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BRAZIL BULLETIN INTERVIEW: Ilan Goldfajn, Chief Economist for Banco Itau –“I don’t think there is a risk of de-industrialization.” Brazil’s economic growth will inevitably cool in 2011 as the government fights down inflation with monetary tightening and budget cuts. However, long-range prospects call for sustainable growth with little or no risk of so-called de-industrialization, according to Ilan Goldfajn, Chief Economist at Brazil’s biggest private bank of Itau. Goldfajn discussed the economy in a recent interview. Excerpts follow:

- On the Brazilian Real and the threat of de-industrialization: “The government is worried about the impact of the strong Real on imports and on the possibility of de-industrialization (crowding out of manufactured products on the domestic market by cheap imports). But I don’t think there is a risk of de-industrialization. The domestic market is too big for that. Rather, what’s happening is that the strong Real is hurting corporate margins. I think the Brazilian authorities will act to keep the Real within a narrow range. They will continue using the same mechanisms as before, including intervention in the spot, forward and futures markets.”
- On the current account deficit: “The growing current account deficit reflects Brazil’s need for foreign capital at a time when domestic savings are inadequate for the country’s development needs. The government takes capital out of the market in order to finance its debts. Private sector savings are not enough. We need investment money for infrastructure, development of sub-salt oil reserves, housing, the World Cup, the Olympics and much else.”
- On the trend for interest rates: “The trend for interest rates depends, to a certain extent, on the government’s fiscal policy. If the government cuts spending more, then interest rates can stabilize or even fall. A failure to change the policy mix will mean continued high interest rates. Brazil’s real interest rate is between 6% and 7%. The average real interest rate among emerging market countries is 3%. I used to think Brazil would take about five years to get to that point. Now, I think it may take more like 10 years.”
- On cooling of the Brazilian economy: “The economy will have to cool if Brazil is to win the fight against inflation. We expect economic growth this year of only about 3.5% to 3.6%. It could rise a bit in 2012, but not much, perhaps reaching 3.6%.”

Chinese Trade Minister pledges broad discussion of foreign exchange issue. Brazilian officials last week managed to do what officials elsewhere have failed at over the past three years—obtain a pledge from a high ranking Chinese official to review the

huge Asian country's controversial foreign exchange system. Chinese Trade Minister Chen Deming visited Brasília last week, meeting with top officials and business leaders. He headed a mission of 70. Following a parlay with Brazilian Trade and Development Minister Fernando Pimentel, Chen said China was prepared to review its largely inflexible foreign exchange rates "at the level of the Group of 20 nations" beginning in the second half of this year. Brazil and other countries have been critical of China for maintaining an artificial weak currency. The weak Yuan helps boost Chinese exports while making it difficult for countries like Brazil to sell to China, especially manufactured goods. Chen vowed to find ways "to increase Brazilian export of value-added goods" to China. In 2010, China replaced the United States as Brazil's biggest trading partner. Joint trade was \$60 billion, with a \$5 billion Brazilian surplus. Brazil earns billions from China through massive sales of mineral and agricultural commodities. Pimentel said joint trade will likely grow 20% this year. Chen said Chinese companies will likely invest some \$8 billion in Brazil in 2011, favoring segments such as energy transmission lines, motor vehicles, pharmaceuticals and infrastructure.

Tax revenues post another big gain; Brazil likely to meet 2011 fiscal target. Federal tax revenues in April rose 10.3%, in real terms, from April a year ago to R\$85.2 billion, the Federal Tax Authority said last week. Revenues rose, in part, because of the continued advance of economic activity and, in part, because of a low basis of comparison from 2010. Tax abatements for key industries were still in place during the first months of last year, reducing revenues. Tax revenues for the first four months of 2011 were up 11.5% at R\$311.4 billion. Brazil's goal for 2011 revenues is R\$730 billion, a figure likely to be met and exceeded, according to economists. The government's primary budget surplus goal for the year is R\$117.9 billion, also likely to be met and exceeded.

