

# BRAZIL AND THE WORLD

*In Brazil and in the world, the year of 2018 still reflected the international financial crisis triggered ten years before. As a more general trend, several countries have moved to withdraw monetary and financial stimuli, which had been established at the beginning of the decade, from their economies.*

There were two very different moments throughout the year. By mid-September, the recovery of major economies pointed to tightening of global liquidity conditions with the end of asset-purchase programs by the respective central banks, launched after the crisis began, in addition to a rise in basic interest rates. This context has maintained the exchange rates of emerging markets under pressure.

However, towards the end of the year, the sharp deceleration in central economies' growth pace, coupled with the escalating USA-China trade war, led to significant changes in the monetary authorities' plan. Financial conditions were once again relaxed, particularly with the suspension of the FED (US Federal Reserve) rate increase, improving future prospects for global economic activity in the short term.

In the Brazilian case, the economy remained presenting low growth, mainly due to the political uncertainties arising both from the electoral process and from

an adverse fiscal framework. However, the political renewal in the Legislative and Executive branches, starting with the October general elections, brought new expectations to the economic horizon, with improved indicators such as inflation expectations, stock market index, and future interest rates.

Soon after being confirmed, the new government indicated an economic team committed to an agenda for deepening the reforms, in order to stimulate the increase of the medium- and long-term economic growth.

There was also a great renewal in the Chamber of Deputies: of the 513 federal deputies who took office in January 2019, 243 are in their first term. In the Federal Senate, of the 54 senators who took office, only eight were re-elected and four had already been there on other occasions.

The noticeable shift in the economic agenda over the last three years, aimed at a set of market-friendly structural reforms whose objective is to raise long-term growth potential, presents its first effects.

It is worth mentioning the continuation of the reduction in inflationary targets, initiated in 2017 for the subsequent three-year period (from 4.25% in 2019, 4.0% in 2020 and 3.75% in 2021), as well as the downward trend in long-term interest rates (the thirty-year NTN-Bs interest rates went from 7.1% in 2015 to 5.2% in 2018).

Such advances were possible in an environment where inflation remained under control, with financial market

expectations based on the goal set by the National Monetary Council. It should be noted that this benign environment occurred in spite of several shocks faced by the Brazilian economy, such as the truck drivers' strike in May and the rise in fuel prices.

The issue of public spending, however, remained as the vulnerable point of the local economy. The new tax regime, supported by the spending ceiling, has made it increasingly evident to Brazilian society that it is necessary to adjust the budget. However, the evolution of compulsory spending, in particular the trajectory of primary expenditure with social security benefits, makes the need for the reform of the country's social security system urgent.

The reduction of credit subsidy concessions, together with the lower level of basic interest rates, has been an important catalyst for private issuances in the domestic capital market. Incentivized debentures, benefited by Law 12,431, are particularly noteworthy: the volume issued surpassed R\$ 20 billion in 2018. In this way, long-term private financing improves the allocation of economic resources and emerges as an important vector for economic development.

Moreover, labor reform brings a perspective of greater agility and flexibility to the labor market, even if has not yet had its full impact materialized. Thus, the economy tends to raise its productivity and reduce unemployment in the long term, as its effects materialize.

# CHALLENGES AND VISION FOR THE FUTURE

The reform agenda is still long, and the effort to implement it must be continuous. Additional measures, such as greater rationalization of the tax system, regulatory simplification to improve the business environment and greater economic openness, among others, are paramount to increase long-term growth.

Although the economy expansion pace in 2018 was still below the desired level (with GDP expanding by 1.1%, at the same level as in 2017), the growth of industrial production of capital goods presented a significant increase (+ 7.3%). Foreign direct investment in the country remains very robust, being more than sufficient to finance the deficit in current transactions.

The slow activity resumption and inflation expectations below the target suggest that interest rates may continue at low levels, which tends to stimulate the economy throughout 2019. With the continuity of implementation of the reforms, the economy growth is expected to accelerate, especially with the increase in investment, which should be reflected in the demand for BNDES's financing.

*Making Brazil a poverty-free and socially just country, with a dynamic economy, sustainable generation of jobs and income, adequate infrastructure, attracting new investments and technologically advanced is a desire of the whole society and, to achieve this goal, we have an important portion of contribution, always in a relevant and effective way.*

This is not an impossible dream, but a task inherent to BNDES's vision for the future, due to its nature and vocation. We are the Brazilian development bank and will make all effort necessary for the country to walk on the path of growth with sustainability.

In recent years, we have experienced a drop in demand for our resources. To a large extent, this drop reflects the very reduction of investments in the economy, but not only that. Deep changes began to take place in the environment in which we are inserted – from changes in financial conditions, such as the convergence of rates charged by BNDES with market rates, to the reduction of public funding availability, among others.

