Looking Ahead → What to watch for?

- **13th May** -- Brazilian Abolition Day (slaves freed 1888), not honored by Afro-Brazilians
- **15th May** -- Central Bank to announce March IBC-Br ➔ +0.% MoM
- **15th May** -- IBGE to announce retail sales for March ➔ % MoM & % YoY
- **15th May** -- IGP-10 ➔ 0.%
- **19th May** -- IBGE: IPCA-15 ➔ +0.% versus +0.% in April
- **20th May** -- Caged data ➔ new jobs created in April
- **21st May** -- IBGE: April unemployment ➔ %
- **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 Brasilia 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

1 - POLITICS

1.1 - Petrolão

The class action suits in NY courts have gained more “accused”. In addition to Petrobras, these suits now include 15 Brazilian banks operating in NY, including Banco do Brasil, Itaú BBA, Votorantim and Bradesco BBI – accused of misrepresentation in the Petrobras bond issues in NY.

Forbes Magazine downgraded Petrobras by 286 positions (30th ⇒ 416th) since its 2015 ranking. In 2012, Forbes ranked Petrobras 10th, 20th in 2013, and in 30th in 2014. Itau Unibanco has the best rating among Brazilian firms (42nd).

The CVM has open investigations regarding former members of the Petrobras Administrative Council (including Guido Mantega, the Council resident and BNDES President Luciano Coutinho) regarding whether they induced (erroneously) investors to buy the firm’s stocks and bonds. This is a similar line of investigation to that under way in NY courts and at the SEC.

The audio recording of the meeting of the Petrobras Administrative Council on 27th January 2015 clearly shows that Guido Mantega opposed the publication of the audit report prepared by Deloitte and the BNP Paribas bank that fixed Petrobras’ losses at R$ 88.6 billion and his “heated” discussion with then Petrobras CEO Graça Foster who argued that the markets should be fully informed. Her position contributed to her final “break” with Pres. Dilma and her sacking.

1.2 – Senate confirmation of Luiz Edson Fachin in doubt

After the approval of the PEC da Bengala ⇒ See Item 3.1 that severely limited Pres. Dilma’s appointment powers to Brazil’s higher level courts, attention is now turned to the Senate confirmation (or not) of Pres. Dilma’s recent (and last) appointment to the STF next week. An opinion issued by the Senate Research Service held that after Fachin was appointed to be a state prosecutor in Paraná he continued to practice Law – in violation of the state constitution. Also, because of his close ties with the PT in the 2010 and 2014 elections his confirmation is now in doubt. When it became apparent that finally Pres. Dilma was about to appoint a replacement for STF Judge Joaquim Barbosa who
resigned/retired in mid-2014, Senate President Renan Calheiros (PMDB-AL) stated flatly – “Any Dilma appointee to the STF with any linkage to the PT will be rejected by the Senate”.

**Detail:** In the 125 years of republican government in Brazil, only five appointees to the STF were rejected by the Senate ➔ ALL appointed by the second president Gen. Floriano Peixoto. In comparison, the 225 years of republican government in the US, only 12 appointees were rejected by the US Senate. These details are a recent (2014) publication by STF Judge Celso de Melo ➔ *Notas sobre Supremo Tribunal (Império e República).* Celso de Melo also identified six persons who refused presidential appointments to the STF.

### 1.3 – Ex-Senator Rodolpho Tourinho dead at age 73

On 7th May, former PFL Senator and ex- Minister of Mines & Energy, Rodolpho Tourinho Neto died at the Sírio-Libanês Hospital in SP. He was 73 and ha been in hospital since November 2014. The cause of death was not available.

Tourinho held a BA in Economics from USP and MA from Bradley University (USA). He occupied various political posts in the state of Bahia and ascended to political positions within the scheme of Antonio Carlos Magalhães (1927-2007) – State Finance Secretary (1991-1998). He was Minister of Mines & Energy during the second term of Pres. FH Cardoso (1999-2002). In early 2002, he left the Cardoso government when the PFL broke with FHC over the “trashing” of the presidential candidacy of then Gov. Roseana Sarney (PFL-MA). This episode was attributed to Ms. Sarney’s rival, José Serra (PSDB-SP).

In the 2002 elections, Senator Paulo Souto (PFL-BA) was elected Governor and Tourinho, as his first alternate, served as senator 2003-2006). In 2006, he ran for reelection but was defeated by João Durval (PDT-BA).

At that point, Rodolpho Tourinho left politics and returned to the private sector where he served as President of SINCICON and Adbib.

