

PAGE ONE

Brazil Joins Front Rank Of New Economic Powers

Nation Launches Wealth Fund as Boom

Boosts Coffers; Putting the 'B' in BRIC

By MATT MOFFETT

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SÃO PAULO -- For much of the decade, slow-growing Brazil seemed out of its league lumped in with the dynamic emerging economies of Russia, India and China in the so-called BRIC group. Skeptics said that RIC was more like it.

But slowly and without great fanfare, Brazil's economy has turned a big corner. Already a global power in agriculture and natural resources, Brazil has added a key ingredient that had long eluded it: a currency with staying power. In turn, that's helping unleash the greatest burst of prosperity the country has witnessed in three decades, attracting foreign investors by the score and providing a growth engine for a flagging global economy.

For the second consecutive year, Brazil's economy is growing at around 5%. That's still a far cry from Chinese growth levels. But the expansion has enabled Brazil, which seemed on the verge of a massive debt default in 2002, to build up enough stockpiles of U.S. dollars to outweigh its entire foreign debt and become a net creditor nation for the first time in its history.

Brazil has enough money lying around that Monday it announced it would follow other booming countries like China and Persian Gulf oil states in setting up a sovereign-wealth fund, worth between \$10 billion and \$20 billion, to invest its excess cash. In addition to the fund, Finance Minister Guido Mantega unveiled a new \$125 billion industrial policy plan to stimulate new export and high-tech industries at home through tax breaks, venture capital and other incentives.

Brazil's newfound stability has elevated millions of poor Brazilians into the middle class, making it the largest population bracket in a nation long known for having only haves and have-nots. Adding to the optimism, Brazil recently made some vast new offshore oil discoveries that could catapult it into the ranks of major oil exporters.





Associated Press
Brazil's Finance Minister Guido
Mantega

Brazil is feeling confident enough about its economic place in the world that its leftist president, Luiz Inacio Lula da Silva, recently joked to an audience of Latin American businesspeople that he had lectured President Bush on cleaning up the U.S. credit crisis. "Here's the problem, son," Mr. da Silva said he told the president, apparently embellishing for effect. "We've had 26 years without growing. And now that we're growing, you come along and complicate things? Settle your crisis!" White House officials said the two had discussed the economy but not in those words.

On April 30, another piece fell into place for Brazil when Wall Street ratings firm Standard & Poor's upgraded Brazil's debt to "investment grade" -- making Brazil the last of the BRIC nations to have its creditworthiness win that coveted seal of approval. Brazilians rejoiced, pointing out that they had overhauled their economy even as the country's 23-year-old democracy was putting down ever deeper roots. India is the only other comparably functional democracy among the BRICs.

Mr. da Silva, the union leader turned business-friendly president, hailed the ratings upgrade as proof that Brazil is "a serious country, with serious policies." The boast echoed -- in reverse -- a famous put-down, apocryphally attributed to Charles de Gaulle, that "Brazil is not a serious country."

The nation of 190 million inhabitants hasn't shed all its economic perils. Much of its economic surge is riding on soaring commodities prices, including agrarian products, oil and minerals; a reversal would be deeply felt. It hasn't been long -- only 15 years or so -- since Brazil's inflation rate reached quadruple digits.

In contrast to the cool and calculating Russian Prime Minister Vladimir Putin, Mr. da Silva often seems an unlikely steward for a rising economy. He's known for off-the-cuff gaffes like once describing himself as the son of "a woman who was born illiterate." More substantively, critics say Mr. da Silva isn't doing enough to downsize a bloated public sector, which lifts Brazil's tax burden to around 36% of output, about twice the level of China or India.

But Mr. da Silva has proven himself an adept bridge builder who seems equally at home having barbecue with George Bush or drinking cafe cubano with Raul Castro. "Brazil doesn't really have any enemies," says economist Claudio Haddad, president of the Brazilian Institute of Capital Markets, a top business school. Brazil is the only one of the four big emerging economies without nuclear weapons. But while India, for instance, must stand vigilant over its nuclear-armed Islamic neighbor Pakistan, Brazil mainly has to worry about instability on its borders in Venezuela and Colombia.

Safe Haven

That's just fine with investors who see Brazil as a relatively safe haven, a resource-rich democracy that's growing steadily, if not spectacularly, in a quiet corner of the world. Brad Edson, chief executive officer of Phoenix-based NutraCea, a maker of rice bran products, was

2

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looking around the world for a site for a new processing plant. "Rice-growing areas are dotted with unstable political, social and economic environments and you tend to gravitate to the most stable ones," he said. Brazil was a no-brainer for the company's approximately \$30 million investment.

Even before the investment-grade designation, Brazil was awash in foreign capital, much of it directed toward brick-and-mortar projects. So far this year, foreign direct investment is flowing into Brazil at a pace higher than last year's \$34.6 billion, which was 84% more than in 2006.

On the outskirts of Rio de Janeiro, 13,000 laborers are working overtime to build German industrial giant ThyssenKrupp AG's new \$4.6 billion steel plant, the largest mill to be built in Brazil in 20 years. Mexican billionaire Ricardo Salinas recently made a whirlwind visit to historically impoverished, but now economically surging, Northeastern Brazil to launch a chain of banks aimed at low-income clients. Illiterate clients will be able to register accounts using their fingerprints. International oil companies, such as Statoil SA of Norway and Royal Dutch Shell PLC, are set to invest \$25 billion in Brazil in the coming years, according to Brazil's industry association for foreign oil companies.



**Luiz Inácio
Lula da Silva**

"Brazil is one of the best places in the world to do business in the natural-resources sector," said Daniel Titcomb, president and CEO of Jaguar Mining Inc., a Concord, N.H., gold-mining company that's investing about \$550 million in the central state of Minas Gerais. "They back up what they say with law."

