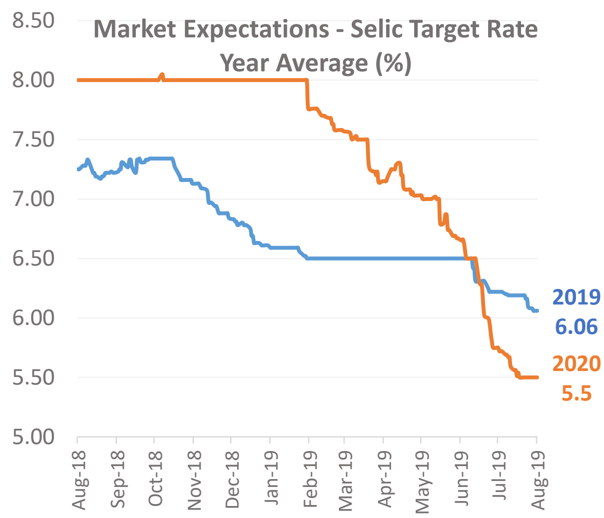
BRAZIL: MACROECONOMIC MONITOR AND REFORM AGENDA

August 6, 2019

Weekly Highlights

- Central Bank of Brazil reduced the Selic target rate was reduced in 50 bps to 6.0%, and indicated the possibility of further cuts. The Copom minutes will be released on Tuesday.
- Brazil and the USA initiated official negotiations of a free trade agreement
- Congress resumes its activities this week. It is possible to have the 2nd round voting of the Social Security Reform in the House of Representatives.



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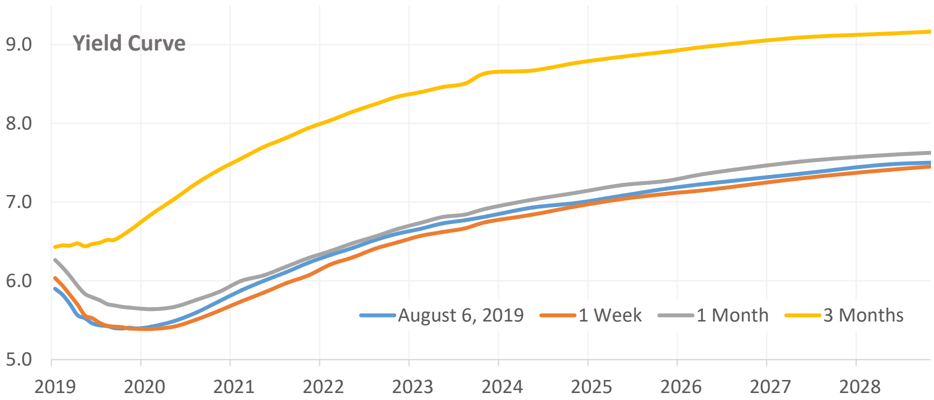
The Pro-Infra Strategy

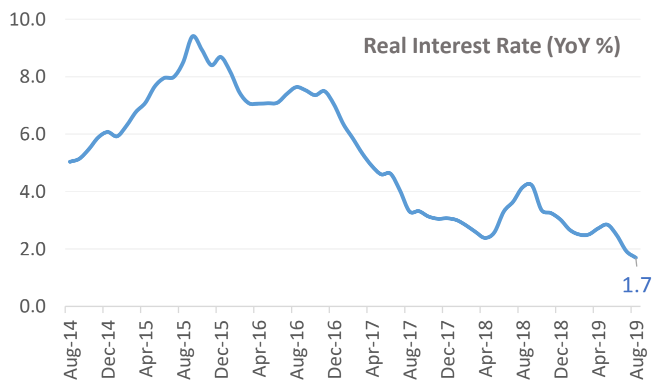
Market View: Estimated impact of new FGTS rules on the economic activity

