



Brazilian Economic Outlook

Fernando de Holanda Barbosa Filho

November 1st 2016

Summary 2013 presentation

- **Change in fiscal and monetary policy after 2009 led to reduction in credibility**
- Inflation will continue around 6%, above the 4.5% target (6.4%).
- Fiscal policy must remain expansionist generating important risks ahead.

Nominal deficit increases to the 3.5%-4.0% interval (too optimistic: 6% in 2014; 10.4% in 2015 and 7.7% until August in 2016; Primary Deficits 0.6% in 2014 and 1.9% in 2015. Worse than expected)

- **Potential Output Growth was reduced due to productivity growth reduction.**

In this scenario, the short run must present low GDP growth and high inflation.

- **Brazilian Foreign Debt Down Grade is on the short term horizon. (2015)**
- Despite low growth labor market will continue strong (until 2014).
- 2014 was an electoral year. Therefore, the fiscal “solution” could only occur only in 2015. (Something was tried in 2015 but effectively It was postponed to 2016...)

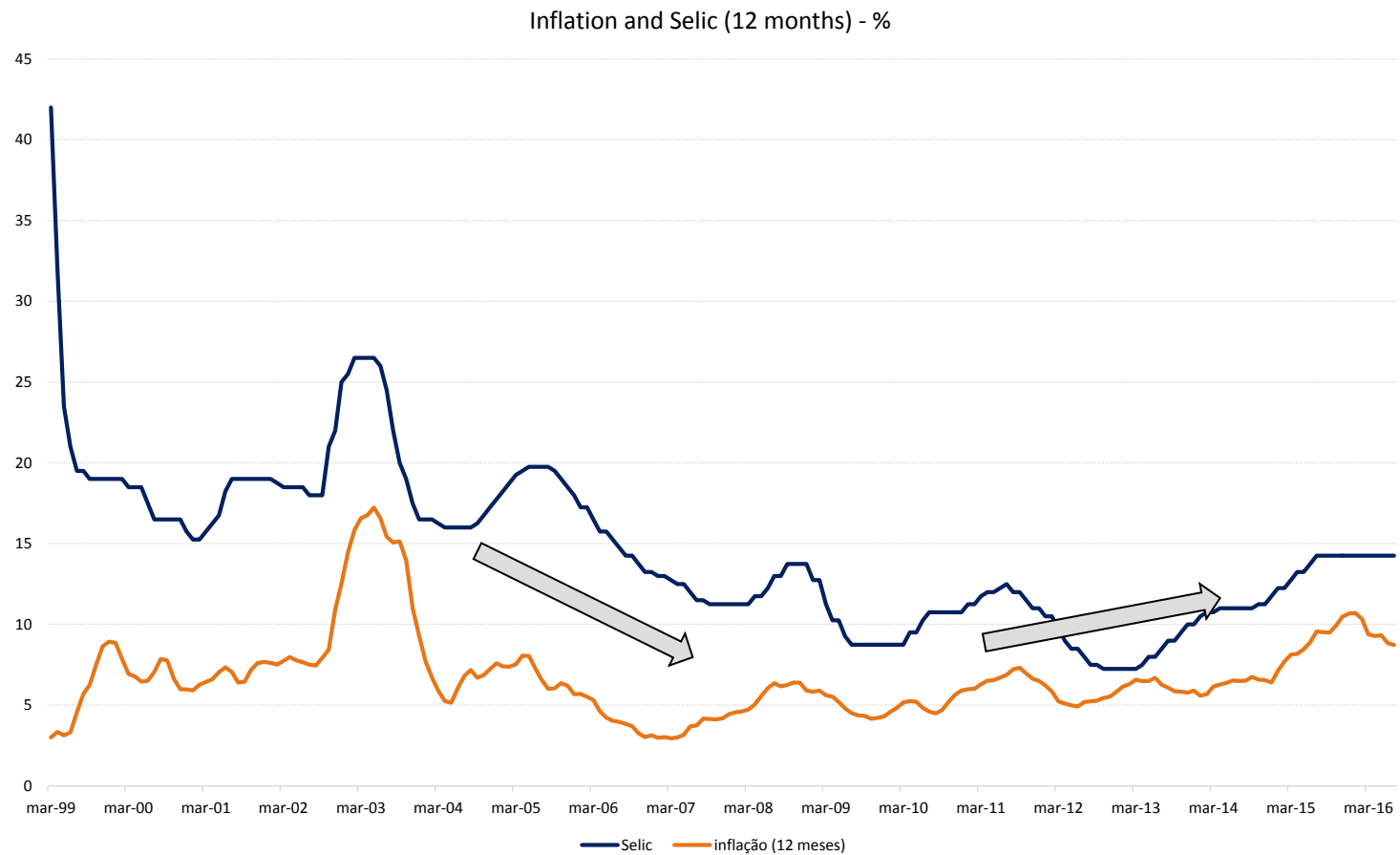
Summary 2016

- Fiscal Dominance X Political Dominance? It seems to be political dominance.
- Inflation above its target: 7.5%. New Central Bank restoring credibility.
- Fiscal Situation is extreme in 2016: nominal deficit 7.7% and primary deficit 2.7%.
- Recession prolonged and deep: 2016 growth -3.2%.
- Good news: External adjustment made. Current account from -4.3% to -0.7% in 2016 (estimated)
- Good news: End of the Impeachment process improved expectations. Will growth resume?
- Political Instability?

Will Temer government approve the necessary fiscal measures?

- Weak labor market and credit constraints
- Despite recovery of confidence economy still very slow.
- Growth possibilities in the short run
- Good possibilities: huge unused capacity

Inflation and Monetary Policy



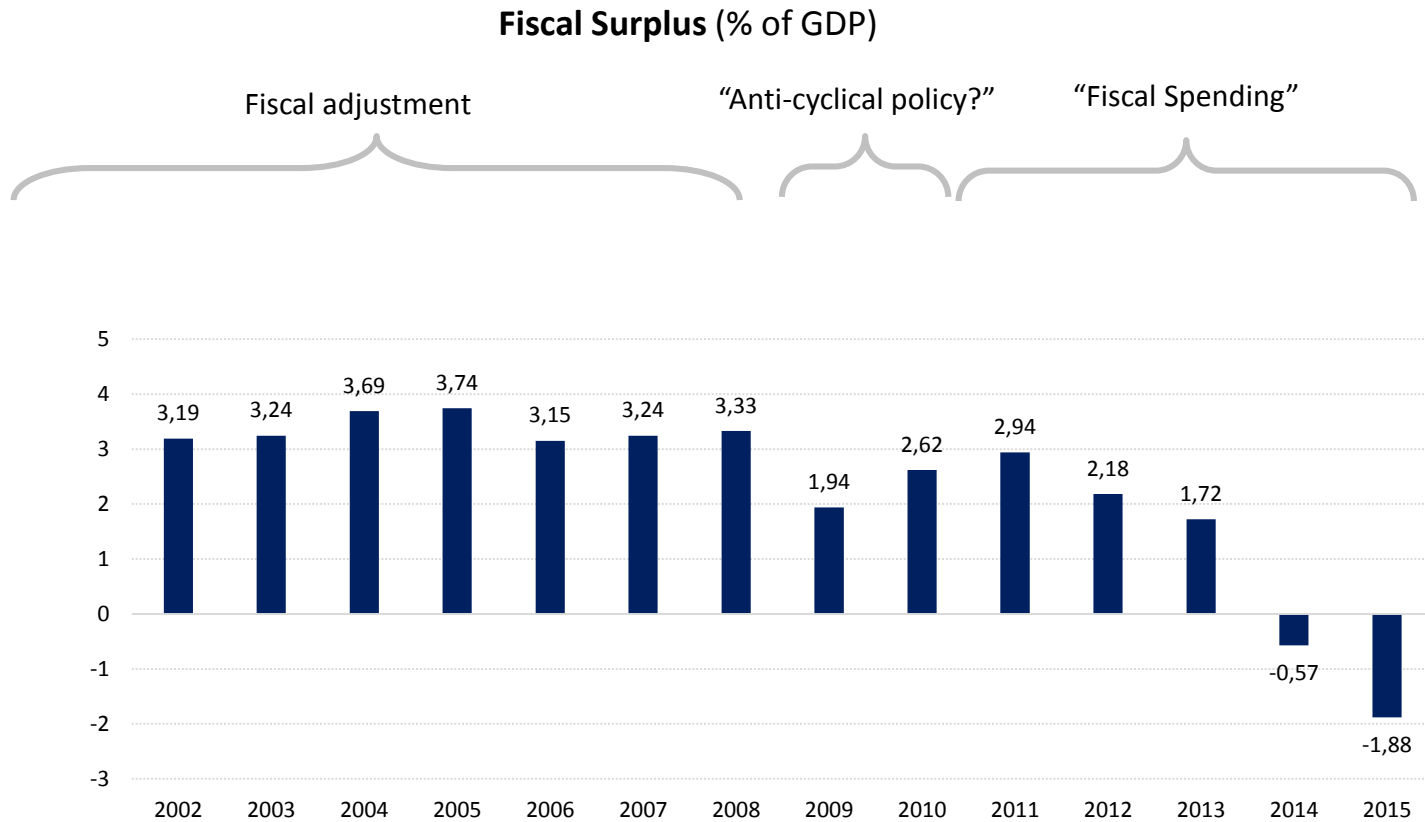
Inflation (%)

