



INTERNATIONAL MONETARY FUND



A Turning Point?

Article IV Report – 20 June 2017

Fabian Bornhorst | IMF Resident Representative | Brasília | September 2017



Main messages

- A bumper crop, FGTS-induced consumption, and a recovery in investment should bring positive growth in 2017
- Political uncertainty—a risk to the recovery
- External environment mixed

Economy at a turning point

Policy heading in the right direction...

- Ensure **fiscal sustainability**
- Consolidate **disinflation gains**
- Strengthen the **financial system**
- Strengthen **medium-term growth**

...follow-through remains essential!



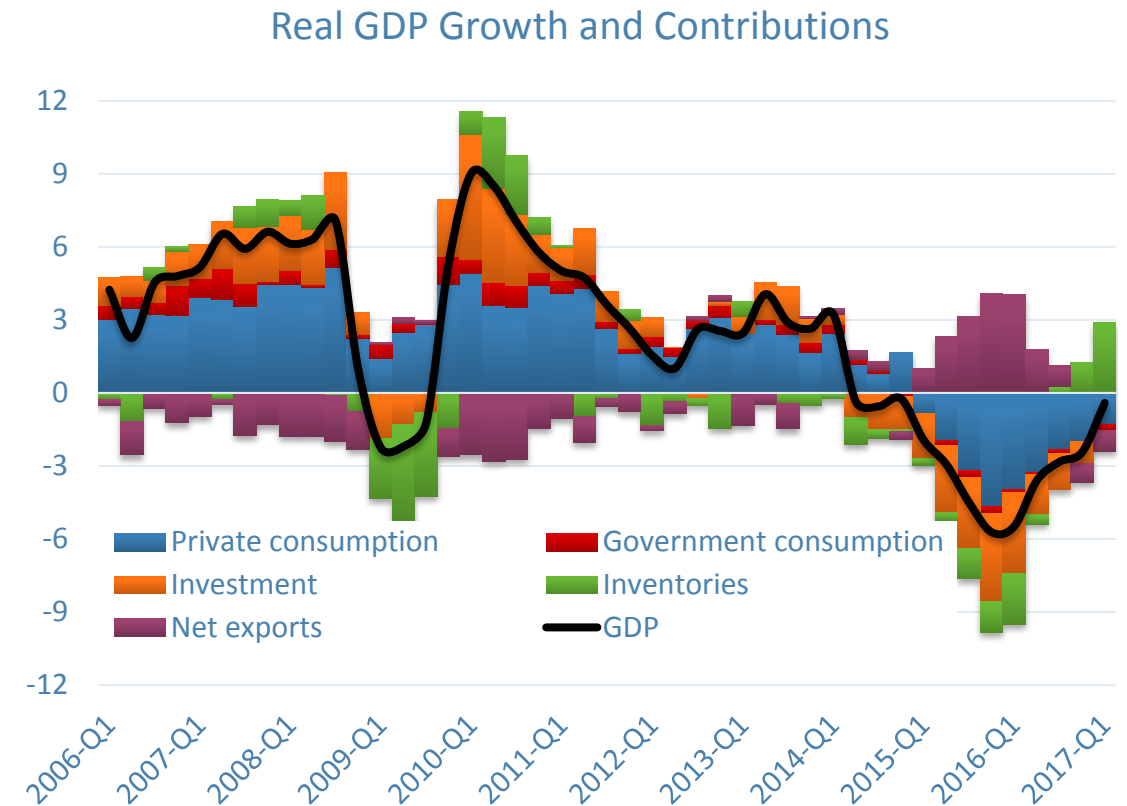
A TURNING POINT?

A turning point?

A long and deep recession

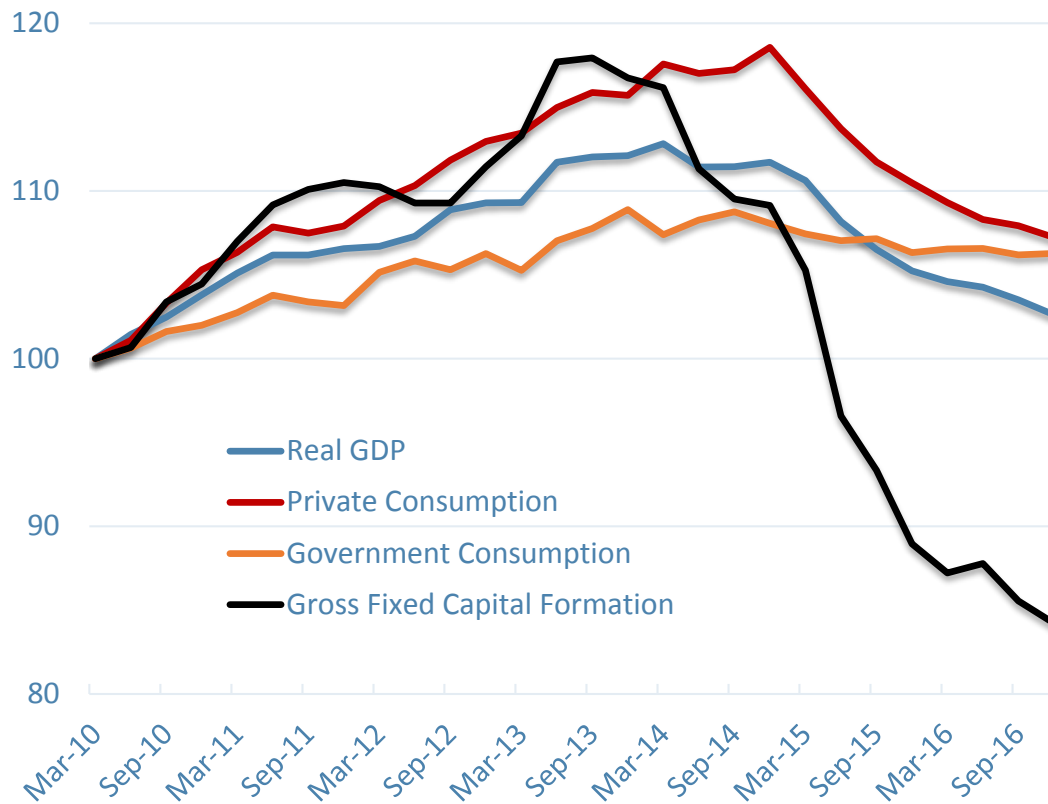
- Investment collapsed
- Consumption contracted amid labor market weakness
- Net exports positive amidst import compression
- Confidence impacted by political uncertainty and corruption probe

