



Interview: José Júlio Senna, Getúlio Vargas Foundation Director of Monetary Studies, and Eduardo Loyo, Chief Economist Banco UBS Pactual

--“What we gain from a weaker Real we may have to give back in the form of lower international prices for our exports.”—

The Brazilian Real has suffered a sharp depreciation over the past several months, fueling inflation but also raising hopes for increased exports. The problem is that other currencies have also lost value against the U.S. dollar, meaning Brazil still has a ways to go before its exports can become truly competitive. Two former Central Bank directors believe the Real will continue to depreciate this year. José Júlio Senna, now a noted academic, and Eduardo Loyo, Chief Economist at Brazil’s Banco UBS Pactual, addressed the issue at a recent meeting at the Getúlio Vargas Foundation. Excerpts follow:

- **José Júlio Senna:** “We are entering a period of a strong U.S. dollar. The strong dollar is being underpinned by economic fundamentals. The strong dollar, unfortunately, means lower global commodities prices. What we gain from a weaker Real we may have to give back in the form of lower international prices for our exports.”
- **Eduardo Loyo:** “When it comes to foreign exchange, the key question is what kind of rate do we need to bring the current account back into balance? (Brazil’s current account deficit is hovering around the \$90 billion mark, or about 4% of GDP). The depreciation to date has done nothing to reduce the current account deficit. Much of the problem has to do with the fact that, while the Real is losing ground against the dollar, so are most other currencies. To become competitive, we need to depreciate as much as the other currencies and then some.”
- **Senna:** “In the last few years, the Real has lost half its value against the dollar. But we’re not there yet. We’re going to need a substantially larger depreciation in order to compensate for lower prices of tradable exports and reverse the trend toward a larger and larger current account deficit. This could mean, among other things, less Central Bank intervention in the market to prop up the Real.”
- **Loyo:** “The Real has already depreciated more than anyone thought it would. Some of this may be in anticipation of higher U.S. interest rates. Some additional depreciation could come when the U.S. actually begins raising rates. The good news is that, so far, the depreciation has had little impact on inflation.”
- **Senna:** “We’re not going to be able to export our way out of the present crisis.”
- **Loyo:** “Other measures (in addition to currency depreciation) will be needed to surmount the current crisis. We’re not going to pull down inflation without some cooling of the economy. You lose jobs when you cut government spending. Every country faces this dilemma. I don’t think it’s more difficult, politically, to do this in Brazil than it is in other countries.”

- **Senna:** “It’s worth remembering that, at the end of his administration, President Cardoso was not popular but he went ahead with austerity anyway. It can be done.”

Top News of the Week

Congress passes 2015 federal budget, paving the way for annual spending freeze. After a long delay, Brazil’s Congress last week finally passed the calendar 2015 federal budget, based on expected revenues of R\$2.84 trillion and a primary surplus of R\$66 billion. Passage of the budget opens the door to a multi-month spending freeze, an annual exercise designed to help the government meet its budget surplus target. The government freezes a portion of spending early in the year and only frees it up in the fourth quarter if expenditure and revenue are on target to meet the surplus. The government is expected to announce the freeze within days, with news reports focusing on the figure of R\$80 billion. Meanwhile, President Dilma Rousseff and Finance Minister Joaquim Levy both signaled they will press Congress for early action on two key tax elements of the government’s fiscal austerity plan for 2015. One element is a proposal to permanently cut certain retirement and welfare benefits that would save the nation’s social security system the equivalent of 0.3% of GDP per year. The other element is a bill to raise social security and welfare taxation rates on businesses operating in 56 separate economic segments. Under legislation passed in 2012, the businesses were allowed to shift such payments from 20% over total payroll to a sliding scale of 1% to 2.5% over total billing. The new proposal would hike rates to a sliding scale of 2% to 4.5%.

