Instituição Fiscal Independente

SENADO FEDERAL

Fiscal Follow-up Report – RAF

April 2018

full report here (portuguese)

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Summary

- IFI projection for GDP growth in 2018 remains at 2.7%. However, the fall in the unemployment rate – supported by the advance of informal employment – and the increase of average bank interest rates – which went up in January and February, after continued fall since March 2017 – are factors that may influence the intensity of economic recovery.

- Fiscal balances in February were influenced by the significant collection of revenues little correlated with economic activity, such as debt refinancing programs ("Refis") and Pis/Cofins on fuels and oil revenues. Withdrawing these events, recurring revenue in February is in real terms 5.6% higher than the same month of the previous year.

- The fiscal adjustment post-2014, supported mainly in the containment of public investment, occurs in most States. The dependence on investment cuts suggests a limitation of the current pattern of fiscal adjustment. It is unlikely that the recovery of State level primary balances will remain in the absence of solutions that reach other expenses (especially personnel) and/or revenues.

- After the bi-monthly Budget update, the Executive projects a primary deficit of R$157.4 billion in 2018, in the face of the R$159.0 billion target. As projections do not endanger the fulfilment of the target, there was no need for spending freezing. Still, the Executive created a R$18.2 billion budget reserve to accomodate the risk of frustrating revenues from the privatization of Eletrobrás and expenses with the federal intervention in the state of Rio de Janeiro.

- The interest rate reduction contributes to containing public debt, as well as the early redemption of the Treasury loans to BNDES. In relation to the primary balance, despite the encouraging developments of the past four months, there is a long way to go, since the stability of public debt and the sustainable fall in interest rates will depend on the consistent generation of primary surpluses.

Macroeconomic Context

- Recovery of economic activity, within the context of a substantial reduction of the basic interest rate, has been accompanied by a fall in the unemployment rate, reduction of credit rates and development of new credit grantings.

- The reaction of the credit market, which is an important channel for the transmission of monetary policy impulses to the real economy, acting as a factor in stimulating domestic demand, strengthen the prospect of accelerated GDP growth in 2018.

- Important to note that the aggregate economic activity indicators had a weak start in 2018.

- In parallel, the fall in unemployment remains explained by the advance in informal occupations, while in the credit market average bank interest rates returned to rise in January and February, after continued fall since March 2017.

- IFI projection for GDP growth in 2018 remains at 2.7%, after the 1.0% growth of 2017. However, these factors, as a whole, may influence the intensity of the activity recovery process.

Macroeconomic Context

- Aggregated indicators of economic activity (Central Bank's IBC-Br and FGV's GDP Monitor).
- The cooling in the first quarter was not enough to reverse the recovery process of the consolidated economic growth since the beginning of last year.

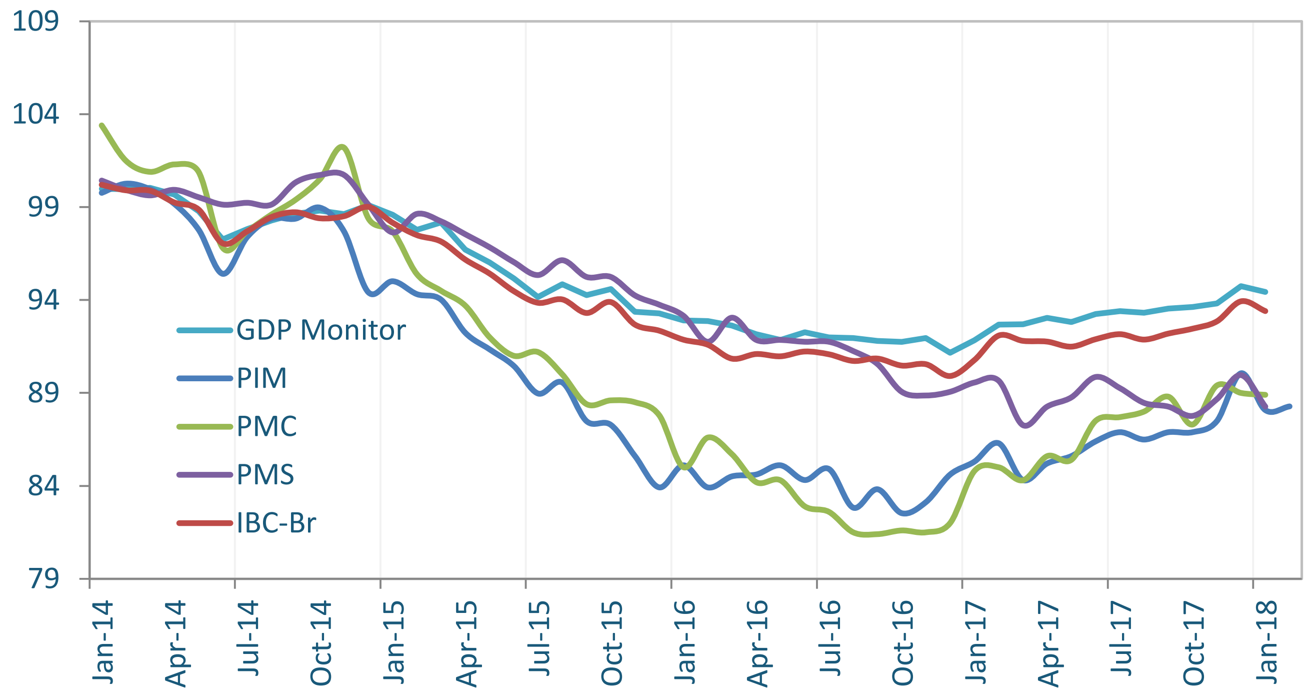
AGGREGATED INDICATORS OF ECONOMIC ACTIVITY

Indicators	MoM (Seasonally Adjusted)			QoQ (Seasonally Adjusted)			Accumulated in 12 months		
	nov/17	dec/17	jan/18	nov/17	dec/17	jan/18	nov/17	dec/17	jan/18
IBC-Br	0.4%	1.1%	-0.6%	0.4%	1.0%	1.2%	0.6%	1.0%	1.2%
GDP Monitor	0.2%	1.0%	-0.3%	0.4%	0.7%	0.9%	0.7%	1.0%	1.2%
Agriculture	2.8%	4.9%	4.1%	-2.7%	-0.2%	5.5%	12.1%	13.0%	12.5%
Industry	0.0%	0.3%	-0.2%	1.4%	1.4%	0.9%	-0.2%	0.0%	0.4%
Service	0.2%	0.4%	-0.5%	0.3%	0.4%	0.4%	0.0%	0.3%	0.4%
Personal Consumption	0.5%	0.1%	-0.6%	0.5%	0.4%	0.4%	0.6%	1.0%	1.3%
Government consumption	1.0%	0.2%	0.3%	0.0%	0.2%	0.9%	-0.5%	-0.6%	-0.7%
Fixed Investiment	0.7%	2.7%	-2.8%	2.6%	3.0%	2.1%	-2.2%	-1.8%	-1.1%
Exports	-4.2%	-0.2%	-6.0%	-1.5%	-2.1%	-5.7%	3.8%	5.2%	5.1%
Imports	4.5%	3.6%	-1.3%	5.4%	3.6%	5.1%	5.6%	5.0%	4.1%

Macroeconomic Context

- The observed pattern of aggregate indices in the beginning of the first quarter accompanied the performance of short-term research concerning trade, services and industry.

