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## Brazil: A power of the present

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*Brazil's elections this weekend are not expected to trouble financial markets, unlike some of the country's previous electoral episodes. This column attributes that to Brazil's embrace of pragmatic policymaking and stable democracy, which have made it a major player in the international economic and political arenas. Brazil is a power of the present.*

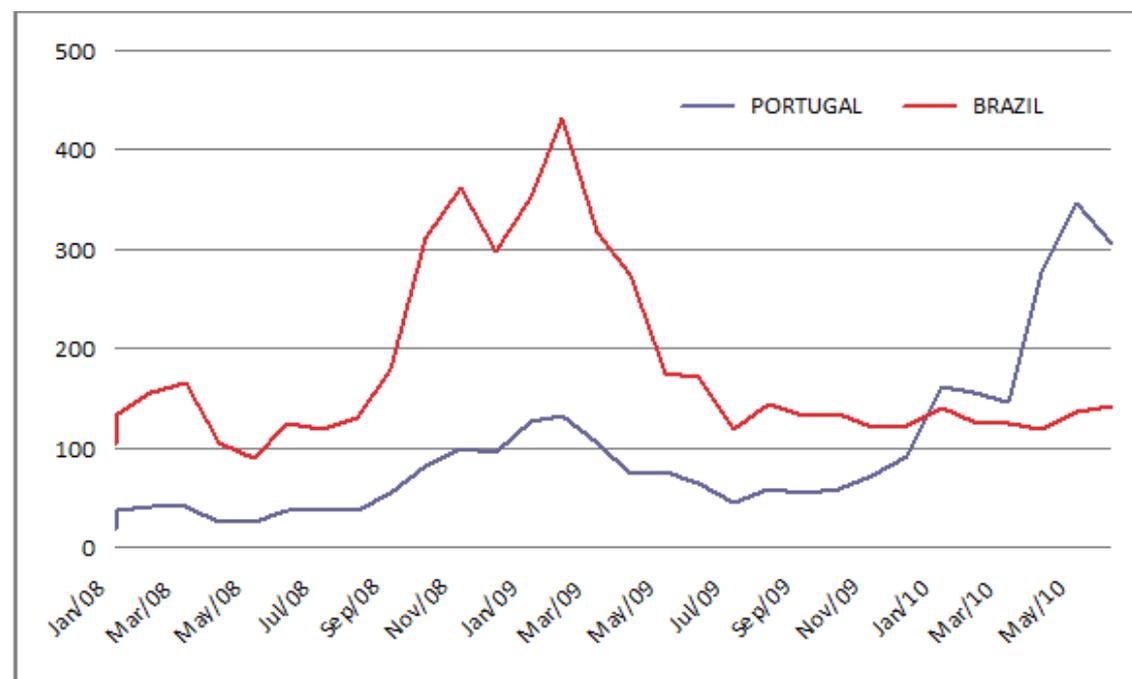
Election time is around the corner once again for Brazil. In early October, the country will go to the polls to elect its new President. This time, like in 2006 when Lula was re-elected, the elections are not expected to cause major financial disruptions as seen in 2002. The major decoupling that Brazil experienced in this regards is the one between financial cycles and political cycles. Here, as in Chile or Mexico, two other investment grades of the region, elections are not disruptive anymore. The 2010 elections will once again confirm it in the Brazilian case.

### Political cycles and financial decoupling

In Brazil, as in many other Latin American countries, one of the major socio-economic shifts of recent times is that elections no longer go hand in hand with financial crises; a pattern that characterised the region in the 1990s. For Brazil, as well as for Chile, Colombia and Costa Rica (who have also been through electoral processes in 2010) election times are no longer dark moments of soaring spreads, slumping foreign exchange and massive financial shocks. As I documented in several co-authored papers, elections in Latin America tended to be disruptive and generated risk aversion from investors and bankers (Nieto Parra and Santiso, 2008). Presidential elections, in particular, have been usually more closely associated with changes of fiscal policy in Latin America than in high-income countries. This has been changing over the 2000s. By comparing the 2005-2006 electoral cycles with respect to prior ones, we noted a slight improvement of fiscal management around elections (Nieto Parra and Santiso, 2009a and 2009b). The Brazilian elections of October 2010 are confirming this trend. Financial markets have been pretty calm ahead, during and after elections, in spite of an adverse global economic context packed with uncertainties. Even more impressive, the credit default swaps (CDS) of Brazil are now less risky than for many

OECD countries. As European countries were caught into financial turbulences, the CDS of Portugal, for example, became riskier than Brazilian ones (Figure 1).

