Brazilian Election Aftermath
– Business Perspectives –

Brazil – Canada Chamber of Commerce
Baker & McKenzie – 19 Nov 2018 – Toronto, Canada

The Colourful Brazilian Political Landscape...
Top-Tier Emerging Markets Remain on The Defensive on the Back of the USA-led Increase in the Cost of Financing
Sizable International Reserves Allow Brazil to Weather Heightened Financial Stress in Core Emerging Markets

Brazil | Solid International Reserves Position

Source: Central Bank of Brazil - Economic Indicators (01-Nov-2018)

Brazilian Bond Market Responds in Kind to the UST Moves

Copyright © 2018, Latin Context | All Rights Reserved

Copyright © 2018, Latin Context | All Rights Reserved
Foreign Direct Investment remains Remarkably Strong, Contributing to Amply Finance the Current Account Gap

Brazil’s External Current Account Deficit Will Remain in A Comfortable Manageable Position in 2019-20
The Broad Trade-Weighted FX Value of the USD has Gained 26% in 5 years, Injecting Stress into EM Currencies

The Broad Index is a weighted average of the foreign exchange values of the U.S. Dollar against the currencies of a large group of major U.S. trading partners.

Source: US Federal Reserve System - Real-Trade-Weighted Broad Currency Index. Includes the Euro Area, Canada, Japan, Mexico, China, United Kingdom, Taiwan, Korea, Singapore, Hong Kong, Malaysia, Brazil, Switzerland, Thailand.

The Brazilian Real (BRL) Was Affected by USD Strength and by Global Currency Adjustments over the Past 5 Years

Source: Bloomberg @ 26-Oct-2018
The Brazilian Real (BRL) is experiencing a modest recovery after a substantial depreciation over the past 5 years.

The Trend is Your Friend … The Equity Market View

Source: Bloomberg

12-Month Return % USD

USA (S&P500) 5.97
BRAZIL (IBOV) 2.44
CANADA (TSX) -2.54
MEXICO (IPC) -17.23
G-20 in Sight: Brazil is the World’s 8th Largest Economy + Systemically Relevant Emerging Market in the Americas

Top-20 World Economies by GDP (PPP) Size

- China (1)
- USA (2)
- India (3)
- Japan (4)
- Germany (5)
- Russia (6)
- Indonesia (7)
- Brazil (8)
- UK (9)
- France (10)
- Mexico (11)
- Italy (12)
- Turkey (13)
- Korea (14)
- Spain (15)
- S.Arabia (16)
- Canada (17)
- Iran (18)
- Thailand (19)
- Australia (20)

Source: International Monetary Fund - World Economic Outlook (Oct 2018) GDP in Purchasing Power Parity terms
BRAZIL IN THE WHITE HOUSE PRESS

Press Briefing by Press Secretary Sarah Sanders

Q: Sarah, thank you very much. About the Brazilian election — the State Department repeated today that a commitment to promote human rights and democracy will continue to guide the relationship with Brazil. However, the Brazilian President-elect, Bolsonaro, has made very controversial comments about minorities. The opposition defended the military declaration in Brazil.

Q: My question is if the White House plans to address this and ask assurances from the government — the incoming government in Brazil — that they will protect human rights and democracy in Brazil.

MS. SANDERS: Let me address the first thing.

Q: Sure.

MS. SANDERS: First, we promote human rights all over the world. We value our longstanding relationship with Brazil, and we want to continue to be able to work with them, and we’ll see what happens from there.

ON THE EXTERNAL FINANCIAL FRONT, THE U.S. SUPPORTS ITS ALLIES VIA ITS DOMINANT ROLE IN MULTILATERAL CREDIT AGENCIES SUCH AS THE IMF

IMF LENDING ARRANGEMENTS = US$202 billion

- 48 Flexible Credit Line
- 97 Other (33)
- 86 Other (33)
- 56 Other (33)

ARGENTINA  MEXICO  COLOMBIA

Unlike China & Mexico, Brazil is not of Strategic Relevance in Reducing The Voluminous Trade Imbalance in the USA

Mexico Has Become a Global Export Powerhouse, with Manufactured Exports Accounting for 88% of the Total
Energy Sector Reform in South America Becomes Relevant to the USA due to its role as the World Leader in Shale Technology

SHALE GAS Reserves | BRAZIL & ARGENTINA in Context

- China (1)
- ARGENTINA (2)
- Algeria (3)
- USA (4)
- Canada (5)
- Mexico (6)
- Australia (7)
- South Africa (8)
- Russia (9)
- Brazil (10)

