



# Fiscal Follow-up Report

*October 2018*

Full report [here](#) (portuguese)

**Felipe Salto**

Executive Director

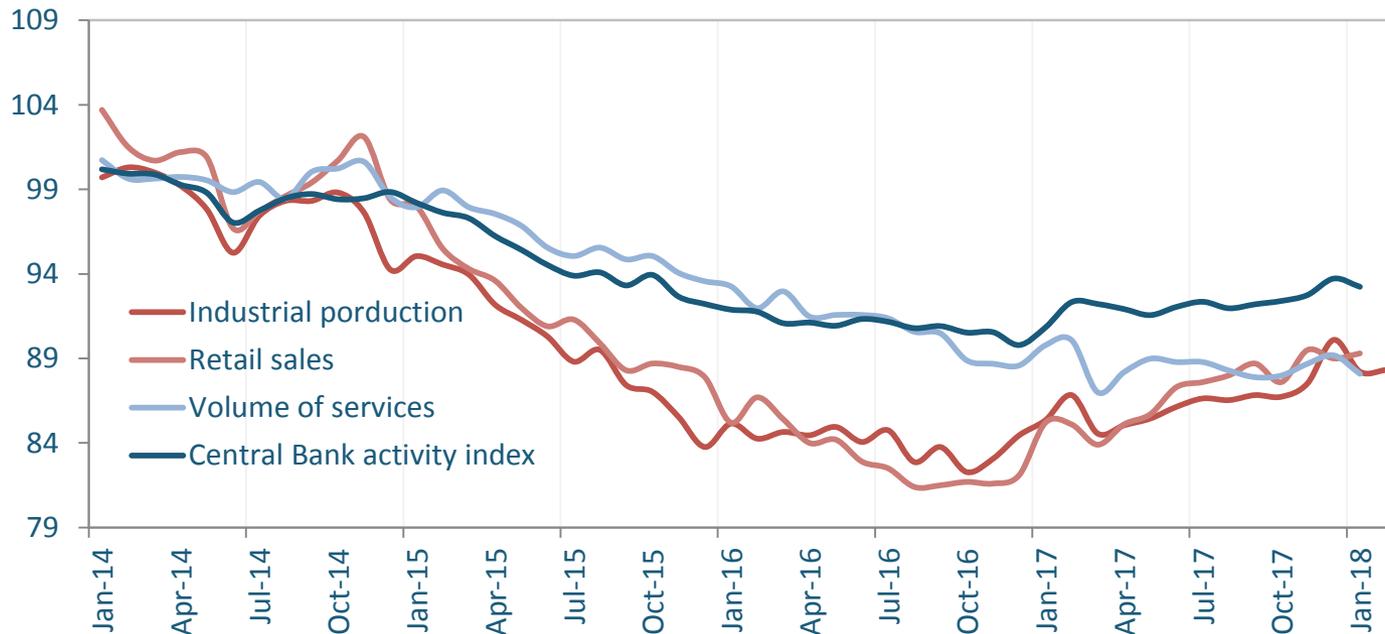
October 8th, 2018

- Our preliminary estimates for the third-quarter's GDP growth is 0.6% compared to the previous quarter (1.3% growth compared to the same period last year). The percentage can be explained largely by the significant reduction in the basis of comparison caused by May's stoppage. Representative indicators of domestic demand show relative accommodation of private consumption and investment.
- In August 2018, the losses of the Central Bank with foreign exchange swap operations totaled BRL 28.6 billion, the largest since September 2015. However, the loss was widely offset by the net balance of foreign reserves (BRL 136.6 billion).
- After the first eight months of the year, the Executive projection for the 2018 primary deficit remains BRL 159 billion. According to the Executive, primary expenditure projection grew and probably reached the expenditure ceiling for the year, which would prevent possible fiscal space generated by the revenue side from being used to enlarge expenses subject to the ceiling.
- Despite the official projection for the 2018 central Government deficit (BRL 159 bi), effective disbursement in compulsory spending below predicted and the "empçoamento" (disbursement below financial limit) of expenses with cash-flow control can bring the 2018 deficit significantly below its target, around BRL 135 bi. Some official projections for the last four months are quite unfeasible, such as those relating to subsidies/grants.
- After about a decade of boom, which made the disposable revenue of local governments achieve its peak of BRL 5,160 per inhabitant, in 2014, this indicator began to fall and its level of BRL 4,818 per inhabitant in 2017 is inferior to the BRL 4,932 observed still in 2011.

