*Brazil Focus –*

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*Weekly Report –*
July 11-17 2015

**Looking Ahead → What to watch for?**

- 20<sup>st</sup> July -- US & Cuba to open respective embassies
- 21<sup>st</sup> July -- CNI → Industrial Employment in June, points *vs.* points in May
- 22<sup>nd</sup> July -- SRF → June tax collections R$ billion, +0.% YoY
- 22<sup>nd</sup> July -- IBGE to release July ICPA-15 inflation data → +0.% *versus* +0.% in June
- 24<sup>th</sup> July -- HDI → Brazil ranked ___ with score of ___
- 24<sup>th</sup> July -- IBGE to release unemployment data for June
- 28-29 July -- 192<sup>nd</sup> Meeting of Copom → Selic rate
- 30<sup>th</sup> July -- June public accounts
- 30<sup>th</sup> July -- FGV to announce July IGP-M → % *versus* % in June
- 31<sup>st</sup> July -- Congressional Recess ends [“officially”]
- 1<sup>st</sup> Aug. -- Congress begins 2<sup>nd</sup> semester sessions
- 1<sup>st</sup> Aug. -- Executive Branch transmits detailed 2016 Budget (LOA) to Congress
- 3<sup>rd</sup> Aug. -- July trade surplus → +US$ billion *vs.* +US$ billion in June
• 3rd Aug. -- IBGE ➔ June Industrial Production data ➔ % MoM & % YoY
• 3rd Aug. -- Anfavea, July auto sales ➔ units, vs. units in July 2015
• 5th Aug. -- FGV to release IGP-DI inflation for July ➔ +0% versus +0% in June
• 6th Aug. -- TSE to air PT’s 20 minute TV propaganda
• 7th Aug. -- IBGE to announce July IPCA ➔ +0% versus +0% in July 2015
• 7th Aug. -- IBGE to announce June Industrial Production ➔
• 14th Aug. -- IBGE to release June retail sales data ➔ -0.0% MoM
• 15th Aug. -- Central Bank, June IBC-Br ➔ % MoM & % YoY

1 - POLITICS

1.1 – Lava Jato - Eduardo Cunha, formal break with Pres. Dilma

On Friday morning, 17th July, the Chamber President Eduardo Cunha (PMDB-RJ) announced his formal break [rompimento] with the Dilma government. In his public statement, he confirmed that this was a “personal decision” and did not (so far) involve his (PMDB) party. BUT – he added that at the next PMDB national conclave (in September), he would propose that the party abandon the Dilma government. Such a decision by the PMDB would be very difficult because that would mean that all the PMDB cabinet ministers would have to resign as well as and the PMDB militants who occupy posts in the 2nd, 3rd, and 4th echelons of her government.

The only party that ever made such a move was the PFL in March 2002, when the party concluded that the presidential candidacy of then Gov. Roseana Sarney (PFL-MA) had been “torpedoed” by José Serra (PSDB-SP) who allegedly had “induced” the Federal Police to invade the offices of her husband Jorge Murad in São Luiz on 1st March 2002 where they encountered R$ 1.3 million in cash (campaign slush fund). The police piled this cash up on a table and the photo was flashed all over Brazil (TV, press, magazines). The PFL was very cohesive and had good party discipline so ALL its cabinet ministers and other federal appointees resigned and the PFL formally broke with the Cardoso government. In part, this episode contributed to the defeat of PSDB presidential candidate by Lula (PT) in October 2002. Roseana Sarney was elected PFL senator from Maranhão.

Cunha was enraged! He was accused by Julio Camargo in his plea bargaining testimony of receiving a US$ 5 million bribe linked to the petróleo scheme because of “good services” rendered in Congress in favor of several of the Lava Jato construction firms. Cunha alleged that Camargo had modified his testimony under pressure from the PGR – Rodrigo Janot – and that this was part of a “scheme” to enhance Janot’s re-appointment at PGR – articulated by Pres. Dilma. See ➔ http://noticias.uol.com.br/politica/ultimas-noticias/2015/07/17/eduardo-cunha-rompe-com-o-governo.htm