Source: EIA.GOV (USA) - Technically Recoverable Shale Gas Resources (% of World)

Global Trade is Relevant!!! Brazil Has a Well Diversified Export Market Base Amongst Asia, Americas & Europe

Brazil | Major Export Markets

- CHINA
- USA
- Argentina
- Netherlands
- Germany
- Japan
- Chile
- India
- Mexico
- Korea
- Belgium
- UK
- Spain
- France

Source: Central Bank of Brazil (2017) - Exports % Share by Country
The Fed's Holdings of UST Debt Distorts the Market-Driven Pricing Mechanism Pushing US Bond Yields Downwards

The USA – Through the Globalization of its Government Bond Market – is Highly Dependent on Asian Creditors
BRAZIL IS A Top-Tier Foreign Holder of UST Debt Assets.  
CHINA + JAPAN ARE the Key Relevant Creditors of the USA


Macroeconomic Developments
Restoring Fiscal Sustainability is a Top Structural Macroeconomic Priority for the Incoming Economic Team

The Structural Fiscal Adjustment Will be Gradual: Select Privatization of State Firms & Income Tax Reform are Key
 Increasing Public Sector Indebtedness Weakens Public Sector Finances With Adverse Effects on Credit Ratings

**Brazil** | Public Finance - Total Government Debt

- **Government Debt (% of GDP)**
- **Last Decade (average)**
- **2018-2020 (forecast)**

*Source: International Monetary Fund (Oct 2018 WEO Report)*

Quarterly Economic Indicators Point Towards a Rate of Expansion of 1.4% Over the Past 12 months

**Brazil** | Gradual Economic Recovery (12-mth Growth)

- **Quarterly GDP Growth (%)**

*Source: Central Bank of Brazil - Economic Indicators (Oct 2018)*
The sharp collapse in fixed investment portrays the depth and length of a multiyear broad-based deep recession.

<table>
<thead>
<tr>
<th>Brazil</th>
<th>Gradual Recovery from Deep Economic Recession</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><img src="chart.png" alt="Chart: Gradual Recovery from Deep Economic Recession" /></td>
</tr>
</tbody>
</table>

Source: Central Bank of Brazil - Economic Indicators (Dec-2018)

An organic cyclical economic rebound is under way, but sustaining maximum growth requires structural reforms.

<table>
<thead>
<tr>
<th>Brazil</th>
<th>Economic Growth Trends</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><img src="chart.png" alt="Chart: Economic Growth Trends" /></td>
</tr>
</tbody>
</table>

The Inflation Targeting Regime (IPCA = 4.5% +/- 1.5%) is functioning well as a policy to solidify price stability.

Brazil has made remarkable progress in containing inflation, and the near-term outlook remains promising.
The US Monetary Tightening Cycle is Affecting the Cost of Finance in Brazil, Injecting Pressure on Emerging Markets

![Graph showing the USA Monetary Policy Target Rate (Fed Funds)]

Source: Bloomberg

Strong Economic Performance in the USA in the Context of Near Full Employment is Good News for the Continent

![Graph showing USA Economic Growth]

Sources: International Monetary Fund (Oct-2018 WEO Report) + Central Bank of USA
The Brazilian Central Bank Will Modify its Policy Stance in 2019; Interest Rates are on The Rise (up 150 bps to 8%)

Sources: Central Banks of USA, Brazil & Mexico
Brazil Ranks in 72th Position (out of 140) in Terms of Global Competitiveness in the World Economic Forum Report

