BRAZIL

FINANCIAL TIMES **SPECIAL REPORT** | Tuesday July 7 2009

Interactive map
An oil-rich country that focuses on renewable resources
FT.com/brazil-map

www.ft.com/brazil-2009

A chance to celebrate amid the global gloom: Carnaval is renowned throughout the world but in north-east Brazil the annual Festival de São João is far more significant

AP

Dancing through the economic crisis

Is the Latin American giant finally living up to its promise? **Jonathan Wheatley** investigates

Francisco Alves and his wife Fernanda have just invested R$70,000 ($35,860), saved up over the past three years, to install new cold-rooms and other equipment at their "micro-distributor" in Recife, north-eastern Brazil.

For two days their 15 saleswomen, earning 30 per cent commission, have been pushing hand carts around the local streets selling Nestlé products – yoghurts, biscuits, coffee – door to door.

They used to distribute a competitor's products but switched to Nestlé because of the marketing and support they were offered and because their customers could increasingly afford what is seen as an aspirational brand.

"Based on what's happened over the past three years, we plan to spend another R$70,000 next year," Mr Alves says.

And the global crisis?

Of course, they say, there has been some cooling in the market. But this crisis is different from the many others that have shaken Brazil over the past couple of decades.

"Margins haven't disappeared as they did the other times," Mr Alves says.

In fact his saleswomen have just had their best two days ever.

A couple of hours inland at Caruaru, the annual Festival de São João – a traditional winter party featuring peasant costumes and forró music – is in full swing. In much of the north-east, the globally renowned Carnaval is insignificant by comparison.

At Caruaru, about 1.5m people will visit the festival between May 30 and July 10, up to 80,000 of them packing a square most days at the top of the town for 27 shows of pulsating, feel-good country music.

This year, sponsors funded the party to the tune of R$6m, a 30 per cent increase on last year, according to the organisers.

Companies such as AB Inbev – the world's biggest brewer, largely created and led by Brazilians – are keen to get their products in front of what has become one of Brazil's fastest growing markets.

AB Inbev recently launched Brahma Fresh, a milder-tasting but still potent brew, for distribution only in the north-east – a region that Ricardo Neves, regional marketing manager, describes as "spectacular".

This is one corner of Brazil's huge domestic market of 190m people, a market capable of supporting not only distinct brands but also entire industries.

Take the "flex-fuel" car. More than 90 per cent of new cars sold in Brazil have "flex" engines, capable of

Continued on Page 3

Voters want transparency and respect from leaders

POLITICS

Old-fashioned greed and graft are under pressure, writes **Jonathan Wheatley**

Reading the political pages of Brazil's newspapers it is easy to form the view that nothing has changed since the bad old days of the early 1990s, when the country teetered on the brink of collapse, with runaway inflation and a president soon to be defenestrated by impeachment proceedings for corruption.

Then, as now, the papers were full of extraordinary revelations concerning the questionable behaviour of Brazil's political leaders. Then, as now, most of those politicians were able, with a good dose of chutzpah, to ride out the storm.

The current head of the Senate, a former president, regards well-documented revelations of nepotism as "a lack of respect" for his 50 years of public service. His predecessor saw nothing wrong in an employee of a construction company delivering cash payments to his former lover. Congressmen formerly regarded as above suspicion have been caught handing out airline tickets paid for by the taxpayer to friends and relations and done little more than apologise, if that. Even former president Fernando Collor de Mello, who resigned in disgrace in 1992, is back in the Senate as a powerful government fixer.

It is hard to reconcile such old-fashioned greed and graft with the modern Brazil emerging on the world stage as an example of successful government. Yet these two Brazils do co-exist. And while the old ways will not disappear soon, new ways are growing up beside them.

"There is a historical, cultural problem of a certain backwardness which is very hard to overcome," says Jorge Gerdau, chairman of Grupo Gerdau, one of Brazil's biggest steelmakers, and of the Movimento Brasil Competitivo, a private sector organisation dedicated to reducing Brazil's enormous tax burden through efficiency in public spending. "But there is also increasing public demand for transparency and respect for the electorate."

There is plenty of evidence to support this view. Mr Gerdau says his initiative got off the ground in the 1990s, when a group of businesses from his home state of Rio Grande do Sul in southern Brazil developed a management quality programme that expanded into the public and "third" sectors. One example is a charitable hospital where the programme increased the usage of operating theatres from 50 per cent of capacity to 80 per cent.

Since 2003, INDG, a management consultancy that works with the MBC, has been selling management advice to state governments. The first was Minas Gerais in south-eastern Brazil, where INDG helped clear the state's debts of R$1.7bn in two years from 2003. Its success in putting the state's finances in order helped secure the re-election of Governor Aécio Neves in 2006.

INDG insists it is entirely non-political. Eight more states have become clients, led by government and opposition governors, and not only in the more developed south and south-east. Pernambuco, Alagoas and Sergipe in the less developed north-east hired INDG and are recognised as examples of more modern, efficient government. The consultancy also works for some of Brazil's biggest municipal governments and with the federal government's planning ministry.

Welerson Cavalieri, a consultant at INDG, says his company takes management systems that have been tried and tested in the private sector and applies them to public administration. State budgets, he says, are little more than statements of intent to which politicians have little commitment. "Our work is to set real budgets with efficient systems of control, so that monthly targets are set and evaluated at all levels," he says.

'There is a historical, cultural problem of backwardness which is very hard to overcome'

Why should politicians bother? "Voters are paying more attention to the quality of services provided by the people they elect," says Mr Cavalieri. "For politicians today, management ability is synonymous with votes. If you look at the last round of elections for state governor, the ones running for re-election who got the highest votes were those who had demonstrated the best management skills."

As he points out, such approval did not follow party lines, with candidates from government and opposition parties doing equally well. At the next presidential election in October 2010, Mr Cavalieri says management ability will be among the deciding factors.

It may well have been an issue in the 2006 poll, when President Luiz Inácio Lula da Silva – the most popular president in Brazil's history, who was seeking re-election – was forced into a second round by Geraldo Alckmin, the former governor of São Paulo state who seemed to epitomise modern managerial efficiency during his campaign.

