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—for now

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Brazil’s trade balance in 2012 took some attention-grabbing turns that suggest change in the flows of exports and their destinations in recent years. Lia Valls Pereira of IBRE’s Center for International Trade Studies suggests that diversification of Brazil’s commodities exports could lessen its dependence on iron ore, soybeans, and oil.

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30 The recovery of Brazil’s economy: Are we there yet?
Even after six consecutive quarters of decline there are no signs that gross investment is recovering. Yet under current conditions, only if there is more investment can the Brazilian economy begin to heal.
**ECONOMY**

**Industry confidence steady, consumer confidence down**
According to Getulio Vargas Foundation surveys, the Industry Confidence Index moved only 0.2% in January, to 106.6 points, but Brazilian consumer confidence fell for the fourth month in a row because of concerns about the economy. (January 24)

**Biggest trade deficit ever**
Brazil posted a trade deficit of US$4.0 billion in January, the worst since 1959, as imports, especially fuel, rose 14.6% and exports fell 1.1% compared with January 2012. (February 1)

**Strong credit growth in December**
Year-on-year real domestic credit expanded by 16.2% in December. Public sector credit expanded 47.6% (up from 33.5% year-on-year in November), and private sector credit by 11.2% (from 9.1% year-on-year in November). However, at 53.5% the overall credit-to-GDP ratio still compares favorably to the ratio in other major emerging markets. (January 28)

**Unemployment at a record low**
Although in 2012 Brazil’s GDP growth was a dismal 1%, unemployment still sank to 5.5%, the lowest level in 10 years, reported government statistics agency IBGE. Average annual income was an estimated R$1,794 (US$918), up 4.1% compared to 2011. (January 31)

**Industrial production in Brazil down 2.7% in 2012**
Industrial production in Brazil closed 2012 with a fall of 2.7%, the first decline since 2009. Capital goods was the worst-performing sector, according to IBGE. The production of capital goods related to investments plummeted 11.8% in comparison with 2011. Brazilian industry performed poorly despite a series of government stimulus measures in 2012. (February 1)

**Petrobras: Fuel prices still not high enough**
According to CEO of state-owned oil company Petrobras Maria das Graças Foster, the increases in the prices of diesel and gasoline—the latter to US$5.49 a gallon—have not been sufficient to eliminate the difference between domestic and international oil prices, and oil production will likely fall this year. Petrobras shares have tumbled. Its profit of R$20 billion (US$10 billion) last year was 36% below profit in 2011 and the lowest in eight years. Blamed for the drop was the lag in fuel price rises, the sharp rise in gasoline imports, a 2% drop in oil production, a large number of dry or uneconomic wells, and the strong depreciation of the real against the dollar. (February 5)

**Inflation again up in January**
The Extended National Consumer Price Index (IPCA) of January increased 0.86%, the highest monthly IPCA since April 2005 (0.87%) and the highest for January since 2003 (2.25%). (January 25)

**Consumer defaults fell 1.5% in January**
For the third straight month, Brazilian consumer defaults fell in January, this time by 1.5%, according to services group Experian Serasa, due in part to more renegotiations of debt and an interest rate drop. However, in comparison with January 2011, defaults were still up 12.9%. As a result, experts are predicting lower sales growth in 2013. (February 15)

**POLITICS**

**Scandal-tainted politicians back in power**
Suspected of a range of crimes, Henrique Eduardo Alves, from the Brazilian Democratic Movement Party (PMDB), was elected president of the Chamber of Deputies; his term will last until February 2015. Alves won easily with 271 votes, more than 100 votes ahead of runner-up Julio Delgado from the Brazilian Socialist Party (PSB). A week before, Renan Calheiros (also PMDB) was elected Senate president five years after he was forced to resign that post amid allegations of corruption. Both Alves and Calheiros had decisive support from the ruling Workers Party (PT). (February 4)
FOREIGN POLICY

Brazil and the European Union summit in Brasilia
At a joint trade summit in Brasilia, European Commission president Jose Manuel Barroso and European Council president Herman Van Rompuy met with Brazilian President Dilma Rousseff, who stressed the fact that a great number of European companies are helping to sustain growth and create jobs in Brazil. Brazil sells 20% of its exports to the EU. The EU, in turn, wants to boost the volume of goods sold to Brazil as a means of creating jobs and growth in Europe. Recently, however, Brazil has been accused of protectionism for hiking tariffs on a number of imports, including cars and pharmaceuticals. The European Commission has also been negotiating a free trade deal with the Mercosur trading bloc, of which Brazil is a member, for 12 years.

Brazil, Chile in agreement
Brazilian President Dilma Rousseff and Chilean President Sebastian Piñera signed three agreements in Santiago, Chile, committing to closer cooperation in education, culture, and the Antarctic. According to Rousseff, the two heads of state also discussed the possibility of cooperating in hydropower production. (January 26)

ECONOMIC POLICY

Domestic airfares: Deregulation worked
In the 10 years since they were deregulated, domestic airfares (adjusted for inflation) have dropped by 40%, according to the National Civil Aviation Agency. Supply (number of seat-kilometers offered) has more than doubled, growing 10% a year, and demand (number of passenger-kilometers transported) almost tripled, growing 13% a year. (January 17)

Brazil unveils new highway concession terms
Finance Minister Guido Mantega announced that Brazil will sell 30-year concessions to bidding investors rather than the previous 25 years, and for highway and railway concessions but the market failed to react as hoped. (February 6)

Central Bank governor says inflation is not comfortable
Central Bank Governor Alexandre Tombini admitted in an interview in O Globo newspaper that January inflation was above expectations, but said that most forecasts indicated no risk of breaching the inflation target ceiling (6.5%) in the first half of 2013. However, recent minutes of the Monetary Policy Committee suggest it is taking a hawkish approach to inflation and is recognizing that monetary policy is inadequate as an instrument to boost sluggish growth. (February 7)
In addition to producing and disseminating the main financial and economic indicators of Brazil, IBRE (Brazilian Institute of Economics) of Getulio Vargas Foundation provides access to its extensive databases through user licenses and consulting services according to the needs of your business.

