Looking Ahead (What to watch for?)

- 25th May -- Memorial Day observed [holiday in the US]
- 27-30 May -- 32nd LASA Congress in San Juan
- 27th May -- SRF (R$ billion tax collections in April
- 27th May -- Protest march on Brasília in favor of Dilma’s impeachment
- 26-27 May -- 191st Copom Meeting (Selic Rate %
- 29th May -- IGP-M for May (%
- 29th May -- IBGE announced GDP for 1st Q/2015 ( % (QonQ) & % YoY
- 29th May -- Central Bank to announce public account data for April
- 1st June -- Trade surplus for May (US$ million
- 2-3 June -- 191st Meeting of Copom (Selic Rate
- 3rd June -- IBGE – IP data for April (% MoM, % MoM in March
- 3rd June -- Italian Regional Administrative Court to deliberate the case of extradition of Henrique Pizzolato
- 3rd June -- Central Bank (US$ billion FX flow in May
- 4th June -- Corpus Christie – national religious holiday
- 5th June -- IBGE to release May unemployment data (new PNAD methodology
- 5th June -- FGV to announce IGP-DI for May, %, versus % in April
- 5th June -- IBGE to post IPCA inflation data for May (+0.% versus +0.% in April
- 5th June -- Anfavea (auto units produced in May, +% MoM & % YoY
- 11th June -- IBGE (Industrial Employment in April, % MoM & % YoY

1 - POLITICS
1.1 – Fachin approved by the Senate

On Tuesday, 19th May, the Senate approved the appointment of lawyer Luiz Edson Fachin to the Supreme Court by a 52-to-27 secret vote. Of the 81-member Upper House, 79 senators were present and voting – with no abstentions. Two senators were absent – Roberto Requião (PMDB-PR) and Zezé Perrella (PDT-MG). Senate President Renan Calheiros (PMDB-AL) worked behind the scenes against Fachin and cast his secret ballot. An absolute majority of 41 senators was the necessary quorum.

Unless some current STF judge dies or resigns before the end of 2018, Pres. Dilma will not be able to make any more appointments to the high court – because of the approval of the PEC da Bengala that extended the mandatory retirement age for higher court judges from 70 to 75.

Destiny – The newest STF judge will become the reporter on the case involving Senator Renan Calheiros who was accused by the PGR of receiving $$$ from the Petrolão bribe scheme.

Want more? The Dilma government scored a victory with the Senate confirmation of Luiz Fachin for the STF – but lost an earlier vote – regarding the confirmation of diplomat Guilherme Patriota to be Brazil’s ambassador to the OAS – by 38 votes no and 37 “Yes”. Three other ambassador appointments were approved before Partiota was rejected – France, Georgia and Mali.

Photo: Earth Negotiations Bulletin

Guilherme Patriota rejected by the Senate

Guilherme Patriota is the younger brother of ex-Foreign Minister Antonio Patriota during Dilma 1.0. On 26th August, 2013, Pres. Dilma removed Antonio Patriota and he was “kicked upstairs” to become Brazil’s ambassador to the UN. This ouster occurred because of the episode involving Bolivian Senator Roger Pinto Molina who had been granted refuge inside the Brazilian Embassy in La Paz and received political asylum in Brazil – but was not able to a free pass to go to the La Paz airport and fly to Brazil. Thus, under orders from Itamaraty, Senator Pinto was confined to a windowless room in the Embassy (for nearly one year) in hopes that “break down” and leave the Embassy. Fearful that Pinto might commit suicide, Acting Ambassador Eduardo Saboia loaded the senator into one if two embassy official vehicles and with several embassy Marine guards drove the senator non-stop to Corumbá, MS – with no interference from the Bolivian police. This created a “diplomatic problem” with Bolivian President Evo Morales and as a result A. Patriota was sacked.

Sen. Lindberg Farias (PT-RJ) protested that “Never in the history of the Senate had a professional diplomat been rejected for appointment as Ambassador”. His research was faulty because in 1995, Sen.
José Serra (PSDB-SP) mobilized senators to reject the appointment of a diplomat to be ambassador – because after 11th September 1973 this person was a junior diplomat in the Brazilian embassy in Santiago and “harassed” many Brazilians who were exiled in Chile (including José Serra).

Recently, while he was serving at the UN (under his older brother), the Brazilian press revealed that the rent for Guilherme’s apartment in NYC was US$ 50,000.00 (per month). This “scandal” revealed in the Brazilian press probably contributed to his rejection to be Ambassador to the OAS in Washington.