Economic activity indicators (seasonally adjusted - 1Q/2014 = 100)



Source: Central Bank

Macroeconomic Context

- First available information about the economy in March brought mixed results: advances in business and consumer confidence indicators and in the utilization of installed capacity, contrasted by the magnification of the economic uncertainty index.

CONFIDENCE INDICES, UTILIZATION OF INSTALLED CAPACITY AND ECONOMIC UNCERTAINTY INDEX

Indicators	Value			MoM (points)			QoQ (points)		
	jan/18	feb/18	mar/18	jan/18	feb/18	mar/18	jan/18	feb/18	mar/18
Consumer confidence index (points)	88.8	87.4	92.0	0.4	-1.4	4.6	4.6	2.5	2.2
Business confidence index (points)	94.8	94.7	95.0	1.4	-0.1	0.3	5.5	4.3	2.9
Utilization of installed capacity (percentage)	74.7	75.6	76.1	0.0	0.9	0.5	0.5	0.7	0.9
Uncertainty index (points)	109.6	102.5	107.7	2.2	-7.1	5.2	-5.2	-2.0	-0.1

Source: FGV.

Macroeconomic Context

- In the composition of employment, the advancement of informal jobs still prevails. Although representing occupations not convered by labor legislation, the incorporation of workers in the informal market had the role of mitigating the impacts of the economic crisis on the labour market.
- Relative progress on the informal market to the detriment of formal occupations in the private sector (which in responded to 37.8% of total occupied February 2017 and to 36.4% in February 2018) caused the percentage of workers who contribute to the social security system to lessen in comparison with the same month of last year.

EMPLOYMENT BY POSITION

Employment indicators	Percentage in relation to the employed population			QoQ			Accumulated in 12 months		
	feb/17	jan/18	feb/18	dec/17	jan/18	fev/18	dec/17	jan/18	feb/18
Employed population	**100.0%**	**100.0%**	**100.0%**	**2.0%**	**2.1%**	**2.0%**	**0.3%**	**0.6%**	**0.9%**
Private sector: formal	37.8%	36.3%	36.4%	-2.0%	-1.7%	-1.8%	-2.8%	-2.6%	-2.5%
Private sector: informal	11.5%	12.0%	11.8%	5.7%	5.6%	5.0%	5.5%	5.1%	5.3%
Domestic worker	6.8%	6.9%	6.9%	4.3%	4.4%	4.2%	0.1%	0.7%	1.4%
Public sector	12.1%	12.3%	12.3%	2.0%	2.9%	3.3%	0.6%	1.3%	1.3%
Employer	4.6%	4.8%	4.8%	6.3%	4.3%	5.5%	8.4%	7.4%	6.8%
Self-employed	24.8%	25.3%	25.4%	4.8%	4.4%	4.4%	0.7%	1.7%	2.3%
Percentage of workers that contribute to Social Security	**65.2%**	**63.5%**	**63.7%**	**-0.9%**	**-0.5%**	**-0.5%**	**-1.9%**	**-1.6%**	**-1.5%**

Source: IBGE.

Macroeconomic Context

- Improvement in employment last year occurred mostly in the States of the South, Southeast and Midwest Regions, with national standard prevailing, characterised by the advance of informal occupations.

EMPLOYMENT BY STATE (% VAR. IN THE LAST 12 MONTHS UNTIL DEC/17)

		Employment	Formal	Informal	Self-employed
	Brazil	0.3%	-2.8%	5.5%	0.7%
North	Rondônia	0.8%	-1.1%	6.9%	-5.2%
North	Acre	0.6%	-1.2%	9.3%	-0.6%
North	Amazonas	-0.1%	-0.1%	-6.7%	-5.5%
North	Roraima	-0.1%	-1.7%	7.5%	-1.5%
North	Pará	0.5%	-4.1%	4.0%	1.1%
North	Amapá	1.1%	-6.3%	7.5%	1.4%
North	Tocantins	-1.1%	-7.3%	-9.4%	-1.8%
Northeast	Maranhão	-4.0%	1.7%	8.7%	-16.0%
Northeast	Piauí	-4.5%	-10.5%	-4.2%	-5.8%
Northeast	Ceará	2.1%	-0.7%	2.3%	-3.0%
Northeast	Rio Grande do Norte	-0.5%	-7.3%	12.0%	-4.8%
Northeast	Paraíba	1.0%	-5.6%	-3.0%	4.1%
Northeast	Pernambuco	-2.9%	-8.3%	-3.1%	-3.0%
Northeast	Alagoas	-7.3%	-6.7%	-3.2%	-10.9%
Northeast	Sergipe	-2.0%	-4.4%	9.6%	-8.4%
Northeast	Bahia	-2.3%	-3.4%	1.9%	-6.2%
Southeast	Minas Gerais	0.5%	-4.4%	9.5%	0.2%
Southeast	Espírito Santo	3.1%	-1.4%	5.0%	4.6%
Southeast	Rio de Janeiro	0.0%	-5.7%	8.8%	7.8%
Southeast	São Paulo	1.4%	-1.5%	10.9%	5.9%
South	Paraná	0.1%	-4.3%	6.6%	5.8%
South	Santa Catarina	3.1%	2.6%	8.9%	1.2%
South	Rio Grande do Sul	0.1%	-3.0%	7.9%	3.4%
Middlewest	Mato Grosso do Sul	0.6%	0.6%	-4.5%	5.2%
Middlewest	Mato Grosso	1.5%	2.0%	4.1%	0.6%
Middlewest	Goiás	3.2%	-1.2%	2.7%	5.0%
Middlewest	Distrito Federal	1.6%	-1.6%	17.7%	7.4%

Source: IBGE.

Macroeconomic Context

- Income gains in real terms are still occurring, benefited by price deceleration, but are concentrated in the higher remuneration groups: formal private sector employees and employers.

