Brazil Bulletin

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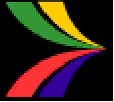

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BRAZIL BULLETIN INTERVIEW: Yoshiaki Nakano, Chairman Economics Department of the Getulio Vargas Foundation –"President Rousseff has said Brazil will fight inflation without giving up growth. But can we really do that?" Brazil's government is gradually introducing distortions into the traditional tripod of economic policies—inflation-targeting, fiscal responsibility and the floating-rate foreign exchange market, according to leading economist Yoshiaki Nakano, Chairman of the Getulio Vargas Foundation Economics Department. The sleight of hand will make it harder for Brazil to meet the government's stated goal of reducing inflation without sacrificing growth. Nakano recently spoke with investors and reporters at a São Paulo seminar. Excerpts follow:

- On government economic policies: "Inflation-targeting now includes not only monetary policy but also so-called macro-prudential measures, such as higher taxes on consumer loans. The floating-rate foreign exchange system is accompanied by its own set of IOF (financial operations) taxes, not to raise revenue but to regulate the market. When it comes to fiscal responsibility, we find that the primary budget surplus no longer includes capital spending."
- On growth and inflation: "President Rousseff has said Brazil will fight inflation without giving up growth. But can we really do that? If you hike interest rates, you will reduce growth. You also bring in a flood of investment dollars, which causes your currency to appreciate. That phenomenon is causing de-industrialization."
- On growth and capital markets: "To promote growth, we need an active capital market, but capital market development is blocked by the crowding out factor represented by government bonds indexed to inflation or to the base rate. We are the only country in the world with a substantial portion of debt indexed in this way. Indexing makes it almost impossible to create a market for private bonds. There is always competition from low-risk, high-yield government paper. The Selic base rate is the floor for interest rates in Brazil."
- On Brazil's investment rate: "We need to reach an investment rate equal to at least 23% of GDP. But last year's rate was only 18.5%. Where does the additional 4.5% come from? Do we get it from government? The government is cutting spending, not raising it. Do we get it from the capital market? What capital market? We could get it from increased foreign loans. But to get to 23% of GDP for investment we would need to take on so much foreign debt that our current account deficit would balloon from 2.2% of GDP to 7.0%, which is not sustainable."

Central Bank expands reserve requirement rule on futures trading. The Brazilian Central Bank last week expanded existing reserve requirement rules for banks holding short-dollar positions in the foreign exchange futures market. Under the new rule, banks must deposit the equivalent of 60% of any short-dollar positions exceeding a base line volume of $1 billion. The banks were given only one week to comply with the order. The government first imposed a reserve requirement on short-dollar positions in January, but the base line volume was $3 billion and bank shad 90 days to comply. The frank purpose of the new rule is to reduce pressure from banks to appreciate the Brazilian Real against the U.S. dollar. Heavy short positions in the dollar among Brazilian banks often become "a self-fulfilling prophecy" because of the banks' huge fire power in the Brazilian futures market. Economists said the measure was likely to cut short-dollar positions by the equivalent of about $5 billion. Short-dollar positions held by banks as of the end of June were nearly $15 billion.

Bidders back away from high-speed train auction; government changes rules. The deadline for receiving bids to build and operate a high-speed train between São Paulo and Rio de Janeiro came and went last week without a single bidder coming forward with either a consortium or a proposal. Four potential bidders had expressed interest in participating in a government-sponsored auction of rights to the train route, but all four told officials they were dismayed by potential costs and discouraged by highly specific government-set criteria for the project. In the wake of the failed auction, the government announced new rules for the R$35 billion project. Under the new plan, the fast-train project will be auctioned in two parts—one concession to build the train line and a second concession to operate it. An auction for the first concession will be held later this year, with the second concession to be sold in 2012, according to the government's Ground Transport Authority (ANTT).

Gol airlines buys small rival WebJet for $61.5 million for market share and slots. Brazil's number two airline, Gol, last week announced the purchase of small rival WebJet for the equivalent of $61.5 million. The purchase must still be approved by Gol shareholders and government regulatory authorities. The purchase could make Gol number one in Brazil's domestic market. Currently, top carrier Tam holds a 42% share, followed by Gol at 38%. WebJet has a 5.4% market share, according to the Civil Aviation Authority (Anac). Gol bought out the privately held WebJet in part to increase market share but also to obtain WebJet's arrival and departure slots at key airports, market analysts said.

