

APRIL 2005



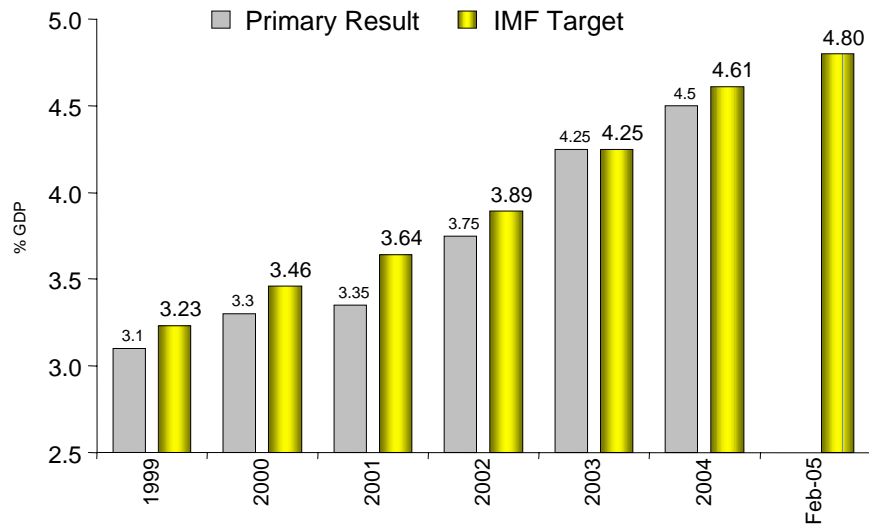
## BRAZIL: institutional development and growth outlook

*Joaquim Vieira Ferreira Levy*  
National Treasury Secretary

## Recent Developments and Policy choices

# Fiscal Commitment: the cornerstone of the economic policy

## Public Sector Primary Balance (in 12 months)

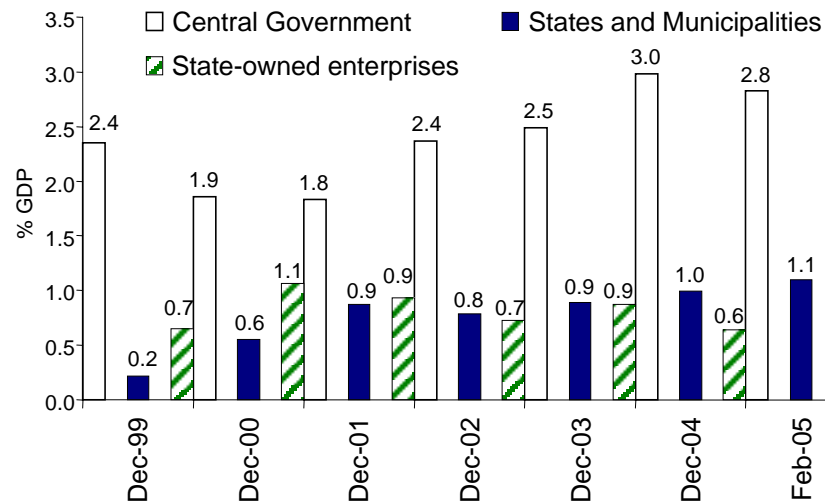


Source: Central Bank

## Fiscal Responsibility Law - 2000

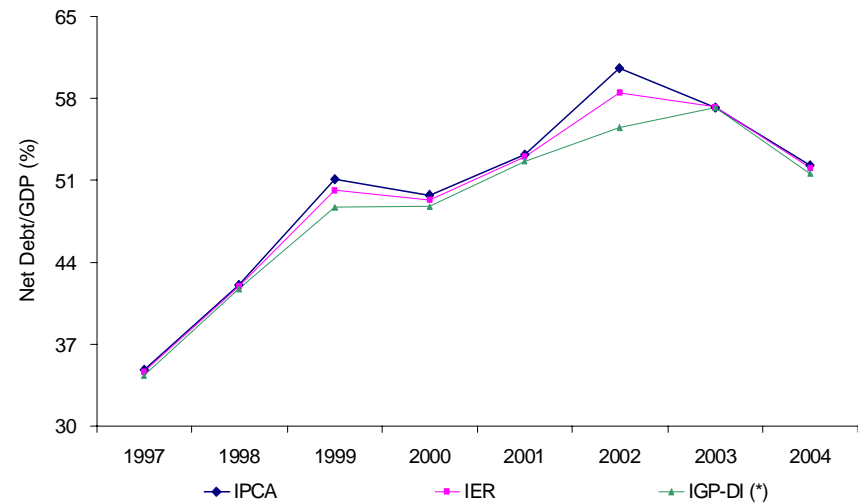
- Requires the government to set FISCAL TARGETS, and imposes limitations on tax expenditure, subsidies and the financing of current expenditure
- Establishes limits on personnel expenditures (including by government branches) and mechanisms to correct slippages for all levels of government
- Requires the publication of timely and comprehensive information on national and sub national fiscal accounts
- Establishes limits for the public debt of sub national governments and convergence paths toward limits;
- Gives a role for the Treasury in integrating national and sub national fiscal policies

## Primary Balance by Government Level



Source: Central Bank

## Net Public Sector Debt/GDP

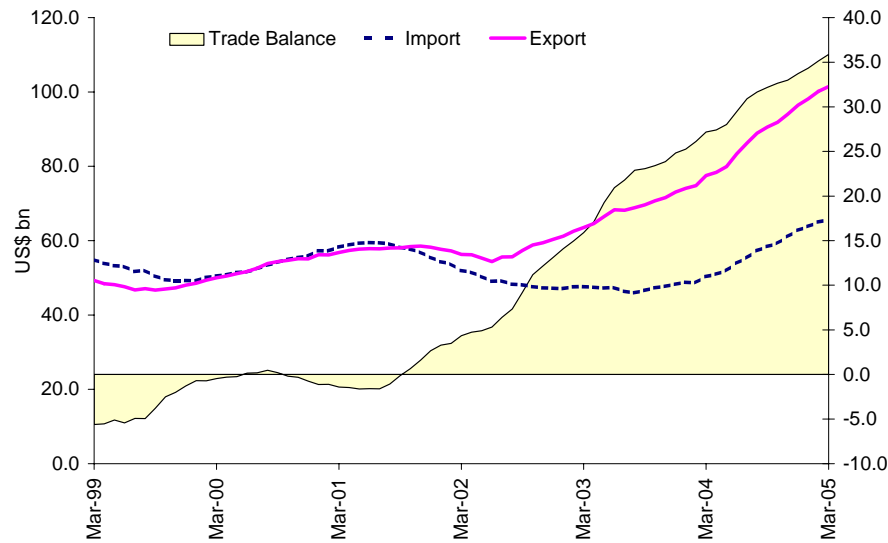


Source: Central Bank



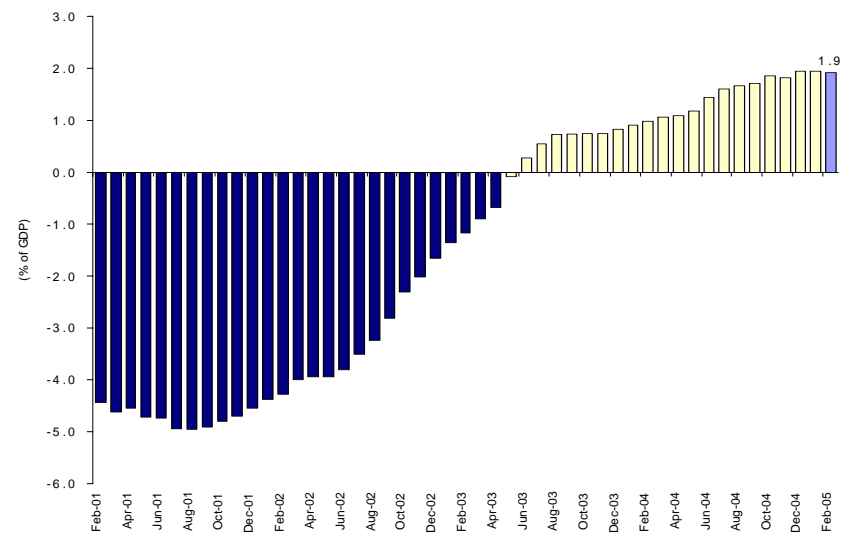
# Big swing in External Accounts, based on a robust export growth

Trade Balance - (US\$ billion)



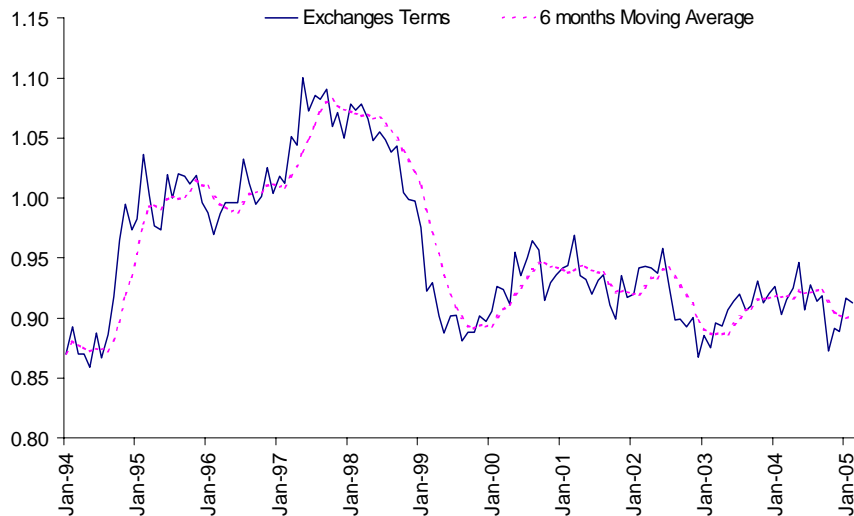
Source: Central Bank

Current Account (12 months cumulated - % of GDP)