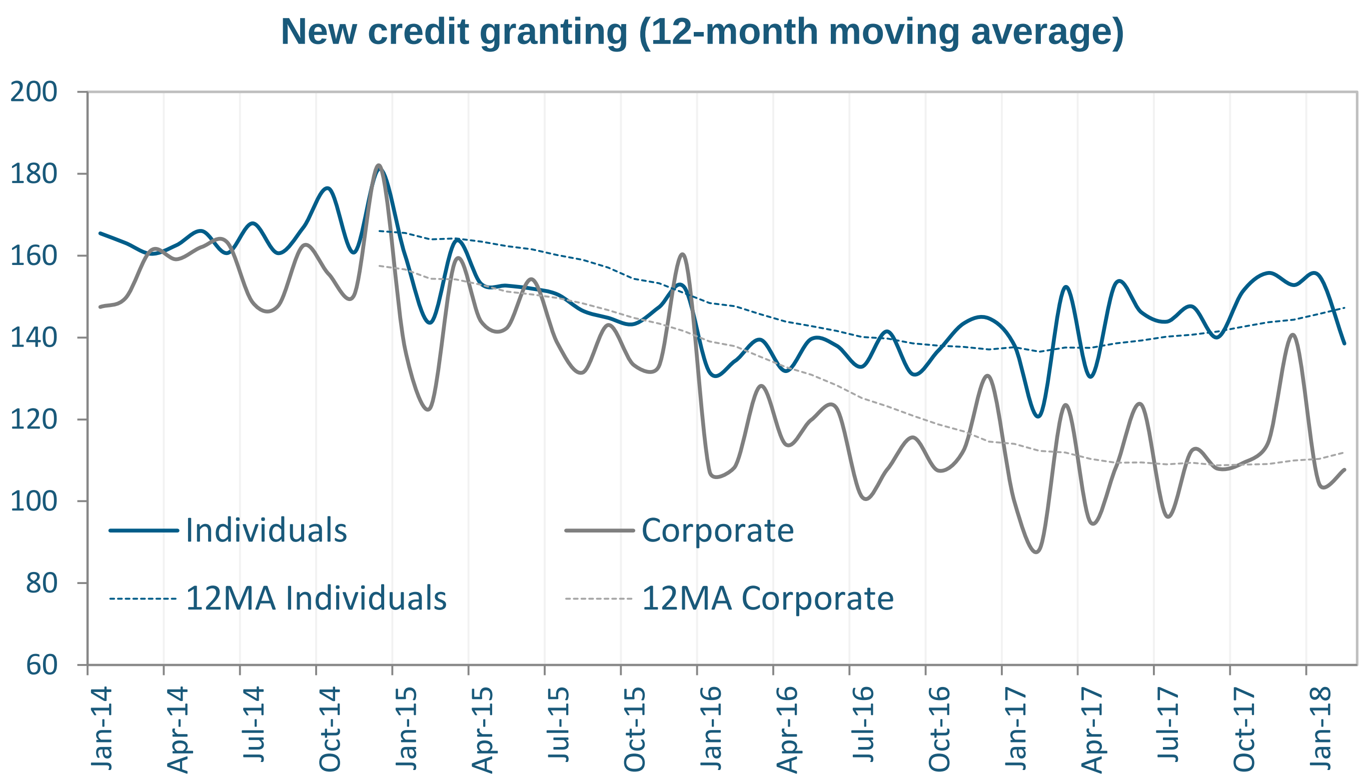
AVERAGE REAL WAGE AND TOTAL WAGES

Wage indicators	Value			QoQ			Accumulated in 12 months		
	dec/17	jan/18	feb/18	dec/17	jan/18	feb/18	dec/17	jan/18	feb/18
Average real wage (R$)	**2,168**	**2,176**	**2,186**	**1.5%**	**1.6%**	**1.8%**	**2.3%**	**2.4%**	**2.2%**
Private sector: formal	2,105	2,104	2,097	3.5%	3.6%	2.6%	2.4%	2.5%	2.5%
Private sector: informal	1,186	1,206	1,207	-1.8%	-2.1%	-3.4%	1.1%	0.3%	-0.8%
Domestic worker	858	861	868	1.4%	1.8%	2.0%	0.8%	0.9%	1.1%
Public sector	3,356	3,409	3,453	-0.1%	-0.1%	0.5%	1.5%	0.9%	0.7%
Employer	5,593	5,600	5,635	-1.6%	-1.1%	0.1%	3.7%	4.9%	4.3%
Self-employed	1,577	1,589	1,594	1.2%	1.2%	1.4%	-0.6%	0.0%	-0.3%
Total wages (R$ million)	**194,662**	**194,480**	**194,071**	**3.5%**	**3.6%**	**3.7%**	**2.6%**	**3.0%**	**3.0%**

Source: IBGE.

Macroeconomic Context

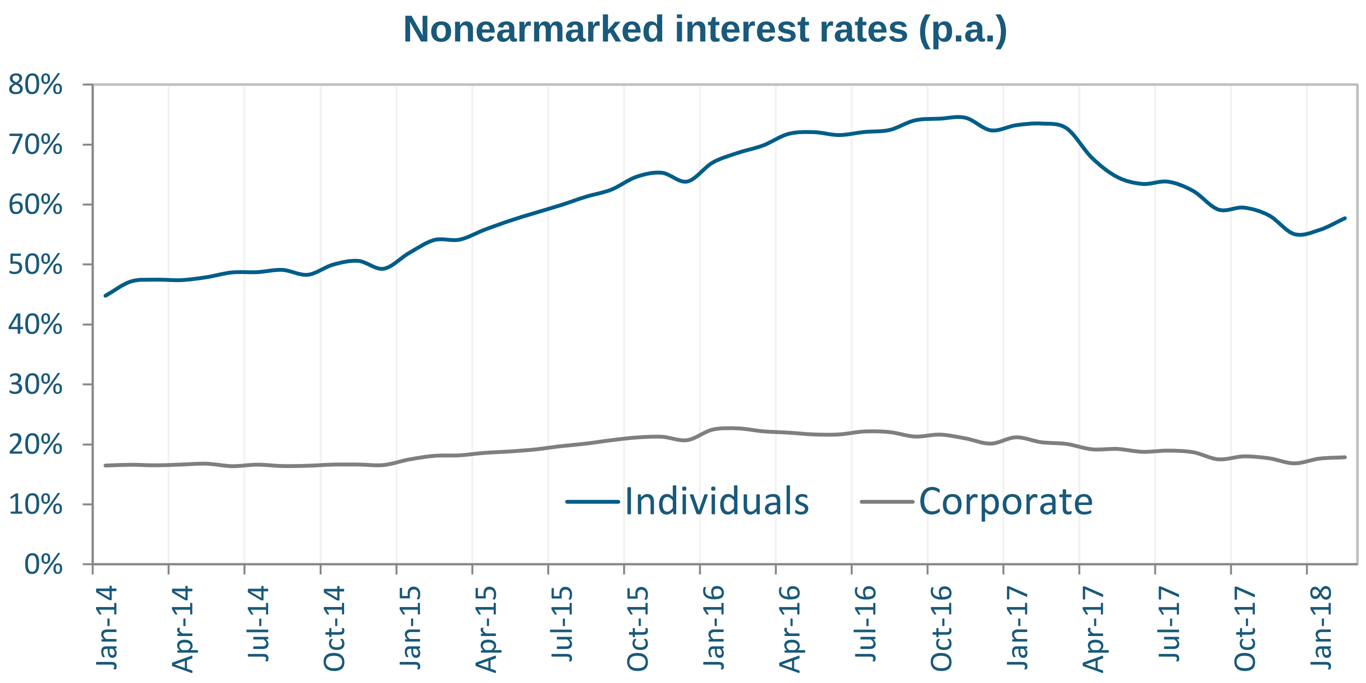
- Data in the Central Bank's Monetary Policy and Credit Operations Note show rising credit granting. The rise is already consolidated in the case of individuals and still incipient within corporate credit.



