The Brazilian recession: origins, consequences and conditions/strategies for economic recovery

Fernando Ferrari Filho
Full Professor of Economics at UFRGS and Researcher at CNPq
https://www.ufrgs.br/ppge/ferrari/ and ferrari@ufrgs.br

Meiji University
Tokyo/Japan, September 22, 2017

Origins

Supply side:

De-industrialization (misaligned exchange rate and interest rate – from 2014 to 2016, the annual average basic interest rate, Selic, was 12.8%, and the real effective exchange rate, despite the overshooting devaluation in 2015 – it was around 50.0% – was appreciated), low labor and capital productivities and infrastructure problems.

Demand side:

Volatility and pragmatism of the economic policy, economic growth based on consumption, low public investiment and deterioration of the world economy ((China ↓ , unstabel economic growths in the USA and Euro zone and commodity prices ↓).

Addtional problems in 2015 and 2016

Stagflation (recession plus inflation);

Fiscal austerity;

Political and institutional crises → Dilma Rousseff *impeachment*, collapse of the presidential coalition and low credibility of the Institutions (National Congress and Supreme Court);

Ethical crisis → Laundry Operation (Operação Lava-Jato) and corruption.

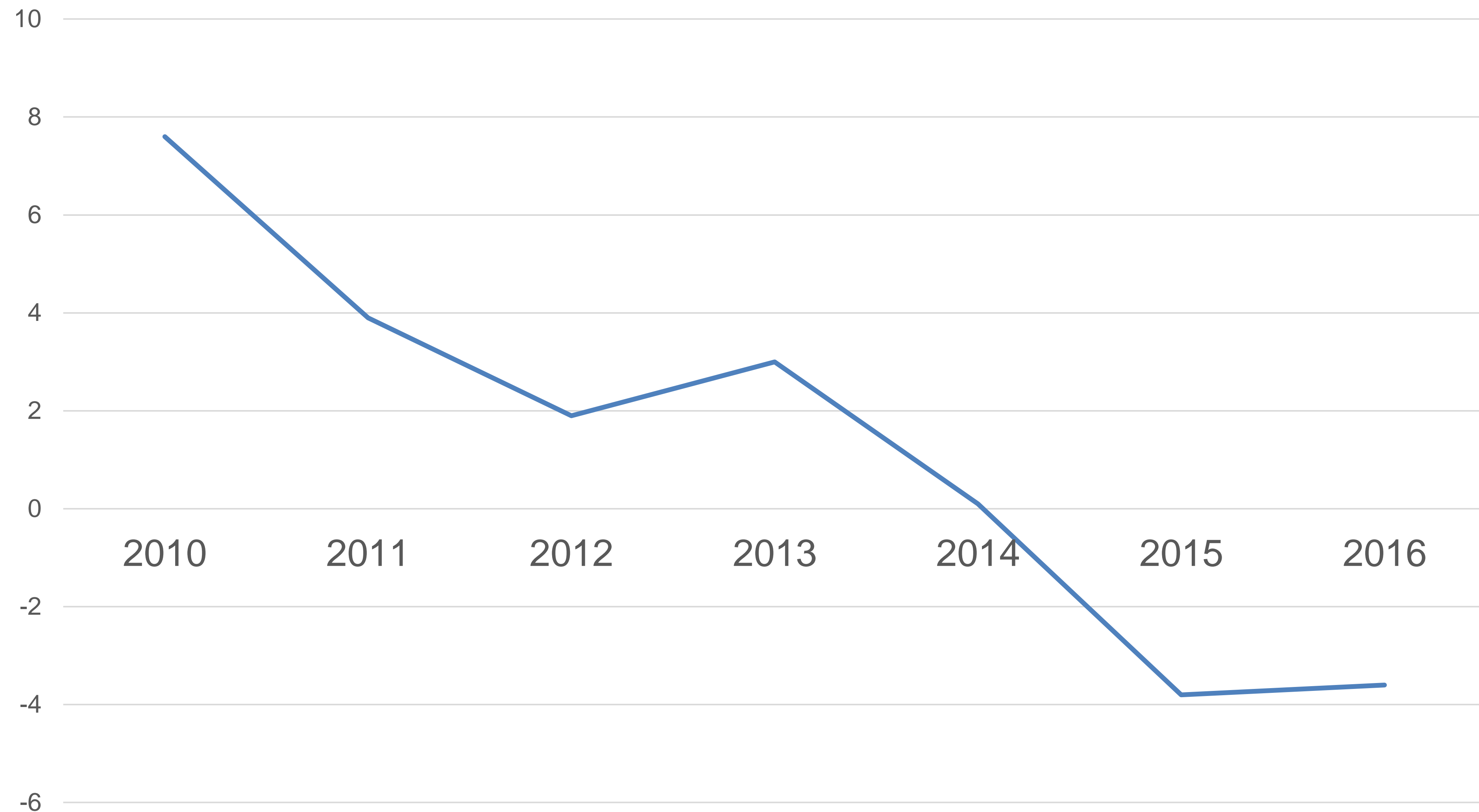
Consequences

Recession:

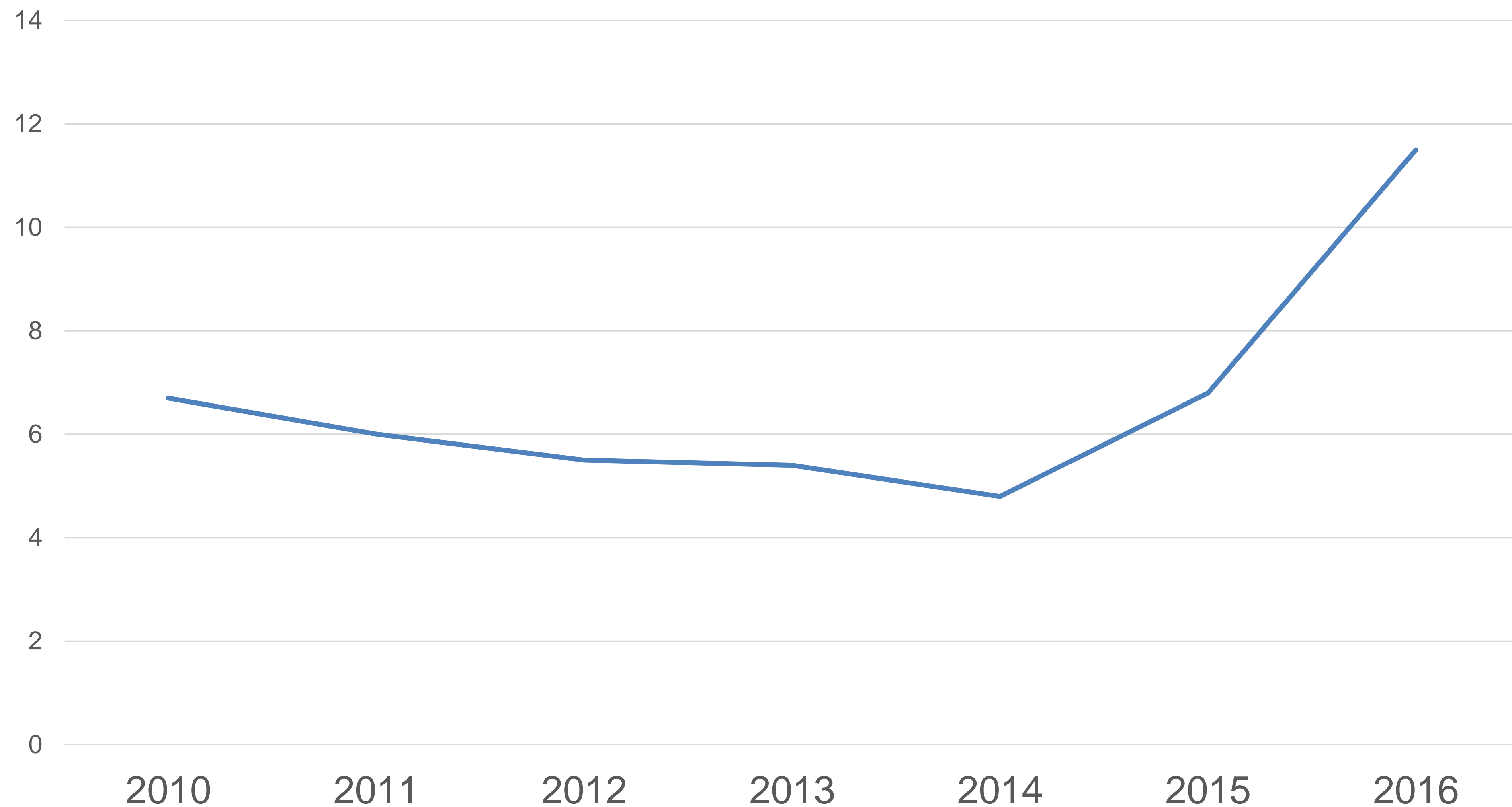
GDP dropped 7.2% between 2014 and 2016 (Ip + Ig/GDP was 17.5%);
Unemployment rate ↑ from 4.8% (2014) to 11.5% (2016).

