

LACEA/LAMES 2007

“Global Financial Markets Turmoil and
Implications for Latin America: BRAZIL”

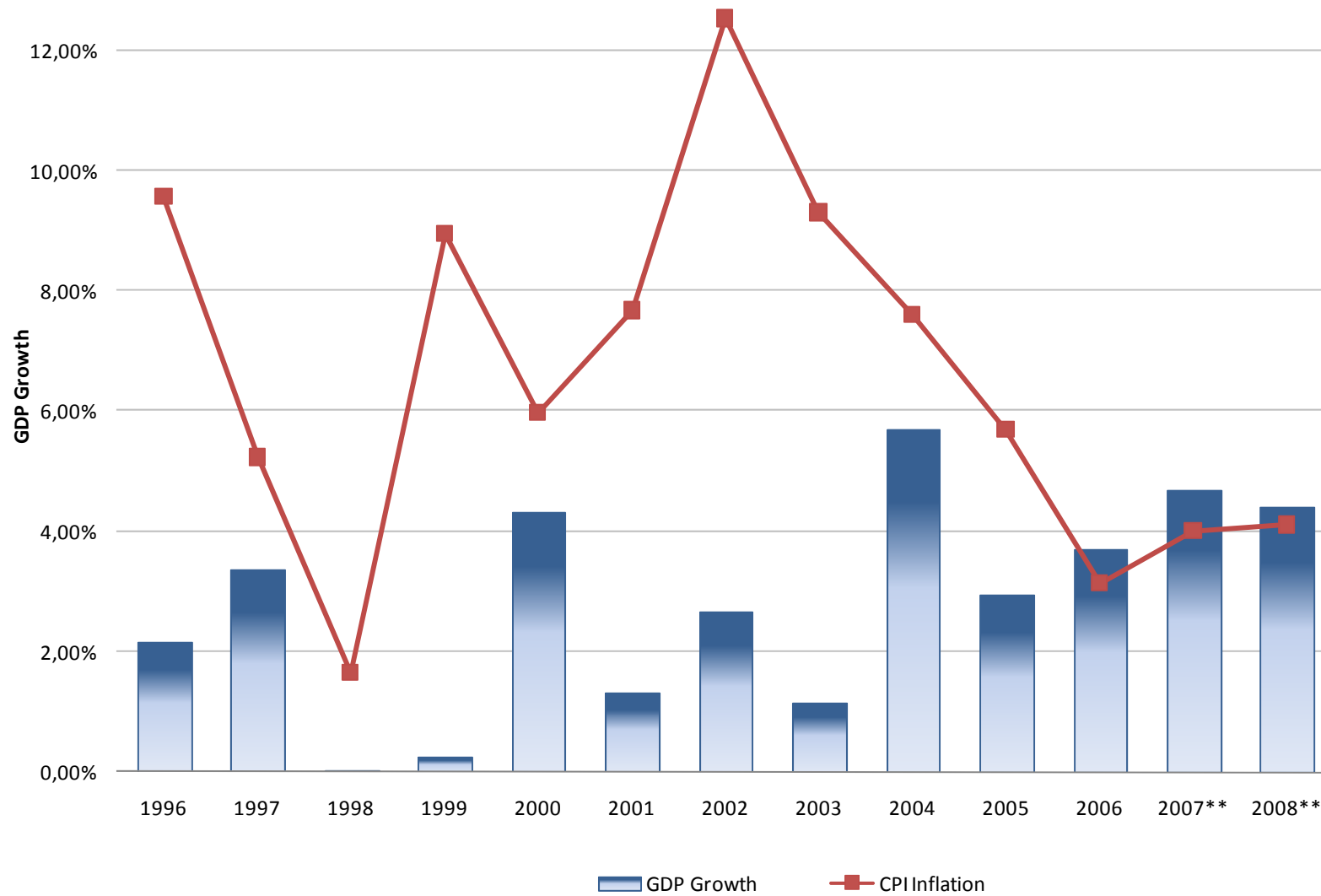
05/10/2007

Márcio Garcia

www.econ.puc-rio/mgarcia

I. Inflation, Output Growth and Unemployment

GDP Growth and CPI Inflation

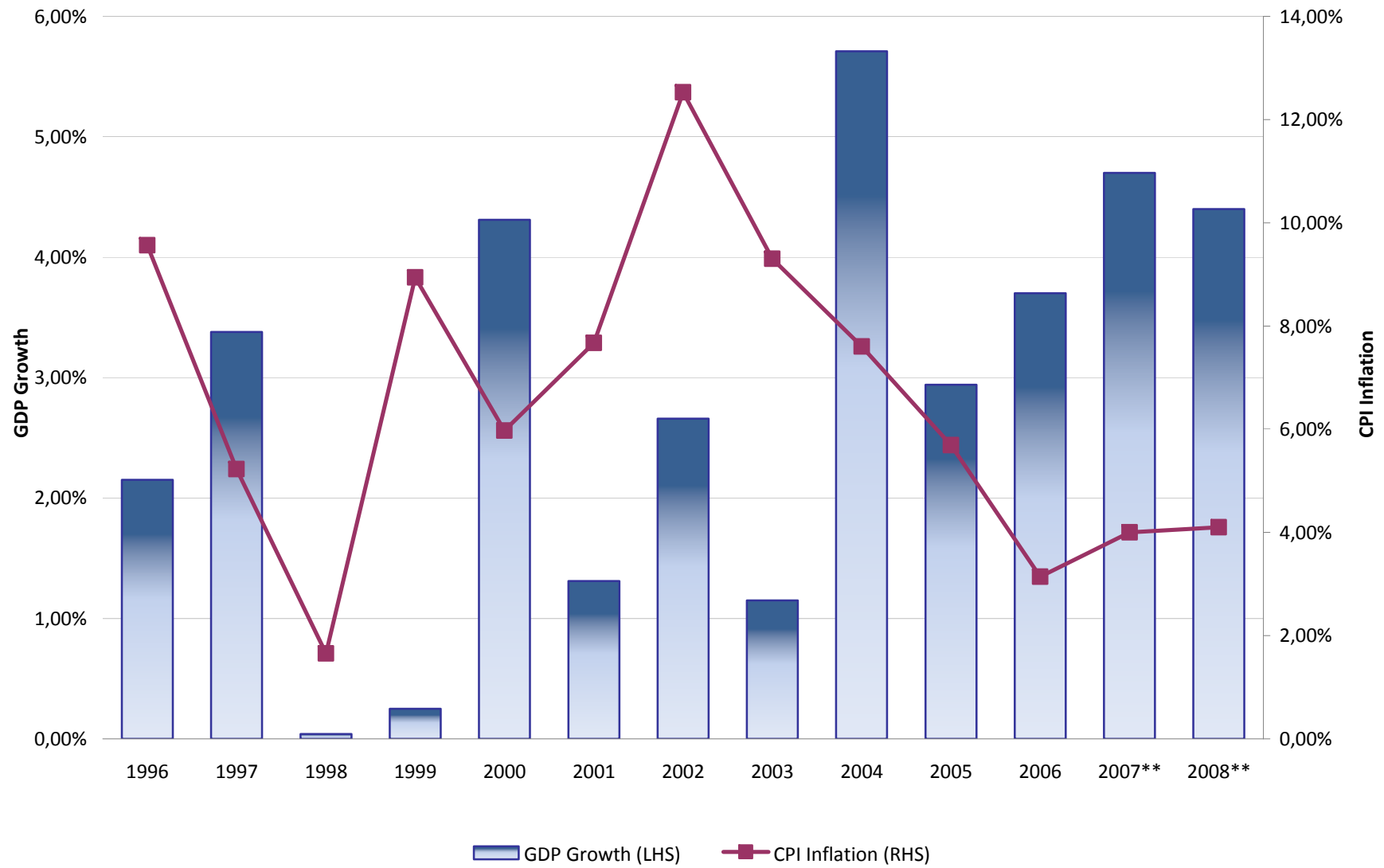


Source: Central Bank of Brazil

**Market Expectations (September 28,2007)

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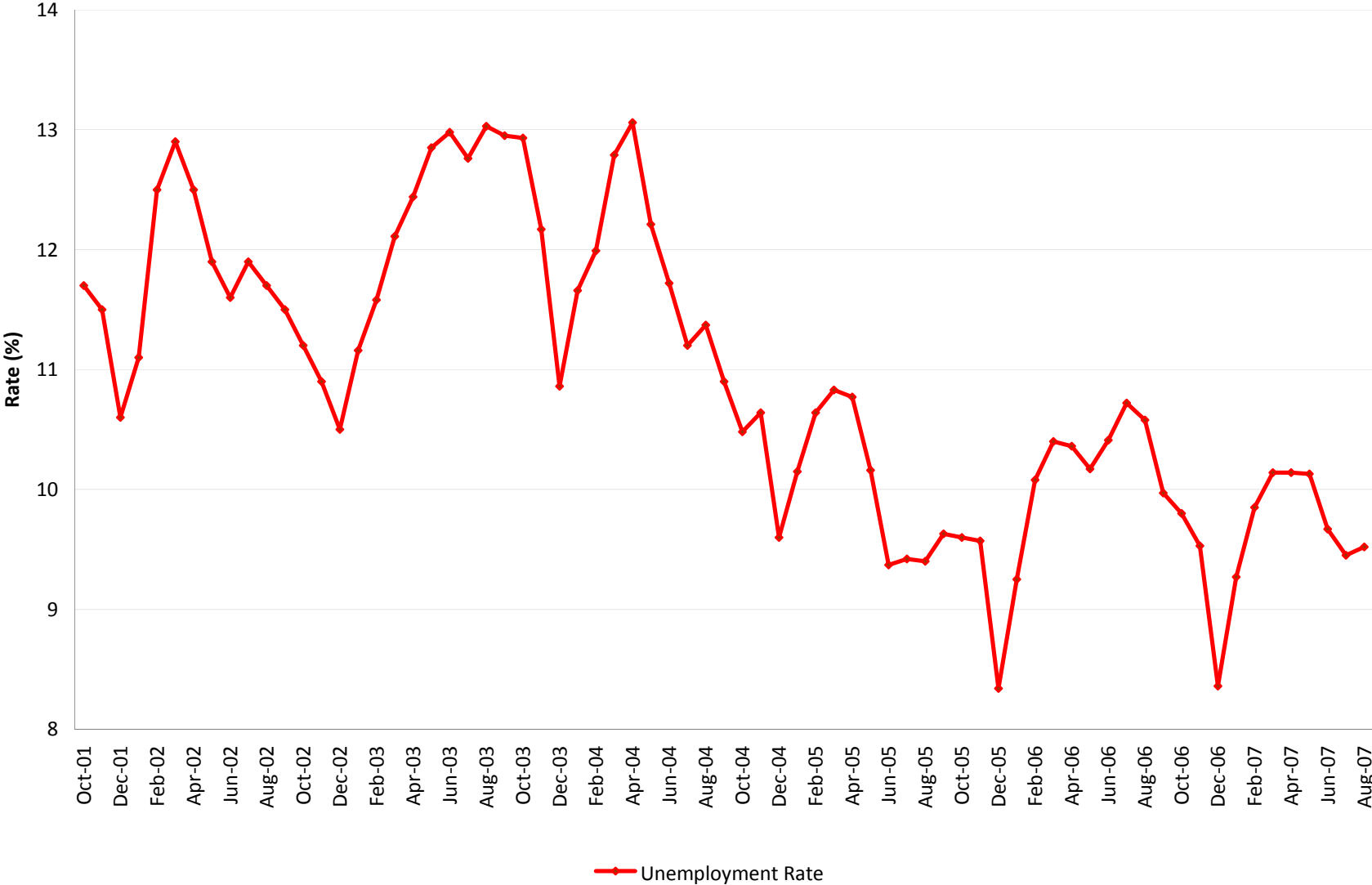
GDP Growth and CPI Inflation



Source: Central Bank of Brazil
****Market Expectations** (September 28,2007)