Inflação	2009	2010	2011	2012	2013	2014	2015	2016*E
IPCA - IBGE (%)	4,3	5,9	6,5	5,8	5,9	6,4	10,7	7.1
IPCA - Livres (%)	4,3	7,1	6,9	6,6	7,3	6,7	8,5	-
IPCA - Serviços (%)	6,9	8,1	9,8	8,7	8,7	8,3	8,1	7.0
IPCA - Bens Ex. Alimentação (%)	2,9	3,5	3,5	1,8	5,2	4,3	6,2	-
IPCA - Alimentação Domiciliar (%)	0,9	10,7	5,4	10,0	7,6	7,1	12,9	12,4
IPCA - Administrados (%)	4,5	3,1	5,6	3,7	1,5	5,3	18,1	5.9
IPCA Ex Alimentação Domiciliar (%)	4,9	5,1	6,7	5,1	5,6	6,3	10,3	-
Taxa Selic (final de período - %)	8,75	10,75	11,00	7,25	10,00	11,75	14,25	14,00

2016*E: expectativa

Source: IBGE and FGV/IBRE.

Fiscal policy



Source: IBGE and FGV/IBRE.

Gross Debt (%GDP)

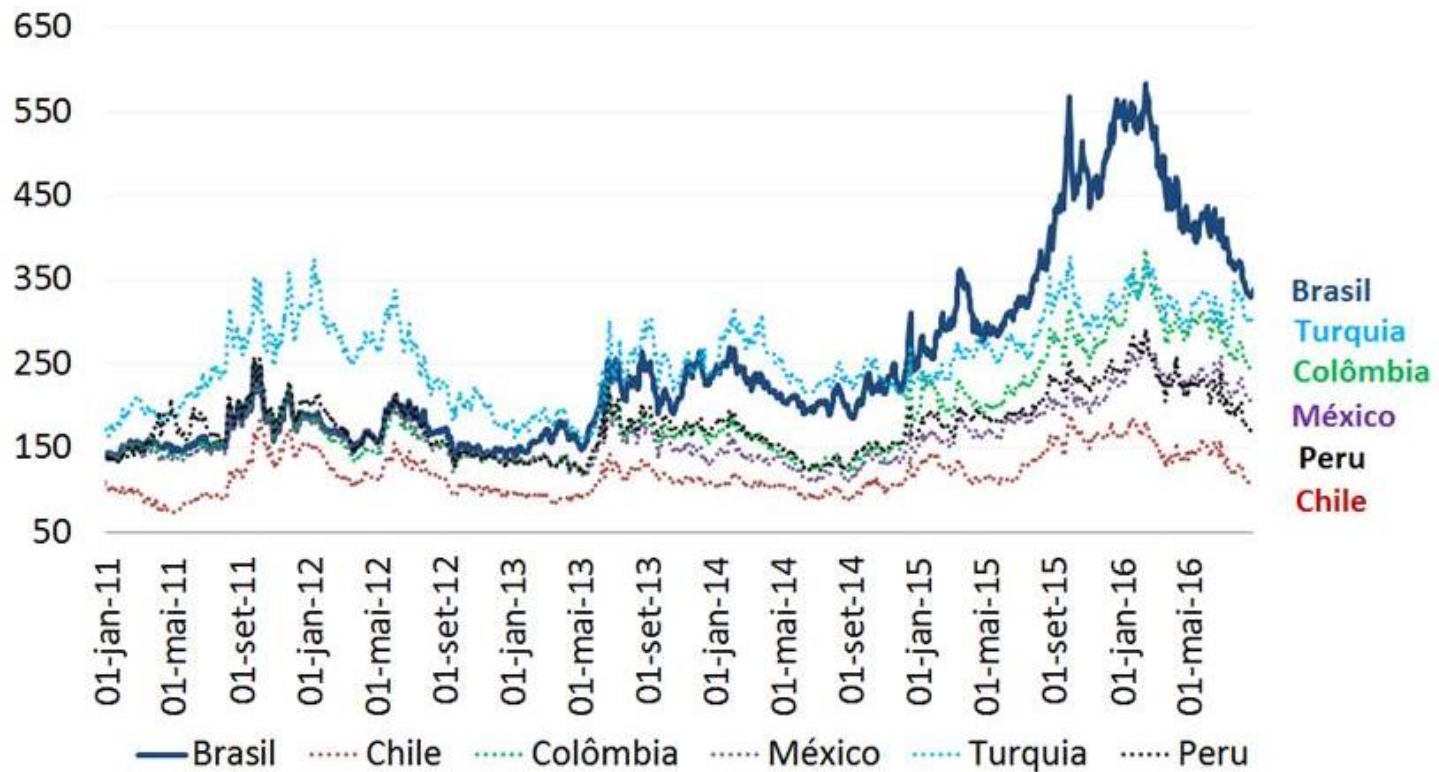
Public Sector Gross Debt (% of GDP)



Source: IBGE and FGV/IBRE.