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WHAT BRAZIL HAS BEEN DOING in recent years seems to be proving that a country can protect domestic industry or it can promote growth, but it can’t do both. Domestic industry, meanwhile, is apparently getting the message that it’s better to stay home than to export: The number of new Brazilian firms entering the export market is the lowest among the 150 countries for which the World Bank collects information. And in the first half of 2012, 352 companies that were already engaged in global trade decided to stop exporting.

Growth certainly doesn’t come from hunkering down behind trade barriers like tariffs on imports. Those tariffs don’t just keep out products that compete with Brazil’s. They keep out equipment and materials that Brazilian manufacturers need to make products that can compete with the best in the world. As Brazil turns inward, the global supply chains are passing her by.

In this issue Vera Thorstensen describes “a disguised protectionism policy using deeply undervalued exchange rates, subsidies to industry and agriculture, unlimited credits via state banks to state enterprises, or restrictive rules of origin.” Does any of this sound familiar?

To our mind José Tavares was accurate in describing current Brazilian trade policy as “somewhat aimless activism” that is not “committed to a central thesis.” Not only is there no sense of coherence, there seems to be no recognition within the government of the trade ramifications of monetary and fiscal policy. Take just the exchange rate: how stable can it be—as it needs to be for trade—if stability takes a back seat to containing inflationary pressure?

The Rousseff administration has correctly diagnosed that the Brazil cost is what keeps the country from being competitive in international markets, and is making efforts to address the problem. The new approach to road, rail, and port concessions will eventually lower logistical costs and help bring prices of exported goods down. Lower energy prices will be good for manufacturers—although not so good for the economy as a whole if the utilities end up in the red and have nothing to invest. However, fiddling with one tax at a time is not doing much to relieve the tax burden, which is a central component in the Brazil cost. So is red tape, but we have yet to hear of any major initiatives to streamline not just filing tax forms but every other aspect of doing business in Brazil.

What would really be refreshing, and hopeful, would be a more coherent trade policy that provide the right incentives for export firms to innovate and improve productivity. Brazil needs to craft a rational trade policy, rather than just issuing a series of unrelated measures.
Low growth saves Rousseff—for now

João Augusto de Castro Neves, Washington D.C.

THOUGH THERE IS ACTIVE DEBATE about a looming energy crisis as water levels in reservoirs sink to new lows in Brazil’s hydropower plants, which supply the majority of the country’s electricity needs, it is not likely to alter the Rousseff administration’s general stance toward the power sector in the short term. Despite the growing concerns about power plant water levels, there are a number of reasons that, for now, support the government’s view that the current crisis is temporary and that the country’s power system is structurally sound. Greater risks for the power sector, however, lie in 2014.

The main support for the administration’s belief that the crisis is temporary is Brazil’s current thermoelectric capacity. The network of thermal power plants is much more extensive today than it used to be, which means that type of energy is now much more to be relied on as a “swing” fuel when reservoir water levels drop. Thus, although there is still a risk of energy rationing, the likelihood that the administration will adopt such a policy is much lower now than it was during the energy crisis in Brazil in 2001. Then, the decision of the Cardoso (PSDB) administration to mandate rationing and its mismanagement of the crisis were among the main reasons that the PSDB is now in opposition instead of in power. The risk of being compared with that administration is surely being factored into the policymakers’ narrative today. That experience, in fact, gives Rousseff ample reason to refrain from explicitly acknowledging the current crisis or changing the direction of her energy policies.

While for now the possibility of energy rationing is still low, risks for the administration will rise in 2014. The thermal power system is currently running at full capacity and a below-average rainy season would mean that hydroelectric reservoir

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levels would still be dangerously low at the beginning of the dry season, which runs roughly from April to October. According to some experts, part of the current problem derives from delays in turning to thermal power plants earlier (before November) to avoid depletion of reservoir levels. The decision was probably driven by politics, not policy. After all, resorting to more expensive thermal electricity at a moment when the government is betting on lower energy costs to boost economic growth would be counterproductive, to say the least.

Meanwhile, the government should be able to support the power sector this year because the economy has been growing much more slowly than originally expected. The government’s energy research office (EPE) estimates in its 10-year energy plan (2010–20) that energy demand, though growing, should remain under control in the shorter term, reducing the risk of rationing even if there is a dry spell (EPE had originally forecast 4.5% yearly GDP growth from 2010 to 2017). But if economic activity should rebound strongly later in the year (to near or just above 3%, as market participants expect) and reservoir levels remain low, the risk of rationing in 2014 will intensify considerably.

For the remainder of this year, the government’s main challenge will be to sustain the announced tariff reduction, avoid increases in power prices, and prevent the power sector from negatively affecting already flagging industrial activity and exacerbating inflationary pressures. While the economic costs to the government could be substantial, the political impact of the energy crisis should be limited. Even though comparisons with the PSDB administration will certainly attract media attention in coming weeks, Rousseff is likely to muddle through the situation with little damage to her image as long as the risks of power outages and severe rationing remain low. And slightly above average rain in coming months would be enough to defuse concerns.

If the situation worsens—through a combination of substantially higher economic growth and below-average rain—officials will probably look into measures to expand power sector capacity. In the longer term, the government could also announce a plan to build more gas and even coal-fired thermal power plants, probably by again turning to the private sector.

But for now there is not much the government can do beyond hope for more rain and, ironically, for economic growth that is a bit slower than anticipated.

While the economic costs to the government could be substantial, the political impact of the energy crisis should be limited.
Trade: No clear view of the future

How effective will Brazil’s trade policy be in 2013? The international outlook matters, but so does what happens at home.

Solange Monteiro, Rio de Janeiro

AFTER NEGOTIATING A PATH full of obstacles in 2012, mainly put up by the economic problems of the major world economies, Brazilian exporters have started the year hoping to recover the ground they lost last year, when foreign sales fell by 5.3% and the trade surplus plunged 34.7%. Exporters are not sure, however, that this time road conditions will be much better.

