



How Reforms and Stability Are Paving the Way for Global Growth

The following article is based on The Bank of New York Mellon Treasury Services' Web seminar, "Spotlight On Brazil." Presented by Nadia S.L. Morandier, The Bank of New York Mellon country Manager and senior representative, Sao Paulo, Brazil. The session was part of our 2008 "Trading Places" Web conference series that offers commentary from our experts on international trade issues and the countries considered hotbeds of today's global commerce. The series is available online at <https://www.bnymellon.com/treasuryservices/webcasts/trade/login.cfm>.

While Brazil's economic growth has been slower than that of more widely recognized emerging markets, such as Russia, China and India, the country is quickly becoming a major player in the global marketplace. Its significant social, economic and political turnaround since 2003 has been due, in large part, to wide-sweeping reforms that have affected all facets of its national constitution. As a result, the economy is seeing an upswing across almost all sectors, and is particularly reaping the benefits of rising hard and soft commodity prices.

Domestic consumer spending is rising, as are the industries that offer consumer products and services. And, the success of Brazil's economic reforms of the early 1990's that have led to the taming of rampant inflation, stability of its political and banking systems and the strength of its capital markets predict solid and continued international growth across all sectors into the future.

A Refurbished Economy

Geographically the largest nation in South America and fifth largest in the world, Brazil's immediate social and economic challenges are not unlike those in other emerging markets. But while it faces wide-ranging issues related to poverty and education, as well as legal and regulatory concerns common to an emerging market, the country is well into an economic turnaround.

Since the early nineties, numerous significant social and economic reforms have spurred this growth, including:

- privatization of numerous public companies;
- establishing a floating exchange rate;
- opening the economy to investment capital and foreign trade; and
- formation of a fiscal responsibility/crimes law that requires fiscal planning, execution and transparency at federal, state and municipal levels.

As a result, the economy is seeing an upswing in most sectors. Services now account for 65 percent of Brazil's GDP; industry for 31 percent; and agriculture for 4 percent. GDP growth for 2007 was 5.3 percent, with 4.5 percent predicted for 2008. And, capital goods production rose by 17 percent in 2007, with durable goods production growing as well, largely due to exports, better credit conditions and more disposable income.

Additionally, inflation has been brought under control (although it remains a manageable factor in Brazil's economy) — falling from 12.5 percent in 2002 to 3.1 percent in 2006 — through the manipulation of interest rates by the Central Bank. The current rate is 4.1 percent and is predicted to rise to 4.42 percent by the end of 2008.

External accounts indicate a record of continuous improvement. Trade balance reached a record surplus of USD \$41 billion in 2007 and should reach USD \$30 billion in 2008 — the drop-off due to increased imports, pegged to an upturn in consumer spending.

Counted among the country's ongoing challenges, however, are high taxes and a complex tax structure (import taxes making technology very expensive); regulatory demands that make it difficult and time consuming to open or close a company; and a multiple party political system that slows the reform process.

Current Financial Climate

The Brazilian banking system, which began a major restructuring in 1994, is today considered both strong and well regulated.

In 2002, the Brazilian Central Bank launched the Brazilian Payment System, which is based on international standards as defined by the Bank for International Settlements (BIS). Through a service similar to FedWire, the Brazilian Payment System provides a foreign exchange clearinghouse that settles on a net basis and provides security and guarantees.

The system allows for real-time inter-bank transfers. All payment orders are handled electronically and those over USD \$2,500 are settled on the same day, in real time and with intraday availability. Checks issued anywhere in the country are cleared and settled within 48 hours, a procedure that has been in place for some 20 years, driven by the country's history of rampant inflation.

Although not formally independent, the Central Bank of Brazil is run without government oversight. The system has 133 banks, the largest five of which represent 47 percent of total in-country assets, and the 50 largest representing 86.2 percent.

Brazilian capital markets in the past 10 to 15 years have developed from virtual non-existence into a position of global strength as well. The Brazilian stock exchange (*Bovespa*), located in Sao Paulo, has a market capitalization of almost USD \$1.3 trillion — the largest in Latin America and the second largest equity-option exchange in the world.

The Brazilian Mercantile and Futures Exchange (BM&F) is the world's fifth largest futures exchange with clearing houses for derivatives, foreign exchange and securities. In February of this year, the BM&F and Bovespa announced plans to merge, creating what will be one of the largest exchanges in the world, measured by market capitalization.

Pension Funds and Investments

There are, in Brazil, both privately owned and government-owned pension funds, with those owned by the government far larger at this time. Pension funds are allowed by law to invest abroad, but local interest rates and regulations dictate that almost all investments are made in Brazil.

