

Brazil Macro Compass**Budgeting Under Uncertainty**

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What's New: Budget Draft, Economic Activity

The 2020 Budget Guidelines Bill (LDO), the first draft of next year's federal budget, was unveiled this week. Total primary spending is set to expand at 4.5% y/y, to BRL 1.48 trillion, with the primary deficit target at 1.6% of GDP. Government estimates take into account the full approval of the pension reform draft and the minimum wage adjusted for past inflation, suggesting a break from the rule of real increases following GDP growth of the past few years. However, the Ministry of Economy made clear that the new official rule for such adjustments has until the end of the year to be defined by President Bolsonaro. As journalist Ribamar Oliveira pointed out in his column at *Valor Econômico* two weeks ago ("A irrelevância da meta fiscal para 2020", April 4, 2019), uncertainties around the approval of the pension reform, the reversal of tax breaks and subsidies, and revenue from privatizations make very hard to evaluate the fiscal effort required to meet the primary result target, or even if that target itself will prove to be feasible or overestimated. There seems to be some margin of safety in the draft, as the 2020 deficit target is higher than the observed 2018 deficit, but such events that depend upon Congress should indeed dominate the best estimates available so far. We forecast a much smaller (0.6% of GDP) primary deficit in 2020, considering one-off revenue from oil and spectrum auctions, in addition to stronger GDP growth. For more on the budget draft, see the "Chart of the Week" on page 2 of this report.

February BCB's monthly economic activity indicator came in at -0.73% m/m, below our forecast (-0.4% m/m) and market consensus. Average yearly growth was at 1.0%, with rolling three-month average growth at -0.21%, pointing to a slow (close to flat) 1Q19 GDP growth.

Political Agenda: Pension Reform Voting Postponed

Lower House's Constitutional Committee (CCJ) postponed to next Tuesday (April 23) a vote on the pension reform report. The voting is still subject to further delays, as it depends on an agreement between the government and the center parties whose representatives are the pivotal voters at CCJ. So far, according to the press (see, for example, "Governo é obrigado a negociar para votar texto na CCJ na próxima semana", *O Estado de S. Paulo*, April 17, 2019), the report's negotiations are not affecting the potential fiscal savings of the reform. With this delay, the expected timeline we presented in our March 28 report, *The Moment of Truth: From Intentions to Bargaining*, has to be adjusted, as it assumed the conclusion of CCJ works on April 17. We now expect the first round vote in the Lower House floor by August 28, assuming all the other estimated deadlines moving one week forward.

The National Council of Energy Policy (CNPE) defined the rules of the oil transfer of rights auction, scheduled for October 28. The total signing bonus (split into four different fields) to be paid to the government was set at BRL 106.6 billion, in a production sharing agreement contract of 35 years, with a minimum share of oil for the government between 19.82% and 27.65%. It remains unclear as to how the auction proceeds will be split between the federal government and other federative entities (negotiations are ongoing, linked to the next fiscal help package to troubled states); in any case, changes in the Fiscal Responsibility Law in Congress will be needed to allow spending of that extra revenue without breaching the constitutional spending cap.

Upcoming Data: April IPCA 15

April mid-month inflation indicator (IPCA 15) will be released next week. We expect monthly inflation at 0.70%, accelerating strongly from mid-March (0.12% m/m). Produce prices will continue to be the main headline inflation driver, affected by the heavy rains during the wet season. However, we expect most of such effects to be seasonal, with prices

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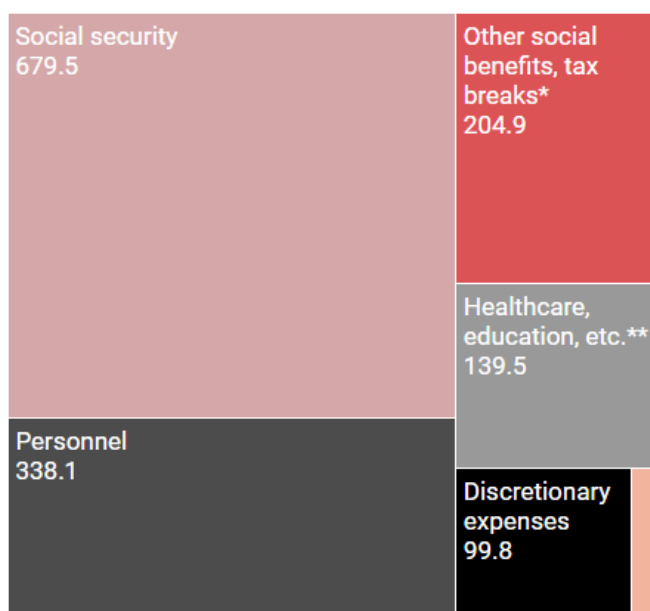


reverting to the previous mild trend in the dry season starting next month. We maintain our view that yearly inflation will end 2019 at 3.5%, comfortably below the target midpoint.