Positive growth to return in 2017

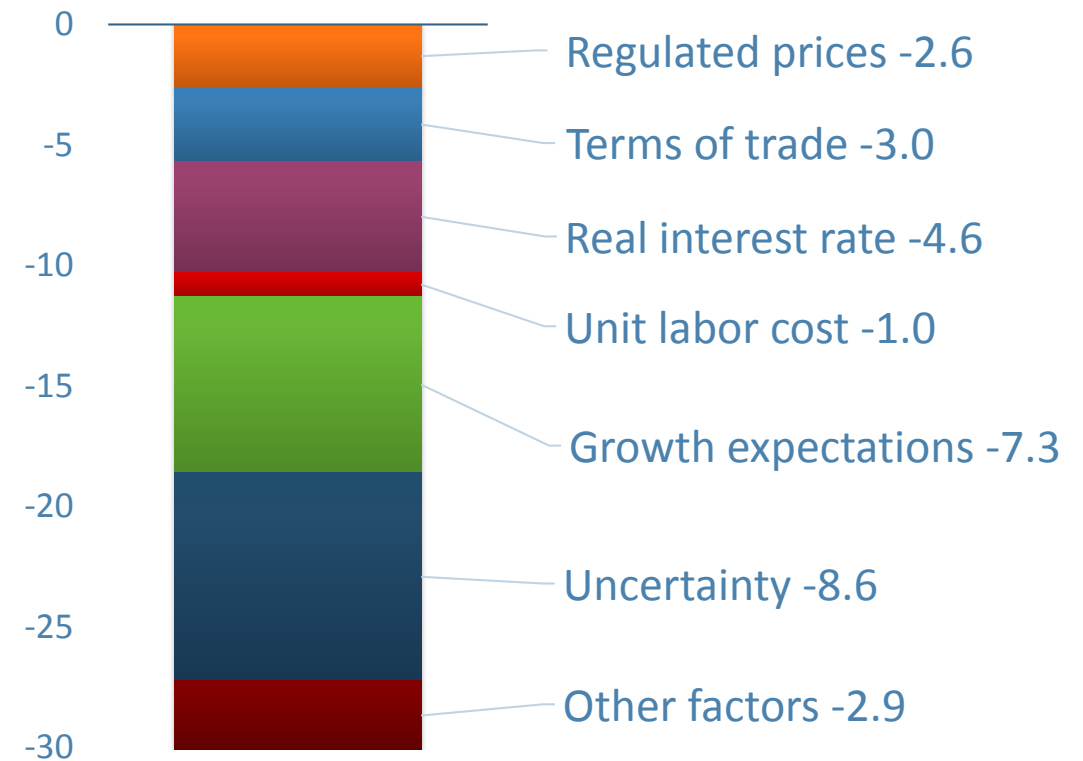


Why did investment collapse?

Brazil: National Accounts Components
(Index, 2010Q1 = 100)



Factors behind the collapse of investment
(estimated, accumulated effect since 2014)

