

## **Recovery and New Challenges**

### **Brazil's Economic Performance in 2004 and Early 2005**

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## Recovery and New Challenges

### Brazil's Economic Performance in 2004 and Early 2005 September 2005.

At the beginning of 2004, Brazilian society found itself facing a hopeful scenario that combined growth, low inflation, fiscal balance and control of spending accounts.

The 4.9% growth of the Brazilian GDP in 2004 was the best rate of growth since 1994 (when the GDP grew by 5.9%). However, this rate is still modest when compared with the median rate of growth for Latin American and Caribbean countries, which was 5.9% in 2004, according to CEPAL.

Various factors contributed to this performance, including: 1) the reduction of the basic interest tax (SELIC); 2) the export sector has brought about an increase in the trade balance (increased rates of agricultural and industrial commodities); and 3) the expansion of the internal market due to more widely available consumer credit.

Tabela 1 - PIB e crescimento da população (em %)

	Varição do PIB	Taxa de crescimento da população	Crescimento do PIB per capita
1990	-4,3	-	-7,1
1991	1,0	1,7	-0,7
1992	-0,5	1,6	-2,2
1993	4,9	1,6	3,3
1994	5,9	1,6	4,2
1995	4,2	1,6	2,6
1996	2,7	1,5	1,1
1997	3,3	1,5	1,7
1998	0,1	1,5	-1,4
1999	0,8	1,5	-0,7
2000	4,4	1,5	2,8
2001	1,3	1,5	-0,2
2002	1,9	1,5	0,4
2003	0,5	1,5	-0,9
3º Trim 03	0,5	nd	nd
4º Trim 03	1,5	nd	nd
2004	4,9	1,5	3,4
1º Trim 04	1,8	nd	nd
2º Trim 04	0,8	nd	nd
3º Trim 04	1,2	nd	nd
4º Trim 04	0,7	nd	nd
2005	nd	nd	nd
1º Trim 05	0,4	nd	nd

Fonte: Banco Central do Brasil e IBGE

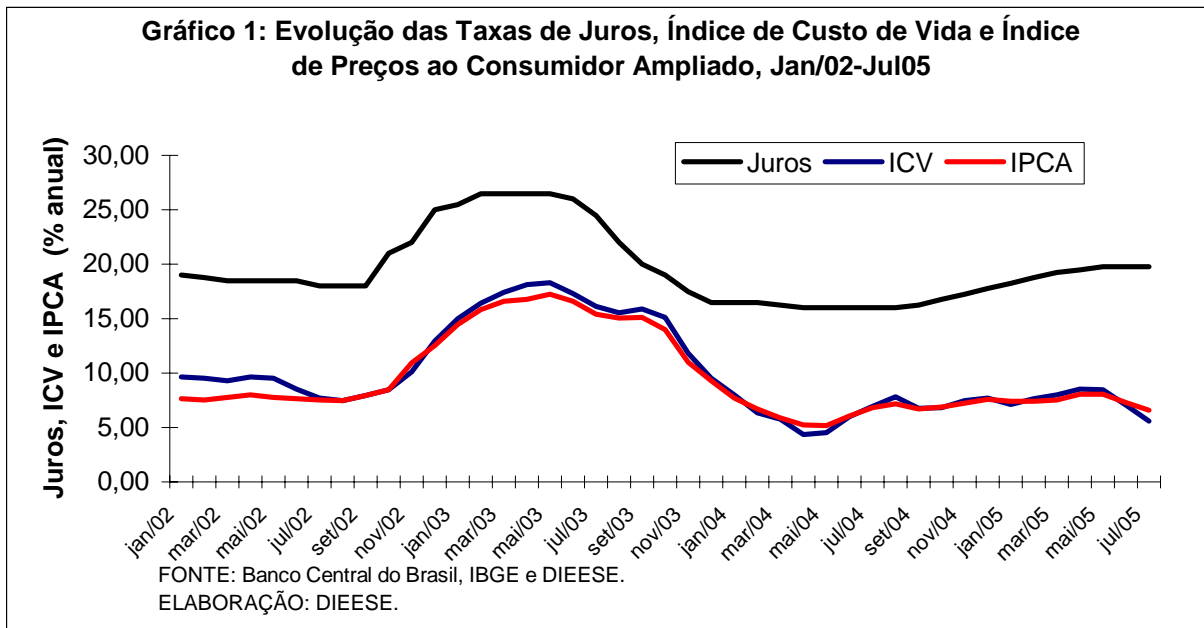
Elaboração: DIEESE

Obs.: Variação no trimestre frente ao trimestre imediatamente anterior.

