

Brazil's Macroeconomic Performance: Q4 2017 GDP and Current Monthly Indicators

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Overview

2017 was the end of the largest recession in Brazil ever recorded. The economy grew 2.1% YoY during Q4 2017, the fastest pace since Q1 2014.

Consumption registered its third consecutive expansion in Q4 2017 (1.9% YoY). This process of recovery was in line with an increase in household credit that is mainly explained by lower interest rates.

Gross Fixed Capital Formation (GFCF) expanded in Q4 2017 (3.7% YoY) for the first time after 14 consecutive quarters of contractions. This could have been driven in part by lower interest rates and a reduction of the idle capacity in the manufacturing sector.

Brazil's inflation rate in February 2018 stood at 2.8% YoY. The falling prices of food were the main driver for low inflation.

During the last meeting in March 2018, the Central Bank cut the interest rate (SELIC-monetary policy rate) by 0.25 percentage points to 6.5%; this is the lowest the interest rate has been over the last 20 years.

For 2018, it is expected that Brazil's GDP growth will accelerate. The tailwinds from low interest rates and low inflation could continue propelling the improved environment for household consumption and the upturn in investment. A continued positive outlook of the global economy and improved commodity prices will be some of the factors that positively affect Brazil's economy.

1. GDP

2017 was the end of the largest recession in Brazil ever recorded. The economy grew 2.1% YoY during Q4 2017, the fastest pace since Q1 2014 (Figure 1). On a quarterly basis, economic activity showed a trajectory of recovery, marking the fourth consecutive quarterly increase in Q4 2017.

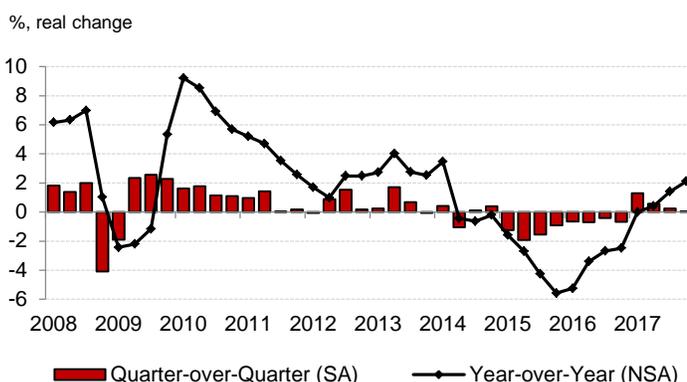
While it is apparent that the economic recovery is consolidating, post-recession GDP growth is the slowest it has been during any recovery period over the past 18 years (Figure 2).

Consumption

Consumption registered its third consecutive expansion in Q4 2017 (1.9% YoY) (Figure 3). This expansion was the highest since Q4 2014.

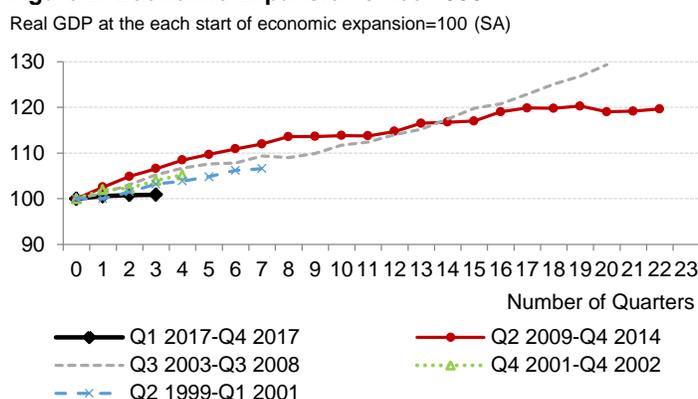
This process of recovery was in line with an increase in household credit (Figure 4) that is mainly explained by lower interest rates.

