

Reinventing Brazil

Tuesday May 16 2017

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Reforms end three years of turmoil and recession

Capital markets are buoyant and the government is tackling some difficult problems, writes *Joe Leahy*

On Brazil's version of Wall Street, Avenida Faria Lima, where many of the large investment banks have their headquarters, excitement is building and that has not been felt for long time.

After a three-year freeze, characterised by recession and political turmoil, Brazil's capital markets are coming to life again. In the first four months of the year, three companies have held initial public offerings in São Paulo, as many as the in past three years combined.

Led by the \$571m offering from Azul, an airline founded and run by David Neeleman, who also launched JetBlue, the New York-based budget airline, the deals are fuelling optimism that 2017 could prove to be a bumper year with an

estimated 10 to 15 other transactions waiting in the pipeline.

"We have raised more equity in capital markets in the first four months of this year than was raised all of last year," says Roderick Greenlees, global head of investment banking at Itaú BBA, the investment banking arm of Brazil's largest private sector bank by assets, Itaú Unibanco. "People are optimistic about the prospects for the economy."

Across the country there is a sense that Brazil is on the move again. After a rocky 2016, in which leftist former president Dilma Rousseff was impeached and replaced with her vice-president, Michel Temer, there are signs that the recession is ending and that finally the nation is debating some of the important changes needed to build a

Fast paced: there's a fresh feeling of optimism on Brazil's version of Wall St

Ricardo Lisboa for the FT

more sustainable future. Despite its low popularity in the opinion polls, the Temer government, comprised of centrist pro-business parties, has started to tackle some of the thorniest problems facing Brazil, such as a runaway budget deficit fuelled by growing pension expenditure.

Markets are taking notice – Brazilian equities were the best-performing among emerging markets last year. Investors know that Latin America's largest economy is too big to ignore. Brazil is the world's biggest exporter of beef, orange juice, sugar, coffee and iron ore, and a large industrial power with the world's third-largest commercial aircraft manufacturer by revenue, Embraer, analysts say.

Brazil's independent federal police,

prosecutors and courts, meanwhile, are attempting to confront corruption – an age-old scourge of Brazil – and there is an continuing investigation into "Car Wash" – a bribery and corruption scandal at state-owned oil company Petrobras. The country's institutions have proved to be remarkably resilient, even as prosecutors have opened criminal inquiries into four former presidents, a third of the senate and 10 per cent of the lower house of congress.

Thirty years after Brazil returned to democracy and instituted its 1988 constitution, which sought to restore civil rights to a population brutalised by dictatorship, there is growing political will for the country to create a modern economic and political system, analysts say.

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'We raised more equity in the first four months of this year than was raised all last year'



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Costão do Santinho, Santa Catarina

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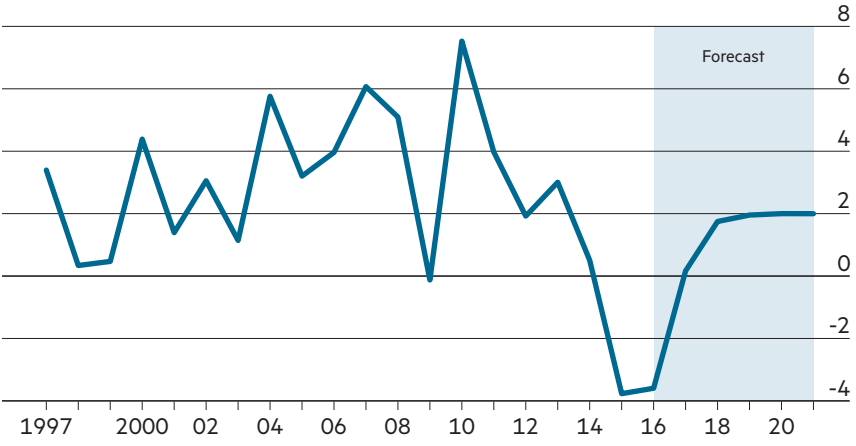
Brasília, Federal District

Reinventing Brazil

Brazil in charts

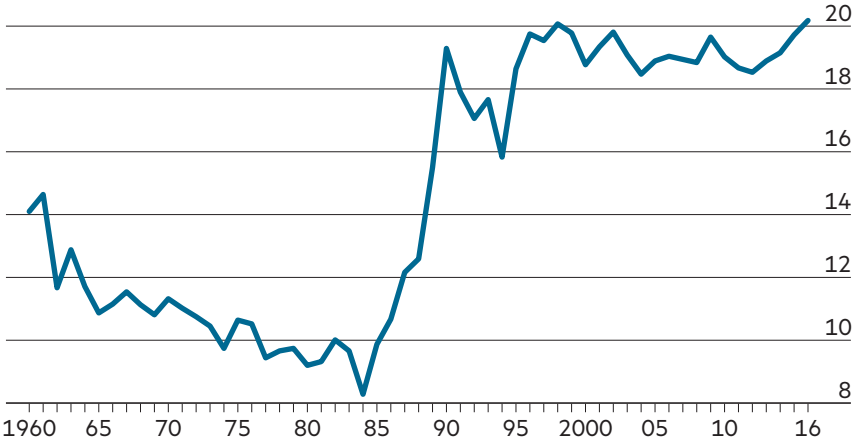
To help its recovery ...

Year-on-year change in Brazilian GDP (%)



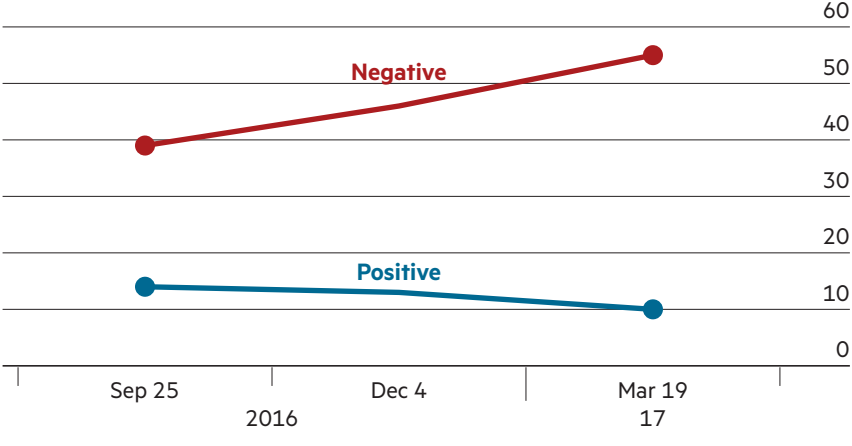
... Brazil needs to control spending ...

Government expenditure (% of GDP)



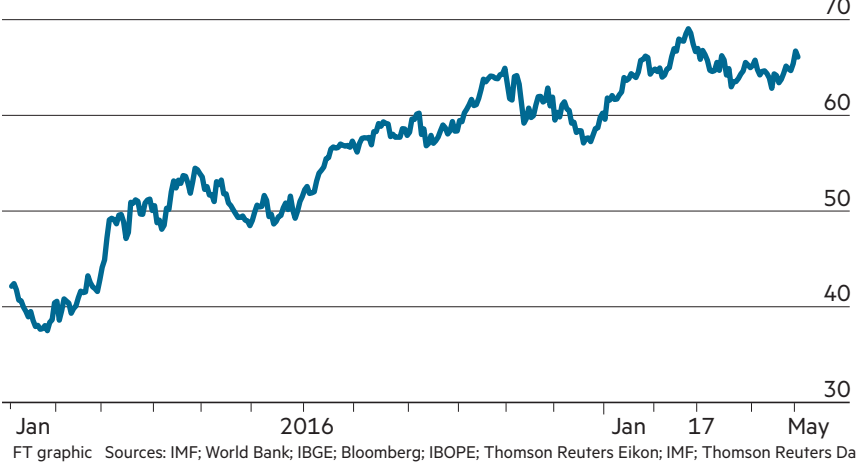
... but President Temer is increasingly unpopular

