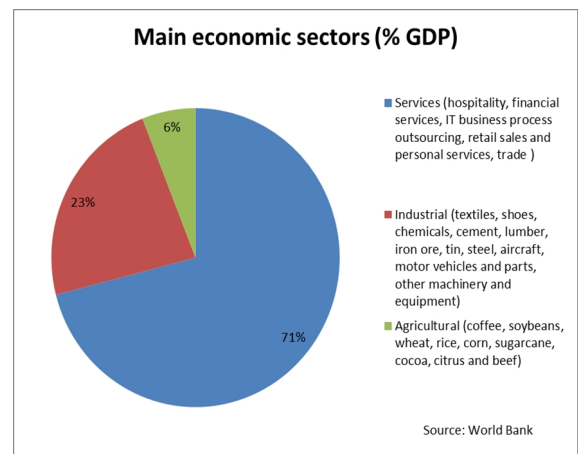


Brazil: Economic situation

Following a cycle of steady growth at the end of the last decade, the Brazilian economy began to contract in 2011, and entered a technical recession in 2015. Declining exports, rising inflation, a growing deficit and corruption have destabilised the economy. Its future course will depend on fiscal adjustment, inflation control and on bolstering the economy's credibility.

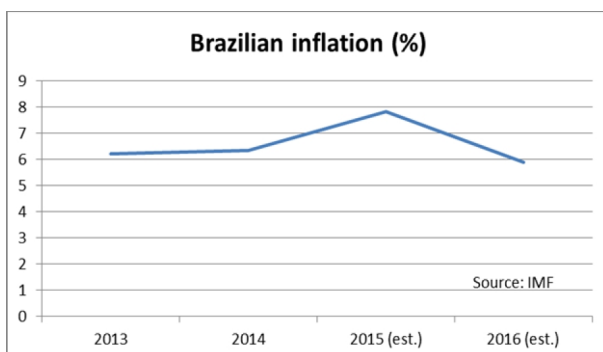
An emerging economic power in crisis

In 2001, Goldman Sachs included Brazil in the BRIC group of emerging economies whose projected growth and weight in global GDP was set to have substantial global impact. Goldman Sachs recommended that these countries be given greater weight in global economic and financial governance. With the onset of the global economic crisis in 2008 and the evolution of the [G20](#) into the premier leaders' forum for international economic cooperation, Brazil, a G20 member, further consolidated its position as a rising economic power. The economic crisis also served as an opportunity for the Brazilian economy to demonstrate its stability and maturity: the [recession](#) only hit it for five months in 2008-2009 and [recovery](#) was speedy. In 2012 Brazil surpassed the UK and became the world's [sixth largest economy](#). The growth of the Brazilian economy in the 2000s was a combination of two key factors: on the one hand, the result of macroeconomic reforms and fiscal adjustment, which began in the mid-1990s, and on the other, the [demand for Brazilian exports](#) of primary products from international markets, and particularly China. The favourable economic environment led to Brazil attaining growth figures as high as [7.5%](#) in 2010. However, the global economic downturn finally reached Brazil, leading its economy to slow to [stagnation from 2011 through 2014](#). Substantial [reductions in global demand for commodities](#), coupled with insufficient [infrastructure modernisation and investment](#) in the Brazilian economy have brought the country to a critical point once again.



Macroeconomic indicators

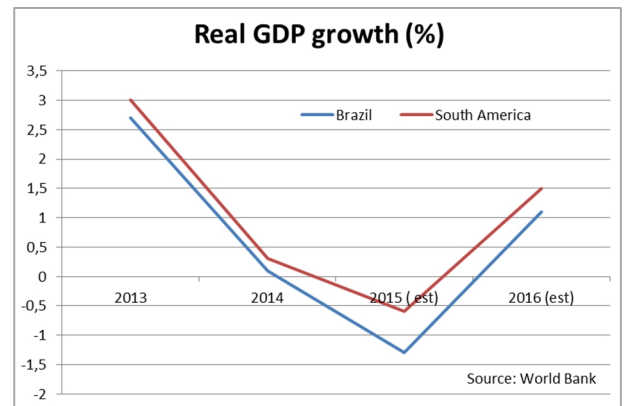
In the second quarter of 2015, Brazil fell into a [technical recession](#) as GDP contracted for a second consecutive quarter. Overall, in the first half of 2015, [real GDP](#) declined by -2.6%. This was the first contraction in the Brazilian economy since President [Dilma Rousseff](#) first took office in 2011. With [GDP](#) of US\$2 346 billion, Brazil is currently the [seventh largest](#) economy in the world. Brazil is classed an upper middle income country by the [World Bank](#). Public sector gross debt is growing rapidly: it is [expected](#) to reach 69.9% of GDP by the end of 2015, having [grown by 17.28%](#) in only a year. Internal debt is growing at a particularly high rate. External debt has been [estimated](#) at US\$535.4 billion. The [current account deficit](#) reached US\$92.3 billion ([4.2% of GDP](#)) in 2014, while the trade balance declined to [US\\$3.9 billion](#). The central government primary budget deficit was [32.5 billion reais](#) (0.59% of GDP). It was [the first time since 1997](#) that Brazil recorded an annual primary deficit. The government is considering reducing its key fiscal goal for 2015 to a [record primary deficit](#) of around 50 billion reais (US\$12.9 billion). [Inflation](#), held at a maximum central bank target of 6.5% until 2014 rose to 9.49% in 2015 so far. [Unemployment](#) declined slightly to 4.82% in 2014 but