Unfortunately for Mr Alckmin, personality also still counts and his shortage of social skills cost him dearly in the final stages.

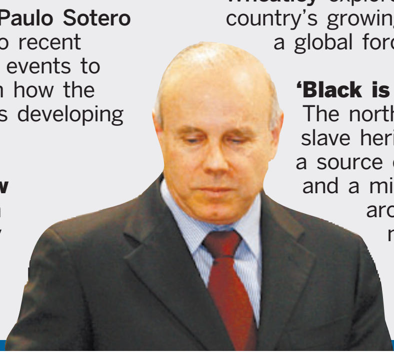
Unless Mr Lula da Silva surprises everyone by trying to run for a third term – which would demand a change to the constitution and could cause severe damage to his democratic credentials – his enormous personality will no longer be a factor.

The two most likely leading contenders are José Serra, governor of São Paulo and a leader of the centrist opposition PSDB, and Dilma Rousseff, Mr Lula da Silva's most powerful minister and a member of his leftwing PT.

Both will make much of their management ability. Mr Serra earned a name as a potent manager as health minister under Mr Lula da Silva's predecessor and has strengthened that reputation in São Paulo. Ms Rousseff is the president's right-hand woman and in charge of running the government's flagship infrastructure investment.

Given that neither has much charisma and both are regarded as prickly, each will hope voters pay more attention to their achievements than the warmth of their smiles.

Inside this issue



Exchange gains from caution and strict rules

CAPITAL MARKETS

In spite of global panic, trading has remained unshaken, says Jonathan Wheatley

As often happens in times of crisis, Brazil's capital markets were the first choice last year for investors needing cash to cover losses in the first wave of subprime panic. The sell-off was gigantic – and, as confidence has started to return, half the outflows had already been reversed before the end of last month.

Yet throughout all the turbulence, Brazil's capital markets have remained unshaken.

"At the height of the crisis and of volatility, when investors needed liquidity, the markets worked," says Maria Helena Santana, head of the CVM, Brazil's securities commission. "They stayed open and the counterparties were there. Of course, this was in line with a narrow exit door. But the BM&FBovespa [the multi-asset exchange formed last year by the merger of São Paulo's derivates and stock exchanges] was solid throughout."

One reason investors can operate with confidence on the BM&FBovespa is that the exchange itself acts as a central counterparty in all trades. "The exchange interposes itself between the two parties," says Paulo Oliveira, director for new business. This is a legacy of times when traders in Brazil had little capital and often did not trust each other to deliver. But as the market has grown – and the BM&FBovespa is now the world's fourth-biggest exchange in terms of market value, bigger than names such as the London Stock Exchange, NYSE Euronext and Nasdaq – it has proved a valuable guarantee that trades will be completed.

Mr Oliveira says stability is further underpinned by Brazilian regulations that force brokers to provide information on every trade executed by every client. In many developed markets, brokers are obliged to reveal only the net position of their clients – so that if a client is long in one asset and short in another, his exposure will count as zero. But if something goes wrong on either side of any trade, he would still be a source of risk.

This is true not only of equities trades on the Bovespa segment but also of over-the-counter derivatives trades – which must all be registered at the BM&F.

Rules governing the fund industry are similarly strict. All funds must be registered at the CVM. They must publish their investment strategy and reveal the make-up of their portfolio within 90 days of any change. They must describe in their prospectus the way they will mark asset prices to market values – the rule in Brazil for several years – and be inspected to make sure they do so. "Our rules are more wide-ranging, even for qualified investors," Ms Santana says. "We really concentrate on getting good quality information to the investor."

In the banking sector, too, rules are stricter than in many other countries. Banks must publish consolidated results – no off-balance sheet vehicles or investments in non-financial companies can be hidden away as they often were in the past. This is a legacy of an overhaul of the banking sector carried out in the late 1990s and is something, says Ross Levine, a banking industry specialist at Brown University, many developed nations could learn from. "If you are going to ask for one major output from a regulatory authority it would be transparency about the riskiness of a bank," he says.

> 'Our rules are more wide-ranging, even for qualified investors. We really concentrate on getting good quality information to the investor'

Other countries may also be watching with interest as Brazil extends the role of public sector banks in the economy. While lending from private sector banks is only about 2 per cent more than it was at the height of the credit crisis last September, lending by public sector banks has risen by nearly 20 per cent, according to the finance ministry.

Banks are more conservative than in many other jurisdictions, too. Many countries use guidelines laid down by the Bank for International Settlements in Basel – the central bank of central banks – saying banks should have assets equal to at least 8 per cent of their lending. The minimum in Brazil is 11 per cent but the average real level is closer to 18 per cent.

Alexandre Tombini, head of regulation at the central bank, says Brazil has tended to take a more conservative approach, after emerging from decades of economic volatility in the mid 1990s and shortly afterwards restructuring its banking system. "Where we have used frameworks established in other markets, we have customised them to our own economic reality," he says. "Our calibration has been very conservative."

Brazil's regulators still face challenges. One of the biggest is bringing down the enormous spreads in the banking industry – the difference between what banks pay to depositors and what they charge to borrowers. While the central bank's target overnight interest rate recently fell below 10 per cent a year for the first time in its history, rates for credit cards and overdrafts are often more than 150 per cent a year.

Among the reasons are high tax rates, obligations on banks to lend to sectors such as housing and farming, high reserve requirements – the amount of their deposits banks must park at the central bank – not to mention big profits.

But reserve requirements, while outdated in the view of many observers, have proved useful as the central was able to release R$100bn from them to provide relief to liquidity-starved banks when the crisis hit. Expect Brazil's regulators to keep erring on the side of caution.

Traders at the Brazilian Bolsa de Mercadorias e Futuros Bloomberg

Investors prepare for a rush to the market

If anyone still doubted Brazil's significance as a global equity market those doubts were surely swept away last week as VisaNet, the Brazilian arm of the credit card giant Visa, completed the biggest IPO in Brazil's history and the world's biggest this year. The sale raised $4.3bn, priced at the top of its target range, and the shares jumped 15 per cent as trading began last Monday. The vast majority of buyers were foreign investors.

