BRAZIL

ECONOMICS 2015-16

1) *HISTORICAL*
   - *2004 – 2010*
   - *2011 – 2013*
2) *2014 – 2015*
3) *ABRIDGMENT*
4) *OUTLOOK FOR 2016*

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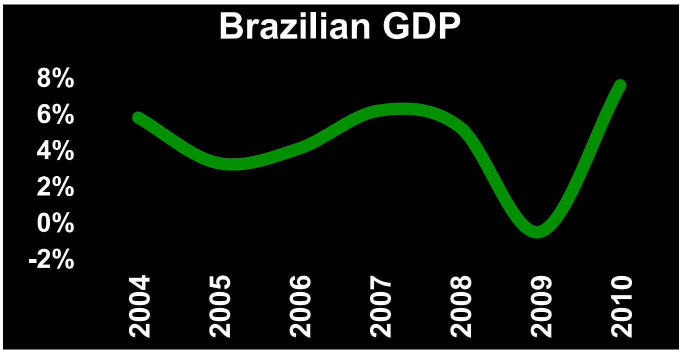
1) HISTORICAL

2004 – 2010

All international economic experts recognized that **since 2004** the mix of economic and social policies adopted by the Brazilian government, also oriented to the social inclusion of the poorest class traditionally marginalized by the circuit consumption and credit access, has promoted a **significant growth of the country**.

However in **autumn 2009**, like in the whole world, the Brazil has felt the effects generated by the worsening of the **international financial crisis**. Nevertheless, due to the exceptional performance of the first half of 2008 and to the effort of adjustment of the basic parameters of the Brazilian economy made in the previous years, the **Brazil was very less affected** by the crisis than the majority of countries belonging to the northern hemisphere, although the annual change in GDP (gross domestic product) in 2009 fell to 0.2%, compared to 5.1% in 2008, while maintaining the economic basic parameters always on positive levels and showing strong signs of recovery since the latter part of 2009, particularly by **supporting the consumption and the credit access**.

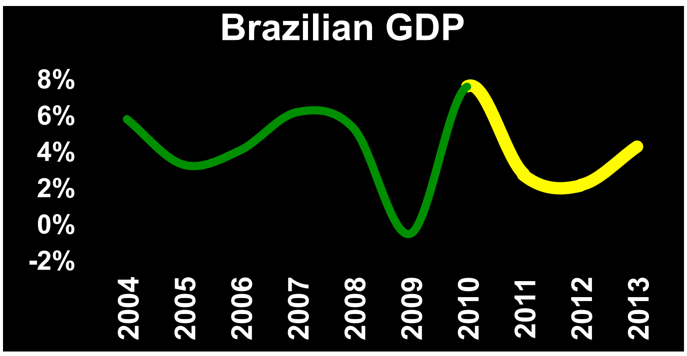
2010 reported an increase in GDP of 7,5%, closing at US$ 3.675 billion (8th largest in the world).
Also in 2010 the per capita income increased by 5.5%, exceeding the psychological threshold of US$ 10.000 per capita.
Thanks to the prompt governmental anti-crisis measures, combined with the global economic recovery, the **Brazilian economy has been able to recover faster than others**.



2011 – 2013

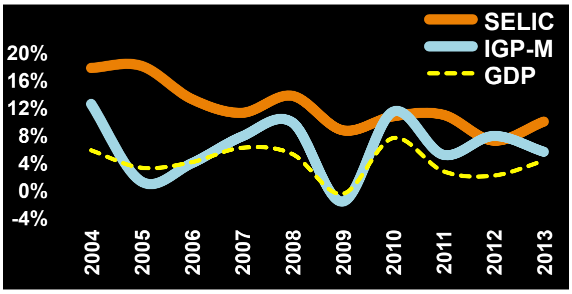
After such a phase of strong cyclical recovery from the economic crisis, the **GDP continued to expand** in the 2011-2013 years at a average rate of the order of 3-4%, driven by **household consumption**, benefiting from the positive dynamic of the labour market.

The **unemployment rate fell** to below 6% in May 2012, lowest monthly level since the Institute of Statistics (IBGE) has revised in 2002 the methodology for calculating this parameter. It has also intensified the process of **formalization of the economy** and in the first four semesters were created nearly 4 millions jobs in the formal sector, compared to 600 thousand in 2009.



The remuneration dynamics continued to be positive, helping to **increase the purchasing power of low and middle class**, improving the trend of incomes redistribution in favour of those social classes that until few years ago were not considered as "consumers" in the meaning that is commonly used in Europe.

