



Highlights and Key Issues

- Recent data confirm that a solid recovery is continuing. Retail sales volumes were up 5.6% year-on-year in July, while in August the level of industrial output rose for the eighth consecutive month and the monthly increase in credit was the largest this year. But growth is being driven largely by consumer spending, while investment has lagged behind – weighed down by low levels of capacity utilisation and an overvalued exchange rate.
- In addition, the performance of exports has remained patchy. The US\$ value of exports in Q3 was 31% lower than a year earlier, and without the support of buoyant Chinese demand the drop would have been even steeper. But compared to the situation of most emergers, Brazil's dependence on exports is modest and, provided the global situation does not lurch back into crisis, the economic outlook is likely to be largely determined by domestic forces. We expect solid quarterly growth in 2009H2, resulting in a GDP fall of just 0.4% in 2009 as a whole. Growth will gain momentum through 2010 and average just over 4%. If this pace is achieved, then interest rates are likely to start rising from mid-2010 onwards.
- Investors' renewed enthusiasm for emerging market assets has been reflected in soaring flows into Brazilian securities and a 30% rally in the BRL since March (as the current account is only in modest deficit). But at some point developments in emerging financial markets will become more mixed, at which point portfolio flows to Brazil will moderate and the BRL appreciation cease.

Forecast for Brazil						
(Annual percentage changes unless specified)						
	2008	2009	2010	2011	2012	2013
Domestic Demand	7.9	-1.2	4.3	5.2	5.3	4.8
Private Consumption	5.3	2.8	4.2	4.7	4.8	4.5
Fixed Investment	13.8	-14.8	6.9	10.3	10.2	8.2
Stockbuilding (% of GDP)	1.8	0.9	0.8	0.7	0.7	0.6
Government Consumption	5.6	3.1	3.6	3.0	3.0	3.0
Exports of Goods and Services	-0.7	-9.7	6.5	10.1	10.7	10.2
Imports of Goods and Services	18.3	-13.3	8.0	10.3	11.5	11.0
GDP	5.1	-0.4	4.1	5.0	5.1	4.6
Industrial Production	2.9	-8.4	7.0	6.8	7.4	6.1
Consumer Prices	5.7	4.9	3.8	4.0	4.0	4.0
Government Budget (% of GDP)	-2.0	-3.9	-3.0	-2.2	-1.8	-1.7
Trade Balance (\$bn)	24.8	27.3	17.7	14.3	13.2	12.8
Current Account (\$bn)	-28.2	-16.1	-22.0	-25.0	-25.1	-24.4
Current Balance (% of GDP)	-1.8	-1.1	-1.3	-1.4	-1.5	-1.4
Short-Term Interest Rates (%)	12.4	10.1	9.3	10.7	10.7	10.4
Exchange Rate (Per US\$)	1.83	2.01	1.86	2.05	2.26	2.35

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Overview

Return to robust growth...

- The Brazilian economy was severely hit by the eruption of the global crisis in September 2008. Despite the fact that going into the crisis domestic demand was growing very strongly and the financial system was healthy, the crisis shattered business confidence, caused a sharp fall in the currency as investors sold emerging market assets and led to a plunge in external trade. As a result, GDP fell 3.4% on the quarter in Q4 and a further 1% in Q1. Despite this reaction, it was expected that the country's solid fundamentals would quickly lead to a return to growth once global economic and financial confidence stabilised. And this was borne out in the Q2 national accounts when seasonally adjusted GDP rose 1.9% quarter-on-quarter. The recovery was led by a 2.1% quarterly jump in consumer spending and a substantial contribution from net external trade as export volumes surged over 14% while imports rose only 1.5%.

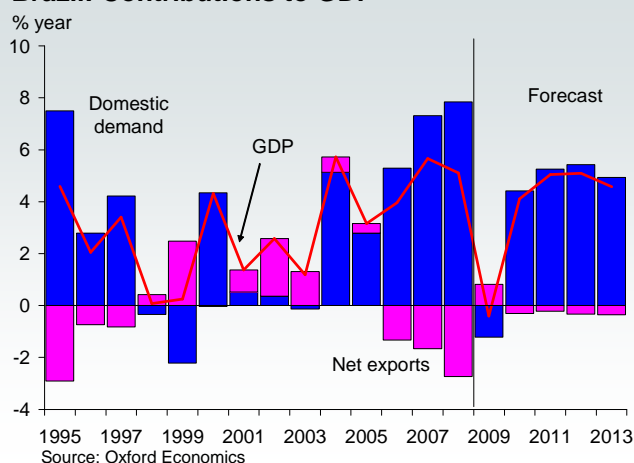
...driven by the consumer...

- Compared to the vast majority of countries, Brazilian consumer spending held up very well during the crisis; it only fell on the quarter in Q4 and was up on a year-on-year basis throughout, at 1.5% in Q1 and 3.1% in Q2. This stems from the fact that although the recession has caused a weakening in the labour market (particularly in manufacturing jobs), the rise in the unemployment rate has been comparatively small and real wages have continued to expand, albeit slowly. In addition, although moderating, credit growth to individuals has remained high this year. And in July seasonally adjusted retail sales volumes gained 0.5% on the month after a 1.7% rise in June.

