Low growth saves Rousseff—for now

João Augusto de Castro Neves, Washington D.C.

THOUGH THERE IS ACTIVE DEBATE about a looming energy crisis as water levels in reservoirs sink to new lows in Brazil's hydropower plants, which supply the majority of the country's electricity needs, it is not likely to alter the Rousseff administration's general stance toward the power sector in the short term. Despite the growing concerns about power plant water levels, there are a number of reasons that, for now, support the government's view that the current crisis is temporary and that the country's power system is structurally sound. Greater risks for the power sector, however, lie in 2014.

The main support for the administration's belief that the crisis is temporary is Brazil's current thermoelectric capacity. The network of thermal power plants is much more extensive today than it used to be, which means that type of energy is now much more to be relied on as a "swing" fuel when reservoir water levels drop. Thus, although there is still a risk of energy rationing, the likelihood that the administration will adopt such a policy is much lower now than it was during the energy crisis in Brazil in 2001. Then, the decision of the Cardoso (PSDB) administration to mandate rationing and its mismanagement of the crisis were among the main reasons that the PSDB is now in opposition instead of in power. The risk of being compared with that administration is surely being factored into the policymakers' narrative today. That experience, in fact, gives Rousseff ample reason to refrain from explicitly acknowledging the current crisis or changing the direction of her energy policies.

Despite growing concerns about power plant water levels, there are a number of reasons that, for now, support the government's view that the current crisis is temporary and that the country's power system is structurally sound.

While for now the possibility of energy rationing is still low, risks for the administration will rise in 2014. The thermal power system is currently running at full capacity and a below-average rainy season would mean that hydroelectric reservoir

castroneves@eurasiagroup.net

levels would still be dangerously low at the beginning of the dry season, which runs roughly from April to October. According to some experts, part of the current problem derives from delays in turning to thermal power plants earlier (before November) to avoid depletion of reservoir levels. The decision was probably driven by politics, not policy. After all, resorting to more expensive thermal electricity at a moment when the government is betting on lower energy costs to boost economic growth would be counterproductive, to say the least.

Meanwhile, the government should be able to support the power sector this year because the economy has been growing much more slowly than originally expected. The government's energy research office (EPE) estimates in its 10-year energy plan (2010–20) that energy demand, though growing, should remain under control in the shorter term, reducing the risk of rationing even if there is a dry spell (EPE had originally forecast 4.5% yearly GDP growth from 2010 to 2017). But if economic activity should rebound strongly later in the year (to near or just above 3%, as market participants expect) and reservoir levels remain low, the risk of rationing in 2014 will intensify considerably.

For the remainder of this year, the government's main challenge will be to sustain the announced tariff reduction, avoid increases in power prices, and prevent the power sector from negatively affecting already flagging industrial activity and exacerbating inflationary pressures. While the economic costs to the government could be substantial, the political impact of the energy crisis should be limited. Even though comparisons with the PSDB administration will certainly attract media attention in coming weeks, Rousseff is likely to muddle through the situation with little damage to her image as long as the risks of power outages and severe rationing remain low. And slightly above average rain in coming months would be enough to defuse concerns.

The decision of the Cardoso (PSDB) administration to mandate rationing and its mismanagement of the crisis were among the main reasons that the PSDB is now in opposition instead of in power.

If the situation worsens—through a combination of substantially higher economic growth and below-average rain—officials will probably look into measures to expand power sector capacity. In the longer term, the government could also announce a plan to build more gas and even coal-fired thermal power plants, probably by again turning to the private sector.

But for now there is not much the government can do beyond hope for more rain and, ironically, for economic growth that is a bit slower than anticipated. ■

While the economic costs to the government could be substantial, the political impact of the energy crisis should be limited.