VotorantimAsset

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Monthly Economic Outlook

More data pointing to the weakness of Brazilian economic activity are due in August

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The first indication of weak economic activity was reported at the very beginning of the month of August. The latest update to IBGE's industrial production index, published on August 1, fell for the fourth consecutive month, reaching the lowest level for any month since the 2008-09 crisis (see chart). IBGE's next retail sales update, due on August 14, is expected to be the lowest of the year on a seasonally adjusted basis, owing mainly to weak sales of motor vehicles. On August 15 the Central Bank is due to report the IBC-Br, considered a proxy for gross domestic product (GDP). We estimate a 1.5% contraction, owing mainly to the fall in industrial production. Finally, on August 29 IBGE is due to report second-quarter GDP. Based on the monthly indicators available, we forecast negative growth in the quarter. If this negative growth is confirmed, technically IBGE will have to revise down first-quarter GDP, making growth negative in that period as well. As a result, we would have two consecutive quarters of negative GDP growth in Brazil, which many analysts call a "technical recession".

IBGE: Industrial production
Monthly change, seasonally adjusted (base 2002=100)

Note: Seasonal adjustment by IBGE.
*Seasonally adjusted monthly change.

Source: IBGE

As noted in previous issues of this Monthly Outlook, one of the factors driving this significant decline in economic activity, which points to annual GDP growth in the range of only 0.7% in 2014, has been the sharp fall in business and consumer confidence, measured by a number of indicators. The chart below illustrates the trajectory of FGV's manufacturing executive confidence index (ICI). After two consecutive monthly falls, the level is now the lowest since the 2008-09 crisis. Confidence indicators for other sectors, such as construction, services or commerce, display a similar trajectory. On this point our assessment is that in recent months an overpessimistic view of the economic outlook has begun to materialize among these different groups of economic agents. While there is indeed gathering frustration with the performance of the Brazilian economy, which is expected to be weak this year and next, and with persistently above-target inflation, the risk of an economic collapse in Brazil is far lower now than it was during the 2008-09 crisis. It is worth recalling that the bursting of the US housing market bubble triggered a collapse in a substantial proportion of the financial system in the developed countries, posing significant risks of pushing the global economy into a recession similar to the Great Depression of 1929. Hence the view that the present low level of confidence is overpessimistic, since it is so close to the rock-bottom level seen in 2008-09.

However, as stressed above, there are no signs of an improvement in confidence in the manufacturing sector (ICI). A number of problems appear to have remained uppermost in the minds of decision makers in industry. The first is the array of structural difficulties faced by a sector that has displayed negative growth in the past six years: industrial production measured by IBGE in the past few months is below the level seen before the collapse of Lehman Brothers in 2008. The structural bottlenecks that must be resolved if this long industrial recession is to end include deficient infrastructure, a scarcity of skilled labor, and an adverse tax structure, among others. A second problem, which appears to be limiting investment decisions in the sector in the near term, is rising uncertainty about the macroeconomic outlook owing to factors associated with persistently high inflation and loose fiscal policy. The Central Bank itself has acknowledged, in the minutes from recent meetings of its Monetary Policy Committee (Copom), that "high inflation rates create distortions leading to increased risks and falling investment". Economic policy must therefore act to restore confidence in the economy to levels more consistent with an advance in investment decisions by private enterprise. It will also be necessary to signal reforms capable of eliminating at least some of the obstacles to greater competitiveness for Brazil. In a market economy, expectations and confidence create an environment akin to self-fulfilling prophecy. To a significant extent, Brazil's weak economic growth is due to this decline in confidence, which prevents consumers from spending and businesses from investing. To improve GDP growth rates in the years ahead, economic policy will certainly have to prioritize strengthening consumer and business confidence.

FGV: manufacturing executive confidence index (ICI)
Seasonally adjusted

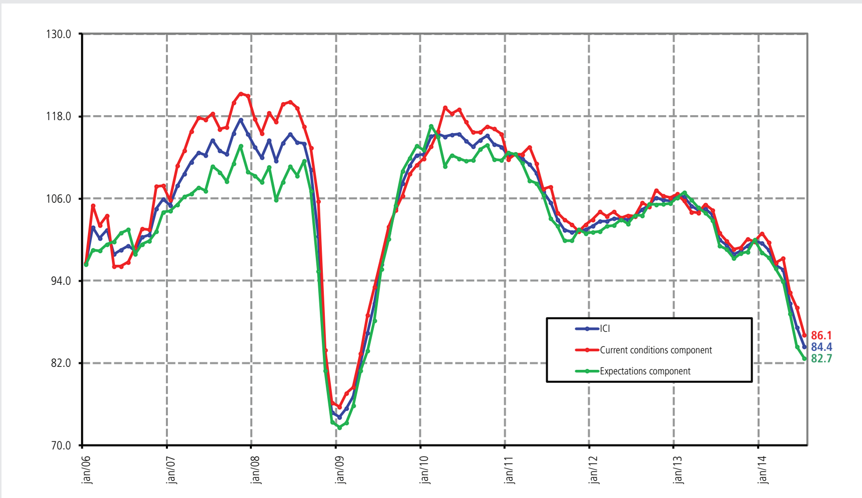

Chart: VAM

Source: Fundação Getúlio Vargas