

Brazil

Back to the game?

Luis Miranda - Senior Partner Belvedere Investimentos



Brazil
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MACRO FUNDAMENTALS

MONETARY POLICY & FX

MICRO DYNAMICS

GOVERNMENT & POLITICAL AGENDA



Brazilian New Government Starting Point on Macro Fundamentals Couldn't Have Been Better

The Positive side:

Balance of Payments & Reserves

- Brazil remain with a strong balance of payments with an elevated trade balance, small current account deficit easily financed by FDI (foreign Direct investments) & portfolio investments.
- Strong reserves of USD 370 billion approximately

Monetary Policy

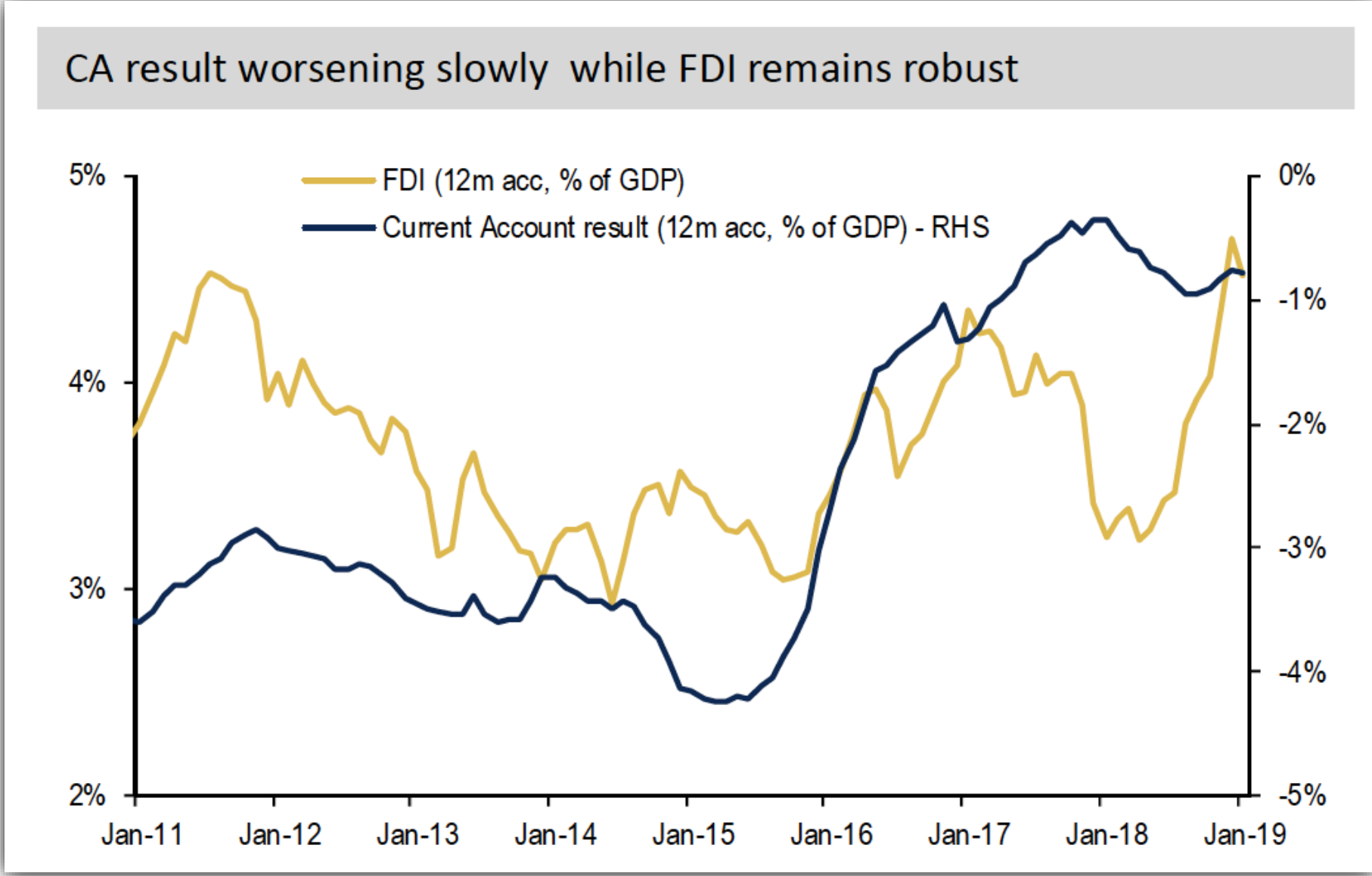
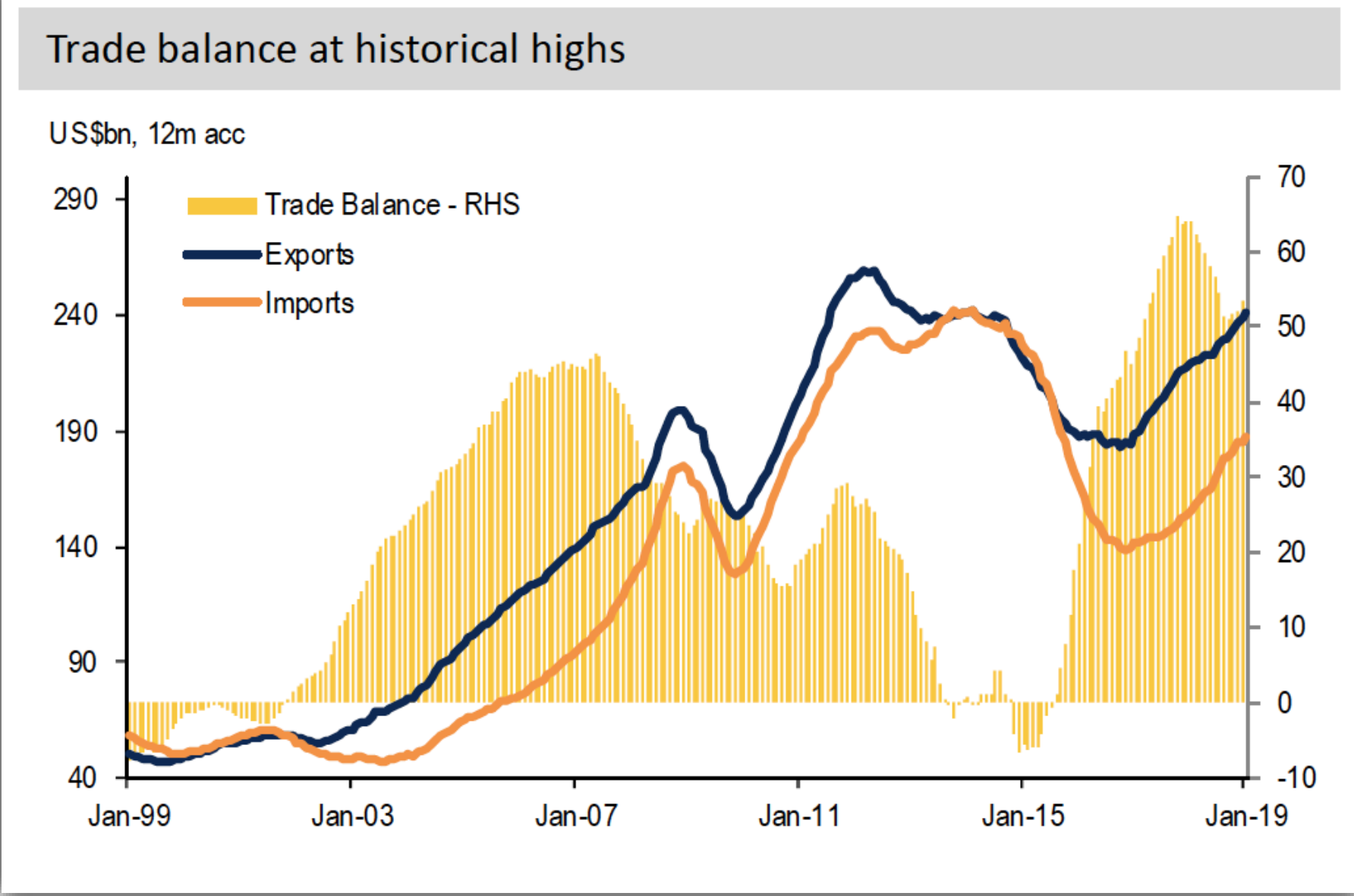
- We have now the lowest SELIC Rate (6.5%) in history,
- An Almost independent Central Bank (acts independently but not legally independent)
- An Inflation Target regime that has increased confidence in Central Bank and has gained over inflation expectations

Inflation

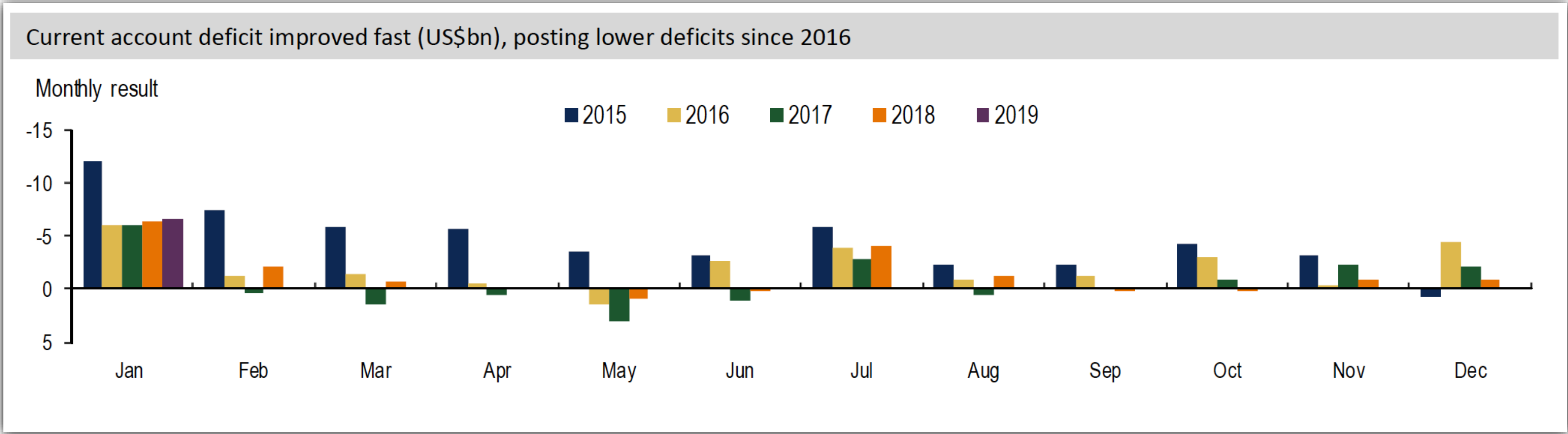
- Inflation and inflation expectations in Brazil is well anchored with both expectations for 2019/20
- below Central Bank target of 4.25% and 4.15% respectively.
- Last Focus survey are showing inflation expectation for 2019 and 2020 at 3.87% and 4.0% respectively

