Brazil Focus – 
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Weekly Report –
Sept. 05-11 2015

Looking Ahead ➔ What to watch for?

- 14th Sept. -- IBGE to announce retail sales data for July, % MoM,
- 14th Sept. -- Central Bank ➔ IBC-Br (index of economic activity) for July, % MoM
- 14th Sept. -- IBGE to release PNAD (National Sample of Households) report
- 18th Sept. -- IBGE to post IPCA-15 ➔ +% vs +% in August
- 19th Sept. -- State Holiday in Rio Grande do Sul [Farroupilha Day]
- 23-24 Sept. -- Pres. Dilma to attend the 70th UN General Assembly session
- 23 Sept. -- SRF to announce tax collections in August ➔ R$ billion, +% YoY
- 25th Sept. -- IBGE to announce August unemployment ➔ %
- 29th Sept. -- Public Accounts data for August
- 29th Sept. -- FGV to post September IGP-M ➔ % versus % in August
- 30th Sept. -- August Industrial Growth ➔ % MoM & % YoY
- 1st Oct. -- Trade Balance for September ➔ US$ billion ( % YoY)
- 5th Oct. -- Auto production in September, units sold
1 - POLITICS

1.1 – S&P downgraded Brazil to “junk bond” status

Shortly after 6 p.m. NY time [markets closed], on 9th Sept., Standard & Poor’s downgraded Brazil from “BBB-” to “BB+” from the last investment grade category to “speculative, junk bond” status – with a negative outlook, which means that S&P might further downgrade Brazil yet another notch (to “BB”) “soon”. S&P said that the chances of a second downgrade are “one-in-three”.

After much effort, Brazil finally achieved “Investment Grade” by S&P on 30th April 2008, some six months before the Wall Street implosion later that year. One month later, on 29th May 2008, Fitch followed suit and upgraded Brazil to “investment grade”. Finally, over one year later, on 22nd September 2009 [nearly one year after the Wall Street “blowout”], Moody’s granted investment grade to Brazil. Again, in 2015, S&P took the lead in downgrading Brazil to “speculative” grade. Most assume that by the end of 2015 the other agencies will follow suit.

Regarding the other two risk evaluation agencies, Fitch rates Brazil at “BBB” – two notches above “junk” grade with a negative outlook. This “BBB” grade has been maintained since April 2011. Moody’s: On Wednesday (before the S&P down grade was announced) Moody’s Vice-President for Communications Eduardo Barker affirmed that Moody’s might revise its evaluation of Brazil “within 12 months” – unless some “abrupt major change” were to occur. On 11th August 2015, Moody’s downgraded Brazil from “Baa2” to “Baa3” (the last notch of investment grade) but kept its outlook at “stable”.

S&P commented – “We find that the ongoing investigations of corruption allegations against high-profile individuals and companies – in both the private and public sectors and across political parties – have led to increased near-term political uncertainty. We continue to believe that economic weakness exacerbates execution risk. We now expect the contraction in real GDP to be deeper and longer.” Managing Director on the S&P sovereign ratings team, Lisa Schineller said “The budget that was tabled last week, in our view, signaled a change”.

Photo: Shannon Stapleton/Reuters
Lisa Schineller, S&P Director in the Sovereign Ratings

The principal reasons for this downgrade ➔ 1) the government presented a 2016 budget proposal with a R$ 30.5 billion deficit - after revising (down) the primary surplus target (twice); 2) a total lack of cohesion among government policy makers; and 3) the inability of the government and Congress to enact fiscal austerity measures.

Brazil’s largest US exchange-traded fund declined by 6.6% in after hours trading along with ADRs for Petrobras. Apparently, the “tipping point” for S&P was the government submission of the 2016 budget proposal on 31st August with a R$ 30.5 billion deficit – for the first time ever. This with the conflicting statements from members of Dilma’s economic team and Vice-President Michel Temer showed complicated discord and Dilma’s unwillingness to cut expenditures. Any tax increases on the private sector (consumers and firms) should provoke very strong reactions and drive her already low (7%) approval rating down even further. With Congress refusing to make the expenditure cuts, the “hot potato” was tossed back to the Executive Branch.

