

The Olympics: A false (economic) start for Brazil

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Daniela Ordóñez, Economist

✉ daniela.ordonez@eulerhermes.com

Executive summary

- **Bronze medal: growth and jobs.** Just like the football World Cup, the Olympics will not give a significant boost to Brazil's economy. The games will contribute only +0.05 point to growth in 2016 and 120,000 temporary jobs. This will not offset the deep recession estimated at -3.5% in 2016, after -3.8% in 2015.
- **Silver medal: Public debt and corporate insolvencies.** The Olympics will add +0.4pp worth of GDP to Brazil's public debt level. This rather small increase (compared to a record acceleration) is concentrated in the State and the City of Rio de Janeiro and contributes to sub-sovereign risks. As for companies, bankruptcies linked to the games could reach +5% in 2016, and +12% among small and micro-enterprises.
- **Gold medal: Inflation.** Inflationary pressures will be visible and long-lasting. We forecast +1pp added to inflation in 2016 (expected at +8.6%). Out of this combined effect of the sporting mega-events, only +0.4pp will be explained by the Rio Olympics.

Minor impact on growth and jobs

Some additional growth but too limited to offset the profound recession

The additional economic activity generated by the Olympic Games should boost GDP growth by a negligible + 0.05 point (see Figure 1).

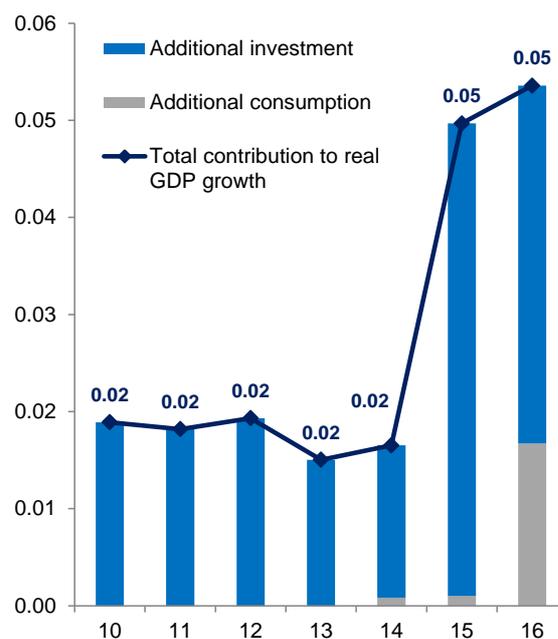
This effect can be divided into higher investment and stronger consumption.

According to official figures, total investment in infrastructure for the Olympics might reach BRL38.5billion over 2009-2016, a relatively small amount given the size of the economy. Delayed projects and the need for readiness caused a disbursement peak in H2 2015 – H1 2016 for infrastructure projects. Euler Hermes estimates that additional investments related to the Olympics added +0.05pp to real growth in 2015 and +0.03pp in 2016.

The Olympics will also generate additional consumption. This will be particularly visible in 2016 thanks to increased tourism. We estimate that the Olympic Games will bring to Brazil 320,000 additional tourists in 2016.

This would add +BRL1.3bn to the economy, mostly visible in the city of Rio de Janeiro, accounting for an additional boost to GDP growth of +0.02pp.

Figure 1
Direct impact of the Olympics on real GDP growth (percentage points)



Sources: National sources, Euler Hermes estimates

This limited positive effect will almost go unnoticed when put into perspective. Political turmoil, structural imbalances and adverse external conditions (commodities, China, Fed hike) have pushed Brazil into its worst recession since 1990.

After shrinking by -3.8% in 2015, the Brazilian economy will contract again by -3.5% in 2016, to eventually stagnate in 2017 (see Figure 2).

Short-lived impact on employment

Official estimates suggest that the Olympics will generate approximately 120,000 jobs. This is a drop in the ocean: Brazil's labor force is a 100 million people (<0.1%), and Rio de Janeiro's stands at 8.1 million (hence only 1.5%).

More than 80% of the jobs created ahead of the Olympics will not be permanent. The first wave of new jobs took place during the investment phase (2011-2014) and primarily involved construction sector jobs. These are now disappearing progressively as infrastructure projects come to an end.

The second wave is mostly linked to the tourism industry. It will be short-lived and low-skilled.

