



MACRO OUTLOOK

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- » GLOBAL: A SLOWDOWN IS UNDER WAY
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» GLOBAL: A SLOWDOWN IS UNDER WAY

» MARKETS: RECENT TRENDS

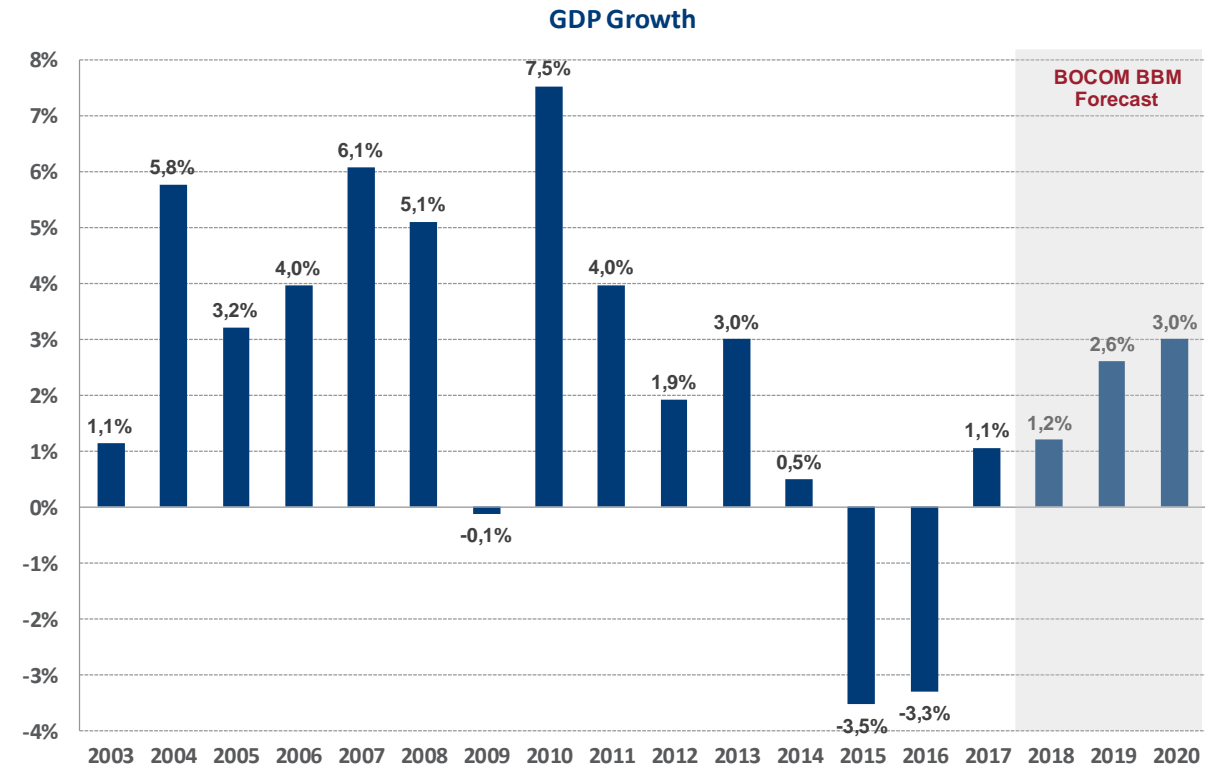
BATTLE FOR PENSION REFORM IS ABOUT TO START

- » Benign outlook: growth should pick up with low inflation and stable Selic rate.
- » Outlook is dependent on the fiscal adjustment, which remains incomplete: pension reform is urgent for the government to comply with the spending cap and stabilize public debt.
- » Paulo Guedes will propose an ample and ambitious pension reform, but main challenge is policy implementation.
- » There are questions about political coordination to approve the reform agenda, but Rodrigo Maia's reelection as lower house president is positive.
- » Downside risks remain if the reform agenda stalls.

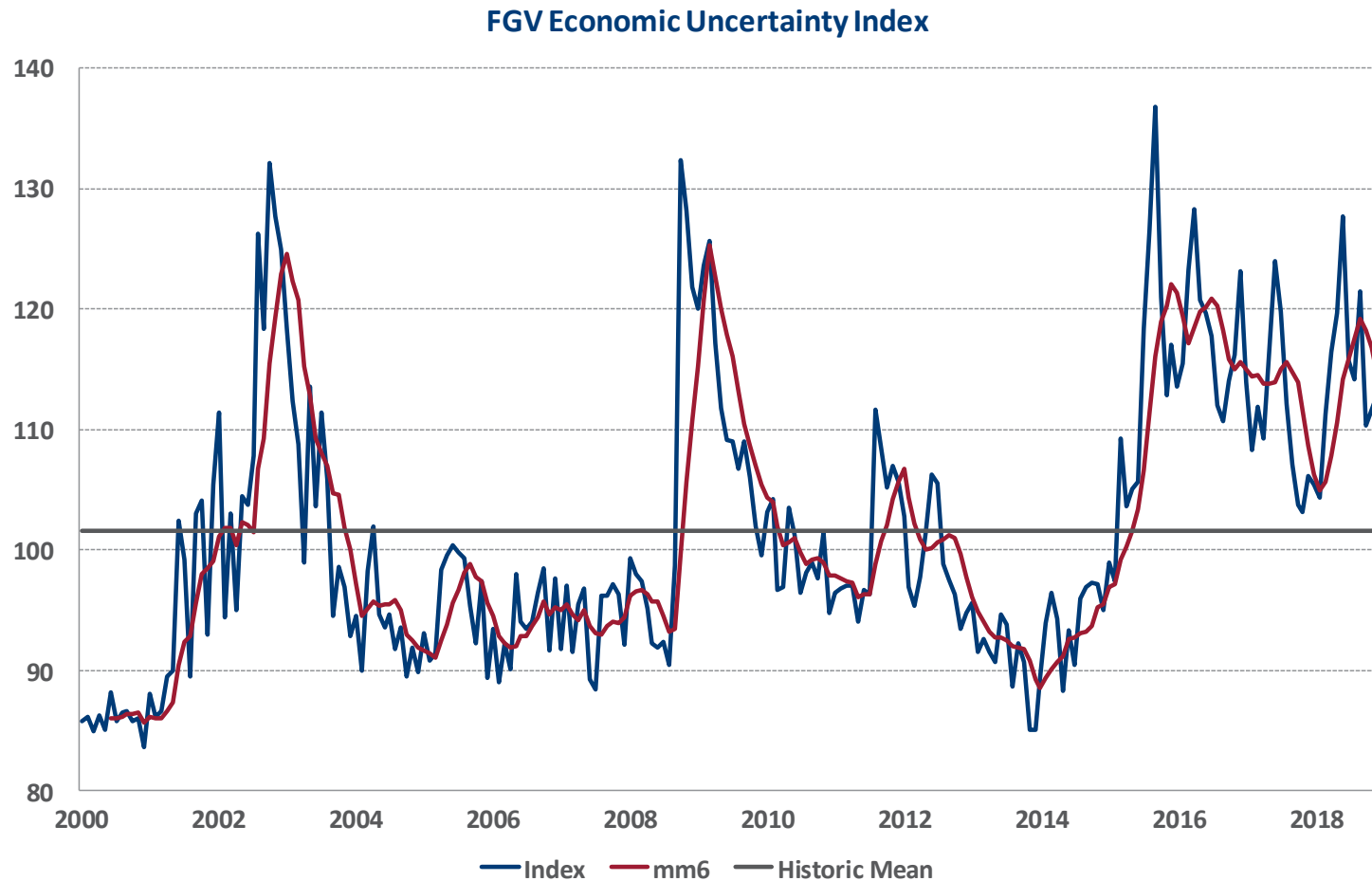
BRAZIL: FORECASTS

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,2%	2,6%	3,0%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	3,8%	4,0%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	6,50%	8,00%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	10,7%	9,9%
Trade Balance (US\$ bn)	3	-4	20	48	67	58	51	39
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-13	-22	-39
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	-1,1%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,1%	-0,6%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	76,5%	76,9%

- » Growth should pick up to 2.6% in 2019 and 3.0% in 2020:
 - » Headwinds are dissipating and economic uncertainty will decline
 - » Confidence and labor market are improving
 - » Monetary policy remains accommodative and credit conditions are improving
 - » No domestic or foreign constraints to growth

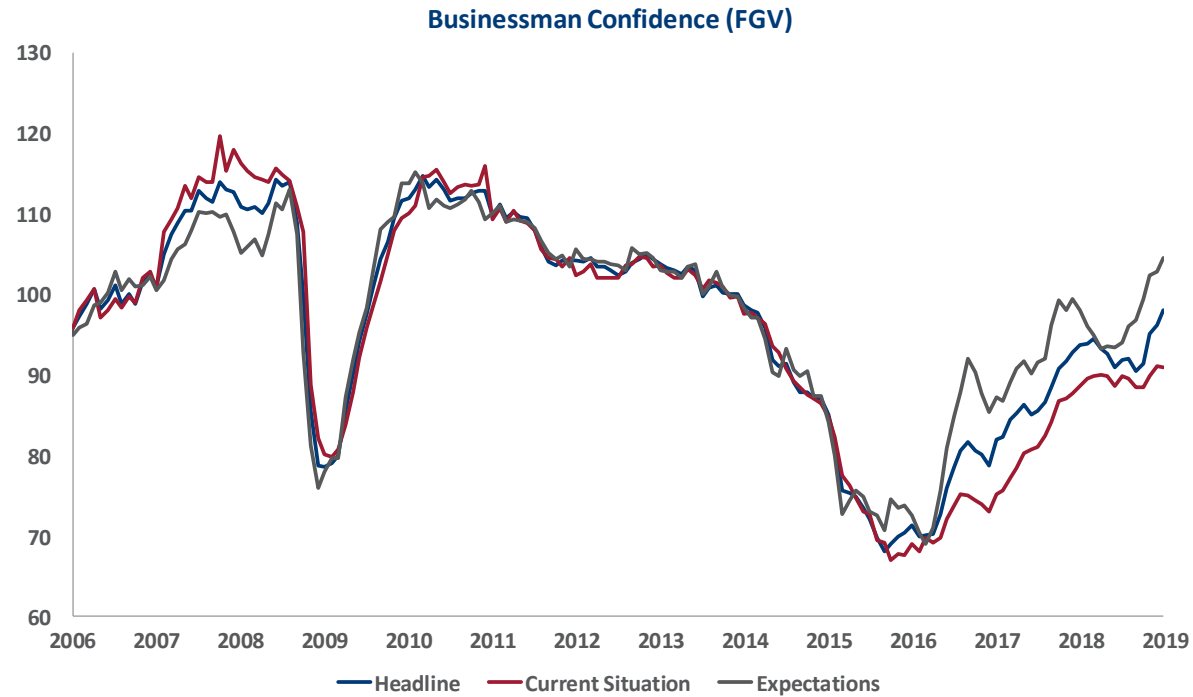


» Higher economic uncertainty has restrained growth since 2015. It should slowly decline as the reform agenda moves forward, supporting growth in 2019 and 2020.