S&P was quite explicit ➔ Brazil’s debt will increase because the nominal deficit will reach 8% in 2015 and 2016; Brazil’s GDP will retract -2.5% in 2015 and -0.5% in 2016; and the average deficit in the four-year period (2014-2017 with by -7% ➔ a very disastrous prediction.

Want more? “The Day After” S&P struck again and downgraded Petrobras to “junk bond” status on 10th September. This downgrade was expected because it has surpassed its debt limits, but the risk agencies preferred to “wait and see”. S&P “saw too much”, decided to wait no more, and downgraded Petrobras. Thus, the situation of the petrol giant was already “bad” is now even worse – especially with the accelerating FX dollar rate. Thirty other Brazilian firms were also downgraded – 24 of the latter into “junk bond” status – including Eletrobras and Itaipu Bi-national.

Even more? On Thursday evening, 10th September, S&P downgraded 13 Brazilian banks and 20 financial institutions. Eleven banks lost their “investment grade” rating – including Banco do Brasil, Itau-Unibanco, Bradesco, CEF, Citibank, Banco Santander and BNDES.

Petrobras affirmed that its financial goals had already been achieved, BUT at the same time announced salary reductions (25% and work week (to 30 hours) – plus reductions in overtime hours.

With this large group of firms and banks downgraded to “junk bond” status, the wrath of the private sector against Pres. Dilma will certainly increase. It might be said that “Pres. Dilma Rousseff was impeached by S&P”!!

From Argentina – Lula said that the downgrade by S&P “doesn’t mean anything at all”. He added – “They [the risk agencies] want us to do what they want ➔ the ‘recipe’ is more tightening up,
more fiscal adjustment, more unemployment and more expenditure cuts”. He quipped that “The
countries in Europe are all ‘broke’ with large deficits, but they were not downgraded”. Detail: Lula
conveniently “forgot” the situation of his hosts – in July 2014, S&P downgraded Argentina to “selective
default” SD status – much worse that any European country – including Greece (“CCC-”).

*The Economist* headline on 10th September read “Brazil Junked” with a rhetorical byline “The

### 1.1.1 – Consequences?

In a late night interview, Finance Minister Joaquim Levy affirmed that the government was
elaborating a series of expenditure cuts and revenue increases to balance the 2016 budget proposal. 
Pres. Dilma said that this downgrade was not “catastrophic”. On Thursday morning, 9th September, 
Pres. Dilma convoked an emergency meeting of the economic team and political council. The result
was a series of “platitude statements/promises” but no concrete measures (to be announced next
week). The press called this response “improvisation”.

The road back to investment grade may be long and treacherous. For example, Colombia was
downgraded in 1999, and only returned to investment grade in 2011. Uruguay was downgraded in 2002
amidst the Argentine crisis and only recovered investment grade in 2011. Former Brazilian Finance
Minister, Maílson da Nóbrega affirmed that it will take at least ten years for Brazil to recover
investment grade.

On 11th September, the press announced that the President would replace Aloísio Mercadante as
Casa Civil Chief with someone “not from the PT”. The consensus is/was that he was responsible for
the imposition of the R$ 30.5 billion deficit in the 2016 budget proposal transmitted to Congress on 31st
August – in an attempt to throw this “hot potato” on to the lap of Congress to force the legislature to
make the necessary expenditure cuts and tax increases. Detail: This was considered “the last straw” by
S&P and precipitated the downgrade on 9th September. Several times, Lula has warned Dilma about
Mercadante impeding the smooth operation of her government and its relations with Congress – and
suggested that she appoint him to be “Ambassador to India” to get him out of Brasília.

Some considered this to be a “stroke of genius” if an experienced politician from the PMDB
were appointed to the Casa Civil – as this would impede the PMDB from joining the “impeachment
coalition”. However, other analysts saw the contrary – this would strengthen even more the PMDB’s
quest for impeachment of Dilma and her replacement by Vice-President Michel Temer (PMDB).

