Brazil Flash

Government announces expenditure cuts to put fiscal accounts on track for meeting fiscal target and to create room for a lower SELIC

The government announced today a restriction of R$ 55bn (1.25% of GDP) of expenditures budgeted for the year. We expect these expenditure cuts to be delivered and the fiscal target (primary surplus equal to R$ 139bn, around 3.2% of GDP) to be fulfilled by the end of the year. The commitment to fiscal targets should help the CB to drive the SELIC down to a single-digit this year and also to prevent significant hikes next year.

- **Expenditure cuts and fiscal target: a sense of déjà vu**

  When the government announced in February of 2011 expenditures cuts amounting to R$ 50bn (1.24% of GDP), few believed that the fiscal target for the year would be met. However, by the end of 2011 the promised cuts were delivered and the (increased) target of R$128bn was met. Even though the fulfillment of 2012's fiscal target will be more challenging (due to lower revenues and expenditure pressures derived from a 15% minimum wage adjustment and investment needs), we expect the government to rely on a strict control of outlays and on extraordinary revenues (from the concession to the private sector of some public services, for example) to deliver it and, therefore, surprise markets positively one more year.

- **Fiscal moderation is part of a strategy to take the SELIC down**

  As a series of facts suggest and as some economic authorities commented, the adoption of a less expansionary fiscal policy is a move to take some pressure off both inflation and domestic demand and, therefore, to pave the way for lower interest rates. We expect today's decision to provide extra support for a single-digit SELIC this year (our call if for two consecutive 50bps cuts in March and April and SELIC constant at 9.5% from them on. The commitment to fiscal solvency (to be shown also in the next few years), together with some other factors (see our Brazilian Economic Outlook Q1 2012 for more on the issue), should create the conditions for the CB to keep the SELIC at a single-digit level also in 2013, instead of driving it up as most currently expect.

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