



Fiscal Follow-up Report

August 2018

Full report [here](#) (portuguese)

Felipe Salto

Executive Director

August 13th, 2018

- In addition to updating macroeconomic variables in the short term, we point out that the nominal GDP level is high throughout the predictive horizon, due to the expectation that the change in the GDP deflator (a wide measure of inflation in the National Accounts) grow above the Consumer Price Index (“IPCA”).
- Scenario updates points out that the reversion of the primary deficit into a surplus will occur only by 2022, if the spending ceiling is fulfilled and the issue of onerous assignment involving the Government and Petrobras is solved.
- The chance of fulfilling the expenditure ceiling until 2020 has increased due to the extinction of the diesel commercialization grant and lower spending on subsidies and grants, helped by elevation of the ceiling in response to the accumulated inflation in the 12 months ending in June/ 18.
- Possible breach of the ceiling and consequent activation of the triggers set out in the CF/88 will not be sufficient to bring the expenditure back to the level required by the rule.
- The scenarios for public debt have improved significantly, but fiscal framework remains challenging. In the base scenario, gross debt will reach 84.1% of GDP in 2023 and 2024.
- The Executive Branch projects a primary deficit of BRL159bn in 2018, BRL6.2bn higher than the previous projection and equivalent to the target. Primary expenditure also advanced and is very close to the spending ceiling, preventing future revenue projections are used for spending expansion.

- In this edition we updated the macroeconomic projections that support the construction of the fiscal scenarios, considering realized data of the first quarter and the set of information already available about the State of the economy in the second quarter of the year
- Economic growth should remain in a more moderate pace than expected initially, having been revised from 2.7% to 1.6% in 2018

GDP PROJECTIONS

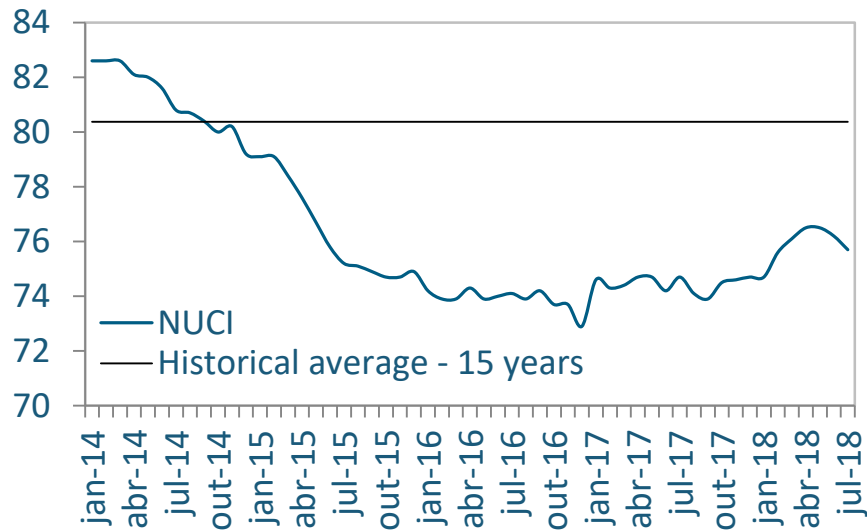
	2014	2015	2016	2017	2018	2019
Gross Domestic Product (Percentage changes)	0.5%	-3.5%	-3.5%	1.0%	1.6%	2.4%
Agricultural	2.8%	3.3%	-4.3%	13.0%	1.4%	2.3%
Industry	-1.5%	-5.8%	-4.0%	0.0%	1.8%	2.1%
Service	1.0%	-2.7%	-2.6%	0.3%	1.5%	2.4%
Private consumption	2.3%	-3.2%	-4.3%	1.0%	2.0%	2.5%
Government consumption	0.8%	-1.4%	-0.1%	-0.6%	0.1%	1.0%
Gross fixed capital formation	-4.2%	-13.9%	-10.3%	-1.8%	3.7%	4.5%
Exports of goods and services	-1.1%	6.8%	1.9%	5.2%	6.0%	5.0%
Imports of goods and services	-1.9%	-14.2%	-10.2%	5.0%	5.7%	5.4%
Contributions to changes in real GDP						
Total domestic demand	0.4	-6.4	-4.9	0.9	1.5	2.4
Net exports	0.1	2.9	1.5	0.1	0.1	0.0

Source: IBGE

Macroeconomic Context

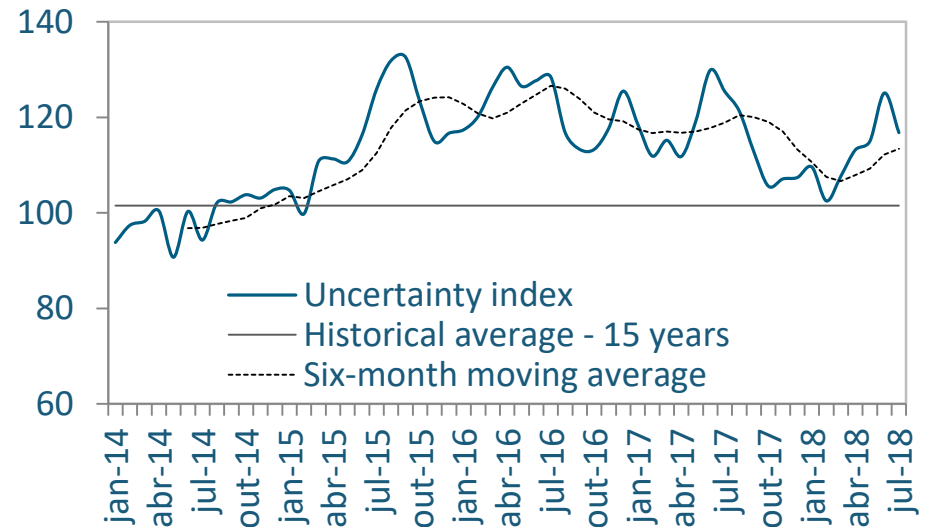
- Industry remains operating with high degree of idleness. The capacity utilization reached 75.7% in July (in seasonally adjusted terms) – distant from the historical average of 80.4% of the last 15 years.
- The uncertainty index declined, but remains above the average of the last 15 years.

Level of Capacity Utilization



Source: FGV.

Uncertainty index



Source: FGV.

- Employment population growth kept decelerating in June.

EMPLOYED POPULATION BY POSITION

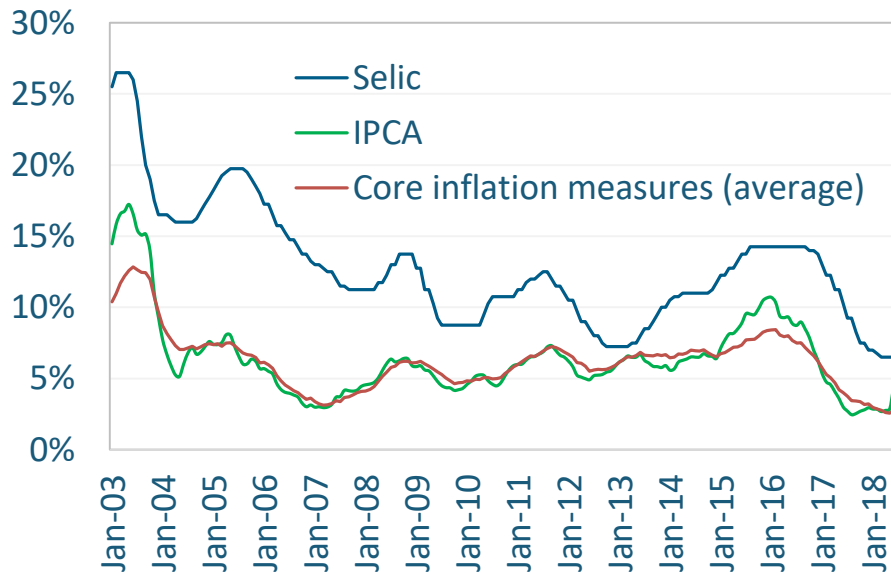
Employment indicators	Percentage in relation to employed population			QoQ			Accumulated in 12 months		
	Apr-18	May-18	Jun-18	Apr-18	May-18	Jun-18	Apr-18	May-18	Jun-18
Employed population	100 .0%	100 .0%	100 .0%	1 .7%	1 .3%	1 .1%	1 .4%	1 .6%	1 .7%
Private sector: formal	36.1%	36.1%	36.0%	-1.7%	-1.5%	-1.5%	-2.1%	-2.0%	-1.8%
Private sector: informal	12.0%	12.2%	12.0%	6.3%	5.7%	3.4%	5.8%	5.7%	5.1%
Domestic worker	6.8%	6.8%	6.8%	1.0%	0.1%	2.1%	1.5%	2.0%	2.4%
Public sector	12.5%	12.6%	12.7%	3.3%	2.9%	2.7%	2.2%	2.1%	2.3%
Employer	4.8%	4.8%	4.8%	5.7%	5.6%	4.2%	6.2%	5.9%	5.1%
Self-employed	25.4%	25.2%	25.3%	3.3%	2.5%	2.5%	3.3%	3.7%	4.0%
Percentage of workers that contribute to social security	63.5%	63.6%	63.7%	-0.2%	0.6%	0.2%	-0.9%	-0.6%	-0.5%

Source: IBGE.

