Brazil & the US

Thursday May 16 2013

www.ft.com/reports | twitter.com/ftreports

Politics put to one side in sign of closer ties

A growing sense of friendship between the two countries makes sense in an increasingly multipolar world, writes *Joe Leahy*

Cordial: relations are warming between Brazil's president Dilma Rousseff and US president Barack Obama Getty

When the Brazilian diplomat Roberto Azevêdo clinched the biggest job in global trade last week – as director-general of the World Trade Organisation – he received a relatively warm response from Washington.

The US could not have been expected to do anything other than vote for Mr Azevêdo's rival, Herminio Blanco, the former trade minister of Mexico.

But Washington's decision to "join the consensus" when Mr Azevêdo was selected by the WTO and back the Brazilian candidate showed both respect for the man and for the emerging power he represents.

The growing sense of bonhomie between the two countries makes sense. For the US, Brazil is looking more than ever like a friendly face in an increasingly multipolar world, one that is tilting slowly towards east Asia. For Brazil, the US, with its technology, quality higher education and capital markets, is an ever more important partner in the effort to become more internationally competitive and escape the middle income trap in which it has languished for decades.

Perhaps for this reason, Barack Obama, the US president, is expected later this year to roll out the red carpet and offer Dilma Rousseff, his Brazilian counterpart, the first state visit for a leader of her country since 1995.

"It's an important time between the US and Brazil," says Eric Farnsworth, vice-president of the Council of Americas and Americas Society.

"Everything I see indicates that Washington views Brazil's rise as a favourable development."

Brazilian and US relations date back to 1824 when Washington became the first state to recognise the independence of the Latin American power to the south. Brazil was also the only South American country to send troops to fight on the allied side in the second world war.

Although the relationship has usually been cordial, it has been characterised by periods of indifference. Like two good enough neighbours, relations remain reasonably good as long as the conversation does not stray too much towards politics, a subject on which Brazil, with its social democratic leanings, mostly sits to the left of Washington.

> The US, with its technology, education and capital markets, is an ever more important partner

In spite of this, Brazilian presidents in recent decades have got on well with their US counterparts. Fernando Henrique Cardoso, president during the 1990s and early 2000s, was very close to US president Bill Clinton. Former Brazilian president, Luiz Inácio Lula da Silva, though once a trade union firebrand, got on famously with his US counterpart, George W. Bush.

Ms Rousseff and Mr Obama are not seen to have the same rapport and both have been more preoccupied with domestic politics. But relations between them are warming.

On the policy side, things have not always been smooth. Mr Lula da Silva prompted US suspicion in 2010 when he tried to intervene alongside Turkey in the dispute over Iran's nuclear programme. Mr Lula da Silva and Ms Rousseff's ruling Workers party has been a traditional friend of regimes considered unpalatable by the US, such as Cuba and Venezuela under the recently deceased Hugo Chávez.

Brazil's independent stance, not only on these countries but in seeking to establish alternative power blocs, has grated on Washington. Ms Rousseff's first overseas trip, for instance, was to Beijing rather than to its western trading partners. "There is a

Continued on Page 2

Inside »

Lucrative business transactions help cash flow in both directions

Deal making

Warren Buffett venture illustrates a growing trend, writes *Joe Leahy*

The day he announced his $28bn deal to buy Heinz, the US food group, Warren Buffett, known as the "Sage of Omaha", waxed lyrical on US television network CNBC about his partner in the transaction, a Brazilian group led by investor Jorge Paulo Lemann.

Describing how his Berkshire Hathaway group will act as the financial investor in the takeover and Mr Lemann's 3G will take care of operations, Mr Buffett said: "It's my kind of deal and it's my kind of partner."

He could just as easily have been summing up the growing business relationship between Brazil and the US as companies from the two increasingly focus on cross-border deal making.

Over the past decade, as Brazil's economy has become more open to global trade, its companies have actively sought US capital, whether in the form of overseas bond offerings, share issues or by courting private equity money.

US investors and banks have been targeting Brazil, whose economy, particularly on the consumer side, has remained buoyant throughout most of the global slowdown.

"We've been on a multi-year plan to build out our Brazil business," said Gary Cohn, Goldman Sachs' chief operating officer, during a recent visit to the investment bank's new São Paulo office.

"We've doubled the capital that we have in the business. Seeing more and more opportunity, we now have more than $400m of capital in the business."

Last year was the second biggest on record for cross-border mergers and acquisitions between Brazil and the US, surpassed only by the boom in 2007, according to figures from Dealogic, the data company.

Brazilian and US companies announced deals worth $12.1bn, compared with $4.9bn a year earlier. In 2007, deals had reached $12.3bn. In debt markets, Brazilian companies in 2012 broke all previous records, raising $43.3bn on issuances marketed in the US, compared with $30.5bn a year earlier.

The soft spot was equity capital markets, with Brazilian companies raising only $292m in 2012 in the US. But this market has been hot in the past, with US-listed equity capital market deals by Brazilian issuers raising $30.1bn in 2010.

Among the leading mergers or acquisitions were UnitedHealth's $5.1bn takeover of Amil Participações, the Brazilian pharmaceutical company, last year, steel producer Gerdau's acquisition of Chaparral Steel in the US for $4.4bn in 2007, and meatpacker JBS's purchase of US rival Pilgrim's Pride for $2.6bn in 2009.

On the debt side, issuance has been dominated by Petrobras, the oil major, which sold $7bn of bonds last year and $6bn a year earlier. Other big corporate issuers include state-controlled Banco do Brasil with $2bn sold earlier this year.