Fiscal imbalance, public debt ↑ and X ↓:

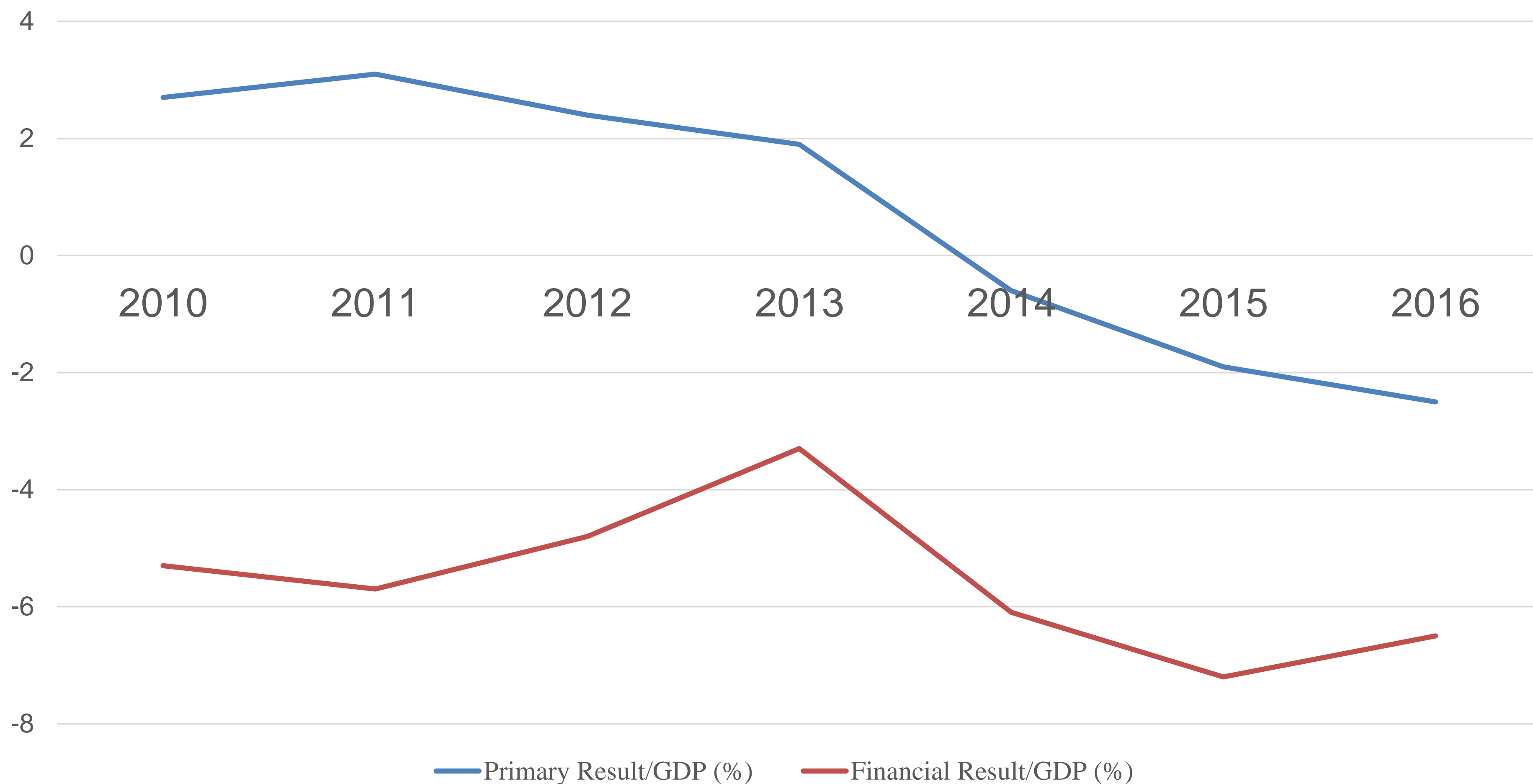
Primary fiscal deficit = f(government revenues ↓, fiscal incentives and social security imbalance due to unemployment rate ↑);
Public debt ↑ = f(financial deficit ↑) = g(Selic rate ↑ and exchange rate devaluation);
Exports ↓ → From US$ 225.1 billion (2014) to US$ 185.2 billion (2016) = f(deterioration of the world economy and commodity prices ↓).



