Headwinds for the Brazillian economy in 2015

BUDGET DEFICIT INCREASING, external current account deteriorating, inflation up . . . the situation is not as unbalanced as it was during the Brazilian hyperinflation in the 1990s but the warning signs are enough to make many of us very nervous.

The Brazilian economy has slowed, the government claims, mainly because private investment fell as a result of a transition to a new policy of a more depreciated exchange rate and lower interest rates. Although changing those economic basics should ultimately have a positive impact on companies, in the short term there are negative effects—such as pushing up indebtedness for companies whose debts are in dollars. But over time, it is claimed, the positive effects will finally appear, and the economy will again grow at 4% a year.

However, the longer private investment takes to recover, the more likely that the fiscal and external imbalances will depress fixed investment and growth. Standard & Poor's has just lowered Brazil's credit rating outlook to negative. Meanwhile, Brazilian economists and analysts have again revised their economic forecasts downward—for the fifth consecutive time. IBRE is now expecting growth to be just 2.3% in 2013 and not much better at 2.7% in 2014 (see p. 29).

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Outside the government many see looming fiscal and monetary problems. The budget surplus has eroded, the center of the inflation target (4.5%) has been bypassed, and the administration keeps intervening in the economy, often sending contradictory signals. The government no longer seems committed to sound fiscal policies.

In an interview in *O Globo* (June 16), the economist Fabio Gianbiagi called for government budget transparency to restore the credibility of the budget and inflation targets. As Teresa Terminassian pointed out (see p. 22), the proliferation of accounting gimmicks has made assessment of the government's fiscal stance almost impossible. As a transparent gauge of the budget deficit, the government should consider a switch from the current primary budget surplus target to a simple nominal deficit target without any adjustments and covering all government spending. To make the budget deficit more transparent and credible, Brazil needs an independent budget office along the lines of the U.S. Congressional Budget Office.

It is also vital to get public spending under control. There is also urgent need to address increasing commitments to Social Security and states' growing debt.

Given the weak economy, the President, with some reason, clearly opposes cuts in spending. However, the persisting fiscal imbalances are likely to depress private investment, which would offset any growth-promoting effects of an expansionary fiscal policy. In contrast, a clear fiscal adjustment strategy would restore confidence. Fiscal adjustment would also resolve the crucial issue of an undervalued exchange rate to support our industry competitiveness, as pointed out by former Finance Minister Antonio Delfim Netto. A tighter fiscal policy would give the central bank more room to cut interest rates, depreciate the exchange rate, and encourage exports—which has to be done to pull the economy out of stagnation.

Unfortunately, 2014 is looking like more of the same: interest rates go up, but just enough so that inflation does not run rampant, a little control of public spending but without jeopardizing the political coalition, and more external deficit. Whoever is elected next year will certainly face very unfavorable conditions and difficult policy choices the year after.