

BRAZIL

# Brazil's potential GDP falls to around 1%

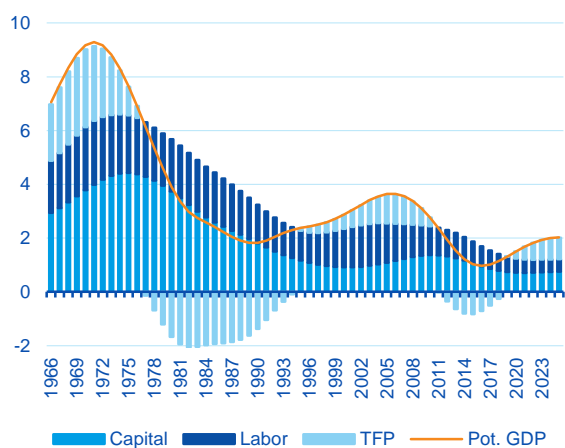
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**Brazil's capacity to grow without generating distortions has declined to around 1%, in comparison to 3.5% between 2004 and 2010. Faster growth could be achieved through the adoption of an ambitious reform agenda.**

The overall deterioration of the Brazilian economy in the last years has produced a significant reduction in the country's capacity to grow without generating distortions. The slowdown of the Chinese economy, the consequent fall in commodity prices, the mismanagement of local economic policies (in particular of the fiscal policy, which has contributed to the emergence of a fiscal crisis), the lack of reforms to spur domestic productivity, among other factors, have all contributed to a fall in Brazil's potential GDP. In fact, these factors have negatively affected each one of the components of potential GDP, namely capital, labor and overall productivity (also known as total factor productivity or TFP).

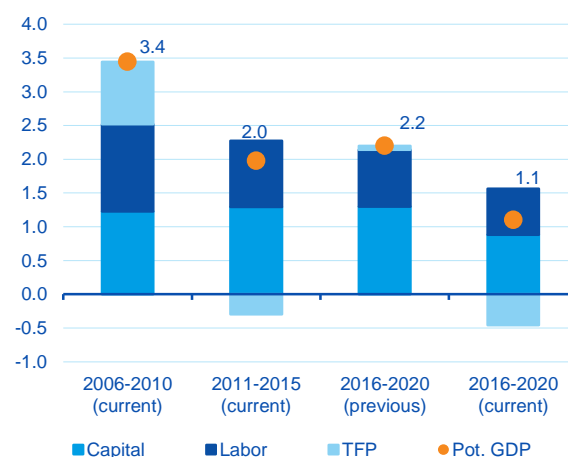
Some examples provide a quick illustration of the deterioration Brazil went through recently: i) investment in fixed capital decreased around 25% from 2013 until 2015, reducing the contribution of physical capital to growth; ii) unemployment jumped from slightly less than 5.0% in the second half of 2014 to more than 8.0% at the beginning of 2016, making less relevant the labor contribution to domestic growth; and iii) Brazil has lately been losing positions in the World Bank's Ease of Doing Business Rankings, which is in line with the view that overall productivity has fallen in recent years.

Figure 1  
Potential output by contributors



Source: BBVA Research

Figure 2  
Current potential GDP estimates for 2006-2010, 2011-2015 and 2016-2020 and previous (2015) estimates for the 2016-2020 period



Source: BBVA Research

Our estimations, based on a production functions methodology, show that Brazil's potential GDP is currently around 1.0% and that it will remain close to that level in the next few years (1.1% on average between 2016 and 2020). Looking beyond 2020, some improvement is likely and potential GDP could then converge to 2.0% (Figure 1).

The potential GDP estimate for the 2016-2020 period is significantly lower than we estimated in 2015 (2.2%), which reflects not only the deterioration recorded in the last few years but also less positive prospects for the future. Moreover, our estimations show that potential GDP will be in the next five years well-below the levels observed in the previous decades (Figure 2).

A faster convergence to a higher potential growth level could be achieved by an early adoption of relevant economic reforms (of the political system, of the social security system, of labor markets, of the tax system, etc), which now we regard as unlikely.

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