INSIDER VIEW

Brazil

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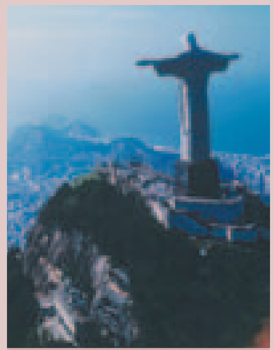

Strengthening the partnership

CLOSE TIES WITH ITS HUGE NATURAL RESOURCES AND EXPORT-ORIENTED INDUSTRIAL SECTOR, BRAZIL IS LATIN AMERICA'S BIGGEST ECONOMY AND AN IMPORTANT FRIEND OF THE UNITED STATES. ON JANUARY 1 A NEW ADMINISTRATION TAKES OVER AND WASHINGTON HOPES TO BUILD AN EVEN CLOSER RELATIONSHIP

WHEN Luiz Inácio Lula da Silva is sworn in on New Year's Day, Latin America's largest nation will get a President who has pledged to combine sound economic management and close ties with the United States with policies aimed at overcoming inequalities within Brazilian society.

The change of government in Brazil is seen in Washington as an opportunity to forge new relationships that could strengthen ties between the two nations.

"We fully expect our common goals to remain unchanged, and we expect the partnership to become even stronger," says U.S. Assistant Trade Representative for the Western Hemisphere, Peter Allgeier.

Of the President-Elect, universally known to Brazilians as "Lula", Mr. Allgeier says, "We understand that he is working to forge a consensus among the stakeholders in Brazilian society, to find a path to the future that will allow Brazil to grow in a manner suiting its undisputed potential, and that provides opportunities for broader participation in the world economy."

OVERVIEW Brazil is a robust democracy with an outward-looking, predominantly liberalized economy—a natural partner for the United States

Compared with its neighbor, Argentina, Brazil has been posting some encouraging economic data. Rampant inflation is a thing of the past, and the stepped devaluation of the national currency, the real, has given a welcome boost to the country's exporters.

Brazil boasts a healthy trade surplus—predicted by the Central Bank to top $12 billion this year, which will be the country's best performance in a decade—but it is also a useful market for American goods. According to the U.S. Commercial Service, sectors such as energy generation, construction, safety and security equipment and metal-working machinery offer some of the best export opportunities.

However, the challenges facing the new administration are enormous. Brazil is reckoned to have the widest gap between rich and poor of any country in the world. The luxurious condominiums alongside Rio de Janeiro's Copacabana beach are only a stone's throw away from some of Latin America's worst shantytowns.

On the other hand, Brazil is also a country with colossal material resources, a well-developed export-oriented industrial sector, a fabulous historical and cultural heritage, and a vibrant and predominantly young population. The economy is outward-looking and largely liberalized, thanks mainly to the outgoing President, Fernando Henrique Cardoso.

"Cardoso was elected President in 1994, on the back of a

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FACTS & FIGURES

POPULATION
170 million

AREA
3,290,000 sq miles

CURRENCY
Real (BRL)

EXCHANGE
1 Brazilian real per US$0.28 (Dec 2002)

CAPITAL
Brasilia

GDP
$1.34 trillion (2001) purchasing power parity

GDP GROWTH
1.9% (2001)

NATURAL RESOURCES
bauxite, gold, iron ore, manganese, nickel, phosphates, platinum, tin, uranium, petroleum, hydropower, timber

EXPORTS
manufactures, iron ore, soybeans, footwear, coffee, autos

U.S. firms led FDI boom in telecoms, cars, energy and steel

BRAZIL has attracted record levels of foreign investment over the past decade—with the biggest proportion coming from the United States.

This very high level of U.S. corporate interest in the country is a reflection of Brazil's success in opening its market to foreign competition and investment and in strengthening macroeconomic conditions for stability and growth.

Hyperinflation has been tamed and a massive privatization program—one of the largest in the world—is underway. Infrastructure has been developed and productivity and competition enhanced in services, utilities and industrial sectors.

A third of the total investments in privatization in Brazil has been made by foreign companies, with the United States leading the way (34.7 percent), attracted by opportunities in the telecommunications, automotive, energy and steel sectors. Other countries that have made major investments include Spain (27.7 percent), Portugal (14.9 percent) and Italy (4 percent).

By the end of the 1990s, according to the U.S. Department of Commerce, the total stock of U.S. foreign direct investment in Brazil had reached more than $35 billion dollars, surpassing the respective figure for Mexico ($34.3 billion) and reaching 4.5 times the level of U.S. direct investment in China ($7.8 billion).

Major U.S. investors include Ford Motor Company, General Motors, Alcoa, Cargill, ExxonMobil, AES, Duke Energy and IBM. Just this year, Ford started exporting Fiestas to Mexico from a new $1.9 billion factory it has built in Bahia in the northeast of Brazil, while Alcoa has announced plans to invest $1 billion by 2008 to become self-sufficient in electricity production at its smelting plants.

The exposure of U.S. banks, such as Citigroup, JP Morgan Chase, Fleet-Boston Financial and Bank of America, in Brazil is estimated at $25 billion.

With more than 2,000 U.S. corporations conducting business there, it is very much in the interest of the United States that the Brazilian economy remains healthy.

Brazil has inevitably been affected by the economic crisis in Argentina, and falling growth worldwide and in the United States in particular. However, the stabilizing effect of the reforms undertaken since the launch of the Real Plan in 1994 have helped lessen the impact.

In August, the Bush administration backed a $30 billion rescue package for Brazil from the International Monetary Fund. It praised Brazil's wise economic policies and said the country deserved international support.

