Brazil Watch

What you missed while you were in Holidays

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GEM Economics
LatAm | Brazil

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VAT reform final approval in LH...

On December 15th, the Lower House (LH) approved the tax reform constitutional amendment in a two-round vote, and one week later – on December 20th – the text was enacted by the Congress. The main changes implemented by this reform are the consolidation of five taxes into a non-cumulative dual VAT - one for federal taxes (IPI, PIS and Cofins) and one for states (ICMS) and municipalities (ISS) - plus an excise tax (federal) on items that are harmful to citizens' health or the environment. The Federative Council will be responsible for centralizing the collection for states and municipalities. In the bill, the transition period to unify taxes will last seven years, between 2026 and 2032, and the two VATs' transition will begin in 2026.

During the final vote, legislators removed some subsidies and tax benefits granted by senators' version of the bill while keeping the excise tax on mining and oil exports - with a limit of 1%. In the final version, still, some services will be levied a reduced 40% of the standard VAT rate, while self-employed professionals will be taxed with a lower 70% of the standard rate. The Zona Franca de Manaus will still have incentives, as federal duties on industrialized goods (IPI) will continue to be levied on competing goods produced elsewhere in the country. Regarding income taxation changes, the approved Constitutional Amendment now includes jets, yachts and speedboats on the list of motor vehicles taxation (IPVA), on top of progressive taxation on heritances and real estate property (IPTU) updates.

For 2024, Congress will focus on secondary legislation setting the details for the new tax system, which includes the VAT rates. The follow-on legislation will also rule on specific regimes, the parameters for credits based on the old tax system (PIS, Cofins, ICMS, ISS), the detailed list of goods and services receiving VAT discounts, exempts and those subject to excise tax regulation. The next phase will require a significant legislative effort in a short span, given the municipal elections in 2H24. For more, see: Brazil Watch: Tax reform final approval in the Lower House. Big win for government and Brazil.

... was followed by S&P upgrade on Brazil sovereign rating

S&P Global Ratings upgraded Brazil's long-term ratings to "BB" from "BB-" with stable outlook. Brazil is now two notches below investment grade. Tax reform was pointed as the main reason for the upgrade as it reinforces the country's pragmatic track record in recent years. Also, the agency highlighted Brazil's strong external position and the fact that monetary policy that is helping to re-anchor inflation expectations. S&P expects a gradual fiscal adjustment, with the expectation that general government deficits will average around 6.2% of GDP from 2023 to 2026. The elevated expected deficits reflect the challenges of complying with campaign promises, while managing a low level of discretionary spending room and only partial success on tax measures, amid still high interest burden.

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Revenue boosting measures were all approved...

On December 20th, the Senate approved, by 48 votes to 22, the provisional measure (MP) on investment subsidies, which changes the rules on states' tax credits. This bill was a key part of the economic team's plan to achieve the 2024 zero primary deficit target. The expectation is for a collection of R$35 billion this year. The approval was a victory for the economic team that managed to approve all the proposed measures in the Budget Guidelines Bill (PLDO), despite some water down. The text also incorporated the topic of cutting JCP tax benefits (interest on equity, remuneration paid by companies to shareholders), limiting the deductibility currently provided by law.

On December 22nd, the bill that regulates online bets was approved in the LH, resuming the possibility of taxing online casinos. The basic text of the project was approved by 292 votes to 114 and implements a tax rate of 12% on the revenue from betting companies, minus the payment of prizes. Bettors must pay 15% per year when the amount received is above R$2,112 — referring to the Income Tax exemption range. Both measures were sanctioned by the president, which was another big win for the economic team.

... while three new initiatives were announced by the MoF

The federal government announced last Thursday (28) a provisional measure (MP) with three measures to restructure specific programs' taxation. The legislation aims to limit the fiscal cost of the payroll tax break approved by congress for companies in 17 labor-intensive sectors until 2027. Moreover, to balance the fiscal implications, the provisional measure rolled back tax incentives for the Events sector. The impact on public accounts, according to the Ministry of Finance (MoF), aims to partially offset R$12bn lost with Congress' decision to extend payroll tax breaks. The text proposes:

i) the end of the four-year payroll tax break extension for companies and replaces it with a new payroll benefit tailored to minimum wage earners, spanning a more comprehensive range of activities at a cost of 6 billion reais annually;
ii) the revision of the PERSE Program (which provided relief to the Events' sector during the pandemic and valid until 2026) – as the tax exemptions far outpaced initial estimates, they should be fully reinstated by 2025;
iii) a 30% limit to the annual amount that companies can deduct from taxes following court decisions that guarantee compensation for previously overpaid amounts – for companies with credits above R$10 million.

