Brazil-U.S. Business Council
Brazil Bulletin

Interview: Maurício Michelotto, Founder Outlet Lingerie; Alexandre Guerra, President of Giraffas Restaurants; and Alexandre Tadeu da Costa, Founder of Cacau Show

--"The fastest growing franchise in Brazilian shopping centers right now is 'For Rent.'"—

Brazil's business environment has become more competitive in the face of an economic downturn. According to three experienced retailers, survivors will be the ones who pay the most attention to details, especially the details of consumer wants and needs. Maurício Michelotto, founder of the Outlet Lingerie chain, Alexandre Guerra, President of fast-growing Giraffas restaurants, and Alexandre Tadeu da Costa, founder of the traditional Cacau Show chain of chocolate and coffee shops, recently met with investors and reporters in São Paulo. Excerpts follow:

- **Maurício Michelotto:** "When selling to women, you have to be aware of the details. Women customers know what they want, and they insist on getting it. They want the whole package—price, product, service, ambience, etc. As a lengerie retailer, you need to keep track of every detail."

- **Alexandre Guerra:** "Brazil is ideal for franchising because of its size and diversity. Consequently, franchising is better developed here than in most other countries. It's becoming more sophisticated and more highly elaborated. In the food industry in Brazil, there is still a lot of competition from "mom and pop" establishments, which also means there is a lot of room for growth by companies that are organized for quality, price, and service."

- **Alexandre da Costa: "**Now is a time for caution, but it is also a time for seizing opportunity. We opened 1,000 stores in the first ten years and expect to open another 1,000 stores in five years. As we open more stores, we're expanding production capacity. It's actually a time of expansion for us, not retraction."

- **Michelotto: "**Costs are like fingernails. You have to trim them periodically. Right now, consumers are trimming their costs, so I have to trim mine. In times of crisis, you need to be selling the right product at the right price. The fastest growing franchise in Brazilian shopping centers right now is 'For Rent.'"

- **Guerra:** "Brazil is cyclical, like everywhere else. In 2010, everybody in Brazil thought growth would go on forever. Today, nobody sees an end to the crisis. Well, this too will pass. *And* it represents opportunity. Store rents are extremely low. Now is the time to reserve your slot."

- **Costa: "**The business environment in Brazil is constantly changing, more so than in most countries. You open tomorrow's newspaper, and there are new regulations for food and drugs. The next day, there are new taxes; the day after that, new environmental norms. Whatever. Get used to it!"

Top News of the Week

Government slashes primary budget surplus goal, orders new spending cuts. Embattled Finance Minister Joaquim Levy last week admitted publicly that economic conditions, and government finances, are considerably worse than officials had expected at the beginning of the year. Disappointing tax revenues, a sluggish response from Congress on fiscal austerity legislation, and continued spending pressure in the face of an economic slowdown have conspired to undermine budget surplus goals. Consequently, Levy slashed the government's early-year surplus target of 1.13% of GDP to a new, and more "realistic," target of just 0.15%. Levy also announced an additional budget freeze of R$8.6 billion for a total so far this year of R$79.5 billion. The minister also admitted that Brazil's government will be unable to meet previously established budget surplus goals for 2016 and 2017. Instead of the originally set targets of 2% of GDP for those years, the government will now aim for a 2016 surplus of 0.7%, rising to 1.3% in 2017. More broadly, the Finance Ministry issued forecasts for overall 2015 economic performance, saying the economy is likely to shrink by 1.49% this year while suffering inflation of 9%.