In 2004, Brazil reached a record in the accumulated commercial surplus, US\$33.7 billion, which represented a growth of 35.8% since 2003. The greater growth in exports relative to imports led to an expansion of foreign trade. The growth of imports reflects an upturn in economic activities as well as efforts to modernize the economy.

This fiscal policy led to a primary surplus, which exceeded the goal set by the IMF and reduced the debt/GDP ratio from 57.2% in 2003 to 51.6% in 2004.

In 2005, expectations at the beginning of the year were that there would be a deceleration in the rate of worldwide economic growth. However, these expectations were not borne out for the following reasons: 1) There were no abrupt and significant variations in the dollar's behavior relative to other currencies; 2) Rising interest taxes in the USA did not reach levels exceeding 4% a year and therefore did not have a negative impact on the global economy's capacity to expand; 3) The prices of commodities continued to be high, due to China's steady rate of growth and 4) Argentina's recovery process continued, which was especially significant for Brazil.

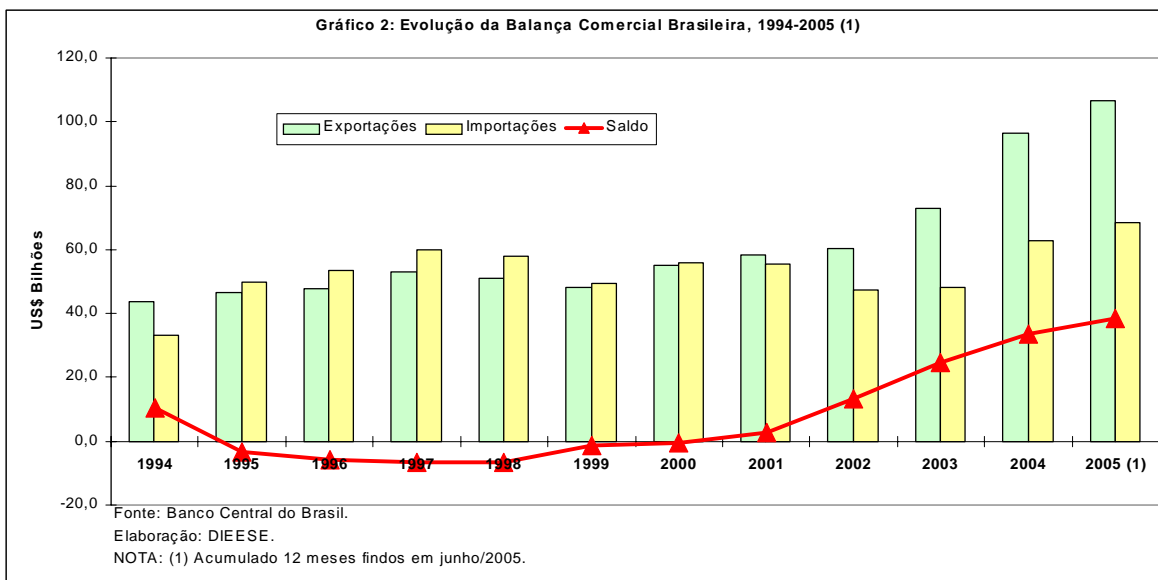


In spite of the favorable international scenario, the Brazilian GDP for the first trimester of 2005, which showed a growth of 0.4% relative to the last trimester of 2004, indicates a lack of confidence in the current economic growth cycle's sustainability over the rest of the year and portends weaker economic performance than was observed in 2004.

