we do not know where BNDES spent the R$180 billion (US$100 billion) funding from the National Treasury. However, we are among the few development institutions in the world that disclose the conditions on loans. When we granted the loan for the Belo Monte power plant, among many others, we disclosed the financing conditions in advance. The projected growth rate of more than 20% for investments in railways and ports is encouraging for the country. These are complex plans that require intelligent assessment and the development of guarantees and negotiations with providers and large investment groups.

*Commercial banks are co-investors in projects like the Madeira River power plant through on-lending resources from the BNDES.*

**Are Brazilian banks ready to participate in more complex undertakings?**

Commercial banks are co-investors in projects like the Madeira River power plant through on-lending resources from the BNDES. They are learning to define the guarantees for bid winners, but they still don't have an effective funding structure because they raise funds with short-term maturities. If the loans they provided had longer terms, their assets and liabilities would be totally unbalanced; that would not be good for the financial system's health. The current structure for pricing capital is totally inappropriate for a country that is increasingly expanding its economic time horizon.

**In your opinion, can the current structure be maintained for some time? How would any change be made?**

We have been discussing this with the entire financial system — investment banks, stock exchanges, pension funds — and fairly quickly we realized that there are many opportunities for credit expansion. We must start to unlock the shackles, though. We are attentive to international experiences, especially in Peru and Colombia. As soon as those two countries' interest rates

declined sustainably to below 8% a year, their credit markets started to move toward long-term maturities, especially for housing credit. And the pension funds started to participate.

It is also widely known that taxation in Brazil is unfavorable to longer-term investments, and the debentures market is very restricted. There are opportunities for companies to finance themselves, but they need tax provisions that favor these investments. There are a variety of options, and the country should discuss them. There is no magic solution. Advances depend on articulation, negotiation, and above all willingness.

**But what role would BNDES be willing to play in this new design?**

For obvious reasons BNDES is leading this discussion, since we would like to see more players participating. The Ministry of Finance, the Brazilian Banking Federation, the São Paulo stock exchange (BOVESPA), and other market agents are concerned with this issue. We are still defining what might be done to allow BNDES to leave the market gradually. We will continue to operate, since this is a gradual process that may take years to consolidate. More simple investment transactions with shorter terms could be an opportunity for other banks.

*The symbolism of Brazil hosting the World Cup and the Olympic Games in a few years is very important. We also have the vast pre-salt oil reserves. When would anyone in the previous history of this country speak of events planned to take place in 10, maybe 15 years?*

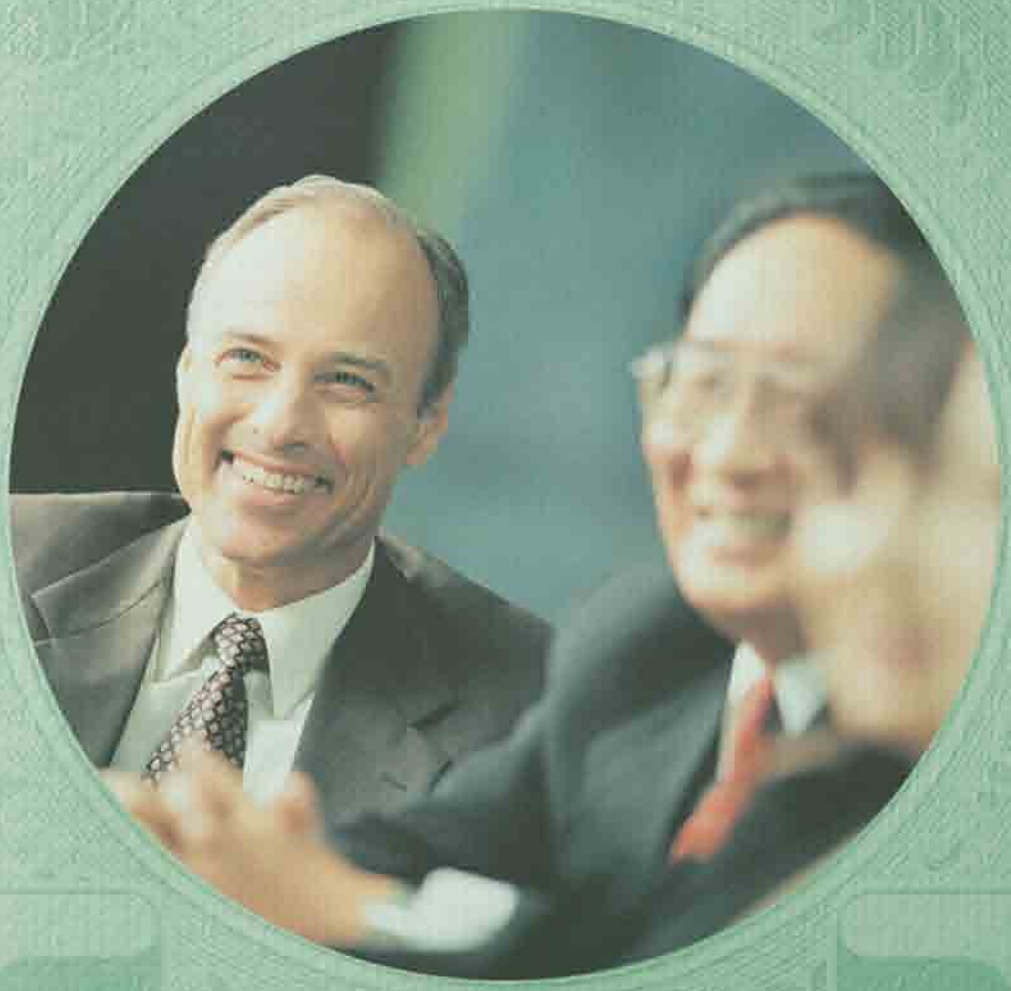
In contrast, for high-risk transactions, such as those relating to innovations or infrastructure investments maturing in 20 or 30 years, it is in the country's best interest to have a more stable financing structure. The United States is planning to create two public banks, one for infrastructure and one for clean energy. The US government is aware of the necessity of a more stable financing structures instead of systems vulnerable to cyclical downturns.

**Is the financial market as a whole beginning to take a long-term perspective?**

The symbolism of Brazil hosting the World Cup and the Olympic Games in a few years is very important. We also have the vast pre-salt oil reserves. When would anyone in the previous history of this country speak of events planned to take place in 10, maybe 15 years?

Since the economic time horizon is expanding, a compatible financing structure is required. That was not possible in the past, and that is why we still have a model of investments based on immediate liquidity. Our savings system is complicated, and we don't have a loan system for housing. These are the challenges of a new country.

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# LONG-TERM CHALLENGES

**Liliana Lavoratti,** Rio de Janeiro

Thanks to structural changes in the past 15 years, the Brazilian banking system has made significant advances. Privatization of public banks; launch of government aid programs to restructure private and state-owned banks; foreign capital inflows; adoption of Basel prudential regulations; and mergers and acquisitions have resulted in a strong — and concentrated — banking sector that is also highly profitable, with relatively low-risk credit portfolios. As evidenced during the world financial crisis, Brazil's banking sector is not likely to run into systemic risks.

Nonetheless, the virtues of the Brazilian banking system coexist with less-admirable aspects. Brazil has the highest spread and interest rates in the world. Credit is predominantly short-term, expensive, and intended for individual consumers. Analysts unanimously predict that there will be a long wait before Brazil's banks participate significantly in long-term financing for infrastructure and industrial projects. These are currently financed primarily by the government's National Bank for Economic and Social Development (BNDES), sometimes with subsidized funds.

