Recognizing that the Brazilian economy is still going through a challenging period, IBRE has marginally revised Brazil's growth outlook up to 2.5% in 2013 but is dropping it to 1.8% for 2014.

SECOND-QUARTER GDP SURPRISED on the upside: It grew a brisk 1.5% quarter-on-quarter (q-o-q) compared to 0.6% q-o-q in the first quarter. GDP growth was 3.3% compared with growth in the same period of last year, 1.0 percentage point higher than our projection and 0.6 percentage points above market expectations.

However, despite the euphoria that followed the release of second-quarter GDP, nothing fundamental has changed. There are still no definitive signs of a more lasting recovery. The IBRE Indicator of Economic Activity, which approximates the moving average for quarterly GDP, fell by 1.2% in July.

We hold to our scenario of a slowdown in growth in the second half of the year. The reasons are various: We expect a downturn for industry and agriculture, whose growth in the first two quarters of the year was exceptionally high. Domestic demand should also slow because investment is cooling and is projected to decline by 1.0% q-o-q. This expectation is supported by the IBRE confidence surveys, which are still low in historical terms and suggest that the economy will slow in the third quarter. In particular, the surveys suggest that gross investments will fall back in the third quarter of 2013, putting at risk the recovery of not just investment but also growth.

We forecast that GDP will fall by 0.4% q-o-q in the third quarter. For the year, our expectation is for 2.5% growth, up from the 2.3% we previously forecast because we expect some recovery in the fourth quarter. Despite the presidential elections next year, we consider it more realistic to reduce our forecast for GDP growth to 1.8% for 2014 rather than the 2.6% of our previous forecast.

Undoubtedly, Brazil is undergoing a process of growth deceleration and exchange rate devaluation, reflecting a more adverse international scenario. The exchange rate has been devalued substantially in recent months, which has helped to push up inflation and is also making it more necessary to adjust domestic fuel prices, which so far the government has been reluctant to do. To curb inflation, the current expansionary fiscal policy will require higher interest rates, which will penalize economic growth in 2014.

Brazil: IBRE baseline scenario, 2010-2014

	2010	2011	2012	2013 June Proj.	2013 Sep. Proj.	2014 June Proj.	2014 Sep. Proj.
Real GDP growth (% change)	7.5	2.7	0.9	2.3	2.5	2.6	1.8
Inflation (% change)	5.9	6.5	5.6	6.1	5.9	5.8	5.9
Central Bank policy rate (end-period, %)	10.75	11.00	7.25	8.75	10.00	8.75	10.00
Exchange rate (average, Reais per U.S. dollar)	1.8	1.7	1.9	2.1	2.2	2.1	2.4
Budget primary surplus (% of GDP)[1]	1.2	2.5	1.7	1.4	1.0	1.2	0.4
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.2	-3.5	-3.4	-3.3
Trade balance (US$ billions)	20	30	18	7	2	9	8
Export (US$ billions)	202	256	243	243	241	254	242
International reserves (US$ billion)	289	352	378	390	380	390	390

Source: Brazilian Institute of Geography and Statistics, Central Bank of Brazil, IBRE staff projections.
[1] Excludes interest payments on public debt, and revenues from dividends and concessions.