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Unemployment Rate

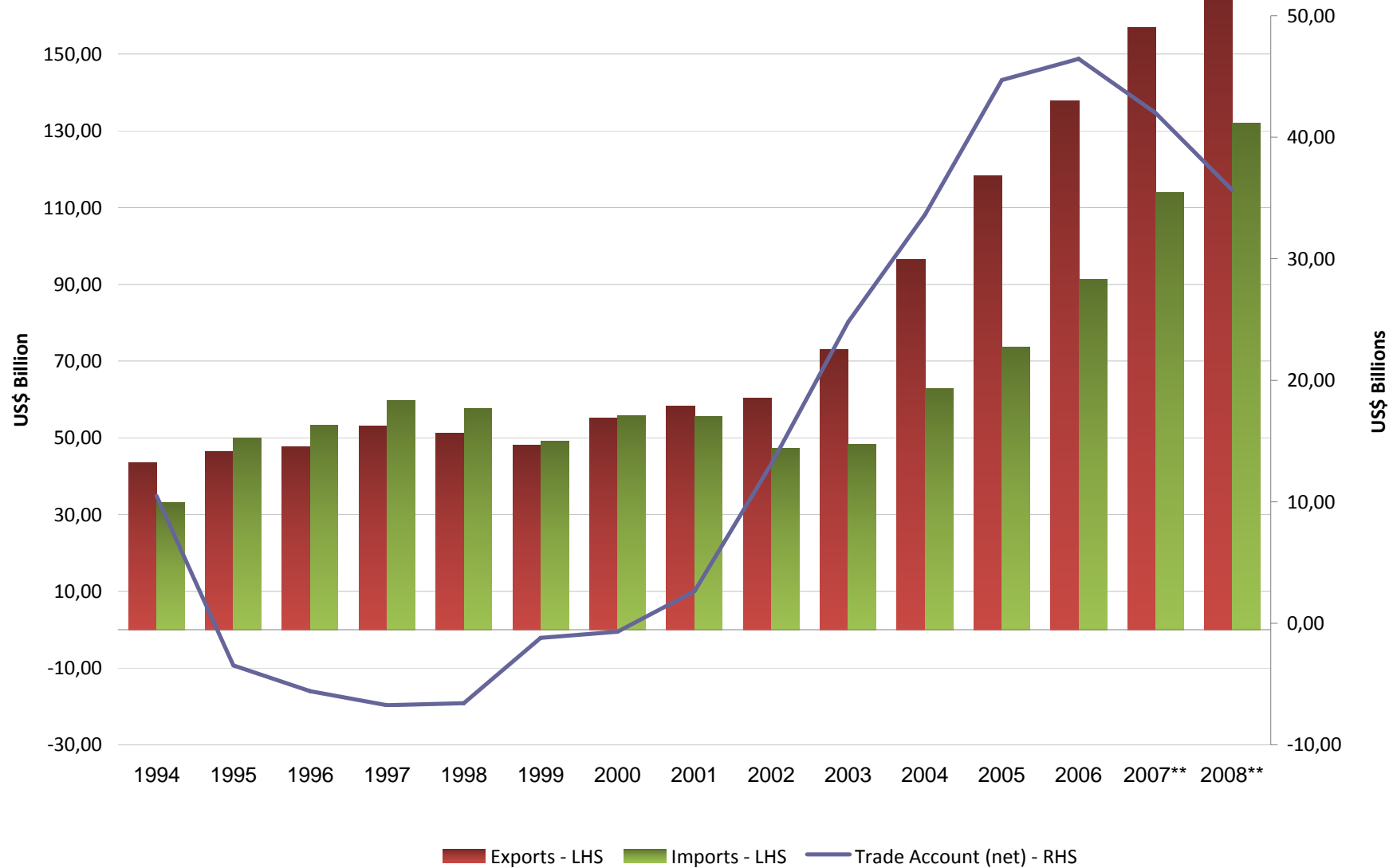


Source: IBGE

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II. External Sector

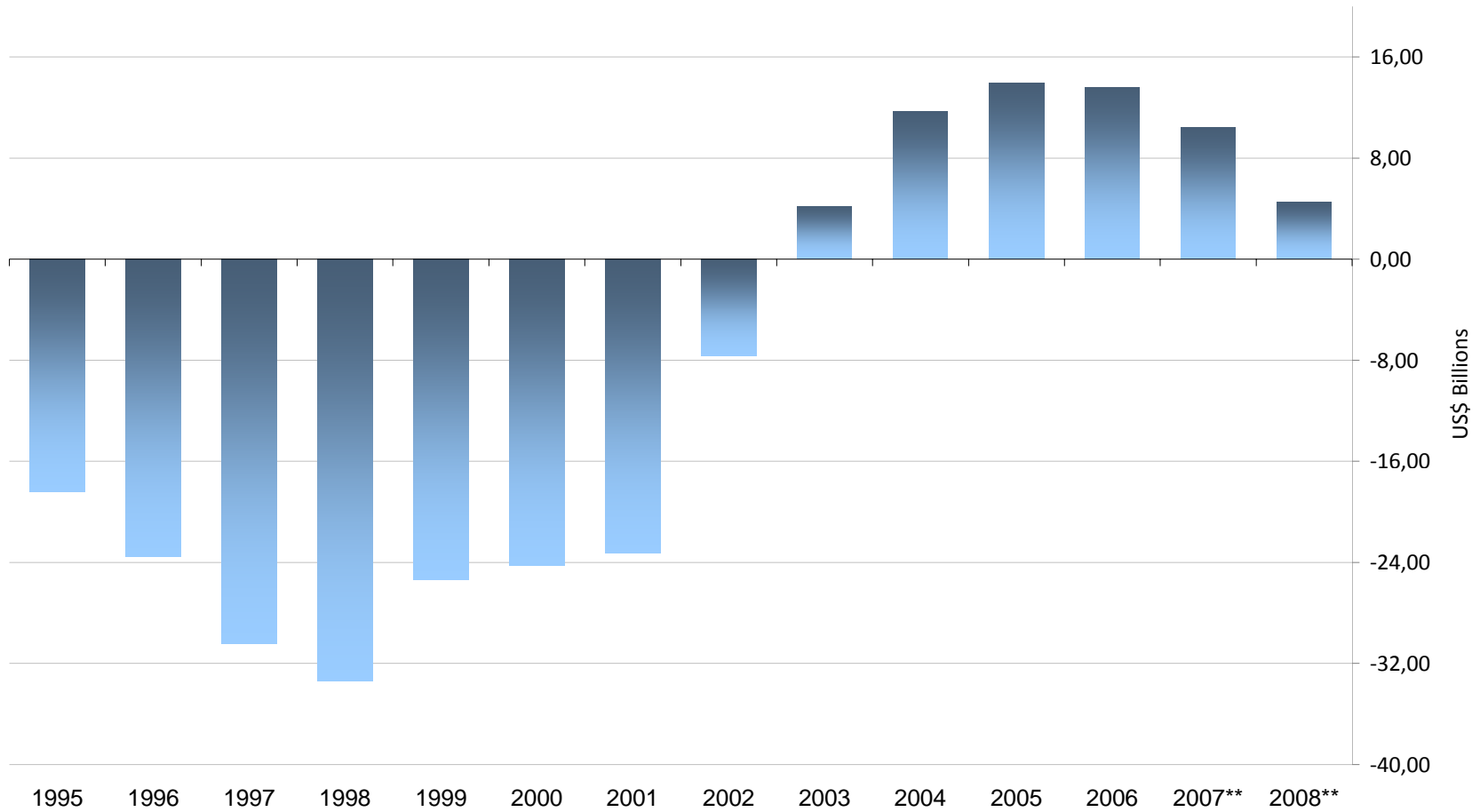
Trade Balance



Source: Central Bank of Brazil
 **Market Expectations (September 28,2007)

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Current Account



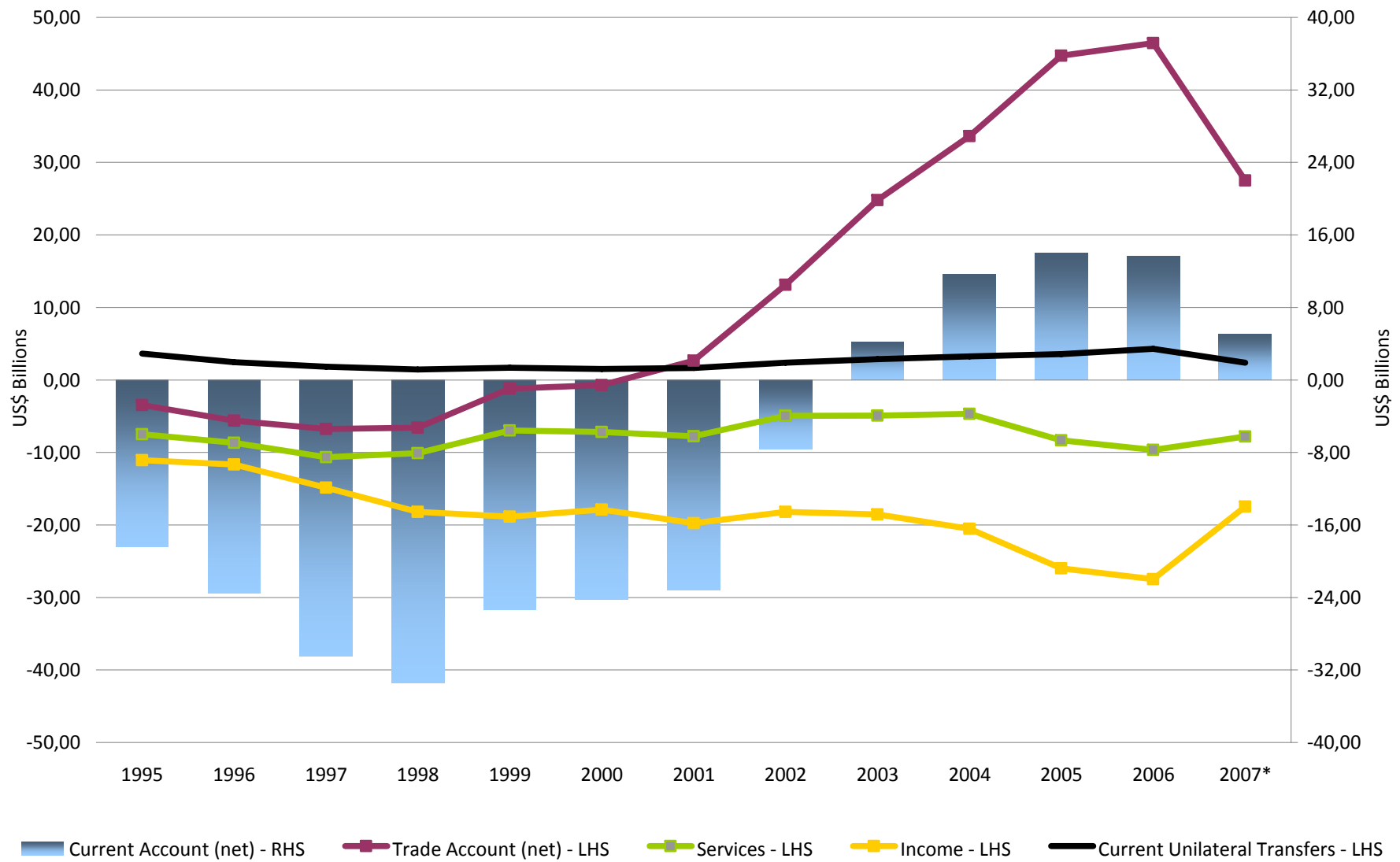
■ Current Account (net)

Source: Central Bank of Brazil

** Market Expectations (September 28, 2007)

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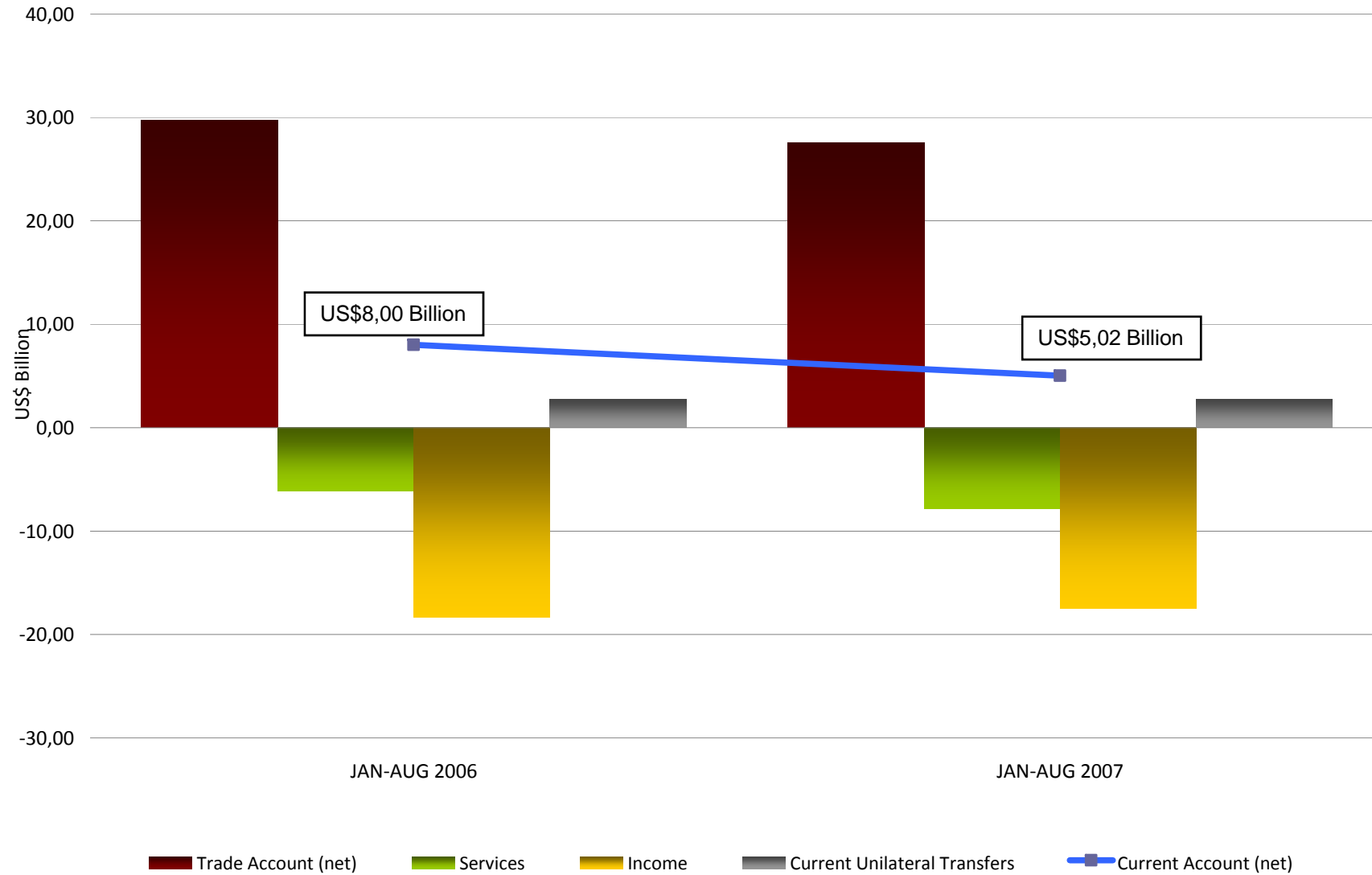
Current Account



