Brazil

In 2008, Brazil's GDP is estimated to have grown by around 5.9%. From September, the impact of the international financial crisis was reflected in a slowing economic growth rate. The slowdown is expected to continue in the months to come, with the GDP growth rate forecast to fall in 2009. Given the nature of the crisis and current economic conditions in Brazil, however, the authorities have a range of economic policy instruments at their disposal to help allay the adverse effects of the crisis.

Economic performance was highly positive in the first three quarters of 2008: GDP growth of 6.4% over the year-earlier period, 2 million more formal jobs over the year, the unemployment rate down to 7.6% of the economically active population (one of the lowest levels since 2002) and a 5.1% rise in real wages (comparing September 2008 with the same month in 2007).

Despite pressure from rising agricultural prices, the inflation rate stayed close to the set targets, with a cumulative rate of 6.4% in the 12 months to November. The fiscal balance continued to post a primary surplus, this time of 5.6% of GDP in the period January-October 2008. Overall, thanks to the lower cost of debt servicing, the public sector nominal deficit has narrowed to 0.33% of GDP.

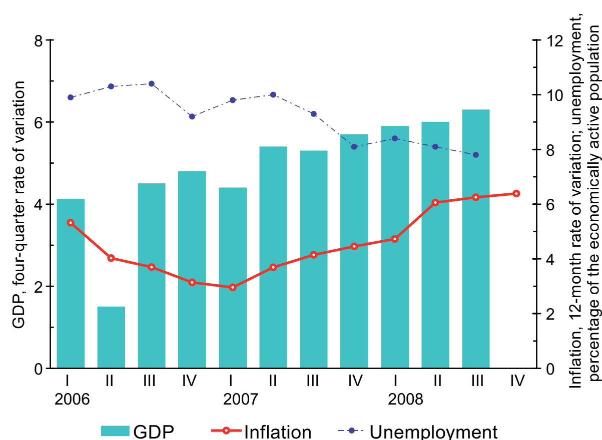
The external accounts reflected the strong economic growth, with a steep climb in imports. Despite the central bank's intervention in the foreign-exchange market, the Brazilian currency continued to appreciate throughout the year and in August 2008, the exchange rate was 1.56 reais to the United States dollar, the lowest rate since 1999. Inflows of capital, in the forms of both foreign direct investment and portfolio investment, also remained strong.

In September 2008 the outlook changed as a result of the international financial crisis. The real depreciated by almost 50% and the exchange rate against the United States dollar, which had been highly volatile since September, reached 2.44 reais to the dollar in November. The strong devaluation was caused by the reduction in lines of credit for foreign trade, the withdrawal of foreign portfolio investors, remittances of the profits of transnational corporations' subsidiaries to their parent firms abroad and Brazilian firms' need for foreign exchange to cover exchange-rate derivative transactions.

In the first few weeks of the crisis, forward foreign-exchange contracts, the country's main source of export financing, were down by over 40%. In October outflows of portfolio investment (shares and securities) stood at US$ 7.8 billion and profit remittances between January and October amounted to US$ 30.5 billion, 67% more than in the same period of 2007.

A number of export firms that were relying on the continued appreciation of the real and that had engaged in derivatives arbitrage and related financial applications have been severely hit by the unforeseen plunge in the exchange rate. Their known losses in the derivatives market stand at over US$ 2 billion, and this figure may rise further yet, as the pre-crisis worth of this type of

BRAZIL: GDP, INFLATION AND UNEMPLOYMENT



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

derivatives contracts was over US$ 37 billion (based on the August 2008 exchange rate).

The shortage of external credit has driven Brazilian banks to adopt a defensive stance and prefer to remain more liquid, thus creating particular difficulties for small and medium-sized banks, which relied most heavily on interbank operations.

Longer-term loans for big-ticket items such as consumer durables and automobiles have become smaller, shorter and more expensive. This is apparent in the figures for October 2008, which also showed a 38% reduction in the monthly supply of credit for agriculture compared with the year-earlier period. Personal and commercial loans dropped by 22% and 12%, respectively, in that period. In October 2008 the total balance of personal loans for automobile purchases shrank for the first time in several years, with monthly loan issues representing less than loan payments.

