Not as bad as 2009, not as good as 2010, a lot like 2011 — most analysts expect no major surprises for the Brazilian economy in 2012. The forecast baseline scenario assumes slowing global growth and international trade. The major risk to the baseline is the unfolding crisis in Europe. The pessimistic forecast is for a severe global recession, especially in Europe. In general, however, participants in the 2012 Brazilian Economic Outlook Seminar, held in November by the Brazilian Institute of Economics (IBRE), are betting that Brazil will sustain growth at least equal to that for 2011.

**IBRE BASELINE SCENARIO**
The baseline scenario for 2012 presented by IBRE researchers assumes a moderate global recession resulting mainly from the uncertainties and dilemmas of the crisis unfolding in Europe, Silvia Matos told the seminar (see box, p. 21 for full titles of all participants).

The deterioration of the international outlook has intensified the slowdown of the Brazilian economy that began with the central bank’s monetary tightening early in 2011 to contain rising inflation. IBRE’s Indicator of Economic Activity — a proxy for GDP —
The deterioration of the international outlook has intensified the slowdown of the Brazilian economy.

did not grow in September and October compared with an average growth of 0.7% in the first half of the year. Matos estimates GDP growth about 2.9 for 2011.

The slowdown was caused mainly by a reduction in fixed investments. IBRE’s monthly investment indicator — a proxy for gross fixed capital formation — fell 0.3% in the third quarter. Apparently, businesses have become more cautious given the difficulties in Europe and the threat of a contraction in the supply of credit.

The consensus at the seminar was that there is a need to rebalance consumption and investment. “It is essential to increase investment in fixed capital and infrastructure,” said José Márcio Camargo. “We need a production structure that can ensure good-quality employment to 150 million Brazilians in 2030,” Delfim Netto commented, adding that the agro-mineral export model helped turn Brazil into a creditor instead of a debtor, but now it is necessary to develop industry and services. João Carlos Ferraz agreed and called for strategic vision, asking entrepreneurs “to identify opportunities for productivity gains, quality, and efficiency in order to add value to local content.”

IBRE projections for 2012 assume growth in GDP will be 3.0% for the world (3.8% is estimated for 2011), 1.4% for the U.S., and 8.2% for China, but will fall by 0.5% for the euro zone. Matos commented that “Lower growth will affect world trade. Prices of commodities, particularly metals, should decline much more than prices of food.” She expected appreciation of the Brazilian exchange rate to R$1.80 per U.S. dollar, and a drop in export prices by 2.0%. The central bank benchmark

### IBRE baseline scenario for the Brazilian economy

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<tbody>
<tr>
<td>Real GDP (% change)</td>
<td>-0.3</td>
<td>7.5</td>
<td>2.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Consumer prices (IPCA) (% change)</td>
<td>4.3</td>
<td>5.9</td>
<td>6.5</td>
<td>5.1</td>
</tr>
<tr>
<td>Central bank benchmark interest rate (end-period, %)</td>
<td>8.8</td>
<td>10.8</td>
<td>11.0</td>
<td>9.5</td>
</tr>
<tr>
<td>Average exchange rate (Reais per U.S. dollar)</td>
<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Primary budget surplus (% of GDP)</td>
<td>2.1</td>
<td>1.9</td>
<td>3.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Trade balance ($US billions)</td>
<td>25.4</td>
<td>20.2</td>
<td>29.4</td>
<td>17.4</td>
</tr>
<tr>
<td>External current account (% of GDP)</td>
<td>-1.5</td>
<td>-2.3</td>
<td>-2.1</td>
<td>-2.8</td>
</tr>
</tbody>
</table>

Sources: Central Bank of Brazil, Brazilian Institute of Geography and Statistics, National Treasury, and Ministry of Development, Industry and Trade; IBRE staff projections.
interest rate is expected to again decline, to 9.5% by year-end 2012, but whether it does so, she said, will depend critically on inflation developments in the first quarter of next year and the outlook for fiscal policy as the central bank tries “to strike a balance of risks between inflation and the international outlook.”

