



# Brazil and MERCOSUR and its Relationship with China: Challenges and Opportunities

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# Summary

## ▶ **Challenges**

- ▶ Will China derail the world economy?
- ▶ Will Mercosur escape the “middle-income trap”?
- ▶ Domestic and external constraints

## ▶ **Opportunities**

- ▶ Trade
- ▶ Investment

# Will China derail the world economy?

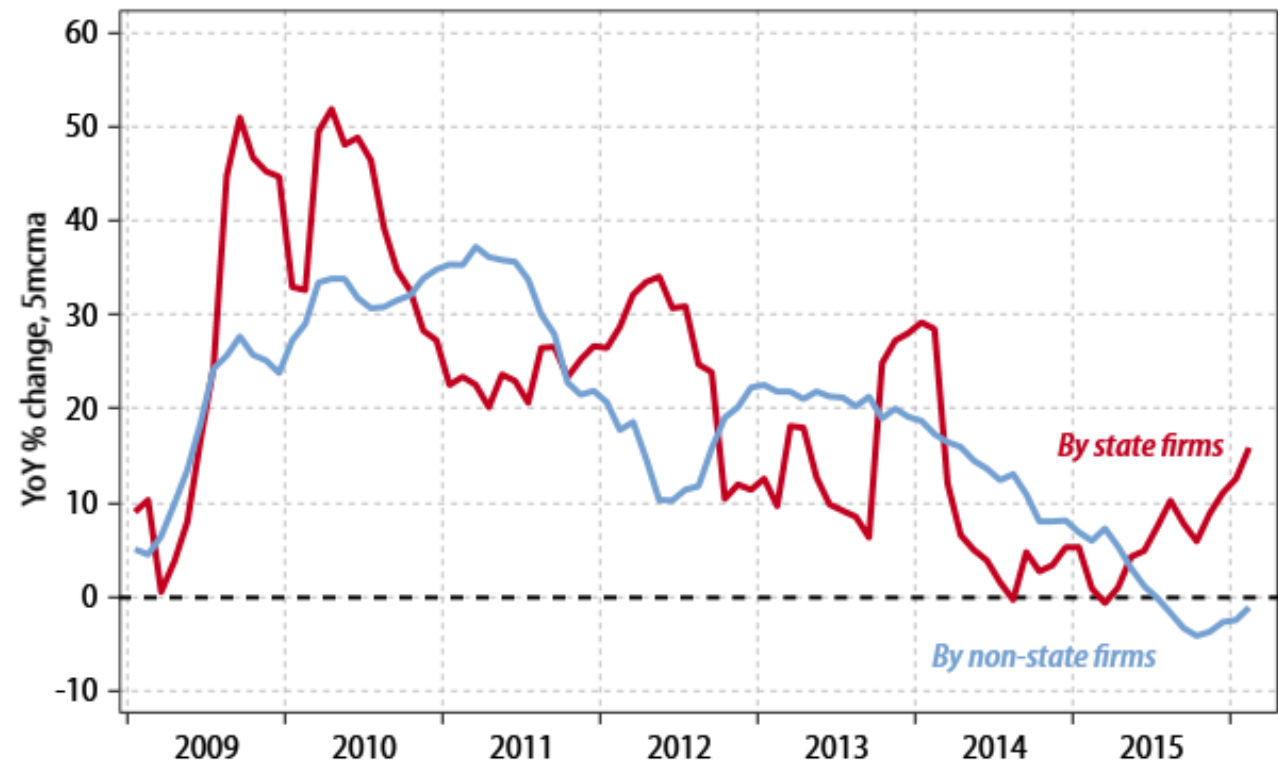
- ▶ Panic in the market in the December 2015-January 2016
- ▶ Fears that China was a black hole at the heart of the global financial system have morphed into mild optimism, as growth indicators have showed signs of stabilizing
- ▶ There remain plenty of longer-term problems, but investors seem to have accepted that muddling through, rather than imminent collapse, is the likely scenario for 2016

# Three short term positives underpin this general relaxation of China worries

- ▶ **Property oversupply is less widespread than feared**
  - ▶ rebound in property investment and construction starts
  - ▶ Official stimulus is behind some of the pick-up, but private sector activity has also stabilized
  - ▶ Some provinces still have huge stocks of empty housing, but others have seen inventories fall sharply in recent months, prompting local developers to start building again

