



Fiscal Follow-up Report - RAF

June 2018

Full report [here](#) (portuguese)

Felipe Salto

Executive Director

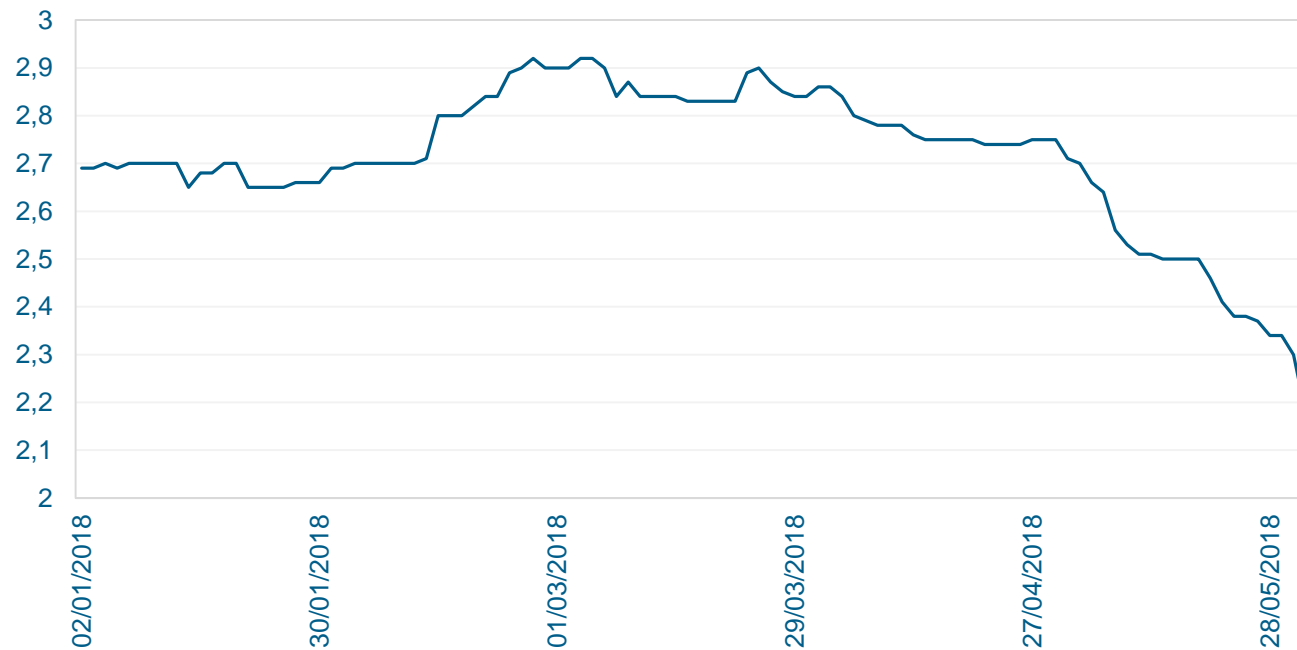
Brasília, 11 de junho de 2018

- Difficulties faced by Argentine economy and the truckers' strike occurred in May should produce negative effects on activity, bringing new elements to induce a revision in our GDP projection.
- The gradual recovery of activity has contributed to the improvement of tax collection. However, recent performance is still particularly influenced by one-off revenues and little correlated with activity.
- High primary deficit and interest payments keep the public sector borrowing requirements high, putting pressure on the debt. Exchange rate devaluation and foreign reserves soften upward trajectory of net debt.
- Tax burden in 2017 represented 32.30% of GDP, very close to the 32.34% of the previous year, indicating maintenance of the trend of stability observed in recent years.
- Participation of parafiscal organisations and funds (“Sistema S” and “FGTS”), municipalities and, to a lesser extent, States in the appropriation of total tax revenue has increased, to the detriment of the federal share.
- After the first four months of the year, Executive Branch projects a primary deficit of BRL152.8bn in 2018, BRL6.2bn below the target (BRL159.0bn). Thus, by the primary balance rule, there would be room for expenditure expansion. However, it will not be possible, given that total primary expenditure is already very close to its constitutional ceiling for the year.
- Government projections released in May do not take into account government's measures in response to the truckers' strike, which will probably impact the 2018 deficit in more than BRL7.0bn.

- The resumption of economic growth has occurred in slow pace. GDP in the first quarter compared to the immediately preceding quarter was 0.2 percentage point below our expectation and left a carry-over effect of 0.9% for 2018 growth, which reinforces the downward bias in our projection (currently in 2.7%).
- Difficulties faced by Argentine economy and the truckers' strike occurred in May should produce negative effects on activity, bringing new elements to induce a revision in our GDP projection.
- The revision of our estimates for 2018 GDP will be calibrated and made official when more accurate information on the impact of such events become available. The effects of the strike should appear more clearly in May conjuncture researches, such as industrial output, retail sales and service sector revenues, and in June confidence indices.

- Market expectations for 2018 GDP 2018 obtained in the Focus Market Readout of the Central Bank were revised down to 2.18%.

