

CHALLENGES FOR DEVELOPMENT: THE NEW CONTEXT

Francisco Eduardo Pires de Souza (BNDES and UFRJ)

Seminar: The Role of the State in the 21st Century

Enap, Brasilia, 03/09/2015

The new (old) world of the 2000s

- China emerges and dislocates the gravity center of the world economy
 - Commodities *super cycle*; great dynamism of emerging countries of Africa and Latin America
 - Greater weight and dynamism of emerging countries heralds a new era in terms of GDP growth and of world trade (4.5% and 6.5%, per year, respectively, between 2002 and 2008)
- Abundance of international liquidity enabling financing of deficits and/or accumulation of reserves by emerging countries

The encounter of Latin America with development in its full sense

- Strong economic growth (per capita GDP growing 3.5% per year, for the first time in more than 40 years)
- Solid macroeconomic foundations (external and fiscal)
- Substantive improvements in income distribution (x rest of the world)

The new international context (the dream is over)

- The repeated illusion of the “little green sprouts” (the “phase of denial“)
- The reality of the post-crisis international economy. After 7 years of Lehman´s collapse:
 - Low growth of the world economy;

Gross domestic product, constant prices (% change)

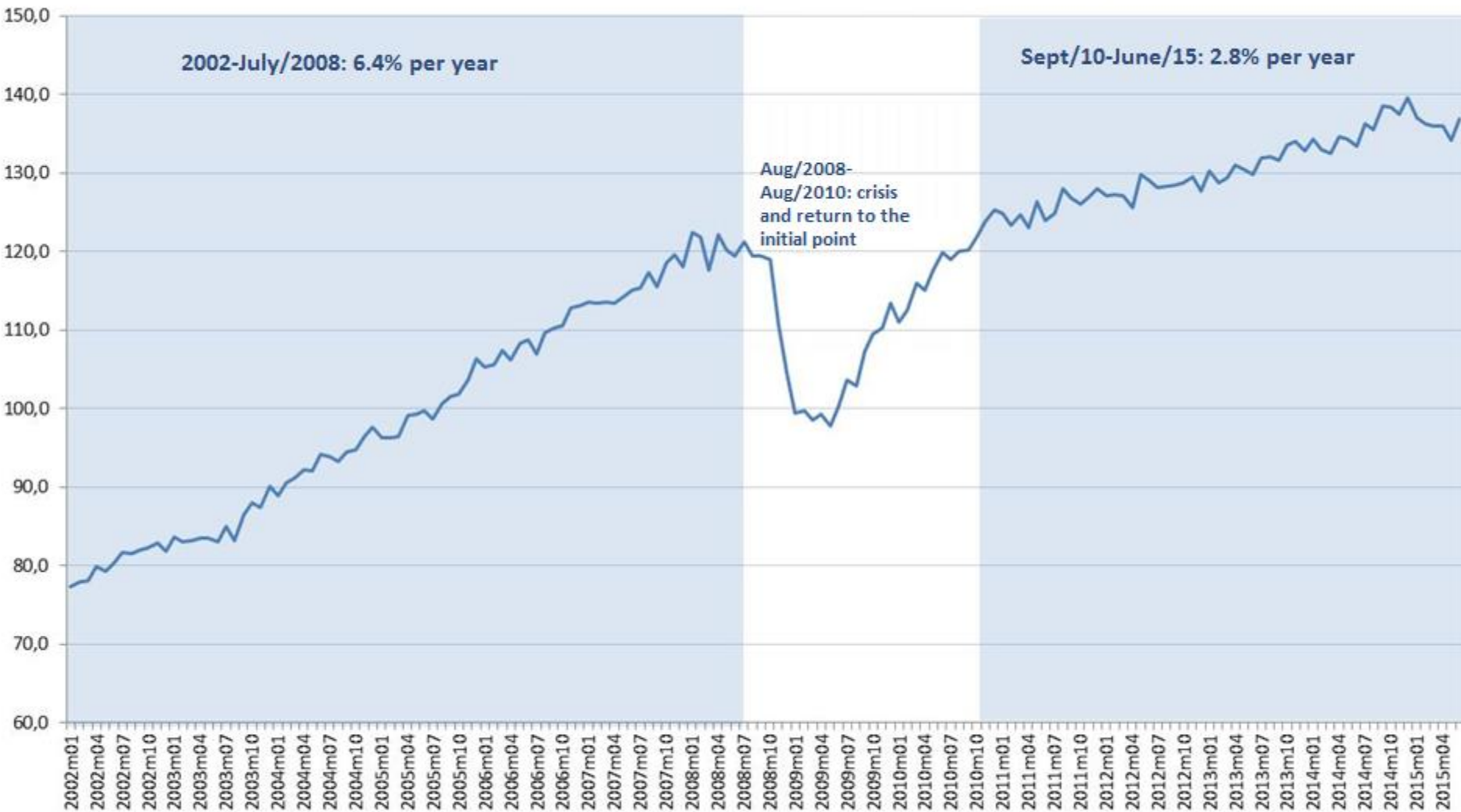
Country Group	2002-2008	2009	2010	2012-2014	2015 p
World	4.5	0.0	5.4	3.4	3.3
Advanced economies	2.3	-3.4	3.1	1.5	2.1
Emerging market and developing economies	7.0	3.1	7.4	4.9	4.2

