

The Week in Review

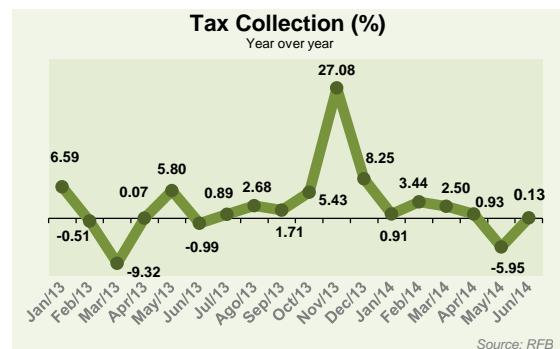
On The Economic Front

Economic Activity

According to a *Focus* poll conducted by the Brazilian Central Bank, financial analysts revised downward for the eighth week in a row the 2014 economic growth forecast. The projected annual growth in Brazilian Gross Domestic Product (GDP) decreased to 0.97%, the first time this year it has fallen below the 1.0% mark. The Serasa Experian Indicator of Economic Activity (Monthly GDP) fell by a seasonally adjusted 0.3% in May 2014 compared to April 2014 and 0.1% compared to May 2013. According to economists, slowing economic activity reflects not only tighter monetary policy (higher interest rates) to combat inflation, but also low business and consumer confidence levels, which can inhibit firm investment and willingness to expand consumer credit.

Tax Collection

Federal government tax revenue for June increased 0.13% over May's receipts to R\$ 91.3 billion (US\$ 41.12 billion). It was, however, the second lowest monthly amount for the year, just behind May receipts, which were the lowest on record since March 2013. The fall in tax receipts reflects reduced corporate revenue and the overall weak economy. Still, the Brazilian Federal Revenue Office (RFB) maintains that for 2014, annual tax receipts will be 3.0% higher than in 2013.



Drought

Hydroelectric dam reservoirs are still at very low levels, and 2014 is set to end without an improved outlook for water resources or power supply, an issue that now seems likely to be carried over to the next administration. According to scenarios outlined by the National Electric System Operator (ONS), which manages Brazil's power resources, 2014 is likely to begin with an even greater need for rain. However, the director general of ONS, Hermes Chipp, does not anticipate serious problems, even with reservoirs well below a secure level. "It's not [a problem] because [the 43% estimate of storage level of the Southeast and Central-West regions] is enough to support [the system] during the rainy period, even if reported rainfall levels are the lowest in the historical average, meaning even less rainfall than this year," Mr. Chipp said during an event in Rio de Janeiro. (See *The Pulse* below)

Electricity Sector

The Rousseff Administration will request that BNDES (the Brazilian National Bank for Economic and Social Development) help stabilize cash flow for the electricity distributors. The Administration's economic team estimates that the sector needs an additional BRL\$ 6.5 billion this year. The state bank would invest BRL\$ 3 billion, and the rest would come from commercial bank loans. The distributors are having trouble paying their monthly energy bills and have been lobbying the government for relief since the beginning of the year. So far, the Administration has injected BRL\$ 1.2 billion from the Treasury, and ten institutions, including *Banco do Brasil* and *Caixa Econômica Federal*, have lent a total of BRL\$ 11.2 billion. The new



loans will likely be announced on Friday and released to distributors by the end of the month. (See *The Pulse* below)

On The Political Front

Campaign Trail

On Tuesday, **President Dilma Rousseff** held her first meeting with coalition party leaders, marking the official beginning of her Presidential campaign. According to President Rousseff's running mate, current Vice President Michel Temer (PMDB), "the first conclusion we reached [at the meeting] is that although we have a lot of airtime on television, we think that it is insufficient to demonstrate all the Administration's achievements [over the past four years]," he said. President Rousseff also met, for the second time this year, with players from FC Common Sense, a group that advocates for improving Brazilian soccer. According to the Ministry of Sports Secretary of Soccer and Fan Rights, José Antonio Carvalho, the Administration's priority is to ensure democracy and transparency in Brazilian soccer activities and to strengthen the Fiscal Responsibility Law of Sports ([Law 11.438/06](#)). After the meeting, José Antonio countered the criticism from the opposition over the alleged nationalization of the Confederation of Brazilian Football (CBF), arguing that the Administration's intervention would be unconstitutional.

On Monday, **Aécio Neves**, the PSDB candidate for president campaigned at the Santuário da Serra da Piedade, em Caeté (MG) - the same place where his grandfather, Tancredo Neves, started the campaign that led to his presidency in 1984. Neves also announced his campaign's general directives which provide guidelines for foreign policy and foreign trade focusing on stimulating investment. According to Ambassador Barbosa's article published at Folha de SP this week, Aécio's Foreign Ministry proposed goals are:

1. to open up new markets to global supply chains;
2. to review regional integration policies, re-establishing the primacy of trade liberalization and deepening of existing agreements;
3. to conclude trade negotiations with the European Union and to initiate activities for a preferential agreement with the United States;
4. to revamp Mercosur, and recover its objectives of trade liberalization and market openness, and to seek flexibility in order to advance negotiations with other countries;
5. to expand and streamline Brazil's diplomatic action on global issues such as climate change, sustainability, energy, democracy, human rights, and foreign trade, as well as new topics such as terrorism, cyber warfare, control of the Internet, and issues of peace and security, including the discussions on the extension of the UN Security Council;
6. to reduce the tax burden on exports; and
7. to simplify legislation on foreign trade and bureaucracy of customs and ports.