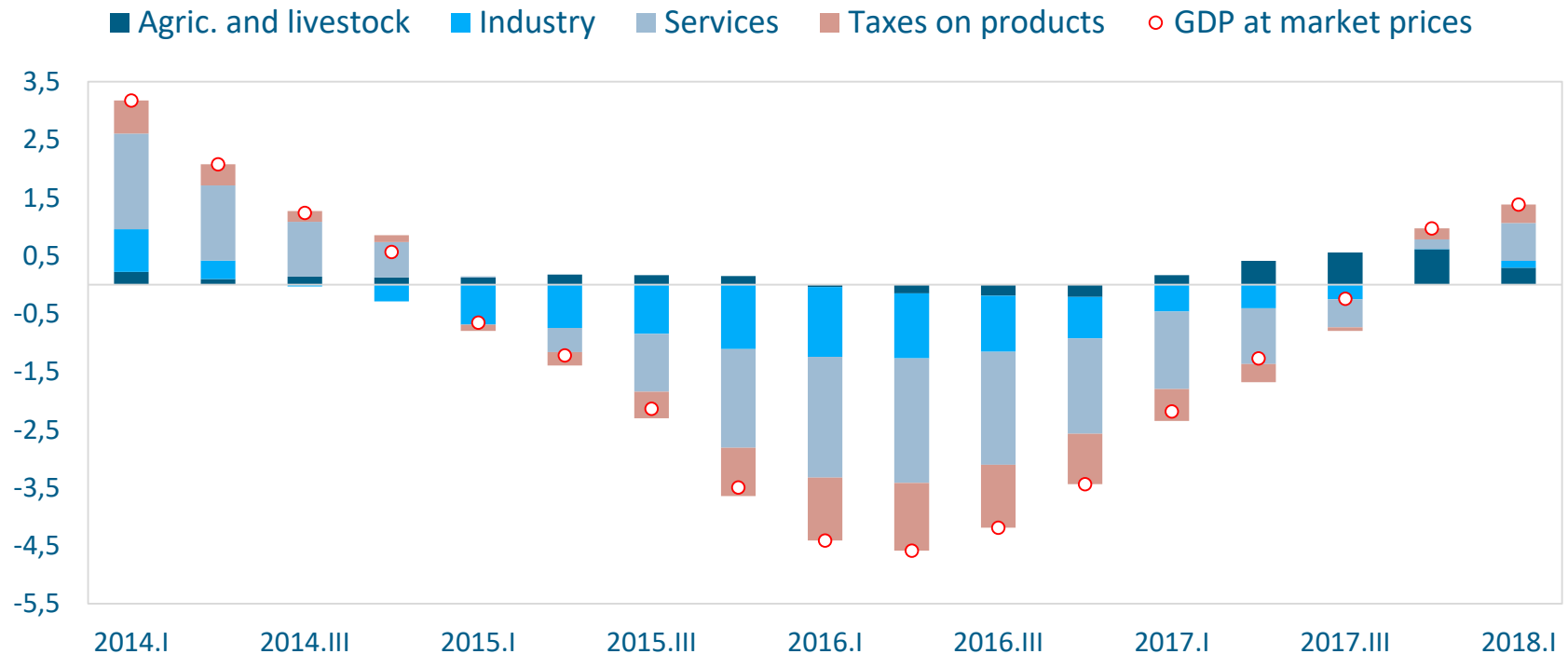
Market expectations GDP 2018



Source: Central Bank.

- In terms of contribution, the service sector added 0.6 percentage point to the accumulated GDP in four quarters, followed by agriculture (0.3 p.p.) and industry (0.1 p.p.).

