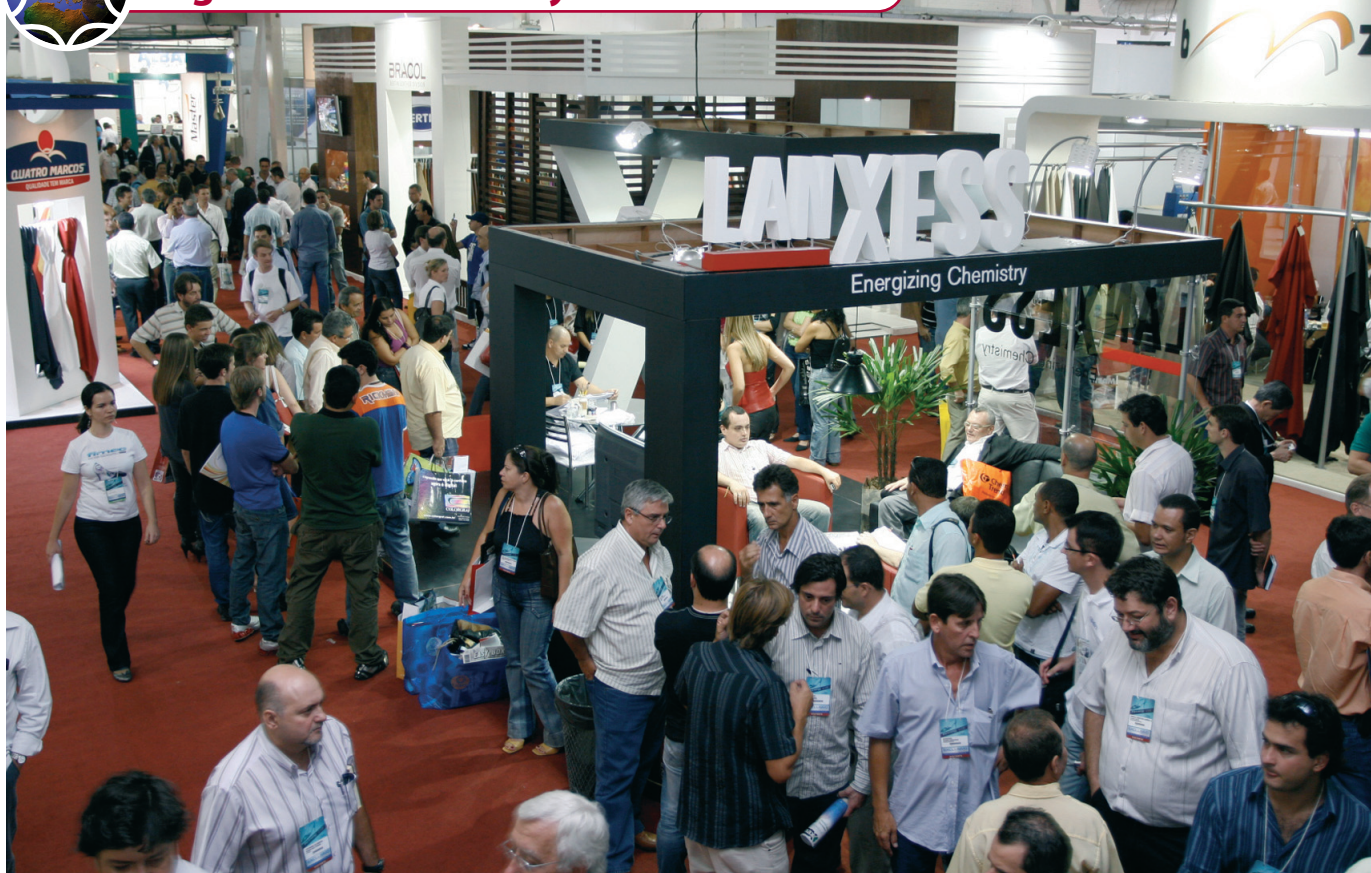




Regional Commentary: South America



Brazil's leather industry faces big challenges, but there was lots of enthusiasm at the Fimec exhibition in Novo Hamburgo in April.

