ECONOMIC REPORT

1ST QUARTER OF 2020

CNI
Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

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BRASÍLIA
FEDERAL DISTRICT
2020

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PANDEMIC CAUSES UNPRECEDENTED CRISIS

Situation requires emergency measures for economic growth to be resumed

In early 2020, the Brazilian economy saw a gradual recovery from the 2014-2016 recession. That is history. The economic indicators for March and April, such as confidence indicators and business opinion polls, point to an unprecedented interruption in economic activity.

The Covid-19 pandemic has brought about an economic crisis unlike any other in contemporary history. It is not a classic crisis of lack of demand or supply restrictions. This time consumers have disappeared due to the impossibility of shopping.

The crisis hit the country at a moment of economic fragility, marked by high unemployment, low income growth, and families and companies still suffering financially from the last crisis.

Therefore, it is essential to create a safety net for families and companies during the social distancing phase, which restricts not only consumption, but also the income of a large part of the population.

Building a safety net has been the response of most countries in the world, and Brazil is no exception. Emergency policies have three main objectives: strengthening the healthcare system; mitigating the income loss suffered by the population, especially by its most vulnerable segment; and providing financial relief to companies to avoid their bankruptcy and consequent increase in unemployment and disruption of productive structures.

The impact of the crisis on the Brazilian economy is profound. In our baseline scenario, we expect GDP and industrial GDP to decline by 4.2% and 3.9% in 2020, respectively. This projection assumes that the economic aid policies adopted by government will be sufficiently effective to prevent the insolvency of a large number of companies and to significantly reduce the impact of the crisis on household income during the social distancing phase.

In a pessimistic scenario, in which the initial impact of the crisis is greater and, mainly, economic aid measures prove to be insufficient to prevent a sharp reduction in household income and widespread bankruptcy of companies, there would be a decline of 7.3% in GDP and of 7% in industrial GDP.

After the moment of paralysis of activities, finding a way out of the crisis will be another considerable challenge. On the public side, we are facing major fiscal restrictions. On the private side, companies are financially debilitated and lacking the financial muscle to invest, while households do not have sufficient consumption capacity to lead the recovery. In addition, international trade has also been negatively affected by the pandemic, hampering export growth.

To overcome the crisis on a sustainable basis, it is necessary to preserve the competitiveness agenda. More than ever, Brazil needs to eliminate the so-called Brazil Cost. With regard to the tax system, for example, it is essential to approve a reform designed to put an efficient and uncomplicated system in place. In the case of consumption taxation, it is necessary to adopt a world standard Value Added Tax (VAT) that eliminates tax cumulativeness completely, fully exempting investments and exports from taxation. Despite its few short-term results, this agenda is fundamental for attracting investments and promoting long-term growth.

The State must continue to strive to reduce public debt. Commitment to fiscal balance and control of inflation are fundamental to ensure confidence in Brazil and attract investment.

However, this cannot be an objective to be pursued regardless of the country's other problems. Fiscal balance must be a goal, but not the only one. We are entering the fifth year with an unemployment rate above 10%. Direct action from the State is necessary to ensure a growth rate high enough to eliminate this problem quickly, even if this means a longer path to achieve fiscal balance.

Although this may seem paradoxical, it is necessary to reconcile the search for fiscal balance with an expansionary fiscal policy (with a reduction in the tax burden and/or an increase in public investments), even if controlled.

The few resources available make the choice of public investments even more crucial.
Priority should be given to investments with high social return and/or that can improve the productivity and efficiency of the economy.

1 ECONOMIC ACTIVITY

Economy will once again experience recession in the first half of 2020

GDP will decline by 4.2% if economic measures yield positive results

Economic activity was recovering gradually early in the year

Economic activity data for January 2020 surprised positively. Industry and Services were showing reasonable growth after their frustrating performance in the last two months of 2019. In February, production performance (PIM-PF/IBGE) was weaker, but still positive for Industry as a whole. The data for services was still positive.

In the first two months of the year, when the outbreak of the new coronavirus was virtually limited to China and some other Asian countries, concerns in Brazil were restricted to the effects of the decline in international demand, which caused commodity prices to plummet, and of the shortage of imported inputs in certain industrial sectors[1]. Entrepreneurs remained optimistic, as indicated by the Business Confidence Index (ICEI / CNI), despite a slight fall in February.

The economic impacts of the pandemic changed in nature in March

Brazil recorded the first case of Covid-19 in late February. As the number of cases increased, large cities began to impose social distancing measures[2], which is the standard response to the pandemic recommended by the World Health Organization (WHO). In this early stage of the response, milder social distancing measures were adopted nevertheless, consumers already started to avoid unnecessary agglomerations and movements of people. Thus, the service sector was the first one to feel the drop in demand, especially bars, restaurants, tourism and transportation.

After the WHO recognized Covid-19 as a pandemic, at the beginning of the second half of March, the number of cases increased in Brazil, and the first death was announced in the country, on March 17, the containment measures adopted by governments became tougher, especially in large cities. They began to shut down most services, except for essential ones, such as hospitals, supermarkets, and drugstores. As a large part of stores closed their doors and people were recommended to stay at home, consumers disappeared.

In Industry, other problems were added to the negative impacts perceived in February (drop in exports and production difficulties caused by the lack of inputs). Additional logistical problems to obtain inputs and distribute final products began to arise, ranging from the closure of borders to unavailability of meals and services on highways. Uncertainties also began to affect access to working capital.

Nevertheless, the sharp drop in sales caused by the crisis was the strongest impact for industry. With no sales prospects, retail stores canceled orders. Bad debt also increased sharply. At the end of March, CNI conducted a Business Survey[3] on the subject, and it showed that 92% of the companies consulted had been negatively affected by the coronavirus epidemic. The drop in sales was the main impact of the crisis brought

[1] According to a report prepared by the Brazilian Electrical and Electronics Industry Association (Abinee), 70% of all companies operating in the electrical and electronics industry that were surveyed were facing problems to receive components and inputs from China in the first week of March.

[2] These measures constitute an enormous challenge from an economic point of view, but they are intended to reduce the rate of spread of the virus and to avoid a high and concentrated peak in the number of cases over time. They are meant to enable healthcare systems to treat a controlled, rather than chaotic and excessive, flow of covid-19 patients effectively. The more coordinated this process is, the smaller the social and economic implications of the pandemic.

about by the pandemic, as it was mentioned by 70% of the surveyed companies, followed by order cancellations, indicated by 49% of the consulted companies. As a result, companies reduced or even interrupted their production altogether.

Industrial production data (PIM-PF/IBGE) for March already show a strong contraction in activity, despite the adoption of more severe containment measures being put in place only in the second half of the month. Production fell by 9.1% in March 2020 in relation to February, after seasonal adjustments. This is the most negative result since May 2018 (effect of the truck drivers' strike), when industrial production declined by 11%.

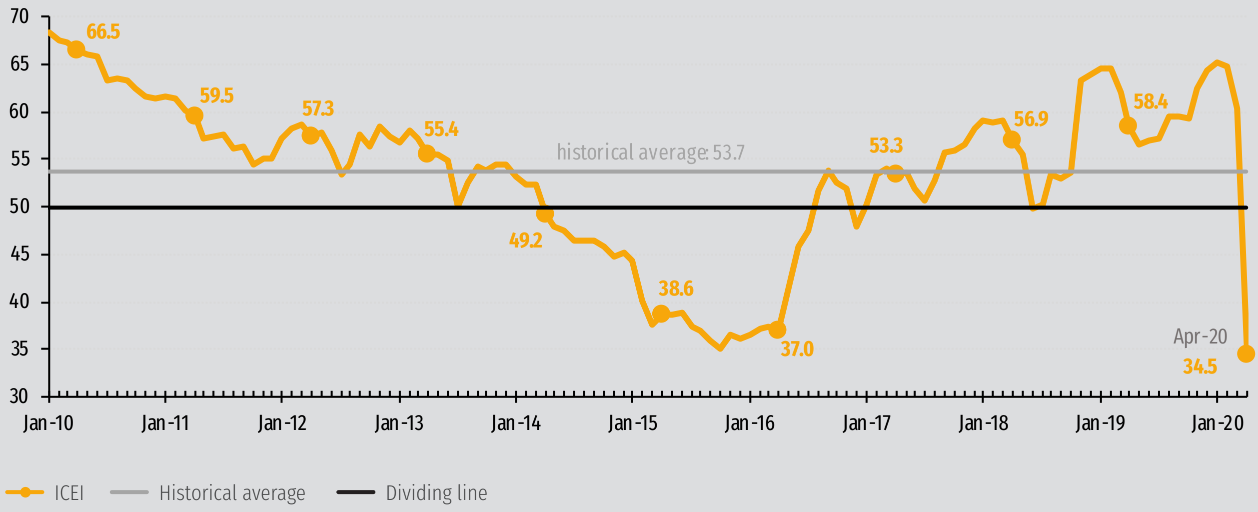
The Business Confidence Index (ICEI/CNI) of April[4] suggests in turn that industrial activity will continue to be affected by the continued strong impact of the crisis. The ICEI index recorded a drop of 25.8 points as compared to March. The index fell from 60.3 to 34.5 points, the lowest figure in the historical series. Until then, the sharpest drop recorded in a single month was 5.8 points, in June 2018, as a result of the truck drivers' strike. The ICEI index had already dropped by 0.6 points in February and by 4.4 points in March, accumulating a fall of 30.8 points over the period.

The sectors most impacted by the crisis are those related to producers of durable consumer goods (furniture, clothing, shoes, automobiles and electronics). The sectors least impacted are those of cleaning and personal hygiene products, pharmaceutical chemicals and pharmaceuticals and food.

Graph 1 - Fall in business confidence in April is unprecedented

Business Confidence Index

*Index (0-100 points)**



* The ICEI index ranges from 0 to 100 points. Figures above 50 points indicate business confidence. The further above 50 points, the greater and more widespread the confidence. Figures below 50 points indicate lack of business confidence and the lower below 50 points, the greater and more widespread the lack of confidence.

