



Interview: Fitch Ratings Senior Director Lucas Aristizabal; Standard and Poor's Chief Sovereign Analyst Moritz Kraemer; Moody's Investors Service Senior Sovereign Ratings Analyst Mauro Leos

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All three of the major international credit rating agencies—Moody's, Standard and Poor's and Fitch—recently downgraded Brazilian state-run oil company Petrobras in the wake of a sprawling kickback and money laundering scandal. Petrobras is now barely holding on to its investment grade rating at all three of the agencies. Any further downgrades will put its bonds into the 'junk' category. But that's not the only problem raised by the scandal. The decline in financial market confidence in Petrobras is also beginning to affect perceptions of Brazil itself. Analysts at all three of the agencies commented on the Petrobras problem over the past few days. Lucas Aristizabal of Fitch and Moritz Kraemer of S&P commented in conference calls while Mauro Leos of Moody's commented at a São Paulo investment seminar. Excerpts follow:

- **Lucas Aristizabal:** “The Brazilian government has sought macroeconomic and social advantages by controlling gasoline and diesel prices and by instructing Petrobras to create local jobs by meeting domestic-content rules on equipment and supplies, rules which do not always represent a good cost-benefit outcome for the company.”
- **Moritz Kraemer:** “Clearly, there are problems when it comes to the company's institutional arrangements. These have implications (for Brazil's sovereign rating).”
- **Mauro Leos:** “The implications of the events surrounding Petrobras are growing in importance. There is a high degree of inter-connection between Petrobras and the Brazilian economy as a whole. The situation at Petrobras raises problems for every aspect of the Brazilian economy.”
- **Aristizabal:** “Petrobras may access government credit (via the BNDES) but it is unlikely to access international credit markets. The company has already announced measures designed to preserve its liquidity.”
- **Leos:** “When we downgraded the (Brazilian sovereign) rating outlook to negative, we had no idea that someone like Joaquim Levy would come along. His appointment as Finance Minister is clearly positive.”

Top News of the Week

Conditions still point to water and energy rationing for some parts of Brazil. Although rainfall was plentiful over the past two weeks in most parts of Brazil, it wasn't enough to remove the specter of energy and water rationing later this year, at least for some regions of the country. In São Paulo, capacity at the main Cantareira reservoir rose to 10.2% as of Friday, roughly double the early-year level. But the

expansion needs to continue through the end of April, when Brazil begins its annual six-month dry season. Some experts have said 14% of capacity at Cantareira would be sufficient to carry Brazil's biggest city through the dry season but São Paulo Governor Geraldo Alckmin last week ruled out such a figure, calling it too low. Alckmin, however, did not set any benchmarks, saying only that water rationing was still a distinct possibility. On the energy side, hydroelectric capacity as of Friday was 21.9% of potential. Capacity was under 20% at the beginning of the year. At the start of 2015, the National Electric Power Grid (ONS) said capacity would have to reach 35% by the end of April in order to avoid energy rationing during the dry season.

Finance Minister Levy seeks to reassure investors on fiscal policy, growth prospects. Finance Minister Joaquim Levy last week brought his jawboning campaign on the Brazilian economy to investors in Washington and New York. Levy met with representatives of multilateral lending agencies in the U.S. capital and with private investors in New York. He underlined the government's commitment to a primary budget surplus in 2015 equal to 1.2% of GDP. He said, "We can do this without draconian budget cuts. It would be enough for us to repeat 2013 fiscal performance in order to meet the 2015 target." The government's approach includes both budget cuts and selected hikes in tax rates. Some of the fiscal measures could face resistance among lawmakers. However, Levy told investors, "We are confident of an adequate degree of support in Congress." On the broader question of economic performance, he admitted that Brazil's economy most likely slipped into recession in 2014. Nor did he promise a return to growth this year. He said, "We know 2015 is going to be a year of challenges...but you can bet on a positive year in 2016." He was especially upbeat on prospects for a sharp reduction in national debt levels, noting that much of the run-up in debt over recent years was due to Treasury loans to the National Development Bank (BNDES) and massive purchases of U.S. dollars for incorporation in foreign reserves. He said the administration has abandoned both policies. Investors were less convinced regarding ongoing corruption investigations at state-run oil company Petrobras. Many fear that the Petrobras crisis could produce fallout for the overall economy. Levy attempted to assuage such worries by saying, "Petrobras is now on the right track." He predicted normalization of activities at the state oil company once Petrobras releases audited balance sheets for calendar 2014.