## SOEs are driving the building upturn, but private activity has steadied

Fixed-asset investment in real estate, by ownership

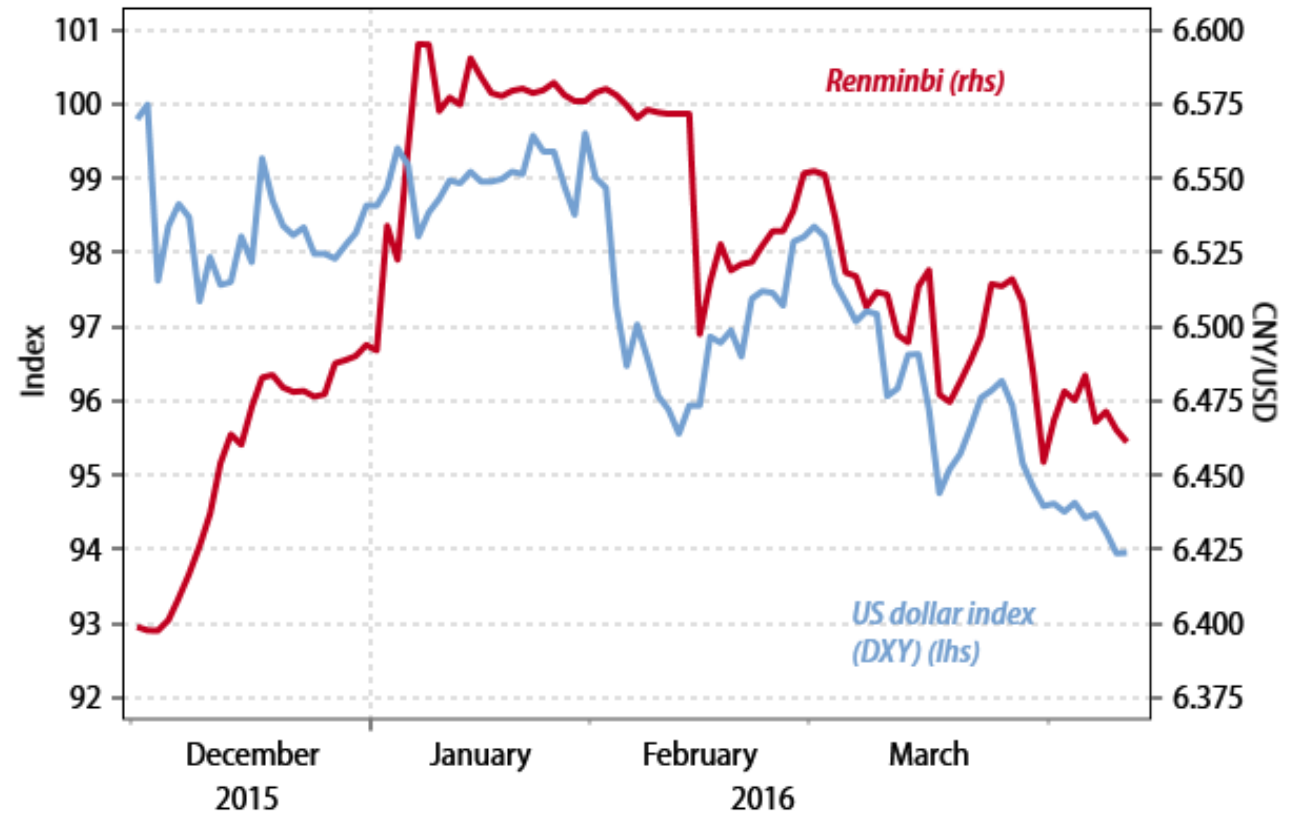


CEIC, Gavekal Data/Macrobond

# Three short term positives underpin this general relaxation of China worries

- ▶ **Market pressure on the currency has faded**
- ▶ The latest foreign reserves data confirmed that capital outflows are not about to force China into a massive devaluation
- ▶ Although capital outflows are continuing, the adjustment of corporations' foreign currency exposure has not escalated into a doomsday scenario in which households rush for the exit

**A weaker dollar has eased pressure on the renminbi**



Gavekal Data/Macrobond

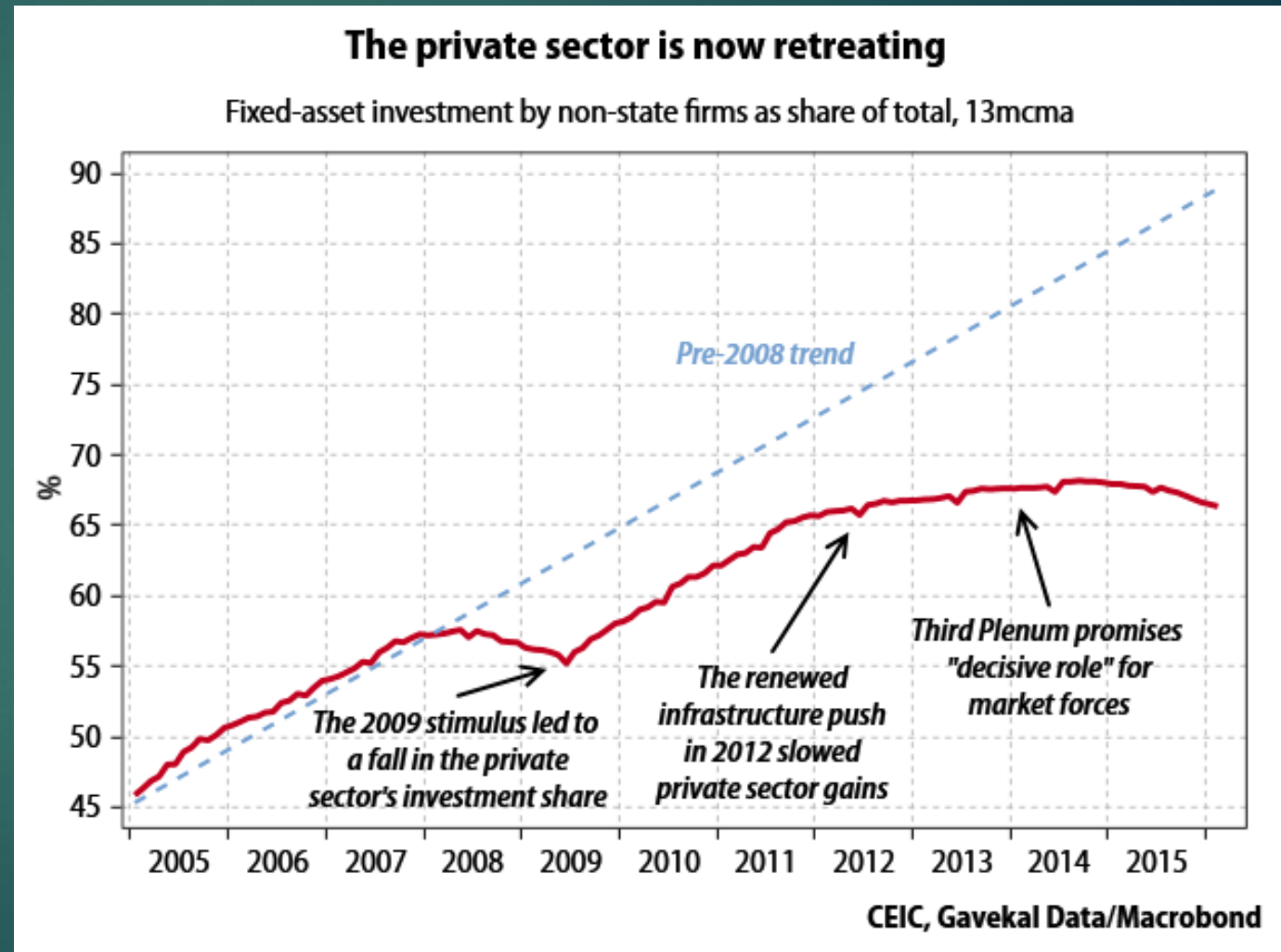
# Three short term positives underpin this general relaxation of China worries

