



Brazil: New Challenges Ahead





Introduction

- Brazil survived strong shocks during 2001 and 2002
- Is time to rethink Brazil, recognize its strengths and reevaluate its remaining weaknesses



Main Issues

- Recovery and financial health indicators
- The new government
- The macroeconomic policy
- Structural reforms
- Main weakness: fiscal
- Risks ahead: political and external
- Scenarios



Recovery and Financial Health Indicators

- Conservative crisis management
- The external sector reacted positively, even under financial and commercial stress
- Fiscal indicators show effort, but still far from a long term stability
- Inflation is receding



Recovery and Financial Health Indicators

Conservative crisis management:

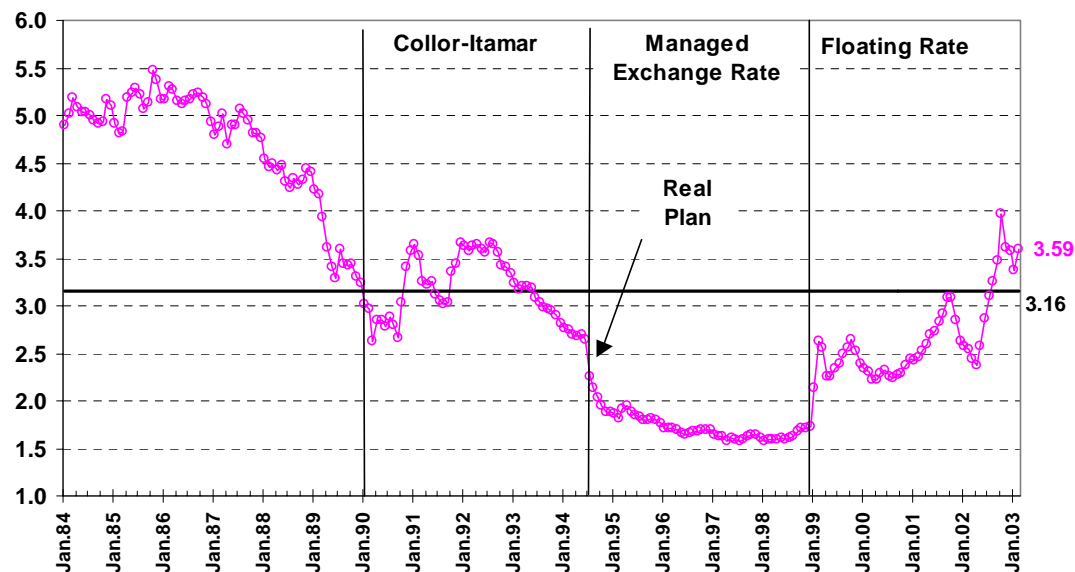
- Non-systematic and prudent intervention in the foreign exchange market
 - Buy-back of US\$ 3 billion of foreign public debt
 - Restrictive monetary policy to contain domestic absorption
 - Increase in primary surplus
 - New agreement with the IMF, supported by all presidential candidates
 - Extremely well managed political transition
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Recovery and Financial Health Indicators

- The floating exchange rate regime is providing competitive terms of trade

Real Exchange Rate





Recovery and Financial Health Indicators

Trade balance surplus and export growth

	2001	2002	%	Sep.01-Mar.02	Sep.02-Mar.03	%
Exports	58.2	60.4	3.7%	30.5	38.4	25.9%
<i>Argentina</i>	5.0	2.3	-53.2%	1.7	1.7	1.4%
<i>Rest of the World</i>	53.2	58.0	9.0%	28.8	36.7	27.3%
Imports	55.6	47.2	-15.0%	27.5	26.9	-2.2%
Trade Balance Surplus	2.6	13.1	397%	3.0	11.5	281%

