Emerging Insight

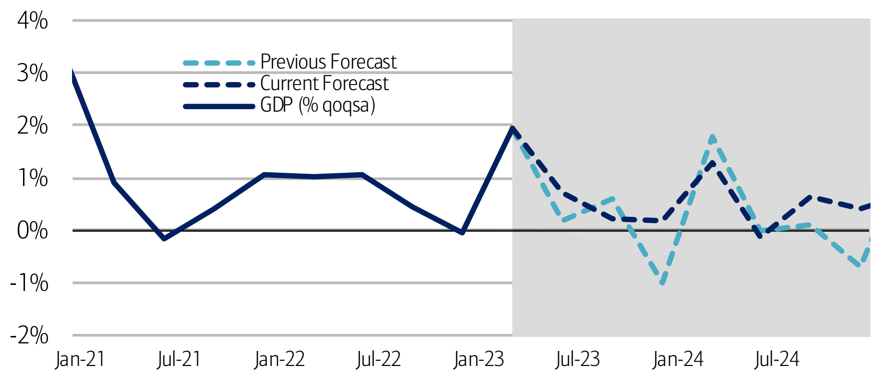
Brazil – We are upgrading our GDP forecasts

Key takeaways

- We revise up our GDP growth forecast to 3.0% (from 2.3%) for 2023, and to 2.2% (from 1.8%) for 2024.
- After a strong carry of 1Q23 GDP and above expected data in the 2Q, we expect higher growth for Brazil
- In 2024, lower interest rates, higher investments and lower than expected unemployment should favor growth.

By David Beker and Natacha Perez

Exhibit 1: We upgrade our GDP growth forecasts for 2023 and 2024
We now expect 3.0% yoy for 2023, and 2.2% yoy for 2024



Source: IBGE, BofA Global Research

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Brazil in Focus

Stars aligning for better growth

We revise up our GDP growth forecast to 3.0% yoy for '23 (from 2.3% before) following recent data. The strong 1Q23 GDP, as well as recent activity releases, surprised to the upside. This year's growth revision is driven by stronger net exports and less negative investment expectations. Although we have barely changed our view on private consumption, the strength of the labor market continued to surprise us to the positive side. Such resilience has been supported by the shift in consumer preferences towards services since pandemics (mirrored in sectoral employment at the highest contribution level in the series, except for 2Q21) and by the (still) low participation rate in the labor market.

Overall confidence levels have been trending up in the past months, influenced by a decline in uncertainty regarding fiscal accounts and the monetary policy framework. The improve in sentiment should boost consumption next year (partially offset by larger imports). Therefore, we upgrade our 2024 GDP growth expectation as well to 2.2% (from 1.8% previously.

Surprise, surprise

GDP growth in 1Q23 surprised market participants to the upside, with a 1.9% qoqsa increase, beating median expectation of 0.5% marginal gain. At the time, the strong print was attributed to the record soybean crop (supply), as agricultural output represented 80% of the quarter result. However, looking deeper into the demand side of GDP, we got to a 0.4%qoq sa contraction of domestic demand, accompanied by a significant increase in inventories, which led us to expect a stalled economy in the following quarters. (For more, see: Brazil Watch: Bad breakdown of 1Q GDP, despite upward surprise.)

Contrary to our expectations, the economic activity remained resilient in 2Q23 amid a higher than expected growth in the developed world. The high level of interest rates did not constrain private consumption, likely due to higher government transfers. The appreciation of the currency stimulated imports, notably of capital goods, and we believe investments partially offset 1Q23 marginal contraction. Domestic demand likely increased 0.6%qoqsa in 2Q23, compensating 1Q contraction. From the supply side, although agriculture should post a negative reading, industry should move sideways while real revenue from services should accelerate at the margin. All in, 2Q23 GDP growth (scheduled to be released on September 1st) should decelerate from 1Q, but should increase 0.8% qoqsa with a better composition.

