Brazil-U.S. Business Council — Brazil Bulletin

Interview: Márcio Luiz Simões Utsch, President of Alpargatas; Ailton Barberino do Nascimento Filho, Vice President of Stefanini; Marcos Jank, Vice President of BRF Brazil Foods

--"The question isn't what we should be exporting, but how we should be exporting."--

The problems Brazil faces in efforts to become more competitive in global markets are well known. And so are the solutions. Much depends on government but there is also a lot that businesses can do for themselves, according to three top executives. The executives recently discussed the challenges and strategies involved in export markets at a forum for investors and reporters. The forum was organized by the National Confederation of Industries (CNI). Excerpts follow:

- **Marcos Jank:** "The question isn't *what* we should be exporting, but *how* we should be exporting. What we export depends on a series of issues like taxes, infrastructure, bureaucracy and the other inhibiting factors we are all familiar with. We need to knock down barriers, including trade barriers. We are behind the rest of the world when it comes to trade liberalization."

- **Ailton Barberino do Nascimento Filho:** "Priorities include infrastructure, education and reduction of the tax burden. The Brazil-U.S. CEOs Forum has discussed these issues, but there has been very little progress on implementation. One result of these discussions was introduction of a bill in Congress that would incentivate companies to provide technical education to their workers. Incentives would be the same as those in the areas of culture and exports. But the bill is still pending."

- **Márcio Luiz Simões Utsch:** "Education is the leading factor in becoming competitive. When you look at the world today, you'll see that countries offering the best technical education are the most competitive. Just look at the difference between North Korea and South Korea. Just to give you one example, virtually everyone in South Korea born after 1960 speaks English. That alone gives the South Koreans greater access to technology."

- **Jank:** "We need to integrate supply chains, both within Brazil and between Brazil and the rest of the world. The region with the most integrated supply chains is Asia and they have done it without negotiating trade blocks. The question is no longer just exports. It's imports, exports and investment, including overseas investment by our own multinationals. These are all essential elements of supply-chain integration. We have to stop thinking that all exports are good and all imports are bad. Imports are an essential part of integration."

- **Nascimento:** "As soon as trade negotiations get going, the first question is always double taxation. Then you get stuck on that question and you get nowhere on anything else. We've been discussing taxation with the U.S. since 1962. Trade negotiations are fine but only if you can put aside some of these thorny questions and get on with the rest of it."

- **Utsch:** “We’re protecting our industries too much. Without competition, we tend to think our products are perfect, but often they are not. Competition from imports challenges us to do better, to experiment and to innovate. Our current mind set is not working.”

Top News of the Week

IMF applauds fiscal drive but calls for more spending cuts, higher budget surplus. The International Monetary Fund last week released its annual report on Brazil, praising the country’s drive toward better fiscal health but calling for even more spending cuts. Brazil is currently aiming at a primary budget surplus equal to 2.0% of GDP by 2016. The IMF suggested a better target would be 2.5% of GDP. The international lending organization also suggested less reliance on tax hikes and more emphasis on spending cuts as a way to achieve the goal. Some spending should also be shifted from subsidies to infrastructure investments, the IMF said. The report projected a 1% drop in GDP for 2015, followed by a very modest rebound next year for growth of just 0.9%. Brazil will only achieve a 2.5% annual growth rate by 2020, the report said.

Administration’s fiscal package takes two steps forward, one step back in Congress. President Dilma Rousseff last week succeeded in pushing two major fiscal austerity bills through the Chamber of Deputies but not without racking up a significant loss on an embarrassing pension amendment. The Chamber completed work on a bill that will restrict access to certain benefits related to sickness and unemployment. It also passed the main body of a bill limiting access to death benefits under the pension system. Total annual savings from the two bills should add up to about R$14.5 billion. The Chamber’s version will produce somewhat lower savings than the government’s original version, which would have saved up to R$18 billion per year. But the price of passage was inclusion of a congressional amendment altering the formula for obtaining pensions under the regular Social Security System. The Chamber adopted an amendment making it easier for workers to obtain full benefits. The amendment is unlikely to have any short-term effect on Social Security payments but could eventually cost R$4 billion per year once workers start using it. All aspects of the fiscal austerity package must still be passed by the Senate. Spokesmen for the Rousseff Administration said they will seek to block adoption of the unwanted pensions amendment in the Senate. Senate President Renan Calheiros, however, has expressed support for the amendment.