CREDIT: FENAC.

Value proposition

If the South American leather industry were football, Brazil would be, well, Brazil.

A bit like the national football team—which in spite of breathtaking resources, including Ronaldinho, Kaká and Gilberto Silva, failed to reach the most recent FIFA World Cup Final—the leather sector in the region's largest economy has enjoyed easier times than it is experiencing at the moment.

The footwear industry there is still battling to come to terms with competition from lower-cost economies and has lost 40,000 jobs in a year with the traditional heartland of Rio Grande do Sul suffering especially heavily. As we shall see further on, it's a battle the Brazilians believe they are winning, but the struggle is real nonetheless.

The turmoil on currency markets and in the North American economy have made life even more difficult, while on the raw materials side, a downturn in beef consumption and consolidation in the packer arena, followed by a ban on Brazilian beef exports imposed by the

European Union at the start of this year have been the main causes of a sector-wide headache.

How then do we account for the optimistic mood and buoyancy at the 2008 edition of the FIMEC exhibition in Novo Hamburgo, where the main industry associations said visitor numbers and quality exceeded all expectations?

Higher earnings

There may be a clue in a set of industry statistics for 2007, passed to World Leather at FIMEC by the Association of Tanning Industries of Rio Grande do Sul (AICSUL).

The big story to emerge from the report, which gives a breakdown of hide exports from Brazil month by month for 2007, is that volume may be down—32.9 million hides in 2007 compared to 34.6 million the year before (a drop of 5%)—but the value of those exports has surged.

This means Brazilian tanneries are taking hides further down the path towards finished leather, boosting the whole local industry in the process by using machinery

and consuming chemicals, and earning more money for their work.

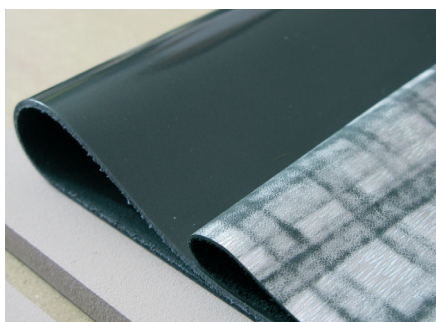
Talk to leather professionals anywhere in the world today and they will all stress the importance of moving up the value chain in this way. High-volume, low-priced product is hard to make a decent living from because the old saying that if you win business on price alone you can just as easily lose it on price alone holds as true in this sector as in any other.

In Brazil's case, those 32.8 million hides exported in 2007 brought in more than \$2.1 billion compared to \$1.8 billion the year before. The 5% drop in volume resulted in a revenue increase of almost 20%.

No export market characterises this situation more clearly than Italy. Tanners there bought in 13% fewer Brazilian hides in 2007 than they did the year before. Nevertheless, exports to Italy were worth \$625.7 million to the Brazilian leather sector last year, an increase on the previous year of 24%.

China overtook Italy in volume last year. Its total was 145 million kilos, compared to

Regional Commentary: South America



Brazilian tanners took advantage of funding to show off their finished leathers at the most recent edition of Le Cuir À Paris.

the 110 million that shipped to Italy. And while Chinese tanners paid less for the leather they imported (\$490 million) this still represented a healthy increase (29%) on the previous year's figures.

The United States imported considerably less Brazilian leather than Hong Kong (15 million kilos as opposed to 48.3 million heading to the Asian destination), but paid slightly more (\$239.6 million compared to \$237.7 million).

Apart from these main markets, there was interesting growth among some of the world's new centres of manufacturing. Most of these countries started with a small base of Brazilian leather imports, but nonetheless, figures of nearly 5,000% growth in volume and 10,000% in value for the Czech Republic are impressive. The Philippines, Lithuania, Sri Lanka and Romania are others that have registered multi-digit growth.

Wet blue drops

We reported at this time last year that wet blue hides from Brazil were in great demand, particularly among tanners in China. Commentators said that Brazilian packers and traders were happy to compromise on price because of the quick payment terms on offer.

