PERSPECTIVE

Insights for America's Business Leaders

The Economic Ascendancy of Brazil:

What It Means for U.S. Companies

Executive Summary:

CHASE

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Brazil Rising

Brazil's ascendancy as a business-friendly market is a fortuitous confluence of fiscal policies, social progress and private sector prowess that are responsible for the country's accelerated growth. Blessed with an abundance of natural resources and a surging consumer market, Brazil is delivering on its immense potential and resurrecting dreams of *grandeza* – greatness – as it steps forward and takes its place on the global stage.

The country's historic struggle to live up to its vast promise has always been summed up in the long-standing view that "Brazil is the country of the future – and always will be." How things have changed. This issue of ***Perspective*** will provide you with insight on the economic forces driving the Brazilian economy and offer a concise picture of the business climate that awaits U.S. companies considering the range of export trade and investment opportunities in Brazil.

To effectively frame the current state and future outlook for the Brazilian economy, Standard & Poor's, Fitch Ratings and Moody's Investor Services have all rated Brazil's sovereign debt investment grade in recognition of the country's sound economic policies and the maturation of its financial institutions.

S & P was the first to take action in April 2008 when it upgraded Brazil's rating to BBB- from BB+. Fitch followed suit a few days later, awarding its BBB- rating, up from BB+. Moody's completed the triumvirate in September 2009 when it upgraded Brazil's foreign- and local-currency government bond ratings to Baa3 from speculative-grade Ba1, along with a positive outlook.

Economic Landscape At-A-Glance

As one of the last major economies to go into recession during the 2008-2009 downturn, Brazil was also one of the first among its G-20 siblings to emerge from it following GDP growth of 1.1 percent in Q2 2009. In addition, back-to-back quarters of GDP growth has given Brazilian policymakers, analysts and U.S. business leaders a number of reasons for optimism.

Global competitiveness is improving too. According to the World Competitiveness Report for 2009-10, Brazil jumped eight positions to rank 56 out of 133 countries. And in terms of GDP, Brazil now ranks as the world's eighth largest economy according to the October 2009 World Development Indicators database published by the World Bank.

Economic Snapshot (2008)
GDP (official exchange rate): $1.573 trillion.
GDP (purchasing power parity): $1.998 trillion.
Annual real growth (2008): 5.1 percent.
Per capita GDP (purchasing power parity): $10,200.

Natural resources: Iron ore, manganese, bauxite, nickel, uranium, gemstones, oil, wood, and aluminum. Brazil has 14 percent of the world's renewable fresh water.
Agriculture (6.7 percent of GDP): *Products* – coffee, soybeans, sugarcane, cocoa, rice, livestock, corn, oranges, cotton, wheat, and tobacco.
Industry (28.0 percent of GDP): *Types* – steel, iron ore, coal, commercial aircraft, chemicals, petroleum, machinery, motors, vehicles, auto parts, consumer durables, cement, and lumber.
Services (65.3 percent of GDP): *Types* – mail, telecommunications, banking, transportation, commerce, and computing.
Sources: CIA World Fact Book, November 2009.

Brazil's unemployment rate has steadily declined over the last five years and that trend continues.

Key Indicators

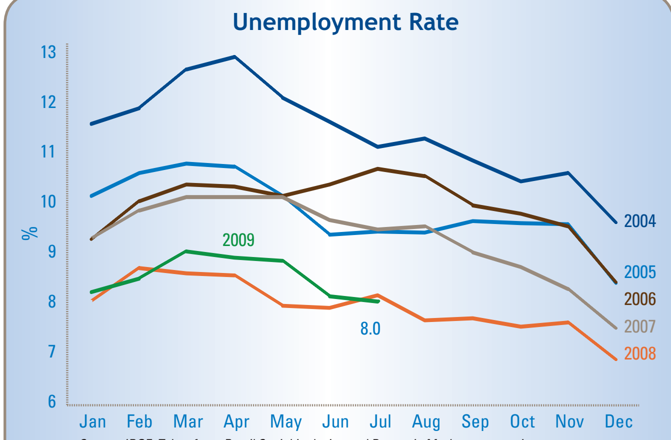
- **Trade and Development:** Brazil's economy is represented by large, well-developed agricultural, mining, manufacturing and service sectors. Brazil's import business with the U.S. is equal to approximately 15 percent of its total import trade and includes machinery, electrical and transport equipment, chemical products, oil, automotive parts and electronics. From the U.S. point of view, American exports to Brazil – our 10th largest trading partner – are rising.