Fonte: Banco Central. Elaboração: IFI.

Macroeconomic Context

- The increase of new credit grantings was accompanied by high average interest rates in January and February. The nonearmarked interest rate for individuals rose from 55.8% in January to 57.7% in February, stopping its downward trajectory, which is more consistent with the monetary loosening cycle.

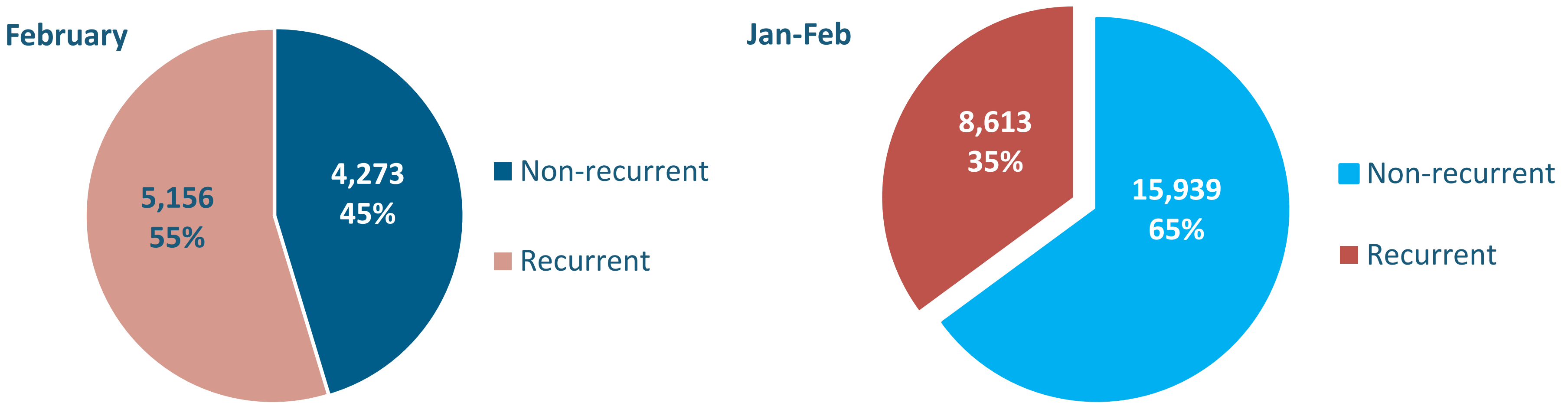


Source: Central Bank

Fiscal Scenario

- In the first two months of 2018 gross collection real growth was 10.3% (or $24.6 billion), compared to the same period of 2017.
- Nonrecurring revenues showed significant growth (R$15.9 billion).
- In February, recurring revenues grew at 5.6% (or R$5.2 billion) in comparison to Feb/17.
- In the first two months of the year, growth rate is at 3.8%.

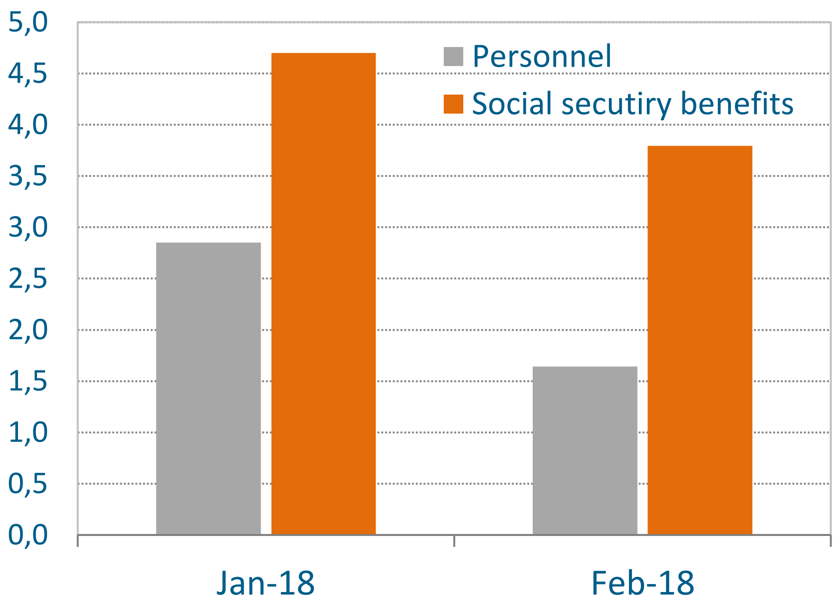
Gross collection composition

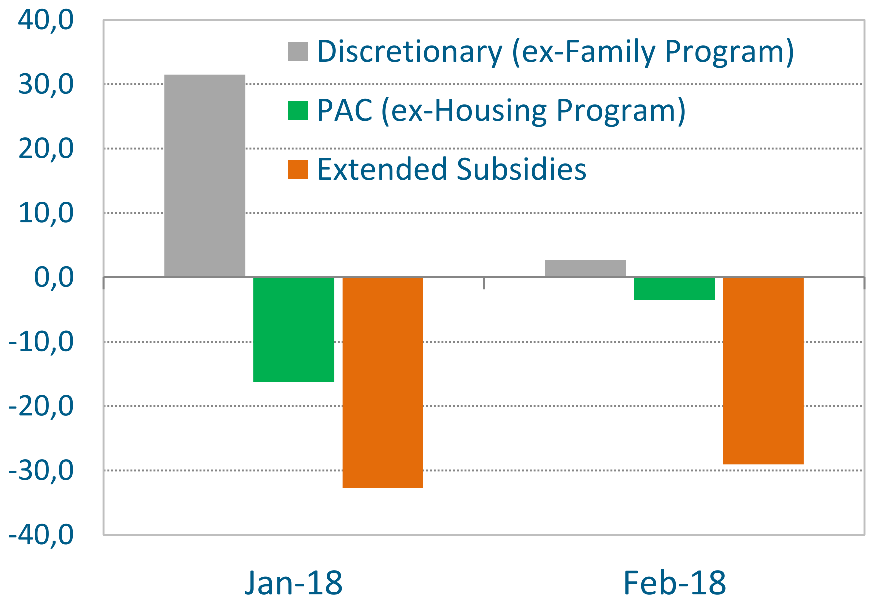


Fiscal Scenario

- In the first two months of 2018, primary expenditure real growth was 0.6% (or R$1.1 billion) in comparison to the same period of the previous year
- Despite the advance of personnel and pension spending, which respond to about 80% of total expenditure, the significant fall in subsidies kept total expenditure nearly unchanged compared to 2017
- The drop in agricultural subsidies (32.1%) and investments (37%) in front of same period of 2017 was substantial
- PAC investments (ex MCMV) advanced 4.9% in february but show a 3.5% retreat in the first two months of 2018