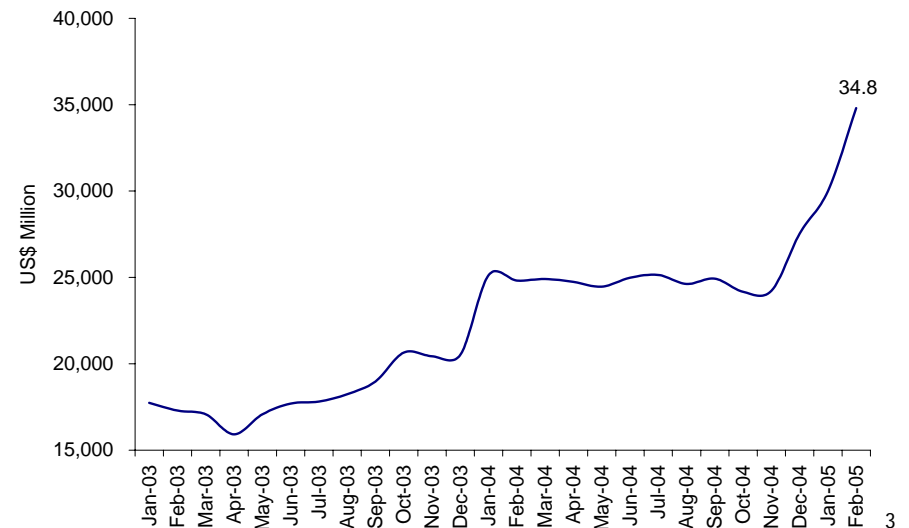
Source: Central Bank

Terms of Trade



Higher number means more favorable terms; source:Tendencias

Net Reserves - Excluding IMF

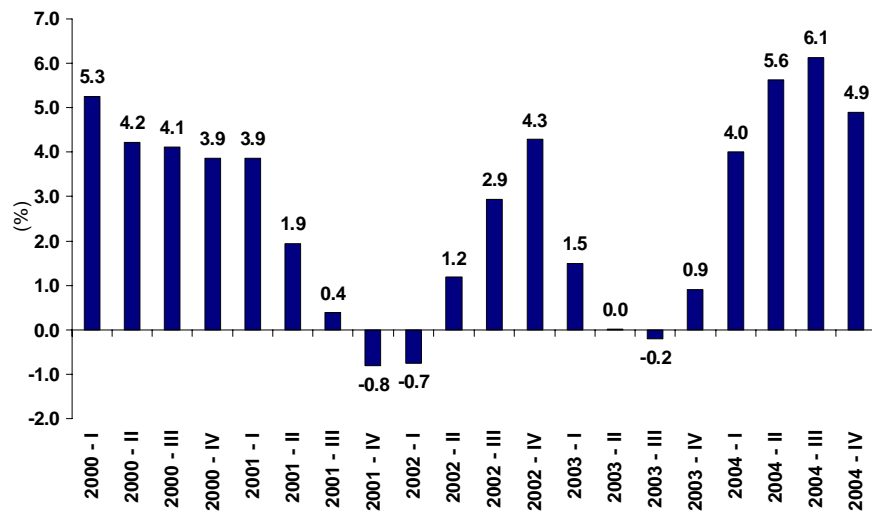


Source: Central Bank



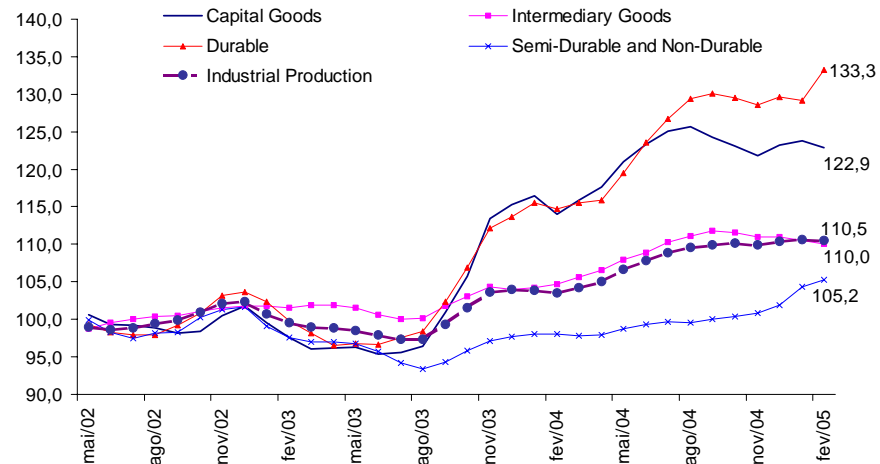
# A sustained economic recovery with a pick up in investment

## GDP Growth quarter on quarter (%)



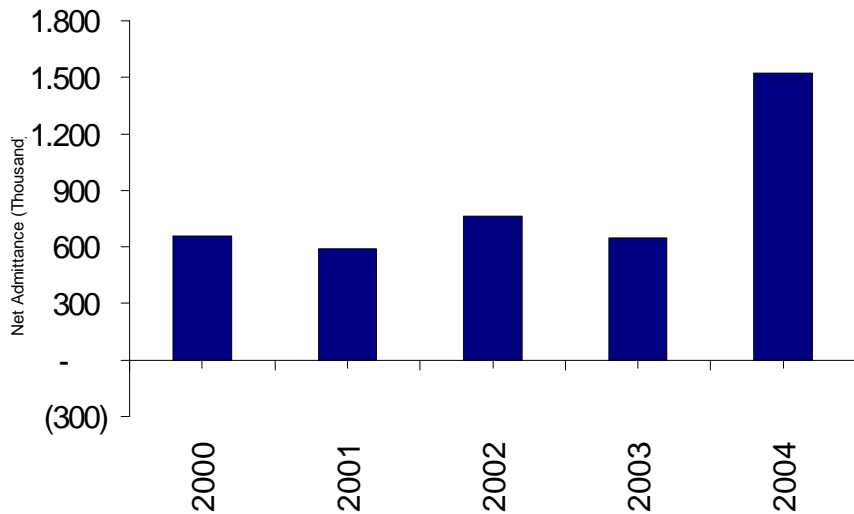
Source: IBGE

## Industrial Production by Category (Quarterly Moving Average)



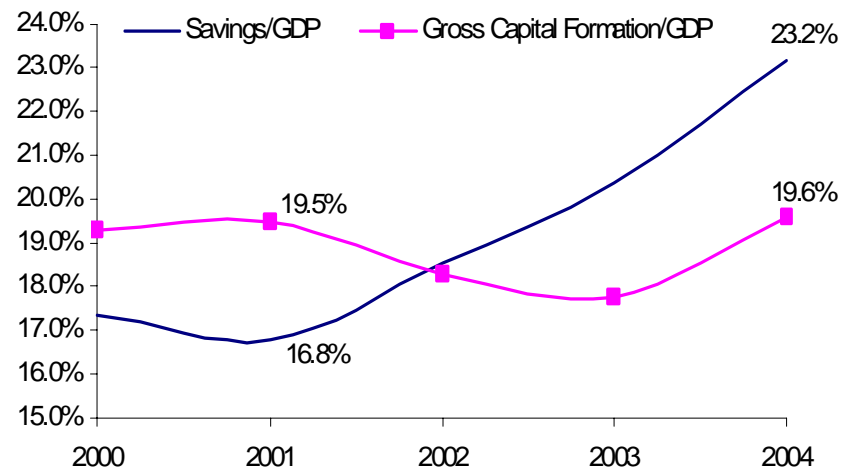
Source: IBGE

## Job Creation in the formal market (thousands)



Source: IBGE  
Note: Average 1990=100

## Savings (as % GDP) and Gross Capital Formation (as % GDP)



Source: IPEA and IBGE



# A wide range of macroeconomic and microeconomic reforms

## Status of Key Reforms

Reform/measure	Type of measure		Status	
			Approved/issued	Work in progress
Social Security Reform (Public Sector Scheme)	EMC #41 Constit. Amendment	2003	✓	The deficit of this scheme amounts of 3% of GDP. The reform will help reduce it in the short, medium and long-term (by taxing high pension funds and creating a complementary pre-funded scheme, in addition to change the number of years of contributions and
Transformation of COFINS in a VAT	Draft Law 474/01	ongoing	✓	This tax raises more than 5% of GDP and loopholes were closed regarding local regulation discrepancies, harmonizing tax schedule and inter-state trade distortions.
Elimination of PIS/Cofins on Financial Receipts	Decree #5,164	2004	✓	
Real Estate Sector Reform Law	Law # 10,931	2004	✓	
Loans guaranteed by Payroll	Law # 10,820	2003	✓	
Securitization of Bank Credits ( <i>Cédulas de Créditos Bancários</i> )	Law # 10,931	2004	✓	
Private rural insurance	Law # 10,820	2004	✓	
Agribusiness Deposit Certificate	Law # 11,076	2004	✓	
Agribusiness call option	Law # 11,076	2004	✓	
Investment Account Law	Law #10.892	2004	✓	Eliminates effect of CPMF on portfolio adjustments and help boost competition in the financial sector
REPORTO	Law # 11,033	2004	✓	Creates incentives to ports modernization and application

## ... reforms that continue to happen

### Status of Key Reforms

em 14/04/2005

Reform/measure	Type of measure	Approved/issued	Status	
			Work in progress	
Bankruptcy Law	Law # 11,101	2005	✓	
Energy Sector Framework		2004	✓	Market-base framework already tested in real auctions
Tax incentives for long-term investment	Law #11,033 and 11,053	2004	✓	
Private-Public Partnership Law	Law # 11.079	2004	✓	
Industrial Development Agency Act	Law # 10,093	2004	✓	
Research and Development Incentives	Law # 10,973 and #11,077	2004	✓	
Technological Innovation Law	Law # 11,080	2004	✓	
Judicial Reform		2004	✓	Key articles approved in 12/08/2004. The " Súmula Vinculante" (will speed up judicial process) and external control approval. Fourteen further measures are to be voted this year, aiming at improving the pace of judicial decisions.
Framework to subject the financial system to the Anti-trust Authority	Draft Law			Approved in the Financial and Tax Commission, is under consideration in the Constitution and Justice Commission
Regulatory Agencies Law	Draft Law # 3,337	2004		Under discussion in the Lower House. Requested as a priority. Expected to be voted by the end of Mar-05

## Zooming on and preserving the strengths of the economy

The main challenge ahead is not *elections* or turbulence in international financial markets, but to ensure an environment more and more favorable to investment and new opportunities to low-income people

This goal is being sought by consolidating the hard-earned advantages from:

