**Brazil Focus –**

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**Weekly Report**  
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**Looking Ahead ➔ What to watch for?**

- **22nd May** -- IBGE: IPCA-15 ➔ +0.% *versus* +0.% in April
- **23rd May** -- FGV-Ibre, Brazil’s GDP data in 1st Q/2017 (estimate)
- **25th May** -- *Caged* data ➔ jobs lost in April
- **29th May** -- Memorial Day observed [holiday in the US]
- **29th May** -- STN, federal debt R$ trillion
- **30th May** -- IGP-M for May ➔ +0.%, *versus* +0.% in April
- **30-31 May** -- Copom Meeting
- **31st May** -- IBGE-PNAD Feb-March-April unemployment ➔ %
- **31st May** -- Central Bank to announce public account data for April
- **31st May** – STF to deliberate the end of the *Foro Previlegiado*
- **1st June** – MDIC to announce Trade Surplus for May ➔ US$ billion
- **1st June** -- Fenabrave – auto sales were units in May, - % YoY
- **1st June** -- IBGE to announce GDP data for 1st Q/2017 ➔ -0.% (QonQ) & - % YoY
- **2nd June** -- IBGE – Industrial Production increased by +0.% MoM, but - % YoY
• 5th June -- Central Bank ➔ FX flow in May
• 6th June -- Anfavea vehicles produced in May, - % MoM & - % YoY
• 7th June -- FGV to announce IGP-DI for May, + %, versus +0.% in April
• 7th June -- IBGE to announce May IPCA ➔ +0.% versus +0.% in April
• 12th June -- St. Anthony’s Day – St. Valentine’s Day in Brazil
• 14th June -- IBGE, April retail sales data +0.% MoM but - % YoY
• 15th June -- Corpus Christie – national religious holida

1 - POLITICS

1.1 – Michel Temer’s tenure threatened

Late Wednesday afternoon, 17th May, Brasília suffered a direct hit by a political “bombshell”. The online Globo News flashed a story drafted by columnist Lauro Jardim that somehow been “leaked” regarding the plea bargaining testimony of the JBS brothers – Joesley Batista and Wesley Batista – with a tape recording secretly made by Joesley of conversations with Pres. Michel in March 2017.

Joesley had asked Temer for help to resolve some “problems” that JBS was having and Temer suggested that he seek out Dep. Rodrigo Rocha Loures (PMDB-PR) who would help him resolve these “problems. Rocha Loures had been (until March 2017) an important staff advisor to Michel Temer before and after becoming president. Later, the Federal Police made a video of Dep. Rocha Loures receiving R$ 500,000,00. The Federal Police and prosecutors had already noted the serial numbers of these bills with a “chip” inside the suitcase.

This was the first time that prosecutors and the Federal Police used what is called a “combined action” that was first used against the Mafia in the US in the early 1960s by they Attorney General Robert Kennedy. Instead of arresting the suspected offender “right away”, the police let him/her continue their trajectory to lead the police to the “final destination” – the Big Chief”. Thus, the Federal Police acted to supply the “go-between” with the marked bills and the “chip” in the “money bag” and then followed this person while videotaping his/her trajectory.

Allegedly, Joesley also received approval from Temer of a plan to “buy the silence” of former deputy Eduardo Cunha – already in prison in Curitiba convicted by Judge Sérgio Moro. In another audio tape, Joesley told Temer that he was operating a “monthly dole” to Cunha and money changer Lúcio Funaro and Temer replied “You have to continue this, OK?”

Joesley also testified that Sen. Aécio Neves (PSDB-MG) had requested a loan of R$ 2 million and that it should be delivered to his cousin Frederico Pacheco de Medeiros and the Federal Police also made a video of this “delivery”.
The Batista brothers began their plea bargaining testimony with the PGR and the Federal Police before these tape recordings were made within a strategy elaborated by the PGR and the Federal Police. Thus, allegedly this testimony (tapes, etc.) is already at the STF awaiting promulgation by Judge Edson Fachin.