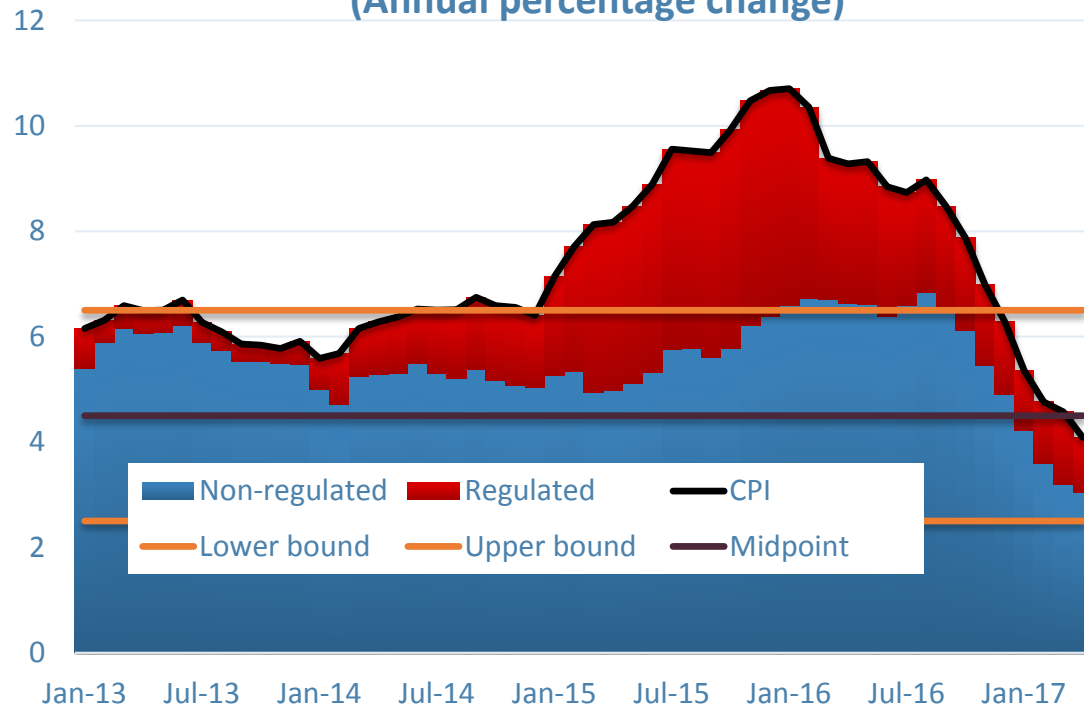




Disinflation and falling inflation expectations

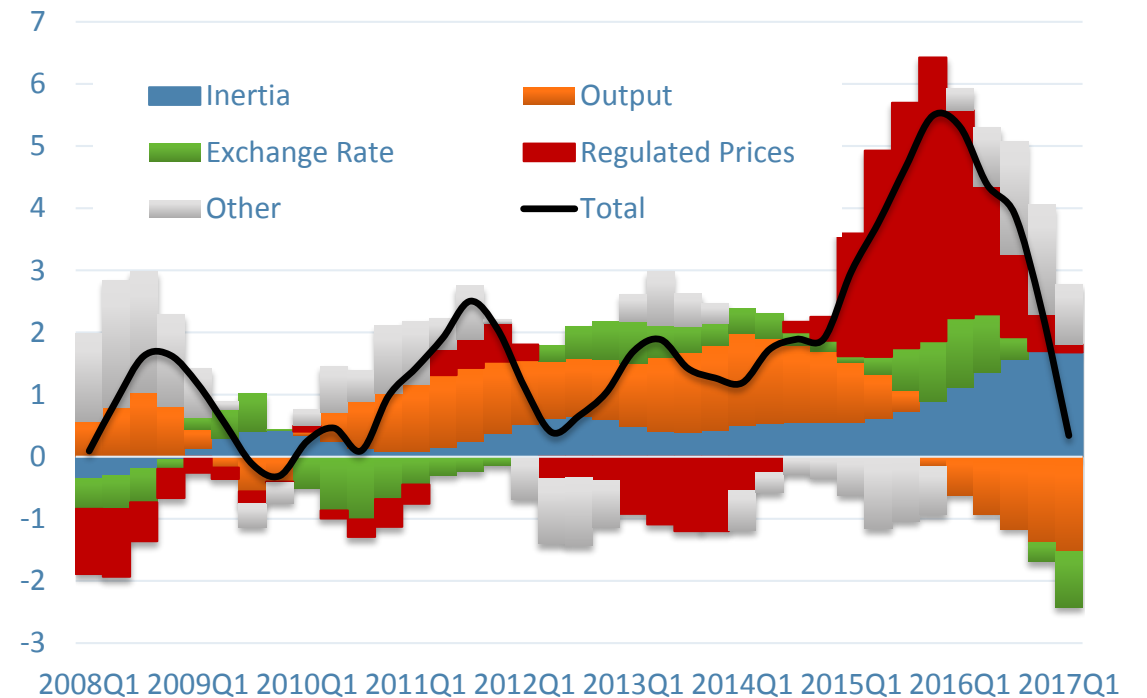
Pressure from regulated prices eased;
economic slack, FX appreciation and food price declines joined declining inflation expectations

Headline Inflation and Contributions
(Annual percentage change)



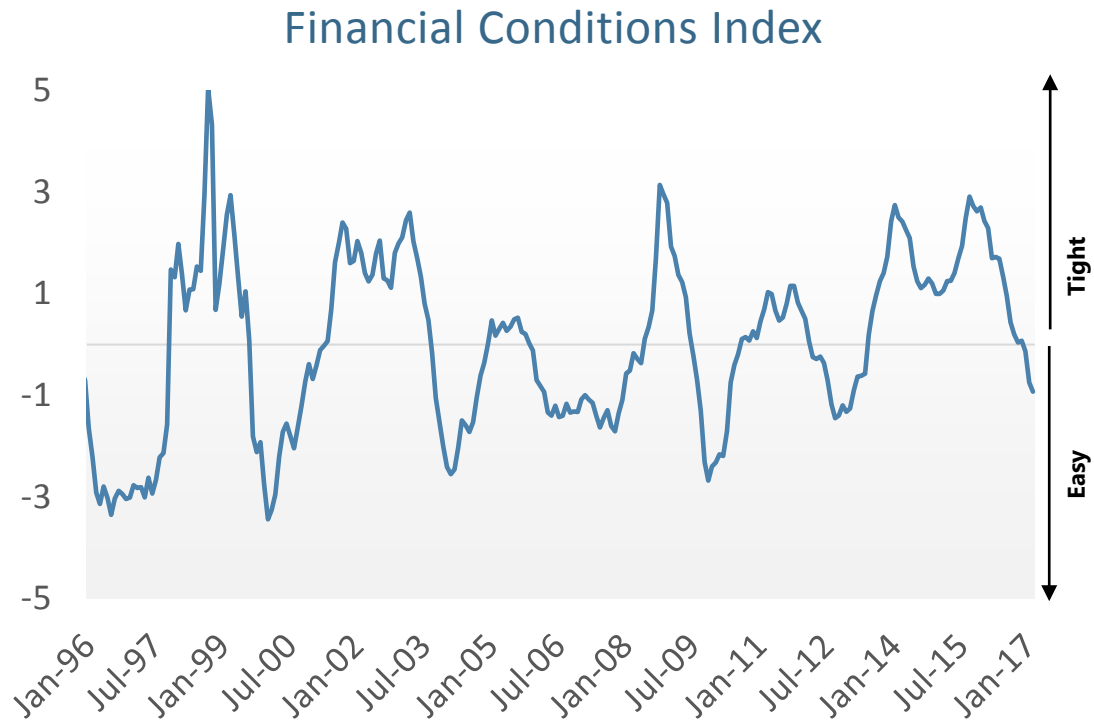
Headline Inflation and Macroeconomic Contributions