"Financial institutions have not yet learned how to operate in a stable environment and perform their traditional role, which is to provide credit," says Maria Antonieta Del Tedesco Lins, an economist and professor at the International Relations Institute of the University of São Paulo (USP).

## Distortion

In the past, economic uncertainties, bearing with them high credit costs and lack of options, discouraged companies from taking long-term loans from private banks. Public sector absorption of a large part of private savings was another unfavorable aspect, Ms. Lins says. "High interest rates allowed banks, as they still do, to be more comfortable lending to the government by acquiring public securities. Financing the public deficit," she emphasizes, "distorts the classic function of financial intermediaries – lending to productive activities."

For 2010, market estimates are for about 20% growth in gross fixed capital. Investments of about R$168 billion (US$93 billion) a year for at least five years are needed to achieve the logistical, energy, and workforce levels required for economic growth of 7% a year. The amount currently invested is less than two-thirds of this amount. Meanwhile, the Ministry of Mines and Energy says that R$214 billion (US$119 billion) should be invested over the next 10 years to ensure higher energy production.

"The market is very encouraged, and the figures are expressive. To invest the amounts needed in all areas, commercial banks must have greater participation in smaller undertakings, while BNDES continues to invest in larger projects," says Carlos Eduardo Mellis, project financing chief at Itaú BBA, the wholesale and investment bank of the Itaú group. This should start to happen, he thinks, within two or three years, now that banks are willing to raise funds with longer maturities. Some studies show that much investment is financed out of corporations' own funds, followed by loans granted by BNDES, commercial banks, and the capital market, as well as foreign direct investments. Octavio de Barros, chief economist at Bradesco bank, says, "We have noticed advances in the viability of commercial banks offering long-term credit."

Samuel Pessôa, an economist at the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation (FGV), says that it may take 10 years for commercial banks to be able to compete with BNDES. "The time will come when the difference between the Central Bank's benchmarck interest rate (SELIC) and the BNDES basic rate will diminish drastically, and private banks will be able to compete in the long term. This already occurs with real estate credit," he explained. Currently, BNDES charges about 9% a year, compared to market interest rates of about 14% a year for maturities exceeding 10 years.

BNDES has lower costs for raising capital because the Federal Constitution provides that 40% of the Workers' Support Fund (FAT), which consists of income from corporations' social contributions (the

> **High interest rates allowed banks to be more comfortable lending to the government by acquiring public securities.**
>
> **Maria Antonieta Del Tedesco Lins**

> **To invest the amounts needed in all areas, commercial banks must have greater participation in smaller undertakings, while BNDES continues to invest in larger projects.**
>
> Carlos Eduardo Mellis

PIS-Pasep program), goes to BNDES economic development programs. In April 2010 the balance of these resources totaled R$124.4 billion (US$69 billion) remunerated at lower than market rates. In addition, during the past two years, the National Treasury invested a total of R$180 billion (US$100 billion) in BNDES, charging less than what the government pays to raise funds by issuing public securities. This has generated a subsidy of R$1 billion a year to the BNDES. As a result, BNDES is able to lend at lower than market rates.

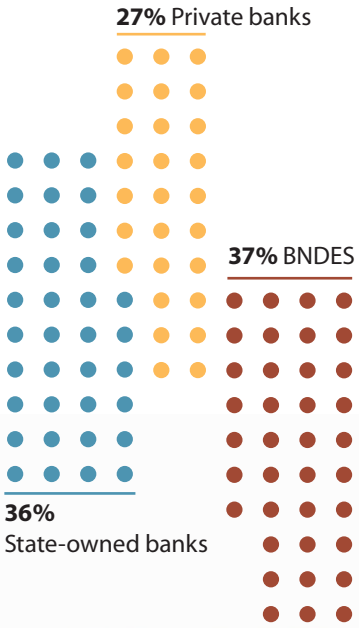
## Competition

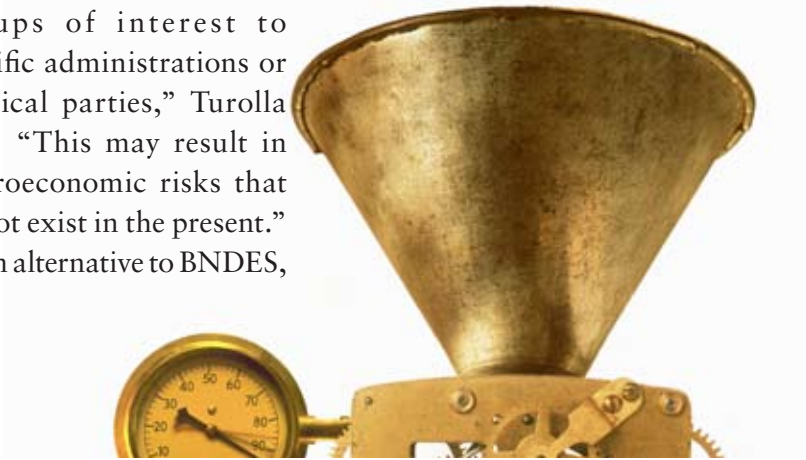
The redefining of the role of public banks in the development cycle that is currently occurring in Brazil is crucial to improving financing conditions for the private sector, says Frederico Turolla, professor at the FGV School of Economics and partner in the Pezco Consultoria & Pesquisa consulting firm. He agrees with those who hold that private banks do not take up their development financing responsibilities because BNDES is such a dominant presence in the market. From September 2008 to January 2010, the BNDES accounted for 37% of all bank credit in Brazil. This share is very close to the 36% recorded by all other public sector financial institutions together and exceeds the 27% disbursed by all private domestic and international banks operating in Brazil.

"The presence of a public sector agent inhibits the development of the private financial sector and creates distortions by favoring groups of interest to specific administrations or political parties," Turolla says. "This may result in macroeconomic risks that do not exist in the present." As an alternative to BNDES, the government should strengthen existing security funds, which would enable corporations to provide the guarantees required by private banks.

Another viewpoint suggests that since the private financial system cannot offer long-term financing, it falls on the state to bridge the market gap. This line of thought is supported by Luiz Afonso Simoens, a researcher at the International

**Brazil's banking credit**
**Sep. 2009 to Jan. 2010**



Economics Institute of the São Paulo State University and a member of the USP's Group for International Conjuncture (Gacint). He states that "Historically, the Brazilian financial system has only contributed to the public segment of economic development. Public sector institutions such as Banco do Brasil [BB] do support rural financing, and Caixa Econômica Federal [CEF] supports real estate financing, but with many restrictions. The private sector has never committed itself to long-term financing."

If high inflation were a reason not to finance long-term, high-risk, or low-profitability projects in the past, today this is not an excuse. "The private segment is finally investing in real estate financing, but this is partly due to mandatory allocation of resources," Simoens thinks.

## Brokerage

Simoens explains that the financial system developed from the perspective of functioning as a brokerage agent for government securities and making hefty profits out of inf ation because client's bank deposits were retained at zero cost: "By the time prices stabilized, banks were not prepared to face losses derived from inf ation gains. Although the interest on public debt has been kept high, many private institutions demonstrate operating inefficiencies." To confront these difficulties, the government launched two aid programs to restructure private and state-owned banks. This resulted in the privatization and internationalization of numerous state-owned banks, and higher credit concentration.