However, the press cited another reason for the Senate’s rejection of Patriota. He worked with Prof. Marco Aurélio Garcia in the President’s international affairs advisory office (2010-2013). In his hearing before the Senate Foreign Affairs Committee on 14th May, where he was approve by only one vote (7-to-6), several senators criticized Prof. Garcia. Patriota felt obliged to defend Garcia – “I hold him [Garcia] in great respect and affection. . . . He is brilliant”. This might have tipped the balance against him. It looked like Prof. Garcia had “suggested” his name to Pres. Dilma. Many senators considered his posture vis-à-vis the Committee to have been “arrogant”.

This reversal was very negative for Itamaraty. First, this episode left the impression that for Brazil the OAS is “secondary” and not important for its foreign relations – because Brazil has not had a “full” ambassador at the OAS in four years – ever since Amb. Ruy Casaes was recalled to Brasília in reaction against the decision by the Inter-American Human Rights Commission to suspend the construction of the Belo Monte hydro electric plant.

Second, the diplomat who is currently Brazil’s interim representative at the OAS since 2011, Breno Costa, has already received the agreement from the Honduran government to be the new ambassador in Tegucigalpa. Thus, Costa will be required to postpone his arrival in Honduras. Third, in lieu of G. Patriota’s designation to be Ambassador to the OAS, Itamaraty already appointed his replacement at the UN (to be number two under Amb. Antonio Patriota), Carlos Duarte, and this appointment was already published in the federal Daily Record.

Thus, Guilherme Patriota became “a man without a country,” as it were – and will be stationed “in the corridors of Itamaraty” until another slot appears. No one knows if, once rejected by the Senate, the same diplomat would be designated again for another ambassadorial post, and run the risk of being twice rejected.

1.2 - Petrolão

This week, the Lava Jato investigation of massive corruption/bribery in Petrobras produced several new episodes.

First, members of the CPI investigating the Petrobras case traveled to the UK to interview (take testimony) from a former top executive of the Dutch firm SBM Off Shore – Jonathan David Taylor –
in the city of Farnborough, near London. He explained in great detail and with many previously unheard of documents the bribery scheme used by SBM to acquire supply contracts with Petrobras for drilling rigs. He explained that the middleman/go between SBM and Petrobras was the lobbyist Julio Faerman.

Photo: Fernando Nakagawa/Estadão

Jonathan D. Taylor with the CPI in London.

Taylor showed the CPI documents that proved that Faerman’s share in one deal was US$ 31 million that he had deposited in his offshore account in the British Virgin Islands. As SBM’s representative in Brazil (2007-2011), allegedly Faerman received US$ 139 million. The CPI wants testimony from Fareman to confirm the information supplied by former Petrobras manager Pedro Barusco that SBM contributed US$ 300,000.00 to Dilma’s presidential campaign in 2010. Allegedly, Faerman in hanging out is the greater London area. If he does not appear, the CPI will request a warrant for his arrest and request that his name be placed on the wanted list of Interpol.

Reportedly, Faerman has “reappeared” and is willing to testify before the CPI. Because his two children, Marcello and Eline Faerman, were convoked to testify, Faerman contacted the CPI deputies.

Upon its return to Brasília, the CPI plans to convocate the chief of the CGU, Valdir Simões, to explain why, after Taylor had delivered all this material to the CGU on 27th August 2014, the CGU only opened its investigation on 12th November – after Pres. Dilma had been reelected on a hotly disputed 2nd round runoff election. Taylor called the CGU action “negligent”.

Detail: SBM was investigated by Dutch prosecutors, accused, prosecuted and convicted by Dutch courts and obliged to pay a US$ 300 million fine.

Second, former Mines & Energy Minister, now Senator Edson Lobão (PMDB-MA) is under investigation at the STF for his involvement in the Lava Jato case – receiving part of the bribes extracted from the cartel of construction firms. The O Estado de São Paulo published a story with “details” – regarding the “results” (Lobão is accused of money laundering and illicit enrichment (hiding assets) – in the Cayman Islands as a member of the Diamond Mountain holding group. STF judge Luís Roberto Barroso authorized the PGR to initiate the investigation and Lobão has 20 days to respond.
Third, among the budget cuts proposed by Dilma 2.0 – the Federal Police allocation in 2015 would be reduced R$ 5.4 billion (R$ 3.7 billion. Apparently, a “reward” for excellent services rendered.