This outcome could be an isolated phenomenon, since the first trimester tends to be the slowest. However, the Brazilian GDP's rate of growth (compared with the previous trimester) has been declining since the final trimester of 2004. This modest rate of growth in the Brazilian economy was primarily due to domestic factors. The most important factor was the Central Bank's policy (starting in September of 2004) of implementing nine consecutive increases in the basic interest tax (SELIC).

With devaluation of the US Dollar on a global scale, and the lack of administration of the stock exchange by the leaders of Brazil's political economy, the Brazilian Real achieved remarkable value.

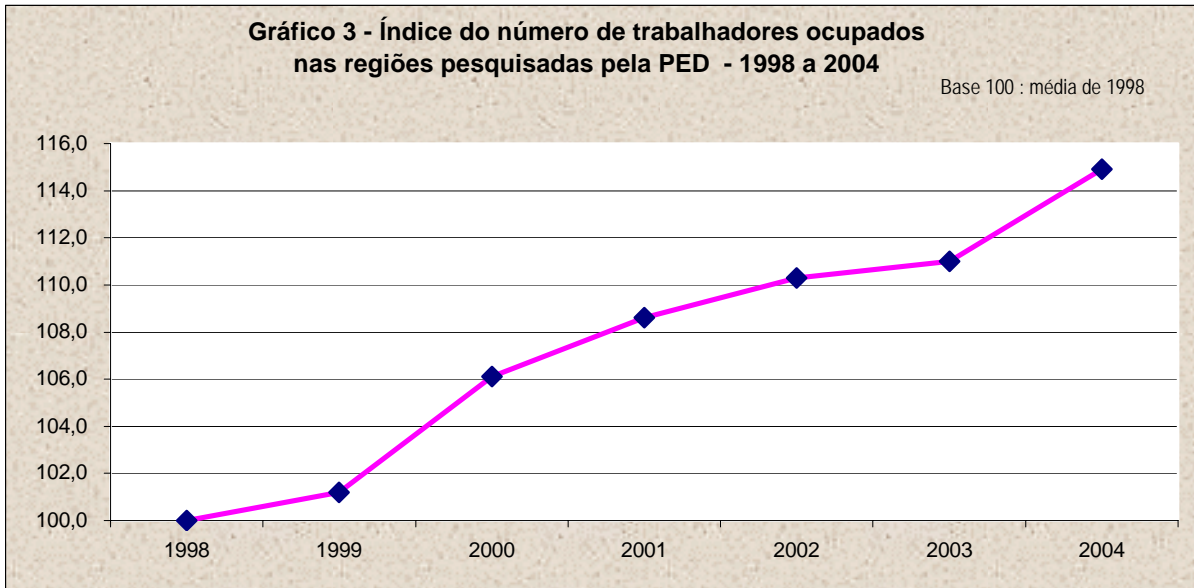
Therefore, it was possible to use the appreciation of the Real as a tool to combat inflation in order to reach the goal set by the IMF, which for 2005 was 5.1% per year. The IPCA-IBGE (General Consumer Price Index) is the index used by the government for the inflation goals, which was 4.5% this year (with a margin of error of 2.5 percentage points above or below). While the goal was 4.5%, the Central Bank announced in September of last year that it would seek an inflation level of 5.1%. One of the Central Bank's motivations for pursuing a stronger monetary policy for nine months (between September of last year and May of this year) was the fear that the economic recovery would encourage industry to adjust prices.



