Brazil's Economic Prospects:
in the Global (and Chinese) Context

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What is the “Global Context”?

1. Short-term Context:
   a. Will U.S. Fed trigger more capital flight?
   b. Is China going to grow fast or not?
2. Medium-term Context:
   a. Growth: from exports or domestic demand?
   b. China’s success is based on domestic demand.
3. Long-term Context:
   a. Can Brazil use a Chinese investment model?
   b. If not, Brazil’s prospects are poor.

All of my "contexts" involve China

1. China's development: a continuing success
   a. Insulated from global financial instabilities
   b. Reliance on domestic demand, not exports
   c. Hands-on optimizing of domestic finance
   d. Rapid private-sector off-farm job creation
2. Brazil's prospects in the *Chinese* context?
   a. Short-term: Brazil seems stuck in weak settings
   b. Medium-term: Are exports the key? Really?
   c. Long-term: 3% growth is a poor performance.

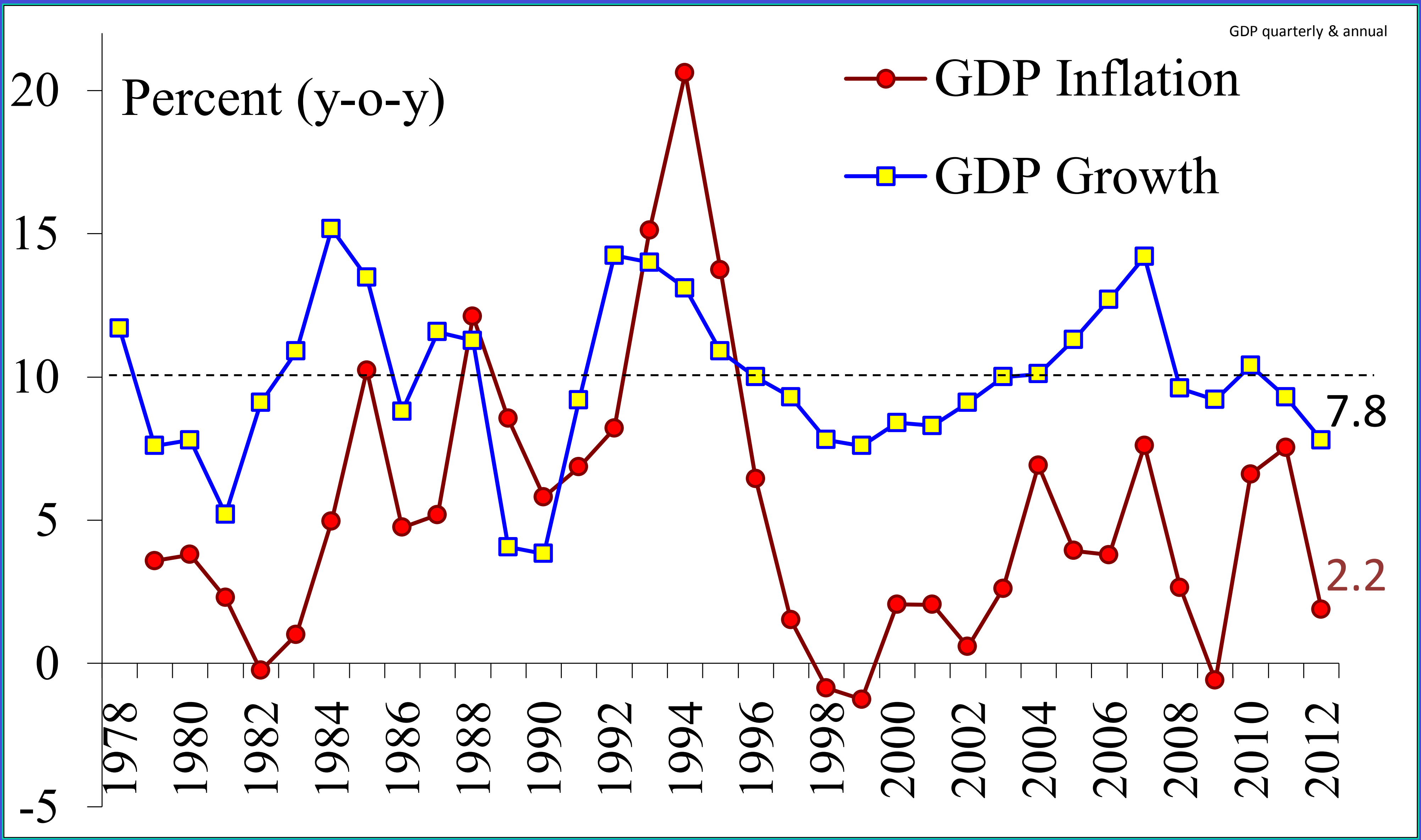
Why is China a Credible Context?

