

Economic

Credit Ratings:

Moody's: Ba1
 S&P: BBB-
 Fitch: BBB-

Nominal GDP (2009 e)

USD 1,500 billion

Population (2009 e):

194.4 million

Total Trade / GDP:

20%

Currency:

Brazilian real

Exchange regime:

Free floating

Merchandise imports from Canada (2009 e):

CAD 1.5 bn

Main sources of Foreign Exchange (excl. FDI):

Transport equipment

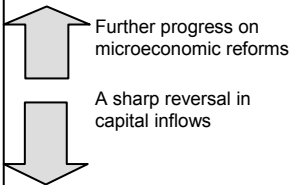
Largest Merchandise Trading Partner

United States
 Argentina

Main imports:

M&E (26%)
 Chemicals (16%)

Risks to the Outlook:



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Market Spotlight: The economy went out of a short recession in 2009 Q2 and is expected to rebound this year. ■ Both equity market and the currency are already showing signs of recovery. ■ The Central Bank is expected to hold rates at least for the first half of 2010 and then start tightening measures. ■ As a host of FIFA WORLD Cup (2014) and The Olympic Games (2016), Brazil is expected to invest massively in new infrastructure starting this year.

Real Sector: The economy went out of a very short lived recession that lasted only two quarters. GDP expanded 1.3% q/q/y in Q3 2009. Nevertheless, EDC Economics expects GDP ended 2009 showing a small contraction (-0.5% y/y). GDP will rebound in 2010 (+5.0%), mainly fuelled by domestic consumption and private and public investment.

Monetary: Responsible economic management and increasing monetary policy independence lead us to believe that inflation will remain within the Central Bank's target band (4.5%, +-2) over the next two years. Last year, the CB's priorities changed from bringing inflation towards target to ensuring liquidity in the domestic market. With that in mind, the CB injected money and eased rates aggressively bringing down the *Selic* to historic lows (8.75%). As the economy picks up speed, the focus will shift back to inflation control. The CB is expected to hold rates for the first half year and then start a tightening stance. The *real* is anticipated to settle around R\$1.6/USD by the end of 2010.

External Sector: The Lula administration has used the last few years of solid global demand, surging commodity prices and elevated liquidity to lower external indebtedness, smooth its debt maturity profile, and improve currency and interest rate dynamics. Massive capital inflows have allowed foreign exchange reserves to grow to around USD 236.1bn (equivalent to more than a year worth of imports) and Brazil has become a net international creditor for the first time in its history. On the downside, the Current Account deficit has been growing very rapidly and is expected to remain in negative territory this year as well. We estimate the CA deficit will amount to around 2% of GDP this year, but it will continue to be comfortably covered by FDI.

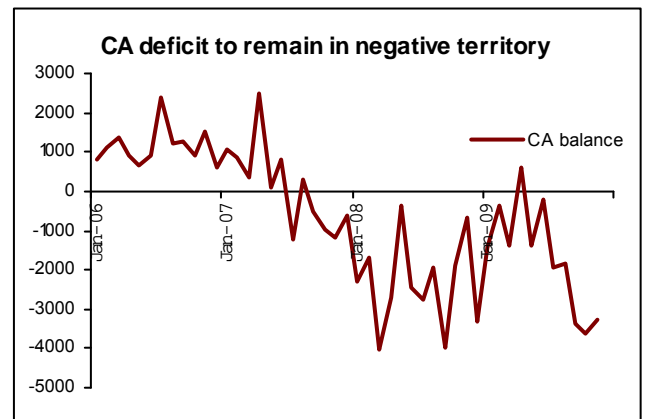
Fiscal: The 2010 budget includes a 10.7% y/y increase in primary spending (mostly PAÇ, minimum wages and the extension of tax breaks). Such increase was based on the assumption that GDP will grow 5% y/y and the primary surplus will reach 3.3% of GDP this year. The latest measures announced by the government to re-candle the economy have been a six month extension of the tax breaks on consumer and capital goods introduced last year, as well as the injection of USD 45 bn in fresh funds into BNDES. Public debt remains at high levels in comparison with other investment grade countries. Nevertheless, net public debt/GDP continues to shrink, standing at an estimated 40.4% in 2009 vs. 58% only 6 years ago.

Outlook: The outlook for the Brazilian economy is positive. Over the short-term, downside risks are associated with a rapid deterioration in the current account balance that may leave the country more exposed to adverse financial conditions. In the medium-term, both private and public consumption will continue to grow faster than GDP, posing pressures on domestic production capacity. More investment will be needed to keep up with increasing domestic demand. In addition, with the goal of ensuring that the country will grow at potential rates and not fall behind, some structural reforms need to be addressed. The FIFA World Cup and the Olympics will offer excellent opportunities for exporting and investing in Brazil over the next 5-7 years.

