Economic Research

05/12/2016

Brazil

Official data confirm that Brazil's recession deepened

- **GDP drops 0.8% in Q3, compared with quarterly decline of 0.4% in three months to June**
- **Manufacturing and services see contraction, and PMI numbers point to further reductions in output in Q4**
- **Labour market hit heavily by economic downturn**

The economic malaise that has plagued Latin America's largest economy since the beginning of 2015 showed no signs of abating. Official data released by the IBGE indicated that Brazil's manufacturing, services and farming sectors were all in contraction during the third quarter of 2016. What's worse, PMI data so far point to a further downturn in the economy in the final quarter of the year.

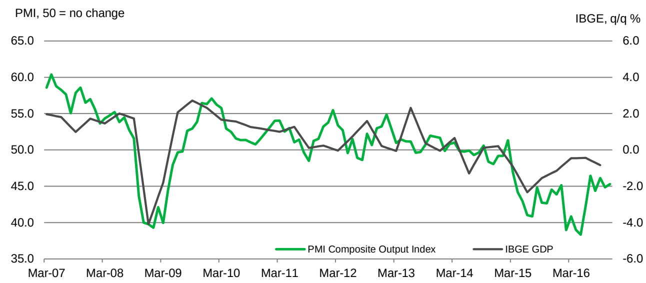
GDP remains negative

Official data released by Brazil's statistics body, IBGE, indicated that the country remained deep in contraction territory during Q3, confirming what had been signalled by the PMI surveys. GDP fell 0.8% on a quarterly basis, the sharpest retreat since the final quarter of 2015, with the accumulated downturn for 2016 so far at -4.0% relative to the same period last year.

For the industrial sector the official figure showed a quarterly drop of 1.3% (within which manufacturing was down 2.1%), while services shrank 0.6%. PMI output readings for these sectors averaged 49.0 and 44.5 respectively in Q3. Moreover, the latest surveys indicate further reductions in activity across manufacturing and services mid-way through the final quarter.

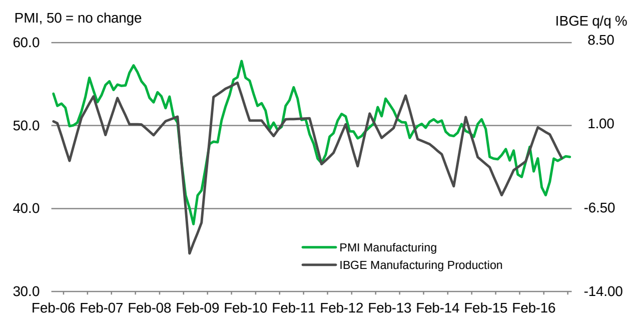
Brazil's poor economic performance stems from high borrowing costs, stubborn inflation and soaring unemployment. These factors, combined with the ongoing investigation into the country's biggest corruption scandal, have hurt investor confidence and consumer spending. According to IBGE, business investment saw the largest quarterly drop (-3.1%) since the end of 2015 in Q3, whereas household expenditure fell 0.6%. The trade situation was also daunting, with exports down 2.8% and imports plunging 3.1%.

Brazil GDP and the PMI



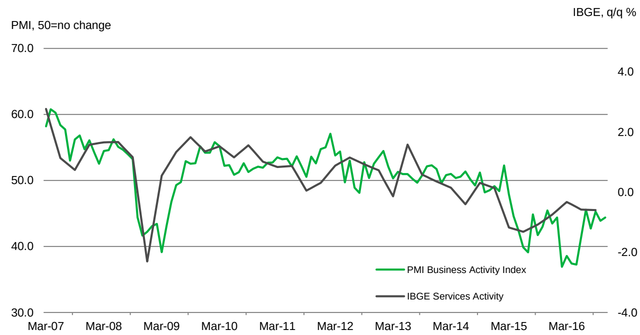
Sources: IBGE, IHS Markit

Manufacturing Sector and the PMI



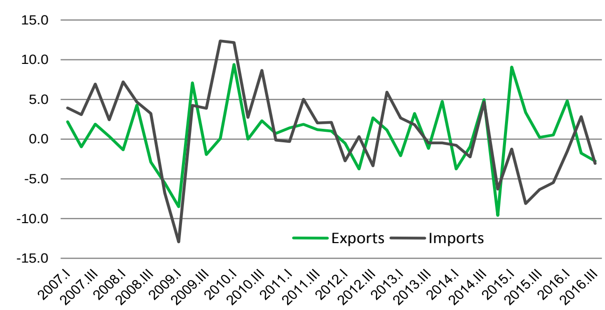
Sources: IBGE, IHS Markit

Services Activity and the PMI



Sources: IBGE, IHS Markit

IBGE: Trade



Source: IBGE

Inflation loses some speed and central bank cuts rates again

One factor hurting Brazilian businesses and families is inflation. Consumer prices climbed 0.26% m/m in November, while on a cumulative basis the IPCA Consumer Prices Index recorded +7.87% in October. Whereas this figure remains well above the central bank's central target of 4.5%, it was nonetheless the lowest since February 2015.