Source: Central Bank of Brazil
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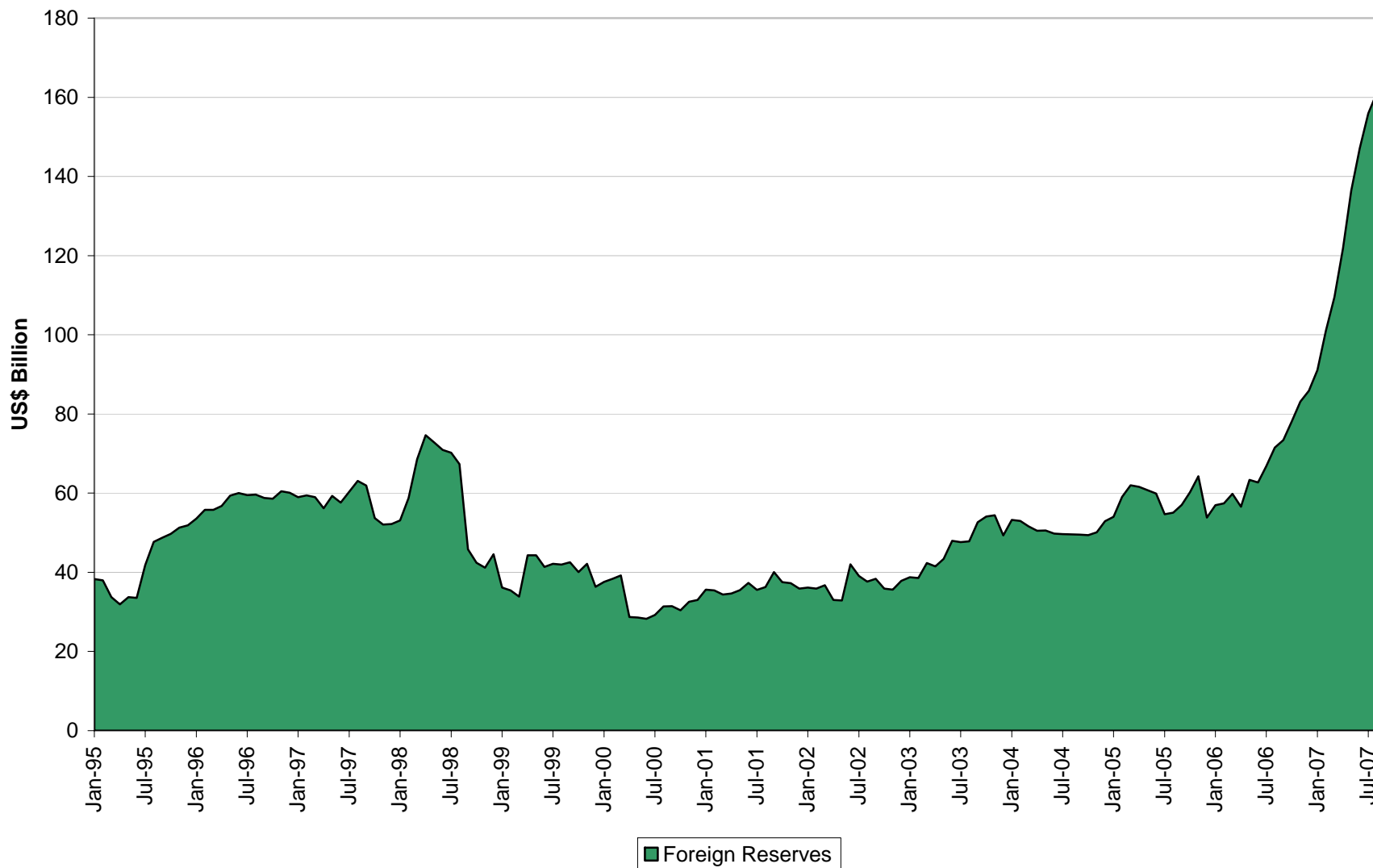
Current Account (Jan-Aug)



Source: Central Bank of Brazil

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Foreign Reserves



Source: Central Bank of Brazil

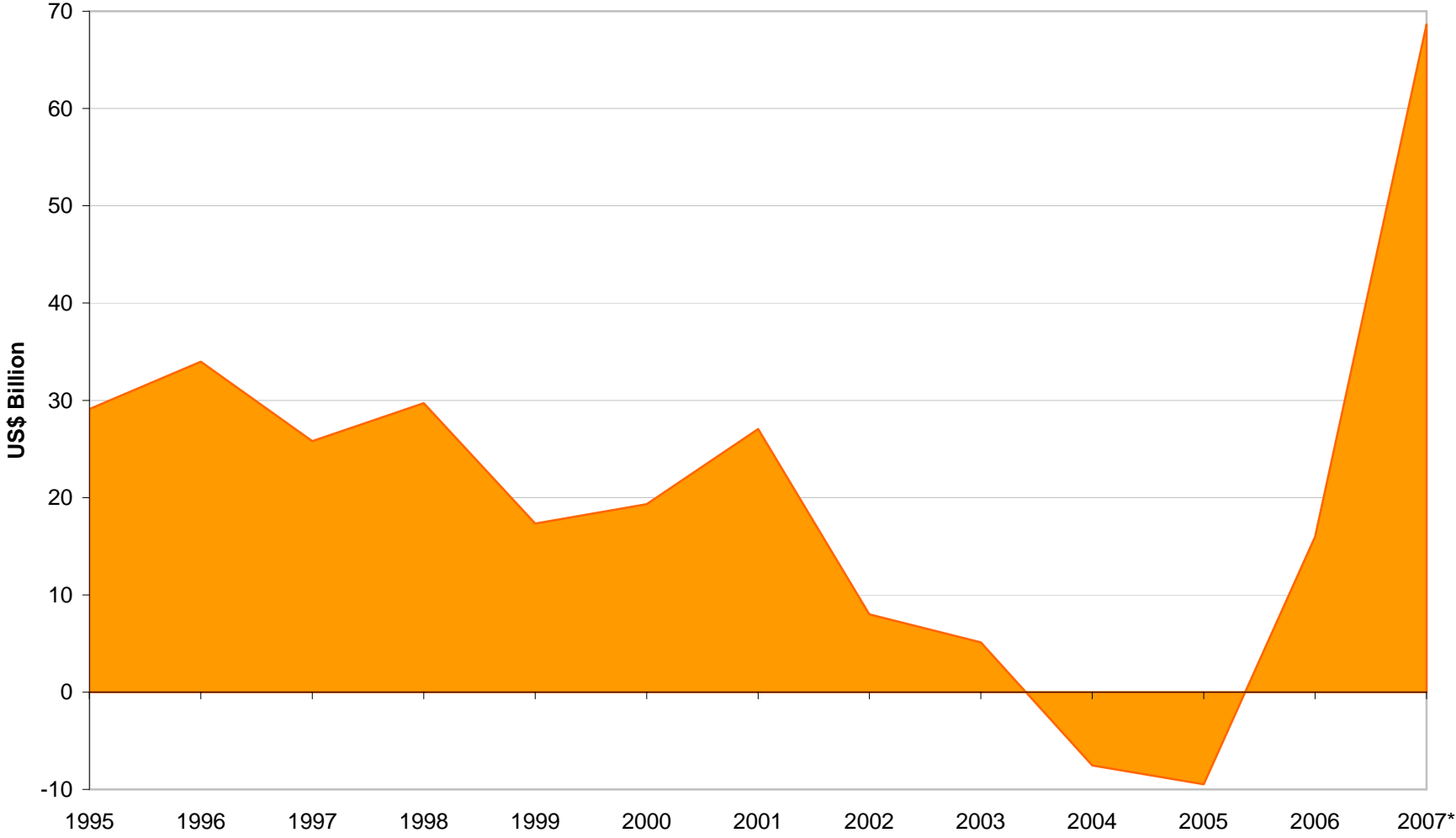
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Capital Account



Source: Central Bank of Brazil
*Jan-Aug 2007

Capital Account

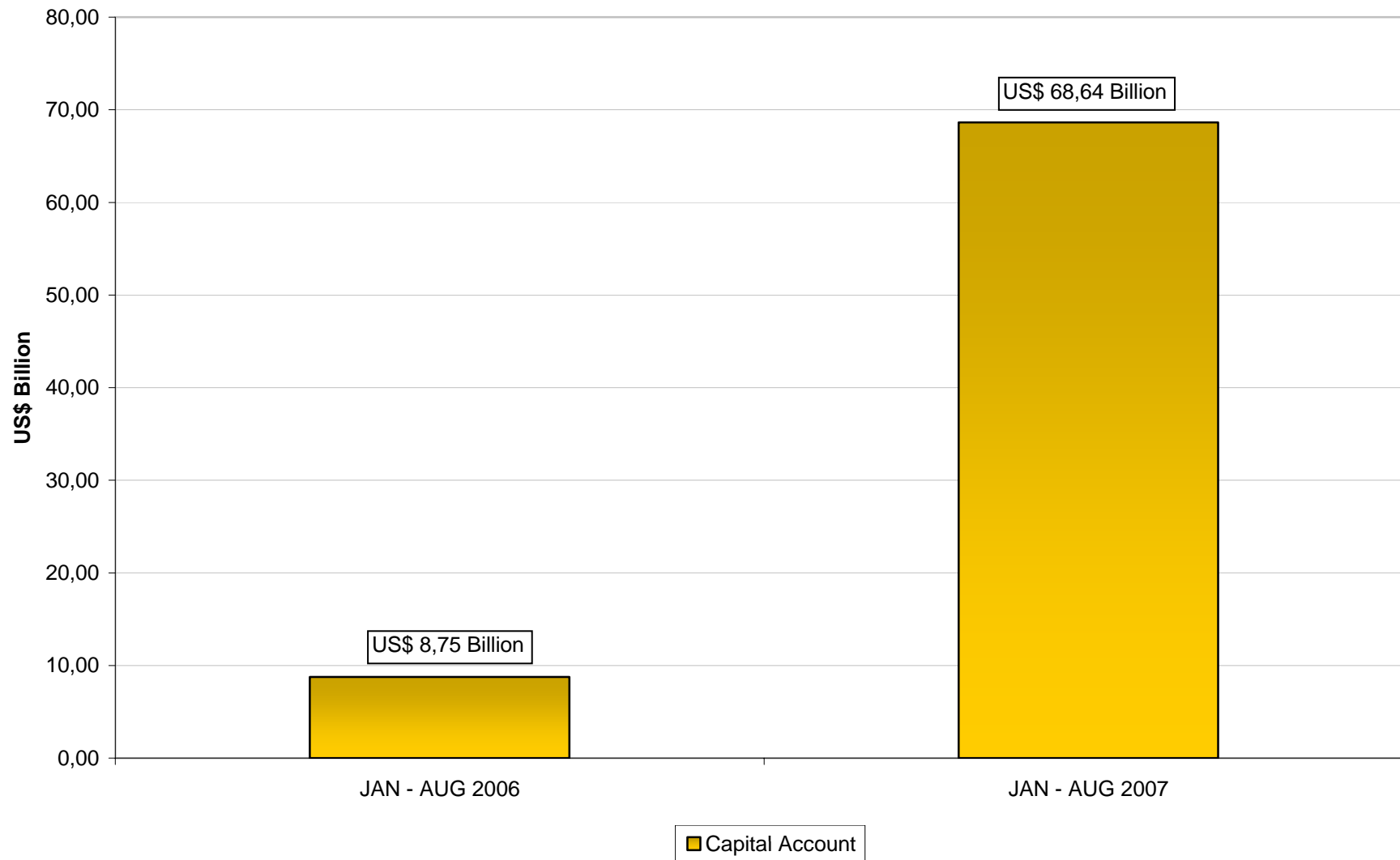


Source: Central Bank of Brazil
*Jan-Aug 2007

Capital Account

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Capital Account



Source: Central Bank of Brazil

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Foreign Direct Investment (FDI)

