Brazil-U.S. Business Council
Brazil Bulletin

Interview: Gilberto Kassab, Minister of Cities; André Esteves, President of BTG Pactual; Hélio Magalhães, President of Citi Brasil; Gonçalo Bernardo, Executive Director Morgan Stanley

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Brazil's real estate market managed to avoid a price bubble during the heady days of rapid growth over the last decade or so. But now investors face a new challenge—how to boost housing stock, and maintain value at the same time, during an economic slowdown. Experts converged on São Paulo recently for a Brazilian Real Estate Summit. Excerpts follow:

- **Gilberto Kassab:** "First, we need to make some economic adjustments. These will get us back on track for growth. No economy can survive for long without economic growth. Lack of growth will eventually bring social conflicts to the fore."

- **André Esteves:** "I don't believe Brazil experienced a housing bubble. What we have experienced, in the housing market, is the normal ups and downs of the business cycle. Right now, we are in the down side of the cycle."

- **Hélio Magalhães:** "The Brazilian market did not suffer anything like the kind of real estate bubble that produces drastic changes or lasting consequences for the wider economy."

- **Gonçalo Bernardo:** "The next six months will be critical for identifying and eliminating points of uncertainty in the economy. This will help produce a new 'comfort zone' for investors wishing to enter the real estate market."

- **Kassab:** "We need to maintain a minimum investment level, even during a period of fiscal adjustment, by creating new funding sources. We can obtain new funding, for example, from the Unemployment Insurance Fund (FGTS), especially for purposes such as public housing, water and sewage. We expect the fiscal adjustment to be brief. It's not a matter of cutting investments for five or six or ten years."

- **Esteves:** "Internationally, the chief consequence of low interest rates is capital abundance as never seen before. There has never been as much money available to finance good ideas as there is today."

- **Magalhães:** "Real estate investments are secure, but they do come with costs. Any investment is subject to the ups and downs of the overall economy. Once we come through the current fiscal adjustment, our projections show good opportunities for investment in an expanding economy."

Top News of the Week

Brazil's 2015-16 farm plan includes reduced spending but increase in loans. President Dilma Rousseff last week announced the government's 2015-16 farm plan, which includes a 20% increase in funding for loans but a 25% cut in government agricultural investments. Total lending availability for farmers and others in the agricultural sector will reach R$187.7 billion, up 20% from last year. Most of the lending will come from state-run Banco do Brasil at subsidized rates equal to an average of 8.75%. Last year's subsidized lending rate was 6.5%. But the government will cut its investments in agriculture from R$44 billion last year to R$33 billion this year. According to the Agriculture Ministry, Brazil is on schedule for a record grains and oilseeds haul in the 2014-15 crop year of 202.2 million metric tons, up from 193.6 million the previous year. The government has made no forecast yet for the 2015-16 crop.

Central Bank orders sixth straight interest rate hike; base rate at 13.75%. The Brazilian Central Bank last week ordered its sixth straight interest rate hike, this time to the tune of a half percentage point to 13.75%. The decision by the eight-member Monetary Policy Committee was unanimous. The bank issued a terse accompanying note, emphasizing the need to remain vigilant on inflation. Brazil's inflation rate is currently running at 8.2%. Brazil's government is commited to inflation this year of no more than 6.5%. According to economists, the brief Central Bank note serves as a signal for more interest rate hikes to come. Most economists expect the base rate to reach, or surpass, 14.0% by July. Brazil's real interest rate of 5.23% is considered the highest in the world.