The concentration of exports in commodities leaves the country vulnerable to international prices and demand, which are as yet undefined. Lia Valls, IBRE head of external sector studies,
Commodities accounted for 93% of the fall in export values in 2012.

points out that commodities accounted for 93% of the fall in export values in 2012, adding that “If commodity prices stabilize, it is possible that Brazilian exports will grow; the trade surplus, however, is likely to be even lower than last year if there is a recovery of the Brazilian economy.” Moreover, whether the manufacturing sector can regain its competitiveness and reduce its trade deficit will depend on how it responds to the incentive policies that the government has been promoting in recent years.

Alessandro Teixeira, who is executive secretary of the Ministry of Development, Industry and Foreign Trade (MDIC), is also cautious: “We hope that 2013 will be better, but we consider it risky to set goals for exports. We still have no certainty of economic recovery in some markets. We are observing the trade performance in January and February, too, to see if the situation is becoming clearer.”

For some experts, the main international risk for 2013 will be in Europe, where unemployment is high. “A deepening crisis in Europe, which accounts for 37% of world trade, could impact the country both directly and indirectly, considering that Europe is also the major buyer of China’s products,” says José Augusto de Castro, president, Association of Foreign Trade of Brazil (AEB).

With regard to China, the attention of Brazilian exporters is for now concentrated on recovery of its demand for iron ore, which was the Brazilian commodity most affected in 2012, when Chinese growth at 7.8% was the lowest it had been in 13 years. Marcelo Ribeiro Tunes, director, Brazilian Mining Institute, is encouraged by what he is seeing this year. He says, “We had a difficult year, but already there are signs of a gradual recovery.”

Agricultural export projections for 2013 are also encouraging, according to Marilis Romano, an analyst at Tendencias Consultoria. In 2013 agricultural exports are expected to increase 8% over 2012. Romano sees particularly positive prospects for soybeans and meat and some accommodation for sugar.

INCENTIVES FOR INDUSTRY

Manufactured exports depend mainly on what is happening economically and politically in the rest of South America, the countries that are the main customers for Brazilian industry, as well as the sector that the government has been stimulating since 2011. “There was a small gain in volumes and prices in manufactured exports in 2012, but our trade deficit in manufactures is huge,” admits Roberto Giannetti da Fonseca, director, Department of Foreign Affairs and Trade, Federation of Industries of the State of São Paulo (Derex / Fiesp).

What had been a deficit for manufactured goods of US$92.5 billion in 2011 grew to US$94.1 billion in 2012.

IBRE’s Valls confirms that there has been little progress in manufactured exports,
“If commodity prices stabilize, it is possible that Brazilian exports will grow; the trade surplus, however, is likely to be even lower than last year if there is a recovery of the Brazilian economy.”

Lia Valls

pointing out that the apparent increase in the share of manufactured goods in Brazil’s exports, which went up 2 percentage points last year, was mainly because sales of iron ore fell. MDIC’s Teixeira, however, believes that in 2013, “Several measures taken in 2012 will begin to show results in the first half of this year.” He cites among those measures the reduction of the industrial product tax, the Program Reintegra, which gives exporters of manufactured goods tax rebates of up to 3% of their sales, and the opening of the National Bank for Economic Development credit line to finance acquisition of capital goods.

While export incentives are always welcome, there is no consensus on their effectiveness in terms of the government’s industrial policy. For AEB’s de Castro, the most important government initiative is payroll tax relief, which has been expanded to 42 industries. “This has given labor-intensive sectors, such as shoes and clothing, a real benefit,” he says, adding that “with most of the measures, despite good intentions, the policies of the various ministries have not been integrated into a true foreign trade policy.” Derex / Fiesp’s da Fonseca is more confident. He ventured to predict that the government’s new policies, together with the reduction in the cost of energy and the development of infrastructure, will in the next two to three years allow industry to become more competitive. For 2013, da Fonseca estimates that the trade deficit in manufactured goods will narrow by US$5 billion to US$10 billion—a modest advance but the first positive sign of recovery.

THE EXCHANGE RATE

Da Fonseca projections, however, depend on an exchange rate that is better than R$2 per U.S. dollar. The appreciation of the Brazilian real seen at the beginning of the year, however, sounded a warning sign for exporters. Although Finance Minister Guido Mantega gave reassurances that the exchange rate policy would stay focused on the search for stability, the fall of the dollar below R$2 in January generated some suspicion that this year the Central Bank will be relying on the exchange rate to contain inflationary pressure.

According to Marcelo Azevedo, economist, National Confederation of Industries (CNI), the distortion of relative prices caused by exchange rate appreciation has forced many sectors to make changes in their operations. “In recent years, several entrepreneurs have started to import inputs, which in some cases has involved changes of machinery and redesigns,” he says, indicating
“We had a difficult year, but already there are signs of a gradual recovery.”

Marcelo Ribeiro Tunes

(Cindes), the sequence of errors and successes that has occurred with Reintegra is characteristic of current trade policy. “There is a somewhat aimless activism that ends up being very pragmatic, because it is not committed to a central thesis: they walk

that, in 2011, when the exchange rate appreciated to R$1.60 per U.S. dollar, the index of import of industrial inputs was 21.7%—considered relevant to an economy like Brazil’s that is not very open. For AEB’s de Castro, a more depreciated exchange rate and the Reintegra program are fundamental to making manufactured goods more competitive.

ACTIVISM WITHOUT DIRECTION
For José Tavares, director, Center for Integrative and Development Studies (Cindes), the sequence of errors and successes that has occurred with Reintegra is characteristic of current trade policy. “There is a somewhat aimless activism that ends up being very pragmatic, because it is not committed to a central thesis: they walk

THE CREATION OF A CREDIT LINE in local currencies between Brazil and China should have major backing from Brazilian exporters, according to José Tavares, Cindes director. The US$30 billion credit line could be signed in February, according to the press service of the Central Bank. Tavares says that the agreement would create “a more predictable environment for exporters, because the currency issue is the martyrdom of any company that has foreign trade activities.”