When this “bomb” broke loose, Pres. Temer was meeting with governors from the Northeast to mobilize support for the Social Security reform. Immediately, this news broke in Congress with nasty discussions in the Chamber with calls for impeachment of Temer. Dep. Alessandro Molon (Rede-RJ) filed a formal request to begin impeachment proceedings in the Chamber. The debate was a bit more “reserved” in the Senate and both sessions were terminated by the respective Presidents. Chamber President Rodrigo Maia (DEM-RJ) – who is next in line of succession of Temer – quickly went to the President’s office at the Planalto Palace.

Temer was surrounded by his key advisors – Eliseu Padilha (Casa Civil), Antonio Imbassahy (Secretary of Government), Moreira Franco (Secretary-General of the Presidency), Sen. Romero Jucá (PMDB national president) and Finance Minister Henrique Meirelles.

In Brazil, Temer can not be prosecuted for crimes/problems the occurred before he assumed the presidency – but is libel to prosecution during his presidency. If this episode is fully confirmed, he could be accused of obstruction of Justice”. Also, this episode might affect the judgment of the Dilma-Temer slate at the TSE as of 6th June.

Many political actors in the government bloc mentioned the possible resignation of Temer because it is thought that now he would not have minimum conditions to continue governing. But, the President’s office released a brief press note around 9:30 p.m. flatly stating that Temer had not had any such “conversations” with Joesley Batista ➔ “stone walling”.

Apparently, now it will be very difficult for the Temer government to approve the Social Security reform in the Chamber and perhaps even the labor legislation reform in the Senate. In addition, the slow movement of investors beginning to consider returning to investing in Brazil will be “put on hold” – after initial signs that Brazil’s economy was beginning to recover and move out of two years of recession.

The consequences of this crisis in the next weeks will have a very heavy impact on the 2018 general elections – including the next president.

If for some reason, Temer resigns or in forced out, the immediate successor will be Chamber President Dep. Rodrigo Maia (DEM-RJ) and a new president would be elected (by Congress) within 30 days. Remember: Maia has been challenged in the past for not being a “native born Brazilian”, because he was born in Chile while his father was there in exile. However, jurists affirm that because his birth was duly registered at the Brazilian consulate in Santiago, Chile (considered “Brazilian territory”) he is considered a “native born Brazilian”. If Maia becomes interim President, finally the PFL turned DEM will get its hands on the Presidency – even for only 30 days (or less).

If Temer resigns, a joint session of Congress would have to “elect” [select] a new President and Vice-President within 30 days.
Thursday, 18th May – “The Day After” ➔ The Day After was much worse than “The Day Before” ➔ Operation Patmos. Because the journalists in Brasília were sure that the PGR had sent this case to STF Judge Edson Fachin several days before O Globo blew out this “bombshell” on Wednesday afternoon, the press was beating on the STF’s doors on Wednesday evening to try to discover what the STF would do. This question was answered on Thursday morning. Apparently, on Wednesday, 10th May, the Batista brothers – Joesley and Wesley – sealed (confirmed) their plea bargaining testimony with STF Judge Edson Fachin [seven days before O Globo broke out (leaked) this story]. Apparently, this plea bargaining operation had begun on 1st March 2017 – before the corrupt operations by JBS with the BNDES was reported last week ➔ Operation Bullish reported in the 12th May issue of Brazil Focus.

Judge Fachin ordered the arrest of Andrea Neves (Senator Aécio Neves’ sister), ordered Sen. Aécio Neves suspended from the Senate, the suspension of Dep. Rocha Loures, and several search-and-seize operations executed by the Federal Police. Judge Fachin rejected the arrest warrants requested by the PGR for Dep. Rocha Loures who assumed the mandate of Dep. Osmar Serraglio (PMDB-PR) as his suplente (alternate) when Serraglio became Justice Minister.

The PGR also requested the arrest of Sen. Aécio Neves (PSDB-MG), but Fachin decided that this decision had to be made by the full STF and on Thursday, 18th May this was denied. Remember: The first time (ever) since Brazil’s re-democratization in 1985, a sitting Senator (Deleidio do Amaral) was arrested (via a warrant issued by the STF) in late 2015 – accused of obstruction of justice (trying to buy the silence of former Petrobras director Nestor Cerveró) then under arrest in Curitiba.

