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Highlights

- **GDP in the 2nd quarter is expected to show retraction, despite some improvements in April and May.**
- **Greater weight in economic activity could lead BC to reduce Selic rate to less than 8% in 2017.**
- **Situation of external accounts remains favorable, amidst the severity of the economic framework.**
- **Brazilian tax burden is falling and we estimate it will reach 31.5% of GDP by 2017.**
- **Discretionary spending disbursements in 2017 evidence significant cuts in comparison to 2016.**
- **Expenditure ceiling will be effective from 2020 and will demand changes in mandatory spending.**

Summary

- Despite some improvements in economic activity data in April and May, our projection for the second quarter indicates a **retraction of 0.3% of GDP in relation to the first quarter**. Statistical effect of March results, **worsening of confidence indexes** and still fragile job recovery explain the negative context.

- IFI estimates for the Selic rate decision rule show some space for the **interest rate to fall** beneath 8% by the end of 2017, as long as the weight for economic performance, decided by the Central Bank, is set equal to 90%. If it is set for 50%, with equal weight to the inflationary control, the Selic rate could still fall to 8.6%.

- External accounts have evolved favourably in recent years, in terms of current and capital flows, but also stocks, notably the balance of foreign-exchange reserves in relation to external liabilities. In addition to the reserves, **this positive picture is due to the impact of economic activity** on imports and to direct investments, which persist at high levels.

- Brazilian tax burden is expected to reach 31.5% by the end of 2017, keeping its downward trajectory. The severe economic crisis and the weight of tax breaks explain this behavior. Compared to its potential evolution – without tax breaks – **collection performance could be at least 4 p.p. of GDP higher than its current level**.

- With discretionary spending cuts already taking place, a considerable part of this subgroup has **little room for further reductions**, for instance investments already being executed, public bodies maintenance expenses, essential discretionary public policies and expenses entailed by mandatory spending.

- Despite the existence of two fiscal rules – the target for primary result and the expenditure ceiling – **only the former has dictated fiscal policy**, that is, has lead the central government to cut spending and seek new sources of revenues. Only from 2020 the ceiling will play the leading role and its fulfillment will require structural changes in mandatory spending.