

Brazil's Current Economic Situation and Outlook

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Overview

Brazil's economy has begun to emerge from one of its deepest recessions. During Q2 2017, Brazil grew 0.3% YoY, the first positive figure after contracting for 12 consecutive quarters (YoY basis)

The low inflation rate and lower interest rate are two of the factors contributing to the economic recovery and they could further affect positively the economic growth going forward.

Brazil's economy is expected to grow in 2017. For 2018, slightly faster, but still modest growth is expected (1.9% YoY).

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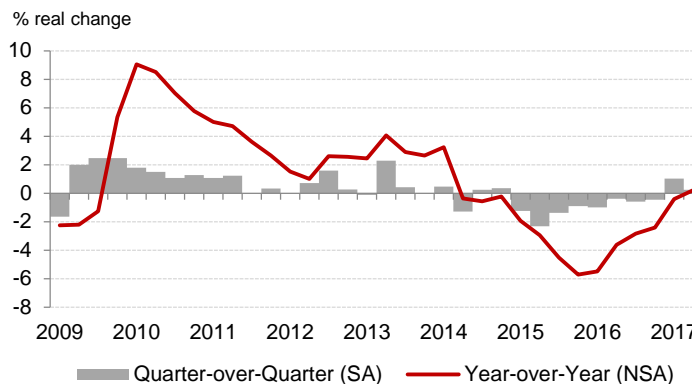
1. GDP

Brazil's economy has begun to emerge from one of its deepest recessions. During Q2 2017, Brazil grew 0.3% YoY, the first positive figure after contracting for 12 consecutive quarters (YoY basis) (Figure 1).

On the demand side, the slow recovery of household consumption and exports contributed to the slight recovery of GDP growth during Q2 2017 (Figure 2).

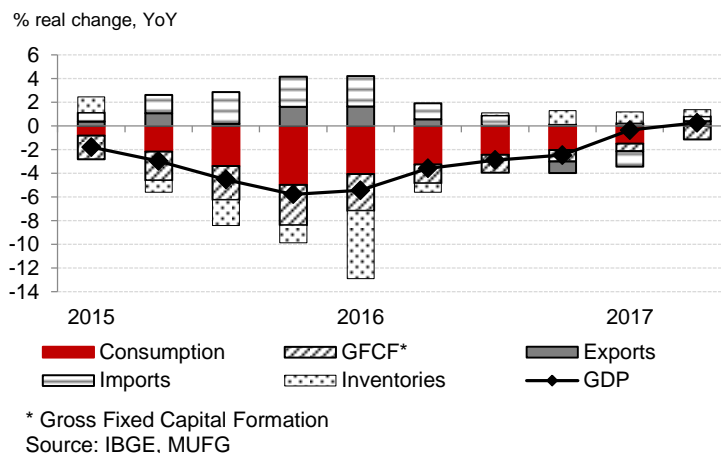
The low inflation rate and lower interest rate are two of the factors contributing to the economic recovery and they could further affect positively the economic growth going forward.

Figure 1: GDP Growth



Source: Instituto Brasileiro de Geografia e Estatística (IBGE), MUFG

Figure 2: GDP Growth by Demand Components



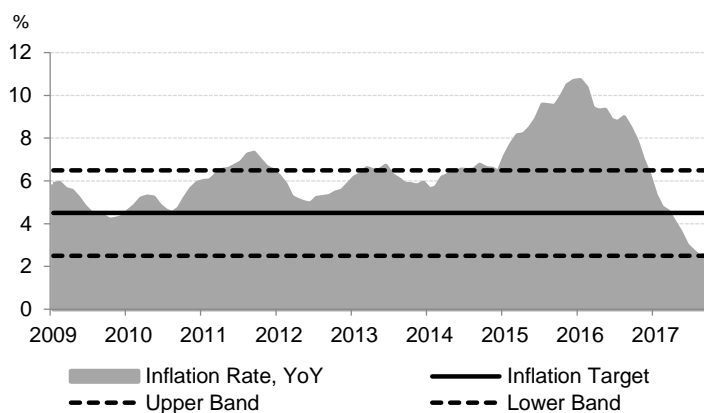
* Gross Fixed Capital Formation
Source: IBGE, MUFG

2. Inflation

a) Current Situation

The high rates of inflation Brazil experienced during 2015 and 2016 have subsided. Inflation has fallen from almost 11% (YoY) at the beginning of 2016 to 2.7% (YoY) in October 2017 (Figure 3).