International Monetary Fund, World Economic Outlook Database, April 2015; Update, July 2015.

The new international context

- The repeated illusion of the “little green sprouts” (the “phase of denial“)
- The reality of the post-crisis international economy. After 7 years of Lehman´s collapse (slides):
 - Low growth of the world economy;
 - Even steeper slowdown of the world trade, which started to grow below the world GDP

Index of the Volume of International Trade, with Seasonal Adjustments



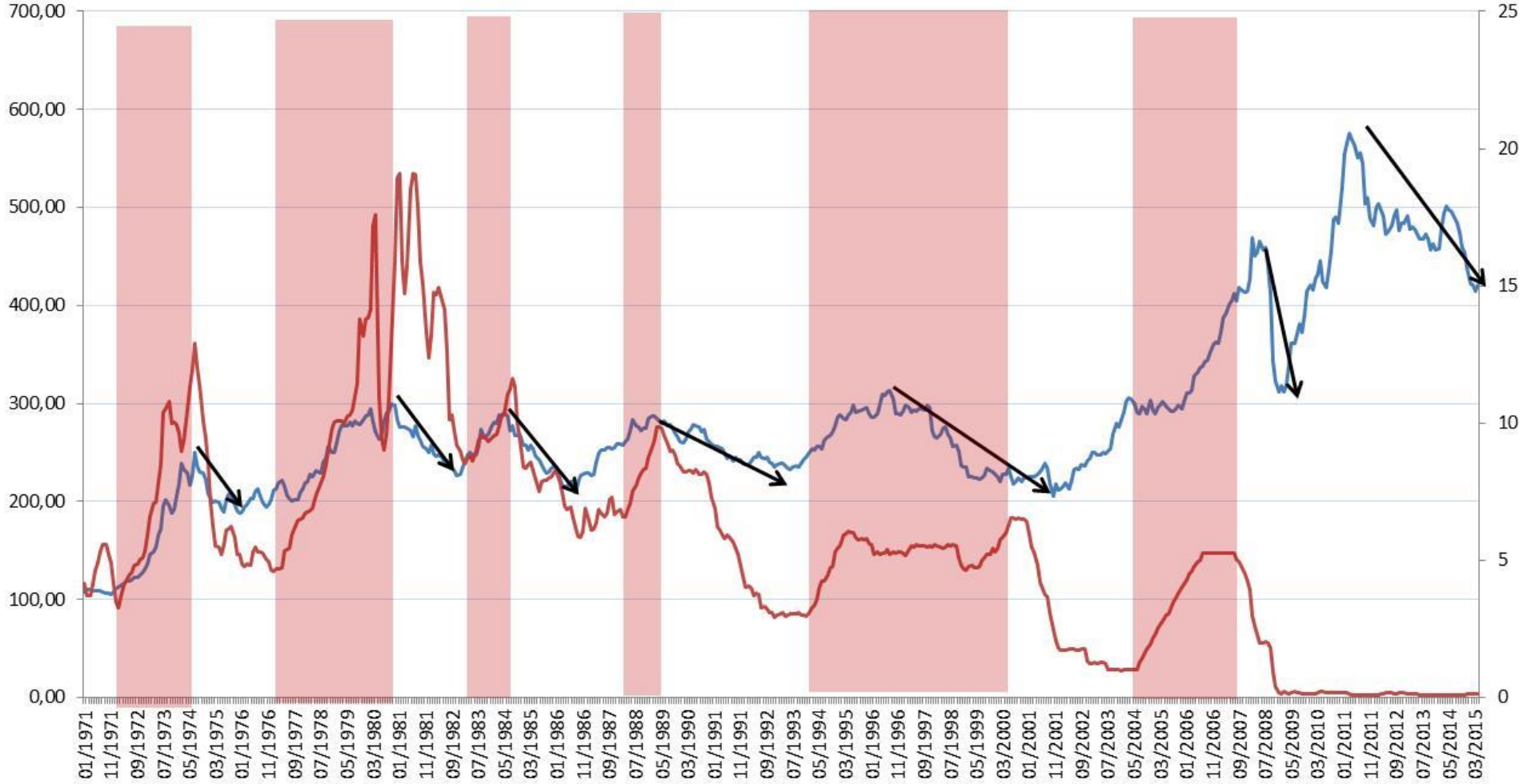
Fonte: CPB, World Trade Monitor.

