Brazil-U.S. Business Council
Brazil Bulletin

Interview: Rui Falcão, National Chairman of the Workers' Party (PT)

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Although confident of victory in October's presidential election, the National Chairman of the ruling Workers' Party (PT) is also wary of early polls. "We don't underestimate our rivals," PT Chairman Rui Falcão told foreign correspondents at a recent breakfast meeting in São Paulo. But the Chairman was even more confident about maintaining the powerful PT-PMDB alliance that brought victory to Brazilian President Dilma Rousseff in 2010. "It's natural to have some pre-election tension in the alliance," he said. "But there's no reason for either side to break up the coalition." An eventual second term for President Rousseff will see a PT agenda including more infrastructure investments via concessions and an effort to promote electoral, tax and labor reforms. Excerpts follow:

- **On run-up to the October elections:** "Our candidate will only begin campaigning in July. Between now and then, she will be governing the country. Currently, polls show the president leading, even to the point of securing a first-round victory. But that can change. The campaign hasn't begun yet. We don't underestimate our rivals. Right now, they are not as well known as President Rousseff but they will become better known once the campaign starts."

- **On tensions with coalition partner PMDB (Brazilian Democratic Movement):** "This is what I call pre-election tension. It will dissipate. There are two problems. The immediate problem is the PMDB's demand for more Cabinet seats. The president has said the Cabinet shuffle will be merely technical. It's necessary to replace ministers who are resigning in order to run in October elections. The shuffle will not be political. In other words, the president will not alter the relative weighting given to each coalition partner in the Cabinet. The other problem stems from the fact that the PT intends to be competitive not only in the presidential election, but also in state and congressional elections. We are out to increase the size of our congressional caucus. Obviously, that implies a certain amount of competition even with our coalition partners. We also intend to run competitive candidates for governorships of ten states, including São Paulo, Rio de Janeiro and Minas Gerais. If we win in even one of those states, it will change Brazil's political landscape."

- **On expectations for President Rousseff's eventual second term:** "The Constitution prohibits press monopolies and oligopolies. Unfortunately, Congress has not passed enabling legislation to enforce these constitutional provisions. We would like to see such legislation passed in President Rousseff's second term. Similarly, Brazil's electoral system is outdated. Brazilians are angry about private money financing political campaigns. They are angry about political parties which do not deliver on their campaign promises. We need to change that. We support tax reform. We are not proposing any new taxes. But we do think the income tax brackets should be reformed. The top bracket is 27.5%. It's absurd that reporters such as yourselves pay 27.5% and millionaires pay the same. We also favor labor reform, but not the kind that would take away any of labor's current rights. Rather, we support legislation proposed by the São Bernardo do Campo Metal Workers Union that would provide for a greater range of issues to be negotiated directly between unions and employers. We believe this kind of reform would be good for both sides and would tend to promote job creation."

- **On infrastructure concessions and foreign investors:** "We are building a new Brazil, both for those who work here and for those who invest here, including overseas investors. This is not a partisan political statement. It's a statement of fact and of national purpose. Multinational companies will continue to earn profits here. In some cases, such as Banco Santander, profits from Brazilian subsidiaries are greater than profits earned by the parent company. The concessions program is creating business opportunities and jobs while helping to remove bottlenecks to national development. It will continue, and be expanded, in the president's second term."

Top News of the Week

Preparations lag just three months before start of soccer World Cup. Worries abound three months before Brazil is due to host the soccer World Cup in 12 cities. Security concerns run high just one year after violent demonstrations marred the Confederations Cup tournament in Brazil. Poor availability of hotel and restaurant accommodations could leave many of the expected 600,000 foreign visitors disappointed. But three specific areas raise the gravest concers:

