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FEATURED Q&A

What's Behind Brazil's Growing Fiscal Deficit?

Brazil's government recorded a deficit of more than $10 billion in May. The country's Congress is pictured. // File Photo: Mario Roberto Duran Ortiz via Wikimedia Commons.

Q Brazil's government recorded a primary deficit of 53.3 billion reais ($10.2 billion) in May, the National Treasury reported on June 29, the largest deficit for a month in inflation-adjusted terms since 2024. At the same time, Treasury Secretary Daniel Leal said he expects spending as a share of gross domestic product to decelerate and end the year at around 19 percent of GDP. What explains the increase in Brazil's primary deficit and what is behind the expected decline of spending? How likely is spending to fall to around 19 percent of GDP by the end of the year? How are Brazil's fiscal policies likely to affect inflation, interest rates and investor confidence in the months ahead, particularly as the government balances its re-election agenda with the need to demonstrate fiscal discipline?

A **Alessandra Ribeiro, partner and director of macroeconomic and sectoral analysis at Tendências Consultoria:** "The large primary deficit in the first half of this year reflects a combination of structural and cyclical factors. Structurally, the main pressures come from social security spending, particularly amid the return of real increases in the minimum wage, which indexes a large share of mandatory expenditures. In addition, stronger tax revenues also raise spending, as they trigger higher outlays on health and education to comply with constitutional minimum requirements. On the cyclical side, the deficit was worsened by the concentration of court-ordered debt payments, the payment schedule of the social security 13th salary bonus and the strong execution of discretionary spending, especially public

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TODAY'S NEWS

POLITICAL

Sheinbaum Rejects DEA Chief's Comments on Mexico, Cartels

Mexican President Claudia Sheinbaum on Wednesday rejected comments from the head of the U.S. Drug Enforcement Administration, who said there is a "deadly connection" between Mexico's government and drug cartels.

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BUSINESS

Codelco Sees Flat Copper Output in Coming Years

Chilean state-run copper miner Codelco expects production to remain near current levels in coming years, its chairman said.

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ECONOMIC

U.S. Announces 25% Tariffs on Goods From Brazil

Following a yearlong investigation into Brazil's trade practices, U.S. Trade Representative Jamieson Greer announced that the United States will impose a tariff of 25 percent on several imports from Brazil.

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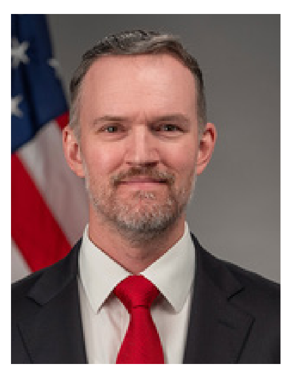

Greer // File Photo: Office of the U.S. Trade Representative.

ECONOMIC NEWS

U.S. Announces 25% Tariffs on Imports From Brazil

Following a yearlong investigation into what it called unfair trade practices by Brazil, the U.S. Trade Representative's Office announced Wednesday that it will impose tariffs of 25 percent on imports from the South American country. "Whether it is punishing U.S. technology companies for refusing to censor political speech, backsliding on anti-corruption enforcement or allowing Brazilian farmers to exploit illegally logged land to gain an advantage over American farmers, Brazil's unfair trading practices have prevented U.S. workers and producers from accessing this important market with over 210 million consumers," U.S. Trade Representative Jamieson Greer said in a statement announcing the tariffs. "Today's action is necessary to address these unfair trade practices to ensure American workers and companies can compete on a level playing field." Greer added that "extensive negotiations" over the past year with Brazil have failed to produce a resolution. In a statement posted to social media site X, Brazilian President Luiz Inácio Lula da Silva said that Wednesday "will go down in the history of relations between Brazil and the United States as a lamentable milestone." He added, "There is no justification for unilateral measures against our country," and pointed out that the United States has a trade surplus with Brazil. The tariffs are being imposed under Section 301 of the Trade Act of 1974, which allows a presidential administration to impose duties if it finds unfair trade practices. The tariff is to take effect on July 22 and applies to several Brazilian goods, though several major categories of imports will be exempted, The New York Times reported, citing an unnamed senior administration official. Those exemptions include oil and gas, beef, coffee, aircraft parts and oranges.

