# BRAZIL



## RESISTING THE PULL OF A DOWNTURN

**After stagnating in the second half of 2023, economic activity has strengthened in recent months, supported by a surprisingly resilient labor market, amongst other. This good start to the year was however not overtly obvious given the divergence of many indicators. The pace of rate cuts is expected to slow down in the second half of 2024. Monetary easing is indeed coming up against slower-than-expected disinflation and upside risks to inflation expectations. The latter have been dented by the revision of the budgetary targets for 2025-28 and a more pronounced interventionism by the State, anxious to revive investment. The annual G20 summit in November and COP30 next year will provide an opportunity for Brazil to strengthen its leadership of the Global South in support of issues pertaining to the environment, poverty alleviation and redistribution.**

### ECONOMIC PERFORMANCE DEFIES EXPECTATIONS (ONCE AGAIN)

As has been the case over the past three years, activity indicators in the first quarter performed much better than expected: in the wake of its rebound last December, the leading indicator of GDP (IBC-Br) continued to rise in January and February 2024. Meanwhile, PMI surveys for March indicate an expansion in activity both in services and manufacturing. These prints have undermined a scenario anticipating a cooling down of the economy in the wake of stagnating GDP figures in the second half of 2023. The unprecedented dengue fever outbreak that the country is undergoing since the start of the year (more than 3 million cases recorded) has yet to have a significant impact on GDP growth.

Consumption has been the driving force behind the economic recovery, backstopped by higher transfers[1] and the solid performance of employment. The labour market has yet to show signs of slowing down – defying expectations. In seasonally adjusted terms, unemployment retreated slightly in the first quarter, while average income (in real terms) continued to rise (9th consecutive month of increase in February). These favourable developments explain the solid growth in retail sales as well as that of service activities.

The reading of certain indicators did however cast some doubt over the strength of economic activity, considering the declines in industrial production and consumer confidence (in January and February), as well as the relative slowdown in export volumes (+0.9% in Q1 vs. Q4 2023). Besides, there has been no particular uptick in lending (real credit growth has been stable at around 3.5% year-on-year, since September 2023). Meanwhile, the stock market (-15% in dollar terms) and the currency (-7.5% against the dollar) have suffered setbacks – underperforming most other major emerging markets and net oil exporters since the start of the year. In the first two months of the year, the equity market recorded nearly USD 3.6 bn in net capital outflows from non-residents.

**FORECASTS**

| | 2021 | 2022 | 2023 | 2024e | 2025e |
|---|---|---|---|---|---|
| Real GDP growth, % | 5,1 | 3,1 | 2,9 | 2,2 | 2,0 |
| Inflation, CPI, year average, % | 8,3 | 9,3 | 4,6 | 4,1 | 4,1 |
| Fiscal balance / GDP, % | -4,3 | -4,6 | -8,9 | -7,1 | -6,9 |
| Gross public debt / GDP, % | 77 | 72 | 74 | 77 | 80 |
| Current account balance / GDP, % | -2,8 | -2,9 | -1,3 | -0,7 | -1,3 |
| External debt / GDP, % | 42 | 36 | 37 | 42 | 40 |
| Forex reserves, USD bn | 362 | 324 | 355 | 348 | 350 |
| Forex reserves, in months of imports | 14 | 11 | 12 | 13 | 12 |

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

**BRAZIL: CONTRIBUTIONS TO REAL GDP GROWTH (PERCENTAGE POINTS)**

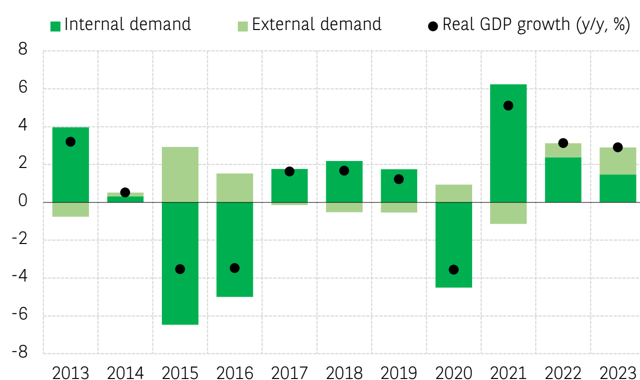


CHART 1 SOURCE: IBGE, BNP PARIBAS

### MULTIFACETED BUDGET SUPPORT

The solid performance of activity in Q1 has led us to revise our GDP growth forecast upwards for this year (2.2% vs. 1.8% previously). The stronger start to the year has in particular been a welcomed development for public accounts (the government recorded a surplus of BRL 5 bn in tax revenues compared to initial forecasts over the first two months of the year). This additional boost is expected to help the government achieve the primary balance target (excluding interest payments) set by the new fiscal framework (zero deficit target in 2024 with a tolerance of 0.25 percentage points of GDP). However, Lula – whose popularity has taken a hit in recent months and who will, later this year face his first electoral test (municipal elections in October)

1 Advanced payments of extra salaries for pensioners and settlement of judicial payment orders owed by government entities to individuals and companies (*precatorios*).

– is keen to further stimulate domestic demand[2]. The Head of State has already announced i/ a new financing program to support microenterprises and microentrepreneurs (*Programa Acredite*), as well as ii/ a subsidy program (*Mover*) for the automotive industry to stimulate, among other things, the national production of electric vehicles (nine car manufacturers have already announced investments of USD 17 bn by 2030). The government is also looking into supporting households with their electricity bills.