- **Stadiums**. Brazil pledged to have all 12 stadiums—some renovated and some built from scratch—ready by the end of 2013. Brazil met the mark for only seven. Of the five that were behind schedule, three are still critical. The new Itaqueirão stadium in São Paulo suffered delays following a fatal construction accident last year and is now due for delivery only in April. Lack of funds caused delays in construction of the new Arena da Baixada in Curitiba and soccer authorities briefly threatened to scratch the city altogether. State and municipal officials came up with a new financing package and now pledge to deliver the stadium at the last minue in May. An October fire, possibly caused by arson, brought construction delays to the new Arena Pantanal in Cuiabá, with officials now promising delivery in April.
- **Airports**. Similarly, local and federal authorities promised upgrades and expansion at airports in all 12 cities. Ten are expected to deliver the promised improvements in time for the June 12 kick-off. In two cities, however, officials have effectively admitted defeat. As of February, work at Fortaleza's airport was only 25% completed, while improvements to Cuiabá's airport were only 50% completed. Meanwhile, unions representing airport and airline workers warn that expansion programs at the 10 other airports may not be enough to accommodate the flood of visitors, leading to long lines, delays and price gauging. Brazil's domestic airlines have been awarded temporary rights to 1,973 additional flights in June and July. Some of the airlines have pledged to cap fares during the period while others have not. The Civil Aviation Authority (Anac) has pledged "vigilance" against abusive fares but without setting any specific parameters.
- **Ground Transportation**. Federal, state and local authorities originally scheduled 56 major road and rail projects, many of them downtown-to-airport and downtown-to-stadium rapid transit links. The total budget was set at R$15.4 billion. Funding problems led to a revision, with promises of only 41 projects and a budget of R$8.0 billion. Of the 41, only five have been completed, with 29 promised for April or May. Officials admit that seven projects will not be completed in time for the World Cup.

January-February motor vehicle sales still strong as dealers clear inventory. Brazil's motor vehicle manufacturers began 2014 with strong sales, but lagging production, as dealers continued to clear inventories. Sales for January and February combined were 571,900 vehicles, up 4.6% against the same period of 2013. But production for the two-month period was 518,640, a decline of 2.7% from January-

February output in 2013, the National Motor Vehicle Manufactuers Association (Anfavea) said last week. Dealers are still selling 2013 models and customers are buying them because of tax breaks on pre-2014 makes. Economists expect a decline in sales in the coming months as old models sell out. In 2014, consumers could be scared off by higher sticker prices, as tax breaks lapse, and costlier financing as interest rates rise. The industry association is predicting a very modest 1.1% increase in 2014 sales and a 1.4% rise in production.

President names six new Cabinet members, defuses congressional crisis. President Dilma Rousseff last week largely defused a rumbling crisis between her Workers' Party (PT) administration and congressional partners belonging to the Brazilian Democratic Movement (PMDB) by maintaining PMDB representation in a long-awaited Cabinet shuffle and signing off on additional public works appropriations for individual party members. The moves came after a pair of painful congressional defeats for the administration. With the support of many in the PMDB, Congress approved an unwanted investigation in allegations of corruption at state-run oil giant Petrobras. PMDB defections also forced the government to postpone congressional consideration of a bill on Internet regulation. Although last week's Cabinet appointments are largely interim, ahead of October elections, they preserved the party lineup in the administration's 39-member Cabinet. The six new Cabinet members are:

- **Cities** Minister Gilberto Occhi, vice president of the government-run CEF mortgage bank, representing the Progressive Party (PP) and replacing PP Congressman Aguinaldo Ribeiro, who will run for an as yet undetermined public office in October,
- **Agricultural Reform** Minister Miguel Rossetto, stepping down as president of the Petrobras biofuels subsidiary and representing the Workers' Party (PT); he replaces PT Congressman Pepe Vargas, who will seek re-election to the Chamber of Deputies,
- **Tourism** Minister Vinícius Nobre Lages, international affairs advisor to the government's Small Businesses Service (Sebrae) and a member of the Brazilian Democratic Movement (PMDB), replacing PMDB Congressman Gastão Vieira, who will run for a seat in either the Chamber of Deputies or the Senate,
- **Agriculture** Minister Neri Geller, stepping up from his post as the ministry's policy secretary and representing the PMDB; he replaces PMDB Congressman Antônio Andrade, who will run for re-election,
- **Fishing** Minister Eduardo Lopes, a Senator in mid-term representing the Brazilian Republican Party (PRB), a small but influential coalition partner with a strong appeal to evangelical voters; he replaces PRB Senator Marcelo Crivella, who will run for governor of Rio de Janeiro,
- **Science and Technology** Minister Clélio Campolina Diniz, a presidential advisor and former rector of the Federal University of Minas Gerais, representing the PT and replacing Marco Antônio Raupp, an academic whose original appointment in 2012 was intended to be temporary.