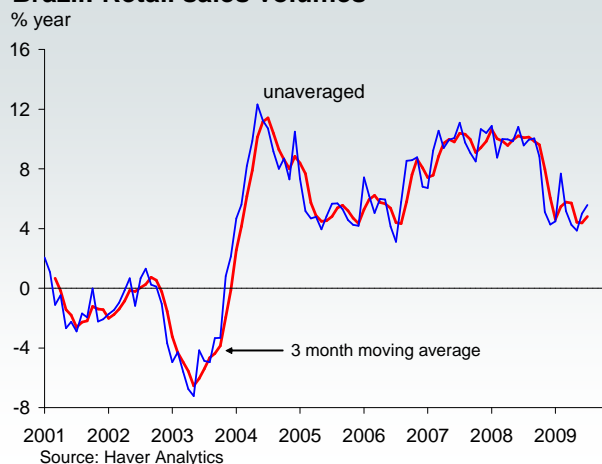
...but investment lags behind

- By contrast investment has suffered much more severely since the crisis began. Despite the improvement in other spending components and returning confidence, the level of investment was only unchanged on the quarter in Q2 after a cumulative drop of 20.3% in the previous two quarters. Moreover although the latest output data for August showed another steady monthly rise at the aggregate industry level, they also indicated that the capital goods sector continued to lag far behind; while total industry has risen 13.5% from last December's low point, capital

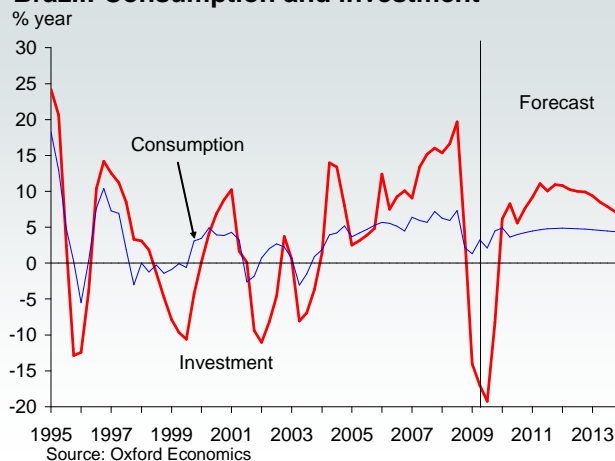
Brazil: Contributions to GDP



Brazil: Retail sales volumes



Brazil: Consumption and investment

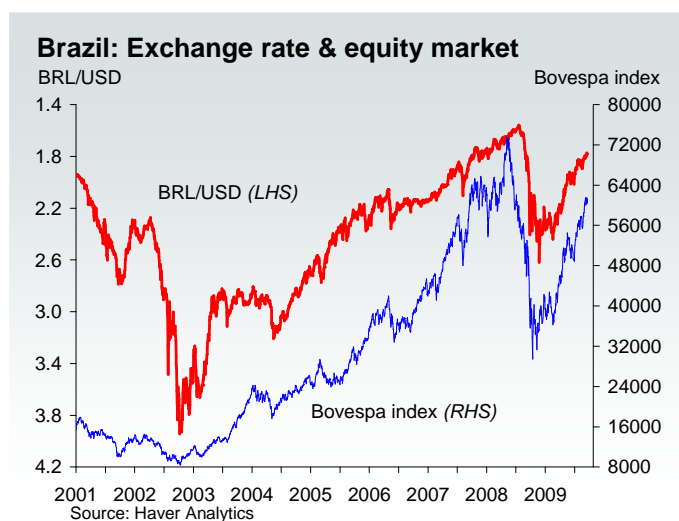
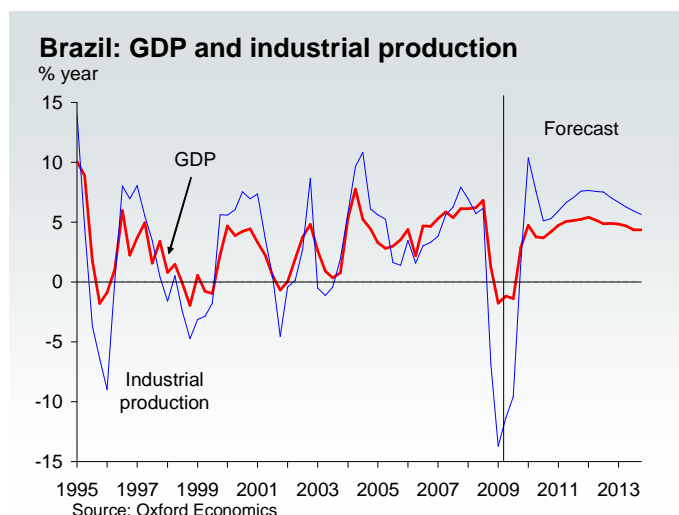
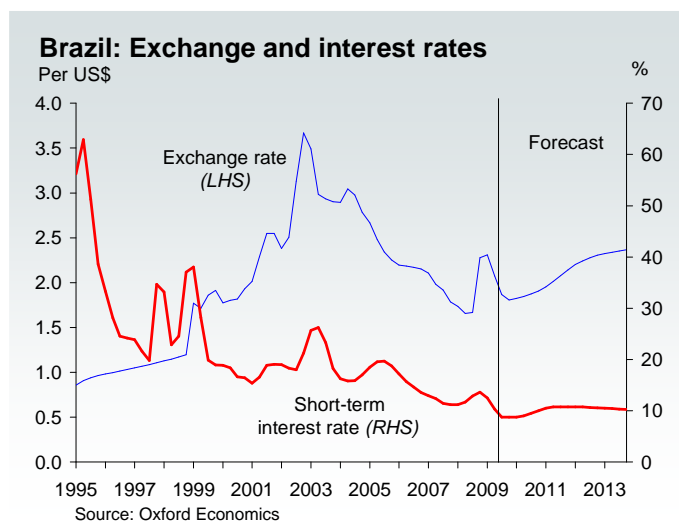


goods output in August was only up 1.1% over the same period. Investment prospects, particularly in manufacturing, face the headwinds of low capacity utilisation and a relatively overvalued exchange rate.

