



A test of “Brazilience”: What next for Brazil?

By Thomas Kamm, Partner, São Paulo

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A test of “Brazilience”

A picture making the rounds of social media in Brazil shows Kevin Spacey, a.k.a. Frank Underwood, the cynical and manipulative villainous hero of TV series *House of Cards*, grinning in appreciation under the caption: “Watching today’s Brazilian news coverage.”

It’s easy to understand his enthusiasm. Here’s what happened in some of the most recent episodes: Facing possible impeachment, the President tries to name her predecessor to a position equivalent to Prime Minister to help her wheel-and-deal her way out of the mess. But the country’s judiciary blocks the appointment after leaked wiretaps (which may be illegal) appear to indicate that it may well be mainly designed to prevent the former President from being jailed for alleged corruption.

Meanwhile, the Vice President announces his party is withdrawing its support for his ticket-mate the President. He calls for his party’s ministers to leave the government – while refusing to leave office himself, because if the President is indeed impeached, the top job is his. When the Vice President accidentally makes public a recording of his draft acceptance speech calling for “a government of national salvation,” a presidential aide exclaims: “The mask of the conspirator has fallen.”

The impeachment proceedings are being led by the Speaker of the House. He is himself subject to possible destitution for alleged corruption. He’s assisted by a 65-person committee, about one-quarter of whose members themselves face some sort of allegation of corruption or misdeed. One of them is even the object of an Interpol warrant.

A former Minister who served under the President and Vice President is planning to file a second impeachment procedure against the Vice President, saying he is “the real captain of the coup” that he alleges is taking place. And the judge at the heart of all the investigations resuscitates an old corruption scandal, saying that newly-obtained evidence may point to the implication of the former President in a blackmail case surrounding the unresolved 2002 murder of a mayor.

President Francis J. Underwood may indeed have met his match in Brazil. If you thought that some of the scenes described above are from a fictional

TV series, you’re wrong. They all occurred in the past few days in Brazil. And if you feel somewhat confused by this real-life reality show, you are not alone. Brazilians also find it hard to keep up with the whirlwind of allegations and accusations. Parodying former President Luiz Inácio Lula da Silva’s habit of bragging about his achievements by saying that they are all firsts in Brazilian history, commentator J.R. Guzzo wrote recently in newsweekly *Veja*: “Never before in the history of this country have we had so many clear opportunities to say ‘Never before in the history of this country...’ “

This is the same Brazil that only a few years ago was the star emerging market, the rising global power, the land of the future, the B of BRICS. The country today is on the verge of what could be the biggest crisis this crisis-prone nation has ever faced – or a cathartic break from its past. “Brazil is going through one of the most challenging moments in its history,” Roberto Setúbal, CEO of banking giant Itaú Unibanco, said recently at a conference.

Engulfed in a massive corruption scandal, a deep political crisis that threatens to bring down the government of President Dilma Rousseff and the worst recession the country has faced since the Great Depression (not to mention the outbreak of the Zika virus just as Rio de Janeiro prepares to host the Olympic Games in August), Brazil is being subjected to a massive stress test that can either lead to a prolonged downward spiral or prove to be a pivotal moment that ultimately sets the country back on a more sustainable political and economic course. Call it a new test of what could be called “Brazilience,” Brazil’s resilience and resourcefulness in the face of crisis.

Indeed, just as the 1992 destitution of then-President Fernando Collor de Mello on corruption charges and exhaustion from years of hyperinflation paved the way for the 1994 Real Plan that set the country on a 15-year growth cycle that had some believing that the proverbial land of the future also had a brilliant present, today’s crisis could contain the seeds of a reinvention of Brazil’s business model. “The positive side of the current crisis is that it has raised awareness for the need to carry out reforms,” says Itaú Unibanco economist

Caio Megale. So for all the apparent mess, investors with an appetite for risk may want to take advantage of the depreciated Real to consider investing in this market of 200 million people at a time when assets are cheap.

