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IBRE's Letter
Many doubts about the post-crisis economic world

Interview with Barry Eichengreen
Where will the US dollar go?

FGV Business Excellence Award
Eduardo Heusi Costa

Fernando de Holanda Barbosa
2010, the year of Lula

Alberto Furuguen
Stabilization: An unfinished process

Lia Valls Pereira
Number of trading enterprises and foreign trade

Brazil's economic and financial indicators

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In this issue

IBRE's Letter

Many doubts about the post-crisis economic world
Once the most critical period of panic is over, the gradual and very soft US external adjustment that was already taking place before the crisis will resume, this time strengthened by the US deceleration. The appreciation of the dollar and low interest rates are yet another indication that fears provoked by the "balance of financial terror" between the US and China may indeed have been indeed incorrect.

Interview with Barry Eichengreen
The US dollar, even though it is likely to fall in value considerably, will continue to be the world's reserve currency for the foreseeable future — if only because there are no viable alternatives. This is the view of Barry Eichengreen, professor of economics and political science at the University of California at Berkeley, in an interview with Anne Grant.

FGV Business Excellence Award
In its 19 years of existence, the award has been presented 234 times to 129 nonfinancial Brazilian corporations. An analysis of the profile of recipients of the award confirms that a trend that began in 2000 has been sustained: there has been a relative increase in the number of awards given to publicly traded companies. Between 1991 and 1999, 31.5% of the awards were granted to publicly traded companies and 68.5% to nonpublic companies. The situation reversed in 2000, when 62.7% of the awards were presented to public companies. This year's awards confirm the positive effects brought about by increased transparency and a commitment to clear corporate governance rules. This is Eduardo Heusi Costa's assessment.

2010, the year of Lula
According to the Chinese zodiac, 2010 is the year of the tiger. For the Brazilian economy, both monetary and fiscal policies seem to indicate that 2010 will be the year of Lula, says Fernando de Holanda Barbosa.

Stabilization: An unfinished process
The Real Plan launched in July 1994 to stabilize the Brazilian economy has proven to be a remarkable success. This 15th anniversary is an opportunity for reflection and for the promotion of measures and decisions to perfect and consolidate the stabilization process, argues Alberto Furuguem.

Number of trading enterprises and foreign trade
Increasing the number of companies in the country's export base — particularly small and medium-sized enterprises — is part of a program to boost exports, but obstacles these enterprises face in maintaining foreign trade must be overcome, analyzes Lia Valls Pereira.

Brazil's economic and financial indicators

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For the 19th edition of the FGV Business Excellence Award *Natura* corporation has been selected as both best business corporation in the country and best in its category, Perfumery and Personal Hygiene. In addition to *Natura*, and based on their 2008 performance, the best business corporations were selected by sector of activity: *Comgás* has once more been recognized as best in the Gas sector; *Whirlpool* in the Machinery and Equipment sector; *Confab* in Metallurgy; *Lojas Renner* in Retail; *Grendene* in the Leather and Shoe sector; *AmBev* in the Beverage sector; *Petrobras Distribuidora* in the Wholesale sector (distribution of petroleum products); *Accor of Brazil* in Real Estate; *Bunge Fertilizantes* in Chemicals; and *Duke Energy* (Paranapanema) in Electricity.

The Brazilian Economy also brings to you an exclusive interview with Barry Eichengreen, the George C. Pardee and Helen N. Pardee professor of economics and political science at the University of California at Berkeley. He is convinced that the US dollar, even though it is likely to fall in value considerably, will continue to be the world's reserve currency for the foreseeable future — if only because there are no viable alternatives. Professor Eichengreen disputes the "dark matter" theory that the existence of a big US external imbalance was an illusion, but he also points out that how the US external account adjusts depends on countries other than the US, and asks where the foreign demand needed for rebalancing will now come from. The answer, he believes, is from emerging markets like Russia, India, China — and Brazil.

Many doubts about the post-crisis economic world

The huge US external current account deficit, with its counterpart in the large Chinese external surplus, has concerned economic analysts for years, long before the global financial crisis emerged. As early as 2000 Obstfeld and Rogoff stated that "The US current account deficit has been persistently large and has brought the country's foreign debt to GDP ratio to 20%, a figure that is high by historical standards."[1] They argued that "while US solvency is not a near-term constraint on ongoing deficits, the sheer size of the US economy makes it likely that its current account will have to approach balance in the next five to ten years, if not sooner".

Soft landing — At the beginning of the present decade many economists expressed similar views, opening a debate on whether the US economy adjustment would be a soft or hard landing. The "soft" hypothesis holds that economic authorities in the major countries would eventually take the reins of the adjustment: the US government would adopt measures to boost domestic savings, and China would promote increased domestic consumption and gradual appreciation of its currency. This came to be known as expenditure switching, a soft change in the pattern of expenditure in the US, with the reduction of domestic consumption offset by increased net exports. This scenario would not have much impact on production or employment, but increased public savings would be combined with currency devaluation and some degree of monetary tightening if controlling inflation should become necessary. In short, it advocated replacing domestic demand with foreign demand.

Hard landing — According to the hard landing hypothesis, failure to coordinate economic policies in the international sphere to counter the global imbalance would bring about an abrupt cut in US credit, forcing the country to suddenly reduce consumption. This would be achieved through expenditure reduction, and the need to speedily reduce domestic consumption would lead to a sharp drop in imports, which in turn would drastically affect production and employment.

In this scenario the US dollar would undergo a "rowdy" depreciation, and the economic authorities would be faced with a dilemma well known to emerging countries of raising interest rates — or holding them steady — in the midst of an economic downturn to avoid a weaker currency triggering inflation. In short, the US would then be forced to reduce domestic demand without the corresponding increase in foreign demand.

So far actual experience seems to invalidate the hard-landing theory as it had been formulated, because the driving force behind the global financial crisis was not the widely feared correction of imbalances between the US and Asia. Also, the crisis failed to produce the effects associated with that scenario, as pointed out by Brad DeLong: "We all, from Lawrence Summers to John Taylor, were expecting a very different financial crisis. We were expecting the 'Balance of Financial Terror' between Asia and America to collapse and produce chaos. We are not living that financial crisis. Instead we are having a very different financial crisis."[2]

Dark matter — It was the persistence of that supposed balance of financial terror that led some economists to formulate theories that, to a higher or lesser degree, question whether a balance is necessary at all. In 2006, Hausmann and Sturzenegger published a paper criticizing the methodology used to measure the US balance of payments.3 According to them, US GDP and exports are underestimated and the current account deficit is overestimated.

