

# Highway To Hell or Stairway To Heaven?

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Simples | Pessoal | Justo



**1) Politics – 2018 elections**

**2) Reform Agenda**

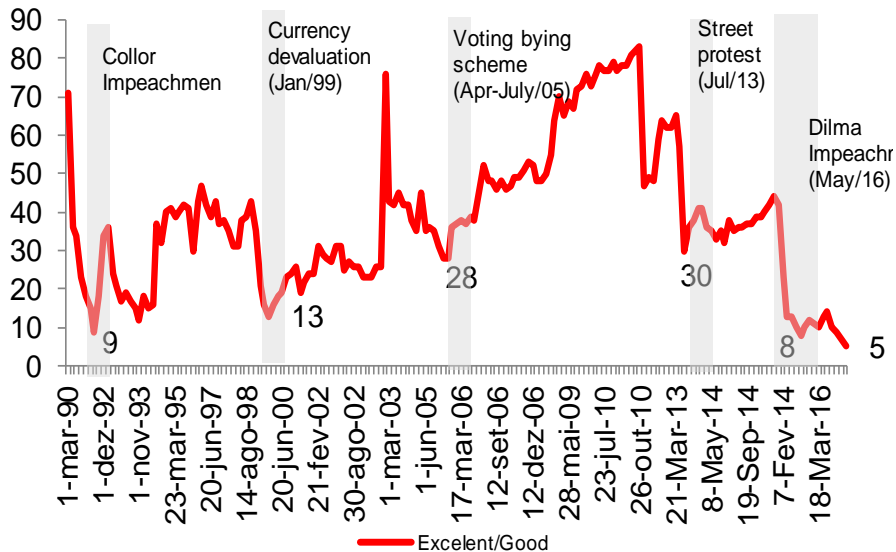
**3) Economic Recovery Path**

# 1) Politics – still, Temer will likely finish his mandate

*Although very weak popularity*

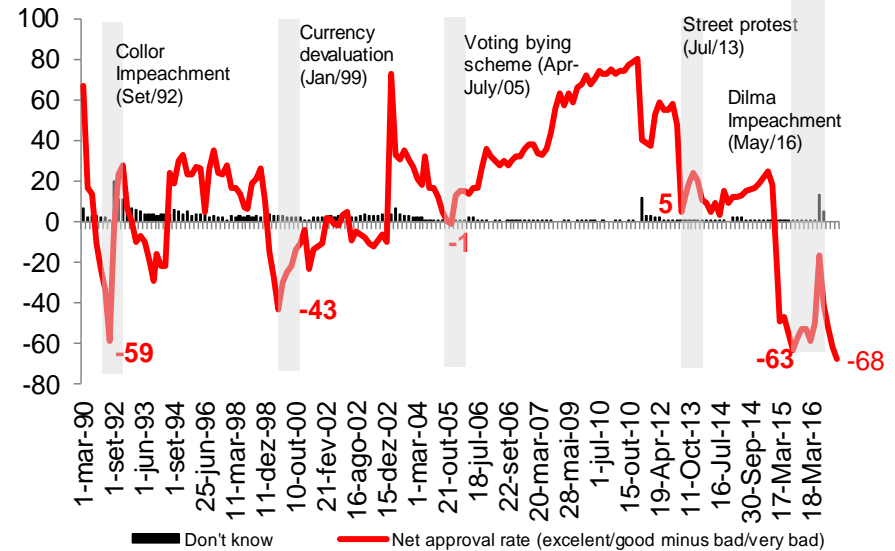
## Presidential Popularity

Source: Datafolha.



## Net Approval rate

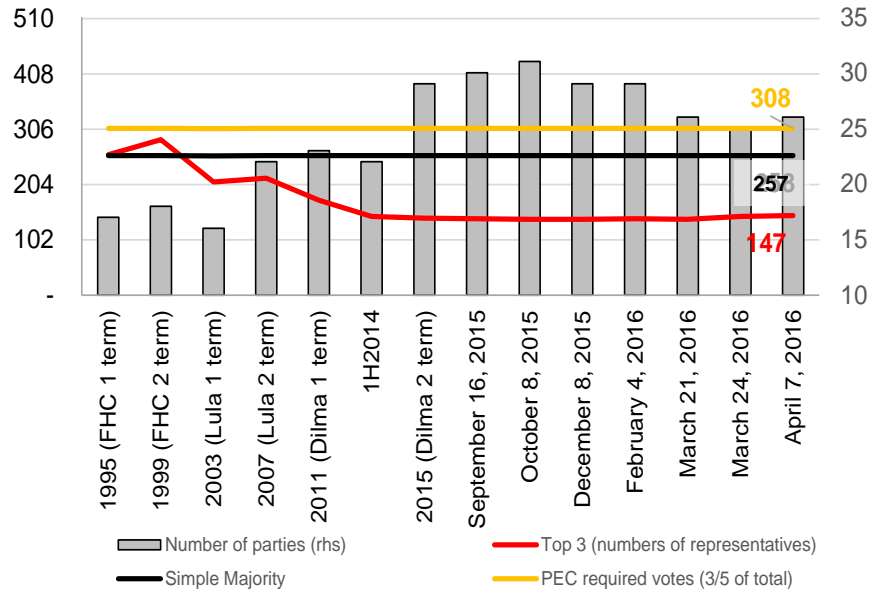
Source: Datafolha.



# 1) Politics – Fractured party system

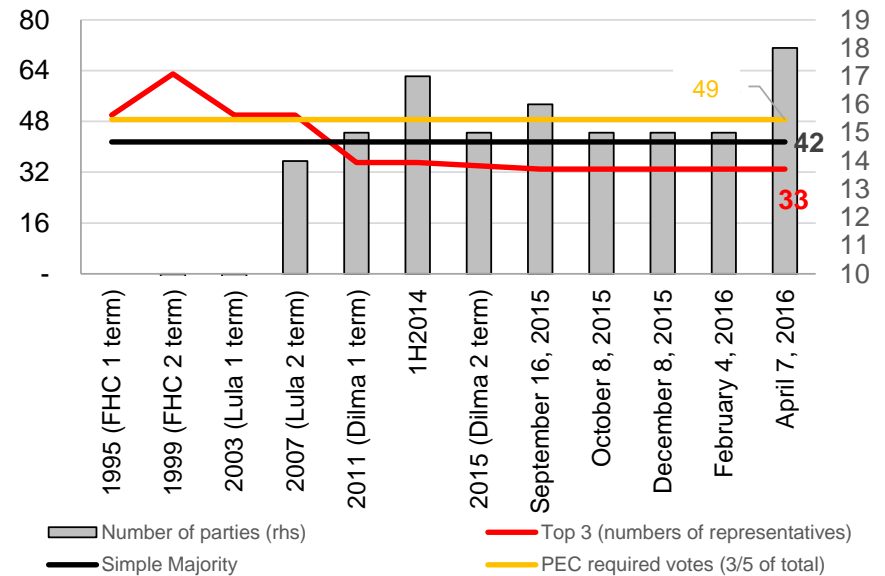
## Lower House (#political parties and representatives)

Source: Câmara dos Deputados.



## Senate (#political parties and representatives)

Source: Senado.



## 2) Fiscal Reform Agenda

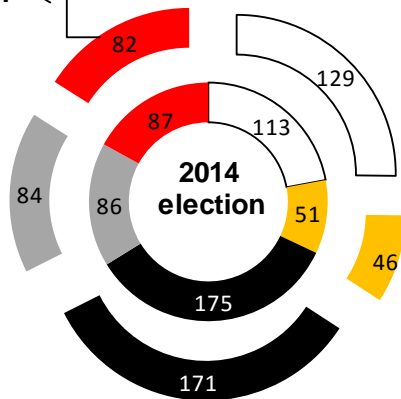
Topic	Legal instrument	Current status	Expected conclusion date
Reduction in revenue earmarking (DRU)	Constitutional Amendment	Approved by the Lower House and the Senate	Concluded in Aug 2016
Investment Partnership Program (PPI)	Provisional Measure	Approved by the Lower House and the Senate	Concluded in Sep 2016
Change in oil field auction rules	Ordinary Law	Approved by the Lower House and the Senate	Concluded in Nov 2016
New Fiscal Regime (freeze of gov't expenditures in real terms)	Constitutional Amendment	Approved by the Lower House and the Senate	Concluded in Dec 2016
Budget Law (PLOA) 2017	Budget Law	Approved by the Lower House and the Senate	Concluded in Dec 2016
States' debt renegotiation	Complementary Law	Basic framework approved by Congress, and partially enacted by the President	Concluded in Dec 2016
Labor Reform	Complementary Law	Approved by the Lower House and the Senate	Concluded in Jul 2017
Creation of TLP (long term rate for BNDES loans)	Provisional Measure	Under Lower House appreciation	Concluded in Sep 2017
Change in Eletrobras law to allow privatization	Provisional Measure or Ordinary Law	Still to be sent to Congress	2018
Social Security Reform	Constitutional Amendment	Approved at the Commission-level by the Lower House	2019
Tax Reform	Different pieces of legislation	Still to be sent to Congress	2018/2019

# 1) Politics – Congress profile

## Lower House

Source: Câmara dos Deputados.

2017 breakdown

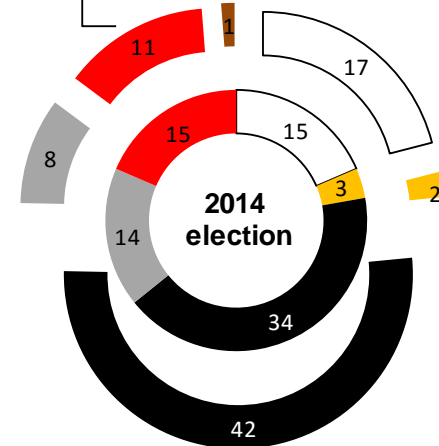


□ Right   ■ Centre Right   ■ Centre   ■ Centre Left   ■ Left

## Senate

Source: Senado.

2017 breakdown

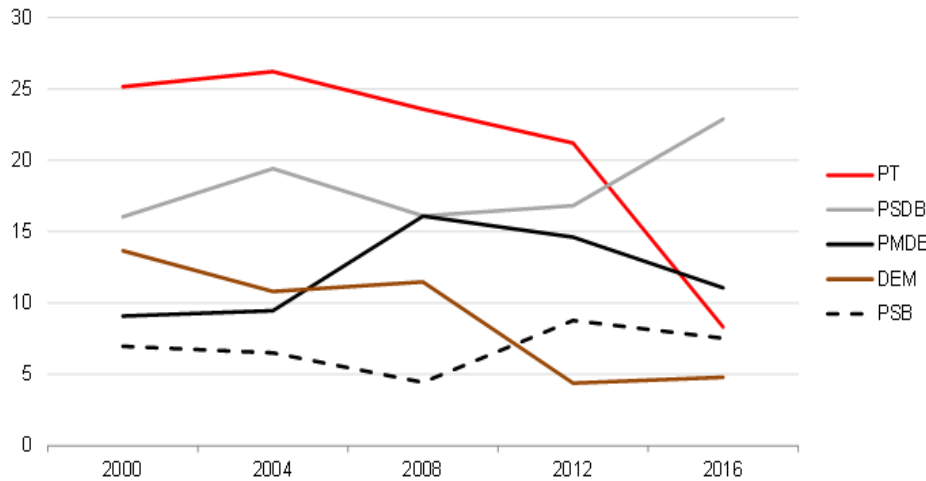


□ Right   ■ Centre Right   ■ Centre   ■ Centre Left   ■ Left   ■ Independent

# 1) Politics – Voters' profile

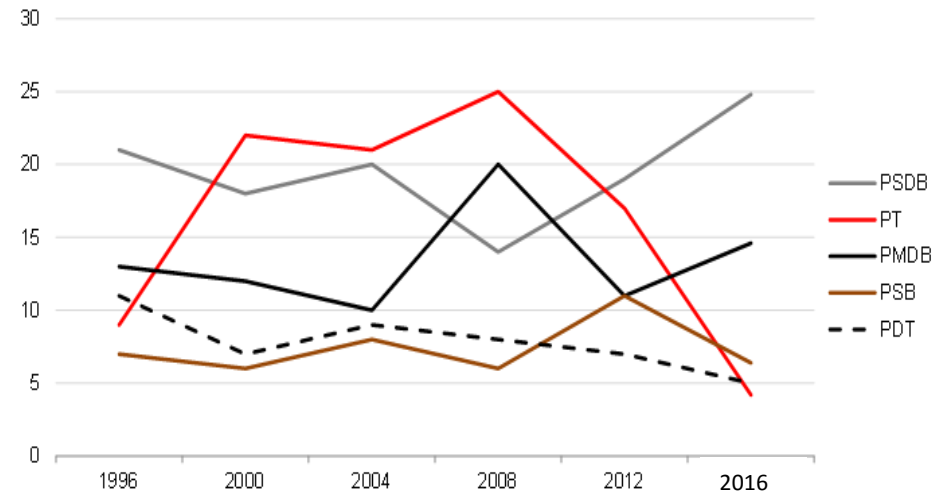
## Share of aggregate valid votes for mayor in Brazil's largest cities and state capitals, %

Source: Brazil Electoral Court.

