



Brazil's Olympic-Sized Challenge

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As it prepares to host the 2016 Summer Olympics next month, Brazil is confronted with challenges of Olympian proportions.

It's not just the usual questions about preparedness, cost or security. It's also a health scare due to the Zika virus. And all of this is against the backdrop of a continuing political crisis and deep recession.

If Acting President Michel Temer is confirmed (suspended President Dilma Rousseff's impeachment trial may be decided during the Games), he faces four key issues that are the equivalent of competing in four simultaneous Olympic disciplines:

- **The sprint:** Hosting a successful Games
- **The 110-meter hurdles:** Remaining in power
- **The steeplechase:** Getting the economy back on track
- **The marathon:** Implementing structural reforms

It will take all of Brazil's inventiveness and spirit to pull it off, but Brazil is always good at parties and there are some encouraging signs beneath the apparent chaos.

For all of the confusion, the country's economic agenda has changed, and the combination of signs of economic improvement and the looming end to months of political uncertainty could drive a Brazilian recovery.

As Brazil prepares to host the summer Olympic Games next month, the country faces a vexing question: Which of its two Presidents will open and close the games? Could one open and the other close?

If uncertainty were an Olympic sport, Brazil would be a top contender for the gold medal. It's not just facing the usual host city questions, such as will the installations and infrastructure be ready, can Rio ensure the security of tourists who will throng the city and how will all this be financed? It's also facing health challenges such as the Zika virus. Above all, Brazil is confronting an existential question: When will it emerge from its deep political and economic crisis?

Indeed, the Olympic extravaganza coincides with another riveting event in Brazil: the ongoing impeachment trial of suspended President Dilma Rousseff — which is part of a broader saga, the Lava Jato investigation into corrupt ties between business and politics — whose daily developments transfix the nation like a larger-than-life soap opera. And the Russian-doll-like confluence of all three, leaves the country, currently governed by acting President Michel Temer, facing a host of unanswered questions just as the world's eyes are on it. "Brazil is going through a moment of several simultaneous crises," economist Marcos Lisboa, the President of the Insper business school, told Folha de São Paulo.

The 2016 Summer Games were meant to be the crowning achievement of Brazil's coming of age as a global superpower. The vaunted "B" in BRICS had left hyperinflation behind, lifted millions out of poverty and escaped the global crisis nearly unscathed. But something happened on the way to the debutante ball: President Luiz Inácio Lula da Silva, who nearly walked on water when he left office in 2010 (but now risks being ensnared in the Lava Jato scandal), was succeeded by Ms. Rousseff; economic policy veered off course, an investigation into money laundering turned into a gigantic corruption scandal and Ms. Rousseff was forced to cede, at least temporarily, her office to her vice-president, Mr. Temer, an ally



turned enemy. And so, the host of the Olympics looks more like a submerging market right now than an emerging one — although there are signs of advances towards a more free-market agenda that offer some medium-term hope.

For Mr. Temer, an accidental President still not certain he won't be more than a temporary one, this is a huge challenge that obliges him, in the words of economist Luiz Carlos Mendonça de Barros, to run “two parallel agendas”: a political one to shore up support in the short term — which means opening the purse-strings, and an economic one aimed at implementing longer-term structural reforms — which requires painful decisions. If it sounds contradictory, it is. If Mr. Temer were an Olympic athlete, he would be participating in four different events at the same time, to wit:

1 The sprint: Hosting a successful Olympics

Like previous host cities, Rio de Janeiro is racing to get ready on time. It has not been smooth sailing: an elevated bicycle path built for the games collapsed in April when hit by a huge wave, killing two people. The velodrome is still under construction, and a key new subway line connecting the Olympic Park to the city is behind schedule. Other infrastructure projects scheduled to be ready by game-time, such as an aquarium by Rio's port, will not be.

Brazil faced similar doubts in 2014 when it hosted the football World Cup, and it pulled it off with flying colors (even if some infrastructure projects remain on the drawing board to this day). While the current situation could be considered a familiar bit of chaos, it is not. With the state of Rio close to bankruptcy due to falling oil prices, the state's interim governor, Francisco Dornelles, declared a “state of calamity” last month to get the Federal government to pitch in 2.9 billion reais in emergency aid to fund security. Striking civil policemen greeted tourists arriving at Rio's Antonio Carlos Jobim Airport with a banner reading “Welcome to hell. Police and firefighters don't get paid, whoever comes to Rio will not be safe” — hardly the sort of publicity a host city wants. And then there's the Zika scare that threatens to keep tourists and even athletes away.