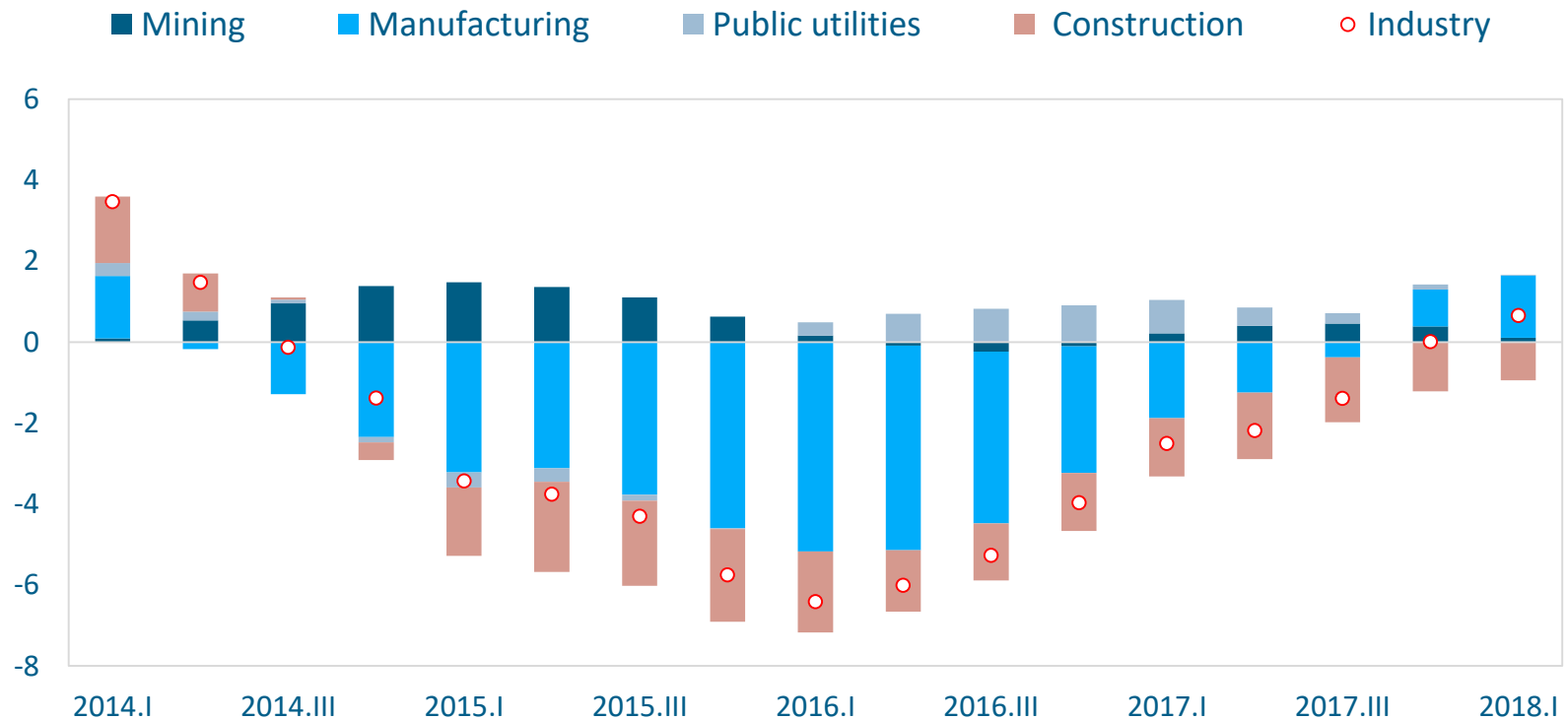
CONTRIBUTION IN P.P. TO GDP GROWTH ACUM. IN 4 QUARTERS



Source: IBGE.

- Contraction of the construction activity subtracted 0.9 percentage point of cumulative growth rate of GDP in four quarters.

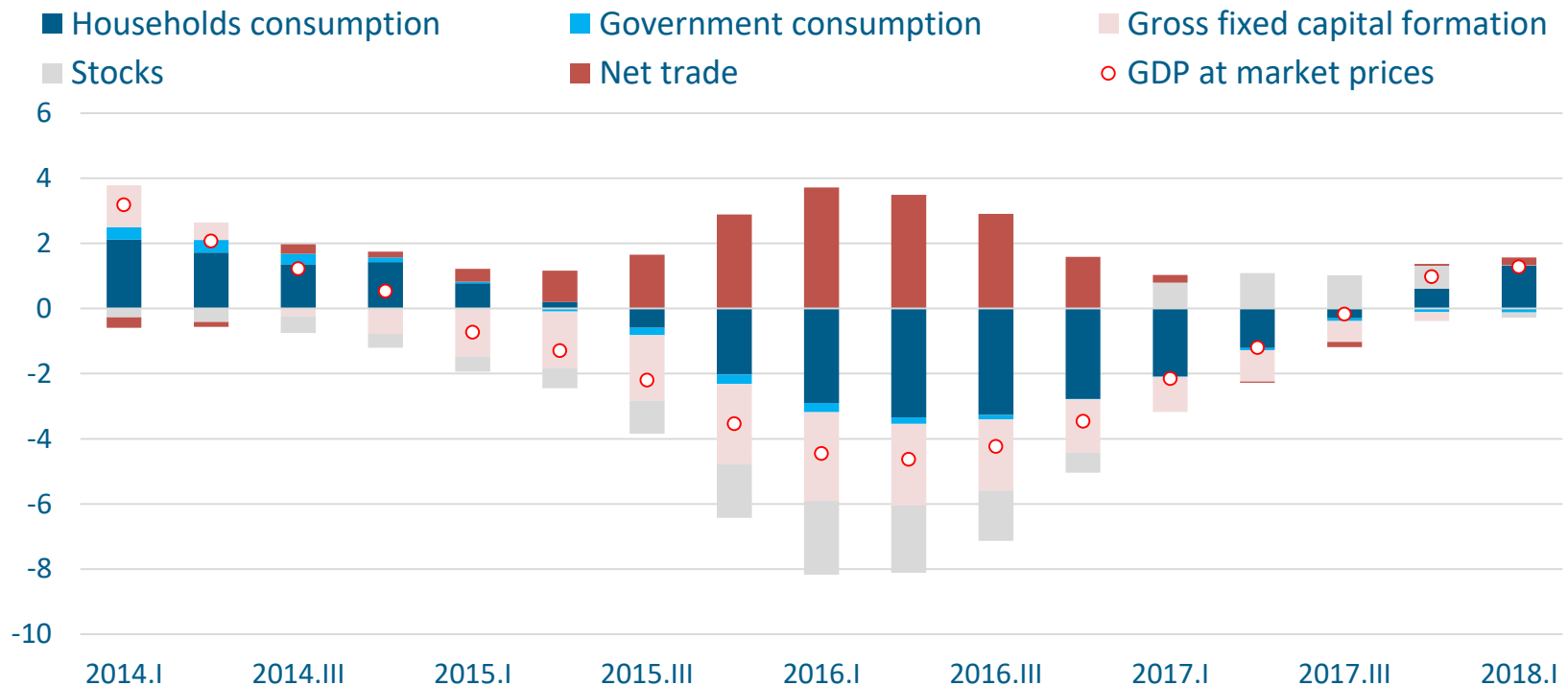
CONTRIBUTION IN P.P. TO INDUSTRIAL GDP GROWTH ACUM. IN 4 QUARTERS



