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BRAZIL BULLETIN INTERVIEW: Demosthenes Madureira Pinho Neto, Director of Asset Management, Banco Itau: "We need more government investment and less government spending." Brazil's economic growth in 2011 will decline from the heady heights of 7.5% in 2010, according to Demosthenes Madureira Pinho, a top executive at Brazil's largest private bank of Itau. Growth of only about 4.5% will make further investments in the economy imperative, but Brazil needs to take care that investments are productive and not speculative. Madureira Pinho spoke with investors and reporters at a recent conference in São Paulo. Excerpts follow:

- On Brazil and investment: "The biggest challenge for Brazil is investment. Over the last ten years, our average investment rate was only 16.4% of GDP. We need 23% for sustainable growth. The current investment rate of 19% is heartening. It's the highest rate in 15 years, but it's not high enough. I do believe, however, that we can reach 21% or 22% of GDP in the next few years because of infrastructure projects related to the 2014 World Soccer Cup and the 2016 Olympics."
- On investment and foreign inflows: "Much of our investment rate is due to foreign investment. We are becoming dependent on the current account deficit and that deficit is rising. We need to boost domestic savings, not foreign inflows. Brazil has a huge capacity to attract overseas investments. Companies are interested in direct investment in order to take part in Brazilian growth. But we are also attracting erratic, short-term inflows that merely take advantage of high interest rates. This is money that can leave the country at the first sign of a change in the international investment climate."
- On government spending: "Here's the problem—we need more government investment and less government spending. The persistent social security deficit, for example, is inhibiting the government's ability to invest in infrastructure projects. Deficits are also hurting our ability to invest in education. There is a correlation between education level and growth. Asian development has demonstrated this. We need to stimulate domestic savings, get control of the social security deficit and cut taxes in order to boost productive investments."
- On foreign exchange and interest rates: "Foreign exchange and monetary policy present a complex problem. As you raise interest rates you provoke an unwanted appreciation of the Brazilian Real. There is no solution to this problem without costs. It's more art than science."

Fitch raises Brazil's sovereign rating another notch to BBB, highest ever. Acknowledging Brazil's strong growth prospects and continued efforts at fiscal restraint, Fitch Ratings last week raised the country's sovereign bond rating one notch to BBB. The rating is now one notch above the minimum for investment grade and is the highest sovereign rating ever obtained by Brazil. Standard & Poors and Moody's Investors Service both rate Brazil at the investment grade minimum. Fitch noted that the transition to the new administration of President Dilma Rousseff has been "smooth" and that "the consensus on responsible macroeconomic policies remains well-anchored." Fitch noted the government's move earlier this year to cut nearly R$51 billion from the 2011 federal budget. Finance Minister Guido Mantega called the news "an acknowledgement that the Brazilian economy is increasingly stable and does not present risks." But he also noted that the increased inflow of dollars likely to follow in the wake of the rating upgrade “presents something of a problem.” Brazil’s government has been fighting to contain inflows of short-term investment money, which tend to appreciate the Brazilian Real and hurt exports.

Auto sales hit first quarter record but may slow later in the year: Anfavea. Brazilian motor vehicle sales rose to a record in the first quarter of 2011, hitting 825,161 for a gain of 4.7% over the same period a year ago, the National Motor Vehicle Manufacturers Association (Anfavea) said last week. But March sales dropped off 13.5% from the previous year on signs that credit availability may be dwindling. Brazil’s government has sought to restrict credit, with shorter terms and higher interest rates, as part of a drive to fight down inflation. Auto production for the first quarter of 2011 climbed 7.9% from 2010 to 902,148 but March showed a 6% decline from the same month a year ago. Exports were up a hefty 26% from the first quarter of 2010 at $3.3 billion, with March registering a gain of 14.5% to $1.16 billion, Anfavea said. But exports may fall off later in the year as the Brazilian Real continues to surge against the U.S. dollar.