Tavares notes that the initiative with China was only possible due to the Brazilian government’s efforts to make the currency more convertible, which he considers an important advance. It’s something that has been happening since the Lula administration, with the unification of the foreign exchange market (2005) and the simplification of exchange rate legislation by former Central Bank Governor Henrique Meirelles. Convertibility is gaining strength under Governor Alexandre Tombini with the government’s strategy of seeking exchange rate stability, Tavares says, noting that “Conditions have been created so that the real can become a regional currency. Now, we need to encourage more agreements, and other countries to adopt [the real] as a store of value.”

During her visit to Russia last year, President Rousseff discussed the possibility of using the real and the ruble in bilateral trade. The creation of a fund in the currencies of the BRICS (Brazil, Russia, India, China, and South Africa) is another alternative being considered. IBRE’s Lia Valls points out, however, that the expanded use of local currencies in Brazilian trade transactions depends on the stability of the currency of the other country—she recalls that a similar arrangement between Brazil and Argentina in 2008 was short-lived. Roberto Giannetti da Fonseca Fiesp, notes that although using local currencies reduces the cost of financial transactions, there is a need to ensure compensation mechanisms, so that currencies can be spent beyond the borders of the two parties to the agreement.
Failure to reform Mercosur creates two problems for its members: It does not enhance the competitiveness of their industries and it stiffens negotiations of trade agreements.

through trial and error, making corrections along the way, discarding what did not work,” he says, citing the strategies of protecting domestic production that have affected imports. Tavares argues, however, that the exchange rate issue implies an important institutional advancement about which little is said: “The Central Bank has been modernizing legislation to make the real a convertible currency, which could have a major effect on trade, as in the case of the agreement to swap local currencies being negotiated with China.”

This trend, according to Tavares, extends to international politics, especially in South America, the main destination for Brazilian manufacturing. Tavares feels strongly that to promote regional integration it is necessary to have a rational institutional framework. Otherwise, trade is very dependent on the economic and political humors in various markets. In the case of Venezuela, where Brazil has built up one of its biggest trade surpluses, this year sales will be influenced not only by the price of oil, Venezuela’s main source of export revenues, but also by the uncertainty about the health of President Hugo Chávez, because government buys most of what Brazil sells there. On the other hand, in the case of Argentina, the good prospects for its soybean crop may reduce import controls, which would create scope for that market to recover after the 20% drop in Brazilian exports to Argentina in 2012.

Failure to reform Mercosur creates two problems for its members:

BRAZIL’S MAIN TRADING PARTNERS
Brazilian exports in 2012

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<th>Share in total exports (%)</th>
<th>Change 2012/2011 (%)</th>
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<td>China</td>
<td>17.0</td>
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<td>United States</td>
<td>11.0</td>
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<tr>
<td>Argentina</td>
<td>7.4</td>
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<td>Holland</td>
<td>6.2</td>
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<td>Japan</td>
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<td>Germany</td>
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<td>India</td>
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<td>Venezuela</td>
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<td>Chile</td>
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<td>Italy</td>
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The appreciation of the Brazilian real seen at the beginning of the year sounded a warning sign for exporters. It does not enhance the competitiveness of their industries and it stiffens negotiations of trade agreements. “Mercosur turned inward, while Chile, Peru, Colombia, and Mexico—which already have trade agreements with countries like Japan, China and the United States—have opened markets and integration possibilities. The dream of South American integration is becoming increasingly remote,” de Castro says.

For Tavares of Cindes, Mercosur will only turn around if the common external tariff (CET) is abolished, making Mercosur a free trade area. He explains that “The CET is part of an old integration system and has zero economic sense today, because the CET tariffs aim at regional import substitution, which is not our problem. Our problem is how to ensure that our industries are able to compete internationally with rational industrial policies that respond to the difficulties industry is experiencing today.”

Tavares argues that Brazil’s trade policy bias of protecting domestic production is actually not good for industry. “Unlike other Mercosur countries, and other emerging economies like China and India,” he says, “Brazil insists on taxing capital goods and intermediates, undermining the competitiveness of Brazilian products.”

The result, for now, is a disincentive for companies to look beyond Brazil’s borders. World Bank economist José Guilherme Reis notes that “One of the things that has attracted our attention is the low number of new firms entering the export market, the lowest among the 150 countries for which the World Bank collects information.” According to the CNI, in the first half of last year, not only were there few new exporters but 352 companies stopped exporting.

A World Bank report points out that the global economic crisis has highlighted the importance of diversification—for products, markets, and companies—to reduce the risks associated with higher volatility, greater specialization and the fragmentation of the global supply chain. Brazil, however, is a laggard in this area: While in the last 10 years, Brazilian exports rose from 10% of GDP in 2000 to 11.2% in 2010, China’s went from 23.3% to 29.6%, and India’s from 13.5% to 21.5%. From Reis’s point of view, “Brazil is a global trader, exporting and importing from different countries of the world—but more as a traditional exporter than an exporter connected to the global supply chain . . . there are issues of competitiveness that need to be addressed.” Brazilian foreign trade policy may need some re-thinking.

“The dream of South American integration is becoming increasingly remote.”

José Augusto de Castro
If elected director-general, what would you see as a minimal agenda that would ensure completion of the Doha round?

It is difficult to define in advance the scope and range of a possible resumption of the Doha round, knowing how much you can move and in what areas. For many years we have avoided talking about the core issues that led to the impasse, particularly market access, industrial goods, agriculture, and services. Market access and subsidies related to the three pillars of the organization—monitoring existing agreements, dispute settlement mechanisms, and development of new rules and agreements—have to be unlocked.

 Basically, there is good news and bad news related to the Doha round impasse. The bad news is that the differences between the [negotiating] parties are big.

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A GOOD EXECUTIVE who rolls up his sleeves and moves negotiations forward. That’s how Brazilian Ambassador to the WTO Roberto Azevêdo presented himself in a press conference in late January in Geneva, announcing that he is a candidate to lead the World Trade Organization (WTO) for 2013–17. Having represented Brazil at the agency since 2008, Azevêdo is well aware of the effects of 20 years without concluding negotiation of the Doha round and the public disbelief caused by the impasse. Azevêdo argues for both an innovative negotiation strategy and for strengthening multilateralism in line with changes in the configuration of power in the world.
The good news is there are problems only in a few areas. So to unlock the round of negotiations we must give priority to these problem areas, however difficult they may be, because unless they are resolved it will not be possible to unlock the round of negotiations as a whole.

