



International Bulletin

BNDES
Brazilian Development
Bank

Nº 17 – April 2012

HALF-YEARLY PUBLICATION

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Available at:

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1) WORLD PANORAMA

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The *World Economic Outlook*, published by the International Monetary Fund in April, shows the latest projections made by the institution for worldwide economic growth (Table 1.1). The document stresses that the global economy is currently undergoing a process of recovery, although still under the threat of the current Euro Zone and other domestic fragilities in other economies. Besides this, there are other risks to economic recovery, such as the problems related to financial regulation in Europe, the course of US tax policies, and the geopolitical factors related to oil.

The IMF predicts that global GDP will increase at a rate of 3.5% in 2012, against the 4.0% previously predicted in September. The reduced projection for growth is mainly due to the Euro Zone situation, which is expected to present a slight real fall in GDP this year as a result of not only the increase in sovereign risks, but also the effects of banks' deleveraging over the real economy and the impacts from tax adjustments made by most national governments in the region.

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Edition closed: 24/04/2012

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Besides this, a deceleration is expected in developing economies, which has been pulling the world economic dynamism over the last few years, due to the worsening foreign scenario, affecting export demands, as well as weakening domestic demand.

Table 1.1: World Growth Projections (%)

	IMF				IIF Projections	
	2010	2011	2012p	2013p	2012p	2013p
World	5.3	3.9	3.5	4.1	3.0	3.6
Advanced economies	3.2	1.6	1.4	2.0	1.3	1.7
US	3.0	1.7	2.1	2.4	2.5	2.5
Euro Zone	1.9	1.4	-0.3	0.9	-0.4	0.9
Germany	3.6	3.1	0.6	1.5	-	-
France	1.4	1.7	0.5	1.0	-	-
UK	2.1	0.7	0.8	2.0	-	-
Japan	4.4	-0.7	2.0	1.7	2.2	1.5
Developing economies	7.5	6.2	5.7	6.0	5.5	6.0
Brazil	7.5	2.7	3.0	4.1	3.2	5.2
Mexico	5.5	4.0	3.6	3.7	3.6	4.0
China	10.4	9.2	8.2	8.8	8.4	8.8
India	10.6	7.2	6.9	7.3	7.0	7.0
South Africa	2.9	3.1	2.7	3.4	2.9	3.7
Russia	4.3	4.3	4.0	3.9	3.5	4.0

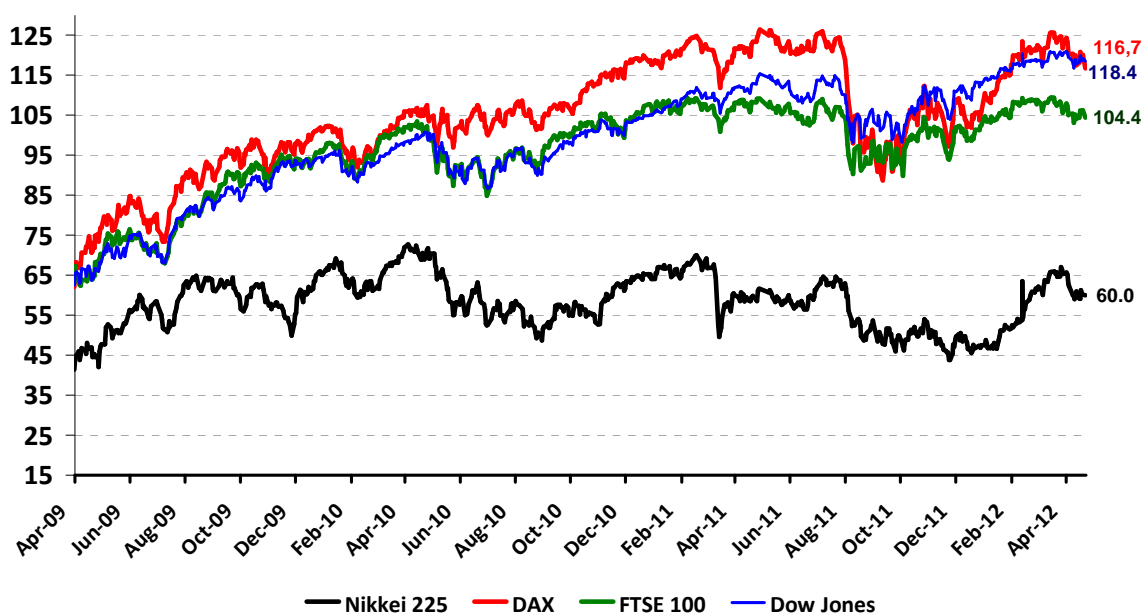
Source: IMF (World Economic Outlook, April 2012) and IIF (Global Economic Monitor, April 2012).

Over the last months in 2011, economic growth of developed economies outside the Euro Zone was above the expected. In the United States, a rise in consumer's confidence was noted, as well as a strengthening in gross formation of fixed capital and signs of the real estate market recovering. In Japan, recovery from the effects of the catastrophes in 2011 – the earthquake followed by a tsunami and the floods in Thailand – concerning production sectors is happening much quicker than expected. For this reason, although the country posted a real drop in GDP in the last quarter, it has been smaller than previously predicted. Nevertheless, emerging and developing economies, despite following a path of firm growth above the world average, are undergoing a deceleration that is slightly more intense than expected. This is due to the effect of the crisis in the Euro Zone on their import markets as well as the effects of contractionist policies adopted in the recent past, which have weakened their private expenditures.

For this reason, short-term predictions suggest that the deceleration process will tend to be gentler than previously predicted. The main challenge for the global economy is the intensifying crisis in the Euro Zone, interacting with domestic financial fragilities in other countries. The concerns over losses in the banking sector, added to the uncertainties with respect to the sustainability of the tax situation in the Euro Zone, have increased the sovereign risks in several countries in the region

to the highest levels since the European Union was created. At this moment of great uncertainty, banks have shown a strong preference for liquidity, reducing the offer of credit in the region. Despite the European Central Bank's initiative to refinance debts, which has forged confidence in financial markets and reduced the volatility of the flow of foreign capital over the last few months (Chart 1.1), the private banks' behavior has affected other economies around the world. More precisely, there was deterioration in credit operations in several developed economies, as well as a drop in capital inflow to developing economies from East Asia and higher volatility in exchange markets, with pressure for the Japanese Yen to appreciate and for Asia's emerging markets to depreciate.

Chart 1.1 – World Stock Markets (Base: 03/01/2007 = 100)



However, it must be made clear that risks faced by the world economy will not result in a new recession. It is expected that advanced economies are able to avoid a new recession, while developing countries decelerate from a path of higher growth. This pattern is expected to remain steady provided that the Euro Zone economic authorities maintain or intensify measures to combat the crisis. The basic interest rate adopted by the ECB was reduced from 1.50% to 1.25% per year in November and to 1.00% in December. A new cut is expected in the middle of this year.

On the other hand, according to the last edition of Global Economic Monitor prepared by the Institute of International Finance, the adjustment measures adopted in the Euro Zone have not worked as expected. That is, the monetary policy in the developed world has never been so loose; however, its results, in terms of aggregate demand, are disappointing and they may even be producing instability in the international financial and exchange markets. According to the institution, the liquidity trap characterized by the limited effectiveness of the monetary incentive

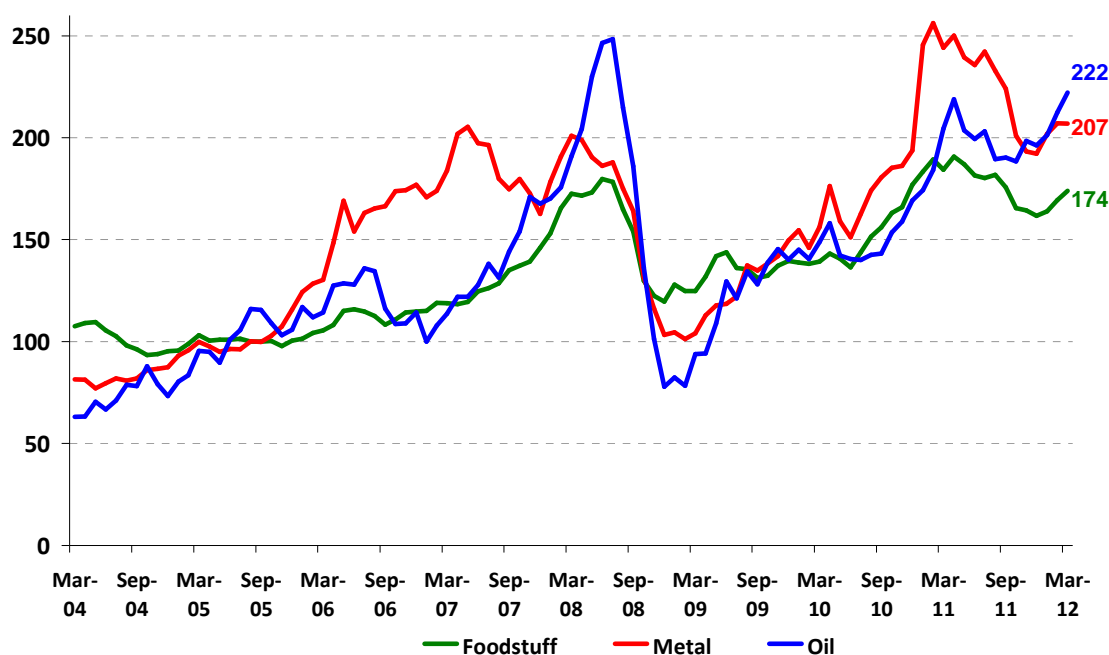
measures proposed by the ECB is a result of three main factors. First, the global ramifications of the European crisis raise uncertainty in credit markets, which promotes banks' aversion to risk worldwide. Second, the banks' preference for liquidity may be worsened by the structural changes in the European financial system, which were adopted as a consequence of the crisis that started in late 2008. Third, the capital inflow to East Asian economies fell in the last month as a consequence of the crisis in Europe. This last factor is a result both of the rising aversion to risk on a global level since investors avoid bonds from less developed countries – seen as riskier. It is also due to the negative wealth-effect of European investors (individual investors and financial institutions), which facing losses in the value of their assets owing to the crisis, now need to adjust their investment portfolio, withdrawing capital from emerging economies.

Given the current scenario, the IMF projects the Euro Zone will suffer a brief recession in 2012, in which GDP will present a fall of 0.3%. This figure was reduced by -0.5 pp with regards to projections for September 2011, because of not only the rising sovereign risk in countries in the region, but also the effects of banks' deleveraging on the real economy, and the impact of new tax adjustment measures on aggregate demand. As for other developed countries, the institution foresees positive growth, even though it is expected to be less than previously expected, given the lack of room to expand macroeconomic policies and spreading adversities from the European economy via international markets, exacerbating domestic financial difficulties in these countries.

In developing economies, modest growth is projected for this year at 5.70%, against the 6.25% forecast in September. The revision is due to deterioration in the foreign scenario and the deceleration of domestic demand in the main countries in the group. Among these countries, Asia is expected to remain in the lead of the group's economic growth, with 7.30% against the 8.25% projected in September. On the other hand, it is expected that the more intense impacts from the crisis will take place on Central Europe and East Europe economies, which maintain the strongest commercial ties with the Euro Zone. Concerning other developing economies, the impact will be softer as governments have certain levels of privilege to act within macroeconomic policies, as a way to mitigate the effects of smaller demand in developed economies and more aversion to risk in global markets.

Oil prices remained steady over the last month due to an expansion in world production. Nevertheless, even with decelerating global economic activity, prices will only marginally retract this year, as geopolitical risks – especially in the Middle East – will remain high for an unspecified term. Besides this, increasing demand in undeveloped countries will present more sway, as it will continue to grow at a rate higher than the average in the world economy. Finally, oil will be used as a hedge by financial investors, given the current situation of the markets, in which international interest rates are low and the currencies in developed countries suffer pressure to depreciate. With regards to other commodities, it is hoped that prices drop over the year due to the combined effect from the positive evolution of supply and the international deceleration in demand (Chart 1.2).

Chart 1.2: Index of commodity prices (Base: Average in 2005=100)



Globally, inflation may decelerate this year, maintaining the same course as the last few months, that is, following a trend of deceleration in aggregate demand and stabilization of or reduction in commodity prices (Table 1.2). In advanced economies, it is expected that the elevated gap in product, together with the market situation and the stability of market perspectives, maintains pressure on prices and reduces the effects of the increase in commodities from last year even more. On average, the variation in index prices to consumers in these countries are expected to remain close to 1.5% this year against 2.75% in 2012, according to IMF forecasts. In developing economies, on the other hand, pressure may also lessen this year due to a slowdown in growth and food pricing, although at different levels in each the country. Inflation may diminish considerably in East Asia and only moderately in Latin America, whereas in India and Indonesia, whose economies operate at the limit of their capacities, the tendency is to accelerate. The IMF projects average inflation close to 6.25% in these countries in 2012, 1pp lower than that registered in 2011.