The measures do not seek extra revenue, but rather to avoid a negative impact for public accounts in 2024. According to the text published, the provisions will become effective on April 1st, but the measure requires legislative approval by the end of May – otherwise it will expire.

Still on the fiscal front: 2024 Budget Guidelines approved and short-term data worsened

The 2024 Budgetary Guidelines Law (LDO) was approved in Congress and established basis for the preparation of the annual budget. The text has a zero primary deficit target and incorporates about R$ 48 billion in parliamentary amendments, of which R$ 37 billion are mandatory. The rapporteur, Danilo Forte, accepted a proposal that limits the cut in expenditures to R$ 23 billion. On the Budget front, there will be R$ 53 bn for programs chosen by parliamentarians, a record amount, and R$ 4.9 bn to fund the local elections campaigns. The matter was already sanctioned by the President.

Regarding short term data, tax Collections reached R$179.4bn in November (down from R$215.6bn in October), according to the Internal Revenue Service. The number was in line with market expectations. Year-over-year, tax revenues increased 4.3% in nominal terms (vs +4.9% in October), while registered a -0.4% decline in real terms (vs 0.1%). The result was boosted by a collection of CSLL (contribution on net income). Tax collections deceleration is in line with the ongoing activity slowdown. Under the National Treasury methodology, the Central Government reported a primary deficit of R$39.4bn in November (vs R$18.3bn surplus in October). The result was below market expectations at a deficit of R$38.5bn. Total revenues were down to R$179.8bn (from R$212.5bn), while transfers to states and municipalities were up to R$42.9bn (from R$32.3bn), resulting in net revenues of R$136.9bn (from R$180.1bn), 4.2% in yoy terms. Total expenditures were R$176.3bn (from 161.9bn), increasing 20.0% yoy in real terms. The central government primary deficit went to R$110.0 bn or -1.0% of GDP in November (from -R$85.4bn or -0.8% of GDP in the previous month) in 12-month accumulated terms.

BCB released the Copom minutes: same guidance

The Brazilian Central Bank (BCB) released the minutes of the last meeting of the Copom (Monetary Policy Committee), after cutting the Selic rate to 11.75% (from 12.25%). The minutes continued to highlight the decision to cut rates by 50bp and maintained the wording about keeping the same easing pace in the next two meetings. After analyzing several forward-looking scenarios, the board stated that this pace of rate cuts is appropriate, based on the still uncertain external environment and de-anchored long-term inflation expectations.

The decision of a 50 bp cut, as well as the forward guidance, was unanimous among the members. Future steps reinforced the board’s commitment to persevere with a contractionary monetary policy stance. The board highlighted the importance of re-anchoring long-term inflation expectations and noted the ongoing disinflationary progress and a more benign inflation behavior. The evolution of the output gap and labor market gap were considered relevant in determining the pace at which inflation could reach the target. The board continued reinforcing the importance of complying with the fiscal targets, as well as strengthening the fiscal framework credibility to re-anchor inflation expectations. For more, see: Brazil Watch - Copom minutes: same guidance.

No major changes in the 4Q23 Inflation Report (IR)

The BCB also published its 4Q23 Inflation Report (IR). The report’s wording was similar to the minutes of the last monetary policy decision. According to the BCB, with inflation expectations persistently unanchored, the monetary easing pace of 50bps clips remains the most adequate. Tight output gap and well-behaved inflation continue to ensure the continuity of the easing cycle. Inflation expectations regained relevance since current inflation is moving towards the target - BCB showed that historically the weight of inflation expectations increases when inflation is lower in Brazil. On external front, scenario is less negative.

Regarding inflation forecasts, the model’s results pointed to a slower print for 2023, while remaining stable for 2024 and slightly higher for 2025, compared to the 3Q IR. Under its baseline scenario (with Selic following Focus survey at 11.75% for ’23, 9.25% for ’24 and 8.50% in ‘25; and BRL at 4.90 and evolving with PPP), inflation forecasts are now at 4.6% for ’23 (from 5.0% in September), 3.4% for ’24 and to 3.2% for ’25 (from 3.1%) – all within inflation target range. Annual growth forecasts changed from 2.9% to 3.0% in 2023 and from 1.8% to 1.7% in 2024. Prospects for the current account also improved, motivated by stronger oil trade balance.