In your press conference, you mentioned the need to modify the methods used to conclude the Doha round. What would these new methods be?
That’s the million-dollar question. The biggest problem today is that the positions are so entrenched that it seems absolutely impossible to make the parties move. We have to seek a more creative, more innovative [negotiation strategy] to allow us to, first, identify what is possible. Once that’s done, we should test how to achieve the possible. We have to promote conversation until we get a clear idea of what is possible or not.

The change in the configuration of global economic power has led many experts to declare the end of the multilateralism built after World War II. Do you agree?
Multilateralism has to be resilient to changes in the configuration of power. Otherwise, we would live in a perpetual tangle of diverse configurations. It is not the first time that the world has been changing, and it will not be the last. The way emerging countries, China among them, are beginning to occupy more space in the international political and economic scenario means that there is a need for a new dynamic in relations between not just central players but all members of the multilateral system. I think it’s natural that this is happening, but the transition will take time.

Between widening the scope of topics covered by the WTO (to the environment, competition policy, and so on) and focusing on areas already negotiated, which should be the priority for the WTO?
Hot topics in the trade agenda cannot be ignored, because in the WTO it is necessary to treat the commercial aspects. At the same time, it’s difficult to give proper treatment to new themes when the Doha round is stalled. Countries aggrieved by the interruption of negotiations resist discussing other matters for fear that the previous Doha development agenda will be forgotten. We have to find a way to give confidence and comfort to members . . . to make them realize that discussing new themes does not mean abandoning the development agenda.

What prompted Brazil to submit your application to the WTO? Would not it be better to join forces with Latin American partners, for example?
The application had been thought of for a long time, even before the nominations of Costa Rica and Mexico. What was missing was simply a final decision, which the president has taken . . . . Regarding this continent, it is natural that there is diversity, a plurality of opinions and interests, and it is good that this is so because it enriches the selection process.
Today, there is a perception that the WTO is weakening and will become just an arbitration center. Can we still believe in multilateralism?

Not only is the WTO in crisis, but so is the whole multilateral spectrum—the UN, the IMF, climate change organizations, the G-20. The WTO, however, has the advantage of already having a set of rules by which member disputes are resolved by the Dispute Settlement Body that has an established jurisprudence and mechanisms for imposing penalties. However, with the WTO crisis, trade rules began to be created by preferential trade agreements (there are about 300) and informally by transnational corporations—global supply chains have huge buying power. Brazil has made only trade integration in South America a priority. As evidenced by recent WTO studies, it is outside the global network of supply chains of goods and services. Because it has isolated itself from agreements centered in the US, the EU, and China, Brazil’s exports will lose dynamism. It is time for Brazil to redefine its trade policy.

Some experts have harshly criticized the industrial policy of the Rousseff government, including subsidies, raising taxes on imports, and legal requirements for hiring and buying locally. Does Brazil deserve to be seen internationally as protectionist?

The issue of protectionism is blurred. There are international rules on trade that allow protectionist instruments, such as tariffs and safeguards, protection against unfair exports (antidumping), and subsidies. If these instruments are being used within the rules, the country has the right to do so. A country cannot, however, take actions that are prohibited, such as requirements for hiring and buying locally for other than government procurement. Other countries have a disguised protectionism policy using deeply undervalued exchange rates, subsidies to industry and agriculture, unlimited credits via state banks to state enterprises, or restrictive rules of origin. That is why it is important to build up the WTO to fight unfair protectionism.

What platform should Ambassador Roberto Azevêdo advocate in his candidacy for head of the WTO?

The WTO has immense challenges, and Ambassador Azevêdo has vast experience in the international economy. It will be essential to get beyond the Doha Round impasse and persuade the major partners to end it with some result because the political cost of burying Doha would be immense. At the same time, mechanisms need to be created that would allow the WTO to address modern trade issues: investment, competition, climate, and private standards. It is also necessary to address the effect of undervalued exchange rates on trade. That has been left to the IMF, but the results have not been impressive.

We live today in a trade farce: countries pretend to comply with WTO rules but undermine the rules with undervalued exchange rates. If the WTO does not neutralize the effects of significantly undervalued exchange, it will never again have relevance as a center of global trade governance.
A RARE SITUATION—that’s how Josélio Moura, president, Brazilian Society of Veterinary Medicine, refers to the atypical case of “mad cow” disease detected in a dead cow in Paraná state. The cow died in 2010, but the information was only released by the Ministry of Agriculture, Livestock and Supply (MAPA) in December 2012. In fact, what made the case truly exceptional was that although investigation found that the animal was infected, the cow had no symptoms and the disease was not the cause of its death. Moura explains that “The big unknown is how the animal may have contracted the disease, since it was not fed with animal protein, the main way the disease is transmitted.

Since it was discovered, the episode, till then unheard of in Brazil, has raised questions about the damage it could cause to Brazilian beef exports, which were US$5.7 billion in 2012, representing 6% of total agribusiness exports. Government, trade associations, and experts, however,
guarantee that there is no need to worry and stress that the occurrence should not much affect the volume of beef exported in 2013. In January, foreign sales of the basic product were up 36.4% over January 2012, according to the Ministry of Development, Industry, and Foreign Trade (MDIC).

For the Dutch Rabobank, a bank active in world agribusiness, the market is still quite favorable for Brazil, since Brazil will have more supply than the United States, for example, which has low production due to a shortage of animals ready for slaughter. Guilherme Melo, an analyst at Rabobank Brazil, notes that “Brazil also competes with Australia, Paraguay, and Uruguay, but their production will be smaller. Argentina, which has high export capacity, loses because of its protectionism.”

However, although analysts see a positive picture, there is no denying that the case is a warning for Brazil that health protection is serious business. “Such episodes cause embarrassment to the Ministry of Agriculture and the Foreign Ministry. We had to give out necessary information to maintain markets, but the impact should be minimal,” said Fernando Sampaio, executive director, Association of Brazilian Beef Exporters (Abiec).