Table 1.2: Index of Prices to Consumers (%) – Selected Countries

Month	US		Euro Zone		Germany		UK		Japan		China	
	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr
Sep-11	0.3	3.9	0.8	3.0	0.3	2.6	0.6	5.2	0.0	0.0	0.5	6.1
Oct-11	0.0	3.5	0.3	3.0	0.1	2.5	0.1	5.0	0.1	-0.2	0.1	5.5
Nov-11	0.1	3.4	0.1	3.0	0.1	2.4	0.2	4.8	-0.6	-0.5	-0.2	4.2
Dec-11	0.0	3.0	0.3	2.7	0.0	2.1	0.4	4.2	0.0	-0.2	0.3	4.1
Jan-12	0.2	2.9	-0.8	2.7	0.2	2.1	-0.5	3.6	0.2	0.1	1.5	4.5
Feb-12	0.4	2.9	0.5	2.7	0.3	2.3	0.6	3.4	0.2	0.3	-0.1	3.2
Mar-12	0.3	2.7	1.3	2.7	0.3	2.1	0.3	3.5	-	-	0.2	3.6

Source: U.S. Department of Labor, Eurostat, Destatis, U.K. Office for National Statistics, Ministry of the Interior and Communications (Japan), National Statistics Office (China)

% yr: 12-month accumulated variation

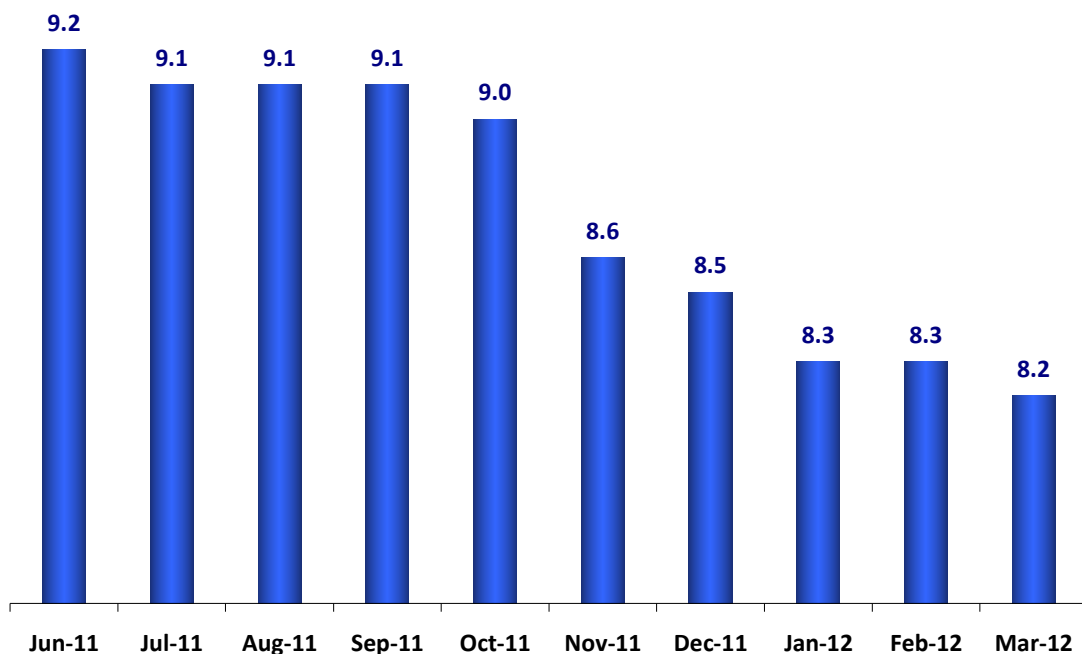
Recent Economic Performance

United States

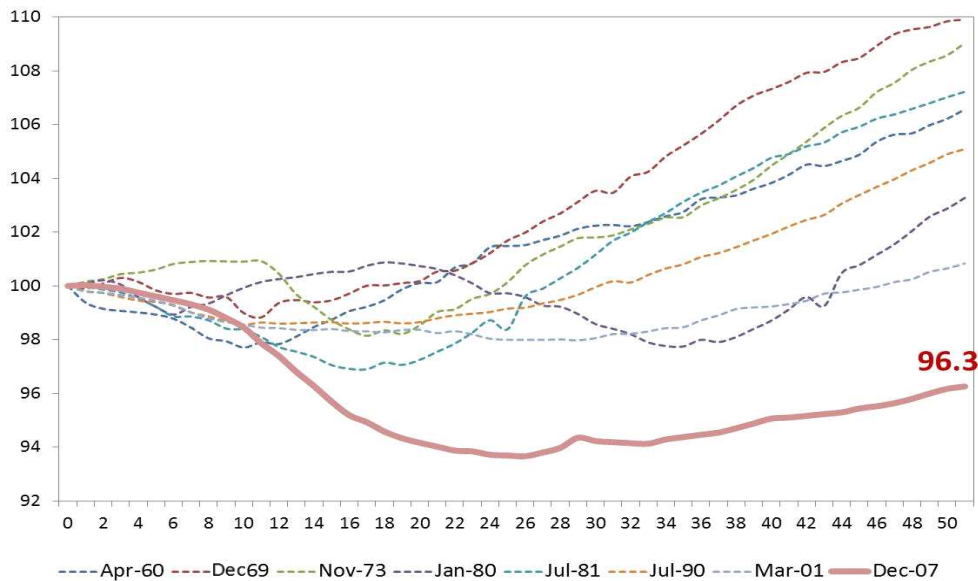
In the United States, in accordance with the Bureau of Economic Analysis, GDP registered growth of 3.0% in the fourth quarter of 2011 in comparison to the quarter immediately before. Highlights include the rise in household consumption, in the gross formation of fixed capital, and in real estate investments. On the other hand, a drop in federal, regional and local government spending was posted along with an increase in imports. In the same quarter in 2010, growth was 1.6%. In the accumulated growth for 2011, the North American economy grew 1.7%.

The highlight of the North American economy over the last few months is the labor market data. The continued reduction in unemployment rates as well as the lower volume of new weekly requests for unemployment benefits in the last four years seem to be a sign of a faster recovery of the country's economic (Chart 1.3). However, the recovery in employment rates in the country is slower than any other post-crisis moment in the last 50 years, as shown in Chart 1.4.

Chart 1.3 – Unemployment Rates (US)



**Chart 1.4 – Recovery in employment in the US
Compared to recessions since 1960
(t = 0 in the month immediately after the beginning of a recession)**



Source: Bloomberg; prepared by: APE-BNDES

The macroeconomic economy is favorable to a return in GDP growth. With regards to tax policy, it is expected that Congress will maintain the current tax cut programs on salaries and unemployment benefits.

Concerning monetary policy, over the last few months, the Federal Reserve adopted measures for qualitative changes, aiming, at the same time, to loosen liquidity in the country even more, and to improve its communication with the public. The group of measures adopted can be grouped in four main items. First, to maintain the interest rates on government bonds exceptionally low, with a ceiling of 1.0% per year until the end of 2014, approximately one year longer than previously decided. Second, to consider the possibility of a new government bond purchase program (Quantitative Easing 3 program). Third, to allow the publication of individual forecasts by members of the Federal Open Market Committee (FOMC), with respect to interest rate evolution in the country. Fourth, to adopt the explicit inflation target of 2.0% per year. The measures have the expected effect of advising private agents that the FED is eager to continue contributing to the country's economic recovery and consequently the market's revival.

Historically, the North American real estate sector is one of the first to recover from a macroeconomic recession. In a contemporary framework, recent indicators are optimistic regarding the sector's performance (Table 1.3). Real estate sales, for example, have registered annual growth for eight consecutive months. Moreover, in February the number of residencies built, as well as licenses for new buildings, grew more than 34% in relation to the volume registered in the same month in 2011. Nevertheless, currently the impact of this sector on the country's recovery, albeit positive, is well short of that expected for three main reasons. Firstly, supply of residencies is high due to a construction boom in the last decade.

Secondly, mortgage conditions to the sector are unfavorable and aggravated by a great number of mortgaged houses. Finally, all this recent growth has taken place during a depression and is still considerably lower than the pattern previous to the 2008 financial crisis. In this sense, it is suggested that policies carried out by the Federal Reserve should help the sector rise up once again, especially regarding regulation of real estate credit.

Table 1.3: North American Real Estate Sector Indicators

Mês	Expenditure on Building		Licenses for New Buildings		Building of New Residences		Sales of Existing Real Estate		Sales of New Real Estate		Real Estate Price Index	
	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr	% mon.	% yr
Sep-11	0.2	-1.3	-5.8	5.7	7.7	10.2	-3.0	11.1	5.7	-0.9	0.3	-3.7
Oct-11	0.8	-0.4	10.9	17.7	-0.3	16.5	1.4	13.6	1.3	8.9	-0.9	-2.8
Nov-11	1.2	0.5	5.7	20.7	9.3	24.3	4.0	12.2	1.6	9.8	0.7	-1.8
Dec-11	1.5	4.3	-0.1	7.8	-4.1	24.9	5.0	3.6	-2.2	-7.3	0.1	-0.8
Jan-12	-0.1	7.1	0.7	19.0	1.5	9.9	4.3	0.7	-0.9	3.5	0.0	-0.8
Feb-12	-1.1	5.8	5.1	34.3	-1.1	34.7	-0.9	8.8	-1.6	11.4	0.3	0.4
Mar-12	-	-	4.5	30.1	-5.8	10.3	-2.6	5.2	-7.1	7.5	-	-

Source: U.S. Department of Commerce, National Association of Realtors, Federal Housing Finance Agency

% year: monthly variations compared to same month in previous year

Europe

The Euro Zone went through a moderate recession in the second half of 2011. According to Eurostat, the Euro Zone GDP, which includes seventeen countries, fell 0.3% in the fourth quarter of 2011 in comparison to the quarter immediately before. In this pattern of comparison, all components of aggregate demand presented a negative performance: household consumption (-0.4%), gross formation of fixed capital (-0.7%), exports (-0.4%) and imports (-1.2%). The economy grew 0.7% in the quarter in comparison to the same quarter in the previous year and 1.4% in the accumulated result for 2011. Yet, given the current factors in the region's economy – fiscal tightening, deleveraging of banks and persistent financial tensions – the development of GDP was above expectations. Besides this, the GDP performance is different among economies in the region. On the one hand, peripheral economies have been in a vicious cycle of fiscal tightening and falling GDP since 2010, which has worsened the effects of the crisis for them. On the other hand, central economies are undergoing a less pronounced deceleration, even if recovery, which started in the third semester of 2009, was interrupted.

According to the Purchasing Managers Index (PMI) published by the Markit Economics Institute, the economic situation in the Euro Zone still presents a reduced rhythm in activities, both in the manufacturing and the services sectors; this tendency should come to light in the next GDP estimate as Table 1.4 shows. The performance of the services sector is slightly better than the manufacturing sector, according to latest results for the region's industrial production (-1.8% in December

in comparison to December 2010), besides the stable confidence of consumers over the last few months. Moreover, the performance of large economies, especially Germany, the United Kingdom and, albeit on a lower scale, France, is higher than the average performance of countries in the region. This strengthens the conclusion that the current crisis is more intense in Europe's peripheral countries.

Table 1.4: Purchasing Managers Index (PMI) – European Countries

	Euro Zone		Germany		France		UK	
	Manuf.	Services	Manuf.	Services	Manuf.	Services	Manuf.	Services
Sep-11	48.5	48.8	50.3	49.7	48.2	51.5	50.8	52.9
Oct-11	47.1	46.4	49.1	50.6	48.5	44.6	47.8	51.3
Nov-11	46.4	47.5	47.9	50.3	47.3	49.6	47.7	52.1
Dec-11	46.9	48.8	48.4	52.4	48.9	50.3	49.7	54.0
Jan-12	48.8	50.4	51.0	53.7	48.5	52.3	52.0	56.0
Feb-12	49.0	48.8	50.2	52.8	50.0	50.0	51.5	53.8
Mar-12	47.7	49.2	48.4	52.1	46.7	50.1	52.1	55.3
Apr-12	46.0	47.9	46.3	52.6	47.3	46.4	-	-

Source: Markit Economics Institute

Obs: over 50, the index shows the sector expansion; below this number is a reduction

The sovereign debt crisis continues to be a potential risk to the European economic panorama. Nevertheless, this risk may be considered low due to the possibility of the European Central Bank (ECB) adopting new aggressive measures to generate liquidity in the region's economy. However, even if these new policies are adopted, expectations are not for a short-term positive performance in GDP, as of shown by the PIM index in the last quarter, since domestic demand is restricted by fiscal contraction and by less availability of bank credit to the public. These factors are reflected, in the first place, in the Euro Zone's insignificant performance in the retail sector, which has accumulated negative annual results since May 2011. For this reason, forecasts for the near future concerning the European economy are for a slight fall in GDP in the short-term and a slow recovery in the mid-term.

On the other hand, with regards to monetary policy, it is noted that ECB maintains an effective systemic barrier to contain the crisis. In December 2011, the institution approved refinancing for long-term operations up to three years, with the injection of 190 billion Euros in the markets. These operations may guarantee two main potential positive effects. Firstly, reduced loans costs in the inter-bank market caused by higher confidence in financial markets. Secondly, concerns over long-term liquidity may facilitate credit inflow to the real economy, as a way to reverse the current tendency of even less availability of bank resources to non-financial businesses and households. According to disclosed reports, immediately after the policy's announcement, an improvement in the economic agents' confidence was noted as well as a reduction in the costs of loans across the region.

In peripheral economies, perspectives are even less promising. The competitiveness of these countries has been on the wane since the Euro was introduced due not only to labor costs outstripping those of their business partners, but also to a drop in productivity gains and exchange rate appreciation. Even with all the changes implemented since the 2008 crisis, it is estimated that only half the drop in competitiveness since the Euro was adopted was reverted.

