

# Market Discipline or a Fallout

Mauricio Rosal, *Chief Economist, PhD*

joao.rosal@bgcpartners.com

March 24, 2017

## Market Discipline or a Fallout?

- *We understand the balance of risks have changed, unfortunately, not for the better.*
- *A muddling through type of social security reform is becoming more likely as opposed to a material one.*
- *This implies a two-fold path going forward: a) market discipline forces a meaningful reform, or b) political forbearance leads to negative re-pricing for the longer term.*

## 1. The Two-fold paths

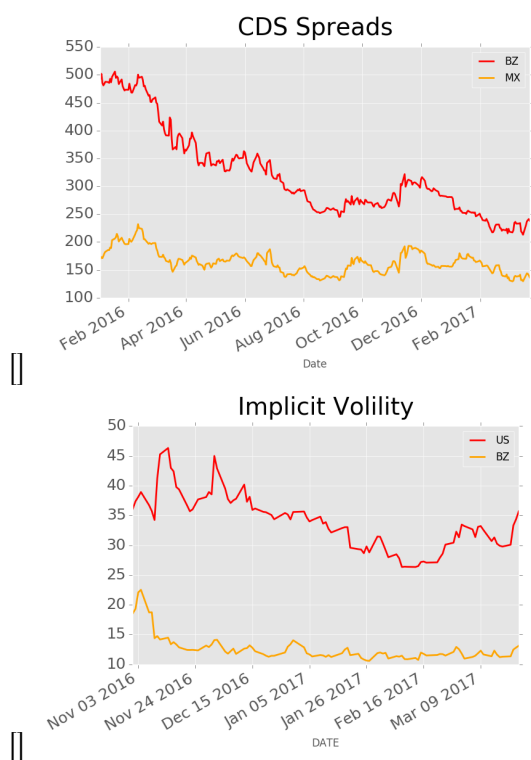
- ◇ **Balance of risks have changed.** The latest flow of news have confirmed the difficulties of Mr. Temer to approve the social security reform as is. While some type of compromising have been expected from the outset, we believe the latest announcement to leave State civil servants out of the reform has opened a Pandora box, making it difficult to predict what is going to come out of it.

More specifically, once one makes such a type of compromising involving specific classes of workers, the incentives in place are such that other classes should soon start to lobby for favoritism. In addition, there is also the interest of less organized citizens, such as those leaving off social benefits in many corners of the country, who hold great voting relevance. Thence, once sums all that up, the budget of acceptable concessions from the fiscal adjustment standpoint may start to fall short of the mounting pressures.

- **A two-fold path.** In light of the fore mentioned, the easy path towards a reform that comprises a) increases the minimum retirement age to 65 for both genders; b) ends with retirement of period of contribution of the system; and c) encompasses rural, urban, private and public workers alike is no longer possible. In fact, in order to reach a compromise that contemplates parts of either of these topics, there ought to be pressure in the opposite direction, and the only possible candidate to look in the positions to do so is the market.

In fact, Brazilian credit spreads as in ??, it's been standing about 90bps above Mexico's year-to-date, a country holding a sovereign credit rating about 4 notches above Brazil's. No doubt, it entails a rather benign vision towards the country's outlook, in particular, with respect to the country social security system. Hence, should this perception changes significantly, there is plenty of room for things to turn sour. In fact, the recent moves concerning the social security reform have been shrugged off by the market, and the volatility of Brazilian assets have clearly take off way from the US's benchmark.

Hence, the question: will the political class remain oblivious to that and follow their own agenda, or will they kneel to market pressures? We think latter of the most likely candidate, but with 2018 general elections take over their agenda, one should not dismiss the former altogether.



## 2. Forecasts

Variable	2016	2017E	2018E
GDP (yoy %)	-3.5	0.3	2.5
Selic Rate (%)	13.25	8.00	7.5
Fx Rate (BRL per USD)	3.20	3.25	3.30
CPI (yoy %)	6.3	4.0	4.4
Gross Debt to GDP (%)	73.0	77.2	83.2
Primary Surplus (% GDP)	-2.1	-2.0	-1.0
Trade Balance (% GDP)	2.0	1.5	1.5
Current Account (%GDP)	-1.2	-1.5	-2.0
Foreign Reserves (xUSD Gross Liabilities)	1.1	1.1	1.1

### 3. Disclaimer

<http://www.bgcpartners.com>

**CONFIDENTIAL:** This document has been sent to you by one of the BGC entities (collectively BGC) Please see important legal information and disclaimer relating to this mail at the following links: <http://www.bgcpartners.com/disclaimers/>

Please see for BGC Disclosures. The link contains company and FCA registration numbers. This e-mail, including its contents and attachments, if any, are confidential. If you are not the named recipient please notify the sender and immediately delete it. You may not disseminate, distribute, or forward this e-mail message or disclose its contents to anybody else. Copyright and any other intellectual property rights in its contents are the sole property of BGC and its affiliates. E-mail transmission cannot be guaranteed to be secure or error-free. The sender therefore does not accept liability for any errors or omissions in the contents of this message which arise as a result of e-mail transmission. If verification is required please request a hard-copy version. Although we routinely screen for viruses, addressees should check this e-mail and any attachments for viruses. We make no representation or warranty as to the absence of viruses in this e-mail or any attachments. Please note that to ensure regulatory compliance and for the protection of our customers and business, we may monitor and read e-mails sent to and from our server(s). The registered offices of the BGC entities are at 1 Churchill Place, London, E14 5RD. For any issues arising from this email please reply to the sender. The FCA register appears at <http://www.FCA.org.uk/register/>. The FCA regulates the financial services industry in the United Kingdom and is located at 25 The North Colonnade, Canary Wharf, London, E14 5HS. BGC Financial LP CFTC Rule 1.55(K) Firm Specific Disclosure Statement