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY)	0.50	-3.55	-3.30	1.06	1.12	*0.82 (*)*	*2.10 (*)*
Consumer Inflation IPCA (% YoY)	6.41	10.67	6.29	2.95	3.75	*3.80 (*)*	*3.90 (*)*
Current Account (USD bi)	-101.4	-54.5	-24.0	-7.2	-14.5	*-21.5 (*)*	*-32.4 (*)*
Foreign Investment in the Country (USD bi)	87.7	60.3	73.4	70.3	88.3	*85.0 (*)*	*85.6 (*)*
International Reserves (USD bi)	364	356	365	374	375	*386 (01 Aug)*	-
Unemployment rate (%)	6.5	8.9	12.0	11.8	11.6	*12 (Jun)*	-
General Government Gross Debt (% GDP)	56.3	65.5	69.9	74.1	77.2	*78.8 (**)*	*80.2 (**)*
Ibovespa Index (BRL, % chg.)	-2.9	-13.3	38.9	26.9	15.0	*16.8 (ytd)*	-
CDS 5 years (year average)	189	475	293	165	208	*165 (Aug 19)*	-
Interest rate (Selic Target) (%, eop)	11.75	14.25	13.75	7.50	6.50	*5.25 (*)*	*5.50 (*)*

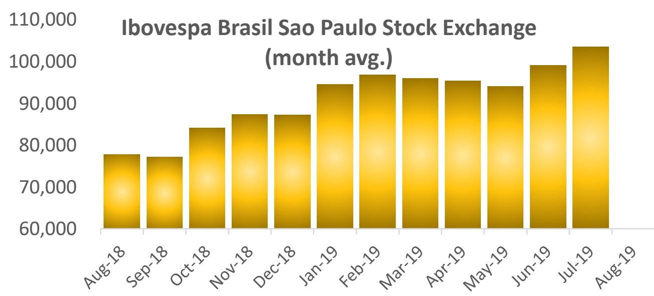
Estimates: (*) Focus Survey, Central Bank of Brazil, Aug. 2, 2019); (**) Prisma Fiscal, Jul.2019

MARKET WATCH





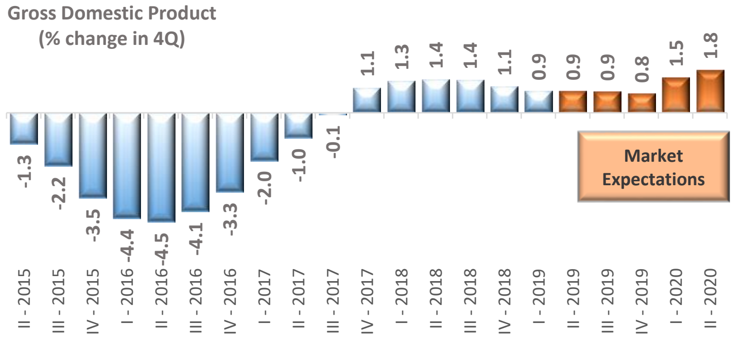
Swap Pre x Di 360 days discounted of the IPCA Expectation for the next 12 months

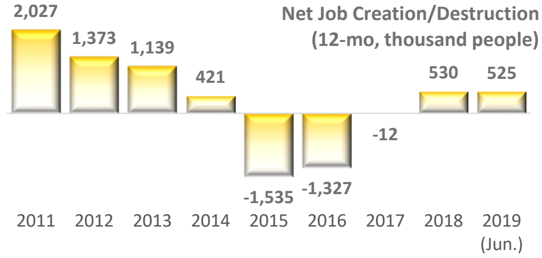


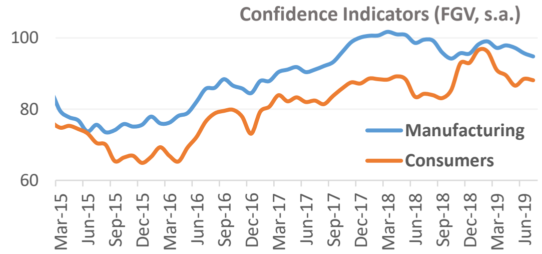
Sources: BCB, Min. of the Economy, Bloomberg