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investment in socially relevant areas, partly due to constraints imposed by electoral legislation. Regarding expenditure as a share of GDP, the National Treasury and the Ministry of Finance are working with more optimistic assumptions than the market and Tendências Consultoria, especially on economic growth. At the same time, the electoral calendar has distorted the usual timing of spending execution, concentrating outlays in this year's first half and making the second-half outlook somewhat less volatile. Our baseline projects total expenditure at 19.6 percent of GDP this year, remaining above 19 percent at least through 2030. More meaningful declines would require stronger expenditure-side measures, especially on mandatory spending, for which there are still no concrete plans. In the coming months, the electoral campaign is likely to outweigh any commitment to fiscal balance. As a result, we expect further currency depreciation in the second half of this year, inflation reaching 5.3 percent and sustained pressure on forward interest rates."

A **Monica de Bolle, senior fellow at the Peterson Institute for International Economics (PIIE) and director for Latin American studies and emerging markets at the Johns Hopkins University School of Advanced International Studies:** "The May increase in Brazil's primary deficit was unsurprising. While spending grew 9.4 percent in real terms, revenues rose only 5.5 percent. The increase in spending was driven mainly by pensions, as the government worked to clear the INSS benefits backlog, which resulted in adding beneficiaries faster than previously estimated. Additionally, court-ordered payments (precatórios) that were scheduled for the second half of 2025 were front-loaded into the first half of 2026. Treasury Secretary Daniel Leal's expectation that spending will drift back toward 19 percent of GDP is rea-

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NEWS BRIEFS

E.U. to Provide Additional $22.8 Million to Venezuela Following Earthquakes

The European Union will provide an additional 20 million euros ($22.8 million) in humanitarian aid to Venezuela following the earthquakes that hit the country last month, Reuters reported. The additional funds will pay for medical equipment and support for search crews. The aid follows a five-million-euro aid package approved last month and 52 million euros in aid that was announced early this year. The official death toll from the disaster stands at 4,829 but is feared to continue rising.

Brazilian Authorities Charge 22 With Money Laundering

Rio de Janeiro prosecutors and police charged 22 people Wednesday with laundering $20 million for gangs designated as terrorist organizations by the United States, Reuters reported. Authorities arrested 10 suspects and are seeking to freeze related assets. Investigators said the scheme laundered funds for the Terceiro Comando Puro while concealing assets tied to Comando Vermelho and the Primeiro Comando da Capital, using shell companies, Rio's civil police said on social media site X. Prosecutors are also probing possible links to Al Qaeda.

Chile's Codelco Sees Flat Copper Output in Coming Years

Chile's state-run copper miner Codelco expects production to remain near current levels in coming years, Chairman Bernardo Fontaine said Wednesday, according to Reuters. Structural projects meant to offset declining ore grades have faced delays and cost overruns, he said. Separately, Fontaine told a congressional committee the board's priority is "leading a transformation that allows Codelco to fully recover its capacity to generate value for Chile."

Countries Sign Deal for Aviation Partnership

Aviation authorities from Argentina, Brazil, Chile and Paraguay signed a memorandum of understanding Tuesday in Asunción laying the groundwork for a proposed South American Single Sky, modeled on the European Union's aviation market, United Press International reported. The agreement, known as the South American Air Liberalization Accord, or ALAS, aims to progressively eliminate barriers to passenger and cargo traffic, treating regional routes more like domestic flights, according to Argentina's government. The countries agreed to grant each other broad, reciprocal rights to operate commercial air services, encompassing all freedoms of the air recognized by the International Civil Aviation Organization, the Argentine government said in a statement. Officials expect the initiative to expand direct routes, boost competition and lower airfares, UPI reported. An initial step allows airlines to fly between two foreign member countries without the route touching their home country; a more advanced phase would let foreign carriers operate domestic flights within another member's territory. An executive working group, coordinated by Paraguay, has 12 months to align safety regulations, recognize flight crew licenses, set passenger-rights standards and streamline customs procedures, according to UPI. Officials said the pact remains open to new members, with talks underway with Uruguay.

THE DIALOGUE CONTINUES

What Will Annual Reviews Mean for the USMCA?

Q The administration of U.S. President Donald Trump on July 1 declined to extend for 16 years the USMCA trade agreement, which Trump negotiated with Canada and Mexico in his first term. While Canada and Mexico in June said they favored extending the trade deal, the U.S. refusal to do so sets the accord up for annual reviews until July 1, 2036, or until the three countries all agree to extend the agreement for another 16 years. What does the U.S. decision mean for the future of the USMCA? To what extent will the U.S. decision lead to economic uncertainty and disruptions in North America? How will businesses and consumers be affected?