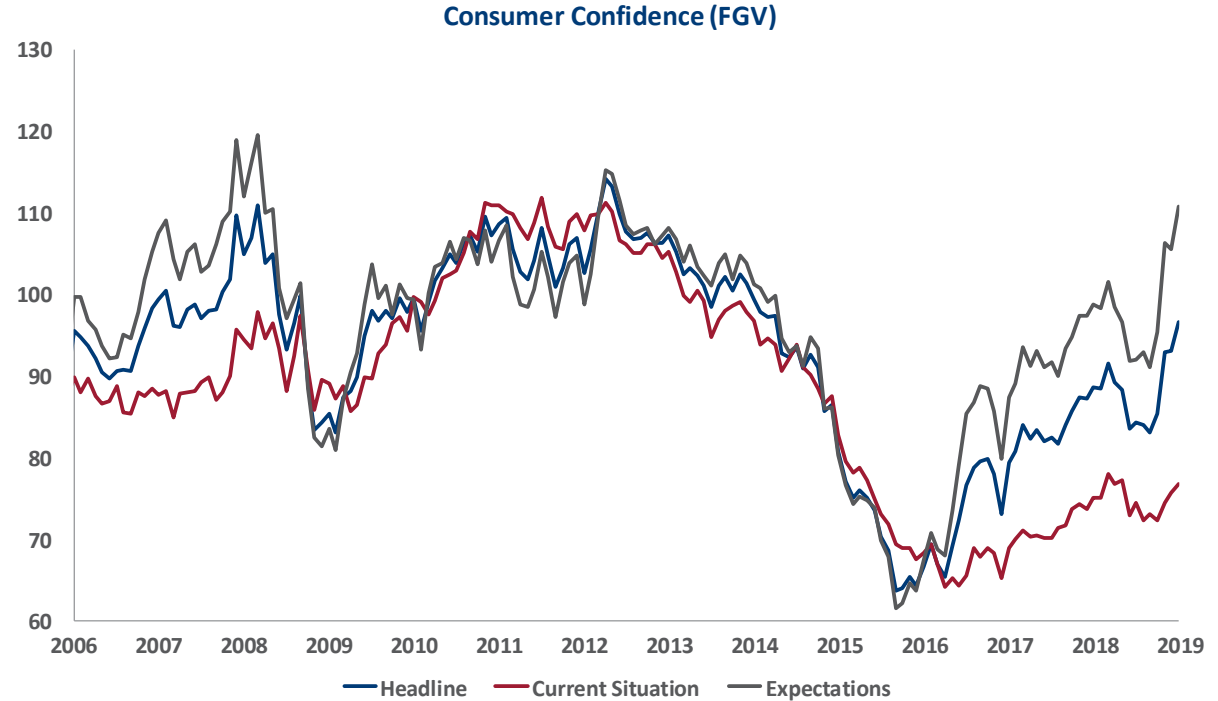


BRAZIL: ACTIVITY

»» Business confidence is starting to improve after pausing in 2018.



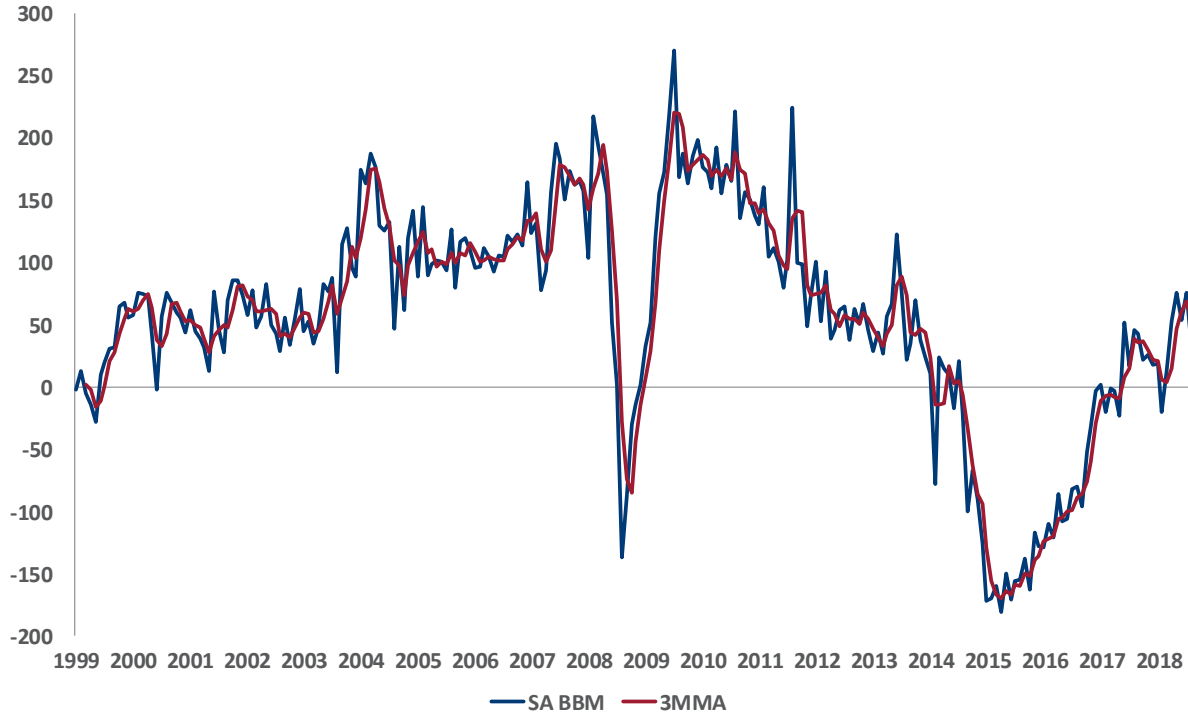
»» Consumers are becoming more optimistic about the future.



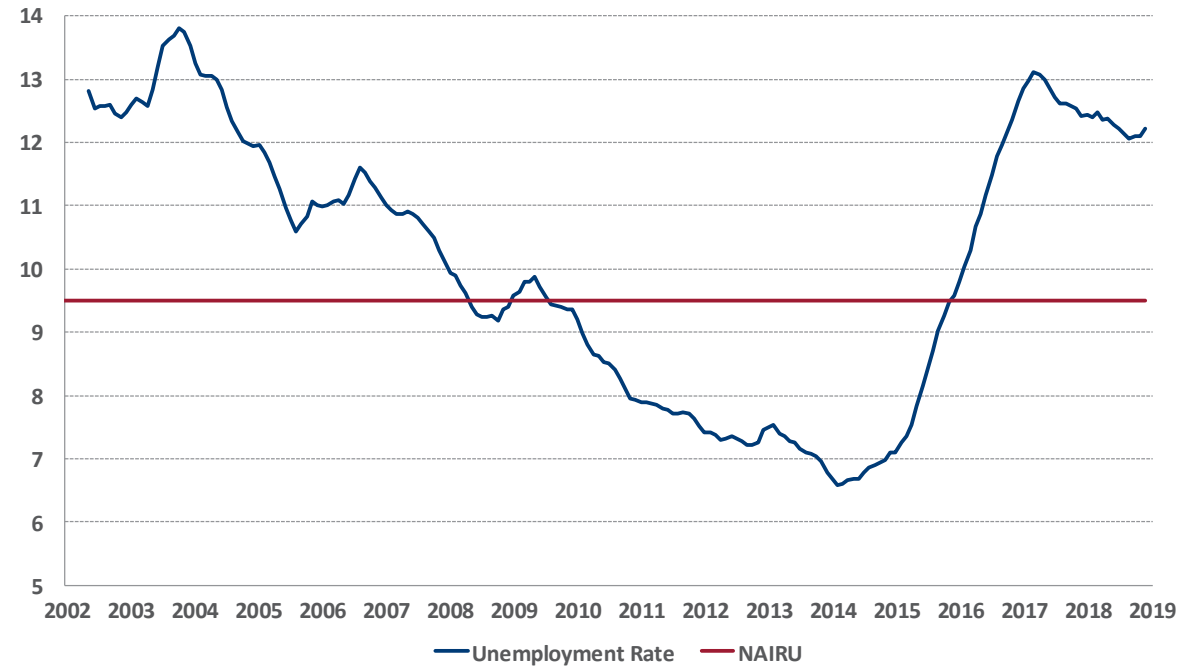
» Formal job creation is picking up and should strengthen in 2019.

» Unemployment rate has room to decline further.

