



Brazil Current Situation & Outlook

6th Brazil Business Summit

The
Economist

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I. Main Messages

II. Adjustment after Successes

III. International Environment

III. Financial Conditions

IV. Activity

V. Inflation Developments

I. Main Messages

- Brazil is undertaking a necessary and classic adjustment process in 2015, tightening fiscal and monetary policies and realigning relative prices (regulated & ER)
- This double relative prices adjustment impacted inflation in 1Q 2015, increasing 12-month accumulated inflation; inflation is high mid-2015; and so is inflation expectation for 2015

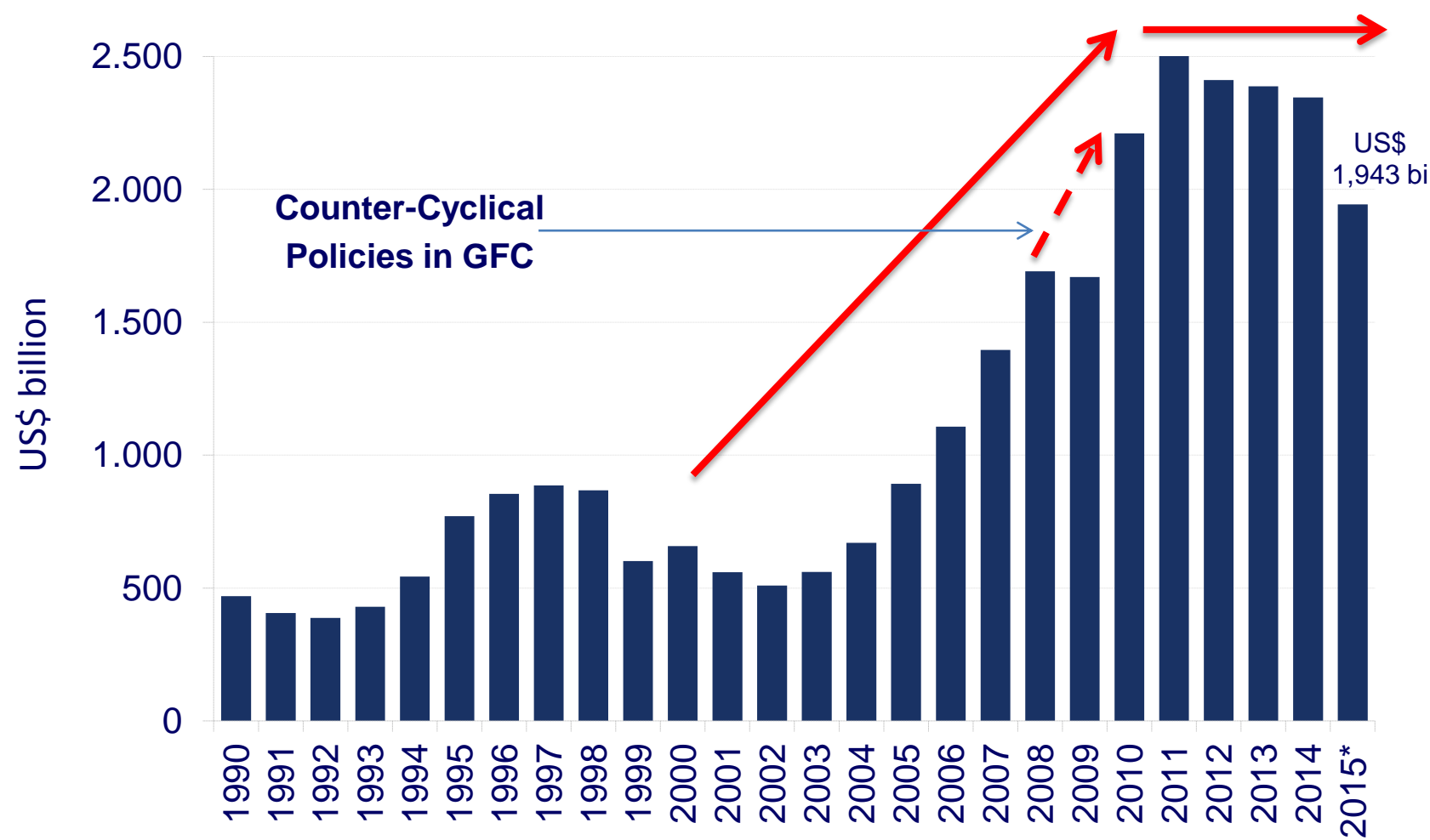
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- **The objective of Monetary policy (MP) is to avoid that this impact of relative price adjustment in 2015 is transmitted to 2016 and beyond**
 - **MP can and should contain the second-round effects and circumscribe these effects to 2015**
 - **For this reason, MP is and will remain vigilant to ensure the convergence of inflation to the 4.5% target at the end of 2016**

- **Brazil Central Bank's Monetary Policy Committee (Copom) reiterates the need for determination and perseverance in the fight against inflation; National Monetary Council (CMN) reduction of tolerance band for 2017 reaffirms commitment to 4,5% inflation target**
- **Best contribution of MP to a new and virtuous growth cycle is to bring inflation to the 4.5% target at the end of 2016 and to anchor inflation expectations**

II. Adjustment After Successes

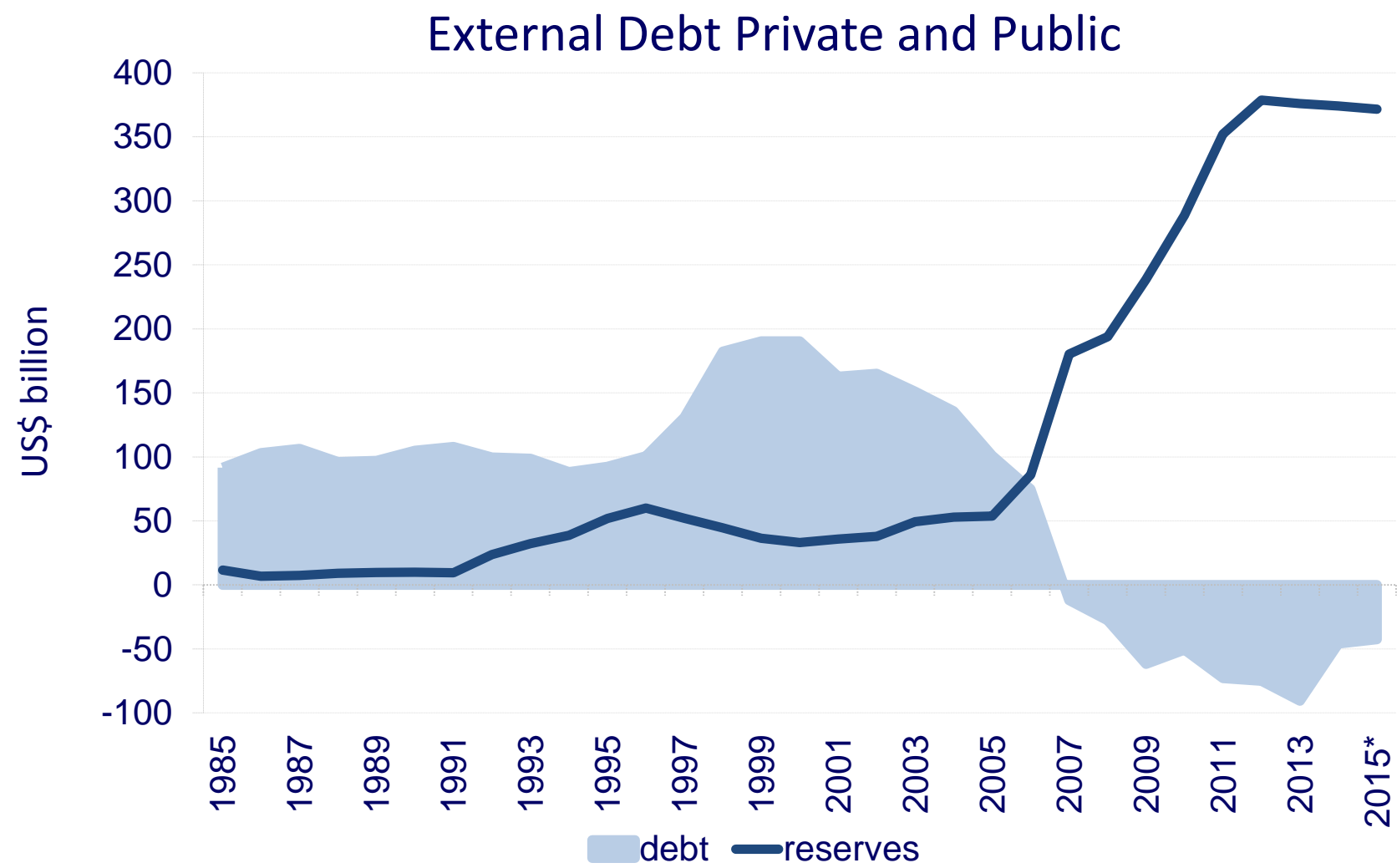
- Inclusive growth cycle in the 2000s resulted in building buffers (fiscal space & international reserves), strong steady growth cycle, better social indicators and got us Investment Grade**
- Buffers were used during Global Financial Crisis (GFC) and counter-cyclical policy response allowed V-shaped recovery; but their exhaustion requires adjustment to rebuild buffers**

GDP Growth Cycle of 2000s Reaches “Plateau”



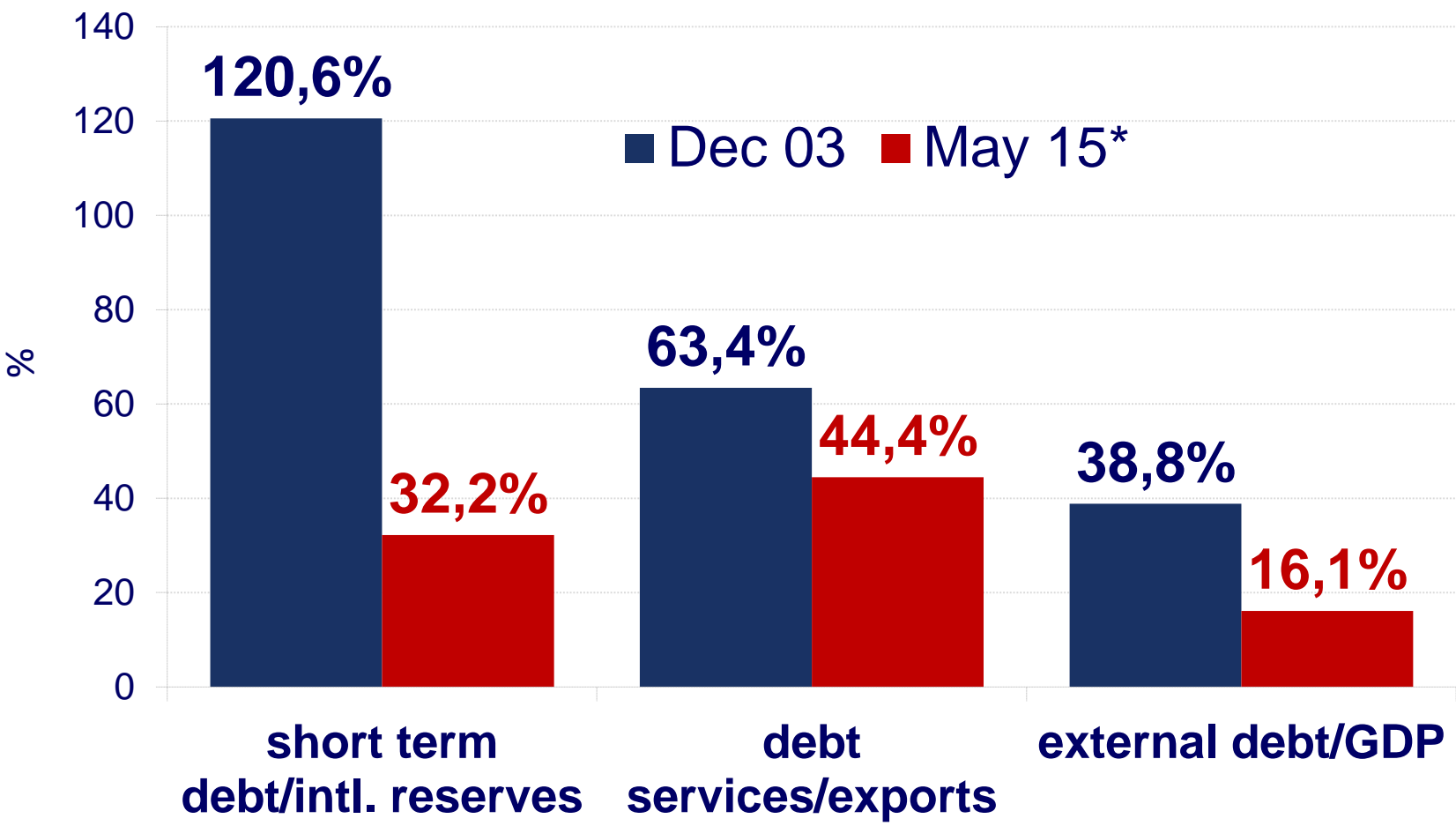
* Central Bank of Brazil Forecast (Inflation Report – Jun 15)