Inflation hits 6.3%, threatens to break through inflation-target ceiling. Hurt by climbing food prices, Brazil registered a monthly inflation rate of 0.79% in March, down only slightly from 0.80% in February, the Brazilian Census Bureau (IBGE) said last week. Twelve-month inflation rose to an alarming 6.3% from 6.01% as of February. Economists noted that the 0.79% monthly rate, extrapolated over 12 months, would yield annual inflation of 9.9%. The 6.3% 12-month rate puts Brazilian authorities in an awkward position. The ceiling for Brazil’s inflation-targeting range this year is 6.5%. Many economists expect the official rate to top 6.5% by June or July. Hurt by flooding in some farm areas and drought in others, food prices rose in March by 0.75%. Finance Minister Guido Mantega said food prices will likely recede beginning in April or May as the annual grain and oilseeds harvest gets under way.

Investment News: Brazil’s government slapped more taxes on foreign inflows last week. This time the target was medium-term loans. The government announced a 6.0% **financial operations tax** (IOF) on loans carrying two-year terms or less. Previously, the tax was charged only on loans of 360 days or less. Finance Minister Guido Mantega said the new tax was part of a frank effort to reduce the appreciation of the Brazilian Real against the U.S. dollar. The strong real has hurt exporters and manufacturers.

Company News: As expected, majority shareholders in mining behemoth **Vale** last week formally replaced company President Roger Agnelli, 51, with their own nominee. The new CEO will be former Vale nickel and aluminum executive Murilo Ferreira, 58. Ferreira is expected to develop warmer relations with Brazil’s government and, heeding government entreaties, increase investments in domestic projects, especially in the area of steel.

Indicators: Crude **oil and natural gas output** rose 2.3% in February against the same month a year ago but showed a decline of 2.8% from January, because of maintenance on offshore platforms, the National Petroleum Authority (ANP) said last week. Total domestic output was 2.03 million barrels per day-equivalent. *** **Utilization of industrial capacity** rose in February to its highest level in three years, reaching 83.6%, the National Confederation of Industries (CNI) said last week. Utilization of capacity was 83.1% in January and 81.5% in February of 2010. The rise in utilization of industrial capacity could spell a worrisome trend, given increased pressures on inflation. Industrial sales rose in February by 6.9% over the previous month and a stunning 14.3% over February of 2010, the CNI noted.

Other News: Brazil will need to invest a total of R$70 billion in sewage-control and water supplies through 2015, according to a report last week by the **National Water Authority** (ANA). The greatest needs are in the populous Southeast and in the traditionally dry Northeast. *** Brazil's **National Ground Transportation Authority** (ANTT) last week ordered a second postponement in the auction of rights to build and operate a planned bullet train between São Paulo and Rio de Janeiro. The auction was originally scheduled for December but was postponed to April. Last week, ANTT put the auction off again, this time to July 29. ANTT said bidders asked for more time to prepare their offers, noting the high cost and complexity of the project. The train is expected to cost some R$34 billion. *** President Dilma Rousseff last week named Wagner Bittencourt de Oliveira as the first secretary of the new **Civil Aviation Department**. The department's task will be attracting private investors to projects including construction of new airports and new airport terminals. Oliveira previously served as a vice president of the National Development Bank (BNDES). *** Brazil's government last week hiked its **IOF financial operations tax on consumer credit** to 3.0% from the previous 1.5%. The new rate will be paid on virtually all forms of consumer credit. Finance Minister Guido Mantega said the measure was a frank effort to reduce consumer spending at a time of rising inflation. Brazilian inflation is currently running at 6.3% and is nearing the ceiling of the government's inflation-target range for the year. The range is 2.5% to 6.5%. Mantega said the tax hike was "temporary" and will be reduced as soon as inflation begins to recede.

Brazilian Calendar for Week of April 11:

- **Tuesday, April 12 -** Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro
- **Thursday, April 14 -** BRIC countries summit in China, with Brazil represented by President Dilma Rousseff

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R$1.58 = $1.00