The Week in Review

On The Economic Front

Focus Growth Projections

Leading financial institutions surveyed weekly by the Central Bank again cut growth projections for this year and 2015. According to the *Focus Bulletin*, GDP is expected to grow by 1.16% in 2014 and 1.60% in 2015, compared to the previous week's survey of 1.24% and 1.73%, respectively. The current projections are the lowest since the bank started publishing *Focus*. Estimates for the Selic benchmark interest rate remained unchanged at 11.0% for December 2014 and 12.0% for December 2015. (See more in the Pulse, below)

Focus Survey of Market Expectations
(For 12/31/2014) Source: Central Bank

	06/06	06/13	06/20
GDP	1.63	1.24	1.16
Inflation	5.96	5.91	5.91
Interest Rate	11.25	11.00	11.00
Exchange Rate	2.45	2.40	2.40

Job Creation

According to the Minister of Labor (MTE), Brazil added 58,836 payroll jobs in May, the lowest job creation for the month since 1992 and almost half the number of 105,000 jobs created in April.

Construction Confidence Index

According to *Fundação Getúlio Vargas* (IBRE/FGV), in June the Construction Confidence Index (ICST) fell by 13.6% for a fourth consecutive monthly decline. On an annualized basis, the ICST declined 9.8% in the second quarter. The latest data are in line with a deceleration trend projected for the second half of 2014 with ICST falling by 3.3% in March, 5.9% in April, and 8.7% in May.

Inflation Target

The National Monetary Council (CMN), a federal government body that comprises the Minister of Finance, the Minister of Planning, Budget, and Management, and the Governor of the Central Bank, announced that the inflation target for 2016 would remain unchanged at 4.5%, a rate first established and maintained since 2005.

On The Political Front

Campaign Trail

On Saturday, June 21st, **during the Labor Party (PT) convention, President Dilma Rousseff** was nominated the party's presidential candidate. Former President Luiz Inácio Lula da Silva, and President Rousseff's running mate, Vice President Michel Temer (PMDB/SP) also attended the meeting. During the convention, Rousseff announced the National Transformation Plan as her platform centerpiece, expanding current federal programs such as *Bolsa Família* (cash transfers), *Luz Para Todos* (subsidized electricity for rural regions), and *Minha Casa, Minha Vida* (housing for low and moderate income families). Quotes: "You see, this [World] Cup is knocking out those pessimists who said that it would not happen. Our strength is laid out in the fact that we dream, we have utopic and limitless dreams. Let's love our country, our yellow and green jersey, and support our team. And let's never let hatred prosper in our souls," said President Rousseff. "We, PT's militants need to know in the first place that an election is to be won with a good program. And second, we have to show off what we have accomplished. We have the obligation to show what we have done in 12 years and [what] they [have done] in one century," said Lula.

In a surprising move, **Partido Trabalhista Brasileiro (PTB)**, a labor party, decided not to endorse President Rousseff's candidacy, and instead to support **Senator Aécio Neves (PSDB/MG)**. The PTB endorsement will grant Neves 37 seconds of airtime for the mandatory TV and radio campaign. Neves also got the informal support of PMDB, the main President Rousseff ally in the Rio de Janeiro state. Despite the defections, President Rousseff is still the favorite candidate and would win the runoff vote, according to major polling institutes, such as Datafolha and Ibope. Quotes: "PTB declares its support to Senator Aécio Neves for this year's Presidential Elections. We are convinced that Aécio qualifies for both the economic growth resumption and to maintain social achievements that today are incorporated into national life," said Benito Gama, PTB's President. "Based on the information I got from the party [PTB], they became frustrated and would like to engage in a new project for Brazil," said Neves.

On Wednesday, at the **Partido da República's (PR)** request, President Rousseff replaced the Minister of Transportation, **César Borges,** with **Pedro Paulo Passos,** a former minister who was heading the Planning & Logistics Company (EPL), a federal government body. The move pleased the PR leadership, which indicated that it will endorse President Rousseff's candidacy.

