Brazil

Economic Watch

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Economic Analysis

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Brazilian government announces expenditures cuts to slow down the economy and control inflation pressures

- The Ministers Guido Mantega and Miriam Belchior announced yesterday that federal expenditures included in the budget approved by the Congress for 2011 will be cut by R\$ 50 billions.
- The value of the cuts was in line with market expectations.
- According to our calculations (see page 11 of our "Brazil Economic Outlook" released yesterday), these cuts are not enough to guarantee that the primary surplus of the public sector will meet the R\$118 billions (2.9% of GDP) target for the year. If these expenditure adjustments are finally implemented, the primary surplus of the public sector is forecasted to reach 2.5% of GDP (higher than 2010's primary surplus net of Petrobras extraordinary resources: 1.6%)
- Taking into account the new cuts, federal primary expenditures (which excludes interest payments) are expected to reach 18% of GDP this year, lower than the 19.1% figure observed in 2010 (and practically the same if we exclude Petrobras extraordinary expenditures from last year's accounts). This level, however, is higher than the levels observed before the crisis (16.8% in average for the 2006-08 period).
- The measures are positive as they will complement counter-cyclical monetary
 policy's efforts and, therefore, help avoid overheating the economy, different
 from what happened in the end of the previous government when the weight
 of the adjustment was essentially borne by monetary policy.
- This fiscal announcement, therefore, contrasts with the loose fiscal spending policy of the last few years.
- The tightening of the fiscal policy should also open space for a new sovereign debt rating upgrade this year.
- The measures should help consolidate the view that the SELIC will be adjusted upwards by 100bps (and not more than that). In addition, they support our growth and inflation forecasts for this year (GDP: 4.1%; IPCA: 5.3%). Market's forecasts (GDP: 4.6%; IPCA: 5.7%) could be adjusted downwards following yesterday's announcements.



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