

Monday, March 24, 2008

Brazil's Moment in the Sun

Brazil's dramatic rise is largely due to the considerable macro-economic achievements of President Lula during his first term.

BY DESMOND LACHMAN

At this time of global financial turmoil, one has to marvel at how Brazil's standing has risen in world financial markets. As recently as 2002, world financial markets convinced themselves that Brazil was bound to follow Argentina down the road to default. Today, by contrast, as global financial markets swoon, Brazil is widely viewed by international investors as a safe haven from a sub-prime mortgage troubled world. This offers President Lula with a golden opportunity to solidify Brazil's place in the sun through market-based reform during his recently begun second term of office.



HAPPY STAR: Brazil - led by President Luiz Inácio Lula da Silva - has been a star of emerging markets. (Photo: Ricardo Stuckert/Brazil President's Office)

STELLAR PERFORMANCE

Measured by almost any financial market metric, Brazil's performance has been stellar since the onset of the global credit crunch last August. While the U.S. dollar has been plumbing new all-time lows, the Brazilian currency has been notching up new all-time highs. Similarly, while U.S.-corporate and municipal bonds have been plummeting, Brazil's government bonds have remained very well bid. Indeed, their interest rates have remained at close to their lowest historic levels relative to equivalent US government bonds.

Equally impressive has been Brazil's equity market performance. While since the start of 2008, U.S. equity prices have fallen by more than 10 percent, Brazil's equity prices have actually increased in U.S. dollar terms. As a result, it is now estimated that Brazil's equity market capitalization exceeds that of China, India, and Russia, the other members of the so called BRIC countries, which are currently so much in favor among international investors.

It is true that Brazil's recent good fortune is at least in part a reflection of the very strong international commodity price boom. As a major commodity exporter, Brazil's economy certainly benefits from record high soybean and sugar prices. At the same time, China's seemingly insatiable appetite for Brazilian iron and steel exports provides the Brazilian manufacturing sector with the firmest of underpinnings.

LULA'S MACRO ACHIEVEMENTS

However, Brazil's strengths go considerably beyond those of simply being a major commodity producer blessed with high international prices for its exports. Rather, Brazil's dramatic rise in the international financial market's assessment owes importantly to the considerable macro-economic achievements of President Lula during his first term in office.

A hallmark of President Lula's first five years in office has been his adherence to disciplined fiscal and monetary policies. As a result of a restrained budget spending policy, Brazil's public finances are now characterized by large primary budget surpluses and by small overall deficits. This has allowed Brazil to considerably reduce its level of public indebtedness and to avoid recourse to inflationary financing.

Wisely President Lula has complemented fiscal prudence with according the central bank full monetary policy independence. By so doing, he has enabled Brazil to join the ranks of those mature countries with low and stable inflation rates. In marked contrast to its high inflation past, under President Lula Brazilian inflation has slowed

to around 4 percent, which is not very different from that recorded today in the United States.

REDUCED VULNERABILITY

Perhaps most striking of all, Brazil's more stable macro environment has allowed Brazil to substantially strengthen its external finances and to reduce the chronic external vulnerability of its past. No longer does Brazil record external current account deficits and no longer is Brazil shunned by foreign investors. On the contrary, foreign investors have flocked to Brazil in search of higher returns as exemplified by Brazil's build up of its international reserves to almost \$200 billion by end 2007.

As storm clouds now gather across the global economy, President Lula's main challenge would appear to be that of revitalizing Brazil's flagging economic reform effort. For without renewed reform, Brazil's economy risks losing its recent growth momentum so necessary to keep Brazil's place alongside that of the world's other major economies. In particular, it would seem that, in the years ahead, every effort will need to be made to reduce Brazil's excessively high tax burden, address its large social security deficit, and make its notoriously inflexible labor markets more flexible.

At a time when protectionism is again rearing its ugly head across global markets, it would also seem to be in Brazil's own self-interest as a major trading nation to do its part to arrest that tide. Perhaps the most valuable contribution that Brazil could make to improve the world trade environment would be to provide leadership among emerging market economies in the stalled Doha Round and to adopt a more conciliatory stance on the contentious issue of intellectual property piracy.

There can be no doubting that the Brazilian economy has come a long way since the dark days of 2002 through its strict adherence to more orthodox financial policies. However, Brazil's own history would suggest the dangers of backsliding on reform. One has to hope that President Lula is sensitive to those dangers during his second term of office, when Brazil will most likely be confronted with a very much less benign international environment than it is enjoying today.

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