Hausmann and Sturzenegger argue that, despite the fact that official statistics may suggest that the US has been a net debtor since 1986, the country's revenue accounts show a surplus.[4] This could be explained by the fact that assets have appreciated faster than liabilities since 1976. To them, this dynamic has been maintained for quite a long time and could be attributed to the export of intangibles — "dark matter" — that have not been taken into account by the standard methodology for national accounts. Examples of intangibles are the net value of currency held by nonresidents that generate seignorage to the US Treasury; the US Treasury bonds that various nations have accumulated in their international reserves, and that represent a very-low-risk investment; and finally, the managerial development and the introduction of new technology that follows American direct investment in emerging countries.

The global crisis did not see a sudden halt of the financing of US foreign debt but rather a misalignment of the financial sector that suddenly put the brakes on credit and threw the country and the world into a recessional skid.

Hausmann and Sturzenegger propose measuring the intangibles, reassessing the US net foreign position, and marking assets and liabilities to market. According to their estimates, the US would never reach the position of net debtor because it would have been a creditor to the world by about US$100 billion in 2004. When the same methodology

is applied to other countries, the two economists conclude that there would be very minor changes; the totals calculated for the official current account deficit and the mark-to-market approach would be very similar. This confirms, somehow, the exceptional position of the US and reinforces the dark matter concept. Only two exceptions to the rule were identified: China has been an important importer of intangibles; and Great Britain, as well as the US, has been an exporter of services.

If there are significant and convincing changes in US financial regulation, investors may conclude that the US still offers the best governance for financial intermediation.

Willem Buiter criticized the methodology Hausmann and Sturzenegger used for their calculations.[5] Although he does not discard the dark matter theory, he suggests that the difference between the yield on US assets and liabilities may be a temporary result of the significant capital gains in the 1990s, when the increased credibility of several emerging countries provided room for very profitable US investment there.

Bretton Woods II — An alternative explanation for the persistent imbalance in the economic and financial relations between the US and China is what has become known as the "Bretton Woods II" theory, introduced in a series of articles published from September 2003 through February 2009 by Michael Dooley, David Folkerts-Landau, and Peter Garber. Dooley and his coauthors build on the features of the Bretton Woods system, which dominated the global economy from the post-war period until the 1970s. At the time, the US posted deficits in its balance of payments while the periphery — then Europe and Japan, which were under reconstruction — accumulated foreign reserves. The Europeans and the Japanese experienced a period of robust growth. Today, the US is again recording balance of payment deficits while the developing countries accumulate foreign reserves and grow at accelerated rates. Thus, the concept of Bretton Woods II would refer to the similarities between the present economic world and that of the aftermath of World War II.

The research of Dooley, Folkerts-Landau, and Garber is based on the supposition that the developing countries, in particular the Asian countries, are rich in labor and capital and poor in terms of natural resources and technology. Therefore, they need foreign direct investment for acquiring technology and management innovations already dominated by the advanced countries, not for supplementing their savings. The problem, however, is that those countries suffer from institutional underdevelopment compared with the advanced countries and do not always offer the legal security foreign investors require.

Dooley and coauthors argue that the reserves accumulated by the emerging market countries in US treasury bills function as collateral for US investments in those

countries. Thus, if an emerging country expropriated American assets or those of a US ally, the US government would have the power to retaliate, blocking or expropriating assets (treasuries or other investments) of the government in question.

The idea may seem extravagant, but the authors provide several historical examples of this sort of retaliation. During World War II, assets of the Axis countries in Allied countries were frozen, as were those of East European countries after they fell under Soviet domination following the war. Similar occurrences were registered in countries like China, North Korea, Cuba, North Vietnam, the former Rhodesia (today Zimbabwe), Cambodia, Iran, Libya, and Panama.

Thus the Chinese development strategy would be based on exports and on the absorption of know-how through foreign investment, with the ensuing massive accumulation of reserves as collateral, which would guarantee the participation of the government and companies of the US (and other advanced countries) in the model. The Chinese advantages would be significant savings and an almost unlimited supply of low-cost labor, which is guaranteed by managing the exchange rate to keep the currency depreciated in real terms. This cycle and the ensuing accumulation of reserves would function until the process of transferring population masses from the countryside (the great reservoir of labor at almost zero cost) to the cities came to an end.[6]

Dark matter and Bretton Woods II are therefore attempts to justify the permanence of a situation that traditional theory sees as intrinsically imbalanced and that, sooner or later, would lead to a potentially painful adjustment.

US dollar as a reserve currency — Given the high pre-crisis US current transaction deficits and the behavior of the world during the crisis, what can be expected from now on? Even though the debacle triggered by the subprime credit market has not been a US current account crisis, it is still possible that the regulatory and institutional deficiencies that surfaced during the turbulence will accelerate the relative loss of importance of the US dollar as a reserve currency — particularly if the dollar continues to devaluate. This is not, however, an inevitable outcome. The markets look ahead: if there are significant and convincing changes in US financial regulation, investors may conclude that the US still offers the best governance for financial intermediation. Additionally, the fact that the European banking crisis has been as deep as the American crisis invalidates the argument that stricter European regulation has meant

Once the panic is over, the gradual and very soft external adjustment that was already taking place before the crisis will resume, this time strengthened by the US deceleration.

a safer financial environment: the failures were generalized. The speedy reactions that have been typical of the US in the crisis, such as the indictment of the megacrook Bernard Madoff, may help send a signal to investors that the US is still the best market for savings. Thus, Americans may well come out of the crisis even stronger than before.

Summing up, the theories and evidence examined tend to go against the view that a painful and rapid adjustment of the US foreign imbalance is inevitable. The global crisis did not see a sudden halt of the financing of US foreign debt but rather a misalignment of the financial sector that suddenly put the brakes on credit and threw the US and the world into a recessional skid.

Once the most critical period of panic is over, the gradual and very soft external adjustment that was already taking place before the crisis will resume, this time strengthened by the US deceleration. The appreciation of the dollar and low interest rates are yet another indication that fears provoked by the balance of financial terror between the US and China may indeed have been incorrect. This does not mean that theories like dark matter and Bretton Woods II — attempts to minimize the seriousness of US-Asia financial relations — are correct. What has become clear today is that their authors have at least asked the right question, which in itself is an important step toward getting a better grasp on this complex economic world.

