Instituição Fiscal Independente

SENADO FEDERAL

Fiscal Follow-up Report

December 2018

Full report [here](#) (portuguese)

Felipe Salto

Executive Director

December 10th, 2018

Summary

- In spite of systematic, the expansion of the GDP over the last 7 quarters (between March 2017 and September 2018) has not yet been enough to bring the economy back to the pre-crisis level. The stagnation of the construction sector in a 30.6% still distant from the pre-crisis level, has handled the recovery of industry and investment.

- The Public Sector Net Debt (DLSP) reached 53.3% in October 2018, down from 52.2% in September and 50.7% in October 2017. It is the highest value since December 2006, at least. The elevation of September to October occurred despite the fall in General Government Gross Debt (DBGG) of 77.2% to 76.5% of GDP.

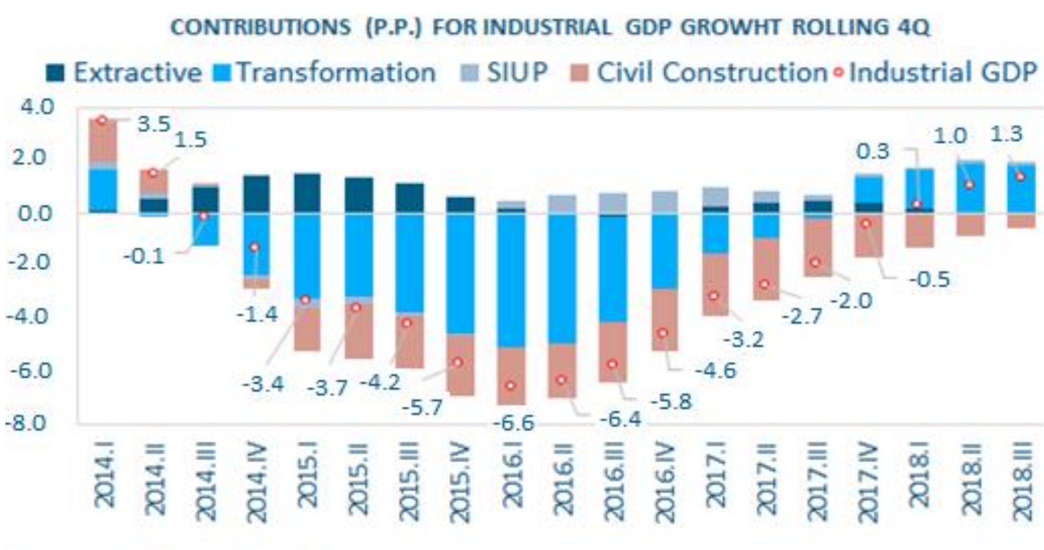
- In November, the Executive projection for the Central Government's primary deficit in 2018 remained in BRL 159 billion, equal to the goal of the year. The National Treasure, however, admits that the deficit in 2018 could be well short of the goal. The deficit projected by the IFI is BRL 137.5 billion and the difference to the official projection is due basically to the expenditure, which has been shown to be much lower than expected initially.

- The latest government fiscal projections incorporate data from execution of the first ten months of the year. The revenue collection turned out better than expected in February and the new revenue projections, to some extent, reflect that performance. In the case of expenditure, the execution was well below the originally intended, but official projections have not yet been reviewed compatibly.

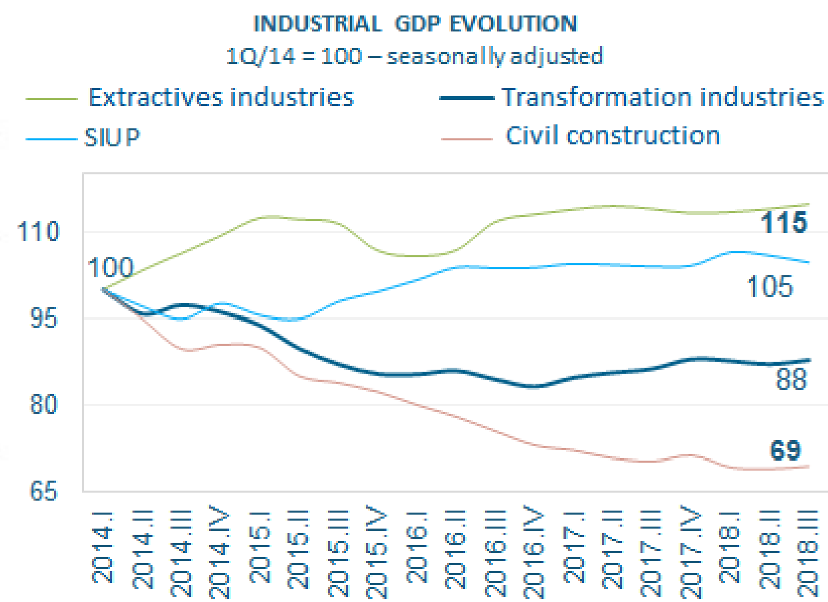
- Brazil has levels of social spending and taxes (20.7% and 32.3% of GDP) a little below the average of the OECD countries (21.1% and 34.2% of GDP). In the case of Brazil, the social spending estimates correspond to 20.7% of GDP.

