



Fiscal Follow-up Report

July 2018

Full report [here](#) (portuguese)

Felipe Salto

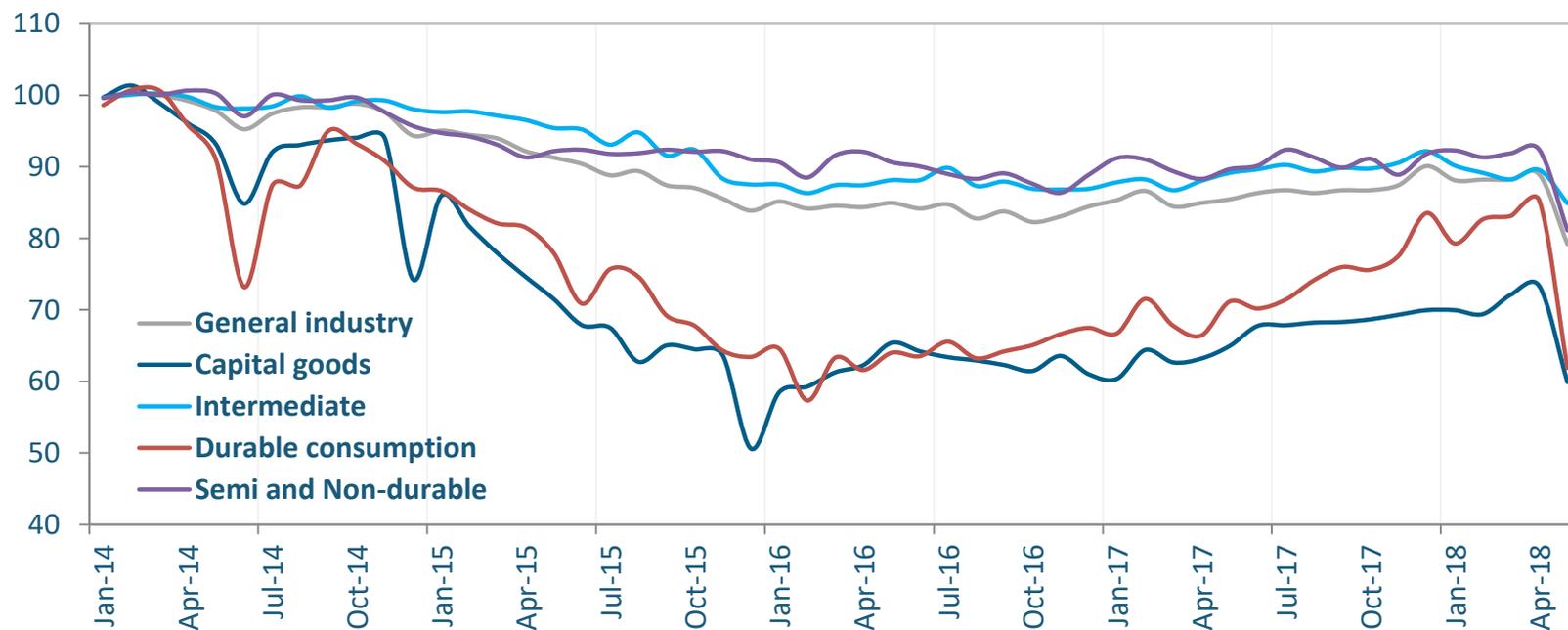
Executive Director

July 9th, 2018

- In May, industrial production shrank by 10.9% compared to April, showing the worst performance since December 2008. The dynamics of indexes of confidence and uncertainty in June reinforced the negative impact of the truckers' strike and the worsening in risk perception of the agents about the prospective performance of the economy.
- The General Government Gross Debt reached in May 77.05% of nominal GDP accumulated in 12 months, following uninterrupted growth since December 2017, when it was at 74%. The Public Sector Net Debt registered a new fall, to 51.28% of GDP accumulated in 12 months.
- The IFI's Budgetary Prudence Index (IPRO) evaluates Government's fiscal projections, based on the results effectively obtained at the end of the year. It is possible to identify distinct periods in the conduct of official estimates, alternating years with more prudent projections (and closer to realized data) and projections displaced from reality, with distinctly optimistic bias (overestimated revenues and underestimated expenditure).
- The exchange rate devaluation raises the real value of the foreign debt and internal debt corrected by the exchange rate held by Federal and State Governments. As for the Central Bank, the gains outweigh the losses largely because foreign reserves are much larger than the value of FX swap contracts. However, this difference may fall in the coming months as a result of the increase in the value of contracts and of the exchange rate.
- Sharing system decenters revenues between levels of government: central government centralizes two thirds of total collection and, after legal and constitutional transfers, see your slice drop to half of total collection; municipalities reach about one fifth and State governments just over a quarter of disposable revenues.

- The impact of the truckers' strike on GDP in the second quarter and, consequently, on our estimates for the year (2.7% with low bias) still depends on other sectorial indicators such as retail sales and services, in addition to the June figures, which will identify if part of the losses was recovered.
- High-frequency indicators already known allow to evaluate, to some extent, the effect of the outages on activity. In May, according to the IBGE, the industrial production fell 10.9% compared to April (-6.6% compared with May 2017). That was the worst performance since December 2008.