However, Eduardo Cunha is already “on the hook”, as it were, at the STF where the PGR has already filed a case against him and some other 30 politicians allegedly involved in the Lava Jato bribe/corruption episode. IF the Supreme Court accepts the PGR case and installs a formal process against Cunha, he would be temporarily suspended from his post at President of the Chamber.
Cunha anticipated his “damage control” operation earlier this week by requesting a national TV hookup earlier this week to detail his performance during his six-month tenure as Chamber President (February-July 2015) – that was aired at 8:25 p.m. on 17th July. However, this five-minute program did not contain any aggressive attacks on the PGR, the Federal Police and Prosecutors or Federal Judge Sérgio Moro. Rather, Cunha presented all the achievements that were voted on (approved) by the Chamber in the first semester. On 17th July, in retaliation, Cunha created a CPI to investigate BNDES. See ➔ [http://g1.globo.com/politica/noticia/2015/07/eduardo-cunha-faz-pronunciamento-em-rede-nacional-de-tv-e-radio.html](http://g1.globo.com/politica/noticia/2015/07/eduardo-cunha-faz-pronunciamento-em-rede-nacional-de-tv-e-radio.html)

After Eduardo Cunha broke off with the Dilma government, Senate President Renan Calheiros (PMDB-AL) canceled (suspended?) his TV hookup to review his first semester performance as

1.2 – Lula investigated [finally]

After a certain period of gathering evidence and documents (proof) regarding ex-president Lula’s “activities” in coordination with several large Brazilian construction firms (the same ones involved in the Petrolão scheme) – Odebrecht, OAS, Camargo Correa and Andrade Gutierrez – seeking confirmation of construction contracts (via BNDES loans) in 14 countries in Latin America and seven nations in Africa plus Portugal – federal prosecutors in Brasília (MPF-DF) opened a formal criminal investigation of Lula’s activities, called “influence trafficking” by the prosecutors.

Lula traveled on corporate jets accompanied by executives of these firms the nations mentioned above in order to “convince” each respective government to accept the contract with the “designated” Brazilian firm. Influence trafficking is detailed as a crime in Brazil’s penal code with prison terms of up to five years.

Federal prosecutors requested information and documents from the MRE (Itamaraty) regarding Lula’s visits between 2011 and 2014 – including telegrams/cables to and from the respective Brazilian embassies. In a vain effort, a MRE employee tried a “cover up” by having all these documents declared “secret”, but only aggravated the situation even further.

1.3 – New Ibope Poll

Ibope conducted a poll on 13-17 June among 2,002 voters in 142 municípios with a two-point margin of error. The focus of this poll was a simulation of the second round presidential election in 2018.

Sen. Aécio Neves (PSDB-MG) the simulation against Lula 48% vs. 33%, with 15% blank-null and 3% DK/NR. Considering only the “valid vote”, Aécio would have an absolute majority on 59% vs. 41%. In the June Datafolha poll, Aécio surpassed Lula by 35% vs. 25%.

<table>
<thead>
<tr>
<th>Candidate</th>
<th>Total</th>
<th>Gender</th>
<th>Age</th>
<th>Salary in Minimum Wages</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Men</td>
<td>Women</td>
<td>16-24</td>
</tr>
<tr>
<td>Aécio</td>
<td>59%</td>
<td>62%</td>
<td>57%</td>
<td>60%</td>
</tr>
</tbody>
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### Lula

<table>
<thead>
<tr>
<th>Candidate</th>
<th>4-8</th>
<th>5-8</th>
<th>Hi Sch</th>
<th>College</th>
<th>NE</th>
<th>N/CO</th>
<th>SE</th>
<th>South</th>
</tr>
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<tbody>
<tr>
<td>Aécio</td>
<td>59%</td>
<td>47%</td>
<td>55%</td>
<td>67%</td>
<td>42%</td>
<td>59%</td>
<td>65%</td>
<td>71%</td>
</tr>
<tr>
<td>Lula</td>
<td>41%</td>
<td>53%</td>
<td>45%</td>
<td>33%</td>
<td>58%</td>
<td>41%</td>
<td>35%</td>
<td>29%</td>
</tr>
</tbody>
</table>

Lula would only surpass Aécio in the lowest income and education levels, and in the Northeast region. This result reflects the “remnants” of the *Bolsa Família* program in the Northeast and that still has political impact on voters in the lower education and income brackets.

With Gov. Geraldo Alckmin as the PSDB candidate, he would win by a much closer margin against Lula – 40% vs. 39% (a technical tie) with 17% blank-null and 4% DK/NR. None-the-less, Gov. Alckmin is “discretely” articulating his public policies in SP to promote his 2018 candidacy.