Macroeconomic Context

- After 3rd quarter of 2018, economy offers persistent recovery, but still not enough to put the country on the pre-crisis level (1st Qtr/2014). The manufacturing industry and civil construction are 12% and 30% below the pre-crisis level, respectively. In our base scenario, the level of the beginning of 2014 will only occur in 2020.
- Civil construction has insured the industry recovery. The industrial GDP growth rate measured accumulated in four quarters (1.3%) has been driven since the end of last year, by the transformation industry. In the third quarter of 2018, it accumulated the high of 3.1% and impacted in 1.7 percentage points the industrial GDP. On the other hand, the contribution of the civil construction (-2.5% and -0.5 p.p.) is negative for the 16th consecutive quarter.



Source: IBGE. Elaboration: IFI.



Macroeconomic Context

- In expenditure optics, the expressive expansion of investments recorded in the third quarter is justified mainly by the performance of the gross formation of fixed capital. However, this should be viewed with some caution, because it was associated with the importation of equipment due to changes in customs procedure REPETRO.
- The internal demand exerts major role in GDP growth (1.4%). In terms of contribution, domestic absorption, composed by household consumption expenditure (1.5 percentage points), the Government (0.0 p.p.) and investments (0.7 p.p.), contributed 2.2 p.p. The external demand (net exports), on the contrary, exerted negative influence (-0.8 percentage points).
- The recovery of household consumption has been driven by: (i) increase in new concessions; and (ii) the gradual retreat of the average rates of interest. It reactivates and relieves the commitment of income of households with Bank debts.

CONTRIBUTIONS (P.P.) FOR TAX ACCUMULATED IN 4Q OF GDP

	2017.I	2017.II	2017.III	2017.IV	2018.I	2018.II	2018.III
Internal absorption	**-2.1**	**-0.9**	**0.1**	**1.0**	**1.1**	**1.7**	**2.2**
Household consumption	-1.8	-0.9	-0.1	0.9	1.5	1.6	1.5
Government consumption	0.0	-0.1	-0.2	-0.2	-0.1	0.0	0.0
Gross Fixed Capital Formation	-1.3	-1.1	-0.8	-0.4	-0.1	0.3	0.7
Stock variation*	1.0	1.2	1.1	0.7	-0.2	-0.3	0.0
Net exports	**0.2**	**-0.1**	**-0.2**	**0.1**	**0.2**	**-0.3**	**-0.8**

Source: IBGE. Elaboration: IFI.

** Corresponds to the net variation in stock of final goods and raw materials used in the production process. The rubric is used as an element for the balance between supply and demand for goods and services.*

Macroeconomic Context

- Reducing unemployment is slowly decreasing, standing at 11.7% in October. It reflects the expansion of the informal sector and in self-employment, while the busy population with officially registered in the private sector is slowing.

POPULATION OCCUPIED BY POSITION

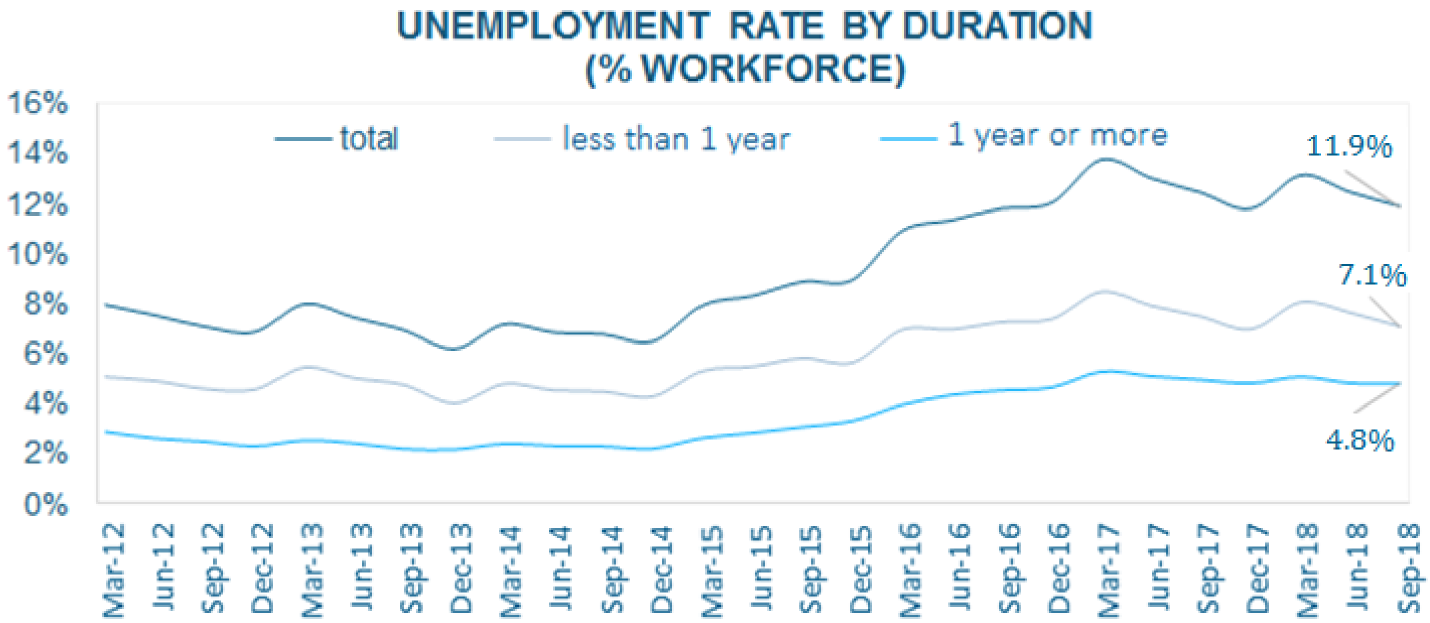
Employment indicators	Absloute values (in thousands)			Accumulated variation in 12 months			Percentage in relation to total of occupied		
	Aug/18	Sept/18	Oct/18	Aug/18	Sept/18	Oct/18	Aug/18	Sept/18	Oct/18
Population occupied	**92,081**	**92,622**	**92,901**	**1.6%**	**1.6%**	**1.6%**	**100.0%**	**100.0%**	**100.0%**
With officially registered in the private sector	32,968	32,972	32,923	-1.8%	-1.5%	-1.4%	35.8%	35.6%	35.4%
Without officially registered in the private sector	11,191	11,511	11,628	5.4%	5.0%	5.3%	12.2%	12.4%	12.5%
Domestic worker	6,302	6,259	6,264	2.9%	2.5%	2.1%	6.8%	6.8%	6.7%
Public sector	11,718	11,732	11,713	2.4%	2.5%	2.4%	12.7%	12.7%	12.6%
Employer	4,433	4,429	4,514	5.5%	5.1%	4.7%	4.8%	4.8%	4.9%
Self-employed	23,283	23,496	23,610	3.5%	3.4%	3.2%	25.3%	25.4%	25.4%
Percentage of workers who contribute to social security	**58,354**	**58,398**	**58,488**	**-0.3%**	**-0.1%**	**0.0%**	**63.4%**	**63.0%**	**63.0%**