Arrest warrants were also issued for a federal prosecutor – Ângelo Goulart Vilela – Frederico Pacheco de Medeiros (cousin of Aécio Neves), Roberta Funaro (sister of money changer Lúcio Bolonha Funaro), Menderson Souza Lima (staffer to Sen. Zezé Perella), and lawyer Willer Thomaz (Pres. for Institutional Relations OAB-DF) for interfering in Operation Greenfield. In addition to Andrea Neves, Aécio Neves and Rocha Loures, the Federal Police carried out search-and-seize warrants at the residences of Sen. Zezé Perella (PMDB-MG), Altair Alves (a close friend and operator for Eduardo Cunha) and Col. (rt) João Baptista Lima Filho (closely linked to Michel Temer).

The PSDB caucus in the Chamber unanimously voted to remove Sen. Aécio Neves as national PSDB President and the Senate PSDB concurred. Reluctantly, Neves took a leave of absence from the PSDB Presidency that was assumed by the PSDB Vice-President Sen. Tasso Jereissati (CE). The PSDB contemplated leaving the Temer support coalition in Congress, but Jereissati led a group of three tucano cabinet ministers – Aloysio Nunes (Foreign Relations), Antonio Imbassahy (Sec. of Government) and Bruno Araújo (Cities) to talk with Temer and the PSDB decided to remain in the coalition. Araújo has voiced his desire to leave the Temer government, but changed his mind. The
DEM is also considering this option. Senator Ronaldo Caiado (DEM-GO) already called on Temer to resign. So far, only two parties left the Temer coalition – PSB and PPS. PPS national president, Roberto Freire, resigned his cabinet position at Minister of Culture, BUT Dep. Raul Jungmann (PPS-PE) remained in his post as Defense Minister. Apparently, the other parties in the Temer coalition have also adopted a “wait-and-see” posture.

**Why arrest a federal prosecutor?** Ångelo Goulart Vilela was “infiltrated” (by Joesley Batista) into the task force (in Brasília) investigating Operation Greenfield that involved questionable financial operations by JBS and its allies. Vilela’s “mission” was to inform Joesley Batista about these investigations.

At 06:00 a.m. Thursday morning, the PGR Rodrigo Janot called Senate President Euclício Oliveira (PMDB-CE) to advise him of these operations and Oliveira instructed the legislative police to assist the Federal Police in these operations.

Financial markets reacted very negatively after positive reactions in mid-May regarding signs that Brazil’s economy is recovering. *(See Items 5.1 & 5.2)* After these arduous austerity efforts over the past 12 months to get Brazil’s economy “back on track”, all might be lost with this “bombshell”. “Bye-bye” political reforms, domestic and international investors returning to a “wait-and-see” posture, and the government’s congressional support coalition disintegrating.

Apparently, there are **three** alternatives for Michel Temer to be removed  1) He could resign (quite possible if Temer’s support coalition in Congress falls apart); 2) Another impeachment process (that might take some 6 months; or 3) The TSE votes to remove Temer (and punish Dilma Rousseff) on 6th June convicting the Dilma-Temer 2014 slate of illegal campaign finance. This third option would be the quickest solution. **However,** after Temer were removed, he could be accused/prosecuted by a first level federal court for his now alleged crimes. **REMEMBER:** On 31st May, the STF will deliberate the end of the foro privilegiado – as unconstitutional (equal treatment before the law). This decision would throw all deputies, senators and cabinet ministers “down” at the mercy of first level federal courts, yet another “judicialization of politics” and a another large “political tsunami”!!!

**Who might succeed Temer?** This is the “64 thousand dollar” question in Brasília. The successor would have to be a person with a ficha limpa (no accusations), who could give continuity to the reform process and Brazil’s economic recovery and be acceptable to a majority of Congress. That person might possibly be the current Finance Minister Henrique Meirelles. If Meirelles becomes President, then who would be his Finance Minister – another very important questions – probably a “market friendly” type.