- Although real net exports boosted GDP in Q2, the monthly trade figures in US\$ terms do not yet point to a sustained upturn. In seasonally adjusted US\$ terms, the average level of exports in Q3 was 4.2% down on that of Q2 and 31% lower than a year earlier. However, as global trade picks up over the next year, exports are likely to stage a more convincing recovery, although their likely boost to growth will be more than offset by the expected bounce back in imports.
- We expect quarterly GDP to grow robustly in Q3, albeit not as fast as in Q2 but over 1%, followed by just under 1% growth in Q4. As a result, we forecast that GDP will fall by just 0.4% in 2009 as a whole, compared to the drop of 1.1% that we expected prior to the release of the Q2 national accounts. The economy is expected to gain momentum through 2010, helped both by the improvement in domestic and global confidence and the 500bp of interest rate cuts implemented in the first seven months of 2009. We forecast GDP growth of 4.1% in 2010 and a fraction over 5% pa in the following two years.

BRL rally continues

- In line with the sharp improvement in global financial confidence, the Brazilian exchange rate has rallied significantly since the end of March – currently it is up 30% from that time and only 11% below the peak seen in July 2008. In the period March-August, foreign investors bought nearly \$20bn of Brazilian securities, nearly offsetting the \$23bn they sold in the previous six months when the crisis was at its height. If investors' enthusiasm for emerging market assets continues at the same intensity as currently, then it seems likely that the BRL will appreciate further in the short term, but at some point these flows are likely to become more modest (since the beginning of 2007, foreigners' buying of Brazilian securities has totalled \$63bn). And while Brazilian interest rates are likely to increase from mid-2010 onwards as strong growth is confirmed, they are unlikely to rise as much as in the developed economies over the following two years. The narrowing of interest rate differentials during this period will put downward pressure on an overvalued BRL.



Key Indicators: Brazil

Percentage changes on a year earlier unless otherwise stated

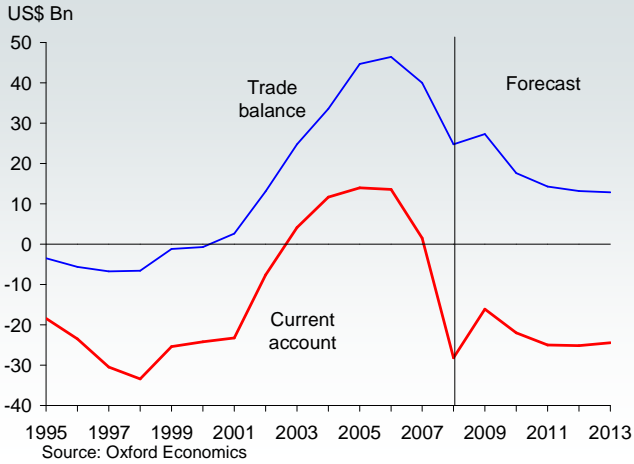
	Industrial prod. (s.a.) % m-o-m	Retail sales	CPI (IPCA)	Wholesale prices % m-o-m	Unemploy- ment %	Public Debt Real bn	Export value in \$	Trade balance (\$ mn)
Sep	2.4	10.0	6.3	0.4	7.6	1,193	41.3	2758
Oct	-2.5	8.8	6.4	1.4	7.5	1,158	17.4	1329
Nov	-7.3	5.1	6.4	-0.2	7.6	1,127	5.0	1635
Dec	-12.5	4.3	5.9	-0.9	6.8	1,154	-2.9	2317
2009								
Jan	3.0	4.5	5.8	-0.3	8.2	1,173	-26.3	-529
Feb	2.3	7.7	5.9	-0.3	8.5	1,176	-25.1	1763
Mar	1.2	5.2	5.6	-1.5	9.0	1,185	-6.4	1758
Apr	1.2	4.3	5.5	-0.1	8.9	1,207	-12.3	3700
May	1.4	3.9	5.2	-0.1	8.8	1,245	-37.9	2647
Jun	0.5	5.0	4.8	-0.6	8.1	1,259	-22.2	4621
Jul	2.2	5.6	4.5	-1.2	8.0	1,283	-30.8	2925
Aug	1.2	-	4.4	0.1	8.1	-	-30.0	3060
Sep	-	-	-	-	-	-	-30.7	1330

Financial Indicators: Brazil

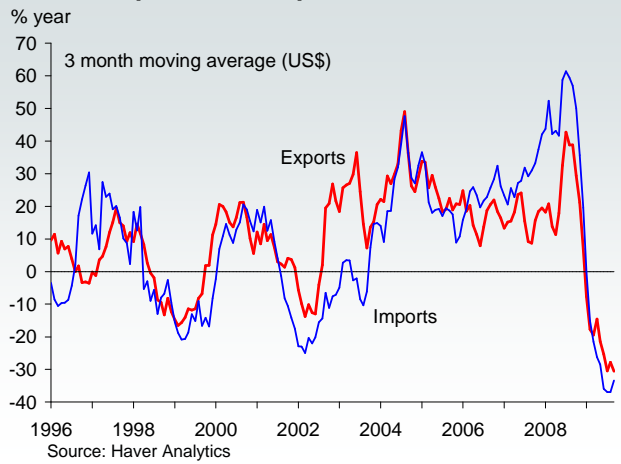
Percentage changes on a year earlier unless otherwise stated