The new international context

- The repeated illusion of the “little green sprouts” (the “phase of denial“)
- The reality of the post-crisis international economy. After 7 years of Lehman´s collapse (slides):
 - Low growth of the world economy;
 - Even steeper slowdown of the world trade, which started to grow below the world GDP
 - End of the commodities super-cycle, in the wake of the loss of dynamism of the Chinese economy (the dimensions of which are not yet very clear)
 - All this amidst the period of greatest monetary expansionism and low interest rates in at least 6 decades

Commodities Prices Index (spot CRB)

— CRB — Fed Funds



Source: CRB

People have awoken to the reality, but the interpretations, prognostics and uncertainties are many:

- Age-old stagnation
- Excess of world indebtedness
- Tendency to a low growth of productivity
- Chinese slowdown (nipponization?)

Aspect about which there seems to be no more doubt: there is no perspective of return to the past (2000s).

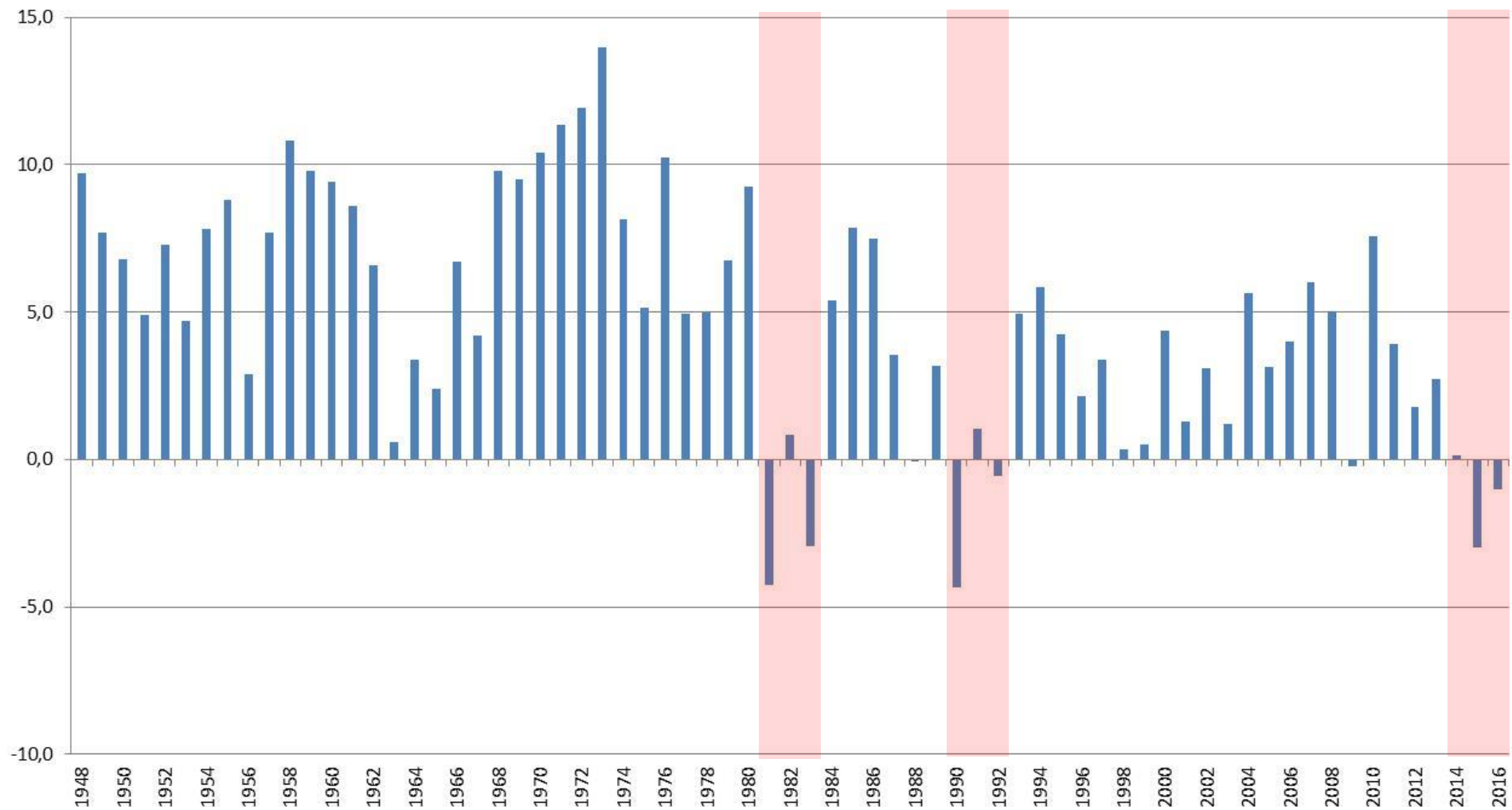
Challenges to LA and particularly to Brazil in the new international environment