International Reserves x Net External Debt



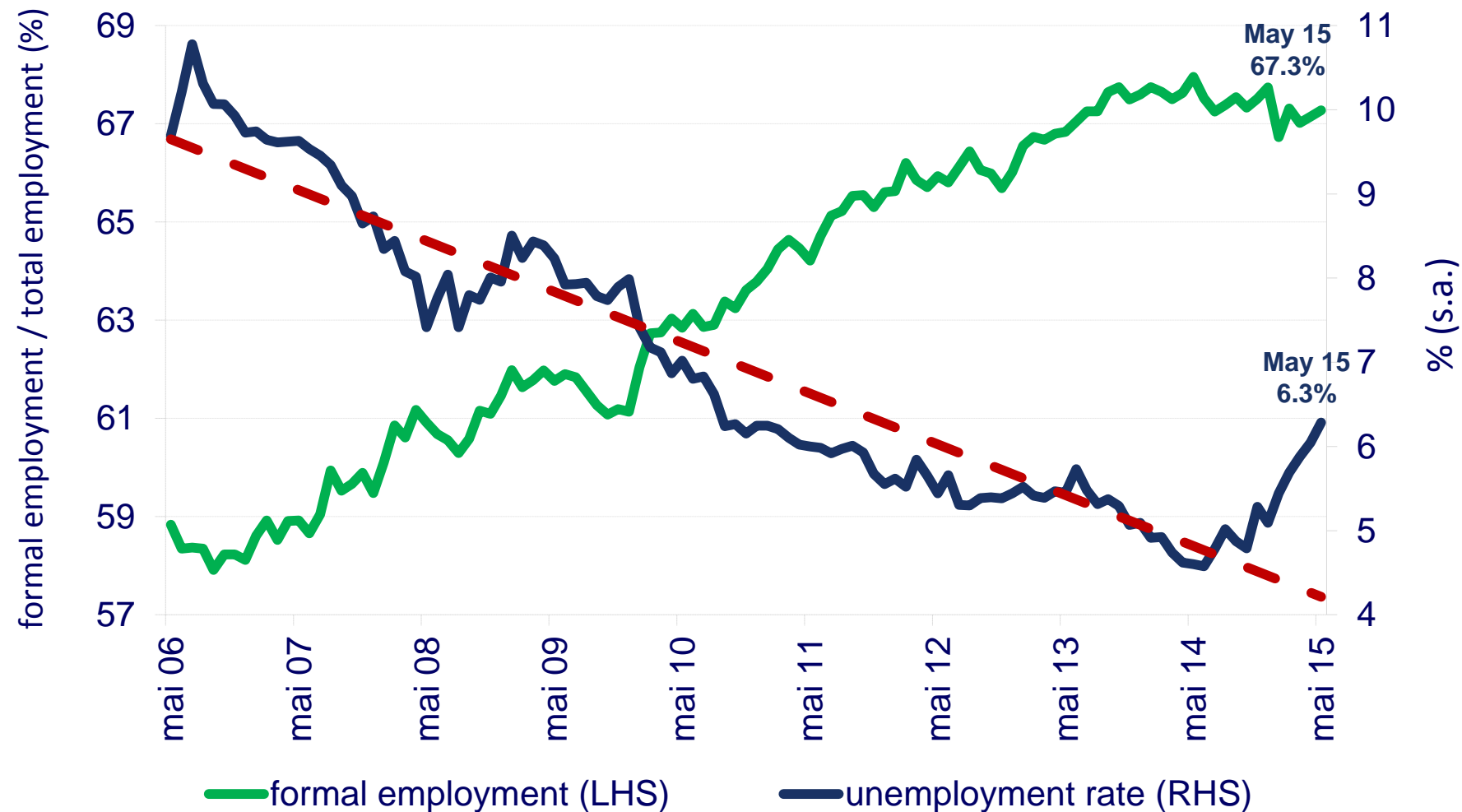
*reserves on Jun 26th; debt in May 2015

External Debt Ratios Improved

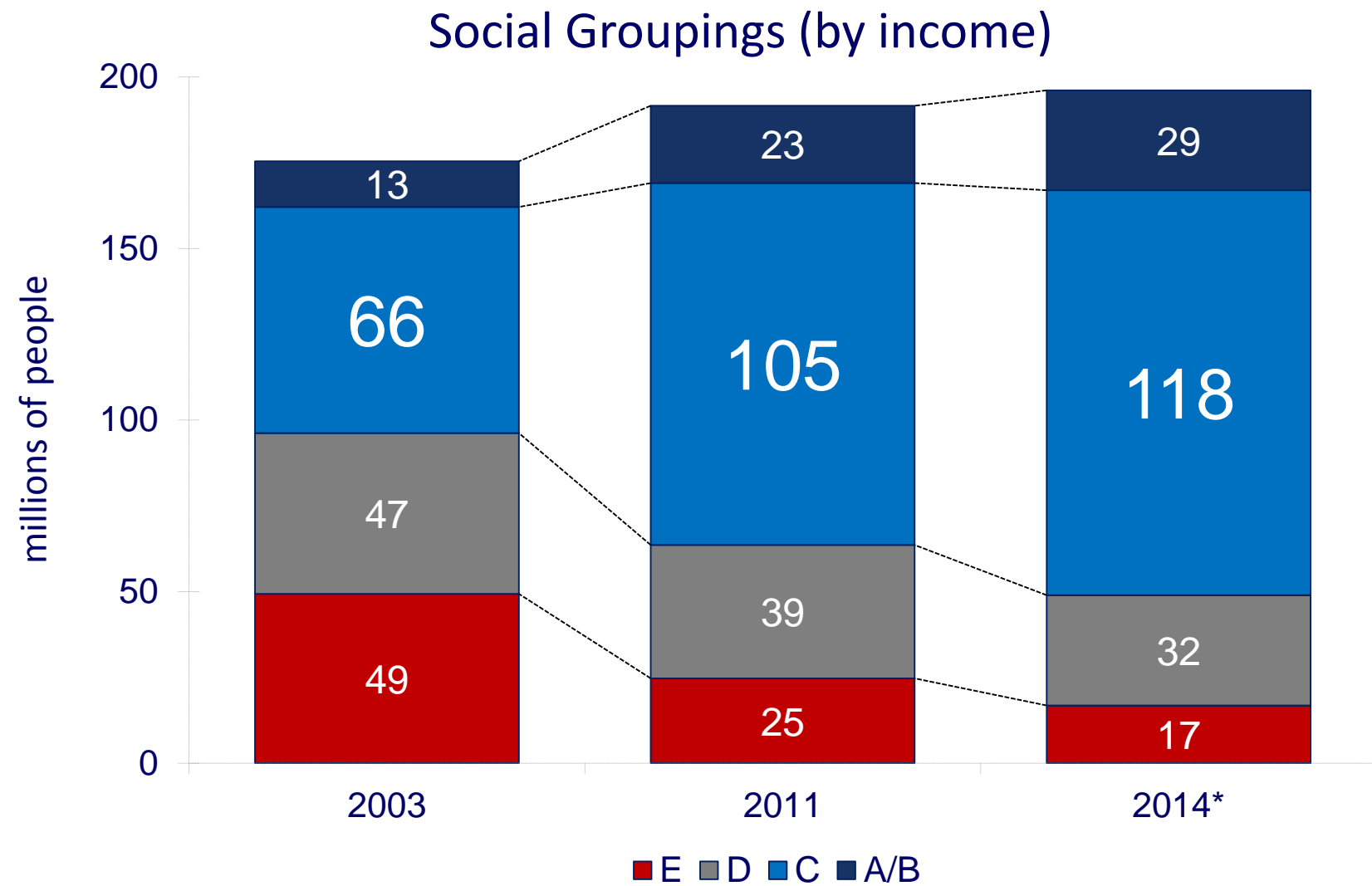


* estimate

Formal Employment and Unemployment Rate

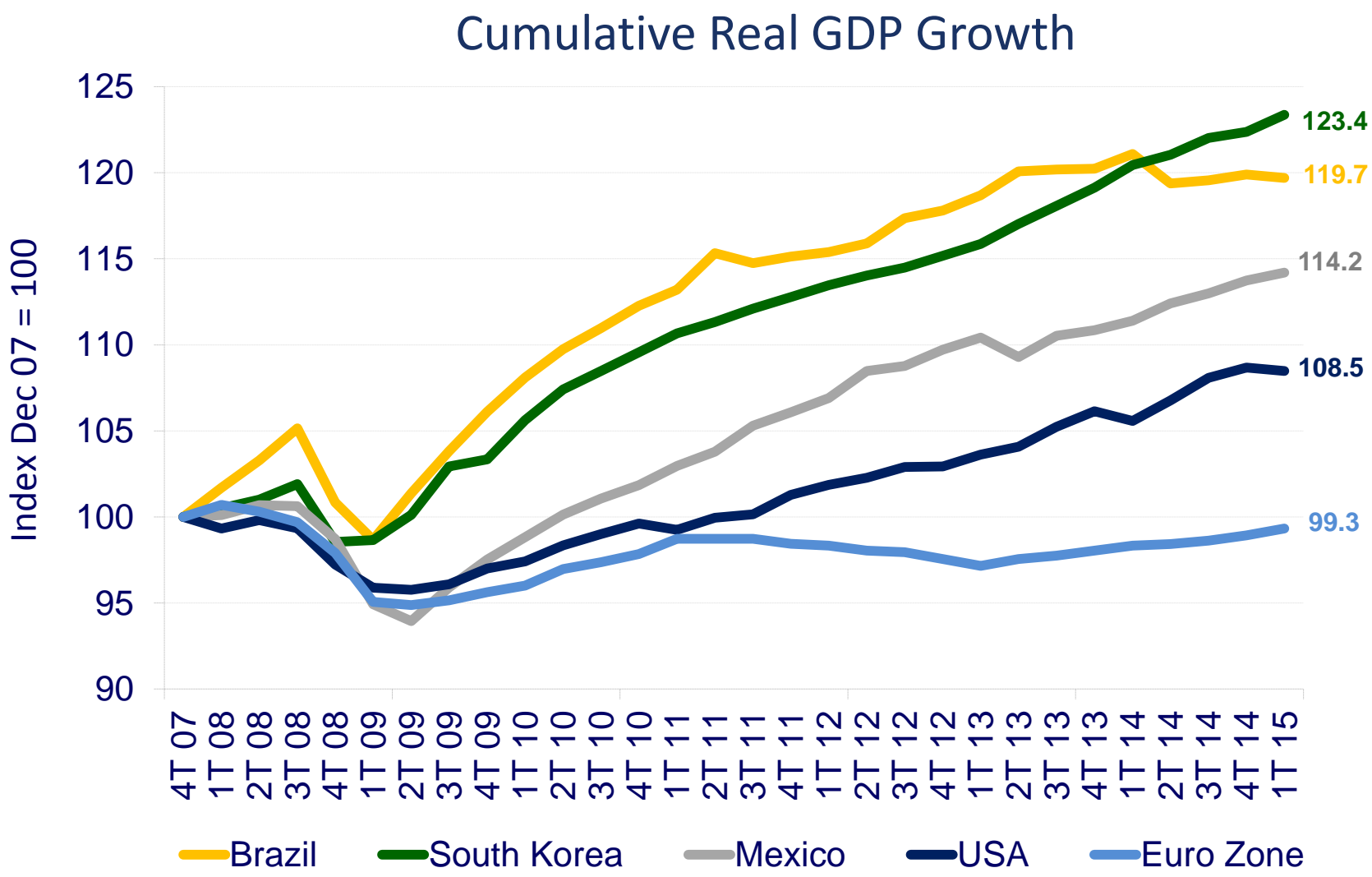


Indicators Shows Mobility and New Middle Class

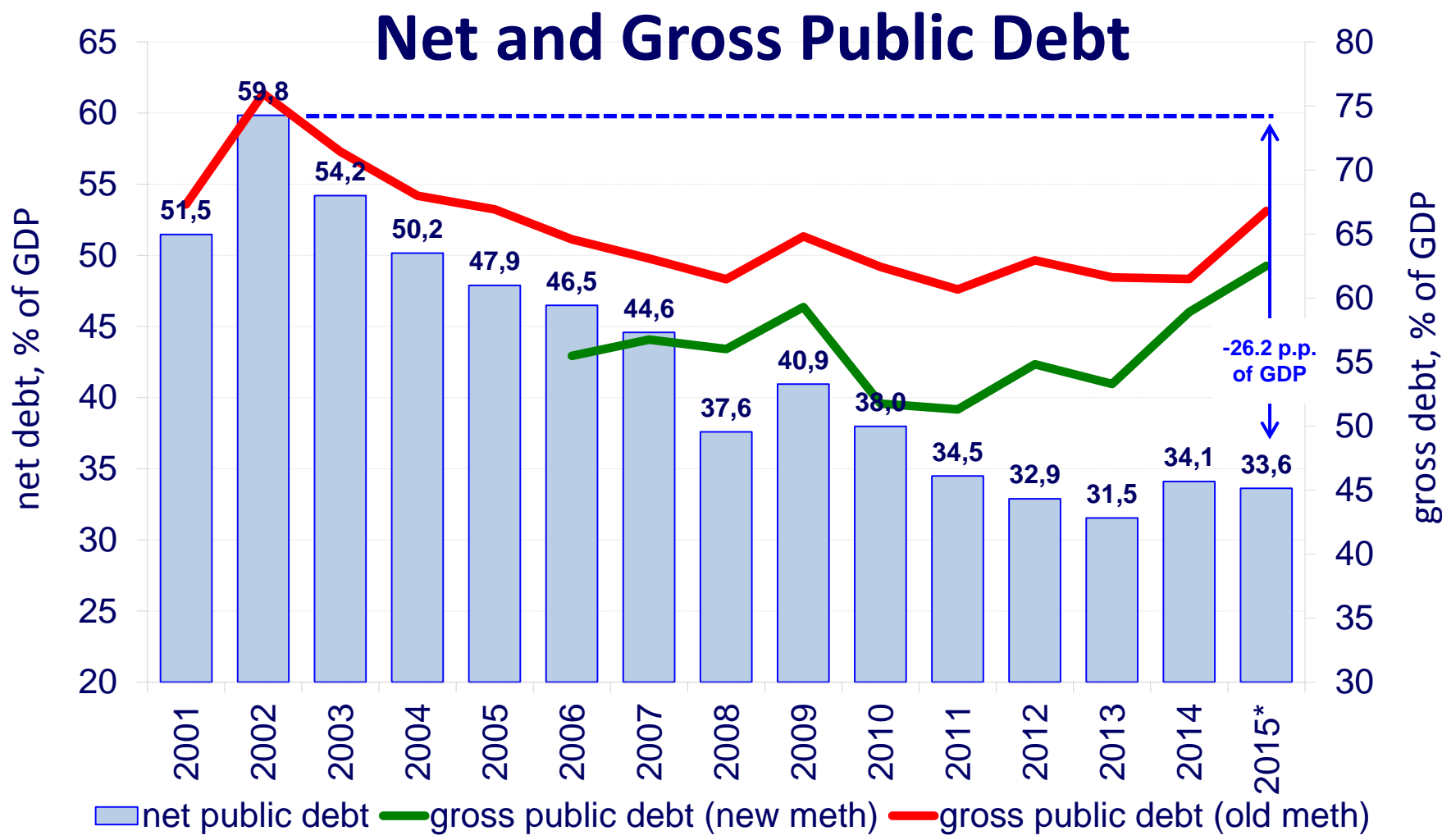


*FGV forecast

Counter-cyclical policies allowed V-Shaped Recovery



Counter-cyclical policies in GFC Used Buffers



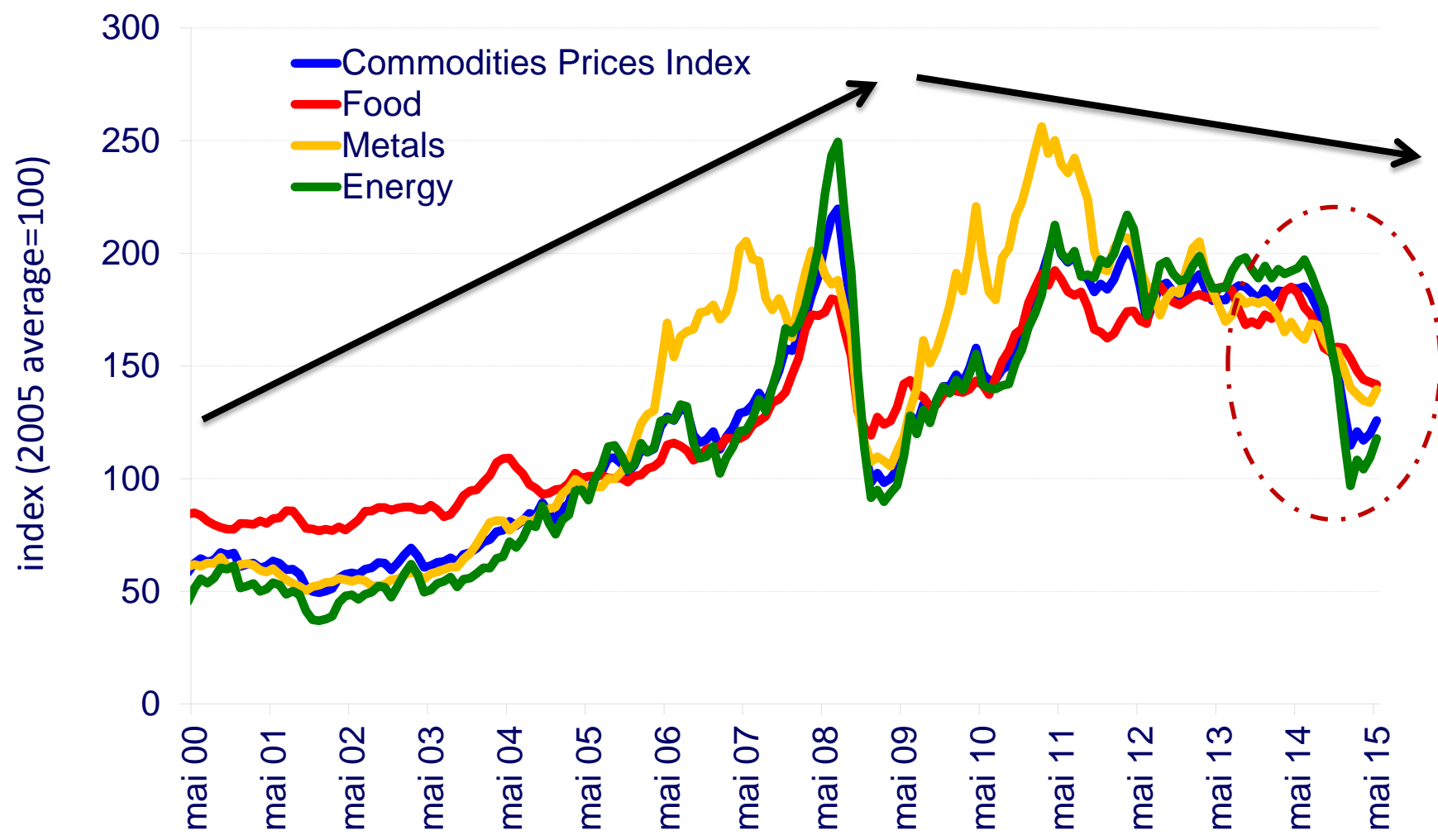
