



# *The Brazilian Economy in 2007*

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Finance Minister*

*London, January - 2007*



# Macroeconomic Soundness

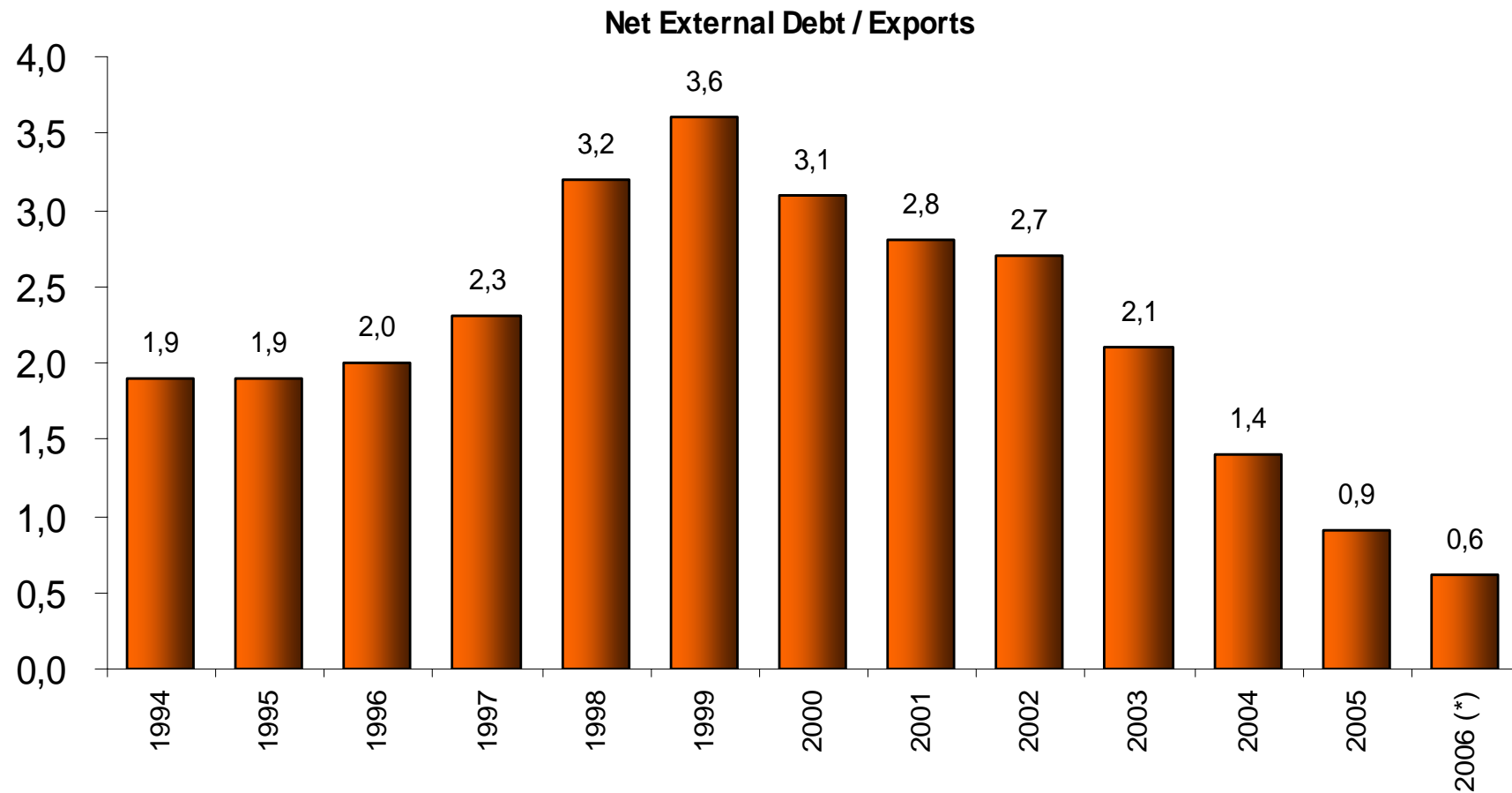
**Brazil is currently in an extremely favorable condition to initiate a period of rapid GDP growth:**

- **High trade surplus and low vulnerability to external shocks**
- **Low inflation rate and high growth potential**
- **Fiscal austerity with a declining public debt/GDP ratio**



## Solvency Increase

The net external debt to exports ratio is currently the lowest ever recorded.

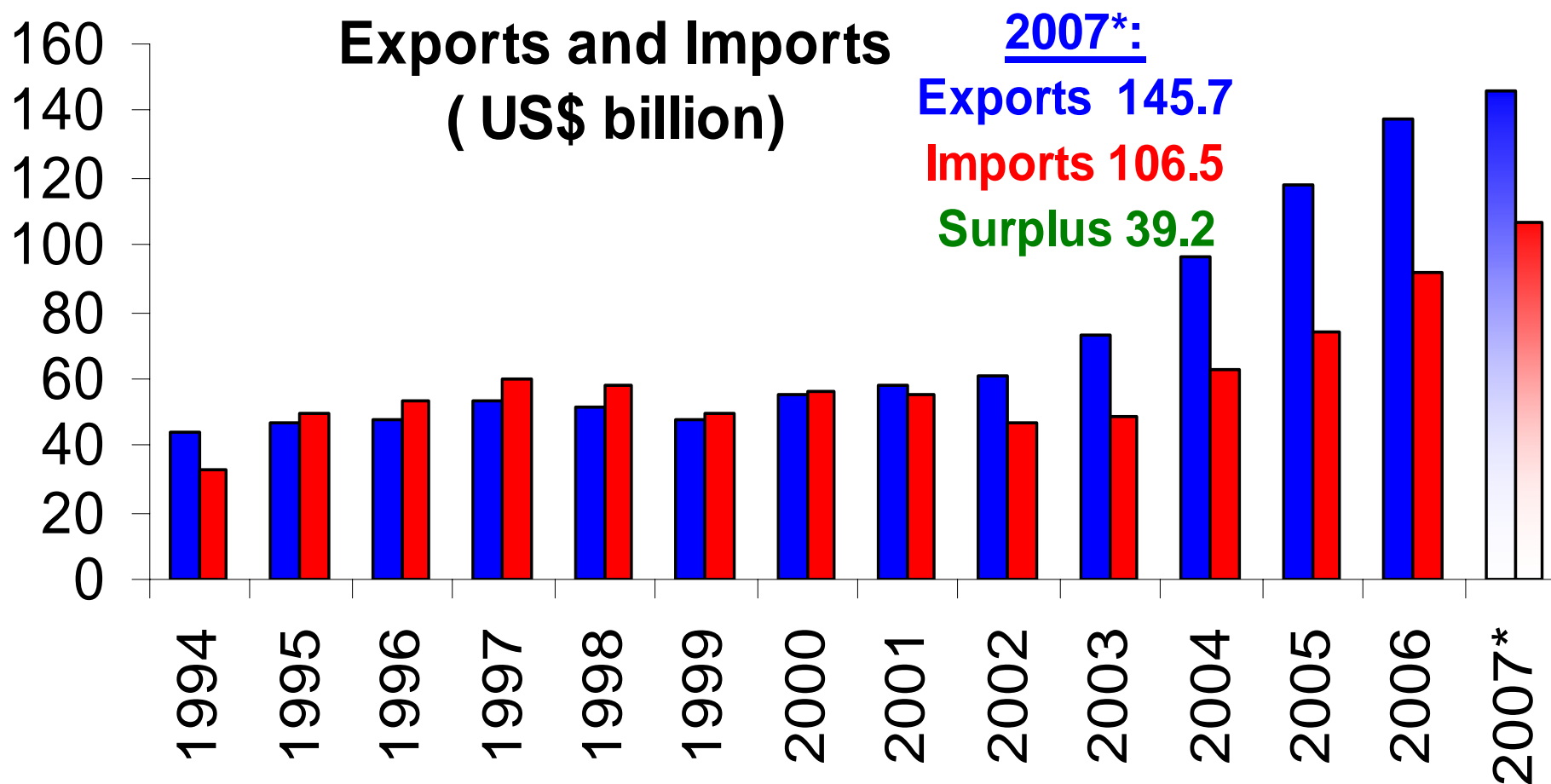


(\*) estimate for November



## Trade Surplus

The exports and imports are expected to continue to grow vigorously in 2007.

