

Surfing a big wave of confidence



Up and away: São Paulo's new bridge seems to typify the mood – brash, daring and confident Reuters

But the task of transformation is far from complete, write Jonathan Wheatley and Richard Lapper

Brazil's prospects, it seems, have never been better. Economically and politically stable, the country has become a poster child on international financial markets – the most fashionable, perhaps, of the so-called Bric group of large emerging markets that also includes Russia, India and China.

At a time of rising global demand for food and energy, Brazil is uniquely placed. Already the world's biggest producer of almost any farm product you like to mention, including ethanol made from sugar cane, Brazil is the fourth biggest manufacturer of cars and will soon become an important oil exporter.

Its home markets are booming and have become a huge magnet for foreign direct investment. Its capital markets are attracting massive inflows from overseas. Meanwhile, Brazilian society is being transformed as incomes rise and inequality falls.

Much of this has been made possible by reforms enacted over the past 15 years that have borne fruit during the past few years. It has all been helped along by international conditions that, for Brazil, have never been so benign.

It is no exaggeration to say that Brazil is on the verge of superpower status. But it is not there yet, nor is that status guaranteed. Things have been going so well – President Luiz Inácio Lula da Silva is the most popular president in Brazilian history – that there is a powerful temptation among the country's leaders to let things take their course. But the task of transforming Brazil is far from complete.

The country's infrastructure is a mess. Public health and education services are persistently inadequate. Businesses must still

struggle through a mass of red tape and Brazilians seem addicted to a large and spend-thrift public sector. The cost of failing to address these issues will be another generation of lost opportunities.

Even so, the momentum for change is strong. On the streets of Brazil's towns and cities, the feelgood factor is hard to ignore. Consumer and business confidence are riding high. In São Paulo, a spectacular new suspension bridge completed last month seems to typify the mood – brash, daring, brightly lit and monumentally confident.

Among the steel and glass towers of the business district around it, new buildings are sprouting like so much tropical undergrowth.

But it is among the lower-income groups and in some of Brazil's poorest states in the north-east that the most important changes are taking place. The Bolsa Família, an income-support programme developed under Fernando Henrique Cardoso, president from 1995 to 2002, and vastly expanded since then under Mr Lula da Silva, has brought a quarter of Brazil's nearly 190m people into the consumer market for the first time.

Across the country, though, there has been a rapid expansion of jobs and credit. Many new jobs – though far from all – are the result of migration from the informal to the formal sectors: workers who previously had no registration or rights are now tax-paying citizens with generous employment benefits.

"The creation of formal jobs is far outpacing that of informal ones," says Cristiano Souza of Dynamo, a Rio de Janeiro investment manager. "Companies are hiring better-educated and more productive people."

One reason for the rise of the formal sector is that government inspectors are cracking down on tax dodgers. But there are many other factors. Any owner of a company thinking of going public, of selling part or all of their business, of opening franchises, or of applying for credit, must be able to show a genuine, clean set of books. Increasingly, companies demand the same of their business partners and suppliers.

It is among the lower income groups that the most important changes are taking place

By coming within the law, of course, many businesses have given up a huge competitive advantage of not paying taxes. This has forced them to work harder to achieve productivity gains. "If you talk to companies you see there has been a real change in expectations," Mr Souza says.

Partly because of Brazil's history of economic turbulence and recent memories of runaway inflation, companies have always been survivors, quick to adapt to

changing circumstances. In the past, they spent much of that energy on maximising financial gains from inflation and other market distortions. Now, after decades of stagnant productivity, they are becoming more efficient and competitive.

With less likelihood of finding themselves unemployed, Brazilians have been able to plan for the future. They have also been able to take out longer-term loans for big-ticket items, especially cars. Changes in the law allowing lenders to foreclose on non-payers have helped a rapid expansion of credit, as have new forms of lending, especially arrangements under which instalments are deducted directly from borrowers' pay packets – or, commonly, their pensions. A new "positive register" of people with good credit histories will help lending expand further.

Such advances are even making a dent in Brazil's notorious income inequality. At the same time, stability has also brought more consistent rates of growth. Between 1990 and 2003, growth was extremely erratic and averaged out at less than 2 per cent a year. Over the past four years, the average has been more than 4 per cent. In the 12 months to the first quarter of this year, it was 5.8 per cent – and this at a time when the US economy has been growing at less than 1 per cent.

In the past it was said that when the US caught a cold, Brazil got pneumonia. "Now the US is in intensive care and we haven't even sneezed," says Aloizio Mercadante, a senator for Mr Lula da Silva's PT (Workers' party) and one of his economic advisers.

The foundations of Brazil's new prosperity were laid under the Cardoso administration and loudly denounced by the then opposition PT. But, in government, Mr Lula da Silva and his advisers have seen the value, especially to the poor, of low inflation and a stable economy.

A floating exchange rate,

Continued on Page 2

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An impressive list of policy achievements

THE ECONOMY
Jonathan Wheatley
on the Workers' party's emergence as a bastion of stability

Back in the bad old days around the turn of the century, when Fernando Henrique Cardoso, the former president, was routinely harangued by Workers' party militants with cries of "FHC out, IMF out", the economic agendas of Brazil's government and opposition could hardly have been further apart.

Now, as in so many mature societies, it often seems difficult to slide a white paper between them. Mr Cardoso's policies, until quite recently accused by his successor President Luiz Inácio Lula da Silva of bequeathing the county a "cursed inheritance", are now credited with having laid the basis of Brazil's current stability. Many investors who, on the eve of Mr Lula da Silva's first election victory in 2002, dumped Brazilian assets in panic that he would overspend the country into debt default, now regard his Workers' party administration as the bastion of that same stability.

Few in government or opposition doubt that Brazil owes much of its current prosperity to orthodox economic policies such as a floating exchange rate, inflation targeting and fiscal restraint.

The danger, many observers say, is that now those policies are established and their benefits are being enjoyed, policymakers may regard their job as done. But just as Brazil's prosperity is the result of reforms carried out over the past 15 years, they argue, its future prosperity depends on keeping the reform agenda moving.

"In the current climate of global stagflation, the only way to keep Brazil out of trouble is to address the issues that have been swept under the carpet by this

BRAZIL



Constitution
Official name
Federative Republic of Brazil

Form of state
Elected president

The executive
The president, who is elected for a term of four years, chooses a cabinet, which he heads; he holds considerable discretionary powers

Head of state
Elected president

National legislature
Bicameral national Congress; 81-seat Senate, comprising the representatives of 26 states, plus the federal district of Brasília; 513-member directly elected Chamber of Deputies

Regional legislatures
Each of the 26 states and the district of Brasília have a legislature and an administration

Legal system
Each state has its own judicial system; the country has a system of courts for dealing with disputes between states

and matters outside the jurisdiction of state courts

National elections
Municipal elections every four years, with the next ones due in October 2008; presidential, congressional and state elections

Main trading partners
Share of total trade to world 2007 (%)



Economic summary

	2008*	2009*
Total GDP (Real bn)	2,808	3,032
Total GDP (\$bn)	1,668.6	1,737.9
Real GDP growth (annual % change)	4.6	3.6
GDP per head (\$PPP)	10,254	10,702
Inflation (annual % change in CPI)	6.0	4.6
Agricultural output (annual % change)	4.3	3.0
Industrial production (annual % change)	4.4	3.8
Money supply, M1 (annual % change)	22.7	15.0
Foreign exchange reserves (\$bn)	237.8	273.9
Unemployment rate (% of labour force)	8.8	8.7
Budget balance (% of GDP)	-1.6	-1.9
Current account balance (\$bn)	-18.4	-19.2
Merchandise exports (\$bn)	189.5	212.0
Merchandise imports (\$bn)	164.0	190.7
Trade balance (\$bn)	25.5	21.3

every four years, with the next ones due in October 2010

National government
Luiz Inácio Lula da Silva took office for a second term on January 1 2007



Area	8,547,400 sq km	Exchange rate:		Population (2007)	183.9m
Language: Portuguese		2007 average	R\$1.9475=\$1	Main towns	
Currencies: Real (R\$)		Latest figure	R\$1.6057=\$1	Brasília (capital)	2,456,000

Sovereign credit rating			Sao Paulo	10,887,000
Standard and Poor's BBB-	Moody's Ba1	Fitch IBCA BBB-	Rio de Janeiro	6,093,000
			* Forecast	Source: EIU

government and the previous one," says Winston Fritsch, a former secretary for economic policy at the finance ministry and now head of investment banking at Lehman Brothers in São Paulo. He says action must be taken on the central issues of tax reform, an overhaul of restrictive labour laws, and cutting government spending.