For now, Brazil is heading into uncharted waters. There are three possible short-term scenarios, all fraught with uncertainty:

Scenario 1: Ms. Rousseff defeats impeachment

While polls show that 61% of the population supports impeachment, the decision belongs to Congress and depends on the political forces at play. Impeachment is a multi-step process (see box) and the first key step will take place as early as April 17, when the lower house is expected to vote on whether or not to pass the matter on to the Senate. For the impeachment procedure to continue, 342 members of the House must vote in favor, while the government needs 171 members to block it. That's why Ms. Rousseff is frantically seeking political support and is prepared to offer government positions and jobs at state entities to parties and deputies willing to vote in her favor – or simply to not show up to vote against her. The wheeling-and-dealing has reached such a fever pitch that even Paulo Maluf, a member of the House and of the special commission on impeachment, whose long political career has been marred by corruption scandals (he's the one with the Interpol warrant against him for alleged money laundering), exclaimed: "I am revolted and nauseated by this policy of buying and selling (votes). The government's action should be in the domain of a legal defense." The question is what would Ms. Rousseff be able to achieve if she survives the impeachment procedure: her popularity and ability to govern are in tatters, as demonstrated by her recent (so far frustrated) attempt to appoint Former President Lula to the government. In fact, many commentators say that if she survives the vote and Mr. Lula da Silva's appointment is confirmed, he will be the real President of the country. As such, wrote Estado de São Paulo in an editorial

entitled "The coup without impeachment," while Ms. Rousseff claims she is the victim of a coup attempt, by appointing Mr. Lula da Silva she waged a coup against herself and "was deposed de facto by what we could call a domestic arrangement." In this scenario, structural reforms are unlikely as the government will try to cater to its leftist base and will need to repay the favors it granted to stay in power.

Probability of this scenario: 25%

Scenario 2: Ms. Rousseff is impeached and Vice President Michel Temer takes office

If the House votes in favor of impeachment and the Senate then confirms the vote, Ms. Rousseff would have to step down for an initial 180-day period and Vice President Michel Temer would take office. Although he was elected and reelected on the same ticket as Ms. Rousseff, the two have never been close and last December, he even wrote a letter to Ms. Rousseff in which he said she showed "complete lack of trust in me" and complained he was reduced to a "decorative" role. A 75-year-old constitutional lawyer with a beauty-queen wife 43 years his junior who has his name tattooed on the back of her neck, Mr. Temer is President of the PMDB party but has always been a discreet politician. His possible appointment is well viewed by Brazil's business community, especially since the October 2015 launch by the PMDB of a government program named "A bridge to the future," which calls notably for fiscal adjustment, a more open economy, privatization, more flexible labor laws and an end to inflation-indexation on pensions and the minimum wage. However, a recent poll showed that only 16% of Brazilians think the low-profile Mr. Temer would do a good or great job as president, and while he is not the object of any investigation at this stage, his name has been mentioned in connection with some of the scandals under investigation, and he also faces

possible impeachment, having been elected on the same ticket as Ms. Rousseff. In this scenario, the change in government could bring a “confidence shock” that could be a boost to markets and the economy, and some limited structural reforms could be implemented.

Probability of this scenario: **65%**

Scenario 3: New elections

Should both Ms. Rousseff and Mr. Temer be impeached or the political situation become untenable, the way out would be fresh elections. In recent weeks, that option has started gaining traction, and politicians as diverse as Marina Silva, the twice-defeated presidential candidate and former Environment Minister under Mr. Lula da Silva and Renan Calheiros, the Senate President, have defended that solution. However, lawyers and political scientists see strong obstacles, and such a move could be contested. It also raises a practical question: who would be the likely presidential contenders? Ms. Silva would definitely be one, but she has yet to articulate a coherent program. Mr. Lula da Silva has indicated he would like to run again, but his legal situation is in limbo and his popularity has been seriously tarnished. Aécio Neves, head of the Social Democratic Party of Brazil, who was narrowly defeated by Ms. Rousseff in 2014, would likely run again, but his name has also surfaced in some of the recent scandals. The Car Wash scandal has also been a political wash, leaving few top politicians untouched.

Probability of this scenario: **10%**

How did Brazil get into this mess?