[1] Maurice Obstfeld and Kenneth Rogoff (2000), "Perspective on OECD Capital Market Integration: Implications for U.S. Current Account Adjustment," in Federal Reserve Bank of Kansas City, *Global economic integration: Opportunities and challenges*, pages 169-208.

[2] DeLong, J. Bradford (2008), "The Wrong Financial Crisis," http://www.voxeu.org/index.php?q=node/2383.

[3] Ricardo Hausmann and Frederico Sturzenegger (2006), "Global Imbalances or Bad Accounting? The Missing Dark Matter in the Wealth of Nations," John F. Kennedy School of Government, Faculty Research Working Papers Series, RWP06-003; http://ksgnotes1.harvard.edu/Research/wpaper.nsf/rwp/RWP06-003.

[4] It must be recognized that measuring the US current account is not easy, as is evident in the procedures adopted by the Bureau of Economic Accounts (BEA), of the US Commerce Department, which is responsible for the official figures. For years the BEA has tried to find correct measurements of net foreign debt. According to the methodology that measures the debt at current value, US foreign debt for a year would be the sum of the deficits of current transactions accumulated up to the year in question. Thus, up to 1986 the US would have a net positive balance, but from 1986 onward, there is a shift in the position, and the country becomes a debtor.

[5] Willem Buiter, (2006), "Dark Matter or Cold Fusion?" Global Economic Paper 136, GS Global Economic Website, January 2006.

[6] According to projections in 2003, when the first article on Bretton Woods II was published, it was estimated that the process would carry on for another 10 to 20 years, that is, ending somewhere between 2013 and 2023.

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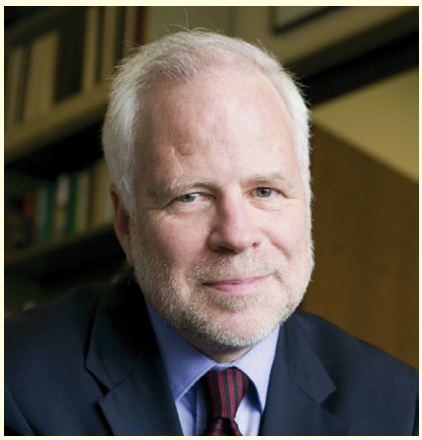
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Where will the US dollar go?



Barry Eichengreen

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Even though it is likely to weaken considerably, the US dollar will continue to be the world's reserve currency for the foreseeable future, says Berkeley professor Barry Eichengreen, if only because there are no viable alternatives. Although the US current account deficit will again probably widen once the current recession ends, it will not reach the dimensions of a few years ago. Professor Eichengreen challenges the theory that the existence of a big US external imbalance was an illusion, but he points out that how the US external account adjusts depends on countries other than the US: "Global rebalancing has two sides," he says, and asks where the foreign demand needed for rebalancing will now come from. The answer, he believes, is from emerging markets like Brazil, Russia, India, and China — "China can't do it by itself."

Professor Eichengreen questions the case for a second economic stimulus in the US: "We need to give the first stimulus time to work and avoid exciting the bond market vigilantes." He is concerned, too, about what type of international financial landscape will emerge from the current crisis: "The new lines of responsibility for financial supervision are far from clear." But he does not foresee a major revision of the Bretton Woods institutions.

The Brazilian Economy — **The huge external current account deficit of the United States, and the massive surplus in China, were of considerable concern to economists in the 1990s and this decade. Many predicted that this imbalance would be corrected and discussed the possibility of a "hard landing" in which the US and global boom would stop dramatically and painfully. In fact, the long phase of rapid growth came to a sudden end not because of a traumatic adjustment of the US current account but with the outbreak of the financial crisis last September. Moreover, it is not clear that the balance of payments of the United States has been a major cause of the turbulence, although some analysts point out that ample Chinese financing of the US current account made possible the credit binge that led to the crisis. Is the current financial turbulence related to the correction of the external imbalance of the US economy?**

Barry Eichengreen — We have seen the U.S. current account deficit shrink by half as American demand for imports has fallen. There is debate about whether the same level of import demand and the same 6% of GDP current account deficit will return once the crisis is over. My view is that at least part of the change will be permanent. US households are currently saving 7% of household income, and this increase in saving is likely to persist as they attempt to rebuild their retirement accounts. And foreign appetite for U.S. debt securities is falling as well, since the US is no longer seen as a supplier of high-quality financial assets to the same extent as before.

Photo: California University, Berkeley

Ricardo Hausmann and Federico Sturzenegger argue that there has not been a big US external imbalance and there are no serious global imbalances once assets are valued according to the income they generate (this is the "dark matter" hypothesis). Hausmann and Sturzenegger observe that while the US has net external liabilities, the country is a net recipient of income from abroad. Their hypothesis is that US assets are worth more than their face value because of intangibles like safety, liquidity and access to technology. Calculating the present value of the flows of rents receivable and payable in the US for the rest of the world, Hausmann finds that the country had no external current account deficit and has not increased its net debt position in relation to the rest of the world. Is there any truth to this explanation? Do US external imbalances really not matter?

I was never a believer in "dark matter." To the extent the theory had merit, it reflected the fact that US investors were buying foreign equities while foreigners were buying US government debt. Because of the greater riskiness of equities, US investors were receiving more compensation. Now foreign investors are no longer buying the debt offerings of Freddie Mac, Fannie Mae, and the US Treasury; increasingly, they're buying US equities, partly through their sovereign wealth funds, so they will be receiving more compensation for their additional risk. The so-called dark matter return differential will be no more.

Niall Ferguson (financial historian, Harvard University) argues that expansionary US Keynesian policy will not be effective but will cause volatility in financial markets. The current financial crisis is essentially a problem of excessive debt; to solve it requires a major restructuring of not just mortgages but also banks.

Massive US budget deficits of 12% of GDP and public debt doubling will eventually undermine the US dollar as an international currency. In short, where will the US dollar go?

There are a lot of assumptions implicit in that question. I do agree that the dollar will weaken against the currencies of emerging markets. As Americans consume less, that weaker dollar will help the US to export more—assuming foreign demand for our exports picks up. But that's my medium-term view, my view of what will happen over the next three to ten years. No one can guess what will happen in the short term. Currency forecasting is a mug's game, as they say.

But I also think that the stimulus is working. Professor Ferguson's question presumes that deficit spending in the United States, resulting eventually in a higher debt ratio, will crowd out private spending one for one. With interest rates close to zero and relatively little private spending at the moment to crowd out, I think he's making a mountain out of a molehill. If the US runs deficits in excess of 10 per cent of GDP indefinitely, we will get into trouble, no doubt about it. Investment and growth will suffer. But those are problems for 2011 and after, when the economy is growing again, not for today.

