Brazil Focus –
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Weekly Report
June 10-16 2017

Looking Ahead ➔ What to watch for?

- 18ª June – Second Round elections French National Assembly
- 18ª June -- Former President FH Cardoso celebrates 86ª birthday
- 19ª June -- Caged data ➔ jobs lost in April
- 19ª June -- SRF, May tax revenues ➔ R$ billion
- 20ª June – Senate CAS should vote out the labor legislation reform
- 21ª June -- FGV – income inequality for 4ª Q/2016
- 21ª June -- IBGE to release IPCA-15 ➔
- 21ª June -- UNCTAD – Brazil's FDI in 2016
- 23ª June -- IBGE-PNAD unemployment in March-April-May ➔ %
- 23ª June -- Caged – jobs in May
- 26-30 June -- 15ª FLIP ➔ International Literary Festival in Paraty, RJ
- 27ª June -- June IGP-M ➔ +% ➔ +% for 12-month period
- 27ª June – “Brazil Briefing”, AS-COA, 680 Park Ave., NYC
- 27ª June -- IBGE: April retail sales ➔ +0, MoM but -% YoY
• 27th June -- June IGP-M ➔ +% ➔ +% for 12-month period
• 27th June -- “Election” for new PGR (three-name list), 1,300 prosecutors vote
• 27-28 June -- Copom meeting
• 29th June -- Brazil-US Business Council, Mid-Year meeting, Washington, DC
• 30th June -- Public Accounts data for May
• 3rd July -- Trade balance for June ➔ US$ billion & 1st semester ➔ US$ billion
• 4th July -- New car sales June, units (+ % MoM), in 1st semester (- % YoY)
• 4th July -- US Independence Day [national holiday]

1 - POLITICS

1.1 – Veja accused Abin spying on STF Judge Edson Fachin

The edition of the weekly news magazine Veja that appeared on Saturday, 10th June had an explosive cover story regarding the new policy of “Total War” by the Temer Government against the Judiciary, federal prosecutors and the Federal Police – an offensive to alleviate the pressures and accusations against Pres. Temer and his inner circle of ministers and advisors.

This story described the request by the President via his GSI chief, Gen. Sérgio Etchegoyen, to direct Abin (the Brazilian Intelligence Agency) to [clandestinely] investigate the life, relationships, contacts, etc. of Supreme Court Judge Edson Fachin – the reporter for the Lava Jato investigation and the STF judge reporting on the investigation of Pres. Temer installed (requested) by the PGR Rodrigo Janot. The objective was to encounter any (and all) “details” that might “shame” Fachin and reduce his legitimacy to continue as reporter on these cases – especially the Lava Jato investigation.


Veja reported that the ongoing Abin investigation had discovered that Fachin had used the private jet plane owned by the Batista brothers (JBA and J&F) to travel to and from Brasília-Curitiba prior to his confirmation hearings at the Brazilian Senate in 2015 – the same plane used by Pres. Temer and his family in 2011. Although these trips on Joesley Batista’s plane were not illegal or a “crime”, Abin and Pres. Temer hoped that this information would embarrass Judge Fachin because he [strangely] quickly accepted the plea bargaining testimony by the Batista brothers and other employees of JBS and J&F without any “sanctions” – they were allowed to leave Brazil for the US “free and clear”.

However – the statutes that regulate and control Abin’s operations (as the successor agency to the SNJ) determine that Abin collect relevant information for the President and his cabinet officers but do not authorize Abin to spy on/collcollect information regarding representatives (authorities) of the other two powers (Legislative and high courts).

Why this reaction by the Temer government? Apparently, Temer and his allies perceive a “conspiracy” involving the Supreme Court and the federal prosecutors to topple the Temer government and feel that their “Total War” strategy is justified. ➔ Stay tuned!!

After the 4-to-3 vote at the TSE alleviated Temer regarding a possible loss of his mandate, the “concerns” continue vis-à-vis the possible VERY negative (damaging) plea bargaining testimony by Lucio Funaro, Rodrigo Rocha Loures, Eduardo Cunha, Henrique Eduardo Alves, and others.