It is possible that in 2018 Marina Silva might again become a presidential candidate – but there are no “major” potential candidates from other political parties on the horizon in 2015. However, the PMDB vows that it will have a presidential candidate in 2018.

### 1.4 – *Operation Politeia*

Early Tuesday morning, 14th July (Bastille Day), the Federal Police carried out 53 “search-and-seize” warrants (in DF, BA, PE, AL, SC, RJ and SP) issued by the STF against politicians of several parties in an effort to secure evidence (documents) before they were destroyed) and certain physical assets – in a new phase of the *Lava Jato* investigation. Among the politicians targeted were: Sen. Fernando Collor (PTB-AL), Sen. Ciro Nogueira (PP-PI) – national president of the PP – federal deputy Eduardo da Fonte (PP-PE), Sen. Fernando Bezerra (PSB-PE), and former minister Mário Negromonte (PP-BA).


This “search-and-seize” operation involved the seizure of property that might have been acquired via illicit funds from corruption. At Senator Collor’s house in Brasília (*Casa da Dinda* in the Lago Norte neighborhood, the Federal Police seized three luxury automobiles ➔ a Porsche (R$ 999,000,00), a Ferrari (R$ 1.5 million) and a Lamborghini (R$ 3 million). These autos were not declared on Collor’s income tax returns – because they were registered businesses. However, the press quickly discovered that these cars had accumulated a large “debt” (R$ 343,000,00) in unpaid annual registration fees (IPVA). In addition to these “luxury cars”, the Federal Police also confiscated R$ 4 million in cash.

One of the persons convicted in the *mensalão* case, former PP staffer João Claudio Genu, was on the “search-and-seize” list. The Federal Police encountered some R$ 100,000,00 in cash at his home
in Brasília. Apparently, he was again involved in the distribution of *Petrolão* bribery funds to members of the PP. In 2012, he was convicted at the STF but appealed and was absolved in 2014.

Anticipating that he might be the next name on the Federal Police “search-and-seize” list, Chamber President Eduardo Cunha (PMDB-RJ) reacted with a dose of humor – “The door of my home is always open; but please don’t come before 6 a.m.”.

**Why Collor?** Because Sen. Fernando Collor (PTB-AL) had “indicated” two key executives at BR Distribuidora between 2009 and 2013 → José Zonis and Luiz Claudio Sanches whose locked office doors at the Petrobras building in Rio were kicked open by Federal Police agents. *Doleiro* Alberto Yousseff testified that Zonis and Sanches had channeled R$ 3 million to Collor. Also, Ricardo Pessoa (UTC) testified that Pedro Paulo Leoni Ramos was the go-between who channeled R$ 20 million to Collor. When the Federal Police invaded the offices of Aster Petróleo in SP (owner Carlos Alberto Santiago) they discovered R$ 3.67 million, US$ 45,600.00 and 24,500 euros -- in cash. Santiago is accused to paying bribes to Collor for access to BR Distribuidora decisions.


Senate President Renan Calheiros (PMDB-AL) attacked this Federal Police operation as violating the Senate’s prerogatives because the apartments occupied by the targeted senators are the property of the Senate [functional apartments].

**A Cartoon by Chico**

![Cartoon](https://www.washingtonpost.com/world/the_americas/brazils-president-says-im-not-guilty-but-even-allies-wonder-if-she-can-survive/2015/07/15/44177414-24ca-11e5-b621-b55e495e9b78_story.html)

“*In that no man’s land…..*”

Renan Calheiros & Fernando Collor “What country is this?” Renato Duque “The country I don’t know, but the phrase is mine”. Francelino Pereira “Beg your pardon, the phrase is mine”.

Tiago Cedraz – was one of the 53 names on the *Operation Politéia* list. The Federal Police did a “search-and-seize” at his home and law office. *Why?* His father former deputy Aroldo Cedraz is the current President of the TCU (external control) and in his plea bargaining Ricardo Pessoa testified
that he had paid Tiago Cedraz R$ 1 million to facilitate a positive decision by TCU minister Raimundo Carrero regarding UTC’s contract in the Angra III nuclear power construction. Also, Tiago received a “monthly allowance” to articulate positive decisions by the TCU. If Aroldo Cedraz has any self-respect, these revelations should have been enough for him to resign from the TCU because of this severe “conflict of interest”. Also investigated by the Federal Police is Luciano Araujo, a partner in the same law firm “consultancy” as Tiago Cedraz. Luciano is a first cousin of Aroldo Cedraz and is national treasurer of the Solidariedade party (SD).