Real growth rate of selected expenditure groups
(1st two months of 2018 over the same period of 2017)

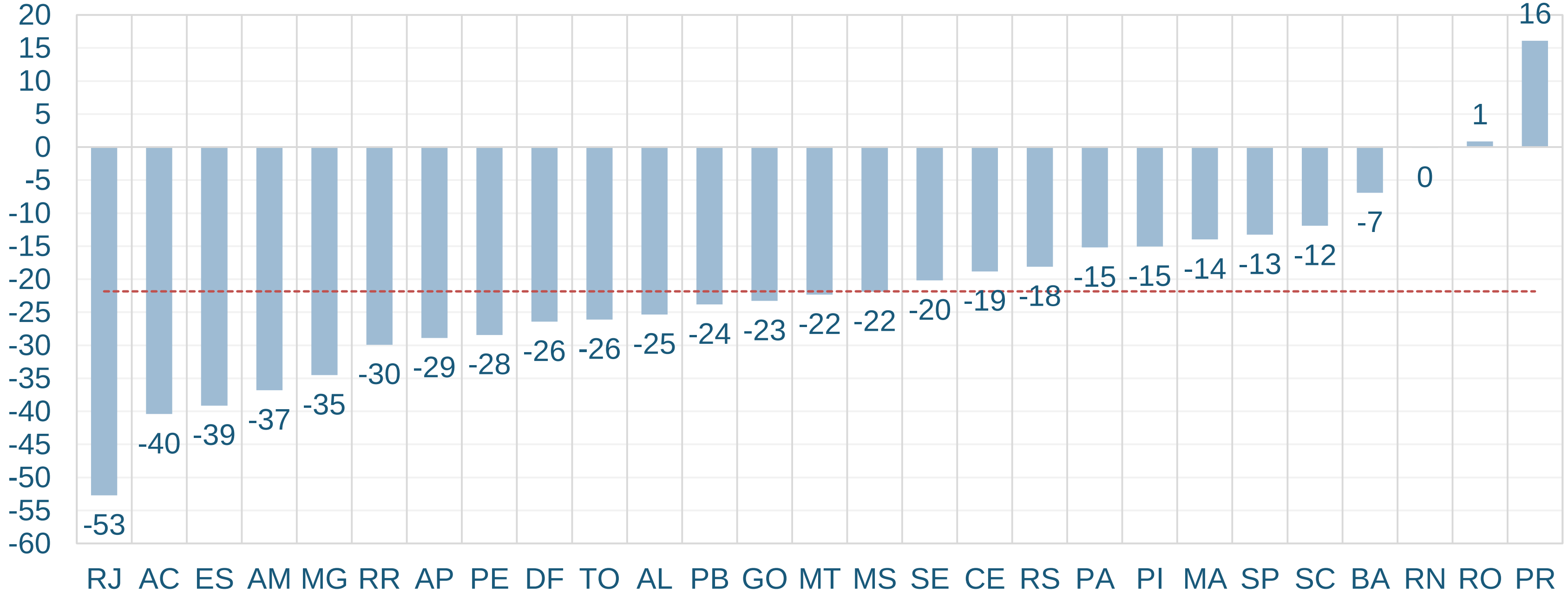




Fiscal Scenario

- Fiscal adjustment post-2014, supported primarily on the containment of investments, occurs in most States.
- The dependence on investment cuts suggests a limitation of the current pattern of fiscal adjustment. It is unlikely that the recovery of State level primary balances will remain in the absence of solutions that reach other expenses (especially personnel) and/or revenues.

Real growth rate of State level investments – 2014/2017 (% p.a.)



Source: IFI.

2018 Budget

- After the 1st bi-monthly budget update, government projects a R$157.4 billion primary deficit in 2018, before a R$159.0 billion target.

- As new projections do not endanger the fulfillment of the target, there was no need for budget freeze.

- Still, the Executive created a R$18.2 billion budget reserve to accomodate the risk of frustrating revenues from the privatization of Eletrobrás and expenses with the federal intervention in the state of Rio de Janeiro.

- February and March budget updates had to reverse the impacts of several fiscal adjustment measures initially considered in the 2018 Federal Budget, but already frustrated or with high risk of frustration.

- The difficult in approving fiscal adjustment measures brings additional challenges to the reduction of primary déficit. These challenges have been, to some extent, offset by economic recovery, witch has positive reflections on tax collection, and by the expectation of non-recurring revenues, such as the the ones provided by the privatization of Eletrobrás.