Source: ICEI/CNI

[3] Business Survey: Impacts of the Coronavirus, available at https://www.portaldaindustria.com.br/estatisticas/business-inquiry/
[4] Business Confidence Index (ICEI/CNI), available at https://www.portaldaindustria.com.br/statistics/icei-business-confidence-index/

Effectiveness of government measures and extension of the quarantine will determine the final impact of the crisis on the economy

Faced with this situation, the Federal Government adopted measures to face the public health and economic crisis brought about by the new coronavirus pandemic. It adopted three main action lines: providing increased funds for the healthcare system to be able to meet an increased demand; ensuring an income to the most vulnerable households; and alleviating costs and enabling companies to survive and preserve jobs (as detailed in the box "Evaluation of emergency measures taken by the Federal Government to address the crisis brought about by Covid-19" at the end of this section).

The final impact of the crisis caused by the Covid-19 pandemic on the Brazilian economy will depend on the interaction between two forces: the evolution of the pandemic, insofar as it allows – or does not allow – relaxation of the toughest social distancing measures; and measures to mitigate its economic impacts.

The interaction between these factors also helps to explain how recovery from this crisis will develop once its most acute moment is over. Effective measures will enable faster recovery by preventing the bankruptcy of a large number of companies[5] and a significant increase in unemployment.

The longer the duration of the social distancing measures, the greater the chances of the crisis intensifying, increasing its impacts on both supply and demand for goods and services. Bankruptcy of companies will disrupt production chains and push unemployment up, leading to a decline in income and thus resulting in lower consumption even after restrictions are lifted.

At this moment, we are facing a major challenge in economic terms, since this crisis is very different from previous ones. It is a crisis where consumers disappear because they were virtually forbidden from consuming. It is a crisis where, for example, measures to stimulate demand are not the solution.

In addition, the crisis hit the country at a delicate moment, when it was beginning to recover from another crisis that, until 2017, had led GDP to decline by more than 7%, resulting in more than 12 million unemployed in early 2020, and had left families and companies in a weak financial situation.

Brazil in recession in the second quarter

All the uncertainties surrounding the Covid-19 pandemic, whether in terms of the importance of its initial impact, in economic terms, or in terms of how we will recover from it, require us to work with scenarios.

In all three scenarios, the impacts in March of the crisis caused by the pandemic are strong enough to reverse the positive result recorded in the first two months of the year. The "disappearance" of consumers has caused demand to decline sharply for services and most industrial activities, except in some specific sectors, such as in those related to healthcare, in the case of services, and in those related to hygiene and cleaning products, pharmaceutical chemicals and pharmaceuticals and food, in the case of industrial activities.

In the baseline scenario, we are estimating a 2.5% drop in Brazilian GDP in the first quarter and expecting economic recovery to start in June. The result in the second quarter will likely be a 7.1% drop in GDP.

[5] Without revenues from sales, routine spending, such as taxes, suppliers, wages, electricity bills, rent, among others, continued. Soon, industry began to struggle to make routine payments. The Business Survey: Impacts of the Coronavirus also revealed that 73% of the companies surveyed were facing difficulties to make routine payments. At the same time, access to credit became more difficult, while uncertainties, not only in Brazil but also in the world at large, increased dramatically.

In this scenario, economic relief measures will avoid widespread bankruptcy of companies and a major disruption of the productive system (i.e. in this scenario, logistical problems and problems caused by the lack of inputs or workers are mitigated). Nevertheless, they are not effective enough to fully prevent companies from closing their doors and their financial situation from worsening (due to the drop in revenues, and/or difficulties to access credit), which will lead entrepreneurs to adopt a more cautious stance.

Recovery in demand will be moderate due to the drop in household income, especially among households whose income comes from informal work or self-employment (see the section Employment and Income). Even families whose income declined more moderately may adopt a more cautious behavior when returning to stores, preserving the precautions adopted during the social distancing period in their contacts with other people.

Thus, in the second half of the year economic activity will quite certainly recover, but the intensity of this recovery will be limited by a moderate recovery of demand, coupled with a more cautious stance on the part of entrepreneurs and households. The year will therefore close with economic activity at similar, albeit still lower levels than those recorded in February, before the economic contraction started. Considering this moderate pace of recovery, we are estimating that GDP will fall by 4.2% in 2020 in relation to 2019. Industrial GDP will likely decline by 3.9%.

In an **optimistic scenario**, which is less likely, the decline in activity in March and April is lower than in the baseline scenario. In addition, economic measures to protect income and make credit available prevent the economic effects of these months from having permanent impacts, i.e. they prevent them from translating into a significant fall in employment and income and do not disrupt the economic supply structure.

Furthermore, fiscal and monetary stimuli will result in an additional boost to the economy, and economic agents, households and entrepreneurs

quickly abandon the more cautious stance they had taken during the most severe period of the crisis. Thus, recovery is extremely fast and in August activity will be back to the level recorded in February 2020. In this scenario, GDP will drop by 2.0% in the first quarter and, in the second, it will decline by 3.8%.

In the second half of the year, the Brazilian economy will return to normal and resume a growth rate similar to that observed last year. However, even in this optimistic scenario, GDP will close the year with a drop of 0.9%, while industrial GDP will decline by 1.8%.

In a **pessimistic scenario**, the fall in activity in March and April is more significant than in the baseline scenario. In addition, restrictive measures will be relaxed at a later time and in a more staggered fashion than in other scenarios. Additionally, in this scenario the measures will not be sufficiently effective to prevent many companies from closing down; thus, unemployment will rise and income will fall, delaying the recovery of demand.

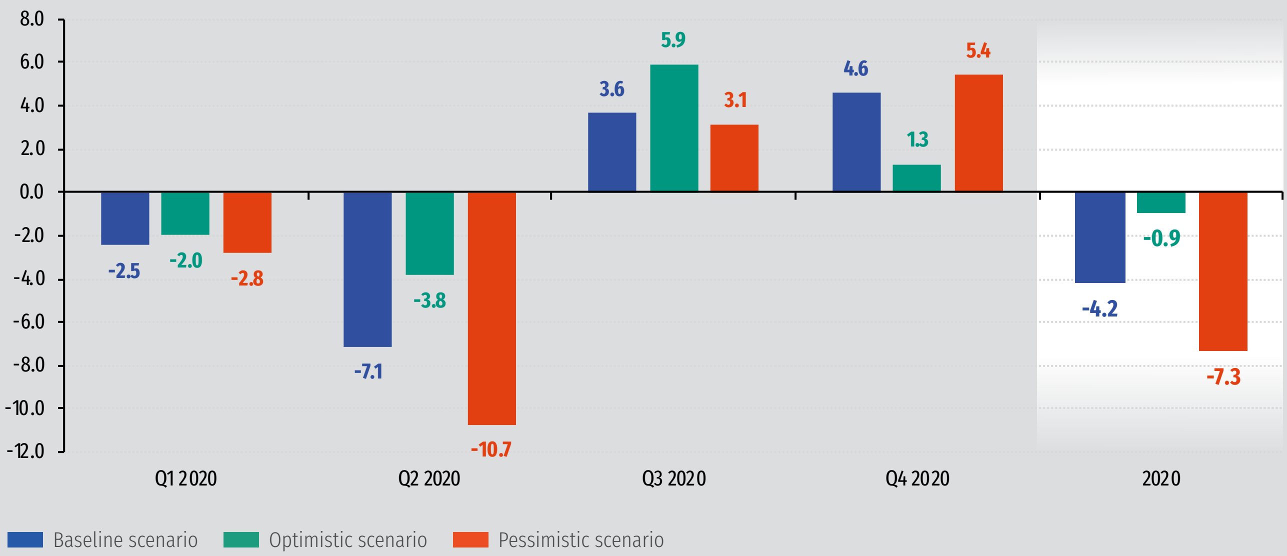
A larger number of bankruptcies and the stoppage of economic activity for longer periods will cause the disintegration of production chains, reducing productivity. In this scenario, GDP will decline by 2.8% and 10.7% in the first and second quarters, respectively.

In the second half of the year, a sharp drop in household income, rising unemployment and supply difficulties would slow down the pace of recovery of the economy. Its growth would then be consolidated over the third quarter and would only gather speed in the fourth quarter. In this scenario, GDP would decline by 7.3% in 2020 in relation to 2019, while industrial GDP would fall by 7.0%. At the end of the year, the level of industrial activity would still be far from that recorded in February 2020.

Graph 2 - Even in an optimistic scenario, GDP is likely to decline in 2020

Estimates of quarterly GDP evolution (seasonally adjusted) and variation in 2020 in relation to 2019

Percent variation



Source: CNI

Evaluation of the federal government's emergency measures to address the crisis brought about by Covid-19

Federal Government made a precise diagnosis of the situation to address the crisis and it now needs to ensure the effectiveness of its measures and evaluate their intensity

The Federal Government adopted measures to meet the main needs of the population in facing the public health and economic crisis caused by the coronavirus. In other words, it took action to ensure an income for the most vulnerable households, alleviate the costs of companies and enable them to survive, and make more funds available for the healthcare system to be able to meet an increased demand.

The question now is ensuring that these measures are actually effective and analyzing whether they will be sufficiently intense. In terms of effectiveness, a point that still lacks new measures is that of the availability of collateral for companies to have access to the new funds made available for financing.

Among the measures taken to ensure an income to the most vulnerable households, the most relevant ones were an emergency aid of R$600 per month for beneficiaries of the Family Grant (Bolsa Família) program, informal workers, unemployed workers, individual microentrepreneurs (MEIs) and intermittent workers, approval of withdrawals from accounts of the Government Severance Indemnity Fund for Employees (FGTS), and advance payment of the 13th salary (Christmas bonus) to retirees and pensioners, of the wage bonus, and of sickness leave and assistance benefits. Altogether, these measures will make an income available to eligible households amounting to over R$200 billion.