**What about the impacts on the 2018 elections?** Another very good question. Probably the turnover in the Chamber would be very large. Usually every four years the Chamber turnover rate is about 50%, a bit more or a bit less. In 2018, this turnover might exceed 70%. The turnover in the Senate should be quite large as well. In 2018, two seats per state are up for election. Currently, one-third of the Senate is accused in the Lava Jato investigation and other penal crimes. Turnover for governors might also be large  currently 12 governors are under investigation and might be removed by the STJ. The governor and vice-governor of Amazonas were recently removed by the TSE and new elections will be held shortly.
Presidential Election? The electorate will be in search for an “outsider” who is not a member of the traditional “political class” (traditional political elite). The PSDB has no viable candidate other than the current Mayor of SP – João Doria. The PMDB has no viable candidate. If Lula’s conviction(s) are upheld by the TRF-4 he would be ineligible and the PT has no other viable candidate. The other two pre-candidates considered “outsiders” are Marina Silva (Rede) and Dep. Jair Bolsonaro (PSC-RJ). She would probably receive her traditional 20% and he currently has some 11% in the recent Datafolha poll. Bolsonaro is in search of a larger party with access to more TV campaign time (perhaps (PP or PR). The other pre-candidate is Ciro Gomes (PDT) who might receive his traditional 12%. Thus – if no other viable “outsider” appears, João Doria might be a strong candidate.

BUT – If Henrique Meirelles succeeds Temer, he might stand for reelection in 2018 with the “federal machine” at his disposal.

Earlier on Thursday morning, the STF decided to open a formal investigation of Pres. Michel Temer.


First, JBS & Joesley Batista. The JBS group hit “big time” in 2007 with LARGE & easy loans from BNDES used to buy up a large part of Brazil’s meat packing sector and acquired several large meat packing firms in the US. The Batista family began its long trajectory quite humbly – a small butcher shop in the interior of Goiás in 1953. It is rumored that one of Lula’s sons is a major shareholder in the JBS group (using funds from the Petrobras corruption/brbery scandal). Second, this conspiracy theory holds that Joesley Batista organized this “sting” back in early April on behalf of Lula and the PT to dislodge Pres. Temer and then pressure for a constitutional amendment to call for direct presidential elections – so that Lula could run before the “ineligibility ax falls” (the confirmation of his convictions by the TRF-4 in Porto Alegre, probably in early 2018).

Finally, why did the authorities investigating the Batista brothers’ plea bargaining testimony allow them (and their extended families) to travel to New York City supposedly to escape from “death threats”?

4:00 p.m., Thursday, 18th May – On a national TV hookup, Pres. Michel Temer affirmed that this week had the “best moment” and the “worst moment” for his government. The “best” being the favorable economic indicators announced earlier this week (positive economic growth in 1st Q/2017, reduced inflation, lower interest rates and positive job creation in April) and the “worst” was the plea bargaining testimony of the Batista brothers including clandestine tape recordings of conversations between Pres. Temer and Joesley Batista where reputedly Temer’s crime was obstruction of justice. Temer affirmed that he had officially requested that the STF provide him with the transcript of these clandestine tape recordings, but nothing has been forthcoming. Then, finally he forcibly and dramatically affirmed (twice) – “I will not resign”!!

See ➪ https://noticias.uol.com.br/politica/ultimas-noticias/2017/05/18/leia-a-integra-do-pronunciamento-de-temer-a-o-negar-renuncia.htm
The *market reaction* was swift and BAD – the worse since the Wall St. blowout in late 2008 when the Lehman Brothers bank was allowed to fail ➔ the US$ FX rate was up 8.16% to R$ 3,39 – the largest FX movement in 18 years. The stock market (Bovespa) plunged to 10% shortly after 10:00 a.m. and the automatic “circuit breaker” kicked in and things “calmed down” somewhat. On Wednesday, Bovespa closed down by -8.79%. The value of businesses traded on Bovespa lost R$ 219 billion. The Central Bank held FOUR US dollar auctions (US$ 4 billion) to calm down the demand for this foreign currency. The STN suspended auctions of public bonds. JBS stocks were down nearly 10%. Brazil’s “political risk” evaluation in NY was up (worsened) by 30%. Many market analysts feel that this episode will doom Brazil to a third straight year of recession.