*May 15

II. International Environment

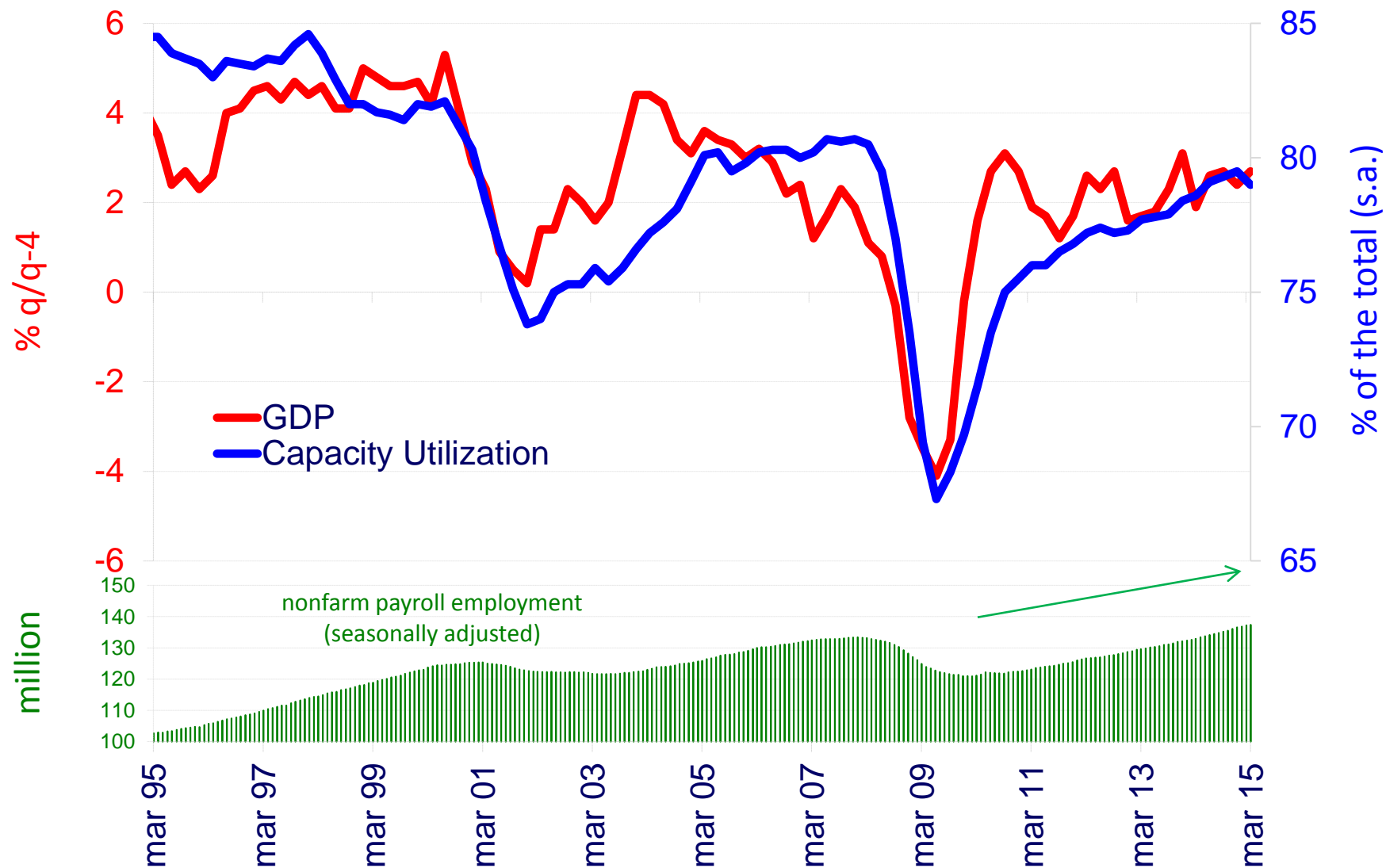
- **Waiting for the interest rate normalization by the Fed; in this context, global strengthening of the dollar with improvement in the US; even with better preparation and good FED communication, volatility is possible**
- **Process of commodities prices moderation with China's slowdown, end (?) of commodity super-cycle**

Change in the Commodities Super-Cycle

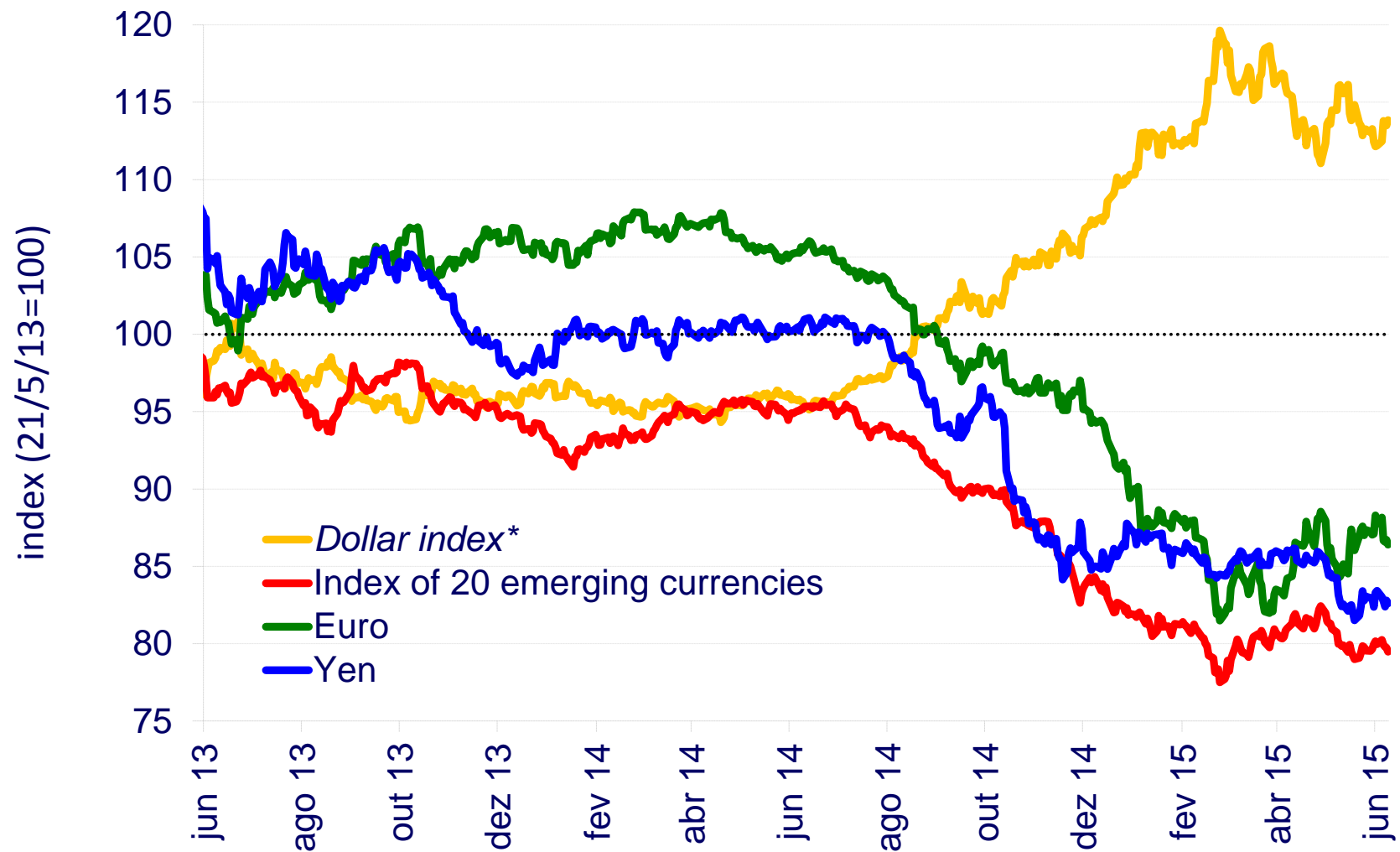
Commodities Index and subindices calculated by the IMF