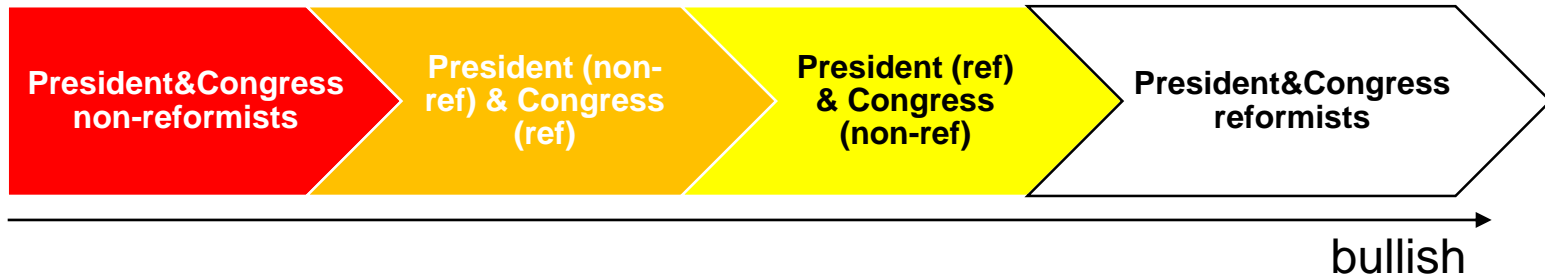


## Number of elected mayors in Brazil's largest cities and state capitals

Source: Brazil Electoral Court.

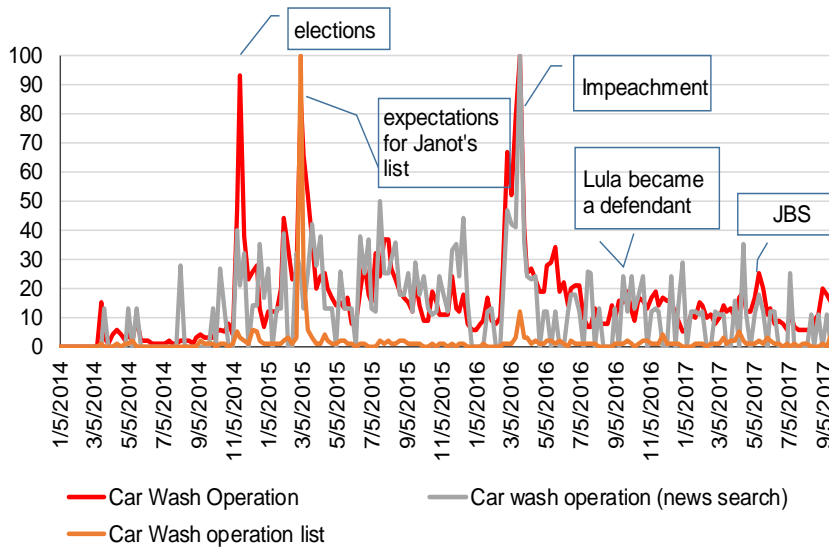


# 1) Politics – 2018 elections



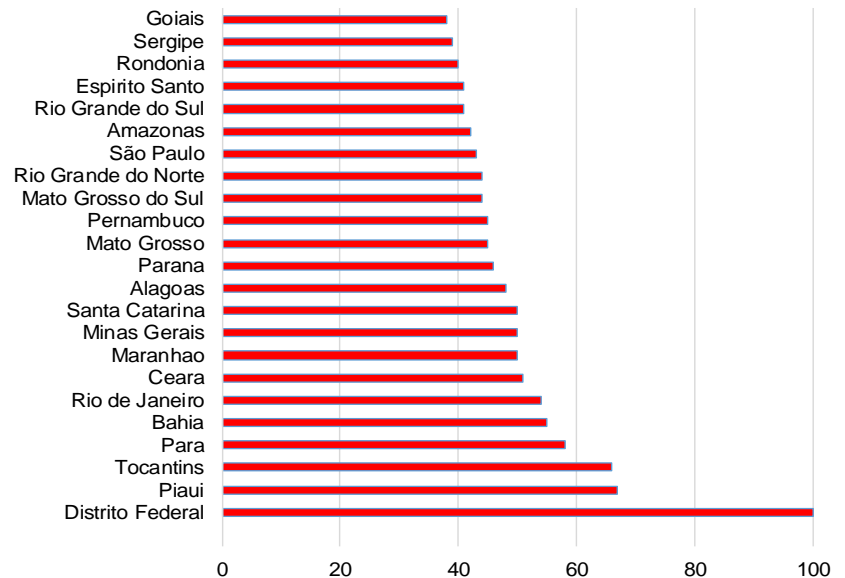
## Google searches for Car Wash operation

Up to Sep 20. Source: Google trends.



## Google searches for Car Wash operation

Up to Sep 20. Source: Google trends.



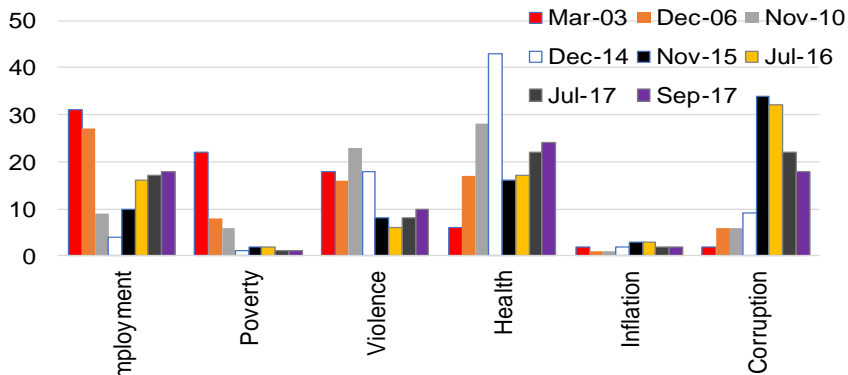


# 1) Politics – 2018 elections

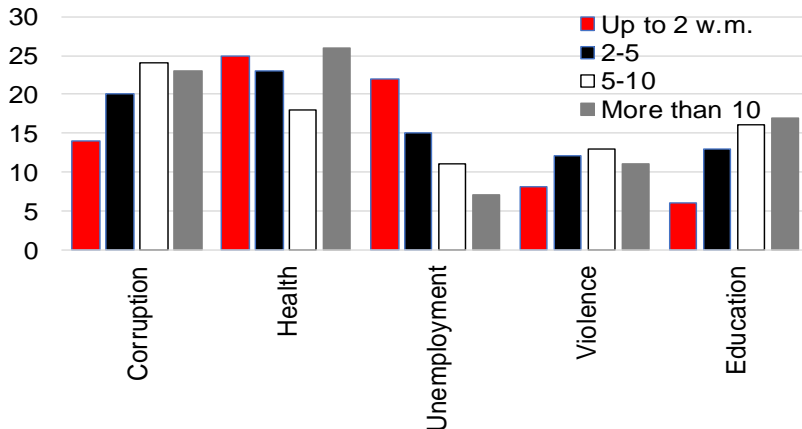
## Societal priorities & Vote Intention by Income Bracket

### Societal priorities

Source: Datafolha.

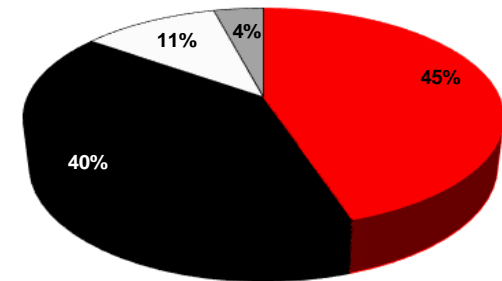
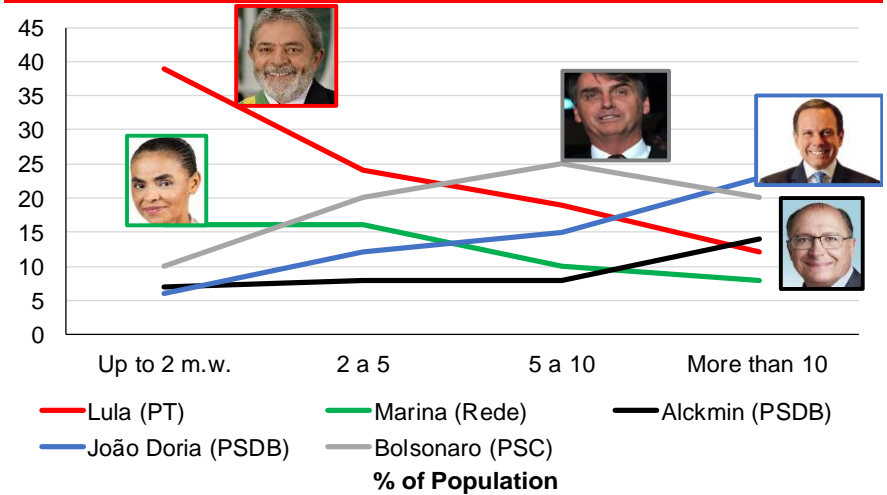


Sep 2017



### Vote Intention by Income Bracket

Source: Datafolha.



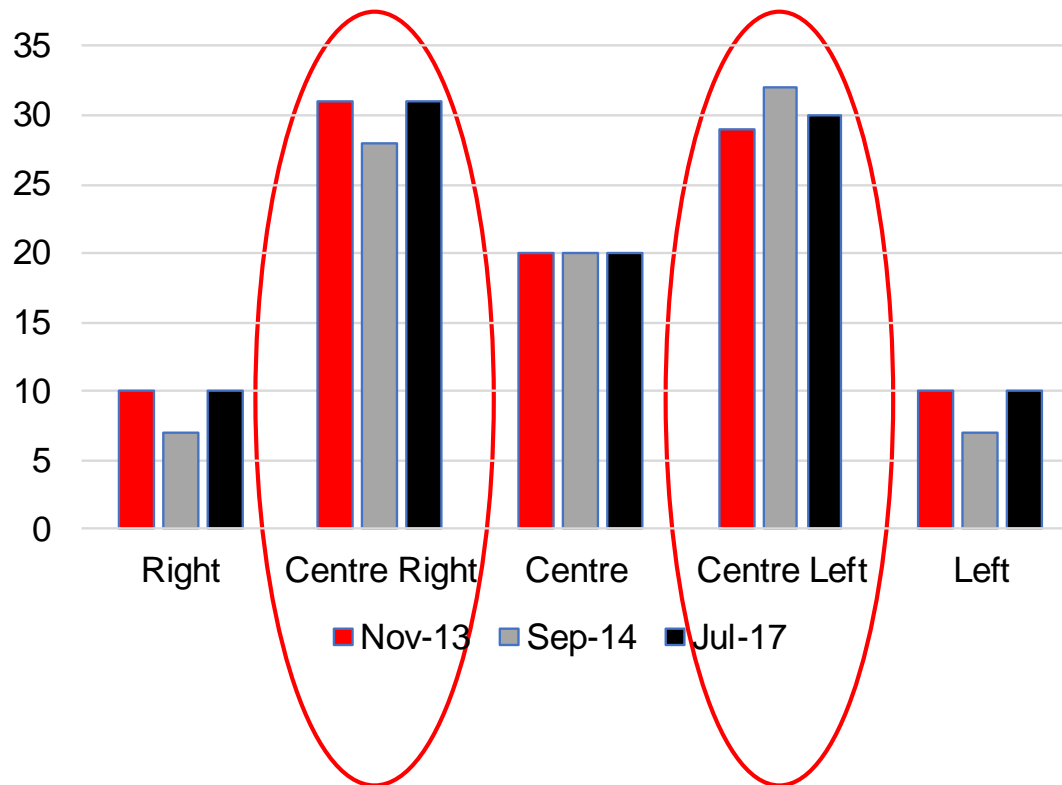
■ Up to 2 m.w. ■ 2 a 5 ■ 5 a 10 ■ More than 10

# 1) Politics – 2018 elections

*Brazilian voter profile*

## Brazilians ideology profile

Source: Datafolha.