**Figure 1.** Brazil and Portugal risks (CDS) in 2010



Source: Based on Datastream, 2010.

Beyond this remarkable decoupling, Brazil also offers an example of the rise of what we labelled *possibilism*, i.e. pragmatic policymaking. This is also at the very heart of the Brazilian, Chilean and Mexican economic transformation of recent decades (documented in my book, Santiso 2007), but also more recently in Colombia, Peru or Uruguay.

In Brazil, the economic success of the Lula years was laid by the reforms of its predecessor, Fernando Henrique Cardoso, a sociologist that adopted Hirschman's possibilism, and became Minister of Finance and later President of Brazil, just before Lula. In the end, one of the greatest success of Lula has been to pursue the incremental changes pursued by Cardoso and abandoned the far-left policies that he had once advocated. He helped Brazil's transition towards embracing capitalism, the irony being that this impressive transformation had been led by a leader that once denounced "neoliberalism". Lula surprised financial markets and investors in 2002 by tackling decisively inflation, reducing debt levels and paying back bondholders while at the same time metamorphosing its country from an IMF debtor into an IMF creditor. Lula became the first president of Brazil to pay all its debt to the IMF and started lending to the same institution more than \$14 billion.

## The country of the present

For many years we have referred to Brazil as the country of the future, a cliché with its origins in the 1940s, when the novelist Stefan Zweig published his last book, dedicated to Brazil. Nevertheless, what we are witnessing this decade is something quite unprecedented, which does not fit with this condescending attitude of the past. Brazil is now close to its potential as a world power to be reckoned and emerging at a rate of knots. It is no longer a country of untapped eternal future potential.

Today Brazil (along with China and India) is one of the major emerging economies shaping the world. Yet uniquely, Brazil is not solely an emerging market, it is also an emerging exemplary democracy. It is a country where a former metalworker and trade unionist became president and transformed his country. In 2010, after two mandates, Lula's Brazil is the seventh economic power in terms of nominal GDP, ahead of Spain and snapping at the heels of Italy and the UK. Not surprisingly, Lula finishes his stint as president with a record level of popularity among his countrymen. Brazil's love affair with Lula even included the financial markets, once reluctant to give him the vote of confidence (in 2002 the country was on the brink of a debt default). Under Lula, Brazil's stock market has been one of the best performers in the world, yielding annual average returns in excess of 40% in dollar terms. The market capitalisation of the Bovespa increased more than ten-fold and the country amassed more than \$250 billion, a record.

In international economic and political forums (the G20, the IMF or the WTO) Brazil's weight has quite rightly increased, and on matters of climate change, nuclear proliferation, food security or international trade, the country's position matters more than ever. Brazil's economic pragmatism, combining monetary and fiscal orthodoxy with important social programs, has become a benchmark for many emerging economies. In fact, one of the major achievements of the Lula Years has been to successfully achieve this combination when in 2002, few believed in it. Last but not least, the country has also targeted programs that helped to reduce endemic poverty and inequality. The Brazilian middle class is now growing more than ever and represents almost half of the total population (an increase of 10% in just five years).

This economic boom and political wherewithal is reflected in new accomplishments. Not only will the country of Pelé host the 2014 World Cup, but also, for the first time in history, Brazil will host the Olympics in 2016. The country also became one of the world's most important agricultural powers and, with the recent oil discoveries in Rio, it is set to become a leading global oil exporter. Petrobras, the Brazilian oil company, is already one of the largest companies in its sector. But let us not make the mistake of thinking of Brazil as solely a source of raw materials: The country not only

exports soybeans, oil and minerals, but also high-tech products and the Brazilian aeronautical, technological services, automotive parts and cosmetic industries are second to none.