- Our preliminary estimate indicates GDP growth of 0.6% in the third quarter. The percentage can be explained largely by the significant reduction in the basis of comparison caused by May's stoppage.

## ECONOMIC ACTIVITY INDICATORS

(SEASONALLY ADJUSTED SERIES: 1Q 2014 = 100)

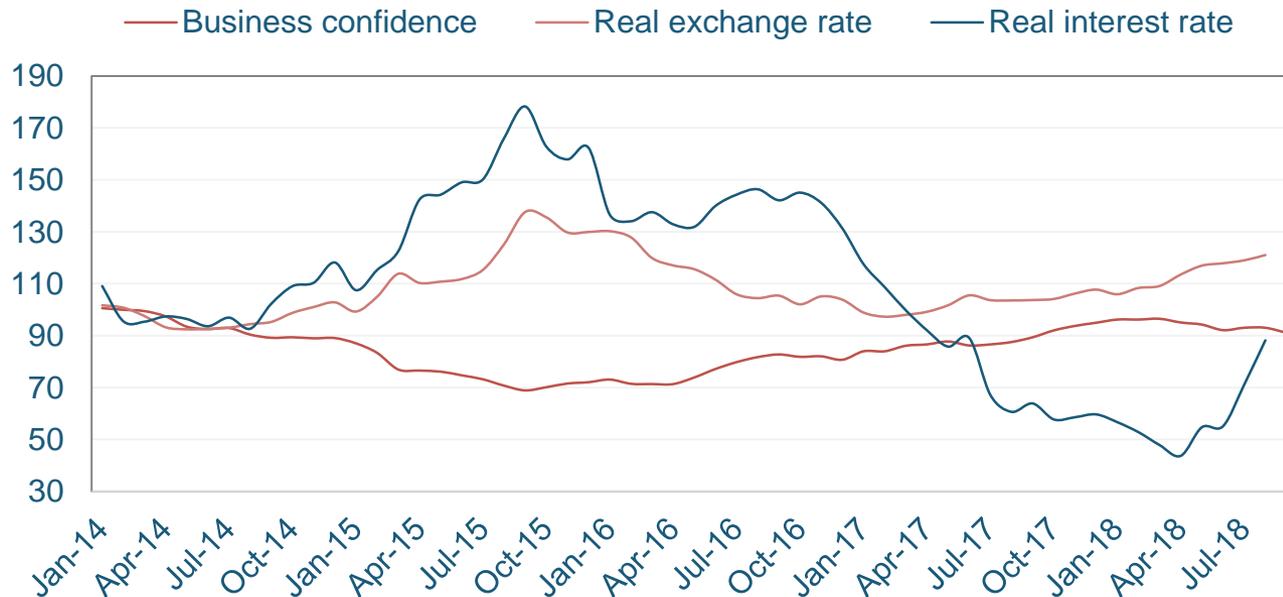


Source: Central Bank

- The context of fiscal restraint and the combination of high real interest rate, exchange rate depreciation and the accommodation of the business confidence index tend to reflect negatively on the recovery of investments.

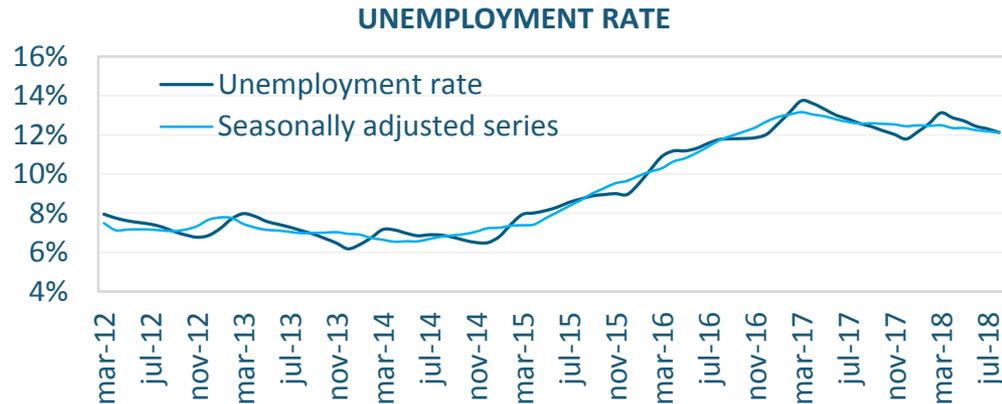
## REAL EXCHANGE RATE, REAL INTEREST RATE AND BUSINESS CONFIDENCE

(INDEX NUMBER: 1Q/14=100)



Source: Central Bank, Anbima and FGV.

