BRAZIL

The recovery is strengthening and growth will reach 2.8% in 2019. Solid investment growth reflects improving confidence thanks to recent reform efforts, including in financial markets. Surprisingly low inflation has enhanced the room for monetary easing, which has improved financial conditions. Growth is expected to gain momentum on the basis of further improvements in investment and a recovery of private consumption on the back of lower inflation.

Fiscal sustainability, and hence investor confidence, remains at risk without a pension reform. Strengthening the focus of social spending towards those most in need and scaling back ineffective regressive tax breaks and subsidies for specific economic sectors can make public expenditures more effective and more inclusive, and rein in opportunities for corruption. Maintaining strong growth will require further efforts to strengthen productivity, including via greater integration into the global economy.

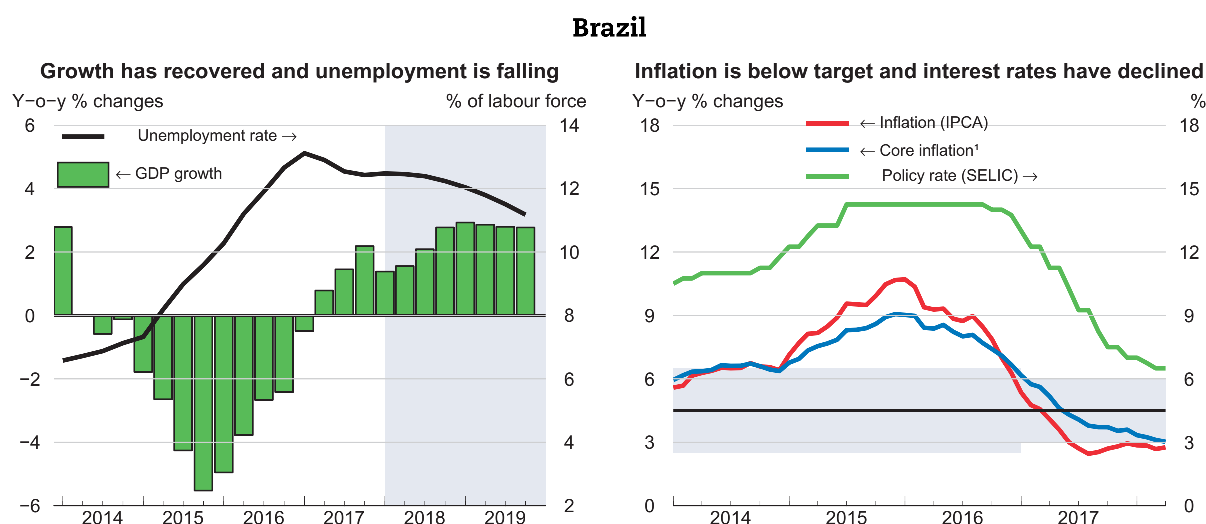
The economy has recovered from the recession

The deep recession is over, and year-on-year growth is now above 2%. Investment has supported the recovery, helped by lower interest rates and reforms that improved confidence. These include measures to contain credit subsidies and deepen private financial markets, as well as a labour market reform. However, consumption has been moderate, and the benefits of the recovery have yet to materialise for many Brazilians. The unemployment rate has fallen below its peak of over 13%, but much job growth has been in informal employment rather than in quality jobs. Inflation has fallen below the target range and has been particularly low for low-income households. The quality of fiscal policy has shown some incipient improvements on the back of lower discretionary expenses, but also lower subsidies.

Structural reforms will be crucial to sustain the recovery

Low inflation is supporting household real incomes and has opened space for significant interest rate reductions, both of which are likely to support stronger private

Brazil



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 103 database.

StatLink http://dx.doi.org/10.1787/888933729686

Brazil: **Demand, output and prices**

	2014	2015	2016	2017	2018	2019
	Current prices BRL billion	Percentage changes, volume (2000 prices)				
GDP at market prices	5 779.0	-3.5	-3.5	1.0	2.0	2.8
Private consumption	3 638.4	-3.2	-4.4	0.9	2.3	3.1
Government consumption	1 106.9	-1.4	0.0	-0.6	0.7	0.7
Gross fixed capital formation	1 148.5	-13.9	-10.4	-1.9	4.8	3.8
Final domestic demand	5 893.7	-4.9	-4.6	0.2	2.3	2.7
Stockbuilding[1]	39.0	-1.3	-0.4	0.8	-0.3	0.0
Total domestic demand	5 932.8	-6.1	-5.0	1.0	2.0	2.7
Exports of goods and services	636.4	6.7	1.6	5.7	5.5	5.5
Imports of goods and services	790.2	-14.0	-10.2	5.5	6.5	4.7
Net exports[1]	- 153.8	2.7	1.6	0.0	-0.1	0.1
Memorandum items						
GDP deflator	_	7.6	8.1	3.8	4.1	4.3
Consumer price index	_	9.0	8.7	3.4	3.4	4.0
Private consumption deflator	_	8.9	9.2	2.9	3.6	4.4
General government financial balance (% of GDP)	_	-10.2	-9.0	-7.8	-7.6	-7.1
Current account balance (% of GDP)	_	-3.1	-1.3	-0.5	-0.9	-0.9

