Issue #2 October 2009

CMMB Emerging Markets Weekly

A proud member of the First Citizens Group

Vangie Bhagoo, Senior Analyst vangie.bhagoo@mycmmb.com

Let the Games Begin: Brazil's Time to Shine On…

Brazil can be considered as the model emerging market economy, which has shown remarkable resilience through the global economic downturn, and was in fact one of the first countries to emerge from recessionary conditions. The Brazilian economy and assets have become one of the most attractive for investors of late and rightly so. Brazil is the largest Latin American economy and the tenth largest globally. It is also one of the four large emerging markets which make up the 'BRIC' economies. Brazil's vulnerabilities have been significantly reduced by the diversification of its export base, which range from primary products and commodities to a large manufacturing sector. In addition to their almost perfect economic track record in the past decade or so, Brazil has for ages also had prominence in the sporting arena, particularly football. Indeed, the South American giant holds the record for the most number of wins in the FIFA World Cup, amounting to five titles from a total of 18 tournaments. It comes as no surprise that Brazil was chosen to host the FIFA World Cup Games in 2014. This will be the second time in the event's history that Brazil will be hosting it; the country last held the event in 1950.

Mega sporting events such as the FIFA World Cup 2014 are now considered to be financial transactions involving high-powered negotiations, intricate intellectual property and high finance. In this regard, they can be either a boom or a bust for the host country. 'The economic impact of a sporting event can be defined as the net change in an economy resulting from the acquisition, operation, development and use of sport facilities and services' (Lieber & Alton, 1983). These activities, in turn, generate visitors' spending, public spending, employment opportunities and tax revenue. Specifically, the economic impact of expenditure comprises direct, indirect and induced effects. Direct effects are regarded as the purchases needed to meet the demand of visitors for goods and services. The major indirect effects can be the ripple effects that can come from tourism spending which can result in higher employment and household incomes.

Nearly every national or international sporting event is accompanied by claims of huge benefits that accrue to the host cities. For example, the National Football League typically claims an economic impact from the Super Bowl of around US$400 million, while Major League Baseball attaches a US$75 million benefit to the All-Star Game and the estimated effect of the NCAA Men's Basketball Final Four ranges from US$30 million to US$110 million. The pre-Olympics estimates for the 1996 Games in Atlanta suggested that the event would generate US$5.1 billion in direct and indirect economic activity as well as 77,000 new jobs in Georgia.

It is anticipated that about 600,000 football fans will visit Brazil for the World Cup, and the Ministry of Tourism is working on four different areas of tourism for the event: international promotion of the event, investment in labor force training, improvement of public tourist attractions and incentives to the hotel industry. A survey conducted on the competition's socio-economic impact on the country, done by Getulio Vargas Foundation (FGV), projects a 20% increase in the number of tourists in Brazil exclusively for the games. It also calculates that by the beginning of the mega football event, the government together with private enterprises is going to invest US$85.6 billion, spent on tourism, infrastructure work, construction and modernization of stadiums and improvement of public services. Brazil's service sector alone is expected to receive substantial investments and millions of jobs are likely to be generated. However, there is the downside of hosting such large events. And the major one is the cost involved in hosting such a large scale event, and the impact upon the fiscal accounts of the host country.

Under the Lula administration, the Brazilian economy has prospered. Pragmatic economic policies, facilitated by a well managed central bank operating within a rigid inflation targeting framework has supported the Brazilian economy through what has been described as the worst global recession since the Great Depression. Driven primarily by the record high prices for soy, iron ore and steel in the past few years, the country's stock of international reserves has grown significantly and it currently stands at US$204.6 billion. Over the past few years, the state-owned oil company, Petrobras has made remarkable strides in deepwater oil exploration which has the potential to transform the company into one of the world's leading oil producers and exporters in the next few years. The oil company has embarked upon a five-year investment program worth US$174 billion in an effort to double Brazil's production to 3.5 million barrels a day by the year 2012. Massive oil discoveries, coupled with strong domestic demand, has helped Brazil to become one of the fundamentally strongest emerging markets in the world, and one of the first countries to emerge from their economic contraction. Real GDP growth rate averaged 3.27% over the past nine years but in 2009 the economy is projected to contract marginally at a rate of 1% due to the weak economic performance during the first few months of the year.