Aside from the introduction of a tax on offshore investment funds, the government, however, has struggled to increase revenues for the long haul. Several government initiatives have had a hard time moving forward in Congress or have been suspended until after the elections (e.g. creation of a dividend tax or modification of the income tax). At the end of March, the Ministry of Planning and Budget therefore announced the freezing of BRL 2.9 bn (USD 581 mn) of discretionary spending. The budgetary targets set in the Project for the Annual Budget Law (PLOA) for 2025 have also been revised in order to spread the fiscal effort over time (ie. provide greater room to maneuver in the short term) : amongst the changes put forward, the primary surpluses targeted for 2025 and 2026 (0.5% and 1% of GDP) were adjusted down by 0.5 and 0.75 points of GDP respectively. The target of achieving a 1% surplus was ultimately postponed to 2028.

Given these obstacles, Lula in recent months, has showcased greater levels of interventionism with large groups (Petrobras, Vale, Braskem) in the hope of reviving investment[3]. For example, the government, which owns roughly 37% of Petrobras, tried to spur the oil-giant to waive dividend payments to investors so the company would be better positionned to both invest and absorb the cost associated with a rise in oil prices (to keep prices low at the pump).

## SLOWER THAN EXPECTED RATE CUTS

Despite the cumulative 300 basis point rate cut since August 2023, and the cuts to come this year, monetary policy is likely to remain in restrictive territory[4] – at least as long as private operators' medium-term inflation expectations remain above the BCB's target. The government's ambiguity with regard to its budgetary objectives and Lula's renewed interference in certain large companies are weighing on expectations but also on the currency – which, in addition, has suffered from a strengthening dollar. The weakening of the currency (and its effect on imported inflation), the escalation of geopolitical tensions and their effects on commodity prices, as well as slower monetary easing in advanced economies are constraining the reaction function of the Brazilian monetary authorities. These considerations, in addition to local factors, are slowing down the disinflationary process (e.g. prolonged effect of El Niño on food prices, accelerating inflation in the service sector, persistence of wage pressures and a rate of unemployment below the NAIRU rate[5]).

BRAZIL: POLICY RATE VS. REALIZED AND EXPECTED INFLATION

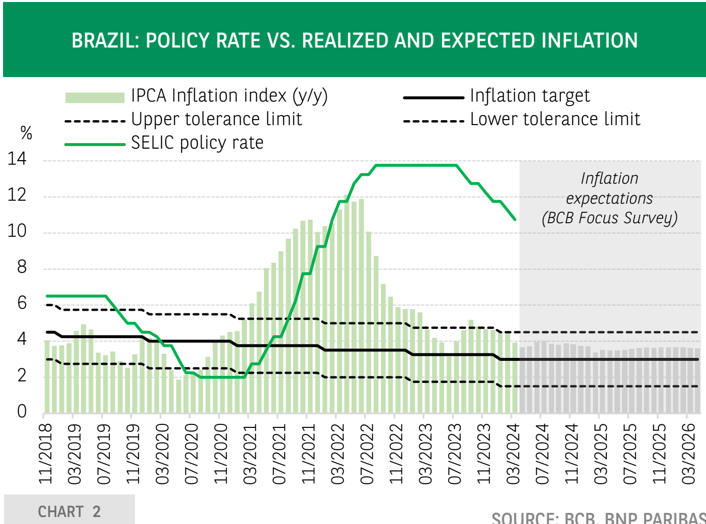


CHART 2 SOURCE: BCB, BNP PARIBAS

In view of this context, and in order to give itself greater room to manoeuvre in the coming months, the BCB has shortened the horizon during which it provides indications on the future direction of its monetary policy (forward guidance). It announced a further half-point cut to the SELIC rate at the next meeting in May, without however vocalizing its position beyond that. Market participants have thereby adjusted their expectations and are now anticipating smaller rate cuts in the second half of the year. The change in the profile of the BCB's monetary policy council (COPOM) at the end of the year (Lula appointing the new governor in particular) should, through its effects on inflation expectations, be another point of vigilance for the markets in H2.

## BRAZIL IN THE SPOTLIGHT

Brazil holds the rotating presidency of the G20 and will hold its annual summit in November 2024 in Rio de Janeiro. A year later, the country will host the UN Climate Change Conference (COP 30) in Belem in the Amazon. In addition to issues surrounding the decarbonization of economies, the main themes likely to occupy the agenda include the fight against poverty and inequality, the reform of international taxation and the representation of the Global South in international financial governance. The formation of a Global Alliance against hunger and poverty as well as the proposal for the introduction of a global tax on the super-rich are amongst some of the initiatives already proposed by the government. In its quest to define the contours of a new, more redistributive globalization, Brazil will have the daunting task of building consensus in a context of growing geopolitical divergences.

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2 Especially since the contribution of external demand to GDP growth is expected to be much more modest this year, perhaps even negative after having been responsible for half of the GDP growth in 2023.
3 In 2023, investment recorded a negative contribution to growth of 0.6 percentage points and the investment-to-GDP ratio reached the same level as during the Covid-19 pandemic in 2020 (16.5%).
4 The ex-ante real rate (nominal interest rate minus expected inflation for the next 12 months) remains a few points higher than the neutral rate (rate compatible with an economy at equilibrium) estimated between 4.1% and 5.5% according to a study by the BCB.
5 The realized unemployment rate (7.7% in February) is about one percentage point below the *non-accelerating inflation rate of unemployment (NAIRU)* which most economists estimate to be in the range of 8.5% to 9.5%.