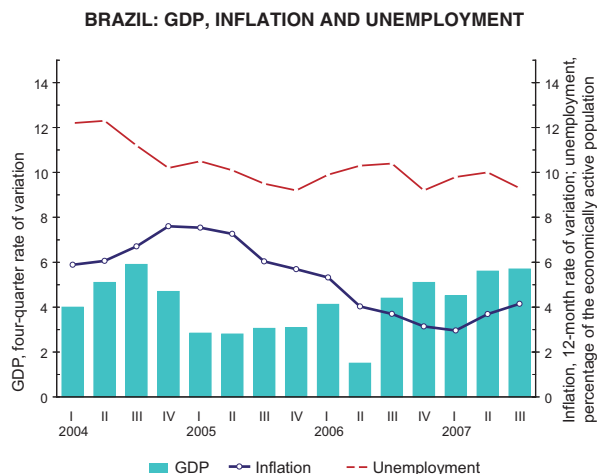


Brazil

In 2007, according to preliminary estimates, the Brazilian economy grew by 5.3% (3.7% and 3.2% in 2006 and 2005, respectively) thanks to the good performance of economic variables such as the annual inflation rate, which was below the 4.5% target; goods exports, whose expansion produced a trade surplus of almost US\$ 39 billion; and international reserves, which swelled by almost US\$ 80 billion. From the fiscal viewpoint, the primary surplus was maintained in accordance with the planned target (3.8% of GDP), influenced positively by a record tax take and improvements in the area of employment, such as a lower unemployment rate (averaging 9.4% in 2007 as against 10% in 2006) and increases in higher real incomes (averaging 3.4%). Market projections suggest that the growth rate will be slightly lower in 2008.

This strong performance was boosted by events in the world economy, with high demand for commodities and abundant liquidity, and by lower domestic interest rates and the resulting growth of credit and the domestic capital market. There were, however, constraints on economic activity in the infrastructure and energy supply sectors. Furthermore, the growing tax burden and the inflexibility of public expenditure have revived the debate on the need for tax reform and the role of public investment.

It is noteworthy that in the past two years, the contribution of investment to growth has been almost 10% per year, although its level has not yet exceeded 17% of GDP. Encouraged by the Growth Acceleration Programme (PAC), the public sector once again boosted its investments, especially in the transport and energy sectors. The private sector had greater access to new resources for investment thanks to the availability of funds on the capital market, market entry by corporations and the issue



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

of shares on the stock market, and the placement of long-term bonds on the local market, all of which came to an unprecedented total of 121 billion reais up to October.

This trend in investment, bringing with it improved production capacity, complements the expansion of credit and domestic consumption which have been the basis of economic growth since 2004. In 2007, the volume of exports, which had sustained growth in the early part of the decade, showed a lower growth rate than that of imports, which soared by almost 20%. As a result, the external sector's contribution to GDP growth was negative for the second consecutive year.

Maintaining the current growth rate in 2008 will depend on trends in world financial markets and on any unexpected constraints in terms of energy costs and supply. In comparison with the past, the Brazilian economy has reduced its vulnerability to unfavourable changes in the world economy. A policy has been implemented to manage public debt, bringing about a significant cut in the proportion of Treasury securities indexed to the exchange rate. The sizeable trade surplus and, to a lesser extent, the balance of payments current-account surpluses of recent years and the sizeable inflows of foreign capital (both FDI and financial flows) have led to a record level of international reserves, whose total amount (US\$ 176 billion) is close to that of the total external debt (US\$ 194.6 billion). Lastly, the growth of the country's economy has been focused on the domestic market, especially the expansion of industrial production and construction, as well as formal job creation.

Uncertainties over developments in the world economy and a greater increase of demand in relation to domestic supply have encouraged the central bank to take a moderate approach to monetary policy. Following a gradual decline in interest rates since September 2005 (when the Special System of Clearance and Custody (SELIC) rate stood at 19.5%), the central bank decided in October 2007 to stabilize the rate at 11.25%. That measure cut the real yearly interest rate to about 8%, which is the lowest since 2002, although high in relation to international rates.