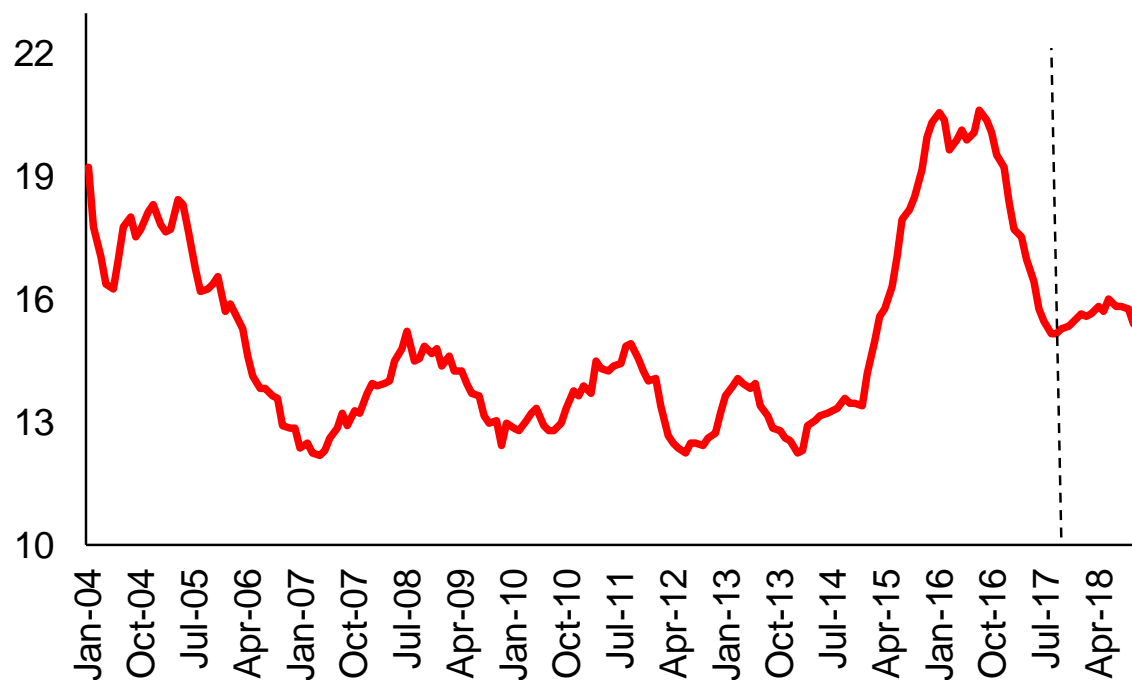


# 1) Politics – 2018 elections

*Good news: economy will help*

## Misery index (Inflation + unemployment)

Sources: IBGE and Santander.

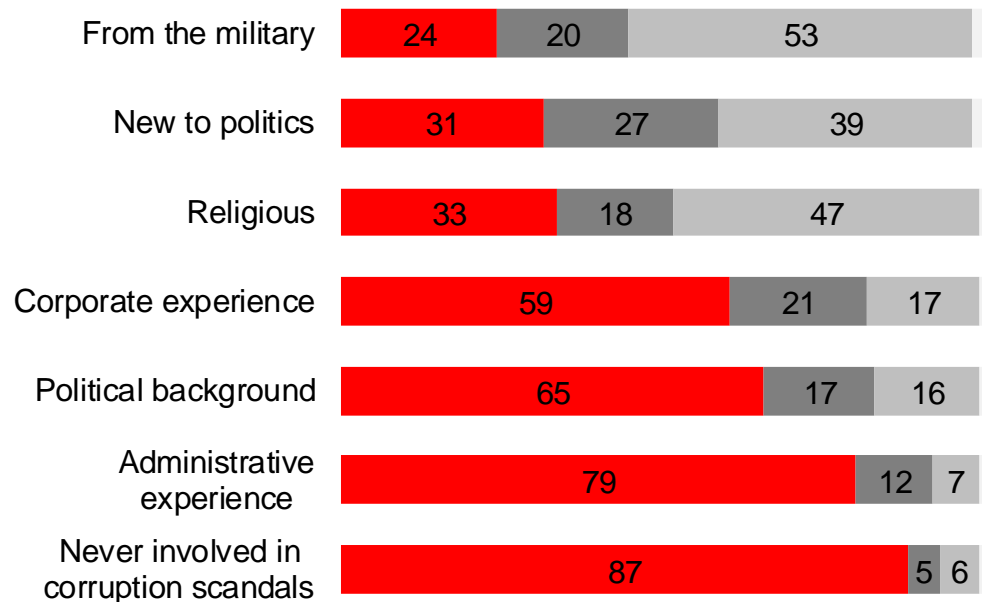


# 1) Politics – 2018 elections

*What people look for in a president ...*

## Desirable aspects of a presidential candidate, %

Source: Datafolha.

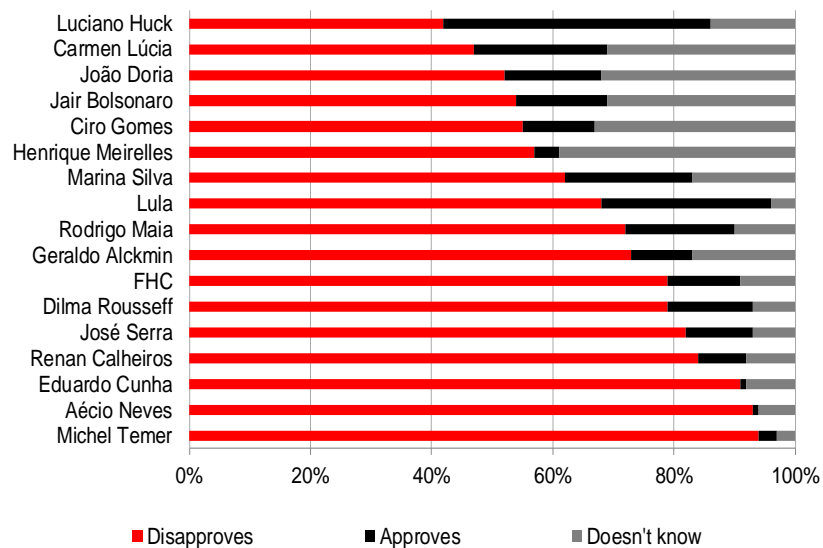


■ Very important ■ Somewhat important ■ Not important ■ Don't know

# 1) Politics – 2018 elections

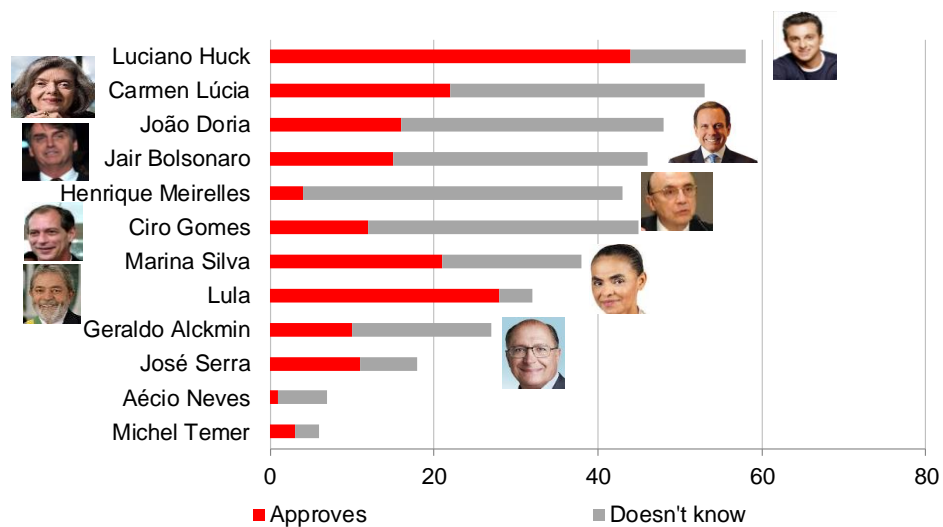
## Approval/rejection of potential candidates

Source: Ipsos Barômetro Político, June, 2017.



## Potential approval, %

Source: Ipsos Barômetro Político, June, 2017.



# 1) Politics – 2018 elections (key dates)

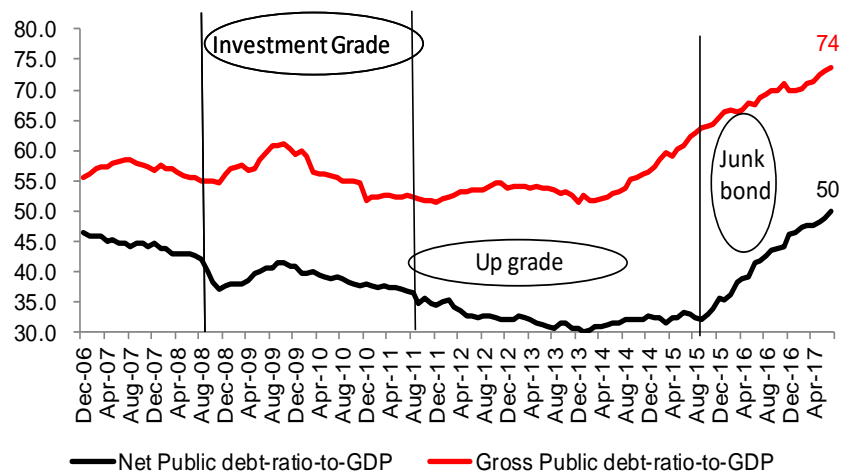
- April 6, 2018: deadline for candidates to join/change political parties. Deadline to register political address. Candidates holding cabinet positions or seating mayors/governors not running for reelection must step down by this date.
- July 5, 2018: pre-candidates can begin intraparty advertisement for nomination
- July 20 – August 5, 2018: period for parties to promote conventions and define candidates (conventions are not mandatory)
- **August 15, 2018: deadline for parties to register candidates**
- August 16, 2018: official beginning of campaigns
- August 25 – September 29, 2018: period of propaganda broadcast on radio and television
- **October 7, 2018: first round of voting**
- October 28, 2018: second round of voting

## 2) Fiscal Reform Agenda - Stalled

*Mismatch between tax collection and spending*

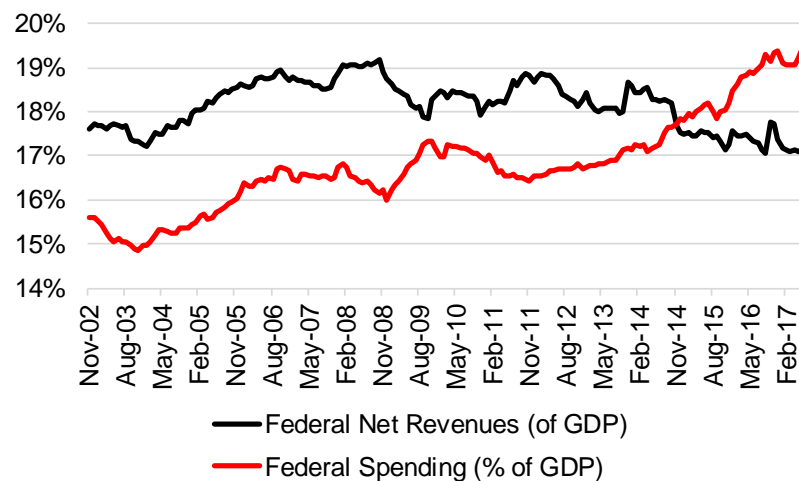
### Public debt

% of GDP. Source: BCB.



### Central government: revenue/expenditure

% of GDP. Source: STN.

