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## **New Version Presented for Valério's Mysterious Bank Withdrawals**

The two leading figures in the congressional budget scandal last week both came forward with similar statements admitting that the PT Party used an advertising executive to make suspicious payments to individuals. Both denied, however, that these payments were bribes paid to members of Congress to vote for the government.

On Friday, in a television interview, accused executive Marcos Valério de Souza said that he had used his two advertising companies to raise bank loans that were then passed on to the PT Party. According to Souza, the party's ex-treasurer Delúbio Soares then gave him the names of persons and companies to receive payments.

Souza said this explained the R\$21 million (US\$9 million) in bank withdrawals from his companies since 2003. Both Souza and Soares have been accused with operating a payoff scheme in which Souza allegedly used the funds withdrawn from his companies' bank accounts to pay bribes to congressmen in return for their votes.

In the interview, Souza refused to name the persons and companies that received payments but denied that there were any monthly payments made to congressmen, as has been claimed. According to Souza, the loans his companies negotiated for the PT occurred in 2003 and 2004. His lawyer, Arnaldo Malheiros, later said that the loans totaled between R\$35 million (US\$15 million) and R\$40 million (US\$17 million).

Souza offered no explanation as to why he did this favor for the PT, saying only that he acted at the request of Soares, his friend, who said the party was in financial difficulty and needed the money to pay off campaign debts from the elections of 2002 and 2004. Souza's advertising firms have several lucrative contracts with government agencies, including the Banco do Brasil.

By coincidence, on Friday, the same day of Souza's television interview, the Banco do Brasil announced it was rescinding its contract with one of Souza's companies to avoid damage to the bank's image.

On Saturday, the day after the Souza interview, Soares also gave a television interview in which he

confirmed the version presented by Souza. Soares admitted that the PT used the funds raised by Souza's firms to make unreported campaign donations in the elections of 2002 and 2004 to politicians from the PT and allied parties. This would be in violation of Brazil's electoral laws but would also be far less of a crime than the alleged bribery scheme in Congress.

Soares also did not name the persons who received these illegal campaign donations but denied that President Lula in his campaign for president in 2002 received any of these funds.

According to Soares, Souza agreed to finance the PT because he hoped that in return PT politicians would contract his firms to handle their campaign advertising.

The similarity of the stories presented by Soares and Souza led opposition members of Congress to question their veracity. Several charged that the two had worked out the latest explanation of Souza's bank withdrawals in order to escape the more serious charge of bribery.

## **Poll Shows No Loss of Support for Lula Despite Scandals**

A nationwide public opinion poll released Tuesday showed a surprising improvement in President Lula's approval rating.

In the July 5-7 poll taken by the Sensus polling firm, Lula's approval rose from 57.4% in May to 59.9% while his disapproval rating fell from 32.7% to 30.2%. The improvement came despite Brazil's largest corruption scandals in more than a decade and the government's most serious political crisis since taking office.

The government's image has also not been tarnished by the scandals. In the poll, the government's approval rating increased from 39.8% in May to 40.3%. The poll's results indicated that the public has not associated the corruption scandals with either Lula or the government. In the survey, 35.4% of the respondents said the accusations are directed at Congress, 31.2% at the PT Party and only 12% said the scandals involve Lula.

When asked to evaluate Lula's actions to deal with the scandals, 47.8% of the respondents said Lula had acted effectively versus 31.9% who said he had not done enough. Also 45.7% of the persons interviewed

said they do not believe Lula was aware of the scandals while 33.6% said they thought he was. But when asked whether corruption had increased in the Lula government, 40.3% said it had, up from 31.2% in the May survey.

The poll's results were generally favorable to the government but they also conflicted directly with a poll cited by *Veja* magazine in last week's edition. In that poll, taken June 21-29 by the Ipsos-Opinion polling firm, 55% of the respondents said they believe Lula was aware of the alleged PT payoff scheme in Congress. Out of these persons, 16% said they believe Lula was involved in the scheme.

### **Gushiken Loses Power in Cabinet Shakeup**

President Lula Tuesday announced more changes in his cabinet including a demotion for the government's communications secretary Luiz Gushiken.

Gushiken, who has been linked in press reports to alleged irregularities involving state company pension funds, lost the status of minister and his agency was placed under the command of cabinet head Dilma Rousseff. The move was interpreted as the first step in his eventual exit from the government.

The government's political coordinator Aldo Rebelo was removed and replaced by Jaques Wagner, head of the government's council for economic and social development (CDES). The ministry of political coordination and the CDES were merged and Wagner will be in charge of both.

Union leader Luiz Marinho took over as labor minister.

Science and Technology Minister Eduardo Campos was replaced by Sérgio Rezende, a highly regarded physicist with administrative experience as head of the ministry's fund for studies and projects (Finep).

