Brazil-U.S. Business Council — Brazil Bulletin

Interview: Raul Velloso, Managing Partner in ARD Consulting Group

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Brazil will meet ambitious fiscal austerity goals in 2015, but at the cost of pushing critical taxation and spending problems forward to next year, according to economist Raul Velloso. A former Deputy Planning Minister, Velloso said structural changes will be needed to make Brazil's public accounts sustainable after the country "muddles through" the present economic difficulties. Velloso discussed the fiscal dilemma at a recent São Paulo meeting of investors and reporters. Excerpts follow:

- **On meeting 2015 fiscal austerity goals:** "It's perfectly possible to meet the 2015 target of a primary surplus equal to 1.2% of GDP. Finance Minister Levy, if he has to, can simply hold back on year-end spending, pushing enough of it into 2016 to meet the 2015 goal. There are also other things he can do, such as holding the states to their debt repayment schedule and slashing government investments. Right now, Levy is working on every front to meet the goal."

- **On Levy's track record:** "Levy has left us some hints from the time he was Treasury Secretary in 2002. For example, in order to meet budget goals that year, he slashed government investments by two-thirds. He could do that again in 2015, cutting investments from the equivalent of 1.2% of GDP last year to just 0.4% this year. He also froze operational expenditure and government salaries. This time around, he has pledged to hold these basic sources of government spending to 2013 levels. If successful, that alone would produce a savings equal to 1.4% of GDP. He has also raised taxes. That will be worth about 0.2% of GDP per year in additional revenue."

- **On fiscal prospects for 2016:** "The problem is what to do next year. The fiscal problem is going to be a lot bigger next year because, this year, we're going to the limit in all the conceivable policy areas. Nobody in Brasília is thinking about 2016. Everybody is focused on surviving 2015. Nobody knows what the next step is. The old economic model is exhausted, but the government doesn't want to admit that."

- **On Brazil's sovereign credit rating:** "In 2014, Brazil was better, on average, than other emerging market countries with the same credit rating. Now, Brazil is better than average on only two variables—tax collections and unemployment. Well, tax collections is not a very good variable for us right now because there isn't much we can do to improve it. Tax rates are at their limit. Unemployment, meanwhile, is rising fast. We're not likely to remain 'above average' in that category for long. What we have to understand is that Brazil's sovereign credit rating is important. If Brazil loses its investment grade rating, that's going to bring a whole new set of problems. Politically, these are problems the Rousseff Administration can't afford to have."

Top News of the Week

Government announces long-awaited plan to boost exports. President Dilma Rousseff last week announced a long-awaited export plan, immediately characterized as “minimalist” by economists and exporters. At the heart of the plan was the government’s decision to make an additional $15 billion available through 2018 under the “interest rate equalization program.” The program pays exporters the difference between a fixed rate and actual market rates on export loans obtained overseas. The government also pledged to reduce paperwork on both imports and exports while negotiating more trade liberalization agreements with foreign partners. Other elements of the plan had been announced previously, including a decision to boost the level of tax reimbursements for exports from 1% over total receipts to 3% by 2018.

CMN takes aim against prices, modifies target band, hikes long-term interest rate. The National Monetary Council, Brazil’s highest economic policy-making body, last week showed renewed vigor in the fight againt inflation, currently running at 8.5% per year. The council reaffirmed its 2016 targets, under Brazil’s inflation-targeting program, and modified its 2017 goals. For 2016, the council set an inflation target of 4.5%, with two percentage points of leeway. That means inflation could weigh in as high as 6.5% and still be considered within the target range. For 2017, the council again set the target at 4.5% but with only 1.5 points of leeway, effectively setting a new, and lower, ceiling of 6.0%. It was the first change in the targeting framework since 2006. The council also hiked its long-term interest rate, boosting it a half percentage point to 6.5%. The rate is used on government-subsidized loans.

Chamber of Deputies passes bill linking retirement benefits to minimum salary. The Chamber of Deputies last week passed a bill linking all retirement benefits under the government-run social security system to increases in the minimum salary. Currently, only the lowest-rung benefits are indexed, while others suffer a so-called “reduction factor” designed to hold down costs and keep the system solvent. The bill must still be considered by the Senate. A spokesman for President Dilma Rousseff said the chief executive will veto the bill if it comes to her desk. Social Security Minister Carlos Gabas said the legislation, if enacted, would cost the system an additional R$9.2 billion per year and would put long-term solvency in jeopardy.

Former President Lula offers critique of PT as donations come under inspection. Former President Luiz Inácio Lula da Silva offered a surprisingly strong critique of his own PT (Partido dos Trabalhadores) last week, even as the party was coming under fire for possible campaign finance irregularities. At a party seminar, Lula told PT leaders, “Maybe it’s time for new blood. Maybe we need an internal revolution.” At the same conference, he said, “We have to decide whether we want to protect our skins, our jobs, and our electoral prospects, or whether we want to protect our vision for the country.” He offered a stiff rebuke to party leaders “interested in only jobs, money, and winning elections.” At a separate meeting of PT leaders, the former president admitted that poor economic performance and spreading scandals “have left me, President Dilma (Rousseff), and the PT under water.” The statements came the same week as the Federal Police said they were investigating possible irregularities in corporate donations to President Lula’s São Paulo-based foundation and to PT campaigns in 2010 and 2014.