President Temer's approval ratings (% of respondents)



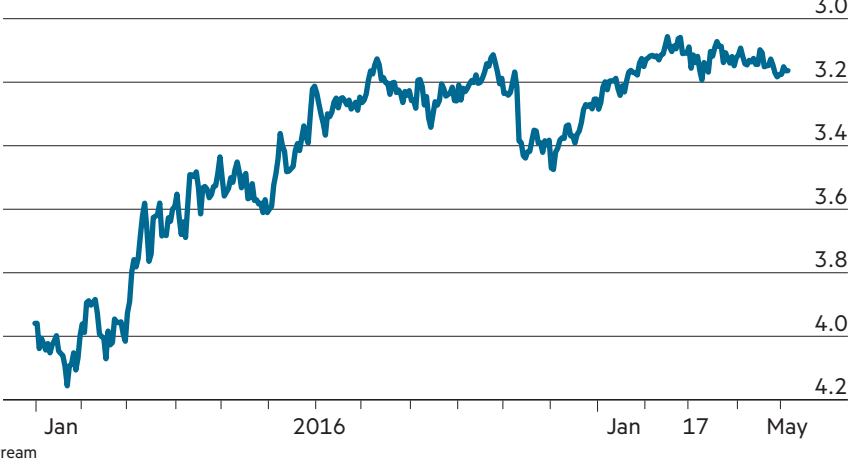
Although Brazil equities have risen sharply ...

Bovespa index, '000



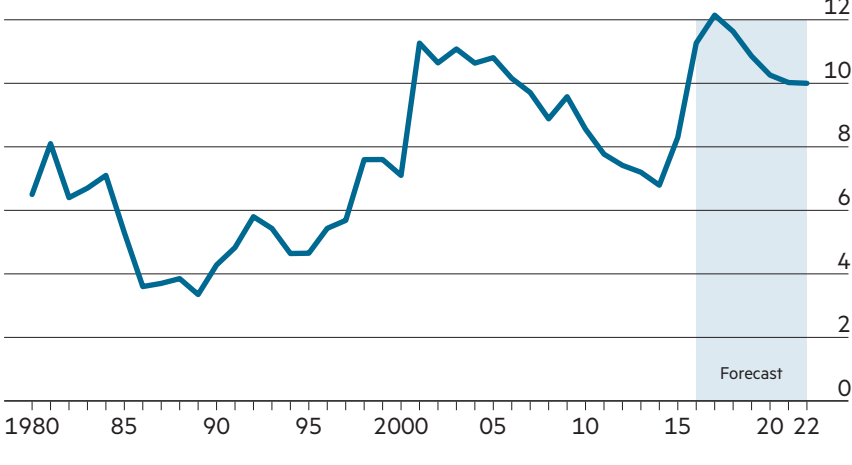
... and the real has rallied against the dollar ...

Real per \$



... unemployment has risen sharply

Per cent of total labour force



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Meirelles reins in profligate spending

Interview Finance minister tells *John Authers* he is determined to make cuts, even if they are disliked

Henrique Meirelles is clear about the problem facing Brazil, and equally clear that he can solve it. “The idea is to size down the government as a percentage of GDP,” Brazil’s finance minister says, and the country has already changed its constitution to ensure this happens. Now, Mr Meirelles has to complete this process by passing the reforms needed to make cuts in spending possible.

He is not a bloodless technocrat, having spent most of his career as a businessman. He rose within what was then the Bank of Boston, once the most active US bank in South America and now part of Bank of America, to become the chief executive.

After Boston, he came back to Brazil and served from 2003 to 2010 as its central bank governor, during a tumultuous period which included two crises that bookmarked a prolonged boom, driven by rising commodity prices. He returned to government when Michel Temer, the former vice-president, took over the presidency last year after the impeachment of Dilma Rousseff.

This is an accidental government, with a president who is only in the job because of Ms Rousseff’s impeachment, but Mr Meirelles sees signs of strength. He points out that all his basic proposals have been approved so far “because this government was, at the end of the day, chosen by congress”.

As a result, he says, “this government is very strong at the level of the congress and is being successful in approving the basic reforms and our expectation is that, in due time when the economy begins to grow, the popular approval will come back.”

When asked if a time of such uncertainty is an opportune time to try to pass sweeping reforms, he replies: “Absolutely. This is the time to do it. What has already been approved wasn’t thinkable two years ago.”

For those still sceptical, he points to the most important reform passed so far, which he says will lead to “the inversion of the trend of continuous growth of fiscal expenditure as a percentage of GDP”.

Total government expenditures have shot up in the past few years, he says, to about 20 per cent. He expects expenditure as a percentage of GDP to fall to 15 per cent in the next 10 years.

He adds: “This is now a constitutional requirement . . . then we have social security reforms on the way, a labour reform, and lastly tax reform. All of that we expect to get through.”

Many question how easy it will be to implement these new measures. Brazil’s existing pension reforms are very generous, and people are unlikely to accept a later retirement age without a fight.

On social security, the idea, currently working its way through congress is to

treat public and private sector workers on the same terms, and the original target was for a universal retirement age of 65. This has already met with stiff opposition and the proposals have already been watered down.

“Evidently the first reaction is that people don’t like it, because they want to retire earlier. That’s OK and understandable. But the question now is how to explain that to people and to make sure that everyone understands that it’s very important for the growth rate in the GDP to be sustainable over time and for Brazil to be able to create jobs, and for that to happen it’s important to have pension reform. And lastly it’s important . . . that we be sure that the pension system is solvent.”

As Brazilian pension commitments are rapidly becoming unsustainable, he accepts that some reform is vital if the constitutional commitment to cutting government spending is to be kept.

He shows similar confidence over proposed labour reforms. “The first part of the labour reform was approved – outsourcing. That is something that eliminates a lot of the rigidity in the economy.”

“The second part, which I think it’s going to be approved as well, is . . . the idea to have the agreement prevailing over the law. Which means if the unions and the companies agree, or the workers, even without the unions and the companies, agree on some set of rules, the judge cannot come and decide that it’s not fair.”

On top of this hugely ambitious agenda, which has to be carried out before a highly unpredictable presidential election in October next year, he is also trying to overhaul and



simplify Brazil’s notoriously complex tax code and introduce measures to cut red tape and reduce costs, for example by reducing the time needed to open or close a business. The World Bank ranks Brazil 175th out of 190 countries on its ease of starting a business ranking.

While he denies this is unrealistic, observers note that an already deeply unpopular government has nothing to lose from attempting to pass long-term reforms that will be disliked in the short term. Perhaps most importantly, the reform package is an attempt by Brazil to take control of its own destiny.

Over the past two decades no other emerging market has suffered greater swings in international sentiment, as foreign investors have flooded in and then flooded out.

So is Brazil reinventing itself? “I think so, I think we are now seeing Brazil approving, discussing reforms, which had never been discussed before.”

Reinventing Brazil

Dissatisfaction with politics drags on economy

Corruption

Scandals have increased the chances that outsiders could win the 2018 elections, writes *John Paul Rathbone*

Brazil's street protests of June 2013 may well go down in history as the moment when public dissatisfaction, and the corruption probes that have since disrupted the country's politics, first took shape.

The protests were small at first, mostly local disturbances sparked by an increase in bus fares. But then, inspired by the Arab Spring of 2010-11, they snowballed. By the middle of June they had become a rolling series of mass marches. At their peak, they drew 2m people on to the streets.

One of the most curious features of the protests is that they cut across party lines and were fomented as much by leftwing anarchists as by well-educated members of the middle class.

Another peculiarity is that it is still unclear what the protests were actually about. Although poor public services and government over-spending on lavish sporting events were all responsible, the real cause seems to have been a general sense of malaise.

