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BRAZIL BULLETIN INTERVIEW: Alvaro Augusto Vidigal, President of Banco Paulista –“The (Lula) administration left the door wide open for inflation...and inflation walked right in.” Brazilian economic growth, a spectacular 7.5% in 2010, is heading for some major barriers, according to Banco Paulista President and former Brazilian Stock Exchange Chairman Alvaro Vidigal. Credit availability, a pillar of growth over the past decade, is quickly reaching a saturation point, while inflation has become a central problem for policy-makers. Brazil’s Selic base interest rate, at 12.0%, remains one of the highest in the world and threatens to choke off economic expansion. Vidigal commented on Brazil’s economy in an interview. Excerpts follow:

- On inflation: “Unfortunately, much of what President Lula accomplished in his first seven years as president was undone in his last year. By raising government spending in 2010 and putting off monetary tightening, the administration left the door wide open for inflation...and inflation walked right in. Inflation could hit 7.0% within the next few weeks. The government will have to keep raising interest rates in order to pull it down. Other measures, like tightening consumer credit, may also be necessary.”
- On the challenges for 2012: “In 2012, inflation could get even worse. Under the current formula, the minimum salary will jump sharply next year. (The formula combines 2010 economic growth and 2011 inflation.) That will pump up demand while, at the same time, undermining fiscal policy.”
- On credit expansion: “Brazil’s growth over the past few years was fueled by consumer credit, especially for the working class and the lower middle class. But credit expansion is reaching a saturation point. Consumer debt is on the rise and so is the default rate.”
- On government fiscal policy: “The government’s fiscal adjustment may have come too late to do any good. Meanwhile, while they cut spending R\$50 billion, with one hand, the Treasury loans the BNDES R\$55 billion, with the other.”
- On foreign exchange policy: “The government faces a dilemma. A strong Brazilian Real hurts exporters and manufacturers, so the government has an interest in trying to arrest the Real’s appreciation. But, at the same time, the government can’t allow the Real to depreciate because that would provoke inflation and inflation has become one of the central problems for policy makers at present.”

Petrobras posts record first-quarter earnings on higher prices, sales and output. State-run energy giant Petrobras last week posted its first-quarter earnings, showing a record for any first quarter of R\$10.99 billion. Earnings advanced 42% against the first quarter of 2010, the company said. A 29% rise in domestic oil-product prices was one reason for the hefty profits. Rising oil and gas production was another. Domestic sales rose 7%, by volume. Petrobras also gained on the financial side, with debt payments declining because of the strength of the Brazilian Real against the U.S. dollar. Most of the company’s debt is denominated in dollars. Petrobras invested R\$15.9 billion during the first quarter, more than 80% of it in oil and gas exploration and development. The company posted a \$656 million foreign trade deficit during the quarter as traditional gasoline exports turned into a series of one-off imports.

Utilization of industrial capacity declines, helping ease inflation worries. Utilization of industrial capacity slipped in March to 82.4% from 83.4% the previous month as Brazil’s economy showed signs of deceleration following torrid growth in 2010. The economy

expanded 7.5% last year but may only manage 4.0% in 2011. According to figures last week from the National Confederation of Industries (CNI), industrial sales in March fell 5.2% from February and 1.7% from March of 2010. Sales were down in 11 of 19 categories surveyed. The figures seemed to underpin hopes that inflation has now hit a peak and will begin to ebb. April 12-month inflation was 6.51%. Brazil's Central Bank has forecast year-end inflation of only 5.6%.

Capital market activity declines 5.2% for the first four months of the year. Brazilian capital market activity fell back 5.2% in the first four months of 2011 on worries about high interest rates and inflation, the Brazilian Capital Markets Association (Anbima) said last week. Total capital market activity, including both share and debt issuance, reached nearly R\$38.4 billion for the period January through April, down 5.2% from the first four months of 2010. High Brazilian interest rates are keeping investors away from stocks in preference to fixed-income investments. High rates also discourage companies from issuing bonds. Brazil's Selic base interest rate is a towering 12.0%. Share issued during the first four months of the year totaled R\$11.8 billion while bond issues were R\$26.5 billion.

