

May 12 – 16, 2014

The Week in Review

On The Economic Front

Focus:

Inflation expectations (CPI) for 2014 eased slightly from 6.5% to 6.39% as reported in *Focus*, a survey of leading market analysts conducted by the Central Bank. Four weeks ago, the expectation was 6.47%. Respondents also expect the Monetary Policy Committee (COPOM) to keep the benchmark interest rate at 11.0% at the next meeting scheduled for May 27th and 28th. Last week, economists expected an increase in the rate to 11.25%.

Focus Survey of Market Expectations			
	05/18	05/21	05/09
Inflation	6.47	6.50	6.39
Interest Rate	11.25	11.00	11.00
Exchange Rate	2.45	2.45	2.45

Tax hikes:

Following President Dilma Rousseff's comments that a definitive timeframe for increasing taxes on consumer products had not been set, Finance Minister Guido Mantega announced that the Administration will postpone the 2.24% tax hike on cold beverages (e.g., beer, refreshments and sport drinks) until September. Quote: "In three months we will have an increase," said Mantega, adding that "we are concerned about inflation remaining under control, and this sector can make a major contribution. We made an agreement [with the cold beverages industry] that there would be no price increase during the [World] Cup."

CNI:

On Tuesday May 14th, the National Confederation of Industry (CNI) reelected unanimously Robson Braga de Andrade as its president for a second four-year term to start in October. According to Andrade, CNI priorities are to increase Brazilian industrial competitiveness, invest in innovation and address foreign trade problems such as the exchange rate level (advocating a weaker Real), and customs bureaucracy. Quote: "We will continue our work in fighting bureaucracy and promoting skills for the Brazilian youth and workers," said Andrade, following his reelection announcement.

Drought:

On Thursday, with water levels at only 8.4% of maximum capacity, the São Paulo state water utility company Sabesp began to drain reserves below the Cantareira reservoir gate levels. According to Sabesp, the additional so-called "dead volume" will provide emergency relief of up to 300 billion liters (80 billion gallons) of water. Meanwhile, the federal regulatory body Water National Agency (ANA) is considering linking the water drainage to the rainfall level, seeking to avoid a total collapse of the system. ANA and Sabesp disagree over the need to save 50 billion liters (13 billion gallons) through December, when the next wet season begins. Quote: "Our position is: less rain, less drainage; more rainfall, drain more. We are facing an absolute anomaly in which we cannot make long-term predictions," said ANA's head Vicente Andreu.



Public policy impact:

A global survey conducted by the consultancy firm Ernst & Young reveals that the main concern of Brazilian business is the potential impact of governmental actions over the next 12 months. While 68% of Brazilian business leaders see public policies as the top risk factor, an average of only 28% of executives surveyed in 53 other countries say they are concerned with government actions. According to E&Y, Brazilian executives are most concerned about increasing government intervention in the economy, the political uncertainty created by the upcoming presidential election, and delays in infrastructure investments.

On The Political Front

Campaign Trail

President Dilma Rousseff's Labor Party (PT) increased its offensive strategy against the opposition. On Thursday, in a 10-minute prime time video broadcast nationally, both President Rousseff and former President Luiz Inácio Lula da Silva defended their income distribution and job creation policies. The video also explored the fear of socioeconomic backlash for the poorer segments of the population, suggesting that an opposition victory in the presidential election would bring back the "ghosts of the past" in the form of regressive policies. Quotes: "My Administration will be one of growth with stability and heavily focused on controlling inflation without hurting workers' wages," said Rousseff. "We need to rescue the pride that was the rationale of this party [PT]. If anyone made a mistake, he must pay for the mistake," said Lula referring to the PT members convicted for the Mensalão scheme.

Both opposition presidential candidates, **Senator Aécio Neves** (PSDB/MG) and former Governor of Pernambuco, **Eduardo Campos** (PSB/PE), attended the XVII Mayoral March to Brasilia, an event promoted by the National Confederation of Municipalities (CNM). It was marked by increasing criticism against what they consider federal imbalances of tax receipt distribution favoring the federal government at the expense of states and municipal governments. President Rousseff was also invited but decided not to attend the March. Quotes:

Aécio Neves: "In 1999 we were aligned with Russia, India, and China forming the BRICs. Today, we are closer to Indonesia and Turkey forming the Freaks."

