If the next government can overcome the policy challenges and increase confidence, a new cycle of more sustainable growth and investment is a possibility.

THE GLOBAL ECONOMIC outlook is for gradual recovery of the developed economies, but with heterogeneity among countries. In the United States, the prospects are very favorable. In contrast, although the Eurozone has come out of the recession, there are still no clear signs of solid growth there. The Chinese economy is still gradually slowing down, but inflation is under control and the government has room to adopt expansionary polices to prevent a further significant slowdown in economic activity.

Although the growth outlook is better for developed countries, the risks for emerging economies remain. A rising U.S. interest rate may attract an outflow of funds from emerging countries. Undoubtedly, this risk is greater for countries with weak economic fundamentals; unfortunately, Brazil is one of those countries.

With the release of second quarter GDP, we revised our GDP growth forecast down to 0.2% for this year; in June we had projected 1.6%. Over the past few months the outlook for economic activity has progressively worsened, leading to successive revisions of the forecast.

What can we expect for 2015?

Economic imbalances have widened in recent years. The growth expected for the Rousseff administration term is 1.6% on average, much lower than the 4% under Lula. Over the last four years the trade-off between inflation and growth has also worsened: the projection is that inflation for this administration term will be 1.1 percentage points above the average for the Lula administration after 2003. And, even with low growth and weak investment, the external current account deficit has risen significantly. This deterioration is troubling.

A major question is how willing the rest of the world will be to continue financing Brazil's external current account deficit. Brazil may experience further volatility if external financing conditions worsen, stimulating another increase in the domestic interest rate and steeper exchange rate depreciation to reduce the external deficit. That would penalize investment and growth.

No doubt, 2015 will be a very challenging year. Our baseline scenario contemplates restoration of monetary and fiscal policy credibility, which would make possible a more effective policy to curb inflation with lower adjustment costs in the medium term. We expect fiscal policy to be much more sound, with a primary surplus of 1.1% in 2015, up from 0.2% in 2014. Such a change in fiscal policy could heighten both confidence and debt sustainability in the medium term.

In addition to dealing with the problems associated with macroeconomic policy, a new cycle of reforms is necessary to raise productivity. Making utility and infrastructure concessions more flexible and improving the business environment would benefit the supply side by increasing investment and productivity.

Brazil: IBRE baseline scenario for 2014-2015.

	2010	2011	2012	2013	2014 Proj. September	2015 Proj. September
Real GDP growth (% change)	7.5	2.7	1.0	2.5	0.2	1.2
Inflation (% change)	5.9	6.5	5.6	5.9	6.3	6.1
Central Bank policy rate (end-period, %)	10.75	11.00	7.25	10.00	11.00	12.00
Exchange rate (average, Reais per U.S. dollar)	1.8	1.7	1.9	2.2	2.3	2.5
Primary balance surplus (adjusted, % of GDP)[1]	1.5	2.4	1.6	0.7	0.2	1.1
External current account balance (% of GDP)	-2.3	-2.1	-2.2	-3.7	-3.6	-3.2
Trade balance (US$ billions)	20	30	18	3	2	7
Export (US$ billions)	202	256	243	242	235	242
International reserves (US$ billion)	289	352	378	374	370	370

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

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