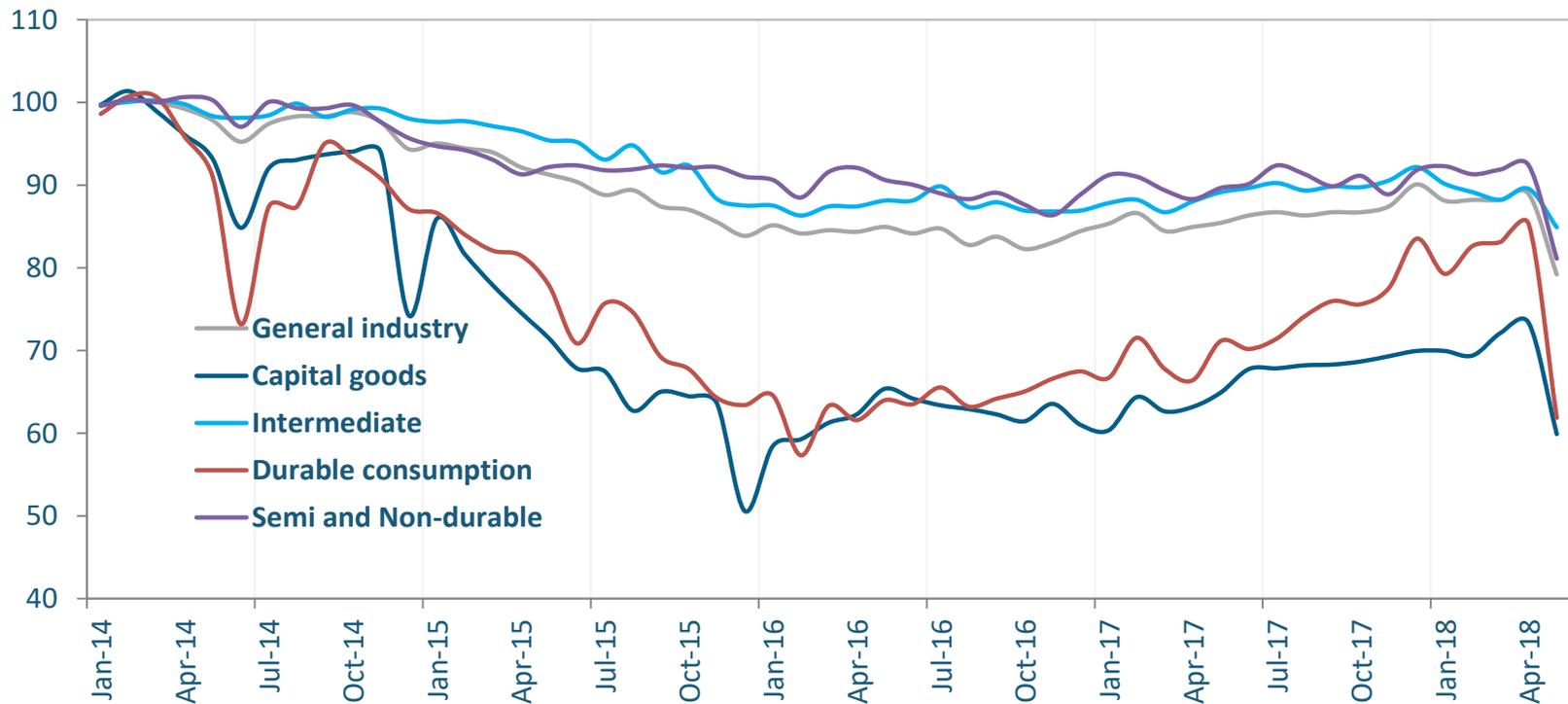
Industrial production (Seasonally adjusted data - 1°T 2014 = 100)



Source: IBGE.

- In May, according to the IBGE, the industrial production fell 10.9% compared to April, in the seasonally adjusted series (-6.6% compared with May of last year). That was the worst performance since December 2008.

Industrial production (Seasonally adjusted data - 1°T 2014 = 100)

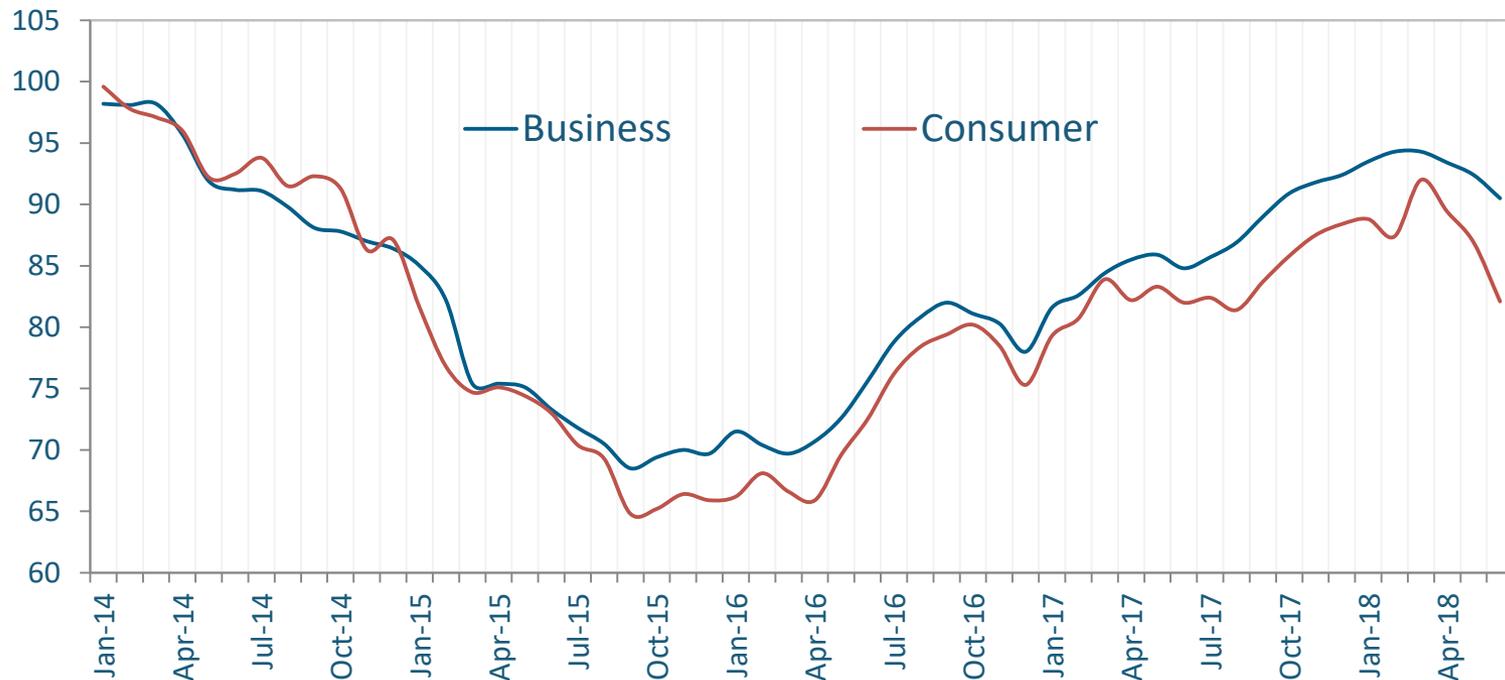


Source: IBGE.

