

Brazil Flash

More measures to support the (suffering) industrial sector

The government extended tax breaks on home appliances and announced tax cuts to some other goods (such as furniture) to provide help to domestic manufactures during the next three months. The measures will have a fiscal cost of R\$ 498 million (less than 0.1% of federal tax revenue) and should have a limited impact on driving activity up.

- **More evidence on the supply – demand gap**

For a long time now we and other Brazil analysts have been emphasizing the significant gap between domestic supply and demand (see, for example, our Q2 11 Brazil Economic Outlook). The contrast between a very robust demand side and an ailing supply was, actually, reinforced by recently released data. Q4 11 GDP figures, released on March 6, showed private consumption grew 1.1%q/q in and industrial output declined 0.5%q/q in the last quarter of 2011. Data for January showed industrial production dropped 2.1%q/q (markets expected a drop of 0.8%q/q) while retail sales (a good proxy for domestic demand) expanded 2.6%q/q (consensus was for a 1.6%q/q growth). Looking forward, we expect this gap to continue significant, in spite of any new measures this government may take, due to a relatively appreciated exchange rate and series of structural problems (poor infrastructure, high tax burden, high interest rates...)

- **Measures to have limited impact but reinforce government's willingness to defend industrial sector.**

We expect measures announced yesterday after markets closed in Brazil to have a small (positive) impact on activity and a small (negative) impact on fiscal accounts. These measures reinforce the view that this government is willing to act to support domestic industry. This support could come in the future (as they came in the recent past) in form of measures to prevent the exchange rate from appreciating, import barriers, export stimulus, more tax breaks, and even extra monetary easing. Unfortunately, this willingness to support the sector is not expected to create solutions to those structural problems that prevent the sector from being more competitive.

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