	Selic rate (actual) %	Short-rate 60 days %	Money supply M3	Exchange rate Real/Euro	Exchange rate Real/\$ avg.	Primary balance Real mn	Asset price (Bovespa)	Reserves (end-month) \$ mn
Sep	13.39	13.0	18.0	2.591	1.803	6,618	50,595	206,486
Oct	13.66	13.4	16.5	2.899	2.176	18,731	38,143	203,179
Nov	13.64	13.3	17.6	2.891	2.270	-1,121	35,908	206,377
Dec	13.66	11.7	17.8	3.228	2.395	-20,661	37,558	206,806
2009								
Jan	13.32	12.3	17.8	3.055	2.308	7,358	39,568	200,813
Feb	12.66	11.0	17.5	2.970	2.323	3,522	40,174	199,412
Mar	11.70	10.4	17.2	3.022	2.316	7,929	39,485	202,460
Apr	11.11	9.5	16.2	2.905	2.203	11,950	45,218	201,250
May	10.16	9.5	16.0	2.824	2.069	1,119	50,893	205,576
Jun	9.54	8.9	16.3	2.745	1.959	3,376	52,061	208,425
Jul	9.01	8.6	15.4	2.724	1.933	3,180	52,068	211,871
Aug	8.65	-	15.0	2.632	1.845	5,042	56,662	219,054
Sep	-	-	-	2.648	1.819	-	59,195	224,213

