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Brazil's economic and financial indicators

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Address
Rua Barão de Itambi, 60 – 5º andar
Botafogo – CEP 22231-000
Rio de Janeiro – RJ – Brazil
Tel.: (55-21) 3799-6840 – Fax: (55-21) 3799-6855
conjunturaredacao@fgv.br

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Program Administrators: Kevin Kellbach and Ray Marin

Address
Duquès Hall, Suite 450
2201 G Street, NW
Washington, DC 20052
Tel.: (202) 994-5205 Fax: (202) 994-5225
ibi@gwu.edu

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Contributors to this issue
Liliana Lavoratti
Martin Guilman
Fernado de Holanda Barbosa
Lia Valls Pereira
Sônia Araripe
Constanza Valdez
Ignez Vidigal Lopes
Mauro Resende Lopes
Aloisio Campelo
Salomão Quadros



Claudio Conceição

Executive Editor
claudioconceicao@fgv.br

Former President Fernando Henrique Cardoso in an interview with *The Brazilian Economy*, gives the first indications of how the Brazilian Social Democratic Party (PSDB) will challenge the Workers' Party (PT) President Luiz Inácio Lula da Silva's candidate in the race to occupy the Presidential Palace of Planalto. "No use for President Lula to say that the social programs, the pre-salt oil fields, and the stability were born in his administration. The elections will be won by who inspires confidence and gets the voter to say 'this person will get us ahead.' Voters cast their ballots thinking about the future, not the past," he says. For Fernando Henrique Cardoso, the Acceleration Program (PAC) and the pre-salt are being used by the administration as electoral campaign instruments.

Economist Martin Gilman, a professor of economics and director of the Center for Economic Policy of the State University Higher School of Economics, Moscow, says that analysts of the Russian economy, one of the members of the BRICS that was most affected by the financial crisis, have begun to accept that the country is starting to recover after the sharp fall at the end of last year that lasted until the first half of this year. He is of the view that the major risk for Russia's recovery is excessive government spending — especially if it occurs all at once.

Another issue that we address in this issue is the question of environmental sustainability and social responsibility that has long been seen in Brazil as philanthropy. More recently, however, under pressure from various civil society organizations and globalization, the corporate world has given in to what previously might have seemed a fad and concluded that sustainable practices must be followed daily, including them once and for all in corporations' strategic planning. Now, sustainability is one more business.

The Central Bank, once again in a tight spot

The Brazilian economy is doing well. And the recovery is surprisingly vigorous, judging from the levels of activity seen since the national accounts for the second quarter were published and from the signs coming from industry in the third quarter. Yet the life of economists could not be harder: predicting GDP for the next year with even minimal precision has never been so challenging. And because projecting economic activity is difficult, so is anticipating how inflation will behave at this delicate political-electoral moment. The Central Bank is entering into a phase that is as challenging as all the successive phases since inflation targets were introduced in 1999. One can only hope that it will come out of it as well as it has in the past.

There is no doubt that Brazil will grow at a good rate in 2010; the extent of next year's growth, however, may vary widely — from 4.5% to 7% is within the bounds of possibility. This broad range is justified by the fact that, for various reasons, as the country comes out of this crisis it is sailing into completely uncharted waters: First, the nature of the turbulence that has affected the global economy since the bankruptcy of Lehman Brothers in September 2008 has nothing in common with previous experiences of world deceleration. Moreover, unlike all previous crises since it defaulted on its foreign debt in the early 1980s, this time Brazil has been successful in using both monetary and fiscal countercyclical tools. How the effects of those policies, as adjusted by the administration, will play out is practically impossible to predict. There are simply no similar past experiences to compare them with.

Recovery — For these reasons, even if the scenario may seem overly positive, 7% growth is by no means inconceivable. Using the current market language, this would be a "V"-shaped process, where the intensity of the recovery equals that of the contraction in late 2008 and early 2009.

There are several signs that the Brazilian economy is racing back at full speed to its precrisis exuberance. Second-quarter seasonally adjusted GDP growth of 1.9% is much higher than market projections. Industry, in fact, has already recovered about half of its 20% loss in production from the precrisis peak to the lowest point.

The behavior of the labor market has also been a positive surprise for a significant number of economic analysts. According to the Institute of Geography and Statistics monthly employment survey (PME), the 8.1% jobless rate in August is close to the figure for August 2008 — and the net creation of 242,126 jobs announced by the General Registry of Employed and Unemployed Persons (Caged) in August is slightly higher than the number of jobs created a year ago.

The PME and Caged statistics reinforce the argument that the crisis may have been

a severe shock to industry demand that pushed down employment in the sector but it has failed to infect the rest of the economy. The crisis was contained through both monetary and fiscal countercyclical policies, such as reduction of the Central Bank policy rate, a cut in commercial bank reserve requirements, more lending by the BNDES (National Bank for Economic and Social Development), and tax breaks for the purchase of cars, home appliances, and construction materials.

The government also introduced two other countercyclical measures that have had powerful effects: the increase in the minimum wage and the adjustment of civil servant pay. Because of their effects on the permanent income of beneficiaries, those two measures facilitated the rebound of the economy by promoting higher household consumption. Thus, after falling investor confidence triggered the abrupt drop in stock prices in the last quarter of 2008 and the first quarter of 2009, the economy, supported by sound macroeconomic and financial foundations that were essentially spared by the crisis, may again find its previous pace.

China — Two other factors will help shape the pace of economic recovery in 2010: the recovery of both manufacturing exports and investment. In the first case, South America is the preferential destination for Brazilian manufacturing exports, so we depend on China to "restart" the region's economy — in other words, the expectation is that Chinese demand for commodities from our South American partners will boost their income and hence their demand so that they again buy Brazilian products in large quantities. Unfortunately, associated with that opportunity is the risk that Brazilian exports will come under increasing competition from the expansion of Chinese manufacturing exports to our trading partners.

Recovery of investment, on the other hand, is more complex. It is associated with the confidence of businesses. This variable is always difficult to predict and often fluctuates considerably. In this case the recovery of the capital markets, based on the perception that Brazil was one of the first emerging countries to come out of the crisis, and in good shape, is promising. It means that the confidence of the business community in the country may be quickly coming back — a trend that Moody's new investment grade rating for Brazilian bonds reinforces.

What is certain is that Brazil will grow at a good rate in 2010; the final results of next year's growth, however, may vary widely, from 4.5% to 7%.

Indeed, however much effort goes into trying to contain optimism, it is hard to justify any projection that 2010 growth will be less than 4.5%. Considering the country's trajectory over the past decade, this is a conservative estimate, particularly after a recession, which amplifies the effects of a turnaround. Furthermore, it is necessary to take into account the spillover effect of GDP from one year to the next, which in this case will be about 2.5%. Thus 4.5% growth in 2010 would represent in effect only a 2% expansion of GDP.

From the perspective of the Central Bank, such a range of GDP projections must certainly be uncomfortable to work with, because growth of 4.5% means that

the output gap will hold at current levels for a long time, perhaps even into 2011. If so, there would be no reason for the Central Bank to be haunted by the ghost of inflationary pressure, so it could keep its policy rate at 8.75% for a long time to come. In that case, the Bank would not have to worry about the timing of the withdrawal of the countercyclical fiscal stimulus.

Pressure — All the previous observations change, however, if growth in 2010 comes close to 7%. Then there would be no doubt that the economy's production capacity would come under pressure, and the Central Bank would face the uncomfortable job of having to slam on the monetary policy brake during an electoral campaign. Such a scenario becomes more plausible, however, when one assesses the powerful stimulus to demand created by the government, the management of which may not be immune from the political-electoral influences of 2010. For example, the minimum wage increase will be significantly higher than inflation next year.

International trade is still under the braking effect of the slow and painful recovery of the economy in the developed as well as in some emerging countries.

According to the current informal rule (it is still awaiting formal approval by Congress), the increase in the minimum wage incorporates the inflation rate for the year plus GDP growth in 2007. According to Ministry of Planning data, the increase would thus be about 8.8%, pushing the minimum monthly wage up to R$505.90 (US$253). In the labor market, moreover, some collective bargaining agreements have increased salary adjustment above inflation.

An analysis of utilization of industrial capacity, the NUCI index formulated by IBRE–FGV, shows that inflationary pressures are not yet evident. After falling to 77.6% in February 2009, at the height of the crisis, the index has already seen a recovery to 81.9% in September, though this is still well below its recent peak of 86.7% in June 2008 and below the average since 2003 of 83%. When analyzing the data, however, caution is advisable. First of all, as we know, this has essentially been an industrial crisis. Also, in analyzing the NUCI index by industrial sector, it becomes clear that the slack is unevenly distributed; in some of the major industrial segments, capacity utilization has been increasing in recent months. For example, in the case of semi-manufactured goods, which are important in determining inflationary pressure, there was a steep fall from a peak NUCI index of 87.9% in June 2008 to 77.1% in February 2009. This September, it was back at 83.3%, having jumped 3 percentage points in just three months. That is still below the 86% post-1994 average, but if the recent recovery rate is maintained, pressures will rise in the not-too-distant future.

Even in durable consumer goods and building materials — the two segments most influenced by the government's countercyclical measures — the NUCI index is, respectively, 88.9% and 89.3% — not too distant from the pre-crisis peaks of 91.7% and 91.3%. Even in the capital goods sector, the one most affected by the crisis, the recovery of investment now shows signs of accelerating. After having peaking

at 89.1% in July 2008, the NUCI index for capital goods sank to 73.1% in February 2009 and held there until July. In August, however, it jumped almost 5 percentage points, to 77.7%, and then stabilized at 77.3% in September.

Exports — A comforting factor for the Central Bank in terms of the inflation outlook, however, is external demand, which seems to be returning to a trend of moderate and gradual recovery. International trade is still slowed by the braking effect of the sluggish and painful recovery of economies in the developed world and in some emerging countries (in Eastern Europe, for example), which have been much more debilitated by the turbulence than countries in South America or East Asia. Loose world demand thus benefits Brazil, where domestic demand slack is tightening fast — it may not do much for the growth side, but it certainly offsets inflation.