- Steep slowdown of C , I and Y
- But the issue is not simply about how to reactivate these variables through anti-cyclical policies, etc
- How to grow and integrate into this new international economy?
A new model of growth and external insertion?
 - Is it possible to maintain the advances in terms of income distribution?
 - How to keep inflation low without the help from the exchange rate?
 - How to avoid the return of the external strangling ghost?
 - To specialize or to diversify? Where to?
- The answers are inevitably diverse for the countries of the region.

The Brazilian Crisis: dimensions and diagnostics

- This is one of the 3 greatest economic crises of the last 70 years

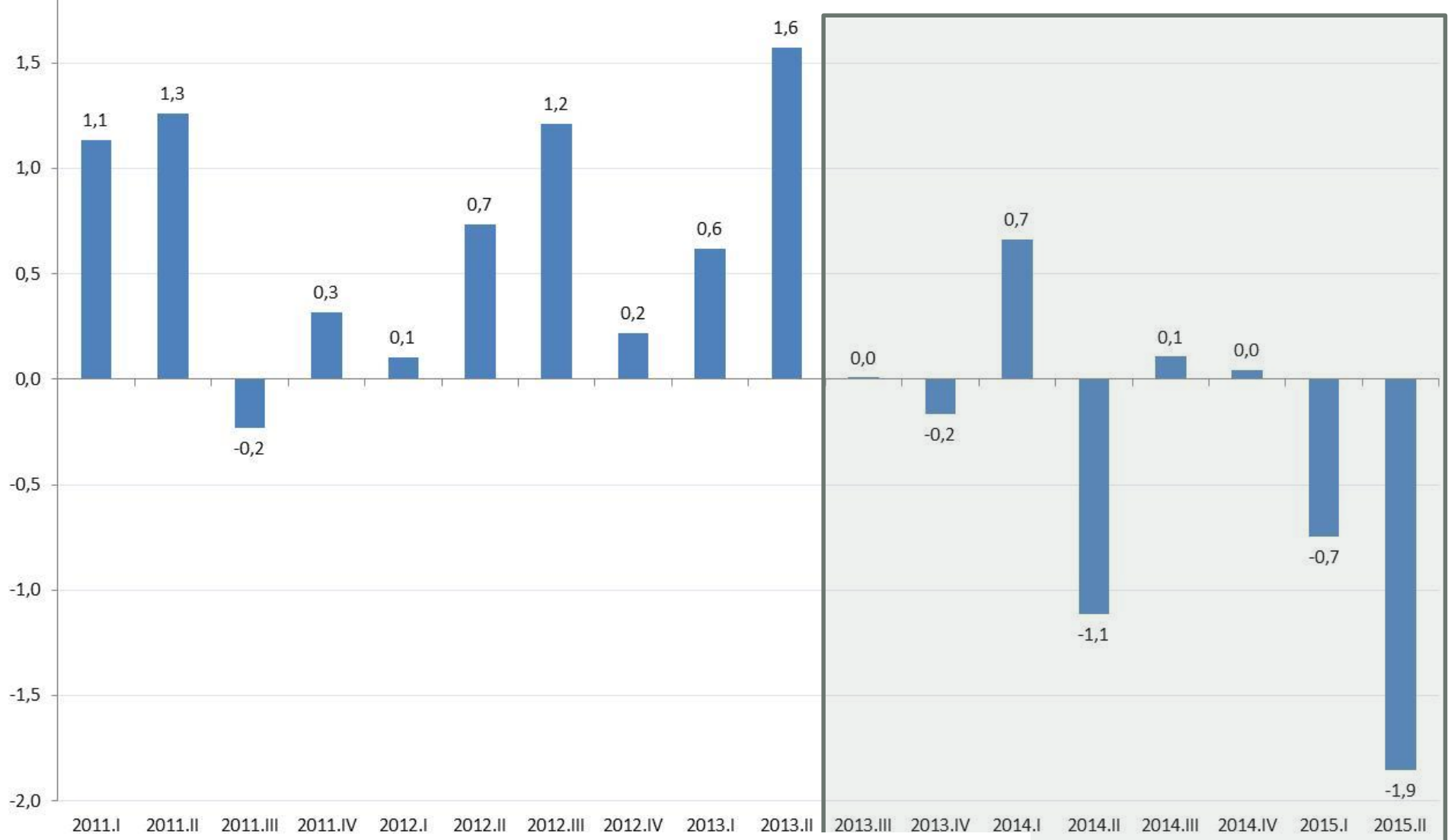
Brazilian GDP Growth: 1948-2016¹ (%)