Minimal but not zero. Since the confirmation of the mad cow case, 12 countries—destinations for 5% of Brazil’s beef exports in 2012—have announced full or partial trade restrictions on Brazilian beef. This has made lots of extra work for the MAPA Secretariat of Agricultural Protection, which has been intensifying its efforts to answer questions about the incident and is sending diplomatic missions to major beef importers, such as Russia, the United States, the European Union, China, Iran, and Saudi Arabia.

According to MAPA, Brazil has a robust health monitoring system and the meat is safe for consumption. That statement was ratified by the World Organization for Animal Health (OIE), which has kept Brazil’s status at “negligible” risk, meaning the probability of occurrence is very low. However, the OIE noted with concern the considerable delay before Brazil sent clinical samples for a confirmatory diagnosis to an OIE Reference Laboratory, and it recommended more careful monitoring. But MAPA’s office of communication reports that “There is no technical support to justify the restrictions imposed by some countries, which is why
we believe that they should not persist for a long time, and there is no reason for other countries to follow that position. All the answers requested are being provided.

However, the case has caused Brazil to lose some credibility, and other countries may prohibit the entry of Brazilian beef. “Technically, there is no justification for the embargo, as the OIE recommends our product. So if Brazil cannot reverse these embargoes, it has every right to appeal to the OIE and the WTO,” says Abiec’s Sampaio.

Sebastião Guedes, director of animal health, National Cattle Council, believes the embargoes are not really for health reasons. In his opinion, “These countries are taking these measures mainly for commercial reasons. They are using the occurrence … to try to bring down the price of Brazil’s beef.” He believes in any case that the worst has passed. But Moura adds, “The sin of Brazil was the delay in diagnosis of BSE. It is a fact that weighs negatively out there.”

Pedro de Camargo Neto, president, Brazilian Association of Producers and Exporters of Pork, agrees: “Historically, Brazil reacts only after an incident happens, which is unacceptable. We need to act preemptively and not just respond to disasters.” Moura and Camargo Neto both think that, considering the billions that agribusiness brings into the Brazilian economy, what is needed are investments in sanitary surveillance, more federal and state agricultural inspectors, and a larger laboratory network. As Moura says, “The country has an obligation to invest in agricultural defense. Today, there is a shortage of 7,300 veterinarians. We need laboratories that make quick diagnoses. The cow that died in Paraná southern state was a simple case, but what if it was something that could do serious harm to the public health?”
The Brazilian Economy — What is the basis of the revolution of shale gas in the United States?

Sergio Quintella — We have known about shale gas for a long time, but until recently it was not possible to produce it economically. The innovative element was the combination of drilling techniques developed by Texan George Mitchell, a partner in a mid-sized oil company whose reserves were declining. He battled alone for 10 years to find a new technique for extracting the gas. The Mitchell technique of hydraulic fracturing drills a vertical well nearly two miles deep; when it reaches the shale, it drills horizontally, fracturing the rock with a lot of water, acids, and sand. Today U.S. shale gas costs US$2.20 per million BTU (the traditional unit of energy, equal to about 1,055 joules), while in Brazil—and similarly in Europe or Russia—natural gas costs US$12 to US$14 per million BTU.

How will this discovery affect the world energy market?

There will be an unquestionable impact. In just five or six years, the U.S. will be close to self-sufficiency in energy, in terms of

How to attract investors?

Sergio Quintella Franklin
Board member of Petrobras

WHILE IN THE NEXT FEW YEARS thanks to shale gas the United States will live through an energy revolution, which promises to reorder geopolitics and the global economy, Brazil will have the dual challenge of preparing for the impact of this change on its oil industry and strengthening the basis for exploiting deep sea oil. “It is a logistical, technological, financial challenge,” says Sergio Quintella Franklin, member of the Board of Directors of state-owned oil company Petrobras. For him, Brazil’s major task today is to attract investors based on a sharing regime. “The presence of the state’s deep sea oil is a new fact that foreign investors have not yet absorbed,” he says. Quintella also talks about the possibilities for exploiting shale gas in Brazil and about the price of gasoline, and defends an adjustment in the requirements to hire and buy parts locally for the oil and gas industry.
either oil or gas. Estimates of gas reserves indicate it has enough for 150 years at 1.5 billion cubic meters per day. The U.S. will no longer need liquefied gas from Qatar. As for oil, the International Energy Agency (IEA) estimates that U.S. imports will decline from 11 million barrels a day—total daily U.S. consumption is 20 million barrels—to 3 million barrels. That means there will be released on the market about 8 million barrels per day, which will certainly influence the oil price unless China’s domestic demand grows considerably. One of the most dramatic impacts for Brazil will be in the petrochemical industry. If the U.S. shale gas boom continues, the U.S. will become a local priority for investment in this sector. The same applies to industries that consume a lot of energy, such as aluminum, ceramic, and glass, for example. Recently the president of Petrobras, Maria das Graças Foster created a working group to prepare a plan for researching hydraulic fracturing technology and identifying the most likely places to find shale. The initiative is welcome, because Petrobras has interests in energy, petrochemicals, and nitrogen fertilizer.

Why was there not the same interest in researching shale gas in Brazil?

For many years, there was general Brazilian disinterest in gas exploration. Brazil was devoted to oil exploration, which Petrobras did very successfully. Today Brazil consumes about 90 million cubic meters of gas a day, 30 million of which come from Bolivia. Increased domestic production of both conventional and unconventional gas is critical to safely diversify the Brazilian energy supply. The conventional gas associated with deep sea oil and the possible extraction of shale gas will allow for gas-fired electric plants. Regarding shale, we produce in Paraná state, with old technology, 150 cubic meters per day, which is very little. For some time, the National Petroleum Agency (ANP) has been working on identifying locations where there may be shale gas. But that is still being studied, and results are far from guaranteed. . . . Even though these reserves exist, however, the Brazilian situation in relation to shale gas is completely different from the American for two reasons: First, in the U.S., shale gas is in a region that already has a large pipeline network, which makes the operation more economical. The second factor relates to legislation. In Brazil, as in France, the owner of the land is not the owner of the subsoil. In the U.S. there is no such difference. Each farmer can trade part of his property for drilling, he sets its price, and wins without risk. This does not happen in Brazil because our system
requires mechanisms for granting and bidding.

