

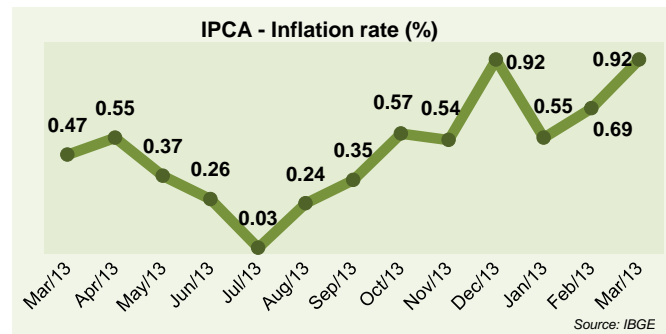
**POLICY
 MONITOR**

April 7– 11, 2014

The Week in Review

On The Economic Front

Inflation: According to IBGE, the Brazilian statistics agency, the monthly inflation rate jumped 0.92%, the highest level for the month of March in 11 years. Although felt broadly throughout the economy, it has been exacerbated by the ongoing drought, with ethanol prices rising 4% and food prices jumping 1.9%. Meanwhile, the Central Bank released the minutes of its last monetary policy meeting. **Quote:** “The Committee considers that a significant part of the response of prices to the current monetary tightening cycle will still materialize.” (See graph and the Pulse below).



IMF: The International Monetary Fund slashed Brazil’s 2014 growth forecast from 2.3% to 1.8% for 2014 and from 2.8% to 2.7% for 2015 because of rising interest rates and weakening earnings. **Quote:** “We think that Brazil should set more ambitious targets, including going back to the 3% primary surplus. (...) Another challenge is to address the fiscal framework, such as the discipline of sub-national governments, which so far is an important point of pressure on public finances,” said Sanjeev Gupta, Acting Director of the Fiscal Affairs Department, adding that those tasks should be tackled over the medium term.

Drought: The São Paulo state utility company Sabesp acknowledged in its annual report that it could implement water rationing in the Greater São Paulo area “if the rain does not return to appropriate levels and reservoir levels are not restored.” As of Wednesday 9th, the Cantareira Reservoir System was at 12.7% of maximum capacity. However, Governor Geraldo Alckmin, who will seek re-election in October, dismisses the risk of rationing. **Quote:** “The [possibility of] rationing is not discarded and the outlook is being monitored by our technical staff...We will evaluate the issue on a daily basis and especially the payment of rebates for the entire metropolitan region....but at this point there is no need [for water rationing].”

Electricity Costs: The Ministry of Finance announced the creation of a syndication of 13 banks, including Itaú, BTG Pactual, Citibank, JP Morgan, Goldman Sachs, and Bank of America to provide a loan for as much as BRL\$ 11.2 billion to the Chamber of Electric Energy Commercialization (CCEE) that in turn will finance the energy distribution sector burdened by increasing electricity costs. According to the Administration, the loan conditions will be detailed up to April 28, when the distributors need to settle their debts with CCEE.

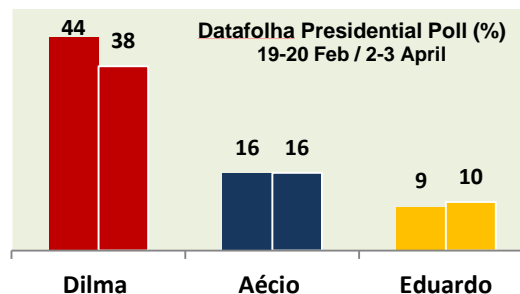
Brazilian Tourists: According to figures released by the U.S. Travel Association’s IPW 2014 event, more than 2 million Brazilians, a historic record, visited the U.S. in 2013. Without considering tourism from U.S. neighboring countries Canada and Mexico, Brazil now ranks third behind the U.K. and Japan, representing 3% of the volume of foreign travelers in the U.S. Compared to 2012, the number of Brazilian tourists visiting the U.S. increased 15%.



