The recent deterioration in Brazil's economic indicators has significantly exacerbated the risk of lower GDP growth in 2013, for which IBRE lowered its forecast to 2.3% last month. It also casts doubts about the performance of the economy in 2014.

THE MAIN FEATURE OF THE RECENT economic situation is how quickly both economic indicators and expectations have deteriorated. Except for agriculture, economic activity, inflation, and external accounts have all deteriorated, leading to the most difficult situation in the last 10 years.

It is difficult to pinpoint a single cause for the deterioration. The change in the external outlook is undoubtedly a central factor. The slowing Chinese economy has pushed down prices for some of our commodity exports and will discourage investment. Since the U.S. Federal Reserve Bank announcement that it was considering tapering off the exceptional monetary easing in the United States, financial assets in Brazil have in any case fallen sharply. The increased cost of financing is also limiting corporate fixed investment.

Moreover, the external shocks are hitting Brazil when its economic policy is already overstretched. In particular, monetary and fiscal policies and lending by state-owned banks have been overly expansionary, seeking without success to accelerate growth despite higher inflation. The economic fundamentals are no longer positive, which means government has less room to react to further changes in the external outlook.

Finally, the impact of the external outlook was magnified by increased economic openness. For almost 10 years economic expansion was dependent on an external context that brought in higher prices for Brazil's commodities and higher inflows of foreign capital. This helped to finance the domestic consumption-led growth, but that is showing signs of exhaustion because the labor market is at full employment, households are deeply in debt, external current account deficits are substantial, and inflation is rising.

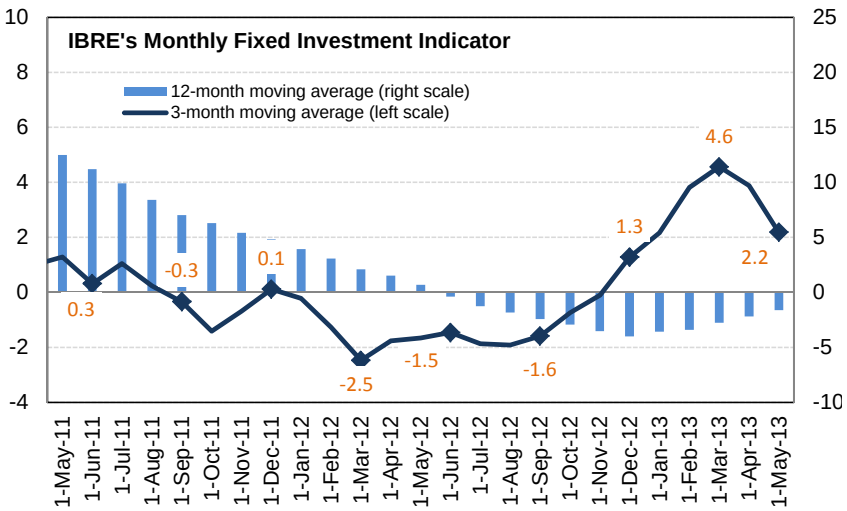
More important, however, was the plunge in potential growth despite numerous tax breaks and government stimulus. The frustration with this year's economic performance casts doubts on how the economy will perform in 2014.

In fact, our forecast for GDP growth for the second quarter is 0.6% (quarter-on-quarter), which matches actual GDP growth for the first quarter. We believe fixed investment will increase in the second quarter but possibly less than had been projected. IBRE's Monthly Investment Indicator slowed from 4.6% last March to 2.2% in May.

The current dire economic situation is pushing down our projections for GDP growth in 2013, currently at 2.3% (IBRE Economic Outlook, June 2013). The risk that growth will be even less in the second half of the year has risen significantly.

Growth in fixed investment has been slowing since March 2012.

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



Sources: IBGE, Funcex, and IBRE staff.