Top-20 World Economies by Global Competitiveness (WEF)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Competitiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>USA</td>
<td>86</td>
</tr>
<tr>
<td>2</td>
<td>Germany</td>
<td>82</td>
</tr>
<tr>
<td>3</td>
<td>Japan</td>
<td>80</td>
</tr>
<tr>
<td>4</td>
<td>China</td>
<td>79</td>
</tr>
<tr>
<td>5</td>
<td>France</td>
<td>77</td>
</tr>
<tr>
<td>6</td>
<td>Italy</td>
<td>76</td>
</tr>
<tr>
<td>7</td>
<td>Singapore</td>
<td>74</td>
</tr>
<tr>
<td>8</td>
<td>South Korea</td>
<td>73</td>
</tr>
<tr>
<td>9</td>
<td>Spain</td>
<td>73</td>
</tr>
<tr>
<td>10</td>
<td>India</td>
<td>72</td>
</tr>
<tr>
<td>11</td>
<td>Brazil</td>
<td>72</td>
</tr>
<tr>
<td>12</td>
<td>Mexico</td>
<td>71</td>
</tr>
<tr>
<td>13</td>
<td>Australia</td>
<td>71</td>
</tr>
<tr>
<td>14</td>
<td>Russia</td>
<td>71</td>
</tr>
<tr>
<td>15</td>
<td>Indonesia</td>
<td>70</td>
</tr>
<tr>
<td>16</td>
<td>Turkey</td>
<td>70</td>
</tr>
<tr>
<td>17</td>
<td>Iran</td>
<td>69</td>
</tr>
<tr>
<td>18</td>
<td>Saudi Arabia</td>
<td>69</td>
</tr>
<tr>
<td>19</td>
<td>Thailand</td>
<td>68</td>
</tr>
<tr>
<td>20</td>
<td>Vietnam</td>
<td>67</td>
</tr>
</tbody>
</table>


The Pursuit of Global Competitiveness – In Search of a New Peer Group to Improve the Institutional Framework

Pillar 1: Institutions

What does it capture? Security, property rights, social capital, checks and balances, transparency and ethics, public-sector performance and corporate governance.

Why does it matter? By establishing constraints, both legal (laws and enforcement mechanisms) and informal (norms of behaviors), institutions determine the context in which individuals organize themselves and their economic activity. Institutions impact productivity, mainly through providing incentives and reducing uncertainties.

Global Competitiveness | Pillar 1 - INSTITUTIONS

- Finland (2): 81.0
- Singapore (3): 80.7
- Canada (11): 75.5
- Australia (15): 73.6
- Korea (27): 65.4
- Spain (28): 64.5
- PEERS: 65.4
- Brazil (93): 49.7
- Mexico (105): 47.7

Source: Global Competitiveness Report (WEF) + International Monetary Fund (IMF) - GDP in PPP terms

“Strong institutions are a fundamental driver of both productivity and long-term growth. Their benefits extend well beyond economics, affecting people’s well-being on a daily basis.”
Improving Brazil’s Institutional Framework Requires an Organized Continuous Battle Against Systemic Corruption

Brazil shows institutional weakness in the fields of organized crime, judicial independence & property rights.
A Major Revamp of Infrastructure is a Major Priority for the Incoming Administration of President Bolsonaro

**Pillar 2: Infrastructure**

**What does it capture?** The quality and extension of transport infrastructure (road, rail, water and air) and utility infrastructure.

**Why does it matter?** Better-connected geographic areas have generally been more prosperous. Well-developed infrastructure lowers transportation and transaction costs, and facilitates the movement of goods and people and the transfer of information within a country and across borders. It also ensures access to power and water—both necessary conditions for modern economic activity.

---

**Source:** Global Competitiveness Report (WEF) + International Monetary Fund (IMF)

---

**Source:** Global Competitiveness Report (WEF - Oct 2018)
Brazil Maintains a Sound & Well Capitalized Banking Sector despite the Dominant Role of the State

Low Banking Sector Penetration and Market Capitalization Prevents an Optimal Development of Local Financing

Source: Global Competitiveness Report (WEF - Oct 2018) Ranking 0 - 7 (best)

Source: Global Competitiveness Report - World Economic Outlook Oct 2018
Labour Market Rigidities Remain a Primary Source of Weakness in Brazil’s Global Competitiveness

The Incoming Administration Inherits a Challenging Labour Market Environment With Double-Digit Unemployment Rates

Sources:
- Global Competitiveness Report (WEF) + International Monetary Fund (WEO)
- International Monetary Fund (Oct 2018 WEO Report) + Central Bank of Brazil
The Brazilian Journey Begins ...

**GOVERNANCE**
- Regime Change ???
- Smooth Election
- Implied USA Support
- ProActive Judiciary

**ECONOMICS**
- Inflation Control
- Diversified Exports
- Economic Recovery
- Privatization Plan

**FINANCIALS**
- Currency Stability
- FDI + FX Reserves
- EM Shock Resilience
- Happy Market Tone

---

Brazil – Canada Chamber of Commerce
Baker & McKenzie – 19 Nov 2018 – Toronto, Canada

Thank You ... Muito Obrigado

Pablo F.G. Bréard

---

pablo.breard@latincontext.com