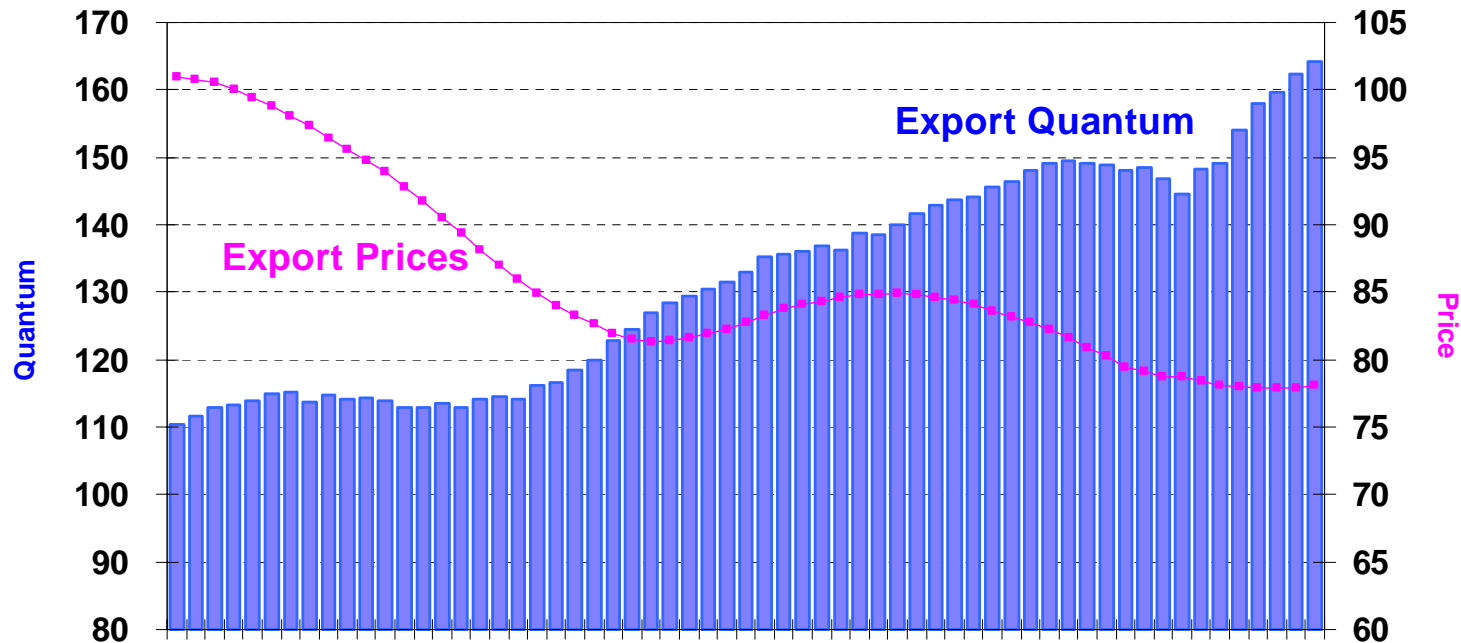
- During the last two quarters trade surplus has increase mostly due exports growth