Caged Net Payroll Job Creation

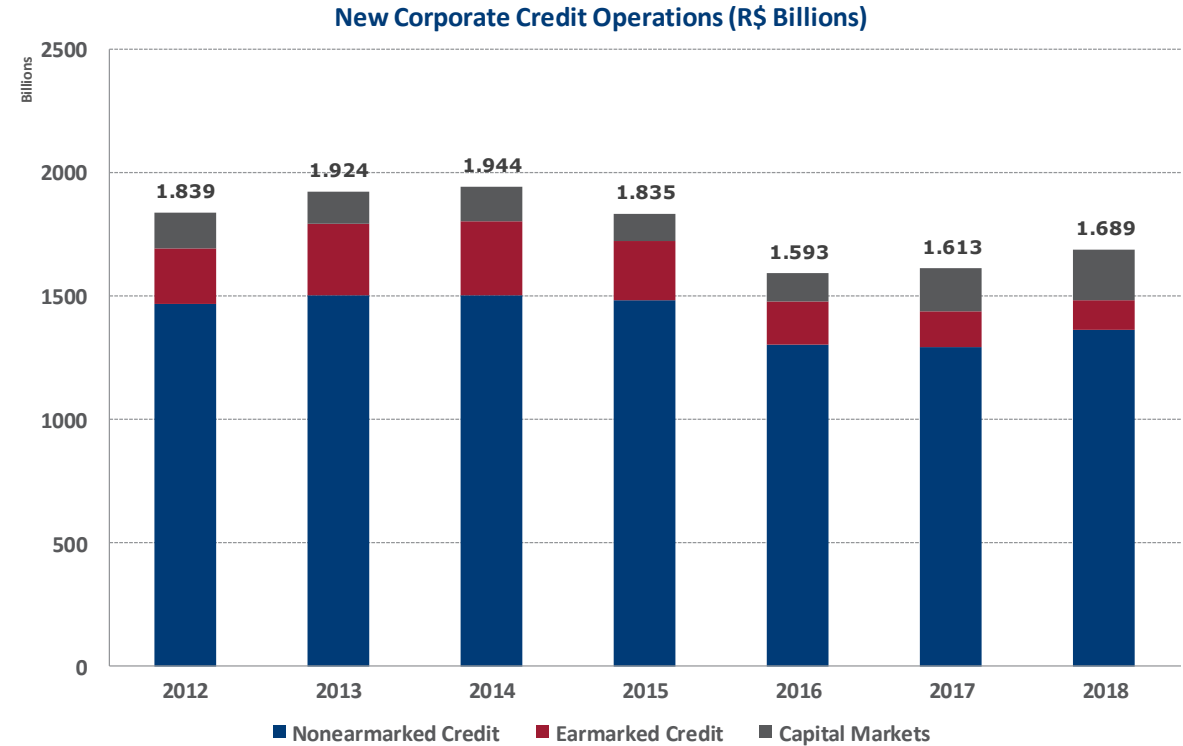
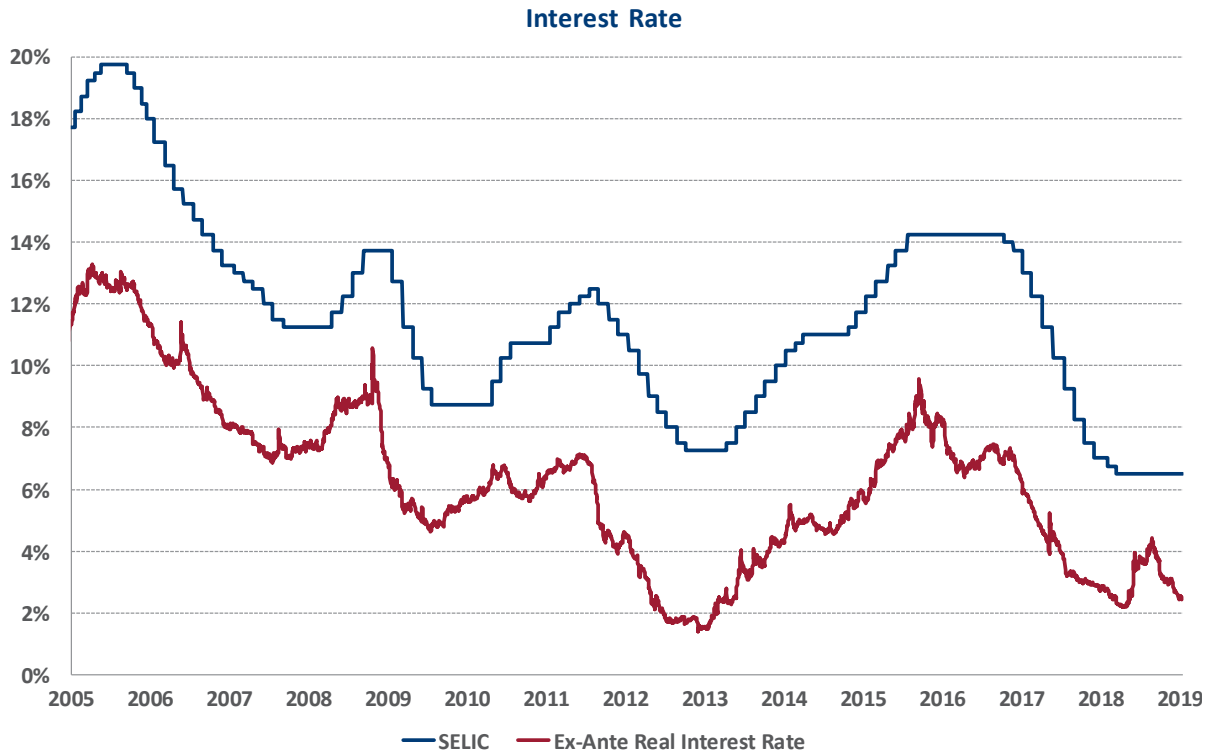


Unemployment Rate



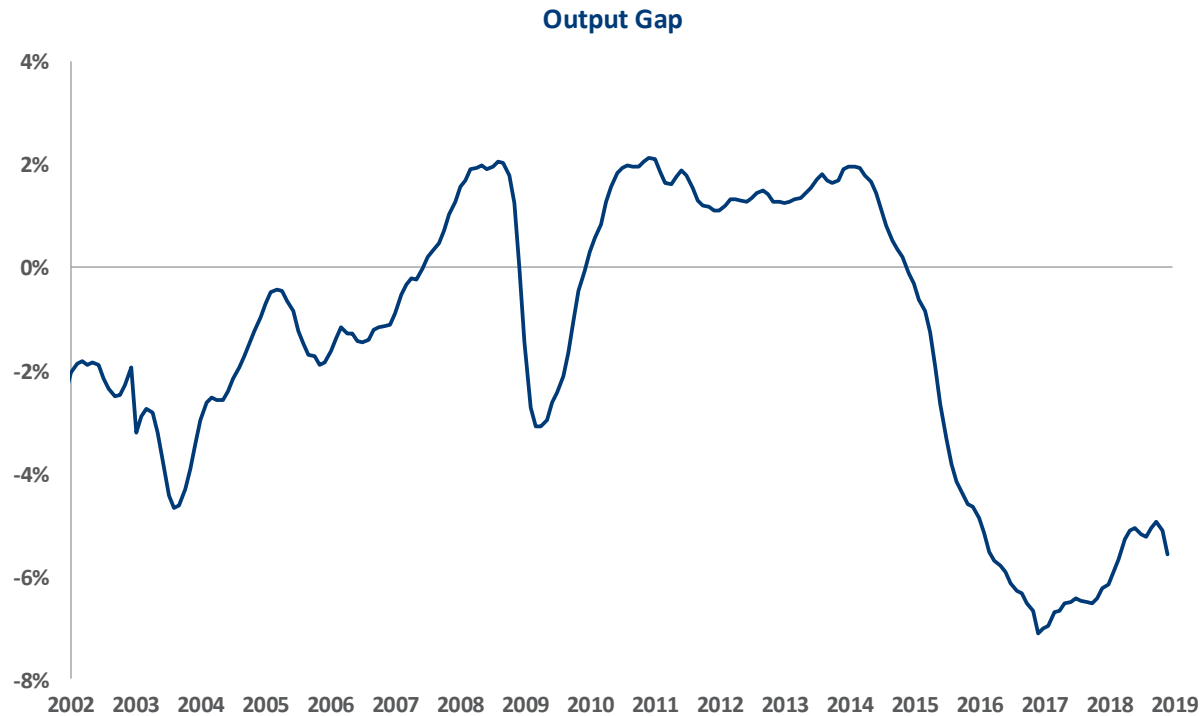
BRAZIL: MONETARY POLICY

» Monetary policy remains accommodative and credit conditions are improving (banks and capital markets).

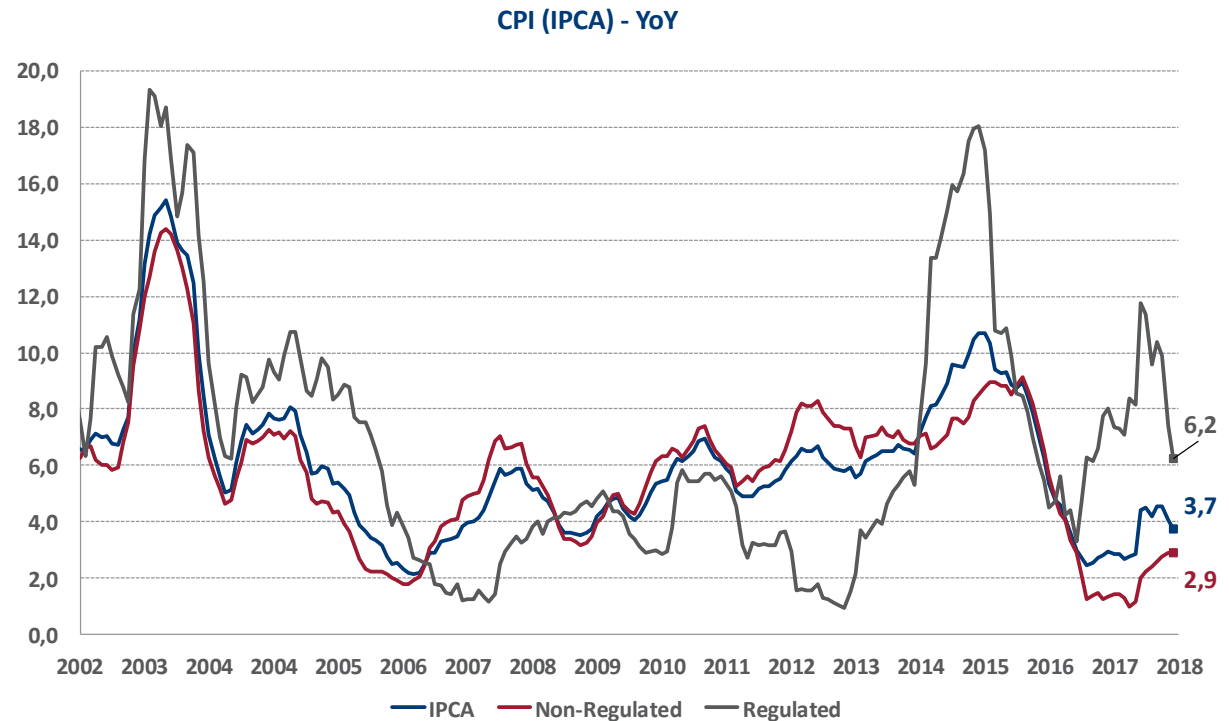


BRAZIL: INFLATION

»» Output gap remains large and continues to put downward pressure on inflation.