Yet ministers can counter such arguments with an impressive list of achievements. Guido Mantega, finance minister, says Bra-

zil has made a "qualitative leap", from growth that averaged 1.6 per cent between 1990 and 2003 to an average since then of more than 4 per cent. More importantly, he says, the stop-and-go growth pattern of the past has been replaced by consistency.

Asked if the government still has an agenda of reforms, he points out that spending on payroll is lower as a share of gross domestic product than it was in 2002, the last year of Mr Cardoso's government, and that the

deficit in the pensions system, while it rose to the end of 2006, has since fallen back.

Paulo Bernardo, planning minister, says the focus has switched from macroeconomic issues to microeconomic ones. He points to new regulations on credit that have driven a rapid expansion of lending.

Other examples are the recent breaking of the state monopoly on reinsurance to allow private-sector participation, and forthcoming bills to improve the qual-

ity of anti-trust regulation. A recent change of environment minister, he says, is likely to speed the process of granting licences to infrastructure projects, one of the main obstacles to investment.

Yet Mr Bernardo admits to concern over a lack of macroeconomic reform. "I am in favour of coming back to pensions reform in the future," he says. The same applies to labour reform and to cutting government spending. The government would like to

move forward with the reforms," he says. "But we have to involve the opposition in their formulation. [Cutting spending] is not easy to do, there is still a very strong culture in Brazil of thinking that you need to earmark spending to priority areas like health, education and welfare. But this creates demands for more money. It's true that this is a problem for Brazil's development."

Henrique Meirelles, president of the central bank, says the pro-

posed creation of a sovereign wealth fund demonstrates the government's concern over the impact of public spending on stability. The fund will initially set aside half a percentage point of GDP – about R\$14bn – to be invested in public debt as a counter-cyclical contingency fund. This is the equivalent of increasing the size of the primary budget surplus (before debt payments) from 3.8 to 4.3 per cent of GDP.

Many critics say that, since the surplus is already running at more than 4.5 per cent over the past 12 months, the benefit of the implied cut in public spending will not accrue. Mr Meirelles agrees, but says the increased surplus is still important.

"Yes, the increase has already taken place," he says. "But there was a concern that, if the surplus had gone back to 3.8 per cent by the end of this year, there would have been a big stimulus [to inflation], and that's not going to happen." He says the central bank is keeping a close watch on the expansion of credit – and on the sharp fall in unemployment, down to 8 per cent from 12 per cent four years ago.

Mr Meirelles was about to enter politics as a member of Mr Cardoso's centrist party, the PSDB, when he was invited to head the central bank from 2003.

The fact that he is still in the job as one of the most determined defenders of orthodox monetary policy after six years of Mr Lula da Silva's administration is as clear a sign as any of Brazil's new policy consensus. Yet he agrees that fiscal policy lags behind monetary policy in creating the conditions for sustained growth. "We would welcome a little more help," he says.

VIDEO ON FT.COM

Henrique Meirelles, Brazil's central bank president, in an exclusive interview with Jonathan Wheatley
www.ft.com/meirelles

Increasingly cheerful about the future

UPWARDLY MOBILE

Richard Lapper
on the stunning turnaround in peoples' lives

School fees, health insurance, bills for two mobile phones, regular monthly payments for a new Fiat Palio bought last year and an occasional evening sipping a caipirinha cocktail or two at the local dance hall: the demands on the R\$3,000

that Edilma Silva and her partner, Neno, bring home each month keep growing.

Even so, Ms Silva, a 25-year-old self-employed manicurist, is delighted with her lot, which she says has changed beyond all recognition since she left her home in the rural north-east 12 years ago. "There are many more options, many more opportunities," says Ms Silva, who owns a modest two-bedroomed house in the eastern São Paulo suburb of Jardim Angela. "Now I am much more independent and

have so much more self-esteem."

Ms Silva is a typical beneficiary of Brazil's economic advance. Since she arrived in the more economically advanced south-east, Brazil has seen more than a decade of financial stability, steady if unspectacular growth and a sharp fall in unemployment. Social assistance programmes, originally introduced by former President Fernando Henrique Cardoso, have been expanded radically, with 13m families benefiting from the Bolsa

Familia, a plan that makes welfare payments dependent on children attending schools and clinics. President Luiz Inácio Lula da Silva has steered through a 50 per cent plus increase in the minimum wage since 2004. And credit has become much more widely available, with loans rising from the equivalent of 22 per cent of economic output in 2004 to 36 per cent this year.

The result has been a dramatic expansion in spending power among lower-income groups, with no fewer than

6m Brazilians moving out of poverty in 2006 alone. At the same time, the perspectives of many low-income groups have been transformed.

A survey last year by Ipsos, a opinion polling group, showed that the "C" social class – a category defined by income, assets and educational attainment – has grown quickly in the past two years, while the numbers of less well-off Ds and Es have shrunk. Families in the C group represented only about 34 per cent of the total in 2005 but that number had increased to 46 per cent by the end of last year.

By contrast, Ds and Es, who made up 51 per cent of Brazil in 2005, dropped to 39 per cent in 2007.

Although the average income of Cs is only R\$1,200, the widespread availability of credit has transformed living standards. "It is a very significant phenomenon," says Franck Vignard-Rosez, executive director of Cetelem, a marketing organisation which worked with Ipsos on the survey. "It is as if we had seen a population twice the size of Portugal entering the consumer economy."

Poorer Brazilians – like Ms Silva, who opened a bank account only two years ago – have suddenly been presented with a range of offers to borrow money. Televisions, DVDs, refrigerators and other white goods, computers and cars are available

on credit and although rates are relatively high, repayment periods are long.

While there is some concern that the credit expansion could prove to be temporary, another recent trend that has helped improve living standards could prove to be more durable: the remarkable growth in the formal economy. Even though Brazil is still an expensive and bureaucratic place to do business, the country has witnessed a stunning expansion in formal employment over the past couple of years.

Improved tax collection and an expansion in public-sector employment are partly responsible. But hundreds of Brazilian companies are choosing to regularise their affairs with the tax authorities in order to access capital more easily.

President Lula da Silva has steered through a 50 per cent plus increase in the minimum wage since 2004

Some 1.6m new jobs were created last year – the highest ever level – and an additional 850,000 new positions in the first four months of 2008, an increase of 27 per cent compared with 2007. "Brazil is creating jobs at unprecedented speed," says



Edilma Silva: life has been transformed

Fátima Carvalho

Marcelo Neri, director of the Centre of Social Policy at the Getúlio Vargas Foundation in Rio de Janeiro.