Enhancing Brazil's attractiveness to capital are the democratic checks and balances that investors count on to protect their rights. But Brazil's chaotic version of democracy is a double-edged sword. Brazil's Congress lacks the internal discipline of the Chinese Communist Party and often seems to lack any discipline at all: About 15% of the Congress members are under formal investigation for alleged crimes, ranging from attempted homicide to money laundering.

Franklin Feder, Alcoa's president in Latin America, says from the standpoint of investor security, Brazil is far preferable to "an autocratic regime that can change radically from one day to another." Alcoa Inc. is putting \$2 billion into hydroelectric power, mining and smelting projects throughout Brazil -- the company's most ambitious investment program anywhere. That said, democracy Brazilian style "provides us with many daily frustrations because of the speed of decision making," says Mr. Feder. Because of exhaustive paperwork, the process of licensing and building an Alcoa hydroelectric joint-venture in the Amazon has already taken a decade and the project still won't go on line until 2010 to 2011.

Nothing moves fast in Brazil. In Congress, bedeviled by corruption and a surfeit of small, weak parties, change occurs almost glacially. One of Mr. da Silva's major victories, a measure to reduce the Supreme Court's caseload, had been in the works since the 1960s.

Strictly from a standpoint of economic efficiency, "there's something to be said for command and control," says Stello Tolda, head of the online auction Web site MercadoLivre. Brazil's

homeless and landless are organized into pressure groups that block trains carrying minerals and conduct paralyzing protests on farms.

Brazil lacks the savings and investment rates of China and India. But Brazil has reached a more mature stage of development than China and India -- with a larger share of the population urbanized and higher per capita wealth -- so it's simply less likely to take giant leaps these days.

Skeptics on the Revival

Indeed, there are still plenty of skeptics on the Brazilian revival. Harvard Business School economist Aldo Mussachio recently wrote a paper whose title suggested Brazil was "off the yellow BRIC Road." Mr. Mussachio says the bubble in commodity prices suggests that there's every chance its economy will eventually fall back to earth.



Brazilian taxpayers don't get much bang for their buck in areas like education, where Brazilian 15-year-olds scored about 20% lower than their Russian peers in a standardized science test.

The government for years deferred tough budget choices by cranking up the money presses to appease competing interest groups. The result was inflation that rocketed to four-digit levels through much of the 1980s and early 1990s. When Mr. da Silva became president in 2003, after

his fourth bid for the office, the problems were so menacing that there was little choice but to confront them head on. Nervous investors had sent the real tumbling to all-time lows, generating a dangerous resurgence of inflation and fears Brazil would default on its debt.

Mr. da Silva, who had moderated his economic position from his early days as a fire-breathing populist, hewed to economic orthodoxy. He gave a free hand to his central-bank president, Henrique Meirelles, former president of BankBoston Corp., to throttle inflation by pushing interest rates well above 20% for most of Mr. da Silva's first year in office. Rates came down only gradually, and the human cost was steep. In 2005, when the Rio de Janeiro trash company was looking to hire 1,000 garbage men earning salaries of around \$300 per month, some 400,000 people put in applications.

Mr. da Silva toughed out the downturn -- as well as a campaign-financing scandal that claimed many of his closest political allies. Then, over the past couple of years, his luck and Brazil's started turning. Prices for Brazil's soybeans and iron ore hit sky-high levels. Brazil's state oil company discovered what some geologists consider one of the biggest global oil strikes in the past 20 years in the Tupi field beneath rock, sand and salt at the bottom of the

Atlantic Ocean. Government social programs, slow to get off the ground, gained momentum, and brought monthly stipends of up to \$57 to 11 million families.

Cledorvino Belini, president of Fiat SpA in Latin America, says those programs helped trigger "a bottom-up economic shock. People bought more bread, and the baker bought a TV, and the guy who sold the TV bought a pickup truck. And so it went."

It also helped that the central bank had established its credibility as defender of the currency during a long campaign raising rates to depress inflation. It could then cut interest rates sharply in 2006 to stimulate lending. Private credit has expanded to about 35% of output from 22% in 2002. The longest terms for auto loans have been extended to a once-unheard-of 99 months, and car sales rose by 28% last year to a record 2.4 million cars.

Consumer Confidence

"Consumer confidence was what moved the needle," says Marcos de Oliveira, president of Ford Motor Co. in Brazil. The consumer thought, "I'm not so concerned about losing my job [and] I can get into longer-term financing."

Many investors are being lured by the growing and diverse consumer class. The top tier of Brazilian shoppers ply plastic as avidly as those anywhere else in the world; the Louis Vuitton shop in São Paulo's chic Jardins district is one of the company's top performers. But what's really new is the emergence of a large middle market. "Everyone's after that broad part of the pyramid," says Jorge Hillman, director general of Brazilian operations of Masisa, a big Chilean company that is building a new \$130 million plant to make particleboard for the booming furniture market.

A recent study by the local office of the French research firm Ipsos found that since 2005 more than 20 million people had entered the middle class, defined here as families with monthly income of around \$635. The percentage of middle-class Brazilians has grown to 46% from 34%.

The new middle class has propelled a doubling in the domestic market for cosmetics, home electrical appliances and computers since 2002, according to Euromonitor International. In the computer sector, middle-class buyers are accounting for about 40% of sales, according to market analysts. Brazil now ranks fourth globally in computer sales behind the U.S., China and Japan.

"You no longer have to live from month to month in Brazil, fearing the next crisis will strike," says Alexandre Mendes, a restaurant maitre d', hefting a new color printer he'd just bought on installment at a tech shop.

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