VotorantimAsset

Monthly Economic Outlook

April | 2015

Plateau?

On March 27, IBGE reported GDP statistics for the fourth quarter and all of 2014. Following the adoption of a new methodology more in line with international best practice, the institution has revised GDP data since 2000 based on the inclusion of new information, the use of new calculation formulas, and some conceptual reclassifications giving certain segments more weight in terms of their contribution to GDP. As a result, nominal GDP has been revised up from R$4.84 trillion to R$5.16 trillion for 2013, and to R$5.52 trillion for 2014. The implications for Brazil's solvency are positive, since total public debt will have decreased by 4.6% of GDP while net debt will have fallen 2.7 percentage points. On the other hand, the nominal primary surplus target will have to increase by about R$5.0 billion in order to remain equivalent to 1.2% of GDP.

Revised GDP growth in 2014 was 0.1% year over year, very close to projections of stability, so that the revision of the series produced neither major changes nor surprises in terms of underlying trends. Nevertheless, it confirmed perceptions that Brazil had a bad year in 2014 and needs reforms.

There can be no question that the economic team are working very hard to balance the budget. Their main aim is to rebuild business and investor confidence in order to promote economic growth. Finance Minister Joaquim Levy has held frequent talks with Congress, negotiating items of the short-term fiscal adjustment and defending his plan. The discussion over income tax rates, in which the government wanted to raise the threshold as little as possible, demonstrated his focus and flexibility. He made concessions where possible and managed to limit potential tax revenue losses to R$500 million. In the process he wrung declarations of support for his measures from the leaders of Congress while persuading other members of both houses to come over to his side. In addition, he won an important endorsement from Standard & Poor's: the rating agency downgraded Brazil to the lowest rung of its investment grade rating last year but in March reaffirmed this rating thanks mainly to positive perceptions of the fiscal adjustment process and Levy's credibility in the eyes of analysts. Similar progress is being achieved on the debts of states and cities. The next step of the adjustment, involving the actual spending cuts made possible by passage of the federal budget by Congress, is also set to go ahead successfully. Despite all the difficulties and ups and downs, it still looks likely that the 2015 primary surplus target corresponding to 1.2% of GDP will be achieved, since compensatory measures have been announced to offset the concessions Levy had to make in his negotiations with Congress.

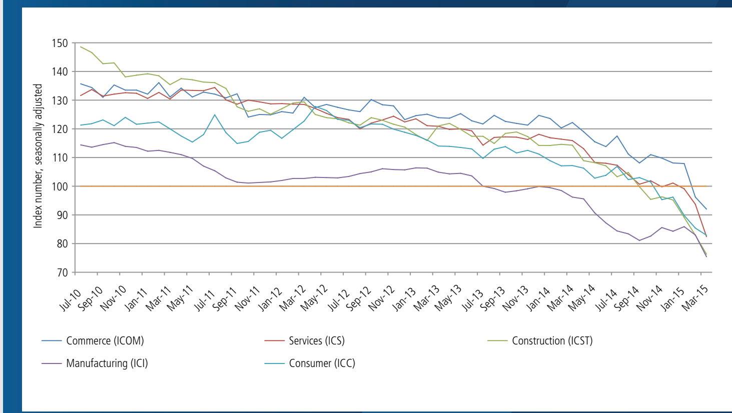
Two movements drew our attention during the month of March. They tend to cancel each other out and we therefore continue to forecast a 1.0% GDP contraction in 2015. The increase in rainfall since the second half of February has not totally eliminated the risk of compulsory electricity rationing but has considerably decreased its likelihood. Participants in the electric sector now see rationing as practically ruled out. This is true of both the official bodies responsible for monitoring the system and private enterprise. In addition, the "tariff realism" strategy implemented by the economic team will drive up electricity rates very sharply during the year. We project 50% on average nationwide, and this alone will foster rationalization of electricity consumption.

On the other hand, the latest surveys show that deterioration in business confidence across all sectors, as well as consumer confidence, has reached troubling levels for the dynamics of aggregate domestic demand. In 2015 household consumption, which has decelerated in recent years and grew only 0.9% in 2014, faces headwinds such as a rising unemployment rate, which will mean less vigorous growth in average real earnings than in recent years, and a less abundant supply of credit because of the feedback loop between low consumer confidence and banks' perceptions, as well as the rising cost of money due to the ongoing tightening cycle implemented by the Central Bank. Investment has been at historically low levels for a considerable period and fell 4.4% last year in response to the uncertain outlook. The prospects for 2015 point to a similar fall in investment, judging by the low levels of confidence.

The expectation is therefore that the foundations of a new fiscal policy are being laid and this will help extend corporate planning horizons. As these fundamentals converge with decreasing projections of future inflation thanks to dissipation of the impact of the administered price shock, and as the perception grows that it will not be necessary to resort to compulsory electricity rationing, we may see a reversal of the deterioration in business and consumer confidence, and the downtrend in GDP growth forecasts may come to a stop this year. Our projection of a 1.0% contraction is absolutely not a positive scenario, but the turning point may be approaching, at least in the sphere of expectations.

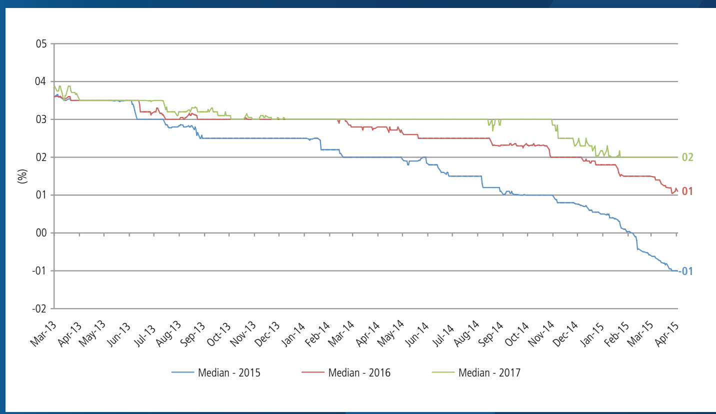
In this process we expect the BRL/USD exchange rate, which is the economy's main price variable, to stabilize and end the year in the range of 3.10. This will be important to help bring about a lower level of inflation in 2016: we project 5.7%, down from a projected 8.2% in 2015. If so, it may be possible to embark on a monetary easing cycle.

Confidence surveys



Source: FGV

GDP growth: median consensus forecast



Source: Central Bank of Brazil ("Focus" report)