The deal shows how ready many investors are to come back to Brazil and their appetite for a piece of its huge domestic market – in this case, a play on its still largely unserviced credit market.

VisaNet's success will encourage other companies to come to market. The next couple of months could see one of the highest levels of issuance in the country's history. But worries persists about how sustainable the coming round will be.

A secular drop in interest rates to single digits and low levels of debt suggest the country will suffer a shorter recession than most of the rest of the world, says Jean-Marc Etlin, executive vice-president and head of investment banking at local Banco Itaú BBA in São Paulo. Brazil implemented counter-cyclical policies early and while interest rates are down substantially they are still as high as 9.25 per cent, leaving the government room for further stimulus measures, adds Scott Piper, executive director and portfolio manager at Morgan Stanley Investment Management.

Signs of economic recovery are laying the groundwork for the issuance bonanza. Up to mid-August, Brazilian companies could raise as much as $8bn, according to Nicolas Aguzin, chief executive of Latin America at JPMorgan.

Cosmetics company Natura is planning to issue more shares and multi-brand firm Hypermarcas has also prepared a prospectus for investors, although both have been coy about details and shares suffered on the announcements, as investors fear dilution.

This jittery reaction shows how brittle confidence remains. The rush to market comes because cash-starved Brazilian companies fear the window of opportunity in equity markets may prove fleeting. Even though bankers and investors are sounding more optimistic, the uncertain outlook globally means that the durability of this latest recovery is anything but certain.

Then there are the scars left by the last boom and bust in equity markets when "investor appetite was tremendous for anything new", says Mr Piper. That allowed investment bankers to turn a fast buck. Not all deals were well executed and many did not perform well, he notes.

That means investors will be more discerning than before. New deals from large companies that have a demonstrably successful track record and proven management should get a good hearing. Mid-cap, small-cap and untested companies will mostly get the brush-off, Mr Piper believes. This is a market that is selective and focused on confirmed stories, such as follow-ons, adds Mr Etlin.

All may not be lost for companies with a less obvious appeal. Mid-cap companies are increasingly showing interest in listing directly on US equity markets, according to Mr Aguzin.

The spotlight on the equity markets means corporate debt issuance, long the wallflower at Brazil's capital markets party, still has a limited dance card. "But falling rates have stimulated two sovereign deals and one fixed-income bond from the BNDES, the national development bank," says Mr Aguzin. Furthermore, asset managers are starting to weigh up corporate issuance more seriously as yields on government debt tumble. This should provide a base for corporate fixed-income deals over the longer-term. In the short-term, international markets will continue to prove more fertile ground, with $10bn-$15bn in new issuance expected in the second half of the year, a big increase over the first half, if nothing spectacular by historical standards, says Mr Aguzin.

Brazilian companies are keeping their fingers crossed that the equity rally of recent months will keep its momentum. Their very haste to come to market is already making investors nervy and the irony is that the sheer volume of planned deals could overwhelm a fragile recovery.

John Rumsey

Natural advantages should sweeten deals

COMMODITIES

Javier Blas reports on agriculture's advantages and the pitfalls the sector needs to avoid

A large landmass, warm climate, abundant water and large amounts of unused fertile land – these are the elements that have made Brazil a leader in global agriculture commodities markets, according to President Luiz Inácio Lula da Silva. He also believes they are likely to facilitate further growth in its food exports.

"Brazilian agriculture has undergone enormous improvement in recent decades, transforming entire regions into rich farmlands and achieving global pre-eminence in the production of several agricultural commodities," says Fabiano Costa and Emma Cardy-Brown in their report "Investing in Agricultural Land in Brazil" by Agri Investments Publications.

"In the process, considerable wealth has been created where previously there was often little more than subsistence farming," they add. "Not only has the general population seen an improvement in living standards but also landowners have seen their personal fortunes rise dramatically."

Starting almost from scratch in the early 1970s with the help of Japanese trading houses such as Mitsui, Brazil has become the world's second-largest exporter of soyabeans – a key commodity for livestock feed in China.

The country is also the world's largest exporter of sugar and coffee and plays critical roles in corn, in which it is the third largest exporter, livestock and lean hogs, in which it is the world's largest and third-largest exporter, and rice, where it is the 10th largest exporter.

Brazil's natural advantages, particularly the large stock of land and abundant water, will continue to enhance the country's critical role in global agricultural markets. However, the financial crisis has also highlighted vulnerabilities of the recent expansion, notably a large accumulation of debt.

In Mato Grosso, Brazil's key state for soyabean production, banks are repossessing farm machinery while credit for fertiliser and other inputs has dried up. Some farmers are selling land or tractors to pay debts, while the government is trying to extend the terms of loans to ease pressure on farmers.

Elsewhere in Brazil, finance is so tight that Bayer, a large European chemical company, is accepting grain as payment for agrochemicals as a way to stave off a slowdown in sales as farmers struggle to obtain bank loans to raise cash.

The sugar sector is emblematic of the overall debt problem, but experts say the sector also serves as an indicator that, through consolidation, Brazil's agriculture industry could emerge stronger from the crisis.

Brazil's capital-intensive sugar industry, which leveraged its expansion on cheap debt, has suffered under the weight of the credit crunch and low prices for most of 2007 and early last year.

Five sugar companies with total production of about 1m tonnes – about 4 per cent of the country's exports – have applied in the past 18 months for "judicial recuperation", the Brazilian form of US Chapter 11 bankruptcy protection. The sector is now undergoing a rapid consolidation, with companies such as Cosan SA Industria e Comercio, the world's biggest sugar-cane processor, buying troubled smaller rivals.

Another key problem is the lack of adequate infrastructure – particularly roads – to transport crops from the frontier areas of the cerrado, near the Amazonian forest, to export terminals on coast of the Atlantic. Although Brazilia has invested considerable amounts in logistics, traders say the country lags behind its neighbour Argentina on infrastructure.

Brazil's environmental record is also a problem – the push to increase agricultural production has come, at least in part, at the cost of cutting down the fringes of the Amazonian rainforest.

Although some in the industry refers to this reputation damage as one of the "myths" about the Brazil's farming industry, the government is aware of the problem and is tightening regulations about the expansion of farmland.