Figure 3: Inflation



Source: IBGE, MUFG

b) Key Determinants

The decrease in inflation could be attributed mainly to a fall in food prices (Figure 4) and a weak labor market.

The fall in food prices is a reflection of the still favorable supply conditions coming from the abundant harvest during Q1 2017.

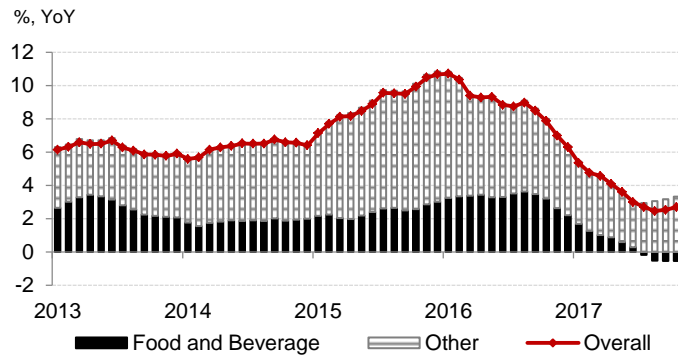
The considerable slack in the labor market has been contributing to the continued fall in inflation during recent months (Figure 5).

c) Outlook

The inflation rate is expected to finish the year below the target rate of 4.5% and to be around the target rate in 2018 (Figure 6).

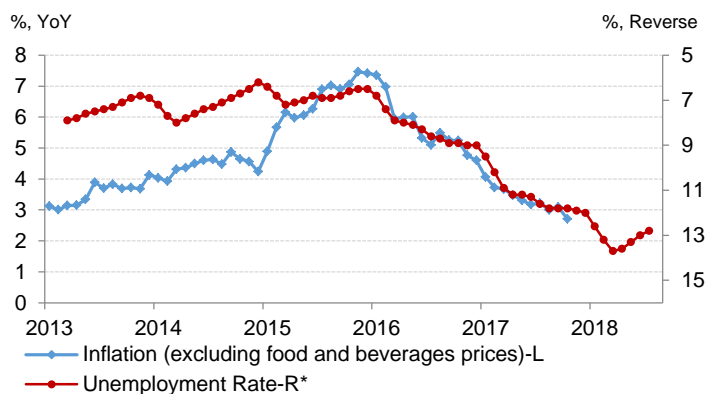
Although the downward pressure on inflation from the abundant harvest will most likely subside, the considerable slack in the labor market will continue to suppress prices, likely keeping inflation low throughout 2018.

Figure 4: Overall Inflation and Food and Beverage Prices Contribution



Source: IBGE, MUFG

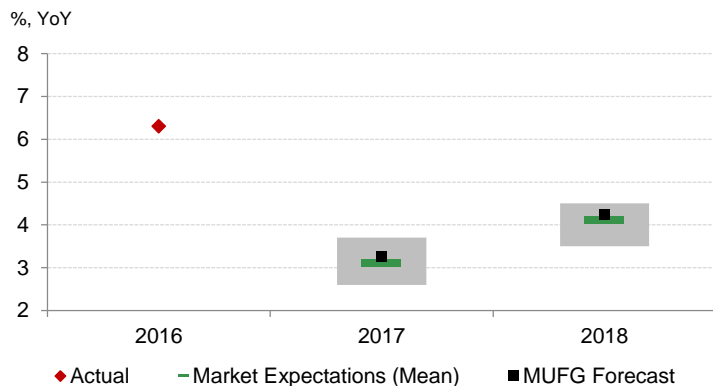
Figure 5: Inflation and Unemployment Rate



* Unemployment Rate is in a 12 month period lag. Unemployment Rate is only available since March 2012.

