Santander Corporate & Investment Banking

ECONOMICS April 5, 2019

Brazil Macro Compass

# The First 100 Days – What We Have Learned

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## Political Agenda: The First 100 Days of the New Government

**April 10 will be the 100th day of Jair Bolsonaro's term as president of Brazil.** Following we list what we consider the main highlights pertinent to the economy during this eventful period and their consequences for the next 100 days and beyond:

1. **Pension reform is the top priority for the economic team this year . . .** This, of course, should come as no surprise to anyone who has been following Brazil in the past few years. What was surprising, in our view, was how ambitious the government's draft turned out to be (although we believe it will be substantially watered down before it is passed by Congress; see our report *Pension Reform – The Moment of Truth: From Intentions to Bargaining*, March 28, 2019) and the extent to which debate about the reform has blocked any other minimally ambitious item on the government's economic agenda. All other policy goals are to be left until after the reform is approved, which may be undermining confidence and slowing the economic recovery, in our view (see item #5 below).

2. **. . . but there is still no clear political strategy to secure approval of the reform in Congress.** So far, the government still has not built a coalition in Congress, which, in our view, makes it difficult to evaluate the potential support for the reform agenda. If the government continues in this way, either coalitions will be built on an ad hoc basis for each specific reform, or the government will rely on its popularity to use public opinion to push lawmakers to vote for its agenda. Both strategies, in our view, are risky and would become costly in the long run, although they may be effective in the first year of Bolsonaro's term. This week President Bolsonaro met with the leaders of six large center parties (PSD, DEM, PSDB, MDB, PRB, and PP), which we see as the first positive (and necessary, in our view) gesture toward some consensus-building around pension reform.

3. **The dominance of Paulo Guedes.** Since the electoral campaign, Paulo Guedes has been seen as the mastermind behind the government's economic strategy, but the extent of his dominance once in office has still been surprising. In addition to consolidating four ministries under the newly created Ministry of Economy, Guedes was influential in the appointment of the heads of several state-owned firms and other government organs. No other finance minister has accumulated such power since the years of military dictatorship.

4. **A patient Central Bank.** Despite the changes in the board, including the installation of a new chairman, the Central Bank has maintained a calm approach to monetary policy. Chairman Roberto Campos has adopted the "caution, serenity, and perseverance" mantra from Ilan Goldfajn's final months, which, coupled with well-contained inflation and inflation expectations, leads us to believe that the Selic rate will stay at its current level (6.5%) for a long period (see our report *Monetary Policy: Low for [Much] Longer*, March 29, 2019).