MACRO FUNDAMENTALS

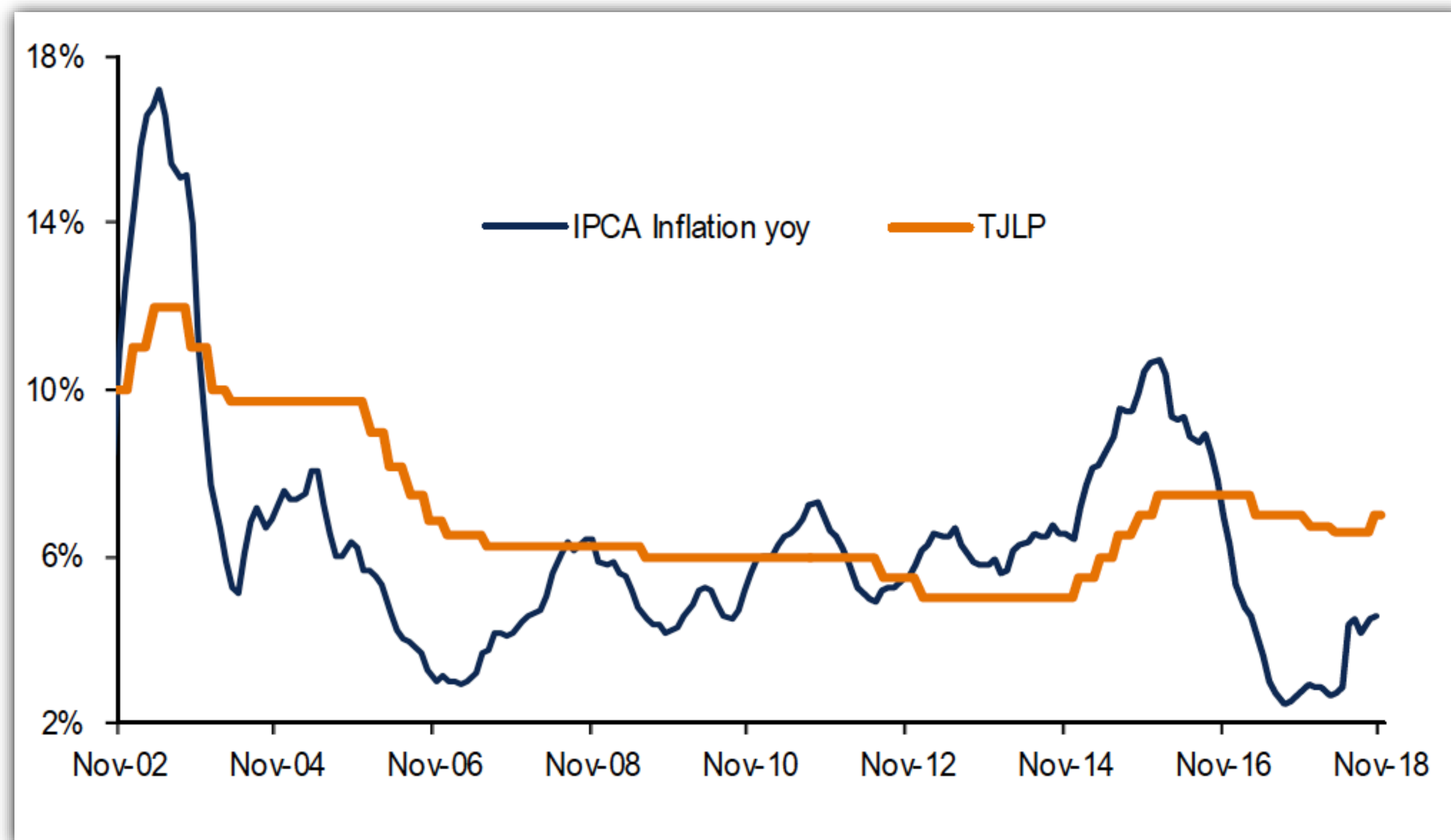
BALANCE OF PAYMENTS



MACRO FUNDAMENTALS



MACRO FUNDAMENTALS



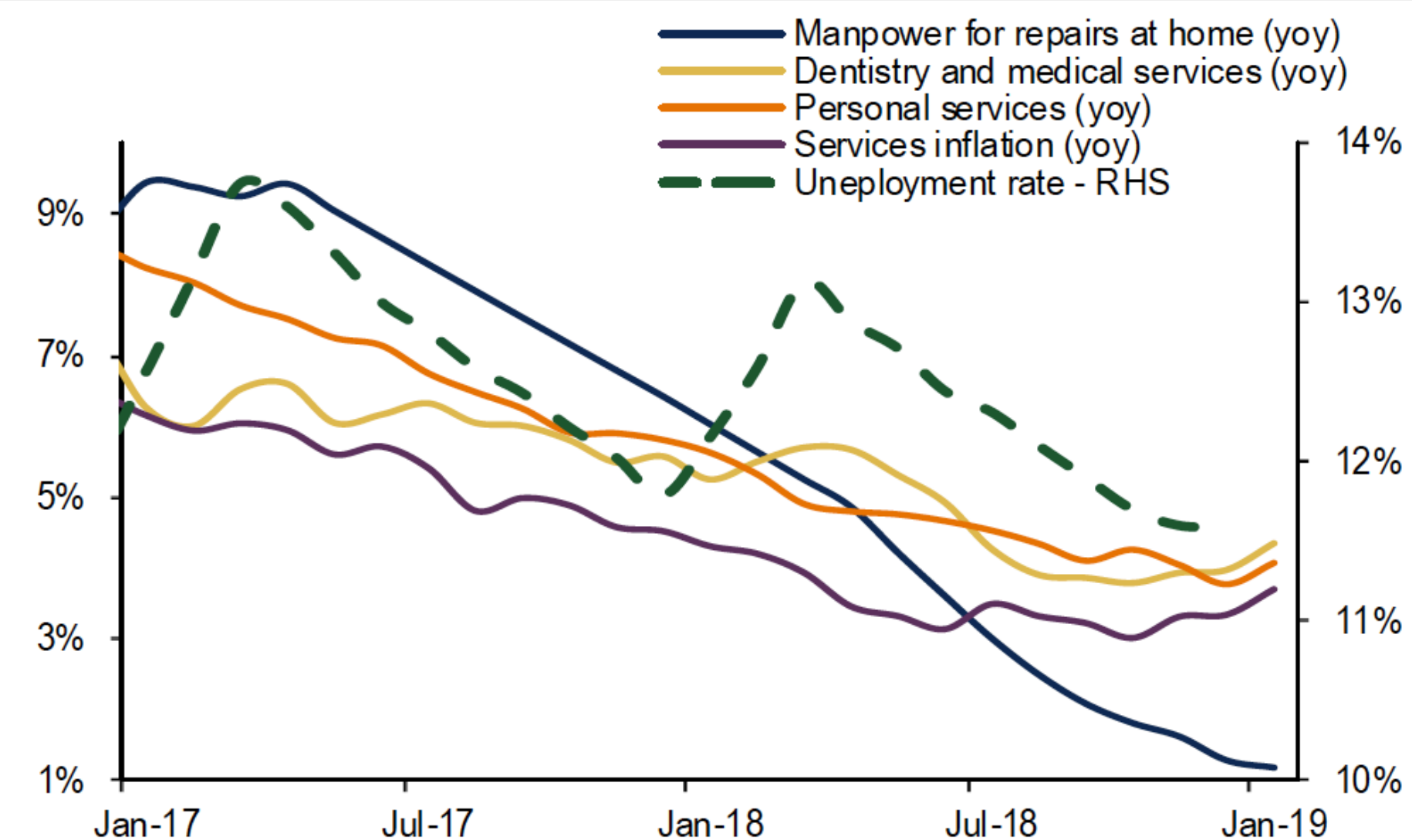
MACRO FUNDAMENTALS

A structurally benign inflation backdrop

	2018	2019F	2020F	Weights (Dec 2018)
IPCA (yoy)	3.7%	4.2%	4.0%	100%
Market-driven	2.9%	4.0%	4.0%	74%
Non-durables	-2.7%	4.5%	4.0%	23%
Durables	-1.2%	2.5%	2.8%	8%
Semi-durables	2.4%	2.7%	2.5%	7%
Services	4.5%	4.3%	4.5%	35%
Regulated prices	6.2%	4.8%	4.0%	26%
Electricity	8.7%	4.5%	4.8%	4%
Gasoline	7.2%	5.0%	4.0%	5%

INFLATION

Services inflation remains benign



The Negative Side:

Fiscal Deficit & Problems

- The fiscal situation in Brazil is a dire problem from past Governments and a reality check for the new one
- The main causes are: Large and growing Social Security deficit; Higher mandatory (current) expenses that even led to spending cap during Temer; Budget rigidity
- The main consequences are: low levels of public investments, crowding-out of private investments and fiercely dispute and fiercely dispute for scarce resources within Government
- Elevated Debt/GDP (78%)

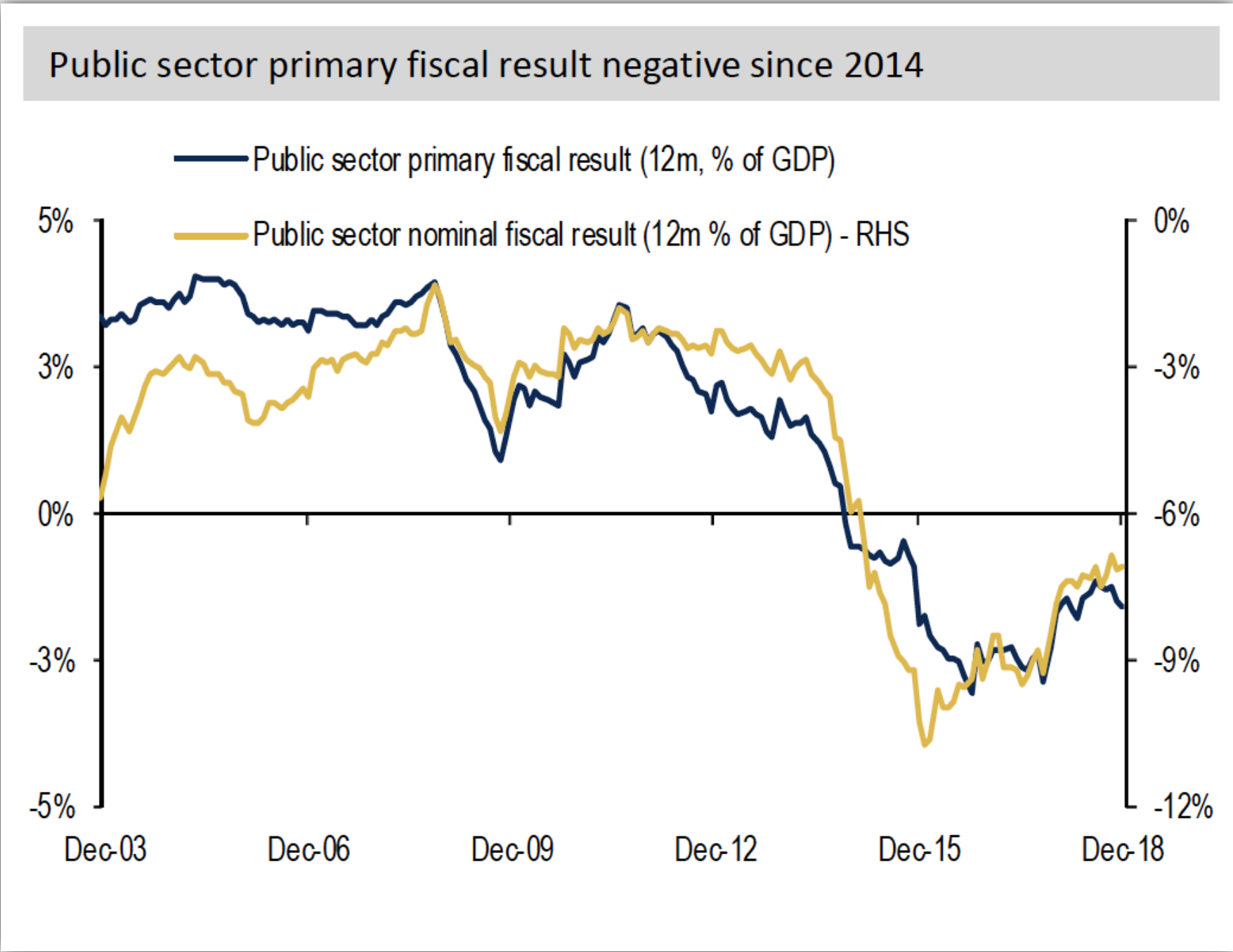
Growth

- Lackluster growth due to low levels of investments and a recession that stills weight down on consumption and labor, but
- Economic growth is resuming at low pace with markets projecting between 2.5 to 3% for 2019 and 3% for 2020

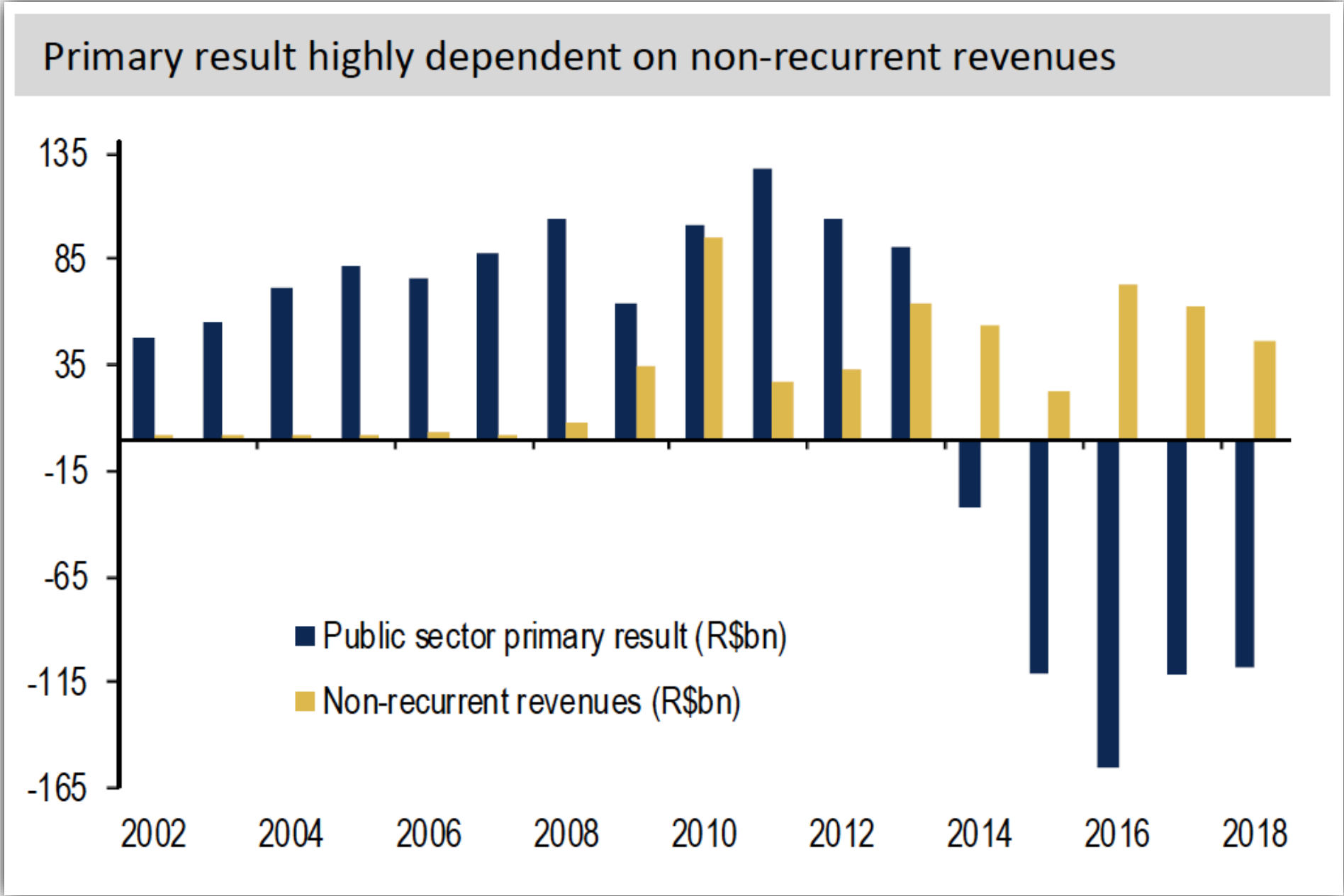
Solution = Reforms

- Social Security reform is probably the most important and the government proposal is probably the one who addresses the problem seeking for savings above R\$ 1 trillion in 10 years
- And the others reforms like taxation, political