Recovery and Financial Health Indicators

Exports: price and quantum 12-month moving average

World economic recovering might raise prices and improve further exports results

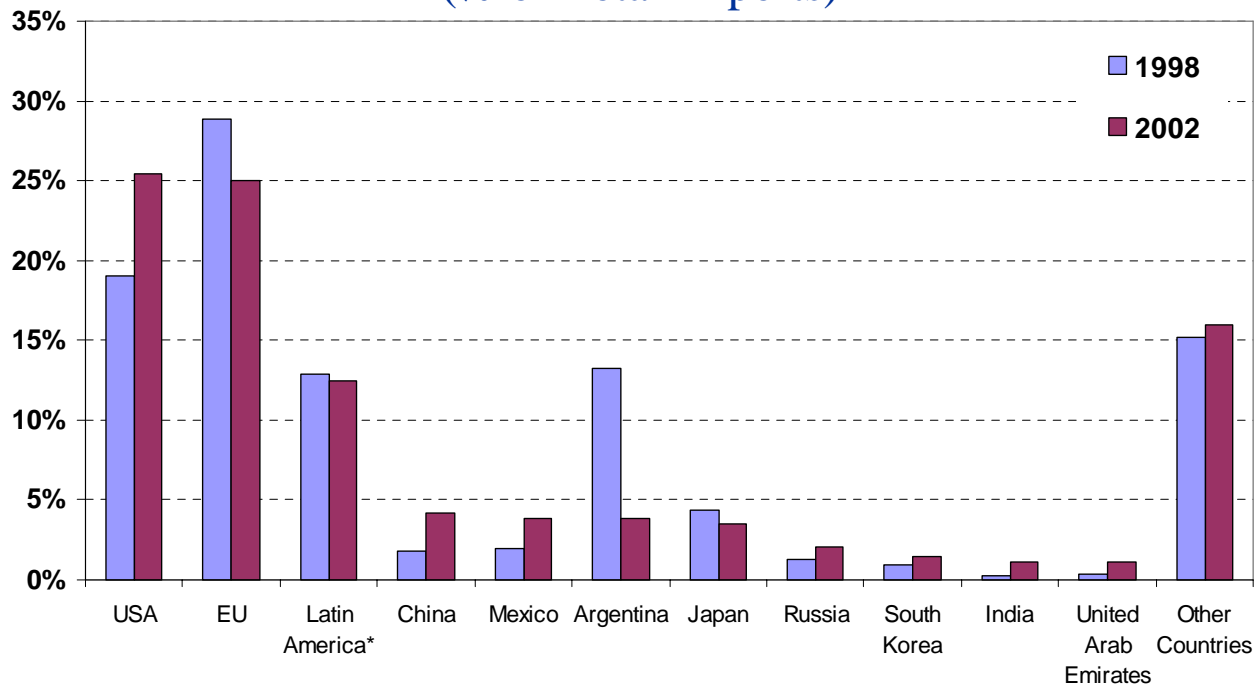




Recovery and Financial Health Indicators

- Trade partner diversification

Brazilian Exports: Main Partners (% of Total Exports)





Recovery and Financial Health Indicators

■ Balance of Payments:

- Recovery of International reserves during 2003
- US\$ 12 billion net withdraw from IMF

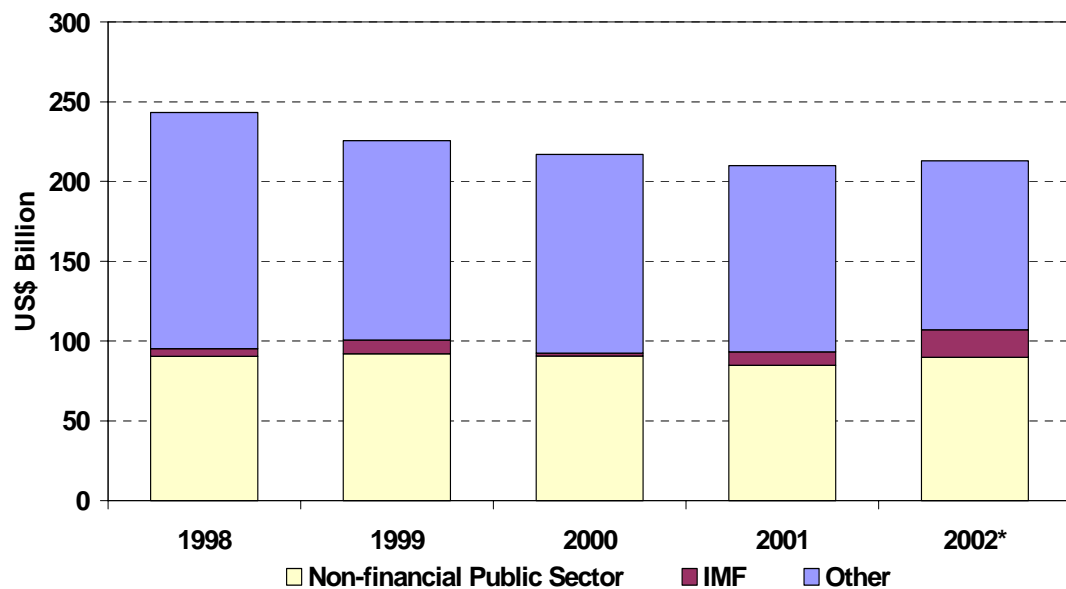
	(US\$ Billion)	2000	2001	2002	2003 Forecast
Uses		-57.1	-58.4	-38.2	-32.2
Current Account		-24.7	-23.2	-7.8	-4.6
Trade Balance		-0.7	2.6	13.1	16.2
Services		-25.5	-27.5	-23.3	-23.2
Current Transfers		1.5	1.6	2.4	2.4
Amortizations		-32.5	-35.2	-30.4	-27.6
Sources		57.1	58.4	38.2	32.2
Foreign Direct Investments		32.8	22.5	16.6	15.0
Portfolio Investments		2.8	2.2	1.8	1.5
Medium and Long Term Loans and Financing		37.3	34.6	18.7	16.9
Other Capital (incl. Errors and Omissions)		-8.1	-4.3	-10.0	1.2
International Support		-10.4	6.6	11.5	12.8
Change in International Reserves (increase, -)		2.3	-3.3	-0.3	-15.2
International Reserves		32.9	35.9	36.2	53.0
International Reserves (excl. IMF)		31.5	27.8	16.6	16.6
FINANCIAL NEEDS AS % OF GDP		9.6%	11.6%	8.2%	6.4%
% Current Account / GDP		-4.2%	-4.6%	-1.7%	-0.9%