In equity, the biggest US-listed transactions were Petrobras' $70.1bn follow-on offering in 2010, a $12.2bn follow on by Vale, the iron ore miner, in 2008 and the initial public offering in 2009 of Banco Santander Brasil, the local unit of the Spanish bank.

> Last year was the second biggest for cross-border mergers and acquisitions

Private equity funds have continued to come to Brazil. In one of the highest-profile moves, global private equity specialist Kohlberg Kravis Roberts named Jorge Fergie, a senior McKinsey consultant, as its São Paulo chief in January.

Private equity funds, including Carlyle Group in the US, raised a record of $10.3bn for Latin America in 2011, with most of this earmarked for Brazil.

In another trend that is expected to lead to increased cross-border flows, Brazilian pension funds are considering investing as much as 10 per cent of their money overseas. "The tendency is usually to first go to the macro picture rather than single names," says André Laport at Goldman Sachs in São Paulo, of the pension funds' likely targets.

Most were still deciding what investment strategy they would pursue but they were expected initially to buy funds targeting indices such as the S&P 500.

While the pace of outward investment by the Brazilian pension funds is likely to be steady rather than explosive, it is indicative of the forces driving deepening ties between US and Brazilian dealmakers.

While Brazilian businessmen operate in a different world from their US peers, given the country's larger state presence and less efficient legal, tax and bureaucratic frameworks, they tend still to have a strong personal rapport with their American counterparts.

As Mr Buffett said of the Heinz arrangement, he had been in contact with Mr Lemann since the pair served on the Gillette board together more than 10 years ago.

Mr Lemann brought the deal to him in December, suggesting that 3G would take care of the operational side as the Brazilian and his investor team had at AB InBev, the global brewer they helped to create. Mr Buffett could not have been happier.

"Any partnership where I don't have to do the work is my kind of partnership," he joked on CNBC.

Bumper crops fall victim to inadequate infrastructure

Bean counting: trucks loading up with soybeans for export Getty

Agriculture Potential to supplant US output is being undermined, writes *Amy Stillman*

There is a rising spectre to the south of the US's grain belt. In the past two years Brazil has reaped the benefits of agricultural innovations and year-round sunshine to produce record soyabean and corn yields, putting it squarely in the rear-view mirror of grain exporters in the US. Brazil's soyabean production this year – at about 83.5m tonnes – is set to scrape ahead of US production of 82.1m tonnes, according to forecasts by the US Department of Agriculture. That could see Brazil overtake the US as the world's biggest soyabean exporter.

"Brazilian farmers are pretty well prepared to realise this potential," says Daniel Glatt, a grain producer in the northern Brazilian state of Tocantins. "If world demand for agriculture continues at its current pace, Brazilian farmers will continue to produce more."

One advantage is that Brazil's tropical climate allows farmers to plant a second corn crop during the year, known as *safrinha* (little crop), which is usually harvested in June and July. The corn is planted on the same soil where soyabeans, cotton or beans were harvested in the preceding months. The rotation technique was developed by Embrapa, Brazil's pioneering national agricultural research corporation, which has also spread the practice of so-called "no-till" farming, where stalks are left to rot, forming a mat to soak up more nutrients. Another Embrapa technique developed to improve growing conditions is the application of limestone to the highly acidic soils of the Cerrado, Brazil's savannah region. That has helped the once-barren area become the main source of grain output over the past 15 years.

Indeed, although the Brazilian government offers little help in the way of subsidies to its farmers, generous public financing for Embrapa over its 40-year lifespan has paid high dividends. Its innovative farming methods have not only increased productivity, but also potential acreage by enabling farmers to plant in previously infertile areas or degraded pastures.

In Mato Grosso, the largest grain-producing state, an estimated 9m hectares could be used for crop production. By contrast, US farmers are using all available acreage. "The US is running into finite space limits," notes Michael McDougall, senior vice-president at commodities trader Newedge. "Brazil definitely has the potential to be much bigger."

Another factor is that biotechnology developed for the temperate US midwest is being adapted to suit the tropics, with genetically modified (GM) seeds being created to resist pests and diseases specific to Brazilian farming areas. The approval process of new GM traits is speedier, taking on average 24 months in Brazil compared with about 40 months in the US, according to Ray Gaesser, vice-president of the American Soybean Association.

> 'The US is running into space limits. Brazil has the potential to be much bigger'

Even so, Brazil's potential to supplant the US in agricultural might is being undermined by a fundamental weakness. Last month, at its peak, the line-up of trucks carrying grain to unload at the Santos port in São Paulo stretched for more than 21 miles. Journey times from the city of Sorriso in northern Mato Grosso to the port more than doubled during the peak season for soyabeans in March. Freight costs have ballooned.

The country's inadequate infrastructure has been unable to absorb the bumper crop yields, fuelling shipping delays and rising transport costs. Problems bringing the produce to port have already led Sunrise Group, the Chinese grain trader, to withdraw a $1.1bn order for 2m tonnes of soyabeans. Other buyers could follow suit.

Furthermore, higher transport costs threaten the competitiveness of Brazilian agricultural exports.

According to the Soy Transportation Coalition, the Iowa-based association, the cost of transporting soyabeans from northern Mato Grosso to Shanghai was $160.22 a tonne in the fourth quarter of last year.

The same journey cost $94.08 and $88.50 a tonne from Davenport in Iowa and Sioux Falls in South Dakota, respectively.