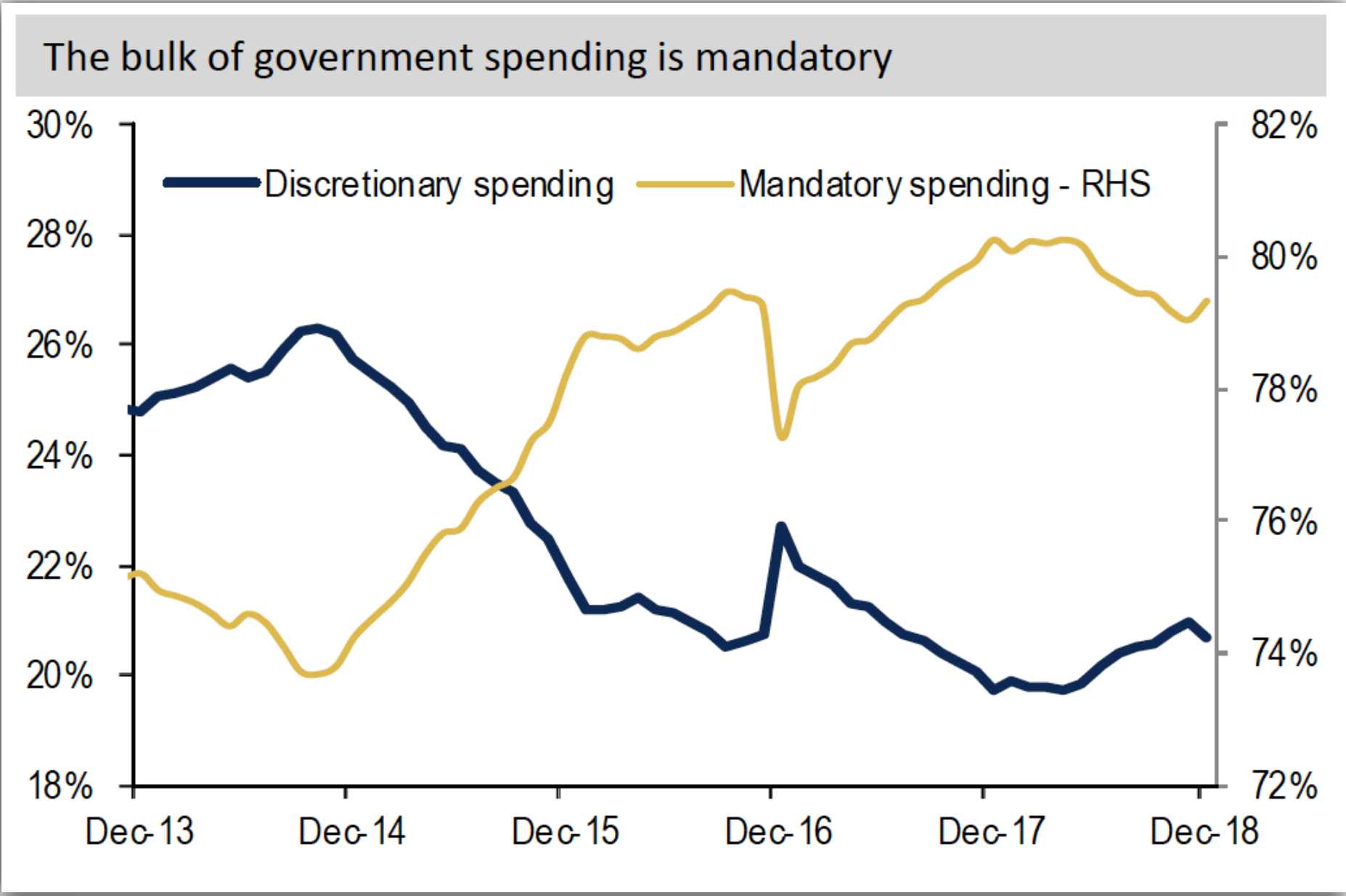
MACRO FUNDAMENTALS



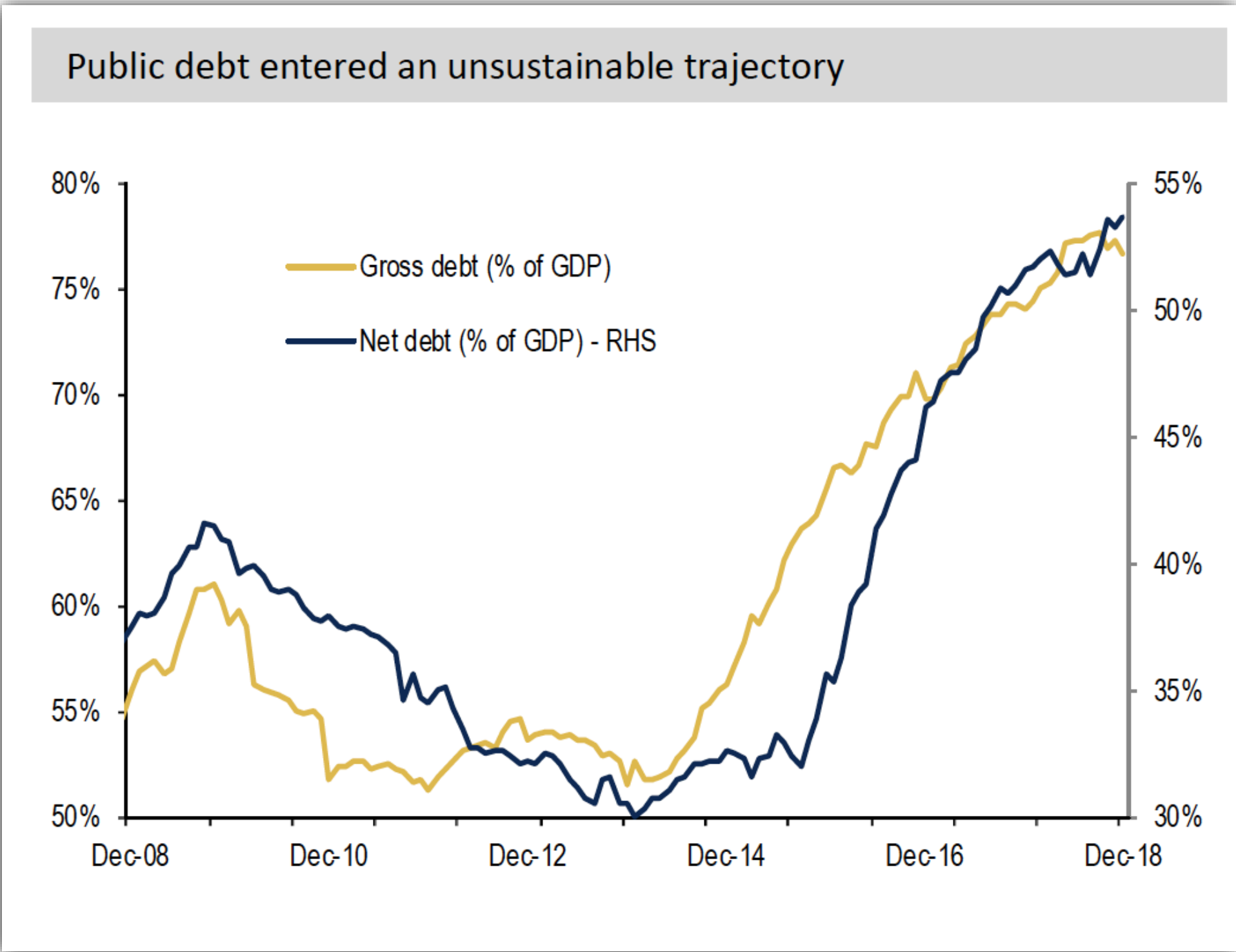
FISCAL DEFICIT & PROBLEMS



MACRO FUNDAMENTALS

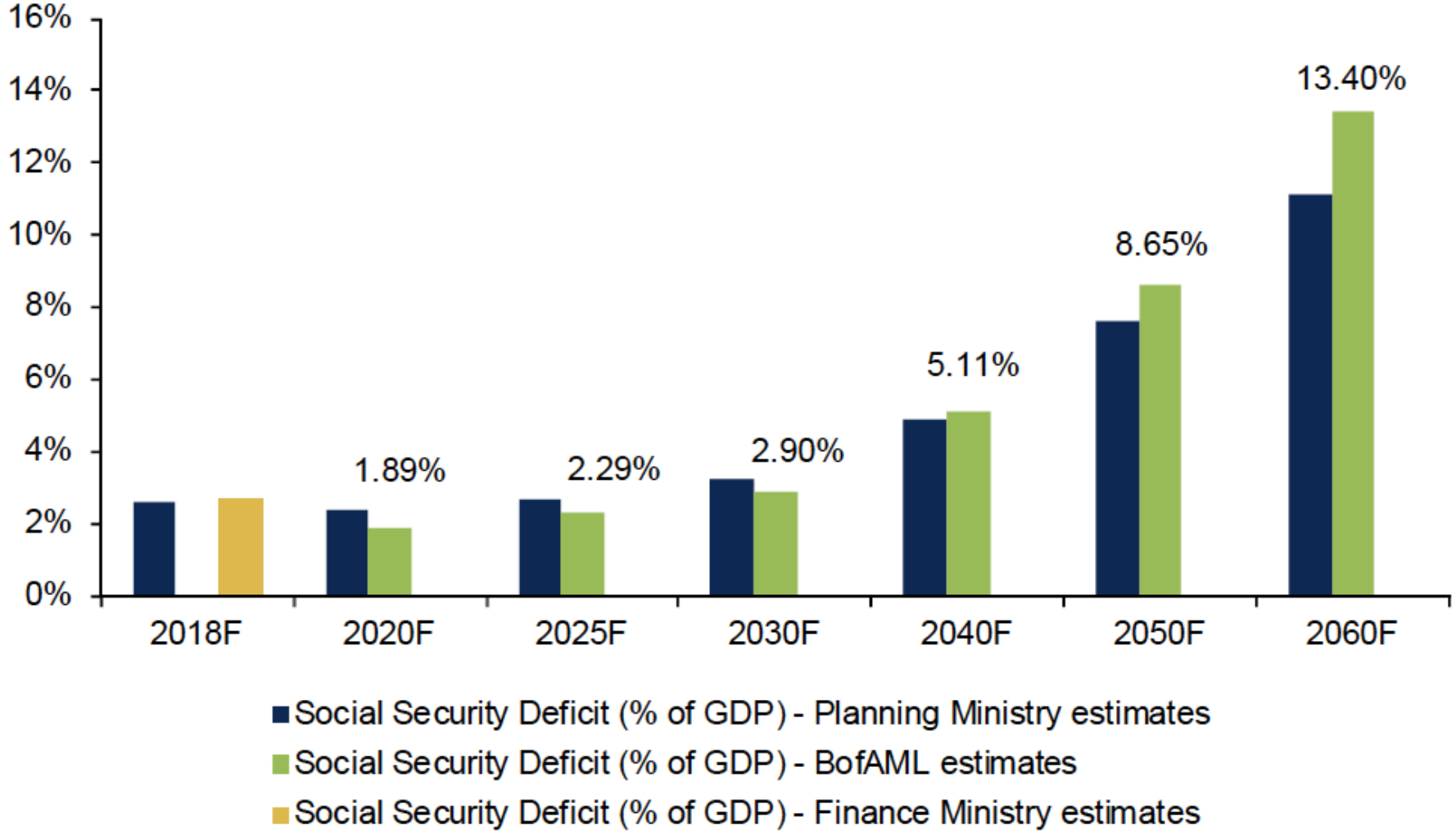


FISCAL DEFICIT & PROBLEMS



MACRO FUNDAMENTALS

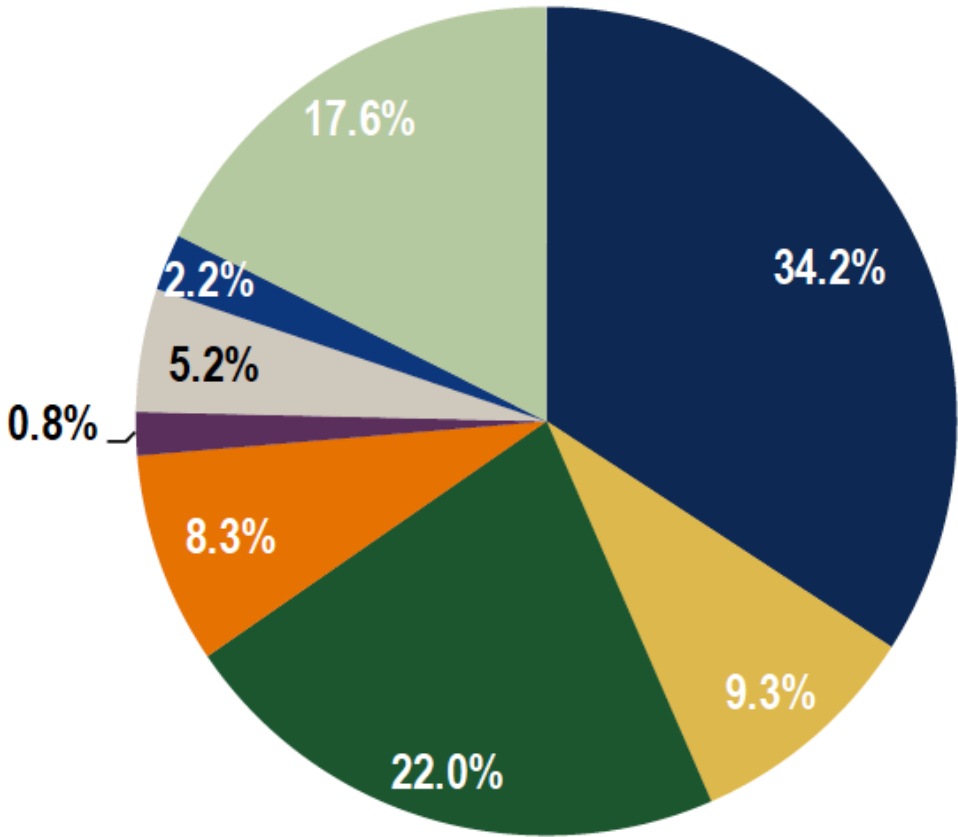
Social security deficit could reach 13.4% of GDP until 2060