Odder still, this dissatisfaction came when Brazil seemed to be doing well. The steep recession the economy went on to suffer, its worst on record, was still two years away. In addition, the Petrobras corruption scandal, and the public ire it provoked, had not yet begun.

"The protests were like one of those moments when certain animals like birds or dogs behave strangely long before an earthquake or a major storm hits," observes Otávio Frias Filho, editor of leading newspaper, Folha de S. Paulo. "They were a premonition of bad times to come."

Crucially, the protests also unleashed groundbreaking legislation, enacted in their aftermath.

At first, the then-government of President Dilma Rousseff reacted to the



protests with arrogance and disbelief. Some leaders of the governing Workers party (PT) even cast them as a betrayal. How could Brazilians be unhappy given that the past decade of PT rule had lifted 30m out of poverty?

But then, as the depth of public anger became clear, Ms Rousseff announced a series of initiatives to calm public disquiet. Most of these measures, such as promises of better public services, came to naught, with one big exception: the introduction of plea-bargaining into the Brazilian judicial system.

Public prosecutors already operated

Only a third of Brazilians believed democracy is the best form of government

with a high degree of independence. But by allowing suspects to give evidence in return for lighter sentences, they could now pursue chains of corruption up to the highest levels.

As a result, plea-bargaining opened the way for judges to pursue the allegedly-corrupt politicians and businessmen who would soon be unveiled in the Petrobras corruption probe.

The dimensions and consequences of this scandal have since proved to be very big indeed.

It indirectly led to Ms Rousseff's impeachment last year and thus the



Protests: at their peak they drew 2m people on to the streets

Vanderlei Almeida, Yasuyoshi Chiba/AFP/Getty Images

new government of Michel Temer, the current president.

It paved the way for a host of other corruption probes, most notoriously into Odebrecht, once Latin America's biggest construction company. Last December, the US Department of Justice reached its biggest anti-bribery settlement under US anti-corruption laws, fining Odebrecht \$3.5bn.

The continuing scandals also tarnished Mr Temer's government. Following the latest batch of Odebrecht plea bargains, the Supreme Court in April opened investigations into scores of

politicians, including eight government ministers. These embarrassing revelations could conceivably topple Mr Temer's government. Suffering from an approval rating of just 9 per cent, he has already had to water down his administration's central initiative: an unpopular but needed reform of the overly-generous public pension system that might otherwise bankrupt the country.

The scandals have also undermined what little faith Brazilians have in traditional politicians. Every major political party, three former presidents, and most of the supposed frontrunners in the 2018 elections have been tarnished.

The result is deep political uncertainty, a delayed economic recovery, and what has been called the "most vulnerable point" in Brazil's three-decade old democracy. Public disenchantment is such that only a third of Brazilians polled in 2016 believed democracy is the best form of government, according to Latinbarometro, a polling group, an astonishing 22 percentage point drop from the year before.

"There is no visibility, there is a massive mistrust in politics, of politicians," laments Arminio Fraga, a former central bank chief. "The only reason we don't have a strong [economic] rebound is because of the uncertainty still ahead of us."

For now, Brazilians are more fed-up than furious. More mass protests are unlikely while the corruption probes continue.

In May, the Supreme Court may even strip politicians of legal privileges that currently mean they can only be tried by the Supreme Court, a process that can conveniently delay corruption cases for years.

All this has left the questions of who might contend and win the October 2018 election wide-open. With the big traditional parties held in such low regard, the spotlight has fallen on potential outsider candidates.

The most contentious possibility is Jair Bolsonaro, a rightwing congressman who is the darling of evangelical and orthodox Catholic groups. The most talked about, though, is João Doria, 59, a former businessman, now mayor of São Paulo, who once hosted the Brazilian version of TV show *The Apprentice*.

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Reinventing Brazil

Views from the top on what Temer should do

Round table
The FT’s bureau chief *Joe Leahy* hosted a panel discussion inviting leading businesspeople to examine some of the challenges ahead

After two years of the worst recession in the history of Brazil, when gross domestic product shrank by more than 7 per cent, Brazil’s economy is beginning to recover. The recession began under the previous populist government of Dilma Rousseff, the former president. Its effects were amplified by a corruption investigation known as *Lava Jato* or Car Wash, into state-owned oil company Petrobras. In turn, this has ensnared much of the political class.

The centre-right government of President Michel Temer, brought to power following Ms Rousseff’s impeachment last year for manipulating the budget, is heavily implicated in the Car Wash probe. Yet, accidental president though he might be, Mr Temer has proved to be one of the country’s most ambitious reformers in decades.

His reform programme includes efforts to limit increases in real budget spending, changes to the labour law, increasing the minimum retirement age from the mid-50s at present, and reforms to allow greater foreign investment in airlines, the oil industry and infrastructure. The challenge is to get all this done before elections in 2018. These promise to be the most unpredictable in more than a decade, with no clear frontrunners yet.

The FT and its partner for the event, FGV Projetos, a consultancy, invited some of the country’s most prominent chief executives to debate how Brazil can reinvent itself to become an economy fit to compete in the 21st century.

The roundtable, at FGV Projetos’ boardroom on Avenida Paulista, the main thoroughfare in South America’s business capital, São Paulo, was chaired by the FT’s bureau chief, **Joe Leahy**. It was hosted by **Cesar Cunha Campos**, director of FGV Projetos, and **Carlos Langoni**, senior adviser of FGV Projetos and former central bank president.

Engaged in the debate were **Pedro Parente**, chief executive of Petrobras, the state oil company; **Claudia Sender**, president of Latam Brasil, South America’s biggest airline; **Nizan Guanaes**, co-founder of Grupo ABC, Brazil’s largest advertising group; **Eduardo Navarro**, chief executive of Telefónica Brasil, the Spanish telecom group’s largest single-country operation; and **Gilberto Peralta**, chief executive of General Electric (GE) Brazil. Here are edited extracts of the conversation.

Lava Jato and the recession
Background The *Lava Jato* investigation has revealed that politicians conspired with former executives of Petrobras and contractors to steal billions from the company and other areas of the economy through bribes and kickbacks. The depth of the corruption has prompted a debate on whether Brazil can overcome its historic problem with graft.
Nizan Guanaes (Grupo ABC) If you read



The Robber Barons [by Matthew Josephson, 1934] you will see the things that are now happening in Brazil happened in the US in the 1920s. So we didn’t invent anything. These kinds of things [the *Lava Jato* investigation] in my belief are going to unleash a better Brazil. This is a fantastic country. Although there is a wonderful quote from Roberto Campos [a Brazilian thinker] who said Brazil never misses an opportunity to miss an opportunity.

Pedro Parente (Petrobras) We can have an optimistic view, but I think that what we need more is indignation. I think that what is lacking for us as a society is indignation because again, there is an enormous gap between what we can be as a country and what we are, I mean it is a shame.

Gilberto Peralta (GE) As a multinational in many countries, this is our third-largest market [after the US and China]. We have not stopped or reduced any of the investments we had forecast in 2015-2020. I think *Lava Jato* is going to be a landmark, a turning point, so I am optimistic about what’s going to come.

The need for labour reform
Background The country’s labour law dates from 1943 and contains incentives for employees to litigate against their employers. There were applications for 4m new cases last year. Critics say the labour judges are pro-worker and random in their rulings. The Temer government is pushing through a bill that will make the plaintiff liable for the legal costs if he or she loses her labour case. It is also making union fees optional for workers rather than mandatory, as is the case now. In addition, it is making temporary and part-time work more flexible and introducing new rules on collective bargaining agreements.

Ambitious reformer: President Michel Temer
Christopher Goodney/ Bloomberg/Ricardo Lisboa



Pedro Parente



Cesar Cunha Campos



Carlos Langoni

GP (GE) We have operations in probably 80-90 countries — this is the most complicated country we have in [terms of] taxes and labour laws. Brazil is only 3-4 per cent of our total revenue in the world but we have more people handling tax and labour issues for Brazil than for anywhere else in the world.

