PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Is Brazil at a Turning Point?

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PIIE

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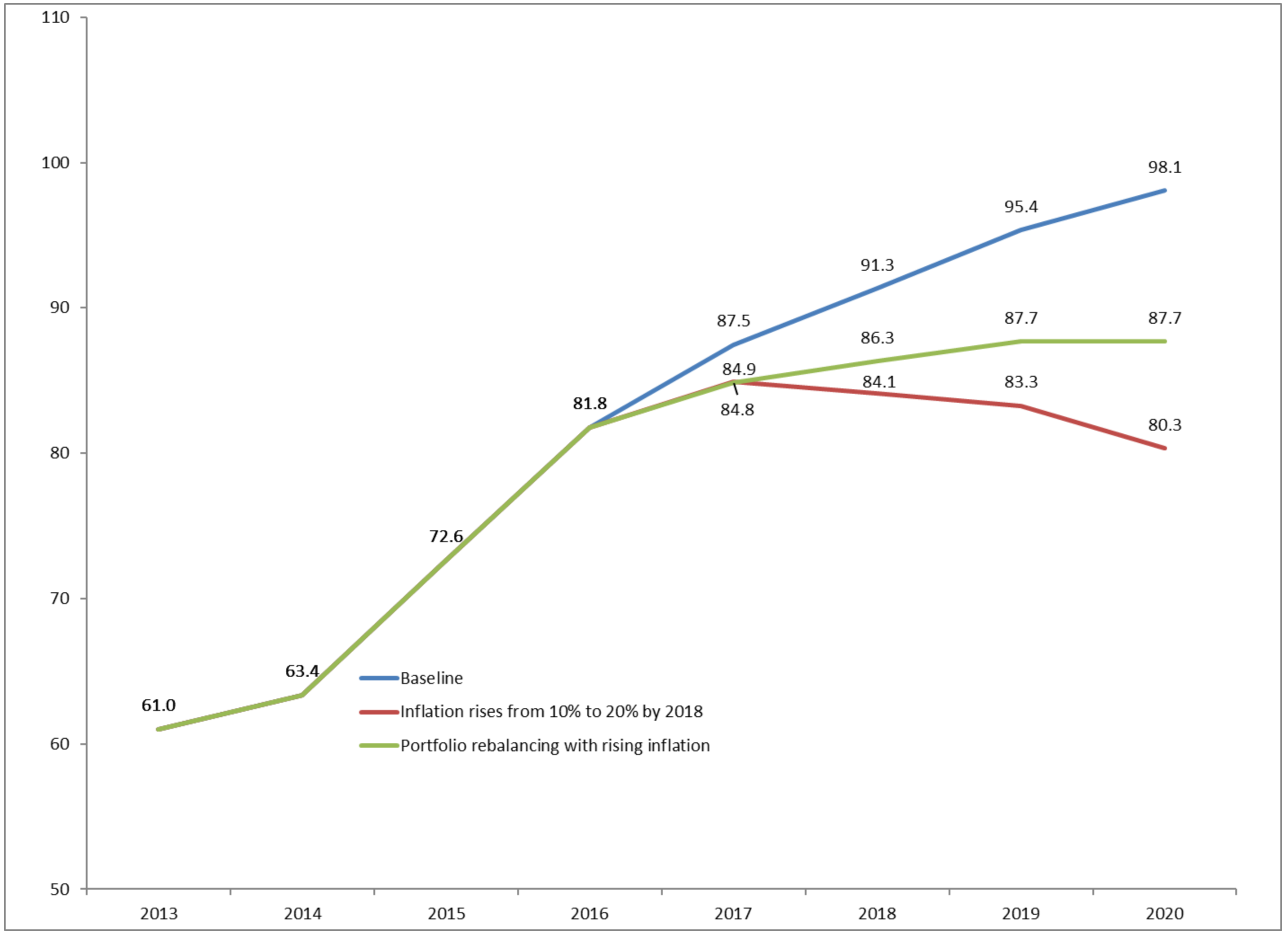
Economic Depression

- GDP contraction 2015-2016: estimated at 7 percent.
- GDP per capita contraction 2015-2016: estimated at 10 percent.
- Unemployment is at 11.8 percent, over 12 million have lost their jobs.
- Real incomes are falling steadily.