Macroeconomic Context

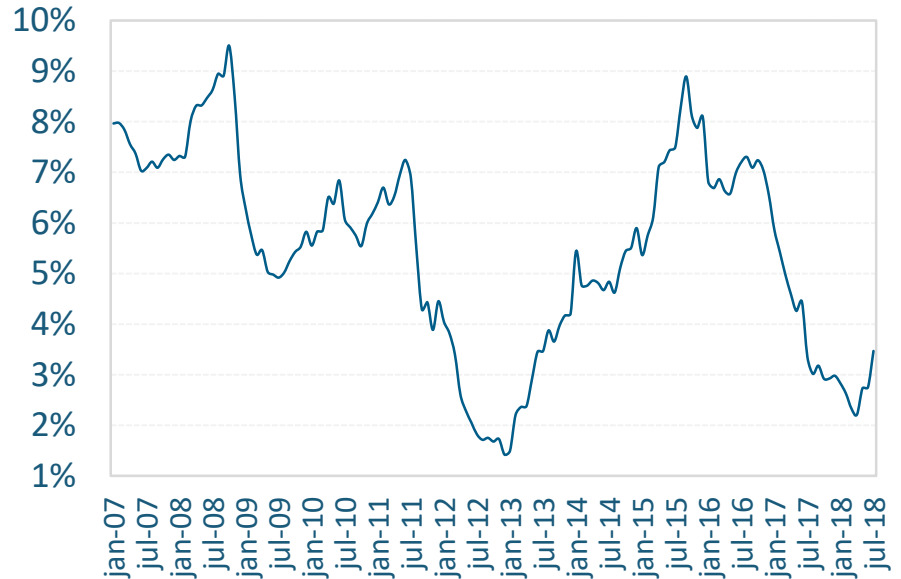
- The consumer price index (“IPCA”) in twelve months rose from 4.4% in June to 4.5% in July;
- Average of inflation cores – calculated with the purpose of capturing price trends – rose from 2.7% in June to 2.9% in July;
- The ex-ante real interest rate, after having hit a lowest point in April (2.2%), rose to 3.5% in July.

Selic and IPCA



Source: Central Bank and IBGE.

Ex-ante real interest rate



Source: Anbima and Central Bank.

- In addition to updating macroeconomic variables in the short term, we point out that the nominal GDP level is high throughout the predictive horizon, due to the expectation that the change in the GDP deflator (a wide measure of inflation in the National Accounts) grow above the Consumer Price Index (“IPCA”).
- In the base scenario, potential GDP growth is estimated at 2.2% (3.4%, optimistic; 1.4%, pessimistic).