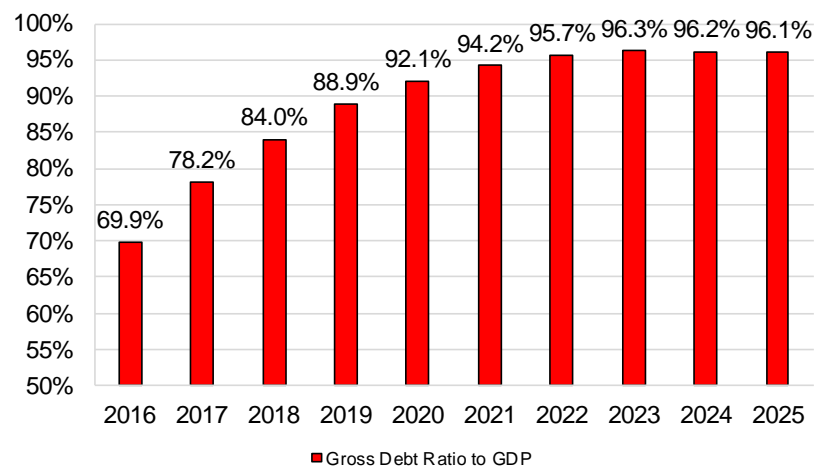


## 2) Fiscal Reform Agenda - Stalled

*As a result, a worsening dynamic in the gross public debt-GDP ratio*

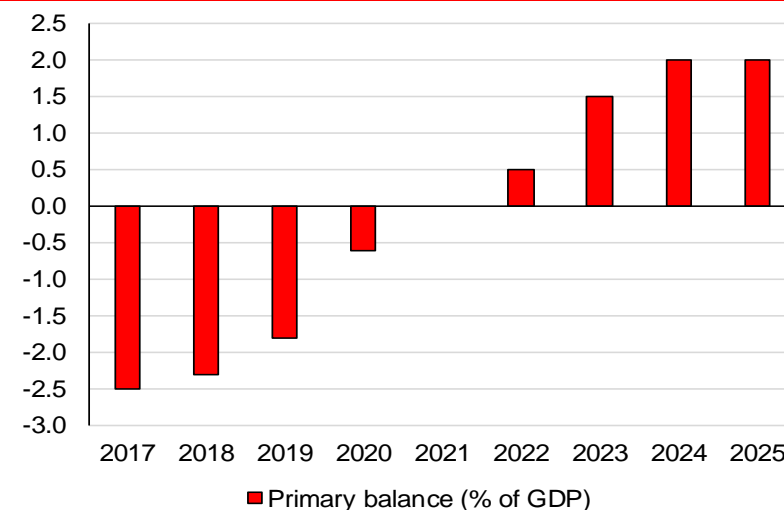
### Gross and Net Government Debt (% of GDP)

Sources: MinFin and Santander estimate.



### Primary Balance (% of GDP)

Sources: MinFin and Santander estimate.



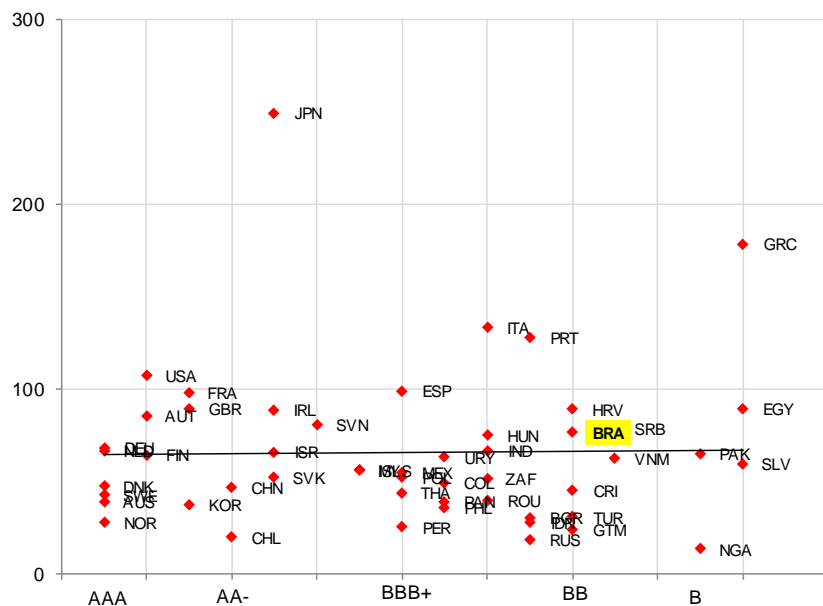


# 2) Fiscal Reform Agenda - Stalled

*However, international capital does not seem to care about public debt level*

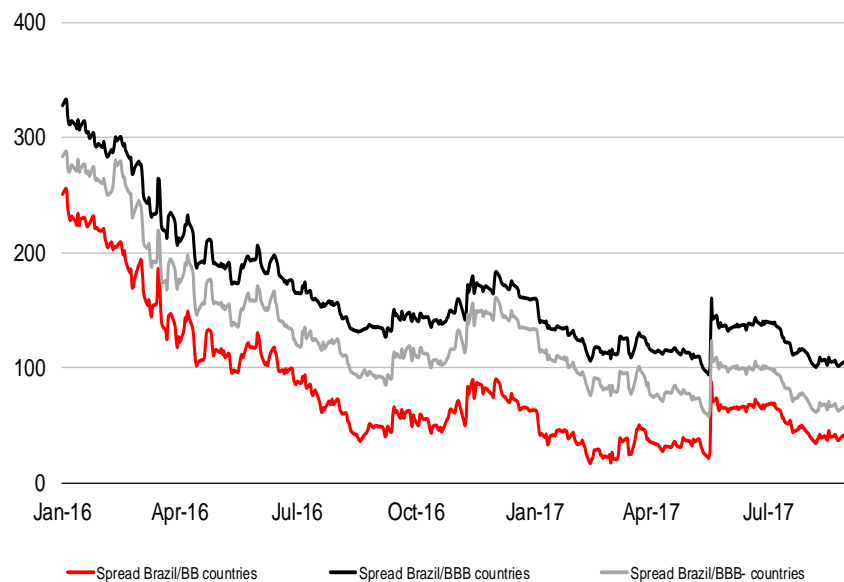
### Gross Government Debt (% of GDP) vs Sovereign rate

Sources: Bloomberg and S&P.



### 5-year CDS spreads (bp)

Source: Bloomberg and S&P.



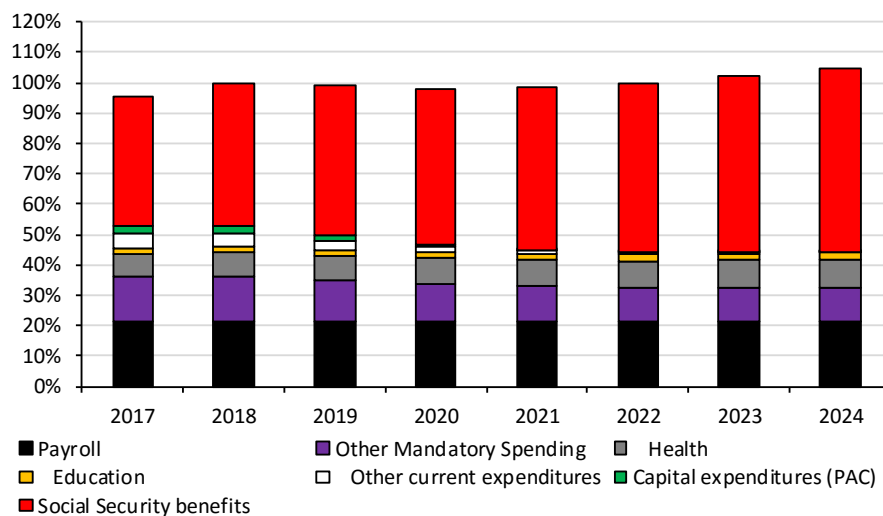
## 2) Fiscal Reform Agenda - Stalled

### Social Security

- ✓ Currently, social security benefits represents ~ 40% of total spending, in 2024 will consume about 60% of total spending (despite still young population) .

### Federal Spending Breakdown- % Of Spending Ceiling

Sources: Min. da Fazenda and Santander estimates.

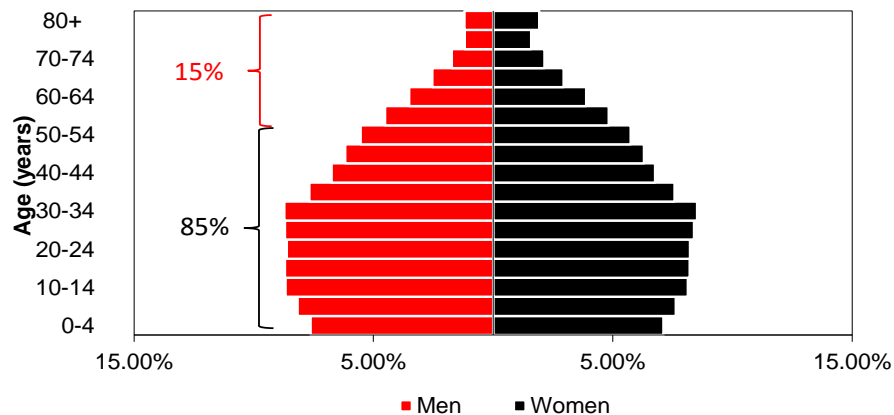


# 2) Social Security Reform

Social Security Reform (proposal), crucial points of the reform:

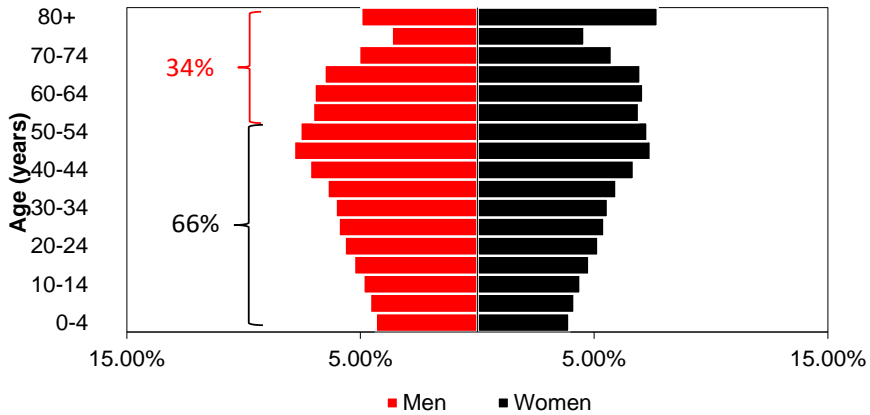
## Age Pyramid 2014

Source: IBGE.



## Age Pyramid 2050

Source: IBGE.



## Contribution (% of GDP)

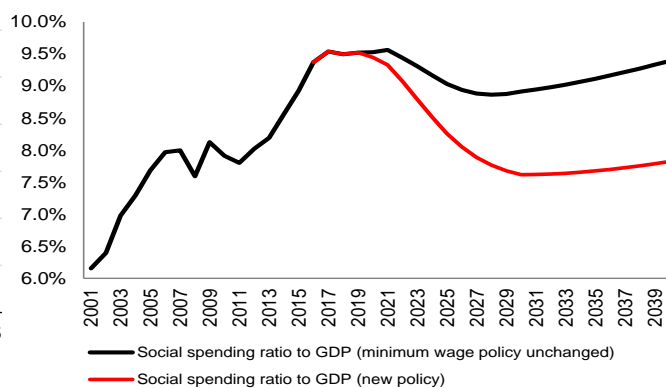
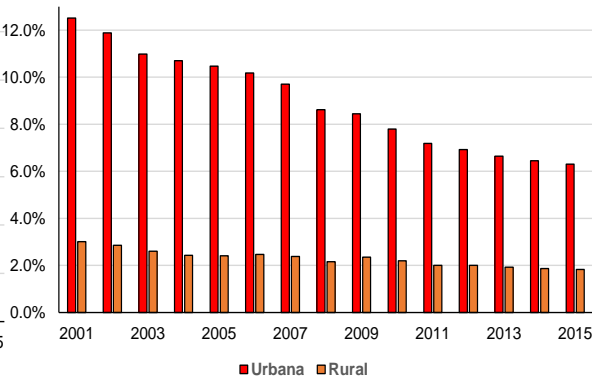
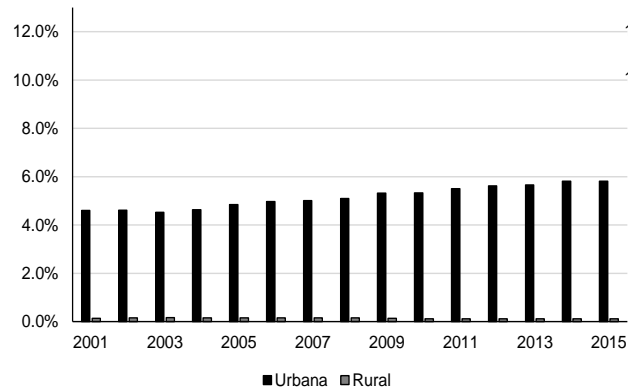
Sources: FinMin and Santander estimate.

