Brazil: How sustainable are recent developments?

GDP GROWTH IN THE FIRST QUARTER is expected to be about 1.0% quarter-on-quarter. However, we believe that because a significant portion of this growth resulted from transitory factors, there are considerable doubts that growth can be sustained over the coming quarters.

The economic outlook has changed little in the past month. But some signs have become clearer, making it possible to better distinguish between what is transient and what is more likely to last out the year. What has become obvious is that consumer price inflation is rising in the short term, though there is hope that by mid-year it should begin to decline. A permanent problem may be the continuation of an expansionary fiscal policy in a situation where anti-inflationary monetary measures should be getting more support from fiscal policy. These are the most worrying aspects of recent developments.

Some factors suggest that part of the economic recovery in the first quarter resulted from events that are transient. First, agriculture is likely to perform well. Second, there was significant growth in the production of capital goods due to the resumption of production of trucks and buses, which had contracted by more than 36% in 2012. Consequently, industry and fixed investment will be looking better in the first quarter of 2013.

With both agriculture and industry performing better, we estimate GDP growth in the first quarter will be about 1%. That means that the 12-month GDP growth will be up to 1.2% for the year ending March 2013.

But there are doubts about whether the growth is sustainable. Industrial production has shown itself to be extremely volatile; in February it sank 2.5% in seasonally adjusted terms over the previous month, nullifying the gain it had recorded in January.

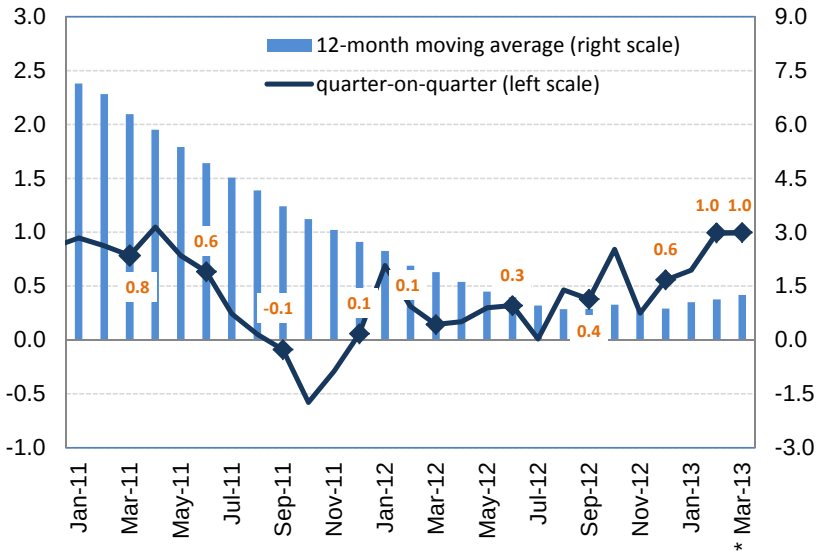
One question is whether, once truck production is back to normal, capital goods production will grow enough to justify significant increases in fixed capital investment. Also, can industry maintain higher growth in the months ahead even without strong growth in capital goods?

Meanwhile, the performance of commerce, which had been quite satisfactory so far, has slowed as real incomes have been eroded by rising consumer inflation and a loss of near-term confidence in the services sector, after the resumption of growth in the third quarter of 2012 was frustrated.

A little skepticism is still in order on the economy's strength as recovery remains shaky with key indicators showing uneven growth.

IBRE Economic Activity Indicator, March 2011– March 2013*

(Percent change over the previous quarter and 12-month moving average over the previous 12 months, seasonally adjusted)



Sources: IBGE and IBRE.
* Preliminary data.