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THE BIG QUESTION OF 2011:

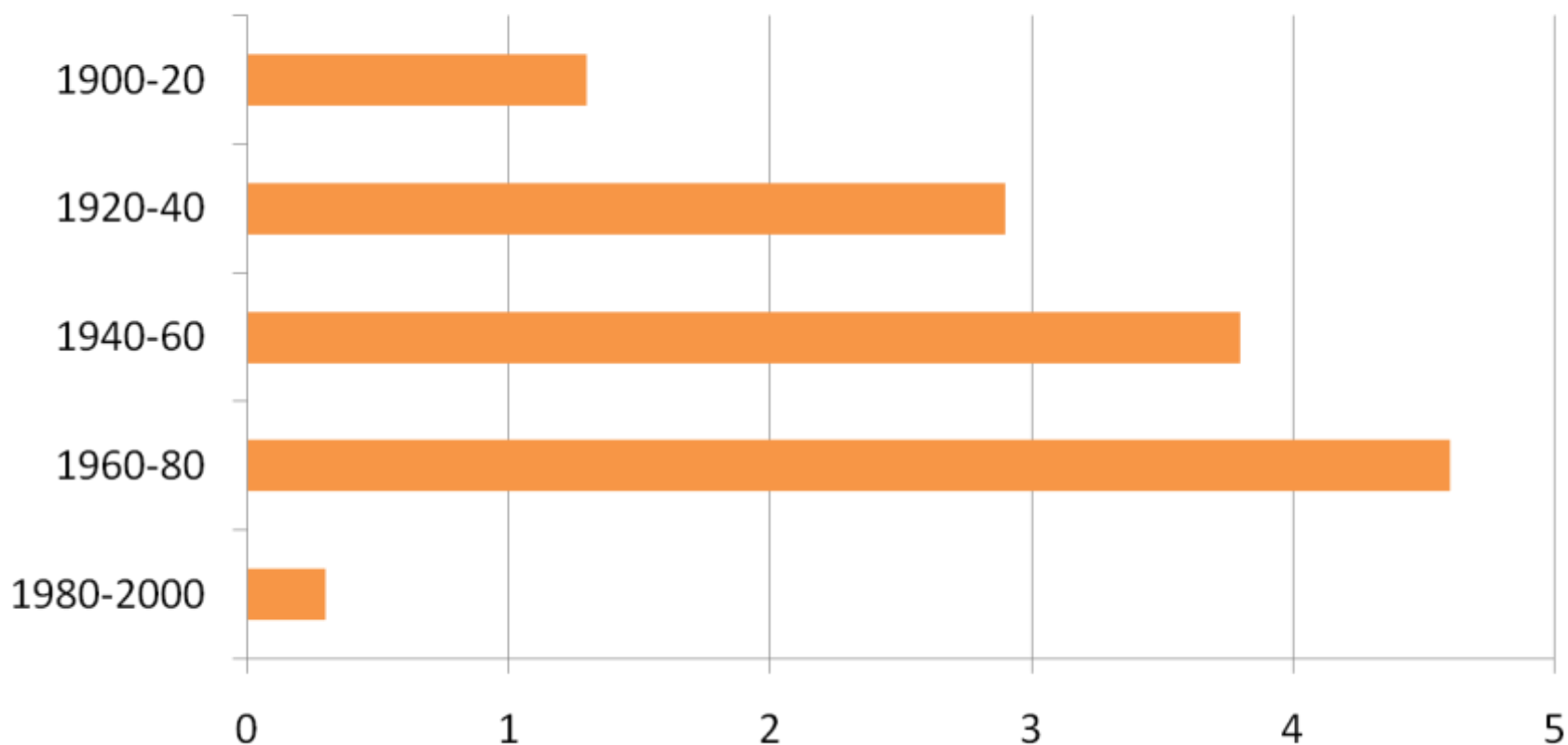
“Is Brazil merely enjoying very good growth – or is it undergoing a fundamental transformation?”