Economic Recovery in the US



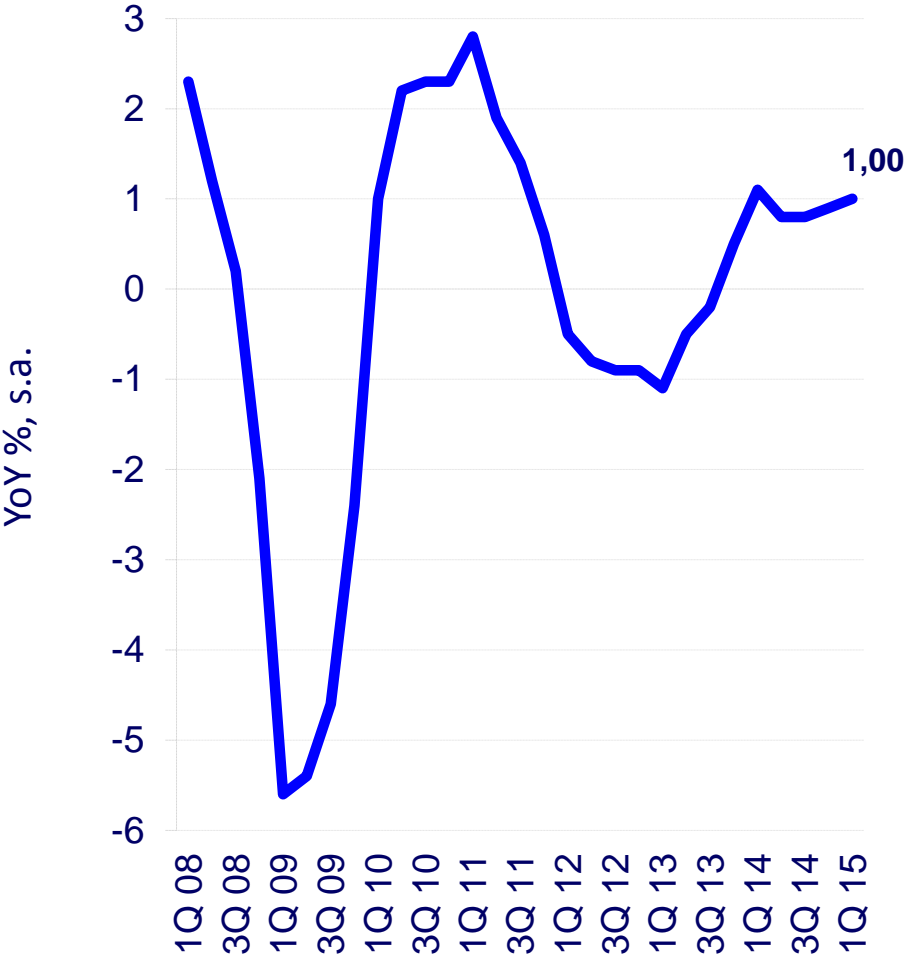
US Dollar Appreciation is a Trend (but there is Vol)



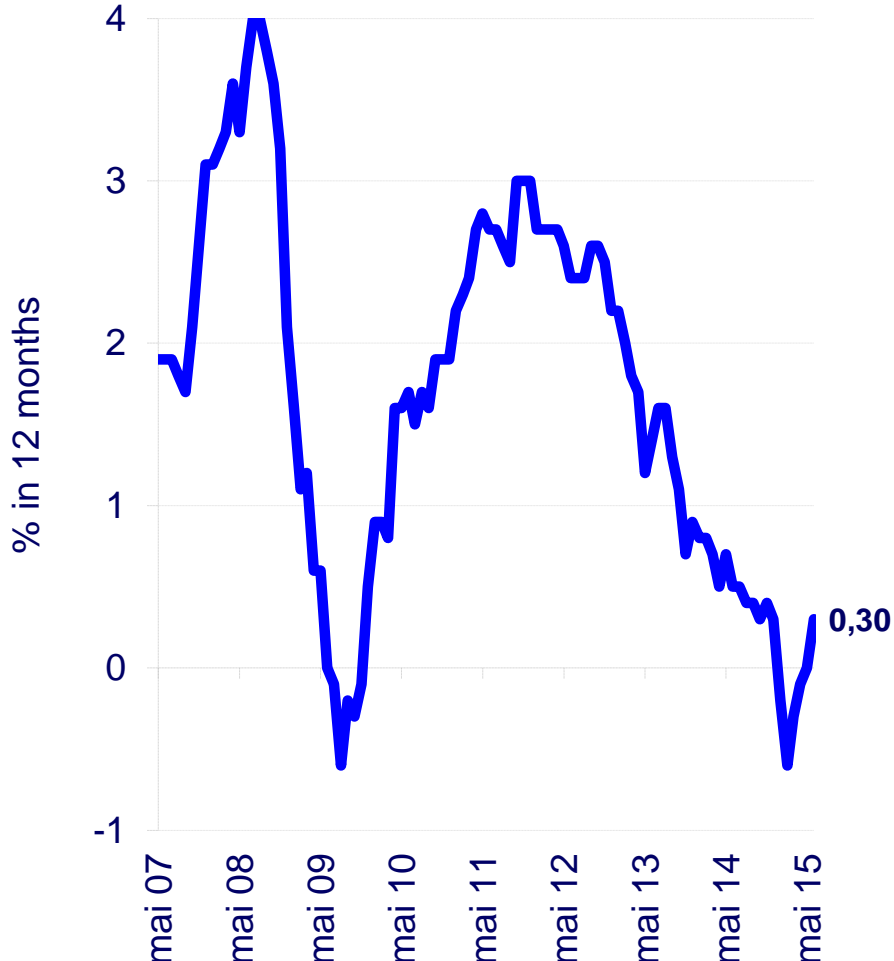
Data through June 26th; *dollar index: measures the international value of the dollar against basket of the six main reserve currencies in the world (Swiss franc, Canadian dollar, Japanese yen, pound sterling, euro and Swedish kron)

Europe – Some Recovery & Lower Deflation Risk

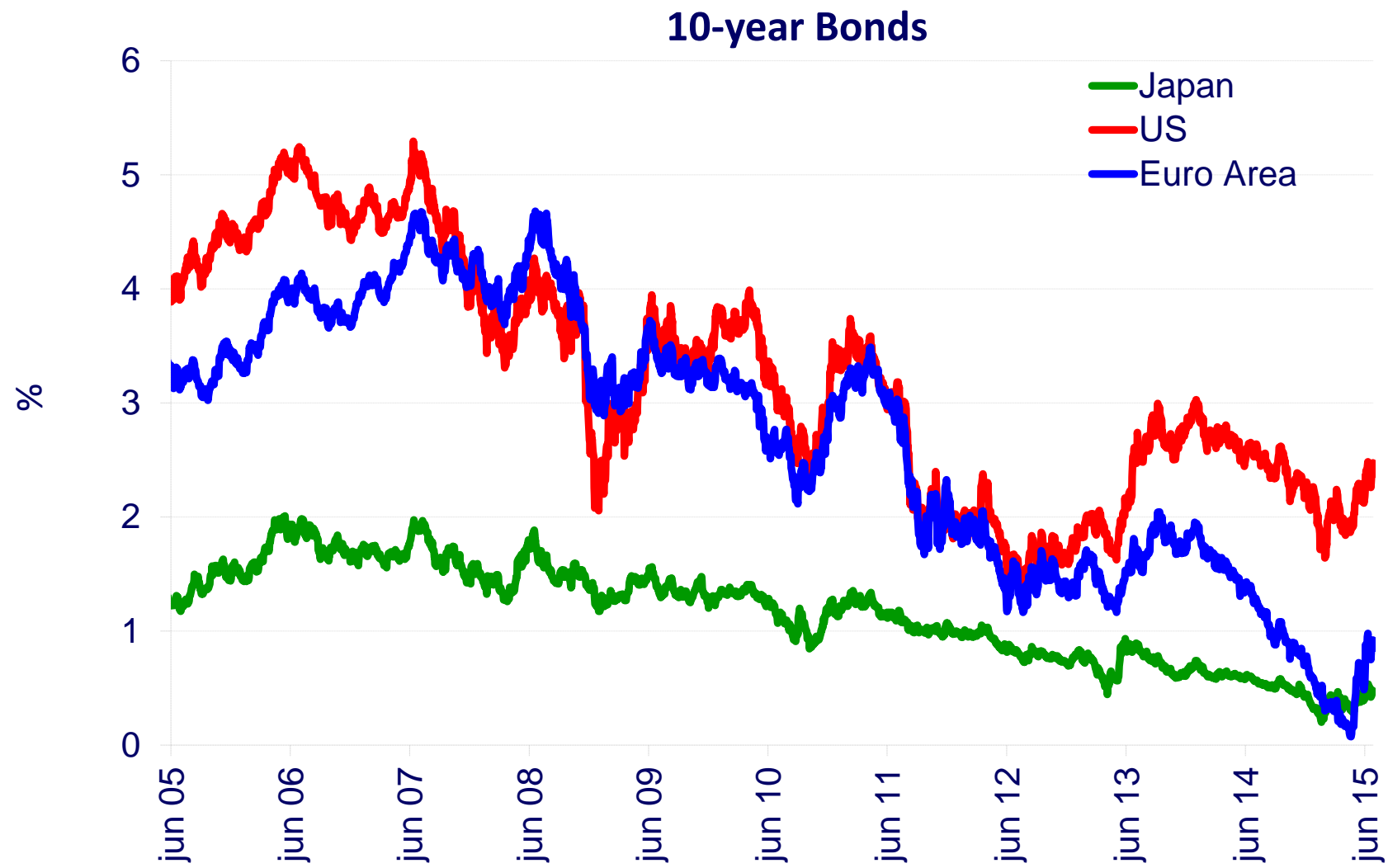
GDP Growth – Euro Area



Consumer Inflation – Euro Area



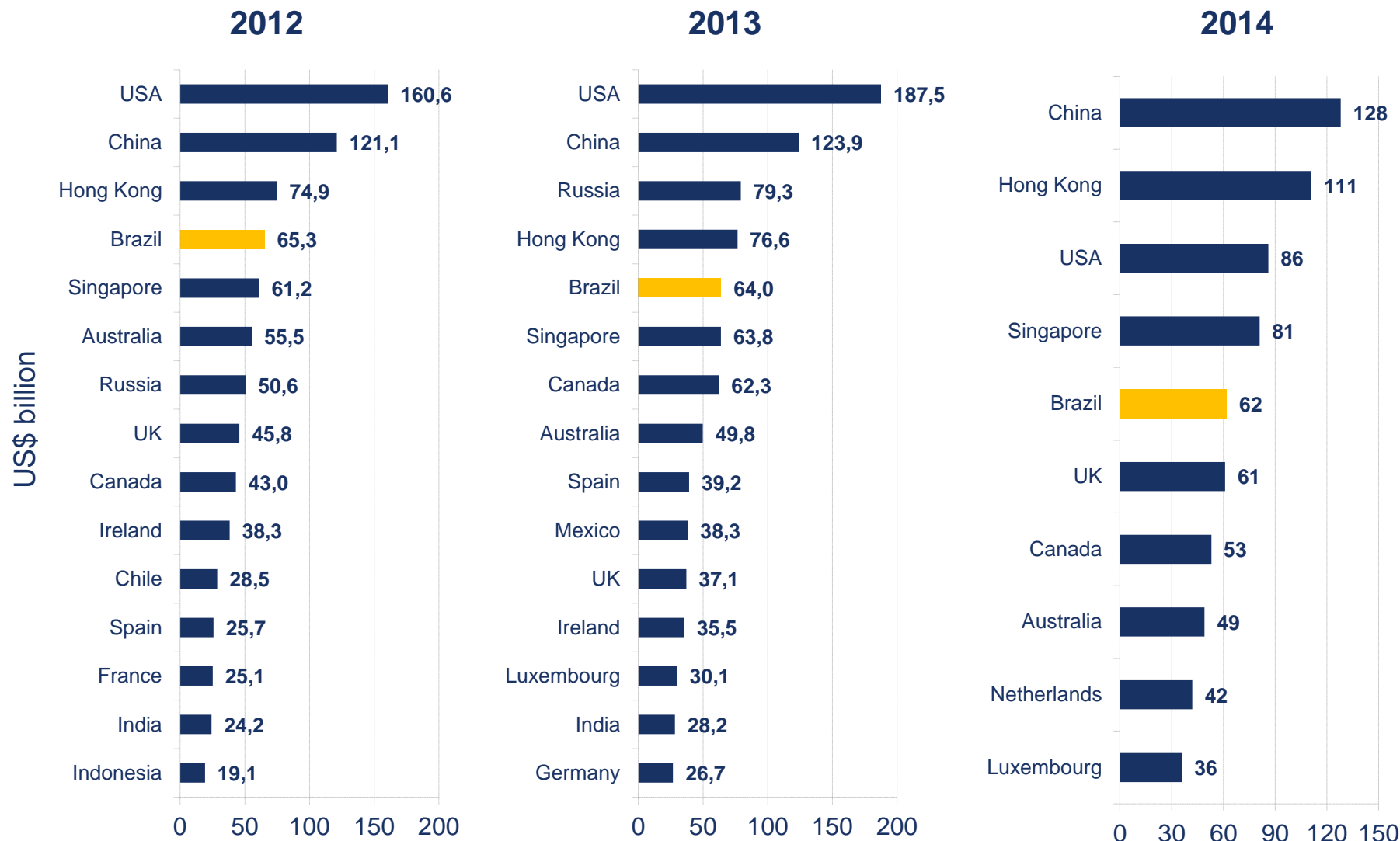
Divergence in Monetary Policy Persists



External Situation: Preparation for Fed Lift-Off

- Normalization is complex; Fed lift-off after tapering is the most expected, well announced and prepared event; Grexit adds some stress
- Perceptions about Brazil are evolving; positive effect of macroeconomic adjustment; no “perfect storm”; but, despite improvement, it is paramount to continue the adjustment process
- We have to keep macro pillars of our “house” in order and stabilized for the lift-off; using standard recipe: strenghtening fiscal and monetary policy framework, keeping solid fundamentals