Source: IBGE. Elaboration: IFI.

Macroeconomic Context

- The permanence in the long-term unemployment (4.8% of the labor force) affects the employability and reintegration into the labour market.

- In addition to the concern about the welfare of individuals in this condition, there is still the fear that part of this increase due to the recessive cycle recent translates also in high structural unemployment, with effect on growth of potential product of the economy.

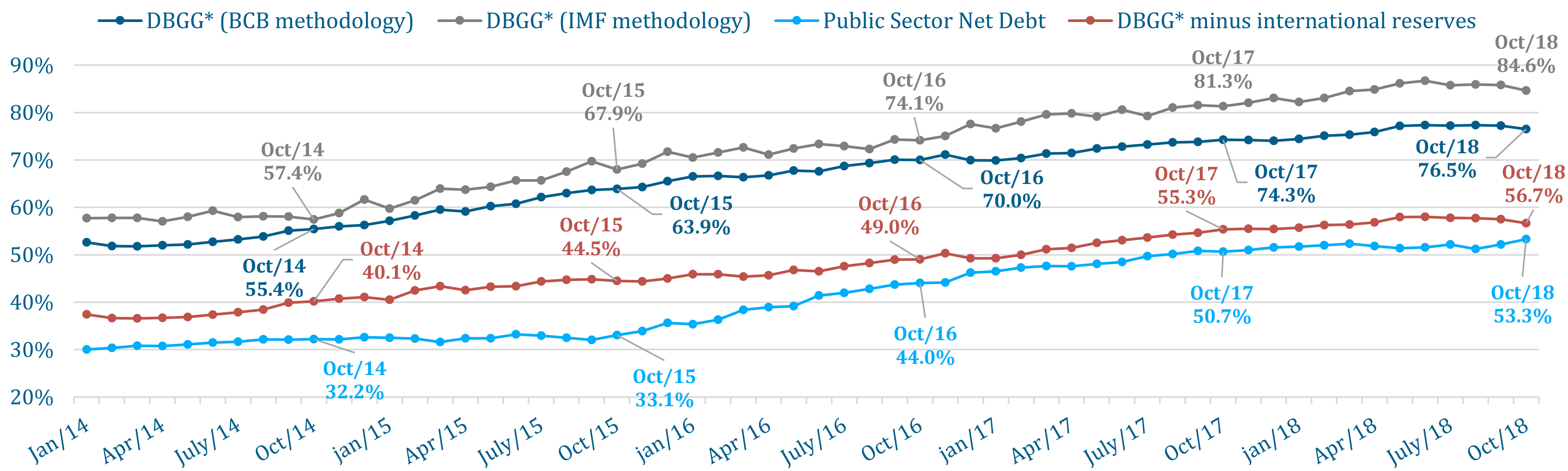


Source: PNADC microdata- IBGE. Elaboration: IFI.

Fiscal Context

- Primary deficit should close 2018 below the target, but the imbalance is still quite significant and will take until 2023 to be fully cured. Interest costs have opened some fiscal space, but a persistent improvement of fiscal framework will only occur under mandatory spending reforms, in particular, social security benefits.
- In October 2018, the Public Sector Net Debt (DLSP) reached BRL 3.6 trillion, value BRL 98.9 billion greater than September. As a percentage of GDP, the DLSP reached 53.3% in October, compared to 52.2% in September 2018 and 50.7% in October 2017.
- In Oct/18, the DLSP reached the highest value since Dec/06, despite the fall of the gross debt (DBGG).

