Brazil-U.S. Business Council

Brazil Bulletin

Interview: Renato da Fonseca, Executive Director of Research, National Confederation of Industries (CNI)

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One trend is clear as Brazil prepares for general and presidential elections in October—President Dilma Rousseff and her ruling Workers' Party (PT) are facing a slow, but steady, erosion of popular support. The question for political pundits, and politicians, is whether that erosion can be reversed or, at least, arrested. In its most recent poll conducted for the CNI, the Public Opinion Research Institute (Ibope) showed the President's personal approval rating at a mediocre 37%, down from a December peak of 43%. The public gave an approval rating of 34% to the PT, down from 43% in December. CNI research chief Renato da Fonseca commented on the data in a recent meeting with reporters. Excerpts follow:

- **On the public's main concerns:** "The President's popularity has declined with respect to virtually all policy areas. The tendency, when it comes to the public's evaluation of the PT, is the same. It is lower regarding nearly all of the 20 policy areas covered by the survey, for example, public safety, education, inflation and many others."

- **On the soccer World Cup:** "The public's perception of soccer World Cup preparations and spending is increasingly negative."

- **On the economic issues:** "Brazil is no different from other countries when it comes to the strong correlation between economic performance and the relative popularity, or unpopularity, of the sitting government. In Brazil's case, at the moment, inflation is undermining purchasing power and that is rebounding against the government. Even worse, for the government, is the fact that food prices have risen the most. This has the biggest impact on the most people."

- **The anatomy of the public's response:** "The biggest increases in negative perception of the government are coming from the youngest cohort of the electorate and from the best educated segments of the electorate."

- **On strategies for a government reaction:** "It's still early. The campaign hasn't started yet. In the campaign, the government will be able to trumpet its achievements and that could bring at least a partial reversal of the recent increase in negative perceptions."

- **On politics and economic policy:** "Much depends on the government's success in fighting inflation. When it comes to economic growth, there is little the government can do at this point to reverse the tendency toward slow growth this year. But they could have more success against inflation. If the government can bring down the inflation rate, it may be able to halt the erosion in its popularity."

- **On economic policy risks:** "Of course, the problem is that fighting inflation involves strong medicine such as cuts in government spending and higher interest rates. Politically, the government needs to weigh the side effects against the cost of continued inflation."

Top News of the Week

Industrial production fails to catch fire, even after change in survey methodology. Brazilian industrial production turned in a weak performance in March, even under a new methodology tending to increase the weight of more sophisticated, up-to-date products. Industrial output in March declined by 0.4% against February and 0.9% against March of 2013, according to data last week released by the Brazilian Census Bureau (IBGE). The IBGE also announced new methodology for calculating industrial production. The March figures were compiled using the new method, which increases the weighting of products such as tablets and bio-fuels while eliminating outdated items such as conventional printing equipment. Using the new methodology, the IBGE revised its 2013 figure for growth in industrial production to 2.3% from 1.2% under the old system. But prospects for 2014 seem poor, according to economists. Output in the first quarter, even under the new methodology, was up only 0.4% against the first quarter of 2013. Problems this year include high inflation, rising interest rates and unwieldy levels of consumer debt.

Latest polls, showing more slippage by President Rousseff, seem to please investors. The latest public opinion poll, a Datafolha survey released last week, showed a continued pattern of slippage by President Dilma Rousseff ahead of October elections. Datafolha showed Rousseff with 37% of voter intentions, down from 38% in April. Opposition candidates gained at her expense, with Social Democrat Aécio Neves scoring 20%, up from 16% in April, and Socialist Eduardo Campos at 11%, up from 10% in April. According to political scientists, voters are increasingly worried about inflation, now running at 6.28% (see item below), and are angry about high taxes and poor public services. Erosion in support for Rousseff is rebounding in favor of risk investments, such as stocks. "Investors are not satisfied with the President's economic policies," said Márcio Cardoso, an analyst at São Paulo's Easyinvest brokerage. The Ibovespa stocks index began a steady rise as of mid-March, when public opinion polls first registered slippage in support for Rousseff. The Ibovespa stocks index has gained some 20% since hitting a year-to-date low on March 14. One of the best performing stocks has been state-run energy company Petrobras, which has gained more than 50% since March 17. The company has been hurt by government price controls (see item below). Election of a business-friendly candidate, such as Social Democrat Neves, could improve prospects for Petrobras. "The market is selling Dilma and buying Petrobras," according to André Perfeito, an analyst at São Paulo-based Gradual brokerage.