Separate investigations probe alleged corruption in 2014 Brazilian World Cup. Separate investigations in the U.S. and in Brazil are probing into alleged corruption at the 2014 soccer World Cup in Brazil. According to news reports, the U.S. Justice Department is investigating as many as 1,000 contracts involving the World Soccer Federation (FIFA), suppliers of equipment and services, sponsors and Brazil's Local Organizing Committee. During most of the period leading up to the 2014 games, the organizing committee was chaired by Ricardo Teixeira, who was also President of the Brazilian Soccer Confederation (CBF). The Justice Department declined comment on the investigation. In Brazil, meanwhile, a separate probe became explicit last week when Federal Police indicted Teixeira and four others in relation to alleged kickbacks, fraud, money laundering and other crimes related to the 2014 games and other soccer events under the aegis of the CBF. Police said they detected some R$465 million in possibly illicit funds moving through accounts controled by Teixeira between 2009 and 2012. Lawyers for Teixeira declined comment on the indictments.

Business News

Investment News:

Overall Brazilian **investment in infrastructure** projects will decline by some 19% this year, partly because of financial problems facing major contractors and partly because of steep cuts in government spending, according to a report last week by the Inter.B consulting group. The report said total infrastructure investments will shrink to R$105.7 billion in 2015, or the equivalent of 1.78% of GDP. In relative terms, that would put infrastructure investments at the same level as 2007. In 2014, such investments were equal to 2.37% of GDP. Hardest hit areas are likely to be electric power generation and distribution, telecommunications services and transportation, the report said.

The Brazilian Financial Exchange (BM&Fbovespa) finally managed to stage its first IPO of 2015 last week. Government-run bank **CEF** sold off its insurance brokerage in an initial public offering of shares netting the bank some R$603 million. The figure was slightly higher than market expectations. CEF is expected to spin off its main insurance unit later this year.

Brazil's **National Development Bank** (BNDES) last week announced new lending rules for large-scale projects. The new rules oblige companies with annual billing of R$1 billion or more to match BNDES loans with debentures issues. The rules apply to expansion projects equal to R$200 million or more. BNDES officials said the new approach is designed to encourage increased use of capital markets at a time of diminishing government financing. They said the BNDES's lending capacity for expansion projects in the coming years could decline by half. BNDES loans come with subsidized interest rates. Rates are sometimes as low as 6%. Brazil's base interest rate is 13.75%.

Company News:

Petrobras surprised critics last week by successfully placing its first overseas bonds since March of 2014. The company sold $2.5 billion in bonds carrying the unusual maturity of 100 years. Demand was heavy but only when the state-run company agreed to pay an annual yield of 8.45%. The money will help Petrobras smooth out its tricky debt profile. Total indebtedness is equal to over R$330 billion, making Petrobras the most heavily indebted oil company in the world. The company has been struggling with problems related to internal corruption and lower world oil prices.

Brazilian Calendar

-Wednesday, June 10, Brazilian Census Bureau (IBGE) release of monthly IPCA inflation data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$3.15 = $1.00**

Brazil fell two places in this year's **World Competitiveness Index** to a miserly 56th. The index is compiled every year by Switzerland's Institute for Management Development. The index ranks 61 countries. The U.S. was, once again, first in this year's index. Brazil has dropped by 18 places since 2010. The reasons are familiar and include a broad economic slowdown, a regulatory system clogged by red tape, increased corruption, poor infrastructure and rigid labor rules that discourage innovation and productivity.

Brazil may have finally turned the corner on its **foreign trade** performance in May but only at the cost of steep declines in both imports and exports. May showed a hefty monthly surplus of $2.76 billion, up from $491 million in April. The January through May deficit was shaved to $2.3 billion, less than half the $4.86 billion deficit rolled up during the first five months of 2014, the Trade and Development Ministry said last week. But overall five-month exports were down 17% on lower international commodities prices. Imports fell even more, 19%, as demand turned sluggish in the face of Brazil's economic downturn.

Brazilian **industrial production** took a sharp downturn in April, falling 1.2% against March and 7.6% against April of 2014, the Brazilian Census Bureau (IBGE) said last week. The performance brought industrial output down to the 2009 level. Worst hit was capital goods, which showed a year-on-year decline of 24%, indicating a lack of interest in investment by manufacturers. Industrial output has been hurt by high levels of consumer indebtedness, persistent inflation and sky-high interest rates.