Brazil's Macroeconomic Performance: Q1 2018 GDP and Current Monthly Indicators

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Overview

GDP rose 1.2% YoY in Q1 2018, a slowdown from the 2.1% YoY expansion registered in Q4 2017.

Consumption registered its fourth consecutive expansion in Q1 2018 (2.0% YoY), the largest expansion since Q1 2014. This was mainly driven by household consumption (2.8% YoY). The good performance of household consumption was influenced, among other factors by low inflation and low interest rates.

Gross Fixed Capital Formation (GFCF) grew 3.5% YoY in Q1 2018, slightly lower than in the previous quarter (3.8% YoY). This was driven in part by lower interest rates.

Brazil's inflation rate in May 2018 stood at 2.9% YoY. The falling prices of food continue to be the main driver of inflation and inflationary pressures remained subdued.

During the last meeting in June 2018, the Central Bank decided for the second consecutive month to keep the interest rate (SELIC-monetary policy rate) unchanged at 6.5%.

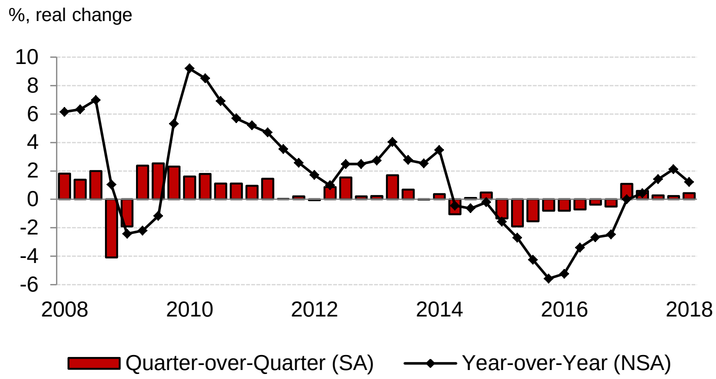
For 2018, it is expected that Brazil's GDP growth will accelerate in comparison to 2017. Household consumption will contribute the most to the economic expansion. The continued low inflation is expected to positively influence household consumption. However, the uncertainty from the presidential elections and more challenging financial markets, especially for emerging economies (the normalization of interest rates in the US have led to a decrease interest in investments in emerging economies), could weigh on Brazil's GDP.

1. GDP

GDP rose 1.2% YoY in Q1 2018, a slowdown from the 2.1% YoY expansion registered in Q4 2017 (Figure 1).

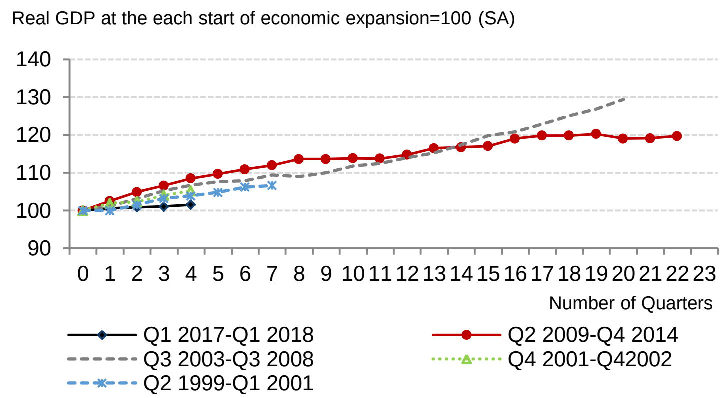
Data confirms that despite the ongoing economic recovery from Brazil's worst recession, this recovery is on weak footing. Post-recession GDP growth continues to be the slowest of any recovery period since 1999 (Figure 2).

Figure 1: GDP Growth



Source: Instituto Brasileiro de Geografia e Estatistica (IBGE), MUFG

Figure 2: Economic Expansion since 1999



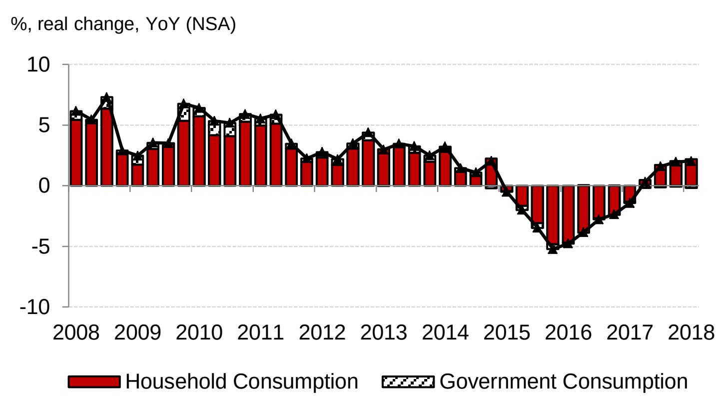
Source: IBGE, MUFG

Consumption

Consumption registered its fourth consecutive expansion in Q1 2018 (2.0% YoY), the largest expansion since Q1 2014. This was mainly driven by household consumption (2.8% YoY) (Figure 3).

