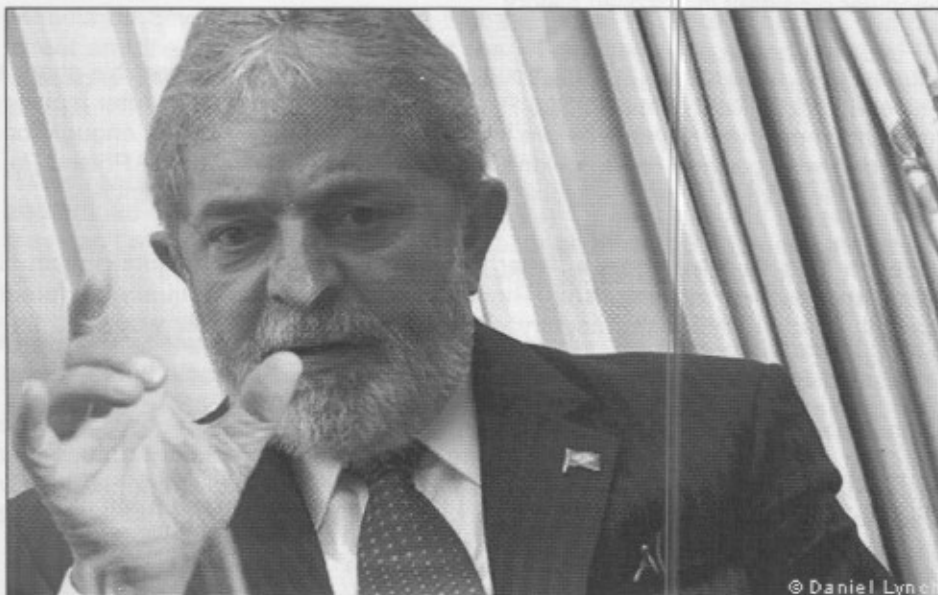


The real reward

By Lionel Barber and Jonathan Wheatley

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Luiz Inácio Lula da Silva is in full flow. Beaming broadly, favourite cheroot in hand, Brazil's president recounts with gusto the day he said No to the International Monetary Fund. "I called [Rodrigo] de Rato [managing director] at the IMF and told him I didn't want his money. He was really upset," he laughs. "Rato said: 'But lending to Brazil is really important to me.'"

For Mr Lula da Silva and his 190m countrymen, the memory of Brazil regularly going cap-in-hand to the IMF still rankles. Only a decade ago, in the wake of the Asian and Russian financial crises, Brazil was forced to devalue its own currency, the real, and seek emergency IMF loans. But now the tables have been turned.

"We were one of the last countries to go into the global crisis and we have been one of the first to come out," says the 64-year-old former lathe operator who was first elected president in 2002.

For next year, his last in office, he is confident Brazil's economy will grow by a more than healthy 5 per cent. "Not long ago I used to dream of accumulating \$100bn in foreign reserves," he says, still smiling broadly. "Soon we will have \$300bn (€202bn, £180bn)."

During an hour-long interview in London, where he was accompanied by a dozen of the country's senior ministers, bankers and business leaders, Mr Lula da Silva made his pitch for Brazil as a country transformed by an economic miracle. Inflation is under control, previously sky-high interest rates have fallen to real-world levels and revived capital markets are helping to fund investment. Income transfer programmes have brought millions of people into the consumer market. In the thick of the global crisis, the government kept sales moving with tax breaks on cars, household electrical goods and construction materials. Brazil was chosen a year ago to host the 2014 World Cup and, last month, the 2016 Olympic Games, leaving many feeling that, at last, their country's time has come.

The question is whether Brazil's recovery, which owes much to the boom in commodity prices, is sustainable. Many analysts worry that the flood of liquidity that is buoying Brazilian assets – the currency has gained about 36 per cent against the dollar this year and stocks are up 135 per cent in dollar terms – could just as easily retreat if the global crisis enters a second stage. Rising government spending on welfare and the public sector payroll, both hard to reverse, could also amount to a fiscal time bomb.

