Brazil-U.S. Business Council — Brazil Bulletin

Interview: Flávio Castelo Branco, Chief Economist for the National Confederation of Industries (CNI)

--"Expectations are not good. Investments are still far below the peak year of 2010."—

The 2014 annual survey of investment intentions by Brazilian manufacturers, undertaken by the National Confederation of Industries (CNI), proved to be another disappointment. Only 78% of companies expressed any intention to make investments this year, down from 83% in 2012 and a peak of 89.6% in 2010. Of those investing, more than half, some 55%, will re-invest profits while only 27% will avail themselves of government-provided credit. The overwhelming majority will focus on investments aimed at boosting domestic market share while a tiny 3.6% are oriented toward becoming more competitive in export markets. "Expectations are not good," according to CNI Chief Economist Flávio Castelo Branco, who met with reporters to review the survey. Excerpts follow:

- **On 2013 performance:** "There was a great deal of frustration in 2013, especially when it comes to lending by government banks. Originally, companies planned to use re-invested profits for 52% of their investment needs but ended up using 63%. They had planned to borrow from the government for 29% of investment needs but that figure ended up at only 20%."

- **On borrowing conditions:** "One factor that restricted borrowing from government banks was the absence of long-term financing. This is a problem the Brazilian economy has never been able to surmount."

- **On 2014 investments:** "Expectations are not good. Investments are still far below the peak year of 2010. It's possible that the government's concessions program and its plan to develop infrastructure may bring about a greater-than-expected boost in investments, but we'll have to wait and see how long it takes for these plans to mature."

- **On investments for the export market:** "Only 3.6% of companies will invest in order to become more competitive in export markets. Brazilian industry has become less competitive. The best way for us to become more competitive is to reduce production costs and improve logistics."

- **On economics conditions:** "Investments are inherently risky. In order to bring an investment to term, a company needs to have a certain degree of confidence in the business environment. Brazil's econony, in recent years, has seen sluggish growth, which has led to uncertainties in relation to both demand and profitability."

Top News of the Week

Vice President Temer seeks to re-assure investors at New York meeting. Brazilian Vice President Michel Temer made a rare appearance before investors at a New York briefing last week. He sought to bring re-assurance on a number of fronts. "There is no palpable reason to lose confidence in Brazil," he told them. He said the government had inflation "well in hand" and pledged Brazil will hold the price spiral this year within the 2.5%-6.5% band stipulated by the country's inflation-targeting program. "The government has the ways and means to stop inflation in its tracks," he argued. He said government accounts were "well within the bounds of necessary controls" and added that there has been "a qualitative improvement" in reporting, monitoring and managing government accounts over the past several years. He noted that Brazil's net public debt has declined over the past five years as a percentage of GDP from 42% to 34% and added that Brazilian foreign reserves of $376 billion will always act as a buffer against international crises.

Inflation reaching critical point, more interest rate hikes seen likely. Despite official disclaimers to the contrary, more interest rate hikes now seem likely, according to economists. The problem is Brazil's creeping inflation rate. Last week, the Brazilian Census Bureau (IBGE) released price data for March, showing a rise in the monthly inflation rate to an alarming 0.92% from 0.69% in February. The 12-month rate crept up to 6.15% from 5.59% as of February. The 12-month rate is edging ever closer to the 6.5% ceiling permitted for inflation this year under the nation's inflation-targeting program. Brazil's Central Bank has been raising interest rates steadily in an effort to stem the rise in prices. The base rate now stands at a towering 11.0%, up from 7.25% at the beginning of 2013. More interest rate hikes are now likely, given recrudescent inflation. March inflation was led by food and fuel, which increased 1.92% and 1.38%, respectively. Finance Minister Guido Mantega downplayed the March figures, saying the inflation rate will begin to fall back once the grain and oilseeds harvest comes on stream in April.

