Brazil

Highlights and Key Issues

- In sharp contrast to many emergers, Brazil was still growing very robustly in Q3. But the intensification of the global crisis, and its numerous repercussions – many of which were unforeseen – since September has been so great that it has stopped the economy in its tracks. The clearest sign of this is that annual import growth, which had been growing at close to 60% mid-year, dropped to only 9.2% in November. This is an indication of the extent to which previously soaring domestic demand growth, particularly investment, has slowed.
- Export volumes were already weakening in Q3 and the major deterioration in the global background since then is expected to lead to exports falling by nearly 3% in 2009 as a whole. This, together with the much lower commodity prices than firms will have budgeted for and the global fall in business confidence, will cause investment to shrink in 2009 after 15% growth in 2008. Consumer spending growth is also forecast to slow significantly but should at least stay positive, helped by an expected moderation in inflation. Meanwhile, given its healthy fiscal position, the government is likely to step up its spending. Overall, GDP growth is now forecast to slow to 1.3% in 2009.
- Although scope for the central bank to cut interest rates remains constrained by the weak BRL and 6%+ inflation, the rapid pace of the slowdown in both Brazil and the rest of the world may lead to a substantial reduction in underlying inflation pressures. This could pave the way for interest rate cuts to start in early-2009.

Forecast for Brazil
(Annual percentage changes unless specified)

	2007	2008	2009	2010	2011	2012
Domestic Demand	7.5	8.7	1.7	3.1	5.0	5.1
Private Consumption	6.3	6.2	2.3	3.3	4.4	4.3
Fixed Investment	13.4	15.6	-4.4	1.8	8.4	9.0
Stockbuilding (% of GDP)	0.8	1.8	1.9	1.8	2.0	2.2
Government Consumption	4.7	5.6	4.9	4.0	3.0	3.0
Exports of Goods and Services	6.7	0.6	-2.9	5.5	10.2	9.5
Imports of Goods and Services	20.8	19.4	0.1	6.6	10.1	10.2
GDP	5.7	5.9	1.3	2.8	4.9	4.8
Industrial Production	5.9	5.0	-1.5	3.6	5.5	5.4
Consumer Prices	3.6	5.7	5.3	4.1	4.0	4.0
Government Budget (% of GDP)	-2.2	-0.8	-2.4	-2.1	-1.7	-1.6
Trade Balance ($bn)	40.0	24.7	11.6	14.0	11.3	11.5
Current Account ($bn)	1.7	-31.0	-34.1	-27.3	-27.2	-26.1
Current Balance (% of GDP)	0.1	-1.9	-2.5	-1.8	-1.7	-1.5
Short-Term Interest Rates (%)	12.0	12.4	12.5	11.2	11.0	10.7
Exchange Rate (Per US$)	1.95	1.84	2.30	2.22	2.24	2.29

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Overview

Very strong growth in Q3…

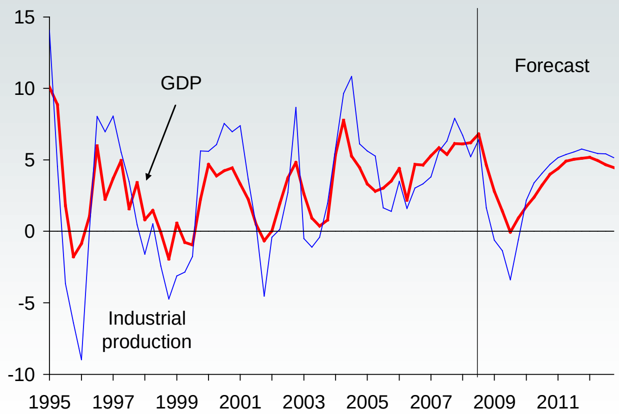
- While many emergers were already beginning to struggle in 2008Q3, the Brazilian economy was still growing very strongly. In seasonally adjusted terms GDP increased by 1.8% on the quarter, considerably more than most analysts had expected, taking the year-on-year growth rate to 6.9%. Activity continued to be driven by soaring domestic demand, with annual consumer spending growth climbing to 7.3% and investment growth close to 20%; unsurprisingly, a lot of this demand leaked out into sharply rising import volumes, up 23.5% year-on-year. By contrast, export volumes fell slightly on the quarter and were up only 2.1% on a year earlier, thus ensuring that net trade was a very substantial drag on overall growth.

…but abrupt slowdown in Q4

- However, the intensification of the global financial crisis since mid-September has been on such a scale that even such a fast-growing economy has been stopped in its tracks. The crisis has lowered Brazil's likely export revenues over the next year or so by its negative impact on both commodity prices and volumes. In turn, this will undermine investment, much of which was planned on the assumption of a reasonable global economy and very strong demand from China – and even the latter has now been called into question. In addition, the crisis has prompted an enormous exodus of capital from the emerging markets, which are now deemed too risky. And, since Brazil attracted large amounts of foreign capital in 2007 and 2008H1, this has caused a plunge in the BRL, down over 34% since the end of August, thereby not only complicating macro policy decisions but also resulting in very heavy losses for those corporates that had been hedging their currency exposure on the expectation that the four-year trend of a strengthening BRL would persist.