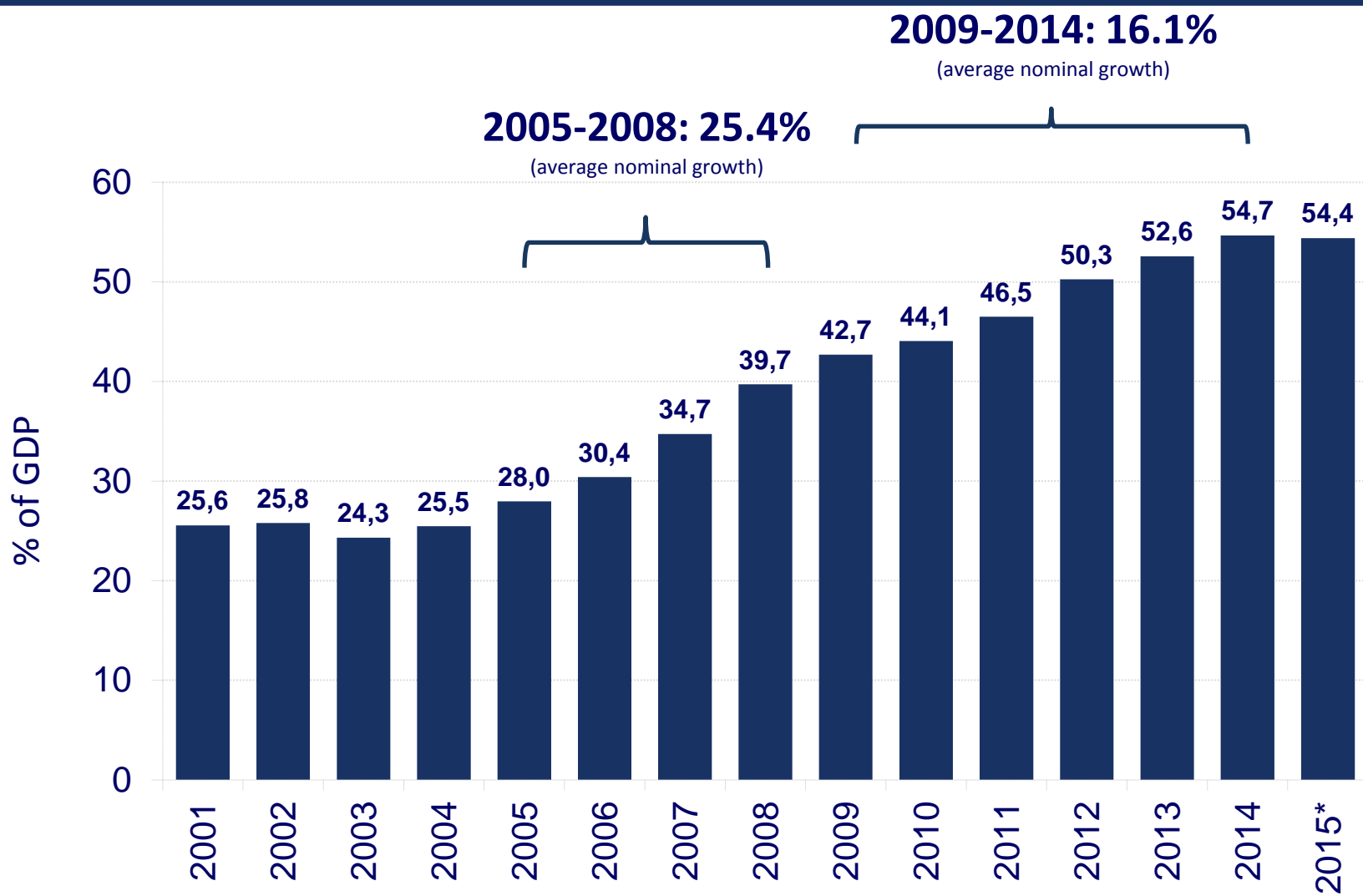
Brazil Stays One of the Leading Recipients of FDI



III. Financial Conditions

- **Moderation in the pace of credit concession consistent with adjustment and cycle**
- **Robustness and liquidity of the National Financial System remain and ensure financial stability**

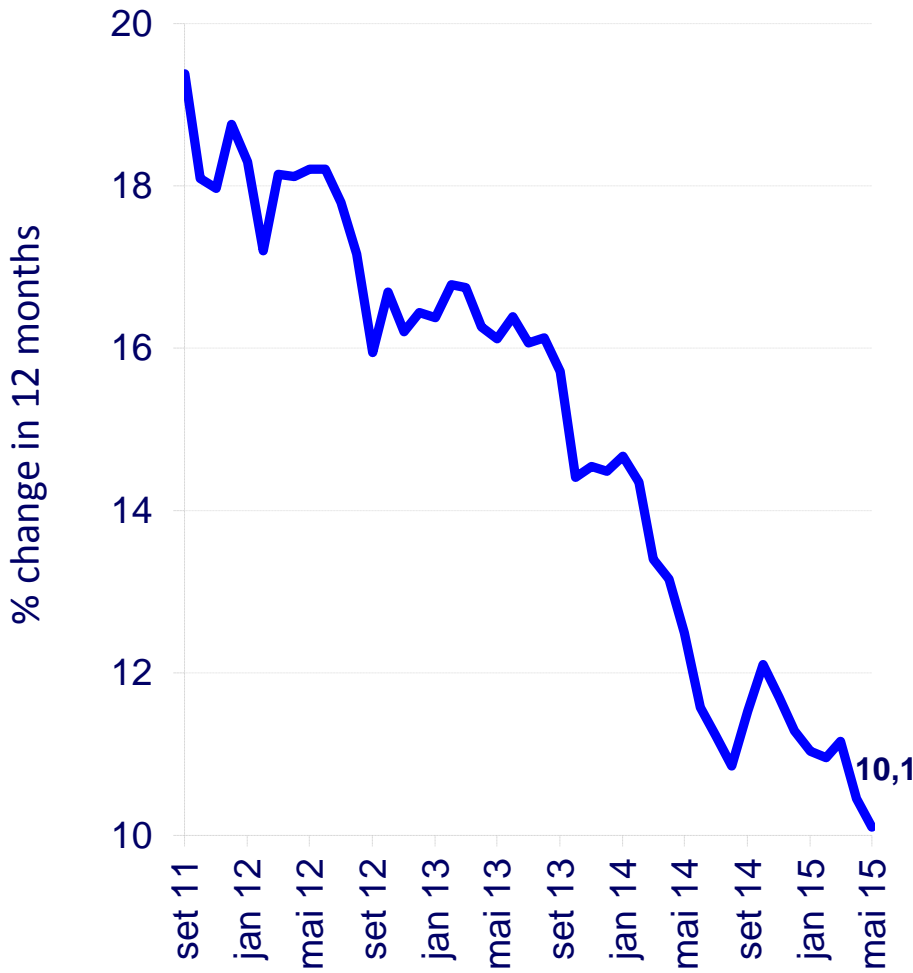
Credit/GDP Ratio Shows Structural Improvement