The good performance of household consumption was influenced, among other factors by low inflation and low interest rates.

Figure 3: Consumption

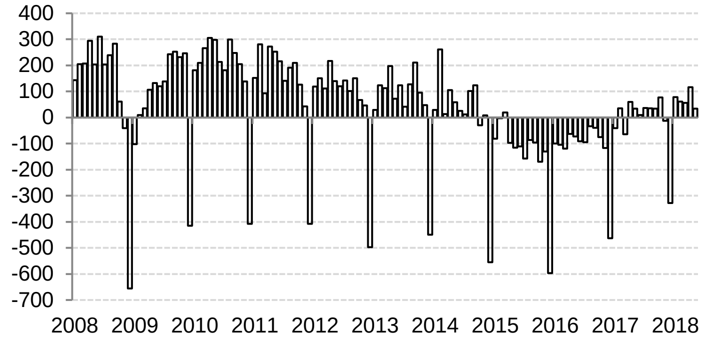


Source: IBGE, DataStream, MUFG

The labor market continued to be weak. On the one hand, the unemployment rate continues to be high (12.7% on average from March to May). On the other hand, although net job creation is improving, the average of net formal job creation during the first five months of 2018 is less than the average registered in 2010-2014 (same period) (Figure 4).

Figure 4: Net Formal Job Creation

Thousand of people (NSA)



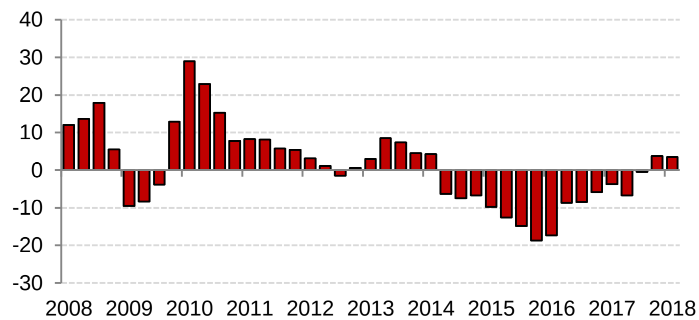
Source: IBGE, Ministry of Labor and Employment, MUFG

Investment

Gross Fixed Capital Formation (GFCF) grew 3.5% YoY in Q1 2018, slightly lower than in the previous quarter (3.8% YoY) (Figure 5). This was driven in part by lower interest rates.

Figure 5: Gross Fixed Capital Formation

%, real change, YoY (NSA)

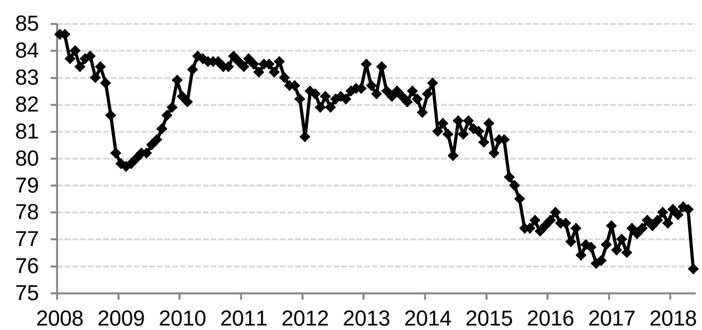


Source: IBGE, DataStream, MUFG

Although the Brazilian economy continues to operate with high levels of slack in manufacturing capacity utilization, the variable has been trending upward since the end of 2016 (Figure 6). In May 2018, the capacity utilization rate in the manufacturing sector dropped to 75.9%, probably a temporary effect caused by the truckers' strike[1].

Figure 6: Capacity Utilization Rate (Manufacturing)

% (SA)



Source: Brazilian National Confederation of Industry (CNI), MUFG

[1] Please see Box at the end of the document for more details.

Exports and Imports[2]

Exports of goods increased 8.7% YoY in Q1 2018, a deceleration from the previous quarter (Figure 7). The reason for this was lower agricultural production in Q1 2018, when compared to the record agricultural harvest registered in same period in 2017. In contrast, manufactured exports experienced a 21.2% YoY increase during Q1 2018 as a result of an increase in exports of vehicles.