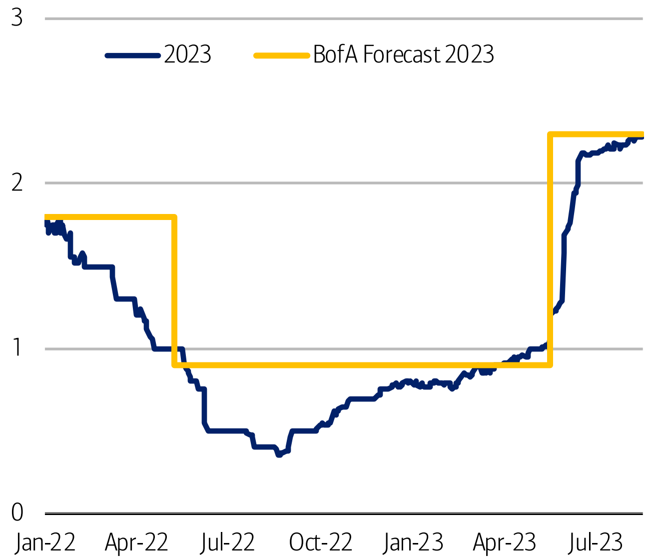
Remaining more optimistic than consensus

Market participants expectation converged to our 2.3% growth forecast. Now we are moving our forecasts up again. The Brazilian Central Bank started the easing cycle in August (Brazil Watch: The holding days are over: BCB cuts 50bp), after inflation and inflation expectations moved down. Indeed, lower prices and unemployment contribute to a better sentiment among consumers, while the progress in the economic agenda in Congress (and consequent decline in uncertainty) is supportive for confidence increase among businessmen. Government initiatives were another component supporting sentiment, for instance the debt renegotiation program (Desenrola) and discounts on new vehicles.

As mentioned earlier, participation rate remains at low levels – counterfactual unemployment rate (with the participation rate at the same level as before pandemics) is running roughly 3p.p. above official rate of 8.0%, as of June 2023. After seasonal adjustment, unemployment rate fell from 8.5% in March 2023 to 7.9% in June. However, unlike what occurred in 1Q23, the improvement in Apr-Jun period was motivated by an increase in occupied population, that was previously outside the labor force, though withing working age. That means that not only employment levels improved, but they did so without pressuring the real wage bill – a dream for every policy maker. The *Desenrola* program is expected to reduce the delinquency rates, at the same time it can bring indebtedness levels down from record highs. This combination is behind the significant improvement in consumer confidence and supports a positive scenario for households ahead.

Looking ahead, as the easing cycle moves forward, the vote of confidence of rating agencies when upgrading Brazil's credit score and the upcoming green bond issuance by the government are positive drivers of investment growth in the medium-term. Still looking into demand, net exports contribution to growth was revised to the upside to account for the positive crop yield in 2023.

Exhibit 2: We continue more optimistic on growth than median market
BofA growth expectations compared to BCB Focus survey (market readout)



Source: BCB, Global Research

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Exhibit 3: Confidence levels trending up
Monthly confidence indices

Source: Fundação Getúlio Vargas (FGV)

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We also upgrade next year's growth expectation

Brazil´s decision to cut rates ahead of the rest of the world should bring positive results for growth in 2024. Higher investments and consumption are expected to be driven by continued interest rate reduction, leaving a more favorable background for growth; as well as better credit market conditions, due to lower costs. Default reduction programs should also increase loan concessions.

Meanwhile, progress in key bills – mainly the Tax Reform and new fiscal framework - may lead to capital inflows, amid a better outlook assessment for the country. Government consumption will also likely increase, as we normally see higher public expenditures in municipal election years. For exports, forecasts of a global activity acceleration and a depreciated BRL are expected to positively impact the trade balance.

Exhibit 4: GDP breakdown forecasts updated
We now expect a stronger activity for 2023 and 2024

		2023F		2024F		2025F	
Brazil	**2022**	**Old**	**New**	**Old**	**New**	**Old**	**New**
Real GDP growth (% yoy)	2.9	2.3	3.0	1.8	2.2	2.5	2.5
Real private consumption growth (% yoy)	4.3	2.4	2.4	1.4	2.7	2.1	2.8
Real government consumption growth (% yoy)	1.5	1.1	1.2	0.3	1.5	1.8	1.1
Real investment growth (% yoy)	0.9	-3.9	-2.2	-1.0	-0.2	1.5	4.0
Real export growth (% yoy)	5.5	3.1	10.6	2.7	2.2	3.5	0.4
Real import growth (% yoy)	0.8	-3.9	2.2	-0.2	0.9	0.8	1.4

Source: BofA Global Research, IBGE

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News and Views

Brazil: Brazil: Current Account and FDI again below expectations

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According to the Brazilian Central Bank's (BCB), current account (CA) posted a US$3.61bn deficit in July (from a US$1.3bn deficit in June, revised from -US$0.84bn). The result was below market expectations of a US$3.9bn deficit. In 12-month accumulated terms, current account deficit reached to 51.1bn in July (from US$52.7bn in June). Trade balance remains at high level with a US$7.2 surplus (from US$8.3 in June), while services balance registered a deficit of US$3.2bn (from -US$3.6bn) and income balance deficit was US$7.7bn (from -US$6.0bn).