Macroeconomic Context

- The dynamics of indexes of confidence and uncertainty in June reinforced the negative impact of the truckers's strike and the worsening in risk perception of the agents about the prospective performance of the economy.

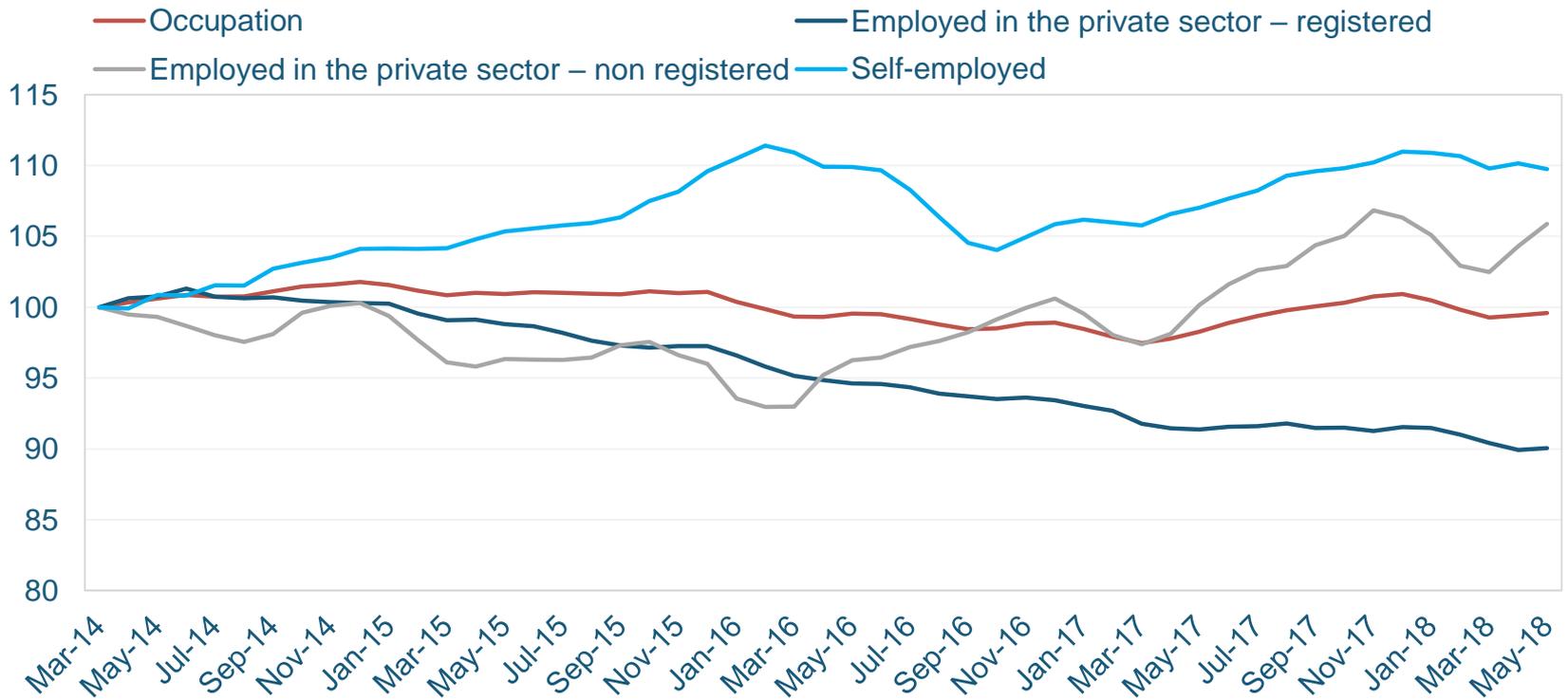
Confidence index



Source: FGV.

- Employed population continues to expand in aggregate terms mainly because of informal market.

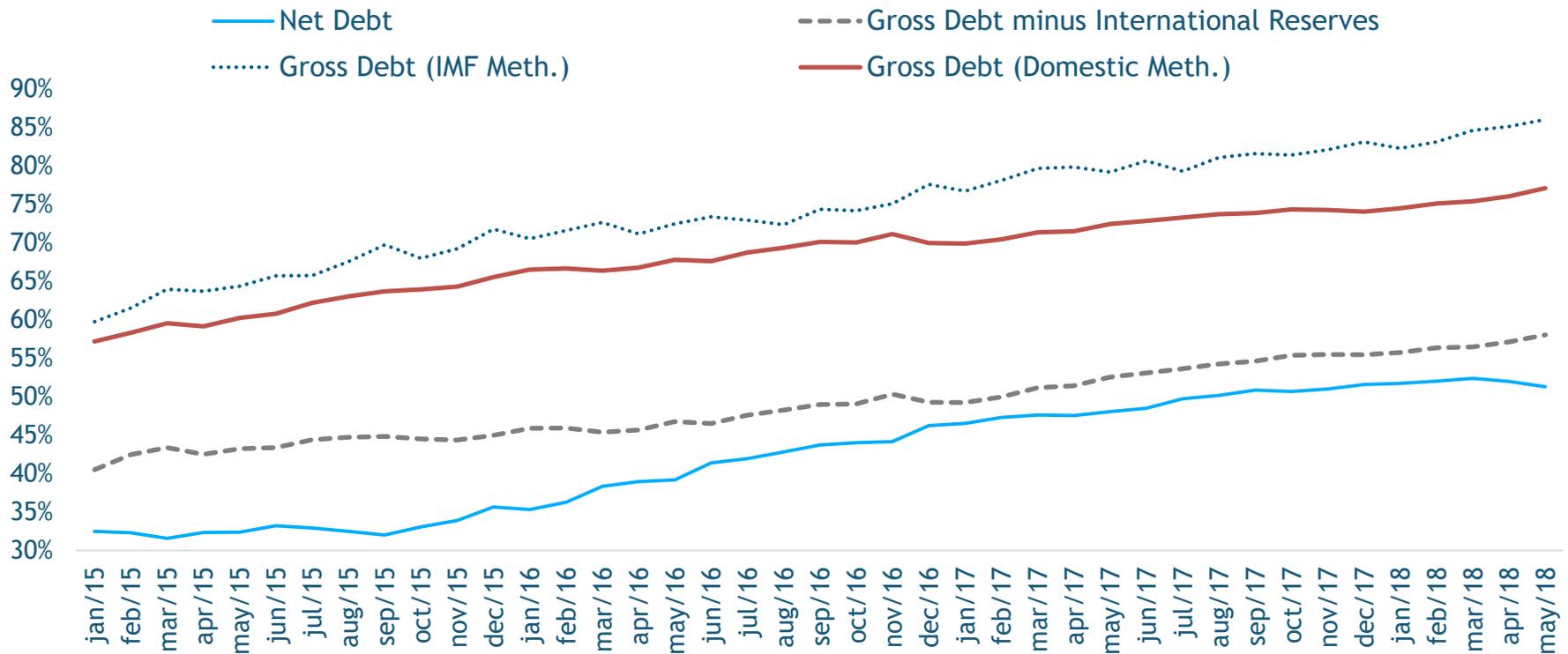
Employed population (1T 2014=100)



Source: IBGE.

