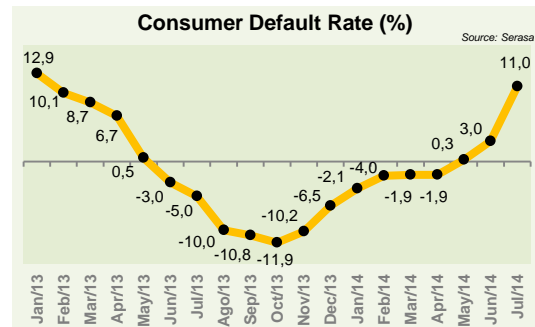


# The Week in Review

## On The Economic Front

### Consumer Default Rate

According to a Serasa Experian survey released on Tuesday, the consumer default rate jumped 4 percentage points in July, hitting 11.0%, the highest rate since January 2013. In a statement made by Serasa Experian economists, the rise in the default rate is the result of "difficulties in the current economic environment, characterized by high interest rates, inflation reaching the central banks' upper target range for the year (6.5%), and a weaker market."



### Inflation

Brazil's inflation rate slowed last month, mostly due to declines in food prices with help from a return to normal rates for airfare and hotels that had spiked during the World Cup. The country's IPCA consumer price index rose 0.01% in July according to the Brazilian Institute of Geography and Statistics (IBGE). It was the smallest monthly increase since 2010, but higher inflation earlier this year caused Brazil's 12-month IPCA inflation index to fall only 0.02 percentage points to 6.50%, which is the ceiling of the Central Bank's target band. Government sources praised the effectiveness of its economic policies in stemming price increases, but private sector economists warn that Brazil could still see higher inflation rates for the remainder of the year.

### Drought

São Paulo is facing its worst water crisis in decades. According to *Folha de São Paulo*, about 2.1 million people already may be effectively experiencing water rationing, equivalent to one in every 20 inhabitants of the country's most populous state. Sabesp, the state company responsible for providing water to 27.7 million people in 364 cities, denies having adopted water rationing in any of them, including the capital, despite residents reporting interruptions in their water supply.

According to *O Globo*, on Tuesday, the governments of São Paulo and Rio de Janeiro exchanged accusations and litigation threats after a São Paulo utility operator (Cesp) reduced the flow of a river to guarantee their own access to the water. Reduction of the Jaguari River water flow, which supplies not only water but also electricity to the states of Sao Paulo, Rio de Janeiro, and Minas Gerais, aggravated the conflict arising from water scarcity due to the prolonged drought. Despite the fact that the national electric grid operator (ONS) recommended that the São Paulo government increase the water flow in the Jaguari River, last Friday Cesp reduced the volume of water flowing into the basin of the Paraíba do Sul River, a move that directly compromises the hydroelectric industry of Rio de Janeiro state. Currently, Cesp is only releasing a third of the water volume from the Jaguari River hydroelectric dam demanded by the ONS.

## On The Political Front

### Presidential candidate Eduardo Campos dies in air crash

The PSB candidate for president, Eduardo Campos died early on Wednesday in a plane crash in Santos (SP). The jet, which was taking the politician to an event in São Paulo, crashed in a residential neighborhood in Santos. The Air Force Command said in an official statement that the Cessna 560XL fell at around 10AM, "The aircraft took off from Santos Dumont Airport in Rio de Janeiro, bound for the airport of Guarujá (SP). When preparing for landing, the plane lunged due to bad weather. Then, the air traffic



control lost contact with the aircraft." Four other passengers and the two pilots were also killed. President Dilma Rousseff has declared three days of national mourning and cancelled all her campaign events. "We lost a great Brazilian today, Eduardo Campos. We lost a great comrade," said Rousseff, and finished by calling him a "great political leader". Campos was a State Deputy, Federal Deputy, Secretary of Finance of Pernambuco under his grandfather Miguel Arraes and Minister of Science and Technology under former President Luiz Inácio Lula da Silva. He was the Governor of Pernambuco between 2007 and 2014, and was, at the time of his death, the President of PSB.

## 2014 Presidential Elections

With the sudden death of Eduardo Campos, the PSB candidate, it is up to his political party and its coalition member parties to appoint a new candidate. To do so, they must submit a request to the Superior Electoral Court (TSE) within 10 days or by August 23<sup>rd</sup>. Marina Silva, his vice presidential running mate, can legally become a candidate. Other considerations for choosing a new candidate include:

- » Affiliation with the PSB, or a coalition party if the PSB agrees with the choice;
- » Replacement by a majority decision of the executive management bodies of PSB and its coalition.