Still to be named is the replacement for social security minister Romero Jucá.

### **PT Nearly Bankrupt with Debts of R\$72 Million**

The new directors of the PT Party stated Tuesday that they have found the finances of the party far worse than expected and warned that the PT is close to bankruptcy.

The PT's debts total more than R\$72 million (US\$30.7 million), including two controversial bank loans guaranteed by advertising executive Marcos Valério de Souza. Most of this debt resulted from campaign expenses in the 2002 general elections and the 2004 municipal elections.

According to the party's new leadership, the debt is now being subjected to an internal audit to determine

more precisely its origins.

### **Political Crisis Lowers Share Prices on Friday**

The political crisis again made its presence felt on the financial market at the end of last week.

After four days of advances, share prices tumbled on Friday after it was learned that advertising executive Marcos Valério de Souza had offered to tell all he knows about the congressional bribery scandal in return for a reduced sentence. The Bovespa index plunged 2.69%, reducing its gains for the week to 3.27%.

On the exchange market, the dollar fell 1.55% to close Friday at R\$2.338. On foreign market's, Brazil's country risk premium fell five points to 404 basis points.

### **Brazil To Pay IMF Debt Ahead of Schedule**

The Central Bank announced Wednesday that Brazil will pay back US\$5.1 billion to the IMF ahead of schedule in an operation that is expected to produce a savings in debt payments.

The payback was scheduled for July 25 and will produce a total savings of US\$82 million, according to the Central Bank.

The bank said in its statement it revised down its year-end forecast for gross foreign reserves to US\$56.6 billion from US\$57.7 billion because of the early payments to the IMF. The bank kept its year-end forecast for net reserves, which exclude IMF loan money, at US\$41.8 billion.

Brazil currently owes the IMF US\$20.8 billion which with the early payments will be reduced to US\$15.75 billion.

### **Retail Sales Recover in May**

Nationwide retail sales volume rose 0.40% in May from April, recovering from April's 0.24% decline. Compared with May 2004, sales increased 2.67% and for the year through May were up 4.51% versus the same period in 2004, according to the monthly survey of the government's statistics bureau, IBGE.

May's improvement was attributed to credit sales which continue to expand despite rising interest rates. Sales of furniture and household appliances, heavily dependent on credit, expanded 18.3% year-on-year.

Supermarket sales rose 1.23%, influenced by May's readjustment in the minimum salary and higher employment.

### **Most States Registered Increased Output in May**

May's industrial recovery was nationwide as shown

by the results for Brazil's 14 industrial states and regions released Tuesday by the government's statistics bureau, IBGE.

Out of the 14, all but one posted an expansion in industrial output in May compared with May 2004. Production in the state of Amazonas, home to much of Brazil's electronics industry, jumped 24.6%. São Paulo industry posted an increase of 6.3% and Minas Gerais 5.5%. The state of Rio de Janeiro recorded a 1.5% increase in industrial production.

### **Survey Shows Growing Pessimism among Industry**

Despite May's recovery of industrial production, industry remains pessimistic for the third quarter, according to the results of a survey taken by the Getúlio Vargas Foundation.

In the survey, a preview of the Vargas Foundation's quarterly review of industry, 33% of the respondents described the current situation of their firms as "weak", up from 15% in April, while 16% called their situation "good", down from 18%. The difference of minus 17 in the two responses was the highest for the survey since July 2003.

Of the 462 companies surveyed, 29% said demand for their products in July was down compared with 15% who gave this response in April and 10% in July 2004. Only 8% of the companies in the latest survey said that their sales remained strong. For 19% of the companies, their current inventories were considered "excessive", up from 12% in April.

For the third quarter, 19% of the companies predicted that demand will decline further versus 43% who are expecting an improvement. In April, 11% expected a second quarter decline and 49% predicted sales would increase. For the coming six months, the number of companies projecting a decline in sales rose from 11% in April to 20%.

When asked if they planned on hiring more workers in the next three months, 16% replied positively but 20% said they expect to reduce their work forces. The difference of minus four was the worst in the survey since April 2002.

Because of their concerns with sales, the companies also reduced plans for price increases. In April, 41% of the firms surveyed said they would raise prices in the second quarter but for the third quarter this total dropped to 24%. At the same time, the total of companies planning on lowering their prices rose from 5% to 23%, another indication that inflation will remain under control in the quarter.

### **No Employment Gains for in Industry in May**

May's improvement in industrial production had no

impact on the job market.

While production expanded 1.3% from April, industrial employment showed no variation, according to the government's statistics bureau IBGE. Compared with May 2004, employment increased 2% but this was down from April's 3% year-on-year improvement. For the year through May, industrial employment expanded 2.6% versus the same period last year.