1. The need to refute various China myths.
   a. China’s rapid growth is sustainable.
   b. China’s financial and fiscal systems are fine.
   c. Local debt is manageable and beneficial.
   d. So-called “imbalances” don’t fit the facts.
2. In this more accurate context,
   a. China’s experience & methods are instructive.
   b. They provide financial governance guidelines.
   c. Brazil doesn’t measure up well in this context.

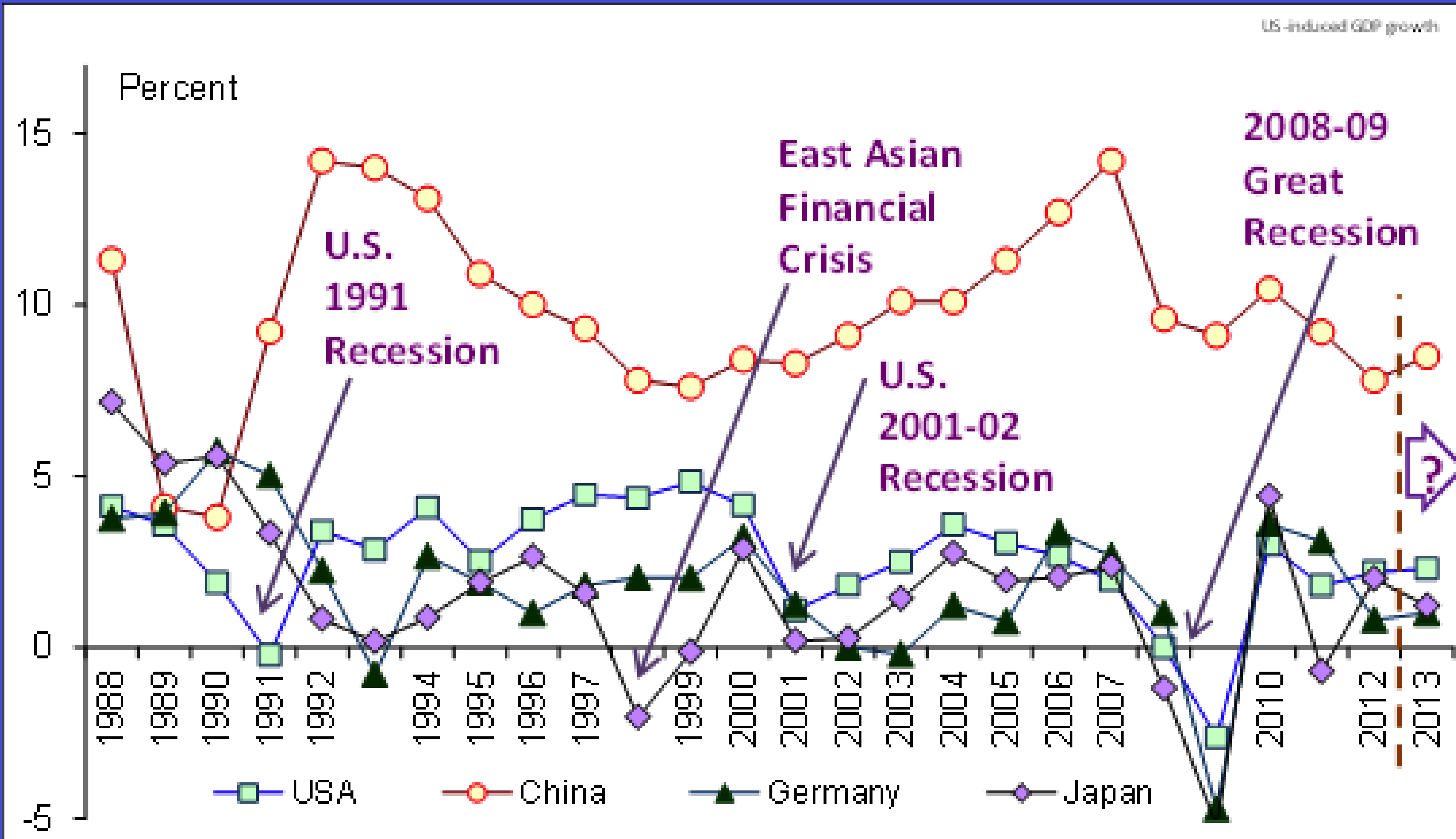
China's growth is *not* slowing sharply

1. China follows a clear macro cycle.
   a. Its most recent low was 2011-2012
   b. The economic cycle got out of sync with the political cycle – It is starting up again now.
2. China won't reduce investment's share in GDP quickly
   a. It is "beginning to establishing a framework …"
   b. Autumn's initiative will be investment-heavy
   c. Exports are a minor part of effective demand.

China has a Macro cycle
GDP Inflation is its Clearest Indicator



Chinese Growth is *not* Export-led
After global crisis, returns it to usual 7~10%



Domestic Demand's Strong Independent Role