- The moderate reduction in unemployment reflects the slow recovery in the level of economic activity.



## EMPLOYED POPULATION BY POSITION

Employment indicators	Percentage in relation to employed population			QoQ			Accumulated in 12 months		
	jun/18	jul/18	ago/18	jun/18	jul/18	ago/18	jun/18	jul/18	ago/18
Employed population	100.0%	100.0%	100.0%	1.1%	1.1%	1.1%	1.7%	1.7%	1.6%
Private sector: formal	36.0%	36.0%	35.8%	-1.5%	-1.1%	-1.3%	-1.8%	-1.6%	-1.8%
Private sector: informal	12.0%	12.1%	12.2%	3.4%	3.4%	4.0%	5.1%	5.3%	5.4%
Domestic worker	6.8%	6.8%	6.8%	2.1%	3.2%	3.1%	2.4%	2.6%	2.9%
Public sector	12.7%	12.7%	12.7%	2.7%	1.9%	2.3%	2.3%	2.3%	2.4%
Employer	4.8%	4.8%	4.8%	4.2%	4.0%	5.2%	5.1%	4.6%	5.5%
Self-employed	25.3%	25.2%	25.3%	2.5%	2.1%	1.9%	4.0%	3.9%	3.5%
Percentage of workers that contribute to social security	63.7%	63.7%	63.4%	0.2%	0.5%	0.1%	-0.5%	-0.3%	-0.3%

Source: IBGE.

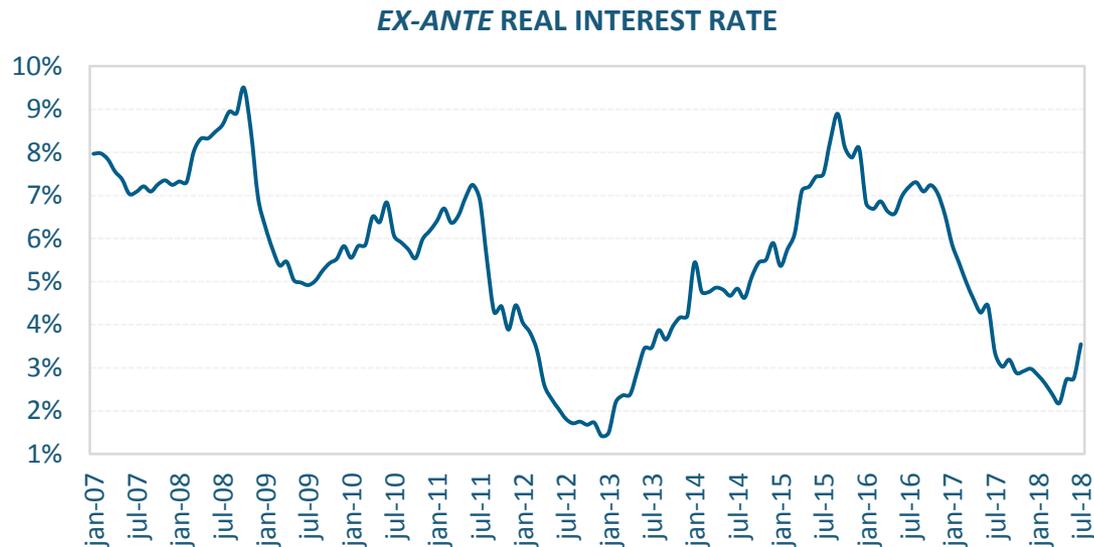
- There is a pronounced difference between the dynamics of free prices (more responsive to economic cycles) and administered prices, sensitized in recent context to the rise in electricity fares (in response to the low level of hydroelectric reservoirs) and to the international quotation of the oil price and the exchange rate on the domestic price of gasoline.
- The rise in administered prices is a relevant source of pressure on the CPI (“IPCA”) and represents a risk for the inflation scenario in the short to medium term horizon.

