Santander Corporate & Investment Banking

ECONOMICS

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Brazil Macro Compass

Honeymoon Mood Prevailing

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Political Agenda: New Government's First Initiatives

In our post-2018 elections scenario change report, *Brazil Post Elections: Honeymoon and Marriage* (October 25, 2018), we wrote: "We believe there is also ample room for the government to improve expectations through the consolidation of a general belief in its willingness and ability to rebalance fiscal accounts." This consolidation of beliefs was one of the main themes for markets this week, triggered by a favorable news flow to the perceived probability of a pension reform getting passed in Congress as early as this year and to other pro-market initiatives, such as deregulation and privatizations.

In our view, the most important development was the announcement that Jair Bolsonaro's Social Liberal Party (PSL), the second largest in the Lower House, will support Rodrigo Maia's bid for reelection as house speaker, in exchange for some leadership positions at the house's governing board and relevant committees. In our view, having the speaker of the house aligned with the government's party and the reform agenda is an important and necessary step for the approval of the pension reform.

In his inaugural speech as Minister of Finance, Paulo Guedes mentioned the three pillars of the economic management of the new government: (i) pension reform, (ii) privatizations, and (iii) tax reform. On pension reform, he mentioned that a proposal will be sent to Congress as soon as the new legislative year starts (early February), and that some measures that do not require constitutional amendments may be announced as soon as next week. On the contents of the pension reform, President Bolsonaro mentioned in a TV interview that the government proposal will set the minimum retirement ages at 62 and 57 for men and women, respectively, without specifying if those ages will be applied to private and/or public workers. This suggests a watering down from the proposal that is in Congress and from what was circulating in the press, although more details are needed to estimate the compared fiscal savings. Our scenario considers the approval this year of a reform with long-term savings similar to those at the Temer proposal.

We believe that the new government is likely to sustain that "honeymoon mood" in the financial markets throughout January with more announcements of economic initiatives and steps toward building a coalition in Congress to support its agenda. The true challenge, in our view, will begin on February 1st, with the elections for the Congress leadership (unlike the race for the Lower House, the definition of the Senate presidency will probably be more challenging, since PSL is only the 10th largest party there and traditional centrist parties such as MDB, PSDB, and DEM managed to keep a strong presence). After that, the government will have a few weeks to present a detailed pension reform proposal and a strategy for getting it through Lower House and Senate. As we also wrote in October, that "marriage" phase should be more difficult, with the president having to spend his political capital in a fragmented Congress, possibly under a global scenario of increased risk aversion. Eventually, we believe that a meaningful pension reform will be approved, but this will not be a smooth process, in our view.

Upcoming Data: 2018 Year-end Inflation

December CPI inflation will be released on January 11. We expect monthly inflation at 0.18%, with 12-month inflation reaching 3.77%, well below the target midpoint (4.5%). The main highlight of the release will be, in our view, falling administered prices, with deflation in gasoline prices (-5.1% m/m) and electricity tariffs (-1.8% m/m).

Slow inflation translated into a relatively mild increase in the minimum wage for this year: 4.6%, as announced this week. That, coupled with a still weak labor market, should contribute to contained services inflation in 2019, in our view. We expect year-end CPI inflation at 3.7% y/y, allowing for a flat Selic rate throughout 2019.

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Chart of the Week: The President's Speech

Clocking in at little more than 9 minutes, with around 1,100 words, Jair Bolsonaro's inaugural speech on January 1 was the shortest among democratically elected presidents in the current regime (in 2015, Dilma Rousseff spoke for 39 minutes). Our Chart of the Week plots a word cloud of the speech's transcription (font size is proportional to the frequency of each word). Besides 'Brazil' and 'Brazilians," the words most mentioned were 'nation' (10 times), 'respect' (7 times), and 'freedom' and 'God' (6 times each).

Word cloud of Jair Bolsonaro's Inaugural Address

Sources: *Folha de S. Paulo*, Wordclouds.com, Santander. Words were filtered and grouped before plotting.

Number of the Week

20%

In his inaugural speech as finance minister, Paulo Guedes stated that the "ideal" tax burden for Brazil would be 20% of GDP. The current tax burden is at around 32% of GDP; according to OECD data; the lowest tax burden since 1990 was 21% of GDP (in 1991).

Quote of the Week

"In the economy, we will bring the brand of confidence, national interest, free market, and efficiency. Confidence that the government will not spend more than it earns and that the rules, contracts, and properties will be respected."

— **President Jair Bolsonaro,** in his inauguration speech (January 1, 2018).

What We've Been Reading

- "Bolsonomics: the reform plans of Brazil's new president," by Joe Leahy and Andres Schipani (*Financial Times*, December 31, 2018). A look at the initial proposals of the new administration.

- "Everything You Need to Know About Brazil's New Government," by Brendan O'Boyle (*Americas Quarterly*, December 31, 2018). A short guide to Bolsonaro's cabinet, opposition, and policy priorities.

- *South America: 2030 Trends* (Global Americans and Steven J. Green School of International & Public Affairs), December 14, 2018). A long (and not much sanguine) view of the region.

- "How Will Latin American Economies Fare in 2019?", by Cecilia Tornaghi (*Americas Quarterly*, December 21, 2018). An interview by Moody's Mauro Leos.

- "Dirty Populists," by Janine R. Wedel (*Project Syndicate*, January 2, 2019). The recent track record of populist leaders self-proclaimed corruption fighters has not been a good one, argues Wedel, looking at what happened in Hungary and Poland.

- "What Populists Do to Democracies," by Yascha Mounk and Jordan Kyle (*The Atlantic*, December 26, 2018). A quantitative assessment of populist governments since 1990 found out that populist leaders pose a danger to democratic institutions and tend to stay in power for long.

- *20 for Twenty: Selected Papers from AQR Capital Management on Its 20th Anniversary* (AQR Capital Management, December 18, 2018). A free e-book with original research from the leading quantitative investment firm.

Recent Publications (Available on Our Website)

- *Economic and Political Calendar: What to Watch in Brazil in 2019* (December 5, 2018)
- *Risks for the Selic in 2019 Expected to Become Even Less Asymmetric* (November 6, 2018)
- *20 Charts that Explain Brazil's New Political Power Structure* (October 29, 2018)
- *Brazil Post Elections: Honeymoon and Marriage* (October 25, 2018)
- *Brazil – Risk Premium: Apples and Oranges* (October 9, 2018)

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