The PSB announced the ticket's slogan, "Courage to change," on the eve of the June 28th convention that will nominate **former State of Pernambuco Governor Eduardo Campos and former Environment Minister Marina Silva** as the Presidential and Vice-Presidential candidates, respectively. Meanwhile PSB and the PSDB agreed to form a ticket to support current Governor Geraldo Alckmin in the race for the São Paulo state governorship. PSB will nominate the running mate. Although she did not veto the alliance, Silva opposes it publicly, saying she will not share the stump with PSDB. Quote: "We are not going to support the alliance. The best way would have been to have [our] own candidacy," she said. Following her comments, former Representative Walter Feldman (PSB/SP) said that the disagreement will not shake "the programmatic alliance" between Campos and Silva.

Petrobras

On Wednesday June 25th, the Joint Congressional Probe (CPMI) responsible for investigating Petrobras' alleged corruption practices held a public hearing to question the former CEO José Sergio Gabrielli about the terms of the acquisition of the Pasadena Refinery System Inc. in Texas in 2006. He repeated what he has already said in a previous Congressional hearing, that the deal was a good one for Petrobras at that time. Quote: "The price for refining capacity was $ 5.54 billion, slightly above half of the average purchase price of U.S. refineries in that period. We bought a cheap refinery below the market price," said Gabrielli.

Task Forces

Tax and Investment

Petrobras: On Tuesday June 24th, the National Council on Energy Policy announced that Petrobras will be given the rights to explore the pre-salt fields of Búzios, Lara outer fields, and Florim and Tupi Northeast under the new Production Sharing Agreement (PSA) framework. In exchange, Petrobras will pay the government in advance BRL$ 2 billion in 2014 and BRL$ 13 billion from 2015 through 2018. The government gains increased revenue at a time when it faces a large budget deficit and also hopes to improve its image relative to the criticism it has received over its relationship with Petrobras. Nonetheless, concerns have been raised over the increased cash flow burden of the cash payments and investment requirements needed to make the oil fields profitable at a time when the company has more reserves than it may be able to develop in the medium term. Petrobras shares fell 3.6% last Friday on this announcement, after climbing 21% over the past three months. However, despite the recent negative market reaction, CEO Graça Foster considers the pre-salt fields a positive deal for the company. Quote: "This is a great opportunity for Petrobras. It is a big challenge, but we are prepared," said Foster.

Innovation

National Education Plan (PNE): On Wednesday, President Rousseff signed into law the National Education Plan, which was approved by Congress earlier this month. It creates 20 goals to be achieved over the next 10 years to improve the quality of education in Brazil. These include having pre-school and the first nine years of education being universal and compulsory. One of the more challenging goals to achieve will be to increase investment in education to 10% of GDP over the coming decade. Currently, the federal government contributes only 1% of GDP for education, while state and municipal investment amounts to 2.2% and 2.3% of GDP, respectively. States and municipalities have already conditioned their fulfillment of the legislation on applying new and increased federal funding.

Access to Genetic Patrimony: The House of Representatives received on Tuesday June 24th the Administration's bill (PL) 7735/14 that would establish a new framework to clarify regulatory control over access to "genetic patrimony." Brazil exercises its sovereign ownership of its rich biodiversity by controlling access and shared use of its genetic resources. According to the Minister of Environment, Izabella Teixeira, the new bill is a way to combat bio-piracy and increase recognition of Brazil's national genetic heritage. Currently a provisional measure (MP) introduced in 2001 regulates the issue, however, due to its complexities, there are concerns that the MP may be encouraging actions that would amount to the criminalization of scientific research. The new draft bill would address these complexities in part by allowing researchers to register their studies digitally, replacing the current requirement for prior authorization. With the new system, which would be integrated digitally by government agencies, researchers must inform the government of their activities and identify which areas of genetic resources they intend to study. Importantly, agriculture and food sectors were not included in the bill.