With regard to measures to reduce the costs of companies and enable them to survive, the most important ones were the postponement of the payment of taxes (Social Integration Program [PIS]/ Contribution to Social Security Financing [COFINS], Employers' Contribution to the Social Security System, Simple Taxation Regime) and of contributions to the FGTS fund; postponement of loan repayments to public banks; and permission for a proportional reduction in working hours and wages or suspension of employment contracts. The tax measures will reduce costs or increase the availability of funds to companies in the amount of R$140 billion. In addition, the federal government will make approximately R$50 billion available to reduce the impact of reducing working hours and wages and of suspending employment contracts on the income of workers.

Other fundamental measures for companies to be able to survive during the period of low economic activity caused by the actions taken to fight the pandemic include increasing the supply of credit and reducing financing costs. Actions such as creating an emergency financing line to fund two months of payroll and increasing the funds available in the Workers' Support Fund (FAT) and Brazil's Development Bank (BNDES) for credit to micro and small enterprises help companies whose sales will drop sharply to get working capital to meet their cash needs.

However, there are doubts about the effectiveness of the various measures taken by the Central Bank to increase liquidity in the financial market and ensure that companies will actually be able to access these funds at feasible costs. In times of high risk, such as those being faced today, financial institutions raise costs and impose more stringent collateral requirements for credit transactions.

For the problem of access to credit to be solved, the risk should be assumed by the National Treasury. This is what was done in Europe and in the United States. It is the only way to minimize bankruptcy claims and the loss of jobs they may cause.

2 EMPLOYMENT AND INCOME

Impact of the crisis on employment and income may be felt until 2021

Employment trajectory was favorable before the crisis

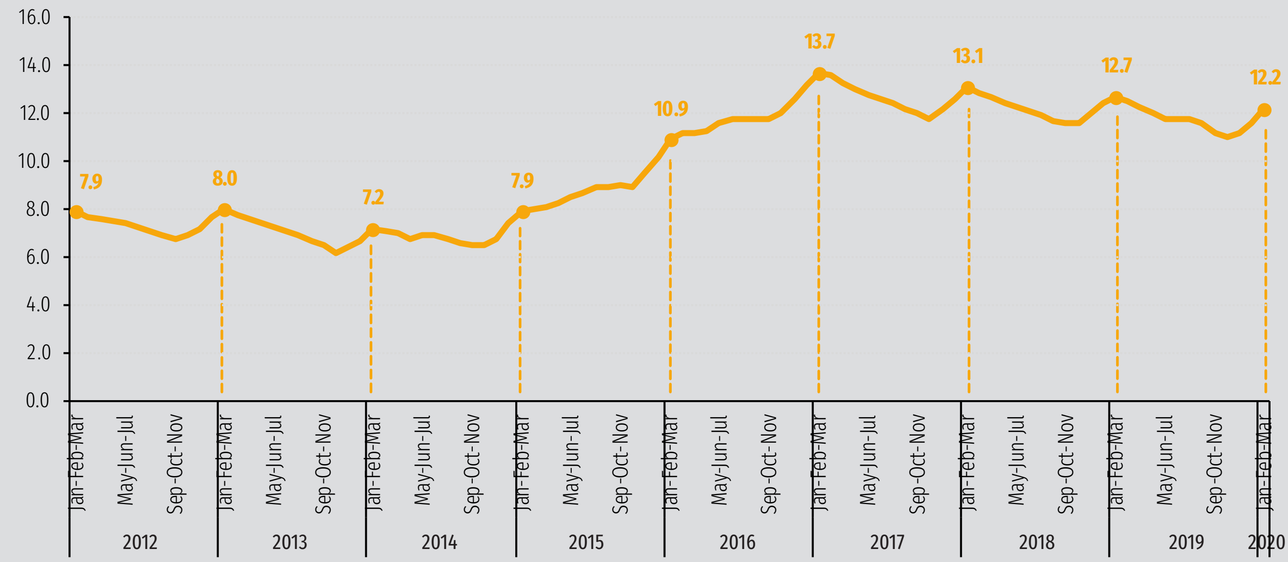
Before March, the unemployment rate reflected a gradual recovery of the Brazilian economy. For example, the unemployment rate in the moving quarter ended in February was the lowest for the period since 2015.

In March, the rise in the unemployment rate is already reflecting the economic crisis caused by Covid-19, albeit only partially. Seasonally, the unemployment rate in the January-February-March quarter tends to increase due to the dismissal of workers hired on a temporary basis to meet the demands of the end-of-year holiday season.

Graph 3 - The unemployment rate was on a downward trend before the crisis

Unemployment rate

Percent (%)



Source: Continuos PNAD survey/IBGE

The strictest measures with a greater bearing on employment, such as store closures, began to be implemented from March 20 in Brazil's main cities. Thus, it is likely that the effects of measures restricting the circulation of people on the unemployment indicator will only be fully observed after the moving quarter ending in June.

However, evidence of the impact of the pandemic on the data can be observed already. As the unemployment rate typically varies during this period every year, it is useful to compare variations observed in 2020 with the average variation seen during this period in the average of the other years in which the survey was carried out. The table below shows variations seen between the moving quarter ended in March and the one ended in February for that year and for the average of the other years in which the survey was carried out.

First, it can be seen that the number of employed people declined by 1.6%, a higher percentage than the usual average recorded for the period (-0.3%). At the same time, the number of unemployed persons increased by 4.1%, less than the usual 5.1%. This result was determined by a greater-than-usual increase in the number of people outside the labor market.

Brazilians aged 14 or over who are engaged in a paid activity are considered to be part of the labor force, in addition to unemployed individuals, who are the non-employed Brazilians actively looking for a job. Those who are neither employed nor looking for a job are considered to be outside the labor force.

Table 1 - Decline in the number of employed persons in March is sharper than the average observed in previous years

Variation in the number of employed persons, unemployed persons and people outside the labor market, by type of occupation

	Variation between the moving quarter ended in February and March	
Work regimes	**Only 2020**	**2013-2019 average**
Outside the labor force	**-1.6%**	**-0.3%**
Unemployed	**4.1%**	**5.1%**
Employed	**2.0%**	**-0.1%**
Employee	-1.8%	-0.3%
Private sector (excluding domestic workers)	-2.5%	-0.4%
With a formal job	-1.6%	-0.5%
Without a formal job	-5.3%	-0.3%
Domestic worker	-3.8%	-0.5%
With a formal job	-4.5%	0.0%
Without a formal job	-3.6%	-0.7%
Public sector	2.5%	0.3%
With a formal job	0.1%	-1.0%
Military and statutory civil servant	2.7%	0.5%
Without a formal job	3.1%	0.3%
Employer	**-0.6%**	**0.0%**
Self-employed	**-1.3%**	**-0.3%**

Source: Prepared by CNI based on data from the Continuous PNAD survey/IBGE

It should be noted that variations in 2020 were more pronounced than the average for the period, even the average for the period spanning the years 2014 to 2017, when the economic crisis had a profound impact on the labor market.

As can be seen in the table, among the employed population the most significant impacts were on private sector employees without a formal contract, domestic workers and self-employed workers. The drop in the number of employed persons in these categories was significantly sharper than the drop usually observed during this period of the year.

Data being collected for April is likely to reflect the effects of the crisis on the labor market more accurately. Nevertheless, one should keep in mind that the statistics yet to be released will represent an average with the data for February and March and will thus still dilute the actual impact. The full impact will only be captured by the survey in the July issue, which will cover the months of April, May and June.

Impact of the crisis will be more pronounced for informal and self-employed workers, despite the emergency aid they were granted

The impact of the crisis on employment and income will depend on three factors. The first one is the duration of the acute phase of the crisis, with social distancing measures in place. The second one is the pace of economic recovery after the peak of the crisis. The third one is the set of public policies implemented to protect people's employment and income and their effectiveness. Each of these factors will have a different impact on employment and income, according to the work regime of the workers in question.

The first group of workers is made up of Brazilians working in the military or who are statutory civil servants, who account for 7.7% of the labor force. This group of workers will suffer the least negative impact of the crisis, as they have job and income stability.

The second group is made up of workers under the CLT (Consolidated Labor Laws) regime (workers in the public and private sectors or domestic workers), who together account for 34.2% of the Brazilian workforce[6]. This group enjoys the second highest level of employment and income protection.

In case of dismissal, workers with a formal employment contract have access to unemployment insurance and severance pay, which tend to protect part of their income in the short term during the acute phase of the crisis.

In addition, the costs involved in dismissing these workers may lead employers not to do so during the crisis and to use the relaxation of rules for moving up holidays and vacations or adopting the mechanisms provided for in the Emergency Employment and Income Preservation Program, such as those allowing for wages and working hours to be reduced or for employment contracts to be suspended.

During the period of suspension of employment contracts and/or reduction in wages and working hours, measures were established to ensure a minimum income for workers, such as access to the Emergency Employment and Income Preservation Benefit and to emergency withdrawals from FGTS compulsory savings accounts.

If companies expect a speedy recovery, they will tend to take advantage of job protection measures to avoid dismissal costs and the costs involved in hiring and training new workers for when they resume their regular operation.

The decision of a company to retain its workers is positive because it allows for a speedier recovery once the acute phase of the crisis is over. This is so because the income of these workers is preserved when the measures to protect jobs are lifted and because the productivity of workers already trained and with the necessary skills to resume their activities is higher than that of newly hired workers.

[6] All data presented in this section are based on the moving quarter ended in March of IBGE's PNAD Continuous Survey.

If companies expect a slow recovery, they may consider that they will be left with excess workers for a long period of time after the quarantine is over, forcing them to increase the number of layoffs.

The third group of workers is made up of informal employees, self-employed workers and employers, who account for 44.0% of the labor force.

This is the most vulnerable group both during the quarantine period and the economic recovery period.

Informal workers are more susceptible to dismissal, as dismissing them does not involve the same costs associated with dismissing workers enjoying the protections provided for in the Consolidated Labor Laws (CLT). In addition, this group is not covered by the Emergency Employment and Income Preservation Program and is not entitled to make emergency withdrawals from FGTS accounts, given that informal jobs do not pay any contributions to the FGTS fund and previous withdrawals from it reduced the amounts available in inactive accounts, from possible previous formal employment.