Already, the momentum is leading many businesses to adapt their commercial strategies in order to meet the needs of newly empowered consumers. Retailers such as Casas Bahia or Insinuante in the north-east have expanded quickly by offering credit to poorer customers. Consumer goods companies are tailoring their sales offers to the less well off, mirroring the tactics of Indian companies that have pioneered sales to the bottom of the pyramid.

Nestlé, for example, sells powdered milk in affordable sachets rather than more expensive cans and employs working-class women to sell yoghurt and dairy products door-to-door, reaching con-

sumers for whom a journey to the supermarket is prohibitively expensive.

All this seems to be producing growing optimism among Brazilians. A recent survey by Gallup, sponsored by the Inter-American Development Bank, found that Brazilians were increasingly confident about the future, with a greater proportion expecting their levels of happiness to increase over the next five years than among the citizens of any other nation in the world.

In São Paulo, Ms Silva is emblematic of that trend too.

She plans to study to be a nurse or a pedologist as soon as she finishes a course that will allow her to complete an interrupted basic schooling. "I think it will improve even more," she says.

Country surfing a big wave of confidence

Continued from Page 1

primary budget surpluses (before debt payments), inflation-targeting and central bank independence: these form the basis of stability which few question. "There is no longer any room in Brazil for populist adventurers," Mr Mercadante says.

His PT and Mr Cardoso's Social Democratic party may be on opposite sides of what remains of the political divide, but both agree that stability must be preserved.

Even so, Brazil faces some big challenges. When Mr Cardoso's government took office in 1995, it presented a list of priorities for change. Many of them were enacted. But others – especially a reform of the pensions, tax and labour systems – remain

to be done. Sérgio Vale, an economist at MB Associados, a São Paulo consultancy, says that Brazil is now reaping the rewards of past reform. "To grow long term, we need to continue with the reforms," he says.

One of the main problems is that the shape of Brazil's expensive state sector is still an obstacle to development. The cost of maintaining over-generous pension and other provisions for the middle class means that Brazil is still heavily indebted and has some of the highest interest rates in the world. Even though external debt has been virtually eliminated, net public debt in domestic currency is officially equal to 41 per cent of gross domestic product, a rate much higher than that of many of Brazil's peers.

Fiscally pressed, the government still invests too little in roads, energy and ports.

The country's soya exports – more than a third of those traded in the world – often travel thousands of miles from farm to port by lorry along potholed highways, at great cost to competitiveness. The threat of electricity rationing, last introduced in 2001-2002, looms on the horizon.

Yet many fear that the government – and even a future PSDB government, should one be elected – has little stomach for the political cost of carrying out the necessary changes. "To do reforms you have to burn up your own political capital," says Mr Cardoso. "But the gains come only over time."

Partly as a result, the reform agenda is subtly

shifting, away from what Mr Cardoso calls "hard" issues such as pensions to "soft" ones such as education and security.

Yet the last thing Brazil can afford now is complacency. There are already signs that its macroeconomic stability is coming under threat. After years of surpluses, Brazil has recently developed a current account deficit, likely to reach \$21bn by the end of this year. For the time being this is being more than covered by foreign direct investment, although the speed with which the deficit has emerged is causing concern. At the same time, inflation is creeping up and may end the year at as much as 6.5 per cent, two points above the centre of the government's target range.

In spite of such worries, Brazil's advances were rewarded this year with investment-grade ratings from Standard & Poor's and Fitch, two of the world's main ratings agencies. Such recognition, many both inside and outside the government feel, was long overdue. But such a view suggests that Brazil has laid the foundations of growth and that all it need do now is to avoid going backwards.

Yet some of the foundation stones of faster, sustainable growth, which is well within Brazil's potential, are still lacking. Leaving them out of place will risk stagnation – something Brazil well deserves to be rid of.

Brazilians, who could so easily enjoy European standards of living, will go on putting up with second best.

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Effort to mend a violent reputation

CRIME
Andrew Downie
on a decline in killings in a highly dangerous country

Brazil has a well-deserved reputation as one of the most violent nations in the world. Between 1993 and 2003, the average number of people killed each year from gunshot wounds was 32,555, according to the United Nations Educational, Scientific and Cultural Organisation (Unesco). That surpassed the annual number of deaths in conflicts in Chechnya, Nicaragua, El Salvador, Guatemala, Algeria and even the first Gulf war.

It is an expensive business. The violence cost the country R\$92bn in 2004, or about 5 per cent of gross domestic product, according to a study released last year by the government's Research Institute for Applied Economics (IPEA). But while these numbers are remarkable, recent developments suggest that all is not lost. Unexpectedly, the homicide rate is declining.

"For the first time in Brazilian history, we have had three years in which the measures of fatal violence have fallen," says Julio Jacobo Waiselfisz, author of the *Violence Map*, a government-sponsored study of homicides nationwide. "There is light at the end of the tunnel."

The reasons for the downward trend are varied. On a national level, a booming economy, rising wages and low unemployment mean more people have more money. And a far-reaching assistance programme that gives cash stipends to the poorest families has lifted

millions of people out of poverty and given them real hope for the future. The most important factor was tighter restrictions on weapons sales, introduced in 2003, says Mr Waiselfisz, a researcher for the Latin American Information and Communications Network.

Although the vast majority of weapons in circulation are unlicensed, new legislation made it harder to legally buy arms. The government also got half a million guns off the street in a buy-back programme and it increased fines and penalties for those caught carrying unlicensed weapons.

The effects of the ban were especially noticeable in the country's most populous state, São Paulo. There, by not renewing gun permits, authorities reduced the number of legal weapons in circulation to about 3,000, from a previous high of 80,000.

In Rio de Janeiro, the homicide rate fell from 46.1 per 100,000 in 2002 to 39.5 per 100,000 in 2006, according to police figures. In Recife, Brazil's most violent big city, the rate went from a high of 58.9 per 100,000 in 2001 to 53.9 per 100,000 last year, again according to police numbers.

But in São Paulo, the state homicide rate plummeted, from 36 per 100,000 in 1999 to 11.6 per 100,000 last year. The total number of homicides in the state capital dipped below 5,000, just eight years after they were at 12,800, according to Tullio Kahn, co-ordinator of planning and analysis at the São Paulo police department.

The gun ban, though, is just one of the reasons São Paulo has had particular success in fighting violence, experts and police say. Another important move was restricting late-night drinking, especially at week-



Arms cash: government has taken 500,000 guns off the street in a buy-back programme AP

ends. Almost two-thirds of homicides take place near or in illegal or unlicensed bars and clubs and more than half take place between Friday night and Sunday morning. Nineteen municipalities in São Paulo state have limited the sale of alcohol at night and dozens of small towns across the country have followed suit.

A reduction in the amount and potency of crack cocaine has also played a role, according to Nancy Cardia, vice-co-ordinator of the Centre for the Study of Violence at the University of São Paulo.

Less drugs means less violence, both by addicts desperate for cash and by dealers settling scores with clients who owe them money, she says.

The police, however, claim the most important factors are the addition of 10,000 new officers since 2000 and the introduction of a new computer system called Infocrim.

A more visible police presence has acted as an effective deterrent, especially in middle-class neighbourhoods. And the Infocrim system, similar to that employed so successfully in the 1990s by Rudy Giuliani, the then mayor of New York, has helped police map

crime and plan accordingly.

"Infocrim has helped us better distribute our force and that, obviously, has an effect. With Infocrim I can put police exactly where they are needed," says Pedro Luis Lopes, a police researcher who uses the programme on a daily basis.