On Friday, investors began to reap “profit taking” and the Bovespa was up +1.7%, but the US dollar FX rate was down by -4%, closing at R$ 3,257.

This crisis subsided “somewhat” on Friday, after the STF released the transcriptions of the clandestine recording that Joesley Batista made with Pres. Temer. It became apparent that Temer did not order Batista to pay “hush money” to Eduardo Cunha nor specifically concur with this. However – it was very clear that Temer had been “very stupid” to accept a late night visit by Batista to his residence at the Jaburú Palace, knowing that the Batista brothers were already had 5 or 6 Federal Police investigations ongoing against them regarding various corrupt and criminal episodes. This visit was articulated by Temer’s close “friend” Dep. Rocha Loures. Also, because Batista described several corrupt and criminal actions that he and JBS had undertaken, Temer should have denounced these actions to the PGR and the Federal Police. Thus, the “conspiracy theory” that Joesley Batista had arranged a “sting” against Temer gains credibility.


More tapes and transcriptions of the pleas bargaining by the Batista brothers and other JBS employees were released on Friday, 19th May:


1) In 2014, JBS had channeled R$ 60 million in *Caixa Dois* to the presidential campaign of Aécio Neves; 2) JBS had paid Neves R$ 15 million for “legislative services rendered” in favor of JBS interests in Congress; 3) JBS had channeled US$ 50 million to Lula and US$ 30 million to Dilma; 4) JBS channeled “monthly allowances” to Eduardo Cunha and Lúcio Funaro while they were in prison in Curitiba; 5) JBS had infiltrated a “friendly” prosecutor into the *Lava Jato* investigations who also was active at CADE; and 6) Then Governor Cid Gomes received R$ 20 million in return for ICMS credits.

### 1.2 – Dilma-Temer 2014 slate threatened at TSE

On 15th May, the prosecutor at the TSE, Nicolau Dino, delivered his final report regarding the proposal that the Dilma-Temer slate in the 2014 elections by annulled (cassado). Dino recommended that the slate be annulled because of some R$ 112 million in *Caixa Dois* (off the books campaign finance). He included the recent plea bargaining testimony by the campaign marketing specialists – João Santana and Monica Moura – that documented the alleged *Caixa Dois*.
The TSE might begin deliberation of this case in June (2017). Nicolau Dino requested that Michel Temer be removed from the presidency and that Dilma Rousseff be denied her political rights for 8 years. **Detail:** When Dilma was impeached finally on 31th August 2016, instead of following the impeachment article in the 1988 Constitution (as was done by the Senate with regards the impeachment of then Pres. Fernando Collor in 1992) – impeachment plus loss of political rights for 8 years – the Senate decided to only impeach her but did not remove her political rights for 8 years..

As a consequence, the reporter on this case, Herman Benjamin, delivered Nicolau Dino’s final report to the other TSE judges “ready to be deliberated”. TSE president Gilmar Mendes set the date for this judgment on 6th June.

**However,** Pres. Michel Temer recently names three new judges to the TSE that should secure a firm majority in his favor.

### 1.3 – Lava Jato

#### 1.3.1 – An arrest warrant for Dilma?

Legal specialists feel that former president Dilma Rousseff funs a strong risk of having an arrest warrant issued by the **Lava Jato** task force to impede her destroying evidence and documents related to her alleged obstruction of justice that was recently revealed by Monica Moura and João Santana. According to their plea bargaining testimony, Dilma allegedly was informed daily by her then Justice Minister, José Eduardo Cardozo, regarding the evolution of the Federal Police role in the **Lava Jato** investigation (the Federal Police are subordinate to the Justice Minister). She advised the Santana-Moura couple to transfer their illicit funds from Swiss bank accounts to accounts in Singapore.

To leak out information is a violation of Article 325 of the penal code (two years in prison). Also, Dilma could be accused of obstruction of Justice. The **Lava Jato** investigators and the Federal Police are trying to find the laptop computer that Dilma used to communicate with the marketing couple and break open the e-mail system used for this communication using “draft e-mails”.

