

The NewsLine

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BRAZIL

Domestic demand tumbles

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The Brazilian economy contracted slightly in the first quarter. An early turn for the better is not in sight. Above all, the urgently needed, but at the same time painful economic policy shift clouds the short-term outlook. We expect real GDP to decline by 1% this year. The economy is only likely to gradually get back on an even keel at the end of 2015.

As the National Statistics Office announced today, the Brazilian economy contracted by a seasonally adjusted 0.2% on the previous quarter in the first quarter 2015. All domestic demand components recorded a hefty fall: private consumption was down 1.5% on the previous quarter. Government consumption and investment both saw a drop of 1.3%. For investment, this is the seventh decline in a row. That real GDP did not slide even further is solely due to net exports. Real exports rose by 5.7%, whereas imports fell by 7.5%.

Brazil's slide into recession comes as anything but a surprise. After years of an inappropriate expansionary monetary and fiscal policy, which has severely undermined business confidence in politics, the change of tack in economic policy is urgently needed and essential for a return to sustainable growth. In the short term, however, it is proving extremely painful, as the restrictive measures are clearly weighing on the economy. The government has cut spending and raised taxes (inter alia on energy and wages) in order to stabilize public finances. Last year the budget deficit climbed to 6.7% of GDP and government debt to over 63% of GDP. Monetary policy is also exerting a drag. Since late October 2014 the central bank has jacked up key rates by a total of 225 basis points. They currently stand at 13.25%, the highest for more than seven years. Further rate hikes are likely to follow in the coming months. In April annual inflation stood at 8.2%. The central bank's inflation target is 4.5% +/- 2 percentage points. The reason that inflation is still so high despite the weak economy lies not least in the sharp drop in the Brazilian real (-12%

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since the start of the year) and the increase in administered prices for transport and electricity.

This year Brazil is paying the price for the economic policy errors of recent years. The corruption scandal engulfing the oil company Petrobras, which is likely to dampen the company's investment activity, and the severe drought (particularly in the first quarter 2015) also weigh on the economic outlook for this year. All told, we see real GDP contracting by 1% on average. The economic policy overhaul is likely to gradually bolster business sentiment in the coming quarters and ultimately help stabilize the economic situation. We expect to see a return to initially modest growth rates next year.

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This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an aging society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

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