ECONOMY WATCH

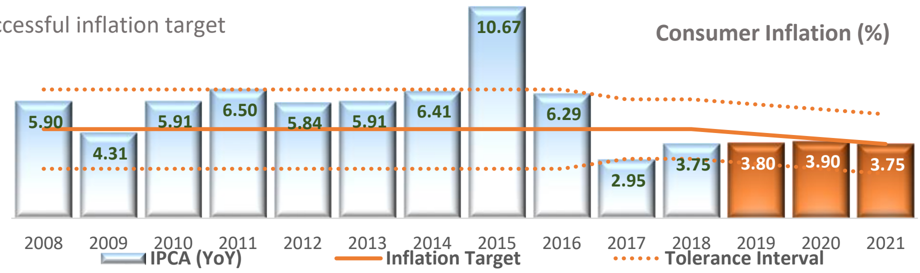
A more robust recovery is still dependent on further advances in the reform agenda



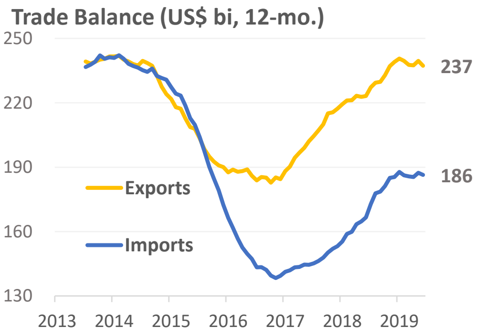


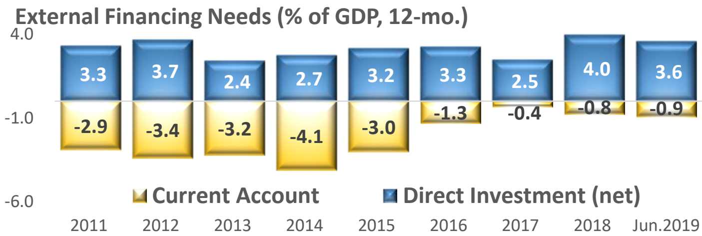


The country runs a successful inflation target regime

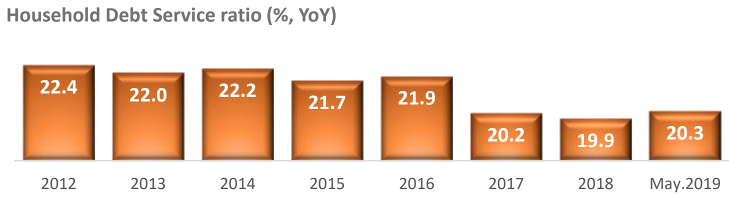


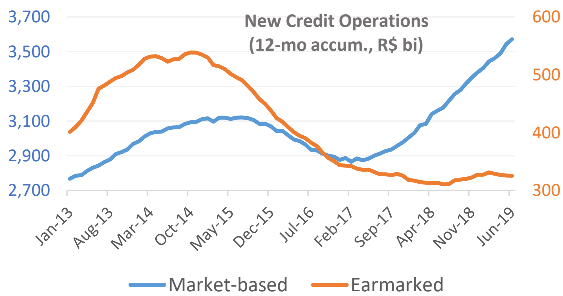
The external accounts are one of the main pillars of the Brazilian economic stability



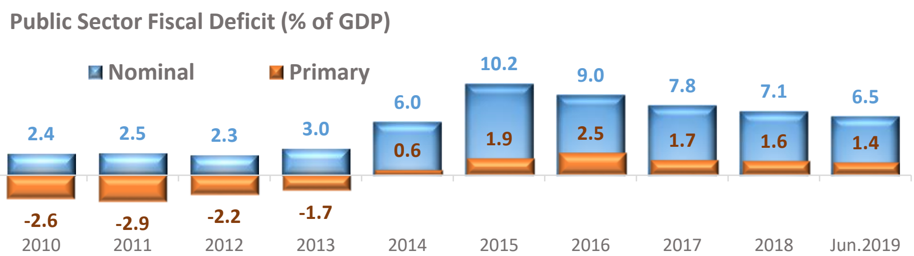


The credit market went through an adjustment process and now favors market-based operations





