Brazil Flash

Government acts to prevent a hard landing.

The government announced today a set of tax reductions to prevent the economy from decelerating sharply. GDP to grow no more than 0.2%q/q in Q3 after growing around 1.0%q/q in the first quarters of the year. The measures announced today could help GDP to recover slightly in Q4.

- **Taxes on equity inflows, consumption credit and some durable goods were cut.**
  The government cut the IOF tax on equity inflows from 2.0% to 0%, the IOF tax on foreign purchases of long-term private bonds from 6.0% to 0%, the tax on consumption credit from 3.0% to 2.5%, the production tax on some durable goods, among others (check the full list of measures adopted here). The goal of these measures is to support domestic demand by stimulating credit concession, capital inflows and private consumption. These measures revert some of the measures announced in the last year as the recent moderation of the economy eased overheating concerns and fueled hard landing worries.

- **Measures to have an impact in the short-term.**
  The implementation of these fiscal and macro-prudential measures adds to the easing of monetary conditions being conducted by the CB. While the latter has, in general, a lagged impact of around 6-9 months, the former is expected to have an impact in domestic demand already in Q4 (this, actually, helps us to understand why they were adopted). Therefore, GDP growth could show a mild rebound in Q4 after growing no more than 0.2%q/q in Q3 (Q3 GDP data to be released next week). Credit and financial markets could also benefit from the measures announced by the government, although the main driver of the economy should continue being external markets' mood.

- **Between overheating and recession fears.**
  Although markets and the government are now mainly focused on the negative impact global turbulences over the economy, inflation remains high and labor and credit markets remain relatively strong. The current moderation of the economy is much milder than that observed in 2008: this time GDP will drop from around 1.0%q/q in Q1 and Q2 to around 0.2% in Q3; in the previous crisis GDP grew around 1.7% in the first three quarters of the years and then declined more than 4.0%q/q in Q4. That is to say that if by any chance the situation in developed economies refrains from deteriorating, overheating problems could gain momentum again. Finally, although at least some of the measures announced today should be labeled as "macro-prudential" instead of "fiscal", they will generate some revenue losses that at some extent could reduce the room for a permanent reduction of the SELIC rate in Brazil.

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