Electoral prospects of ex-President Lula seem to fade, poll shows. Allegations of corruption, and other issues, have finally caught up with once popular ex-President Luiz Inácio Lula da Silva, according to a poll released last week. A nationwide poll by the MDA organization, conducted for the National Transport Confederation, showed Lula trailing opposition Social Democrat Aécio Neves in a sounding of public opinion well ahead of the scheduled 2018 election. The poll gave Neves 35.1% of the vote, against 22.8% for Lula and 15.6% for environmentalist Marina Silva. Lula served two terms as president from 2003 through 2010, exiting from power with a personal popularity rate of about 80%. That helped Lula get his hand-picked successor, Dilma Rousseff, elected and re-elected. But allegations of widespread corruption in the Rousseff administration, coupled with an economic downturn, have robbed the current chief executive of her popularity and tarnished the reputation of her predecessor. Last week's MDA poll showed only 15.3% of voters supporting President Rousseff, down from 18.9% in a similar poll in March.

Government will allow companies to use tax credits to offset arrears. President Dilma Rousseff last week signed an order allowing companies to use tax credits to offset tax arrears. The order comes into effect immediately although Congress could veto it at any time during a 120 review period. According to tax officials, some 29,000 Brazilian companies have accumulated arrears of R$860 billion. Companies may now apply virtually any and all tax credits to pay such arrears but can only do so by dropping related administrative or judicial suits against the government. Officials noted that the new program is not an amnesty. Companies owing penalties and interest must still make good on them, although now they can do so using offsetting tax credits.

Government slashes tariffs on 272 capital goods, data, and telecom parts. Brazil's Foreign Trade Board (Camex) last week slashed tariffs on 272 capital goods and parts in efforts to spur investments in various industries. The capital goods covered by the council resolution included transportation and manufacturing equipment. A separate resolution covered parts for equipment used in the telecommunications and data processing industries. The council said the reduced tariffs will help Brazilian companies planning some $1.4 billion in investments, especially in logistics and manufacturing enterprises in the Northeast. Previously, tariffs on the 272 items ranged from 14% to 16%. They will now drop to just 2%. The reductions will be in effect through the end of this year for the data and telecom parts and through the end of 2016 for the capital goods. The council estimated that 22.8% of the expected imports during the period will come from the United States.

Business News

Investment News:

Brazilian sugar and ethanol giant **Raízen** last week completed an ambitious R$240 million investment by inaugurating its premier second-generation ethanol mill, located in Piracicaba, São Paulo. The 2G mill uses sugarcane bagasse and even straw to process into ethanol. Raízen is a joint venture between Cosan and Shell. Company officials said Raízen could build as many as seven more of the mills in the coming years depending on market conditions and performance at the Piracicaba site.

Company News:

Brazilian airline **TAM** last week announced a series of cutbacks, citing a sluggish economy and rising costs because of inflation and the depreciation of the Brazilian Real against the U.S. dollar. TAM said it will cut back its operations by 8% to 10%, but without abandoning any domestic or foreign routes. The company will gradually scale back its workforce by about 2%.

Brazilian Calendar

-Wednesday, July 29, Brazilian Central Bank Monetary Policy Committee meeting, Brasília

-Thursday, July 30, Brazilian Central Bank release of monthly banking data, Brasília

-Friday, July 31, Brazilian Central Bank release of monthly primary budget data, Brasília

Indicators

Foreign exchange rate: **R$3.35 = $1.00**

Brazil's **current account deficit** continued its easing trend in June, but only because of declining imports and sparse profit remittances by multinational companies. According to Central Bank figures released last week, the June deficit was only $2.5 billion, less than half the $5.1 billion deficit in June of 2014. The first-half 2015 deficit was $38.3 billion, down sharply from $50 billion for the first half of 2014. But foreign direct investment is also declining, as multinational companies shy away from a faltering economy. FDI in June was $5.4 billion for a first-half total of $31 billion. That was down sharply from FDI of $46 billion in the first half of 2014.

Brazil's **unemployment rate** jumped to 6.9% in June, up from 6.7% in May and 4.8% in June of 2014, the Brazilian Census Bureau (IBGE) said last week. Employment opportunities are drying up in the face of an economic downturn, high interest rates, and persistent inflation. Wages are also in decline, falling 2.9%, in inflation-adjusted terms, from June 2014 to R$2,149 per month for the average registered worker as of June of this year.