Economic Indicators

	03-07 avg.	2008	2009	2010
GDP (% growth, real)	3.9	5.1	-0.5	5.0
Inflation (% change, eop)	7.1	5.7	4.5	5.0
Fiscal Balance (% of GDP)	-3.0	-1.5	-2.0	-2.0
Exports (% growth)	21.6	23.2	-25.4	8.3
Imports (% growth)	20.6	43.5	-25.7	10.7
Current Account (% of GDP)	1.1	-1.8	-1.8	-2.0
Reserves (month of imports)	7.1	8.4	12.5	11.4
External Debt (% of GDP)	26.3	14.7	16.2	15.6
Debt Service/Current Account	42.7	19.9	23.2	20.6
Exchange rate (eop)	2.4	2.3	1.7	1.6

Source: EIU, EDC Economics



Source: HAVER

General Political Environment:

Brazilian politics are characterized by a fractiousness that mirrors the country's diverse socio-economic make-up. Relations are generally difficult between the executive and the legislature, as well as between federal and state governments. In addition, a tradition of switching parties has made party politics and political strength in Congress fluid. In 2007 the Supreme Court barred members of Congress from party-hopping; this will likely forge stronger party loyalty over time.

For now political progress requires constant horse-trading that slows the passage of reforms, including those widely considered necessary to maintain fiscal sustainability and to accelerate growth to a level that will move Brazil forward. A difficult balancing between promoting business and making progress on social issues undermines the government's ability to meet expectations on all fronts.

Populist president Luiz Inácio Lula da Silva (Lula) won a second term in October 2006 and has fashioned an 11-party PT-led coalition. The coalition depends on the support of the PMDB, the centrist party that won the most seats in both houses in the 2006 elections. Lula's greatest challenge for 2009 and 2010 will be to construct an electoral coalition out of the current government in preparation for elections in October 2010. He will seek to ensure that Brazil's next President is also from the PT and committed to his policies. He has chosen to back a solid PT performer, Dilma Roussef, for the presidential elections and will need to ensure that his party is solidly behind her candidacy. She is currently significantly behind her strongest competitor.

Lula's task is made more difficult by the economic crisis and his administration's priority is tackling the negative effects of the global economic slowdown, including a slowing of important flows of FDI and rising unemployment rates. Lula's administration is focussing on its expansionary "growth acceleration" programme of public investment (*Programa de Aceleração do Crescimento*, or PAC).

Although Brazil's ratings for control of corruption (see sidebar) are improving, corruption is an ongoing concern. It is more visible now than in the past because of increased transparency and willingness to prosecute. Lula has skilfully remained at arm's length of the various corruption scandals that have touched many of his close allies as well as his PT party.

Investment Environment:

Lula is a poster child for the moderate left in Latin America, promoting policies that strengthen the investment environment. This said, Lula advocates for both government participation in the economy and respect for investors' contractual rights; he actively promotes public-private partnerships, not privatizations, to attract private capital. This approach functions as a moderate disincentive to investment. The government is finalizing the regulatory framework for oil investments, and is adopting a model with a high level of government participation in exploiting significant new reserves.

Despite significant progress in the liberalization of the foreign exchange regime, important residual controls remain. Foreign currency bank accounts (such as in USD) are not permitted in Brazil. Regulatory agencies are weak and the bureaucracy is cumbersome. According to the World Bank's 2010 *Doing Business* survey, procedural requirements to start a business in Brazil take 120 days against a regional average of 45.5 days. The judicial system is generally regarded as fair, but is considered slow and complex.

Political Violence:

The main source of violence in Brazil is criminal rather than political. Personal security is poor as there is an extremely high rate of criminal activity in major cities, where 25% of the population is believed to live in *favelas* or shantytowns. Although Lula's social policies have helped to reduce inequalities in Brazil, significant work must be done to improve conditions.

An imbalance in land distribution leads to episodic violence in rural areas, specifically in the Amazon. Land invasions are common and mostly affect the agriculture sector, although the scope of land so targeted is broadening. Protests by groups of landless individuals known as the Landless Workers' Movement (MST) have become more prevalent of late.

Political

Political Structure

Federal Republic; currently ruled by coalition

President

Luiz Inácio Lula da Silva

Vice President

José Alencar

Legislative Bodies

- Federal: Chamber of Deputies (513 seats), Senate (81 seats)
- States: Unicameral legislatures in each state (26) and Federal District

Major Parties (seats in Chamber of Deputies/ Senate)

- Partido dos Trabalhadores - PT (80/12)
- Partido do Movimento Democrático Brasileiro - PMDB (92/18)
- Partido da Social Democracia Brasileira - PSDB (56/12)
- Democrats (DEM (exPFL)(58/13)
- Others (187 seats)

Last Elections

- Presidential and Legislative: October 2006

Next Elections

- Presidential and Legislative: October 2010

Press Freedom Survey:

- 2009 Score: 42 (Partly Free) (0: Free; 100: Not Free)

freedomhouse.org

Control of Corruption Index:

- 2008 Score: -0.03 (-2.5: Worst; +2.5: Best)

worldbank.org

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Political Outlook

A mix of moderate nationalism and neo-liberal economic policies will likely continue to underpin Lula's policy program, striking a balance between the interests of the country's various stakeholders. However, for the foreseeable future the administration's energies are expected to be directed to the management of oil policy and the 2010 elections. On the international front, Lula will pursue his diplomatic campaign to promote Brazil as the region's leader and a key player on the world stage.