

History Repeats Itself: Another Year of Low Growth

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Brazil's economic performance in 2019 now appears to be heading in the same direction as in previous years, with players initially betting on a stronger resumption of growth and then revising down their forecasts as the data on key economic indicators frustrates their expectations.

There has indeed been no shortage of disappointing data. GDP growth was timid in fourth-quarter 2018, and all the signs are that it practically stagnated in the first quarter of this year. Industry is unable to grow, formal job creation has decelerated, and the unemployment rate has stopped falling. Business and consumer confidence, which improved after the elections, also turned down again in recent months.

The negative growth surprise is due to a number of factors, including tighter financial conditions during the 2018 election campaign. The impact of this tightening has probably yet to dissipate. The ongoing global slowdown and the crisis in Argentina have also contributed to the weakness of the industrial sector. However, the main constraint on growth is uncertainty regarding the domestic reform agenda.

The positive market mood at the start of the year was sustained by the expectation that the new government would quickly achieve congressional approval for a robust pension reform, which would stimulate "animal spirits" and assure a strong and sustainable resumption of growth. So far, however, what we have seen is a lack of dialogue between the executive and legislative branches, and a resulting increase in uncertainty regarding the passage of pension reform.

The government has not yet succeeded in building a reliable majority in Congress, undermining the foreseeability of the reform bill's approval. Passage by the lower house is unlikely before midyear and will probably take place only in the third quarter.

More important than the timetable for passage through Congress is the saving to be enabled by the reform. If it is to have a reasonable impact on the fiscal accounts, Congress must approve at least 50% of the original proposal sent by the government, so as to assure savings of about BRL600 billion in ten years.

There are signs that the lower house's special committee will reject the proposed changes to rural pensions and to the BPC ("Continuous Benefit") paid out to the elderly and handicapped without other sources of income. Further expected amendments will strike out proposals to lower the threshold for the annual bonus paid to low-wage workers ("abono salarial"), remove schoolteachers from the reform altogether, and maintain the entitlements of government employees to retire on full salary and receive the same pay raises as their colleagues in active service. However,

the reform as a whole risks being watered down even more if the rules on the transition to the new setup for private-sector employees are also made less stringent.

In light of all these hurdles, we have revised down our growth forecast for 2019 to 1.2%, similar to the actual rate seen in 2017 and 2018. We continue to expect a faster pace of growth in 2020, but this depends on genuine progress with pension reform.

We should stress that even if the actual reform passed by Congress produces a satisfactory fiscal savings it will not be the panacea some people imagine because other fiscal reforms will be needed if the government is to comply with the spending cap, stabilize the debt in the medium term, and create a climate favorable to economic recovery.

Lastly, it is increasingly clear that by keeping its policy rate (Selic) on hold at 6.5% p.a. the Central Bank may not actually be stimulating the economy as much as was supposed. However, it has signaled that it does not want to cut the rate at this time and will consider a cut only when there is evident progress on pension reform. So we are in the hands of the politicians as far as the prospect of a resumption of economic growth is concerned.

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,1%	1,2%	2,7%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	4,0%	3,9%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	6,50%	6,50%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,5%	10,3%
Trade Balance (US\$ bn)	3	-4	20	48	67	58	56	44
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-13	-21	-38
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	-1,0%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,4%	-1,0%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	77,8%	78,7%