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Brazilian External Sector so far in the XXIst century



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*Renato Baumann**

I - Introduction

Brazil has traditionally been characterized by a culture of inward-looking policy making. A big and diversified geographical space with a large population, surrounded by neighboring countries with different language and history, yet no significant frontier conflict, topped by a century-old history of immigration has led the country to concentrate most of its intellectual effort and policy initiatives in the domestic market. The systematic exploitation of external markets, based on specific policies to foster exports is only four decades old.

This is not to say that the Brazilian economy has been closed to foreigners. The presence of foreign firms in the Brazilian productive sector has always been significant and the share of foreign-owned firms is one of the highest that can be found among developing countries. The intensification of industrialization efforts in the mid-1950s relied heavily on foreign investment. Additional favorable policies to attract investment were adopted in the mid-1960s, and again in the early 1990s. This has hardly changed in the present decade.

Multilateral opening to trade was intensified in the first half of the 1990s, together with efforts to foster preferential trade on a regional basis. The degree of openness of the economy (exports plus imports as a percentage of GDP) increased from an average 13.6% in the 1990s to 21.5% in 2000-2008. The imported component of the domestic consumption basket and the share of imported producer goods in the productive processes have increased quite significantly. No major policy change to reduce imports has taken place since the early 1990s.

Foreign direct investment inflow has traditionally been close to US\$ 2 billion per year. This changed dramatically in the mid-1990s, partly due to the privatization of public firms. But even then other factors played a major role, as the share of privatization in FDI inflow was less in Brazil than in most other Latin American countries. The typical figure for annual FDI inflow has become since the mid-1990s some eight to ten times higher than what it used to be. Opportunities in the domestic market, coupled to macro stabilization and political/institutional stability have increasingly been taken into consideration by potential investors.

A peculiar feature in the present decade is the process of internationalization of Brazilian firms, very much like what is being observed in other Latin American countries, such as Mexico, Chile and Argentina. In Brazil this has become an

* From UN/ECLAC and Universidade de Brasilia. Opinions herein are my own and might not correspond to the official position of these institutions.

active policy matter, based on the assumption that it is important to have big players of domestically-owned capital.

Policies towards the external sector have maintained their basic characteristics since the beginning of the present decade, although emphasis has been given to some specific aspects. Little doubt remains that the positive outcome - at least until recently – has been clearly a result of the country having profited from very favorable circumstances in the international scenario.

That has helped quite significantly to reduce the economy's vulnerability (in terms of external debt indicators), to increase reserves of foreign currencies and to maintain market-friendly import policies. This set of characteristics, on its turn, has helped to foster the country's external image and gave support to a more pro-active positioning in the international scenario.

As is well known, things have changed in the international markets since the 2008/9 crisis. This has raised some concern with regard to the actual conditions of the Brazilian economy to cope with these new circumstances.

This article discusses the main features of the external sector of the Brazilian economy, regarding trade flows, foreign investment, the internationalization of Brazilian entrepreneurial groups and the short-term financial requirements in foreign currencies. This is done in four sections, following this Introduction. Next section presents a set of basic indicators, as a background picturing of the external sector conditions and achievements since year 2000. Section III concentrates on merchandise trade. It discusses the basic features and recent changes, as well as the recent debate about the composition of the export bill. Section IV deals with the financial exposure of the Brazilian economy. It will become clear that it has been in this area where the most significant recent achievements have taken place. Section V presents some final remarks and overall appraisal.

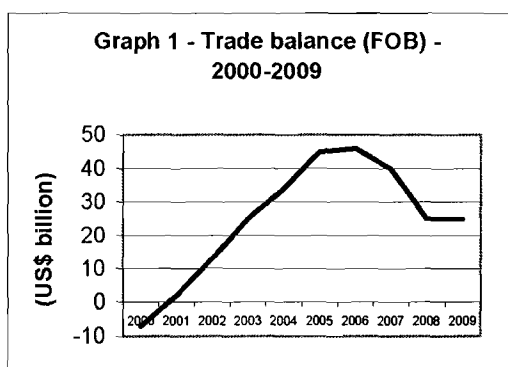
II – An overall scenario of basic indicators

Brazilian trade relations with the rest of the world in the present decade reversed the trade deficits that characterized the second half of the 1990s. Trade surpluses increased every single year to reach a record US\$ 46 billion in 2006 (one third of total exports that year) and have come down to about US\$ 25 billion since 2008. At the same time the share of Brazilian products in total world exports increased marginally from an average of 0,95% in the 1990s to 1,06% in 2000-2008.

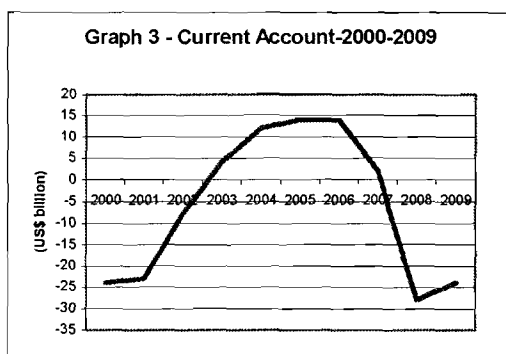
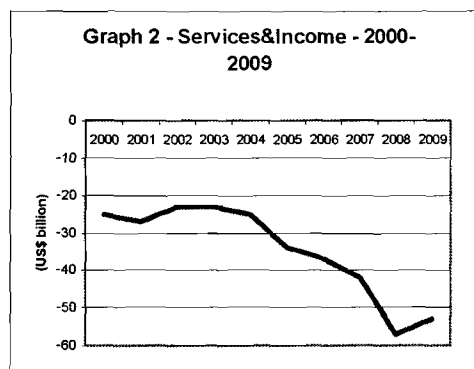
At the same time the balance of services and income remained increasingly negative, having reached a bottom of US\$ 57 billion in 2008. This is hardly surprising, given the structural dependence on freight, travelling, remittances, etc., as well as the recent evolution of the exchange rate, as will be discussed further on.