**Borrowing costs** – for the government and private firms will increase and some “hot money”
is exiting Brazil. If (and when) the FED increases the basic US interest rate, the outflow of dollars will
become a “stampede”. When Fitch or Moody’s downgrade Brazil, this will inhibit certain investment
funds will be prohibited from investing in Brazil and will also exit.

**Values** ➔ The face value of Brazilian firms will decline, favoring mergers and acquisitions. New
IPOs will no longer be viable – according to Edmir Pinto, President of BM&F and Bovespa.
1.2 – Independence Day in Brasília

Brazil gained its “independence” from Portugal in 7th September 1822 via a “family arrangement”. The then “Regent” for Brazil – Dom Pedro I – declared Brazil’s independence from Portugal (his father, Dom João VI, was still king at that time) with the famous “Grito do Ipiranga” (“The shout from the bank of the Ipiranga (small) River in SP). Immediately, the new Brazilian monarch contracted a large loan from Rothschild’s in London to “compensate” Portugal’s loss of its former colony – a “family deal”. Thus began Brazil’s eternal foreign debt problem.

Currently, this is Brazil primary “civic holiday”. The other civic holiday is 15th November that marks the declaration of the Republic in 1889, ending the monarchy. This is more a civic-military holiday because the Army deposed Dom Pedro II and installed the Republic.

Traditionally, the Brazilian President addresses the nation on a radio/TV hookup to commemorate these dates. However, in 2015, any such TV address by Pres. Dilma has been met by massive “pot-banging” in most large cities – to the point that she did not make the traditional Labor Day address to the nation on TV on 1st May. She did the same on 7th September 2015 – no TV address.

However, she did appear in the reviewing stand for the traditional civic-military parade on the Esplanade of [Cabinet] Ministries together with Vice-President Michel Temer (PMDB), the Governor of Brasília Rodrigo Rollemberg (PSB) and several cabinet ministers. Detail: Of the SIX PMDB cabinet ministers, only ONE appeared.

Because it was anticipated that the crowd watching this ceremony (parade) would jeer and boo the President, a tall metallic wall (barrier) was erected in front of the President’s reviewing stand.

![Photo: André Dusek/Ag. Estado](image)

However, the police detachment did not impede the anti-Dilma militants from displaying two large inflated figures – of Lula in prisoner’s clothes, and Pres. Dilma with a long “Pinocchio Nose”.

![The metal wall erected to “protect” President Dilma – 7 Sept. 2015](image)
1.3 – Dilma government provokes military crisis

If it weren’t enough to have GIANT economic and political crises (complicated by the S& P downgrade) to plague the Dilma government, with the threat of impeachment and a downgrade to “junk bond” status, the totally incompetent Dilma government provoked its own “military crisis”.

Since 2013, a GT (Task Force) involving all the units in the Defense Ministry studied how to adequate the Consolidation of Military Legislation with that created the Defense Ministry 16 years ago (by then Pres. Cardoso in early 1999).

Supposedly – as a result of this task force study, on 4th September (just before the festive civic-military holiday – Independence Day on 7th September, the Secretary-General of the Defense Ministry, Ms Eva Chiavon, had Decree 8515 published in the Diário Oficial [federal daily record] that removed the authority [competency] of the Army, Navy & Air Force commandants to decide and implement military personal policies – such as, transfers to the reserve (retirement) and transfers for overseas duty.

Instead of these competencies being delegated to the commandants directly by the President, this Decree stated that these powers would be sub-delegated by the Defense Minister. This “bureaucratic mishap” occurred while Defense Minister Jaques Wagner (PT-BA) was on an official visit to China. He returned “just in time” to face this crisis and sit next to Pres. Dilma in the official reviewing stand during the 7th September civic-military parade.