Brazil-Argentina trade spat flares with latest Brazilian measures on motor vehicles. Brazil's government last week eliminated automatic licensing for motor vehicle imports. Manual licensing will mean delays of up to 60 days on most motor vehicle shipments, according to government and industry spokesmen. The move may have been the start of promised Brazilian retaliation against Argentina for similar Argentine restrictions on many Brazilian products. More than 50% of Brazilian motor vehicle imports come from Argentina. Argentine Trade and Industry Minister Deborah Giorgi criticized the Brazilian measure as a violation of informal agreements between the two governments reached in February. Brazilian Trade and Development Minister Fernando Pimentel countered by saying Argentina has not complied with its side of the February accords. Pimentel called for a new round of meetings between trade officials of the two countries.

Investment News: The **National Petroleum Authority (ANP)** last week approved the transfer of nine concession contracts from U.S.-based Devon Energy Corp. to BP. The contracts include some pre-salt blocks in the Campos Basin. The ANP had originally delayed approval after BP's huge Gulf of Mexico oil spill. *** The Brazilian unit of U.S. construction equipment company **Caterpillar** last week announced \$350 in new investments for 2011 and 2012. The company will expand its existing Piracicaba, São Paulo plant and build a new plant in Campo Largo, Parana.

Company News: The U.S. trustees of investors who lost money in the Bernard Madoff scandal announced last week that they have sued the New York branch of Brazilian bank **Safra**. "Safra New York knew or should have known of numerous irregularities concerning investing through (Bernard Madoff Investment Securities) given its background and its own investments with Madoff," the suit stated. Spokesmen for Safra declined comment. *** Latin America's largest bank, state-run **Banco do Brasil**, last week reported first quarter profits of R\$2.93 billion, up from R\$2.35 billion for the same quarter in 2010. Profits rose on expansion in credit portfolios, which advanced to R\$398 billion, up 21% from the previous year. Provisioning against bad loans, meanwhile, declined to R\$2.63 billion from R\$2.96 billion the previous year.

Indicators: Brazilian **retail sales** rose 1.2% in March from the previous month, mainly on seasonal factors, the Brazilian Census Bureau (IBGE) said last week. Year-on-year growth was

a modest 4.1%, indicating a possible slowdown in the pace of consumer demand. Month-on-month growth was led by motor vehicles, while the year-on-year figure was led by an 11% jump in sales of domestic appliances.

Other News: The National Power Authority (Aneel) last week set June 10 as the date for auction of concessions to some 430 kilometers of electric power **transmission lines** in the Northeast. The lines involve minimum investments estimated at R\$750 million. The concessions will be granted based on the lowest proposed fee. The concessions are located in Paraiba, Rio Grande do Norte, Bahia and Ceara. *** Brazil's Congress last week completed action on a government bill altering **personal credit** information and dissemination practices. The new rules will allow credit institutions to obtain complete credit records of their clients, although only with client permission. The bill will allow clients with clean credit records to obtain loans at lower interest rates than before. *** Brazil's Congress last week completed action on a bill that will triple Brazilian payments to Paraguay for electric power from the jointly owned **Itaipu** dam on the Parana River. Brazilian payments to its neighbor will rise three-fold to \$360 million per year. *** Brazil's **Civil Aviation Authority** (Anac) last week set the date for the country's first ever auction of a new airport concession. On July 19, the government will auction a 25-year concession for the proposed Sao Goncalo do Amarante Airport in Natal, Rio Grande do Norte. Bidding will start at R\$51.7 million. Concessions for new airports in Rio de Janeiro, São Paulo, Minas Gerais and Brasília are also in development.

Brazilian Calendar for Week of May 16:

- **Monday, May 16** - Chinese Trade Minister Chen Demin visits Brasília
- **Tuesday, May 17** - Swedish Premier Fredrik Reinfeldt visit to Brasília
- **Wednesday, May 18** - Annual Brazilian Capital Markets Association (Anbima) Congress on Investment Funds, Sheraton WTC Hotel, São Paulo
- **Friday, May 20** - Brazilian Census Bureau (IBGE) release of IPCA-15 mid-month inflation data, Brasília

R\$1.63 = \$1.00

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