In his “short” career, Tiago Cedraz (age 33) has reportedly accumulated R$ 13 million in real estate holdings.

Stay tuned ➔ This Operation Politéia will probably impact negatively on the approval of PGR Rodrigo Janot for a second term in August. First, whether Pres. Dilma will reappoint him, and second whether the Senate will confirm him on a secret vote.

1.5 – The Anti-Dilma plot “thickens”

On Tuesday, 14th July, the FSP revealed that on 9th July, Chamber President Eduardo Cunha (PMDB-RJ) hosted a “working breakfast” for STF judge Gilmar Mendes and Dep. Paulinho da Força (SD-SP) where various scenarios of the current political crisis were discussed – including the impeachment of Pres. Dilma Rousseff. However, apparently there is another strategy to weaken and possibly destroy the PT by the 2018 elections ➔ let Dilma remain “dangling and bleeding in the wind” with continuing investigations on several fronts that increasingly reduce her Presidential powers and prerogatives. This was the strategy used against Gov. Olívio Dutra (PT-RS) in 1999-2002 – the state assembly had enough evidence to impeach him but instead allowed him to remain in office “dangling in the wind”, a strategy that insured his defeat (for reelection) in 2002. See ➔ http://www1.folha.uol.com.br/fsp/mundo/226055-so-ps-opera-em-hospitais-do-brasil-no-haiti.shtml

Want more?? Chamber President Eduardo Cunha (PMDB-RJ) requisitioned via TSE a block of TV time as of 8:25 p.m. on Friday, 17th July to “report on” (evaluate, review) on his first six months as President of the Lower House. Reportedly, this “presentation” will be filled with criticism of the PT and Pres. Dilma – and praise of the Legislature for occupying the “space left vacant” by an inoperative President.

1.6 – Rosinha Garotinho cassada

On 16th July, a RJ election judge removed the Mayor of Campos, RJ, Rosinha Garotinho (PR) and her Vice-Mayor Dr. Chicão (PP) from office (cassação). In 2012, during their reelection campaign, Rosinha authorized the hiring of an additional 1,166 municipal employees on 7th July 2012 after the cutoff date (4th July) for this procedure. They now will appeal to the TRE-RJ – the regional electoral court in the state of Rio.

Roinsinha and Anthony Garotinho have been active in politics in Campos and the state of Rio since he was elected PDT Mayor in 1988 and 1996. In 1998, he was elected governor and in 2002 he switched to the PSB and ran for President (placed third). He was elected PR federal deputy in 1n 2010 and ran for governor in 2014.
Ms. Garotinho was elected Governor in 2002 and then Mayor of Campos, RJ in 2008 and 2012. Their daughter, Clarissa, was elected to the Rio city council in 2008 and state deputy in 2010.

2 – FOREIGN RELATIONS & TRADE

2.1 – 48th Mercosur Summit met in Brasília

The five permanent members of Mercosur (Brazil, Argentina, Uruguay, Paraguay and Venezuela) met in Brasília on 16-17 July. The seven “associate” members (Chile, Peru, Bolivia, Ecuador, Colombia, Suriname and Guyana) were also present. The rotational presidency of Mercosur passed to Paraguay until the next meeting on 10-11 December when Argentina will assume the Mercosur presidency. It was thought that this Mercosur Summit would approve Bolivia as a full member, but not this time.

2.2 – Moody’s in Brasília

The Moody’s evaluation team visited Brasília on 15-16-17 July to meet with the Finance Minister, the Central Bank, the STN and the SRF. In March, S&P and Fitch also visited Brasília. In September 2014, just before the general elections in October, Moody’s reduced Brazil’s perspective from stable to negative but maintained the risk rating as investment grade”. S&P maintains Brazil at “BBB-” – one notch above “junk bond” status, but in March also reduced its perspective from stable to negative. Moody’s current risk rating for Brazil is “Baa2” – two notches above “junk bond” status.

Moody’s is looking at three basic questions 1) Deceleration of the economy; 2) Reduction of investments; and 3) Deterioration of the fiscal scenario. Many specialists and consultancies feel that a Moody’s downgrade is “eminent”.