Multinational grain traders that swallowed higher transport costs in the first part of the year are now lowering the amount they are willing to pay for Brazilian corn. That has delayed sales for this year's corn harvest since farmers are waiting for better prices.

According to the Mato Grosso Institute of Agricultural Economics (Imea), just 22.3 per cent of corn production in Mato Grosso was sold by April, down from 50 per cent the same time last year.

The US's integrated freight transport system of rail, road and barge seems in far better stead to handle what is shaping up to be a better harvest than last year, when US corn production was hit by the worst drought in half a century.

"The infrastructure we have in the US has made us very competitive," says Mr Gaesser. "Brazil is expanding its infrastructure but it will not happen overnight."

That might just allow the US to maintain its lead on corn exports – for this year at least.

Politics has been put to one side

Continued from Page 1

certain frustration in Washington," says Mr Farnsworth. "Brazil seems to be as interested in developing a relationship with China as they are with the US. I don't think most people would suggest the Chinese and US models are compatible."

Throughout it all, trade in goods has continued to grow. It increased from as little as $28bn in 2002 to nearly $77bn last year, with a $11.6bn surplus in favour of the US, according to the US Census Bureau.

Brazil is the kind of trading partner the US needs, and it supports about 300,000 jobs in its northerly neighbour. It also buys the types of products the US wants to sell more of – aircraft parts, machinery and plastics. US services exports to Brazil have also increased, more than tripling between 2002 and 2011 to nearly $20bn.

For Brazil, the US, with its transparent business practices and focus on innovation and intellectual property, is the kind of trading partner it prefers. After an initial honeymoon with Beijing in the first decade of this century, when China became its biggest trading partner, Brazil is growing frustrated with aspects of the business relationship.

An old developing world ally, China is importing Brazil's iron ore and soyabeans but in return swamps the Latin American country with cheap imports. "We are a rare example of a country that holds a sizeable trade surplus with China – $11bn in 2011 – but it's not the quality of trade that we would like to see sometimes," says Antônio Patriota, foreign minister.

Mindful that US universities are one means of improving its competitiveness, Brazil is sending a large number of students under its R$3bn ($1.5bn) science without borders scholarship programme to colleges in the US.

Brazilian companies, meanwhile, are tapping the strengthened capital markets of the US for private sector investment.

Defence co-operation is improving, with the US maintaining an order for a group of Brazilian light attack aircraft, the country's first such contract with the US military. Embraer, the Brazilian builder of the aircraft, has signed a co-operation agreement with Boeing to develop a jet-engined military transport aircraft. This has strengthened aspirations in Washington that the US might eventually win a contract to supply the Brazilian air force with fighters.

The growing relationship is leading to hopes that thorny technical issues may one day be worked out. These include visa-free access for Brazilians to the US and a tax treaty that would simplify business dealings between the two.

The two countries which are competitors on global soya, orange juice and other commodities markets, are occasionally at odds on trade.

The US sometimes accuses Brazil of protectionism while Brazil has attacked US agricultural subsidies. Brazil is concerned that it is being left out of US efforts to build a web of bilateral agreements, such as with the EU, which it fears will undermine the global trading system.

> The US sometimes accuses Brazil of protectionism while Brazil has attacked US agricultural subsidies

US officials counter that Brazil is too wedded to the slow-moving South American trading bloc, Mercosur.

In the long run, the US seems willing to embrace the rise of a Brazil that pursues an independent foreign policy and insists on friendly relations with most countries in the world, no matter how distasteful Washington might find some of them. Brazil seems happy to expand its influence with a sense of responsibility to all.

"Brazil sees itself as a country that has a role in the global space, as an actor that will contribute and benefit from more integration with the international system," says Paulo Sotero, director of the Brazil Institute at the Woodrow Wilson International Center for Scholars.

In a 2011 report, the think-tank Council on Foreign Relations went further: "Brazil is on the short list of countries that will most shape the 21st century. US and Brazilian policy must adjust accordingly."

Record low borrowing rates lure corporations north

Capital markets

The US is a better option for companies seeking debt, says *Vivianne Rodrigues*

Brazil's domestic bond markets have strengthened considerably in the past decade.

The country's rapid growth has brought a new wave of companies, lenders and investors into local capital markets as its financing needs have risen sharply.

Yet, compared with other developing regions, in particular east Asia, it continues to lag.

The local bond market, relative to gross domestic product, is small and some of the most developed segments remain those of government bonds, interest rate futures and currency derivatives, a legacy of Brazil's reliance on heavy government borrowing in order to fund large deficits.

"There has been a great improvement in Brazil debt capital markets in recent years, with more products, larger volumes and new players," says Michael Cummings, head of Latin American debt capital markets at Credit Suisse.

"But, given the size of its economy and the sophistication of its financial system, it remains in need of further development."

Sales of fixed income securities in the first quarter reached R$15bn ($7.5bn), according to Anbima, the country's capital markets association. This was 41 per cent down on the same period of 2012, much thanks to a slowdown in the economy.

Debentures and commercial paper account for more than 80 per cent of sales, with primary offerings and mortgage debt securities accounting for only 10 and 2 per cent, respectively.

In addition, many corporate debt securities are not regularly traded for extended periods. This absence of price quotes in secondary markets prevents many institutional investors from holding such securities, which further reduces an important source of liquidity.

As a result, when many Brazilian companies want to raise big money, they still have to go the US debt markets.