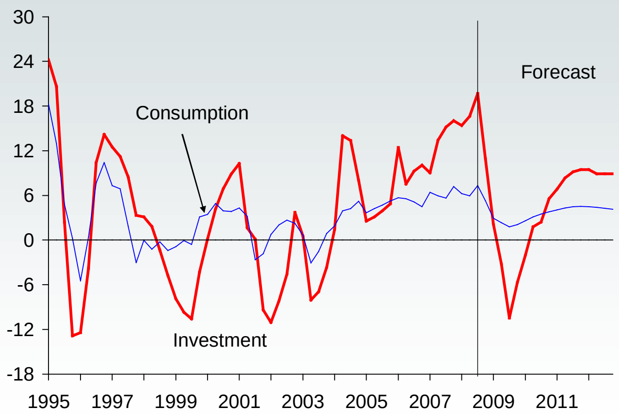
- But as well as these negative factors, the crisis has generated other headwinds. Despite little or no exposure to the securities and types of lending that have so crippled banks in western economies, Brazilian banking activity has become much more sluggish in Q4 – with banks concerned about the financial soundness of both their counterparties and their clients. And prior to September, the increasing availability of credit (from a comparatively low level) had been a significant boost to growth. On top of this,

Brazil: GDP and industrial production



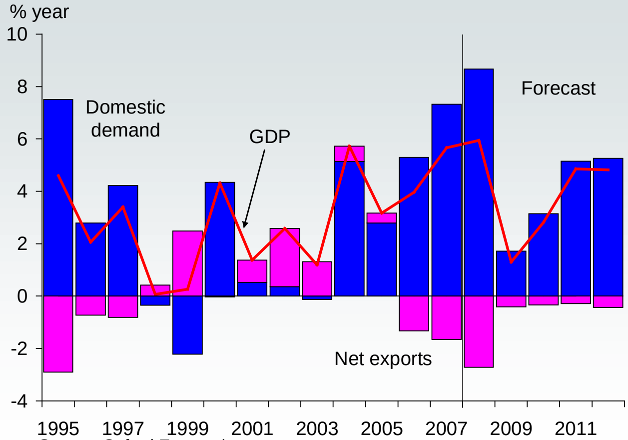
Source: Oxford Economics

Brazil: Consumption and investment



Source: Oxford Economics

Brazil: Contributions to GDP

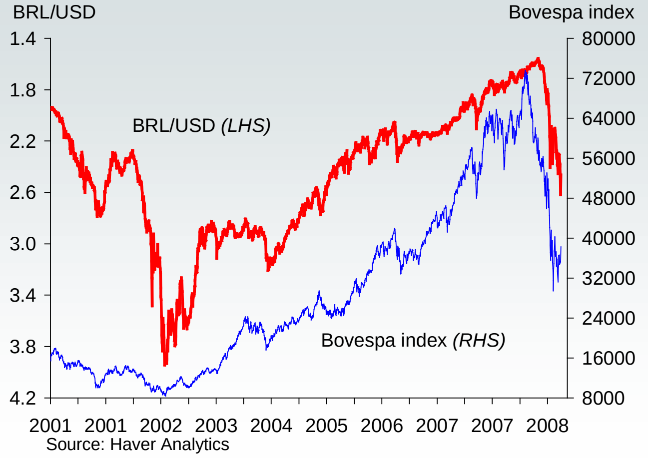


Source: Oxford Economics

falling levels of trust between banks in different countries have made it more difficult to finance the normal functioning of external trade flows. There is the possibility, however, that if the global crisis eased, some of these headwinds could fade, allowing a resumption of domestic-focused growth

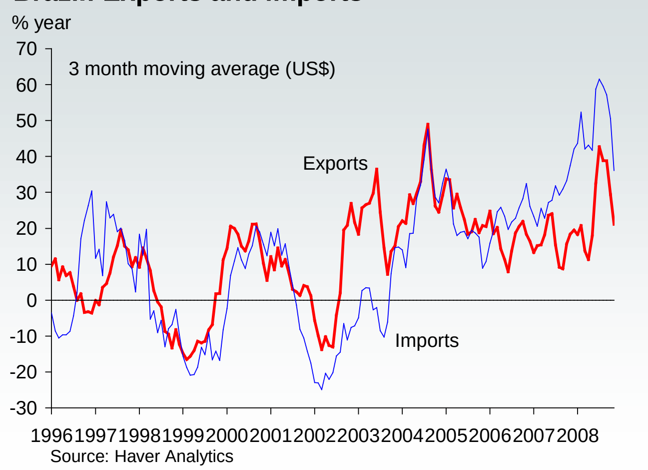
- But for now the dramatic turnaround in economic fortunes is fairly clear from the last couple of months' trade data, with year-on-year import growth slowing from nearly 60% in Q2 and Q3 to 40% in October and then just 9.2% in November. Given that the strength of imports in mid-year reflected soaring capital and consumer goods imports as well as fuel, this change suggests that domestic demand growth has slowed very abruptly. Other evidence is the fact that the annual growth in domestic car sales slowed from 30% in H1 to around 20% in Q3, before falling by over 25% from a year earlier in November.
- In the light of these developments and a much more pessimistic view of the developed economies, we have further reduced our GDP growth forecast for 2009 to 1.3% from 2.4% last month. But, despite assuming a significant drop in seasonally adjusted GDP in Q4, this may follow the strongest annual growth performance, of 5.9% in 2008, for over two decades. With regard to the slowdown, we expect this to be most marked in investment, falling from over 15% annual growth in 2008 to -4.4% in 2009. Consumer spending growth should hold up better, remaining in positive territory, helped by falling inflation. And while export volumes are forecast to shrink by nearly 3%, the net drag from external trade will be much less as import growth will come to a halt. Given the scale of the slowdown and the healthy fiscal position currently the government is likely to step up its spending to support the economy.
- There is more uncertainty about monetary policy though. With inflation still at 6.4% in November, compared to the central bank's target of 4.5%, the sharp drop in the BRL and the fact that the rate will not benefit much from collapsing global oil prices (as transport fuel prices are regulated and did not go up that much when oil prices soared), the local market consensus is that the central bank will only start cutting interest rates in 2009H2. Rates were again left on hold on 10 December but, given the slowdown in Brazil and elsewhere and the weakness of nearly all commodity prices, there is a growing chance that interest rates will start to fall as early as 2009Q1.