Annual U.S. Trade with Brazil

Year	Exports	Imports	Balance
2009	26,175.3	20,073.9	6,101.4
2008	32,298.7	30,452.9	1,845.7
2007	24,172.3	25,644.2	(1,471.9)
2006	18,887.0	26,366.7	(7,479.7)
2005	15,371.7	24,435.5	(9,063.8)
2004	13,886.4	21,159.7	(7,273.5)
2003	11,211.0	17,910.3	(6,699.3)
2002	12,375.9	15,780.5	(3,404.6)
2001	15,879.4	14,466.3	1,413.1
2000	15,320.8	13,852.6	1,468.2

NOTE: All figures are in millions of U.S. dollars, and not seasonally adjusted unless otherwise specified.
Source: U.S. Census Bureau, Foreign Trade Division, Data Dissemination Branch, Washington, D.C. 20233

- **Job Creation:** Brazil's unemployment rate has steadily declined over the last five years (see chart) and that trend continues. The addition of almost 231,000 new jobs in October 2009 – the ninth consecutive month of job increases – has brought the total for the year to over 1 million. Labor Minister Carlos Lupi recently told reporters at a press conference in Brasilia that he expects 2 million new jobs to be created in 2010.



Source: IBGE. Taken from: Brazil Social Inclusion and Domestic Market presentation; Henrique de Campos Meirelles, Central Bank of Brazil, August 2009.

- **Energy Independence:** Following severe energy shortages in the 1970's, Brazil initiated an alternative energy development policy as a matter of national security. Decades later, the country has become the world's largest exporter of ethanol, a global leader in biofuels and clean energy development, and now uses hydropower to meet over 80 percent of its electric energy needs.

Hydroelectric power looms large in Brazil's energy plans, and the country is considering a joint venture with neighboring Peru to develop five new hydroelectric power generation plants with an investment of more than $15 billion. Brazil's Energy Minister has stated that the dams would supply Brazil's burgeoning industry, but that power output could also be exported to other countries. The dams are targeted to be operational by 2015 and expected to generate 6,000 megawatts of electricity, of which Peru would take 20 percent and export the rest to Brazil.

The recent discovery of major offshore oil fields with estimated reserves of 55 billion barrels has put the country's petroleum industry into overdrive and could propel Brazil into the world's top 10 oil-producing countries. Thirty-five years ago, more than 85 percent of Brazil's oil was imported. Today it is a net exporter.

“Latin America’s biggest economy has to manage its own success and plan its actions for a long-term horizon.”[1]
– Henrique Meirelles, President, Central Bank of Brazil

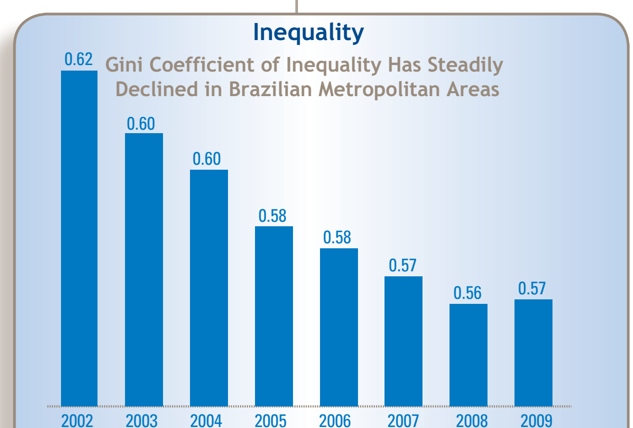
- **Agribusiness:** A surge in prices and growing global demand for coffee, soybeans, sugarcane, cocoa, rice, livestock, corn, oranges, cotton, wheat and tobacco has turned the country into a commodities powerhouse.

According to Finance Minister Guido Montega, the Q3 2009 performance indicates “Based on positive trends in industry and investments, we expect the projected growth for 2010 – currently around 5 percent – to hold.”[2]

Consumer Drivers

Brazil’s economic development in recent years has created a booming – and growing – middle class that is helping to drive consumption. For a country long divided between a small, wealthy upper class and a vast population of have-nots, it’s a positive development that many doubted just a few years ago.

Upward Mobility: Leading economists use a five-tier ranking system to classify Brazil’s population by income. Classes “A” and “B” are positioned at the top of the social ladder and make up about 15 percent of the population.

