Brazil-U.S. Business Council
Brazil Bulletin

Interview: Antônio Delfim Netto, Former Finance Minister

Former Finance Minister (1967-1974) and Planning Minister (1979-1985) Antônio Delfim Netto is an eternal optimist, “even in old age.” However, recent policy shifts and trying economic circumstances have strained even his philosophical outlook. Brazil’s former economic Czar recently shared his views with analysts and reporters in São Paulo. Excerpts follow:

- **On the administration of President Dilma Rousseff**: “The current administration has made its share of mistakes, but even the PT can learn economics! They allowed salaries to rise faster than productivity. They delayed their concessions program far too long.”
- **On the 2014 election**: “However, if President Dilma (Rousseff) is re-elected, I wouldn’t expect profound changes in economic policy. The election is the ultimate test of economic policy. If the people re-elect the President, it’s because they’re satisfied with the economy.”
- **On salaries and productivity**: “Since 2008, we have been hiking salaries faster than we have been accumulating productivity gains. This is producing inflation and a current account deficit because of heavy demand and heavy imports needed to meet that demand.”
- **On the need for a policy shift**: “There is going to be a cost when it comes time to fix this. We need to cut back on salary gains and we need to depreciate the Real in order to make our manufactured products competitive again. Our industries are unable to export. In some cases, they’re not even able to compete in the domestic market against cheap imports.”
- **On the strong Real**: “The strong Real is robbing Brazil’s manufacturers of their own market. But there are few finance ministers who can resist the temptation to use the foreign exchange rate as a counterweight to inflation.”
- **On upward social mobility**: “But there is also some good news. From 2005 to 2011, ‘C’ class consumers rose from 34% of the population to 54%. The ‘D’ and ‘E’ cohorts declined from 51% to 24%. This represents a structural change in Brazilian society.”
- **On the government’s concessions program**: “The concessions program has been a success so far. The Libra oil field auction brought in oil companies which have a keen appetite for investment. The airport auction showed that the government is really committed to the process.”

Top News of the Week

Auto industry posts record production in 2013 at 3.74 million vehicles. Brazilian auto makers posted a record year for production in 2013, with 3.74 million motor vehicles rolling off assembly lines. That figure represented an astonishing 9.9% increase over 2012. Assembly lines pumped up production at the start of 2013, in part, to make up for declining inventories in the face of heavy 2012 demand. Meanwhile, demand rose again in the first half of 2013 on low interest rates and government tax breaks for consumers. Sales in 2013 actually topped production, at 3.77 million units, although that figure represented a small 0.9% decline from the 2012 level. It was also a good year for exports, with revenues rising 13.5% from 2012 to $16.6 billion as a global economic recovery took shape. Prospects for 2014 are less sanguine, although the industry is hoping for small increases in production and domestic sales. Interest rates in 2014 are expected to remain at much higher levels than in 2013, crimping car loans. Brazil's government, meanwhile, will allow consumer tax breaks to gradually phase out during the course of the year. December figures already showed a worrisome trend, with a 12% decline in production against December of 2012.

Ratings agencies muddy the waters on Brazil's 2014 sovereign credit. The three major international credit rating agencies last week offered somewhat contradictory evaluations of Brazil's prospects for 2014. All three agencies currently rate Brazil two notches above investment grade. From a purely investment viewpoint, Brazil could stand a sovereign ratings downgrade and still remain an investment-grade venue, attracting pension funds and other institutional investors. A downgrade, however, would hurt national prestige at a time when Brazil is in the international spotlight for events such as the soccer World Cup and the Olympics. Executives at Standard and Poor's took the most critical view among the three major credit agencies. In 2013, S&P cut Brazil's outlook from "stable" to "negative," with executives this week saying a full-blown ratings downgrade was possible in 2014 because of slow growth, persistent inflation and deteriorating government accounts. Fitch, on the other hand, was upbeat about Brazil's prospects, saying recent developments such as concession auctions for infrastructure projects represented signs of progress on the policy front. Fitch currently rates Brazil's outlook as "stable" but said an upgrade to "positive" was possible later in the year. Moody's Investors Service took a middle position, saying it was likely to hold its "stable" evaluation for Brazil through the end of the year.