Eduardo Campos: "Let's end this terrorism, this lack of respect for the Brazilian people by talking about Brazil on the basis of threat and fear. We do not want to take away people's rights; we want to take the corruption away from Brazil," said Campos on PT's advertising video responding to the "ghosts of the past" comment.

Lula and the media:

During an event promoted by the Association of Regional Daily Newspapers (ADI) honoring former President Lula, he defended a new regulatory framework for the Brazilian media and also criticized the economic press coverage of Rousseff Administration policies by *The Economist* and the *Financial Times*. Quote: "[Brazil] has reserves of US\$ 338 billion and [an outlook marked by] full employment at a time when the rest of the world has destroyed 62 million jobs. And they [the British press] keep repeating the same thing like parrots. I would like them to study economics before repeating predictions that do not materialize."

Mass Protests and Strikes

Led by unions, homeless movements, and anti-World Cup activists, a wave of protests took place in 12 of Brazil's largest cities on Thursday May 15th. In São Paulo, traffic on the main highways was disrupted by protests that included burning tires. In Rio de Janeiro, a protest took place in front of the main train station. Considered a barometer of popular dissatisfaction leading up to the soccer tournament, the demonstrations gathered a small number of protesters, around 4,000 people in São Paulo, a city of 12 million inhabitants. Meanwhile, there has been a series of strikes pushing for pay increases and better working conditions. In Rio de Janeiro, bus drivers conducted a two-day work stoppage that left 230 vehicles damaged. In São Paulo, public school teachers have been on strike since April 23rd. In Recife, the capital of the state of Pernambuco, looters ransacked supermarkets and shops, unimpeded by police who were on a three-day strike. Also, 500,000 federal civil servants, from police officers and firefighters to consular officers, are threatening to cross their arms as the World Cup parade approaches.

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Petrobras

On Wednesday, Senator Vital do Rêgo (PMDB/PB) was elected president of a Senate Parliamentary Inquiry Committee (CPI), which was created to investigate alleged allegations of corruption by state-owned oil company Petrobras. The allegations cover the controversial acquisition of the Pasadena System Refinery Inc. (PSRI) in Texas, charges of bribery payments made to Petrobras employees by the Dutch oil platform leasing company SBM Offshore, and the ballooning construction costs of the Abreu e Lima refinery in Pernambuco state. The CPI scope was recently expanded to include alleged irregularities in the Pernambuco state Suape Port construction. Senator José Pimentel (PT/CE) was appointed the rapporteur and Senator Antonio Carlos Rodrigues (PR/SP) the CPI vice president. The governing coalition filled ten of the 13 CPI positions, giving it an overwhelming majority and reducing the likelihood of a thorough and nonpartisan investigation.

Task Forces

Tax and Investments

New Airport Terminals: The São Paulo-Guarulhos International Airport (GRU) opened Terminal 3 on Sunday, with completion of a BRL\$ 2.9 billion renovation that will accommodate an additional 12 million passengers per year. The new terminal is dedicated to international flights and adds 47 aircraft gates, expanding the total airport capacity to 108 gates. Initially, the new terminal will operate with only European carriers such as TAP and Lufthansa. Before the World Cup opens on June 12th, United, Air China, and Singapore Airlines will begin service, and American Airlines and TAM will be added in September. In April, Brasília opened its new domestic flight terminal and will likely open the new international terminal before the World Cup begins at a total cost of BRL\$ 1.2 billion. Other major cities hosting soccer games, such as Rio de Janeiro and Belo Horizonte, will not be able to finish airport renovation in time for the tournament.

Trade and Regulation

Freedom of Speech: On Tuesday, the House held its 9th Legislative Conference on Freedom of Expression, an event that also focused on the challenges confronting Brazilian democracy in the upcoming elections. Speakers included media experts, such as Bob Boorstin, former director of public policy for Google, the Brazilian Attorney General Luiz Inácio Adams, and representatives from the National Newspapers Association (ANJ). The latter advocated in favor of changing parts of bill [\(PL\) 6446/13](#), which grants the right to respond to false information published by the media.

BNDES Funding: On Tuesday, a Joint Congressional Committee approved Provisional Measure [\(MP\) 633/13](#), which allows the National Treasury to transfer BRL\$ 30 billion to the Brazilian Development Bank (BNDES). The MP also established that BNDES must finance national projects and products made for exportation with subsidized interest rates. The bank can also finance services abroad provided it receives prior authorization from the Finance Ministry. These operations should be contracted by the end of the year.