### 1.4 – PT propaganda hour *sans* Dilma

On Friday, 1st May (Labor Day national Holiday, for the first time since TV was introduced in Brazil in the 1950s, the President did not requisition a national radio/TV hookup to make a pronouncement to “the workers of Brazil”.

Again, on 6th May, the PT aired its propaganda hour on the prime time slot (8:30-9:30 pm) reserved by the TSE and Pres. Dilma decided not to participate. Apparently, the fear of provoking negative demonstrations and reactions motivated her decisions. The Opposition in larger cities has taken to “pot-beating/banging” from their apartment windows as a reaction tactic – that was quite pronounced on 6th May – despite the absence of Dilma. The main “TV stars” from the PT were former president Lula and the current PT national president Rui Falcão. The latter promised that any PT militant convicted and sentenced in court cases would be expelled from the party. Later the PT
explained that this would not be **retroactive** — that is, not included any of the convicted in the *mensalão* case — José Dirceu, José Genuino, João Paulo Cunha, Delúbio Soares, e Henrique Pizzolato.

**Want more?** Pres. Dilma was scheduled to participate in the 70 anniversary of VE-Day on 8th May in Rio de Janeiro, **but** her participation was canceled due to fear to large protest demonstrations

1.5 – Chamber approved part of fiscal adjustment

On 7th May, the Chamber of Deputies approved (by a slim margin of 25 votes, 252-to-227) the basic text of MP 665 that restricts (reduces) labor legislation benefits for Brazilian workers — as part of the Dilma 2.0 fiscal adjustment. Some deputies from parties in Dilma’s support base in Congress voted against this measure ➔ PMDB (13), PP (18), PTB (11), PSC and PRB (8 each). But the worst was the PDT — **ALL** 19 deputies voted against MP 665.

Thus, the other parties in Dilma’s support base are pressuring to replace Labor Minister Manoel Dias (PDT-SC) and appoint someone from another (more “loyal” party.

The Chamber still needs to deliberate MP 664 that restricts social security benefits for workers.

2 – FOREIGN RELATIONS & TRADE

2.1 – April trade surplus

Because 1st May was a national holiday, the April trade balance data was released on 4th May. For the second straight month Brazil posted a trade surplus ➔ +US$ 491 million. Exports were US$ 15.2 billion (-23.2% YoY) and imports were US$ 14.7 billion (-23.7% YoY). The Jan-April accumulation was a deficit of –US$ 5.066 billion.

2.2 – Italian court suspends Pizzolato extradition

On 6th May, the President of the Regional Administrative Court in Lácio, Italy — Luigi Tosti, suspended the extradition of Henrique Pizzolato, accused, convicted, and sentenced to 12 years and 7 months in prison (by the STF) for embezzlement of funds from the Banco do Brasil during the *mensalão* episode in 2003-2005). The full Administrative Court will decide [finally?] this case on 3rd June. Most thought that the appeals in this case had been exhausted by the decision by the Italian *Corte de Cassação* in favor of Pizzolato’s extradition that had already been determined by Government Minister Matteo Renzi. **However,** in EU countries, different from the Brazilian Judiciary, there exists a structure of Administrative Courts. **Stay tuned!!**

3 - REFORMS

3.1 – **PEC da Bengala**
On 7th May, Congress promulgated PEC (Constitutional Amendment) 457/05 nicknamed the “PEC of the Cane” that extends the mandatory retirement age for STF judges from age 70 to 75. If the STF judges who will reach the new mandatory retirement age before 31st December 2018 decide to remain on the Supreme Court and not retire, this will deprive Pres. Dilma from appointing any more judges before the end of her second term in office. This PEC also includes judges on the STJ, the TRFs and the TCU.

The “lighting quick” vote on this PEC caught the government leaders by surprise as they thought that it would only be voted on after the Chamber had deliberated the MPs on the agenda. Chamber President Eduardo Cunha (PMDB-RJ) surprised both government and opposition deputies by inverting the agenda and put this PEC to a vote on Wednesday, 6th May. The opposition parties joined the PMDB in favor of this PEC and the PT was against. The final vote was 333-to-144. The Senate had already approved this PEC (in 2005) and so it was promulgated straight away. PECs are not submitted to the President for approval.

One of the STF judges who soon reach the mandatory age of 70, Marco Aurélio Mello (who was appointed by his cousin, Pres. Fernando Collor de Mello) quipped that this PEC da Bengala was approved by Congress within a “climate of retaliation” against Pres. Dilma Rousseff.

