Private capital gives Brazil much-needed energy boostBy Jonathan Wheatley

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Investors are bullish on the prospects for economic growth in Brazil this year. The latest market consensus is that gross domestic product will expand by more than 4.5 per cent, well in excess of the government's target at the start of the year of 3.5 per cent.

But there is mounting concern that the country's creaking infrastructure will not stand the pace. This month the ONS, a joint industry and government body that oversees the electricity sector, warned that the country faces power shortages by 2008. The last time electricity ran short was in 2000/2001. Then, too, the economy was growing at more than 4.5 per cent a year. Power rationing put a stop to that and annual growth has averaged just 1 per cent since.

Tendências, a consultancy in São Paulo, says the electricity sector needs investments of R$20bn ($7bn) a year for the next 10 years to keep pace with demand. The government is expected to put up a third. Many international energy groups that regret investing heavily in Brazil in the late 1990s face even bigger problems in their home markets. They are unlikely to provide the rest.

The conclusion might be that the lights will start going out soon. But there is a glimmer of hope.

One cause for optimism is the interest being shown in the sector by pension funds. They are just the kind of institution, with their long-term commitments and corresponding need for long-term assets, that should be expected to invest in the sector. Traditionally, though, they have been happy to sit on high yielding, short-term government debt.

This is starting to change. The central bank's base rate fell from 26.5 per cent at the beginning of last year to 16 per cent by the second quarter of this year, though a spike in consumer price inflation sent it back up to 16.75 per cent over the past

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month. Lower yielding government debt, and a bigger than expected increase in the wholesale price indexes to which many funds' actuarial targets are linked, has made it hard for many to reach those targets this year.

Guilherme Lacerda, president of Funcef, the pension fund for employees of government savings bank Caixa Econômica Federal, says any difficulties are strictly short-term and that government debt is still a safe investment. Funcef has R$17bn under management, of which about two-thirds is in government bonds with average maturities of less than four years. His faith in such debt notwithstanding, Mr Lacerda says the fund is working hard to extend the life of its assets.

Funcef, indeed, has led the way in investing in longer-term public debt. This month it bought R$200m of a R$210m issue of government debt maturing in 2045, paying consumer inflation plus 9.1 percentage points a year.

Now it is preparing to find new money for electricity. Funcef will provide up to 25 per cent of a fund to be launched in coming weeks by the BNDES, the government development bank, to raise at least R$600m for investment in oil-fired power stations to produce 3,000 megawatts of electricity. In a similar vein, it is forming a special purpose company with other pension funds to buy oil exploration equipment for leasing to Petrobras, the government-controlled oil group. The company will have capital of about R$180m.

Other bits of Brazil's infrastructure need money, too. Transport is one. There will be shortfall of 20m tons in the system's capacity to take cargos to ports in southern Brazil this year, according to grain exporters. The trade ministry says capacity must be built to transport an additional 200m tons by 2007.

One potential source is a new fund to be launched soon by the Inter-American Development Bank. Called the Brazil Infrastructure Investment Fund, it aims to raise R$1.5bn, of which the bank will provide a US$75m senior loan. The bank hopes to attract some of the huge liquidity available at Brazilian pension funds, allowing them to diversify their portfolios while still meeting actuarial targets.

Other investors are joining in. GP Investimentos, a São Paulo investment company specialising in private equity, has launched a $200m infrastructure fund to raise money outside Brazil. This is the company's third private equity fund, but the first time it has raised this type of capital since 1997. Brazil's improving economic outlook has reawakened investor interest.

Such initiatives will not be enough on their own. The government hopes more money will be raised through forthcoming legislation on joint public and private sector partnerships (PPPs). But the potential for PPPs remains unclear. One problem is the regulatory environment. Investors went into Brazil's electricity sector in the 1990s before regulations were fully in place. Although much has been done since, there are still large grey areas, including the way in which tariffs are to be adjusted. Tariff structures in telecommunications, for example, have been challenged in court, leaving many investors wary of the powers of Brazil's unpredictable judiciary.

Investors are also concerned about the government's intentions. While liberal-minded technocrats at the central bank and finance ministry have pushed through market friendly reforms, some investors fear that ideologues close to president Luiz Incio Lula da Silva, of the formerly firebrand leftwing Workers Party, remain suspicious of private initiative.

While legislation on PPPs will be welcomed, they say, the government has failed to use existing powers to put more public services, including transport, out to private concessions.

But necessity is known to be the mother of invention. Few doubt the need for more private capital in Brazilian infrastructure.

It is starting to find a way through.

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