»» Non-regulate prices are running close to the inflation target floor.



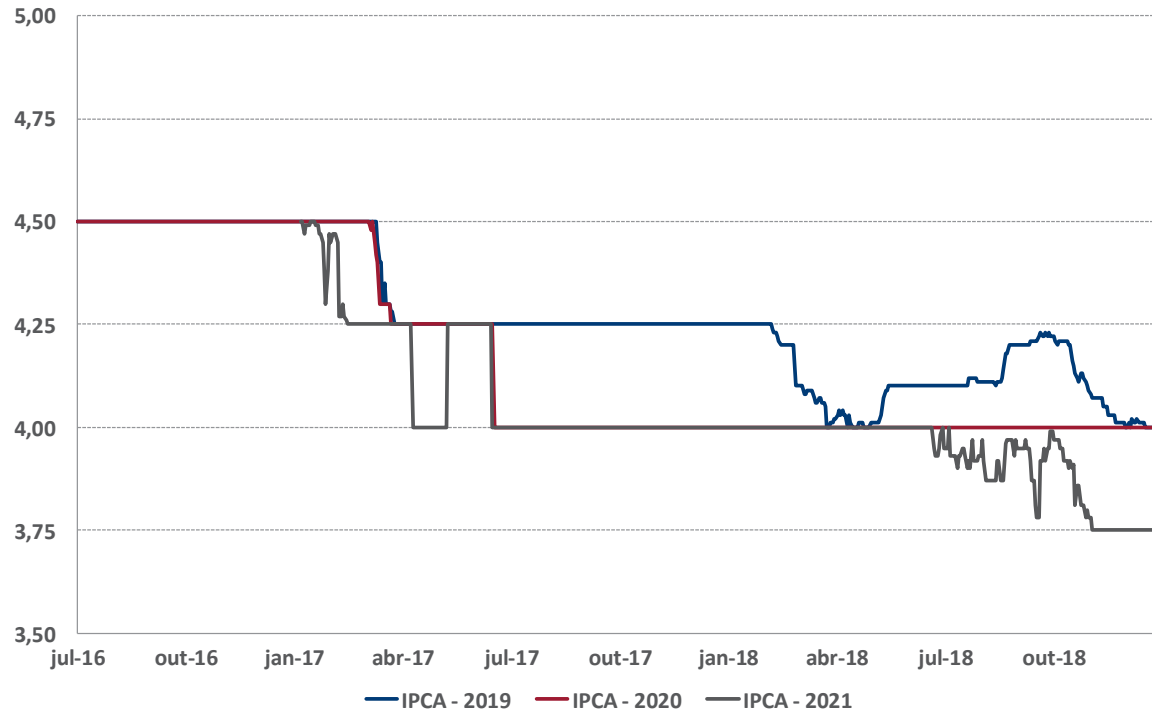
BRAZIL: INFLATION

Baseline Scenario											
Exchange rate of 3.80 in 2018, 2019 and 2020											
Selic: 6.50% in Dec/18 and Dec/19; 8% in Dec/20											
	IPCA	Non-Regulated (74.7%)	Regulated (25.3%)	Core Inflation (59.0%)	Tradables Ex-Food (20.2%)	Services (35.8%)	Core of Services-BBM (16.7%)	Food at Home (15.7%)	Output Gap	GDP	Selic
1T16	9,39%	8,96%	10,79%	7,26%	6,61%	7,50%	6,54%	15,31%	-5,5%	-4,5%	14,25%
2T16	8,84%	8,52%	9,91%	6,85%	6,87%	7,03%	5,86%	14,67%	-5,9%	-4,7%	14,25%
3T16	8,48%	8,68%	7,88%	6,67%	6,25%	7,03%	5,70%	16,14%	-6,3%	-4,2%	14,25%
4T16	6,29%	6,55%	5,49%	5,78%	5,24%	6,47%	4,84%	9,36%	-7,0%	-3,3%	13,75%
1T17	4,57%	4,26%	5,59%	4,62%	3,18%	6,04%	4,52%	3,00%	-6,8%	-1,9%	12,25%
2T17	3,00%	2,89%	3,30%	3,91%	1,52%	5,72%	4,52%	-0,57%	-6,6%	-1,0%	10,25%
3T17	2,54%	1,40%	6,13%	3,37%	0,98%	4,99%	3,71%	-5,33%	-6,6%	0,1%	8,25%
4T17	2,95%	1,35%	8,00%	3,12%	0,93%	4,52%	3,58%	-4,86%	-6,2%	1,1%	7,00%
1T18	2,68%	1,27%	7,06%	2,84%	0,65%	3,93%	3,21%	-4,29%	-5,7%	1,4%	6,50%
2T18	4,39%	2,02%	11,78%	2,55%	0,80%	3,14%	2,75%	0,11%	-5,0%	1,5%	6,50%
3T18	4,53%	2,57%	10,38%	2,66%	1,38%	3,22%	2,54%	2,23%	-5,0%	1,4%	6,50%
4T18	3,75%	2,90%	6,22%	2,47%	1,11%	3,35%	2,61%	4,52%	-5,4%	1,16%	6,50%
1T19	4,07%	3,27%	6,41%	2,41%	0,93%	3,55%	2,91%	6,56%	-5,2%	1,3%	6,50%
2T19	3,20%	3,18%	3,26%	2,82%	0,98%	4,18%	3,01%	4,47%	-4,5%	1,7%	6,50%
3T19	3,03%	3,15%	2,71%	2,55%	0,42%	3,83%	3,06%	5,19%	-3,7%	2,0%	6,50%
4T19	3,80%	3,29%	5,26%	2,91%	0,79%	3,99%	3,21%	4,49%	-3,0%	2,6%	6,50%
1T20	4,12%	3,70%	5,30%	3,32%	0,99%	4,34%	3,17%	4,91%	-2,6%	3,1%	7,50%
2T20	4,06%	3,76%	4,92%	3,30%	0,71%	4,44%	3,40%	5,13%	-2,3%	3,4%	8,00%
3T20	3,92%	3,76%	4,37%	3,26%	0,46%	4,51%	3,52%	5,38%	-2,0%	3,4%	8,00%
4T20	3,96%	3,91%	4,11%	3,11%	0,18%	4,44%	3,43%	6,44%	-1,8%	3,0%	8,00%

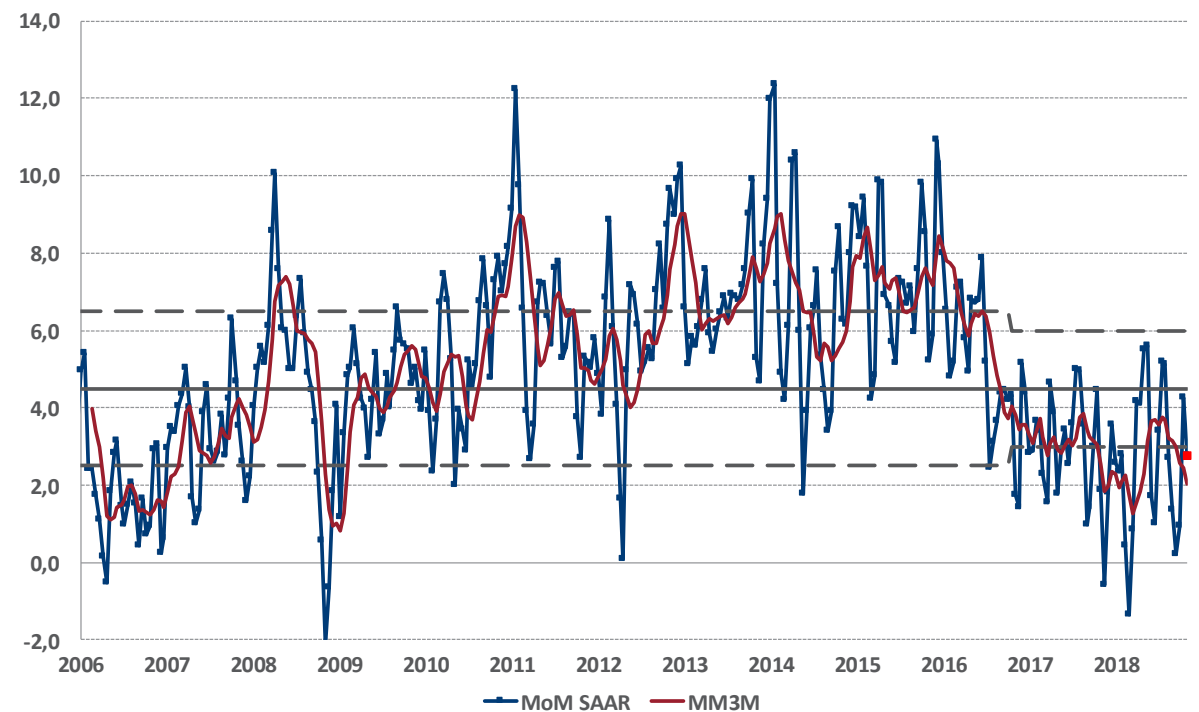
» Inflation expectations below target in 2019 and anchored thereafter.