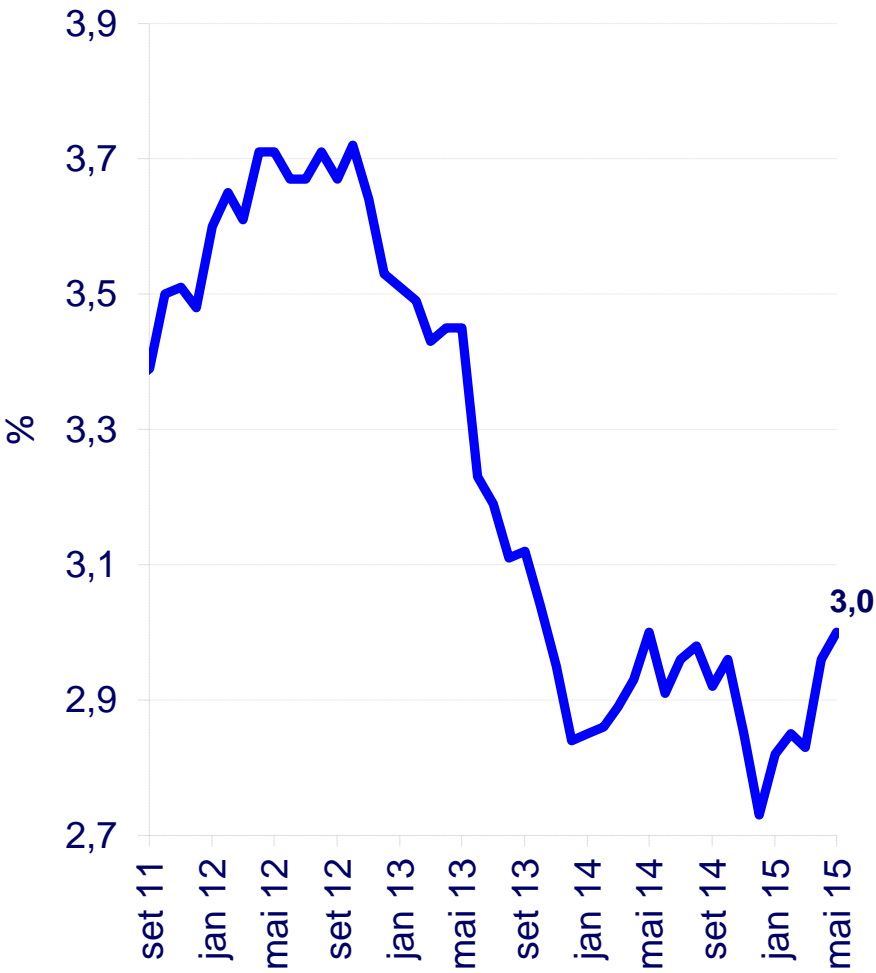
new methodology as of 2011; *May 15

Credit Moderation with no increase in Delinquency

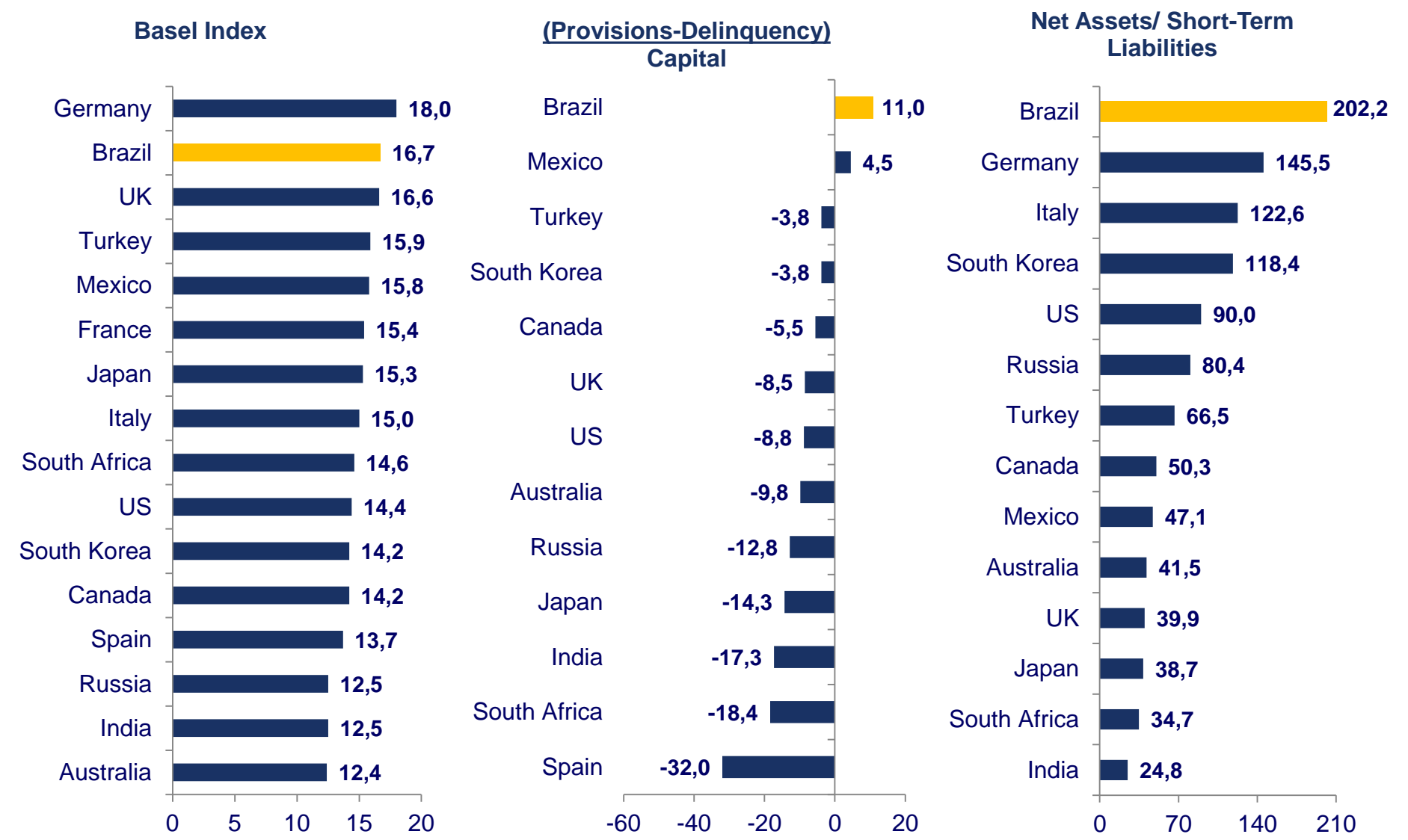
Expansion of Credit Outstanding



Delinquency



Financial Stability and Strength Indicators

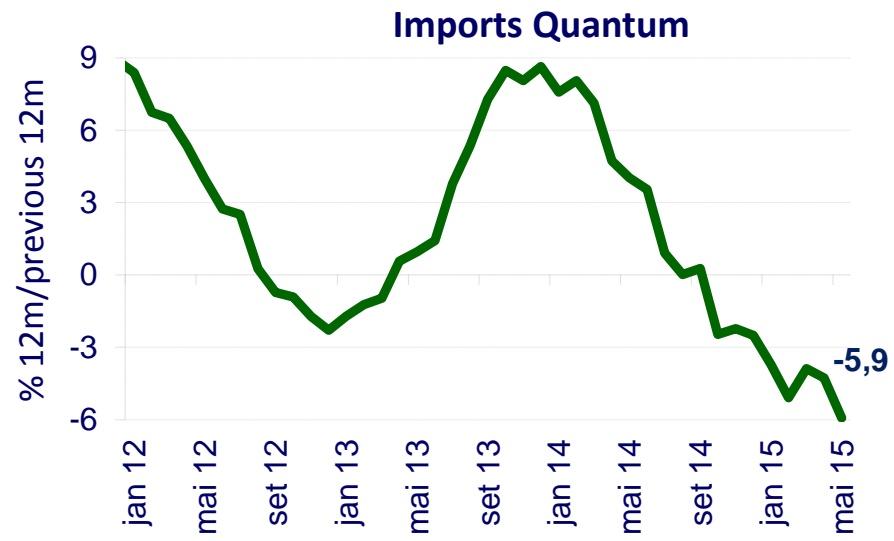
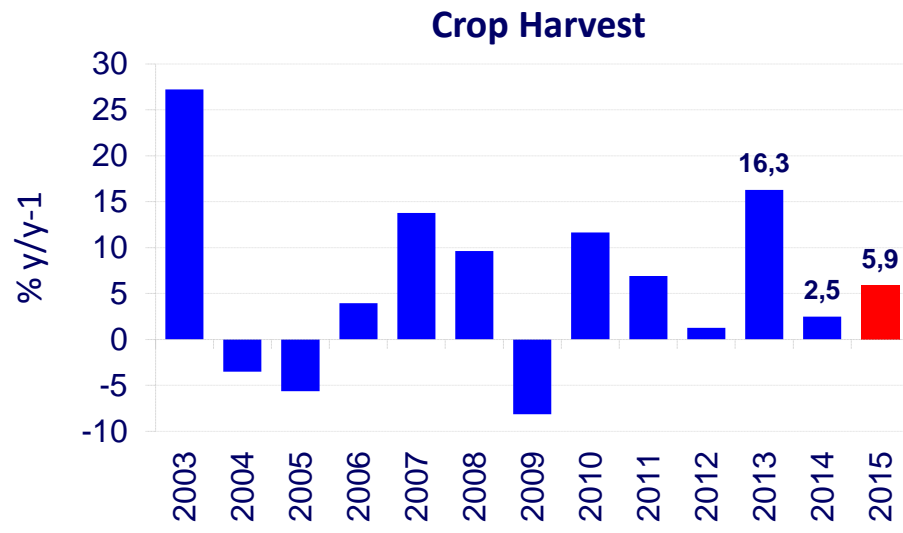
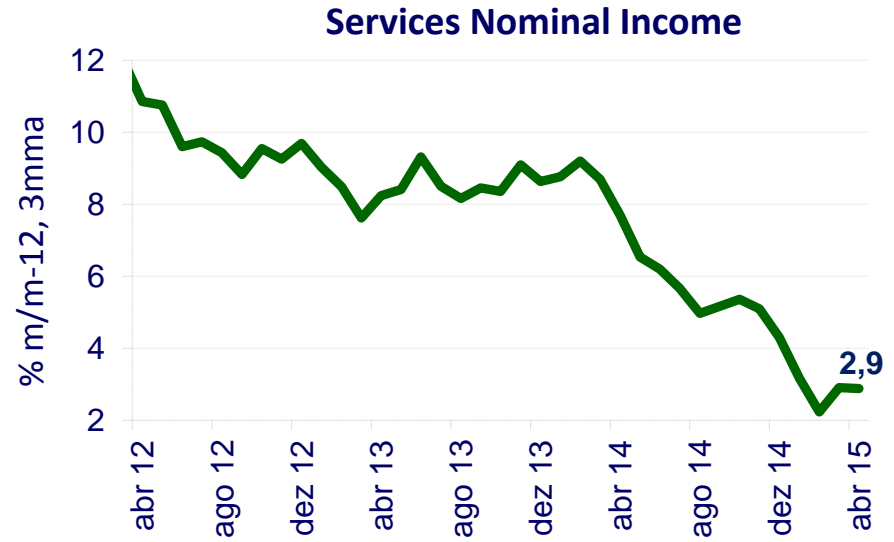
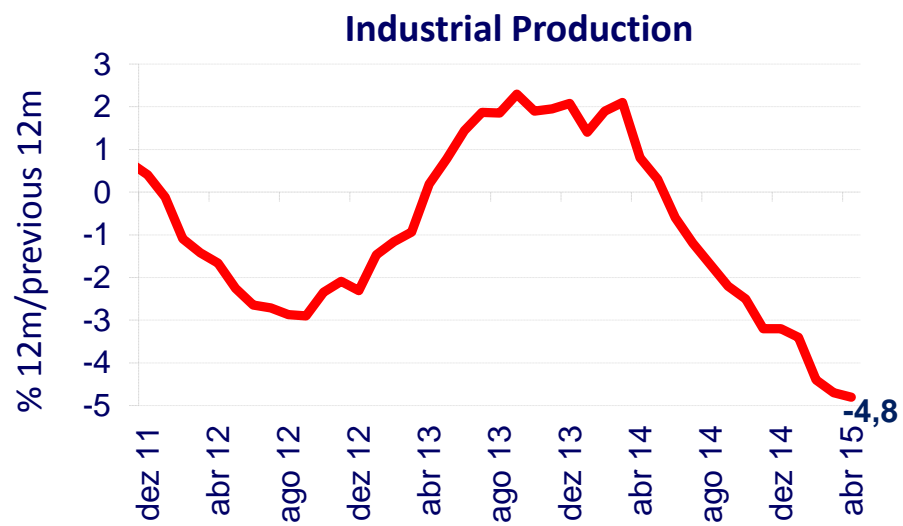


Source: IMF (FSI – last available data)

IV. Activity

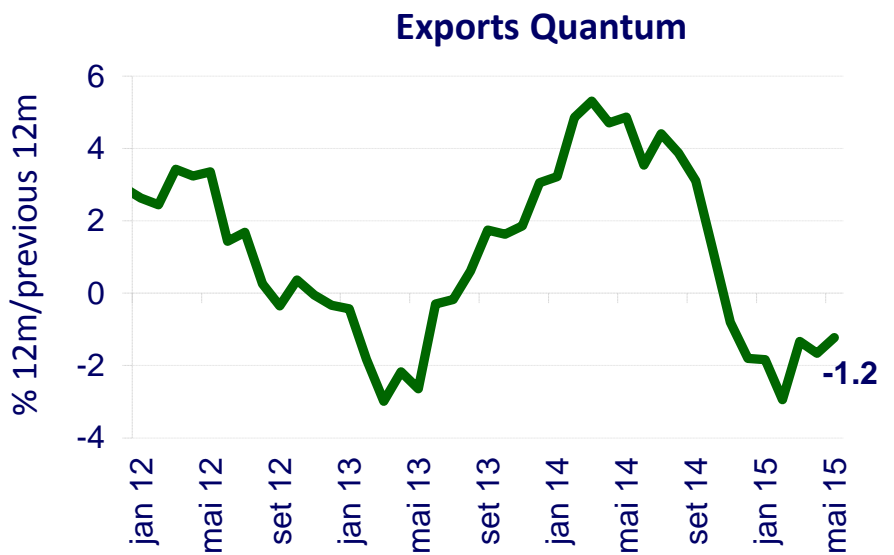
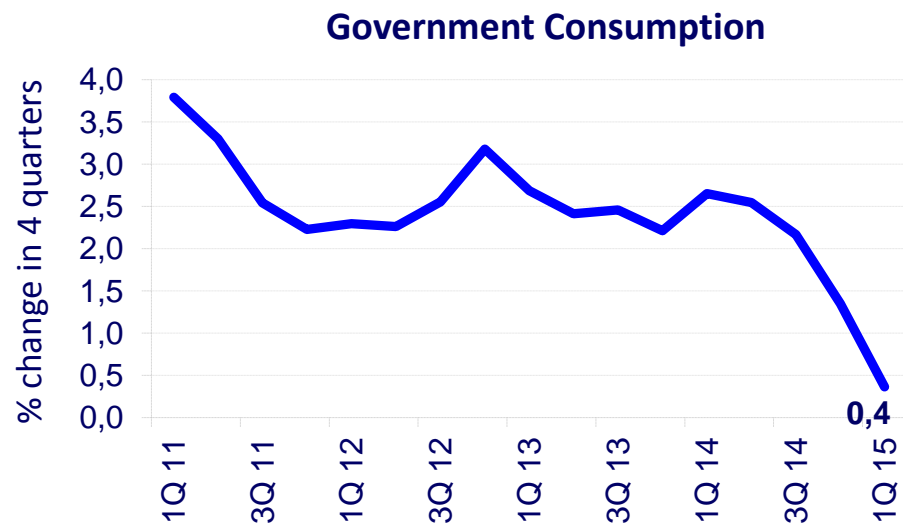
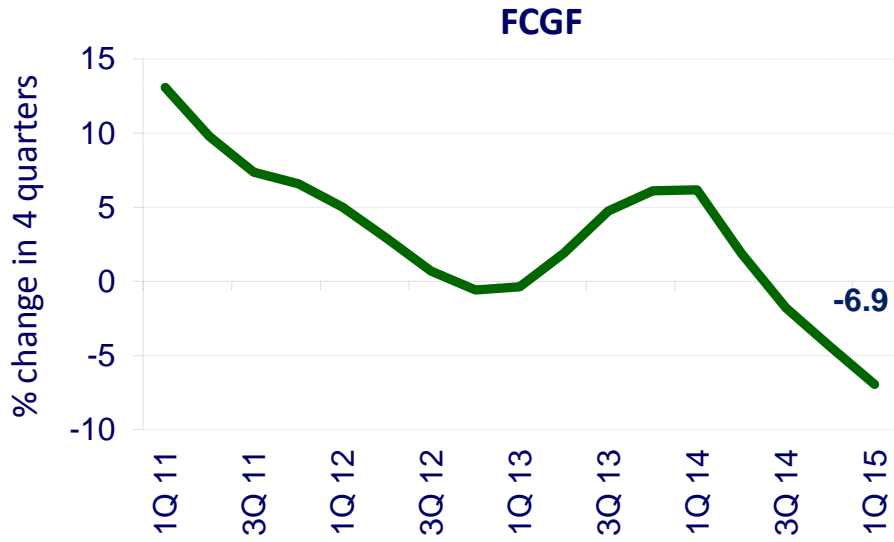
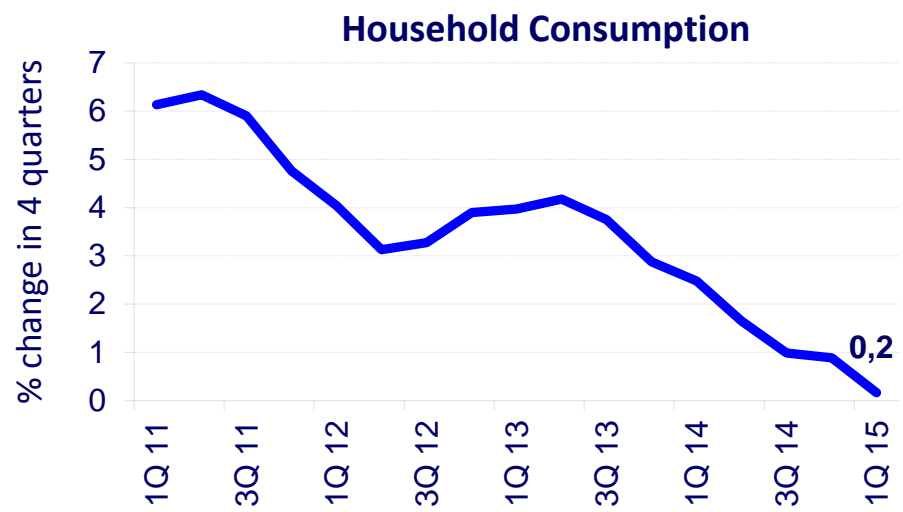
- 2015: a year of adjustment; impact on activity is normal; lower growth rates (below potential) are expected; non-economic events overlap with the business cycle**
- Resumption of growth is expected after confidence is strengthened**
- Agenda of concessions, reforms underway to boost physical (infra) and human (education) more TFP-based new sustainable growth cycle**