In fact, the new AICSUL report confirms that wet blue exports rose in January and February 2007, but they went down each month after that. By December, wet blue exports were 40% down on the same month in 2006. Brazilian traders and

packers exported 1.6 million wet blue hides in the last month of 2006; a year later this was down to 981,760.

The total for 2007 was 15.3 million wet blue hides exported, compared to 17.8 million the year before. That means that, while 51.4% of Brazil's exported hides left the country at wet blue stage in 2006, this figure fell to 46.5% last year.

It's hard to know for certain if this is a genuine trend or a mere blip. However, if you look at the proportion of revenue that wet blue hides brought in, there are grounds for hoping that Brazilian tanners are going to maintain the higher level of involvement they had last year.

In 2006, wet blue exports earned Brazil \$639.6 million, which represented 35.5% of all hide export revenues. The 2007 figures are interesting in that, once again, a lower volume of wet blue hides earned a larger amount of money, \$702.2 million. But the proportion of total hide export revenues was lower, 32.4%.

At the crust stage, 4.9 million hides left Brazil's ports and border crossings for overseas markets last year, compared to 4.1 million the year before. Crust exports earned \$381.3 million in 2007, but only \$247.4 million in 2006.

Last year, then, exports of semi-finished hides rose by 19.5% in volume. The increase in revenue from these hides, though, was much greater, 54.1%.

The big finish

If we move on to look at finished hides,

the picture becomes even clearer.

Curiously, six out of the 12 months of 2007 registered a lower volume of finished hide exports from Brazil. But only one month, September, showed a drop in value.

Some of the increases are staggering. Volume of finished hides was up by 69% in January 2007 compared to a year earlier, earning revenues that were 84% up. An 11% dip in volume in July produced a 24% increase in value.

In total, Brazil exported 12.5 million finished hides last year, 2% more than in 2006. In terms of value, however, the increase was 18% overall, from \$920 million to \$1.08 billion.

One final statistical point of note is that while finished hides accounted for only 37.9% of the total volume of hides exported, 51.4% of the money this sector brought in in export revenue was thanks to finished hides.

With space on container ships becoming harder and more expensive to find, there is another advantage in moving up the value chain to finished hides: they weigh less. The average finished bovine hide weighs 5.5 kilos, whereas a medium-sized wet blue hide can easily weigh three times as much.

Aside from being where the money is, taking hides to the finished leather stage is allowing talented Brazilian tanners to express their flare and love for a natural material they've been working with for generations. 🌐



Reflections on South America's shoe situation

It's clear from the most recent set of statistics we have seen—published by Serma in Argentina earlier this year—that in South America Brazil dominates the footwear space too.

Exports of footwear from Brazil to all of its trading partners in the region are on the rise. In the case of Venezuela, the volume of pairs exported went down in the course of the three years we have looked at, 2004–2006, but the value of Brazil's footwear exports to its neighbour to the north went up by 157%.

This is an indication that good quality leather shoes manufactured by Brazilian footwear producers and designed by Brazilian footwear stylists are making an impact on the international market.

This is true beyond the context of Latin America. The top ten markets for Brazil in the region accounted for \$331 million in footwear exports in 2006, but this represents only 17.4% of Brazil's global total for the year.

This worldwide total, \$1.9 billion, held steady in 2006 compared to the previous year. It is healthy (although China's footwear exports for the same year of \$21 billion dwarf the figure) and augers well for the value proposition of the industry there, even if volumes diminish.

The Chinese market holds plenty of attraction for South American footwear producers. Shoe imports into the Asian country went from \$157 million in 2004 to \$215 million the following year and \$279 in 2006. The industry in South America has watched while Italy and Spain make the biggest inroads into this attractive new market, confirming the point that high-fashion, high-value shoes are the ones they must try to sell to Chinese distributors, retailers and consumers.

Growing importance

Returning to the internal South American market, Argentina is Brazil's biggest customer, with Venezuela in second place.