(Percent year-over-year, deviation from center of tolerance range)





Financial conditions are easing

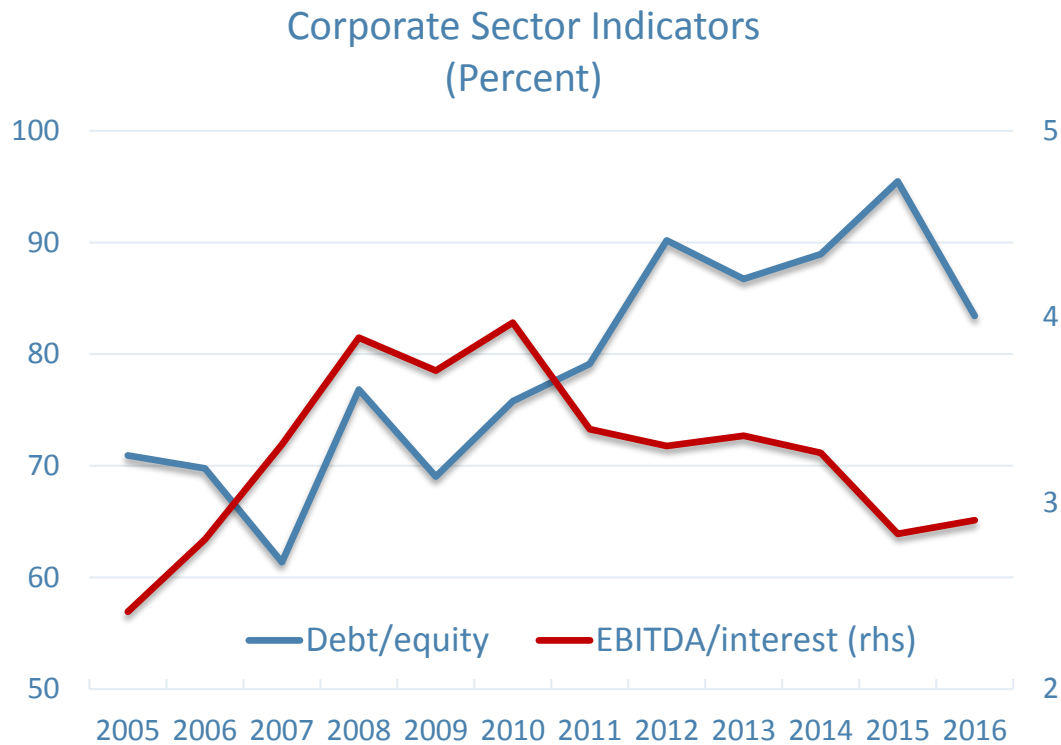


- Monetary easing is underway
- Credit cycle bottoming out?
- Increase in bad loans limited as banks renegotiate credit and write off bad loans
- Private balance sheet repair is underway