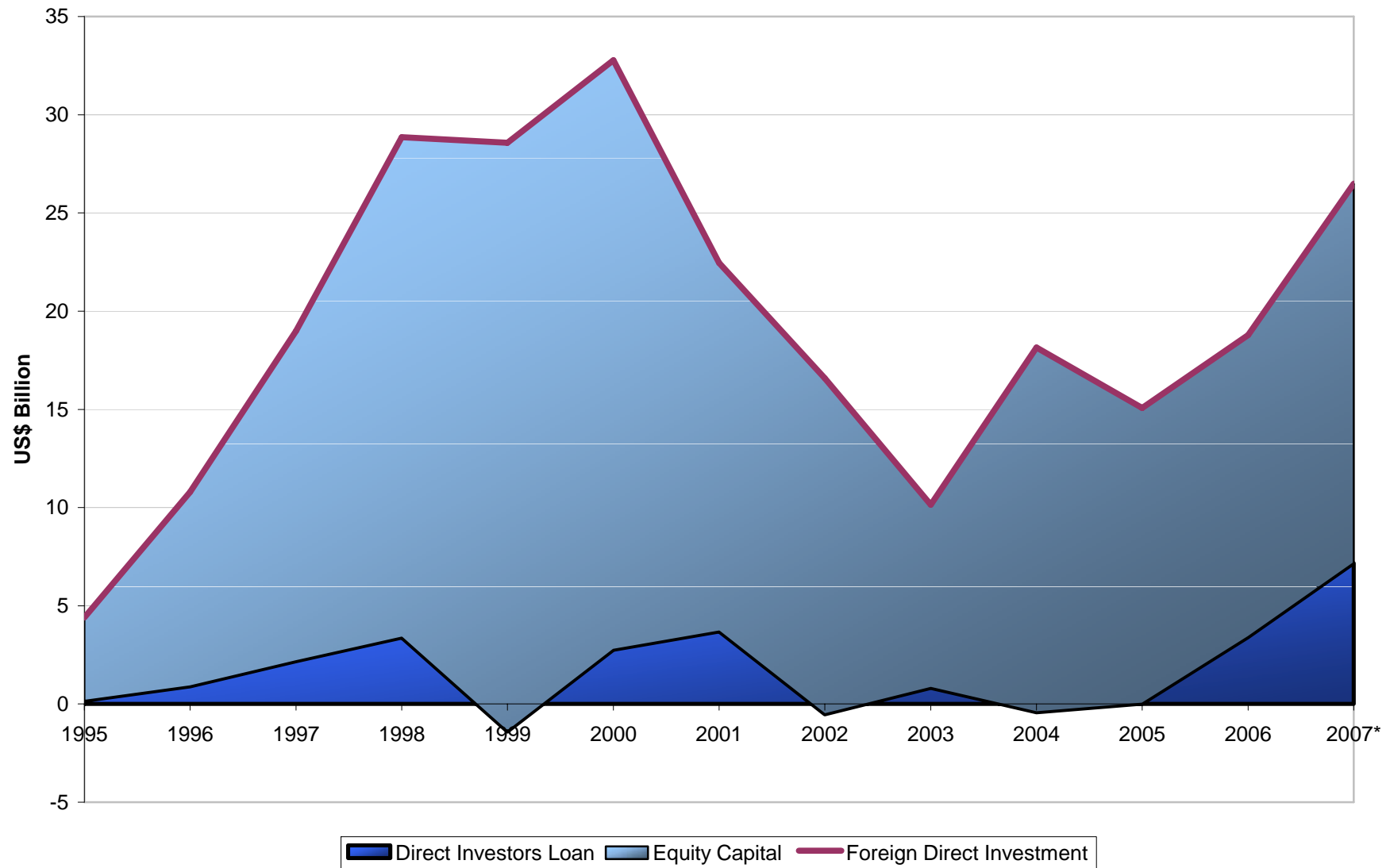


Source: Central Bank of Brazil

** Market Expectations (September 28, 2007)

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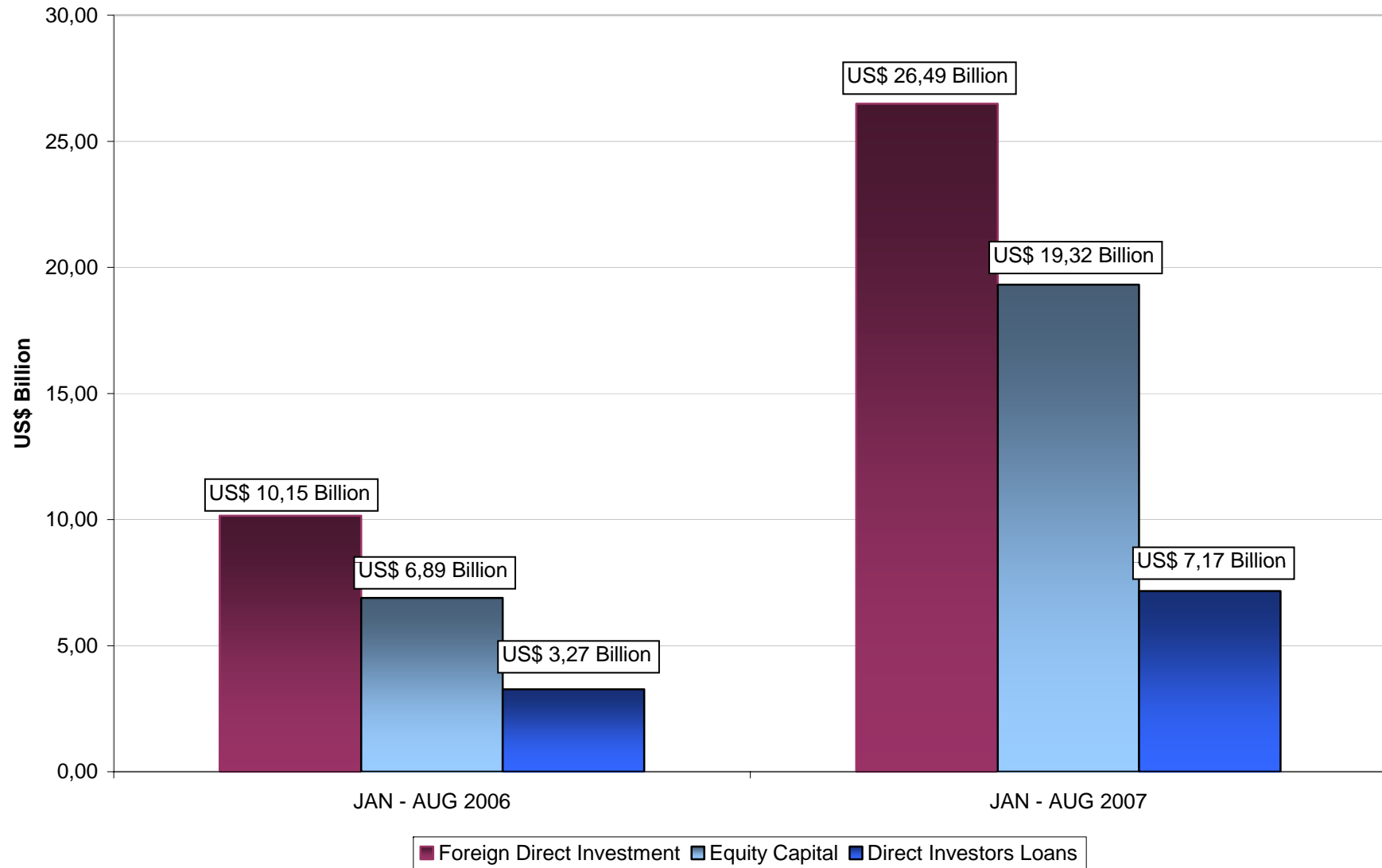
Foreign Direct Investment



Source: Central Bank of Brazil
*Jan-Aug 2007

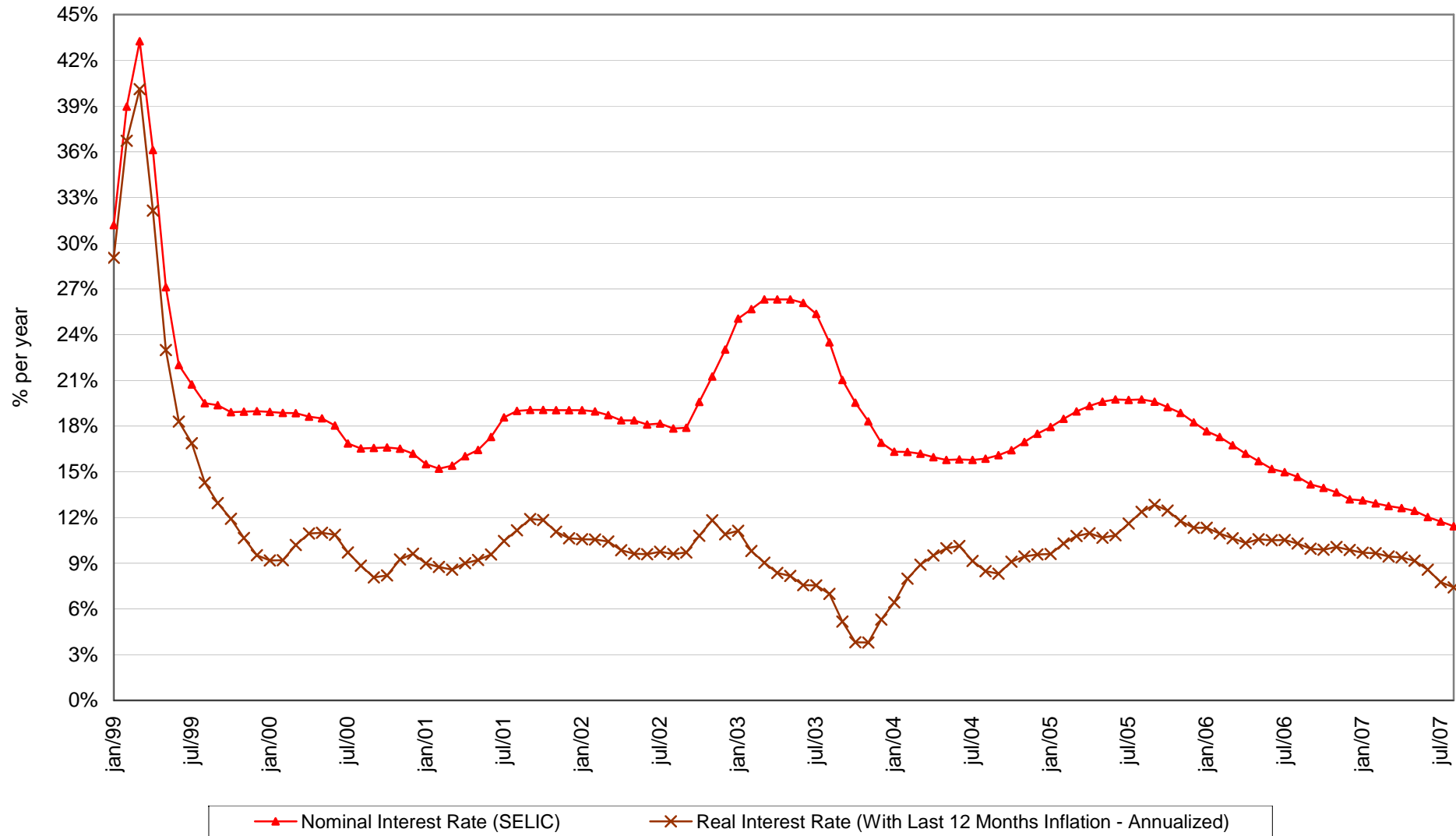
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Foreign Direct Investments (FDI)