Source: Banco Central do Brasil.

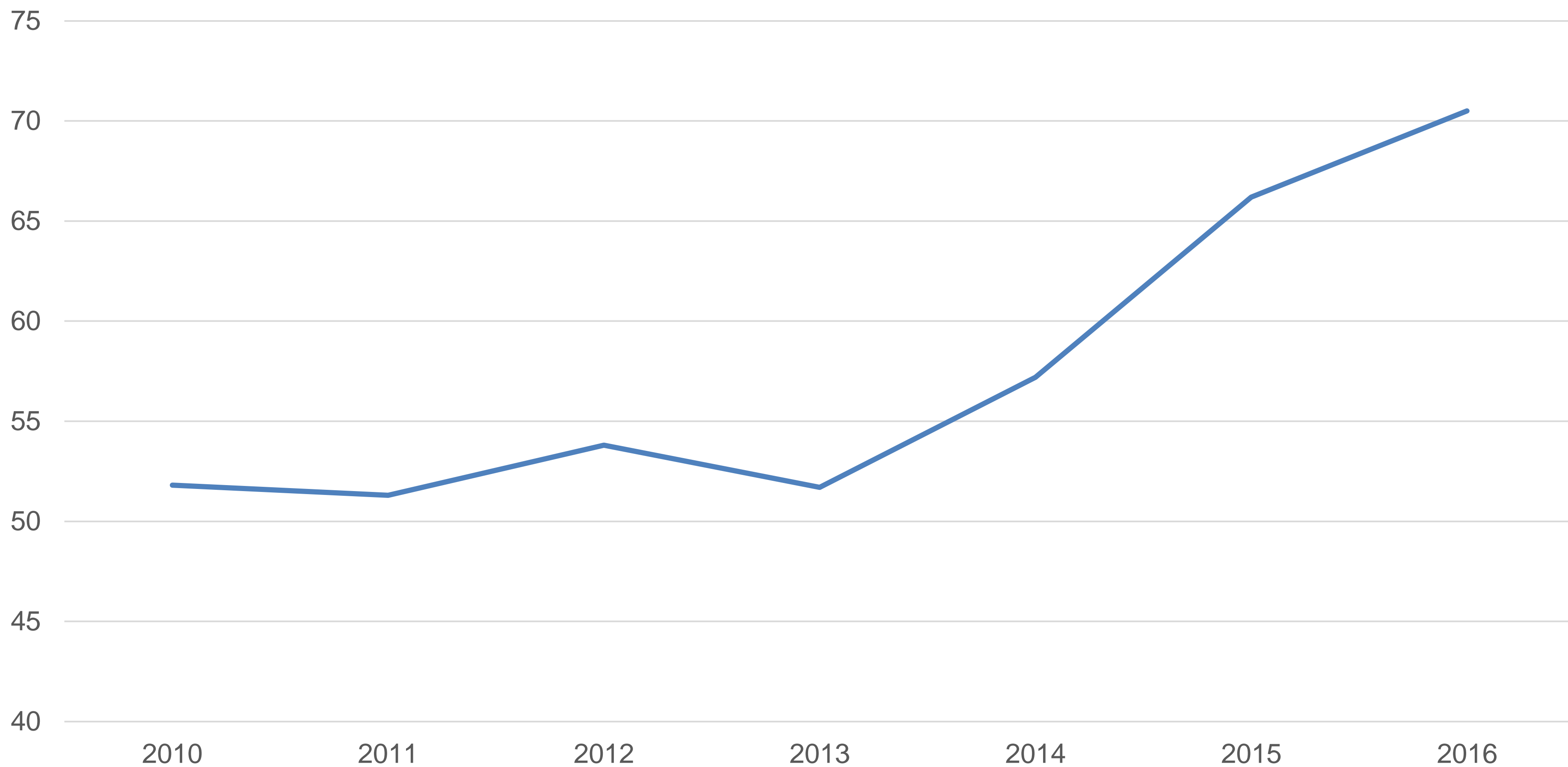


Source: Banco Central do Brasil.