Brazil's main TV newscast, *Globo's Jornal Nacional*, is broadcasting interviews recorded live earlier in the week with the top four candidates for president, defined as having support of at least 3% in the latest research polls conducted by IBOPE and Datafolha. They were, at the time, President Dilma Rousseff (PT), Aécio Neves (PSDB), Eduardo Campos (PSB), and Pastor Everaldo (PSC). They were chosen for a 15-minute interview with the order determined by a random drawing taken in the presence of representatives of all four parties.

On Monday, **Aécio Neves** reiterated that if elected, he will "clean up" the government by reducing from 39 the number of federal ministries currently in place. In the social area, the PSDB candidate said he intends to maintain and improve the *Bolsa Família* cash assistance program.

On Tuesday, **Eduardo Campos**, in referencing Brazil's lopsided loss to Germany in the World Cup, said that Brazil is losing 7-to-1, when it comes to the economy, "Seven goals for inflation and one for economic growth." He promised at the time that if he wins the election, the country will begin growing again at 4% per year. Campos also highlighted that Latin American countries are growing at a higher pace than Brazil and that recent economic performance is putting the country at the end of the queue of regional growth. As for inflation, he said it cannot be tackled only with high interest rates. The lack of infrastructure also makes Brazil more expensive in many ways.

President Dilma Rousseff would have been interviewed on Wednesday, but she canceled following the death of Eduardo Campos in Wednesday morning's private jet crash.

## Political Dissatisfaction

According to electoral experts, disillusionment with politics and politicians is widespread among Brazilians. There are some who believe it may lead to an increase in the number of "non-votes," which include null, blank, and abstention votes. The latest Datafolha poll indicated that this may include up to 27% of the electorate. In 2010, 27% were non-votes, including 21% abstaining. It is up to the opposition to win those votes, but if neither Aécio Neves nor the PSB candidate capitalize on this dissatisfaction, the number of non-votes could increase. Strategists believe that disaffected voters trend toward voting for the opposition.

## Petrobras

According to *Estadão* newspaper, the Federal Audit Court (TCU) may block Petrobras CEO Graça Foster's assets as part of the process to compensate for financial losses caused by the purchase of the refinery in Pasadena, Texas. According to the publication, the Minister of TCU José Jorge, rapporteur of the case for Pasadena, said that Graça Foster's name was not included among the people who were potentially responsible for the damages caused to the refinery, but it should have been since she was part of Petrobras' board at the end of the negotiations to purchase the refinery. The scandal surrounding the company has contributed greatly to President Rousseff's fall in popularity, whose approval rating has dropped from over 60% early last year to under 40% today.

## Congress

Traditionally, the House of Representatives and the Senate go into informal recess during the general election year and hold only two weeks of concentrated sessions to vote on critical bills, one in August and

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another in September. Political barriers can, however, prevent voting sessions. In 2010, for example, the year in which there was a general election, the House only held one concentrated effort in August. The House President, Henrique Eduardo Alves, said he will ponder whether Congress is in the mood to vote on important bills in September, "No use having controversial matters [to vote on], which will generate discussion and find no consensus in this House, [and] we will end up not approving anything in September. So we wait for August to pass, and if we do not vote on anything in September, we will do so in October when we resume our work."

## Task Forces

### Innovation

**4G Auction:** On June 5<sup>th</sup>, the Federal Audit Court (TCU) suspended a public auction of 4G wireless airwaves, potentially thwarting a financial windfall the government was counting on to help meet its year-end fiscal targets. TCU requires more information from Brazil's telecommunications regulator Anatel, which had planned the auction for September. Anatel has 15 days to provide more details about the process and is forbidden to publish the auction terms until the court has given it the green light. The auctions hold high interest for Brazil's main telecom companies. It is also important for President Rousseff during the critical election period running through October. The government was planning to raise around BRL\$ 8 billion (US \$3.5 billion) and use the proceeds to strengthen its accounts. With the economy slowing and growth in tax revenue eroding, Brazil in recent years has relied on extraordinary one-time measures, such as sales of oil leases, to bolster its accounts.