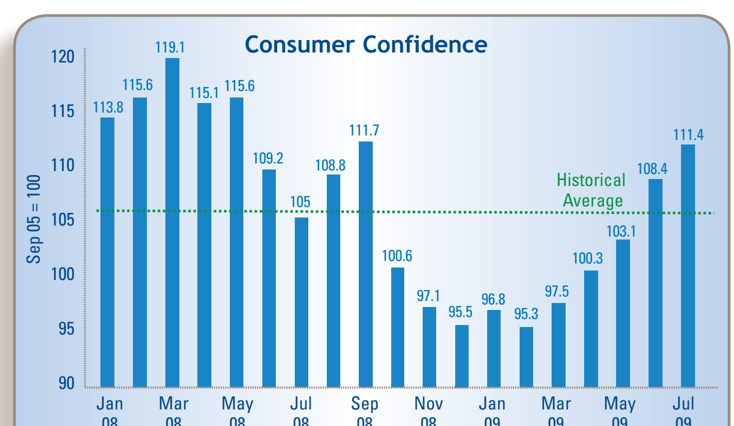


Source: FGV, year averages, until June for 2009. Taken from: Brazil Social Inclusion and Domestic Market presentation; Henrique de Campos Meirelles, Central Bank of Brazil, August 2009.

In contrast, Classes “D” and “E” lie at the bottom of the scale and are on the periphery of the economy. The Class “C” consumer segment represents the rising middle class. Based on Brazil’s robust economy generating more jobs and better salaries over the last few years, over 23 million citizens have moved up to Class C from the lower income classes. This new middle class represents 46 percent of the population, compared to 34 percent in 2005. Meanwhile, the number of people in the “D” and “E” classes has decreased to 39 percent – down from 51 percent in 2005.

Decline in Inequality: “Economies with more equal income distribution are likely to achieve higher rates of poverty reduction than very unequal countries.”[3] Brazil’s long fight against poverty and inequality has begun to bear fruit. The nation’s Gini coefficient – the calculation economists use to measure inequality – has steadily dropped throughout the decade (see chart). (The closer the Gini is to 1.0, the greater a society’s inequality.) The decrease reflects improvements in education that enabled the workforce to gain more equal access due to universal admission to primary schooling and other policies.

Increased Consumption: As consumer confidence rises, people are making big purchases again. The growing middle class as well as easier access to credit and low interest rates are lubricating sales. With credit penetration among Brazilian consumers still quite low, and bank loans – although increasing – relatively small as a percent of GDP when compared to other economies, a huge upside potential for credit expansion exists as interest rates continue to decline. Total outstanding credit as a percent of GDP increased



Source: FGV. Taken from: Brazil Social Inclusion and Domestic Market presentation; Henrique de Campos Meirelles, Central Bank of Brazil, August 2009.

from 25 percent in 2000 to 45 percent as of December 2009, and credit to households improved from 5 percent to a still low 15 percent of GDP. Home mortgage loans, as an example, is the credit component lagging behind in Brazil and currently represents only 4 percent of GDP.

> *"If the world is looking for savers, Brazil is not much good... But if it's looking for consumers, then we might be able to help."[4]*
> *– Illan Goldfajn, Chief Economist, Banco Itaú*

Financial Drivers

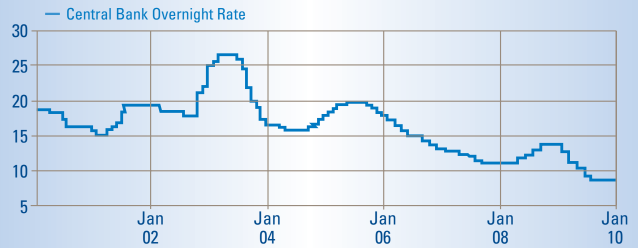
The recipe for Brazil's success is grounded in its ability to balance economic consistency over time with tremendous upside growth potential moving forward. The country is currently enjoying what Central Bank president Henrique Meirelles calls the "dividends of stability." But it wasn't always so.

- **The Plano Real:** In the 1980's and early 1990's, Brazil was in the throes of a punishing round of hyperinflation compounded by its enormous foreign debt. After careful scrutiny of its fiscal policies, the government responded with a comprehensive turnaround plan in 1994 – the Plano Real – a set of measures designed to stabilize the economy and control inflation. The plan implemented a revaluation of the currency, thereby using cheap imports to contain price inflation. This was combined with a series of contractionary fiscal and monetary policies, restricting its expenses and raising interest rates, also with the effect of dampening inflation. In addition, high interest rates attracted foreign capital essential to Brazil's development.