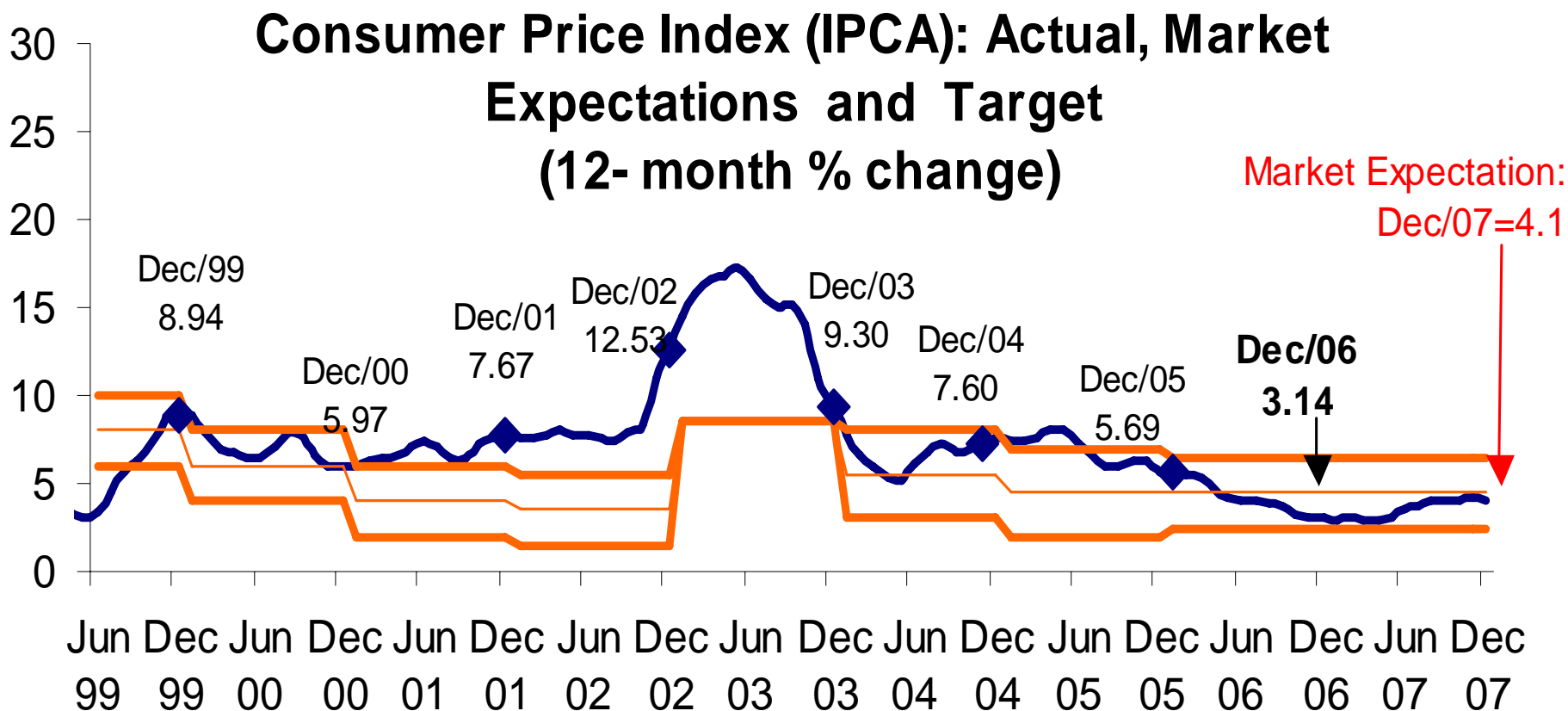


(\*) forecast  
Source: MDIC



## Inflation: Reduction and Control

The inflation rate is under control and market expectations indicate that the target for 2007 (4.5% +/- 2%) will be met.

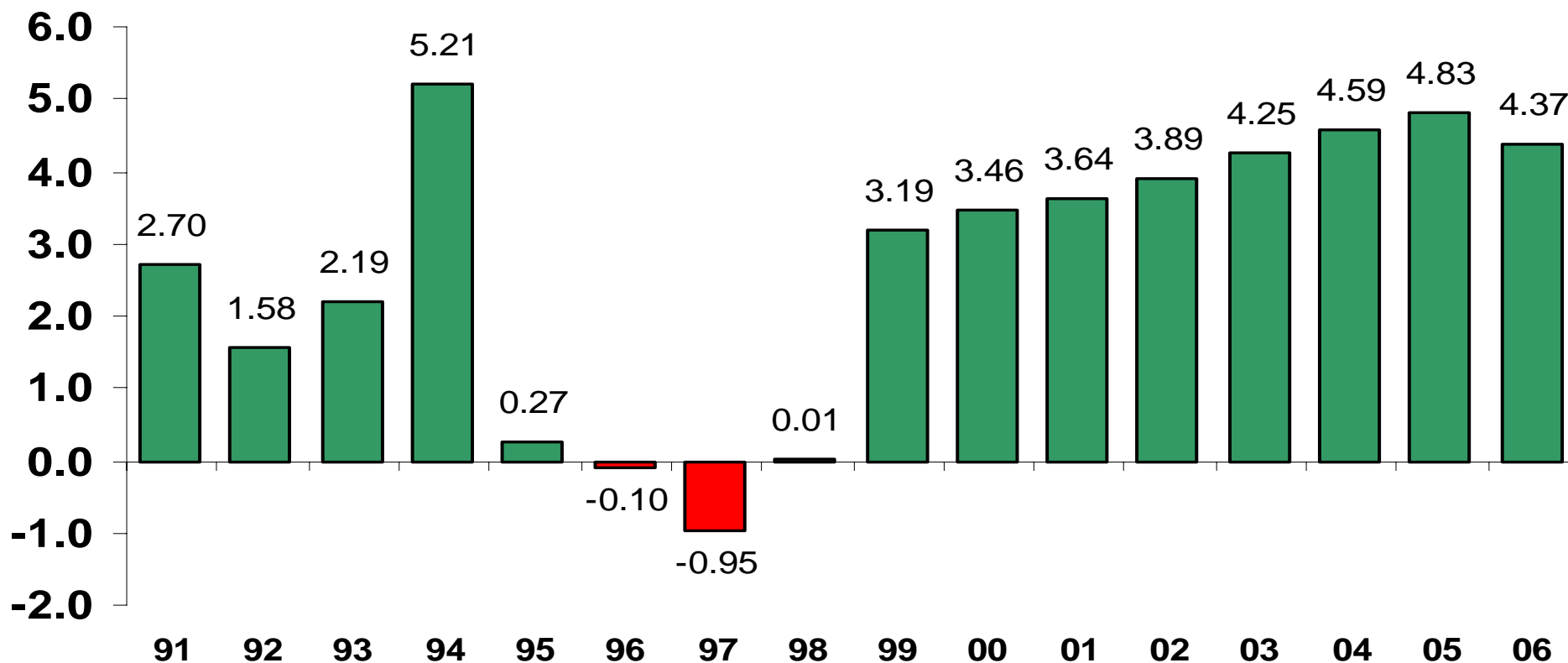




## Consolidated Government Primary Surplus

The primary surplus is currently greater than what would be necessary to maintain the net public debt / GDP ratio stable.

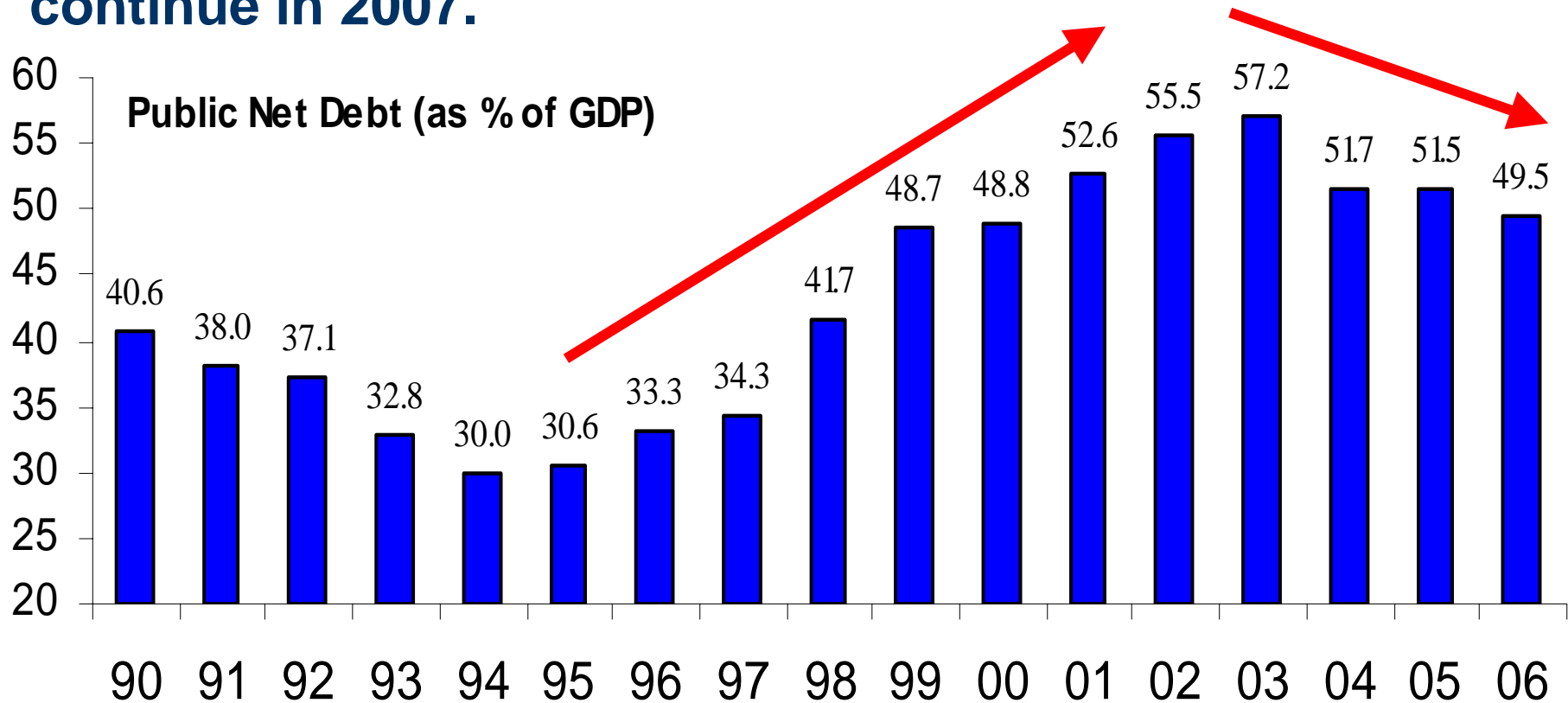
Government Primary Surplus ( as % of GDP)





