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BRAZIL BULLETIN INTERVIEW: Paulo Francini, Chief Economist, São Paulo Federation of Industries (Fiesp). –"There has to be a better way to fight inflation… than interest rate hikes."— Brazil faces major challenges in 2011 when it comes to growth, jobs and inflation but, so far, the government has chosen the wrong tools for confronting the nation's problems, according to Fiesp Chief Economist Paulo Francini. The long-time Fiesp executive recently met with specialized journalists to discuss prospects for 2011. Excerpts follow:

- On monetary policy: "There has to be a better way to fight inflation…than interest rate hikes. Raising interest rates is the equivalent of throwing a bomb into every downtown in every Brazilian city. High interest rates make all Brazilian businesses less competitive."
- On the threat of inflation: "I hate inflation. Inflation is the biggest factor contributing to social inequality. But we should be focused mainly on core inflation, not 'full' inflation. Core inflation removes the most volatile elements, food and energy prices, from the calculus. Then we can ask ourselves the question: is an interest rate hike going to pull down inflation? Is an interest rate hike going to make the rains stop falling? After all, it was heavy rain that damaged crops and led to food price rises last year. We have to act, but we have to make sure the medicine isn't worse than the disease."
- On 2011 uncertainties: "There are a lot of uncertainties hanging over 2011. There are a number of question marks: the foreign exchange rate, interest rates, international prices, domestic production versus imports. Our latest sounding of business confidence registers broadly 'neutral' sentiment, rather than the positive sentiment we had expected. We think this might have something to do with increasing competition from imports."
- On competition from imports: "In at least three industries, imports already account for more sales than domestic products. They are capital goods, electrical machinery and electronic goods. The appreciation of the Brazilian Real has created a kind of euphoria among consumers. But for Brazilian manufacturers it's more like a hangover."

Overseas accounts continue to deteriorate as current account gap widens. Brazil's current account deficit widened in January to $5.41 billion, from $3.5 billion in December, on rising imports, according to Central Bank figures last week. The 12-month current account deficit rose to $49.1 billion, or 2.35% of gross domestic product, from $47.5 billion, or 2.28% of GDP, as of December. Foreign direct investment fell in January to $2.96 billion from an extraordinary $15.4 billion in December. But FDI held its own for the 12 months through January, rising to a record $50.8 billion from $48.5 billion as of December. Recent months have seen rising outflows for everything from insurance and services to overseas travel and profit and dividend remittances. Economists are predicting a current account deficit in 2011 of $60 billion or more.

Primary budget surplus rises in January, but still behind target. Brazil's public sector rolled up an impressive primary budget surplus in January of R$17.75 billion, up from R$10.9 billion in December. Spending is typically heavy in the last month of the year due to special year-end payments. The 12-month primary budget surplus rose to R$103.4 billion, or 2.81% of gross domestic product, as of January. In December, the comparable 12-month figures were

R$101.7 billion and 2.79% of GDP. However, the government is still lagging behind its 2011 target for the primary surplus of R$118 billion. Primary figures do not include interest payments on debt. With such payments included, Brazil ran a 12-month nominal deficit in January of R$97.2 billion, or 2.64% of GDP. The nominal deficit could rise in 2011 on higher interest rates, according to economists. The Central Bank has already raised its Selic base rate a half percentage point to 11.25% as part of the government's anti-inflation drive. Inflation is 6.0%.

Brazil: WTO report includes finding against "zeroing" of anti-dumping charges. In a press release last week, the Brazilian Foreign Ministry outlined the main points of a World Trade Organization finding against the practice of so-called "zeroing" for purposes of calculating anti-dumping charges. The WTO panel report found that "zeroing" violates international trade rules. According to the Brazilian Foreign Ministry, the practice distorts calculation of the dumping margin, producing higher anti-dumping charges. Brazil brought the case to the WTO in relation to U.S. anti-dumping charges against Brazilian orange juice imports. The U.S. has 60 days to appeal the ruling.

Investment News: Mergers and acquisitions in Brazil rose 55% in 2010, by financial volume, to R$185 billion, according to final figures last week from the **Brazilian Association of Capital Market Institutions** (Anbima). There were 143 transactions, up from 95 in 2009. Anbima said 2011 will likely match or exceed 2010 in both volume and number of transactions. *** Executives of South Korean auto maker **Hyundai** laid the cornerstone last week on a $600 million assembly line in Piracicaba, São Paulo. The company's goal is to begin production in 2012, reaching full capacity of 150,000 vehicles per year in 2013. Hyundai will also continue imports of approximately 100,000 vehicles per year.