While Brazil's economic prospects are strongly positive, the country's fiscal position is one of the major weaknesses which dents the country's creditworthiness. Even though the fiscal performance has improved slightly since 2006, the budget deficit as a percentage of GDP averaged 3% over the past four years. The net general government debt is forecasted to end 2009 at 50% of GDP, well above the BBB-rated sovereign median of 30% of GDP. Indeed, for 2009 thus far, as the government sought to limit the impact of the global recession upon the domestic economy, the country's public sector debt has been steadily increasing and in August, recorded its highest growth rate of 14.3% since June 2007. To help finance the public spending programs across Brazil, the government has depended largely on the domestic credit market. The Lula administration has reiterated its full backing of the ongoing infrastructural programs under the growth acceleration plan, know as PAC. With the PAC in its final stages, the government has announced a US$344 billion infrastructure development program to be launched next year.

With the additional spending expected to take place over the next few years in preparation for the FIFA World Cup in 2014 as well as the Olympics games in 2016, the fiscal accounts are expected to worsen. And with Presidential elections due in 2010, it means that the new government will inherit a growing fiscal burden. However, there is the potential for tremendous benefits to the economy in terms of foreign currency inflows from tourism, investments, and the positive impact these will have upon the country's capital account in the balance of payments. These benefits should be sufficient to outweigh the possible increases in import demand on the current account side. Brazil's economic strengths and prospects seem to far outweigh any negative implications that the FIFA World Cup will have upon the country's fiscal accounts. Indeed it seems as though the biggest impact would be on government coffers, and as mentioned before, Brazil's fiscal position is one of the major weaknesses that can threaten to undermine the country's creditworthiness. Therefore fiscal prudence and prioritizing will become even more critical going forward. Sports also bring intangible benefits to a country as they contribute to the health, well-being and identity of individuals, communities and an entire nation, in addition to inspiring passion. Football is a fundamental element of culture in Brazil, and the FIFA World Cup in 2016 will indeed be a celebration of the sport in a country where some will argue is the rightful home of football.

FINANCIAL & ECONOMIC INDICATORS

As at 15 October, 2009

Exchange Rate/US$	Closing Value	Previous Week
Yen	90.55	88.39
Euro	1.49	1.48
Jamaica	88.88	88.88
Guyana	202.90	205.20

Commodity Prices	Closing Value	Previous Week
Crude oil (US$/bbl)	77.58	71.69
Natural Gas (US$/mmbtu)	3.86	4.25
Gold (US$/Troy Ounce)	1,050.20	1,055.10

Eurobond Indices (As at 15-10-09)

Lehman Brothers Global Aggregate Index (Return % YTD)	8.50
JP Morgan EMBI+ (Basis points)	291
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	34.91

Policy Interest Rates (%)	Closing Value	Previous Week
United States	0.14	0.12
Euro Zone	1.00	1.00
Japan	0.10	0.09
Brazil	8.75	8.75
Trinidad	6.25	6.25
Jamaica	12.50	12.50
Barbados	2.50	2.50

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	0.06	0.06
US 10-Yr Treasury	3.46	3.25
3-month UK Libor	0.57	0.55
Japan 90-day T-Bill	0.28	0.28
Brazil 90-day T-Bill	8.65	9.07
TT 90-day T-Bill	1.59	1.86
Jamaica 90-day T-Bill	16.39	16.39
Barbados 90-day T-Bill	3.65	3.65

Sources: Bloomberg, J.P. Morgan, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com