

**Brazil Macro Compass****Bracing for a GDP Contraction in 1Q19**

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**What's New: Economic Activity Data, Copom Minutes**

**The last set of monthly economic activity indicators for March was released this week, painting a bleak picture for economic activity in 1Q19.** IBGE's volume of services index contracted 0.7% m/m, contributing to an average 0.6% marginal contraction in the quarter. Central Bank's monthly GDP gauge (IBC-Br) came in at -0.28% m/m, 8 bps below market consensus. That translates into a 0.68% quarterly contraction for the index, compatible, in our view, factoring in other indicators already released, with a 0.3% GDP contraction, to be released on May 30.

All major economic activity indicators either decelerated or outright contracted at the margin in 1Q19 (see the Chart of the Week below), frustrating the big jump in confidence indicators triggered by the October 2018 election results. Industry was hit by the slowdown in Argentina (an important market for auto exports, as we showed in last week's issue of this report) and by a sharp contraction in the mining sector (-11% q/q), on the back of mine shutdowns after the collapse of the Brumadinho dam. Core retail sales grew only 0.2% in the quarter, from a 0.6% expansion in 4Q18. Finally, the growth of real aggregate wages was little changed at 0.6% q/q (from 0.5% q/q in the previous period), providing little fuel for a stronger consumption growth despite healthy credit markets.

Central Bank's monetary policy committee (Copom), in the minutes of its latest meeting, released this week, recognized this deterioration in the country's economic performance, anticipating that it expects a contraction in GDP during 1Q19. The committee repeated the moderated tone from the statement that followed the decision to keep rates unchanged, highlighting uncertainties related to the fiscal consolidation process and repeating that the evaluation of how the economy is doing in the absence of the external shocks from 2018 will not be concluded in the near future. In our view, this speech is compatible with our forecast that no rate changes will take place in the foreseeable future.

**Upcoming Data: IPCA-15**

May preliminary inflation readings will be released next week. We expect monthly inflation at 0.44%, decelerating from April's 0.72%. Foodstuff prices should be behind most of the deceleration, giving back part of the seasonal summer rises. Services inflation should have stayed flat in the month, with an expected large drop in air ticket prices (-23.5% m/m) offsetting other price increases. With this result, yearly inflation should jump to 5.03%, which will be, in our view, this year's peak. We reiterate our expectation for year-end inflation at 4.0%.

**Political Agenda: Expiring Decrees**

Returning from the United States, the leaders of the Executive and of the both houses of Congress should have a busy week ahead. With the pension reform temporarily on the backburner (the public hearings stage in the Special Committee has been attracting little attention and is scheduled to continue until May 29), the attentions in the next couple of weeks will turn, in our view, to several presidential decrees (or MPs, short for *medidas provisórias*) issued between December 2018 and January 2019 that start expiring next week. (A MP loses effect if not approved by Congress after four months of its initial appraisal.) MP 863, which allows for fully foreign owned airlines to operate in Brazil, is the first on the list, expiring May 22 if not voted. In the following week, there are deadlines for MPs 870 (cabinet restructuring), 871 (social security fraud prevention program), and 868 (changing water and sanitation legal framework). We believe the negotiations between Executive and Congress to vote the MPs (especially 870, whose reversion may entail the re-creation of several ministries that were either consolidated or extinguished) will provide us important data points on whether the relationship between the two powers have been improving and on the ability of the government to push for its policy agenda.

**IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.**

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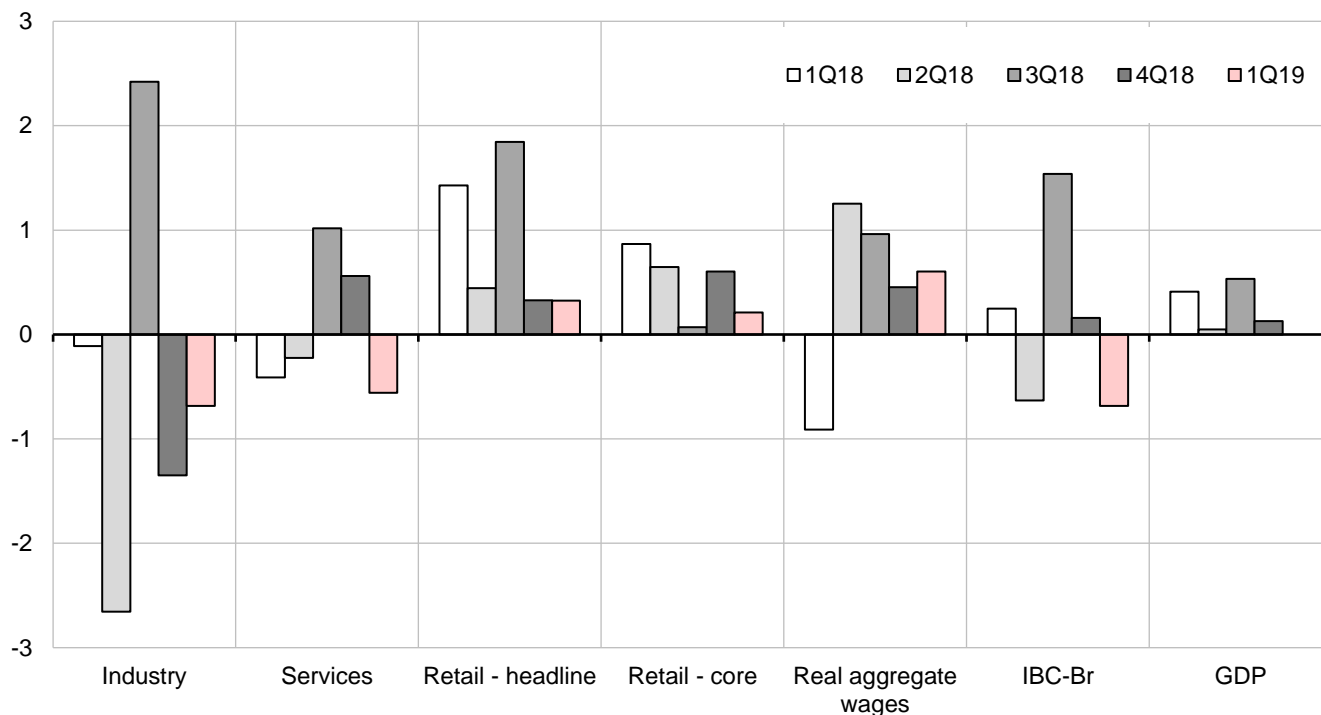
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## Chart of the Week: 1Q19 Activity Indicators

Our Chart of the Week looks at a set of relevant economic activity indicators for 1Q19. Recently released March data completed the picture of a disappointing quarter, with most indicators decelerating or outright contracting. We expect national accounts data, to be released on May 30, to show that GDP contracted by 0.3% in the period. That would be the worst quarter since the end of the 2015-16 recession.

Brazil Economic Activity Indicators, Q/Q Changes (%)



Sources: IBGE, Brazil Central Bank, Santander.

## Number of the Week

222

Protests against spending cuts by the Ministry of Education took place in 222 cities throughout Brazil on May 15, according to a report by São Paulo's Jovem Pan radio.

## Quote of the Week

*“Regardless of markets wanting things to happen fast, our reality is that we are at rock bottom. It’s in the hands of the Congress to take us out of there with fiscal consolidation.”*

— **Paulo Guedes**, Ministry of Economy, on a hearing at the Congress Joint Budget Committee (May 14, 2019).

## What We’ve Been Reading

- “New Trade Routes: US-Brazil” (*Financial Times*, May 14, 2019). Can anything concrete emerge from the recent strengthening of ties between Brazil and US leaders?
- “In Brazil, Reality Check for New President Bolsonaro,” by Kenneth Rapoza (*Forbes*, May 16, 2019). Summing up the recent wave of market disappointment with the Brazilian government.



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- “Latin America’s missing middle: Rebooting inclusive growth” (*McKinsey Global Institute*, May, 2019). A comprehensive report on the regions’ two “missing middles”: middle-class consumers and midsize companies.

### **Recent Publications (Available on Our Website)**

- *Inflation—Year of the Pig: Good Fortune?* (April 30, 2019)
- *Economic Activity: No News Is Bad News* (April 22, 2019)
- *Will Credit Be Enough to Revive Consumption?* (April 1, 2019)
- *Monetary Policy: Low for (Much) Longer* (March 29, 2019)
- *Pension Reform—The Moment of Truth: From Intentions to Bargaining* (March 28, 2019)



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