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FEATURED Q&A

Will Brazil Soon Finalize New Free Trade Agreements?

Brazilian President Jair Bolsonaro met July 31 in Brasília with U.S. Commerce Secretary Wilbur Ross. The two countries are discussing a possible free trade agreement, Ross said. // Photo: U.S. State Department.

Q Brazil is in "advanced" stages of trade talks with South Korea and Japan, Brazilian President Jair Bolsonaro said Aug. 6. Just days before, U.S. Secretary Wilbur Ross was in the South American country, where he said negotiations were underway on a possible free trade agreement between the United States and Brazil, a country that has traditionally kept its economy closed. How likely are trade deals with the Asian nations and the United States to materialize in the near-term, and what would such agreements look like? What are the most significant ways in which trade liberalization could affect Brazil's economy? Which Brazilian sectors are set to gain and lose the most from a more open economy?

A **Luiz Eduardo Salles, partner and international trade expert at Azevedo Sette in São Paulo:** "Brazil's current administration has demonstrated great disposition to negotiate new trade agreements, including with the United States, Canada, the European Free Trade Association (EFTA), South Korea and Japan. There is a widespread perception in Brazil that the conclusion of the E.U.-Mercosur agreement will catalyze other trade negotiations. However, with the possible exception of the Mercosur-EFTA talks—which have taken place for longer and given the EFTA ties with the European Union—other agreements are unlikely to materialize in the near-term. Any negotiation of a trade agreement is a complex exercise, and managing different negotiations at the same time would require an unprecedented amount of effort and coordination within Brazil. Moreover, present circumstances make negotiations less straightforward, notwithstanding the

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Mexico Cuts Key Interest Rate by Quarter Point

Mexico's central bank lowered the country's benchmark overnight rate for the first time in more than five years. The cut came amid low inflation and anemic growth.

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Maduro Annuls Citgo Board Named by Opposition

Venezuelan President Nicolás Maduro's government nullified the ad-hoc board that the country's opposition named for U.S.-based refiner Citgo.

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ECONOMIC

Brazil Threatens to Leave Mercosur if Peronists Win Argentine Election

Brazil will leave the trade bloc if the opposition Peronists are elected in October and implement protectionist policies in Argentina, said Brazilian Economy Minister Paulo Guedes.

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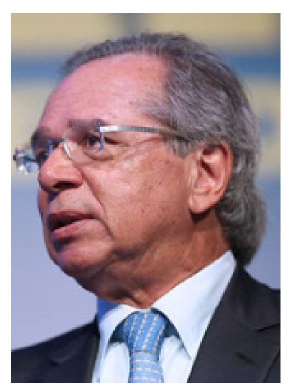

Guedes // File Photo: Brazilian Government.

ECONOMIC NEWS

Mexico Cuts Key Interest Rate for First Time in Five Years

Mexico's central bank on Thursday lowered interest rates for the first time in more than five years, reducing its benchmark overnight rate by a quarter percentage point to 8 percent. The Bank of Mexico said the move was due to a lower level of inflation and weak domestic economic growth, the Financial Times reported. The recent U.S. Federal Reserve rate cut also played a role in the decision, the Mexican central bank said. The Bank of Mexico said a majority of its members voted to lower the overnight rate by 25 basis points, but added that one member voted to keep it unchanged, The Wall Street Journal reported. "The balance of risks remains biased to the downside," the central bank said in a statement. Banxico's rate cut ends a tightening cycle that policymakers began in December 2015, the Financial Times reported. Since then, Banxico had hiked the key interest rate from 3 percent to 8.25 percent. The central bank last cut interest rates in June 2014, lowering them to 3 percent from 3.5 percent. Mexico's level of inflation is currently within the central bank's target of 3 percent. Inflation slowed in July to 3.8 percent, as compared to 4.8 percent at the end of last year, The Wall Street Journal reported. Most of the decline in inflation has been due to the prices of noncore items such as energy and fresh produce. The country's core rate of inflation stood at 3.8 percent in July. Mexico's economy grew just 0.1 percent in this year's second quarter. Gross domestic product contracted 0.2 percent in the first quarter, as compared to the previous three-month period, the Financial Times reported. In addition to the U.S. Federal Reserve, other central banks, including those of Brazil and India, have also lowered interest rates amid growing concerns about a global economic slowdown. [Editor's note: See related **Q&A** in the July 29 issue of the Advisor.]