On the other hand, there are signs that the global deflationary pressure is behind us. Commodities prices have been rising in the last few months; industrial commodities have already registered 50% average growth this year, which affects the metal and petrochemical sectors in Brazil. There are even some extreme cases, such as the 100% increase in copper prices. Oil is now almost half the price registered at its peak in 2008, when the barrel was negotiated at US$140 before crumbling to US$40. There is also pressure on agricultural commodities, for example sugar and alcohol. All those movements, incidentally, have been picked up by the US Producer Price Index, which has recently risen after a period of deflationary risk.

It would be a mistake, however, to consider that inflation will return revivified to the global scenario — at least not within the next year. Indeed, during the crisis, commodity prices that had been showing a trend of consistent increase simply collapsed. It can be expected that once the worst is over, they could recover vigorously. Perhaps the most sensible attitude for the moment as far as world prices are concerned is not to bet on a severe inflationary risk — but also not to put all the chips on the assumption that the world is on the eve of an inflationary spiral.

In the months ahead, in successive meetings of the Monetary Policy Committee the Central Bank will have to face many of the difficult issues reviewed here. The Bank team will have to handle a very wide range of macroeconomic projections — including scenarios that may or may not include all the relevant inflationary risks — and will also need to work on premises about how the world will come out of an absolutely unique crisis. The political heat of the electoral season and the doubts related to the permanence of the current Central Bank governor, the successful Henrique Meirelles, will certainly not help the Bank's job in the next year. In fact, even facing the possibility (though not the certainty) that 2010 will see an exceptionally hot economy, it is still too early to guarantee that inflationary pressures are returning. On the other hand, it is no longer admissible to ignore the risk.

It is still too early to guarantee that inflationary pressures are on their way back. But it is no longer admissible, on the other hand, to ignore this risk.

"Voters cast their ballots thinking about the future, not the past"



Fernando Henrique Cardoso

President of the Republic (1995-2002)

Liliana Lavoratti, from São Paulo

With the 2010 presidential elections a year away, former President Fernando Henrique Cardoso, 78, gives the first indications of how the Brazilian Social Democratic Party (PSDB) will challenge the Workers' Party (PT) President Luiz Inácio Lula da Silva's candidate in the race to occupy the Presidential Palace of Planalto. "No use for President Lula to say that the social programs, the pre-salt oil fields, and stability were born in his administration. The elections will be won by who inspires confidence and gets the voter to say 'this person will get us ahead.' Voters cast their ballots thinking about the future, not the past," says the honorary chairman of the PSDB. The presidential campaign, expected to be polarized between the PSDB tucano candidate (the party mascot is the blue and green bird) and the PT candidate, will bring forward subtle yet relevant differences between the two programs, Cardoso stresses. "Against controlled capitalism, dirigisme, a swelling administration, and the weakening of the state as we see it today, we are going to stand up for an open and competitive society," he says. He also says that the PAC — the Growth Acceleration Program — and the pre-salt oil fields are being used by the administration as electoral campaign instruments.

***The Brazilian Economy* — What is your assessment of the Brazilian economy in the aftermath of the global crisis?**

Fernando Henrique Cardoso — In the United States, Spain, and England the bleeding has been contained, but questions persist. In the United States, consumption has not risen and the situation is not settled. China has increased credit to stimulate its domestic market, but the consequences of that move are still unknown. In Brazil, the scenario is less distressing except for the lower investment rate and increased public current expenditure. The economy has started to react, but through consumption. Although inflation has risen slightly, it still is not enough to cause concern. If the favorable winds continue to blow our way, we'll be all right. Otherwise, the market will contract, affecting industrial production and exports. I do not see a more worrying situation; but the next administration will have some thorny issues.

Such as?

The increase in federal public expenditure, with a ripple effect on state and local administrations, cannot be turned around. All will depend, however, on our ability to secure a more reasonable investment rate. Everyone

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seems to be satisfied with zero growth this year. In comparison with some other countries, that is good news; the reality, however, is that we will be 5 percentage points below 2008.

Do you share the view that Brazil is coming out of this crisis in better shape than other countries?

In relative terms, that is possible. But with a caveat: from the 1980s up to the stabilization in 1994, growth was out of step. The world economy went one way, our economy went the other. After the stabilization our economy adjusted to the world economy, and its growth has been slightly below world growth. That continues today. The reason for that is the investment rate. We do not have a savings ratio that can be transformed into investment to sustain more vigorous performance. The economy had improved globally — we rode that wave — but there has not been a change in the growth level.

Will the issue of tax reform also be put off to the next administration's agenda?

The rationale behind the Lula administration is circumstantial rather than structural. He has enjoyed a tide of favorable circumstances and has not been concerned with structural reforms. It is not possible to carry out reforms without antagonizing certain sectors. And now, with elections on the horizon, the administration will not change anything.

Your administration had to face resistance as well.

Yes, but I confronted it. That is not the case today. Even confronted, the changes are marginal. Creating a value-added tax in Brazil, incorporating federal, state, and local taxes, is very difficult. We have bureaucracies that oppose it. It is a political rather than a technical issue. I think we have to carry it out gradually. When we aimed at 100%, we achieved 15% at most. We did away with superimposition of certain social contributions, we went on improving.

The crisis has rekindled the debate about a more active role of the state in the economy. What is your opinion?

The question of a minimalist versus a maximalist state is an ideological debate. The state must have the right size. Operational capacity is essential; we need more quality and less quantity. It's bad when the state swells without quality. We have to be vigilant, because it seems we are heading that way.

Are you suggesting that the Lula administration is interventionist?

The Lula administration has undeniably followed the macroeconomic policies introduced in 1999 — a fluctuating exchange rate, fiscal responsibility, inflation targets — and benefited from the solid financial systems that we had built. On the other hand, there have been a few changes. An example is the regulatory system created to strengthen the state. The regulatory agencies used to be accountable to the state, not to the government of the day. Today, however, the power of those agencies has been reduced, to the benefit of governmental discrimination. Hence, it is not the state that comes out strengthened, but rather the government. What is this compat-

The economy has started to react, but through consumption. Although inflation has risen slightly, it is still not enough to cause concern. If the favorable winds continue to blow our way, we'll be all right.

ible with? It could be compatible with groups that the administration wants to favor. In China, the economy is monopolistic in certain sectors, with state interference. In Brazil, nobody is talking about socialism, but instead about the form of capitalism: Is capitalism more open or more managed by the state? In the last few years we have been heading toward a state-managed capitalism.

Hasn't the more prominent presence of the state in the economy been fundamental to overcome the crisis?

Currently, it may help boost the economy; however, for the future it creates distortions and may lead to a more closed society. In Brazil power groups have been formed that are anchored on the government and on pension funds. In other countries, a pension fund is a financial investment institution, not a management institution. That is not the case here: pension funds take part in management and own corporations. In other countries those funds are not party-affiliated; in Brazil they are. In addition, one single party controls all pension funds. Their management composition is bipartite — one half is government, and the other half is the pension fund — but both sides belong to the same political party. So, part of the economy is strongly linked to a party, and that is worrisome, for the hegemony is not only political, it is total; it is economic as well. This may lead to a high growth rate but it will not generate a competitive society. Brazil is in general a democracy; but in the particular aspect of the partisan relationship with the economy there appears to be a trend toward state intervention.

Brazil is in general a democracy; but in the particular aspect of the partisan relationship with the economy there appears to be a trend toward state intervention.

Are the projects in the Growth Acceleration Program (PAC) focusing on those areas where investment is most needed?

PAC is another name for the budget; it is not a program of priorities. The government keeps saying PAC, PAC, PAC. What works in the PAC are the state-owned companies. How many ports have been built under the current administration? During our term we built Sepetiba, Pecém, and Cabedelho. The Belo Monte power plant remained inactive for a long period of time while government interference was being discussed. In our administration the opposition insisted that we could not grant concessions; we created the PPPs (public-private partnerships), but they also ended up inactive. The truth is that the infrastructure sector in Brazil came to a standstill. PAC has been transformed into many things, including a propaganda tool.

In this context, isn't the pre-salt oil field relevant?

The Tupi field in the bay of Santos was auctioned in 2000, against severe PT opposition. In 2001 we already knew of the pre-salt oil reserves. So that is nothing new, it is something that goes way back. The great leap in oil production happened in the past. And how is pre-salt oil going to be used? I think that the haste is election-linked, as there will be no developments in the next five to six years. It is not a bad idea to discuss it: personally, I still cannot say whether sharing or concession is best. The proposal of the regulators

foresees the sharing alternative. According to that model, the company exploiting the oil must share the benefits with the public authorities.

Should the debate in Congress have taken longer?

Is concession better than sharing or the other way around? What shape will Petrobras capitalization take in this context? The monopoly belongs to the state, according to 1997 legislation that also includes provisions on increased competition. Petrobras, which was practically a government-run office in the past, has grown enormously and become globalized. Now they want to force Petrobras to take part in all investments. They are lending a new monopolistic character to Petrobras, which in fact is not solely government-owned and to which we owe everything as far as oil is concerned. Is this the best way to strengthen the company? Petrobras has become stronger since 1998, and its value has increased seven-fold. It remains unclear how Petrobras will be able to go into every field and what the risks are for the company. It is not up to me to answer that; I am no expert. The issue deserves broader debate. This urgency is election-fever-related.

How does the PSDB intend to conduct the debate on the economy with a view to the presidential elections?

I do not know if this will be the debate of the people. The people are mostly concerned about salaries, health, education, jobs, transportation. One year from the elections it is difficult to measure people's feelings. I think the voters will take a look at the candidates and wonder: who is the best candidate to follow? Voters cast their ballots thinking about the future, not the past. What is essential is to come up with leadership that inspires confidence and makes the voters say, "This person will get us ahead." The voter will weigh those differences we are discussing: more or less regulation, dirigisme. Definitely, the issue will not be more state or less state. In a country like Brazil, it is inconceivable for the state to do without the BNDES, the Bank of Brazil, and Petrobras.

Is the privatization issue out of the debate this time around?

We never intended to privatize Petrobras. We have strengthened the Bank of Brazil. We are not against state-owned companies. Some sectors such as steel production must be privatized. What is important for the debate is not the private or public nature of a company, but rather its orientation: is it business-like or political, with appointed friends and allies? The 2010 debate will be different: increased state discretionary power or the participation of society in regulation? Granted, this is not an election platform debate, but it will permeate the decisions.

