BRAZIL

Growth will gain momentum during 2019 and 2020 as private consumption, supported by improvements in the labour market, will increase. Recovering credit and greater policy certainty as a new administration takes office will buttress the recovery. Political uncertainty around the implementation of reforms remains significant and could derail the recovery, but if uncertainty fades and reforms advance as assumed, investment will become stronger.

Monetary policy is projected to tighten during 2019 as the economy gathers momentum. Without a major expenditure reduction, the sustainability of the fiscal accounts remains at risk, especially due to rising pension spending. Building a political consensus for a pension reform will be an important challenge for the incoming administration. Maintaining strong growth will require further efforts to strengthen productivity, including closer integration into the global economy.

After a temporary setback from a transport strike, the expansion continues

After a temporary strike-related setback, growth momentum appears to be strengthening, supported by recovering credit flows. A repricing of risks in international capital markets has led to capital outflows and a depreciation of the currency, but low foreign debt exposure has limited the impact on the domestic economy. Inflation and core inflation are below target and interest rates have remained low, supporting household spending. Moderate wage growth and improvements in labour markets, though gradual, are adding to private consumption. However, the composition of jobs created has been of low quality so far, with a disproportionate number of jobs created in the informal sector.

Improving the quality of the public finances remains a priority

Gross public debt has risen to 77% of GDP and the primary balance of -1.2% of GDP remains significantly below the estimated +2% required to stabilise public debt.

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1. Core inflation is defined as the average of the three core inflation measures published by the Central Bank of Brazil.

Source: Central Bank of Brazil; IBGE; and OECD Economic Outlook 104 database

StatLink: [http://dx.doi.org/10.1787/888933876366](http://dx.doi.org/10.1787/888933876366)
The deterioration of the fiscal accounts over the past years is mainly due to rising social security expenditures and this trend is likely to continue without a reform of social benefits, most notably old-age pensions.

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A pension reform remains the key priority to ensure a stabilisation of public debt over the medium term and maintain investor confidence in sound public finances and
management of the economy. Increases in pension spending have left fewer resources for social benefits to fight inequality and poverty, which is concentrated among children and youth. The minimum wage serves as a floor for all pension benefits and has increased rapidly over the past years. As a result, rising pension benefits have benefitted mostly middle-class households, while highly effective transfers to poor households have stagnated. Limiting future increases in pension benefits could finance more social transfers to the most needy, while putting fiscal accounts on a more sustainable path.

Raising participation thresholds in the conditional cash transfer programme *Bolsa Família*, which costs only 0.5% of GDP, would also strengthen incentives for school attendance and medical check-ups, thus reducing inequalities with respect to education and health. Efforts to reduce tax expenditures and credit subsidies for private sector enterprises, which have created fertile grounds for corruption without generating any discernible benefits for either well-being or productivity, should continue.

Policies designed in response to the recent trucker strike included lower taxes on diesel fuel and price regulations in cargo transportation services. These measures should eventually be rolled back as they have undermined fiscal consolidation efforts, curtailed competition and hurt export competitiveness by raising input prices for many other sectors. Diesel fuel was already taxed less than petrol, while environmental considerations would suggest the contrary. As the CO₂ intensity of the economy has increased recently, fossil fuel taxes should be raised rather than reduced. Moreover, the poor are most exposed to the negative health effects from air pollution.

Productivity growth will be the main engine of growth in the longer term. Strengthening it will require more competition in many sectors to allow labour and capital to move to activities with strong potential. Closer integration into the global economy would raise efficiency by exposing more firms to foreign competition and improving access to lower cost intermediate and capital goods. Efficiency would also be enhanced by reducing domestic barriers to entry and implementing policies to reduce costs, such as easing tax compliance or improving contract enforcement. A substantial overhaul of the fragmented indirect tax system, with a view towards a unified value added tax, could raise the competitiveness of firms across the country.

**Growth is projected to rise**

Growth is projected to increase during 2019 and 2020 as low inflation, moderate wage growth and falling unemployment support stronger private consumption and reform progress stimulates investment. As business confidence improves, unemployment is projected to continue to decline, including through the creation of more jobs in the formal sector.

Risks are mainly related to the implementation of reforms. The fragmented political landscape will make it difficult to create political consensus for key reforms, including a pension reform, without which public debt is set to rise. While Brazil’s external vulnerabilities are limited due to a low current account deficit and a low share of public debt denominated in foreign currency, spill-overs from a deterioration of the situation in Argentina are conceivable. Argentina accounts for around 7% of Brazil’s exports, but is a key destination for industrial exports. The possibility of rising trade tensions also bears risks for Brazil, as China and the United States are Brazil’s two major trading partners.