Fourth, on 21st May, the Federal Police arrested Milton Pascowitch who is accused of operating as an intermediary between Pretolão bribes for politicians and parties from Engevix, according to ex-Petrobras director Pedro Barusco. Reportedly, Pascowitch passed R$ 1.16 million to the JD Consulting fire of José Dirceu in 2012. The explanation was that JD was hired to examine prospective business opportunities in Peru.

1.2.1 – Petrobras - Creative Accounting

Last week, Brazil Focus reported that Petrobras has posted its 1st Q/2015 financial balance report with a net profit of R$ 5.3 billion – much higher that expected by financial analysts. Now, one week later, after examining this report in detail, the press accused the new Petrobras administration of severe use of “creative accounting” to achieve this result. Allegedly, this profit result was “inflated” by R$ 1.3 billion by the inclusion of an item dated 7 May 2015, 37 days after the end of the first quarter (31 March 2015). As a result, Petrobras stocks were down by -6% on Bovespa on 19th May.


On 21st May, commenting on the inclusion of a 7th May operation in its 1st Q/2015 financial statement, Leonardo Pereira, President of Stock Market Regulator (CVM) in São Paulo affirmed that “If it is proven that Petrobras has not followed the accounting norms stipulated by the Accounting Pronouncement Committee (CPC), it will be forced to republish its 1st Q/2015 results”.

Once again, the “new” management of Petrobras has clearly shown that it is not much different from the previous administration and does not take the firm’ accounting procedures seriously. It is amazing that PriceWaterhouseCoopers signed off on this financial report.

1.2.2 – Petrobras to sell five asset groups

On 21st May, Petrobras announced that it plans to sell FIVE groups of assets to raise some US$13.7 billion. One of the most important group of assets is the group of thermal electricity generators with a total capacity of 7 gigawatts. Some pre-salt prospection areas also will be sold.

1.3 – The “Mother of all Scandals”

Over the past months, there have been “straws in the wind” in Brasília regarding a vast corruption scandal at BNDES – much worse that the Lava Jato has revealed so far regarding Petrobras. Created in the mid 1950s, BNDES has never been audited. The TCU has tried several times but was always rebuffed by the allegation of “bank secrecy”.

NOW – the federal prosecutors involved have taken a different approach than in the Lava Jato-Petrolão when they concentrated everything with one federal judge (Sérgio Moro). In the BNDES case, they have divided the more than 60 requests for arrests among five separate federal judges.
1.4 - Political Party mergers

Previously reported by *Brazil Focus*, the PTB-DEM merger now seems more viable after the “SP question” was resolved. Campos Machado (PTB) will become the president of the new party at the state level, and Rodrigo Garcia (DEM) will be the president at the municipal level. Reportedly, the PSB-PPS merger will become official on 20th June. A third merger (PT-PCdoB) is also possible.

1.5 - Mensalão

One of the accused in the *Mensalão* case, Dep. José Janene (PP-PR) allegedly was the intermediary who received and passed on the “quota” of payments to his PP colleagues in 2003 and 2004 – before this scheme was revealed in 2005. Reportedly, he received R$ 4.1 million and died on 14th September 2010. Now, the CPI that is investigating the more recent Petrobras corruption/bribery case, suspects that Janene “falsified” his death and is hiding out somewhere in Central America. Thus, the CPI is demanding that Janene’s body be exhumed for DNA analysis to verify where the corpse is really that of the ex-deputy. Until now, Henrique Pizzolato was the only accused in the *Mensalão* case to escape [alive] to Italy and awaits possible extradition back to Brazil.

(Stay tuned!!)

1.6 – “Stroking” the PR

The Dilma government is trying to attract the PR more firmly into its coalition in Congress and has been passing out a series of “goodies” to this party, mostly in the form of 2nd and 3rd echelon federal appointments. The most recent of the latter, was former deputy Luciano Castro (PR-RR) who had been the PR floor leader in the Chamber in 2014. Last year, he ran for Senator but placed second, defeated by PDT city council member in Boa Vista – Telmário Mota. This week, Pres. Dilma named Castro to be Secretary for Management of Transportation Projects in the ministry of Transportation. The Minister is Antonio Carlos Rodrigues (PR-SP).