Recovery and Financial Health Indicators

Foreign Debt

- Excluding IMF, the private and public debt has been declining

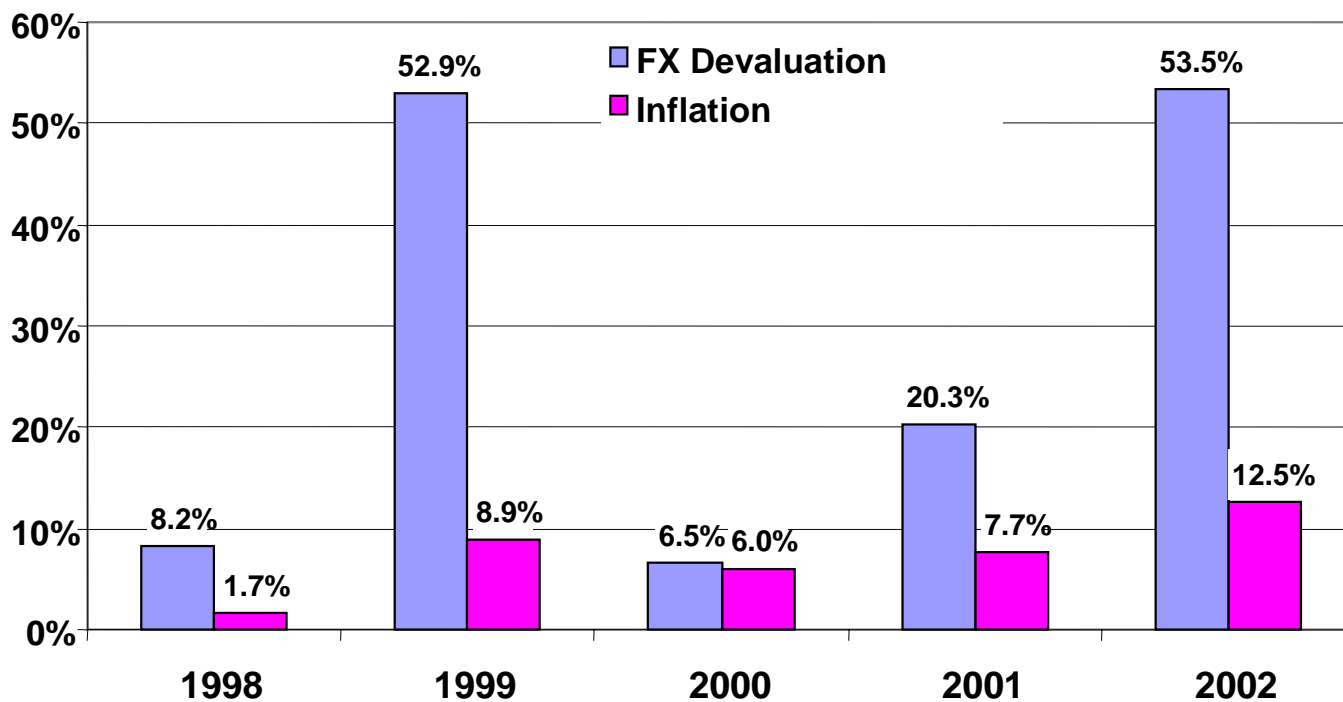


* Sep/02



Recovery and Financial Health Indicators

FX Devaluation and Inflation (CPI)