- ▶ **Industrial deflation is easing**
- ▶ More stability in commodity prices will in turn feed into narrower declines in China's producer price index and GDP deflator, helping to support nominal growth
- ▶ In March, the PPI declined -4.3%, improving from the -5.9% drop in December malaise
- ▶ As further improvements come through, market worries about deflation will abate, since severe deflation has been a problem mainly of China's own commodity sectors rather than an economy-wide malaise
- ▶ The dire state of China's industrial sector is therefore likely to improve at the margin this year, thanks to the bounce in property and reduced deflationary pressure



# Two reasons for China “muddling-through”

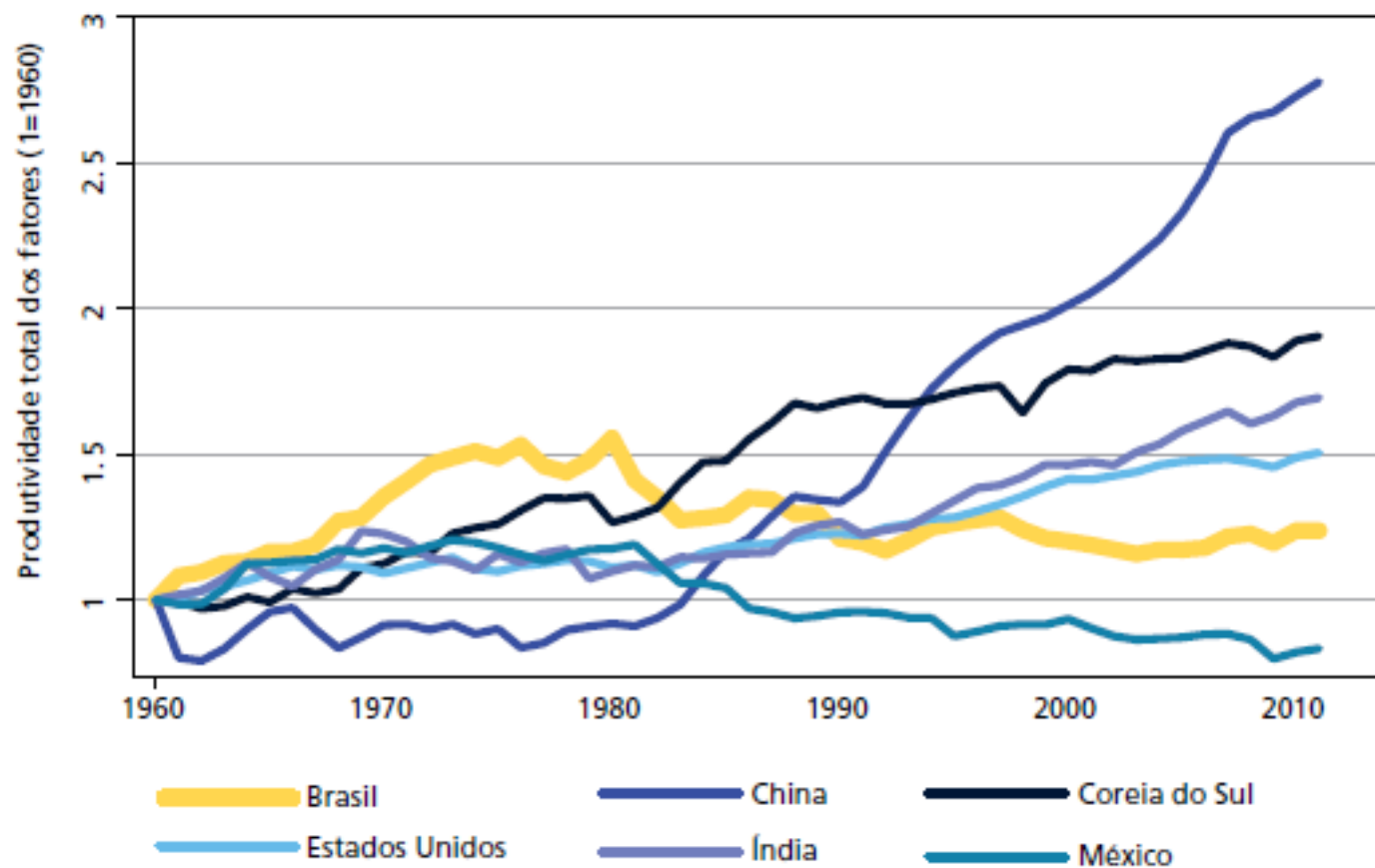
- ▶ **Leverage is rising**
- ▶ China's already-high debt levels are continuing to rise, as the government steps up its borrowing and endorses a further increase in household mortgage debt
- ▶ **The private sector's share of the economy is not increasing**
- ▶ Since 2012, the private sector's share of capital spending, has not risen significantly, and since late 2015 it has started to decline outright



# “Will Mercosur escape the middle-income trap”?

GRÁFICO 6

Evolução da Produtividade Total dos Fatores (com ajuste para capital humano) em países selecionados





# Will Mercosur escape the middle-income trap?

- ▶ Total factor productivity gains (TFP) have played a significant role in the Chinese economic growth over the past decades
  - ▶ Over the period 1970–2013, Chinese GDP grew 8.7% on average per year
  - ▶ In the same period, Chinese TFP contribution was 36% to this rate of growth
  - ▶ Estimates of the average TFP growth contribution during 1970–2013 vary from 3.1% to 3.8% per year
- ▶ China has repeated in the past 30 years the experience of other Asian countries that developed earlier
- ▶ This is the case of Japan, where the country achieved an annual TFP growth of 3.1% during 1960–1973—about the same contribution of TFP contribution to GDP growth as the Chinese's

# Opportunities: Trade

Gráfico 5: Corrente de comércio entre Brasil e China entre 2002 e 2013 (US\$ milhões)