Best practices are a key to investor interest

RAISING STANDARDS BRAZILIAN COMPANIES HAVE BECOME MORE AWARE OF THE NEED FOR GOOD INVESTOR RELATIONS, HIGH STANDARDS OF CORPORATE GOVERNANCE AND TRANSPARENCY. AGENCIES SUCH AS THE BRAZILIAN INSTITUTE FOR INVESTOR RELATIONS ARE SETTING STANDARDS FOR OTHER COUNTRIES TO FOLLOW

BECAUSE of the crisis in Argentina, some North American investors have been wary about committing themselves south of the Rio Grande. But the picture in Brazil is quite different. Indeed, legislative changes and other reforms have improved the general climate for investment there, despite the downturn affecting most of the Western hemisphere.

"One very important thing we have is the fiscal responsibility law," says Roberto Castello Branco, President of the Brazilian Institute for Investor Relations (IBRI). "This makes politicians accountable for the management of public finance. Moreover, we have a regime of inflation targets that has been working since 1999, keeping inflation under control."

Over the past ten years, Brazil has been deregulating its economy. "Of course, there is still much to do in the future," says Mr. Castello Branco. "Some necessary reforms have not been implemented yet. The incoming government has a full agenda to boost economic activity in the long term. However, Brazil has improved a lot in comparison with the early 1990s."

Most important of all, he believes, is the preservation of Brazil's macroeconomic stability. "Without that, there can't be a healthy capital market," he argues. "I have never heard of a country that had a high degree of volatility in terms of economic policy, yet had a strong capital market."

Maintaining macro-economic stability should lead to a much more favorable environment for investors who have an interest in the stock market. "Brazil has a mutual fund industry that invests only eight percent of its assets in equities," he points out. "That is very low. In that sense, there is a very high potential for investment growth."

The IBRI is dedicated to encouraging Brazilian companies to recognize the importance of good investor relations and demonstrating how to achieve them.

"We are teaching people about best practices and have been bringing in experts in the field, mainly Americans, who are much more advanced in this kind of thing, to tell us about their experience and knowledge," says Mr. Castello Branco. "IBRI's main role is to educate people and try to implement best practices, in order to improve the competitiveness of Brazilian companies in capital markets."

PRODUCTION LINE Billions of dollars have been invested in Brazil by U.S. car manufacturers like Ford, which has opened a new factory in Bahia

Regulatory changes have been introduced by the Comissão de Valores Mobiliarios (CVM), Brazil's equivalent of the Securities Exchange Commission, to raise standards of corporate governance in minority shareholder protection, accounting standards, the role of auditors and board directors' responsibilities.

"Over the last couple of years moves have been made to reform the capital markets," says Mr. Castello Branco. "Both the government and the private sector have taken initiatives aimed at protecting minority holders' rights and company transparency."

He cites the public offers relating to the Companhia Vale do Rio Doce (CVRD), the world's third largest diversified mining company, as a success in attracting investor interest. "That company acquired almost 800,000 new shareholders," he says. "There is a big opportunity to invest in good companies in Brazil. A company must have a very dynamic capital market, so there is a transition process."

The nature of company ownership in Brazil is evolving significantly. In the past, the Brazilian corporate sector was basically controlled by a few families and government enterprises. After privatization and in-flows of foreign direct investment, the corporate scene was dominated by shared-control companies. Now it is moving towards a much more American or British model, with a less concentrated structure of ownership.

A number of larger Brazilian corporations have chosen to be listed on the New York Stock Exchange, as well as on the São Paulo bourse. Companies that are listed in New York are subject to stricter rules regarding transparency, which IBRI thinks is a good thing for the Brazilian market as a whole. "If a company stays listed only in the local market, the growth in its liquidity is very limited," says Mr. Castello Branco.

ROBERTO CASTELLO BRANCO
President of the Brazilian Institute for Investor Relations

He also believes that the fact that Brazilian stocks are traded at a discount on the international market offers special opportunities for U.S. investors.

"There is no economic reason for world-class Brazilian companies, like CVRD or Embraer, to be traded at a lower value," he asserts. "So this is a source of opportunities for U.S. investors. These companies are good players and are very competitive, by any standards. They are as good as any other company in the world."

Mr. Castello Branco remains very optimistic about the future. "The Brazilian economy almost stagnated for the past 20 years, so now we are in a very good position to start a sustained process of economic growth," he says.

Greater access to U.S. markets would help redress trade balance

EXPORT AMBITIONS THE UNITED STATES ACCOUNTS FOR A QUARTER OF BRAZILIAN TRADE BUT SELLS MUCH MORE THAN IT BUYS. BRAZIL WANTS TRADE BARRIERS TO BE LOWERED TO ALLOW MORE OF ITS PRODUCTS TO REACH AMERICAN CONSUMERS. MEANWHILE, IT IS BUSY SEEKING OUT NEW MARKETS FURTHER AFIELD

TRADING PLACES The incoming administration believes Brazil would benefit from a strengthening of South America's common market, Mercosur

THE UNITED STATES is Brazil's biggest single trading partner, with bilateral flows running at nearly $30 billion a year. However, according to Senator-Elect Aloizio Mercadante, who is International Relations Secretary of the Brazilian Workers' Party and a close colleague of the incoming President, this figure could be much higher. "We can double the flow of exports in four years, and triple it in eight," he says.

Mr. Mercadante seized the opportunity, at a meeting with U.S. Under-Secretary of State Otto Reich in Brasilia last month, to press for the restoration of trade credit lines for Brazil, arguing that these are essential if the Brazilian economy is to recover. "The U.S. government has a considerable influence on multilateral organizations and private banks," he told Mr. Reich.