Simoens highlights the recent new public sector bank expansionary trend that started in 2008. Until the middle of the 1990s, the public financial system was bigger than the private system in terms of asset, deposits, net assets and credit indicators. This changed with the Plano Real economic plan (1994), plunging a considerable portion of the Brazilian financial system into crisis. As a result, by 2007 this situation had reversed: public sector banks accounted for 32% of credit transactions and private banks for 68%. But in 2008, public sector financing shot up again to 42% of the total, against 58% for the private segment.

More aggressive action by public sector banks led to a credit boom — in April 2010, total credit had already reached 45.2% of GDP (US$815 billion) against 31% in 2005. However, the supply of credit, especially to business, is still limited, expensive, and short-term. One of the reasons suggested is large bank spreads (the difference between the rates paid to savers to raise capital and the interest rates charged borrowers).

> **"The presence of a public sector agent inhibits the development of the private financial sector and creates distortions by favoring groups of interest to specific administrations or political parties.**
>
> Frederico Turolla

## Unavoidable fact

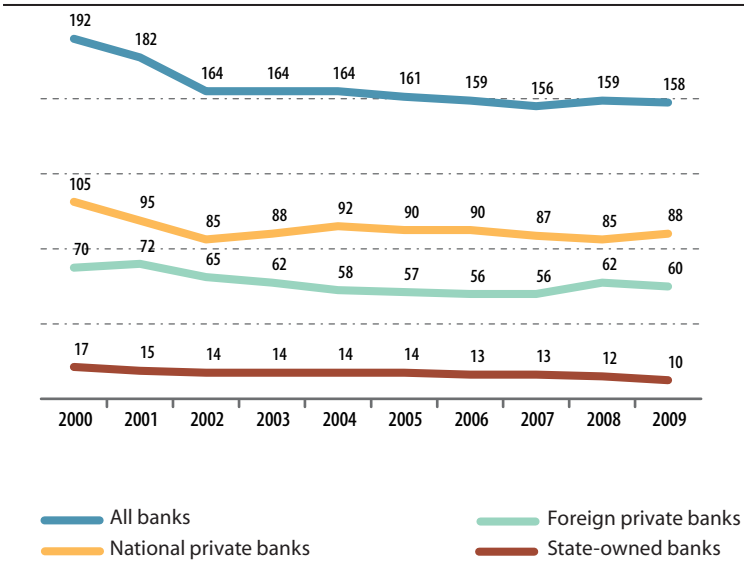
Regardless of BNDES's share in the Brazilian financial system, the solution for the old problem of how to finance development will depend on greater participation by national and international private banks. That is the opinion of Rubens Sardenberg, chief economist at the Brazilian Banking Federation (Febraban). "We can't expect an answer only from the public sector," he says.

Although no one has the formula for an immediate solution, opinions are at least converging at some points, Sardenberg thinks: "First, there is an absence of long-term funding. Brazilian investors still prefer short-term transactions. They fear macroeconomic changes, and incentives are low because long- and short-term interest rates are similar. Barriers still remain, such as excessive compulsory deposits and the lack of privileged tax treatment for these transactions." Legal uncertainty is also an issue, he thinks: "A history of constant changes in the rules is still in our minds. Moreover, the recovery of collateral following a default is still complicated, in spite of developments in this area."

> **"Historically, the Brazilian financial system has only contributed to the public segment of economic development. The private sector has never committed itself to long-term financing.**
>
> **Luiz Afonso Simoens**

Brazil still needs to do its "homework" so as to lower the costs of funding via international private capital, says Nicolas Tingas, director of the Brazilian Society for the Study of Transnational Companies and Economic Globalization (Sobeet) and professor at FGV Management in São Paulo. He explains that Brazil has the conditions to undergo a relevant expansion cycle, but it may be a mistake to trust too much in direct investment. It will come, in the form of partnerships and mergers, but only to certain projects. The other portion of investments should come from a new long-term

**Brazil's banking sector concentration**




Source: Central Bank of Brazil

**Financial system deposits (balance at end of period)**

| Bilions of Reais | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|---|---|---|---|---|---|---|---|---|---|
| Sight deposits | 46 | 51 | 66 | 67 | 76 | 87 | 105 | 149 | 132 | 142 |
| Saving deposits | 112 | 120 | 141 | 144 | 160 | 169 | 188 | 235 | 271 | 319 |
| Time deposits | 90 | 108 | 138 | 144 | 188 | 252 | 282 | 298 | 550 | 563 |
| Investment funds | 254 | 285 | 280 | 408 | 475 | 559 | 684 | 794 | 773 | 938 |
| Total | 501 | 564 | 624 | 763 | 898 | 1068 | 1259 | 1476 | 1726 | 1963 |

Source: Central Bank of Brazil

financing model at lower costs, since BNDES will not be able to do everything by itself.

As a possible solution, Tingas cites improvement in Brazilian regulation, which should include tax treatment that reduces the risk premium by lowering costs for private banks so as to make this financing modality more attractive. "There is money abroad, but investors are not always willing to face Brazil's tax and legal costs, which are excessive," he comments. The Ministry of Finance has announced studies to facilitate financing, at least for domestic companies. The ministry is, for instance, considering differentiated tax treatment for the issuance of debentures, which would lower business dependence on raising funds abroad.

## Capital market

According to Frederico Turolla, another permanent challenge is to build up Brazil's capital market, which was introduced only in this decade. Its development was only possible after the disappearance of alleged political risks attached to governance by the left-trending Workers' Party, whose policies were even more liberal than those of its predecessors, the Social Democrats. He says that the plunge in macroeconomic risks "was the final ingredient for the development of the Brazilian capital market."

The capital market has stimulated the emergence of a variety of alternatives in the past few years. In addition to initial public offerings (IPOs), through which new companies can offer shares on the Stock Exchange, and the issuance of debt securities starting early in the 1990s, Brazil has seen the creation of private equity, venture capital, and equity investment funds. "This is the capital market segment that is largely responsible for the dynamism of the US economy, and it can play a strategic role in Brazil," Turolla says.

We are already seeing the effects. From January to October 2009, 29% of mergers and acquisitions (M&As) in Brazil involved private equity funds. In 2009, the country saw a record-breaking 509 M&As. And Brazilian private equity funds currently have R$15 billion to invest. Heavy demand for credit lines with maturities longer than 10 or 15 years stimulates market segmentation, says Sandro Marconi, head of BB's commercial practice, which uses capital plus debt to finance telephony, energy, and road concession works that have self-sustainable promise.

"We seek our niches by offering assistance to the development and financing of new undertakings; pro-

viding advice to investors; identifying appropriate sources; and helping with negotiations with domestic or foreign investors," Marconi explains. He says that well-structured projects promising good profitability generally do not suffer from a lack of resources.

## Infrastructure

Itaú BBA's plans also show a great interest in infrastructure projects. Carlos Eduardo Mellis, head of Itaú BBA's project finance area, says that last year wind energy bids alone cost R$8 billion. Some highway projects will start this year, along with the Rodoanel Leste beltway in São Paulo. The Porto Sul project in Ilhéus (State of Bahia) is also being considered. The company also expects good investment opportunities related to railways, sanitation, and pipeline construction, in addition to what the oil and gas sector needs to develop the pre-salt oil field.

Improving urban transportation for the World Soccer Cup and the Olympic Games to be held in Brazil will boost public-private partnerships (PPPs). "Estimates are high at R$200 billion (US$111 billion) a year in all these sectors," Mellis said.