The country is actually facing not one, but three simultaneous crises that are interlinked and feed on each other like a vicious circle.

The first is the so-called Lava Jato, or Car Wash, corruption scandal at Petrobras. What started as an investigation into apparent money-laundering at a gas station in Southern Brazil (hence the Car Wash moniker) has mushroomed into a huge graft scandal in which top politically-appointed executives at Petrobras colluded with contractors to grant overpriced contracts in return for kickbacks that benefited political parties and funded election campaigns.

Using a form of plea bargaining known in Brazil as *delação premiada*, under which denunciations of previously undisclosed misdeeds lead to reduced sentences, the team of investigating magistrates led by Judge Sergio Moro has uncovered a large-scale web of corruption involving a Who's Who of Brazilian politics and business. This scandal has already led to the imprisonment of the CEOs of several construction giants, including Marcelo Odebrecht, the CEO of the eponymous Odebrecht group that is Latin America's biggest in its sector, the resignation of André Esteves, the CEO of BTG Pactual, one of the country's biggest investment banks, allegations that former President Lula is the beneficiary of a beachfront triplex and a country estate, and accusations against several top politicians, including the Presidents of the Chamber of Deputies and the Senate and the ruling party's whip in the Senate. The most recent wave of denunciations that have leaked to the press have brought the scandal dangerously close to the Presidency: The former CEO of construction company Andrade Gutierrez, Otávio Marques de Azevedo, revealed that money diverted from Petrobras and other projects was allegedly used to finance legally-declared contributions to



Ms. Rousseff's victorious 2010 and 2014 presidential campaigns.

The second crisis facing Brazil is an economic one. The situation is so bad that when former Central Bank Governor Affonso Celso Pastore was asked recently at a conference what would be his first decision if he were appointed Finance Minister, he replied: "Resign!" Indeed, Brazil finds itself today in the sort of mess some had thought it had forever left behind following the 1994 Real Plan: a paralyzing morass of recession, inflation and deficits. The country has been stripped of its investment-grade rating by all three top global rating agencies and has been cut to junk. The commodities-fueled 7.5% GDP growth posted in 2010 now seems a distant memory: Brazil's economy contracted by 3.8% last year, and economists are predicting another drop this year of between 3.7% and 4%. "If the 4% contraction in GDP is confirmed, we would be facing the most profound recession in a century," says Itaú's Mr. Setúbal. Inflation last year returned to double-digits, at 10.67% - although there are signs now that Brazil's slowdown is gradually strangling inflation as well. Unemployment has nearly doubled in two years to 9.5%. While some countries today are grappling with negative interest rates, Brazil's base Selic rate is at 14.25%. Brazil's gross debt has jumped by almost a third in the past two years and now represents 66% of GDP.

The government created much of this situation itself by progressively abandoning the so-called economic tripod that was the hallmark of Brazil's economic stabilization plan - a combination of inflation targeting, fiscal responsibility and a floating exchange rate - in favor of what it called a "new economic matrix" of Keynesian stimulative measures, price controls and subsidized credit. The shift was started under President Lula to counter the 2009 global financial crisis, but it was continued and amplified under Ms. Rousseff. It helped her win the 2010 and 2014 elections, but it has thrown the economy off course. After a half-hearted attempt to restore order by appointing fiscal hawk Joaquim Levy as Finance Minister following her reelection, Ms. Rousseff jettisoned him less than a year later, and his successor, Nelson Barbosa, is left trying to fix the mess. And now, in a desperate attempt to save her job, Ms. Rousseff and her government have embarked on

another wave of deficit spending that threatens to worsen Brazil's deficits and debt.

And this, in turn helps fuel Brazil's third crisis: a political one. Within months of her narrow reelection in 2014, Ms. Rousseff had already fallen to record low popularity levels, and with the corruption scandal and economic downturn, things are going from bad to worse. Although Ms. Rousseff has not been personally implicated in corruption at this stage, each new revelation makes it harder to stave off impeachment. The irony is that while a DataFolha poll shows there is widespread support for Ms. Rousseff's impeachment and for Mr. Temer's as well, the reason invoked is not the one that has brought millions of Brazilians into the streets against corruption, but a technical one: she is accused of having violated Brazil's Law of Fiscal Responsibility and presenting an artificially low deficit by temporarily transferring payments due by the state to state-controlled financial institutions. Though the amounts in question are significant, Ms. Rousseff claims that such maneuvers have been done by previous governments and says she committed no "crime of responsibility" that would justify impeachment.

