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BRAZIL: RECOVERY INTERRUPTED AS INVESTMENT DECLINED IN 3Q

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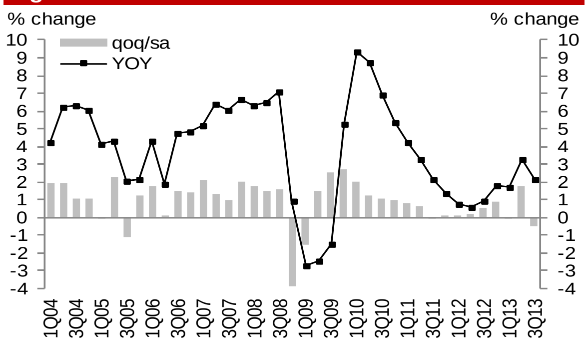
3Q13 GDP result: Recovery disappoints with 0.5% contraction qoq/sa

Interrupting the recent and gradual recovery of growth seen in 1H13, Brazil's 3Q13 GDP result disappointed with a decline in economic activity and the enduring imbalance of growth drivers. Resilient private consumption led growth again, while fixed investment contracted and exports slowed.

Real GDP contracted 0.5% quarter-on-quarter (qoq/sa) in 3Q after having increased 1.8% qoq/sa in 2Q, according to results released on Tuesday. In year-on-year terms, GDP rose 2.2% in 3Q versus 3.3% in 2Q. (Figure 1.) Key data revisions include a downward adjustment for 1Q to 0.0% qoq/sa (from 0.63% previously) and an upward adjustment for 2Q to 1.8% qoq/sa (from 1.5%). For 2012, growth was revised upwards to 1.0% (from 0.9%).

Figure 1: Real GDP



Source: IBGE; BTMU Economic Research (NY).

Figure 2: Real GDP

% variation	quarter-on-quarter/sa					year-on-year				
	3Q12	4Q12	1Q13	2Q13	3Q13	3Q12	4Q12	1Q13	2Q13	3Q13
Total	0.6	0.9	0.0	1.8	-0.5	0.9	1.8	1.8	3.3	2.2
Supply-side										
Agriculture	7.7	-6.7	5.8	4.2	-3.5	4.0	-7.0	13.2	11.6	-1.0
Industry	0.8	0.0	-0.4	2.2	0.1	-0.7	0.0	-1.2	2.7	1.9
Services	0.5	0.9	0.1	0.8	0.1	1.4	2.8	1.7	2.4	2.2
Demand-side										
Private consumption	1.0	1.1	-0.1	0.3	1.0	3.6	4.2	2.3	2.6	2.3
Public consumption	-0.4	1.0	-0.5	0.5	1.2	3.4	4.4	2.4	0.8	2.3
Fixed investment	-1.1	1.8	4.2	3.6	-2.2	-5.6	-4.2	3.2	9.1	7.3
Exports	1.2	3.7	-5.1	6.8	-1.4	-3.2	2.1	-5.7	6.3	3.1
Imports	-6.1	8.2	5.4	0.3	-0.1	-6.4	0.5	7.5	7.7	13.7

Source: IBGE; BTMU Economic Research (NY).

More of the same: Growth composition upsets prospects of re-balanced, broad-based recovery

On the demand side, consumption continues to be the main growth driver of the economy. (Figure 2.) Private consumption, which accounts for two-thirds of GDP, picked up momentum on account of a tight labor market, real wage gains, and slowly declining inflation to register growth of 1.0% qoq/sa compared to 0.3% in 2Q. While remaining the driving force for growth, it has nevertheless moderated upon a slowed credit market, still-high inflation, and less optimism. Indeed, private consumption grew 2.3% yoy and 2.8% in the four quarters through 3Q, decelerating from growth of 3.2% in 2012 and 4.1% in 2011.

In 3Q, public consumption rose 1.2% qoq/sa (vs 0.3% in 2Q) and 2.3% yoy (vs 0.8% in 2Q) despite the deterioration of fiscal balances and inflation pressures.