III. Interest Rate and Exchange Rate

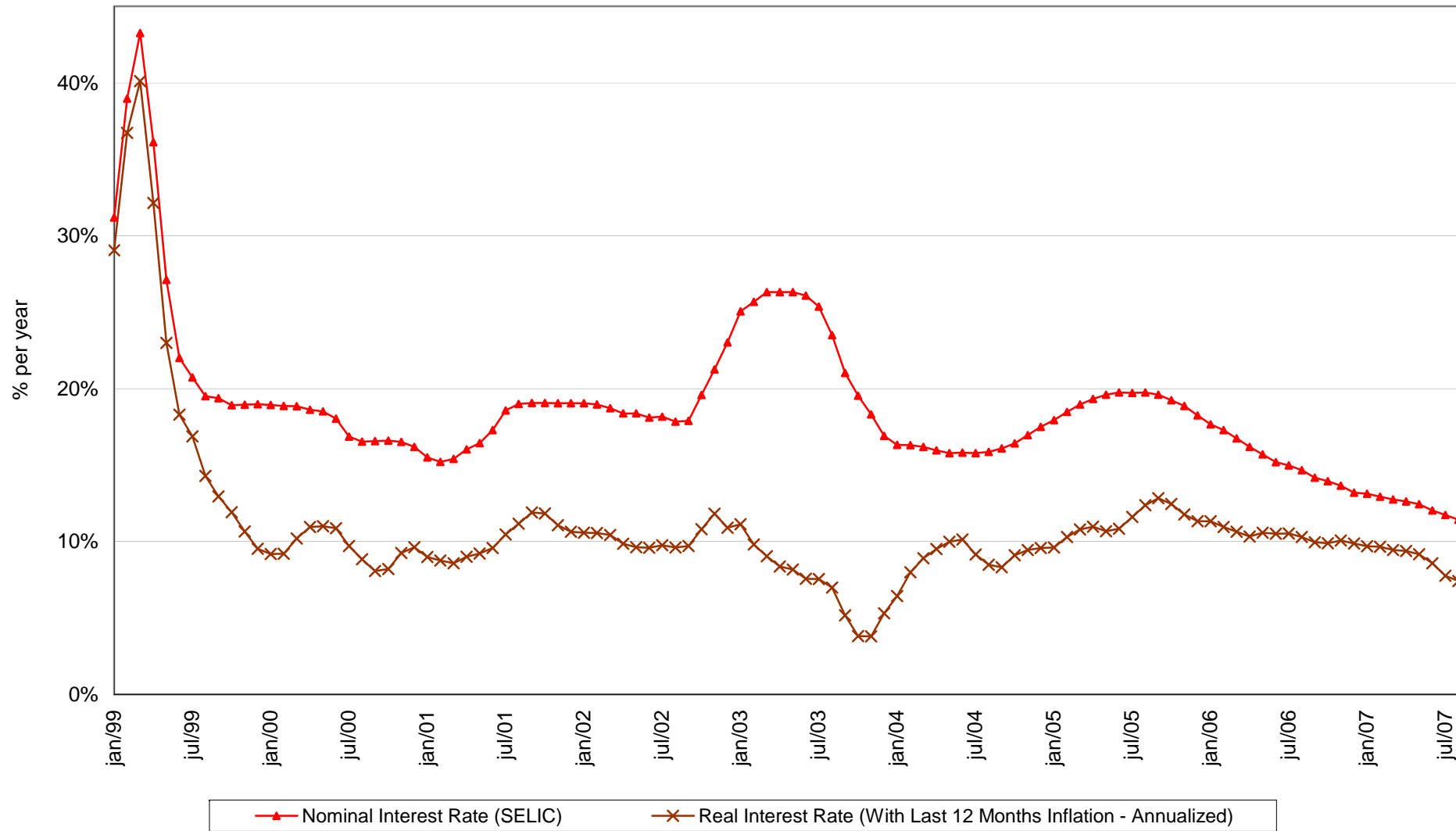
Nominal and Real Interest Rate



Source: Central Bank of Brazil

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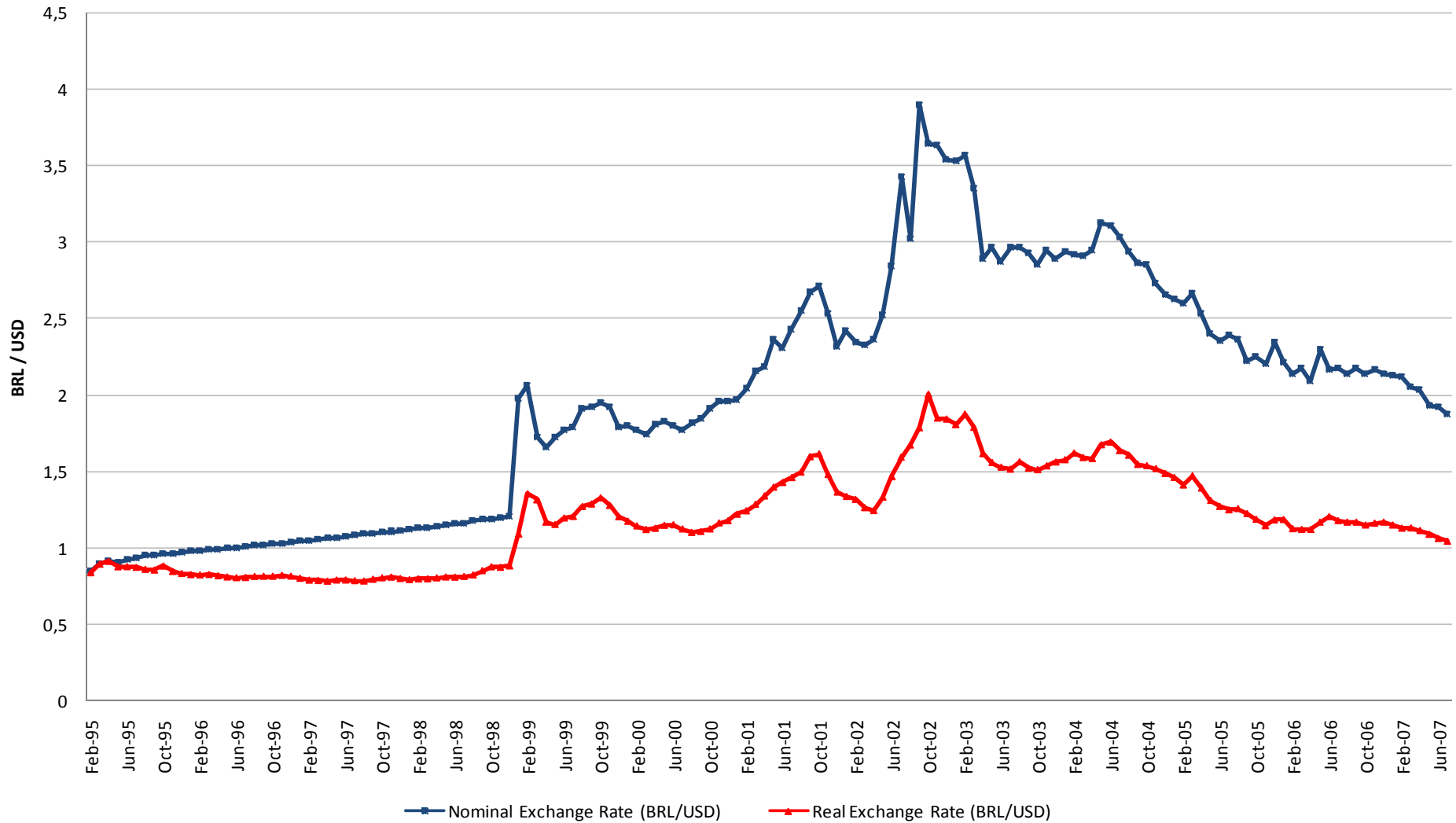
Nominal and Real Interest Rate



Source: Central Bank of Brazil

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Nominal and Real Exchange Rates

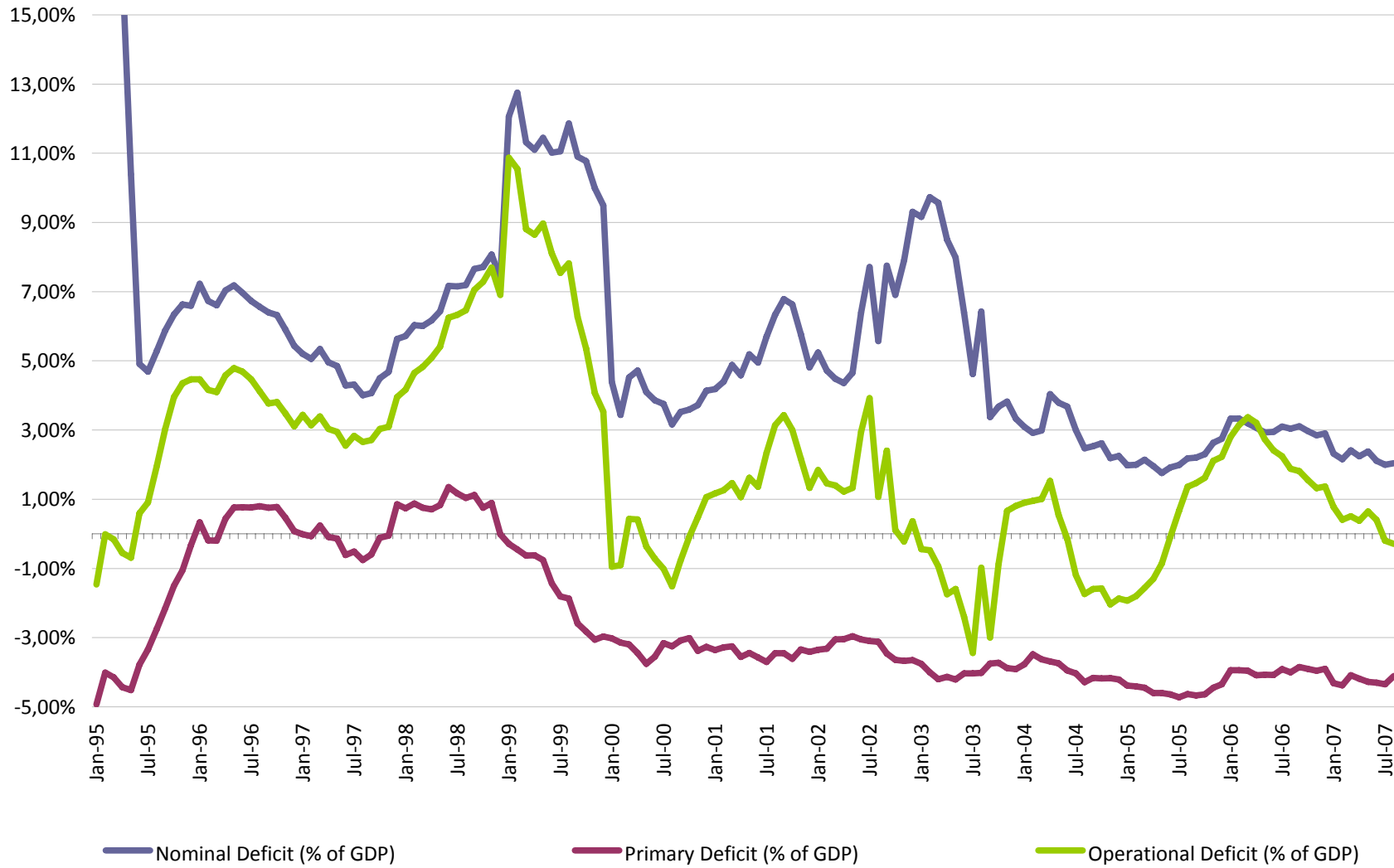


Source: Central Bank of Brazil

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IV. Fiscal Accounts and Public Debt

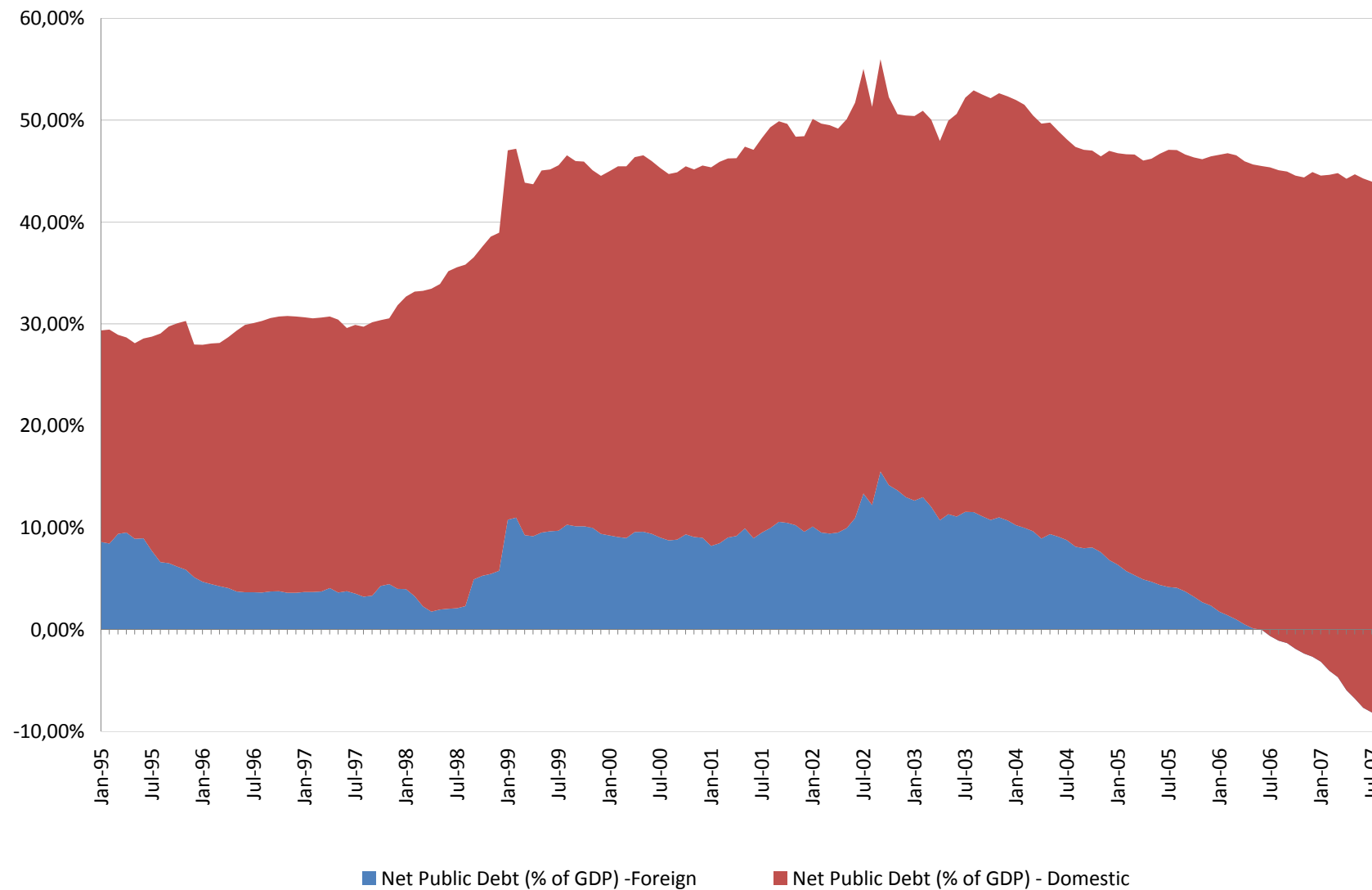
Public Sector Borrowing Requirements (% of GDP)



