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WORLD | LATIN AMERICA

Brazil's Economic Crisis Beats the Emerging Middle Class Back Down

Rising inflation, taxes and unemployment threaten to derail progress in reducing country's income gap



The once-improving fortunes of people in Santa Marta, a neighborhood in Rio de Janeiro, are now at risk from Brazil's troubled economy. PHOTO: PAUL KIERNAN/THE WALL STREET JOURNAL

By **PAUL KIERNAN**

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RIO DE JANEIRO—When proper electricity arrived in Santa Marta, a small favela in the shadow of Rio's Christ the Redeemer statue, longtime resident Cândida Oliveira Silva was happy to get the bill.

For the 52-year-old homemaker, it meant having legal proof of address and “feeling like a citizen” for the first time. But in recent months it has also meant cutting back on all but the most basic expenses. Reduced government subsidies and a drought have raised her bill to about 280 reais (\$72) a month, roughly five times what it was a year ago.

“I can’t travel anymore, I can’t afford to eat at even a modest restaurant,” Ms. Silva said. Rising inflation and Brazil’s plummeting currency have quashed any hopes of visiting her daughter in San Francisco.

Ms. Silva’s struggle to maintain her standard of living amid rising prices shows how a spiraling economic crisis has pushed Brazil’s emerging middle class to the brink.



Job seekers waited in line at an employment fair in Rio de Janeiro earlier this year. *PHOTO: DADO GALDIERI/BLOOMBERG NEWS*

Urban unemployment rose to 7.6% in September, tied with August for the highest rate in more than five years. Economists on average expect gross domestic product will shrink 3.1% this year and 1.9% next year, according to the Central Bank of Brazil’s latest weekly survey. Inflation approaching 10% has forced the poor to stop buying meat and the central bank to ratchet up interest rates. A disorganized effort by the government to stem a widening budget deficit has resulted in painful tax increases, further crimping family budgets.

Experts say it is hard to estimate how many people are at risk of falling down Brazil’s social ladder, as official data aren’t yet available. But with wages rising less than inflation, around 35 million members of Brazil’s lower middle class are vulnerable, says Maurício Prado, a partner at research firm Plano CDE.

“They have low education and low job formalization,” he said. “There is confluence of negative factors.”

The situation is threatening to derail what Brazilian leaders have extolled as a transformation of the country’s economy and society. Long counted among the world’s most unequal nations, Brazil made significant progress in the past

‘Money comes in and then it’s gone. I even owe the bricklayer money.’

—Maria Eliane de Alcântara, a housecleaner living in Santa Marta

decade toward reducing its gaping income disparity, authorities say.

Strong prices for commodity exports stuffed public coffers with money that was used to weave a social safety net, including a cash-transfer program targeting nearly 14 million impoverished families. Minimum-wage increases averaging more than 11% a year since 2003 transferred more wealth toward the bottom of the spectrum.

Between 2003 and 2013, Brazil’s median household income grew 87% in real terms, compared with a 30% rise in per capita gross domestic product, says Marcelo Neri, an economist who wrote a book on the “new middle class” and served as President Dilma Rousseff’s strategic-affairs minister.

“People who were left behind—uneducated people, people in the northeast and rural areas, poor people, black people, domestic workers, informal workers—these people grew at a much faster rate than the country as a whole,” Mr. Neri said.

‘Having gone through a period over the past decade where workers managed to get a bigger share of a growing pie, they’re now going to have a smaller share of a pie that’s growing at a much slower pace.’

—Neil Shearing, chief emerging-market economist at Capital Economics

To be sure, Brazil’s middle class is poorer than its U.S. counterpart, with household incomes ranging between about 2,300 and 9,500 reais a month. But its ranks swelled to 112.6 million people in 2013 from 67.9 million in 2003, according to government estimates.

Communities like Santa Marta exemplify the trend. Featured as a scene of grinding poverty in the music video to Michael Jackson’s 1996 single “They Don’t

Care About Us,” it now boasts schools, activity centers, public housing and a tram to transport locals up steep slopes. Most homes have the appliances like refrigerators and televisions that Brazilian social scientists use to delineate the country’s “C class,” roughly at the middle of the income ladder.