Despite expectations for future deep sea oil production, the situation for Petrobras today is complex, with production stagnating and little prospect for growth in 2013, increasing imports of gasoline and diesel, and a fragile financial situation, with pressures from ANP for new investments. How tough will 2013 be for Petrobras?

Petrobras is a great company with high-level technical staff and has succeeded in deep-water oil exploration in the Brazilian coast. It currently produces 2 million barrels per day, and strategic planning projects raising that to over 5 million barrels over the next decade. This is a huge challenge, not only technological but also logistical and financial and in terms of human resources. The new system for sharing deep sea oil revenues imposes new responsibilities on Petrobras as the sole operator. And with the growth in demand for oil products (gasoline, diesel, jet fuel), new refineries are under construction in the northeast (Pernambuco state), southeast (Rio de Janeiro state), and probably soon in the Midwest. The whole program relies on a solid financial structure with both generation of own resources and external financing. The arrival of foreign investors in deep sea oil will be welcome, and ANP will certainly seek a diversity of nationalities to avoid excessive concentration of power in a few exploration companies and countries. International investors who have great respect for Petrobras are still raising questions because they do not yet understand the structure and the people who will lead the company’s deep sea oil exploration.

How about decisions to raise the price of gasoline and diesel, which the government has little interest in at this time because of inflationary pressure?

That had to be solved: prices on January 1 went up 6.6% for gasoline and 5.4% for diesel. The price control has two effects, both negative. Petrobras for many years has had to import gasoline and diesel at one price and sell it for less. The price correction was made to compensate the company, which then faced a low volume of imports of derivatives. Today existing refineries cannot meet domestic market demand, due to the growing fleet of trucks and passenger cars. Price controls also have the effect of discouraging production of ethanol. The price controls also prevent private investment in refineries. There will be no private refineries in Brazil as long as there are price controls. Personally I think pricing for derivatives should be clearly stated in order to reduce uncertainty and attract private sector interest.

Deep sea oil has created another controversy related to incentive mechanisms, such as legal requirements to hire
and buy parts locally, to stimulate generation of a local chain of suppliers to absorb technology and add value. Will this measure be successful?

Added value is always desirable . . . . The point is to get that increase in added value within economic principles and without creating subsidies that end up burdening taxpayers. The requirement to hire and buy locally is not new, and was well-executed in the case of countries like Korea . . . One must craft an ingenious policy of incentives that sets criteria, deadlines, and gradual phasing out. I believe it is necessary to examine the model of South Korea, which established goals and criteria to stimulate innovation and increase the competitiveness of its emergent capital goods industry.

The form chosen by the government to renew leases in the electricity sector raised uncertainty about the risk of breach of contracts. Do you see an improvement of the business environment in Brazil?

The price of electricity in Brazil, for both industry and households, is extremely high. Because federal and state taxes are a major factor in this cost, the importance of reducing them is evident. The federal government, I believe, correctly diagnosed the problem, but made changes in the compensation to be paid to the concessionaires without the necessary care, for example, such as opening the debate in public hearings. On the other hand, one cannot speak of breaking contracts, because dealers were not required to join the program, as indeed is the case of the Brazilian power company in Minas Gerais state (Cemig) and in São Paulo state (Cesp) among others. The important thing is to open new bids, ensure that there are reservoirs for hydroelectric power, research and produce conventional gas or shale, and develop a pipeline network to locate plants near consuming areas. With these actions Brazilian energy prices would be at international averages. The economic crisis that started in 2008 still affects the United States and to an even greater degree Europe. All sorts of government interventions have been tried, from public financial support to banks and industries (e.g., automobiles in the U.S.) to the loosening of monetary policy by the U.S. and European central banks. Here in Brazil stimulus spending by cutting federal taxes on durable goods was successful. There remains the recovery of public and private investments, reduction of the “Brazil cost” (taxes, labor and pension costs, inadequate infrastructure). There are, in fact, many complaints from businesses about federal government intervention in private activities, discouraging new investment. The Economic Forum in Davos (Switzerland) discussed this issue in relation to Brazil. I hope this perception ends soon, which might be the case with the recovery of the economies of developed countries.

In Brazil, as in France, the owner of the land is not the owner of the subsoil. In the U.S. there is no such difference.
THE TRADE BALANCE in 2012 took some attention-grabbing turns that suggest change in the flows of exports and their destinations in recent years. The concentration index of Brazilian exports fell 16% between 2011 and 2012, returning to the same value it had in 2010. The level is still high compared to what was seen...
in the early 2000s, but the continuous rise in the index since 2006 was interrupted. What happened?

Brazilian exports have increased every year since 2000 with two exceptions: in 2009 they fell by 23% compared to 2008, and in 2012 they fell by 5.3%. This behavior is repeated for the main groups of exports. But there is an important difference: After 2006 the surge in basic commodities led to a steady rise in the share of commodities in Brazilian exports, especially as the manufacturing share steadily declined, from 54% in 2006 to 36% in 2011.

In 2012, the picture was reversed: there was a decrease in the share of basic commodities and an increase of 2 percentage points in the share of manufacturing. The change in the pattern of export concentration, however, was not because manufacturing exports performed better. It mainly came from the drop in exports of iron ore (the value of ore exported fell 26%, and its share in total exports fell 13% between 2011 and 2012), accompanied by the increased participation and value of other exports, notably commodities like corn (101%) and soybean meal (16%), and
manufactures like fuel oils (34%), aircraft (21%), and ethanol (47%). Except for aircraft, therefore, the main contributors to the change in concentration were agricultural commodities and fuel.