Brazil: Exchange rate & equity market



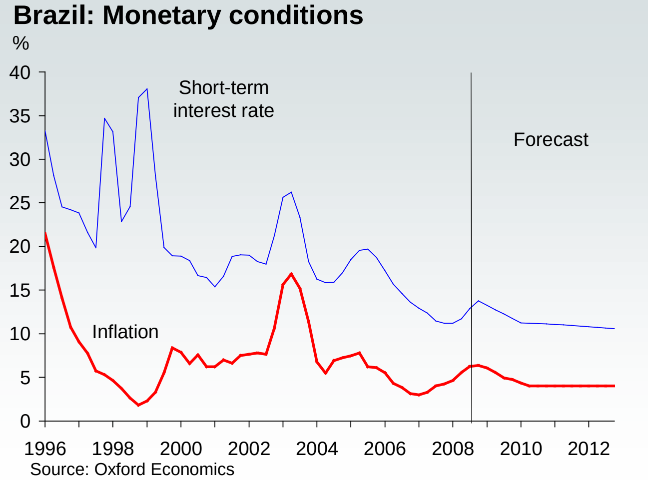
Source: Haver Analytics

Brazil: Exports and imports



Source: Haver Analytics

Brazil: Monetary conditions



Source: Oxford Economics

Key Indicators: Brazil

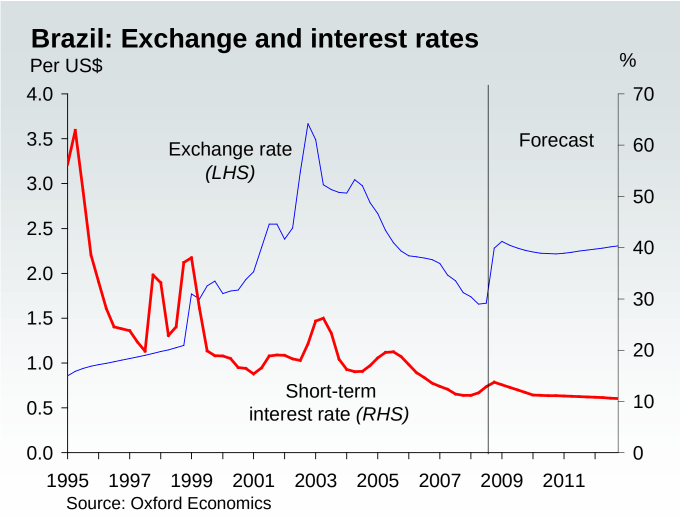
Percentage changes on a year earlier unless otherwise stated

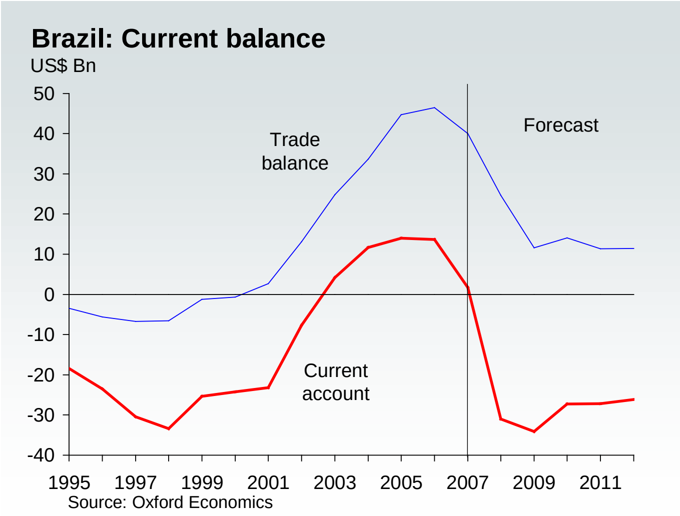
	Industrial prod. (s.a.) % m-o-m	Retail sales	CPI (IPCA)	Wholesale prices % m-o-m	Unemploy-ment %	Public Debt Real bn	Export value in $	Trade balance ($ mn)
Nov	-2.1	10.4	4.2	1.5	8.2	1,128	18.1	2020
Dec	-0.7	9.5	4.5	1.9	7.4	1,150	16.0	3636
2008								
Jan	1.7	11.8	4.6	1.1	8.0	1,141	20.9	923
Feb	-0.4	12.8	4.6	0.5	8.7	1,157	26.4	849
Mar	0.5	11.0	4.7	0.8	8.6	1,141	-2.1	990
Apr	0.2	8.7	5.0	1.3	8.5	1,153	13.0	1738
May	-0.9	11.0	5.6	2.2	7.9	1,168	41.4	4072
Jun	3.0	8.2	6.1	2.3	7.8	1,180	41.7	2723
Jul	1.4	11.3	6.4	1.3	8.1	1,192	44.8	3317
Aug	-1.5	9.9	6.2	-0.8	7.6	1,183	30.8	2274
Sep	1.5	9.4	6.3	0.4	7.6	1,127	41.3	2727
Oct	-1.7	-	6.4	1.4	7.5	1,089	17.4	1207
Nov	-	-	6.4	-	-	-	5.0	1613

