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Brazil Business Forecast Report Q3 2014

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Abstracts

Core Views

With persistent currency weakness and rising interest rates set to temper private consumption growth, and fixed investment to receive only a moderate boost from the June 2014 FIFA World Cup and final year of the PAC II growth acceleration programme, we expect Brazil's economic recovery to falter this year. Indeed, we forecast real GDP growth of 2.0% in 2014, down from 2.3% in 2013.

Elevated inflation will keep interest rates high in the coming months, and we forecast one more rate hike to 11.25% before the central bank pauses. However, we maintain our view that the bank will switch focus from reining in inflation to stimulating growth by year-end, in line with our end-2014 Selic rate forecast of 10.75%.

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.

With President Dilma Rousseff the candidate best positioned to win the October 2014 presidential election, we anticipate that major reforms are likely to be limited in the coming years, implying a modest reining in of expansionary fiscal policy and a continued piecemeal approach to improving the outlook for state-owned oil company Petrobras.

Major Forecast Changes

We have downgraded our 2014 real GDP growth forecast from 2.4% to 2.0%, as the potential for a more significant increase in interest rates than we initially anticipated, as well as persistent currency weakness will temper real private consumption growth this

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year. A continuation of the Banco Central do Brasil's aggressive monetary tightening cycle saw us upgrade our short-term Selic rate target to 11.25%, implying 25 basis points of hikes from the current level. In light of more significant rate hikes in the short term, we increased our end-2014 interest rate forecast to 10.75%, from 10.50% previously.

Given a very weak start to 2014, and our view that downside pressures on the Brazilian real will persist in the coming months, we have revised our average and end-year exchange rate forecasts to BRL2.400/USD and BRL2.450/USD respectively, from BRL2.350/ USD and BRL2.400/USD previously.

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