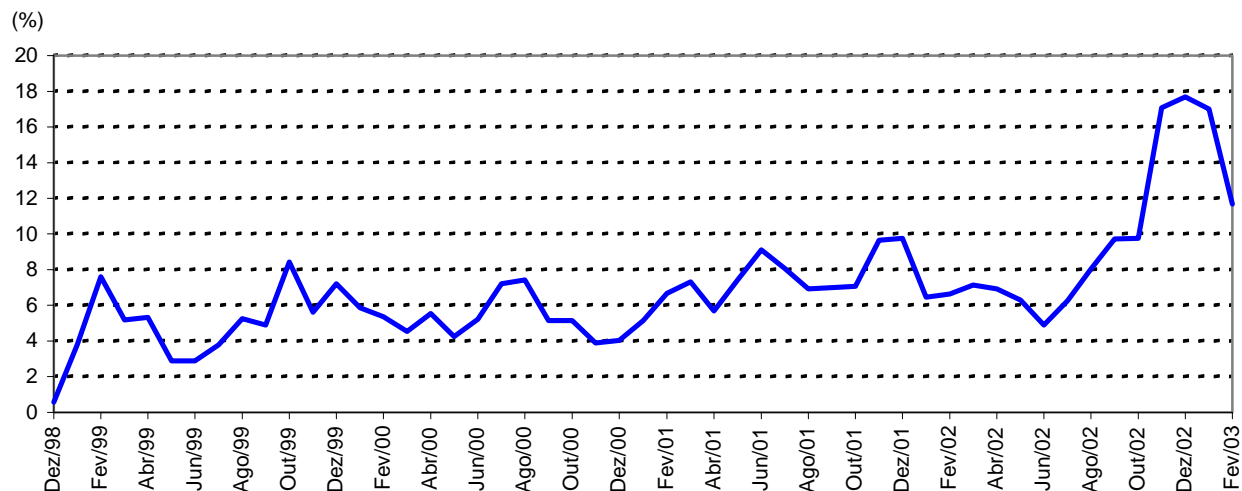
■ Low pass-through



Recovery and Financial Health Indicators

CORE INFLATION – CPI (IPCA) (Annualized)