## Real estate

An early indication that numerous commercial banks, not just development or public sector institutions, are starting to think in terms of long-term financing is the increase in real estate credit. "After the failure of the government National Housing Bank, private institutions resumed their operations in this niche," says Luis Santacreu, financial institutions analyst at Austin Rating. However, demand for credit is much stronger now due to the challenge of increasing Brazil's production capacity. Real estate credit, which does not exceed 3% of GDP, is among the segments with great potential for expansion.

The higher demand for corporate credit, a segment that has reacted positively since the end of 2009, will be clearer in the second half of this year, Santacreu says, adding, "From then on, domestic and foreign banks will take action."

With controlled default rates, financial institutions can estimate the growth of credit portfolios without risking quality, Santacreu says. "The sector is optimistic about the future, although it is not euphoric and wants to avoid surprises, since the perspective is still somewhat cloudy. No one knows how the crisis in Europe will turn out, which brings uncertainty about possible instabilities." He notes that "the market also takes into account a certain degree of uncertainty relating to the presidential elections in Brazil."

## Future

In fact, there are no magic solutions or likely shortcuts. Febraban's Sardenberg warns: "Various problems still have to be faced, and their answers are difficult and may take some time to find. Any direction it takes will imply maintaining macroeconomic achievements and improving government's fiscal position."

Luiz Afonso Simoens summarizes some aspects of the debate:

"The structural changes that occurred in the Brazilian financial system starting in the 1990s led to internationalization, privatization, and concentration trends in all relevant indicators. The concentration of credit among large banks hurts competition. It explains

# Mergers and acquisitions

| Buyer | Comprado | Date |
|---|---|---|
| Itaú | Banco Francês e Brasileiro (BFB) | Jul. 1995 |
| Nacional de Paris – BNP | Comercial de S. Paulo | Aug. 1995 |
| Itamarati | Crefisul | Sep. 1995 |
| Comercial de France | Montreal | Sep. 1995 |
| Unibanco* | Nacional | Nov. 1995 |
| Pontual | Continental | Jan. 1996 |
| United* | Antonio de Queiroz | Apr. 1996 |
| Mitsubishi | Tokyo | Apr. 1996 |
| Dibens | Battistella | Apr. 1996 |
| Excel* | Econômico | May 1996 |
| Bandeirantes* | Banorte | May 1996 |
| Rural* | Mercantil | May 1996 |
| Deutsch Sudamerikanische Bank | Banco Grande Rio | Jun. 1996 |
| Pontual | Martinelli | Jun. 1996 |
| BCN | Itamarati | Jul. 1996 |
| Cindam | Fonte | Jul. 1996 |
| Lavra | Segmento | Nov. 1996 |
| Caoa | Schahin Cury | Nov. 1996 |
| Galicia | BCN Barclays | Dec. 1996 |
| Société Générale | Sogeral | Jan. 1997 |
| Lloyds Bank | Multiplic | Feb. 1997 |
| Santander | Geral do Comércio | Mar. 1997 |
| Arabian Bank | ABC Roma | Mar. 1997 |
| HSBC* | Bamerindus | Mar. 1997 |
| Morgan Greenfeld | Irmãos Guimarães | Apr. 1997 |
| Itaú | Banerj | Jul. 1997 |
| Bco. Geral do Comércio (Santander) | Noroeste | Aug. 1997 |
| BCN | Credireal | Aug. 1997 |
| Interatlântico (Bco. Espírito Santo) | Boavista | Sep. 1997 |
| American Express Bank | SRL (associação) | Sep. 1997 |
| AIG Consumer Finance Group | Fenícia | Sep. 1997 |
| Bradesco | BCN | Oct. 1997 |
| Swiss Bank Corporation | Ômega | Nov. 1997 |
| Nations Bank Corporation | Liberal | Nov. 1997 |
| Pactual | Sistema | Dec. 1997 |
| Bozano Simonsen | Meridional | Dec. 1997 |
| Wachovia Corp. Finance | Português do Atlântico | Dec. 1997 |
| Caixa Geral de Depósitos | Bandeirantes | Jan. 1998 |
| Flemings | Graphus | Feb. 1998 |
| General Eletric Capital Corporation | Mappin S.A. | Feb. 1998 |
| Unibanco | Dibens | Mar. 1998 |
| Mellon Bank | Brascan | Mar. 1998 |
| Bilbao Vizcaya | Excel Econômico | May 1998 |
| Crédit Suisse First Boston | Garantia | Jun. 1998 |
| Sudameris | América do Sul | Jun. 1998 |
| ABN-Amro Bank | Real | Jul. 1998 |
| Itaú | Bemge | Sep. 1998 |
| Bradesco (BCN) | Pontual | Nov. 1998 |
| ABN-Amro Bank | Bandepe | Nov. 1998 |
| Internacional do Funchal (Banif ) | Primus | May 1999 |
| Bradesco | Baneb (Bco. Est. da Bahia) | Jun. 1999 |
| BBA | Icatu (associação) | Aug. 1999 |
| Bank of New York | Credibanco | Oct. 1999 |
| Santander | Bozano Simonsen / Meridional | Jan. 2000 |
| Unibanco | Credibanco | Feb. 2000 |
| Unibanco | Bandeirantes | Jul. 2000 |
| Bradesco | Boavista | Jul. 2000 |
| Itaú | Banestado | Oct. 2000 |
| Santander | Banespa | Nov. 2000 |
| Bank of América[1] | Liberal | Jul. 2001 |
| Barclays e Gallicia | Gallicia (50%) (parte do Gallicia) | Aug. 2001 |
| ABN-Amro Bank | Paraiban | Nov. 2001 |
| Itaú | BEG - Bco. Estado de Goiás | Dec. 2001 |
| Bradesco | Mercantil de São Paulo – Finasa | Jan. 2002 |
| Bradesco | Banco do Estado do Amazonas | Jan. 2002 |
| Bradesco | Banco Cidade | Feb. 2002 |
| Uinbanco | Investcred | Apr. 2002 |
| Unibanco | Banco Fininvest | Apr. 2002 |
| Itaú | Banco BBA | Nov. 2002 |
| Itaú | Fiat | Dec. 2002 |
| Bradesco | Banco Bilbao Vizcaya | Jan. 2003 |
| Trapézio S.A. (Bco. Rural) | Banco Sul América | May 2003 |
| Rural | Rural Mais (Antigo Banco Sulamérica) | May 2003 |
| ABN-Amro Real | Sudameris | Aug. 2003 |
| HSBC | Lloyds TSB | Oct. 2003 |
| Societé Generale | Banco Pecúnia | Oct. 2003 |
| Bank of America | Fleet Boston | Nov. 2003 |
| Bradesco | Banco Zogbi | Nov. 2003 |
| Bradesco | Banco do Estado do Maranhão (BEM) | Feb. 2004 |
| Itaú | Banco AGF | Feb. 2004 |
| Unibanco | BNL/AS | Jun. 2004 |
| Bradesco | BEC | Jan. 2006 |
| Itaú | Bank Boston | May 2006 |
| Bradesco | Alvorada | |
| Itaú | Citicard | |
| Bradesco | Banco American Express | Jun. 2006 |
| UBS | Pactual | Sep. 2006 |
| American Express S.A.[2] | Banco Bankpar S.A. | Oct. 2006 |
| Bradesco | Banco BMC | Aug. 2007 |
| Société Générale | Banco Cacique | Nov. 2007 |
| Santander | ABN Amro Real | Jul. 2008 |
| BNP Paribas | Banco BGN | Jul. 2008 |
| Banco do Brasil | Banco do Estado de Santa Catarina (BESC) | Jan. 2009 |
| Itaú | Unibanco | Feb. 2009 |
| Banco do Brasil | Banco Nossa Caixa | Mar. 2009 |

*Purchase was done under the government aid restructuring program for banks (PROER).