“We’re blazing our own path, and we have all the potential to become **the world’s first developed tropical country.**”

-Aloizio Mercadante, Brazil’s new Science and Technology Minister, speaking at his inauguration ceremony; Jan. 3, 2011

GDP GROWTH, 20th CENTURY

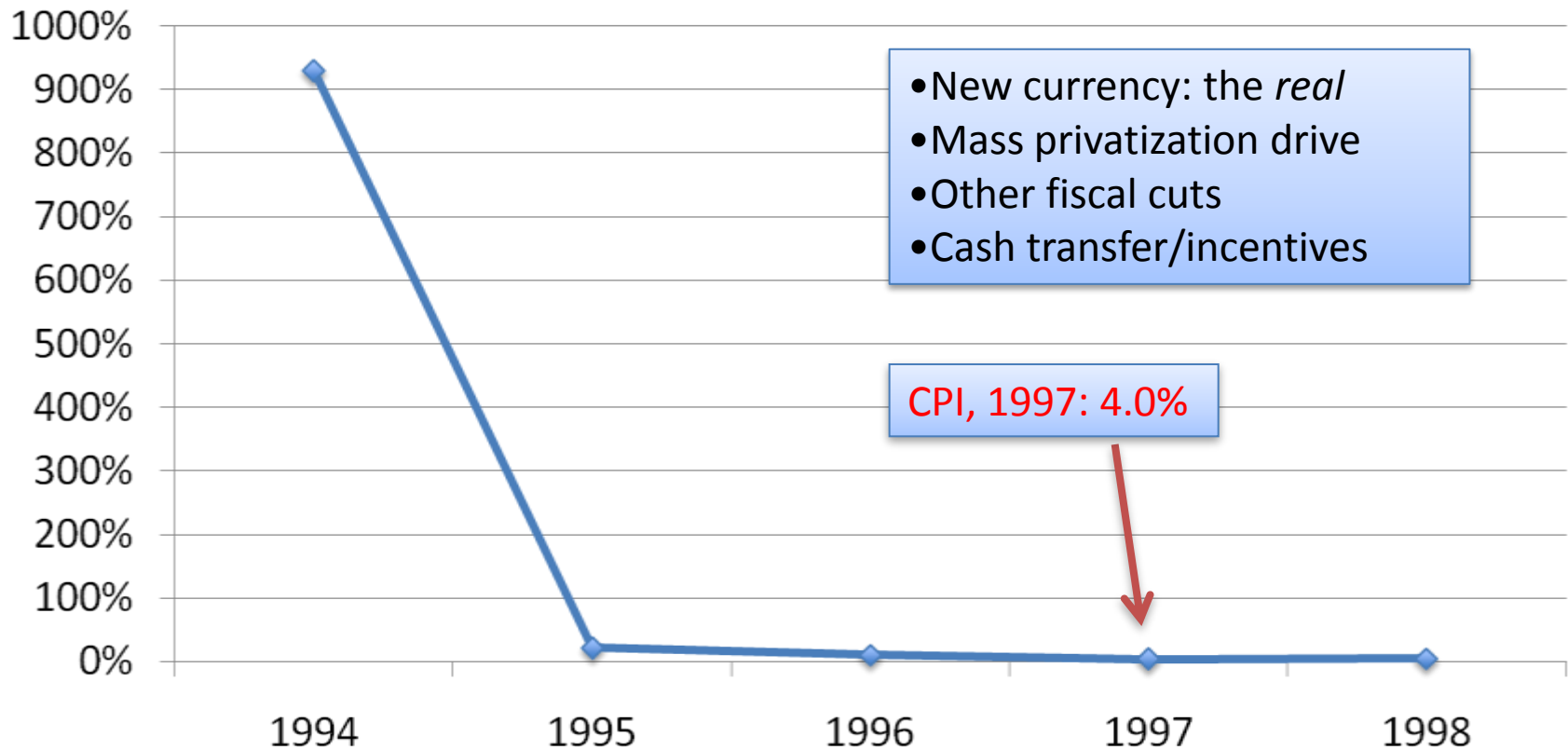
Annual GDP expansion, average during 20-year period



Source: IBGE

INFLATION FALLS TO SINGLE DIGITS

Consumer price index, 1994-98



“EXTERNAL FACTORS”