Despite the massive US budget deficits, there has been a remarkable increase in private savings (from negative to about 7% of GDP) and the latest US trade balance data indicate a substantial improvement (the trade balance deficit was cut in half to US$120 billion in Jan.-Apr. 2009 compared with US$240 billion a year earlier). Would this suggest

The dollar will weaken against emerging markets. And as Americans consume less, a weaker dollar will help the US to export more.

that the US external account is adjusting gradually (the "soft landing" hypothesis) through expenditure-switching (Americans consume less and the rest of the world consumes more)? Is a hard landing unlikely?
What has happened so far is not expenditure-switching but expenditure-reducing. U.S. imports and exports have both gone down in the recession; it follows that as a result the difference between them (the deficit) has gone down. Expenditure-switching needs to come next, enabling us to export more while importing less. Depreciation of the dollar will help. But how smoothly this will work is a question. A great deal depends on demand from emerging markets, not least Brazil.

Global rebalancing has two sides—it takes two to tango. Since there is not going to be additional demand from Europe or Japan, both of which are going to be growing at best slowly, by process of elimination that additional demand will have to come from emerging markets, especially the BRIC countries, Brazil, Russia, India, and China. So if the dollar depreciates, it is their currencies that are going to have to be on the other side of this trade.

Obviously, if China and other emerging countries can't stimulate their domestic demand and US savings remain high — the American shopping mall closes down — the global recovery will be protracted. At the same time, it does not seem that the interruption of symbiosis between the US and China economies will trigger a US balance of payments crisis because US private savings are increasing enough that the US Treasury needs to sell fewer bonds to China. How likely is China to change its export-led growth model in the short run to offset the US increase in savings?

How can the international financial institutions be reformed? There needs to be more clarity about priorities.

China can't offset the decline in spending by the United States by itself. The Chinese economy is barely a third the size of the US economy at market exchange rates. This means that to offset the decline in U.S. spending there will have to be an accompanying rise in spending by the other big emerging markets, India, Russia, and Brazil, and by the oil exporters as well.

Although confidence indicators have recovered recently in some advanced and emerging countries, economic growth (except for China) was contracting in the first quarter of 2009. What are the recovery prospects for the global economy? Will it turn around in 2010?
I'm hopeful that we will see positive global growth some time in 2010 — I just don't know when, whether this will start toward the beginning or the end of the year. But whenever it begins, that growth will be tepid, that is to say relatively weak, by the standards of the typical recovery. Banks in the advanced countries, which remain inadequately capitalized, won't be lending to the normal degree. The monetary-fiscal policy mix will be unfriendly to investment. Structural change and the search for new growth engines to replace the financial sector will be painful. So there are any number of reasons to expect a subdued recovery.

As the crisis unfolds, it seems that the global financial system has contracted to the point that credit is unlikely to recover to the pre-crisis level any time soon. What type of international financial landscape will emerge from the current crisis?
I certainly hope that credit doesn't recover to where it was! Monetary policy was too loose, notably in the United States. There were excessive inflows of capital and liquidity from

China. And leverage was excessive. We don't want to go there again. We need a more vigorously regulated and more transparent financial system. And with the financial sector growing more slowly, countries like the U.S. are going to need new growth engines like high tech and green technologies.

Some argue like the French president, Nicolas Sarkozy, that "we must rethink the financial system from scratch, as at Bretton Woods." How likely is a Bretton Woods II? What reforms of the international financial and monetary system, in particular of the IFIs, are likely to occur?

The likelihood of a Bretton Woods II is approximately zero. In other words, our leaders are unlikely to go back to the drawing board and start from scratch. That's not the way the world works: existing institutions are deeply embedded, and existing stakeholders, including the big financial institutions, will push back. Very briefly after the Lehman Bros. bankruptcy everything might have on the table. But that period of "extraordinary politics" is already over.

What should we focus on? Requiring financial institutions to hold more capital. Making capital adequacy requirements less procyclical. Clamping down on regulatory arbitrage. Insisting on more transparency. Reforming compensation practices in the financial sector to align the interests of key decision makers with the long-term interests of society and their own firms. Giving chief risk officers more independence from the chief executive officer and tying their compensation to the stability of the firm. Moving trading in credit default swaps and other derivative securities onto an organized exchange. None of these changes are revolutionary, but they are no less important for that fact.

Clearly, the dollar has grown less attractive as a reserve currency. Its reputation has certainly been tarnished. The problem is that there are no attractive alternatives.

Indeed, the financial earthquake that struck the world economy in 2008 did not resolve what has been a dilemma for many years: Is it possible that the United States will continue indefinitely borrowing from the rest of the world and at the same time the dollar will maintain its hegemonic role in world economy? Will the US dollar be eventually replaced by another currency?

Clearly, the dollar has grown less attractive as a reserve currency. Its reputation has certainly been tarnished by the crisis. The problem is that there are no attractive alternatives. Winston Churchill once said that democracy is the worst form of government except for all the others. The same applies to the dollar. What could replace it as a reserve currency? Markets for euro area bonds are not as liquid as the markets for U.S. treasuries, and some euro area countries have serious problems. The yen has never seemed a likely possibility. Switzerland and Britain are too small to issue first-class reserve currencies. Some day China's renminbi might be the answer, but not for decades. Or maybe it could be agreed internationally to make something like the IMF's special drawing rights the reserve currency. That would also take decades. So like it or not, what we have for the time being is the dollar.

It may seem unfair that despite past US mismanagement and though the dollar is going to weaken, it will still remain the world's dominant reserve currency. But sometimes life is unfair.

FGV Business Excellence Award

Eduardo Heusi Costa, from Rio de Janeiro

Created in 1991, the FGV Business Excellence Award seeks to recognize excellence in the business world by annually identifying among the Top 500 Brazilian companies those businesses that have shown good profits and moderate levels of risk, contributed to the country's development, and served as a model of excellence to the market. In its 19 years of existence, the award has been presented 234 times to 129 nonfinancial Brazilian corporations.