Brazil-UK Relations: Following a meeting on Tuesday, Finance Ministers Guido Mantega and George Osborne announced the launch of the Economic and Financial Dialogue, which is expected to strengthen mutual cooperation and promote trade and investment between the two countries by establishing regular meetings. The ministers also made an assessment of the international economic outlook and the performance of the Brazilian and British economies.

On The Political Front

Presidential Poll: A new poll conducted by Datafolha indicates that President Dilma Rousseff is losing support for her re-election bid with respondents citing concern over increasing inflationary pressures and slow growth. Other candidates did not show improvement, so if the election were held today, despite having lost six points since the previous February poll, she would still have enough votes to win the first round on October 5th (see graph).



Campaign Trail: As many expected, the new poll has fed rumors that former President Luiz Inácio Lula da Silva may make a comeback as the PT presidential candidate. However, he has dismissed such a possibility. Quote: "I am not a candidate...My candidate is Dilma Rousseff, and if you could help to end this wave of gossip, you will be contributing to the process of democratization of the country," Lula said in an interview with leftist bloggers on Tuesday April 8th (see more in *The Pulse* below).

Petrobras: Despite the Administration's political maneuvers, the Senate Committee on Constitution and Justice (CCJ) approved a report favoring the creation of a probe (CPI) into Petrobras' various alleged corruption schemes. The CPI aims to investigate the state-controlled oil company's alleged bribery scheme involving the procurement of oil platforms leased by SBM Offshore, a Dutch platform supplier, the controversial purchase of the Pasadena refinery in Texas, and the skyrocketing construction costs of Abreu e Lima refinery. However, in accordance with the Administration's wishes, the CCJ report also included as part of the investigative agenda areas that could hurt the opposition as well, including the alleged subway cartel in São Paulo state run by PSDB, and an alleged overpricing scheme in the construction of the Suape port in Pernambuco state, run by PSB. Next step: A Senate floor vote on the CPI.

Bribery Charges: Representative André Vargas (PT/PR) resigned on Thursday as House Vice-Chairman due to the opening of the House Ethics Committee disciplinary proceeding over allegations that he was involved in a money laundering and bribery scheme related to drug procurement and other illicit activities at the Health Ministry. These actions could be found to be a breach of parliamentary standards. The case is being investigated by the Federal Police. Next step: If the Committee finds that Vargas's actions were a breach of parliamentary decorum, he could face impeachment.

2016 Rio Games: Aiming at speeding up the pace of the preparations for the Rio 2016 Games, the International Olympic Committee (IOC) announced on Tuesday, April 8th a series of new steps, including a stronger presence in Rio de Janeiro and a construction tracking system. Quote: "We had the meeting in a very constructive atmosphere with our partners from Rio...We then made some decisions about how we can accelerate one way or another the work in Rio and how we can work even closer with the organizing committee and the different levels of [the Brazilian] government," said Thomas Bach, the president of IOC.

Task Forces

Innovation:

» **Internet Framework Bill:** A joint public hearing to analyze the Internet Framework Bill PLC 21/14 was scheduled for April 10 by three Senate Committees: Science and Technology (CCT); Constitution and Justice (CCJ); and Environment, Consumer Protection, and Surveillance and Control (CMA). At the hearing it was generally agreed upon that the bill should be voted on by the Senate floor by April 23rd. Two additional hearings were scheduled for April 15th and 22nd. The bill is being considered under the constitutional urgency provision, which means it must be voted on within 45 days or other legislation will be blocked on the Senate floor. The bill is being simultaneously analyzed by three committees (CCJ, CCT, and CMA). Also, according to the newspaper *Estado de São Paulo*, President Rousseff will propose a global internet governance bill in the next meeting on the future of internet governance, NetMundial, to be held in São Paulo, April 23rd and 24th. Next step: If approved by the Senate as is, the



bill will proceed to the Planalto to be enacted by President Rousseff. If the Senate amends the bill, it must be returned to the House for a second vote.