Brazilians who are self-employed workers or employers are exclusively dependent on their production to earn their income. Due to the quarantine measures, many of them were prevented from carrying out their regular activities and had their income greatly reduced or were left with no income at all.

Table 2 - Work profile in Brazil, by work regimes

Work regimes	Number of workers (million)	Share in the population aged 14 or over (%)	Share in the labor force (%)	Usual average monthly income from work in Reais (R$)
Employees with a formal employment contract	**35,940**	**20.9%**	**34.2%**	**R$2,281,99**
Private sector	33,096	19.2%	31.5%	R$2,276,00
Public sector	1,204	0.7%	1.1%	R$3,795,00
Domestic workers	1,640	1.0%	1.6%	R$1,292,00
Employees without a formal employment contract	**17,696**	**10.3%**	**16.8%**	**R$1,395,14**
Private sector	11,023	6.4%	10.5%	R$1,504,00
Public sector	2,342	1.4%	2.2%	R$2,024,00
Domestic workers	4,331	2.5%	4.1%	R$778,00
Self-employed workers	**24,158**	**14.0%**	**23.0%**	**R$1,753,90**
Self-employed workers with a corporate income tax ID number (CNPJ)	5,444	3.2%	5.2%	R$3,022,00
Self-employed workers without a corporate income tax ID number (CNPJ)	18,714	10.9%	17.8%	R$1,385,00
Employers	**4,384**	**2.5%**	**4.2%**	**R$5,944,75**
Employers with a corporate income tax ID number (CNPJ)	3,584	2.1%	3.4%	R$6,463,00
Employers without a corporate income tax ID number (CNPJ)	800	0.5%	0.8%	R$3,623,00
Statutory civil servants and military personnel	**8,106**	**4.7%**	**7.7%**	**R$4,258,00**
Unemployed workers	**12,850**	**7.5%**	**12.2%**	-
Auxiliary family worker	**1,938**	**1.1%**	**1.8%**	-
Outside the labor force	**67,281**	**39.0%**	-	-
TOTAL	**172,353**	**100.0%**	-	-

Source: Continuous PNAD Survey/IBGE, mobile quarter ended in March 2020.

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It should be noted that 77.5% of all self-employed workers were active without a corporate income tax ID number (CNPJ) and, even among employers, 18.2% worked without a CNPJ number. Informality poses an additional difficulty for these Brazilians, who will find it difficult to access credit during the acute period of the crisis. In addition, the average monthly income of informal self-employed workers or employers is about half the income of those owning a formal business. Thus, their financial reserves to support their businesses and families during the crisis are likely to be smaller.

The Brazilian government has offered an emergency aid ranging from R$600 to R$1,200 to this group of workers. Albeit positive for preserving a minimum consumption pattern for these families during the acute phase of the crisis, this measure represents a reduction of more than 50% in the income of informal and self-employed workers, considering the average income of these categories as reported in the Continuous PNAD survey carried out in the moving quarter ended in March.

After the three months during which this aid will be available, the income of these workers will depend on the pace of recovery of the economy, given that informal employees will only be rehired as the economy picks up. In addition, the income of self-employed workers and employers also depends on households resuming their consumptions and on companies resuming their operations.

The fourth group of Brazilians in the workforce is made up of 12.8 million people who were unemployed before the crisis hit. For these workers, the prospect of getting a job in the coming months is substantially lower, increasing their time outside the labor market and resulting in further depreciation of human capital.

Access to the emergency aid of R$600 announced by the government was extended to unemployed people who were not receiving unemployment insurance, ensuring them a minimum income over the following three months. After this three-month period, these workers' income prospects depend on the pace of economic recovery and on the additional number of workers who lost their jobs during the height of the crisis, considering that people who have been unemployed for the least time are usually the ones who are rehired more quickly.

Finally, the income of Brazilians who were outside the labor market, including students, retirees, pensioners, housewives, discouraged workers, among others, must be analyzed.

In this group, retirees and pensioners will receive their 13th salary (Christmas bonus) in advance between the end of April and early June, in two installments. Additionally, retirees and pensioners will also benefit from lower interest rates and longer terms to pay off payroll loans. This injection of funds at a time of widespread reduction in income is beneficial and helps families to continue consuming essential goods. It should be noted that this measure applies not only to retirees and pensioners, but also to their families, given that family members with a more stable income usually help those who lost their jobs or whose income was sharply reduced in times of crisis.

Prospects for the labor market in late 2020

In the baseline scenario, the impact of the pandemic on the economy will be mitigated, albeit not entirely, by economic aid measures, and gradual recovery will allow the economy to recover to a level close to the one recorded in early 2020, but not quite the same. In this scenario, an unemployment rate of about 12.5% is expected for December, with an increase of approximately one million unemployed people in relation to the mobile quarter ended in February 2020.

In the optimistic scenario, the negative impact of the crisis on income will be effectively mitigated by the economic measures already announced by government. In this scenario, economic activity will decline less sharply during the acute phase of the crisis and economic recovery will be faster. As a result, fewer jobs will be lost at the height of the crisis due to a more intense adoption of the measures contemplated in the Emergency Employment and Income Preservation Program and informal and self-employed workers will recover their jobs and income more quickly. Thus, by the end of the year jobs and income will likely have recovered to the level seen in early 2020, when the unemployment rate was 12.0%.

In the pessimistic scenario, in which the economic retraction will be even stronger in the second quarter and the economy will recover more slowly, economic activity will close 2020 at a level close to that observed in early 2017, when the unemployment rate exceeded 13.5%. This represents an increase of about two million unemployed workers at the end of 2020 in relation to the mobile quarter ended in February.

This scenario will have a significant impact on household income at the end of the year, as formal workers who lost their jobs during the height of the crisis will have used up a large part of their savings and all of their unemployment insurance. The income situation will be even worse for informal workers who lost their job and could not find a new one, considering that the emergency aid will only be granted for three months. Even if they find a way to resume their activities, self-employed workers and employers will in turn experience a lower level of economic activity and will lose part of their income compared to before the crisis.

3 INFLATION, INTEREST RATES AND CREDIT

Bank credit is essential to ensure the survival of companies

Economic situation increases the need for monetary stimulus

In early 2020, before the Covid-19 crisis broke out, inflation was well-behaved, the credit market reflected a gradual recovery of the economy and the basic interest rate, the Selic rate, seemed to have interrupted its downward trend.

The Extended National Consumer Price Index (IPCA) recorded a growth of 0.53% in the year to March and of 3.3% in 12 months, below the 4% target set by the National Monetary Council (CMN).

In the bank credit market, total lending increased by 6% in the first two months of 2020 as compared to the same period in 2019, in real terms. Total credit stock increased in turn by 3.1% in real terms in February as compared to the same month in 2019.

The Monetary Policy Committee (Copom) had reduced the Selic rate by 0.25 percentage points (p.p.) at its first meeting of 2020, which was held in February, and its minutes suggested that the cycle of reductions in the basic interest rate had been interrupted after its fifth reduction in a row. This decision was based on the perception that with inflation under control, based on anchored expectations, and economic activity being resumed, there was no need to continue to pursue monetary easing, as had been done since July 2019.

Uncertainties increased with the pandemic, with effects on the credit market

However, as of March, the Covid-19 pandemic triggered the beginning of a recessive process in Brazil as a result of the measures adopted to restrict the circulation of people. Consumers quickly disappeared, drastically reducing demand. Sales and, consequently, production shrank, while bad debt rates increased, quickly affecting companies' cash flow.

As a result, the need for financing for economic agents increased. In industry, the combination between an abrupt drop in sales and continued current spending, such as with taxes, suppliers, wages, electricity bills, rent, among others, created difficulties for dealing with routine payments[7].

To address these difficulties and try and prevent the financial situation of companies from deteriorating further, the Federal Government and the Central Bank came up with a series of emergency programs contemplating measures such as temporary suspension of tax and loan payments, creation of special credit lines for the most vulnerable sectors and activities, and actions designed to capitalize the financial system and increase its liquidity.

However, additional measures are needed to ensure that these funds can be accessed by all companies in need of financing, especially by smaller and more vulnerable ones. It should be mentioned that even before the new coronavirus crisis broke out, companies were already indicating that access to capital and the cost of capital were two of the main challenges to the competitiveness of the productive sector. Insufficient funds, high costs and inadequate loan terms were already being pointed out as problems that make it more difficult for companies to access investment and working capital finance for their daily operations.

[7] CNI's Business Survey on the effects of the pandemic revealed that 73% of the companies surveyed were facing difficulties to make routine payments in late March. The Business Survey: Impacts of the Coronavirus is available at https://www.portaldaindustria.com.br/estatisticas/business-inquiry/.

These dysfunctionalities were enhanced by the crisis, deepening the urgent need of companies for financing, especially of the most exposed ones at the moment, which need to resort to loans to keep paying their current costs and preserve the jobs of their employees.

Additionally, over the past few years a significant reduction was observed in earmarked funds, in particular in credit lines directly or indirectly made available by Brazil's Development Bank (BNDES). Considering this sharp reduction in earmarked funds and bottlenecks hindering operations with non-earmarked funds, transfers of new public funds to finance the productive sector and efforts to ensure that the private credit market functions as efficiently as possible are of crucial importance.

More needs to be done to prevent credit restrictions

Brazil's Central Bank adopted measures to increase liquidity in the credit market and to adapt the structure of credit operations to current needs. The actions taken by the monetary authority have been structured in such a way as to keep the financial system capitalized and ensure that credit channels are functioning normally, and also to restructure capital and provisioning requirements to make it possible for sectors affected by the crisis to roll over their debts without compromising any of the prudential rules defined by Basel.

However, despite the measures adopted by the Central Bank to increase liquidity – estimated at R$1.2 trillion – additional solutions must be sought for smaller companies operating in the most vulnerable segments of the market to access credit on a timely basis.