¹ Author's estimates for 2015 and 2016

Sources: IBGE, 21st Century Statistics for data up to 1996 and Quarterly National Accounts, 2nd quarter of 2015 for data from 1997 onwards

Quarterly GDP Growth Rates (Quarter x previous Quarter, with seasonal adjustment), %



Source: IBGE, Quarterly National Accounts, 2nd quarter of 2015

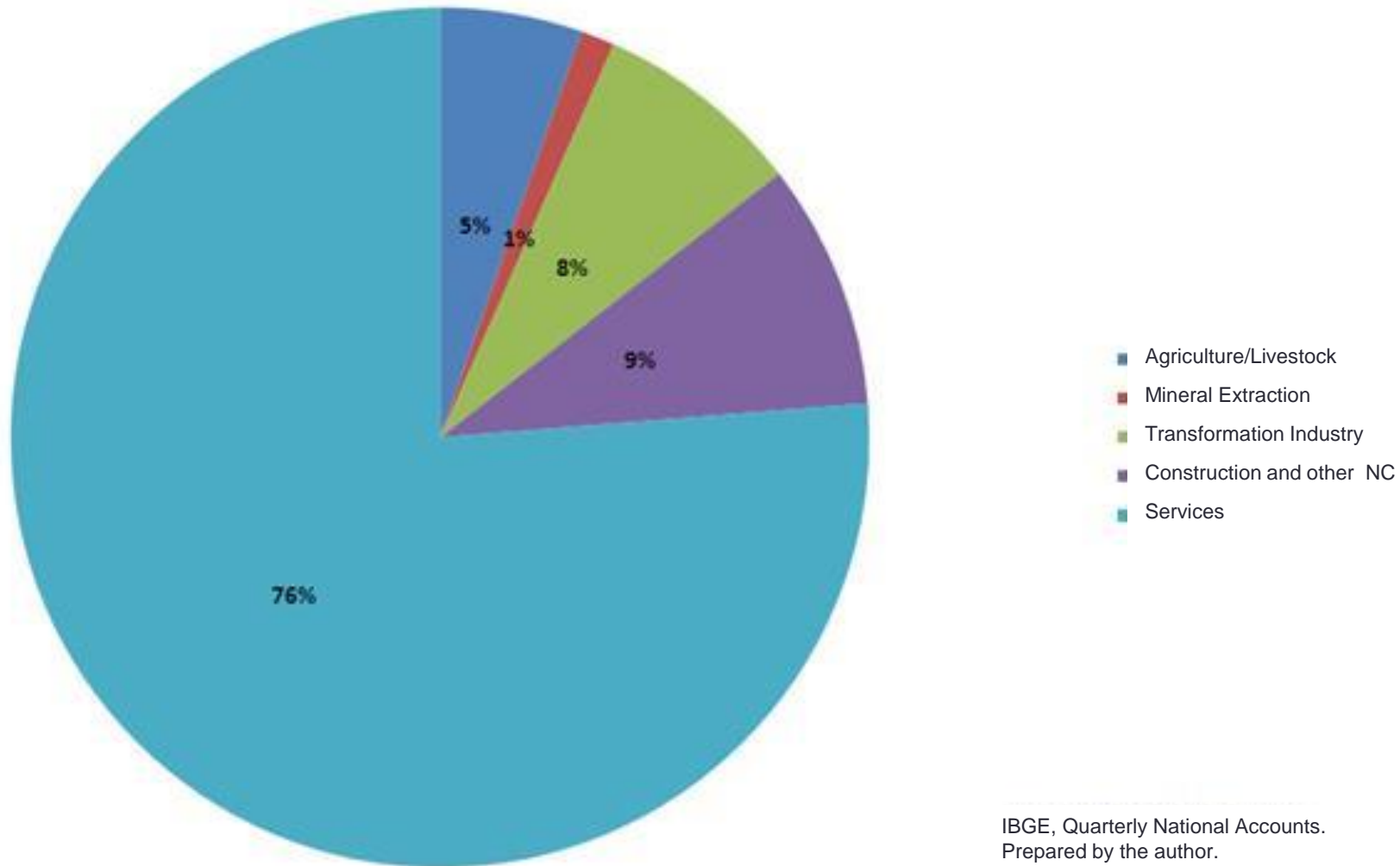
The Brazilian Crisis: dimensions and diagnostics

