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BRAZIL BULLETIN INTERVIEW: Rafael Cortez, Political Risk Analyst, Tendencias Consulting Group—"Inflation will be the central problem of the Rousseff administration." — The biggest challenge faced by Brazil's new president, Dilma Rousseff, will be inflation, according to political risk analyst Rafael Cortez of São Paulo's Tendencies consulting group. "How she handles inflation will go a long way toward determining her ability to handle other issues, including infrastructure investments and potentially unpopular reforms," said Cortez in an interview. Excerpts follow:

- On the shape of the Rousseff Cabinet: "Everything about Dilma's Cabinet choices spells continuity, both in the economic policy area and among line ministries. She is still somewhat in Lula's shadow. We could see a Cabinet shuffle in about a year or so. That would bring the administration closer to her profile."
- On the economic policy focus: "Inflation will be the central problem of the Rousseff administration. How she handles inflation will go a long way toward determining her ability to handle other issues, including infrastructure investments and potentially unpopular reforms. If inflation gets out of hand, there will be little scope for government investment and no room for maneuver within Congress. Inflation can compromise everything else—interest rates, government spending, economic growth and the administration's popularity."
- On tensions within the economic team: "Dilma has decided to maintain the tensions that existed within the economic team under Lula. Central Bank President Alexandre Tombini is wedded to inflation-targeting. He is one of the authors of the original inflation-targeting program. But Finance Minister Guido Mantega has made noises critical of inflation-targeting, suggesting that a different inflation index be used and that measures other than interest rate hikes can be employed to check the advance of prices. Lula was able to conciliate these conflicts and reduce tensions. The question is whether Dilma will be able to do the same."
- On Cabinet picks: "Some ministers are perhaps less than ideal when it comes to technical matters. But ministers are politicians, not technicians, and they're supposed to be politicians."
- On infrastructure investments: "When it comes to infrastructure investments, there are some things Brazil will *have* to do. That's where the impetus will come from. There will be *no* choice. The travel industry will pressure the government to get its act together. Things will come together in time to host the 2014 World Soccer Cup."

Mantega, Rousseff prove tough sell for Geithner on trade, currency issues. Although billed as the precursor to President Obama's visit to Brazil in March, U.S. Treasury Secretary Timothy Geithner this week focused more on immediate issues of trade and currency than on longer-range problems involving the business climate and investment. Geithner met with business leaders in São Paulo and then with Finance Minister Guido Mantega, Central Bank President Alexandre Tombini and President Dilma Rousseff in Brasília. Points covered included the following:

- **Bilateral Trade**. President Rousseff complained about the large U.S. trade surplus with Brazil, more than \$10 billion in 2009 and more than \$7 billion in 2010. Brazil holds the biggest deficit of any U.S. trading partner. Rousseff asked Geithner to find ways to allow more Brazilian manufactured products entry to U.S. markets.

- **Global Trade.** On global trade, there was more agreement, with both sides expressing a desire to kick start the Doha Round of World Trade Organization talks. In comments at the Getulio Vargas Foundation in São Paulo, Geithner said, “It is important for Brazil and the U.S. to help restart global trade talks. It would be easier for China, and others, to follow if Brazil and the U.S. were already going in that direction.”
- **On the “Currency War.”** Geithner was unable to extract a public statement from Brazilian officials on the need to pressure China on its over-valued currency. A united front on the China currency problem is, therefore, unlikely at the upcoming meeting of G-20 finance ministers in Paris. Brazilian officials, for their part, complained about the U.S. Federal Reserve Board’s policy of quantitative easing. Much of the money issued by the Fed under the policy ends up as unwanted short-term investment in Brazil. Geithner mollified Finance Minister Mantega by saying further quantitative easing is unlikely, given the current U.S. economic recovery.
- **On Commodities Prices.** Both sides found ample room for agreement regarding commodities. The French government recently floated the idea that some form of price cap is needed for agricultural commodities, which have risen sharply in price in recent months. Rousseff said, “Commodities prices are not responsible for any global economic imbalance.” Geithner said the U.S. supports “greater transparency” in commodities markets but no direct controls. “This is an issue on which Brazil and the U.S. can stand shoulder to shoulder,” he added.

