Brazil-U.S. Business Council Brazil Bulletin

Interview: Aloisio Campelo, Director of Business and Consumer Surveys for the Getúlio Vargas Foundation; Salomão Quadros, Coordinator of the Economic Analysis Unit of the Getúlio Vargas Foundation; Silvia Matos, Editor of the Getúlio Vargas Foundation macro-economic bulletin

--"The uncertain political climate is hurting business and consumer confidence."—

Brazil is unlikely to reach even modest government-set goals for inflation, growth and government accounts this year, according to a trio of economists at the prestigious Getúlio Vargas Foundation. The economists are marginally more hopeful for 2016 based on the expected success of fiscal and monetary adjustments being put in place this year. The economists recently spoke with investors, academics and reporters. Excerpts follow:

- **Aloisio Campelo:** "The uncertain political climate is hurting business and consumer confidence. Confidence fell sharply in 2015 and there is no sign it will improve for the balance of the year. Business confidence is lower than it was during the 2008-2009 global crisis. This could affect prospects for a second-half economic recovery."

- **Salomão Quadros:** "Inflation expectations have risen with unusual speed this year, moving from the region of 6% to over 8%. Worse still, early-year projections usually turn out to be overly optimistic. Inflation is being underpinned by the new policy of realistic public utility rates. This was a long time coming and is being implemented gradually. We expect an overall 58% rise in electric power rates this year and an average 12.8% rise in all public utilities rates. We see inflation closing out 2015 at between 8.4% and 8.6%."

- **Silvia Matos:** "We do not expect the government to meet its primary budget surplus targets in 2015 or 2016. (The target for 2015 is a surplus equal to 1.2% of GDP, rising to 2.0% in 2016.) Instead, we see something like 0.7% this year and 1.2% next year. Revenues are declining in both nominal and relative terms. Expenditure in recent years has consistently risen faster than growth or inflation. The government will have to make a huge effort to reverse these trends. Much of the fiscal adjustment will have to come from slashing government infrastructure investments. Another part of the adjustment depends on Congress."

- **Campelo:** "Businesses are retrenching on both investments and hiring. They are worried about the combination of rising costs and declining consumer demand. On the cost side, they are being hurt by rapid increases in fuel prices and electric power rates. The steep decline in consumer confidence is due to deteriorating family finances. Inflation is eating up family budgets. High interest rates are making it harder for them to manage consumer debt. Families are also worried about job security."

- **Matos:** "The fiscal adjustment will not be enough to reverse the trend toward higher debt-to-GDP ratios. Stagnant GDP growth won't help either. We see gross national debt rising from 59% of GDP in 2014 to 61% this year and 62% next year."

Top News of the Week

Gross Domestic Product falls 0.2% in first quarter against previous quarter. Brazilian GDP fell back by 0.2% in the first quarter against the fourth quarter of 2014 while declining 1.6% against the first quarter a year earlier, the Brazilian Census Bureau said last week. IBGE figures follow:

First Quarter 2015 Gross Domestic Product

	Versus Fourth Quarter 2014	**Versus First Quarter 2014**
GDP	***-0.2%***	***-1.6%***
Industry	***-0.3%***	***-3.0%***
Agriculture	***+4.7%***	***+4.0%***
Services	***-0.7%***	***-1.2%***
Investment	***-1.3%***	***-7.8%***

(Source: IBGE)

Brazil's economy was hurt in the first quarter by persistent inflation and a series of interest rate hikes by the Central Bank designed to fight it. Inflation is currently running at over 8.0%, while the base interest rate is 13.75%. High prices and towering interest charges have discouraged consumers. But long-term business confidence is also low, causing a worrisome 7.8% year-on-year decline in investments. Such problems have led economists to forecast an overall 1.5% decline in GDP for Brazil this year following bare 0.1% growth in 2014. There were a few bright spots, however. A record soybean harvest this year is helping lead a rally in agriculture. Meanwhile, oil, gas and minerals extraction all gained during the first quarter. Finance Minister Joaquim Levy said the government is hopeful of a broad, if modest, economic recovery in the second half.

Brazil signs investment agreement with Mexico, opens talks on broad trade accord. Brazil and Mexico last week signed a Cooperation and Investment Facilitation Agreement, only Brazil's third such bilateral accord. The other two are with Portuguese-speaking Angola and Mozambique. The agreement offers various forms of legal protection to companies working in both countries. The accord was signed in Mexico City by visiting Brazilian President Dilma Rousseff and Mexican counterpart Enrique Peña Nieto. The two countries also announced the start of talks on an ambitous trade accord that could eventually turn Brazil and Mexico into virtual free trade zones for each other's products and services. Brazil and Mexico are, respectively, Latin America's largest economies, together accounting for more than 50% of GDP and trade. Current bilateral trade agreements cover only about 12% of total trade between Brazil and Mexico. President Rousseff admitted that the negotiations represented a change in strategy for Brazil, which has tended to shun trade liberalization over the past decade. Brazilian officials said the talks with Mexico pose no problem with respect to Brazil's membership in the Mercosur South American trade bloc. The 1991 Mercosur accord specifically allows bilateral agreements between members and Mexico.

Sports join list of scandals following stunning arrests in Switzerland. The sports world was stunned last week with the arrest in Switzerland of seven top soccer officials ahead of a crucial World Soccer

Federation (FIFA) meeting. Among those arrested was Brazilian representative at the FIFA gathering José Maria Marin, a former President of the Brazilian Soccer Confederation (CBF). Marin now awaits extradiction to the U.S. in a Swiss jail. A U.S. probe led to the arrests. U.S. officials are investigating what they called a widespread corruption ring surrounding international soccer. Marin said through his attornies that he will fight extradiction and seek to be repatriated to Brazil. On Brazilian soil, however, he could face more trouble. Federal Police announced they will open their own probe into alleged kickbacks, conspiracy and money laundering involving CBF contracts for both international and domestic soccer events. Separately, Rio de Janeiro Senator Romário Faria, a former soccer star, succeeded in an effort to set up a special congressional investigative committee. Among other things, the committee will probe allegations of corruption surrounding the 2014 soccer World Cup in Brazil.