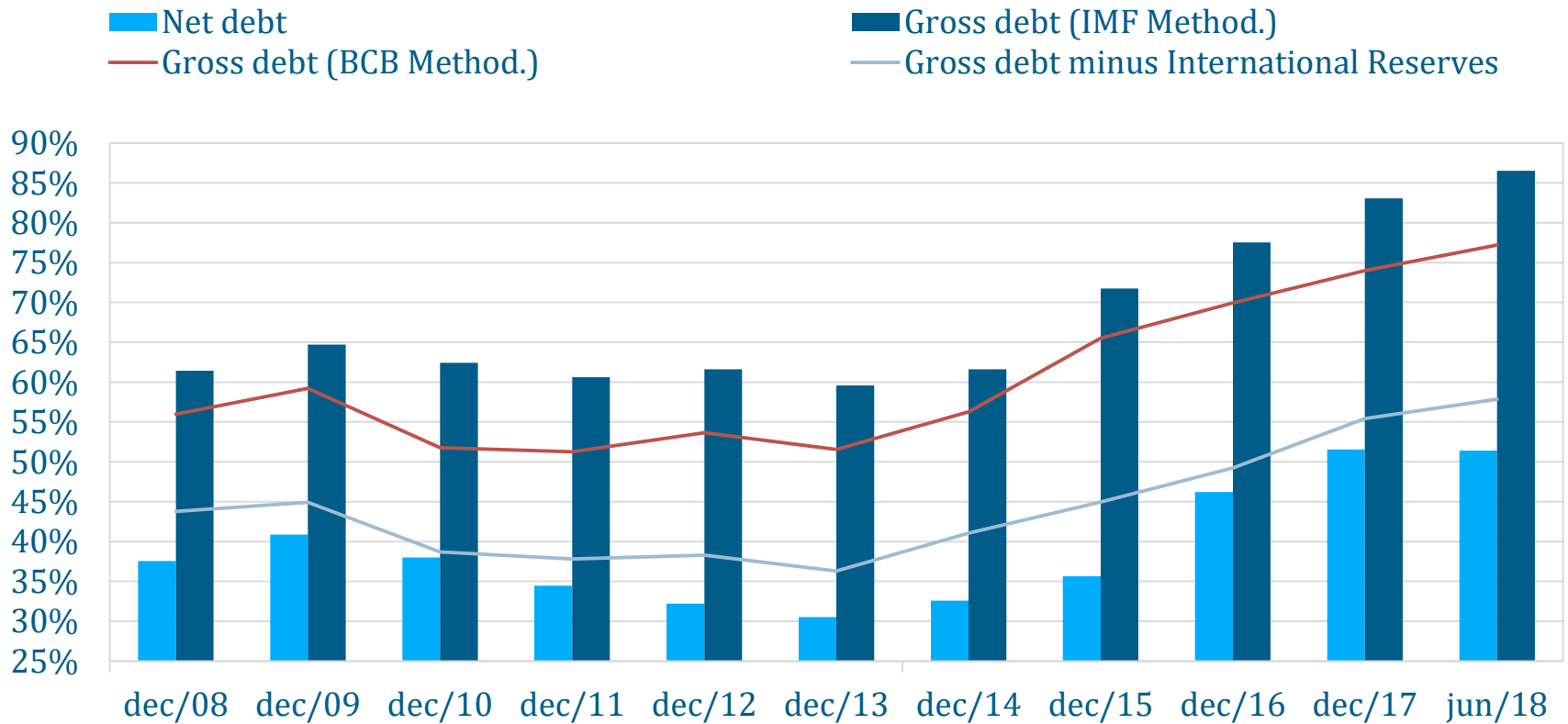
MACROECONOMIC VARIABLES ESTIMATES

Current	Base Scenario						Optimistic Scenario			Pessimistic Scenario		
	2015	2016	2017	2018	2019	2020-2030	2018	2019	2020-2030	2018	2019	2020-2030
GDP Nonimal (BRL billion)	5,996	6,259	6,560	6,971	7,471	11,360	6,959	7,446	11,950	6,975	7,443	11,862
Real GDP growth	-3.5	-3.5	1.0	1.6	2.4	2.2	1.8	2.9	3.4	1.4	1.3	1.4
Overall wages growth	0.4	-3.4	2.3	2.2	2.8	2.1	2.4	4.1	2.9	1.9	1.8	1.7
Consumer prices (IPCA, end of period)	10.7	6.3	3.0	4.00	4.10	4.00	3.70	3.40	3.70	4.30	4.70	5.70
GDP Deflator (end of period)	7.6	8.1	3.8	4.6	4.7	4.6	4.3	3.9	4.3	4.8	5.3	6.3
Exchange rate R\$/US\$ (end of period)	3.90	3.26	3.31	3.69	3.61	4.02	3.54	3.32	3.56	3.73	3.76	4.56
Selic rate (end of period)	14.25	13.75	7	6.5	8	8.5	6.5	7	7	7.5	9.5	11.86
Real interest rate (%)	3.23	7.02	3.94	2.4	3.7	4.3	2.4	3.7	3.2	3.1	4.6	5.8
Risk premium (EMBI-BR) - end of period	523	328	240	270	250	250	250	200	190	350	350	350
Last version	2015	2016	2017	2018	2019	2020-2030	2018	2019	2020-2030	2018	2019	2020-2030
GDP Nonimal (BRL billion)	5,996	6,259	6,560	6,970	7,418	10,970	6,984	7,471	11,738	6,986	7,446	11,563
GDP real - Percentage change	-3.5	-3.5	1.0	2.7	2.5	2.3	3.2	3.5	3.5	1.9	1.5	1.3
Total wages - Percentage change	0.4	-3.4	2.3	3	2.8	2	4.2	4.9	2.6	2.7	1.8	1.5
Consumer prices (IPCA, end of period)	10.7	6.3	3.0	3.50	3.90	4.10	3.10	3.40	3.80	4.50	5.00	5.90
GDP Deflator - Percentage change	7.6	8.1	3.8	3.5	3.9	4.1	3.1	3.4	3.8	4.5	5.0	5.9
Exchange rate R\$/US\$ (end-of-period)	3.90	3.26	3.31	3.45	3.55	3.82	3.30	3.30	3.50	3.71	3.84	4.79
Selic - (end-of-period)	14.25	13.75	7	6.25	7.5	8.5	6	6	7	8.5	9.5	11.9
Real interest rate (%)	3.23	7.02	3.94	2.7	3.5	4.3	2.7	3.5	3.1	3.8	4.3	5.7
Risk premium (EMBI-BR) - end of period	523	328	240	265	261	239	234	220	194	349	354	366

Source: IFI.

- In June 2018, gross debt was at 77.19% of GDP (Central Bank methodology), and net debt was at 51.41% of GDP.
- In June 2018, public debt grew again, except for the net debt (“DLSP”).

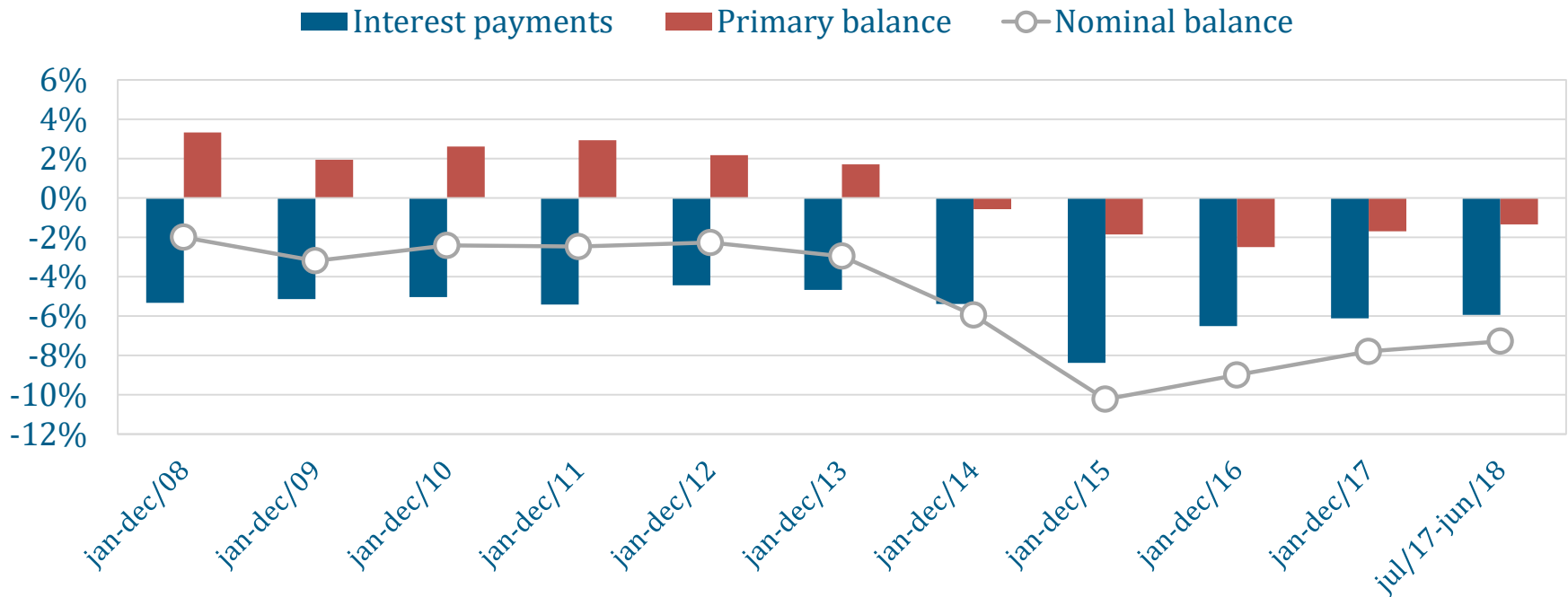
PUBLIC DEBT OVER THE LAST 10 YEARS (% OF NOMINAL 12-MONTH GDP)



Source: Central Bank.

- Nominal deficit was BRL57.9bn in June 2018, as a result of primary deficit and interest payments.
- Nominal deficit accumulated in 12 months has remained above 7% of GDP since 2015.
- Since 2015, growth of the social security deficit (“RGPS”) has pressed the primary deficit of the Central Government.

12-MONTH PUBLIC SECTOR BORROWING REQUIREMENTS OVER THE LAST 10 YEARS (% OF NOMINAL 12-MONTH GDP)



Source: Central Bank. The graph shows 12-month current values divided by 12-month nominal GDP. Data for the last period refer to the July 2017 – June 2018 time span. Positive values indicate surplus; negative values, deficit.

- Between June 2017 and June 2018, all items of expenditure fell, except for discretionary spending.

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

Breakdown	Monthly					Year-to-date				
	Share %	Jun-18	Jun-17	Var.	Var. %	Share %	Jun-18	Jun-17	Var.	Var. %
Total Revenue (A)	100.0	108,840	109,359	-519	-0.5	100.0	740,554	695,165	45,389	6.5
Collected by the Federal Revenue Office	61.6	67,059	66,761	298	0.4	63.7	471,782	437,553	34,229	7.8
Net Social Security Revenues	27.9	30,350	31,091	-741	-2.4	24.9	184,634	182,830	1,804	1.0
Not Collected by the Federal Revenue Office	10.5	11,432	11,508	-76	-0.7	11.4	84,139	74,800	9,340	12.5
Transfers by Revenue Sharing (B)	100.0	20,508	18,917	1,591	8.4	100.0	131,444	121,994	9,450	7.7
FPM / FPE / IPI-EE	84.2	17,258	16,101	1,157	7.2	79.1	103,956	98,279	5,677	5.8
Constitutional Funds	3.5	722	736	-14	-2.0	3.2	4,185	4,289	-104	-2.4
Education-Salary (social contribution)	4.7	962	966	-4	-0.5	5.0	6,637	6,609	28	0.4
Financial Compensations	7.5	1,548	1,098	449	40.9	11.8	15,566	11,637	3,929	33.8
CIDE - Fuels	0.0	0	0	0	-	0.6	813	870	-57	-
Other	0.1	18	15	3	21.1	0.2	287	310	-23	-7.5
Net Revenue (C=A-B)	-	88,332	90,442	-2,110	-2.3	-	609,110	573,171	35,940	6.3
Total Expenditure (D)	100.0	105,275	111,157	-5,882	-5.3	100.0	646,188	632,053	14,135	2.2
Payroll	21.6	22,699	22,932	-233	-1.0	22.3	144,035	142,962	1,073	0.8
Income Transfers*	52.5	55,234	55,421	-187	-0.3	53.8	347,774	342,117	5,657	1.7
Subsidies and Grants (extended)**	1.8	1,876	2,049	-172	-8.4	2.5	16,403	20,306	-3,904	-19.2
Discretionary (except for Family Grant Program)	19.2	20,175	15,786	4,389	27.8	14.7	95,154	85,216	9,938	11.7
Legislative, Judiciary Branches and Prosecutor's Office (LEJU/MPU)	0.9	997	1,055	-58	-5.5	0.9	6,006	5,430	576	10.6
PAC (Growth Acceleration Program), except for MCMV	1.4	1,509	1,881	-372	-19.8	1.3	8,226	9,332	-1,107	-11.9
Extraordinary credits (excluding PAC)	0.0	22	63	-41	-64.8	0.0	178	447	-269	-60.2
Judicial Remedies	0.2	160	8,807	-8,647	-98.2	2.0	13,019	10,109	2,910	28.8
Other current spending	2.5	2,603	3,163	-560	-17.7	2.4	15,394	16,133	-739	-4.6
Primary Balance (C-D)	-	-16,943	-20,716	3,772	18.2	-	-37,078	-58,882	21,805	37.0
National Treasury and Central Bank		-2,430	-7,312	4,882	66.8		55,137	27,798	27,338	-98.3
Social Security		-14,513	-13,404	-1,109	-8.3		-92,214	-86,681	-5,533	-6.4