Mr Costa and Ms Cardy-Brown, echo a widely-held view among industry participants and acknowledge in their report the current difficulties of farming in the country, but they add: "Brazil is definitely not for the uninitiated but, despite the turbulence in world markets, it continues to offers huge opportunities."

> Brazil is definitely not for the uninitiated but, despite the turbulence in world markets, it continues to offers huge opportunities

One of these opportunities is the local food market: Brazil's 200m population is becoming more affluent and is demanding more and more varied food.

But the export market is likely to continue to dominate production as Brazil is a world leader in low cost agricultural commodities, particularly soyabeans.

Analysts also continue to point to natural factors such as high soil quality and favourable weather – particularly rainfall – application of the latest technology such as genetic modified organisms to achieve higher yields and a move towards large-scale farms that achieve economy of scale: "As a consequence of these factors – and despite some trade barriers – the trend has been for Brazil to consistently increase exports year-on-year," the Investing in Agricultural Land in Brazil report states.

Chopped down to size: the sugar industry is facing a period of consolidation because of low prices and a lack of credit AFP

Contributors

Jonathan Wheatley
São Paulo Correspondent

Javier Blas
Commodities Correspondent

Oliver Balch
FT Contributor

Paulo Sotero
FT Contributor

Tom Griggs
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

Stability and democracy are catalysts of success

HISTORY

The sugar ethanol industry mirrors the nation's rise, says Paulo Sotero

Presidente Prudente, a bustling community of 206,000 in the south-western corner of São Paulo state, offers a good view into Brazil's rise.

From its unremarkable beginning as a stop on the Sorocabana railway when coffee was king, it is now one of two dozen prosperous municipalities at the centre of one of Brazil's success stories – agro-industry.

Less than one hour to the west, a state-of-the art ethanol plant is nearing completion. Conquista do Pontal, is one of three plants being built by ETH, a subsidiary of Grupo Odebrech with Sojitz Corporation, the Japanese trading company.

Agriculture has historically been associated with slavery and, in recent decades, with the abuse of workers rights. But, thanks to the rapid expansion of the sugar ethanol industry alongside flex-fuel cars that were introduced in 2003, it is now being transformed into an industry that is emblematic of the South American country's emergence as a social innovator on the world stage.

From 1968 to 1973 – the worst years of repression by the military regime that ruled the country until 1985 – impressive growth in gross domestic product led to predictions of a rise to global prominence. That prosperity, however, proved short-lived and unevenly distributed, aggravating the historic social inequality.

The oil shocks of the mid-1970s exposed the fragility of Brazil's position and caused a crisis that accelerated the end of military rule. It took almost a decade of civilian leadership and a series of crises for Brazil to find a route to economic stability in a politically plural, open and competitive environment.

The feat was accomplished in mid-1994 by a team lead by Fernando Henrique Cardoso. The combination of democracy and price stability, achieved for the first time in the country's history, is the root of much of the current good news coming from Brazil.

Under president Cardoso, privatisation of telecommunications, mining, aviation and highways and the regulatory reform that ended the monopoly of Petrobras further contributed to Brazil's international economic integration. Exposed to international competition, companies historically associated with Brazil's state driven development, such as Petrobras, CVRD and Embraer, became successful global enterprises.

Gerdau, Odebrecht, bus builder Marcopolo, Natura, the cosmetics maker, and other private companies followed the trend of seeking expansion abroad, generating further pressure for international integration.

The roots of this historic change have grown deeper under current President Luiz Inácio Lula da Silva. A former union leader who built his career denouncing the liberal reforms of the 1990, rose to power in 2003 after promising, in his fourth presidential campaign, to embrace and preserve the economic stability brought the reforms he once criticised.

Stability, world growth and income distribution programmes have contributed to a lowering of the country's notorious levels of inequality and to the expansion of the middle class, which now encompasses half of the population.

Brazil's resilience to the current global crisis undermines the argument that the recent economic success of South American's giant was simply a byproduct of good luck made possible by the rapid expansion of the world economy before last year's crash.

While it is true that Brazil was shielded from the worst effects of global meltdown by the shallowness of its capital markets and its limited exposure to the international economy, the country still increased its presence on the world stage.