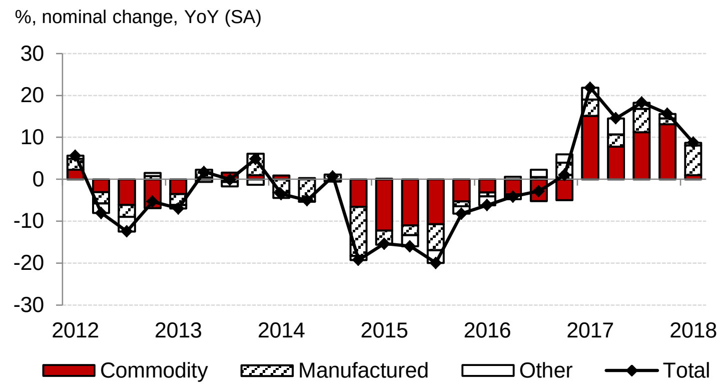
Imports of goods increased in Q1 2018 (19.1% YoY) (Figure 8). This expansion was driven by the imports of capital and intermediate goods. This is in line with the results of investment during Q1 2018.

In general terms, the increase of exports is aligned with a scenario of relatively good economic growth for some of Brazil's trading partners, and the growth of imports is influenced by stronger domestic demand as compared to last year.

2. Inflation and Monetary Policy

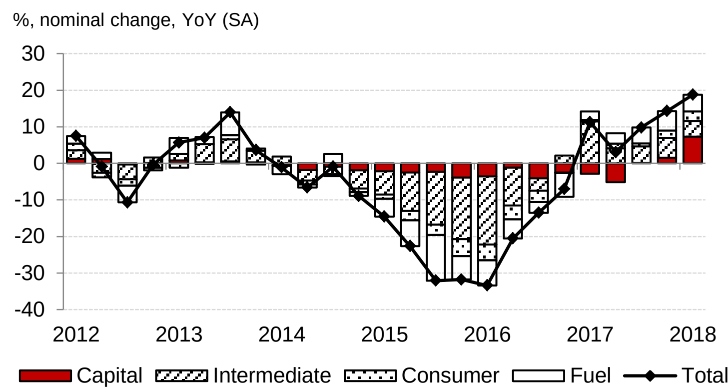
Brazil's inflation rate in May 2018 stood at 2.9% YoY (Figure 9), just below the lower band of the Central Bank's inflation target (4.5% plus or minus 1.5% points) and slightly higher than in the previous month (2.8% YoY). The falling prices of food continue to be the main driver of inflation and inflationary pressures remained subdued. Core inflation remained below the target rate.

Figure 7: Exports of Goods



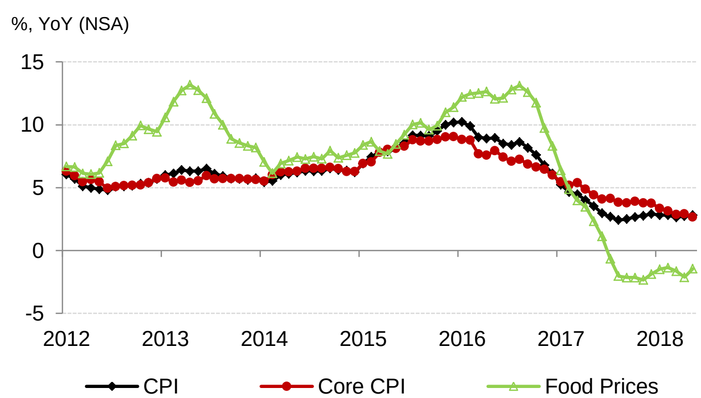
Note: 'Other' includes semi-manufactured goods and other goods.
Data was seasonally adjusted using Census X-13, DataStream.
Source: Ministry of Development, Industry and Foreign Trade, DataStream, MUFG

Figure 8: Imports of Goods



Note: Data was seasonally adjusted using Census X-13, DataStream.
Source: Ministry of Development, Industry and Foreign Trade, DataStream, MUFG

Figure 9: Inflation



Source: IBGE, Central Bank of Brazil, MUFG

[2] This section is reporting nominal values.

In addition to the trucker strike's potential upward impact on inflation[3] (although this impact is expected to be transitory), the depreciation of the currency could put some additional inflationary pressures on the economy.

