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BRAZIL'S MACROECONOMIC SCENARIO: PRESSURE AND UNCERTAINTIES OF THE CURRENT MOMENT

With elections in the final stretch (first round of voting will be on October 7), the market is currently experiencing a strong rally given the uncertainties regarding the country's macroeconomic direction once our next government representatives are defined (mainly President and Governors).

The level of tension in markets is also under negative influence, due to the serious economic crisis the country finds itself in. The population and productive sector want a strong and immediate market turnaround. However, several indicators show that the country's situation is seriously bad in several perspectives, and we need a package of comprehensive and intense solutions to fix the current problems.

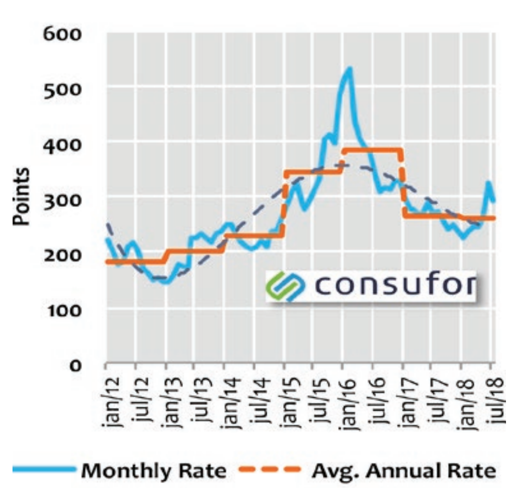
Making an analogy with medicine, you can't simply treat a cancer patient with natural teas and a balanced diet. With the country in the "ICU", one cannot expect Brazil to return to economic growth without a series of in-depth economic interventions.

As such, in this month's column, CONSUFOR summarizes some of the indicators that reflect the Brazilian market's situation as a way to help readers position themselves in relation to what awaits us starting January 2018, already under "new management".

Figure 1 shows the Country Risk trajectory. As of 2002, when the country received a rating of 2,500 points, this indicator was on an interesting reduction trajectory, with a certain amount of oscillation near 2008-2009, due to the global financial crisis. However, as the country's fiscal situation deteriorated over the years, Brazil was excluded from the list of "good payers" and its rating began to soar. Since the country has difficulty solving the public accounts deficit equation, this indicator's trajectory is expected to increase next year.

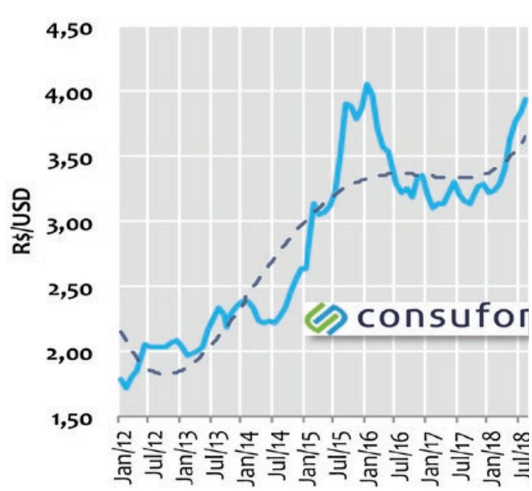
Figure 2 shows the strong devaluation of the Brazilian real in relation to the US dollar (in nominal terms). 2018 has been highly volatile due to internal and external factors. However, the Brazilian Central

