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BRAZIL BULLETIN INTERVIEW: Carlos Thadeu Gomes Filho, Vice President and Chief Economist of Franklin-Templeton of Brazil –“There is no danger of a current account crisis.” Despite rising worries about inflation and interest rates, Brazil will be able to post modest but sustainable growth in 2011 and 2012, on the order of about 4.0% per year, according to Carlos Thadeu Gomes Filho, Vice President and Chief Economist of the Brazilian unit of U.S. investment fund Franklin-Templeton. Gomes discussed Brazil’s economic and investment climate in an interview. Excerpts follow:

- On Brazilian stocks: “Stock prices in Brazil grew four-fold during the eight years of the Lula Administration. Investors were attracted by the fact that the economy was better structured and the currency more stable. The Central Bank gained credibility and inflation came down. In Brazil, it’s better to see the whole market, not just the Ibovespa index. Stocks linked to construction and retail as well as bank stocks have performed well.”
- On the rising current account deficit: “The current account deficit is rising and Brazil, at some point, will have to correct this. But there is no danger of a current account crisis. It’s easy to sell Brazil to foreign investors. There is low political risk, plenty of resources like energy, farm commodities and water. Brazil is credit worthy and has a healthy financial system. Also, the world is awash in liquidity. There is no danger of a current account crisis like that of the 1980s.”
- On interest rates and growth: “Brazil has proven that it can grow even with high interest rates. We had a base rate of 30% at the beginning of the Lula Administration and Brazil grew. It’s an aberration! But it happens!”
- On the trend for monetary policy: “Brazil will eventually be able to pull down interest rates to classic levels of 3% to 4% above inflation, but I think it will take about five years to get there.”
- On Brazilian inflation: “The rise in Brazilian inflation will bring back some old problems. For one thing, there will be an increase in demands for indexing of salaries, prices and benefits. We’re going to need a serious discussion of indexing in Brazil at some point.”

Current account deficit declines as foreign direct investment continues advance. Brazil’s current account deficit posted a respectable, but telling, decline this month while foreign direct investment showed an important advance. The April monthly deficit declined from the previous month to \$3.49 billion for a 12-month deficit of \$48.9 billion, equal to 2.25% of gross domestic product. The 12-month deficit as of March had been 2.33% of GDP. The deficit declined on an improved trade account and a falloff in profit and dividend remittances by multinational companies. Remittances fell to \$2.12 billion

from \$3.72 billion in March. Meanwhile, the 12-month deficit continues to be amply covered by foreign direct investment. The 12-month figure for foreign direct investment as of April was a hefty \$63.9 billion, up from \$60.4 billion as of March.

Standard and Poor's revises Brazil sovereign outlook to 'positive' from 'neutral.'

Brazil took a step toward another sovereign credit rating upgrade last week with a new report from Standard and Poor's. The report praised Brazil's economic growth record and current efforts to fight down inflation. The agency lifted its outlook for Brazil's economy and sovereign debt rating to 'positive' from 'neutral.' In practical terms, the move opens the door to a formal ratings upgrade, possibly before the end of the year. S&P currently rates Brazil at triple-B-minus, the lowest investment grade rating. The report said, "Brazil's diverse economic structure, expanding middle class and the potential for higher exports should sustain both GDP growth and external liquidity in the next three to five years."

Chamber of Deputies approves controversial forest code bill. The Chamber of Deputies last week approved a sweeping bill protecting forested areas, but with a controversial amendment offering amnesty to landowners who violated existing environmental legislation. The bill must still be approved by the Senate. The bill creates Permanent Protection Areas for the country's forests, wetlands and jungles. Areas around rivers, wetlands and hillsides, even on private property, will be protected from development. Most landowners in agricultural areas will be obliged to protect at least 20% of their holdings. Some may have to protect up to 80%. The lower house also approved an amendment offered a sweeping amnesty to violators of previous environmental laws. Proponents of the amendment said virtually all Brazilian farmers and ranchers are in violation of existing laws. President Dilma Rousseff expressed strong disagreement with the amnesty amendment, saying she will veto that portion of the legislation if it is retained by the Senate.