Brazil has seen a downward trend in interest rates as they've fallen from around 30 percent in 1995 to under 10 percent in today's market. A snapshot of the country's official interest rate, the Special System of Clearance and Custody rate (SELIC), covering the period of January 2000 through January 2010 is provided for reference.

- **Capital Markets:** A stable currency, fiscal balance and increased confidence set the stage for favorable developments in Brazil's capital markets. Growing activity in Brazil's equity index (BOVESPA) is helping re-ignite interest in buying emerging market assets through initial public offerings (IPOs). Investors, picking up signs that the global economy is healing, have devoured IPOs by newly emerging public companies in Brazil, signaling the recovery of Brazil's capital markets. For example, in 2009:
    - VisaNet raised $4.3 billion U.S. amidst excessive demand that saw them turn investors away
    - Santander Brasil, a unit of Spain's Bank Santander SA, raised $8.62 billion U.S.

Brazil Interest Rate



Sources: Banco Centro do Brasil

Meanwhile, Brazilian companies with strong balance sheets are exploiting opportunities to grow through mergers and acquisitions. The number and size of recent M&A activity is on the increase both inside and outside the country:

- InBev, a combination of Brazil's Ambev and Interbrew, acquired Anheuser-Busch
- Vale, a major Brazilian mining company, acquired Canada's Inco, beating out its two North American rivals
- Banco Pactual was sold by UBS to the bank's original Brazilian owners

- **Equity Market:** The best performing stock market in 2009, according to Reuters, was Brazil's. The São Paolo-based BOVESPA Index BVSP surged 145 percent in dollar terms, fueled in part by the rise in the value of the real versus the dollar. As the fourth largest stock exchange in the Americas in terms of market capitalization, BOVESPA lists all the country's publicly listed blue-chip firms, including Ambev, Electrobras, Embraer and Vale, among others.

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- **Debt Market:** The local corporate debt market now includes longer-maturity real-denominated assets, and there is significant liquidity in the secondary market for corporate bonds. Real-denominated corporate bond sales totaled 19.5 billion reais over the first 11 months of 2009 – more than double the amount in the same 2008 timeframe. Brazil's state development bank has announced that it will provide 10 billion reais for corporate bond purchases over the next few years. This initiative is projected to stimulate 50 billion reais in corporate debt sales as demand among wealth management companies, private banks, institutional investors and other clients for corporate bonds increases.

Brazilian companies across all lines of business are stepping up their corporate bond issuance. Phone carrier Telemar Norte Leste SA announced plans in December 2009 to raise 3.5 billion reais by selling bonds in local markets. Cia Brasileira de Distribuicao Grupo Pao de Acucar, Brazil's largest retailer, said it will issue 500 million reais in the local bond market. Large Brazilian companies are also active in offshore markets. For example, São-Paulo-based Brasil Foods, the country's biggest pork and poultry producer, plans to sell 10-year global bonds to take advantage of the rising demand for emerging market corporate debt.

- **Banking Sector:** Sound, well capitalized and led by a strong and active central bank, Brazilian banks will be key to maintaining liquidity and access to credit. In addition to necessary funding, U.S. companies doing business in Brazil now have at their disposal a number of sophisticated financial instruments, including swaps, options, futures and forward contracts, and other short-term instruments.

Industrial Drivers

With its abundance of water, food and energy, Brazil has one of the world's most advanced industrial sectors, accounting for almost 30 percent of its GDP. The country's robust $1.6 trillion economy presents attractive and potentially lucrative business opportunities for U.S. companies. Market sectors deserving of special consideration include:

Energy:

- Global leader in biofuels production, including sugarcane-based ethanol – a market that's growing at 17 percent a year, according to *The Economist,* and driven by the increased demand for flex-fuel vehicles that run on gasoline, ethanol or any mix of the two
- Discovery and development of new offshore oil and natural gas fields should generate opportunities in extraction and refining as well as infrastructure for pipeline, road and rail construction, supply chain management, information technology and logistics needs
- State-owned Petrobras ranks among the top 15 oil companies in the world; elimination of their oil monopoly opened up competition and attracted 50 international companies to the country
- Positive climate for business based on size of oil reserves, prospects for output growth, an attractive licensing regime, and a competitive environment
- Five new hydroelectric power plants being considered in joint venture with Peru

Agriculture:

- One of the world's most competitive producers of agricultural commodities
- Success rooted in market deregulation, opening markets to competition, a stabilized economy and government-supported research and development
- World leader in production of coffee, soybeans, sugarcane, beef, oranges and more
- Fourth largest agricultural exporter in the world, according to the World Trade Organization
- Potential opportunities exist for farm equipment, machinery, parts, supplies-related services and transportation logistics

Brazil is relatively unthreatened by social, demographic or political upheavals.