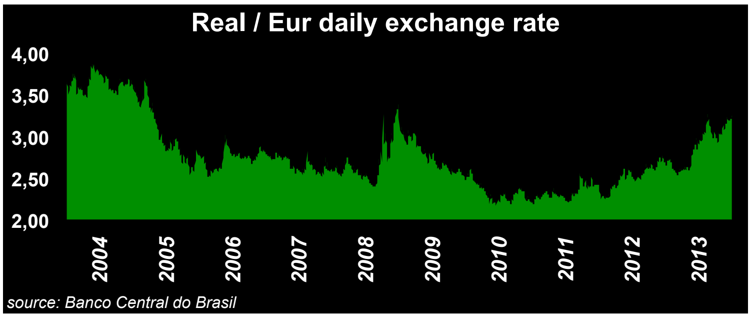
Also the **Brazilian monetary policy** has contributed to the development of the country and allowed to strengthen its emerging role in the global economy.



The combined management of

- SELIC - official interest rate,
- IGP-M - consumer prices index,
- exchange currency rates,

has supported the **development of the country**, leaving definitively the recession that had affected the Brazil in conjunction with the global financial crisis in late 2008 and early 2009.



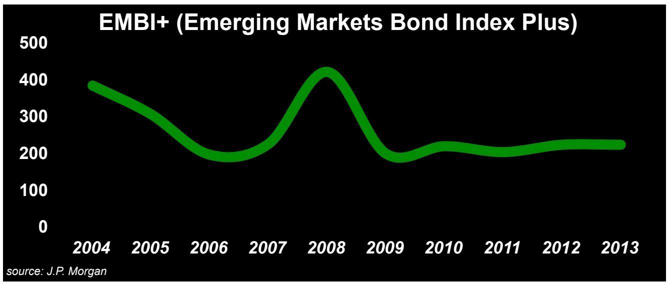
The positive global trend was sustained by

- the improvement in the international environment,
- good growth perspectives,
- favourable financing conditions and increased investments in fixed capital, on the order of 5-6% per year.

This scenario confirmed the **macroeconomic stability of the country** and a considerable substantial **reduction of risk**, which was ample evidence in the strength of public finances and monetary stability.

The Brazilian "country risk", namely the EMBI+ (Emerging Markets Bond Index Plus) index** rated by J.P.Morgan, stabilized at a level of 200 points, confirming the reliability that the Brazil was getting into the international economic panorama.

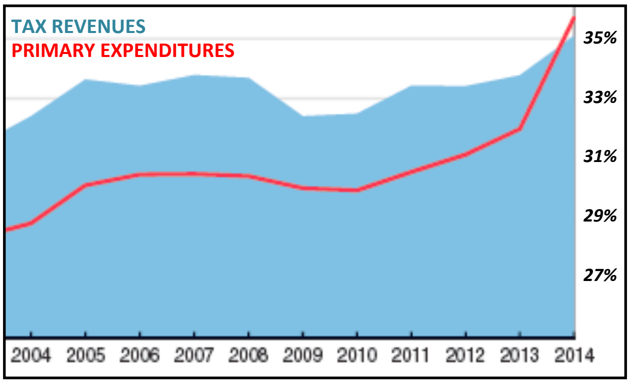
*** EMBI+ index measures the spreads on US bonds. Every 100 points of risk correspond to a spread of 1%.*



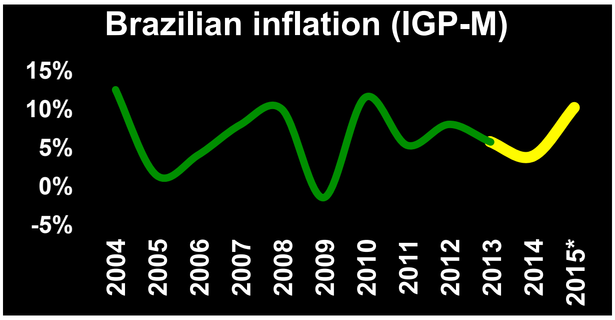
2) 2014 – 2015

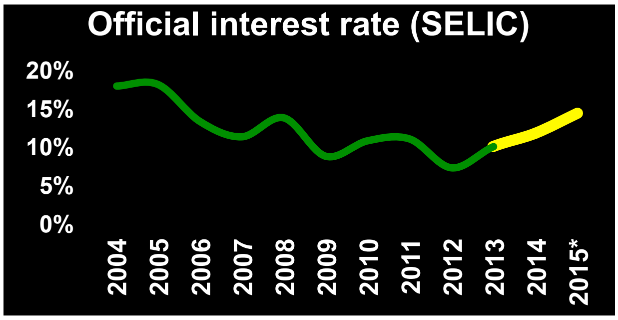
The 2014, year of the presidential election made in November, was characterized by a governmental policy oriented to the electoral consensus, neglecting the economic development and the stability of the monetary balance and public budget. This **trend worsened in 2015**, also aggravated **by the following factors**, some of which were previously “masked” by the overall positive performance of macroeconomic indicators, and worsened by the flop of medium to long term policies launched in 2013 by the economic government team (the so-called “*Brasil Maior*” plan).