China Contributions to GDP growth

(Percentage points and Percent

	Domestic	Trade	GDP
2001	8.3	0.0	8.3
2002	8.4	0.7	9.1
2003	9.9	0.1	10.0
2004	9.5	0.6	10.1
2005	8.7	2.6	11.3
2006	10.6	2.1	12.7
2007	11.6	2.6	14.2
2008	8.7	0.9	9.6
2009	12.7	-3.5	9.2
2010	10.0	0.4	10.4
2011	9.6	-0.4	9.2
2012	8.0	-0.2	7.8

Government Optimizes Finance

1. Better than Pure Market-based Finance
   a. Deposit rate caps are a good tax.
   b. Required directed bank loans are essential.
   c. A non-independent central bank obliges.
   d. Public outlays encourage private projects.
2. Capital Controls are Critical
   a. Debts are all in local currency.
   b. Capital flight is limited to harmless levels.

No Serious Domestic Imbalances

1. China's high GDP investment share is good.
   a. Essential for job growth & higher wages.
   b. We cannot ignore $g = s/ICOR$.
   c. China controls inflation, and *ICOR* is good.
   d. Note that $g = (1-c-e)/ICOR$.
2. Most important: Rapid consumption growth
   a. Consumption accelerates after s increases.
   b. Don't confuse consumption's *share* in GDP.