Source: IBGE.

- The contributions of domestic absorption, composed by household consumption (1.3 p.p.), government (-0.1 p.p.) and investments (-0.1 p.p.), and external demand (net exports) were 1.1 p.p. 0.2 p.p.

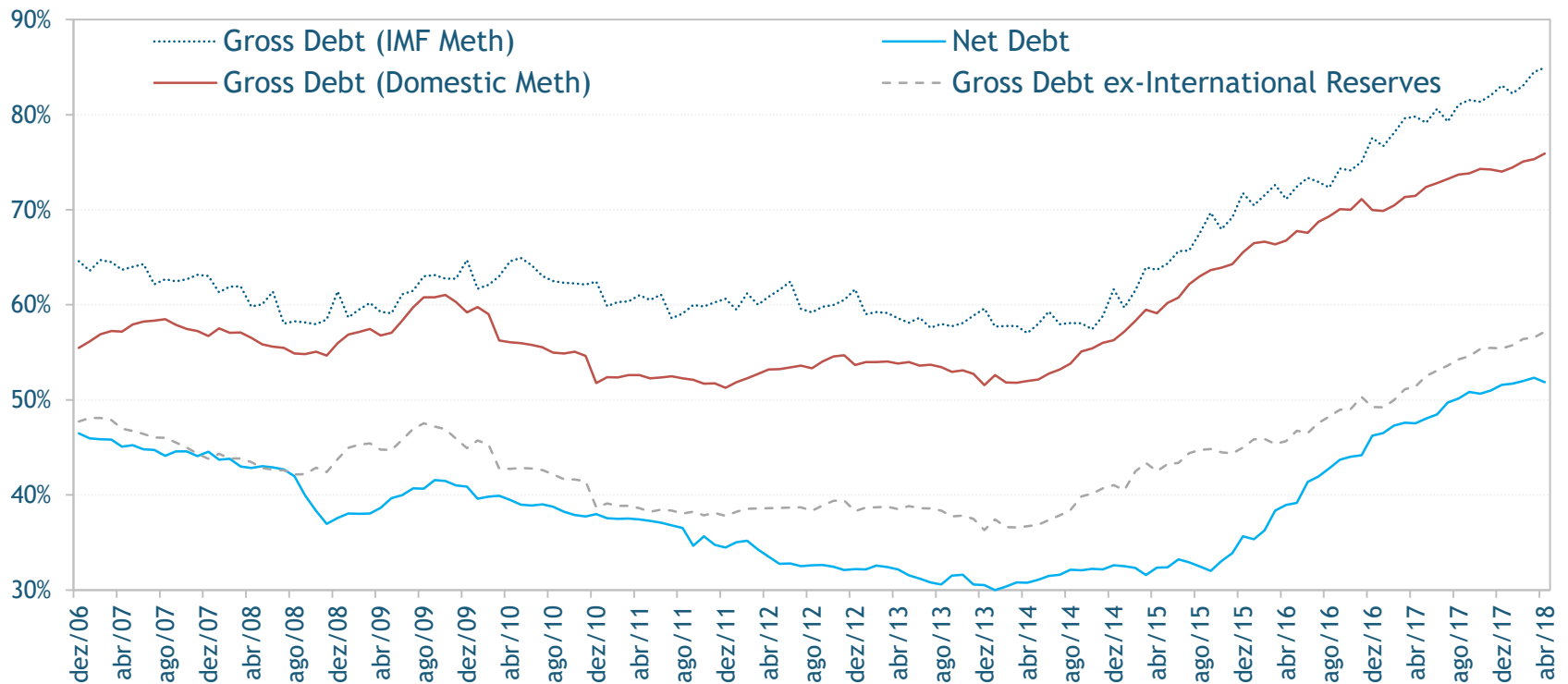
CONTRIBUTION IN P.P. TO GDP GROWTH ACUM. IN 4 QUARTERS



Fonte: IBGE.