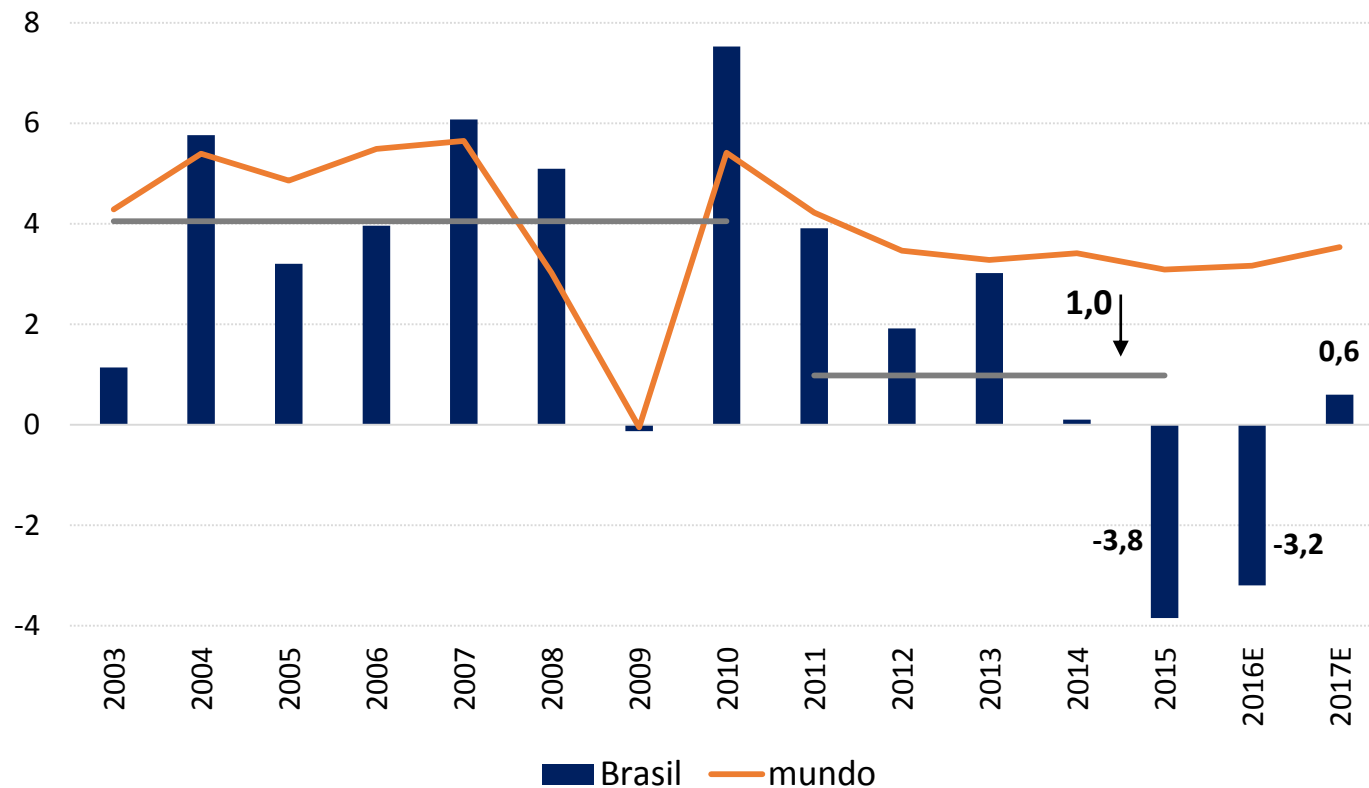
CDS

Brazil and selected Emerging Countries



Fonte: Bloomberg

-3.2% Growth in 2016 and 0.6% in 2017



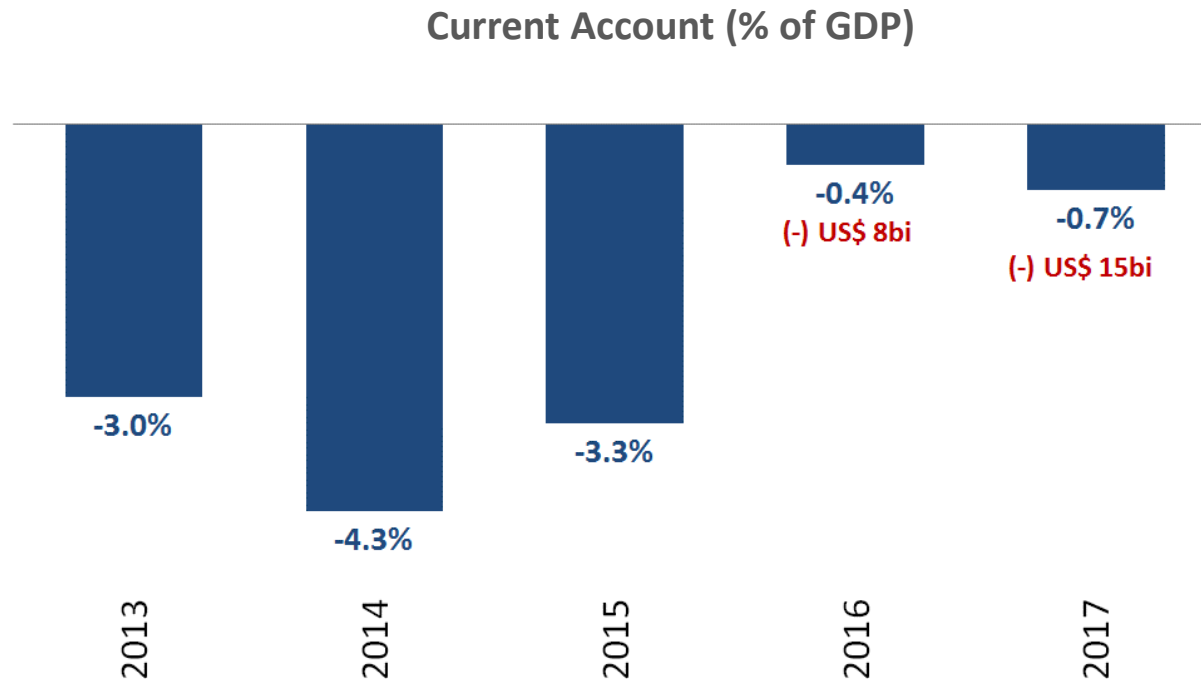
2016 GDP by Demand

	2010	2011	2012	2013	2014	2015	2016F
GDP	7.5	3.9	1.9	3.0	0.1	-3.8	-3.2
Family Consumption	6.2	4.7	3.5	3.5	1.3	-4.0	-4.1
Government	3.9	2.2	2.3	1.5	1.2	-1.0	-1.1
Investment	17.9	6.7	0.8	5.8	-4.5	-14.1	-8.5
Exports	11.7	4.8	0.3	2.4	-1.1	6.1	8.6
Imports	33.6	9.4	0.7	7.2	-1.0	-14.3	-10.3

External sector adjustment

FX depreciation and external sector adjustment

- Trade balance and current account under adjustment
 - FX depreciation and increasing growth differential are the relevant drivers;
 - Sadly, most of the latter comes from domestic recession;