➔ **Stay tuned!!**

#### 1.3.2 – Lula. More accusations

It is possible that more accusations against Lula maybe formulated by the **Lava Jato** investigators ➔ obstruction of justice. Lula already is considered a **réu** (formally accused) in the case being deliberated by a federal judge in Brasília regarding attempts to buy the silence of former Petrobras director Nestor Cévere. Now the additional accusations of obstruction of justice involve Lula’s attempts to silence two other persons involved in the Petrobras corruption/bribe scheme – former Petrobras director Renato Duque and former CEO of the OAS construction firm – (“Destroy all your documents”).

On 15th May, Judge Sérgio denied the requests by Lula’s lawyers and the public prosecutors to call more witnesses for the interrogation of Lula on 10th May. He affirmed that these were not
necessary. This was yet another attempt by Lula’s lawyers to postpone a final decision by Judge Moro regarding Lula’s conviction that should occur in late July.

**Leo Pinheiro** – On 15th May, the former CEO of OAS, Leo Pinheiro, delivered solid legal documents (to Judge Moro) that prove the renovations that OAS completed on the triplex apartment in Guarujá and on the rural *dacha* in Atibaia, SP.

### 1.3.3 – Lula indicted – *Operation Zelotes*

On 15th May, former president Lula was indicted by the Federal Police in Brasília accused of “passive corruption” – 12 other persons were also indicted – accused of “selling” a *MP-Medida Provisória* (MP 471) – that extended fiscal advantages to auto manufactures from 31st March 2010 to 31st December 2015. Allegedly, the “price” for the issue of this MP was R$ 6 million that was “delivered” to the PT. Lula’s lawyers deny this accusation, of course.

See ➞ [http://g1.globo.com/politica/noticia/pf-indicia-lula-por-corrupcao-em-novo-inquerito-sobre-compra-de-mps.ghtml](http://g1.globo.com/politica/noticia/pf-indicia-lula-por-corrupcao-em-novo-inquerito-sobre-compra-de-mps.ghtml)

### 1.3.4 – Claudia Cruz

Wife of Eduardo Cunha, Claudia Cruz, had her appeal to the STJ (to annul her *Lava Jato* case) denied by a unanimous decision by the 5th STJ working group. Thus, her trial by Judge Sérgio Moro will continue in Curitiba and probably she will be convicted. Whether she will be jailed is an open question.

### 1.4 – *Operation Lucas*

On 16th May, the Federal Police launched *Operation Lucas* in the state of Tocantins with 62 warrants issued by federal judge in the city of Palmas. The corruption scheme again involved sanitation inspectors from the Ministry of Agriculture (like in *Operation Carne Fraca*) and involved the chief inspector in Tocantins, Adriana Carla Floresta Feitosa, her husband, ex-husband and two sons. Four meat packing plants and two dairy products firms paid some R$ 3 million in bribes to avoid “problematic” inspections. These bribes were used by Adriana to pay tuition for her two sons in a private medical school and the costs of the funeral of her mother.

In Santa Catarina the Federal Police attacked a scheme where bribes were paid to other Ministry of Agriculture employees to refrain from inspecting shipments of fish imports from China and Vietnam.

### 2 – FOREIGN RELATIONS & TRADE

Nothing this Week

### 3 – REFORMS
Nothing this week.

4 – PRIVATIZATION & REGULATION

Nothing this week.

5 - ECONOMICS

5.1 – IBC-Br

On 15th May, the Central Bank released its Index of economic activity for March and 1st Q/2017. In March, the IBC-Br was negative ➔ - 0.44% (MoM) but was positive for 1st Q/2017 ➔ +1.12% (QonQ). The main reason for this positive result was the February IBC-Br ➔ +1.37% due to the large, increased grain harvests in 2017 (+26% above the 2016 harvest) and the January result ➔ +0.37% (MoM). The 12-month accumulation is now -2.78%. IBGE should release the official GDP result for 1st Q/2017 on 1st June, and this result should be positive – for the first time the 4th Q/2014.

5.2 – Caged -- 60,000 new jobs created in April

On 16th May, the Ministry of Labor released the Caged employment data for April ➔ 59,800 new jobs were created – in all sectors, except civil construction. This is very good news for the Temer government and indicates that, finally, the two-year recession is being reversed.