- Inflation is starting to return to previous levels



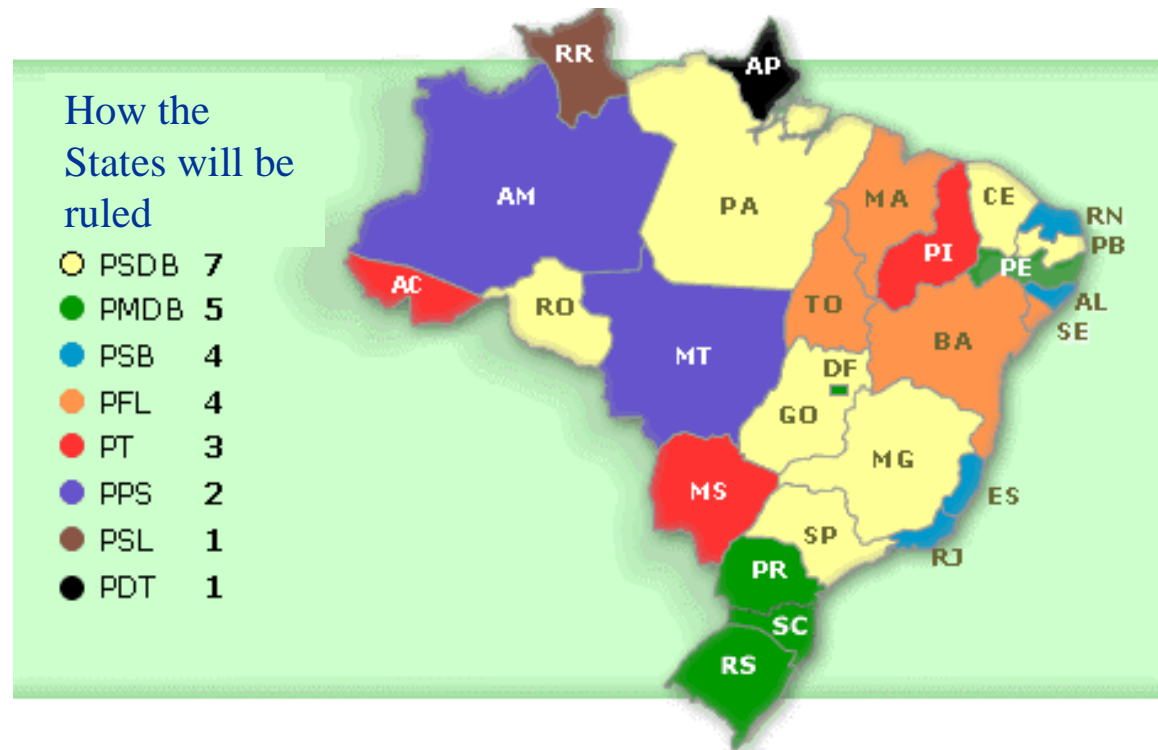


The New Government

- No red wave in Brazil: PT did not win the elections with the ideological votes of the left. Actually, PT only elected the governors of three small states
- The new government appointed a professional team of executives to formulate economic policy
- Governability conditions are not so difficult to attain



The New Government





The New Government

- (1) **Minister of finance: Antonio Palocci**
Physician, former mayor of Ribeirão Preto
He appointed a team of professionals for the Ministry and the Central Bank
- (2) **Chairman of the Central Bank: Henrique Meirelles**
- Engineer, former international CEO of Fleet Boston.
- (3) **Ministry of Industry and Trade: Luis Fernando Furlan**
- former CEO of Sadia S/A (Successful Brazilian company in the food industry)
- (4) **Ministry of Agriculture: Roberto Rodríguez**
- Engineer, former Secretary of Agriculture of the State of São Paulo.
- (5) **Planning Ministry: Guido Mantega**
- Moderate Economist from PT
- (6) **International Affairs: Celso Amorim**
- Ambassador, moderate vision of international integration
- (7) **Chairman of Banco do Brasil: Cassio Casseb**
- Engineer, former executive from the financial sector in Brazil



The New Government

- Political analysts point out that the congressional majority needed to pass the reforms already proposed by the previous government could be reached
- PT needs from PMDB, PFL and PSDB:
 - ◆ 26% of the their votes at the Lower House; and
 - ◆ 35% at the Senate
- The leaders of PT will have to keep the radicals under control. A new document has clearly stated the priorities of the new government. It was signed by 67% of the party's leaders.



The Proposed Reforms

- Bankruptcy Law
- Central Bank Independence
- Pension System for Civil Servants
- Tax Reform
- Labor Market Regulation Reform