This small boost will therefore not reverse the negative trend in the Brazilian labor market. The unemployment rate is increasing rapidly and reached 11.2% in May, up from 8% a year earlier. We estimate it will reach 11% on average in 2016 and 12.8% in 2017 (see Figure 3).

An unnecessary pressure on (local) public debt

Investment in infrastructure and additional public spending for the Olympics will add +0.4pp worth of GDP to Brazil's public debt level.

While relatively limited the timing is extremely bad. A sharp rise in public debt was registered over the past years. It reached 74% of GDP in 2015, up from 63% in 2013. Public debt is expected to reach 90% sometime in 2017 (see Figure 4).

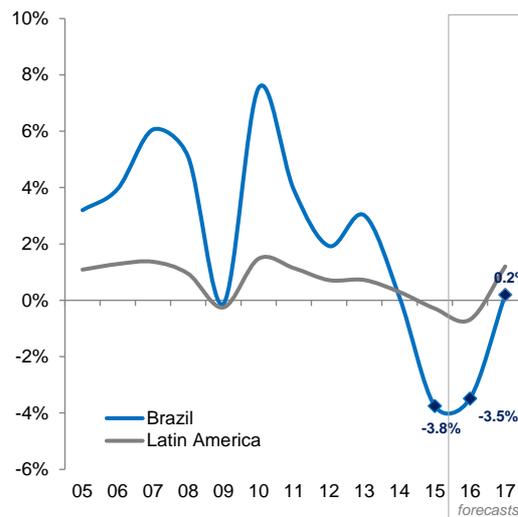
Though manageable at the federal level, the State of Rio de Janeiro will experience a record increase of expenditures leading to a steep +17% increase in state-level debt. This already stands at twice the state's total fiscal revenue.

This sub-sovereign risk is not negligible.

In recent months, the state of Rio de Janeiro has been unable to deliver basic services, delayed payments of pensions and civil servant salaries. It also missed an interest payment due to the French Development Agency last May.

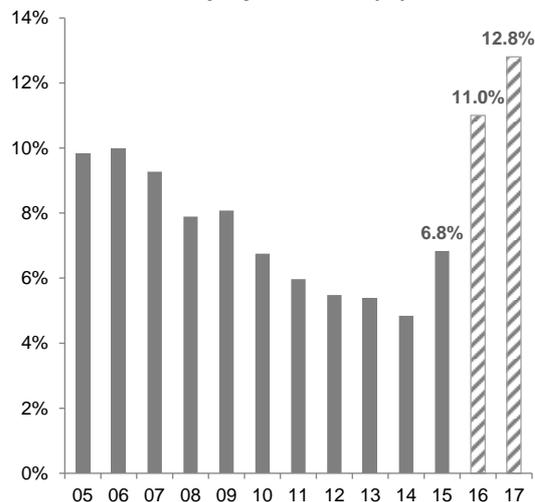
Worse, the city of Rio de Janeiro already declared a "state of financial emergency" and asked the Federal Government for financial support. Authorities authorized an emergency package of BRL2.9bn aimed at finalizing infrastructure projects and financing security needs during the Olympics.

Figure 2
Real GDP growth (%)



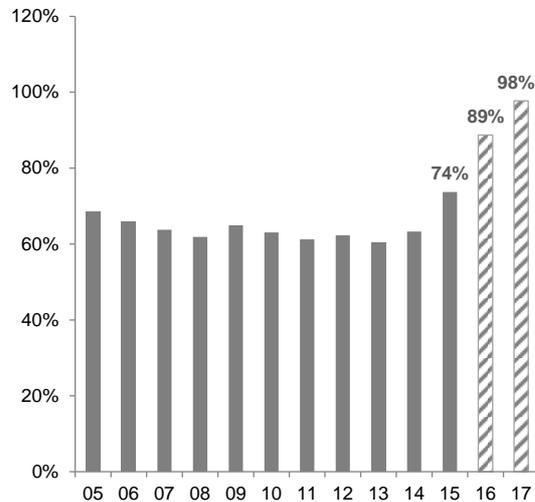
Sources: National sources, Euler Hermes forecasts

Figure 3
Unemployment rate (%)



Sources: National sources, Euler Hermes forecasts

Figure 4
Public debt (% of GDP)



Sources: National sources, Euler Hermes forecasts

Additional bankruptcies expected

The Olympics will inflate corporate insolvencies by +5% in the State of Rio de Janeiro in 2016, +12% when zooming in on small and micro-enterprises. The number of new companies, especially smaller ones, surged ahead of the Olympics. During the investment phase, these were mainly construction and services companies; starting earlier this year, accommodation, food, transport, domestic services, leisure and communication services were also the focus of increased activity.