Serma's Argentinian commentators believe that Brazil's footwear industry went

through “a strong transformation and change of strategy” between 2004 and 2006 and only really began to recover in 2007. For this reason, they conclude that its importance in the internal South American market can only increase.

Importance as an exporter, that is. The regional market's largest player really has no tradition at all of importing footwear from its neighbours.

Footwear imports into the Brazilian market have increased, much to the chagrin of local producers. Imported shoes increased in value from \$137 million in 2004, to \$173 million in 2005 and \$229 million in 2006. No South American country achieved more than Argentina's

\$800,000 share of that total, with the vast majority of imported shoes coming from Asia to meet demand at the lower end of the market.

Across the mountains

If Argentinian footwear manufacturers are finding it hard to make an impression in Brazil, the market across the Andes in Chile—the region's most developed economy—is much more rewarding for them.

Chile has offered them export growth of 68% over the three-year period under scrutiny. Volumes of exports to Uruguay, while lower overall have increased even more, with a figure of 120%.

The government in Argentina has been active in supporting attempts by the industry there to make market access for Asian producers difficult. In the years ahead, this may make a difference, but there can be no doubt that cheaper shoes from across the Pacific made their way into Argentinian shops in increasing volumes in the middle part of this decade.

In 2004, Brazil's \$106 million worth of the import market in Argentina represented a 77.3% share of the total. By 2006, the \$138 million worth of shoes that Argentina had imported from its neighbour represented a share of 60.2%.

Imports from Uruguay were only \$1.3 million and those from Chile were worth a mere \$300,000, so it's fair to say Brazil was losing market share to non South American sources.

Government action

As mentioned above, this development led to action by the Argentinian government to keep cheap imports from flooding the market; it increased the tariffs on shoes from China in the course of 2007. The Brazilian government took similar steps, following a directive from the region's common market organisation, Mercosur.

At that point, the head of the Chamber of the Uruguayan Footwear Industry, Daniel Tournier, issued a hard-hitting statement saying that Uruguay had to take



The best of South American footwear design on show at GDS, March, 2008.

CREDIT: MESSE DÜSSELDORF.



Regional Commentary: South America

Footwear exports—Argentina (\$m)

	2004	2005	2006
Chile	7.4	10.8	12.5
Uruguay	1.7	3.1	3.8
Brazil	0.4	0.6	1.0
Total (global)	16	23	26

Footwear exports—Colombia (\$m)

	2004	2005	2006
Venezuela	7	17	27
Ecuador	6	8	9
Mexico	5	5	4
Total (global)	33	49	58

Source, Serma, Argentina, February-March 2008

Footwear exports—Brazil (\$m)

	2004	2005	2006
Argentina	104	113	125
Mexico	69	58	44
Venezuela	14	21	36
Chile	34	33	34
Paraguay	17	18	22
Total (global)	1800	1900	1900

Footwear exports—Chile (\$m)

	2004	2005	2006
Mexico	1	1	2
Peru	1	2	2
Ecuador	0.4	0.7	0.9
Total (global)	5	6	7

similar measures or risk losing its footwear production industry altogether.

Several Brazilian states, he claimed, were already making attractive incentives available for Uruguayan producers to move their factories north. They wanted the jobs and the economic activity that the footwear firms could offer, even if Uruguay did not.

Mr Tournier explains: "I made those comments because the whole of Mercosur had announced a tariff of 35% on these imports. The Brazilian government ratified

the change that same week and Argentina already had the 35% tariff in place. Our government waited until the very last day possible to ratify it."

By that time, another rule had come out stating that five different kinds of footwear (one synthetic, the other four made of leather) were to carry lower tariffs, 30% for the shoes made from synthetic material and 25% for the leather ones.

The 25% tariff was something Uruguay had agreed to at the Marrakech round of trade talks in 1994. Mr Tournier's

organisation wrote to the government in Montevideo at the end of November last year to suggest that it revoke the lower-tariffs rule and stick to Mercosur's 35% as Brazil and Argentina are doing, but at the time of talking to us in April, no response had come.

Common market comparisons

He feels it's hard to talk about a Mercosur policy on footwear because there is no comparison between the industry in his country, for example, and that of Brazil.