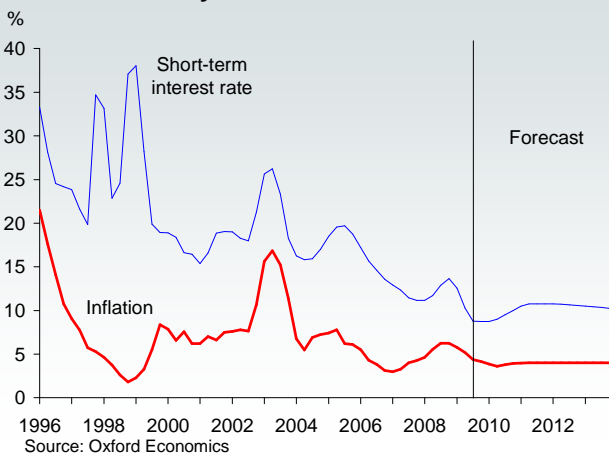
Brazil: Current balance



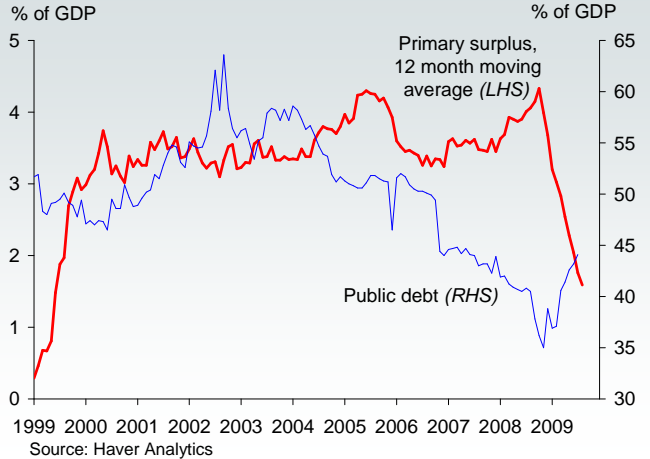
Brazil: Exports and imports



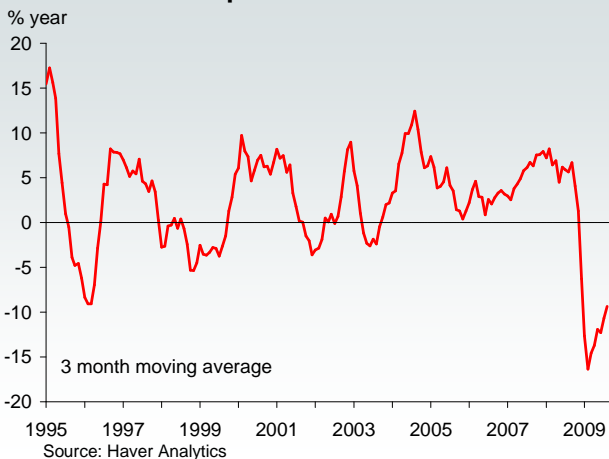
Brazil: Monetary conditions



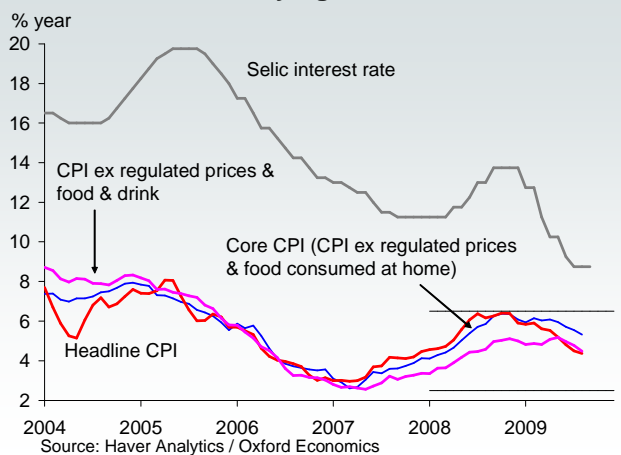
Brazil: Fiscal policy & public debt



Brazil: Industrial production



Brazil: CPI & "underlying" CPI measures



BRAZIL

TABLE 1 SUMMARY ITEMS

Annual Percentage Changes, Unless Otherwise Specified

	CONSUMERS EXPENDITURE (C)	TOTAL FINAL EXPENDITURE (TFE)	TOTAL FIXED INVESTMENT (IF)	REAL GDP (GDP)	INDUSTRIAL PRODUCTION (IP)	UNEMPLOYMENT RATE (%) (UP)	AVERAGE EARNINGS (ER)	WHOLE ECONOMY PRODUCTIVITY (GDP/ET)	COMPETITIVENESS (2000=100) (WCR)	PRODUCER PRICES (PPI)	CONSUMER PRICES (CPI)
YEARS BEGINNING Q1											
2007	6.30	7.36	13.35	5.66	5.92	9.29	5.50	3.03	131.25	5.58	3.64
2008	5.35	6.77	13.78	5.11	2.89	7.89	5.50	1.69	134.26	13.69	5.68
2009	2.82	2.20	-14.80	-0.40	-8.43	8.31	5.50	-1.03	132.09	-0.11	4.87
2010	4.17	4.59	6.88	4.11	7.03	8.58	5.50	2.47	140.50	1.20	3.79
2011	4.71	5.72	10.30	5.04	6.82	8.29	5.50	2.40	130.38	4.29	3.99
2012	4.80	5.95	10.24	5.09	7.45	8.02	5.50	2.46	120.89	4.40	4.00
2013	4.51	5.48	8.22	4.57	6.12	7.71	5.50	2.13	119.65	4.13	4.00
2007											
I	6.41	6.73	9.04	5.30	3.82	9.77	5.50	2.86	117.16	4.33	2.99
II	5.92	7.18	13.41	5.85	5.64	9.97	5.50	3.11	127.00	4.58	3.29
III	5.65	7.22	15.17	5.38	6.27	9.33	5.50	2.87	137.90	5.45	4.02
IV	7.19	8.32	16.03	6.14	7.92	8.10	5.50	3.30	142.95	7.88	4.25
2008											
I	6.26	7.52	15.36	6.12	6.96	8.43	5.50	2.88	130.49	10.73	4.64
II	5.93	8.49	16.63	6.20	5.72	8.07	5.50	2.07	138.87	15.34	5.56
III	7.31	8.98	19.69	6.81	6.16	7.77	5.50	3.44	146.21	16.27	6.26
IV	2.16	2.19	3.78	1.27	-6.86	7.30	5.50	-1.67	121.49	12.43	6.23
2009											
I	1.33	-3.50	-14.03	-1.77	-13.71	8.57	5.50	-3.10	112.48	6.86	5.78
II	3.21	-3.22	-17.00	-1.16	-11.34	8.60	5.50	-1.27	124.55	0.94	5.18
III	2.12	-3.56	-19.23	-1.40	-9.60	8.33	5.50	-1.82	142.98	-3.62	4.39
IV	4.48	1.64	-8.33	2.92	1.78	7.73	5.50	2.28	148.33	-4.04	4.18
2010											
I	4.94	5.14	6.16	4.75	10.39	8.99	5.50	3.79	134.13	-1.93	3.89
II	3.60	4.20	8.27	3.77	7.59	9.18	5.50	2.00	139.05	0.46	3.59
III	3.97	4.21	5.58	3.69	5.11	8.88	5.50	2.09	144.51	2.90	3.77
IV	4.26	4.79	7.65	4.20	5.31	7.28	5.50	2.00	144.30	3.49	3.92
2011											
I	4.48	5.25	9.17	4.73	5.93	8.83	5.50	2.24	128.43	4.09	3.96
II	4.66	5.66	11.09	5.06	6.65	8.92	5.50	2.45	129.93	4.23	4.00
III	4.80	5.89	10.04	5.15	7.05	8.55	5.50	2.46	132.54	4.42	4.00
IV	4.85	6.08	10.96	5.25	7.60	6.87	5.50	2.46	130.62	4.41	4.00
2012											
I	4.86	6.07	10.82	5.41	7.65	8.38	5.50	2.58	116.01	4.41	4.00
II	4.83	5.95	10.23	5.17	7.59	8.52	5.50	2.39	119.24	4.40	4.00
III	4.79	5.86	10.00	4.88	7.53	8.28	5.50	2.27	124.04	4.41	4.00
IV	4.73	5.91	9.89	4.89	7.05	6.88	5.50	2.58	124.29	4.37	4.00
2013											
I	4.65	5.64	9.40	4.85	6.66	8.15	5.50	2.47	112.68	4.33	4.00
II	4.56	5.56	8.48	4.70	6.27	8.20	5.50	2.23	117.59	4.29	4.00
III	4.47	5.37	7.86	4.37	5.95	7.96	5.50	1.91	123.76	4.10	4.00
IV	4.38	5.35	7.14	4.36	5.65	6.53	5.50	1.88	124.55	3.81	4.00

