

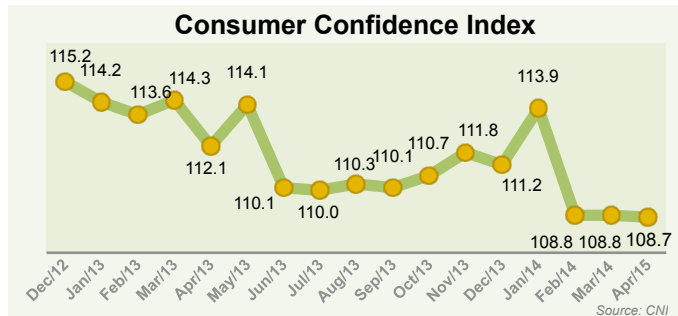
April 28 – May 2, 2014

# The Week in Review

## On The Economic Front

### Consumer Confidence:

The National Consumer Confidence Index (INEC) fell slightly in April relative to February and March to 108.7. INEC is now at the lowest level since June 2009. According to the National Confederation of Industry (CNI), which publishes INEC, consumers remain pessimistic over the rising costs of high-priced goods relative to income, yet retain some optimism over employment and the government's efforts to control inflation.



### Inflation:

The Central Bank's weekly survey of market analysts, Focus, registered virtually no change in inflation expectations for 2014, coming in at 6.50% compared to last week's 6.51%. Four weeks ago, the survey projected inflation at 6.30% for 2014. Brazil targets inflation at 4.50% within a band of plus or minus two percentage points. Market analysts also foresee a slight increase in GDP growth from 1.63% to 1.65%.

### Government Revenue:

According to the Internal Revenue Service (SRF), in March the government collected BRL\$ 86.6 billion in tax receipts and other federal contributions, a 2.5% inflation-adjusted increase over March 2013. Federal government revenue in the first quarter totaled BRL\$ 293.42 billion, a historic record despite sluggish economic activity and BRL\$ 26 billion in tax cuts targeted at labor intensive and foodstuff industries. Tax receipts still came in below the Administration's expectations because the 2.06% growth in corporate income tax and Social Security contributions (CSLL) fell short of the expected 3.5% to 4.0%.

### Tax Hikes:

To increase revenue, the Rousseff Administration announced on Tuesday that beginning June 1<sup>st</sup>, it will raise taxes (PIS-Cofins) on cold beverages including beer, soda, and sports drinks. According to SRF, the tax hikes are expected to raise BRL\$ 1.5 billion by year-end and should have minimal inflationary impact. The Administration has also indicated that it may raise taxes on cosmetics and imports in the second half of the year.

### Drought I:

According to *Valor Econômico*, anonymous National Grid Operator (ONS) employees are advocating an immediate 4%-6% decrease in electricity use in order to save about 10% of water in the hydroelectric reservoirs, which generate 67% of Brazil's electricity. *Valor* further reports that in order to avoid major power rationing, the ONS would have to recommend that the Rousseff Administration advocate voluntary restraint on electricity use by energy-intensive industries such as steel, aluminum, and cement to guarantee a minimum water level through the dry season, which runs until the end of November. For water



levels of the Southeast and Midwest regional dams, which provide 70% of the country's hydroelectric water storage, estimates as of April 28<sup>th</sup> indicate that they will end the month at 38.1% of maximum capacity. ONS reports that for sufficient hydroelectric generation to be assured until 2015, water levels would have to increase to 43% of maximum capacity by the beginning of the dry season at the end of April. Meanwhile, the Administration, which has dismissed the need to adopt power rationing, has indicated that it will wait until early May to decide about possible next steps.

## Drought II:

In São Paulo state, the water level at the Cantareira system was 10.9% of maximum capacity on Tuesday April 29<sup>th</sup>. Since March 17<sup>th</sup>, the state water utility company Sabesp has begun emergency work to drain water below the reservoirs' gate levels. Sabesp notes that this so-called "dead volume" could add as much as 300 billion liters (80 billion gallons) to the system, or enough to supply water to over 9 million consumers in the Greater São Paulo area until February 2015.

## Energy Bid:

The National Agency for Electric Energy (ANEEL) held an auction on Wednesday April 30<sup>th</sup> that contracted 2,046 MW for BRL\$ 27.3 billion, or enough to meet 85% of the electricity distributors' needs in 2014. According to the Administration, the exposure level for the electricity distributors will now be minimal. Quote: "We see a trend toward fast normalization [of the electrical sector]," said Márcio Zimmermann, the Executive Secretary of the Ministry of Mines and Energy.

