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Economic Watch

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Economic Analysis

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The Brazilian manufacturing sector loses competitiveness

Deterioration is more serious in the non-basic manufactured production sector, less primary product-intensive

- **Loss of competitiveness between 2007 and 2012 follows a relatively positive period between 2002 and 2007**

  This recent deterioration is connected to the appreciation in the exchange rate, increased labour costs, paltry improvement in labour productivity and the lack of meaningful economic reforms.

- **The most likely outcome is that this lack of competitiveness is solved (or rather, mitigated) by an exchange rate depreciation and moderation in economic activity**

  The absence of a wider-reaching and more ambitious reform programme waters down hopes of an improvement in competitiveness through productivity gains, which would be the most desirable outcome.

International trade data reveal the loss of competitiveness in manufactured products, particularly non-basics, between 2007 and 2012[1]

Brazilian exports as a proportion of GDP remained virtually unchanged at around 13% of GDP between 2002 and 2012, with an increase in the weighting of primary product exports (from 4% to 6% of GDP) being offset by a reduction in the weighting in GDP of manufactured goods exports, particularly non-basic manufactured products, i.e. those which are less raw material-intensive, in the second half of the period analysed.

As a proportion of world exports, Brazilian exports did increase from 0.54% in 2002 to 0.68% in 2007 and to 0.74% in 2012. However, increased primary product exports account for a large part of this gain. Basic manufactured goods, i.e. those which are most raw material-intensive, account for 39% of growth in both periods, while non-basic manufactured goods contributed positively (+5%) in the first five-year period, but very negatively in the second (-86%). Taken together, basic and non-basic manufactured goods contributed positively to the expansion in Brazil's exports as a proportion of global exports between 2002 and 2007, and negatively between 2007 and 2012 (for the period as a whole the contribution is small, but positive).

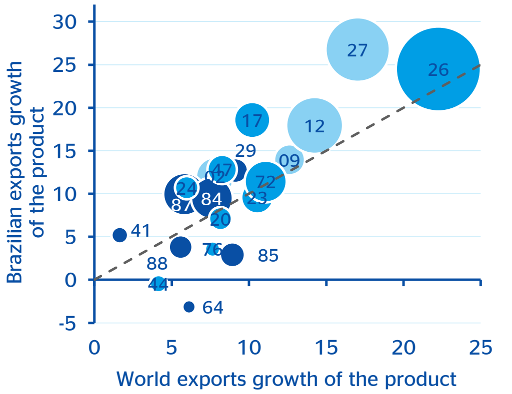
In line with the above, Brazilian exports of manufactured products grew at a noticeably faster rate than global exports of manufactured goods in the first five-year period analysed. However, the situation changed significantly in the second five-year period: Brazilian exports of manufactured goods slackened as did global exports, but the non-basic manufacturing segment showed a slight contraction contrasting with global growth (see chart 1).

The comparison between the growth in Brazilian exports and global exports by product type (see chart 2) and RCA (revealed comparative advantage) indicators (see table 1) in general terms bear out these conclusions.

Chart 1
Annual growth in manufacturing exports (total and non-basic) in Brazil (%)

Source: WITS and BBVA Research

Chart 2
Brazil: annual growth in exports in 2002-12 (%)*



* The bubble size shows the product's share in the country's exports and colours classify the products by: ● Primary, ● Basic manufactured goods, ● Non-basic manufactured goods. In addition, each product is identified by two HS 2002 classification digits. Above the 45º line, product exports have grown more in the country than in the world, and as such the country has increased its share of world exports.
Source: WITS and BBVA Research

1: This Economic Watch is a summarised version of the analysis of progress made in the last decade by the Brazilian manufacturing sector, covered in Chapter 4 of BBVA Research's Working Paper 14/10: "Competitiveness in the manufacturing sector in Latin America: trends and determinants"

With a few exceptions, the main primary product categories retained and even increased their (already high) level of competitiveness in the last decade, in line with the RCA indicator. Similarly, Brazilian exports of these products almost always grew faster than global exports. Performance in the oil sector was particularly good; here the country appears to be developing a comparative advantage.

There is a more varied set of results among the main categories of manufactured products. In basic manufacturing, the RCA indicators show relatively stable and relatively high levels of competitiveness in the last decade, with growth in exports equivalent to or higher than global exports, with the main exception in the wood and aluminium sectors. When it comes to non-basic manufacturing, most of the main product categories showed a positive development between 2002 and 2007 and very unfavourable performance between 2007 and 2012. This is the case of the "Machinery and electrical equipment" and "Transport" categories, which have more weight in Brazilian exports. RCA data show that only "Hides and skins" continues to be competitive (RCA>1), although less so than a decade ago. The loss of momentum and competitiveness in the "Footwear" category is very clear.