Brazil is working to improve its fiscal sustainability



Sources: BCB, Bloomberg

Fiscal consolidation and productivity increase are crucial inputs for Brazil to grow strongly and sustainably. The new government is going forward to put in place a set of reforms for speeding up growth and increasing potential output.

Main Measures	Description	Next Steps
Social security reform (*PEC 06/2019*)	• Brazil spends more than half of the Federal budget on social security and benefits. The Gen. Govt. Gross Debt is expected to climb 25 p.p. in the next 5 years. • The reform was approved in the House of Representatives in the first of the two necessary rounds. In general, the Reform increases the time to retire, limits benefits, raises the rates of contribution for those who earn above the INSS ceiling and establishes rules of transition for the current contributors. • Impact: estimated savings of around BRL 0.9 trillion in the ten years (improving the primary balance in around 1.9 p.p. of GDP by 2027). • The reform will stabilize the social security expenditures in 8.5% of GDP from 2022 on.	• Second voting round in the House of Representatives on Aug. 06th. Needs 308 of the 513 votes. • Analysis of its constitutionality by a Senate comission. • Two voting rounds in the Senate. Needs 49 of the 81 votes. Changes made at this point must be sent to the House of Representatives. • Expected to be approved in 2019.
Combat embezzlement of social security benefits *(MPV 871/19)*	• Revision of 6.4 million benefits granted, with expected savings of R$ 9.8 billion in 12 months; stricter rules for the concession of new benefits. • New rules to simplify and make more efficient the judicial collection of debt due and unpaid to the Social Security, focused on big debtors.	• Presidential approval.
Tax reform	• Aims at simplifying the tax system and at reducing the tax burden on companies, legal insecurity and excessive legal dispute • Includes the merger of federal taxes (PIS/COFINS, IPI, CSLL and IOF) into the Federal Single Tax.	•Legislation being prepared by the Government • Instrument: PEC and infra constitutional measures
Subsidies reduction	• Reduction and streamlining of subsidies granted by the Government, which amount to around 4.7% of GDP in the 2019 budget.	• Instrument: Congressional approval
Trade liberalization	• The openness degree (exports plus imports over GDP) is targeted to increase from 22% to 30% of GDP in four years. • 2019 initiatives include: the end of quantitative restrictions on the free trade agreement of autos with Mexico; modernization of tax agreements; agreement with Sweden to end the double taxation of income tax; import tax reduced to zero on 1.189 industrial machines and equipment not produced domestically; reduction of the import tax for inputs and products of the chemical sector. The EU-Mercosur Free Trade Agreement was announced by both parties on June 28th. The Free Trade agreement is to be ratified by all Parliaments involved.	• Expand the Agreement for Economic Supplementation with Mexico • Free Trade agreement with the US • Instruments: Government decrees and resolutions
Central Bank Independence *(Senate PLP 19/19)*	•On April 11th, the Government sent to Congress a bill establishing formal independence to the Central Bank of Brazil. It comprises a four- to eight-year term for the directorate of the institution, with no overlapping with the presidential mandate; and the end of ministerial status given to the president of the Bank.	• Congress appreciation • Instrument: Supplementary Bill.
Fight corruption, criminal organizations and violent crimes *(PL-881/2019, PL-882/2019 and PLP-38/2019)*	• Changes to the Code of Criminal Procedure, Criminal Code, Criminal Law, Electoral Code, among others; • Criminal law enforcement measures will reduce costs of doing business. Include the provisional execution of a criminal conviction after second instance sentences; the criminalization of irregular funding in elections; tighter sentences and penalties increase.	• Proposal submitted to Congress on February 19th • Instrument: 3 Infra constitutional
Digital Government	• Initiatives such as *The Digital Citizenship Platform (* access and provision of digital public services); *GovData (* crossing and information analysis of the main official databases); and *ConectaGov (c* onnection and exchange of information between government systems).	• Broader digital integration, services provision, and database unification; Changes in the legal framework; among others.
Extreme poverty reduction	•On April 11th, the Brazilian president enacted a fast track bill granting one additional allowance per year for the 14 million households covered by conditional cash transfers (Bolsa Família Program). There is no fiscal impact, due to the relocation of public expenditures.	• Interim order must be issued in Oct. 2019
Private Credit	• On June 27th the Ministry of Economy announced the release of more than R$100 billion in reserve requirement on deposit liabilities to private banks. The goal is to allow financial institutions to extend credit to individuals and companies.	• Reduction of bank´s compulsory rate from 33% to 31%.
Employment	•The registers of the unemployed were opened to private recruitment companies, extending the use of the national employment system dataset.	• New Work Booklet (*Verde e Amarela*) to ease access to the labor market. • *Emprega Mais* : new workforce training strategy.

