LATIN AMERICA ECONOMICS UPDATE

4th Mar. 2010

CAPITAL ECONOMICS

Brazilian industry bounces back

- **Brazilian industrial production bounced back in January following a disappointing end to 2009. Although the manufacturing PMI dipped in February, it continues to point to strong growth over the coming months, driven primarily by domestic demand. Nonetheless, we think that the second half of this year is likely to prove more challenging.**
- Data released today show that Brazilian industrial production expanded by 16.0% y/y in January, down from 18.9% y/y in December last year. **Despite the drop in the annual rate of growth, output rose by a seasonally-adjusted 1.1% m/m.** (See Chart 1.) The outturn was broadly in line with the consensus and our forecast. As a result, the industrial recovery appears to be back on track after a disappointing performance in the last two months of 2009, when output fell back.
- Drilling down into the numbers, manufacturing as a whole expanded by 0.9% m/m. The pick-up was driven by metals – both processed metals which rose 12.0% m/m and basic metals which expanded by 2.5% m/m. At the same time, the production of electrical appliances increased by 4.5% m/m. **More disappointing was the 1.1% m/m fall in vehicle production, which had been the star performer last year on the back of the government's programme of tax breaks.** However, those tax breaks began to be phased out in October and vehicle production has since contracted on a month-on-month basis in the following three months, dropping a cumulative 5.2%. **The expiry of tax breaks in other sectors may weigh on production in a similar manner.** Discounts on construction materials are set to end in June, as will those on commercial vehicles, while cuts on furniture are due to expire this month.
- **Leading indicators dipped in February.** Most notably, the manufacturing PMI survey fell to 55.8 in February from a record high of 57.8 in January. **The detail of the PMI survey continues to suggest that the recovery in industry, just like the recovery in the wider economy, has been driven by domestic demand.** While new orders ticked down to 57.8 in February – still far above 50, the threshold between expansion and contraction – the export orders reading was much lower at 51.0. **The external sector has been under the cosh from general weakness in global demand, along with the strength of the real which has appreciated by more than 30% against the dollar over the past year.**
- **A more recent development has been the rise in the stocks of finished goods component of the PMI survey**. Although last year's tax cuts were successful in stimulating domestic demand, it appears that this demand was at least partly met from existing stocks. Indeed, the stocks of finished goods balance remained below 50 throughout 2009. **That figure has since risen and was above 50 in both January and February, suggesting that firms may now be starting to rebuild their inventories.** (See Chart 2.)
- **Looking ahead, the stock cycle should continue to drive industrial production growth of around 1.0% m/m over the coming months.** But with activity in the wider economy set to slow in the second half of this year, we continue to believe that industrial growth will ease to an average of around 0.5% m/m.

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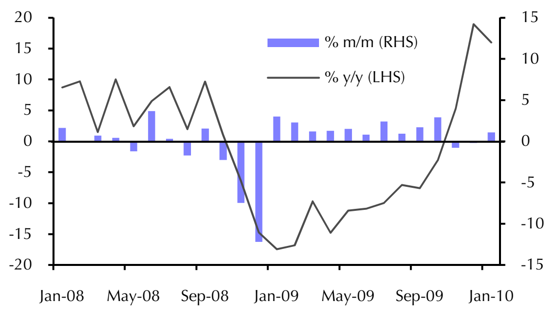
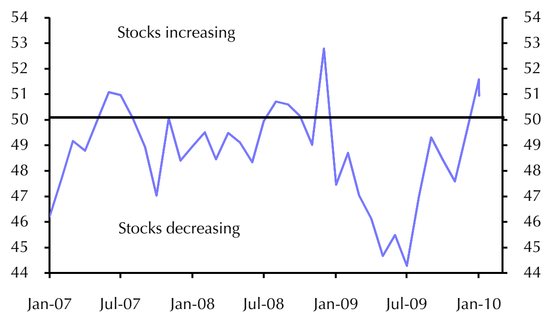
Chart 1: Industrial Production



Source – Thomson Datastream

Chart 2: Manufacturing PMI – Stocks of Finished Goods



Source – Markit