Economic Update Brazil

11 March 2013

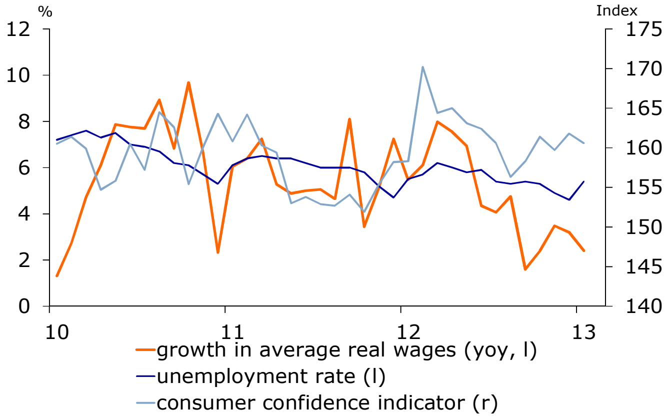
A very disappointing year

Year-on-year change (%)	'11	'12	'13
Gross Domestic Product	2.7	0.9	3.0
Private consumption	4.1	3.1	3.3
Government consumption	1.9	3.2	3.3
Investment	4.7	-4.0	3.0
Exports	4.5	0.5	1.8
Imports	9.7	0.2	6.0
Inflation	6.6	5.4	5.7
Unemployment (%)	6	5.3	5.0
Government budget (%GDP)	-2.6	-2.5	-2.0
Government debt (%GDP)	54.2	58.6	59.0

Source: EIU, IBGE, Rabobank estimates

For the Brazilian economy, 2012 has been a very disappointing year. In the first part of the year, the economy stayed in the state of near-stagnation it had entered in the middle of 2011. The economy recovered in the third and fourth quarters of 2012, but with a q-o-q growth of 0.4% and 0.6% respectively, the recovery was more modest than expected. As a result, GDP growth fell to roughly 0.9%, after the already low 2.7% growth of 2011, which followed the impressive 7.5% growth of 2010. With a 4% contraction, investment was particularly weak in 2012. We expect economic growth to move close to its 3%-3.5% trend rate in 2013.

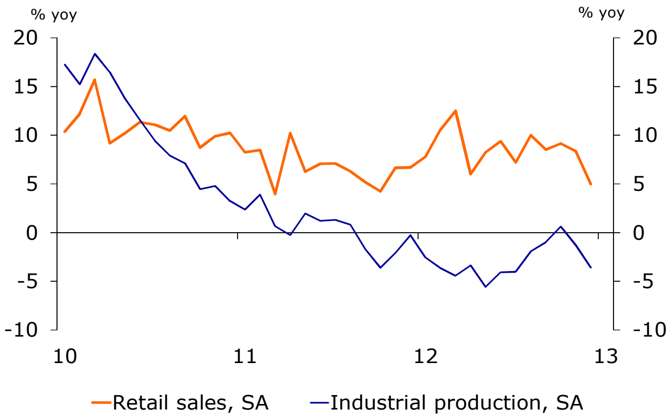
Unemployment remains low



Source: EIU, IBGE

Unemployment has remained very low, despite the low level of economic growth and the fact that the labor market is very tight. The low level of unemployment seems to be driven by two factors. First, some labor intensive sectors, particular within the services sector, have continued to do rather well. Second, there might be labor hoarding. Firms may not dare to fire people, as they fear they will not find new people once the anticipated recovery materializes. In the course of 2012, real wage growth, which had been very high since early 2010, has started to ease. Nevertheless, consumer confidence has remained rather strong.

Industrial sector remains weak



Source: EIU, IBGE

Partially as a result, retail sales continued to be strong during 2012. Meanwhile, industrial production remained weak. While the contraction of the industrial sector seems to have halted in the second half of 2012, the sector so far has not recovered vigorously. Subsectors that benefitted from direct fiscal stimulus have performed relatively well recently, while capital goods producers continued to struggle. However, the January industrial production data are expected to be good. Industry may indeed recover somewhat in 2013 thanks to fiscal stimulus and the depreciation of the real during 2012, but it continues to struggle with high labor costs.