Brazil's outgoing Minister of Development, Industry, and Trade, Sérgio Amaral, says the U.S. market is extremely important to Brazil. "The United States is our main partner as a country and an extremely important market because we export products of higher aggregate value there than we export to Europe."

From 1991 to 1999, U.S. exports to Brazil increased 114 percent while Brazilian exports to the United States increased only 68 percent. The Brazilians would like to see the United States removing import barriers to allow freer market access for their products, from footwear, sugar, textiles and steel to soya beans, citrus fruits, and ethanol.

Brazilian companies have increased their productivity and become more competitive, says Mr. Amaral. "But in most of our important markets, we face very high protectionism. If we are to export orange juice to the United States, for example, we must pay a 63 percent tariff."

This makes it important for Brazil to seek out new places to sell its goods. Commercial missions have been organized recently to Russia, China and India. "Our first priority is to open markets," Mr. Amaral says. "This includes exploring markets where we don't have a presence at the moment."

The incoming administration in Brasilia is confident that bilateral trade with the United States can be boosted significantly, but it is also keen to see North and South America inter-relating much more on a regional basis.

Senator-Elect Mercadante, who is one of the incoming President's top advisors, believes that just as the United States, Canada and Mexico are benefiting from working more closely together within NAFTA (the North American Free Trade Agreement), so Brazil and its neighbors would gain from strengthening South America's common market, Mercosur.

> Production is up and Brazil is becoming increasingly competitive

Mr. Mercadante argues that macroeconomic coordination mechanisms within Mercosur need to be enhanced. "Perhaps if Brazil's exchange devaluation had been coordinated with the devaluation of the peso, Argentina's situation would be different," he says.

Mr. Mercadante would like to see U.S. negotiations with the South American economic bloc Mercosur taking place in parallel with talks about the Free Trade Area of the Americas (FTAA).

He points out that Washington has been negotiating bilateral agreements with other countries or groupings in the region, including Central America, Chile and the Andean Pact. "We are interested in seeking negotiations with the United States, which is the biggest importer in the world, independently from the FTAA," he says.

According to Mr. Amaral, Brazil regards a free trade agreement as a positive development. However, he adds, "It is very important that the United States puts the real issues on the negotiation table. It is not useful for us to negotiate a trade agreement if all the specific import barriers are not removed."

It is largely because of Brasilia's firm commitment to trade liberalization that the United States has agreed to have Brazil as co-chairman of the FTAA talks. The hope is that this will ensure the final stages of negotiations reach a successful conclusion two years from now.

SERGIO AMARAL
Outgoing Minister of Development, Industry and Trade

At the same time, Washington hopes to enlist Brazil as an ally in its trade disputes with the European Union (EU), mainly within the framework of the World Trade Organization.

In particular, Deputy Treasury Secretary Kenneth Dam would like to see the two countries working together to counter EU farm subsidies. Washington has proposed that all subsidies for agricultural exports should be eliminated. "We want the EU to agree to that," Mr. Dam says.

Continued from page 1

successful anti-inflationary program he introduced as Finance Minister," explains Brazilian affairs analyst Sue Branford. "Since then, he has pushed ahead with market reforms. He has privatized state companies and dismantled trade barriers, opening up the economy to the world market."

Lula has pledged to maintain the main thrust of his predecessor's economic policies, while giving added value by tackling poverty and hunger. At the same time, his social concerns have won U.S. endorsement. "Lula's objective of eliminating hunger is one every American can support," Under-Secretary of State Otto Reich has declared.

"Nutrition is an essential element of economic development because it affects education and health, which are two essential elements of development."

Around 53 million Brazilians out of a total of 170 million are classified as living under the poverty line and their advancement is essential for the future stability of the country. Moreover, the United States does not intend simply to wait and see if that actually happens.

"The economic, political and social health of Brazil is important to the U.S.," says Mr. Reich. "Brazil is a key to the economic recovery of South America and it is a world economic power. So to the extent that Brazil is weak, it hurts us."

Enlightened self-interest is at play in the way that the Bush administration is actively championing Brazil's cause on the international stage. "We are going to do everything we can to help bilaterally and through our influence in the international financial institutions," Mr. Reich says.

As co-chairs of the Free Trade Area of the Americas negotiations, both countries are playing a vital role in the process to integrate the economies of the Western Hemisphere into a single free trade arrangement.

Peter Allgeier sees this as "a great opportunity to strengthen our relationship in ways that we haven't had in the past."

Of course the relationship with the United States extends beyond trade. "The United States has always viewed Brazil as a friend, and as a leader in the hemisphere," says Mr. Allgeier. He is confident that ties with Brazil will not just continue but intensify under the new government.

"We face many common challenges, from combating terrorism and money-laundering to fighting poverty and stimulating economic growth," he says.

"Brazil is the fifth most populous country, a robust democracy, and is the eleventh largest economy in the world. It is therefore a natural partner for the United States."

Energy giant is the nation’s biggest exporter

GROWTH SPURT BRAZIL’S LARGEST CORPORATION, THE COUNTRY’S EXPORT LEADER, HAS ITS SIGHTS SET ON EXPANSION AND HAS RECENTLY BEGUN PRODUCTION AT A MAJOR NEW OILFIELD

IN FRONT Petrobras is a leader in retail distribution of oil products in Brazil, with 34 percent of market share based on volume of sales

OIL AND GAS corporation Petrobras has become Brazil’s largest exporter, overtaking aircraft manufacturer Embraer. In the first nine months of this year, the company’s exports totalled nearly $2.5 billion.