Consumption Growth Accelerated in the Crisis

GDP Expenditure Components

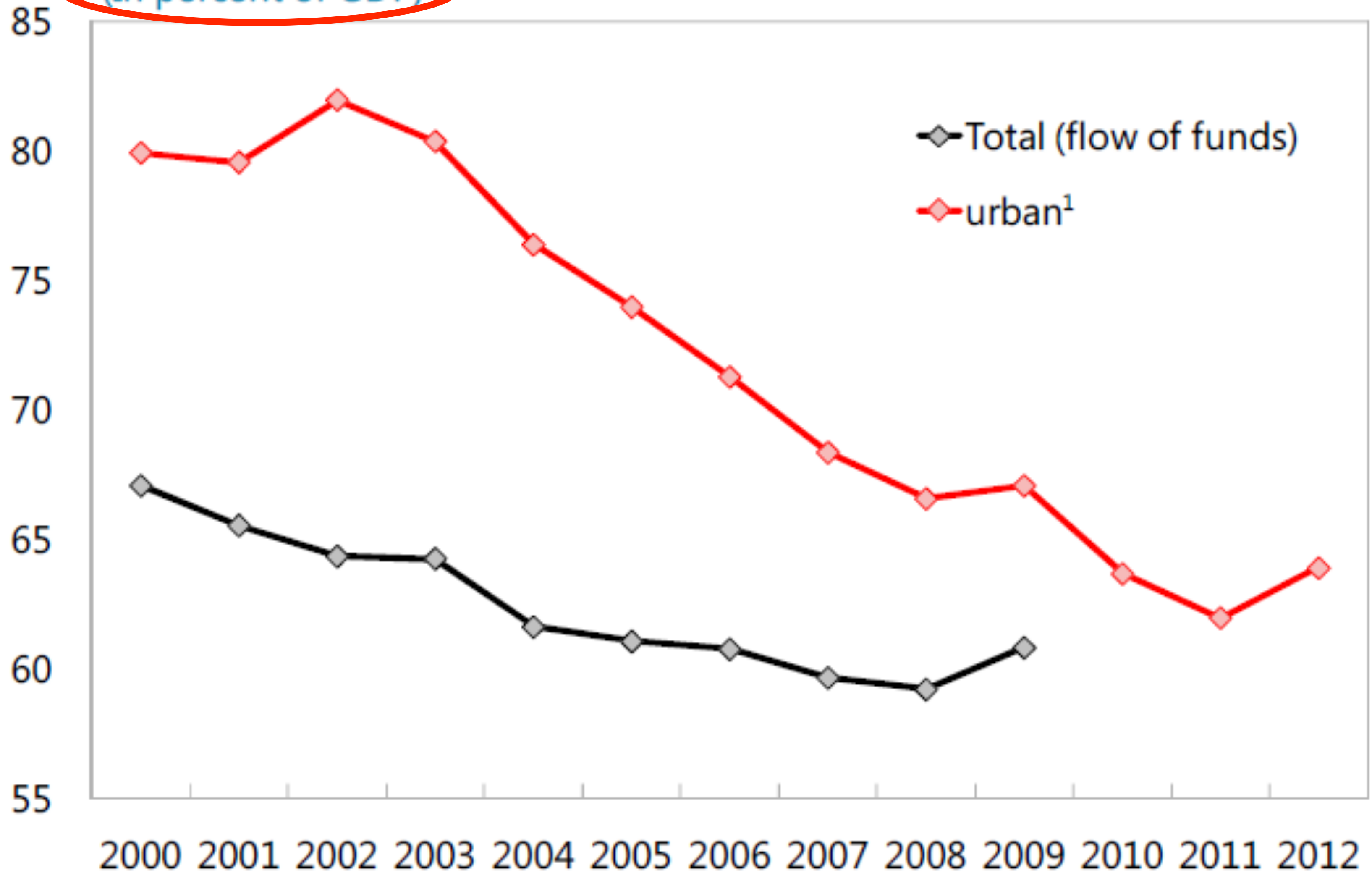
	Real Growth	
(Percent)	Consumption	Investment
2001	6.7	11.6
2002	6.5	12.1
2003	6.0	16.7
2004	6.9	13.4
2005	8.1	10.2
2006	9.6	13.2
2007	11.0	14.6
2008	8.5	10.8
2009	9.5	18.5
2010	9.3	11.7
2011	11.0	9.2
2012	8.3	8.1

IMF Blooper Reveals a Distorted Mindset

Per capita household income increased last year, after declining for much of the previous decade…

Household Disposable Income

(In percent of GDP)



[1] Per capita as a share of per capita GDP; household survey.