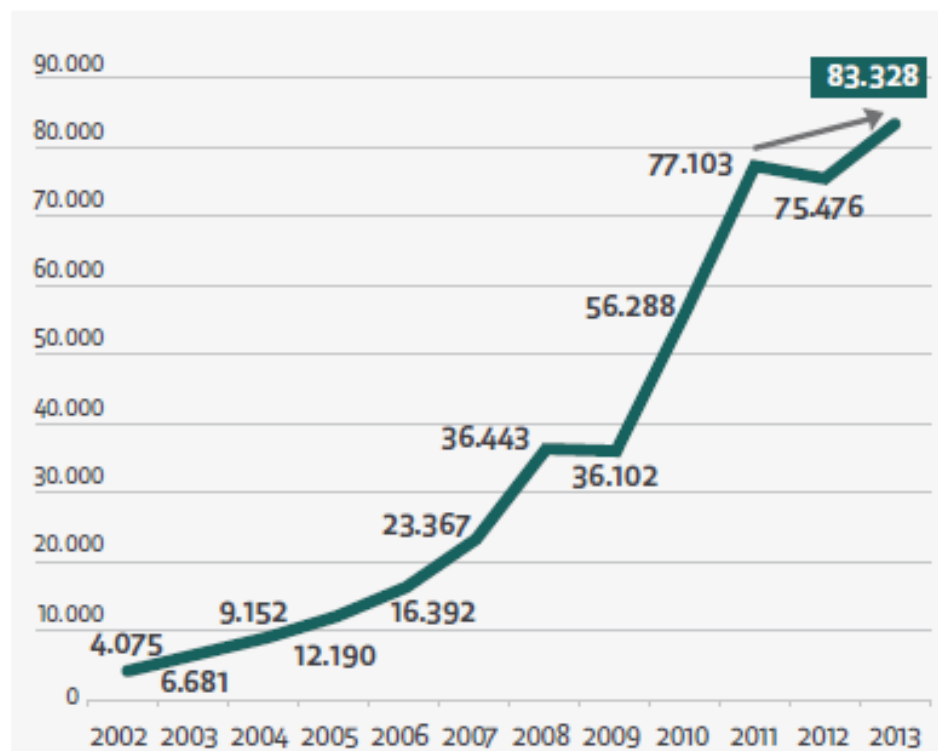
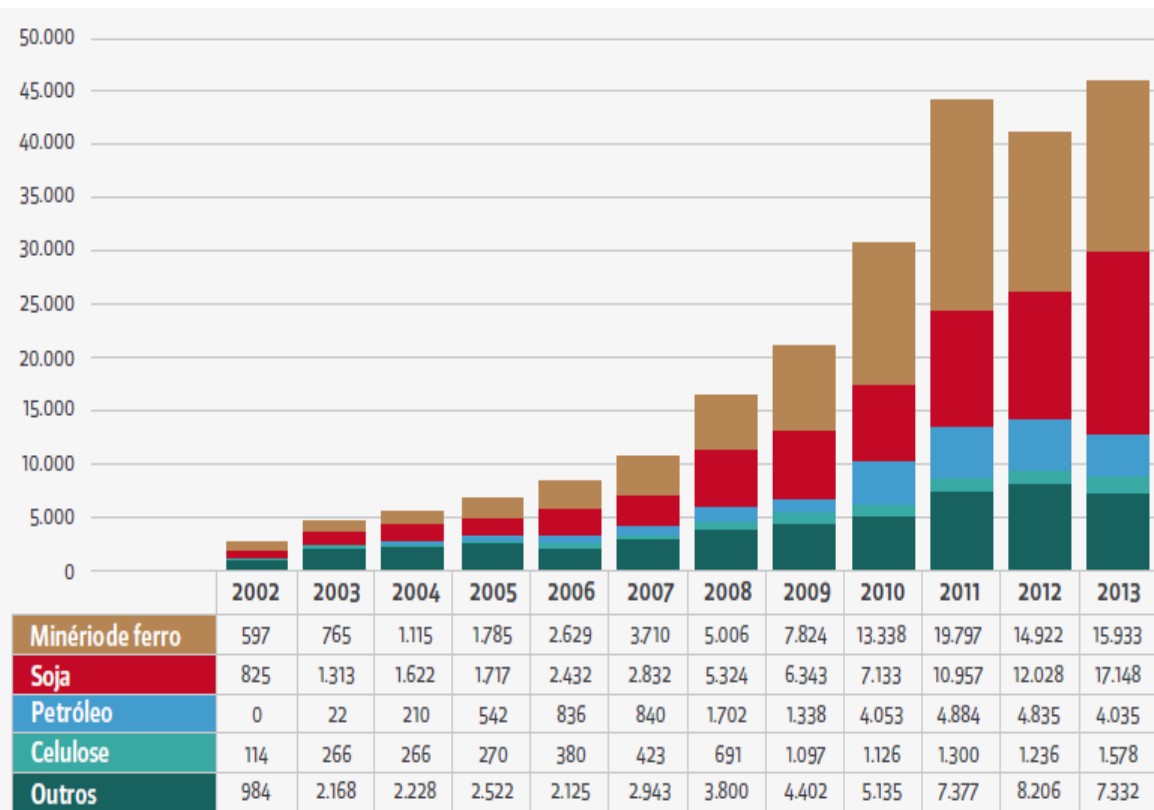
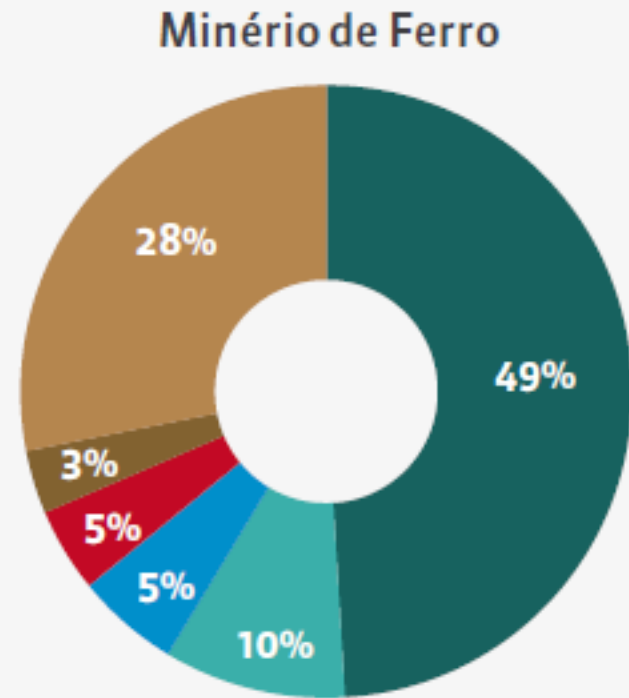
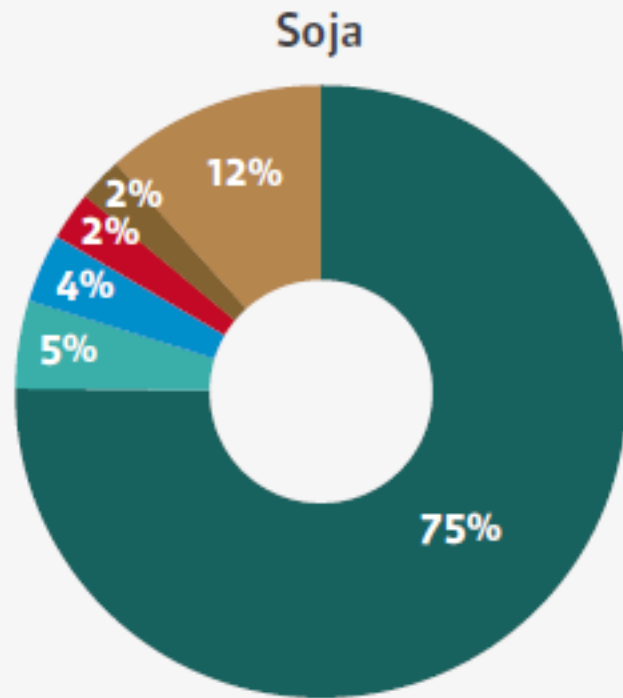