“I can’t say things are too bad, because for me it got better,” said Uerlem Queiroz, a 27-year-old film cameraman. He expects to spend New Year’s on vacation in the northeastern party city of Salvador, a trip he said would have been “unimaginable” for someone living in a favela in the past.

Paradoxically, economists say the same policies that lifted millions of Brazilians from poverty in recent years also helped fuel the inflation now eroding their living standards. Brazil’s labor productivity has badly lagged behind most other emerging economies, underscoring the shaky foundation on which the new middle class was built.

“Having gone through a period over the past decade where workers managed to get a bigger share of a growing pie, they’re now going to have a smaller share of a pie that’s growing at a much slower pace,” says Neil Shearing, chief emerging-market economist at Capital Economics.

Austerity measures have made Brazil’s tax system more regressive, eating away incomes for middle- and lower-class households. Seeking to bolster revenue, the government has increased flat-rate taxes on consumer credit, imports and some manufactured products. It also pushed people into higher income-tax brackets by raising cutoff levels by as little as 4.5%, less than half the inflation rate.

The number of Brazilians behind on their payments rose to 57 million in September, or 39% of the country’s adult population, credit bureau SPC Brasil says.

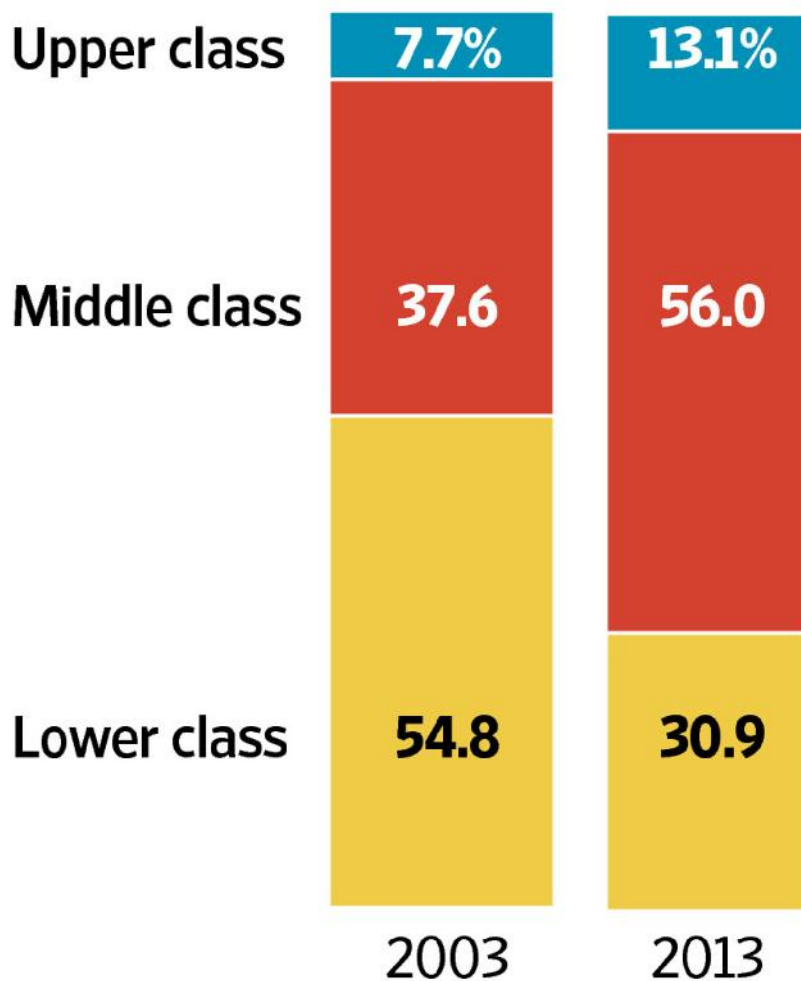
One of them is Maria Eliane de Alcântara, a 46-year-old housecleaner who lives in Santa Marta. After taking out a loan with a massive interest rate to upgrade her wooden shack; now her food budget won’t stretch much beyond rice and beans.

“Money comes in and then it’s gone,” she said. “I even owe the bricklayer money.”

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Fragile Gains

Share of Brazil's population in each group:



Note: 'Middle class' household income is 2,300–9,900 reais (\$600–\$2,600) a month

Source: Brazil's government

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