

Fiscal Monitor: Short-term scenario

The relevance of Brazil's fiscal triggers

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After the adoption of significant fiscal measures in response to COVID-19¹, one of the main debates on the future of Brazil's public accounts is the expansion of the social protection network. The new social program aims to protect the most socially vulnerable people, who may be left without income due to labor market weakness in the post-pandemic period. In this sense, the challenge is to conciliate social and fiscal responsibility, which we already showed ~2 months ago to be perfectly and technically possible². The complexity thus derives from the political economy involved.

The challenge of respecting the spending ceiling next year, however, is greater than just conciliating the new social protection network with fiscal discipline. Even without the new program (Renda Brasil or Renda Cidadã), our calculations signal the need to reduce spending by ~R\$20bn, revealing the complexity of the fiscal scenario from 2021 on (*table 1*). The gap mainly reflects the expectation of higher inflation (INPC) used to correct a big chunk of mandatory expenditures, whose correction will exceed the spending ceiling (IPCA).

Table 1: Outlays, indexation and effects on spending cap in 2021

Expenditure Item	Legal Index	Index (%)	Share (%)	Expenditures (in R\$bn)		
				2020 (1)	2021 (2)	(3=2-1)
Spending cap	IPCA	2.13	100.0	1,455	1,486	31.0
Personnel	None	-	22.1	321	331	9.8
Social Security (RGPS)	INPC	3.25	45.8	666	703	36.8
Social Assistance (BPC)	INPC	3.25	4.2	61	64	2.9
Unemployment Benefits	INPC	3.25	4.0	59	59	0.4
Family Allowance Program	None	-	2.3	34	35	1.0
Others	None	-	21.5	313	293	-19.9

Source: BTG Pactual

As highlighted in *table 1*, 55% of mandatory spending, notably government income transfers to families via social security, welfare and unemployment benefit programs, is corrected by the INPC index. The acceleration in INPC inflation, which encompasses the basket of families earning 1-5 MW and whose weighting in food is higher than in the IPCA, is a relevant communication vehicle with fiscal policy. In 2021, while income transfers will be corrected by 2020 INPC inflation (we forecast 3.25%), the spending ceiling correction will be only 2.13%.

The discrepancy between the two indices and the major share of spending legally indexed and subject to the spending ceiling produces a deficit of ~R\$20bn in the fiscal anchor in 2021, even without the new social program. In other words, regardless of Renda Brasil, the early, deep activation of fiscal triggers is vital to meet next year's spending cap.

¹ The measures totaled 12% of GDP, higher than in other countries, including central economies. For more details, see our 'Fiscal Monitor: Debt Overhang' report.

² There is a major possibility of merging social policies and more progressiveness in implementing them. For more details, see our 'Fiscal Monitor: Can we conciliate social and fiscal responsibility?' report.

Given the relevance that the fiscal anchor of the new fiscal regime created by the spending cap has in the trajectory of stabilizing Brazil's spending, deficit and public debt, as well as the spillover to economic agents' expectations, there is little to no doubt that the priority should be advancing on measures that guarantee the mathematical feasibility and credibility of the current fiscal framework. Beyond the short-time available, the challenge will be reaching a consensus on the political economy.

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