Ascent of publicly traded companies — An analysis of the profile of recipients of the award confirms that a trend that began in 2000 has been sustained: there has been a relative increase in the number of awards given to publicly traded companies. Even though the rate of opening companies to shareholders slowed down in Brazil last year, particularly after the international financial crisis, this year's awards confirm the positive effects brought about by increased transparency and a commitment to clear corporate governance rules. Between 1991 and 1999, 31.5% of the awards were granted to publicly traded companies and 68.5% to nonpublic companies. The situation reversed in 2000, when 62.7% of the awards were presented to public companies. The trend might be ascribed to the Bovespa initiatives starting that same year, aimed at encouraging businesses to adopt a more transparent and professional management model. Levels 1 and 2 and New Market were then created for securities issued by companies voluntarily embracing good corporate governance practices and publishing in-depth information beyond the standards required by law. The initiatives sought to improve the quality of the information made available to the market and to enhance shareholders' rights in the Brazilian market, which in turn helped to increase the value of the businesses adopting this new set of rules.

There has been a relative increase in the number of awards given to publicly traded companies.

In the 19 years of the Excellence Award Brazil has undergone periods of political and economic instability; companies honored with the award, however, have continued to be sound. The results relating to award recipients this year indicate that they average 19.3% profitability; the average of the Top 500 corporations in 2009 was 13.1%. The debt-equity ratio of 1.16 of companies receiving the award is lower than the 1.39 average of the Top 500 corporations, which confirms that those businesses continue to be cautious about intensive use of third-party capital, even though their profitability is impressive.

Of the 129 award recipients to date, no company has gone bankrupt, though some have been taken over by other businesses or have gone private and ceased to publish their results.

This year the award recipients rank, on average, at 110 in the Top 500 rankings. In the 19 years of the Business Excellence Award, the average ranking has been 171. The larger size of the average corporation today reflects the trend toward the increased soundness of the publicly traded companies as a consequence of enhanced professionalism in management.

Of the 11 companies receiving the award this year, 4 (about 36%) are first-time recipients, maintaining the average rate of renewal of the list of FGV honorees over the years. The first-time recipients are: Confab, Hotelaria Accor Brasil, Bunge Fertilizantes e Duke Energy. Among the repeat honorees, the record goes to Natura Cosméticos, which has received the award for five consecutive years. Next come Comgás (fourth-time recipient, third consecutive award), Whirlpool (third-time recipient), and Lojas Renner, Grendene, Petrobras Distribuidora, and AmBev (all second-time recipients).

Performance by region and activity — Of the excellence awards presented by FGV to date, 68.7% are in the Southeastern region; together, the states of São Paulo and Rio de Janeiro have received more than half the awards (57.1%). The Southern region comes in second, having received 19.7% of total awards (29 companies, of which 19 are in the state of Rio Grande do Sul); next is the Northeastern region, with 6.4% of the awards (11 companies, with 3 companies each in the states of Ceará, Bahia, and Rio Grande do Norte) and, finally, the Northern region has 3.0% of the awards and the Center-Western region 2.1%.

The industries with the highest number of award recipients since 1991 are food products (13); chemical products (12); nonmetal minerals and metallurgy (10); telecommunications (7); mining and construction (6); and wholesale trade (5).

Of the 129 award recipients to date, no company has gone bankrupt.

How the award is granted

The FGV Business Excellence Award has been granted yearly since 1991 to a group of companies ranked in the Top 500 Brazilian Business Corporations, as recognition of their competence and entrepreneurial efficiency. The companies are selected by the Vargas Foundation, specifically by the economists and analysts at the Brazilian Institute of Economy (IBRE), who take into account each company's recent performance in terms of objective economic and financial parameters; they examine particularly the results of the financial year immediately before the award year.

Companies eligible for the Business Excellence award are those that have posted positive net results for the last three financial years and have secured high levels of profitability and a sound financial situation, taking into account reference parameters in their sector of activity.

For the 2009 awards, 11 corporations from different sectors were selected after an assessment of their performance during the reference period, as reflected on their consolidated balance sheets.

2010, the year of Lula

Fernando de Holanda Barbosa

In its July 22nd meeting, the Monetary Policy Committee (COPOM) cut the Selic rate — the interbank market interest rate — to 8.75% a year. Critics of COPOM consider this reduction too little too late. The ideal moment for policy changes may only be determined after the shock and its impact on the economy have been assessed. This assessment involves a certain degree of subjectivity; there is no possibility of being conclusive.

As far as the interest cut is concerned, one should compare the real interest rate with the natural rate — the rate consistent with full employment and the inflation target. The central bank's real policy rate is currently 4.1% a year, taking into account an inflation forecast of 4.5% for the next 12 months. The natural rate in an open economy is the equivalent of the external real interest rate. For the sake of this exercise, let's use the rate on 10-year US Treasury bonds for the external interest rate. This rate is slightly above 3.5%, and Brazil's country risk is in the neighborhood of 250 points (2.5%). Thus, the estimated external real interest rate in Brazil would be 6.1% a year (3.5% plus 2.5%), without taking into consideration US inflation, which is currently negative. There can be no doubt that Brazilian monetary policy is in an expansionist mode.

How long will the Central Bank be able to keep the interest rate below the natural rate? Only a few months, as long as the economic recovery does not start to put pressure on prices. The information at hand shows that the expected interest rate for the next 12 months is higher than for the next six months. In other words, the market forecast is that the current interest rate will be short-lived. The upside is that the Brazilian economy may start showing robust signs of recovery in the 12 months ahead, restoring the full employment seen before the financial crisis.

The fiscal surplus is the one instrument of fiscal policy the government can control. Data made available by the government on fiscal policy for the first half of 2009 reveal a primary fiscal surplus of 2.44% of GDP (fiscal balance less interest payments), compared with 5.86% of GDP for the same period last year. There is no doubt that Brazilian fiscal policy in the first half of the year was expansionist — it resulted in a 3.42% reduction of the primary surplus.

Critics of Brazilian fiscal policy argue that a great part of this expansion was fueled by an increase in current expenditure that they fear is permanent rather than temporary. This expenditure will not disappear once the crisis is gone. The second complaint is that, from a social point of view, it would have been better to have a countercyclical fiscal policy based on increased public investment.

Those arguments were ignored, and fiscal policy was used to counter the global financial crisis *tsunami*. Political economy may help explain why policy makers made this choice. The President's Workers' Party has always received massive support from civil servants. It is therefore only natural that the party acknowledge this support by increasing current expenditure for, among other things, the civil servant wage bill. With regard to public investment, the government's Growth Acceleration Plan (PAC) has run into problems in trying to fulfill its promises and the project calendar has been systematically delayed. It would therefore be extremely difficult for the government to increase investment in the very short run.

According to the Chinese zodiac, 2010 is the year of the tiger. For the Brazilian economy, both monetary and fiscal policies seem to indicate that 2010 will be the year of Lula.

