Outlook still far from sunny

THE BRAZILIAN ECONOMY seems to have slowed further, though as yet there is no indication that it is seriously under stress, at least for 2014.

The growth of GDP, seasonally adjusted, was modest at 0.2% quarter-on-quarter in the first quarter of the year, down from 0.4% in the fourth quarter of 2013. Not surprisingly, gross fixed investment declined by 2.1% quarter-on-quarter. This was the third consecutive decline; it appears that expectations for growth of the economy have become increasingly pessimistic. Certainly economic activity this year will be slower than last year.

For 2014, we have revised our growth forecast to 1.6% compared to our March forecast of 1.8%. On the demand side, growth will continue to be supported primarily by the consumption of households and government and secondarily by net exports, which will offset an expected contraction of 2% in gross fixed investment. On the supply side, the main growth driver is services. Despite the weakness of the economy, we have again raised our inflation forecast for the year, up from 6.4% to 6.7%.

Since 2008, the expansion of consumer credit, particularly from public banks; greater tolerance for inflation; looser fiscal policy; and more government intervention in the economy have shown disappointing results. The Brazilian economy came out of recession in 2009 but has not been able to achieve a robust and sustained recovery. The external current account has deteriorated significantly, even with low growth, and inflation has risen despite a variety of price controls.

For 2015, we forecast that growth will slow to 1.2% and inflation will rise to 6.8%. We expect that the next government will make corrections to economic policy by tightening fiscal and monetary policies, reducing credit from state-owned banks, and correcting controlled prices. In the short run, these policies will have an adverse effect on growth and inflation, but over the medium term, as economic imbalances and distortions are reduced, confidence and investment should rise, gradually pushing up the potential growth rate of the economy.

Brazil: IBRE baseline scenario for 2014-2015

	2010	2011	2012	2013 Actual	2014 Proj. March	2014 Proj. June	2015 Proj. June
Real GDP growth (% change)	7.5	2.7	1.0	2.5	1.8	1.6	1.2
Inflation (% change)	5.9	6.5	5.6	5.9	6.4	6.7	6.8
Central Bank policy rate (end-period, %)	10.75	11.00	7.25	10.00	11.00	11.00	12.25
Exchange rate (average, Reais per U.S. dollar)	1.8	1.7	1.9	2.2	2.5	2.3	2.3
Primary balance surplus (adjusted, % of GDP)[1]	1.5	2.4	1.6	0.7	0.8	0.7	1.5
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.7	-3.9	-3.6	-3.5
Trade balance (US$ billions)	20	30	18	3	1	-2	2
Export (US$ billions)	202	256	243	242	241	237	241
International reserves (US$ billion)	289	352	378	374	370	380	290

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

[1] Recurring government primary balance 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.