

POLICY MONITOR

September 24 – 28, 2012

THE WEEK IN REVIEW

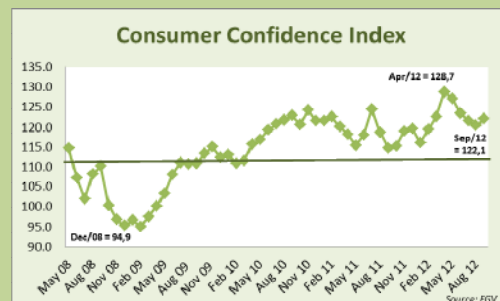
On the economic front:

- **GDP/Inflation:** Central Bank [raised the inflation forecast to 5.2%](#) and reduced GDP growth to 1.6%, a number closer to market expectations. This increases the pressure on growth expectations for 2013.
- **Bank Taxes:** Banks cut credit card interest rates, following pressure from Rousseff.
- **Investment:** [Central Bank raised FDI forecast to US\\$60 billion and reduced the 2012 current account estimate to US\\$53 billion.](#) FDI attraction will probably continue to be strong with recently announced concessions to private companies and major sporting events.
- **Local Content:** Similar to previous measures, Rousseff is expected to announce a new package for the auto sector that includes, among other requirements, 70% use of local content.
- **Cotton Case:** In Geneva, Brazil and the U.S. agreed to continue the cotton dispute agreement after the expiration of the Farm Bill. Brazil will temporarily not retaliate.
- **ICMS Tax:** Espírito Santo is questioning in the Supreme Court the constitutionality of Resolution 13, aimed at ending the state fiscal incentives war over imports. This week, Confaz, the body made up of financial officials, decided not to request the postponement of its implementation.
- **Mercosur-EU:** President Rousseff and the president of the European Commission, José Manuel Barroso, decided to re-launch (they had already been re-launched in 2010) negotiations for a Mercosur-EU free trade zone (see below).
- **Consumer Confidence:** FGV's Index goes up, indicating improvement in the current and future perceptions of the general economy.

- **Transfer Pricing:** New transfer pricing rules will be implemented in January for import and export operations between Brazilian multinationals and affiliates abroad.

On the political front:

- **Forest Code:** Approved by the Senate, awaiting Rousseff's sanction or veto.
- **Mayoral Race:** According to a Datafolha survey there are more conservative than liberal voters in São Paulo. These conservatives tend to favor frontrunner Celso Russomano (PRB). In the meantime, Fernando Haddad (PT) gained ground in polls and is technically tied with former mayor, José Serra (PSDB).
- **Rousseff's Popularity:** Latest poll shows an increase, to 62%, of Brazilians who consider her administration "great," and a 77% approval rate. Brazilians are pleased with her government and don't seem to associate her with the Mensalão (vote-buying scheme).
- **Strikes:** Bankers returned to work after accepting a 7.5% wage increase.



Below, key policies that were tracked by PATRI during the week.

U.S.-Brazil Relation / Rousseff in NY

UN General Assembly

Overview

At the opening [speech of the UN's 67th General Assembly](#), President Rousseff praised Brazil's progress, defended the balance between austerity and growth, criticized rich nations' monetary policy, disapproved of the U.S. embargo on Cuba, and condemned the violence in Syria. She also repudiated the discriminations against Islam, called for institutional reform of the IMF (International Monetary Fund) and the UN Security Council, and reaffirmed that the integration and insertion of Latin America into the global sphere will be through Mercosur and Unasur. Besides a meeting with president of the European Commission, José Manuel Barroso, Rousseff also had an informal meeting with President Obama. Below are some excerpts from this year's speech and major differences from 2011:

Protectionism:

- "Protectionism and all forms of trade manipulation should be tackled insofar as they provide greater competitiveness in an illegitimate, spurious and fraudulent fashion."
- **2011:** Although she talked about protectionism in 2011, this year it was the focal point.

Brazil:

- "My country has done its part. In recent years, we have maintained prudent economic policies, accumulated significant foreign reserves, heavily reduced government borrowing and, through innovative social policies, we removed 40 million Brazilians from poverty, consolidating a broad market of mass consumption."

Economic Crisis / Currency War:

- "Orthodox fiscal policies are exacerbating the recession in developed economies with consequences in emerging countries."
- "Developed countries have continually made use of expansionary monetary policies, which introduces an element of imbalance in foreign exchange rates."
- "Monetary policy cannot be the only answer to solve growing unemployment."
- **2011:** Last year, Rousseff had a stronger stance against leaders of developed countries and the currency war was the main theme of her speech. This year she didn't request control mechanisms against the currency war.

Syria

- "There is no military solution to the Syrian crisis. Diplomacy and dialogue are not just our best option: they are the only option."
- **2011:** Last year, focus was on the Arab Spring, whereas this year it was on Syria.

For President Rousseff's full speech (in Portuguese), click [here](#). For the video, click [here](#).

During a press conference in New York this week, she also highlighted the following points:

Local Content:

- "Our local content policy is a national policy that does not necessarily demand that a part of the factory be in Brazil ... Brazil is a country that wants two things: part of the production and a piece of the technology and technological research as well. This does not mean that the rest of the production chain cannot be distributed in other countries. We are aware that what drives an economy is that ability to have that flexibility. But we have a strong stance on having national components, technology and knowledge."