## Public Sector's Net Debt Reduction Trend

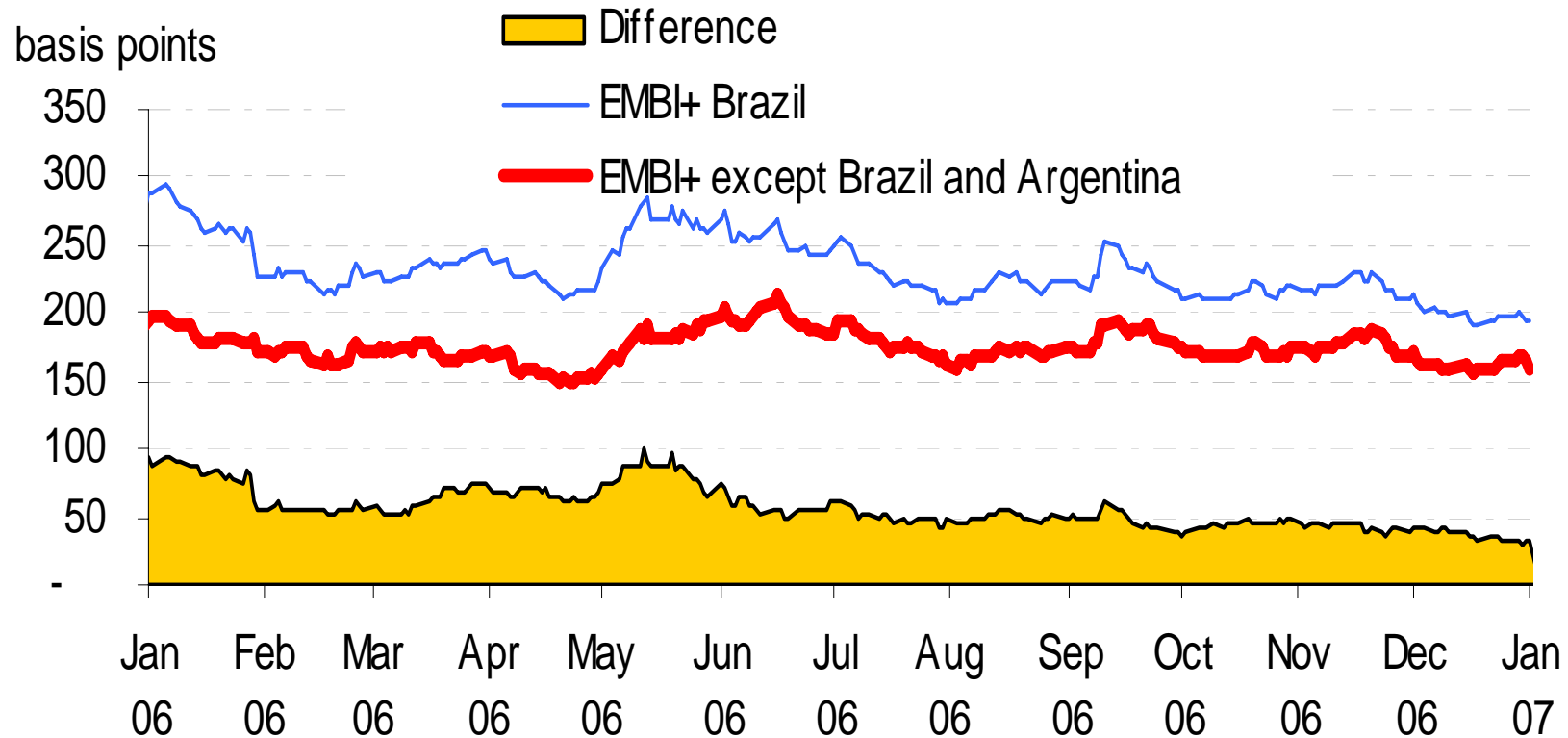
The increase in the government's primary surplus over the last four years interrupted the growth of the debt/GDP ratio. Since 2003, the debt/GDP ratio has been falling, and this will continue in 2007.





## Reduction in the Sovereign Risk

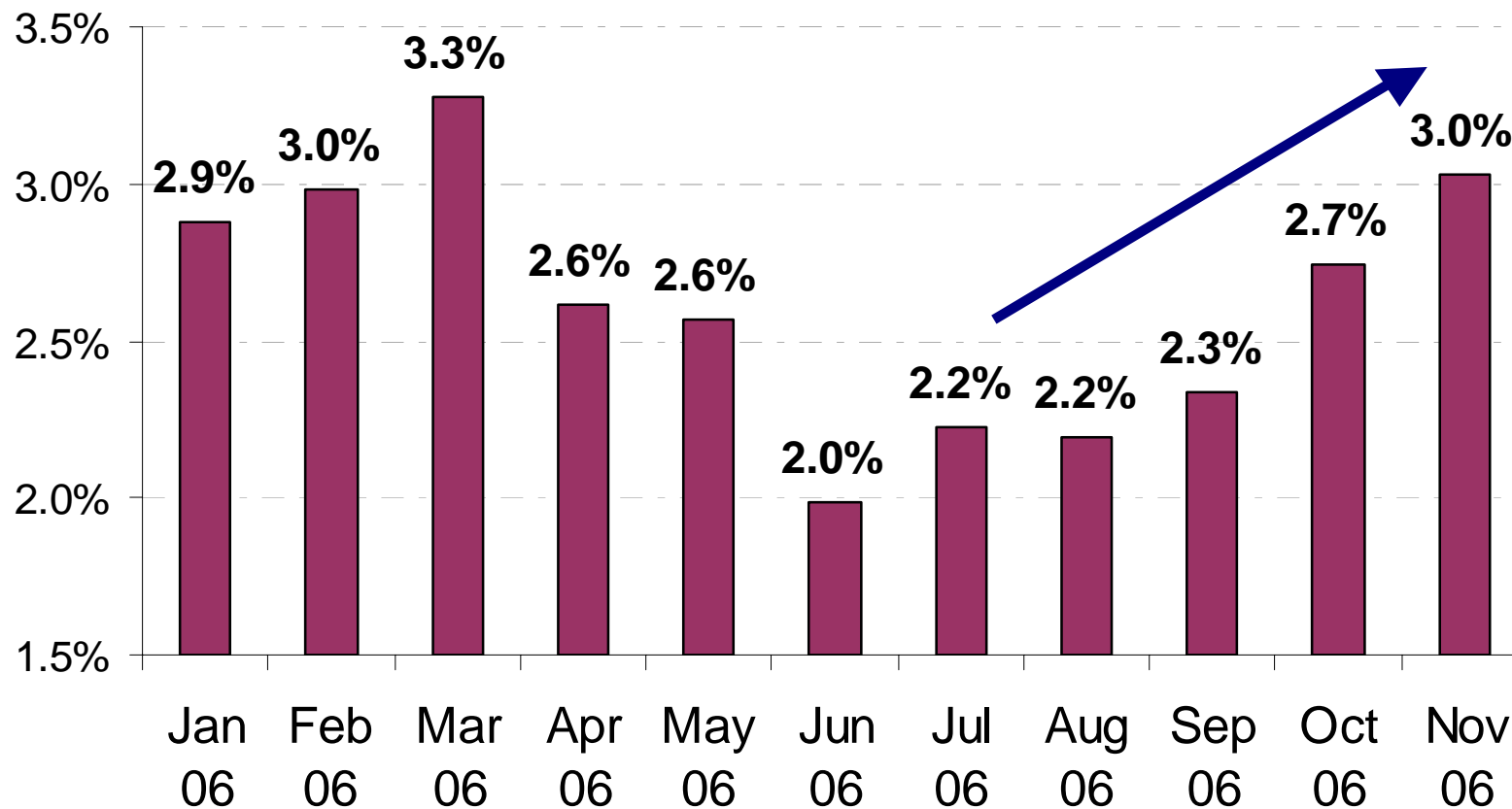
The sovereign risk has been falling since 2003, and the difference between Brazil's spread and the spread of other developing countries has also been reduced. Due to such improvement, Brazil issued US\$ 1.5 billion in 10- year bonds in Nov/2005, with a 159 bps spread over US bonds, which represents a historic landmark.