## CONSUMER PRICES

Consumer Price Indices	Accumulated in 12 months					
	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18
<b>National Consumer Price Index - INPC</b>	<b>1.7%</b>	<b>1.8%</b>	<b>3.5%</b>	<b>3.6%</b>	<b>3.6%</b>	<b>4.0%</b>
<b>Extended National Consumer Price Index - IPCA</b>	<b>2.8%</b>	<b>2.9%</b>	<b>4.4%</b>	<b>4.5%</b>	<b>4.2%</b>	<b>4.5%</b>
Administered prices	8.3%	8.1%	11.8%	11.3%	9.6%	10.4%
Free prices	1.0%	1.1%	2.0%	2.2%	2.4%	2.6%
Food-at-home	-4.7%	-3.8%	0.1%	0.3%	1.5%	2.2%
Industrial goods	1.3%	1.3%	1.6%	1.7%	1.6%	1.8%
Services	3.5%	3.3%	3.2%	3.5%	3.3%	3.2%
<b>Core inflation - average</b>	<b>2.6%</b>	<b>2.6%</b>	<b>2.7%</b>	<b>2.9%</b>	<b>2.95%</b>	<b>3.04%</b>

Source: IBGE.

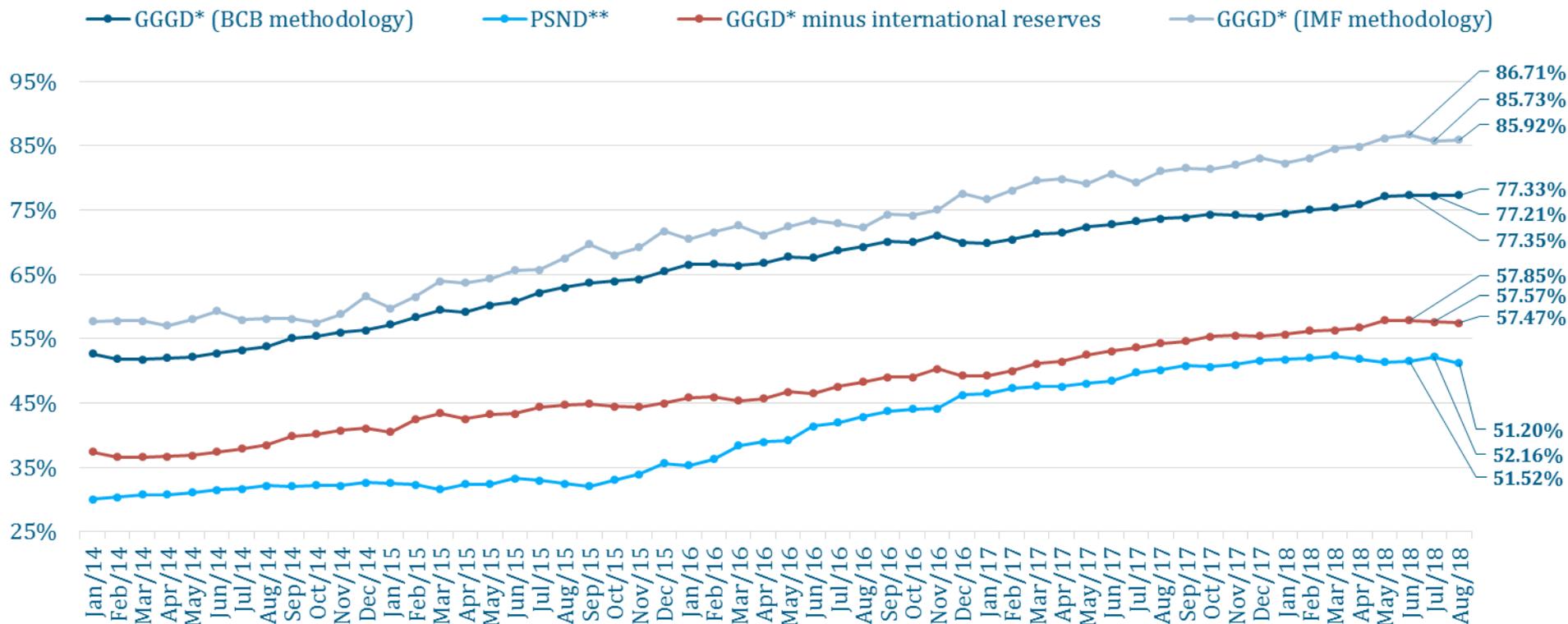
- The forecasts underlying future interest contracts embed the likelihood of a rise in the Selic rate still in 2018, in a domestic scenario of fiscal constraint and uncertainty arising from the electoral race and an external scenario of rising interest rate in the US that bring potential risks to the prospective inflation dynamics.
- The ex-ante real interest rate (measured by the rate of the one-year futures contracts deflated by inflation expectations for the next 12 months obtained in the Focus Market Readout), after having reached its minimum point in April (2.2%) rose to 4.4% in August and 3.7% in September.
- The elevation of the interest curve sensitizes the cost of credit and may affect the recovery of activity and employment.