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BRAZIL

TABLE 2 SUMMARY ITEMS

	TRADE BALANCE (\$ BN) (BVIS/ 1000)	CURRENT ACCOUNT (\$ BN) (BCUS/ 1000)	CURRENT ACCOUNT (% OF GDP) (BCUR%)	GOVERNMENT FINANCIAL BALANCE (REAL TRN) (GB/1000)	GOVERNMENT FINANCIAL BALANCE (% OF GDP) (GB*100/ /GDP)	SHORT-TERM INTEREST RATE (RSH)	SPREAD OVER US SHORT-TERM RATE (RSH - RSH US)	REAL SHORT-TERM INTEREST RATE (Note 1)	EQUILIBRIUM EXCHANGE RATE PER US DOLLAR (RXEQUIL)	EXCHANGE RATE PER US DOLLAR (RXD)
YEARS BEGINNING Q1										
2007	40.0	1.6	0.1	-71.5	-2.8	12.0	6.7	8.3	2.10	1.95
2008	24.8	-28.2	-1.8	-57.2	-2.0	12.4	9.4	6.7	1.98	1.84
2009	27.3	-16.1	-1.1	-116.9	-3.9	10.1	9.4	5.2	2.25	2.02
2010	17.7	-22.0	-1.3	-97.1	-3.0	9.3	8.9	5.5	2.35	1.86
2011	14.3	-25.0	-1.4	-77.7	-2.2	10.7	8.1	6.7	2.40	2.05
2012	13.2	-25.1	-1.5	-68.5	-1.8	10.7	5.3	6.7	2.45	2.26
2013	12.8	-24.4	-1.4	-70.3	-1.7	10.4	4.7	6.4	2.52	2.35
2007										
I	8.7	0.2	0.1	-10.9	-1.8	12.9	7.6	9.9	2.16	2.11
II	11.9	2.2	0.7	-4.2	-0.6	12.3	7.0	9.1	2.12	1.98
III	10.4	1.1	0.3	-23.6	-3.6	11.5	6.0	7.4	2.09	1.92
IV	9.1	-2.0	-0.5	-32.8	-4.8	11.2	6.2	6.9	2.04	1.79
2008										
I	2.8	-10.3	-2.7	2.5	0.4	11.2	7.9	6.5	1.99	1.74
II	8.5	-6.6	-1.5	-9.7	-1.3	11.7	8.9	6.1	1.97	1.66
III	8.4	-6.0	-1.3	-9.9	-1.3	12.9	10.0	6.6	1.95	1.67
IV	5.2	-5.3	-1.6	-40.2	-5.4	13.7	10.9	7.4	2.01	2.28
2009										
I	3.0	-4.9	-1.7	-21.1	-3.1	12.5	11.3	6.8	2.11	2.31
II	11.0	-2.1	-0.6	-22.5	-3.0	10.3	9.4	5.1	2.22	2.08
III	7.3	-4.8	-1.2	-30.3	-3.9	8.8	8.4	4.4	2.33	1.87
IV	6.0	-4.2	-1.0	-42.8	-5.3	8.8	8.4	4.6	2.35	1.81
2010										
I	2.3	-6.0	-1.5	-19.9	-2.7	8.8	8.5	4.9	2.34	1.82
II	5.5	-5.1	-1.2	-16.4	-2.0	9.0	8.7	5.4	2.35	1.85
III	2.7	-5.3	-1.2	-28.2	-3.4	9.5	9.1	5.7	2.36	1.88
IV	7.1	-5.6	-1.2	-32.5	-3.7	10.0	9.1	6.1	2.37	1.91
2011										
I	2.0	-7.0	-1.7	-13.1	-1.6	10.5	9.1	6.5	2.38	1.95
II	4.1	-5.9	-1.3	-13.9	-1.6	10.8	8.6	6.8	2.40	2.01
III	0.9	-6.3	-1.5	-24.2	-2.7	10.8	7.8	6.8	2.41	2.08
IV	7.3	-5.7	-1.3	-26.5	-2.8	10.8	6.9	6.8	2.42	2.14
2012										
I	1.8	-7.3	-1.8	-9.8	-1.1	10.8	6.1	6.8	2.43	2.20
II	3.7	-6.0	-1.4	-11.7	-1.2	10.7	5.4	6.7	2.44	2.24
III	0.1	-6.4	-1.5	-22.9	-2.3	10.7	5.0	6.7	2.46	2.28
IV	7.6	-5.5	-1.2	-24.2	-2.3	10.6	4.7	6.6	2.48	2.31
2013										
I	1.6	-7.1	-1.7	-10.3	-1.1	10.5	4.6	6.5	2.49	2.32
II	3.7	-5.8	-1.3	-12.5	-1.2	10.4	4.5	6.4	2.51	2.34
III	-0.2	-6.2	-1.4	-22.6	-2.1	10.3	4.6	6.3	2.53	2.35
IV	7.9	-5.3	-1.1	-25.0	-2.2	10.3	4.9	6.3	2.55	2.37