Similar signs of inflation losing strength have been evident in the PMI surveys. Between July and November, the private sector noted softer increases in average cost burdens. Nevertheless, it is worth noting that PMI input prices indicators were consistent with steep rates of increase that remained above the respective series averages. Often, survey participants blamed this on currency weakness driving import prices higher, albeit evidence also highlighted increased tax rates and a generally inflated domestic economy. That said, fierce competition for new work continued to weigh on pricing power, and private sector companies consequently lowered their selling prices for the second straight month on average in November.

Softer inflationary pressures, combined with no signs of an economic turnaround, encouraged the central bank to cut its benchmark rate for the second consecutive time in November from 14.0% to 13.75%, the lowest rate since June 2015.

Ongoing recession takes a toll on jobs

Deteriorating economic conditions and excess capacity continues to hurt jobs, with an overwhelming 12 million of Brazilians currently unemployed. The unemployment rate recorded 11.8% for the August to October period, according to IBGE's Pnad indicator.

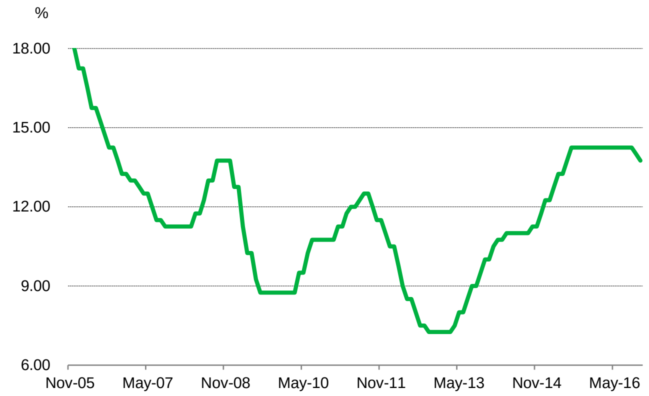
Indeed the PMI surveys have pointed to job losses in both the manufacturing and service sectors in each month since March 2015. This is the longest period of continued job shedding seen in the history of the respective surveys, in which rates of contraction have reached new records.

Uncertain outlook

Until the government addresses the unemployment situation in Brazil, it's hard to see what may break the downward cycle of falling employment and declining consumer spending. Consumer spending has in the past provided a robust contribution to GDP, but this is no longer the case. External conditions remain challenging too, and panel members of the PMI survey continue to report financial struggles, with some indicating difficulties in staying afloat.

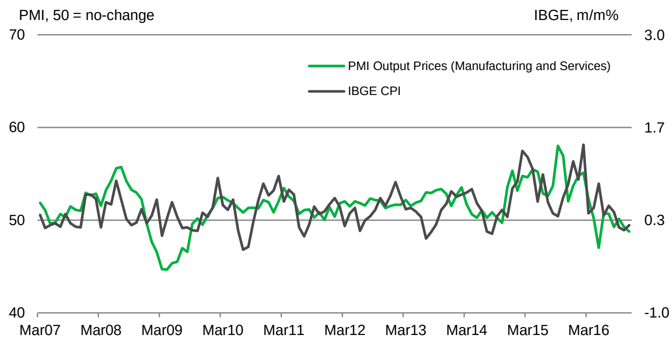
Provided that the government proves that it's able to fix economic policies and create an environment of economic stability in which firms can be assured private investment will not be crowded out, IHS Markit forecast a stabilisation of Brazil's economy in the first half of 2017, with GDP estimated to grow 0.5% over the year as a whole.

Brazil Interest Rate – SELIC



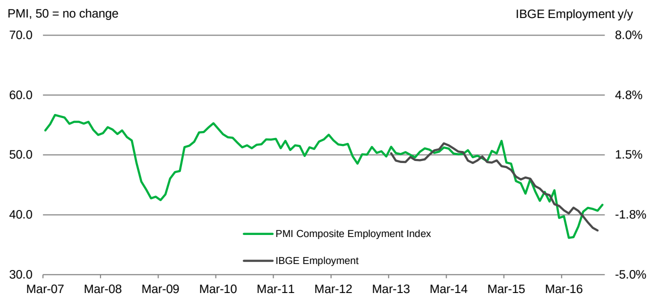
Sources: Datastream, Banco Central do Brasil

Consumer Prices and the PMI



Sources: IBGE, IHS Markit

Employment and the PMI



Sources: Datastream, IBGE, IHS Markit

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