Source: Anbima and Banco Central.

- Gross debt (“DBGG”) reached 77.33% of GDP in August 2018, as a result of the increase in foreign debt.
- Unlike DBGG, the net debt (“DLSP”) fell between July and August: from 52.16% to 51.20% of GDP.

## PUBLIC DEBT OVER TIME (% OF GDP)

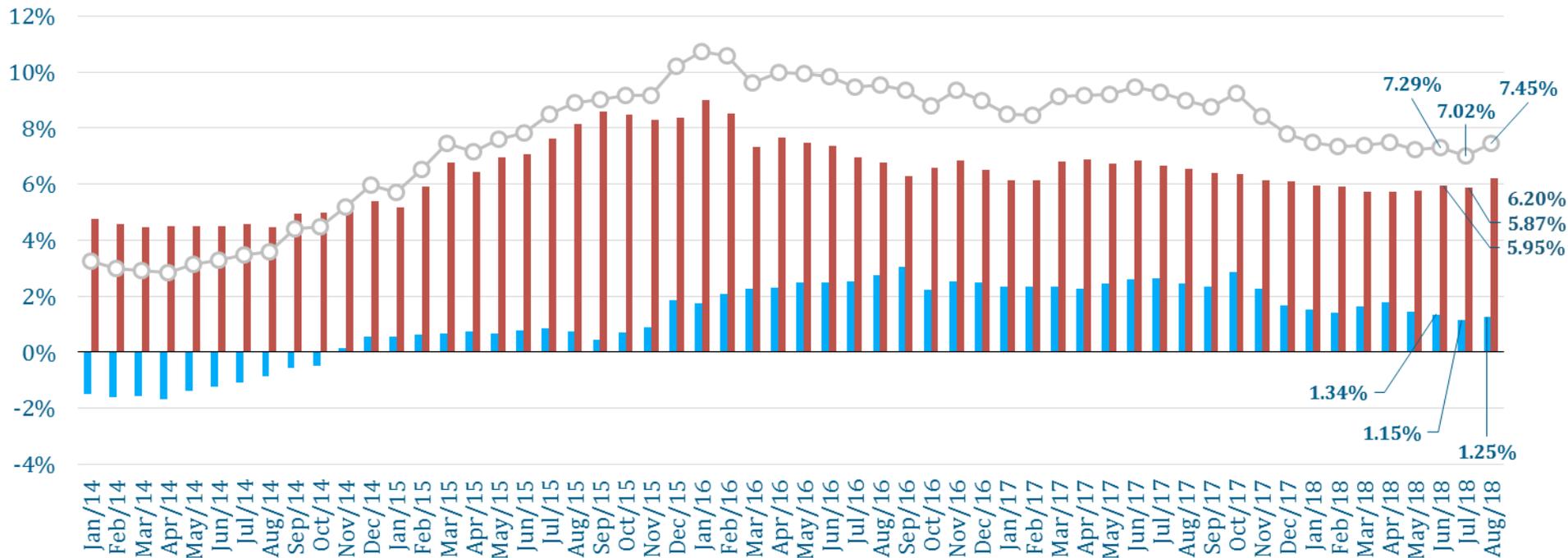


Source: Central Bank of Brazil. Elaboration: IFI. \*General Government Gross Debt. \*\*Public Sector Net Debt.

- Despite the increase of primary deficit in August to 1.25% of GDP, it remains below the level of 2016/2017.
- Interest payments rose in August, as a result of losses on foreign exchange swap operations.