Japan

In Japan, the Statistics Bureau informed that GDP registered a fall of 0.2% in the fourth quarter of 2011 compared to the quarter immediately before, as a result of the 11.8% drop in exports and the 8.4% decline in of public investments. On the other hand, highlights include the 20.7% rise in non-residential private investments and the 10.3% increase in gross formation of fixed capital. Compared to the same quarter in 2010, the country's economy registered a 0.6% decrease. The performance of the Japanese economy is especially influenced by the decline in companies' inventories and negative pressures from the foreign sector.

Exports accumulated losses of 12.0% in 2011, registering negative results since October 2011 in the annual comparison. In January this year, the country registered a commercial deficit of 1.3 trillion Yen. This was due to three reasons: first, the impact of the floods in Thailand on the electronic and automotive production chains; second, the persisting appreciation of the national currency; third, the drop in foreign demand. However, imports increased by approximately 12.0% per month over the last six months, boosted by the growing demand for fossil fuels, considering the current difficult situation of the country's nuclear complex.

According to the Economy Watchers Survey, a document released by the Bank of Japan (BoJ), domestic demand in the country maintained a moderate path to recovery, persistent over the last few months. Household consumption has been stimulated by subsidy programs in the automotive sector adopted by the national government. With regards to companies' expenditures with investments, the highlight is in the building sector; especially as a consequence of rebuilding infrastructure after the catastrophes that took place in the beginning of last year. In this sector, employment rates have risen for 23 consecutive months.

In 2012, it is expected that the country will maintain a moderate path to economic growth, lead by reconstruction works, which are expected to maintain domestic demand in the short-term. As for long-term forecasts, a recovery in exports is expected since the problems caused by the floods in Thailand should be solved soon.

The country's monetary policy is favorable to aggregate demand. The Bank of Japan broadened its assets purchase program to the amount of 65 trillion Yen, reducing the cost to issue public bonds which has fallen due to reconstruction works. Besides this, the explicit inflation target of 1.0% per year indicates that new

expansionist measures will appear as the latest data released on the price index for consumers reveals an annual rise of 0.3% in February.

Nevertheless, the future of the Japanese economic dynamism is surrounded by major uncertainties, especially with respect to its energy sector. The earthquake which took place in March 2011 severely reduced the country's energy production capacity since two thirds of Japanese nuclear power plants were closed after Fukushima's leak, which affects investment decisions and company production. This way, the country is becoming more dependent on foreign energy sources, especially fossil fuels, affecting the balance of payments and the current account balance over the last few months. Added to this is the growing fiscal deficit due to national infrastructure reconstruction works, with an additional effect from maintaining the appreciation of the national currency.

Emerging Countries

According to IMF estimates released by the World Economic Outlook in April 2012, emerging economies, as a whole, grew 6.2% in 2011. The estimated growth in Latin America and the Caribbean was 4.6%, while Asia rose 7.9% (see Table 1.1). The economic scenario, as well as the short and long-term challenges, is different among the countries in the two groups.

Asian emerging economies overcame the effects of the 2008 financial crisis and managed to come to grips with moments of great uncertainty in the international scenario. Nevertheless, maintaining the current growth model focused on exports may make these economies vulnerable to prolonged deceleration in foreign demand.

For this reason, the consequences of the international financial crisis are gradually determining the macroeconomic panorama in the region. Uncertainties concerning the Euro Zone's future, aggravated by the implementation of increasingly stricter bank regulation measures, increase the global demand for liquidity in strong currencies (especially the dollar). Countries from East Asia, due to their massive supply of liquidity deriving from foreign investments and commercial surplus, are becoming source for resources and, consequently, are suffering huge capital outflows. Such capital outflows heat up the exchange markets, placing pressure so that local exchange rates depreciate in relation to the dollar. To prevent this pressure from boosting inflation, central banks in the region are trying to sterilize it, burning reserves in foreign currency. Even China, a country that maintains a strict system to control foreign capital has shown deterioration in its current accounts, with higher Chinese investments in the foreign framework and smaller volumes of foreign capital flowing in.

With the relative change in the financial circumstances at the end of 2011, thanks to refinancing operations adopted by the European Central Bank, which allowed an improvement of the confidence level in financial markets and a relief in

the preference for dollar liquidity by the part of investors, the tendency for foreign influence on the Asian macroeconomic panorama has changed. Countries began, once again, to receive foreign capital inflows over the last few months and the pressure on its exchange rates also moderated. However, private equity fund prices are still out of date, especially in more mature economies in this region.

In China, according to the National Bureau of Statistics, GDP registered a growth of 8.1% in the first quarter of 2012 in comparison to the same period in the previous year. The highlight was growth in the industrial sector (9.1%). In comparison to the quarter immediately before, growth was 1.8%.

In India, high deficit in current accounts along with dependence on foreign financing has generated increasing vulnerability in the country with regards to the situation in international financial markets. In the last month of 2011, before the new ECB measures came into effect, the country accumulated a loss of 24 billion dollars in reserves. Even with the European debt crisis slowing down, the country's current accounts worsened with the drop in exports, a trend that it followed throughout the second half of 2011. India's situation is similar to Indonesia's and Malaysia's.

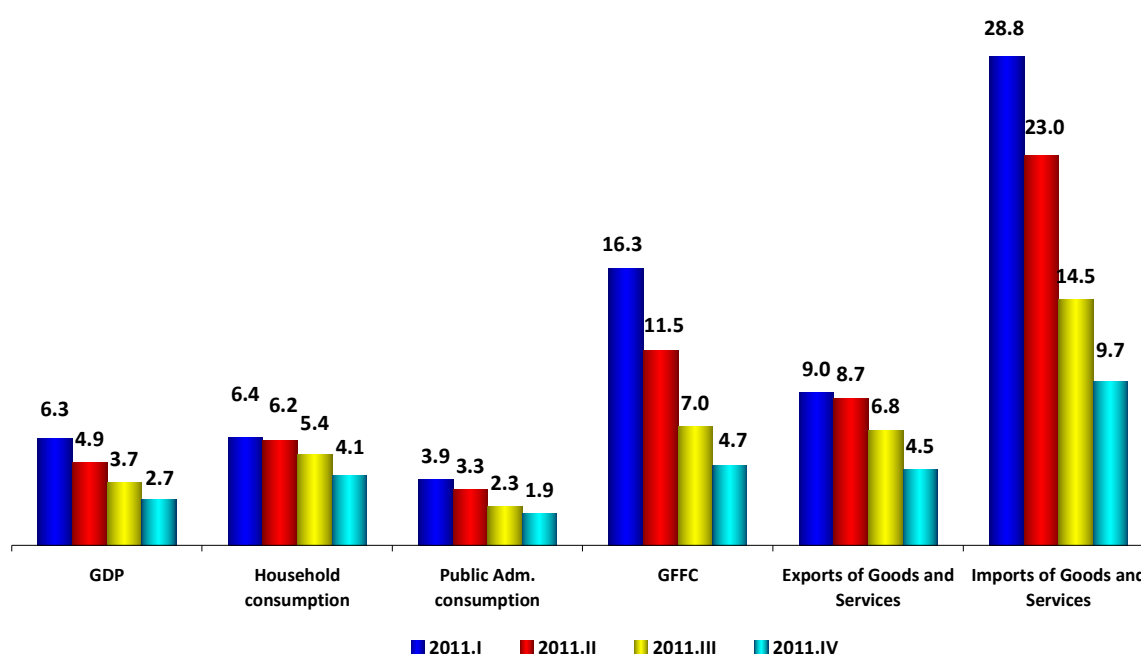
In Latin America, economies were, in general, more intensely affected by the European crisis than Asian economies. This contamination was due to the fall both in exports and in the confidence of economic agents regarding the future. Nonetheless, in the first few months of 2012, recovery began thanks to the relative recovery of the world economy and the loosening of monetary policies in several countries in the region. Inflation is declining despite being over the target in many countries. This happens due to the recent GDP growth falling below the historical average, which reduces the companies' bargaining power with their products.

Brazil

In Brazil, according to some data released by the IBGE, the gross domestic product at market prices together with seasonal adjustments presented a positive variation of 0.3% in the fourth quarter of 2011 in relation to the quarter immediately before, reaching R\$1.09 trillion Real in current values. In comparison to the fourth quarter of 2011, GDP at market prices registered a growth of 1.4%. The highlight was agriculture and cattle-raising with a growth of 8.4%, justified not only by the performance of some products with relevant crops in the quarter, but also by the growth in harvest productivity in 2011 proportionally related to the planted area. Industry fell 0.4% due to the transformation industry (-3.1%). Services showed a rise of 1.4% with highlights including information services (4.6%). Among the components of aggregate demand, exports of goods and services were the high point (3.7%). Household consumption grew 2.1%, the 33rd consecutive positive variation in this level of comparison.

In 2011, GDP at market prices grew 2.7% in relation to the previous year, as shown in Chart 1.5. Thanks to this growth, GDP *per capita* reached R\$21,252.00 (in current values), an increase of 1.8% in relation to 2010. Agriculture and cattle-raising rose 3.9%, influenced by productivity gains and favorable climate conditions. Industry grew 1.6%, and highlights include the energy and gas subsector, water, sewerage and urban cleaning (3.8%). Services grew 2.7%, boosted by the information services subsector. In aggregate demand, the highlight was growth of 4.7% in gross formation of fixed capital, driven by civil construction and influenced by growing machinery and equipment imports.

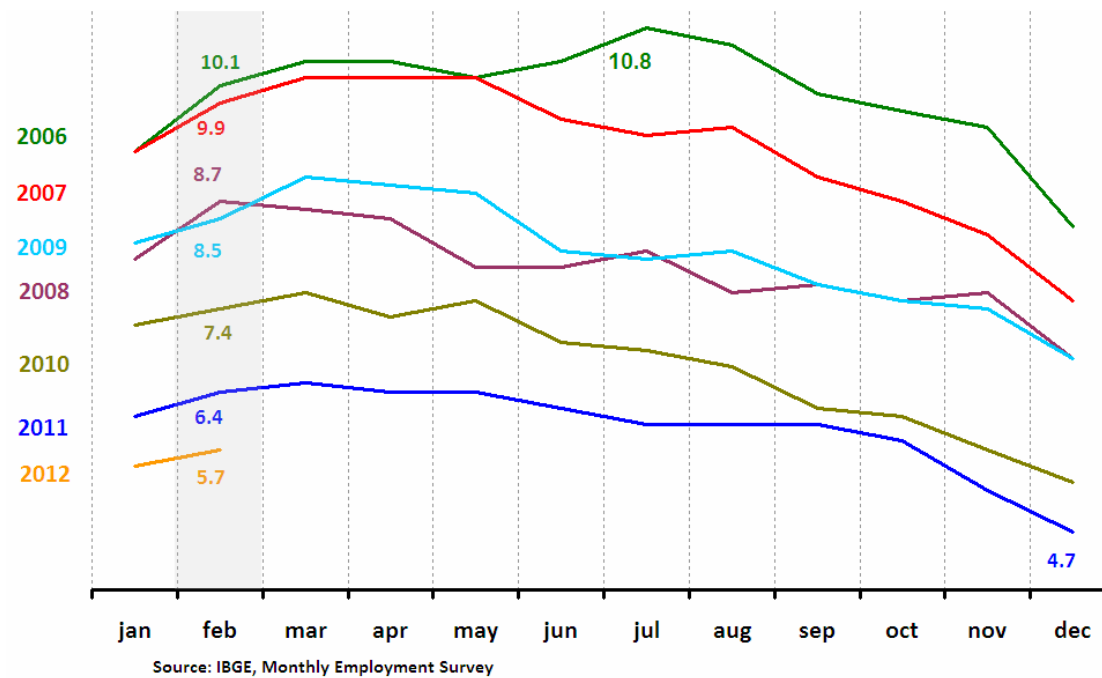
Chart 1.5: Components of Demand - Variation Rate in Relation to the Previous Year (%)



The recent Brazilian economic scenario is characterized by slowing of activities, which has been happening since the beginning of the second half of 2011. The main causes of this are the macroprudential measures adopted in late 2010 and the rising Selic tax in the first half of 2011, both policies adopted to contain the growth rhythm of the economy up to that moment, which was associated with growing inflation to a level higher than the limit of the target followed and disclosed by the Central Bank (6.5% per year).