PUBLIC DEBT OVER TIME (% OF GDP)

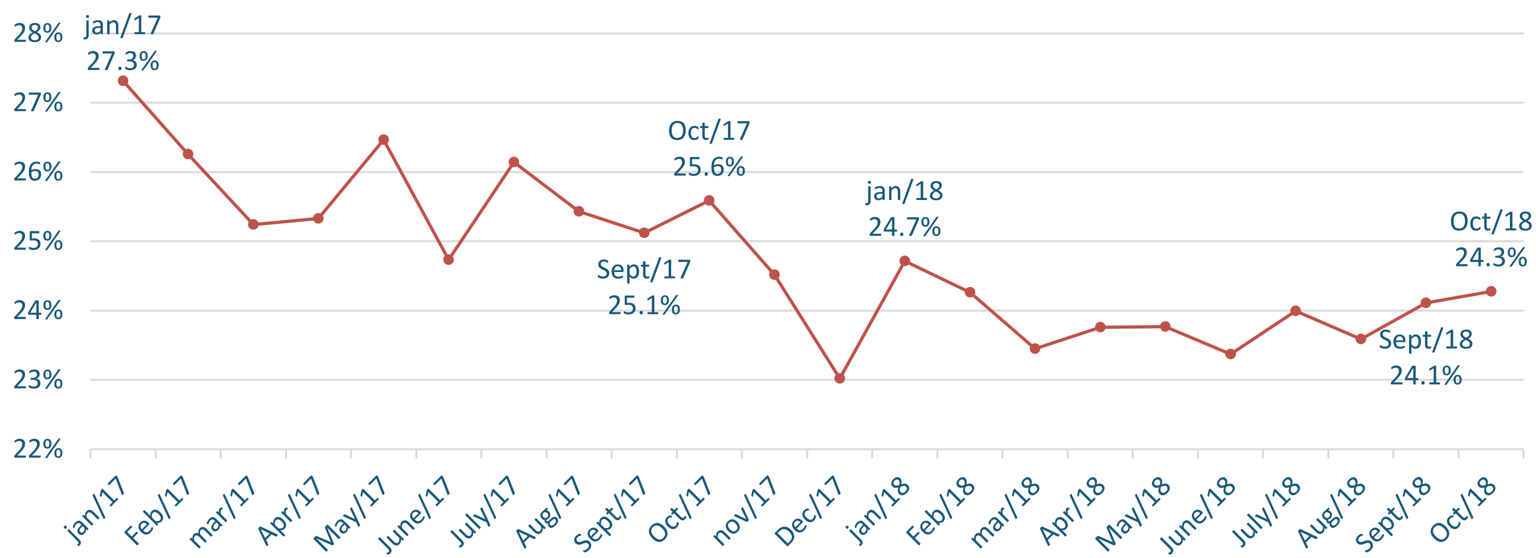


*Source: Central Bank of Brazil. Elaboration: IFI. *General Government Gross Debt.*

Fiscal Context

- The fall in the DBGG was due to the drop in domestic and external indebtedness.
- The stock of Central Bank's repo operations amounted in 7.76% between September and October 2018 and with that, its participation in domestic debt remains on track, which is located below that prevailing over 2017.

REPO OPERATIONS OF CENTRAL BANK OF BRASIL (% OF DOMESTIC DEBT)

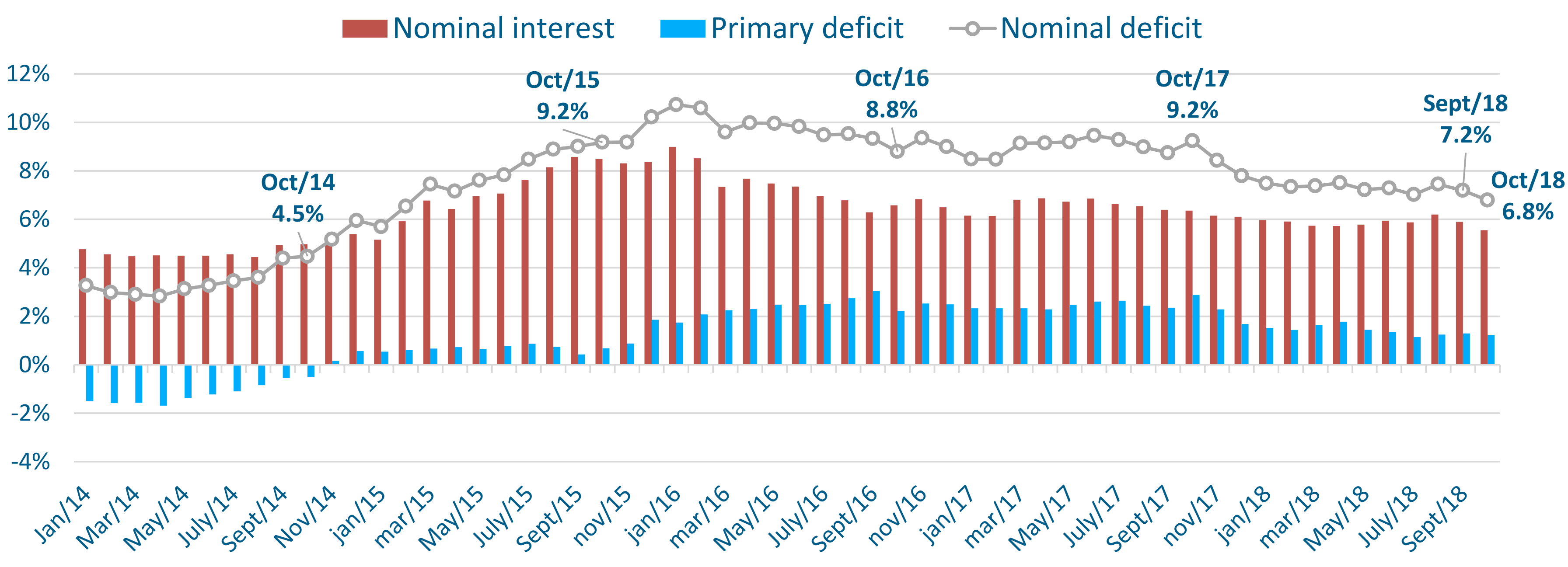


Source: Central Bank of Brazil. Elaboration: IFI.