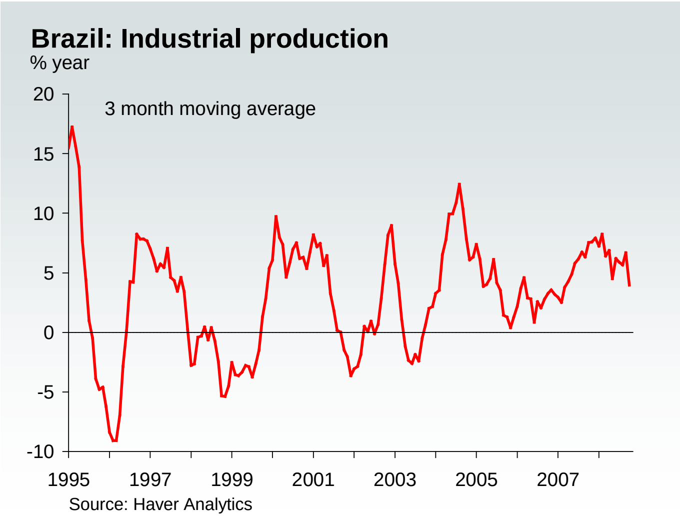
Financial Indicators: Brazil

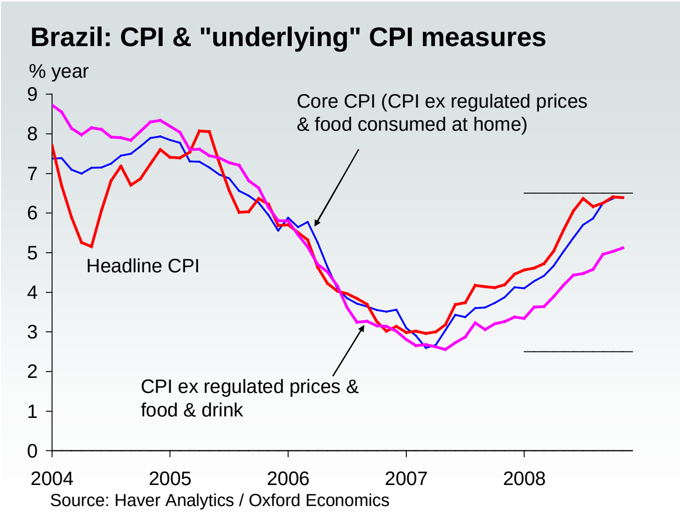
Percentage changes on a year earlier unless otherwise stated

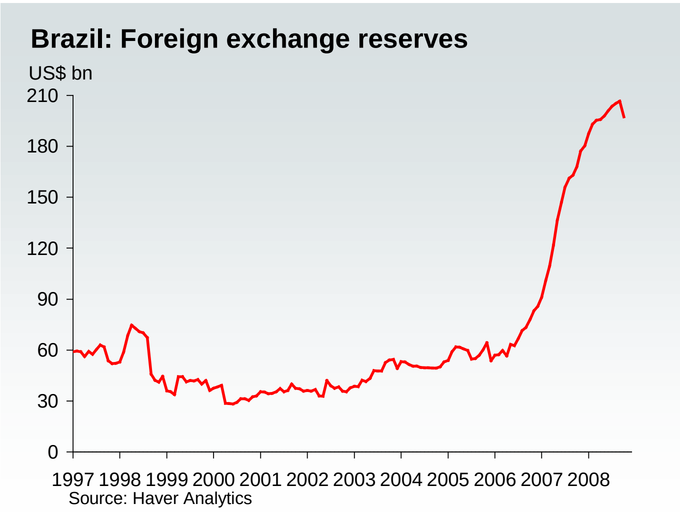
	Selic rate (actual) %	Short-rate 60 days %	Money supply M3	Exchange rate Real/Euro	Exchange rate Real/$ avg.	Primary balance Real mn	Asset price (Bovespa)	Reserves (end-month) $ mn
Nov	11.18	10.4	17.6	2.593	1.766	6,817	62,435	177,060
Dec	11.18	9.8	17.4	2.601	1.785	-11,780	63,466	180,334
2008								
Jan	11.18	9.9	16.2	2.606	1.771	18,662	59,546	187,507
Feb	11.18	10.4	16.2	2.550	1.729	8,966	62,555	192,902
Mar	11.18	10.3	16.7	2.654	1.709	15,403	61,542	195,232
Apr	11.37	10.3	17.1	2.656	1.686	18,712	64,231	195,767
May	11.63	10.8	17.5	2.580	1.658	13,207	71,210	197,906
Jun	12.09	11.9	16.8	2.516	1.618	11,166	67,235	200,827
Jul	12.36	12.2	17.8	2.507	1.590	12,109	59,762	203,562
Aug	12.92	12.8	19.3	2.415	1.613	10,184	55,455	205,116
Sep	13.39	13.0	18.0	2.591	1.803	10,005	50,595	206,494
Oct	13.66	13.4	17.1	2.899	2.176	14,472	38,143	197,229
Nov	13.64	-	-	2.891	2.270	-	35,908	-