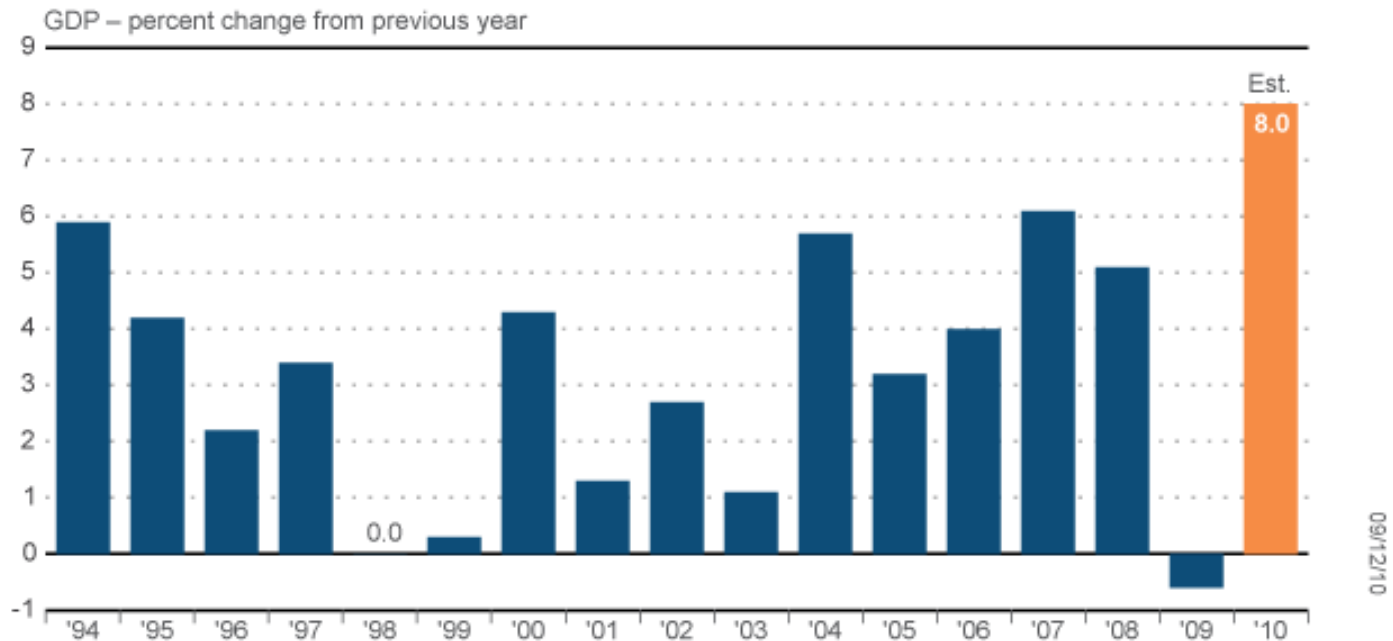
THE OUTLOOK



STRONG, CONSISTENT GROWTH, ESPECIALLY SINCE '04...

Brazil GDP

1994, the year Brazil introduced the real, proved to be a turning point in Brazil's economic history.