Fiscal Context

- Fall of the primary deficit in Oct/18 reached 1.24% of GDP, the lowest percentage since December 2015 (with exception of July this year, when it hit 1.15% of GDP).
- Interest payments fell in Oct/18, mainly due to the gain of BRL 19.3 billion with swaps, largest gain for the Central Bank since July 2016.

PUBLIC SECTOR BORROWING REQUIREMENTS (% OF GDP)



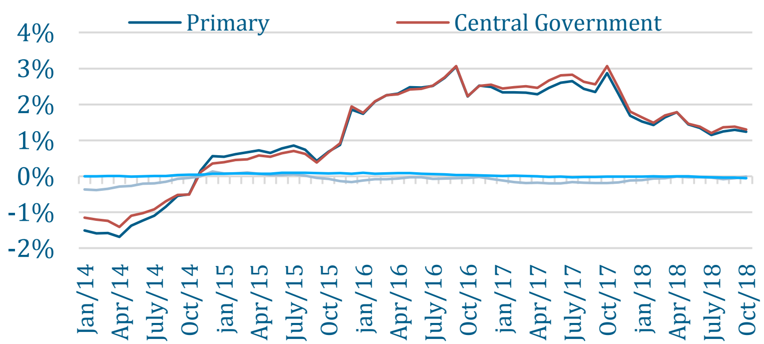
Source: Central Bank of Brazil. Elaboration: IFI. Positive values indicate deficits; negative values indicate superpluses. Each series corresponds to the sum of preceding 12 months divided by the sum of monthly GDP the same 12 months.

Fiscal Context

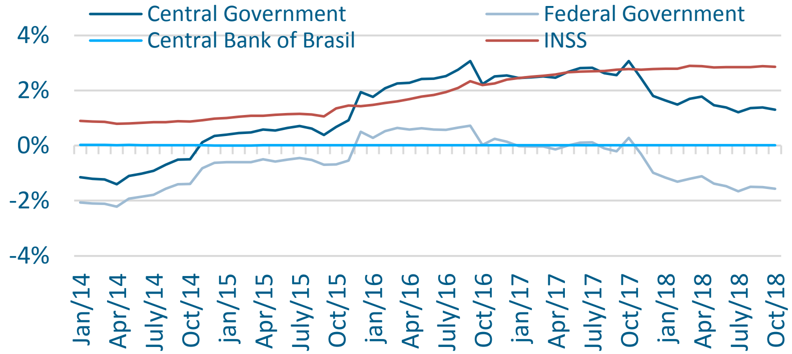
- The primary deficit of the consolidated public sector was 1.24% of GDP in Oct/18.
- Since April of 2018, the primary result of the regional governments has remained surplus (accumulated in twelve months), contributing very modestly to shoot part of the deficit of the GC in the context of the consolidated public sector.

PRIMARY DEFICIT DECOMPOSITION (% OF GDP)

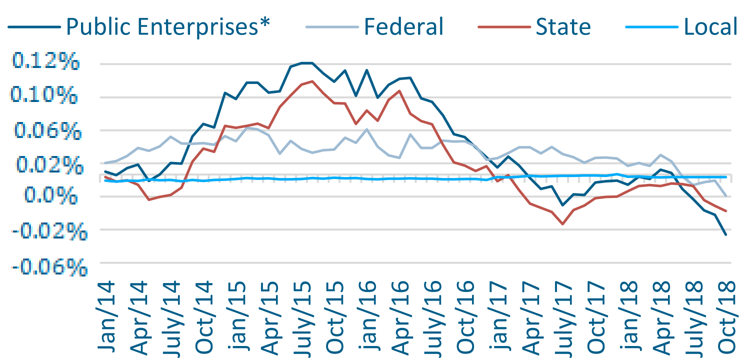
CONSOLIDATED PUBLIC SECTOR PRIMARY DEFICIT DECOMPOSITION



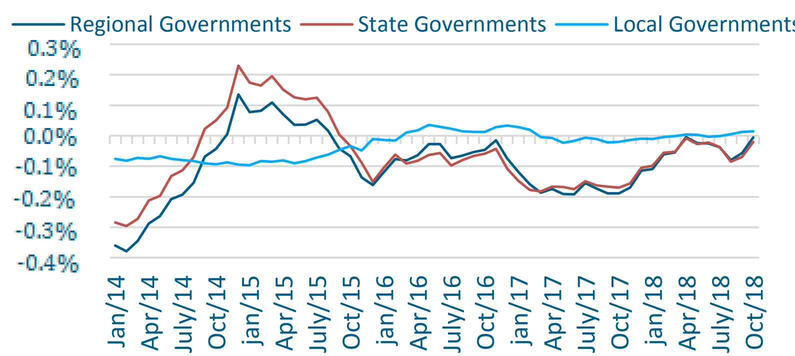
CENTRAL GOVERNMENT PRIMARY DEFICIT DECOMPOSITION