Inflation ends 2013 at worrisome 5.91%, higher than 2012, despite rate hikes. The Brazilian Central Bank's strategy of interest rate hikes, followed during the second half of 2013, may be a case of too little and too late, according to most economists. Even after hiking the base rate from an historic low of 7.25% to the present 10.0%, Brazilian inflation ended 2013 at 5.91%, slightly higher than the 5.84% clocked the previous year. The rate is only slightly below the 6.5% ceiling of Brazil's 2.5%-to-6.5% inflation-targeting range. The December monthly figure, released last week by the Brazilian Census Bureau (IBGE), was even more worrisome, showing single-month inflation of 0.92%, up from 0.54% in November. More inflationary pressures are on the way. Brazil's government is likely to continue its policy of fuel price hikes in order to boost revenue for state-run oil giant Petrobras. Currency depreciation is likely to continue throughout the year, raising import costs. Government spending will be difficult to control as Brazil hosts the soccer World Cup in June and organizes for a general election in October.

Government scrambles to avoid intervention in Maranhão following prison riots. The impoverished Northeast state of Maranhão was rocked last week by a series of bloody prison riots. Inmates rebelled at the Pedrinhas state prison, aiming their ire at prison guards, state authorities and rival criminal factions. The riot spilled over to city streets in São Luis, with criminal gangs burning buses and damaging store fronts. The events were the culmination of three months of unrest in state prisons, leaving 62 inmates dead, many of them tortured by their fellow prisoners. The violence represents a major crisis for Maranhão Governor Roseana Sarney and here powerful family. It is also a political dilemma for President Dilma Rousseff, who counts the Sarney clan as allies. Prosecutors have hinted that they will seek a court order for federal intervention in the state government, a proposition that Governor Sarney has denounced as politically motivated. Intervention would embarrass the Sarney family while handing a prickly administrative problem to the federal government. Justice Minister Eduardo Cardozo attempted to defuse the problem last week by setting up a joint federal-state task force designed to restore law and order and improve prison conditions in the state.

Business News

Investment News:

Global auto maker **Renault-Nissan** last week announced additional investments in its existing plant in Resende, located in southern Rio de Janeiro state. The company will boost investments at the site by R$140 million to a total of R$2.6 billion. The objective of the latest investment is to meet new government standards for domestic production of parts. Renault-Nissan will now manufacture engines at Resende for its estimated annual production of 200,000 vehicles.

Company News

State-run energy giant **Petrobras** last week issued the equivalent of some $5 billion in overseas bonds as part of the company's debt rollover program. Total indebtedness is about $106 billion. The company's financial program calls for issuance of $12 billion in new debt this year. Last week's issues were the first of 2014. The company sold bonds in two tranches, one for 3.05 billion euros and a second tranche of 600 million pounds sterling. The bonds were sold for terms ranging from two to 20 years. Yields ranged from 2.829% to 6.732%.

Brazilian Calendar

Wednesday, January 15, Central Bank Monetary Policy Committee (Copom) meeting, Brasília

Thursday, January 16, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$2.37 = $1.00**

Brazilian **crude oil production** rose a bare 0.1% in November against the previous month and 1.8% against November of 2012, reaching 2.081 million barrels per day, according to data released last week by the National Petroleum Authority (ANP). New wells merely counterbalanced maintenance and environmental compliance problems at existing sites, the ANP said.

Supported by government-subsidized credit, heavy use of fertilizers and other inputs and good weather, Brazil harvested a record **grain and oilseeds crop** in 2013 of 188.2 million metric tons, the Brazilian Census Bureau (IBGE) said last week. Farmers are likely to build on those gains this year, with a small increase in the crop to 189.5 million metric tons. The big harvest could help boost export revenues while, at the same time, dampening inflationary pressures, according to economists.

Industrial production figures, released last week by the Brazilian Census Bureau (IBGE), brought another disappointment. Output in November was down 0.2% from the previous month, the first decline after three months of gains. November industrial production was up a bare 0.4% against November of 2012. Manufacturers have been hurt by rising interest rates, cost pressures from inflation and competition from cheap imports. November output was down in 14 of the 27 segments surveyed. Worst performers included the auto industry and capital goods.