The need for greater intervention from the Central Bank and the Federal Government is corroborated by the latest results announced for the credit market. In March, total credit granted increased by 60%, well above the increase typically observed in the month. In the first quarter of 2020, it increased by 23% in real terms in relation to the first quarter of 2019.

This increase in credit granting is a result of both a higher demand for credit and of the measures taken by the Central Bank to increase liquidity in the financial market. It should be noted that demand increased more than supply, considering the complaints from companies. In addition, the increase in credit granting was for the most part absorbed by large companies and with good credit rating[8].

Possible complementary measures that could be adopted at this most acute moment of the crisis include: relaxation of guarantee and counter-guarantee requirements; increased participation of the National Treasury, via Central Bank and public banks, in the sharing of risks; and restructuring of Guarantee Funds already in place.

Greater assumption of risk by the National Treasury is an essential measure to ensure that finance can be accessed as urgently as required by companies in need of credit, so that they can keep paying their current costs and avoid dismissing workers. This measure has been taken in other countries around the world, such as in the United States, which created credit lines assuming 95-100% of the risk involved.

The Central Bank's authorization to change corporate credit risk rating for granting new loans would also be positive. This measure avoids the need for increased provisioning for bad loans, with impacts on the supply of credit, and contributes to reducing the cost of credit and to increased access to the banking market. Permission has already been granted for redefining conditions for operations renegotiated between March 1 and September 30, 2020 according to their risk rating in February 2020, before the economic effects of the measures taken to fight the Covid-19 pandemic began to be felt.

[8] According to the Central Bank, the total credit stock of micro, small and medium enterprises increased by 2.1% between February and March, from R$541 billion to R$552 billion. In the case of large companies, the balance rose from R$903 billion to R$984 billion, meaning that it grew by 9.0%.

Corporate debt market has also been affected

The spread of the new coronavirus around the world also affected the capital market. Investors' risk aversion increased significantly, affecting emerging economies, including the Brazilian economy, more intensely.

It should be highlighted that the capital market is always on the alert to try and anticipate repercussions on economic activity and had been observing declines already, following the devaluation of commodities and the downward trend in international oil prices, which became more intense after the outbreak of the pandemic.

In addition, increased risk aversion and uncertainties about the duration of the crisis have been hampering transactions in the secondary market. Considering the pricing difficulties caused by the current scenario, those who need to sell their bonds to redeem their debt cannot find buyers for them or have been receiving offers not in line at all with the risk assessed before the crisis broke out.

This pressure on the non-banking financial market also has an impact on the productive sector, since the possibility of financing through corporate debt has been compromised. In addition, there are many companies with investments in their balance sheet that need to dispose of their positions as stockholders to meet working capital needs that have been finding it very difficult to raise liquidity (make withdrawals) in recent weeks.

Extended Consumer Price Index (IPCA) below the 2020 inflation target floor

In addition to its effects on the financial and credit markets, as already explored in this section, the crisis brought about by the Covid-19 pandemic also triggered a deflationary process that may even become more intense in certain sectors of the economy over the next few months.

In our baseline scenario, the impacts of the pandemic, albeit comprehensive, would be partially circumvented by the socioeconomic assistance measures taken by government, preventing widespread bankruptcy of companies (which would disrupt the productive process, affecting the supply of goods and services). Demand will in turn recover, but only moderately, due to the combined effects of falling income, uncertainties, and prudent consumer behavior to some extent.

In this scenario, the prices of items falling under the Industrial and Services groups are likely to remain free from upward pressure. In the case of the Industrial group, there would be little room for passing costs on to consumers due to the strong contraction in demand being experienced now. Service prices would be more affected due to the measures taken to restrict the circulation of people. Items such as tourist packages, lodging, cultural events (movies, plays and concerts), among others, will likely record negative variation in the coming months.

Food prices have in turn been rising more rapidly as a result of the influence of items falling under the eating at home (as opposed to eating out) subgroup. Initially, this rise in food prices resulted from an increased demand as families thought it was necessary to stockpile food items at home in the wake of the first social distancing measures. Then they continued to rise as people began to buy their groceries more in stores or supermarkets to cook them at home. Additionally, there is a supply restriction, a natural phenomenon in the first months of every year, but which is likely to lose momentum as the seasonality period ends.

Thus, food prices are likely to decline to normal levels in the coming months, without putting additional pressure on inflation.

The group of government-regulated prices will not put pressure on inflation in 2020. The green flag (normal conditions and no extra cost for consumers) applied to electricity rates, which will continue to be applied in the second quarter, and the fall in fuel prices will influence the good behavior of prices in this group for the rest of the year.

Considering this expected price dynamic and the baseline scenario of a 4.2% decline in GDP as estimated by CNI, inflation is likely to close 2020 at 1.97% per year, below the lower limit of the target set by the National Monetary Council (CMN), of 2.5% per year.

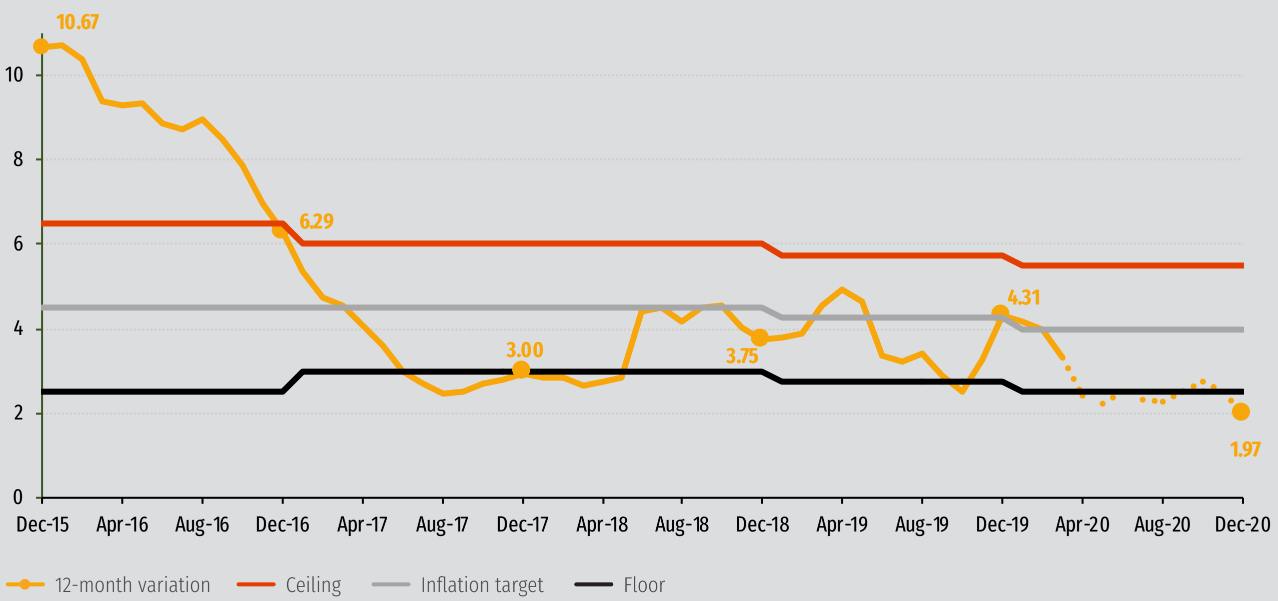
In addition to the baseline scenario, CNI has been working with two alternative scenarios – an optimistic and a pessimistic scenario – of GDP growth in 2020.

In the optimistic scenario, which is less likely, the slowdown in activity would be less intense than in the baseline scenario and economic recovery would be faster. Furthermore, there would be a significant decline in income, on the contrary: the fiscal stimulus measures taken by government will lead to increased demand with the economy back to normal levels. This resumption of economic activity and consumption would put some additional pressure on prices, leading the inflation rate to drop to 2.9% per year in the 12-month period ending in December.

In the pessimistic scenario, the downturn in activity would be more pronounced in the second quarter and economic recovery would be slower. In this environment, income would decline more sharply. Considering that interrupting the production of goods and a higher corporate bankruptcy rate would not trigger a disruption in the production chain big enough to cause supply problems, little variation – or even deflation – is expected in the prices of products and services that make up the IPCA basket. In this case, inflation would close 2020 at 0.8% a year. If the chain is disrupted, supply problems could put more pressure on prices and on the inflation rate.

Graph 4 - 12-month inflation declines to 2.40% in April and is below the floor of the 2.5% inflation target in 2020

Extended National Consumer Price Index (IPCA)
12-month figure (%)



Source: IBGE and BACEN
* CNI projection, baseline scenario

New cut in the Selic rate brings it down to 3% per year

At the third meeting of the Monetary Policy Committee (Copom) of the Central Bank in 2020, which was held in May, the monetary authority decided for yet another reduction in the basic interest rate (Selic rate), this time of 0.75 percentage points.