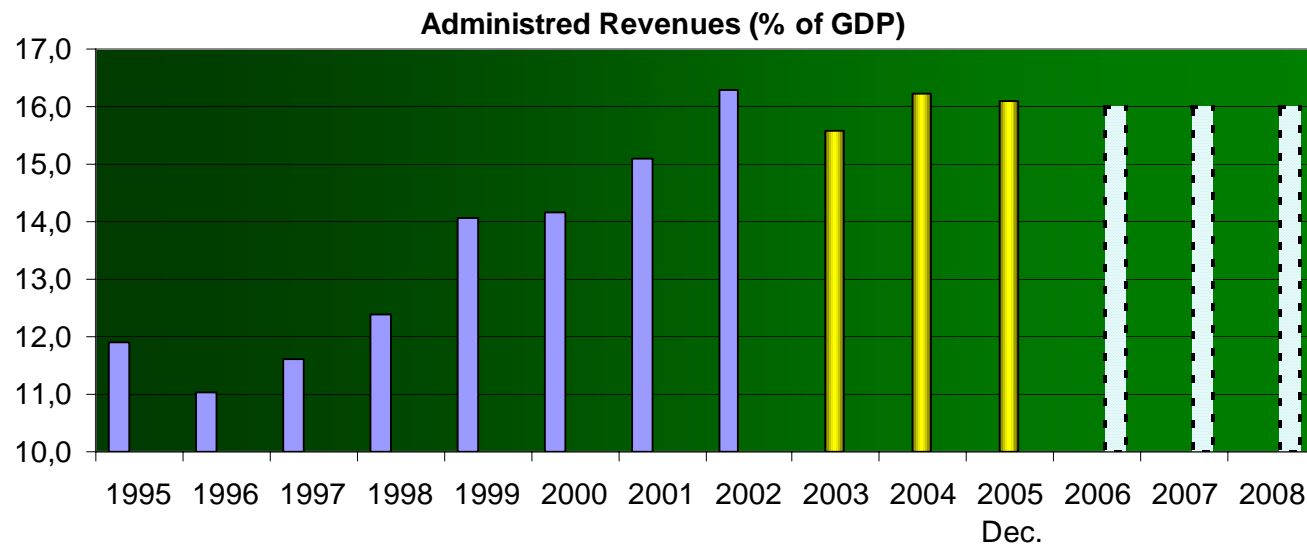
- Firm, rather than relaxed fiscal stance
- Renewed commitment to put a lid on taxes
- Strong external sector (current account surplus)
- Well-defined, comprehensive reform agenda
- Private sector participation in well-regulated infrastructure sectors, e.g., through energy auctions, road concessions, municipal sanitation programs.
- Pilot Project with IMF to innovate in public investment
- Strong and open financial sector



The 2006 LDO provides strong guidelines for the few years

## LDO 2006 Highlights:

- 4,25% primary target for 2006-2008, with potential allowance of R\$ 3 billion/year for IMF-pilot project investment
- Ceiling of 16% of GDP for Administrated Federal Tax Revenue (excludes Social Security contributions)
- Ceiling of 17% of GDP for current expenditures (Central Government, including Social Security)
- The 2007-2008 LDO and budget law will consider further reductions in taxes and expenditure



## ... main challenges ahead

Credit risk assessments feed in the cost of capital, the growth outlook and the room for implementing further sound economic policies

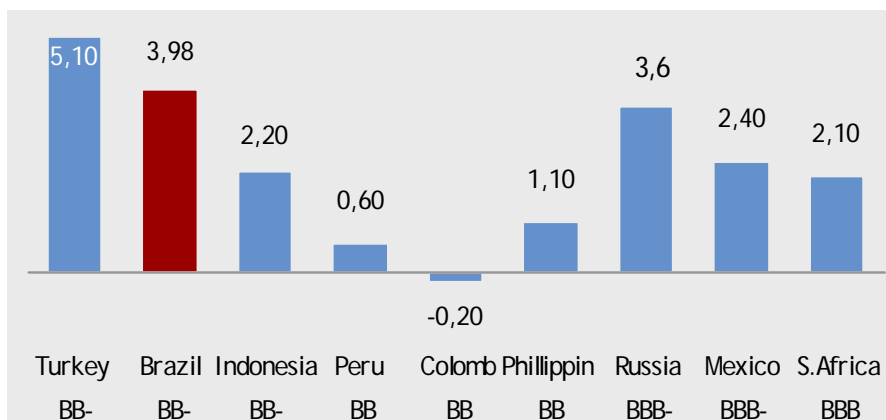
### Brazilian firms are eager to flex their muscles

- Petrobras has large proven reserves, the technology to develop them, financial resources to do it (most of its earnings are retained) ; still high cost of capital;
- CVRD stock price is increasing, but still reflects a high discount rate in long-term projects;
- Many other private companies in the steel, energy, transportation, sanitation, agribusiness, technology and logistics sectors have, the competitive skills and important capital needs;
- The banking sector is strong and can provide increasing support to business and investors.

## Comparative Indicators

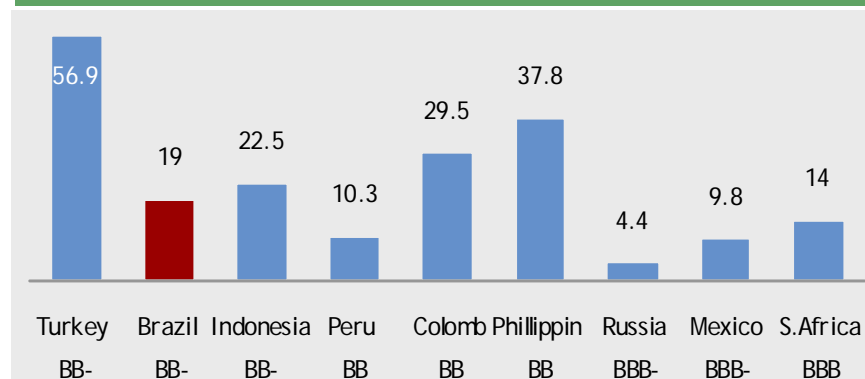
# Brazil: Comparative debt burden and fiscal position

## General government: Primary balance 2004 (% of GDP)



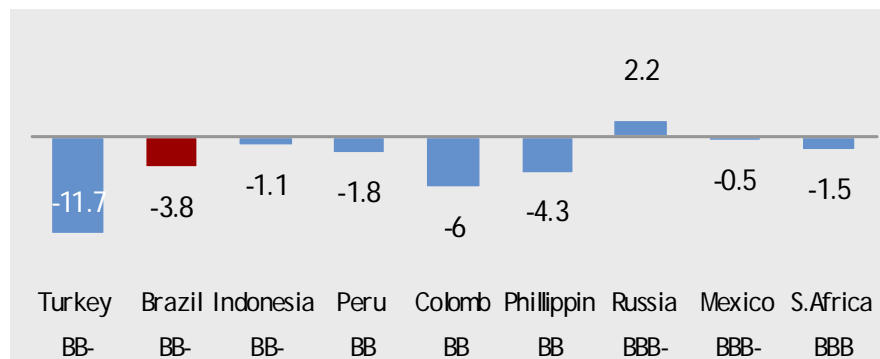
Source: Rating Agencies, Central Bank

## General government interest payments 2004 (% of revenues)



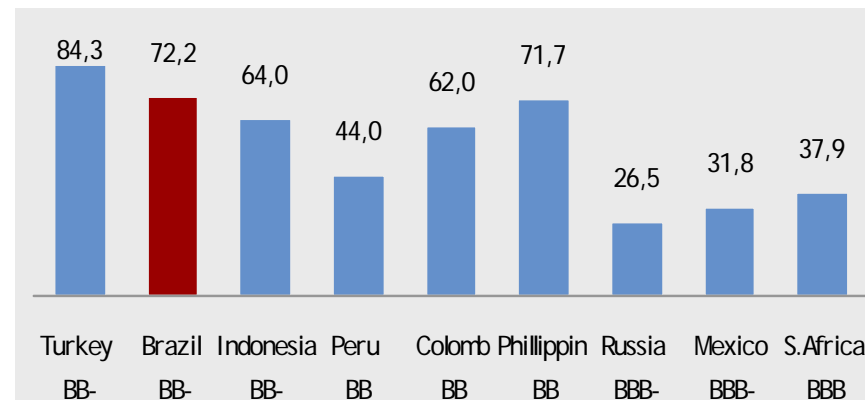
Source: Rating Agencies

## General government: Nominal balance 2004 (% GDP)



Source: Rating Agencies, Central Bank of Brazil

## General government gross debt 2004 (% GDP)



Source: Rating Agencies, Central Bank of Brazil.

Note: Ratings as of Apr-05

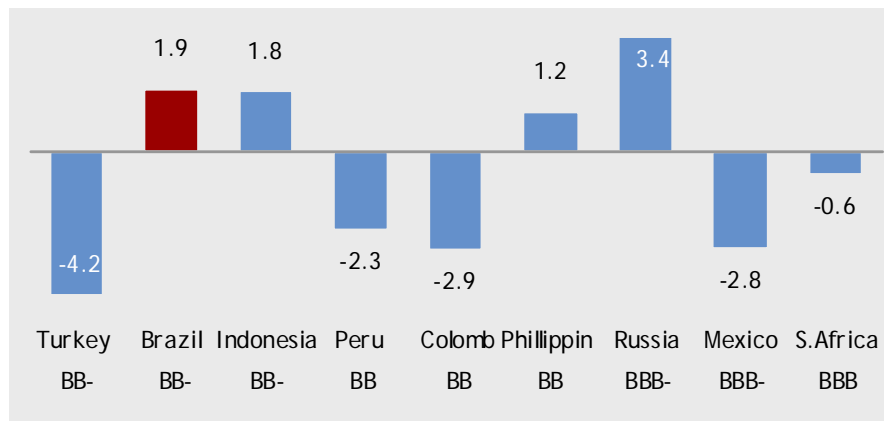


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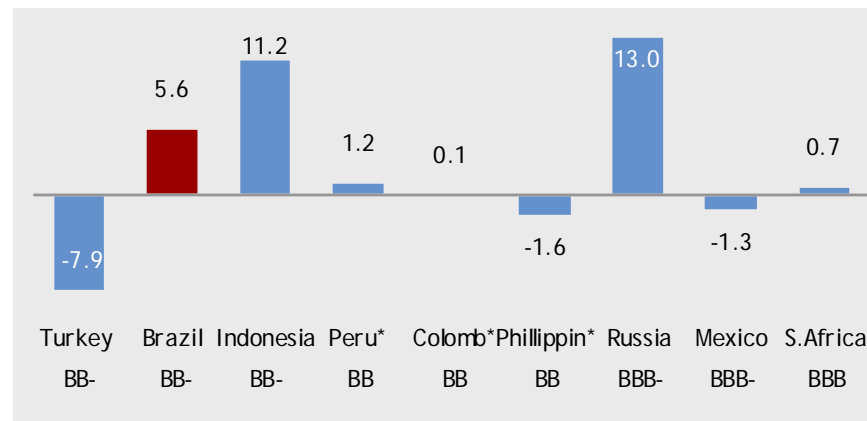
# Brazil: comparative external position

