Brazil-U.S. Business Council
Brazil Bulletin

Interview: Octávio de Barros, Chief Economist at Banco Bradesco; José Roberto Mendonça de Barros, Partner at MB Associates; Ilan Goldfajn, Chief Economist at Banco Itau

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Even at the end of the first quarter, the word most commonly used by economists in Brazil is "uncertainty." Some of the uncertainty comes from overseas—China, Europe and the U.S., for example. Some of it comes from close neighbor Argentina, where a one-two punch of inflation and recession could send bilateral trade into a tailspin. A lot of the uncertainty comes from within Brazil itself, where question marks about inflation, government spending and elections are holding up investment decisions. Three prominent economists offered their views about the economy at separate briefings for investors and reporters in São Paulo as the first quarter came to a close. Excerps follow:

- **Octávio de Barros:** "The year 2014 is going to be a good one for the world economy. We're going to see global growth of 3.8%, up from 3.0% last year. The WTO foresees growth in world trade on the order of 8.0%. The doubt we have is about the impact of global growth on Brazil. The question is how much global capital the U.S. will attract as it recovers. If it attracts a lot of capital, that could pressure the Brazilian Real and Brazilian interest rates."

- **Mondonça de Barros:** "There is still a great deal of uncertainty, bringing with it the risk of becoming a self-fulfilling prophecy. This year, and 2015, are going to be years of transition. This is the last year of President Dilma Rousseff's first term. In 2015, Brazil's economy will enter a new phase. We need to shift from a demand-based economic policy to an investment-based model."

- **Goldfajn:** "Markets were turbulent at the start of the year. There were a lot of doubts and question marks. We believe these doubts are exaggerated. The U.S. will continue its growth pattern. Capital will flow away from Latin America and towards the U.S. but we believe that, once expectations become more balanced, some of that money will flow back. China will not suffer an abrupt decline."

- **Octávio de Barros:** "Brazilian inflation has proven highly resistant over the years. That will mean a vigilant Central Bank. We foresee GDP growth this year at about the same 2.0% level as last year. But expectations are so low that almost any bit of good news will tend to tip the balance in favor of more growth."

- **Mendonça de Barros:** "There are three constraints on the economy this year. In 2014, the agriculture sector will grow at normal rates, not at the extraordinary rate seen in 2013. There are danger signs in the auto industry. We started 2014 with large motor vehicle inventories. Given new investments in capacity that are coming on stream, the auto industry is heading for a period of over-production. From 2015 on, we could see a 1.5 million annual surplus of motor vehicles. A third constraint comes from the fact that, after three straight years of sluggish growth, companies are postponing their investments."

- **Goldfajn:** "Inflation will persist. We are forecasting 6.2% for this year and 6.0% for 2015. That will mean higher interest rates, peaking at 11.0% this year and rising again to 12.0% in 2015."

Top News of the Week

S&P downgrades Brazil's sovereign rating, government calls move "inconsistent." Standard and Poor's last week downgraded Brazil's sovereign credit rating to BBB- from BBB, citing problems such as deteriorating public accounts, persistent inflation and slow growth. S&P had warned of a possible downgrade earlier in the year. The move puts Brazil at the lowest "investment grade" level. S&P was the first of the major ratings agencies to boost Brazil to "investment grade" back in 2008. Last week's decision will lead to higher interest charges on Brazilian debt. S&P also downgraded state-owned firms Petrobras and Eletrobras by one notch to BBB-. Brazil's government called the moves "inconsistent" with Brazil's economic fundamentals and prospects. In a statement, the Finance Ministry said the government was committed to a primary budget surplus goal of 1.9% of GDP this year. The government is also committed to a program of infrastructure investments, via private-sector concessions, and a long-term goal of reducing inflationary pressures. Inflation is currently running at nearly 6.0%.

Current account takes another big hit in February, Central Bank revises forecast. Brazil posted another big current account deficit in February, the Central Bank said last week. The February deficit was $7.445 billion, lower than the record January deficit of $11.6 billion but still high enough to push the 12-month figure up to $82.5 billion, or nearly 3.7% of GDP. The continued heavy deficits caused the Central Bank to revise its forecast for 2014. The bank is now predicting a current account deficit of $80 billion, up from the previous $78 billion forecast. February performance was hurt by a $2.1 billion trade deficit and a $1.3 billion deficit in travel accounts. Some of the current account deficit was made up by foreign direct investment, which hit $4.13 billion in February.