Stage set for President Rousseff to meet U.S. counterpart, investors in U.S. President Dilma Rousseff traveled to the United States over the weekend in preparation for a series of meetings Monday through Wednesday in New York, Washington, and San Francisco. On Monday, the President will meet business executives and investors in New York for a discussion of opportunities represented by the Brazilian government’s program of infrastructure concession auctions, which will involve 266 projects and billions of dollars in investments. Monday night, she will dine at the White House. Tuesday will see a series of White House meetings with President Barack Obama followed by an appearance at the 3rd Brazil-U.S. Business Summit hosted by the Brazil Council and the U.S. Chamber. The two presidents are expected to address a number of issues in a joint statement. These could include a drive to double bilateral trade within 10 years by taking a series of steps designed to remove non-tariff barriers and create more uniform technical and legal standards. The two countries may also issue a joint statement on efforts to combat global warming. Other areas to be addressed include mutual recognition of social security payments, Brazilian meat exports to the U.S., easing of visa restrictions, and an increase in cooperation in defense, technology, and education. On Wednesday, Rousseff will visit hi-tech businesses and research facilities in California.

Business News

Investment News:

Abril Educação, the education and education publishing arm of Brazilian publishing giant Abril, last week announced the acquisition of the educational services and educational publishing units of Editora Saraiva for R$725 million. The Saraiva units include two well-known English schools in Brazil, Red Balloon and Wise Up. Private educational services is one of the few growth areas in Brazil's economy currently, according to investment specialists.

Brazilian meatpacker **JBS** last week purchased the European assets of another Brazilian-based protein giant, **Marfrig**. JBS paid $1.5 billion to Marfrig, through a combination of cash and debt assumption, to purchase Marfrig's Moy Park unit. Based in Ireland, Moy Park specializes in poultry products and serves the entire European Community. JBS said it will use the purchase to improve its position in Europe. Marfrig said it will use proceeds from the sale to pay down debt.

Company News:

Brazilian restaurant chain **Giraffas** is planning a massive campaign to sell franchises for its brand in the United States. The company plans to offer franchising opportunities to both Brazilian and U.S. buyers. Currently, the company operates 400 restaurants, including ten in the U.S. Giraffas plans to reach 150 U.S. restaurants by 2020.

Brazilian Calendar

-Monday, June 29, SENACOM communications seminar, São Paulo Engineering Institute, São Paulo

-Tuesday, June 30, Brazilian Central Bank release of monthly primary budget data, Brasília

-Tuesday, June 30, White House meeting between Brazilian President Dilma Rousseff and U.S. President Barack Obama, Washington, D.C.

-Wednesday, July 1, Trade and Development Ministry release of monthly foreign trade data, Brasília

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

Indicators

Foreign exchange rate: **R$3.13 = $1.00**

Brazil's **current account** showed marked improvement in May but only because of a sharp decline in profit remittances and overseas spending on travel. These, in turn, were hit by Brazil's broad economic slowdown and the depreciation of the Brazilian Real. May posted a current account deficit of $3.4 billion for a 12-month figure of $95.7 billion, the Central Bank said last week. April, by contrast, produced a monthly deficit of $6.9 billion for a 12-month total of $100.2 billion. Foreign direct investment also brought some good news, rising in May to $6.6 billion from $5.8 billion in April.

Total **credit availability** in the Brazilian financial system rose 0.7% in May against the previous month and 10.1% against May of 2014, the Central Bank said last week. Credit growth has decelerated somewhat from 2014, when the year closed with robust expansion of 11.3%. The Central Bank said it expects credit to expand by about 9% in 2015. Average interest rates have been on the rise, hitting 27.1% in May, up from 26.5% the previous month and 24.1% in May of 2014. Demand for loans is slackening on a sluggish economy and heavy existing levels of consumer debt.

May saw one of the most disappointing months to date for federal **tax revenues**. Total revenues were R$91.5 billion, down 15.6% from April and 4% from May of 2014, the Federal Tax Authority said last week. Revenues for the first five months of the year were R$570.1 billion, a decline of 3% from the same period a year ago. Revenues are down on an overall sluggish economy. Behind-schedule revenues are hurting the government's ability to meet 2015 fiscal targets.

Brazil's **unemployment rate** rose to 6.7% in May from 6.2% in April and only 4.9% in May a year ago, the Brazilian Census Bureau (IBGE) said last week. Average salaries, meanwhile, plunged 2% from April and 5% from May of 2014 to R$2,117 per month. Employment is being hurt by an overall sluggish economy.