[1]Bank of America was purchased by the Nations Bank Corporation in US. [2]Changed name.

Sources: Central Bank and FEBRABAN.

low leveraging rates and excessive concentration by size of transaction. Our financial system is making a mistake that is opposite to that of foreign financial markets, whose leveraging rates became too high."

Although, default rate is the most relevant component of bank spread (contributing about a third of total spread), Nicolas Tingas thinks there is a structural economic factor that boosts interest rates: "The government itself contaminates the cost of money by guaranteeing quite high interest rates on Treasury securities sold in the financial market to cover the public accounts deficit." Considering the Central Bank's benchmark rate (Selic) at 9.5% a year and inf ation between 4.5% and 5%, a 4% real interest rate is seen as high. Tingas adds that this situation cannot be changed without lowering the public debt to GDP ratio from 41.2% (in May) to 30%.

Changes need also to be made especially to boost the access of low-income Brazilians to credit and other financial services. US citizens, for example, are able to fit their car and mortgage installment payments to their wages for some decades. "Low interest rates in the US allow this possibility. Brazilians are still financing their first car, and a significant number of persons are not able to own their homes because their income is not sufficient to pay mortgages. But this is due not only to their income, but also to high interest rates," Santacreu says.

**"The government itself contaminates the cost of money by guaranteeing quite high interest rates on Treasury securities sold in the financial market to cover the public accounts deficit.**

**Nicolas Tingas**

For the Central Bank reducing disparities in fees, spreads, and interest rates depends on a series of measures that it is already undertaking. Moreover, actions to improve the relationship between financial institutions and their clients have a direct impact on improving consumer credit conditions, according to the BC's press department.

In 2007 the National Monetary Council (CMN) approved new regulations for bank fees that made it easier for consumers to compare the services and prices offered by each institution. According to the BC, there is also the "bank spread agenda," which includes standardization and transparency of credit contracts; portability of individual banking records — at the request of clients, banks must disclose their clients' data to other institutions, allowing new relationships on more favorable bases; and wage portability — the wages and other compensation deposited in the financial institution elected by the employer can be transferred to a bank chosen by the employee at no cost.

The Central Bank is convinced that the regulations relating to the domestic financial system are effective, transparent, and can minimize business risks in general.

# Banks' assets and profits (Millions of Reais)

| Institutions | Assets | | Net profits | |
|---|---|---|---|---|
| | Dec. 08 | Dec. 09 | Dec. 08 | Dec. 09 |
| Banco do Brasil* | 521,272,817 | 708,548,843 | 8,802,869 | 10,147,522 |
| Itaú Unibanco* | 632,728,403 | 608,273,230 | 7,803,483 | 10,066,608 |
| Bradesco* | 454,413,043 | 506,223,092 | 7,620,238 | 8,012,282 |
| Santander* | 340,635,472 | 342,323,741 | 1,580,613 | 1,805,899 |
| Caixa | 295,920,330 | 341,831,823 | 3,883,289 | 2,999,706 |
| HSBC Bank Brasil* | 112,100,300 | 100,104,481 | 1,354,577 | 673,752 |
| Votorantim* | 72,309,956 | 84,800,810 | 901,786 | 801,773 |
| Safra* | 61,939,959 | 65,863,012 | 843,392 | 911,272 |
| Citibank* | 40,479,564 | 41,431,264 | 1,339,556 | 1,953,357 |
| Banrisul* | 25,205,375 | 29,084,137 | 590,873 | 541,096 |
| BTG Pactual* | 19,270,837 | 21,914,810 | 838,817 | 629,285 |
| Deutsche Bank* | 17,233,504 | 20,759,658 | 485,131 | -71,725 |
| BNB | 16,177,235 | 19,154,466 | 421,029 | 459,012 |
| Volkswagen | 12,491,808 | 16,648,164 | 241,168 | 63,591 |
| BNP Paribas | 26,391,435 | 14,244,674 | 266,491 | 250,526 |
| Alfa* | 14,718,781 | 12,780,804 | 191,101 | 157,510 |
| Fibra* | 9,181,473 | 11,835,256 | 102,456 | 101,744 |
| Panamericano* | 8,976,475 | 11,590,557 | 95,575 | 174,021 |
| BicBanco* | 12,007,347 | 11,399,660 | 320,531 | 318,204 |
| BBM * | 14,177,926 | 10,595,552 | 93,754 | 68,956 |
| BMG* | 7,192,009 | 10,257,197 | 240,748 | 522,344 |
| Sicredi | 7,190,702 | 9,095,631 | 21,122 | 26,837 |
| Banestes* | 8,524,501 | 8,944,222 | 161,285 | 131,163 |
| BMB* | 6,765,507 | 7,861,817 | 43,034 | 40,389 |
| Basa | 7,239,780 | 7,805,744 | 215,850 | 26,300 |
| Gmac | 8,820,179 | 7,764,261 | 137,198 | 140,687 |
| Abc Brasil* | 7,494,921 | 7,377,224 | 150,088 | 151,154 |
| Cruzeiro do Sul* | 5,694,852 | 7,352,446 | -130,573 | 107,479 |
| JP Morgan | 8,858,570 | 7,246,572 | 94,304 | 73,970 |
| Daycoval* | 6,830,983 | 7,060,828 | 200,150 | 211,088 |
| Societe Generale* | 6,480,050 | 7,008,149 | -148,806 | -81,650 |
| Pine* | 6,196,880 | 6,984,014 | 132,987 | 85,086 |
| Rabobank | 7,683,719 | 6,968,786 | 70,603 | 58,187 |
| Bancoob | 5,123,953 | 6,801,937 | -11,095 | 19,088 |
| BRB* | 5,620,546 | 6,612,133 | 110,317 | 190,455 |
| IBI | 5,612,296 | 5,768,403 | 58,600 | -449,849 |
| Mercedes Benz | 4,626,412 | 5,637,762 | 43,133 | 15,641 |
| PSA Finance Brasil* | 3,843,436 | 5,340,044 | 47,713 | 60,693 |
| Clássico | 3,585,232 | 4,849,050 | 141,591 | 37,021 |
| Sofisa* | 4,510,095 | 4,677,127 | 92,201 | 10,586 |
| CNH Capital | 4,657,517 | 4,374,752 | 48,221 | -255,953 |
| Fidis | 3,230,094 | 3,539,810 | 54,101 | 105,560 |
| Rural* | 2,503,362 | 3,443,985 | 50,854 | 49,851 |
| Lage Landen | 3,173,532 | 3,351,145 | 21,025 | -5,952 |
| Morgan Stanley | 1,722,691 | 3,027,423 | 94,911 | 78,100 |
| BVA | 876,749 | 2,971,340 | 6,811 | 48,426 |
| Toyota* | 2,672,721 | 2,854,955 | 25,135 | 37,155 |
| Paraná Banco* | 1,977,783 | 2,823,119 | 84,127 | 104,301 |
| Westlb | 3,814,276 | 2,769,511 | 59,170 | 56,179 |
| Indusval* | 2,225,397 | 2,730,202 | 71,773 | 12,778 |