is expected to rise again in 2015 and 2016. The Sao Paulo Stock Exchange Index ([Ibovespa](#)) has lost over 20% of its value since 2011. As Brazil represents [40.5%](#) of the nominal output (GDP) of Latin America and Caribbean, the course of its economy will have [regional impact](#) (see graph below).

Monetary policy

In September 2015, the Brazilian real hit its [weakest point](#) since its introduction in 1994. Trading as low as 4.14 to the dollar, the real has lost 35% of its value against the dollar so far this year, leading to [interventions](#) by the [Banco Central do Brasil](#). In agreement with the government, it [introduced](#) a tighter monetary stance and a fiscal adjustment to contain inflation and stabilize public debt. The Bank's Monetary Policy Committee ([Copom](#)) has been targeting the [Selic](#) rate (short-term interest rate) as the main monetary instrument. Between April 2013 and September 2015 the Selic almost doubled from 7.5% to 14.25% and is likely to [remain high](#) until the target inflation rates are met.



Fiscal system

Brazil's [complex](#) corporate and indirect taxation systems have led to its [ranking](#) as the most time-consuming tax regime in the world. In 2012 (latest World Bank data) tax revenues (excluding indirect taxes) were [14.4% of GDP](#). They have [increased](#) consistently in the past decade. [Indirect taxes](#) on goods and services account for 49.7% of tax revenues, while 50.3% are from direct taxes (on payroll, profit, real estate and financial transactions). The [ICMS](#) (*Imposto sobre Operações relativas à Circulação de Mercadorias e Prestação de Serviços de Transporte Interestadual e Intermunicipal e de Comunicação*), the equivalent of VAT is managed and collected at state [level](#). Brazil has one of the highest [tax to GDP](#) ratios in the region.

Current issues

According to [analysts](#), the country failed to capture the momentum of the China-led 'commodity supercycle' and the domestic demand boom to invest in necessary structural reforms. Inadequate investment in infrastructure threatens to constrain longer-term growth prospects. A serious [corruption scandal](#) involving Brazil's major oil company, [Petrobras](#) and politicians has shaken investor interest in spite of the enactment, in August 2013, of Federal Law [12846](#) (Anti-Corruption Act). [High unit labour](#) costs reduce competitiveness. Concerns about the sustainability of Brazil's public debt have led to continual downgrading of Brazil by rating agencies, most notably to BB plus '[junk](#)' status by Standard & Poor's in September 2015. Deindustrialisation – driven by China's demand for commodities – is also a concern: in the current breakdown of Brazilian exports, primary and intermediate products and raw materials account for [over 60% of exports](#).

Future prospects

Economic growth is [projected](#) to contract again this year, by [3%](#). [Forecasts](#) for 2016 estimate further contraction of 1%, an increase of Public Sector Gross Debt to 74.5% and of [unemployment](#) to over 6%. [Experts](#) do not expect recovery before the second half of 2016 and emphasize the need for price stability (containment of inflation) and of fiscal consolidation. The new economic team that took over in January, led by incoming Finance Minister, [Joaquim Levy](#), introduced a [fiscal austerity package](#) and [expects](#) a return of inflation to below the 6.5% target and a slight reduction in the current account deficit in 2016. Recovery may be helped by a possible boost of exports due to the depreciation of the *real*. The acceleration of trade negotiations, mainly with Mexico, the EU and South America, and [others](#), as envisaged in the [National Exports Plan](#) (PNE), can be a further lever for growth. The [projected](#) negative [impact](#) of [TPP](#) on Brazilian exports has led to renewed [emphasis](#) on trade policy; 35% of Brazil's industrial exports are to TPP signatories.

Brazil has been a [member of the WTO](#) since 1995 (GATT Contracting Party since 1947). In 1991 it became a founding member of the Common Market of the South ([Mercosur](#)). Through Mercosur it has a number of [preferential trade and free trade agreements](#). The EU is currently negotiating [a trade agreement with Mercosur](#) as part of the overall negotiation for a bi-regional Association Agreement. The EU is Brazil's first trading partner, accounting for [19.5%](#) of its total trade, and Brazil is the EU's tenth trading partner, accounting for 2.0% of total EU trade (2014). Faced with a need to increase exports, Brazil appears more [determined](#) to advance Mercosur/EU talks. The EU is the biggest foreign investor in Brazil; it [invests more in Brazil](#) than in any other BRICS country.