The emergence of a new middle class makes the Brazilian domestic market one of the most attractive in the world. Building up that group, however, will require the new government to focus on industry and investment.

Solange Monteiro, Rio de Janeiro

Maria Lucia Moreira is a self-employed saleswoman who has left the Paraisópolis slum in São Paulo city for an apartment purchased with a federal government “My House, My Life” subsidy. “Here I have a legalized property, I have security and comfort for my children, and I can have my friends over,” she says. Thanks to a US$765 income, Moreira has already bought a new stove and DVD and is anxiously awaiting installation of her fixed telephone line to ensure that her children can access the Internet on their computer. Her next goal is to buy a car. “It will speed up my life,” she says, describing her busy schedule that includes a technical course on sales management, which...
“We are still among the ten most unequal countries in the world, but the image of Brazil today is considerably better.”

Marcelo Neri

encouraged her to think about finishing high school and even considering college in the future. “I think until I’m 50 there is still time to improve professionally,” she says.

This year Moreira is encountering consultants and corporate executives interested in surveying her tastes and preferences. Why? They want to learn how to sell to people like Moreira who have just moved into the emerging Brazilian middle class. “Until 2007, this population was considered a niche; today it is the true Brazilian market,” says Renato Meirelles, managing partner of Data Popular consulting. The numbers confirm his opinion: at the end of 2009 the emerging middle class numbered 94 million, according to the study “The New Middle Class in Brazil” (Center for Social Policies of the Getulio Vargas Foundation). “From 2003 to 2009, 29 million people were added to the emerging middle class. Soon we will reach the lowest level of income inequality since 1960,” says Marcelo Neri, coordinator of the study. The methodology used defines the portion of the population in this emerging middle class as those whose monthly income ranges from US$660 to US$2,855. “They already represent 50% of Brazilians,” Neri says, “and in 2009 they had more than 46% of Brazil’s purchasing power.”

This emerging middle class emerged thanks to government countercyclical policies adopted at the peak of the global financial crisis in late 2008; its continued consumption has helped the country maintain a pace of recovery that has turned Brazil into a global star. “Brazil has succeeded in showing that the engine of the economy may be the domestic market as the poor increase their income and demand more goods and services,” says Alicia Bárcena, executive secretary of the Economic Commission for Latin America and the Caribbean (ECLAC; see interview, page 12). According to Neri, the National Household Survey

BRAZIL HAS BECOME LESS POOR.

Source: Center for Social Policies of the Getulio Vargas Foundation.
(PNAD) recorded per capita income growth of 2%.

“Today, Brazilian society expresses a desire for a development pattern based on a social contract that is in turn based on better income distribution,” says Samuel Pessoa, head of the Economic Growth Department of the Brazilian Institute of Economics. He reminds us that the income transfer model — most prominently the Family Grant program and an aggressive policy of raising the minimum wage — was possible thanks to continuous improvement in stable macroeconomic policies over the last 15 years, including the consolidation of fiscal responsibility and primary surpluses, inflation targeting, and a floating exchange rate. “However,” he adds, “a model centered on income distribution and consumption implies slower economic growth and a fiscal cost, which increases the tax burden and slows reduction in interest rates. This stifles the productive sector and raises the question of whether the model is sustainable in the future.”

A GREAT CONSUMER FAMILY

Voices in the market sound a note of optimism. “This is justified mainly by the growth of formal jobs, the main engine of income growth,” says Neri. “Formal employment accounts for 70% of the income increase, compared with 20% from welfare benefits and 10% from the Family Grant and other benefits.” Meirelles expects that those who have achieved some upward mobility in recent years will make every effort not to backtrack. “Moreover, there is the demographic factor: Today, the largest share of Brazil’s population is concentrated in the productive age group, which means less in benefit payments and more opportunity for growth,” he says.
The increase in formal employment has been responsible for the proliferation of credit and debit cards. “This market has grown by 430% since 2000. There are now 628 million credit, debit, and store cards,” says Milton Kruger, president of the Brazilian Association of Credit Cards. “And the emerging middle class participation jumped from 42% in 2003 to 53% in 2010 without any changes in the default rate.”