If current interest rate and credit policies continue and the global scenario brightens, growth in Brazilian GDP could be 3.0% in 2012 and 4.0% in 2013. IBRE is predicting that in 2011 inflation will be close to the official target ceiling of 6.5% and will fall to about 5.1% in 2012. Matos points out that services inflation is high; it may come down, “but we do not believe in a sharp fall, because the labor market is still tight and we have the minimum wage increase,” although economic activity will be slowing.

THE PUBLIC BUDGET

In 2011 the government was able to reach its planned primary surplus by curtailing spending and relying on extraordinary revenues, but IBRE foresees budget

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According to the graph, Brazil's economic activity has declined sharply since last June. The IBGE economic activity indicator, which captures the 3-month and 12-month moving % change, shows a decline from 1.6% in April 2010 to 0.0% in October 2011. The 12-month % change (right scale) and the 3-month % change (left scale) are shown, with values ranging from 3.0% to -1.5% and from 3.0% to 0.0%, respectively. Sources: Institute of Geography and Statistics (IBGE) and Brazilian Institute of Economics (IBRE); IBRE staff estimates.
If current interest rate and credit policies continue and the global scenario brightens, growth in Brazilian GDP could be 3.0% in 2012 and 4.0% in 2013.

difficulties in 2012. With a more adverse economic scenario, net revenues adjusted by inflation are expected to grow just 5.7% in 2012 compared with 10% in 2011, while total expenditure is projected to increase by 9.5% in 2012 compared with 4.7% in 2011. With revenues falling and spending rising, the public sector primary surplus will fall from 3.2% of GDP in 2011 to 2.5% in 2012.

The trade surplus is expected to fall from US$29 billion in 2011 to US$17 billion next year. As a result, the current account deficit would increase to 2.8% of GDP, compared to 2.1% in 2011. However, IBRE believes it can be fully financed even in an adverse international climate.

THE WORST-CASE SCENARIO

The most pessimistic scenario presented assumes a deeper downturn of 3.5% in the euro zone, a fall of 0.5% in U.S. GDP, and more moderate growth of 7% in China. Trade volumes and commodity prices would fall more. Brazil would thus grow only 0.5% in 2012, and inflation would decline to 4.2%. The central bank benchmark interest rate would likely be 8% to mitigate the economic slowdown, and the exchange rate would depreciate to R$2.10.

Both baseline and worst-case scenarios incorporate fiscal risks estimated at R$44 billion (1% of GDP), including the loss of revenues from the Kandir Law, wage adjustments, and statutory minimum health spending. Matos concluded that “Controlling public spending will be challenging, but if the government can achieve a bigger budget surplus, it may lower interest rates, favoring somewhat higher growth next year.”

In the following pages, see what experts have to say about the 2012 outlook.

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1 The Kandir Law of September 13, 1996, exempts products and services for export from states’ VAT.
2011 was a difficult year for the Brazilian economy and the world. In the first half of the year, the United States recorded annual growth below 1%, though that is improving. Europe started the year better but is on its way to deepening recession …. With excess liquidity in the U.S. economy, the Brazilian real appreciated, there was a significant increase in commodity prices, and the supply of credit expanded too much, forcing central banks around the world to tighten monetary and credit policies, which affected Brazil’s growth very significantly — it fell from 7.5% in 2010 to 3.2% in 2011. As the real appreciated and there was substantial idle capacity in industry worldwide, our imports increased. However, in sectors like commerce and services, there is no possibility of importing and productivity gains are small, which adds inflationary pressure. So the Brazilian economy grows slowly, but inflation is high.