| Institutions | Assets | | Net profits | |
|---|---|---|---|---|
| | Dec. 08 | Dec. 09 | Dec. 08 | Dec. 09 |
| ING Bank | 5,092,929 | 2,683,448 | -45,551 | 77,977 |
| Volvo | 1,841,583 | 2,479,079 | 13,086 | -246 |
| CSF | 2,275,059 | 2,475,520 | 156,658 | 118,766 |
| Schahin * | 1,601,712 | 2,437,712 | 31,985 | 26,551 |
| Barclays | 5,202,852 | 2,269,164 | 190,981 | 73,487 |
| Banese | 2,150,383 | 2,237,721 | 34,112 | 39,114 |
| IBM | 2,257,016 | 2,026,848 | 684 | 63,091 |
| John Deere | 1,977,199 | 1,845,624 | 36,520 | 9,434 |
| Industrial* | 1,643,735 | 1,787,935 | 36,515 | 38,558 |
| Banpara | 1,537,896 | 1,773,464 | 78,397 | 43,695 |
| Bonsucesso | 985,051 | 1,670,886 | 23,865 | 84,120 |
| Tribanco | 1,512,700 | 1,667,338 | 57,821 | 41,735 |
| Ford | 1,569,222 | 1,509,335 | 46,053 | 49,006 |
| Banif | 1,384,597 | 1,486,465 | 4,737 | 899 |
| Credit Suisse | 1,462,782 | 1,472,694 | 6,821 | 4,562 |
| Honda | 971,767 | 1,409,869 | 22,654 | 27,133 |
| Paulista | 1,182,528 | 1,403,311 | 14,997 | -13,292 |
| Tokyo-Mitsubishi | 1,880,803 | 1,388,680 | 8,221 | 75,731 |
| Credit Agricole | 1,195,703 | 1,247,806 | 38,591 | 21,284 |
| Sumitomo | 1,484,422 | 1,181,246 | 12,833 | -26,222 |
| Fator* | 1,009,312 | 1,123,158 | 7,797 | 52,294 |
| Goldman Sachs | 905,375 | 1,103,694 | 7,682 | -59,534 |
| Rendimento | 758,885 | 973,145 | 25,440 | 15,135 |
| Modal* | 782,068 | 956,543 | 59,680 | 18,363 |
| KDB do Brasil | 1,549,708 | 946,725 | 3,398 | -60,675 |
| Matone | 586,865 | 871,123 | -47,715 | -1,657 |
| Cargill | 621,470 | 864,397 | -16,424 | 10,889 |
| GE Capital | 1,701,909 | 805,548 | -40,743 | -63,198 |
| Guanabara | 766,047 | 783,969 | 10,056 | 15,218 |
| Rodobens | 702,065 | 731,378 | 36,174 | 33,755 |
| Dresdner Brasil | 1,880,653 | 706,879 | -14,800 | -49,220 |
| Brascan* | 661,301 | 701,404 | 1,040 | -4,934 |
| Moneo | 486,385 | 646,919 | 11,362 | 10,558 |
| Morada | 272,193 | 595,976 | 6,706 | 13,209 |
| Commercial Trust | 651,875 | 518,734 | -14,380 | 5,706 |
| Maxima* | 219,303 | 443,170 | 10,970 | 25,351 |
| Semear | 255,039 | 434,835 | -468 | 9,411 |
| BPN Brasil | 424,346 | 419,272 | 3,049 | -11,902 |
| Tricury | 372,743 | 408,648 | 22,338 | 16,545 |
| BRP | 348,192 | 386,135 | 4,797 | 3,724 |
| Intercap* | 379,646 | 382,501 | -4,386 | -6,087 |
| Ficsa | 168,784 | 353,113 | 4,167 | 14,969 |
| VR | 557,845 | 345,344 | -10,658 | 12,888 |
| Intermedium Banisa | 257,990 | 343,776 | 6,233 | 12,718 |
| Luso Brasileiro | 292,897 | 332,525 | 1,092 | -13,488 |
| Lloyds TSB Bank | 309,561 | 310,735 | 12,741 | -1,257 |
| Cedula | 202,107 | 305,263 | 11,610 | 10,024 |
| JBS | 155,764 | 273,384 | -525 | 1,801 |
| A,J, Renner | 217,033 | 270,771 | 4,619 | 2,834 |
| Caixa Geral | 135,987 | 256,970 | -3,553 | 37 |
| **TOTAL** | 2,919,224,072 | 3,206,757,802 | 40,830,586 | 42,440,365 |

* Financial group consolidated data. Source: Austin Rating

# Agenda and Agreements

**Lia Valls Pereira**

The difficulties surrounding the end of the World Trade Organization (WTO) Doha Round negotiations have led to debate over the role of multilateralism in today's world.

WTO's decisions are taken by a consensus that, until the Uruguay Round (1986-1994), consisted of developed countries: the United States, Japan, Canada, and the European Union (the Quad). Quad relevance in global trade at the time meant that the negotiations reflected primarily the interests of those countries. But things have changed. The emergence of a new group of nations having an influence on international trade has resulted in the creation of other alliances that could effectively influence trade talks. The constitution during the Doha Round of the G20 — a group in which Brazil, China, and India are prominent — was a milestone in multilateral negotiations.

The perception that the order established after World War II needs to be reviewed is under discussion within the financial sphere, though global trading countries are considering changes to the WTO. However, beyond the debate, bilateral and regional agreements are proliferating. According to the WTO, 271 preference agreements are currently in force. Although the WTO accepts these agreements, they contradict the multilateral principle that all countries should enjoy equal trade treatment.

## The Strategy

Brazil's strategy for the failed Doha Round has been criticized by business leaders and former diplomats. The strategy is said to have supported the WTO to the detriment of the negotiations, especially with developed countries. It is worthwhile to notice that the modest offers that the EU made to Mercosur in the agricultural area in 2004 reflected some skepticism about the consequences of multilateral talks.

The resumption of trade talks with the EU in July this year is motivated partly by the lack of Doha Round results and partly by Spain's presidency of the European Union — given the economic and cultural ties, Iberian countries seem more likely than other EU members to come to agreement with Latin American countries. The success of the negotiations, however, is not guaranteed. France, Ireland, and some Eastern European countries refuse to negotiate agricultural issues. The agreements the EU has entered into are not with the large agricultural exporting countries of Central America, or with Peru and Colombia.

What is being, or has already been, negotiated? An analysis of Brazil's

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recent foreign trade helps to understand better Brazil's trade agenda.

## Global trader

What has happened with trade in the first four months of 2010 suggests that Brazil's agenda is to be a global trader. Brazilian exports to Latin America, the Caribbean, and Asia are of similar volume, almost 25% each. For imports Asia is Brazil's principal supplier (30%), closely followed by Latin America (27.4%). The high Asian percentage in both cases is mostly due to China, whose share in both Brazil's exports and imports is 13.2%. China is the main destination for our exports, surpassing the United States with 10.7%. For imports, the United States is our principal supplier (14.7%). In Latin America and the Caribbean, Brazil trades more heavily with its South American neighbors, who account for 18.7% of exports and 14.6% of imports.

The EU is third among Brazil's principal export and import partners, ahead of the United States. The difference between exports to developing countries and to developed countries is 13 percentage points: The first group accounted for 55.5% of Brazilian exports in the first four months of 2010. For imports, developed countries represented 51.2%, while developing countries corresponded to 48.7%.