PUBLIC ENTERPRISES PRIMARY DEFICIT DECOMPOSITION



REGIONAL GOVERNMENTS PRIMARY DEFICIT DECOMPOSITION



*Source: Central Bank of Brazil. Elaboration: IFI. Positive values indicate deficits; negative values indicate superpluses. *Except Petrobras and Eletrobras. Each series corresponds to the sum of preceding 12 months divided by the sum of monthly GDP the same 12 months.*

Budget 2018

- In November, the official projection of Executive for the Central Government’s primary deficit in 2018 remained in BRL 159 billion, equal to the goal of the year. The National Treasure, however, admits that the deficit in 2018 could be well short of the goal. The deficit projected by the IFI is BRL 137,5 billion and the difference to the oficial projection is due basically to the expenditure, which the execution has been shown to be much lower than expected initially.

PRIMARY BALANCE COMPOSITION – BUDGET LAW X FINANCIAL PROGRAMMING X IFI (BRL BILLION AND % OF GDP)

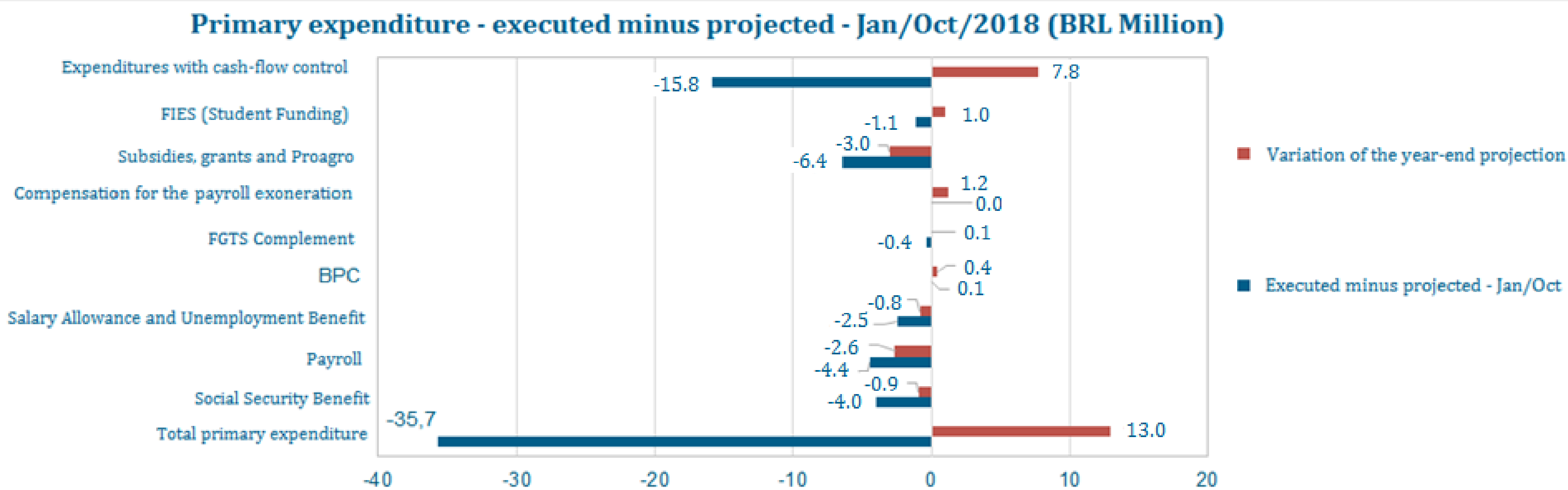
Breakdown	2018								IFI minus Decree 9.590/18	
	Budget Law		Decree 9.515/18		Decree 9.590/18		IFI (RAF 22)			
	Value	% GDP	Value	% GDP	Value	% GDP	Value	% GDP	Value	Dif. %
I. TOTAL REVENUE	1,462.1	21.0	1,486.0	21.6	1,482.5	21.6	1,476.3	21.1	-6.2	-0.4
I.1 - Revenue Collected by the Federal Revenue Office	890.3	12.8	905.1	13.2	903.7	13.2	894.6	12.8	-9.1	-1.0
I.2 - Net Social Security Revenues	405.3	5.8	390.5	5.7	389.8	5.7	393.3	2.7	3.5	0.9
I.3 - Revenue Not Collected by the Revenue Office	166.5	2.4	190.4	2.8	189.1	2.8	188.4	0.0	-0.6	-0.3
II. TRANSFERS BY REVENUE SHARING	244.2	3.5	255.9	3.7	256.9	3.7	254.8	3.6	-2.1	-0.8
III. NET REVENUE (I-II)	1,217.8	17.5	1,230.0	17.9	1,225.6	17.8	1,221.5	17.5	-4.1	-0.3
IV. TOTAL EXPENDITURE	1,373.4	19.8	1,389.0	20.2	1,384.6	20.2	1,359.0	19.5	-25.5	-1.8
IV.1 Compulsory expenses	1,091.4	15.7	1,098.2	16.0	1,096.2	16.0	1,085.8	15.6	-10.4	-0.9
Social Security Benefits	596.3	8.6	592.9	8.6	591.5	8.6	589.2	8.4	-2.2	-0.4
Payroll	296.9	4.3	300.7	4.4	299.9	4.4	303.1	4.3	3.1	1.0
Salary allowance and unemployment benefit	62.6	0.9	55.6	0.8	56.1	0.8	56.1	0.8	0.1	0.1
Assistance benefits (LOAS/RMV)	56.0	0.8	56.3	0.8	56.3	0.8	56.3	0.8	-0.1	-0.1
Payroll exoneration*	11.5	0.2	13.4	0.2	13.6	0.2	13.0	0.2	-0.5	-3.8
FUNDEB (Federal Complementation)	14.1	0.2	13.8	0.2	13.8	0.2	13.3	0.2	-0.5	-3.4
Judicial remedies	14.6	0.2	14.6	0.2	14.3	0.2	14.3	0.2	-0.1	-0.4
Subsidies and grants	20.3	0.3	19.2	0.3	19.2	0.3	13.9	0.2	-5.4	-27.8
Other	19.1	0.3	31.8	0.5	31.5	0.5	26.6	0.4	-4.9	-15.6
IV.2 Expenses with cash-flow control – all Branches	282.0	4.1	291.6	4.2	289.1	4.2	273.3	3.9	-15.9	-5.5
V. CENTRAL GOVERNMENT PRIMARY BALANCE	-155.5	-2.2	-159.0	-2.3	-159.0	-2.3	-137.5	-2.0	21.5	-13.5