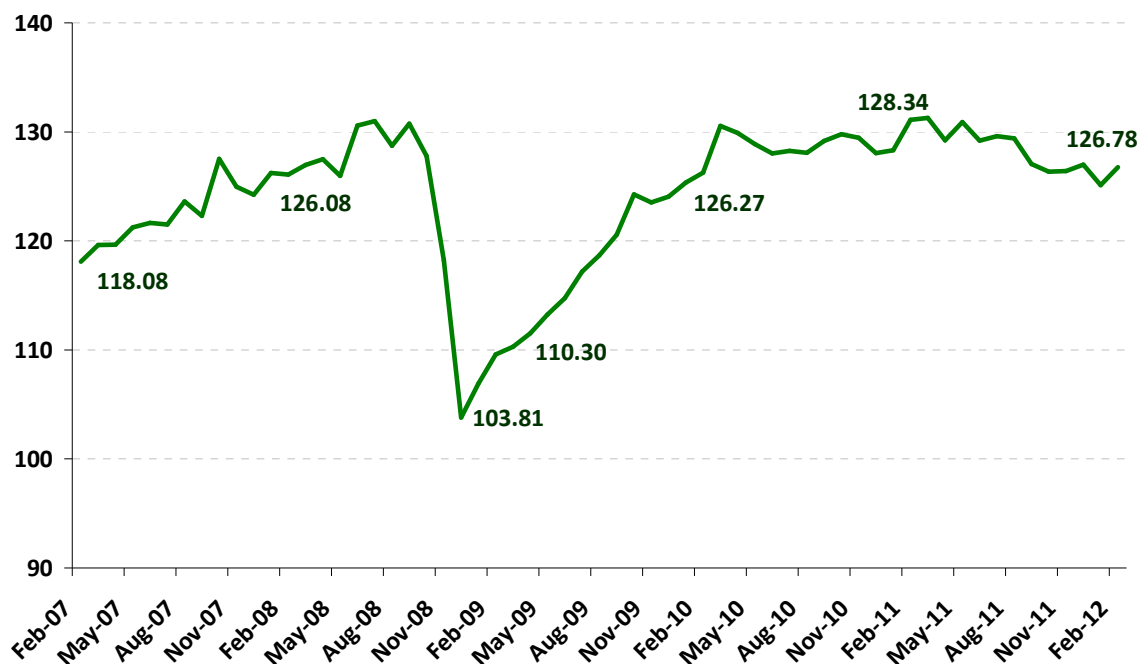
Even with the slowdown in the economy, several components in aggregate demand still presented signs of growth at the end of 2011. The labor market situation, in which the low rate of unemployment is tied to the maintenance of real income at high levels, kept the confidence of consumers high, with positive influence on household consumption (Chart 1.6).

Chart 1.6 – Unemployment Rate in Brazil (%)



Analyzing GDP under the perspective of production, industry's performance largely explains the drop in the rhythm of the country's economic activity. Except for the first three months of 2011, which posted accumulated growth of 3.4% on an annual basis, the performance of country's industrial production has stayed on the path to stagnation, according to Chart 1.7. The poor performance of the manufacturing sector reflects problems connected to its low competitiveness, which is explained especially by structural factors. Among these factors, highlights are the over appreciated exchange rate, the high tax burden, bottlenecks resulting from the country's poor infrastructure, aggravated by the low level of public investments, and the fiscal tightening carried out at the end of 2010 until mid 2011.

**Chart 1.7 – Industrial Production in Brazil (%) – Index with Seasonal Adjustment
(base: Average in 2002 = 100)**

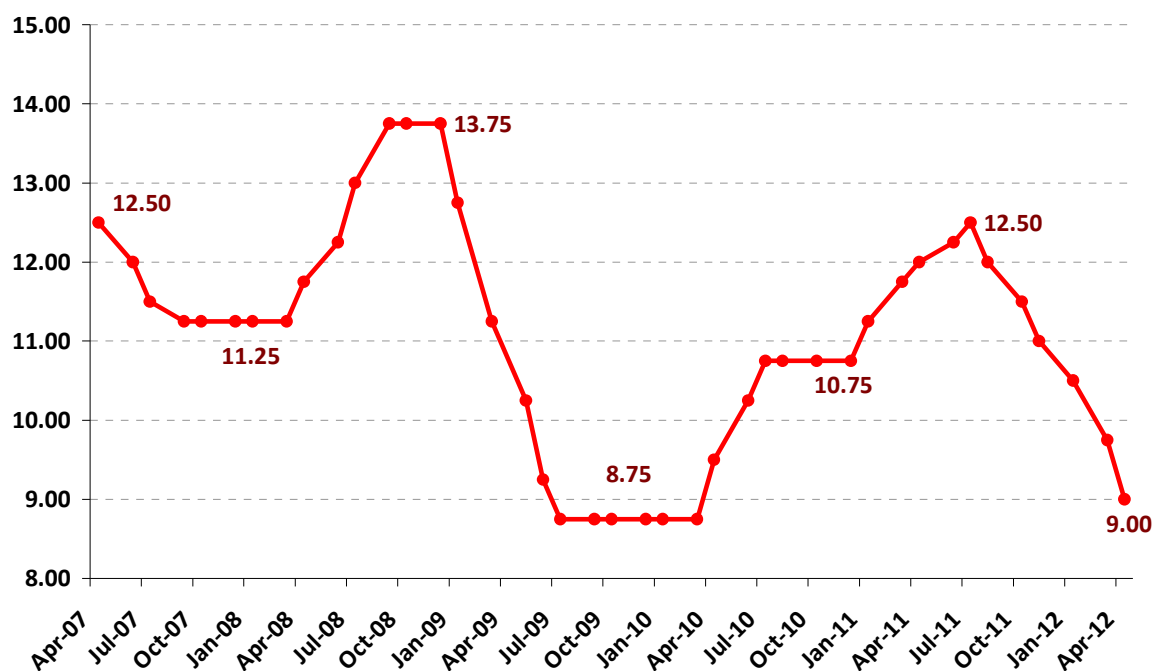


In the last quarter of 2011, the slowdown in the Brazilian economy intensified and became across the board, at the same time that industrial production continued to decrease, worsening its loss of competitiveness. Associated with the fear that the slowdown may affect sectors connected to aggregate demand and to the international scenario currently in difficulty, this led Brazil to change the direction of its economic policy – both monetary and fiscal – in the last months of 2011.

From the monetary policy point of view, a drop in the basic interest rate from 12.50% per year in July, to 9.00% in April this year (Chart 1.8). Besides this, part of the macroprudential measures adopted in December 2010, such as the requirement for extra capital for mid-term credit operations and credit restrictions on the acquisition of vehicles, came to an end.

Considering the fiscal policy, recent approval was given to a group of measures for tax incentives with a rather wide scope, covering several sectors of the Brazilian economy, especially industry, retail, construction, as well as publicly-listed companies and consumers in general. Also, there was also an indication of growth in public investment, with the expansion of debt limits for states, which will be able to contract new loans from the BNDES and other international financial institutions, such as the World Bank (IBRD) and the Inter-American Development Bank (IDB)

Chart 1.8 – Basic Interest Rate –COPOM Decisions (%)



For this reason, expectations are for the Brazilian economy in 2012 to resume growth, stimulated not only by the measures adopted in the last few months, but also by the rising minimum wage, which should drive household consumption. The return to growth is made evident by the stable and low unemployment rate and increased confidence of the consumer concerning the future.

Box 1.1: Macroeconomic performance in commodity-exporting countries and foreign vulnerability

Commodity prices presented considerable growth over the last decade, interrupted only by the global financial crisis in 2008-2009 (Chart 1.2). Late 2011, average real prices of raw-material for energy and metals were approximately three times higher than in the previous decade, reaching and even surpassing 40-year long record levels. Food and unprocessed raw-material have already appreciated, although they continue lower than the level reached in the 1970s. The main cause for this trend, according to studies, is the pressure of global demand, due to sustained economic growth in emerging economies.

Within this context, an important debate arises regarding the impact of commodity appreciation on the macroeconomic performance in countries which export them. More specifically, evidence is sought to answer three main questions never solved by economic theory. First, how do the economies of commodity-exporting countries present different sensitivity to the price cycles of their products? Second, how are these differences revealed according to the type of commodity exported? Third, how is sensitivity affected when commodity prices are modified due to supply in its own market and demand in the global economy?

Economics evidence indicates that commodity exporters presented stronger macroeconomic performance in the 1970s and 2000s, when prices of these products were higher on the world market rather than in the 1980s and 1990s, when prices were relatively low. Real GDP growth for commodity exporters was between 1.5 and 3.0 pp higher in the 1970s and between 2.0 and 4.0 pp higher in the 2000s than in the period before. Besides this, inflation rates in those times were lower when commodities were expensive, while there was higher financial stability back then. Finally, in the 2000s, metal and energy exporting countries presented better macroeconomic performance than other commodity exporters, as shown in the table below.

Table 1.5: Macroeconomic Performance of Commodity Exporters (1970-2010)

Groups of Countries	1970-1979	1980-1999	2000-2010	Average 1960-2010
Real GDP Growth (percentage points)				
Energy Exporters	5.6	2.5	4.6	4.3
Metal Exporters	5.6	2.2	6.4	3.5
Foodstuff Exporters	5.1	2.9	4.5	4.0
Raw-material Exporters	5.0	3.3	5.3	4.3
Differential in real GDP growth in relation to emerging economies that do not export commodities (percentage points)				
Energy Exporters	1.1	-0.8	-0.8	0.5
Metal Exporters	2.0	-1.8	0.5	-0.4
Foodstuff Exporters	0.6	-0.8	-0.6	0.2
Raw-material Exporters	1.4	-0.6	0.2	0.5
Average Inflation (percentage points)				
Energy Exporters	8.6	14.4	6.6	12.5
Metal Exporters	8.4	22.5	9.2	16.1
Foodstuff Exporters	6.4	13.2	7.3	10.7
Raw-material Exporters	4.6	12.4	6.8	10.1

Source: IMF

Source: IMF, WTO April, 2012

That is, the macroeconomic performance of commodity exporters tends to follow the price cycle, improving during periods of appreciation and falling during periods of depreciation. This pattern is evident for four defined types of commodities. According to IMF calculations, the effect is magnified in accordance with the size of the cycle and the size of the variation in the commodity price. Studies also estimated that real average economic growth in these countries is between 0.5 pp and 1.25 pp lower in depreciation cycles than during moments of appreciation.

Nevertheless, it was also noted that energy and metal exporters are more vulnerable to product price oscillations than food and unprocessed raw-material exporters. This is due to, among other factors, a possible effect of royalties on public

resources in these countries. Besides this, these goods are industrial inputs and are more susceptible to real cycles in the global economy, besides generally occupying a large proportion of the export list and the GDP in their production countries. Vulnerability is even higher if countries adopt fixed exchange rates or higher capital mobility since the dynamics in financial markets tend to be pro-cyclical, restricting credit in moments of greater uncertainty in the global economy, which coincide with recessions and depreciation of commodities.

The performance of exporters is also different for the distinct sources of commodity price variations. Demand shocks usually have a significant effect on GDP in these countries. The effect is even higher for energy exporters, especially oil producers. Supply shocks, on the other hand, are not always significant, in a way that the effects of reduced production and high prices (or vice-versa) may cancel each other out in the evolution of GDP in these countries.

Therefore, commodity exports may allow accelerated economic growth in developing economies. However, their economic cycle is connected to the price evolution of the commodities exported, which depends, especially, on the world economic performance. Vulnerability is raised if it is combined with domestic financial markets exposed to global uncertainties or in oil exporting countries. For this reason, it is recommended that developing countries protect themselves from such vulnerability and invest in economic structure, taking into consideration the depletion of natural resources, the social and intergeneration equanimity, and the challenges brought by possible cases of the Dutch disease. Moreover, any policies adopted should consider the specific conditions in each country, the production structure of the commodity, the national institutional capacity and its level of development.

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2) GLOBAL FOREIGN INVESTMENTS - PERFORMANCE AND TENDENCIES

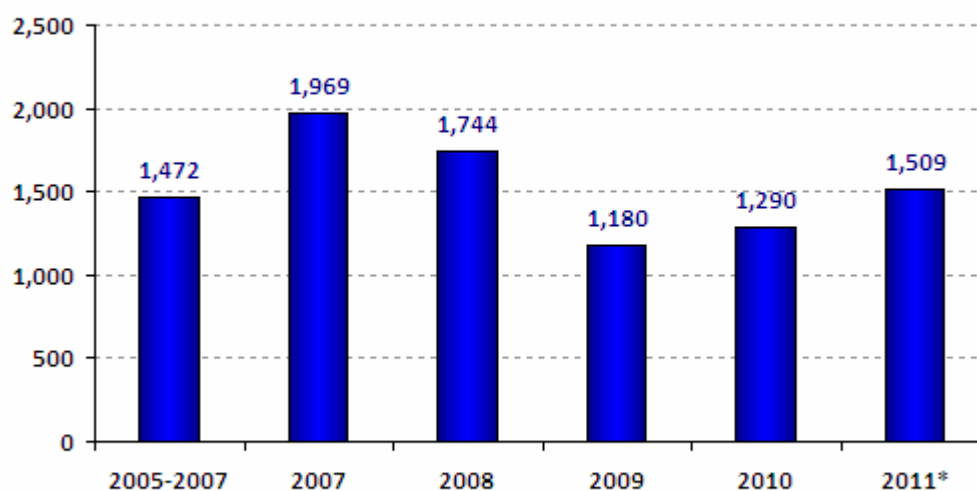
Preliminary data show recovery of FDI to pre-crisis levels

The preliminary statistics from the United Nations' Conference on Trade and Development (UNCTAD) show good performance in global inflows of direct investment in 2011, which has not only grown for two consecutive years, but also recovered the average level registered in the years prior to the economic crisis (Chart 2.1). The US\$ 1.5 trillion in estimated total inflow confirms UNCTAD's base scenario, for now (see International Bulletin Nº. 16).

The rise in investment inflow gained strength last year: variation was 17% against 9% in the previous year. Another important difference regarding the recent past was the fact that the increase in inflows was common to all groups of countries, especially developed nations, which, in the three previous years, presented a fall in investments received (table 2.1). These results are surprising considering that over almost the entire period there was a sense of uncertainty in relation to the future of the world economy, especially in the United States and in Europe.