These new companies crowd out more fragile businesses which cannot compete due to the cost of real estate, wrong positioning (locals vs. tourists), leaner business models, and access to financing and public bidding. In addition, newcomers are often the first to go belly up once the mega event is over.

At an aggregate level, corporate insolvencies would increase by +0.4% (+1% for micro-enterprises). Overall, we expect corporate insolvencies to surge by +22% at a national level this year (see Figure 5). However, insolvency proceedings are not often used in Brazil (~2,000 cases). Companies tend to prefer the amicable route to settle debts with providers.

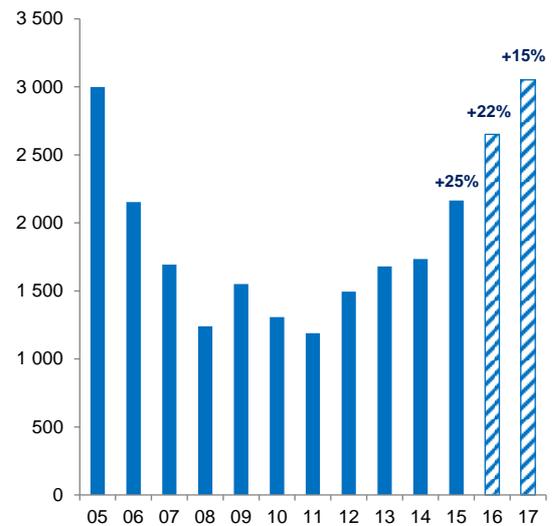
Inflation, inflation and more inflation

The sporting mega-events (World Cup + Olympics) will add a full +1pp to overall inflation in 2016. Out of this figure, +0.4pp is explained by the lasting inflationary effects of the 2014 World Cup, +0.4pp is attributed to the Olympics this year, and +0.2pp to the holding both in a (too) short period of time (see Figure 6). The key drivers are anticipations, which come on top of a perfect storm (import tariffs and taxation, depreciation of the real, structural imbalances).

Inflationary effects started to be visible back in 2009 when it was officially announced that, in addition to the World Cup in 2014, Brazil would also host the Olympic Games in 2016. These pressures will begin to diminish after the Olympic Games, but may not disappear before 2020, given the rigidity of prices in Brazil.

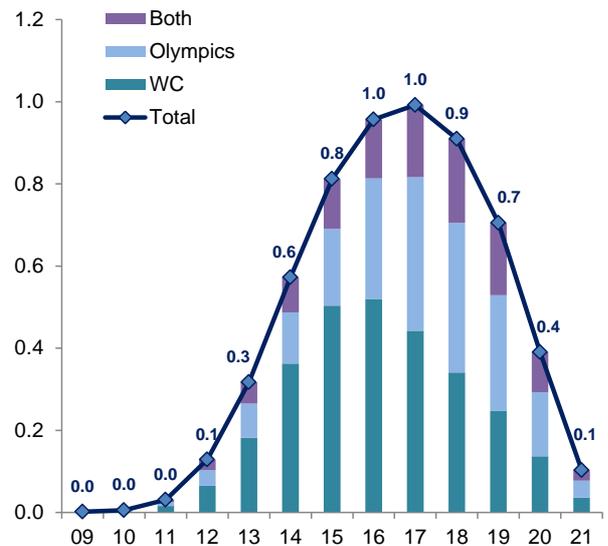
Additional pressures come on top of already high (yet easing) inflation. It stood at +9.3% y/y in May, far above the Central bank target of +4.5% +/-1pp. The inflation rate is not expected to recede before 2017. For 2016, we expect inflation at +8.6% on average and +6.8% in December y/y.

Figure 5
Insolvencies (% change)



Sources: National sources, Euler Hermes forecasts

Figure 6
Direct impact of the Sporting mega-events on inflation (percentage points)



Sources: National sources, Euler Hermes estimates

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