The Problem: Debt and Inflation (PIIE Briefing, March 2016)



Source: IMF and own calculations

Policies

- An expenditure cap.
  - Should Brazil have a debt ceiling?
- Social security reform.
- Concessions, PPPs, privatization.
- A renewed focus on trade.
  - Bad timing?

Caveats

- Policies and reform effort focused on restoring medium term fiscal sustainability.
- Fiscal reform is contractionary in the short term.
- Investments tied to privatizations not expected until late 2017, early 2018.
- No immediate short term relief.
- No strong rebound in the near term: Growth at 2 percent not before 2020.

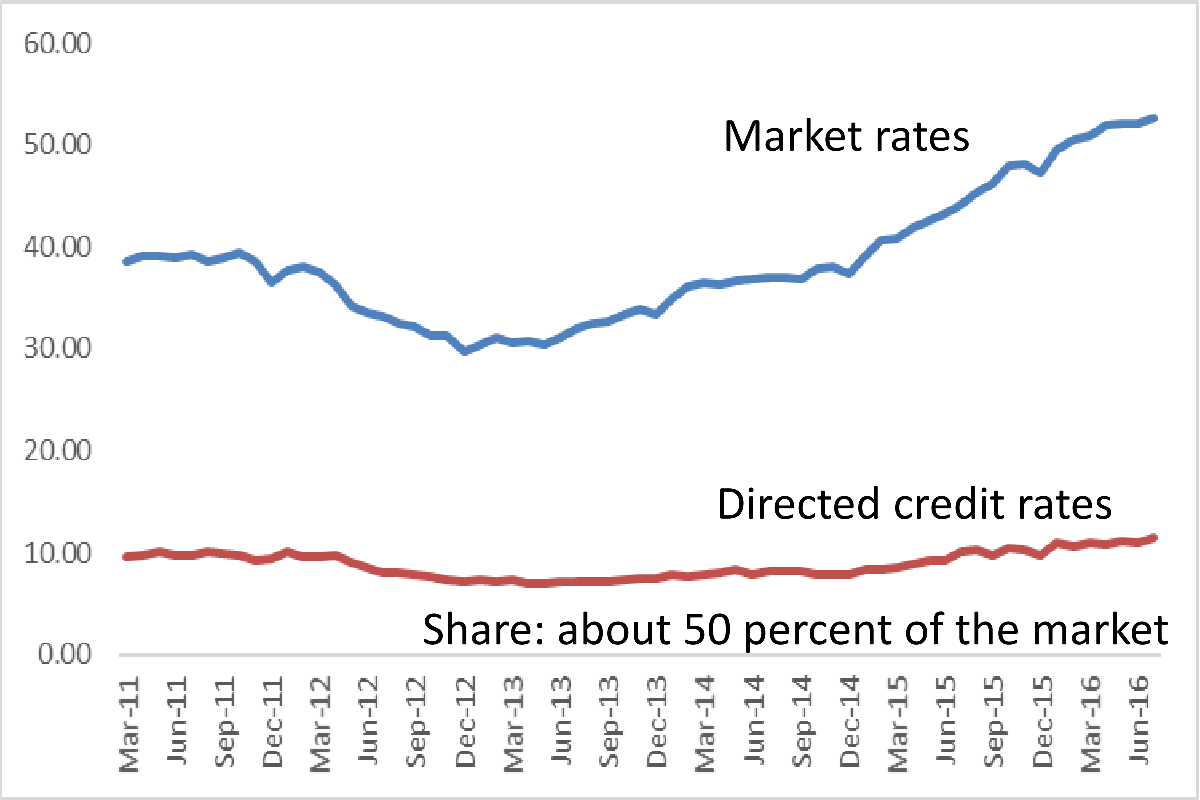
Additional Challenges

- Renegotiating state debts with the Federal Government.

