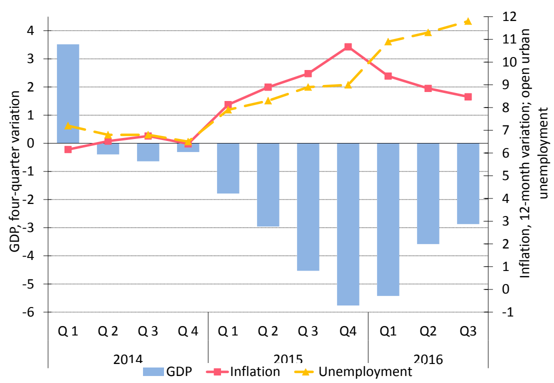
Brazil

The Brazilian economy remained in recession in 2016, with gross domestic product (GDP) shrinking by an estimated 3.6% the second consecutive year fall of more than 3.5%. This panorama pervades all sectors of production and demand. Consequently, unemployment rose to an average of 11.8% in the third quarter of 2016, compared to 8.9% a year earlier; and the monthly wage lost 2.45% of its real value over the four quarters to October 2016. In a context of repressed domestic demand, the deficit on the current account of the balance of payments narrowed, as a sharp fall in imports boosted the trade surplus to US$ 38.5 billion. The total public sector deficit amounted to 7.3% of nominal GDP in October 2016, compared to 9.1% in the year-earlier period. The total net public debt grew from 36.2% of GDP in late 2015 to 44.2% in October 2016. In contrast, inflation pressures started to ease, with the rate dropping to 7.9% in October, compared to 10.7% in late 2015. In 2017, the economy is expected to grow slightly by 0.5%.

Fiscal difficulties monopolized the attention of economic policy in 2016; federal government revenue excluding exceptional income from the programme to repatriate Brazilian assets held abroad fell by 5.8% in real terms. The slower pace of economic activity had a major negative impact on federal and subnational government tax revenues —particularly in states or municipalities that were receiving special royalty payments on the exploitation of natural resources, such as oil and minerals. At the federal government level, revenue was lower in real terms for the main taxes, such as import duties (-28.1%), industrialized product tax (-21.6%), and the tax on financial transactions (-11.2%), along with the Contribution to Finance Social Security (COFINS) (-7.4%) and employee and employer contributions to the National Social Security Institute (INSS) (-6.0%). Income tax receipts grew by 3.4% in real terms owing to the exceptional inflow of 46.8 billion reais resulting from the repatriation of Brazilian capital held abroad, which represents 16.1% of total income tax revenue up to October. Receipts from the goods and services sales tax (ICMS), the main source of state-level tax revenue, declined by 3.7% in real terms up to September 2016, compared to a year earlier. For most of the country’s municipalities, the main funding sources were the mandatory transfers received from the federal government, which declined by 8.5% in real terms between January and October.

Financial constraints made it hard for the Brazilian public sector to adjust and meet its payment obligations. Federal government discretionary spending was cut by 6.8% in real terms, with deep cuts in the investments of the growth acceleration program (-18.8%) and in personnel expenses (-2.4%). Payments in respect of social security benefits and retirement and other pensions, which account for 41.5% of federal primary expenditure, grew by 6.5% in real terms, such that the federal government’s total primary expenditure virtually flatlined (a rise of 0.1%). This generated a primary deficit of 124 billion reais between January and October 2016, equivalent to 1.1% of GDP, compared to 0.7% a year earlier. In the states, it was necessary to stagger the payment of civil servants’ wages and to implement new rules and an increase in contributions to retirement and other pension systems for those personnel.

Brazil: GDP, Inflation and Unemployment, 2014-2016



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The consolidated public sector posted a primary deficit of 0.89% of GDP to October 2016, compared to 0.41% in the previous year. The global deficit amounted to 7.3% of GDP in the first 10 months of 2016, owing to interest payments equivalent to 6.45% of GDP.

Brazil: main economic indicators, 2014-2016

	2014	2015	2016 [a]
	Annual growth rate		
Gross domestic product	0.1	-3.9	-3.6
Per capita gross domestic product	-0.8	-4.7	-4.4
Consumer prices	6.4	10.7	8.5 [b]
Real average wage [c]	1.0	1.0	1.0
Money (M1)	4.7	-1.6	-1.7 [b]
Real effective exchange rate [d]	3.3	24.6	1.7 [b]
Terms of trade	-3.4	-11.0	1.1
	Annual average percentage		
Open urban unemployment rate [e]	7.8	9.3	12.9
Central government			
Overall balance / GDP	-5.1	-9.2	-7.9
Nominal deposit rate [g]	7.1	8.1	8.3 [f]
Nominal lending rate [h]	44.6	49.1	53.1 [f]
	Millions of dollars		
Exports of goods and services	264,063	223,870	217,330
Imports of goods and services	318,799	243,118	201,526
Current account balance	-104,181	-58,882	-19,533
Capital and financial balance [i]	115,014	60,451	27,633
Overall balance	10,833	1,569	8,100

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

a/ Estimates.
b/ Figures as of September.
c/ Private-sector workers covered by social and labour legislation.
d/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
e/ New mesurements have been used since 2012; the data are not comparable with the previous series.
f/ Figures as of October.
g/ Nominal saving deposits rates.
h/ Interest rate on total consumer credit.
i/ Includes errors and omissions.

