The Week in Review

On the Economic Front

Economic Measures for 2015

On Monday, Finance Minister, Joaquim Levy announced tax increases that could generate up to BRL$ 20.6 billion in revenue, estimated to equal one-third of the targeted fiscal adjustment. Four major changes in tax measures will be made by the Rousseff Administration affecting particularly fuels (gasoline and diesel), financial transactions, imports, and cosmetics. The tax increases are part of an effort to adjust the public accounts and *"to increase confidence in the economy."* The increase in the Tax on Financial Transactions (*Imposto sobre Operações Financeiras* – IOF) from 1.5% to 3% was published on Wednesday in the Official Gazette. It targets personal loans, increasing the cost to consumers, which in part is intended to discourage consumption and lower inflation.

Electricity

On Monday, rolling power blackouts hit at least eight Brazilian states including Sao Paulo, Rio de Janeiro, and the Federal District. An increase in energy use and transmission problems forced ONS (*Operador Nacional do Sistema Eletrico*), which oversees power generation, transmission, and distribution, to require utilities to cut electricity in the Southeast. Most of the power was restored after about 90 minutes. The prolonged draught in a country heavily dependent on hydroelectric power has forced utilities to purchase increasing amounts of energy from gas-fired plants, raising their costs significantly. Between supply constraints and the fiscal need to eliminate subsidies, electricity rates are projected to increase by 30% this year. Although energy rationing has been avoided so far, it would further weaken Brazil's slowing economy, which is projected to grow by less than 0.4% this year. Power outages are increasing hardships for residents of the most densely populated areas of Brazil, like São Paulo, where millions are already experiencing shortages of drinking water.

On the Political Front

World Economic Forum

In Davos, Finance Minister Joaquim Levy said on Wednesday that Brazil is working "step by step" to implement policy adjustments that will eventually return economic growth to Brazil, and that there should not be too much concern over the effects of falling oil prices and the possibility of U.S. interest rate increases. He also stated that the needed austerity measures could negatively affect economic growth in the short term, but that his team is working hard to regain credibility and reinvigorate growth as soon as possible. President Dilma Rousseff declined to participate in Davos, ostensibly to attend the inauguration ceremony of Bolivian President Evo Morales in La Paz. (See *The Pulse* Below)

Task Forces

Healthcare

Sanitary Measures: On Tuesday, Provisional Measure (*Medida Provisoria* – MP) 656/14 was signed into law (Lei Nº 13.097). The MP originally covered taxation on wind power equipment, but several amendments on different issues were included.

Highlights covering sanitation measures are:

- ✓ Brazilian Health Surveillance Agency's (*Agencia Nacional de Vigilancia Sanitaria* - ANVISA) directors will have the authority to develop and approve its rules of procedure, as well as define the area of expertise of the organizational units and the executive structure of the agency;
- ✓ Anvisa will also regulate companies operating licenses, where each license expiration date to be decided on a case by case basis, which would allow future terms to exceed the current one-year limit;
- ✓ Deadline extension from five to ten years for product registration at Anvisa, diminishing bureaucratic procedures and simplified registration renewal for drugs;
- ✓ Renewal exemption of operating permits for companies engaged in health promotion (pharmacies, drug stores, importing medicines, among others).

Highlights on direct or indirect participation, including control, of foreign companies in the Brazilian healthcare sector are:

- ✓ Through the donation of an international body linked to the United Nations, or technical cooperation organization for financing and loans;
- ✓ Companies who intended to install, operationalize, or explore:
  - general hospital, specialized hospital, polyclinic, general clinic, or specialized clinic;
  - clinical analysis laboratories, pathological anatomy, and genetics;
  - physiotherapy services;
  - diagnostic imaging services;
  - actions and surveys on family planning;
  - health insurance and private health care plans.
- ✓ In philanthropic general hospitals;
- ✓ In health services without lucrative purpose, maintained by a company for its employees and their dependents, without any burden on social security

Today, the Brazilian Constitution provides that healthcare is open to private initiative; however, it restricts the participation of foreign companies in the provision of healthcare assistance.

Oil & Gas

13th Bidding Round for Oil and Gas: The government will likely hold the 13th round of bidding for oil and gas exploration at the end of this year. There were expectations of it happening in the first half of 2015; however, according to government sources, the dramatic fall in the international price of oil has led oil companies to reduce investments in general, and the Petrobras crisis, in particular, has further encouraged a more cautious

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approach to the auction. Because of ongoing investigation into the Petrobras “kickback” scandal, 23 companies are now forbidden from working with the state oil company, raising questions as to how the local content requirement can be met in the next round of bidding. Experts point out that the local content policy may suffer a major setback given that Petrobras started the year with international bids already part of the investment schedule, inviting foreign companies to build gas compression modules for six pre-salt FSPO (Floating Production Storage and Offloading).

The Pulse

President Rousseff Demurs on World Economic Forum Invitation

President Rousseff had intended to make Brazil’s case personally to foreign investors at the World Economic Forum in Davos this week. In the end, as was increasingly expected, she demurred, sending Joaquim Levy, her Minister of Finance, in her stead. She expressed a preference to attend President Evo Morales’ third inauguration as President of Bolivia. In her absence, Minister Levy outlined Brazil’s policy adjustments, arguing that in the short run, needed austerity measures would stabilize the economy and eventually return it to a path of sustainable growth, irrespective of the challenges it faces internally and abroad.

Joaquim Levy, head of Brazil’s economic team, offered an extraordinarily frank assessment of the economy in his public remarks. He acknowledged that the government will have to make cuts to several areas of government spending, including some social programs, reduce or eliminate subsidies for energy and transportation, and continue the cycle of fiscal and monetary tightening. He noted that the austerity package could result in “flat growth” this year, offering a difficult truth in an approach refreshing for a candor long absent from previous government announcements.

Indeed, the new administration has made major policy strides already. It raised interest rates, restricted credit, cut social benefits, reduced government expenses, elevated public tariffs (especially on energy and public transportation), and announced new and larger taxes for various economic sectors (although the latter have not been formalized yet). The main goal is a return to a primary budget surplus of at least 1.2% of GDP in 2015. The measures taken so far could achieve half of that objective, which, although a good start, suggests that more austerity is on the way.

Some dissatisfaction has already be voiced by the Brazilian people as seen by public demonstrations against industry layoffs, the rise of public transport tariffs, rising labor claims, and water and energy shortages that are already occurring. Brazilian society, however, has yet to feel the full sting of a slumping economy and the new restrictive economic policies. Employment levels are just beginning to fall, price adjustments are new, wages have long benefitted from oversized increases, and many people are distracted by vacation as the summer festivities head toward Carnival. But by March, the reality of a restrictive economic environment will hit Brazil harder, and there is little expectation that a turning point will occur before August, so Brazil is about to enter a period that will test the sustainability of the new middle class for the first time in a period of economic hardship.

At this juncture, many simply hope that the promise of future growth will generate the needed support to survive this difficult transition. On February 2, President Rousseff will send to Congress her State of the Union address, where she will publicly show what she fully has in mind in order to overcome this difficult period.