Gráfico 3: Pauta de exportação do Brasil para a China (US\$ milhões)



# Share of China in Brazilian exports of selected products



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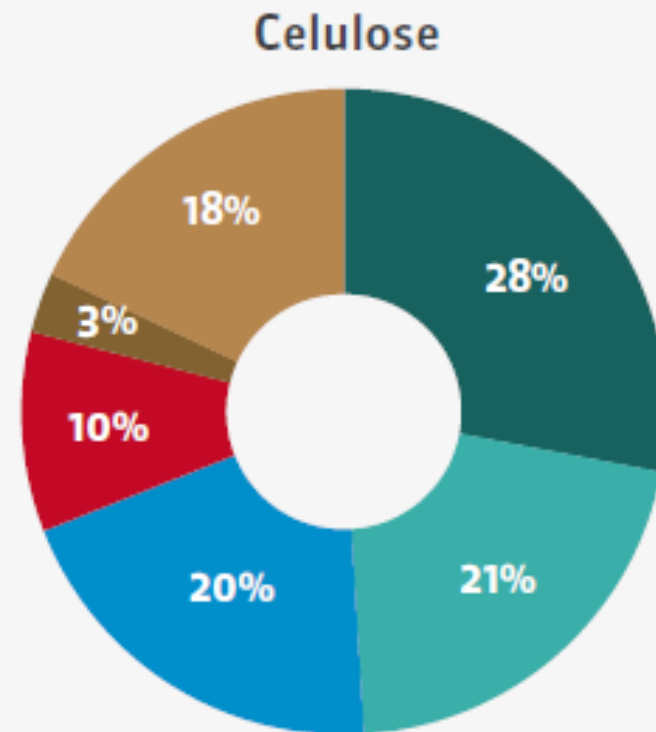
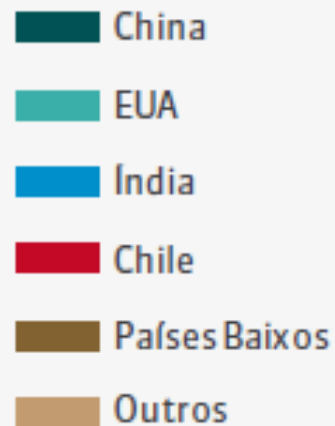
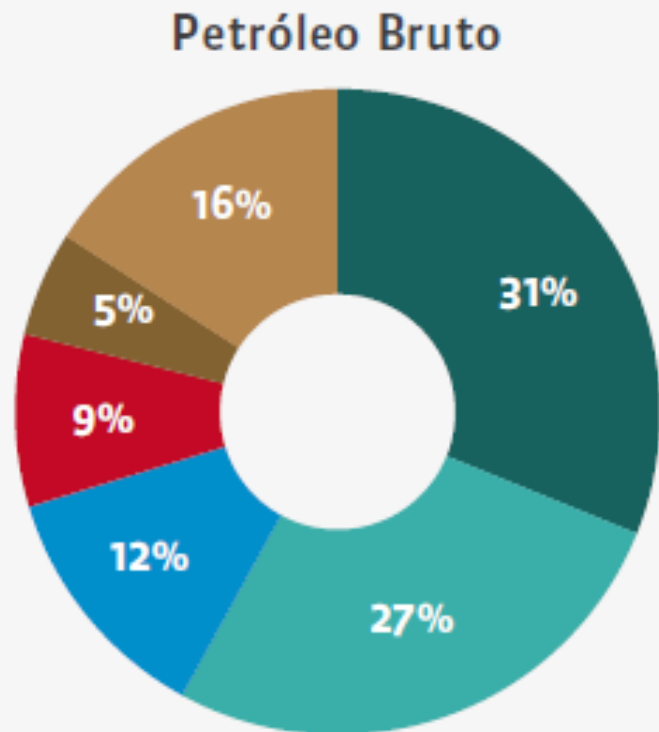


Gráfico 8: Exportações do agronegócio brasileiro para a China entre 2009 e 2013 (US\$ milhões)