Another factor is more access to credit. Supported by a high level of consumer confidence, credit terms with long maturities enable consumers to think about purchasing more durable goods, says Aloisio Campelo, coordinator of the IBRE confidence surveys: “Income ensures direct consumption of nondurable goods, but it is confidence in the future that leads consumers to borrow to purchase high-value durable goods.”

The increase in credit, especially tied to retailers, and the overvalued exchange rate have benefited such sectors as information technology, where the price of components is dollarized and much is imported. “Today, the middle class is experiencing a period of euphoria and ties the purchase of a computer to incredible achievement related to professional improvement,” says Adriana Flores, director of new products of Positivo. The company’s computer sales rose from 22,000 in 2003 to a million in 2010, mostly to individual consumers.

Another novelty is the expansion of shopping malls in the countryside, tracking the growth in purchasing power of those living outside major cities. “We currently have 100 shopping mall projects under construction and will finish the year with 39 mall openings,” says Nabil Sahyoun, president of the Brazilian Association of Shopping Mall Storeowners. The same optimism can be seen in the tourism sector. For the airline TAM, which this year opened ticket counters in Casas Bahia stores, class C accounted for 6% of passengers through October. “Our goal is to reach 17% over the next five years,” a company spokesman says.

EDUCATION

In creating a new consumer class, the major breakthrough comes from education. According to Neri, increasing the number of years at school between 2003 and 2009 was responsible for 65% growth in average income per capita for the poorest 20% of the country. “The creation of programs like the Evaluation System of Basic Education in 1988 and the Index of Basic Education Development in 2007 was fundamental,” he says. According to Meirelles, new members of class C believe that education is part of their path to social ascension. “Today, consumption by the class C population focuses on improving the quality of life,” he says, citing as major consumer purchases electronics, educational services, and hygiene and beauty products, adding, “Each year of additional schooling represents on average a 15% increase in earnings.”

“Today, Brazilian society reflects a desire for a development pattern based on better income distribution.”

Samuel Pessoa
Nevertheless, considering Brazil’s deficit in education progress is still slow. Analysis by the Institute of Applied Economic Research (IPEA) of PNAD 2009 data points out that it took 17 years to expand by 2.3 years the average number of school years. At that rate, it would still take five more years to reach the eight years of elementary education required by the Constitution.

“The issue of lack of qualified workers can already be seen in specific sectors, but it is possible that at some point the economy as a whole will experience a shortage of qualified people,” says João Sabóia, director of the Institute of Economics, University of Rio de Janeiro. For Márcio Pochmann, IPEA president: “It’s not a question of lack of resources. Today if we compare the education expenditure-to-GDP ratio, Brazil spends about 50% more than the United States on training programs. But the fact is that many actions of the ministries and the private sector are not complementary but competitive.”

**SALARIES**

Even if Brazil can ensure a good education to open the doors to social mobility for most of the population, we will still not have eliminated all the negative factors. "The social contract we have today privileging income distribution implies..."
slower economic growth and less dynamic markets. Consequently the private sector pays little and does not generate prospects of advancement,” Pessoa says.

Data from the General Register of Employed and Unemployed of the Ministry of Labor show that, although September 2009 to August 2010 saw the creation of 2.5 million formal jobs with salaries of up to twice the minimum wage, there was a loss of 284,600 higher-income jobs. “On the one hand, this reflects the value of the minimum wage in recent years,” says Sabóia. “On the other it indicates that the bulk of the jobs created paid workers poorly. This is alarming.” He suggested a risk of frustrating Brazilians who have just climbed to the base of Class C and invest in a college degree seeking a better quality of life.