Claudia Sender (Latam) We have a large number of claims for things that really do not make any sense. I will give you a very silly example. We have a lot of young employees and one of them, by mistake, recently posted on social media that he was smoking a joint on the stairs of an emergency exit. Someone brought it to compliance, we fired him for just cause, so he sued us.

The judge told him off and said: “Of course you should have been fired, but not for just cause.” So the company had to pay him a severance package. This outcome is an example of the mindset that we, as a country, need to change.

Problems with taxation
Background Promised by the Temer government but not yet introduced to congress, the reform of Brazil’s labyrinthine tax system is considered essential for the country to become more business friendly. The World Bank’s Doing Business report ranks Brazil 181st out of 190 countries in terms of the difficulty of paying taxes. Tax department auditors have tremendous power, business leaders complain.

Eduardo Navarro (Telefónica) The tax issue is not only a question of how high [taxes] are. For me the big question that could be addressed is the complexity and the uncertainty.

PP (Petrobras) Nowadays, you can have just one tax department auditor coming to your company and deciding what is right and what is wrong regardless of the law. The auditor can fine you billions of

reals and you have to keep it in an escrow account in the bank. And you have to hire lawyers and defend yourself and your company and it can take 15 years to get rid of that. Tax reform would not require constitutional amendments and would really make for a much better business environment.

Bureaucracy, deregulation and the nanny state
Background Another thing that troubles business is the state’s tendency to overly regulate areas ranging from consumer rights to aviation and telecoms. The mobile phone industry, for instance, is waiting desperately for a reform that is stuck in congress that will remove requirements for it to maintain 1m public phones that are almost never used any more in a country that is one of the world’s biggest cellular markets. Meanwhile, the state also provides benefits, such as early retirement, to those lucky enough to be eligible, including public servants, even though the federal budget is suffering huge deficits.

EN (Telefónica) We have a public phone in every corner in Brazil and they are not used at all but they have to be working, or we face huge fines. This is just an example, but we have a lot of obligations that are related to the past [and] very few obligations that are related to the future. For example, broadband. People do not want fixed-voice lines any more, they want mobile or they want broadband — in schools, in small villages, in hospitals

CS (Latam) Something that I believe we have to change as Brazilians, especially from a government point of view, is believing that individuals are incapable of making their own wise decisions and the state or the unions and the consumer protection entities always



Claudia Sender



Nizan Guanaes



Eduardo Navarro



Gilberto Peralta

need to intermediate somehow.

NG (Grupo ABC) If you don’t reform the welfare system how are you going to pay pensions to people who are going to live 80 years, 100 years? The world has changed. This is a time of truth in Brazil. We need these kind of reforms.

President Temer’s reforms
CL (FGV) He is an unpopular president doing unpopular reforms.

NG (Grupo ABC) [jokingly] Exactly, like my mother. I did not really agree with her, for example, about taking a bath, or switching off the television. But we need these reforms and then we need to reform our expectations, and our mindset. Brazil today is certainly better than Brazil was in the old days. But Brazil has to be better than India and China because we are competing globally.

Political appointments in state-owned companies and changes at Petrobras

Background Car Wash has shown that politicians appointed directors to state-owned companies such as Petrobras, who then used their positions to siphon money out to their political patrons in the form of kickbacks and bribes. Yet, in spite of rule changes requiring appointees to have technical expertise, the law still leaves the way open for political preferences.

PP (Petrobras) I can say I don’t recall any other chief executive of Petrobras who enjoyed the autonomy that my team is enjoying right now. We don’t have any ministers on the board of Petrobras. We’ve got nothing against ministers or people from the army. But what I am saying is, when we talk about reinventing Brazil, we really need to choose people for state-owned companies and regulatory agencies who are professionals.

Foreign investment and trade
CL (FGV) Foreign direct investment in the 12 months to March reached the highest level ever — almost \$85.9bn. So if you have this level of investment in the middle of this still high degree of uncertainty, that says a lot about Brazil.

GP (GE) Brazil has to have the mindset of: “We need to export”, not just make it the flavour of the month that because we have a crisis, we have to export.

The 2018 election — populism versus economic reform
Background Brazil’s political system is urgently in need of reform. There are about 36 registered parties. The proportional representation system means that few of the 513 members of the lower house of congress are directly elected in their own right, creating low accountability. With President Temer vowing he will not stand, the 2018 election is shrouded in uncertainty, with no obvious leading candidates.

CL (FGV) We have done a simulation. If we just keep the reforms at a moderate level, GDP will grow, but at a very moderate pace — may be 2 per cent. If we follow through with a sequence of reforms, including political reform and tax reform, opening up the economy, and consolidating a new level of governance for state enterprises, GDP growth will double.

EN (Telefónica) May be the time has come for business to be more engaged in the public debate over populism vs liberal economic policies.

NG (Grupo ABC) Brazil needs global leaders, modern laws and old values — people who can understand what’s happening around the world. We also need to modernise our laws and finally we need to rely on traditional values, not cynical values. We really need these three things desperately.

‘Car Wash’ launches revolution in transparency and compliance

Governance

As corruption probe widens, recruiting trained staff is a wise move, says *Dom Phillips*

Launched in 2014, Brazil’s ever-expanding probe into graft and kickbacks at Petrobras has ignited a regulatory compliance boom in corporate Brazil, with companies rushing to open departments and bring staff up to speed.

“There is currently a revolution happening in the country in this area of transparency, anti-corruption and compliance,” says Bruno Brandão, Brazil country manager for Transparency International, an international non-profit group.

Mr Brandão says Operation Car Wash, as the investigation is known in Brazil, has forced Brazilian companies to improve compliance.

“This area was virtually non-existent in the country five years ago,” Mr Brandão says. “There are still profound

uncertainties but what is happening here is a historic moment.”

Paulo Suzart, a compliance consultant at the Hage, Fonseca, Suzart & Prudêncio law firm in São Paulo, says he has never before had so many requests for training in compliance from company executives, judges, police officers, prosecutors, business leaders and students.

“Compliance today is on executives’ minds as a way of protecting themselves,” he says. “We train top management in what are the risks to executives, what is compliance, how to introduce this into the company, how to detect criminal fraud, how to meet what the law requests.”

The work also includes selecting and training compliance officers, setting up compliance departments, and offering support once these are up and running. One of the practice’s partners, Jorge Hage, was formerly Brazil’s comptroller general and instrumental in writing Brazil’s Clean Companies Act, an anti-bribery law that came into effect in January 2014.

Under the law, companies found guilty of graft can be fined up to 20 per cent of the previous year’s gross income. Having a compliance department can be a mitigating factor when it comes to punishment.

“This is a very big incentive,” says Mr Brandão, adding that, for companies, setting up a compliance department is almost like buying insurance.

A separate law from 2013 allows judges to slash sentences for those who agree to collaborate with investigations.

The Car Wash investigation has made effective use of plea bargains, under which senior executives have been agreeing to provide information to prosecutors in return for leniency.

“Without plea bargains, this scandal would have not come out,” says Mr Suzart.

He also highlights the importance of another piece of legislation, known as Brazil’s State Companies Law and approved in 2016. This establishes governance, risk and compliance mechanisms for public companies and private companies in which the state holds a



Security: a guard outside Brazil’s National Congress building

controlling interest — such as Petrobras.

Under this new law, these companies can no longer appoint government ministers or people directly connected to political parties to its board of directors or top management, which is a practice that used to be common at Petrobras.

“Compliance has reached a central place in Brazil’s reinvention in terms of its corporate structure,” says Marcos

Troyjo, professor of international relations and public affairs and expert on Brazil at Columbia University. “Now things are very public.”