Table 1
Brazil: RCA indicator, weighting in total exports and growth rate by sectors

	RCA			Share of total exports (%)			Annual growth*	
	2002	2007	2012	2002	2007	2012	2002-12	2007-12
Animals and animal products	2.7	3.5	2.7	5.7	5.9	4.3	11.7	-0.4
Vegetable products	4.2	4.2	5.0	10.8	10.6	14.8	18.6	13.6
Food products	4.3	3.9	4.2	12.9	10.2	11.6	13.7	9.2
Mineral products	10.3	9.6	10.5	7.9	13.7	20.0	26.1	14.5
Fuels	0.4	0.5	0.6	3.3	6.5	11.2	29.8	18.4
Chemical products	0.5	0.6	0.6	4.7	4.9	5.2	15.9	7.5
Plastics and rubber	0.6	0.7	0.5	2.5	3.1	2.3	13.6	0.0
Hides and skins	2.1	2.3	1.4	1.8	1.4	0.8	5.7	-5.1
Wood and wood products	2.1	2.1	1.8	7.4	5.8	4.0	8.0	-1.4
Textiles	0.3	0.3	0.4	1.9	1.4	1.5	11.6	7.2
Footwear and headgear	2.8	1.7	0.7	2.8	1.3	0.5	-3.4	-12.0
Stone and glass	0.8	0.6	0.3	2.3	1.8	1.2	8.2	-1.8
Metals	1.6	1.2	1.0	9.7	10.7	6.9	11.1	-2.5
Machinery and electrical equipment	0.4	0.4	0.3	12.0	10.3	6.4	8.0	-3.4
Transport equipment	0.9	1.0	0.8	11.0	9.9	6.4	8.9	-2.6
Miscellaneous	0.3	0.2	0.2	2.0	1.3	0.9	5.7	-1.8
Primary products	1.7	1.7	1.8	0.3	0.3	0.4	21.5	12.8
Basic manufacturing	2.9	2.7	3.2	0.4	0.4	0.4	16.4	7.4
Non-basic manufacturing	0.6	0.6	0.4	0.4	0.3	0.2	9.5	-0.7

* Compound Annual Growth Rate.
Source: WITS and BBVA Research

Performance data for Brazilian exports in the period between 2002 and 2012 leave little room for doubt; in the last few years, between 2007 and 2012 to be precise, there has been a significant loss in competitiveness in the Brazilian manufacturing sector, particularly concentrated in the non-basic manufacturing group. This recent loss of competitiveness wiped out a great deal of the gains from the previous five-year period, between 2002 and 2007.

In general, over the last decade, and particularly in the last five years, Brazil has lost further competitiveness in the sectors where it had been uncompetitive (in non-basic manufacturing) and has gained competitiveness in the sectors where it already had an edge (primary products and, to a lesser degree, basic manufacturing).

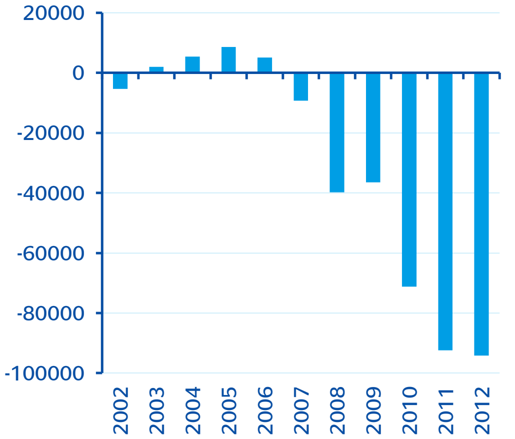
It could be argued that the poor growth in manufactured products, in particular non-basics, is due to incentives to sell in the internal market, generated by the relatively high growth of the Brazilian economy between 2002 and 2012 (3.5% Avg. YoY) and the high share of internal consumption in GDP (84%, on average, between 2002 and 2012). In this case, manufactures' weak performance would not be due to a loss of competitiveness in industry, but a consequence of the dynamism in internal economic activity.

However, expansion in the manufacturing sector was less than GDP expansion and internal consumption growth. As a result, the manufacturing industry's share of GDP went down from 17% in 2002 to 13% in 2012. In addition, manufactured product imports, as a proportion of these products' internal consumption, increased from 12% to 22%, and manufacturing exports were practically flat at around 15% of domestic manufacturing production in the last decade. As the accompanying charts show, deterioration in all these indicators is highly concentrated between 2007 and 2012, consistent with the trade data presented earlier.

Likewise, the manufacturing sector's trade deficit went from USD5bn in 2002 to USD94bn in 2012, due to an annual 14% increase in manufactured product imports compared with a growth of scarcely 6% in manufactured exports (see Chart 3).