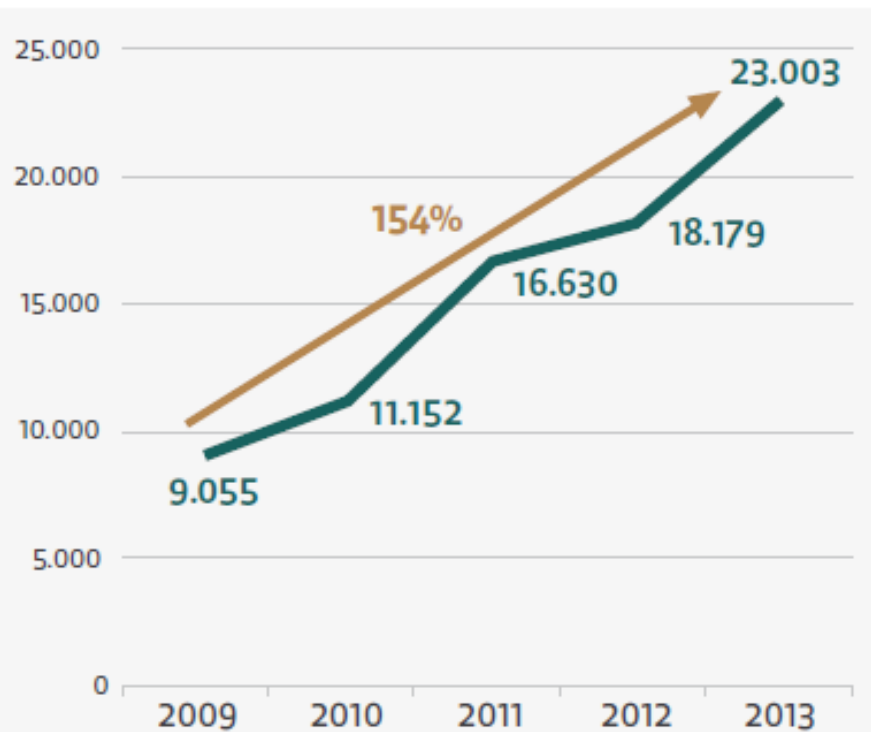
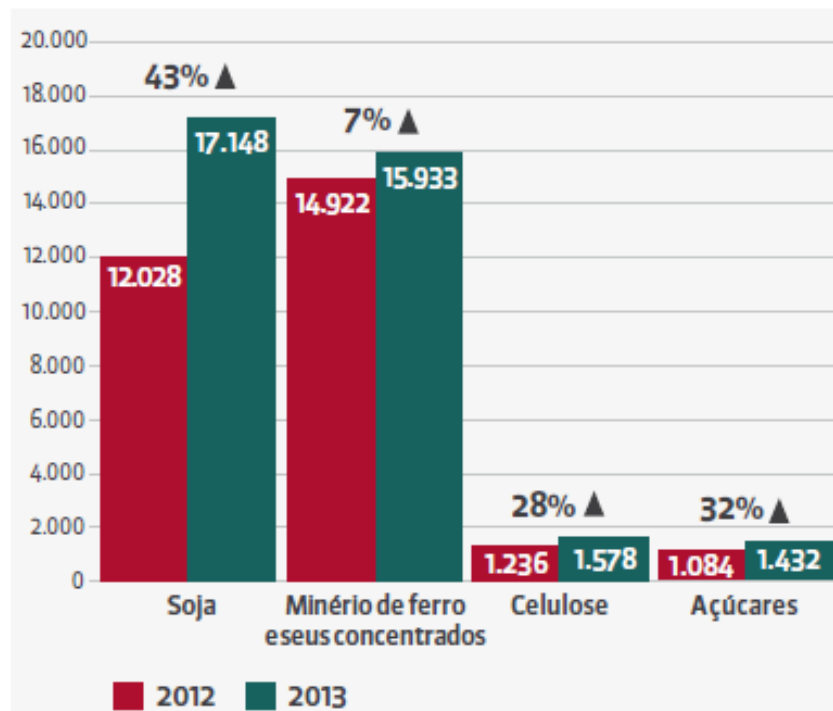
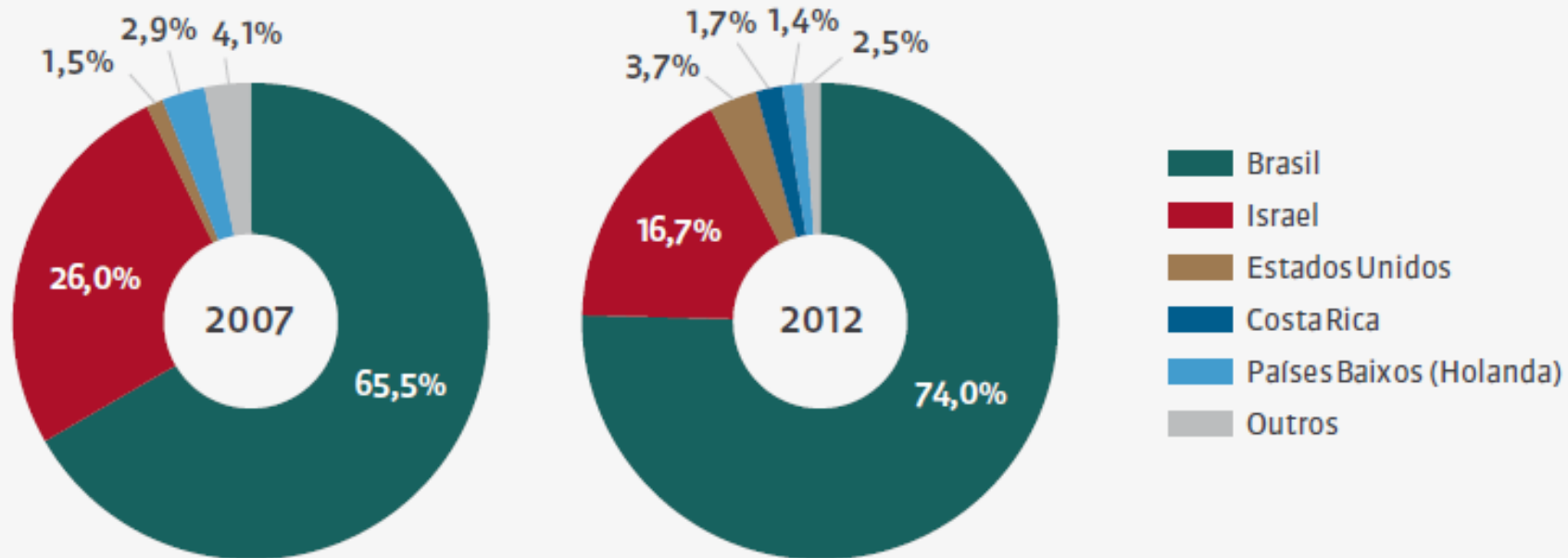


Gráfico 9: Evolução de produtos selecionados da pauta de exportação do Brasil para a China entre 2012 e 2013 (US\$ milhões)



