LatAm Daily | A more gradual implementation of the fiscal adjustment in Brazil

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The government reduced its primary surplus targets to only 0.15% of GDP in 2015, 0.7% in 2016 and 1.3% in 2017, implying that it will take longer to halt the upward trend in public debt. This downward revision, together with the mid-July inflation figures also released yesterday, increases the likelihood of another 50bp hike of the Selic rate next week.

Brazil - Government reduces fiscal targets

The government decided to reduce the primary surplus target for the year to BRLBRL8.7bn (0.15% of GDP) from BRLBRL66.3bn (1.1% of GDP). Federal and regional governments will now have to deliver a primary surplus of BRLBRL5.8bn and BRL2.9bn, respectively, rather than BRL55.3 and BRL11.0 previously. The targets for the coming years were adjusted to 0.7% in 2016, 1.3% in 2017 and 2.0% in 2018 from 2.0%previously. Due to its impact on fiscal revenues, the ongoing contraction of domestic demand and the difficulties in reining in expenditure were making it practically impossible to deliver on the previous targets and therefore their downward revision was already expected. Even though meeting the new targets would still represent a gradual improvement of the primary result going forward (from -0.6% of GDP in 2014), it means that public debt (which now stands at 62.5% of GDP, vs. 58.9% in December 2014 and 53.6% in December 2013) will increase more than expected this year and that it will take longer to bring the upward trend to a halt. Even though relaxing the fiscal targets should prevent fiscal policy from exacerbating the slowdown in domestic demand, it makes the government's task of recovering the credibility of economic policy more difficult, it increases the likelihood of new sovereign debt downgrades ahead and puts additional pressure on monetary policy (which reinforces our view of a 50bp hike in the Selic rate next week). Finally, yesterday the government also announced an additional budget freeze of BRL8.9bn this year, but this cut does not offset the overall negative impact of the announcement of a more gradual implementation of the needed fiscal adjustment.

Brazil - Annual inflation rose above 9% in mid-July

Inflation from mid-June to mid-July as measured by the IPCA-15 declined in monthly terms to 0.60% MoM from 0.99% MoM in the previous reading due to a moderation in both food and administered products. However, inflation was much higher than one year ago (0.17% MoM), implying an increase in annual inflation from 8.80% YoY in mid-June to 9.25% YoY in mid-July. The figures, which were in line with forecasts, reinforce our view that the full-month IPCA will come in at 9.43% YoY / 0.50% MoM in July. Abnormally high inflation as well as lower contribution from the fiscal side to fighting inflation (see above) should keep the BCB under pressure and trigger another 50bp adjustment of the Selic rate next week, even though the sharp deceleration of economic activity means that a 25bp cannot be ruled out.

Brazil - External adjustment gains momentum

The current account deficit declined again and reached USD2.6bn in June, half the size of the deficit a year ago. In 1H15 the accumulated external deficit reached USD38.2bn, 23% lower than in 1H14 thanks to an improvement in the current account's three mainelements: the trade balance and the service and revenue accounts. This correction of the external deficit has been determined by the recent currency depreciation and by the sharp moderation of domestic demand. We expect this process to continue in 2H15 and the current account deficit to close the year at 4.1%, in comparison to 4.5% in 2014.

Chile - Traders expect a prolonged pause in the policy rate

Results showed inflation expectations at 0.4% MoM for July (BBVAe: +0.3% MoM) while long-term expectations remained anchored to the central bank's 3% YoY target. In terms of policy rates, traders do not expect any changes for the next 12 months and only a 50bp increase in 24 months ahead (anticipating a more dovish stance than the last survey). Finally, the results revealed expectations of a mild depreciation in the exchange rate to levels around CLPUSD660 towards the year end.

What to watch today

Brazil - Labour market report (June, 08:00hrs NYT)

We expect the report to show that labor markets went through another round of deterioration in June. The unemployment rate is expected to increase by the sixth month in a row and to reach 6.9% in June (vs. 6.7% in May and 4.8% one year ago).

Mexico - Inflation (First half of July, 09:00hrs NYT)

For the first two weeks in July, we estimate a fortnightly rise of 0.22% for headline inflation and of 0.12% for core. If our predictions prove right, in annual terms headline inflation would be 2.89%, whereas core would have eased down to 2.33% (compared to 2.35% for the previous fortnight). We still expect the exchange-rate pass-through to inflation to remain minimal, largely because of the flatness of domestic demand, and that the rise in goods inflation will continue to be offset by a decent performance of the services component. Over this fortnight, the seasonal rise for tourist services due to the summer holiday peak period will be partly offset by a drop in the other services component associated with the summer sales. As regards the non-core component, our price-monitoring suggests substantial rises in tomato prices within the fruit and vegetables sub-index, while for the livestock prices component a further fall is anticipated in the egg price, although this will be compensated by price rises for chicken, beef and pork.

Calendar indicators

	Date	Period	Consensus	BBVAe	Actual	Prior
Brazil						
IGP-M Inflation 2nd Preview	20 July	Jul	--		0.71%	0.59%
IBGE Inflation IPCA-15 MoM	22 July	Jul	0.48%	0.6%	59.00%	0.99%
Current Account Balance	22 July	Jun	--		-$2547.3M	-$3366M
FGV CPI IPC-S	23 July	22-jul	0.66%		--	0.72%
Unemployment Rate	23 July	Jun	6.90%	6.9%	--	6.70%
FIPE CPI - Weekly	24 July	23-jul	--		--	--
FGV Consumer Confidence	24 July	Jul	--		--	83.90
Chile					--	
Central Bank's Traders Survey	22 July	--	--		--	--
Colombia					--	
Trade Balance	21 July	May	-$790M	-$672M	-$870.9M	-$1038.9M
Industrial Confidence	21 July	Jun	--	5	0.10	0.90
Mexico						
Retail Sales YoY	22 July	May	5.00%	5.0%	4.1%	4.6%
Retail Sales MoM	22 July	May	0.20%	0.3%	0.20%	-0.3%
Unemployment Rate SA	24 July	Jun	4.46%	4.4%	--	4.4%
Unemployment Rate NSA	24 July	Jun	4.42%	4.36%	--	4.45%
Economic Activity IGAE YoY	24 July	May	1.03%	2.0%	--	2.09%

Fuente: BBVA Research

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07.20.2015	Mexico: Home loan advances 20% in May
07.17.2015	Mexico: We expect services to have spurred the growth in activity in May
07.15.2015	Peru: Economic activity slows down in May
07.13.2015	Chile: Central Bank of Chile keeps MPR at 3% as expected
07.10.2015	Colombia: Client presentation on real estate in Santa Marta
07.10.2015	Mexico: Inflation touches record low; industrial production shows weakness
07.10.2015	Peru: Monetary dilemma remains; activity, exchange rate, inflation?
07.09.2015	Chile: Analyzing the new fiscal scenario
07.09.2015	Mexico: Inflation YoY reached its lowest level in June
07.08.2015	Chile: "One timers" drive inflation above expectations
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07.04.2015	Chile: IMACEC grows 0.8% YoY in May: slowdown speeds up
07.04.2015	Colombia: Inflation in June stood at 4.4% YoY