Figure 1: GDP Growth



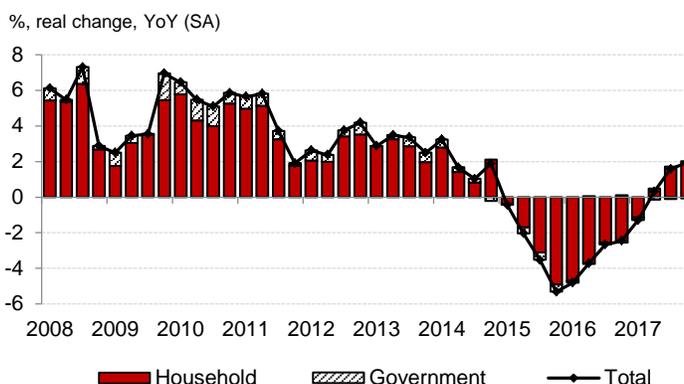
Source: Instituto Brasileiro de Geografia e Estatística (IBGE), MUFG

Figure 2: Economic Expansion since 1999



Source: IBGE, MUFG

Figure 3: Consumption



Source: IBGE, MUFG

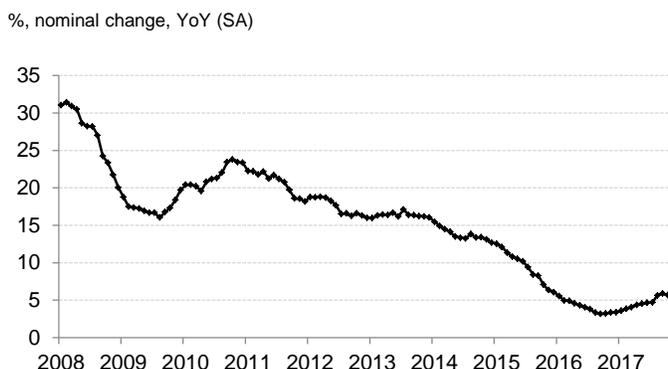
Recent data demonstrates a mix of results in the labor market. On the one hand, the unemployment rate continues to be high (Figure 5). On the other hand, net job creation is improving.

Consumer confidence was 6.7 points higher in February 2018 (87.4) than in February 2017 (80.7). Although this represents a general improvement, the still high unemployment rate could make consumers more cautious and less optimistic moving forward. Further complicating matters are that the upcoming presidential elections could put downward pressure on consumer confidence as the elections approach.

Investment

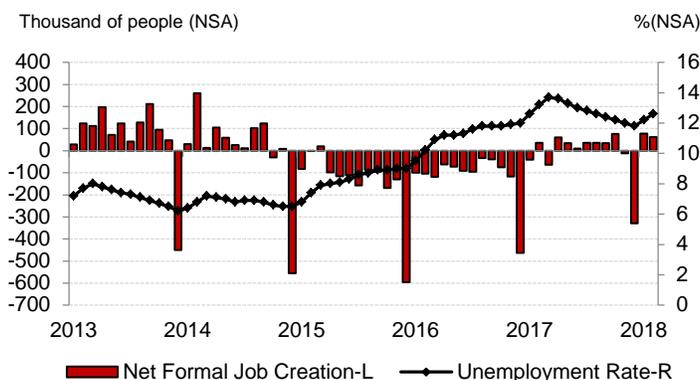
Gross Fixed Capital Formation (GFCF) expanded in Q4 2017 (3.7% YoY) for the first time after 14 consecutive quarters of contractions (Figure 6). This could have been driven in part by lower interest rates and a reduction of the idle capacity in the manufacturing sector. In addition, the general improvement in the economic outlook of Brazil could be contributing to improvements in investment.

Figure 4: Outstanding Household Credit



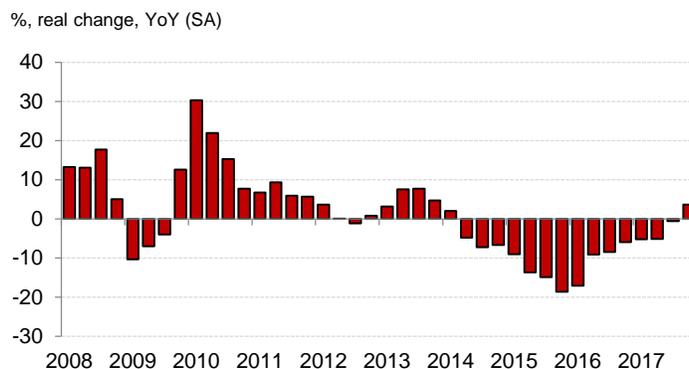
Source: Central Bank of Brazil, DataStream, MUFG