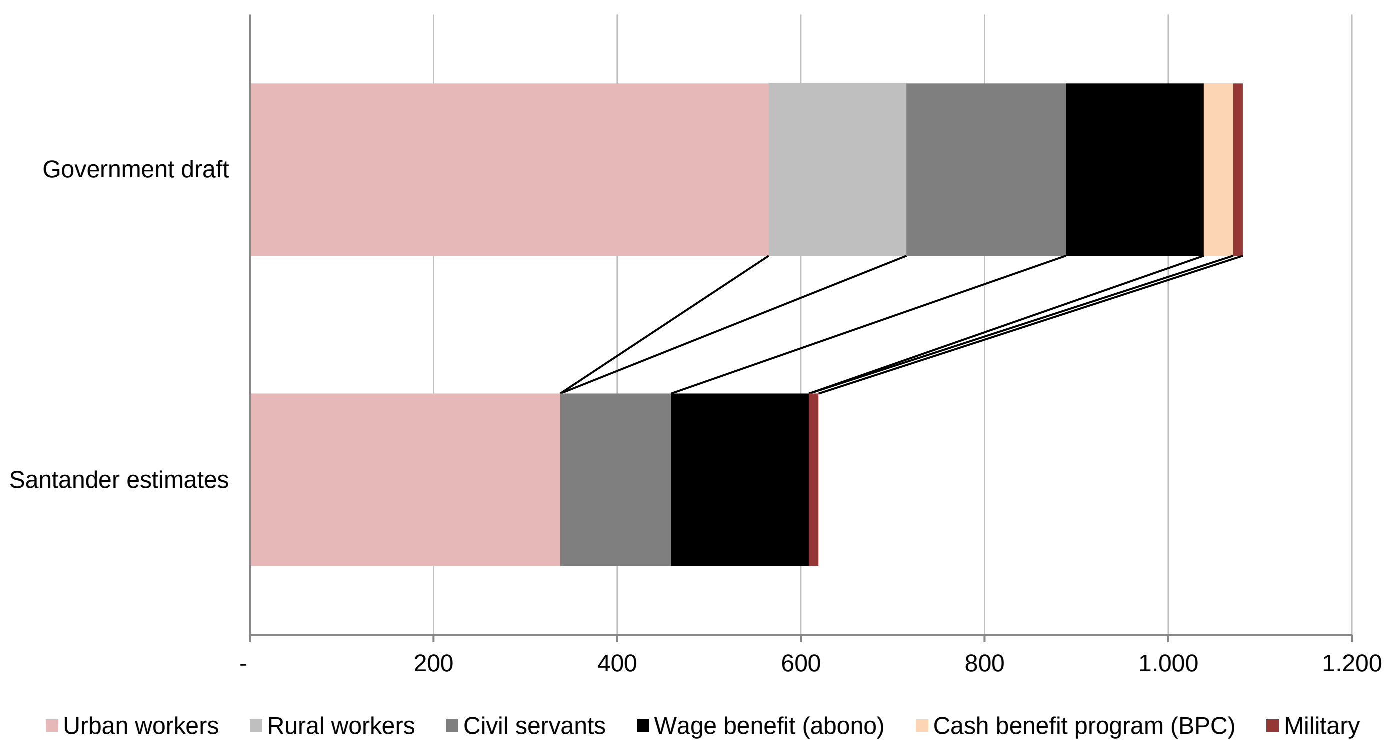
5. **Hard data has failed to confirm the improvement in soft data.** As we noted in last week's edition of this report (*Past the Honeymoon*, March 29, 2019), the jump in confidence that followed the October 2018 elections has not been reflected in hard economic activity data, which led us (and the rest of the market) to slash GDP growth forecasts for this year even before the release of full 1Q19 data (our latest forecast is 2.3% growth, from 3.0%).

**The pension reform's rapporteur in the Lower House Constitutional Committee, representative Marcelo Freitas, is expected to present its report on April 9,** which, according the committee's chair, Felipe Francischini, should allow for a vote the following week, before the Easter holidays. These deadlines, which are in-line with the expected timeline we presented in our report *Pension Reform – The Moment of Truth: From Intentions to Bargaining* (March 28, 2019), imply that a first floor vote is possible by late August.

## Charts of the Week: Pension Reform Savings

Our "Chart of the Week" shows the areas where we expect the pension reform proposal to be watered down in Congress, using estimates we presented in the report *Pension Reform – The Moment of Truth: From Intentions to Bargaining* (March 28, 2019). The backbone of the reform, in terms of fiscal savings, relates to the changes in the retirement regime (minimum retirement age and transition rule) for workers in the private sector. We expect most of such savings to make it into the final version of the reform, eventually adding up to around BRL 340 billion in 10 years and constituting about half of the total fiscal impact of the reform. The other half, in our view, should come from changes in the parameters for public servants' retirement and in the wage benefit currently conceded annually to workers who earn less than two minimum wages (*abono salarial*).

**Savings from Pension Reform – Original Proposal vs. Expectations for the Modified Version (savings in 10 years, BRL billion)**




Sources: Ministry of Economy, Santander estimates.

## In-Depth Research: Updated Selic Rate and Credit Growth Forecasts

In *Monetary Policy: Low for (Much) Longer* (March 29, 2019), we revise our 2020 year-end Selic rate forecast to 6.5% from 8.5%. According to our most recent estimates, the output gap, currently at around 3% of GDP, should stay negative until mid-2021, leaving room for non-inflationary monetary stimulus. However, we believe the Central Bank will remain relatively cautious, given the risks of a challenging international scenario, a bumpy social security reform process, and the risks of frustration with the fiscal consolidation agenda. In our central scenario, delayed approval of pension reform (not before 2H19) will prevent residual rate cuts this year, as by then, in our view, the 2020 outlook will be one of growth above potential and inflation close to the target midpoint.