In a move that smacked of desperation, Ms. Rousseff recently tried to appoint her predecessor, Mr. Lula da Silva, to the position of Ministro da Casa Civil, a sort of Prime Minister or Chief of Staff, charged with translating his (now significantly reduced) popularity and political skills into support for the government. The appointment is in limbo after having been temporarily blocked by a Supreme Court justice for possible obstruction of justice. A wiretap of a conversation between Ms. Rousseff and Mr. Lula da Silva was released suggesting that the offer of a government post may have been designed to help Mr. Lula da Silva escape the clutches of Judge Moro's investigation into his real estate properties, as standing ministers can only be tried by the Supreme Court. The recent decision by the PMDB party to leave the ruling coalition deprives Ms. Rousseff of another key ally. In what newsweekly *Veja* called in its latest issue a "super-sale" of government positions and favors, Ms. Rousseff is now throwing all her energy into trying to cobble together enough votes to fend off her impeachment.

So where does all this leave Brazil? In the short-term, facing paralysis until there is clearer



resolution. But take a medium-term view and there are some reasons for cautious optimism. That's where Brazilience comes in.

Indeed, equally fascinating as the day-to-day developments of the unfolding drama are the less visible undercurrents that are playing out. By laying bare the entrails of what makes Brazil's economy and political system function, today's huge crisis is exposing that Brazil's state-led growth model has run its course and leading to calls for a rethink of what economist Sergio Lazzarini has called the country's "capitalism of links," a closely intertwined, incestuous relationship between politics and business in which laws, jobs and favors are up for sale while the population watches helplessly from the sidelines. "Brazil has a historical opportunity to define its future," political scientist Carlos Pereira told *Folha de São Paulo* recently.

This will certainly not happen overnight and changes will be incremental, but consider some recent signs: Forsaking the Constitution, Renan Calheiros, the President of the Senate and an ultimate political survivor of a host of scandals over the past two decades, has called for general Presidential, Congressional and Gubernatorial elections (including for his own Senate seat) to wipe the slate clean. Former Finance Minister Mailson da Nóbrega devoted one of his recent columns in *Veja* to a call for the privatization of state-controlled oil giant Petrobras, the company at the heart of the current corruption scandal, whose status as a ward of the state is an untouchable sacred cow in Brazil. "In practice, [Petrobras] has been privatized in favor of groups who used it to peddle influence, finance political projects and enrich themselves," he wrote. "It would have been difficult for such a catastrophe to happen if Petrobras had been a private company." And the repeated street protests that have shaken Brazil since 2013 attest to the rise of a consuming class that wants to see a return on the taxes it pays and does not want to lose the gains that have come with stability. "We have an analog political class and new, digital voters who don't want to just listen, they want to be heard, be players," Renato Meirelles, President of polling institute Data Popular, which specializes in the rising middle class, told business daily *Valor Econômico* recently.

There are some strong parallels to the Collor de Mello situation, and Brazil emerged stronger from it. Brazilians long showed tolerance with very high inflation, but it took hyperinflation to finally make them accept the tough medicine that broke its back in the mid-1990s. An apparently weak Vice President, Itamar Franco, took office when Mr. Collor de Mello was ousted, and after running through three Finance Ministers, he eventually named Fernando Henrique Cardoso to the post. Mr. Cardoso implemented the Real Plan, and then leveraged his success in fighting inflation into two successive presidential terms that resulted in major structural reforms that paved the way for Mr. Lula da Silva's important social reforms.