Our expectation is that inflation will end 2011 close to the target ceiling of 6.5%. For 2012, we estimate inflation of 5.7%, unless there is a very serious world recession, which cannot be ruled out. The central bank is likely to make at least two or three interest rate cuts of half a percentage point. We estimate GDP growth of 3% for 2012. Overall, the Brazilian economy can be considered as in relatively good shape compared to developed economies but relatively poor shape compared to emerging countries. In the last 10 years, Brazil economic policy has favored consumption at the expense of investment in physical and human capital. Growing the economy based on consumption and an income transfer programs has the advantage of reducing inequality faster but the disadvantage of reducing the rate of sustainable economic growth. With the job market still overheated and the loosening of monetary and credit policies, there is the risk of higher than expected inflation.

José Márcio Camargo
Professor of Economics of the Catholic University, Rio de Janeiro, and economist, Opus Gestão de Recursos
In 2011, on the domestic front, the government adopted monetary and fiscal measures to deal with inflationary pressures arising from excessive growth in 2010. Abroad, there are the uncertainties arising from the worsening global crisis, particularly in Europe. A positive point was that President Rousseff acknowledged the need for a bigger fiscal effort, without the accounting gimmicks of 2009 and 2010, which disguised excessive public spending. The Rousseff administration has many shortcomings, but I would highlight the return to the 1970s interventionist views of the world. The administration resumed controlling gasoline prices and postponed tax increases and the readjustment of telecommunications service prices. Arguably the manipulation was aimed at staying within the inflation target. The government raised old and outdated ideas of import substitution. There have also been worrisome signs of political interference in the Central Bank and an excessive role of the Ministry of Finance.

My scenario [for 2012] assumes that the euro zone leaders confirm their intent to prevent the default of the most indebted countries and the risk of a panic that spreads uncontrollably, thus preserving the currency. The European Central Bank will act as lender of last resort, providing unlimited liquidity to the public bonds of those countries. In this scenario, the Brazilian economy can grow up to 3.7% — enough to maintain or reduce the unemployment rate. The Central Bank will not be able to curb inflation unless there is a serious worsening of the external environment. In that case, in the second half of the year it would resume a tightening cycle. I expect consumer price inflation of 5.6%, a central bank benchmark interest rate of 11.5%, and an external trade balance surplus of US$28 billion. Domestically, the biggest risk is that the administration will try to make the economy grow more than it should by credit expansion, unwarranted reduction in interest rates, and expansion of public spending. Countercyclical measures would be in the wrong direction.
In 2011 came the cooling off, planned and unplanned, of the Brazilian economy. The central bank took action to reduce the high growth rate of 7.5% inherited from 2010, but then the global crisis slowed Brazil’s economic activity even more. Earlier this year, … when the government announced a more robust fiscal stance, it was viewed with suspicion. The same happened with monetary policy, when the central bank first raised and then lowered interest rates. But when the inflation results came in, the markets were reassured. The economy has been slowing more than expected because individuals and businesses are more cautious, particularly given the European crisis. On the positive side, I would highlight our resilience to this crazy world, and the fact that markets continue to have a favorable perception of the Brazilian economy.

For 2012, the best scenario is zero growth in Europe, and minimal growth in Japan and the U.S. Anything between zero and 2% would be great. We must also be aware of political developments, such as the elections of presidents in the U.S. and China (whose economy should cool off to about 8%). In the euro zone, there are two possible scenarios: the European central bank resolves the crisis without major damage, or there is a stress situation, with the recession reaching Germany. I do not believe it would be as serious as when Lehman Brothers broke but it might affect the European banking sector.

For Brazil, our baseline scenario is growth between 4% and 5%, with the exchange rate between R$1.50 and R$1.80. With inflation falling and wages holding steady, income and consumption will increase …. Investment as a whole is expected to grow at about twice the rate of GDP. The driver for the next year will be the construction sector.

The more Brazil can grow through investment, decreasing the relative importance of consumption, the more resilient it will be to an unfavorable external environment. Domestic interest rates are likely to continue falling, encouraging the financial industry to create longer-term instruments and enhance its synergy with institutional investors. Our policy instruments are strong enough to protect the economy and keep it on a sustainable path. The BNDES will continue to focus on infrastructure, with the same level of disbursement — no reason to change this policy now.

