Brazil

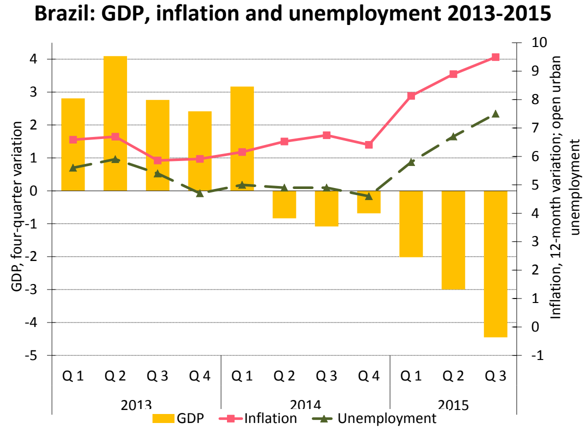
In 2015 the recession in the Brazilian economy deepened and GDP is estimated to have shrunk by around 3.5%, owing to a sharp fall in investment and lower family consumption. The latter partly reflected the rise in the unemployment rate in the main metropolitan areas, from 4.7% to 7.9% in the 12 months to October. The consumer price index rose by more than 10% over the year, owing to a sharp depreciation of the national currency and rising energy and fuel prices. Lower import values allowed for a substantial improvement in the trade balance, and the current account deficit narrowed from 4.4% of GDP in January-October 2014 to around 3.7% of GDP (US$ 53.5 billion) in the same period of 2015. Despite the decline in foreign direct investment (FDI), the net inflow in this category was sufficient to cover the current account deficit, and the country's international reserves remained stable. The public sector will record a primary deficit of up to 2.0% of GDP in 2015, with the overall deficit rising to over 10% of GDP.

Having been re-elected for a new four-year term in 2014, the government changed the direction of economic policy in 2015 so as to regain the primary surplus and rein in the burgeoning debt. To that end it made reforms to the labour market and social security and also in a number of production sectors.

Specifically, the government sought to achieve fiscal adjustment by increasing revenue and cutting expenditure, aiming to generate a primary surplus following the deficit of 0.54% of GDP recorded in 2014. The initial objective was to attain a surplus of 0.6% of GDP by raising tax rates on industrialized products and on profits; tightening rules governing access to social security benefits, such as unemployment insurance; reducing a range of tax expenditures and subsidies extended under countercyclical policy efforts; and taking steps to attract the return of Brazilian capital held abroad. Nonetheless, Congress revised several of the government's proposals, such as the scope and starting date for the adjustment measures, and has yet to make a pronouncement on the others. As the recession worsened and its revenue impacts became more pronounced, and given the need to eliminate off-balance-sheet liabilities equivalent to over 1.0% of GDP accumulated in earlier years, the government downgraded the fiscal targets approved by Congress, from an initial primary surplus to a potential primary deficit of almost 2.0% of GDP in 2015.

Owing to lower levels of production, sales, employment, wages, imports and credit operations, the entire tax structure suffered a revenue loss amounting to 5.4% in real terms between January and October 2015, relative to the year-earlier period. However, primary expenditure decreased by less than 3.3% in real terms, because it is still forced up by mandatory increments such as the payment of retirement and other pensions or subsidies. Successive interest-rate hikes, compounded by financial losses sustained by the central bank, caused interest payments to balloon to 8.9% of GDP, compared to 4.8% in the first 10 months of 2014. As a result, the nominal deficit to October 2015 was 8.9% of GDP, while the gross public debt surged to nearly 67% of GDP.

Brazil: GDP, inflation and unemployment 2013-2015



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

For 2016, the federal government has taken a proposal to Congress to restore the financial transactions tax, which in the past had raised revenue equivalent to nearly 1% of GDP, with the aim of financing social security expenses. Administrative reform is also being implemented to reduce current expenditure, and civil servants' pay rises have been put on hold. Falling income among the states and municipalities has required a rapid reduction in expenditure, given the constraints imposed on their borrowing. In several cases, particularly Rio Grande do Sul and the Federal District, contracts have been revised and payments to civil servants and service providers have been held back.

In 2015, the central bank adopted measures to curb money supply growth and credit expansion, the most significant of which was an interest rate hike from 11.75% to 14.25%. Average interest rates on business loans rose to 21.5%, while rates for loans to private individuals climbed to 38.7%. The monetary base and cash in circulation recorded nominal variations of 3.7% and -4.5%, respectively, in the 12 months to October.

Brazil: main economic indicators, 2013-2015

	2013	2014	2015 [a]
	Annual growth rate		
Gross domestic product	2.7	0.1	-3.5
Per capita gross domestic product	1.8	-0.8	-4.3
Consumer prices	5.9	6.4	9.9 [b]
Real average wage [c]	2.1	1.7	-3.2
Money (M1)	10.7	4.7	-1.0 [b]
Real effective exchange rate [d]	6.8	3.6	19.7 [b]
Terms of trade	-2.3	-3.4	-9.7
	Annual average percentage		
Open urban unemployment rate	5.4	4.8	6.9
Central government			
Overall balance / GDP	-2.6	-5.3	-8.3
Nominal deposit rate [e]	6.4	7.1	8.0 [b]
Nominal lending rate [f]	39.1	44.6	48.8 [b]
	Millions of dollars		
Exports of goods and services	279,658	264,063	223,468
Imports of goods and services	325,571	318,699	248,795
Current account balance	-74,769	-104,076	-68,017
Capital and financial balance [g]	68,843	114,909	63,664
Overall balance	-5,926	10,833	-4,353

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
a Estimates.
b Figures as of October.
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 extraregional real effective exchange rate.
e Nominal saving deposits rates.
f Interest rate on total consumer credit.
g Includes errors and omissions.