Figure 1 – Country Risk – Brazil



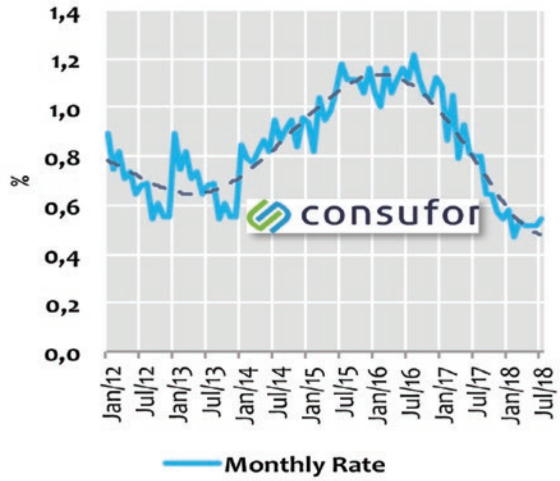
Source: JP Morgan

Figure 2 – Exchange Rate – US Dollar



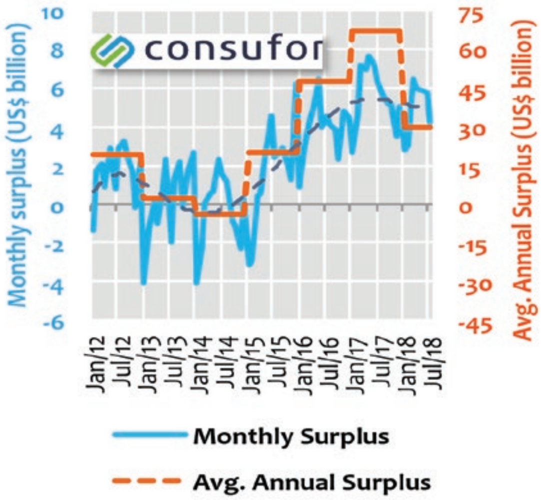
Source: BACEN

Figure 3 –Selic Rate



Source: BACEN

Figure 4 – Brazil's trade balance surplus



Source: MDIC

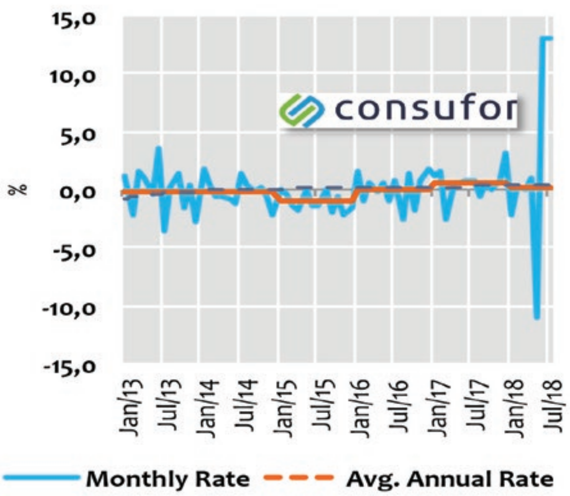
Bank revised its perspectives for the next years, defining an average exchange rate of ~R$ 3.80 for the end of 2018, and around R$ 3.70 for 2019 and 2020.

The Selic Rate is presented in Figure 3. We see that the current level is well below 2015-2016 levels, when the annual rate was close to 14%. In 2017, the rate stayed below 8% p.a. For 2018, the rate is expected to be around 6.5%, increasing to 8% p.a. over the next two years. As a result, credit in Brazil tends to become more expensive, keeping investments from resuming.

Figure 4 shows the trade balance surplus for the last years. We see there's been a recovery since 2014. However, the forecast is that the country should close 2018 with a surplus of roughly US$ 55 billion, which is less than the 2017 balance. This reduction trajectory is also expected over the next years, where the projected surplus is US$ 47 billion (2019) and US$ 43 billion (2020), showing that the country will face international trade difficulties, even with a highly depreciated exchange rate.

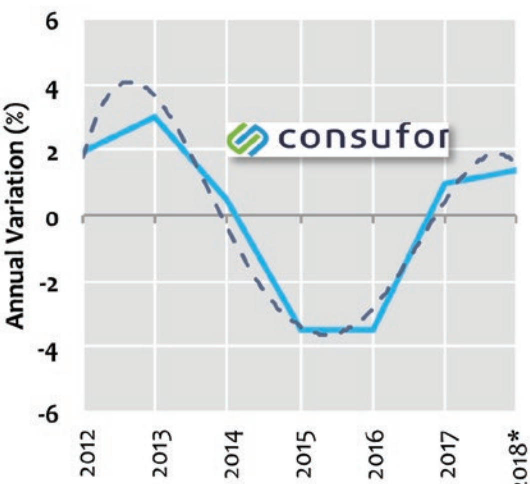
Industrial production in Brazil (Figure 5) has suffered strong pressure over the last years. The annual accumulated rate has been dropping since 2013. In 2017, the situation turned around and registered growth of 2.5% in relation to 2016. However, it is necessary to point out that this positive growth is over a very low production level. For the next two years, the government is projecting annual growth rates of almost 3%, quite optimistic considering the current macroeconomic scenario.