» Core inflation has been running at very low levels.

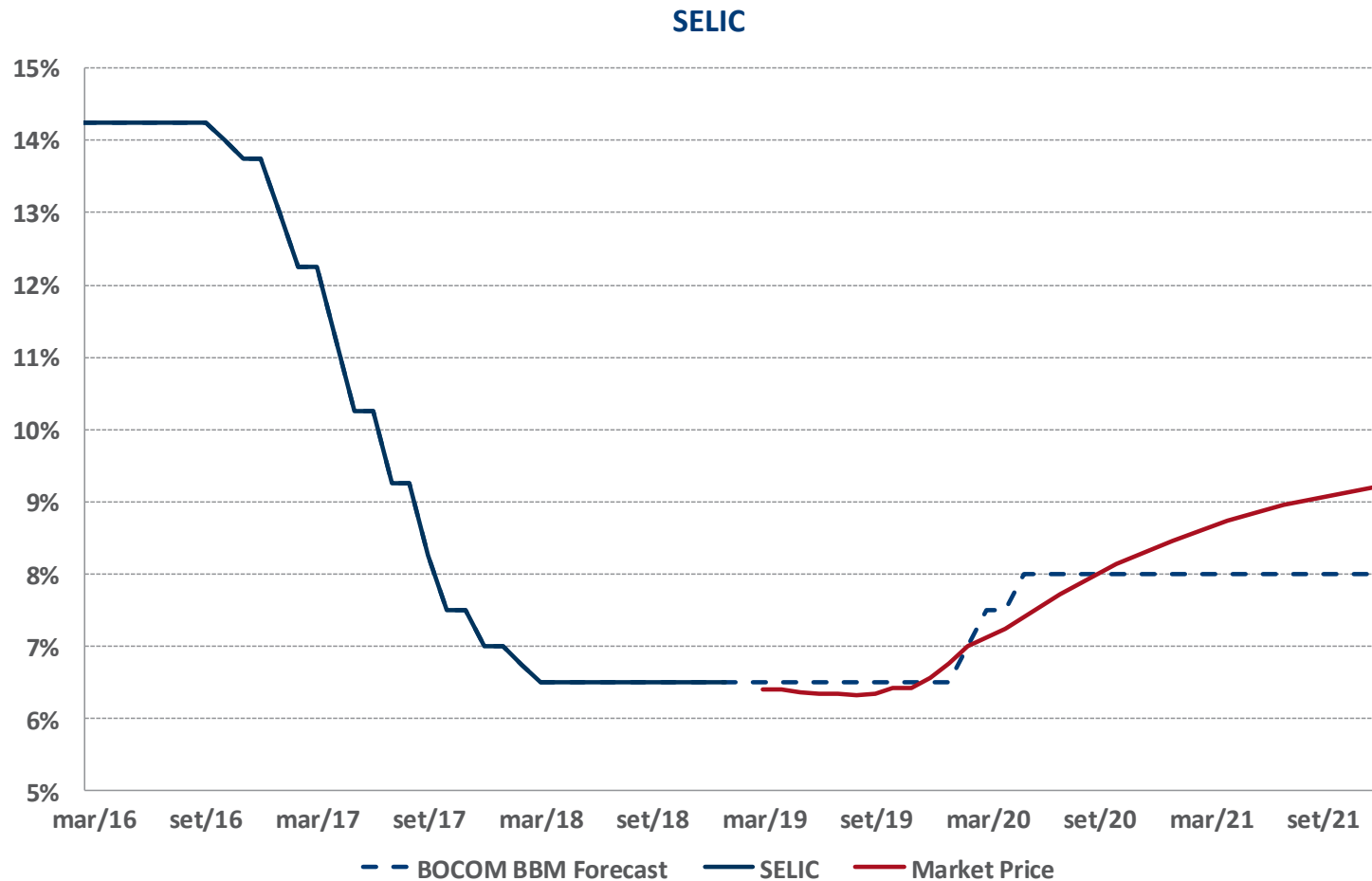
Inflation Expectations (Focus)



IPCA - Ex 'Food at Home' and 'Regulated' (EX0)

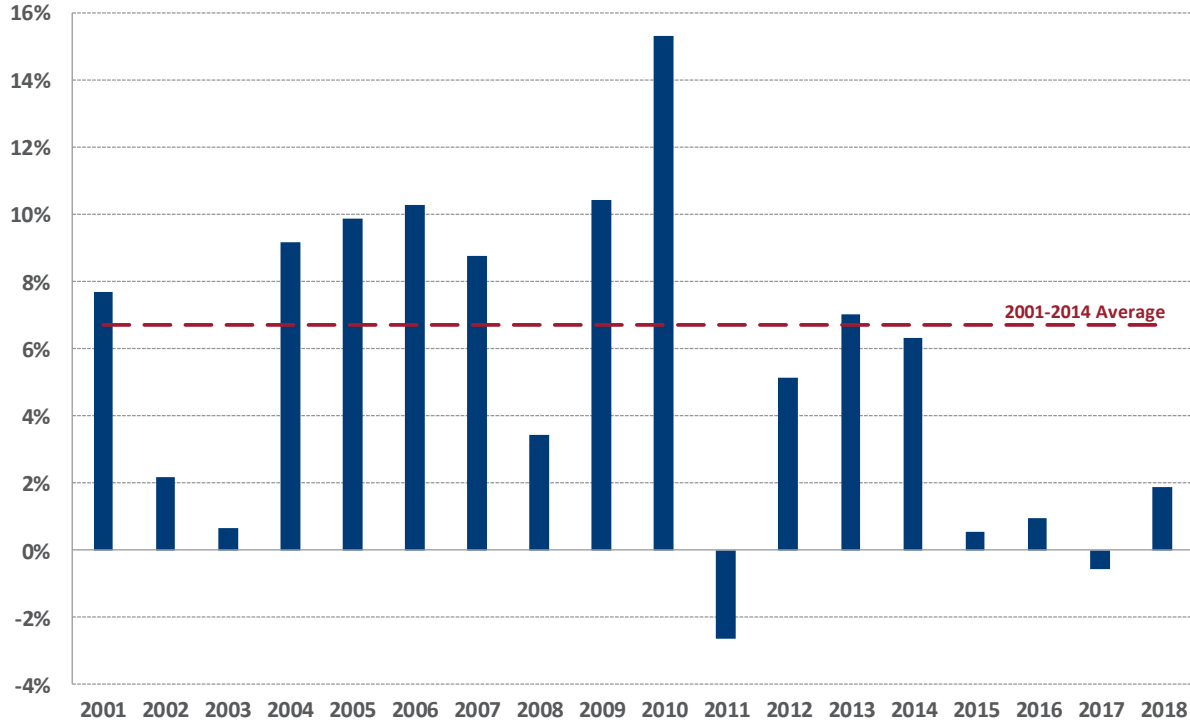


» The SELIC rate will remain stable throughout 2019 and an additional reduction cannot be rule out if the reform agenda moves forward.

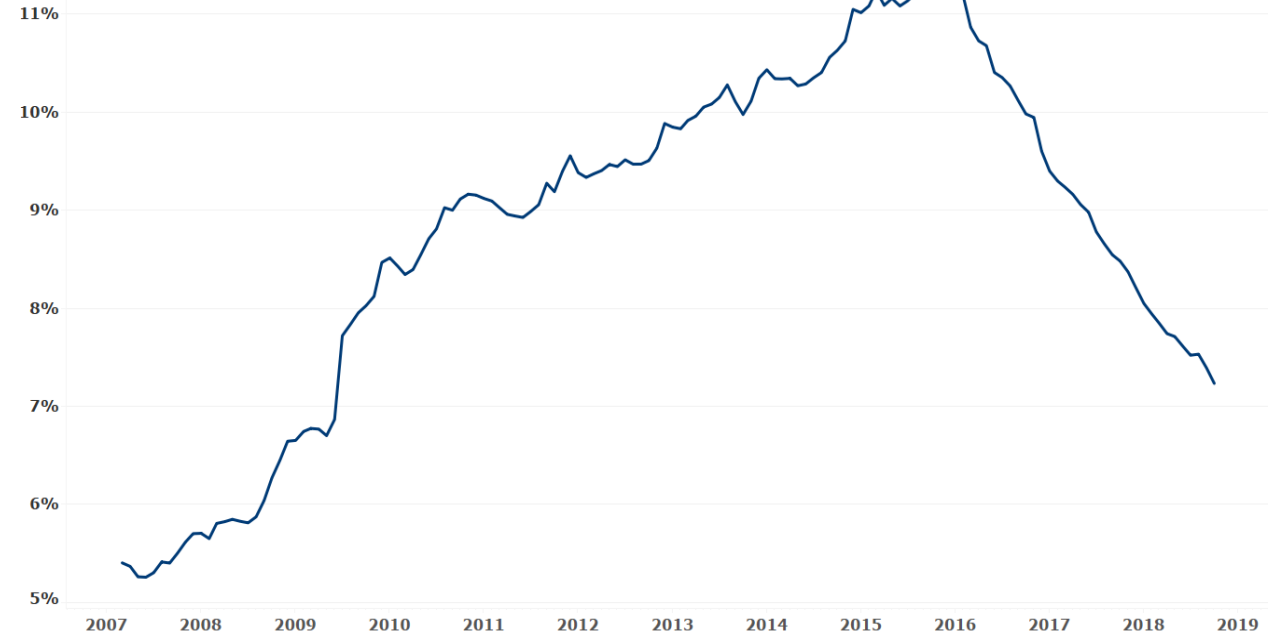


» Real government spending has stabilized for the first time, BNDES continues to retrench and TLP was approved: how far have those factors reduced the neutral interest rate?