Since she became President in January 2011, Dilma has appointed five STF judges – including UFPR law professor Luiz Edson Fachin who still needs Senate confirmation. Because of his many links with the PT (discovered by the Brazilian Press), it is quite possible that the Senate might reject his appointment ➔ the “retaliation” climate cited by Judge Mello. Mello and the STF “Dean” Celso de Melo affirmed that they hoped that Congress would extend the retirement age to 75 for ALL federal employees of the three branches of government – so as to remove the stigma of this “reform” being applied only to higher level federal courts. Sen. José Serra (PSDB-SP) has filed this proposal in the Senate. Initially, the focus of this PEC was to apply to judges and professors at federal universities.

The other three STF judges who will remain on the High Court through 2018 are – Ricardo Lewandowski (appointed by Lula), Teori Zavascki and Rosa Weber (both appointed by Dilma).

With the five-year extension, the five judges’ tenure would be:

- Celso de Melo: 2015 ➔ 2020
- Marco Aurélio de Mello: 2016 ➔ 2021
- Ricardo Lewandowski: 2018 ➔ 2023
- Teori Zavascki: 2018 ➔ 2023
- Rose Weber: 2018 ➔ 2023

With a certain “irony”, Senate President Renan Calheiros (PMDB-AL) affirmed that this PEC was well within the “fiscal adjustment” proposals of Dilma ➔ “This PEC will save some R$ 20 billion over the next five years, while this government is ‘extracting’ some R$ 18 billion by cutting working class benefits”. Calheiros added that “It is evident that Pres. Dilma has had her appointment powers reduced”. Pres. Dilma’s new Minister of Social Communication, Edinho Silva (PT-SP) stated that this was not a defeat for the government.

A critic of this PEC, Diego Werneck, professor of constitutional law at FGV-Rio, affirmed that the extension of the mandatory retirement age for judges tends to “fossilize” judicial ideas and
concessions. He cited the case of the German Constitutional Court that limits the mandates of its judges to 12 years and retirement at age 68. He cited examples where “out of date” judges contribute to institutional crises. FDR was elected US president in 1932 at the height of the Great Depression that his New Deal sought to reverse. Systematically, the US Supreme Court (with most conservative judges had been appointed in the early 20th century) found this emergency measures to be unconstitutional. In FDR’s reelection campaign in 1936, he proposed to “pack” the Supreme Court with additional judges to break this deadlock. This was not necessary because, suddenly, Judge Owen Roberts reversed his position and reversed the 5-4 majority in favor of the New Deal proposals.

**Detail:** It is possible that the judges who reach age 70 and want to continue until age 75 might have to be “re-confirmed” by the Senate.

**Want more?** Chamber President Dep. Eduardo Cunha (PMDB-RJ) is certain that the PGR Rodrigo Janot including him on the list of politicians who received “side payments” from the corruption/bribe scheme at Petrobras because Janot has a “personal quarrel” with him (Cunha). To this end, Cunha is preparing a new PEC that would limit the PGR (Chief Federal Prosecutor) to only one term in office and prohibit any continuation in that office. ➔ Stay tuned!!

### 3.2 – Labor relations for domestic workers

On 7th May, finally, Congress regulated the inclusion of domestic workers within Brazil’s labor legislation. The employer contribution to social security was reduced from 12% to 8%, and maintained the FGTS contribution at 8%. The other requirements are – a signed labor contract, 44-hour work week with one hour for lunch, a rest period of one hour per day, an extra 20% pay for work between 10 pm and 5 am, 50% for regular over time, 10% overtime for work on Sundays and holidays, and 30 days vacation per year.

This regulation provides domestic workers with the same labor rights as all other Brazilian workers. Over the past five years, the number of domestic workers has decreased – but in early 2015 the number of domestic workers has increased because of unemployment in other sectors and these new regulations have made this area more attractive. It is estimated that a domestic servant will cost 36% more after this regulation and the number of sacking for justifiable reasons should increase. .

### 4 – PRIVATIZATION & REGULATION

#### 4.1 – Concessions – Dilma wants a 4th airport included

Last week, Brazil Focus reported that three airports would be privatized via concessions in 2014 ➔ Salvador, Florianópolis and Proto Alegre. Apparently, Pres. Dilma wants to add a fourth airport to this list, either Fortaleza (6.5 million passengers) or Recife (7.2 million passengers). While Fortaleza recorded less takeoffs and landings in 2014 than Recife, it had more tons of air freight ➔ 37.4 million tons vs. 27.4 million tons.

**Detail:** These new concession auctions may have many foreign firms bidding and winning concessions – because Brazil’s large construction and engineering firms have been weakened by the
**Petrolão** corruption/bribery scandal – to the point that some concession holders are trying to sell off their stakes in concessions already granted – for example Engevix is selling its stake in the airports in Brasília and Natal to Corporación América for R$ 400 million.