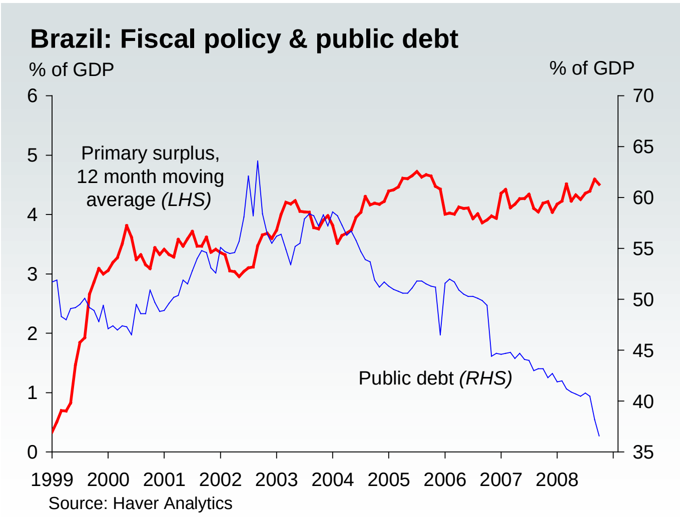

Brazil: Exchange and interest rates
Per US$
%
Exchange rate
(LHS)
Forecast
Short-term
interest rate (RHS)
Source: Oxford Economics


Brazil: Current balance
US$ Bn
Trade
balance
Forecast
Current
account
Source: Oxford Economics


Brazil: Industrial production
% year
3 month moving average
Source: Haver Analytics


Brazil: CPI & "underlying" CPI measures
% year
Core CPI (CPI ex regulated prices
& food consumed at home)
Headline CPI
CPI ex regulated prices &
food & drink
Source: Haver Analytics / Oxford Economics


Brazil: Foreign exchange reserves
US$ bn
Source: Haver Analytics


Brazil: Fiscal policy & public debt
% of GDP
% of GDP
Primary surplus,
12 month moving
average (LHS)
Public debt (RHS)
Source: Haver Analytics

BRAZIL — **TABLE 1 SUMMARY ITEMS**
Annual Percentage Changes, Unless Otherwise Specified

	CONSUMERS EXPENDITURE (C)	TOTAL FINAL EXPENDITURE (TFE)	TOTAL FIXED INVESTMENT (IF)	REAL GDP (GDP)	INDUSTRIAL PRODUCTION (IP)	UNEMPLOY-MENT RATE (%) (UP)	AVERAGE EARNINGS (ER)	WHOLE ECONOMY PRODUCT-IVITY (GDP/ET)	COMPETIT-IVENESS (2000=100) (WCR)	PRODUCER PRICES (PPI)	CONSUMER PRICES (CPI)
YEARS BEGINNING Q1											
2006	5.18	5.41	9.86	3.96	2.85	9.98	5.57	1.87	123.34	0.81	4.18
2007	6.30	7.36	13.35	5.66	5.92	9.29	5.50	2.62	131.80	5.57	3.64
2008	6.19	7.64	15.62	5.94	4.96	7.82	5.50	2.15	133.93	13.92	5.71
2009	2.26	1.13	-4.36	1.30	-1.50	8.75	5.50	0.33	112.52	6.68	5.33
2010	3.26	3.34	1.82	2.81	3.58	9.36	5.50	1.42	115.03	3.46	4.09
2011	4.36	5.60	8.42	4.85	5.46	8.40	5.50	1.66	117.36	4.42	4.00
2012	4.31	5.62	9.04	4.82	5.40	7.79	5.50	2.02	118.12	4.72	4.00
2006											
I	5.67	5.38	12.43	4.39	3.49	9.90	5.63	2.89	117.06	-1.23	5.51
II	5.55	3.28	7.53	2.19	1.59	10.33	5.58	0.94	120.46	-1.62	4.30
III	5.15	6.40	9.25	4.68	3.03	10.43	5.55	1.96	127.70	2.23	3.84
IV	4.48	6.66	10.08	4.65	3.32	9.23	5.53	1.79	128.12	3.97	3.14
2007											
I	6.41	6.73	9.04	5.30	3.81	9.77	5.50	2.46	117.43	4.31	2.99
II	5.92	7.18	13.41	5.85	5.60	9.97	5.50	2.71	127.47	4.59	3.29
III	5.65	7.22	15.17	5.38	6.31	9.33	5.50	2.46	138.56	5.44	4.02
IV	7.19	8.32	16.03	6.14	7.90	8.10	5.50	2.86	143.74	7.87	4.25
2008											
I	6.26	7.52	15.36	6.12	6.72	8.43	5.50	2.48	130.88	10.73	4.64
II	5.93	8.49	16.63	6.20	5.22	8.07	5.50	1.64	139.31	15.33	5.56
III	7.31	8.98	19.69	6.81	6.40	7.77	5.50	3.00	146.92	16.27	6.26
IV	5.29	5.64	10.95	4.64	1.65	7.01	5.50	1.45	118.58	13.33	6.35
2009											
I	2.95	3.07	2.17	2.81	-0.61	8.56	5.50	0.96	105.59	11.09	6.08
II	2.32	0.93	-3.20	1.43	-1.36	8.82	5.50	0.28	111.16	7.46	5.54
III	1.76	-0.67	-10.48	-0.06	-3.39	8.99	5.50	-0.71	116.95	4.95	4.95
IV	2.10	1.15	-5.71	0.93	-0.61	8.61	5.50	0.66	116.38	3.59	4.77
2010											
I	2.60	2.00	-2.04	1.73	2.18	9.88	5.50	1.14	107.38	3.27	4.34
II	3.09	2.84	1.78	2.39	3.38	9.75	5.50	1.37	113.01	3.25	4.01
III	3.47	3.91	2.42	3.24	4.07	9.29	5.50	1.49	119.53	3.43	4.00
IV	3.80	4.66	5.57	3.99	4.70	8.52	5.50	1.79	120.18	3.88	4.00
2011											
I	4.06	5.02	6.82	4.39	5.15	9.33	5.50	1.67	110.07	4.20	4.00
II	4.31	5.61	8.32	4.91	5.38	8.84	5.50	1.76	115.29	4.41	4.00
III	4.50	5.83	9.15	5.03	5.56	8.10	5.50	1.57	122.12	4.54	4.00
IV	4.52	5.93	9.48	5.11	5.75	7.34	5.50	1.67	121.95	4.54	4.00
2012											
I	4.47	5.87	9.47	5.19	5.59	8.41	5.50	2.03	111.21	4.73	4.00
II	4.38	5.70	8.89	4.95	5.45	8.13	5.50	2.04	116.26	4.72	4.00
III	4.27	5.54	8.89	4.67	5.42	7.58	5.50	1.98	122.77	4.72	4.00
IV	4.15	5.38	8.89	4.45	5.16	7.02	5.50	2.00	122.26	4.72	4.00