- » **Espionage Probe:** The Select Committee responsible for investigating alleged espionage by the NSA completed its final report, which contains recommendations on how to improve Brazilian cybersecurity. The Committee also completed work on a new draft bill that will likely be presented in Congress to be analyzed by House committees. Highlights:
 - » Regulates provision of Data from Brazilian citizens or companies to foreign bodies;
 - » Requests the publication of the National Intelligence Policy (NIP) which, according to the rapporteur, has been ready since 2010;
 - » Recommends investment in counter-intelligence capabilities as well as increasing the budget allocation for intelligence agencies;
 - » Creates a temporary committee in the Senate to propose reforms to Brazilian intelligence legislation;
 - » Recommends that Congress approve the Proposed Amendment to the Constitution (PEC) 67/12, which regulates intelligence activities;
 - » Creates a Working Group on the Executive branch for drafting a National Policy for Cybersecurity;
 - » Suggests that the Administration give ANATEL the necessary human, budgetary, and technology resources necessary to manage the radio spectrum;
 - » Suggests that the executive branch invest in the creation of national communications hardware in cloud security and develop national encryption algorithms.

Tax and Investment:

- » **Cosmetics Tax:** The Administration backed down from its decision to increase taxes on the personal hygiene, cosmetics, and perfume industries. The decision was communicated by Finance Secretary Paulo Rogério Caffarelli to José Carlos Basilio, President of the Brazilian Association of Personal Hygiene, Cosmetics, and Perfume Industries (ABIHPEC) last Friday, March 31st. According to Basilio, the Administration did not indicate when or if the cosmetic tax hike initiative would be resumed. Quote: "I think that this year nothing will happen," said Basílio.

Trade and Regulation:

- » **Visa Process Facilitation:** Draft bill (PLC) 04/14, which would allow for creation of an international agreement permitting reciprocal waivers for tourist visas, temporary visas for business trips, and visas for artists or athletes, was approved on the Senate floor. The bill is intended to reduce bureaucratic inconveniences for select travelers. Next Step: The bill goes to President Rousseff for her signature.
- » **State Debt:** The Senate Committees for Economic Affairs (CAE) and Constitution and Justice (CCJ) approved Draft Bill (PLC) 99/13, which regulates the renegotiation of state and municipality debt. The text aims to provide relief to states and municipalities that had their debt refinanced by the federal government in the late 1990s. It alters the debt index (currently IGP-DI plus 6 to 9 percentage points) to the lower of either IPCA plus 4 percentage points or the benchmark Selic rate. The main changes brought about by the bill are particularly favorable to the city of São Paulo, led by Mayor Fernando Haddad (PT). Next step: The bill proceeds to the Senate floor.
- » **4G Auction:** The 4G Auction (700 Mhz spectrum) to be carried out by the Administration in the second half of the year faces opposition in Congress and also from the private sector. During a public hearing held Tuesday in the House Committee on Science, Technology, Communications and Informatics (CCTCI), the Committee of Social Communications requested that the auction be postponed until the Administration runs conclusive tests about the interference of the 4G signals with the neighboring open digital TV spectrum. The Brazilian Association of Radio and Television Broadcasters (ABERT) and the Personal Mobile Service Providers, Fixed Telephone Service Providers, and Multimedia Communication Service Providers Union (SINDITELEBRASIL), also pressured the National Agency of Telecommunications (ANATEL) to halt the auction. The Administration counts on the bid, which could generate as much as BRL\$ 12 billion, to bolster the fiscal front. ANATEL dismisses the risks of signal interference. Quote: "It [the auction] will only be carried out when the interference issue is resolved," said Nilo Pascoali, the agency's regulation manager.
- » **World Cup 2014:** The Administration published ordinance 113/2014, which requires that office hours end at 12:30 Brasília time on the days that the Brazilian soccer team plays in World Cup 2014 matches. The schedule is: First stage of the World Cup games, **Brazil vs. Croatia** - Friday, June 12th at 5pm in São Paulo; **Brazil vs. Mexico** - Tuesday, June 17th at 4pm in Fortaleza; and **Cameroon vs. Brazil** - Monday, June 23rd at 5pm in Brasília. So far, only Rio de Janeiro has decreed three public holidays: June 18th and 25th from 12pm, and July 4th applies to private companies. Other state and municipal decrees restrict its scope to public administration bodies associated with them, excluding private companies.