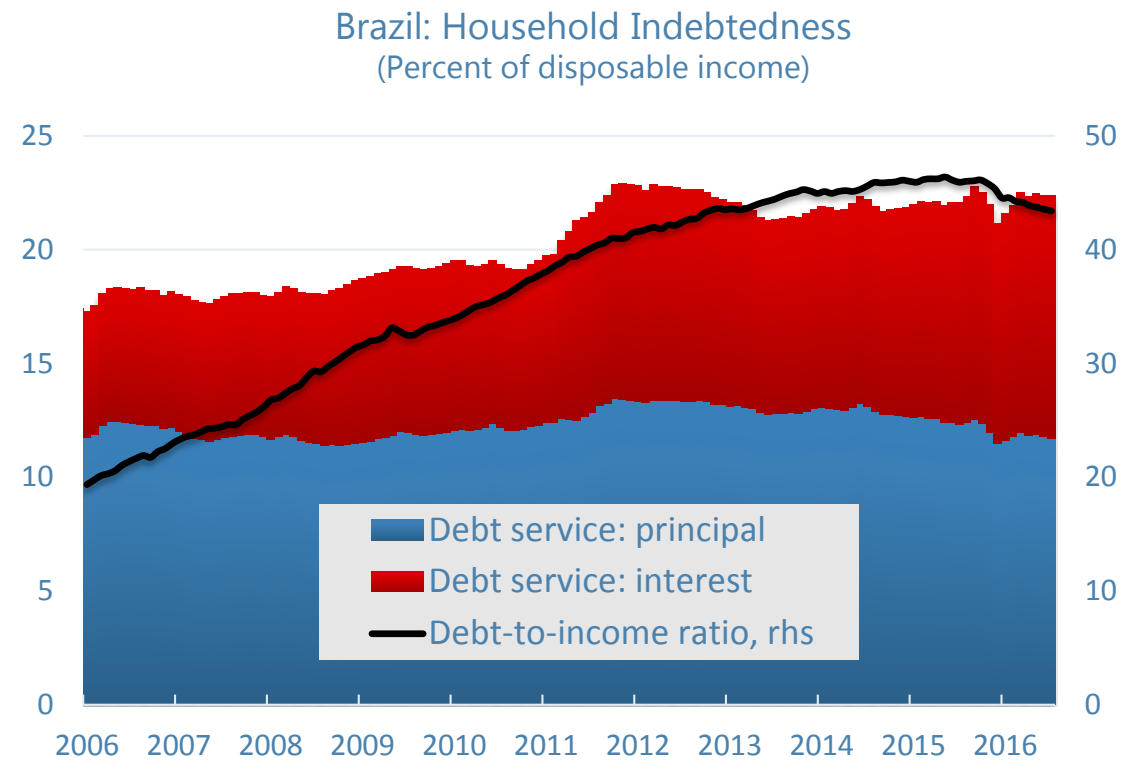


Private sector balance sheets are improving

Firm's indebtedness is high but may have peaked



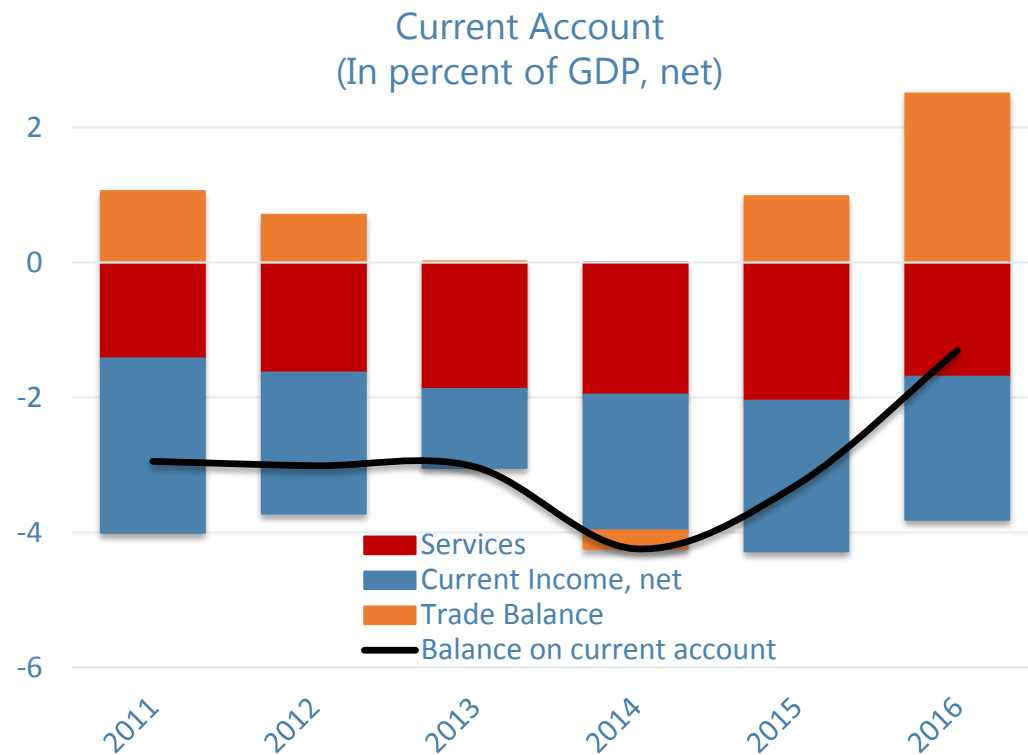
Households' debt burden is easing—slowly