Government Expenditures - Real Annual Growth

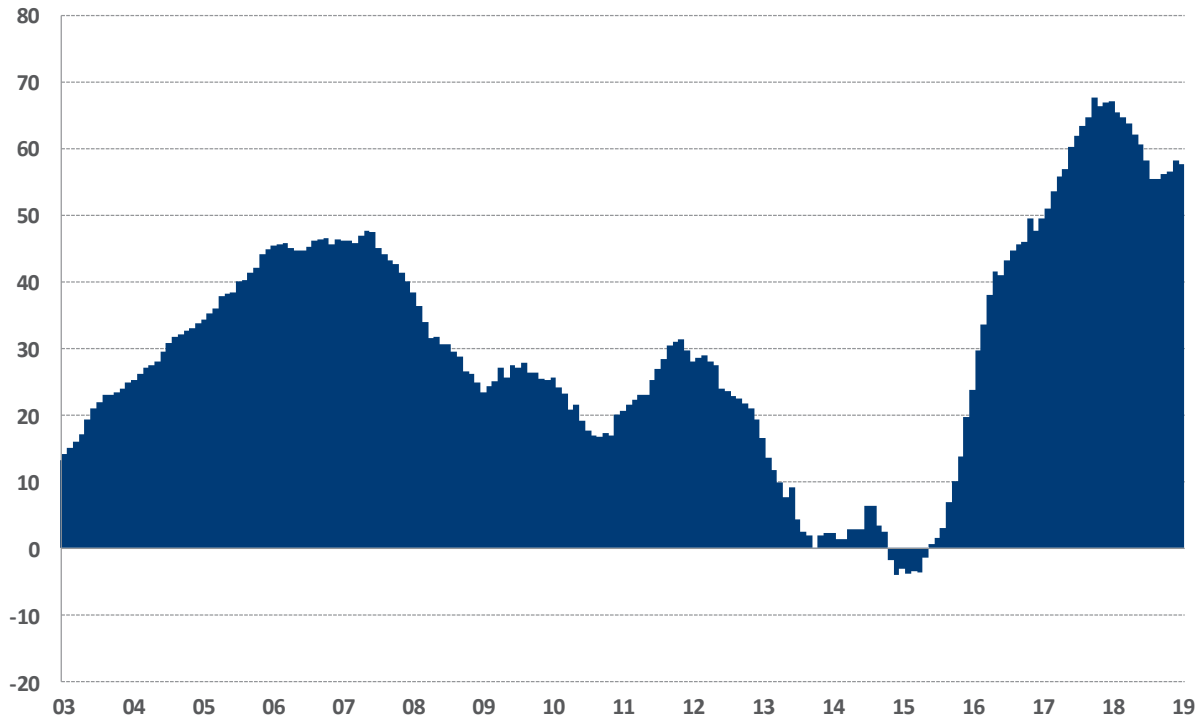


BNDES Credit Stock - % of GDP

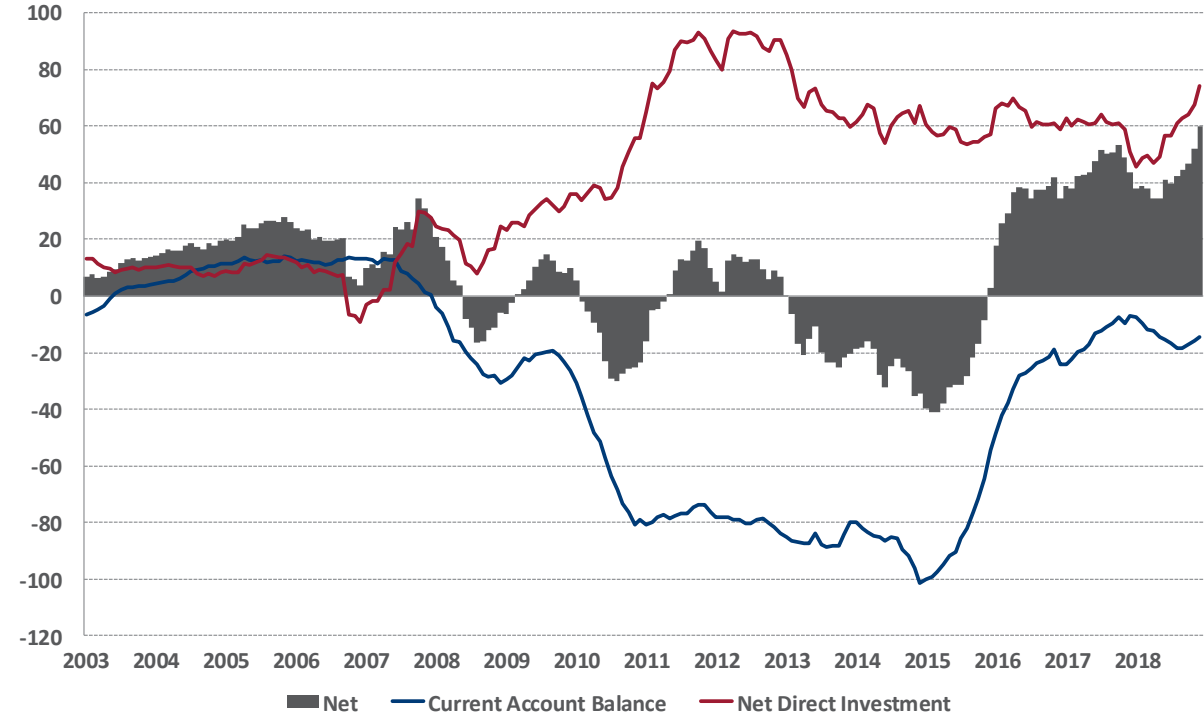


» Country has no external vulnerability: trade surplus remains large and FDI continues to overfinance the current account deficit.

