

Economic Prospects for Brazil over the Next Decade

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Introduction

This 'Brazil in Focus' Policy Brief follows the publication of Development Viewpoints #84 and #85, both of which focused on the evolution of macroeconomic policies during the Workers Party administrations of Luís Inácio Lula da Silva and Dilma Rousseff (2003-2014).

Those Development Viewpoints assessed the record of these administrations in implementing progressive macroeconomic policies, particularly in contrast to the tight monetary policies advanced by the Brazilian Central Bank.

However, during the start of Dilma Rousseff's second administration in 2015, the economy of Brazil has begun to experience a recession, the government is facing a larger fiscal deficit, and the deficit on the country's current account is widening. Many people are now asking whether economic conditions in Brazil will continue to worsen.

In response to these concerns, we employ the CAM global macroeconomic model to project Brazil's likely economic trends over the next ten years, between 2015 and 2025¹. Given its demand-driven structure and large database of historical trends, the CAM has succeeded in providing, in past research efforts, credible projections of such medium-term trends.

We consider our projection to be a 'baseline' scenario, into which a minimum of assumptions have been introduced. But we do explicitly assume 1) a nominal depreciation in the euro as a result of the ECB's quantitative easing and 2) a slow rise of the real price of oil over the medium term relative to its fall during 2014-15. Both of these assumptions are embedded in our programming.

But, importantly, we do not assume any changes in economic policy by Brazil's government. Thus, its future prospects in this scenario are driven primarily by the momentum of its historical performance and the evolution of global external forces.

¹ See alpha-fss.com/main/services.html; details on the CAM model are available from the authors.

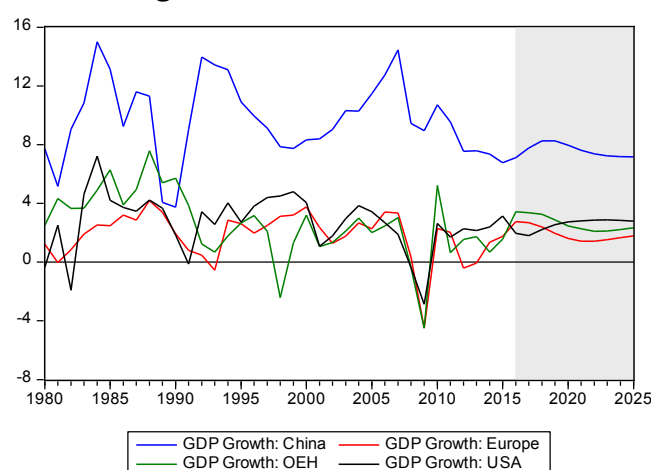
The result is that while Brazil faces a continued risk of recession over the short term, its economic prospects over the medium term look more positive. The baseline scenario projects a return to positive GDP growth by 2017, and a return to GDP growth rates consistent with Brazil's historical average by 2020.

Global Context

We start our overall assessment of Brazil's prospects with a review of trends in the global economy. In doing so, we focus on four major blocs: the USA, Europe, mainland China and the high-income region in East Asia outside mainland China (which is dominated by Japan and the Republic of Korea and is labelled "OEH").

Collectively, these four blocs account for about 70% of world GDP. Thus, their medium-term outlooks will be a major global determinant of the economic prospects of Brazil.

Figure 1: Global GDP Growth (%)



In general, global growth is projected to be subdued over the next ten years (**Figure 1**). It will be lower than the pre-2000 average for each of the four major blocs considered here. Thus, this trend is consistent with the "secular stagnation" thesis recently revived by Lawrence Summers².

² See, for example, Summers, L. 2015. "Demand Side Secular Stagnation." *American Economic Review* 105.5: 60-65.

In addition (and in common with a number of other observers), we do not project a substantial correction of global imbalances over the medium term.