FISCAL DEFICIT & PROBLEMS

Social security represents almost 44% of total spending

- SS expenses - urban
- SS expenses - rural
- Staff & social spending
- Unemployment insurance & social assistance
- Judicial deposits
- Other mandatory spending
- PAC spending
- Other discretionary expenses

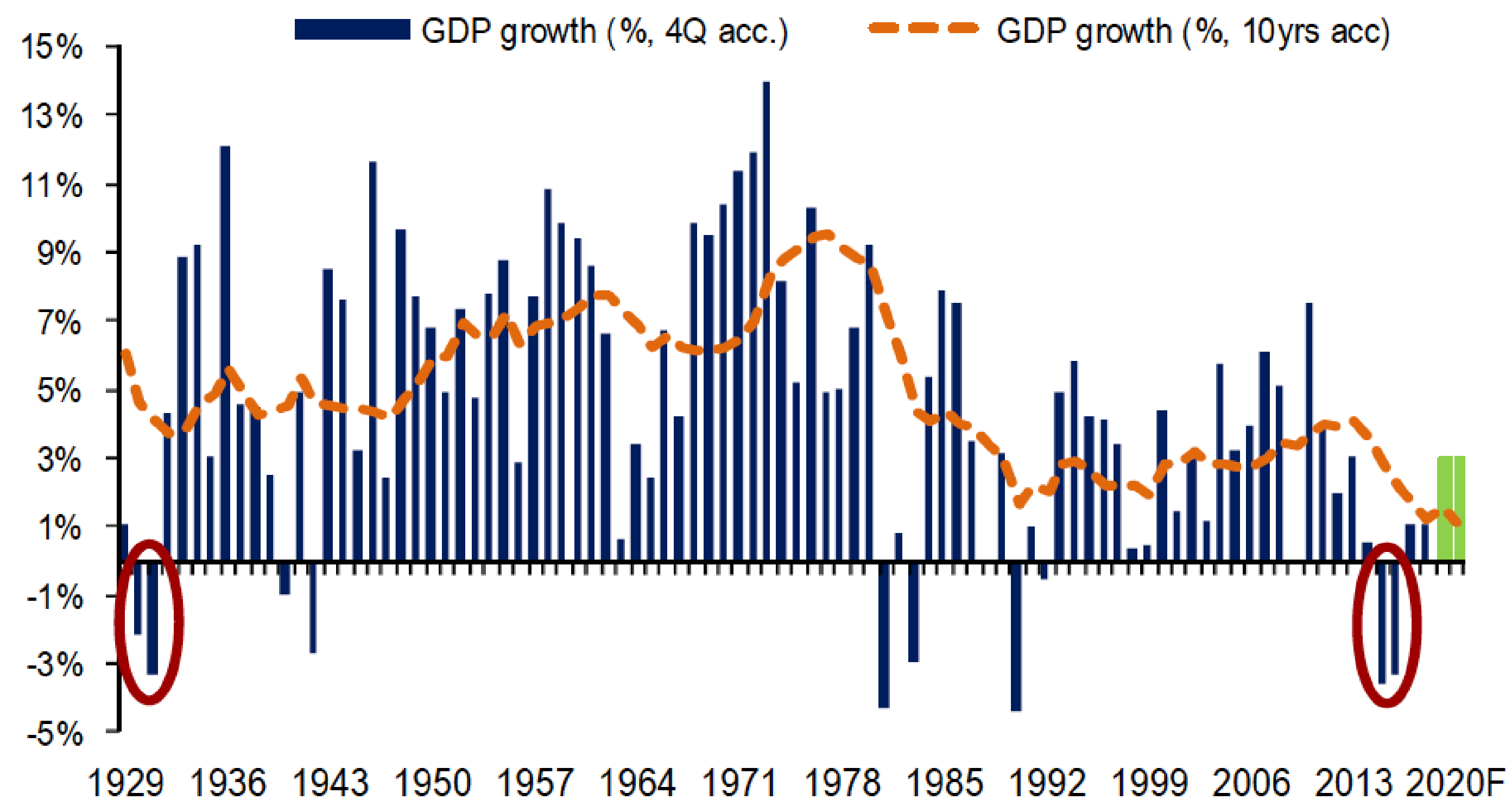


SOCIAL SECURITY REFORM

Rules proposed by Bolsonaro's reform		Current pension rules
Retirement requirements for private workers	Initial minimum retirement age for private sector of 61 years for men and 56 for women. These ages will begin to rise six months each year from the approval of the reform, until reaching 65 years (men) and 62 years (women). The minimum retirement time is 20 years.	Men and women retire on average with 55 and 50 years, respectively, after completing 35 years of contribution if men and 30 if women. However, if men and women reach 65 and 60 years of age, respectively, and have contributed for a minimum period of 15 years they can also retire.
Transition rules for private workers	<ul style="list-style-type: none"> ▪ Time of contribution (35 years for men and 30 years for women) + scores attributed by the individual age and time of contribution. ▪ Time of contribution (35 years for men and 30 years for women) + minimum retirement age - initial minimum retirement at 61 years (men) and 56 (women). Minimum age to rise six months each year, until reaching 65 years (men) and 62 years (women). ▪ For those who need two years old to meet the minimum contribution time for retirement (35 years for men and 30 for women) can opt for retirement without minimum age. ▪ Initial minimum retirement age at 65 years for men and at 60 years for women (to rise six months each year until reaches 62 years). 	-
Retirement requirements for public workers	Initial minimum retirement age for public sector is 55 years (women) and 60 years (men), which will rise gradually until reaching 62 years (women) and 65 years (men).	Minimum retirement age is 60 years for men and 55 years for women.
Transition rules for public workers	▪ Time of contribution (35 years for men and 30 years for women) + scores attributed by the individual age and time of contribution + 20 years working as a public employee.	-
Benefit calculations	In the permanent rule, the percentage may exceed 100%. The value of the benefit cannot be less than 1 minimum wage (R\$988.00) or higher than the ceiling of the INSS (R\$5,839.45). The benefit is calculated with 60% of the average contribution wages + 2% per year of contribution exceeding 20 years.	Limit for the benefit for private workers' regime at R\$5.189.82 in 2016 and yearly adjusted by inflation. Maximum benefit corresponds to the average of the 80% highest wages during working life. The benefit is calculated according to the 85/95 formula (age + contribution for women/men), where a worker gets the maximum benefit with 35 years of contribution if men and 30 if women.
Other benefits	Beneficiary will have the benefit of higher value, plus a portion of the lower value, obeying a ladder: 80% If the value is equal to a minimum wage; 60% of the value exceeding the minimum, up to the limit of two; 40% of the value exceeding two minimum and 20% of the value above three minimum wages.	Possible accumulation of more than one type of benefit such as death, disease or disability pension benefits. Annual readjustment of benefits according to the minimum wage.
Teachers	Minimum retirement age at 60 years and minimum contribution time of 30 years for men and women.	Minimum contribution time of 30 years (men) and 25 (women).
Rural workers	Minimum retirement age at 60 years for men and women. The minimum retirement time will be 20 years.	Minimum retirement age is 60 years for men and 55 for women. Minimum time of rural activity is 15 years.
Rate of contribution of the private regime	The rates of contribution to retirement are now more progressive. For those who earn a wage until R\$1751.81 (8%), between R\$1,751.81 - R\$2919.72 (9%) and more than R\$2919.72 (9%).	For those who earn a wage until R\$998 (7.5%), between R\$998.01 - R\$2000 (7.5% - 8.25%), between R\$2000.01 - R\$3000 (8.25% - 9.5%) and more than R\$3000 (9.5% - 11.68%).
Rate of contribution of the public regime	The rates of contribution to retirement are now more progressive. For those who earn a wage until R\$998 (7.5%), between R\$998.01 - R\$2000 (7.5% - 8.25%), between R\$2000.01 - R\$3000 (8.25% - 9.5%), between R\$3000.01 - R\$5839.45 (9.5% - 11.68%), between R\$5839.46 - R\$10000 (11.68% - 12.86%), between R\$10000.01 - R\$20000 (12.86% and 14.68%), between R\$20000.01 - R\$39000 (14.68% and 16.79%) and more than R\$39000 (more than 16.79%).	11% for all the wages ranges.

MACRO FUNDAMENTALS

Recovering from the worst recession in history



A Strong Economic Central Bank Teams are Supportive for a Road of Recovery

Monetary Policy

- SELIC rate at the lowest level in Brazilian history and expected to remain at 6.5% in 2019 and 7.25% for 2020.
Is it too low or still room to fall?
First copom meeting with Roberto Campos (new CB president) was neutral but markets was implying and pricing the possibility of lower rates.
- Inflation Expectation below Central bank targets for the next few years
- Wide output gap implying that growth can resume without being inflationary
- New Government agenda of reforms should support lower level of Interest rates for longer

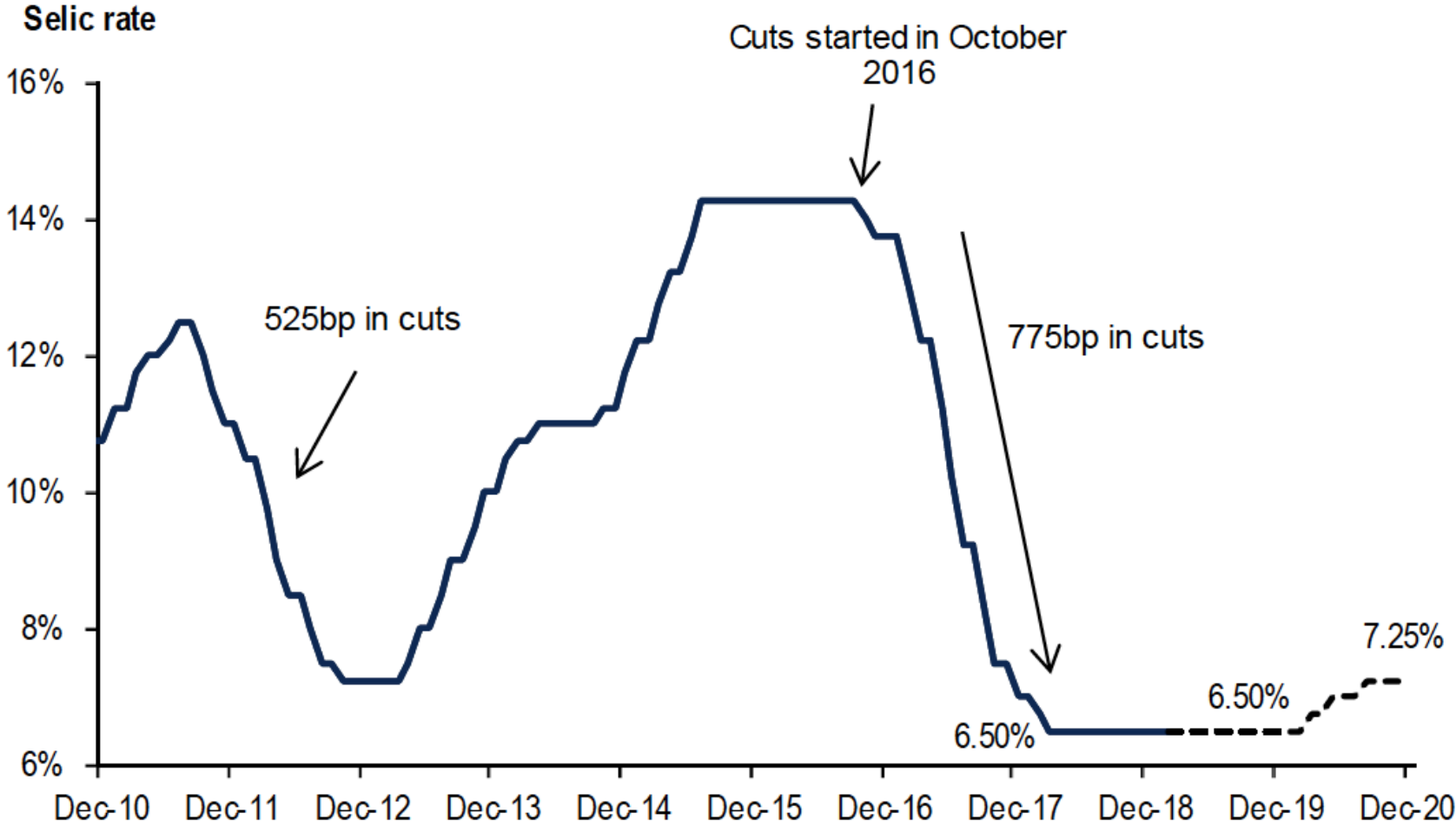
Brazilian Foreign Exchange – A Struggle Between Flows & Fundamentals

- Foreign Direct Investments (FDI) remains strong but with lesser quality due to higher intercompany loans. Nevertheless, it still a higher percentage of GDP and easily financing Brazil current account needs
- Portfolio Investments is on a waiting mood not adding to inflow at the moment. Reforms are key to the return of foreign investors
- External scenario is still the main risk but level of FX is positive for trade balance and reduced current account deficit
- High levels of reserve has been a safety protection on global crises