- This is one of the 3 greatest economic crises of the last 70 years.
- Debate about the causes: external determinants x domestic economic policy
- Polarization (government x opposition) misses a central issue: the Brazilian growth model of the 2000s in spite of all its merits and successes, while it lasted, was unsustainable.

The flaws of the model

- On the demand side, the engine was a growth of consumption systematically above the GDP

Contribution of the Activity Sectors for the GDP Growth in the 2005-2010 period



The flaws of the model

- On the demand side, the engine was a growth of consumption systematically above the GDP
- $\Delta \text{ demand} > \Delta \text{ GDP}$ could only be resolved via current account deficit or π ; option of letting the exchange rate appreciate, led the unsustainable route to current account deficit.

Year	Current Account / GDP	
	At current prices	At prices of 2005
2003	0,8%	2,0%
2004	1,8%	2,4%
2005	1,6%	1,6%
2006	1,3%	0,4%
2007	0,1%	-1,0%
2008	-1,7%	-2,9%
2009	-1,5%	-2,3%
2010	-2,2%	-3,8%
2011	-2,1%	-4,1%
2012	-2,4%	-4,0%
2013	-3,6%	-4,8%
2014	-4,2%	-5,0%
2014-2004	-6,0%	-7,4%

Source: Central Bank of Brazil. Prepared by the author.

The flaws of the model

- On the demand side, the engine was a growth of consumption systematically above the GDP
- $\Delta \text{ demand} > \Delta \text{ GDP}$ could only be resolved via current account deficit or π ; option of letting the exchange rate appreciate, led the unsustainable route to current account deficit.
- On the supply side, appreciation of the exchange rate \Rightarrow deindustrialization \Rightarrow economy pulled by:
 - Commodities
 - Services. When nearing full employment, this one ceased growing

Growth of Production and of the Apparent Consumption of Selected Activity Sectors (% per year)⁽¹⁾

Period	Agriculture / Livestock		Extraction Industry		Transformation Industry		Services		Total	
	Production	AC	Production	AC	Production	AC	Production	AC	Production	AC
2004-2010	3,1	2,6	5,0	2,2	2,8	4,4	4,5	4,8	4,4	5,0
2011-2013	2,9	1,6	-0,1	3,6	0,1	0,6	2,3	2,6	2,1	2,4
2004-2013	3,0	2,3	3,4	2,6	2,0	3,2	3,8	4,1	3,7	4,3

