



Brazil Crisis Deepens with Downgrades

Monica de Bolle explains the latest twists in Brazil's turbulent economic saga after a second credit downgrade.

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Pedro da Costa: Hi, I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. I'm joined by Monica de Bolle a fellow here and our Brazil expert, resident Brazil expert.

So, we know Brazilian politics are a complete mess and there are impeachment proceedings against the President. Let's leave that small detail aside for now and focus on the economic crisis at hand. We're also facing a deep recession and high inflation. Can you give us a rundown of the latest developments economically and in the markets?

Monica de Bolle: We had recently the GDP numbers coming out showing that the country is going to face the worst recession in 2015 since 1990. So, that was the first batch of bad news as of the last three weeks. And soon after that there's been a whole discussion about what's going to happen or what's going to be the 2016 fiscal target. And there was a lot of back and forth between the Ministry of Finance and the Ministry of Planning and the Ministry of Finance fighting for a higher primary surplus target for 2016 and the Minister of Planning taking a different stance.

And basically what's happened as of yesterday is that the government decided to go with a fiscal band, which is rather weird because countries don't normally do this. I mean, they set fiscal targets for themselves rather than a band whereby you say you set a floor and a ceiling and you say the primary surplus is going to vary between such and such. And that's what the government announced yesterday. So, basically it said, "For 2016 we're looking at a fiscal target that can be anything from zero to 0.5% of GDP."

And this sounds a lot like what happened a couple of months ago when S&P downgraded Brazil. This was on September 9th. The day before, the government had actually hinted that the 2016 fiscal target could be negative. And then Brazil got downgraded the very next day.

Pedro da Costa: And so, how are international markets likely to react to the latest, this kind of very original idea, if you could call it that, of a flexible band.

Monica de Bolle: Well, in a sense it's kind of following that script back in September where the government announces something that sounds totally off the wall and then the ratings agency downgrades the country the very next day.

Pedro da Costa: This time it was fit for it.

Monica de Bolle: This time it was fit. A lot of that...

Pedro da Costa: Which means that we have two of the three major rating agencies now have Brazil in junk territories, is that right?

Monica de Bolle: That's right. So, we are now waiting for Moody's. And in a way this is already priced in. I mean, markets had already pretty much seen this coming, given just the depth of deterioration and the depth of political dysfunction and everything else. But I think the thing that is most important here is that looking forward, since there is no kind of sign that anything is going to improve, we will probably see a Moody's downgrade very soon. We might see S&P downgrading Brazil further into junk territory. Fitch has left Brazil on negative outlook, meaning that they can do a further downgrade within the next whatever, 12 months or even less. So the situation really is looking very, very tricky.

Pedro da Costa: And what is the role of Finance Minister Joaquim Levy because there has been rumors that he's going to leave and the government has repeatedly asserted that's not the case; that he's remaining. And he's one of the few sort of internationally credible figures within the government. What do you think is likely to be his fate?

Monica de Bolle: Well, it's looking like he will leave this time. Especially because...

Pedro da Costa: This time it's different?

Monica de Bolle: This time is different. As of this morning, a batch of news came out saying that a number of people on his team are leaving or have recently left, meaning that basically this is like, "Okay. We've tried all we could do. We haven't been able to get what we needed to get done on the fiscal front. So, perhaps a new team needs to come in and try to get things done." Though it's really difficult to see how that will happen in this extremely difficult political environment that I don't think we're going to talk about this time.

Pedro da Costa: Indeed. We'll leave it for another segment and we'll try to sort out what the impeachment process might look like and how prolonged that would be, but we'll leave it there for now. Thank you, Monica.

Monica de Bolle: Thank you.