Starting in October, a number of sectors began to adjust their levels of production to cope with credit market difficulties. Seasonally adjusted data show that Brazilian manufacturing contracted by 1.7% in October as compared with September, as production of consumer durables and intermediate goods dropped by 4.7% and 3%, respectively. This followed the decision by automobile manufacturers to give their staff early vacations and suspend production for one or two weeks in order to avoid building up excess stock, after sales dropped by 11% in October. The mining and iron and steel sectors turned in similar performances, owing to falling international prices for metals and minerals, with production cuts announced for the coming months. Consequently, in 2008 automobile production is expected to be down by about 200,000 units on initial forecasts. Net monthly generation of employment was 61,000 jobs, which was the lowest October figure since 2004.

The Government of Brazil has adopted measures to soften the impact of the crisis. Its first steps were aimed at the credit market, with a view to guaranteeing greater liquidity in the interbank market. Between September and the end of November, the central bank used the large sums held in the form of compulsory deposits (259 billion reais in August) to reinject almost 85 billion reais into the financial system. This was enabled by the lowering of reserve requirements, specifically for large banks purchasing loan portfolios from smaller banks, which generated around 30 billion reais. Credit for agriculture was increased by 6 billion reais, while the remaining 50 billion reais were used to augment liquidity in the banking system, both for direct credit and for interbank operations.

Another economic policy priority was to provide foreign exchange to the market. To this end, the central bank engaged in a variety of transactions, mainly swap contracts worth US$ 30 billion and direct sales of foreign exchange for US$ 6.7 billion.

The central bank set up direct credit lines to the value of US$ 11.3 billion to finance exports, to help banks to maintain or rediscount external trade operations. Between August and the end of November, international cash reserves shrank by 5.4% to stand at US$ 194 billion. In addition, the United States Federal Reserve announced that it was making available US$ 30 billion for swap operations with the central bank of Brazil, which brought the amount available in liquid reserves, including other operations of this type, to US$ 235 billion.

New legislation was introduced affording the central bank far-reaching powers to intervene in the banking system and broadening the scope of action and range of operations allowed to federal banks (such as Banco do Brasil and Caixa Econômica Federal). Between October and November, two major bank mergers took place: one between the private banks Itaú and Unibanco (that now form the largest South American bank); and the other between the State banks Banco do Brasil and Nossa Caixa (from the State of São Paulo), which enabled Banco do Brasil to expand considerably into major markets.

BRAZIL: MAIN ECONOMIC INDICATORS

	2006	2007	2008 [a]
	Annual growth rates		
Gross domestic product	4.0	5.7	5.9
Per capita gross domestic product	2.6	4.3	4.5
Consumer prices	3.0	4.5	6.4 [b]
Average real wage [c]	3.5	1.5	1.7 [d]
Money (M1)	20.4	32.7	7.4 [e]
Real effective exchange rate [f]	-11.5	-7.7	-8.8 [g]
Terms of trade	4.7	2.8	3.3
	Annual average percentages		
Urban unemployment rate	10.0	9.3	7.9 [h]
Central government operating balance / GDP	-2.9	-2.0	-2.6
Nominal deposit rate	8.3	7.7	7.8 [i]
Nominal lending rate	40.0	34.5	36.7 [j]
	Millions of dollars		
Exports of goods and services	157 283	184 458	229 918
Imports of goods and services	120 467	157 483	222 721
Current account	13 643	1 712	-27 752
Capital and financial account	16 927	85 772	54 752
Overall balance	30 569	87 484	27 000

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 2008.
[c] Workers covered by social and labour legislation, private sector.
[d] Estimate based on data from January to September.
[e] Twelve-month variation to October 2008.
[f] A negative rate indicates an appreciation of the currency in real terms.
[g] Year-on-year average variation, January to October.
[h] Estimate based on data from January to October.
[i] Average from January to November, annualized.
[j] Average from January to October, annualized.

A number of production sectors received special credit lines to maintain the momentum of consumption; one example was 8 billion reais for the auto-finance portfolio purchase by Banco do Brasil and Nossa Caixa.

As far as interest rates are concerned, in October the central bank's Monetary Policy Committee decided to suspend the rises in the basic interest rate that had begun in March 2008 (when the basic interest rate in the Special System of Clearance and Custody (SELIC) had reached a historical low of 11.25%). The rate was thus held steady at 13.75%. On the financial market, annual lending rates rose by around 2.5 percentage points in October for all types of operation, while the average term for corporate loans was shortened (especially for working capital).