President offers strong defense of top aide, dodges congressional probe. President Dilma Rousseff last week offered her strongest defense to date of top aide Antonio Palocci, saying there was no administrative or judicial investigation into Palocci's financial affairs and no indication of wrong-doing. "The issue has become nothing more than a political football, which I find shameful," Rousseff told reporters. According to press reports, Palocci earned the equivalent of at least \$4.5 million from 2006 through 2010 as owner of a São Paulo consulting firm called Projeto. Palocci offered consulting services to some 20 clients during the period, including major banks and construction companies. He was also a member of Congress during those years and, in 2010, served as President Rousseff's campaign manager. Opposition leaders have called for an investigation of Palocci's activities as a consultant, saying there is reason to believe he was engaged in influence-peddling. However, efforts to form a special congressional committee to investigate Palocci were defeated last week in the Chamber of Deputies. Successful efforts to rally pro-government forces in Congress were led by former President Luiz Inacio Lula da Silva.

Investment News: Brazil's second largest private bank of **Bradesco** last week completed the purchase of a 96% stake in the former state bank of Rio de Janeiro (BERJ). Bradesco paid R\$1.03 billion for the stake, beating out rivals Banco do Brasil and Itau.

Company News: Workers at the two Brazilian factories owned by the local subsidiary of U.S. car giant **General Motors** reached agreement with management last week on a profit-sharing plan. The deal avoided a strike at the two plants. Workers will receive a lump sum payment equal to slightly more than \$8,000 a piece. Brazil's GM units produce some 650,000 motor vehicles per year.

Indicators: Brazilian **crude steel output** rose by a robust 10.4% in April, year-on-year, to 2.9 million metric tons, the Brazilian Steel Institute (IABr) said last week. Production increased mainly due to a decline in imports, which slumped 48% from April 2010 to 261,200 tons. Exports were up 10% at 857,100 tons in April. Four-month output was 11.5 million tons, up 7.5% from the same period in 2010. *** Brazilian **supermarket sales** put in a bravura performance in April, rising 13.6% against the same month a year ago and 7.2% against March, the Brazilian Supermarket Association (Abrasa) said last week. Sales were up on higher food prices, the Easter long weekend and rising employment and salaries. *** The Getulio Vargas Foundation's **Consumer Confidence Index (ICC)** declined in May for the third month in a row. Nevertheless, the index was still strong at 115.4 points, although down from 118.2 in April. The index is based on a scale of 1 to 200, with 100 as 'neutral.' Economists said the index was down in May because of rising inflation, higher interest rates and curbs on consumer credit. *** Brazil's **unemployment rate** fell slightly in April to 6.4% from 6.5% in March, as the nation's economy maintained modest growth based on expanding credit and consumption, the Brazilian Census Bureau (IBGE) said last week. Unemployment in April of 2010 was 7.3%. *** **Mergers and acquisitions** declined in the first quarter to R\$32.7 billion from an historic high of R\$52.7 billion for the same quarter the year before, the Brazilian Capital Markets Association (Anbima) said last week. M&A activity was down mainly because of a slowdown in economic growth. There were 24 mergers or acquisitions in the first quarter of 2011, down from 35 for the same quarter of 2010.

Other News: Brazil's government last week reinstated a 1% **financial operations tax (IOF)** on most short-term investment instruments. The tax had been suspended since January. The main purpose of the reinstatement was to encourage investors to seek longer-term investments. The government also made it easier for businesses and consumers, including credit-card holders, to renegotiate past-due debts. Under the new rules, back taxes will not be charged automatically on past-due debts. Rather, past-due taxes can be renegotiated along with other elements of consumer or business debts that are in arrears.

Brazilian Calendar for Week of May 30:

- **Monday, May 30** - French Finance Minister, and candidate for IMF director-general, Christine Lagarde visits Brasília
- **Tuesday, May 31** - World Bank President Robert Zoellick begins four-day Brazil visit (São Paulo, Brasília, Rio de Janeiro, and Recife)
- **Tuesday, May 31** - Brazilian Census Bureau (IBGE) release of monthly industrial production figures, Rio de Janeiro
- **Tuesday, May 31** - Brazilian Central Bank release of monthly primary budget surplus data, Brasília
- **Tuesday, May 31** - C40 Large Cities Climate Summit, WTC Convention Center, São Paulo
- **Wednesday, June 1** - Mexican Central Bank President, and candidate for IMF director-general, Agustin Carstens visits Brasília
- **Wednesday, June 1** - Annual Brazilian Steel Congress, Transamerica Expo Center, São Paulo
- **Wednesday, June 1** - Trade and Development Ministry release of monthly foreign trade figures, Brasília
- **Friday, June 3** - Brazilian Census Bureau (IBGE) release of first-quarter GDP figures, Rio de Janeiro

R\$1.60 = \$1.00

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