3. Finally, some green shoots

The INDEC (EMAE) economic activity estimator (see Figure 3.1), which is a monthly proxy for GDP, in November, and for the second consecutive month, registered a monthly increase; after the 0.5% (seasonally adjusted) rise in October, it grew by 1.4% in November, in line with the turnaround in the economy in 4Q indicated by our nowcasting estimates (MICA). However, despite the GDP growth of 0.6% QoQ we forecast for the last quarter of 2016, last year was expected to have closed with a fall in GDP of 2.2%, somewhat higher than previously expected (-2%), as the GDP data for 3Q16 were more negative (-0.2% QoQ s.a. and -3.8% YoY) than projected, especially in terms of investment, although private consumption also showed greater weakness. The recovery of activity in the period, both in industry and in agriculture, is confirmed by other indicators such as car production, which grew by 2.2% YoY in 4Q16 and the wheat harvest, which increased by 30% over the previous year due to the lifting of restrictions that had affected the sector.

Even so, a slower exit from the 2016 recession, according to the results of our MICA model, has led us to revise GDP growth downwards in 2017 (from 3.2% to 2.8%), maintaining it at 3% for 2018 as private consumption will provide slightly more momentum to the economy. Domestic demand will be the main driver of GDP this year and next, despite the fact we are still expecting exports to perform well, although not as spectacularly as in 2016 when the remainder of early years' harvests was liquidated after the release of the "exchange rate trap" ("cepo cambiario"). It is estimated that the harvest of the 4 main grains will exceed that of 2016 by 12% (depending on the final impact of the floods on soybean production). The gradual recovery of the Brazilian economy (+0.9% YoY) is likely to contribute to boosting industrial exports, which in the case of the placement of cars already began to show a growth of 12% YoY in 4Q16. However, the external sector will have a negative contribution of 0.8% to GDP in 2017 and 2018, since imports of both inputs and capital goods will grow at a faster pace than exports in the face of the recovery in investment (Figure 3.2).

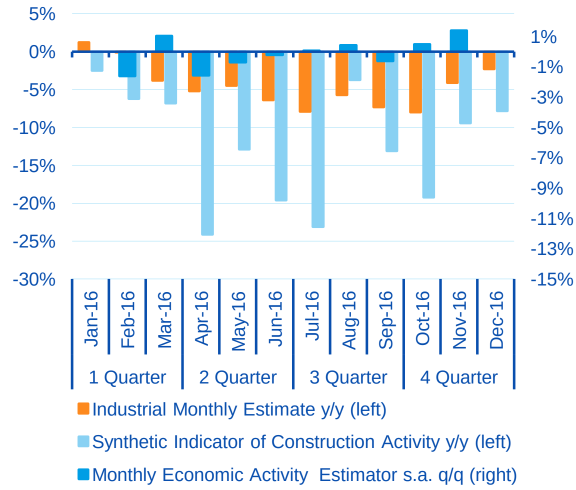
Private consumption will also perform positively in 2017 to the extent that the increase in nominal wages is likely to, on average, exceed expected inflation for the year. Consumer confidence still remains below historical averages, but with some ups and downs it has begun to recover slowly from August 2016. This trend is likely to continue in the face of continued low inflation and deepen in 2018 leading to a 2.9% YoY increase in private consumption next year, which is up from 2.2% in 2017.

Investment will continue to be the main driver of expansion this year but now we are expecting slightly less momentum (we reduced the increase in 2017 from 11.1% to 9.0% YoY), as the latest available official information suggests that the implementation of the announced investments has been slower than anticipated. However, together with the ambitious plan of public investment in infrastructure (USD 11 billion according to the budget) and private investments in agriculture and renewable energies (USD 4 billion in 2/3 years) encouraged by regulatory changes, the recovery will be significant vis-à-vis 2016, where investment would have contracted 4% YoY. Much of the poor performance of investment in 2016 was due to the considerable delays in the progress of public works, due to implementation difficulties linked to the need to clarify the legacy of the previous government and establish corruption-free contract awarding circuits. Private construction also showed no greater dynamism as building costs did not register a reduction in relation to real estate prices while mortgage credit in indexed units has not yet taken off. These projects, which are generally multi-annual, will also have an impact on the formation of capital assets in 2018, rising 7%, after falling 2.3% per year from the imposition of the trap (cepo).

Although the results of the first and second stages of the justification of undeclared assets were very significant, around USD 92 billion, it is still a question of whether new declared assets (15% of GDP) will translate into greater investments within the country because more than 80% of the new declared capital remains abroad. But this possibility, opening up as it is, could potentially be turned over to real estate and other short-term investment projects. This, together with the recent changes in the Ministry of Treasury and Finance, which promise greater control of the fiscal deficit that is worrying potential investors, could turn out to be two events that strengthen confidence and boost higher levels of investment, thus further increasing GDP in the current year.

Figure 3.1

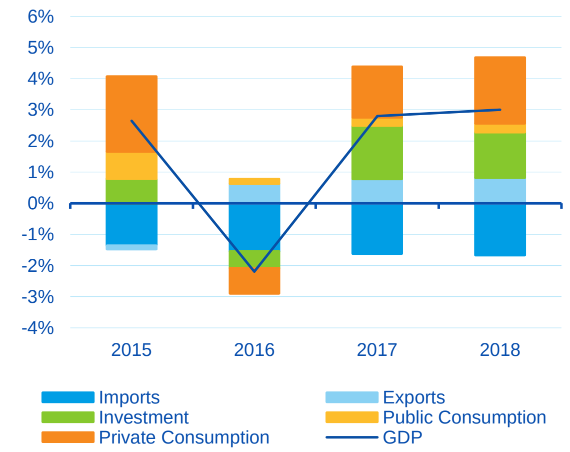
Selected activity indicators (Variation %)



Source: BBVA Research

Figure 3.2

GDP growth and contribution from aggregate variables



Source: BBVA Research

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