Source: Banco Central do Brasil

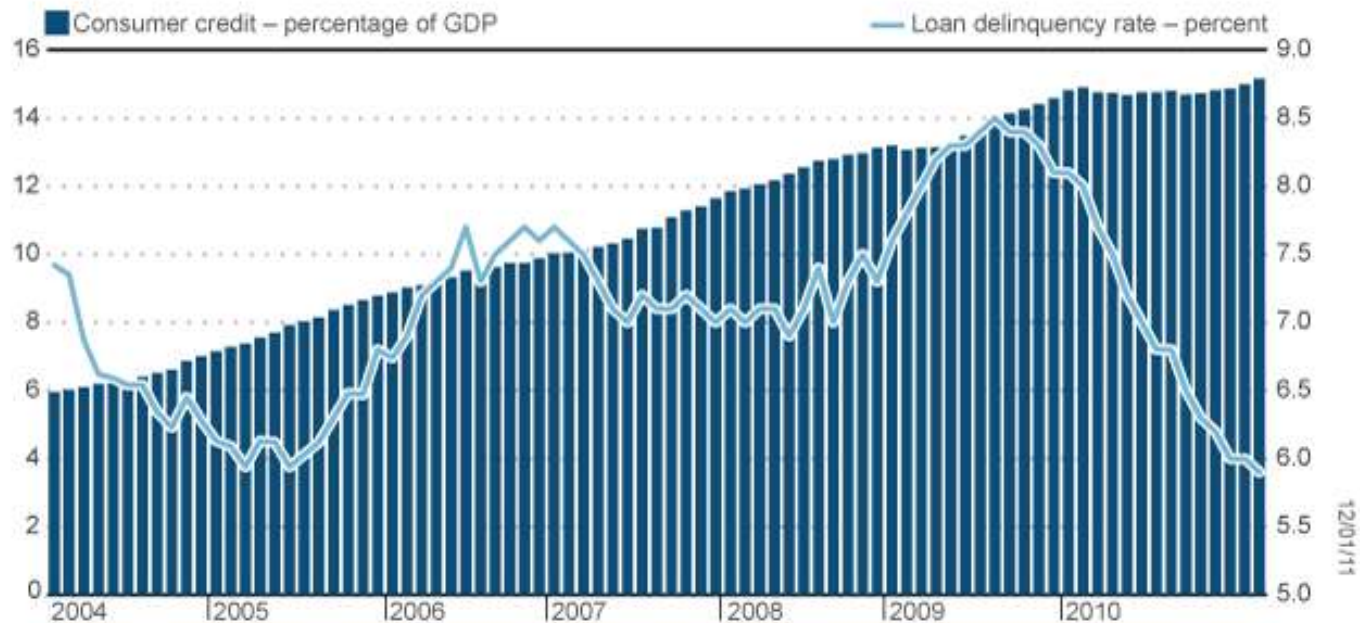
Reuters graphic/Stephen Culp



... PUSHED BY A MASSIVE CREDIT EXPANSION, AND....

Brazil consumer credit, loan delinquency

Brazil's outstanding consumer credit is steadily growing while loan delinquency has fallen in recent years.



Source: Brazil's central bank

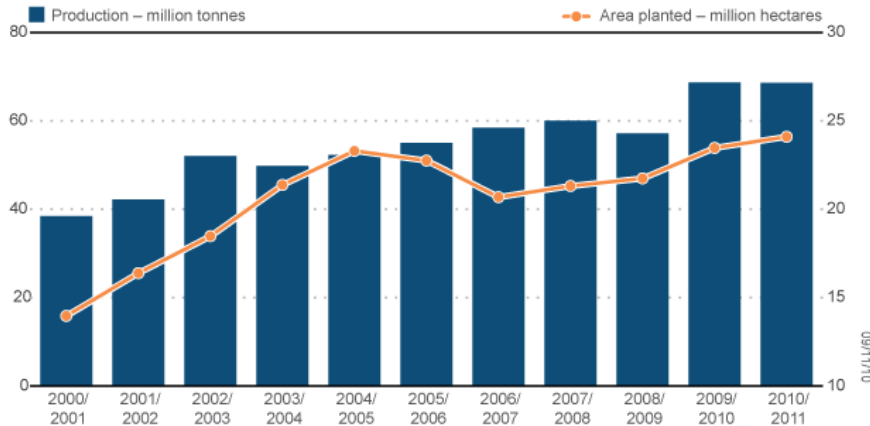
Reuters graphic/Stephen Culp



... AN OLD-FASHIONED COMMODITIES BOOM ... (THANK YOU, CHINA!)

Brazil soy production

Brazilian soy output has grown by more than 70 percent in the past decade.