This year the company’s production, both in Brazil and abroad, has averaged more than 1.5 million barrels per day (bpd), an increase of 14 percent on the previous year and a much higher rate than the worldwide average. If natural gas is added, the daily average of hydrocarbons produced by Petrobras rises to the equivalent of more than 1.83 million bpd. The company reported net profits for the third quarter of $660 million, a 48 percent increase on the same period last year.

The largest corporation in Brazil, Petrobras has oil and gas interests in 11 other countries, including Argentina, Bolivia, Colombia and the United States. In Angola its oil production has averaged 13,272 bpd.

The company plans to increase its international operations, partly through the acquisition of assets or companies. It has signed agreements with major international oil companies, including Texaco, ExxonMobil, Phillips and Shell, and is a partner in several consortiums which have won bids for exploration blocks auctioned off by the government.

In October, production began in the Jubarte field, in the Campos Basin about 45 miles offshore of the state of Espírito Santo. Drilling in 4,000 feet of water, output at Jubarte has been averaging 16,500 bpd. The well is also producing more than a million square feet of gas a day.

Discovered in January 2001, the Jubarte field was the greatest new find by Petrobras since the Roncador field in 1996. Reserves are estimated at 600 million barrels of oil.

The well has the potential to produce 25,000 bpd, and an increase in production is being made gradually. There are plans to drill five wells in the Jubarte field, three of which are already built. The total investment of Petrobras in Jubarte so far is estimated to be in the region of $100 million.

Petrobras is also planning to construct several new oil and gas pipelines. Among them is a $900 million network of natural gas distribution pipelines in the south-eastern states of Minas Gerais, Rio de Janeiro, the industrial center of Cubatão in São Paulo state, as well as some areas of north-eastern Brazil.

A second project is to build an oil pipeline connecting Brazil’s main oil production center, the Campos Basin, to São Paulo, the industrial heartland of Brazil. The cost of building the pipeline, part of which will be laid on the ocean floor, is estimated at $1 billion.

Petrobras also plans to construct a smaller pipeline for liquefied natural gas (LNG) in the middle of the Amazon rainforest. Company officials say the pipeline should be ready by 2006 and it is expected to cost $340 million.

The company expects to more than double natural gas sales by 2005

Meanwhile, a gas pipeline from Bolivia to Brazil will nearly double the latter’s capacity to 1,059 million cubic feet a day. Petrobras will be responsible for selling the gas.

The company expects to more than double its natural gas sales by 2005. Brazil could certainly use the gas; the country has been hard hit by a drought that has sharply reduced the supply of hydro-power. A large portion of the projected incremental supplies of gas is expected to come from the San Alberto and San Antonio fields in Bolivia, in which Petrobras has a 35 percent stake.

Petrobras owns one of the most important South American refining complexes, with total refining capacity representing approximately 27 percent of the current total crude oil refining capacity in South America and the Caribbean.

Brazil needs more refining capacity, and, according to government energy advisor Luiz Pinguelli Rosa, the incoming Lula administration favors building a new refinery in Brazil, rather than buying one abroad.

“Why invest in refineries abroad which, like those now in Brazil, can’t process the heavy crude oil without having to mix it with lighter oil?” he asks.

Mr. Rosa says the new government will provide fiscal incentives to strengthen the competitiveness of the local exploration and production (E&P) equipment sector. The sector is currently not very competitive because the administration of President Fernando Henrique Cardoso gave foreign oil platform builders and foreign E & P equipment manufacturers tax exemptions for importing rigs and equipment into Brazil, while local E & P equipment makers do not enjoy such tax breaks.

“These sectors would be more competitive if they were also exempted from paying taxes,” says Mr. Rosa. “So the new government plans to give the local oil platform and equipment makers the same fiscal advantages now enjoyed by foreign firms.”

NYSE listing confirms world class status

INTERNATIONAL interest in Petrobras has increased enormously since its listing on the New York Stock Exchange two years ago. The listing confirmed the company’s world-class status and exposed it to a much wider range of investors.

Some180 million shares were sold to local investors and on the NYSE in 2000. The government’s stake in the oil company is now 55.7 percent.

Since then, there has been a sweeping reorganization to improve the company’s competitiveness and Petrobras’ new status has also provided it with greater flexibility in financing.

Luciana Bastos de Freitas Rachid, Executive Manager of Investor Relations at Petrobras, says there has been a tremendous increase in the demand for information about the company and its activities.

“Not only Brazilian, but American shareholders have been interested in following the performance of the company,” she says. “We have a group of people dedicated to providing information to individual shareholders, and another group dedicated to institutional investors.”

Petrobras offers tremendous potential, not only in upstream activities but also in its operations abroad, making it an attractive prospect for investors.

“We have all the fundamentals,” says Ms. Rachid, “production growth, a clear financial position and, despite the high cost of capital, as a Brazilian company we compete fairly well with any other major oil company in the world.”

Along with other Brazilian blue chip companies like CVRD and Embraer, Petrobras is committed to an investor relations program to keep it highly visible within the international markets. Good governance practices and transparency are at the core of the company’s philosophy, in line with recent legislation and codes of practice.

LUCIANA BASTOS DE FREITAS RACHID
Executive Manager of Investor Relations at Petrobras

“The scrutiny that we come under is even greater than before,” says Ms. Rachid. “We are working at a very high level of transparency.

“The fact that we are operating in an emerging market implies that our disclosure must be better than the disclosure of most American companies. We are very happy to have this kind of disclosure, as investors now realize that risk is everywhere, even in the United States."