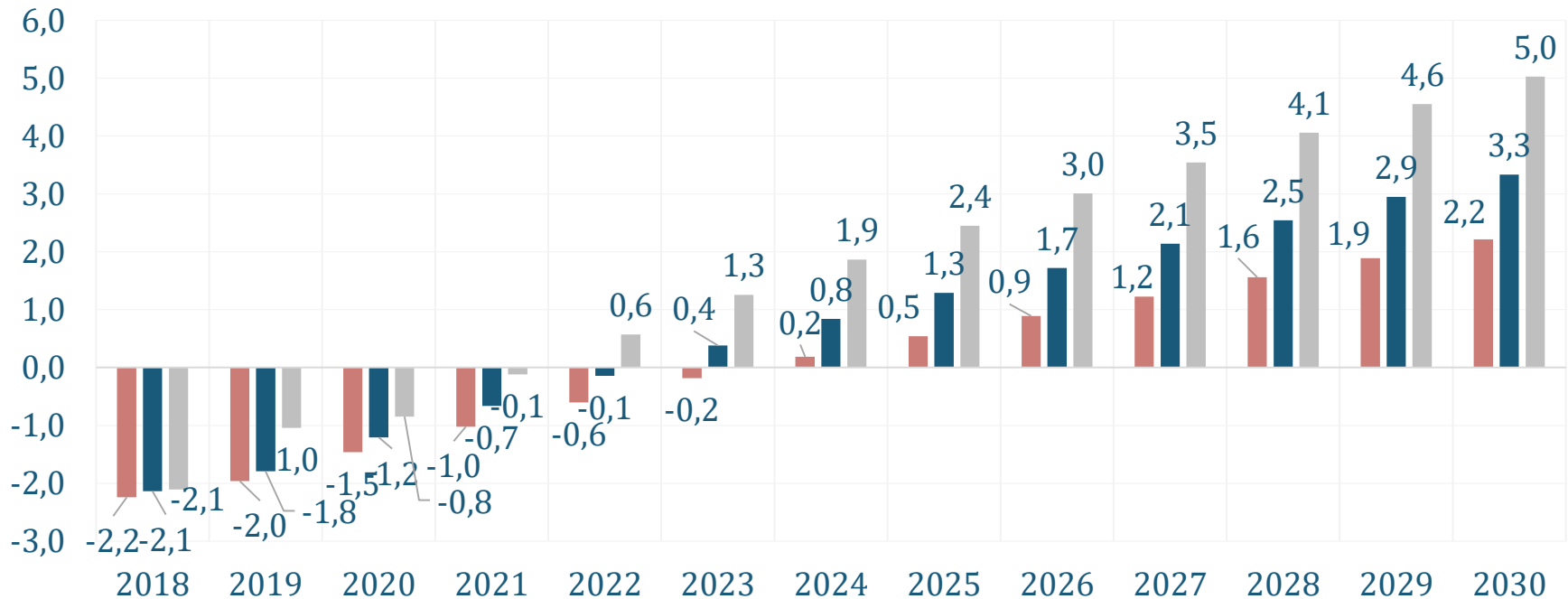
*Income transfers: Social Security benefits, Salary Allowance and Unemployment Benefit, Assistance Benefits (LOAS/RMV) and Family Grant Program.

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

- In the best-case scenario, the primary deficit reversal occurs only in 2022.

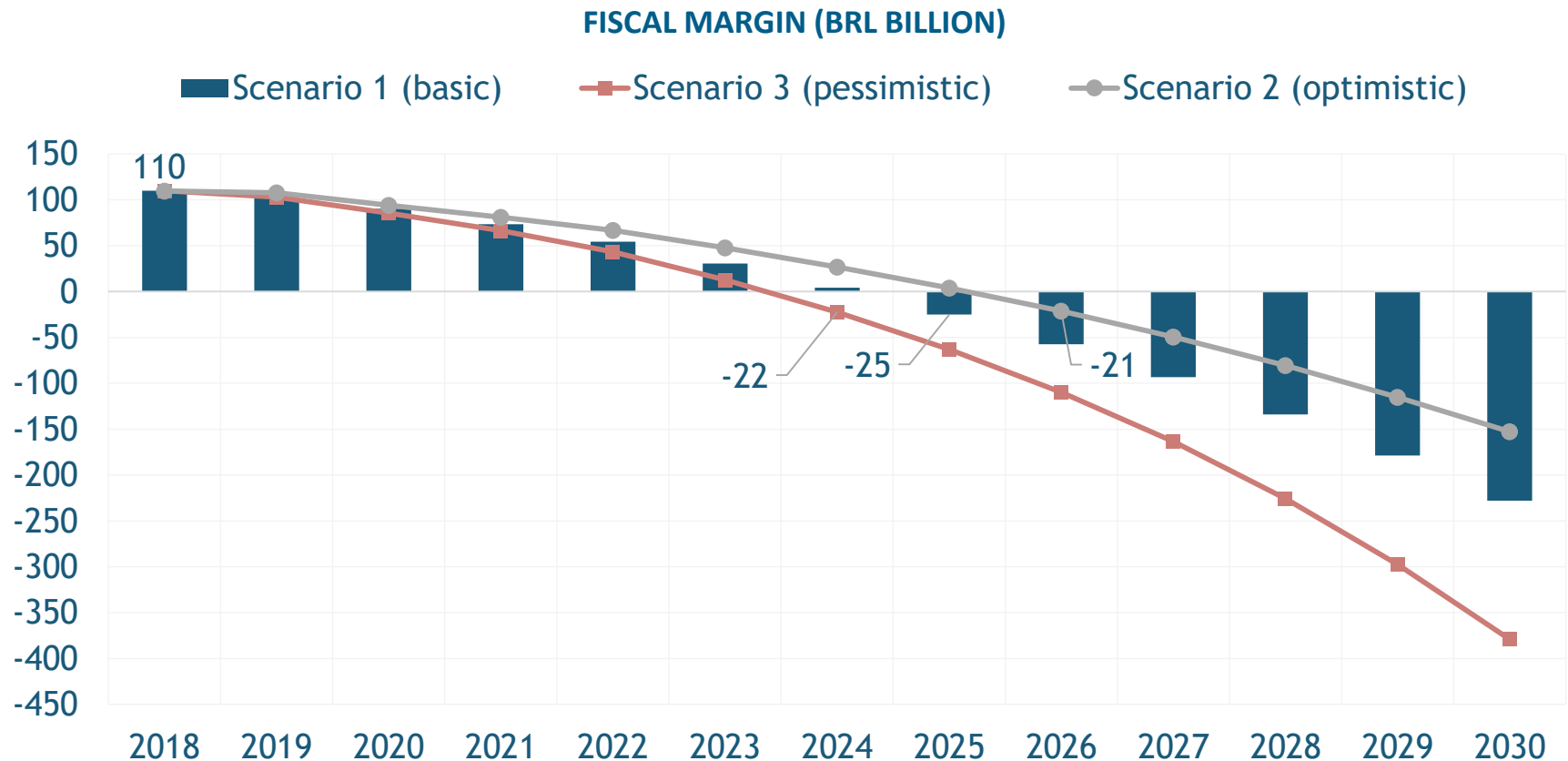
CONSOLIDATED PRIMARY BALANCE (% GDP)

■ Scenario 3 (pessimistic) ■ Scenario 1 (basic) ■ Scenario 2 (optimistic)



Source: Federal Revenue Office, National Treasury and Central Bank.