## **On The Political Front**

### World Cup:

During a dinner with sports reporters at the Alvorada Palace on Monday April 28<sup>th</sup>, President Rousseff said she has confidence in the World Cup security system. Quote: "I am not afraid of demonstrations, but I can assure you that no one will get close to the teams, [nor] will anyone touch the team buses as occurred with the Italian bus during the Confederations Cup. This is unacceptable...Outside the stadiums, I guarantee that everyone will be protected, from the delegations to Heads of State and fans. Inside the stadiums, it is FIFA's responsibility." According to the Minister of Institutional Relations, Ricardo Berzoini, the Administration will not seek new legislation to establish specific penalties for individuals involved in violent acts during mass protests. Quote: "This is not the Administration's initiative anymore," said Berzoini. "If there is a congressional initiative, [we] will monitor it to see if there is any contradiction with the Administration's thinking."

### Campaign Trail:

Amid increasing rumors about former President Lula's comeback as a presidential candidate in the October general elections, President Rousseff has stressed their close ties and also demonstrated a renewed willingness to challenge her opponents. Quotes: "Nothing pulls us [Lula and me] apart. I know about his loyalty to me and he knows about my loyalty to him," she told reporters on Monday April 28<sup>th</sup>. During a political event in the state of Bahia, President Rousseff added: "I am sure that the Brazilian people will not regress or go back on giving up everything we achieved: the reduction in social inequality and the largest job creation Brazil has ever enjoyed." Lula has also denied he would seek a third term, insisting he will campaign for Rousseff.

### Petrobras:

Following Supreme Court Judge Rosa Weber's decision in favor of creating a Senate Probe (CPI) only to investigate Petrobras' alleged corruption practices, President of the Senate, Renan Calheiros (PMDB/AL), announced that the CPI will be established next Tuesday May 6<sup>th</sup>. He has also said that he will file an appeal to the full Supreme Court in order to create a joint House and Senate CPI to investigate alleged irregularities in the procurement of subway machinery and ports construction in the states of São Paulo

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and Pernambuco, which are run by the opposition parties PSDB and PSB. Also, on Wednesday, Petrobras CEO Graça Foster attended a House Public Hearing to testify on the controversial acquisition of the Pasadena Refinery System in 2006. Two weeks ago she attended a similar hearing on the Senate side. **Quote:** "At that time, in 2006 and 2008, the deal looked potentially good based on revamping the refining plant to process heavy oil extracted mostly in Brazil. After 2008, the [deal] had a low rate of return because the bottom had dropped out of the market, and we did not proceed with revamping the refinery," said Foster.

## Car Wash Operation:

On Tuesday, April 29<sup>th</sup>, the Judiciary charged the former head of supply and refining of Petrobras, Paulo Roberto Costa, his two daughters, and their husbands with conspiracy to destroy criminal evidence in their Costa Global company office, and also for removing cash obtained illegally prior to a Federal Police raid. On Friday April 25<sup>th</sup>, Costa was charged with financial crimes including money laundering and illegal exchange rate operations in the so-called *Operação Lava Jato* (Car Wash Operation). Among the defendants is money changer Alberto Yousseff, charged with operating the alleged US\$ 4.5 billion scheme, along with construction companies contracted by Petrobras and politicians. Police are also investigating a related scheme involving former Health Minister Alexandre Padilha (PT), who will run for governor in the state of São Paulo. His name was mentioned in text messages exchanged between Yousseff and former House of Representatives Vice President André Vargas, but he has denied any involvement with the scheme. **Quote:** "I will challenge in court those who used my name in vain," said Padilha during a TV interview

## Task Forces

### Trade and Regulation

**Animal Testing:** The full House approved an urgency request for voting on bill (PL) 6602/13, which would prohibit the use of animal testing for the purpose of cosmetic research and would increase fines for violations. The bill has yet to be included in the floor agenda but is expected to be voted on next week. The decision, however, depends on an agreement between party leaders, who are scheduled to meet on Tuesday May 6<sup>th</sup>. It is worth noting that House President Henrique Eduardo Alves (PMDB/RN) must still nominate a rapporteur to report on the bill. If approved by the House, the bill will proceed directly to the Senate.

