

Brazil

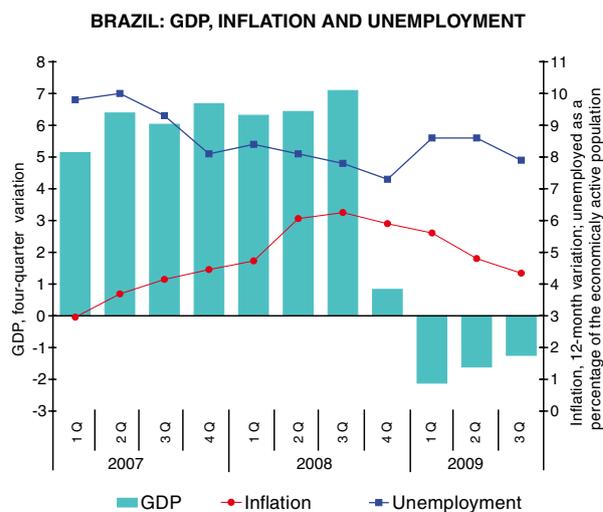
In 2009, the Brazilian economy recovered from the effects of the international financial crisis of 2008. Despite some initial difficulties, the central bank's measures to maintain domestic liquidity and reduce interest rates together with the stimulus provided by the increase of public bank lending, succeeded in increasing credit flows. An expansionary fiscal policy was adopted, with tax cuts for specific sectors and higher spending, which widened the budget deficit. Private consumer spending also bolstered the recovery. Lastly, the fact that Brazil's macroeconomic conditions and prospects remained attractive encouraged capital inflows in the form of both FDI and portfolio investment, which helped to swell international reserves. The policy mix adopted helped to fuel the economic upswing and, after projected GDP growth of 0.3% in 2009, growth expected to approach pre-crisis levels (5.5%) in 2010.

The achievement of higher investment rates and the levels of the exchange and interest rates represent the main macroeconomic challenges for Brazil's economy. In order to boost investment, which had been badly hit by the crisis, the government increased capital spending and investment in infrastructure and energy, and started up an extensive programme of government incentives and subsidies for housing construction. In the final months of the year, there were hints of a revival in private sector investment plans, particularly those funded by public sources such as the National Bank for Economic and Social Development (BNDES).

With regard to monetary policy, a number of measures were adopted in 2009. The central bank reduced deposit requirements and authorized the use of a portion of deposits to buy portfolios from smaller banks and to provide loans to micro- and small enterprises, among other banking instruments. Because of the liquidity problems that surfaced during the early months of the crisis, the central bank authorized the financing of exports through advance exchange contracts, and offered credit lines to refinance the foreign debts of Brazilian firms. Several of these mechanisms were used, but once credit lines were re-established, demand tapered off.

The central bank reduced the basic interest rate in the Special System for Settlement and Custody (SELIC)

to its lowest level in over 20 years (8.75%, equivalent to a real annual rate of less than 5%), given projected inflation of 4.0%. This rate, however, remains far above that of other countries. As the economic recovery proceeds apace, no further cuts in the rate are anticipated for 2009. Maintaining the interest rate differential could prompt the



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

revision of investment plans and sharpen the appreciation of the Brazilian real.

In addition to these measures, the government decided to use public banks to expand credit. As of September 2008, total loans represented 38.7% of GDP, and by September 2009 this figure had risen to 45.7%. In June 2008, nearly 34% of all loans (12% of GDP) were concentrated in public banks, but by September 2009 this percentage had increased to 41% (18.5% of GDP). During this same period, lending by private domestic banks, foreign banks and public banks swelled by 7%, 2.4% and 38.8%, respectively

With regard to the exchange rate, the real had regained its pre-crisis value by October 2009, after a nominal devaluation of nearly 50% in the initial weeks of the crisis. This upward movement was spurred by developments in the real sector, including prospects for future production of new oil fields (pre-salt layer) and expectations of increased commodities exports. An additional factor was expectations with respect to financial variables, such as short-term transactions generated by domestic and international interest rate arbitrage. In order to mitigate the impact of these expectations, the authorities levied a 2% tax on foreign-exchange inflows related to the purchase of stock or fixed-yield securities. Taking into account the cumulative change in the wholesale price index between September 2008 and September 2009, the value of the currency rose 9.5% in real terms. According to ECLAC data, the real effective exchange rate dropped 3.4% in the 12 months ending September 2009.

In terms of fiscal policy, one of the principal measures adopted was to temporarily (between March and September 2009) reduce the industrial products tax on automobile sales before, in the final quarter of the year, gradually raising the rate towards its previous levels. This measure was also extended to household electrical appliances and construction inputs. Lower income tax rates were introduced for middle-income families. The federal government and a number of states implemented some additional tax cuts and extended payment deadlines for various taxes.

The lower level of activity, especially in the industrial sector, along with the tax reductions, led to a nominal drop of 1.9% in federal tax receipts between September 2008 and October 2009, in comparison with the same period over 2007-2008. Meanwhile, federal government spending increased by 16.5% (approximately 10% in real terms), owing principally to rises in wages, income transfer programmes and payments of social welfare benefits. Federal government investment rose 12.7%, reaching 20.5 billion reais —slightly over 5% of total primary spending.