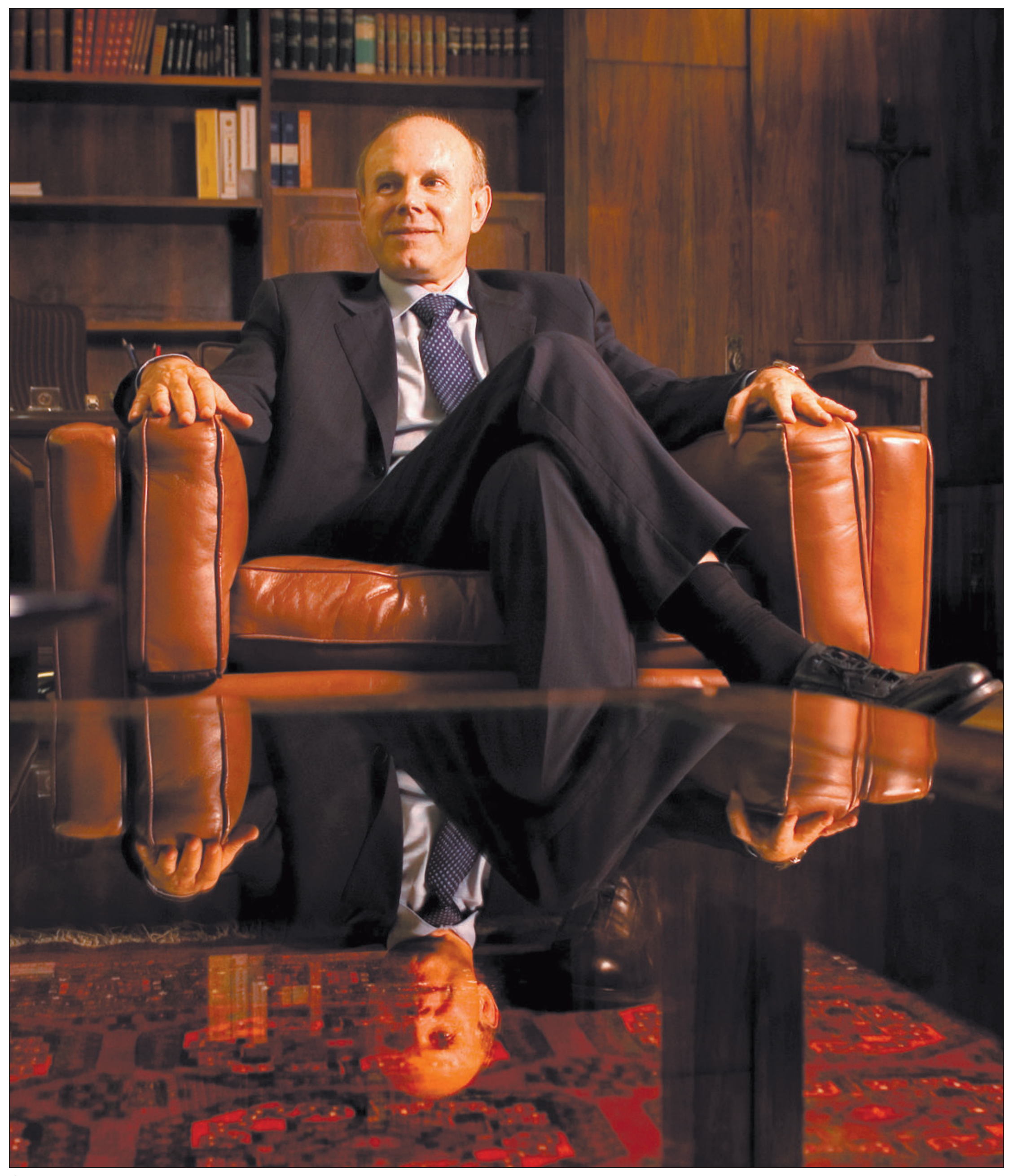
According to most measures, last year the country took Canada's place as the second-largest economy of the Americas, after the United States. It is 50 per cent bigger than Mexico and represents close to 60 per cent of South America's GDP, compared with 40 per cent in 1980.

As the country approaches next year's presidential election, the good news is that the world seems to have "brazilianised" its approach economic policy, responding to the crisis with heavy state intervention.

Furthermore, none of the top candidates to succeed Lula in January 2011, in a still unpredictable election scheduled for October 2010, advocate a change in the direction of the economic policies that helped propels Brazil's current rise.

Paulo Sotero is director of the Brazil Institute at the Woodrow Wilson International Center for Scholars

Interventionist basking in new economic orthodoxy


Sitting pretty: Mantega is keen on state intervention – which is currently in vogue anderson schneider

INTERVIEW
GUIDO MANTEGA

The finance minster tells **Jonathan Wheatley** why his economic stimuli will work

Guido Mantega, Brazil's finance minister, is finally in his element.

For years he languished in opposition as economic adviser to the leftwing PT (Workers' Party), his views clashing with the orthodox, market-friendly policies introduced by the previous government and which the Lula administration surprised many by keeping largely in place from 2003.

Since taking office in March 2006 – replacing the highly-regarded Antonio Palocci, who became caught up in scandal – he has often been derided by market economists for indecisiveness and for subverting the central bank's austere monetary policies with a softer approach to fiscal policy.

But now that state intervention is fashionable, economic orthodoxy and Mr Mantega's instincts are more closely aligned.

Often defensive in interviews, he began a recent conversation with the Financial Times in subdued mood but during 90 minutes warmed up to a cheerful ebullience, reflecting his confidence that Brazil's economic policies are working, that they are his, and that he has more successful measures up his sleeve.

He begins with a romp through the impressive array of initiatives the government has taken in response to the global economic crisis: the R$100bn released from reserve requirements to rescue a banking system starved of liquidity; the additional R$100bn provided to the BNDES, the government's development bank, to finance investment and working capital for business; and the cuts in sales taxes on motor vehicles, construction materials and household electrical goods such as fridges, cookers and washing machines.

He says the cost of the measures is far outweighed by their benefit. Revenues lost from vehicles sales taxes between December and June, for example, were just R$2bn, while sales and production have bounced back.

"Sales of cars and buses are now back to pre-crisis levels," he says. "I know of only two other countries that have done that: China, which is *hors concours*, and Germany, which is giving people a fat cheque to buy a car."

Policies such as these have been criticised for indulging a corporatist habit of picking winners, instead of giving everyone in business a smaller but equal boost.

Mr Mantega is unrepentant. "These are the sectors that most promote employment and earnings," he says.

He stresses the central role of programmes such as Bolsa Família – a relatively cheap income transfer programme that has turned millions of poor people into consumers for the first time – plus increases above inflation in the national minimum wage and pension payments – policies often criticised, in contrast, for their expense and comparatively small impact on inequality.

Far from simply reacting to the global downturn, he says, Brazil "was ready for the crisis before it happened". He cites the increase in the country's rate of investment – from 16 per cent of gross domestic product in 2006 to 19 per cent in 2009 – although economists say the rate still needs to be much higher to make Brazilian business competitive.

MORE ON FT.COM

For a map including political, economic and social statistics
www.ft.com/brazil-statistics

Increasingly, he says, investment will be driven by the state. Petrobras, the government-controlled oil company, will be hugely important.

Its investment plan of $174bn between 2009 and 2013 will drive demand for steel, ships, drilling gear, helicopters and a lot more. "It's at the head of a huge production chain," he says.

Other investment will be led by the government's "accelerated growth programme", or PAC, which in addition to Petrobras's spending includes big infrastructure projects, such as power stations, roads and railways, being contracted out to the private sector.

Mr Mantega says such stimulus to growth, along with falling public debt, low inflation, a solid fiscal base and, above all, Brazil's healthy domestic market, will push the country to the forefront of a new world order.

"Emerging markets will come out of the crisis more quickly," he says. "They have greater dynamism and smaller fiscal imbalances. The US is no longer the locomotive of world growth. Emerging countries will have to rely increasingly on their own and each other's economies."

He says those with big domestic markets – China, India, Brazil – will take a lead in driving growth, while those with abundant natural resources – Russia, Brazil – will benefit as exporters.