Source: Central Bank of Brazil and IBRE/FGV

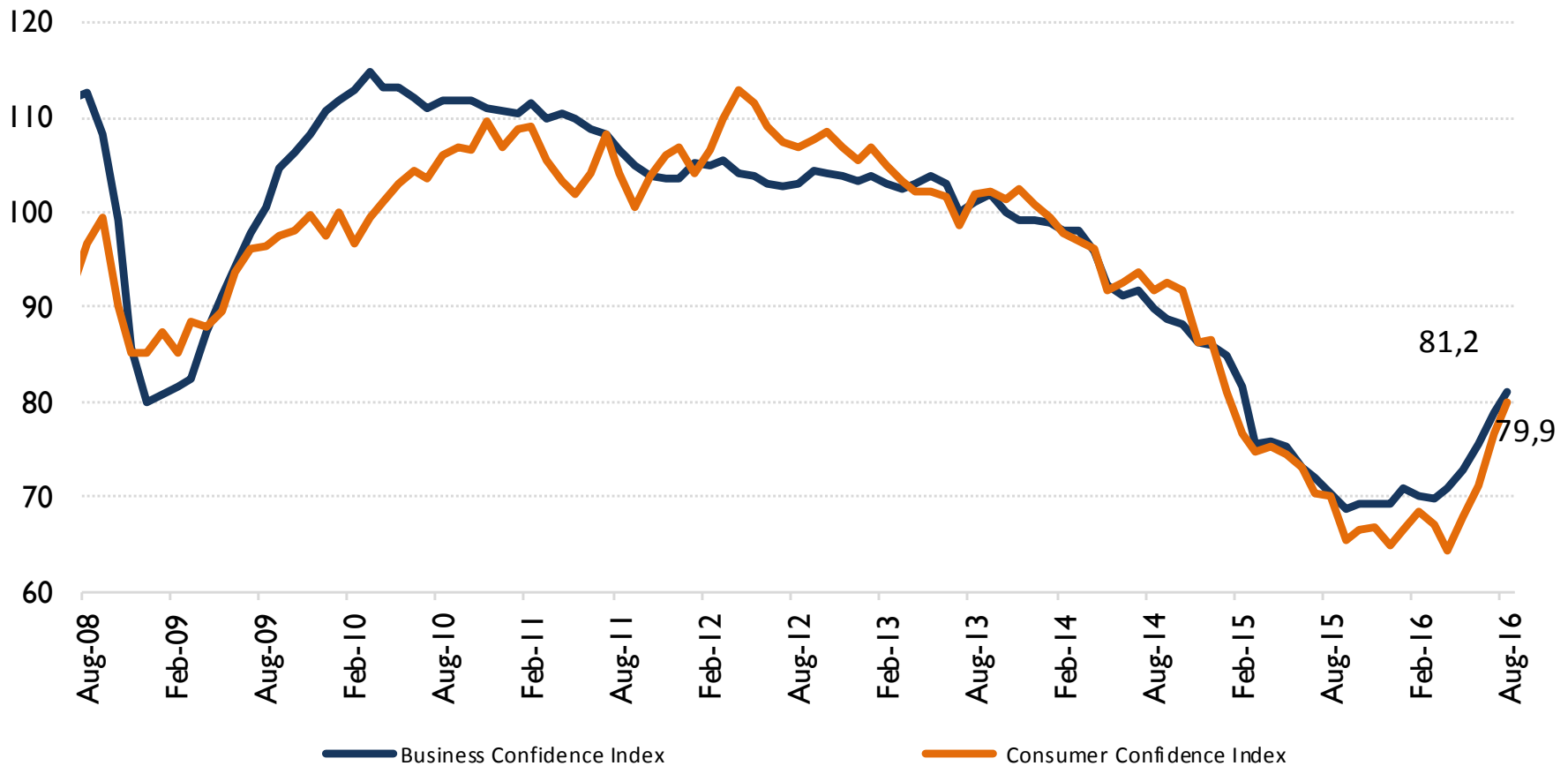
External Sector Adjustment

	2009	2010	2011	2012	2013	2014	2015	2016*
Trade Balance (US\$ bi)	25,0	18,5	27,6	17,4	0,4	-6,6	17,7	51,0
Exports (US\$ bi)	153,6	201,3	255,5	242,3	241,6	224,1	190,1	189,0
Imports (US\$ bi)	128,7	182,8	227,9	224,9	241,2	230,7	172,4	138,0
Trade Flow (% PIB)	16,8	17,4	18,5	18,9	19,6	18,8	20,4	19,1
Déficit em serviços e rendas (US\$ bi)	-19,6	-30,2	-37,2	-40,2	-46,4	-48,1	-36,9	-62,4
Current Account (US\$ bi)	-26,3	-75,8	-77,0	-74,2	-74,8	-104,2	-58,9	-11,4
Current Account (% GDP)	-1,6	-3,4	-2,9	-3,0	-3,0	-4,3	-3,3	-0,7
Exchange Rate (year average) R\$ / US\$	2,0	1,8	1,7	2,0	2,2	2,4	3,3	3,49

Source: IBGE and FGV/IBRE.

Domestic front

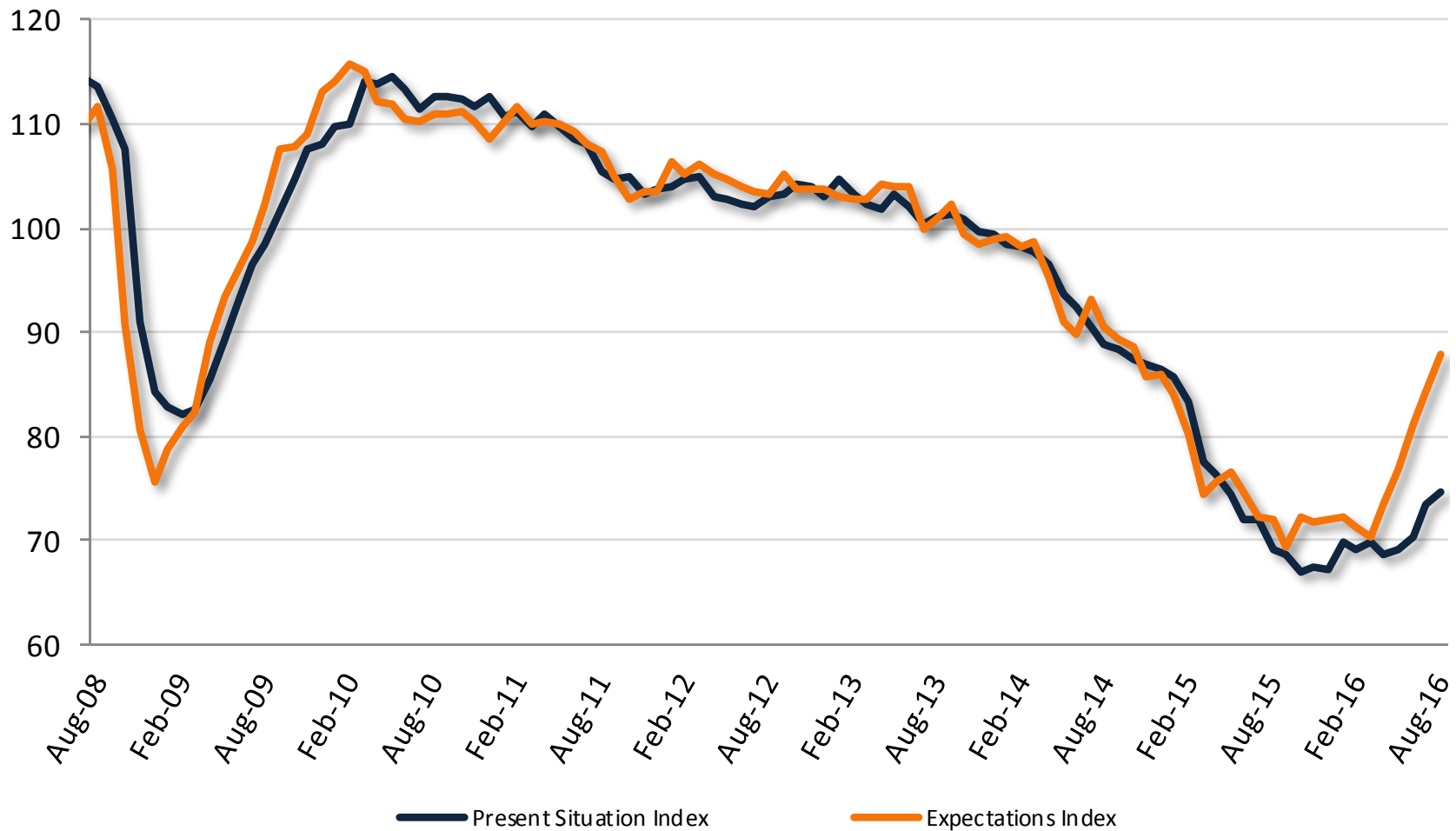
Recovery in domestic confidence



Source: FGV/IBRE.