The Current Account reached a maximum of US\$ 14 billion in 2005, dropping to a deficit of close to US\$ 30 billion in 2008¹, a three-years shift of US\$ 44 billion. It is an unprecedented outcome for the economy to have achieved simultaneously an increase of imports together with trade and Current Account surpluses, in a period of GDP growth, as Brazil experienced in 2003-2007. Only very peculiar conditions allow for such result, another aspect to be elaborated in the next Section.

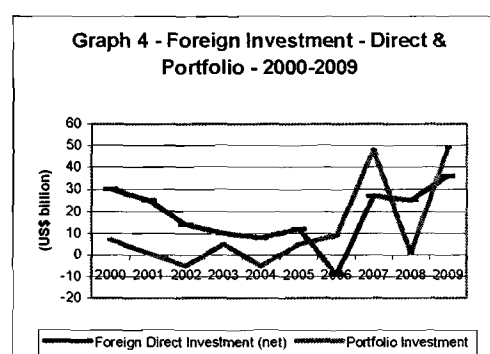
Net inflow of foreign currency in the second half of the present decade has been fostered not only by unprecedented trade surpluses, but also by a significant amount of investment – both FDI and portfolio – as well as external loans, allowing for significant Balance of Payment surplus. The following graphs illustrate the major indicators.



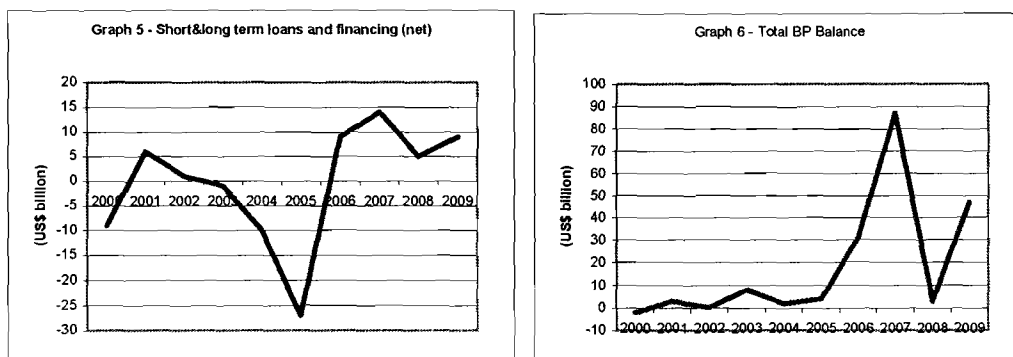
Source: Central Bank



Source: Central Bank



¹ The net inflow of unilateral transfers is relatively modest in Brazil: the top recorded value was US\$ 4.3 billion in 2006, when it accounted for only about 3% of total merchandise exports.



Source: Central Bank

In 2008 the economy was affected by the international crisis and experienced a decrease of its trade surplus and a sharp reduction of portfolio investment, only partially compensated in 2009.

The favorable results achieved in the mid-2000s are by and large the outcome of an extremely positive scenario, more than the result of specific policies. As a matter of fact an estimate of the potential incentives to export has shown² that total incentives have had rather small variation: between 1990 and 2003 they varied between a minimum of 24.1% and a maximum of 29.4% and in 2004 they corresponded to 33.0% of total export value.

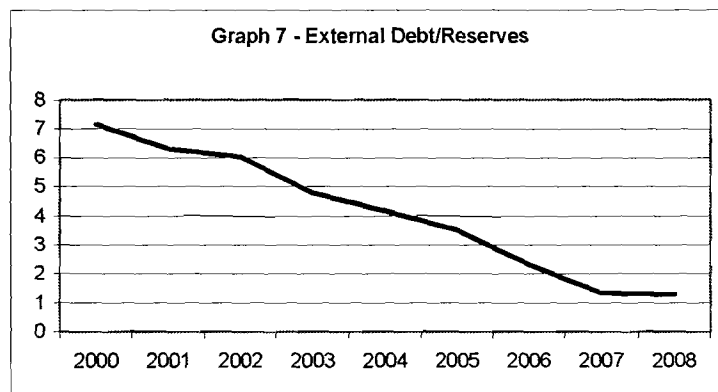
Active administration of the external sector variables has helped as well. Brazilian authorities aimed at improving the profile of the external commitments both by increasing the amount of foreign currency reserves (from US\$ 33 billion in 2000 to US\$ 207 billion in 2008) as well as reducing the relative weight of the external debt (worth US\$ 236 billion in 2000 and US\$ 267 billion in 2008, with a sharp reduction of public external debt) and improving its profile, thus fostering confidence in the economy. As a result the ratio of the external debt to total reserves fell constantly since 2000, as Graph 7 illustrates. These points will be considered in more details in Section IV.

It goes without saying that this signaling of an improved capacity to face external commitments³ has indeed contributed quite significantly to the attraction of external investment as well as to the willingness to lend by foreign creditors, as shown in Graphs 4 and 5.

Be that as it may, the Brazilian economy achieved in 2008 and 2009 an investment grade classification by three rating agencies, precisely when the international economic scenario was being affected by the crisis. This has further contributed, among other things, to attract resources from investment funds.

² H.C.Moreira, M.Panariello (2005), *Os Incentivos às Exportações Brasileiras: 1990 a 2004*, CEPAL, LC/BRS/R.176, Novembro

³ Coupled to macroeconomic and political stability.



This is not to say that a number of aspects could – and perhaps should – have been dealt with in a different way, raising criticism to the policies towards the external sector. The following section discusses the evidence and some controversial issues related to merchandise trade.

