Brazil

PMI shows improved growth momentum during opening months of 2018

- **First quarter sees robust manufacturing performance and rebound in services activity**
- **GDP growth anticipated to improve**
- **Employment falls as job creation among manufacturers is offset by cuts in services**

Brazil's private sector economy remained on an upward trajectory in March, rounding off the best quarter since the end of 2013. Both manufacturing production and services activity contributed to the expansion, with the latter lagging the former but showing a welcome turnaround since late last year.

These positive developments bode well for GDP, with PMI data pointing to a stronger quarterly upturn in the first quarter than the 0.1% rise seen at the end of 2017. Employment trends remain disappointing, however, as services firms seek to lower costs via job shedding.

Manufacturing firms outperform service providers throughout opening quarter

Goods producers led the first quarter upturn, recording one of the strongest periods of growth seen for over five years. The upswing in output largely reflected robust gains in new work and efforts to rebuild inventories. [Manufacturers] not only reported that underlying domestic demand improved, but also that clients abroad, notably in Mercosur nations, purchased greater quantities of their goods.

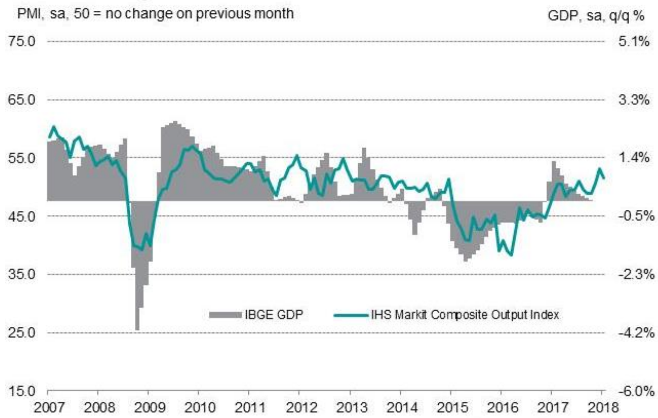
The recent survey data followed similar upbeat news from government sources. Official industrial production figures showed a rebound in output in February (+0.2% m/m), from the 2.2% decline noted in January. On an annual basis, the expansion rate was at 2.3%.

Although [service providers] continue to underperform their manufacturing counterparts, the first quarter of 2018 saw a marked improvement on the contraction seen at the end of 2017. New business growth picked up in February and March, with firms in turn lifting activity in response to the upturn in demand.

Mixed employment trends

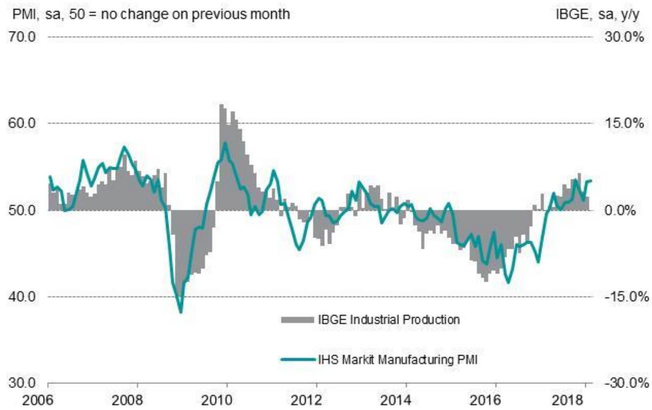
On a less positive note, the PMI data also indicated

Brazil Composite PMI v Official GDP



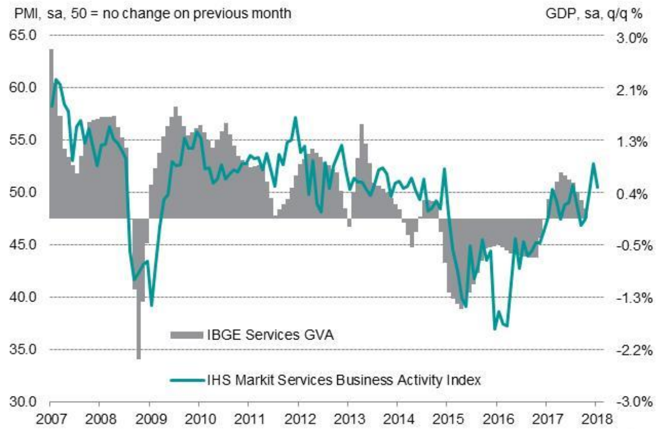
Sources: IBGE, IHS Markit

Brazil Industrial Production vs Manufacturing PMI



Sources: Datastream, IBGE, IHS Markit

Brazil Services Activity vs Services PMI



Sources: IBGE, IHS Markit

that private sector employment in Brazil continued to fall in March. This brings further unwelcome news to policymakers after recent official data from IBGE revealed an increase in unemployment.