2018 Budget

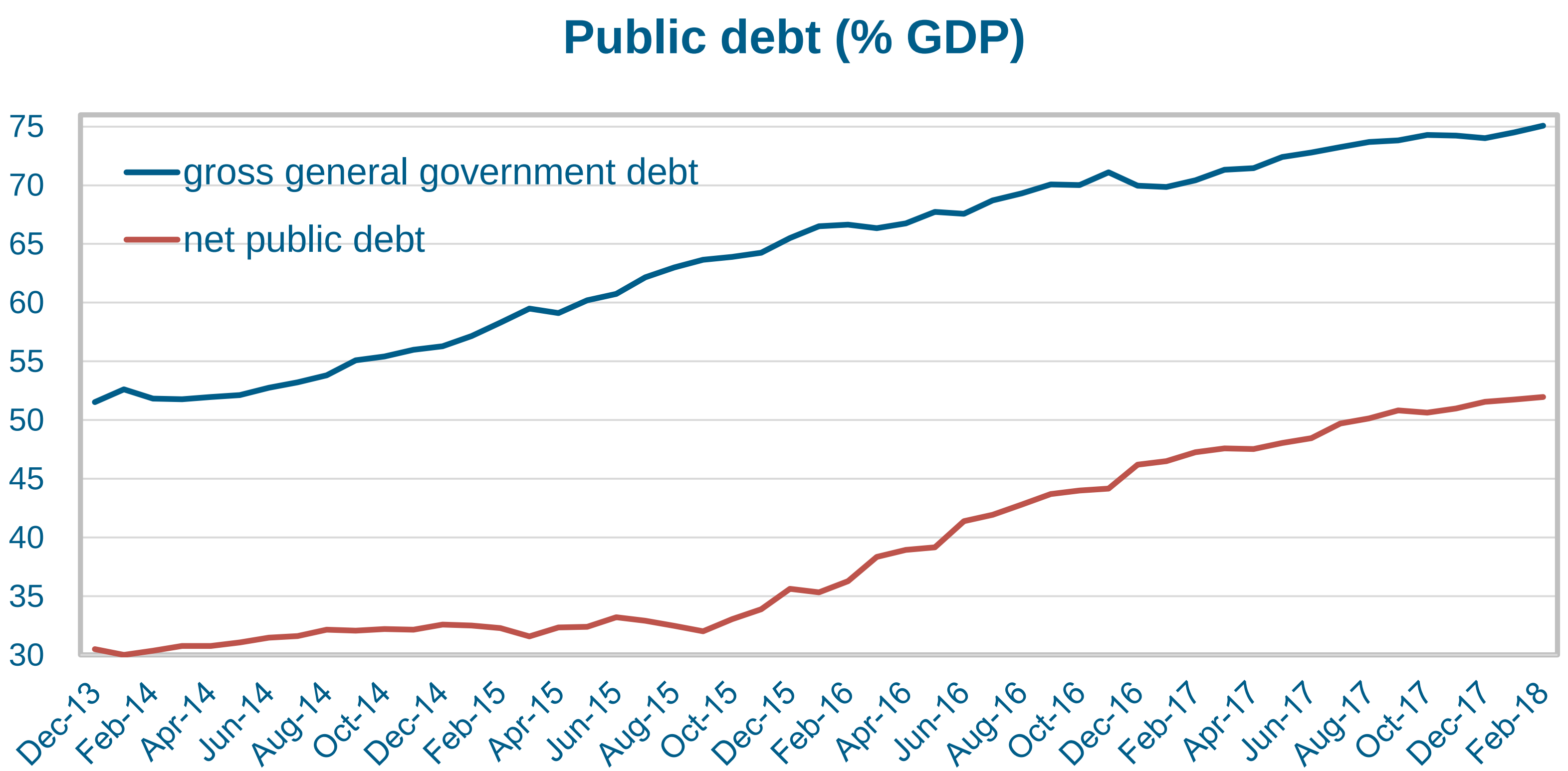
- Evolution of government projections shows no relevant changes in the expected primary revenue and expenditure.
- IFI projections point to a primary déficit lower than the expected by the government. The difference is explained mainly by the expenditure side.

R$ billion

Breakdown	Budget Law	Feb Update (Decree 9.276/18)	Mar Update (Decree 9.323/18)	IFI	IFI - Decree 9.323/18	
					Dif.	Dif. %
I. TOTAL REVENUE	**1,462.1**	**1,460.7**	**1,462.9**	**1,454.2**	**-8.7**	**-0.6**
Manageable	**890.3**	**880.9**	**894.0**	**892.3**	**-1.8**	**-0.2**
Social Security	**405.3**	**403.3**	**395.7**	**398.5**	**2.7**	**0.7**
Non Manageable	**166.5**	**176.4**	**173.2**	**163.5**	**-9.7**	**-5.6**
II. TRANSFERS TO SUBNATIONAL GOV.	**244.2**	**243.9**	**246.1**	**240.5**	**-5.5**	**-2.3**
III. NET REVENUE (I-II)	**1,217.8**	**1,216.8**	**1,216.9**	**1,213.7**	**-3.2**	**-0.3**
IV. TOTAL EXPENDITURE	**1,373.4**	**1,371.6**	**1,374.3**	**1,361.9**	**-12.4**	**-0.9**
IV.1 Mandatory	**1,091.4**	**1,090.1**	**1,093.1**	**1,086.8**	**-6.3**	**-0.6**
Social security benefits	596.3	592.4	592.4	590.6	-1.8	-0.3
Personnel	296.9	302.6	302.6	303.1	0.5	0.2
Unemployment Benefits	62.6	56.9	56.9	57.2	0.4	0.6
Elder and Disabled Benefits	56.0	55.9	55.9	56.3	0.4	0.6
Others	79.7	82.4	85.4	79.6	-5.8	
IV.2 Discretionary	**282.0**	**281.5**	**281.2**	**275.1**	**-6.0**	**-2.2**
V. CENTRAL GOV PRIMARY BALANCE	**-155.5**	**-154.8**	**-157.4**	**-148.2**	**9.2**	**-5.8**

Public Debt

- Public debt maintains its upward trajectory.