Growth rates in Europe, the USA and OEH are projected to be moderate—close to their post-2000 averages over the medium term. These are slower than the 1980-2000 averages. In particular, China’s growth is projected to slow to about 7% by 2025.

Figure 2: Global Investment (% GDP)

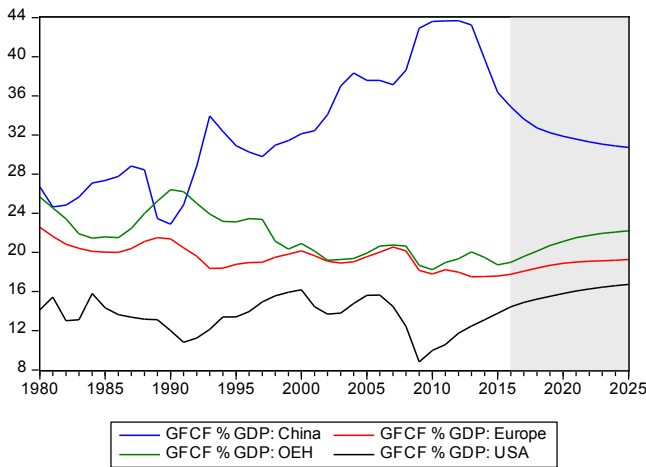


Figure 2 charts projected gross fixed capital formation as a percentage of GDP for the four blocs in our scenario. While investment levels are expected to increase moderately in the USA, Europe and OEH, these increases would represent a subdued response to historically low real interest rates. Meanwhile, there would be a pronounced continuing fall in Chinese investment (but from a relatively high peak in 2010).

Figure 3: Global Current Accounts (% GDP)

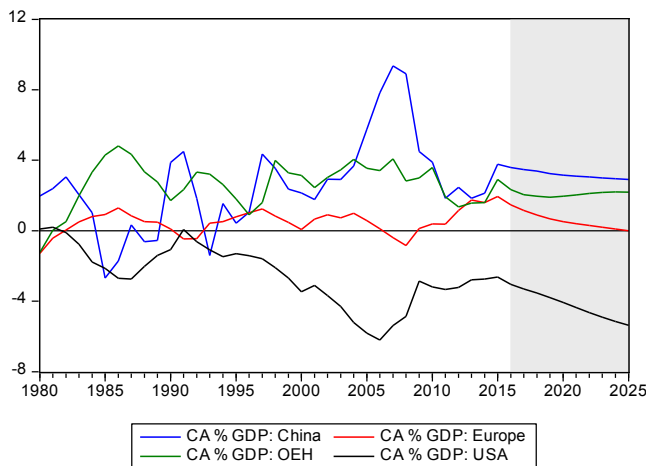
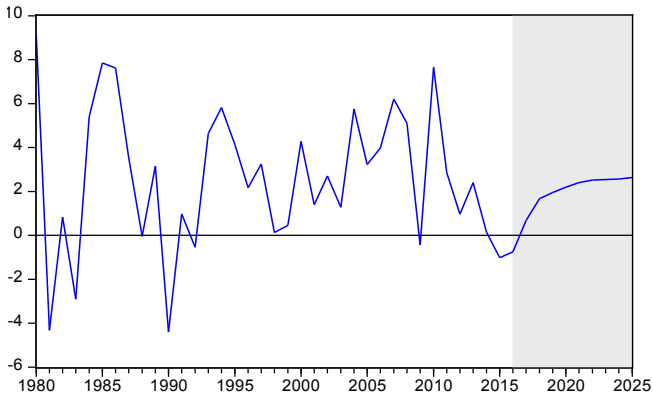


Figure 3 shows that the current-account surpluses in East Asia, specifically in China and Other High-Income East Asia (such as Japan) would remain significant. Meanwhile, the surplus in Europe (determined largely by Germany) is projected to progressively decline towards zero by 2025. However, the large and persistent current-account deficits of the United States are expected to progressively worsen over the next ten years, reaching 5.4% of GDP by 2025. This trend is indeed troubling, though it is reinforced, in effect, by continuing current-account surpluses in East Asia.

