

Brazilian economy remains in poor shape at the start of the World Cup

13 June 2014

Following two rather disappointing World Cup tournament results, host country Brazil is determined to do better in 2014. Similarly, political leaders in Brazil are desperately seeking to push economic growth higher after three years of economic disappointment. If the first goal will be difficult to attain, the second may be even more challenging against the back of rapidly falling confidence in the authorities' capacities to turn things around. All in all, election year 2014 will not be a golden year for Brazil's economy.

Brazil's economic success throughout most of the past decade stands in sharp contrast to the economic malaise since 2011. Whereas growth averaged almost 5% in the five years prior to the 2008-2009 crisis, that number has fallen back to only 2% over the last three years. Importantly, confidence indicators continue to decrease. Also, for all the talk that hosting the World Cup will spur optimism among Brazilian households and firms, confidence in the government's economic policy is falling quickly in the run-up to the October presidential elections. This comes on top of the steep increase in interest rates. Since the spring of last year the Central Bank of Brazil has raised policy rates nine times from 7.25% to 11%. This period of very aggressive monetary tightening in combination with very low confidence will continue to weigh on investment and consumption in the next couple of quarters. Meanwhile, inflation (6.4% in May) continues to come in at the high end of the target (between 2.5% and 6.5%) and inflation expectations show little sign of easing. As a result, monetary policy is set to remain tight. Expectations with regards to exports should also be tempered. Global appetite for commodities, on which Brazilian exports heavily depend, is likely to remain downbeat as economic activity in China, Brazil's most important trading partner, will slow down further. At the same time, the country's third largest export destination Argentina, is experiencing severe economic difficulties.

Brazil is one of the BRIC's wrestling with deep structural problems. Underinvestment is arguably the most important issue. First, Brazil's low domestic savings keep investment down. Importing foreign capital could help to address this but already recording a current account deficit of more than 3% of GDP, this would only increase the country's external vulnerability. The only sustainable solution would come from a rise in the national savings rate but this requires difficult political choices. The other important factor weighing on investment is the so-called "Brazilian cost", pointing to the many difficulties experienced when doing business in Brazil. Political leaders have acknowledged this for many years but the progress on this front remains remarkably slow. While much of the developed world suffers from inadequate demand, Brazil's problems are mostly supply-side related. This is illustrated by Brazil's stubbornly high inflation and relatively poor performances in international competitiveness rankings. Brazil's national football team is doing much better on the international scene. It remains to be seen whether Brazil will win the World Cup. But given its strong performance in the Confederations Cup last year (Brazil actually beat Spain 3-0 in the final) and the advantage of playing at home, this is a real possibility. By contrast, it's almost certain that that 2014 will not be a golden year for the economy.