Petrobras has no fears that a change in government will adversely affect the company, which is, as Ms. Rachid points out, the biggest taxpayer in Brazil.

“Four of our nine board members represent minority shareholders. They cannot be changed without a publicly announced General Shareholders’ Meeting, which would discourage excessive political interference, if it were ever sought.

“We do not believe that it is in the interest of any Brazilian government to reduce Petrobras’ strength,” she adds.

Brazilians are seeking to secure their future

RAPID RISE THE MAJOR LATIN AMERICAN INSURANCE MARKET IS GROWING FAST AS NEW PRODUCTS ARE INTRODUCED. SAO PAULO-BASED BRASILPREV HAS BECOME THE COUNTRY'S SECOND LARGEST INSURANCE INSTITUTION IN JUST SEVEN YEARS

THE INSURANCE sector in Brazil has grown phenomenally in recent years and the market is now worth nearly $5.2 billion in premiums annually. Overall growth this year alone is estimated to be close to 22.5 percent.

The fastest growing segment in 2002 has been life insurance. This year it was equal to 27.9 percent of the premiums in the industry, compared to 17.6 percent last year. This is thanks largely to the launch of the new VGBL (Vida Gerador de Beneficios Livres) pension plans, which are usually sold with an accompanying life insurance policy.

Brazilians are increasingly aware that—as in many other countries—their public social security system is no longer able to assure everyone of a retirement pension commensurate with their standard of living as taxpayers.

Nearly a decade ago, Banco do Brasil recognized the problem and, together with several large institutions, created Brasilprev Seguros e Previdência S.A.. Just seven years later, the São Paulo-based company has become the country's second-largest insurance institution providing pensions—after the much longer-established Bradesco—and manages funds of more than $1 billion. Revenues at Brasilprev, which has more than 860,000 clients, grew a staggering 67 percent to $345 million last year.

Earlier this year, a Brazilian magazine reported that the three top priorities for the country's growing middle class are health, education and a private pension. As Brasilprev's President, Fuad Noman points out, "In just five years a product which almost nobody had heard about has become one of their three most important desires."

> The fastest growing sector of the market has been life insurance

Nevertheless, there is still a long way to go in developing a culture where people plan for their retirement. "Teaching people how to manage their retirement is a big effort, which is being made by the market, the government and us," says Mr. Noman.

From next year, life insurance will be tax redeemable, which will encourage even more people to make financial provisions for their future. Mr. Noman expects to see the life insurance market increase even more rapidly as new legislation comes into effect.

Brasilprev offers two essentially similar types of insurance, full income (PGBL) and guaranteed income, for pension provision. PGBL offers an income based on premiums paid into a fund, but carries a risk as funds can go down as well as up in value. Guaranteed income is for those who are not willing to take the risk and prefer a minimum guaranteed pension.

One of the most important factors that has contributed to the rapid growth of Brasilprev is the fact that the retirement pension schemes are marketed through a readymade distribution system—Banco do Brasil's nationwide branch office network.

Brazil was a pioneer in Latin America in this type of private pension marketing, and now other countries are adopting similar schemes. However, Mr. Noman says, "Private pensions are still not a product which is demanded, they are a product that has to be offered."

To further encourage the habit of pension provision and saving for the future, Brasilprev introduced Clube Junior for children and teenagers, who will benefit from Brasilprev's Junior Pension Plan. This is a form of saving, usually with a parent paying the premium, which will provide a sum to help to pay for further education, for example. "It makes young people aware of the importance of the private security concept," says Mr. Noman.

A second major factor in the

FUAD NOMAN
President of BrasilPrev

expansion of Brasilprev is the fact that one of its major shareholders is the Principal Financial Group, one of the leading private pension, insurance and financial services companies in the United States, founded in 1879. Principal brought new technology to Brasilprev.

"This technology was transferred very fast, and today it is a very positive partnership for both of us. It was very good for Brasilprev to enter the market with U.S. high technology and to be seen in the U.S. market as a partner of the company," says Mr. Noman. "It was also good for Principal, in that they entered the market in second position and with the strong brand presence of Banco do Brasil."

Horácio Cata Preta, Executive Director of Federação Nacional das Empresas de Seguros Privados e de Capitalização (Fenaseg), the national insurance companies federation, says providing for retirement is still a relatively new concept in Brazil.

"Before 1995, Brazilians didn't buy insurance because they didn't have the money," he says. "Saving was a risk for them as their money lost value overnight. The best thing to do at the time was to spend money as quickly as possible, or invest it in a new car or house. Since inflation was finally brought under control in 1996, Brazilians have discovered they do have a savings capability."

Banking system in good shape

THE EFFECTS of the 1999 devaluation linger but, unlike the Asian tiger economies in 1997 and, more recently, the woeful situation of neighboring Argentina, Brazil has avoided a crisis in its banking system.

In fact, it's in good shape. Last year the banking sector achieved a robust growth in profits of above 22 percent, based on the returns from 10 leading banks. As this year draws to a close, banks are in a position to capitalize not only on sectoral stability but also on renewed business confidence.

Arminio Fraga, President of the Central Bank, says the level of capital in Brazilian banks is above the world average, as well as higher than the Central Bank's own requirements. The large volume of reserves in the banking sector could "irrigate the economy" and provide for healthy growth, he adds.

Brazil is also the world's second-largest e-banking market after Norway, according to Marcelo Tonhazolo, Internet Director of local bank Unibanco. Despite Brazil's low internet penetration of around 10 percent, about 24 percent of Internet users have made at least one online banking transaction, he says.