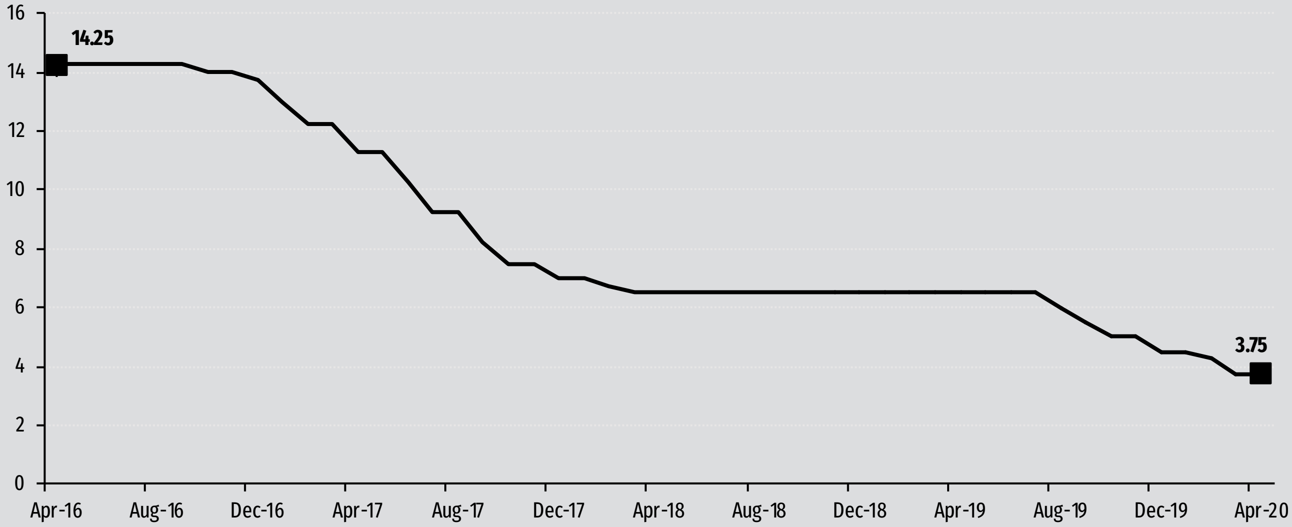
The decision to continue monetary easing, as has been done since July 2019, was of great importance, considering the recessive effects and increased risk of insolvency among companies posed by the crisis resulting from the Covid-19 pandemic.

In addition, inflation projections are below the target floor set by the National Monetary Council (CMN) for 2020, of 2.5% per year, and expectations for the coming years remain anchored.

The need for high monetary stimulus when the crisis is at a more acute level will likely lead the Copom to reduce the Selic rate further at its next meeting in June. Uncertainties regarding the intensity and duration of the current crisis and, consequently, about its effects on the financial situation of households and companies may influence the decision of the monetary authority for further cuts in the rate to reduce the cost of financial capital.

Graph 5 - Intensity of the cut in the Selic rate in May surprised positively

Basic interest rate, Selic rate
End-of-period rate (% p.a.)



Source: Central Bank of Brazil

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4 FISCAL POLICY

Crisis brought about by the new coronavirus requires strong fiscal expansion in 2020

Increased spending to fight the pandemic will lead to increased public debt

The measures taken to address the public health crisis and mitigate its effects on society and on the economy require a drastic change in the fiscal landscape. Even though federal government spending declined in the first three months of the year, the measures will lead to a significant increase in spending accompanied by a significant drop in revenues, largely caused by the retraction of economic activity.

As a result, the fiscal situation is likely to deteriorate in 2020 and cause a greater deficit than that contemplated in the 2020 Budget Guidelines Law and spending beyond the limit set in the Spending Ceiling Rule. In this regard, it should be emphasized that both tax rules provide for mechanisms that allow them to be waived in situations of public calamity, and these mechanisms were recognized by the National Congress on March 20. In addition, government has been working to approve Constitutional Amendment Bill (PEC) 10/2020, known as the War Budget PEC, which allows for setting apart spending to fight the pandemic within the general budget of the Union and eases the criteria for increasing such spending.

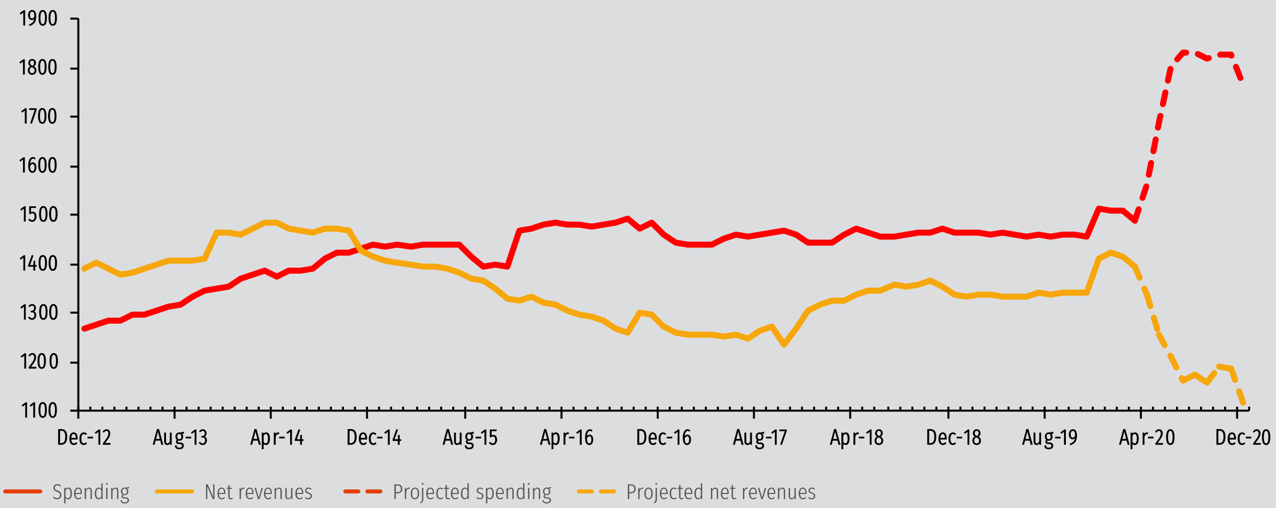
The measures taken by the Brazilian State in the current scenario are essential and its actions must be focused on preserving public health and mitigating the effects of the crisis for workers and companies. These measures, however, must be transitional in order not to hinder the resumption of the process of adjusting public accounts started in 2016, when the Spending Ceiling Rule was established.

Graph 6 - Crisis caused by the coronavirus will result in a significant increase in spending and in a drop in revenues in 2020

Evolution of federal government primary spending and net revenues

*12-month figure - R$ billion in December 2020 * (IPCA deflator)*

**FOCUS monthly forecast*



Source: National Treasury

Revenues and spending on the decline in the first quarter

The federal government's net revenue fell by 0.9% (IPCA deflator) in the first three months of 2020 in relation to the same period in 2019. Among the components of revenue, the one that contributed the most to this reduction was that of revenues managed by the Brazilian Federal Internal Revenue Service, which decreased by 0.6% in real terms over the period. This drop was mainly influenced by a real decrease of 1.1% in revenues from the Income Tax and of 9.2% in revenues from the Tax on Industrialized Products (IPI) over the period. Social security revenues and revenues not managed by the Federal Internal Revenue Service, which are the other components of revenues, have in turn decreased by 1.5% and 1.3%, respectively.

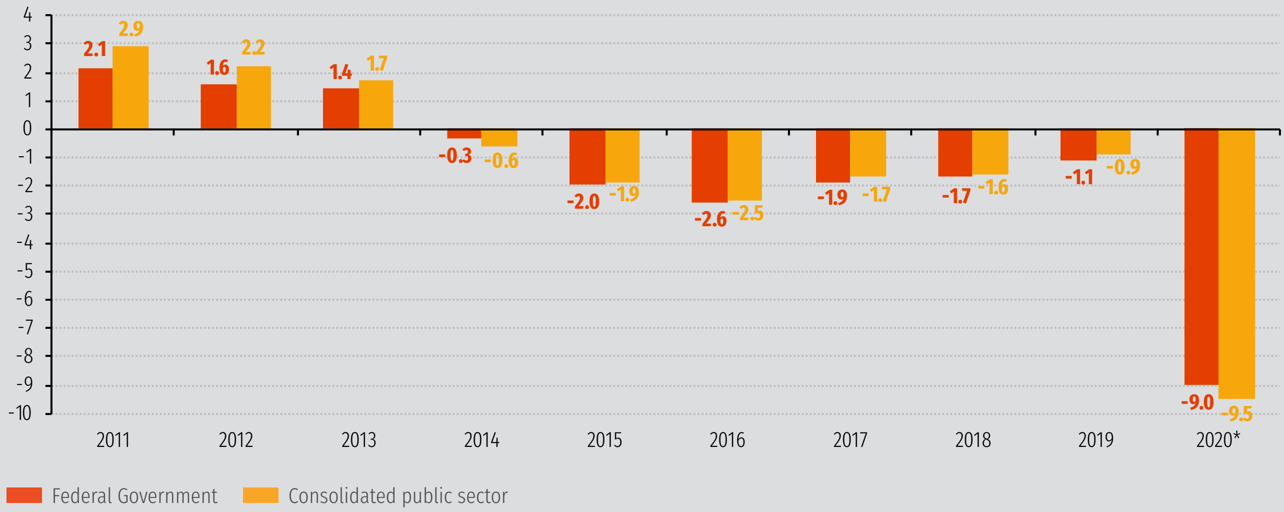
Federal government spending dropped in turn by 2.9% in the first three months of 2020 in relation to the same period in 2019. The increases in mandatory spending with its flow controlled by the Executive Branch and in non-mandatory spending were more than offset by the decrease in spending on personnel, social security benefits and other mandatory spending items.

As for regional governments, both their revenues and spending increased in early 2020. CNI estimates that regional government spending rose by 2.6% in real terms in the first two months of 2020 in relation to the same period in 2019. As for revenues, the available data show a real increase of 1.8% on the same basis of comparison.

Graph 7 - Significant increase in the primary deficits of the federal government and of the public sector in 2020

Primary result of the federal government and of the consolidated public sector

12-month figure - % of GDP



Source: Central Bank of Brazil and CNI
*CNI estimate

The improvement seen in the primary result of the federal government was accompanied by a deterioration in the primary result of regional governments, which led to a small increase in the primary deficit of the consolidated public sector. The public sector recorded a primary deficit of R$63.4 billion (0.86% of GDP) in the last 12-month period ended in March 2020. In December 2019, the negative result amounted to R$61.8 billion (0.85% of GDP).

The increase in the primary deficit together with an increase of 0.31 percentage point of GDP in nominal interest spending led the 12-month nominal deficit to increase from 5.91% in December 2019 to 6.24% of GDP in March 2020. This increased nominal deficit in a scenario of exchange rate devaluation led the Gross Debt/GDP ratio to increase from 75.8% in December 2019 to 78.4% in March 2020.