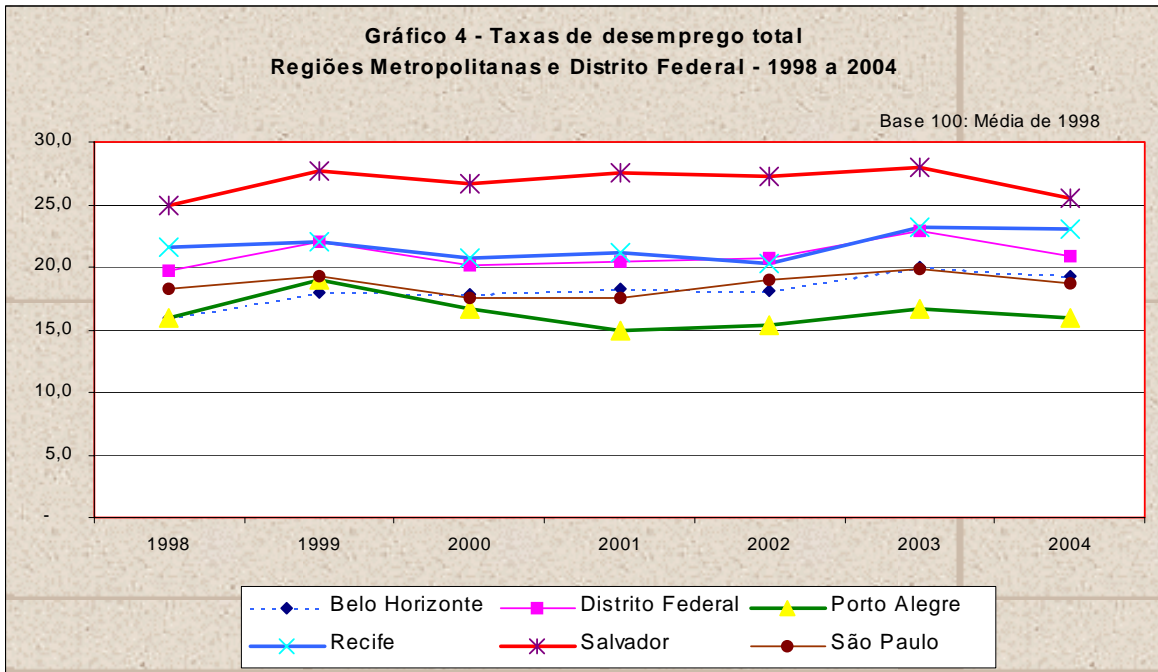
However, this important change did not significantly impact Brazil's external competitiveness, due to extraordinary circumstances involving the price of commodities in internal markets. But that policy had clear limitations that, if violated, could begin to take the wind out the trade balance's performance. Overall, the changes in the trade balance through June were solid, with an accumulation of US\$38.3 billion over the past 12 months.

This positive growth outlook allowed for contractions in the labor market. The surveys of households (while limited to the conditions of workers living in major urban centers, an especially problematic limitation in a country of continental dimensions such as Brazil) demonstrate in great depth the tendencies of that market.

Without doubt, the rhythm of recovery of these regional labor markets was enabled by a significant growth in jobs. This trend, which was already underway in 2003, became more significant in 2004 with the generation of 497 thousand jobs in the regions investigated by the PED, resulting in an increase of 3.4% in the number of employed workers.



The context of intense growth in levels of economic activity recently experienced by Brazil resulted in a decline in rates of unemployment that, in general, was sufficient only to balance out the growth experienced in 2003 and return to rates very close to those recorded in 2002.



The most intense reduction in the rate of unemployment occurred in Salvador, the region with the country's highest levels of underutilized urban labor. These rates declined from 28% in 2003 to the current level of 25.5%. The drop in the proportion of unemployed people in the Federal District of Sao Paulo is also notable. The Metropolitan Region of Recife, on the other

hand, was the only region to show relatively stable levels of unemployment, remaining at around 23.1% of the local active workforce.

At the same time as the percentage of unemployed workers dropped, there was an increase in the average length of unemployment, reaching an average of 13 months in Sao Paulo.

**Tabela 2 - Desemprego de longo prazo e desemprego oculto. Região metropolitana de São Paulo. (Em %)**

	Desemprego Oculto	Desemprego de longo prazo (1) +12 meses	Desemprego de longo prazo (2) +24 meses
1990	2,9	12,2	5,3
1991	3,8	15,0	6,3
1992	6,0	21,6	8,4
1993	6,0	27,5	11,1
1994	5,3	27,3	12,5
1995	4,2	22,0	10,8
1996	5,1	25,4	11,9
1997	5,7	28,6	13,2
1998	6,5	31,5	14,7
1999	7,2	36,7	17,6
2000	6,6	37,7	20,6
2001	6,3	33,6	19,5
2002	6,9	32,8	17,9
2003	7,1	33,9	18,4
2004	7,1	35,8	18,7