- New projection of the fiscal margin calculated by the IFI shows the possibility of fulfilling the expenditure ceiling until 2020

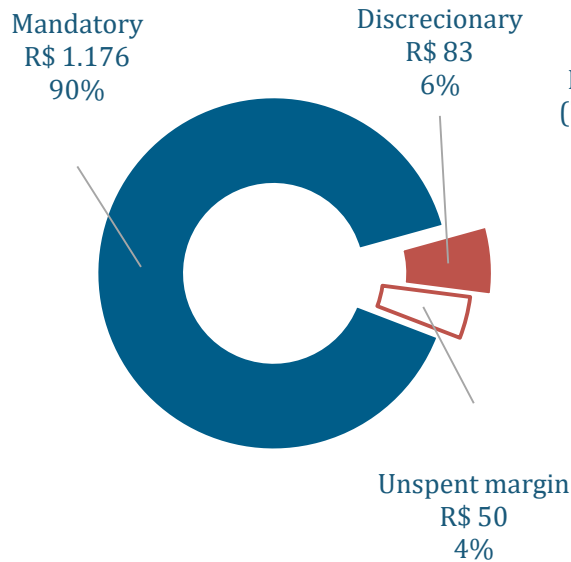


Source: Federal Revenue Office, National Treasury and Central Bank.

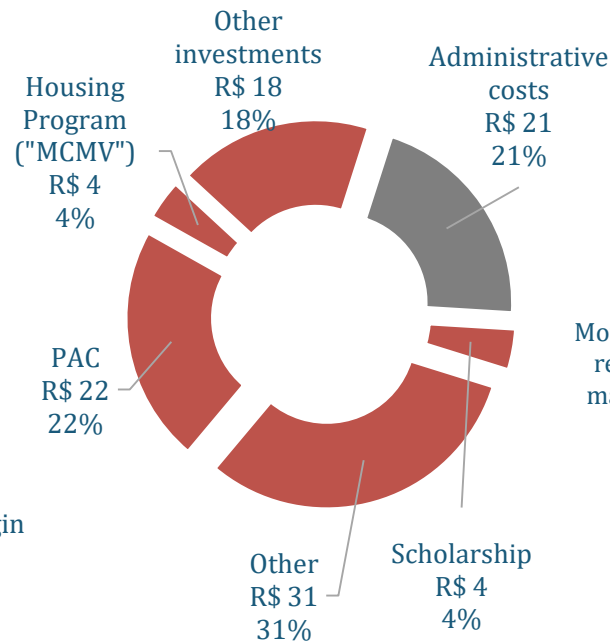
- New projection of the fiscal margin calculated by the IFI shows the possibility of fulfilling the expenditure ceiling until 2020

CENTRAL GOVERNMENT'S FISCAL MARGIN IN 2017 – BRL BILLION AND % OF TOTAL

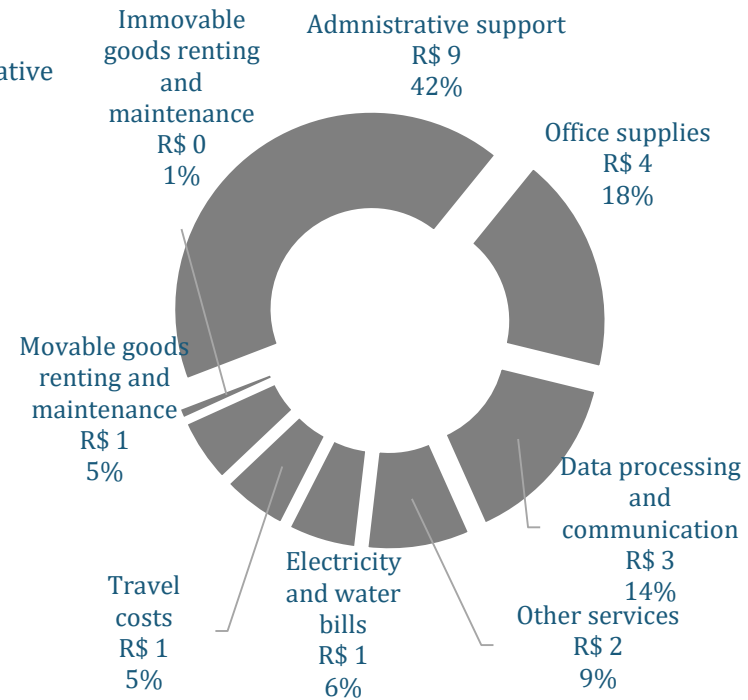
Expenses subject to the ceiling



Fiscal Margin



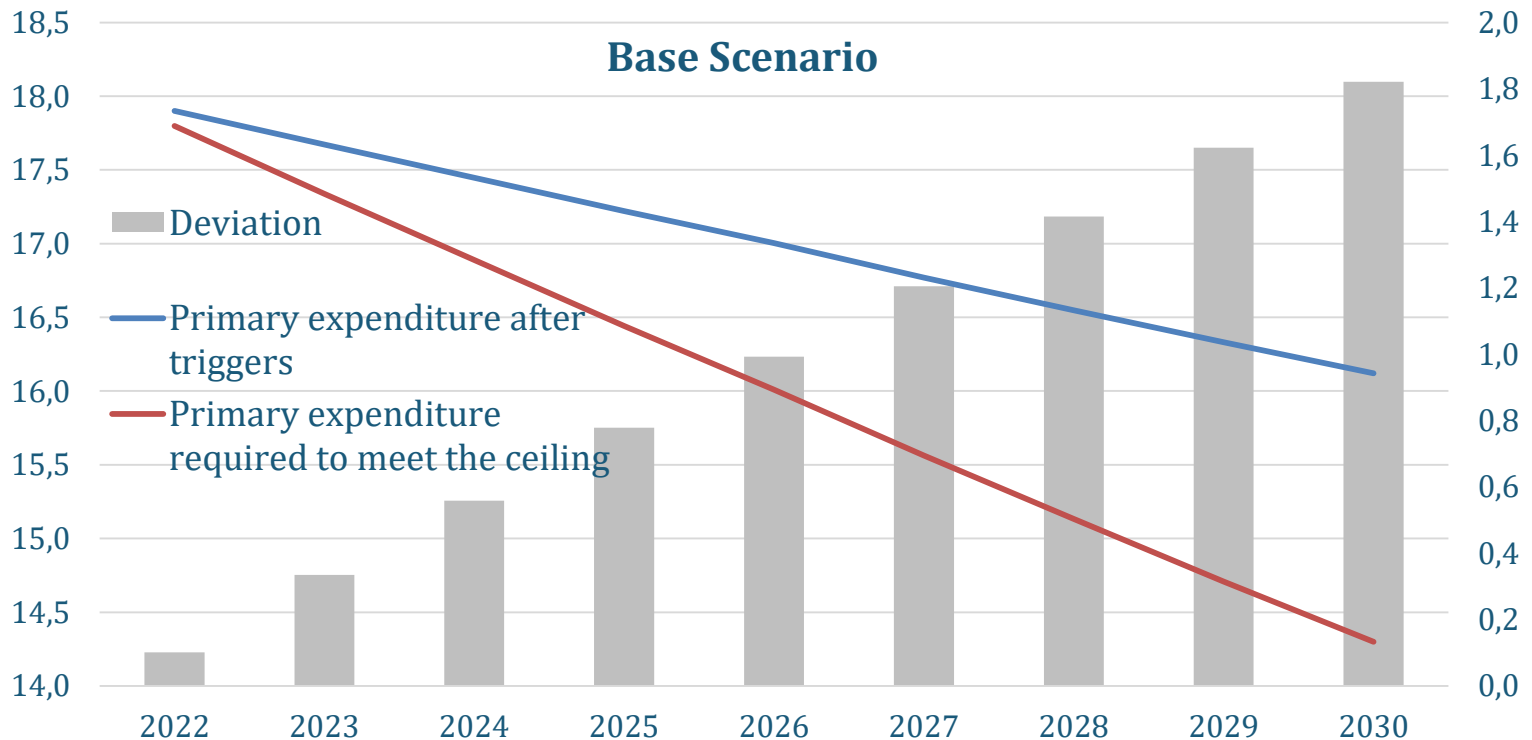
Administrative Costs



Source: Siga Brasil (Federal Senate).