Source: IBGE, MUFG

Figure 6: Inflation (Forecast)



Note: The grey box represents the variation of the market expectations showing the minimum and maximum values

Source: Consensus Economics, MUFG

3. Policy Rate

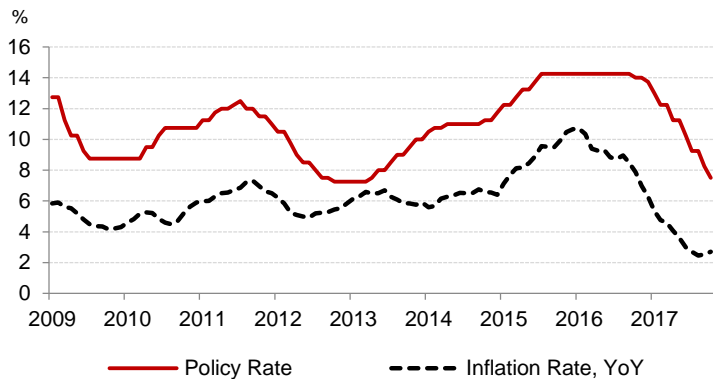
a) Current Situation

In its last meeting in October, the Central Bank cut the SELIC interest rate by 0.75 percentage points to 7.5% (Figure 7).

b) Outlook

It is expected that the Central Bank will further cut the interest rate during the remainder of 2017 and keep it at that level throughout 2018. The expected low/moderate inflation going forward will allow the Central Bank to keep the interest rate low. As a result, Brazil should benefit from the stimulating effect of its monetary policy and this should lead to an expansion in economic activity.

Figure 7: Inflation and Policy Rate



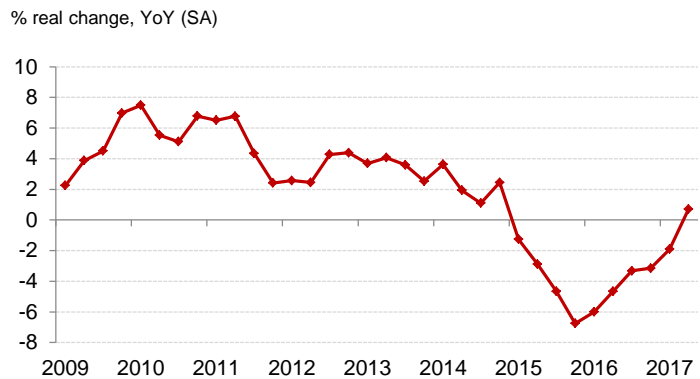
Source: Central Bank of Brazil, IBGE, MUFG

4. Household Consumption

a) Current Situation

Household consumption registered positive growth of 0.7% YoY during Q2 2017 (for the first time in ten quarters) (Figure 8). This is an important signal that the Brazilian economy is beginning to improve after the lengthy recession.

Figure 8: Household Consumption



Source: IBGE, DataStream, MUFG

b) Key Determinants

The continued decline in inflation and low interest rates are the two main factors for the improvement in household consumption.

In addition, after a long period of increasing unemployment, the unemployment rate began to fall, reaching 12.4% in September, marking the sixth consecutive month of decline after recording a record high in March of 13.7% (Figure 9).

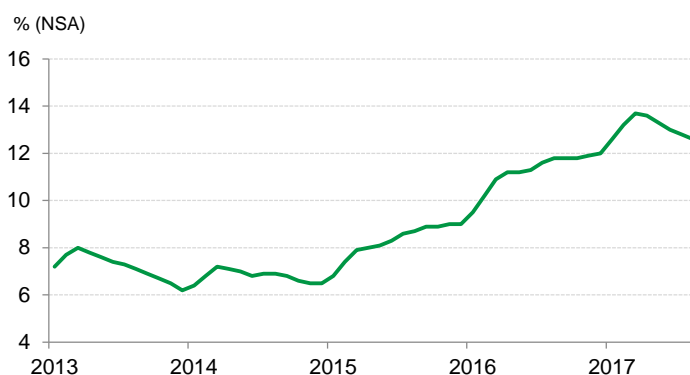
Meanwhile, the consumer confidence index, although still low, is improving (Figure 10). In October the consumer confidence index reached 83.7 points, 20 points higher (an almost 30% increase) from its lowest point in September 2015 (63.6). This result is explained by the improvement in expectations.

c) Outlook

It is expected that household consumption will have modest growth in 2017 and will accelerate further in 2018 (Figure 11).