## Industrial Production (12-month % change)

After a deceleration in mid-2006, due to the monetary policy needed to reduce inflation, industrial growth has been accelerating, and is expected to continue this trend in 2007.



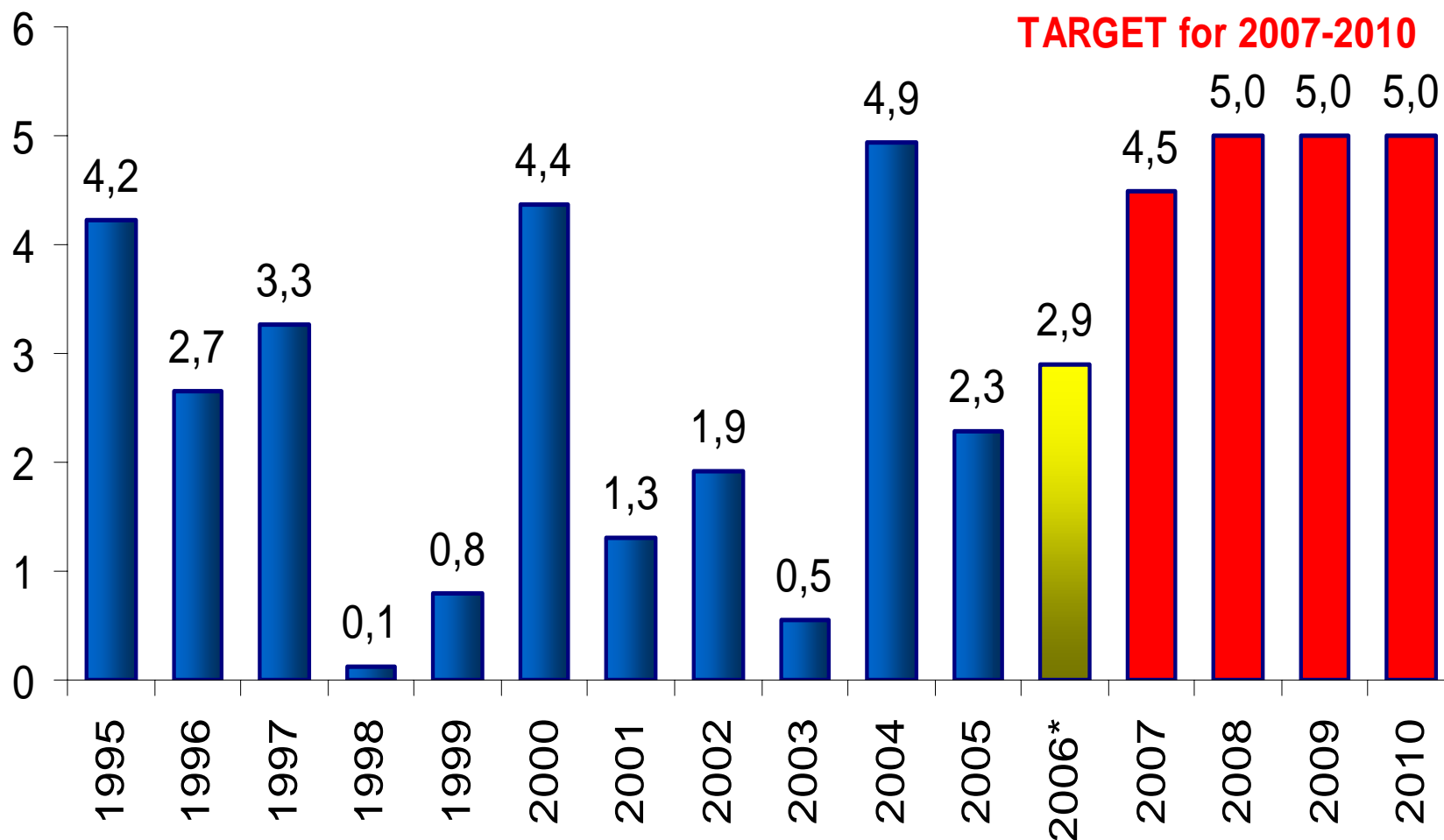
Source: IBGE.

Prepared by : MF/SPE.



## GDP: growth rate (%)

The main macroeconomic challenge for 2007-10 is to accelerate GDP growth.



(\*) forecast

Source: IBGE.

Prepared by: MF/SPE.



## Growth-Accelerating Program: 2007-2010 (*Programa de Aceleração do Crescimento – PAC*)

**The PAC is a set of government actions to:**

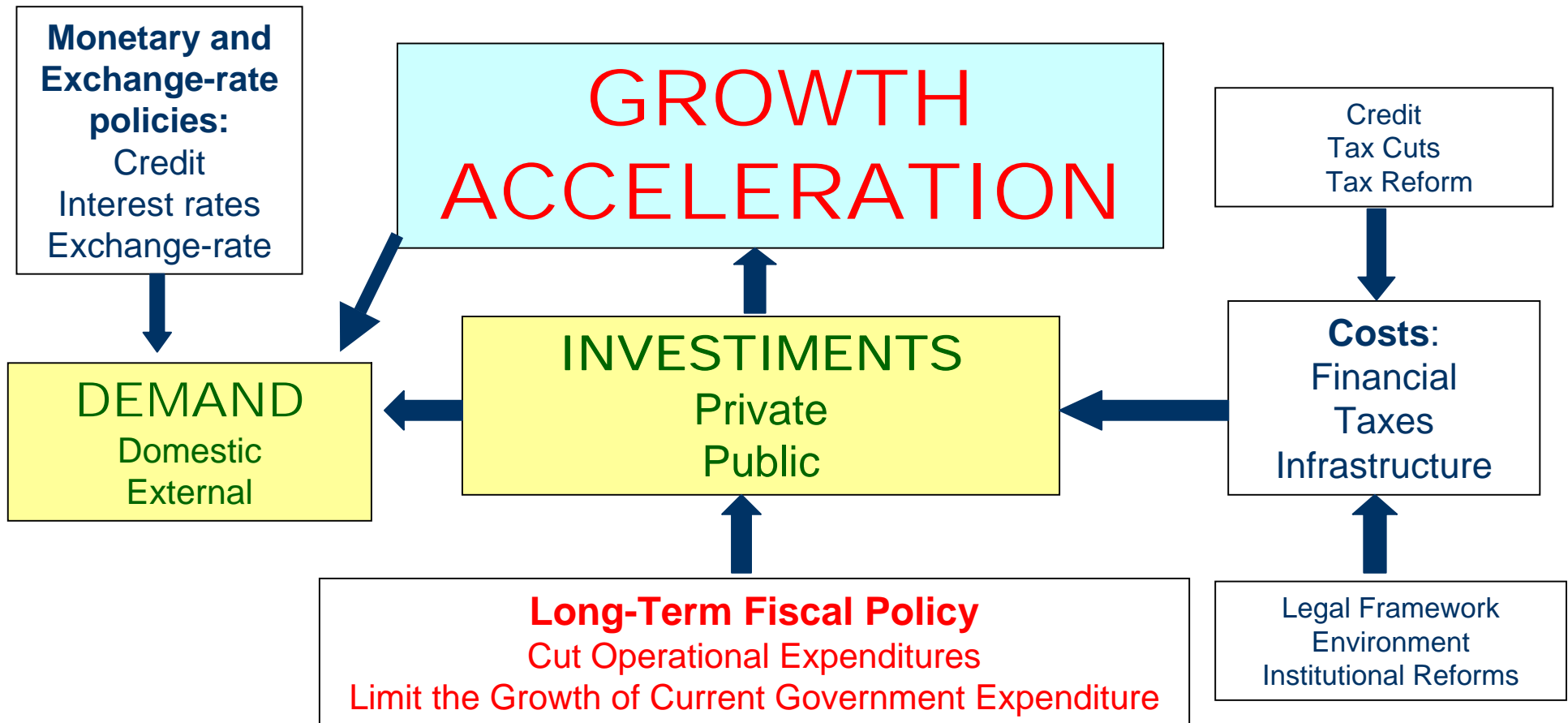
- **Stimulate private investment;**
- **Increase government investment in infra-structure;  
and**
- **Remove the main obstacles to economic growth  
(bureaucracy, inadequate norms and regulation)**

**The PAC depends on the collaboration between the Executive and Legislative branches of the Government, as well as on the participation of workers' and business' leaders.**



