

IT IS THE EXCHANGE RATE, MR. PRESIDENT

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Brazil will only achieve high growth rates when it managed its exchange rate

The newspaper *Valor Econômico* of last August 11 informed, in its front page headline, that the automobile industry experiences its "3rd. wave of investment", whereas on the same day the newspaper *Folha* announced that "the fall in exports prevents automakers from recovering" and added: the accumulated slowdown of automobile industry exports in this year reaches 12.9%. The two news are contradictory. Why would the enterprises plan major investments when their exports are falling? And what if one of the causes of this decrease is the exchange rate appreciation that is now taking place? One could answer: to primarily orient the intended expansion to meet the demands of the domestic market. But, even though automobile industry is one of the few protected sectors, the exchange rate appreciation opens the domestic market to imports.

I can only see one explanation for this contradiction. The investment plans probably exist, but they were conceived in the setting of another exchange rate — the rate that was defined after the crash of October 2008. Investment plans take time to conceive and even more to implement. I wouldn't be surprised, therefore, if a good portion of such projects is abandoned or postponed, given the new exchange rate.

President Lula, however, does not seem willing to face the problem. In the same newspaper *Folha*, Kennedy Alencar informs that "despite being concerned with the negative effect of the appreciation of the real on exports, president Luiz Inácio Lula da Silva dismisses intervening in the floating exchange rate system". How to explain this fact? I can only see two answers: first, president Lula is satisfied with the performance of Brazilian economy and is unwilling to

take stronger measures in the sector second, the president is not yet aware of the severity of the Brazilian exchange rate problem he presumes that the overvaluation that is showing up again is related to the economy ndash to the high interest rate ndash when it is a structural issue.

I think that the president is content with little, but I understand his satisfaction. It reflects the contentment of Brazilian population, who, after 14 years of high inflation and low growth, understood that a low inflation and a slightly better growth are the best we can expect. If my constituents are satisfied, why would I intervene in the market? he probably thinks. I respect the presidents political genius, but the fact is that this exchange rate is incompatible with Brazilian economic development. It already was so before the crisis, but it was then temporarily compensated by the increase in the domestic market caused by his distributive measures ("Bolsa Família" [family allowance] and increase in the minimum wage). There is, however, no more room in this area. And the exchange rate is once again following its structural tendency to overvaluation.

This tendency has two basic causes: the moderate but real Dutch disease existing in Brazil and the attraction that foreign capital has for the higher profit and interest rates existing in the country. This is the reason why we cannot let the exchange rate be run by the market. The market makes it not only volatile, as acknowledged by all economists, but this volatility has a tendency to overvaluation that results, in the short run, in reduced investment opportunities and, in the medium term, in balance-of-payment crisis. Brazil has only achieved high growth rates when it managed its exchange rate. It is only by doing it again that those high rates will reappear.