Brazil

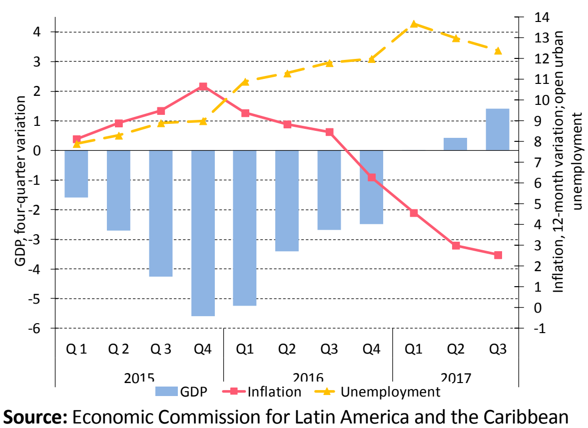
Following a deep recession in 2015 and 2016, there are signs that the contraction in GDP has come to an end, with annual growth of 0.9% expected in 2017. However, demand and production figures do not indicate a sustained improvement yet. Consumption and investment are still lower than the levels seen in 2014, before the crisis, and public investment has been reduced sharply. The good news stems from an export shock which, despite stronger imports, will result in a record surplus of goods in the trade account and a reduction in the balance-of-payments current account deficit. The unemployment rate peaked in March and has been falling since then, but this improvement is a reflection of the increase in employment of informal and own-account workers, while formal employment levels have still not picked up. Despite fiscal adjustment efforts, the public deficit remains high and debt continues to grow. Against the backdrop of weak economic activity and record agricultural harvests, inflation continued to decline, leading to a substantial reduction in the nominal basic interest rate. However, the decline in the real interest rate was not as steep.

Economic policy, which seeks to resolve problems through structural changes in the State apparatus, generation of new income and reduced public spending, continues to focus heavily on the fiscal agenda. With respect to State reforms, the government has imposed a constitutional limit on the expansion of primary public spending, which must not exceed the previous year's level of inflation for 20 years. This should reduce primary spending as a percentage of GDP and affect social spending, investments and the anti-cyclical capacity of fiscal policy.

The public sector primary deficit is expected to amount to 2.4% of GDP at the end of 2017, compared with 2.5% at the end of 2016. Despite lower interest rates, financial spending, on the basis of existing public debt, remains high. In September 2017, nominal interest spending on a cumulative 12-month basis was equivalent to 6.5% of GDP, which should result in a negative nominal figure of 8.9% of GDP at the end of the year. Hence, public debt will maintain the upward trend that began in 2014. Gross debt rose from 69.8% of GDP at the end of 2016 to 73.9% in September 2017 (net debt stood at 50.9% of GDP). Virtually all public debt is denominated in local currency, which reduces the impact of exchange rate volatility. With respect to aggregate demand, the absence of growth in public spending means that fiscal policy cannot serve as an anti-cyclical growth stimulus. Stronger growth is needed to stabilize debt, and fiscal policy —particularly investments— could play a key role.

Moreover, at the end of 2017, the government is continuing to reform the pension system in order to generate fiscal savings. Meanwhile, with a view to generating non-recurring income, it has renegotiated tax and non-tax liabilities, raised fuel taxes and proposed concessions and privatizations as a means of offsetting the increase in debt. At August 2017, the government had renegotiated 5.4 billion reais of its debt. The privatization and concession agenda includes airports, oil exploration sites, energy transmission lines, ports and highways, and plans to sell stakes in some State-owned companies,

Brazil: GDP, Inflation and Unemployment, 2015-2017



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

particularly Eletrobrás. According to the Independent Fiscal Institution (IFI), this non-recurring income amounted to 29 billion reais at August 2017. As the sale of public assets is not expected to generate more than 40 billion reais, the implementation of this agenda is not likely to cover the government's projected primary fiscal deficit of 159 billion reais. The government is also seeking to reduce public spending and has focused on cuts in discretionary spending, with a considerable reduction in public investment. For example, the Growth Acceleration Programme (*Programa de Aceleração do Crescimento*), which includes public works and social housing, suffered additional cuts of 28% in real terms between December 2016 and September 2017, on a cumulative 12-month basis. Given the rigidity of mandatory spending, overall spending posted a slight increase of 0.47% in 2017 (spending on staff and pensions stood out with 5% growth). With respect to tax revenue, there were some signs of improvement in taxes on employment, production, income and company earnings. Combined with non-recurring income, this resulted in a slight increase (about 1%) in overall real public revenues in the period under review.

Brazil: main economic indicators, 2015-2017

	2015	2016	2017 [a]
	Annual growth rate		
Gross domestic product	-3.5	-3.5	0.9
Per capita gross domestic product	-4.4	-4.3	0.1
Consumer prices	10.7	6.3	2.7 [b]
Real average wage [c]	-3.3	-1.4	2.0
Money (M1)	-1.6	-0.3	3.3 [d]
Real effective exchange rate [e]	24.3	-4.2	-11.1 [d]
Terms of trade	-11.0	3.0	6.9
	Annual average percentage		
Open urban unemployment rate [f]	9.3	13.0	14.5
Central government			
Overall balance / GDP	-9.0	-7.6	-7.8
Nominal deposit rate [g]	8.1	8.3	7.0 [d]
Nominal lending rate [h]	49.5	53.7	50.9 [d]
	Millions of dollars		
Exports of goods and services	223 870	217 753	250 442
Imports of goods and services	243 118	203 163	218 779
Current account balance	-59 434	-23 530	-11 938
Capital and financial balance [i]	61 003	32 767	27 105
Overall balance	1 569	9 237	15 167

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/ Figures as of September.
e/ A negative rate indicates an appreciation of the currency in real terms. Refers to the global real effective exchange rate.
f/ Twenty metropolitan regions.
g/ Nominal saving deposits rates.
h/ Interest rate on total consumer credit.
i/ Includes errors and omissions.