Petrobras continues to normalize investor relations, releases first quarter report. State-run oil company Petrobras got its balance sheets back on track last week by releasing first-quarter 2015 earnings, only weeks after announcing disastrous 2014 figures. The first-quarter produced a better-than-expected profit of R$5.3 billion, down only 1% from the same quarter a year earlier. For 2014 as a whole, Petrobras lost R$21.6 billion as assets lost value in the face of a sweeping bribery and money laundering scandal. First-quarter profits were based on solid gains from domestic oil-product sales in the wake of government-ordered price hikes. Petrobras still remains vulnerable, however, on the debt front, facing higher debt-service payments due to a stronger U.S. dollar.

Business News

Investment News:

Brazil’s **BTG Pactual** investment bank last week announced creation of a fund for investment in re-forestation projects aimed at supplying the paper and pulp industry. The bank said the new fund raised $860 million, higher than the $750 million originally projected. Projects will be located throughout Latin America but will concentrate on Brazil.

Brazil’s **Fibria**, the world’s largest short-fiber pulp manufacturer, will make its first substantial investment since the 2009 merger of VCP and Aracruz that created the company. The company last week announced investments totaling $7.7 billion to expand production at its Três Lagoas plant in Mato Grosso do Sul. Fibria will add capacity of 1.75 million metric tons per year, reaching total capacity of 7.0 million. Money for the investment will come mianly from government loans and capital market operations.

Company News:

Brazilian renewable energy company **Renova Energia** last week announced the sale of wind and hydroelectric assets to U.S.-based **SunEdison.** The assets include 14 wind-energy parks and three small hydroelectric generating stations for total generating capacity of 336 megawatts. SunEdison will pay the equivalent of R$1.63 billion in cash and shares.

Aircraft manufacturer **Embraer** last week announced it will move one of its assembly line operations to its U.S. unit, based in Melbourne, Florida. Beginning next year, the Melbourne facility will assemble Embraer's new Phenom corporate jet. Parts for the jet will be manufactured in Brazil and then shipped to Florida for assembly. Embraer said it was moving the Phenom assembly operation to Florida in order to make room in its main São Paulo plants for manufacture and assembly of its new line of E2 commercial planes.

Brazilian Calendar

-Monday, May 18, Faimafe 2015 Latin American heavy equipment fair, Anhembi Expo Center, São Paulo

-Monday, May 18, Chinese Prime Minister Li Keqiang visit to Brasília

-Thursday, May 21, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

-Thursday, May 21, Brazilian Census Bureau (IBGE) release of monthly unemployment data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$2.99 = $1.00**

Brazilian **crude oil output** fell back slightly in March against the previous month but continued a sturdy advance against year-ago production, the National Petroleum Authority (ANP) said last week. March output was 2.413 million barrels per day, down 0.7% against February on maintenance and other delays, but up 13.9% from March of 2014. Year-on-year growth was due to continued development of the ultra-deep pre-salt region, which saw March output of 673,000 barrels-per-day.

Retail sales fell back by 0.8% in the first quarter against the same quarter a year earlier, the Brazilian Census Bureau (IBGE) said last week. It was the worst performance for retail sales since 2003. Economists saw little prospect of improvement. March sales were down 0.9% against February, with the critical supermarket segment showing a 2.2% decline. Retail sales are off because of rising job security worries, inflation and high interest rates.