## FUNDAMENTALS

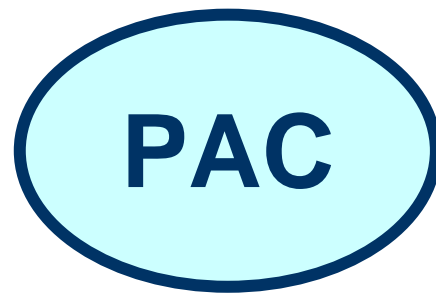
- ✓ Monetary Stability
- ✓ Fiscal Responsibility
- ✓ Low Vulnerability to External Shocks





## PAC 2007-2010

The PAC is organized in five blocks:



- 1) Investment in Infra-Structure**
- 2) Credit and Long-Term Finance**
- 3) Investment Climate**
- 4) Tax Cuts and Tax Policy**
- 5) Long-Run Fiscal Policy**



## Investment in Infra-Structure

**The increase in investment aims to:**

- **Eliminate the main bottlenecks that may constrain the growth of the economy;**
- **Reduce costs and increase productivity;**
- **Induce an increase in private investment; and**
- **Reduce the regional inequalities within Brazil.**



## Investment in Infra-Structure

**The fiscal conditions allow an increase in public investment without compromising macroeconomic stability and the reduction in the ratio of net public debt to GDP.**

**A special executive committee will monitor the selection and evolution of the investments contained in the PAC.**



## Investment in Infra-Structure

2007-2010

	US\$ billion	as % of GDP
<b>Logistic</b>	<b>27.3</b>	<b>0.58%</b>
Federal Budget	15.4	0.33%
Government Enterprises and Other Sources	11.8	0.25%
<b>Energy</b>	<b>128.6</b>	<b>2.71%</b>
Federal Budget	-	-
Government Enterprises and Other Sources	128.6	2.71%
<b>Social and Urban Infra-Structure</b>	<b>79.9</b>	<b>1.69%</b>
Federal Budget	16.3	0.34%
Government Enterprises and Other Sources	63.6	1.34%
<b>Total</b>	<b>235.8</b>	<b>4.97%</b>
Federal Budget	31.7	0.67%
Government Enterprises and Other Sources	204.1	4.30%



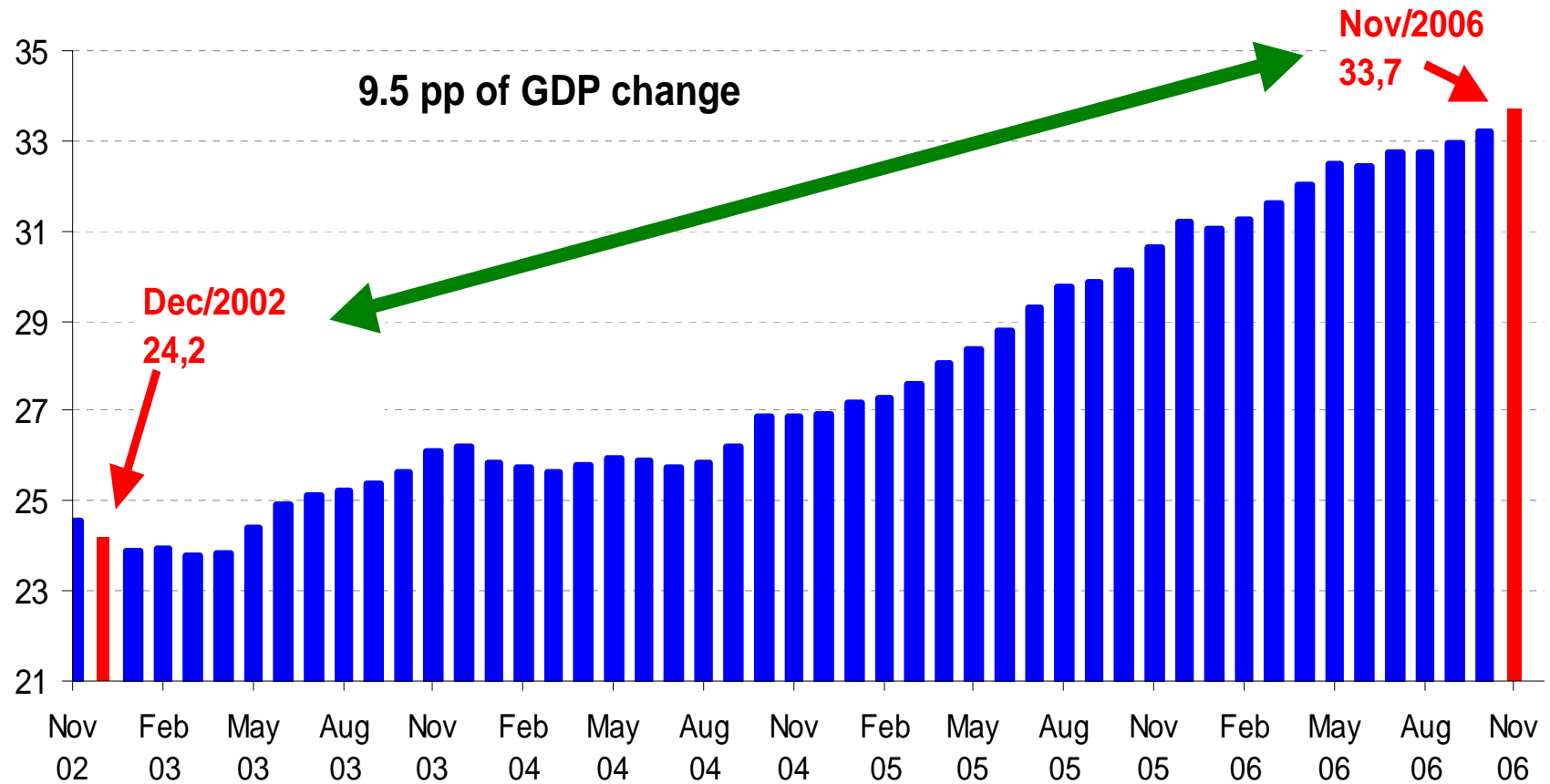
## Investment – Federal Budget 2007-2010

	2007		2008-2010		Total	
	US\$ billion	as % of GDP	US\$ billion	as % of GDP	US\$ billion	as % of GDP
<b>PAC - Infrastructure</b>	<b>7.4</b>	<b>0.71%</b>	<b>24.4</b>	<b>0.66%</b>	<b>31.7</b>	<b>0.67%</b>
PPI funds	5.3	0.51%	19.3	0.52%	24.6	0.52%
Other funds	2.1	0.20%	5.1	0.14%	7.2	0.15%
<b>Other investments</b>	<b>4.1</b>	<b>0.39%</b>	<b>17.5</b>	<b>0.47%</b>	<b>21.5</b>	<b>0.45%</b>
<b>Total</b>	<b>11.4</b>	<b>1.10%</b>	<b>41.8</b>	<b>1.13%</b>	<b>53.3</b>	<b>1.12%</b>



## Bank Credit Volume (as % of GDP)

The volume of bank credit increased from 24% of GDP, in Jan/03, to 33.7% of GDP, at the end of 2006. This rise was pulled mostly by the increase in personal credit, due to the improvement in employment and wages, and to a change in the rules of such operations implemented by the Government.