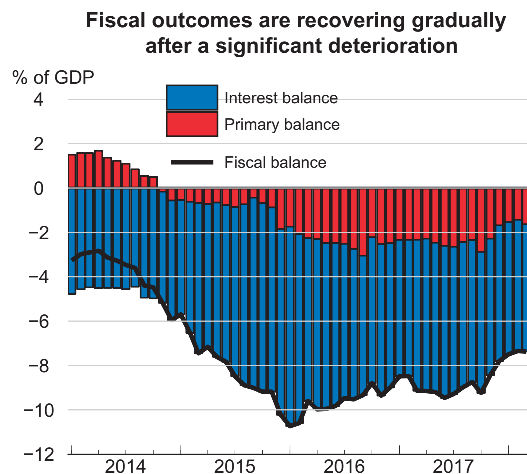
1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD Economic Outlook 103 database.

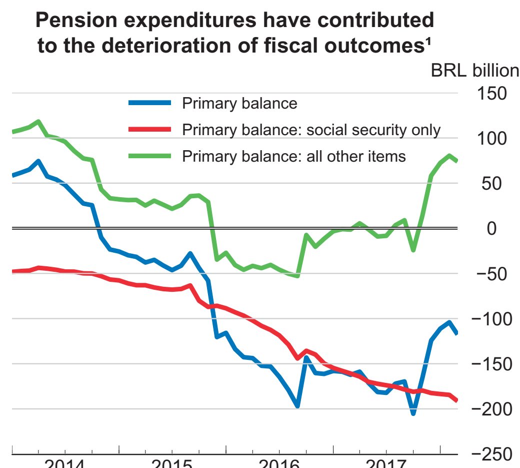
StatLink http://dx.doi.org/10.1787/888933730807

consumption going forward. The current mix of easy monetary policy and fiscal restraint is appropriate given subdued inflationary pressures and significant fiscal challenges.

The sustainability of public debt and compliance with existing fiscal rules will require structural changes in public expenditures, as the current primary balance of -1.6% of GDP is significantly below the estimated +2% required to stabilise the public debt ratio in the

Brazil





1. Accumulated over 12 months.
Source: Central Bank of Brazil; and National Treasury.

StatLink http://dx.doi.org/10.1787/888933729705

medium term. Gross public debt has reached 75% of GDP, an increase of 20 percentage points over 3 years. Without reforms, public debt is set to rise even further. A rising social security deficit has driven the deterioration of the primary balance, and pension reform hence remains a key priority to maintain investor confidence in sound public finances and management of the economy.

Recalibrating public expenditures holds strong potential to make growth more inclusive and reduce corruption. A large and rising share of the 15% of GDP spent on social benefits is paid to households that are not poor. In the pension system, the life-time difference between benefits and contributions is skewed towards those with higher incomes. At the same time, poverty is concentrated among children and youth. Limiting future increases in social benefits that mostly reach the middle class could finance more social transfers to the poor, children and youth, with a strong inequality-reducing impact. A very successful example is the conditional cash transfer programme *Bolsa Família*, which represents only 0.5% of GDP. Spending more on this programme by raising eligibility thresholds and benefit levels would reduce poverty and inequality. The attached conditionalities regarding school attendance and medical check-ups also help to reduce inequalities with respect to education and health, which in turn strengthens productivity. Tax expenditures and credit subsidies for private-sector enterprises have created fertile grounds for corruption and political kick-backs, without any discernible benefits for either well-being or productivity. Recent efforts to reduce these subsidies should be continued.

Looking forward, stronger productivity growth will have to become the main engine of growth in the longer term. This will require more competition in many sectors to allow labour and capital to move to those activities and firms 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. In particular, 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 accelerate

As private consumption recovers, growth is expected to accelerate. Assuming favourable prospects for the continuation of reforms, confidence and easier credit conditions will continue to support investment. Unemployment is projected to decline further, including through the creation of more formal sector jobs. In light of remaining slack, inflation is projected to rise to the target only gradually. In the run-up to the general elections in October 2018, uncertainty regarding the continuation of the reform agenda, including the much-needed fiscal adjustment, remains substantial. In particular, a successful implementation of the pension reform, which is key for compliance with the expenditure rule in the medium term, will be a litmus test for the ability of the authorities to ensure fiscal sustainability and implement further structural reforms. Otherwise, confidence could decline and trigger a return to recession. Bouts of volatility on financial markets could re-emerge as a result of political developments or interest rate increases in advanced economies, but such episodes have been well managed by the Central Bank in the past. Reserves and the strong FDI component of inflows would cushion related exchange rate risks.