MONETARY POLICY & FX

MONETARY POLICY

Selic rate on hold at new historical low

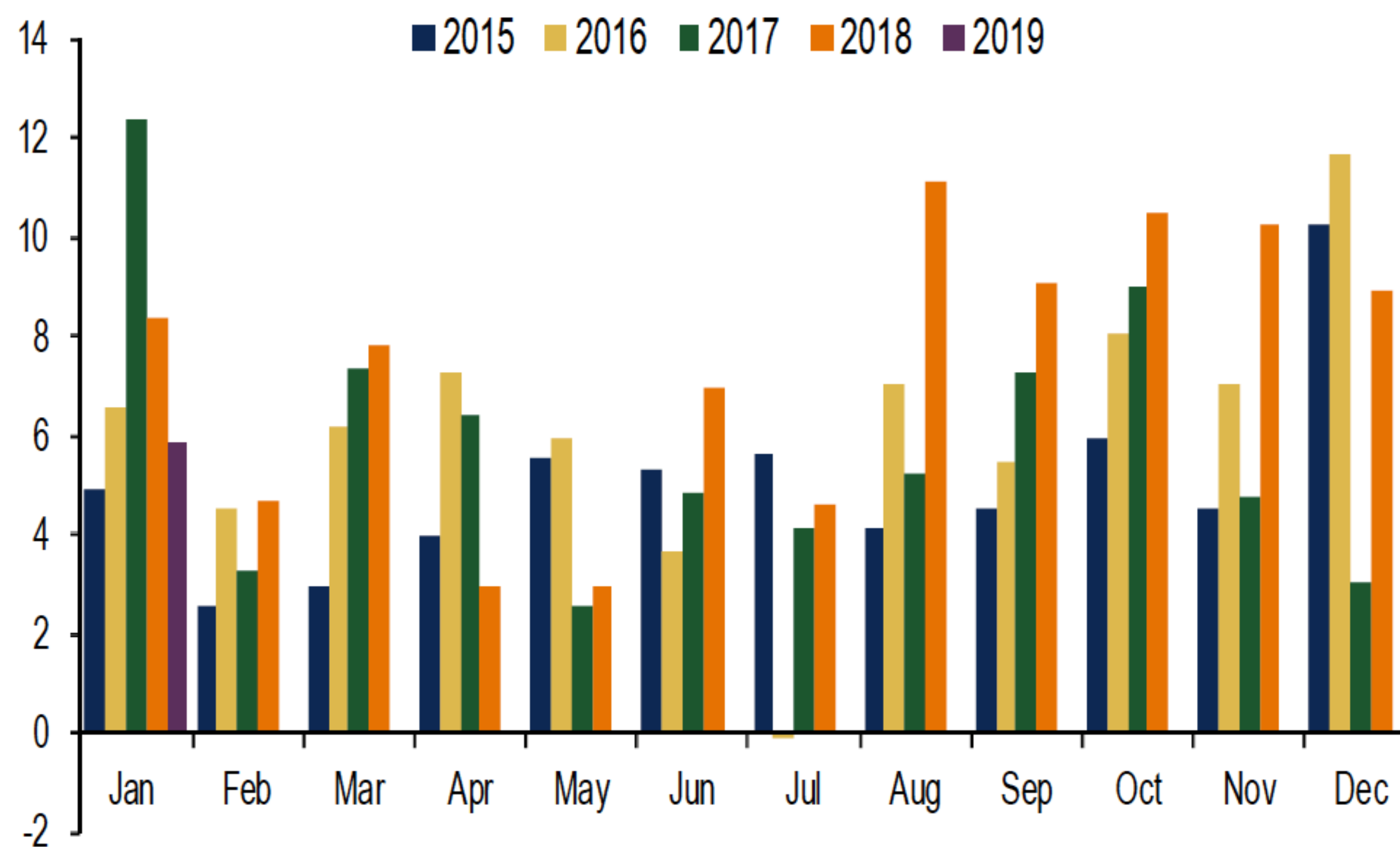


Fiscal uncertainties: a risk to monetary policy stance

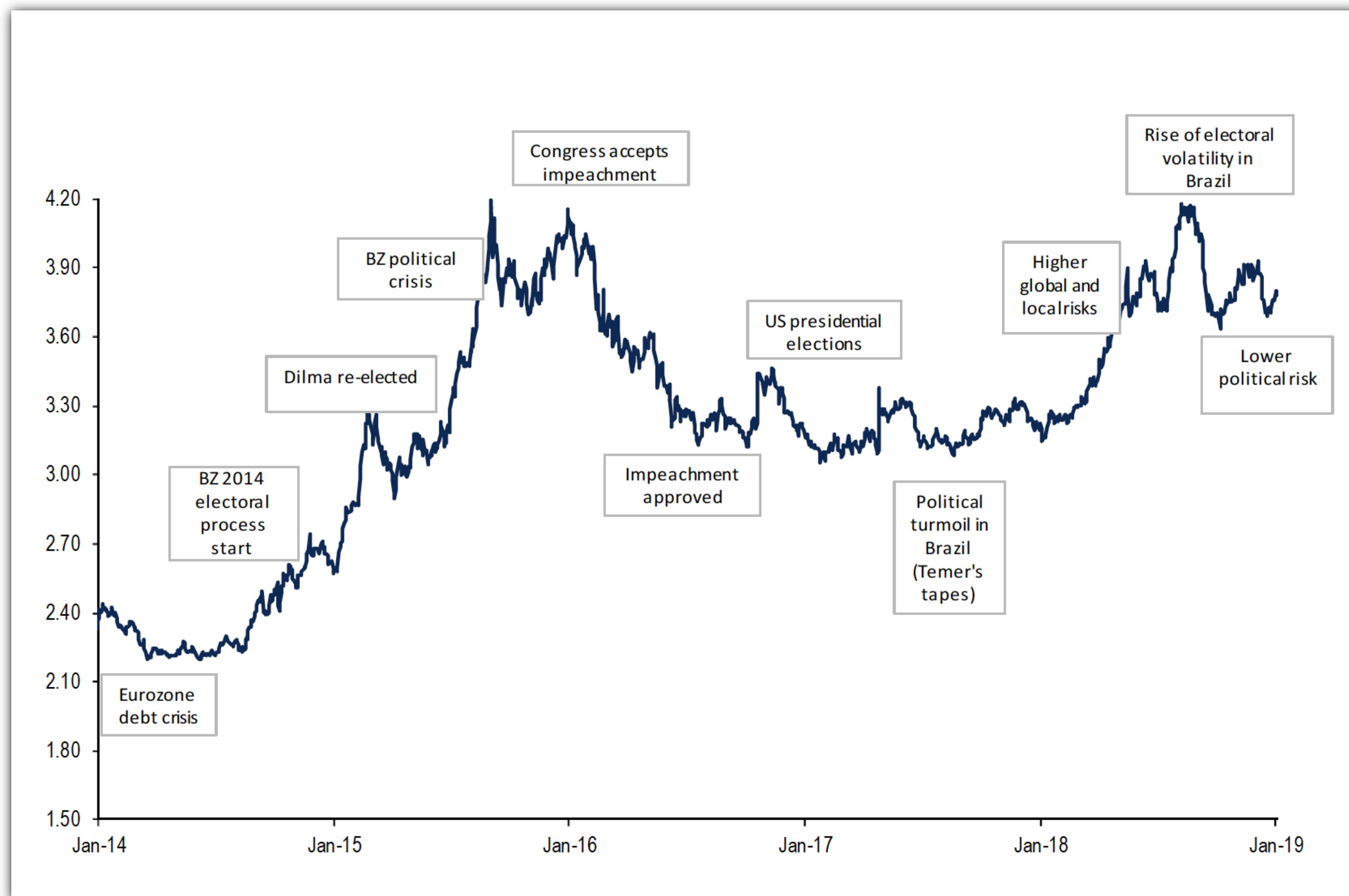
	Monetary policy rate (%)	Stance	Public Sector primary fiscal surplus (% GDP)	Stance
2008	13.80	contractionary	3.3	contractionary
2009	8.80	expansionary	1.9	expansionary
2010	10.80	contractionary	2.6	contractionary
2011	11.00	contractionary	2.94	contractionary
2012	7.30	expansionary	2.18	expansionary
2013	10.00	contractionary	1.72	expansionary
2014	11.75	contractionary	-0.6	expansionary
2015	14.25	contractionary	-1.9	expansionary
2016	13.75	expansionary	-2.5	expansionary
2017	7.00	expansionary	-1.7	contractionary
2018F	6.50	expansionary	-1.8	expansionary
2019F	7.00	neutral	-1.7	contractionary
2020F	8.00	contractionary	-0.9	contractionary

MONETARY POLICY & FX

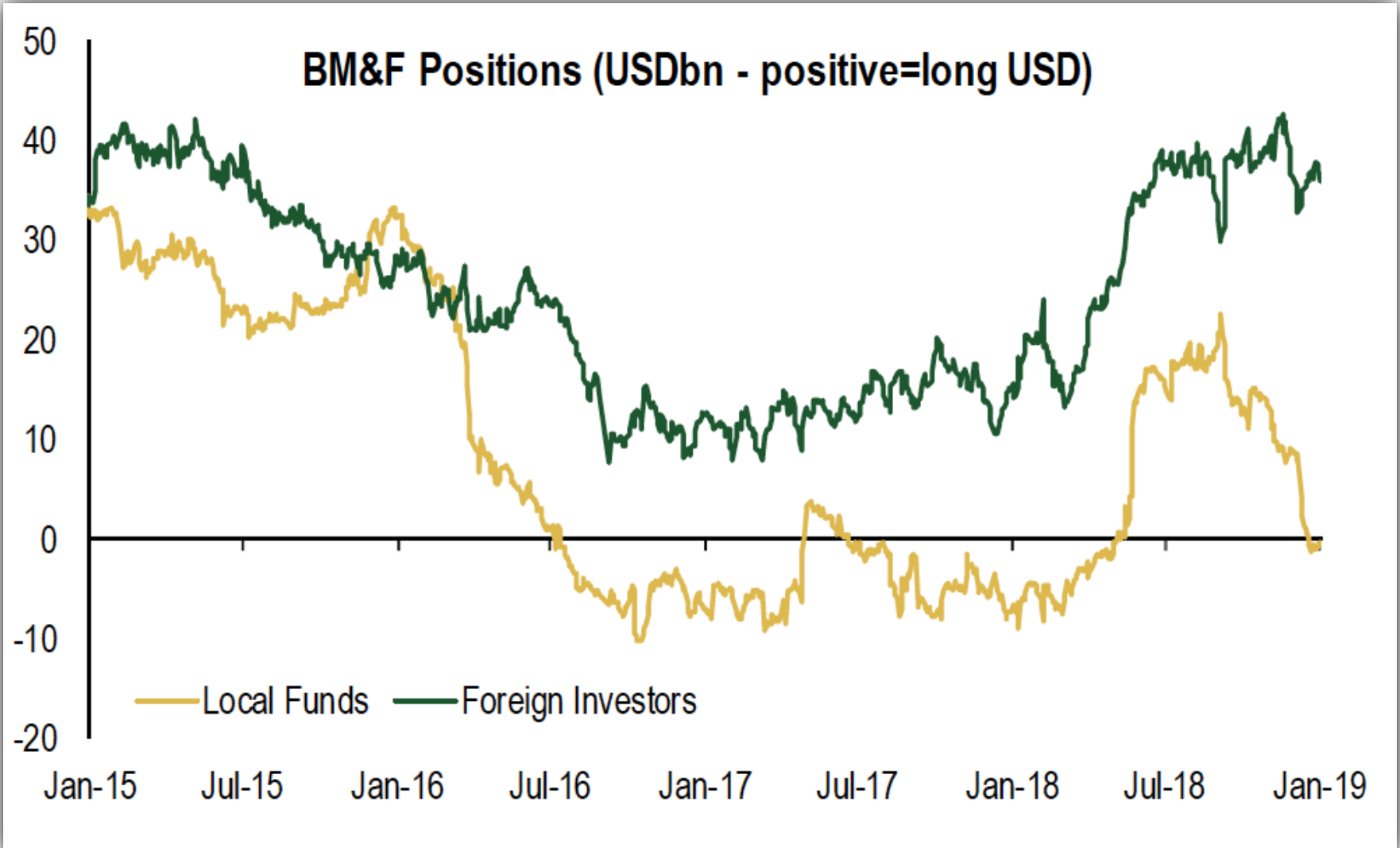
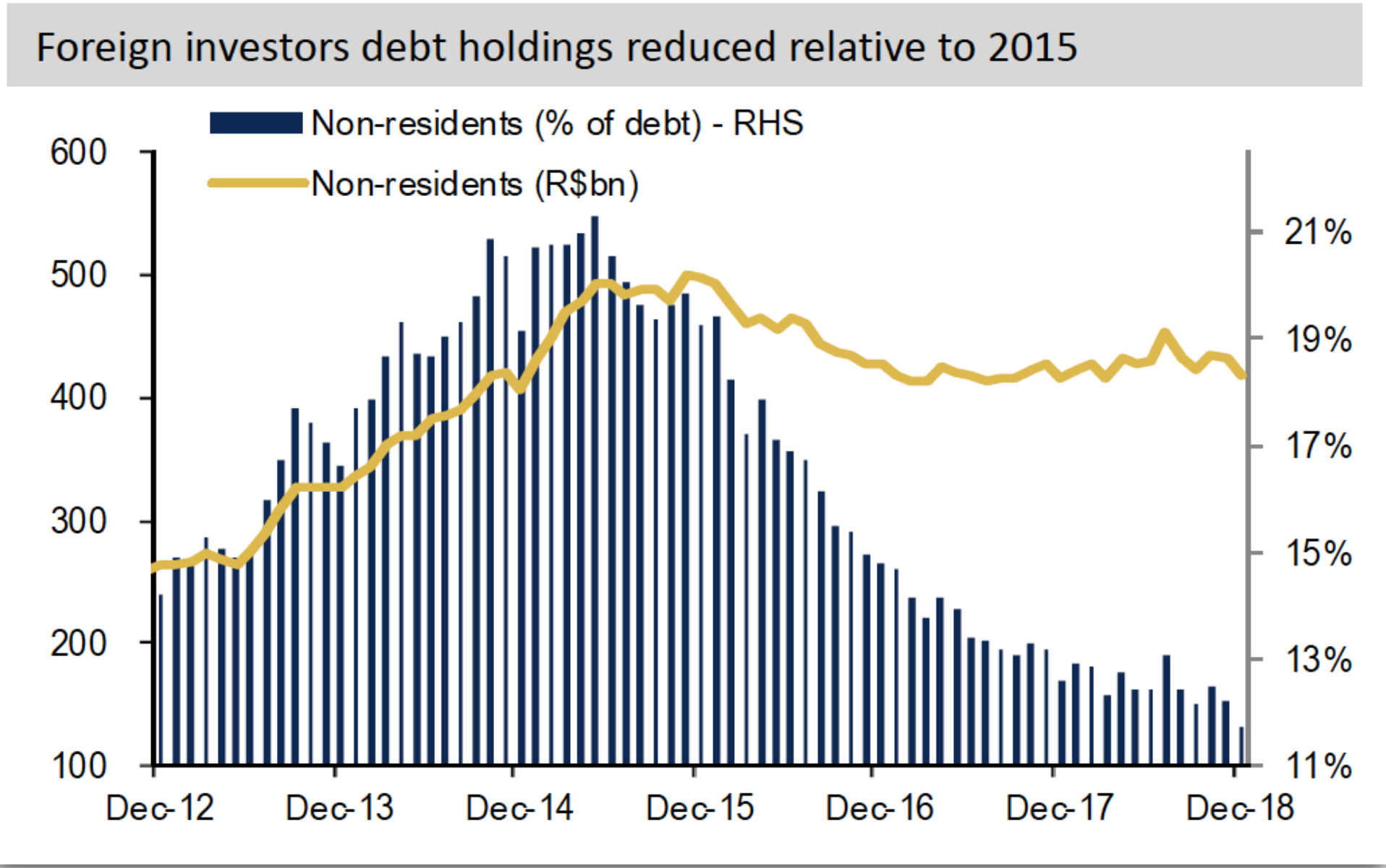
FDI (US\$bn) remains robust amid economic rebound