Figure 5 – Industrial Production Growth Rate



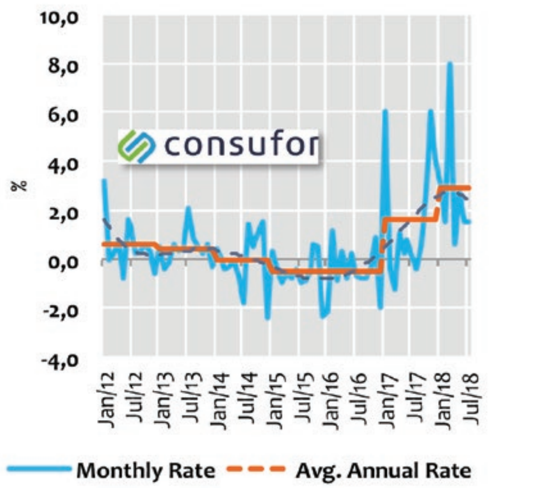
Source: IBGE

Figure 6 - GDP Growth Rate



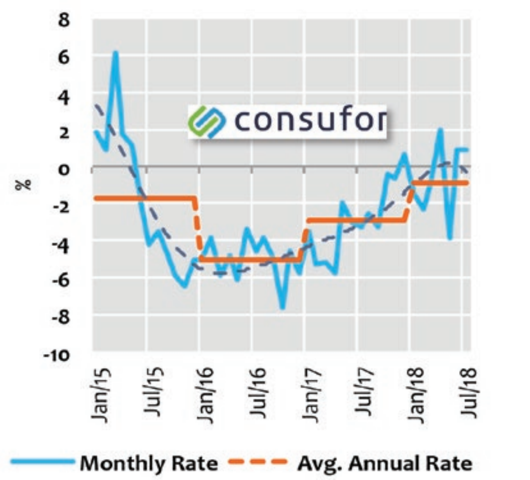
Source: IBGE

Figure 7 - Variation in Retail Trade Sales Volume in Brazil



Source: IBGE

Figure 8 - Growth Rate of Brazil's Services Sector



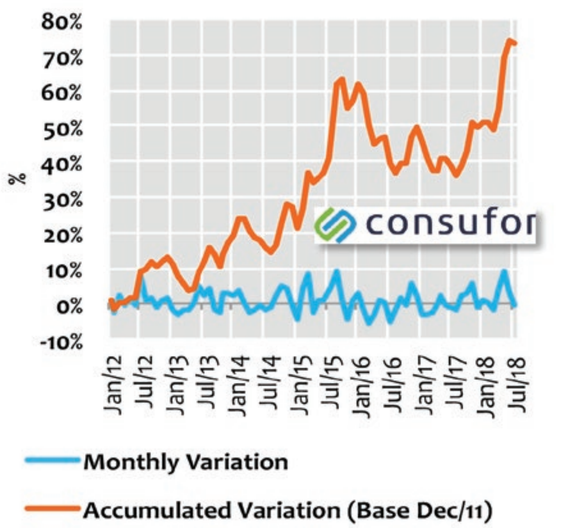
Source: IBGE

Brazil's GDP growth is presented in Figure 6. Until 2014, the country registered positive growth at timid rates. Between 2015 and 2016, the country posted a high retraction in GDP due to the economic crisis. In 2017, GDP grew 1% in relation to the previous year. The Central Bank, in an extremely optimistic expectation, projects 2.5% growth p.a. for 2019 and 2020, entirely neglecting the problem of public accounts and the country's inability to equate spending and prioritize investments.

Two other important "thermometers" of the economy are the performance of the Trade and Services sectors (see Figures 7 and 8, respectively). In trade, the retraction has been quite significant over the last years, even though the country registered a slight recovery in sales as of 2017. The same scenario is seen in the services sector, where a slight improvement has been observed since 2016. However, due to the high level of family indebtedness and expected increases in credit costs, one should not expect expressive growth in either of the sectors over the next two years.

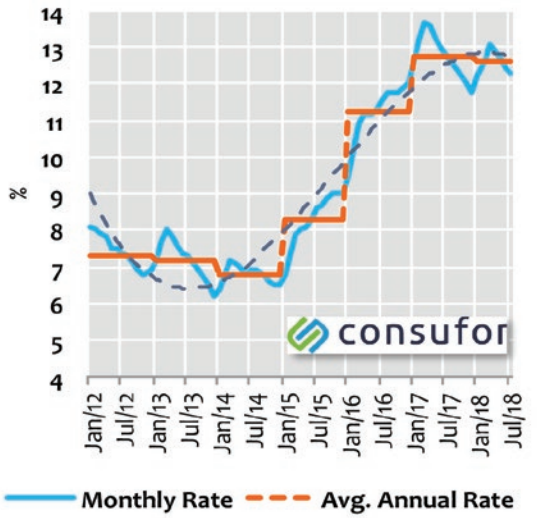
Another interesting indicator for the country refers to the average price of commodities. Figure 9 shows that since 2015 average prices in the country have dropped (energy, agricultural and mineral commodities). However, since the middle of 2017, prices registered a strong increase. If sectorially for a producer of such products this is a positive aspect, for the other sectors in the economy it's a disaster,