Aerospace:

- World-class leader; fifth largest market in the world with sales of over $16 billion
- Embraer, based in São Paolo, is the world's fourth largest commercial aircraft company behind Toulouse, France-based Airbus SAS, Chicago-based Boeing Co. and Montreal-based Bombardier, Inc. It's also the second-biggest seller of medium-sized regional jet aircraft seating up to 110 people and trails only Bombardier, which it is challenging for dominance in that market space
- The country is a major importer of aircraft parts and generated $1.6 billion between January and August 2008 alone:
    - Potential opportunities exist in civil/military aviation for helicopter parts and components (world's sixth largest fleet) – and for avionics and control systems for fixed-wing aircraft, plus maintenance, repair and overhaul
    - Growth of airline passenger traffic is creating need for airport management services
    - Potential in space sector for satellite equipment, ground support systems and consulting

Telecommunications:

- Represents largest market in Latin America and generates 35 percent of the region's revenues
- 2008 net revenue from equipment sales was $62 billion and is expected to hit $74 billion by 2012
- Mobile phone market at 151 million users in 2008 ranks Brazil fifth in the world; 78 percent market penetration

Automotive:

- World's sixth largest producer: will sell 3.1 million vehicles in 2009 and 3.4 million in 2010
- Exports estimated at $8.2 billion for 2009 and projected to hit $9.2 billion this year
- Dominated by global leaders Ford, GM, Fiat and Volkswagen
- Over 90 percent of new cars sold have flex-fuel engines
- Automotive parts industry generated sales of $38 billion in 2008; major manufacturer of factory parts, OEM parts and parts for the aftermarket

The Business Climate for U.S. Companies

Brazil is not only a stable, mature and diversified free-market economy, it is also relatively unthreatened by social, demographic or political upheavals. U.S. business leaders who consider their companies serious global contenders can ill afford to overlook the advantages of doing business in Brazil based on the country's:

- Vibrant financial markets with a full array of financial products and services
- Openness to Foreign Direct Investment (FDI) and the largest recipient of FDI in Latin America
- Prudent monetary and fiscal policies, solid macroeconomic position and controlled inflation
- Domestic consumption-led growth
- Booming middle class – better educated, more disposable income and willing to spend it
- Increasing demand for U.S. imports
- E-commerce and direct marketing potential:
    - Latin America's most advanced Internet and e-Commerce market with 20 million consumers online regularly

- Excellent postal system enables targeting of 35 million middle-class consumers
- Highly sophisticated, automated electronic payment systems in place

- Government-friendly policies that promote public-private partnerships to attract private investment
- Ambitious infrastructure development programs, e.g., the Growth Acceleration Program initiated in 2007 to address significant infrastructure needs

However, there are challenges for U.S. companies and the business landscape is somewhat Byzantine. You'll need intimate knowledge of the local environment, including the explicit as well as hidden costs of doing business. U.S. companies face tariff barriers, a difficult customs system, a heavy and unpredictable tax burden and a complex legal system. Nevertheless, many companies find that the opportunities outweigh the risks.

How JPMorgan Chase Can Help

Clients doing business in the Brazilian marketplace can leverage a broad array of commercial banking solutions, including local treasury services, foreign exchange, trade finance, local working capital finance alternatives and escrow services. In addition, you'll find:

- In-depth experience and perspective based on over 60 years of operation in Brazil
- Bilingual sales, implementation, product and customer service professionals who fully understand the nuances of Brazil's unique cash management and banking environment
- Global/regional integrated solutions that augment country-based expertise

Plus, our focused strategy and commitment to your financial needs will enable you and your company to work towards achieving business success in Brazil with greater confidence.

This issue of *Perspective* is part of a series of publications for executive business leaders compliments of Chase Commercial Banking. Each in-depth report is designed to present you with relevant news you can use on emerging business issues. For more information, please visit us online at www.chase.com/NewsYouCanUse.

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