"Brazil still has its internal market," he points out. "Its population is 170 million and it imported around 20 million pairs of shoes last year. On top of that, its exports are on a big scale too. Argentina's population is 35 million and it has achieved a record-breaking level of production for its domestic market (80 million pairs in 2007). And then you have Uruguay, with a population of 3.4 million and footwear imports of 13 million pairs last year. What's more, for the first three months of this year, imports are up by a further 33%."

He blames the fall in value of the US dollar, which suddenly makes home-produced footwear look expensive. The price-gap between imported and domestically produced shoes is certainly becoming wider and the situation, Daniel Tournier fears, is unlikely to improve in the near future. "What can we do?" he says. "Raw material costs are going up, we face salary increases every six months and, from last July, a corporate tax of 7.5%."

This might be enough to tempt some producers to think seriously about those offers to relocate to Brazil, except, Mr Tournier says, that in this regard "things have gone a bit cooler" on the Brazilian side of the border.

Brazil's benefits

Perhaps only the government and Mercosur can help the footwear sector in Uruguay now. But, as if to emphasise the point about the difficulties in comparing the footwear industry in one Mercosur member country with that of another, Enio Klein—for years the international face and voice of Brazil's main industry association, Abicalçados—believes that his member companies benefit more from keeping their distance from the corridors of power.

"It's a long way from Novo Hamburgo to Brasilia," he says, "so we're not really acquainted with macroeconomic policies."

His feeling is that Brazil's footwear-

Footwear imports—Argentina (\$m)

	2004	2005	2006
Source			
Brazil	106	120	138
Uruguay	1	1.5	1.3
Chile	0.2	0.2	0.3
Total (all sources)	137	173	229

Footwear imports—Colombia (\$m)

	2004	2005	2006
Source			
Ecuador	10	18	22
Brazil	9	13	17
Peru	0.2	1	4
Total (all sources)	98	137	174

Source, Serma, Argentina, February-March 2008.0

Footwear imports—Brazil (\$m)

	2004	2005	2006
Source			
Argentina	0.2	0.4	0.8
Mexico	0	0.1	0
Chile	0	0	0.1
Uruguay	0.1	0	0.1
Total (all sources)	65	115	140

Footwear imports—Chile (\$m)

	2004	2005	2006
Source			
Brazil	38	36	37
Argentina	8	11	13
Peru	0.6	1.7	1
Total (all sources)	255	301	368

Regional Commentary: South America



producing neighbours have always been “a little afraid” of the country’s strength. “But we have spent 50 years building up our infrastructure,” he points out, “and we have the ability here to make one type of shoe and change the pattern really quickly to make something completely different. It means we have a huge range of shoes to show our customers. That’s what makes the difference and that’s why we are in a better position to sell to the other countries in South America than they are to sell to us.”

He thinks Argentina should do a better job of developing genuine winter collections as it’s a country that tends to have much colder weather than Brazil. Winter shoes (including men’s shoes) and boots would go down well in Brazil, even if cold winters are rare. Mr Klein makes the point that he’s more concerned about fashion than the weather.

Chile, with its free-market economy, ought to be of interest to high-end footwear manufacturers everywhere, but Enio Klein explains that importers have to



CREDIT: MESSE DÜSSELDORF.

pay duty of 5% or 6% on shoes produced in Brazil, while those from China can enter the country duty free. Chile has a free trade agreement with China and has held back from becoming a full member of Mercosur.

It sounds amazing, but he argues that even the logistics favour China when it comes to competing for shelf-space in Chile’s shoe shops.

“The logistics are more straightforward for China,” he says, “even though it’s much further away. The shoes come on a container ship all the way across the Pacific Ocean and straight into port. Ours have to spend days on a truck, cross into Argentina, get through the mountains and then cross the border again on the Chilean side.”

It’s in this that he believes Mercosur could possibly make a difference. “We need better infrastructure,” he says. “We need roads and ports and we need to be sure the dockers at the ports are not going to go on strike. We need the logistics to work.”

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