III – Merchandise Trade

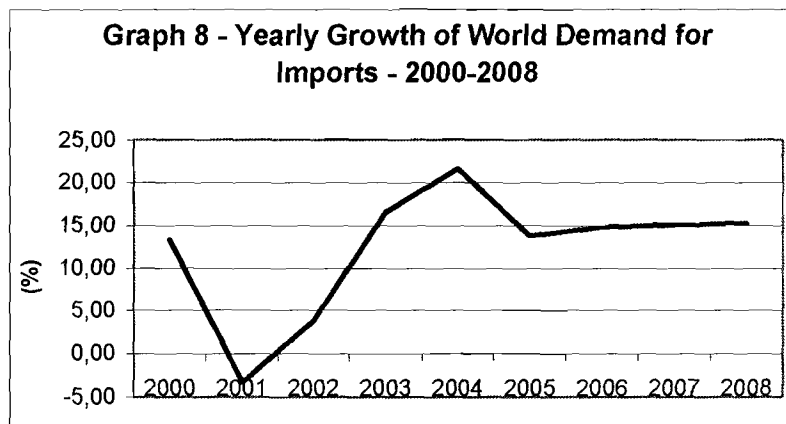
The present decade has been remarkable, as a period when the Brazilian economy: a) maintained its commitment to opening the economy – the degree of openness (exports + imports as a percentage of GDP) was 18% on average during the 1990s and went up to 26% in 2000-08⁴ and b) took advantage of a period of high global trade growth to improve its export performance. Between 2000 and 2009 exports increased 178% in current US dollars, surpassing the 129% variation of imports. This is a different outcome from the 1990s, when exports increased by less than half the variation of imports (75% and 170%, respectively), leading to systematic trade deficits in the second half of the decade.

The figures for the whole period conceal, however, quite different situations in the first and the second halves of the present decade. From 2001 to 2005 the average annual rate of growth of exports was 17%, well above the 7% average growth of imports. Since then the situation has reversed quite sharply, with exports increasing on average at a yearly rate of 8.4% and imports growing at 18.4% in 2006-2009. Trade balance is still positive, but has been falling at a sharp, worrying pace.

A good deal of the positive outcome of exports in the first half of the present decade is clearly explained by exceptionally good conditions in the international market for merchandise trade. As shown in Graph 8, there was a remarkable, sustained increase in international demand conditions between 2001 and 2004,

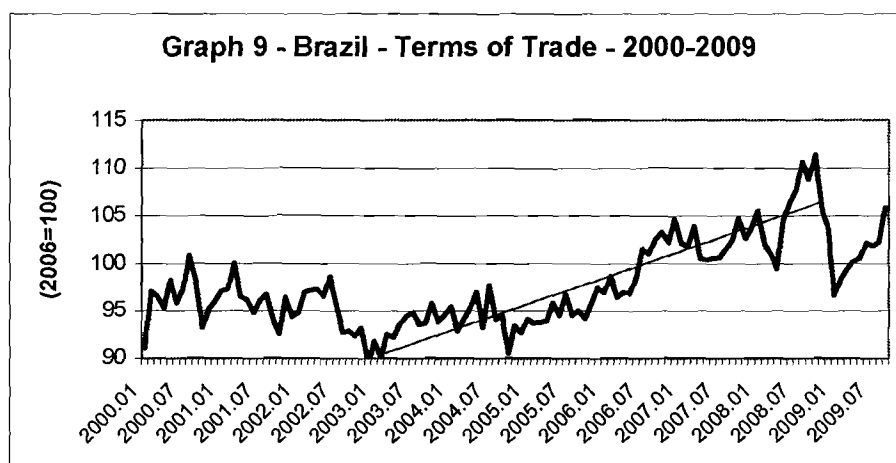
⁴ Data from the World Bank, World Development Indicators. This compares poorly with the corresponding indicators, for instance, for the other BRIC countries (China, India, Russia), where the degree of openness is well over 40%.

and a stable but high rate (15%) of yearly growth until 2008, which benefited most trading economies.



Source: Ipeadata

These active market conditions have affected international prices. Between January/2003 and October/2008, when the financial crisis started to be felt, Brazilian terms of trade improved no less than 44.6%, as shown in Graph 9.



Source: Ipeadata

This favorable outcome is, of course, directly linked to the special conditions in the demand for 'commodities'. From 2000 to 2008 total Brazilian export prices increased 88%, boosted by the prices of intermediate goods (96%) and non-durable goods (88%), whereas capital goods and durable goods experienced an improvement of less than 30%.

Table 1 summarizes the main results, for manufactures and non-manufactured goods.

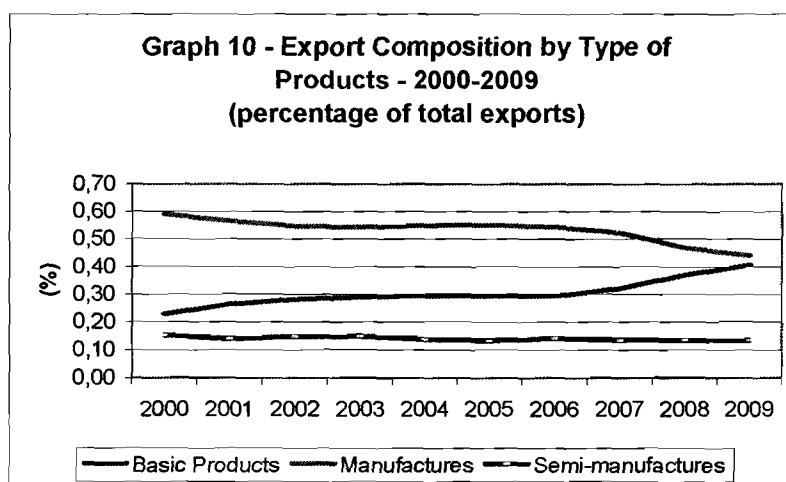
	Basic Products	Semi-manufactures	Manufactures
Prices			
1990-2000	111,5	80,0	48,2
2000-2008	131,4	99,8	57,8
Volume			
1990-2000	303,9	185,6	267,3
2000-2008	150,6	59,4	80,4

Source: FUNCEX

According to Table 1 the increase in prices of all export goods were more intense in the present decade than in the previous one, and even more so for basic products and semi-manufactures. Variation in export volumes, however, corresponded to only a third or less of those registered in the 1990s.

Furthermore, the ratio of the increase in export volume for basic products to the increase in manufactures was much higher in 2000-2008 (1:1.87) than in 1990-2000 (1:1.13). This has led to a significant change in the composition of the export bill towards a higher component of basic products, a quite controversial subject.

