Brazil: Boundless and Bold

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Two extremes – that might have crossed the mind of Luiz Inácio Lula da Silva, the Brazilian president, when he visited Panama last year and compared the size of his own country, the continent's largest, with the sliver of land famous for its canal. In economics, however, size isn't everything and this year Panama's GDP percentage of growth is expected to be twice that of Brazil's. The minute, mercantile republic is on The Economist Intelligence Unit's list of the 10 countries which are expected to have the fastest GDP growth this year. It may be number ten on the list, but it is also the only Latin American country on it. Panama comes in just behind China with Angola (just over 20%) taking first place; the World Bank expects Brazil, the region's largest economy, on the other hand, to grow by 4.5%.

Foreign Direct Investment is another thing. In 2007, Brazil overtook Mexico and became Latin America's largest FDI recipient. In fact, the inflow figure this January was USD4.8 billion – over USD2 billion more than the total in January 2007. According to the Morgan Stanley Capital International index, Brazil has become the world's biggest emerging market, moving ahead of China.

An abundance of investment funds, however, cannot disguise the problems highlighted by the Latin American Economic Outlook, published by the Organisation for Economic Co-operation and Development at the end of last year. Brazil (along, it should be said, with the rest of Latin America) must invest a lot more in health, education and services. The tax regime needs a complete overhaul (tax revenues collected presently equate to about 35% of GDP) because the present system is confusing and complicated to follow. Fiscal reform should be a priority.

As the title of my February 2005 (Issue 153) column suggested, Brazil is both ambitious and confident, but its vitality and boldness need to be harnessed and its economy better organised for its true potential to be realised. Last year the Bovespa, Brazil's stock market, rose in value by 60% and Brazilian companies raised capital of USD32 billion (which was twice as much as companies in the United Kingdom did) and all of it from within the country. The country's potential is boundless.

My 2005 column also mentioned the anticipated Chinese investment in Brazil's infrastructure, as opposed to the normal transitory nature of FDI. It is true that trade flows between China and Latin America as a whole have exceeded expectations, but the hoped-for long-term investment in Brazil, as well as the rest of the region, has not materialised. What's more, 90% of China's direct investment in Latin America in 2006 was found to have had a connection with the Cayman Islands, an international offshore centre. This led to many economists wondering about just how direct these investments truly were.

Africa is a different matter altogether. The Chinese are pouring funds into the Darkest Continent and it must be asked why would the Chinese choose Africa over Latin America? Stability, for a start, would not have been the attraction. It's more a case of several favourable factors fitting China's way of doing business which are welcomed by the Africans but shunned by the Latin Americans. The Chinese will bring their workers with them to build, for example, roads and ports. Besides the degree of control this gives them, it entails foreigners taking jobs from the local market which, in the case of Latin America, and particularly Brazil, would be political dynamite.

But a more pressing question, perhaps, is this: how will Brazil fare this year with the world in the financial doldrums? The answer would seem to be, rather well. For a start, domestic demand has increased and the country does not rely on just the US and Europe for overseas markets. The US, for example, accounts for under a fifth of exports with Europe, Asia and the rest of Latin America making up the balance. In January, Brazil became a net creditor to the rest of the world for the first time.

Brazil is also better insulated against financial shocks than it once was. A well-functioning and transparent central bank coupled with a floating exchange rate (since 1999) has contributed greatly to this. Having retired all of its US dollar debt, with government debt now denominated only in reais, the country avoids the past exchange rate shocks it experienced whenever its currency depreciated. But government debt is still uncomfortably high and needs to be addressed.

The robust economy owes much to the world demand for commodities which, at the same time, has meant that a great deal of reliance has been placed on commodity prices for export growth. Commodities, of course, have provided a much-needed hedge against inflation but it is a dependency that could prove to be a weakness unless you belong to the school of thought that is convinced that the demand for raw materials, driven by the 21st century's new economic powers, will be a constant and will serve as a counterbalance to the weak, world economy – including a US recession.

Is Brazil set to defy the critics and begin an era of steady growth? It has always been known as the land of the future, but one which has never arrived; perhaps it still hasn't, but one thing is clear: Brazil is certainly a land with a future.

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