## PUBLIC SECTOR BORROWING REQUIREMENTS (% OF GDP)

■ Primary deficit ■ Nominal interests ○ Nominal deficit

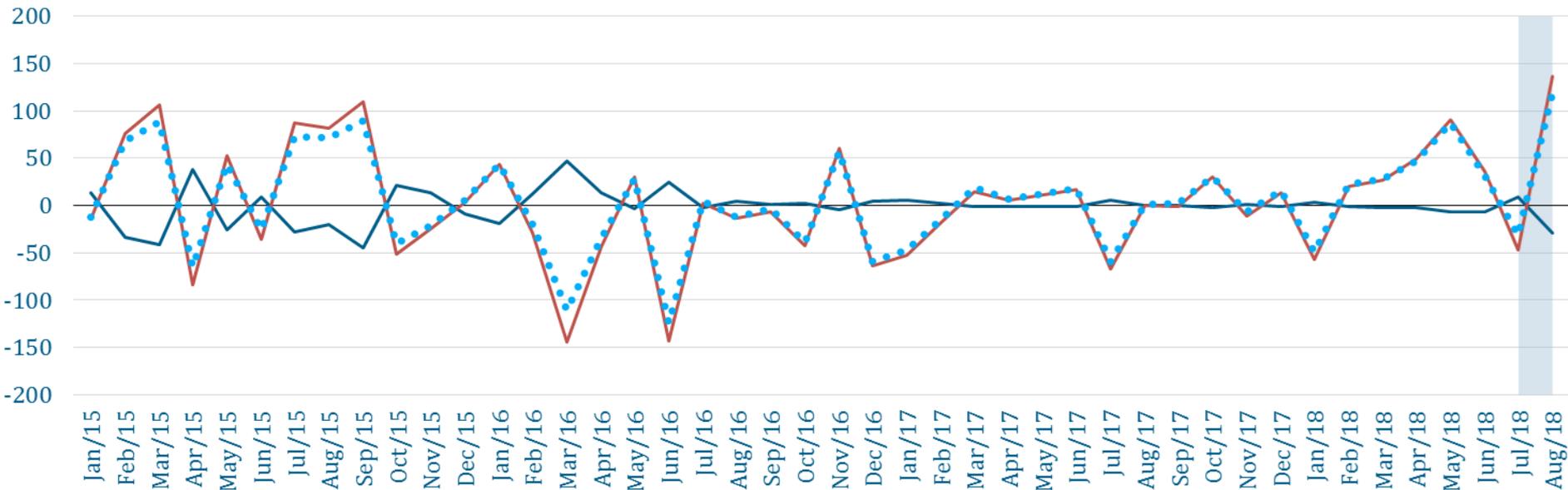


Source: Central Bank of Brazil. Elaboration: IFI. Each series equals the 12-month deficit at current prices, divided by the 12-month GDP at current prices. Positive values indicate deficits; negative values indicate surpluses.

- Losses of BRL 28.6 bi with FX swap operations in August was the largest since September 2015, in real terms.
- The losses were largely offset by the net balance of foreign reserves (BRL 136.6 bi) in the month.

## RESULTS OF FOREIGN EXCHANGE OPERATIONS (R\$ BILLION, PRICES OF AUGUST 2018, IPCA)

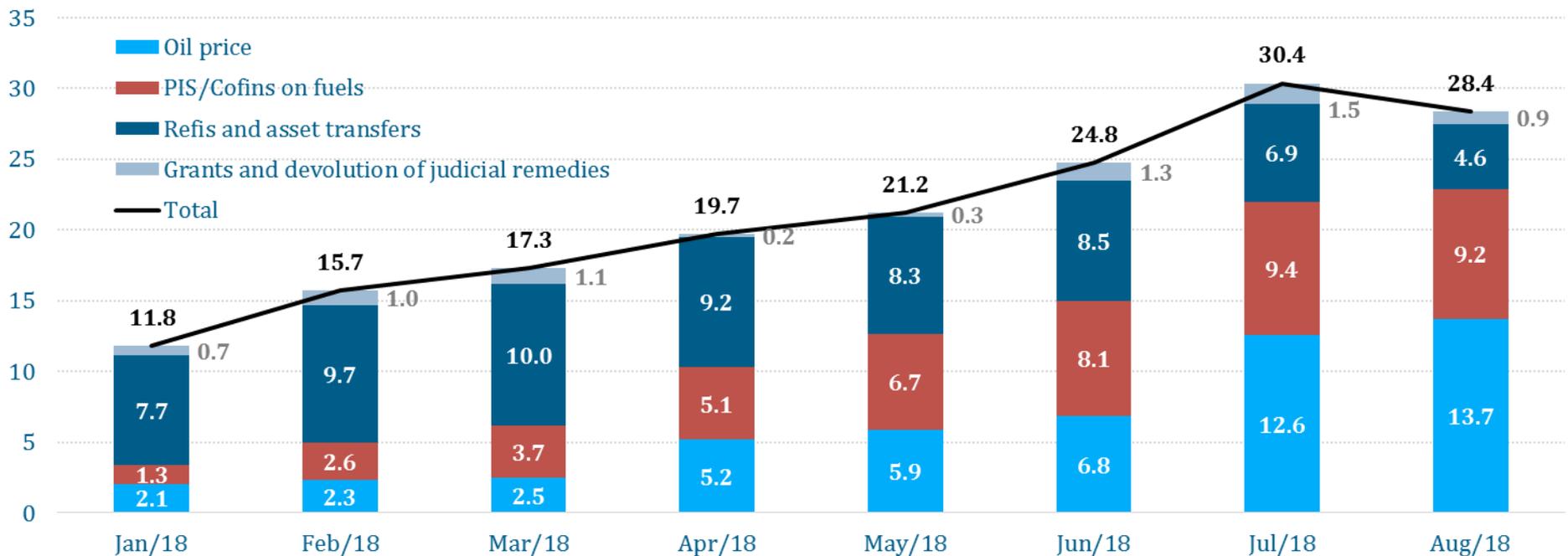
— Balance of foreign exchange swap operations  
 ●●● Balance to be transferred to the National Treasury  
 — International reserves (net balance)