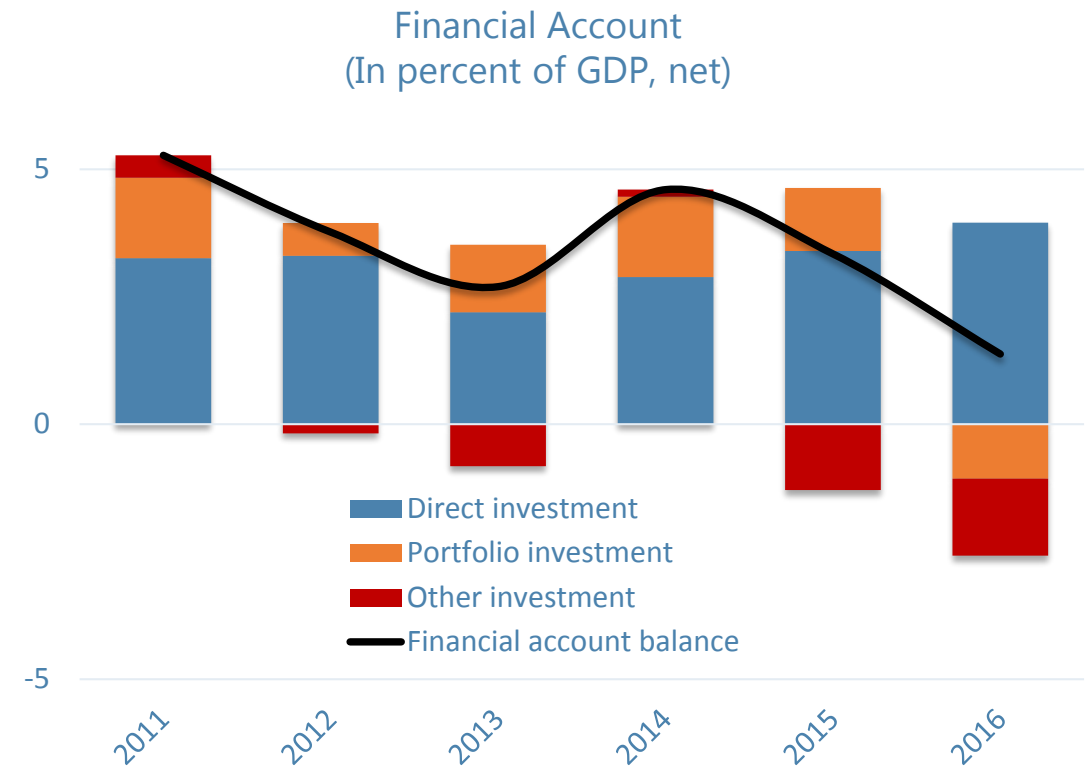


External position consistent with fundamentals

The recession has been the main driver of the current account adjustment



Portfolio liabilities turned negative in 2016—
despite improving sentiment





A subdued recovery is projected

Outlook

- Elevated political uncertainty
- Indebtedness holds back faster growth
- Inflation undershoots and unemployment remains high

	2017	2018	2019	2020	2021	2022
Growth, %	0.3	1.3	2.0	2.0	2.0	2.0
Inflation (IPCA), %	4.0	4.0	4.5	4.5	4.5	4.5
NFPS Primary Balance, % GDP	-2.1	-1.8	-1.1	-0.4	0.2	0.8
Public Debt (GFSM 2014), % GDP	81.5	85.8	88.6	90.5	91.7	92.4

Downside risks

- Political instability and spillovers from corruption investigation
- Policy uncertainty with 2018 elections looming
- Failure to enact social security reform

Upside risks

- Supply boost from agricultural output and demand impact from FGTS money



POLICIES



Policy heading in the right direction – *follow-through remains essential*

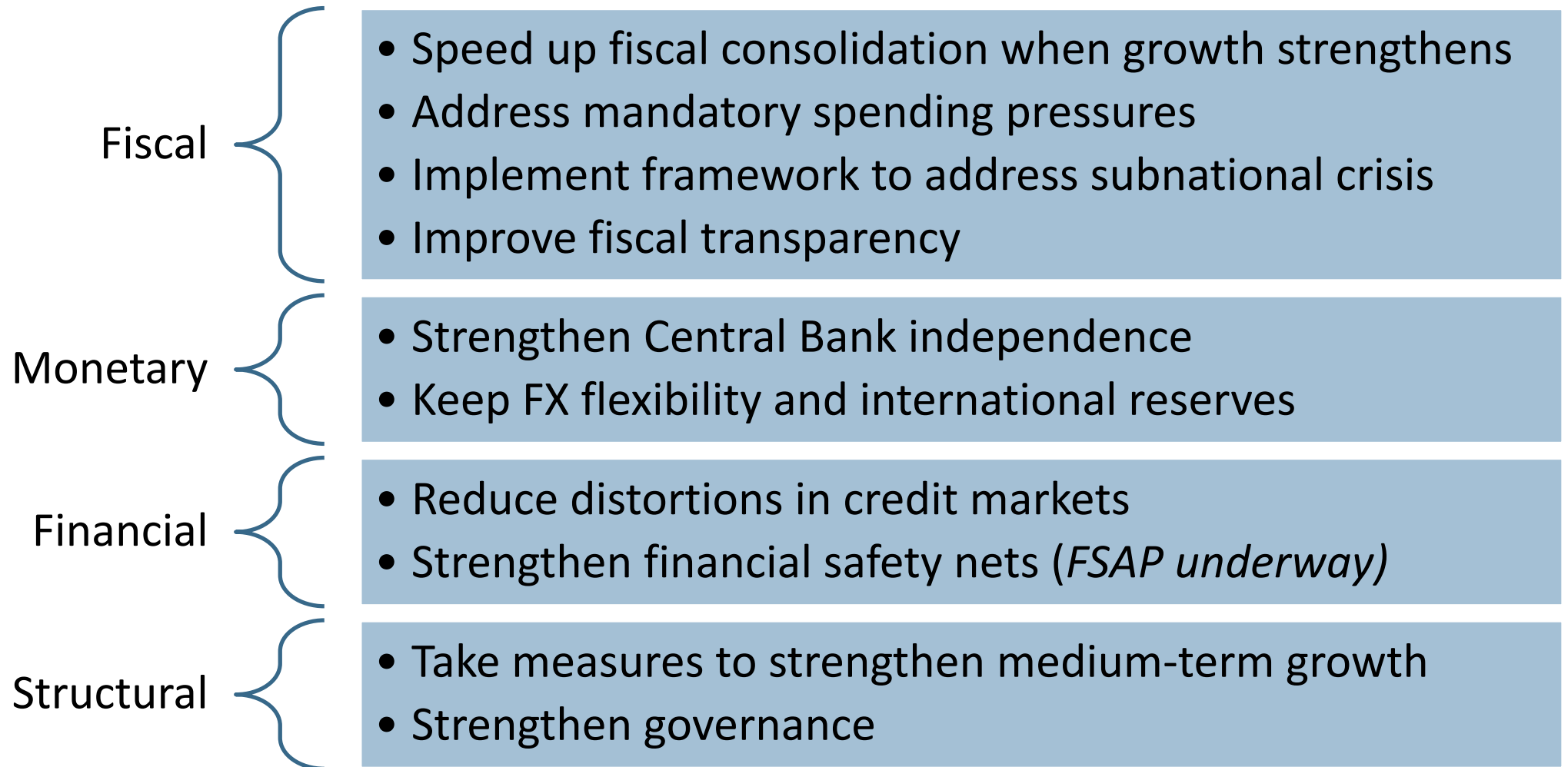
- Expenditure cap, review of government spending, subnational rescue framework
- Monetary easing amidst falling inflation expectations, revision of inflation target
- Labor reform, microeconomic reforms, trade measures, concessions, SOE reforms
- Independent Fiscal Institution (IFI)