Figure 5: Unemployment Rate and Net Formal Job Creation



Source: IBGE, Ministry of Labor and Employment, MUFG

Figure 6: Gross Fixed Capital Formation



Source: IBGE, MUFG

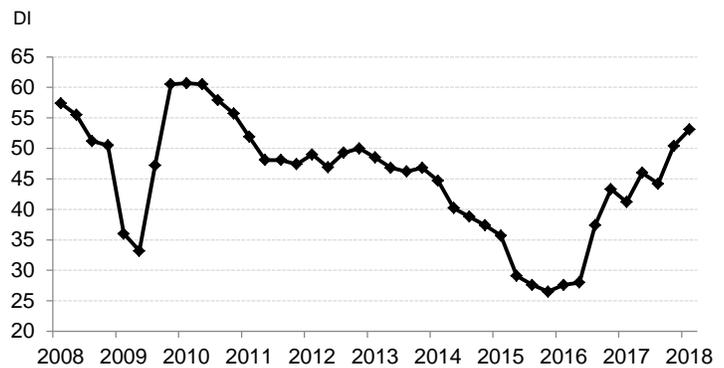
As the overall economic outlook improves, business confidence has also picked up. During Q1 2018, business confidence reached its highest level (53.1) since Q4 2010 (Figure 7), reflecting businesses' optimism about the current conditions.

Exports and Imports

Exports increased in Q4 2017(16.3% YoY) (Figure 8). This expansion was mainly driven by primary goods (commodity goods), principally soybeans, iron ore and oil. This is in line with an improved external condition and a record agricultural harvest in 2017.

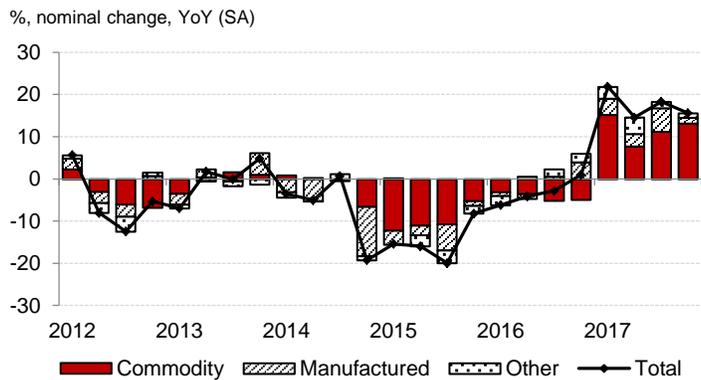
Imports increased during Q4 2017 (14.7% YoY) (Figure 9). This expansion was mainly driven by the imports of intermediate goods and fuel. This is in line with the improvement of investment and also with a general improvement of the economy.

Figure 7: Business Confidence



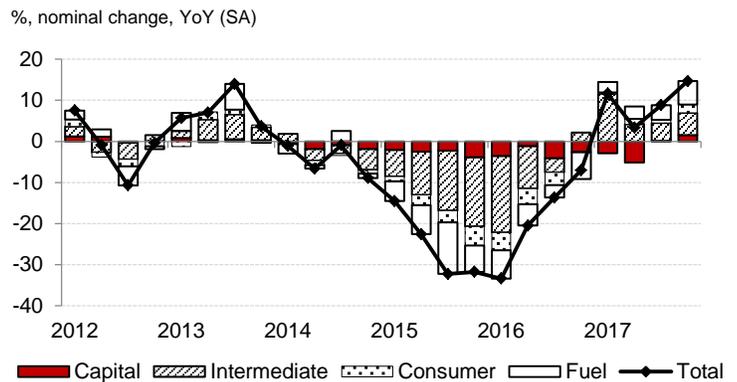
Note: A level equal to or greater than 50 points reflects optimism
Source: National Confederation of Industry (CNI), MUFG

Figure 8: Exports of Goods



Note: Other includes semi-manufactured goods and other goods.
Source: Ministry of Development, Industry and Foreign Trade, DataStream, MUFG

Figure 9: Imports of Goods



Source: Ministry of Development, Industry and Foreign Trade, FUNCEX, DataStream, MUFG

2. Public Finances

The central government's primary fiscal balance for 2017 was a deficit of 1.9% of GDP, compared to a deficit of 2.6% of GDP in 2016 (Figure 10).

This positive result was mainly driven by an increase in exceptional revenues from tax amnesty programs and concessions. Tax collection so far is increasing faster than expected, this could help the government to meet the 2018 primary fiscal target¹ (around -2.3% of GDP).

