



## Monthly Report February

# Volatility affects government projections

THE BRAZILIAN GOVERNMENT HAS ATTENTIVELY FOLLOWING THE BREAKDOWNS OF THE INTERNATIONAL FINANCIAL CRISIS AND ADAPTING ITS STRATEGIES TO THE NEW ECONOMICAL REALITY, AS IT CAN BE OBSERVED IN THE REPORT OF THE CENTRAL BANK ON FIGURES FROM THE EXTERNAL SECTOR AND PAF – ANNUAL FINANCING PLAN FOR 2009, DISCLOSED BY THE NATIONAL TREASURY IN JANUARY. IN BOTH CASES, PROJECTIONS TAKE INTO ACCOUNT THE PERSISTENCE OF VOLATILITY IN THE MARKETS, WHICH JUSTIFIES THE CONSERVATIVE POSITION CONCERNING EXPECTATIONS.

The news from abroad continued to dictate the behavior and attract the attention of economic agents in February, especially concerning the solutions that the US government has been presenting to face the economic crisis. Most agents' concerns is that the measures announced are not enough to recover trust, and consequently, cannot operate as boosting element for growth retake, so as to recover the US banking system. In the end of February, the US GDP result in the last quarter was revised, a decrease from 3.8% to 6.2%, the highest one in 26 years.

It is still hard to identify a trend for the Brazilian economy based on the figures disclosed so far, but some data reinforce analysts' concern with the reflexes from the international financial crisis. The unemployment rate, disclosed by the IBGE, for instance, had strong increase in January, to 8.2%, compared to 6.8% posted in December. It got back to the level of January last year, while consumers' trust reached the lowest level since the creation of the index in 2005.

The Brazilian Monetary Authority's expectation is that the deepening of international crisis shall have negative effects to national external accounts, as it can be observed in the projections of Payment Balances for 2009, disclosed by



the Central Bank jointly with January data in the report “Nota para a Imprensa – Setor Externo” [Note to Press – Foreign Sector]. The deficit in Current Transactions projected is slightly lower than the figure posted last year (US\$ 25 billion versus 28.3 billion), highlights to an estimated decrease of 43.4% in the commercial balance, resulting from a 3.4% increase in imports and 2.5% decrease in exports. Direct foreign investments, which last year recorded inflow of US\$44.5 billion shall suffer strong slowdown in 2009. In the first month of the year, the net inflow of foreign investments had the worst result since February 2008: US\$1.9 billion. According to the Central Bank’s estimates, the item should end the year with a 33.3% decrease compared to last year.

Economic agents’ expectation as to the maintenance of the decrease in the Selic Rate during the year, aligned to the forecast of an international scenario still unstable for the forthcoming months probably contributes to the Central Bank’s projection concerning non-residents’ investments in shares and

long-term fixed-income securities, which ended 2008 with net inflow of US\$6.3 billion. The Authority estimates that the item will end 2009 with net outflow of US\$3 billion.

Thus, the persistence of a volatile international environment and the subsequent indisposition of agents to expose themselves in positions in emerging countries’ and under development markets should affect the inflow of foreign resources in the Brazilian financial market, in both the fixed-income segment and the share market. Foreign investors’ aversion to these markets, which had already been signaled over the past months, proceeded in January, when the net outflow of investments in fixed-income securities traded in the country was US\$1.63 billion, and the total resources in the segment was 87% lower than the one recorded in the same month in 2008. The inflow of resources for investments in shares decreased by 52% in the same period.

The government was also cautious in the preparation of the Annual Financing Plan for 2009, adopting a scenario which takes into account the international uncertainties and their impact in emerging markets. Thus, as to the goals for this year, the National Treasury Department works with an increase in the federal public debt inventory due to the need of punctual issues to face the difficulty to obtain resources in the international market in an environment which has low liquidity, so as to avoid the Brazilian government’s programs are impacted.

Last year, the Treasury’s operations were affected by the intensification of the crisis, leading to the revision, in August, of the goals to the debt profile, especially concerning the participation of prefixed securities, which ended the year with



29.9%, way below the minimum limit of 35% (before revision) desired. For 2009, the minimum limit for the participation in these roles is 24%, while the maximum is 31%. Thus, the market conditions recently observed (especially as from August 2008) ended up affecting one of the guidelines which guide the public debt management: gradual replacement of securities indexed at the Selic Rate by prefixed and inflation pegged securities.

The Treasury chose not to sanction higher interest rates for the issue of prefixed securities, thus preferring, at least temporarily, to leave this strategy for maintaining stability and preventing the volatility which could result from an increase in premiums paid by prefixed public securities. In an analog manner, the improvement process in the structure of maturities of public debt was also affected, translated in the extension of the average term and the reduction in the percentage to mature in 12 months, once the volatile environment leads agents to require higher premiums to carry securities having longer terms – especially the prefixed ones -, increasing the debt financing cost.

Concerning credit operations, the data disclosed by the Central Bank referring to January show that the balance of operations in the financial sector had a slight variation (0.2%) compared to the previous month, reaching a total of R\$1.23 trillion and giving continuity to the growth observe in the previous months. However, the decrease in the demand of the productive sector deserves attention, making the activities of the industry and the commerce to record decrease of 0.8% and 1.7%, respectively, putting an end to the sequence of rises recorded in these periods.