João Carlos Ferraz
Vice-President and Director of Planning of the National Bank for Economic and Social Development (BNDES)

Construction in the driver’s seat
Brazil is better off than the world

Delfin Netto
Former Minister of Finance, Planning and Agriculture

2011 was a reasonable year for the Brazilian economy. It was very clear that the president’s view on monetary policy was correct, and the central bank governor was more attuned to the reality of the world and new mechanisms of monetary control than most of his critics. On fiscal policy, my impression is that there was a clear understanding by the president and the minister of finance that it is essential to improve the public budget balance. The government has shown willingness to address chronic problems, such as social security and civil servants.

It is important that the government continue to cut interest rates. In my opinion, the country will grow between 3% and 3.5% next year — not bad, given the global scenario — and inflation will converge to the mid-point of the target, 4.5%. But the world will get worse. In the United States, it is an election year, which means heightened political confrontation. U.S. fiscal policy has been a disaster. Nevertheless, the U.S. still has the conditions to overcome the crisis, because it has innovation and credit. In Europe, the central bank cannot carry out its basic function of lender of last resort, there is no fiscal responsibility law, and countries are not willing to give up their autonomy to form a sovereign federal government, so there is not likely to be a resolution of the crisis. This instability reduces world growth and affects Brazil’s foreign trade. Today we have large international reserves, the monetary policy stance is sensible, and we are moving toward a more solid fiscal balance. Brazil’s real problem is to equalize domestic and international real interest rates. This will require a huge government effort, [but] President Rousseff has a good chance to succeed: 80% of public domestic debt is maturing during her mandate, which will allow for a gradual restructuring at lower interest rates and longer terms…. Brazil is in a relatively better position than the world.
The economy followed the expected course in 2011. As growth was negative in 2009, the 7.5% recorded in 2010 represented a catch-up. Not surprisingly, that growth exceeded the level that would be considered normal, and efforts to raise the level of activity would produce negative effects, such as inflationary pressure, exacerbated by external factors, including rising commodity prices. In 2011, concerns about the previous year ... affected business expectations, as the FGV confidence indexes show. But overall, the performance of the Brazilian economy, if not brilliant, can be considered satisfactory. ... There have been negative aspects, such as a return to a protectionist mentality in terms of foreign trade instead of improving quality and productivity to become more competitive.

For 2012, I see a picture not much different from 2011, with growth at about 3.5%. There is a risk of a worsening global scenario, especially if one or more European countries goes into a tailspin, but this is not very likely. Brazil has chosen an economic model that assumes very moderate growth with low domestic savings and factors that discourage business. I think domestic interest rates will continue to decline. This policy slightly increases the risk of inflationary pressures in 2012. Interest rates in Brazil are very high, but the solution is to reduce the tax burden, substantially improve the quality of fiscal policy, and reduce inefficiency, especially the “Brazil cost” as it affects infrastructure. I see the situation of industry with great concern, because the diagnosis of its problems is not correct. The problem is not the exchange rate but the lack of productivity, competitiveness and innovation, and a direction more open to research and development programs. It is up to the government, industry, and society together to change that.

Marcílio Marques Moreira
Former finance minister and chairman of the Advisory Board of the Brazilian Institute for Ethical Competition

Industry concerns
Externally, 2011 was a year of growing tension. The epicenter of the crisis now is Europe. In this complex and not yet resolved situation of reducing [financial institutions’] leverage and world debt, economic activity has been greatly impacted. … In this respect, 2011 and 2012 are very connected, and it cannot yet be predicted what will change, for better or for worse. Brazil … began 2011 with an overheated economy and higher inflation, prompting the central bank to tighten, but by midyear it had changed direction as economic indicators showed the economy was no longer overheated and there were signs of slowing.

It seems reasonable to work with conservative scenarios for 2012. In Brazil, the task of bringing inflation back to target is not complete. The credit markets may become less exuberant, not only because of central bank adjustments but also because credit is cyclical, going through phases of expansion followed by adjustment when bank financing capacity reaches its limits.