Outlook for Brazil

Having sketched out very briefly some of the projected major trends in the global economy through 2025, we now turn to an examination of Brazil’s prospects within this context.

Figure 4: Brazilian GDP Growth (%)



The risk of a recession in Brazil in the short term is high. The CAM model projects a contraction of -1% for 2015 as a whole, and a continuation of recession in 2016. But the model projects an escape from recession by 2017 (see **Figure 4**).

Over the medium term, Brazil’s prospects are brighter. The CAM projects Brazil’s GDP growth to progressively rise to 2.6% through 2025. Though the escape from recession is a positive development, future growth rates are still expected to remain moderate by historical standards.

One of the major drivers of future Brazilian growth is expected to be an improvement in the country’s current account (see **Figure 5** next page). Brazil’s current-account improvement is explained mainly by an increase in the country’s trade surplus in primary commodities, and a rapid improvement towards a surplus in fuels.

At the same time, its trade deficits in manufactures and services are expected to narrow slightly, and its deficit on income and transfers is also projected to improve modestly.

These trade-balance improvements are aided by a projected decline in Brazil’s real exchange rate of about 10% through 2020, followed by only a slow, slight appreciation thereafter.

Figure 5: Current Account (% GDP)

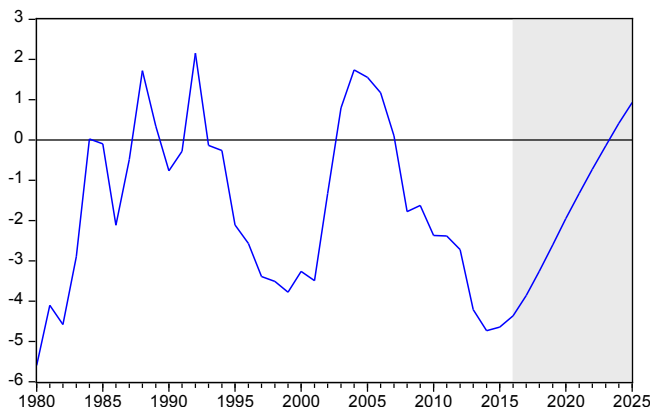
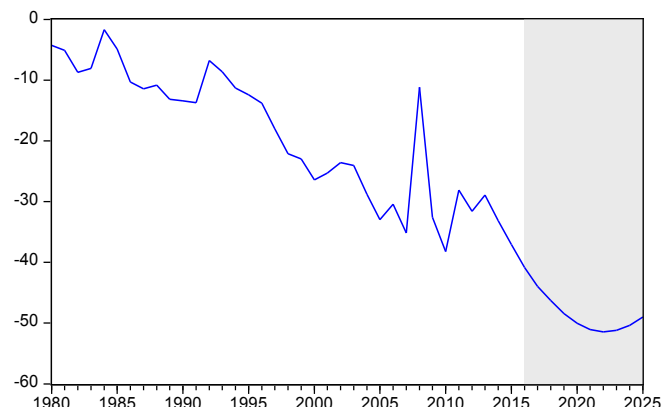


Figure 6: Net External Assets (% GDP)



Unfortunately, Brazil's investment as a ratio to GDP is projected to remain at a historically low level of about 15%. This is one of the explanations for the expected moderation in growth rates of the economy over the next ten years.

It is noteworthy that while Brazil is projected to improve its current-account balance, its net external asset position will still continue to deteriorate, reaching -51% of GDP by 2021, before it begins to improve marginally thereafter (Figure 6). A country's net external asset position results from adding its financial assets held abroad and subtracting foreigners' financial assets held in the country.

Brazil's projected worsening net external asset position will leave it markedly vulnerable to any future international financial turbulence (and the expected rapid outflow of short-term investment from the country).

