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BRAZIL BULLETIN INTERVIEW: Mailson da Nobrega, Partner Tendencias Consulting Group, former Finance Minister – "I'm optimistic about Brazil, but I'm more optimistic about the country than about the government." – Although Brazil is badly in need of structural reforms in order to become more competitive in global markets, the administration of President Dilma Rousseff may lack the political will to carry them out, according to former Finance Minister (1987-1990) Mailson da Nobrega. The former minister, and current partner in the Tendencias Consulting Group, shared his views in an interview. Excerpts follow:

- On Brazil's future: "I'm optimistic about Brazil, but I'm more optimistic about the country than about the government."
- On the reform agenda: "Brazil is badly in need of structural reforms in the areas of taxation, social security and labor legislation, but I'm doubtful about the political will of the new administration. There are powerful lobbies against fiscal reform, led by the state governors. Social security reform is blocked by powerful retiree lobbies and the unions are able to block labor reform."
- On the problem of public spending: "Public spending needs to be sustainable and, as it is, it's not sustainable. The minimum wage doubled in value, in real terms, during the Lula Administration. This is suicidal. Two-thirds of the benefits paid out by government programs are tied to the minimum wage."
- On challenges for the Rousseff Administration: "Reining in government spending is going to be one of the greatest challenges of the Rousseff Administration. She will need to confront powerful public employee unions and retirees. Some 90% of government spending is mandated by constitutional or legal provisions. Most of that, 70% of the total, goes to payroll and entitlements."
- On the secrets of tax reform: "The tax structure is one of the biggest sources of inefficiency in the Brazilian economy, worse than the infrastructure bottlenecks. At least, you can fix the infrastructure. The tax burden is 36% of GDP. That's about the same as Germany. But we don't have Germany's wealth to support that kind of tax burden. Only 15% of Brazilians pay income tax, so the burden of taxation falls on consumption taxes. We have six different taxes over consumption. Most countries have one."
- On demand and inflation: "Demand is overheated. We're consuming too much and the economy is growing at a pace faster than its potential. Government spending fuels this. The Central Bank needs to break this cycle with interest rate hikes."

Foreign trade surplus drops 20% in 2010 despite record exports. Brazil registered a foreign trade surplus in 2010 of $20.3 billion, down 20% from $25.3 billion in 2009, on soaring imports. Both imports and exports for the year were records, but exports rose only slightly from 2009 while imports rose sharply, the Trade and Development Ministry said last week. Exports were up less than 2% at $201.9 billion but imports rose 42% to $181.6 billion. Imports rose on heavy demand because of Brazil's booming economy. Gross domestic product rose by at least 7.0% in 2010, according to most economists. A strong Brazilian Real, meanwhile, made imports seem cheap to Brazilian consumers and businesses. Export revenues rose mainly because of higher international commodities prices. Brazil accounted for 1.3% of world trade in 2010, up slightly from 1.25% in 2009, the ministry said.

Change is in the air on oil, interest rates and social security as Cabinet takes office. Change was in the air as President Dilma Rousseff's Cabinet took office last week. Energy Minister Edison Lobão pledged to hold the first auctions of offshore oil blocks from the so-called pre-salt region by the end of the year. Science and Technology Minister Aloizio Mercadante promised to outline new rules for winners of overseas science scholarships designed to bring science scholars back to Brazil once they complete advanced degrees. Social Security Minister Garibaldi Alves made two frank admissions: first, that Brazil's social security deficit is getting out of control and, second, that broad legislation to deal with the problem is unlikely. Instead, he said the government will work to reduce fraudulent claims and dun businesses in arrears on social security taxes. Newly installed Communications Minister Paulo Bernardo said he will create a special department for "digital inclusion" as a way to make good on the government's promise to extend broadband Internet services to virtually the entire population by 2014. Finally, Central Bank President Alexandre Tombini hinted that he will seek a new set of inflation targets, lower than the current 4.5%. A lower inflation target, however, could lead to higher interest rates and would require greater fiscal austerity.