Experts do not question the trend, but they are sceptical about how much is down to better policing. Petty crime has not fallen to nearly the same degree and police are still accused of corruption, violence and abuse of authority.

Experts warn that the number of killings will rise again if the authorities do not invest more in urban centres and renew efforts to get about 14m illegal weapons off the streets.

"In 2004, the homicide rate fell a lot, in 2005 it fell a little and in 2006 it levelled out," Mr Waiselfisz says. "My belief is that in 2007 it will start to rise again. The government needs to restart the disarmament campaign and take more action in poor communities. If it doesn't, more violence is inevitable."

Paying a high price for new-found wealth

TRAFFIC
Increased salaries and easier car loans have a serious downside, writes Andrew Downie

When Ariovaldo Ribeiro started life as a taxi driver 30 years ago, driving around São Paulo was still as much a pleasure as a job.

He would routinely clock up 200 miles each week without ever crossing the city limits. Today, he is lucky if he does 80.

"It's just not possible to do more than that any more," he says with a sigh. "The traffic is just too heavy."

Such sentiments are increasingly common in Brazil's biggest and most dynamic city.

Morning, noon and night, at weekends and on holidays, on main avenues and on side streets, traffic jams have sped into the collective consciousness with all the force and anguish of a head-on collision.

The main reason is the booming economy. Brazil's auto industry had a record year in 2007, producing an unprecedented 2.97m vehicles.

Higher salaries and billions given away as part of the government's social assistance programmes mean there is more discretionary income available and, with interest rates falling to their lowest in years,

more and more people can get loans.

"Why is the Brazilian automobile industry going ballistic?" President Luiz Inácio Lula da Silva asked recently. "Because of two fundamental miracles: first, an increase in people's salaries, and second, an increase in the number of payments that a person has to pay for a car."

Mr Lula da Silva added: "It used to be that, to sell a car, payments had to be made over 24 months. Only a small sector of society could afford it. Now the payments are spread over 72 months or 82 months so that the poor also have the right to buy a car."

Such "rights" have led to a growing middle class and a laudable shrinking of the gap between rich and poor.

But one of the side effects is traffic chaos, especially in São Paulo, a megalopolis with more than 10m people and 6m cars.

Almost 1,000 new vehicles hit the roads each day and gridlock is growing.

The city monitors 519 miles of roads every minute of the day and, during rush hours, it is common for more than 70 miles of them to be clogged with immovable jams.

When it rains or when accidents cause snarl-ups, collective tailbacks can surpass 140 miles.

The average speed for commuters has fallen from 20 miles an hour in 1998 to 15 miles an hour today.

"I've taken this same route to work for 10 years and

it used to take me an hour, now it takes two," says Adriana Correia da Silva, a sales analyst at an electrical company.

"It's great that people can buy cars now, great for the lower classes and great for the economy. But the government has to do more to keep up with the growth."

With typical Brazilian ingenuity, Paulistanos such as Ms da Silva have come up with creative ways to insulate themselves from the tedium of bumper to bumper tailbacks and the noise of incessant of blaring horns. She learns Spanish from CDs and flosses her teeth.

Others read, put on make up, shave, do stretching exercises, fill in crosswords and Sudoku, make telephone calls and even watch DVDs.

However, the congestion comes with serious costs, financially, socially and in terms of lives lost.

Four people die each day in traffic accidents and 25 victims of motorcycle accidents are taken to hospital.

Economically, congestion costs the city £13.5bn a year in lost labour, according to Marcos Cintra, a former São Paulo planning secretary.

And psychologically, more and more Paulistanos say they are at their wits end.

"People are stressed, people are highly strung, there's no way not to feel that way," says Valdiran Perreira, a building foreman who spends about three hours each day visiting construction sites across the city.

Rate rise threat to sector's rude health

BANKING
John Rumsey
on the dramatic rise in credit to the country's masses

Brazilian banks are defying global trends by posting healthy increases in profitability and by oozing confidence about their long-term future. Bradesco and Itaú, the two leading private-sector banks, have shot past many large European and US counterparts in market capitalisation, and are rapidly growing credit portfolios just as the rest of the world frets over how to shrink their exposure to borrowers. Still, in the near-term, higher interest rates are set to challenge the new model, threatening to choke longer-term lending and cut off cheaper funding sources.

Marcelo Cypriano, president of Bradesco, paints a picture of rude health. In a sign of long-term confidence, Bradesco is opening 194 branches this year, up from 140-150 last year, as well as increasing points of sale in a hodge-podge of outlets, such as supermarkets and pharmacies.

The bank's highly valued shares and the strength of the real would make acquisitions overseas cheaper, but Mr Cypriano does not see any reason to consider buying abroad. It is not the right moment. "We don't know where the crisis is going to end. We have been surprised by the recent turn of events and there could be more bad news," he says. While there are such rich pickings in Brazil, diverting resources to expensive foreign acquisitions is unappealing.

For now, then, the bread and butter is domestic credit. Banks are targeting the kind of clients that a few years ago they would have

thumbed their noses at, the lower-middle and working classes, Mr Cypriano says. In the past, these classes were clamouring for credit, but credit cards were considered elite products and were not issued, he says.

With consumer credit representing just 36 per cent of gross domestic product, the same level that it was in 1995, there is plenty of room for all-comers. A raft of smaller banks, that have used the more vibrant capital market scene to raise funds to on-lend, are mining the area with success, too.

Morris Dayan, executive director at São Paulo-based Banco Daycoval, says there is so much new business that the bank has not been fazed by the increasing focus of the larger operators on consumer finance. To keep

The danger is that the increase in rates will lead to increased defaults and deter banks from expanding

ahead of the big boys, Daycoval has been rapidly expanding in niche areas, such as loans to second-hand car buyers.

Increases in consumer lending have been spectacular to date, but further business is threatened by a big rise in inflation and interest rates. "What we are seeing is an increase in inflation and this is a big preoccupation to which the central bank is very attentive," says Mr Cypriano. He sees short-term rates increasing by as much as 3 percentage points from the current level of 12.25 per cent before the cycle turns and rates start to fall, probably in 2009.

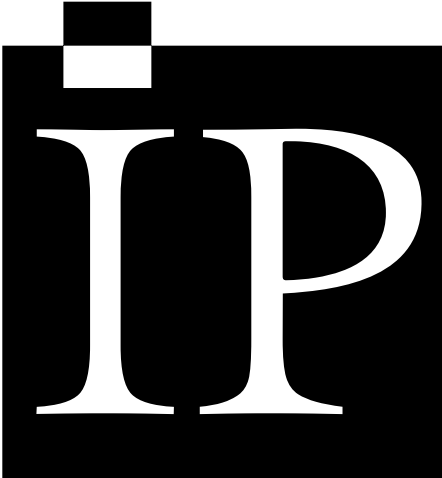
The effect of higher rates

is a double-edged sword. Banks are enjoying the extra yield on their investments and have passed on the central bank's increased rates to borrowers – and added some extra jam for themselves in the form of higher spreads, says Celina Vansetti-Hutchins, senior analyst at Moody's. The danger is that the increase in rates will lead to increased defaults and deter banks from expanding portfolios and making longer-term loans, she says.

That will slow the development of Brazil's very new mortgage market in which high loan values make long payback periods a prerequisite. Mr Dayan acknowledges that his bank's plans to roll out loan products in the housing sector have been put on hold thanks to the rise in rates. Mr Cypriano says Bradesco still has plans to triple lending to R\$6bn this year from R\$2bn in 2006. But the bank is requiring tougher credit scores and is reducing loan tenures.

