

# CONFERENCE CALL NOTES

18 Oct 2022 18:44 EDT



## Brazil's economic outlook: A conversation with Henrique Meirelles

### Short-term trajectory:



### Long-term trajectory:



- Eurasia Group hosted a conference call with former finance minister and former central bank governor Henrique Meirelles, who has recently publicized his support for presidential candidate Luiz Inacio Lula da Silva, on his views of the Workers' Party (PT) economic policies plans and outlook for 2023.
- According to Meirelles, even though a spending waiver would be needed to maintain social expenditures in 2023, the constitutional spending cap continues to serve an important role; Meirelles said the government should pursue administrative and tax reforms in order to meet spending limits.
- Meirelles said Lula was inviting free market and left-leaning economists to discuss ideas, but said the former President is being very guarded over whether he will in fact follow the policy agenda of his first mandate, or listen more to economists who believe in a state led economy and helped draft the PT's government plan.

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*A recording of this call is available [here](#).*

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- **Christopher Garman (C.G.):** Minister, could you please share your view on the fiscal challenges that Brazil faces in the midst of a deteriorating global backdrop we are seeing?
- **Henrique Meirelles (H.M.):** I think a lot depends upon where we're headed when it comes to an economic growth point of view. The government has been injecting cash in the economy through financial aid programs which could become a problem. But today, it has been helping growth.

- But there are also other incentives like a financial aid for trucker drivers and financial aid for cooking gas. All that is fueling growth and might be also helping President Jair Bolsonaro electorally. All that is part of the equation.
- All this together is somewhat responsible for GDP growth but also generated a significant fiscal challenge for 2023. Evidently, it is impossible for the next president-elect to take a step back and try to lower the amount paid in the Auxilio Brasil program from the current BRL 600 to BRL 400 since people are already counting on the continuity of this amount. The most likely and plausible thing to happen is to keep the BRL 600 payments generating a budgetary deficit (or spending outside the cap) of BRL 10 billion dollars approximately.
- There is a constitutional cap on spending on public expenses in Brazil. It was approved in 2016 when I was the finance minister. It was very important at the time to recover Brazil's credibility. The approval of the spending cap had an immediate effect on the level of confidence in the economy. The economy began to grow again, and many things changed. That was critical at the time.
- The cap has been very useful during the last two years, even with the government finding several ways to go around it. For instance, the approval of an increase in the Auxilio Brasil was put outside of the cap. The cap was artificially increased by changing the period of the year for which the inflationary adjustment to the cap would be considered. They changed it and that was an important change because the inflation in the second half of 2021 was higher than the first half and created an artificial space under the cap to accommodate for the federal government's desired spendings.
- That created lots of uncertainties and its one of the basic reasons why the Real is somewhat depreciated despite the increase in commodity prices. In a situation like that the Real normally appreciates and now it is not happening even though Brazil is a commodity exporter.
- The spending cap however was useful, because it at least necessitated the need to approve constitutional changes and forced a public debate on what should be a priority. It was better to have the cap and the maneuvers created around it rather than not have it at all and have no limits on spending.
- The fact is that we now have expenses already in the budget that will need to fit next year budget without any cuts to the social welfare programs.
- And the question is now what to do with that? The risk again is to lose control of expectations. Lose control of all the anchors which have sustained the level of confidence in the Brazilian economy in the last years. We are in this scenario now.
- Then we have the elections coming up and a new president (potentially) will take over next year. What is going to happen? Well, I think the problem is even more complicated than it seems. Because there is a problem with the spending cap which is basically a misunderstanding. The cap itself was never viable until the end of the period for which was planned (end of 2026) without subsequent reforms.
- As a result, the main benefit for the spending cap was to force congress and executive branch to decide on priorities. That was what made the social security reform possible. Pension spending was growing at an unsustainable pace with retirement ages that were not appropriate for the system's sustainability. But other reforms are still necessary. The most important one is the administrative reform, and the tax reform should come right after. The two would be crucial to increase productivity in the economy. We worked alongside the World Bank on a series of projects to increase the Brazilian productivity.

- We had a similar issue when I was the finance secretary in the state of Sao Paulo. We had a budget that was balanced but tight, without room for investments. It was necessary to postpone payments sometimes. We made an administrative reform that was able to help the state achieve a USD 10 billion surplus in cash in 2022. I believe there is a large room to do something similar in the federal government.
- That was done by focusing on companies that were created to work on very specific projects that did not follow through. A good example at the federal level is the railroad between Rio and Sao Paulo. The project was too expensive and did not advance but the state-owned company created for it remained an expense for the state. We closed several of those companies and generate tremendous savings.
- Applying the same to the federal government is possible and generate income for future investments that respect the spending cap. However, we will still need to deal with a timing issue. It's impossible to do all in time to keep the payments of Auxilio Brasil in the beginning of next year, for example. In that case the most likely is that we will need to request a spending waiver from congress and try to approve these measures already in the next year.
- The election is very tight at this point. Lula's chances are higher but I still believe president Jair Bolsonaro has a real chance of winning.