Next Step: The MP will go to the House for a floor vote. It expires on 06/02/14.

Tax Reform: President Rousseff signed into law, with some articles vetoed, [MP 627/13](#), which alters important provisions of the Brazilian taxation system, including treatment of profits made by Brazilian multinationals from foreign subsidiaries. Articles vetoed included those covering the extension of the Tax Recovery Program (Refis) for debts due by June 30, 2013, reduction in the amount of fines imposed by the National Health Agency (ANS) for health plan operators, and the functioning of airports under private concessions.

President of TSE: Minister Dias Toffoli took office as president of the Superior Electoral Tribunal (TSE), replacing Minister Marco Aurélio. Toffoli, formerly attorney for the PT during President Rousseff's 2010 election run, will be responsible for the tribunal during President Dilma Rousseff's reelection campaign. Toffoli joins two other ministers who also worked as lawyers in President Rousseff's first campaign, Luciana Lóssio and Admar Gonzaga.

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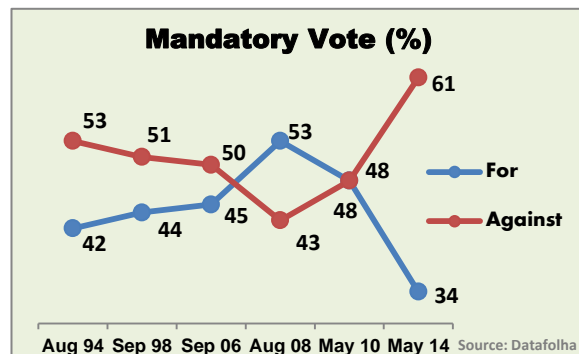
The Pulse

The increasing chance of an election runoff and growing voter disenchantment with government, the political parties, and the mandatory voting system suggest this may be the most unpredictable election in Brazil's 26-year-old democracy

The May 9th Datafolha poll of likely voters indicates that although President Dilma Rousseff has been losing support, she is still the favorite to win the October election in a second round of voting. Rousseff received 37% of the responses (a 1 percentage point drop from the April poll), her main contender, Senator Aécio Neves (PSDB/MG), captured 20% (a 4 percentage point increase), and the former governor of the state of Pernambuco Eduardo Campos (PSB) took 11% (a 1 percentage point increase). A runoff is held when no candidate gets more than 50% of the valid votes in the first round, which excludes null and blank ballot.

Some 74% of the respondents also expressed a deep desire for change, unhappy with the deteriorating economic outlook as felt through the combination of high inflation, low growth, high tax burden, and substandard public services (notably health, public transportation, education, and public security). They also repudiate alleged cases of corruption in state-run companies such as Petrobras and other government agencies.

A revealing example of popular dissatisfaction is the increasing objection to Brazil's mandatory voting system. Currently 61% of the electorate disapproves of it, the highest level since 1994 (see graph). If they could choose not to vote – without risking penalties like loss of passport and ineligibility for state-owned bank loans – 57% of voters would do so.



Another important indicator of dissatisfaction is that 24% of the electorate has expressed some kind of distance from or rejection of politicians chosen by their parties. In addition, according to the 25-year statistical series compiled by Datafolha, the percentage of voters feeling detached from the electoral process has never been so high. This may be seen in the 16% of the electorate who would vote null or blank if the election were today – a record number for a survey in May of an election year. In May 2010, only 6% of voters said they would vote null or blank, almost a third of the latest poll.

In a recent interview with *Veja* magazine, Datafolha's pollster Mauro Paulino noted that given the high probability of a record number of blank and nullified ballots, this will be the most unpredictable election in Brazil's 26-year-old democracy. "The emotional legacy of the World Cup could also contribute [to the high abstention rate]," he said, adding that "the percentage of the population that is proud to be Brazilian fell from 87% to 78%, the first drop in 13 years." If Brazil loses the soccer tournament at home, the defeat could contaminate the political scene, as millions of voters would condemn even more strongly the large public investment in 12 arenas. Overall, the picture painted by Datafolha conveys a democracy whose voters are increasingly concerned with, and demanding more of, their rights as citizens and taxpayers.

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