Note 1 : REAL INTEREST RATE = Nominal interest rate (RSH) - % change in CPI

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Background

- With a GDP of US\$1.6 trillion in 2008, and over 190m people, Brazil is the tenth largest economy in the world and by far the largest in Latin America. In the last 15 years, the country has pursued a strategy of export-led growth and regional integration. The economy is relatively well diversified with a strong manufacturing and agricultural base, and mineral riches. However, in regional terms, economic activity is still concentrated in the southeast, particularly in the state of São Paulo, and income inequality remains among the worst in the world.
- During the period 1950-80, the economy grew by an average yearly rate of 7.4%. This was achieved through an inward-looking strategy of industrialisation (ISI) led by the state. However, eventually this model of development generated high inflation, sustained external and fiscal deficits and growing public debt. Already in the 1970s the ISI began to show signs of exhaustion, but trade liberalisation did not begin in earnest until 1990. The recent economic history of the country is dominated by three crises linked to the balance of payments.
- The 1982 debt crisis, and the shrinkage of capital inflows that followed, was a major shock for the Brazilian economy. A period of macroeconomic instability and hyperinflation ensued, prompting a series of unsuccessful stabilisation plans from 1986 to 1994 – the name of the currency was changed four times during the period. Only in 1994 did the Real Plan restore macroeconomic stability to the economy. This plan, devised by Fernando Henrique Cardoso (later to become president during the period 1994-2002), used the nominal exchange rate as an anchor for domestic prices, as in previous stabilisation attempts, but this time it was underpinned by the opening up of the economy to global influences and a reform of public finances.
- The 1997-98 Asian and Russian crises found Brazil with rising public debt and large current account deficits, exposing its economy to swings in investor sentiment and speculative attacks against the BRL (a crawling peg was then in place). At the start of 1999 there were doubts over fiscal sustainability following the rejection by Congress of an IMF adjustment package. This, together with a debt moratorium declared by the state of Minas Gerais, prompted speculative pressures that forced the central bank to float the BRL, causing an immediate depreciation of 30% against the US\$. However, the maxi-devaluation did not lead to high inflation and the introduction of inflation targeting in June 1999 helped to support the transition to the new exchange rate regime.
- Again in 2002, the increasing likelihood of a new government led by the left-wing candidate Luiz Ignacio “Lula” da Silva threw the markets into turmoil (exacerbated by weak global financial sentiment). The electoral risk, a fragile public debt structure and perverse debt dynamics, and the increased risk aversion of international capital markets were major sources of instability for the economy at this time. Over 80% of domestic debt was linked to either the Selic interest rate (the key monetary policy instrument) or to the US dollar, meaning that any major decline in the currency would result in a higher burden of interest payments and a rise in the domestic value of the public debt. Moreover the average maturity of the domestic debt was only three years, so vast sums needed to be rolled over every year. As a result, Brazil was walking a tightrope.
- But contrary to excessively pessimistic market expectations, one of the main achievements of President Da Silva’s first-term administration was a strengthening of fiscal discipline, needed to honour debt payments and improve investor confidence. The debt structure is now much less exposed to currency fluctuations and its maturity has been lengthened (although about 30% is still linked to the Selic rate). This has improved the debt profile significantly. In 2004 and 2005 Brazil ran primary fiscal surpluses (excluding interest payments) of over 4.25% of GDP per year, and the surpluses were only marginally lower between 3.8% and 4.1% during 2006-08. However, the government’s control over the overall nominal deficit is limited by high interest payments, which account for over 5% of GDP (even though they have fallen significantly over the last five years). But despite only implementing a relatively modest fiscal boost in the wake of the global crisis, the primary surplus has fallen sharply this year, down to just 1.6% of GDP in the twelve months to August.
- President Lula comfortably won a second term in office, and promised to boost economic growth and to narrow the gap between rich and poor. But with his left-wing Workers’ Party (PT) having lost seats in the highly fragmented 513-member Congress, he has had to rely on alliances to push through legislation. Moreover in the key reform areas of tax, pensions, social security and political structures there has been little appetite to press

for far-reaching changes. The still very popular Lula cannot run for a third consecutive term and at the moment his chosen successor at the 2010 presidential election, Dilma Roussef, is running behind Jose Serra of the opposition PSDB, current governor of Sao Paulo state and somebody who might press harder for reforms. But if the economy picks up strongly in 2010, a wave of optimism about the country's future, brought about by hosting both the 2014 World Cup and the 2016 Olympics, together with the prospect of a potentially huge windfall from tapping the oil deposits discovered in 2007, might dampen voters' enthusiasm for reform