Government announces R$50 billion in budget cuts to fight inflation. Finance Minister Guido Mantega and Planning Minister Miriam Belchior this week announced R$50 billion in 2011 budget cuts designed to meet ambitious surplus goals for the year while also fighting down inflation and high interest rates. The government will cut proposed spending from R$770 billion to R$720 billion. Infrastructure and social spending will be preserved, with all the cuts coming from operational expenses and a freeze on most new hiring. The government hopes to meet its primary budget surplus goal for the year, which is equal to 3.0% of gross domestic product. The spending cuts should also help pull inflation down from its current level of 5.99% while easing pressure for higher interest rates. Brazil’s Selic base rate is currently a sky high 11.25%.

Brazilian motor vehicle sales, output continue to beat year-ago performance. Although output and sales fell from the previous month, January auto industry performance was better than 2010, the National Motor Vehicle Manufacturers Association (Anfavea) said this week. Production hit 261,777 vehicles, up 6.4% from January, 2010 although down 9.1% from December. January domestic sales were 244,873 vehicles, up 14.8% from January, 2010 and down only 3.8% from December. Anfavea executives said a month-on-month decline in output and sales is typical of January, a vacation month in Brazil. They said January performance pointed the way to another record year for the industry in Brazil. The industry is benefitting from continued Brazilian economic expansion and readily available credit. Even exports did better this January than last year. January Brazilian motor vehicle exports totaled $886.3 million, down 17.2% from December but up a hefty 18.2% from January of 2010.

Fernandez: Brazil-U.S. relations have reached a “sweet spot.” A top U.S. official said during a visit to Brazil this week that bilateral relations have reached “a sweet spot” best symbolized by President Barack Obama’s decision to visit the country in March. “We are at a very important point in our relations,” said Deputy Assistant Secretary of State for Economic, Energy and Business Affairs Jose Fernandez. “We have what I would call a sweet spot. We have a new government in Brazil. We have our president coming here. We have a lot of opportunities and we believe now is the time to try to take advantage of those opportunities." Fernandez said U.S. companies were especially interested in "the stadiums, roads, power plants and electricity" Brazil will need for its current growth spurt as well as special infrastructure projects in the lead up to the 2014 World Soccer Cup and the 2016 Rio de Janeiro Olympics.

Investment News: Korea's **LG Electronics** this week said it will build a new plant in Brazil for the manufacture of liquid crystal display modules. The plant is one of three new overseas LG units. The company said the Brazil factory enjoyed "the highest priority" of the three. The display modules are a key component of flat-screen LCD television sets. The new plant will most likely be located in Manaus, because of tax advantages. LG did not release financial details of the investment.

Company News: President Dilma Rousseff this week named a new chief executive for state-run utilities holding company **Eletrobras**. He is experienced utilities executive and engineer Jose da Costa Carvalho Neto, who will replace outgoing President Jose Antonio Muniz Lopes. Carvalho Neto is currently president of private sector energy investor Arcadis Logos Energia. Arcadis specializes in thermal, hydroelectric and wind-power projects.

Indicators: Brazilian **IPCA consumer price inflation** rose in January to 0.83% from 0.63% as of December, according to the Brazilian Census Bureau (IBGE). Rising food and fuel prices contributed to the increase in the inflation rate, along with annual hikes in school tuition fees. Twelve-month inflation rose from 5.91% to 5.99% in January, well above the government's 2011 target of 4.5%. *** **Utilization of industrial capacity** rose again in December, this time to 82.8% from 82.6% as of November, the National Confederation of Industry (CNI) said this week. The increase in utilization of capacity signals continued heavy demand in the economy, a factor likely to pressure inflation and lead to monetary tightening. *** Brazilian **foreign reserves** topped the $300 billion mark for the first time this week, reaching $300.27 billion on continued purchases of dollars from the market by the Central Bank. Foreign reserves hit $200 billion for the first time in June, 2008.

Other News: The Brazilian **Mines and Energy Ministry** this week released its 20-year mining investment report, forecasting total investments in the industry of $350 billion through 2030. Investments in the first five years of the plan will total $65 billion, according to the report. Iron ore output will more than double in the next 20 years to one billion metric tons per year while production of other minerals, such as copper and nickel, will increase five-fold. About two-thirds of total investment will come from the private sector, the report predicted.

Brazilian Calendar for Week of February 14:

- **Tuesday, February 15 -** Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro
- **Thursday, February 17 -** Banco do Brasil release of 2010 earnings report, Brasília

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R$1.67 = $1.00