- Primary deficit together with a deficit in net interest payments kept public sector borrowing requirements high, pushing up public debt.

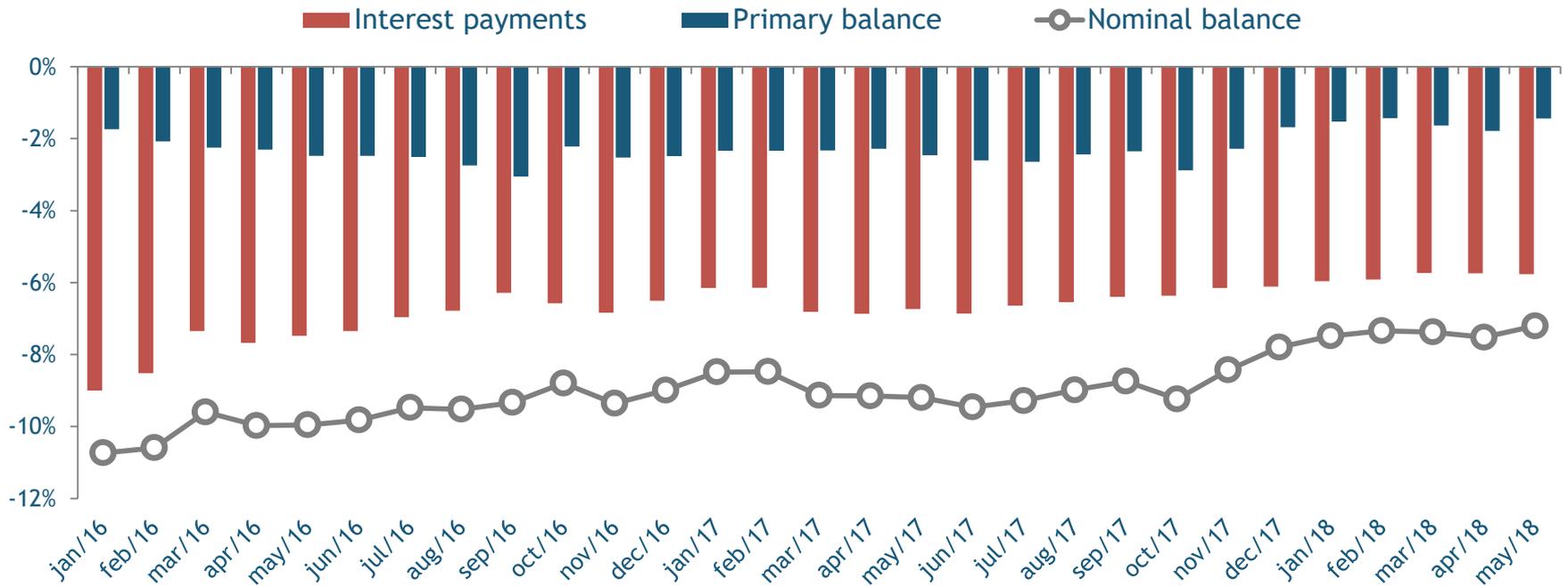
ALTERNATIVE MEASURES OF PUBLIC DEBT (% OF NOMINAL 12-MONTH GDP)



Source: Central Bank.

- 12-month nominal deficit fell to 7.2% of 12-month GDP in May, due to a shrinkage of the 12-month primary deficit to 1.4% (versus 1.8% in April).
- Such a shrinkage to 1.4% was mainly due to the 12-month surplus of the Treasury, which has offset half of the 12-month deficit in social security (“Previdência Social”, RGPS).

12-MONTH PUBLIC SECTOR BORROWING REQUIREMENTS (% 12-MONTH GDP)



Source: Central Bank. For each month, the graph shows the 12-month nominal amount divided by the 12-month nominal GDP.

- Revenues still influenced by nonrecurrent components (i.e, components weakly correlated to economic activity),

PRIMARY BALANCE OF CENTRAL GOVERNMENT (R\$ MILLIONS AND REAL CHANGE)