As a result, the federal government's primary surplus declined. In order to reach the target of 2.5% of GDP in 2009 (compared with 3.8% of GDP for 2008), the government will have to deduct from its expenditures the

BRAZIL: MAIN ECONOMIC INDICATORS

| | 2007 | 2008 | 2009 ^a |
|--|---------|---------|-------------------|
| Annual percentage growth rates | | | |
| Gross domestic product | 5.7 | 5.1 | 0.6 |
| Per capita gross domestic product | 4.6 | 4.1 | -0.3 |
| Consumer prices | 4.5 | 5.9 | 4.2 ^b |
| Average real wage ^c | 1.5 | 2.1 | 2.1 ^d |
| Money (M1) | 32.7 | -3.5 | 10.2 ^b |
| Real effective exchange rate ^e | -7.3 | -3.9 | 7.3 ^f |
| Terms of trade | 2.1 | 3.6 | -5.6 |
| Annual average percentages | | | |
| Urban unemployment rate | 9.3 | 7.9 | 8.1 ^g |
| Central government operating balance/GDP | -1.9 | -1.3 | -2.9 |
| Nominal deposit rate | 7.7 | 7.9 | 7.0 ^h |
| Nominal lending rate | 34.5 | 38.8 | 41.1 ^h |
| Millions of dollars | | | |
| Exports of goods and services | 184 603 | 228 393 | 181 499 |
| Imports of goods and services | 157 790 | 220 247 | 171 399 |
| Current account balance | 1 551 | -28 192 | -18 418 |
| Capital and financial account balance ⁱ | 85 933 | 31, 161 | 55 758 |
| Overall balance | 87 484 | 2 969 | 37 340 |

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

^a Preliminary estimates.

^b Twelve-month variation to October 2009.

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

^d Estimate based on data from January to September.

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

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

^g Estimate based on data from January to October.

^h Average from January to October, annualized.

ⁱ Includes errors and omissions.

equivalent of nearly all of its investment. The nominal deficit is projected to rise by GDP percentage points, to around 4% of GDP. A primary surplus target of 3.3% of GDP was set for 2010.

The final quarter of 2008 saw a pronounced drop in GDP, which shrank by around 3% with respect to the third quarter. This decline flattened significantly in the first quarter of 2009 (0.9% contraction with respect to the previous quarter), as the downturn in the industrial sector eased (down 4.4% on the fourth quarter of 2008, compared with a contraction of 8.1% between the third and fourth quarters of that year). In the second quarter of 2009, GDP saw an upturn (1.0% on the previous quarter), on the back of the upswing in manufacturing (which gained 2.6% over the first quarter), as firms reduced surplus inventories and consumer and business confidence indices improved. In the third quarter, growth picked up further, inventories reached an acceptable level and business confidence indices rose above their pre-crisis levels. The third quarter also saw the first increase in industrial employment in 2009.

Agricultural production is estimated to have contracted in 2009. Nevertheless, the year's harvest is expected to be the second-largest ever recorded, while it is anticipated that the services sector could show an expansion.

On the demand side, the countercyclical response has been driven by consumption, both private and government. In the first three quarters of 2009, government consumption was 4.3% up on the fourth quarter of 2008, while household consumption rose 2.7%. Goods and services export volumes declined 11.3%, while investment fell 7.8%. The volume of imported goods and services dropped 13.2%. If these rates of decrease continue for the year overall, it is estimated that investment will decline to 16% of GDP.

Between December 2008 and January 2009, the number of jobs in the formal sector fell by 755,000. The unemployment rate increased from 7.6% in September 2008 to 9% in March 2009. The labour market then saw a gradual upturn up to September 2009, with a net increase of 300,000 jobs over September 2008. The employment impacts of the international financial crisis varied by sector: while industry saw a net loss of 280,000 jobs, the number of jobs in commerce and services rose by over 570,000. The unemployment rate was 7.7% in September 2009, comparable to its level in September 2008, with some of the reduction due to a lower participation rate (56.8% in September 2009, as compared with 57.4% 12 months earlier). In August 2009 the wage bill was 3.2% higher than a year earlier, while average income increased 1.9% in the same period.

Inflation, as measured by the consumer price index, declined gradually, from 6.4% in October 2008 (near the ceiling of the target band) to 4.2%, below the target range, in October 2009, while the wholesale price index fell 4.8%.

In the first 10 months of 2009, the current account deficit rose to US\$ 14.8 billion (1.26% of GDP), as compared with US\$ 28.2 billion in the year-earlier period.

This reflected the combination of a larger trade surplus (US\$ 22.6 billion) and a smaller deficit on the income account (US\$ 40.1 billion). Net interest payments fell to US\$ 7.5 billion, while net remittances of profits and dividends declined to US\$ 17.9 billion (as compared to US\$ 29.3 billion for the same period in 2008).

The capital and financial account posted a surplus of US\$ 52.2 billion. FDI fell to US\$ 19.2 billion (US\$ 34.8 billion between January and October of 2008), while portfolio investment increased to US\$ 39.3 billion (US\$ 9.6 billion between January and October of 2008), reflecting the interest of international capital investors in Brazilian assets.

Between January and September of 2009, goods exports slid by 25.9% from the previous year (down 12.5% in volume and 15% in price), reflecting a drop in commodities exports (down 15.3%, with a 4.9% rise in volume and an 18.7% drop in prices), while exports of manufactured and semi-manufactured goods slumped by 32% (down 9.4% in volume and 6.7% in price) and 30.8% (down 26.8% in volume and 23.3% in price), respectively.

Imports of goods tumbled 31% in the same period, owing to drops in imports of intermediate goods (32.3%), fuels (52.5%), capital goods (14.4%), consumer durables (11.4%) and non-durables (4.0%). In volume terms, only durable consumer goods showed an increase (1.9%); all the other categories registered falls.

In November 2009, international reserves stood at US\$ 236 billion (equivalent to approximately 22 months of import cover), which represents an increase over the figure for the end of 2008 (US\$ 194 billion). In September 2009, total external debt stood at US\$ 276 billion, of which US\$ 169 billion was medium-term debt and US\$ 32 billion was short-term debt.