The Brazilian Economic Collapse Reaches Unprecedented Proportions

By Zero Hedge
Global Research, September 01, 2016
Zero Hedge 31 August 2016
Region: Latin America & Caribbean
Theme: Global Economy

While the mainstream media was focused on today's primetime Brazilian spectacle, namely Dilma Rouseff's impeachment vote in the Senate, which passed as expected with a substantial majority permanently removing Rouseff from office and assuring that her replacement, Michel Temer rules until at least 2018 (unless the unpopular politician is also impeached in the meantime), what has gotten far less press is the ongoing devastation of the Brazilian economy which has failed to see even a token pick up in recent months despite the change in the ruling administration.

Here are the latest stunning updates.

According to the most recent economic data, the labor market continues to implode: the unemployment rate surged to 11.6% with the ranks of the unemployed topping 11.8 million (up from 8.6 mn a year ago) as the following chart from Goldman Sachs shows.

The national unemployment rate printed at 11.6% in the 3-month period ending in July, up from 11.3% in June and up from 8.6% a year ago, and 6.9% two years ago. In seasonally adjusted terms the unemployment rate climbed to 11.4% in July, from 11.1% in June and 8.4% a year ago.

Formal salaried employment in the private sector shrank 3.9% yoy, while employment in the informal sector grew 0.9% yoy. Self-employment grew 2.4% (a reflection of increasingly limited salaried employment opportunities). By sector of economic activity, industrial employment shrank by a large 10.6% yoy (-1.4mn jobs).

Employment declined 1.8% yoy in the 3-month period ending in July, while the economically active labor force grew 1.5%.

Meanwhile, as the number of working Brazilians tumbles, average real wages conttinued their unprecedented decline, sliding 3.0% yoy. The labor force participation rate rose one-tenth from a year ago: to 61.5%.

Alas, there is little hope in sight: according to Goldman, the labor market is set to deteriorate further given the forecasted weak performance of the economy, particularly of the labor-intensive services sector.

It wasn't just the labor market that continues to flounder, however. According to today's

GDP report, in the second quarter the economy continued to contract , driven, among other things by the impact of the ongoing credit crunch and severe labor market deterioration on consumption. Specifically, real GDP dropped -0.6% qoq in Q2 sa (non-annualized) once again missing the consensus print of -0.50%. Real GDP contracted 0.6% qoq sa in 2Q2016, adding to the large contractions averaging -1.3% qoq sa during 1Q2015-1Q2016. The 1Q2016 figure was revised to -0.43% qoq sa, down from the original -0.28% qoq sa.

In yoy terms, real GDP declined -3.8% during 1Q2016, a modest improvement from the -5.4% Q1 plunge. Private consumption declined 5.0%, and public consumption retrenched 2.2%. Finally, gross fixed capital formation declined by a large 8.8% yoy. Just like in China, which historically was a major source of Brazilian upside, aggregate investment remained low and decline again: 16.8% of GDP during 2Q2016, down from 18.4% of GDP in 2Q2015 and 20.1% of GDP in 2Q2014. The national gross savings rate was even lower (15.8% of GDP), still much lower than the 19.7% of GDP reached during 1Q2013 and 18.8% of GDP in 1Q2014.

According to an analysis by Goldman's Alberto Ramos, the contraction of real activity during 2Q was driven by private consumption on the demand side and services on the supply side. Final domestic demand contracted again (-0.5% qoq sa); sixth consecutive decline and printed in negative territory in eight of the last nine quarters. On the supply side, the large labor intensive services sector retrenched again at the margin as noted above (-0.8% qoq sa; -3.3% yoy); sixth consecutive quarterly decline averaging -0.9% qoq sa.

As Ramos concludes, "the ongoing economic recession/depression has now lasted an extraordinarily long period of time and has been unusually deep: leading to a 9.7% cumulative decline in per-capita real GDP. By 2Q2016, real GDP was at the same level of 3Q2010. Final private sector domestic demand has declined a very large 12.4% cumulatively since 2Q2014."

* * *

Completing the abysmal picture was the latest capital flow data, according to which Brazil's primary fiscal deficit remained stuck at -2.5% of GDP, while gross debt now approaching a record 70% of GDP.

More details: The consolidated public sector posted a R$12.8bn primary deficit in July significantly worse than the R$4.7bn deficit recorded a year ago. The central government posted a R$11.9bn deficit, and the states and municipalities a smaller R$334mn deficit. The performance of subnational governments is expected to deteriorate further in the months ahead given tightening budgetary pressures and the recent re-profiling of debt service payments to the treasury. Finally, state-owned enterprises recorded a larger than expected R$629mn deficit.

On a 12-month trailing basis, the consolidated public sector primary fiscal deficit remained broadly unchanged from June to July at a high 2.54% of GDP (vs. 2.51% of GDP in June), but rose visibly from 1.88% of GDP in December 2015. The overall public sector fiscal deficit (primary surplus minus interest payments) is running at an extraordinarily high 9.6% of

GDP (slightly down from 10.4% of GDP in December due chiefly to gains in the outstanding stock of Dollar swaps driven by the recent BRL appreciation). The 12-month net interest bill is tracking at 7.0% of GDP, compared with 8.5% of GDP in December.

According to Goldman, given the 0.9% BRL depreciation against the USD in July, the stock of Dollar swaps issued by the central bank added R$1.8bn from the overall public sector net interest bill (the difference between the DI rate and the exchange rate variation plus the "cupom cambial"). The 12-month trailing implicit interest rate on total net public debt is tracking at a very high 22.3%.

Putting all this together means that gross general government debt is now tracking at 69.5% of GDP, up from 66.5% of GDP at end-2015. Net public debt has deteriorated 5.6 percentage points of GDP since December.

Goldman's conclusion:

> A deep, permanent, large structural fiscal adjustment remains front-and-center on the policy agenda to restore both domestic and external balance. In our assessment, fiscal consolidation in Brazil will be a multi-year endeavor. Most likely, returning to primary fiscal surpluses will take no less than 2-3 years, and returning to a primary surplus level that stabilizes the debt dynamics (around 2.5% of GDP) likely 4-5 years, or perhaps longer. At the end of the fiscal consolidation process we estimate that Brazil needs to end up with a primary surplus of 3.0% to 3.5% of GDP. This would be the level of primary surplus that would put gross public debt on a clear declining trajectory, something that is required for Brazil to rebuild fiscal buffers and regain room to use fiscal policy counter-cyclically, whenever needed and appropriate. Furthermore, we believe a deep fiscal adjustment that would elevate public sector savings is needed to facilitate a permanent structural current account adjustment (rather than just a cyclical adjustment driven by the sharp contraction of domestic demand), and also to endow the central bank with extra degrees of freedom to set monetary policy at a less restrictive level.

What is most fascinating, however, is that despite the all too clear economic depression raging in Brazil, which gets progressively worse by the month, the stock market continues to rise pricing in a Phoenix-like recovery, which even Goldman now admits will take "4-5 years, or perhaps longer." Why this unprecedented surge in asset prices? Simple: a mountain of central bank-created liquidity which finds its way into any market that offers even a modium of incremental yield, such as Brazil's. Alas, for those asking when the record divergence shown below closes, and the Bovespa will be painfully reacquainted with gravity, we have no answer.

Articles by: Zero Hedge