He is confident Brazil will meet his target of 1 per cent economic growth this year – although "we will have to work hard and keep taking measures" to make that happen – and of 4 per cent in 2010.

Among new measures in preparation is what, by Brazilian standards, is a radical move to cut the very high cost of labour. According to the World Bank/IFC's annual Doing Business report, Brazil ranks 121st out of 181 countries in terms of the ease and cost of hiring and firing workers. The average cost of firing somebody, for example, remained stuck at 37 weeks' wages from 2004 to 2009.

Mr Mantega is preparing to announce the abolition of charges – equal to 25.5 per cent of employees' wages – that companies must pay into Brazil's welfare system. He says he will do this without infringing worker's rights and that the shortfall will be covered by other measures – although he does not say what those will be.

Other initiatives in the pipeline include subsidised credit for lorries and for working capital loans from public sector banks, lower taxes on investment, and special incentives for labour-intensive industries.

"We are going to deliver a qualitative leap in productivity," he says. "We want to grab the opportunities open to Brazil in the post-crisis world."

Dancing its way through the global economic crisis

Continued from Page 1

running on gasoline or ethanol or any mixture of the two. This means motorists can decide at the pump which fuel to buy, depending on price.

Flex-fuel cars have helped Brazil become the world's sixth biggest auto producer but they are made almost entirely for Brazilians.

And the global crisis? It hit the auto industry hard, because sales depend on credit and credit disappeared from Brazil last year as it did from the rest of the world.

But the government pumped liquidity into the economy by releasing R$100bn from banks' reserve requirements – the share of their deposits they must park at the central bank – and temporarily removed vehicle sales taxes.

In May, a quarter of a million cars were sold in Brazil – 2 per cent up on May 2008.

This is the Brazil that finally, after years of unfulfilled promise, is catching the world's attention – and sucking in foreign direct investment, while many rivals go without.

It is a mature democracy with a diversified economy, a young, adaptable population revelling in increasingly stable employment and rising incomes.

It is also a rising power in food and industrial commodities, a big future exporter of oil and home to the world's fourth biggest derivatives and equities exchange.

But it is also a Brazil where old, bad habits die hard and where policy makers are still content, as the Brazilian expression has it, to push unappealing fiscal problems forward with their stomachs. And the fact that Brazil appears to be coming out of the global crisis more quickly than expected does not mean no damage has been done, nor that it is immune to further global downswings.

Instead of consistently chalking up primary fiscal surpluses (not including debt repayments) as it has for the past few years, the government has recently gone into the red, reflecting not only a slump in tax revenues but also the high cost of its stimulus packages, including tax cuts, subsidised credit and – most worryingly for the future – more public sector jobs and higher public sector pay.

Why worry? After all, bigger, more developed economies than Brazil's are going into debt to a much more alarming extent. But it is precisely because it has done much to put its fiscal house in order that Brazil has become so attractive to investors. And the government has been able to produce primary surpluses largely because tax revenues have been rising even more quickly than public spending – a trick it will not be able to pull off for ever.

Ever since Fernando Henrique Cardoso – the predecessor to President Luiz Inácio Lula da Silva – launched the inflation-busting Real Plan in 1994, there has been a well-known list of "strategic" reforms that Brazil must enact if it is to achieve sustainable, faster rates of growth and the developed nation status that is coming into view but remains tantalisingly out of reach.

There is still ambivalence about how such reform should be achieved. Guido Mantega, finance minister, told the Financial Times in an interview for this report that he is preparing to do away with the 25.5 per cent "contributions" that employers must pay on top of payroll to a slew of welfare and educational institutions.

> There is no intention to tackle the rigidities of Brazil's labour code – imported from Mussolini's Italy

This, without a doubt, would remove a big element of the *custo Brasil* that saps the competitiveness of Brazilian business.

Yet there is no intention to tackle the rigidities of Brazil's labour code – imported wholesale from Mussolini's Italy – to deliver real dynamism and agility to the jobs market.

Similarly, the government prefers to give targeted tax breaks to labour-intensive parts of the economy rather than tackle the much harder job of pushing a meaningful tax reform through Congress, delivering greater productivity and competitiveness to all.

Two storm clouds threaten to spoil Brazil's otherwise bright and sunny outlook. One is the danger of further trouble from the global crisis.

The other is the danger that this or a future government, emboldened by the global distaste for free markets, may drift away from the path of reform towards one of increasing state intervention and control of the economy.

Yet Brazil seems unlikely to veer off course into adventurism of any kind.

The country has been following broadly the same economic policies for the past 15 years, under one centre-right and one leftwing administration.

That may not sound like the full political spectrum but – unlike, say, Mexico, which has yet to put a leftwing government to the test – there is no serious contender for government in Brazil who could be expected to jeopardise the achievements of the past decade and a half.

One reason is that in the 1980s and early 1990s, Brazilians tired of quick-fix populism as its experiments went badly wrong.

Another is that Brazil, unlike Russia, India and China, with which it is constantly compared as a member of the Bric group of big emerging nations, is not only a mature, stable and diversified economy but also one largely unthreatened by social, demographic or economic upheavals.

Its institutions have developed slowly and solidly. Some economists complain that the central bank needs de jure as well as de facto independence. Yet any attempt by government, for example, to make it cut interest rates at the stroke of a pen would risk its board walking out en masse and plunging the country into crisis.

"There are powerful constraints on the will of the president," says Maílson da Nóbrega, a former finance minister and now head of Tendências, a São Paulo consultancy.

As well as the strength of democracy and institutions, he points to Brazil's independent, investigative media and the population's abiding intolerance of inflation.

Such constraints on power, he says, are akin to England's Glorious Revolution of 1688 and are what makes Brazil different from some of its neighbours and other emerging market rivals.

This does not mean Brazil's work is done. Everywhere you look in the country, the old Brazil is present: in its dilapidated roads and other infrastructure, its out-of-my-way drivers, the threat of violent crime and the acceptance of graft as normal in public life.

But if talk of green shoots makes sense anywhere in the world it is in Brazil, an emerging world leader in farming, mining, oil, even investment banking, and with a home market its rivals can only dream of.