## Benefits (% of GDP)

Sources: FinMin and Santander estimate.

## Simulation of Social Assistance spending ratio of GDP

Sources: FinMin and Santander estimate.



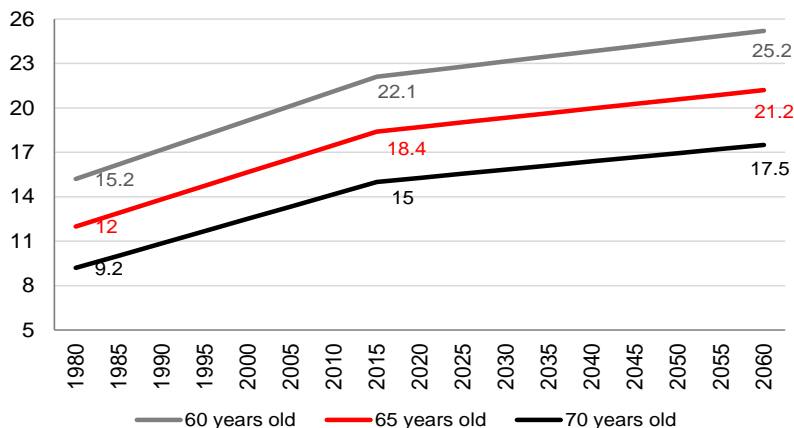
## 2) Social Security Reform

*Social Security Reform (proposal), crucial points of the reform:*

- ✓ *Eligibility criteria (minimum age for retirement at 65 years old for men and 62 for women, but without unification of social security regime),*
- ✓ *Stricter criteria for survivals benefits,*
- ✓ *Not allowing accumulating benefits higher than 2 minimum wages,*
- ✓ *Transition rules : Additional of 1/3 to the number of years remaining for retirement under the current rule (30 years of contribution for women and 35 years for men), given the minimum age for retirement is 55 years old for men and 53 years old for women*

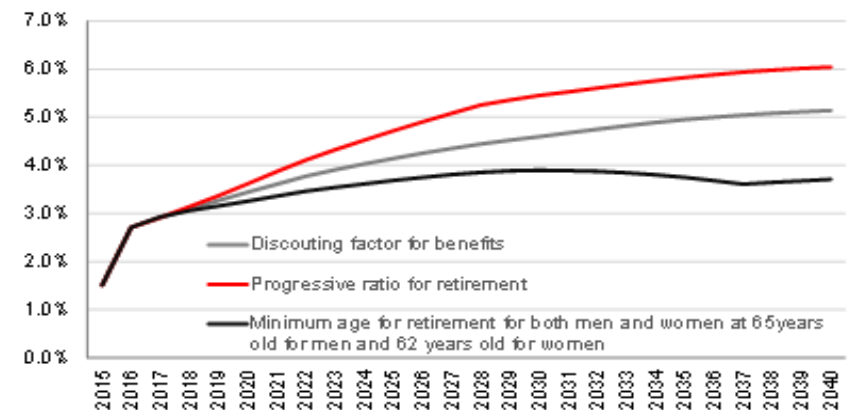
### Expected Survival by age (number of years)

Source: IBGE.



### Social Security deficit ratio of GDP simulation.

Sources: IBGE, Social Security Minister and Santander estimate.



## 2) Privatization Calendar

	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	Gov't expectation (BRL bn)
Airports							12.0
Highways							8.5
Ports							12.0
Electric Energy Co							24.0
Oil (pre-salt)							
Others							
Brazilian Mint							
Instant Lottery							2.0

Tender Offer  
Auction



	Gov't expectation (BRL bn)
Eletrobras*	13.0
Cemig **	11.0
Congonhas (SP Airport)	6.0

\* secondary offer / \*\* 4 Power plants

BRL 58.5bn

## 2) Ending of Fiscal Slippage

*The end of tax exemptions*

### Fiscal Slippage

Source: MinFin.

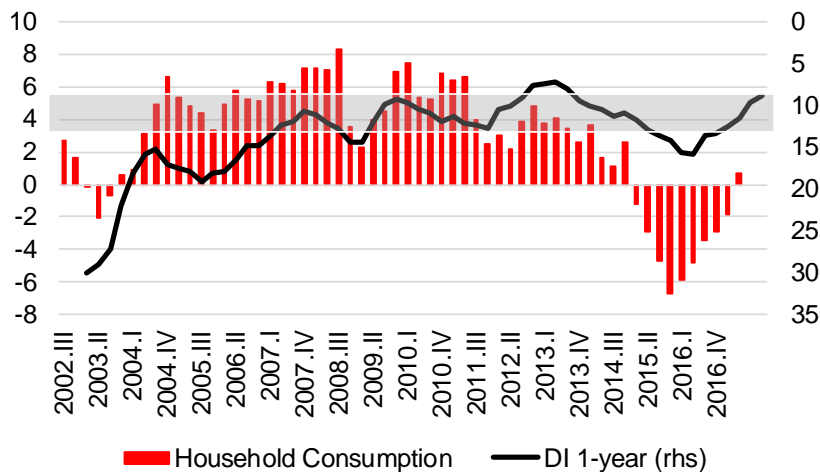
	<b>BRL</b>	<b>%GDP</b>
Simplified tax regime for SME	82.9	1.3%
Tax free industry zone	25.6	0.4%
Non profit entities	24.5	0.4%
Tax Exemption of consumer staples	23.8	0.4%
Reduction in payroll taxation	17.0	0.3%
Income tax deduction	16.9	0.3%
Worker benefits	11.4	0.2%
Tax exemption for saving account	8.4	0.1%
Tax exemption for medicines	7.4	0.1%
Tax exemption for Regional development	6.6	0.1%
<b>Total</b>	<b>224.5</b>	<b>3.6%</b>

# 3) Economic Recovery Path

*Monetary Policy is effective!*

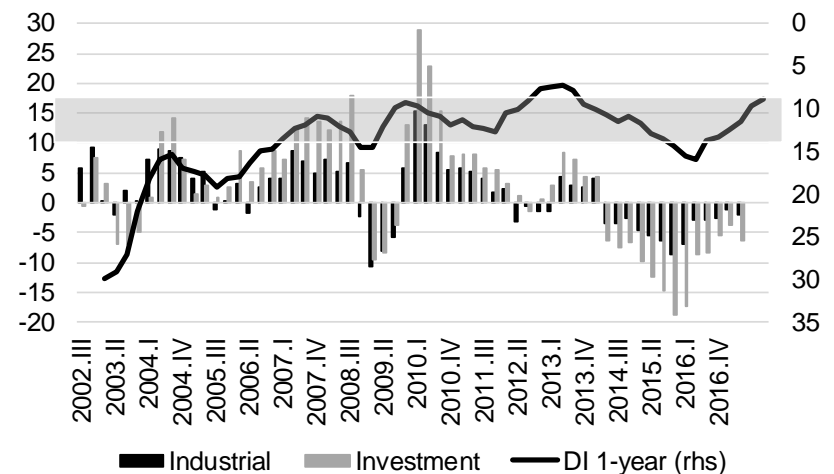
## Household Consumption y/y vs DI 1-y (2 quarters lagged)

Sources: IBGE, BCB and Santander.



## Industrial and Investments y/y vs DI 1-y (2 quarters lagged)

Sources: IBGE, BCB and Santander.



### 3) Economic Recovery Path

*So far the economic recovery was based on Agriculture and Consumption, looking ahead the risks are on the upside (if there is strong Investment recovery).*

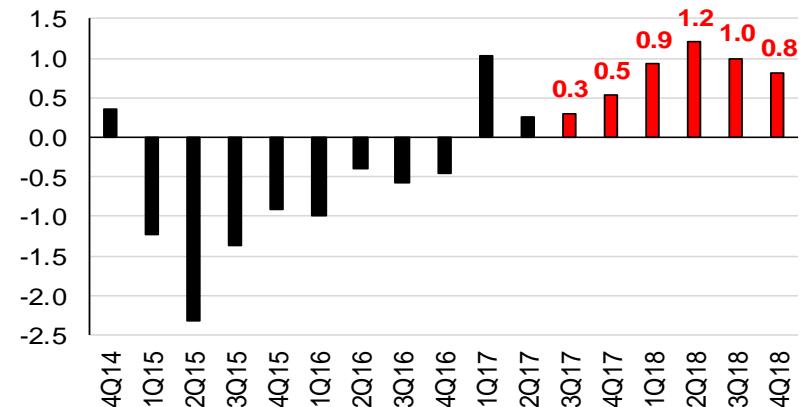
#### Forecast

Source: Santander estimates.

		GDP Breakdown - Annual Change (%)				
Components	Weights (%)	2014	2015	2016	2017F	2018F
<b>Total GDP</b>	100.0	<b>0.5</b>	<b>-3.8</b>	<b>-3.6</b>	<b>0.8</b>	<b>3.2</b>
Agriculture & Livestock	5.6	2.7	3.2	-6.6	11.6	3.7
Industry	21.4	-1.5	-6.3	-3.8	0.2	3.5
Services	73.0	1.0	-2.7	-2.7	0.1	2.8
Household Consumption	63.5	2.3	-3.9	-4.2	0.9	3.4
Government Consumer	20.3	0.8	-1.1	-0.6	-1.5	0.3
Investments	15.7	-4.2	-13.9	-10.2	-2.2	6.0
Exports	12.2	-0.9	6.2	1.9	4.2	2.8
Imports (-)	11.7	-1.9	-14.1	-10.3	3.7	3.6

#### GDP growth q/q

Source: Santander estimate



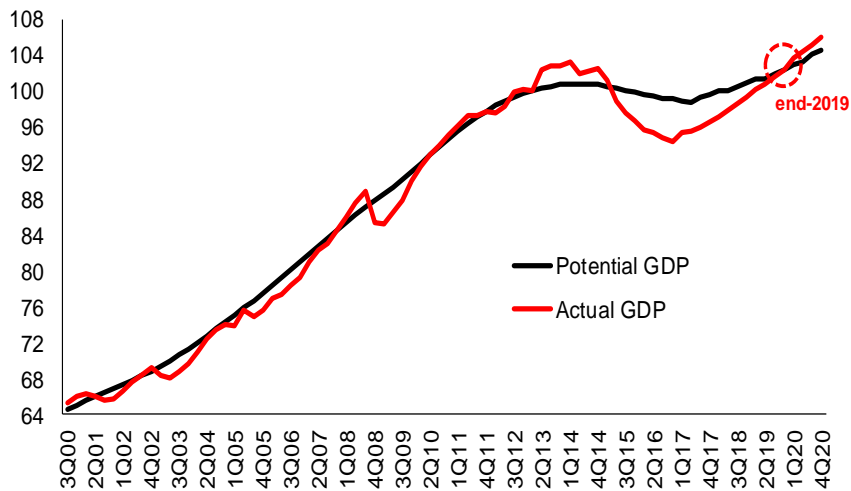


### 3) Economic Recovery Path

*Output gap will likely close at the end of 2019, therefore the CB has room to maintain its expansionary monetary policy.*

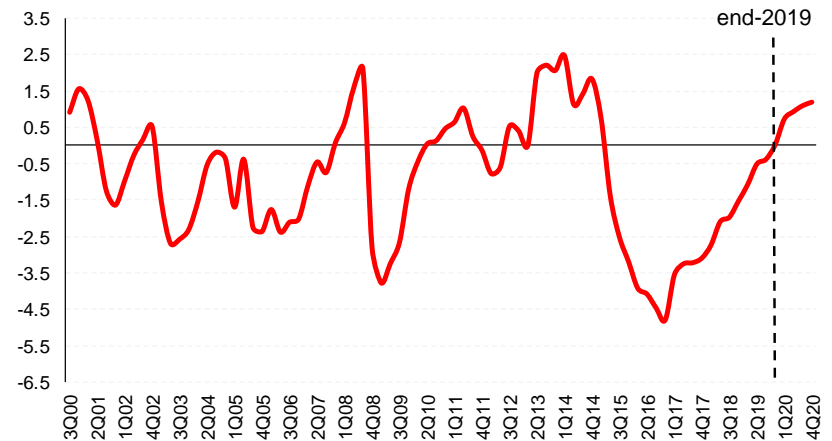
#### Actual GDP vs. Potential GDP

Source: IBGE, FGV, IPEA and Santander estimates / (level series - basis: 2013:1=100) .



