Brazil-U.S. Business Council
Brazil Bulletin

Interview: Afonso Bevilaqua, Catholic University of Rio de Janeiro economist

--"The Rousseff Administration's New Economic Framework has failed."—

President Dilma Rousseff's first four-year administration produced the lowest average GDP growth for any similar period since inception of the Real Stabilization Plan in 1994. "And her second administration could be even worse," according to Catholic University of Rio de Janeiro economist, and former Central Bank director, Afonso Bevilaqua. The reason is not the international financial crisis, a factor frequently cited by the President, but rather fundamental failures of policy, according to Bevilaqua. The former central banker addressed broad economic concerns at a recent meeting of investors, academics and reporters at the Getúlio Vargas Foundation. Excerpts follow:

- **On macro-economic policy:** "The government has tried to blame international economic conditions for Brazil's problems. But the truth is that, today, international interest rates are still extremely low and there has been tremendous liquidity in international capital markets. The overseas situation is not to blame. The problem is Brazilian economic policy. There were frequent errors in diagnosis and in use of economic policy instruments."

- **On micro-economic policy:** "Meanwhile, there was also confusion on the regulatory front and abandonment of structural reforms. The Rousseff Administration's New Economic Framework has failed."

- **On fiscal policy:** "On the policy side, the biggest let-down was on the fiscal front. In the 1990s, with great difficulty, Brazil put in place a responsible fiscal system. Early in the decade of the year 2000, that policy began to produce a decline in debt as a percentage of GDP. However, over the last four years, the government has dismantled that system, using accounting sleight-of-hand, increased spending and selective tax cuts to undermine fiscal responsibility. Brazil is now producing primary budget deficits."

- **On policy credibility:** "The credibility of the Brazilian government has been undermined in a number of ways. The budgetary sleight-of-hand is one. The huge increase in government-directed credit, at the expense of the Treasury, is another. Still another is government interference in state-bank lending operations. The rise in government debt as a percentage of GDP puts a question mark on the country's sovereign credit rating."

- **On current challenges:** "The challenges are great. First of all, we need to make primary budget surpluses permanent. That won't be easy. The most important step is to restore the institutional framework supporting fiscal responsibility. Finance Minister Levy has started down that road but it's only the beginning. The government will need political support and it is not clear the President will be able to muster it."

- **On inflation:** "Inflation is another difficult challenge. Markets no longer believe the government is commited to the 4.5% inflation target. In President Rousseff's first term, annual inflation averaged 6.1%, closer to the 6.5% ceiling of the target range than to the 4.5% target. The market doesn't believe in the Central Bank's stated goal of pulling inflation down to target at 4.5% by the end of 2016. Current trends suggest we could see inflation at 8.0% or 8.5% by the end of this year. Convergence toward 4.5% by the end of 2016 is looking very difficult right now."

Top News of the Week

Petrobras takes huge write-down on assets as it finally delivers 2014 balance sheets. State-run energy giant Petrobras finally made good last week on its promise to deliver audited 2014 balance sheets. As expected, they were not a pretty sight. The company showed its first net loss since 1991, to the tune of a whopping R$21.6 billion, reversing a 2013 net profit of R$23.6 billion. Losses came from all quarters, including a rise in debt-servicing expenses, lower overall revenues and direct costs from payment of bribes to contractors and political figures. The latter came with a price tag of R$6.2 billion. But the biggest cost resulted from a write-down of asset values, caused directly by the corrupt practices and the resulting investigation. Petrobras took a one-time write down of R$44.6 billion, much of it due to lost investments at major refinery and petrochemicals projects which are now stalled. Just as worrisome to investors was news of a large run-up in debt, caused partly by the depreciation of the Brazilian Real. The company's total indebtedness rose 31% from 2013 to R$351 billion, considered the highest of any oil company in the world.