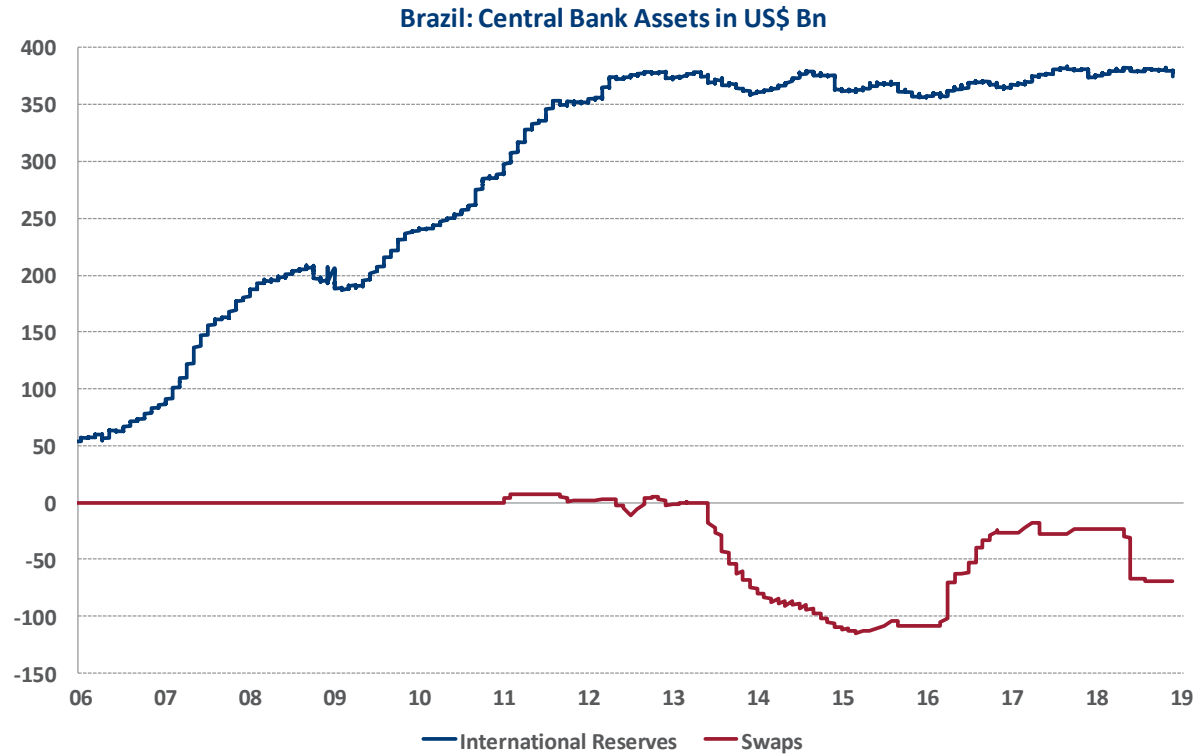
Balança Comercial - US\$ Bilhões em 12m



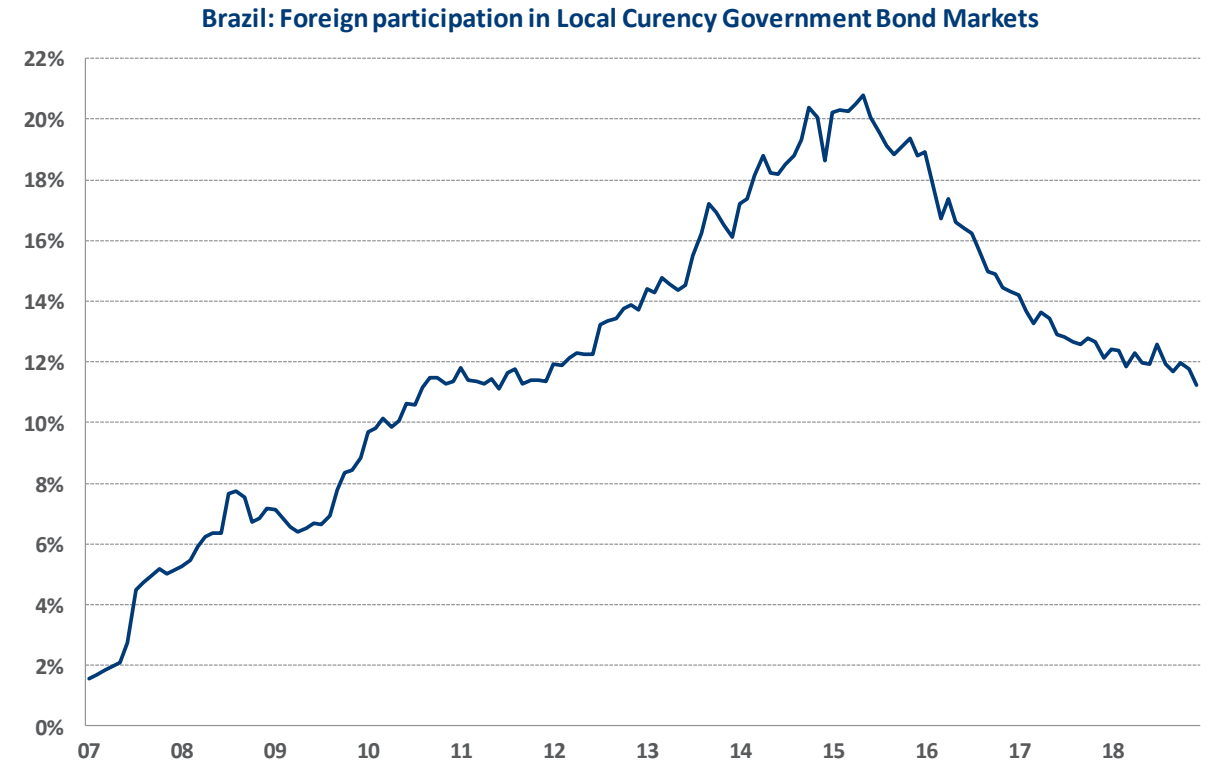
Current Account vs Net Direct Investment - US\$ Billion in 12m



»» Central Bank holds substantial international reserves.

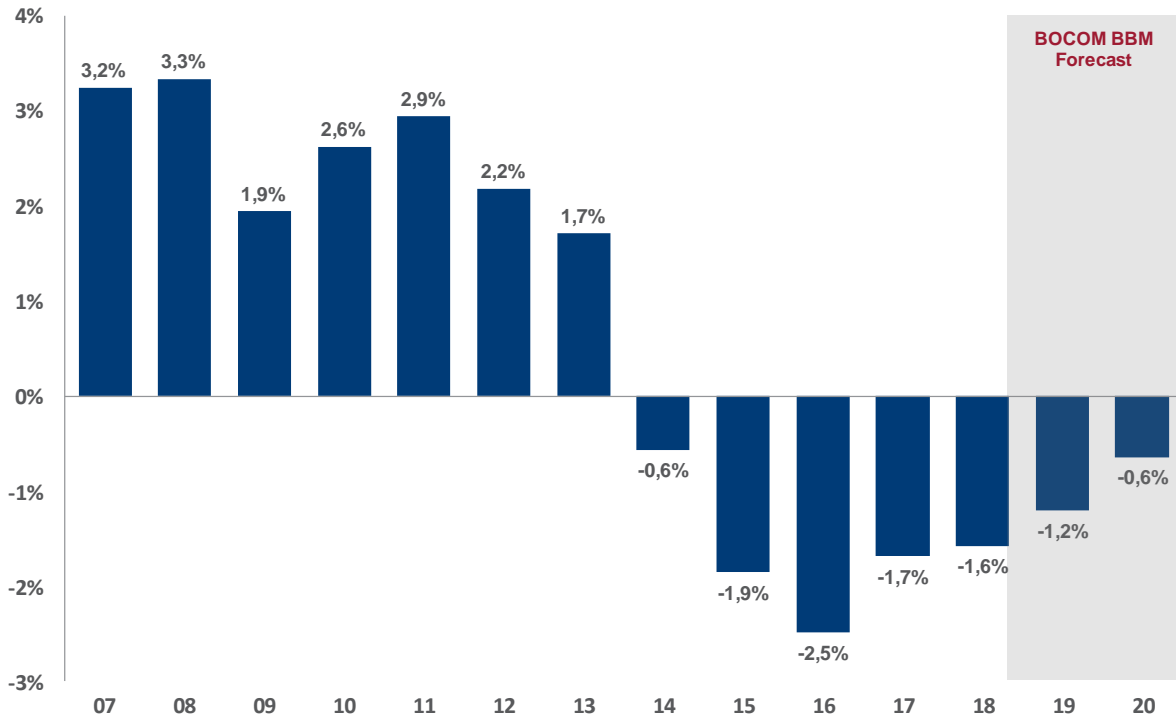


»» Government domestic debt exposure to foreign investors continues to fall.



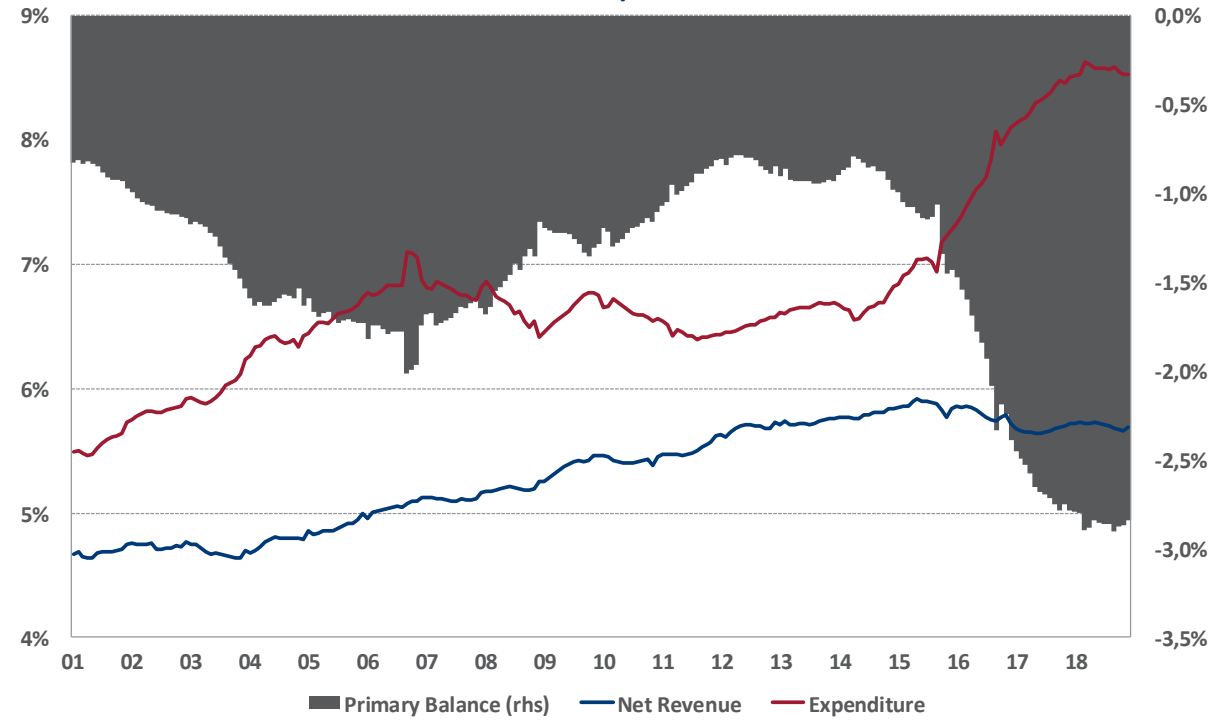
» Fiscal policy remains the main challenge: the country has run a primary deficit for 5 years.

Public Sector Primary Balance - % GDP

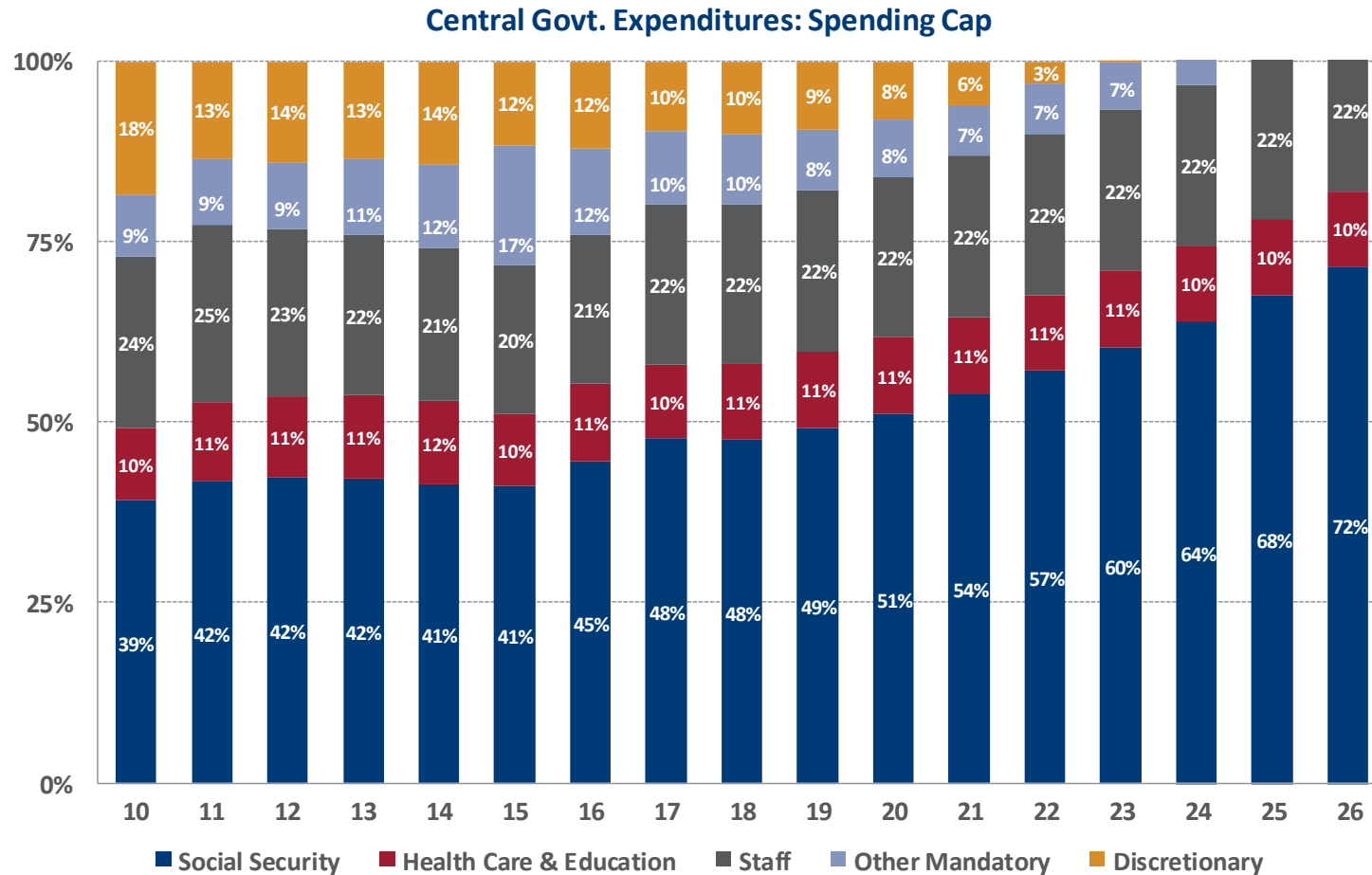


» Social security deficit (RGPS) is rapidly increasing.