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>
> **— Bank of Mexico**

BUSINESS NEWS

Venezuela's Maduro Annuls Citgo Board Named by Opposition

Venezuelan President Nicolás Maduro's government on Thursday nullified the opposition-appointed ad-hoc board of state oil company PDVSA's U.S.-based refiner Citgo amid a political struggle for control of the country's assets, the Associated Press reported. State comptroller Elvis Amoroso, who made the announcement on state television, said the country's opposition leaders had no right to appoint a Citgo board, adding that members of the board are banned from leaving Venezuela and that their bank accounts in the South American country have been frozen. It is unclear whether any of the members live there. Citgo is seen as Venezuela's most prized foreign asset, valued at an estimated $8 billion. Citgo's holdings include three refineries, in Louisiana, Texas and Illinois, as well as a network of pipelines. Venezuela's opposition-run National Assembly in February appointed a new 15-member Citgo board after Juan Guaidó, the head of the assembly, invoked the Constitution to declare himself the country's interim president, arguing that Maduro's re-election last year was illegitimate. The United States and dozens of other nations recognize Guaidó as Venezuela's rightful leader, but Maduro has retained political control in the country as well as the backing of the armed forces. On Wednesday, Citgo's ad-hoc board officially announced in a statement that it had selected Carlos Jordá as the company's new chief executive officer. Jordá served as chairman of Citgo between 1999 and 2002, retiring from the company in the early 2000s, the Voice of America reported. [Editor's note:

NEWS BRIEFS

Brazil Threatens to Leave Mercosur if Peronists Win Argentina Election

Brazilian Economy Minister Paulo Guedes said the country will leave the Mercosur trade bloc if the opposition Peronists win Argentina's October presidential election and proceed to implement protectionist policies, Reuters reported. "If Cristina Kirchner gets in and closes the economy, we will leave Mercosur," Guedes said at an event in São Paulo. In Sunday's PASO election, seen as a mock vote ahead of Argentina's presidential vote, the Peronist ticket of Alberto Fernández and his running mate, former President Cristina Fernández de Kirchner, trounced business-friendly incumbent President Mauricio Macri.

Colombia's Economy Expands More Than Expected in Q2

Colombia's economy expanded more than expected at 3 percent in the second quarter, as compared with a year earlier, as the retail, wholesale and transport sector and the financial industry grew, the country's statistics agency said Thursday, Bloomberg News reported. The outcome surpassed the median forecast of 2.9 percent growth from analysts in a Bloomberg survey.

Avianca Investigators Probe Potential Bribery

Internal investigators at Colombia's Avianca Holdings are looking into potential bribery, as the airline in the past had a practice of giving free tickets and upgrades to government officials of several countries, the company said on Thursday, adding that it has now discontinued that practice, Reuters reported. The carrier has undergone internal turmoil in recent months after longtime chairman and controlling shareholder Germán Efromovich was ousted in a boardroom coup in May.

See related **Q&A** in the March 8 issue of the Energy Advisor.].

POLITICAL NEWS

Bolsonaro Blasts European Leaders as Norway Freezes Aid

Brazilian President Jair Bolsonaro on Thursday dismissed European leaders' concerns about his government's environmental policies after Norway froze $33 million in financial aid to an Amazon rain forest preservation fund, Bloomberg News reported. Norway is not in a position to lecture Brazil, Bolsonaro told reporters in Brasília following the European country's announcement. He also blasted German Chancellor Angela Merkel, saying she should understand that Brazil is now under new management. Germany also recently announced it would suspend 35 million euros of financial aid earmarked for protecting the Amazon in Brazil. "We are losing the information war regarding the Amazon rain forest," Bolsonaro said. "Brazil will truly take off once we manage to sensibly extract the riches there." The Brazilian president also said he has discussed the topic with European leaders, saying, "I have said to Angela Merkel and [French President Emmanuel] Macron in a polite but firm manner that we will not be subservient anymore," Bloomberg News reported. Macron and leaders of other European countries have threatened to back out of the European Union's recent landmark trade deal with the Mercosur trade bloc unless the Brazilian government commits to better environmental policies, Reuters reported. Deforestation in Brazil's Amazon rain forest accelerated in the first half of July, as an area of almost three times the size of New York City was cleared in the last month alone, Bloomberg News reported, citing Brazil's National Institute for Space Research, or INPE. [Editor's note: See related Q&A on Bolsonaro's environmental policies in the Dec. 14 issue of the **Energy Advisor** and on the E.U.-Mercosur trade deal in the July 8 issue of the **Latin America Advisor**.]

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will of Brazil's administration. For instance, because of its Mercosur membership, Brazil cannot currently negotiate trade agreements on a bilateral basis independently from other Mercosur countries. Measures to further integrate Brazil into the global economy would affect the domestic economy in several ways, especially given the country's relative insulation in terms of trade policy. First, as is the case with any country, further integration would increase consumer choice and competition and negatively affect several sectors that are not ready for increased import competition. Although the balance would likely be positive, there would be disruption and many losers along the way. In order to minimize disruption, maximize the gains and allow them to be more evenly shared, it would be extremely important to implement structural reforms and policies. In terms of sectors, the winners and losers depend on the trading partner. Brazil is competitive in agriculture and mining commodities, and these sectors would probably gain in any setting. Identifying clear losers would be more difficult, because this would depend on the partner at issue, and heavily on the broader institutional framework. If the right structural reforms and long-term policies are put in place and are pursued in tandem with trade negotiations, in the long term, Brazil as a whole would benefit from more integration with the global economy."