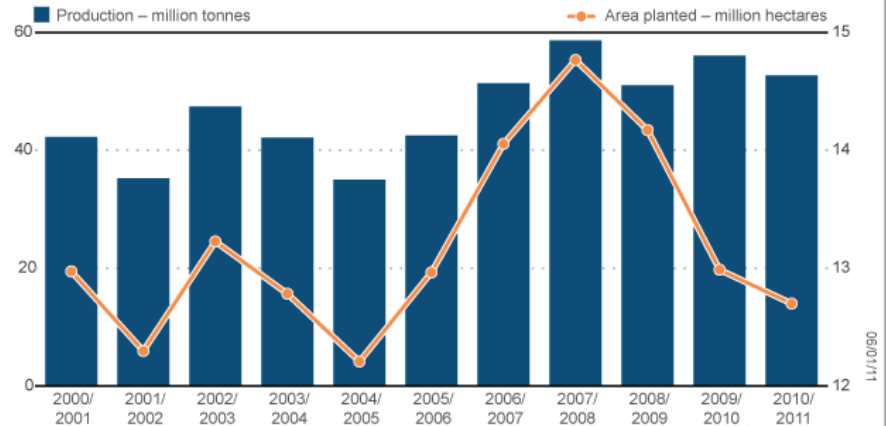
Source: CONAB

Reuters graphic/Stephen Culp



Brazil corn production

Brazil has become a more important corn exporter in recent years.



Source: CONAB

Reuters graphic/Stephen Culp



... PUSHING STOCKS 600% HIGHER SINCE 2003



Source: Reuters 3000 Xtra

2010: AN ECONOMY IN FULL BLOOM

- **AUTO SALES:** Up 11.9% to 3.51 million units (4th straight annual record; critical market for Ford, VW, Fiat; enabled a profit for GM in '10)
- **SMARTPHONES:** Up 70% versus previous year
- **COMPUTER SALES:** Up 13% to 14 million units (expected to be world's #3 market in 2011, behind only USA and China)
- **TELEVISIONS:** Up 75% to 13 million units
- **CREDIT CARD USE:** Up 20% (more on this later)
- **HOUSING:** 22 million families, or roughly 80 million people, plan to build or refurbish a house (equivalent to nearly half the country, or Spain, Holland and Portugal combined)
- **Lula leaves office with 87% popularity**

Sources: Data Popular, Agencia Estado, others



“CLASSE C”: WHY PEOPLE ARE EXCITED ABOUT BRAZIL



- Definition: Families with monthly net income between USD\$ 655-2827
- Ranks have DOUBLED in last decade, now at 90 million people – that’s half of Brazil, or bigger than population of Germany (80 mln)
- Combined net worth of R\$ 500 billion (about USD\$300 billion)
- They are extraordinarily avid, “aspirational” consumers:

- Now account for 54.9% of mobile phone users nationwide
- 80% say they “can’t live without a computer”
- 60% own a DVD player
- 66% want to have a cell phone with camera
- 82% own some kind of leisure technology (DVD, PS2, etc)
- Spending on domestic goods has quintupled since 2002
- Companies selling to this group enjoying fastest growth**

ADVANTAGES OVER BRIC PEERS

- Robust democracy (China, Russia)
- Relatively good per-capita income, dramatically improving social indicators, hunger is nearly gone (India, parts of China)
- Population growing, but not too fast (Russia/India)
- Peaceful neighborhood (Russia, China, India)



OTHER REASONS FOR OPTIMISM





WHAT IF IT'S ALL JUST A DREAM?



THE BOGEYMAN RETURNS

- 2011 clearly a year of reckoning post-Lula
- Lula behaved for seven years, but lost control of fiscal spending at the end
- Inflation at 6-year high in 2010: 5.91%
- Old ghosts: It won't get out of control, but...
- Interest rates rising again, at 11.25% after last night
- Domestic demand only economic motor right now? (Fazenda)
- Even in best-case, growth will struggle to get back to 2010 levels anytime soon: 4.5% GDP growth forecast in '11

CREDIT BUBBLE?