Similarly, Brazilians have long tolerated corruption, but today's hypercorruption may be what it takes to finally attack it - and the system sustaining it - head-on. By exposing how the strong role of the state in the economy and its attendant political patronage have plunged Brazil into today's mess, the Lava Jato scandal is also pointing to what needs to be fixed. In fact, as the PMDB's program shows, calls to open up and flexibilize Brazil's economy are rising from several quarters, and the need for political reform, to reduce the number of parties (there are currently 28 in Congress, and they are more interest groups than parties) reform party financing and make politicians more accountable, are also emerging. "The failure of 'presidential coalitionism,' precipitated by the disaster of the Dilma government, imposes rethinking the *modus operandi* of Brazilian politics," economist Eduardo Giannetti wrote in *Folha de São Paulo*.

Brazilians have had a taste of economic stability and prosperity and have seen the emergence of a middle class, and they have more to lose than ever from the perpetuation of the current crisis. So while the headlines bring new revelations every day and seemingly plunge Brazil deeper into scandal, the very fact that the investigation is proceeding unabated is a sign of the vitality of Brazil's democratic institutions. The coming months will be messy, but they could well lay the ground for measures that could ultimately consolidate democracy and strengthen the world's seventh-largest economy. In the meantime, however, it's likely that Francis Underwood will have a few more reasons to smile appreciatively as he watches the Brazilian news flow.

Brazil's impeachment process: A step-by-step guide

Articles 85 and 86 of Brazil's 1988 Constitution set out the procedures for impeachment. Following is a summary of the key steps:

Step 1:

The lower house, or Chamber of Deputies, sets up a 65-member special commission to determine whether the impeachment bid is valid. This was done on March 17. President Dilma Rousseff gets to present her defense, and the commission's rapporteur then issues its recommendation.

Step 2:

Following the special commission's recommendation this Monday by a 38 to 27 vote that the impeachment procedure should proceed, the full House votes on it. Ms. Rousseff's opponents need to garner 342 votes, or two-thirds of the house members. Ms. Rousseff needs to garner 171 votes or enough abstentions to defeat impeachment. The vote could take place as early as mid-April.

Step 3:

Should 342 or more members of the house vote in favor of impeachment, the case then moves to the Senate. The Senate also sets up a special commission. If a simple majority of the Senate votes in favor of impeachment, Ms. Rousseff is removed from office for up to 180 days and Vice President Michel Temer takes over. The Senate vote could take place as soon as early May.

Step 4:

The Senate uses the 180-day period to conduct its trial, chaired by the President of the Supreme Court. If two-thirds or more of the 81 Senators vote to impeach Ms. Rousseff, she is permanently removed from office and is banned from public office for eight years. If less than two-thirds of the Senate votes in favor of impeachment, Ms. Rousseff reassumes office.

In this particular case, there is a further element of uncertainty, as Vice President Michel Temer is possibly facing impeachment proceedings as well, having been elected on the same ticket as Ms. Rousseff and having, while in his role of acting President while Ms. Rousseff was out of the country, approved decrees that contributed to the accounting maneuvers for which Ms. Rousseff is being threatened with impeachment. Should both the President and the Vice President be removed from office, a new election is called with 90 days.

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For more information



Thomas Kamm,
Partner, São Paulo
+55 11 3076 7629
tkamm@brunswickgroup.com

Thomas Kamm is co-head of the São Paulo office. He has extensive experience in diverse aspects of corporate communications, including corporate positioning, media relations, financial communications, M&A and IPOs. Thomas acts as a senior consultant to clients on corporate and financial issues, with a particular emphasis on retail and consumer goods.

Thomas joined Brunswick in Paris in 2005, prior to which he worked for 18 years as a foreign correspondent and bureau chief for The Wall Street Journal in Europe, South America – he was based in Rio de Janeiro from 1989 to 1994 – and Africa. Subsequently, he was vice-president for communications and corporate affairs and a member of the Executive Committee of PPR (now called Kering), the French luxury and retail Group.

Contact Brunswick São Paulo



Address

Avenida Dr. Cardoso de Melo,
1340, Sala 42, Vila Olimpia,
Sao Paulo, SP, Brasil, 04548-004

Tel: +55 11 3076 7620

Email: saopaulooffice@brunswickgroup.com