Holding nearly one-third of the market, foreign banks too have proven agile in both the retail and wholesale segments.

JORGE EDUARDO PRADA LEVY
President of the Brazilian Banking Association

They rapidly increased their presence through acquisitions during the 1990s, and now have more than 27 percent of the market. ABN Amro, for example, plans to open another 40 branches.

"We have a very solid and stable financial system," says Jorge Eduardo Prada Levy, President of the Brazilian Banking Association (ABBC). "Credibility is very important for the industry, and this positively influences the way in which Brazil is evolving in international business and international relations."

The introduction of the modern Brazilian Payment System (SPB) has also proven to be successful, not only in speeding up clearance between banks but also in the sector's international standing, says Mr. Levy.

The SPB is essentially a high-speed, computerized clearance system between the banks, enabling them to make online payments to each other. This real-time system has greatly improved banks' efficiency, and enables them to avoid the lengthy clearing system at the end of each working day.

"The ongoing consolidation in the industry is also going to help," Mr. Levy adds. State-owned banks that were not in good shape have been undergoing restructuring in preparation for privatization.

"We have one of the most efficient financial systems in the world for services," he continues. ""Brazilians trust most of their economic lives to our banks. They leave most of their economic operations in their hands, including payments, billing, mutual funds and insurance.

"The rendering of services is the business that all the banks are looking at and for that, scale is very important. Local banks are more prepared because they have an extended network of branches."

Most of ABBC's members are small to medium-sized banks, says Mr. Levy. "Basically, they are looking for shared services in order to reduce their costs," he says. "ABBC is providing, through an agreement with the service providers, the infrastructure, services and software in order to allow cost reductions for small banks."

There's an awful lot of mobiles in Brazil—and more on the way

ON THE MOVE ONE IN THREE BRAZILIANS IS LIKELY TO HAVE A CELLULAR PHONE BY 2007. ONE IN SIX ALREADY HAS ONE AND TEXT MESSAGING HAS TAKEN OFF. TELE NORDESTE CELULAR AIMS TO BE A BENCHMARK OF EXCELLENCE IN THE FIVE STATES IT SERVES

IN TOUCH Mobile phone services are available to Brazilians whenever and wherever they want them

THE HUGE landmass of Brazil and the expense of rolling out fixed lines inevitably mean that mobile phones will dominate future telecommunications.

The Brazilian cellular market has expanded rapidly since deregulation and the entry of major European players, with the development of mobile data technology and digital technology also contributing to the sector's growth.

By 2007, it is estimated that one in three Brazilians will have a mobile phone, out of a population of more than 170 million. Currently, approximately one in six uses one and for many it is their principal phone.

António Carlos Valente da Silva, Vice President of Anatel, the National Telecommunications Agency of Brazil, says, "Right now we are seeing a veritable revolution in the provision of telecommunications services in Brazil.

"Until not long ago, it was unthinkable for the great majority of the population to have access to fixed or mobile telephone services at affordable prices. Every day, advertisements throughout Brazil offer those services at prices that even many low income citizens can afford.

"Citizens of Brazil today can obtain mobile cellular services whenever they want, wherever they want, in virtually any part of the nation's territory."

Tele Nordeste Celular, however, sees low income as one of the limiting factors on the market. The rate of growth in mobile telephony in Brazil's northeastern region, where the company operates—comprising the states of Piaui, Rio Grande do Norte, Paraiba, Pernambuco and Alagoas—was about 485 percent between 1997 and 2001. Mobile penetration is now above 10 percent of the regional population.

Walmir Urbano Kesseli, Tele Nordeste Celular's Chief Financial Officer, says, "We operate in a very specific region of Brazil, with 27 million people, but with an unusually high income distribution."

The company calculates that, in the nation as a whole, less than half the population can afford a cellular phone. Growth has been around two percent a quarter, but the company says it is working in an almost saturated market at present.

"In order to increase our market penetration we have to deal with the issue of income distribution," says Mr. Kesseli.

"On the other hand," he adds, "we have a large group of corporate clients, for whom our treatment is completely different. Small companies can see in the services that we provide a good platform in which to invest and develop their businesses and they are accepting the new services we offer. The revenues from the corporate market represent the larger part of our total revenues."

Most of the population in the region lives along the coast, in cities like Recife. "However, there are several areas of economic activity where our coverage is much higher than any of our competitors," he adds.

Although the states served by Tele Nordeste Celular have the lowest gross domestic product (GDP) per capita in the country, the region has experienced growth above the national average, spurred by a rise in tourism. Many companies from the southern states, particularly from São Paulo, have moved to the region, persuaded that the environment, the labor force and the prospects of growth are better.

The sole controlling shareholder of Tele Nordeste Celular is Telecom Italia Mobile (TIM), one of a number of European telecommunications companies to have entered the Brazilian market in recent years.

Tele Nordeste Celular's aim to be a leader and a benchmark of excellence in the telecommunications market has ensured that the company continues to provide new services and to satisfy customers both corporate and individual.

> European companies have entered the Brazilian market in recent years

Last year, its digitalized network reached more than three-quarters of voice channels, and the vast bulk of customers now use digital handsets. Through roaming agreements, customers can call not only the rest of Brazil but also Uruguay, Argentina and Paraguay.

Although new technology enables mobile users to access the internet through their handsets, Mr. Kesseli says, "I think that the first need of our people is to communicate. More advanced uses of cellular telephony will come as a natural development.

"Nevertheless," he adds, "we are experiencing a huge increase in the use of text messages. In the past six months we have had more than a 500 percent growth in text messaging, and we are exploring these possibilities."