MONETARY POLICY & FX



MONETARY POLICY & FX



The worst for Brazilian Corporations is Over After Years of Recession and Commodity Slump

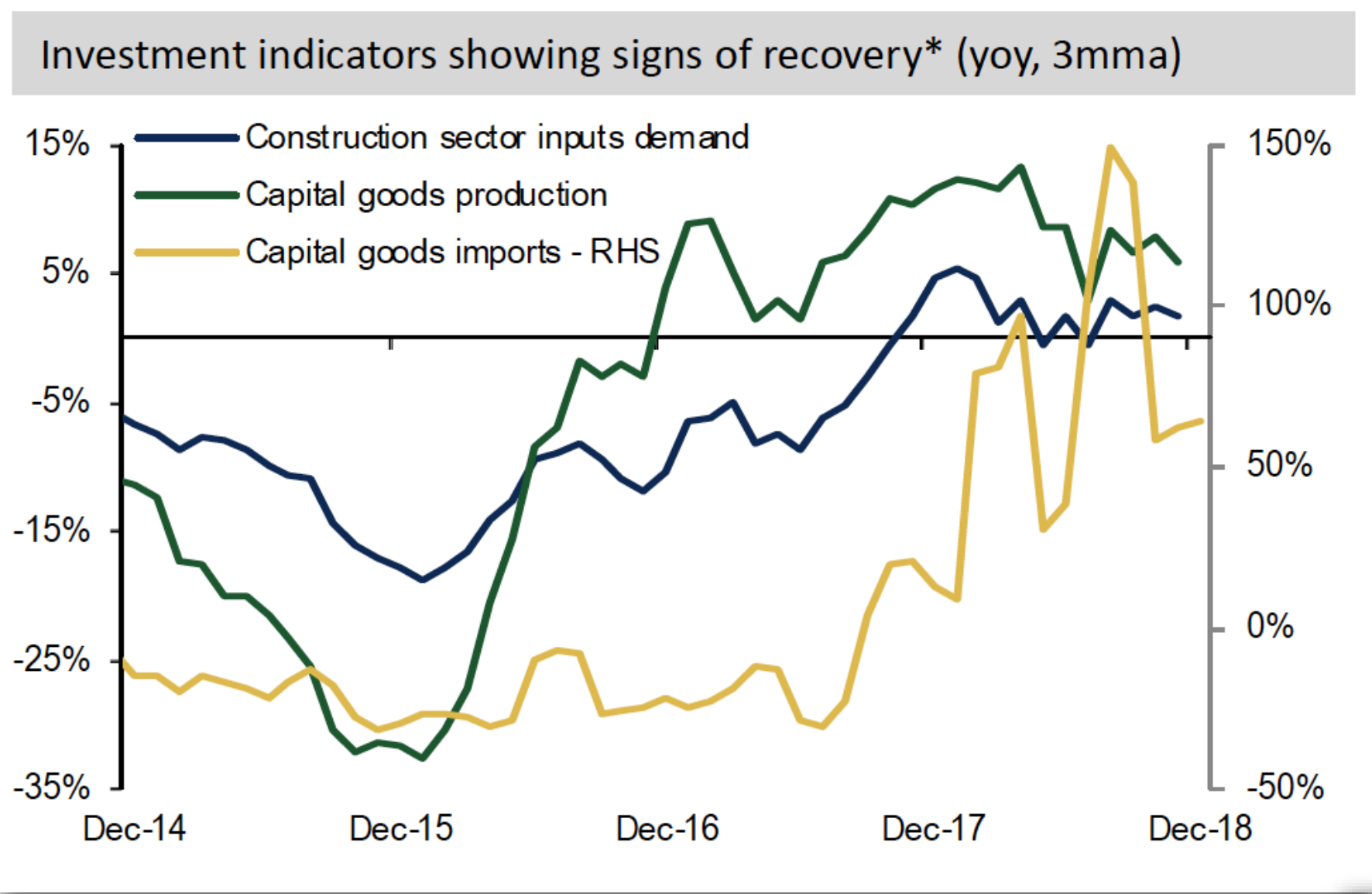
The Positive side:

- The worst of recession has been left behind with high level of production slack a positive for future growth without risk of elevated inflation
- Corporate debt levels have been mostly addressed in the past few years leaving major companies well positioned and capitalized for a “secular” growth
- Credit Cycle – There are positive signs for credit growth:
Lower utilization of credit for both consumption and investments offer an opportunity in several sectors to lead growth based on credit: Real Estate, Infrastructure, and energy
There is availability of credit as well as growing capital markets and well capitalized bank system

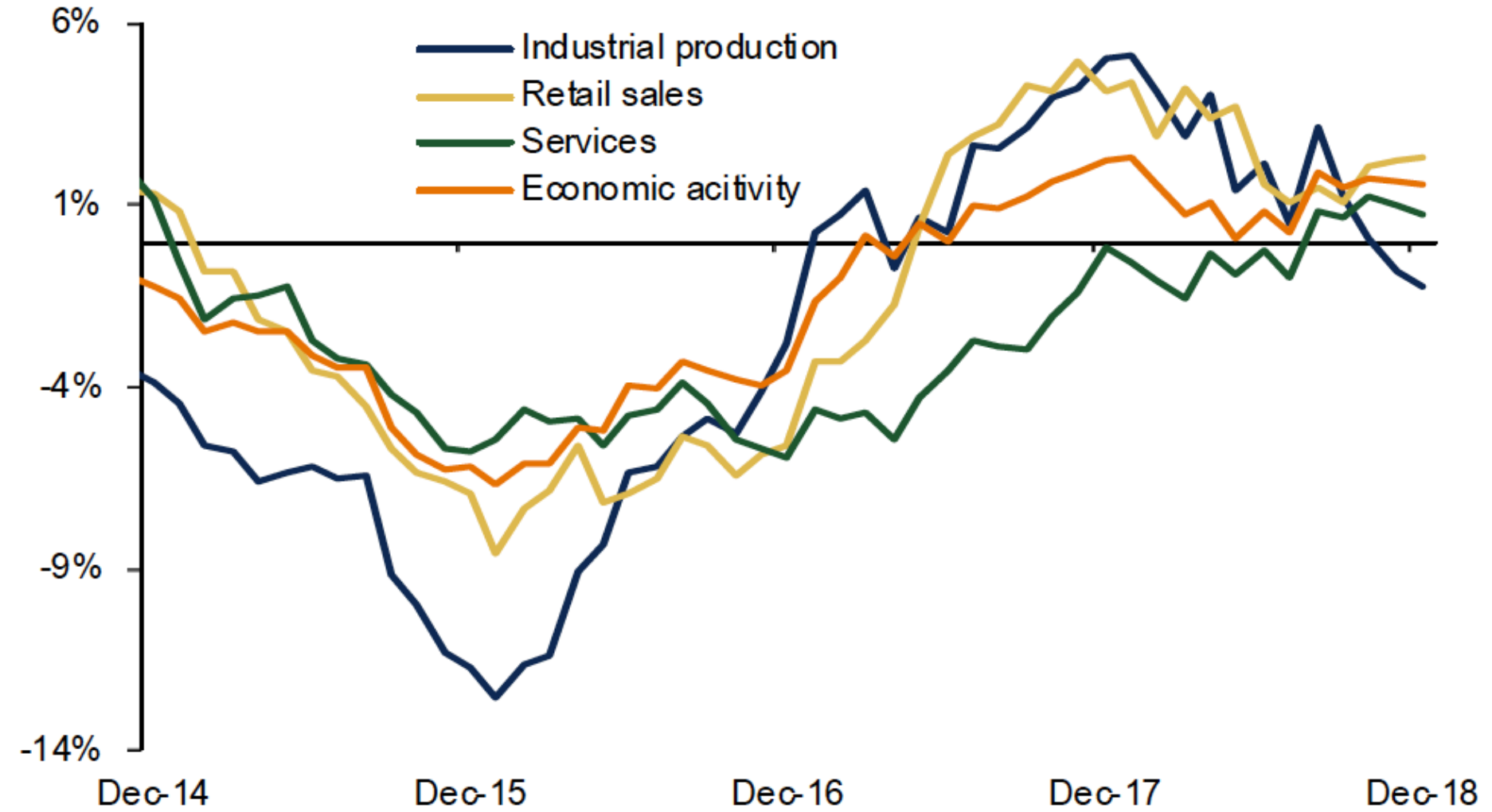
The Negative Side:

- Growth potential due remains low due to lower capacity utilization (economic slack) and productivity
- Growth expectation around 2.5% for 2019 and 3% for 2020 are still far from what is needed to recover the 8% of GDP lost in the previous recession (2015-2017)
- Uncertainty about the reform agenda by the new government still delaying the economic recovery
- Growth is of key importance for Brazil
- Quality of growth – credit vs investments

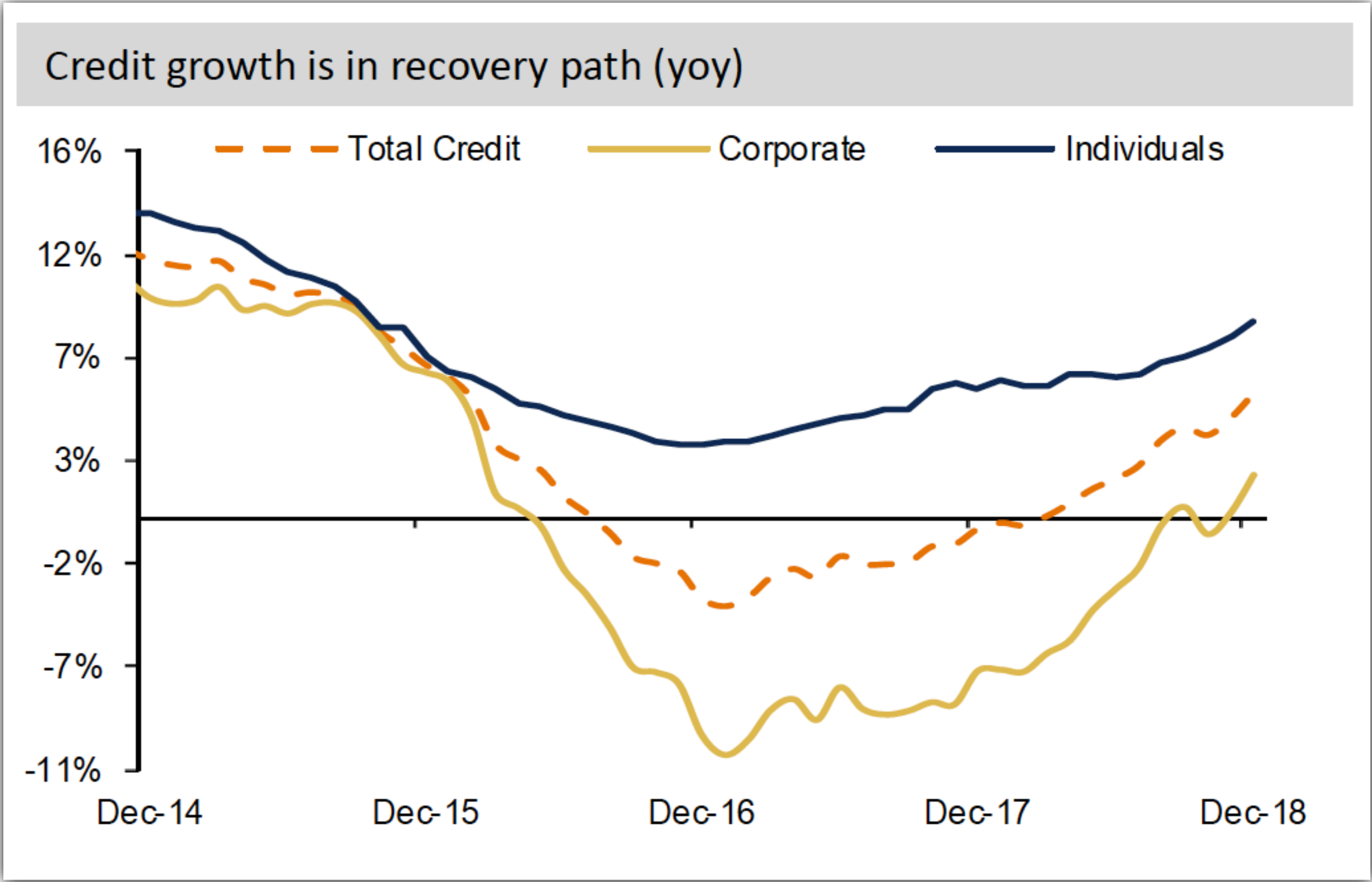
MACRO FUNDAMENTALS



Activity data improving despite recent weakening (yoy, 3mma)