Brazil runs gauntlet of questions at IMF meeting in Washington. Top Brazilian officials attended the Spring meeting of the International Monetary Fund in Washington last week, facing a gauntlet of questions about the nation's troubled economy. Among highlights were the following:

- The IMF itself released a new—and worrisome—evaluation of Brazil's economic prospects. The institution reduced its forecast for Brazilian economic growth this year to just 1.8% from a previous projection of 2.3%. For 2015, the IMF is now predicting only a modest rebound to 2.7% growth, not the previous 2.8% projection. The IMF also cited continued bottlenecks from inadequate infrastructure, slack consumer demand due to job security worries and problems such as persistent inflation. The institution also came down hard on the government's deteriorating accounts, saying it will be difficult for Brazil to reach even the modest goal of a 2014 primary budget surplus equal to 1.9% of GDP. At a news conference, Finance Minister Guido Mantega argued that the IMF was exposing what he called "a pessimistic bias toward emerging countries." He added, "I hope they're wrong in their forecast about Brazil."
- Central Bank President Alexandre Tombini attempted to deflect the IMF critique in a series of meetings with investors, academics and reporters. He noted that Brazil today "enjoys a cushion of support against international crises that it did not enjoy in the past." He particularly cited foreign reserves nearing the $400 billion mark. He argued that inflation, currently over 6.0%, was likely to ease in the coming months as Brazil's big grain and oilseeds harvest comes on stream.
- Brazil received some reinforcement from two major credit rating agencies, Fitch and Moody's. Both said they were unlikely to downgrade Brazil's sovereign rating. Standard and Poor's downgraded Brazil by one notch earlier this year. However, Fitch economists noted that Brazil's government will have to implement at least some fiscal controls as of 2015 in order to avoid further deterioration in public accounts.
- Led by the four Bric countries (Brazil, Russia, India and China), the G20 nations demanded U.S. congressional passage by the end of this year of changes in the IMF's quota system designed to give emerging market members a greater voice. The U.S. Obama Administration supports the changes but Congress has declined to take action. The G20 leaders said they will take action next year to find alternative management strategies for the IMF in the event of failure to act by the U.S. Congress.

Wave of strikes is latest challenge ahead of soccer World Cup. At least 16 nationwide unions are gearing up for what could turn out to be a wave of strikes right in the middle of the June-July soccer World

Cup, set to be staged in 12 Brazilian cities. Some unions, such as the group representing the Federal Police, are already engaged in targeted slowdowns. Federal Police are due to play a critical role in the World Cup since they man immigration and customs services at ports and airports. Some 600,000 foreign visitors are expected for the games. Construction workers at selected sites are also engaging in job actions, including workers at stadiums being prepared for the games in Bahia and Rio de Janeiro. Other unions that may strike, as of June 1, include taxi drivers in key cities, airline workers and workers for public transit authorities in major cities. Most of the strikes are related to wages and other issues. Some unions are demanding extra pay in June and July because of the World Cup.

Business News

Investment News:

The Brazilian unit of sprawling Spanish bank **Santander** last week announced the purchase of an 88.5% stake in local network services provider GetNet for R$1.1 billion. The two companies have been operating under a partnership agreement since 2010. The acquisition will help Santander compete with rivals Itau and Bradesco in the transaction processing market.

U.S. manufacturer of agricultural and construction equipment **John Deere** last week announced $40 million in additional investments for expansion and upgrades to its factory in Catalão, Goias. The plant will expand capacity by 30% beginning next year, the company said. John Deere is preparing for continued growth in Brazil's grain and oilseeds harvests.

Company News:

State-run oil company **Petrobras** last week announced resumption of operations at its P-20 offshore oil drilling platform. The platform had been idle since a fire in December. P-20 operates in the Marlim field, which is part of the Campos Basin. It pumps 20,000 barrels per day of crude oil at its peak.

Brazilian Calendar

Tuesday, April 15, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

Thursday, April 17, Brazilian Census Bureau (IBGE) release of monthly unemployment data, Rio de Janeiro

Friday, April 18, Good Friday national holiday

Indicators

Foreign exchange rate: **R$2.22 = $1.00**

Utilization of **installed industrial capacity** rose very slightly in February to 82.6% from 82.5% in January, according to the National Confederation of Industries (CNI). However, the CNI warned that continuing problems such as a strong domestic currency and high interest rates were making it difficult for manufacturers to plan new investments (see interview above).