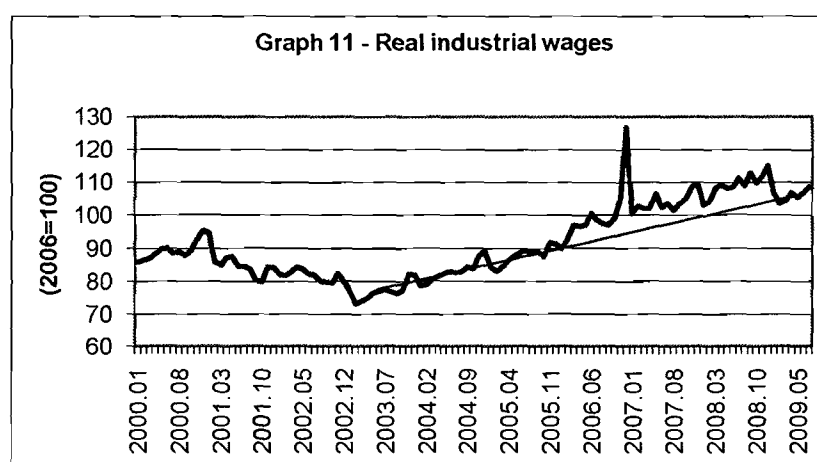
Graph 10 illustrates the recent evolution of the structure of Brazilian exports. It is clear that there has been a systematic loss in the relative weight of manufactures and a corresponding gain by basic products, with their respective shares in total exports, changing from a ratio of almost 3:1 in 2000, favoring manufactures, to an almost even situation in 2009. This has led to a fierce debate with regard to a 're-primarization' of exports.



Source: FUNCEX

Before we go into that discussion, however, two pieces of additional information are needed.

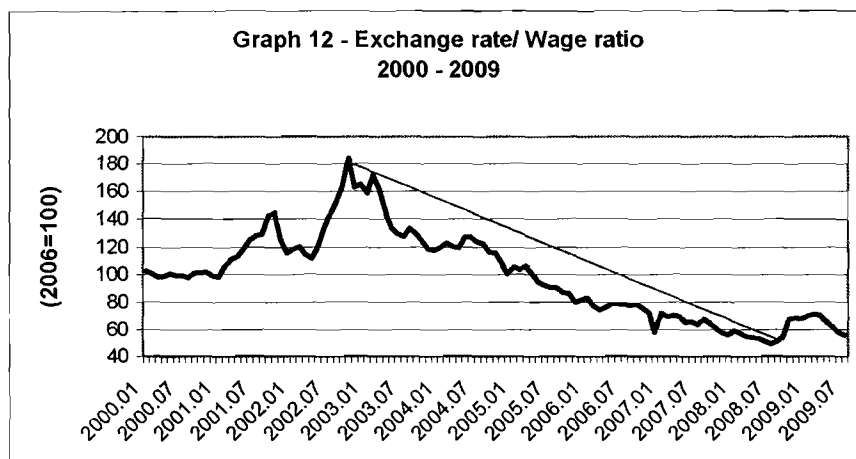
First, relative prices have reduced the stimulus to the export activity, via a significant exchange rate appreciation. This period comprises a peak level in the second semester of 2002 that is clearly an outlier, resulting from political and financial uncertainties. To avoid these extreme points we take as reference the average exchange rate in the second semester of 2003. The effective exchange rate⁵ appreciated between the second semester of 2003 and December/ 2009 no less than 40.3%. But even worse for the exporters of manufactures, this appreciation has taken place in a period of sharp increase in real wages in the industrial sector, as shown in Graph 11: between March/2003 and December 2008 real industrial wages increased 55.5%.



Source: IBGE

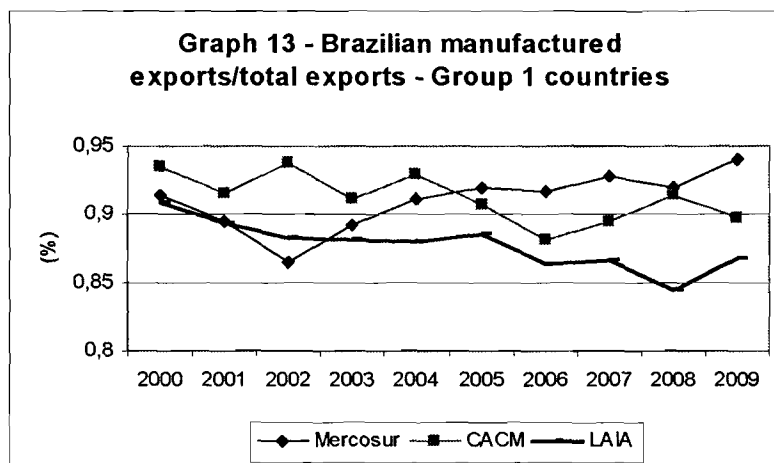
As an outcome, the exchange rate/wage ratio experienced systematic reduction, falling 56.0% between the second semester of 2003 and the first semester of 2009, as shown in Graph 12. This is a clear indication of loss of attractiveness of the export activity for producers in the industrial sector, to the extent that not all domestic producers are able to 'export' their cost pressure to consumers abroad ('pass-through').

⁵ Based on wholesale price indexes. Estimates by FUNCEX.



Source: Ipeadata

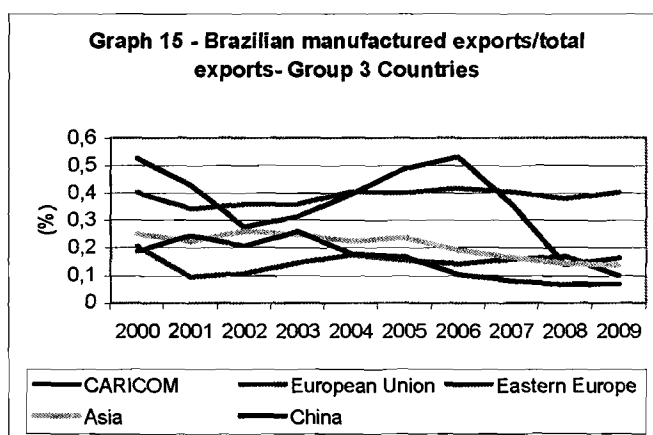
The second aspect to emphasize is the uneven geographical distribution of manufactured exports according to destination. Brazilian manufactures seem to be more competitive in some markets. Whatever the reason for this geographical concentration, if one considers the share of manufactures in total bilateral exports, there are clearly three groups of countries, as indicated in the following graphs.