Domestic front

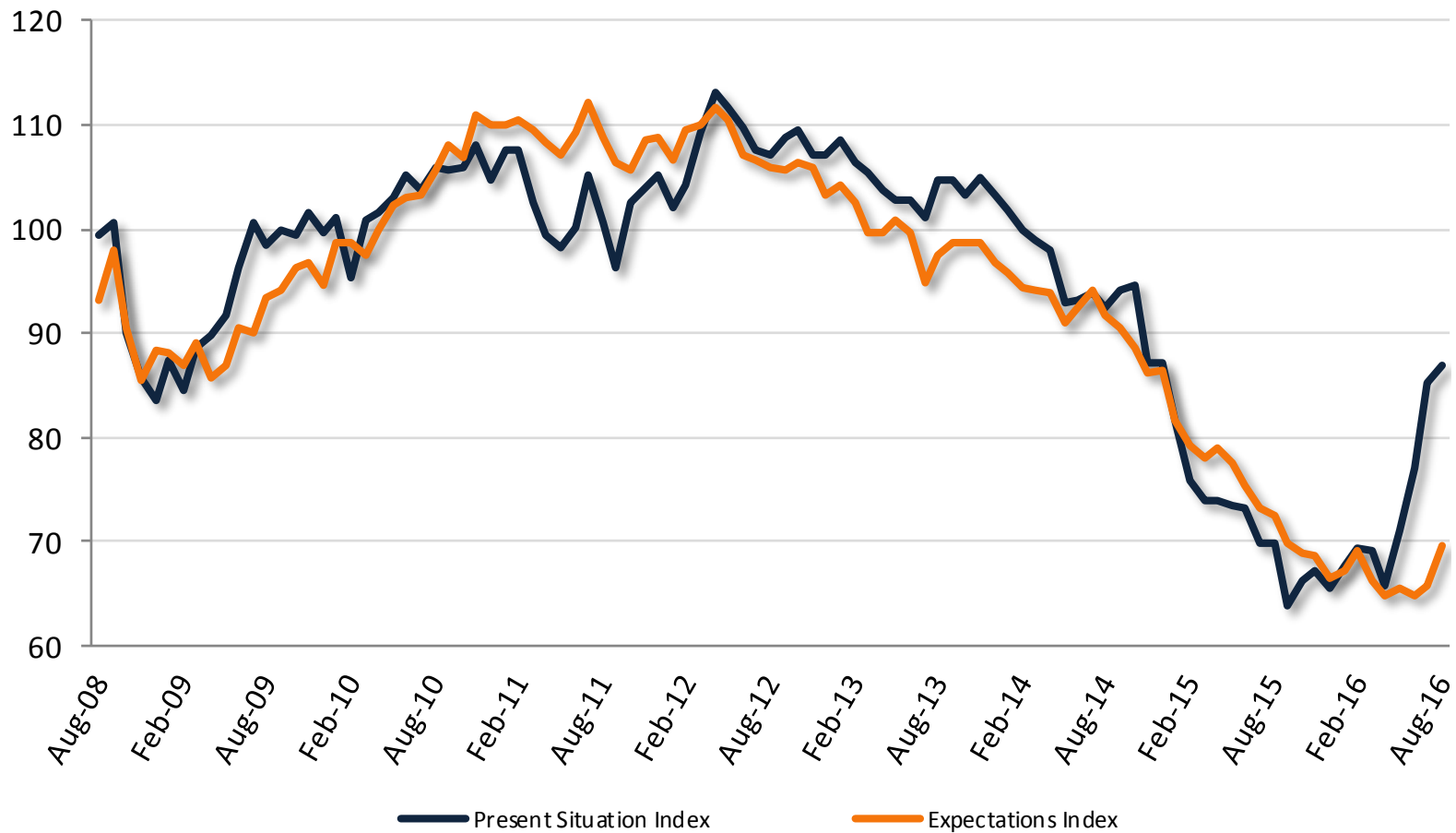
Recovery in business confidence: mismatch between expectations and current situation



Source: FGV/IBRE.

Domestic front

Recovery in consumer confidence: mismatch between expectations and current situation

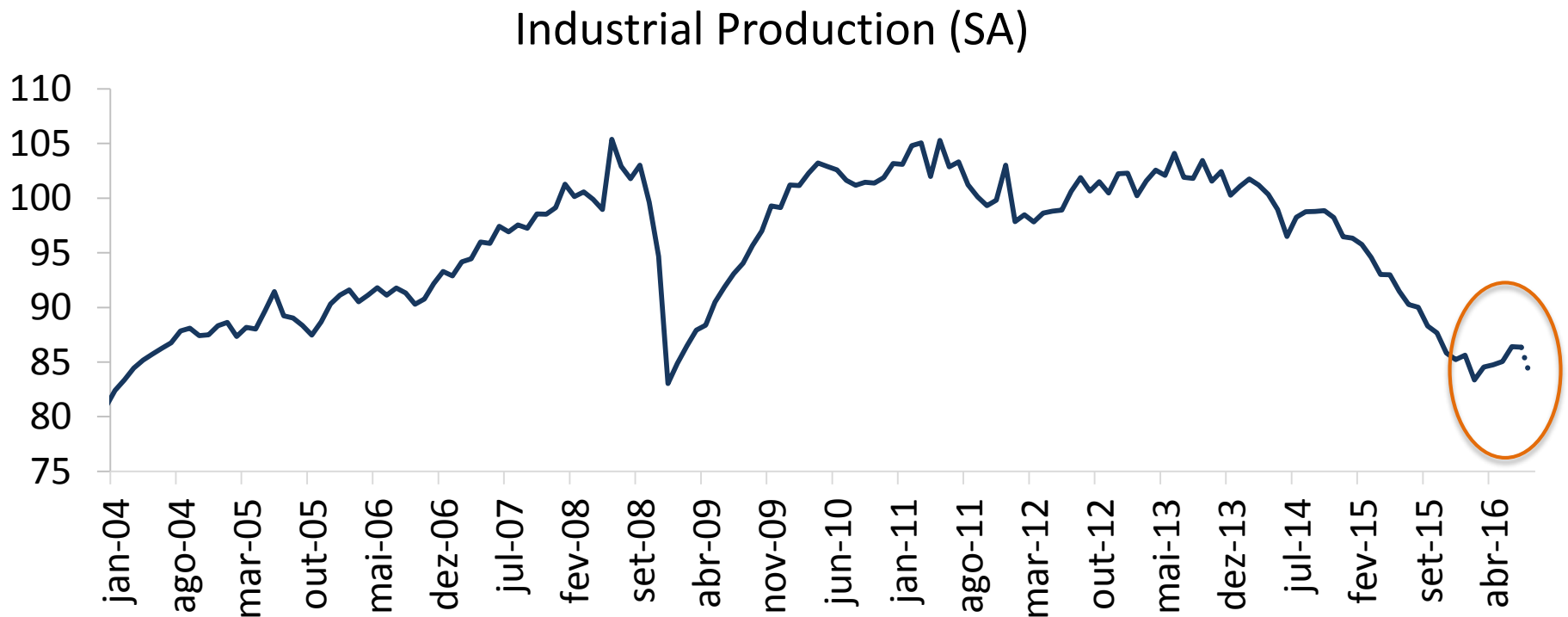


Source: FGV/IBRE.

Domestic front

Industrial production has bottomed-out.

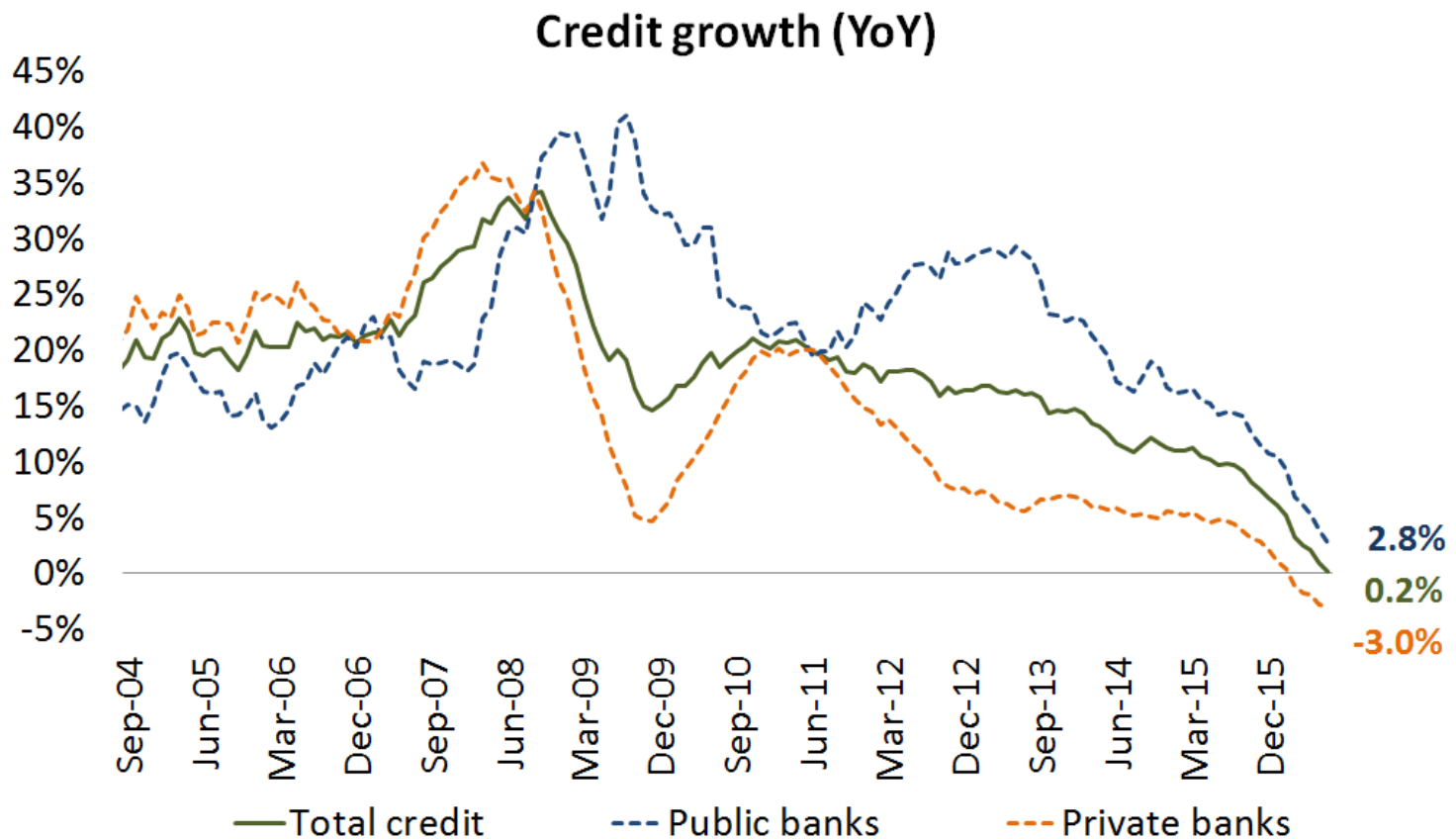
- But our preliminary numbers for August suggest a huge contraction (-4,7% YoY and -3,2% MoM)