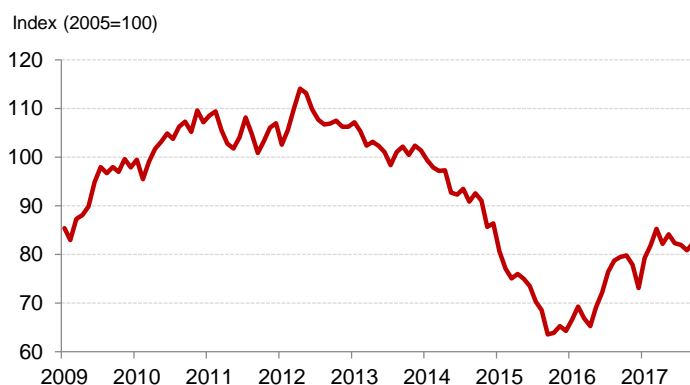
This recovery is being led by a combination of low inflation and low interest rates. The continued improvement in the labor market may also impact household consumption as workers could see their wages increase as the labor market becomes tighter. The improvement in consumer confidence indicates that households are beginning to feel more confident in the economy and as a result, may be more likely to increase their consumption.

Figure 9: Unemployment Rate



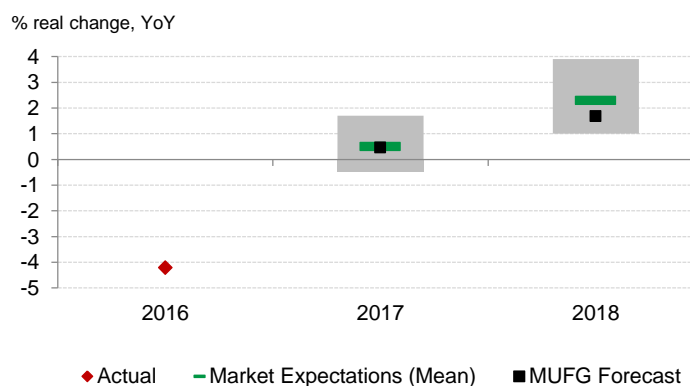
Source: IBGE, MUFG

Figure 10: Consumer Confidence



Source: Fundacao Getulio Vargas, MUFG

Figure 11: Household Consumption (Forecast)



Note: The grey box represents the variation of the market expectations showing the minimum and maximum values.

Source: Consensus Economics, MUFG

5. Investment

a) Current Situation

Gross Fixed Capital Formation (GFCF) contracted once again in Q2 2017 (-5.7% YoY), marking the 13th consecutive quarter of contraction (Figure 12).

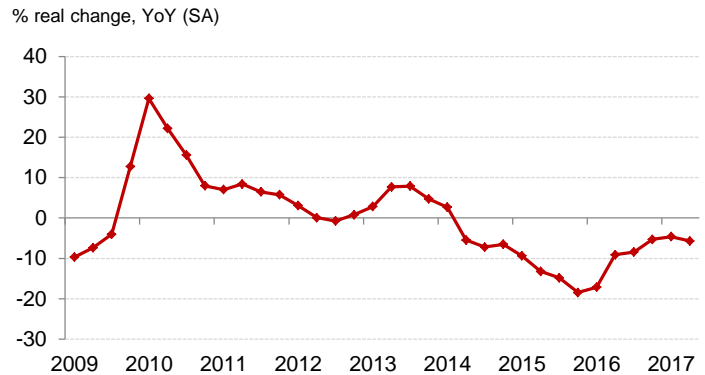
b) Key Determinants

Low interest rates are the main factor that will help investment to have a less severe contraction in 2017.

While the business confidence index is still low, it is improving. The average for the first 3 quarters of 2017 is more than 10 points higher than the previous year for the same period (Figure 13). This increase in business confidence could indicate a slow improvement in investment going forward.

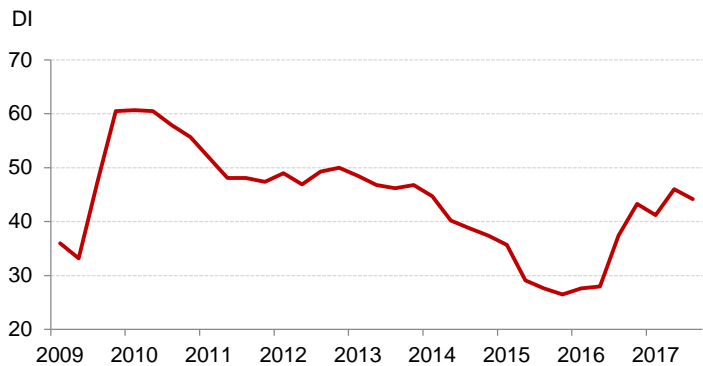
However, capacity utilization in the manufacturing sector remains low. The average of the capacity utilization rate from January to September 2017 was 77.2%, unchanged from the same period in 2016 (Figure 14). This slack in capacity utilization in the manufacturing sector will hamper a more vigorous improvement in investment.