Source: SECEX



Source: SECEX



Source: SECEX

For Group 1, comprising other Latin American countries, Brazilian exports are mostly manufactured products. Preferential agreements, lower transportation costs, similarity of demand structures are clearly some of the reasons that might explain this outcome. As a matter of fact, this result has led to criticism of regional preferential agreements as a means to force consumers in the region to purchase less efficient or dearer products. This set of countries absorbed on average between 2000 and 2009 some 21% of total Brazilian exports, but with a decreasing importance, their share being reduced from 23% in 2000 to 19.5% in 2009.

A second set of markets comprise the US and the African continent, where manufactures account for between 60 and 80% of Brazilian exports. These countries absorbed on average 24% of total Brazilian exports in 2000-2009, but with opposing trends: whereas the share of the US market went down from 24% to 10% between those two years, trade with Africa gained importance, increasing from 2.4% to 5.7%. The clear downward trend in the US market is indicative of a lack of competitiveness of Brazilian production, mainly in comparison to competing Asian suppliers.

A third set of markets, and where Brazilian performance is most worrying, comprise Europe, Asia and the Caribbean. These regions absorbed on average half of total Brazilian exports in 2000-2009. Once again, aggregate figures hide different trends: the share of the European Union came down from 27.8% to 22.2%, whereas Asia (China in particular) more than doubled its share, from 11.5% to 25.8%, at the same time that the share of the Caribbean countries increased from 0.5% to 2.1% and Eastern Europe also gained importance, from 0.9% to 2.2%.

Typically Brazilian exports to the Group 3 markets are mostly (over half) non-manufactured products, and in Asia and the Caribbean the share of manufactures is becoming even lower. Asia is the region where trade has been most dynamic in recent years, but clearly the strong effect of high commodity prices has been decisive in stimulating an increasing share of primary products in total Brazilian exports, as suggested in Table 1 above.

Taken together, the fall of manufactures in Brazilian exports to the US, plus the low and decreasing share of manufactures in total exports to Europe and Asia make a picturing of low competitiveness precisely in the most rich and dynamic markets.

This has led to an intense debate about the 're-primarization' of the Brazilian export bill.

This debate is centered on two positions. The most critical appraisals stress: a) the negative impact of the exchange rate over manufactured exports and b) the increase in domestic demand, which absorbed most of the production in the manufacturing sector.

For instance, Souza (2009) sustains that between 1998 and 2008 there has been an increase in relative prices favoring commodities and the export volume of manufactures fell in comparison to the exports of primary products (from an index of 100 in 2005 to 84 in 2008). According to Souza, however, there is no point in considering this a result of external demand. Brazilian exports of manufactures have grown much less than world exports in 1994-99, recovered up to 2005 and have been falling again since then. Furthermore, world exports of manufactures have been growing in volume, also in those periods when Brazilian exports have stagnated, which means that on a world scale there has been no tendency to a de-industrialization of exports.

Souza puts emphasis in 1994-2008 having been a period of exchange rate appreciation that corresponded to stagnation of manufactured exports. The reduction in the share of manufactures in total exports has also to do with the dynamism of domestic demand; this is confirmed by the simultaneous boom in imports in recent years.

An alternative view questions the very argument that there has been a 're-primarization' of the export bill in recent years.

From a more detailed sector analysis, Puga (2009) argues that in the last 13 years there have been no significant changes in the composition of exports and imports in favor of commodities: in 2008 the products of agribusiness, metals, metallurgy and oil corresponded to 60% of total exports, a figure close to the 58% of 1996 and 55% in 2002. A closer look at commodities shows as the main change the increase – 5 p.p. – in the importance of oil and fuels, both in imports and exports.

Hence the improvement of trade balance in 2002-2008 does not seem to be related to the higher growth of commodities. Between 2002 and 2008 the export prices of Brazilian agricultural products had an increase of 85%, well below the increase of 132% of international prices for commodities, and little above the 81% increase for the prices of total Brazilian exports.

For non-commodities there has been an increase of export prices (40%) above the corresponding increase in import prices (32%) in 2002-2008. The producers of non-commodities have been able to partially compensate for the overvaluation of the exchange rate, via the mechanism of transferring price pressure ('pass-through') to consumers abroad. The extent of this effect is still an open empirical matter⁶.

These two positions suggest that a good deal of additional empirical work is still needed in order to precisely identify the extension and sector concentration of the effects of the overvaluation of the exchange rate on the composition of the export bill.

A final aspect related to merchandise trade has to do with the structure of the export sector. An additional outcome of the overvalued exchange rate⁷ is its impact over the number of exporting and importing firms.

The total number of importing firms increased from 25.542 to 34.033 between 2002 and 2009, an increase of 8.5 thousand new importers in seven years⁸. Between these two years total exports increased 152%, largely surpassed by the 170% increase in total imports.

On the export side this increase has not meant more firms. Instead, it reflects more clearly the fact that the same exporters increased their export value: the average annual export value per firm increased from US\$ 3.5 billion in 2002 to US\$ 7.7

⁶ Barroso (2010) analyses quarterly data of Brazilian exports to 53 destinations in 1997-2006 and finds evidence that 58% of exchange rate appreciation would be passed-through to foreign consumer prices, with Brazilian exporters absorbing a 42% loss via reduced mark-ups, with the degree of pass-through being positively related to the technological intensity of the productive sector.

⁷ As well as other distortions, such as structural constraints imposed by inadequate infrastructure, tax costs and others.

⁸ Data from 'Real valorizado eleva número de importadores e reduz exportadores', *O Estado de São Paulo*, 28/02/2010. The number of exporting firms increased from 17407 in 2002 to 19823 in 2009, but figures are not strictly comparable, as the government includes (since 2006) in these statistics about 3 thousand firms that export small values via postal services.

billion in 2009. At the same time the average annual import value per firm increased from US\$ 1.8 billion to US\$ 3.7 billion.