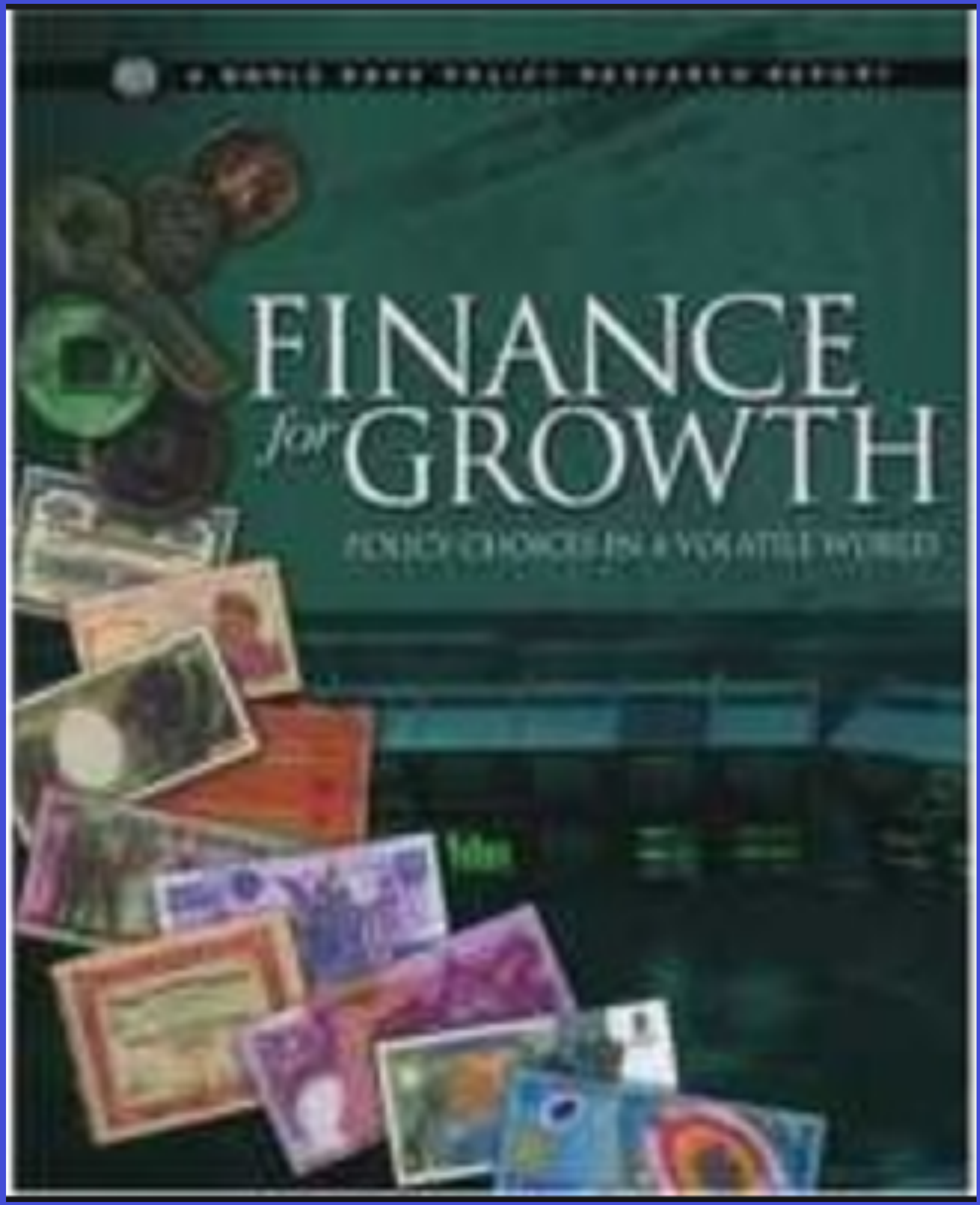
China’s Local Debt is Manageable

1. Rapid nominal GDP growth defuses worries.
   a. 2008-2012 nominal GDP grew 65 percent!
   b. 2008-2012 fiscal revenues grew 91 percent!
   c. Debt-funded stimulus did its job.
   d. New audit will come out like the last one.
2. Most of China’s banks aren’t banks.
   a. They are government-run and are helpful.
   b. Debt for worthwhile projects is rolled over.

Conclusion: China is a Good Standard

1. Post-crisis, China is the new global context.
   a. It shows what can be done.
   b. Its methods correct for market dysfunction.
   c. It has real-world, not ideal-world, solutions.
2. China’s growth will stay in high single digits.
   a. Yes, they will be a good market for Brazil.
   b. But China’s domestic demand methods are worth more to Brazil than export markets.

World Bank: “Finance is Fragile”



What justifies China's Financial Methods?

1. Finance is "fragile,' especially in EMs.
   a. It needs an appropriate "environment."
   b. What if that environment is impossible for EMs like Brazil to create and sustain?
   c. <u>Finance for Growth</u> ignores the issue.
2. China's methods answer the question.
   a. Local investment platforms work well.
   b. Rate caps, directed credit, capital controls.
   c. Otherwise, financial systems are inefficient.