Under discussion

- Social Security Reform
- Rollback of payroll tax exemptions
- TLP to replace TJLP
- New role for BNDES
- Tax reform
- Bankruptcy law
- BCB/STN relations



Policy priorities





An intense effort needed for fiscal consolidation

Mandatory spending

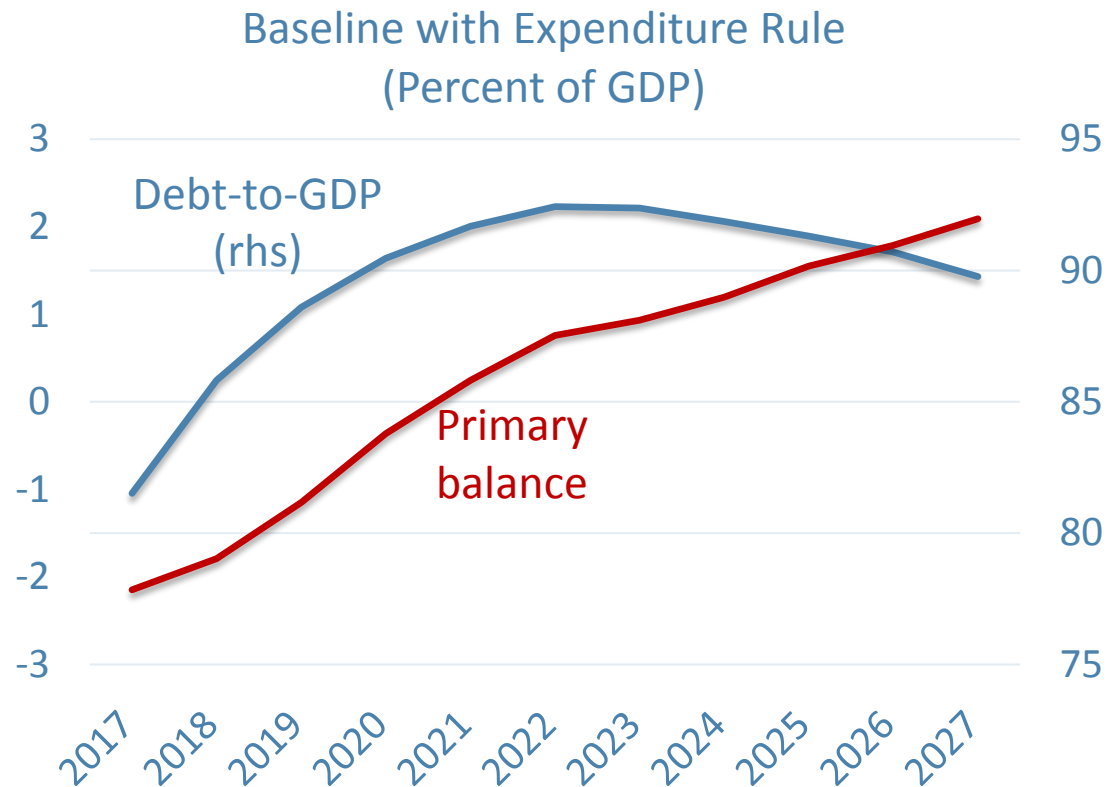
- Implement social security reform
- Introduce a medium-term *fiscal* and *budget* framework
- Revise of minimum wage formula
- Rein in public sector wage bill

Subnational finances

- Implement fiscal recovery regime for stressed states
- Rein in mandatory spending
- Increase fiscal transparency
- Monitor municipal finances

Debt sustainability faces risks

Improving fiscal balances essential to ensure fiscal sustainability



- Debt sustainability risks remain large—despite more favorable real interest rates and lower FX intervention costs
- Speeding up fiscal adjustment is recommended when growth strengthens



Policies to strengthen medium-term growth

Opening the Economy

- Reduce tariffs and eliminate non tariff barriers
- Pursue Free Trade Agreements

Tax Reform

- Simplify tax system
- PIS/COFINS
- Harmonize federal taxes

Labor Market

- Reduce informality and of excess litigation, lower labor tax wedge; flexibility welcome
- Watch labor market duality and fiscal impact



Governance: economic costs counterbalanced by gains in transparency and improved governance

Ongoing efforts to combat corruption are of the highest importance. Going forward:

- Continue pursuing corruption and money laundering cases
- Follow-up on existing ENCCLA action items
- Continue populating the Transparency Portal

See also: 2017 IMF Fiscal Transparency Evaluations of the Federal Government and of the State of São Paulo

The IMF and Governance

- “Corruption also has a broader corrosive impact on society. It undermines trust in government and erodes the ethical standards of private citizens” *MD Christine Lagarde.*
- Active areas include: Discussion in surveillance when systemic, improving public financial management (FTE, PIMA), AML/CFT, and international collaboration

www.imf.org/en/About/Factsheets/The-IMF-and-Good-Governance



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Want more?