Chart 2.1 - Evolution of FDI Flows in the World

Inflows in US\$ billion



Source: UNCTAD; Global Trade Investments Monitor, Jan. 2012

* Preliminary data

Table 2.1 - FDI Flows per Region 2010-2011

US\$ billion and variation %

Region	2010	2011*	Var. %
World	1,289.7	1,508.6	17.0
Developed Economies	635.6	753.2	18.5
Europe	346.8	425.7	22.8
European Union	314.1	414.4	31.9
US	228.2	210.7	(7.7)
Japan	(1.3)	(1.3)	-
Developing Economies	583.9	663.7	13.7
Africa	54.7	54.4	(0.5)
Latin America and the Caribbea	160.8	216.4	34.6
Asia and Oceania	368.4	392.9	6.7
West Asia	58.2	50.4	(13.4)
East, South and Southeast Asi	308.7	343.7	11.3
Transition Economies	70.2	91.7	30.6

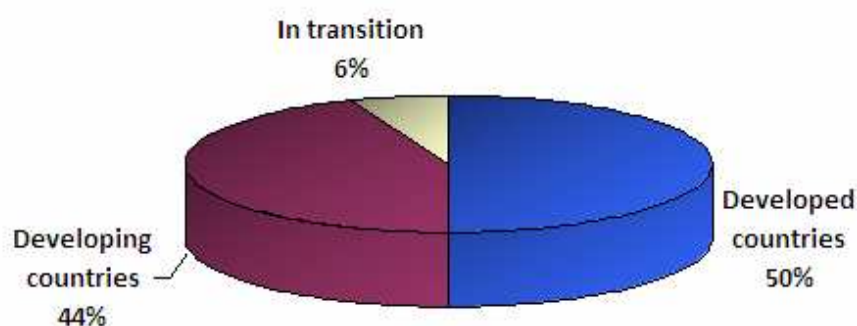
Source: UNCTAD; Global Trade Investments Monitor, Jan. 2012

* Preliminary data

As a group, inflows to developed countries grew 18.5% and represented approximately half of the total inflows of direct investments in the world (chart 2.2).

Chart 2.2 - Net FDI Flows per Group of Countries

2011



Source: UNCTAD; Global Trade Investments Monitor, Jan. 2012

Within the group of developed countries, Europe received US\$ 425.7 billion, the highest increase in net investment inflows in this group: 23%. In country members of the European Union, the expansion was even higher: 32%. Except for Greece and the Netherlands, all registered net inflow of direct investments, and in Ireland, Italy and Portugal, inflows more than doubled in relation to the previous

year, a growth partially favored by low comparison basis: in 2010, investments flowing into the European Union dropped more than 20%.

Inflows to the United States, however, decreased almost 8% in 2011 after rising more than 40% the year before. Even though, the country received a total of US\$ 211 billion, with outflows already discounted, and remains, individually, the main destination of global inflows of direct investment.

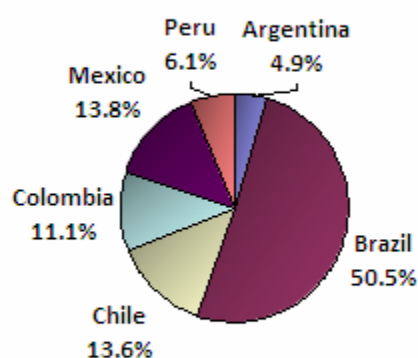
Different from the pendulum movement registered in Europe and the United States, in which investment inflows received over the last two years have swung high and low, Japan's inflows remain weak, with inflows surpassing outflows by the same amount of US\$ 1.3 billion.

Among developing countries, a regional highlight in 2011 was Latin America and the Caribbean, which led growth in net inflow of investments, an expansion of 35%. Among the main receivers of investments in the region, only Argentina and Mexico registered a fall (10% and 9%, respectively). On the other extreme, Colombia's inflows more than doubled.

Brazil alone received a little more than the inflows in Argentina, Chile, Colombia, Mexico and Peru all together (chart 2.3). Besides this, the 35% increase posted in the previous year was intense, and only Colombia exceeded this amount. According to UNCTAD's assessment, the size and the strategic position of the Brazilian market is particularly attractive to foreign investors, as it allows access to other emerging markets such as Argentina, Chile, Colombia and Peru. Indeed, except for 2009, which was the peak in global crises, the net inflow of direct investments in Brazil has accelerated since 2006 (chart 2.4).

Chart 2.3 - Net FDI Inflows in Latin America

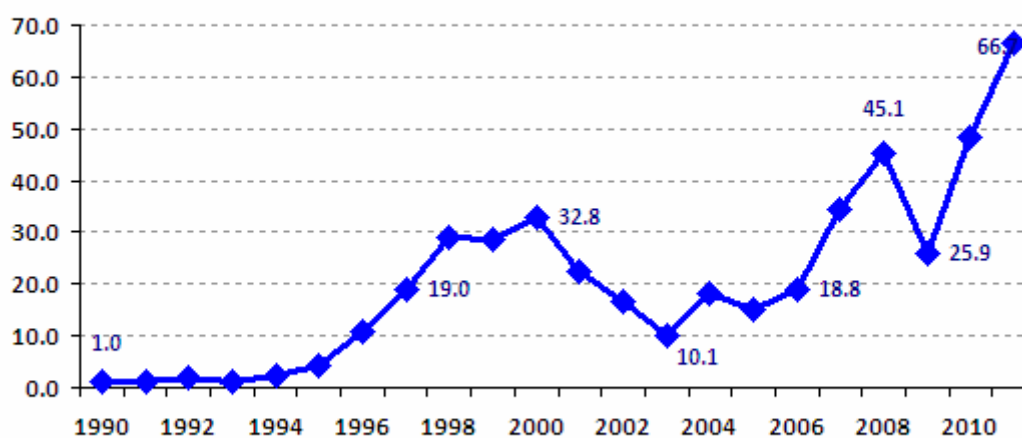
2011



Source: UNCTAD; Global Trade Investments Monitor, Jan. 2012

Chart 2.4 - Direct Investments in Brazil

Net amounts in US\$ billion



Source: Brazil's Central Bank

In the region including countries in the south, south east and east of Asia, all those with UNCTAD estimates (Singapore, China, Hong Kong, India, Indonesia, Malaysia and Thailand) registered a rise in investment in 2011, although rates were less spectacular than those in the previous year. In China, excluding Hong Kong, investments continued growing moderately over an already high base and the estimate is that investments reached US\$ 124 billion in 2011 (almost double the inflow into Brazil). Hong Kong is the second main destination of direct investments in the region (US\$ 78.4 billion, 14% more than the year before), followed by Singapore (US\$ 41 billion and up 6%).

Africa was the only region to show a decline in the net flow of investments. This result was strongly influenced by Egypt's performance, where net foreign investments fell 92% although they still remain positive (approximately US\$ 500 million).

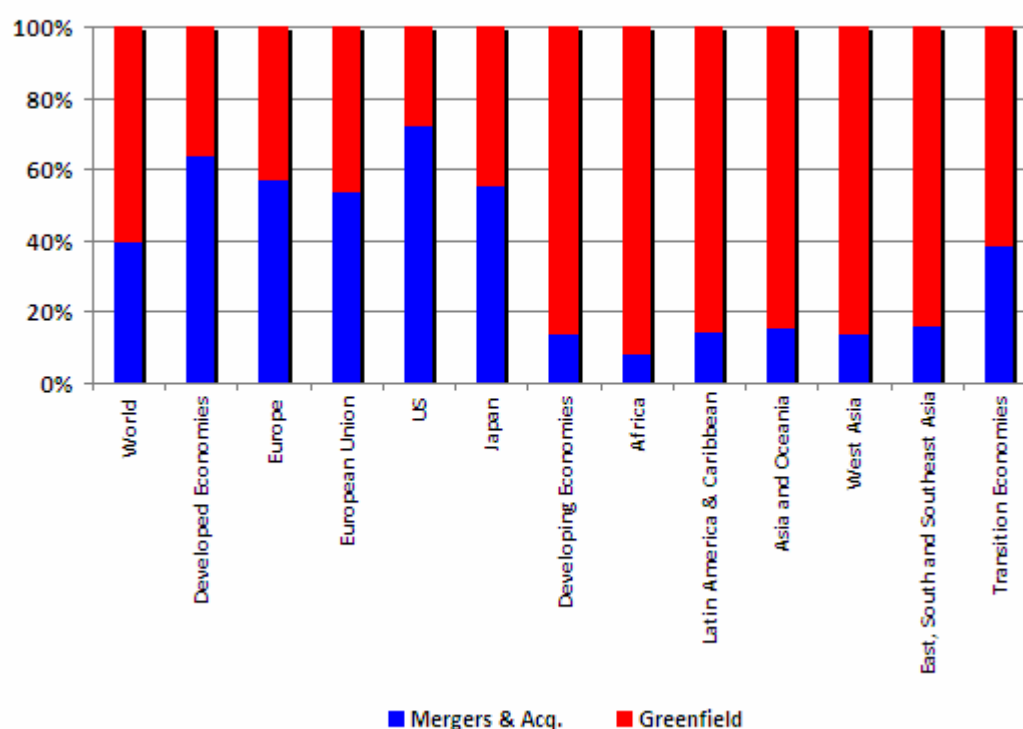
Transition economies from Southeast Europe and the Independent States Community (comprising ex-members of the former Soviet Union), FDI inflows grew 31%.

Greenfield investments diminished in 2011

Separating FDIs per type of inflow shows that investments are typically earmarked for mergers and acquisitions in developed countries as well as new projects (Greenfield) in developing countries and in transition economies, where not only are opportunities to expand capacity higher, but expectations for return on capital are too (Chart 2.5). In 2011, variations in global investment inflow was determined by merger and acquisition business, which grew 50% in value, while investments in new projects (greenfield) fell for the third consecutive year. This

general pattern, nonetheless, was not uniform in the regions and groups of countries (Table 2.2).

Chart 2.5 - FDI breakdown per region and inflow type in 2011



Source: UNCTAD; Global Trade Investments Monitor, Jan. 2012

Table 2.2 - FDI evolution per inflow type

Amounts in US\$ billion and variation %

Region	Mergers and acquisitions			Greenfield		
	2010	2011*	Var. %	2010	2011*	Var. %
World	338.8	507.3	49.7	807.0	780.4	(3.3)
Developed Economies	251.7	396.3	57.4	263.5	229.9	(12.8)
Europe	123.4	191.2	54.9	148.9	145.2	(2.5)
European Union	113.5	162.8	43.4	143.1	142.2	(0.6)
US	80.3	129.7	61.5	57.1	51.3	(10.2)
Japan	6.7	5.1	(23.9)	4.5	4.2	(6.7)
Developing Economies	82.8	78.8	(4.8)	491.6	498.1	1.3
Africa	7.6	6.3	(17.1)	84.1	76.6	(8.9)
Latin America and Caribbean	29.5	20.3	(31.2)	118.2	126.9	7.4
Asia and Oceania	45.7	52.3	14.4	289.3	294.7	1.9
West Asia	4.6	9.5	106.5	52.0	60.2	15.8
East, South and Southeast Asia	32.1	42.7	33.0	236.2	231.4	(2.0)
Transition Economies	4.3	32.2	648.8	51.8	52.3	1.0

Source: UNCTAD; Global Trade Investments Monitor, Jan 2012

* Preliminary data

Among developed countries, mergers and acquisitions amounts between borders grew 57%, of which 55% was in Europe and a little more than 60% was in the United States. According to UNCTAD's survey, these were more of a consequence of

the large amounts involved in some merger and acquisition operations rather than the quantity of such operations. Greenfield investments, on the other hand, fell both in the group of developed countries as well as in their large sub-regions.

The opposite happened in developing countries, with a moderate fall in mergers and acquisitions and a slight increase in Greenfield projects when comparing 2010 and 2011. With regards to their sub-regions, nevertheless, the behavior was not homogeneous. In Africa, mergers and acquisitions fell as did new investments, while in East, South and Southeast Asia the increase in more than one third of mergers and acquisitions was followed by a fall in new investments. In Latin America and the Caribbean, the opposite was registered: a considerable fall in mergers and acquisitions and a boom in Greenfield investments. In West Asia and transition economies, investments grew in both inflow types. A highlight is the increase in mergers and acquisitions in this last group, a result of the substantial number of enterprises in Russia, especially in the mining sector (oil and gold).

UNCTAD's estimate is for moderate growth in FDI in 2012

Last January, in the Global Investment Trends Monitor, UNCTAD published an estimate of US\$ 1.6 trillion for net foreign investments in 2012. The amount would represent an expansion of approximately 7% over the preliminary result in 2011. This is still relevant, but much lower than that registered over the last two years. In UNCTAD's assessment concerning this scenario, risks show a tendency for pessimism, considering the evolution of investments per quarter. However, it is important to note that UNCTAD's estimates are based on the announcement of investments and that such announcements are quite sensitive to investor's trust at the moment the announcement is made. Given that world economic perspectives improved throughout the first quarter of 2012 after the aforementioned estimate was published, it seems that risks of less favorable evolution to direct investments may have dropped, which may lead to a positive revision of the scenario.