## Current Account Balance (as % of GDP - 2004)



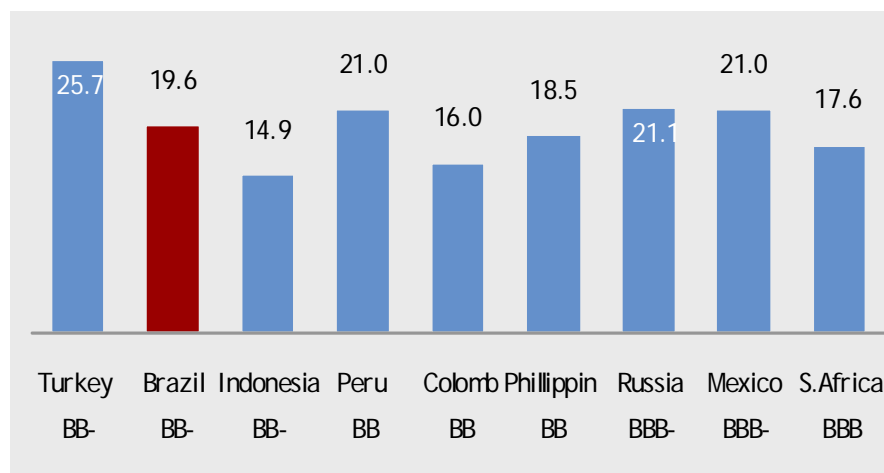
Source: Rating Agencies, Central Bank

## Trade Balance (as % of GDP - 2004)



Source: Central Bank and IIF  
\*IIF 2003

## Gross Investment (as % of GDP - 2004)



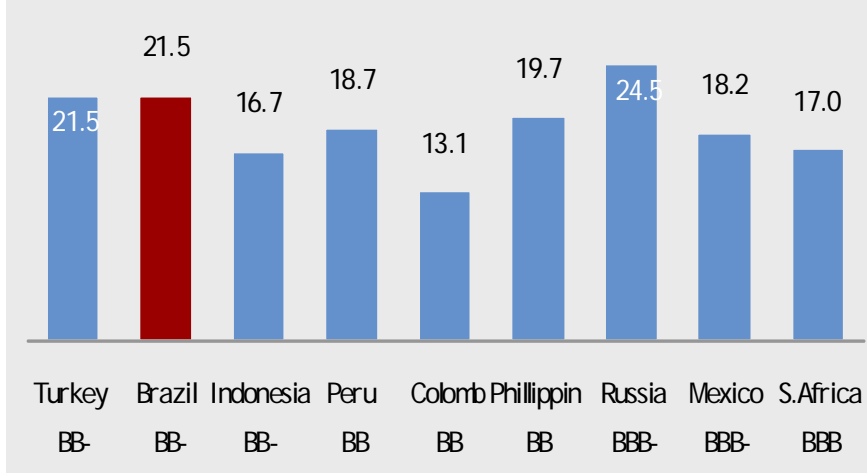
Source: Rating Agencies, IBGE

Note: Ratings as of Apr-05



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## Savings (as % of GDP - 2004)

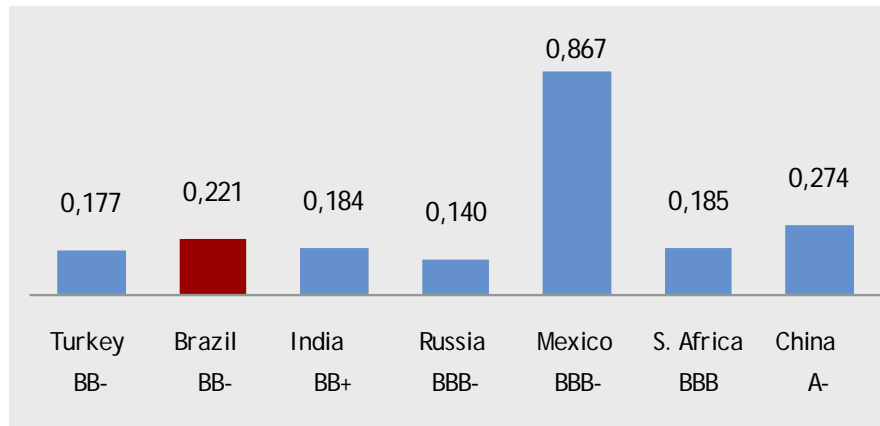


Source: Rating Agencies, IBGE

Note: Savins were computed as the sum of CA Balance and Gross Investment

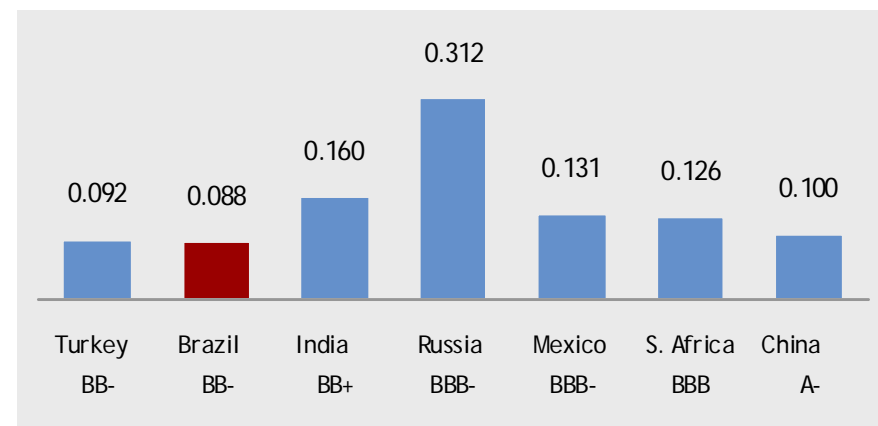
# Brazil: comparative trade diversification and debt ratio

Herfindahl-Hirschmann Exports Concentration Index - Destination



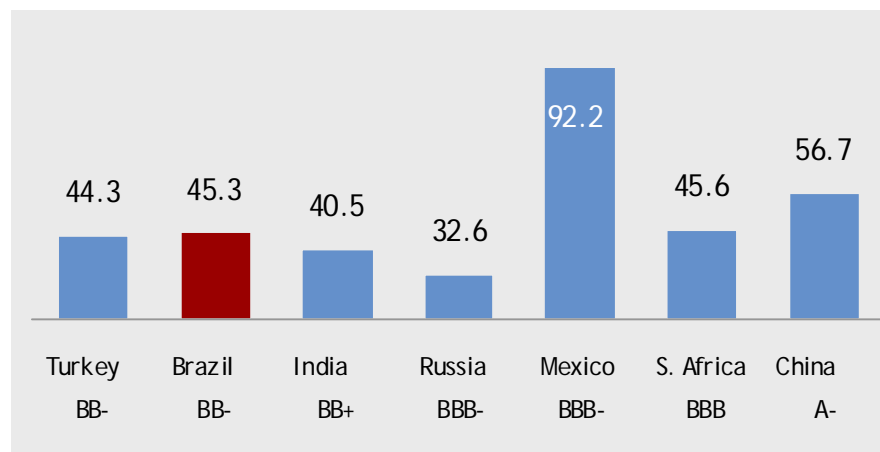
Source:UNCTAD

Herfindahl-Hirschmann Exports Concentration Index - Products



Source:UNCTAD

Exports to Top 5 Trade Partners (as % of total exports) - 2003



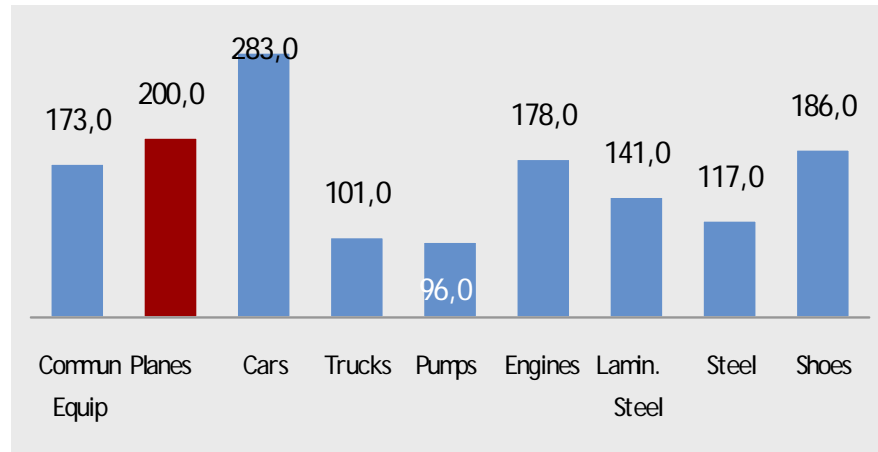
Source:IMF

Note: Ratings as of Apr-05



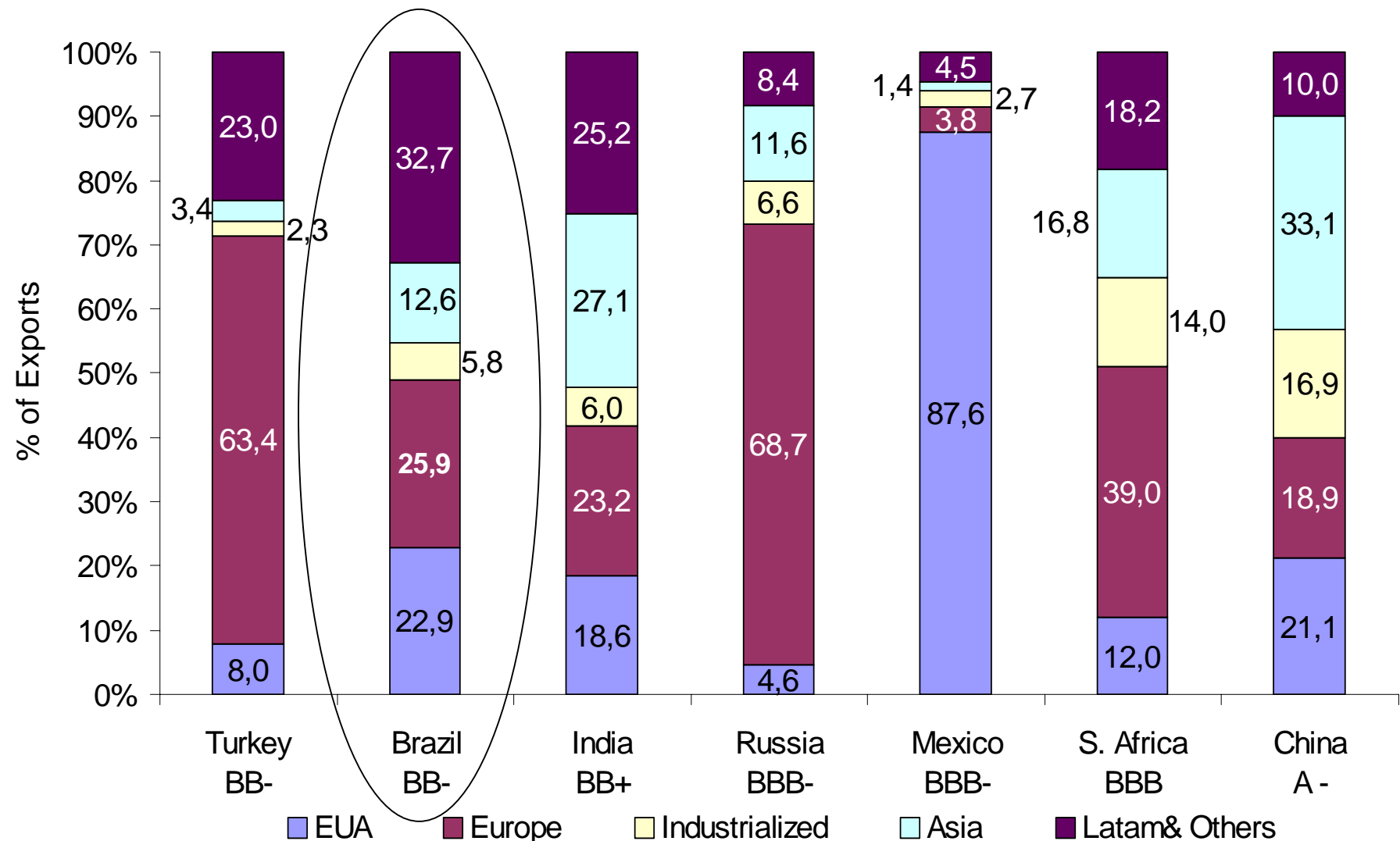
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Exports of Manufactures in Feb 2005 (US\$ 4,5 billion)