The sporting events mentioned serve to illustrate the massive (re)shifting of world economic balance we are witness to, where Brazil, China and India are taking centre stage. The effect of the financial crisis of 2008-2010, felt most deeply by OECD countries, is accelerating the transition process and emerging economies are becoming more prominent at an increasing rate. The world has been turned upside down. Now more than ever, investing in emerging markets has not only become more attractive but also carries less risk. Current and future opportunities lie in these markets, it is true, but it is perhaps the increased risk associated with investing in (previously safe) OECD countries (as seen with the Greek and Irish crises), has played the biggest role in bringing emerging and OECD countries into line in terms of attracting investors.

With this global rebalancing increasing at a rapid pace, we need to be ready to significantly amend our mental maps, breaking down our preconceived ideas. We are numerically behind the times. At the end of 2009, Goldman Sachs (who coined the term BRICs in the early 2000s to describe the rise of the emerging markets of Brazil, Russia, India and China) had to re-estimate all its world's GDP projections. These new forecasts predict an acceleration of trends that economists only imagined possible a few years ago. A prime example is that Brazil's GDP may overtake Italy's as soon as the end of 2020 - five years ahead of the estimates initially conducted in 2003. Moreover, in 2029 Brazil may well be on a par with Germany - seven years earlier than originally anticipated, and in 2034, with Japan - something not even contemplated in previous projections.

## **A re-balanced world**

The world does not revolve around OECD countries anymore. In fact, in 2009, trade between emerging countries already exceeded that with OECD countries. The biggest trading partner of Brazil, India and South Africa, is no longer an OECD country, but rather another emerging one, China. For the first time, in 2009, foreign direct investment in emerging countries was almost on par with that in OECD countries.

Financial centres are also shifting (and not only towards the East). Petrobras is concluding, in the second semester of 2010, the biggest share issue ever undertaken (\$67 billion). This operation is however more than just a big deal. It underlines the rise of Brazil as a financial centre where companies from OECD countries are also looking to be listed (such as the Brazilian subsidiaries of Spanish firms like the bank Santander – already done – and

the oil company Repsol YPF – pending -). The Brazilian bank Itaú Unibanco is already the world's eight biggest bank by market capitalisation while BNDES, Brazil's development bank, has already a balance sheet larger than the World Bank's and is opening offices abroad (in London in 2010). The Petrobras operation also underlines the way economic and financial power is shifting away from OECD countries (on the shifting wealth of nations see OECD 2010). It is not only the biggest share offering ever (coming from an emerging multinational) but the underwriter is not a US or a European investment bank, but an emerging markets bank, in this case a Chinese one. It is the first time also that a Chinese bank plays such role in an international operation. By Mid 2010, ICBC International, a wholly-owned investment banking subsidiary of the Industrial and Commercial Bank of China Limited, has been appointed by the Brazilians as one of the book-runners for Brazil-based Petrobras' IPO. More than ever South-South connections and deals, financial, and trade flows are on the rise.

Brazil's story is symbolic. In 2008, in the midst of the global crisis, the country achieved a record level of investment (\$45 billion) and the country reached the top investment grade status by all rating agencies as many sound OECD ones were downgraded. Going forward, it seems that the sun will continue to shine on Brazil. After zero growth in 2009, Brazil is reaching new high levels, attracting more European and North American investors than ever, as well as Asians and Arabs who are rushing to invest in the country. More significant is the fact that Brazil has also become a powerful investor abroad. The beginning of this decade saw the rise of Brazilian multinationals whose market capitalisations are now comparable to those of their peers in OECD countries. The Brazilian bank Bradesco (like the previously mentioned Itaú Unibanco) surpasses also many of its European rivals in terms of market capitalisation, while the iron ore giant, Vale is worth the same as the Anglo-Australian giant Rio Tinto and Petrobras outperforms most of its European competitors.

The world has changed and Brazil is now one of the countries leading the OECD stragglers by the hand. No longer is it merely the land of future promise, but rather it is an emerging power delivering in the present.

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