Court sentences two American pilots to community service in 2006 air crash case. A local Brazilian court last week sentenced two American pilots to four years and four months of community service for their role in a 2006 air crash over the Amazon jungle. Joseph Lapore and Jan Paladino were flying a Legacy executive jet when it clipped the wing of a Gol commercial aircraft. The Gol plane crashed, killing 154 people. The court found Lapore and Paladino guilty of negligence because the Legacy's transponder and collision avoidance systems were disconnected during the flight. The Legacy later landed in Manaus without incident. The pilots have denied any negligence and will appeal the decision. Later this month, the court is due to hear the case of air traffic controllers who are also accused of negligence in the case.

Investment News: Japan's **Sumitomo Rubber Industries** last week announced a \$345 million Brazilian investment. Sumitomo will build its first Latin American tire factory in Brazil, most likely in the southern state of Parana. The plant is set to open in 2016, manufacturing 15,000 tires per day. *** Brazilian steel giant **CSN** last week announced the purchase of cement and long-steel production assets held by Spain's Grupo Alfonso Gallardo. The properties are located in Spain and Germany. CSN will pay 543 million euros for the properties and will assume 403 million euros in debt. CSN said the deal will help the company expand into the European market for construction materials.

Company News: A group of four major banks, four pension funds and state-run oil giant Petrobras last week created a new special purpose company to build offshore oil drilling platforms. The company will be called **Sete Brasil SA** and will build seven huge offshore platforms, all of them for use by Petrobras and its partners in development of the so-called pre-salt offshore oil reserve. The first platform is due for delivery in 2015. *** The Brazilian subsidiary of **Honda** last week laid off 400 employees at its São Paulo assembly line due to lack of parts from Japan. Parts delivery has been hampered by poor production and transportation from Japan in the wake of that country's earthquake. Honda cut output in half at the plant to about 300 vehicles per day. Unions promised to protest the layoffs.

Indicators: Primary **aluminum production** continued to decline in April on closer of superannuated mines and smelters. Output was 118,400 metric tons, down 6.2% from April of 2010, according to the Brazilian Aluminum Association (Abal). Production for the first four months of the year was 473,100 tons, down 6.1%. *** Brazil fell six positions in this year's **World Competitiveness Yearbook** ranking, plunging to 44th place. Brazil is just ahead of Ukraine and just behind Peru. Rising costs, continued inefficiencies in government and infrastructure and an overvalued currency made Brazil less competitive in world trade than it was last year. *** Brazilian **domestic air traffic** rose 31.5% in April from the same month in 2010 as carriers continued to offer steep discounts to customers, the Civil Aviation Authority (Anac) said last week. Air traffic reached 6.68 billion passenger/kilometers with a seat occupancy rate of 73.4%, up from 64.4% in April of 2010.

Other News: Press reports last week took aim at huge gains in personal assets presented to tax authorities by Presidential Chief-of-Staff **Antonio Palocci**. The tax filings showed Palocci's personal estate rising from the equivalent of some \$250,000 in 2006 to \$4.5 million in 2010. Palocci said the rise in asset values came from work performed as a São Paulo business consultant. From 2007 through 2010, Palocci served as a member of Congress. In January, he joined the administration of President Dilma Rousseff as Chief-of-Staff.

Brazilian Calendar for Week of May 23:

- **Monday, May 23** - Internews seminar Dynamic Growth in Question, Hotel Intercontinental, São Paulo
- **Monday, May 23** - LIDE business leadership group seminar on The Challenge of Modernizing the Brazilian Judicial System, Grand Hyatt Hotel, São Paulo
- **Tuesday, May 24** - Brazilian Census Bureau (IBGE) release of monthly unemployment figures, Rio de Janeiro
- **Wednesday, May 25** - Brazilian Central Bank release of current account data, Brasília
- **Thursday, May 26** - IV Brazilian Infrastructure Seminar, Teatro Vivo, Morumbi, São Paulo
- **Thursday, May 26** - Seminar on Prospects for Brazilian Agribusiness, 2011 and 2012, Hotel Transamerica, São Paulo

- **Thursday, May 26** - Brazilian Central Bank release of data on lending volumes and interest spreads, Brasília

R\$1.61 = \$1.00

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