Source: Central Bank of Brazil

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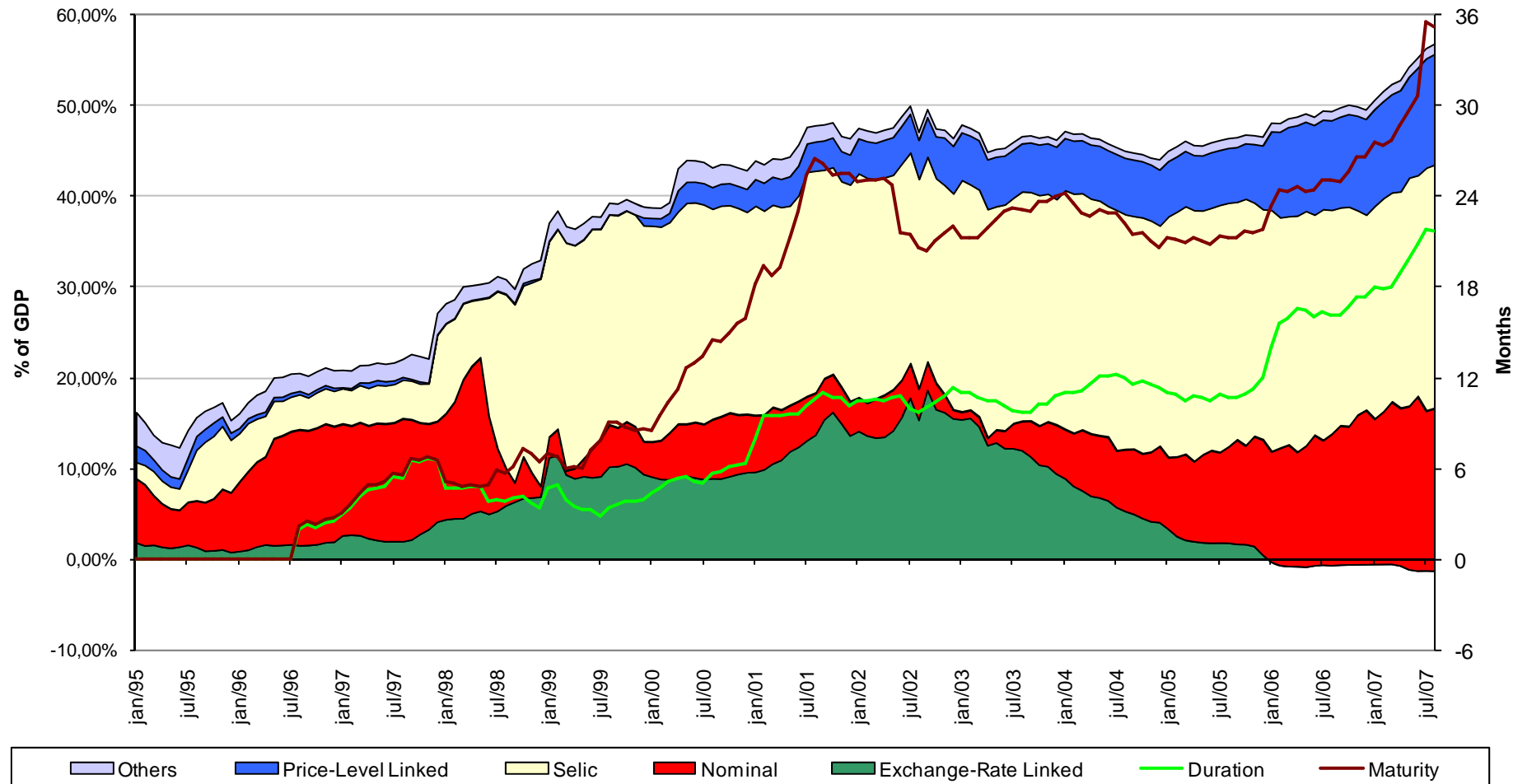
Domestic and Foreign Public Debt (% of GDP)



Source: Central Bank of Brazil

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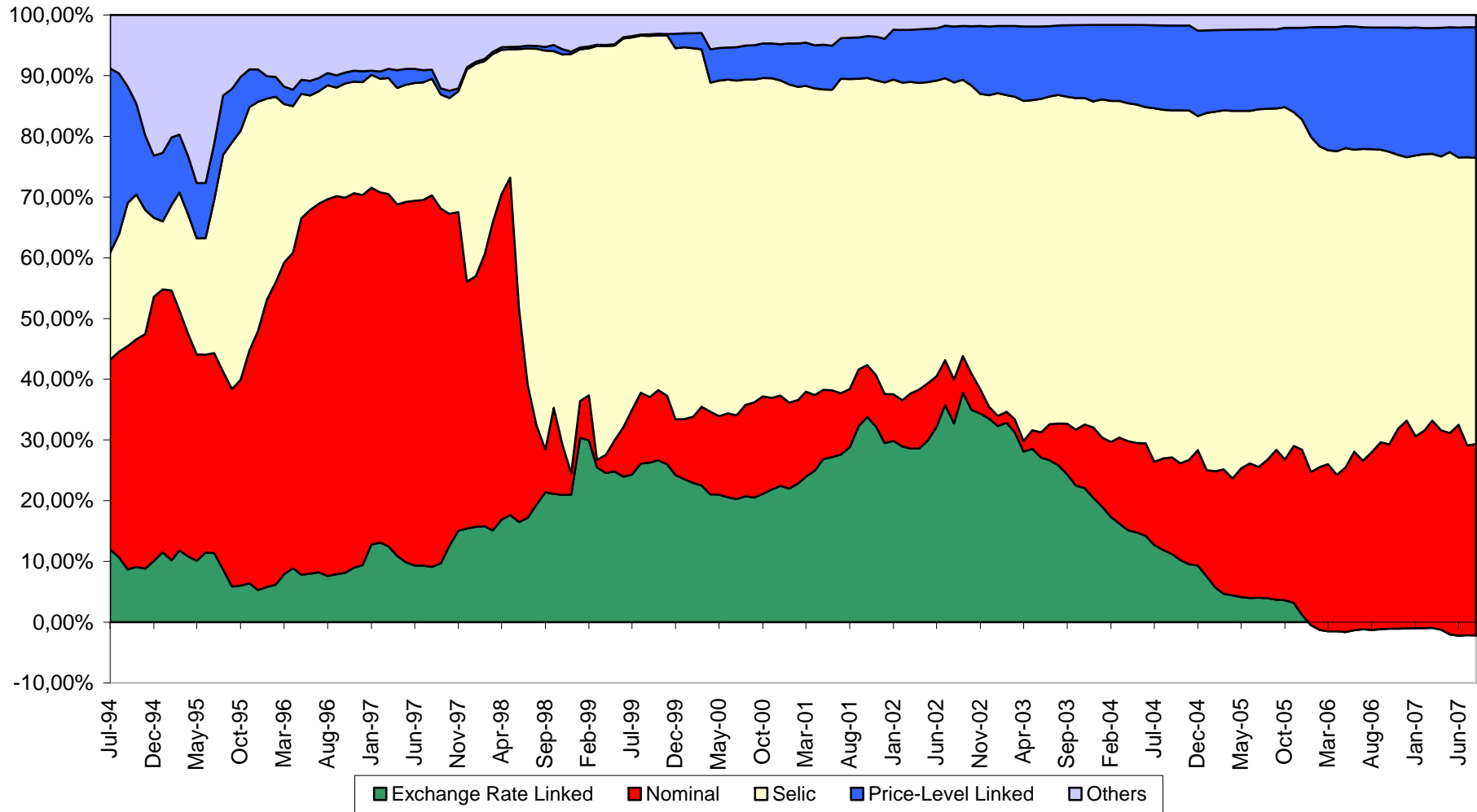
Federal Bond Debt: Composition and Maturity



Source: Central Bank of Brazil

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Federal Bond Debt: Composition

