A bull diminished

The economy has slowed, but there are still opportunities around

For Brazil's government recent weeks have brought some long-awaited victories. The overvalued currency has weakened to two reais to the dollar, from its peak of 1.54 last July. At 9% the Central Bank's policy interest rate is near to historic lows and should fall further after President Dilma Rousseff's brave decision to cut returns on government-backed savings accounts, which had previously acted as a floor. Both developments were welcomed by manufacturers, who have been labouring under a turbocharged currency and sky-high interest rates for years. Neither, though, was enough to reverse a recent shift in mood against Brazil.

Investors were initially sceptical about Brazil's inclusion in the BRICs, the acronym devised in 2001 by Jim O'Neill of Goldman Sachs to group Brazil, Russia, India and China. But macroeconomic stability, falling income inequality and the global commodity boom ensured Brazil's steady, politically harmonious growth. Strong banks and domestic demand made for a speedy rebound from the 2008 credit crunch. In 2010 Brazil's economy grew by 7.5% to become the world's seventh-largest. Brazilians, made vigilant by a history of hyperinflation and debt default, finally relaxed and accepted the applause.

It did not last long. During 2011 Brazil grew just 2.7%. That sat ill with membership of the high-growth BRICs: Russia, India and China managed between 4.3% and 9%. Foreign investors and those who advise them are reporting a new, less starry-eyed approach. "The days of Brazil being given a free pass are over," says Ivan de Souza of Booz & Company, a consultancy. Some go further: in an article in Foreign Affairs magazine called "Bearish on Brazil", Ruchir Sharma of Morgan Stanley argues that the country rose with commodity prices and will fall again when they do.

A reassessment of Brazil's recent performance is overdue. Between 2000 and 2010 Brazil's terms of trade improved by around 25%; in the past five years private-sector credit doubled. Such tailwinds cannot continue to blow—and even with them Brazil has grown on average by only 4.2% a year since 2006. Only productivity gains, and more savings and investment, can provide fresh puff. Those are nowhere to be seen: IPEA, a government-funded think-tank, puts annual productivity growth for the past decade at a paltry 0.9%, much of it from gains in agriculture. Investment is only around 19% of GDP. Add soaring labour costs and a still-strong currency, and many analysts are lowering their sights for potential annual growth to about 3.5%.

Lower interest rates could give a fresh boost to credit. But not a big one: consumers are already overstretched. Serasa Experian, a credit analyst, says that demand for loans between January and April was nearly 8% lower than during the same period in 2011. Defaults are rising and banks are tightening their terms. Loans that are more than 90 days overdue are now 8% of the total. Itaú and Bradesco, two big banks, saw their share prices fall recently when they upped their provisions against bad loans. Banco Votorantim, which has lent heavily against cars in recent years, has posted three quarterly losses and is rumoured to be a take-over target.

Irritations that were overlooked with growth at 4.5% are likely to resurface when it is nearer to 3%. Taxes are hideously complicated, and take around 36% of GDP, a far higher number than in other middle-income countries. Guido Mantega, the finance minister, points out that the government has cut some taxes, and that tax collection is rising because more businesses are formalising their activities. But Raphael de Cunto of Pinheiro Neto, a São Paulo law firm, argues that the government's ability to collect taxes has run far ahead of any effort to streamline them, increasing the burden on businesses.

For some, political intervention has supplanted an overvalued currency as the biggest risk in Brazil. Petrobras, a state-controlled oil giant, and Vale, the world's biggest iron-ore producer, are now being run more to suit government aims than in minority shareholders' interests, says Joseph Harper of Explorador Capital Management, a fund manager. Such concerns have weighed on both firms' share prices. Explorador is gradually reducing its Brazil exposure in favour of Peru, Colombia, Chile, Panama and Mexico, where it sees similar opportunities at lower prices, and with less political risk.

Such worries have been amplified by Argentina's expropriation last month of YPF, a Spanish-controlled oil firm. Though in private ministers are keen to stress that Brazil respects property rights, they are unwilling to irritate an important trading partner or jeopardise Petrobras's Argentine interests by criticising their neighbour publicly. That is risky: Brazil is indeed different from Argentina, but outsiders may not realise that. The governments of both Colombia and Mexico openly distanced themselves from Argentina's move.

The threat by a prosecutor to impose huge fines on Chevron, an American oil firm, and jail its executives after a small leak off the coast of Rio de Janeiro earlier this year raises concerns about the treatment of foreigners. Lawyers say that some clients are now asking whether a misstep in Brazil means risking having one's passport confiscated, as happened to several Chevron executives. The answer is almost certainly not; that the question is even asked is an unnecessary own goal.

A little less Brazil-mania could be salutary. No country has yet been able to abolish business cycles, and some caution now might prevent exuberance from becoming irrational. Even better, it might persuade the government to remove some of the barriers that hold Brazil back. But although overall growth is likely to be modest for some years, there are still plenty of opportunities, particularly in agribusiness and mining, and in catering for growing demand for education, health-care and the like. The new mood, says Mr Harper, is "selectively bullish on Brazil".

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