Also on Monday, **Eduardo Campos**, the PSB candidate for president, and Marina Silva, his running mate, inaugurated their central campaign committee in São Paulo. According to Campos, the country will have more than BRL\$ 100 billion over the next ten years. "We have the resources but lack discussion on where to invest. We are discussing our government program very carefully," he said. Campos defended once again using 10% of the federal budget for health and supporting career paths for health professionals. He reinforced that the inflation target for his government will be 4.5% and that, if elected, he will fight for the independence of the Brazilian Central Bank. Campos also inaugurated campaign committees in Marília, Araçatuba e Limeira, along with São Paulo Governor, Geraldo Alckmin (PSDB).

Petrobras

On Wednesday, the Court of Audit (TCU) approved unanimously rapporteur Judge Jorge José's report on the case investigating irregularities in Petrobras' purchase of the Pasadena refinery in Texas (USA). TCU condemned Petrobras' directors at the time, including ex-Chief Executive Officer Jose Sergio Gabrielli, calling to have them pay US\$ 792.3 million for mismanagement in the purchase of the U.S. refinery. The councilors of calling Petrobras, including President Dilma Rousseff, were not held liable. Also on Wednesday, the Joint Parliamentary Committee of Inquiry (CPMI) responsible for investing Petrobras held a private hearing to question Osvaldo Vicente Perrou Cardoso, Secretary of External Control of the Court of Audit. Perrou asked for a secret hearing on the allegation that reports on the purchase of the Pasadena

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refinery is confidential and he could break the trade secrets of Petrobras. Leader of the PPS party in the House, Representative Rubens Bueno said that the Administration will use in their favor TCU's decision to end the joint probe.

Task Forces

Trade and Regulation

Electrical sector relief: Provisional Measure 641/14, which would have altered Law 10.848/04 regulating the sale of electricity expired on July 22nd. The MP would have allowed distributors to push up delivery of electricity to the same year in which it was contracted and purchased at public auction. The MP received 54 amendments, many beneficial to the industry by avoiding the higher prices of electricity faced in having to make deliveries the following year. Among the changes sought in the amendments was the extension of electricity contracts between large industrial consumers and the São Francisco Hydroelectric Company (Chesf). In an attempt to maintain the extension of the contracts, the same amendment was introduced to three other MPs that are still valid: MP 643/14, which regulates the office of Director General of the National System Operator (ONS); 649/14, which deals with the surveillance guidelines regarding tax transparency in tax documents (receipts); and 651/14, which establishes tax cuts on foreign sales and subsidized credit lines and permanently extends the payroll tax exemption policy for companies that are already receiving the benefit.

Tax and Investment

Infrastructure Concessions Program: The National Confederation of Industry (CNI) sent a document to the three main presidential candidates proposing changes to the federal infrastructure concessions program. The document addresses a variety of sectors but concerns mainly railways and the ability of the federal government to subsidize investments.

The Pulse

Prolonged drought, dubious policy choices, and structural problems in the power grid could lead to electricity and water rationing by 2015, with potentially significant consequences for the election

Brazil faces the worst drought in 80 years, nearly emptying the reservoirs of their usable reserves in a country where hydroelectricity accounts for two-thirds of its power generation. The Southeast (including São Paulo) and Central West regions, which house 60% of the nation's water reserves, face the worst problems and the greatest likelihood of electricity and water rationing. Even a forecasted "El Niño," which would increase rainfall for Brazil, is not expected to bring relief to the regions that need it most.

Structural problems in the power grid and policy choices have compounded nature's hardship. As Minister of Energy in the 2000's, Dilma Rousseff planned expansion of thermal electric plants to reduce Brazil's dependence on hydroelectric power. Execution, and therefore capacity, fell behind schedule, and during her presidency, she has forced utilities to reduce energy prices 30% below market levels. Hydroelectric capacity constraints and artificially low prices pushed electricity demand upward as the drought diminished supply, forcing greater use of far more expensive thermal power. With thermal plants now operating at full capacity, the government's subsidy costs have increased and are expected to reach BRL\$ 20 billion (\$9 billion) for the year. The government has withheld \$1.6 billion owed to the sector and negotiated loans with commercial banks and requested that the national development bank, BNDES, bail out electricity distributors unable to meet the rising costs of spot-market energy purchases.

The Administration disavows the need to begin rationing or raise prices, largely to avoid any political backlash right before the national elections. The costs of this energy policy, however, have been high. Subsidies threaten fiscal targets, reduced utilities revenue limits investment, and higher thermal energy

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costs lower corporate profits, putting downward pressure on economic growth, and eventually fueling inflation because price increases cannot be delayed indefinitely. A survey by FIESP this month showed that two-thirds of São Paulo companies predict that their output will be negatively affected by the energy crisis, and that it may increase unemployment, which has become increasingly worrisome with recent announcements of reduced hirings.

The drought poses multiple threats to the economy and has already become an electoral issue. The Rousseff Administration blames the policies of state governments in the hands of opposition parties, and opponents point the finger at the president with the two major contenders, Aécio Neves (PSDB) and Eduardo Campos (PSB), calling for transparent rules for regulated price adjustments. If the energy and water situation deteriorates, and economic repercussions deepen, the drought could become a major electoral issue.