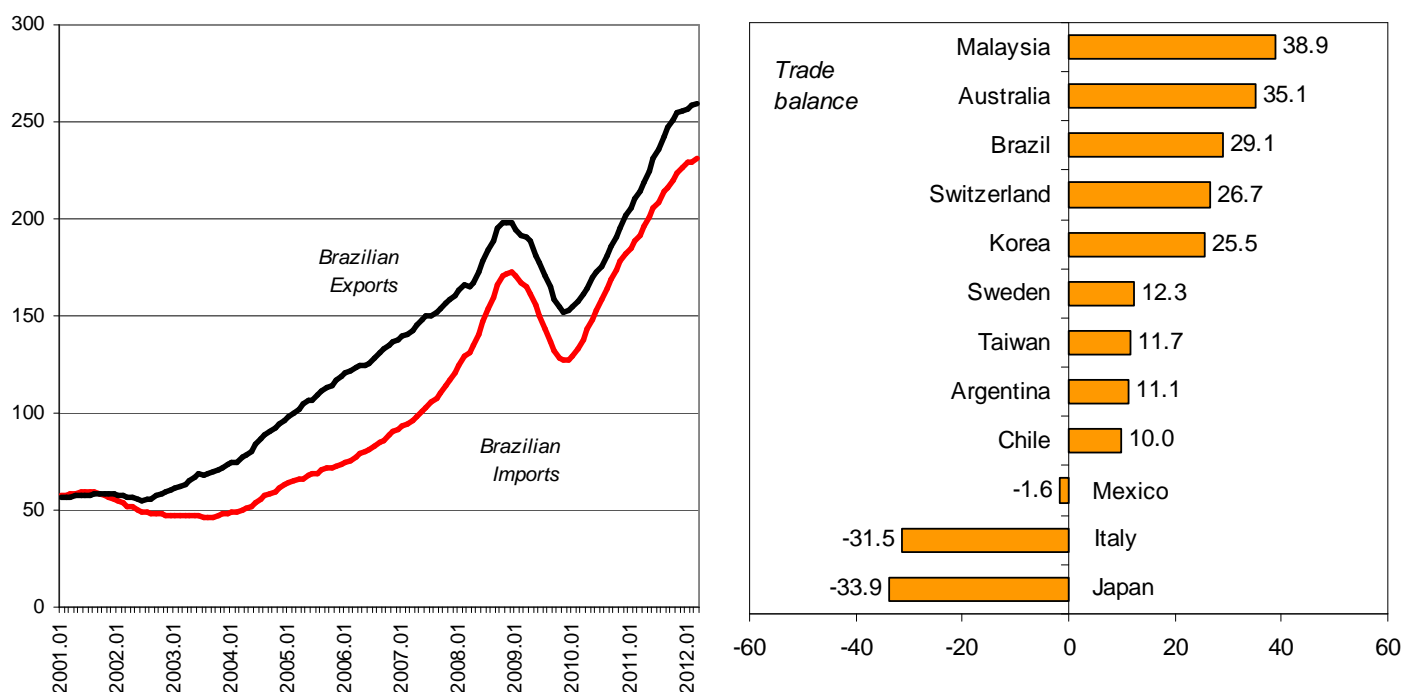
3) FOREIGN TRADE

The Brazilian trade balance reached US\$ 2.4 billion in the first three months of the year. After January's trade deficit which drew considerable attention in the analyses of Brazilian foreign accounts, February and March showed better results. In the last two months, surplus was higher than in the same period last year and the year before.

Brazil's exports totaled US\$ 55.1 billion in the first three months of 2012, while imports amounted to US\$ 52.6 billion. Both are the highest amounts in the history of Brazilian foreign accounts. Regarding the 12-month accumulated result, a similar record was posted in trade flows, while import and export rates are almost the same, with a slight advantage in the former (21.5% and 20.5%, respectively).

In comparison to other countries, the Brazilian trade surplus is still one of the highest. In the 12-month accumulated result up to March, Brazil's trade balance is US\$ 29.1 billion, significantly higher than in the period immediately before (US\$ 22.4 billion in April 2010 to March 2011). Exports and imports also posted record amounts, US 259.9 billion and US\$ 230.8 billion, respectively, over the last twelve months – see Chart 3.1. The main component of the Brazilian trade balance is the continuous increase in the exports of basic products, often strengthened by favorable price conditions in the foreign market.

Chart 3.1 – Brazilian trade balance compared with selected countries (US\$ billion, 12-month accumulated)



Source: Prepared using data of the Brazilian Ministry of Development, Industry and Foreign Trade (MDIC) and the Economist Intelligence Unit (EIU).

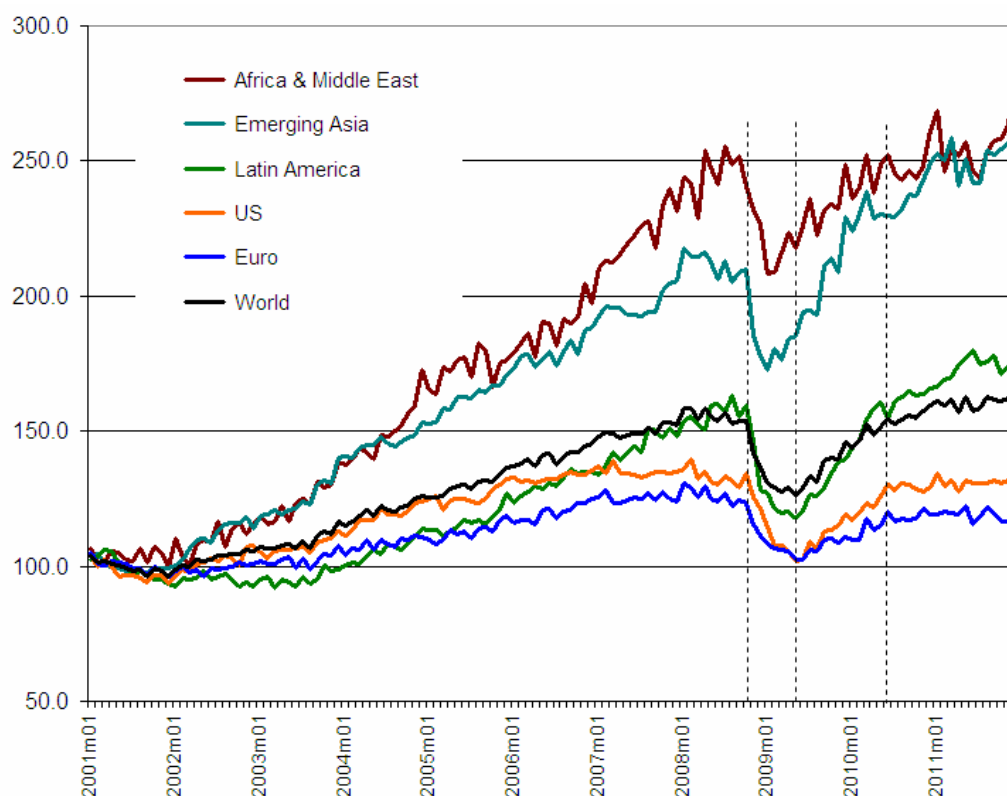
Besides the large-scale oil exporters, that is Saudi Arabia and Russia, which present a trade balance of more than US\$ 200 billion in the 12-month accumulated result, the highest world surpluses were posted by Germany (US\$ 224 billion), China (US\$ 153 billion), Ireland (US\$ 63 billion) and the Netherlands (US\$ 56 billion). As seen in the chart, there is a succession of countries with balances between US\$ 20 and US\$ 40 billion, in which Brazil is included.

The international trade scenario is currently on a shy course although it is possible to note higher dynamism in some markets. Chart 3.2 presents foreign trade per geographical regions from the perspective of imports. Considering this, there is an evolution in demand for foreign goods, which is clearly associated with recovery tendencies – or not – of economic growth and may generate a better understanding over the world scenario than export flows which are generally used to analyze the foreign trade framework. The first dotted vertical line on the chart shows the practically synchronized fall in foreign trade that took place in November 2008 in all regions. The strong reduction continued over five months worldwide up to the beginning of a recovery, which was quicker in some regions and slower in others, marked by the second line on the chart.

The last line aims at defining the phase after June 2010 when trade seemed to return to normality, with the world average returning to levels recorded before the crisis. While Europe and the United States are currently at levels even lower than the world average, the tendency in Asia and Africa is already clearly to grow. Asian developing countries (“Emerging Asia” the figure) present the most successful course of all regions, due to China’s influence. A separation between the African continent and the Middle East has become particularly visible since 2007 and followed the increased commodity market as a result of Asian demand, which produced more revenue to supply such input and consequently more import capacity.

Dynamics to sustain the growth index in Asia ends up determining the continuous increase in commodity prices, which is interrupted only in more serious moments of the crisis. On the other hand, maintaining prices of basic products high is one of the main reasons the import capacity in the African continent and some Latin American countries has risen.

**Chart 3.2 – Imports per geographical region: January 2001 to February 2012
(monthly data of unseasonal volume, average of 2000 = 100)**



Source: Prepared using data of the CPB Netherlands Bureau for Economic Policy Analysis (CPB).

Commodity prices fall significantly throughout the crisis in 2009, experiencing a recovery in the following years and declining again over the last few months, except for oil – see Chart 3.3. Agricultural raw-materials presented less volatility in the last few years, but they also showed lower increases in prices.

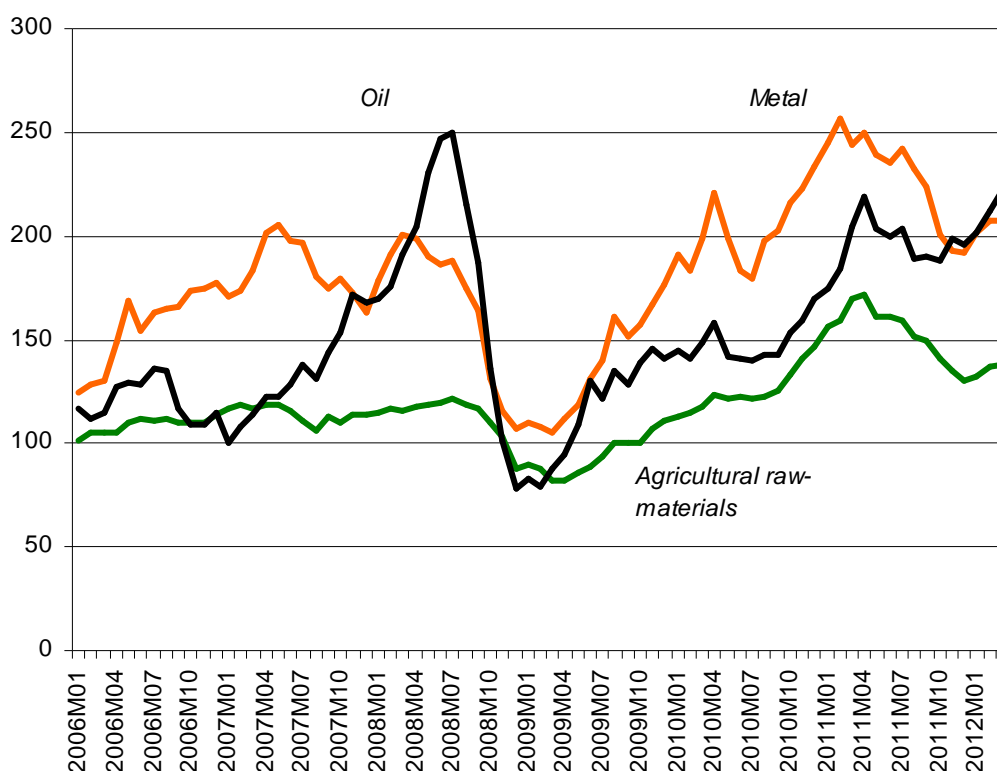
However, it is important to remember that the increasing commodity prices may not favor some undeveloped countries. As a group, African and Latin American countries have generally been considered the main beneficiaries of increasing prices in recent years, but there are exceptions. Increasing prices of agricultural products is harmful to poor countries and to large-scale food importers, or to countries that do not produce oil and need to import fuel.

The effect of differentiated income-elasticity between basic and manufactured products remained in practically all countries, but there is significant difference depending on the level of income. Recent estimates from the US Department of Agriculture¹ confirm higher income-elasticity in manufactured goods for all 144 countries in the group analyzed. Income-elasticity in food in the United States was estimated at 0.34%, while footwear was 0.96%, and transport and

¹ See Evenett, S.J. e Jenny, F. (2012) *Trade, Competition, and the Pricing of Commodities*. Londres: Center for Economic Policy Research.

communication was 1.13%. For Ethiopia, the differential in elasticity remains, but in a distinct proportion: regarding food (0.83%), albeit still lower, was much closer to the others (footwear with 0.97%, and transport and communication with 1.27%). In other words, the known effect in elasticity differential was confirmed, tending to cause a deterioration in commodity prices in the long term, but at the same time reaffirming the greater importance of expenditure on food in poorer countries.

**Chart 3.3 – Commodity price index: January 2006 to March 2012
(Average of 2005 = 100)**



Source: Prepared using IMF data

The foreign market of manufactured products presents a different dynamic. Europeans and North Americans, who aim at pushing their economies towards exports, presented an excess in production capacity. Besides this, the current strategy to expand exports in Asian countries still remains. Markets purchasing Brazilian manufactured products have presented a low GDP recovery index in recent years. If this is added to the continuous tendency for the Brazilian currency to depreciate, then the possibility of raising exports was considerably limited over the last few years. Indeed, the fact that Brazilian exports have recovered to pre-crisis absolute amounts may be understood as a positive result, when considering the adverse factors that were pressuring in the opposite direction.