Source: Ministry of Planning and IFI.

** Provisional Measures 540/11, 563/12 and 582/12*

Budget 2018

- With data held up to October, the Government's projections for the year are unrealistic. Even with better performance than expected in the revenue and expenditure, the Government report for the fifth bi-monthly budget update holds primary deficit estimates that run counter to the signs of the own National Treasure.
- Expenditure until October was well below the predicted in February. The biggest difference is in the flow control expenses (benefits to public servants, specific actions in health and education, etc.) and discretionary.
- The difference of our projections and the officers justified, in short, by: (i) incorporation, by the IFI, the "puddling", reducing projection of expenditure with cash-flow control; and (ii) reduction of projection of some items of compulsory expenditure, with a view to implementing data already available.

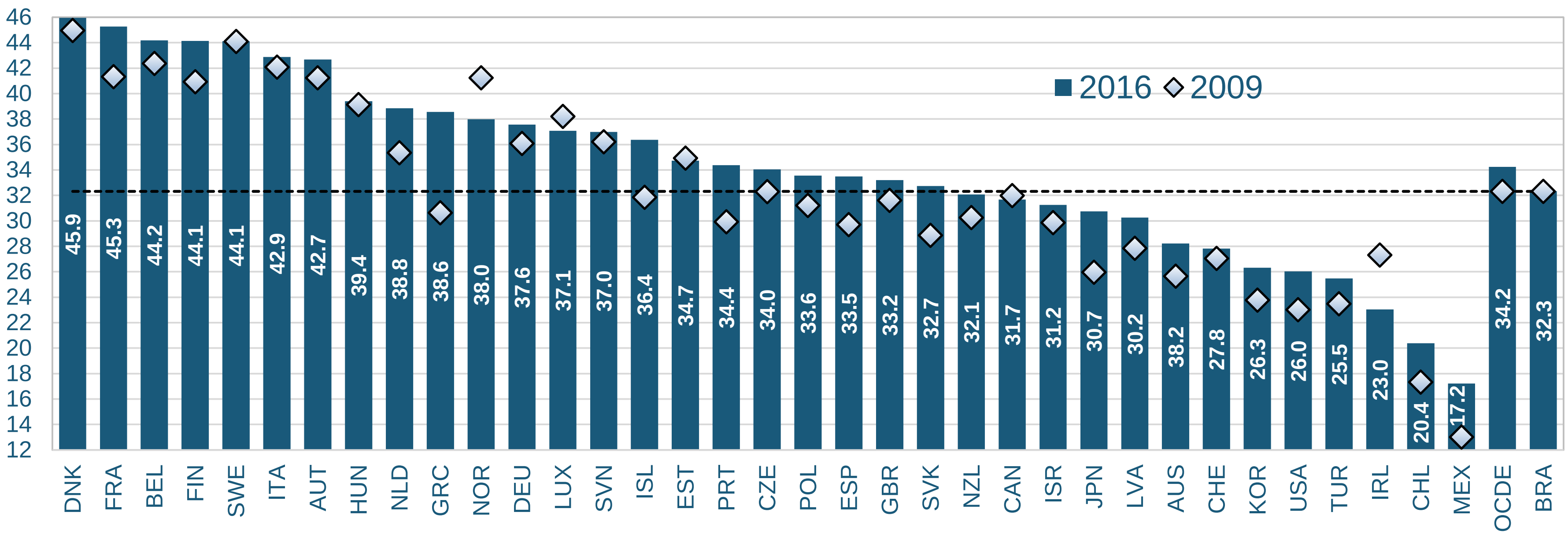


Source: Decree 9.276/2018 and updates.

Tax burden in Brazil and the OECD countries

- The more general trend of tax burden growth in the OECD countries is out of the pattern observed in Brazil. In 2009, the tax burden of 32,3% of GDP was identical to the average of the OECD countries. Since then, the brazilian load was stabilized in the 32,3% of GDP in 2016, it is situated about 2 percentage points of GDP to below the average for the OECD countries.
- The Brazil remains with highest load than the group of 13 OECD countries.