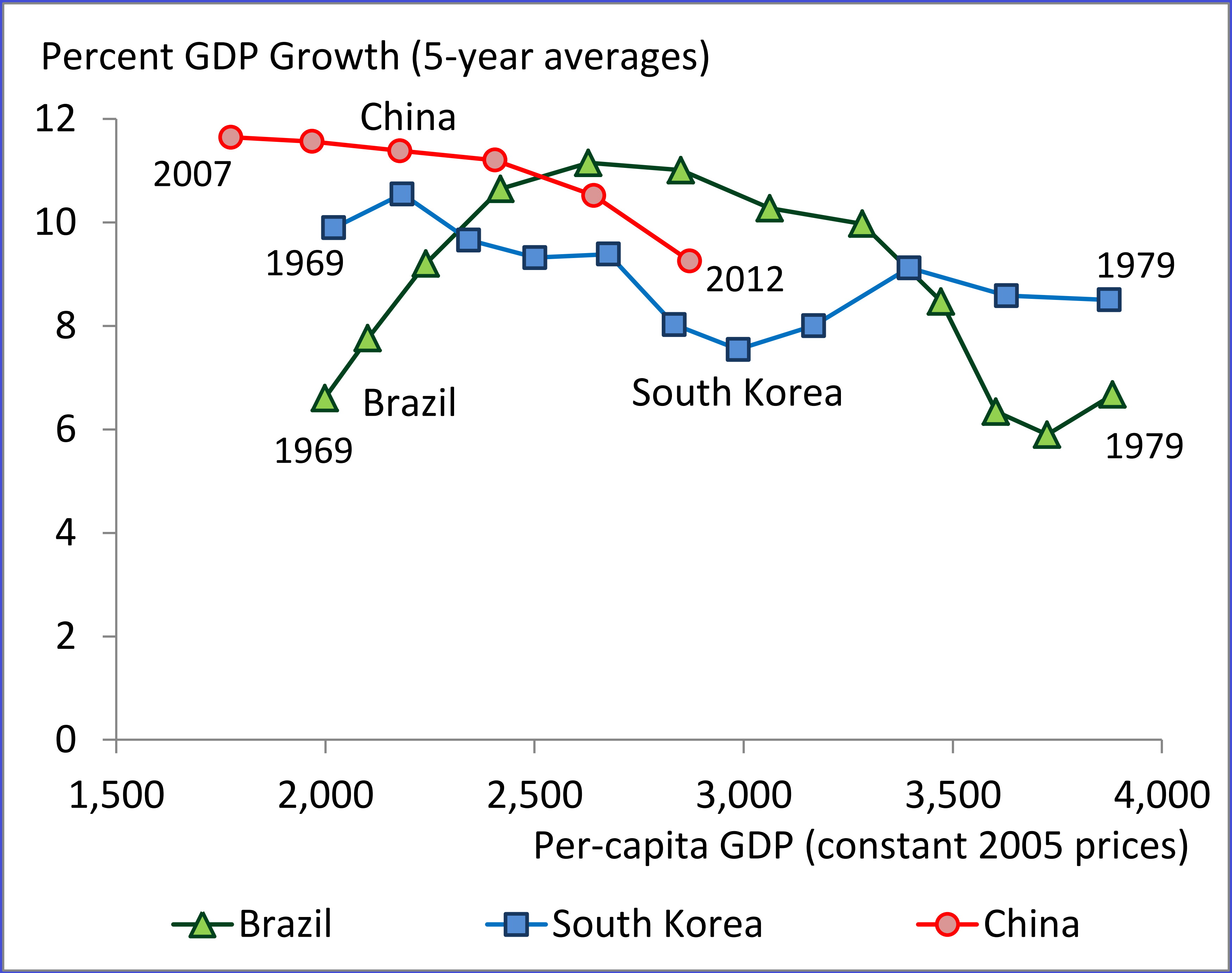
Summary: Brazil's Prospects

1. Brazil's Economic prospects seem poor.
2. Past and current records are discouraging.
3. Going forward, policy tools are inadequate.
4. External finance is dysfunctional.
5. Social pressures lead to fiscal failures.
6. Major institutional changes are needed.
7. This would take strong national leadership.
8. Otherwise, Brazil's prospects are not good.