Pushed up by volatile prices for energy and some foodstuffs, the inflation rate exceeded forecasts for the second semester. In August, the wholesale price index posted a monthly variation of 1.96%. The volatility reflected trends in the exchange rate; in early August the latter exceeded 2.00 reais to the dollar, then returned to the nominal appreciation trend observed since 2003. In November, the nominal exchange rate fell to almost 1.73 reais to the dollar, the lowest since March 2000 and almost 19% below its level in

BRAZIL: MAIN ECONOMIC INDICATORS

	2005	2006	2007 ^a
Annual growth rates			
Gross domestic product	2.9	3.7	5.3
Per capita gross domestic product	1.5	2.3	3.9
Consumer prices	5.7	3.1	4.2 ^b
Average real wage ^c	-0.3	3.5	0.5 ^d
Money (M1)	14.0	15.3	21.6 ^e
Real effective exchange rate ^f	-18.3	-10.9	-6.5 ^g
Terms of trade	1.4	4.7	3.3
Annual average percentages			
Urban unemployment rate	9.8	10.0	9.4 ^h
Central government operating balance / GDP ⁱ	-3.2	-3.1	-2.8
Nominal deposit rate	9.2	8.3	7.9 ^j
Nominal lending rate	43.7	39.8	34.9 ^j
Millions of dollars			
Exports of goods and services	134 356	157 270	184 979
Imports of goods and services	97 962	120 466	156 394
Current account	13 985	13 621	4 624
Capital and financial account	13 606	16 948	85 376
Overall balance	27 590	30 569	90 000

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a Preliminary estimates.

^b Twelve-month variation to November 2007.

^c Workers covered by social and labour legislation, private sector.

^d Estimate based on data from January to September 2007.

^e Twelve-month variation to October 2007.

^f A negative rate indicates an appreciation of the currency in real terms.

^g Estimate based on data from January to October 2007.

^h Year-on-year average variation, January to October.

ⁱ Includes the central bank.

^j Average from January to October, annualized.

late 2006. Nonetheless, consumer prices remained below the annual target of 4.5% for 2007 and showed cumulative increases of 3.3% for the year and 4.1% for the 12 months to October. Market projections for 2008 suggest that that level of inflation (4.1%) will continue, and that the nominal exchange rate will be more stable, coming close to 1.80 reais to the dollar.

Federal government spending rose by 12.4% between January and October 2007. Notable in the area of fiscal policy is the recovery of public investment, particularly by the federal government, which was up by 28% in terms of the cumulative total to October, compared with 2006. There was also a marked upswing in other spending by the federal government, for the same period. Spending on personnel and benefits by the social security system rose by 11.9% and 10.9%, respectively.

Nonetheless, that higher spending did not endanger the primary surplus target of 3.8% of GDP in 2007, thanks to greater increases in government revenue and

the financial results of subnational governments and state-owned corporations. Total federal government revenue to October was up 15.4%, over 10% in real terms. Swelling economic activity (production and imports), unprecedented profits in banking and other businesses, and rising salaries and financial-sector gains have boosted revenue from taxes of all kinds. There were improvements in the tax take from corporate income tax (41% in real terms), personal taxation (14%) and the car tax (18%). Revenue from social security contributions reflected the expansion of the payroll (11.5% in real terms). The strong growth of receipts increased the tax burden to a new maximum of 35% of GDP, calculated by the new methodology for national accounts; as a result, in the 12 months to October the primary fiscal surplus remained at 4.2% of GDP and the nominal overall fiscal deficit stood at 2.2% of GDP.

The accelerating economic growth was accompanied by greater sectoral diversification. Unlike previous years, estimates call for relative homogeneity in sectoral growth rates. Agriculture and industry were the leaders in growth (4.5% and 5.0%, respectively), and 4.4% growth is estimated for the services sector. Mining, which had performed strongly in the previous two years, is expected to post a growth rate close to 5%. Civil construction achieved a growth rate of over 5.5%, higher than the 2006 figure (4.6%); the figure for manufacturing industry is expected to be 5.3%, significantly higher than the 1.6% posted in 2006.