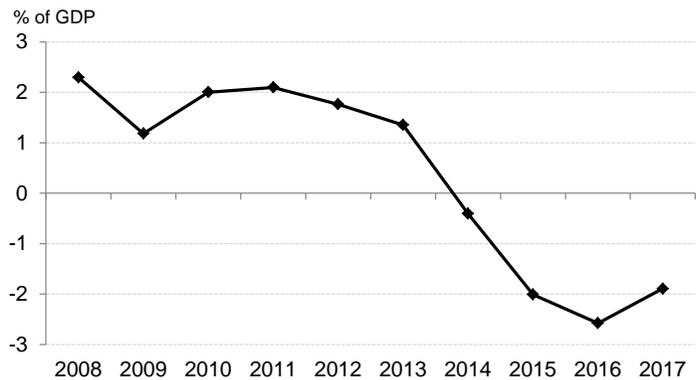
The proposed pension reform continues to be key in order to have fiscal sustainability. This will likely need to be addressed by the next administration.

3. Inflation and Monetary Policy

Brazil's inflation rate in February 2018 stood at 2.8% YoY (Figure 11). The falling prices of food were the main driver for low inflation.

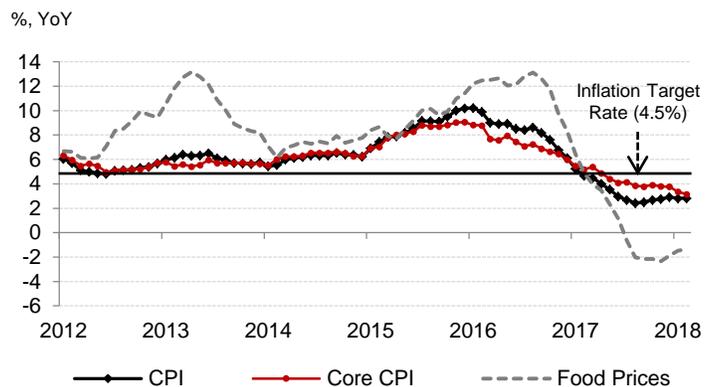
Core inflation continues to be lower than the target rate (4.5%) and the diffusion index, which measures the proportion of inflation components with positive price variations, registered an average of 48.5% in February, lower than in the same period in 2017 (50.9%) (Figure 12). Core inflation and the diffusion index indicate an absence of upward pressure on prices. Some risks going forward are the Niña phenomenon that could bring a less benign scenario to food prices.

Figure 10: Central Government Primary Fiscal Balance



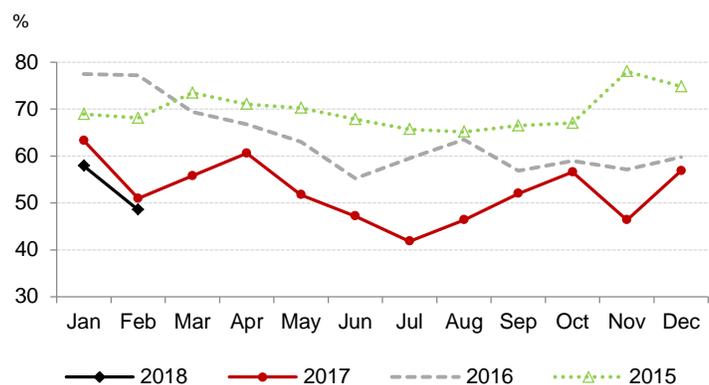
Source: National Treasury, MUFG

Figure 11: Inflation



Source: IBGE, Central Bank of Brazil, MUFG

Figure 12: Inflation Diffusion Index



Source: Central Bank of Brazil, MUFG

¹ A deficit of 159 Billion of Brazilian Reals

During the last meeting in March 2018, the Central Bank cut the interest rate (SELIC-monetary policy rate) by 0.25 percentage points to 6.5%; this is the lowest the interest rate has been over the last 20 years. It is expected that the Central Bank is likely to end the rate cut cycle soon in order to give the economy some time to react to the monetary stimulus already in place and to evaluate its effects before changing the SELIC again.

4. Outlook

For 2018, it is expected that Brazil's GDP growth will accelerate. The tailwinds from low interest rates and low inflation could continue propelling the improved environment for household consumption and the upturn in investment. A continued positive outlook of the global economy and improved commodity prices will be some of the factors that positively affect Brazil's economy. There are some risks internally and externally that could impact the Brazilian economy, among them are the Brazilian presidential election, the possibility that the Central Bank of Brazil could start raising the policy rate by the end of 2018, fears of a trade war between the US and China, and the speed at which the Federal Reserve adjusts interest rates.

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