An additional 432,000 people joined the ranks of the unemployed in February, taking the total jobless number above 13 million. PMI survey meanwhile showed that in the service sector, the current trend of falling headcounts has now stretched to three years, with the rate of job cutting accelerating in March to the fastest since last August. Companies continued to mention that job losses were due to ongoing efforts to cut operating expenses. Conversely, participants of the manufacturing PMI panel have, on average, signalled employment growth over the past six months.

Brazilian companies bear cost burdens

Currency weakness, combined with higher prices for petrol and utilities, translated into strong overall cost pressures during the first three months of the year. Sharp increases were reported in the manufacturing and service sectors, but only companies in the former raised their charges substantially. Service providers, on the other hand, bore a large proportion of the added cost burden amid efforts to secure new work. Providing support to broadly unchanged selling prices were ongoing reductions in employment and lower interest rates.

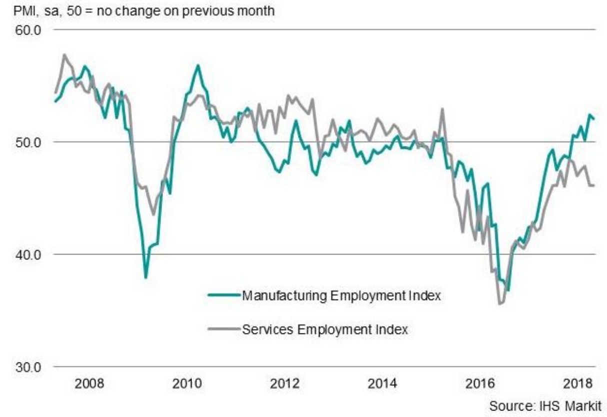
Policymakers in Brazil continue to provide incentives for production and consumption growth by maintaining an accommodative stance to monetary policy. The official interest rate (SELIC) was reduced for the twelfth month in a row in March, to 6.5%, reaching its lowest level on record. With the cumulative consumer price index at 2.68% in March – below the central bank's target of 4.5% – another cut to the SELIC is on cards.

2018 GDP growth forecast at 2.3%

Economic growth is expected to gain speed in 2018, according to IHS Markit, rising from 1.0% in 2017 to 2.3% in 2018. The upswing reflects anticipations that the manufacturing industry will remain on its robust growth path and the service sector will experience a rebound. Improved business sentiment, coupled with a favourable external environment and increasing commodity prices, are set to aid the upturn.

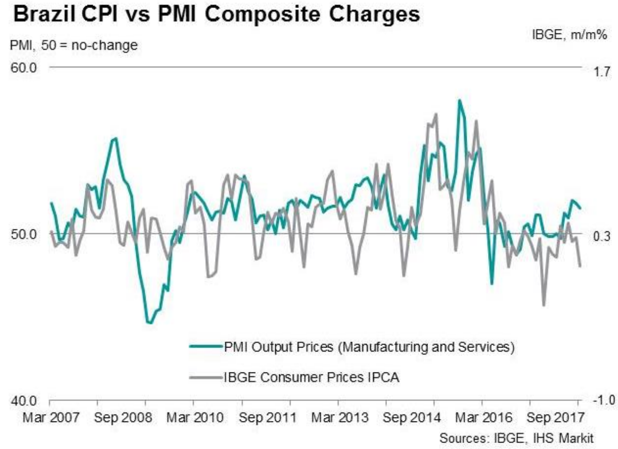
Nonetheless, delays in approving reforms, ongoing corruption investigations and the upcoming presidential elections have the potential to weigh on growth, with the forecast assuming a pro-business president is elected.

Manufacturing v Services Employment



Brazil Spot Rates, USD/BRL

Brazil CPI vs PMI Composite Charges



Pollyanna De Lima

Principal Economist, IHS Markit
Tel: +44 1491 461075
Email: pollyanna.delima@ihsmarkit.com

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