Higher rates do not just hurt the banks' ability to lend, but their ability to raise capital too. Access to cheap funding is the number one challenge for smaller operators such as Daycoval. Just as rates make borrowing less appealing, the bank has seen the price of its shares fall – from R\$17 at the time of its IPO to R\$12 today. That comes in spite of a doubling of profits in 2007.

The combination of more expensive borrowing, tougher conditions for lending and higher yields on government paper is likely to see the clock turn back. The next year is likely to see a reversion to the profitable but stodgy business of taking deposits and investing conservatively in government paper. That will slow down, but not stop, the trend to bring credit to small businesses and the masses.



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Unwilling to rock the boat

POLITICS
Richard Lapper on why no one wants to approve reform of the existing system

At times over the past five or six years, it has been easy to get the impression that Brazilian politics does not matter very much. Nightly TV news reports of corruption seem to have no more relevance to the country's real development prospects than the soap operas that precede them.

The main newspapers are full of political intrigue but, for much of the business community, especially the foreign investors who have ploughed billions of dollars into the country in recent years, none of it is of any moment. Since President Luiz Inácio Lula da Silva embraced economic orthodoxy six years ago, it has been often been impossible to distinguish the politics of his left-wing Workers' party with those of the main oppo-

sition party, the Brazilian Social Democratic party of former president Fernando Henrique Cardoso. As Christopher Garman, head of Latin America at the New York-based political risk consultancy, Eurasia Group, puts it: "We are in cruise control."

Economic consensus partly explains why politics has become so unexciting. There is broad agreement about the need to maintain low inflation. After the failed experiments of the 1960s, 70s, 80s and early 90s, virtually every political leader agrees that financial instability is a bad thing.

"In the past we have tried every gimmick in the book, tried and failed," says Arminio Fraga, the former head of the central bank, who runs a fund management company in Rio de Janeiro. "There is no going backwards."

At the same time, the debate surrounding fiscal policy is narrow. In part that is, as Mr Garman explains, simply because, at a time of relative economic abundance, few politicians are prepared to argue the case for public-spending cuts,

however necessary these might be for long-term prospects. Several other inter-related factors underpin the stability of the political system. Party politics is fragmented. That is partly because of Brazil's size and the extent of regional divisions, and partly also because of an electoral system – based on the so-called open list – which makes individual legislators much more autonomous from their

Lula da Silva has embraced as many as 14 parties during certain periods of his second mandate

parties than in most other countries.

Attempts to tighten party discipline through comprehensive political reform have routinely failed. "It is one of the great taboos," says Rogerio Schmitt, political analyst at Tendencias, a São Paulo-based consultancy, who argues that politicians and the lobbies and

regions that they represent have become a vested interest opposing change. "The politicians who have to approve reforms are the same people who are elected under the existing system."

As a result, effective government depends on building coalitions between parties. President Lula da Silva has been especially expansive, building a coalition that has embraced as many as 14 parties during certain periods of his second mandate. Mr Cardoso ran a narrower coalition of four parties. But the centrist non-ideological Brazilian Democratic Movement (PMDB) – the biggest party in the country – has been a common element in both administrations.

Brazilians describe the PMDB as "physiological", by which they mean the party exists purely to occupy positions in the public administration.

Mr Lula da Silva's PT and Mr Cardoso's PSDB are still at loggerheads, mainly because of differences over long-term strategy, with the PT tending to favour a more state-centred and the PMDB a more market-based approach to development.

But there are signs that this antagonism has begun to break down, especially at a local level where representatives from both parties frequently work together.

All of this is underpinned by the relative strength of Brazilian institutions, whose very solidity softens the edges of political debate and tends to discourage radical or violent change. Constitutional law has changed little since the 19th century and electoral institutions have been in place since the mid-1930s, explains Amaury de Souza, a Rio de Janeiro-based political analyst.

Historically, Brazil has tended to evolve relatively slowly from one governmental and economic system to another. Independence was achieved not through bloody wars of liberation as in Spanish Latin America, but through the peaceful transfer of the Portuguese court from Lisbon to Rio de Janeiro. Slavery was abolished formally towards the end of the 19th century, well after it had been outlawed elsewhere in the Americas. Brazil's military dictatorships of the 1960s and 70s were less repressive and its



Lula's luck: the president (above) is reaping the rewards of economic orthodoxy Bloomberg

liberalising governments of the 1990s less radical than their equivalents in Argentina and Chile.

In the short term, there may be some uncertainty ahead of the 2010 presidential election, when Mr Lula da Silva intends to step down. Mr Garman says his clients are concerned about

the departure of Henrique Mireilles from the central bank (Mr Mireilles intends to run for political office), for example.

Even none of the four leading candidates to take over seems likely to take Brazil into a radically different direction than that followed over the past decade and a

half. True, Brazil may move slower than China, Russia or India, its fellow so-called Brics, or significant emerging market economies. But as Mohammed Grimeh, head of emerging markets at Lehman Brothers in New York puts it: "I think Brazil is the most attractive because it is always moving forward."

Names to conjure with

PRESIDENTIAL ELECTIONS
Richard Lapper profiles four front-runners

José Serra
In many ways, José Serra, the leading candidate for the opposition PSDB, is the most un-Brazilian of politicians. While his fellow citizens are well-known for their easy-going cordiality, Mr Serra is an intellectually intense and abrasive figure, obsessed by the day-to-day detail of policy.

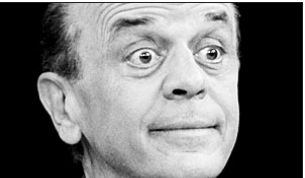
Even old friends from the political community exiled under military dictatorship find him stiff and hard to deal with, although no one doubts his enormous talent.

Now 64, Mr Serra played a big role in the government of Fernando Henrique Cardoso. In a liberal pro-market administration he was well-known as a "developmentalist", favouring a more active state stance in economic policy. As health minister, he extended basic care and was the architect of a successful anti-Aids policy, confronting the

as an individualist, refusing, for example, to support his own party's presidential candidate in the 2006 election.

Dilma Roussef
Within President Lula da Silva's Workers' party, Dilma Roussef, the 61-year-old chief of staff, has emerged as a frontrunner. That is mainly because of her reputation as a workaholic and tough manager. Ms Roussef served as energy minister between 2003 and 2005. She has a chequered past. Thirty-eight years ago, Ms Roussef, then in her early 20s, took up arms against Brazil's military dictatorship, earning particular notoriety by participating in the spectacular robbery of the house of a prominent São Paulo businessman. She was imprisoned for three years and tortured. Ms Roussef was released in 1973 and has been active in a variety of left-wing parties ever since.

Ciro Gomes
Brazilian politicians are notoriously disloyal to their parties. The 51-year-old **Ciro Gomes** exemplifies that



Clockwise from top left: José Serra; Dilma Roussef; **Ciro Gomes** and **Aécio Neves**

pharmaceutical industry in his efforts to develop generic treatments for HIV.

An unsuccessful candidate in the 2002 election, Mr Serra re-launched his political career by winning the race to become mayor of the city of São Paulo in 2004 and governor of the state of São Paulo two years later.

Aécio Neves
Aécio Neves, 48, entered political life as secretary to his grandfather, Tancredo Neves, a democratic leader who played a prominent role in the movement that brought down the military government. Initially, a member of Mr Tancredo's PMDB, Mr Neves then joined the PSDB. He is a popular governor of Minas Gerais and has sought to streamline governance and service delivery in the state. Mr Neves has been skilled at building alliances of various types and Minas Gerais has been a pioneer in the development of partnership with private business in order to develop infrastructure. At the same time, Mr Neves has been iconoclastic in breaking down antagonism that has divided the PSDB from Mr Lula da Silva's Workers' party. He is seen, however,

trend. After starting his political life as a member of a pro-military party, he switched to the middle-of-the-road Brazilian Democratic Movement party (PMDB), flirted briefly with the Brazilian Social Democratic party (PSDB), and ran for president as candidate of the ex-communist Popular Socialists (PPS) before arriving in the left-of-centre Socialist party (PSB).