Also, it is expected that within a few days the PGR will formalize the accusation (denunciation) against Temer at the STF. This would be the first time such an accusation regarding “common crimes” filed at the STF against a sitting President. To precede the STF investigation, a concurring vote of 342 federal deputies would be needed ➔ yet another “give-and-take” challenge for Temer in Congress than will further delay any vote on the Social Security Reform in the Chamber.

The conclusion ➔ Temer is not yet “out of the woods” but now “even deeper in the woods”.

Two suspicions are actively discussed in the press ➔ 1) That Temer’s new Justice Minister, Torquato Jardim, will soon replace the Director of the Federal Police with a “less activist” person to reduce the Lava Jato Operations and other actions against “authorities”; and 2) When Rodrigo Janot’s term as PGR ends in mid-September, Temer would replace him with someone less “activist” to reduce the federal prosecutors’ involvement with all these investigations – perhaps a person not even included in the three-name list that will be prepared via a direct vote by all federal prosecutors.

Also, STF Judge Gilmar Mendes will work diligently to reduce the scope and powers of the Lava Jato investigation and release some to the accused who are still held under temporary arrest by order by Federal Judge Sérgio Moro in Curitiba. He also will work hard to reverse the STF decision that once a conviction is confirmed by a second level court, the accused should go straight to jail on appeal.

Reactions to the accusations in the Veja cover story were swift and very harsh:

Judge Carmen Lúcia, Supreme Court President
http://g1.globo.com/politica/noticia/carmen-lucia-diz-que-possivel-devassa-contra-fachin-e-propria-de-ditaduras.shtml

Opposition deputies will try to convocate a CPI

OAB defended Fachin against Temer/Abin

AMB repudiated Temer/Abin action

From Reuters
http://in.reuters.com/article/us-brazil-economy-idINKBN1932JR

From Bloomberg
However, On Sunday, Pres. Temer called STF President Carmen Lúcia on the phone to assure her that no Abín espionage against STF Judge Fachin had existed and later she announced that this “case was closed” and that no one should doubt the word of the President of the Republic. On Monday, Temer recorded a video message broadcast on “social networks” to the effect that there must be mutual respect and harmony among the three posers and that none of the three powers should impose its will on the other powers.

1.1.2 – Fachin extended Federal Police deadline

On Monday evening, 12th June, STF Judge Edson Fachin extended the deadline for the Federal Police to conclude their investigation of the “Temer case” until 18th June. Thus, the PGR will postpone the delivery of a formal accusation against Temer to the STF. When this happens, before the STF can proceed with this formal investigation, the Chamber must concur via a two-thirds vote.

1.2 – PSDB decided “not to decide”

On Monday, 12th June, the PSDB national executive committee plus its principal leaders met in Brasília and decided that it would (for the time being) break out of the Temer government support coalition – but reserved the right to change its mind “if new facts appear”. The party stated its determination to approve the “reforms”.

The press quickly speculated regarding a possible PSDB-PMDB “accord” regarding 2018, when the PSDB expects that the PMDB would support its candidate for President and the PMDB expects that the PSDB will continue to support the Temer government in 2017/2018. A “delicate case” hangs in the balance ➔ Senator Aécio Neves (PSDB-MG). He was “suspended” from his mandate as Senator by STF Judge Edson Fachin because of the plea bargaining testimony by the Batista brothers and other accusations of corruption – but PMDB Senate President Eunício Oliveira has not carried out this STF imposition. In the same Fachin dispatch, he ordered that the Chamber suspend the mandate of then deputy Rodrigo Rocha Loures (PMDB-PR) and the Chamber immediately carried out this order. Thus, part of this “accord” aims at “saving” the mandate of Aécio Neves. To this end, the PGR Rodrigo Janot has reiterated his request that Fachin (or the full STF) order the arrest of Neves.

However – Aécio Neves and the PSDB will appeal the TSE decision to the STF. The PSDB delegation in the Chamber (46) had a large majority in favor of breaking off with the Temer government. Reportedly, these deputies will vote against Temer and in favor of opening a full investigation of the President at the STF.
On 14th June, PSDB President Sen. Tasso Jereissati affirmed that if Pres. Temer wants to recover his authority he should prove his innocence regarding the current accusations.

