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Brazil Business Forecast Report Q2 2014

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Abstracts

Core Views

Further exchange rate weakness, still-high interest rates and our view for only a moderate pick-up in fixed investment inform our view that real GDP growth will remain near 2013 levels this year. Indeed, we forecast real GDP growth of 2.4% in 2014, only modestly higher than our 2.3% estimate for 2013.

Elevated inflation will keep interest rates high in H114, but we believe that a still-weak growth outlook, combined with more moderate price pressures, will see the Brazilian bank move to ease monetary policy in late 2014.

While the widespread public protests begun in June have largely subsided, we believe that this marked a turning point for the Brazilian electorate. As such, we anticipate that public unrest could flare up again should political progress on reforms stall.

Major Forecast Changes

We have upgraded our 2013 real GDP growth estimate to 2.3%, from 2.0%, following indications that economic activity is likely to come in stronger than we previously expected in late 2013. That said, we modestly downgraded our 2014 real GDP growth forecast to 2.4% (from 2.5% previously). We believe that exchange rate weakness and still-high interest rates will temper private consumption growth, while delays will continue to weigh on the infrastructure sector’s potential, implying little acceleration in growth from 2013 levels.

Following 325 basis points (bps) of hikes since April 2013, we anticipate only another 25bps to 10.75% in the coming months. After a pause, we then expect a still-weak growth outlook and more moderate inflation in H214 to prompt the central bank to cut rate to 9.75% by end-2014.

After more significant weakness than we expected in end-2013, and in light of growing capital outflows, we have revised our 2014 average and end-year exchange rate forecasts to reflect greater weakness. We now forecast the real to average BRL2.350/US$ in 2014 (from BRL2.300/US$ previously) and end the year at BRL2.450/US$ (from BRL2.380/US$).

Key Risks To Outlook

Downside Risks To Growth Forecast: A more significant tightening cycle than we expect in early 2014, combined with another substantial sell-off in the exchange rate could hit private consumption growth hard, posing downside risks to our 2.4% real GDP growth forecast. Further delays to major construction projects related to the FIFA World Cup and PAC growth acceleration programme would also pose downside risks to our 2014 growth forecast. Upside Risks To Interest Rate Forecast: With inflation ticking up in December 2013, the Brazilian central bank remaining concerned about inflation expectation, and a more aggressive rate hike than we expected in January, we highlight upside risks to our end-2014 interest rate forecast of 9.75%. Indeed, hawkish rhetoric by the central bank and/or indications that inflation will continue to accelerate in the coming months could cause us to upgrade our end-2014 Selic rate forecasting, potentially forestalling our call for monetary easing until 2015.

Downside Risks To Exchange Rate Forecast: Should the real take another leg lower in the coming months, on the back of a change in investor sentiment, we could see the unit depreciate more aggressively than we currently expect. Such a scenario would pose downside risks to our average and end-year exchange rate forecasts for 2014 and 2015.

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While we are adjusting our current account forecasts for Brazil for the next few years to reflect narrower shortfalls, we maintain our view that further deterioration is ahead. This is underpinned by our view that export growth will remain modest and imports will tick higher, in line with a recovery in the manufacturing sector, keeping the trade account in deficit.

Table: CURRENT ACCOUNT

Fiscal Policy

Policy To Remain In The Spotlight

Brazilian fiscal policy will remain under intense scrutiny in the coming years, as a significant deterioration in the nominal and primary budget balances has increased the prospect of a sovereign credit rating downgrade. While we believe that an outright ratings downgrade is unlikely before the October general election, there will be significant pressure on the next government to stem the deteriorating trend or risk further ratings action.

Table: FISCAL POLICY

Monetary Policy

BCB To Shift From Tightening To Easing By End-2014

With growth set to remain relatively weak this year, we believe that the Banco Central do Brasil (BCB) will keen to begin easing monetary policy in late 2014 once price pressures begin to moderate.

Table: MONETARY POLICY

Regional Sovereign Risk Ratings

Credit Deterioration Has Largely Run Its Course

The deterioration in the credit profile of Latin American and Caribbean sovereigns seen over the course of 2013 has largely come as far as it will go after a substantial re-pricing of credit risk in the region.

Table: Sovereign Risk Ratings – Evolution Of Ability To Pay

Table: Sovereign Risk Ratings – Evolution Of Willingness To Pay

CHAPTER 3:10-YEAR FORECAST

The Brazilian Economy To 2023

Days Of Easy Growth Are Gone

Although substantial mineral wealth and one of Latin America's largest consumer bases will keep investor interest rooted in Brazil over the long term, the next 10 years will not be easy for the economy. Indeed, the consumer story is set for a period of slower growth in the medium term while infrastructure bottlenecks and a substantial tax burden are likely to continue weighing on the country's business environment.

Table: Long-Term Macroeconomic Forecasts

CHAPTER 4: BUSINESS ENVIRONMENT

CHAPTER 5: KEY SECTORS

CHAPTER 6: BMI GLOBAL ASSUMPTIONS

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