Although the trade surplus fell from US$29.7 billion in 2011 to US$19.4 billion in 2012, bilateral balances between Brazil and its main trading partners did not all fall in parallel. The trade surplus with Asia fell US$160 million. China accounts for more than half of Brazil’s exports (55% in 2012) to Asia, followed by Japan (11%). In both cases, exports fell. For India, the third main market, there was an increase in exports of 74% and a drop of 17% in imports. In 2012, 62% of Brazilian exports to India were crude oil, representing an increase of 101% over 2011, though imports of diesel (42% of the total) fell 33%. Netted out, the trade surplus with India went from a deficit of US$2.8 billion in 2011 to a surplus of US$534 million. For all other major Brazilian partners in Asia (South Korea, Singapore, Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, and the Philippines), there was an increase in the trade surplus or a decrease in the deficit, sometimes with increases in exports, as to Singapore (5.6%), Hong Kong (13%), Taiwan (1.7%), Thailand (14%), and Indonesia (16.5%). As with India, the increases were based on commodity exports, though in these cases mainly from agricultural sources. Thus in Asia, diversification of Brazil’s commodities exports was the main factor offsetting the drop in sales to China.

Brazilian exports to the U.S. grew 3.5%. Among the top 10 products heading north that recorded increases between 2011 and 2012 were semi-processed steel (14%), ethanol (165%), aircraft (47%), and

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**Brazil: Trade balance with trading partners**

**Billions of U.S. dollars**

<table>
<thead>
<tr>
<th>Regions/Countries</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>6.6</td>
<td>6.5</td>
</tr>
<tr>
<td>Asia (excluding China)</td>
<td>-4.9</td>
<td>-0.5</td>
</tr>
<tr>
<td>China</td>
<td>11.5</td>
<td>-7.0</td>
</tr>
<tr>
<td>United States</td>
<td>-8.2</td>
<td>-5.7</td>
</tr>
<tr>
<td>European Union</td>
<td>6.5</td>
<td>-1.2</td>
</tr>
<tr>
<td>South America</td>
<td>15.2</td>
<td>10.5</td>
</tr>
<tr>
<td>South America (excluding Argentina)</td>
<td>9.4</td>
<td>8.9</td>
</tr>
<tr>
<td>Argentina</td>
<td>5.8</td>
<td>1.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>29.8</td>
<td>19.4</td>
</tr>
</tbody>
</table>

If there are no major changes in commodity prices and there is a more depreciated exchange rate, exports should grow in 2013. The moderate optimism, however, may be premature, as the global economic recovery has not yet consolidated.

electric motors (86%). The predominance of manufactures, which increased by 15% between 2011 and 2012, raised the share of this group in Brazilian sales to the U.S. market from 45% to 50%. This is still far from the 75% recorded in 2002, but it may indicate some recovery.

In South America, Argentina accounts for 44% of Brazilian exports and 54% of its imports. Thus, the reduction of the Brazil-Argentina trade surplus by US$4.2 billion was the main reason Brazil’s trade surplus for the region sank—excluding Argentina, Brazil’s trade balance with South America fell only US$456 million. Between 2011 and 2012 there was an increase in exports to Colombia (10%), Peru (7%) and Venezuela (10%). The only exception was Chile, where the trade surplus fell. South American markets account for over 70% of Brazilian manufacturing exports.

Finally, the trade deficit with the European Union increased because of the crisis there. Brazilian exports to EU countries fell by 7.7%, and its imports from the EU rose by 2.7%.

What conclusions can be drawn from these observations? The change in export concentration and the increased participation of manufactures have not yet changed the trends observed in recent years. However, the diversification of Brazil’s commodities exports could attenuate the dependence on iron ore, soybeans, and oil.

It is possible that the devaluation of the exchange rate (the average real effective rate increased by 10.3% between 2011 and 2012) may have contributed to the improved performance of manufacturing relative to other exports. In this case, manufactures may increase as a share of Brazilian exports to the U.S. If there are no major changes in commodity prices and there is a more depreciated exchange rate, exports should grow in 2013. The moderate optimism, however, may be premature, as the global economic recovery has not yet consolidated.
WITH THE FIRST QUARTER OF 2013 ALREADY in its second half, there is mounting evidence that the long-awaited recovery of the Brazilian economy is nowhere near. Confidence indexes remained relatively stable in January and confirmed the tendency for leveling off indicated in December. Though there are some indications of economic growth in January, optimism about the months ahead is receding.

What is deeply worrying is that even after six consecutive quarters of decline there are no signs that gross investment is recovering, yet under current conditions, only if there is more investment can the Brazilian economy begin to heal.

The general scenario is still that there will be moderate economic growth. But as expectations worsen, doubts rise about how fast gross investment can recover.

Meanwhile we are seeing the government getting more and more involved in micro-management in its attempts to reassure households and companies, raise their confidence, and thus stimulate investment. But improvement in the economy at large has simply not been decisive enough to really be encouraging.

The tepid economic activity that prevailed in the last quarter of 2012—when we estimated GDP growth of 0.6% quarter-on-quarter and annual GDP growth of 0.9%—seems to have followed us into 2013. As pointed out in previous reports, a major reason that 2012 did so badly was the dismal performance of investments, which have not taken off for almost two years. We estimate gross fixed capital investment was just over 18% of GDP in 2012.

On the demand side, therefore, GDP growth in 2012 was sustained mainly by consumption, since net exports contributed negatively to growth despite acceleration in exports in the fourth quarter. On the supply side, what economic activity we saw was due entirely to services and to a very tight labor market and an increase in real incomes.

The current situation is all the more troubling because there has been no respite from inflation. January inflation increased by 0.86%—the highest January increase since 2003. With this increase, the cumulative 12-month rate rose for the seventh consecutive year to hit 6.15%—not that far from the government’s inflation target ceiling (6.5%). The tradeoff between growth and inflation in Brazil seems to have worsened considerably. Even though the economy has grown much less, inflation is still rising. How to mitigate the tradeoff is the big question in economic policy making. Both the governor of the central bank and the minister of finance have made it clear that if necessary to curb inflation the central bank’s policy rate would have to go up. If that happens, it would undoubtedly contribute to cooling any incipient economic recovery.