1.3 – CVM investigates Petrobras “capitalization” in 2010

Finally, the Petrobras case has arrived at the end of Lula’s second term and the CVM-SP Stock Market watchdog will investigate the “irregularities” in the Petrobras IPO in 2010 (the then Petrobras Presidents – José Sérgio Gabrielli and Graça Silva Foster on 11th July. This IPO involved R$ 120 billion. The CVM is investigating the allegations that Petrobras induced investors to commit errors.


1.4 – JBS ➞ IDP

On 14th June, the press reported that the IDP-Instituto Brasileiro de Direito Público had received R$ 2.1 million from JBS (Joesley Batista) to “sponsor events”, scholarships for needy students. This contract was signed on 11th June 2015. So what? The IDP was installed by Gilmar Mendes and some minority participants and all employees of the STF, STJ, TST, TSE, TRF and more or less obliged to study law at the IDP and these courts pay their tuition. The problem? JBS and J&F will eventually have cases decided by the STF where Judge Gilmar Mendes will participate.

Want more? Gilmar Mendes and his family have large farms in Mato Grosso that produce beef cattle that are sold to JBS meat packing plants.

1.5 – Lava Jato

Sérgio Cabral ➞ On 13th June, Judge Sérgio Moro convicted Sérgio Cabral to 14 years in prison – his first conviction related to corruption vis-à-vis the Petrobras case. Cabral and two of his associates had extracted bribes from the Andrade Gutierrez contract for the construction of the Comperj petrochemical installation. Judge Moro described Cabral’s motives as “unrestrained greed”.

Joesley Batista arrived back in Brazil on Sunday, 11th June, after a quick business trip to Asia and on the next day, 12th June he gave additional testimony at the PGR regarding the US$ 80 million that JBS passed on to Lula and Dilma Rousseff.

Aécio Neves – In May, STF Judge Edson Fachin determined the suspension of then federal deputy Rodrigo Rocha Loures (PMDB-PR) and Senator Aécio Neves (PSDB-MG). Immediately, the Chamber suspended Rocha Loures from all activities in the Chamber, but the Senate took no similar action against Neves. On 12th June, this inaction by the Senate was questioned by the STF and Senate President Eunício Oliveira (PMDB-CE) met with STF President Carmen Lúcia in an attempt to resolve this situation. Oliveira argued that there was no internal norm in the Senate’s bylaws that covered this case of suspension – although in late 2015 the Senate heeded the STF order and suspended then Sen. Delcídio do Amaral (PT-MS). Oliveira requested that Judge Fachin detail how this “suspension” should be implemented. As a result, several STF judges complained saying that the STF should issue an arrest warrant for Neves that would effectively suspend his Senate mandate. As ordered by the STF,
finally the Senate cut off Neves' salary and funds to operate his Senate office on 14th June. Also, his name was removed from the voting panel on the floor of the Senate. The STF will deliberate a possible arrest warrant for Aécio Neves on 20th June. On 13th June, the first STF group voted 3-to-2 to maintain Aécio's sister, Andrea, in prison in Belo Horizonte.

Want more? Part of the "problems" (accusations) regarding Neves was his "relationship with Joesley Batista - a "supposed loan" of R$ 2 million from JBS that had been delivered in three installments via Aécio's cousin, Frederico Pacheco de Medeiros. Before the Federal Police and PGR intervention, three installments of R$ 500,000.00 had been delivered in suitcases that were video taped by the Federal Police as part of the plea bargaining scheme with Joesley Batista. On 13th June, the lawyer for Frederico Pacheco (still in prison) delivered (deposited) R$ 1.5 million at a branch of the CEF in Belo Horizonte.

Aldemir Bendine - the Lava Jato task force has opened an investigation of Aldemir Bendine regarding R$ 3 million in bribes received from Odebrecht when he was President of Petrobras. While Bendine was President of the Banco do Brasil, this bribe was 1% of the Odebrecht debt held by the BB in return for a decision by Bendine to extend the repayment period. Reportedly, this was part of a larger bribe of R$ 87 million articulated by then Dilma Rousseff's Finance Minister Guido Mantega.