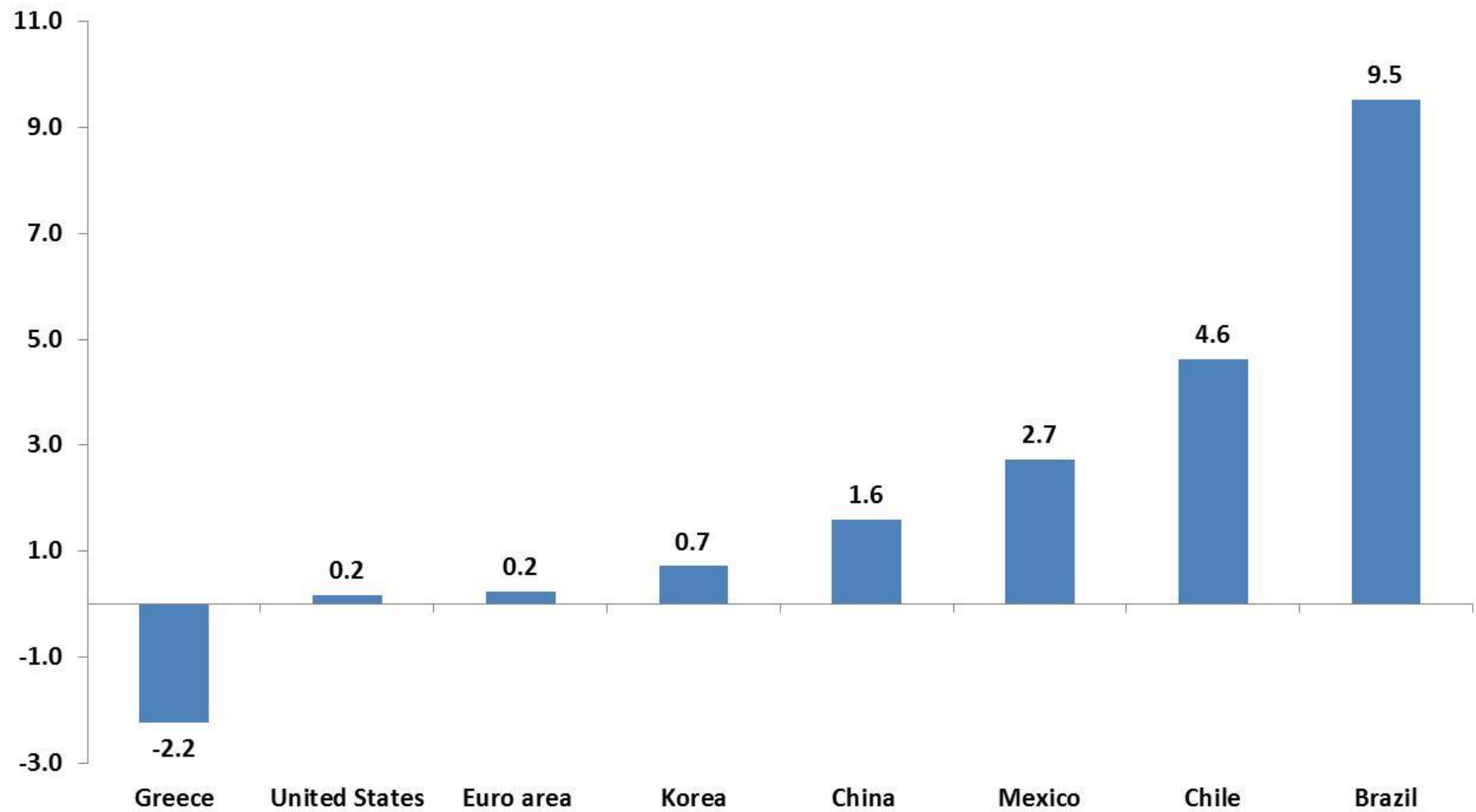
(1) The weighting of the indices of production quantum, exports and imports was based on 2006 figures

Sources: IBGE, National Accounts. Table of Resources and Usages and Quarterly Accounts (2nd Quarter of 2014); Funcex, Indicators; Central Bank of Brazil (for exchange rates)

What are the alternatives ? (or, beyond the fiscal adjustment...). The issues are many, but:

- On the demand side, Investment in general and in infrastructure + exports (infrastructure -> productivity and capacity; exports -> BP);
- On the supply side, (what production structure? What external insertion): reindustrializing is essential; but how, what sectors? The dilemmas are many (Sandwich effect)

Inflation Rates of Selected Countries and Blocs (% in 12 months up to July/2015)



Source: OECD

**Evolution of the Unitary Cost of Labor (UCL) in the Transformation Industry
(% variations accumulated in the indicated periods)**

Variável	2005-2010	2011-2013	2005-2013
Nominal wage per worker	56	33	107
Productivity	13	2	16
UCL in BRL	38	31	80
UCL in US\$	129	7	144
UCL deflated by IPA-Ind	2	10	13

(1) The first period includes the variation in 2005 and the second, the one of 2011. I.e. the bases are 2004 and 2010.