Company News: Brazilian aircraft manufacturer **Embraer** last week inaugurated its first assembly plant in the United States. The plant is located in Melbourne, Florida. It will assemble Phenom 100 private jets for the U.S. market and for export. Embraer invested $50 million in the site. The plant will be able to assemble up to 80 jets per year. *** After only eight months on the job, Denise Johnson last week announced her resignation as president of the Brazilian unit of **General Motors**. Johnson cited personal reasons for the decision. GM South America President Jaime Ardila will assume the Brazilian post on an interim basis. *** Brazilian mining giant **Vale** last week reported 2010 net profits at a record level of $17.26 billion, up roughly three-fold from the recession year of 2009. Profits rose on higher international iron ore prices and increased mineral ores production and export by Vale, the company said. *** State-run energy giant **Petrobras** last week posted its 2010 earnings report, showing a record profit of R$35.1 billion. Annual profits were up 17% from 2009. Profits rose on increased output and on rising international and domestic fuel prices, the company said.

Indicators: Brazilian **steel output** continued its advance in January, rising 3.8% year-on-year and a hefty 16.2% month-on-month to 2.8 million metric tons, the Brazilian Steel Institute (IABr) said last week. Domestic sales of 1.7 million tons were up 11.4% from December and 4.5% from January, 2010. Exports hit 1.1 million tons, down 1.0% from December but up a striking 60% from January, 2010 and reflecting an expected global economic recovery this year. *** Brazil's **unemployment rate** rose in January to 6.1% from 5.3% in December, the Brazilian Census Bureau (IBGE) said last week. The rise was due mainly to seasonal factors, with both retailers and manufacturers laying off workers after the Christmas season. Economists said Brazil's economy was still effectively operating at full employment level. Unemployment in January a year ago was 7.2%. *** **Consumer confidence** continued to improve in Brazil in February, rising to 122.6 points on the Getulio Vargas Foundation's ICC index from 121.6 in January. The index is based on a scale from 1 to 200, with 100 as neutral. Consumer confidence is rising because of continued job opportunities, rising salaries and abundant credit, according to foundation economists. *** **Tax revenues** reached R$91.1 billion in January, down 3.1% from December on seasonal factors, but up an astonishing 15.3%, in real terms, from January of 2010, the Brazilian Tax Authority said last week. Year-ago revenues were hurt by a sluggish economy and by government tax abatements designed to boost consumption. *** **Lending volume** continued its advance in January, rising 0.5% from December to R$1.715 trillion, or 46.5% of gross domestic product. Lending volume was up 20.3% from January of 2010. But average interest rates rose to 37.4% from 35.0% as of December, following a Central Bank hike to the Selic base rate. The Central Bank in January raised the Selic rate a half percentage point to 11.25%. The average default rate rose in January to 4.6% from 4.5% in December.

Other News: The administration of President Dilma Rousseff last week won an important victory when the Senate completed congressional action on a government bill to limit this year's **minimum salary** increase to only about 7%. Opposition lawmakers wanted to hike the minimum salary by as much as 17%. The bill, already passed by the Chamber of Deputies, now goes to the president for her signature. The legislation sets the monthly minimum salary at R$545. The administration argued that a higher level for the minimum salary would raise government spending levels and spark inflation.

Brazilian Calendar for Week of February 28:

- **Tuesday, March 1 -** Trade and Development Ministry release of monthly trade figures, Brasília
- **Tuesday, March 1 -** Seminar on Brazil's Economy: Challenges and Opportunities, Melia Jardim Europa Hotel, São Paulo
- **Wednesday, March 2 -** Brazilian Central Bank Monetary Policy Committee (Copom) meeting, Brasília
- **Wednesday, March 2** - Brazilian Census Bureau (IBGE) release of monthly industrial production figures, Rio de Janeiro
- **Thursday, March 3 -** Brazilian Census Bureau (IBGE) release of 2010 GDP figures, Rio de Janeiro
- **Friday, March 4 -** Brazilian Census Bureau (IBGE) release of monthly IPCA inflation data, Rio de Janeiro

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R$1.67 = $1.00