Supply: Lower Dynamism

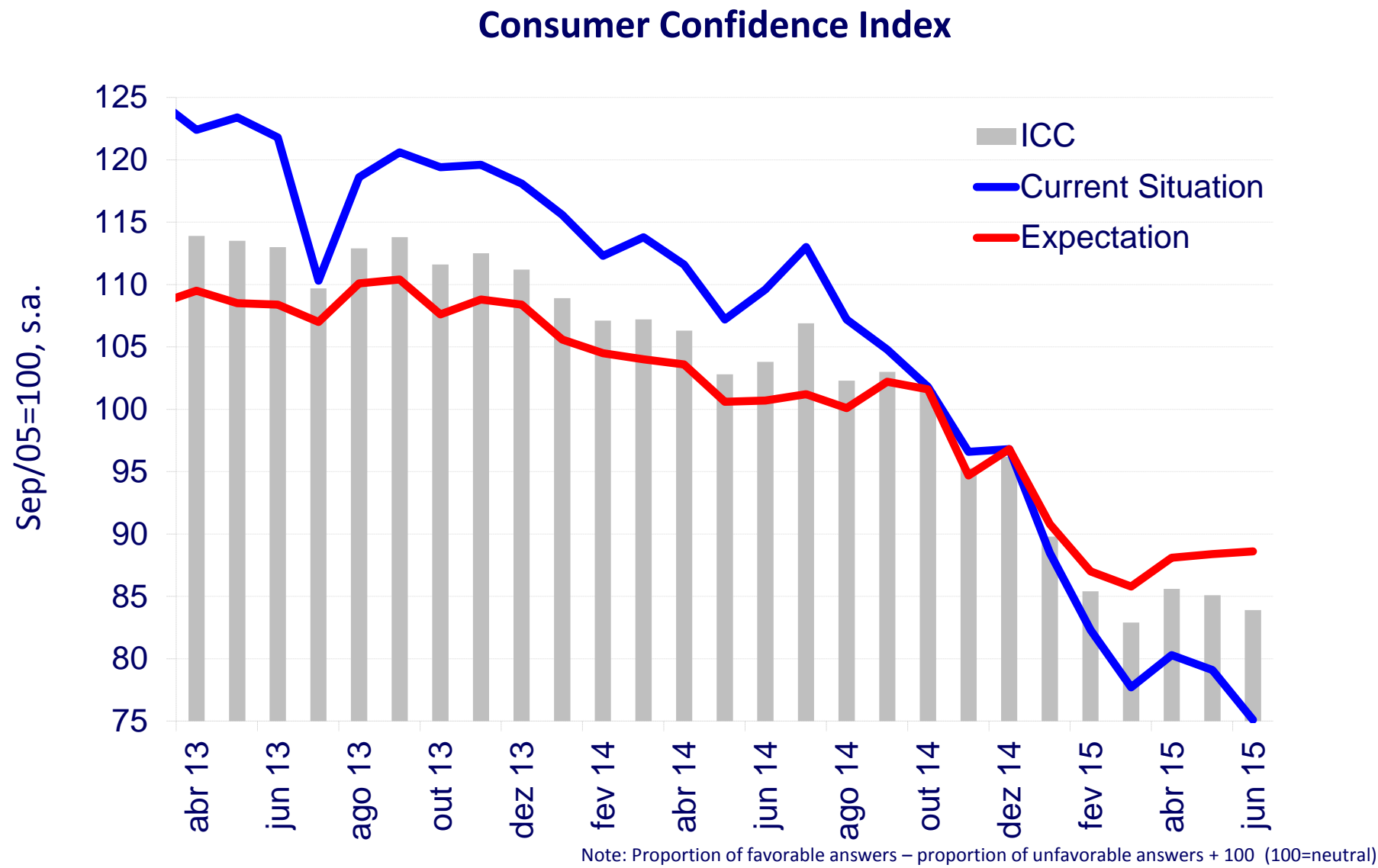


2015: IBGE estimates in May/15

Demand: Moderation in Line with Adjustment



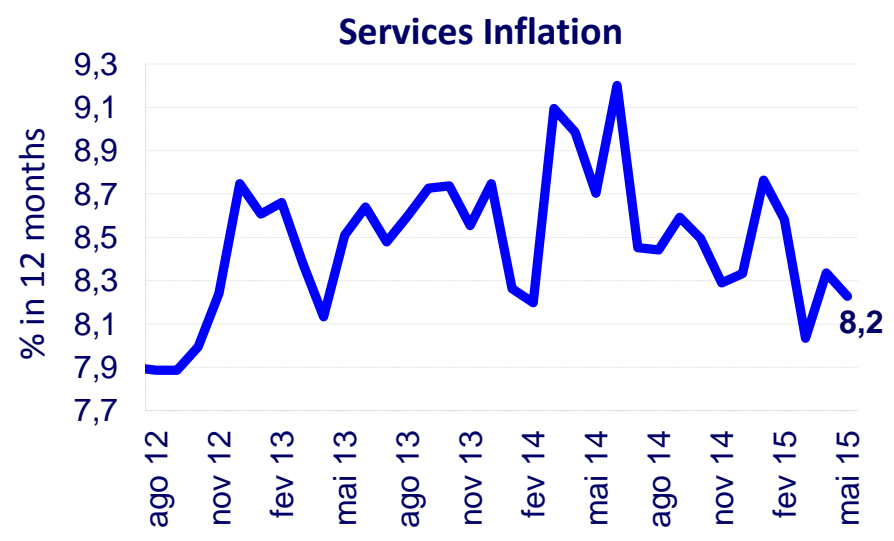
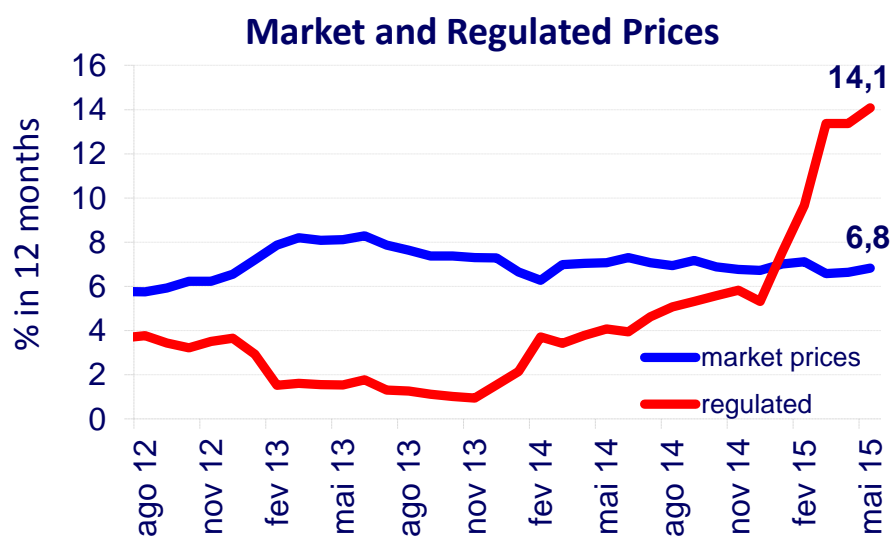
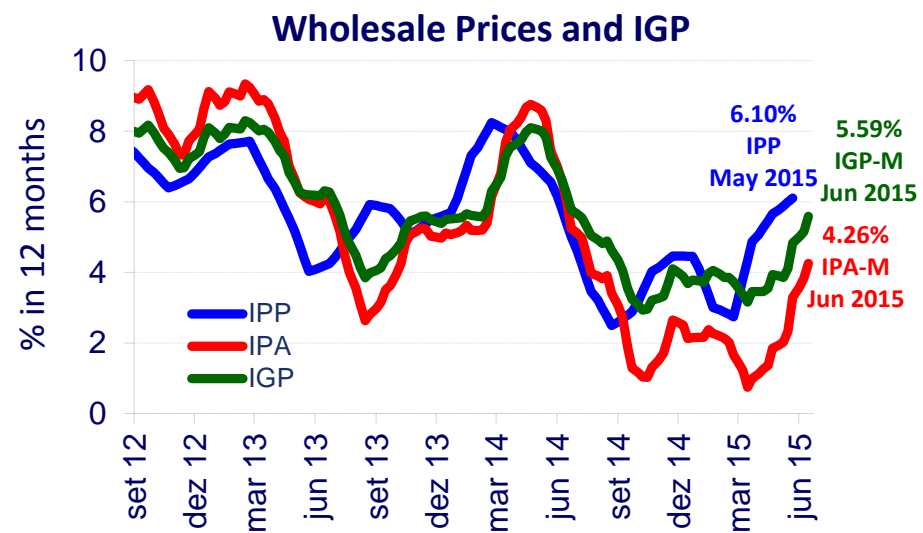
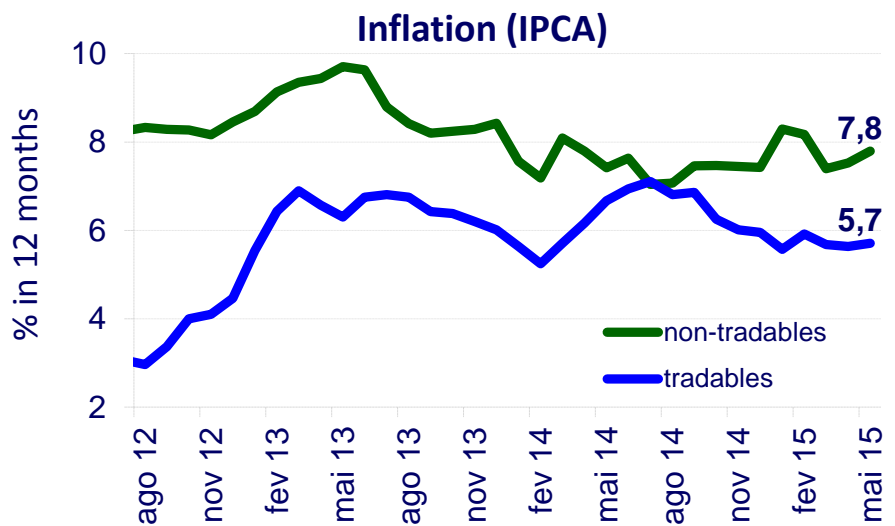
Consumer Confidence: Stabilization of the Decline



V. Inflation Developments

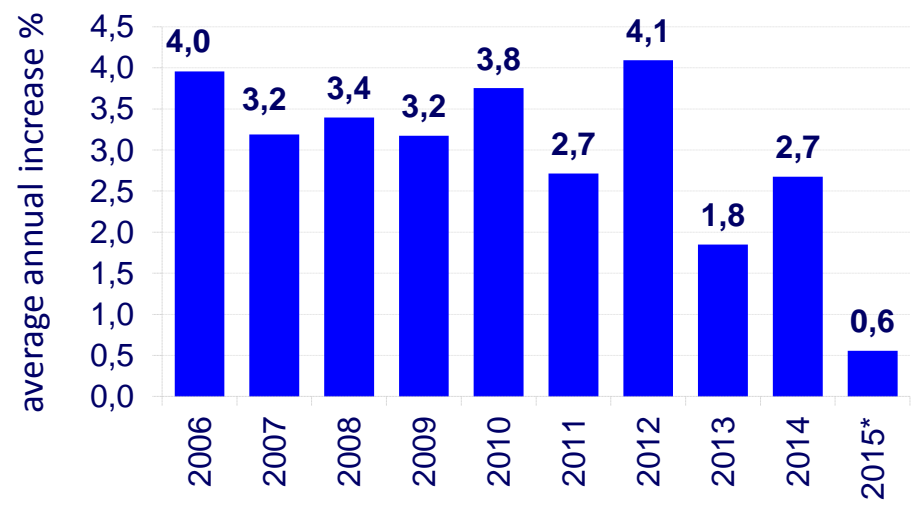
- The double relative price adjustment (regulated and external) impacted inflation in the first half of 2015, increasing the 12-month accumulated inflation; the objective is to avoid its transmission to 2016 and beyond
- Monetary policy can and should contain the second-round effects of current price hikes, to circumscribe them to 2015; so it must remain vigilant to ensure the convergence of inflation to the target of 4.5% at the end of 2016

