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ECONOMICS

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Brazil Macro Compass

2017 GDP: End of Recession Confirmed?

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Upcoming Data: 2017 GDP

Next week's big economic release (4Q17 GDP figures on March 1) will likely, in our view, trigger a wave of upward revisions for this year's growth. Following a strong December IBC-Br (see below), we expect 0.4% (non-annualized) quarterly GDP growth, which would bring full-year 2017 growth to 1.1%. If our estimates prove correct, the carryover for this year should be around 0.6%. We forecast 2018 growth at 3.2%, above market consensus (2.8%), with household consumption as the main growth driver this year (for more information, please see our January 3 report, *The Unstoppable Force of Consumption*.

What's New: Yet Another Low Inflation Reading

February IPCA-15, the preliminary official CPI reading, came in slightly above consensus (0.38% m/m versus 0.37%), although, in 12 months leading up to this number, still below the inflation target lower bound (3.0%). Foodstuff prices continued to surprise to the downside, whereas education services, the group that usually explains most of first quarter inflation, showed stronger price rises than expected (4.9% m/m, our forecast was 3.3% for the period). Nevertheless, this is the slowest inflation in this group since 2008 and well below the 2009-17 February average (6.1%). We continue to expect full-month February inflation at 0.33%, which would still be significantly lower than the Central Bank's forecast (0.47%). In our view, lower-than-expected inflation in the first two months of the year justifies another rate cut in March, bringing the Selic rate to 6.5% (for more details, see our February 15 report, *Even Better Than the Real Thing*).

December IBC-Br (Central Bank monthly GDP proxy), released last Monday, surprised to the upside, growing 1.4% in the month. According to this indicator, 4Q17 was 1.3% (this does not translate into similar GDP growth in the period because of different seasonal adjustment methods). This indicator corroborated our 2017 GDP forecast (see above), confirming that the economic recovery has been increasingly widespread — in December, industrial production, services, and agriculture all performed strongly.

In-Depth Research: Looking at the Structural Fiscal Balance

In a report published this week (*One-Off Is Not Enough*, February 20, 2018), we provided updated estimates for the structural fiscal balance (discounting one-off revenue and expenditures, factors not correlated with the business cycle, as well as the effect of the output gap). According to our calculations, the structural primary deficit will still widen in 2018 (to 2.3% of GDP), whereas the reported primary deficit for the central government is expected to be 2.0% of GDP in the same period. This means that the economic recovery will contribute to a 0.3% of GDP improvement. A further narrowing of the primary deficit depends on extraordinary revenue, such as privatizations and concessions that are pending a Congressional vote. In a best-case scenario, the primary deficit this year could be as narrow as 1.0% of GDP (see the report for more details).

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Political Agenda

To nobody's surprise, the government announced this week that it is giving up on trying pas pension reform this year. As a sort of compensation, the government announced a laundry list of "microeconomic reforms", most consisting of bills that have already been sent to Congress, such as the privatization of state-owned utility companies and new rules for a credit bureau (*cadastro positivo*).

Most of the items are sensible, in our view, although they do not intend to make up for the foregone savings in social security. Moreover, with the presidency now strongly focusing on a public security agenda (and spending resources and political capital, accordingly), few of these proposals are likely to be approved in Congress before the October presidential elections.

The failure in voting the pension reform was widely expected, and we do not see any potential negative reaction in asset prices (the impact on this year's budget is also negligible). The move only adds more tension to the presidential elections, since market participants and rating agencies will wait for the reform to be voted upon in the first months of the new government.

Recent Publications (Available on Our Website)

- *One-Of Is Not Enough* (February 20, 2018)
- *Even Better than the Real Thing* (February 15, 2018)
- *Social Security Reform: Same Proposal. Different Probability?* (February 8, 2018)
- *Why Has the BRL Weakened in 2017?* (January 8, 2018)

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