# Selected opportunities: orange juice

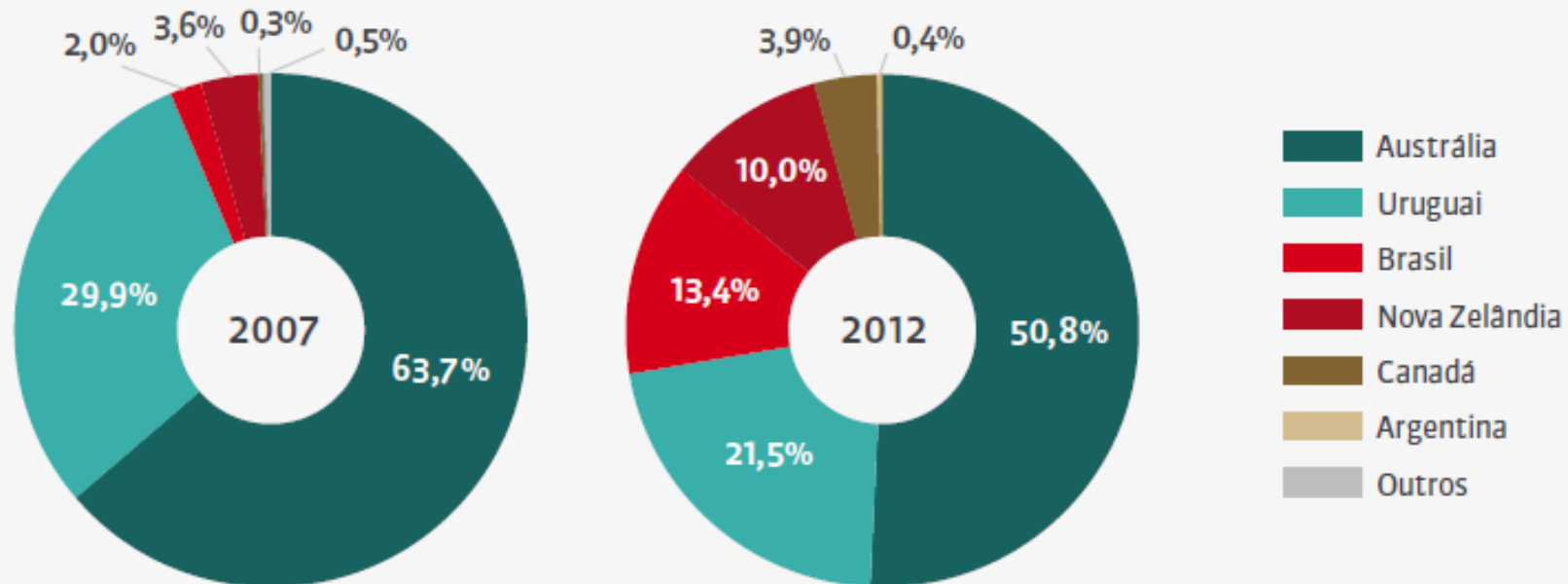
Gráfico 22: Principais fornecedores de suco de laranja para a China em 2007 e 2012





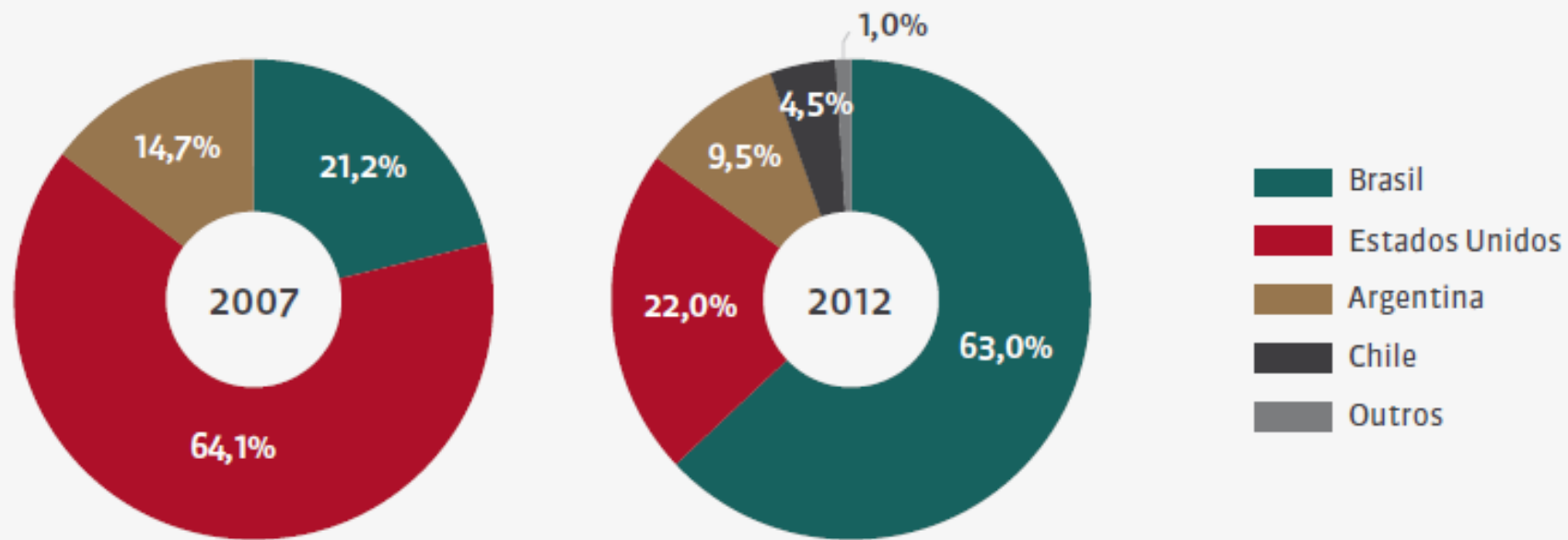
# Selected opportunities: orange juice

Gráfico 29: Principais fornecedores de carne bovina 'in natura' e demais carnes bovinas para a China