In addition to the interest rate hike, monetary policy was complemented by a further tightening of the credit squeeze that private banks had begun to impose in 2013. Unlike in 2014, the official banks did not take countercyclical measures in 2015, but followed the suit of the private banks by reducing the growth of their lending operations. Loans made by the National Bank for Economic and Social Development (BNDES) were down by 28% as of October, and housing loans at regulated interest rates, most of which are extended by the Caixa federal mortgage bank, rose by just 0.4%. Total credit grew by 8.1% in the same 12-month period to October, while private sector lending grew by 6.7%, both figures below the inflation rate, which topped 9%.

In terms of exchange-rate policy, the real depreciated by over 40% against the dollar between January and late November 2015, to a rate of more than four reais per dollar, and it remained highly volatile. With the aim of restraining exchange-rate volatility and currency depreciation, the central bank maintained its policy of currency swaps, which exceeded US$ 110 billion, together with a number of credit line operations amounting to US$ 8 billion. However, the real's steep and continuous depreciation led to losses on swap operations, although these were mitigated by the higher local-currency valuation of international reserves, which stood at US$ 363.2 billion in late October.

The domestic difficulties of the Brazilian economy had repercussions on the external sector, already affected by the weak trend of the global economy. The balance-of-payments current account deficit narrowed from 4.4% of GDP (US$ 83.4 billion) in the first 10 months of 2014 to 3.7% of GDP (US$ 53.5 billion) in the same period of 2015. Much of that result was attributable to the trade surplus of US$ 10.7 billion recorded up to October, following a US$ 3.9 billion deficit in the year-earlier period. Moreover, this adjustment coincided with a 23.7% fall in the value of imports (to US$ 148.9 billion) sapped by weaker domestic demand, and a 16.5% contraction in export value (to US$ 159.6 billion), despite a volume increase in this case.

Export values to October fell in the main groups: commodities (20.1%) and industrialized products (9.5%). Imports of Brazilian products in the country's main export markets were also down, particularly in the European Union (19.7%), MERCOSUR (14.7%), China (13.3%) and the United States (8.2%).

Imports were down by 22.4% overall, with the fall occurring across all categories, particularly oil (55.3%), owing to the increase in domestic production; capital goods (18.2%) and intermediate goods (18.8%).

Aside from the impact of the recession, the sharp domestic currency depreciation (amounting to over 50% during the year) caused reductions in expenditure on services, the number of Brazilian tourists abroad (34.7%), and profit remittances (33.2%).

The narrowing of the current account deficit was matched by the trend in external financing sources. Specifically, net direct investment declined by 32.2% in the first 10 months of 2015, compared to the year-earlier period; but its level of US$ 54.9 billion still exceeded the current account deficit. By contrast, loans and portfolio investments plunged from US$ 50.6 billion to US$ 16.6 billion. Brazil's international reserves fell only slightly and ranked with a balance of US$ 361.2 billion in cash terms in late October 2015.

Brazil's GDP shrank by 3.2% in the first three quarters of 2015. The main indicator of the domestic economy's loss of vigour is the fall in the investment rate, which declined for nine consecutive quarters to 21.2% below its first-quarter-2013 level by the third quarter of 2015. In addition to lower levels of investment, family consumption, the main component of aggregate demand, retreated by 5.8% from its end-2014 level.

Nearly all the production sectors are displaying lower activity levels; industrial output declined by 5.6% and services by 2.15%, thereby eliminating its positive contribution to economic growth in recent years. Manufacturing output dropped back to the levels recorded in the crisis of the first half of 2009, with a 12% fall in the third quarter of 2015, compared to a year earlier. Lastly, output in the services sector decreased by 2.1% over the year.

Although the agriculture sector is still recording positive growth of 2.1% for the year as a whole, third-quarter output was down by 2.0% on the year-earlier level. This figure illustrates the recessionary climate prevailing in Brazilian production, given reduced demand and successive year-on-year falls in investment (12.7%), family consumption (3.0%) and government consumption (0.4%) over the first three quarters of 2015.

Inflation to November 2015, measured by the broad consumer price index (IPCA), posted a cumulative increase of 9.6% over 2015 and 10.5% in the preceding 12 months, the fastest price rises since 2002. This inflationary spike was due to the electricity and fuel price correction policy implemented when the current government took office, with hikes of 50.4% for residential energy, 22% for cooking gas and 18.6% for gasoline. These rises have increasingly been passed through to all products, including food and housing. The lower levels of activity and real income have already had an impact on the prices of services, which rose by less than average in 2015 —8.3% in the 12 months to November compared with a 10.5% increase in the overall index.

The output contraction translated into job losses totalling 819,000 in the formal sector. Nationwide, between the first three quarters of 2014 and the same period a year later, the employment rate fell from 56.8% of the working-age population to 56.1%, while the unemployment rate rose from 6.9% to 8.4%. Real wages dropped by 3.3% during the year.

Political difficulties, in conjunction with the uncertainty surrounding the implementation of fiscal measures, the scant impact that the high-interest-rate monetary policy had on inflation, compounded by exchange-rate volatility and flat foreign trade, all combined to create a difficult environment for investor and consumer decision-making on medium and long-term commitments. Should these conditions persist throughout 2016, the Brazilian economy will endure another year of recession, with GDP growth negative by 2.0%.