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5 - ECONOMICS

5.1 – Inflation declined in April

On Friday, 8th May, IBGE released the IPCA data for April +0.71% -- the highest April result since +0.77% in 2011. In March 2015, the IPCA was +1.32% and in April 2014 at +0.67%. The 12-month accumulation is now +8.17%, considerably above the upper limit of the Central Bank’s annual inflation target +6.50%. Even worse, in 2015, the accumulation is now +4.56% – above the Central Bank’s target of +4.50%. This result means that Copom will probably continue its increases in the Selic rate at its next 2-3 June meeting.

This April IPCA result was below the median estimate (+0.75%) by 41 economists surveyed by Bloomberg News.

5.2 - Unemployment

On 7th May, IBGE announced that unemployment in 1st Q/2015 had reached 7.9% (7,934,000 persons seeking employment in Brazil). This is the highest first quarter unemployment rate since 2013. In 4th Q/2014, the rate was 6.5%, indicating a rapid increase in 2015 – with more people seeking employment and a smaller new job creation rate. In 1st Q 2014, the rate was 7.2%. The highest rate was in Rio Grande do Norte (11.5%), and the lowest was in Santa Catarina (3.9%).

5.3 – Auto production declines

On 7th May, Anfavea announced that auto production had declined by -21.7% YoY in April. This was the worst April result since 2007 due to sharply declining domestic sales and reduced exports, especially to Argentina. In April, 217,100 units were produced vs. 211,147 units in April 2007. In the Jan-April 2015 period, 881,800 units were produced (-17.5% YoY).

In spite of decreased production, stocks of unsold new cars increased reaching 367,200 units vs. 360,400 units in March. This contraction has caused sackings at some auto plants and collective vacation for employees at other installations.
Fenabrave announced that in the January-April period of 2015, 250 auto retail stores had been closed and 12,000 employees sacked. On 1st Jan. 2015, Brazil had 8,000 auto retail stores with 411,000 employees.

The production of trucks in April was down -44.3% YoY – an important indicator of the confidence of business leaders to invest.

Argentine auto assembly plants are now importing parts and components from China rather than from Brazil. Brazil is negotiating the continuation of the auto accord with Argentina. Within Mercosur rules, for autos to be sold within Mercosur without and taxation, the parts and components must be 60% produced within the Mercosur “free trade” zone.

In addition to a certain “flexibilization” of the auto sector rules, Argentina also wants BNDES to liberate a US$ 1.5 billion loan to construct a tunnel for the rail link between Haedo and B. Aires. This project is to be implemented by Odebrecht and should have begun in 2012. This project is very important for the Argentine government in this pre-election period.

5.4 - Industrial production down in March

On 6th May, IBGE announced that IP had retracted by -0.8% MoM and -3.5% YoY. This was the worst decline for March since 2006. The January→February IP declined by -1.3%. The 12-month decline of IP now stands at -4.7%. In January 2010, the 12-month decline was -4.8%. This negative result is attributed to a lack of confidence in Dilma 2.0 by investors as well as consumers, with reductions in domestic demand, an accumulation of stocks and a weak international demand. After posting positive growth between January and May 2014, IP began a continuous decline as of June 2014. See→ http://www1.folha.uol.com.br/mercado/218452-industria-encolhe-59-no-1-tri-e-tem-pior-inicio-de-ano-desde-2009.shtml

→ See Item 5.2

5.5 – Moody’s “Crossover Zone”

The Brazilian economy is in a progressive downward slump complicated by the Petrolão scandal that has tarnished some large construction firms involved in the Petrobras corruption/kickback scandal.

Moody’s Investors Service published a recent report that highlighted the so-called “Crossover Zone” – where firms rated at Baa3 (the lowest investment grade with a negative outlook or on review for a downgrade to Ba1 (the highest speculative rating – junk bond status) → potential “fallen angels”. Also included in this “Crossover Zone” are firms rated Ba1 with a positive outlook or on review for an upgrade).
Brazil's potential fallen angels illustrate the economy's fall from grace

The Moody’s report states that “We downgraded 10 Brazilian corporates in 1st Q/2015 with no upgrades. Corruption allegations and the consequent tighter liquidity... were directly or indirectly responsible for five downgrades. The balance were related to lower commodity prices and company specific operating challenges amid a worsening economy, rising inflation, corruption scandals, growing unrest and even threats of water and energy rationing. There are nine issuers with negative outlooks, which could result in further downgrades over the next 12-18 months.”
See ➔http://www.ft.com/intl/cms/s/0/d5af17de-f3de-11e4-99de-00144feab7de.html#axzz3ZVj85Ilv