- High primary deficit and interest payments keep the public sector borrowing requirements high, putting pressure on the debt. Exchange rate devaluation and foreign reserves soften upward trajectory of net debt.

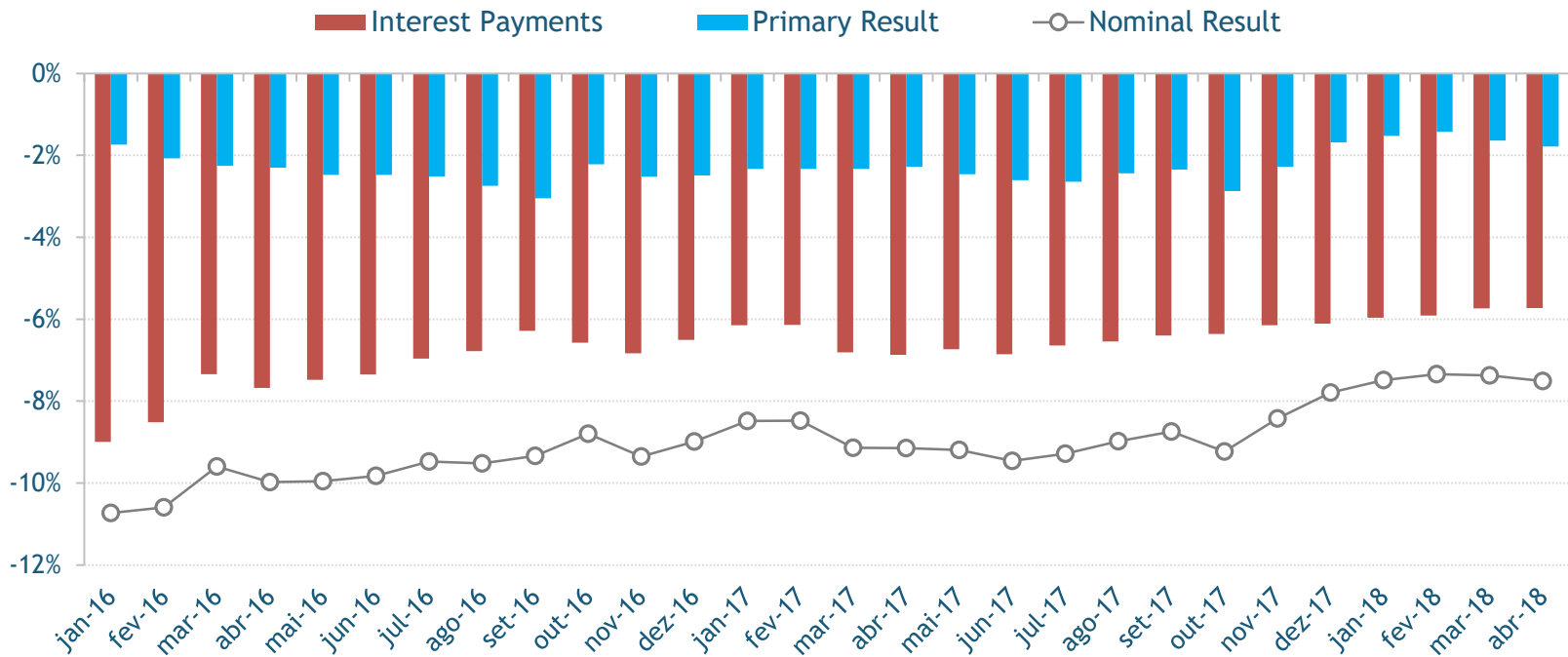
PUBLIC DEBT DIFFERENT MEASURES (% GDP)



Source: Central Bank.

- In 12 months, there have been relevant reduction of nominal deficit, to 7.5% of GDP (compared with 9.1% of GDP in April/17), influenced especially by the retraction of net interest expense.
- Also contributed the decrease of primary deficit, to 1.8% of GDP, anchored in the better performance of the national treasure balance, rather than the social security balance (“RGPS”).

CENTRAL GOVERNMENT PSBR (% DO PIB)



Source: Central Bank.

- Gradual recovery of activity has contributed to the improvement of tax collection.
- However, this performance is still influenced by one-off revenues and little correlated with the activity.