After two successive administrations adopting similar macroeconomic policies, what will people weigh when the time comes to cast their vote?

They want to force Petrobras to take part in all investments. They are lending a new monopolistic character to Petrobras.

One has to be more determined: Do I trust or don't I? Will this candidate help me get ahead? This is how Barack Obama arrived in the White House; this is also how Lula and I won the elections. Our parties didn't. Of course, you cannot win

elections by yourself, but you need to use a language that makes the voters feel that you have the capacity to lead them ahead. The dilemma of the population is: Whom can I trust? Whose turn is it? In 1994, it was my turn; in 2002, it was Lula's; and in 2010, I have no idea whose turn it is. The elections will be won by the candidate who manages to awake a feeling in the population that this is the one I am going to follow.

But won't the PSDB propose changes with regard to the PT administration?
What we are going to change, and this is important: less partisan dirigisme. Those subtle differences will come out. As to the general lines, our economy is integrated and growing with room to grow more; all countries have been adopting the same social policies: Chile, Mexico, Brazil — all of them granting health and education benefits. Will all these then be better or worse managed? Will the demand be met, or will it all remain a promise? This is what the voter will ponder.

Do the current possible presidential candidates offer the voter good alternatives?
I think so. Who would have expected Marina Silva in the race? And Ciro Gomes, who initially wanted the São Paulo governorship, now promises to enter the race for the presidency. It is difficult to make predictions because the scenario is still changing. Sometimes one has the impression that this will be a plebiscite-type election, heads or tails. However, it will not be plebiscite-like, as there are many dimensions to this game. A few months ago, the big news was a woman in the race; now there are two, perhaps even three, women running. Marina's candidacy brings to the center of the debate an issue that the other candidates would only have touched on lightly. Now all candidates will be forced to improve their environmental proposals.

Who could have expected Marina to run? There is plenty of time and we may still have other surprises. The ballot box is still green.

What about Dilma Rousseff, what are her qualities?
Qualities, she has, but I hardly know her. She has administrative and managerial abilities. It remains to be seen whether she has leadership. I am not sure Lula has managerial abilities, but he is a leader. The President of the Republic must have both.

In your party, who has those abilities? José Serra or Aécio Neves?
[Laughter] As both belong to my party, I'd rather remain silent. The most important decision has already been taken: It has been both publicly and privately established that the PDSB will converge around a single candidate. One candidate will support the other; any other attitude would be suicidal. We still cannot predict which of the two will be the candidate. Who could have expected Marina to run? There is plenty of time and we may still have other surprises. The ballot box is still green.

If there is no convergence, what criteria will be adopted if there are primaries?
The primaries have not been ruled out; what has been said is that perhaps they will not be held. The criterion has to be always political convergence, to see whether one candidate gives up to support the other. Otherwise, there must be a selection criterion, either a convention or a primary.

You argue that the ballot may not be "pure-bred." Is there any hope that the PMDB will form an alliance with the PSDB?

It would be a good thing to have one more party in our ballot but, having said that, I am not against "pure-breed." It would depend on the circumstances; it is still too early to know what the best will be. In principle it is the alliance. If our allies think that the best alternative is to have their vice-presidential candidate on the PSDB ballot, we'll go for it. It is unlikely that the PMDB will form an alliance with us. The government's instruments to seduce them are more powerful, although some PMDB members are sensitive to our candidacy.

To make way for his successor, Lula will stress growth with controlled inflation and the entry of 25 million more Brazilians into the middle class. What does the tucano candidate have to show?

Lula may have done a lot, but the population does not vote on what has been done. It is useless to say that the social programs, the pre-salt oil finds, and stability were generated under my administration. When he comes to the end of his administration, Lula will be able to say with all propriety: never before have so many Brazilians lived in a country such as the one we have today. That is obvious, because the population has grown. The latest administration has done more than the previous one because there is a cumulative effect. Nonetheless, the cuts that changed the structure were carried out under my administration; the same is true for stability and changes to social policies, as well as the passage from one social class to another. The poverty line dropped way back and has continued to fall. The drop may have increased in speed at certain points.

Brazil set the course during Itamar Franco's administration, not mine. In my administration there was an impulse; with Lula, there was another impulse. I am hopeful that, whoever is elected, the next administration will do even more.

Why do you support the decriminalization of marijuana?

Last March in Vienna I attended a meeting of the Latin American Commission on Drugs and Democracy, which is within the scope of the United Nations, where former presidents met to reassess the international policy against drugs adopted in the last decade. It was an opportunity to reinforce the Latin-American perspective in comparison with the US perspective of "arrest and kill and you will have solved the problem." That policy has not succeeded, and the idea that legalization is the lesser of two evils is gaining force. In Europe, instead of repression the emphasis is on prevention of consumption and a public health apparatus that supports and reduces the number of drug addicts. We have already registered significant progress; the stance of the current administration, by the way, is similar to mine. A PT legislator from São Paulo is the author of a proposal that seeks to establish that the marijuana user shall not be subject to repression.

Couldn't the liberalization of marijuana serve as an incentive for young people to try this and other drugs?

If that were true, the ban would have limited consumption; however, consumption is increasing. Nonsmoking legislation and the condom campaigns work. There is nothing similar for drugs. Why insist on repression alone? Consumption is increasing at an alarming rate and consumers are not being offered treatment. Marijuana is being decriminalized in Argentina, Colombia, and México. Portugal has decriminalized it. Every consumer of drugs should be treated as a medical case.

IBI: GEORGE WASHINGTON UNIVERSITY ACADEMIC CENTER PROMOTES US-BRAZIL CONNECTION

Created in 1992, The George Washington University's Institute of Brazilian Business and Public Management Issues — IBI for short — has strived to promote greater understanding of Brazil among U.S. audiences and to help Brazilian public servants become better stewards of the public trust. Its main instruments for pursuing those aims are public forums and academic and professional development courses for managers of federal, state, and local government services. Recognizing that a historic opportunity exists for fomenting a closer Brazil-U.S. partnership to help address pressing regional and global challenges, IBI plans to step up its programs over the coming year.

Public forums: Toward a deeper understanding

Over the years, IBI has hosted many public forums that have explored issues of public policy in Brazil or that interest Brazil. These sessions have included discussions with panels of experts on Brazil's economic outlook as well as sessions on broader issues, such as trade and investment, that touch on Brazil's interests and on Brazil-U.S. relations. In September 2009, for example, IBI hosted a roundtable discussion among Brazilian and U.S. legislators and other private and public sector experts on expanding bilateral cooperation on biofuels development, an area in which both countries are world leaders.

Over the coming months, IBI plans to host several high-level panel discussions on seminal issues affecting Brazil and the Brazil-U.S. partnership. Among these are a conference on the implications for regional security of Brazil's new defense strategy and posture, and opportunities for broadening U.S.–Brazil security cooperation to the benefit of all countries in the hemisphere. Another forum will explore areas of common interest — in trade, environmental policy, poverty mitigation, etc. — and how the two countries can forge a closer partnership to promote common objectives in those realms. A third forum will explore how to broaden Brazil–U.S. energy collaboration beyond ethanol and provide leadership to the rest of the region, and the world, in that domain.

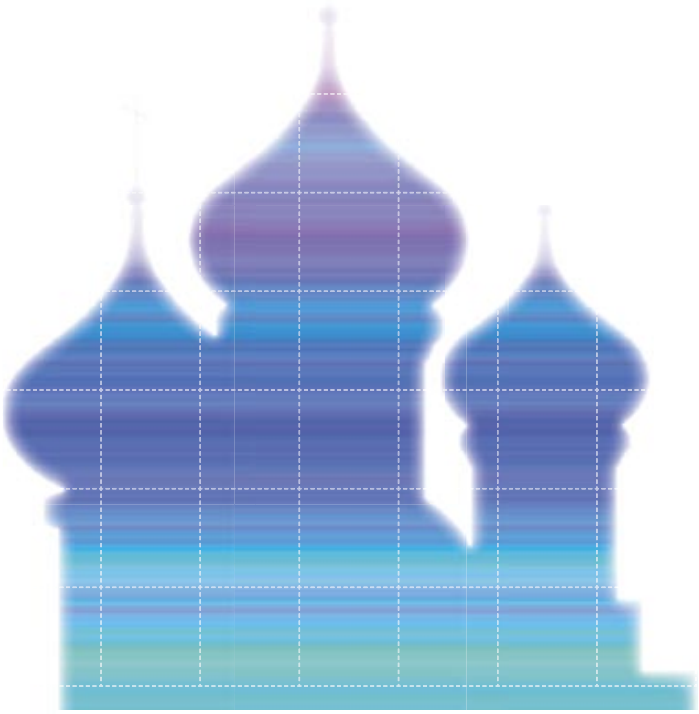
Equipping managers with better tools for addressing modern challenges

IBI's location in the very heart of the U.S capital (the White House is a mere five blocks away) gives it a privileged position for organizing and delivering professional development programs that cater to the needs of Brazilian public managers. Access to The George Washington University's world-class faculty and the major international organizations headquartered in Washington — including the World Bank, the Inter-American Development Bank (IDB), the International Monetary Fund (IMF), the Organization of American States (OAS), and the full panoply of U.S. federal agencies — allow IBI to draw on an array of government, public policy, and academic assets unique in the world. As a result, participants in IBI professional development programs and other academic programs acquire exceptional insights and perspectives they could not obtain otherwise. Participants also broaden their professional networks and establish working relations with counterparts in important U.S. and multilateral organizations that help them in fulfilling their public duties. Over the coming months, IBI will receive groups of Brazilian regulators, regional development officials, financial inspectors, and political leaders for special short-term (one- to two-week) courses geared to their particular interests. In addition to lectures at GW by experts in their respective fields, the participants will engage managers and policy officials at U.S. and multilateral agencies in Washington on real-world issues and how their counterparts in those agencies address them. But IBI does not confine itself to the Washington area; when warranted, it will take participants to other locations, such as Chicago, where this past April a group of 22 Brazilian elected officials spent three days exploring how that city tackles the challenges of public safety, security, and delivery of services to its citizenry.

