E.2

Read the article entitled "Surging Oil Prices Pressure Brazil To Pick Up the Pace on Exports," taken from the Wall Street Journal, September 27th, 2000. Use the information contained in the text to address the following questions:

E2.1 Describe, step by step, how the increase in the price of oil, the devaluation of the Real and the fall in international agricultural prices will affect the merchandise trade balance and so the Current Account of Brazil.

E2.2 The article mentions an increase in foreign investment as a "helper" against the growing trade deficit. Is that so? Describe the connection between the CA balance and the KA balance and use that relationship to explain the article's description of the Brazilian case.

E2.3 Would you expect the article's conclusion about how the increase in the price of oil will affect the merchandise trade balance to be any different if the Brazilian government's subsidies on gas were to be eliminated? Would you recommend such an economic policy for the US during winter times?
Surging Oil Prices Pressure Brazil To Pick Up the Pace on Exports

BY JONATHAN KARP
Staff Reporter of The Wall Street Journal

SAO PAULO, Brazil—Unlike U.S. and European consumers, Brazilians have hardly felt the spike in oil prices, thanks to state controls at their gasoline pumps.

The government isn’t so blithe, even as world prices ease. For despite Brazil’s comfortable position relative to other developing countries, the oil mini-shock is increasing pressure on one sector that Latin America’s largest economy needs to solidify its recovery: exports.

Trade Secretary Lytha Spindola confirmed the deteriorating picture on Monday, saying that Brazil will have to spend $2.2 billion more than anticipated on oil imports this year. As a result, the government has abandoned its projection of a merchandise-trade surplus for 2000. It had originally set a goal of $4.5 billion, only to pare it down as the year has progressed.

Independent economists expect Brazil to achieve a trade surplus of at least $1 billion this year. The latest trade figures, released on Monday, showed a surplus of $741 million through Sept. 24. But thanks largely to a sharp increase in fuel imports, Brazil looks headed for its first monthly deficit since January: As of the 24th, the gap stood at $295 million.

Ms. Spindola said that the government will concentrate on improving exports, though she didn’t elaborate. A sharp devaluation of Brazil’s currency, the real, in January 1999 has increased foreign demand for Brazilian products. In August, the country’s exports reached a historic monthly high of $5.5 billion.

But many challenges remain, and the oil spike is exacerbating them. Agricultural products, which account for more than one-third of Brazil’s exports, continue to suffer from a global slump in commodity prices. These exports fell slightly in the first six months of this year, compared with the first half of 1999.

Picking up the farmers’ slack are manufactured exports, which have found new markets since the 1999 devaluation. Aircraft maker Embraer, which has had success in the U.S., delivered its first regional passenger jet to China last week. Brazilian aircraft exports rose 60% in the first half of this year, while newer export products such as cell phones soared 150%, says Eduardo Freitas, senior economist at Brazilian bank Unibanco. “Exports are reacting well to the new foreign-exchange levels, and we should have this for several years,” he says.

But will they be robust enough to outstrip strong demand for imports? So far this month, exports have risen 16% over the same period last year, while imports have surged 24%. Above and beyond oil, imports of cars and auto components rose 60%; electronics 34%.

Adding pressure, notes Marcelo Carvalho, vice president of J.P. Morgan in Sao Paulo, is Brazil’s success in attracting billions of dollars in foreign investment. The reason: 60% of those funds are going into so-called nontradable services, such as telecommunications, banking and power, which often require imported capital goods but offer no export potential.

The upside of that investment, Mr. Carvalho adds, is that it finances Brazil’s current-account deficit. Also, strong tax revenues generated by Brazil’s economic revival give the government at least a temporary cushion against the recent oil spike.

The government’s dilemma is more political than economic: Having already raised gasoline prices 22% this year, it faces municipal elections next month and presidential elections in 2002. “Either it has to hike domestic gasoline prices or absorb the hit from subsidies,” says Mr. Carvalho.