Source: Central Bank of Brazil. Elaboration: IFI. The series "Result of foreign exchange swap operations" refers to cash basis amounts. The shaded area highlights the variation between July and August.

- From January to August, the total volume of revenue weakly correlated with economic activity was BRL 28.4 bi above the same period of 2017, BRL 66.7 bi.
- This total refers to BRL 13.7 bi (48%) from oil revenues, BRL 9.2 bi (32%) from PIS/Cofins on fuels, followed by BRL 4.6 bi (16%) from tax renegotiation programs ("Refis") and asset transfers between private companies.

## NONRECURRENT REVENUES – TOTAL AND COMPOSITION (R\$ BILLION, CURRENT PRICES) YEAR-TO-DATE IN 2018 *MINUS* YEAR-TO-DATE IN 2017



Source: National Treasury, Federal Revenue Office and Siga Brasil (information system on the federal budget, kept by the Federal Senate). Elaboration: IFI.

- In September, the Executive updated its macroeconomic and fiscal projections for 2018.
- The forecast for the IPCA had a slight retreat (from 4.2% in July to 4.1% in September) and the expectation to real GDP growth was maintained at 1.6%.
- Overall, updated official projections approached IFI (revised at the beginning of August), market (collected by Bacen) and IMF latest projections.

## MAIN MACROECONOMIC PROJECTIONS FOR 2018

Indicator	Government					IFI (RAF 19)	Market (Focus)	IMF
	Budget	Feb-18	Mar-18	May-18	Jul-18			
GDP real growth (%)	2.5	3.0	3.0	2.5	1.6	1.6	1.5	1.8
IPCA acum (%)	4.2	3.9	3.6	3.4	4.2	4.0	4.2	3.5
Average overnight SELIC rate (%)	7.3	6.7	6.5	6.3	6.5	6.8	6.5	-
Average exchange rate (BRL / USD)	3.3	3.3	3.3	3.4	3.6	3.5	3.6	-
Average oil price (USD/barrel)	52.2	68.2	65.0	68.3	74.7	74.1	-	62.3
Salary mass nominal growth (%)	6.1	6.3	5.9	5.1	4.2	6.3*	-	-

Source: Central Bank, IMF, Ministry of Planning and IFI.

\* Our estimates for the nominal salary mass considers the entire employed population, not only registered employment.

- After the latest update, Executive's primary deficit projection remained BRL 159 billion, equal to the year-end target.
- Primary expenditure projection rose and probably reached the year-end ceiling.
- Possible fiscal space generated by future revenue projections cannot be used to raise expenses subject to the ceiling.
- Our projection for the déficit is BRL 156 bi and the distance to the expenditure ceiling is BRL 15 billion.

## 2018 PRIMARY BALANCE – EXECUTIVE BRANCH OFFICIAL PROJECTIONS (BRL BILLION)

Breakdown	Budget Law	Decree 9,452/2018 (May)	Decree 9,515/2018 (September)	Variation	
				Value	%
I. TOTAL REVENUE	1,462.1	1,482.2	1,486.0	3.8	0.3
II. TRANSFERS BY REVENUE SHARING	244.2	256.1	255.9	-0.1	0.0
III. NET REVENUE (I-II)	1,217.8	1,226.1	1,230.0	3.9	0.3
IV. TOTAL EXPENDITURE	1,373.4	1,385.1	1,389.0	3.9	0.3
V. CENTRAL GOVERNMENT PRIMARY BALANCE	-155.5	-159.0	-159.0	0.0	0.0

Source: Ministry of Planning.