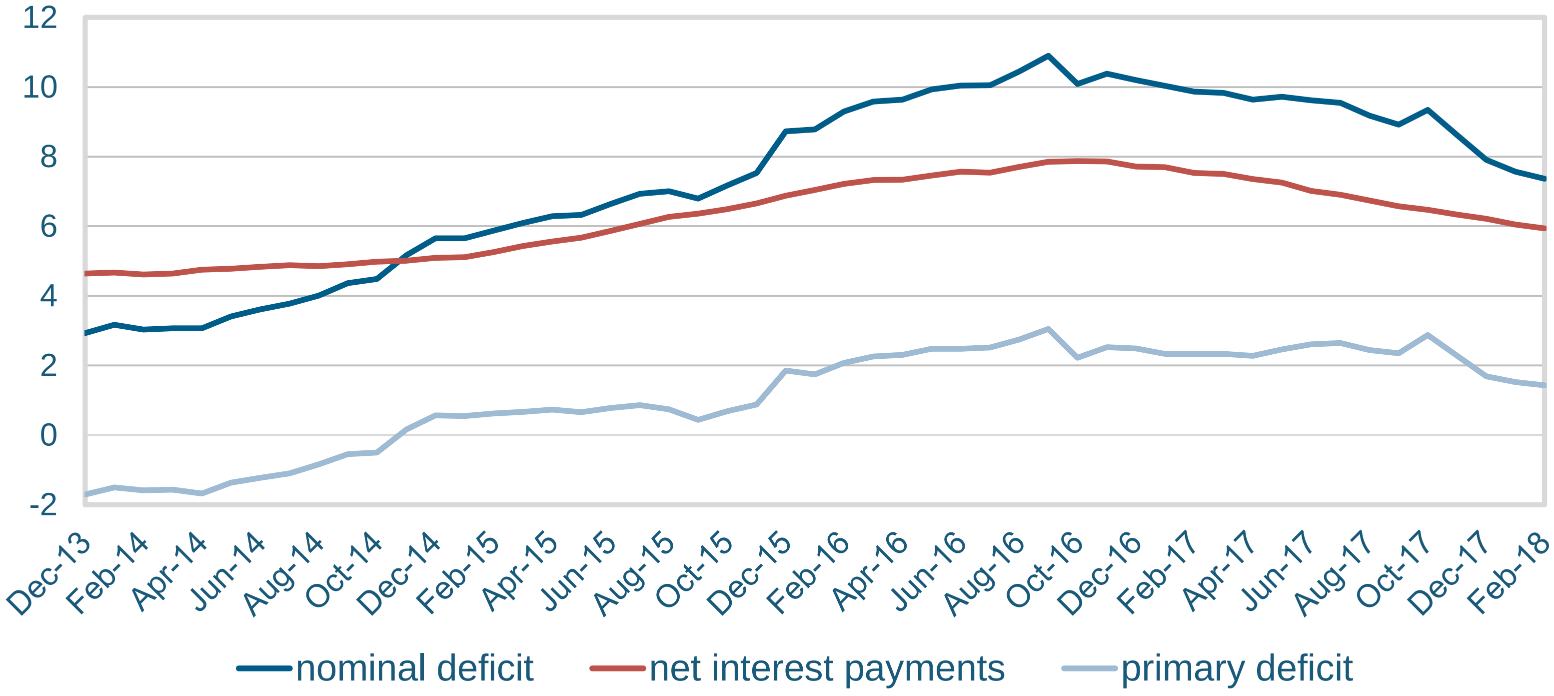


Source: Central Bank.

Public Debt

○ Reduction of the public sector nominal deficit continues, determined by the fall in interest rates and, more recently, primary deficit.

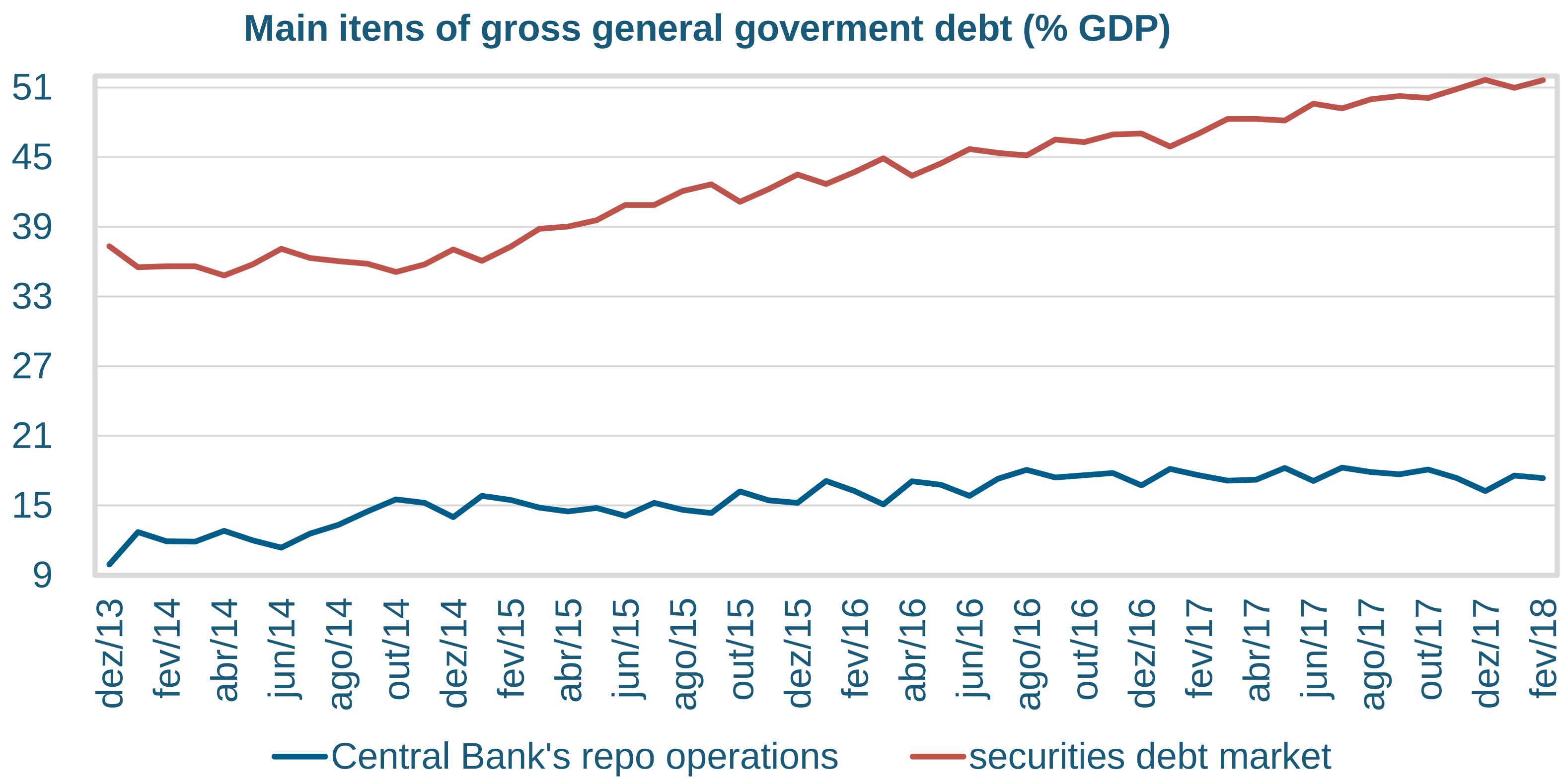
Nominal deficit, net interest payments and primary deficit (accumulated in 12 months, % GDP)



Source: Central Bank.