Foreign Direct Investment (FDI) accelerated to US$4.2bn in July from US$1.9bn previously, but was below expectations of US$6.0bn inflows. Net flows of intercompany loans returned to positive territory, at US$0.7bn (from -US$1.8bn). Also, capital holdings and international reserves moved up, going to US$3.5bn in July (from US$3.7bn in June) and to US$345.5bn (from US$343.6bn), respectively. 12 months accumulated FDI totaled US$71.7bn (from US$74.6bn).

- **To follow:** Our preliminary forecast for August is a current account deficit of US$3.4bn and FDI of US$11.2bn, pushed by high commodities exports and Brazil's positive outlook for investments. For YE23, we maintain our forecasts of a US$48bn Current Account deficit and US$80bn FDI.

Brazil: Brazil: Mid-August IPCA inflation surprised to the upside

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IPCA registered 0.28% mom increase in mid-August (from -0.07% mom in mid-July), according to the Brazilian Institute of Geography and Statistics (IBGE). The print was above our and market expectations of 0.19% mom and 0.16% mom, respectively. Annual inflation accelerated to 4.24% yoy in August (from 3.19% yoy in July), still within the upper bound of inflation target (3.25% + 1.5%). The monthly result was mainly driven by an increase in the prices of electricity bills, due to the end of the Itaipú bonus, pressuring Housing costs. Seasonality also contributed to the print, with mid-year tuition adjustments pushing the Education costs up.

- **To follow:** Given the expected acceleration in underlying measures of inflation and recent upside surprises to inflation, such as the increase on fuel prices, we see upside risks to our YE23 IPCA forecast of 4.8%, though we continue to expect inflation to decelerate to 3.7% in 2024.

Mexico: Banxico minutes portray a unanimously hawkish board

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Banxico minutes are out. All five board members are hawkish, which is unusual. All of them are still worried about the inflation outlook and agree that the policy rate will be at the current level for an extended period of time. Many said that it is unlikely that there are cuts this year and that other CBs cutting is not a reference for Banxico. One board member, probably Espinosa, said that there are two risk factors for monetary policy: 1) low investment for years and low productivity may have reduced potential growth in Mexico, and 2) Pemex's finances are a risk for public finances, financial stability, and MXN. Another board member mentioned that the level of MXN is not an objective of monetary policy. One more underscored the role of the tightening of monetary conditions on the achoring of inflation expectations.

- **To follow**: All-in-all hawkish minutes, in line with our view that Banxico will remain on hold for a long period. We have the first cut in June 2024. The comment on Pemex is unusual (although it has happened in the past) but could become more relevant given the current government's stance on giving financial aid to the state-owned enterprise.

Mexico: Headline inflation decelerates to 4.67% yoy in 1H August

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Biweekly headline inflation in 1H August was slightly above expectations at 0.32% (E. 0.31%, BofA 0.30%). Core inflation was below expectations at 0.19% (E. 0.22%, BofA 0.22%). The downside surprise in core inflation is mostly explained by lower-than-expected food inflation at 0.08% (soda) and non-food merchandise inflation at 0.26% (softener), although education inflation surprised with an all-time high print at 1.4%. There was an upside surprise in non-core inflation explained by higher-than-expected energy inflation at 1.14% (LP gas). In annual terms, headline inflation is now at 4.67% from 4.78% yoy while core inflation is now at 6.21% from 6.52% yoy a fortnight ago.

- **To follow:** Outside from education the print was a good one as inflation keeps falling. But core inflation remains high and services inflation is not clearly trending down yet. The high print for inflation in education will likely worry Banxico. We continue to expect Banxico to remain on hold for many months (we have the first cut in June 2024).

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