- However, the major efforts of the last decade to secure macroeconomic stability, together with the more modest structural reforms, have created the right conditions for a period of sustained growth. The country is now more integrated into the world economy and, at the same time, it has become more resilient to external shocks. Meanwhile, there has been important progress in the conduct of economic policy, with the passage of legislation to ensure fiscal responsibility, introduce inflation targeting, simplify the tax system and reduce the fiscal burden of the pension system. Other reforms have been enacted to deal with central bank independence and the credit market. The Law of Monetary Responsibility aims to consolidate price stability by extending the operational autonomy of the central bank in the conduct of monetary policy and the control of inflation. Meanwhile, the credit market reform aims to stimulate the expansion of credit in the private sector, reduce intermediation costs and improve investor confidence. This legislation seeks to reduce lending risks for banks – so as to encourage a willingness to reduce the gap between the official Selic rate and the actual interest rates faced by individuals and companies. Prior to the global crisis, bank lending was growing very strongly (despite still high interest rate spreads) and although it has slowed since, it has not stopped altogether as public sector banks have stepped in to supply credit. Against a background of inflation remaining under control and more households looking to own their homes, the demand for and supply of credit is likely to be on a strong uptrend over the next decade from the comparatively low level of 42% of GDP in mid-2009, supporting consumer spending and overall activity.
- Brazil has made significant progress in terms of its integration into the world economy. The openness indicator (the ratio of exports and imports to GDP) has doubled since 1990 (from 14% then to over 28% in 2008). This was partly the result of a deliberate strategy to diversify and open up new markets for Brazilian products in the US and the EU over the last ten years or so, while the expansion of exports to China since 2001 was a response to the rapid growth in Chinese demand for commodities.
- Greater openness to international trade has been accompanied by a more diversified export base (both in terms of products and geography), resulting in a considerable reduction in the country's exposure to external risks. Since 1990, the composition of products has become more varied, including a wide range of products from aircraft to commodities. In 2008 about 46.8% of Brazilian exports were finished manufactures, 13.7% semi-manufactures and 36.9% primary goods (the bulk of which were agricultural products, though iron ore exports accounted for 8.3% of all exports). In 2008 the main markets for Brazilian exports were the EU (a 23.4% share), the US (14%), Argentina (8.9%), the rest of Latin America (17%), China (8.3%) and the rest of Asia (10.6%). However, with the Chinese economy much stronger than any of these other regions in 2009, the share of Brazilian exports going there has shot up, reaching 14.8% in the period January-July (mostly in the form of iron ore and soyabeans, though in the future it will also be supplying oil).
- These new fundamentals have underpinned a turnaround in the country's external accounts. In the seven years 2002-2008 the current account balance averaged a surplus of 0.3% of GDP (a relatively modest deficit of 1.1% is expected in 2009), whereas in the previous seven years there was an average deficit of 3.6% of GDP). This, together with investors' increasing confidence in the soundness of the policy framework and in the country's growth potential, prompted a steady appreciation of the exchange rate between mid-2004 and mid-2008. Indeed by the latter date the BRL appeared to be in overvalued territory – with its real trade-weighted exchange rate in August 2008 over 25% higher than its long-term average. Although this had relatively little impact on the commodities sector, parts of the country's manufacturing sector were finding it increasingly difficult to maintain market share against foreign competition. The eruption of the global crisis prompted a 33% fall in the BRL (at its worst). However, the return of confidence to global markets from March 2009 has led to a major rally, so much so that the BRL is currently only 11% below last year's peak, placing it in overvalued territory once again.

Key Facts

Politics

Head of state: President Luiz Inacio LULA DA SILVA
 Head of government: President Luiz Inacio LULA DA SILVA
 Political system: Democracy
 Date of next presidential election: October 2010
 Date of next legislative election: October 2010
 Currency: real (BRL), floating exchange rate

Long-term economic & social development

	1975	1985	1995	2007*
GDP per capita (US\$)	1144	1638	4758	7058
Inflation (%)	-	226.0	66.0	3.6
Population (mn)	108.1	136.1	161.7	190.1
Urban population (% of total)	62.0	71.0	78.0	85.0
Life expectancy (years)	-	65.0	69.0	72.0

Source : Oxford Economics & World Bank

Structure of GDP by output

	2007
Agriculture	5.0%
Industry	31.0%
Services	64.0%

Source : World Bank

* 2007 or latest available year

Long-term sovereign credit ratings & outlook

	Foreign currency	Local currency
Fitch	BBB- (Stable)	BBB- (Stable)
Moody's	Baa3 (Positive)	Baa3 (Positive)
S&P	BBB- (Stable)	BBB+ (Stable)

Structural economic indicators

	1990	1995	2000	2007*
Current account (US\$ billion)	-3.8	-18.4	-24.2	1.6
Trade balance (US\$ billion)	10.8	-3.5	-0.7	40.0
FDI (US\$ billion)	0.3	3.3	30.5	27.5
Debt service (US\$ billion)	8.2	21.6	64.8	55.3
Debt service (% of exports)	22.1	36.6	93.6	34.9
External debt (% of GDP)	25.9	20.9	37.5	14.3
Oil production (000 bpd)	631	695	1269	1748
Oil consumption (000 bpd)	1466	1788	2166	2400

Source : Oxford Economics / World Bank / EIA

Destination of goods' exports (2007)

European Union (27)	25.2%
United States	15.8%
Argentina	9.0%
China	6.7%
Bolivarian Rep. of Venezuela	2.9%

Source : WTO



Source : CIA Factbook

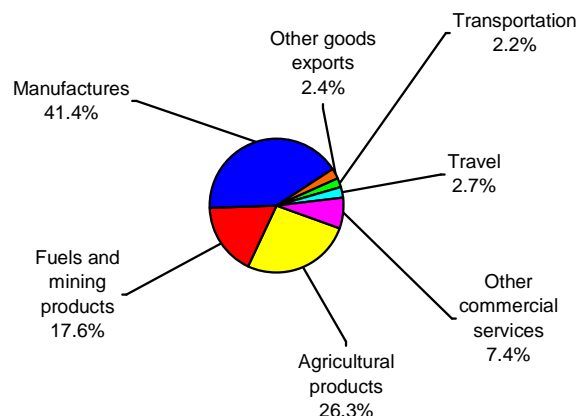
Location : Eastern South America, bordering the Atlantic Ocean (CIA Factbook)

Corruption perceptions index 2008

	Score
Developed economies (average)	7.73
Emerging economies (average)	3.44
Brazil	3.50
Western Hemisphere	3.87

Source: Transparency International
 Scoring system 10 = highly clean, 0 = highly corrupt

Composition of goods & services exports, 2007



Source : WTO