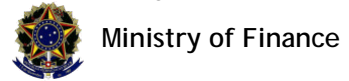
# Brazil: comparative trade diversification

Selected Countries Exports Concentrations - % of Exports - 2003



COMPARATIVE ANALYSIS

Source: IMF  
 \* Japan is among the industrialized countries  
 Note: Ratings as of Apr-05



# Brazil: Trade Diversification (cont.)

## Brazilian exports by type (as a % of total exports)

	2002	2003	2004	Feb/05
Primary products	28.1%	29.0%	29,6%	24,0%
Intermediary goods	14.9%	15.0%	13,9%	15,8%
Manufactures	54.7%	54.3%	54,9%	58,5%
Special operations	2.4%	1.8%	1,6%	1,7%
<b>Total (US\$ mn)</b>	<b>60,4</b>	<b>73,1</b>	<b>96,5</b>	<b>7,8</b>
<i>% growth</i>	<i>3.7%</i>	<i>21.1%</i>	<i>32.0%</i>	<i>35,6%</i>

Source: MDIC/SECEX

## Exports: Contribution by sector 2005

	Exports		
	Basics	Semi-manu- factured	Manu- factured
Feb 2004 (US\$ bn)	22,1	11,1	40,4
Feb 2005 (US\$ bn)	28,8	14,0	55,7
% Change	30,5%	26,2%	38,0%
Price % Change	12,8%	10,6%	14,6%
Volume % Change	15,77%	14,13%	20,38%

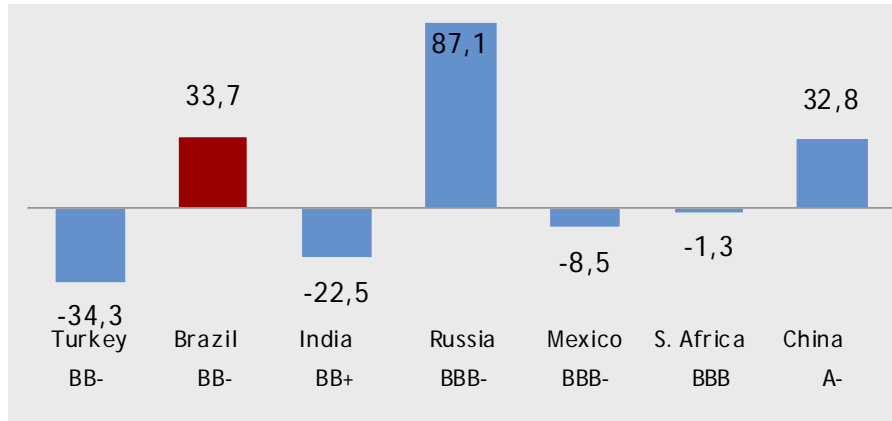
Source: MDIC/SECEX

## Main Export Markets - 12 months cumulated (Mar-04 to Feb-05)

	US\$ bn	12-months percentage change Feb 05/Feb 04	% of total exports	Contribution (p.p) growth
1. USA	21,0	28,1%	21,0%	6,2
2. Argentina	7,7	55,1%	7,7%	3,7
3. Netherlands	5,9	35,7%	5,9%	2,1
4. China	5,5	14,8%	5,5%	0,9
5. Mexico	4,2	49,5%	4,2%	1,8
6. Germany	4,1	26,6%	4,1%	1,2
7. Italy	3,0	28,1%	3,0%	0,9
<b>Others</b>	<b>48,9</b>			<b>17,2</b>

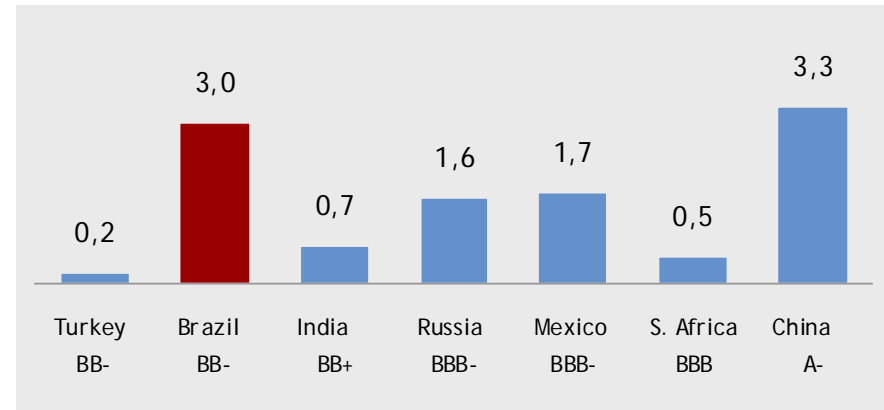
# Brazil: comparative external flows and external debt

## Trade Balance (USD Billion-2004)



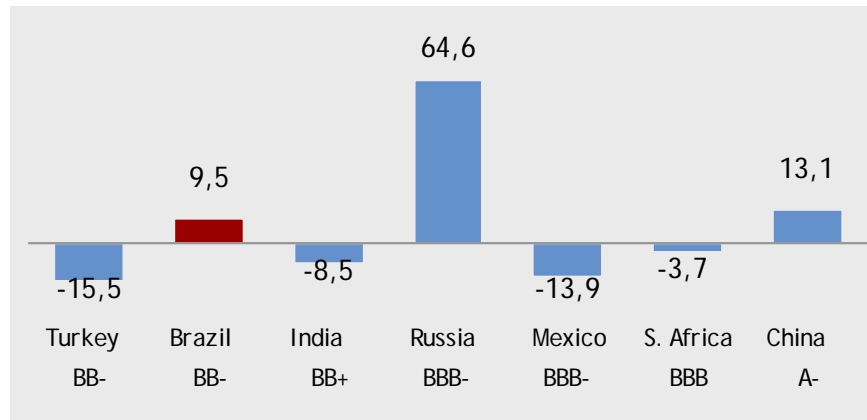
Source:IMF, JP Morgan and Local official

## FDI (as % of GDP -2003)



Source:Fitch Ratings

## Trade Balance (as % of External Debt -2003)



Source: Moody's Ratings

Note: Ratio for Brazil in 2003 was 238.8

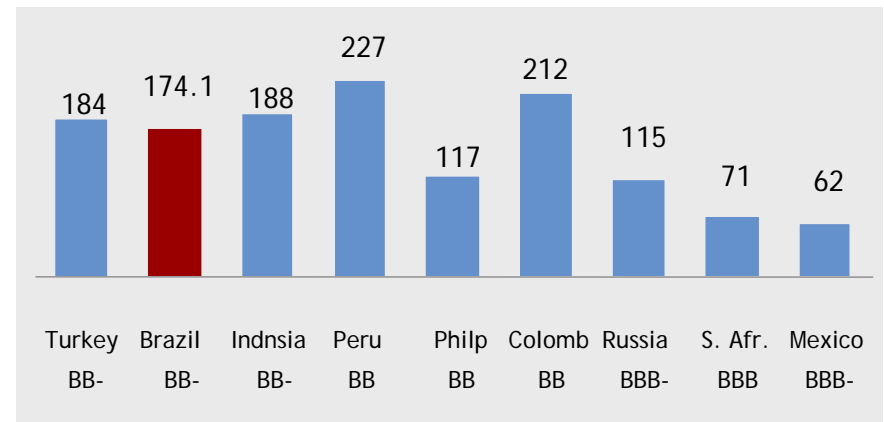
Note: Ratings as of Apr-05



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Source:IMF

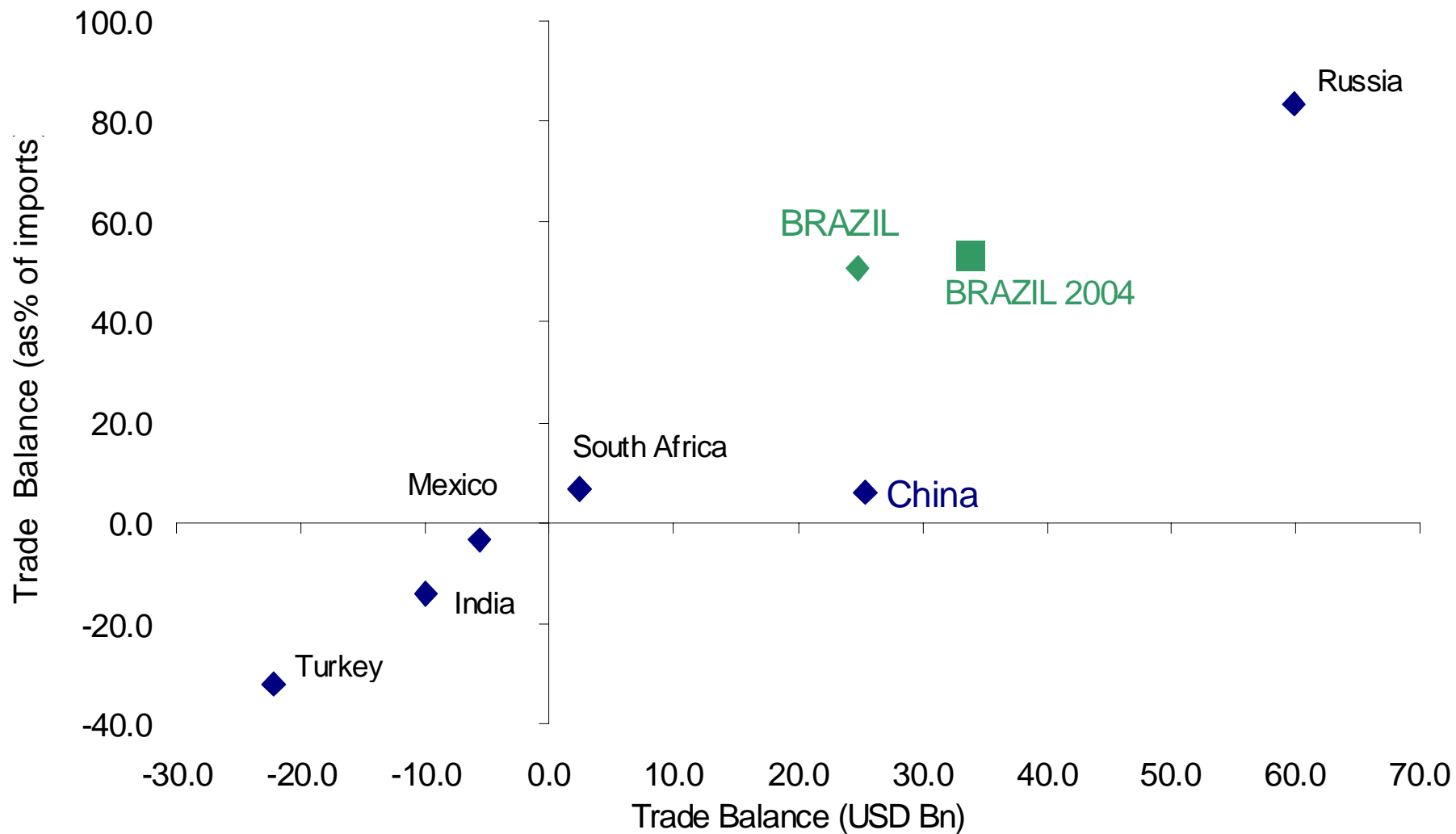
## External Debt as % of CA receipts -2004