Science and Technology: On Thursday, the Administration published Ordinance 8269/14, which creates the National Program for Platforms of Knowledge and its Management Committee. The program seeks to increase the scale of science and technology in the country while offering solutions to priority issues of Brazil's economic and social development. The program will encourage research in 20 areas of knowledge such as IT, health, energy and defense for the next ten years. Each platform will bring together leading researchers in their fields, with the support of companies, to organize resources and develop products to launch in the market. The Administration will provide funding for researchers and companies to develop their projects.

The Pulse

The Rousseff Administration’s new stimulus package is another attempt to promote growth through subsidies. It raises the questions of how much stimulus Brazil can afford – and if it will be big enough to make a difference

As the electoral campaign heats up and an already weak economy continues to decelerate, President Dilma Rousseff’s Administration unveiled a new stimulus package last week that supports labor-intensive industrial sectors such as electronics and capital goods. The main initiative is the extension of the Reintegra program, which provides exporters with tax rebates of up to 0.3% of foreign sales. At the private sector's urging, the Administration also extended the Program to Support Investments (PSI) through 2015, enabling the Brazilian Development Bank (BNDES) to grant subsidized credit for the acquisition of capital goods, among other initiatives, to stimulate exports, innovation, and technology. The Administration also announced it will expand the Refis program, which allows companies more flexibility in paying overdue taxes. According to Finance Minister Guido Mantega, although PSI will cost BRL$ 80 billion in 2014, the federal government will recover as much as BRL$ 12 billion from Refis this year. During the announcement at Planalto Palace, Mantega added that the stimulus is also intended to “improve competitiveness of Brazilian industry.”

The new package was unveiled in an environment of increasing political polarization and economic uncertainty. According to the latest data, from January through April, industrial output declined 1.2% and as the *Focus* poll of leading economists surveyed by the Central Bank indicates, confidence in the nation’s economic growth continues to erode rapidly. Meanwhile, the private sector has indicated that it would like to see President Rousseff replaced in the next election by someone it perceives as a more market friendly candidate, either Senator Aécio Neves (PSDB/MG) or former Pernambuco State Governor Eduardo Campos (PSB), as a survey published by *Valor Economico* indicates. Last Friday, while stock market investors expected support for President Rousseff to fall, a new Ibope poll showed that her lead in the Presidential race remained steady at 39%, 18 percentage points ahead of Neves. As Brazilian and foreign media outlets have reported, investors’ negative response to the poll resulted in a 1% loss of the Ibovespa index that day.

It is also worth noting that the Rousseff Administration industrial policy is nothing new, comprising the Greater Brazil (*Brasil Maior*) umbrella policies announced in 2011. The Greater Brazil rationale combines subsidies granted by the National Development Bank (BNDES) with national content and technology transfer requirements. These policies intend to promote Brazilian development. However, they have been criticized for incurring challenges by the European Union under the World Trade Organization (WTO), their high cost (BRL$ 300 billion in transfers to BNDES from 2009 through 2013), negative fiscal effect, and stimulating very little private investment. The national investment rate remained stubbornly low, at 18.4% of GDP last year, dropping to 17.7% of GDP in the first quarter of 2014. Meanwhile, analysts surveyed by *Valor Econômico* estimate that Brazil’s primary surplus will range between 0.7% to 1.0% of GDP, a low level for an emerging country with a projected 2014 budget deficit of 4% of GDP. Given these concerns, the next Brazilian President may have to consider a change in policy to address structural hurdles and adopt much-needed tax, labor, and pension reforms to increase productivity and promote sustainable growth.

BRASÍLIA
SAF Sul Quadra 02, Lote 04.
Edifício Via Esplanada
Salas 103 a 106

CEP 70070-600
Fone: (61) 3327-2606
Fax: (61) 3327-1619

SÃO PAULO
Rua Olimpíadas, 134, 5º andar, Cj 52.
Condomínio Alpha Tower
Vila Olímpia

CEP 04551-000
Fone: (11) 3079-4533
Fax: (11) 3079-2202

WASHINGTON, DC
1101 17th St.
NW Suite 1010

Phone: (202) 822-6420
Fax: (202) 822-6423
www.patri.com.br
relgov@patri.com.br