BRAZIL — **TABLE 2 SUMMARY ITEMS**

	TRADE BALANCE ($ BN) (BVI$/ 1000)	CURRENT ACCOUNT ($ BN) (BCU$/ 1000)	CURRENT ACCOUNT (% OF GDP) (BCUR%)	GOVERNMENT FINANCIAL BALANCE (REAL TRN) (GB/1000)	GOVERNMENT FINANCIAL BALANCE (% OF GDP) (GB*100 /GDP!)	SHORT-TERM INTEREST RATE (RSH)	SPREAD OVER US SHORT-TERM RATE (RSH - RSH US)	REAL SHORT-TERM INTEREST RATE (Note 1)	EQUILIBRIUM EXCHANGE RATE PER US DOLLAR (RXEQUIL)	EXCHANGE RATE PER US DOLLAR (RXD)
YEARS BEGINNING Q1										
2006	46.5	13.6	1.2	-69.9	-2.9	15.3	10.1	11.1	2.30	2.18
2007	40.0	1.7	0.2	-57.9	-2.2	12.0	6.7	8.3	2.24	1.95
2008	24.7	-31.0	-2.0	-24.5	-0.8	12.4	9.5	6.7	2.17	1.84
2009	11.6	-34.1	-2.6	-75.2	-2.4	12.5	11.6	7.2	2.35	2.30
2010	14.0	-27.3	-1.8	-68.1	-2.1	11.2	9.7	7.1	2.43	2.22
2011	11.3	-27.2	-1.7	-62.7	-1.7	11.0	7.2	7.0	2.48	2.24
2012	11.5	-26.1	-1.5	-63.7	-1.6	10.7	4.9	6.7	2.54	2.29
2006										
I	9.3	1.6	0.7	-23.2	-4.2	17.2	12.5	11.7	2.28	2.20
II	10.2	1.1	0.4	-1.3	-0.2	15.7	10.5	11.4	2.31	2.19
III	14.7	7.5	2.7	-16.6	-2.8	14.6	9.2	10.8	2.30	2.17
IV	12.2	3.4	1.1	-28.8	-4.5	13.6	8.2	10.5	2.28	2.15
2007										
I	8.7	0.2	0.1	-11.6	-1.9	12.9	7.6	9.9	2.26	2.11
II	11.9	2.2	0.7	4.4	0.7	12.3	7.0	9.1	2.24	1.98
III	10.4	1.2	0.4	-21.0	-3.2	11.5	6.0	7.4	2.24	1.92
IV	9.1	-1.9	-0.5	-29.8	-4.3	11.2	6.2	6.9	2.22	1.79
2008										
I	2.8	-10.3	-2.7	3.0	0.5	11.2	7.9	6.5	2.20	1.74
II	8.5	-6.9	-1.6	-5.0	-0.7	11.7	8.9	6.1	2.17	1.66
III	8.3	-6.1	-1.4	-5.1	-0.7	12.9	10.0	6.6	2.14	1.67
IV	5.0	-7.7	-2.3	-17.4	-2.3	13.8	11.0	7.4	2.18	2.28
2009										
I	-0.6	-10.7	-3.5	-19.0	-2.6	13.3	12.0	7.2	2.24	2.35
II	3.0	-8.7	-2.6	-9.0	-1.2	12.8	11.8	7.2	2.33	2.31
III	1.4	-7.4	-2.1	-21.8	-2.8	12.3	11.6	7.3	2.41	2.28
IV	7.8	-7.4	-2.1	-25.3	-3.1	11.8	11.0	7.0	2.42	2.26
2010										
I	2.5	-8.1	-2.3	-13.4	-1.7	11.3	10.3	6.9	2.42	2.24
II	4.1	-6.5	-1.7	-9.9	-1.2	11.2	10.1	7.2	2.42	2.22
III	0.7	-6.9	-1.8	-21.7	-2.6	11.2	9.5	7.2	2.43	2.22
IV	6.8	-5.9	-1.5	-23.0	-2.6	11.1	9.0	7.1	2.44	2.22
2011										
I	1.4	-7.9	-2.1	-8.6	-1.0	11.1	8.4	7.1	2.46	2.22
II	3.2	-6.5	-1.6	-10.4	-1.1	11.0	7.6	7.0	2.47	2.24
III	-0.2	-6.9	-1.7	-20.7	-2.3	10.9	6.8	6.9	2.49	2.25
IV	6.9	-6.0	-1.4	-23.0	-2.4	10.9	6.0	6.9	2.51	2.26
2012										
I	1.3	-7.5	-1.9	-8.6	-0.9	10.8	5.4	6.8	2.52	2.27
II	3.3	-6.2	-1.4	-10.5	-1.1	10.7	4.9	6.7	2.53	2.28
III	-0.4	-6.6	-1.5	-21.7	-2.2	10.7	4.8	6.7	2.55	2.30
IV	7.2	-5.7	-1.3	-23.0	-2.2	10.6	4.7	6.6	2.56	2.31