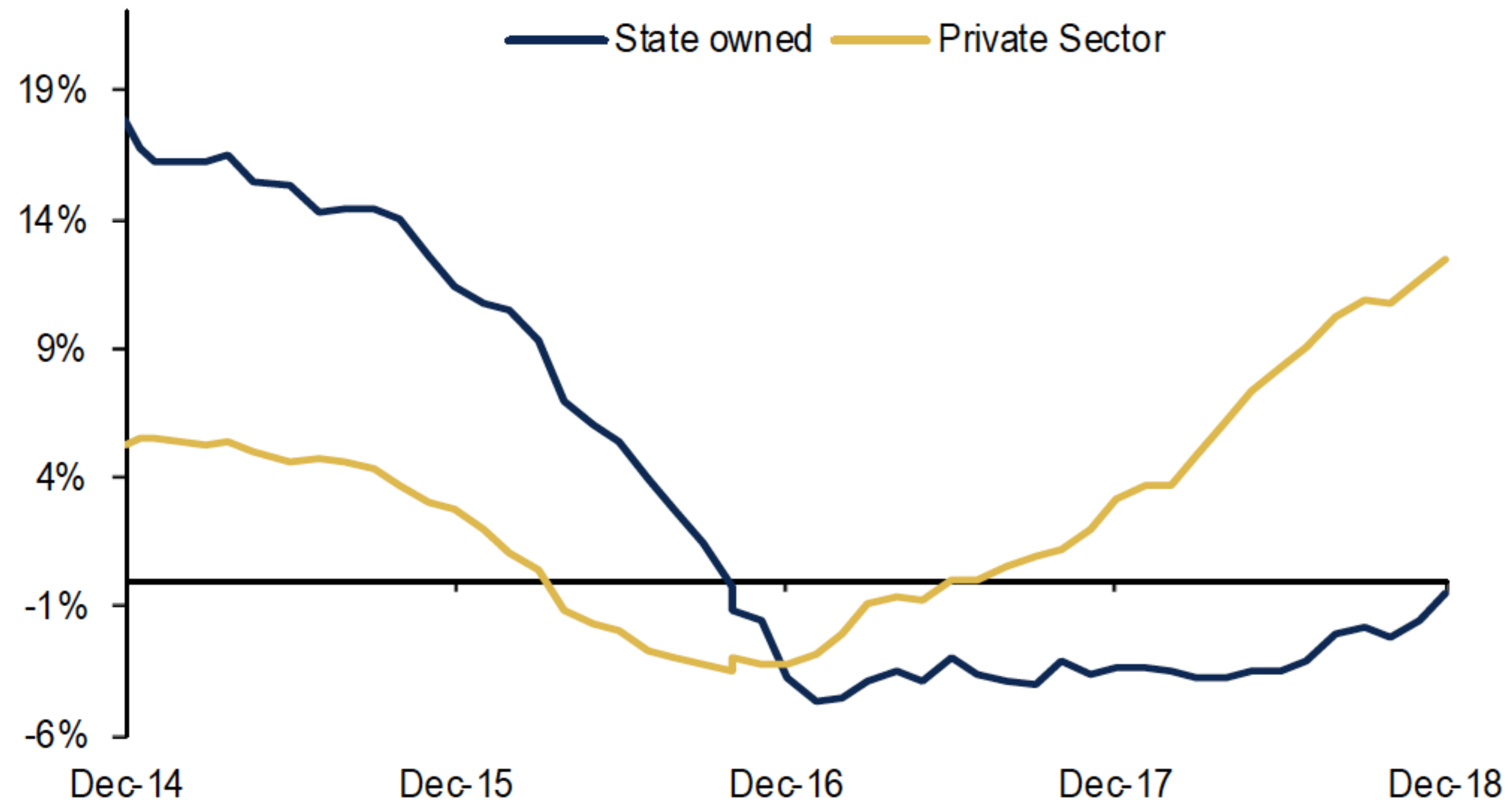


MICRO DYNAMICS



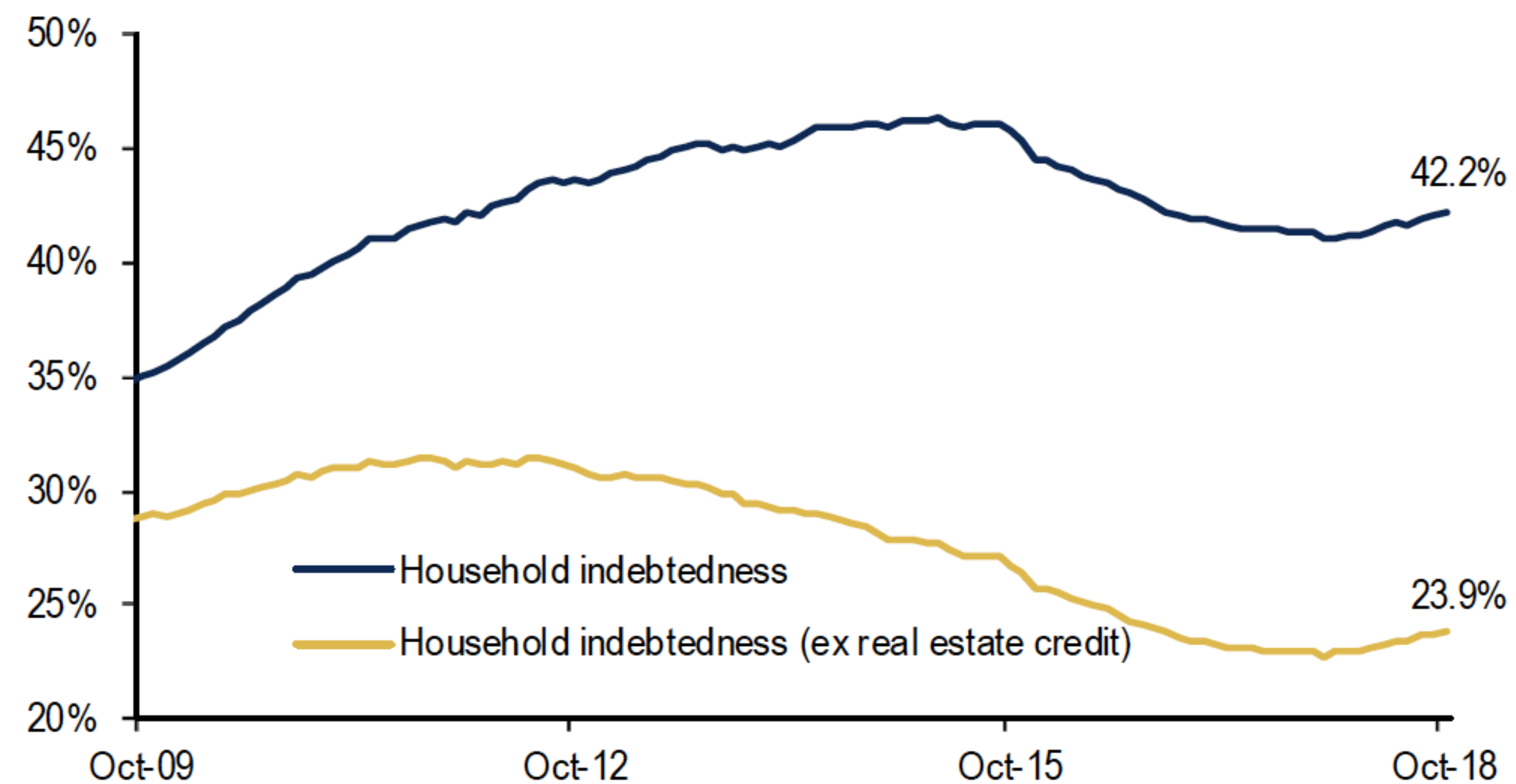
MICRO DYNAMICS

Private banks credit growth showing a strong pickup (yoy)



MICRO DYNAMICS

Deleverage reached inflection (household debt/12m acc. disp. income)



Government Focused on The Right Agenda but Delivery of It is of Maximum Importance

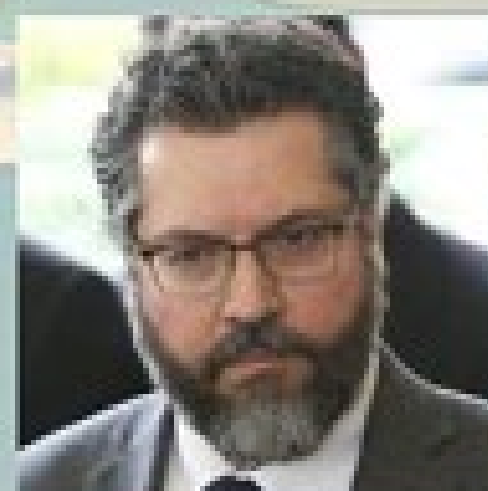
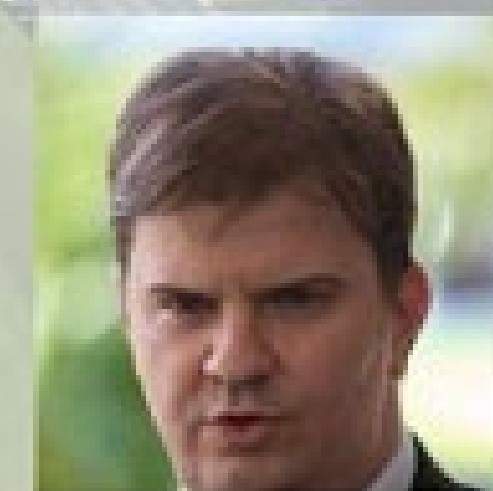
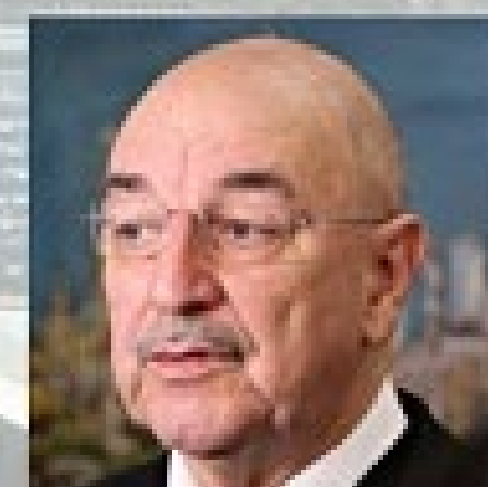
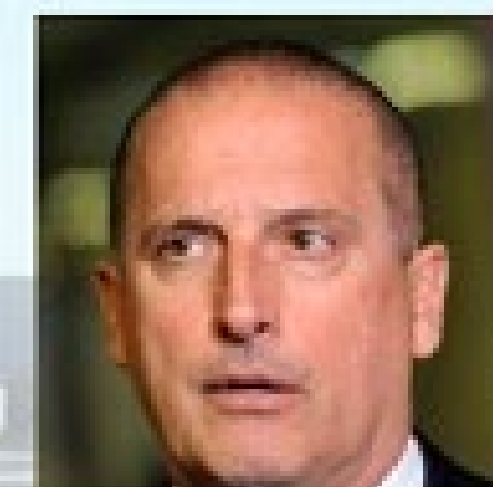
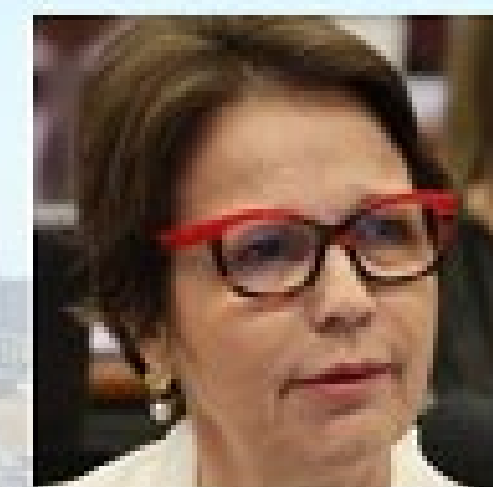
Government:

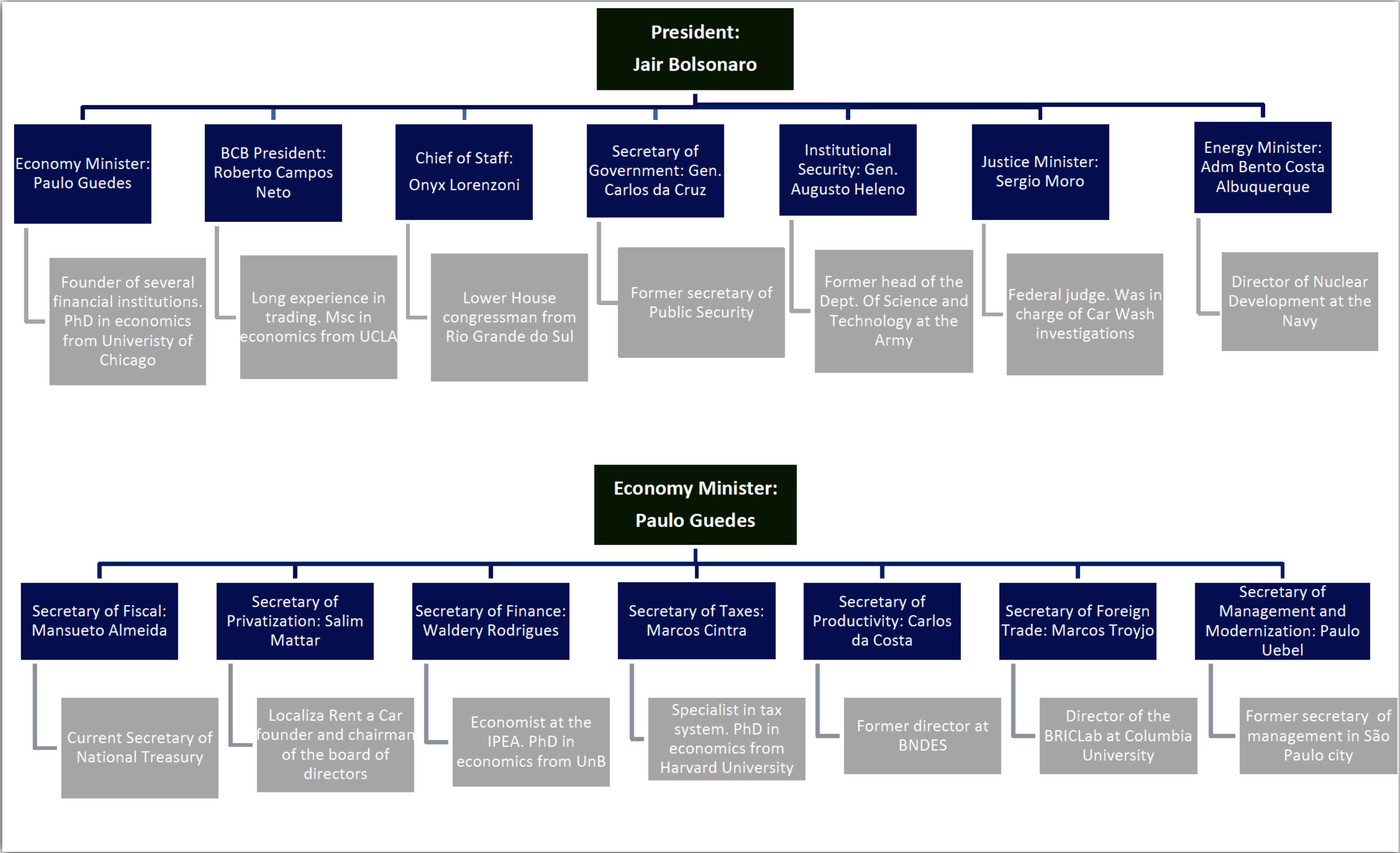
- There are 3 major support for the new government: The economic team; The justice & corruption agenda led by Sergio Moro and the military group
- What are the real agenda of the new Government?
 - An economic one with focus on fiscal sustainability, growth and corruption, or
 - The Social & Cultural agenda focused on conservative approach
- Does the Government have enough support to tackle both?