Inflation in 2010 reaches 5.91%, highest in seven years and well above target. Brazil's inflation rate reached 5.91% in 2010, the highest annual rate in seven years and well above the government's target for the year of 4.5%. Inflation in 2009 was only 4.31%. Monthly inflation for December declined slightly to 0.63% from 0.83% in November, but high food prices and rising costs in the services sector will mean continued inflation pressure in the first quarter of 2011, economists said. Brazil's 2011 inflation target is once again 4.5%. Economists said Central Bank interest rate hikes are almost inevitable. Brazil's Selic base interest rate is already a towering 10.75%.

Industrial output shows slight decline in November on competition from imports. Industrial production showed a slight decline of 0.1% in November against the previous month, the Brazilian Census Bureau (IBGE) reported last week. Output was up 5.3% against November of 2009. The IBGE said the pace of industrial production was declining because of increased competition from imports of manufactured products. Imports are looking cheaper and cheaper to Brazilian consumers and businesses because of a strong Brazilian Real. The Real has gained more than 30% against the U.S. dollar since 2009. Industrial output is also slowing because of buildup of inventors as Brazil's economy moderates the pace of its overall growth, the IBGE said.

Central Bank adopts reserve requirement for banks holding short-dollar positions. In an effort to contain further appreciation of the Brazilian Real against the U.S. dollar, the Central Bank last week announced a new reserve requirement rule for banks holding "short" positions in the American currency. Under the new rule, banks will be required to make compulsory deposits with the Central Bank equal to 60% of their short-dollar positions. The new rule takes effect April 4. Government economists said they expect many banks to close out their short-dollar positions by April 4 in order to avoid the new reserve requirement. Deposits made with the Central Bank under the new rule will receive no interest payments. "Short" dollar positions in the futures market are one of the main causes of pressure on the American currency, according to economists. The new rule should reduce pressure on the dollar by making it harder to "short sell" the American currency in the Brazilian market. Brazil's government has been anxious to halt the appreciation of the Real against the dollar, because the strong Real hurts exports. The Real has gained more than 30% against the U.S. dollar since 2009.

Investment News: Giant global mining company **Anglo-American** last week announced an increase in its investments at the signature Rio-Minas mine in Minas Gerais state. The company will boost investments in the transport and port logistics of the project by $525 million to a new total of $1.2 billion. Investments will be centered on the Acu Port facility in Rio de Janeiro. Rio-Minas is due to begin production of 26.5 million metric tons of iron ore in 2012.

Company News: Brazil posted a record volume of **mergers and acquisitions** in 2010 at $120.6 billion, a rise of 76% from 2009, according to a study last week by Thomson-Reuters. Mergers and acquisitions numbered 693 in 2010, up 38% from 2009. M&A activity was led by the energy industry, followed by telecommunications and commodities. Brazil was second only to China in M&A activity in 2010, the study said, reflecting the country's rapid economic expansion and prospects for sustainable growth.

Indicators: Brazilian **supermarket sales** dipped 5.2% in November from the previous month, while posting a bare 1.1% rise over November of 2009, the Brazilian Supermarket Association (Abras) said. Sales were disappointing because of a sharp rise in food prices. Food prices rose by some 5% during the three month period from September through November on heavy demand and shortages of some farm products. Supermarket sales for the period January-November were up 4.3% from the same period a year earlier, with the association maintaining its 2010 forecast of 4.5% overall growth.

Other News: Brazil's **foreign reserves** reached a record level of $288.6 billion at the end of 2010, up an astonishing 21% from 2009, the Central Bank said last week. Most of the growth came from direct Central Bank purchases of dollars from the market, mainly as part of a government effort to prevent continued appreciation of the Brazilian Real against the U.S. dollar. The Central Bank bought $41 billion from the market in 2010. The strong Real has hurt Brazil's exports. Reserves also showed astonishing growth during the eight years of the Lula Administration. At the end of 2002, reserves stood at only $37.7 billion.

Brazilian Calendar for Week of January 10:

- **Wednesday, January 12 -** Brazilian Census Bureau (IBGE) release of November retail sales data, Rio de Janeiro
- **Friday, January 14 -** First Cabinet meeting conducted by President Dilma Rousseff, Brasília

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R$1.68 = $1.00

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