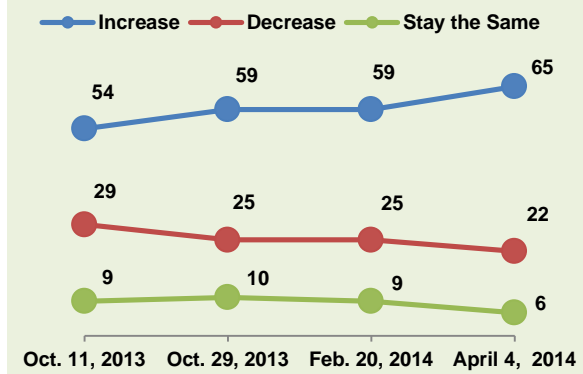


The Pulse

Popular reaction against high inflation is behind President Rousseff's loss of support in the polls. The New Middle Class does not accept backtracking on economic stability and will demand clear answers from Presidential candidates on economic policy

The so-called New Middle Class, a strong and increasingly demanding political sector, is largely behind the *Datafolha* poll showing President Rousseff's loss of support for re-election. Today the New Middle Class (118 million people) and the poorest Brazilians (49 million) constitute 85% of the population. Over the last two decades, both segments of the population have enjoyed a steady socioeconomic rise resulting from the macroeconomic stabilization programs under the Fernando Henrique Cardoso Administration and furthered by the income redistribution policies of former President Lula and President Rousseff. But now most Brazilians are afraid the trend may be backtracking. In the *Datafolha* poll, this concern may be seen in the growing economic pessimism marked by a negative perception of the inflation trajectory (see graph).

In your opinion, inflation will...



Today, 71% of respondents expressed discomfort over rising prices, compared with 5% a year ago. Some 89% of the poorer segment of the electorate, defined as individuals earning up to twice the value of the minimum wage (BRL\$ 1,450), who have also tended to be more optimistic, have conveyed their distress over price increases in foodstuff and services the past 12-months. According to *Datafolha*, March 2013 makes for an interesting comparison to the current outlook because it was the moment when President Rousseff's approval ratings were at their highest, at 65%. In June, following the first wave of mass protests, her approval rating fell to 30% but then recovered to 41%, only to tumble again to the current 36%.

Brazil is a young democracy at only 26 years old and is often fragmented if not dysfunctional at times. It has 32 different parties, which usually leads to a coalition government that must accommodate them through a large and politically diverse cabinet comprising 24 ministries of state and 14 other cabinet-level offices. As such, most Brazilians are not drawn toward strong political partisanship. Instead, they are largely political pragmatists who value a government that will respect them as citizens and taxpayers and provide opportunities for steady employment and income, better public services (education, health, public security, etc.) and undergird consumer growth through accessible and affordable financial credit. Given these priorities, the economic anxiety that dominates most hearts and minds today is a major political challenge for all presidential candidates, who will be expected to provide concrete answers to questions such as: how can the recent achievements be sustained? What will the candidates do to assure continuing socioeconomic gains? The new assertiveness of the lower and middle classes suggests this will be an election like no other in Brazil.

Although Lula continues to demonstrate strong support for President Rousseff, he has also expressed concern about the current popular dissatisfaction. During a recent interview, he said that the economic outlook "could be better" and that during her re-election campaign, President Rousseff must "say clearly how she will improve the Brazilian economy." A major issue facing the next government is the virtually unavoidable fiscal adjustment in the order of 4% of GDP to be carried out over four years. Such an adjustment will need to take popular sentiment into consideration. While the New Middle Class rejects the economic populism seen in Brazil's neighboring countries, it does not seem to embrace a strong market-friendly approach of deep cuts. A more compelling strategy might be one that relies on a marginally less interventionist state that would encourage the private sector to help solve major public problems, such as investing in much-needed infrastructure. Such a strategy could reduce the investment outlays of the Brazilian government, freeing up resources to support a fiscal adjustment or meet other needs, such as maintaining current social transfer programs.