Figure 12: Gross Fixed Capital Formation



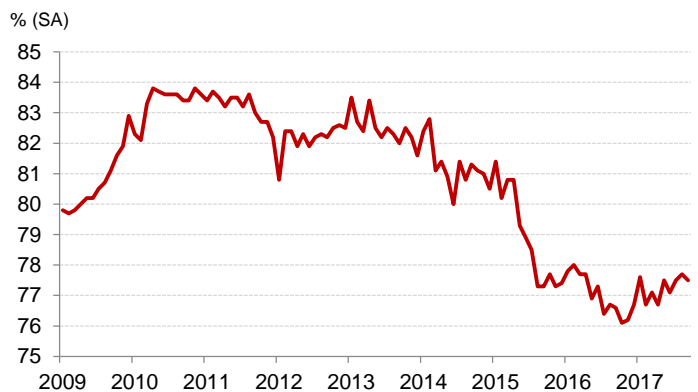
Source: IBGE, DataStream, MUFG

Figure 13: Business Confidence



Source: Central Bank of Brazil, NCI, DataStream, MUFG

Figure 14: Capacity Utilization Rate (Manufacturing)



Source: National Confederation of Industry (NCI), DataStream, MUFG

c) Outlook

It is expected that investment will once again contract in 2017, although the contraction will be less severe than in previous years. In 2018, investment is expected to record positive growth (Figure 15).

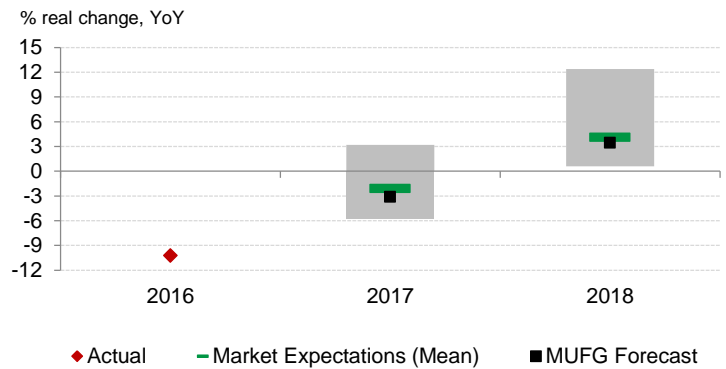
The increase in private investment will be due to lower interest rates and the continued improvement in business confidence.

6. Overall Economic Outlook

Brazil's economy is expected to grow in 2017 (Figure 16). For 2018, slightly faster, but still modest growth is expected (1.9% YoY).

This recovery will be influenced by a slow improvement in domestic demand that is benefiting from low inflation and low interest rates.

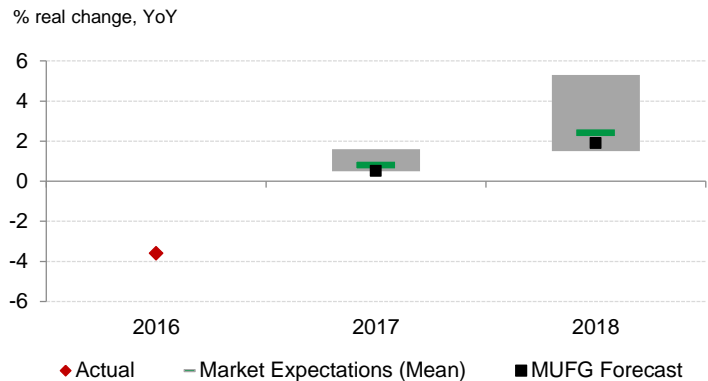
Figure 15: Gross Fixed Capital Formation (Forecast)



Note: The grey box represents the variation of the market expectations showing the minimum and maximum values.

Source: Consensus Economics, MUFG

Figure 16: GDP Growth (Forecast)



Note: The grey box represents the variation of the market expectations showing the minimum and maximum values.

Source: Consensus Economics, MUFG

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