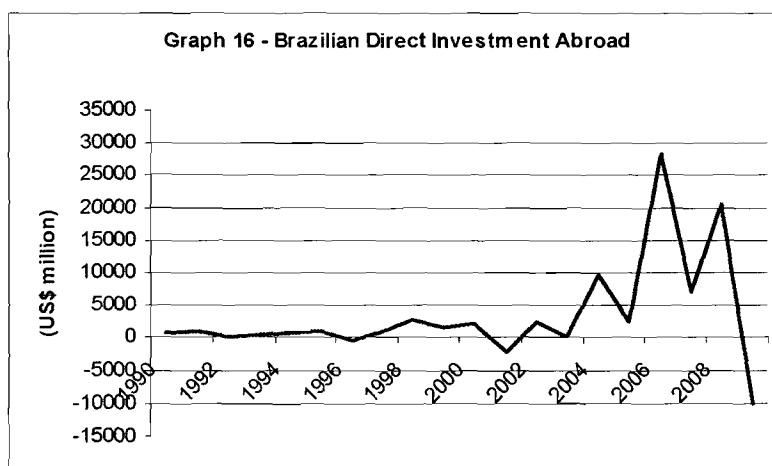
Participation of smaller agents in exporting activities has also been affected. The number of micro and small firms involved in the export activity varied from 8854 in 1998 to 14154 in 2004; but accompanying the exchange rate appreciation that number fell to only 10114 in 2008.

What the evidence presented in this section indicates is that the Brazilian economy has been affected to a significant extent by the conditions of the international market – influencing the composition of trade flows and the geographical distribution of its trade - but also that domestic policies (exchange rate policy in particular, but also the usual list of unresolved obstacles to exporters, such as the fiscal cost, infrastructure constraints and others) have contributed to determine a trade performance that could have been much improved. It is also suggestive that regional integration exercises (such as Mercosur and LAIA) might help the exporters in some sectors, like manufacturers, but have not been a source of dynamism for the export sector as a whole. Next section discusses another remarkable recent feature of the external sector, the internationalization of Brazilian firms.

III – The internationalization of Brazilian firms

Another peculiar characteristic of the Brazilian external sector in the present decade is the process of internationalization of domestically-owned firms. This movement started to gain momentum as an initiative by a few large firms with significant direct investment abroad, mainly in natural resources-intensive sectors (mining, energy, steel makers).

Resource-seeking strategies helped these firms to control their supply of raw materials as well as to place them in a stronger competitive position in the international market. Graph 16 shows the recent intensification of Brazilian FDI, having reached a record US\$ 28 billion in 2006.



During the 1990s Brazilian FDI remained virtually stable at a very low level, with a light increase since 1997. In 1998-2000 Brazilian FDI worth about US\$ 2 billion was recorded but this has changed, with a much intense dynamism, since 2004: the stock of Brazilian investment abroad increased by 14% per year until 2006, thanks to the improvement in the financial capacity of Brazilian firms in recent years, the exchange rate overvaluation, and the strategy of accumulating assets by domestic firms aiming at consolidating their position as global players (Ambrozio (2009)).

Most of the FDI is merging & acquisition of existing firms, with a small number of operations at very high value. Typically Brazilian firms aim at the control of natural resources, such as mining and hydrocarbon. The largest operation took place in the mining sector⁹. As for greenfield investments, they take place mostly in the oil and gas industry.

Table 2 shows some of the most important Brazilian investors abroad, their sectors and the geographical distribution of their investment. As indicated, these six companies – operating in mining, energy and steel industry - are present in Latin American and the Caribbean, but have also invested in other continents.

More recently the government has adopted as an explicit policy the stimulus to investment abroad as well as the financing – mostly via BNDES credits – to mergers and acquisition of large companies, as a means to strengthen and consolidate selected domestic firms as major players in specific sectors, able to face international competition.

⁹ Vale has purchased a zinc producing unit.

Table 2 - Some Brazilian Transnational Companies

Company	Number of countries	Sector	Countries
Gerdau	13 countries	Steel	Latin America: Argentina, Chile, Colombia, Uruguay, Peru, Venezuela Dominican Republic, Guatemala, Mexico North America: USA, Canada Europe: Spain Asia: India
Vale	25 countries	Mining	Latin America : Argentina, Chile, Colombia North America: USA, Canada Africa: South Africa, Angola, Mozambique, Guinea Europe: France, Wales, Switzerland, Germany, UK, Norway Asia: India, Oman, Mongolia, China, Singapore, Indonesia, South Korea, Japan Oceania: Australia, New Zealand
Petrobras	26 countries	Energy	Latin America: Argentina, Uruguay, Paraguay, Chile, Peru, Bolivia, Ecuador, Colombia, Venezuela, Mexico North America: USA Africa: Angola, Lybia, Mozambique, Nigeria, Senegal, Tanzania Asia: China, Singapore, India, Iran, Japan, Pakistan Europe: Portugal, UK, Turkey
Votorantim	14 countries	Various Sectors	Latin America & the Caribbean: Argentina, Bolivia, Peru, Colombia, Bahamas North America: USA, Canada Europe: UK, Belgium, Germany, Switzerland Asia: China, Singapore Oceania: Australia
Camargo Correa	13 countries	Various Sectors	Latin America: Argentina, Bolivia, Peru, Colombia, Venezuela, Paraguay, Chile, Uruguay, Mexico North America: USA Africa: Angola, Morocco Europe: Spain
JBS	14 countries	Meat	Latin America: Argentina, Chile, Mexico North America: USA Europe: UK, Italy, Switzerland Africa: Egypt Asia: China, Hong Kong, South Korea, Taiwan, Japan Oceania: Australia

Fonte: Carvalho/ Sennes (2009)

This process of internationalization is also found among Brazilian commercial banks. According to the BIS, Brazilian banks have exposure in third markets worth US\$ 51.4 billion¹⁰. Here, too, there are geographical differences. Operations in developed economies account to US\$ 29 billion, mostly in Europe (US\$ 15 billion), mainly in the United Kingdom (US\$ 3.6 billion) but also in Germany, Belgium, Portugal and Spain.