Council on Foreign Relations report calls for "more mature" U.S.-Brazil relations. A report last week by the U.S. Council on Foreign Relations called for a more productive and mature relationship between Brazil and the U.S. The report was prepared for the Council by 30 experts from a number of fields. The authors said the U.S. should give its formal support for Brazil's candidacy to the United Nations Security Council. The report recommended dropping visa requirements for Brazilians traveling to the U.S. Such a move would automatically result in dropping reciprocal requirements for U.S. citizens visiting Brazil. The report also recommended ending the U.S. tariff on imported ethanol,

a long-time bone of contention between the two countries. Brazilian Foreign Minister Antonio Patriota called the report "a constructive contribution toward improved relations."

Investment News: German manufacturer **Siemens** announced $600 million in investments in its Brazilian unit through 2016. The investment package includes a $50 million Rio de Janeiro-based research and development center linked to the Federal University. New manufacturing initiatives will focus on equipment for oil and gas, mining and ethanol industries, the company said. *** Korea's **Hyundai Heavy Industries** announced last week that it will invest $150 million in a new Brazilian equipment plant. The plant will begin operations in late 2012 and will manufacture equipment used in heavy construction. The company expects a boom in construction ahead of the World Soccer Cup, which Brazil hosts in 2014, and the 2016 Rio de Janeiro Olympics.

Company News: Shareholders in Brazil's leading supermarket chain, **Pao de Acucar**, last week backed away from a planned merger with the Brazilian assets of French retailer **Carrefour**. Owners of Pao de Acucar's French partner, **Casino**, effectively vetoed the deal by saying it would not add shareholder value. *** The Brazilian Anti-Trust Board (CADE) last week approved the merger of meatpackers Sadia and Perdigao. The 2009 merger resulted in creation of **BRF Foods**, Brazil's largest food packaging company. But CADE imposed some restrictions on the deal, forcing BRF to drop use of the Perdigao brand name while also obliging the company to sell off many of its food processing units.

Indicators: Brazilian f**oreign reserves** rose $2.76 billion in June to $335.8 billion, the Central Bank said last week. Reserves have been growing because of consistent daily purchases of dollars from the market. Reserves have risen $47.3 billion since the beginning of the year. *** Brazilian **retail sales** continued to post robust gains in May, rising 0.6% from April and 6.2% from May of 2010, the Brazilian Census Bureau (IBGE) said last week. Retail sales rose on continued easy credit terms and rising employment. But continued expansion in consumer demand may also be underpinning inflation, economists said. Brazil's 12-month inflation rate is currently running at a worrisome 6.7%. *** São Paulo and Rio de Janeiro are now officially the most expensive cities in the Western Hemisphere. According to this year's **Mercer Consulting** survey, São Paulo is the tenth most expensive city in the world, up from 21st place last year, and the most expensive city in the Americas. Rio de Janeiro is 12th in the world, up from 29th a year ago, and the second most expensive in the Americas. A combination of consumer-price inflation, rising real estate costs and a sharp appreciation of the Brazilian Real against the U.S. dollar have conspired to make the cost-of-living extremely high in Brazil's two biggest cities.

Other News: Brazilian President Dilma Rousseff last week officially named Paulo Passos as the new **Transportation Minister**. Passos replaces Alfredo Nascimento, who resigned last week in a scandal over kickbacks and influence-peddling. Passos had been the ministry's second in command. In assuming the office, Passos said he will review procedures for contract bidding in efforts to avoid future scandals.

Brazilian Calendar for Week of July 18:

- **Monday, July 18** - 66th Annual Brazilian Minerals and Metals Congress, Frei Caneca Convention Center, São Paulo
- **Tuesday, July 19 -** Brazilian Census Bureau (IBGE) release of monthly unemployment figures, Rio de Janeiro
- **Wednesday, July 20 -** Brazilian Central Bank Monetary Policy meeting, Brasília

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R$1.57 = $1.00

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