Note 1 : REAL INTEREST RATE = Nominal interest rate (RSH) - % change in CPI

Background

- With a GDP of US$1.3 trillion in 2007, and nearly 190m people, Brazil is the tenth largest economy in the world and by far the largest in Latin America. In the last 15 years, the country has pursued a strategy of export-led growth and regional integration. The economy is relatively well diversified with a strong manufacturing and agricultural base, and mineral riches. However, in regional terms, economic activity is still concentrated in the south-east, particularly in the state of São Paulo, and income inequality remains one of the worst in the world.
- During the period 1950-80, the economy grew by an average yearly rate of 7.4%. This was achieved through an inward-looking strategy of industrialisation (ISI) led by the state. However, eventually this model of development generated high inflation, sustained external and fiscal deficits and growing public debt. Already in the 1970s the ISI began to show signs of exhaustion, but trade liberalisation did not begin in earnest until 1990. The recent economic history of the country is dominated by three crises linked to the balance of payments.
- The 1982 debt crisis, and the shrinkage of capital inflows that followed, was a major shock for the Brazilian economy. A period of macroeconomic instability and hyperinflation ensued, prompting a series of unsuccessful stabilisation plans from 1986 to 1994 – the name of the currency was changed four times during the period. Only in 1994 did the Real Plan restore macroeconomic stability to the economy. This plan, devised by Fernando Henrique Cardoso (later to become president during the period 1994-2002), used the nominal exchange rate as an anchor for domestic prices, as in previous stabilisation attempts, but this time it was underpinned by the opening up of the economy to global influences and a reform of public finances.
- The 1997-98 Asian and Russian crises found Brazil with rising public debt and large current account deficits, exposing its economy to swings in investor sentiment and speculative attacks against the BRL (a crawling peg was then in place). At the start of 1999 there were doubts over fiscal sustainability following the rejection by Congress of an IMF adjustment package. This, together with a debt moratorium declared by the state of Minas Gerais, prompted speculative pressures that forced the central bank to float the BRL, causing an immediate depreciation of 30% against the US$. However, the maxi-devaluation did not lead to high inflation and the introduction of inflation targeting in June 1999 helped to support the transition to the new exchange rate regime.
- Again in 2002, the increasing likelihood of a new government led by the left-wing candidate Luiz Ignacio “Lula” da Silva threw the markets into turmoil (exacerbated by weak global financial sentiment). The electoral risk, a fragile public debt structure and perverse debt dynamics, and the increased risk aversion of international capital markets were major sources of instability for the economy at this time. Some 80% of domestic debt was linked to either the Selic interest rate (the key monetary policy instrument) or to the US dollar, meaning that any major decline in the currency would result in a higher burden of interest payments and a rise in the domestic value of the public debt. Moreover the average maturity of the domestic debt was only three years, so vast sums needed to be rolled over every year. As a result, Brazil was walking a tightrope.
- Contrary to excessively pessimistic market expectations, one of the main achievements of President Da Silva’s first-term administration was a strengthening of fiscal discipline, needed to honour debt payments and improve investor confidence. The debt structure is now less exposed to currency fluctuations and its maturity has been lengthened, improving the debt profile significantly. During the period 2003-05, Brazil ran primary fiscal surpluses (excluding interest payments) of over 4.25% of GDP per year. The figure for 2005 was 4.8% of GDP. However, the government’s control over the overall nominal deficit is limited by high interest payments, with a large share (close to 45% by mid-2006) of domestic public debt still linked to the Selic rate.
- Having failed to win outright in the first round of elections on 1 October 2006, Lula secured a second four-year term commencing in January 2007 with a landslide victory in a run-off vote against Geraldo Alckmin of the centrist Brazilian Social Democracy Party (PSDB) on 29 October, winning 60.8% of the vote to Alckmin’s 39.2%. Lula has promised to boost economic growth and to narrow the gap between rich and poor, but with his left-wing Workers’ Party (PT) having lost seats in the highly fragmented 513-member Congress – down into second place behind the Brazilian Democratic Movement Party (PMDB) with 83 seats against 91 in 2002 - he will have to rely on building stronger political alliances to proceed with planned tax, social security and political reforms.