The Rede Inteligente (Smart Network) service, for example, provides its customers with leading edge technology, exclusively geared to the corporate market. This allows companies to create private cellular networks (starting with three post-paid active lines) with a significant reduction in cost, plus several other features such as call blocking and quick dialling.

Reduced rates are also available to pre-paid customers, while Timmy Wave is a prepaid service which provides a range of innovations including a mailbox that sends voice messages to groups of up to eight people.

"When cellular companies started in Brazil, Tele Nordeste Celular was in a completely different situation," adds Mr. Kesseli. "After three years, we have built new systems and have a new kind of employee. We have a new approach to the market and a new customer service. We have learnt very quickly and our productivity is growing incredibly fast."

Fixed-line firms face services challenge

THE TELECOMMUNICATIONS market has plenty of room for growth and as competition increases, services will continue to expand to meet demand. While mobile telephony is the most cost-effective in the largest country in Latin America, the established fixed-line network remains a core provider for both city-based businesses and homes.

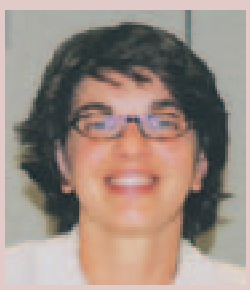
Brazil has the eighth-largest fixed-line network in the world, with more than 66 million subscribers—half of all Latin American fixed-line customers. With such a subscriber base and substantial capacity for expansion, the huge potential for providing new services is hard to miss.

As fixed-line penetration is still well below Western levels—at around 22 fixed lines for every 100 citizens—and with a population estimated to grow to 180 million by 2005, Brazil represents an attractive market for new entrants. There are currently three major local loop operators that were former monopolies and still control about 90 percent of the market, but since liberalization began a few years ago, new operators have slowly made inroads.

Carla Cico, Chief Executive Officer of Brasil Telecom, says privatization is good for the country because it brings in money, while competition has had the effect of driving down prices and sharpening up the business environment.

"The market expects us to be more than just an installer of telephones. It expects us to be a service company," she says. "There is going to be revolution among fixed-line operators, who will have to become service operators."

As telecommunications have become more flexible, as well as more specialized, meeting the needs of different clientele has opened up niche markets for some operators. For example, Ms. Cico points out the power telecommunications possesses as an educational



CARLA CICO
CEO of Brasil Telecom

tool. "Telecommunications and education means business, and that is good," she says.

And more consumer transactions are increasingly being made by telephone which is to the advantage of Brasil Telecom. "In reality," says Ms. Cico, "we are a monopoly in residential terms. But we have to fight to win corporate clients."

As a major player in the fixed-line market, Brasil Telecom has reasons enough to feel confident about its future. "The Brazilian telecoms market is undergoing the same process of consolidation that all other markets are facing," says Ms. Cico. "In the medium to long-term, Brasil Telecom is a very safe and stable investment."

The speed with which fixed-line networks can be rolled out is expected to accelerate over the next three years. By the end of 2005, the aim is to provide every community of 100 inhabitants with at least one public telephone, while in towns and cities with more than 300 inhabitants it is expected that installation of a fixed-line should take no longer than a week.

Ms. Cico says that everybody today is able to access the same information, so information alone is not going to give a company an edge. "People are the key," she says—her goal is to employ the best people in the telecommunications business and make Brasil Telecom a company "from which other companies are trying to poach its managers."

Trains are on track to give exports a boost

SIGNAL FOR GROWTH RISING AGRICULTURAL PRODUCTION IS DRIVING EXPANSION OF THE RAIL NETWORK TO GET THE GOODS TO MARKET. BRASIL FERROVIAS IS MEETING THE INCREASED DEMAND FOR COST-EFFECTIVE TRANSPORTATION

HIGH FLYER Brasil Ferrovias transported around 5.3 million tons of goods along its 2,800 miles of track in 2002, compared to 3.3 million tons last year

RAILROADS play a vital role in Brazil's economy, transporting goods to ports for export and linking several of the country's main cities.

Last year, Brazilian railroad concessionaire Brasil Ferrovias transported 3.3 million tons of goods. This year, it was around 5.3 million tons and Nelson de Sampaio Bastos, the company's President, estimates this will rise to 7.1 million tons next year.

Much of the growth is being driven by increased agricultural production, particularly in soybeans, which are exported all over the world. Most of the beans are used for animal feed and Mr. Bastos believes this market will continue to increase as the demand for "real food" for livestock increases.

NELSON DE SAMPAIO BASTOS
President of Brasil Ferrovias

Brasil Ferrovias, which has 2,800 miles of track, has helped to make Santos, in the state of São Paulo, Latin America's largest port, accounting for almost a third of Brazil's foreign trade. Traffic at Santos has been running at record levels—last August, 5.5 million tons of goods were loaded and unloaded there. Over the first nine months of 2002, soybean exports from the port rose 11 percent to 4.5 million tons.

Brazil is now the second-largest producer and exporter of soybeans after the United States. Four years ago only four percent of goods were transported by railroad. That amount has now risen to more than a fifth of all goods.

Mr. Bastos says the only cost-effective way of transporting millions of tons of produce is by rail. The railroad uses about a third of the fuel of trucks, per ton transported.

"We are carrying about 87 percent of the goods to the port of Santos," he says. "We are serving this huge territory of the central-west and we are the only connection to that area."

In January, Brasil Ferrovias starts work at Santos on the construction of what will become the country's largest terminal. The terminal—to be built at an estimated cost of $54 million—will enable Brasil Ferrovias to increase traffic to the port from Brazil's central-west region.