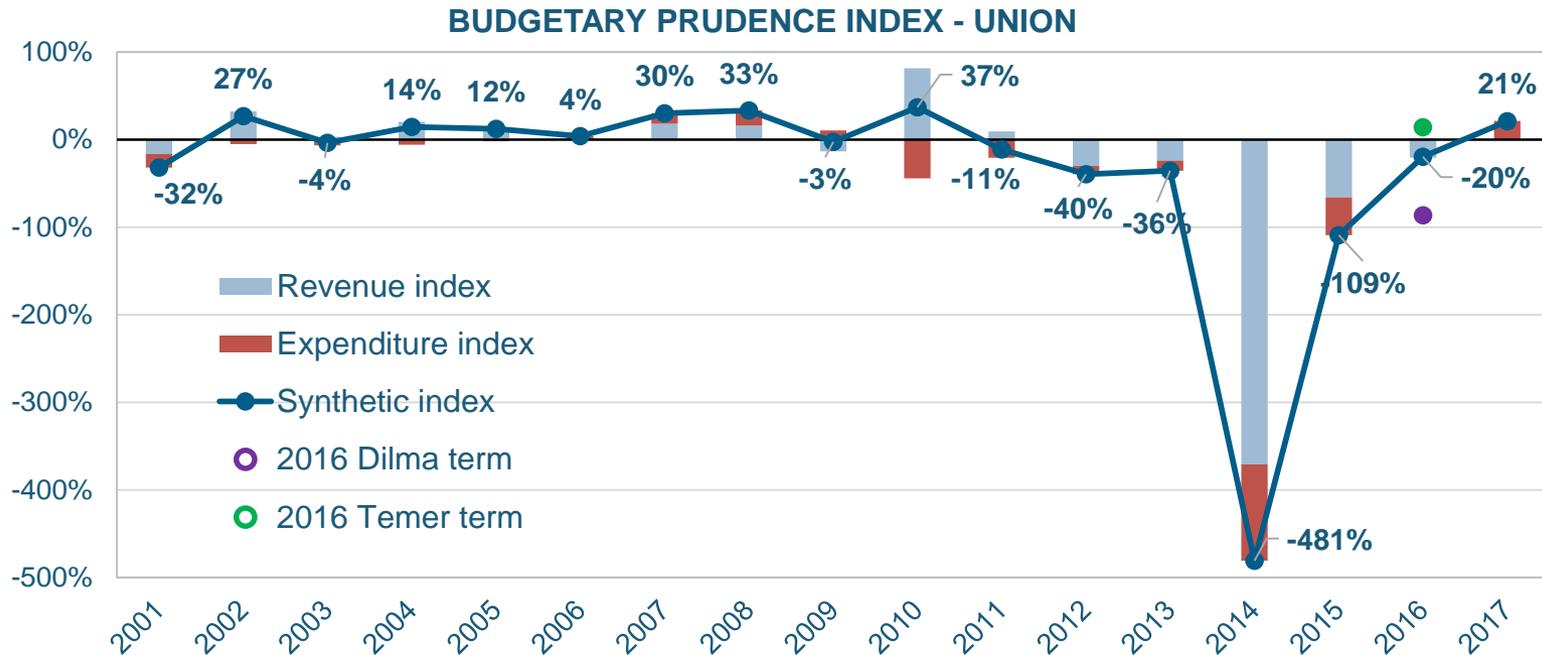
Breakdown	Monthly					Year-to-date				
	Share %	May-18	May-17	Var,	Var, %	Share %	May-18	May-17	Var,	Var, %
Total Revenue (A)	100.0	112,748	102,161	10,587	10.4	100.0	623,854	578,516	45,337	7.8
Collected by the Federal Revenue Office	59.5	67,065	62,244	4,822	7.7	64.1	399,687	366,179	33,509	9.2
Net Social Security Revenues	27.0	30,435	30,393	41	0.1	24.4	152,365	149,851	2,514	1.7
Not Collected by the Federal Revenue Office	13.5	15,250	9,525	5,725	60.1	11.5	71,803	62,505	9,298	14.9
Transfers by Revenue Sharing (B)	100.0	24,989	22,216	2,773	12.5	100.0	109,559	101,794	7,765	7.6
FPM / FPE / IPI-EE	73.4	18,351	17,179	1,172	6.8	78.1	85,619	81,155	4,463	5.5
Constitutional Funds	2.9	731	711	19	2.7	3.1	3,424	3,508	-84	-2.4
Education-Salary (social contribution)	3.8	952	968	-16	-1.7	5.1	5,604	5,572	32	0.6
Financial Compensations	19.8	4,938	3,319	1,619	48.8	12.6	13,844	10,407	3,436	33.0
CIDE - Fuels	0.0	0	0	0	-	0.7	803	859	-56	-
Other	0.1	17	38	-21	-55.6	0.2	265	291	-26	-9.0
Net Revenue (C=A-B)	-	87,759	79,945	7,814	9.8	-	514,294	476,722	37,572	7.9
Total Expenditure (D)	100.0	102,283	110,171	-7,889	-7.2	100.0	534,182	514,414	19,768	3.8
Payroll	22.1	22,581	26,518	-3,937	-14.8	22.4	119,825	118,536	1,289	1.1
Income Transfers ¹	55.1	56,331	59,529	-3,199	-5.4	54.1	288,900	283,129	5,771	2.0
Subsidies and Grants (extended) ²	1.3	1,334	1,728	-394	-22.8	2.7	14,345	18,030	-3,685	-20.4
Discretionary (ex Family Grant Program)	16.3	16,711	16,176	535	3.3	13.9	74,047	68,567	5,480	8.0
Legislative, Judiciary Branches and Prosecutor's Office (LEJU/MPU)	1.1	1,093	1,050	43	4.1	0.9	4,947	4,321	626	14.5
PAC (Growth Acceleration Program), ex MCMV	1.5	1,494	2,367	-873	-36.9	1.2	6,633	7,358	-725	-9.9
Extraordinary credits (excluding PAC)	0.0	37	84	-48	-56.5	0.0	154	378	-225	-59.4
Judicial Remedies	0.2	156	760	-604	-79.4	2.4	12,699	1,286	11,413	887.5
Other current spending	2.5	2,547	1,959	588	30.0	2.4	12,632	12,809	-177	-1.4
Primary Balance (C-D)	-	-14,524	-30,226	15,703	51,9	-	-19,888	-37,692	17,804	47,2
National Treasury and Central Bank		572	-11,687	12,259	104,9		56,847	34,674	22,173	-63,9
Social Security		-15,096	-18,540	3,444	18,6		-76,734	-72,365	-4,369	-6,0

¹Income transfers: Social Security benefits, Salary Allowance and Unemployment Benefit, Assistance Benefits (LOAS/RMV) and Family Grant Program

²Subsidies and Grants (extended): Agribusiness, Housing Program ("Minha Casa Minha Vida"), Compensation for Payroll Exoneration, Investments ("PSI") and other