The description of trade flows by product points up differences between the markets. Asia and the EU buy basic and semi-finished products, while manufactured goods go heavily to Latin America (44%), the vast majority of them (83%) to South America. The EU gets the second highest amount of manufactured goods, followed by the United States.

Trade with Asia in manufactured goods is far from balanced. Brazil sends 7% of its exports there, but Asia sends 35.5% of our imports. The situation is somewhat reversed for Latin America: Exports of 44% contrast with imports of 13.5%. Developed countries account for 41% of Brazilian manufacturing sales, while developing countries are responsible for 59%. Thus, both markets are relevant.

**Brazilian foreign trade structure**
by regions/product groups

| Products/Regions | Exports | Imports |
|---|---|---|
| Basic products | 100.0 | 100.0 |
| Asia | 41.57 | 5.62 |
| European Union | 23.82 | 2.33 |
| Latin America, the Caribbean | 10.9 | 31.8 |
| United States | 8.1 | 6.4 |
| Africa | 2.9 | 34.2 |
| Others | 12.7 | 19.7 |
| *Developed Countries* | 42.1 | |
| *Developing Countries* | 57.9 | |
| Semi-finished products | 100.0 | 100.0 |
| Asia | 34.1 | 3.7 |
| European Union | 23.3 | 19.4 |
| Latin America, the Caribbean | 6.1 | 44.4 |
| United States | 11.8 | 8.4 |
| Africa | 5.6 | 2.7 |
| Others | 19.1 | 21.6 |
| *Developed Countries* | 53.6 | |
| *Developing Countries* | 46.4 | |
| Manufatures | 100.0 | 100.0 |
| Asia | 7.0 | 35.5 |
| European Union | 21.1 | 25.2 |
| Latin America, the Caribbean | 44.0 | 13.5 |
| United States | 13.6 | 16.6 |
| Africa | 5.4 | 2.6 |
| Others | 9.0 | 6.6 |
| *Developed Countries* | 41.0 | |
| *Developing Countries* | 59.0 | |

Source: Secretariat of Foreign Trade (Secex) of Ministry of Development, Industry and Foreign Trade, www.desenvolvimento.gov.br.

The constitution during the Doha Round of the G20 – a group giving prominence to Brazil, China, and India – was a milestone in multilateral negotiations

The high Asian percentage in both cases is mostly due to China, whose share in both exports and imports from Brazil in the first four months of 2010 was 13.2%.

The structure of bilateral trade agendas shows a high percentage of manufacturing imports (above 90%) from the EU, the US, and Asia. Manufacturing exports flows to the US (40%) and the EU (53%) are relatively balanced. Exports to Asia are concentrated on basic products (69%).

Mapping trade flows shows the diversity of Brazil's interests in terms of demand, but its agenda should include multilateral prospects.

## Agreements

Free trade agreements are already effective among all countries in South America.[1] The most recent are with Colombia, Ecuador, and Venezuela (2005) and Peru (2006). Domestic manufacturers have criticized the agreements for distinctly liberalizing trade terms. In general, Brazil allows immediate free access of most products to its market, although it does not always get a similar benefit from its partners: Full liberalization terms for Andean countries are from five to ten years.[2]

More recently Brazil has entered into other agreements, one with Israel in April 2010, and another with India effective in June 2009, though the Indian agreement so far covers only 450 products. An agreement on preferential taxes encompassing some 1,000 products has been signed with the SACU, whose members are South Africa, Namibia, Botswana, Lesotho, and Swaziland, but it has not yet been submitted to Congress for approval.

Since 2002 Brazil has engaged in trade talks with Mexico on the definition of a free trade area, but the talks have not yet reached a conclusion. An agreement affecting the automotive sector, entered into in March 2003, provides for reciprocal reductions in import taxes.

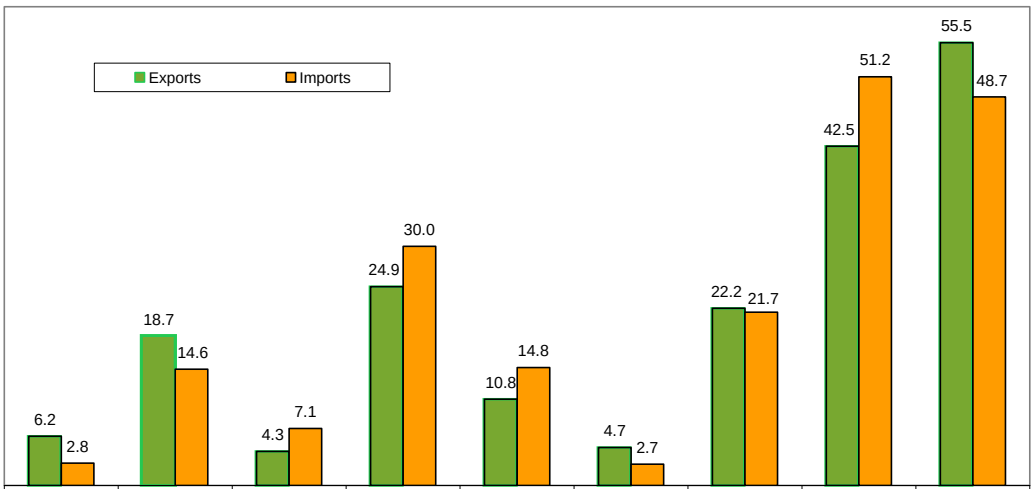
A preliminary agreement with the EU on creation of a free trade area was signed in 1999. By 2004 negotiations had advanced and full agreement seemed to be closer, but European offers in the agricultural area were considered insufficient: simply expansion of Brazil's export quotas currently in effect

**Bilateral trade structure: January- July 2010**
(in percentage)

| | Asia | | European Union | | Latin America and the Caribbean | | United States | | Africa | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Exports | Imports | Exports | Imports | Exports | Imports | Exports | Imports | Exports | Imports |
| Basic products | 69.0 | 2.7 | 44.3 | 1.5 | 18.6 | 26.2 | 30.8 | 6.2 | 28.3 | 68.4 |
| Semi-finished products | 18.9 | 0.5 | 14.5 | 3.5 | 3.4 | 10.1 | 15.1 | 2.2 | 18.0 | 1.5 |
| Manufatures | 12.0 | 96.8 | 40.3 | 94.9 | 77.8 | 63.7 | 53.3 | 91.6 | 53.5 | 30.1 |

"Source: Secretariat of Foreign Trade (Secex) of Ministry of Development, Industry and Foreign Trade."

**Regions' share in Brazilian foreign trade, January-April 2010 (in percent)**




| | Central America and the Caribbean | South America | Africa | Asia | United States | Middle East | European Union | Developed Countries | Developing Countries |
|---|---|---|---|---|---|---|---|---|---|
| Exports | 6.17 | 18.69 | 4.26 | 24.91 | 10.81 | 4.74 | 22.21 | 42.51 | 55.49 |
| Imports | 2.79 | 14.57 | 7.13 | 29.97 | 14.78 | 2.65 | 21.71 | 51.22 | 48.69 |

Source: Secretariat of Foreign Trade (Secex) of Ministry of Development, Industry and Foreign Trade.

and reduction in tariffs on Brazil's exports exceeding quotas. Moreover, the gains applied primarily to ethanol exports.[3]

## Barriers

Before negotiations can go forward, the EU must first come to an understanding with members that defend agricultural protectionism. Considering Europe's current crisis, free trade offers are likely to be rare. And what might be demanded from Brazil? In 2004, domestic businesses did not welcome EU's demands in the services and government purchases sectors.