Source: Moody's

# Brazil: export growth and free cash flow generation

Selected Countries Trade "Effort" - 2003

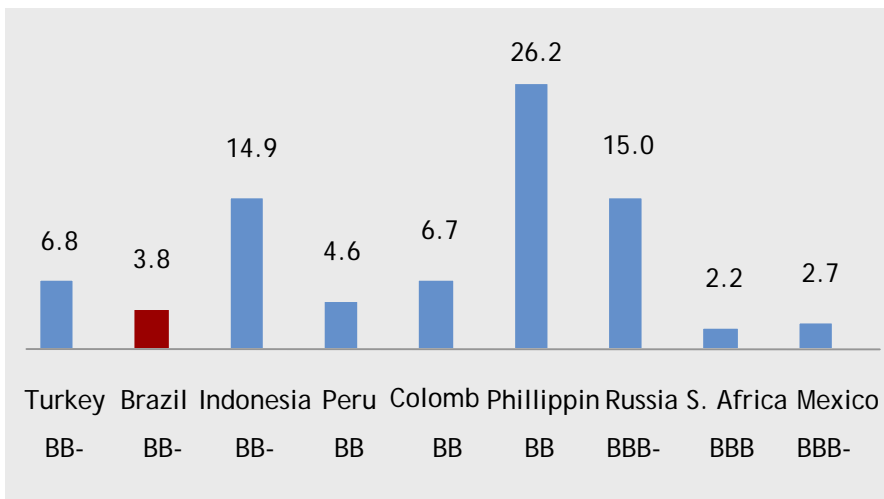


Source: IMF and OECD



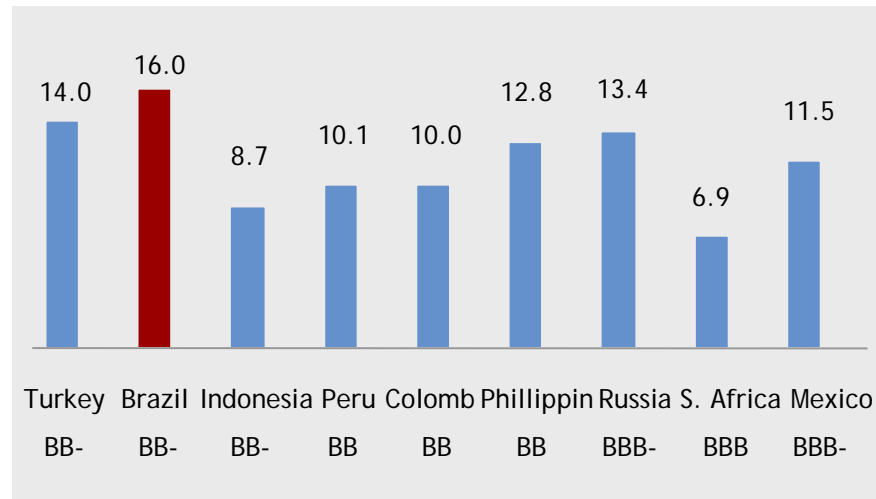
# Brazil: comparative institutional indicators

## Banking Risks: Non performing loans as % total loans



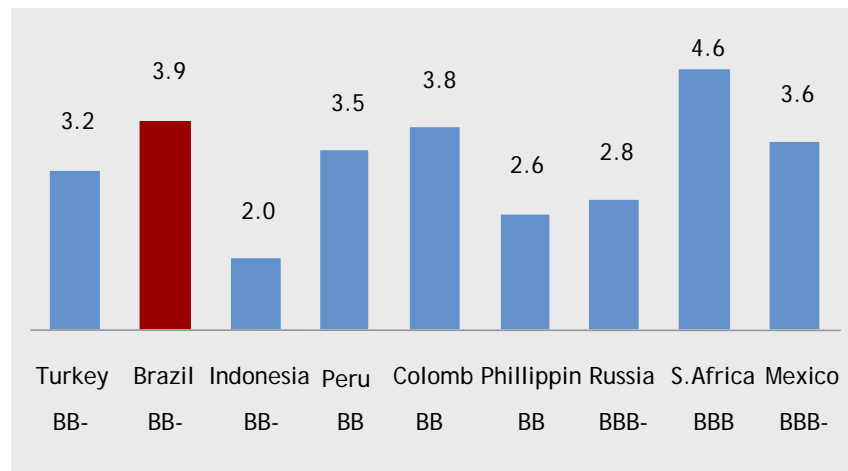
Source: IMF - GFSR 2005 - Table 24: data for Indonesia and Philippines include real estate and other assets acquired; e.g., foreclosed real estate)

## Capital to Asset Ratio (IMF-GFSR 2005)



Source:GFSR Table 23

## Business Practices



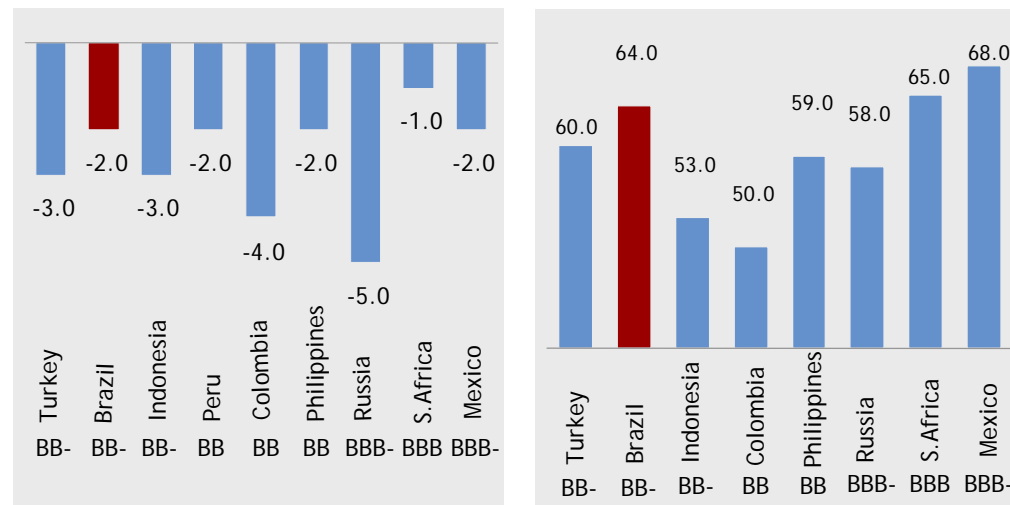
Source: Transparency International; corruption perception index

Note: Ratings as of Apr-05



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## Freedom House Political Rights & Eurasia Stability Indices