To make matters worse, the Defense Ministry distributed a press note affirming that the military commandants were fully cognizant of the contents of Decree 8515. This enraged the three commandants even more. The “correction” ordered by Pres. Dilma was for Wagner to sign a portaria sub-delegating such authority to the commandants. Want more? The publication of this Decree occurred while Navy commandant Alm. Eduardo Bacelar was interim Defense Minister during Wagner’s trip to China. Apparently, this decree was passed to the Casa Civil with out his knowledge and signature.
1.4 – Fernando Baiano concludes plea bargaining

At the strong advice of his lawyers, Fernando Soares (Fernando Baiano) had consistently refused to do plea bargaining with federal prosecutors in Curitiba. However, after ten months in prison and two convictions (16 years each), he decided to switch lawyers and his new counsel, Sérgio Riera, met four times with the prosecutors who took his testimony.

Fernando Soares (Fernando Baiano)

Fernando Baiano is well recognized as the “PMDB lobbyist” within the Petrolão corruption episode and probably gave testimony about the distribution of rip-off bribes to PMDB leaders in Congress – including Chamber President Eduardo Cunha, Senate President Renan Calheiros, former Chamber President Henrique Alves (now Minister of Tourism), and government floor leader in the Senate Delcídio Amaral. It is reported that he also operated “donations” to the PT.

Because this plea bargaining involves testimony against deputies and senators, Fernando Baiano’s testimony can not be incorporated by (first level) Federal Judge Sérgio Moro in Curitiba, but rather by STF Judge Teori Zavascki who is the reporter on the petrolão case at the Supreme Court. Thus, the public will only have access to this testimony after the STF has incorporated this evidence into this case. ➔ Stay tuned, this testimony should be “bombastic”!!

1.5 – The end of Lula???
On 10th September, Federal Police *delegado* Josélito Azevedo de Sousa delivered a report to the STF requesting authorization of “question” [not “interrogate”] former President Lula. This report recognizes that there is no hard evidence of any “direct” involvement of Lula in the Petrolão corruption case, BUT the Federal Police have collected much testimony that points to the fact that then Pres. Lula “was aware” of the Petrolão (during his second term) and was also aware of what was going on after 2011. For example, in the plea bargaining testimony by Paulo Roberto Costa and *doleiro* Alberto Yousseff, they “presumed that then President Lula knew about the Petrobras corruption scheme”.

Before this request can be deliberated by Supreme Court judge Teori Zavascki, the PGR must file a brief favorable or unfavorable to this request. If Zavascki agrees, only then will the Federal Police summon Lula for “questioning”. This report also requested that others be “questioned” ➔ PT National President Rui Falcão, PT national president José Dutra (also former Petrobras President), former Petrobras President José Sérgio Gabrielli, former PT treasurer José Filippi Jr., and former cabinet ministers Ideli Salvatti, Gilberto Carvalho and José Dirceu. The Federal Police also asked to “question” several leaders of the PMDB and PP – such as Francisco Dornelles and Mário Negromonte.

Why was this request directed to the STF? Because this “questioning” involves many politicians who have *foro privilegiado* – can only be tried at the Supreme Court.

Brazilians have a saying that “If you run the beast will get you; if you stay the beast will eat you” – and this seems to apply to Lula. If he refuses this “invitation”, he will be admitting his guilt; if he accepts, this would open the first chapter of the book – *The End of Lula*

1.6 – Chamber Dress Code?

Dep. Cristiane Brasil (PTB-RJ) – daughter of former deputy Roberto Jefferson who was convicted in the mensalão case – began a campaign to impose a “dress code” for women who enter the Chamber of Deputies buildings ➔ prohibit short mini-skirts and “plunging” necklines – that apparently “distract” deputies from their serious business of legislating. In her attempt to “grab some headlines”, Dep. Brasil did not include men in her “dress code” proposal. Currently, men are not allowed to wear sandals or hats, and are required to use a coat and tie if they enter the Chamber floor. So far, the Senate has not installed a dress code for women.

Photo: André Dusek/Estadão

Chamber female staff protest against proposed “dress code”.

On Wednesday, 9th September, female staff in the Chamber donned Muslim-type head wear and staged a protest against the proposed “dress code” “You take care of your decorum and we will take care of our necklines” and “More ethics, less esthetics”.