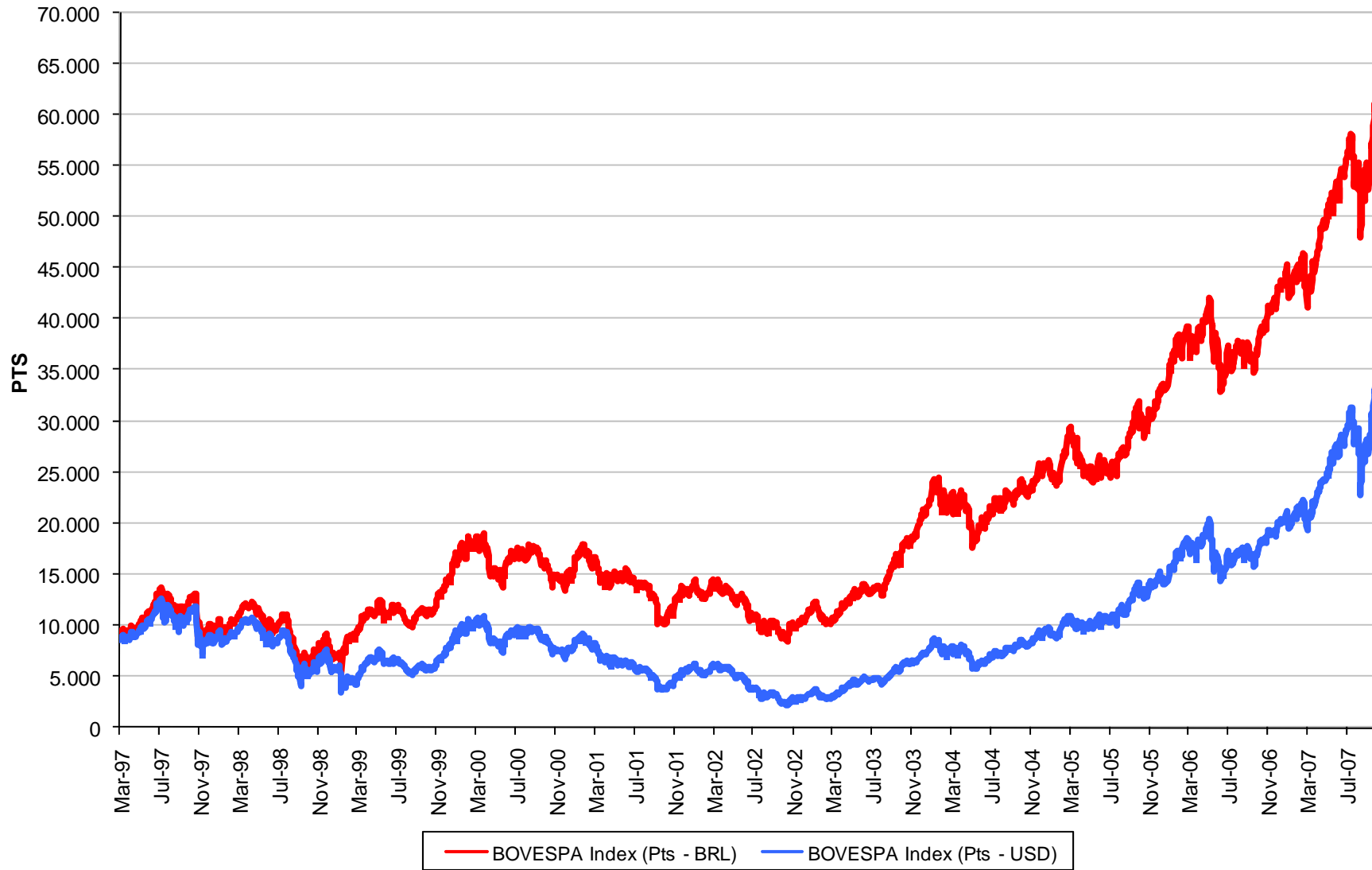


Source: Central Bank of Brazil

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V. Investments

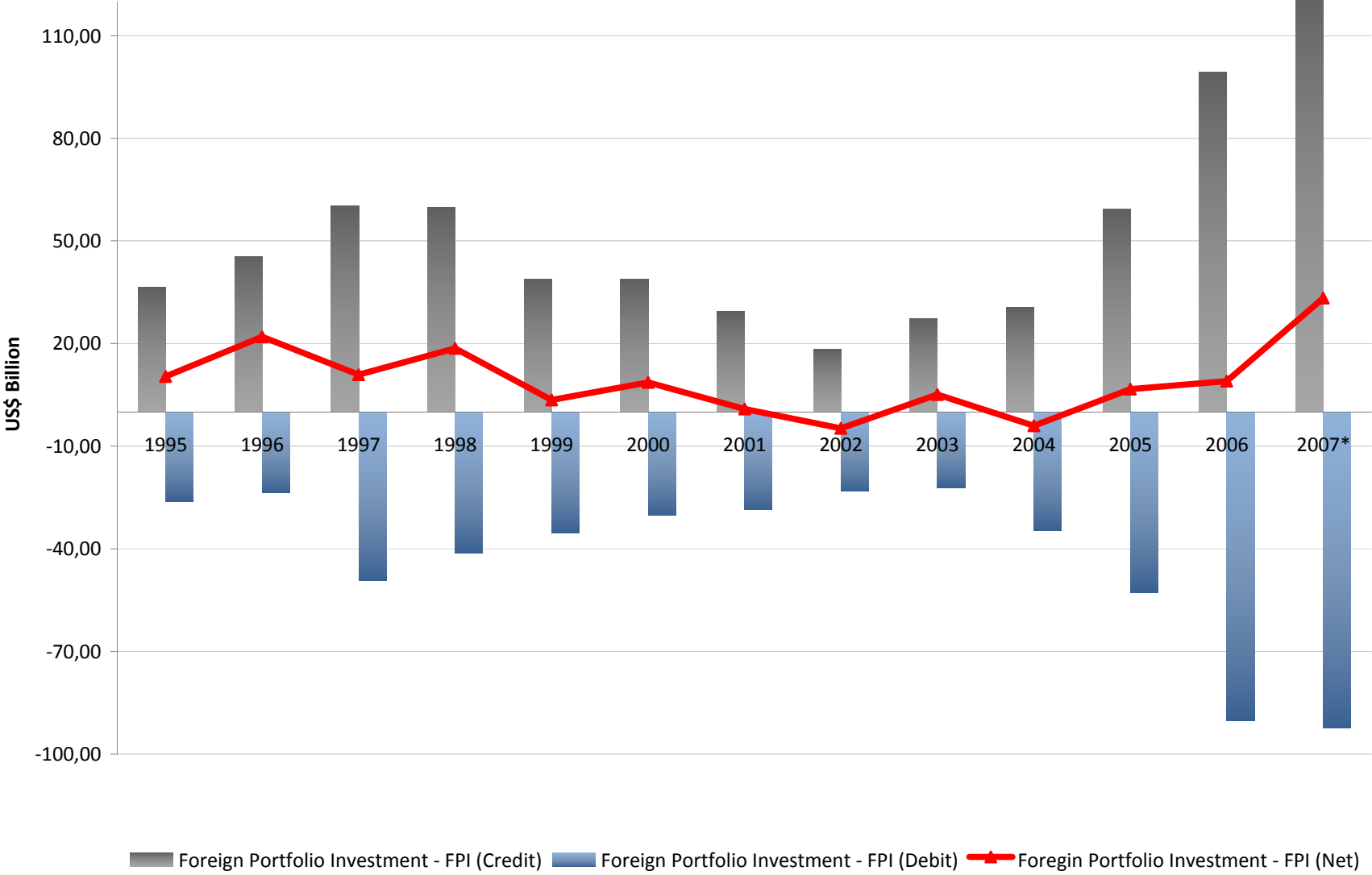
BOVESPA Index



Source: Bovespa

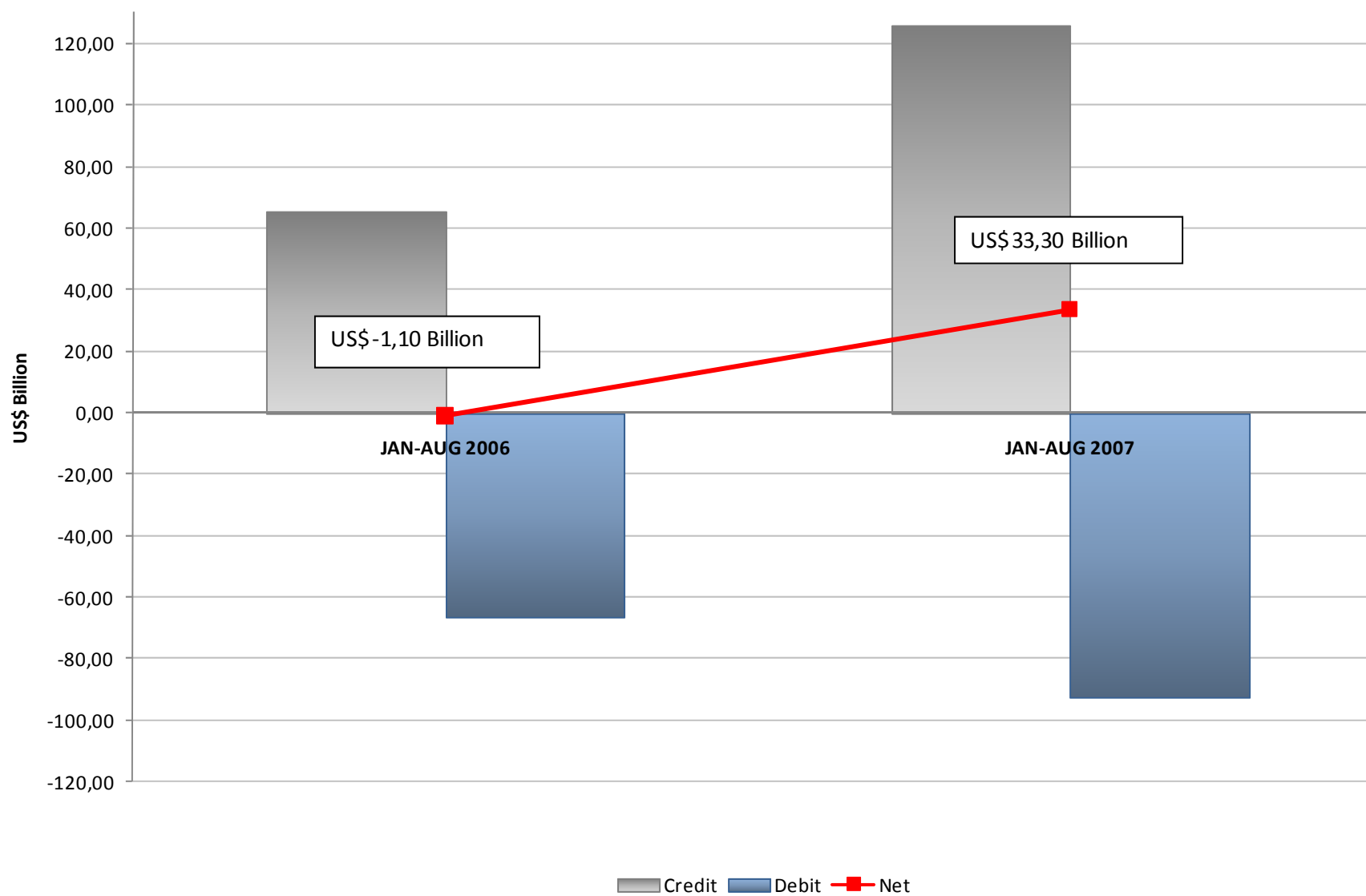
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Foreign Portfolio Investment - Total



Source: Central Bank of Brazil
 *Jan-Aug 2007

Foreign Portfolio Investment - Total (Jan-Aug)



Source: Central Bank of Brazil

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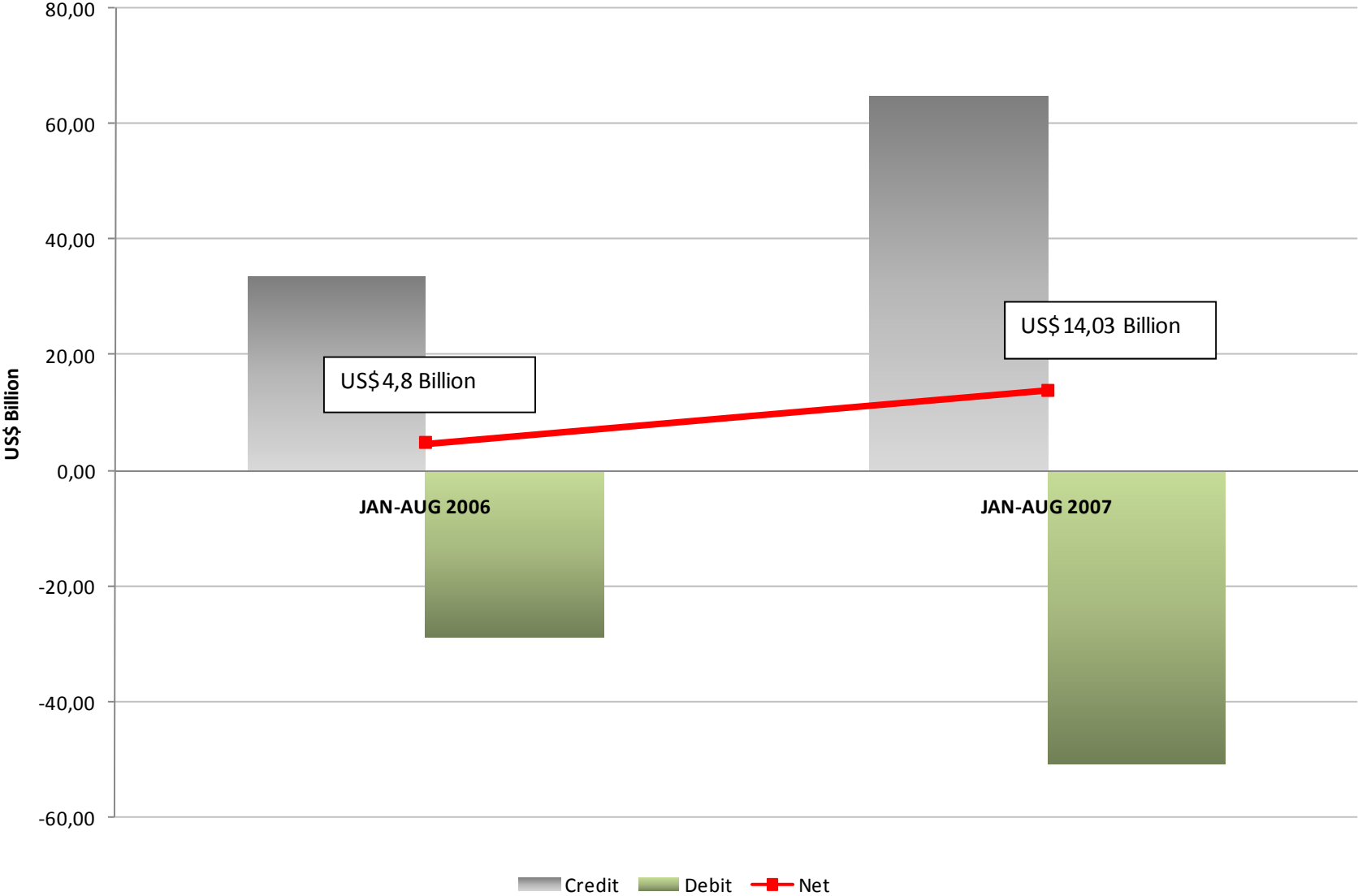
Foreign Portfolio Investments in Brazilian Stocks