Primary deficit will grow at a more intense rate by the end of the year

Federal government spending will reverse its downward trend and will start to grow strongly by the end of the year. A set of measures with a significant fiscal impact has already been announced, all of which are focused on controlling the effects of the crisis brought about by the new coronavirus. Some of these measures have only changed the timing of spending, while others entail additional expenses that had not been planned for previously.

Among the measures entailing additional spending by government, special mention should be made of the granting of an emergency aid in the amount of R$600 to informal workers, self-employed workers, individual microentrepreneurs (MEIs), unemployed workers and beneficiaries of the Family Grant (Bolsa Família) program (in this case, there will be an increase in the amount of the benefit and in the number of beneficiaries). This measure will account for an increase of approximately R$123.9 billion in spending in 2020. Beneficiaries will receive the equivalent of three installments of the aid and this mechanism may be extended for as long as the state of public calamity remains in effect.

In addition, the federal government announced the Emergency Employment and Income Preservation Program, which is intended to preserve the income of formal workers whose working hours and wages were reduced or whose employment contracts were temporarily suspended. This measure has been estimated to have an impact of approximately R$51.6 billion on unemployment insurance spending. Finally, an additional sum of R$23.5 billion in extraordinary credits has been announced to be used, for the most part, to cover healthcare expenses.

With regard to measures that only change the timing of spending, special mention should be made of the advance payment of installments of the 13th salary (Christmas Bonus) of the Social Security System (INSS) to retirees and pensioners in April and May and the advance payment of wage bonuses in June. These measures will have no impact on annual spending, as they only represent advance payments of expenses that would have to be borne throughout the year.

CNI estimates that federal government spending will likely grow by 17.9% in real terms in 2020. This increase would amount to 21.6% if the portion to be paid by Petrobras under the auction for onerous assignment of pre-salt acreage for oil exploration were disregarded, which significantly increased federal government spending in December 2019.

The federal government's net revenues will in turn intensify the decline observed up to the first quarter and will likely close the year with a 20.0% decrease as compared to 2019. If the extraordinary revenues from the auction for onerous assignment of pre-salt acreage in December 2019 were disregarded, this drop would amount to 16.4%. The decline in GDP, estimated at 4.2% by CNI, and the aid granted to states and municipalities to make up for their decreased tax revenues, which is likely to increase transfers to them by R$76 billion, will be the main causes of the reduction in net revenues in 2020.

Government-managed revenues will also be negatively influenced by tax waiver measures designed to address the effects of the crisis caused by the new coronavirus. Among these measures, special mention should be made of the reduction of import tariffs to zero, the exemption from the Tax on Industrialized Products (IPI) for necessary products for preventing and treating the disease caused by the coronavirus and the exemption from the tax on financial operations (IOF). As a result, tax revenues managed by the Federal Internal Revenue Service are likely to decline by 6.4% in 2020.

With respect to revenues not managed by the Federal Internal Revenue Service, the drop in oil prices, which has a direct bearing on revenues from financial compensations, will contribute to reducing these revenues in relation to 2019. Furthermore, the extraordinary revenues from the auction for onerous assignment of pre-salt acreage held in 2019 will not be repeated, negatively affecting the annual comparison of revenues not managed by the Federal Internal Revenue Service. Even disregarding the effect of extraordinary revenues, a real drop of 23.6% in this variable in 2020 in relation to 2019 is expected.

Social security revenues will in turn be affected both by the reduction in total payroll resulting from the fall in employment and by the possibilities for making changes to employment contracts, which will affect the revenues of the social security system. In the case of suspension of employment contracts, the workers affected will not be paying their contribution to the social security system, and in the case of wage reductions their contribution will be lower, as it will be proportional to their income. As a result, social security revenues are likely to drop by 14.3% in 2020 as compared to 2019.

CNI estimates that the federal government and its state-owned companies will likely close the year with a primary deficit of R$642.9 billion (9.01% of GDP as estimated by CNI). This result will be well above the deficit of R$78.6 billion (1.08% of GDP) recorded in 2019.

In relation to regional governments, the economic downturn will likely strongly affect revenues from the ICMS (state turnover tax). Transfers received from the federal government will also be greatly impacted by the decline in revenues from exploitation of natural resources and by the drop in revenues from shared taxes resulting from the economic downturn.

However, the federal government announced that it would contribute R$16 billion to replenishing state and municipal participation funds (FPE and FPM) and another R$60 billion from the aid under discussion in Congress, which will likely mitigate the drop in state and municipal revenues.

Regarding the spending of regional entities, the measures announced by the federal government will provide a fiscal relief of around R$50 billion by interrupting the repayment of debts with the federal government and approving new credit operations, which will allow states to make new expenditures in healthcare and in other areas to fight the coronavirus. As a result, these entities are likely to have a deficit of R$33.0 billion in 2020 (0.46% of GDP as estimated by CNI).

Considering all these factors, the consolidated public sector is likely to record a primary deficit of R$675.9 billion (9.47% of GDP as estimated by CNI) in 2020. This represents a marked increase in relation to the deficit of R$61.8 billion (0.85% of GDP) recorded in 2019.

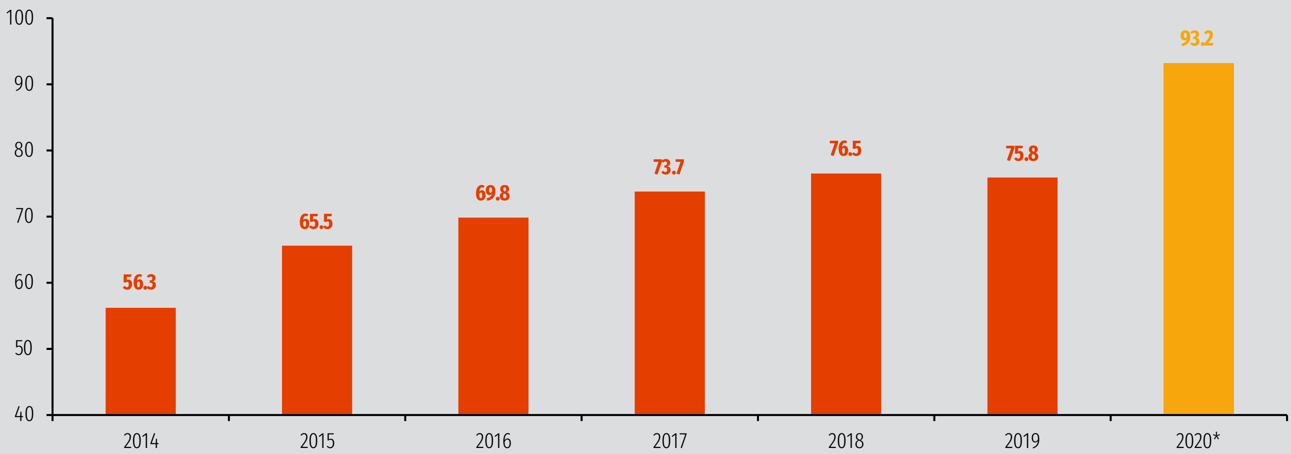
In addition, an increase of 0.5 percentage point of GDP in interest spending is expected, influenced by the exchange rate devaluation, despite the reduction in the Selic rate. As a result, the nominal deficit is likely to grow from 5.91% of GDP in 2019 to 15.0% of GDP in 2020, leading to a further increase in the Gross Debt/GDP ratio in the year. CNI estimates that this variable will likely close 2020 at 93.2%, against 75.8% in 2019.

Actions by the Brazilian State are key for facing this crisis scenario both from the point of view of public health and from an economic standpoint and they should focus on protecting the population's income and on helping companies survive. However, it should be highlighted that the measures adopted by government must be transitory and should not become permanent expenses, as this would jeopardize the resumption of the process of adjusting public accounts started in 2016, when the Spending Ceiling Rule was issued. Moreover, it is worth recalling that increased public indebtedness resulting from actions to fight the coronavirus crisis poses greater challenges to fiscal adjustment in the coming years.

Graph 8 - Gross Debt/GDP ratio will exceed 90% in 2020

Trajectory of the public sector's gross debt

% of GDP



Source: Central Bank of Brazil
* CNI estimate

Alternative scenarios

Difficulties to estimate the magnitude of the impacts caused by the coronavirus pandemic on the economy make it imperative to analyze the fiscal result of the government in two different scenarios, besides the above-described baseline scenario.

In a first, more optimistic scenario in which GDP drops by 0.9%, government-managed revenues, which are more intensely affected by economic activity, would record a real drop of 3.4% in 2020 in relation to 2019, contributing, in combination with increased transfers to states and municipalities, to a real drop of 18.4% in net revenues in the year (or of 14.7% if the extraordinary revenues from the auction for onerous assignment of pre-salt acreage for oil exploration held in December 2019 were disregarded). Thus, the primary result of the consolidated public sector would be negative by R$653.7 billion (8.86% of GDP as estimated by CNI in this scenario) and the nominal deficit would reach 14.2% of GDP. The increased nominal deficit in this scenario would lead the Gross Debt/GDP ratio to 89.8%.

In the pessimistic scenario, the expected drop of 7.3% in GDP would lead to a real drop of 9.3% in government-managed revenues as compared to 2019. Thus, the federal government's net revenue would fall, in real terms, by 21.5% on the same basis of comparison (or by 17.9% if the extraordinary revenues from the auction for onerous assignment of pre-salt acreage held in December 2019 were disregarded). This result would push the consolidated public sector up to a primary deficit of R$697.0 billion (10.1% of GDP as estimated by CNI in this scenario) and the nominal deficit to 15.8% of GDP. As a result, the Gross Debt/GDP ratio would hit the mark of 96.6%.

5 FOREIGN TRADE SECTOR

Emerging countries have become more vulnerable due to increased risk aversion

Uncertainties will remain high for as long as the pandemic lasts

Devaluation of the Brazilian currency hits a new record due to global instability

The real/dollar exchange rate hit the mark of R$5.84/US$1, rising to an all-time high in the first week of May. The exchange rate followed the trend recorded for the currencies of emerging countries, which showed greater volatility and depreciation as compared to those of more developed economies.

