Editors' Note

SINCE THE BRAZILIAN Senate voted 61-20 to impeach President Dilma Rousseff on August 31, the market has been waiting for action from the new government to ensure that the public budget is adjusted and the economy grows again. The path will be painful. Brazil's GDP fell by 0.6% in the second quarter of this year compared to the first—more than the market expected. And compared with the first half of 2015, through June 2016 GDP had already shrunk by 4.6%.

How fast the economy can recover from such a deep recession is a huge unknown. There are some indicators that recovery could be fast: industrial production grew 0.3% in the second quarter over the first, investments increased by 0.4% after 10 quarters of decline, and confidence indices are going up. As the cover story shows, the capital goods sector of industry could be the main driver of a speedy economic recovery.

Unfortunately, other indicators are not so promising. The service sector, which accounts for about 70% of GDP, shrank by 0.8% in the second quarter over the first, and for the sixth consecutive quarter, household consumption fell, by 0.7%. The macroeconomic outlook is further clouded by persistent high inflation, soaring real interest rates, a weak labor market, high unemployment, and a severe fiscal crisis.

With the end of the interim period, the new government of (no longer Acting) President Michel Temer is expected to gain the power to initiate the reforms Brazil needs to resume growth. But the political negotiations needed to get there will be delicate and intense. When the interim government granted salary adjustments to public employees and gave states generous terms in renegotiating their debts, the market saw the promise of tight public spending apparently going down the drain.

The expectation now is that the government will send Congress proposals for an austere fiscal adjustment, with reform of social security a major element. That is where the assessment of the new government will begin.

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