### Trade and Regulation

**Super Simples:** On August 7<sup>th</sup>, President Rousseff signed the General Law of Micro and Small Enterprises, which now allows around 142 new businesses in the services sector to be included in a new taxation regime. About 450 thousand companies with annual revenues of up to BRL\$ 3.6 million may benefit from the law beginning January 1, 2015. The amended law allows doctors, lawyers, journalists, and other service professionals to benefit from the differentiated taxation system based on company size and cash flow rather than type of business activity, as previously used. The program unifies federal, state and local taxes into a single bill, reducing the average tax liability by 40%, according to the president of Sebrae, Luiz Barretto, who said, "This measure strengthens entrepreneurship and encourages businesses to become part of the formal economy." He believes that there is no real development without including micro and small enterprises, noting, "They are responsible for 27% of Brazil's GDP, 52% of all formal jobs, and 40% of the the country's salaries."

### Tax and Investment

**Airports:** On August 12<sup>th</sup>, Rio Galeão took over the operations of Brazil's Antonio Carlos Jobim International Airport. Rio Galeão, a partnership between Odebrecht TransPort, Changi Airports International, and Infraero, signed a 25-year contract in April 2014 to manage the expansion, maintenance, and operation of the airport. This is the beginning of the third stage of a change in the management process, which is expected to take three to six months. The operator will remodel the gateway and has promised to introduce bilingual customer service representatives, bring in a wider variety of retail establishments, and improve parking facilities with enhanced security and free Wi-Fi service. In addition, Rio Galeão says it has been working to attract new airlines to the airport and develop more routes and will start the development of new infrastructure in preparation for the 2016 Olympic Games.

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# The Pulse

Health care, public security, unemployment, education, transportation, and inflation are the six issues of greatest concern to Brazilians

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Datafolha, the Brazilian public opinion research institute, released a poll at the formal kickoff of the 2014 presidential campaign, defining the six issues of most concern to Brazilians. They are, from the most to the least important: health care, public security, unemployment, education, transportation, and inflation.

Almost one-third of Brazilians (32%) picked healthcare as the biggest public problem for Brazil (58% among women, 42% among men), despite the fact that several indicators have shown progress in this area. For instance, life expectancy rose from 66.9 years in the early 1990s to over 74 years by 2013, with infant mortality and the incidence of infectious disease decreasing sharply. Public spending on healthcare increased 340% between 2000 and 2012.

As is the case with other social problems, it seems that progress has only increased societal desire for more, better, and faster services. Public health care is slow, public hospitals are crowded, and several are ill-equipped and unprepared to care for chronic diseases, which have superseded infectious diseases as the main cause of death in Brazil. One of the most controversial initiatives of President Dilma Rousseff's government has been the "More Doctors" program, which has been trying to fill gaps by importing physicians from abroad, mostly from Cuba. Although "More Doctors" has received good reviews from the public, Brazilian physicians are critical of it.

One-fourth of Brazilians believe that public security is the worst problem of the country, coming in second on the list of national concerns. The number of homicides has been rising nationally, particularly in areas that have been experiencing strong economic growth, such as in the North and the Northeast. On the other hand, traditionally violent cities and centers of the economy, such as Rio and São Paulo, have seen a relative decrease in homicides. For the country as a whole, however, violence is still considered to be endemic by the World Health Organization, with a death rate from crime of 29 per 100,000 inhabitants (the threshold for defining endemic violence is 10 per 100,000). Even worse, 90% of homicides are not solved by police, and most murderers avoid punishment.

Despite the fact that Brazil is living in a period of almost full employment (the official unemployment rate is 5%), 12% of Brazilians say that joblessness is the most important issue for the country. Ranking third among the major concerns, it reflects increasing anxiety over the economic future of Brazilian society.

The fourth most important issue in the polls is education: 7% believe this is the greatest challenge the country faces, despite evidence of improvement in recent years. Basic education is now almost universal, the number of college students has doubled in ten years, and 18 new federal universities have been created over the last two years. However, as in the case of healthcare, there is intense criticism of the quality of services provided by government at all levels, and the aspiration for better schools is widespread.

Public transportation ranked fifth among concerns, with 7% of those in the Datafolha poll citing it as the nation's worst problem. It was also the main cause of the June 2013 demonstrations in dozens of cities throughout Brazil. This is a sector where few improvements have been seen. Almost no city has an efficient subway or bus systems to serve the people. In places such as Rio and São Paulo, workers spend many hours commuting each day in crowded, slow, and uncomfortable vehicles.

Finally, inflation is considered by 7% of those polled as the most important issue facing Brazil, a perennial concern for those who remember that the country suffered decades of hyperinflation until it was finally tamed in the early 1990s. This year, inflation rates have reached the upper bound of the government's target (6.5%) and many household budgets are suffering because salaries have not kept pace with rising prices. Although it seems unlikely that inflation will spiral out of control, it has become an increasing reality, particularly for the important, but fragile new emerging middle class.

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