Fiscal austerity measures inch their way through Congress, more to come in June. Congress last week completed action on three major fiscal austerity measures demanded by President Dilma Rousseff. Compromises whittled down total savings from the original proposals but the measures will still succeed in promoting substantial savings for the Federal Treasury. Congress passed two bills limiting access to certain welfare, retirement, unemployment and salary benefits that should deliver total annual savings of some R$14.5 billion. A third bill increases welfare-related taxes on imports and should raise about R$1.2 billion per year in fresh revenues. In June, Congress will take up bills to raise taxes on banking profits and roll back tax breaks on business payrolls. Together, those measures should raise annual revenues by more than R$9 billion.

Congress begins work on complex political reform proposals. The Chamber of Deputies last week began work on complex political reform proposals that are part of an omnibus constitutional amendment. The Chamber approved a proposal ending re-election of incumbent executives (president, governors and mayors), although exempting those elected in 2012 and 2014. The Chamber also approved a proposal explicitly permitting political donations by corporations and individuals. A proposal limiting political party access to free television time and federal financing also won approval. Only parties with congressional representation will have such access. The Chamber also rejected several controversial measures. For example, they voted down a proposal that would ban political party alliances in legislative elections. They also defeated a proposal that would have altered Brazil's proportional representation system for legislative elections by favoring individual over party vote totals in assigning seats. Additional proposals will come under scrutiny in June. One measure would unify all local, state and federal elections as of 2022 while setting the tenure for all offices at five years. Another would end the traditional practice of mandatory voting for all Brazilian citizens.

Business News

Investment News:

The Board of Directors of Brazil's government-run Unemployment Insurance Fund (**FGTS**) last week agreed to a government request to lend R$10 billion to the National Development Bank (BNDES), also a government-managed financial institution. The loan is seen as necessary following suspension this year of lending to the BNDES by the Federal Treasury. The FGTS controls more than R$300 billion in funds.

Company News:

A pair of U.S. pension funds last week filed separate suits against **Petrobras** in a federal court in New York. One fund represents government workers of the state of Ohio, the other represents government workers in various states in the South and Southwest. Petrobras now faces seven different suits, six of them brought by individual pension funds and one a class-action suit representing various funds and individuals. All the suits are based on the same broad complaint—that Petrobras failed to inform investors of the company's true financial condition in the face of a sweeping corruption investigation dating back to 2013. The Brazilian oil company is fighting the claims before New York-based federal judge Jed Rakoff. Separately, Petrobras shareholders, meeting last week, approved the company's 2014 balance sheets, showing a R$21.5 billion loss. They also endorsed management's decision not to distribute dividends this year. Brazil's Federal Treasury holds a controlling stake in the company.

Brazilian Calendar

-Monday, June 1, Trade and Development Ministry release of monthly trade data, Brasília

-Tuesday, June 2, Brazilian Census Bureau (IBGE) release of monthly industrial production data, Rio de Janeiro

-Tuesday, June 2, Second Annual Fashion Forum, São Paulo Commercial Association, São Paulo

-Wednesday, June 3, Brazilian Central Bank Monetary Committee meeting, Brasília

-Thursday, June 4, Corpus Christie national holiday

-Friday, June 5, National Motor Vehicle Manufacturers Association (Anfavea) release of monthly motor vehicle production, sales and export data, Hotel Mercuré, São Paulo

Indicators

Foreign exchange rate: **R$3.18 = $1.00**

Federal **tax revenues** once again showed a marked decline in April, falling 4.6%, in real terms, from the same month a year earlier, the Brazilian Tax Authority reported. Revenues totaled R$109.2 billion for a January-April total of R$418.6 billion, or 2.7% less than the same period in 2014. Revenues are down mainly because of a sluggish economy, but also because of congressional reluctance to scrap tax breaks for consumers.

Brazil's 12-month **current account deficit** has finally begun to shrink on lower travel spending by Brazilians abroad and reduced profit remittances by multinational companies. The 12-month deficit as of April was $100.2 billion, down from $101.6 billion as of March, the Central Bank said last week. The April monthly deficit was $6.9 billion, up from $5.7 billion in March. Travel spending has declined because of a weaker Brazilian Real while profit remittances are lower because of a sluggish economy. But foreign direct investment is also falling. FDI in April was $5.8 billion, down from $8.6 billion for the same month in 2014.

Growth in **total lending** stalled in April in the face of higher interest rates and a broad economic slowdown, the Central Bank said last week. Total lending increased by a mere 0.1% from March to R$3.06 trillion. The rise against April of 2014 was 10.5%. Interest rates shot up in April to an average of 26.4% for all loans from 25.9% in March and 23.9% in April of 2014. Interest rates are rising as the Central Bank battles to pull down inflation, currently running at an annual rate of 8.0%. Arrears also rose in April, hitting 3.0%, up from 2.8% in March and 2.9% in April of 2014.

Brazil's public sector took a small step forward in April by rolling up a monthly **primary budget surplus** of R$13.5 billion, up from just R$239 million the previous month. But the 12-month figure continued to show a deficit, this time to the tune of R$42.6 billion, up from R$39.2 billion as of March. Brazil is aiming at a 2015 surplus of R$66.3 billion.