"Demand pressure is growing beyond our original plan because Brazil is becoming more and more competitive in agricultural grains," says Mr. Bastos.

When construction is completed, the terminal—dubbed TGG—will have the capacity to increase shipments of grains and soybeans from the interior to Santos from the current 2.5 million tons a year to 10 million tons. Partners in the terminal project include agricultural companies Bunge and Maggi.

A proposed rail line will link Cuiabá, the capital of Mato Grosso state, sometimes referred to as "the geographical center of South America", to Porto Velho, a port town on a major tributary of the Amazon river in the state of Rondônia. This would open up an even greater area of land, which could be used for grain and soybean cultivation.

Mato Grosso is now the largest producer of soybeans in Brazil. "But we are going to become the largest producer in the world, there is no doubt about that," says Mr. Bastos. "Already, for the first time, Mercosur is a bigger producer than the United States, which originally cultivated soybeans.

"The capacity for expansion is enormous. Only about 25 percent to 30 percent of the central-west region is being exploited. In that region of Brazil alone we could triple agricultural production."

> Work has begun on what will become Brazil's largest terminal at Santos Port

Brasil Ferrovias also serves companies like Rio Tinto Zinc, which has mining operations in Mato Grosso do Sul. Growth in mining as well as agriculture means the railroad company is also carrying more fuel for these sectors.

"The only really practical solution is alcohol fuel," says Mr. Bastos. "So we are now delivering diesel fuel into the interior, and transporting out alcohol."

Brazil is not only one of the biggest sugar producers in the world, it is also the most cost-effective producer. Brasil Ferrovias transports alcohol for fuel to a refinery close to São Paulo. This year, the company transported about 100,000 tons of alcohol fuel and Mr. Bastos says this could grow to three million tons within three years.

"In the next two to four years we intend to make an initial public offering (IPO), and we are seriously considering a share offer in New York," he adds. "But even before that, we are totally open to new investors."

Prospects for IT sector growth remain strong

BRAZIL is the most advanced country in information technology in Latin America and has the largest infrastructure of installed networks, overtaking both Argentina and Mexico.

In just one year, it has streaked ahead in the IT industry and now leads its Latin American neighbors, according to the World Bank. Both the Bank and a UN survey rank Brazil in eighth position worldwide.

The country has the ninth largest number of users connected to the internet in the world. Last year, internet use grew 26 percent. By 2005, analysts forecast that 77 million Brazilians will be connected.

Online spending is projected to grow to $4.26 billion by 2005.

WELL CONNECTED BRAZIL LEADS LATIN AMERICA IN GLOBAL COMPETITIVENESS IN THE IT INDUSTRY, AND DEMAND FOR APPLICATIONS AND SERVICES CONTINUES TO RISE. ONE OF THE LEADING COMPANIES, CIMCORP, ANTICIPATES A BRIGHT FUTURE FOR THE INDUSTRY

And with 40 percent of the e-commerce market share in Latin America, the demand for applications and services in Brazil is on the rise.

Prospects for the IT sector remain strong, says a recent report from the OECD (Organization for Economic Cooperation and Development), despite the global economic downturn. Software is one of the most rapidly expanding sectors, and there are more than 20,000 independent software vendors in Brazil.

Revenues from Brazilian e-commerce are estimated at $255 million this year

Brazilian e-commerce grew by 144 percent last year, most of it in broadband via cable-modem and multichannel multipoint distribution systems (MMDS). Revenues from e-commerce this year are estimated at $255 million and this sector continues to receive significant investments.

One of the most successful IT companies to emerge in Brazil is Cimcorp, based in São Paulo. "We started from zero 14 years ago and today we are among the top 100 high technology companies in the country," says Tadeu Vani Fucci, the firm's President.

The company has enjoyed an annual growth rate of between 50 and 55 percent for several years. Even with the global downturn last year after 9/11, it achieved growth of between 17 and 20 percent—a result Mr. Fucci describes as "respectable."

Established in 1988, Cimcorp offers a wide range of products and services to business. It has a particularly strong presence in São Paulo, Rio de Janeiro, Belo Horizonte, Brasilia and the south of Brazil. In the past two years the company has picked up a number of awards for quality and service.

With an injection of capital from ABN AMRO Bank and the Bank of Boston, Cimcorp has set about consolidating its image and structure. "Throughout the year, we have been reinforcing the objectives of our business and services in order to develop a strong and competent structure, and to carve ourselves a distinguished place in the market," says Mr. Fucci.

"We are intent on building strong partnerships with our customers in order to achieve the services they demand. This includes reduction in costs and greater efficiency.

"Cimcorp is therefore spending more time as an outsource company. We look at every level of an application and its evolution in the structure of the client company to obtain a precise solution.

TADEU VANI FUCCI
President of Cimcorp

"The aim is to consolidate delivery processes and increase the quality of service in order to take the customer to a more developed high technology solution and a higher level of efficiency."

The company has built up excellent working relationships with the big players in IT, including Cisco, EMC, Sun and Oracle. It has also extended its expertise in security, which is a rapidly growing area in IT in Brazil.

"We are able to provide excellent solutions regarding security and confidentiality," says Mr. Fucci. "These range from the protection of personal data files to restrictive systems between different users to avoid any leaks. We are also able to resolve disaster recovery systems and other contingencies."

Plans for the future include expansion into the north and northwest of the country. "There is a lot of room to grow, but it depends on the different business sectors we become involved with," adds Mr. Fucci.

"We aim to obtain more capital for development. Our progress will have to be backed up not only by foreign investors but also our own profits. The company has always grown by reinvesting its gains."

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