

Challenges confronting Brazil

Getulio Vargas Foundation,
April 4, 2013

Luiz Carlos Bresser-Pereira
www.bresserpereira.org.br

Just before the 2008 global financial crisis

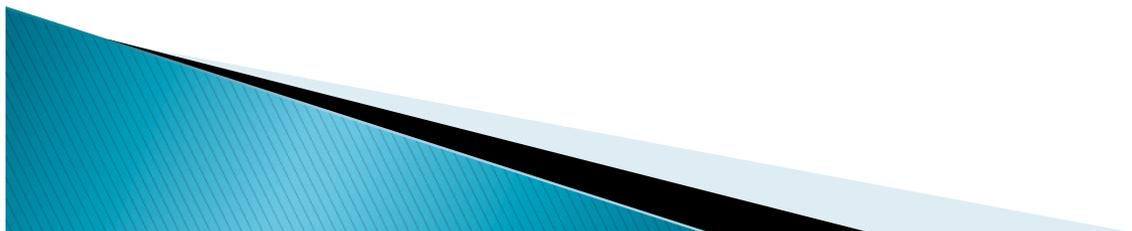
- ▶ Brazil was seen by rich countries as a highly dynamic economy and the “the best o the BRICs”.
- ▶ In the early 2010s, back to 2,5% growth
Growth numbers in the mid 2000s was back to modest 2,5%

BRICs	GDP Growth
China	10%
India	8
Russia	6
Brazil	4,5

Why so much enthusiasm, given so modest performance?

Because, among the four countries, Brazil was the one

1. that followed more industriously the economic policies and reforms recommended;
2. that proportionate easy gains in carry-trade operations by appreciating gradually the real since 2003;
3. that offered better conditions to multinationals' investments.



Why was Brazil's growth satisfactory in mid 2000

- ▶ Because, pushed by China, the price of the commodities increased, and exports were multiplied by more than three

Ano	Exportações (US\$ bi)
2002	60,4
2004	96,6
2006	137
2008	197,9
2010	201,9



Why has been Brazil's growth so modest since 1994?

(Note that I am using as starting point 1994 because in this year the Real Plan finally controlled high inertial inflation)

Because, by following dutifully Washington's recommendations, Brazil:

1. Kept the interest rates too high,
2. Kept the exchange rate highly overappreciated,

What meant a disincentive to investment.
and resulted into a small (1.8%)



Why is the investment rate low?

Not because

- ▶ Domestic savings are small
- ▶ Lack of investments in the infrastructure
- ▶ Lack of good institutions.

But because

- ▶ Although the interest rate fell, it remains too high and
- ▶ the exchange rate continues to be highly overvalued.



Why does the interest rate continue to be high

- ▶ Because the Brazilians continue to be hostage of inflation.
- ▶ Because the rentier neoliberal coalition gains from high real interest rates.
- ▶ Because this coalition claims that the “natural interest rate” is much higher here than in other countries, and successfully persuades the government and civil society on that freak argument.



Why is the exchange rate overvalued in Brazil?

Because Brazil does not neutralize the tendency to the overvaluation of the exchange rate. Or, in other words, because:

- ▶ The interest rate is high.
- ▶ Brazil suffers from a non-neutralized Dutch disease.
- ▶ Because Brazil does not control sufficiently capital inflows.
- ▶ Because politicians, households and foreign interests are happy with an overvalued real.



Politicians are happy with an overvalued currency

- ▶ Because, when a currency depreciates, wages (and other incomes) will fall in real terms.
- ▶ Because firms and banks indebted in foreign currency will suffer from the depreciation.
- ▶ Because when elections get near, a common strategy is to appreciate the national currency – what will decrease inflation and increase wages, and facilitate politicians' reelection.

I call this “exchange rate populism”.



Households and firms are happy with an overvalued currency

- ▶ Households, because wages and salaries remain high;
- ▶ Agribusiness, because they know that a tax on exports will be required to neutralize the Dutch disease. (Although what they will pay with the export tax will be returned to them on the form of a depreciated currency).
- ▶ Business firms. Only the ones that are indebted in dollars.
- ▶ Banks. Most of them, because they often have credits with the above firms.



And the inflation?

- ▶ Inflation is **not** the fundamental problem that the Brazilian faces since 1994.
- ▶ If the indexation of the contracts signed with the government had been forbidden, Brail's inflation would be just a little above the one existing in rich counties.



My modest predictions

- ▶ The exchange rate will continue in the same level in the two next years.
- ▶ Brazil will continue to grow modestly.
- ▶ But, after the October 2014 presidential election, in which Dilma Rousseff will most likely reelected, either the government will realize that he must depreciate the real, or it will face a new balance of payment crisis.



Luiz Carlos Bresser–Pereira
Professor Emérito da Fundação Getúlio Vargas
www.bresserpereira.org.br