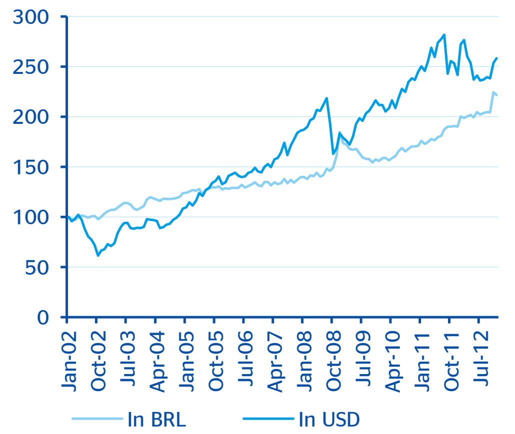
These indicators support the argument that there has been a loss in competitiveness in the manufacturing industry in the last few years.

Chart 3
Trade balance of manufactured goods (USD mn)



Source: MDIC and IPEADATA

Chart 4
Unit labour cost in the industrial sector in BRL and USD (Index, January 2002=100)



Source: IPEADATA, BCB, IBGE and BBVA Research

Progress in the business environment, infrastructure and other areas has been limited and insufficient to offset the impact of the appreciation in the exchange rate and the gap between the growth in labour costs and productivity

One of the factors that explains the deterioration in competitiveness levels in the Brazilian manufacturing sector is the 22% increase in the real effective exchange rate between 2002 and 2012, most of it between the end of 2002 and the middle of 2008. The exchange rate was much stronger in the second half of the 2002-12 period, which helps to explain the loss of competitiveness in the manufacturing sector in this period.

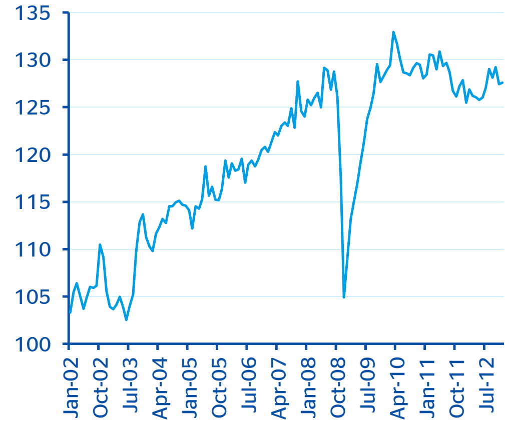
Another key factor in understanding the deterioration in the competitiveness in the manufacturing sector in the last few years is the gap between the growth in labour costs and labour productivity.

In the 2002-12 period, unit labour costs in the industrial sector measured in BRL went up by an average of 7.5% a year (growth in USD was 9.0% a year). This growth was particularly high in the last two years of the period analysed, when it grew at a rate of around 14% a year (see chart 3). This growth is much higher than productivity in the Brazilian industrial sector, which at an annual rate of just 2.2% saw particularly low growth, even turning negative in 2011 and 2012 (see chart 4).

There are other factors which have the potential to impact the economy's competitiveness and that of the manufacturing sector: the institutional environment, energy costs, tax burdens, capital costs, logistics costs, access to markets, etc. In the case of Brazil, evidence available on these areas for the last decade suggests that there has been little progress – in some cases none at all – in terms of promoting competitiveness. Progress made in some particular cases was not nearly enough to compensate for the general picture of loss of competitiveness in the manufacturing sector. It is illustrative that in 2012 Brazil occupied 27th position out of 188 countries for the cost in dollars of exporting a container and, out of all the countries, registered the second biggest increase in this cost between 2005 and 2012 (+252%).

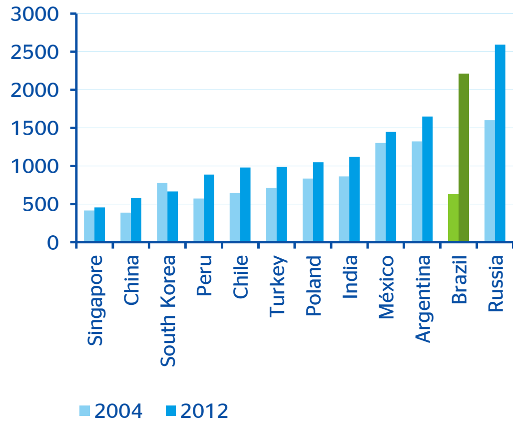
The lack of a more general and ambitious reform plan reduces the likelihood of there being an improvement in Brazil's competitiveness through productivity gains, which would be the best scenario. So the most likely outcome is that the problem of the lack of competitiveness is resolved (or reduced) by an exchange rate depreciation and an economic activity slowdown.

Chart 5
Work force productivity in the industrial sector (Index, January 2002=100)



Source: IPEADATA, BCB, IBGE and BBVA Research

Chart 6
Cost of exporting a container (USD)



Source: World Bank