Government announces subsidy program for power distributors. Brazil's government last week announced a subsidy program for electric power distributors in an effort to defray rapidly rising costs and avoid short-term rate hikes for consumers. The government will make available R$4 billion from Treasury funds and R$8 billion from bank loans. The subsidies follow an additional R$9 billion in payments by the Treasury to distributors who opted to take early renewal of concession contracts due to lapse between 2015 and 2017. The subsidy program comes at a time of sharply rising costs for distributors, who are now paying R$822 per megawatt/hour for power, more than double the R$294 charged as recently as December. Electric power has become more expensive because of shortages at hydroelectric generating stations. The shortages are due to drought conditions in many parts of the country. The government will recover the R$4 billion in direct subsidies later this year through as yet undetermined tax hikes. It will recover the R$8 billion in loans through rate hikes for electric power in 2015.

Business News

Investment News:

Mining companies operating in Brazil will slash investments for the period 2014 through 2018, according to a report last week by the **Brazilian Mining Institute** (Ibram). Investments should total $53.6 billion. The last time the institute measured investment intentions was 2012, with companies estimating their investments at $75 billion for the period 2012 through 2016. Mining executives said they were scaling back investments because of lower domestic demand for steel, declining world prices for mineral ores and rising production costs.

Company News:
State-run oil giant **Petrobras** last week wrapped up its 2014 overseas financing drive by placing $8.5 billion in bonds at terms ranging from three to 30 years. The bonds were oversubscribed by a margin of nearly three-to-one, according to banking sources. However, Petrobras paid yields averaging nearly a full percentage point more than similar bonds sold in 2013. Investors are worried about the company's rising level of indebtedness as Petrobras struggles to surmount production difficulties and domestic price controls for its products.

In a case unusual for its length, content and breadth, the Brazilian Supreme Court last week awarded R$3 billion in damages to stakeholders in defunct airline **Varig**. The payments will be made by the Federal Treasury. The court accepted arguments saying that a 1986 government-ordered freeze on air fares represented illegal interference in an essential service. Varig, once Brazil's largest airline, was liquidated in 2006. The remaining stakeholders in Varig are mostly former employees. The case originated in 1993. It reached the Supreme Court in 2007. The court accepted the argument that Brazil's government of the time had the right to impose a broad wage and price freeze. However, a majority of the justices said the freeze should not have been applied to companies or individuals performing essential services.

Brazilian Calendar

Tuesday, March 18, Brazilian Annual Construction Fair (Feicon), Anhembi Park, São Paulo

Indicators

Foreign exchange rate: **R$2.35 = $1.00**

Electric **power consumption** advanced by an unexpectedly robust 4.9% in January against the same month a year earlier, according to the Brazilian Energy Research Corp. (EPE). A heat wave in the populous Southeast led to a 7.9% rise in residential use in January. Retailers saw a 7.6% increase as stores and homes cranked up air conditioning units. Industry continued to lag, with demand rising only 0.9% against January of 2013, the EPE said.

Brazilian **industrial production** advanced by an unexpectedly robust 2.9% in January against the previous month but was still lagging behind 2013 levels, the Brazilian Census Bureau (IBGE) said last week. January output was down 2.4% against January of 2013. Economists were heartened by the month-on-month figures, which were led by motor vehicles and capital goods. However, they said it was still too early to tell whether Brazil will experience an industrial recovery this year. Question marks include inflation, interest rates and consumer confidence.

Inflation continued its advance in February, led by seasonal hikes in school fees and higher prices for home appliances. Monthly **inflation in February** was 0.69%, up from 0.55% in January. The 12-month rate rose to 5.68% from 5.59% as of January. Economists said inflationary pressures could ease somewhat in the coming months as the annual grain and oilseeds harvest comes on stream. However, they said it was highly unlikely Brazil will meet its 2014 inflation goal of 4.5%.

Retail sales showed a solid rebound in January, led by supermarkets and motor vehicles, according to figures last week from the Brazilian Census Bureau (IBGE). January sales were up 0.4% from December and 6.2% against January of 2013, on a seasonally adjusted basis. Post-Christmas discounts on consumer goods helped support sales. Meanwhile, many auto dealers were selling off remaining 2013 models, which still benefit from an IPI tax abatement. Economists said retail sales growth will tend to flatten in the coming months, however, as IPI-free inventories fall and higher interest rates reduce demand for big ticket consumer goods.