Antonio Palocci is reported to be preparing his plea bargaining testimony assisted by a new lawyer. This could be VERY bad news for Lula and Dilma Rousseff as well as several banks that might have been involved in articulation of corruption/bribes to the PT and its leaders. To this end, these banks are anticipating a "leniency agreement" with the Lava Jato task force.

1.6 - State enterprise pension funds

1.6.1 - Petros was "ripped off"

Petros (the Petrobras pension fund) was one of the state enterprise pension funds (Previ, FunCEF, Postalis, etc.) that were "ripped off" by managers appointed by Presidents Lula and Dilma Rousseff. Auditors have discovered that Petros suffered a R$ 26 billion "rip off" and, like Postalis, will be forced to increase the contribution by current employees in an attempt to "cover" this gap (deficit). Postalis went even further ➔ the contribution by current Post Office employees was increased by +18% and the pensions of retirees were reduced by -18%.

1.6.2 - JBS ➔ Fapes

Reportedly, BNDES employees and retirees are VERY upset with the news that their retirement fund (Fapes) was induced to acquire JBS stock shares prior to Operation Bullish and the plea bargaining testimony by the Batista brothers that provoked a sharp decline (-50%) in the value of these shares.

1.7 - Temer on the Offensive

On Tuesday evening, 13th June, Pres. Temer invited all 27 governors for a formal political dinner at the Palácio da Alvorada. Twenty showed up. This encounter was a "give-and-take". Pres.
Temer needs the political support of these governors to pressure their respective deputies and senators in favor of the proposed reforms and to surmount the current political crisis. In return, the President offered to alleviate “the fiscal dilemmas” of these states – such as a “roll over” of the R$ 50 billion in states’ debts with BNDES.

Temer is “on the ropes” and is distributing many “fiscal advantages” in search of political support. Many analysts are concerned that these “giveaways” might have a negative impact on the government’s efforts to reduce the fiscal deficit in 2017 and 2018.

2 – FOREIGN RELATIONS & TRADE

2.1 – A new Brazil-Mexico trade agreement?

This week (of 12th June), Brazil and Mexico resumed their trade agreement talks that had been suspended since last year. These negotiations focus on a possible expansion of products in the “duty free” category.

In 2016, Brazil exported US$ 3.8 billion to Mexico, 45% of which autos and related components – included in the trade agreement in place since 2015 through 2019. Mexico is the seventh largest recipient of Brazil’s exports.

The main impasse regarding an over all trade agreement is the Mexican resistance to opening its market to Brazilian agri-business exports. The percentage of “local content” for exports is another problem. Mexican industries receive many imported components and then export the finished product. In previous trade agreements with Mexico, Brazil accepted a local content of less than the 60% used by the Mercosul nations.

Brazilian negotiators fully understand the “dilemma” faced by Mexico under the pressures by the US (Pres. Donald Trump) to renegotiate the NAFTA agreement and that Brazil might be able to fill Mexico’s “trade gap” that might result from these Trump pressures.

2.2 – Pres. Temer ➔ European trip

In yet another attempt to demonstrate that his government continues on a “normal” pathway, Pres. Temer will begin a trip to Russia and Norway next week (20-23 June). In Russia, Brazil hopes to attract new investments (energy, ports and railroads) – See Item 4.1. In Oslo, Temer will also seek new investments. Recently, Brazil Focus described the plans of Norwegian Statoil to increase production in Brazil’s offshore oil fields. (See Item 5.1)

2.3 – EU vs. Brazilian meat

Alleging that Brazil has taken no measures to “clean up its act” after the Carne Fraca episode (investigation) by the Brazilian Federal Police in March 2017, the EU sent a “stern” letter to Brazil’s Minister of Agriculture stating that “Brazil has done nothing to restore the EU’s confidence in the quality of its meat exports”. In a symbolic act (a prelude, warning), the EU suspended its imports of
horse meat from Brazil. EU inspectors discovered more than 100 cases of contamination in meat exported to the EU.

Between 2-10 May, EU sanitation authorities visited several of the meat packing plants identified in the *Carne Fraca* episode and found “serious sanitation/quality problems”. The EU wants Brazil to implement a system of microbiological tests for a thorough examination of the quality of beef and chicken exports to the EU and plans new inspections visits in the second semester. The veiled threat is that the EU might suspend all meat imports from Brazil.

