

In Brazil, the Carnival Seems to Be Over. Next Stop: Hangover

Written by Ed Catchpole

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Carnaval in the historic Brazilian city of Olinda is a non-stop, noisy affair that showcases Brazilians at their very best; happy, energetic and creative. Wearing costumes of every possible description they jump to the sound of the frevo brass and percussion bands in 104-degree heat spraying one another with water-pistols wearing cans of beer around their necks.

The party rocks day and night, long after the official four day religious festival has ended.

But all good things must come to an end and in early March each year the revelers start to melt away, the tourists move on and Olinda's original residents - who had left to escape the noise - move back home and the town returns to its sleepy self.

Right now, Brazil feels like it's on the brink of a just such a post-Carnaval hangover.

It has been quite a party. Festivities have been in full swing across the country since 2004 to the rhythm of the Lula Model, the growth engine unofficially named after Brazil's former president, based on high demand for Brazil's commodities such as Chinese appetite for iron ore, which has in turn fueled a domestic credit boom.

The recent Brazilian growth miracle has propelled the country to the heights of the second largest emerging market in the world, briefly knocking the UK off sixth-place in global GDP rankings in 2012.

Foreign companies, excited by the prospect of one of the few growth markets in the world post-financial crisis have piled in, as Brazilians snap up flat screen TVs, cell phones, fridges and cars. And credit has expanded to pay for it all. The number of credit cards issued between 2004 and 2011 grew 132%, according to Brazilian credit consultancy, GoOn, a higher rate than the

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United Kingdom.

However, just like Olinda there are signs that the party might be winding down.

Firstly, on the domestic front there are signs now that the Brazilian consumer may have overdone it. According to a study by the Brazilian Consumer Defense Association (Proteste Study) debt servicing now represents an average 46% of monthly household income.

And for lower income Brazilians, who have largely driven the consumer boom, debts in arrears are rising (from 22.4% in July to 23.7% in August, 2012).

Then there is Brazil's export performance. One good indication is that showcase of Brazilian industrial might, the mining giant, Vale do Rio Doce. This year it has seen falling Chinese demand for its iron ore, which has halved in value in the last year and has reined in spending accordingly. The Chinese slowdown is already having an impact on the Brazilian economy and a hard landing would undoubtedly exacerbate this situation.

If these two wheels have indeed fallen off Brazil's wagon, does that mean the party is over?

Well, Brazilian consumers here aren't likely to lose their substantial appetite for the latest gadgets or cars anytime soon, so the idea this is a massive consumer market is absolutely correct.

There are also signs that the current Rousseff administration recognizes things need to change and aims to tackle Brazil's problem head-on to increase competitiveness. It launched one of the largest infrastructure projects in the world to reduce bottlenecks. It has also reduced taxes (today it announced electricity bills will be cut by 16% in 2013), lowered interest rates and cut Federal VAT (IPI) on cars.

But can such tinkering really "keep the shuttlecock in the air?" - as the Brazilians say.

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The key question I think is how long all this will take? While the government has a lot of room to maneuver and money to spend, the improvements to infrastructure will take years.

There are also deeply entrenched interests in Brazil that do not necessarily want to see any changes at all, i.e. some trade unions oppose any modernization of its archaic labor laws.

Another Achilles heel is educational reform, which would require a whole generation before any improvement is clear.

Personally, I think the Brazilians will be able to party on, but the 24 hour Olinda street Carnival is definitely over. For the foreseeable future festivities here are likely to assume the frivolity of a low alcohol beach Luau.

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