Fonte: Convênio DIEESE/SEADE e MTE/FAT. PED - Pesquisa de Emprego e Desemprego.  
Elaboração: DIEESE  
Notas: (1) Mais de 12 meses de desemprego  
(2) Mais de 24 meses de desemprego

The lengthy time of unemployment and the brevity of unemployment-insurance coverage explain, in part, the growing number of workers classified as the “hidden unemployed,” who can be divided into:

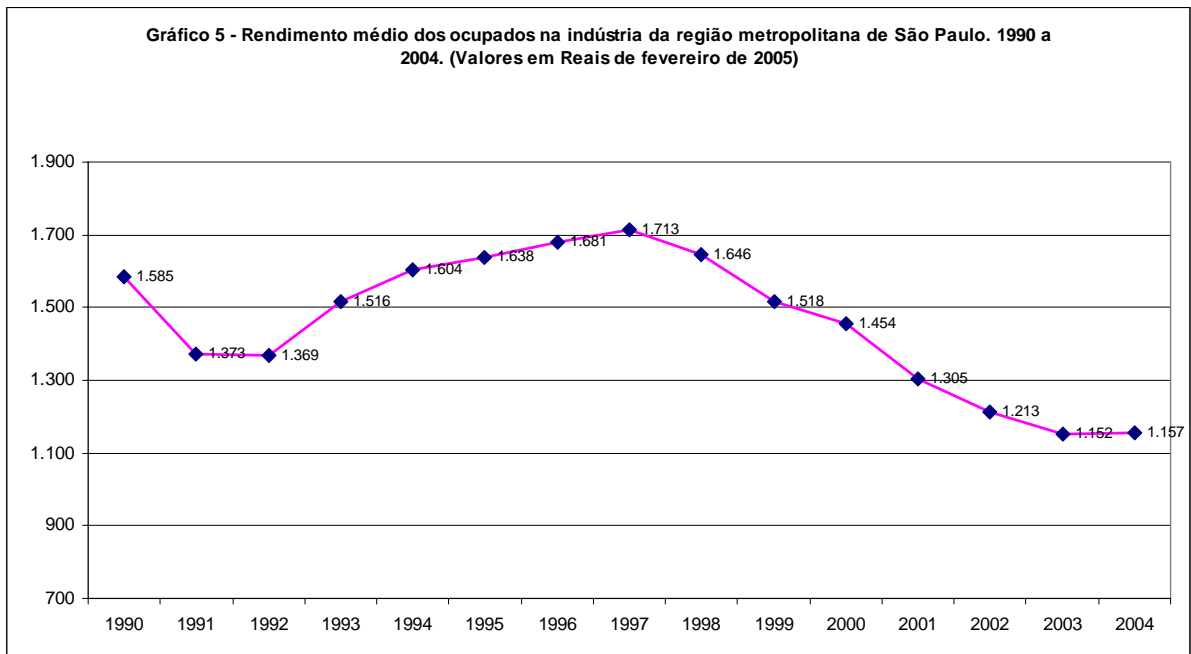
- a) *Hidden unemployment due to precarious work: people who carry out precarious work – self-generated, irregularly paid work; or people that carry out non-paid work in the businesses of family members and who sought new employment in the 30 days preceding the interview; and those who did not seek work in the past 30 days but did unsuccessfully seek work within the previous 12 months.*
- b) *Hidden unemployment due to discouragement: people who do not have employment and have not sought it in the past 30 days, due to labor market disincentives or for fortuitous circumstances, but did successfully seek work within the past 12 months.*

The need to undertake precarious work in order for family survival, as well as discouragement when faced with a labor market that offers few opportunities for entry, explain the increase in hidden unemployment between 2001 and 2003. Compared with 2002, this group of unemployed people increased 2.9% in 2003. In 2004, this rate of increase remained steady.