- ✓ The **fiscal position deteriorated**, posting a primary deficit in 2014 for the first time since 1996, as illustrated in the graph to the side showing the trend of tax revenues and primary expenditures, both expressed as % of GDP. The final fiscal position in 2015 will be even worse and long-term fiscal challenges arise, due to a rapidly ageing population and to a worrying increase of the primary expenditures.

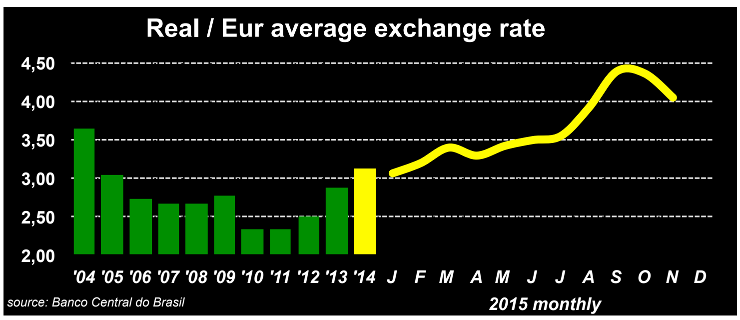


- ✓ Since August 2015, the **inflation has risen** above the tolerance band (4,5% ± 2%), despite the increase of the official interest rate (SELIC), which could undermine the credibility of the Central Bank.

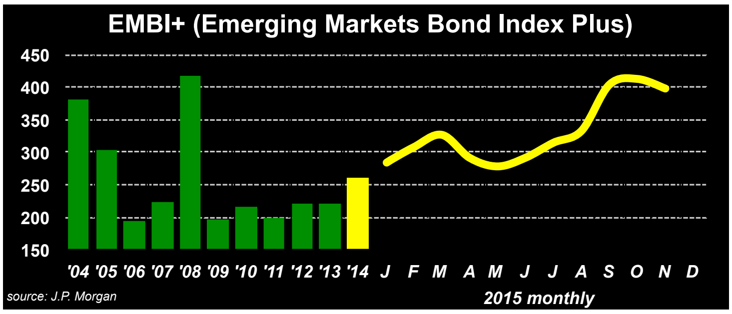




- ✓ **Taxes are high** and compliance costs generated by a fragmented system of indirect taxes are large.
- ✓ High trade protection and weak competitive pressures have been **holding back productivity gains** and the integration of the economy into international trade.
- ✓ **Infrastructure bottlenecks** drive up transport and logistics costs for industrial companies.
- ✓ **Public services** are facing capacity constraints and complex bureaucratic processes.
- ✓ **Lower growth in China** is limiting export demand with low prices for Brazil's commodity exports.
- ✓ The ongoing investigations of **corruption and bid-rigging** in the national oil company Petrobras have raised governance issues and affected confidence, and will delay the recovery of investment, both from domestic and overseas investors.
- ✓ Recent **rating downgrades**, that entailed the loss of investment grade rating for some Brazilian sovereign bonds by major rating agencies, may also weigh on investment and increase the cost of capital.
- ✓ The **currency devaluation trend**, started in 2013, worsted in 2014-15 pressing the prices (the imported content is relevant in the Brazilian prices composition) and contributing significantly to the inflation increase.
- ✓ The **gross debt increased** from 53% of GDP in 2013 to 60% expected in 2015.