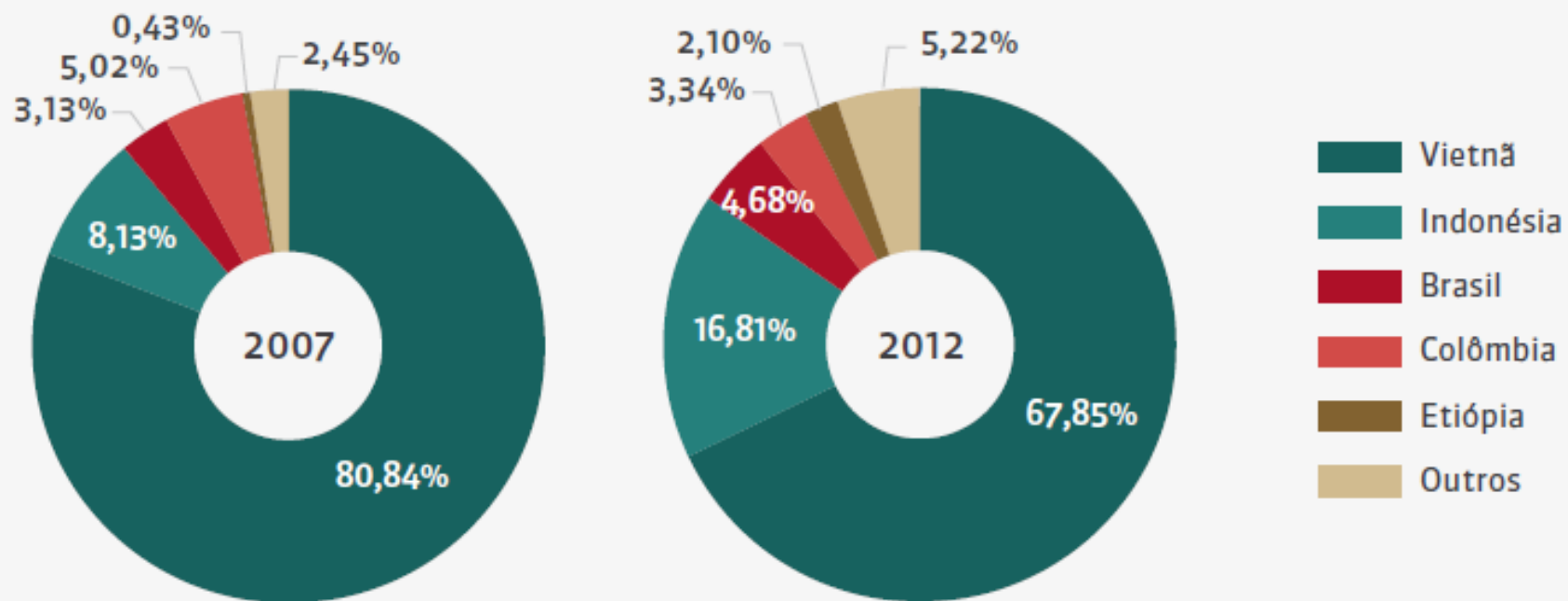
# Selected opportunities: carne de pollo

Gráfico 36: Principais fornecedores de carne de frango 'in natura' em 2007 e 2012



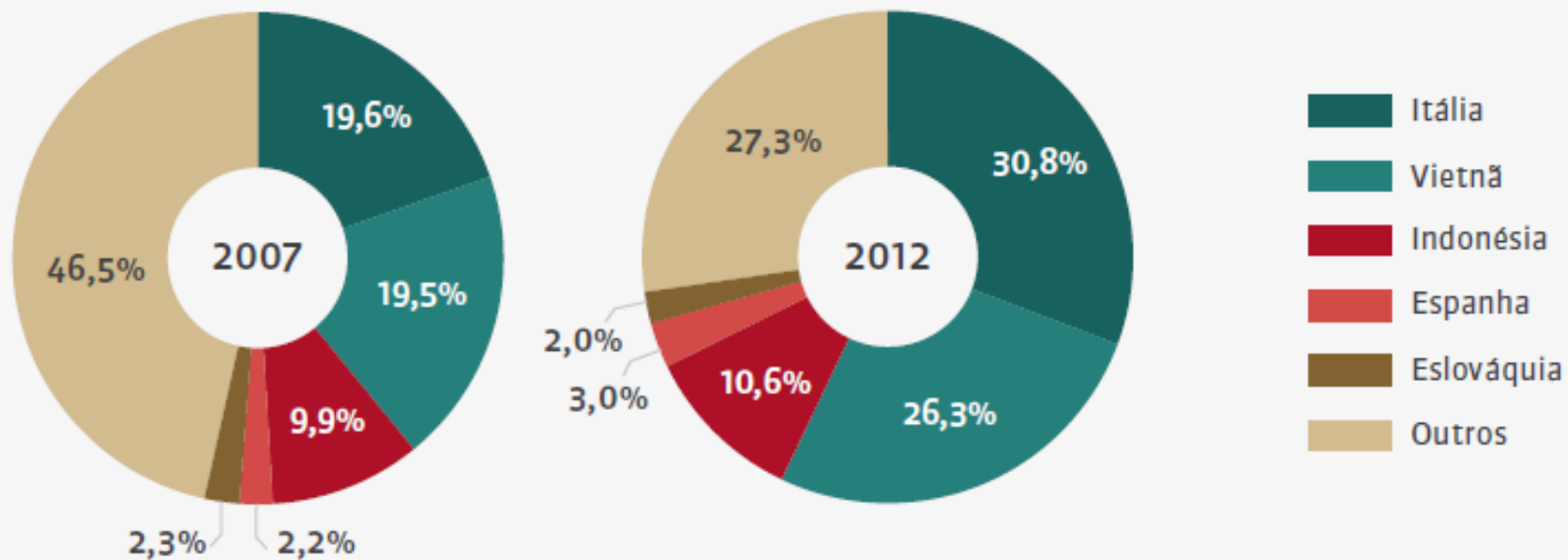
# Selected opportunities: Coffee

Gráfico 57: Principais fornecedores de café não torrado, não descafeinado em 2007 e 2012



# Selected opportunities: Shoes

Gráfico 72: Principais fornecedores de calçados para a China em 2007 e 2012



# Opportunities: investment

- ▶ Main drivers of Chinese OFDI were access to natural resources (merger and acquisitions investments) and access to markets (new investments)
- ▶ Between 2005-2014, 97% of Chinese OFDI through mergers and acquisitions in LA went to energy and mining
- ▶ 53% of new investment went into industry (from 2010 on) and mining
- ▶ In the specific case of Brazil, big opportunities in infrastructure (State Grid, transmission line from Belo Monte Power Station) and agribusiness (Chongquin Grain Group invested in soybean processing)