3 – REFORMS

3.1 – Labor Legislation

The President of the Senate CAS-Social Affairs Committee, Sen. Marta Suplicy (PMDB-SP) announced on 14th June that she expects the CAS to vote out the Labor Legislation Reform on Tuesday, 20th June. Before going to a full Senate vote (perhaps on 28th June?), this reform must still be approved by the Senate CCJ-Constitution & Justice Committee.

4 – PRIVATIZATION & REGULATION

4.1 – Norte-Sul railroad

The North-South railroad was initiated during the government of José Sarney (1985-1990) and finally a large section (between Porto Nacional, TO and Estrela do Oeste, SP) will be auctioned for concession on 15th February 2018. This concession contract would be for 30 years and perhaps yield R$ 1.5 billion with R$ 3.087 billion in investments. Reportedly, this concession should have bids by several foreign groups – Russia, China, US and Spain. One of the “natural” bidders should be VLI that already holds the concession for the Porto Nacional, TO – Açailândia (MA) section. Reportedly, this is one of the items on the agenda of Pres. Temer during his visit to Russia next week.

4.2 – CESP

On Tuesday, 13th June, CESP (the SP state owned electric company) announced that it would hold privatization auctions in September 2017 for its hydroelectric installations. The current concessions will not be renewed. The hydro installations involved are ➔ Porto Primavera (1,540 MW), Paraíbuna (87 MW) and Jagurai (27.6 MW).

4.3 – Mubadala Fund ➔ Invepar

The Invepar consortium that administers the Guarulhos Airports in SP has received a proposal from the Abu Dhabi sovereign wealth fund (Mubadala Fund) to acquire a 51% stake in Brazil’s largest airport. This consortium includes the Previ, Petros and Funcef pension funds and the OAS
construction firm. It is estimated that the value of this transaction would be between R$ 2 billion and R$ 2.5 billion/ 

5 - ECONOMICS

5.1 – Statoil to triple production in Brazil

On 12th June, the Norwegian firm, Statoil, announced that it plans to triple its current offshore oil production in Brazil by 2030 and become the main operator in the Cacará field in the Santos basin. Last year, Statoil acquired a 66% share from Petrobras for US$ 2.5 billion to become the operator of the BM-S-8 block (including Cacará) in the Santos basin. The Norwegian oil firm also took control (35%) of the BM-C-33 field in the Campos basin from Repsol Sinopec. So far, Statoil has invested US$ 10 billion in exploration activities in Brazil.

5.2 – JBS and J&F debt

Reportedly, the J&F group has R$ 10 billion in reserve and R$ 58 billion in debts – one-third of which falls due in early 2018. In Brazil, five large banks (Itaú, Banco do Brasil, CEF, Bradesco and Santander) hold some R$ 25 billion of this debt – the largest share (R$ 15 billion) by the BB and CEF.

The negotiations to “roll over” this debt are on going and the toughest creditor is Banco Itaú that has threatened to close its credit line with J&F.


On 14th June, S&P followed the lead of Moody’s and Fitch and downgraded the risk classification of JBS. S&P downgraded the global credit rating of JBS from “BB” to “B+.”

According to the Vincent Wong law office in New York, a group of investors who bought JBS shares between 2nd June 2015 and 19th May 2017 have organized a class action suit against JBS because of HUGE losses.

5.3 – Services sector expanded

On 14th June, IBGE released a surprising result ➔ +1.0% MoM in April. This was the best result since March 2016 (+1.2% MoM). In March 2017, the result was negative (-2.6% MoM). **However**, this result was negative compared to April 2016 (-5.6%). According to Roberto Saldanha, IBGE research coordinator, this positive result was due to expansion of the agriculture and transportation sectors in early 2017. The tourism sector had a negative result ➔ -2.0% MoM.

5.4 – Retail Sales increased in April

Due to the FGTS disbursements, lower inflation and interest rates, for the first time in two years retail sales increased by +1.9% YoY and +1.0% MoM in April. Although access to consumer credit has improved, the basic Selic rate has been reduced and consumer interest rates only began to
decline in April, analysts are concerned that this trend will not continue in May and June. This was the best April result since 2006.