Despite these obstacles and polls showing that half of Brazilians disapprove of hosting the Olympics, the government, the city and local Olympic authorities express confidence that Rio will deliver a “spectacular Games” in the words of Carlos Nuzman, president of the organizing committee. The mayor of Rio, Eduardo Paes, maintains that the games will be on budget (and below the cost of Summer Olympics in other cities), leave a lasting legacy for the city, and be a big party —although he also told the Guardian that the current environment makes the Olympics “a missed opportunity” to showcase the country. Mr. Dornelles strikes a more cautious note: “We can have a great Olympics,” he told O Globo, “but if some steps aren't taken, it can be a big failure.”

2 The 110-meter hurdles: Surviving the impeachment trial and Lava Jato

Mr. Temer's other urgent challenge is to remain in office. “Who will be the country's President at Christmastime?” asked former Finance Minister Antonio Delfim Netto in business daily, Valor Economico. By a vote of 55 to 22, Ms. Rousseff was suspended in May by Brazil's Senate for a maximum of 180 days, during which the Senate will conduct an impeachment trial. If two-thirds or more of the Senate vote to impeach her, the 75-year-old Mr. Temer serves out the rest of Ms. Rousseff's term, until end-2018. If less than 54 of the 81 Senators vote in favor of impeachment, Ms. Rousseff returns to office with Mr. Temer as vice president. Although the focus of Brazil is on the Lava Jato scandal, Ms. Rousseff's personal integrity is not the issue, despite mounting evidence that her victorious campaigns of 2010 and 2014 may have been financed by money skimmed off from government contracts. She was suspended for alleged budgetary irregularities used to mask the size of Brazil's deficit in violation of the country's Fiscal Responsibility Law.

Ms. Rousseff claims she is the victim of a “coup” to remove her, but Mr. Temer denies this saying the entire procedure was in line with the Constitution and has been approved by both houses.



Ms. Rousseff is pinning her hopes on a recent report by a nonpartisan team of Senate budget analysts that cleared her of some, but not all, of the irregular bookkeeping allegations. She is also counting on Mr. Temer's low popularity: a recent poll by DataFolha showed just 14% said his government was good, barely above Ms. Rousseff's 13% rating in April. His rejection rates are half those of Ms. Rousseff's and he has been more skillful than his predecessor at building Congressional support. Most political analysts give Ms. Rousseff slim chances of returning. Even if Mr. Temer survives the impeachment trial, his troubles are not necessarily over. Though some would like to stop it, the Lava Jato investigation continues relentlessly, and by one recent count it has already put 95 politicians under investigation, 47 people under arrest, 101 people awaiting judgment and 77 condemnations, some of whom are among the country's most important businessmen. In his two months in office, Mr. Temer has already had to sack three of his Ministers, and the Lava Jato could even impact Mr. Temer himself, though he has denied all allegations of wrongdoing and told Folha de São Paulo in an interview that he had "zero" concerns about being involved.

3 The steeplechase: Getting the economy on track

Should he survive the impeachment proceedings and Lava Jato, Mr. Temer faces another huge challenge in fixing the economy. Brazil is in its worst recession since the Great Depression, with GDP down last year by 3.8% and set to contract by about the same level this year. Unemployment has soared by more than 40% in one year and today stands at 11.2%, with 11.4 million people out of work. Inflation, in double digits last year, is at 8.84% over the past 12 months. Brazil's gross debt has jumped by almost one-third in the past two years to 66.2% of GDP and rising rapidly. Brazil has been cut to junk status by all three major credit rating agencies.

Reading Brazilian newspapers today yields a cornucopia of negative superlatives. Telephone company Oi just filed for the biggest-ever Chapter 11 proceeding in the country to restructure its debt. Auto production has fallen to 2004 levels and the country has slipped from the world's seventh biggest automaker to the 10th in the space of six months. First-half retail sales in São Paulo are the worst since 1995: industry is operating at 64% capacity, GDP per capita over the 2014-2016 period has fallen by 9% and according to consultants Tendencia, between 2014 and 2018 5.21 million families will be relegated from the much-vaunted C class which, as the consuming class, was the symbol of Brazil's rise.