The Proposed Reforms

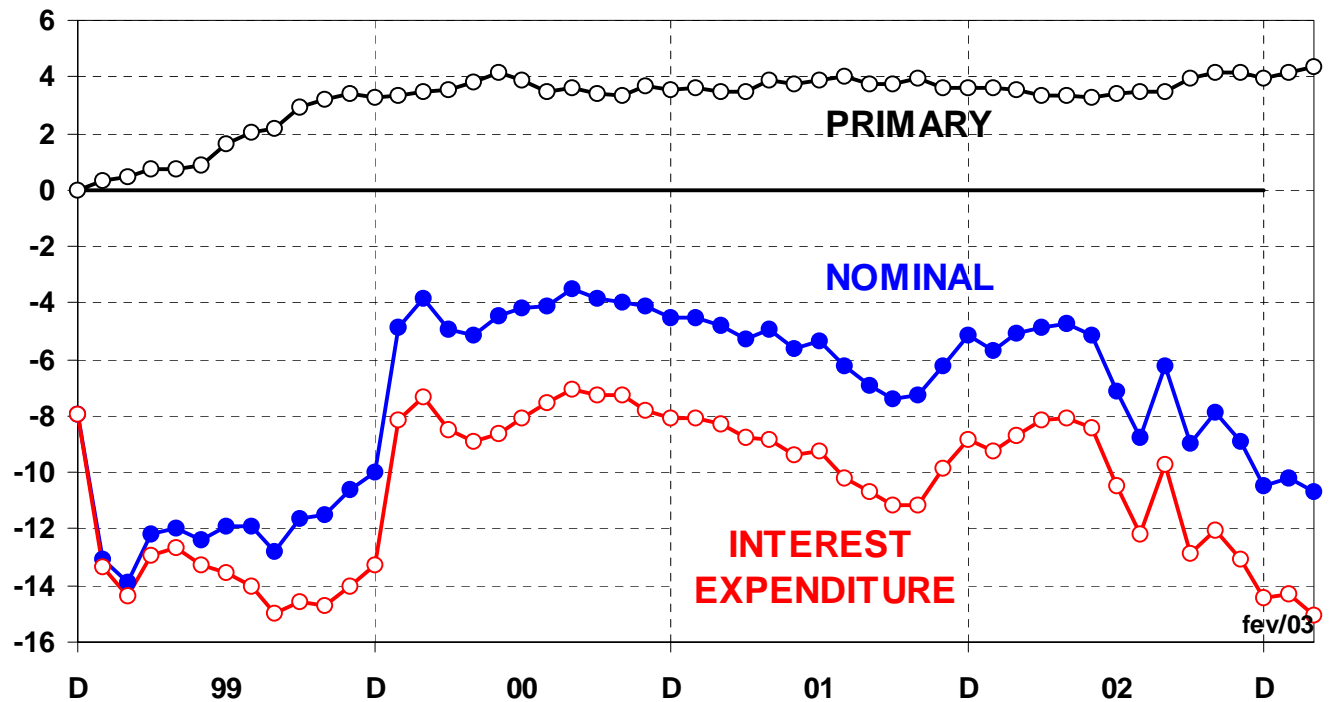
- Central Bank Independence: A previous Constitutional Reform is required for future regulation by ordinary laws.
- The pension system for civil servants proposes a minimum pension on a pay-as-you-go basis and a complementary pension on capitalization basis. As a first step, it requires a regulatory law for complementary pension funds



Main Weakness is Fiscal

- The government has committed to a surplus of 4.5% of GDP in 2003. Good effort; but with this surplus, the real interest rate has to be 7% to stabilize debt.

PUBLIC SECTOR SURPLUS - % OF GDP
12-month cumulative flow





The Risks Ahead

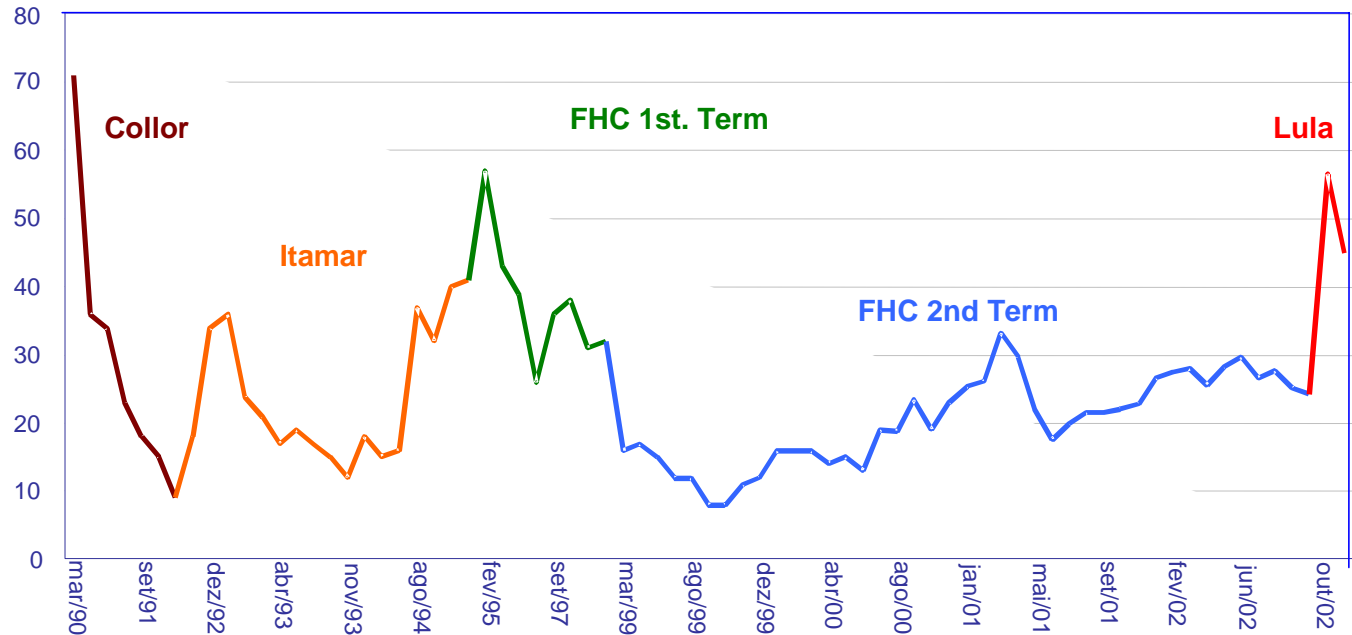
- Political: PT needs to forge an alliance with PMDB
- An oil shock may prevent inflation from falling and delay a reduction in interest rates
- Delicate political decisions will have to be taken soon:
 - ★ Minimum wage
 - ★ Rise in civil servant's wages
 - ★ Regulation of public utility rates