Budgetary Prudence

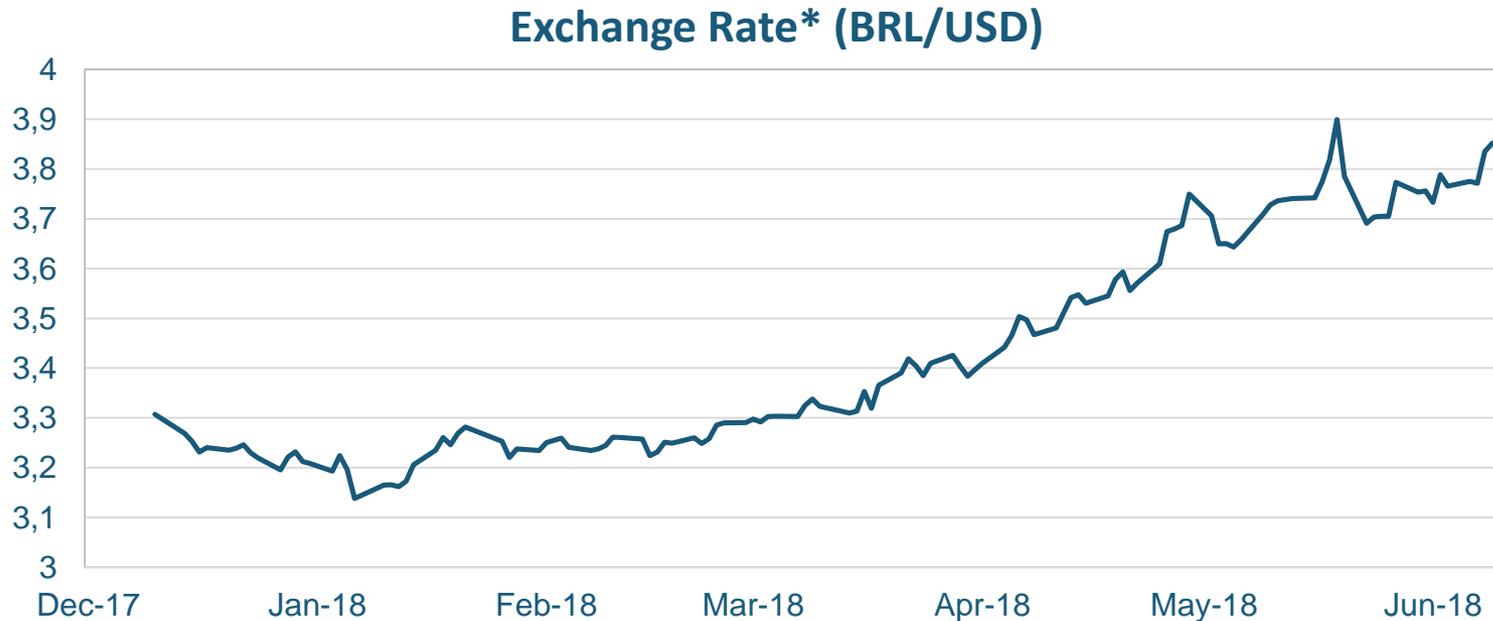
- We updated with 2017 data the IFI's Budgetary Prudence Index (IPRO), an evaluation measure of Government's fiscal projection, based on the results effectively obtained at the end of the year
- The indicator is built in such a way that positive figures indicate more prudent projections and negative figures indicate less prudent projections
- Figures suggest three different periods in the conduct of official estimates
- From 2001 to 2010 and from mid-2016: more prudent projections and closer to realized data
- Between 2011 and mid-2016: less prudent projections and more distant to realized data.



Source: IFI.

Special Topic: Fiscal Effects of Currency Devaluation

- After the sharp exchange rate devaluation from September 2014 to September 2015, when the dollar price rose from BRL2.25 to BRL4.00, and the correction of excesses in the first quarter of 2016, the exchange rate remained relatively stable between BRL3.10 BRL3.30 until March 2018. However, in April, the country has entered a new phase of exchange rate devaluation.



* USD price, in the free market, end of period.

Source: Central Bank.

Special Topic: Fiscal Effects of Currency Devaluation

- The positive fiscal effect from foreign reserves held by the Central Bank prevails in comparison to the negative effect from the increase of foreign debt and domestic debt corrected by the exchange rate.
- States are more vulnerable than the other levels of government, in part because of external indebtedness contracted between 2011 and 2014.

EFFECTS OF CURRENCY DEVALUATION ON THE PSND¹ (2018)

BRL BILLION

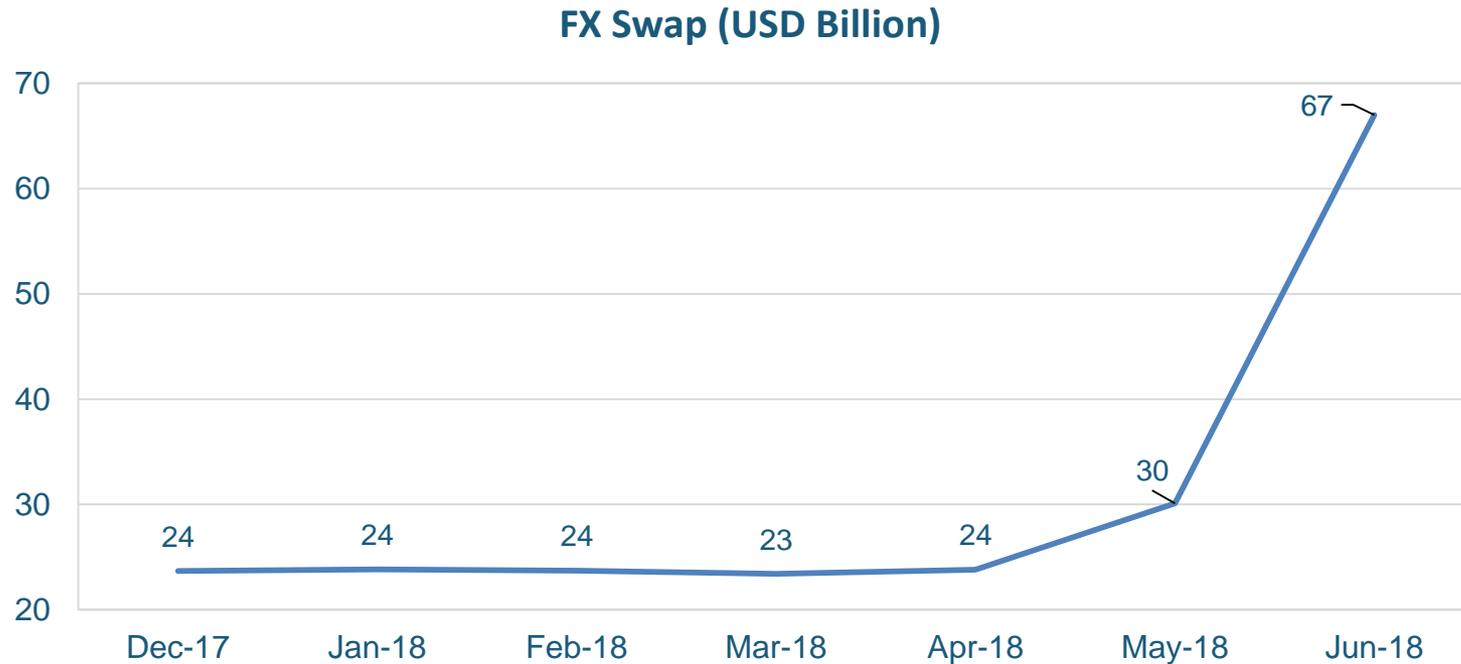
	Jan	Feb	Mar	Apr	May	Total
PSND	45.1	-25.5	-24.3	-48.4	-78.6	-131.8
Federal Gov.	-3.9	2.3	2.2	4.3	7.0	11.9
Central Bank	55.1	-31.3	-29.9	-59.5	-96.7	-162.3
States	-5.6	3.2	3.1	6.2	10.3	17.1
Municipalities	-0.5	0.3	0.3	0.5	0.9	1.4