#### Output Gap (Actual GDP - Potential GDP) - %

Sources: IBGE, FGV, IPEA and Santander estimates

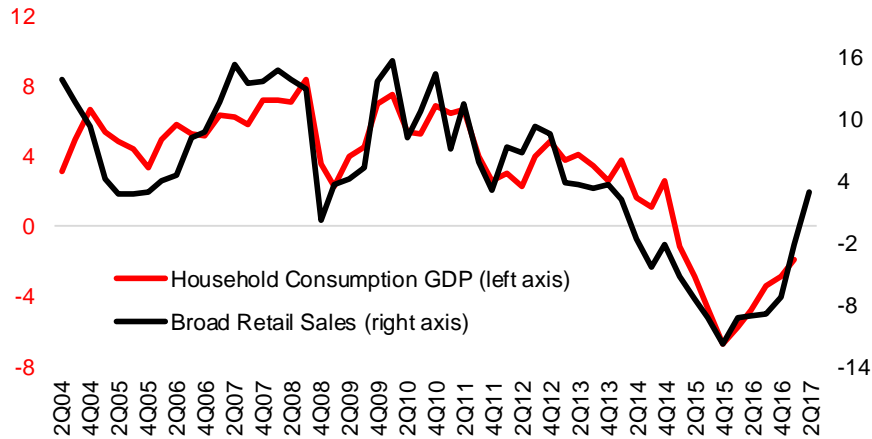


# 3) Economic Recovery Path

*Labour market and retail sales should keep improving*

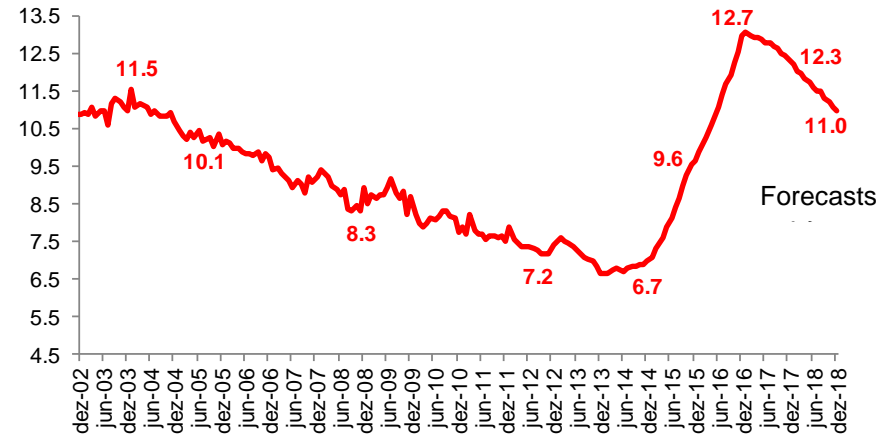
## Household Consumption GDP x Broad Retail Sales

Source: IBGE



## Unemployment rate

Source: IBGE.

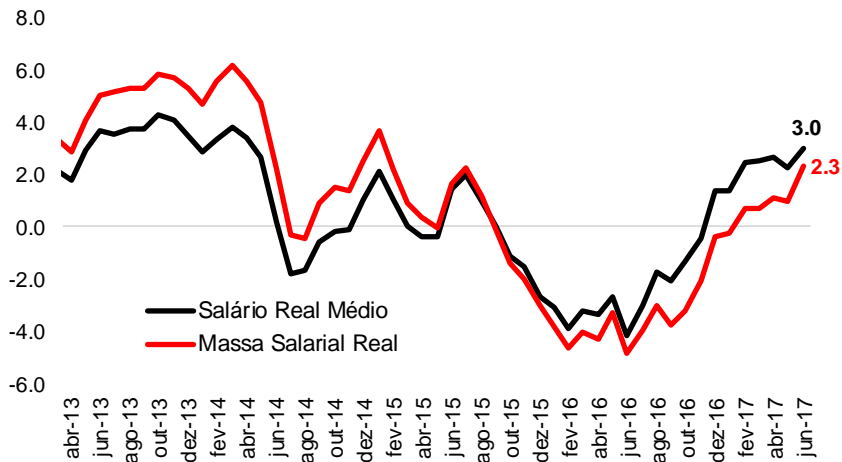


# 3) Labour Market

*Some positive signals are emerging in the labour market*

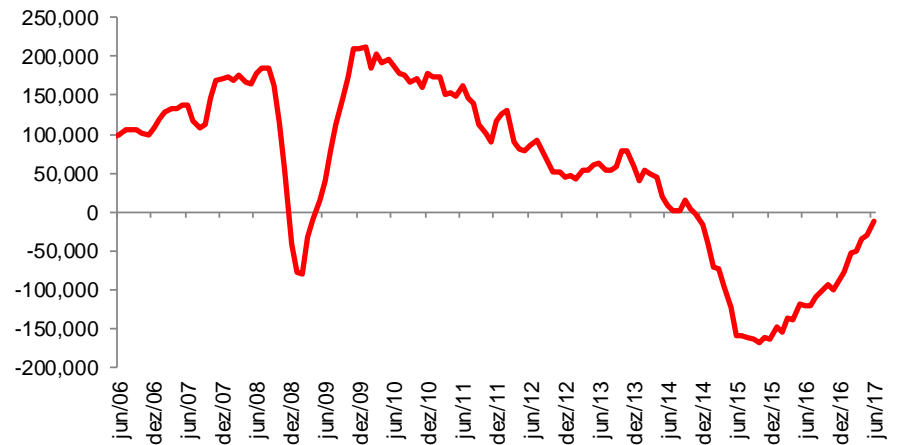
## Income and Total Income

y/y. Source: PNAD (IBGE)



## Formal Jobs net creation

y/y%. Sources: IBGE and Santander.

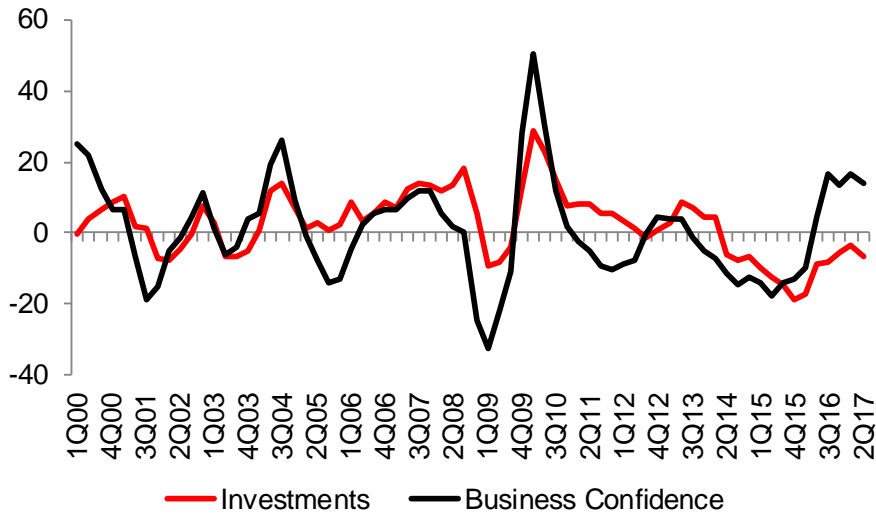


# 3) Confidence and Investments

... however, still timid effect on the confidence indices

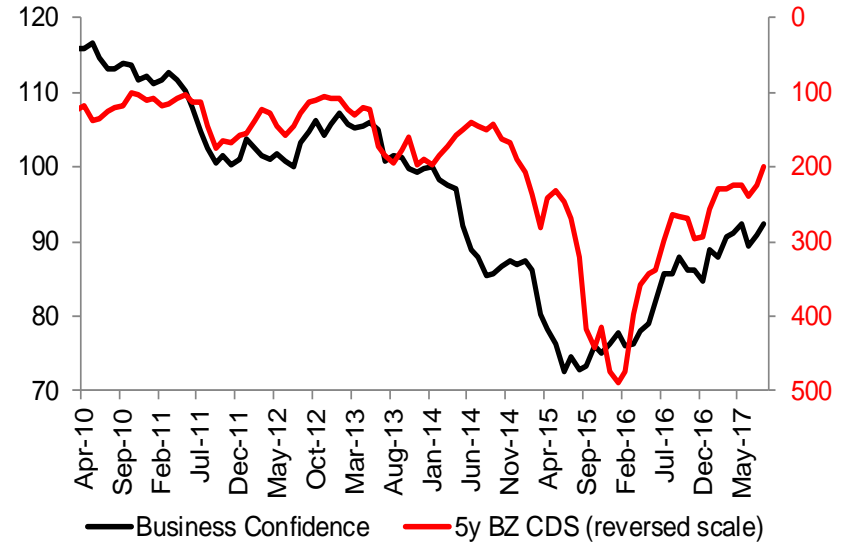
## Investment vs Business Confidence

y/y. Sources: IBGE and FGV.



## Business Confidence vs Brazil CDS 5-y

Sources: IPEA and Santander

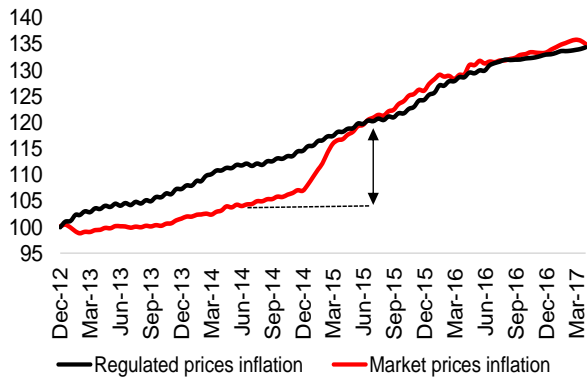


# Inflation

... all the way down, which helps the economic recovery

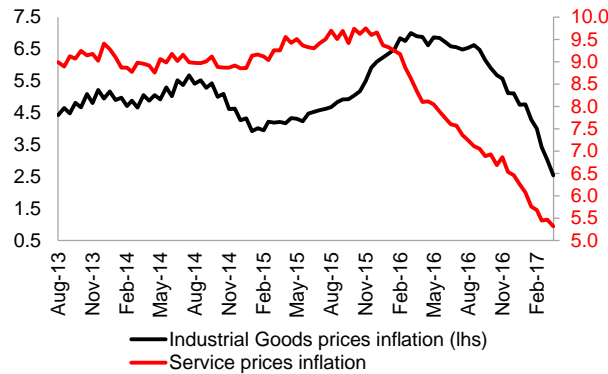
## Regulated prices vs Market prices inflation

Index 2013 Base 100. Sources: IBGE and Santander.



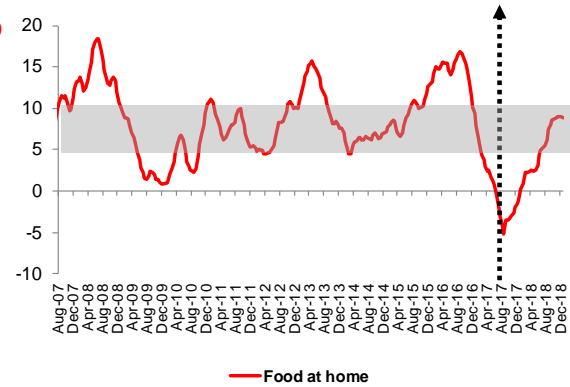
## Service prices vs Industrial prices inflation

%yoy. Sources: IBGE and Santander.



## Food at home

%yoy. Sources: IBGE and Santander.



# Inflation

## Inflation Forecasts

%. Source: Santander.

	2015	2016	2017 (f)	2018 (f)	2019 (f)
<b>IPCA</b>	<b>10.7</b>	<b>6.3</b>	<b>3.2</b>	<b>4.2</b>	<b>4.2</b>
Regulated Prices	18.1	5.5	7.0	5.5	5.0
Market Prices	8.5	6.5	2.0	3.7	3.9
Industrial Ex Foodstuff	6.2	4.8	1.4	3.0	3.1
Non-durables Ex Foods	10.9	9.3	2.1	4.3	4.8
Food at home	12.9	9.4	-3.5	9.0	5.3
Semi-durables	5.3	4.1	3.0	4.0	4.0
Durables	3.3	1.4	-0.8	0.5	0.5
Services	8.1	6.5	4.9	3.3	3.8

## Regulated inflation Forecasts

%. Source: Santander.

