

## Economic

### Credit Ratings:

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

### Nominal GDP (2009)

USD 1,543.7 billion

### Population (2009):

194.4 million

### Total Trade / GDP:

20%

### Currency:

Brazilian real

### Exchange regime:

Free floating

### Merchandise imports from

#### Canada (2009):

CAD 1.4 bn

### Main sources of Foreign

#### Exchange (excl. FDI):

Transport equipment

### Largest Merchandise

#### Trading Partner

China  
United States

### Main imports:

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

### Risks to the Outlook:

Further progress  
on microeconomic  
reforms



A sharp reversal in  
capital inflows or  
asset bubbles  
formation

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**MARKET SPOTLIGHT:** GDP expanded 9% y/y in 2010 Q1. ■ As host of FIFA WORLD Cup (2014) and The Olympic Games (2016), Brazil is expected to invest massively in new infrastructure starting this year. ■ The Current Account deficit is expected to widen in 2010.

**Real Sector:** The economy emerged un-scratched from a brief 2-quarter recession. GDP expanded 9% y/y in Q1 2010 as domestic consumption and investment fuelled growth. GDP is expected to grow 7% in 2010 and 5.4% in 2011. Employment market data, as well as industrial and economic activity indicators are showing strong signs of recovery.

**Monetary:** Inflation has started to come down once again (4.8% y/y) in July but is still above the CB target rate (4%). EDC Economics considers it likely that the Central Bank will continue with rate hikes in the near future. The CB has already started to withdraw some of its monetary stimulus by increasing banks' reserve requirements to almost pre-crisis levels as well as increased the Selic by 200 bps since April to 10.75%. Credit growth is expanding very rapidly and the CB estimates that financial credit will be equivalent to 48% of GDP by the end of the year. Responsible economic management and growing 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. The *real* is anticipated to settle around R\$1.8/USD by the end of 2010.

**External Sector:** The Lula administration has used the last few years of solid global demand 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 257.7bn (equivalent to more than a year worth of imports). On the downside, the CA deficit will amount to around 3.5% of GDP this year, and although FDI may not be sufficient to cover the deficit; EDC Economics does anticipate any financing problems over the forecast horizon.

**Fiscal:** Although the government has managed to respect primary surplus targets and despite recently announcing cuts in spending for the 2010 budget, the lack of spending restraint in the recent past has meant a continuous increase in the tax burden, general budget deficits and a deteriorating public debt to GDP ratio over the last couple of years. In fact, gross public debt (around 63% of GDP in 2009) remains at high levels in comparison with other investment grade countries. In addition, at around 10% of GDP, Brazil's public sector financing needs (government deficits and amortizations) are high by regional standards; however, the solid domestic market will likely be able to absorb most of the burden.

The second phase of the PAC has been approved and the government has expanded its projections for spending in infrastructure and social developments to USD 886bn between 2011 and 2014.

**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 leave the country more exposed to adverse financial conditions. The government also needs to prevent the formation of asset bubbles in the economy. In the medium-term, both private and public consumption will continue to grow faster than GDP, posing pressures on domestic production capacity and prices. More investment will be needed to keep up with increasing domestic demand. Some structural reforms need to be undertaken to ensure sustainable growth and improve fiscal accounts. The FIFA World Cup and the Olympics will offer excellent opportunities for exporters and investors in Brazil over the next 5-7 years.

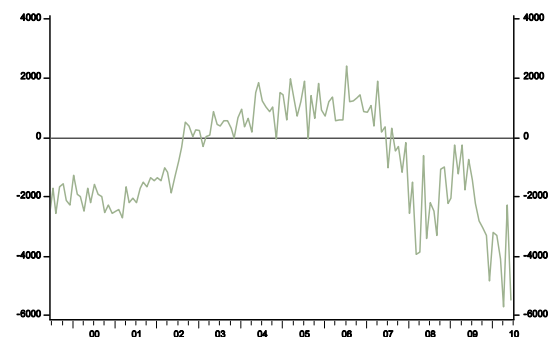
### Economic Indicators

	04-08 avg.	2009	2010	2011
GDP (% growth, real)	4.8	-0.2	7.0	5.4
Inflation (% change, eop)	5.4	4.9	4.5	4.5
Fiscal Balance (% of GDP)	-2.6	-3.3	-2.4	-2.0
Exports (% growth)	22.1	-22.7	13.0	18.0
Imports (% growth)	29.1	-26.3	44.0	8.0
Current Account (% of GDP)	0.6	-1.5	-3.5	-2.8
Reserves (month of imports)	7.4	13.0	9.8	11.2
External Debt (% of GDP)	21.0	17.8	15.7	15.8
Debt Service/Current Account	34.7	27.5	24.8	24.0
Exchange rate (eop)	2.2	1.7	1.8	1.9

Source: EIU, EDC Economics

Brazil: BOP: Current Account

SA, Mil. US\$



Source: Banco Central do Brasil/Haver Analytics

## Political

### Political Structure

Federal Republic; currently ruled by coalition

### President

Luiz Inácio Lula da Silva (PT)

### 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 Brasileiro - 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:

- 2010 Score: 43 (Partly Free)  
(0: Free; 100: Not Free)  
[freedomhouse.org](http://freedomhouse.org)

### Control of Corruption Index:

- 2008 Score: -0.03  
(-2.5: Worst; +2.5: Best)  
[worldbank.org](http://worldbank.org)

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**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 but only 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 worked hard to ensure that his party is solidly behind her candidacy. She has made some progress in early polling, but still lags behind her strongest competitor, Jose Serra of the PSD and recently governor of Sao Paulo state.

Lula's popularity is still high, in part due to his administration's actions to cushion the impact of the global credit crisis on Brazil. His administration is focussing on its expansionary "growth acceleration" programme of public investment (*Programade Aceleraçãodo Crescimento*, or PAC), and is aggressively using the PAC to boost the ratings of PAC manager Roussef.

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. Weak regulation and cumbersome bureaucracy are hallmarks. According to the World Bank's 2010 *Doing Business* survey, starting a business in Brazil take 120 days against a regional average of 45.5 days. The judicial system is regarded as fair, but 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) highlight the issue.

### Political Outlook

State intervention in the economy is likely to increase with Brazil's policy of supporting "national champions" – companies that can perform well in both the domestic and international spheres. On the international front, Lula energetically pursues his diplomatic campaign to promote Brazil as the region's leader and a key player on the world stage. Increased power will likely come with increased responsibility that will limit Brazil's ability to date to appear as an ideal mediator that is friendly with nations of all ideologies.