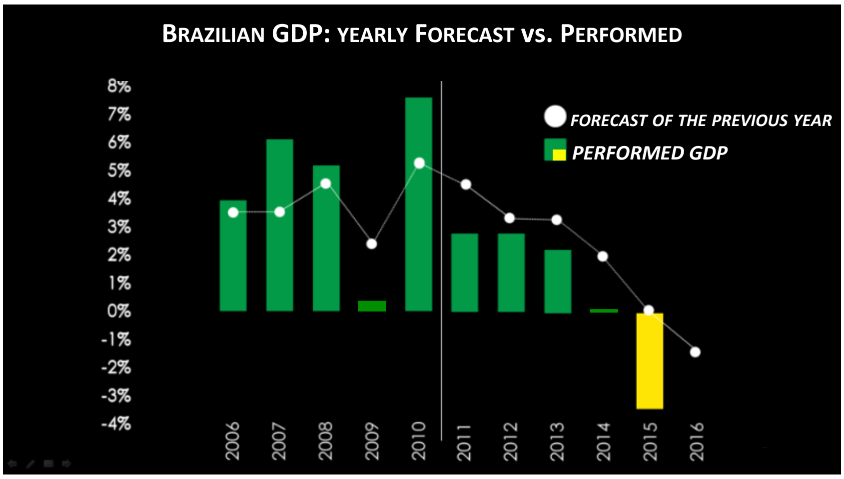
- The **Brazilian "country risk"** (the EMBI+ index, rated by J.P.Morgan), that was stabilized around 200 points since 2010, increased significantly in 2014 and worsened in 2015 reaching 400 points (close to the level at the global financial crisis in late 2008 and early 2009).



3) ABRIDGEMENT

- Since 2011, two outstanding trends were emerging.
  - The **GDP growth expectations deteriorated**.

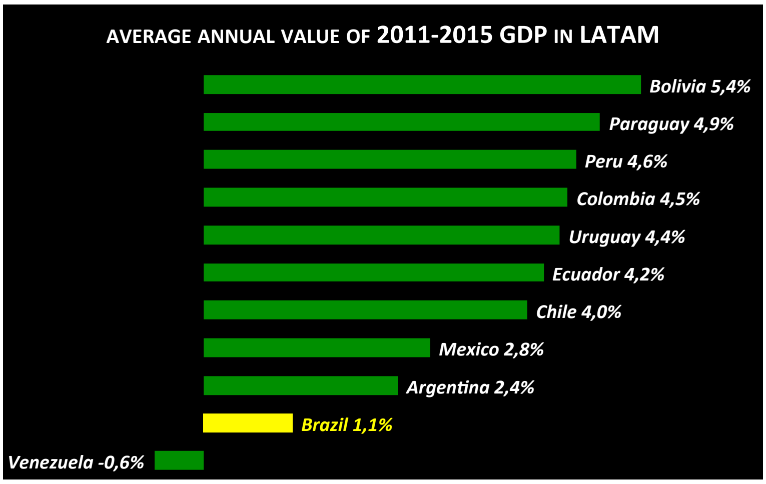
    The GDP growth expectations is measured by the Central Bank at the end of the each year calculating the average of the banks poll on the forecast of the expected growth for the following year.
  - The **real growth in each year was even worse** than GDP growth expectations.



- Indeed the real performance of the Brazilian economy has been consistently getting worse since 2011.

  In fact, since 2011 the **Brazilian economy was the second less grown all over Latin America**, only surpassing Venezuela and just because Venezuela's GDP dropped 10% in 2015 due to political crisis.

  The Brazilian economy was mainly sustained by the internal demand. When the consumers' confidence dropped, because of rising inflation and difficulties in credit access, **the crisis began**.



- The economic policies that favoured the low class and encouraged the consumptions, but depressing the industrial production, led the **entrepreneurs' confidence to fall**, reducing productive investment and generating the major imbalances in the Brazilian economy that appeared in 2014-15: negative trade balance, rising inflation, fiscal deficit, growing interest rates, pressure on exchange rates, loss of political credibility.

4) OUTLOOK FOR 2016

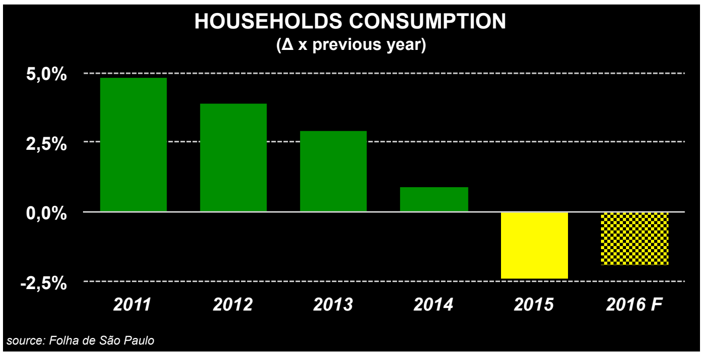
- The **increased political uncertainties** depress confidence further and lead to greater policy inaction. For 2016, the analysts see **the economy remaining in contraction**, waiting for the needed fiscal adjustment and a tighter monetary policy. Only in the second half of the year some improvements can be expected.