## EXPENDITURE CEILING IN 2018 (BRL BILLION)

Breakdown	Budget Law	Update					Decree 9,515*	IFI
		Feb	Mar	May	Jul	Sep		
Total primary expenditure	1,617.6	1,615.5	1,620.4	1,623.4	1,641.2	1,636.8	1,645.0	1,616.7
Expenses not included in the limit	269.7	270.5	273.9	275.9	293.3	293.0	297.1	283.9
Total expenditure subject to the limit	1,347.9	1,345.0	1,347.4	1,347.4	1,347.9	1,343.8	1,347.9	1,332.9
Expenditure limit	1,347.9	1,347.9	1,347.9	1,347.9	1,347.9	1,347.9	1,347.9	1,347.9
Respite (+) / Excess (-)	0.0	2.9	0.4	0.5	-	4.1	-	15.0

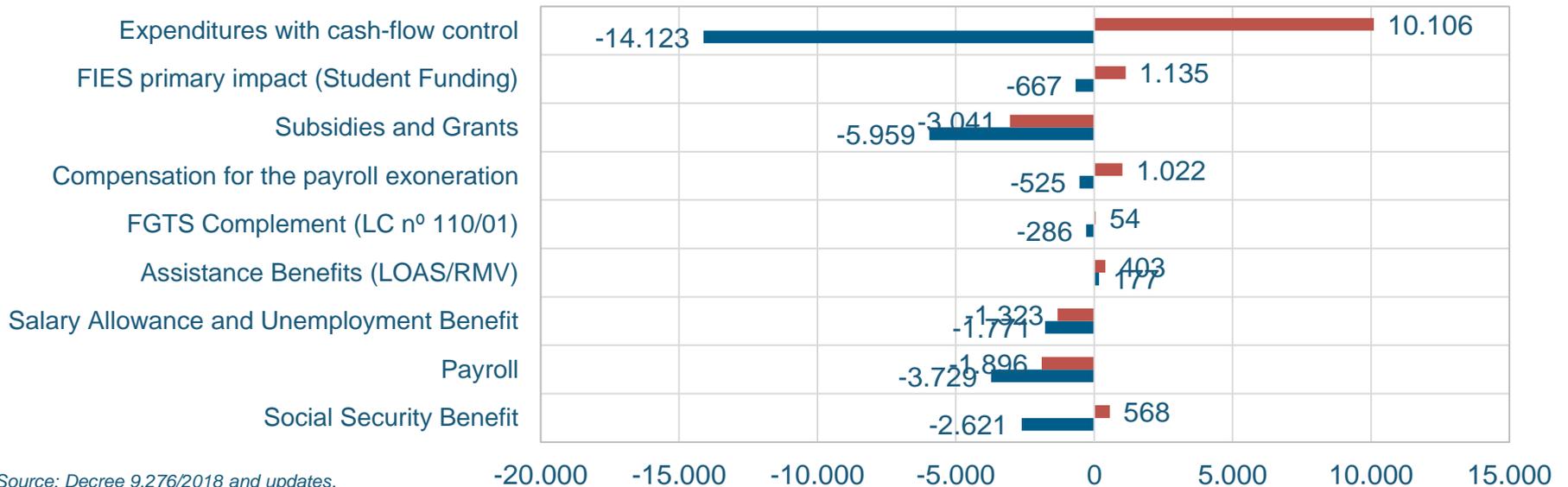
Source: Ministry of Planning.

\* We assumed, by hypothesis, that the rise of BRL 8.2 bi in comparison to the previous update consumed all the fiscal space to the ceiling (BRL 4.1 bi) and was also destined to expenses not subject to the ceiling.

- Until August, expenditure was well below predicted in February (difference of BRL 32 bi, or 3.6%), but the official projection for the year remains growing (increase of BRL 17 bi compared to February, or 1.3%).
- Two factors help to explain the low level of expenditure: the "empçoamento" of expenses with flow control (disbursement below the financial limit); and the apparent conservatism in compulsory expenditure projections.
- Thus, the central Government's primary deficit in 2018, despite the official projection, can be around BRL 135 bi.
- Such deficit is lower than our current estimates, which will be revised in detail in the next month.

## Primary expenditure - executed minus projected - Jan-Aug/2018 (BRL Million)

■ Variation of the year-end projection    ■ Executed minus projected - jan/aug



Source: Decree 9,276/2018 and updates.

# Local Government Disposable Revenue

- After about a decade of boom, which made the disposable revenue of local governments achieve its peak of BRL 5,160 per inhabitant, in 2014 this indicator began to fall and its level of BRL 4,818 per inhabitant in 2017 is less than the BRL 4,932 observed still in 2011.

**LOCAL GOVERNMENT DISPOSABLE REVENUE – BRL PER INHABITANT, PRICES OF 2017 (“IPCA”)**

