Brazil-U.S. Business Council

Brazil Bulletin

Interview: José Roberto Mendonça de Barros, Partner in MB Associates Consulting Group

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Brazil's government has worked hard since the 2008 global financial crisis to support the country's often hard-pressed manufacturing sector, with a plethora of incentives, policy initiatives and programs, but the time has come, according to a leading expert in industry and foreign trade, to admit the effort has largely failed. At a recent meeting of investors and reporters in São Paulo, José Roberto Mendonça de Barros, a former Brazilian Foreign Trade Secretary, addressed the issues behind Brazil's industrial malaise. Excerpts follow:

- **On efforts to revive Brazilian manufacturing:** "Today in Brazil, instead of having an industrial strategy, we have an array of disparate industrial policies, including all kinds of aid and incentive programs, and more trade protectionism than at any time in the last 30 years. We have subsidized credit. We have national-content and government procurement rules. But it's not working and Brazil's government doesn't seem to know why and it doesn't seem to know what to do to get us out of the hole we're in."

- **On approaches to a new industrial policy:** "The first problem is macroeconomic policy. There is no piecemeal approach to industrial policy that will work if macroeconomic policies are out of kilter. Today, they are out of kilter in virtually every area—monetary, fiscal and regulatory. The first order of priority is to fix the economic policy mix."

- **On the broader array of problems facing industry:** "There is no amount of subsidized BNDES credit that is going to compensate for the problems arising from an overvalued currency. Other problems include the tangled tax code. The tax code has become as much an obstacle to growth as inflation was in the 1980s. Without tax reform we will not have sustainable growth."

- **On infrastructure and growth:** "We have advanced very little in this regard. It took the government eight years to come to the conclusion that offering concessions to the private sector was a good way to get projects moving. But now the Petrobras scandal, and the involvement of major contractors in the scandal, is going to push back the concessions calendar."

- **On other obstacles to industrial development:** "Rising energy costs are another concern. We are falling behind in energy supplies. Antiquated labor laws are yet another problem. It's not the labor unions that are holding back on more flexible labor laws, it's the labor courts and the Labor Ministry."

- **On the trend for investment:** "Private investment could actually shrink in 2015. Confidence is at an all-time low. The only good news is that we might have a modest increase in exports because of the depreciation of the Brazilian Real."

Top News of the Week

New finance minister Levy sets fiscal austerity as top priority. Banker and economist Joaquim Levy formally took over as Brazil's new finance minister last week, setting fiscal austerity as his top priority. In a speech, and subsequent news conference, Levy said all government taxation and spending policies will be viewed against the light of fiscal responsibility. His comments were often bitingly critical of policies pursued by his predecessor, Guido Mantega, who did not attend the ceremony. Levy said Brazil's government will abandon the practice of picking so-called "national champions" by directing subsidized loans to favored companies. Nor will the government adopt what he called "non synchronized" tax incentives, policies that favor some industries but not others. He warned of budget cuts to come in the near future, noting that the government has already targeted some welfare and social security benefits for reductions. He said tax hikes were also under consideration. "There is a concensus in Brazilian society around the idea that fiscal discipline is imperative if we are to attain sustainable growth," Levy said. Levy was also critical of subsidized treasury loans to the government-run National Development Bank (BNDES) and he blasted government controls over fuel prices and utility rates.

Government orders 'emergency' cuts in federal operating budget. In an effort to underscore the government's commitment to fiscal austerity, Finance Minister Joaquim Levy last week ordered an immediate reduction in the operating budgets of all 39 line ministries as well as dozens of semi-autonomous government agencies. The cuts will equal one-third of appropriations for all budget items except salaries and investments. The government expects to save some R$1.9 billion per month. The policy will be reviewed once Congress formally passes the 2015 federal budget, expected in March. Officials said cuts under the full 2015 budget could be even steeper as the government seeks to meet its target of R$66 billion in fiscal savings this year.

