The purpose of this snapshot is to provide an overview of key elements of President Rousseff’s response to Brazil’s crisis and the current challenges she confronts with the implementation of her reform agenda. IREP Snapshot 23-14 [The re-election of Dilma Rousseff] considered Brazil’s closely contested general election which was narrowly won by the Workers’ Party in October 2014. Rousseff ran on a platform of record low unemployment levels and sustained commitment by the Workers’ Party to address poverty and inequality.

**Growth, Employment and Macroeconomic Performance**

Economic growth in Brazil made a dramatic recovery from the global financial crisis. However, its has been decelerating since 2010, coming to a complete halt by late 2014 (Fig.1). While employment reached a record low by mid-2014 of 4.5% by January 2015 it has begun to climb and is now estimated to be closer to 5.5%. There is a widening budget deficit and inflation has spiked above the tolerance band of 6.5% (Fig.2). Industrial and consumer confidence have also declined dramatically since October 2014 (Fig.3) and the current account deficit continues to widen (Fig.4).

Brazil is also going through a prolonged drought contributing to problems of water supply. This, together with underinvestment in energy infrastructure, has increased the risk of power outages, as a significant proportion of the country’s electricity is generated through hydroelectric schemes.

**A new team**

With an increasingly severe economic crisis, in January 2015, Rousseff appointed a new economic team with a mandate to improve the macroeconomic outlook and restore the credibility of her administration.

On 1 January, Guido Mantega, who had served as Finance Minister for 8 years, was replaced by Joaquim Levy. Levy has worked in public service in a number of positions including Finance Secretary of the State of Rio de Janeiro, Deputy Secretary of Economic Policy in the Finance Ministry and Chief Economist in the Ministry of Planning, Budget and Management. He has also served as Treasury Secretary (Deputy Minister of Finance). Before his appointment to Finance Minister he was President of Bradesco a private asset management fund. His approach to fiscal and macroeconomic policy is perceived as hawkish with media stressing his PhD from Chicago as well as the 7 years he worked at the IMF (1992-1999).

Levy’s planned reductions in public spending has already earned him the nickname ‘Mr Scissorhands’ by critics within Brazil. He has set very ambitious macroeconomic targets including a budget surplus of 1.2% of GDP for this year and 2% in 2016 and 2017. He plans to end policy lending by the Treasury to public banks and intends to stabilise inflation at 4.5% by the end of 2016. The Central Bank increased interest rates by 325 basis points between April 2013 and April 2014 and further 125 basis points between October 2014 and January 2015. Interest rates in Brazil are currently 12.25%. Fiscal adjustment plans include tightening eligibility for unemployment benefits, a reintroduction of tax of fuels and tariff adjustments to eliminate electricity subsidies.

These measures are expected to revive investor confidence in the Brazilian economy. However, having won with a very narrow majority, Rousseff lacks the popular mandate enjoyed by for example India’s Prime Minister Modi [see IREP Snapshot 4-15, Modi’s Reform Agenda and the 2015 Union Budget]. Some members of the Workers’ Party fear the political fallout from the erosion of benefits and subsidies, and resistance to reform has come from within the coalition itself. Senate President Renan Calheiros recently threw out the proposals for pay-roll tax reform. Public dissatisfaction with Rousseff’s administration has also been expressed in marches across the country since January.

**Brazil’s Growth and Development Strategy**

Brazil’s credibility in the first decade of the 21st century is rooted in the impressive social and economic gains that had been made under Presidents Cardoso and da Silva (Lula). Investment of government revenue in people on the margins of the economy produced a rapid expansion of a domestic consumer class. Initiatives such as Bolsa Familia,
a conditional cash-transfer program, together with subsidised loans for housing and an increase in minimum wage, have contributed to poverty reduction.

Rosseff’s challenge is sustaining expanded provision for the immediate needs of the poor, while increasing investment into infrastructure goods for future economic growth and development. This needs to be achieved in a global context of lower demand and increased capital market volatility. In addition to domestic resistance to the Levy’s stabilisation policies, looking ahead, Rousseff faces three major challenges.

1. The Petrobras Crisis

The first challenge is the effects of the investigation into corruption in the state oil company, Petrobras. Until this is concluded investment is likely to be low. The investigation could also contribute to a prolonged period of insufficient capital market access for Petrobras, necessitating financial support from the government. This would make attainment of debt reduction targets more difficult. Corruption concerns within Petrobras were elevated in March 2014 when a former Chief Executive was arrested for money-laundering. Police continued their investigation and in November 2014 arrested another former executive and senior management in some of the country’s top construction firms, citing bribery and kickback arrangements. In February 2015 the Chief Executive resigned and Moody’s downgraded Petrobras to junk. Earlier this month Brazil’s Supreme Court announced an investigation into the role of congressmen and senators in this scandal.

The share price of Petrobras has been falling steadily since 2010 accelerating during these investigations (Fig.5). This has co-incided with a dramatic fall in global oil prices since November 2014 [see IREP Snapshot 3-15 The 2014-2015 Oil Shock] which is likely to have been a further contributing factor. With Petrobras representing about 10 percent of total investment in the Brazilian economy, this crisis of confidence and deteriorating oil prices is likely to have a profound multiplier effect on Brazil’s economy. In addition, Petrobras had been identified catalyst within the government’s developmental industrial strategy. The current crisis is likely to have negative implications for these policy and planning frameworks.

2. Exchange rate

The second challenge is that the Brazilian Real is highly volatile, more so than the average of a basket of other emerging countries’ currencies (Fig. 6). If the real continues to deteriorate it could increase Brazil’s risk premium making it more difficult to finance the current account deficit—with knock-on effects for corporate exposure to foreign exchange risk.

In January 2015, Lagarde warned that it is the IMF’s assessment that emerging and developing countries currencies may face ‘a triple hit of a strengthening US dollar, higher global interest rates and more volatile capital flows’ [see IREP Snapshot 1-15 Forecasting Growth for 2015]

3. Commodity prices

The third challenge is that slowing growth in the rest of the world has led to falling commodity prices. Brazil’s major exports are iron ore, oil, soya and sugar and the prices of these have all fallen (Fig 7.) A decline in export volumes also seems likely, as the demand from China, Brazil’s largest export market, is expected to moderate.

Brazil’s last Article IV Report was published in October 2013. There was an IMF Staff Mission to Brazil from 2-15 December 2014 and a Staff Report for the 2014 Article IV consultation has been compiled. Their findings are still under consideration by the IMF Executive Board and the Brazilian authorities and have not yet been published. It is worth noting that Brazil’s full compliance with the IMF’s surveillance mandate is relatively recent. They have preferred to limit publication to the Public Information Notice (PIN) which summarises the Article IV Report rather than release the full report itself.

In January 2015, Lagarde appointed a new IMF Deputy Managing Director, a Brazilian national, Carla Grasso. Ms Grasso joins a management team that is made up of a 1st Deputy Managing Director, David Lipton (US) and Deputy Managing Directors Naoyuki Shinohara (Japan) and Zhu Min (China). Ms Grasso’s role is as Chief Administrative Officer and is not focussed on policymaking. It is likely that this appointment is related to both the IMF’s improving relationship with the Brazilian authorities following Mr Mantega’s departure. Lagarde may also be trying to signal willingness to increase the presence of officials from emerging economies in her management team. Brazil is among the BRICS counties especially frustrated by the failure of the US to ratify the 2010 agreement on IMF reform [see IREP Snapshot 10-14 The 2010 Reforms of the IMF].