The performance of the various branches of manufacturing has been more uneven. The capital-goods sector was the most dynamic, up 15% for the 12 months to September. This is a positive result, since Brazil's productive capacity needs to be broadened and most supply is devoted to investments within the country. Brazil needs to strengthen this sector of its productive structure, given its importance for innovation and the dissemination of technology. Meanwhile, activity in the consumer durables sector expanded by 6.8%, boosted by increases in the payroll and consumer credit. Much slower growth is expected in intermediate goods (3.7%) and non-durable consumer goods (3%).

The investment mood is optimistic in the petroleum and mining sectors, encouraged by very favourable world prices and the availability of natural resources, as well as the recent discovery of a large oil and gas

deposit. There are signs that this favourable trend may be spreading throughout the private sector. According to the business survey entitled *Sondagem especial da Confederação Nacional da Indústria*,¹ 86% of the 1,655 industrial companies surveyed stated that they intended to invest in 2007, and this was borne out fully or partially in 85% of cases. The outlook for 2008 is also encouraging. The same survey reports that 42% of industrial firms stated their intent to increase their investment in machinery and equipment, a percentage well above those of previous years (about 30% in 2005 and 2006) and close to the figure for 2004, when the trend was very positive.

The balance of payments was improved by considerable inflows of foreign exchange. In the first 10 months of 2007, the overall balance of payments surplus more than tripled relative to the same period in 2006 (from US\$ 23.1 billion to US\$ 78 billion) and the current account surplus rose to US\$ 6 billion (0.5% of GDP), on the basis of a trade surplus of US\$ 34.4 billion and a US\$ 32.2 billion deficit in the services and income balance (US\$ 30 billion in 2006). This result is much less striking than that of the first 10 months in 2006, when the surplus reached 1.3% of GDP. Noteworthy among the country's exports was the upswing in external sales of commodities (26.1% in value terms, 12.8% in volume) and semi-manufactures (14.2% in value, 2.3% in volume), while sales of manufactures also picked up (12.7% in value, 7.5% in volume). Imports soared to the unprecedented level of US\$ 98 billion, boosted by increased imports of consumer durables (50.6% in value, 54.4% in volume) and non-durables (32.8% in value, 17.8% in volume). Also noteworthy were increases in import volumes of capital goods (38.5%) and of intermediate goods (28.6%). Improvements in the terms of trade have contributed a great deal to the trade surplus. In October 2007 the real effective exchange rate showed an appreciation of 13.3% compared with December 2006.

In the first 10 months of the year, the income balance showed a deficit of US\$ 22.1 billion, close to the US\$ 21.9 billion deficit during the same period in 2006. The figure for net outflows including interest payments was negative (US\$ 6.4 billion), an improvement over the 2006 figure of US\$ 9.5 billion. Net outflows including profit remittances showed a deficit of US\$ 16 billion (US\$ 12.5 billion in 2006).

The capital and financial account posted a surplus (US\$ 77.5 billion) larger than that of 2006 (US\$ 11.8

¹ National Confederation of Industry (CNI), *Sondagem especial da Confederação Nacional da Indústria*, year 5, N° 4, November 2007.

billion), reflecting net FDI inflows (US\$ 31.1 billion in the first nine months of 2007 compared with US\$ 4.1 billion during the same period in 2006), as well as purchases of shares on the local market by foreign investors (US\$ 19.1 billion, more than double the 2006 figure of US\$ 7.7 billion) and purchases of Brazilian fixed-income bonds (which totalled US\$

22.7 billion as against US\$ 1.1 billion in 2006).

In October 2007 the total external debt stood at US\$ 194 billion, of which US\$ 153 billion was medium-term debt and US\$ 41.6 billion was short-term debt. Measured as a percentage of the total value of exports, debt servicing was reduced from 41.3% in December 2006 to 36% in October 2007.