Agreements are also being discussed with Jordan, Turkey, Morocco, Egypt, the Gulf Cooperation Council, and Pakistan.

Given how extensive the trade agenda is, some priorities have to be defined. Mercosur and South America's integration deserve further negotiations that go beyond trade issues. A comprehensive agreement with Mexico might consolidate intra-industry trading among trans-Latin companies. A trade agreement with the EU would be welcome, but an approach to the US would be needed to avoid trade diversion.

Ineffective multilateral negotiations cause losses to the global economy. To compensate, a country like Brazil with a global trade agenda must expand its network of agreements. ■

[1] All agreements into which Brazil has entered can be found the website of Secretariat of Foreign Trade (Secex) of Ministry of Development, Industry and Foreign Trade, http://www.desenvolvimento.gov.br/sitio/interna/index.php?area=5.

[2] See analysis on IBRE's website, Applied Economy Center – International Economics, http://portalibre.fgv.br/main.jsp?lumChannelId=8A7C8233253AEA0A01253B0A09222084.

[3] A detailed analysis of this offer was carried out by H. Kume and others (IPEA Discussion Texts nos. 1054 and 1296. Available on www.ipea.gov.br, under "Publications – Texts for Discussion").

## Real wages rising

After a slight decline between January and May of 2009, real wages have begun to grow again, influenced by labor market demand and low inflation. The brisk pace of the Brazilian economy, supported by the fiscal stimulus measures and loose monetary and credit policy, has sustained real income growth despite an acceleration of inflation in recent months. In the first quarter real income grew at an annualized real rate of nearly 4%. Some segments are now facing shortages of skilled labor that are pushing up wages and prices.

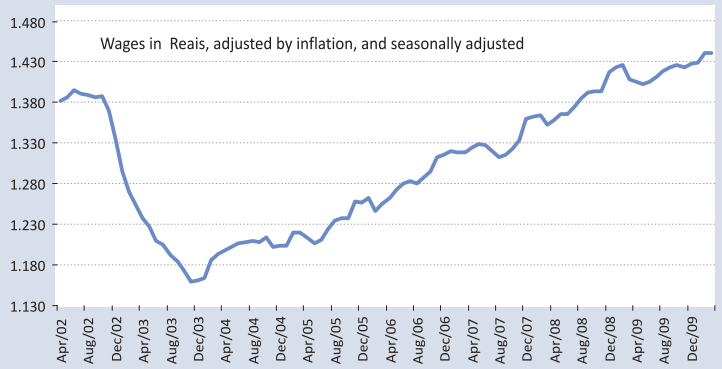
## Unemployment falling

Using seasonally adjusted data, the unemployment rate in April 2010 fell to its lowest level (6.7%) since 2002. Between September 2008 and June 2009 favorable developments in the service, construction, and public sectors more than offset the largely negative results of the industrial sector. Unemployment is likely to continue declining in the second quarter of 2010; the May FGV Labor Market Survey indicates that consumers expect strong labor demand.

## Industry at full speed ahead

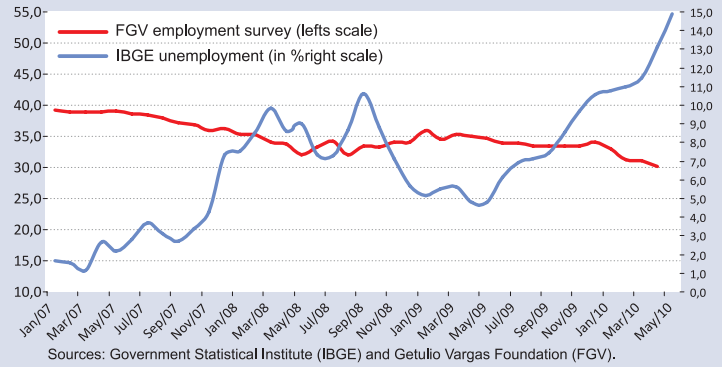
Domestic demand brought about a sharp increase in industrial capacity utilization throughout the second half of 2009. Encouraged by subsidies for purchasing machinery and equipment, the industry returned to investing heavily, as recorded by IPEA's machinery purchase index. The FGV industry capacity utilization index grew by 7 points, to 85%, in the 12 months through March 2010. It appears from recent developments that industry capacity utilization may stabilize or grow more slowly over the coming months. Inflationary pressures, originating from the expansion of profit margins to pre-crisis rates and the strength of domestic demand, threaten the government's inflation target. The Central Bank is expected to continue raising interest rates cautiously in the near future to curb inflation.

**Real wage earnings have resumed growth since April 2009**



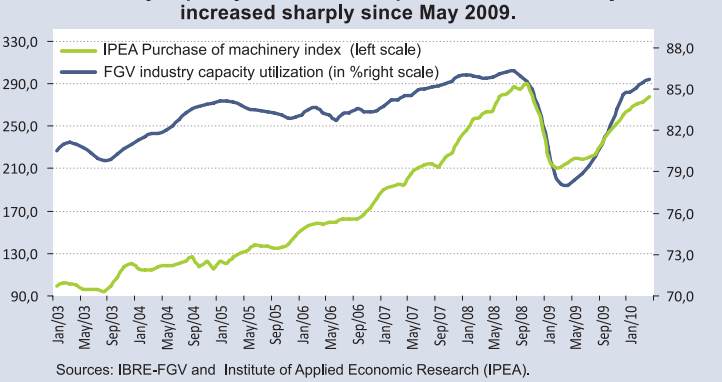

Source: Government Statistical Institute (IBGE).

**Unemployment continues to decline on the back of a strong economy.**



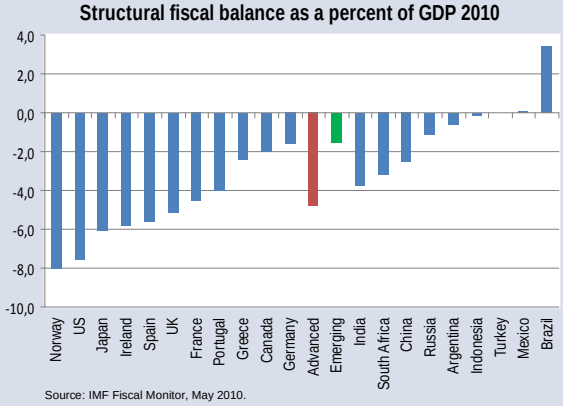

Sources: Government Statistical Institute (IBGE) and Getulio Vargas Foundation (FGV).

**Industry capacity utilization and purchase of machinery increased sharply since May 2009.**




Sources: IBRE-FGV and Institute of Applied Economic Research (IPEA).

**Structural fiscal balance as a percent of GDP 2010**




Source: IMF Fiscal Monitor, May 2010.

## Great fiscal divide between advanced and emerging economies

A striking fact of the global crisis is the major deterioration in the structural deficits in advanced compared with emerging economies. The structural deficit (the deficit adjusted for tax revenue losses resulting from the business cycle) is projected for 2010 at –4.8% of GDP for advanced countries compared to –1.5% for emerging countries. Except for Canada and Germany, advanced countries entered the crisis with much larger fiscal structural deficits, which were aggravated by huge fiscal stimulus packages to shore up their economies. In contrast, emerging countries entered the crisis with fiscal surpluses and thus had room to stimulate their economies without deepening fiscal imbalances.