In *Will Credit Be Enough to Revive Consumption?* (April 1, 2019), we present our latest estimates for credit growth in 2019 and 2020. In our view, in both years lending will be led by private banks, with a smaller (but also accelerating) contribution from state-owned banks. We forecast growth in the outstanding credit amount at 7.4% and 9.1% in 2019 and 2020, respectively. Credit, therefore, should not be a constraint on the recovery in domestic demand, in our view.

## What's New: February Industrial Production

**Industrial production grew 0.7% m/m in February (+2.0% y/y)**, slightly above our estimates (+0.5% m/m, +1.6% y/y) but still below market consensus (+1.0% m/m, +2.4% y/y). The apparently strong y/y growth may be misleading because of the effect of the Carnival holidays, which hit February 2018 production and will only appear this year in March data. Another factor that contributed to robust headline growth in the month was the poor performance of the auto sector in January, offset by a stronger February (+6.6% m/m). In fact, aggregate January/February total production in 2019 was 0.4% weaker than in the same period of 2018, showing that there is little to celebrate in the recent performance of this sector, in our view. We also highlight a significant contraction in the mining industry, triggered by the collapse of the Brumadinho dam in February: the sector plunged 14.8% m/m (-9.9% y/y) and should remain a drag on the headline index in the next few months.

## Upcoming Data: March Inflation

March CPI inflation data will be released next week. We expect monthly inflation at 0.65%, accelerating from 0.43% in February. Twelve-month inflation should rise strongly to 4.47% (from 3.89%). Foodstuff inflation, estimated at 1.67% m/m, should be the main culprit behind the rising headline. However, we expect most of this effect to be seasonal, with food prices receding after the end of the rainy season, in May. More importantly, core inflation should, in our view, remain at around 2.5% (three-month seasonally adjusted and annualized), the main factor behind our forecast of year-end inflation at 3.5% y/y.

February retail sales and services volume data are also expected next week. As was the case with industrial production, we think the higher number of business days this past February compared to last year should add an upward bias to the inter-annual comparisons. We expect core retail sales to grow 0.3% m/m (+4.5% y/y). The volume of services should be up 4.8% y/y (flat m/m).

## Number of the Week

**93%**

93% of Brazil's cultivated land with soybeans, corn, and cotton in 2017-18 used genetically modified crops, according to estimates from Céleres, an agribusiness consultancy.

## Quote of the Week

"*You are* 'tigrão' *[big tiger] when dealing with the retirees, the old folks, the people with special needs, the teachers, the rural workers, but you are* 'tchutchuca' *[slang for cute girl] when it comes to the privileged elites.*"

— **Representative Zeca Dirceu,** from the Workers' Party, to Minister of Finance Paulo Guedes in a debate on pension reform in the Lower House's Constitutional Committee (April 3, 2019). The session was suspended after the fracas triggered by Dirceu's statement.

## What We've Been Reading

- "Fence-Sitting Lawmakers Cast Doubt Over Brazil's Flagship Reform," by Simone Preissler Iglesias and David Biller (*Bloomberg*, April 4, 2019). An update on the political environment that forms the backdrop for the pension reform discussions.

- *Effects of the Business Cycle on Social Indicators in Latin America and the Caribbean: When Dreams Meet Reality*, by Carlos Végh and others (*The World Bank*, April 4, 2019). The economic slowdown in the region seems to be negatively affecting poverty indicators, which casts doubts over the substance of social progress in the previous expansionary cycle.

- "Your Mom's a Tchutchuca!" by Alex Kliment (*GZero Media*, April 4, 2019). Putting in context the slang presented to the world during this week's pension reform debates in the Lower House.

- "Brazil: judge rules identical twins must both pay support for nine-year-old girl," by Dom Phillips (*The Guardian*, April 3, 2019). What happens when DNA tests are of no use?

## Recent Publications (Available on Our Website)

- *Will Credit Be Enough to Revive Consumption?* (April 1, 2019)
- *Monetary Policy: Low for (Much) Longer* (March 29, 2019)
- *Pension Reform – The Moment of Truth: From Intentions to Bargaining* (March 28, 2019)
- *Is Monetary Policy Stimulative for Consumption?* (March 6, 2019)
- *Lower Inflation Forecast for 2019* (February 28, 2019)

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