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Subject: FW: Faria: Brazil Daily Update
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-----Original Message-----

From: Isin Sumengen-Ziel (DEUTSCHE BANK AG, LO) [REDACTED]
Sent: Friday, July 03, 2015 04:54 PM Eastern Standard Time
To:
Subject: Faria: Brazil Daily Update

The political risk is increasing

Newspaper Folha de S.Paulo reported on Friday that a black-market dollar dealer who is currently under arrest in connection with the Petrobras bribery scandal recently testified that someone working on behalf of President Dilma Rousseff's campaign organizers asked for his help to repatriate BRL20mn illegally kept in offshore deposits last year. While the details are sketchy and it seems that the defendant does not have any proof to corroborate his allegations, the overall impression is that the investigations are getting closer to the government. Folha also reported that Vice President Michel Temer (PMDB) is seriously considering quitting the position of Rousseff's chief political coordinator. Speculation about Temer's abandoning the post increased this week after Lower House Speaker Eduardo Cunha (PMDB) argued that Temer should quit. The PMDB reportedly resents the fact that the government is blocking the appointments that Temer has offered lawmakers in exchange for passing the fiscal adjustment bills in Congress. Deterioration in the political atmosphere has led to some important defeats recently to the government, such as the proposed increase in wages for civil servants in the judiciary system, reduction in fuel taxes, and automatic adjustment of social security benefits – all of which will have to be vetoed by Rousseff in order to minimize the strain on the fiscal accounts. Writing on newspaper Valor Economico on Friday, columnist Claudia Safatle argued that, given the steep decline in Rousseff's approval ratings and deepening economic recession, congressmen are willing to wait until October to see which way the wind blows. If things do not improve significantly, there could be two solutions: 1) keeping Rousseff as president under the tutelage of the PMDB and former president Lula's acquiescence; or 2) impeaching Rousseff, and replacing her with Vice President Michel Temer. We continue to believe that scenario number one is much more likely than number two, as impeachment would be legally complex and politically extremely traumatic. However, it is hard to deny that the political environment has deteriorated and the risk of scenario number two materializing has increased. The latest developments suggest that Rousseff is becoming increasingly isolated, and unable to regain political initiative. We would see enormous uncertainty in an impeachment scenario. It would not be clear at all, for example, how fiscal and monetary policies would be managed, as the new president would continue to face the same economic problems that Rousseff is struggling to tackle, and would probably have to deal with enormous opposition from the PT in Congress.

The BCB reduced the rollover of FX swaps again

On Thursday night, the BCB announced that it would offer on Friday only 6,000 contracts to roll over USD10.7bn in FX swaps due in August. At this pace, the BCB will roll over only 60% of the next maturity, approximately, down from 70% in July. Thus, the BCB continues to signal that it is comfortable with a weaker BRL (which stimulates net exports and helps reduce the current account deficit), taking advantage of appreciating movements to reduce the supply of FX swaps (which are currently at approximately USD111bn), and using interest rates to curb inflation.

Week ahead:

On Monday, the BCB will release its Focus survey of market participants, and we do not expect major changes (we expect the consensus forecast for the 2015 IPCA to remain at 5.5%). The government could release the trade balance for the first week of July. On Tuesday, FGV will publish the IGP-DI inflation index for June, and we expect it to accelerate to 0.70% in June from 0.40% in May, due to lower deflation of agricultural products, increase in lottery ticket prices, and seasonal increase in construction wages. On Wednesday, FIPE will release the first July preview of São Paulo's consumer price index, and we expect 0.45%. For the first preview of the IPC-S to be released by FGV, we forecast 0.75%, down from 0.82% in June due to the tapering off of the increase in lottery ticket prices. IBGE will publish the IPCA consumer price index for June, and we project 0.85%, up from 0.74% in May, mainly due to lottery tickets and air travel. We expect 12-

month inflation to accelerate to 8.96% from 8.47% in the previous month. On Thursday, FGV will release the first July preview of the IGP-M inflation index, and we expect 0.60%, compared to 0.47% in the first June preview, mainly due to the end of deflation of agricultural prices and seasonal increase in construction wages.

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