1.7 – Renan staffer recruited by Joaquim Levy

On 6th May, Finance Minister Joaquim Levy recruited senior Senate staffer Cláudia Lyra Nascimento to head his legislative liaison team. Ms. Nascimento joined the Senate staff in 1981 and became the General Secretary of the Senate (directly under the Senate President (2007-2014) – working with two Senate Presidents – José Sarney and Renan Calheiros. Ms. Nascimento has good knowledge of the intricacies and political operations in Congress and certainly will reinforce Levy’s legislative relations.

1.8 – Dilma 2.0 - Austerity

The Dilma Rousseff government did not wait until Congress had deliberated all of its fiscal austerity adjustment proposals and on 21st May announced that it would cut R$ 69 billion from the 2015 annual budget. Cuts is budget amendments proposed by members of Congress would come to R$ 20 billion of this total. The government also revised its projection for the retraction of Brazil’s 2015 GDP, from -0.9% to -1.2%.
2 – FOREIGN RELATIONS & TRADE

2.1 – Brazil - China

On Tuesday, 19th May, Chinese PM Li Keqiang visited Brasília and 35 bilateral agreements were signed with Pres. Dilma Rousseff totaling US$ 53 billion – in the areas of planning, infrastructure, trade, energy, and mining, among others. Petrobras was contemplated with US$ 7 billion in projects.

The biggest project is the Transoceanic Railroad that would link Brazil to a Pacific Ocean port in Peru and would cost between US$ 5 billion and US$ 12 billion. The route through Brazil’s western Amazon regions to Peru will probably meet with resistance from environmental and Indian protection groups. Another concern is voiced by Abifer-Brazilian Assoc. of Railroad Industry that this project would be “totally Chinese” – with Chinese locomotives, rails, ties, freight cars, etc. – and not supplied by Brazilian industries. Abifer points out that when the Chinese built a railroad in Argentina the local railroad industry was ignored.

China will again import beef and frozen chicken from Brazil (perhaps US$ 520 million in 2015). The Chinese Bank of Communications will acquire 80% of the BBM bank in Brazil (US$ 525 million).

Photo: Pedro Ladeira/Folhapress

Dilma Rousseff and Chinese PM Li Keqiang

The Belo Monte hydro electric project might also receive Chinese investments. Another worry is that all laborers and personnel involved would be Chinese – from engineers to manual laborers. Brazil would have to modify its slow and reluctant policy of granting visas at the Ministry of Labor to accommodate the Chinese.

On of these accords involves the acquisition of 40 Embraer planes by Tianjin Airlines – the E190-E2 model. Also, Chinese shipyards will build 22 super-large iron ore ships for Vale.

Because many of Brazil’s large engineering/construction companies have become more or less non-viable to compete/execute large infrastructure projects because of their involvement in the Lava Jato Petrolão scandal, it is possible that Chinese companies might acquire some of the latter – OAS in particular – so as to be able to execute these new (and large) projects via a “national” firm.
This visit has more economic content than “politics”.

2.2 – Brazil - Uruguay

On 21st May, Uruguayan President Tabaré Vázquez visited Brasília. Two points were on the bilateral agenda – 1) Plans to integrate the electric systems of the two nations; and 2) Revitalize Mercosur. They also discussed a possible “democratic solution” for Venezuela.

2.3 – Christine Lagarde visited Brazil

The IMF Managing-Director, Christine Lagarde, visited Brazil this week. After conversations with Pres. Dilma, Finance Minister Levy and others in Brasília, she visited Rio and the pacification program at the Complexo do Alemao and participants in the 
Bolsa Família program. She urged Brazil to maintain discipline (courage) in its proposed fiscal adjustment program.

3 - REFORMS

3.1 – Political Reform

A vote on the political reform package by the Chamber special committee was postponed until next week. One of the proposals is to deny access to the “Party Fund” (R$ 868 million per year) for the so-called “micro-parties”. The “threshold” for access would be that the party should have received at least 2% of the valid vote and 1% in at least nine states in the previous election for deputy. If this measure is approved, 16 parties would be denied access to the national party fund ( PCdoB, PSOL, PRTB, PHS, PTdoB, PSL, PTN, PRP, PEN, SDC, PMN, PTC, PSTU, PPL, PCB and PCO.

Because of this measure and the possibility that this reform might prohibit coalitions in proportional elections and install a 2% or 3% “threshold barrier” for election of deputies, several party mergers are being contemplated. (See Item 1.4)

4 – PRIVATIZATION & REGULATION

4.1 – Nothing this week

5 - ECONOMICS
5.1 – Default increases

According to a recent report by Serasa Experian, consumer default in the January-April 2015 period was up +14.9% compared to the same period in 2014. The increases in unemployment, inflation and higher interest rates are the main reasons for this increase, according to Serasa Experian economists. Serasa Experian also reported that in April the number of people taking out credit declined by -12.2% MoM.