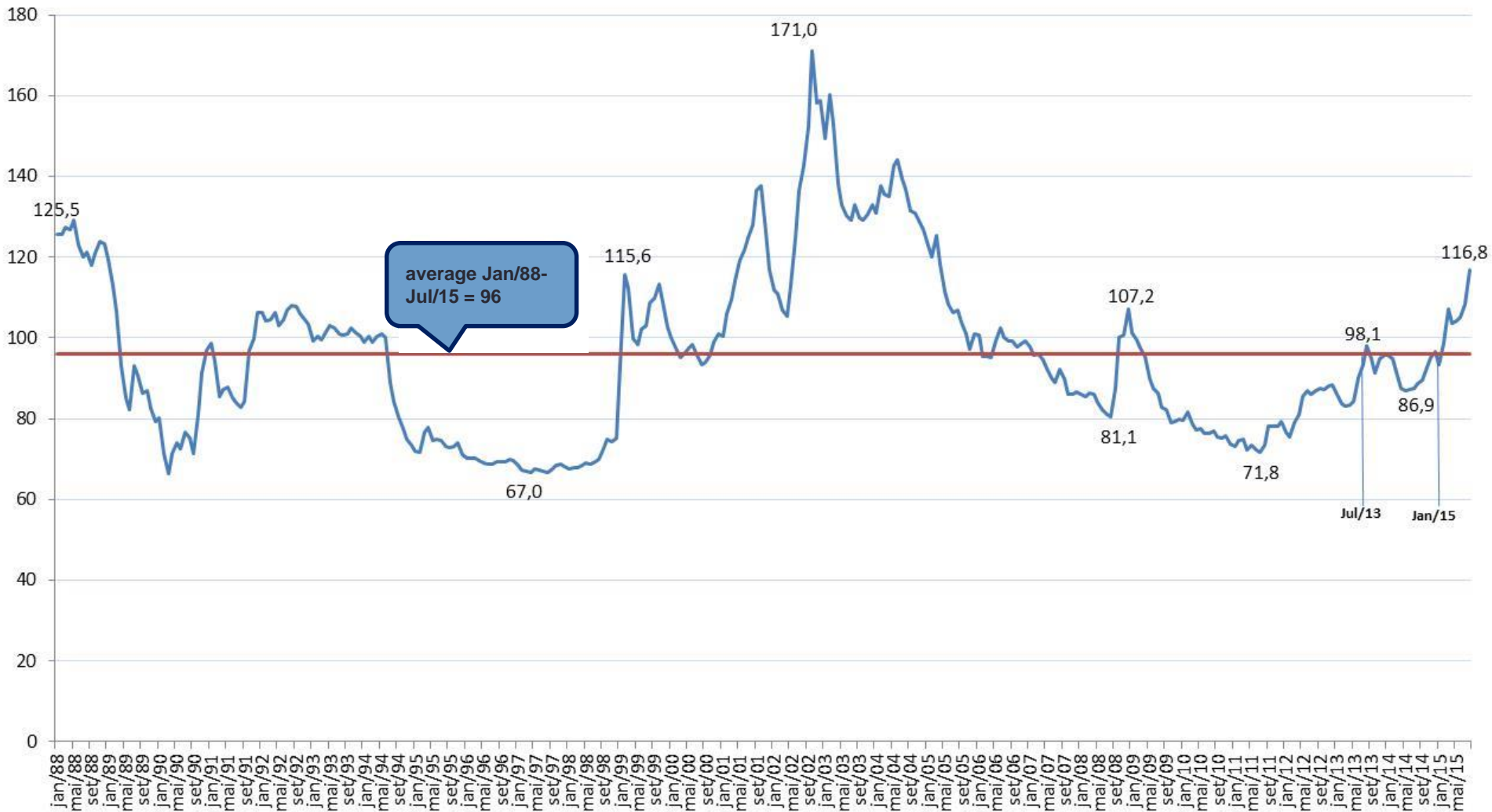
Sources: IBGE and Central Bank of Brazil.

Trade Balance by Activity Sector (Yearly Averages in US\$ Billions)

Setor	2004-2006	2011-2013	Variação Absoluta
Agriculture / Livestock	7,6	27,6	20,0
Mineral Extraction	1,5	31,8	30,3
Petroleum and Gas	-4,2	-1,1	3,1
Metallic Minerals	6,7	36,3	29,6
Other	-0,9	-3,3	-2,4
Transformation Industry	30,6	-47,4	-78,0
Special Operations and Others	2,0	5,2	3,2
Trade Balance	41,7	17,2	-24,4

Source: FUNCEX and MDIC/SECEX. Prepared by the author.

Real Effective Exchange Rate Index (June 1994 = 100)



Source: Central Bank of Brazil.