Prosecutors open civil suit in Petrobras case amid charges of political interference. Federal prosecutors last week added a new wrinkle to the ongoing investigation into alleged corruption involving Petrobras and private contractors doing business with the state-run oil company. Prosecutors filed a civil action against six of the contractors for material and punitive damages adding up to R\$4.5 billion. Lawyers for the contractors said they will contest the suit. The latest action comes at the same time as charges of political interference in the case. Justice Minister José Eduardo Cardozo admitted to meetings, in his Brasília office, with lawyers representing some of the contractors. He said there was nothing improper about the meetings. However, Federal Judge Sérgio Moro, who is overseeing the investigation, lambasted the minister, saying the meetings constituted a form of political pressure in the case. Popular, controversial former Supreme Court Chief Justice Joaquim Barbosa joined the fray at mid-week, saying Cardozo should resign because of the contacts. Press reports said representatives of some of the contractors have also met with aides to former Brazilian President Luiz Inácio Lula da Silva in an apparent effort to obtain political support against prosecutors.

Business News

Investment News:

Engineering and contracting company **Engevix** last week sold its 36.9% stake in Desenvix, an electric power utility, to Norway's Statkraft, which will assume complete control over Desenvix. Engevix is one of the contractors caught up in the spreading Petrobras kickback and money laundering scandal. Because of the scandal, credit

sources for Brazilian contractors working with Petrobras have tended to dry up in recent months, creating cash-flow problems. Engevix will gain some R\$500 million from sale of its stake in the local utility, which has 350 megawatts of installed capacity along with a number of new projects under development.

The **Brazilian Real** was the fourth biggest loser against the U.S. dollar in international currency markets during the first six weeks of 2015, according to a survey last week produced by Brazilian financial newswire Broadcast. Among 47 tradable currencies, only the Nigerian, Swedish and Canadian currencies lost more ground to the greenback. The Real suffered an overall 7% depreciation during the period, with many analysts predicting more losses once the U.S. Federal Reserve Board begins monetary tightening, expected later this year. The Real is losing ground because of a widening current account gap as well as a loss of investor confidence because of a sluggish economy and a spreading corruption investigation of state-run oil company Petrobras.

Company News:

Brazilian companies are not ready for the kind of devastating **cyberattacks** experienced recently by multimedia giant Sony, according to a study last week. A survey by consulting group Alvarez & Marsal, showed 60% of Brazilian companies admitting they had inadequate strategies for dealing with hacking crises. Executives claim a lack of adequately trained professionals in the field. Experts say protection against such attacks is crucial for modern businesses since cyberattacks can damage basic infrastructure such as electric power and telecommunications as well as denying Internet services to customers.

Brazilian Calendar

Tuesday, February 24, Brazilian Central Bank release of monthly current account data, Brasília

Wednesday, February 25, Brazilian Central Bank release of monthly bank lending data, Brasília

Thursday, February 26, Brazilian Census Bureau (IBGE) release of monthly unemployment data, Rio de Janeiro

Friday, February 27, Brazilian Central Bank release of monthly primary budget performance data, Brasília

Indicators

Foreign exchange rate: **R\$2.88 = \$1.00**

Last week, the 100 economists consulted weekly by the Brazilian Central Bank gave their most pessimistic appraisal so far this year of **prospects for 2015**. For the first time, they projected negative growth, saying GDP will decline by 0.42%. Inflation will remain intransigent at 7.27% despite monetary tightening by the Central Bank. The base interest rate, already a towering 12.25%, will rise to 12.75% by the end of the year, according to the economists.

