

**Brazil Macro Compass****Holidays, but No Rest for Politicians Ahead of Elections**

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**Political Agenda: A Pause Before the Electoral Sprint**

Activity in Congress remains light amid soccer games and the traditional midwinter parties in the Northeast. Still, the Lower House managed to pass a final version of the bill that allows some oil exploration blocks to be auctioned. The bill now must be approved by the Senate, and the auctions are expected to take place before year-end, adding to this year's government revenue.

Next week is the last one before the Congress's winter recess (July 17 to August 1). The period defined by the Electoral Justice for party conventions starts on July 20 and ends on August 5, so the coming weeks should involve intense backstage negotiations (especially related to the formation of coalitions for state and national elections), with most sitting representatives back home campaigning among their respective electoral bases. Coalitions are key to the allocation of campaign money and time on television, both of which are mostly divided among parties according to their relative importance in Congress.

A new presidential poll, by DataPoder360, was released on July 3. The only changes outside the reported margin of error (2 pp) from the latest comparable poll (from May) were Jair Bolsonaro, falling to 21% vote intentions (from 25%), and the share of declared blank/null votes raising to 31% (from 28%). Still, Bolsonaro has maintained a lead over Ciro Gomes (13%), Geraldo Alckmin (8%), Marina Silva (7%), Fernando Haddad (6%), and Alvaro Dias (5%).

**What's New: Industrial Production and Inflation after the Strikes**

**Industrial production plunged 10.9% m/m in May (-6.7% y/y), reflecting the truckers' strike during that month.** Since most of the halted production resumed relatively fast, we expect a strong comeback in June (+8.5% m/m in our preliminary estimates). In our view, the greater impact of the strike on economic activity will be indirect, in the form of a long-term loss in business and consumer confidence. We expect 2018 GDP growth at 2%, with a downward bias. (For more details, see our report *Truck Strike: A Preliminary Assessment*, May 29, 2018.)

**June CPI also was affected by the disruption in supply lines caused by the strike.** Inflation came in at 1.26% m/m (4.39% y/y), mostly because of rising prices for foodstuffs (+3.1% m/m) and fuel (+4.48% m/m). However, preliminary July readings show that many of those prices have already started to normalize, so we believe that part of the surge in June will be offset during the current month. We still see 2018 year-end inflation below the target midpoint and anticipate little contamination of 2019 expected inflation, which should keep the Central Bank on hold until 2H19. Core inflation remains relatively low (3.3% y/y), and inflation in services, at 3.14% y/y, is still on a downward trend.

**Upcoming Data: May Retail Sales and Services Volumes**

A light week in terms of economic releases starts with markets closed on Monday (July 9) due to a holiday in the State of São Paulo. IBGE ends the cycle of its May economic activity data with the release of surveys on retail and services. We forecast core retail sales contracting 0.2% m/m (-4.3% y/y), a figure little affected by the strike, as suggested by supermarket sales data already available. Broad retail sales (which include the auto sector) are expected to show a worse performance (-1.2% m/m, -6.7% y/y). We expect the services sector to show a 2.7% m/m contraction (2.5% y/y) caused by disruptions in the supply of services to both individuals and companies.

**IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.**

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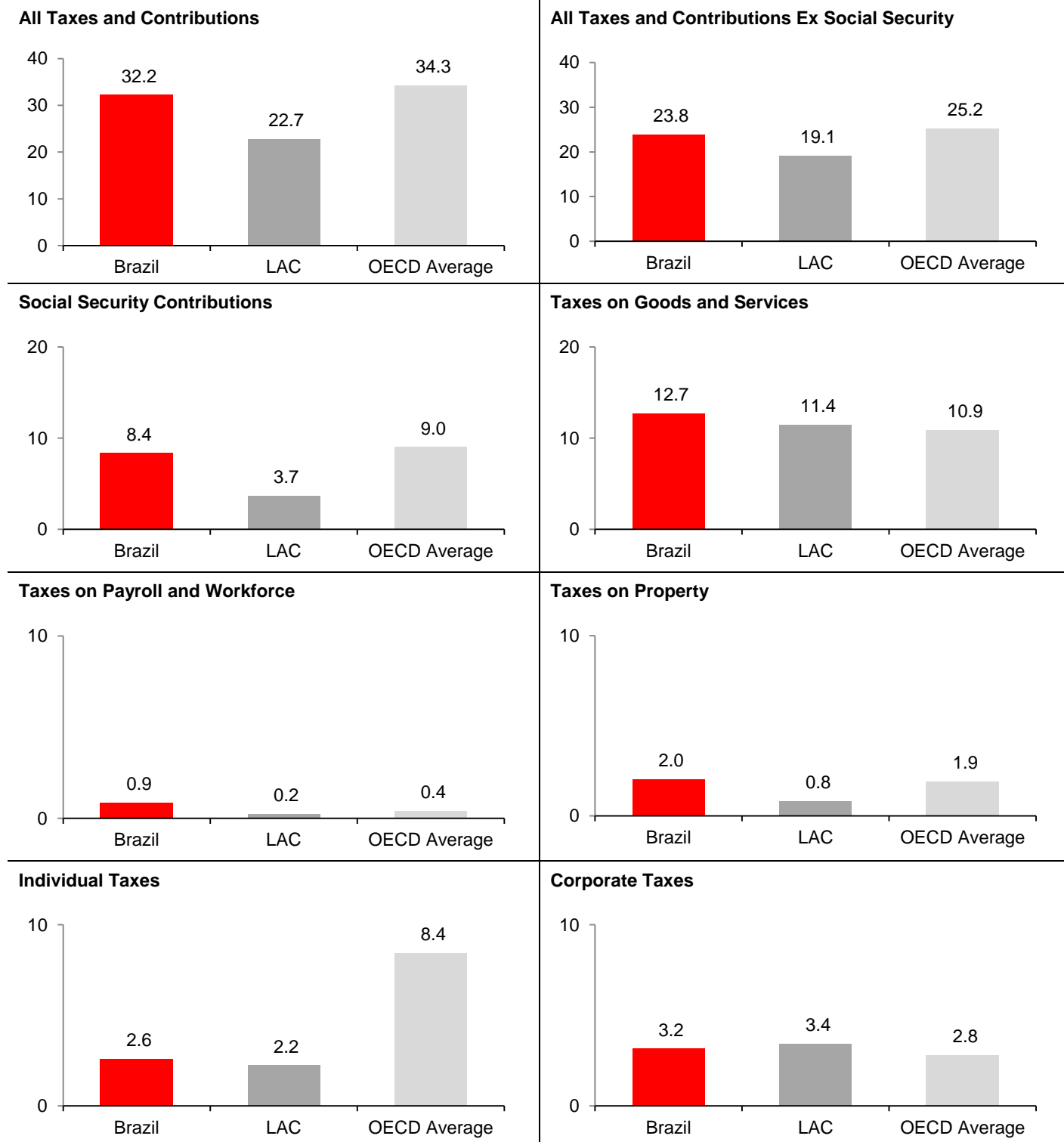
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## Chart of the Week: Taxes, Here and There

On June 28 OECD released a comprehensive cross-country database on tax levels and structures through time (Global Revenue Statistics Database). We used it to compare tax revenue from different sources in Brazil with the averages for OECD members and Latin America and the Caribbean (LAC). Brazil's total tax revenue is much higher than the LAC average and comparable to OECD, mostly because of relatively high social security contributions. Individual taxes in both Brazil and LAC are considerably lower than in OECD countries.

### General Government Tax Revenue as % of GDP (2016 or latest available)



Sources: OECD, Santander.



## Number of the Week

**-10.9%**

Following the truckers' strike, industrial production in Brazil dropped 10.9% (m/m) in May, the most for a single month since December 2008 (see "What's New" on the previous page).

## Quote of the Week

*My diagnosis is the following: public spending, public spending, public spending; fiscal reform, fiscal reform, fiscal reform.*

— **Paulo Guedes**, Jair Bolsonaro's economic advisor, in an interview with Valor (July 2, 2018).

## What We've Been Reading

- "Global Aging and Fiscal Solvency," by Martin Feldstein (*Project Syndicate*, July 2, 2018). Feldstein suggests increasing the retirement age and combining existing pay-as-you-go systems with equity funding as necessary reforms to keep sustainability of pension systems in several countries.
- "Lopez Obrador Should Learn from Lula's Mistakes," by Mac Margolis (*Bloomberg*, July 3, 2018) and "Amlo as Lula?" by John Paul Rathbone (*Financial Times*, June 29, 2018). Parallels and differences between Mexico's president-elect and Brazil's former leader.
- "It's Lula Forever in Brazil's Northeast," by Richard Lapper (*Americas Quarterly*, July 3, 2018). A good account of Brazil's top soccer stars.
- "Chart of the Week: The Productivity Penalty: World Cup Winners and Losers" (*IMF Blog*, July 2, 2018). Brazil's Southeast has the biggest overlap of the soccer games with normal working hours.
- "Mirth and Melancholy: The Collected Stories of Machado de Assis," by Morten Høi Jensen (*The Los Angeles Review of Books*, July 4, 2018). English-language readers can now enjoy the short stories of Brazil's finest writer ever.

## Recent Publications (Available on Our Website)

- "*Lethal Weapon*": How Far Can the BCB Go with Swaps? (June 15, 2018)
- *Rely on Fundamentals and Carry On* (June 8, 2018)
- *Truck Strike: A Preliminary Assessment* (May 29, 2018)
- *Copom Capitulates to Changing Balance of Risks* (May 16, 2018)
- *Monetary Policy: The Good Governance* (May 9, 2018)
- *Infinite (Trade) War: Does It Matter for Brazil?* (May 2, 2018)



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### Electronic Media

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