Source: Central Bank

¹Public Sector Net Debt

Special Topic: Fiscal Effects of Currency Devaluation

- Given the uncertainty about the path of the dollar price, the Central Bank quickly raised the offer of foreign exchange swaps in order to reassure the market.

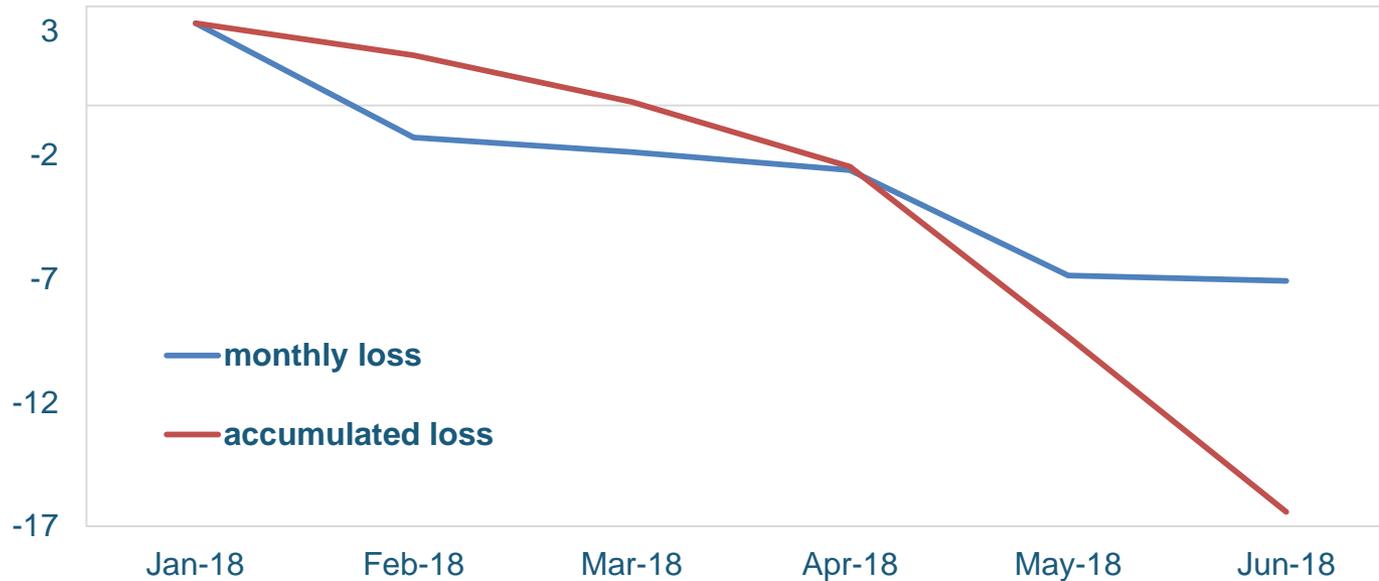


Source: Central Bank.

Special Topic: Fiscal Effects of Currency Devaluation

- The combination of rapid increase of swaps and currency devaluation has led to an increase in the same pace of losses of the Central Bank with these operations, offsetting in part the gains arising from the increase in the BRL value of international reserves.

Balance of FX swap operations (BRL Billion)



Source: Central Bank.

Special Topic: Disposable revenue by level of Government

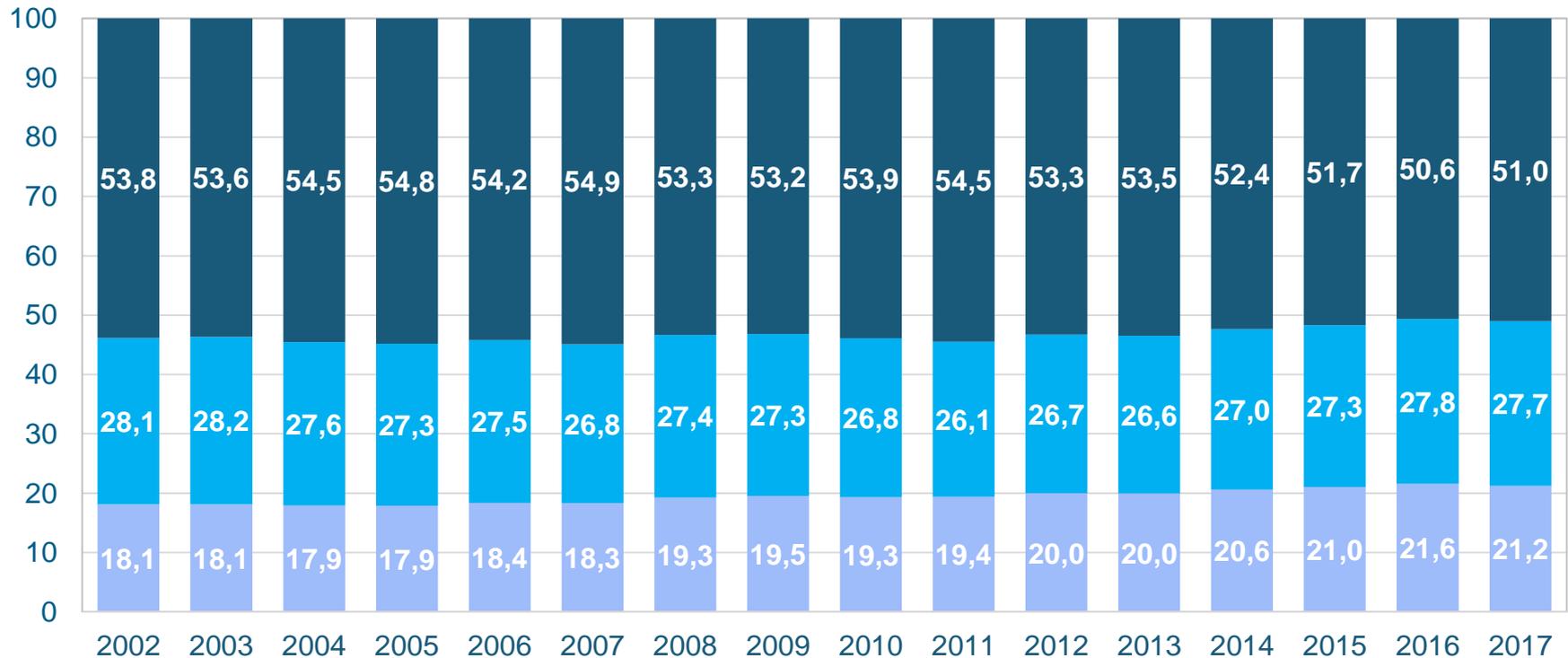
- Sharing system decenters revenues between levels of government: central government centralizes two thirds of total collection and, after legal and constitutional transfers, see your slice drop to half of total collection.
- After transfers, decentralization mainly favors municipalities, which end up concentrating about one-fifth of total revenue. Transfers tends to favor less States, which end up with around one quarter of revenues.
- Disposable revenue (i.e. revenues after transfers) of municipal government are growing almost continuously in recent years, both as a share of GDP and in proportion of the total revenue.
- Disposable revenue at State level, in its turn, noted a small drop as a share of GDP, but gained weight on total revenues.
- In the opposite direction, in recent years, the disposable revenue of the central government has fallen both in relation to total revenue and in relation to GDP.