Credits in developing economies are worth US\$ 9.7 billion, almost all of it in South America: US\$ 6 billion in Chile, US\$ 1.1 billion in Argentina and US\$ 1.1 billion in Uruguay. In Asia total credits by Brazilian banks amounts to US\$ 609 million, almost all of it in South Korea.

What the figures shown in this section indicate is that there has been a clear, unprecedented increase in the degree of internationalization of the Brazilian economy in recent years, having intensified in the present decade. They are also indicative that belonging to preferential trade agreements – such as Mercosur – is not a sufficient condition to determine the geographical concentration of direct investment or bank operations.

IV – Financial Exposure

Until as recently as the late 1980s the traditional view about the Brazilian economy with regard to its external equilibrium was that as a latecomer in the industrial world it presented structural characteristics that are typical of a developing economy. Basic features comprised an unstable outcome in its trade balance, by and large influenced by the terms of trade, a systematic deficit in its services and rent account, due to constraints on transportation, payment for technology, remittances, etc., as well as a restricted access to capital markets, hence a constant need for external financing. Over time there is a quite strong correlation between the net inflow of foreign currencies and GDP growth: the economy could only grow when it had no binding external constraint.

What has changed since the beginning of the 1990s is that: a) the diversification of exports (at a product level as well as in geographical terms) has allowed for additional degrees of freedom in terms of the export dynamism (notwithstanding the qualifications discussed in section II); b) broader access to international capital market coupled to the attractiveness to foreign investors have facilitated the financing of the requirements in foreign currency; c) monetary authorities have adopted active policies towards the external debt, comprising the reduction of public indebtedness in the external market, changes in the currency composition of the debt, increasing the share of commitments in domestic currency, broadening the term structure of the debt, together with parallel actions towards increasing the stock of foreign currency reserves.

¹⁰ Data from 'Cresce presença de bancos brasileiros no exterior', *O Estado de São Paulo*, 01/03/2010.

This has allowed for a significant change in the profile of external commitments, as summarized in Table 3.

Debt service fell from over half of total export revenue by 2005 to less than 30%. Compared to GDP Brazilian foreign debt has always been smaller than in other Latin American countries. Yet that share came down from 19% to 13% between 2005 and 2009.

Favorable conditions and active policies allowed the country to build up reserves of foreign currency to an unprecedented level. Foreign currency reserves corresponded to less than a third of total external debt in 2005; four years later it surpassed total debt by almost one-fifth.

A low increase in external debt coupled to a sharp increase of reserves, plus the accumulation of assets of Brazilian banks and Brazilian credits abroad led to negative net indebtedness. The ratio of net external debt to exports varied from 0.9 in 2005 to -0.4 in 2009, at the same time that the ratio between reserves and debt service went up from 0.8 to 5.5 in the same period, meaning a much reduced pressure over the foreign currency market.

	2005	2006	2007	2008	2009
Debt service/exports (%)	55.8	41.3	32.4	19.0	28.6
Total debt/GDP (%)	19.2	15.8	14.1	12.1	12.9
Reserves*/total debt (%)	31.7	49.7	93.3	104.3	118.2
Net External Debt/Exports (ratio)	0.9	0.5	-0.1	-0.1	-0.4
Reserves/Debt service (ratio)	0.8	1.5	3.5	5.5	5.5

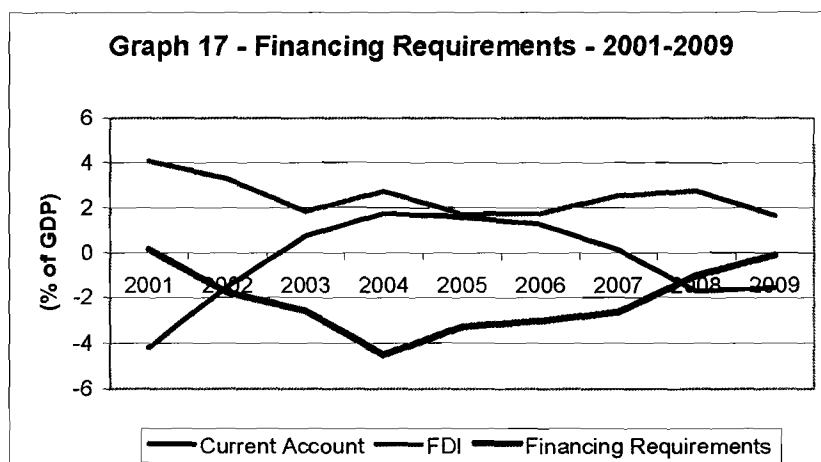
* liquidity

Source: Central Bank

As shown in Section II part of this outcome was made possible by the unprecedented results achieved in trade balance, leading to record levels of Current Account surpluses, plus the historically high level of inflow of foreign direct investment. Graph 17 illustrates the trajectories.

Brazil presented five continuous years of Current Account surpluses, between 2003 and 2007, reaching an unprecedented level of US\$ 14 billion in 2005 and 2006, corresponding to over 1.5% of GDP. This is all the more surprising when one would have expected that a developing economy is more likely to experience deficits in its Current Account, for the lack of enough domestic savings.

Between 2001 and 2009 net inflow of FDI in Brazil varied in the range of 1.7 – 4.0% of GDP. These two movements together have led to unprecedented negative financing requirements in all but one year between 2001 and 2009.

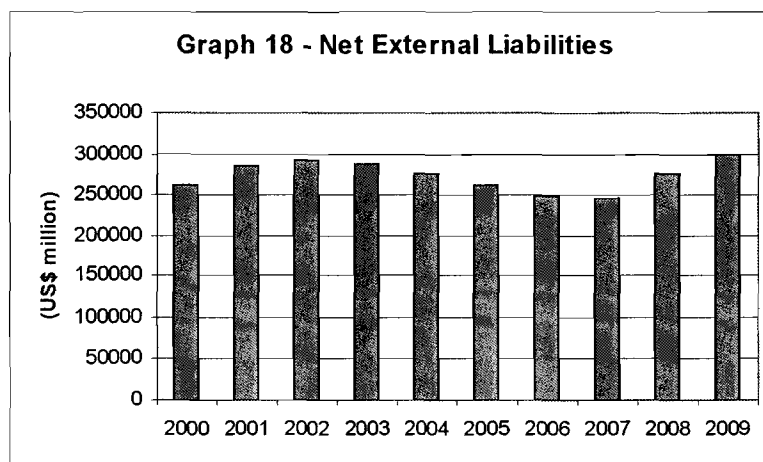


Source: Central Bank

Furthermore, the fact that net external debt became negative led to several manifestations stressing the fact that the country has become a net creditor in the international scenario. This was by and large due to the relatively stable value of total debt, from which to deduct an increasing amount of foreign currency reserves. This would indicate an increasingly comfortable position in the country's external accounts, and even more so when one takes into account the fact that the share of public external debt is quite low.