Football funds: World Cup projects will boost debt issuance

In 2012, Brazil took second place among foreign issuers of corporate debt in the US. Most of the sales came from investment-grade companies, with large groups such as oil producer Petrobras, state-owned bank Banco do Brasil and Vale, the mining company, pushing the country's market share to more than 10 per cent of overseas dollar-debt issuance, according to figures from Dealogic, the data company.

Brazilian companies are attracted to the US market because of its record low borrowing rates and by its huge pool of long-term investment funds.

While interest rates in Brazil have declined in the past decade, the central bank last month had to increase the benchmark Selic interest rate by 25 basis points to 7.5 per cent in a response to a surge in inflation. That, in turn, limits the development of a market for large bonds with a maturity date of more than five to seven years.

Lower borrowing costs are not the only reason many Brazilian companies rely on foreign debt sales. Offerings in international markets attract a much larger pool of investors to the companies' debt.

"When Brazilian companies take into account the level of local rates and compare that with the rates in the US, plus the opportunity to sell longer-term debt to a larger pool of investors, for many of them, the better option is to come to the US markets," says Roberto D'Avola, managing director and head of Latin America debt capital markets at JP Morgan Chase.

While liquidity in local debt markets has been rising steadily, the US is still a better option for the mixture of long-term and large issuances, such as Petrobras' $7bn bond last year.

"Even for large companies, it could be challenging to replicate in Brazil such a large offering, which included longer-dated tranches," says Joao De Biase, global head of DCM and syndication manager at Banco Itaú BBA. "Many of the large local funds, are still not very active in such markets and don't traditionally buy such type of securities."

Still, Mr De Biase notes that the outlook for the country's debt capital markets remains bright. The large pipeline of infrastructure projects, anticipated expenditures in preparation for the 2014 World Cup and the 2016 Olympics, and a boom in residential and commercial real estate, will boost both private and government debt-issuance in coming years.

Efforts by the Brazilian government to boost local debt markets have had mixed results. The government has been providing tax incentives to local and foreign investors buying real estate funds, for example, to encourage financing options in the housing and construction industries.

The government also keeps a tight control of money flows in and out of the country. Its national development bank, BNDES, remains the nation's largest direct lender to corporations.

"It could be hard for commercial and investment banks to match the level of financing and the rates offered by a government bank such as BNDES," says Mr Cummings. "But even that is changing in Brazil, and for the better."

Contributors »

Joe Leahy
Brazil Bureau Chief

John Paul Rathbone
Latin America Editor

Vivianne Rodrigues
US Capital Markets Reporter

Amy Stillman
Senior Researcher, Brazil Confidential

Samantha Pearson
Brazil Correspondent

Gregory Meyer
Markets Reporter

Stephanie Gray
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

For commercial opportunities please contact **John Moncure** at john.moncure@ft.com or **Alejandra Mejia** at alejandria.mejia@ft.com

All FT Reports are available on FT.com at ft.com/reports
Follow us on Twitter at **twitter.com/ftreports**

All editorial content in this supplement is produced by the FT. Our advertisers have no influence over articles or online material.

Change of tone starts to pay dividends in Washington

Foreign policy Rousseff has avoided conflicts of a previous era, writes *John Paul Rathbone*

One sign of how Brazilian foreign policy has changed subtly under Dilma Rousseff – and become less aggravating to the US – can be seen in the Brazilian president's response to the death of Hugo Chávez.

Ms Rousseff declared three days of mourning following the death on March 5 of Venezuela's president and led a minute's silence live on national television.

"We recognise a great leader, an irreparable loss and above all a friend of Brazil," she said of the socialist leader, adding carefully that "on many occasions, the Brazilian government did not agree" with his policies.

Since assuming office in 2011, Ms Rousseff, a technocratic manager, has taken a more restrained approach to foreign policy than her predecessor Luiz Inácio Lula da Silva, the charismatic former trade unionist who often publicly embraced Mr Chávez.

While Mr Lula da Silva liked to travel the world and make front page news, Ms Rousseff has focused more on domestic affairs, especially the economy. She has avoided the kind of high-profile foreign policy bust-ups that rubbed western capitals up the wrong way.

Although it would be wrong to call the US and Brazil antagonists or even adversaries, as Peter Hakim, president emeritus of the Washington-based think-tank InterAmerican Dialogue, says, their most notable disagreement came in 2010, when Brazil mediated a Turkey-Iran uranium swap as an alternative to additional sanctions against Tehran for its nuclear programme. Washington subsequently all but accused Brazil of being a political ingénue, even though the scheme had been initially encouraged by the White House.

Those days seem to have passed as Ms Rousseff, a former guerrilla and human rights activist, has distanced herself from Iran.

"Quietly, the mutual unease that often characterised relations during the last months of Lula has dissipated," says Matias Spektor, a Brazil foreign policy specialist at Kings College, London.

"The reasons are partly personal – Dilma is less interested in and suited to foreign affairs. And partly structural – Lula gave such a push to Brazilian foreign relations, which had been neglected before, that anything Dilma does is bound to be less."

That lower profile does not mean Ms Rousseff has switched tack. A permanent seat on the UN Security Council remains a long-term goal; Iran remains an important trade partner, as does Venezuela. Brazil continues to promote regional agreements, such as Unasur, the Latin American integrationist treaty that excludes the US.

The US has never publicly objected to Unasur and has largely deferred to the grouping, even welcoming at times Brazil's role in addressing thorny regional problems.

One example of the country's heft came in neighbouring Paraguay last year. When Paraguay's former president was legally – if suddenly – removed from office, Brazil joined several nations in expelling Paraguay from Mercosul, the South American trade group. "It was an exercise in damage limitation," says Mr Spektor.