- Brazil has made significant progress in terms of its integration into the world economy. The openness indicator (the ratio of exports and imports volumes to GDP) has nearly doubled in the last fifteen years (from 18.5% circa 1990 to about 36% currently). This was partly the result of a deliberate strategy to diversify and open up new markets for Brazilian products in the US and the EU over the last ten years or so, while the recent expansion of exports to China was a response to the rapid growth in Chinese demand for commodities.
- Greater openness to international trade has been accompanied by a more diversified export base (both in terms of products and geography), resulting in a considerable reduction in the country's exposure to external risks. Since 1990, the composition of products has become more varied, including a wide range of products from aircraft to commodities. Whilst in 2005 about 56.8% of Brazilian exports were durable manufactures, trade in commodities is still important, with agriculture products accounting for 29.3% of total exports. Currently the main markets for Brazilian exports are the EU (with a share of 22.4% in 2005), the US (19.2%), Argentina (8.4%), China (5.7%), Japan (3.0%), and other Asian economies (7.0%).
- These new fundamentals have underpinned a turnaround in the country's external accounts. Between 2000 and 2004, the current account moved from a deficit of 4% of GDP (US$24bn) to a surplus just below 2% of GDP (US$11bn). In 2005, the surplus was 1.8% of GDP, although this improvement occurred while domestic demand growth was weak. This surge was helped by the big downward shift in the exchange rate in 2002 (although this was subsequently reversed in real terms in 2003-05) and, more importantly, by a much greater emphasis on finding new markets for Brazil's products. In recent years, Brazil has greatly benefited from its ability to supply a booming China (particularly in 2002-05) with key commodities such as soya and iron ore. Moreover, Brazilian industries have gained even more as China's rising demand has driven up global prices, thereby raising total export revenues from selling these products to all other countries.
- But since the beginning of 2003 the nominal exchange rate has been appreciating, supported by the strong export performance and capital inflows. The strengthening of the BRL has undermined the competitiveness of local exporters, although not all of the advantages of the 1999 devaluation have been lost a considerable portion has been - given the BRL's continued appreciation through 2007. The real exchange rate (calculated as the nominal exchange rate adjusted for the inflation differential between Brazil and the US, a key trade partner) in December 2007 was similar to that prevailing in December 1998, prior to the decision to float the exchange rate, while about 18 months earlier it was still about 20% below that value. Within the export sector, manufacturers have felt the burden of a stronger currency most acutely, and exports of the clothing and footwear industry have lost market share against other emerging economies, including China. Exporters of commodities (in particular base metals) are in a better position to withstand the undesirable consequences of currency appreciation, especially as they sell into markets influenced by a strong expansion of demand and high prices. But slower export growth and strong imports have seen the trade surplus falling steeply and the current account has moved back into deficit in 2008 for the first time since 2002.
- The efforts of the last ten years to secure macroeconomic stability and introduce structural reforms have created the right conditions for a period of sustained growth. The country is now more integrated into the world economy and, at the same time, it has become more resilient to external shocks. Meanwhile, there has been important progress in the conduct of economic policy, with the passage of legislation to ensure fiscal responsibility, introduce inflation targeting, simplify the tax system and reduce the fiscal burden of the pension system.
- More recently, other reforms have been enacted to deal with central bank independence and the credit market. The Law of Monetary Responsibility aims to consolidate price stability by extending the operational autonomy of the central bank in the conduct of monetary policy and the control of inflation. Meanwhile, the credit market reform aims to stimulate the expansion of credit in the private sector, reduce intermediation costs and improve investor confidence. This legislation seeks to reduce lending risks for banks – so as to encourage a willingness to lower commercial interest rates - and borrowing costs for both individuals and companies. However, further progress with structural reforms (eg counter-cyclical fiscal policy and the regulatory framework) and a greater investment effort are needed - particularly for infrastructure - if the country is to fulfil its growth potential.

Key Facts

Politics

Head of state: President Luiz Inacio LULA DA SILVA
Head of government: President Luiz Inacio LULA DA SILVA
Political system: Democracy
Date of next presidential election: October 2010
Date of next legislative election: October 2010
Currency: real (BRL), floating exchange rate

Source : CIA Factbook
Location : Eastern South America, bordering the Atlantic Ocean (CIA Factbook)

Long-term economic & social development

	1975	1985	1995	2006*
GDP per capita (US$)	1144	1638	4758	5755
Inflation (%)	-	226.0	66.0	4.2
Population (mn)	108.1	136.1	161.6	189.3
Urban population (% of total)	62.0	71.0	78.0	85.0
Life expectancy (years)	-	65.0	69.0	72.0

Source : Oxford Economics & World Bank

Structure of GDP by output

	2007
Agriculture	5.0%
Industry	31.0%
Services	64.0%

Source : World Bank

* 2006 or latest available year

Corruption perceptions index 2008

	Score
Developed economies (average)	7.73
Emerging economies (average)	3.44
Brazil	3.50
Western Hemisphere	3.87

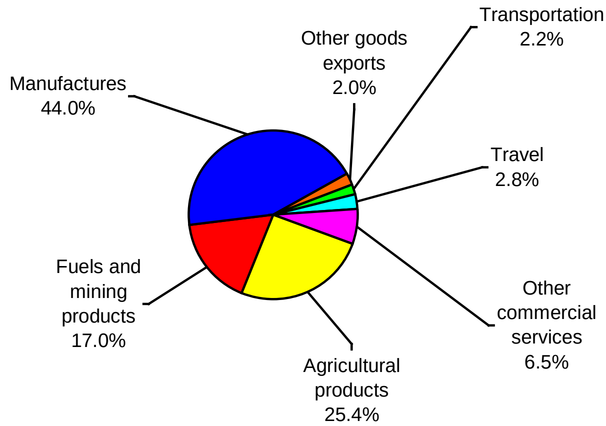
Source: Transparency International
Scoring system 10 = highly clean, 0 = highly corrupt

Structural economic indicators

	1990	1995	2000	2006*
Current account (US$ billion)	-3.8	-18.4	-24.2	13.6
Trade balance (US$ billion)	10.8	-3.5	-0.7	46.5
FDI (US$ billion)	0.3	3.3	30.5	-9.4
Debt service (US$ billion)	8.2	21.6	64.8	62.1
Debt service (% of exports)	22.1	36.6	93.6	45.8
External debt (% of GDP)	25.9	20.9	37.5	15.1
Oil production (000 bpd)	631	695	1269	1723
Oil consumption (000 bpd)	1466	1788	2166	2252

Source : Oxford Economics / World Bank / EIA

Composition of goods & services exports, 2006



Source : WTO

Destination of goods' exports (2006)

European Union (27)	22.6%
United States	18.0%
Argentina	8.5%
China	6.1%
Mexico	3.2%

Source : WTO