As for legal entities, one may observe a 1.9% decrease in the balance of referential credit operations for interest rates, highlighting the negative variation in operations destined to the acquisition of assets (4%), vendor (9%) and discount of trade bills (11.4%), while those of working capital, representing a higher volume among the operation made available to legal entities, represent little positive variation (0.5%), even though still below the averages recorded over the past 12 months.

The balance of reference operations in interest for individuals increased by 1.4%, fundamentally connected to credit facility check, personal credit and credit card operations (probably due to seasonal factors), while the credit operations destined to the acquisition of assets and real estate financing decreased in the comparison with December (0.4% and 1.7%, respectively). Another element observed in data disclosed by the Central Bank is the increase in default, taking



into account the 90 days overdue balance in relation to the total, both as to individuals (from 8% to 8.3%) and as to legal entities (from 1.8% to 2%).

Lastly, it is worth pointing out the disclosure of fiscal data of January, recording primary surplus of 3.58% of GDP accumulated over the past 12 years – thus below the 3.8% target established by the government. It is worth pointing out that in December surplus was 4.06%.



### Interview – Albert Fishlow

## **Tax collection requires cooperation with states and cities**

FONTE ANDIMA PUBLISHES AN INTERVIEW WITH ECONOMIST ALBERT FISHLOW, PROFESSOR AT COLUMBIA UNIVERSITY, IN WHICH HE ANALYSES THE MAIN EFFECTS OF THE CURRENT CRISIS ON THE WORLD ECONOMY AND THE RECOVERY CAPACITY OF ITS PARTICIPANTS.

**Specialists are unanimous in stating that the year of 2009 will be marked by a strong retraction of the world GDP. However, some believe that the economy can return to its expansion course as from 2010. Do you include yourself among the more optimistic or do you believe that the current crisis will extend well beyond 2009?**

Many of the former optimists have now turned into fervent pessimists. Clearly 2009 is now expected by everyone to be a year of little or no expansion. The key question has shifted to 2010. Then, the new and large government expenditures will enter into the US market, providing an important source of stimulus. Consumption is the real unknown, and critical to better performance. It is 70% of American gross national product, and no recovery is possible without its growth beginning again. Additionally, many other economies will slacken in 2009: the BRICs, the oil producers, the other Asian economies, South Africa, etc. These countries can expect somewhat faster revival, because their banking systems have not been so deeply affected. International trade can be a source of genuine upward impulse once more, but only if all countries are able to resist the many domestic pressures for increased protection that will continue to emerge in the next several months.

**Among the several unusual aspects of the current crisis, one of the most surprising was the fast deterioration of the economic activity indicators observed in most countries around the world. The real economy was infected very quickly by a crisis which origin was on the U.S. real estate segment. Which factors contributed to that spread speed?**

The last quarter of 2008 produced an estimated decline in output of 3.8 percent, the worst performance in almost 30 years. The fall would have reached something closer to 5 percent, had there not been unintended accumulation of inventories. And this happened, despite the continuing stimulus efforts by the Federal Reserve Bank that created about a trillion dollars of new loans over the



year. Declining consumption and almost total absence of residential construction led the process. In addition to the ongoing banking and mortgage crises, consumers were facing problems with credit card balances. Additionally stock prices fell significantly, wiping out accumulated assets to the amount of something like \$4 trillion! So it was an exceptional period, despite the \$700 billion voted by Congress to help, of which half has been spent. Some say it was the decision to let Lehman fail that provoked as substantial a decline, but the problem extended much further to Citibank, Bank of America, Merrill Lynch, not to mention the mortgage companies. In many ways, it was the final phase of the 2000-2001 recession, whose recovery was only partial and driven by the rise in housing prices.

**Do you believe that an extraordinary capital injection on the financial systems will work to remove obstructions on the credit market of the developed economies? How do you evaluate the market's skeptic reaction in relation to the stimulus measures that have been announced by the U.S. government?**

The new stimulus measure just passed by the Congress amounts to almost \$800 billion. But it cannot work by itself. There can be no real recovery until the banking system is able again to be a reliable and continuing source of credit. That is the reason the Treasury Department and the Federal Reserve are trying so hard to draw private resources into recapitalizing the banking system, and why they are seeking, once and for all, to eliminate the bad loans still on the banks' asset sheets. Many are still saying the problem is the bad mortgages; but this is only part of the total mess. A variety of new types of financial instruments were created by clever people, whose value depended upon still other supposed assets. When the house of cards falls, all of the components go.

**President Lula has affirmed that this crisis is a developed countries' problem. Do you agree with this statement, as well as the perception that the Brazilian economy is best prepared to face the current crisis than the previous ones?**

Some thought, just a few months ago, that this economic decline would be limited to the developed world: the US, EU and Japan. Now few would agree. Foreign investment flows have been much reduced. World trade will fall in absolute terms. It seems the World Bank and the IMF are recalculating growth in the developing world, and not for the better, virtually every month. Brazil is no exception, as the dramatic decline in automobile production at the end of year affirmed. Some now even suggest a likely decline in gross domestic product this year, although the mean prediction is still for low -2 percent- growth. Brazil is



doing better than some others. First, consumption seems to be holding up, in part because lower income groups have benefited from the expansion in recent years. Second, while prices of exports of mineral products and agricultural commodities have fallen, the large share of manufactures has held up better. Third, the Central Bank has been proven right to have accumulated such a large stock of international reserves, and they have enabled additional lending to occur and real interest rates to fall. What is critical is that excesses not occur, in the midst of accommodation. Brazil has been partially caught up in the maelstrom: internal policy can assure a soft landing.