New status still relies on global economy

WORLD STAGE

Jonathan Wheatley investigates how the global view of the Latin American giant is changing

For Brazilians only just waking up to their country's new-found global status, it was a revelatory moment.

"He's my man. I love this guy," Barack Obama, US president, was captured saying by a television crew as he approached his colleague Luiz Inácio Lula da Silva of Brazil at the G20 summit in London in April. "He's the most popular politician on earth."

Never mind that the comment was flippant ("It's because of his good looks," Mr Obama added). The effect on Brazilians was electric. Here was recognition indeed.

Brazil's global ambitions have often been thwarted in the past. It granted market economy status to China in the hope of Chinese support for its claim to a permanent seat on the United Nations Security Council and on the expectation of $8bn of Chinese investment in infrastructure in Brazil – neither of which have materialised.

In South America – a continent from which Brazil often feels peculiarly distant – it has met uppity behaviour from trading partners, such as Bolivia and Ecuador, with a magnanimity whose driving impulse often appears to be little more than a need to be liked.

But over the past year, Brazil has found itself being taken more seriously.

The stability of its banking system and capital markets in the face of the global crisis have made regulators in other countries keen to hear its views.

Brazilian officials have newly prominent roles on the Financial Stability Board (the enhanced and re-launched Financial Stability Forum), the Basle Committee on Banking Supervision, the International Accounting Standards Board and the International Organisation of Securities Commissions.

Last month Mr Lula da Silva took part in the first heads of state meeting of the Bric countries. If many commentators wondered what Brazil, Russia, India and China had in common, beyond forming a catchy acronym dreamt up by the sell side of an investment bank, few would deny that the countries will have a higher profile on the post-crisis international landscape.

"The world knows it cannot go forward without these countries," says Rubens Barbosa, a former ambassador to London and Washington.

Mr Barbosa says Brazil should resist a tendency to concentrate its diplomacy on "south-south" relations at the expense of building closer ties with developed countries. The US and Brazil, for example, while on perfectly friendly terms for years, have also been happy largely to ignore each other.

Yet many aspects of Brazilian monetary and fiscal policy – not to mention the strength of its institutions and diversity of its economy – have more in common with developed nations than emerging ones. As the shape of the world's multilateral organisations changes at a rate accelerated by the global crisis, Brazil's position can only be strengthened.

Last month, it agreed to buy $10bn of bonds to be issued by the International Monetary Fund – an institution that Mr Lula da Silva and his followers used to enjoy telling raucously to go home.

> Brazil should resist a tendency to concentrate diplomacy on 'south-south' relations

Just a few years ago it was unthinkable that the G7 group of the world's richest nations should take a back seat to the G20, composed of the biggest developed and developing ones. Now the reverse is true.

Nevertheless, Brazilian officials are wary of celebrating their new status too soon.

"It is a fact that the G20, rather than the G7, is at the centre of the global response to the crisis," says one diplomat. "But we don't suffer from the illusion of seeing this as a definitive conquest."

The advance of Brazilian diplomacy has been mirrored by the private sector. Petrobras, the government-controlled oil group, is already one of the biggest companies in the global industry and is destined for greater prominence with the discovery in 2007 of massive new reserves off Brazil's coast.

Vale, the world's biggest producer of iron ore, has been expanding for years – although the global crisis forced it to fire more than a tenth of its workers last year and scale back production. It came close to buying rival Xstrata last year and has again been the focus of acquisition rumours as the mining industry shows signs of pulling out of the downturn.

AmBev, formed by the merger of two Brazilian brewers in 1998, first merged with Interbrew of Belgium, then bought Anhauser-Busch of the US last year to form AB InBev, the world's biggest brewery, firmly under Brazilian command. Yet even in a "defensive" sector such as brewing – where sales tend to hold up even in times of crisis – AB InBev has been trying to sell some of its smaller brewers to pay its debts.

Brasil Foods, formed in May by the merger of Perdigão and Sadia, two food processors, is being described as "the AmBev of chicken". But the company's origins suggest a note of caution: Sadia agreed to merge with its formerly smaller rival after losing R$2.3bn in bets on Brazil's currency that went badly wrong.

Jorge Gerdau, chairman of Grupo Gerdau, one of Brazil's biggest steel makers, which makes more steel outside than inside Brazil, says the "irresponsible euphoria" of recent years has disappeared. "Consolidation used to be driven by the search for profit," he says. "Now it is being driven by the need to cut costs."

That is a sober warning not only to Brazil's newly emerging multinational companies but also to its diplomats. The biggest threat to their future success – fresh turmoil in the world economy – lies largely beyond their control.

Presidents embrace: Barack Obama and Luiz Inácio Lula da Silva meet at the G20 summit in London AFP

Banker making waves on world stage

Andre Esteves

André Esteves is overflowing with enthusiasm. A billionaire in his early forties, a workaholic who is also a dedicated family man, his energy levels are so high he cannot sit still but is apologetic to the point of being embarrassed when he has to step outside briefly during an interview to take a phone call.

He also admits to having been annoyed – though he is perfectly nice about it – when the FT accused him of having reversed his strategic thinking.

In 2006, he hailed the benefits of being part of a large global financial institution as he explained the decision to sell Pactual, the Brazilian investment bank, to UBS for $2.5bn. But in April this year, he argued that the private partnership could expand globally as he revealed that BTG, his new investment vehicle, was buying back Pactual from the Swiss bank.

"I didn't change my view," he says now. "The world changed."

Pactual, the Rio de Janeiro-based investment bank he joined as a 21-year-old systems analyst in 1989, has its roots in the emergence of Brazil's small but aggressive results-based investment banking culture in the 1970s and 1980s. Mr Esteves rose quickly through the bank and, in 1999, he and other younger partners wrested control from its founding partners.

When UBS bought Pactual in 2006, Mr Esteves sensed the chance to rise to the top of a much bigger organisation. Yet while he avoids criticising his former colleagues at UBS in London – where he moved to become head of the bank's fixed-income operations – he gives the impression of frustration at not being given the freedom to turn the business around.

He left UBS a year ago and returned to Brazil to create BTG – which nominally stands for Banking and Trading Group but which Mr Esteves let it be known early on really stood for "back to the game".