Public Debt

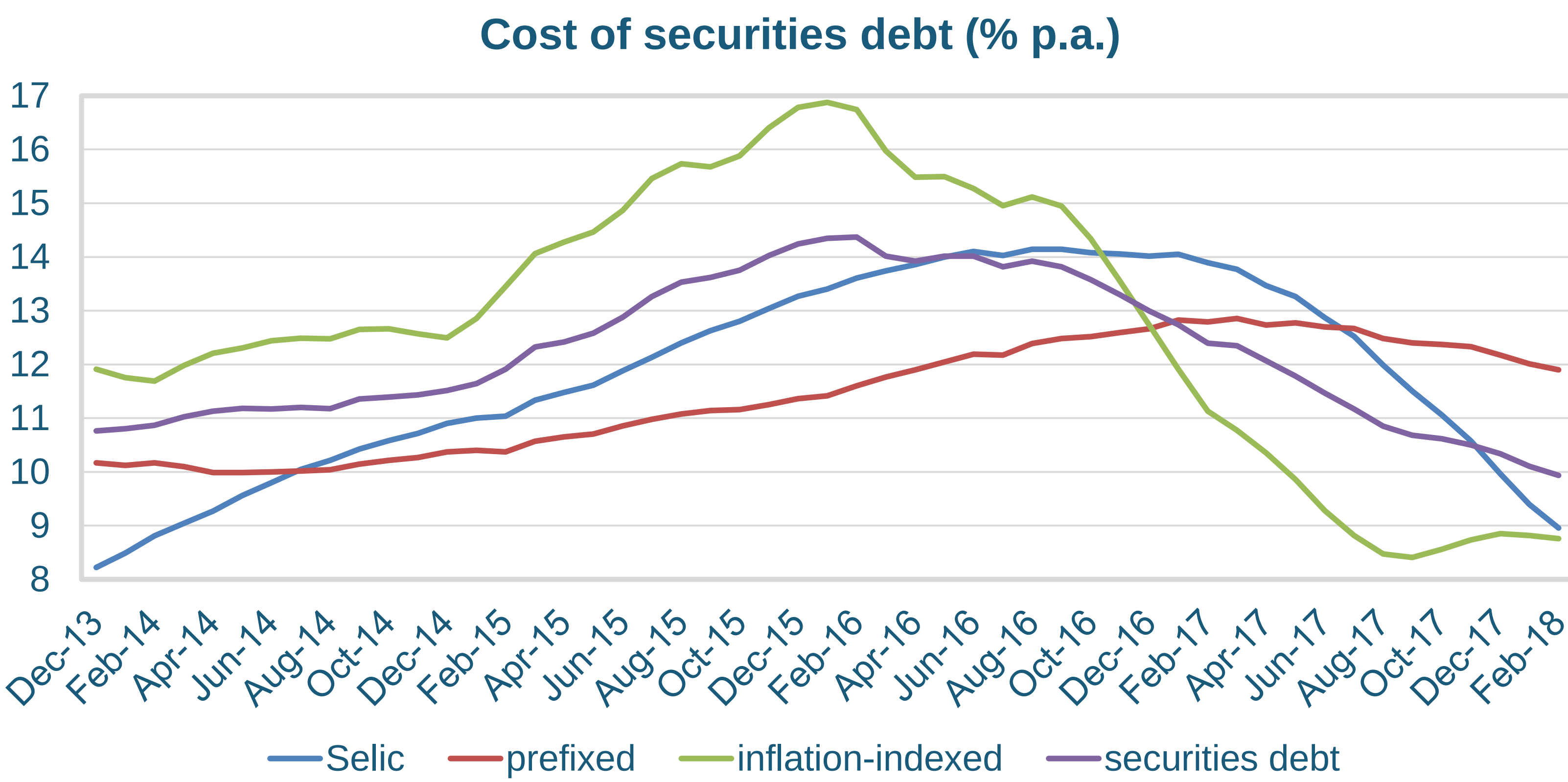
- Securities debt grows because of primary deficits and Central Bank's repo operations stop growing because of the early redemption of credits from BNDES by the Treasury.



Source: Central Bank.

Public Debt

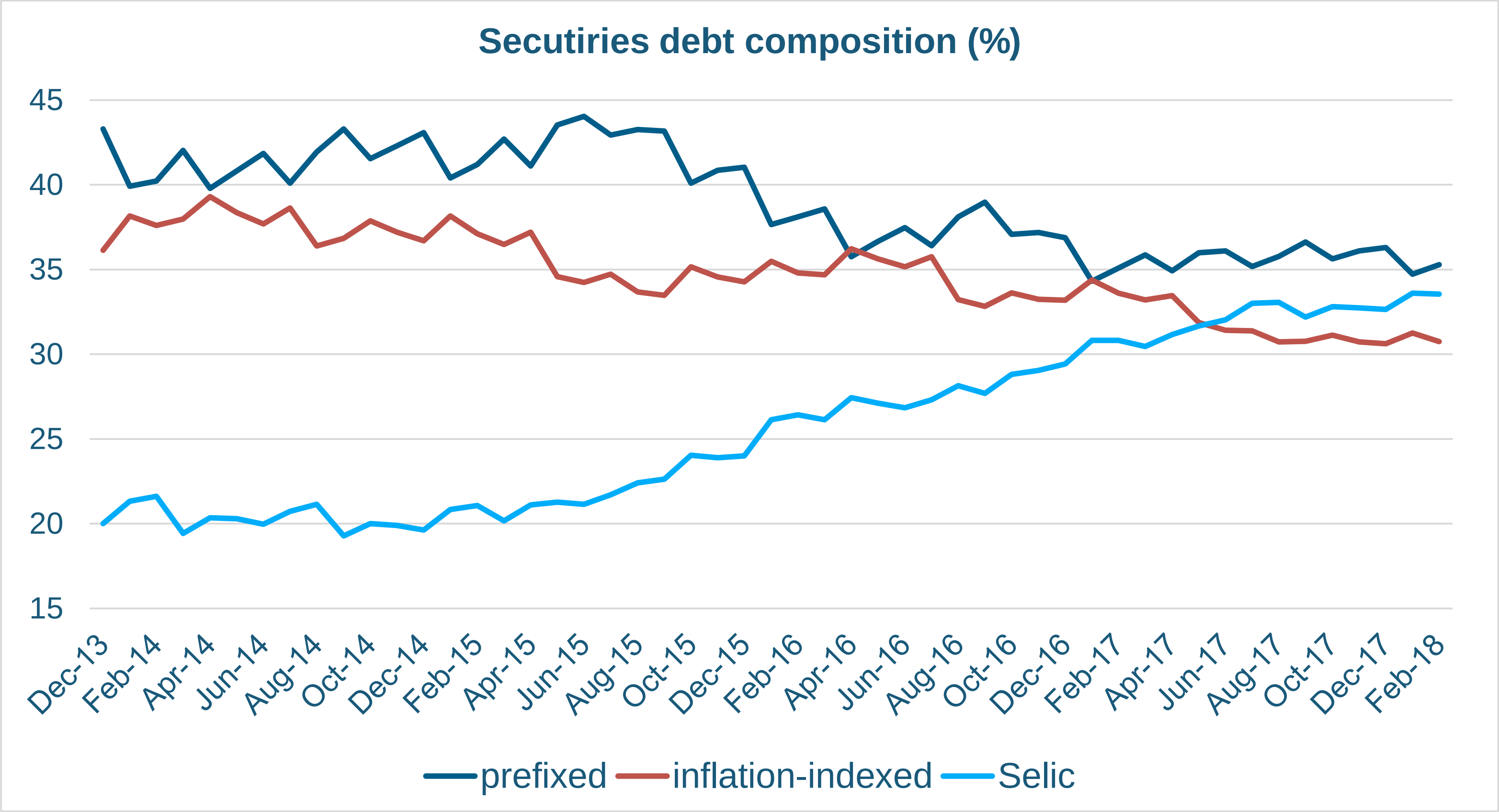
- The cost of securities debt is falling not only because of the Selic rate but also due to prefixed rates.



Source: Central Bank.

Public Debt

- Increase of the Selic-indexed stake in the securities debt.



Source: Central Bank.