Yet within the coalitions that have backed Luiz Inácio Lula da Silva's two governments, Mr Gomes has been one of the president's closest allies.

He is close to the political dynasty that has governed the rapidly growing north-eastern state of Ceará and served as governor there between 1991 and 1999, and is a federal deputy for the state. Charismatic, youthful in appearance and glamorous – in part because of his marriage to Patricia Pillar, a soap-opera star – many see him as the most likely pro-Lula candidate to survive into a second round fight against the front-runner, José Serra. But he is also temperamental, prone to indiscretion and to public losses of temper.

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In search of the perfect production partnership

OIL
Jonathan Wheatley
on the debate over
rules for companies
interested in new fields

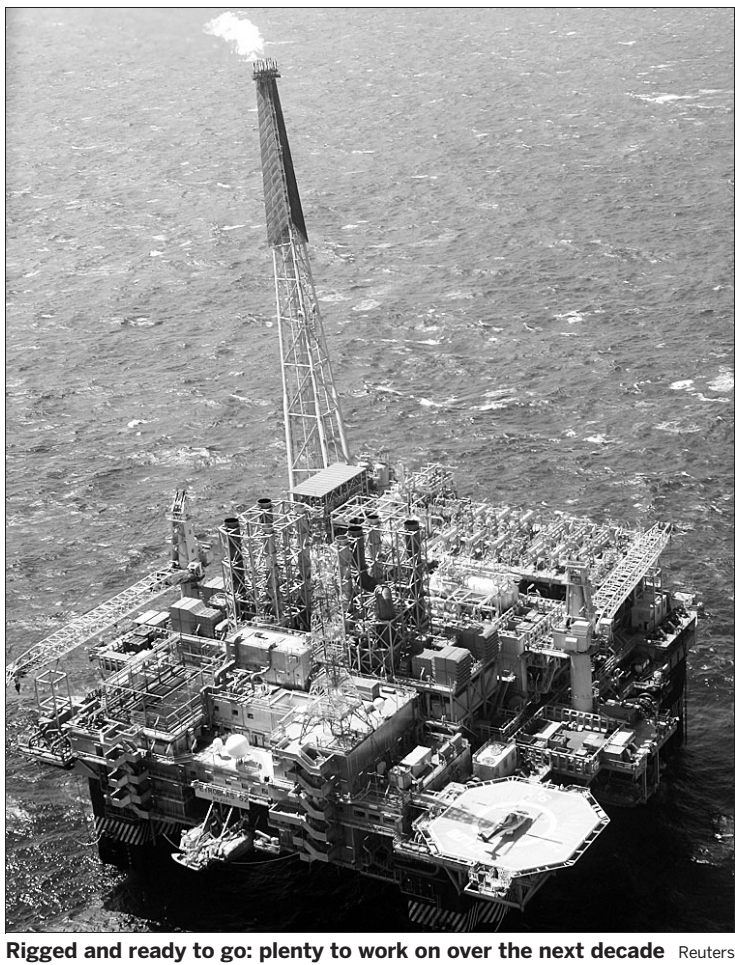
Nine months after the discovery of potentially huge deposits of oil off the coast, there is little doubt that Brazil will soon become one of the world's leading oil-producing nations. There is much more uncertainty over how the country will manage its new-found wealth. The biggest immediate doubt – beyond the technical difficulties of getting at the very deep reserves trapped beneath a salt shelf below the ocean floor – concerns the regime under which oil companies will be invited to join Petrobras, the government-controlled oil company, in bringing oil and gas to the surface. Moreover, oil has often turned out to be a curse for developing nations. “We are a late-coming oil power,” says Aloizio Mercadante, a senator for the ruling Workers’ party and an economic adviser to President Luiz Inácio Lula da Silva. “That means we can go more quickly

and learn from other nations.” Many oil-based economies have engendered authoritarian or populist regimes that find it hard to industrialise and have difficult relations with the rest of the world. Brazil, a mature democracy with solid institutions and a diverse industrial sector, should be able to avoid the worst pitfalls, he says. But it must still take care to manage its wealth properly. “We must create a sovereign wealth fund to create a post-oil society,” he says. “We need to promote health, education and technological advance – not a wave of consumption.” Plans are under way to create such a fund, which could receive between \$200bn and \$300bn within the next five years once the new oil begins to flow from 2012, according to Guido Mantega, the finance minister. But while Mr Mantega wants to create a counter-cyclical fund that would be set up immediately by buying about \$14bn in government debt – equal to about half a percentage point of gross domestic product – Mr Mercadante sides with those who would rather see Brazil use all its available resources to pay down public debt immediately, thereby producing the genuine, nominal

budget surpluses (including debt repayments) that are the basis of many other sovereign wealth funds around the world. Brazil, in contrast, runs a nominal deficit expected to be a little more than 1 per cent of GDP at the end of this year. Mr Mercadante is also at odds with those – including Sérgio Gabrielli, president of Petrobras – who would like to see Brazil change its laws to introduce a “shared-production” regime to cover reserves in the pre-salt fields. Under the present system, the Brazilian government sells concessions to companies – often working in partnership with Petrobras – to look for oil in geographical blocks. Concession holders have rights over any oil they find in return for the risk they take in looking for it, and pay royalties to the government.

Under the shared production model, the oil remains the property of the nation and companies are allowed to keep a share of whatever they produce. The main drawback of this model from the oil companies’ perspective is that the government may decide to increase or reduce production according to non-commercial considerations such as the exchange rate or the rate of inflation. Many in the government or close to it, including the director of the ANP, the industry regulator, would like simply to see a modification of the existing system, under which oil companies would merely pay a higher level of royalties for concessions in the pre-salt fields. It is easy to see why the government would want to change the rules for the pre-salt region. The first field to be analysed, known as Tupi, holds between 5bn and 8bn barrels of oil and natural gas equivalent, a huge addition to Brazil’s proven reserves of 14.4bn barrels. Initial estimates suggest the entire pre-salt field may be much larger, containing between 50bn and 70bn barrels. That would put Brazil ahead of Russia in the ranking of global oil nations. As well as being big, the pre-

salt fields contain light crude of much higher quality than the heavy crude normally found in the country. Indeed, it seems likely that much of the oil so far found has seeped up through the salt layer, expelling impurities on its way. Crucially, every well that has so far been drilled through the salt layer has struck oil. This is why the government says selling concessions for the new fields would be like handing investors a winning lottery ticket, and why it wants to change the rules. The biggest danger here, says Adriano Pires of CBIE, and energy consultancy in Rio de Janeiro, is that the regulatory uncertainty that has plagued so much private investment in Brazil will be perpetuated. “Any change involves a risk of change for the worse,” he says. “Many people are worried about what is really being proposed and what could emerge at the end of the process.” Whatever the outcome, the government had already sold nine concessions to Petrobras and private partners for blocks in the pre-salt region before it decided to stop last November, pending a rule change. That will give Petrobras and its partners plenty to work on over the next decade.