From poverty to presidency

Few presidents of big nations can have risen from such humble origins as Luiz Inácio Lula da Silva and certainly none in the history of Brazil. One of eight children born in poverty in Brazil's north-east, he began work in a laundry aged 12

How a well insulated Bric became a hot property

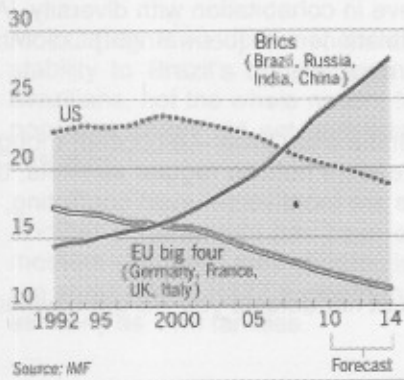
After the dotcom bust, it was western housing markets that helped reflate the world economy. Some hope the Brics will do the rebuilding after the credit crunch, writes John Paul Rathbone.

For sceptics, this is a pipe dream. Yet in 2001, when the term was coined, Brazil, Russia, India and China made up barely one-sixth of the world economy. This year, according to the International Monetary Fund, they account for almost one-quarter, having together overtaken the US.

"Even I get excited about Brazil's prospects," says Sir Robert Wilson, the normally understated chairman of **BG**, the UK energy group. Brazil does not suffer from the ethnic and border conflicts of India, Russia's loose regard for contracts or China's supercharged credit- and investment-led growth. The domestic market is relatively insulated: exports account for 13 per cent of gross domestic product. Net debt is a manageable 30 per cent of GDP – less than half the UK level. With foreign currency reserves of \$230bn (€155bn, £139bn), it is a net global creditor. Export markets are diversified, with China overtaking the US last year as Brazil's biggest trading partner. No big bank has failed.

The Brics' rising share

Share of global GDP at purchasing power parity (%)



Source: IMF

All this has fuelled investor enthusiasm. "Brazil is in fashion now, although it wasn't always so," says Emilio Botin, chairman of Spain's Banco **Santander**.

In the 1980s and 1990s the country mostly funded itself externally, in dollars. When global investors grew nervous they sold the currency, debt service costs soared and the fiscal deficit exploded, compounding the problem. A debt crisis and devaluation followed. Now most of the country's debt is domestically funded, reducing its risk premium and allowing funds to be raised more cheaply. With less needed for debt payments, more can be spent on investment – and consumption. The vicious cycle turned virtuous.

There are risks, of course. Brazil's commodity wealth is a boon when mineral and food prices are high. But an abrupt Chinese slowdown could reverse that trend – and half the companies on the stock market have commodity exposure. Domestic industry could be hollowed out by an uncompetitive real strengthened by hot money inflows. Government spending is also rising. Although the fiscal deficit is small, the constitution makes it hard to cut entitlements and the public wage bill is

a growing concern.

Enthusiasts are unperturbed. "We have full confidence in Brazilian economic growth," says Mr Botin. The Santander chairman, whose bank has a large operation in the country, is a dealmaker rarely on the wrong side of a bet.

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"I am against the state being the manager of the economy. The state has to be strong – but as a catalyst of development. And we have run sound fiscal and monetary policies. That is why the banking sector did not break down during the crisis."

Mr Lula da Silva declared last year that the global financial crisis was the fault of blond, blue-eyed bankers in Wall Street and the City of London. When the FT suggests his nation escaped the worst of the crisis because Brazil is running a deficit of blond, blue-eyed boys, there is laughter among the entourage. But the president himself remains serious.

"I was reacting to comments by people who put the blame for the crisis on migrants," he says. "Poor people in Africa and around the world are going to have to pay for the crisis and it wasn't them who caused it. The rich countries say they can't afford to fund poverty relief in poor countries. But to save their banks, they found trillions. If they had paid some of that in aid to poor countries, the world would be a better place."

Brazil's relations with the rest of the world under the Lula administration have shifted away from traditional trading partners and allies such as the US and the European Union in favour of diversifying trade and forging links with other parts of the world such as Asia, the Middle East and Africa. China has become its single biggest trading partner.

Mr Lula da Silva has pursued a "make friends with everybody" approach that includes reaching out to counterparts including Mahmoud Ahmadi-Nejad of Iran and Hugo Chávez of Venezuela, both *bêtes noires* in Washington. Critics say the Brazilian president's foreign policy is naive, but he will have none of it.