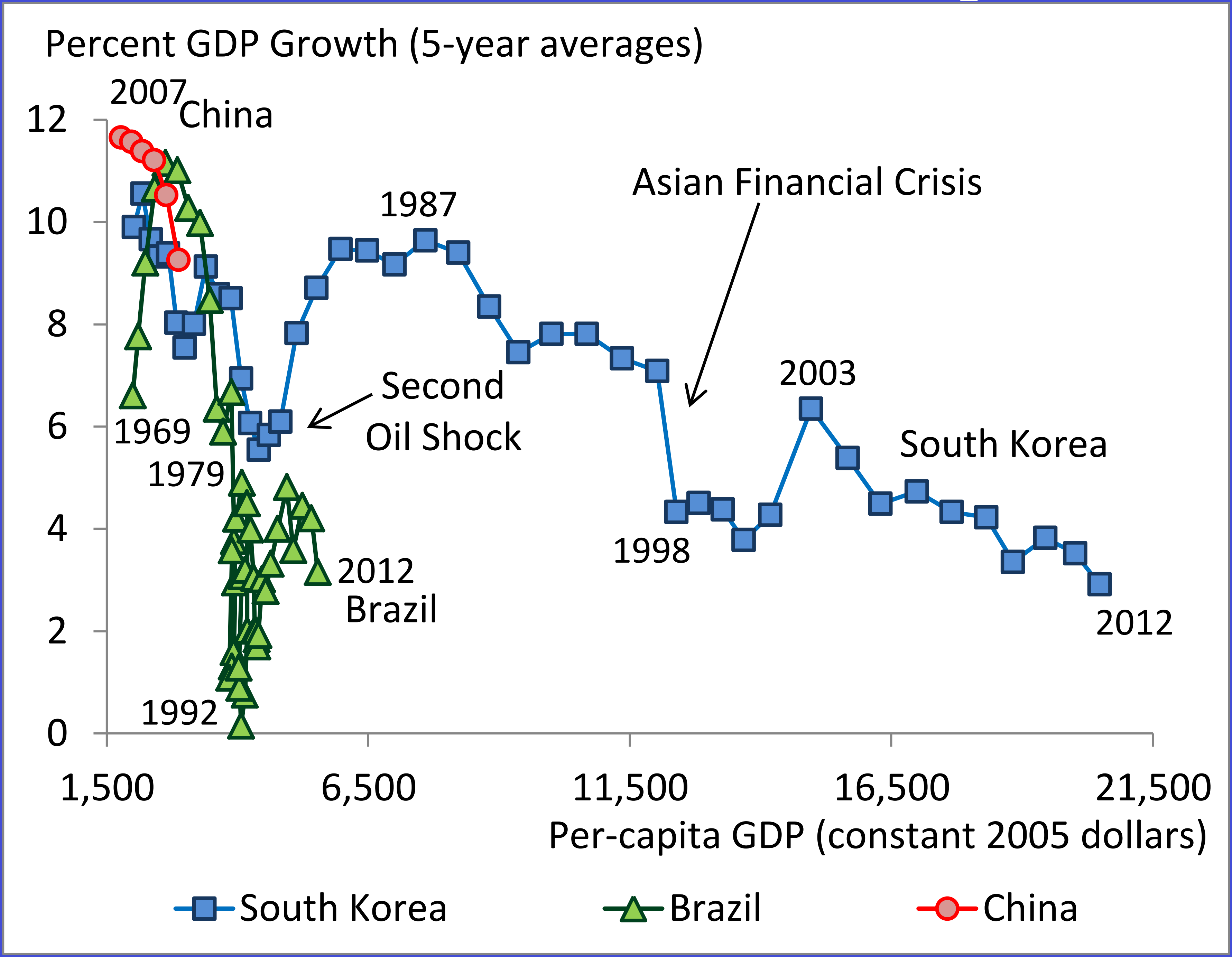
Brazil's Record is Discouraging

1. Since the 1970s, it is discouraging.
2. Since the 1990s the performance is poor.
3. In recent years, a victim of capital inflows.
4. This year – Agriculture-led growth!