PSDB congressional caucus to bring impeachment motion before Congress. The Chamber of Deputies caucus of the opposition PSDB (Partido Social Democrático Brasileiro) last week voted to present an impeachment motion against President Dilma Rousseff. Party leaders said they could present such a motion before the full Chamber of Deputies as early as this week. Under Brazil's Constitution, the Chamber of Deputies is responsible for considering impeachment motions. In the event such a motion is passed, the Senate would be responsible for actually removing the President from office. Caucus leaders said the motion would be based on two complaints. One is alleged violation of the 2000 Fiscal Responsibility Act. According to PSDB congressmen, President Rousseff violated the act by failing to pass on funds for payment of social welfare benefits to state-run banks, thus forcing the banks to meet such payments out of their own funds. The second complaint involves alleged negligence in relation to a sweeping bribery and money laundering scandal at state-run oil company Petrobras. The initiative by PSDB lawmakers comes despite reluctance by other party leaders to embrace the cause of impeachment. PSDB National Chairman Aécio Neves said he will only endorse an impeachment motion after receiving a legal brief on the matter from noted constitutional lawyer Miguel Reale.

Congress inches forward on labor, voting and government re-organization bills. The Chamber of Deputies last week gave its final approval to sweeping legislation that will allow increased use of outsourcing in the Brazilian labor market. The lower house of Congress, however, stripped away government-supported provisions in the legislation designed to protect tax revenues. The bill now goes to the Senate. Powerful Senate President Renan Calheiros expressed immediate opposition to the bill, saying it undercuts labor rights. Separately, the Chamber of Deputies Judiciary Committee voted its approval for a constitutional amendment that would permanently cap the number of Cabinet Ministries at 20. President Dilma Rousseff's Cabinet has 38 members. The proposal will go before the full Chamber of Deputies. Meanwhile, the Senate Judiciary Committee voted to approve a constitutional amendment creating single-member voting districts for city council members in municipalities with at least 200,000 registered voters. That proposal will now go to the full Senate for a vote.

Business News

Investment News:

A sluggish economy and high borrowing costs will bring a sharp decline in infrastructure investments by Brazil's **telecommunications companies** this year, according to a study last week by the Inter.B consulting group. The study forecast investments this year of R$21.7 billion, down 26% from 2014. The retrenchment could lead to deteriorating services while stalling the spread of telecommunications infrastructure to rural and low-income areas.

Company News:

Traditional Brazilian steakhouse **Fogo de Chão,** with restaurants in the U.S. and Brazil, has decided to go public. The company announced it will hold an initial public offering of shares, most likely later this year. Financial details were not unveiled. The company was founded in 1979. More recently, it was purchased by private equity owners. U.S. based investors Thomas H. Lee Partners hold a controlling stake.

Brazilian Calendar

Tuesday, April 28, Brazilian Census Bureau release of monthly unemployment figures, Rio de Janeiro

Wednesday, April 29, Central Bank Monetary Policy Committee meeting, Brasília

Thursday, April 30, Central Bank release of monthly primary budget surplus figures, Brasília

Friday, May 1, International Labor Day holiday

Indicators

Foreign exchange rate: **R$2.96 = $1.00**

The Brazilian Central Bank last week unveiled new methodology for tabulating overseas accounts. The new method alters the way intra-company loans are computed as well as re-invested profits of multinational companies. Under the new method, Brazil posted a March **current account deficit** of $5.7 billion, down from $6.9 billion in February. The 12-month deficit ballooned to $101.6 billion while the 2014 calendar year deficit hit a record $103.9 billion. According to economists, the deficit is large under any methodology. Continued monthly deficits, caused by weak trade performance and high debt-service costs, could lead to a renewed depreciation of the Brazilian Real in the coming months.

Total lending in the Brazilian financial system continued to expand at a smart pace in March as consumers re-financed heavy existing debts despite rising interest rates. According to Central Bank data last week, **total lending** advanced by 1.2% from February and 11.2% from March of 2014 to R$3.06 trillion. The increase came in spite of consistent Central Bank monetary tightening, which led to average interest rates in March of 25.8%, up from 25.6% the previous month and 24.1% in March of 2014. Arrears remained stable at 2.8% of total loans.