Figure 9 – Commodities Prices Index Growth (IBC-BR)



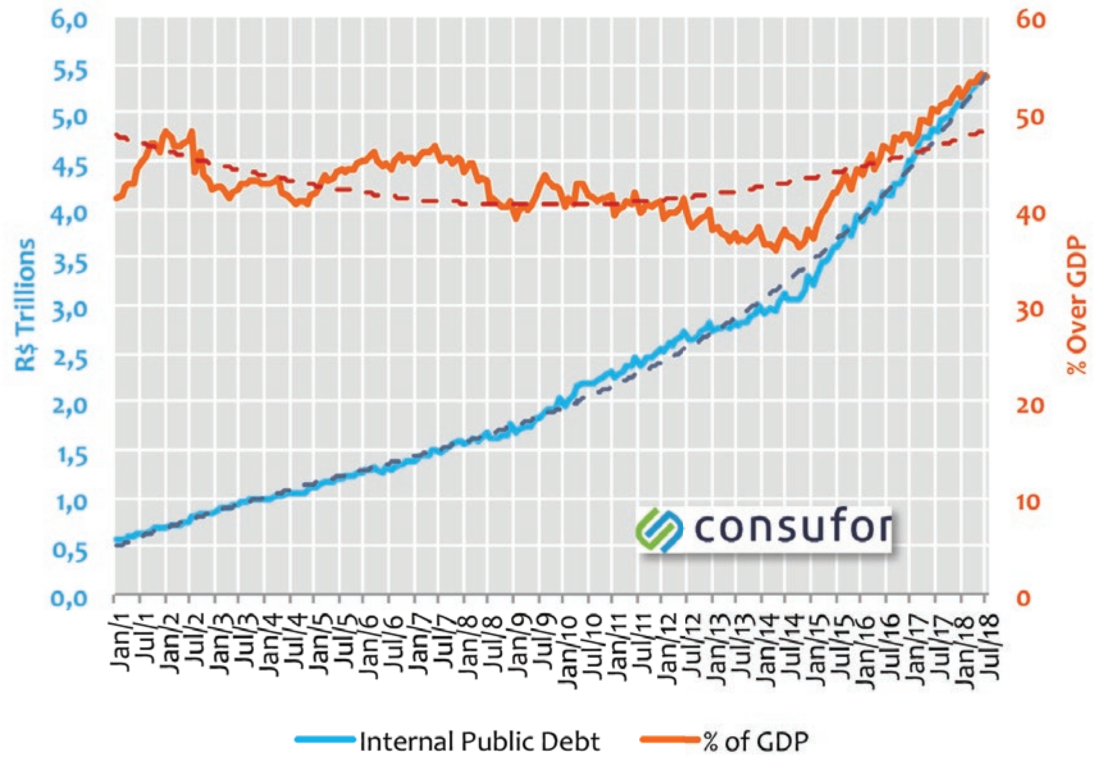
Source: BACEN

Figure 10 – Unemployment



Source: IBGE

Figure 11 – Brazilian Public Debt



Source: BACEN – Federal Government Securities Debt

since this negatively impacts production costs (especially energy, which is linked to all productive activities in industry, trade and services). The future scenario allows pointing to a continued increase in prices.

Figure 10 shows that the unemployment level grew considerably between 2013 and 2017. In 2018, this indicator stabilized, but at a very high level, which is bad for the economy. Despite signs of this indicator dropping, a significant reduction is not expected in the unemployment rate, since companies are pretty much operating with a high level of idleness.

The last indicator of this column shows the frightening increase in Brazil's public debt. The numbers presented in Figure 11 only represent internal federal public debt (representing roughly 95% of the country's debt). Among the various aspects, the most important thing to point out is the indebtedness growth trajectory, particularly since 2014, with bombastic growth. In 2001, debt was at R$ 500 billion and now it's about to reach R$ 5.5 trillion, almost 55% of Brazil's GDP.

By spending more than what it raises in taxes, the government needs to finance its debt by issuing debt securities. If this indebtedness growth rhythm is not interrupted immediately, the country's entire economy will collapse. Unfortunately, there are no clear movements on the part of government that measures will be taken to correct this serious problem.

Based on the indicators presented, we have a highly uncertain macroeconomic scenario for the next two years, regardless of the president and governors that are elected. What can be said for certain is that times will be difficult, where priority is to remain alert to the strategy and operation of companies ready to act. More than ever, the moment is to protect business and focus on profitability. ■