The participation of Brazilian manufactured goods in the foreign market has been and continues to be modest when compared to large-scale world producers, but it was granted the merit of not falling back over the last decade. In the last ten

years, the Brazilian market share in world exports presented a slight increase, when it matched China's expansion. In the transport machinery and equipment sector, Brazil's participation was 0.63% in world trade in 2001 and went up to 0.66% in 2010. In the meantime, China expanded from 3.8% to 15.4%, replacing almost all traditional large-scale exporters. From 2005 to 2008, Brazil's participation reached between 0.7% and 0.8%, reducing with the world crisis.

Box 3.1: WTO and OECD sign memorandum of agreement to disclose foreign trade statistics per aggregate value

On March 15, 2012, an agreement was signed by the WTO and the OECD to develop foreign trade statistics per aggregate value within the scope of the initiative Made in the World (see International Bulletin Nº. 16). The organizations will develop a methodology to measure trade flows per aggregate value, taking as a starting point experiences already acquired in other studies, and a database on the topic will be made available to the public. Statistics will include OECD countries as well as the most relevant nations that are not part of the organization. Several studies on the matter have already been developed, but this is the first initiative of international institutions in the sense of disclosing statistics of this type in a systemic, periodic manner.

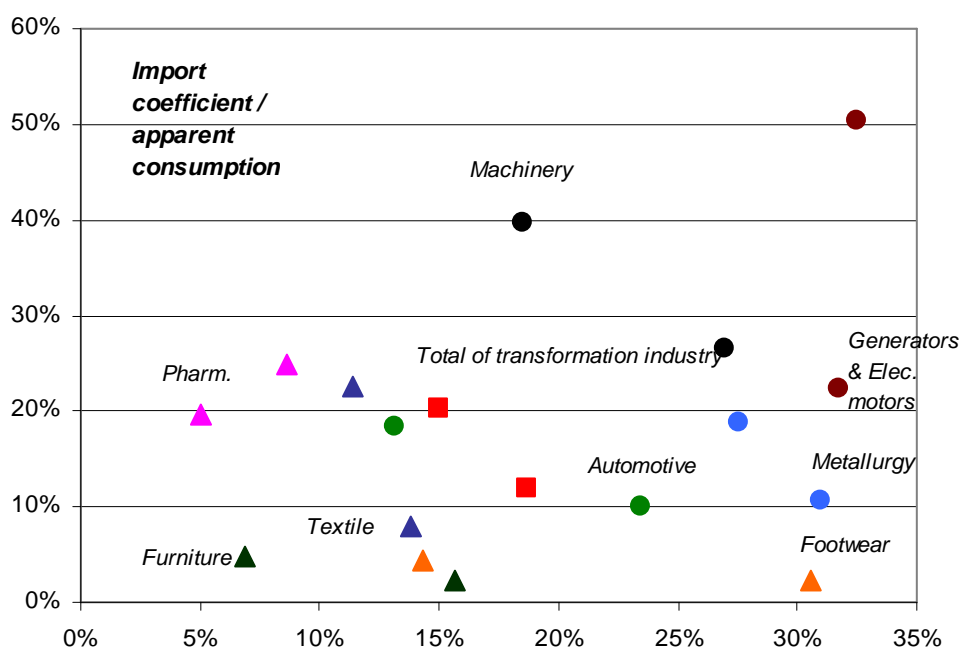
The use of foreign trade statistics as they had been disclosed up to then has always deserved special attention due to possible distortions brought about by added-value criteria and to foreign production sectors. When it is mentioned that a country has, for example, 10% of world trade, this number is reference to final products exported by it, regardless of how much of that content is actually produced inside its territory. The added value of the country may be (i) higher, if it presents well-developed national supply sectors for production and/or it has intensive stages in know-how (research and development); or (ii) lower, if it produces using several imported components, such as the extreme case of concentrating solely on final assembly without much capacity to influence the other stages of the production process. The more a country is integrated into foreign production sectors, the less the content of its products will tend to be national. The "real" participation of exported national production may be much less than that measured by usual export statistics, which present only the final value of goods.

The fact that Brazil has maintained a solid economic growth index combined with adverse conditions in the foreign market to expand exports helped determine a path to increase imports and reduce Brazilian production for foreign markets. That is, over the last few years, in almost all sectors of the Brazilian economy, there has been an increase in imported goods in total consumption and a reduction in exports over total production. Chart 3.4 shows the evolution of import and export penetration coefficients from 2005 to 2011. The penetration coefficient measures the total of imported goods in apparent consumption in the economy which is defined as the

total production minus exports and plus imports. The coefficient result shows how much of the final items consumed are imports. For example, in a simple explanation, it can be understood that an index of 5% in the footwear sector shows that R\$1 in each R\$20 of the value of shoes bought in the country originated from the merchandise produced in foreign countries.

The average penetration coefficient for imports in the Brazilian transformation industry went up from 11.9% to 20.4% over the last six years, with a generalized increase in all industry sectors of the Brazilian transformation industry. In general, this coefficient is higher in small countries and lower in large countries, due to the fact that the latter present higher production capacity to serve domestic consumption. The value calculated for Brazil, even with the fast growth in recent years, is not currently high, internationally speaking. The calculation performed by OECD² points out that among the lower coefficients in the manufacturing industry, there are Japan (15%), the United States (26.6%) and Korea (26.7%), while Spain (38.2%), France (43.8%) and Germany (47.7%) present the higher index. Small countries show even higher coefficients such as Israel (56.2%) and Switzerland (66.2%).

Chart 3.4 – Export coefficient and import penetration coefficient in Brazil: from 2005 to 2011 (follow the arrow)



Source: Preparation from data of Funcex, prices of 2007

² Statistics may be found at www.oecd.org/sti/stan/indicators. The latest available data at the OECD is for 2009, but 2008 was used to compare since the statistics of 2009 were strongly distorted by the international crisis. In almost all countries, there was a significant fall in the coefficient due to a more intense reduction related to foreign purchases rather than domestic production. For a precise comparison in chronological terms, the indicator for Brazil in 2008 was 17%.

The second coefficient showed in the chart is of more immediate interpretation and indicates how much of a country's production is earmarked for exports. Also in the footwear example, it can be noted that, even though there was no great increase in imports, footwear exports in relation to the total fell over half. Imports did not significantly substitute Brazil's production, but national goods were gradually directed to serve the growing domestic demand instead of being exported. Almost all Brazilian industrial sectors presented the same tendency for reduced production for exports and increased imports in consumption, represented in the chart by the displacement of the arrows from left to right, from the bottom to the top. The only exception were pharmaceuticals, whose imports and exports expanded at the same time.

SPECIAL ARTICLE: EXPORT CREDIT PERSPECTIVES IN THE WORLD

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The scenario after the crisis

One of the main defining aspects of the international crisis which started in 2008 was its origin in the financial market and its later effects, which produced cumulative impacts in the banking sector and its other institutions. Within this context, no segment may be deemed untouched by substantial losses and crucial changes in the way of doing business in the last three years. Trade finance was no different, as both the fall in liquidity and lower demand led to a decrease in the number of operations carried out.

According to the follow-up performed by Dealogic consulting, the number of trade finance operations fell from over 900 in 2007 to approximately 800 in 2009. In the same period, the amounts of contracts continued to rise, possibly supported by emergency measures adopted by public institutions, as will be demonstrated in the second section of this text. In 2010, it was even more significant as it indicated a substantial recovery in quantities and amounts, with 1,254 transactions in the amount of US\$ 17.1 billion. In 2011, according to the Trade Finance Magazine, consulting statistics showed the second best number, and was only behind last year's result. In that year, some US\$ 168.6 billion was registered in 1,085 transactions, slightly lower than in 2010. Of these transactions, some 409 were guaranteed by Export Credit Agencies, totaling US\$ 68 billion. The number of contracts in the last quarter, however, was lowest since the first quarter of 2004. Negative factors requiring more attention include the uncertainties associated with the direct and indirect consequences of new regulation defined within the scope of the Basel Committee and the renewed Euro Zone crisis.

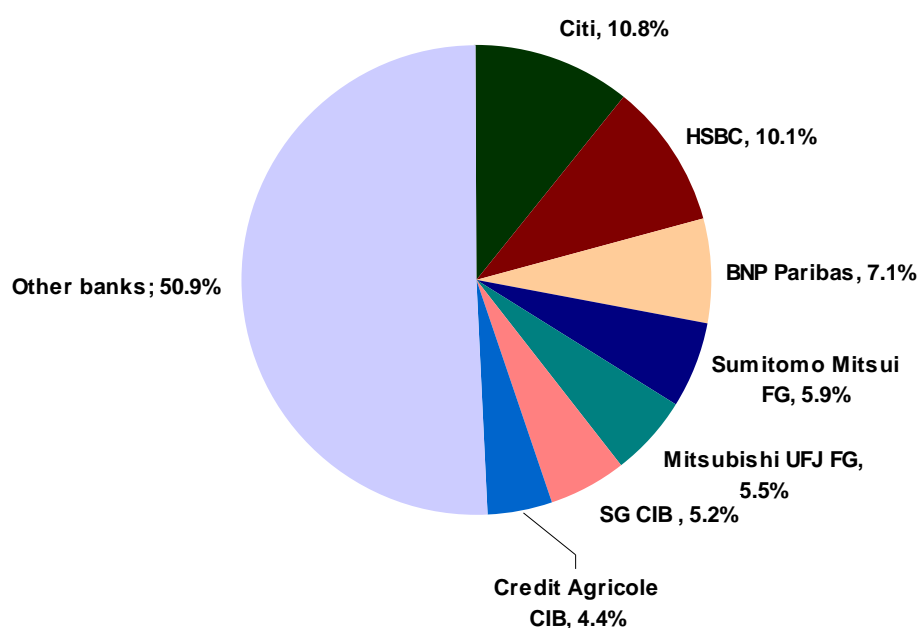
Export credit is traditionally seen as a “low risk and low return” activity, given its nature of easy liquidation and backing in tangible assets. Even so, at first, this perception was not reflected in the rules under discussion in the Basel agreement. In these rules, trade finance operations were subject to the same type of restrictions imposed on other riskier operations. To deal with such distortion and make their point, several institutions came together under the coordination of the Asian Development Bank and the International Chamber of Commerce (ICC) to create a database of losses from trade finance⁴. The results obtained were encouraging as

³ BNDES Foreign Trade Economists

⁴ ICC collected data used in the report “Global Risks – Trade Finance 2011” through the Trade Finance Register. The project is a collective initiative of the ICC and the Asian Development Bank and contains a portfolio with more than 11 million in transactions, totaling more than 5 billion dollars offered by 14 international banks that operate both in the OECD and non-member countries. The data comprise the period from 2005-2010. Available at <http://www.iccwbo.org/policy/banking/index.html?id=46278>

they showed quite low levels of default and indeed lead to the implementation of important changes. However, they did not guarantee trade finance a differentiated status as a relatively safer activity in Basel, according to what was originally planned.

Chart 4.1 – Main banks in the world trade finance segment, according to Dialogic follow-up for 2011



Source: Trade Finance Magazine

Both proposals accepted by regulators regard treatment conferred to letters of credit (LCs) as guarantees for financing. According to the Advanced Internal Ratings-Based Approach (AIRB), capital requirements for exposition to credit were defined as a maturity standard of at least one year. Such a recommendation was in conflict with the characteristics of the majority of short-term trade finance instruments, especially LCs, which present a much shorter term. Questioned about the average duration of 115 days in the ADB/ICC database, the Basel committee opened an exception to LCs, giving local authorities the power to decide on the proper treatment to be given to similar instruments. A second problem regards the “sovereign floor” to banks confirming LCs. Also, under AIRB, the risk ponderation for payables of a bank with no international rating is 50%, or 20% in shorter terms. Nevertheless, such percentages cannot be lower than those defined for the sovereign risk of the issuing market, which in the case low-income, higher risk countries reaches 100%. This way, trade in poorer regions would be affected, decreasing the access of their populations to highly-sophisticated imported products. Convinced by the argument, the committee corrected the distortion.

In the near future, participants in the trade finance industry consider the fact that regulators are reluctant to define rules that respect segment specialties may

present serious non-intentional implications to trade and the international financial system. According to Kah Chye Tan, the chairman of ICC's bank committee , "If the capital cost between low risk and low margin activities, such as trade finance, is the same as high risk and high margin activities, banks will naturally move to lower risks. This is exactly the opposite of what Basel aims at reaching and we will work with them (the Committee) to highlight this non-intentional consequence, as it will affect the world capacity to generate jobs through trade"⁵.

The scenario for public support to exports

In the years immediately prior to the collapse of the American bank Lehman Brothers, when the private financial market was keen on assuming growing exposure to risk, export credit agencies (ECAs) realized their role in trade finance was gradually more restricted to specific sectors and to long-term maturity projects. This framework was radically changed by later turbulences and, from 2009 on, ECAs went up to the first level as one of the main instruments for public intervention to mitigate the effects of the crisis. As an example of this performance, Auboin (2009) estimates that, from the US\$ 250 billion promised by G-20 leaders as support for trade finance in September 2008, some 70% was disbursed by March in the following year only by agencies from the United States, Canada, Japan, South Korea, China and European countries⁶. In the rest of the world, equivalent institutions almost unanimously followed a tendency of expanding their activities, both in volume and in scope.