Minerva, the jewel in the crown

IBI is probably best known for its flagship Minerva training program. Formally known as the Course on The Theory and Operation of a Modern National Economy, the 16-week resident program, designed specifically for Brazilian mid-level public service mangers, rigorously examines the key underpinnings of a modern market economy, from micro- and macroeconomic theory, to finance, international trade, and so on. It explores also important issues in public policy, such as globalization, good governance, and other areas that modern managers need to understand if they are to be responsible and effective stewards. In addition to the rigorous coursework, in order to graduate participants must complete a research paper, in English, on a Brazilian public policy issue of their choosing. The collected Minerva research papers are published on IBI's Web site, www.gwu.edu/~ibi. To date, the Minerva program has graduated more than 400 Brazilian public servants, many of whom now serve at the highest levels of the Brazilian public administration.

IBI is open to collaboration with other like-minded organizations. It has teamed successfully with the OAS, the IDB, the Embassy of Brazil, various U.S. government agencies, and other academic and non-governmental institutions to present joint programs that give participants richer offerings than the co-hosts could provide on their own. Proposals are welcome.



Russia's uncertain economic recovery



Martin Gilman

Finally joining with economists in the rest of the world, analysts of the Russian economy are beginning to recognize that the country is starting to recover from the plunge recorded at the end of last year that continued into the first half of 2009. In contrast to the downward spiral early in the year of increasingly pessimistic forecasts trying to play catch-up with worsening data, these same analysts for the most part started revising their projections upward starting in July. The process is hesitant and ongoing, as it has been in most other countries.

For Russia it is useful to recall that the gloom and doom when real gross domestic product fell by 9.8 percent in the first quarter over a year ago were overdone: approximately 7 percentage points of that

Professor, Higher School of Economics, Moscow; former senior representative of the International Monetary Fund in Russia

drop was accounted for by inventory destocking (largely from Gazprom, which is likely to be temporary). Focusing on month-to-month rather than annual data, it looks as if the economy has stabilized. Evidence of a return to growth started to appear in the second quarter, even though base effects pushed the growth number down by 10.9 percent over a year earlier. In July physical data, such as those on industrial production, rail loadings, natural gas production, and metals sector performance, all started to point to a return to growth.

Credit crunch easing

Personal income indicators have also shown a good recovery, largely reflecting an increase in government social benefits. After a long period of lending compression in Russia's financial system, the credit crunch started to ease in July. Loans by the aggregated banking system were unchanged for the month and should start rising in coming months, because deposits have grown and banks are flush with liquidity. As resources gradually start flowing into the real economy again, this should provide positive momentum for economic recovery.

The shift in the government's budget position from a surplus of 8 percent of GDP in the first nine months of 2008 to an expected deficit of almost 8 percent in 2009 is arguably the biggest government stimulus package globally on a relative basis. The opening up of credit markets, looser monetary policy, and fiscal stimulus all suggest that economic growth can resume more strongly than many observers, including overly cautious government officials, would suggest. With positive growth in the second half, the real decline in GDP this year should be no worse than 5 percent.

Of course, it goes almost without saying that oil prices remain a major risk. Globally, oil inventories are close to all-time highs and utilized capacity is historically low. Financial demand in commodity markets clearly makes economic sense as a hedge against dollar depreciation, but at some point there has to be actual demand. The risk to the current $70 per barrel oil price is considerable in the short run should current optimism in advanced economies prove to be premature. In general, an increase in global economic activity is a necessary condition for continued improvement in Russia.

For Russia the uncertainty is poignant because the country has been severely, even if temporarily, affected by the external crisis.

Uncertainties

Those who seek certainty are likely to be confounded by the period of instability ahead. Even the best economists and financial analysts do not know what letter of the alphabet to use to describe the shape of the recovery — V, U, W, or L. Historical parallels

Excessive government spending — especially if it occurs all at once — is the major risk.

are inexact, and economic theory about debt crises is of only limited help. Volatility in exchange, commodity, bond, and equity markets is more likely over the next couple of years than a nice linear trend.

For Russia the uncertainty is poignant, although contradictory. It is poignant because the country has been severely, even if temporarily, affected by the external crisis. People are worried about their economic prospects, and for historical reasons there is an unfortunate but understandable lack of confidence in the government. This is manifested in uncertainty about the ruble exchange rate in the face of decelerating but still high inflation, which is projected to be 10.5 percent for 2009. It is also contradictory because Russia — as a large, low-debt, emerging economy — should inherently be in a better position than most of its Group of 20 partners. Whereas some highly indebted advanced economies may face a double-dip recession, this is highly unlikely for Russia unless there is a plunge in energy prices. So the recent euphoria on Russian equity markets (with the RTS index up 82% since the beginning of the year) may actually be warranted—although you would not know it when even senior officials warn of trouble ahead and difficulties for the banks because of escalating bad loans.

Leaving aside longer-term issues and given the wait-and-see attitude of the Russian population, the real test in the short run is whether inflation can be brought down permanently to the rates prevailing in leading financial centers. This is critical because so many seem to think that another ruble crisis is inevitable — as indeed it will be if the exchange rate continues to appreciate in real terms relative to the currencies of other countries. Perhaps more than any other single factor this uncertainty about the future strength of the ruble clouds the country's economic prospects by keeping nominal interest rates too high and discouraging savings and investment.

Budget at risk

The key policy variable here is the budget. Excessive government spending — especially if it occurs all at once — is the major risk. From a budget of about 10 trillion rubles ($318 billion), only 4.7 trillion rubles ($149 billion) were spent in the first seven months of the year. This suggests that 5.3 trillion rubles would need to be spent in the remaining five months, which would mean an increase in the monthly rate of expenditure of 64 percent. If that happens the fiscal deficit would jump by 2.5 trillion rubles between August and December. The economy would be overwhelmed by excessive government spending, with most of it bunched in late November or early December.

Even though in reality the budget deficit may be smaller than the expected 3.4 trillion rubles, an enormous spike in ruble liquidity could occur by year-end. This would obviously create turmoil on the foreign exchange market and translate into high inflation in January and February. It looks as if the economy will once again receive money at year-end that it does not need, and the financial system will experience undesirable volatility. Too many in the Russian Government still do not seem to appreciate the risks created by budgetary spending in terms of excessive aggregate demand, and hence the persistently high rate of inflation.

So even though the ruble currently appears to be in equilibrium, with the balance of payments strong and no need for artificial appreciation or depreciation (as some commentators have recently suggested), the massive increase in ruble liquidity to finance the budget may fuel even more speculation and as a result additional volatility.

Excessive liquidity

From a flow perspective, there is no pressure at all on the ruble to weaken. The current account was positive to the tune of $17.2 billion in the first half of 2009, and with higher oil prices it should be even stronger in the second half, probably leading to a current account surplus of about 4% of GDP. Net private capital flows turned positive in the second quarter, with inflows of $7.2 billion. Thus, the balance of payments is over-financed and there should be pressure for the ruble to appreciate, not depreciate. Net foreign holdings of the public sector, including foreign exchange reserves and the Central Bank's likely accumulation of Russian foreign liabilities, are keeping the ruble where it is.

The only serious threat to stability on the foreign exchange market comes from the financing of the budget deficit. Hence, greater exchange rate volatility can be expected during the traditional end-of-year growth in public expenditures. The issue, then, is whether the government is prepared to curb its spending in order to break inflationary expectations. Finance Minister Alexei Kudrin is already sending appropriate signals regarding the 2010 budget, which he proposes to freeze in 2009 nominal terms, but he must stand up to the spending pressures from his colleagues in government and lay the foundation for the country's new economic paradigm in the last quarter of 2009. The next few weeks will be critical. It is by no means assured that the stalwart Finance Minister can prevail.

If he does, however, the economy has a chance to increase its competitiveness through higher productivity. This could lead to a long-term strengthening of the ruble and lower interest rates, which would help stimulate investment and private demand. In other words, while some advanced economies risk an extended period of stagnation, it may be possible for Russia to enter a virtuous cycle along with the other BRIC economies. The ball is in the government's court.

The crisis of macroeconomics, 2008-2009

Fernando de Holanda Barbosa

Just over a year ago, in September 2008, Lehman Brothers went bankrupt, spreading panic around the world. According to many analysts, given the dimension of the shock and its destructive propagation it was the 1929 Great Depression over again. But that opinion proved wrong. The world is already recovering.

A significant number of studies have already looked into the origins of the crisis in both market and government failure. Some economists have claimed that the development of macroeconomic theory since the 1980s has become sterile, disconnected from the real world, and totally useless in a crisis of such dimensions. Macroeconomists have been more concerned about the formalism of models than about their content, they charge. To what extent is that true?

Macroeconomics emerged with the publication of Keynes's General Theory in 1936. This classic work laid out the research agenda for the following half century. The Keynesian agenda led Hicks, Modigliani, Friedman, Tobin, Mundell, Fleming, and Phillips to build the architecture of the macroeconomic model in the late 1960s and was incorporated into undergraduate textbooks in the second half of the 1970s.

Two contributions by Lucas in the early 1970s signaled the culmination of the Keynesian agenda. The first, referred to as "rational expectations," allows the construction of consistent models in which people's expectations about future events play a crucial role. Until then, each person had a unique set of projections and the model produced another, completely different, set. Shortly after, rational expectations were entirely incorporated in Keynesian models, which promoted rigor, coherence, and empirical evidence.

The second contribution by Lucas is known in the economic literature as the "Lucas critique." It is a devastating analysis of models that were built on the Keynesian agenda. Why is that? The explanation is so simple that, once you understand it, you will ask yourself: why didn't I think of that before?

Let us imagine that you play soccer with your friends twice a week, and that there is always a team alongside waiting its turn to play. On one day, the organization is as follows: the winning team stays for the following match and the losing team goes home. On the other day, the matches are organized differently: For the first match, the winner criterion is applied. For the second and following matches, each team, winner or loser, gets to play only two matches. Is the behavior of the player different or is it the same on those two days? The answer is obvious: When the rules change, people's behavior changes accordingly.

Macroeconomic models are conceived to simulate economic policies, which are the rules of the game for consumers, workers, and businesses. Models where behavior does not change when economic policy changes must be regarded with caution. The Lucas agenda has attempted to build models in which the players make decisions that respond to the rules of the game. To what extent should Keynesian models be dismissed, and replaced exclusively by Lucas models? Empirical evidence does not provide a definitive answer so far.