Brazil's tone has begun to pay dividends in Washington. The US air force has bought 20 light attack Super Tucano aircraft, built by Embraer, and the talk is of greater naval co-operation in the South Atlantic.

Another sign came in April, when Reuters reported Ms Rousseff had been invited on a state visit to Washington, the first for a Brazilian leader in almost 20 years.

Although Ms Rousseff visited Washington in April 2012, and met Mr Obama briefly, a state visit includes formalities such as a black-tie dinner and a military ceremony on arrival. Although not officially confirmed, the state visit may take place in October.

It would be wrong to say this marks a honeymoon period. The mutual misperceptions in their "non-relationship" remain large.

Brazil, seeking a greater international role. sometimes views the US as a hegemon that wants to keep it down, while the US sometimes views Brazil as an upstart. What a mooted state visit might deliver, therefore, is open to question.

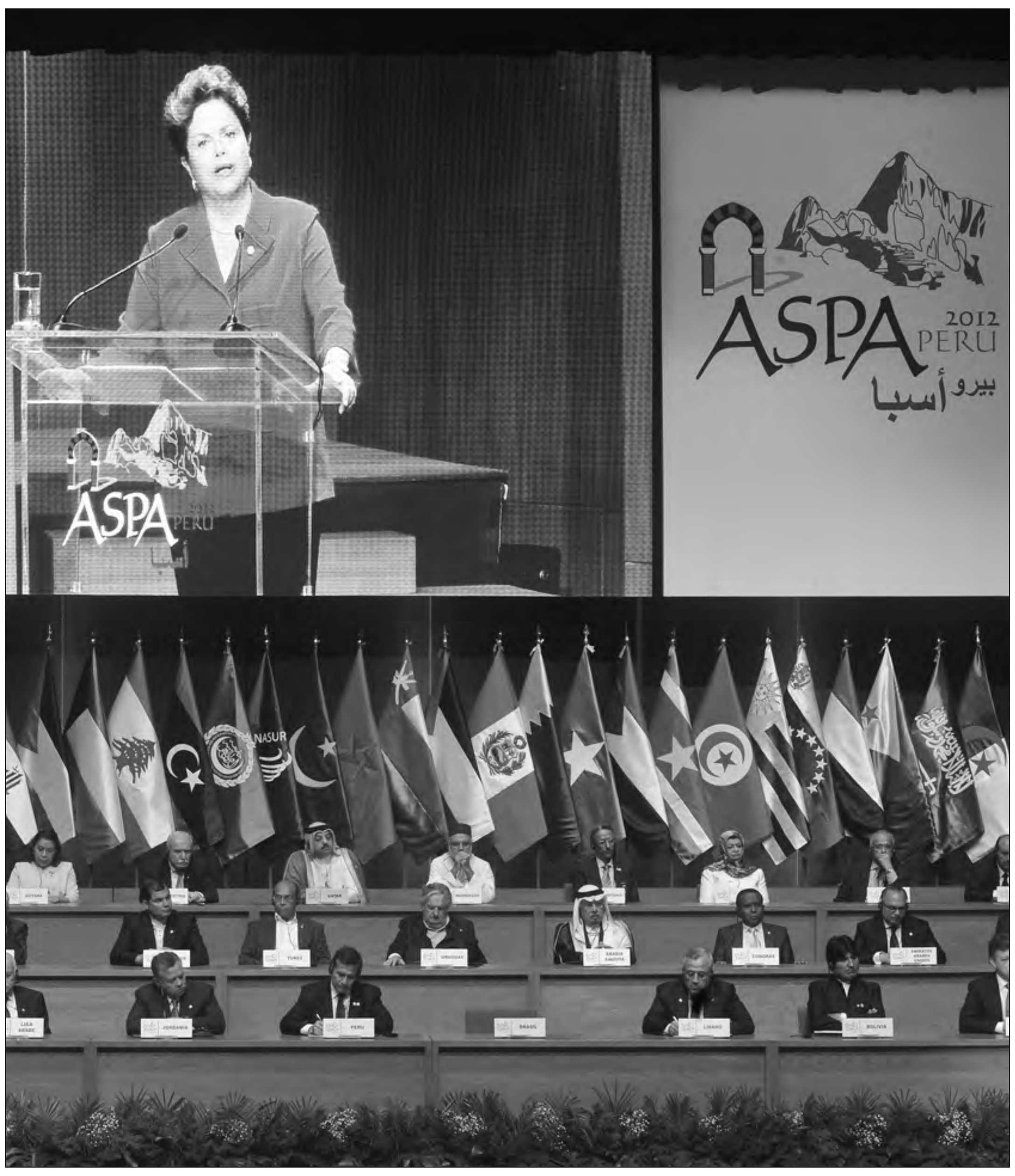
One outcome might be "a state dinner from Obama, which would lift Brazil into a small elite at very little cost to the US. That might be one way to satisfy Brazil without any policy change," says Mr Hakim.

A more ambitious possibility, he adds, is that Ms Rousseff, worried about the Brazilian economy's fading competitiveness and the stalled Mercosul trade pact, wants to boost US trade ties.

Mr Spektor believes there are good chances of meaningful change. Ms Rousseff is preparing for a re-election attempt while Mr Obama is on his last term and US businesses itch to get into Brazil's booming market.

Such conditions "could lead to US concessions, something that advances Brazil's drive for a Security Council seat", Mr Spektor says.