Go to www.imf.org/external/country/BRA/ for Article IV report and papers on

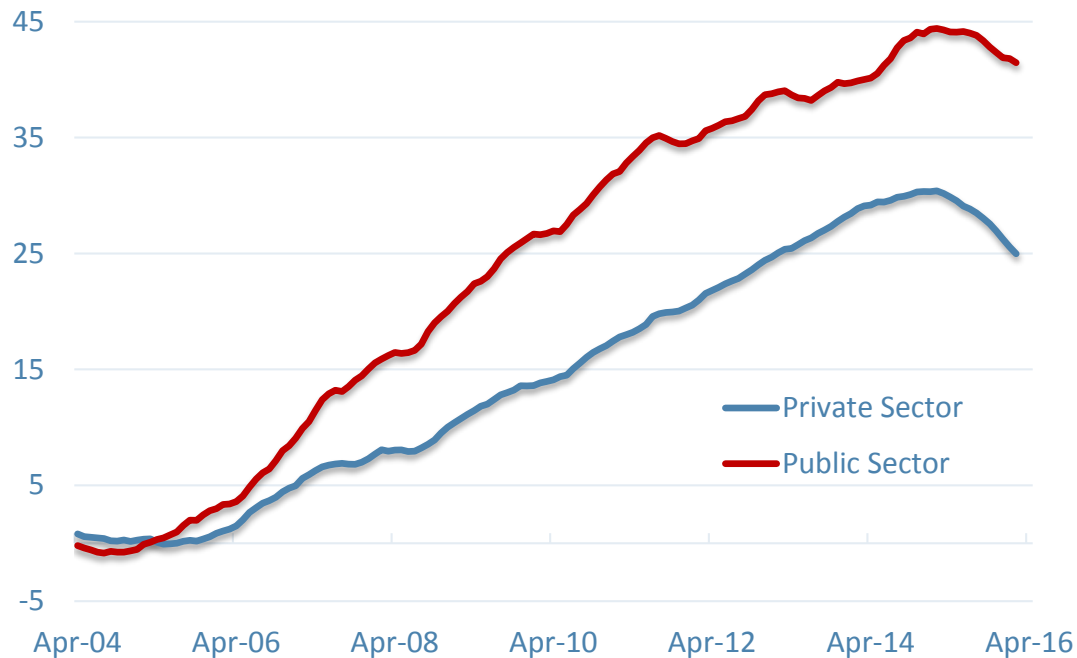
- Investment in Brazil: From Crisis to Recovery
- Brazil's Business Environment and External Competitiveness
- Distributional Effects of Brazil's Pension Reform
- Inequality in Brazil: A Micro-Data Analysis
- Interest Rates and Inflation in Brazil
- The Effect of Fiscal Consolidation on Real Interest Rates
- Boosting Productivity: Taxes and Resource Misallocation in Brazil



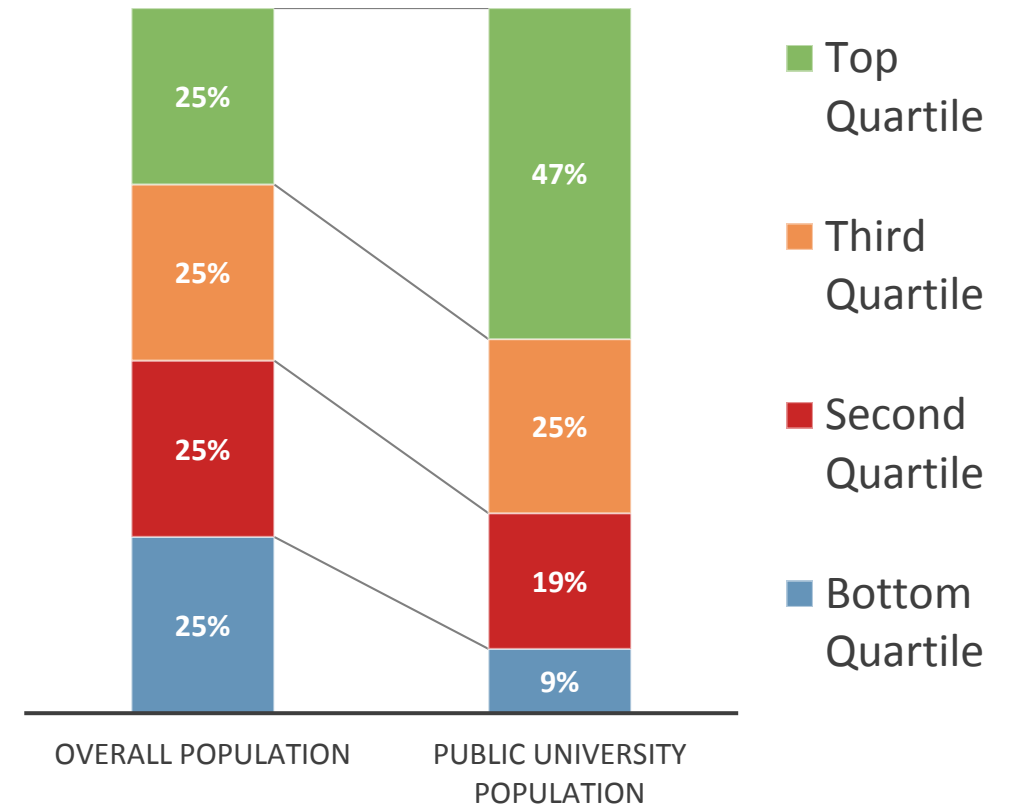
Inequality challenges remain large despite recent progress

Public sector wage growth widened markup over private sector jobs

Brazil: Real Annual Earnings, per Sector
(12-month rolling change since 2002, in percent)



Overrepresentation of Top Quartile in Public Universities, 2014





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Thank you