Brazil’s attempts to improve compliance standards has not been without criticism. For example, the Ministry for Transparency’s role in signing leniency agreements with companies that have already agreed to co-operate with prosecutors has raised concern because it is seen as being less independent than the prosecutors’ office, says Mr Brandão.

André Rosilho, a São-Paulo lawyer and co-ordinator of the public law course at the city’s Getúlio Vargas Foundation, points out that a number of other bodies, in addition to the Ministry of Transparency, can also sign leniency agreements, including the Federal Attorney General and the Federal Court of Accounts. This, he argues, has created a huge amount of uncertainty in the judicial system.

Meanwhile, in May last year, Fabiano Silveira, former minister of transparency, resigned after he was secretly recorded criticising the Car Wash inves-

tigation and giving advice to a government senator implicated the scandal.

“There is a concern over the degree of independence,” Mr Brandão says. “It is an organ of the government.”

Despite misgivings, the measures introduced in Brazil in recent years are credited with leading the transparency boom.

Research by the Brazilian offices of consulting outfit KPMG over the past two years bears this out.

In 2015, just 57 per cent of about 250 companies questioned for a survey into compliance in Brazil said they had ethics and compliance programmes and policies. In 2016 this went up to 76 per cent. “It is significant growth but it does not mean that we are at an ideal stage. It means we have a long way to go,” says Emerson Melo, director and compliance leader at KPMG, who co-ordinated the study.

It might be early days, but Mr Brandão says the Car Wash clean up is too big for anyone to stop. And, as others point out, the transparency it has helped bring in is long overdue.

Reinventing Brazil

Megacity’s talent for renewal is paying off

São Paulo is home to big business, entrepreneurs and a rich arts scene, say *Joe Leahy* and *Carina Rossi*

At Itau Cultural in central São Paulo, a hip arts centre that would not be out of place in Tokyo or Berlin, youngsters crowd into an exhibit paying homage to African-Brazilian writer Conceição Evaristo, who was born in a *favela*, or slum, in the southeastern city of Belo Horizonte.

A queue snakes around a corner and down the block from the centre’s theatre, which is hosting a show by Ana Muller, a singer who found success on the internet and is now launching her first record.

“It’s so great that there are these shows for free here on [Avenida] Paulista,” says a teenage girl in the queue. Like everything at Itau Cultural, the concert is free.

Art and free shows are not normally the first things about São Paulo that strike visitors from abroad.

The megapolis, with a population of 21m, is the economic powerhouse of Brazil’s continental economy. New arrivals are often confounded by its endless phalanxes of concrete residential towers – greater São Paulo is said to have one of the biggest concentrations of high-rise buildings in the world – and its multiple business districts.

Unlike Rio de Janeiro, whose beaches are set against lush green mountains, landlocked São Paulo has concreted over many natural features to make way for its relentless traffic. While Rio’s inhabitants have a brash charisma that puts tourists at ease, *Paulistanos*, as residents of the country’s biggest city are known, have an indifference to newcomers that would not be out of place in any of the world’s global business hubs.

São Paulo also boasts one feature few other Brazilian cities can claim – a talent for transformation. Today, it is morphing from a heavy industry and financial powerhouse into a technology and services centre where those working in creative industries rub shoulders with internet entrepreneurs, or the bosses of multinationals.

A history of change

São Paulo was founded in the mid-16th century by Jesuits keen to convert the local Tupi Indians to Christianity. Next came the *bandeirantes*, vagabond fortune hunters who forayed inland in search of gold and Indians as slaves.

When Brazil’s gold rush ended in the 18th century, the state of São Paulo turned its hand to growing sugar and then coffee. The following century, waves of Italian and Jewish immigrants helped convert São Paulo into an industrial centre.

In the 20th century, the nation’s automotive industry set up in greater

São Paulo, from which emerged the metalworker unionist firebrand, Luiz Inácio Lula da Silva, the populist president who ruled Brazil between 2003 and 2010 and left office with approval ratings above 80 per cent.

Today, São Paulo is shape-shifting again, says Eduardo Saron, director of Itau Cultural and acting president of the Bienal de São Paulo, the city’s art festival. He points to the history of Avenida Paulista itself to illustrate how much São Paulo has changed. It originally showcased the fabulous mansions of the coffee barons before the nation’s banks moved in. Today, Avenida Paulista has evolved into a centre for universities, museums, cinemas and arts and cultural centres.

“São Paulo desires to be a place of knowledge, creativity and cultural activity,” says Mr Saron.

The arts

Founded in 1951, the Bienal de São Paulo is the second-oldest art biennial after the Venice exposition. It has grown rapidly in recent years, with nearly 900,000 people visiting the event in 2016.

The strong showing was a boost for a sector that has suffered during Brazil’s deep recession, which saw gross domestic product contract more than 7 per cent in two years, ending a spate of museum and art gallery building across the country, says Mr Saron.

But, even as the recession took hold, fiscal incentives such as the Rouanet law, which lets companies earn tax breaks by investing in the arts, helped keep the arts sector afloat.

One beneficiary has been the São Paulo Museum of Art, better known as Masp, whose red modernist building is a symbol of the city.

“You have critics, galleries, collectors and artists – and that is the city’s great advantage,” says Heitor Martins, head of Masp.

Politics

São Paulo’s capacity for rapid reinvention is reflected in its political choices too. The last mayor, Fernando Haddad, of Mr Lula da Silva’s leftist Workers’ Party, or PT, sought to make the city more liveable, reducing speed limits and increasing the number of cycle paths and exclusive bus lanes.

His replacement as mayor, João Doria, who took office in January this year, is a former businessman aligned with the PSDB, the market-friendly centrist party that runs the government of São Paulo state.

Mr Doria has already sparked controversy by painting over prominent graffiti as part of his “beautiful city” campaign. But he also aims to put the municipality’s bureaucratic processes



Clockwise from bottom left: São Paulo’s metro system; Paulo Filho and Camila Romano, proprietors of King of the Fork; one of the city’s cycle paths leads past Itau Cultural; the São Paulo Museum of Art (Masp)

Ricardo Lisboa for the FT

biggest consumer market, São Paulo has become the principal technology hub in Brazil,” he says.

Culinary sector

That consumer market also supports a thriving scene for eating out. Marisabel Woodman, a Peruvian married to a Brazilian, began cooking dishes from her homeland in a food truck before setting up La Peruana Cevicheria, a restaurant in the upmarket Jardins district.

“The city has been very good to me in terms of business because even with the crisis, *Paulistanos* like to eat out,” says Ms Woodman.

At King of the Fork, a café, owners Camila Romano and Paulo Filho have capitalised on São Paulo’s ability to embrace change. Located on a bike lane on a street in Pinheiros, a hip São Paulo neighbourhood, the café is doing good business tapping into the city’s emerging cycling culture.

Financial and services centre

It is São Paulo’s role as a financial and professional services centre for Latin America’s largest economy that will continue to drive businesses large and small to set up there.

A few kilometres away from King of the Fork, in an office tower in Brazil’s main investment banking district, Alain Carrier, the head of international at the Canadian Pension Plan Investment Board, looks out over the city’s bright lights.

CPPIB has set up offices in London, Hong Kong and opened its Latin American regional base in São Paulo in 2014. In spite of the recession, the office already has 15 employees, growing faster than Mr Carrier had expected. Reflecting a view shared by many multinationals, Mr Carrier says: “There’s nothing like having a local presence. We don’t see any substitute for that.”

‘As the biggest consumer market, São Paulo has become the principal technology hub in Brazil’

online and reduce the time it takes to open a business. But he has a battle on his hands if he truly wants to make great improvements in the city. São Paulo’s problems are as big as its opportunities. The two most difficult issues – public transport and crime – are out of his control, because they are largely the responsibility of the state government.

The metro system is good but too small and the city has one of Brazil’s better police forces yet is also the home of the country’s biggest crime gang, the *Primeiro Comando da Capital*, or First Capital Command.