CENTRAL GOVERNMENT PRIMARY BALANCE (BRL MILLION AND VARIATION IN REAL TERMS)

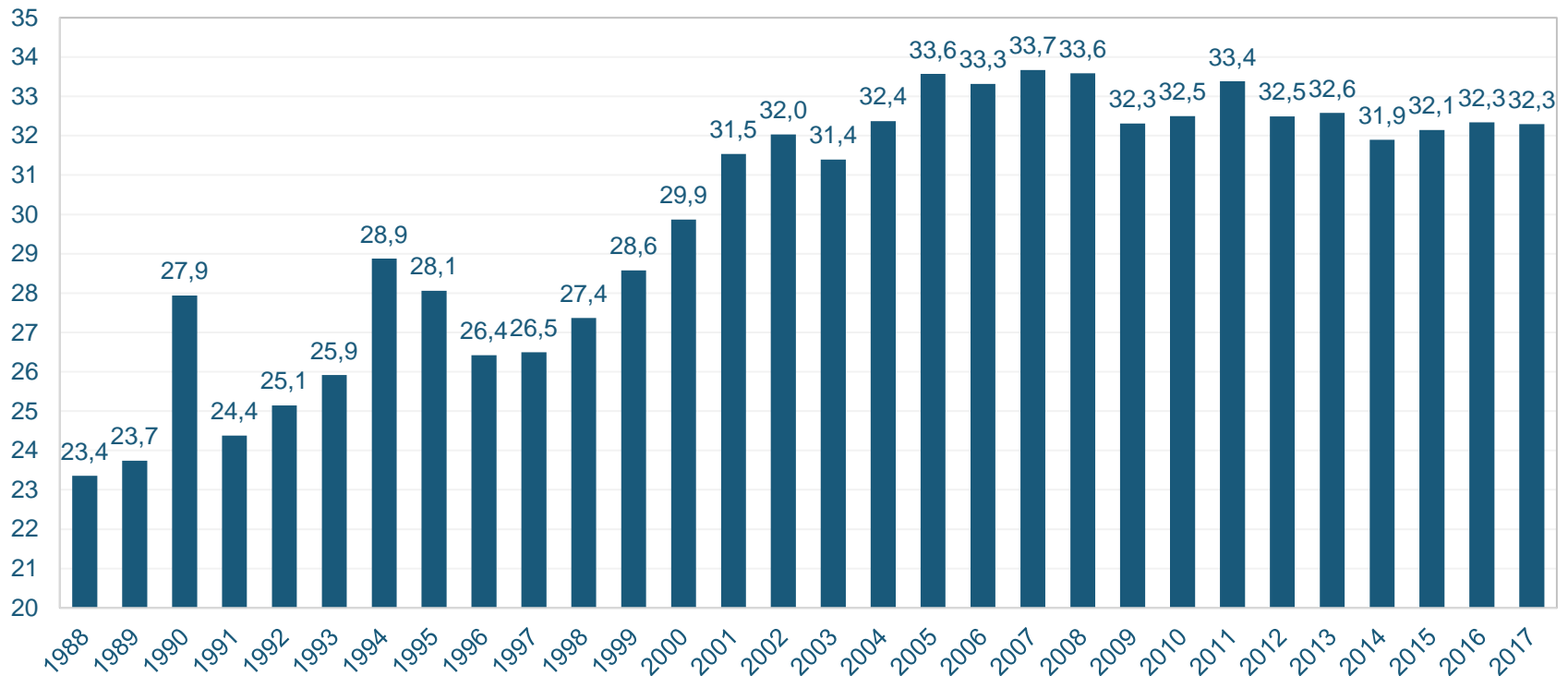
Breakdown	Monthly					Year-to-date				
	Share (%)	Apr-18	Apr-17	Var.	Var. %	Share (%)	Apr-18	Apr-17	Var.	Var. %
Total Revenue (A)	100.0	137,706	129,506	8,200	6.3	100.0	509,045	474,457	34,588	7.3
Collected by the Federal Revenue Office	61.9	85,259	79,545	5,714	7.2	65.1	331,297	302,724	28,573	9.4
Net Social Security Revenues	23.8	32,805	31,992	812	2.5	23.9	121,444	118,982	2,462	2.1
Not Collected by the Federal Revenue Office	14.3	19,642	17,987	1,655	9.2	11.1	56,303	52,769	3,535	6.7
Transfers by Revenue Sharing (B)	100.0	18,497	18,494	4	0.0	100.0	84,232	79,261	4,971	6.3
FPM / FPE / IPI-EE	81.2	15,028	15,197	-169	-1.1	79.5	67,000	63,721	3,279	5.1
Constitutional Funds	3.7	691	699	-8	-1.2	3.2	2,682	2,786	-105	-3.8
Education-Salary (social contribution for education)	5.2	965	961	4	0.4	5.5	4,633	4,585	48	1.0
Financial Compensations	7.7	1,422	1,209	213	17.6	10.5	8,870	7,060	1,810	25.6
CIDE - Fuels	2.0	373	407	-35	-	0.9	800	856	-56	-
Other	0.1	18	20	-2	-8.5	0.3	247	252	-5	-1.9
Net Revenue (C=A-B)	-	119,209	111,012	8,196	7.4	-	424,813	395,196	29,617	7.5
Total Expenditure (D)	100.0	112,022	98,356	13,666	13.9	100.0	430,178	402,632	27,546	6.8
Payroll	20.1	22,469	22,077	393	1.8	22.5	96,857	91,651	5,206	5.7
Income Transfers ¹	49.3	55,172	54,688	484	0.9	53.8	231,643	222,709	8,934	4.0
Subsidies and Grants (extended) ²	3.1	3,425	3,365	61	1.8	3.0	12,960	16,237	-3,278	-20.2
Discretionary (ex Family Grant Program)	13.6	15,197	13,348	1,849	13.9	13.3	57,108	52,182	4,926	9.4
Legislative, Judiciary Branches and Prosecutor's Office (LEJU/MPU)	0.9	1,013	864	149	17.2	0.9	3,838	3,257	581	17.8
PAC (Growth Acceleration Program), ex MCMV	1.5	1,702	1,627	75	4.6	1.2	5,119	4,971	147	3.0
Extraordinary credits (excluding PAC)	0.0	24	50	-26	-51.5	0.0	117	293	-177	-60.2
Judicial Remedies	9.7	10,882	186	10,696	5746.8	2.9	12,493	524	11,969	2284.1
Other current spending	1.9	2,138	2,152	-14	-0.7	2.3	10,045	10,807	-762	-7.0
Primary Balance (C-D)	-	7,187	12,656	-5,470	43.2	-	-5,366	-7,436	2,070	27.8
National Treasury and Central Bank		19,347	24,980	-5,634	22.6		56,027	46,176	9,852	-21.3
Social Security		-12,160	-12,324	164	1.3		-61,393	-53,611	-7,782	-14.5