Source: IBGE and FGV/IBRE.

Credit constraints

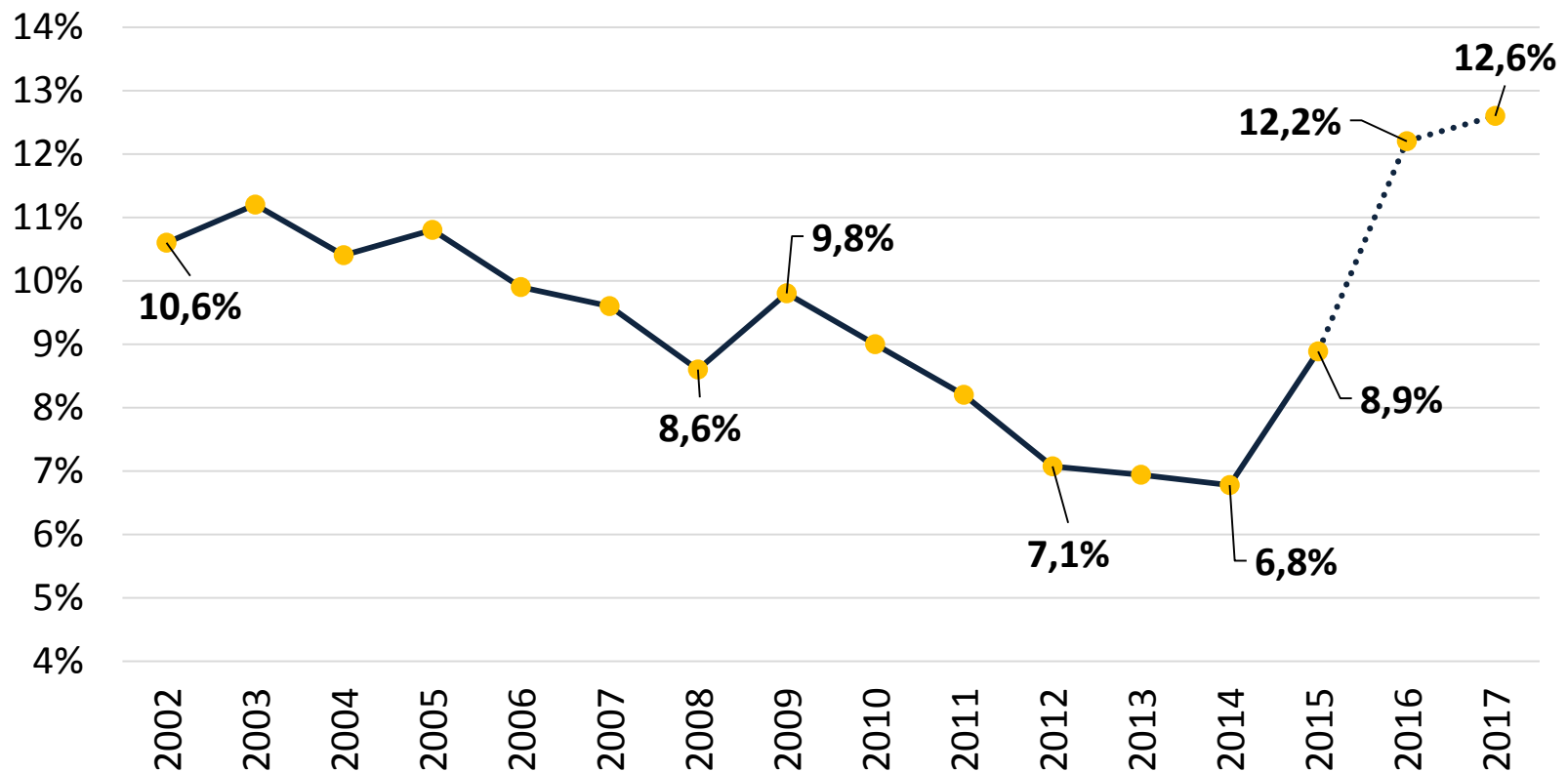
- Credit conditions are worsening due to lack of demand and supply