The Risks Ahead

- Delicate political decisions might affect the government's popularity

Presidential Popularity Survey
(% "good and excellent")



Sourcess: Datafolha (Collor and Itamar) and CNT/Sensus (FHC and Lula)



Scenarios

- Optimistic scenario: still low growth in 2003, improving in 2004

Period (Quarter)	Average nominal exchange rate (R\$/US\$)	Overnight interest rate (% p.a.)	CPI inflation (% q-o-q)	CPI inflation (% y-o-y)	WPI inflation (% q-o-q)	WPI inflation (% y-o-y)	Real GDP growth (%)	Ex post real interest rate (% p.a.)
2002 4	3.68	21.34	6.56	12.53	13.36	25.30	1.52	5.9
2003 1	3.50	25.84	4.54	15.91	5.99	32.13	1.96	4.3
2003 2	3.50	26.22	1.98	16.54	2.72	31.83	2.03	5.4
2003 3	3.51	24.99	3.42	17.49	5.05	29.65	2.38	6.0
2003 4	3.61	22.64	1.73	12.17	2.72	17.48	1.88	11.4
2004 1	3.69	19.50	1.51	8.92	2.37	13.47	1.83	13.2
2004 2	3.77	17.50	1.10	7.97	1.76	12.41	1.97	12.2
2004 3	3.86	16.42	2.54	7.05	3.88	11.16	2.16	11.2
2004 4	3.94	15.58	1.60	6.92	2.50	10.92	2.94	9.7



Scenarios

- Pessimistic scenario: deterioration of inflation and growth, but with better trade surplus results

Period (Quarter)	Average nominal exchange rate (R\$/US\$)	Overnight interest rate (% p.a.)	CPI inflation (% q-o-q)	CPI inflation (% y-o-y)	WPI inflation (% q-o-q)	WPI inflation (% y-o-y)	Real GDP growth (%)	Ex post real interest rate (% p.a.)
2002 4	3.68	21.33	6.56	12.53	13.36	25.30	1.52	5.9
2003 1	3.58	25.91	4.68	16.07	5.86	31.98	1.96	4.2
2003 2	3.78	27.00	3.12	18.00	4.64	34.13	1.60	4.3
2003 3	3.70	26.11	3.88	19.50	5.67	32.69	0.91	4.7
2003 4	3.85	23.40	2.45	14.88	3.61	21.29	0.32	9.3
2004 1	4.02	22.50	2.31	12.28	3.41	18.48	0.11	11.1
2004 2	4.21	21.67	2.04	11.10	3.02	16.64	0.24	11.1
2004 3	4.40	21.00	3.36	10.54	4.97	15.86	0.59	10.5
2004 4	4.61	20.00	2.20	10.28	3.26	15.46	0.80	10.0



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End of Presentation

For further information, please contact:

- Tomas Malaga
 - tomas.malaga@itau.com.br
 - Phone: 55 11 5029 2650