Brazil aims at figuring among the 50 best positioned countries in the Doing Business report

Main Measures	Description	Next Steps
Business Facilitation *(MP 881/19)*	• Economic Freedom Bill: reduces red tape and Government intervention, facilitating the opening of new businesses. It eliminates the need for low-risk activities to obtain any type of license, regardless of the company size; limits the restrictions on trading hours, service and industry; prevents laws to define prices; establishes a binding and isonomic treatment for similar situations; overrules outdated legislation; eliminates license requirements for testing, developing or implementing a product/service that does not pose high risks; impedes business contracts to be changed judicially; establishes that license requests unanswered are automatically granted; simplifies the access of small and medium-sized companies to the capital market; extends higher court decisions to all cases, without the need to appeal; creates the "regulatory abuse" situation; makes the analysis of regulatory impact mandatory for any new legislation; among others issues.	• *Simplifica* : Set of 50 measures to reduce red tape to production. • Brazil 4.0: Encourage companies' digitization and modernization. • *Pró-mercado* : regulatory changes to end barriers to market operation and competition.
Positive Credit Registry	• Law that includes individuals and companies in a database with information on their credit track record, aiming at broadening and easing credit opportunities for those with a good payment record.	
Ombudsman for Direct Investments	• Provide consultation for foreign investors about legislation or administrative procedures related to investments in Brazil.	
National Tourism Policy *(Decree 7.763/19)*	• Bill to develop and promote the tourism segments related to the World Cultural and Natural Heritage of Brazil, within the scope of the National Tourism Policy.	
Public administration overhaul *(Decree 9.725/19)*	• 21,000 commissioned positions eliminated. • Limitations for creating collegiates. Elimination of unnecessary collegiates. • Restrictions for hiring civil servants and rules for hiring senior officials.	
Restrictions to public banks	• Bill provides that the Central Bank must approve the appointment of directors and administrators of public financial institutions, in accordance to the technical criteria established by the National Monetary Council.	•Congress appreciation
Fiscal sustainability of subnational entities	• Federal support to states with some counterparts, such as fiscal adjustment measures and opening of regional markets for gas distribution. • Sharing resources from the pre-salt with states and municipalities.	• Launch of the Financial Equilibrium Plan and elimination of the Federal exclusivity to the Social Fund.
Auction of Assignment Agreement	• The auctioning of the surplus of around 5 to 6 billion barrels will result in a compensation for Petrobras of US$ 9.0 billion. The signature bonus is estimated at around US$ 26.5 billion.	• Auction scheduled for Oct. 28th, 2019
Privatization	• The sale of state-owned companies and Voluntary Dismissal Programs are under preparation. There are 134 companies owned by the Fed. Govt. (being 88 subsidiaries), with more than 450,000 employees.	• On June 6th, 2019, the Supreme Court ruled that subsidiaries do not need Congress approval to be sold.