Prices: Slow Adjustment in Non-Tradables

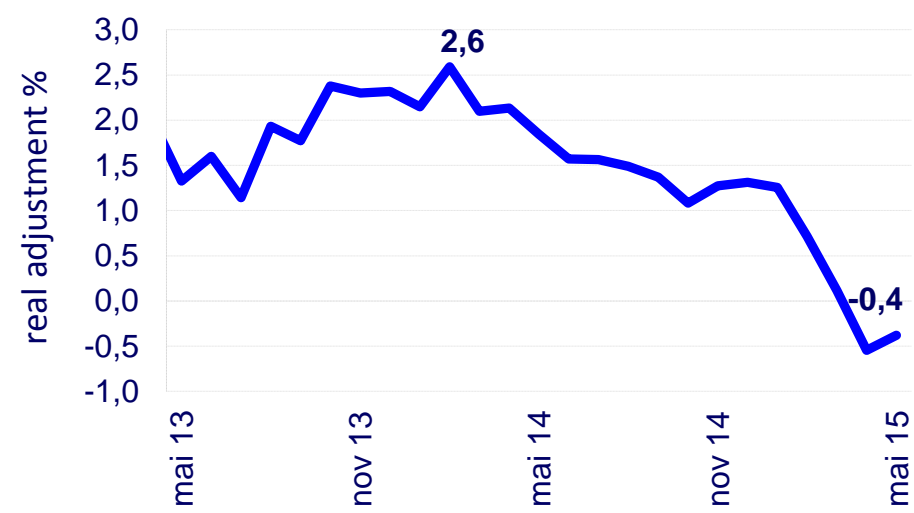


Wages: Adjustments in Progress, but still Risks

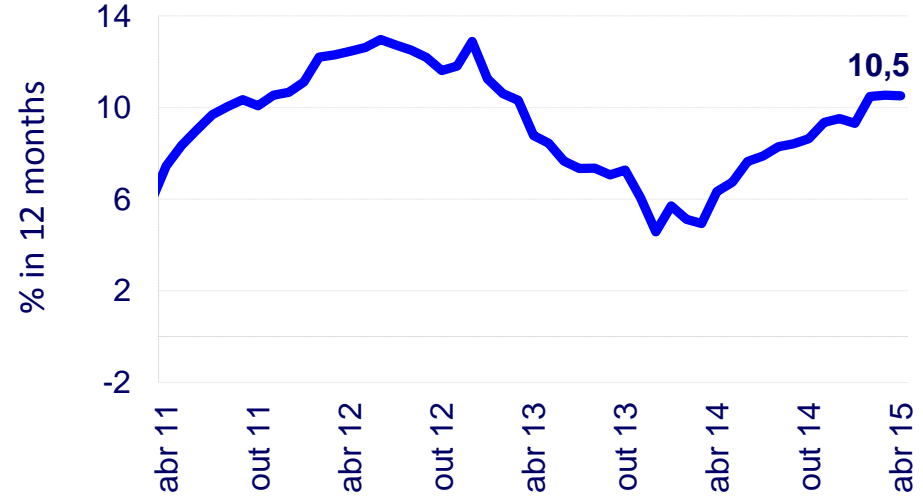
Real Wages



Labor Collective Conventions



ULC**



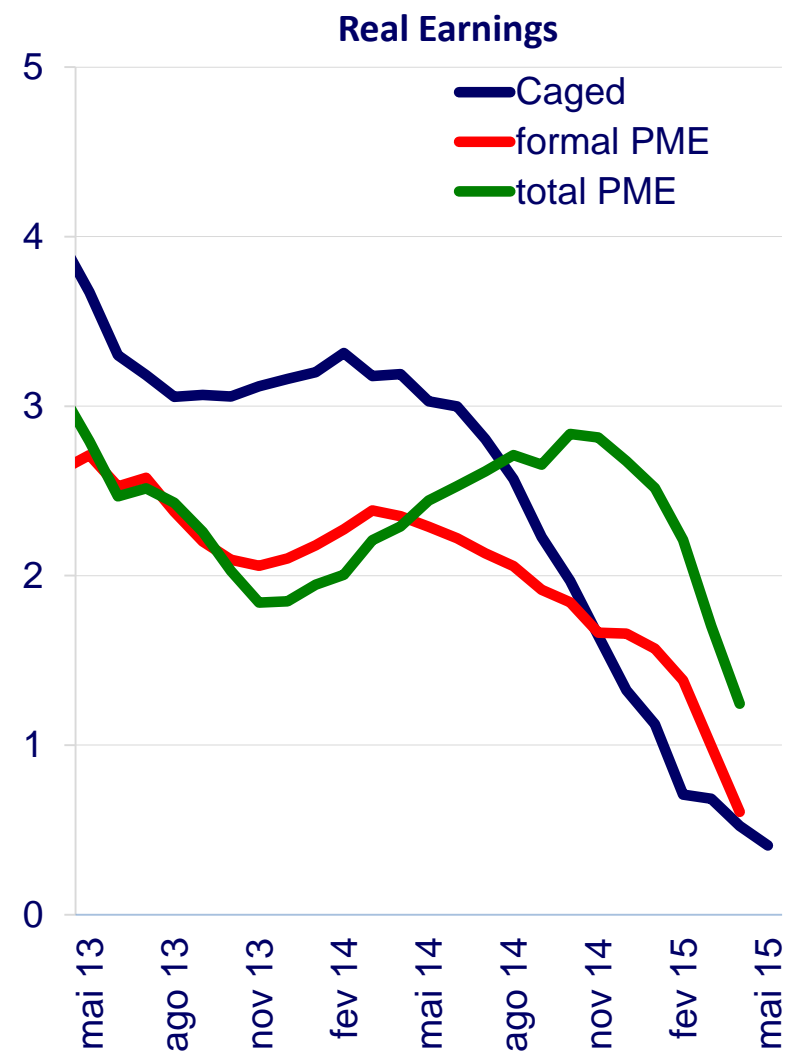
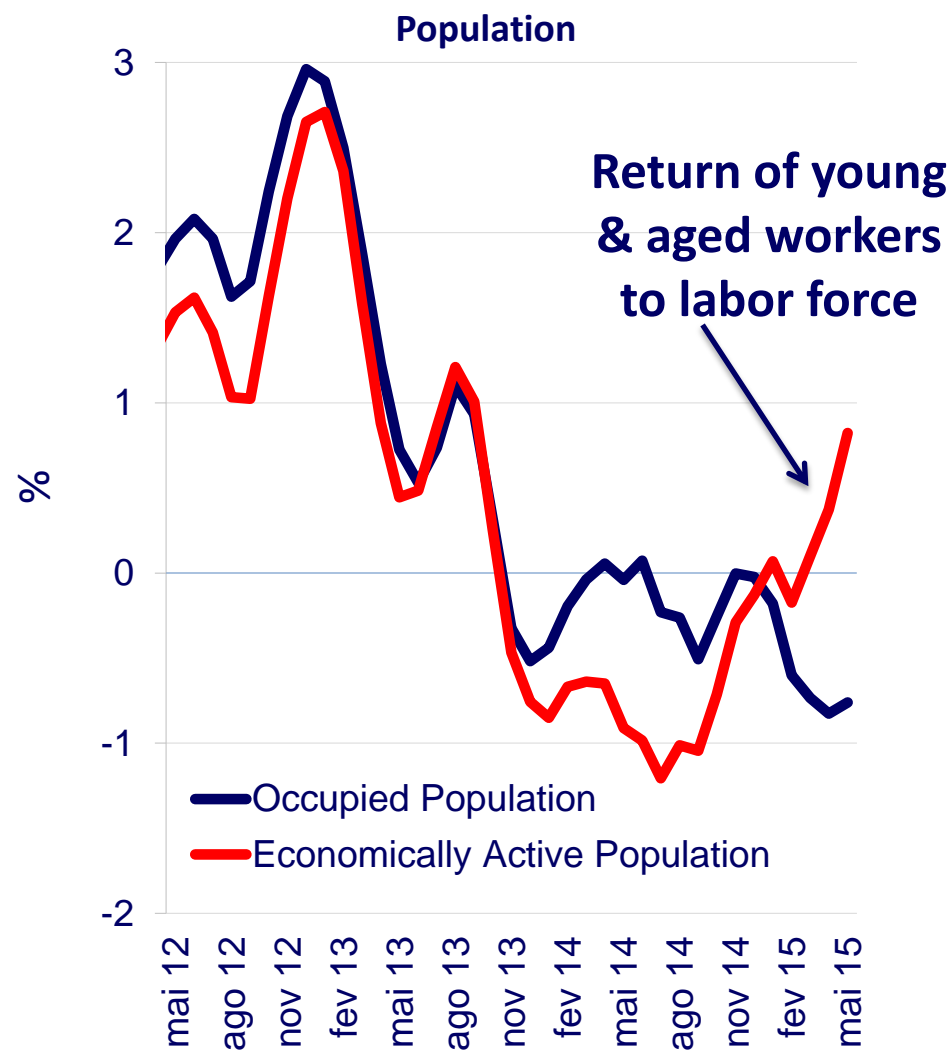
* 12m through May; ** Unit Labor Cost in the Manufacturing Industry: Nominal Payroll/Physical Output

Balance of Risks for Inflation in 2016

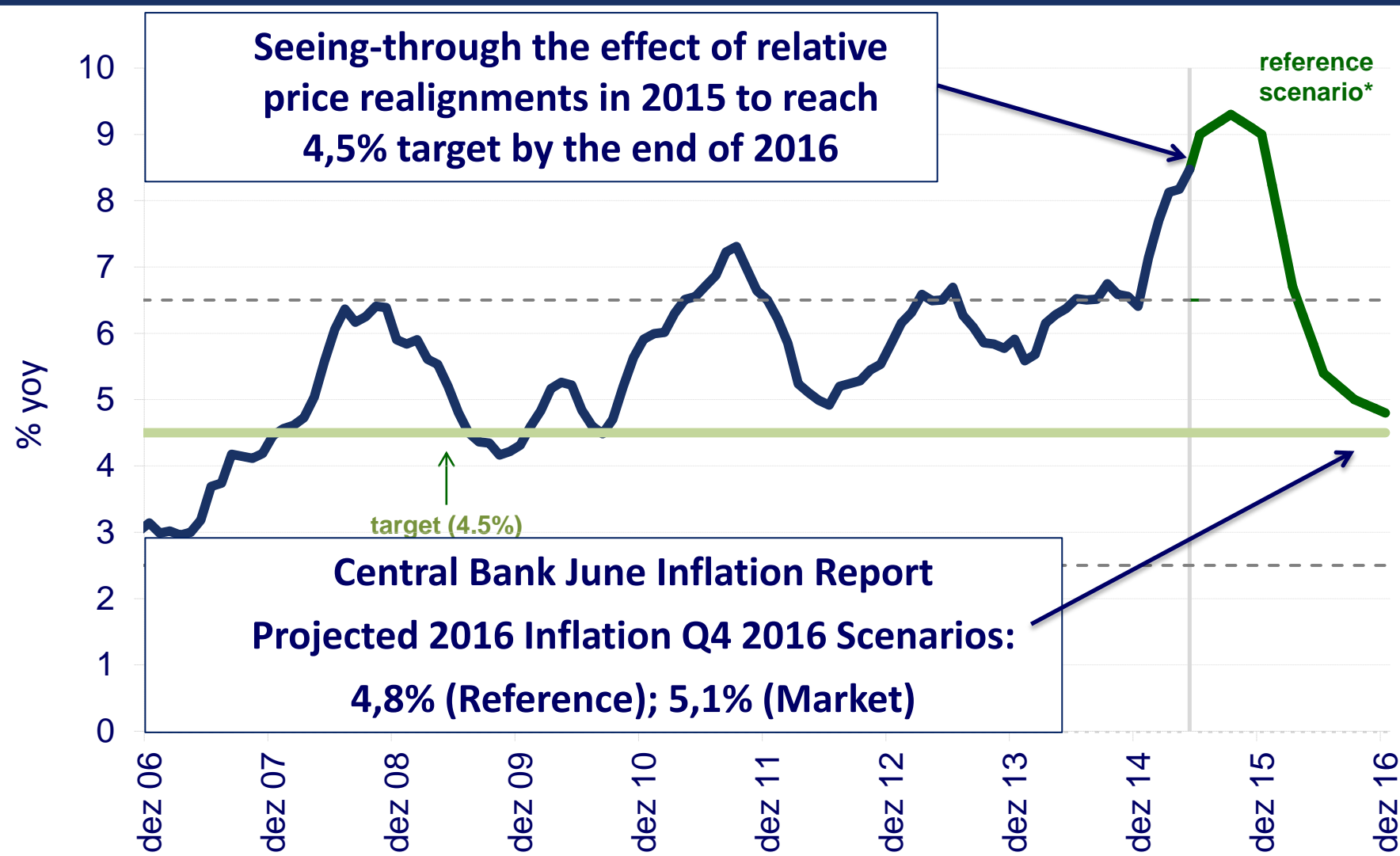
- Most price realignments occurring 1st half of 2015, may 1Q2015; the 12-month accumulated inflation will have a significant reduction in the 1Q 2016
- Slower intensity of the pass-through effect in the current phase of the business cycle
- Fiscal Policy contributes to contain demand pressure
- Moderation of credit and reduction of subsidies
- Asset price volatility might increase with normalization of monetary conditions

Labor Market: Signs of More Slack & Adjustment

YoY change of the 3-month moving average



Inflation Evolution and Projection



*Central Bank of Brazil Forecast (Inflation Report – Jun 15)

Survey of Market Expectations for Inflation (IPCA)

**Shows convergence to 4.5 % in ML Term (2017, 2018 and 2019)
But not sufficient yet in Short Term (2016)**



Conclusions: Adjustment in 2015 is Working

- **Adjustment process under way takes toll on ST growth but is designed to build a solid base for a new cycle of sustainable growth**
- **Adjustment is working and it is important to continue with fiscal and monetary policies in progress; example of reduction of imbalances with improvement in current account balance**
- **Efforts to strengthen fundamentals should continue, to prepare for Fed lift-off with stronger policy stance**

Conclusions: 2016 Should See Growth Resumption

- After adjustment, the reduction of imbalances improves fundamentals, increases agents confidence, favors “animal spirit” of investors
- Adjustments contribute to change demand composition and favor investment, increases potential output and productivity
- Brazil retains a strong domestic market with “low hanging fruits”, and investment opportunities

Conclusions: Policies are working, should persevere

- **Adjustment policies should contribute to the consolidation of a favorable macroeconomic scenario in longer term horizons for private sector**
- **Inflation convergence to 4.5% has strengthened in MLP still not enough for ST (2016); so MP must remain vigilant to ensure the convergence of inflation to the target of 4.5% at the end of 2016**
- **Progress so far in fighting inflation shows that we are on the right track**

Brazil Current Situation & Outlook

Thank you!

July 2015