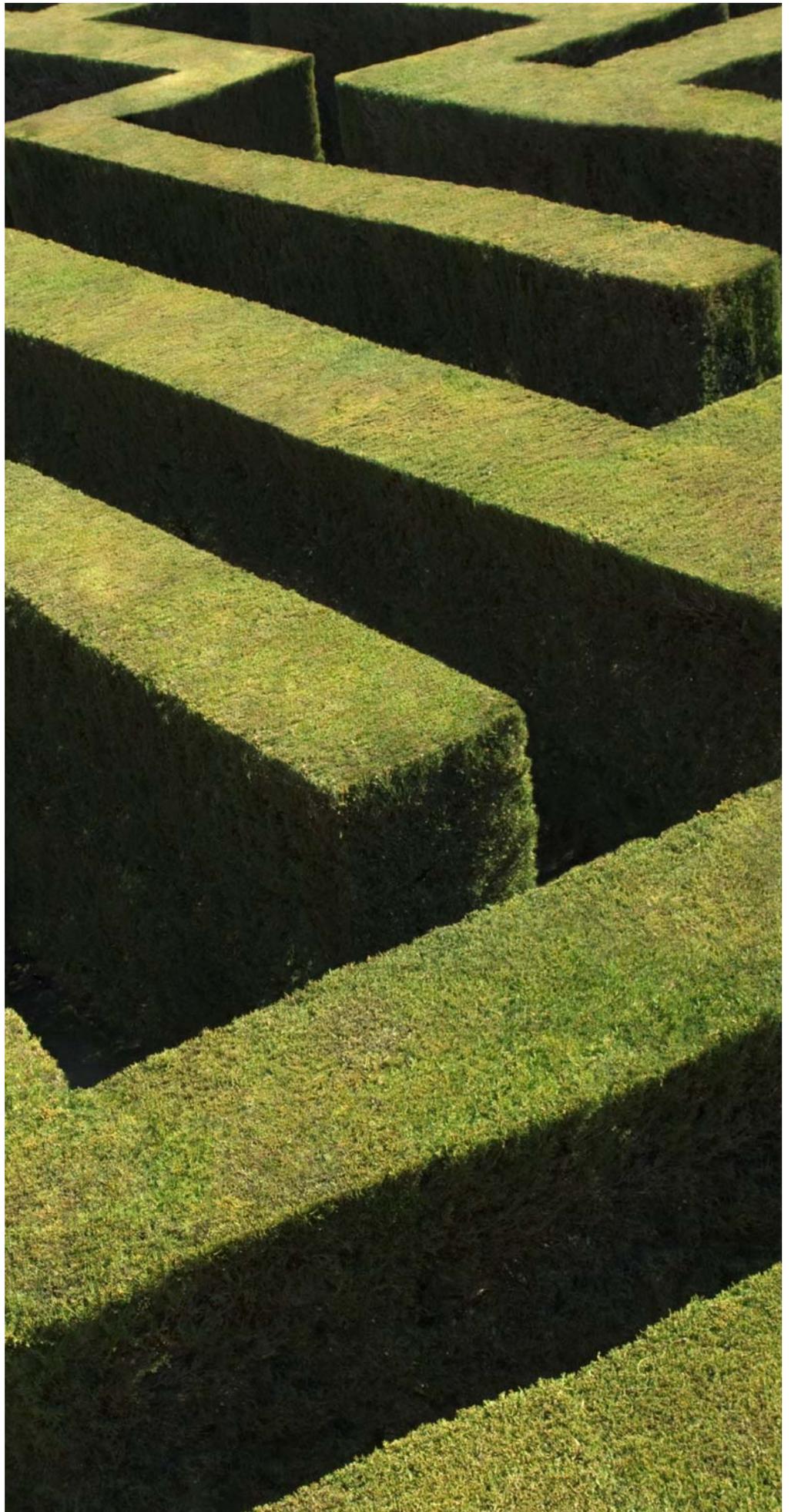
Asset management is a promising market in Brazil as interest rates drop, and an increasing number of asset managers are offering a broader diversity of products. The largest asset manager currently is BBDTVM (BB Distribuidora de Titulos e Valores Mobiliarios), which is associated with Banco do Brasil.

Trade Finance

As more Brazilian companies become international, Brazil has moved in step with the world's tendency in trade finance: diminished use of letters of credit in favor of open accounts. Traditional bank-to-bank trade finance continues, but tenors are increasing and spreads have diminished.

An Emerging Player

With the surge of growth in its markets, built upon sound investments to its social, political and economic fabric, Brazil is well on its way toward making the adjustments necessary to place itself among the central players of today's global commerce. The next few years will tell us much about whether the country will harness this change to reach its full potential.





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