Self-reliance

Individuals often remain the main agent of change, take Thomaz Srougi, for example. The founder and chief executive of Dr Consulta, a rapidly growing health clinic start-up, Mr Srougi was a trader in an investment bank before becoming an entrepreneur.

Brazil is supposed to have free universal healthcare but in practice patients can wait months for

consultations. Meanwhile, private sector healthcare is characterised by expensive insurance plans and luxury hospitals for the rich.

“There was not the balance there, doctors were not making money, patients didn’t have access to doctors, and doctors were working 15 hours a day,” Mr Srougi says.

In 2011, he decided to set up a budget private healthcare clinic in São Paulo’s biggest favela, Heliópolis. Patients could make appointments online and secure immediate access to a doctor and specialists. Payment is with cash – no expensive healthcare plans.

Today, the business is growing rapidly – two and a half years ago it had 40 doctors; today it has 1,000.

Another entrepreneur who is thinking of getting into the medical industry is Rodolfo Ohl. Credited with bringing international internet-based services provider SurveyMonkey to Brazil, Mr Ohl is also part of a group of entrepreneurs who have set up a fund to provide seed capital to start-ups. “As the

Temer’s radical reforms end three years of turmoil and recession

Continued from page 1

A new lower middle class that emerged during the boom years of the first decade of this century has grown to account for half of Brazil’s population. It is demanding better public services and reforms to an economy built on nepotism, patronage and state control. “The mindset of the politicians is still stuck in the 1980s,” says Ricardo Sennes, a political analyst with Prospecitiva, a consultancy. “But the middle class has changed. They are better informed.”

Many mark the beginning of the political reawakening of Brazil to 2013, when millions took to the streets to protest – ostensibly against public spending on the 2014 World Cup. The protesters targeted the political class in general as the first allegations began to emerge of wrongdoing at Petrobras.

The government of President Dilma Rousseff pulled out the stops to win the 2014 election, stimulating the economy through a system of price controls and ad hoc tax breaks. But the economy collapsed in 2015 as the country sank into its worst recession on record with growth shrinking by 3.8 per



cent that year and 3.6 per cent last year.

Ms Rousseff was impeached for manipulating the budget, opening the way for Mr Temer, who had already prepared an ambitious reform programme called “A Bridge to the Future”. President Temer and eight of his ministers have also been implicated in the Petrobras scandal, and they vehemently deny any allegations of wrongdoing. But in spite of this, the Temer government has set out to restructure Brazil’s economy in a way not seen for decades.

It has quickly passed a budget ceiling that limits growth in expenditure to zero in real terms. To ensure this promise is met, it is now trying to pass pension reforms to unravel one of the world’s most generous and costly retirement systems. As part of the reform, the government is seeking to raise the minimum retirement age for men to 65 and for women to 62 from the current average of the early 50s.

The government is also passing legislation freeing up the labour market. The new rules cover workplace collective bargaining agreements and make it more difficult for employees to sue

companies, while removing compulsory contributions to unions.

The government has also opened up the oil and gas sector to greater foreign investment, allowed 100 per cent foreign ownership of airlines and is auctioning off highway and airport concessions to foreign investors.

The central bank, meanwhile, has returned to Brazil’s earlier, successful inflation-targeting policies. Under Ms Rousseff, inflation had soared even as the economy fell into recession. But now inflation is back near the central bank’s official target range of 4.5 per cent plus or minus 1.5 percentage points.

The government is also cutting back on subsidised lending by the national development bank, BNDES.

The bank had grown to become the main source of long-term finance in Brazil. But its loans, which were offered at below market rates, were a burden on the treasury.

Its lending to the country’s biggest and most able businessmen also led to allegations it was favouring politically well-connected borrowers, accusations it has denied. Its flow of cheap loans also

‘We have to make a distinction between populism and popularity . . . I am not disposed to fiscal populism’

fuelled inflation, forcing the central bank to increase interest rates on other forms of lending.

Ilan Goldfajn, central bank president, says Brazilians have to decide what sort of state they wanted – a big, free-spending government that sprinkles benefits around or a one with more disciplined approach. “Fifty per cent of our lending is at subsidised rates,” he says, adding, “someone has to pay.”

The window for further reforms is narrow. Brazil will go into election mode next year, with the presidency and congress up for grabs.

In an interview with the FT earlier this year, Mr Temer said he would not be standing for re-election. Partly because of this, he said he was not afraid to push ahead with tough reforms. “We have to make a distinction between populism and popularity,” he said. “It would have been very comfortable for me, seeing that I would be staying [in power] only for two-and-a-half years, to have taken populist measures and left Brazil to the consequences . . . But that would be fiscal populism and I am not disposed to fiscal populism.”

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Reinventing Brazil

Pensions at centre of nation’s reality check

Reforms Proposed changes to retirement and labour laws spark fierce protests, writes Dom Phillips

President Michel Temer’s government is battling to introduce an ambitious agenda of reforms. In December, congress approved a 20-year cap on public spending. To implement this it is now it is debating changes to restrictive labour laws and a sweeping reform of the country’s generous and expensive pension system.

Coming from a deeply unpopular administration facing a deluge of corruption investigations, the reforms have sparked fierce opposition, street protests, brief invasions of congress by police and prison officers, and even an attempted general strike. But economists see the changes as crucial to resolving Brazil’s huge fiscal deficit.

“They are fundamental,” says Fernando Holanda, a professor of economics at the Getulio Vargas Foundation in Rio.

Marcos Troyjo, a professor of inter-

national relations at Columbia University, says the reforms are crucial to “levelling the playing field” for an economy that has been mired in the worst recession in its history. “These are steps that lead you away from danger,” he adds.

Public spending soared under the left-ist government of President Dilma Rousseff. In 2014 the central government reported Brazil’s first primary deficit since the current tallying system was started in 1997.

Ms Rousseff was impeached last year on charges of breaking budget laws and Mr Temer, her former vice-president, took charge.

In December, the senate approved a constitutional amendment limiting increases in public spending to the previous year’s inflation rate, sparking protests across the country. The government said health and education spending would be maintained, but Philip Alston, the UN special rapporteur on extreme poverty and human rights, called the austerity measures “socially retrogressive”.

The amendment’s approval was seen as an important sign of the government’s ability to sway Brazil’s unruly congress.

In March, congress passed a bill



National strike: people take to the streets in Rio de Janeiro — AFP/Getty Images

allowing companies to outsource any job and extended the maximum term for temporary work contracts to six months from three. In April its lower house approved reforms to Brazil’s restrictive labour laws, ending obligatory union contributions and permitting collective bargaining. “It’s Ground Zero for Brazil,” says Prof Troyjo.

The government had also proposed introducing a universal minimum pension age of 65, up from its current very generous provisions that mean many retire in their 50s.

According to government figures, the number of Brazilians over 65 will grow from 17.5m to 58.4m by 2060. That increase matters because according to a

World Bank report published in April, pensions already represent around a third of government spending in Brazil. “The proposed reform would move Brazil closer to international benchmarks,” the World Bank said in a staff note in April. “Without it, the public pension system is not financially sustainable.”

But protests have already resulted in the government watering down its proposals. It is now, for example, targeting a minimum retirement age of 62 for women. Benefits for the poorest will continue to be linked to the legal minimum salary and a retirement age of lower than 65 is already being proposed for teachers, police and rural workers, reducing potential savings.

The National Confederation of Bishops of Brazil, the Brazilian Bar Association and the Federal Council of the Economy have attacked the proposals and called for more discussion.

The National Association of Tax Auditors has challenged the government’s figures, arguing the pension deficit could be overcome by increasing productivity, savings, taxes and creating more formal jobs.

On April 28, strike action against pension and labour law reform shut down

schools, companies and transport networks across Brazil. Street protests in São Paulo and Rio de Janeiro descended into violence as police used tear gas and rubber bullets on crowds.

