



## Brazil Has Buzz

By Levi Folk, October 2009



When you're hot you're hot, and recently Brazil has been on a roll. It locked down the 2016 summer Olympics for Rio de Janeiro last week and completed an US\$8-billion public offering on its stock market yesterday, the biggest globally since the financial crisis began. China was making all the headlines at the start of the year, but recently the buzz is all about Brazil – and for good reason, too.

With the announcement this week that Brazil is becoming a creditor to the International Monetary Fund, with a US\$10-billion loan, it completed its transformation from sinner to saint. **The country was among the first to emerge from the global economic recession and looks destined for more gains in the near term.**

It was just over a decade ago that Brazil was forced into an IMF-recommended austerity plan with the promise of a US\$30-billion loan. The IMF plan was equivalent to a medieval torture ritual devised to cure Brazil of its profligate ways. The country was on the verge of collapse from a debt and inflation spiral that forced it to the brink of bankruptcy.

Despite the intense pain inflicted on its people, the IMF plan worked, and over the course of this decade the country has since shed much of each its foreign debt (with a tailwind of rising oil revenues) and wrestled inflation back under control.

**Its achievement was crowned last week with the announcement that Rio de Janeiro will play host to the 2016 Olympic games.** That news is creating a positive buzz that will continue

to attract capital to the region and allow the currency, the real, to build on its 32% gain versus the U.S. dollar since the start of the year.

The Olympics will catalyze the need for more infrastructure development in Brazil that will see billions of dollars in outlays over the next decade. The country is planning on building a new rail link between Rio de Janeiro and São Paulo, Brazil's capital city, for example.

**The outlook for the economy has been given a significant bump by the IMF in its World Economic Outlook** released last week and after it registered positive growth of 1.9% in the second quarter of the year. GDP growth is forecasted to grow 3.1% in 2010, up from an earlier estimate of 1.0% growth back in July. Domestic demand is strong in Brazil, far more developed than in China, and is propelling the economy forward, with auto sales reaching a record pace in September, rising 15% on the month. Trade is also benefiting from strong trade links to emerging countries, China in particular, its main trading partner.

Growth this year and next does come at a price – a smear of red ink on the government's books, forecasted to be in deficit of more than 5% of GDP this year.

**Yet despite perceptions of greater risks to investors in emerging markets, Brazil stood this concept on its head over the past year.** Its banking system proved far better regulated than those in the developed world, with the exception of banks here in Canada. Brazilian banks were subject to higher capital requirements that encouraged less risky lending practices.

Yesterday, Banco Santander, the Brazilian unit of Spain's largest bank, completed an US\$8-billion initial public offering, the largest ever in Brazil, and the biggest IPO globally since the financial crisis spoiled investors' taste for new deals. The bank's share price fell 3.74%, but the potential for growth in banking is substantial in Brazil given the very low credit penetration across the economy. Mortgage credit represents a mere 2% of GDP.

The stock market has appreciated 90% since the start of the year in Canadian dollar terms, and as a result a market that was a screaming buy at the end of last year, is trading slightly above its long-term average valuation measure. That may not stop the market from moving higher in the near term because Brazil has a buzz and investors are buying in.

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