Source: Transparency International and Eurasia Group 2

# Brazil is not alone in presenting an important structural reform scorecard

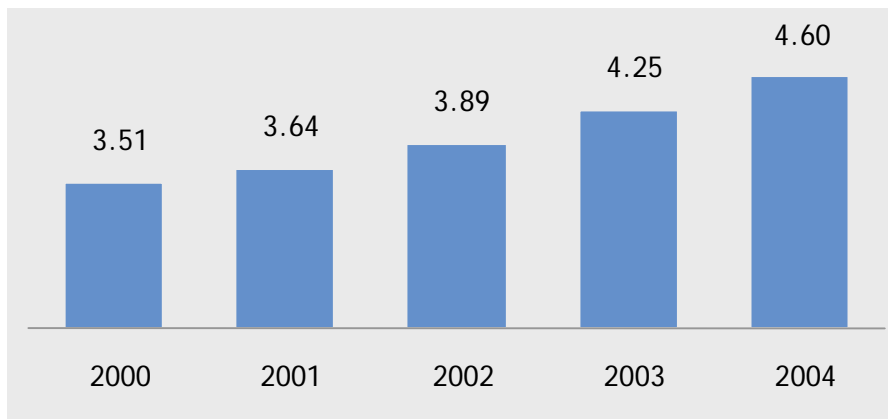
	BRAZIL	MEXICO	TURKEY	INDIA
<b>INFRA-STRUCTURE</b>	<ul style="list-style-type: none"> <li>• <b>Telecomm:</b> model is consolidated</li> <li>• <b>Electricity:</b> New framework consolidates early measures on secondary market for energy and private sector role</li> <li>• <b>Ports:</b> new concessions (RJ, MA, ES, SC).</li> <li>• <b>Roads:</b> resumption of concession process.</li> <li>• <b>Railroads:</b> rulings clarifying corporate structure and investment compensation</li> <li>• <b>PPP Pilot Project with IMF.</b></li> </ul>	<ul style="list-style-type: none"> <li>• Electricity: overhauling of supervisor;</li> <li>• Telecomm: Reporting of quality of service.</li> </ul>	<ul style="list-style-type: none"> <li>• Government is attempting to reduce cross subsidies in the energy sector (now favoring households and burdening business)</li> <li>• Several reforms have been started, but have not yet been completed</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Electricity and gas:</b> new rules for secondary markets;</li> <li>Ports, shipping, etc.: new support mechanisms</li> <li>• <b>Railroads:</b> strengthening of intermodal operation;</li> <li>• <b>agriculture:</b> crop insurance</li> <li>• <b>PPP.</b></li> </ul>
<b>BUSINESS ENVIRONMENT</b>	<ul style="list-style-type: none"> <li>• <b>Bankruptcy law:</b></li> <li>• <b>Consolidation of competition authorities</b> and clarification of attribution of different bodies (in congress)</li> <li>• <b>Gas:</b> continuation of auctioning of oil/gas fields and consolidation of supervisory powers since the end of government monopoly in 2001; review of gas transportation regulation (in discussion) .</li> <li>• <b>Judiciary Reform:</b>, increasing the predictability of rulings and speeding up conflict resolution</li> <li>• <b>Industrial policy</b> based on the support of research and lab infrastructure.</li> <li>• <b>Innovation law</b> providing incentives to researchers who team up with the private sector</li> <li>• <b>Stock markets:</b> most IPOs in the high-governance new market</li> </ul>	<ul style="list-style-type: none"> <li>• Bankruptcy law: focus on preserving viable firms</li> <li>• Oil and chemicals: discussions about liberalization of the market</li> <li>• Aviation: breaking up and privatization progressing, although at slower-than-anticipated pace.</li> <li>• Stock markets: new law protecting minority stockholders;</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Competition law:</b> harmonization with EU law</li> </ul>	<ul style="list-style-type: none"> <li>• Insolvency Law: new law facilitates reorganization of loss-making firms;</li> <li>• Competition: reduction of import restrictions and simplification of process.</li> </ul>
<b>FISCAL AND TRANSPARENCY</b>	<ul style="list-style-type: none"> <li>• Substantial share of procurement through internet</li> <li>• Fifth year of the Fiscal Responsibility Law</li> <li>• Transformation of PIS/COFINS in VAT.</li> <li>• lower taxes on long-term savings, pension plans and life insurance</li> <li>• New taxation of securities backed by housing loans</li> </ul>	<ul style="list-style-type: none"> <li>• E-government;</li> <li>• New classification of expenditures, new periodic reporting requirements</li> <li>• Reduction in discretion regarding sub-national transfers</li> <li>• new bank prudential requirements.</li> </ul>	<ul style="list-style-type: none"> <li>• Decentralization of expenditure</li> <li>• Anti-corruption law.</li> <li>• Increased fiscal transparency.</li> </ul>	<ul style="list-style-type: none"> <li>• Budget execution procedures law;</li> <li>• New rules for fiscal transparency</li> <li>• Taxation: improvement in the taxation of capital gains and credit</li> </ul>
<b>HOUSING AND SANITATION</b>	<ul style="list-style-type: none"> <li>• Low-income, budget-supported housing program (<b>PSH</b>).</li> <li>• New rules for mortgages, protecting buyer and banks.</li> </ul>	<ul style="list-style-type: none"> <li>• Tax break for interest on housing loans.</li> </ul>		
<b>FINANCIAL SECTOR/ CREDIT</b>	<ul style="list-style-type: none"> <li>• Legislation on loans with payroll as collateral</li> <li>• Regulation of loan securitization mechanism (CC) Positive Credit Report for firms (Cadastro Central Bank)</li> </ul>	<ul style="list-style-type: none"> <li>• Microcredit with support of USAID;</li> <li>• Independence of Central Bank.</li> </ul>	<ul style="list-style-type: none"> <li>• Reform of banking system after 2001 shock.</li> </ul>	<ul style="list-style-type: none"> <li>• Liberalization of foreign investment</li> </ul>
<b>EDUCATION AND LABOR MARKETS</b>	<ul style="list-style-type: none"> <li>• Overhauling of tax-supported grants by private universities with a view to effectively reach poor students (e.g., those coming from public high schools), on a merit base.</li> </ul>	<ul style="list-style-type: none"> <li>• New model for vocational training;</li> <li>• New system of skills certification.</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in the taxation of temporary workers</li> </ul>	
<b>SOCIAL SECURITY AND SAFETY NET</b>	<ul style="list-style-type: none"> <li>• Reform of public sector Social Security consolidation of income transfer mechanism (Bolsa Familia/Fome Zero)</li> <li>• Micro-entrepreneur program (in Congress)</li> </ul>	<ul style="list-style-type: none"> <li>• Additional resources to improve curricula and general education.</li> </ul>	<ul style="list-style-type: none"> <li>• Incentive to competition in the pharmaceutical sector.</li> <li>• Increase in the length of contribution period for social security benefits.</li> </ul>	<ul style="list-style-type: none"> <li>• Strong focus on financial support of very-low-income entrepreneurs.</li> </ul>



Brazil: snapshot x trends

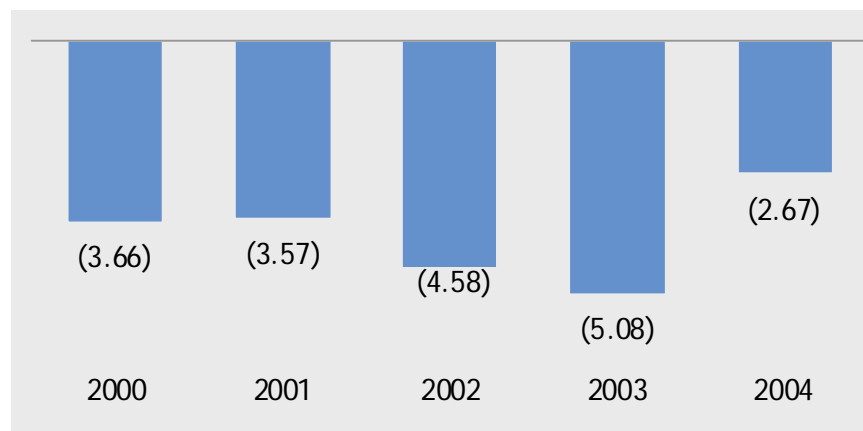
# Steady strengthening of key indicators

Brazil Public Sector Primary Balance (%GDP)



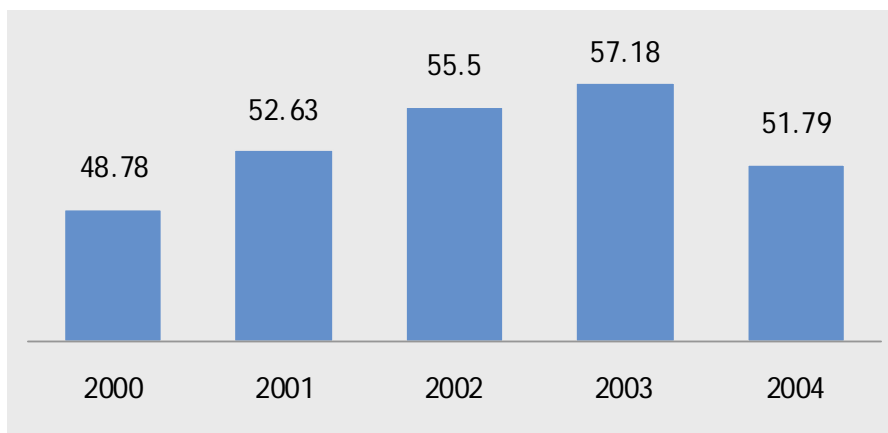
Source: Central Bank

Brazil Public Sector Nominal Balance (%GDP)



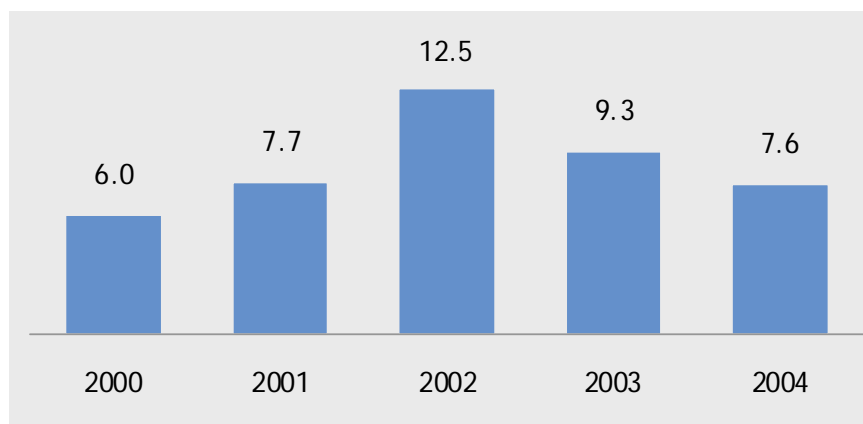
Source: Central Bank

Brazil Net Public Sector Debt (%GDP)



Source: Central Bank

Brazil Inflation (CPI Index)

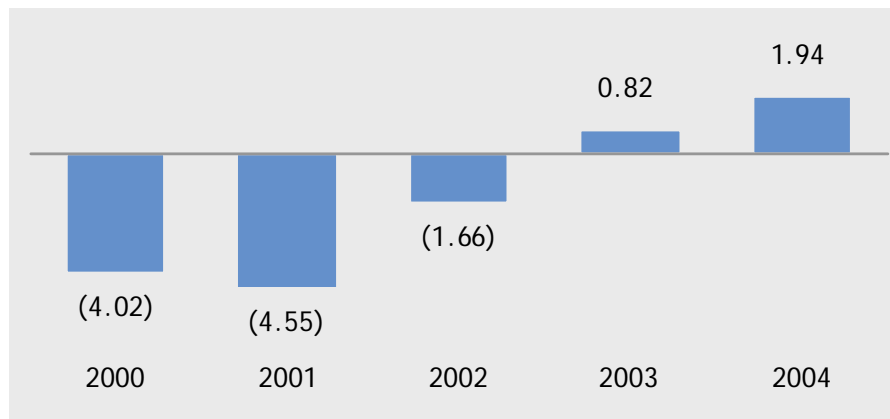


Source: Central Bank



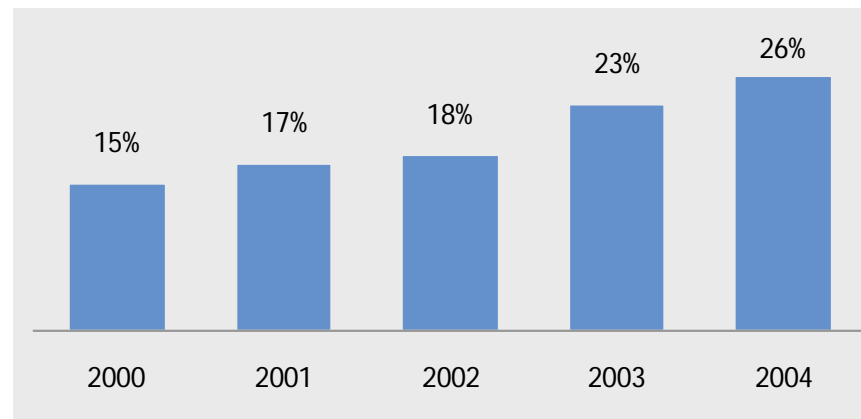
# Strengthening of indicators (cont)

Brazil Current Account Balance (% GDP)