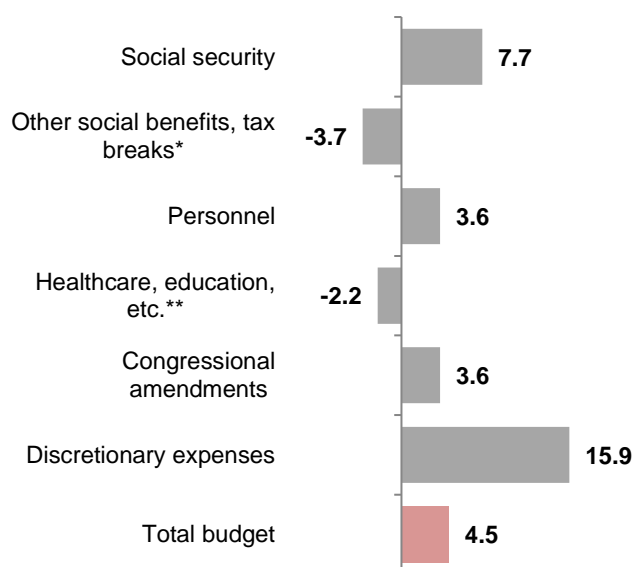
Chart of the Week: 2020 Budget Draft

Our “Chart of the Week” presents a breakdown of the 2020 budget draft released this week by the federal government. Social security spending eats up the lion’s share (around 46%) of the BRL1.5 trillion budget. Discretionary spending, which includes public investment and utility bills of public facilities, is limited to little less than BRL100 billion, or only 1.3% of GDP. In terms of changes from the last version of this year’s budget, social security spending is set to grow 7.7%, even under the assumption that the pension reform will be approved in full this year. The big change in discretionary expenses is not to be taken at face value, as this type of spending is usually used as a buffer to accommodate revenue surprises into the primary deficit target (this year’s initial expectation was already cut by BRL29.7 billion in the first bimonthly revision of this year).

Brazil 2020 Budget Draft – Main Spending Categories (BRL billion)



Brazil 2020 Budget Draft – Changes from Previous Year, Main Spending Categories (%)



The smaller (light orange) area in the left-hand chart refers to congressional amendments (BRL 14.2 billion). * Includes, among others *BPC*, *abono salarial*, unemployment insurance, and tax benefits. ** Includes other expenses set by the Constitution and *Bolsa Família*. Sources: Ministry of Economy, Santander.

Number of the Week

**5.5
mn**

According to a study by Locomotiva Instituto de Pesquisa using IBGE’s household survey data, there are 5.5 million people working as delivery professionals in Brazil. This corresponds to 23% of all the self-employed people in the country.

Quote of the Week

“What leaves me perplexed is this lack of strategy.”

— **Representative Felipe Francischini**, from Jair Bolsonaro’s Social Liberal Party (PSL), talking about his own party following a session on the pension reform at the Lower House’s Constitutional Committee (CCJ), chaired by him.



What We've Been Reading

- “Investors Realizing Brazil President Bolsonaro's Political Party Not All That,” by Kenneth Rapoza (*Forbes*, April 16, 2019). How the Social Liberal Party is making the reform path more difficult.
- “Jair Bolsonaro,” by Ian Bremmer (*Time*, April 17, 2019). Entry in Time’s list of the 100 most influential people of 2019.
- “Bolsonaro’s Perfect Storm in Brazil: From Outraged Voters to Extreme Right-Wing Votes,” by Carolina Botelho (*Center for Latin American Studies, UC Berkley Blog*, March 8, 2019). A multifaceted explanation for Bolsonaro’s electoral triumph.
- “Rethinking Central Bank Independence” by Erik Jones and Matthias Matthijs (*Journal of Democracy*, April 2019). Under pressure from populist leaders and demands for a faster economic recovery, central banks will have to act more politically to keep their legitimacy, argue the authors.
- “Between *simpatia* and *malandragem*: Brazilian *jeitinho* as an individual difference variable,” by Marco Akira Miura and others (*PLoS ONE*, April 15, 2019). A scientific approach to the (in)famous Brazilian *jay-tchee-nyoo*.

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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