5.5 – Federal revenues declined in May

The SRF announced that federal revenues declined in May, in spite of R$ 2.5 billion from the Refis program revenues were down by -3.0% YoY. This result cast doubts on the “end of the recession in Brazil”. Personal income taxes were up +1.6% in May, but the IRPJ was down -12.1%, the IPI was down by -12.7% and the CSLL was down by -17.0%.

5.6 – Possible sale of Banco Original

Many Brazilians were surprised in early 2017 by the massive barrage of TV commercials promoting the new Banco Original, with many TV stars featured in these commercials. Equally surprising was the removal of these TV commercials in late May, after the JBS plea bargaining testimony was announced. This bank was one of the “creative initiatives” of the JBS/J&F group.

Now markets are predicting the sale of this Banco Original that was created in 2011 with the acquisition of the Banco Matone. The “problem” is the R$ 3.5 billion debt that Original has with the FGC (sort of the FDIC in Brazil). This outstanding debt is more than the estimated sale price of Original. In its 1st Q/2017 balance sheet, Banco Original has net assets of R$ 2.1 billion.

The FGC loaned JBS R$ 1.85 billion for its acquisition of Matone for repayment in 15 years at interest rates tied to the Selic. Reportedly, Santander is interested in acquiring Banco Original due to its investments in the agri-business sector.

It is possible that J&F might divest some R$ 20 billion in assets to meet short term obligations ➔ Banco Original, Vigor, Alpargatas and Eldorado.

5.7 – June Inflation ➔ IGM-10

On 14th June, the FGV announced the result of its IGP-10 ➔ -0.62% (deflation). In May, the IGP-10 posted deflation of -1.10%.

5.8 – Positive FX Flows

On 14th June, the Central Bank releases FX flows data for 2017. Up until 9th June, Brazil had a positive net FX flow of +US$ 10.474 billion. In the same period in 2016, the FX flow was negative ➔ -US$ 8,480 billion. After a positive result in May (+US$ 744 million), the June result (so far) was negative (-US$ 1.305 billion)

5.9 – Central Bank launched “Newsletter”

Every Monday, the Central Bank releases its weekly bulletin ➔ Focus that complies opinions and economic projections by a group of financial analysts. On 13th, the Bank announced that it will
launch a newsletter to communicate with Brazilian “society” → *Conexão Real com o Banco Central*. Those interested in receiving this newsletter can communicate with the e-mail address below:

→ *comunicacao@bc.gov.br*

5.10 – Central Bank IBC-Br

On 16th June, the Central Bank announced its IBC-Br (Index of Economic Activity) for the month of April → +0.28% MoM and +0.51% YoY. **However**, the 12-month accumulation is still negative → -2.66%. The specialists surveyed by the last weekly Central Bank bulletin *Focus* (on 12th June) reduced their projection for the IBC-Br for 2017 (+0.41%) and 2018 (+2.30%).

5.11 – Central Bank reduced inflation target

The CMN-National Monetary Council has reduced the inflation target for 2019, 2020 and 2021 4.50% → 4.25%. The target of 4.50% was established in 2005. **However** – the Central Bank continues to carefully analyze the “uncertainties” (current and future) as it decides the basic Selic interest rate at the next Copom meeting on 25-26 July.

5.12 – FDI → Brazil declined 2013→2017

In a study conducted by A.T. Kearney and Amcham-SP (FDI Confidence Index), Brazil was in third rank in 2013 and declined to 16th rank in 2017 → FDI as a % of GDP.

5.13 – Five banks to create a Credit Bureau

On 14th June, the Banco do Brasil, CEF, Bradesco, Itau Unibanco and Santander announced that they will create new **Credit Bureau** → *Gestora de Inteligência de Crédito S.A.* The “target” is clear – the three large “consumer credit protection” agencies with net some R$ 3 billion per year → SPC, SCPC and Serasa Experian – “to create conditions for a more solid and sustainable market” in Brazil. This initiative must be approved by the CVM and should become operational in 2019.