Rigged and ready to go: plenty to work on over the next decade Reuters

Smooth path in jeopardy

INFRASTRUCTURE
Jonathan Wheatley
on obstacles in the
way of an elegant
trajectory

Economic growth in Brazil has often been likened to the flight of a chicken – short, noisy, and ending with an ungainly fall to earth. Until recently, every time the economy achieved lift-off, it quickly ran into the barrier of capacity constraints and, as a result, rising inflation. If growth did not collapse on its own, the central bank would be forced to bring it down with higher interest rates. Now, Brazil’s trajectory is altogether more elegant, largely as a result of many years of stable macroeconomic policies and of the increase in investment such policies have encouraged. Brazil’s investment rate remains low by many standards but it is rising quickly. From 16.9 per cent of gross domestic product at the end of the first quarter of 2007 it jumped to 18.3 per cent this year. It is expected to be more than 25 per cent by 2015. Foreign direct investment is expected to be \$35bn this year, or about 2 per cent of

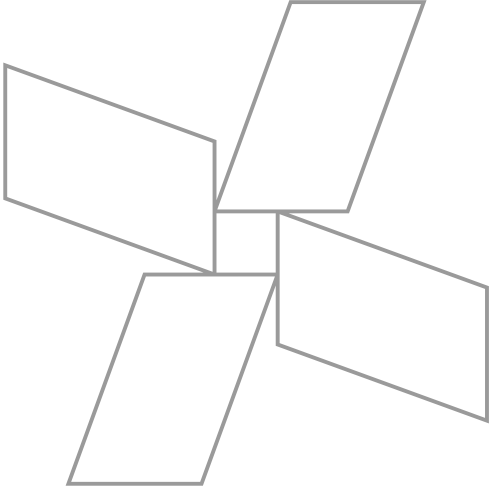


‘If it could, the government would do the investment itself. But it spent its money on things like social security’

Arminio Fraga Gávea

GDP. Local companies are investing too. Industrial production rose by 7.3 per cent in the year to the first quarter, faster than overall economic growth of 5.8 per cent. In the auto industry, output raced ahead by 21.7 per cent, with no sign of slowing. But while Brazil is quickly emerging as one of the world’s most promising markets, it still faces barriers to growth from a woeful lack of infrastructure. With rare exceptions, its highways are atrocious, adding to transport costs and eating into competitiveness. Its ports are overburdened and in need of modernisation. Electricity generation once again risks falling behind growth in demand, raising the threat of rationing, last used in 2001-02. The government has sought to show eagerness to tackle this with a programme known as the PAC, or accelerated growth programme. It proposes investments of more than \$300bn by 2010, although the bulk of the money is expected to

come from the private sector and it includes many projects already under way. Paulo Godoy, head of Abdib, an association of companies in infrastructure and basic industries, says the rate of investment, though rising, is still short of Brazil’s needs. Abdib recently produced figures showing that, at 2007 prices, investment in infrastructure rose from R\$53.6bn in 2003 to R\$84.3bn last year, and was expected to reach R\$86.6bn this year. That is still short of the R\$108.4bn Abdib says is necessary each year over the next decade to keep pace with growth. “What was lacking in the past and that we are beginning to have now is the prospect of continued economic growth, and that stimulates investment,” says Mr Godoy. But he warns that the increase in demand for infrastructure is moving more quickly than the supply. One of the most common complaints is a lack of regulatory certainty. The electricity industry is one example. Saturnino Sérgio, head of infrastructure at the São Paulo State Federation of Industry (Fiesp), says the lack of clear rules means that companies investing in generation in Brazil demand an internal rate of return of 15 per cent, compared with 8 per cent in Chile. Some progress has already been made. The government recently put stretches of federal highway out to concession, in a much-delayed but well-managed auction. But critics say it has only reluctantly agreed to private sector involvement. “If it could, the government would do the investment itself,” says Arminio Fraga, a former president of the central bank who now runs Gávea, an investment management company in Rio de Janeiro. “But it has spent all its money on things like social security so it has no alternative but to work with the private sector.” Others say Brazil’s traditional leaning towards a state-led economy is far from over. Adriano Pires of CBIE, an energy consultancy in Rio de Janeiro, says the government is seeking to expand the involvement of state-owned electricity companies in the construction of new generating capacity. “There is a clear tendency for the government to strengthen the role of state companies and increase the government’s control over the sector, to encourage migration from the free to the regulated market,” he says. Brazil embarked on privatisation in the 1990s and several sectors – steel, mining, telecommunications, electricity transmission and distribution (though so far little generation) – have delivered huge improvements in services and efficiency. The government’s apparent unwillingness to complete the job puts at risk the smooth path to growth in the future.



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**ETHICS
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Brazil | The Amazon & Capital Markets

Pragmatic solutions win the day

THE AMAZON
A consensus is emerging on saving the forest, says Jonathan Wheatley

Nowhere else on the planet do the debates over food, fuel and environmental conservation come together as they do in Brazil. The country is the world's leading exporter of a basket of agricultural commodities including soya and beef; it vies with the US to be the biggest producer of ethanol, which it makes it from sugar cane much more efficiently than US producers make it from maize; and it is home to most of the Amazon, easily the world's biggest surviving tropical rainforest. Growing output of food and fuel, critics say, is putting the Amazon at risk. It is a bald statement that contains some truth but also hides a host of complications. Yet signs are emerging of a consensus between agribusiness, conservationists and government that could allow Brazil to fulfil its natural role as food store to the world and save the Amazon at the same time. As countries develop, it seems, they must tear down their trees. The job has long been all but finished in Europe and the US. In industrialised southern Brazil, only isolated slivers remain of the once-ubiquitous Atlantic forest. The Amazon is still largely intact but if its current rate of destruction goes unchecked, it will be reduced to a patchwork of isolated forests within the next half century. This year, more than 13,000 sq km look likely to disappear, up from

about 11,000 last year – the first time the annual rate has accelerated since its steady fall from 27,000 sq km in 2004. The government says more effective policing has been responsible for the improvement in recent years and that it will redouble efforts to return the rate of destruction to its downward path. But many argue that commodity prices are a bigger influence than policing on the forest's chances of survival. Rising global demand for beef and soya has made clearing the forest for cultivation a temptation that land grabbers have little reason to resist. Even along its edges, where the modern world has encroached in the form of roads and settlements, police and environmental inspectors are so thin on the ground as to be largely ineffectual. "There are large parts of the region where the state is absent," admits Alvaro Palharini, head of the There is a greater willingness to get tough with illegal loggers and crack down on corruption

federal police environmental crimes division. Economic imperatives and lack of policing have proved a poisonous combination. The pattern of destruction has been largely unchanged for decades. Settlers first take out any trees of value then tear down the rest to clear land for pasture. As more infrastructure arrives, pasture gives over to farming – soya, rice, cotton, maize – and the ranchers



Bend in the river: the idea that landowners should not be criminalised is gaining ground

advance deeper into the forest. But this is starting to change. On one side are market forces. As consumers become more concerned about global warming, they are starting to reject products that may contribute to it. Under a voluntary soya moratorium in place since 2006, big traders have stopped buying soya from recently deforested land. Similar schemes are under way in the beef sector. Ranchers have begun signing up to programmes that encourage them to replant the most sensitive areas of forest and adopt better land management. Meat packers have begun to demand better behaviour from their suppliers, rejecting any who deforest or use forced or child labour. A new fund is being set up by the government's development bank, the BNDES, to pay landowners to conserve their forest. In the Amazon, they are obliged to keep at least 80 per cent of their land as a natural reserve – a rule that is fraught with legal imprecision and has largely been ignored. Until recently, the notion of paying landowners to obey the law was

anathema to environmentalists and the government alike. Now, the idea that landowners should be supported rather than criminalised is gaining ground. The BNDES is negotiating a contribution to the fund from Norway of \$200m a year. The fund is part of what appears to be a broader change in attitude. Previously, the government was unwilling even to talk about deforestation for fear that international pressure would dilute its sovereignty over the Amazon – always a sensitive issue. A recent change of environment minister is likely to result in and more pragmatism.