"I think of when Nixon made China a preferential trading partner," he says. "I believe in cohabitation with diversity. We don't have the right to think other people should think like us. We have excellent relations with [centre-right] Colombia and Peru and with [leftwing] Venezuela and Bolivia. You can't push people into corners."

The president is also a fervent believer in the future of the Brics – Brazil, Russia, India and China – a concept thought up by Goldman Sachs, the investment bank. This has led to the countries' four leaders holding regular summits, the next one billed for São Paulo next year. Yet many believe the interests of the Brics are too diverse, even conflicting, to form a meaningful group.

"It's like when you meet a new girlfriend," Mr Lula da Silva smiles. "If you only look at her defects you will get nowhere. But if you look on the bright side you might end up getting married."

He also sees inspiration in the model of the EU, noting that only two generations ago France and Germany were at war. "That's how we will build a strong alliance among the Brics. At our first meeting I suggested we should begin trading in our own currencies. We don't need the dollar. It's just cultural and it can change."

With elections to take place next October, Mr Lula da Silva has avoided the temptation of seeking a third consecutive term, a move that would involve changing the constitution. Other Latin American leaders, notably in Colombia and Venezuela, are either considering or actively pushing for such changes to prolong their hold on power. But the president says it never occurred to him to become another *caudillo*.

"I was even afraid to run for a second term, remembering what happened to Fernando Henrique Cardoso [whose second period in office was much less successful than his first]," he says.

In fact, the president is already preparing to consolidate his political legacy through his chosen successor, Dilma Rousseff, his chief minister. Ms Rousseff, a tough technocrat, will struggle to emulate Mr Lula da Silva, partly because she lacks his trademark charisma and partly because she must hold together a broad coalition of often conflicting parties that is already showing signs of fraying. One or two possible candidates from his PT have fallen by the wayside, ensnared in corruption scandals. Another strong woman, Marina Silva, his former environment minister, has defected to the Greens.

"The coalition will hold together and we are making it stronger," he says. "And we have a very good candidate...If I elect Dilma, my big contribution will be to allow her to create her own style."

During the interview and in speeches in London the following day, the president and his colleagues refer repeatedly to the old joke that claimed Brazil was the country of the future and always would be. Now, they exude a new confidence. Brazil is not just the country of the present, the president says. "It is really living a magical moment."

How a well insulated Bric became a hot property

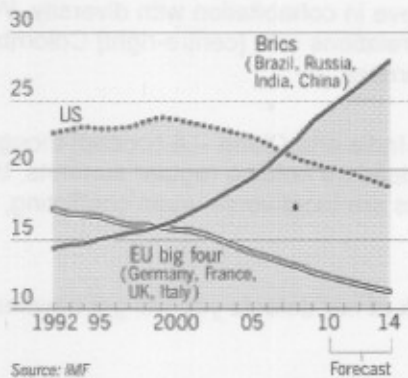
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and was a shoeshine boy and office boy before becoming a metalworker, when his involvement with the trades union movement started.

His political career began as a leader of strikes against the industrial backers of Brazil's 1970s military dictatorship. In 1980 he was founding president of the Workers' party (PT). His experience as a union negotiator has made him a talented politician as well as the most popular president in Brazilian history.

Mr Lula da Silva points to his own personal story as evidence that his country has undergone an irreversible change. A poor migrant from the north-east, he began his political career in São Paulo as a trade union leader. After founding the Workers' party (PT) it took three failed attempts over 12 years before he won the presidency. "That is enough for a candidate to mature. And I was the only one who couldn't fail. I couldn't do what [Lech] Walesa did in Poland [in a term so unimpressive that he failed to win re-election] or no worker would ever have been elected president again."

Between being elected and taking office, Mr Lula da Silva wrote a "letter to the Brazilian people" assuring them his government would honour all contracts and eschew adventurism. The message was aimed equally at foreign investors – and it worked. Foreign capital, which had fled the country on fears that the leftwinger would go on a spending spree that would end in a debt default, returned.

The Lula administration also refused to break contracts or to undo any of the orthodox, inflation-busting policies inherited from Fernando Henrique Cardoso, his centrist predecessor. Some of the president's leftwing supporters have challenged Mr Cardoso's privatisations but the courts – which used to have a reputation for subjective waywardness – have consistently upheld the law. Other institutions have proved to be similarly robust, helping Brazil to earn a reputation for reliability on an often fickle continent.

