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TD Economics

Data Release: Brazil's economy contracts for a 6th consecutive quarter

- Brazil's economy continued its descent in the second quarter, contracting by 2.3% q/q (annualized). This was slightly worse than market expectations (-2.0%q/q) and marks the sixth consecutive quarterly contraction.
- The domestic economy remains quite weak, with personal consumption falling by 2.7% and government spending down by 2.2%. Providing some offset, investment managed to eke out a 1.7% increase, breaking a 10-quarter streak of declines. Brazilian final domestic demand remains more than 10% below its peak in the first quarter of 2014.
- After surging by 18% in the first quarter, exports grew by a more modest 1.7% in the second. Imports, on the other hand, staged a rebound, shooting up by 19% during the quarter, following four consecutive quarters of large double-digit contractions. As such, net exports were a drag on growth during the second quarter.
- Looking at the industry breakdown, gains in mining extraction and utilities were not enough to offset the losses in agriculture and most services. Manufacturing was flat during the quarter.
- The weak second quarter performance was not enough to trigger a move by the Brazilian central bank as it decided to leave the SELIC rate unchanged at 14.25%, widely in line with market expectations.
- On the political front, the Brazil Senate voted yesterday to impeach President Rousseff, removing her permanently from office. This means that interim President Michel Temer will remain in the position until 2018. Following the announcement, the currency reversed earlier losses and was up slightly against the US dollar, while the benchmark stock market pared losses by about half, and was down by around 1%.

Key Implications

- Brazil is experiencing one of its deepest recessions on record and the second quarter data shows that the domestic economy is still quite weak. Perhaps a positive in an otherwise dismal GDP report is the fact that investment grew for the first time since mid-2013. That said, it is too early to call a bottom and we should not read too much into it as it could be driven by preparations for the Olympic Games. The surge in imports could also be Olympics related, and thus could unwind next quarter. Indeed, the external sector is expected to be supportive of growth going forward, with exports of goods and services supported by a relatively weak – although rising – currency and stronger demand from advanced economies.
- While confidence in the Brazilian economy seems to be improving, economic conditions in the country remain quite challenging, as it is faced with high unemployment, high inflation, and high interest rates. The Olympic Games may provide some much needed support in the third quarter, but the impact will likely prove temporary. Overall, we expect the economy to contract by a little more than 3% in 2016, a slightly better showing than the 3.8% contraction recorded last year.
- Low growth, combined with high inflation makes setting monetary policy particularly challenging. However, while core inflation is elevated, it has been trending down. As such, we expect the central bank to cut rates by 50 basis points by the end of the year.
- Even with the political situation now somewhat more certain, the government has a tough road ahead. Fiscal adjustments will need to be made in order to revive the economy, which will be a difficult task given that only a fraction of public spending (less than 15%) is discretionary. It will be up to the current government to persuade congress to approve unpopular measures – including a pension reform – if it wants to bring growth back into positive territory and closer to its potential rate of around 3%.

Dina Ignjatovic, Economist
416-982-2555

@TD_Economics