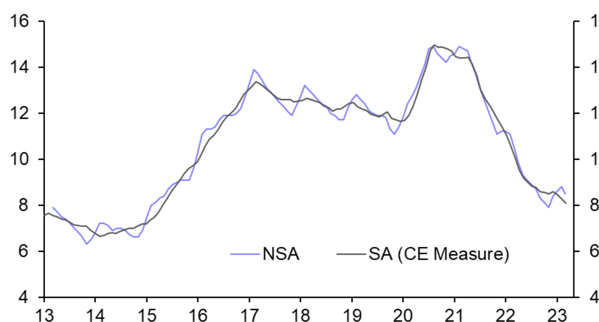
LATIN AMERICA ECONOMICS UPDATE

Brazil: labour market strength likely to worry Copom

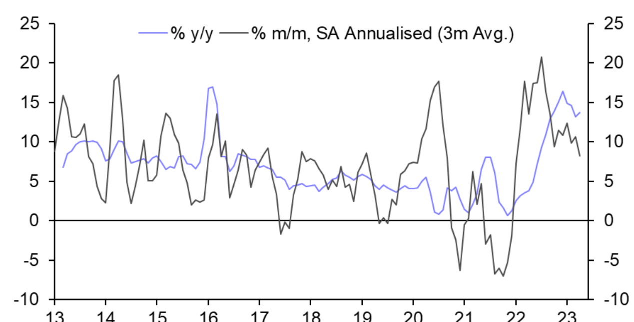
- **The latest data suggest that Brazil's labour market isn't softening as quickly as we and many others (not least the central bank) had anticipated. That's keeping wage growth high and, while that may help to support growth in Q2, it will probably deter Copom from lowering interest rates for some time – despite the drop in headline inflation and progress on the fiscal front.**
- In a *Focus* published earlier this year, we flagged rapid wage growth in Brazil as a factor that is flying under the radar. **And while the prevailing view had been that some of the steam would come out of the labour market, there's little sign of that happening so far**. Indeed, figures published yesterday showed that Brazil's unemployment rate came in below consensus expectations for the second month running in April (at 8.5%, Refinitiv consensus: 8.8%). On a seasonally-adjusted basis, we estimate that the unemployment rate stood at 8.1%, its lowest rate since the second quarter of 2015. (See Chart 1.)
- It doesn't look like strong growth and high demand for labour is driving this tightening of the labour market. The level of employment has been broadly flat, something backed up by the Ministry of Economy's recently-released CAGED payroll data for April. We also haven't seen a shift from informal to formal employment, as we might expect if labour demand was picking up.
- **Instead, the tightening of the labour market has been driven by exits from the labour force**. Our seasonally-adjusted measure of the labour force participation rate fell to its lowest level (outside the pandemic) since the data series began in 2012. This trend has been underway since last year and, irrespective of the cause (we suspect early retirements and expanded social welfare), it's not reversing.
- **The upshot is that wage growth is likely to remain very strong**. Wage growth actually ticked up in year-on-year terms in April (and is running at c. 8% y/y in real terms). (See Chart 2.) On a seasonally-adjusted m/m basis, there's a bit more evidence that wage pressures have passed their peak and have begun to ease. But even so, wage growth is running at a strong rate that will still generate inflation pressures.
- **This is good news for economic growth**. Rapid wage growth has cushioned the impact on households of higher debt servicing costs. It helped consumption in Q1 (albeit not to the extent we might have expected) and it's likely to provide a prop to consumer-facing sectors in the second quarter too.
- **But it's worrying news for the central bank**. The arguments in favour of near term interest rate cuts had strengthened recently following the release of the IPCA-15 inflation figures for this month and the approval of the government's new fiscal framework in the lower house of congress. **Copom flagged concerns about the labour market adjustment for the first time at its latest meeting in May. Rapid wage growth will reinforce concerns that core inflation (and core services inflation in particular) will remain high.**
- **As a result, we're sticking to our view that policymakers will wait until the Copom meeting in November before lowering rates, which is a bit later than the consensus expectation and implied market pricing.**

Chart 1: Unemployment Rate (%)



Sources: Refinitv, IBGE, Capital Economics

Chart 2: Nominal Average Wages



Sources: Refinitv, IBGE, Capital Economics

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