Mr Hakim is less sure. "My own view is closer to some pieces of paper to sign but it hard to see any real game changers."



Independent: Dilma Rousseff at a summit of South American-Arab Countries Getty

Embraer deal seals cordial relationship

Defence

Brazil may be about to return the favour with its own aircraft purchase, writes *Samantha Pearson*

It is not what many would expect to find buried deep in the peaceful and verdant countryside of São Paulo state in southeastern Brazil. A 5km-long tarmac runway juts out alongside fields of sugar cane, leading to Embraer's vast complex of blue and white warehouses.

Inside, rows of attack aircraft, many painted with sinister shark faces, are waiting for a few final touches before being flown to assist countries such as Angola on border patrol and counter-narcotics missions.

Embraer's assembly plant in Gavião Peixoto, where the group manufactures several jets and completes the production of its Super Tucano light attack aircraft, has long been at the forefront of Brazil's manufacturing industry.

However, as Embraer signs more contracts to supply air forces around the world, the manufacturing hub has also become a focal point for the country's foreign relations.

The turning point came in March this year when the US air force finally gave Embraer the go-ahead to supply 20 of its Super Tucano aircraft for counter-insurgency missions in Afghanistan. Embraer and its US partner Sierra Nevada were awarded a contract worth about $428m – the Brazilian company's first with the US air force.

The deal was not only taken as a "seal of quality" from the world's biggest defence spender, but also a sign of better relations with the US after a long and politically charged bidding process.

Embraer was first awarded the contract in January 2012, then valued at about $355m. However, a month later, the US air force suddenly cancelled the deal, saying it was not satisfied with the documentation.

US authorities had been facing immense pressure from the losing bidder, Hawker Beechcraft, which filed for bankruptcy three months later. The contract's cancellation, which came just before a visit by Brazil's president Dilma Rousseff to Washington, was seen as a big political blow.

Many in Brazil suspected the decision had been politically motivated, given that the bitter fight over the contract had gradually escalated into a public row over which programme would generate more jobs in the US. Embraer and Sierra Nevada responded by suing the US defence department in a federal court, and, in February, they were once again awarded the contract.

After a last-minute suspension of the contract following another challenge from Beechcraft, as the US aircraft maker was named after emerging from bankruptcy, the US air force finally authorised Embraer in March to go ahead with production.

The deal is relatively small for the US, which, despite its shrivelling defence budget, still accounts for more than 40 per cent of estimated global military expenditure.

For Embraer, it represents a vital foothold in the US market and one that could lead to further business in the US and elsewhere. "Even if the US air force doesn't exercise options for additional planes and service beyond the current award, the contract for the A-29 Super Tucano aircraft could be worth much more than the initial stated amount, particularly in light of service-related business," wrote Moody's in a recent note. "Having the US department of defence attached to a sizable order should boost the company's success rate on future contract bids with other international customers," the rating agency added.

The contract comes as Embraer is also developing the KC-390 military transport jet in co-operation with Boeing, a partnership that could provide further inroads to the US defence market.

"Embraer's defence and security business is about 16 per cent of total company sales but we expect it to rapidly become a more important component of consolidated revenue over the next couple of years," said Moody's.

After the happy ending for Embraer in the US, the time may soon come for the Brazilians to return the favour. Ms Rousseff has promised to make a decision this year on a long-awaited deal to overhaul Brazil's air force that is estimated to be worth at least $4bn, almost 10 times the size of the US air force deal. Boeing is bidding against France's Dassault Aviation and Sweden's Saab for the contract, under which the winner will provide more than 36 fighter jets.

> The company is also developing the KC-390 military transport jet with Boeing

Brazilian officials have indicated that Boeing is now in a better position to clinch the contract.

Last month, Boeing also announced plans to build a research centre in São José dos Campos in São Paulo – where Embraer is based – in what appeared to be yet another attempt to woo the Brazilian government.

Brazil has been putting off the decision for years now and budget constraints may prompt Ms Rousseff to delay the decision yet again until after next year's presidential elections.

A victory for Boeing in Brazil would certainly help further cement US-Brazil relations but, faced with an economic slowdown at home, Ms Rousseff may decide to keep the US waiting.

Logic of circular biofuel trade comes into question

Ethanol

Sales of commodity intended to reduce greenhouse gases have opposite effect, writes *Greg Meyer*

Despite having the world's biggest ethanol industry, the US imported 9.6m barrels of the biofuel from Brazil last year.

Brazil, the ethanol pioneer, imported 2m barrels from the US.

The circular trade shows how government policy still guides much of the ethanol market, despite strides towards commercialisation.

The US and Brazil, the giants of the market, together produce 87 per cent of the world's output, according to analysts FO Licht. The US product is largely distilled from corn, while Brazil makes ethanol from its sugar cane crop. For the engine of a car, the two vintages are virtually identical. Yet in the eyes of the law they are quite distinct.

This helps explain why the US and Brazil are shipping one another ethanol at great expense rather than simply using it at home.

Washington is weaning its domestic ethanol industry off subsidies. In 2011 a tax credit for ethanol blenders expired, as did a corresponding import tariff.

Nonetheless, the industry still has the support of a government mandate requiring domestic ethanol consumption to grow each year. The mandate is indirectly helping to drive imports from Brazil.

The mandate, known as the renewable fuel standard, is split between volumes for traditional corn-based ethanol and "advanced biofuels" whose production releases less greenhouse gas impacts than ploughing fields for grain.

Corn ethanol has the biggest share, but the advanced biofuel requirement is growing more rapidly.