Nevertheless, the renewed importance of ECAs, allied with the difficult moment experienced by the global economy, shed some light on aspects of its performance, which, until recently, were barely discussed, such as the capacity of usual practices to promote a level playing field in a crisis. Particularly, three subjects have been repeatedly raised as being of great importance: asymmetries regarding the type of support offered, the deterioration of debt capacity and the sovereign risk of some countries, as well as the spectrum of predatory practices by those who do not adhere to the OECD agreement such as China, and the way to fight them .

In first place, the US Ex-Im, in its 2008 competitiveness report, called attention to an emerging division among ECAs focused on the "pure cover" supply (securities and guarantees for operation funded by private entities) and those that directly offered export funding. Due to liquidity restrictions, even with the support of an ECA, trade banks had difficulties in extending credit to their best clients. Additionally, because of the intervention of governments in the financial markets worldwide, interest rates fell to the lowest historic level. As a consequence, buyers who were still capable of and willing to acquire goods and services are more attracted by the option of direct funding that several ECAs offer because it is offered

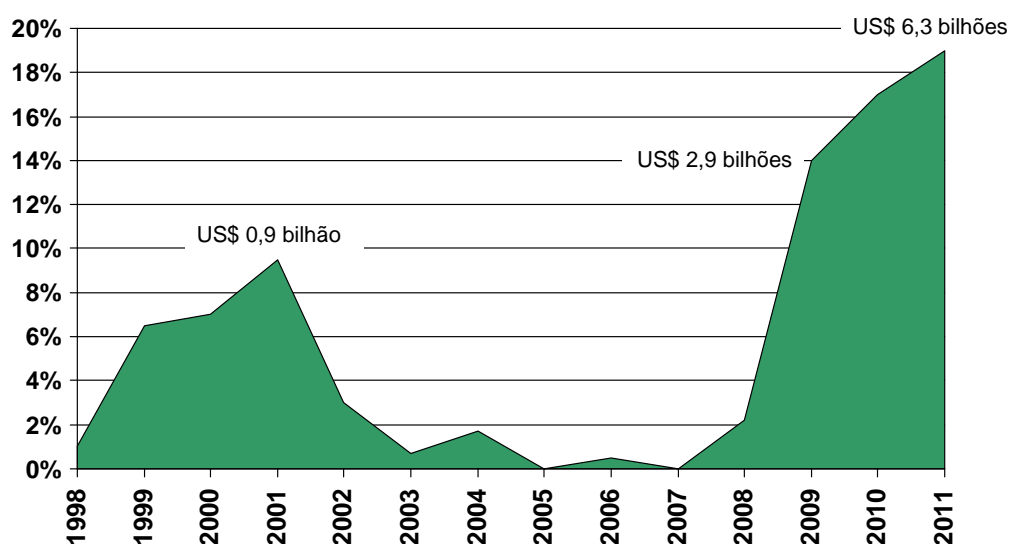
⁵ "Basel Committee eases trade finance rules". Trade Finance Market Outlook 2012, Trade Finance Magazine.

⁶ "Restoring trade finance during a period of financial crisis: stock-taking of recent initiatives". WTO Staff Working Paper, 2009-16.

to the buyer at a stable, quantifiable rate, with low cost, fixed for the whole contract⁷. It is not surprisingly that several agencies have launched products of this type (direct support) in their portfolios, even including working capital finance, but those that had difficulties redirecting their operations lost competitiveness when they became hostages of the preference for liquidity in the private financial market.

Statistics disclosed in a report from the United States' Government Accountability Office in early February indicate that direct financing from the US Ex-Im reached US\$ 6.3 billion in 2011, representing 19% of the institution's total approvals. In the years immediately before the crisis, the modality was barely used, reaching no approvals in several years over the past decade. G-7 European credit bureaus do not have similar tools and tried to deal with the problem through programs of interest rate equalization, but were less successful. The need to rely on trade banks to carry out financing, even with fixed interest rates guaranteed by public programs, ran into the lack of market liquidity to meet funding for transactions.

**Chart 4.2 – US Ex-Im Direct financing:
participation in total support each year**



Source: US Ex-im

Second, the expanding influence of the ECAs required a movement proportional to the amount of resources earmarked for them by their respective governments. In 2012, with liabilities from considerable fiscal and monetary stimulus on their balance sheets, some of the highly indebted sovereign entities seemed unwilling to reissue the crisis strategy with the same dedication. This is especially true regarding European countries forced to reconsolidate their finances and whose ability / willingness to pay the public debt have been placed in doubt. Perhaps as a fact of greater severity, the situation of the weakest countries may be impairing their ability of their ECAs to attract business, insofar as their sovereign guarantee is

⁷ "Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States", June 2009.

considered of poor quality. A recent article in the Global Trade Review magazine, for example, suggests that the market has been more receptive to operations of Euler Hermes, while prices in transactions with coverage of PIIGS institutions are on the rise. Even the German market for export credits is in a position that is considered much stronger than its neighbors, although the Euler Hermes is involved in only 3% of the country's total exports.

Finally, with global demand still low, there is an additional incentive so that governments capable of subsidizing domestic enterprises attempt to capture segments of the market open to dispute. In the 1970s, the collective effort to reverse trade deficits in oil-importing developed countries, allied with high interest rates, encouraged a "race to the bottom", which was mutually destructive to better export financing conditions. This process is what led the OECD members to establish the Agreement on Export Credits, setting clear rules to be respected among each other, with a clear focus on conditions that would not foster "artificial" competition. The crisis that began late last decade creates a similar situation, since some of the largest ECAs in operation (e.g. the Chinese and Indian Eximbanks) have no formal commitment to abide by the rules of the Agreement. In this sense, Steve Tvardek, chief of the OECD export credit division, in an article for the Trade Finance magazine defending the adhesion of non-members to the Agreement, warns that "[...] the lack of mutually agreed and voluntary cooperation would introduce - at least in the mid-term - a cycle of disputes in the WTO and destructive financial practices that would seriously undermine fair and efficient competition in exports and the responsible administration of the global economy". In this sense, it should be noted that the definition of "destructive financial practices" is complex, but the recent decision of the US Ex-Im to match the Chinese proposal to finance locomotives for Pakistan (see Box 1), using parameters prohibited by the OECD, is indicative that rich countries will not necessarily remain inactive when facing losses for their exporters.

Box 4.1: US Ex-Im and the *matching* practice for Pakistan

As described in its performance report, the American ECA, the US Ex-Im, experienced one of the years with the highest activity in its history in 2011, funding more than US\$ 32 billion. Only to Africa, some US\$ 1.4 billion was allocated, while another US\$ 6 billion was earmarked specifically for small businesses. Achieving a position of US\$ 89 billion in asset transactions, the agency is currently awaiting authorization from the Congress so that the ceiling of its portfolio can be raised from US\$ 100 billion to US\$ 140 billion.

Despite the good results, the United States' support for its exporters was more intensely reported last year with the Pakistani government's decision to reopen a public bid to acquire locomotives for its rail system, previously won by Dong Fang Electric Corp, with an offer of financing from China Exim. Upon hearing that the American offer had been overturned in the bid in light of more attractive conditions offered by the Chinese, the US Ex-Im made use of Article 45 of the OECD agreement, which allows signing countries to match the parameters of financing /

guarantee offered by their ECAs to others, should they understand that their competitiveness is affected. Given the new offer, Pakistan considered it would be necessary to consider the merits of buying from China and the matter should be solved in 2012. If the quality and the price of the American product proves to be better than the competitor's, a new winner for the bid may be declared.

The event is noteworthy as the first time in the history of the US Ex-im in which the agency operates outside the parameters defined by the OECD. This uniqueness derives less from the lack of opportunity in which a competitor took advantage of not belonging to the Agreement to displace competitors and more from the rites of the group, which require more detailed proof of matching conditions. Under normal circumstances, both the borrower and the lender have little interest in making such information public. In this case, the Trade Finance Magazine report indicates that Americans relied on the help not only of their ambassador in the Asian country, but also the department of trade and, more crucially, the cooperation of the Railway Authority of Pakistan itself, which was apparently dissatisfied and provided detailed documentation of China Exim's offer. With such data, the American ACE decided it was sufficiently justified to offer a letter of interest for the funding of US\$ 437 million over a period of 12 years, with an interest rate equal to that offered by the treasury plus approximately 3% and commission for exposure of 8.2%.

Regardless of the eventual winner of the bid in Pakistan, the magazine highlights the uncertain consequences that the US initiative may have: "[...] the process of matching puts the OECD in a particularly difficult situation: they cannot be understood as sanctioning the US Ex-Im's abandonment of the agreement, but meanwhile they have also been openly critical of China's reluctance to embrace the efforts to be included in the OECD. Should they be worried that, given the size and clout of China, this will become a systemic issue? Will participants in the OECD seek to broaden the existing rules if China refuses to obey them?

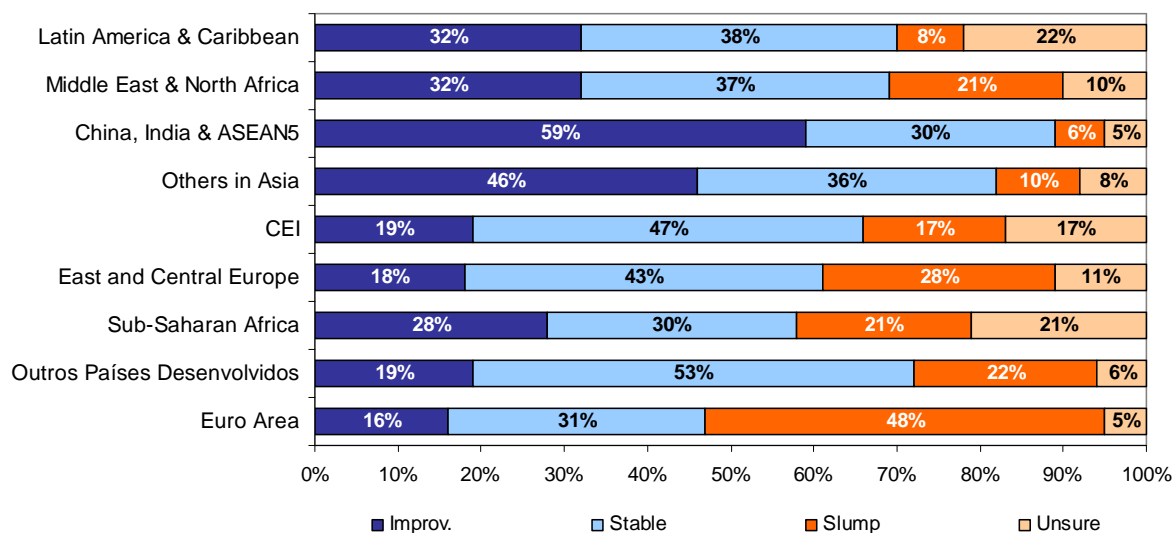
Expectations for export credit in 2012

In December 2011, the International Chamber of Commerce (ICC) and the International Monetary Fund (IMF) carried out a survey with financial institutions concerning the perspective of international trade finance in 2012. The ICC-Market Snapshot research received information from 337 financial institutions representing 91 countries. Over 30% of the banks that responded to the survey are large banks (global assets worth over US\$ 100 billion), while small banks (assets up to US\$ 500 million) represented 21% of the sample. In addition, the survey also revealed that banks in the Euro area account for over half of global trade finance products.

Approximately 60% of those surveyed believe that the demand for trade finance banking products will grow in 2012 in the Asian market while approximately 50% of banks consider that there will be a fall in demand for this type of service in the European market. For Latin America and the Caribbean, in particular, opinions

are divided. Research indicates that 32% of banks believe in growing demand, while 38% voted for stabilization and 8% for deterioration. The remaining 22% do not know.

Chart 4.3 – Export credit perspectives for 2012



Source: ICC/ IMF

Research highlights what the main factors are that contribute to the financial institutions' belief in the deterioration of trade finance activities in most regional markets. Approximately 90% of respondents indicated that reduced credit or liquidity available at partner banks will be the main cause of market deterioration in 2012. At the same time, some 80% of respondents believe that there will be less credit available from international financial institutions, 73% consider that their own institutions will reduce credit available to finance trade, and almost 60% say there will be a reduction in ECAs support.

The research also demonstrates how deleveraging which has occurred in European banks has affected the trade finance industry. Because of this deleveraging, almost 80% of financial institutions surveyed said they made their rules stricter for specific countries, 76% decreased availability of credit for trade finance, 75% have become more selective with clients, and 69% experienced an increase in the cost of resources.

Also according to the survey, measures taken recently by the multilateral development banks (MDBs) and central banks to increase the liquidity of financial institutions were perceived as having some positive effect on the supply of trade finance. Over 60% of respondents indicated that the measures taken by the multilateral banks, such as the Global Trade Finance Program (GTFP) and the Global Trade Liquidity (GTLF) the International Finance Corporation (IFC), have achieved the desired effect of reducing restrictions on trade finance. In addition, some 57% of

respondents said that swap lines adopted by many central banks have also helped to generate liquidity and allow the maintenance of trade finance.

Preparations for the implementation of Basel III rules are already causing negative pressure on the cost of funds and on the availability of liquidity, and will contribute to the deterioration of trade finance in 2012. Nearly three quarters of respondents said that their activities have been affected by regulation, with a greater effect on large banks. According to the institutions, not having disregarded the nature of low-risk trade finance, the new capital requirements of Basel III are expected to make less trade finance available to exporters and importers, especially affecting small and medium-sized enterprises.