Source: Central Bank of Brazil

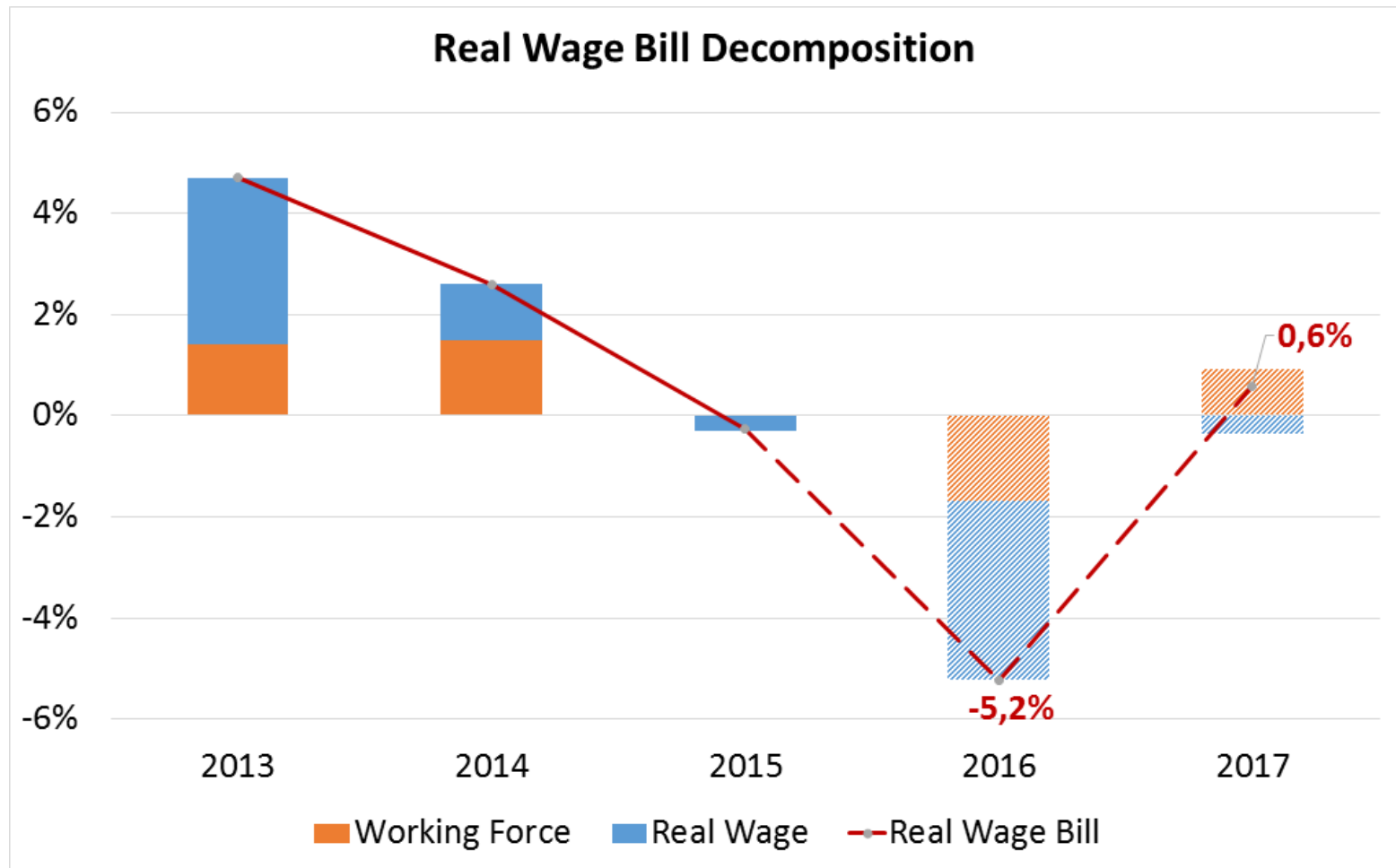
Labor Market weak

- Despite growth improvements, the labor market is set to weaken in 2016 and 2017



Sources: PNAD and PNAD-C (IBGE). Values for September. Retropolation of National Household Survey (PNAD-C) using PNAD.

Labor Market weak



Sources: PNAD and PNAD-C (IBGE).

- Government Spending Ceiling law. It may allow the government to control increase in spending;
- Historically government spending growth is around 6% per year in real terms.
- Government Spending Ceiling law will require extra reforms to be respected: pension and retirement reforms.
- Compulsory spending reforms.
- Improve spending quality.

Source: IBGE and FGV/IBRE.

2016 GDP by Demand

	2015	2016	2017
GDP	-3.8%	-3.2%	0.6%
Household consumption	-4.0%	-4.1%	-0.3%
Government consumption	-1.0%	-1.1%	-0.5%
Investment	-14.1%	-8.5%	2.3%
Exports	6.1%	8.6%	4.4%
Imports	-14.3%	-10.3%	4.4%

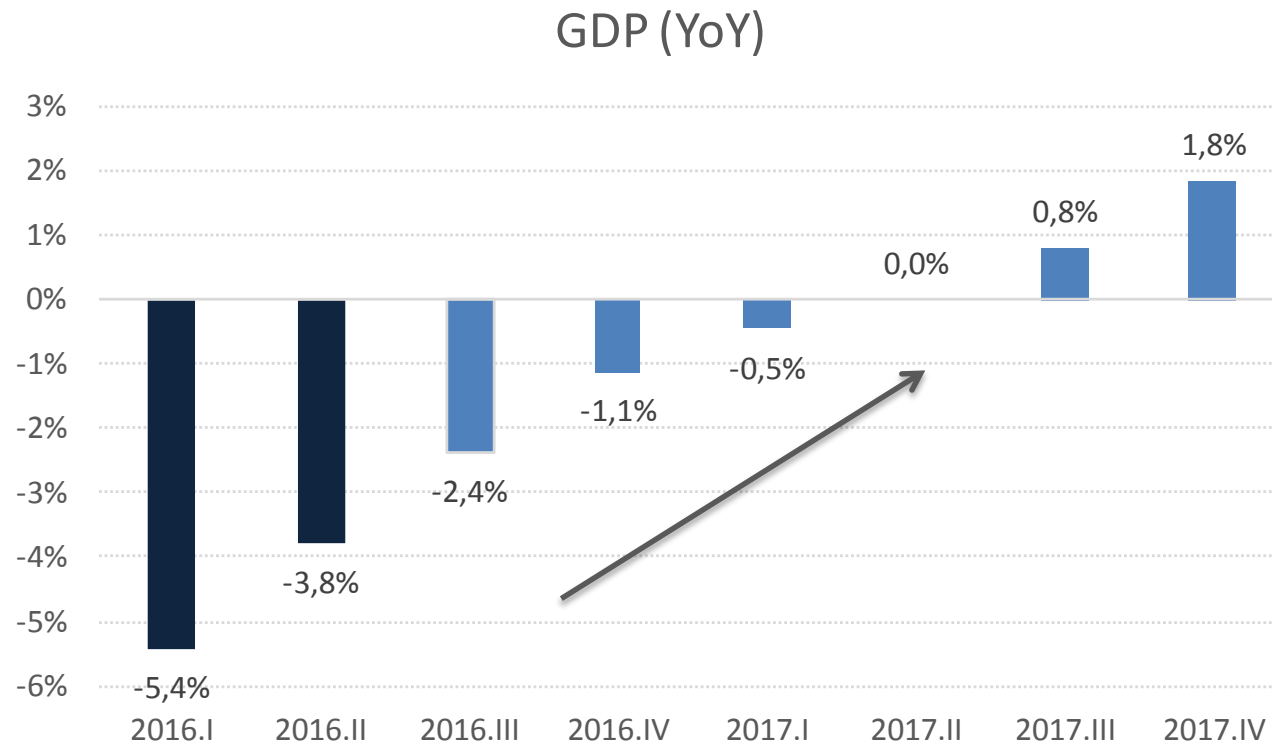
2016 GDP per sector

	2015	2016E	2017E
GDP	-3.8%	-3.2%	0.6%
Agriculture	1.8%	-1.0%	3.3%
Industry	-6.2%	-3.3%	1.5%
Services	-2.7%	-2.7%	0.2%

Forecast output growth per quarter

(sem ajuste sazonal, AsA)

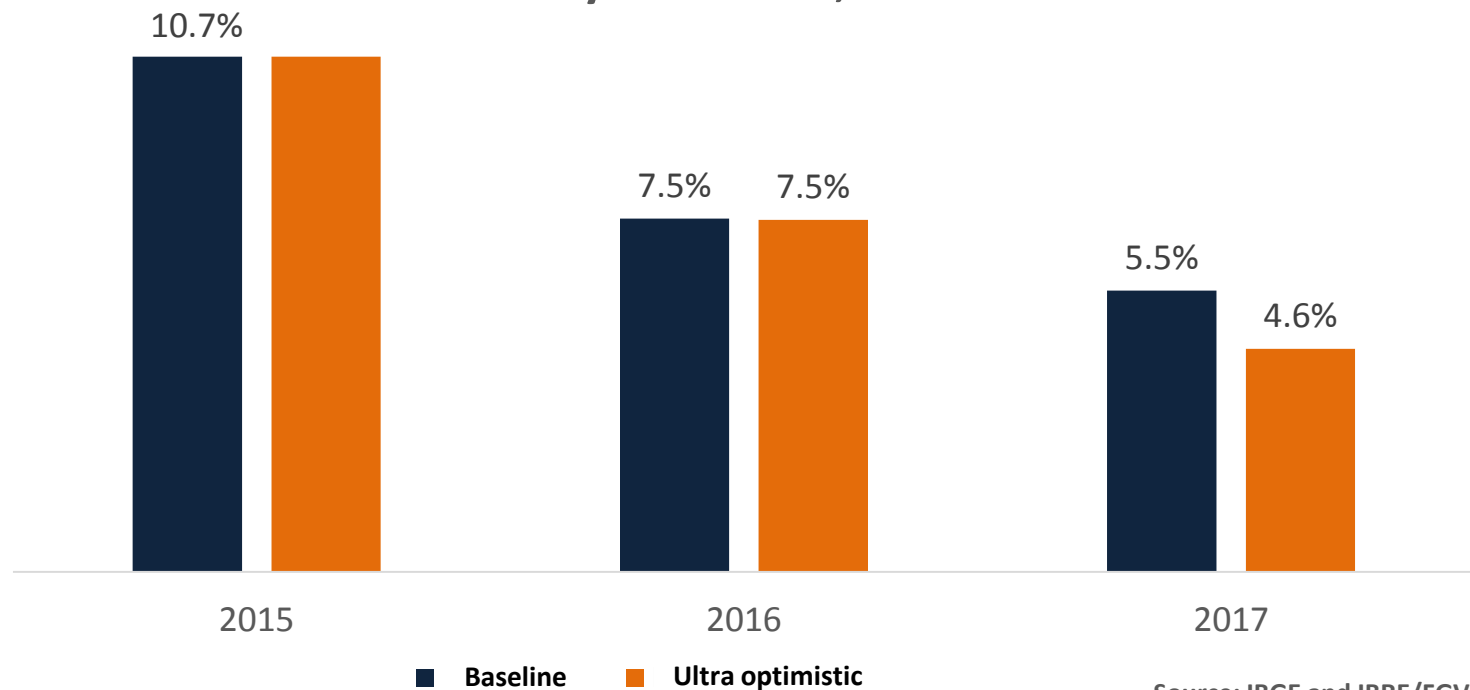
- Interannual growth rates are set to improve ahead – but will remain negative throughout this year