The “events” this week in Brasília probably will have a negative impact on Moody’s evaluation. See http://oglobo.globo.com/opiniao/a-um-passo-do-rebaixamento-16794781

3 - REFORMS

3.1 – New municípios?

On 15th July, the Senate delivered yet another “defeat” for Pres. Dilma Rousseff the approval of a measure that would allow the creation [emancipação] of up to 200 new municípios to be dismembered from current municípios. Similar measures have been approved and vetoed by Pres. Dilma in 2013 and 2014. In 2014, the government estimated that the creation of new towns would cost
an additional R$ 9 billion via the FPM (Fundo de Participação dos Municipios) – federal revenue sharing.

4 – PRIVATIZATION & REGULATION

Nothing this week.

5 - ECONOMICS

5.1 – May retail sales down

On 14th July, IBGE released data on retail sales in May. In spite of Mother’s Day, sales were down by -4.5% YoY – the worst decline since 2003. Hyper-market sales were down -2.1% and products directly linked to Mother’s Day, such as textiles, clothes and shoes were also down by -2.1%. The 12-month accumulation was -0.5% versus +4.9% in May 2014. These results show the results of a deepening recession in 2015. This 12-month negative accumulation is the first in eleven years.

5.2 – Consumer default increased in June

According to the CNDI and the SPC, the number of consumers in default increased by +4.52% YoY in June. The six-month accumulation through June was +5.02%. In June 2015, 56.5 million consumers were registered as in default at the SPC. This reflects the deepening recession in 2015 and is one of the reasons for the decline in retail sales (See Item 5.1 above).

5.3 – Federal revenues down in June

On 14th June, the SRF released data on federal tax collections in June → R$92.374 billion (-6.9% YoY). The 2015 accumulated total (Jan-June) was R$609.868 billion (-4.6% YoY). This retraction in federal revenues together with the difficulties of the Dilma government to approve the fiscal austerity readjustment means that achieving the fiscal surplus target in 2015 (+1.1% of GDP) will be extremely difficult. (See Item. 2.2)

Based on this 1st semester decline in revenue collections, the SRF recalculated its estimate for Brazil’s GDP in 2015 → a -1.5% retraction. However, leaders in the Dilma government consider that the retraction might reach -2.0%.

Want more? IF the Fed increases the basic interest rate in the US, this will add another negative component to Brazil’s attempts at fiscal austerity readjustments.

5.4 – Fiscal adjustment

TWO proposals are being discussed → 1) a reform of Brazil’s sales tax (ICMS) system; and 2)
The repatriation of funds held (laundered) overseas by Brazilian citizens. The latter scheme would involve only funds from “licit” sources and would pay a flat 35% income tax. It is estimated that this “repatriation” might yield some R$ 150 billion in taxes and recover up to US$ 400 billion.

In a “disparate” effort to promote the fiscal adjustment, the government decided to sell some R$ 2.5 billion in Banco do Brasil shares held by Brazil’s Sovereign Wealth Fund. Also, the Finance Ministry is trying to approve legislation to facilitate the “repatriation” of “legal” funds held by Brazilians overseas – via payment of a flat 35% income tax.

On 17th July, it was revealed that the primary surplus in the first semester of 2015 is zero – decreasing federal revenues and increasing federal expenditures. Thus, the 2015 primary surplus “target” will have to be achieved in the second semester.

5.5 – Industrial employment

On 17th July, IBGE released industrial employment data for May down by -1.0% MoM (versus April) and -5.8% YoY. This was the largest MoM decline since January 2009 (-1.3%) following the Wall Street blowout in October 2008.

5.6 – IBC-Br “stagnant” in May

On 17th July, the Central Bank announced its Index of Economic Activity (IBC-Br) for May +0.03% -- practically stagnant. However, this result was an improvement since the negative result of -0.88% in April. This index now accumulates -2.64% in 2015 (January-May). But compared with May 2014, the result was -3.08% YoY. The IBC-Br is seen as a “preview” for Brazil’s GDP result.

5.7 – Caged – 111,199 jobs lost in June

On Friday afternoon, 17th July, the Ministry of Labor announced the Caged employment results for the month of June. On balance, 111,199 jobs were lost – economists had predicted 102,000 lost jobs. This was the worst result for the month of June since this index was created in 1992 and quite similar to the 115,599 jobs lost in May. The Labor Ministry blamed the Services sector for this negative result. The accumulated result for the first semester was 345,517 jobs lost.