

Critically Assessing Macroeconomic Policies in Brazil from Lula da Silva to Dilma Rousseff

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Introduction

This Development Viewpoint assesses Brazil's macroeconomic performance during the 'leftist' governments of Lula da Silva (2003-2010) and Dilma Rousseff (2011-2014).

During this whole period (2003-2014), GDP grew by an average of about 3.4% per year while the average inflation rate was 5.9% (see Table 1, next page). In addition, the unemployment rate dropped from 12.3% to 4.8%. The fiscal surplus averaged 3.1% of GDP and the net public debt dropped from 52% of GDP to 37%.

Foreign reserves increased from US\$49 billion to US\$364 billion while the yearly trade balance averaged US\$25.5 billion. However, the current account as a ratio to GDP began running a deficit in 2008, in the wake of the international financial crisis, and this deficit worsened to -4.2% by 2014. While the policy interest had declined from its peak in 2003, it was still almost 11% in 2014.

But, overall, Brazil has displayed a healthy combination of macroeconomic resilience, income redistribution and poverty reduction. For example, between 2000 and 2012 the Gini Index fell from 0.589 to 0.526 and by the end of 2012 about 13.6 million families were benefitting from *Bolsa Família*, the government's main program against poverty.

Assessing Policies over Time

The whole period of the 'leftist' governments of Lula da Silva and Dilma Rousseff can be divided into two parts. Lula da Silva's first term (2003-2006) was notable for continuing the macroeconomic policies of the outgoing government of Fernando Henrique Cardoso. This stance was based on the New Consensus Macroeconomics, which was based on maintaining inflation targeting, a fiscal surplus and a flexible exchange rate.

In Lula da Silva's second term (2007-2010) and Dilma Rousseff's first (2011-2014), they had to introduce structural measures and economic policies that were designed primarily to respond to the global financial crisis and the resulting 'Great Recession'.

Lula da Silva's First Term (2003-2006)

In his inaugural speech in January 2003, President Lula da Silva announced his intention to tackle social problems and rekindle self-sustaining economic growth. But by the end of his first term, the economic results were relatively poor: average GDP growth was only 3.5%, the inflation rate stood at 6.4% and the unemployment rate was still 10.9%.

During this period, net exports were the main source of growth for the Brazilian economy. By 2006 the trade balance had risen to over US\$46 billion and the current account as a ratio to GDP had improved to a 1.3% surplus.

But Brazil's success depended on improvements in the global economy, especially in China and the USA. Global growth sparked increases in the prices of commodities on international markets. As a result, during 2003-2006, Brazil's foreign reserves expanded from US\$49 billion to US\$86 billion.

But Lula's administration was hampered by the New Consensus Macroeconomics still being implemented by the Brazilian Central Bank. It operated a tight monetary policy, maintaining, for example, the average nominal interest rate at over 18% and the real interest rate at about 12%. The Central Bank also pursued financial liberalization, which facilitated the outward and inward flow of short-term capital.

Critically, the Central Bank also insisted on promoting an average primary fiscal surplus of about 4.5% of GDP. This level was even higher than the 4.25% target proposed by the International Monetary Fund.

Lula da Silva's Second Term (2007-2010)

In 2007, at the start of Lula da Silva's second term, fiscal policy shifted course slightly, broadening the coverage of the government's social protection programs and expanding public investment. Noteworthy was its new *Programa de Aceleração do Crescimento* (PAC), which sought to boost public investment in infrastructure and stimulate private investment.

During previous financial crises, Brazil's governments had tightened fiscal and monetary policies, usually within the framework of an IMF stabilization program. But in response to the global financial crisis that erupted in 2008, Lula da Silva sought to implement more expansionary, counter-cyclical policies.

Begrudgingly, the Central Bank did finally decide in 2009 to reduce the policy interest rate from 13.75% in January to 8.75% in September. And Brazil's state-owned banks – *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES), *Banco do Brasil* (BB) and *Caixa Econômica Federal* (CEF) – were instructed by the government to expand credit to the economy, in order to counteract the contraction of credit from private banks (both national and foreign).

The government's fiscal policy combined tax reductions and increased spending. As a result, its stimulus package injected a total of US\$20.4 billion into the economy (equivalent to 1.2% of Brazil's GDP in 2009). In addition, in order to boost aggregate demand, the government launched the *Minha Casa, Minha Vida* program of government incentives and subsidies for housing construction, and it also expanded its social programs.

After experiencing a recession in 2009 (with GDP contracting by -0.2%), the Brazilian economy increased strongly by 7.6% in 2010 as a result of these countercyclical economic policies.