By comparison, a number of other major emerging economies, such as the People's Republic of China, Russia and most countries in East Asia, are expected to continue running positive net external asset positions. Even India's position is expected to be closer to -15% of GDP over the projected period.

The financing position of the Brazilian government is also projected to remain vulnerable. Although its public-sector lending as a ratio to GDP would improve over the next ten years, it would still remain worse than -6% (see Figure 7).

Moreover, its debt-to-GDP level would be expected to rise progressively to over 76% by 2025—namely, to a worrying pinnacle last observed in 2002 (Figure 8).

Figure 7: Government Net Lending (% GDP)

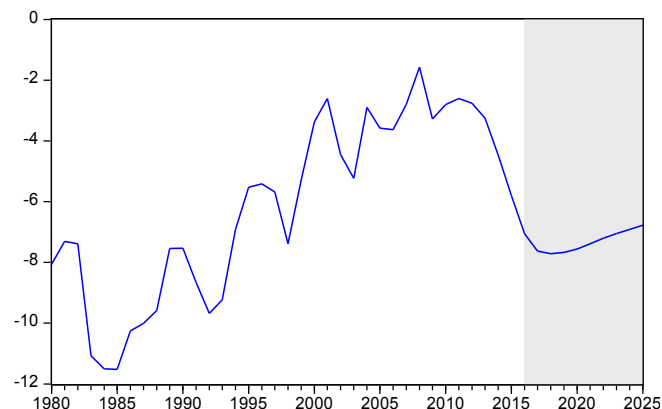
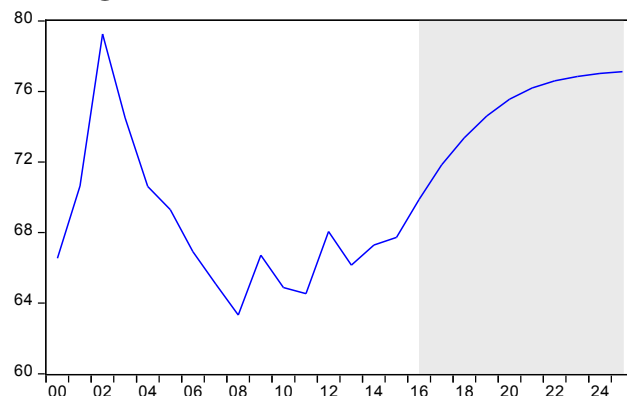


Figure 8: Government Debt (% GDP)



Concluding Remarks

In this Policy Brief we have used the CAM global macro model to construct a 'baseline' scenario for the global economy in general and for Brazil in particular over the next 10 years.

The expected global context for this period is one of subdued growth. This projection is consistent with the recently revived "secular stagnation" thesis. At the same time, global imbalances are expected to persist.

This trend would apply especially to the USA, which is likely to run a progressively larger current-account deficit, with a net external asset position approaching a negative 55% of GDP by 2025.

Such an ominous deterioration in the external position of the world's dominant reserve-currency country is not likely to be a globally sustainable trend. Such stark and growing imbalances will surely generate, sooner if not later, a return to international financial turbulence.

The results of our CAM modelling do paint a more optimistic medium-term picture of the Brazilian economy than would likely be imagined on the basis of assessing its current bleak economic conjuncture.

Brazil is expected to start growing moderately by 2017 and its current-account deficit is projected to progressively diminish and turn into a small surplus by 2023.

Yet Brazil's net external asset position will continue to worsen over most of the next ten years. While the government's net lending will likely improve marginally, its debt as a ratio to GDP will continue to progressively rise throughout this period.

In closing, it should be noted again that these results for Brazil as well as for the global economy are based on a 'baseline' scenario that assumes no important changes in economic policies either at the global level or in Brazil.

Addressing the need for such policy changes and testing their usefulness through designing further CAM projections will be the priority of our on-going research.