A poll by the Datafolha Institute published on May 1 found 71 per cent of respondents opposed pension reform.

But the situation in Rio de Janeiro, where a broken state government struggles to pay more pensioners than employees, serves as a warning, says Thiago de Aragão, director of intelligence at Arko Advice, a Brasília political consultancy. “People would like a pension reform that changed virtually nothing,” he says, adding that such a solution would be mathematically impossible.

Mr Temer has a more solid base in congress than Ms Rousseff, Mr Aragão says, while his unpopularity might actually help his administration to pass pension reform because he has nothing to lose.

The reforms may not enjoy popular support, but they do at least have parliamentary backing, adds Gil Castello Branco, an economist and founder of the non-profit watchdog, Contas Abertas, which scrutinises public accounts. “This has been necessary for a long time,” he says.

Young founder puts soil analysis on farm phones

Profile

Mariana Vasconcelos, chief executive of Agrosmart, tells Vinod Sreeharsha how she capitalised on her roots



Mariana Vasconcelos: her father is a farmer growing sugar cane and corn

When Mariana Vasconcelos founded Agrosmart in 2014, her youth made it particularly difficult to get the agricultural technology business off the ground.

Ms Vasconcelos, then 23, and her two male co-founders, Raphael Pizzi and Thales Nicoleti, both 25, soon realised that the traditional farmers welcomed them into their homes mainly because they reminded them of their own children.

As a result, the farmers did not take Ms Vasconcelos and her co-founders seriously. They showed interest in the company’s crop monitoring technology but when it came time to close a sale “they did not want to talk money”, she recalls.

But thanks to help from start-up accelerator programmes, the company’s technology — which uses data harvested from the sensors it supplies that are installed in farmers’ fields — is now monitoring 50,000 hectares in nine of Brazil’s states. The aim is to boost production of corn, wheat, sugarcane, coffee, fruits and vegetables.

The Agrosmart platform on the farmers’ phones helps interpret the field data and adds it to extra information, such as climate modelling, to allow users to make informed choices on matters such as irrigation.

Coca-Cola is using the start-up’s technology with its fruit farm suppliers in the state of Espírito Santo to help them reduce water use and promote sustainable agriculture.

‘There is no doubt when you walk into the company, or a management meeting, that Mariana is the leader’

Agrosmart is also expanding to other countries, including Kenya.

Globally, agricultural technology continues to gain momentum. Brazil is a large exporter of agricultural produce and last year Microsoft and Monsanto launched a start-up fund specifically to invest in Brazilian agri-tech ideas.

While few people in technology industry understand agriculture, Ms Vasconcelos grew up on a farm in Itajubá, in the south of Minas Gerais state. Her father grew sugar cane and corn and was always out working in the fields.

Ms Vasconcelos, however, did not take much of an interest in farming and did not wish to follow her father in running the business. “I thought it was very boring. I liked the horses but I did not like the farming.”

Instead, from an early age, she wanted to study business and work in

technology. It was after she left home for university that she realised that farming could benefit from the application of internet-connected sensors and devices.

A few months after Agrosmart was founded, the company entered a national government programme called Start-up Brasil and was sent to an accelerator, which helped support the company in its early stages.

Further help came in 2015, when Agrosmart was selected as part of the first batch of companies in Google Launchpad, a global start-up accelerator programme run by the US technology giant.

Ms Vasconcelos made a strong impression. “I think she has a brilliant future ahead of her,” says José Papo, start-up relations manager for Latin America at Google.

Ms Vasconcelos also set about hiring people with expertise, such as agronomists and engineers, and an older executive to handle negotiations and close deals with the farmers. “The smartest move to make was to get me out of that function,” she says, adding the staff allow her to focus on what she feels she does well, explaining and selling the company’s vision and technology.

Her ability to communicate her vision helped to win over one of the company’s earliest supporters, Francisco Jardim, founding partner of the venture capital firm SP Ventures, in São Paulo.

He says: “She had a very pure clarity of where the market was . . . progressing in Brazil and globally in terms of technology.”

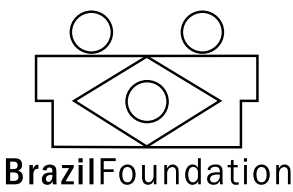
Mr Jardim’s firm invested \$1m in the company early 2016 and he says he has not been disappointed.

“There is no doubt when you walk into the company, or when you walk into a board meeting or a management meeting, that Mariana is the leader,” says Mr Jardim, who also serves on Agrosmart’s board.

Among her other duties, Ms Vasconcelos is hoping to raise a new round of financing for Agrosmart and SP Ventures has expressed an interest in being the lead investor.

“We have absolutely no worries about writing a much bigger cheque at a much higher valuation,” Mr Jardim says.

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Reinventing Brazil

Interview Central bank president tells *Joe Leahy* that he expects the economy to recover this year

Goldfajn: stick to new policies and inflation will stay low

Brazil's economy may be struggling to emerge from recession but on one front at least there is good news — inflation is finally falling.

Inflation, an old enemy of the Brazilian economy, last year reached a high of nearly 11 per cent before falling to 4.08 per cent in April, its lowest since 2010. For the first time in years, it is below the centre of the central bank's target of 4.5 per cent plus or minus 1.5 percentage points.

For Ilan Goldfajn, Brazil's central bank president, the fall is giving Latin America's biggest economy a chance to begin addressing the country's other scourge, high interest rates.

"I think we are in a new period [in terms of the level of inflation]," said Mr Goldfajn, speaking in his office at the central bank in São Paulo. "The most important thing is that you need to keep policies [moving] in the right direction."

Driven by a vast, profligate and inefficient state with a tendency to index salaries, pensions and other benefits to historical inflation, recent high levels of inflation have proven particularly controversial.

Things used to be much worse. In recent decades, Brazilians became accustomed to a steady decline in inflation, which fell from nearly 5,000 per cent a year in 1994 to about

5 to 7 per cent in the first decade of this century.

But this trend went into reverse in the final years of the government of Dilma Rousseff.

In power from 2011 until her impeachment for budgetary abuses last year, Ms Rousseff tried to subsidise fuel and energy prices and stimulate the economy through tax breaks and by pumping up state bank lending.

These policies caused a blowout in the budget deficit, undermining investor and consumer confidence and sparking a currency depreciation, inflation and recession.

"The elements were all in the wrong direction. If we had just had a recession it would be easier. If we had just had inflation that would also be easier, but when you have recession on one side and inflation on the other, that's much more difficult," Mr Goldfajn said.

The scenario changed last August when the new pro-business government of President Michel Temer launched reforms to cap real increases in public spending for up to 20 years and to overhaul pensions.

Mr Goldfajn said he expected the economy to recover and be expanding at 2.5-3 per cent by the end of the year, helped in part by these reforms. "The first element [that started the recovery] was changing policies, and with changing policies I would put the fact



Sifting coffee cherries: farmers can access heavily subsidised loans (left); Ilan Goldfajn (below)

Patricia Monteiro, Lula Marques/Bloomberg



where loans are not subsidised to make their profits. Market-based interest rates in Brazil, such as those charged by banks on consumer loans, or credit cards and overdrafts, or on corporate credit provided by private sector banks, are among the highest in the world.

Mr Goldfajn said a study of Brazil's interest rate spread — the average amount banks charged on non-subsidised loans — revealed further inefficiencies. Nearly 56 per cent of the average spread charged on loans between 2011 and 2016 was to account for the risk of non-performing loans, the central bank study showed. This was partly because banks have difficulty recovering bad loans and because they lacked clear information about borrowers, especially small and medium enterprises. They covered this risk by charging high interest rates. Taxes accounted for another 16 per cent of spreads, while regulations, such as reserve rules, ate up another few per cent. Profit and "other items" accounted for 23.3 per cent.