**Brazil-Argentina:** During a meeting between business leaders and representatives of the Brazilian and Argentine governments in Brasilia, a working group was created to discuss ways to increase automobile trade between the two countries. Two additional meetings were scheduled for May 6<sup>th</sup> and 7<sup>th</sup> to define the group's parameters and goals for increasing trade in the region. In a statement made by the Ministry of Finance, "Increased car purchases strengthen production integration and foster bilateral trade." In support of the agreement, the two governments have also undertaken "measures to ease bilateral trade in order to increase exports on both sides," according to the text. The use of financial instruments will also be evaluated as measures to facilitate business operations and increase bilateral trade.

**ANVISA:** José Carlos Magalhães da Silva Moutinho was appointed director of the National Health Surveillance Agency (ANVISA). The nomination was approved by the Senate Social Affairs Committee (CAS) and followed by a Senate floor vote. During the hearing, Moutinho said one of ANVISA's challenges is to reduce the evaluation period for new products and accelerate the registration process.

**Truck Driver Framework bill:** The House approved a bill that allows greater flexibility in work rules for professional truck drivers by increasing from two to four the number of additional driving hours permitted over and above the normal eight-hour work day and by lowering the amount of uninterrupted time required for rest from nine to eight hours. The bill has the support of truckers and employees of large transport companies but became the target of criticism from other sectors, especially large farmers and self-employed truck drivers. The bill goes next to the Senate, and if passed, on to President Rousseff.

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# The Pulse

Despite a challenging economic and political outlook, the Rousseff Administration is focused on passing bills aimed at promoting investment and unlocking infrastructure projects. The Administration will also bring a halt to so-called “fiscal bombs,” politically appealing bills that have negative fiscal impacts

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The Rousseff Administration is now focused on passing priority bills aimed at increasing investment and easing specific regulatory bottlenecks to unlock infrastructure projects following Congressional passage of the Internet Framework Bill and despite an increasingly challenging economic and electoral outlook.

A top priority is Provisional Measure (MP) 628/13, which would allocate up to BRL\$24 billion in additional funding for the Brazilian National Development Bank (BNDES). Since MP 628 has already been approved in the House, the Administration is making its final push for Senate approval before the May 8<sup>th</sup> deadline, when the bill would expire.

Another critical proposal is MP 630/14, which would extend the Differentiated Government Procurement Law (RDC) to any public service or construction project procured by federal, state, or municipal governments. Originally created to expedite World Cup and Olympics projects, RDC has been expanded to the Growth Acceleration Program (PAC) and the Public Health System (SUS). Also approved by the House, this MP must be passed by the Senate before it expires on June 2<sup>nd</sup>. The bill's rapporteur is former Rousseff Administration Chief of Staff and now Senator Gleisi Hoffmann (PT), who will likely run for governor in her home state of Paraná. It is worth noting that the Union Court of Auditors (TCU) opposes the RDC extension, arguing that it could hamper public procurement controls.

In addition, given a shortened legislative calendar because of the World Cup (June 13<sup>th</sup>-July 13<sup>th</sup>) and the October general elections, the Administration's agenda has turned to blocking politically popular bills that would have negative fiscal impacts. The list of so-called “fiscal bombs” is a long one and includes: the Supplementary Law Bill (PLC) 99/13, which would regulate the renegotiation of state and municipal debt; the Constitutional Amendment Bill (PEC) 300/08, which would create a national minimum wage for police and firefighters; Bill (PL) 7495/06, which would establish a national minimum wage for community health agents; and PL 3299/08, which would modify the method for calculating Social Security benefits.

The Rousseff Administration is aware of the budgetary implications of these bills and has convinced Senate President Renan Calheiros (PMDB/AL) to postpone the vote on at least one, the renegotiation of state and municipal debt, until after the second round of the general elections scheduled for October 26<sup>th</sup>. The bill would provide relief to states and municipalities that in the 1990s refinanced BRL\$468 billion of debt with the federal government. The bill would retroactively reduce the current interest rate (IGP-DI plus 6 to 9 percentage points) to the lower of either IPCA plus 4 percentage points or the benchmark Selic rate. There are no estimates of the fiscal impact. The bill would favor the states of Minas Gerais, Rio de Janeiro, Pará, Alagoas, and the Federal District. The city of São Paulo, led by PT Mayor Fernando Haddad, would also see large benefits by having its debt reduced from BRL\$54 billion to BRL\$24 billion. Given the breadth of political benefits this bill offers, efforts to revive the bill will be difficult to derail after the elections, notwithstanding Standard & Poor's recent sovereign debt downgrade. The next president will confront a difficult situation of having to either disarm the “fiscal bombs” to support a much-needed fiscal adjustment or face the possibility of another ratings downgrade.

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