- Rethinking the role of public banks.

- Outlining a strategy for trade. Mercosur? Regional integration?

Brazil's Segmented Credit Market



Source: Central Bank of Brazil

Room for monetary easing?

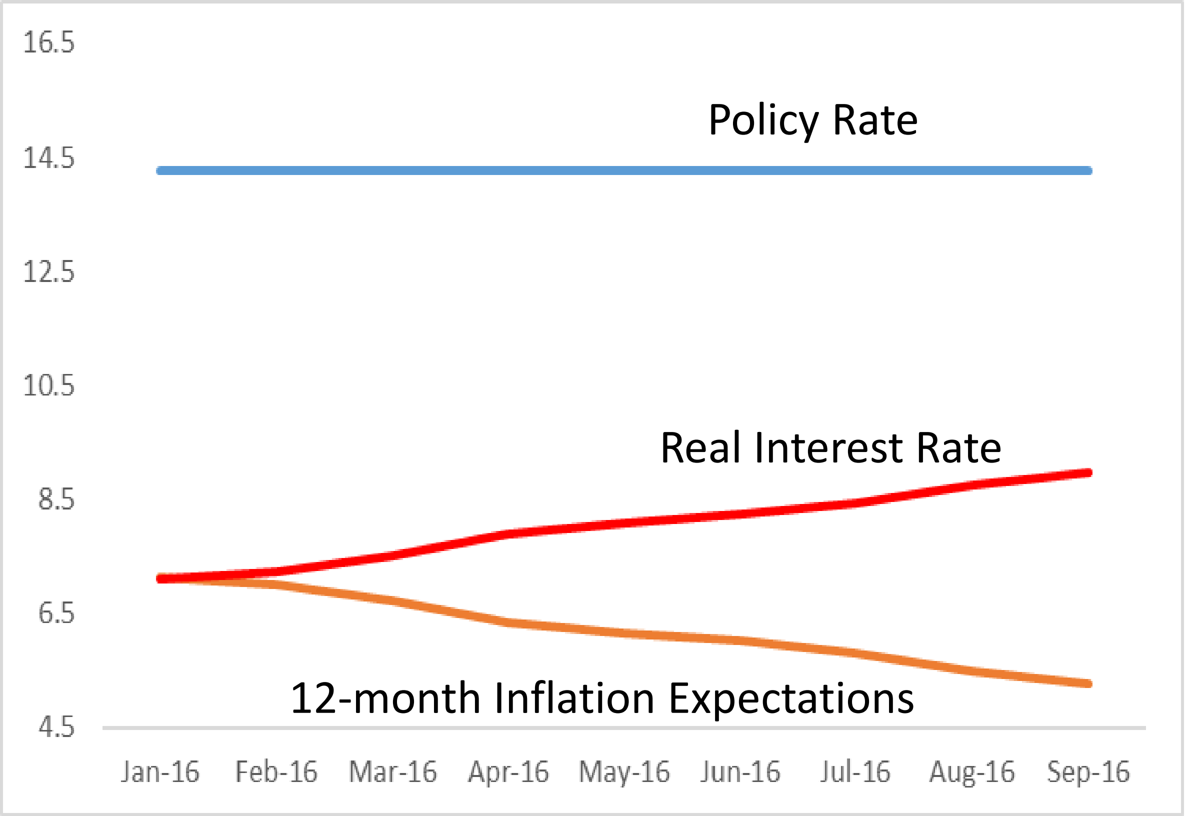
- Inflation expectations are falling, but headline inflation is still high (8.8 percent; 10.7 percent in January 2016).

- Easing under these conditions is tricky, but inflation will likely continue to fall as a result of negative labor market trends, shrinking wages.

- Hence a case could be made for easing policy even if fiscal adjustment is not yet guaranteed.

- In any event, a very difficult transition over the next two years. Households: one quarter of monthly income consumed by debt service obligations. Deleveraging slow due to labor market conditions and very high interest rates.

Passive Monetary Policy = Tighter Monetary Conditions



Source: Central Bank of Brazil