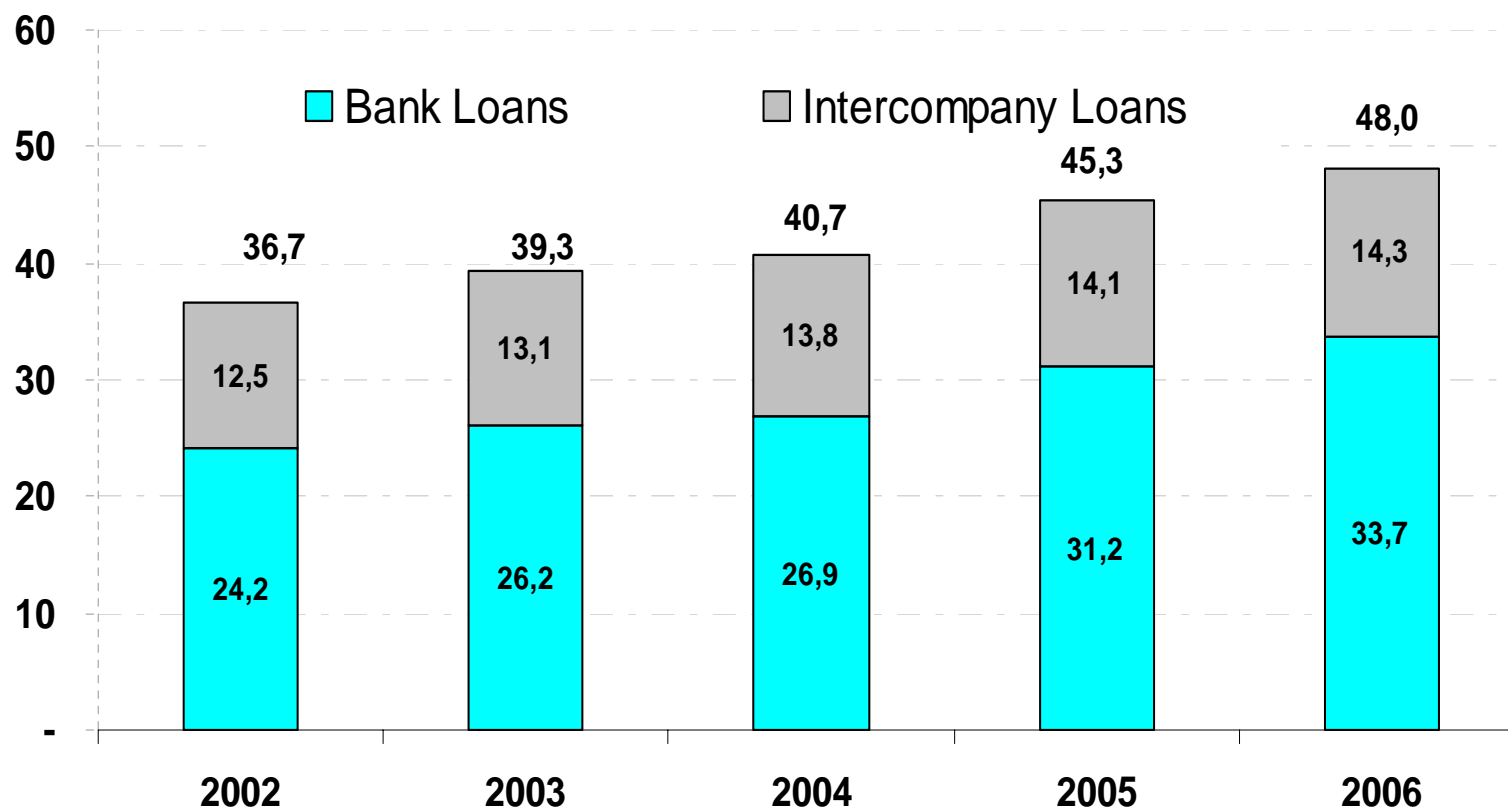
Source: BCB

Prepared by: MF/SPE..



## Brazil's Economy Financing Sources (as % of GDP)

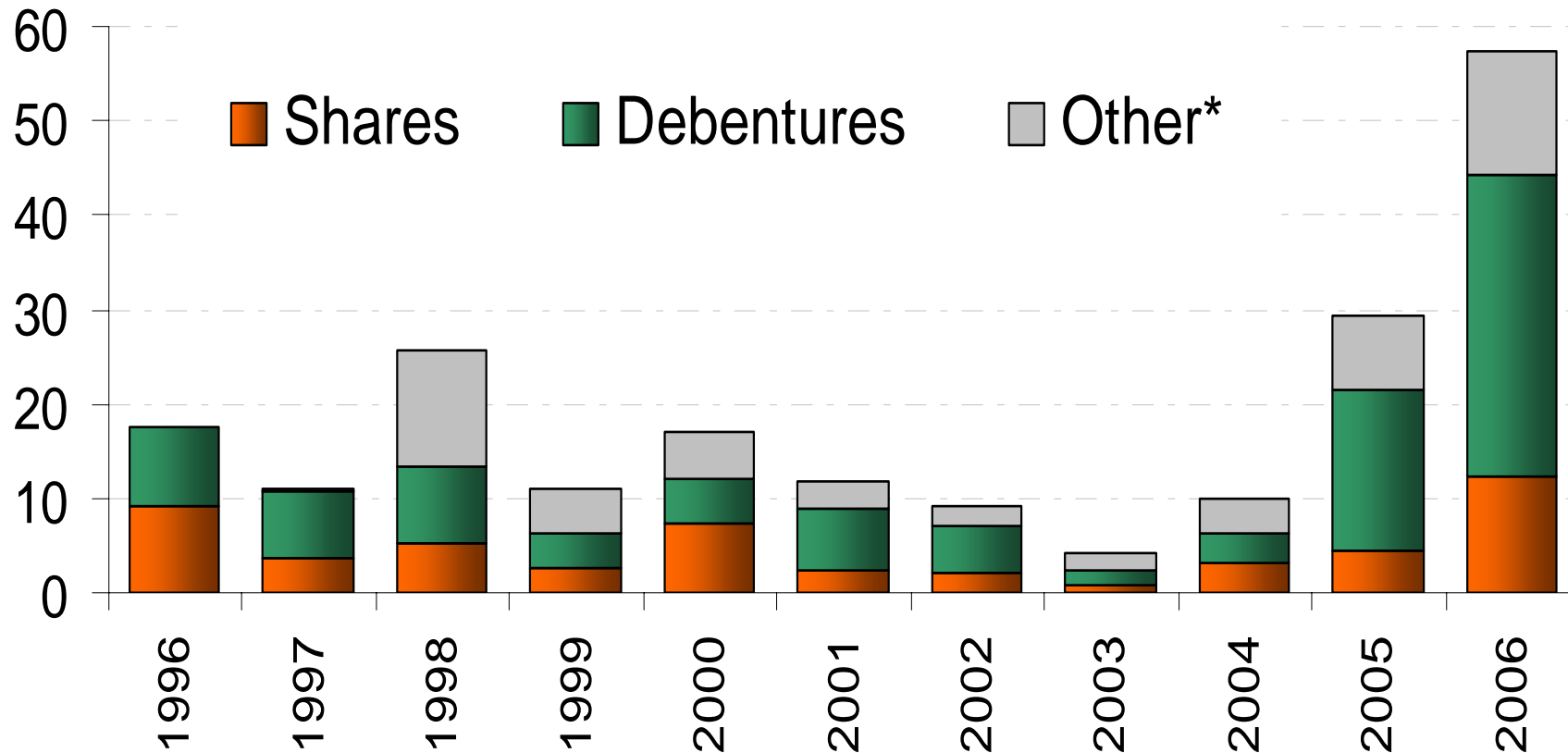
Considering the intercompany loans, the total credit in Brazil was close to 50% of GDP at the end of 2006.





## Capital Markets (US\$ billions)

**In addition to the credit expansion, the volume of new issues in capital markets has also been growing fast since 2003.**



(\*)Includes promissory notes, CRIs (real estate receivables certificates), and quotas of credit rights investment funds, among others.

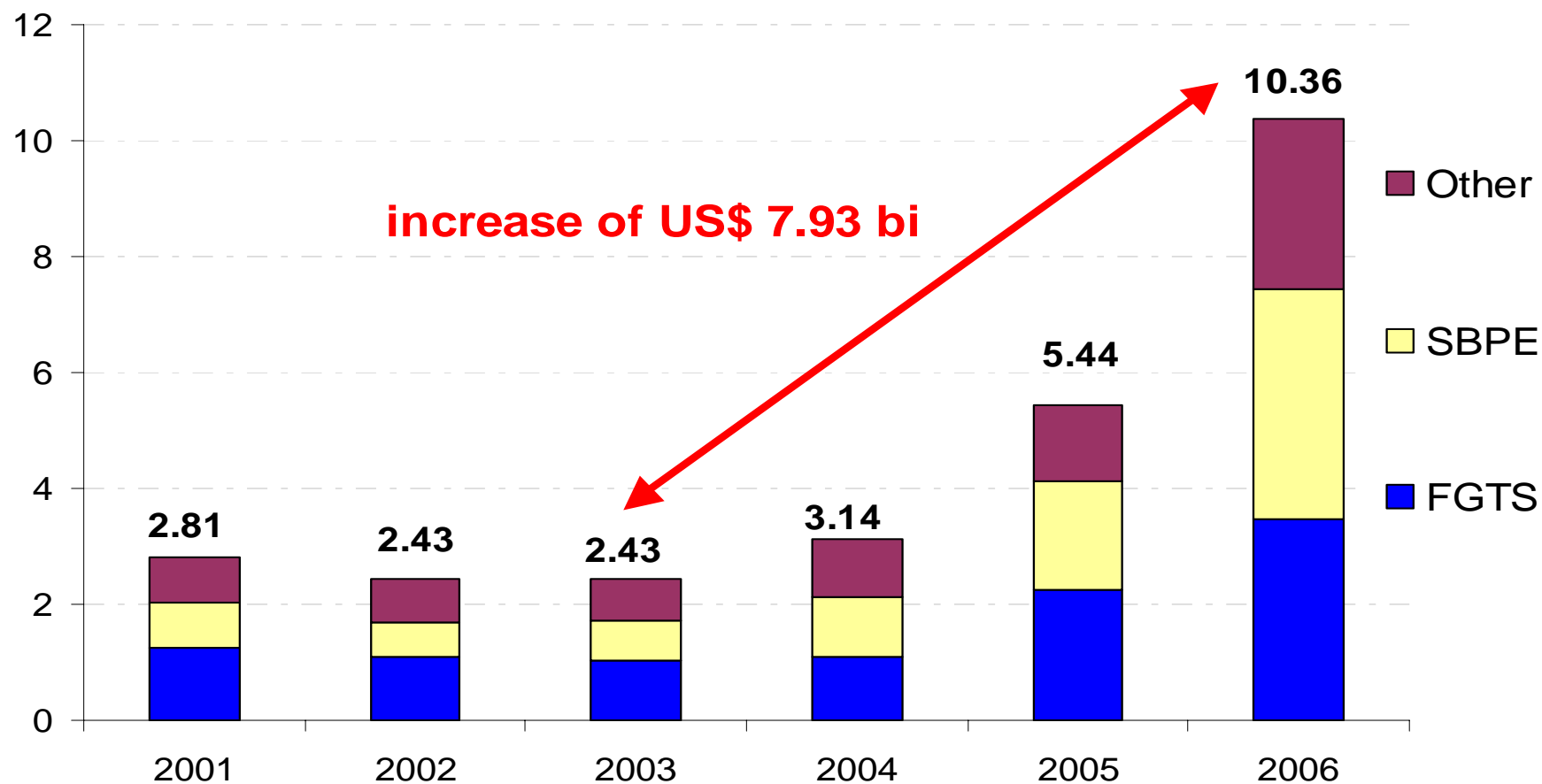
Source: CVM.