Motor vehicle sales down 7% in 2014, while production plunges 15%. Last year was the worst for Brazil's auto industry since 2010, with both domestic sales and overall production posting steep declines. According to data last week from the National Motor Vehicle Manufacturers Association (Anfavea), domestic sales were off 7.1% at 3.498 million while production plummeted 15.3% to 3.146 million. Sales outstripped output as dealers and manufacturers attempted to clear up stagnant inventory. The effort only paid off late in the year, a signal that 2015 could be better for the industry. December 31 inventories were 351,000 vehicles, down sharply from 414,300 as of November 30. The industry group is now forecasting steady 2015 domestic sales, a slight increase in exports and a 4% jump in production. The industry was hurt in 2014 by inflation, high interest rates and heavy consumer indebtedness. Hopes for 2015 focus on an expected decline in inflation and a reduction in consumer debt levels. Interest rates, however, are likely to remain high and the industry will have to cope with higher taxes after the December 31 lapse of an abatement in value-added levies.

Business News

Investment News:

Global mining giant **Anglo American** last week announced 2015-2016 investments of $800 million in its Sistema Minas-Rio mining and logistics project. The project produced just 700,000 metric tons of iron ore in 2014 but that figure will rise sharply to 13 million this year and more than 26 million in 2016, the company said. Much of the production will go for export to China through Rio de Janeiro's new Açu port.

Nissan President Carlos Ghosn last week announced R$100 million in additional Brazil investments by the Japanese company. During a Brazil tour, Ghosn expressed skepticism about a 2015 auto industry recovery for Latin America's biggest country but predicted a rebound in 2016. The R$100 million investment will go to Nissan's plant in

Resende in Rio de Janeiro state. The Brazilian auto industry has been plagued by declining sales in the face of inflation, high interest rates and faltering consumer confidence. Layoffs this month by Volkswagen and Mercedes Benz have led to labor protests in the São Paulo industrial belt.

Company News:

Sugarcane and ethanol giant **Raizen** last week announced a multi-year investment plan for so-called second-generation ethanol, adding that the company is anxious to begin production in the United States. However, the company did not offer a timetable for eventual investments in the U.S. Raizen is a joint venture of Cosan and Shell and is Brazil's largest sugarcane and ethanol producer. The company will invest between R$2.0 billion and R$2.5 billion through 2024 to develop second-generation ethanol, which produces higher yields than conventional ethanol. The company aims to be producing one billion liters per year of G2 ethanol by 2024. Currently, Raizen produces about two billion liters of G1 ethanol per year.

Brazilian Calendar

Wednesday, January 14, Brazilian Census Bureau (IBGE) release of monthly retail sales figures, Rio de Janeiro

Indicators

Foreign exchange rate: **R$2.63 = $1.00**

Brazil posted its first **foreign trade deficit** in more than a decade in 2014, the Trade and Development Ministry announced last week. The deficit was $3.9 billion, reversing a modest 2013 surplus of $2.6 billion. Both imports and exports declined in 2014, the ministry said. Export revenues were hit hard by falling prices for commodities. Export volumes were hurt by spreading economic crises in neighboring Argentina and Venezuela, traditional importers of Brazilian manufactured goods. The last time Brazil posted a trade deficit was in 2000 at $731 million. Last year marked the biggest deficit since 1998, when the trade gap was $6.6 billion.

Industrial production declined in November by 0.7% against the previous month and by a worrisome 5.8% against November of 2013, the Brazilian Census Bureau (IBGE) said last week. Capital goods were the worst hit, falling 9.7% against November a year ago and signaling a continued lack of investment by manufacturers. Auto output was also down sharply. Industrial production has been hurt by falling exports and slack domestic demand due to inflation and high interest rates.

Brazilian **inflation** weighed in for 2014 at 6.41%, up from 5.91% in 2013 but still below the 6.5% ceiling of the government's annual target range for price increases, the Brazilian Census Bureau (IBGE) said last week. The trend for inflation continues worrisome. December monthly inflation was 0.78%, up from 0.51% in November. Food and fuel were the main price villains in December. Inflationary pressures are likely to continue in the first quarter of 2015 as a persistent drought hurts food prices and government-ordered hikes in bus and subway fares take hold. The inflation target for 2015 will once again fall within a range of 2.5% to 6.5%. Brazil has met the target range for every year since 2003.