Nevertheless, since the publication of the General Theory, which led to the Keynesian and Lucas agendas, macroeconomic theory has a better understanding of the dynamics of monetary and fiscal policies, even in situations like the recent crisis. The result of this developmental advance is that the 2008-2009 Great Depression did not happen.

Professor at the Graduate School of Economics at the Getulio Vargas Foundation

Changing patterns of trade surpluses

Lia Valls Pereira

In September Brazil's trade balance registered a surplus of US$2,758 million, which led to a trade surplus of US$21,575 million for the year, compared with US$19,686 million last year. Through August the increase in the surplus was followed by a change in its composition.[1]

In South America Brazil's trade surplus fell by 56%, from US$9,398 million to US$4,137 million (Table 1). The biggest decline occurred in Argentina, where trade cumulatively through September fell from US$3,570 million to US$283 million.

The recession in the United States is the main factor explaining the turnaround: Brazil's trade balance with the US went from a surplus of US$1,796 million to a deficit of US$3,024 million in August, which increased in September to US$3,465 million. The surplus with Mexico also turned into a deficit.

In the five European countries, the surplus decreased from US$4,551 million to US$2,797 million. In Russia, China, and India, the other BRICs, the 2008 deficit of US$1,551 million turned into a surplus of US$6,528 million in 2009. The largest contribution comes from China, with a surplus of US$4,915 million through August. The September result confirms this trend, raising the balance to US$5,193 million.

Growth

The drop in exports through September was lower than the drop in imports. From January through September, exports declined by 26% over the same period in 2008, while imports fell by 31% (Table 2).

Table 1. Brazil's trade balance, January - August (Million of US dollars)

Countries	2008	2009
South America		
Argentina	3,570	283
Bolivia	-1,023	-593
Chile	265	73
Colombia	967	813
Ecuador	474	348
Paraguay	1,232	671
Peru	714	550
Uruguay	476	53
Venezuela	2,724	1,940
Total	9,398	4,137
Other countries		
Mexico	768	-58
USA	1,796	-3,024
China	-888	4,915
Netherlands	6,215	4,603
Germany	-2,406	-2,344
France	-315	-327
Rússia	835	1,203
India	-1,528	399
Italy	251	-270
United Kingdom	806	1,134
Total	5,533	6,233

Source: SECEX/MDIC; IBRE-FGV staff estimates.

Coordinator, Center for External Sector Studies, IBRE -FGV

This pattern does not apply to all the countries analyzed. With trading partners in Mercosur, exports fell more than imports. Notably, Brazil's exports to Argentina fell by 40.9%, while imports from that country fell by 19.4%. In this case, Brazil's exports are affected not only by the Argentine recession but also by authorities' controls (licensing) of imports. In the case of Uruguay, Brazil's trade surplus fell because Brazilian imports — wheat, milk, malt and rice — increased by 22%.

Mexico, the United States, Germany, France, and Italy follow the same trend. In the United States, Brazil's exports fell by 45.5% and imports by 21%.

Only with China and India has Brazil recorded positive growth in exports. Exports of iron ore and soybeans to China totaled 72% of sales in Brazil. In India, drought depressing the sugarcane crop has led to imports from Brazil, which had not previously occurred. This, in addition to the large increase in Brazil's exports of crude oil (19% of total), explains the fact that Brazilian exports to India increased 140%.

Because of the size of its market, Brazil tends to be chosen as a platform for exports to South America by global corporations.

Table 2.
Brazil's trade flows: Selected countries

Countries	Change % . Jan-Aug 2009/Jan-Aug 2008			Share of manufacturing in exports(%)
	Exports		Imports	
	Total	Manufactures	Total	
South America				
Argentina	-40.9	-39.1	-19.4	95.0
Bolivia	-26.4	-25.5	-35.4	95.0
Chile	-48.1	-43.0	-45.8	75.0
Colombia	-25.8	-30.0	-42.5	85.0
Ecuador	-26.0	-29.0	-13.4	92.0
Paraguay	-40.5	-39.1	-26.2	93.0
Peru	-46.2	-46.0	-61.2	76.0
Uruguay	-25.0	-25.5	22.0	90.0
Venezuela	-28.4	-30.0	-26.0	68.0
Others countries				
Mexico	-40.4	-35.6	-14.4	91.0
USA	-45.5	-42.5	-21.1	60.0
China	20.5	16.1	-26.3	6.1
Netherlands	-27.0	-8.7	-34.2	42.0
Germany	-32.7	-29.2	-24.0	48.6
France	-30.2	-18.4	-27.0	42.0
Russia	-41.0	-74.0	-70.3	5.7
India	140.6	79.7	-42.0	24.9
Italy	-39.0	-26.0	25.1	34.0
United Kingdom	-2.4	-33.2	-24.0	37.6

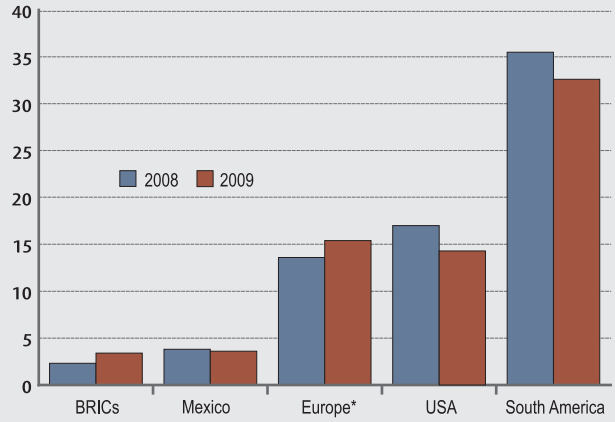
Source: SECEX/MDIC; IBRE-FGV staff estimates.

Manufacturing

In 2003 when Brazil's exports began to grow, exports to China grew 80%. The balance of trade with China reached US$2,385 million in 2003. By 2007, however, the surplus had turned into a deficit of US$1,872 million, and US$3,641 million by 2008. It is likely that Brazil will again have deficits with China when the Brazilian economy recovers. If Brazil grows about 5% in 2010, its purchases of machinery and electronic equipment from China will increase again. Moreover, exchange rate appreciation will further increase imports.

In previous years the expansion of exports to China,

Brazil should reject the imposition of protectionist measures by trading partners because it is not in the best interests of South American countries.



Source: IBRE-FGV staff estimates.
* Germany, France, Italy , Netherlands and United.

consisting mainly of primary products, went together with an increase in exports, mainly manufactures, to South American countries. South America accounts for some 35% of Brazil's manufactured exports, the United States accounts for 17%, Mexico for 3.8%, and the five European countries for 13.6% (Figure).

Data for January through August show a fall in exports of manufactures for all countries except China (up 16.1%) and India (up 80%). But the share of manufacturing in their imports is small: 6.1% in China and 25% in India compared with South American countries and the United States. The participation of Russia, India, and China in Brazilian exports of manufactures increased only to 3.4% through August 2009 from 2.3% for the same period last year.

The strategies of global corporations have a crucial impact on Brazil's exports of manufactures. Because of the size of its market, Brazil tends to be chosen as a platform for exports to South America by global corporations. In addition, investments by global and international Brazilian corporations determine intra-industry trade flows. A large increase in manufactured exports from Brazil to China would be associated with a possible increase of Chinese investments in Brazil.

How to increase exports to South America?

The main determinant will be increases in income in the countries of the continent. However, we must be careful to ensure compliance with the free trade agreements in the region. Brazil should reject the imposition of protectionist measures by trading partners because it is not in the best interests of South American countries.

Also, the issue of financing trade should again be a priority in negotiations. The recent crisis has shown how the absence of regional mechanisms and trade in local currency has exacerbated the decline in trade flows.

[1] We selected the 9 major economies of South America, 5 European countries (Germany, France, Holland, Italy and the United Kingdom), United States, Mexico, and the other BRIC countries (Russia, India, and China). These 19 countries accounted for 66% and 70% [how can 2 percentages apply to 1 thing?] of Brazilian imports in the period.

Environmental sustainability and social responsibility

Sônia Araripe, from Rio de Janeiro

For years, for lack of a better definition sustainability has been defined in terms of and confused with philanthropy, charity, or marketing activity. More recently, however, as the issue gained urgency and pressure increased from different stakeholders in society, it became necessary to make up for lost time and face its true magnitude. The corporate world capitulated to what earlier may have seemed to be a passing fad and came to the conclusion that it is indeed necessary to adopt sustainable practices in daily life and include them once and for all in their strategic planning. Now, sustainability has become one more aspect of company business.

"There is no turning back. A company must practice sustainability; otherwise it runs the serious risk of being left outside the competitive global market," warns Carlos Rossin, a PricewaterhouseCoopers partner who is an expert in this area. Tapping into the experience of those who can run strategic planning, in the hands of company executives sustainable practices start to make practical sense and may generate profits or prevent losses. It goes without saying that they also bring good returns in terms of image and reputation. "A transparent and sustainable corporation has great assets," Rossin underlines. He adds that the issue is moving from the communications and marketing area to a more technical one. "There is a very important market value involved," he stresses.

Pressure

Yet articulating this entire process is no easy task. Companies need to ensure their own survival, the perpetuation of their businesses in times of increased pressure from all sides. Because the planet is at risk, the issue has decidedly become everyone's priority, from the young student worried about the lack of recycling facilities in the neighborhood to elected officials and experts dedicated to mitigating the crisis triggered by global warming. A loud choir has become aware of and has begun, above all, to demand coherent social and environmental action.

While in the past the less

credulous considered this to be an issue for a few experts alone, suited for members of nongovernmental organizations and academic circles with very little exposure, in recent years there is an awareness that the urgency demands a general mobilization. "The pressure is intense and demands concrete action. A company that does not know how to deal adequately with the community will have serious difficulties," warns Patrícia Centeno, manager at BDO Trevisan. Often such issues are raised by international multilateral institutions, shareholders, or banks granting credit. According to Centeno, despite the financial crisis, demand for consulting services in the field of sustainability has increased in recent years: "Companies realize that being sustainable is a competitive advantage."