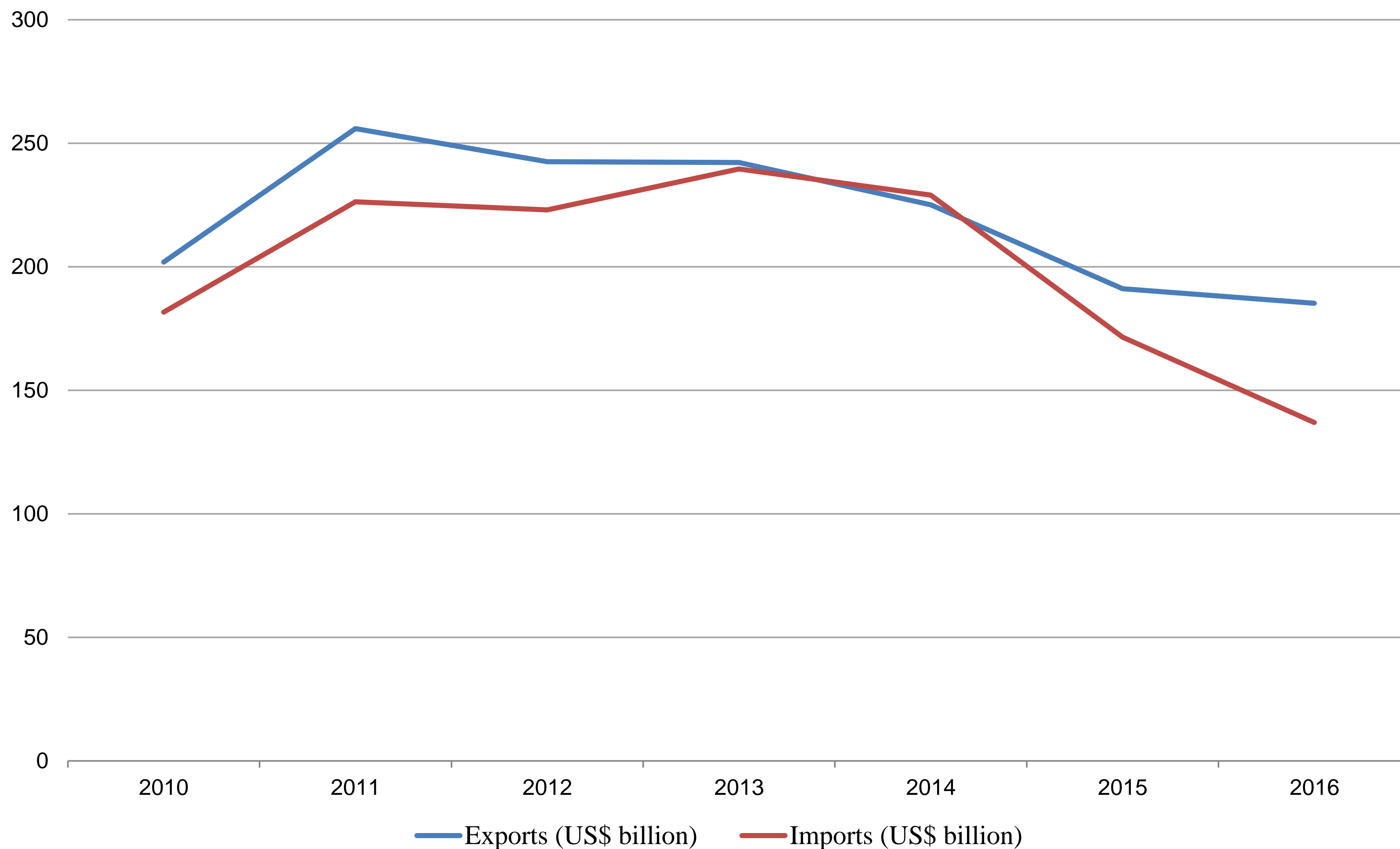


Source: Banco Central do Brasil.

Public Debt/GDP(%)



Source: Tesouro Nacional.



Source: Banco Central do Brasil.

2017 and ...

Fiscal austerity and labor and social security reforms → Minimum State;

Inflation Targeting Regime → Monetary policy to keep inflation under control;

Economic growth? Stagnation = f(uncertainty/low degree of confidence – weight of argument) = g(AD cannot sustain GDP in the short run, political and institutional crisis and uncertainty in the world economy). More specifically:

(i) High unemployment rate and credit squeeze do not stimulate C;

(ii) Low capacity utilisation, high private debts and uncertainties about the political and institutional crisis do not push I;

(iii) Fiscal crisis prevents countercyclical fiscal policies;

(iv) Uncertainties about the world economy (Trump's economic plan (?), China ↓ and commodity prices ↓, among others) create problems to X.

Perspectives for 2017

GDP growth rate = 0.5%;

Inflation rate = 3.5%;

Unemployment rate (annual average) = 12.5%

Fiscal deficit/GDP = - 2.5% (primary) and - 6.0% (financial);

Gross public debt/GDP = 74.0%;

Trade balance and current account/GDP = US$ 55.0 billions and - 1.7%, respectively.

What to do?

Stabilization (inflation under control, sustainable economic growth and fiscal and balance of payments equilibria) = f(State – to assure economic stability –, Market – to alocate limited/scarce resources –, and Institutions – to demand the fundamental rights and democratic principles).

Theoretical approach? Keynesian (monetary theory of production – money is a strategic institution in the capitalism system) and Institutionalism (habits, rules, economic agents and conventions matter).

Macroeconomic policy:

Monetary → Discretionary policy (monetary policy has to keep inflation under control – when AD > AS – and to maintain output stablilization);

Fiscal → Government expenditures t = f(moving average of GDP t-3) and countercyclical fiscal policy. In other words, fiscal responsibility;

Exchange rate → Flexible, but adjustable, exchange rate and capital controls.

Sectoral policies:

Industrial and technological policies and economic openness;

Income policies → Deindex W and P – ΔW and ΔP = f(productivity and regulation and trade openness, respectively) –, tax system and financial market;

Public investment → Health, education, etc.

Structural reforms:

Social Security = f(demographic bonus);

Public-private partnership;

Political reform;

Tax reform.