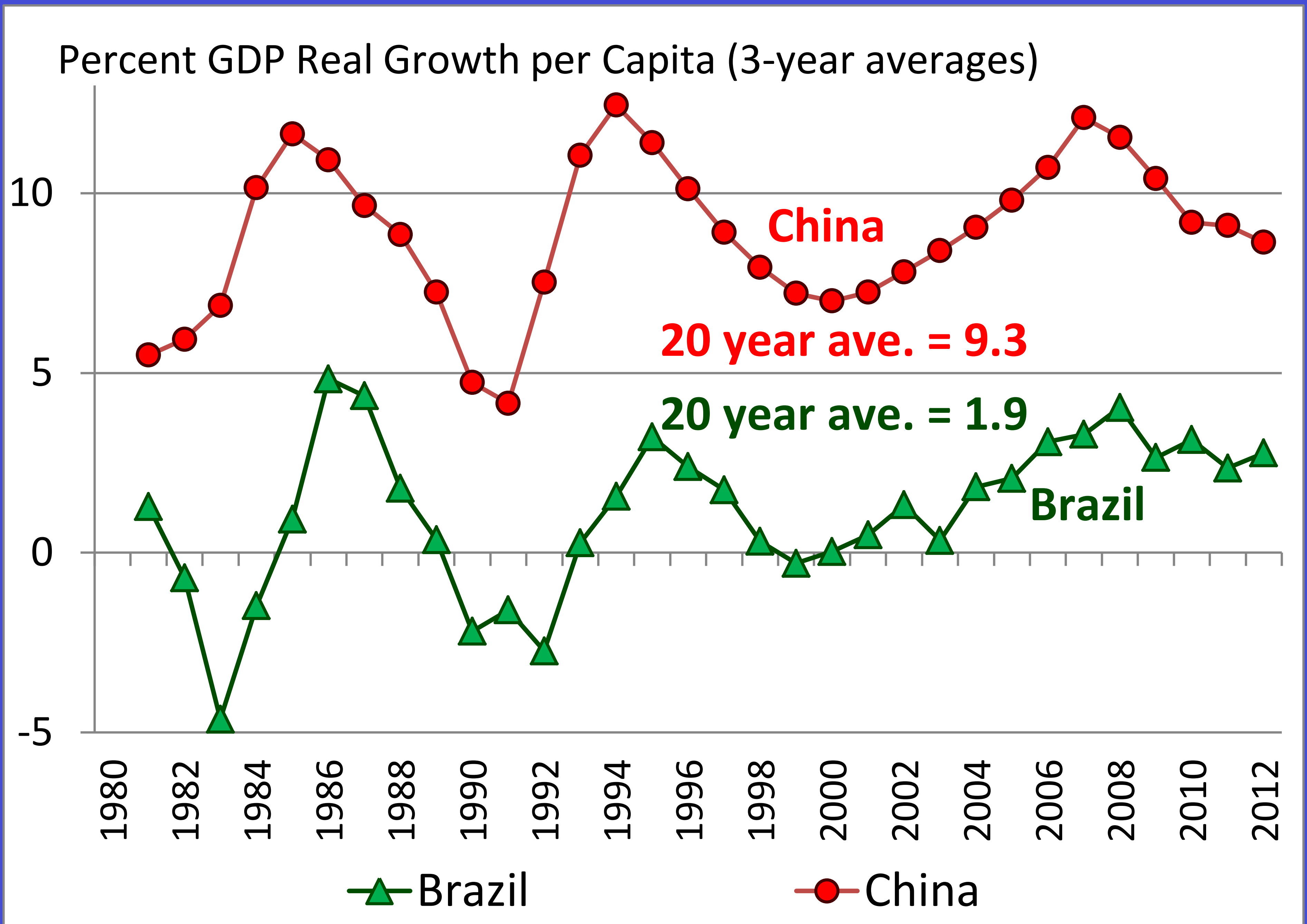
China Now vs. Brazil and South Korea in 1970s



China, Brazil and South Korea up to 2012



Good Prospects Require More than 2½ Percent



Brazil's PPP Ranking is not Impressive

Per-capita Measures of Output and Income

2012 U.S. dollars	At Exchange Rates GDP	At Exchange Rates GNI	At PPP Conversion GNI	At PPP Conversion Ratio
Kenya	862	840	1,760	2.10
India	1,489	1,530	3,840	2.51
Philippines	2,588	2,470	4,400	1.78
Indonesia	3,420	3,420	4,810	1.41
China	**6,091**	**5,740**	**9,210**	**1.60**
South Africa	7,508	7,610	11,190	1.47
Brazil	**11,340**	**11,630**	**11,720**	**1.01**
Malaysia	10,381	9,800	16,530	1.69
Mexico	9,740	9,740	16,630	1.71
South Korea	22,490	22,670	30,890	1.36
United States	49,965	50,120	50,610	1.01

Over-Valued Real

What might Brazil need to Do?

1. Dramatically expand Financial Supervision
   a. First monitor then prohibit short-term capital flows – in both directions.
   b. Intervene to weaken & manage the Real
   c. Introduce caps on bank deposit rates.
2. Gradually increased required bank loans to BNDES at low spreads over deposit rates.
   a. Greatly expand BNDES operations.
   b. Strengthen off-budget local public investment platforms.

These Steps Require Leadership

1. Strong resistance from financial interests
   a. Tough challenges from international agreements and financial institutions
   b. Requires administrative resources & skills
2. Expanded BNDES low-cost financing is the most workable component.
   a. It's the best way to increase Brazil's low investment rate in GDP.
   b. But capital flight might quickly need controls.

Otherwise …

1. Brazil will continue resource-heavy export orientation and weak domestic job growth.

   a. Capital flows will continue to push the exchange rate around,

      - Weakening competitiveness and markets with Real appreciations, and
      - Worsening debt service with devaluations

2. Domestic investment level and structure will remain too low to raise living standards at a pace to match development needs.

The End
Thank you

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