The large Brazilian corporations are renowned for their environmental sustainability, social responsibility and corporate governance in Latin America. A recent study published by Management & Excellence (M&E), a strategy consulting company that has operated in Brazil for eight years, assessed the performance of the 50 largest Latin American companies with regard to sustainability, social responsibility, and corporate governance, analyzed in terms of 140 criteria that took into account risk analysis and financial and process indicators. The study analyzed companies in Brazil, Mexico, Argentina, Chile, Peru, and Venezuela. Brazilian corporations led the ranking, with CPFL (energy) in the first position, followed by Petrobras (oil), Embraer (aeronautics), and TAM (air carrier). Usiminas (steel) and Eletropaulo (electricity) share the fifth position, and Mexican companies Cemex, Perdigão (food), and Vivo (telecommunications) rank sixth, above the Mexican operations of Wal Mart (retail).

The Brazilian Institute of Economics of the Getulio Vargas Foundation separately studied global Brazilian corporations that are known for adopting sustainability in their business plans. The companies included financial institutions Bradesco, Itaú, and Santander Brasil (together with Real), as well as Brasken, Coca-Cola, O Boticário, Petrobras, and Vale. Executives from those companies explained how sustainable production works in practice.

The large Brazilian corporations are renowned for their environmental sustainability, social responsibility and corporate governance in Latin America.

Clean energy

Experts were also consulted to show the importance of clean energy and of businesses generated with carbon credits. New technologies, such as ethanol, biodiesel, and wind energy, are being adopted and show great growth potential. The investments in green technologies are very close to what is still seen in information technology (IT) as thousands of businesses introducing innovative products continue to sprout. Richard Youngman,

New technologies, such as ethanol, biodiesel, and wind energy, are being adopted and show great growth potential.

European managing director at Cleantech, in a recent lecture in London claimed that clean energy has already become one of the most attractive segments for risk capital in the world, second only to IT. About one-fourth of all risk capital is invested in clean technologies, he said.

Remarkable development in this area can be seen particularly among major global corporations; however, according to the experts caution is recommended when making investment decisions on sustainability. "Often, companies ignore how much exactly they are spending, where to spend, and how to do it correctly," warns Orlando Lima, director of Janus Consultoria em Sustentabilidade. "The first problem companies face is determining how much they have effectively spent and invested in socio-environmental projects and actions. Company accounts are seldom prepared to provide a precise report," he says. "There are also difficulties associated with the breakdown of social and environmental costs incorporated into production processes or into commercial and administration lines."

Many specialists cite the accounting for and metrics of quantifying the results as a major difficulty when it comes to verifying what has been done in terms of social and environmental actions. According to the Global Reporting Initiative (GRI), balance sheets help but cannot work miracles. "I see many companies that are still undergoing a transition process," Lima says. "They are interested in enhancing their knowledge of the issue and want quickly to carry out social responsibility actions, mostly directed toward institutional marketing. Most of them still have a long way to go before sustainability becomes effectively incorporated into their business agendas."

Lessons

Even though companies have started to incorporate sustainability issues into their strategies, the work is far from completed, Roberta Simonetti, professor at the Center for Studies on Sustainability at the Fundação Getulio Vargas Business School, reminds us. What is missing is adoption of the concept by the entire universe of companies, large or small. The issue of image and marketing is also important. In some cases, Simonetti says, companies have not made an authentic commitment to sustainability: "There are still companies that consider this change as an additional 'cost' or 'work' involving, for example, producing reports on sustainability or filling out questionnaires, such as the Business Sustainability Indicator (ISE) of the BM&F and BOVESPA (the Commodities and Futures Exchange and São Paulo Stock Exchange). Those companies have not effectively incorporated those issues into their practices; the issues are still not part of their strategic planning."

The FGV Sustainability Center is conducting several programs that demonstrate the growing involvement and interest in the issue on the part of companies. In addition to the ISE, it offers the Companies for the Climate project and a program on the Green House Gas Protocol whose objective is to promote the protocol and prepare companies to create greenhouse gas emission inventories.

Simonetti reminds us that Brazil is recognized for its maturity in the field, in spite of some backward steps or a slower pace than desired. For example, Brazil is the Latin American leader when it comes to GRI reporting on sustainability performance. While this is highly positive, Simonetti warns of the risk of a company becoming a specialist in reporting rather than effectively changing strategies and practices. And she emphasizes that there is still a lot to be done: "Companies and financial institutions could invest more in research and development, particularly those companies that focus on sustainability."

Success stories

Several corporations, among them O Boticário, Coca-Cola Brasil, Petrobras, and Vale, report success in convincing suppliers to adopt the same sustainable standards. This process can neither be imposed nor made mandatory, but it is to be hoped that the process will help build a new society based on equitable and ethical principles from both a social and an environmental perspective. "One must work both at home and outside," stresses Malu Nunes, manager of social responsibility of O Boticário and executive director of Fundação O Boticário.

There are daily challenges, such as identifying the way to communicate actions correctly, to be seen and to face pressure agents, for example. The recent "Farra do Boi" report by Greenpeace Brazil, containing data gathered over three years of research on the Amazon region cattle production chain, is an example.

Patricia Ashley, professor in the Department of Accounting Sciences at the Federal University of São João del Rei, is an expert on corporate ethics and social responsibility. She emphasizes that companies are under increasing pressure not only from society and consumers but also, and more significantly, from the financial system, which introduces new demands from investors and shareholders wishing to assess the social and environmental risks of the projects they finance: "We advocate that new legal instruments — such as the incorporation of socio-environmental criteria — also be included in government procurements and in tax policy related to companies and products."

Companies are under increasing pressure not only from society and consumers but also, and more significantly, from the financial system.

Changing food demand challenges Brazil's farm sector

Constanza Valdes, Ignez Vidigal Lopes, and Mauro de Rezende Lopes

Brazil, an upper-middle-income country, is facing rapid socioeconomic shifts: rural to urban migration, a larger middle class, and a better distribution of income. These shifts present Brazil's farm sector with new challenges, such as shifts in commodity demand and subsequent changes in economic signals. Here we examine the magnitude of the production challenge from increased food demand and evaluate whether the farm sector can meet that challenge.

Brazil, where land, water, and labor are readily available, has achieved impressive agricultural performance. From 1996 to 2008 the GDP of agriculture expanded by an annual average of 12%. This growth, driven by increasing productivity and an increase in the land devoted to agriculture, has allowed Brazil to become a major food supplier to international markets: a quarter of what Brazil produces in grain, oilseeds, and meats is sold beyond its borders.

With a population of 191 million, Brazil is also one of the world's leading consumers of cereals, pulses, oil crops, and meats. Domestic demand is likely to grow as Brazil gains 23 million people by 2018. Income growth, a more balanced income distribution, and increased urbanization are expected to lead to higher demand for all foods, and a shift from staple foods to a diversified diet with higher consumption of animal protein.

Brazil's rising food consumption will require continued increases in food supplies. The question is whether its farm sector can sustain its productivity growth to meet increasing domestic demand and at the same time retain its position as a major supplier of agricultural commodities to other countries. The growth of Brazil's biofuel industry could affect the availability of grains and oilseeds for other domestic uses or exports. Brazil still has much potential to supply more agricultural products if it can address financial constraints for farmers, infrastructure challenges along the food supply chain, and environmental concerns about increased use of land for farming.

Income and food consumption

Brazil is categorized by the World Bank as an "emerging country" based on its large population, large resource base, and large market, and, with per capita gross

Constanza Valdes (cvaldes@ers.usda.gov), is an Agricultural Economist, U.S. Department of Agriculture, and Ignez Vidigal Lopes (Ignez.Lopes@fgv.br) is Head of the Center of Agricultural Economics Studies, and, Mauro de Rezende Lopes (Mauro.Lopes@fgv.br) is Research Project Manager of the Center of Agricultural Economics Studies, Getulio Vargas Foundation. Rio de Janeiro, Brazil. The article is a reprint from CHOICES, 2nd Quarter 2009 • 24(2).

national income of $5,860 in 2008, as an upper-middle-income country. The average masks a disparity between the very rich and the very poor. The richest 10% of the population receive 44% of total income and the poorest 50% receive less than 10%. Living in poverty are 22 percent of the Brazilian population, especially those in rural areas. About 8% of the population consumes less than the minimum level of dietary energy.[1]

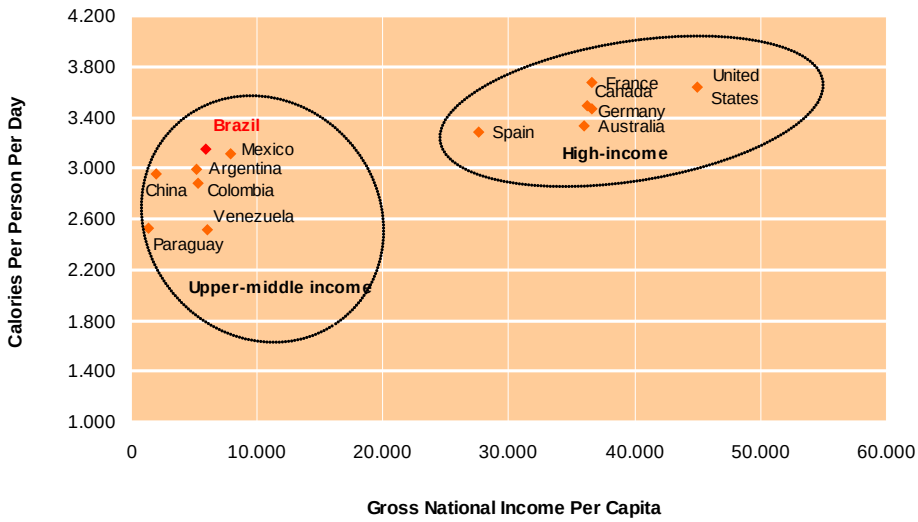
Economic reforms implemented during the 1990s and early 2000s in Brazil restored steady economic growth and reduced annual inflation from over 1,000% to about 5%. The resulting economic stability and "wealth effect" from slower inflation triggered a domestic demand boom. Other reforms implemented since the early 1990s also helped stimulate food demand. Labor reforms kept the real minimum wage above inflation, trade reforms increased imports of foods and other consumer goods, financial reforms increased credit availability, and family farming programs provided credit to low-income producers owning less than 26 hectares of land (small holders).

