

The LatAm Feedbaker

Brazil trip notes: setting a new standard (of lower noise)

Noise is low

We spent 3 days with foreign investors in Brazil visiting local market participants, policy makers, political consultants and a politician. Overall, the perception is that noise declined as discussions on a potential change in the fiscal target got postponed for later down in the year. The greatest doubt revolves around the 2025 fiscal target.

Congress leadership is a focus for next year

According to political analysts we met, Haddad proved to be politically savvy. Few people have direct access to Lula, but Haddad is an exception. The finance minister was able to convince the president to approve the fiscal framework and keep the inflation target stable. The expectation is for Lula to run for a second term and his eventual re-election would depend a lot on the economy. The main concern is that if growth derails before next presidential elections, the govt might flip towards a more expansionary fiscal stance. Another concern is the leadership changes in Congress at the beginning of 2025.

Fiscal: not target change for now

The improved relationship between Congress and government allowed for the approval of all fiscal bills that were sent to Congress last year. Last year's growth was good, but revenues surprised to the downside. The approved revenue-boosting measures, which closed several loopholes in tax collection, will be key for achieving this year's fiscal target. The focus for 2024 are the secondary laws for the value-added tax (VAT) reform. Locals do not expect much progress on the income tax reform (yet to be presented). The 2025 fiscal target should be difficult to achieve, as several revenues in 2024 are one-offs. Local participants expect the fiscal targets to be changed down the road even though fiscal forecasts are being upgraded at the margin.

No changes on the monetary easing strategy

The central bank is expected to continue with the easing cycle. Local hedge funds see further risks for inflation deceleration. The de-anchoring of long term inflation expectations is perceived as being related to the succession in Brazilian Central Banks Presidency (on top of the fiscal risks) by the end of this year. There is no consensus locally on who will be named for this position.

Fed remains a key focus

Although the local hedge funds we met shared positive views on Brazil, when asked about how they were positioned most mentioned that they had low risk exposure in Brazil. The improvement in external accounts led to more optimism on the BRL and the perception is that further decline in yields is completely dependent on a decline in US yields.

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