Congress splits the different, will investigate both Petrobras and subway scandals. Congressional leaders last week decided to undertake broad investigations that could prove embarrassing to both the ruling Workers' Party (PT) and the opposition Social Democrats (PSDB). Congress will establish two joint committees, one to probe allegations of wrong-doing by state-run energy giant Petrobras and a second to investigation possible bribery in the purchase of equipment and services for the São Paulo subway. The Petrobras allegations cover a period when Brazilian President Dilma Rousseff was Energy Minister and later Presidential Chief-of-Staff. The subway scandal covers administrations by three separate São Paulo governors, all of them elected by the PSDB.

April figures confirm decline in motor vehicle output, sales. A combination of high interest rates, rising consumer debt and the collapse of exports to neighboring Argentina, a traditional customer, has led to a pattern of declining Brazilian motor vehicle production and sales. The trend was confirmed by April figures, released last week by the National Motor Vehicle Manufacturers Association (Anfavea). April production was 277,091 vehicles, down 21.4% against April of 2013. Sales were 293,240, down 12.1%

against the same month a year ago. The pattern of falling output and sales has led most auto makers in Brazil to order forced vacations or layoffs for selected workers. For the first four months of the year production totaled 1.069 million, a decline of 12% against the same period of 2013. Sales were down 5.0% at 1.106 million.

Business News

Investment News:

In a research note to clients last week, **Deutsche Bank** recommended increased caution over Brazilian investments. The bank downgraded its recommendation for sovereign Brazil debt to "underweight" from "neutral." The bank cited a number of problems, including economic policy uncertainties ahead of this year's general and presidential elections as well as persistent inflation and stagnating growth. On the political front, the bank specifically cited what it called the risk of "populist" economic policies in the event President Dilma Rousseff is elected to a second four-year term. Deutsche Bank also cited difficulties in meeting fiscal targets.

Company News:

U.S. online sales giant **eBay** last week launched its first full-time Portuguese language sales web site. The company plans to compete in Brazil's tricky but lucrative e-commerce market. The market is currently dominated by a half dozen players. The biggest, B2W, controlled nearly one fourth of the market in 2013 with R$7 billion in sales. Total Brazilian e-commerce sales reached R$28.8 billion last year, according to consulting firm e-bit. Sales are projected to reach R$34.8 billion this year, according to e-bit.

Boeing Defense last week took a step toward selling Brazil 16 Harpoon missiles when the U.S. government gave its permission to go ahead with negotiations on the sensitive technology. The missiles will be used by Brazilian patrol aircraft. An eventual deal would be worth about $167 million. The U.S. government is required to sign off on any overseas sales of sensitive defense equipment manufactured by American companies.

State-run energy giant **Petrobras** last week released its first quarter earnings report, showing a 30% decline in profits against the first quarter of 2013 at R$5.39 billion. Profits declined on rising debt service costs. The company also faced one-off costs of some R$1.6 billion on a voluntary retirement program. Petrobras has also been hurt by government price controls over its main products, such as gasoline and diesel fuel.

Brazilian Calendar

Thursday, May 15, Brazilian Census Bureau (IBGE) release of monthly retail sales data, Rio de Janeiro

Indicators

Foreign exchange rate: **R$2.22 = $1.00**

Demand for **electric power** surged in the first quarter of 2014 on heavy use of air conditioning units by residential users and retailers, the National Energy Research Corp. (EPE) said last week. Total utilization reached 122,922 gigawat/hours, a rise of 6% over the first quarter of 2013. An unusually hot summer led to a 10% increase in residential demand. Industry, as in the past, lagged because of a sluggish economy. Industrial demand for power rose only 0.7% against the first quarter of 2013.

Brazil's monthly **inflation rate** eased in April but 12-month inflation continued to advance, coming perilously close to the ceiling of the government's target range for the year. According to the Brazilian Census Bureau (IBGE) last week, April inflation weighed in at 0.67%, down from 0.92% in March. But the 12-month rate rose to 6.28% from 6.15%. The government's target range for this year is 2.5% to 6.5%. Inflation has been fueled mainly by rising food prices in recent months. Food prices rose by a punishing 1.19% in April, due chiefly to effects of an early-year drought on perishables. Economists are hoping for some relief in the coming months as the country's big grain and oilseeds crop comes on stream.