2 – FOREIGN RELATIONS & TRADE

2.1 – Lula ➔ Buenos Aires

“A little help for your friends”. On 9th September, ex-President Lula lent his prestige and charisma to the presidential campaign of Daniel Scioli, the succession candidate promoted by Pres. Cristina Kirchner. Lula participated in the inauguration of a new UPA [local medical assistance unit] – named “The Luiz Ignacio Lula da Silva UPA” -- that has become the trade mark of Buenos Aires governor Scioli – modeled after the UPAs in Brazil. Lula exacerbated his praise of Pres. Kirchner and her husband Nestor and added – “It was here in Mar del Plata that we buried the FTAA proposal – together with Kirchner, Cristina, Chávez, Evo Morales and Daniel [sic] Correa”.

Scioli’s campaign is in difficulties – including various corruption accusations – the polls show that he has some 40% preference for the 25th October election versus 32% for the opposition candidate Mauricio Macri. If Scioli does not achieve 45% on the first round and does not have a 10% spread over the second place candidate, a second round election should be held – and these polls show that Scioli would lose a 2nd round runoff election.

Pres. Cristina Kirchner, in turn proposed that Argentina be included in the BRICS(A) group.

3 - REFORMS

3.1 – Political Reform

3.1.1 – Quotas for female candidates
On 8th September, on a second round vote, the Senate approved a PEC that would impose “quotas” for the election of women in PR elections for federal & state deputy, and city councils on a 52-to-5 vote. If approved by the Chamber before 2nd October 2015, this system would go into effect for the 2016 municipal elections. If approved, after the 2nd October deadline, it would go into effect for the 2018 elections. In July, the Chamber defeated a similar proposal.

This PEC would impose a 10% quota for women candidates to be elected in the first election, 12% in the second election and 16% in the third for all party/coalition lists. If the list does not achieve the “quota”, then the women candidate(s) who received the most votes would be considered “elected” in order to fill the “quota”. For example, with the 16% quota in effect, if a party/coalition list in that state elects 12 candidates, the quota would determine the election of 1.92 (or two) women. If no female candidates on this list were “elected”, the two female candidates who received the most votes would be elected AND their first alternate (suplente) would be the third most voted woman on the list.

⇒ Don’t hold your breath on this one!!!

Photo: Pedro Ladeira/Folhapress

In July, female deputies pressured to approve the quota system for proportional elections.

Currently, the Chamber has 51 women deputies out of a total of 513 (9.94%). In comparison, the Senate that uses a majority (“first past the post”) election system has 13 women senators out of a total of 81 (18.5%). No quota system was proposed for the Senate.

3.1.2 – Campaign contributions by firms

After one year and five months, on 10th September, STF judge Gilmar Mendes released the case he had kept in his desk drawer (pediu vistas) for further study that would declare campaign contributions by firms to be unconstitutional. At that point, six STF judges (an absolute majority) had voted in favor of this measure. Mendes vote was negative (in favor of these contributions). Mendes waited until the Chamber had approved a PEC allowing such contributions to parties (not individual candidates). This measure was defeated in the Senate, and on 9th September 2015 the Chamber restored such contributions by firms. The STF President put this question back on the high court’s agenda for 16th September. It is possible that some of the (six) judges who originally voted in favor of profiting such contributions might reverse their position. ⇒ Stay tuned!!
4 – PRIVATIZATION & REGULATION

Nothing this week.

5 - ECONOMICS

5.1 – August Inflation

“Some good news for a change!” On 10th September, IBGE announced the IPCA for August ➔ +0.22%, down from +0.62% in July. In August 2014, the IPCA posted +0.25% inflation. The IPCA had “peaked” in January, February and March 2015 – 1.24%, 1.22% and 1.32%, respectively. This result was in line with the +0.23% prediction by economists consulted by Bloomberg News. The 12-month accumulation now stands at +9.54%.

5.2 – Industrial Production declines

On 9th September, IBGE released data for Brazil’s industrial production in July ➔ -1.5% MoM and -8.9% YoY – the worst July since 2009. The seven-month accumulation in 2015 is now at -6.6% and the 12-month accumulation is -5.3%