- If the ceiling is breached, activation of the triggers set out in the CF/88 will not be sufficient to bring expenditure back to the level required by the rule

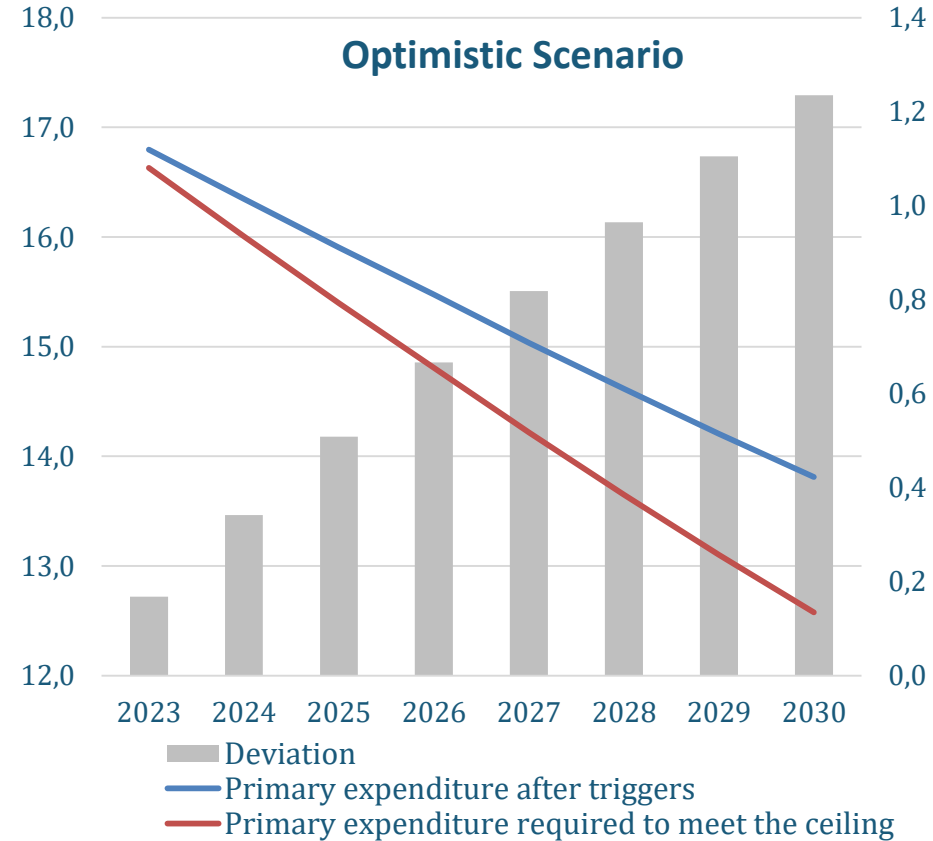
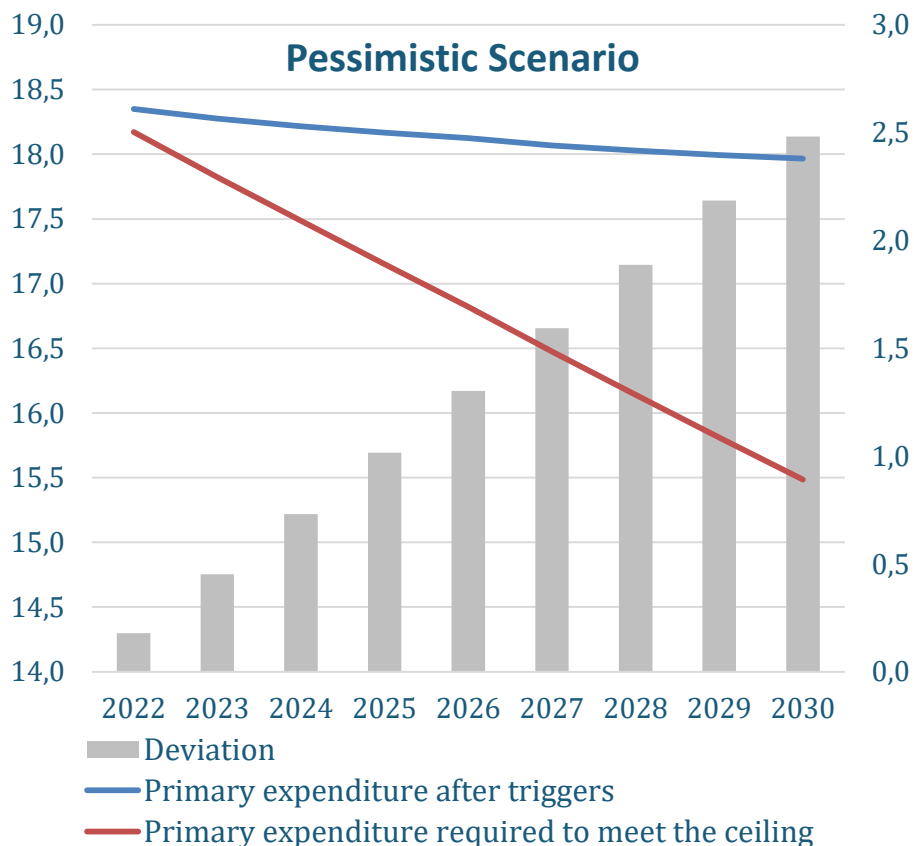
PRIMARY EXPENDITURE AFTER TRIGGERS VERSUS REQUIRED TO MEET THE CEILING (% OF GDP)



Source: National Treasury and Siafi.

- Activation of the triggers set out in the CF/88 will not be sufficient to bring expenditure back to the level required by the rule

PRIMARY EXPENDITURE AFTER TRIGGERS *VERSUS* REQUIRED TO MEET THE CEILING (% OF GDP)