Retail sales and IBC-Br pointing to activity slowdown

October Core Retail Sales declined -0.3% momsa (from 0.6% momsa in September), well below market expectations of +0.4%. In the month, the main downward pressure came from supermarket sales (-0.8% momsa, vs 1.4%). Just 3 out of the 8 groups posted monthly positive prints. In yoy terms, sales were up by 0.2%yoy (from 3.2% yoy). Meanwhile, broad sales, which includes Building Materials, Vehicles and wholesale food items, were down by 0.4% momsa (from 0.0% in September). In yoy terms, Broad sales decelerated to 2.5% yoy (from 2.8% yoy).

Economic Activity declined for the third month in a row. IBC-Br Index declined -0.06% momsa in October, versus -0.05% momsa in September (revised from -0.06% momsa), according to the Brazilian Central Bank. The number was below our (+0.1%) expectation but above the market's (-0.10%). In yoy terms, IBC-Br increased by 1.5% yoy, accelerating from 0.1% yoy in the previous month. With October's Economic Activity Index, the domestic activity trajectory in 4Q23 started in negative ground. The result was in line with negative readings of broad retail sales (-0.4% momsa) and services volume (-0.6%), partially offset by gains in the industrial output (+0.1% momsa).

Labor Market (still) resilient in November

According to the Nation-wide Job Market Survey (PNAD), unemployment rate reached 7.5% in November (vs 7.6% in October), in line with market's expectations. In seasonal adjusted terms, the result remained unchanged at 7.9% (from 7.9% previously). The print showed a higher occupation, resulting in a historical high in the non-seasonally adjusted series. November data also reinforced the resilience in the domestic labor market, with real income growth of 3.8% yoy (vs 3.9% yoy previously) - mainly driven by an increase in industrial sector real earnings (5.6% qoq).

The CAGED (General workforce registration system) reported the net creation of 130,097 formal jobs in November (from 190,366 in October), below market expectations of 158k jobs. Still, in 12-months accumulated terms, net formal job creation remained at 1.48mn. In seasonally adjusted terms, net job creation was of 119.2k (vs 207.4k in October), with 3mma moving up to 135.9k (vs 131.6k). There was positive net job creation in almost all the sectors, except for retail. Meanwhile, other services continue to be the main positive contributor.

Mid-December IPCA above forecasts

IPCA-15 registered a 0.40% mom increase in mid-December (from 0.33% mom in mid-November), according to the Brazilian Institute of Geography and Statistics (IBGE). The print was above our (0.26%) and market expectations (0.25%). Compared to our forecast, main upward pressures came from Transportation (airfare prices – the fourth consecutive print) and Healthcare (Personal hygiene items). Regarding underlying measures, key core metrics decelerated, with core average down to 4.47% yoy (vs 4.58% yoy previously), core industrials going to 2.95% yoy (from 3.72% yoy), while core services inching up to 4.73% yoy (from 4.60% yoy). Annual inflation decelerated to 4.72% yoy (from 4.84% yoy), below the upper bound of inflation target (3.25% + 1.5%).

December IGP-M increased 0.74% mom (vs 0.59% mom in November). This result was above market and our expectations of 0.67%. In this print, agricultural prices were the main upward pressure (3.07% mom, from 0.69% previously), while airfare continue to contribute to the upside on the consumer side.

Small changes in inflation and Selic expectations

According to the Brazilian Central Bank's weekly survey (Focus), Selic went down for 2024 to 9.00% (from 9.25%, 4 weeks ago), while remained unchanged at 8.50% for 2025. Regarding IPCA, expectations for inflation in '23 declined, now at 4.46% (from 4.54%), 2024 had small changes (3.90%, from 3.92%), while 2025 and 2026 remained at 3.50% (recall mid-target is 3.0% in the next 3 years). Consensus is below our forecast of 4.8% for YE23 and 3.7% for YE24. Selic rate consensus are below our forecasts of 9.50% for 2024 and 2025. GDP consensus are below our forecast of a 3.0% growth in 2023, and 2.2% in 2024. FX consensus forecasts are above our 4.75 for '24, and 5.00 for 2025-end.

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