Lower than expected rainfall and the cost of subsidizing oil- and coal-generated power plants could compromise the fiscal effort. The outlook therefore is for lukewarm economic activity and GDP growth of at best 1.8%.

THERE WERE ALREADY ENOUGH uncertainties complicating the fiscal scenario: for instance, inflation is still resistant to falling and has not pushed through the target ceiling (6.5%) only because of government price controls; and the external scenario is far from benign, typified by unprecedented trade deficits in January and February. Now recent weeks have seen more dark clouds forming because of lower than expected rainfall and the costs associated with administered electricity prices.

Though it is premature to even mention the idea of energy rationing, the theme is worrying. The delay in the rainy season has led to heavier use of oil- and coal-generated power plants rather than hydropower to meet demand, and the government is expected to cover the higher cost of producing electricity. More money flowing into energy subsidies could compromise the government fiscal effort, triggering predictable reactions about Brazil's country risk and future interest rates.

One solution would be to pass part of the cost of producing electricity on to electricity prices. But as with the fuel price increases, that would likely push inflation above the target ceiling, which may not be tolerable in an election year. The government thus has a difficult trade-off: Either let electricity tariff adjustments pass through to inflation, or pay the costs of higher electricity prices and increase the fiscal deficit.

We hold to our growth forecast of 1.8% in 2014 but are raising our inflation projection from the previous 5.9% to 6.4%. However, forecasting has become more tentative in recent months, and even lower growth is possible. Currently, our scenarios do not incorporate the possibility of energy rationing, but even without it, the outlook is for only lukewarm economic activity with an expected modest slowdown in GDP growth, mainly because of lower growth in manufacturing.

Brazil's economic policies since 2008 have failed to promote sustainable economic growth but have instead led to such macroeconomic imbalances as high inflation, low fiscal primary surpluses, and a significant increase in the external current account deficit. The next government will have to take corrective measures to address these if the economy's growth rate is to improve.

Brazil: IBRE baseline scenario for 2014

	2010	2011	2012	2013 Actual	2014 Proj. March
Real GDP growth (% change)	7.5	2.7	1.0	2.3	1.8
Inflation (% change)	5.9	6.5	5.6	5.9	6.4
Central Bank policy rate (end-period, %)	10.75	11.00	7.25	10.00	11.00
Exchange rate (average, Reais per U.S. dollar)	1.8	1.7	1.9	2.2	2.5
Budget primary surplus (adjusted, % of GDP)[1]	1.5	2.4	1.6	0.7	0.8
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.7	-3.9
Trade balance (US$ billions)	20	30	18	3	1
Export (US$ billions)	202	256	243	242	241
International reserves (US$ billion)	289	352	378	374	370

Source: Brazilian Institute of Geography and Statistics, Central Bank of Brazil, IBRE staff projections.

[1] Recurring primary surplus defined as budget balance excluding interest payments on public debt, extraordinary revenues from dividends and concessions, and some investments of the Growth Acceleration Program.