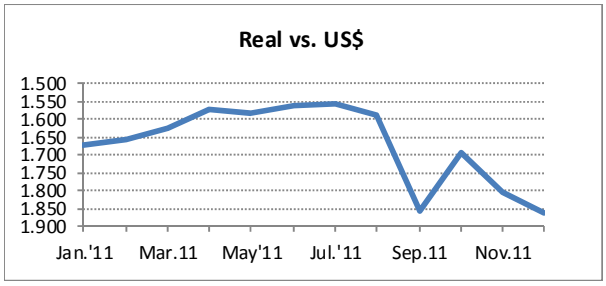
# Country Risk Update – Brazil

January 2012

***Significant Recent Development***

*The current account deficit widened to US$6.8bn in November and probably exceeded US$7bn in December. The deficit should nonetheless remain benign in relation to GDP (below the IMF's recommended 3% of GDP limit). Moreover, it will be easily financed by strong inward FDI flows, particularly as Brazil retains its appeal as an important, strong-growing emerging market. Capital inflows and investment growth will be boosted by the hosting of the FIFA World Cup (in 2014) and the Summer Olympic Games (2016).*




**Risk Outlook**

Brazil's economic expansion slowed sharply in 2011, with recent indicators showing disappointing trends in both industrial production and the services sector, especially retail sales. Real GDP growth ground to halt between Q2 and Q3 and is unlikely to rebound swiftly in 2012. In this respect we disagree with the views of the finance minister, Guido Mantega, and central bank president, Alexandre Tombini, who have recently suggested that the economy will strengthen in 2012 (we do agree, though, that inflation will be lower, although the central bank's 4.5% inflation target will still be difficult to achieve).

The country will continue to struggle with weakened exports, particularly to Europe. Export earnings have fallen in recent months, curtailing employment growth – highlighting the impact on the local jobs market of reduced sales for Brazilian firms. Lower interest rates and tax cuts, combined with an easing of bank lending restrictions, will all help to support the economy – it was the earlier tightening of credit that promulgated the slowdown. However, measures taken to arrest the downturn may not be sufficient to push Brazil back onto a strong growth path if global uncertainties persist.

The government has, meanwhile, indicated that there will be an on-going attempt to weaken the value of the currency, the real, in real (i.e. inflation-adjusted) terms. The central bank's main policy target interest rate (the benchmark Selic rate), which has been lowered sequentially since August to 11%, may be further eased in the coming months. The central bank may also seek to intervene more directly in the FX market. These manoeuvres should assist exporting industries to compete in a more difficult global economic climate. However, there is also a risk of the currency either failing to respond, due to other countervailing factors, or of 'over-shooting' a particular target.

Another notable development to affect the risk outlook occurred recently at a summit of Mercosur, the regional trade bloc, which also includes Argentina, Paraguay, Uruguay, Venezuela (pending ratification) and other associate members. Brazil is party to – and indeed a chief protagonist of - a rise in trade protectionism within the Mercosur bloc. Colloquially known as the *Common Market of the South*, Mercosur has agreed to raise tariffs on 100 products to protect local markets from a flood of cheap imports, a move that raises fears of retaliatory action and that can only prove detrimental to enhanced inter-regional trade flows. Capital goods, textiles and chemicals, mostly from Asia, are being targeted, with 35% tariffs imposed for a period of three years (to December 2014).

**Risk Level: Slight** **Risk Trend: Stable**

| Annual Avg. % change | 2010 | 2011e | 2012f | 2013f |
|---|---|---|---|---|
| **Real GDP growth** | **7.5** | **3.0** | **2.8** | **2.9** |
| *- IMF* | *7.5* | *3.8* | *3.6* | *na* |
| *- OECD* | *7.5* | *3.4* | *3.2* | *3.9* |
| **Inflation (CPI)** | **5.9** | **6.2** | **5.4** | **5.0** |
| *- IMF* | *5.0* | *6.6* | *5.2* | *na* |
| *- OECD* | *5.9* | *6.5* | *5.8* | *4.7* |
| **Current Acc. (% GDP)** | **-2.3** | **-2.5** | **-2.7** | **-2.6** |
| *- IMF* | *-2.3* | *-2.3* | *-2.5* | *na* |
| *- OECD* | *-2.3* | *-2.0* | *-2.2* | *-2.5* |
| **Budget Bal. (% GDP)** | **-2.5** | **-2.4** | **-2.5** | **-2.7** |

| | |
|---|---|
| **Head of State:** | President Dilma Vana Rousseff |
| **Head of Government:** | As above |
| **Ruling Party:** | Workers' Party |
| **Next Election:** | 2014 (presidential & parliamentary) |
| **Capital City:** | Brasilia (GMT -3 hours) |
| **Currency:** | Real |

| | | | |
|---|---|---|---|
| **GDP (USDbn)** | 2090.3 | **Doing Business** | 127 |
| **Population (m)** | 1918 | **Competitiveness** | 4.32 |
| **Bank Debt (% GDP)** | 9.9 | **Corruption** | 3.8 |
| **Economic Freedom** | 56.3 | **Corporate Tax (%)** | 34.0 |

Sources: BBC, IFES Election Guide, IMF, FT, MJE, OECD, The Times and;
Index of Economic Freedom (The Heritage Foundation): 0-100; 100 is best
Doing Business Ranking (World Bank): 1-183; 1 is best
Global Competitiveness Score (World Economic Forum): 0-6; 6 is best
Corruption Perceptions Index (Transparency International): 0-10; 10 is best
Headline Corporate Tax Rate (Deloitte)