Lack of predictability in relation to social distancing measures and to economic recovery has intensified the feeling of risk aversion globally and has increased the search for safer investments. This scenario has led to a more intense capital flight in emerging countries, contributing to a sharper devaluation of their currencies against the dollar.

The height of the Covid-19 shock on international financial markets appears to have occurred in mid-March, resulting in sharp falls in stock exchanges. However, markets are likely to remain tense for as long as the pandemic lasts. In this scenario of high uncertainty, the currencies of emerging countries will remain under pressure in coming months.

Exchange rate will remain high in the coming months

In all scenarios, the real/dollar exchange rate will remain at a high level in the coming months.

Externally, developed economies are likely to resume growth in May and/or June, as the various measures being taken to address the crisis begin to show their effects. With this recovery, uncertainty will tend to decrease, reducing the feeling of risk aversion.

In the baseline scenario, the Brazilian currency will likely stop devaluating as the economy resumes growth, probably in June. For the year, this behavior will result in an average exchange rate of R$4.68/US$1, and in December the rate will be R$4.48/US$1.

In the optimistic scenario, the impact of the crisis will be less intense, and the Brazilian economy will recover at a faster pace. In this case, Brazil will stand out from other emerging markets and will likely attract foreign capital and lead its currency to appreciate more significantly by the end of the year. In this scenario, the Brazilian currency will appreciate earlier and a little more quickly, returning to the level of R$4.35/US$1 in December, recording an annual average of R$4.58/US$1.

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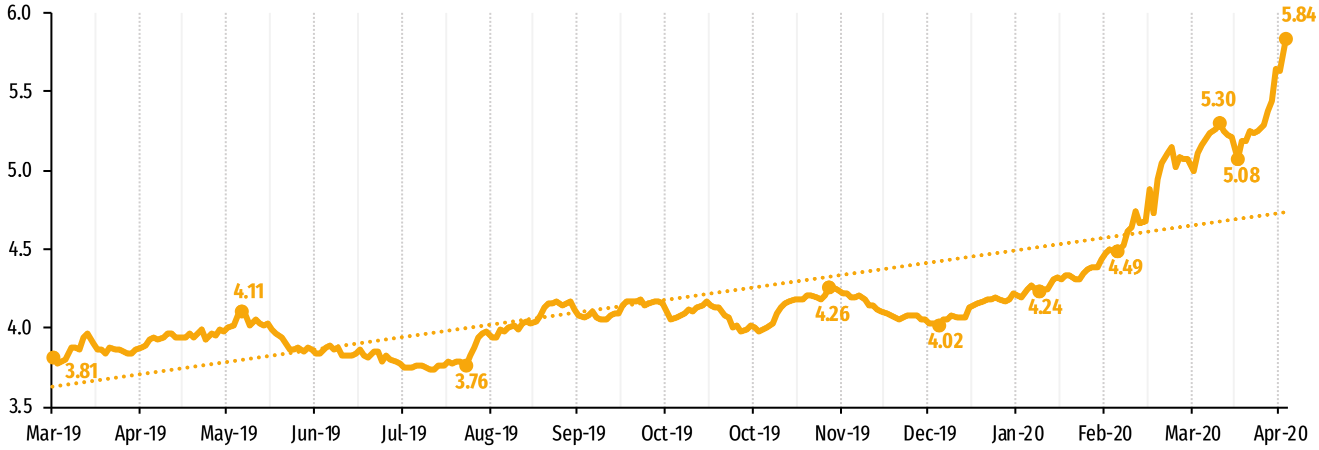
In the pessimistic scenario, in which the impact of the crisis would be stronger, and the economy would recover more slowly, the Brazilian currency would remain on a downward trend against the dollar for a longer period. Its appreciation, as of August, would be slower and the average exchange rate in the year would be of about R$4.87/US$1. The average real/US dollar exchange rate in December would be R$4.53/US$1.

Graph 9 - Sharp exchange rate depreciation with increased risk aversion

Daily exchange rate - in R$/US$

*Ptax closing * until April 23, 2020*



Source: Central Bank of Brazil.

* The closing Ptax rate is the arithmetic average of bid and offer rates published in daily bulletins.

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Imports drop more sharply due to reduced economic activity

The impacts of the pandemic on Brazilian foreign trade began to show in the weekly data for March and April. Over the weeks, the daily average of imports decreased, while the daily average of exports remained somewhat stable.

This stability in exports is partly due to the devaluation of the Brazilian currency, which increased the competitiveness of our exports, and to the resuming of economic activity in China after the peak of the crisis in that country. The main products exported by Brazil – soybeans, oil and oil by-products, ores and meat – have China as their main destination. Based on the consolidated data for March, these products accounted for 41% of the total value exported by Brazil, and China accounted for 63% of the exports of this group of products.

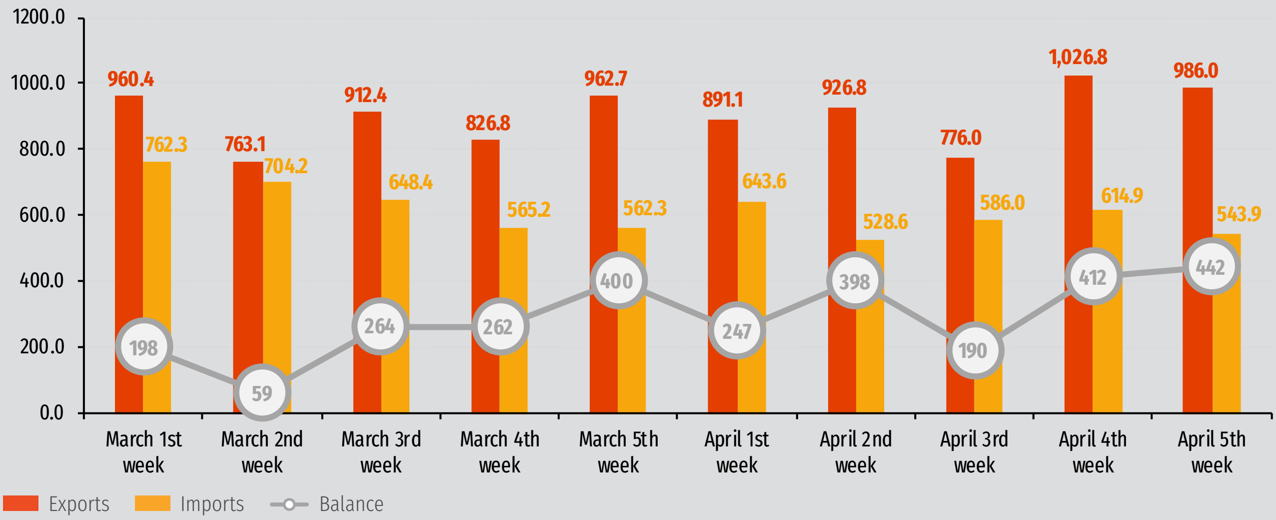
Imports in turn recorded a significant drop over the last two weeks of March and remained at a low level in April, resulting in a decline of 29% between the first week of March and the last week of April. Among the main products imported in March, those that declined the most in the daily average in relation to March 2019 were the following ones: motor vehicles and parts, fuels and lubricants, aluminum and articles thereof, cotton, and milk and dairy products, which declined by more than 20%. In April, among the main imported products, those that fell the most in relation to April 2019 were the following ones: motor vehicles and parts, heating and cooling equipment, fuel oils and natural gas, with dropped by more than 40% in the daily average.

The fall in imports is a consequence of supply problems recorded for some of these products on the world market, due to production interruptions caused by the pandemic, especially in China. In the case of fuels, the sharp drop in their price also affected the imported value. The reversal of the economic scenario and increasing uncertainties in relation to the rest of the year also help to explain the fall in imports.

Graph 10 - Imports drop more sharply as a result of low economic activity

Weekly movement of the Brazilian trade balance

(daily average in US$ million FOB)



Source: Foreign Trade Secretariat (SECEX)

Scenario of a slowdown in exports in 2020

The scenario for Brazilian exports for the rest of the year is not favorable: commodity prices are likely to remain low in this scenario of lower demand until the end of the year. Thus, how the value of exports will evolve in 2020 will be more dependent on increased volume, which is a more uncertain result, considering that the volume of world trade is likely to decrease.

Regardless of the scenario of the effects of the pandemic on the Brazilian economy and of its recovery pace, Brazilian exports will drop in 2020. This drop may be sharper or less pronounced depending on global economic activity in 2020 and, in particular, on the recovery pace of the Chinese economy. A more favorable scenario for China's recovery may boost exports of agricultural products and of goods based on natural resources.

In the following scenarios, we assume the IMF's baseline scenario for GDP growth and foreign trade (3.0% drop in world GDP and 11% reduction in world trade in 2020).

By the end of the year, exports will decrease by 8.2%, to R$205 billion. The evolution of imports depends in turn on the scenarios calculated for the intensity of the impact of the pandemic and for the recovery pace in Brazil.

In the baseline scenario, of intermediate impact of the pandemic and slow recovery, but fast enough to ensure the recovery of a large part of economic activity by early 2021, imports would decline by 4.8%, to US$169 billion. Thus, a trade balance of US$36 billion would be expected.

In the optimistic scenario, the rapid recovery of the economy will allow for imports to recover at an equivalent pace. In this scenario, imports will drop by 4%, to US$ 170 billion, between 2019 and 2020. The trade balance will amount to US$ 35 billion in late 2020 in this scenario.

In the pessimistic scenario, the intensity of the initial impact of the pandemic would not be sufficiently mitigated by economic aid measures. In addition to a significant drop in the income of households and companies, there would be a disruption of the production chain and a drop in supply and productivity, especially in industry. In this scenario, imports would decline by 9%, to US$160 billion. Thus, a trade balance of US$45 billion is expected in the pessimistic scenario.

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