Another set of fiscal policy measures was implemented to boost domestic demand and improve expectations of adjustment to the crisis. In the short term, the federal government and some states, such as São Paulo, have legnthened the period for the monthly payment of taxes, reducing pressure on companies' cash flows. The federal government made a commitment to maintain its investment programme, which has been stepped up in recent months.

In the first 10 months of 2008 (compared with the same period of 2007), federal government revenues expanded strongly, with a nominal rise of 18.6%. Total expenditure increased by 11% during the same period. The Treasury's capital expenditure rose by over 40%. It is estimated that the crisis will have a negative impact on fiscal revenues, in the light of lower manufacturing sales (especially of automobiles) and reduced profits expected from State companies (owing to falling export prices).

Despite the performance of economic variables over the last few months of the year, economic activity in 2008 maintained a strong momentum. In the first nine months of the year, manufacturing was up 6.5% on the year-earlier period (boosted by a 17.6% rise in automobile production and an 18.9% increase in capital goods production), while commerce expanded by 10.4%. According to estimates by the National Confederation of Agriculture, agricultural production could be up by more than 10% in 2008.

In the first semester of 2008, gross fixed investment was 15% higher than in the year-earlier period, thereby continuing the rapid expansion observed in 2006 and 2007 (11% and 14%, respectively). Gross fixed investment as a percentage of GDP (in constant prices) rose from 14.3% in 2005 to 17.1% in the first half of 2008. Although these growth rates represent a recovery from extremely low levels, the fast pace of the expansion shows that Brazil's investment climate has improved considerably. Purchases of machinery and equipment (from home and abroad) also rose by about 19% in 2007 and 22% between January and August 2008. This suggests that supply is responding quickly to demand pressures. Civil construction investment also expanded, albeit more modestly (by 5% and 11% in the two periods).

The strong increase in production and the impact of high interest rates combined to ease the pressure on prices caused by rising demand. From July, the increased supply of agricultural goods following the harvest helped to lower the average monthly variation of the extended national consumer price index from 0.69% in the second quarter of 2008 to 0.36% in the third quarter. This strengthened expectations that inflation would remain within two percentage points of the 4.5% target in 2008. In October, variation of the extended national consumer price index rose again to 0.45%, driven by the exchange rate. What remains uncertain is whether the lower levels of economic activity can offset the pressures of currency devaluation.

In the external sector, the cumulative current account deficit for January to October stood at US$ 24.8 billion (1.86% of GDP). This represented a departure from the surpluses recorded in recent years, and is attributable to the drop in the trade balance to US$ 20.8 billion (compared with US$ 34.4 billion in the year-earlier period) and to the deficit of US$ 48.9 billion on the services and income balance (compared with US$ 34.1 billion in the same period of 2007).

Merchandise exports and imports rose by 28% and 51.6%, respectively. Export performance reflected increased exports of commodities (48.7%) semi-manufactured products (29.9%) and manufactures (12.6%). The rise in export values breaks down into a 1.7% fall in volumes and a 29.7% jump in prices (47% for commodities, 27.5% for semi-manufactured products and 18.1% for manufactures). The value of imports was US$ 148 billion in this period, an unprecedented level that was underpinned by a surge in imports of consumer durables (67.1%), capital goods (53.1%) and intermediate goods (46.5%). There was a marked increase in import volumes for consumer durables (56.1%) and capital goods (40.3%), as well as a rise in imports of intermediate goods (20.9%).

Capital flows in the capital and financial account of the balance of payments posted a surplus of US$ 41.8 billion between January and October 2008, which was much less than the US$ 77 billion recorded in the same period of 2007. This was attributable to a major shift in the country's foreign direct investment position, from net inflows of US$ 850 million in the first 10 months of 2007 to net outflows of US$ 15.6 billion in the same period of 2008. Added to this was a significant reduction in inflows of foreign portfolio investment, which dropped from US$ 40.9 billion between January and October 2007 to just US$ 9.6 billion in the same period of 2008.

Total foreign direct investment inflows between January and October reached a record US$ 34.7 billion (up from US$ 31 billion one year previously). Direct investment represented 2.6% of GDP between January and October 2008 (compared with 2.9% one year earlier).

In October, total external debt stood at US$ 214 billion, of which US$ 165 billion was medium-term debt and US$ 49 billion was short-term debt. As a proportion of total export values, the cost of debt servicing fell from 32.4% in December 2007 to 18.4% in October 2008.