



NEW ZEALAND
FOREIGN AFFAIRS & TRADE
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Brazil: Trade and economic update

A MARKET INTELLIGENCE REPORT

Summary

- Brazil is the biggest economy in Latin America and a commodity-exporting powerhouse. After a rebound from the pandemic, economic growth is slowing this year (in line with global trends) and Brazil's economy continues to be hampered by high interest rates. However, decreasing inflation, low unemployment, and continued international investment are positive signs for this G20 economy.
- For New Zealand exporters Brazil offers many opportunities particularly in the agritech, energy and resources, technology, and security sectors. However, at times Brazil can be a challenging market with a complex operating environment. Pre-pandemic more than 50% of New Zealand's exports to Brazil were in education and tourism, and as borders have reopened, education and tourism continue to recover.

Report

Brazil is the 12th largest economy in the world and the biggest in Latin America. It has a diversified economic profile, spanning from the production of agricultural commodities (as a major exporter of soybeans, coffee and sugar) to industrial goods, as well as mining of minerals such as iron ore. The G20 economy attracts high levels of foreign direct investment (FDI), and in 2022 received \$90.6 billion USD in FDI.

In the absence of a free trade agreement with New Zealand, Brazil is not always the most obvious destination for kiwi goods; and goods trade is modest - in the year ended December 2022, New Zealand exported NZD 119.45 million of total goods to Brazil and imported \$352.62 million. However, with a large population of more than 217 million people, and strong demand for niche solutions in areas such as agriculture, security, technology and mining (and strong trade in services in the education and tourism sectors), Brazil can provide a high payoff to those willing to invest time and energy.

On 1 January 2023, Luiz Inácio Lula da Silva (Lula) took office as President, bringing the left wing Worker's Party (PT) back to power. The new Lula administration has stated it is focused on balancing economic responsibility with social spending. The creation of new trade and economic policy is not an easy task, given the need find an equilibrium to keep the business community, financial markets, voters and centre-left coalition happy as well as the conservative and predominantly centre-right Congress. This balanced approach has meant selecting centrist advisors, as the appointment of key positions at the economic ministries show, and pursuing an orthodox economic policy while also expanding social spending.

A challenging post-pandemic economic scenario

Brazil's economy was initially impacted heavily by the COVID-19 pandemic; GDP fell by 3.3% in 2020 and unemployment and poverty levels reached 14.2% and 18.7% respectively. However, economic growth quickly returned to pre-pandemic levels with a 5% increase in 2021, slowing to 2.9% in 2022. The labour market also rebounded with unemployment dropping to 7.9% in 2022, the lowest level since 2014, but poverty (those with a monthly income of less than \$155 NZD per month), which now affects almost 30% of the population, will endure longer.

Since the pandemic, inflation has been persistent (4.52% in 2020, 10.06% in 2021 and 5.79% in 2022), surpassing the upper limit of the government/Central Bank target for the past two years. This year, the GDP growth forecast for 2023 is a modest 1.4% (IMF) and the estimated rate of inflation is 5.96%. The downwards trending economy, combined with the not so optimistic global outlook, has affected both business and

consumer confidence, which are currently at 91.4 and 87 (on a scale of 0-200). However, high demand and prices for commodities as well as a stabilising international environment are positive, and the Brazilian economy remains robust despite the challenging outlook.

A new government takes the reins, with a review of the government-spending cap, challenging interest rates and a tax reform on the horizon

President Lula has appointed Fernando Haddad as Minister of Finance, who has stated that fiscal responsibility is a key focus for his first few months in the job. Having promised to increase government spending on core public services and welfare, President Lula has negotiated with Congress to temporarily raise the governmental spending cap via a constitutional amendment. The spending ceiling, put in place in 2016 as one of several measures to lift Brazil out of a severe economic crisis, limits the growth of government spending to the previous year's inflation rate. To replace the spending cap, the government last week announced a new fiscal framework - a set of budget guidelines that will limit spending increases to 70% of the annual increase in revenues, excluding spending for health and education, which will be maintained at respectively 15% and 18% of government revenues. The framework also establishes budget targets, starting at a 0.5% deficit this year, a zero primary deficit in 2024, followed by surpluses in subsequent years. The new framework is being discussed with Congress, who have reportedly promised to quickly approve the legislation needed to put the rules into practice.

Curbing inflation is another pressing issue for the government. In a country that experienced a long period of high inflation in the 80s and 90s, double-digit inflation figures in 2021 rang alarm bells. However, tax reductions and exemptions implemented last year were successful in lowering inflation to a more manageable figure (5.79%). The independent Central Bank has set higher interest rates after reaching a record low of 2% in 2020, the benchmark interest rate (Selic) is currently at 13.75% and it is likely that the Central Bank will keep it unchanged until the end of the year.

Brazil's government has also committed to implementing a tax reform for a "more transparent, simpler and fairer" tax system. Brazil's tax system is known for its complexity, according to the World Bank, the average time companies spend per year on tax-related administration in Brazil is 1,501 hours. [Brazil's time-consuming tax regime is one of a number of high operational costs - in the World Bank's Ease of Doing Business Index, Brazil was placed 124 out of 190 countries surveyed]. A simplified tax system, combined with a recovery of the government's accounts and inflation control, would contribute to the government's goal of restoring growth with sustainability and social responsibility, and facilitate increased ease of doing business.

Trade policy: a focus on regionalism, exports to China, a question mark over OECD accession, and reindustrialisation

The new administration's trade policy is still under development, but will likely focus on Mercosur and regional economic integration. Differing views from members[1] on the future of the Mercosur have complicated progressing trade issues in the bloc in recent years.

The “reindustrialisation” of Brazil is a key platform for Lula's Worker's Party, which has a large union base (Lula himself is a former metalworker). Industry is a large economic force in Brazil, and accounts for 24% of GDP. No specific industry revitalisation policies have been announced yet, however, general policies in the areas of tax reform and improving the business environment should contribute to more favourable conditions for the sector.

[1] Brazil, Argentina, Uruguay, Paraguay

An important market with big opportunities

With the largest consumer market and GDP in Latin America, as well as a diversified economy and appetite for international solutions, Brazil is a popular market for foreign companies, particularly those from China, the EU, the US and southern neighbour Argentina. Important Brazilian economic sectors include agriculture, mining, automotive and pharmaceutical industries. Brazil is one of the largest oil producers in the world and is a growing key global player in the digital economy.

New Zealand exporters and investors – many supported by NZTE, whose Latin America regional hub is located in São Paulo – are finding success across a range of sectors including dairy production and communications. Technology has been a key sector for kiwi businesses, who have provided solutions for different industries, from agriculture to retail and health. Energy and resources is another important area with interesting prospects as Brazil looks for sustainable approaches to the oil, gas and mining industries and explores the potential of renewable energies including green hydrogen.

Prior to the pandemic, international education and tourism were New Zealand's biggest export earners in the Brazilian market: in 2019, these services accounted for more than 50% of the value of New Zealand's total exports to Brazil. Even after the reopening of New Zealand's borders and restarting of direct NZ-Latin America air links via LATAM, these export services have yet to rebound to pre-pandemic levels but are continuing to grow.

Speciality consumer goods such as lamb and wine, can find a lucrative niche market (however, limited numbers of these products are exported to Brazil currently). Complex domestic regulatory and tax frameworks often present challenges to exporters, especially small and medium sized companies, but these can be overcome by working with local partners who have knowledge of local market trends and regulations.

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