5.2 – Industrial sector declined in March

Employment in the industrial sector was down by -5.1% YoY and salaries declined by -4.3% YoY. This was the worst decline since 2009.

5.3 – Santander to Acquire HSBC??

The Spanish Banco Santander SA is considering the acquisition of HSBC Holdings PLC in Brazil – according to The Wall Street Journal. HSBC is the seventh largest bank in Brazil with 20,500 employees and a market share of 2.7% and posted a loss of US$ 306.8 million in 2014. It is not clear how much of the Brazil unit would be up for sale. The Latin American Division of HSBC (that includes Argentina and Mexico) with before taxes adjusted profit down by -50% YoY in 2014. At the same time, costs (salaries and inflation) in the region have increased.

Santander is cautiously contemplating this acquisition possibility because HSBC has the highest worker-to-asset ratio of all private sector banks in Brazil – that would have to be taken into account when calculating the costs of sacking employees. HSBC has set aside some R$ 600 million in lieu to cover eventual labor claims, but potential bidders are worried would not be enough.

HSBC will probably select a “preferred bidder” in June and might raise up to US$ 4 billion. In addition to Santander, other possible bidders are Bradesco and Scotiabank.

5.4 – Itau-Unibanco US$ bond issue

On 19th May, Itau-Unibanco (Brazil’s second largest bank in assets) conducted a US$ one billion bond issue via its Grand Cayman branch. These bonds will ay an annual yield of 2.85%. Bank of America, Merrill Lynch and CitiGroup coordinated this bond issue. This was the second bond issue in foreign currency in 2015. Earlier this year, Votorantim Cimentos SA conducted a bond issue, but in euro-denominated bonds and raised US$ 564 million.

5.5 – Petrobras to issue debentures

In a filing on Friday, 15th May, Petrobras plans to issue up to R$ 3 billion (US$ 1 billion) in debentures on the local debt market “sometime” in 2015. In recent years, Petrobras has tapped international bond markets for tens of billions of dollars, often at interest rates below 5%. Current rates are now much higher in the local market where the current interbank rate is 13.13%.
Petrobras’ free cash flow continues to be deeply negative and has the biggest debt load of any major oil firm, and thus the possibility of the willingness of investors to loan even more money to this Brazilian state enterprise, at affordable interest rates remains “questionable”.

On 15th May, Petrobras stated that interest and amortizations on existing debt are expected to cost R$ 21 billion in 2015 with capital expenditures forecast at R$ 29 billion. On the other hand, the companies operations in 2015 are expected to generate only R$ 25 billion. The Lava Jato Petrolão corruption/bribery scandal has further damaged the firm’s credibility.

5.6 – Federal Revenues decline in April

On 21st May, the SRF announced that federal revenues had declined -4.6% in April YoY – the worst result in five years. Part of this problem is the high level of tax exemptions and incentives granted to certain economic sectors in an effort to stimulate the economy. In 2015, between January and April, the federal government “lost” R$ 38.3 billion due to these “stimuli”.

5.7 – Tax on bank profits increased

In an effort to raise more revenues, on 21st May, the government increased the tax on bank profits from 15% to 20%. This measure would affect all financial institutions – financial brokers, money changers, investment houses, home loan institutions, credit cooperatives and market brokers.

5.8 – April unemployment

On 21st May, IBGE reported the the rate of unemployment had reached 6.4% in April. The average wage of workers was down to R4 2.138,00 (-2.9% YoY).

5.9 – Moody`s downgraded Eletrobras

On 21st May, Moody`s Investors Service announced that it had downgraded Eletrobras to “junk bond” status (Baa3 ( Ba1). Moody’s considered the “reservations” made by KPMG regradint Eletrobras’ 1st Quarter 2015 financial statement, but especially fragile nature of its cash floow situation.

5.10 – Azul & Embraer sign agreement

On 21st May, Azul airlines signed a long-term agreement to acquire 50 Embraer planes (the 195-E2 model) for a total of US$ 3.2 billion. Azul currently uses 82 Embraer planes in Brazil.

5.11 - Azul & Avianca dispute TAP

Portugal is trying to sell off its state-owned airline – TAP – in order to improve its cash flow situation. Two Brazilian airlines are on the final "short list” competing to acquire TAP – Azul and Avianca.