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Stabilization: An unfinished process

Alberto Furuguem

The Real Plan launched in July 1994 to stabilize the Brazilian economy has proven to be a remarkable success. There is no question about that. It appears, however, that the process remains unfinished. This 15th anniversary should celebrate the results achieved, but it also provides an opportunity for reflection and for the promotion of measures and decisions to perfect and consolidate the stabilization process.

Inflation persistence — The celebration is a good time to try to answer a few questions. One of them is how long Brazilians will hold on to the idea of indexation — the practice of changing prices today based on past prices, which in turn perpetuates inflation.

After a long period of high inflation, the culture and practice of indexation have become impregnated in the minds of the population. Complete eradication of this practice from our economic scenario will only occur gradually, as younger generations born during the stabilization period come of age. This does not mean, though, that we should remain passive, waiting for time to pass. Administrative and political measures in particular could be taken to speed up the process of eradicating indexation.

The goal of the Real Plan was, in theory, the immediate and complete elimination of indexation from the Brazilian economy. Theoretically, this could be achieved provided that inflation dropped drastically, to near zero, immediately after the plan was announced; and the indexation "culture" was eliminated swiftly to allow inflation to fall more easily. The expectation was that inflation would drop to near zero if all prices had previously been transformed into a URV (real unit of value) in preparation for the launching of the real, the new currency. However, that failed to happen, for political reasons: the technical calendar conceived by the Real Plan creators did not coincide with the political calendar, which had elections scheduled in October 1994.

Adjustments — In the months after the launch of the real, it became clear that many contracts (principally rentals) continued to be adjusted at relatively high rates because they had not been submitted to URV indexation when the new currency was introduced. Thus, inflation could not fall rapidly to near zero, as the plan technically projected based on the assumption of complete conversion of all prices to the URV before the new currency was introduced. The relatively high adjustments in the value of contracts not previously transformed into URVs meant that inflation did not drop far enough. The problem of the inflationary feedback triggered by the unconverted contracts was mitigated by the initial appreciation of the real against foreign currency: the real was stronger than the dollar in the first phase of the stabilization plan.

The indexation culture, in turn, was and still is difficult to eradicate because it is embedded in the minds of the population. To this day it seems natural, often even expected, that employees and liberal professionals

One of the reasons inflation persists in Brazil at levels that are still relatively high compared with countries with a long tradition of stability is the fact that indexation, besides being a cultural factor, has been institutionalized in important segments of the economy.

get a raise in the nominal values of their salaries, fees, etc. simply because time, say a year, has elapsed. In economies with a long tradition of price stability, nominal variations in the value of salaries, medical fees, etc. may occur upward or downward, depending on market conditions; they are usually not restricted to a single direction, though it is obvious that in the long run nominal values are as a rule adjusted upward because there will always be some residual inflation even in the most stable economies, as in the Japanese and European economies. But the indexation culture helps explain why inflation in Brazil is always slightly higher than it should be.

Another pertinent question is why Brazil has not pursued inflation targets lower than 4.5% (recently defined as the target rate for 2010). It would be correct to say that the government has chosen to tolerate inflation, even at rates that are not completely satisfactory, rather than addressing the real causes of this resistance, even if this entails real interest rates that are high by international standards.

One of the reasons inflation persists in Brazil at levels that are still relatively high compared with countries with a long tradition of stability is the fact that indexation, besides being a cultural factor, has been institutionalized in important segments of the economy, such as public services. Of course, aside from simply breaking contracts, a perfectly feasible alternative would be to conduct a negotiated review of contracts that would allow eradication of the automatic and indefinite indexation of certain strategic services, such as road tolls, which significantly increase the cost of transportation in general.

Political will — The decision to seek more ambitious inflation targets is relatively simple, as long as there is political will; this decision could be taken in an ordinary meeting of the National Monetary Council (CMN), composed of the Ministers of Economy and Planning and the Governor of the Central Bank. (Obviously, the members of the CMN would consult with the President beforehand, because such decisions have wide-ranging implications.)

Official inflation targets should be established below 4.5% — the rate that has persisted over several years and that has come to be regarded as the "normal" inflation rate for the Brazilian economy. There is no reason, however, to consider 4.5% inflation normal. The truth is that there are factors that have prevented inflation from falling lower. What is required, therefore, is to eliminate those factors while refusing to accept an inflation rate that is relatively high by international standards. Defining 4%, 3.5%, and 3% targets must become the goal of economic policy in future. This would privilege action over complacency.

It is common knowledge that Brazil suffered external shocks from the prices of oil and of agricultural and metal commodities that ended up feeding inflation through indexed contracts, which, in turn, prevented inflation from

falling despite the practice of high real interest rates over a long period. It is important, however, to stress a couple of additional and very relevant facts that help explain the additional inflationary pressures in the first 15 years of the Real Plan: the abandonment of the exchange rate peg at the beginning of 1999 (introduction of the floating exchange rate) and the sharp depreciation of the exchange rate after the first election of President Lula late in 2002.

Tax burden — Still another question: Has the fall of inflation contributed to the rise of the tax burden? Clearly, federal, state, and municipal administrations, besides being the first to reintroduce indexation as a practice in contracts for privatization of companies and for concessions of services, took advantage of the fall in inflation to raise the tax burden to historically high levels for Brazil. With inflation reduced it became easier (and less costly from a political point of view) to introduce real tax rises, to the despair of helpless taxpayers. As a result, since the Real Plan was introduced, the tax burden has increased from 25% of GDP to the current 36%: a Brazilian citizen today must work more than four months a year to fulfill his tax obligations, compared to three months in the past. The situation is aggravated by the fact that the tax burden has been increased first and foremost to accommodate the expansion of current expenditure rather than to cover investments necessary to improve economic infrastructure (highways, harbors, hydroelectric power plants) or social infrastructure (hospitals, sewage network, prisons). The taxpayer has paid a high price without receiving corresponding benefits.

Institutionalized indexation, the culture of indexation and the high tax burden have helped make inflation resistant to falling despite the real interest rates in force.

Perhaps we should question the idea that "Brazil needs higher real interest rates" to bring inflation down or, more importantly, to ensure that it is kept under control. If the factors that feed inflation were eliminated, would the Brazilian economy begin to resemble that of most developed and emerging countries — where the interest rates necessary to guarantee price stability are much lower? Real interest rates in Brazil, though already much lower than they were a few years ago, are still considerably higher than those in most international financial markets. Should we accept this as a "structural feature" of the Brazilian economy? Or should we seek to eliminate the reasons that inflation persists, so that we can have interest rates comparable with the international market?

