

Benign Economic Outlook Amid Old Challenges

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Brazil faced several negative shocks in 2018. A crippling truckers' strike hit the economy hard in May. Moreover, the global outlook deteriorated significantly, causing the currency to depreciate more than 15%. Lastly, a deeply divisive election kept uncertainty high for several months. Now that 2018 is over, what should we expect going forward?

Headwinds that restrained economic activity in 2018 are already dissipating, supporting a growth pickup in 2019. Political and economic uncertainty is declining, as the makeup of Bolsonaro's economic team indicates a clear commitment to a liberal and reformist agenda.

Monetary policy remains accommodative, households and corporates have deleveraged, and banks are ready to support the recovery. There are no domestic or foreign constraints to growth, as the output gap remains large and the current-account deficit small. Confidence indicators and formal job creation are already improving, and we expect GDP growth to accelerate to 2.8% in 2019 from 1.2% in 2018.

Inflation is estimated to have reached 2018 in 3.7%, below the 4.5% target. The inflation outlook remains positive, with the large output gap, anchored inflation expectations and lower gasoline and electricity prices keeping inflationary pressure at bay even amid stronger growth. We expect inflation to reach 3.9% in 2019, below the target for the third year running.

The Central Bank of Brazil has kept the SELIC rate stable at 6.5% since March and is set to continue doing so throughout 2019. As noted, the large output gap will allow the economy to accelerate without inflationary pressures. Moreover, there are still questions about how far the spending cap, BNDES's retrenchment and approval of the TLP have reduced the neutral interest rate.

Some old challenges remain. The fiscal adjustment is incomplete, and an ambitious pension reform is urgently needed for the government to comply with the spending cap and stabilize public debt in the medium term. Moreover, the global outlook remains complex.

Bolsonaro's new cabinet has little intersection with the political forces represented in Congress, raising questions about political coordination. Congress remains deeply fragmented and it is still unclear who the speakers of the lower house and Senate will be. Support for the reform agenda is therefore not guaranteed.

The global economy is also facing difficulties. US growth was strong in 2018, but there is now fear of a significant slowdown in 2019 as the fiscal stimulus loses steam

and tighter financial conditions begin to bite. Europe has stagnated, and China is facing downside pressures amid a complicated external environment, especially as it is still unclear if a permanent US-China trade deal will be feasible.

All in all, Brazil's economic outlook for 2019 is benign: growth should pick up with low inflation and stable interest rates. However, downside risks remain if the reform agenda stalls or if global growth slows abruptly.

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018 F	2019 F	2020F
GDP Growth (%)	3.0%	0.5%	-3.5%	-3.3%	1.1%	1.2%	2.8%	3.0%
Inflation (%)	5.9%	6.4%	10.7%	6.3%	2.9%	3.7%	3.9%	4.0%
Policy Rate (%)	10.00%	11.75%	14.25%	13.75%	7.00%	6.50%	6.50%	8.00%
Unemployment Rate (%)	6.8%	7.1%	9.6%	12.6%	12.4%	12.1%	10.6%	9.7%
Trade Balance (US\$ bn)	3	-4	20	48	67	62	50	39
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-12	-25	-42
Current Account Balance (% of GDP)	-3.0%	-4.3%	-3.3%	-1.3%	-0.5%	-0.6%	-1.1%	-1.7%
Fiscal Primary Balance (% of GDP)	1.7%	-0.6%	-1.9%	-2.5%	-1.8%	-1.8%	-1.2%	-0.1%
Government Gross Debt (% of GDP)	51.7%	57.2%	66.2%	69.4%	74.0%	74.4%	75.8%	76.2%