Political:

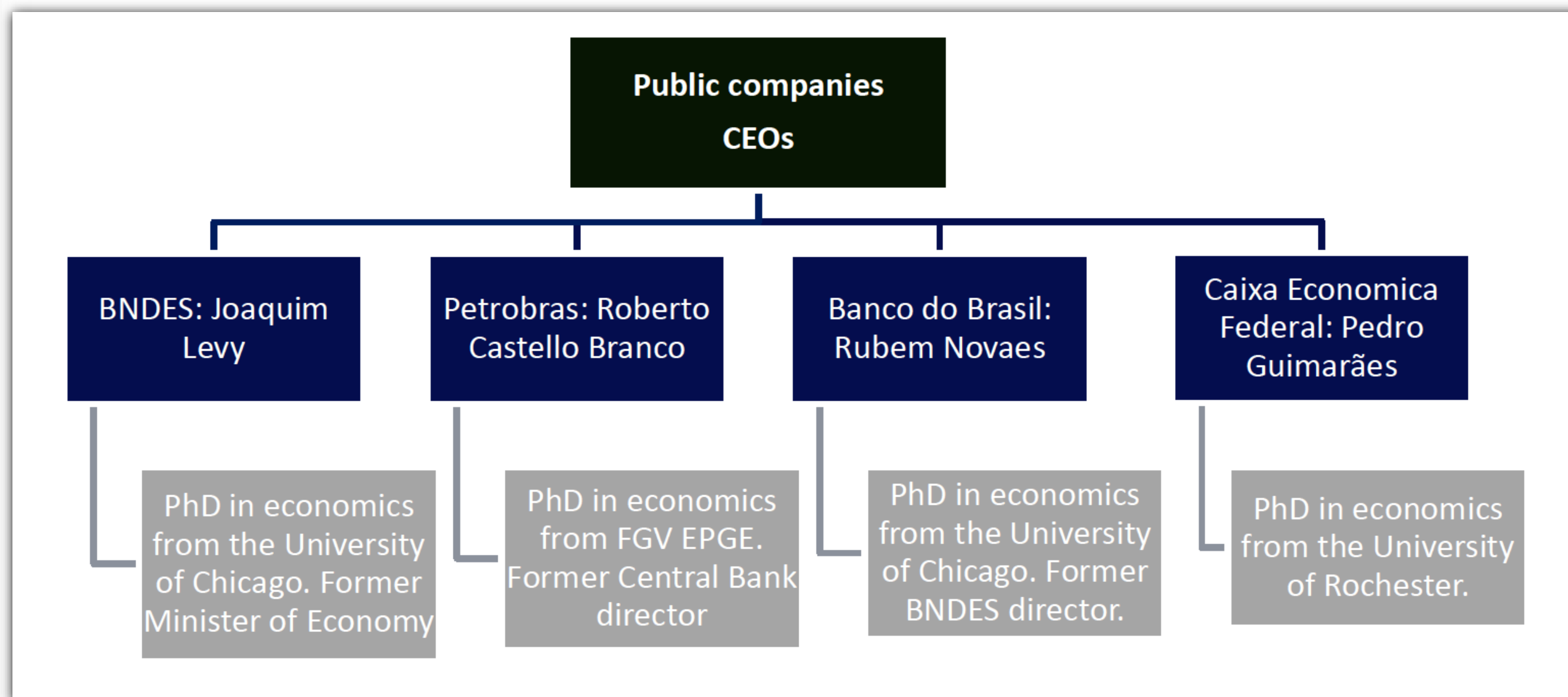
- The political agenda may not necessarily be the Government one. Could it pose a treat to reforms?
 - On the positive side, there is overall support for Government agenda of reforms, but coordination of a strong party base is of KEY importance
 - The opposition is far from being cohesive and organized to pose a significant treat to government proposal
- The beginning of new Government has been somewhat problematic with disperse agenda, lack of leadership in congresss, and difficulty in agglutinate the center toward its cause
- New Congress:
 - There was a significant renewal of congressmen in both lower and upper houses. A new congress can make more difficult to coordinate a supporting base for the Government.
 - There was a significant change in how the Government was constitute and how it intend to negotiate with Congress

GOVERNMENT AND
POLITICAL AGENDA





GOVERNMENT AND
POLITICAL AGENDA

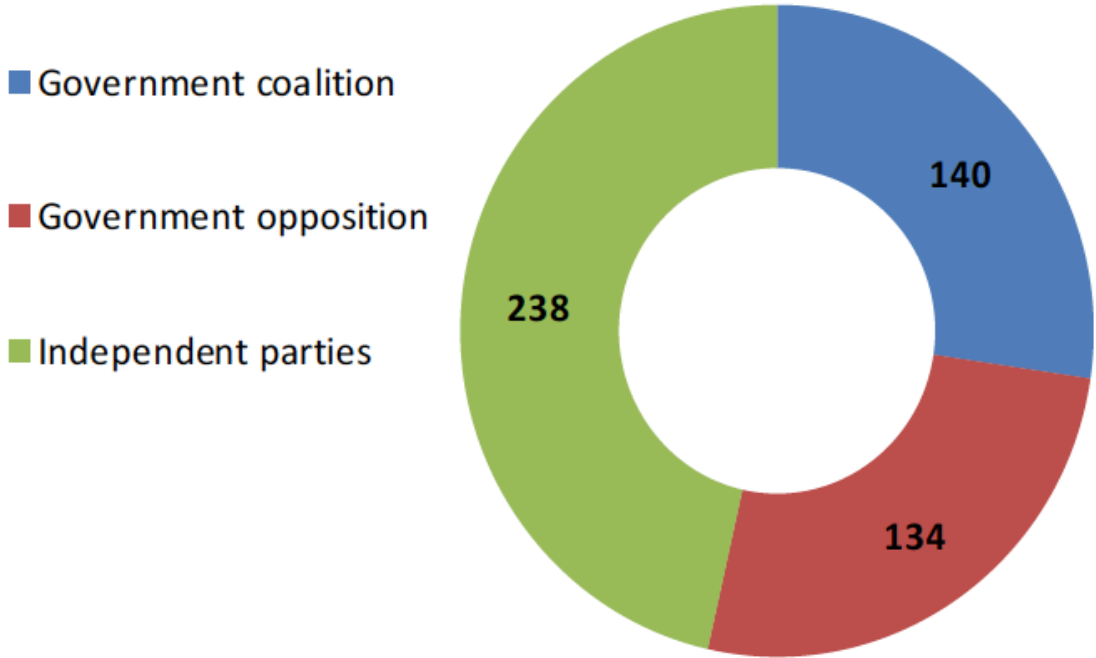


SOLUTION = REFORMS

GOVERNMENT AGENDA

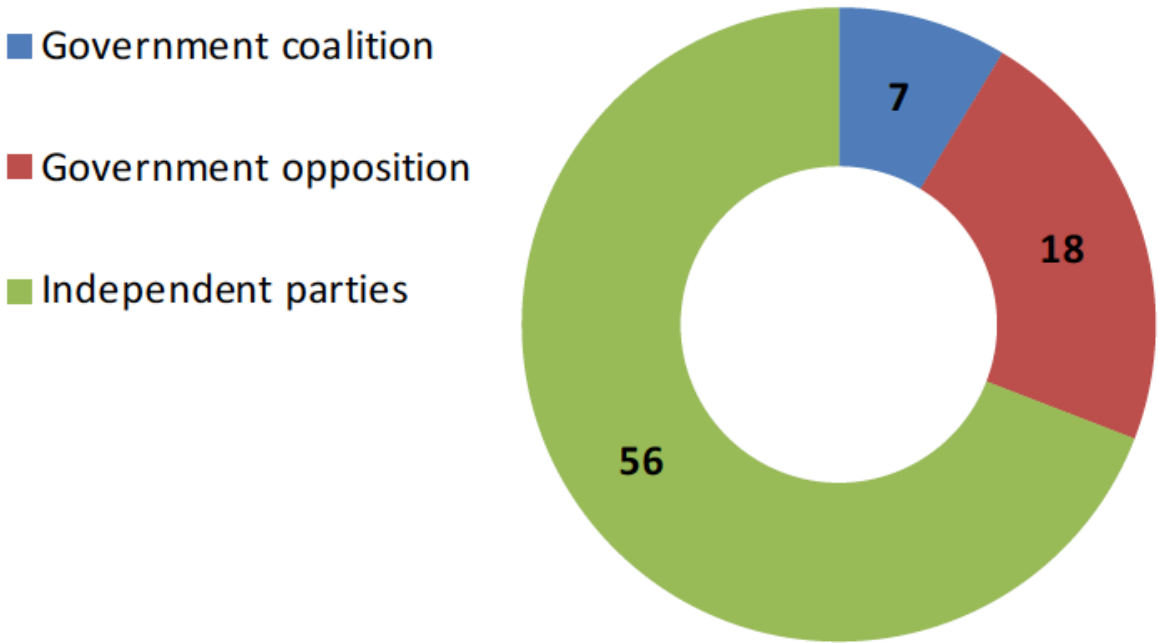
Finance Minister	Paulo Guedes , founder and partner of several financial institutions. PhD in economics from University of Chicago
Social security reform	<ul style="list-style-type: none"> *Partial migration to a capitalized pension system *Older workers would be kept in the current contribution system but under new parameters like higher minimum retirement age
Tax reform	<ul style="list-style-type: none"> *Simplifying the tax system by creating a single, value-added federal tax *Tax cuts of about 2-2.5% of GDP throughout the presidential term
Growth & development	<ul style="list-style-type: none"> *Increasing fiscal independence of local and regional governments *Reducing regulatory bureaucracy and deepening the role of private sector in the economy
Privatization program	<ul style="list-style-type: none"> *Privatizing 2/3 of SOEs, maintaining only the "strategic" ones (Petrobras and public banks) *Revenues would be used to finance the partial transition to a capitalized pension system
Monetary policy/ banking sector	<ul style="list-style-type: none"> * Granting legal indepence for the Brazilian Central Bank (BCB) *Maintaining current BCB board
External policy	*Shifting focus to bilateral trade agreements with DMs from multilateral ones with EMs

Lower House



	Elected in 2010	Elected in 2014	Elected in 2018	Current
PT	88	70	56	54
PSL	1	1	52	54
PP	41	36	37	37
PSD	-	37	34	35
MDB	79	66	34	34
PR	41	34	33	33
PSB	34	34	32	32
PRB	8	21	30	30
DEM	43	22	29	27
PSDB	53	54	29	30
Others	125	138	147	147
Total	513	513	513	513

Senate



	Elected in 2010	Total after 2010 election	Elected in 2014	Total after 2014 election	Elected in 2018	Total after 2018 election	Current
MDB	16	19	5	19	7	12	13
PSDB	5	11	5	10	4	8	8
PSD	-	-	2	3	4	7	9
PT	11	15	2	13	4	6	6
PP	4	4	1	5	5	6	6
DEM	2	7	2	5	4	6	6
PODE	-	-	-	-	1	5	8
REDE	-	-	-	-	5	5	3
PSL	-	-	-	-	4	4	4
PDT	2	4	2	6	2	4	4
Others	14	21	8	20	14	18	14
Total	54	81	27	81	54	81	81

Brazil

Back to the game?

A STRUCTURAL CHANGE IN GOVERNMENT:

From State Intervention TO a Liberal Agenda
Strong Economic Team TO Deliver Reforms Needed

A POSITIVE AGENDA:

Fiscal & Tax Reforms
Privatizations
Fiscal Decentralization
Deepening Role of Private sector in the Economy

A GROWING DEMAND FOR CHANGES

Bolsonaro Elected TO Implement Changes
New Politics vs Old politics

A blue-tinted photograph of the Christ the Redeemer statue and the Statue of Liberty standing side-by-side against a cloudy sky. The Christ the Redeemer statue is on the left, with its arms outstretched. The Statue of Liberty is on the right, holding a torch aloft. The image has a monochromatic blue color scheme.

THANK YOU