During the entirety of Lula da Silva's second term (2007-2010), GDP grew by an average 4.5% per year (aided by increases in investment, private consumption and exports); the average annual inflation stood at 5.1%; and the unemployment dropped from 9.3% to 6.7%.

However, Brazil's external trade deteriorated significantly from 2007 to 2010. The yearly trade surplus dropped from US\$40 billion to about US\$20 billion and the current account as ratio to GDP declined from about 0% to -2.2%.

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Rousseff's First Term (2011-2014)

In 2011, immediately after Dilma Rousseff's presidential inauguration, Brazil's Central Bank boosted the policy interest rate in order to dampen inflationary pressures associated with the healthy economic growth of 7.6% in 2010. Fiscal policy also became tighter.

Thus, by the end of the year the policy interest rate had risen to 11.75% and the primary fiscal surplus had reached 3.1% of GDP. But the Brazilian economy still managed to grow by 3.9% in 2011.

After the middle of 2011 there was a gradual worsening in the international context for Brazil's economy due to the Euro crisis. In response, Brazil's Central Bank tightened up its regulation and supervision of Brazil's financial sector. And it lowered its policy interest rate to 7.25% by the end of the year.

Also, the government implemented a fiscal stimulus package that included increased government spending and subsidies and cuts in taxation. It also planned to boost investment to close to US\$500 billion for the period 2011-2014. In addition, it initiated a new industrial policy, the *Plano Brasil Maior*.

But these counter-cyclical measures failed to sustain economic activity and, as a result, the Brazilian economy grew by only 1.8% in 2012. The inflation rate also began to increase by the end of 2012.

In response, the Central Bank began to implement tighter monetary policies. Hence, by the end of 2014, the policy interest rate had risen back up to almost 11%. But Brazil's exchange rate became very volatile during this period, reflecting both the uncertainties over US monetary policy and the deterioration of its own external accounts. By 2014, Brazil's current account balance as a ratio to GDP had deteriorated to -4.2%.

In order to counteract tighter monetary policies, Rousseff's administration continued to expand public expenditures. But, as a consequence, the government's primary fiscal balance dropped from +2.4% of GDP in 2012 to -0.6% in 2014.

As a result, during Dilma Rousseff's first administration (2011-2014), the average yearly GDP growth rate declined to only 2.1%. And in 2014 it was only 0.1%. The average inflation rate over the four years had risen back up to 6.2%. And the average current account deficit as a ratio to GDP had risen to about -3.1%.

How to Revive the Brazilian Economy

In summing up Brazil's macroeconomic policy trends since 2007, it is reasonable to argue that despite generally progressive efforts to pursue developmentalist policies, the 'leftist' governments of Lula da Silva and Dilma Rousseff have been hampered by the more conservative inflation targeting regime maintained by Brazil's Central Bank. However, such conventional inflation targeting does not ensure macroeconomic stability, at least not from a demand-side Keynesian perspective.

From a Keynesian perspective on maintaining stability, macroeconomic policies should be coordinated in such a way as to (i) operationalize fiscal policies that can expand effective demand as well as reduce social inequalities, (ii) institute more flexible monetary policies so as to maintain adequate levels of consumption and investment, and (iii) coordinate and regulate financial and foreign-exchange markets in order to stabilize capital flows and exchange rates.

Such a fundamental policy stance would imply that the Brazilian government should maintain its Keynesian countercyclical macroeconomic stance and developmentalist strategy, not just in response to international financial crises—but, more importantly, also in response to the policy demands of more normal economic conditions.

Table 1: Brazilian Macroeconomic Indicators, 2003-2014

Macroeconomic Indicator/Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Inflation Rate (IPCA), %	9.30	7.60	5.69	3.14	4.46	5.9	4.31	5.91	6.50	5.84	5.91	6.41
GDP growth (%)	1.2	5.7	3.1	4.0	6.1	5.0	-0.2	7.6	3.9	1.8	2.7	0.1
Interest rate (Selic), average (%)	23.0	16.4	19.2	15.2	12.0	12.7	10.1	9.9	11.75	8.63	8.29	10.96
Trade balance (US\$ billion)	24.8	33.6	44.7	46.1	40.0	24.7	24.6	20.3	29.8	19.4	2.6	-3.9
Current account/GDP	0.8	1.8	1.6	1.3	0.1	-1.7	-1.5	-2.2	-2.1	-2.4	-3.6	-4.2
Fiscal surplus/GDP (%)	4.3	4.6	4.8	4.3	4.0	4.1	2.1	2.8	3.1	2.4	1.5	-0.6

Source: Brazilian Central Bank, *Séries Temporais*, <http://www.bcb.gov.br> (2015).