There are, however, factors that can make up for growth below normal. … Next year we may see some increase in investment in infrastructure. Other areas that have been growing a lot and may continue to do so in 2012 are the oil and gas sectors and sectors related to preparations for both the World Cup and the Olympic games. [Thus] next year may mark the beginning of a very welcome change in the composition of domestic demand toward less consumption and more investment.
2012 Brazilian Economic Outlook Seminar

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Despite a currently very uncertain international environment, the projections of economic analysts for 2012 are much more convergent than they were for 2011, when the outlook was less uncertain. So said Ilan Goldfajn in his presentation at the Seminar on the Brazilian Economic Outlook for 2012, noting, “There’s something strange about that. What are we missing?”

Nélson Barbosa of the Ministry of Finance may have a clue. The government scenario was one of the more optimistic. Though optimism may be a duty of his office, it is worth remembering that the shift to more accommodating monetary and credit policies in the second half of 2011 to counter the slowdown was successful, surprising analysts.

Barbosa made a point of contrasting the government and market projections, especially with regard to growth and inflation. The government is forecasting GDP growth of 3.8% for 2011 (the market average is about 3.0%), and 4%–5% for 2012, when it expects a slowing world economy but no banking crisis or collapse of the euro. “If this situation does not worsen, I think the market estimate of 3.5% in 2012 is too pessimistic, given that certain economic policy measures to which the government is committed should promote a substantial increase in income for 2011,” he said, citing the minimum wage increase, tax cuts, and increased public investment. He also noted that private investment is expected to grow in the second half of 2012.

For inflation the government is projecting 6.4% for 2011 and the market 6.5%. On the seemingly insignificant 0.1 percentage point difference depends whether the inflation target ceiling is met or breached. For 2012 inflation, the projected difference is even greater: government, 4.7%, and the market, 5.6%. Government optimism, Barbosa said, is based on stable or declining commodity prices, a more moderate increase in some utilities prices, a stable price for ethanol, the lagged impact of the current growth slowdown, and a neutral fiscal policy. The government projects a 2012 primary budget surplus of 3.1% of GDP and an external current account deficit of 2.5%–2.7% of GDP. Barbosa also reminded the seminar that over the last 10 years, the real interest rate fell from 22% to the current 8%. “There may be a new opportunity to cut interest rates,” he said. “It depends on keeping fiscal policy sound and increasing investment. I think the government’s reaction so far has been appropriate and will continue to be so.”
From the market point of view Goldfajn’s scenarios are very similar to those of IBRE. They assume the world economy slows down from 3.7% in 2011 to 3.0% in 2012, but no collapse of the euro zone; Brazilian GDP growth of 3.0% in 2011 and 3.5% in 2012; an exchange rate of R$1.80 in 2011 and R$1.75 in 2012; external current account deficits of 2.2% this year and 2.9% next; primary budget surpluses of 3.2% of GDP in 2011 and then 2.5%; and inflation of 6.5% this year, falling to 5.6% next year. “Above-target inflation … is a risk, but I see a good chance of recovery of the Brazilian economy in the second half of next year,” Goldfajn said.

The good news is that the public- and private-sector scenarios converge in one of the most sensitive areas of the Brazilian economy: the benchmark interest rate. Both Goldfajn and former central bank governor Affonso Celso Pastore agreed that rates may again fall next year. Goldfajn projected a benchmark rate of 11% for 2011 and 9% for 2012 — which after estimated inflation of 5.6% corresponds to a real interest rate of about 3.4%. Pastore, more conservative, would not anticipate specific percentages: “Undoubtedly, interest rates will keep falling. What nobody knows yet is the level of the neutral interest rate, the one that balances supply and demand in the long term. I will not guess. The important thing is not to ask for perfect forecasts but for a continuation of the fiscal policy that has brought about this positive scenario.”

Forecast made prior to the disclosure of zero GDP growth in the third quarter of 2011 by the Brazilian Institute of Geography and Statistics.