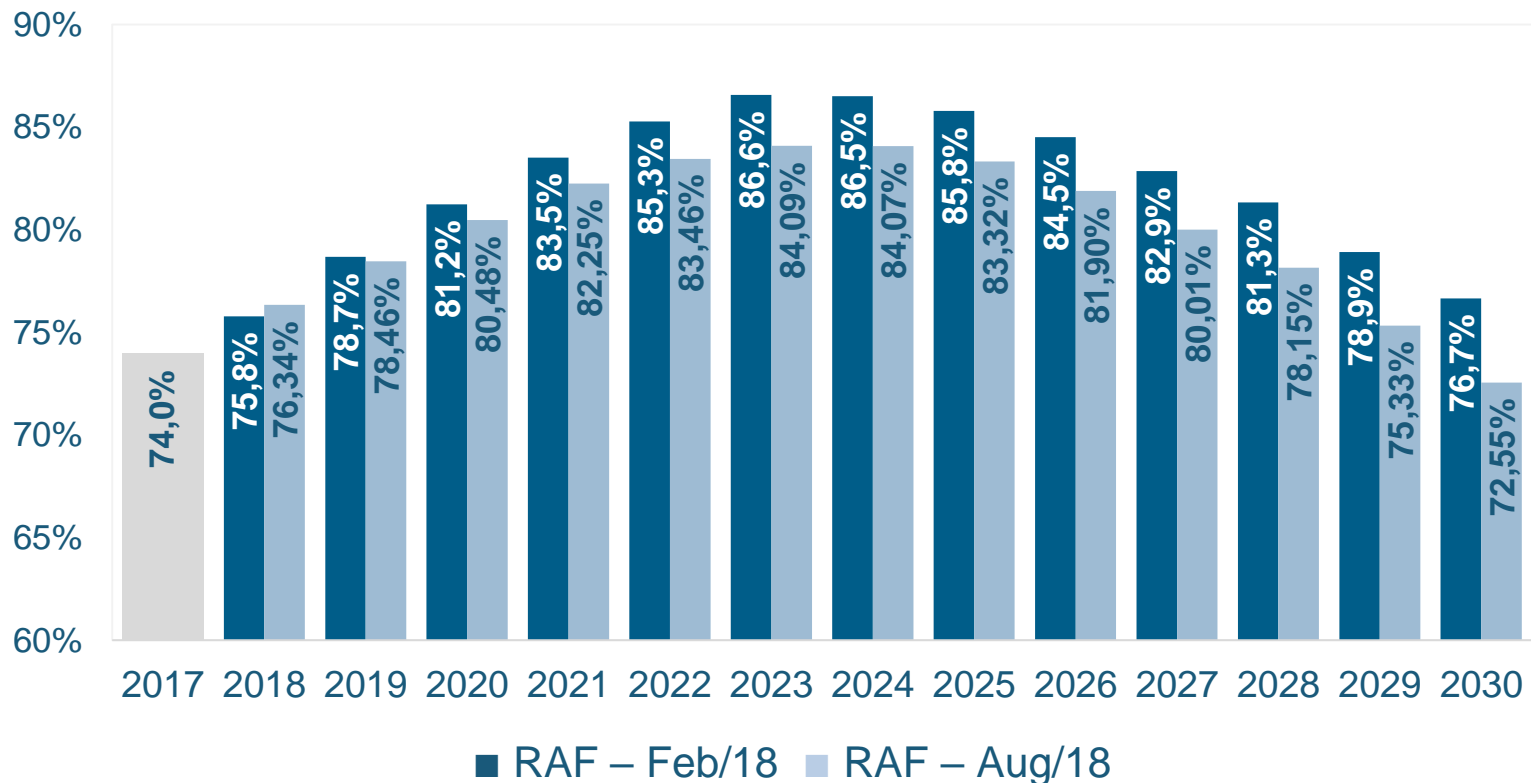


Source: National Treasury and Siafi.

Public Debt Scenarios

- The scenarios for public debt have improved significantly, but fiscal framework remains challenging.
- In the base scenario, gross debt will reach 84.1% of GDP in 2023 and 2024.

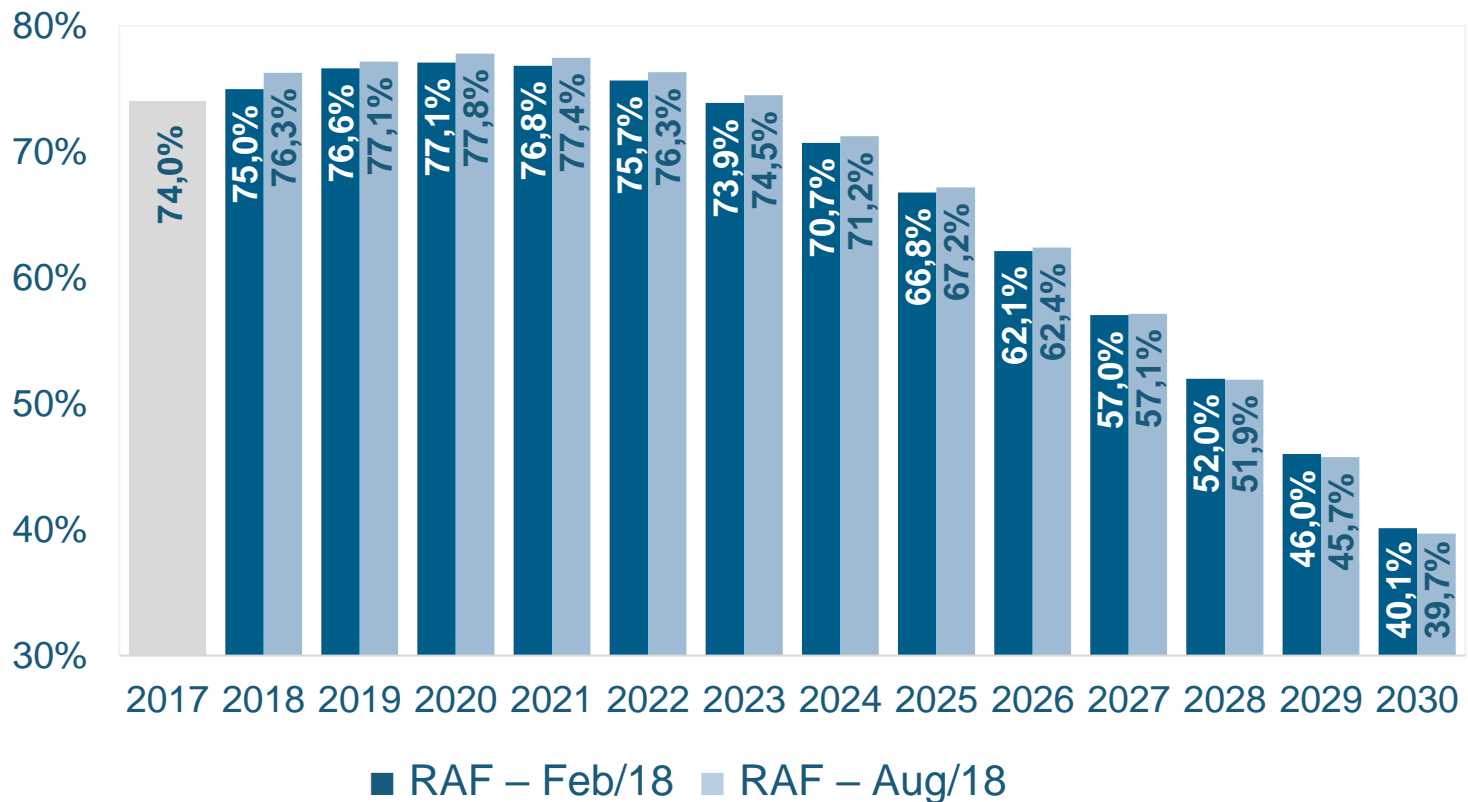
GROSS DEBT (“DBGG”) BASE SCENARIO (% OF GDP)



Public Debt Scenarios

- In scenario 2 (optimistic), the less likely for the IFI, the debt moves from 74%, in 2017, to 77.8% of GDP in 2020, declining afterwards.
- In relation to our last review (feb/18), there was a slight worsening in the estimates.

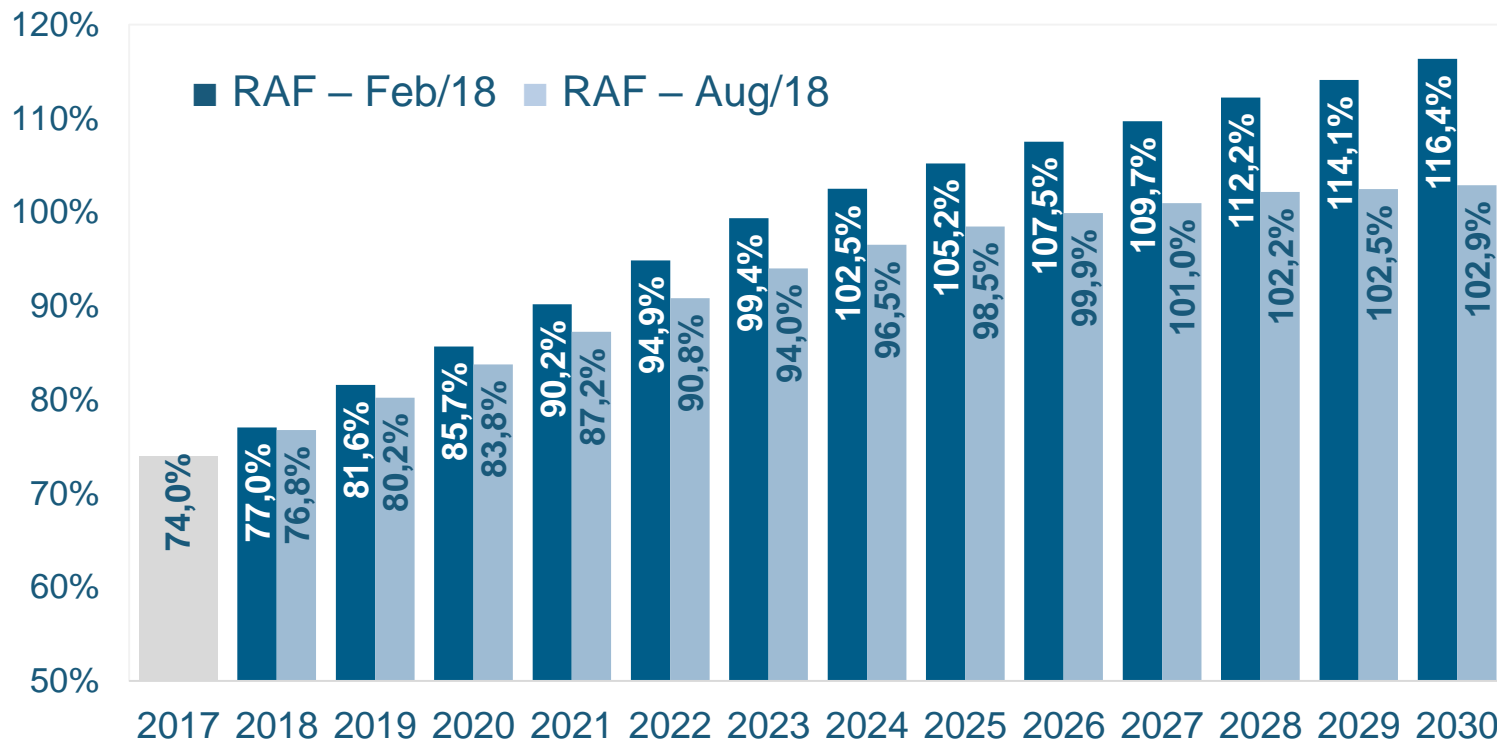
GROSS DEBT (“DBGG”) IN THE OPTIMISTIC SCENARIO (% OF GDP)