With the government due to decide in June whether to lower its inflation target from 2019, Mr Goldfajn believes Brazilians have a decision to make.

"If you want more rights, more benefits, you need to find a way to pay for that," he says. "So this is one thing we have to think about in terms of reinventing Brazil."

that there was a political change in government that supported all this."

The other factors contributing to the fall in inflation were spare capacity in the economy created by the recession and hawkish monetary policy.

The central bank has now begun easing benchmark interest rates. But

Mr Goldfajn said Brazil also needed to address many of the other structural elements that led to high inflation and interest rates. He said there was still a lot of indexation built into wage negotiations, with courts almost always taking historic inflation as the basis in labour disputes over salary rises, regardless of the expected outlook for a given sector.

The other problem, he added, was that half of all lending in Brazil is subsidised by the government. Brazilian farmers, large companies and lower income home buyers all receive discounted loans.

In another example of structural economic challenges, the country's 1988 constitution had awarded different groups various benefits but not said how they would be paid for.

"When you go to the movies, if you are a student you pay half-price, if you are a senior above 60 you pay half, if you are a teacher you pay half. At the end of the day, someone has to pay for this half-price," Mr Goldfajn said.

The subsidised loans flushing through the system force the central bank to make monetary policy tighter to control inflation, pushing up market rates. Banks also seek to charge more in areas

‘If you want more rights, more benefits, you need to find a way to pay for that’

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Reinventing Brazil

Technology start-ups lure capital back after recession

Funding Investors are focusing on fintech and are keen to back innovators, says *Vinod Sreeharsha*

Despite the recession and political turbulence, Brazil's technology start-up scene is still attracting attention from investors. Yet there was a marked slowdown in overall new amounts pledged in 2016.

Nonetheless, Brazil's technology-savvy citizens have an obvious appeal to start-ups and their backers. Brazil ranks third globally in the number of Facebook users, behind the US and India. It is fourth in number of internet users and is one of Google's most important markets for products such as Android.

Research from the Latin American Private Equity and Venture Capital Association (Lavca) shows a 37 per cent decline year on year in the overall amount invested by venture capital firms, from \$442m invested in 2015 to \$279m in 2016. The number of deals also declined, from 101 in 2015 to 64 in 2016.

The reluctance among some VC backers is understandable. Investors bet heavily on consumer-focused internet companies during Brazil's most recent economic boom from 2010 to 2013, pouring money into companies that were often replicating business models from the US and Europe.

However, observers say many of those companies failed, with few ever reaching profitability and, to date, exits that would provide VC firms with returns have been virtually non-existent. "The first vintage [of investment]

was poorly invested, mostly in e-commerce, and you're seeing the result of that now," says Edson Rigonatti, a founding partner at Astella Investimentos, a VC investment firm.

Since that period though, investors have made adjustments and there has been a new crop of start-ups. Fintech is growing in importance and bucked the recent downward trend in overall VC investment, according to Lavca.

In 2016 the fintech sector attracted \$113m in venture capital in 14 deals, more than 10 per cent higher than the \$102m pledged in 2015 in nine deals.

"I was not sure if we'd ever see it, but we're beginning to see companies export their business model to Europe, the US, and Latin America for the first time," says Kevin Efrusy, a partner with Accel, the US venture capital company, who has been investing in Brazil for over seven years.

Neoway, the Florianopolis-based big data start-up, is among the businesses drawing the interest of global financial companies as potential customers. It is even looking to make acquisitions this year, possibly in the US, its founders have said.

The new crop of investors will also be hoping to find the next Nubank, a digital credit card company, or GuiaBolso, a personal finance platform. Both are based in São Paulo and were founded before the recession.

Both are growing fast and have been successful in attracting new rounds of



Important market: Fabio Coelho, Google's president for Brazil — Paulo Whitaker/Reuters

investment. Nubank's early investors included Sequoia Capital, the US VC firm. GuiaBolso backers included Brazilian VC company e.Bricks Digital.

Meanwhile, more money looks to be on its way for local start-ups. VC providers that primarily back early stage internet companies are currently raising new funds.

They include São Paulo-based Red-point eVentures and DGF Investimentos. DGF is raising an early stage fund for technology companies. Kaszek Ventures, which has offices in Buenos Aires and São Paulo, is also securing commitments for its third fund.

"Some [venture capital firms] have pulled back but we've seen a number of new firms that are starting to look at Brazil opportunistically because they feel the worst is over," says Andy Tsao, a managing director at Silicon Valley

Bank, who specialises in emerging market innovation companies.

Pierre Schurmann, co-founder of Bossa Nova, an early stage investor, also sees signs of a recovery. In March, Bossa Nova raised a R\$100m (\$31m) fund to make pre-seed investments in Brazilian internet start-ups. It has invested in 146 companies to date, he says.

"The quality of the entrepreneurs is improving a lot, compared to five to six years ago," says Eric Acher, a founding partner of Monashees, a São Paulo-based VC company.

Accel's Mr Efrusy says it is the slightly more mature companies that had received funding in the past that impressed him most on a recent visit to Brazil: "I felt like there were seven or eight companies that could be public companies almost anywhere, in the US, on Nasdaq, within three years."

Development bank overhauls lending

Finance

State-run BNDES plans to raise interest rates in a move that could boost private sector investment, writes *Vinod Sreeharsha*

BNDES, the state-run national development bank, is at the sharp end of the reforms that President Michel Temer is trying to bring in.

The bank, which has become the main source of long-term finance in Brazil, has been criticised for lending large amounts to the country's richest businessmen at below market rates.

Now BNDES is trying to reduce subsidised lending, apply stricter criteria for financing and achieve a steep increase in the benchmark interest rate it has long used. By bringing that benchmark closer to market rates, the bank hopes Brazil's economy will become more competitive.

In March, Maria Silvia Bastos Marques, the bank's president, proposed phasing out the lowest rate, beginning in January 2018.

Brazil's Congress needs to approve this proposal, and one of Brazil's most powerful business lobbies, São Paulo-based FIESP, has already raised objections to the change.

BNDES is not backing down. Officials insist that the change will ultimately benefit a broader swath of Brazil's economy and will also help to bring down interest rates at the central bank.

"We have to learn the lesson that credit is not the way to make the economy more productive," says Vinicius Carrasco, BNDES director of planning and research. "Cheap credit is not the solution to all problems."

In addition to proposing an increase to interest rates, BNDES has introduced other measures. The bank is distancing itself from the treasury, which provides a fiscal cushion. BNDES returned R\$100bn (\$315m) to the treasury last December, despite opposition from pressure groups, and does not plan to

turn to it for financing in the future, says Mr Carrasco.

The bank has also rewritten criteria used to select companies to finance over the next five years, while its loans will still be subsidised. The bank is seeking projects that have more social benefits.

"The changes at BNDES are very welcome," says Carlos Antonio Rocca, director of research at Instituto IBMEC, which provides training and research.

The reforms should help to control inflation. In recent years, when the central bank has tried to tighten monetary policy to bring down inflation the government was simultaneously boosting credit at BNDES and other large public banks.

"It's long overdue that the bank goes through the kinds of changes that are being put in place, including more logical criteria for their lending and more transparency," says Arminio Fraga, former central bank governor.

The bank plans to focus on invest-

Maria Silvia Bastos Marques: has proposed phasing out the lowest lending rate starting in January



ment in education, health, small businesses and modernising public administration.

In infrastructure, the highest priorities are sanitation, solar energy, urban mobility, waterways and railways, transport of gas and biofuels, and distribution of gas. But these projects are also expected to attract non-governmental institutions.

Alexandre Teixeira, head of project finance at Brazilian bank Itaú BBA, says: "We expect greater participation from the local private capital markets for financing these projects." He says Brazilian pension funds and insurance companies could also become interested.

As to the complaints from FIESP and other business lobby groups, Mr Carrasco says he thinks they will eventually come around.

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