## Q&A

**Q. Mr. Minister, you have a lot of first-hand experience in a Lula administration. In case Lula wins, do you believe he is likely to tackle the challenges just described? Also, any thoughts on the specific debate over the potential modifications to the fiscal rule that is occurring within the PT?**

- **H.M.:** Lula's first four years were highlighted by strong fiscal and social responsibility – probably the strongest in the history of Brazil. I was president of the Central Bank at the time and able to give some advice for his team. We had a very successful government. We were able to extend social safety nets for poor families, take millions out of poverty, and maintain fiscal responsibility.
- Though his second mandate was not that responsible on the fiscal side of the equation, there was good momentum, with external conditions pushing the government (commodity boom and other factors) to continue a growth trajectory. With the 2008 financial crisis, there was some fiscal expansion to tackle the challenges, which at the time was defensible, but it worked out well. The net result of these eight years was a 4% average of GDP growth per year, 11 million jobs created and almost 50 million Brazilians got out of poverty. It was also a very successful period of government.
- Then came the Dilma Rousseff government. Lula had strong approval ratings and decided to help elect Dilma. Though some advisors in government warned Lula that Dilma had a different approach to the fiscal side, he decided to support her anyway. As a result of that, Brazil entered a recession.
- We saw, therefore, three different Lula governments. The first with fiscal responsibility. The second with some relief on the fiscal side and more open to political demands. The third, not being president, but with the support coming from Lula, ended in a recession. The main question now is which Lula will take place if he indeed wins.
- I say it depends. If you take his current government program, it would be bad news. It is drafted by with a view similar to his third government (Dilma's administration), especially because who developed the program was a group of economists who

strongly believe in the role of the State and state-owned companies for fostering development. This view is prevailing at this moment.

- But there is another group of economists who are supporting Lula. They are a more liberal group (in the European sense of the word, not the US), who care more about fiscal responsibility and debt sustainability. They supported the idea of increasing expenses above the ceiling for fostering growth – by proposing the waiver –, which appears somewhat close to BRL 300 billion for four years (a high number that does not appear viable).
- For me, I announced my support in Lula on a public event based on my experience as part of his government when he was president—and based on the assumption over the set of policies in his first mandate will be adopted because that created millions of jobs and helped millions of poor families to get out of poverty.

**Q. A critical element of how you described the above evolution may well depend on the lessons Lula took regarding the disastrous outcomes of the Dilma administration. Do you think that he appreciates that the reasons for a historic recession was driven by the mismanagement of the fiscal accounts? Or does he believe this happened by other factors?**

- **H.M.:** Lula is very careful and is taking into consideration different economic lines of thinking. This means he does not talk about this matter and is careful about expressing any explicit ideas.
- Economists who believe that the state should lead the economy are constantly talking to him and they have an idea that Dilma's administration did not fail because of a wrong fiscal policy. Their argument is that she did the right things but the economy dropped due to businessmen and farmers who decreased production as an act of sabotage against Dilma's government.
- This is an absurd idea as a businessman—that businesses would willingly take losses as an act of political sabotage.
- They also blame the press and other institutions that were against Dilma's government, to justify her fiscal failure. These economists believe that if Lula takes forward these same policies they would work out due to his popularity and political capacity.
- But Lula wants to keep both these left leaning economists and the market pleased. He is looking for support everywhere, including within Bolsonaro's base such as evangelical groups. As a result, it is very hard to gauge where Lula will land in this debate.

**Q. The market believes that the current center-right composition of the lower house and senate would provide some checks and balances to a Lula government. Do you agree?**

- **H.M.:** Yes, it is possible, but I am not sure of that. I believe he will receive support from congress, due to his political ability, but I am not sure he would adapt his fiscal policy because of a more conservative congress. My answer to whether he would become more conservative because of the congressional results is no.

**Q. What is your role in this economic debate and the campaign?**

- **H.M.:** The group who wrote the economic plan is the one that believes the state should lead the economy. In practical terms, they are still the ones that are working with Lula. Some liberals have joined that group recently and now it seems that they will expand the debate and invite some new experts like myself.
- I am not part of the group which I call the Brazilian left thinking group.
- But for the first time now there is some signals that there might be a joint meeting between the liberal economists and the leftist group to discuss openly different policy proposals. But that has not been decided yet.
- Still, we are in the campaign. Lula will not announce any of his economic plans or the names who will lead the economy before the election. Despite market desire or wishes, he does not believe that this would have a big impact in him winning the election.
- By making these announcements he could add some people but also lose some people.
- **C.G.:** Yes, and we agree. We at Eurasia Group believe that Lula does not need to detail his economic plans in order to win the election. There is a difference between catering to the centrist voter and signaling to the market regarding a responsible fiscal management.