Prepared by: MF/SPE.



## Credit Operations – Housing (US\$ billions)

Housing finance started to growth fast in 2005.





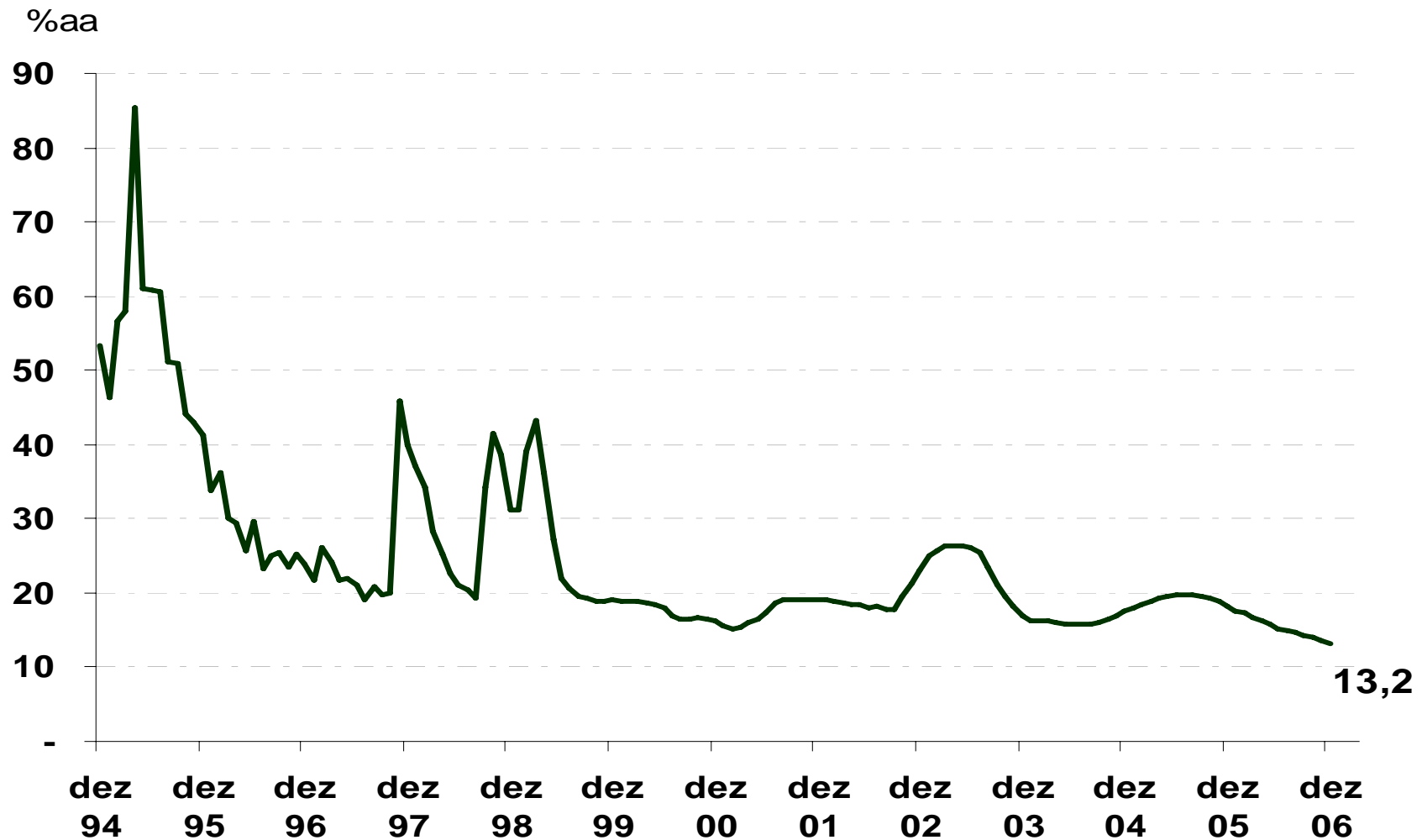
## Credit and Long-Term Finance

- ✓ Reduction in the **base interest rate (SELIC)**
- ✓ Reduction in the Government's **long-term interest rate (TJLP)**
- ✓ Increase in the **long-term finance** to investments in infra-structure, specially to **water, sanitation and urban development**
- ✓ Increase in the finance of investments in **housing** for low-income families.



## Credit and Long-Term Finance – Recent Government Measures

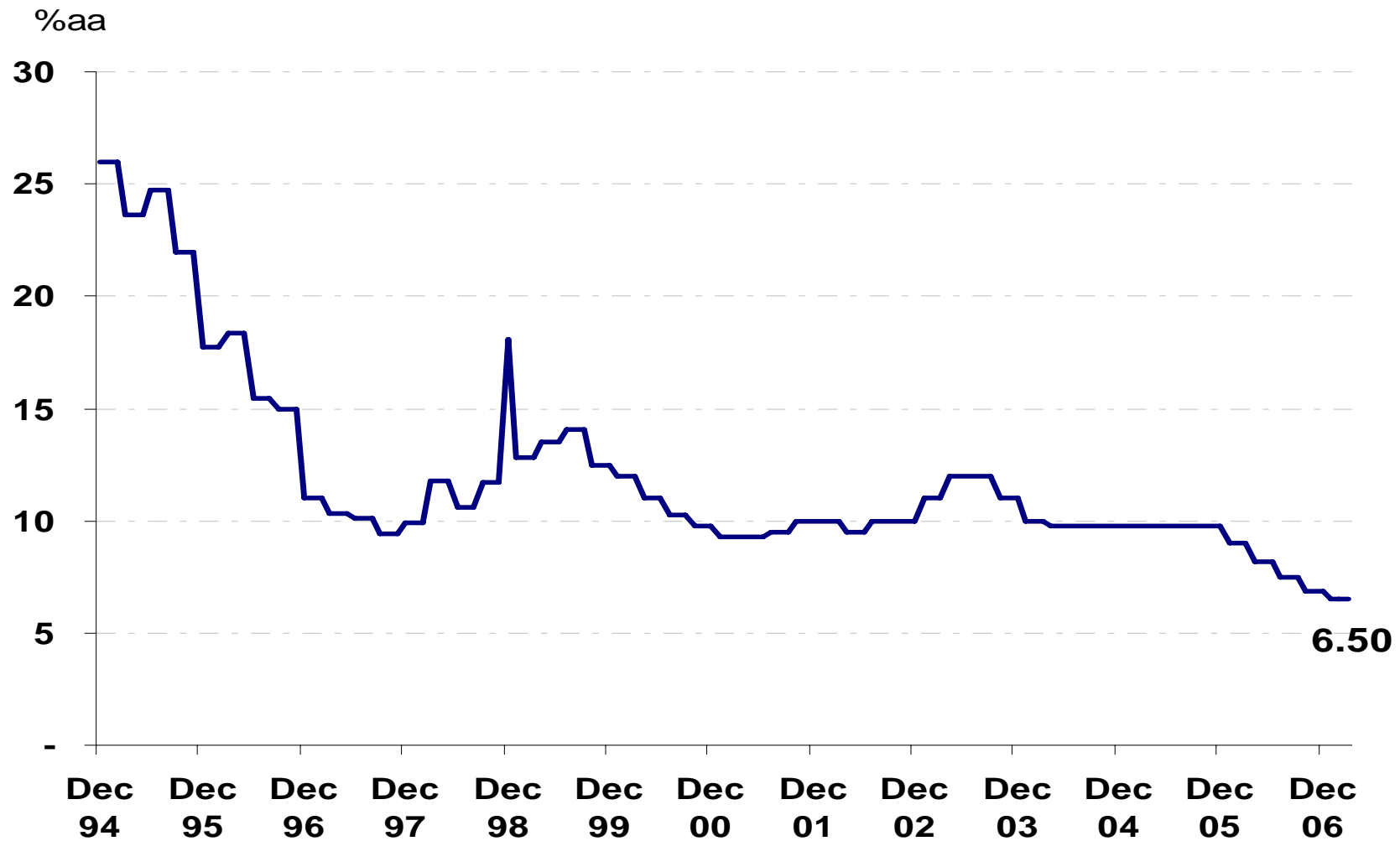
### Reduction of the Selic rate





## Credit and Long-Term Finance – Recent Government Measures

### Reduction of the TJLP rate





## Investment Climate

- ✓ Definition of the **environmental competence** of the Federal and Regional Governments (Article 23).
- ✓ Definition of the norms and performance contracts of the Government's **Regulatory Agencies** (PL 3.337/2004).
- ✓ Expedite the approval of the **Natural-Gas Law** by the Congress (PL 6.673/2006).
- ✓ Expedite the approval of the **Brazilian System for the Defence of Competition** by the Congress (PL 5.877/2005).