A rather different result comes out when one considers the amount of net external liabilities. There are two basic criteria to measure such indicator. One is to accumulate the Current Account deficits. Since Balance of Payments statistics are available since 1947, this would correspond to the accumulation of those deficits since then.

Graph 18 shows the results. There is a period of improvement between 2003 and 2007, when the amount of liabilities was systematically reduced, as expected on the basis of Graph 17, but a worrying upward trend in the last couple of years: the Current Account balance went down from US\$ 14 billion in 2006 to minus US\$ 28 billion in 2008, a US\$ 42 billion fall in only two years.



Source: Central Bank

An alternative criterion is divulged by the Central Bank in the 'International Position of Investments' that accompanies the Balance of Payment statistics. This measure computes all external assets and all external liabilities (comprising net FDI flows, net position in portfolio investment, external loans, fixed income bonds and commercial credits, minus reserves). It takes into account changes in the value of assets and liabilities, monetization via gold and variations in SDR positions.

This concept reflects not only the remuneration to loans, but also the return to risk capital. Hence, when there is a reduction in the external debt coupled to an increase in the inflow of FDI the net debt position of the country reduces, but not so its external liabilities, as this would correspond to lower payment of interest but to higher remittances to non-residents. This is why its values differ from the previous indicator.

According to this criterion the net external liabilities position of Brazil increased from US\$ 230 billion in 2002 to US\$ 588.9 billion in 2009, again indicating a worsening of the profile of the country's external position in absolute values, although not so in terms of total domestic production. Table 4 shows the relevant figures.

Table 4 – External Liabilities (% of GDP)		
	2001	2009
A - Foreign Direct Investment	22.0	25.4
B - Portfolio Investment	27.4	35.6
In stocks	6.7	23.8
In fixed income bonds	20.7	11.8
C – Commercial credits & loans	17.8	7.6
Total liabilities D = A + B + C	67.2	68.6
E – Brazilian Direct Investment abroad	9.0	9.9
F – Portfolio Investment	1.2	1.2
G – Other investment	2.7	5.2
H - Reserves	6.5	15.1
I – Total External Assets	19.3	31.4
J – Net External Liabilities	47.8	37.2

Source: figures for 2001 - Boletim SOBEET, Ano VII, No.55, julho/2008; for 2009 - Central Bank

According to Table 4 there has been in fact a reduction in net external liabilities in terms of GDP, from 47.8% to 37.2% between 2001 and 2009. It is worth noticing, however, the significant change in the participation of some items: the composition of both assets and liabilities has changed throughout the decade.

Among the components of external liabilities there has been a noticeable increase in the importance of the inflow of FDI but even more so an increase in the investment in stocks, with a corresponding loss of importance of loans and commercial credits. It is also remarkable that even with one of the highest real interest rates in the planet investment in fixed income was reduced as a proportion of GDP, from 21% to 12% between 2001 and 2009. The higher share of FDI and the increasing importance of investment in stocks imply a higher degree of pro-cyclicality in the inflow of resources. It is also an indication of the interest, by non-resident investors, in the Brazilian stock exchange, what has stimulated the entrance of new firms in that market at an unprecedented pace. Long-term financing of investment projects has changed of lately.

Among external assets it is worth noticing the increase of about one percentage point of GDP in Brazilian investment abroad, as previously discussed (section III). 'Other investment' almost doubled its relative importance, but most important than anything else is the impressive increase in the amount of foreign currency reserves, from 6.5% to 15% of GDP (second only to the variation in investment in stocks).

The picturing that figures in Tables 3 and 4 suggest is that of an economy with clearly improved indicators relative to external solvency, far more integrated in the international scenario via investment (both inflow and outflow of direct investment, as well as portfolio operations), hence less dependent upon loans and quite active in making profit out of this situation in order to build up its own 'self-insurance' via the accumulation of relatively large foreign currency reserves. Yet Graph 18

reminds us of a worrying situation in the worsening of the external equilibrium conditions in recent years.

V – Final Remarks

This article aimed at presenting the basic features of the Brazilian external sector in the first decade of the XXIst century. The overall picturing that comes out from the basic indicators is one of an economy that knew how to profit out of very favorable international circumstances, by improving its basic financial conditions with regard to indebtedness and the building up of self-insurance via actively increasing its foreign currency reserves. Little doubt remains that the administration of the financial side of the external sector was successful.

It has been helped also by the maintenance of a reliable macroeconomic environment (plus political stability) that has helped quite significantly to attract foreign investors, at the same time that it allowed the economy to 'flex its muscles' and promote the strengthening of domestic groups to compete in a better position both in the domestic market and abroad.

Nevertheless, this picturing gives margin to increasing concern in two directions. In the short-run, in view of the indications of a rapidly worsening condition in the Current Account: at the time of writing (early April) there is an increasing concern with regard to the forecasts for 2010, with most analysts, including the Central Bank, expecting a Current Account deficit insufficiently covered by the inflow of direct investment, a quite different scenario from the one described here for the 2000-2009 period.

A good deal of this deficit is related to a sharp reduction in the trade surplus. This leads to concern in the long-term, for the lack of structural policies to sustain the external equilibrium, by assuring competitiveness of exports.

Overall it can perhaps be said that most of the focus of the external sector policy has been concentrated on reducing the financial constraints. But it has been less active in promoting initiatives that might help to overcome the remaining difficulties and lack of stimulus to external trade, and this might turn into a high price to be paid in the medium-term, if it translates into less competitive production of exports and import-competing goods.

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