US production of advanced biofuels has not matched government expectations.

To meet the mandate, fuel companies are allowed to import sugar cane ethanol, mainly from Brazil. The US Environmental Protection Agency estimates about 15.9m barrels of sugar ethanol imports will be needed this year.

"As the mandate grows, ethanol imports rise accordingly," say economists at the University of Missouri's food and agricultural policy research institute.

Another US policy encouraging Brazil to export ethanol is set by California. The state, known for standard-setting vehicular pollution controls, welcomes the use of sugar cane ethanol to satisfy its low carbon fuel standard programme.

In the reverse direction, US ethanol exports to Brazil are well below a peak of 9.4m barrels reached in 2011 when the South American country suffered poor sugar harvests.

The Brazilian ethanol industry has also been hurt by domestic government policies that have kept petrol prices artificially low to fight inflation.

Cane crop: market skewed

This year, Brasilia raised the required ethanol blending rate to 25 per cent from 20 per cent of motor fuel in a bid to help the domestic biofuel industry. But imports from the US are expected to continue nonetheless.

The US corn-based ethanol industry has more capacity than needed for a domestic fuel market where demand is weak and most fuel companies refuse to blend more than 10 per cent ethanol with petrol.

Brazilian imports arriving under the advanced biofuels mandate further add to supplies. So a portion of the relatively cheap, unwanted corn ethanol barrels flows back to Brazil.

The Energy Information Administration, in a note last year, called it a "complex environment" where blenders and ethanol producers "not only have to produce enough corn ethanol to meet the overall renewable fuels mandate, but . . . must also import significant volumes of sugar cane ethanol to meet the advanced biofuel mandate, all in the face of demand constraints".

The US and Brazilian ethanol industries are squaring off as regulators consider how to apportion this year's US ethanol mandate.

The Renewable Fuels Association, the main US corn-based ethanol lobby, argues that the EPA should lower the advanced biofuels mandate to insure against unreliable supplies from Brazil. Furthermore, tight corn stocks and slowing output suggest the US may not be able to export as much ethanol as in years past, the association says. The circular trade between the companies is "economically absurd", the RFA added.

Unica, the Brazilian sugar cane industry group, contends that the US should uphold its advanced biofuel targets, which would support ethanol imports from Brazil.

"The fact that there is two-way trade in ethanol between the US and Brazil demonstrates both the complexity and success of government intervention into fuel markets," Unica wrote to the EPA in April.

There is nonetheless an irony in the fact that biofuels promoted to reduce greenhouse gases are being ferried between the US and Brazil in ships belching petroleum exhaust.

As the EPA comments: "This two-way trade of ethanol engenders additional transport-related emissions."

Institutions poised to capitalise on an expanding middle class

Education

Amy Stillman reports on rising demand for skills such as engineering and technology

Along the six-lane highway that runs through Rio's vast southwestern district of Barra da Tijuca, it is easy to spot the influence of Latin America's wealthy northern neighbour.

US restaurant chains such as Outback Steakhouse and shopping centres including a New York City-themed mall surround the aptly named Avenida das Américas motorway. The artery, located in the newest area of the city, is an indication of the affinity between two nations that have similarly large, consumer-orientated populations.

Capitalising on this, US education institutions that face declining growth at home are increasingly looking to Brazil.

Not only are more Brazilians studying in the US, but also US for-profit education companies such as DeVry, Whitney International and Laureate International have acquired assets in Brazil and are seeking to expand. US private equity funds are also eyeing education opportunities.

Such groups aim to take advantage of the expansion of Brazil's middle class, which has led to a surge in demand for higher education.

Kroton, Brazil's biggest listed education group, saw a fivefold increase in net profit last year, while Anhanguera, its closest rival, more than tripled its 2012 net profit over the previous year.

Last month, the two companies agreed to merge, creating the world's largest for-profit education group by market capitalisation.

Growth in higher education is partly driven by the fact it is starting from a low base. In 2009, just a quarter of Brazilians aged 18-24 were enrolled in post-secondary education, compared with 86 per cent in the US and 69 per cent in neighbouring Argentina. The government has aggressively sought to boost enrolment and plans to invest R$24bn ($11.9bn) in education by 2014. One example is the Science without Borders scholarship programme.

The R$3bn scheme plans to send more than 100,000 Brazilians to top universities abroad. Scholarship students will study subject areas in which there is a shortage of skilled labour, such as engineering and technology.

Fies, a government-funded student loan plan launched in 1999 has been extended to include vocational courses and students with poor credit ratings. A bill in Congress could see Fies applied to distance learning courses.

While Fies has reached just a handful of students so far, investors expect the programme to provide an important boost for the private education market.

"Fies is likely to drive growth in the sector for the next five to 10 years," says one international private equity fund manager with education investments in Brazil. The manager says such expectations are pushing up the value of listed education companies and could lead several private operators such as Ser Educacional, Anima Educação and Grupo Multi Educação that have "scale and good growth prospects" to soon launch initial public offerings. Cruzeiro do Sul, the São Paulo-based university, will also list in the next 18 months, says Patrick Ledoux, a partner at Actis, the UK private equity firm, that has a minority stake in the university.

The hand of US private equity funds and asset managers lie behind many of such growth stories. Kroton is 10.2 per cent owned by Advent International and 5.48 per cent of Anhanguera belongs to BlackRock.