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

- Tax burden in 2017 represented 32.30% of GDP, very close to the 32.34% of the previous year, indicating maintenance of the trend of stability observed in recent years.

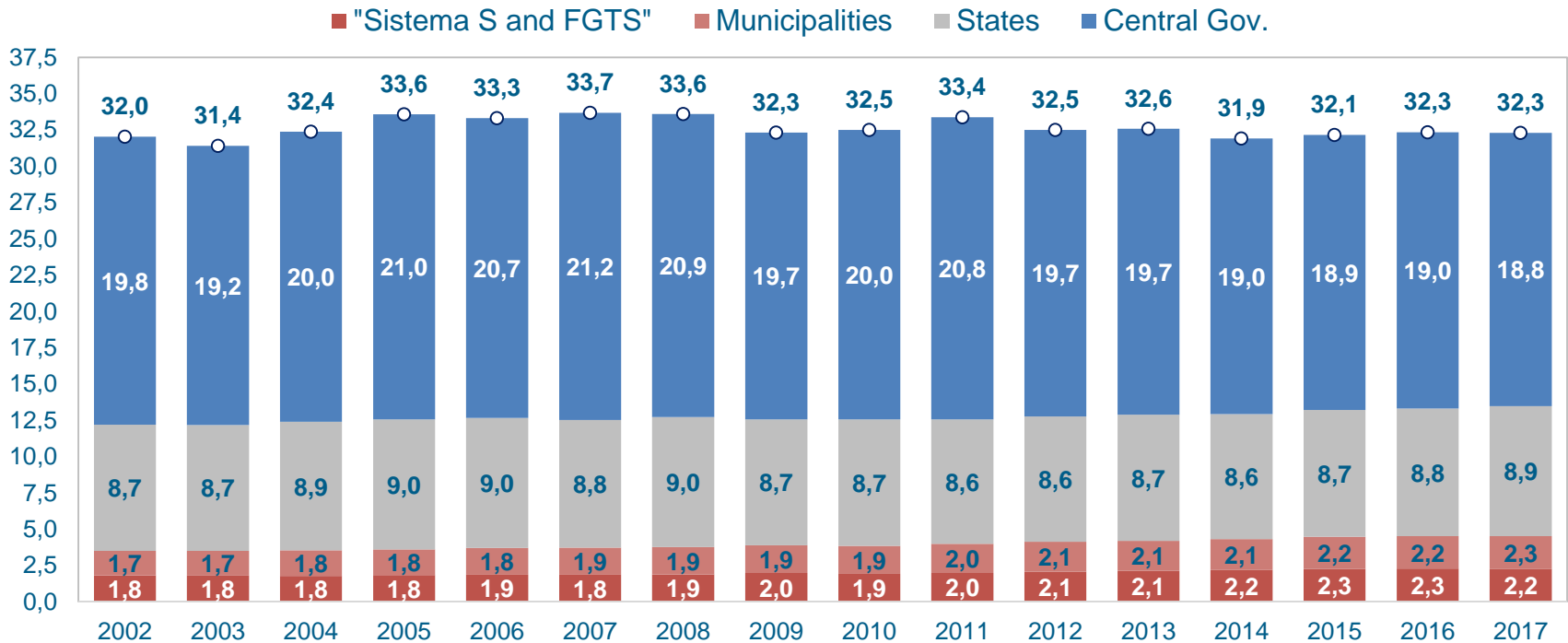
GROSS TAX BURDEN - % OF GDP 1988/2017



Source: IFI.

- Participation of parafiscal organisations and funds (“Sistema S” and “FGTS”), municipalities and, to a lesser extent, States in the appropriation of total tax revenue has increased, to the detriment of the federal share.

GROSS TAX BURDEN BY GOVERNMENT LEVEL - % OF GDP 2002/2017.



