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Pension Reform: First Challenges

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A sequence of events triggered momentary political turbulence in Brasília. The bellicose climate began with President Jair Bolsonaro's reluctance to open negotiations with Congress in order to build a majority capable of passing the pension reform bill. A truce was declared to keep the reform moving, but the market mood had already soured.

Bolsonaro justified his initial attitude as an expression of the "new politics", in which the three branches of government are supposed to be totally independent. He believes he has done his duty by delivering a robust and comprehensive pension reform proposal to Congress. His critics, however, suggest the "new politics" is not a new way of doing politics but a way of not doing politics at all. Congress demands negotiation and active participation by Bolsonaro throughout the reform proceedings. More importantly, Congress wants to share power with the executive branch.

The strife began with the presentation of a bill proposing a new pension scheme for the armed services that would save the public purse R$10 billion in ten years, much less than the R$90 billion originally promised, and would anyway reuse the money saved to invest in career restructuring, a longstanding demand of the officer class. The markets were disappointed, not least as the bill appeared to open the door to similar demands by other vested interest groups who dislike the proposed pension reform.

The turbulence increased with the arrest of former President Michel Temer, inspiring his successor to reaffirm his belief in the "new politics" and leading to another clash with Speaker Rodrigo Maia. The first reading of the pension reform bill, by the Constitution & Justice Committee (CCJ), was delayed and Economy Minister Paulo Guedes shied away from testifying to the committee about the bill.

Tensions rose when the leaders of 14 parties representing almost 300 members of the lower house announced in a letter their intention of striking from the pension reform bill all changes relating to BPC ("Continuous Benefit"), payable to the elderly and handicapped without other sources of income, and rural pensions. Disquiet peaked when the lower house swiftly passed a constitutional amendment that leaves the executive controlling only 3% of the federal budget. The debate and two rounds of voting took less than an hour. In the second ballot 453 deputies voted in favor, and only 6 against.

The deletion of changes to BPC and rural pensions was expected and will not significantly impact the estimated saving to public expenditure. Moreover, the budget amendment is not effective immediately. Nevertheless, Congress has sent a message to the executive telling it to get its act together and negotiate properly.

A ceasefire appears to have been declared, and the CCJ's reading of the pension reform bill is finally under way. Moreover, Bolsonaro started conversations with the main parties' leaderships. However, a long and winding road clearly lies ahead for the reform and the government will indeed have to engage in grueling negotiations that require skillful political leadership. A reform of some kind will pass Congress, but uncertainty has increased regarding when that will happen and how effective it will be.

Turning to the global outlook, the latest reports confirmed a slowdown in Europe counterbalanced by better numbers at the margin for China and the US, positively surprising the markets. This may be a sign that the expected deceleration in the world economy will be milder than previously thought. In addition, global financial conditions remain more favorable to emerging countries.

On the home front, economic growth remains disappointingly low, and we have revised down our 2019 GDP growth projection to 1.8%. The inflation outlook remains comfortable, and the Central Bank's policy rate is set to remain on hold for the rest of the year, but until the prospects for pension reform become clear we are unlikely to see a faster pace of economic growth in Brazil.

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,1%	1,8%	3,0%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	3,9%	3,7%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	6,50%	6,50%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,0%	10,0%
Trade Balance (US$ bn)	3	-4	20	48	67	58	56	44
Current Account Balance (US$ bn)	-75	-104	-59	-23	-10	-13	-21	-38
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	-1,0%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,4%	-0,8%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	77,8%	78,7%