INVESTMENTS, CONCESSIONS AND PRIVATIZATIONS

52 PPI Projects Auctioned or Renewed

Electric Power
- Privatization of 7 Distributors (CELG, CEAL, CEPISA, CERON, Eletroacre, Amazonas, Boa Vista)
- Concessions of 2 Hydroelectric Plants (Jaguara, UHE and 2 Small Plants
- Transmission Lots

Oil and gas
- 4th Marginal Fields Round
- 14th and 15th Exploratory Blocks Bidding Round
- 2nd to 5th Pre-Salt Production Sharing Bidding Rounds

Railways
- 5 Extensions and 1 Concession (Norte-Sul)

Airports
- 16 Concessions

Port Terminals
- 22 Projects (leasing, extension or assignment agreement)

Highways
- Concession of Rodovia da Integração do Sul

Supply
- Privatization of CASEMG

47 ongoing PPI Projects

Electric Power
- Transmission Lots
- 2 Auctions of New Energy

Nuclear Power
- Angra 3 Thermonuclear Plant

Mining
- 4 Concessions of CPRM Mining Rights

Oil and gas
- Concession of 14 Marginal Fields Areas
- 16th Exploratory Blocks Bidding Round
- 6th Pre-Salt Production Sharing Bidding Round
- Auction of Assignment Agreement

Airports
- 6th Round (North I, South and Central)

Port Terminals
- 12 Leasing Projects
- 1 Privatization

Railways
- 4 Concessions

Highways
- 11 Concessions

Other
- Privatization - Casa da Moeda, CEASAMINAS, Infraero shareholdings and Eletrobras
- Concession of LOTEX
- PPP for COMAER

Project Portfolio

HIghways

Investments of US$ 34.9 bi

Extension of 16,574.82 km

Highways	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
BR-364/365/GO/MG	✓	✓	✓	◑ 2Q19	4Q19
BR-101/SC	✓	✓	◑	3Q19	1Q20
BR-381/262/MG/ES	◑			2Q20	3Q20
BR-163/230/MT/PA	◑			1Q20	2Q20
BR-153/080/414/GO/TO	◑			4Q19	1Q20
BR-470/282/153/SC	◑			2Q20	3Q20
BR-040/495/MG/RJ (Concer)	◑			3Q20	4Q20
BR-116/465/101/SP/RJ (Dutra)	◑			3Q20	4Q20
BR-116/493/RJ/MG (CRT)	◑			3Q20	1Q21
Highways Integradas do Paraná	◑			2Q21	3Q21
Highways 7200 km	◑			2Q22	3Q22

Airports

39 airports

Investments of US$ 2.1 bi

Signature bonuses of US$ 0.6 bi

Airports	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
5th round - Central West Block (4)	✓	✓	✓	✓	✓
5th round - Northeastern Block (6)	✓	✓	✓	✓	✓
5th round - Southeast Block (2)	✓	✓	✓	✓	✓
Viracopos	◑				
6th round - South Block (9)	◑				
6th round - Northern Block 1 (7)	◑				
6th round - Central Block (6)	◑				
Disposals of Infraero shares (4)	◑				

Railroad

Investments of US$ 14.8 bi

Extension of 15,107 km

Signature bonuses of US$ 0.7 bi

Railroads	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
EF-151 – FNS	✓	✓	✓	✓	✓
EF-334 – FIOL	✓	◑		3Q19	4Q19
EF-170 – Ferrogrão	✓	◑		4Q19	1Q20

Railroads	Studies	Public Hearing	TCU Assessment	Legal Opinion	Subscription
Contract Extension Malha Paulista	✓	✓	◑		3Q19
Contract Extension Carajás (EFC)	✓	◑			4Q19
Contract Extension Vitória-Minas (EFVM)	✓	◑			4Q19
Contract Extension MRS	✓	◑			2Q20
Contract Extension FCA	✓	◑			2Q20