Meanwhile, policing is getting better. A recent operation known as Arc of Fire suggests a greater willingness to get tough with illegal loggers, and follows a crack-down on corruption among environmental investigators. Better policing, more sensitive government and a shift in market forces at last hold out the possibility of keeping the Amazon intact. That would leave farmers to concentrate on the enormous amounts of arable land available elsewhere to go on providing protein and biofuels to the world.

Book Review Primal wonderland fated to exploitation

Publication of John Hemming's history of the Amazon has coincided with the release of photographs by Brazil's indigenous affairs department of a rainforest tribe uncontacted by outsiders and with the resignation of the country's environment minister amid strains over development policies. *Tree of Rivers* highlights themes that have long shaped the fate of the Amazon rainforest and river system – the irresistible desire to explore a wilderness, and the strains generated by the compulsion to exploit its natural riches. As a breathtaking reminder of its size, Hemming points out that there may still be 40 to 50 uncontacted tribes. That is plausible because, even after decades of destruction, the Amazon forests with those of the adjacent Orinoco and Guianas extend to nearly 2m square miles. The river system discharges a fifth of the water that flows into the oceans from all the rivers on the planet. A consummate explorer and former head of the UK Royal Geographical Society, Hemming has done much to nurture an interest in Brazil's indigenous peoples. But his book is much more than a thrilling account of the derring-do – and foolhardiness – of determined explorers. It is an economic history of a region coveted – despite the relative poverty of much of its soil – by outsiders for its capacity to yield in abundance all the factors of production: land,

labour and capital. *Tree of Rivers* traces journeys by explorers, adventurers, slavers, biologists, soldiers, rebels and opportunists up and down the Amazon river and its tributaries since the first incursion in 1500 by a Spaniard, Vicente Yáñez Pinzón. It stops along the way at moorings that permit forays into the dark stories of unspeakable cruelty that have been played out beneath the forest canopy. Thinking he had sailed up the Ganges, for example, Yáñez provided an ominous portent – seizing 36 indigenous men as slaves.

TREE OF RIVERS
The Story of the Amazon
John Hemming
Published by Thames and Hudson
RRP £20

soya producers. Even scientific missions often had a commercial imperative. The 19th-century rubber boom is, perhaps, the most well-known period in this story but, today, land for ranches and farming is the new commodity driving development – and deforestation. The Amazon has also been a fertile source of dreams – it germinated tales of El Dorado and of what Hemming calls the "legendary tribe of sexually liberated women" after whom the river itself is named; it fuelled the radical ideas of the Enlightenment and of the noble savage; it nourished bizarre racist theories, then buried their inventors; it legitimised the colonising zeal of General Emílio Médici as a "land without people for a people without land"; and, today, it ventilates green politics everywhere as the "lungs of the world", a vast carbon sink essential for the survival of the planet. It provided a ready supply of souls for theocratically inclined Jesuits, and was a haven for runaway slaves, esoteric cults and all the most significant South American guerrilla movements. While there will always be optimism that a middle way between extraction and conservation can be found, it is a measure of how so much, yet so little, has changed since the 15th century that the story Hemming tells is one pregnant with the inevitable conflict between wonder at the discovery of new worlds, and our capacity to ruin them.

Gavin O'Toole

IPO market set to revive in second half

CAPITAL MARKETS
John Rumsey on share issuance that has come to a screeching halt

Share issuance on Brazil's capital markets has come to a screeching halt this year after a record-busting 2007 which saw the country come from nowhere to be one of the most significant issuers of new deals in the world. Faced with a hostile market environment, companies are hobbling along without new cash, fingers crossed for a second half reopening of markets. The numbers speak for themselves. In the first five months of 2007, there were just three initial public offerings (IPOs), one of which was a titdler. Throughout 2007, there were 64. With one exception, this year's IPOs have met a decidedly lukewarm reception compared with last year's deals, with rock bottom pricing. The blame for the IPO drought lies in large part with the US subprime crisis and a consequent drop-off in foreign interest. Foreigners remain vital for the Brazilian market, accounting for 70 per cent of IPO buying last year. Jittery investors have led to a jump in volatility, which has killed bankers' ability to get a clear pricing on deals. It comes at an awkward time for banks, which were betting hand over fist on Brazilian markets to make up for weaker performance elsewhere in the world. Merrill Lynch has been particularly aggressive and big local bank franchises, Bradesco and Unibanco, have both been staffing up in a belated attempt to catch up with Itaú, the local market leader. "We are having a difficult year, mainly if you compare it to 2007," admits Gilberto Mifano, CEO of Bovespa Holding, the stock exchange company. "But we are very optimistic about our future,

even our near future," he insists. There are plenty of reasons to predict a turnaround. Although Brazil is held back by global investor gloom, it is not showing signs of the developed world's stagflation: although inflation is on the rise, the economy continues to sail along nicely with gross domestic product growing at 5.4 per cent last year. The banking sector has avoided the shoals of the credit crunch, and better economic management saw the republic clinch an investment grade, allowing a far wider base of investors to at least consider investment. Despite gyrations, the Bovespa index was up, if by a modest percentage point year on year at the end of June – very much a global exception.



'Foreign investors were optimistic last year and accepted almost any kind of IPO'

Gilberto Mifano
CEO, Bovespa Holding

And Brazil is big in fashionable sectors such as oil, gas and commodities. This has allowed Eike Batista, a prolific entrepreneur, to pull off the feat of listing an untested oil company holding a clutch of licences and some good staff but no track record: investors, many of them foreign, paid \$3.9bn for shares in his OXG last month. That suggests the IPO market will revive in the second half, but selectively and not at the level of 2007. "International investors were optimistic last year and accepted almost any kind of

IPO. They are now much more selective. They won't accept just any kind of company, but want very good business prospects and large, liquid offers," says Mr Mifano. Smaller companies, which made up a large part of last year's IPOs, face specific difficulties in Brazil, says Jean-Marc Etlin, executive VP at Itaú's investment bank. There are very few funds dedicated to small- and mid-caps in Latin America and that has stymied interest, he notes. "When you have large funds taking \$15-\$20m positions in small deals, you don't leave much liquidity," he says. Rodolfo Riechert, head of investment banking at UBS Pactual in São Paulo, points out that interest may be revived because smaller companies are starting to report better-than-expected earnings. Bankers say they are not twiddling their thumbs. There has been a surge of M&A activity, Mr Riechert says, as Brazilians snap up competitors at home and expand overseas. Meanwhile, there is hope that the debt markets, traditionally terra incognita for Brazilian companies, open up with longer tenures and more competitive rates thanks to the investment grade. Corporate debt market volumes remain low because Brazil's chronically unstable past has led the central bank to adopt particularly hawkish monetary policies. The toxic combination of global inflation and higher interest rates could derail Brazil's economy and capital markets. Luiz Fernando Figueiredo, founding partner of fund manager Mauá Investimentos, is cautious. Slower growth in the G-7 countries is likely to harm commodity prices and that could bring Brazilian growth skidding down to 3.5 per cent next year, he says. Overall, he thinks, there is more downside risk than upside potential in the equity markets.

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3. HSBC (UK)	€ 123.5
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5. JP Morgan (USA)	€ 86.9
6. B. of America (USA)	€ 81.4
7. B. Santander (Spain)	€ 75.9
8. Citigroup (USA)	€ 71.4

Source: Bloomberg

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