- According to the conclusions of the "*OECD Economic Survey Brazil - November 2015*" approved in 14 September 2015 by the Economic and Development Review Committee of OECD (Organisation for Economic Co-operation and Development): *"… **GDP is projected to contract in 2015 and 2016. However, once the fiscal results improve and inflation starts to return to the target, there will be clear growth pay-offs as recovering confidence will support stronger investment and consumption, particularly if coupled with the implementation of structural reforms. Growth is projected to turn positive sometime in 2016, without lifting the annual growth rate for that year into positive territory. During 2017, growth is projected to return gradually towards the economy's growth potential, which has been curbed by supply-side bottlenecks and low investment in the past**…"*

MACROECONOMIC INDICATORS	*Source*	2015	2016
GDP growth	*(1)*	-3,1%	-2,0%
Industrial production (variation on previous year)	*(1)*	-7,5%	-2,3%
Inflation (average of the year)	*(1)*	9,1%	6,6%
Inflation (end of the year)	*(1)*	9,4%	4,9%
Interest rate - SELIC (end of the year)	*(1)*	14,25%	14,13%
Household consumption (variation on previous year)	*(3)*	-2,4%	-1,9%
US$ exchange rate (end of the year)	*(2)*	R$ 3,96	R$ 4,20
EUR exchange rate (end of the year)	*(2)*	R$ 4,16	R$ 4,40
Unemployment	*(3)*	6,7%	7,2%
Fiscal balance	*(1)*	-7,4% of GDP	-7,2% of GDP
Gross debt (*with continuing 1.9% GDP transfers to public banks*)	*(1)*	60% of GDP	68% of GDP
sources: (1) OECD Economic Outlook Database (2) IBGE Monthly Employment Survey (3) Financial analysts			

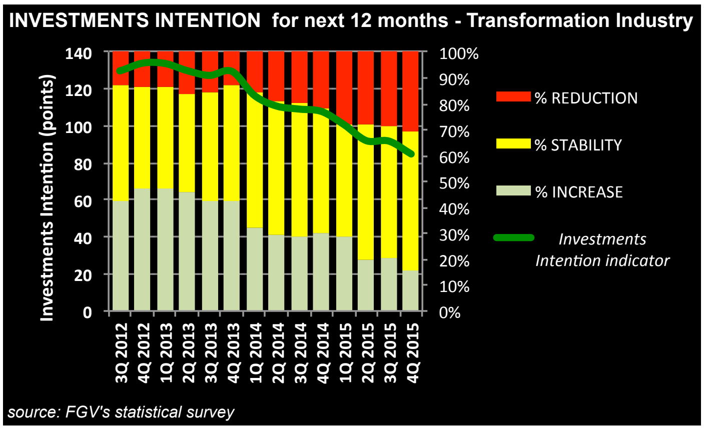
HOUSEHOLD CONSUMPTION

- During the period of growth, the Brazilian economy was sustained by household consumption, which grew at a rate of 3% to 5% per year until 2013.
- 2014 was the first slowdown (only 0,9% consumption increase), while Brazil registered a **drop in consumption** of 2,4% in 2015, mainly due to distrust in politics, economic uncertainty and higher interest rates.
- For 2016 the expectation is to assist at a further contraction, although lower, forecasted in a 1,9% reduction of the household consumption.



INVESTMENTS

- According to the statistical survey quarterly made by FGV (Getulio Vargas Foundation):
  - in 2016 **31% of the Brazilian industries will invest less** in 2016 (was 22% at end 2014), while only 15% expect to increase their investments (was 30% at end 2014);
  - the **Investments Intention Indicator fell by 22%** in 2015, from 108 points in 4Q'2014 to 85 points in 4Q'2015, confirming the negative trend already registered since 2014.



A POSITIVE APPROACH

- Despite such negative scenario, the economists agree in a **recovery forecast**, perhaps more intensive than predictable today, once the government will be able to achieve a stronger political base (therefore with unsure deadlines), which would let to complete the fiscal adjustment and to resume the confidence and the growth. In **2017 is expected to return** gradually towards the economy's growth potential, with possible first positive results already in the second half of 2016.

- Such perspective of positive trend in the medium term, together with the actual currency rate conditions (the real plunged to the lowest level in 12 years against the dollar), can create today an **environment encouraging foreign investment**. Believing in this positive outlook, recently three foreign companies have made huge investments in the country:
  - cosmetics: the Coty (French company) bought part the operations of Hypermarcas for about US$ 1 billion;
  - advertising: the Omnicom (American company) bought the ABC Group for about US$ 0,3 billion;
  - aviation: the HNA (Chinese company) bought 23% of the Azul for about US$ 0,5 billion.

A traditional Brazilian byword quotes: "In the country of the blind, the one-eyed man is king", that is the scenario offered today by the Brazil to foreign investors: but for how long?

The report authors

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