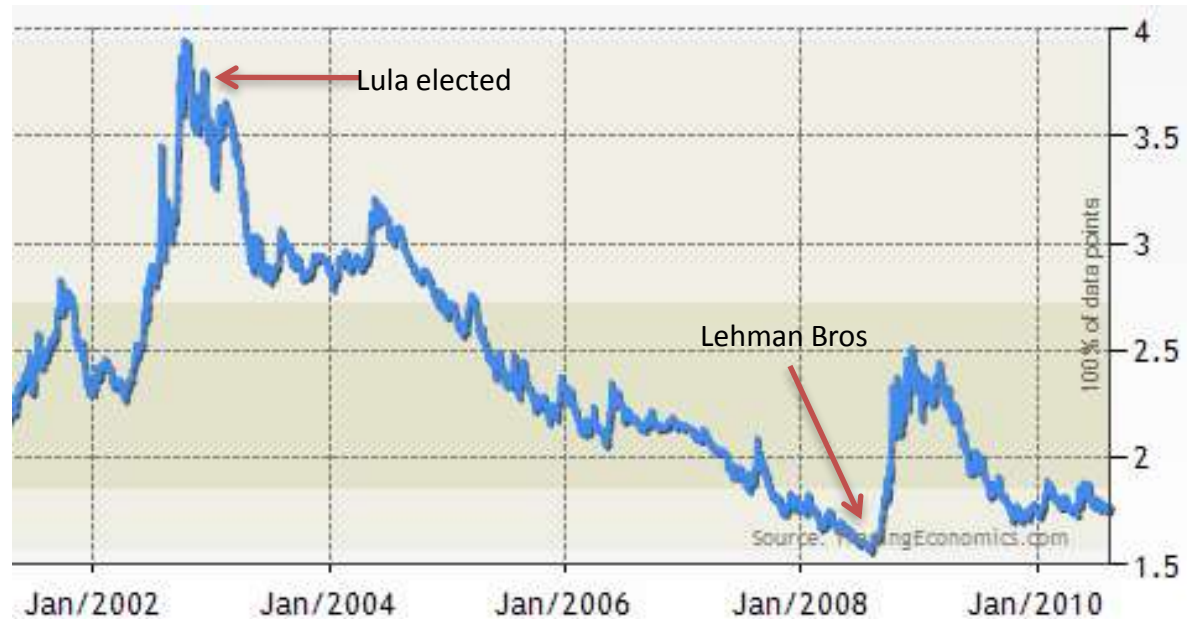
- QE2; Low yields in developed world
- Benchmark Selic rate at 11.25 percent
- Rates on consumer loans average 43.6 percent
- Consumer loan delinquencies up 29% in Dec y/o/y; 23.2% Nov

“We are seeing people who don’t have a culture of finance, who don’t know how to administer their finances ... They reach a point where they have promised 95 percent of their income on payments ... The risk of non-payment is high.”

- Jose Dionisio Cavalcanti, president,
Brazil Association for Defense of Consumers

“THE CURRENCY WARS”

Brazilian real (BRL) versus US dollar



- BRL now more than 100 percent stronger vs USD since 2003
- Term coined by Finance Minister Mantega; an elaborate excuse?
- Devastating impact on manufacturers; industrial production has been flat or shrinking since mid-2010
- Possibility of protectionism/trade battle under new admin

NEW PRESIDENT DILMA ROUSSEFF



- Former leftist guerrilla in 1960s; gov't technocrat who rose through ranks
- Pragmatic moderate in Lula's mold; promises continuity; lacks charisma
- Focused on poverty reduction; signs of greater transparency vs. Lula
- Early focus on currency, bringing interest rates down (but fiscal situation making this enormously difficult)
- Has promised fiscal reform; size remains completely unclear
- Fears about leftward drift seem unfounded; but Petrobras is worrying
- Impressive in early political gestures, meetings with dignitaries
- **No appetite for structural reforms that could improve business climate.**

PROBLEMS WITH BUSINESS CLIMATE

- Brazil ranks **129** out of 183 countries in World Bank “Doing Business” report; behind regional peers such as Chile (49), Mexico (51) and even Argentina (118)
- Primary culprits: onerous tax and labor system.
- Brazil tax burden (**34.4%** of GDP) far exceeds BRIC peers and even Japan (17.6%) and U.S. (26.9%)
- Typical manufacturer in Brazil must pay **46** weeks’ worth of salary to terminate a worker
- Tax changes possible under Rousseff; others seem to be out
- Education improving rapidly, still trails other BRICs

OPTIMISM CURES A LOT OF ILLS

Gallup World Poll asked respondents in 132 countries to rank on a scale of 0 to 10 how prosperous they think they'll be in 5 years.

Most optimistic score:

8.78, BRAZIL



THANK YOU.