Ports

21 terminals and 2 ports

Investments of US$ 1.1 bi

Signature bonuses of US$ 0.2 bi

Ports	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
Port of Vitória/ES (TGL CAPUABA)	✓	✓	✓	✓	✓
Port of Cabedelo/PB(AE10,AE11,AI01)	✓	✓	✓	✓	✓
Port of Belém/PA (BEL02A,02B,04,08,09)	✓	✓	✓	✓	✓
Port of Vila do Conde/PA (VDC12)	✓	✓	✓	✓	✓
Port of Paranaguá/PR (PAR01)	✓	✓	✓	✓	◑ 3Q19
Port of Santos/SP (STS 13A)	✓	✓	✓	✓	◑ 3Q19
Port of Santos/SP (STS20)	✓			✓	◑ 3Q19
Port of Suape/PE (SUA05)	✓	✓	◑	3Q19	4Q19
Port of Santos (STS 14)	◑	4Q19	4Q19	1Q19	2Q19
Port of Itaqui (IQI 03, 11, 12, 13)	◑	3Q19	3Q19	4Q19	1Q20
CODESA Privatization	◑	2Q20	3Q20	4Q20	1Q21
São Sebastião Privatization	◑	3Q20	1Q21	1Q21	2Q21
Port of Paranaguá/PR (PAR12*)	✓	✓	✓		
Port of Suape/PE (SUA01*)	✓				

✓ Completed

◑ In progress

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The Pro-Infra Strategy

• On Aug. 01st, the Government launched the Pro-Infra strategy, designed to further develop the economic infrastructure of the country (logistics, energy, sanitation, urban mobility, telecommunications and popular housing), increasing productivity, competitiveness and employment.

• The goal is to raise annual investment in the sector from the current 1.6% to 3.8% as a proportion of GDP by 2022.

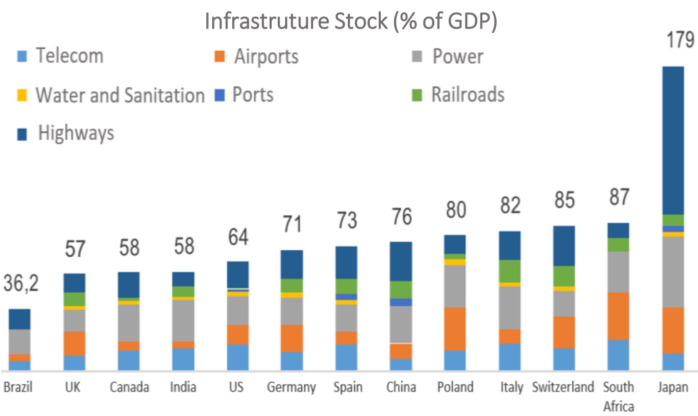
• The strategy will rely on the attraction of private investments. Pro-Infra will also have the participation of BNDES and PPI.

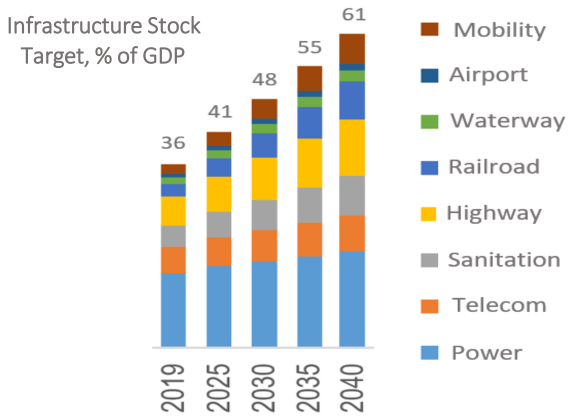
• Brazil needs investments in infrastruture. The infrastructure stock is currently at 36% of GDP. As a goal, the strategy aims at reaching both developed countries and BRICS peers, with an infrastructure stock of around 60% of GDP.