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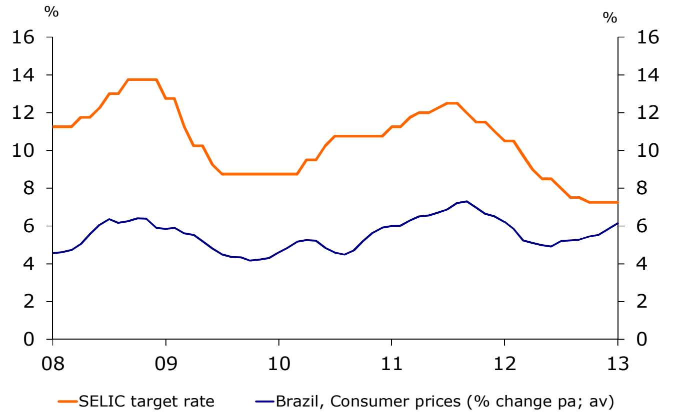
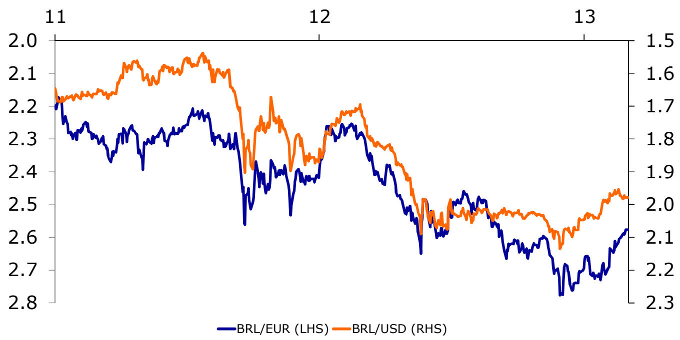
Real interest rates have fallen strongly



Source: EIU, IBGE

Since mid-2011 the central bank has reduced its policy rate by 525 basis points to 7.25%. However, after falling from 6.8% y-o-y in August 2011 to 4.9% in August 2012, inflation picked up to 6.15% in January 2013. Inflation would have been higher had the government not applied a cap on petrol prices. The central bank expects inflation to fall in the course of 2013, thanks to a relatively low increase of the minimum wage and a good harvest. However, with inflation being close to the 6.5% upper bound of the inflation target range, the central bank may tighten policy if inflation turns out to be higher than anticipated in the coming months.

Real has started to appreciate again recently



Source: Ecowin

Recently, some exchange rate volatility has returned and the *real* appreciated below 2 per USD. Investors seem to believe the central bank has become more concerned about inflation and will allow a higher exchange rate. In the first part of 2012, the *real* depreciated rapidly and then stayed flat at an exchange rate against the USD between 2 and 2.1, after Brazil had further tightened its capital controls. In the course of 2012 these controls were eased. Although the central bank now focuses more on inflation, Brazil may reinforce its efforts in the "currency wars" and tighten the controls again if strong upward pressure on the real would reappear.

The recovery is likely to gain momentum

Source: EIU, Rabobank estimates

So far the recovery of the Brazilian economy has been weak. However, in recent months some positive developments became visible. Firstly, after four quarters of contraction, in q-o-q terms investment grew by 0.5% in the fourth quarter of 2012. Meanwhile, the PMI for manufacturing was above 50 points in for the fifth month in a row in February 2013. Furthermore, monetary and fiscal stimulus implemented in 2012 and infrastructure and the 2014 football WC programs may boost investment in 2013. As a result, we expect growth to come in between 2% and 4%. However, growth in 2013 might be affected by problems in the energy sector.

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