

Monthly Macro Letter

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Act One: An Ambitious Proposal

Leandro Rothmuller
Chief Economist
leandrorothmuller@bocombbm.com.br

The first act of the pension reform drama began with the delivery of the government's bill to Congress. The proposed constitutional amendment (PEC) was handed to the Speaker of the lower house by President Jair Bolsonaro himself. It came as a positive surprise in several respects: it is well designed from the conceptual standpoint; it attacks privileges; and it toughens rules that are no longer in line with real conditions in Brazil.

The economic team expect the reform to reduce federal expenditure by R\$1.1 trillion in ten years. The proposal focuses on eliminating inequality and injustice from the current system by introducing a minimum retirement age (65 for men and 62 for women), and introducing a new progressive contribution system under which the higher-paid contribute more. In addition, the rules are to be the same for government and private-sector employees. More important than the minimum age is a 12-year transition to the new system, less than the 20 years proposed by the previous administration under former president Michel Temer.

Armed services pensions, a strategic item in negotiations on the reform, will be the subject of a separate bill to be brought forward in late March, but details have not been divulged. The government expects this part of the reform to save R\$92 billion, bringing the total reduction in spending on pensions to R\$1.2 trillion.

The lower house is unlikely to pass the PEC before June. And the Senate should only pass it at the end of the third quarter of this year. Exactly when voting occurs is not essential, as the fiscal impact of the reform will be felt mainly in the medium term. However, it will be important to monitor progress through both houses.

The first challenge to be faced by the government is the negotiation of a solid majority in Congress. So far this has not happened. On the contrary, the government has already been defeated once this year (in voting on an executive decree that extended classified information), besides losing cabinet member Gustavo Bebianno, a key link with Congress who was forced out of office in mid-February. The government urgently needs to learn how the political game is played.

The second challenge will be to win approval for a reform that achieves sufficient fiscal saving to assure compliance with the spending cap and stabilize the public debt in the medium term. The government's proposal is very ambitious, but it remains to be seen what kind of reform Congress will pass.

Despite these and many other challenges, the local markets remain optimistic about the soundness and comprehensive scope of the reform proposal. They expect some items to be watered down or even excluded during its passage through Congress, but are confident that the measure eventually approved will have a more significant

fiscal impact than the proposal approved by a special committee of the lower house during the Temer administration, i.e. more than R\$500 billion-R\$600 billion.

Meanwhile, the economy is taking its course. The recovery has been slower than anticipated but improving financial conditions and private confidence should translate into more growth going forward. The inflation outlook remains comfortable, and the Central Bank of Brazil is set to leave its policy rate on hold throughout the year. However, pension reform is a necessary condition for this benign scenario is to be consolidated.

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,1%	2,0%	3,0%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	3,7%	3,7%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	6,50%	6,50%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,0%	10,0%
Trade Balance (US\$ bn)	3	-4	20	48	67	58	56	44
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-13	-21	-38
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	-1,0%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,3%	-0,7%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	76,7%	77,2%