TAX BURDEN: BRAZIL AND THE OECD COUNTRIES, GDP PARTICIPATION (%) IN 2009 AND 2016

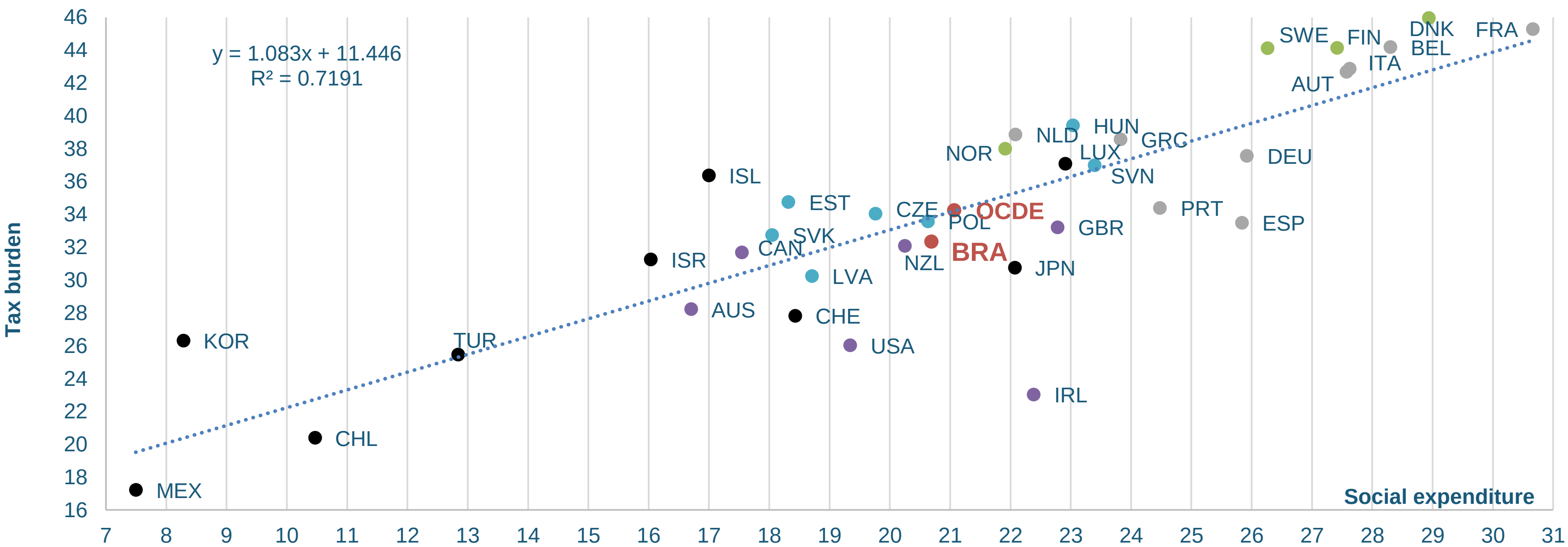


Source: Calculations of the IFI to Brazil and OECD data. Stat por the other countries: Australia (AUS), Austria (AUT), Belgium (BEL), Canada (CAN), Chile (CHL), Czech Republic (CZE), Denmark (DNK), Estonia (EST), Finland (FIN), France (FRA), Germany (DEU), Gréece (GRC), Hungary (HUN), Iceland (ISL), Ireland (IRL), Israel (ISR), Italy (ITA), Japan (JPN), South Korea (KOR), Latvia (LVA), Luxembourg (LUX), Mexico (MEX), Netherlands (NLD), New Zealand (NZL), Norway (NOR), Poland (POL), Portugal (PRT), Slovak Republic (SVK), Slovenia (SVN), Spain (ESP), Sweden (SWE), Switzerland (CHE), Turkey (TUR), United Kingdom (GBR), United States (USA), average of the 35 OECD countries and Brazil (BRA).

Tax burden in Brazil and the OECD countries

- One of the factors that most explains the size of the tax burden in Brazil, which can be considered relatively high for a developing economy, is the amount of social expenditures.
- On average, 62% of tax burden is representend by social expenditure of OECD countries. Brazil has a good grip of 64%.

TAX BURDEN AND SOCIAL EXPENDITURE: BRAZIL AND OECD COUNTRIES, GDP PARTICIPATION (%) IN 2016



Source: Calculations of the IFI to Brazil and OECD data. Stat por the other countries: Australia (AUS), Austria (AUT), Belgium (BEL), Canada (CAN), Chile (CHL), Czech Republic (CZE), Denmark (DNK), Estonia (EST), Finland (FIN), France (FRA), Germany (DEU), Gréece (GRC), Hungary (HUN), Iceland (ISL), Ireland (IRL), Israel (ISR), Italy (ITA), Japan (JPN), South Korea (KOR), Latvia (LVA), Luxembourg (LUX), Mexico (MEX), Netherlands (NLD), New Zealand (NZL), Norway (NOR), Poland (POL), Portugal (PRT), Slovak Republic (SVK), Slovenia (SVN), Spain (ESP), Sweden (SWE), Switzerland (CHE), Turkey (TUR), United Kingdom (GBR), United States (USA), average of the 35 OECD countries and Brazil (BRA).