A **Lia Baker Valls Pereira, professor at the State University of Rio de Janeiro:** "The conclusion of the negotiations of the Mercosur-E.U. free trade agreement last June was a clear sign of the commitment of the current Brazilian foreign and trade policy to the deepening of trade liberalization. The agreement is not only about merchandise trade, but also includes services, investments, technical barriers and other themes that have been present in new trade agreements. The deal still needs to be approved by the parliaments of the countries of the European Union and Mercosur, but one of the effects of this agreement is already in force: the priority given to the accomplishment of new agreements by the Brazilian government. Negotiations to speed up trade agreements with Japan, South Korea, Singapore, Canada and the European Free Trade Association are on the foreign trade policy agenda. In addition, the Brazilian government has announced the possible inclusion of the United States in the trade agreement agenda. The proposal to advance the liberalization process has been an important part of the Brazilian debate to increase the productivity of the country's industry. Brazil has higher tariffs in relation to capital goods and intermediate goods than India, a country identified as protectionist. As with any liberalization process, some sectors lose out and will have to adjust, as is the case with electrical and electronic equipment. However, mechanisms to reduce adjustment costs can be implemented. Brazil has a tradition of being a global trader. With the deadlocks in the negotiations at the WTO, it is fundamental that the country broaden its trade agenda. It will be better to go as a Mercosur member, but the issue of trade liberalization belongs to the debate about the main restraints to Brazilian economic growth and cannot be postponed. Mercosur is not only about trade."

A **Jon E. Huenemann, member of the Advisor board and former corporate and government senior executive:** "Brazil's strategy has pointedly been to engender diverse 'strategic' ties in the pursuit of economic development and the national interest. Given the degradation of more traditional forms of multilateralism that Brazil's foreign ministry relied upon for this purpose—such as the WTO (ironically under the capable Roberto Azevêdo's watch)—one could say the time has come for it to forge deeper ties using a modified method, and through this help realize a more prosperous country. But this

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is a Mount Everest to climb. Just the respective country trade politics in agriculture, standards, intellectual property, investment and other realms mean exceedingly tough slogging. Adding to that, the overlay of invasive global commons/rights considerations, not to mention the sovereign, security and related systems confrontations and the reality of upcoming elections, there is enormous uncertainty, such as in the case of Argentina, if one assumes that Mercosur will be integrated. Brazil, the largest global net agriculture exporter and minerals powerhouse and potentially a significantly bigger global investment and manufacturing destination—with better domestic policies and rule of law over time—arguably has much to gain in income growth and diversification and more via forging properly structured ties with such partners. Brazil's leadership also has the challenge of discerning courageous, lasting and adept counterparts in Asia, the United States and Mercosur, which is a roll of the dice. And make no mistake, Brazil's leadership must engender a compelling cause within the body politic or it may as well step back from the task."

A **Mauro Rochlin, professor at the Getúlio Vargas Foundation (FGV) in Rio de Janeiro:** "There are two crucial aspects of a possible U.S.-Brazil commercial accord: its impact on specific sectors, and its potential effects in relation to capital flows and transfer of technology. To analyze the first aspect, it is worth considering which Brazilian export sectors are included in bilateral trade, particularly aeronautics, steel and iron ore, cellulose and petroleum. These four sectors alone account for one-third of Brazilian exports to the United States. Given their high level of competitiveness, it is realistic to believe that they will benefit the most. In aircraft manufacturing, the deal could promote a jump in scale for Brazilian industry. A reduction in tariffs, associated with the sale of Embraer to Boeing, would increase the competitiveness of Brazilian products, paving the way for access to the U.S. market. In the steel industry, the treaty would bury threats of barriers, an instrument the Trump administration favors. With less uncertainty on the horizon, a major investment in the sector would be expected. The cellulose sector, with its comparative advantages, would also be able to intensify its participation in the U.S. market. A lowering of barriers would put producers on both sides on an equal footing, and advantages for Brazilian producers (climate and soil) would see them prevail in the market. In the petroleum sector, given that it is a strategic commodity, the impact would be limited. Moreover, the treaty could increase U.S. direct investment into Brazil. By incentivizing business between the two countries and given the increased volume of intra-company business in bilateral trade deals, reduced tariffs could stimulate the inflow of American capital. Considering Brazil's competitive advantage in the highlighted sectors, barrier reduction should represent an incentive to productive investment in these sectors. The same goes for the transfer of technology. A less restrictive environment would promote greater interaction between head offices and subsidiaries of businesses installed in Brazil, and this would favor an intensification in the transfer of technology. As the majority of bilateral commerce happens between multinationals' headquarters and subsidiaries, fewer tariffs could promote Brazil's integration into international production chains."

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> **— Mauro Rochlin**

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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