Reflecting weak economic growth momentum and strong agricultural production, annualized inflation (extended national consumer price index or IPCA) —which had stood at 6.3% in December 2016— fell to 2.5% in September 2017, a historically low level not seen since 1998. Market projections recorded by the central bank point to inflation of 3.1% at the end of 2017, following the price increases implemented in the last few months of the year. This downward trend in inflation resulted in a decline in the nominal basic interest rate from 13.75% in December 2016 to 7.0% in December 2017. However, in terms of economic stimulus, the lower real interest rate has not had such a significant impact. In December 2016, the real interest rate (discounting inflation over the 12 previous months) stood at 6.93%, compared with 5.67% in September 2017. The difficulty of the recovery is also visible in the lending portfolio, which continued to deteriorate, to 47% of GDP.

The exchange rate remained highly volatile in 2017 in light of various political events and the subsequent uncertainties about economic policy. The falling interest rate has not led to exchange rate devaluation, given the differences that remain between the interest rate in Brazil and those in other global financial centres. Over the course of the year, the exchange rate ranged from 3.05 to 3.37 reais per US$ 1 (3.28 reais per US$ 1 at the end of October). Market projections recorded by the central bank point to 3.20 reais per US$ 1 at the end of 2017. The average real effective exchange rate between January and October 2017 was almost 10% lower than the level seen in 2016, owing to political changes, and 8% lower than the level seen in June 1994, when the real was created.

The crisis of 2015 and 2016 had led to a sharp decline in imports, and in turn a stronger surplus in the trade account. At October 2017 the trade account reflected a surplus of US$ 56.1 billion, which was 24.6% higher than the level seen in 2016. Over the same period, exports of goods amounted to US$ 183 billion, 19.8% higher than the year-earlier period. Meanwhile, imports picked up again and amounted to

US$ 125 billion in October 2017, 9.1% higher than the year-earlier period. Exports were boosted by a positive commodity price shock (particularly for metals) and a substantial increase in agricultural production, which contributed to a 28.3% jump in commodity exports between January and October 2017, compared with the same period in 2016. Other groups of exported products posted strong increases, such as semi-manufactured products (32.5%) and manufactured products (27.0%). Imports improved slightly. From January to October 2017, Brazil posted a sharp increase in fuel imports (41.2%) owing to stronger international prices, and saw a 10.8% jump in intermediate goods imports, particularly in the industrial sector. Meanwhile, in line with the fragility of the economic recovery, capital goods imports continued to fall, and were down 13.5% in the period from January to October 2017, compared with the year-earlier period. The exceptional trade climate and the larger deficits posted between January and October 2017 in services (US$ 27.1 billion) and in net primary income (US$ 34.1 billion), led to a drastic reduction in the current account over the same period, to a deficit of US$ 3.0 billion, compared with US$ 23.5 billion in the year-earlier period.

Foreign direct investment inflows remained strong as in the previous two years, at US$ 60 billion in the 10 months to October. Risk-based investment, for example the buying and selling of stocks, significantly boosted inflows, which amounted to US$ 9.4 billion between January and October 2017, compared with net outflows of US$ 600 million in 2016. Lastly, the balance of payments stood at US$ 8.5 billion, net of errors and omissions. At the end of October 2017, Brazil's international reserves amounted to US$ 380.7 billion.

After two consecutive years of declines in GDP, of 3.5% in 2015 and in 2016, the prolonged recession came to an end in 2017. Up to the third quarter of 2017, GDP had grown by 0.6% compared with the year-earlier period. The agricultural sector led this expansion with a 14.5% increase in the first three quarters. The other sectors continued to post negative rates (-0.9% for industry overall and -0.2% for services). Nonetheless, compared with the previous quarter, data for the third quarter point to a marked improvement, especially on the demand side, with a return to growth in investment (1.6%) for the first time in 14 quarters, and an expansion of 1.2% in household consumption.

The improvement in employment reflects weaknesses and a fragile recovery. After rising to a record level of 13.7% in the first quarter of 2017, unemployment fell to 12.4% in the third quarter, while labour income increased by 2.4% in the third quarter compared with the year-earlier period. This improvement in unemployment was not reflected in stronger formal employment, but rather in growth in informal employment and in the number of own-account workers. Formal employment fell by 2.4% in the third quarter of 2017 compared with the year-earlier period, while informal employment grew by 6.2% and own-account employment rose by 4.8%. Against the backdrop of adopted labour reforms, precarious employment may worsen, especially as a result of hourly contracts and collective agreements that can overrule general labour laws.

In 2017 the Brazilian economy showed its capacity to respond to growth stimuli (albeit short-term ones), for example in the ability to access resources from employment savings accounts, such as the unemployment insurance fund (*Fundo de Garantia do Tempo de Serviço*), which in the first half of the year increased the economy’s liquidity by roughly 40 billion reais, and in other government initiatives that made resources available through a number of funds. The decline in nominal interest rates to record low levels should lead to stronger growth in lending and to an increase in fixed investment, and contribute to fiscal efforts to rein in public debt. If international commodity prices remain favourable and there are no speculative changes in capital flows owing to political tensions, economic growth should strengthen in 2018.