Source: IFI

- After the first four months of the year, Executive Branch projects a primary deficit of BRL152.8bn in 2018, BRL6.2bn below the target (BRL159.0bn).
- However, according to the government, expenditure already close to its 2018 ceiling hinders any raise.
- IFI projects lower deficit (BRL141.8bn) and a BRL15.0bn respite from the expenditure ceiling.

PRIMARY BALANCE – BUDGET X MAY UPDATE X IFI (BRL BILLION AND % GDP)

Breakdown	2018						IFI - Decree 9.390/18	
	Budget Law		May Update (Decree 9.390/18)		IFI		BRL Billion	Diff. %
	BRL Billion	% GDP	BRL Billion	% GDP	BRL Billion	% GDP		
I. TOTAL REVENUE	1,462.1	21.0	1,470.6	21.2	1,461.8	21.0	-8.8	-0.6
Revenues Collected by the Fed. Revenue Office	890.3	12.8	897.2	12.9	891.3	12.8	-5.9	-0.7
Net Social Security Revenues	405.3	5.8	393.8	5.7	398.4	5.7	4.6	1.2
Revenues Not Collected by the Fed. Revenue Office	166.5	2.4	179.6	2.6	172.0	2.5	-7.5	-4.2
II. TRANSFERS BY REVENUE SHARING	244.2	3.5	247.6	3.6	241.7	3.5	-6.0	-2.4
III. NET REVENUE (I-II)	1,217.8	17.5	1,222.9	17.6	1,220.1	17.5	-2.8	-0.2
IV. TOTAL EXPENDITURE	1,373.4	19.8	1,375.7	19.8	1,361.9	19.5	-13.8	-1.0
IV.1 Compulsory Expenses	1,091.4	15.7	1,094.0	15.7	1,086.4	15.6	-7.6	-1.0
Social Security Benefits	596.3	8.6	592.4	8.5	588.4	8.4	-4.0	-0.7
Payroll	296.9	4.3	302.4	4.4	303.1	4.3	0.6	0.2
Salary Allowance and Unemployment Benefit	62.6	0.9	56.9	0.8	56.4	0.8	-0.5	-0.9
Assistance Benefits (LOAS/RMV)	56.0	0.8	55.9	0.8	56.3	0.8	0.4	0.6
Other compulsory expenses	79.7	1.1	86.4	1.2	82.3	1.2	-4.1	-4.8
IV.2 Expenses with cash-flow control	282.0	4.1	281.7	4.1	275.5	4.0	-6.2	-1.2
V. CENTRAL GOVERNMENT PRIMARY BALANCE	-155.5	-2.2	-152.8	-2.2	-141.8	-2.0	11.0	-7.2

Source: Ministry of Planning and IFI.

PRIMARY EXPENDITURE CEILING IN 2018 (BRL BILLION)

Breakdown	May Update	IFI
Total primary expenditure	1,623.4	1,595.5
Expenses not included	276.0	262.6
Expenditure subject to the limit	1,347.4	1,332.9
Limit	1,347.9	1,347.9
Respite (+) / Excess (-)	0.5	15.0

Source: Ministry of Planning.

- Government projections released in May do not take into account measures in response to the truckers' strike.
- For the Government, measures will have a impact of BRL6.2bn in 2018, which would make projected deficit reach BRL159.0bn, equal to the 2018 target.
- IFI projects an impact of BRL7.4bn, which, alone, would raise our deficit projection to BRL149.2bn

IMPACT OF THE ANNOUNCED MEASURES IN RESPONSE TO THE TRUCKERS' STRIKE

Impact of the announced measures	Executive Branch*	IFI	Difference
Revenue (A)	-	(1.086)	(1.086)
Reduction of CIDE tax on diesel (from BRL 0,05 to BRL 0,00)	(4.014)	(1.600)	(1.086)
Reduction of PIS/Cofins tax on diesel (from BRL 0,46 to BRL 0,35)		(3.500)	
Restoration of payroll tax (Law 13.670/2018)	834	834**	-
Reduction of Reintegra tax incentive (Law 13.043/2014)	2.270	2.270 **	-
Reduction of IPI tax incentive on soft drinks	740	740 **	-
Elimination of Reiq tax incentive (Law 10.865/2004)	170	170 **	-
Expenditure (B)	6.200	6.300	100
Grants on the diesel commercialization (MP 839/2018)	9.500	9.600	100
Compensatory expenditure cuts (MP 839/2018)	3.300	3.300 ***	-
Net impact (C=B-A)	6.200	7.386	1.186
Primary balance projection before measures (D)	152.800	141.800	(11.000)
Primary balance projection after measures (D+C)	159.000	149.186	(9.814)

Source: IFI, Ministry of Finance and press (<https://glo.bo/2Jh3rRE>).

* Executive Branch data were gathered mainly through press news.

**Until the basis of calculation of the Executive data is not revealed, we will adopt its estimates.

***We have adopted the spending cuts indicated in the Annex of the Provisional Measure 839/2018.