UN Security Council:

- "I do not see significant signs of progress. But, we cannot lose our hope, right? I believe in a multipolar world ... this progress in the Council will reflect a change in reality too."
- **2011:** Whereas this year Rousseff urged reform of the UN Security Council, last year she also argued for a permanent seat in a reformed UNSC for Brazil.

Turkey & Iran:

- When asked if she had talked about Iran with the Turkish Prime Minister, Recep Tayyip Erdogan, the President responded that she hadn't. It had been reported by the media that Brazil and Turkey could be discussing another mediation plan with Iran.

Energy & Environment

Forest Code

Overview

The Senate approved the Provisional Measure ([MP](#)) 571/12, amending the New Forest Code (Law [12.651/12](#)). They passed it as a [Conversion Bill \(PLV\) 21/12](#), according to an agreement by the joint committee. The text was adopted without amendments by the House or Senate.

Due to the changes made by Congress, MP 571/12, now PLV 21/12, includes the following provisions, among others:

- Requires that cleared areas bordering rivers wider than 10 meters be replanted with 15 meters on each bank (APP - Permanent Preservation Areas). Before, the MP required that the replanted areas be of 20 meters.
- Allows the conversion of new areas for alternative uses when the APPs added to other forests and native vegetation that exist on the property exceed:
 - 80% of the rural property that is located in forest areas in the *Legal Amazon*.
 - 50% of any other rural property.
- Fixes at 15 meters the minimum mandatory radius for restoration in cases of APP near water springs, independent of the size of the property.

Next Steps

The bill has to be sanctioned by the President. Rousseff had previously vetoed 12 items. One of the rejected items was the reduction of preservation areas that farmers had to maintain. The signed decree withdrew fines for illegal deforestation for farmers that agreed to replant a portion of the area.

Trade Facilitation

Mercosur-EU

Overview

MDIC (Ministry of Development, Investment and Foreign Trade) opened a [Public Consultation](#) until November 26th to receive comments on the negotiations on a Free Trade Agreement between Mercosur and the European Union. Comments should be e-mailed to mercotel.ue@mdic.gov.br. A similar public consultation was conducted in 2010.

Tax & Investment

World Cup – Customs Clearance

Overview

The Ministry of Finance published [annexes, which provide for the custom clearance](#) of goods from abroad that are going to be used in the Fifa 2013 Confederations Cup and 2014 World Cup, established under [Law 12.350/10](#).

Extra

Federal Revenues

Overview

Federal revenues totaled BRL\$ 77.1 billion (US\$ 38.55 billion) in August, representing a real decline of 1.84% over the August last year. Despite the negative result, it is a better result than observed in the last two months (when there was a decrease of 7.36% in July and 6.55% in June, compared to the same month of the previous year), which may indicate an early economic recovery.

Despite the increase in sales of goods and services (10.20%) and payroll (10.13%), tax collection in August continued to be negatively influenced by the drop in industrial production (- 2.87%) and reduction in dollar value of imports (- 5.49%).

The last two results in federal collection demonstrate the impact of the economic slowdown on government revenues. Tax breaks given by the government since last year also impacted the July results. Given this scenario, the IRS (*Receita Federal*) revised its estimate of revenue for the year to between 1.5% and 2%. Last month, the forecast was more optimistic: between 3.5% and 4%.

THE PULSE

BRAZIL'S NEW MIDDLE CLASS: AN AGENT OF CHANGE?


Brazil has been undergoing in the last decade structural socioeconomic changes, which have brought opportunities and challenges for consumer industries, services providers and policymakers. According to SAE (Presidency's Secretariat of Strategic Affairs), **the mix of economic growth and income distribution has brought 35 million Brazilians into the middle class, which now accounts for 100 million people, over 50% of the population.** This *new middle class* has been characterized by formal jobs, greater access to higher education and, especially, stronger purchasing power. Of every BRL\$ 100 (US\$ 50) spent, 40% comes from the middle class.

SAE launched last week the project "Voices of the Middle Class" to better define the middle class, understand its needs, and establish ways to maintain and improve social mobility. Based on the concept of social vulnerability, the study aims to improve the quality and appropriateness of public policies. This government initiative might help better define the middle class, which is still unclear to most.

"The middle class is not only a motor of consumption and domestic demand. Their social role is equally as important," explains Mario Pezzini, OECD Development Centre Director. The middle class is believed to support democracy and influence economic development through a more active participation in the political process. Nonetheless, it is still uncertain how far their role as opinion makers goes. In Brazil, where voting is mandatory, this *new middle class* is noticeably changing the political process, but more as consumers than as citizen-voters. It is still unclear what changes this middle class brings, but it is certain that higher average income has allowed increased access to goods and services, such as health insurance, tourism, education, private pension plans, and information and communication technologies. This leads to an increased pressure on product quality and service efficiency, and it could be an **opportunity for companies that more quickly adjust their strategies to capture this new group of empowered consumers.**

Brazil's Middle Class
Great Opportunities Through Social Mobility

104 million are now part of the middle class, which accounts for 53% of the population. BRL\$ 291 to BRL\$ 1,019 is the monthly per capita income of a middle class family*, who is responsible for 40% of Brazil's total consumption. They are likely to move BRL\$ 1 trillion this year.



* SAE definition, based on social vulnerability criteria: low probability of sinking back into poverty in the near future