Brazil

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Fraga: "a film of deterioration and frustration"

Furthermore, Brazil has been registering a current account deficit of over 3.5% of GDP. "Brazil will have to finance this internationally at a time when international liquidity may fall quite a bit. The China slowdown may also hurt us, this would hamper exports, all of this may squeeze us," Fraga told *Emerging Markets*. "If we get to this point with a relatively large current account deficit, the impact will be even greater."

Fraga also said Brazil is ill-prepared for an eventual hike in US interest rates. "It is not possible to avoid the impact of such an event, so Brazil has to prepare for it, it has to recover its credibility in terms of macroeconomic policies. The impact cannot be totally avoided, but it can be softened."

Brazilian officials have been bolstered by the market reaction in the aftermath of this week's Standard & Poor's downgrade, but their policy record has continued to be questioned. Critics have stopped short of predicting an immediate collapse of the Brazilian economy or a sudden stop of capital flows in the light of the new US monetary policy, but they say warning signs have already been flagged.

POOR QUALITY

The Institute of International Finance has pointed at "policy inconsistencies" that led to a mix of low economic growth, high inflation against a background of low productivity. The central bank now forecasts economic growth to reach 2% this year, following 2.3% last year, according to its quarterly report issued yesterday, while inflation is expected to reach 6.1%.

"Policies are of poor quality. But the government seems to be ignoring the warnings. If they continue the way they do, the situation [is] not going to be stable," said John Welch, emerging market macro strategist at CIBC in Vancouver.

The government has pledged to restore fiscal discipline during an election year in order to alleviate investors' fear and boost Dilma Rousseff's chances of re-election. In order to restore credibility, Brazilian officials have said they will pursue a primary surplus target of 1.9% of GDP in 2014. But in February, the central government actually registered a primary fiscal deficit of over R$3bn, is the worst performance in five years.

Nevertheless, Standard & Poor's, which downgraded Brazil's sovereign ratings this week, said they did not expect greater fiscal damage. However Sebastian Briozzo, senior director at S&P said Brazil had "very little room of manoeuvre to face an external shock".

THE final word

Countries that learned the lessons of past crises are likely to continue performing well and overcome immediate challenges

By William R. Rhodes

When looking at the prospects of Latin America it is important to look beyond short-term concerns and place the economies of the region in a broader framework. I have been engaged in the region since my days as a student and my early years as a banker when I lived in Venezuela. My associations deepened when I played lead negotiating roles on behalf of creditors in the 1980s and 1990s in the Latin American debt crisis working with then US Fed chairman Paul Volcker, IMF Managing Director Jacques de Larosiére, and US Treasury Secretary Nicholas Brady on the "Brady Plan" to find sustainable crisis solutions.

Since then, my travels to the region have brought me together with many new entrepreneurs and leaders of governments. My conclusion today is straightforward: those countries that learned the lessons of the crises of the 1980s and 1990s have done well and are positioned for significant further prosperity; those that have ignored the experiences of the past are now in difficulties and their problems may multiply.

> "Never delay tough actions in the hope that things will somehow get better, they will only get worse."

Countries like Mexico, Chile, Brazil, Peru, Uruguay and Colombia, have worked to put in place sound economic policies and institutions to support and foster these policies. Each country has faced major economic and financial crises and each saw courageous and intelligent leaders come forward to mobilize public support behind essential and difficult economic reform programmes that offered the promise of restored growth.

A number have used the era of "quantitative easing" and high liquidity to make further progress on structural reform and deregulation to modernize their economies and provide entrepreneurs with opportunities to build globally competitive businesses. Sound fiscal policies have mostly accompanied the structural reforms. At the same time, a number have appointed highly skilled central bankers and ensured they have the independence to take unpopular, but necessary, measures.

Every country is different and there are no 'cookie-cutter' solutions to economic challenges. But as we learned in the 1980s, it never pays to underestimate the dangers of contagion. Today, given the intensity of globalization and the integration of financial markets, the damage contagion can produce is substantial. It forces government leaders and central bankers to remember a key lesson of the 1980s: never delay tough actions in the hope things will somehow get better, they will only get worse.

The most successful political leaders in the region understand this. Their effectiveness underscores another lesson: strong political leadership that can build public support behind economic measures that may be unpopular, but necessary, is crucial.

There are three major global developments that are clouding the short-term prospects for the countries of Latin America:

- First the deterioration in global geopolitics created by Russia's moves on Crimea and the Ukraine will have a negative impact on the global economy due to uncertainties in financial markets and corporations becoming more cautious about foreign investments.
- Second, the decision by the US Federal Reserve board to slow its purchases of government bonds and the possibility of an early move to push up interest rates hinted at by Fed chair Janet Yellen have stimulated short-term capital outflows from Latin America and will continue to exert pressures.
- Third the economic slowdown in China is impacting non-food commodity exports by a number of countries.

While the lessons of past crises are influencing the actions of many of today's leaders, there remains much work to be done in understanding the dynamics of our globalized economy and introducing the appropriate policy responses. Many countries remain too dependent on natural resource exports and that makes them vulnerable. Globalization demands countries build diverse economic bases. In the case of a number of Latin American countries the tempo of such efforts needs to accelerate. They also need to continue investing in education and new technologies and in building effective public sector institutions.

Economies that encourage private sector investment, both domestic and foreign, will be the ones that best weather the storms that volatile short-term money often creates. Latin America will continue to be subject to hot inflows and outflows and its best defence rests in ensuring its economic fundamentals are solid and generate confidence.

Overall, I am optimistic about the region's prospects, despite the concerning conditions in some countries that pursue bad policies and whose populations suffer as a result. Democracy is firmly entrenched in most countries; younger generations of technology-savvy entrepreneurs are emerging fast; education standards are rising; and, leaders most responsible for public policy remain acutely aware of the lessons of past crises.

It is these strengths that not only make me confident that most of the major national economies in the region will manage prudently the short-term strains unleashed by geopolitics and the Fed's exiting from its exceptionally easy monetary policies. Therefore I think the region will continue to be an important engine of the world's economy.

William R. Rhodes is President & CEO, William R. Rhodes Global Advisors, LLC. He is the author of Banker to the World: Leadership Lessons from the Front Lines of Global Finance, *now been published in both Portuguese (foreword by Arminio Fraga) and Spanish (foreword by Angel Gurria).*

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