Brazil-U.S. Business Council
Brazil Bulletin

Interview: Marcelo Cherto, President of Grupo Cherto

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As the old saw has it, every crisis brings an opportunity. That is nowhere more true than in today's Brazilian retail trade, according to Marcelo Cherto. Cherto is president of Latin America's biggest consulting group in the area of franchising. Even better news, according to Cherto, is that the Brazilian crisis is likely to be short-lived. The opportunity, on the other hand, is long-term. Shopping centers and other commercial property owners have been forced by Brazil's economic slowdown, as well as a long period of over-building, to chop rents and other occupation costs. Concession-holders and other retailers can lock in those advantages with long-term leases. Cherto discussed the issues facing retailers at a recent conference in São Paulo. Excerpts follow:

--On Brazil's current crisis: "Even before the crisis hit, companies that were really tuned in were making adjustments. What do you do? You pause, review, make the necessary changes and then go on. Every crisis brings with it the opportunity to clean up your act! It's a chance to get rid of what doesn't work and then proceed in better condition than when you started."

- **On Brazil's economic prospects:** "The crisis will be comparatively short in duration, while the opportunities will be long-lasting."

- **On opportunities for retailers in Brazil:** "Before the downturn, occupation costs for retailers were very high, sometimes absurdly high. It was taking retailers ten years to reach break-even. Those costs have come down *very* sharply as a function of the crisis. There are no longer lines of people outside shopping centers clamouring to buy concessions. In fact, the shopping centers, in some cases, are *looking* for people to buy concessions, especially well-known retailers that are known to attract customers."

- **On financing:** "There's plenty of money floating around. The problems are red tape and high interest rates. In Brazil today, it's easy to borrow R$100 million, but it's hard to borrow R$500,000. You need to think twice before paying the interest charges they're asking. Bank loans may not be the best way to finance your expansion."

- **On the future of shopping centers:** "There has been some over-building. We're seeing more and more empty storefronts. Some cities in the interior have more shopping centers than they can handle. We might see some closings."

- **On the future of franchising in Brazil:** "Overseas investment funds are looking at buying some of the franchising brands. They like the depreciated Brazilian Real. We could see some developments in this area soon. More broadly, we are slowly getting to the point in Brazil where we have multi-franchising. These are people who own various concessions. They may even own concessions from various different brands in various different areas, such as fashion, food and cosmetics. There are people in Brazil who hold 40 and 50 concessions. There are even a few who have incorporated, not as brands but as holders of brand concessions."

Top News of the Week

Brazilian auto industry posts its worst first half since 2006. Brazilian auto makers last week posted their worst first-half performance figures since 2006. First-half output of 1.276 million was down 14.8% from the first half of 2014 while domestic sales of 1.1 million plunged 19% against the first half of last year, the National Motor Vehicle Manufactuers Association said. Even exports were down, by revenue, despite growth in foreign markets. Export revenues totaled $5.5 billion, down 7.4% from the first half of 2014. June figures pointed to a stagnant second half. June domest sales of 179,600 were down 0.4% from May. Production in June decline 12.5% from May to 184,000. The industry has been hurt by sky high interest rates and rising job security worries among consumers, with little prospect for improvement until next year.

Administration issues emergency order designed to reduce job losses. The administration of President Dilma Rousseff last week issued an emergency order instituting a government program designed to discourage companies from firing their employees. The order will remain in force for 120 days while it is reviewed by Congress. Under the order, the government will allow companies to reduce hours and wages by up to 30% against a 'no-firing' pledge. In addition, the government will pay a portion of remaining wages according to a formula linked to unemployment insurance rules. The government will pay its portion of wages, under the plan, from the existing Unemployment Insurance Fund. Unemployment recently reached 6.7%. The unemployment rate during much of 2014 was under 5.0%.

President Rousseff vows to fight impeachment "tooth and nail." In an exclusive interview with *Folha de São Paulo* newspaper last week, embattled President Dilma Rousseff vowed to fight "tooth and nail" against any effort to remove her from office. She said impeachment talk was "a way to foment a coup d'etat in Brazil." Opposition groups are pursuing the possibility of removing the President via two different strategies. A possible impeachment motion in Congress would be based on alleged violations by Rousseff of the 1999 Fiscal Responsibility Act. Meanwhile, the Supreme Electoral Tribunal is investigating allegations of possible campaign finance violations by the 2014 Rousseff campaign. The Tribunal could rule to void the election results because of such violations. However, Tribunal members last week warned that they will need documentary evidence of violations and not merely testimony from witnesses. Rousseff told *Folha* bluntly, "I will not fall from power."

Congress hands President Rousseff another hot potato with minimum salary bill. Congress last week completed action on a bill likely to boost the minimum salary in real terms from 2016 through 2019. Congress also accepted a rider linking hikes in the minimum salary directly to all retirement benefits. Under current law, only the lowest retirement benefits receive the full increase every year with other benefits receiving hikes based on a sliding scale. The administration of President Dilma Rousseff supports the minimum wage element in the bill but opposes linkage to retirement benefits, saying such a link will quickly lead to bankruptcy for the social security system. According to press reports, the President is likely to veto the bill and then send a substitute measure to Congress with a compromise version of the retirement rider. Passage of the bill comes at a time when the administration is seeking to implement a fiscal austerity program.

BRICS countries pledge greater economic co-ordination, launch development bank. President Dilma Rousseff last week attended the annual meeting of the BRICS countries (Brazil, Russia, India, China and South Africa), held this year in Moscow. The five leaders pledged increased co-ordination of economic policies. President Rousseff appealed for greater mutual trade and investment. She re-inforced Brazil's hopes for participation by multinational companies in upcoming concession auctions for infrastructure projects. The five nations also launched the so-called New Development Bank as an alternative to financing by the World Bank and other multilateral agencies. The bank will begin operations in the first half of 2016 with an initial capitalization of $50 billion. Capitalization will later rise to $100 billion. Rousseff said the new bank will co-ordinate lending activities with Brazil's National Development Bank (BNDES). Projects will include concessions for Brazilian infrastructure development. Brazil will name the bank's first executive director.

Business News

Investment News:

Underwriting of **new issues of stocks and bonds** hit a five-year low in the first half of 2015, the National Financial Markets Association (Anbima) said last week. Issues totaled R$56.5 billion, down sharply from R$81.1 billion in the first half of 2014. Many of Brazil's traditional issuers of bonds are currently unable to access the market because of bankruptcies and other legal proceedings associated with the Petrobras bribery and money laundering scandal. Stocks issues are at a near standstill because of the sluggish economy.

Company News:

Executives at Brazilian mining giant **Vale** were celebrating last week. China lifted a three-year ban on docking Valemax bulk cargo vessels. The vessels, among the largest in the world, can move up to 400,000 metric tons each of mineral cargoes. Vale had the ships designed specifically to transport iron ore from Brazil to China. The Chinese imposed the ban in 2012, alleging security reasons. Vale executives have always argued the ban was a non-tariff protectionist barrier designed as a market reserve for Chinese cargo ships.

Brazilian Calendar

-Tuesday, July 14, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$3.16 = $1.00**

Brazilian **inflation** continued to roar in June, hitting 0.79% for the month and 8.89% for the 12 months ended on June 30. The 12-month figure was the highest for inflation since 2003. Services led the list of price rises, with food and fuel lagging. Economists said inflation may have peaked and will begin to ease in the second half of the year. However, few believe Brazil will be able to keep the inflation rate below the 6.5% cap set by the government for this year.