Special Topic: Disposable revenue by level of Government

- In relation to the total, disposable revenue of municipal government went from 17.9% in 2005, to 21.2% in 2017.
- In the same period, States participation rose from 27.3% to 27.7% of the total.
- Central Government, instead, saw your participation fall from 54.8% to 51.0%.

DISPOSABLE REVENUES BY LEVEL OF GOVERNMENT - % OF TOTAL - 2002/2017

■ Municipalities ■ States ■ Central government

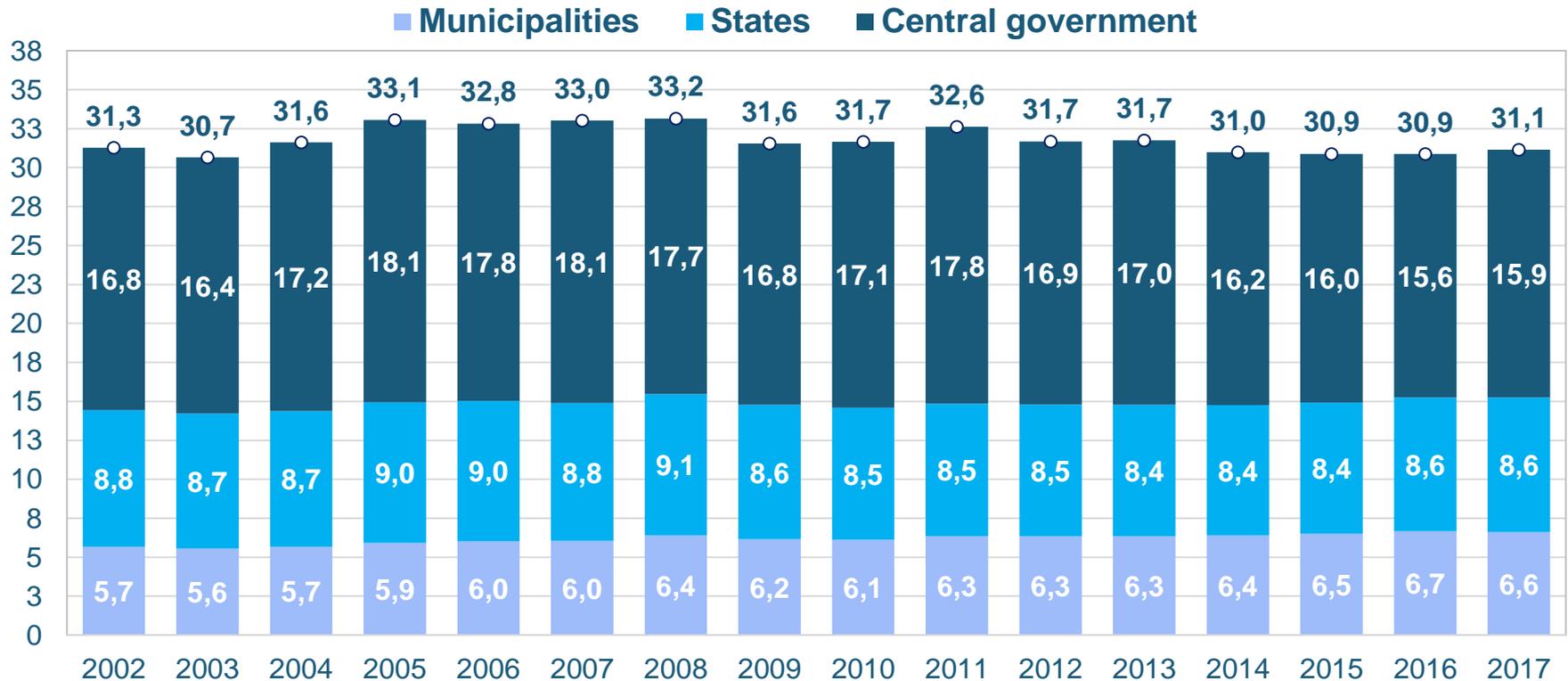


Source: IFI

Special Topic: Disposable revenue by level of Government

- In relation to GDP, disposable revenues of municipal government have increased from 5.9% in 2005, to 6.6% in 2017.
- In the same period, the participation of States fell from 9.0% to 8.6% of the total.
- Meanwhile, the central government had its participation reduced from 18.1% to 15.9%.

DISPOSABLE REVENUES BY LEVEL OF GOVERNMENT - % OF GDP - 2002/2017.



Source: IFI