A **Turenna Ramirez Ortiz, partner at Holland & Knight in Mexico City:** "Since the USMCA's implementation in 2020, the value of trade among the United States, Mexico and Canada (the 'region') has increased by more than 30 percent to $1.9 trillion. Our economies are integrated with profitable supply chains; in the event of a major disruption to the USMCA, the ill effects for our countries could be substantial. This economic fact, including the extent to which jobs in the region depend on the USMCA, should give the three countries legal and political incentives to eventually extend it. The annual USMCA reviews provide an opportunity to update conditions that the three countries see as unfair or non-compliant. However, prolonged reviews will increase trade and business uncertainty in the region. Such uncertainty complicates the business environment, and creation of jobs, as well as conditions for foreign investment and long-term strategic planning. The USMCA means affordable and high-quality goods and services for consumers in the region, as well as supply chain integration. There are still many open items on the U.S. agenda and concerns for Mexico and Canada including rules of origin, labor standards and tariffs in the areas of steel, aluminum, copper and automobiles. These combined with China's activities in the region must be agreed upon for the USMCA to be extended. A suitable understanding sooner rather than later is needed to prevent an economic crisis."

EDITOR'S NOTE: The comment above is a continuation of the Q&A published in Wednesday's issue of the Advisor.

POLITICAL NEWS

Sheinbaum Rejects DEA Chief's Remarks on Mexico, Cartels

Mexican President Claudia Sheinbaum on Wednesday rejected comments from U.S. Drug Enforcement Administrator Terry Cole, who said Tuesday that there is "a deadly connection" between the Mexican government and drug cartels, Reuters reported. In her morning news conference, Sheinbaum called Cole's comments "unfortunate" and unsupported by evidence. During an anti-drug summit in Florida, Cole said the Mexican government and cartel networks were "one and the same" and called fighting cartels and their associates the agency's top priority. Sheinbaum called the comment "a very unfortunate statement," adding, "It seems more like a political statement than one backed by evidence," Reuters reported. Sheinbaum also urged the DEA to focus on combating drug trafficking within the United States, saying the agency "has a lot of work to do" there, Telemundo reported. The Mexican government issued a formal statement Tuesday rejecting Cole's remarks, according to Reuters. The dispute adds to strained U.S.-Mexico relations, following Washington's April indictment of Sinaloa Governor Rubén Rocha, which Sheinbaum's government called unsupported by evidence, and Mexico's criminal complaints this week over deaths of Mexican nationals in U.S. immigration custody. The U.S. Treasury on Wednesday designated the Cártel de Juárez and Los Viagras, as terrorist organizations.

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sonable and reflects the calendar effect in reverse: the large increase in court-ordered payments will not repeat in the second half of 2026. However, the underlying fiscal situation is deteriorating, and the 2026 target will likely be met only because a constitutional amendment excluded some 70 billion reais in court-ordered payments from the calculation. As a result of a weakening fiscal position, inflation is above the target band ceiling, and 2026 inflation expectations have risen above 5 percent, with the central bank explicitly flagging fiscal stimulus as an inflation risk. With real interest rates at about 9 percent, Brazil remains very attractive to investors despite the fiscal deterioration. This said, everyone assumes adjustment will come in 2027, regardless of who wins in October. If the assumption is not validated by the next government, repricing of Brazilian assets will be abrupt."

A **Silvia Matos, professor at the Getulio Vargas Foundation:** "In May, Brazil's consolidated public sector posted a seasonal primary deficit of 56.1 billion reais. The 12-month balance widened to 1.1 percent of GDP, even though we observe a resilient revenue. For the central government, the deficit was 53.3 billion reais. The main reason for the fiscal deterioration is the increase in spending. For instance, in May, for the central government, expenditures rose 9.4 percent year-on-year in real terms, driven by pension benefits, mandatory spending and the continued normalization of discretionary expenditures. Stimulus measures during an election year will keep the primary deficit in the first half of 2026 at a higher level. Due to electoral law, there are many restrictions on public spending in the second half of the year. Even anticipating a slowdown in the growth of public spending, we project a primary deficit of 0.6 percent of GDP and gross debt at 84.5 percent of GDP in 2026. The deterioration of public finances is reflected in higher risk premiums demanded by the market to finance the government. Furthermore, with public spending rising at high rates, a higher interest rate is required to keep inflation under control. In summary, there is a need for significant fiscal adjustment going forward."

> **"The main reason for the fiscal deterioration is the increase in spending."**
> **— Silvia Matos**

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta.

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