"The sectors that are more dependent on the domestic market are still showing a decline in employment. Those that aim their production for exports such as food and beverages increased employment and the number of hours paid," said IBGE economist André Macedo.

### **Pace of Job Creation Slowing in SP Industry**

São Paulo industry is continuing to hire but the pace of job creation is slowing sharply.

In June, the job indicator of the São Paulo State Federation of Industries (Fiesp) expanded 0.28%, signifying a net gain of 5,816 jobs. This, however, was the smallest increase of the year. The indicator has been in decline since April when it increased 0.61% followed by 0.34% in May and now June's increase of 0.28%.

### **Brazil's Leading Luxury Store Accused of Tax Fraud**

In another mega operation against white collar crime, over 300 Federal Police officers and tax agents raided the offices of Brazil's largest luxury store, Daslu.

The São Paulo-based retailer is considered Latin America's leading luxury department store but according to the police and tax agents, its owners are guilty of massive tax evasion. The two principal owners, Eliane Tranchesi and her brother Antônio Carlos Piva de Albuquerque were both arrested although Tranchesi was later released.

Police are investigating whether the company underreported revenue and the cost of imports to reduce the amount of taxes owed, according to federal prosecutor Matheus Magnani.

Wednesday's operation which police dubbed "Operation Narcissus," was the second massive crack-down on white collar crime in less than two months. In June, more than 600 police officers arrested several executives at Schincariol, Brazil's second-largest brewer, and seized documents in the largest tax evasion probe against a company in the country.

### **Brazil Moves up One Spot in Ranking of Economies**

The World Bank Tuesday released its ranking of the world's economies, showing Brazil in 14th place

based on last year's GDP of US\$605 billion. This is one place higher than in 2003.

Mexico, in 12th place, continued to lead Latin American nations although it fell two places from 2003. Argentina ranked 35th.

In terms of per capita GDP, however, both Mexico and Argentina were ranked ahead of Brazil at, respectively, 69th and 91st. Brazil was ranked 96th in per capita GDP.

### **Inflation Decline Slows in July**

Prices are continuing to fall in July but the pace of the decline has slowed.

In the first preview for July of the Market General Price Index (IGP-M), inflation was minus 0.09%. But this was less than the 0.30% decline registered by the index in its first preview for June. Wholesale prices in the latest survey fell 0.23% compared with a 0.79% decline in June's first preview. Consumer prices declined 0.02%, down from a 0.08% drop for the same period in June.

In São Paulo, the Fipe rate posted deflation of 0.13% for the month ending in the first week of July. This was down from June's 0.20% decline in the consumer price index.

### **Exports Set Weekly Record**

Neither the political crisis nor the devaluation of the dollar have had any impact on Brazil's exports which in the first full week of July set another all-time record.

In the week of July 4-8, exports totaled US\$2.68 billion, the highest weekly result on record. Imports for the week were US\$1.347 billion, leaving a surplus of US\$1.333 billion, also the highest ever for a single week. For the month the surplus reached US\$1.7

billion and for the year US\$21.384 billion.

In the week, exports averaged US\$536 million a day, 19.6% higher than in June and 35.7% over the average of July 2004. Imports averaged US\$269.4 million a day, down 4.1% from June but 7.2% above July 2004.

For the year, exports to date have increased 23.7% and imports are up 18.6% over the same period in 2004.

### **Government Asks WTO To Impose Sanctions on U.S. Intellectual Property**

Brazil asked the World Trade Organization Friday for permission to block US\$3 billion worth of U.S. trademarks, patents, financial and engineering services until the US Congress ends illegal cotton subsidies to American farmers.

The government said it wants the WTO to authorize the sanctions, after WTO judges ruled March 3 that U.S. cotton aid breaches commitments signed in 1994.

If applied, the sanctions would be the first time any of the WTO's 148 governments retaliated by targeting commercial services and property rights rather than increasing tariffs on goods. The government said it can't afford to jeopardize efforts to contain inflation by raising import costs through the usual mechanism of higher customs duties.

The government agreed to hold off on the sanctions to give the American congress time to approve the Bush administration proposal to end cotton aid.

Brazil has so far only outlined a list of 18 industries and intellectual property rights to be targeted. Along with patents and financial services, that list includes tourism and distribution services that Brazil is proposing to suspend under WTO market-access agreements.

## **INVESTMENTS**

<b>Options</b>	<b>Closing (July 15)</b>	<b>Variation Week</b>	<b>Variation Month (July)</b>
Black Market Dollar	R\$2.69	-1.10%	-1.82%
Gold	R\$32.00	-0.62%	-3.32%
São Paulo Stock Exchange	25,221	3.27%	0.68%
31-day CDs (pre-fixed), annual yield	19.60%	-	-
CDI	19.71%/year	-	-
Savings Deposits (maturing July 27)	0.79/month	-	-