Mr Lula da Silva does not mention Mr Cardoso by name, even though many credit him as the man who brought stability to Brazil's tempestuous economy. He says his predecessors governed for the better-off 40 per cent of Brazilians, not the whole nation. Moreover, those who worried that his election in 2002 would herald a shift to leftwing populism simply did not understand him. "I was working obsessively under the conviction that I couldn't make any mistakes."

Another achievement has been dramatically to expand income transfer programmes that pay poor people – usually mothers – to keep their children in school and make sure they have medical check-ups. The Bolsa Família payments are small – from R\$22 a month to a ceiling of R\$200 per family – and cost less than 1 per cent of GDP. But they reach as many as 11m families.

As so often, Mr Lula da Silva uses a homespun anecdote to illustrate the broader argument about his country's transformation. He recently met a woman in Brazil's arid north-east who a year ago borrowed R\$50 from a friend to make *pasteis* (fried snacks) for construction workers on one of the government's flagship infrastructure projects. Since then she has built up a catering business big enough to pay R\$5,000 (\$2,900, £1,750, €1,960) in annual income tax.

Grasping the interviewer's arm, the president declares with passion and pride that this woman is typical of the 30m Brazilians who have emerged from poverty and the 20m who have joined Brazil's middle class over the past five years.

Mr Lula da Silva will never forget his roots and, as his second term draws towards a close, some critics detect signs that he may be reverting to his leftwing instincts. Plans for potentially enormous oil fields discovered off Brazil's coast in 2007 include a new 100 per cent government-owned company to oversee production contracts. This would signal a much greater role for the state. Recent pressure on Vale, the mining giant privatised in 1997, to adjust its investment plans to suit government policy has also raised alarm in some quarters.

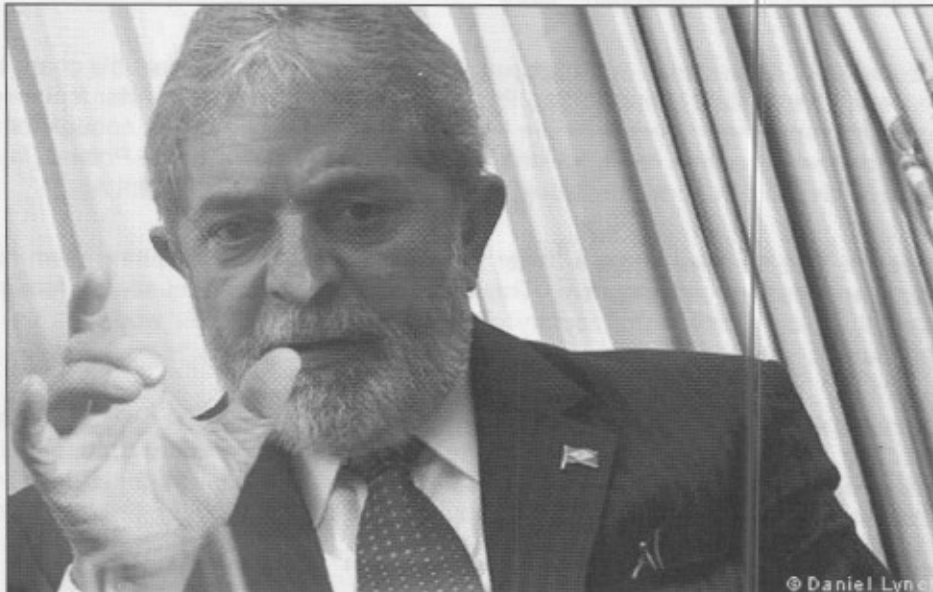
The president responds to such criticism with uncharacteristic defensiveness. "I doubt that at any time in Brazilian history the private sector has had more respect from the state than it has today, or that it has ever made more money. What I ask of Vale is that they turn iron ore into steel in Brazil and that they buy ships from Brazilian shipyards."

The self-styled economic patriot is more at ease when asked about the state's role in the economy. "The usual discussion about the role of the state has ended as a result of the global crisis. For a long time people said the state had failed and the markets could rule everything."

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