Fixed investment was the major disappointment. After having expanded for three consecutive quarters in sequential terms, it contracted 2.2% qoq/sa in 3Q. (Figure 3.) Its increase of 7.3% yoy, however, is attributed to a weak result in 3Q12. Domestic and external factors combined to restrict investment conditions. In the context of a deteriorated domestic investment climate and the monetary tightening cycle, the combination of global financial market volatility and a weakened BRL lowered confidence levels, widened Brazil's 5-yr CDS spread, and raised the costs of capital and imports to slow investment growth. (Figure 4.)

Net exports dragged on growth. Exports fell 1.4% qoq/sa upon lower prices and volumes as external demand is weak. Imports dropped 0.1% qoq/sa.

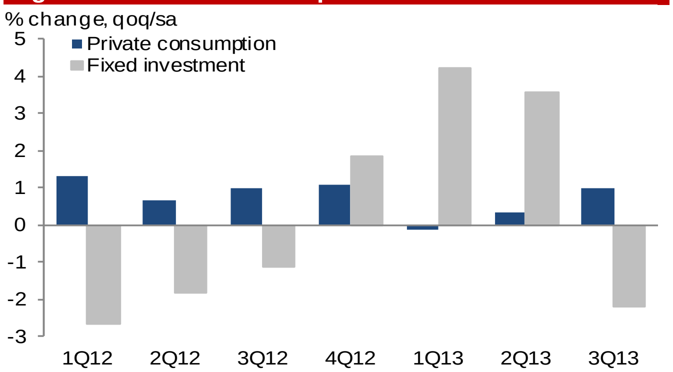
On the supply side, services recorded a notable deceleration as it grew 0.1% qoq/sa (vs 0.8% in 2Q). Industry also struggled; it rose 0.1% qoq/sa (vs 2.2%).

With low growth-high inflation dynamic, monetary tightening cycle is closer to the end

Activity indicators for 4Q show some improvement, led by retail sales, which should place growth at 2.3% in 2013. As the recovery has not seen sustained improvement in key sectors or the investment climate, growth will stay modest near 2.1% yoy in 2014. With moderated—but high—inflation, consumption will remain the main growth driver, while the concessions and World Cup preparations should support a slight cyclical acceleration of investment from 3Q. Yet, risks are to the downside due to the prospects of lower commodity prices, tighter financial conditions, and a higher risk premium. Investment is fragile in a low growth-high inflation environment where uncertainty surrounds government policy. Brazil's investment ratio is 19% of GDP, below the regional average of 22%.

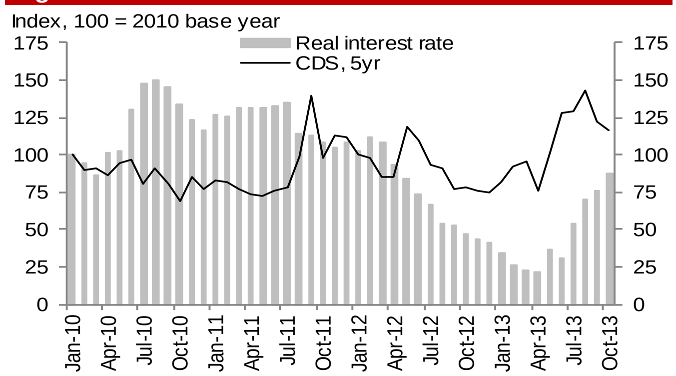
Mediocre growth is likely to prompt the BCB to conclude the monetary tightening cycle in early 2014. The chance for holding has risen. However, we expect a 25bp hike in January, raising the SELIC to 10.25%, where it will remain for the rest of 2014 amid the run-up to the October election and concerns over growth.

Figure 3: Private consumption vs. fixed investment



Source: IBGE; BTMU Economic Research (NY).

Figure 4: Investment conditions



Source: Central Bank; Bloomberg; BTMU Economic Research (NY).

For historical data and commentary following BTMU's Economic News Releases, see our website at: http://www.bk.mufg.jp/report/ecolatin2013/index.htm