To help reduce income inequality, Brazil established food assistance programs as part of the Zero Hunger (Projeto Fome Zero) government initiative to provide low-income program participants with supplemental food. Bolsa Familia is a targeted conditional cash transfer program that serves nearly 25% of Brazil's population.

Brazil's income and food consumption are rising.

The economic reforms implemented after 2003 led to increases in real per capita income and better income distribution. Real per capita income increased 14% between 2004 and 2007 and inequality in the distribution of income as measured by the Gini coefficient (which ranges from 0, equality, to 1, inequality) diminished from 0.6 in 2000 to 0.5 in 2007. The reforms brought more people into the formal labor force and expanded the middle class (defined as families earning between $600 and $2,600 monthly) to 54% of the total population in 2008, up from less than 42% in 2004.[2]

Figure 1 Food consumption in 2007: Brazil, upper middle income, and high income countries



Sources: World Bank, WDI, 2008. United Nations Food and Agriculture Organization, FAOSTAT database. ERS calculations.

Brazil's food consumption patterns are changing.

As per capita income grew from 1980 to 2007, Brazil's food consumption, measured by calories per person per day, has grown steadily at an annual rate of 0.8% and now exceeds the average for upper-middle-income countries.

Changing food consumption patterns

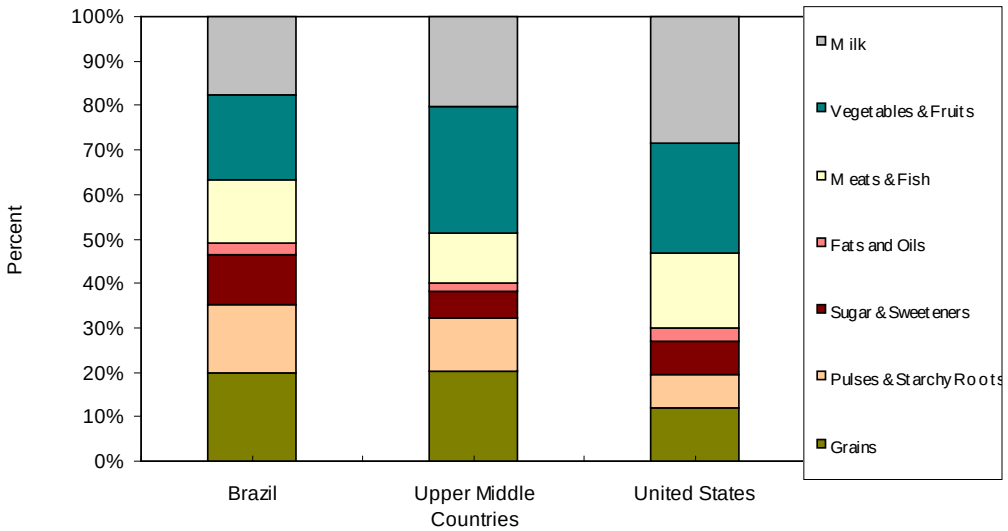
Food consumption in Brazil is shifting toward vegetables, fruits, oils, meats, and milk. Consumption of meat and milk is expanding fastest. By 2008 total red meat and poultry consumption had risen to 89 kilograms per person, 31 kg above the 1993 level.[3] Per capita consumption of milk has risen to 112 kg in 2008, up 20 kg from 1993, aided by milk donations to low-income populations through the food and nutrition security programs (Bolsa Familia and School Meals).

Rising incomes have led to an increase of consumption of some grain products to 131 kg per person in 2008, up 6% from 1993. Rice (41 kg per person) and wheat (52 kg) were the most popular cereals in 2008. Consumption of staples (beans and starchy roots) has reached 97 kg per person, and there has been a 12% gain in vegetable and fruit consumption since 1993. Sugar consumption — currently double the world average — reflects abundant domestic supply and low prices.[4]

As Brazil becomes more urbanized and Brazilian consumers grow wealthier, the composition of food demand will move toward that of higher-income countries (Figure 2). To match average shares in high-income countries, consumption of meat, vegetables, fruit, and milk would grow the fastest. Consumption of pulses will be relatively unaffected by urbanization, since urban and rural consumption levels are similar.

USDA agricultural projections to 2018 indicate that 2.9% annual growth in Brazilian incomes will lead to consumers spending more on food. Per capita consumption of red meats and poultry will increase from 89 kg per person in 2008 to 92 kg in 2018.

Figure 2 Food consumption shares by selected countries in 2005



Note: Based on per capita consumption measured in kilograms per year.
Source: United Nations Food and Agriculture Organization, FAOSTAT database.

Poultry will be the fastest-growing component of meat consumption, with its share of meat consumption increasing from 45% in 2008 to 47% in 2018. While per capita beef consumption is projected to decrease 0.2% annually through 2018, annual per capita poultry and pork consumption will rise steadily as incomes increase (by 0.8% and 0.2%, respectively).

Overall food use of grains is projected to decrease, probably by a shifting of coarse grains to feed use, but wheat and rice consumption will rise to the levels observed in high-income countries. Brazil's per capita demand for wheat is projected to rise to 56 kg per person by 2018, 7% above the 2008 level. Consumption of rice, a major staple in the diet of more than half of Brazilians, is projected to grow to 43 kg per person by 2018, a 5% increase from 2008.

Sugar consumption is expected to decline to levels similar to those of higher-income countries, leaving more sugarcane available for biofuel production. About 53% of Brazil's sugarcane is already being distilled into ethanol. Domestic demand for ethanol has increased 3% annually since the late 1990s as sales of "flex-fuel" cars powered by gasoline and ethanol in any proportion in a single tank of fuel have boomed as Brazilian incomes increased. Ethanol represents 41% of the gasoline used in Brazil, compared to 7% in the United States. Brazil's ethanol consumption is projected to rise to 14 billion gallons by 2018, from 4.3 billion gallons in 2008.[5]

Rising demand

USDA projections indicate that Brazil will need to produce 7% more grain and 43% more oilseeds than in 2008 to meet projected domestic and foreign demand in 2018 as demand increases from major soybean importers, such as China, and soybean exports from the United States fall. More than 57 million tons of feed grains would be needed to supply Brazil's livestock, 6% more than in 2008.

To meet domestic and foreign demand, ethanol production is projected to rise to 16 billion gallons by 2018, from 7 billion in 2008. Brazil's ethanol exports are expected to increase an additional 1 billion gallons, to 2.3 billion by 2018.[6] This increase could help the U.S. meet ambitious biofuel demand targets under the 2007 Energy Independence and Security Act (EISA). The law allocates 3 billion gallons out of 26 billion in 2018 for renewable fuel other than ethanol derived from corn starch, a category that could include sugarcane-based ethanol.

Brazil will need to increase agricultural output to meet rising demand.

Brazil will need to import commodities it does not produce competitively, including wheat and rice, two commodities that Brazilian consumers are expected to demand more often over the next decade as incomes grow. Wheat imports, which for the past decade have accounted for over two-thirds of supply, are projected to increase to 7.4 million tons in 2018, a 376,000 ton increase over 2008. The main suppliers of wheat to Brazil in recent years have been Argentina, the United States, and Canada. Brazil is usually a net importer of rice, and its imports are projected to increase 26% to reach 43 kg per capita in 2018.

Factors affecting farm sector expansion

Brazil produces most of the foods it consumes. It has quadrupled output since the 1970s through technological improvements, expansion of cultivated area,

and shifting production from smallholders to large-scale farming to achieve economies of scale. Large-scale agriculture now accounts for over three-quarters of total grain, oilseed, and meat production.

Increasing government investment in agricultural research since the 1970s, carried out through the Brazilian Corporation for Agricultural Research (Empresa Brasileira de Pesquisa Agropecuária, EMBRAPA), a public company linked to the Ministry of Agriculture and Food Supply, is credited with stimulating the rapid expansion of the land base and increasing agricultural productivity, with the greatest gains for soybeans, cotton, and rice. Yields of beef, pork, and poultry also increased significantly. Recent gains in area and yields for soybeans and corn reflect Brazil's response to growing export demand and expansion of Brazil's hog and poultry industries (Table 1).

This agricultural productivity growth has helped Brazil meet domestic demand while increasing exports. Brazilian farm exports performed well between 2003 and 2008, increasing at an annual rate of 22% in US dollar terms. Brazil is the world's largest exporter (global market shares in parentheses) of sugar (48%), ethanol (40%), beef (18%), coffee (30%), and orange juice (39%); and the second largest exporter of soybeans (32%) and poultry (27%), after the United States These gains are also reflected in the US loss of market share.

Despite its successes in expanding production, growth in agriculture could slow unless Brazil can address financial constraints for farmers, infrastructure constraints along the food supply chain, and environmental concerns about land expansion. Also, the growth of Brazil's biofuels industry could reduce the availability of Brazil's exportable surpluses of some commodities. Demand for soybeans as a raw material for biodiesel will likely increase use of Brazil's excess crushing capacity and dampen the recent boom in soybean exports. Planned increases to Brazil's biodiesel mandate from the current 3% of transportation fuel would also likely reduce soybean oil exports.

Lack of credit is a constraint on farm investment and output growth, and prospects for farmers to access more credit for production and marketing of crops and livestock are poor because the sector is currently highly indebted. In Brazil the cost of credit is high and its availability is limited. Total credit granted by the financial system is less than 30% of GDP, one of the lowest levels of credit availability anywhere in the world.

Table 1
Brazil's land use and yields

Commodity	2000-02		2003-05		2006-08	
	Area	Yields	Area	Yields	Area	Yields
	Ha 000	Tons/ha	Ha 000	Tons/ha	Ha 000	Tons/ha
Soybeans	14,628	2.7	20,962	2.5	21,410	2.8
Corn	12,459	2.9	12,319	3.3	13,867	3.6
Cotton	784	1,018.7	1,002	1,146.3	1,007	1361.7
Wheat	1,482	1.6	2,421	2.0	1,979	1.8
Rice	3,315	2.2	3,613	2.3	2,946	2.7
Sugarcane Ethanol	5,036	68.5	5,609	73.4	6,739	76.1

Source: Foreign Agricultural Service (FAS), U.S. Dept. of Agriculture.