## Tax Cuts

- ✓ Tax cuts to stimulate private investment, specially in **civil construction and infrastructure** projects.
- ✓ Tax cuts to stimulate the growth and formalization of **micro and small enterprises**.
- ✓ Tax incentives to the development of the production of **Digital TVs and semiconductors** in Brazil.
- ✓ Tax cut of the **personal income tax**.



# Summary of the Tax Cuts

	(R\$ billions)			
	2007		2008	
	US\$ billions	as % of GDP	US\$ billions	as % of GDP
Personal Income Tax	0.6	0.06%	1.2	0.10%
Extension of Fast Depreciation	0.4	0.04%	0.4	0.04%
Extension of Tax Breaks for Civil Construction	0.3	0.03%	0.3	0.02%
Micro and Small Enterprises	1.1	0.11%	2.3	0.20%
Fast Recovery of Tax Credits due to Investment in Civil Construction	0.5	0.05%	1.1	0.09%
Tax Exemption to New Investments in Infra-Structure	n.e.	-	n.e.	-
Tax Reduction of the Investments in Infra-Structure Funds	-	0.00%	-	0.00%
Increase in the Tax Break to Purchase Computers	0.1	0.01%	0.1	0.01%
Tax Incentives to the Digital TV Sector	-	0.00%	-	0.00%
Tax Incentives to Semiconductor Sector	-	0.00%	-	0.00%
Tax Reduction for the Purchase of Steel and Iron Tubes	0.0	0.00%	0.0	0.00%
<b>TOTAL TAX CUT</b>	<b>3.1</b>	<b>0.30%</b>	<b>5.4</b>	<b>0.47%</b>

n.e = not estimated  
Source: MF.



## Tax Policy

- ✓ Improvement in the collection of social contributions - **change in the dates.**
- ✓ Implementation of the **Brazilian Public System of Digital Registration** in two years – reduce bureaucracy and increase efficiency.
- ✓ Resume and widen the discussion of the proposal of **Tax Reform**, under analysis in Congress.



## Long-Term Fiscal Policy

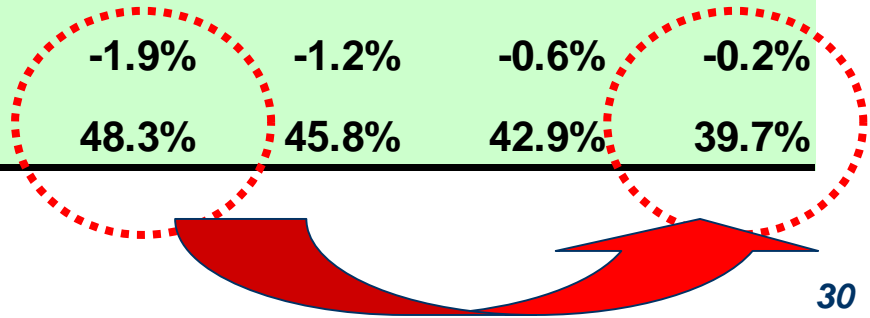
- ✓ Limit the growth of **personnel expenditures** of the Federal Government (ceiling = inflation + 1,5% per year).
- ✓ Create a **long-run policy for the minimum wage** (four-year policy – for 2008-2011: real growth rate = GDP growth of two years before).
- ✓ Create a **national forum of social security**, to propose both incremental changes and structural reforms.



# Fiscal Consistence

The increase in public investment is consistent with the reduction of the public debt and the budget deficit.

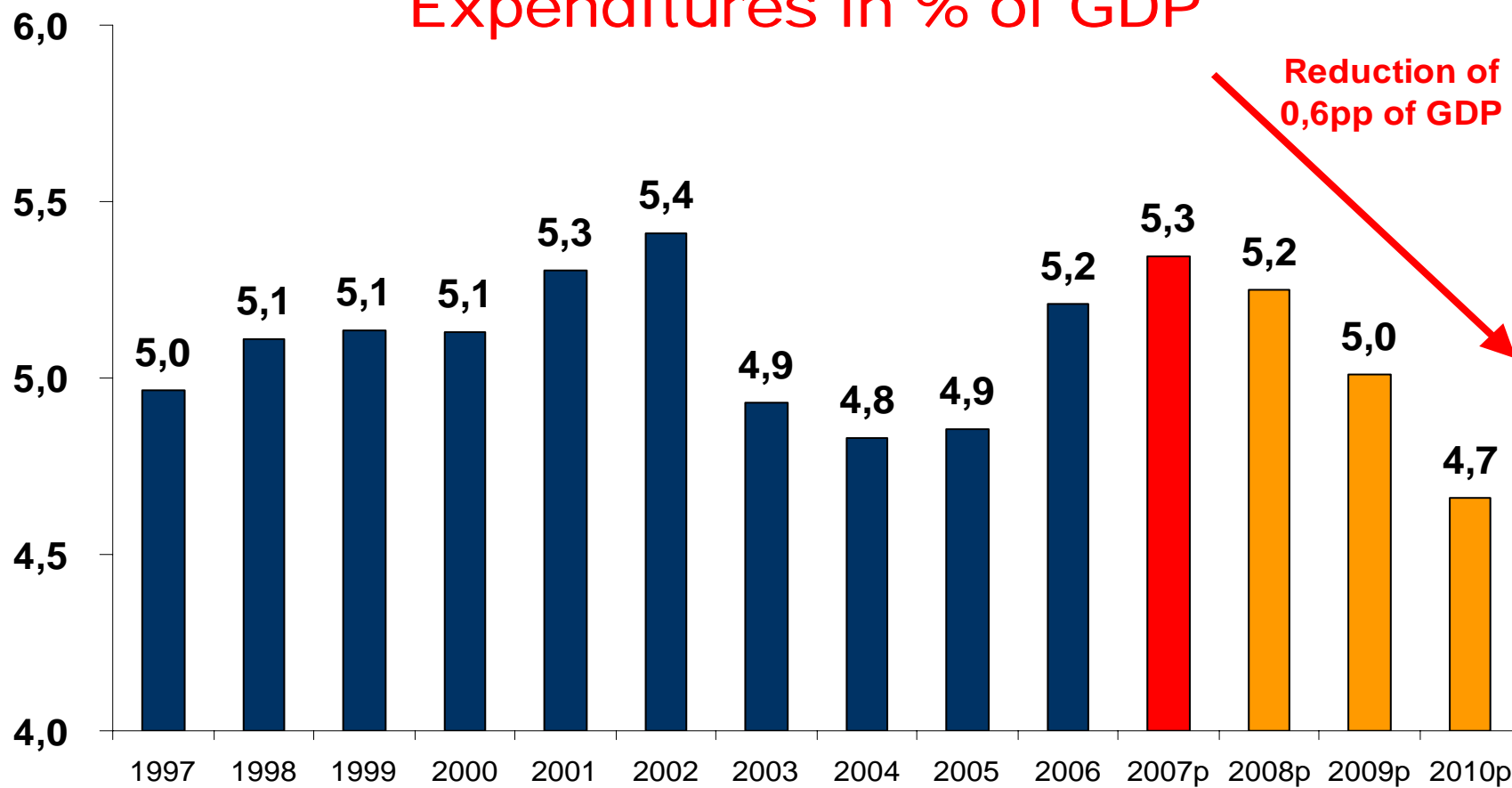
PAC Macroeconomic Scenario	2007	2008	2009	2010
Average Base interest rate (SELIC rate)	12.2%	11.4%	10.5%	10.1%
Inflation Rate	4.1%	4.5%	4.5%	4.5%
Real GDP Growth	4.5%	5.0%	5.0%	5.0%
Primary Surplus in % of GDP	4.25%	4.25%	4.25%	4.25%
PPI (Public Investment Priorities) in % of GDP	0.50%	0.50%	0.50%	0.50%
Net Interest Payments in % of GDP	5.6%	5.0%	4.4%	3.9%
Budget Surplus in % of GDP	-1.9%	-1.2%	-0.6%	-0.2%
Net Public Debt in % of GDP	48.3%	45.8%	42.9%	39.7%





# Fiscal Consistence

## Federal Government's Personnel Expenditures in % of GDP





# Fiscal Consistence

## Social Security Benefit Payments in % of GDP