Source: Central Bank of Brazil
*Jan-Aug 2007

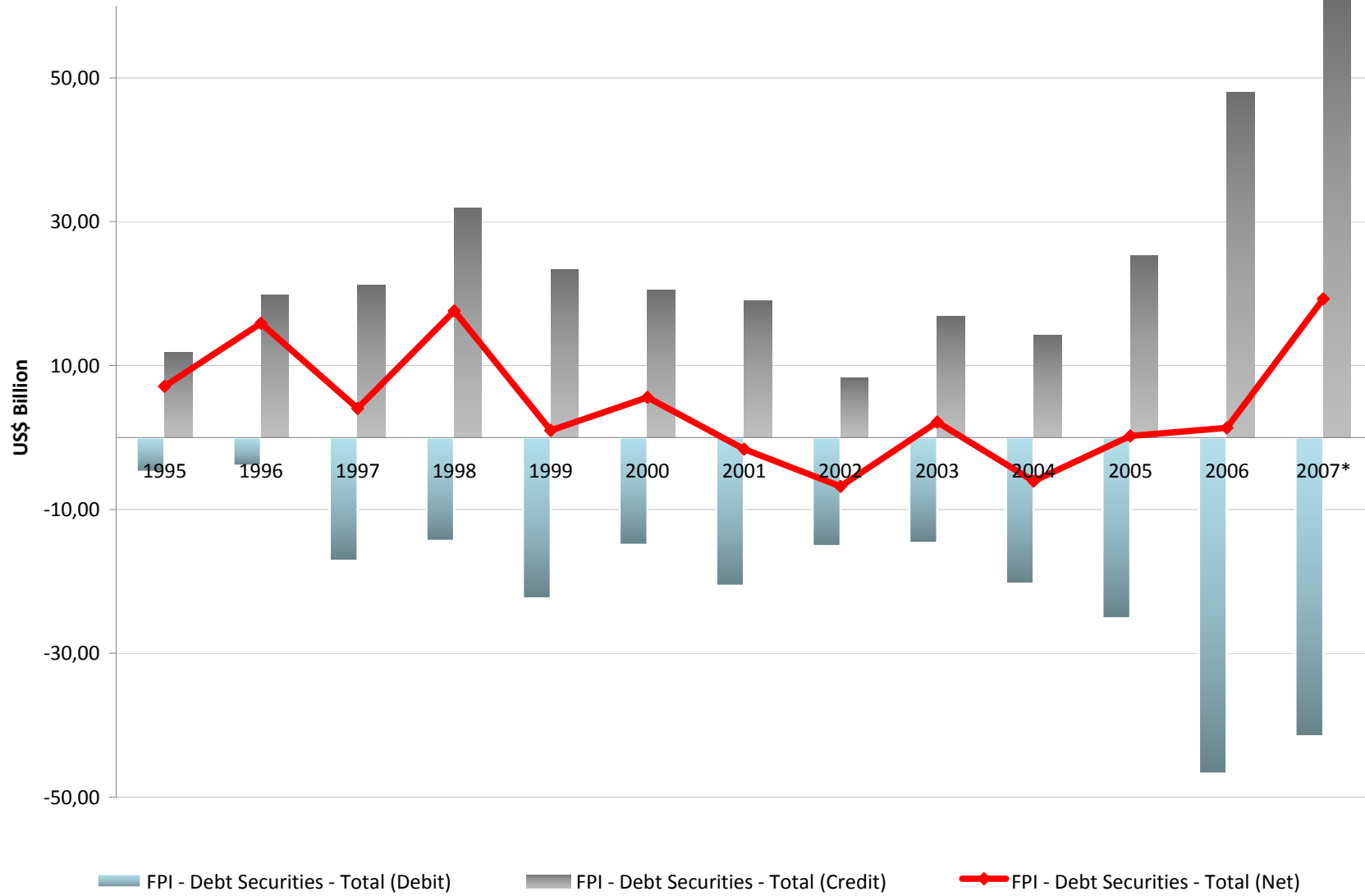
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Foreign Portfolio Investment - Brazilian Stocks (Jan-Aug)



Source: Central Bank of Brazil

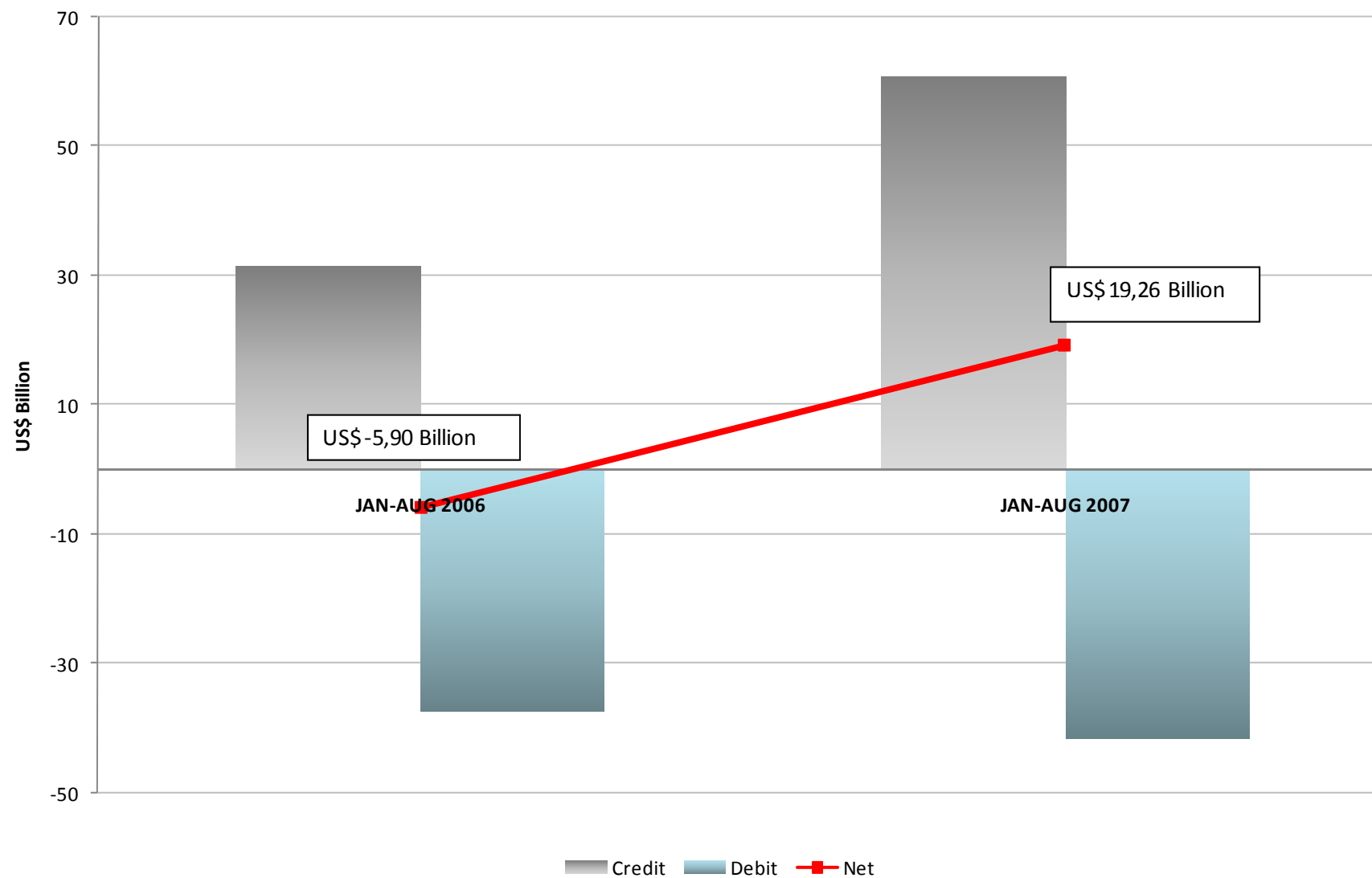
FPI - Debt Securities - Total



Source: Central Bank of Brazil
*Jan-Aug 2007

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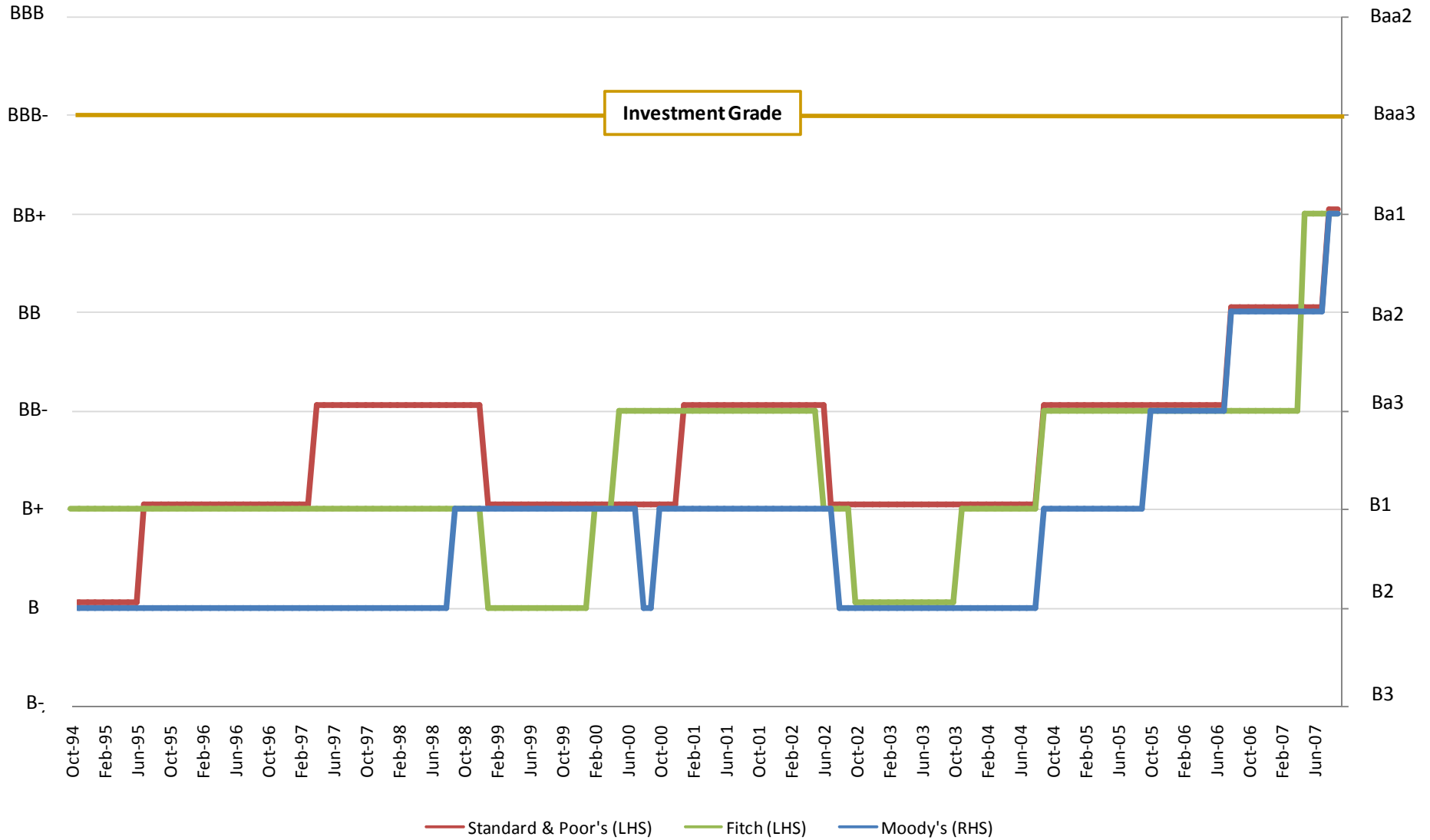
FPI - Debt Securities - Total (Jan-Aug)



Source: Central Bank of Brazil

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Towards Investment Grade



VI. How the current crisis may affect Brazil?

How the current crisis may affect Brazil? (1/5)

- Assumptions:
 - If the US economy slows down, there will be lower US interest rates and US inflation will not be a problem, or
 - If the US economy remains strong, US inflation might be a problem, and US interest rates will have to rise in the future, but
 - There will be no stagflation, since we are not dealing with a supply shock or productivity meltdown.

How the current crisis may affect Brazil? (2/5)

- Crisis` channels of transmission:
 - 1) Capital Flows:
 - Unlike in 1994,1997, 1998, 1999, 2001 and 2002, the effects of a reversal in capital flows in both the financial sector and the real economy would be much weaker, because today:
 - The foreign debt is much smaller;
 - There is both a large trade account surplus and a current account surplus;
 - The foreign reserves are above USD 160 billion; and
 - The public debt is no longer linked to the exchange rate.

How the current crisis may affect Brazil? (3/5)

- Crisis` channels of transmission:
 - 2) World output growth and international trade:
 - With world output slowdown, demand for Brazilian exports will decline, commodities prices will fall, the terms of trade will worsen, and export growth will also decrease. Brazilian real exchange change will depreciate, and output growth will be negatively affected.

How the current crisis may affect Brazil? (4/5)

- Scenarios:
 - 1) Continued world growth with world inflation:
 - Brazil will keep its abnormally high real interest rates to meet the inflation target, but output growth will remain strong (compared to recent history).
 - 2) World slowdown:
 - Since there will no longer be a combination of low demand for Brazilian exports with massive capital flight, there will be room for countercyclical monetary policy (fiscal policy is already expansionary). Output growth will suffer, but not like in previous crises.

How the current crisis may affect Brazil? (5/5)

- Bottom line:
 - Although the current crisis will affect Brazil, most likely, the effects will not be as severe as in the recent past. Of course a worldwide depression like during the 1930s would be a different story, but such catastrophic scenario has very low probability.
 - Economic policy measures to promote output growth would help to weather the crisis` effects:
 - Reduce the growth rate of primary expenditures, which have been growing at a rate twice as large as GDP growth since the Real Plan, opening room to decrease the tax burden (35% of GDP) and introduce flexibility to conduct countercyclical fiscal policy;
 - Structural reforms (Tax reform, Social Security reform, Labor reform) to increase employment and promote growth;
 - Improve regulation and privatize to be able to increase infrastructure investments in key parts of the economy (electricity, roads, ports).

Muchas Gracias

- I thank Laura Macedo and Pedro Maia for superb research assistance. Some of the ideas used in part VI were taken from presentations made by Ilan Goldfajn, Affonso Pastore and Paulo Leme at the seminar “Brasil e a Turbulência Mundial”, held on September 14 by the Department of Economics, PUC-Rio (www.econ.puc-rio.br). Of course, they are not responsible for any misuse of their ideas.