During the last meeting in June 2018, the Central Bank decided for the second consecutive month to keep the interest rate (SELIC-monetary policy rate) unchanged at 6.5%. The Central Bank stated that although inflation will have temporary upward pressures as a result of the trucker's strike, inflation is likely to remain low and inflation expectations continue to be well anchored. Therefore, if current economic conditions continue, it is expected that the interest rate will remain unchanged throughout 2018.

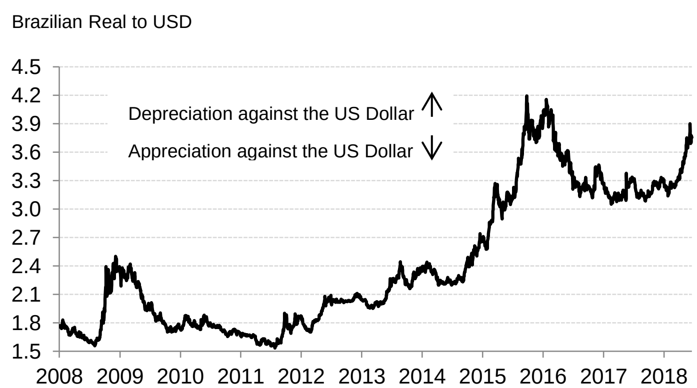
3. Exchange Rate

Brazil has experienced the second highest rate of currency depreciation (16.6%) in Latin America through the first six months of 2018 (Figure 10).

The political uncertainty of the presidential elections and rate hikes by the Federal Reserve of the US are factors that could cause the Brazilian Real to depreciate further.

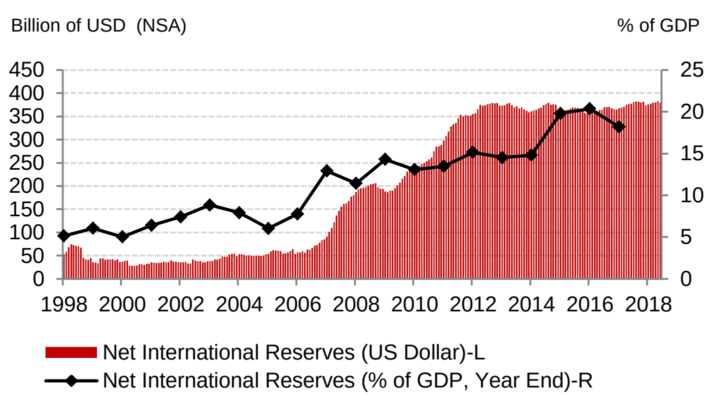
It is expected that the sharp decline of the exchange rate will not continue. The main reasons for this are the following. 1) The Central Bank interventions in the foreign exchange market seem to be controlling the pace of the depreciation; 2) Net international reserves stood at 18.2% of GDP in 2017, although lower than in 2016, they are still higher than the average of the last 20 years (10.8%) (Figure 11); and 3) In the 12-month period through March 2018, the current account balance showed a moderate deficit of 0.5% of GDP[4] (Figure 12), a position that is not likely to put additional pressure on the currency.

Figure 10: Exchange Rate



Source: DataStream, MUFG

Figure 11: Net International Reserves

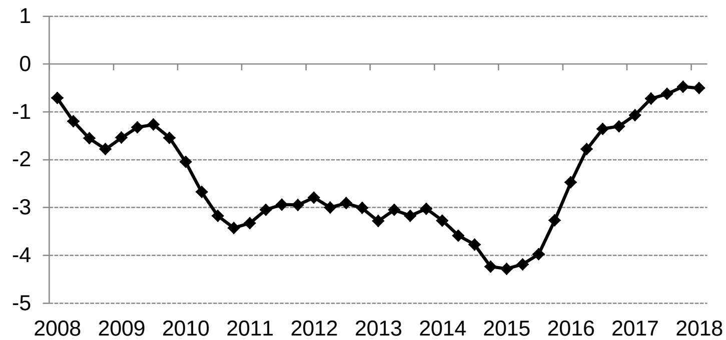


Source: Central Bank of Brazil, International Monetary Fund, MUFG

[3] Please see Box at the end of the document for more details.
[4] This number corresponds to the sum of the last 12 months of the current account balance divided by GDP. Nominal GDP in Brazilian Real was converted to US Dollars using the average of exchange rate of the corresponding period.