Domestic front

Bad equilibrium: high Inflation and interest rates

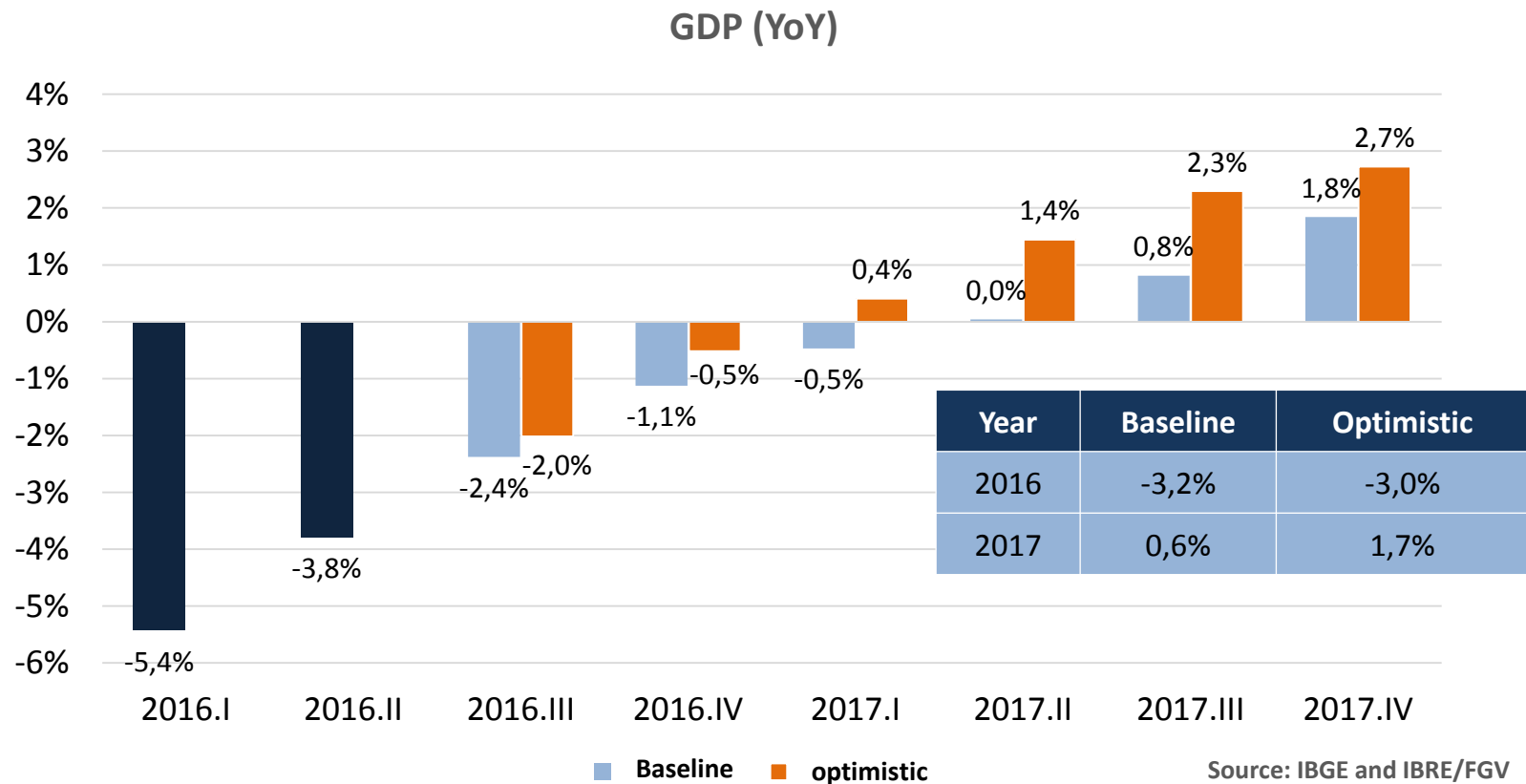
- Inflation will be above the upper bound of Central Bank's target in 2016 – but likely below it in 2017
 - Deceleration is happening mostly in regulated prices;
 - Deceleration in services is very moderate;



Source: IBGE and IBRE/FGV

GDP Forecast (2016 and 2017): Optimistic Scenario

- The first step is to restore fiscal solvency. If government's agenda gets approved, then we can expect higher growth in 2017



Short run growth possibilities

- In recent years GDP growth was severely reduced while inflation continued at high levels.
- A possible explanation is a low potential output growth.
- Once again slower productivity growth is the main cause of its lower potential output growth.

Potential Output Growth				
	GDP	Productivity	Labor	capital
2002-2008	4,3%	2,3%	1,9%	2,0%
2002-2010	3,6%	1,6%	1,8%	2,3%
2010-2015	2,3%	-0,1%	1,0%	4,4%
Atual A	1,5%	0,0%	1,2%	2,0%
Atual B	2,2%	0,5%	1,2%	2,5%

- Potential GDP growth is below 2% per year.
- The Dilma government apparently had strong negative shocks on potential output growth. TFP was very negative the last two years.
- Can we grow in the near future?

Short run growth possibilities

➤ What's the possible growth rate in the next years?

1 – Employment forecast

2017: 0,8%

2018: 1,1%

2 – Capacity Utilization Index (NUCI) is very low today: 73,9 (year average).

Three possibilities:

No recover in the NUCI: 2017=73,9; 2018=75

Nuci partial recovery: 2017=75; 2018=78,1

Nuci total recovery(equal 2010) : 2017=78,1; 2018=83,4.

3 - Investment: 2017: 15%; 2018: 18%

Short run growth possibilities

4 – 2010 recovery:

	GDP	TFP	Labor	capital	Nuci
2009-2010	7,5%	2,7%	2,0%	2,9%	5,6%

5 – Estimates:

	GDP	TFP	capital	Nuci	Labor
2017A	1,0%	0,0%	1,3%	0,0%	0,83%
2017B	1,6%	0,0%	1,3%	1,5%	0,83%
2017C	3,4%	0,0%	1,3%	6,0%	0,83%
2018A	2,1%	0,0%	2,2%	1,5%	1,10%
2018B	3,2%	0,0%	2,2%	4,1%	1,10%
2018C	4,3%	0,0%	2,4%	6,8%	1,10%

Conclusion

- Fiscal Situation requires immediate measures in order to recover debt sustainability.
- Monetary policy authority is trying to regain credibility. Inflation is going down (but at a slower rhythm?).
- External Adjustment “complete”.
- Growth rate negative (Deep recession).
- End of impeachment process triggered a recovery of confidence.
- However, economic activity still slow.
- Weak labor market and credit constraints will make economy recovery difficult. Slower path.
- However, there exist room for sharp recovery over the short run. Resources available to be used.
- Fiscal path to stability may trigger recovery
- Possible stronger short run recovery depending on approval of fiscal measures