Over the past 10 years, to alleviate the unavailability of official credit, input supply and trade companies provided the bulk of production financing for farmers — a critical factor in the expansion of the agricultural sector. However, with the current global financial crisis these companies are less able to finance farmers in the near term. Many Brazilian farmers are now struggling to pay debts. Brazil's agriculture-related debt arrears in 2008 reached 7% of agricultural GDP.[7]

Infrastructure bottlenecks are the main obstacle to Brazilian agriculture's capacity to supply domestic and world markets. Poor roads impose high costs on farmers in the Center-West region, where crops have the highest yields in the country. Large investments in maintenance and expansion of transport infrastructure are needed to keep up with the expected growth in demand, reduce delivery times and costs, and maintain product quality. In recent years, private investment in infrastructure has exceeded federal investments, and new public-private partnerships (PPPs) have been improving roads and port facilities. The Brazilian government estimates that it needs to invest $200 billion in infrastructure over the next decade.

Potential for output growth from bringing more land under cultivation is limited. Although there is still land available for crop and livestock expansion, continued expansion in the Cerrados (savannah areas) and Amazon region is likely to be constrained by environmental concerns about land clearing. Based on yield projections, production projections through 2018 assume that an additional 10 million hectares of cropland will be brought into production. The expected rate of expansion is one of the world's highest at 2.1% annually for the next 10 years. This expansion in cropland is likely to come from new land brought into production and from converted pasture land. Pasture land is expected to decline as cattle growers adopt new technologies and feeding practices.

Brazil's current agricultural area totals 76 million hectares, with 58 million hectares of annual crops and 18 million of perennial crops. Pasture now stands at 172 million hectares. The scope for cropland expansion in Brazil is estimated at 119 million hectares, with 69 million hectares in the Cerrados and 50 million from pastureland conversion.

Biofuel production in Brazil is facing increasing pressure to respond to environmental sustainability concerns about land use of cropping systems (sugarcane, soybean, and palm oil plantations) to produce biofuels and land use change impacts. Frequently cited are the environmental risks from intensified competition for land currently planted to other crops and the conversion of forest or grassland to crop production, which may result in habitat loss. Sugarcane area is projected to increase 2.2% annually through 2018, from 8 million hectares in 2008 to over 10 million in 2018, driven by biofuel demand.[8]

Farm sector up to the challenges

Over the past two decades Brazil's rapid economic growth has been driven by stabilization and structural reforms that have led to high rates of investment and gains in productivity throughout the economy. Reforms led to growth in employment and income, better income distribution, poverty alleviation, and more demand for food. More consumers are participating in formal markets, expanding the quantity and quality of food products demanded by Brazilian consumers. As household incomes rise, the structure of Brazilian food expenditures is changing, with demand shifting toward fruits, vegetables, and meats.

At this point it appears that Brazil will be able to meet these challenges and that the agricultural

sector will produce enough food to meet domestic demand and — depending on future changes to Brazil's biofuels mandate — exports as well. Brazil's impressive agricultural performance of the past few years is likely to continue, despite the pressures on the farm sector. On the positive side, productivity advances for crops and animal products seem almost guaranteed given the anticipated supply of improved seeds, soil correction techniques, and other technologies generated by EMBRAPA.

In addition, the PPP (public-private partnership initiatives) will enable accelerated investment in much-needed transport, ports, and storage infrastructure. The large investments needed for infrastructure development and budgetary constraints make PPPs the most viable option. These positive factors will minimize pressures from the lack of credit availability and the rapid growth of the biofuel sector, allowing Brazil to meet the new challenges from changes in dietary consumption patterns.

For more information:

Ministério do Desenvolvimento Social e Combate à Fome,
http://www.mds.gov.br.

World Trade Atlas, Global Trade Information Services.
Available online:
http://www.gtis.com/english/GTIS_WTA.html.

[1] World Bank, World Development Indicators 2008. WDI Online: http://publications.worldbank.org/WDI/; accessed April 14, 2009.

[2] Neri, Marcelo. Crônica de uma crise anunciada. FGV, Revista Conjuntura Econômica, March 2009. http://www.fgv.br/cps/crise/; accessed on April 17, 2009.

[3] USDA, Agricultural Projections to 2018, OCE-2009-1, Office of the Chief Economist, World Agricultural Outlook Board, February 2009. www.ers.usda.gov/publications/oce091; accessed on April 24, 2009.

[4] Food and Agriculture Organization of the United Nations, FAOSTAT, http://faostat.fao.org/default.aspx; Accessed March 29, 2007.

[5] MAPA: Ministério da Agricultura, Pecuária e Abastecimento, http://www.agricultura.gov.br/pls/portal.

[6] Ibid.

[7] Banco Central do Brasil, 2008. www.bcb.gov.br.

8 MAPA, op. cit.



CONJUNTURA ECONÔMICA

Address

Rua Barão de Itambi, 60 – 5º andar
Botafogo – CEP 22231-000
Rio de Janeiro – RJ – Brazil
Tel.: (55-21) 3799-6840 – Fax: (55-21) 3799-6855
conjunturaredacao@fgv.br
www.conjunturaeconomica.com.br

Consumer confidence stable

After increasing for five consecutive months, the FGV Consumer Confidence index (ICC) has leveled off at 112, above its historical average of 107 points. Although the assessment regarding the financial situation is considered the best in the last 10 months, consumers seem guardedly optimistic about the direction of the Brazilian economy in the short term. The increase in the minimum wage and the adjustment of civil servant pay has facilitated the rebound of the economy by promoting higher household consumption.

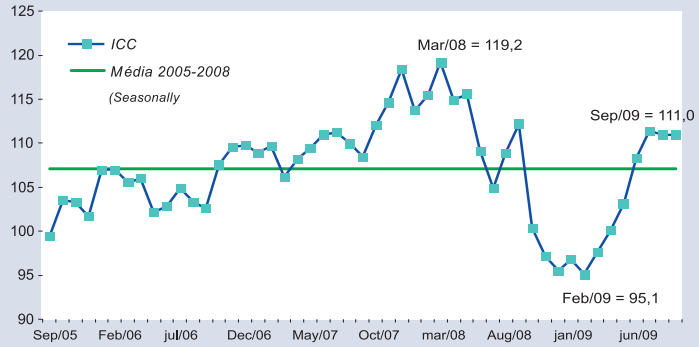
Industrial production rebounds

There are several signs that the Brazilian economy is recovering at full speed. Second-quarter seasonally adjusted GDP growth of 1.9% was much higher than expected. Industry has already recovered about half of its 20% loss in production from the precrisis peak to the lowest point. Labor market developments have also been positive: unemployment declined for four consecutive months to 8 percent.

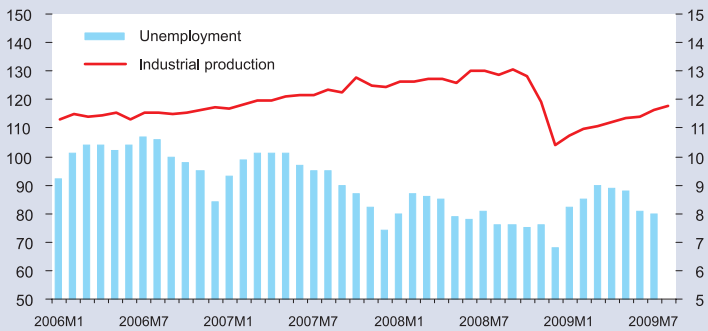
Slow recovery of tax revenues

Federal government tax revenues have been hit hard by the downturn in economic activity. From January to August, adjusted for inflation, gross revenue fell 10.2% over the same period last year. Income tax, which represents the largest portion of the collection, was the least affected, suffering a decline of just 5.7%, because employment is recuperating and income has been maintained by the government fiscal stimulus. The tax on industrial products (IPI) fell by 28.5% because of numerous tax exemptions to stimulate consumption. Because of lags in tax collection and extension of deadlines for tax collection authorized by the Ministry of Finance at the height of the crisis, the reaction of tax revenues to the resumption of production should take several months.

Consumer confidence index has leveled off, indicating that consumers are cautious

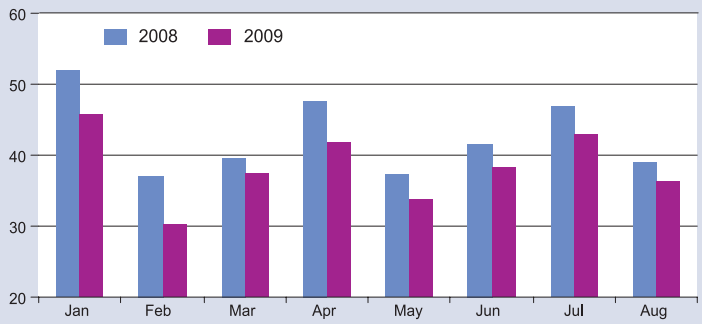


"V" shaped industrial recovery

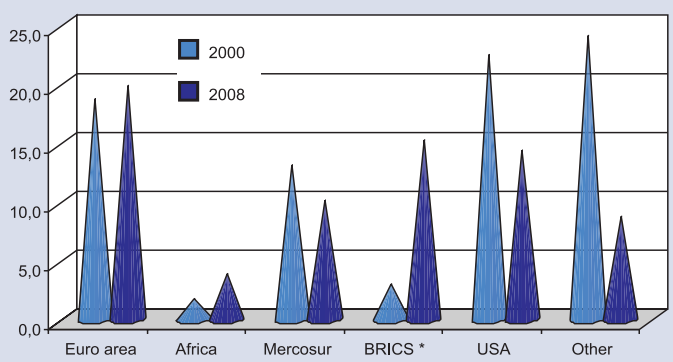


Souce: IBGE.

Tax revenues are recovering slowly



Brazilian exports by market (percent of total)



Brazil — Changing trade patterns

Between 2000 and 2008, the shares of Russia, India and China in Brazil's exports grew significantly, while at same time the US share declined and the euro area remained about the same. Brazilian exports to Africa also increased. Mercosur's share in Brazil's exports declined in part due to Argentina's protectionism and the recession that hit member countries in the second half of 2008.

For additional series and methodology contact: Industry and consumer surveys: (55-21) 3799-6764 or sondagem@fgv.br; Price indexes and data bank services: (55-21) 3799-6729 or fgvdados@fgv.br.