Figure 12: Current Account Balance

12-month accumulated, % of GDP



Source: Central Bank of Brazil, MUFG

4. Outlook

For 2018, it is expected that Brazil's GDP growth will accelerate in comparison to 2017. Household consumption will contribute the most to the economic expansion. The continued low inflation is expected to positively influence household consumption. However, the uncertainty from the presidential elections and more challenging financial markets, especially for emerging economies (the normalization of interest rates in the US have led to a decrease interest in investments in emerging economies), could weigh on Brazil's GDP.

Box: The impact of truck drivers' strike on the economy

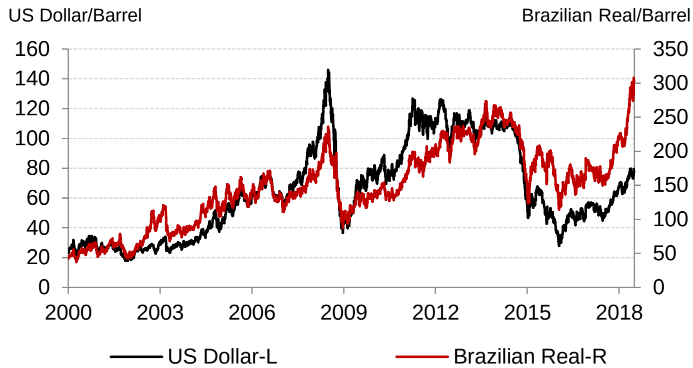
On May 21st, truck drivers started a strike due to the high price of diesel. Diesel prices have increased due to oil prices increasing and the depreciation of the Brazilian Real (Figure 13).

The automotive industry which accounts for around one-fifth of total industrial production was one of the sectors affected. Vehicle production contracted 15.3% YoY in May 2018 (Figure 14).

Prices were also affected (Figure 15). The mid-month consumer price index increased to 1.1% MoM in June 2018 from 0.1% in May 2018. Food and transport prices were the most affected by the strike. Food prices were affected because the strike prevented many food items from reaching the market.

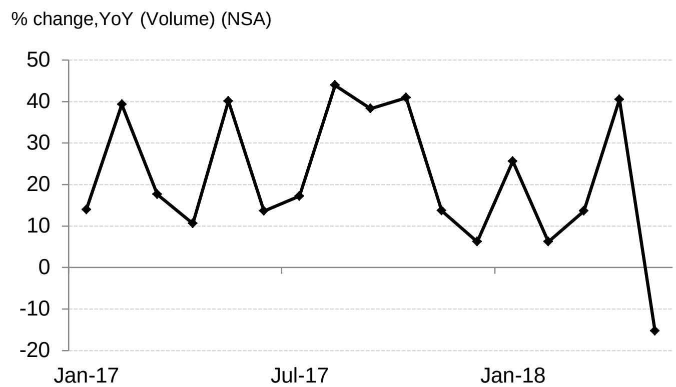
In order to end the strike the government agreed among other measures[5] to cut diesel prices by 0.46 Brazilian Reals per liter (a 12.8% reduction) and to freeze this lower price for 60 days, after which the government would adjust the price once per month[6]. The impact from the strike is expected to be transitory.

Figure 13: Brent Oil Prices



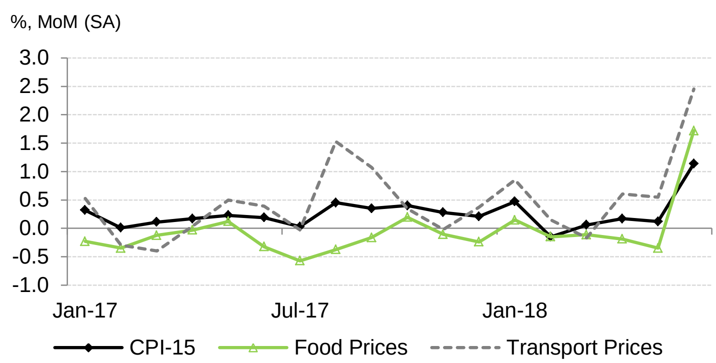
Source: Bloomberg, MUFG

Figure 14: Vehicle Production



Source: National Association of Vehicles Producer (ANFAVEA), MUFG

Figure 15: Inflation



Note: CPI-15 (IPCA-15 as the government presented in Portuguese) shows the CPI from the 16th of the previous month to the 15th of the reference month. Data was seasonally adjusted using Census X-13, DataStream.
Source: IBGE, DataStream, MUFG

[5] The government also announced the establishment of a minimum freight rate for the truckers on all government associated contracts and a toll exemption for empty trucks on federal, state and municipal highways.

[6] Before the prices were adjusted on a daily basis.