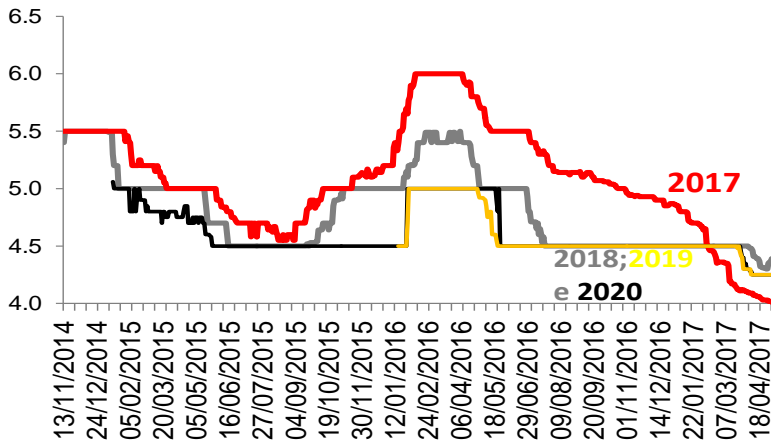
	2015	2016	2017 (f)	2018 (f)	2019 (f)
<b>Regulated</b>	<b>18.1</b>	<b>5.5</b>	<b>7.0</b>	<b>5.5</b>	<b>5.0</b>
Water and Sewage	14.8	20.1	10.6	5.2	4.0
Electric energy	51.0	-10.7	10.6	5.0	4.0
Urban transportation	9.2	7.8	5.5	6.3	4.0
Gasoline	20.1	2.5	5.9	4.9	4.0
Medicines	6.9	12.5	4.6	3.1	3.5
Healthcare plan	12.2	13.6	13.6	12.0	12.0
<b>Market</b>	<b>8.5</b>	<b>6.6</b>	<b>2.0</b>	<b>3.7</b>	<b>3.9</b>
<b>IPCA</b>	<b>10.7</b>	<b>6.3</b>	<b>3.2</b>	<b>4.2</b>	<b>4.2</b>

# Monetary policy

*Inflation expectations are anchored in the long term, and the output gap is very negative*

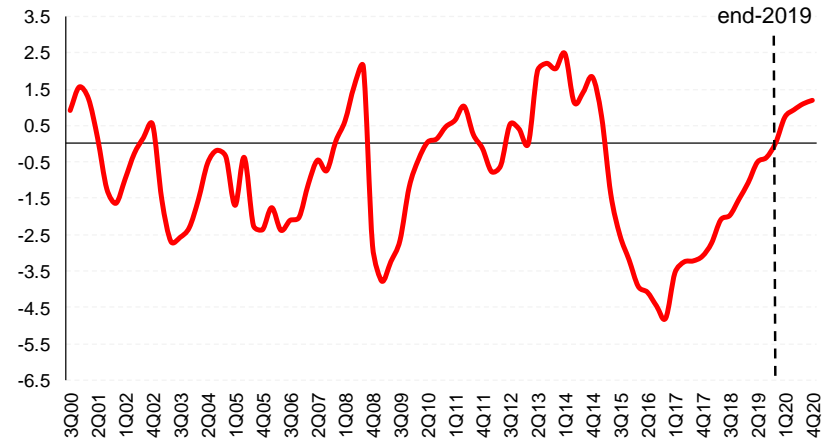
## Inflation Expectations behavior

Source: BCB.



## Output Gap (Actual GDP - Potential GDP) - %

Sources: IBGE, FGV, IPEA and Santander estimates

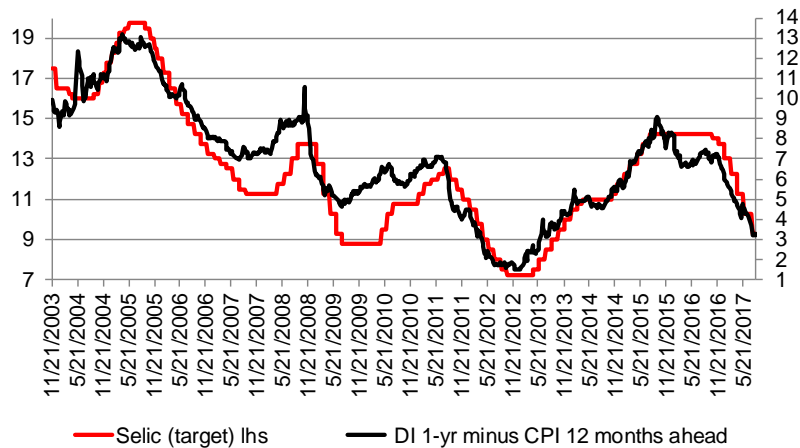


# Monetary policy

*Therefore, there is still room for further interest rate cuts*

## Real interest rate ex-ante (DI 1-y minus inflation expectation)

Sources: BCB and Santander.



## Real Neutral Rate

Sources: Santander estimate.

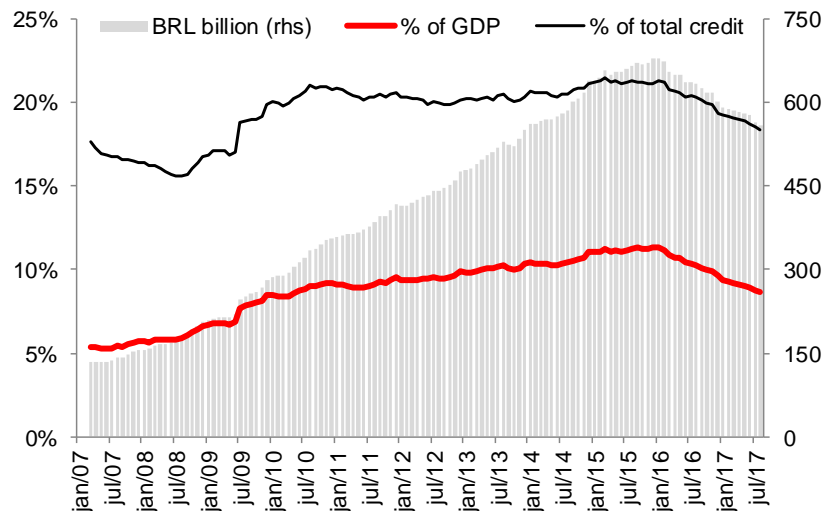
Method	Last Value	Lower Bound*	Avg*	Upper Bound*
HP statistical filter	5.9	3.6	5.2	6.6
Yield curve	5.7	2.4	6.2	9.5
Taylor rule (10-year window)	5.7	5.7	7.3	8.1
Fundamentals-based long term	5.2	2.9	5.3	8.0
Taylor rule (8-year window)	3.4	2.8	5.8	7.3
Fundamentals-based short term	4.1	2.9	5.4	12.2



# Credit Market / Monetary policy

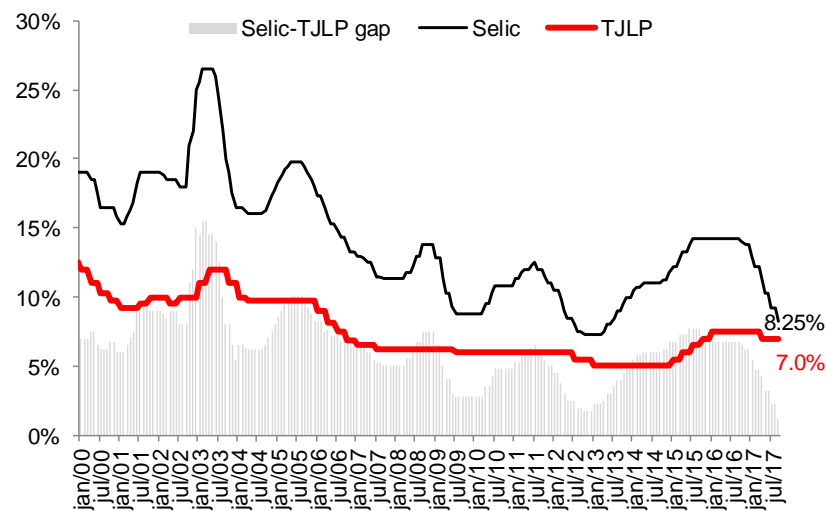
## BNDES credit portfolio: outstanding loans

Source: BCB.



## Selic and TJLP differential

Sources: BCB and Santander estimate.

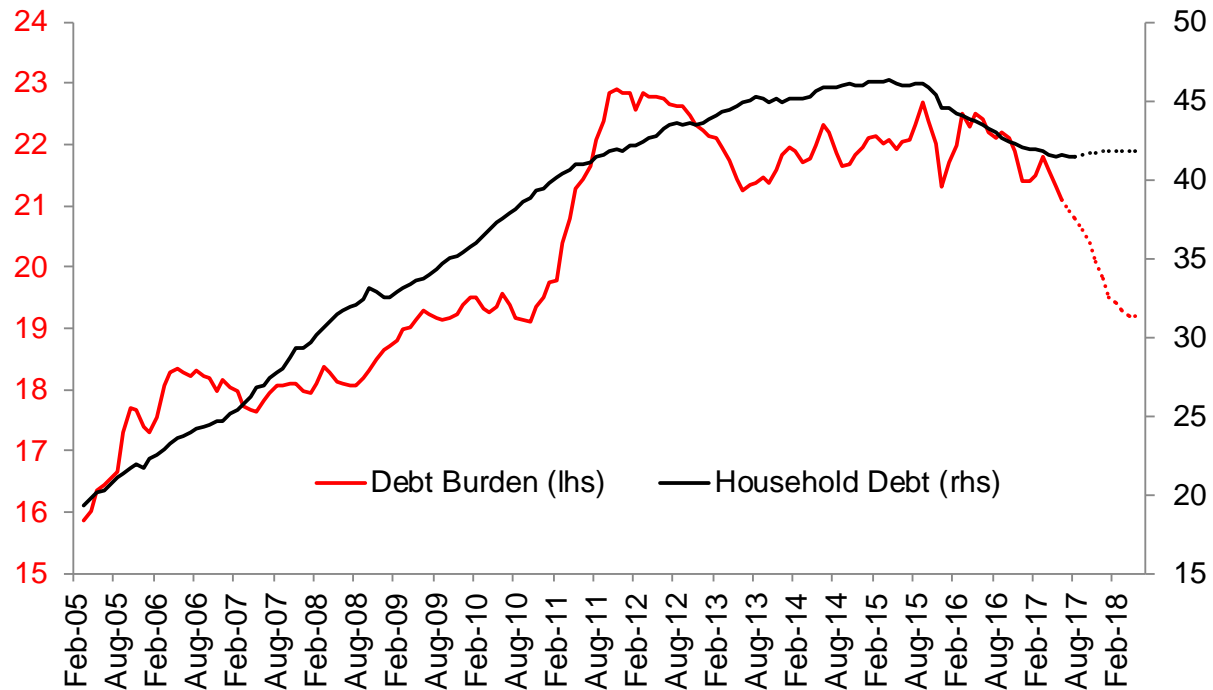


# Credit Market

*The debt burden is declining*

## Debt Burden and Household Debt

Sources: BCB and Santander.