There is no reason to consider 4.5% inflation normal. The truth is that there are factors that have prevented inflation from falling lower.

Public administration plays a crucial role in stabilizing the Brazilian economy. The increased tax burden has permitted it to buy time for this process, but stabilization will only be completed when the factors that prevent inflation from falling are eliminated from the practices and the culture of the country. A sustainable fiscal balance that does not depend on a high tax burden is a fundamental requirement for consolidating stabilization of the Brazilian economy.

Reviewing the laws that today help obstruct the fall of inflation should be a priority. The most conspicuous is labor legislation, which does not allow enough flexibility in negotiations, an essential tool in times when there are frequent changes in the economic scenario.

Finally, the 15th anniversary of the Real Plan must certainly be celebrated; but we should not forget that there is much still to be done to consolidate economic stability into a fundamental and long-lasting achievement for Brazilian society.

Number of trading enterprises and foreign trade

Lia Valls Pereira

In 2007 75% of Brazilian exporting companies were micro, small, and medium-sized enterprises. When considering total exports, however, their share was just 7.8%.[1]

Increasing the number of companies in the country's export base — particularly small and medium-sized enterprises — is part of a program to boost exports. However, the difficulties these enterprises face in maintaining regular foreign trade are well-known. Bureaucratic processes and in accessing credit are two of the main obstacles. The Brazilian Export Promotion Agency (APEX) has now launched a program dedicated to helping boost the exports of small and medium-sized enterprises.

Even though there are no detailed data related to company size, the number of exporting companies was 19,446 in 2005. By 2007 the total had increased to 23,528. True, the total fell to 23,021 last year, but that still meant an 18% increase between 2005 and 2008. During the same period, exports increased by 67%.

In 2008 according to the Foreign Trade Office the number of importing companies was 36,843, a 48% increase from 2005. The volume of imports amounted to a 135% increase. Average exports by company rose from US$6.1 million to US$8.6 million, and imports from US$2.9 million to US$4.7 million. The expansion of exports and imports, although partly explained by the increase in the number of businesses, can be attributed to the increase in the volume of trade carried out by each company.

Company size — 2007 data show that large companies (those with over 200 employees and exports exceeding US$20 million) account for 92% of exports. Independent of company size, most companies export less than US$1 million: 75% in 2007, and 73% in 2008 (16,817 companies). The change is not significant. On the import side, the figures are similar. The percentage of companies importing up to US$1 million was 77% in 2008 (28,546 companies).

There are no data broken down by company size. However, the five largest exporters in 2008 (Petrobrás, Vale, Embraer, Bunge Alimentos, and ADM of Brazil) account for 23% of Brazilian export revenue. The two largest companies alone export 17% of the total; they trade over US$10 billion, the other three US$2–US$5 billion. On the import side, the five largest companies (Petrobrás, Embraer, Alberto Pasqualini, Bunge Fertilizantes, and CISA Trading) account for 21% of total imports.

Center for External Sector Studies (IBRE-FGV)

Markets — We selected eight major destination markets for Brazilian exports in 2008 plus India and South Africa, two countries that are a priority for Brazilian trade policies. On the import side, Italy ranks 9th and France 8th; however, for purposes of this comparison, Italy was selected. India and Russia are not among the 10 most important markets for imports.

The first table shows the number of companies exporting or importing up to US$1 million. Apart from the US market, the number fell or remained constant for all countries. The fall suggests either that companies have increased the value of their operations, or that there has been a concentration of exports in commodities, which are normally traded at higher volumes. The smallest concentrations in this bracket are the countries where the sale of commodities is predominant, such as Russia, China, and Holland. On the import side, the increase in the number of companies in Nigeria (from 50% to 77%) and in Russia (from 27% to 66%) that trade under US$1 million suggests a possible increase in the number of companies, large and small, that are not associated with purchases of large volumes of commodities.

Table 1
Share of Brazilian enterprises that export/import up to US$1 million by main markets

Exports			Imports		
	2005	2008		2005	2008
Germany	84	80	Germany	89	86
Argentina	85	82	Argentina	86	81
Chile	90	90	Chile	88	83
China	76	73	China	90	87
United States	76	79	United States	88	86
India	83	87	India	94	90
Japan	84	84	Japan	91	90
Russia	69	65	Russia	27	66
Netherland	77	69	Italy	93	91
Venezuela	90	83	Nigeria	50	77
South Africa	87	85	Korea	93	90

Sources: Ministry of Development, Industry and Foreign Trade (www.desenvolvimento.gov.br); IBRE-FGV preparation.

Increasing the number of companies in the country's export base, particularly small and medium-sized enterprises, is part of a program to boost exports.

It is not possible to establish a clear relationship between the increase in trade and the increase in the number of companies. The most significant variation in exports between 2005 and 2008 was in China, 140%; however, the number of companies increased by only 9.8%. In India, the number of exporting companies increased by 27.2% while foreign sales rose by 98%. The ratio of increase in the number of exporting businesses to values exported is 0.26 (a ratio of 1 would indicate that the two increases are identical).

On the import side, the ratio is higher, 0.35, but it also suggests that other factors must be taken into account to explain the rise in imports. It is worth noting that the increase in the number of importing companies is higher than that of exporting companies. China deserves special attention: The number of importing

The data show that the opportunities for expansion in recent years have been concentrated on import activity, which is partly explained by the exchange rate.

companies rose 117%, against a 9.8% increase in the number of exporting companies.

Explanation — An appreciated exchange rate and higher prices for commodities are among the factors that could explain the greater increase in the number of importing than exporting companies. Furthermore, the reduction in the number of companies trading under US$1 million and the increase in imports in some markets confirm that the scenario may have been more favorable for companies whose imports had lower values.

The increase in the number of companies explains part of the increase in Brazilian exports in recent years. Programs aimed at boosting exports should assess other benefits deriving from small and medium-sized companies participating in foreign trade. As companies become more efficient through experience, they may diversify the risks associated with demand cycles; in addition, insertion in the international market may lead to a permanent increase in a company's activities. An analysis of markets and products is an essential part of this type of policy. The data show that the opportunities for expansion in recent years have been concentrated on import activity, which is partly explained by the exchange rate.