Prosecutors implicate Treasurer of ruling PT in Petrobras scandal. An investigation of alleged corruption at state-run oil company Petrobras spread directly to the ruling PT (Partido dos Trabalhadores) last week. Prosecutors accused PT National Treasurer João Vaccari of obtaining illegal campaign funds for the party by skimming Petrobras contracts in collusion with top company executives. Through his lawyers, Vaccari denied the charges. Prosecutors also charged former Petrobras Engineering and Services Director Renato Duque as part of the same accusation. In testimony before a congressional investigative committee last week, Duque refused to answer questions related to the alleged scheme. In a related development, prosecutors said they uncovered a money laundering operation run by former presidential aide José Dirceu. They said Dirceu billing Petrobras for as much as R\$29 million in phoney consulting fees, with the money being turned over to the PT.

Rousseff Administration wrestles with dismal poll numbers as Congress rebels. President Dilma Rousseff experienced one of the roughest weeks of her presidency last week, facing a sharp decline in popularity and increasing resistance from Congress. A mid-week poll by the Datafolha organization showed support for the president plummeting to just 13% from an already dismal 23% in February. Disapproval rose to a stunning 62% from 44%. The poll was conducted in the days following massive street demonstrations against government economic policies. Support for the president has evaporated because of a spreading scandal at state-run oil company Petrobras and an economy stalled by low investment and 8% inflation. The President’s weakness has tended to make Congress more free-wheeling and critical. In an angry and theatrical Chamber of Deputies speech, Education Minister Cid Gomes called nominal pro-government members “opportunists,” saying they should “support the administration or clear out.” Speaker Eduardo Cunha demanded Gomes’ immediate resignation. The Education Minister obliged within hours. The tiff led to speculation about a possible Cabinet shuffle. However, President Rousseff herself nixed the idea later in the week, saying she will only consider changes after Congress acts on key fiscal austerity measures. In a nominally secret internal document, obtained by local news organizations, unnamed presidential aides told the president her administration has failed to communicate adequately with the general public and with congressional leaders. The document described the current political situation as “chaotic.”

Business News

Investment News:

Brazilian manufacturers are in a decidedly pessimistic mood when it comes to plant and equipment expansion, according to a quarterly survey released by the **Getúlio Vargas Foundation**. The survey found that only 27% of manufacturers intend to increase investments this year, while 31% said they will scale back. It was the first time for the “reduced investment” category to outweigh “increased investment” since the survey was instituted in 2012. Reasons for retrenchment include rising inflation, declining consumer confidence and high interest rates.

Company News:

Brazil’s biggest steel maker, **CSN**, last week announced a 41% reduction in its investment budget for 2015. The company will invest only R\$1.3 billion this year, with the largest portion destined for its iron ore unit and smaller investments for steel and cement. The decision comes amid declining domestic demand and a sluggish economy. CSN also released 2014 balance sheets, showing a loss for the year of R\$112 million. In 2013, the company registered a profit of R\$534 million.

EcoRodovias beat out five other contenders at an auction last week to win a 30-year concession to operate the Rio de Janeiro-Niteroi Bridge. EcoRodovias won the concession by pledging the lowest toll, R\$3.28 per user. EcoRodovias will take over the concession from CCR, which high-balled its bid at the auction. The concession winner also pledged R\$1.3 billion in bridge improvements, mainly additional approach ramps.

Brazilian Calendar

Wednesday, March 25, Brazilian Central Bank release of monthly current account data, Brasília

Thursday, March 26, Brazilian Census Bureau (IBGE) release of monthly unemployment data, Rio de Janeiro

Friday, March 27, Brazilian Census Bureau (IBGE) release 2014 gross domestic product data, Rio de Janeiro

Friday, February 27, Brazilian Central Bank release of monthly banking performance data, Brasília

Indicators

Foreign exchange rate: **R\$3.23 = \$1.00**

The Brazilian Central Bank’s monthly **Economic Activity Index** (IBC-Br) showed another downturn in January, this time declining 0.11% against December and 1.75% against January of 2014. The indicator is seasonally adjusted. Economists said economic and political uncertainties were likely to keep the index in negative territory during much of the first half of 2015. Inflation and high interest rates, among other factors, are contributing to reduced business and consumer confidence.