The indicator that expresses long-term unemployment rose in 2004. Of the total number of unemployed people, 35.8% have been unemployed for over a year. This group rose 5.6% in 2003 and 2004. For those who were unemployed for over two years, the increase was 1.6%, reaching a rate of 18.7% of the total unemployed population.

These fairly high rates worsened at the same time that the economy grew and the overall unemployment rates dropped, suggesting that people who have spent more time without work have faced the greatest difficulty in entering the labor market and tend to remain unemployed for longer periods. Furthermore, it is worth noting that unemployment-insurance coverage lasts only six months and includes only those workers who have a signed contract, which represents only about 40% of the employed population.

Income levels for work tended to be weak, depending on the sector. For those employed in industry, there was an increase in average incomes of 0.4% between 2003 and 2004. The average value corresponded to R\$1.157 in 2004. The average income for industrial workers in the Sao Paulo metropolitan region decreased by 27% relative to 1990.



The poor distribution of income in Brazil highlights the concentration of wealth in the hands of a few. According to the data on income distribution in various sectors of the population, we see that in 2003, 20% of those who earned the highest income (5th quintile) received 61.9% of the total income, while those in the 3rd quintile claimed only 10.4%. The 20% with the

lowest income faced an even worse situation, receiving only 3.1% of the total Brazilian income. The data from 2003 vary slightly, due to the recession facing the Brazilian economy.

**Tabela 4 - Distribuição de renda por quintil (em %)**

Quintil	2001	2002	2003
Quinto (20% com maior renda)	62,6	62,7	61,9
Quarto	17,3	17,1	17,5
Terceiro	10,2	10,3	10,4
Segundo	6,4	6,5	7,1
Primeiro (20% com menor renda)	3,5	3,4	3,1

Fonte: IBGE.PNAD

Elaboração: DIEESE

Obs: Pessoas em idade ativa com qualquer tipo de rendimento.

The country grew in 2004 and there is still a possibility it will grow by more than 3.5% in 2005, despite the high levels of interest rate taxes and an extremely tight fiscal policy. Brazil's capacity to grow while having very high interest rates is a rare phenomenon in the world (although not exclusive to Brazil, as demonstrated by Turkey, which has real taxes over 10% in 2004 and a growth of 9.7% in the GDP.

If the outlook can seem encouraging, concerns about its sustainability cast serious doubts over the short- and medium-term future.

To continue to grow without risking inflation will require enlarging the capacity of businesses, whose utilization levels should reach 87.1% by the end of 2005, according to projections by the IPEA. Historically, these levels had only been higher twice, during peaks in the 1970's (when the average growth rate was 86.4%). The productive capacity's growth means a rise in investment rates (in terms of solid fixed capital, that is, investments in civil construction, machines and equipment), which the IPEA projects will make up 21.6% of the National Domestic Product in 2005.

In the medium-term, doubts continue over the Brazilian infrastructure – strategic sectors depending directly on government investment, which have suffered limitations due to adjustments to public accounts, which require a high primary surplus.

The sustainability of Brazil's growth will continue to depend on a favorable global outlook, behaving on the model of a "reflexive" economy, rather than one based on high levels of investment and continual growth in consumption.

Finally, yet no less significantly, better income distribution in Brazil is imperative if we are ever going to turn growth into effective development, which requires justice and social equality.

### **Other statistical links for Brazil:**

SEADE – Fundação Estadual de Análise de Dados / State Foundation for Data Analysis  
[http://www.seade.gov.br/homev98/seade\\_i.html](http://www.seade.gov.br/homev98/seade_i.html)

XSERVE – DIEESE – Banco de Dados Macroeconômico / Macroeconomic Data Bank  
<http://www.intranet.DIEESE.org.br/bmacro/autentic.html>

IPEA Data Online -- Instituto de Pesquisa Econômica Aplicada / Applied Economic Research Institute  
<http://www.ipeadata.gov.br/ipeaweb.dll>

Banco Central do Brasil / Brazilian Central Bank  
<http://www.bacen.gov.br/defaulti.htm>

IBGE -- Instituto Brasileiro de Geografia e Estatística / Brazilian Institute of Statistical Geography  
<http://www.ibge.gov.br/english/default.php>