The government is in a policy bind. Despite the deep recession, the persistence of high inflation and deficits forces it to pursue a restrictive monetary policy, with the benchmark Selic interest rate at a whopping 14.25%, and enforce spending cuts and possibly even some tax hikes. Still, for all the gloom, the government's economic team is highly respected and there are encouraging signs. Industrial production has been at least stable for three consecutive months — the first time since 2012. Inflation is falling, and the hawkish stand by the new Central Bank President Ilan Goldfajn has raised hopes of a sharper fall next year. GDP contraction may have bottomed out. The country's deficits are still huge, but Finance Minister Henrique Meirelles has promised a deficit next year of 139 billion reais, down from an estimated 170.5 billion reais this year. More importantly, he has proposed a constitutional amendment that would freeze budget spending for 20 years, which would actually represent a drop in spending once inflation is discounted.

But for now, Mr. Temer has his hands tied. Even as Brazil faces yawning deficits, he has opened the coffers to build support ahead of the impeachment vote — including a 12.5% increase in the Bolsa Familia welfare program. "The government has been ambiguous," Insper's Mr. Lisboa told Valor Economico, "Some important measures are starting to go in the right direction, and others are off-track." The interim government, he says is "a hostage to its fragility."

4 The marathon: Implementing structural reforms

Though Brazil's economic mess requires a quick fix, there's a broad consensus that the country needs to remove strangleholds on growth and pursue deep structural reforms. While the government is focused on emergencies such as staunching deficits, it has shown encouraging signs of being open to reforms once the contingency of the impeachment trial is overcome. Among the expected reforms are:

- **Liberalizing local content laws:** In a recent damning report, the Federal Accounting Court, a watchdog body, wrote that local content requirements — one of the Workers' Party's standard bearers — have been ideologically motivated and have in fact been detrimental to Petrobras and the oil & gas industry's competitiveness. The government is planning to announce changes soon.
- **Opening up pre-salt exploration:** The government is currently pushing a bill through Congress that would remove Petrobras's obligation to hold at least 30% of all exploration blocks in pre-salt oil fields. The requirement is viewed as penalizing both to Brazil and to Petrobras, and its new CEO, Pedro Parente, supports lifting it.
- **Privatization:** Although privatization is something of a dirty word in Brazil, the government is contemplating a vast program to raise up to 30 billion reais. The plan could include assets owned both by the Federal government and State governments, including airports, road concession, energy companies and financial institutions. Petrobras is also seeking to sell part of its stake in its distribution arm, BR Distribuidora.

- **Pension reform:** Brazil runs an unsustainable deficit in its pension system, equivalent to 2% of GDP, largely because it is one of the few countries in the world to have no minimum retirement age: men can retire after 35 years in the labor market and women after 30 years. The government is seeking to set a minimum age requirement, introduce a minimum number of years of contribution into the system and reduce disparities between the public and private sectors. The issue is very sensitive politically, but the government has indicated it could seek a step-by-step approach.

For all the apparent gloom and doom, the Temer presidency has clearly changed the country's economic agenda and even its mood. With polls showing that optimism is on the rise, this could mean a Brazilian comeback in the medium term as more pro-business policies take hold. Prominent businessman Abilio Diniz has said repeatedly that Brazil is cheap and investors are just waiting for signs of political stability to jump in to sectors such as agribusiness, services and information technology. "If the economy enters a positive trend, you will see how much money will come in," he told Bloomberg recently.

The challenges faced by Brazil are daunting, but at the same time, the unpredictable situation could actually be an opportunity. The economic and political situation clearly points to a need for deep structural changes. The confusion around the impeachment trial will be resolved, one way or another, by November and possibly during the Olympics. If Mr. Temer is confirmed, he will have a freer hand to deliver reforms, especially since he has already said he would not run for re-election in 2018. Lava Jato will continue to weigh on the political class, but it's also a sign of functioning institutions that could also lead to a more robust fight against corruption. Despite Rio's manifold ills, Brazilians are experts at last-minute solutions and are great at parties, so the Olympics could well be a success. And the sports-crazy country may well win a batch of gold medals in the stadiums as well.



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