Public Debt Scenarios

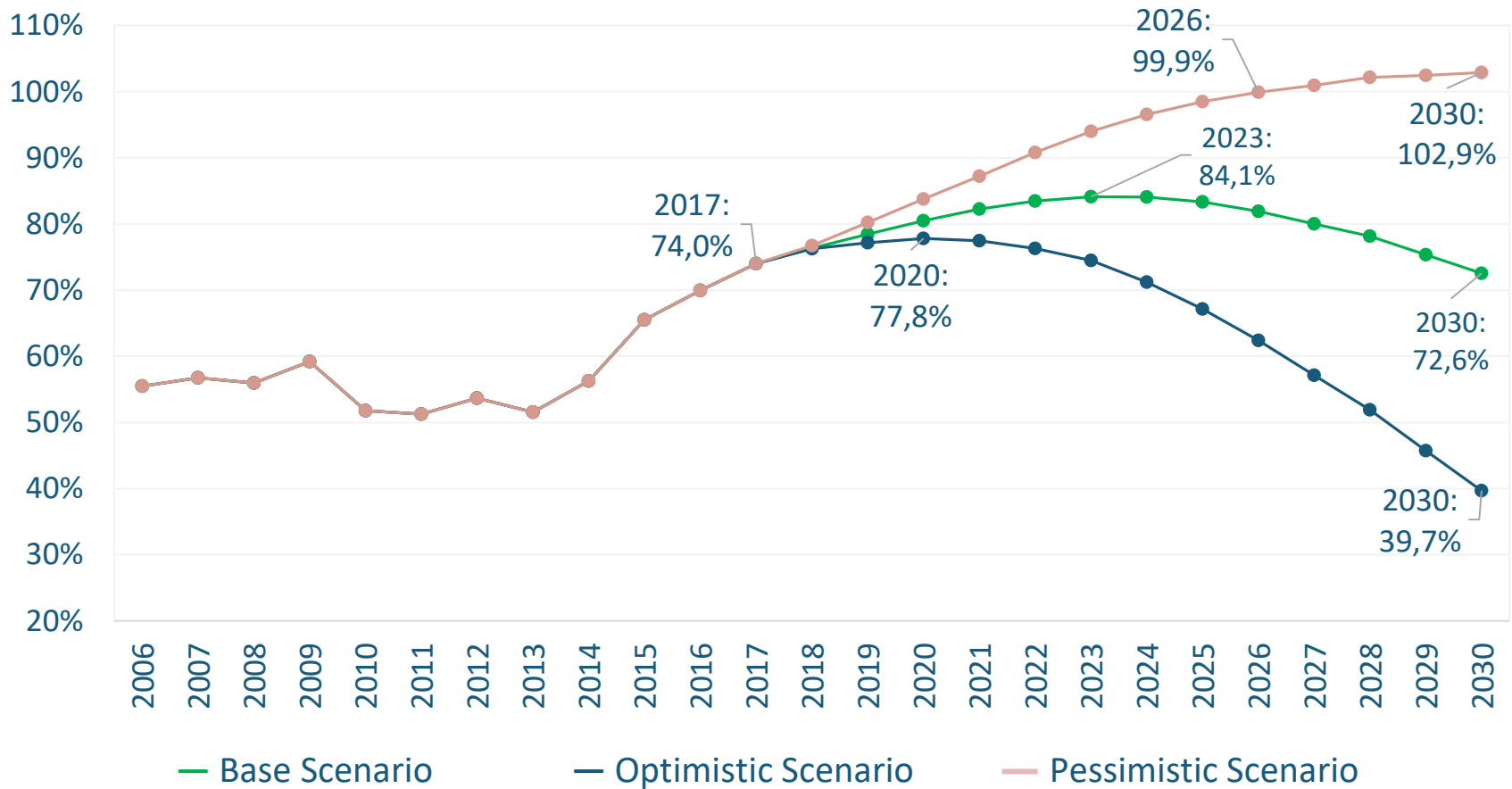
- In scenario 3 (pessimistic), the second most likely to the IFI, there has been a reduction in the entire curve until 2030
- The upward trajectory throughout the predictive horizon persists, but in a much more moderate pace. The level of 100% of GDP moved from 2023/2024 to 2026/2027

GROSS DEBT (“DBGG”) IN THE PESSIMISTIC SCENARIO (% OF GDP)



Public Debt Scenarios

GROSS DEBT SCENARIOS – AUGUST 2018 (% OF GDP)



- After the 1st semester, deficit projected by the Executive reaches BRL159.0bn in 2018, equivalent to the target
- Primary expenditure also advanced and is very close to the expenditure ceiling
- Better revenue projections in future reviews may not be used to enlarge expenses subject to the ceiling
- Deficit projected by the IFI is BRL156bn, lower than the target, and the distance to the ceiling is BRL15.0bn

PRIMARY BALANCE – BUDGET LAW X OFFICIAL UPDATES X IFI (BRL BILLION AND % GDP)

Breakdown	2018								IFI - Decree 9.452/18	
	Budget Law		May Update (Decree 9.390/2018)		July Update (Decree 9.452/2018)		IFI (RAF 19)			
	BRL BN	% GDP	BRL BN	% GDP	BRL BN	% GDP	BRL BN	% GDP	BRL BN	Diff. %
I. TOTAL REVENUE	1,462.1	21.0	1,470.6	21.2	1,482.2	21.3	1,468.9	21.1	-13.3	-0.9
II. TRANSFERS BY REVENUE SHARING	244.2	3.5	247.6	3.6	256.1	3.7	250.5	3.6	-5.6	-2.2
III. NET REVENUE (I-II)	1,217.8	17.5	1,222.9	17.6	1,226.1	17.6	1,218.4	17.5	-7.7	-0.6
IV. TOTAL EXPENDITURE	1,373.4	19.8	1,375.7	19.8	1,385.1	19.9	1,374.4	19.7	-10.7	-0.8
V. CENTRAL GOVERNMENT PRIMARY BALANCE	-155.5	-2.2	-152.8	-2.2	-159.0	-2.3	-156.0	-2.2	3.0	-1.9

PRIMARY EXPENDITURE CEILING IN 2018 (BRL BILLION)

Breakdown	Budget Law	Update				IFI (RAF 19)
		February	March	May	July	
Total primary expenditure	1,617.6	1,615.5	1,620.4	1,623.4	1,639.3	1,616.7
Excluded expenses	269.7	270.5	273.9	275.9	292.1	283.9
Expenditure subject to the ceiling	1,347.9	1,345.0	1,347.4	1,347.4	1,347.2	1,332.9
Ceiling	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	0.7	15.0

Source: Ministry of Planning and IFI.

- Realized data until June suggests that, in general, government projections for revenues are consistent with the behavior throughout the year, while, in the case of expenditure, projections have remained relatively conservative since the beginning of 2018
- In total, expenditure in the first semester was BRL27.5bn below projected in February. Even so, official projections grew BRL13.5bn in the period

Primary expenditure - difference between executed and projected - Jan-Jun/2018 (BRL Million)

■ Year projection change ■ Executed minus projected - 1st semester