"Brazil," he says, "is going through its best period ever. We will never forget that Brazil is our core market."

BTG already has operations in London, New York and Hong Kong. The Brazilian operation will focus on selling Brazilian securities to foreign customers and attracting foreign direct investment to Brazil. The New York office is a broker dealer focussed on US Treasury bills, mortgage-backed securities and other bonds –"a very nice rates business I developed based on my experience at UBS".

The question is how far he can take BTG Pactual in the post-crisis world. At the risk of offending him again: a year ago, he talked of building BTG into a genuinely global investment banking franchise. Now, he talks of creating a Brazilian investment bank with significant international operations.

"You shouldn't try to do everything for everybody," he says. "You should do what you do with quality and consistency."

In the post-crisis world, he says, banks will have to go back to basics. Hence BTG Pactual's culture of meritocracy and long-term alignment through a partnership structure. "There's been a lot of criticism of bonuses," he says. "We pay completely on performance but we really execute it. If we're not performing well, nobody gets a bonus, including me."

He sees BTG Pactual taking its place in a world with fewer multiservice banks and more niche players, such as Blackstone, the US private equity, asset management and advisory group, and Citadel, the US alternative investment and trading group.

Big investment banks have collapsed, he says, through being cavalier about risk. "There were a lot of fake financial results around," he says. "People need to be more conservative in understanding their own abilities."

His model? "It's difficult to replicate Goldman Sachs and Morgan Stanley. But you can work to the same standard and we're not far from that."

Jonathan Wheatley

Society's glass ceiling for Afro-Brazilians remains

CULTURE

Oliver Balch visits the former slavery-dominated region of the north-east

"Black is Culture". The phrase appears on t-shirts and banners across Brazil. It is more than lazy stereotyping. No float during Rio de Janeiro carnival is more eagerly anticipated than the Blocos Afros. No footballer is more highly vaunted than the "next Pelé".

And nowhere is Afro-Brazilian culture more vaunted than in Pernambuco. Jutting into the Atlantic ocean, this black and mestizo dominated state survived for centuries on its slave-driven sugar trade.

Around three million Africans made the torturous journey to Brazil during the colonial era. In the country's north-east, their descendants continue to vigourously celebrate the music, art and religions of their African origins.

My introduction to this region's rich cultural legacy came in bohemian Olinda. Inside a community theatre, the audience was drinking rum and wolfing down heaped platefuls of feijoada while a flamboyant company of bare-foot dancers bounded onto the stage. The troupe resembled a band of Congolese warriors.

I had stumbled on an authentic marakatú in session – up there with a candomblé religious ceremony or capoieira martial art class as one of the region's most authentic cultural experiences.

The performance concluded with a glittering coronation scene: originally styled on the Portuguese court, a local marakatú instructor gave a different take on the ceremony: "It's to remind us we were once kings, not slaves."

Given that many of the slaves shipped to Pernambuco came from tribal kingdoms in West Africa, the interpretation contains more than a grain of truth.

Brazilians are proud of their cultural and ethnic heritage, especially in the Afro-Brazilian dominated north-east. Its importance goes beyond the fun of carnival. It backs up the country's carefully manicured image as a champion of multiculturalism.

"Brazil is a racial democracy. To see that, you only need to compare our experience with that of the United States…There were never segregation laws here after emancipation," argues Professor Maria Coelho Prado, a historian at the University of São Paulo.

She cites tough anti-racism legislation passed in the past three decades as evidence of Brazil's official commitment to colour blindness. "But that not to say that Brazil still doesn't suffer silent discrimination", she admits.

It is an important caveat, and one backed up by statistics. Seven in ten of very poor Brazilians are non-white. As well as being one of the most Afro-Brazilian provinces, Pernambuco is also one of the poorest.

Education figures are equally alarming. Children of mixed-race or Afro-Brazilian couples typically receive two years less education than their white peers, according to the Ministry of Education. Only one in 20 Afro-Brazilians between 18 and 24 is enrolled in a university or equivalent institution. That number jumps to 37.3 per cent for whites of the same age.

In the light of such disparities, race activists argue that the strong association of culture with Afro-Brazilians is potentially restrictive and unhelpful.

"Naturally, black music, art and religion…[are] a vital tool in self-identity", concedes Silvio Humberto, director of the Steve Biko Institute, a black rights advocacy organisation.

> 'Brazil is a racial democracy . . . there were never segregation laws here'

But when a black person tries to step into the worlds of politics, business or academia, then the "fiction" of Brazil's racial democracy becomes apparent, he argues: "Culture is a space reservoir for blacks here. It hems them in."

Brazil's strong African roots are celebrated in Pernambuco

Six kilometres down the coast from Olinda lies Recife, the state capital and scene of one of Brazil's best-known carnivals. I arrived in time to catch a month-long Afro-Brazilian cultural festival, organised by the province's tourism authority in December to provide a warm-up to carnival season.

The event offered a dizzying array of music and dance genres: forró, frevo, coco, maculele, afoxé, ciranda, seresta, caboclinhos.

I opted to follow my ear, which led me to a bandstand where a guitar-led quartet was playing charinho.

The romantic spell was soon broken by a costumed troupe acting out a traditional samba, which has a more hard-edged, backcountry feel to than its contemporary namesake.

A fiddler-cum-clown led a curious musical assortment comprising a tambourine, a pair of elongated maracas and an 'agogo' – a high-pitched, conical bell connected by what looked like a plumber's U-bend and struck with a metal baton.

By midnight, a forró party in the main square had reached full swing. Forró is not the easiest of musical genres to nail down: heavy percussion, and accordion, overlaid with a splice of rock and jazz, and charged up with some serious electronics.

My party legs worn out, I returned to my hotel to find a procession of musicians blocking the door.

Eventually they moved on, their romantic serestra ballads and midnight cheer growing fainter and fainter as they danced down the hill and into the night.

Black is culture – of that there's no doubt. But it needs to mean more.

When it does, South America's self-acclaimed rainbow nation will have a true cause for celebration.

Oliver Balch is author of the travel book, Viva South America, published by Faber & Faber in March 2009.