Brazil

Outlook

	Average 10-14	2015	2016	2017	2018	2019	Forecasts		
							2020	2021	2022
Growth in GDP (%)	3.4	-3.5	-3.3	1.3	1.3	1.1	-5.0	3.0	2.5
CPI inflation (%)*	5.9	9.0	8.8	3.5	3.7	3.7	2.8	3.2	3.7
Fiscal balance (% of GDP)	-3.2	-10.2	-8.9	-7.8	-7.1	-5.9	-18.0	-9.2	-6.9
Public debt (% of GDP)	52.9	65.5	69.8	73.7	76.5	75.8	97.9	102.2	101.7
Reference rate (%)*	9.9	13.5	14.2	10.2	6.6	6.0	2.9	2.5	3.0
Exchange rate (BRL/USD)*	2.0	3.3	3.5	3.2	3.7	3.9	5.2	4.9	4.5
Current account balance (% of GDP)	-3.5	-3.0	-1.3	-0.7	-2.2	-2.8	-0.4	-1.3	-1.6
External debt (% of GDP)	18.1	33.5	27.7	25.9	29.8	31.2	39.6	39.2	37.4

Note: * Annual average.
Source: CaixaBank Research, based on data from Thomson Reuters Datastream.

- Although Brazil has one of the highest rates of COVID-19 in the world, **the economic shock has been relatively modest compared to other emerging countries.** This is due to a combination of the health strategy, which could be described as more lax than in other economies, and an aggressive fiscal policy, focused on supporting households. However, looking to the future, it is difficult to imagine that the fiscal stimulus can continue without jeopardising **public finances, which were already in a delicate situation before the crisis**. Nevertheless, the way in which it has handled the pandemic has aided the political consolidation of the current government and reduced the governance risks that were a cause for concern a few months ago, at least from a short-term perspective.

- **COVID-19 economic shock and health strategy.** Although there are numerous coexisting levels of government in the country that are acting differently in the fight against COVID-19, overall the lockdown strategy has been among the most lax in Latin America. As a result, the numbers of infections and deaths have also been markedly worse than in other, more restrictive countries. Consequently, GDP fell by 9.7% quarter-on-quarter in Q2 2020 (–11.4% year-on-year). The lifting of restrictions on mobility and, in particular, the effects of the economic policy (see the following point) are likely to enable a significant upswing in activity in Q3.

- **Economic policy response**

  - **Monetary policy.** The Central Bank has increased the monetary easing that it had begun before the pandemic (in July 2019), so the reference rate stands at 2% (450 b.p. total reduction during the easing phase). Additionally, in a major regulatory shift, the Central Bank has been given the power to purchase assets, paving the way to implement the unconventional monetary policy that is already common in advanced central banks. However, it is yet to seize on this opportunity. This expansionary monetary policy has been facilitated by the fact that, unlike in previous crises, on this occasion Brazil is facing the situation with reasonably subdued inflation expectations. Therefore, despite the significant depreciation of the real partly impacting on inflation due to the price of imported goods, any rise in the CPI will remain at moderate levels throughout 2020 and 2021.

Closing date of this edition: 20 November 2020

Outlook (continuation)

› **Fiscal policy.** At the end of March, the declaration of the "state of calamity" paved the way for the adoption of fiscal stimulus measures that were equivalent to 18% of GDP (the IMF estimates that it is one of the largest anti-COVID-19 fiscal stimulus packages in the G-20). The bulk of the stimulus has taken the form of household income transfers, making it possible to support private consumption (unlike investment, which has plummeted and has a rather negative outlook).

- **Sovereign debt outlook**. As a result of fiscal expansion, the primary deficit is expected to exceed 12% of GDP in 2020 (–0.9% in 2019). To avoid overly increasing a pubic debt stock that was already high before the crisis (75.8% in 2019), the public deficit has been financed by resorting to using Treasury deposits in the Central Bank (which in turn have been sterilised by placing more bonds on the market through repo operations). This is a temporary solution and, in fact, the public debt outlook in 2021 is a cause concern when there is no certainty that fiscal revenues will rise significantly, while pressure on expenditure will continue to be high (public debt is expected to exceed 100% of GDP in 2020 and this will not fall in the medium-term). Consequently, clear and credible post-pandemic fiscal consolidation plans are essential.

- **Exchange rate trajectory**. The Brazilian real has been highly volatile throughout 2020 due to uncertainty about the impact of the pandemic and its fiscal repercussions and the slowdown of the global economy. In the medium-term, a modest appreciation of the currency is to be expected, although this is highly dependent on the fiscal situation not deteriorating significantly.

Main risks

The balance of risks is clearly skewed to the downside. In particular, these risks take several different forms:

- **Macro-financial risk.** If investors are not offered a convincing fiscal consolidation strategy, once the exceptional period of shock starts to subside, the risk of an increase in risk premiums and a hypothetical decline in credit quality will be significant. However, it is worth remembering that the country has certain strengths in the event of increased financial volatility: a high volume of international reserves (covering 2.5 times the external debt), a reasonably strong banking sector and a low proportion of public debt denominated in foreign currencies.
- **Political risk.** The municipal elections that are being held at the time of writing this Country Outlook will provide a good insight into whether the public support that has been given within the context of the pandemic (largely due to the increase in social transfers) translates in political terms, possibly being indicative of the Bolsonaro government's electoral expectations for the presidential elections (which will be held in October 2022). The President will need support to move forward with his socially conservative agenda and avoid any risk of impeachment, which first emerged at the start of 2020 in the midst of Bolsonaro's confrontational rhetoric against the Congress and the Supreme Court. These risks may resurface when his political rivals seek to undermine his push for re-election in October 2022.

	Rating	Last changed	Outlook	Last changed
STANDARD & POOR'S	BB-	11/01/18	Stable	06/04/20
Moody's	Ba2	24/02/16	Stable	09/04/18
FitchRatings	BB-	23/02/18	Negative	06/05/20

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".