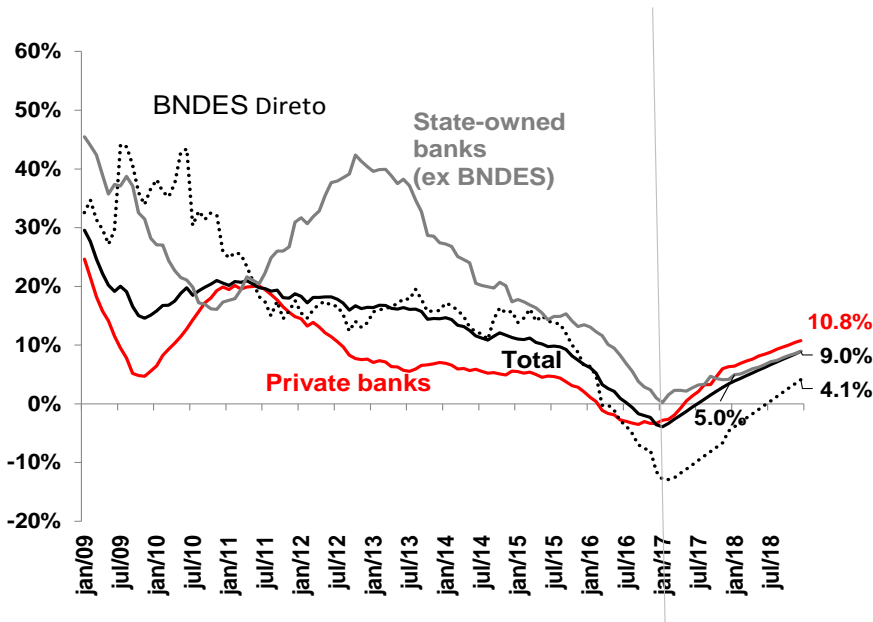


# Credit Market

...so the credit channel will work

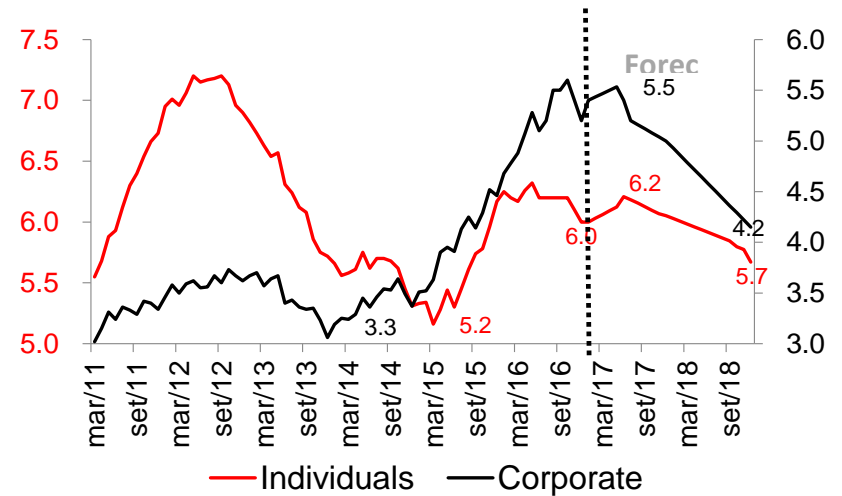
## Credit Outstanding

Sources: BCB and Santander.



## NPL (individuals and corporates)

Sources: BCB and Santander.

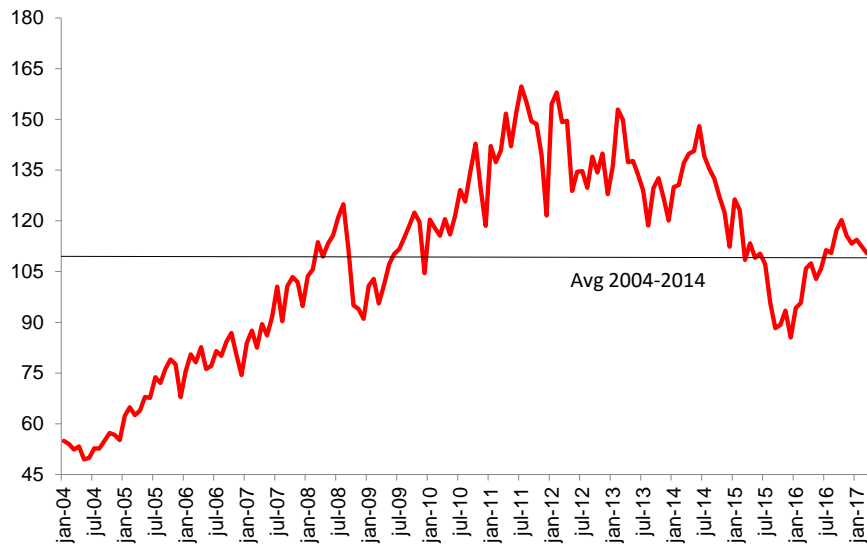


# Competitiveness

*Competitiveness improvement of 2015 has lagged effect in labor cost and trade balance*

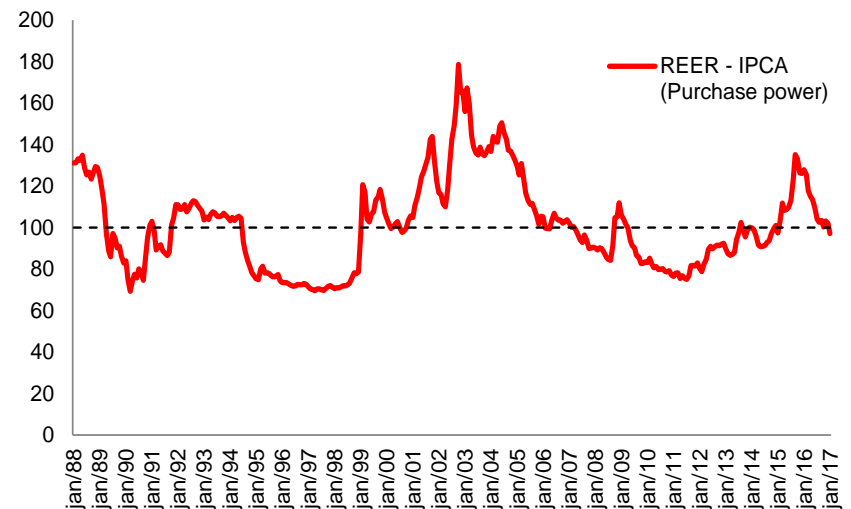
## Unit Labor Costs (USD)

Up to Jul16. Sources: IBGE, CNI and Santander.



## Real Effective Exchange Rate

1988-2016=100. Sources: BCB and Santander.

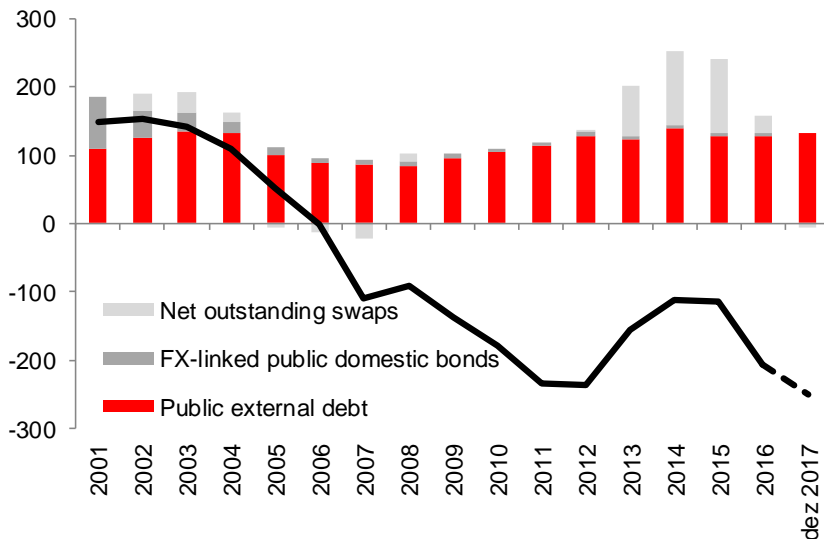


# Balance of Payments

*External solvency: External financing is sufficient for declining needs. Therefore, the room for BRL depreciation is limited*

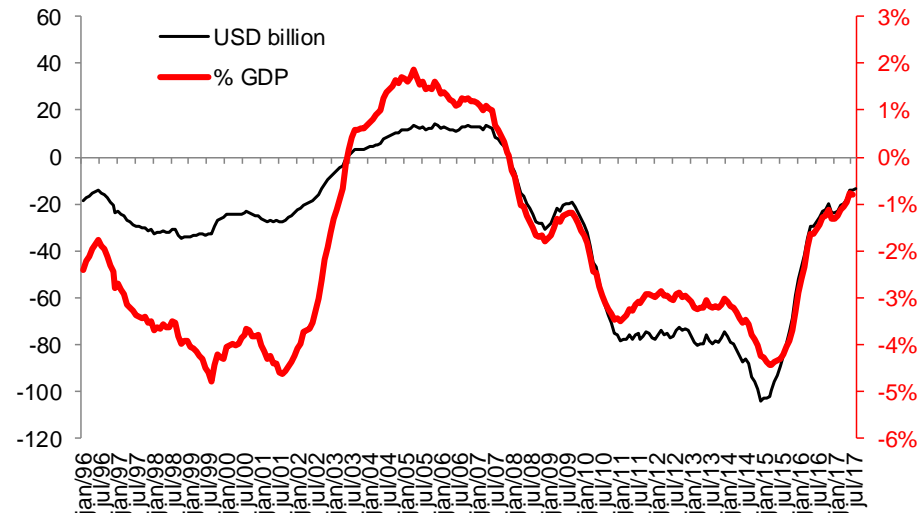
## Public sector: net FCY exposure (USD billion)

USD bn, 12-month flows. Source: BCB.



## Current account deficit

USD bn, 12-month flows, % GDP Source: BCB

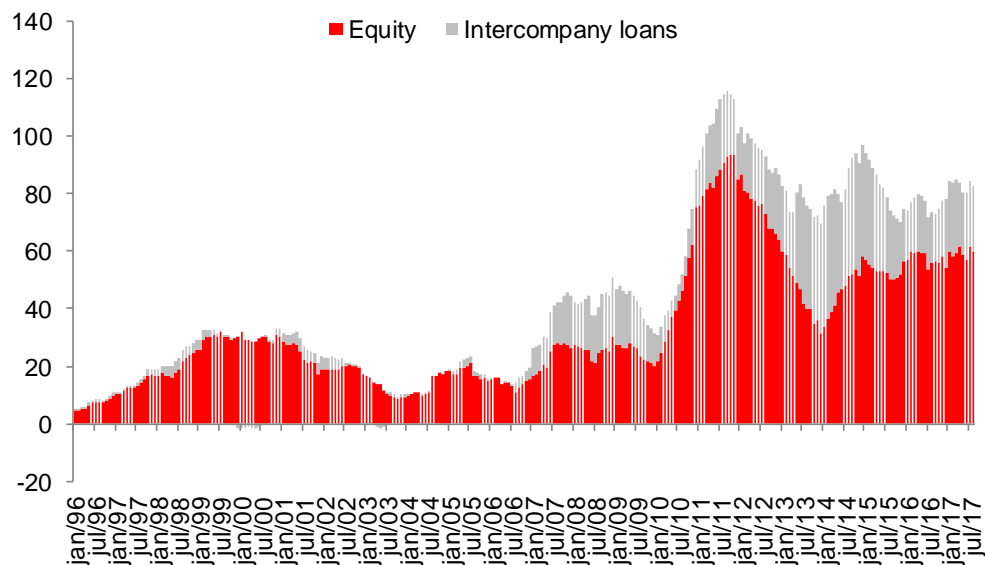


# Balance of Payments

## Foreign Direct Investment

### FDI (USD billion)

USD bn, 12-month flows. Source: BCB.



# Santander forecasts

	2014	2015	2016	2017	2018	2019
<b>GDP (%)</b>						
GDP Growth	0.5	-3.8	-3.6	0.8	3.2	3.0
<b>Inflation (%)</b>						
IPCA-IBGE	6.4	10.7	6.3	3.2	4.2	4.0
IGP-M	3.7	10.5	7.2	-0.4	4.5	4.0
<b>FX Rate</b>						
BRL/USD - end of period	2.66	3.90	3.26	3.20	3.50	3.57
BRL/USD - average	2.35	3.33	3.49	3.18	3.37	3.53
<b>Interest Rates (%)</b>						
SELIC - end of period	11.75	14.25	13.75	7.00	6.75	8.50
<b>Labor Market</b>						
Unemployment rate (average)	6.8	8.5	11.5	12.9	11.4	10.2
<b>Balance of Payments</b>						
Exports (USD bi)	225.1	191.1	185.3	207.8	226.1	251.0
Imports (USD bi)	229.1	171.5	137.6	150.9	166.3	185.3
Trade Balance (USD bi)	-4.0	19.7	47.7	56.9	59.9	65.8
Current Account (USD bi)	-104.2	-58.9	-23.5	-23.8	-23.5	-20.7
Current Account (% of GDP)	-4.2	-3.3	-1.3	-1.1	-1.1	-1.1
<b>Fiscal Accounts</b>						
Primary Balance (% of GDP)	-0.6	-1.9	-2.5	-2.5	-2.3	-1.8
Net Public Sector Debt (% GDP)	32.6	35.6	45.9	50.0	57.9	62.8
Gross Public Sector Debt (% GDP)	56.3	65.5	69.5	77.2	84.0	88.9



*Thank you!*