> A $1.5bn scheme could send more than 100,000 Brazilians to top universities abroad

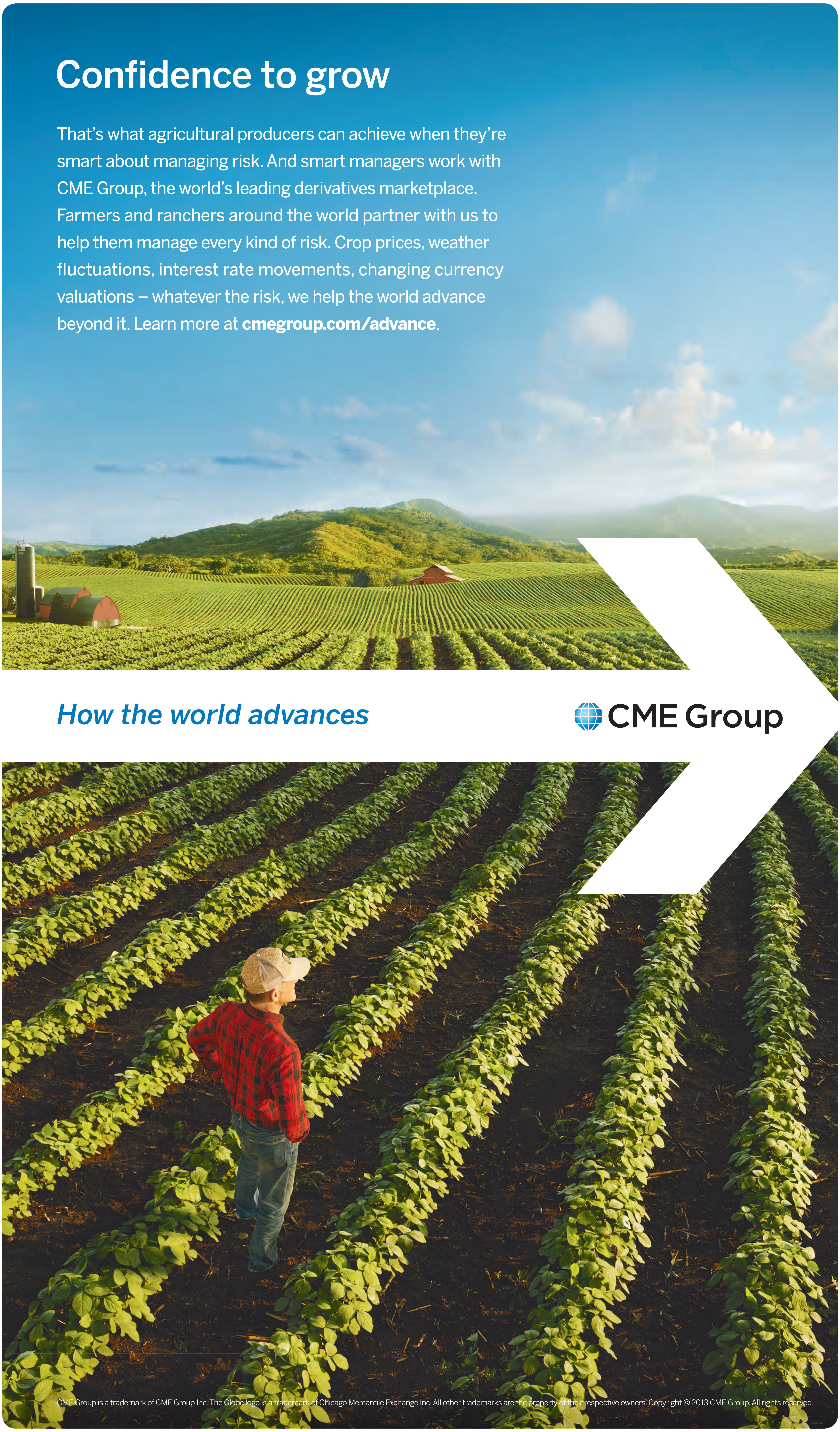
Capital Group has invested in Ibmec, the Rio-based business school, helping it develop a niche in the for-profit education sector by targeting wealthy Brazilians who have traditionally opted to study abroad.

Two new Ibmec campuses will be modelled on Stanford University and the Massachusetts Institute of Technology.

Cartesian, another US private equity group, owns a minority stake in Ser Educacional, which has focused on Brazil's under-developed but fast-growing north and northeast regions. Janyo Diniz, Ser's chief executive, says the company expects to have 25 per cent more students in 2013.

Arizona-based Apollo Group has had similar ambitions. In 2008, it offered R$230m to buy University Paulista (Unip) in order to expand its distance learning system in Brazil. The bid was rejected by Unip's founder João Carlos Di Genio because it was considered too low. However, Mr Di Genio says talks with Apollo have continued as the Brazilian group has expanded its distance learning programme.

Meanwhile, Pearson, owner of the FT, paid $500m for the learning systems division of Brazilian company Sistema Educacional Brasileiro in 2010.


Confidence to grow
That's what agricultural producers can achieve when they're smart about managing risk. And smart managers work with CME Group, the world's leading derivatives marketplace. Farmers and ranchers around the world partner with us to help them manage every kind of risk. Crop prices, weather fluctuations, interest rate movements, changing currency valuations – whatever the risk, we help the world advance beyond it. Learn more at cmegroup.com/advance.
How the world advances
CME Group
CME Group is a trademark of CME Group Inc. The Globe logo is a trademark of Chicago Mercantile Exchange Inc. All other trademarks are the property of their respective owners. Copyright © 2013 CME Group. All rights reserved.