• Pro-Infra will tackle issues that hinder the attraction of foreign capital for infrastructure, such as legal certainty, adequate regulatory frameworks and long-term planning.

• The strategy is based on three pillars: reducing government participation in infrastructure projects, increasing private investment and long-term planning. There is also the goal of, until 2022, making Brazil rise 10 positions in the global competitiveness ranking, made by the World Economic Forum, from 81st to 71st in the infrastructure pillar, and to be among the top 20 positions in 2040.

• The necessary investments, of around R$ 10 trillion by 2040, will bring both short-term and long-term effects, by stimulating the economy and by reducing costs and expanding the supply of infrastructure services.





Market View: Estimated impact of the new FGTS rules on the economic activity

• The Government released new FGTS rules for withdrawals, fund remuneration and its use as collateral in credit operations, and simplified the rules for withdrawal of PIS/Pasep.

• LCA Consultores estimated the impacts of the new rules as presented below.

• In the *Immediate Withdrawal* option, every citizen with a FGTS account will be entitled to withdraw up to R$ 500 per account from Sep/2019 to Mar/2020. The Ministry of Economy (ME) estimates an injection of about $40 billion (R$ 28 billion in 2019 and R$ 12 billion in 2020) in the economy. In addition, it will be made available permanently to withdraw funds from the PIS/PASEP (deposits made until 1988). According to ME, PIS/PASEP amounts to R$ 22.8 billion, divided among 11.7 million quota holders but, in this case, the expectation is to release only R$ 2 billion. The joint impact in activity is 0.5 to 0.6 pp of GDP in 12 months, with maximum impact in the first half of 2020.

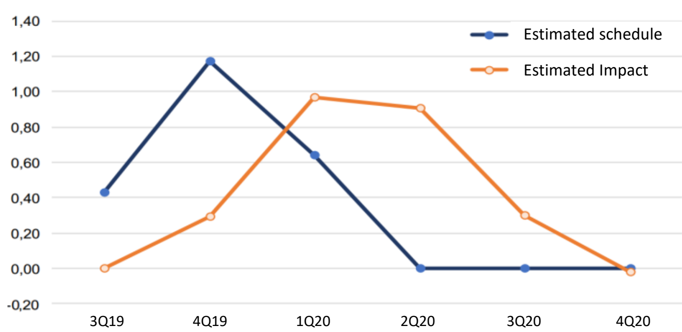
• The estimated impact is higher than the calcuted by the ME, of 0.35 p.p. of GDP in 12 months, and consider both direct and indirect effects.

• LCA projections were based on the results from the FGTS withdrawals allowed in 2017, considering that there are reasons to believe the effects will be stronger this time: i) the number of people contemplated (96 million) will be 4x higher than in 2017; ii) the average withdrawal per person should be close to R$ 415, therefore, with a higher consumption profile and, finally, iii) household indicators in comfortable levels, such as delinquency rates (0.6 pp lower), the income commitment (fell from 21.1% in 2017 to 20.3%), confidence (5.8 pp higher) and employment (formal jobs expanded by 640,000 between Jul/17 and Jun/19).

• The new *Anniversary Withdrawal* option could inject from R$ 16.6 billion to R$ 31.2 billion into the economy in 2020. Direct/indirect effects on activity are expected to be relatively minor but, if successful to reduce incentives for high labor turnover, there could be positive effects in the medium and long term to labor productivity. There are no estimates from the Government.

• Under this last option, workers will be allowed, from 2020 on, to withdraw a percentage of the resources (active or inactive) in the month of birthday. Upon entering this mode, the worker will be prevented from full withdrawal for the next two years. At any time, this choice can be reverted, always effective only two years after the change. These resources can be used as collateral in credit operations (similar to what happens today with the anticipation of the income tax).

Estimated Impact in % of GDP
Sources: IBGE and ME. Projection: LCA



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