Lower house passes Internet regulation bill, Senate action expected soon. The Brazilian House of Representatives last week passed legislation regulating commercial practices and usage of the Internet. The bill must now be considered by the Senate, which could approve it as early as mid-April, according to Senate President Renan Calheiros. The legislation provides for so-called Internet "neutrality," by which providers would be prohibited from charging different fees for access to different data transmission velocities and commercial services. However, under certain circumstances, the president can allow for discrimination of Internet traffic based on advice from specific government agencies. The bill guarantees consumer rights under Brazilian legislation. It does not permit government-ordered removal of Internet content by providers, in most cases, except by court order. The administration of President Dilma Rousseff withdrew a provision that would have mandated maintenance of Brazilian-origin data in Brazilian data centers.

Approval ratings slip for President Rousseff, Workers' Party administration. Public approval for President Dilma Rousseff and her Workers' Party (PT) administration has slipped significantly, according to a poll last week by the Public Opinion Research Institute (Ibope). The institute conducted the poll for the National Confederation of Industries (CNI). The poll showed approval for the administration falling to 36% from 43% in a similar poll conducted in November. Personal approval of the president's performance slipped from 56% to 51%. Poll-takers said economic conditions were the main reason for the slippage. Respondents expressed rising concerns over problems such as inflation, job security, high interest rates and poor government social services. The issue of social services ignited a series of massive public protests last year. President Rousseff will seek a second four-year term in elections in October.

Public sector appears to be closing in on primary budget surplus target. Better than expected fiscal figures for February, released last week, raised hopes that Brazil will be able to meet its 2014 primary budget surplus target. The government racked up a monthly primary surplus of R$2.13 billion for a 12-month figure of R$86.1 billion, or 1.76% of GDP. That was an improvement over the January 12-month figure of 1.66%. The government's target for the year is a primary surplus of 1.9% of GDP. Officials said continued solid performance in the area of tax collections should assure compliance with the target.

Business News

Investment News:

Shell oil company executives said last week the multinational powerhouse will step up investments in Brazil by about 20% this year to R$500 million. The company aims to add 200 gas stations to its existing network of 4,921 and 200 convenience stores to its chain of 900. The company will also invest in highway service centers, including restaurants. Shell operates in Brazil in a partnership with domestic sugar and ethanol group Cosan.

Company News:

Electronics giant **Samsung** last week announced that it will begin manufacturing Ultra-High Definition (UHD) television sets at its Manaus Free Zone factory in April. The company is hoping to sell as many as 100,000 units, all of them within the Brazilian market, ahead of the June-July soccer World Cup. The sets come with a unique curved screen. Price tags begin at R$8,000. The company claims that UHD images are four times as detailed as the previous Full HD technology.

Brazilian Calendar

Monday, March 31, Start of São Paulo Fashion Week, Parque Cândido Portinari, São Paulo

Wednesday, April 2, Brazilian Central Bank Monetary Policy Committee meeting to review interest rates, Brasília

Wednesday, April 2, Brazilian Census Bureau (IBGE) release of monthly industrial production figures, Rio de Janeiro

Friday, April 4, National Motor Vehicle Manufacturers Association (Anfavea) release of monthly sales, production and export data, Hotel Sofitel, São Paulo

Indicators

Foreign exchange rate: **R$2.26 = $1.00**

Brazil racked up **tax revenues** of R$83.1 billion in February, down from the unusually high figure of R$123.6 billion in January but up substantially from the February 2013 level of R$76.0 billion. January revenues were high because of a series of one-time payments of back taxes by corporations. Revenues for the first two months of the year were up 1.9%, in inflation-adjusted terms, from the same period of 2013, the Brazilian Tax Authority said last week.

Total **lending volume** continued to advance in February, despite higher interest rates, the Central Bank said last week. Lending volume rose 0.6% from the previous month and 14.7% against February of 2013 to R$2.733 trillion. Average interest rates rose to a punishing 20.9% from 20.7% in January. Loan defaults were steady at 3.0%, the Central

Bank said. Lending costs are rising as the Central Bank itself hikes the base interest rate, now a towering 10.75%.

Brazil's **unemployment rate** rose to 5.1% in February from 4.8% the previous month on sluggish manufacturing activity, the Brazilian Census Bureau (IBGE) said last week. But unemployment was still lower than the 5.6% rate in February of 2013, with jobs in the agriculture and services sectors remaining strong. Such jobs, however, often come with comparatively low pay. Average salaries of registered workers have declined, even in nominal terms, over the past year. The average monthly salary as of February was R$1,954, down from R$2,000 in January and R$2,015 in February a year ago.