In addition to financial issues, there are those of a more structural nature, such as population aging; the sustainability agenda, in which Brazil can be a protagonist, and disruptive technological advances, with far-

reaching consequences on employment and professional qualification. Increasing the economy productivity, with particular attention to the infrastructure and education gap, remains a major challenge. The relation between increase in violence and indicators of poverty and social inequality also stands out as concerns in the country.

Risks associated with climate disasters and the worsening of trade and geopolitical tensions have gained strength in the international scenario. Dissemination of the digitalization agenda remains as another major challenge. If, on the one hand, this agenda can be a solution to increase productivity, in the long term it can imply increase of inequalities both within and between nations. According to the *Trade and Development Report 2018* of the United Nations Conference on Trade and Development (UNCTAD), large investments are necessary in telecommunications infrastructure, data infrastructure organization and professional retraining for the benefits of increased productivity of new digitalization technologies to be achieved without accentuating social and regional inequalities. From the point of view of global financial sustainability, pressures for flexibilization of financial regulation rules and increase of private indebtedness are also points of attention in medium-term scenarios.

In the national economic scenario, due to threats from the international environment or for increased political and institutional instability, there are

significant risks and challenges but, at the same time, opportunities, which require our positioning in several fields.

As a development bank, an active agent of transformation that anticipates and supports promising futures and promotes best practices, our work goes far beyond merely providing financial support, serving the Brazilian society. It is up to us to understand the dynamics of transformation and its impact on our clients, as well as implementing the necessary changes in our business model, reviewing processes, product portfolio, and even internal competencies.

That is why BNDES is on the move. We are transforming ourselves internally to help the country's transformation and to be a relevant agent of development, whatever the scenarios.

Our transformation involves assuming the business-promoting posture even more effectively. Structured development campaigns are bringing new clients and stimulating new businesses, expanding and democratizing our credit, either for companies with less access due to their size, or for offering financial solutions to clients in regions, territories and sectors not satisfactorily served by the private financial system. New products have been created to respond to the needs of different client segments, focusing on new and promising business niches. This vision for the future is already materializing: in 2018, almost half of our disbursements have already been to micro, small and medium-sized enterprises (MSME).

Making investments in infrastructure remains a priority to which we have contributed effectively. To unlock investments in segments so necessary to the country, the expansion of project structuring activities is

essential. In this regard, our role is to develop and support projects that increase productivity and connection between markets, making new business possible for the country.

Brazil is facing a new cycle of asset concessions. We have the example of success in the electric power sector, with the privatization of federalized state distributors. After 20 years of huge losses to the public sector, they were sold in auctions with the private sector's commitment to invest in the service improvement and expansion. New opportunities for sale of lots of highways, airports, and sanitation and gas companies are presented. In all these cases, private investment will boost prospects for more efficient use of these assets, creating new job opportunities.

In the sanitation sector, the challenges to unlock investments are great, and we engage our expertise to support the improvement of the business environment and promote such an important sector for the population's health, especially in less developed regions. It will be necessary to look for solutions that contemplate higher risk assets and high externalities, elaborating appropriate financing structures (that can be made possible by us or by our market partners). This agenda is in line with what development banks from other countries have been doing, and it is essential to stimulate the country's development

In addition to infrastructure, we operate in productive structure, education, health and safety, with the aim of stimulating innovation, strengthening the capital market, leveraging regional development, and promoting sustainability.

The expansion of our dialogue with Brazilian society is another line of

progress. In 2018, we launched the second *Effectiveness Report*, which has improved in relation to the first. The public hearing held jointly with the Federal Court of Accounts (TCU) was also an important step in improving the disclosure of our information in the section Transparency of our website. Our vision points to a greater effort not only towards accountability, but also to communicate the effectiveness of our actions to various audiences: society, clients, class entities, regulatory agencies, and governments, among others.

This transformation involves internal changes. We have become more agile and more digital, adjusting processes to accelerate our procedures and better contribute to the economy's recovery and access to credit, without compromising quality or compliance in our activities. New, simpler and more efficient credit matrices have already been implemented, accelerating concessions significantly.

We are transforming ourselves to better pursue our purpose of transforming the lives of generations of Brazilians, promoting sustainable development. Working to make Brazil a developed country is our vision, our desire, what inspires us: to promote greater income growth, with reduction of inequalities and improvement of the Brazilian population's standard of living, in a sustainable way. The construction of Brazil's future counts on a bank that is enthusiastic in supporting the formulation of public policies, competent in structuring projects, and driven by the mission of making financial solutions feasible, both with its products and with solid partnerships. Besides, we have the deep-rooted commitment to clearly communicate such actions through a continuous dialogue with society.