Table 2
Number of Brazilian exporting enterprises

	Number of enterprises		Change in number of enterprises (%)	Change in exported value (%)
	2005	2008	2008/2005	2008/2005
South Africa	1,626	1,577	-3.0	28.0
Germany	2,645	2,978	12.6	75.9
Argentina	6,080	6,662	9.6	77.3
Chile	4,118	4,405	7.0	32.2
China	1,952	2,143	9.8	140.0
United States	6,903	7,249	5.0	21.7
India	835	1,062	27.2	98.3
Japan	1,494	1,810	21.2	-3.1
Netherland	1,960	2,176	11.0	75.6
Russia	668	827	23.8	59.5
Venezuela	2,571	3,046	18.5	131.6

Sources: Ministry of Development, Industry and Foreign Trade (www.desenvolvimento.gov.br); IBRE-FGV preparation.

Table 3
Brazil: Number of importing enterprises

	Number of enterprises		Change in number of enterprises (%)	Change in the imported value (%)
	2005	2008	2008/2005	2008/2005
Germany	7.607	9.328	22,6	95,7
Argentina	4.874	5.390	10,6	112,4
Chile	1.246	1.379	10,7	133,6
China	7.158	15.533	117,0	274,3
Korea	2.252	3.175	41,0	132,6
United States	11.662	15.444	32,4	102,3
India	2.052	3.201	56,0	196,2
Italy	6.368	8.102	27,2	102,6
Japan	4.038	5.677	40,6	99,9
Nigeria	24	44	83,3	153,7
Russia	425	514	20,9	361,4

Sources: Ministry of Development, Industry and Foreign Trade (www.desenvolvimento.gov.br); IBRE-FGV preparation.

[1] The Foreign Trade Office (SECEX) has not yet reported disaggregated trade data by company size for 2008.

Industry capacity utilization

Capacity utilization in Brazilian industry — which registered in June 2008 its highest level since the 70s (86.7%) — sank to 77.6% last February because of the international financial crisis. Since then, capacity recovered up to 79.8% by July, but it is still below its historical average of the last 10 years (82%), showing that industry has not fully recovered. Although the FGV confidence index of industry has been recovering faster since the second quarter, significant investments in industry should occur only in 2010.

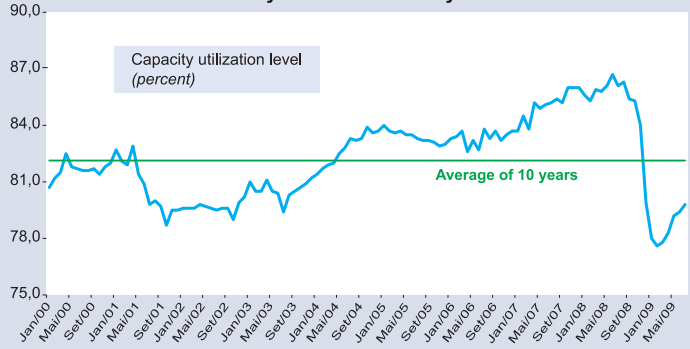
Industrial production and retail sales

The international crisis affected differently Brazilian industrial production and retail sales. Industrial production fell sharply in the fourth quarter of 2008 due to credit shortage, loss of consumer confidence and especially the fall in exports. Since January, the industry is recovering some of the ground lost as a result of tax exemptions and lower interest rates. In contrast, retail sales declined little in the fourth quarter of 2008, and most of the fall was in durable goods. In 2009, the industry has been recovering on the strength of the domestic market and counter cyclical effect of social programs.

Industrial input prices

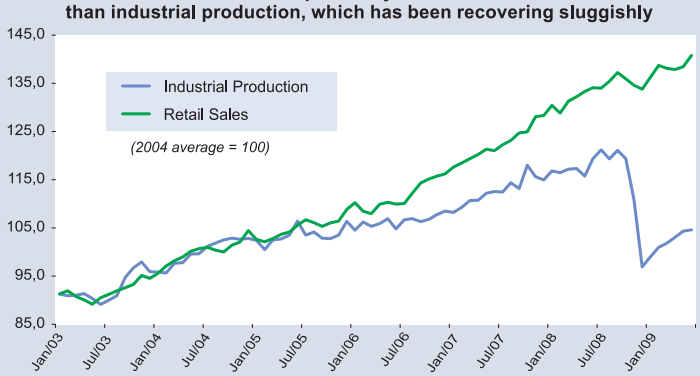
For the ninth consecutive month, industrial input prices fell. They have fallen 11.5% since October 2008 —, when prices reached their peak. Industrial input prices followed the decline of international industrial commodities prices (18.3% in the past 12 months). Recent increases in commodities prices in view of prospects of recovery of the global economy have been offset by the appreciation of the Brazilian currency (12.7% in the last three months). This reduction in prices is good news for controlling domestic inflation as it ensures the current industrial production recovery with modest cost pressures.

Although confidence index of industry has been recovering faster since second quarter, significant investments in industry should occur only in 2010



Source: IBRE-FGV.

Retail sales have suffered comparatively less from the international crisis than industrial production, which has been recovering sluggishly



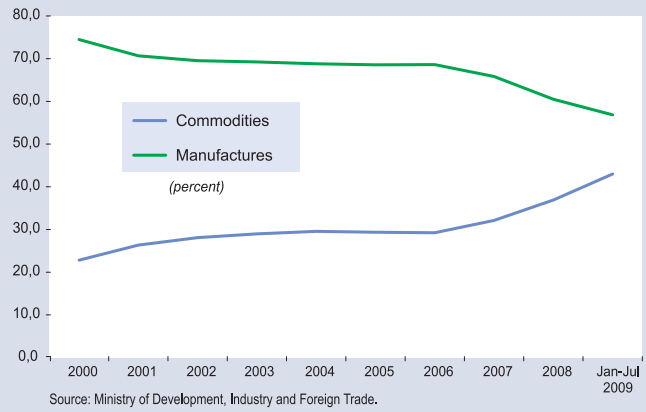
Source: Brazilian Institute of Geography and Statistics (IBGE).

Industrial input prices in Brazil fell following the decline in international industrial commodities prices



Source: IBRE-FGV.

Brazil: Commodities and manufactures shares in total exports



Source: Ministry of Development, Industry and Foreign Trade.

Brazil's challenge to recapture lost export markets

While the share of commodities in total exports has increased, manufactures' share has fallen in recent years. Brazilian manufacturing has lost competitiveness partly due to exchange rate appreciation. Also, with international demand having contracted, exporters of manufactures are fighting for a smaller slice of the market, and need to offer lower prices and financing on more advantageous terms, especially when compared with China. China is taking advantage of the current international scene to take over markets by offering generous financing to countries in exchange for their purchase of Chinese manufactured goods.

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.