Source: Central Bank

Brazil FX Reserves/ Total Gross External Debt



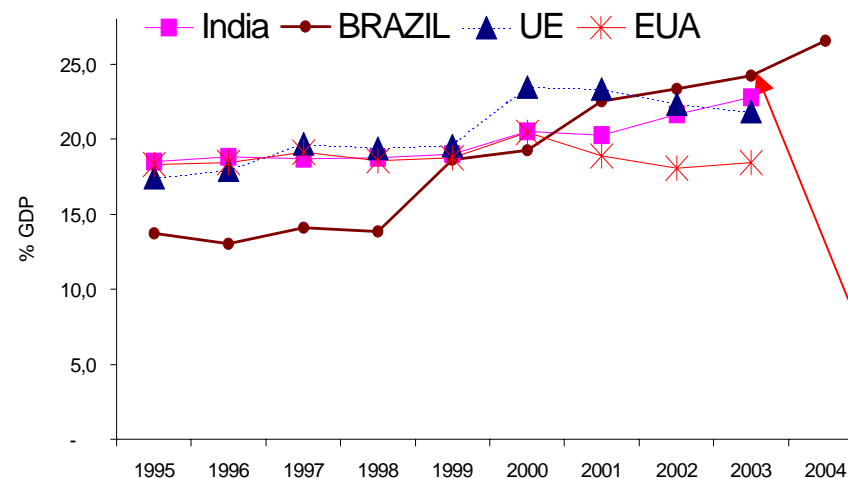
Source: Central Bank

Brazil Annual Exports/Total Gross External Debt



Source: Central Bank

Openness (exports as % of GDP)

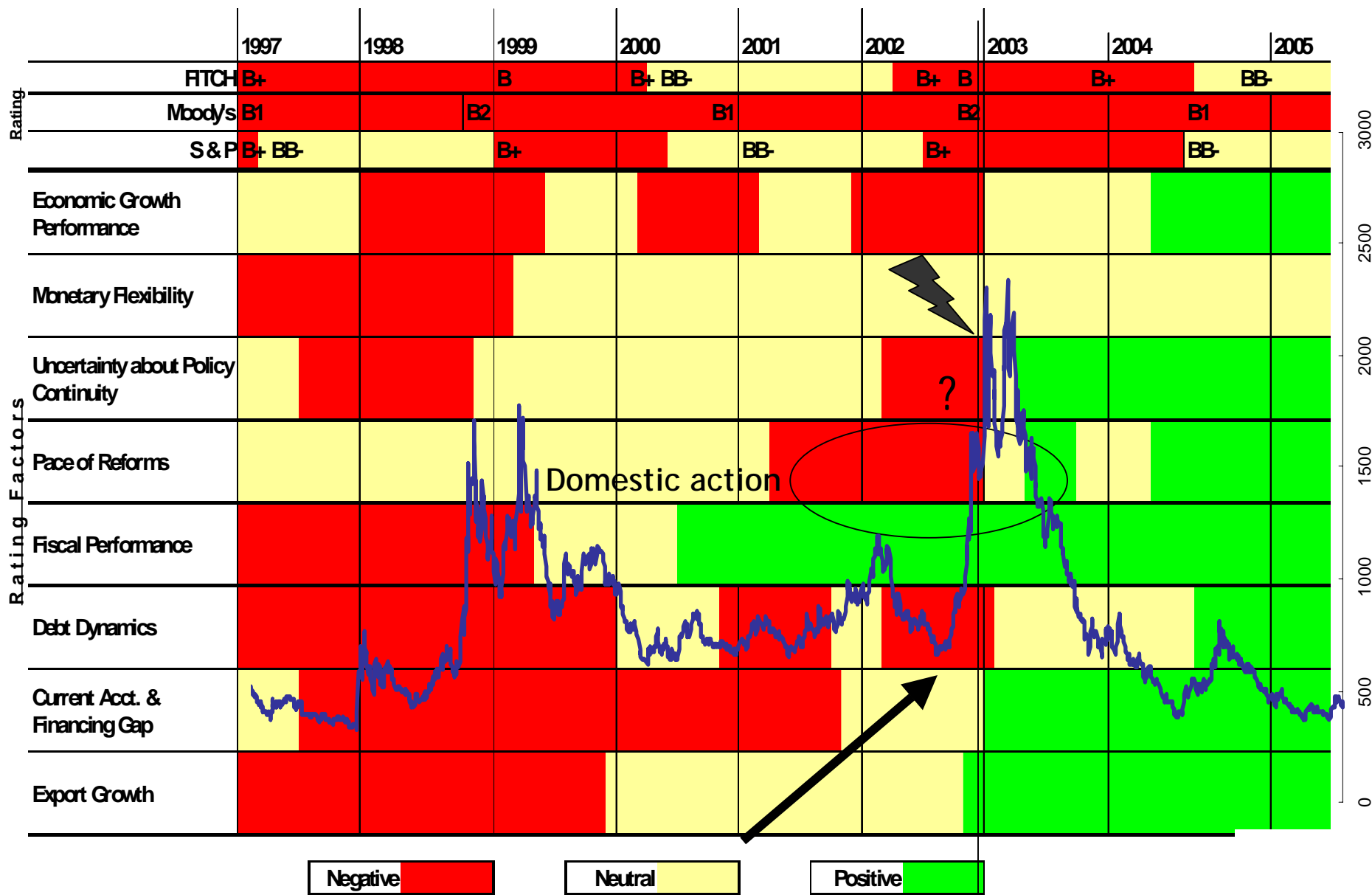


Source: Central Bank and IMF

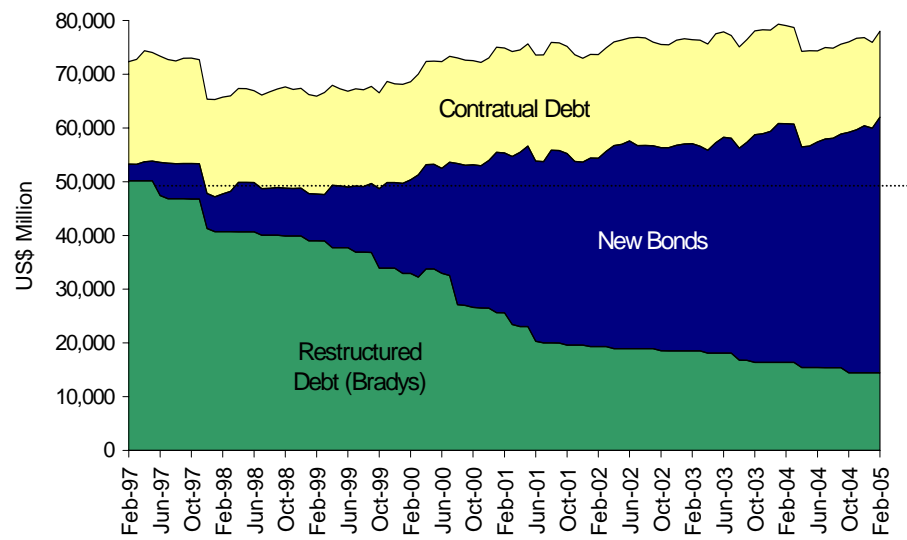
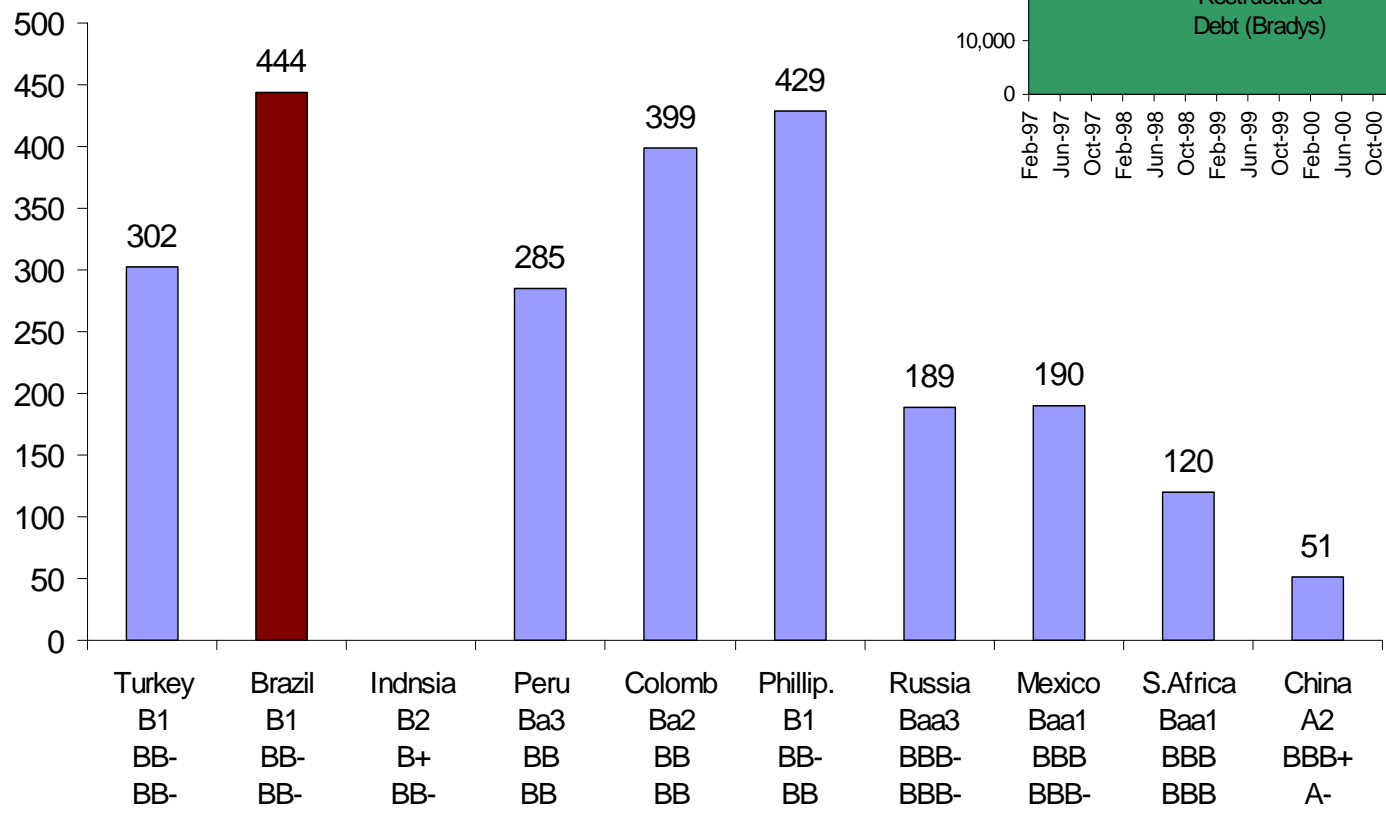


Brazil: some remaining apparent puzzles

# Fundamentals, market sentiment and credit ratings



# Spread over US Treasury and total supply of foreign debt



COMPARATIVE ANALYSIS

Note: Ratings as of Apr-05



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# *Thank you !*



The Brazil we all know... and the Brazil we are building



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