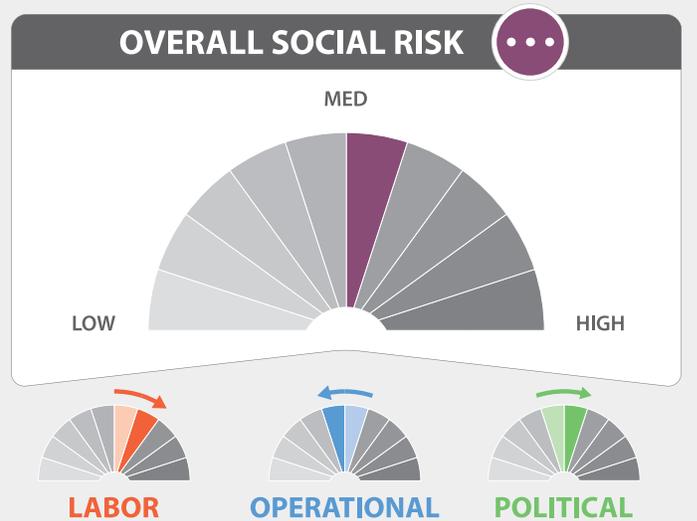


Brazil

Forecast for Q3 2015

Labor and political risk will rise a notch in Q3, according to Monitor Global Outlook's Social Risk Survey. Political paralysis and a recession, likely to be the worst in decades, boost the threat of protests and riots. One bright spot: The government will pass a major infrastructure bill.



Brazil Q3 outlook: Political risk rises

DOUBTS ABOUT THE ABILITY of government to function under unpopular President Dilma Rousseff will boost political risk in the third quarter, according to Monitor Global Outlook's latest Social Risk Survey. The fallout from such political paralysis is unclear, however, as most on-the-ground panelists remain neutral on whether cabinet changes will ensue.

Given the unpopularity of Ms. Rousseff as a result of a massive corruption investigation at *Petróleo Brasileiro SA (Petrobras)* and painful austerity measures, most of our in-country experts doubt she can retain control of the legislative agenda. But the fallout is unclear, with most panelists neutral on whether she will shake up her cabinet and replace controversial Finance Minister Joaquim Levy, the architect of the austerity plan.

"Dramatic risks such as presidential impeachment and deep cabinet changes seem highly improbable," says a panelist, "but the fact is the scenarios are still extremely uncertain. It's a very bumpy road ahead both in Congress and for the president."

An updated gauge on Ms. Rousseff's popularity will come Sept. 7, Brazil's Independence Day. Brazilians have taken to clanging pots and pans out their windows whenever Rousseff makes a televised address. Rousseff's popularity plummeted to about 13 percent in early 2015, coinciding with an unprecedented loss of authority over Congress. "Although a more fragmented Congress was already on the radar, no analysts foresaw this scenario and the extreme difficulties Dilma would have to pass her legislative agenda in this first semester," says one panelist.

While considered necessary to restoring a legally binding budget surplus, austerity is not expected to yield economic results anytime soon, according to most panelists. This will stretch the patience of unions and consumers who are suffering from high inflation projected to exceed 8.3 percent this year. The Central Bank is raising interest rates to tame inflation, which is further sapping Brazilians' access to cash.

With high risk for labor strikes in the third quarter, a controversial bill on worker outsourcing could become a flash point, warn our panelists. Legislative Bill 4330/04, which would allow firms to expand worker outsourcing, has already sparked union protests and could further fracture Congress.

One bright spot for the economy will be diminished risk of drought-induced power cuts for the state of São Paulo, the nation's industrial and economic heartbeat. Another bright spot: Rousseff's major infrastructure package, unveiled June 9, will begin rolling out in Q3 with the auction of interstate road projects and the private-sector lease of port terminals, offering new opportunities for construction companies and investors..

Developments to watch in Q3 2015:

- **Social unrest** and **political paralysis** will worsen, with a litmus test coming on Brazil's Independence Day celebration **Sept. 7**. Whether Rousseff makes a public address, and how Brazilians react (with "**pots and pans**" being the mildest protest), will be a gauge of the rising or falling popularity of Rousseff and her Workers' Party (PT).
- **Political jockeying** will begin for the 2016 mid-term elections. The PT's most important coalition partner, the Brazilian Democratic Movement Party (PMDB), may begin to **dismantle its regional alliances** with the **PT** in order to build up new strategic support, particularly in the densely populated triangle of cities Rio de Janeiro, Belo Horizonte, and São Paulo, which will each begin the one-year countdown to mayoral and council elections.
- The Petrobras **corruption investigation** reaches a pivotal moment when Prosecutor-General **Rodrigo Janot's term ends in September**. Congress, which has seen many of its own implicated in the scandal, threatens to **block his reappointment**.
- Rousseff's **major infrastructure package** will begin rolling out **in Q3** with the auction of interstate road projects and the private-sector lease of port terminals. Analysts expect better investment returns than past government offerings.
- **Tax reform** is expected to merge the federal social security taxes (PIS and COFINS) as well as unify the state value-added tax (ICMS). Either move would make it **easier to do business** in Brazil.
- The **Central Bank** is expected to raise the benchmark Selic interest rate to **14 percent** as soon as its **July 29** meeting.

METHODOLOGY

Most risk rating systems focus only on the most obvious or immediate risks to doing business in Emerging and Frontier Markets. But many high-impact threats develop slowly and under the radar while other medium-impact risks can accelerate so quickly that they demand an immediate response.

That's why we built MGO's Social Risk Profile, which lies behind our Social Risk Dashboard. It clearly interprets high-profile risks, but it also monitors less-visible but high-impact threats facing businesses and driving investment. Clients can compare risks against one another, determine which are heating up or cooling down, and identify key drivers of uncertainty.

Our Social Risk Dashboard displays a unique combination of Labor Risk, Operational Risk, and Political Risk. Each category is scored (0 – 10), which is generated from a weighted index of the drivers listed below. With standardized input from our on-the-ground specialists and in-country experts, our team constantly reviews and updates risk ratings as driven by current and emerging dynamics.

Labor – We track how local labor dynamics impact supply chain and reputational risks:

Strikes / Work stoppages
Workplace conditions
Forced labor / Trafficking
Unionization / Industrial relations
Underemployment / Talent shortage

Operational – We monitor the ability of organizations to operate effectively, whether locally invested or sourcing from a country:

Sabotage / Infrastructure attacks
Ethnic / Religious clashes
Environmental threats
Community relations / Land rights
Corruption / Bribery

Political – We analyze how political, security, and regulatory shifts impact the needs of businesses and investors:

Challenges to governmental control
Riots / Protests
Unanticipated political transition
Adverse regulatory changes
Political paralysis