Waldir Quadros, professor of economics at the University of Campinas, argues that this problem is due to Brazil’s lack of an industrial policy, which deters growth. “I believe the problem is not social spending but the lack of industrial progress that energizes the entire chain of suppliers and services,” he says. “At the moment, this sector is constrained by high interest rates and the appreciation of the exchange rate.” IPEA’s Pochmann says that “One should not bemoan the fact that in recent years precarious informal jobs declined: for every ten jobs created, nine were in occupations that are protected by the labor laws. However, we must complete the cycle of industrialization, making it more technology-intensive and ensuring the “The problem is not social spending but the lack of industrial progress that energizes the entire chain of suppliers and services.” Waldir Quadros

![Graph: FORMAL EMPLOYMENT IS ON THE RISE.](net increase in thousands)

Source: Caged.
“There is room to reduce poverty and strengthen the domestic market, provided there is improvement in public accounts and growth of 5% a year.” João Sabóia

lower interest rates needed to make this possible,” he says. “The focus on production and export of primary commodities like iron ore and soybeans does not create industrial jobs.”

In mid-November a Ministry of Development, Industry and Foreign Trade report expressed concerns that the country was experiencing “deindustrialization,” highlighting the role of the external trade balance. Deindustrialization, the report said, is characterized not by a fall in industrial output, which may even increase, but by a loss of dynamism in generating income and employment. “The electronics and pharmaceutical sectors cannot compete internationally, they end up importing raw materials, and so the best jobs we need are created outside the country,” says Pochmann.

Data from the Brazilian Association of Electrical and Electronics Industry show a record sector trade deficit of US$20 billion in the first nine months of 2010 — 69% higher than in the same period in 2009. In the pharmaceutical sector, in the first six months of the year drug imports totaled US$3 billion. “There is no way to deny that this year cheaper imports of certain products were a great ally in keeping inflation under control, especially given pent-up demand for some durable goods,” says Denise de Pasqual, a partner at Tendências Consultoria. “But it is clear that we need a correction, more focused on external competitiveness, since devaluing the exchange rate is one of the most inefficient measures there is.”

The result of all these factors was a reduction in industrial confidence. IBRE surveys indicate that confidence in the manufacturing industry fell 18% from August 2009 to August 2010 in the consumer durable goods segment. “Our diagnosis is clear: We have been saying for years that we need to reduce interest rates to prevent exchange rate appreciation and discourage foreign investors from pouring dollars so eagerly into the economy,” says Eduardo Eugênio Gouvea Vieira, president of the Federation of Industries of Rio de Janeiro. He thinks “It is necessary to reduce interest rates, cut payroll taxes, and ensure adequate infrastructure for production.”

EXTERNAL DEFICITS

With growing external deficits, Brazil needs to attract more foreign direct investment. (US$ billion)

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<th>2008</th>
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* Estimates.

Source: IBRE/FGV.
THE NEW GOVERNMENT’S POLICIES

Even before President-Elect Roussef announced her economic team, the market showed reservations about the possibility of a consistent reduction in the Central Bank benchmark interest rate in 2011. IBRE projects that in 2011 the benchmark rate will remain at the 10.75% it reached in late 2010. This is understandable because until now, high interest (though trending downward) has been the main policy for curbing inflation threats — the first victims of which would be the emerging middle class. In their first declarations, the future president’s new team showed some sensitivity to this important issue, signaling concern about reducing the public deficit and an intention to accelerate the reduction in interest rates.

The market is betting that the Rouseff government will pay attention to the demands of the emerging middle class. Sabóia thinks, “There is room to reduce poverty and strengthen the domestic market,” provided there is an improvement in public accounts and no slowing in the pace of growth, which, he says, must be at least 5% a year. Pessoa notes that the country needs to attract foreign savings to complement domestic saving and finance investment: “If we want this, we must persevere in building the institutional framework, guaranteeing contracts, improving the regulatory agencies, and recovering the primary surplus.” For Neri, Brazil has the potential to react strongly and positively to the new government changes in policy. The general outlook, then, seems to be hopeful despite the challenges.