Monetary policy in 2016 focused on maintaining the benchmark interest rate (SELIC) at 14.25% between January and August. The easing of inflation pushed up the real interest rate, which discouraged borrowing by families and firms, owing to the credit constraint and its negative impacts on the activity level. Credit shrank steadily, with a nominal fall of 8.6% in new loans granted in January-October 2016, compared to the year-earlier period. Public sector banks also reduced their lending by 3.1% in that period, while foreign banks reduced their outstanding loans by 18.2%, as several of the leading institutions sold credit portfolios to private Brazilian banks. Moreover, given the recessionary climate and unemployment, the non-performing loan rate grew to 4.2% in the case of families and 3.6% in the case of corporate borrowers. In November 2016, the Central Bank of Brazil lowered the benchmark SELIC interest rate to 13.75%, and set an annual inflation target of 4.5% to be attained by December 2017. The benchmark rate, in conjunction with expected inflation of 4.8% over the next 12 months, would make the real rate 8.5% per year. In October 2016, the average nominal interest rate on loans stood at 33.3% per year.

Exchange-rate movements were highly volatile in 2016, owing to uncertainties or expectations surrounding political events and their impacts on economic policy. In late January 2016, the exchange rate reached a level of 4.04 reais per dollar, and by late October it had fallen to 3.18, representing an appreciation of 21.2%. Nonetheless, in November, the situation reversed and the exchange rate rose to 3.43 reais, representing a monthly devaluation of 7.8%. The central bank intervened on the foreign-exchange market through swap operations. With the appreciation up to October, swaps were fewer and their costs declined, having amounted to nearly 2.0% of GDP in 2015.

The balance-of-payments current account deficit shrank from US$ 53.4 billion in January-October 2015 to US$ 16.9 billion in the same period a year later —mainly owing to a larger trade surplus (US$ 38.5 billion) generated by exports totalling US$ 153.1 billion and imports of US$ 114.6 billion. The increase in the trade surplus stems from the continuing slide in imports (-22.0%) and a slight decline in exports (-4.6%) in the first 10 months of 2016, although export volumes actually grew. The highest value foreign sales were in commodities such as soybeans (US$ 18.9 billion), iron ore (US$ 10.3 billion) and oil (US$ 8.2 billion), although the amounts were smaller than in the year-earlier period. Among manufactures, automobile exports grew by 33.8% (US$ 3.6 billion) and aircraft sales increased by 16.5% (US$ 3.4 billion). The shrinking of imports, in both value and volume terms, reflected the slower pace of activity, with foreign purchases of oil and hydrocarbon products 44.5% lower (at US$ 10.3 billion), and a widespread fall in other imports, such as capital goods (US$ 15.7 billion, down by 21.6%) and consumer products (US$ 17.9 billion, down by 23.1%). Imports increased only in the case of basic food products for domestic consumption, growing by 20.0% (to US$ 1.7 billion), to make up for the crop losses that occurred in the first half of 2016.

Although foreign direct investment (FDI) remained steady at US$ 54.9 billion in 2016, other capital inflows were weaker, so the financial account balance was US$ 10.7 billion in the year, compared to inflows of US$ 51.3 billion in the first 10 months of 2015. International reserves were broadly stable, at US$ 367 billion.

Agricultural production fell by a cumulative 6.9% in the first three quarters of 2016, owing to weather problems, particularly the drought that afflicted various regions. Activity levels in the transport and commerce sectors were down by 6.9% and 7.2% respectively in the same period. The recession in industry continued for the twelfth consecutive quarter, as continues to be reflected in lower output figures. The manufacturing and construction industries reported falls of 6.7% and 4.4%, respectively, in the first three quarters of the year. The only production sector recording an expansion in that period was electricity, water and sanitation services, which grew by 5.6%, following the lifting of the water restrictions implemented in 2015.

On the demand side, only exports of goods and services posted positive growth (+5.2%) in the first three quarters of 2016. Family consumption declined by 4.7%, while government consumption was down by 11.6%; investment fell by a cumulative 11.7%, dropping to 27.3% below the peak recorded in the third quarter of 2013.

The recession directly affected price and labour market trends. The Extended National Consumer Price Index (IPCA) was up by 7.9% over 12 months to October 2016 a smaller rise than in the year earlier period (9.9%) and below the end-year inflation rate (10.7%). The main factor driving that trend was a reduction in the prices of housing-related expenses, particularly public utilities and rents. After climbing by 18.3% in 2015, prices in that category rose by just 4.4% in the 12 months to October. Another factor was transport costs, which fell by 5.3% after rising by 10.2% in 2015. Nonetheless, food prices are continuing to rise by 12.4% in 2016 following a 12.0% rise in the previous year.

The easing of inflation helped to relieve pressure on real wages. Nonetheless, given the deterioration in the labour market, the unemployment rate climbed steadily from 6.8% in September 2014 to 8.9% a year later and to 11.8% in the same month of 2016. In the first 10 months of this year, 751,000 formal jobs were lost, representing 4.2% of total employment. The real average wage fell by 2.45% in the 12 months to October 2016.

The new government expects the reversal of recession in 2017 to be based on expectations and the credibility of economic policy. The key measure in that regard is the presentation to the National Congress of a new fiscal regime with long-term rules, in which a constitutional amendment puts a ceiling on the growth of total federal government primary expenditure equal to the previous year’s inflation rate, at least for the next 10 years; and the approval of new rules governing access to the retirement another pensions system, and new benefit calculations to take account of demographic changes and income sources. The central bank has contributed to this with the first interest rate cut since 2012. In short, it is estimated that the Brazilian economy could grow by 0.5% in 2017.