Social Security - % GDP 12M



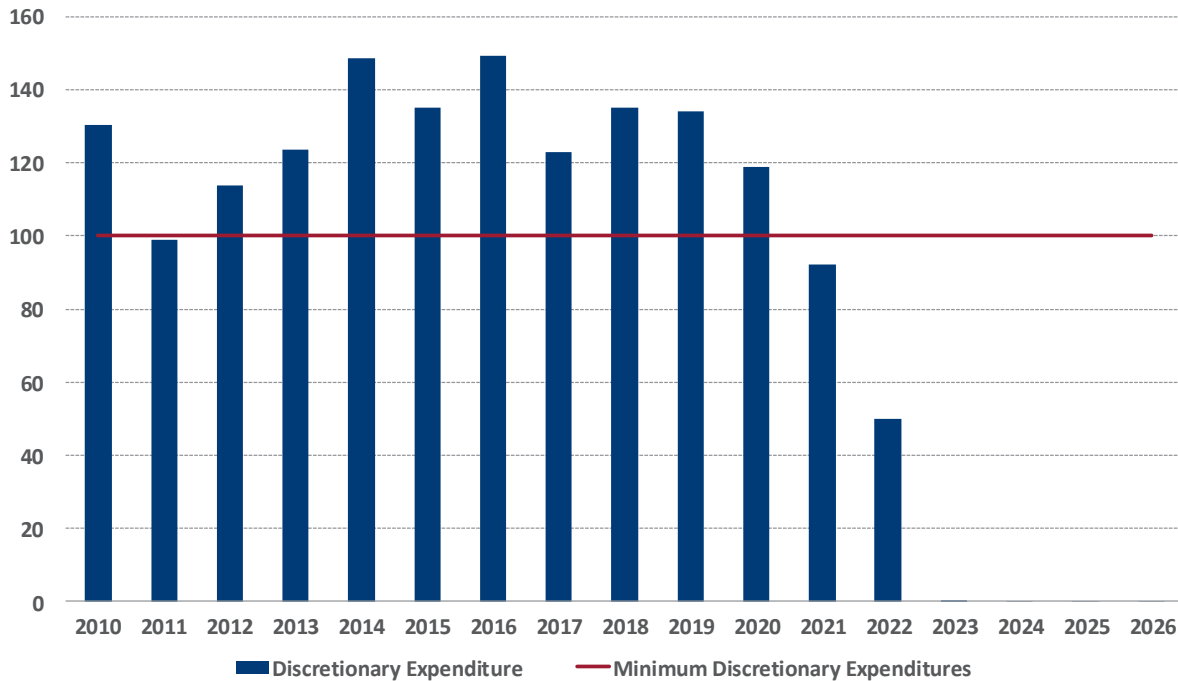
»» The government spends 50% of its budget with social security and 90% of it with mandatory spending. Without reforms, the spending cap becomes unsustainable in 2023.



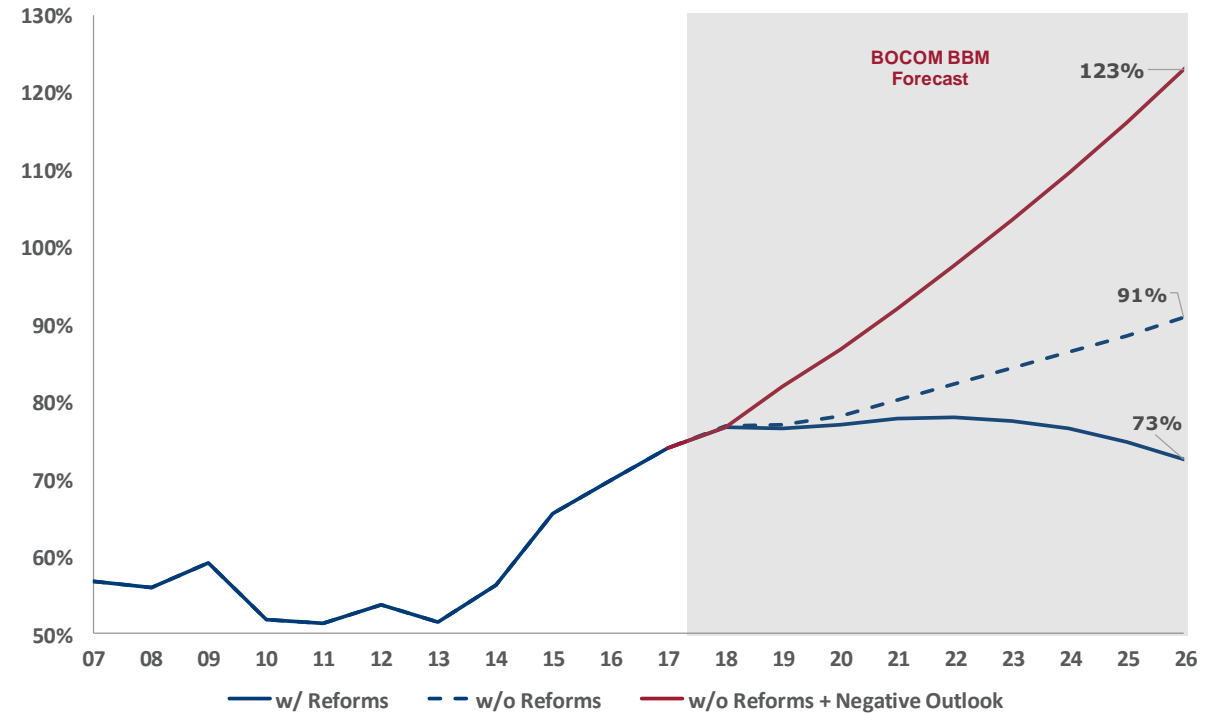
» The spending cap will be hard to sustain already in 2021.

» Without reforms, government debt will reach more than 100% of GDP by 2026.

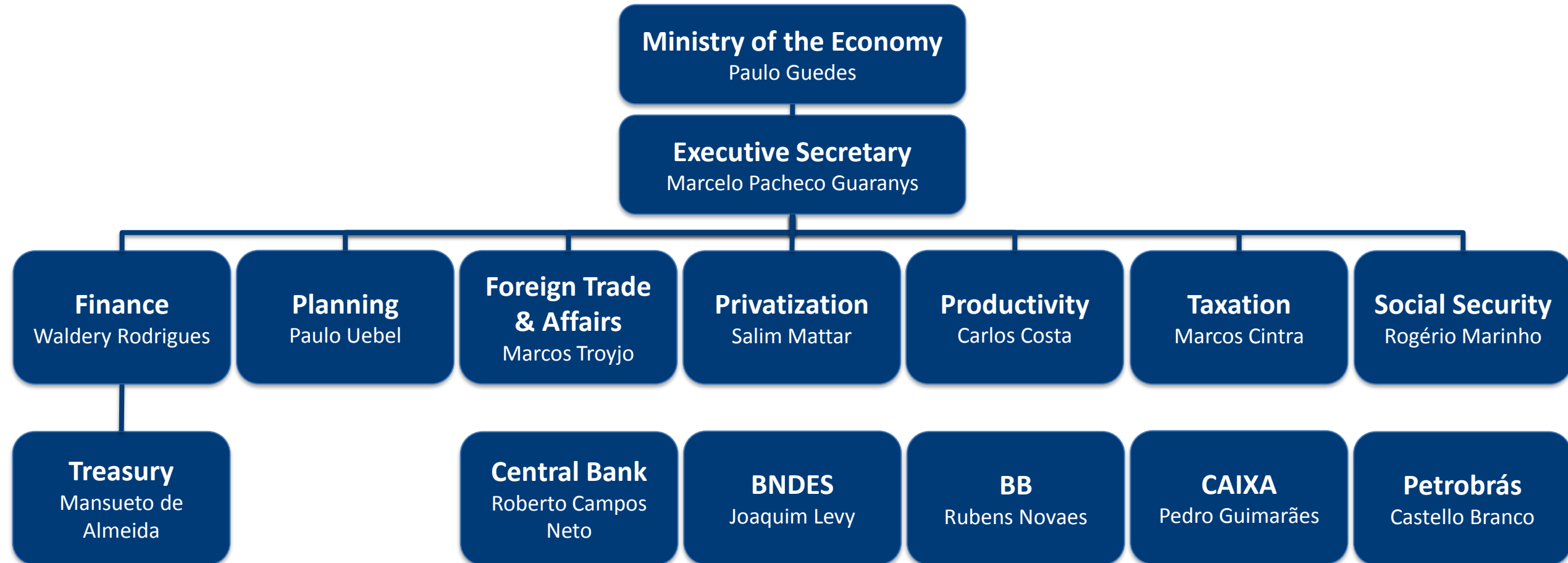
Discretionary Expenditures
R\$Billion



General Government Gross Debt - % GDP

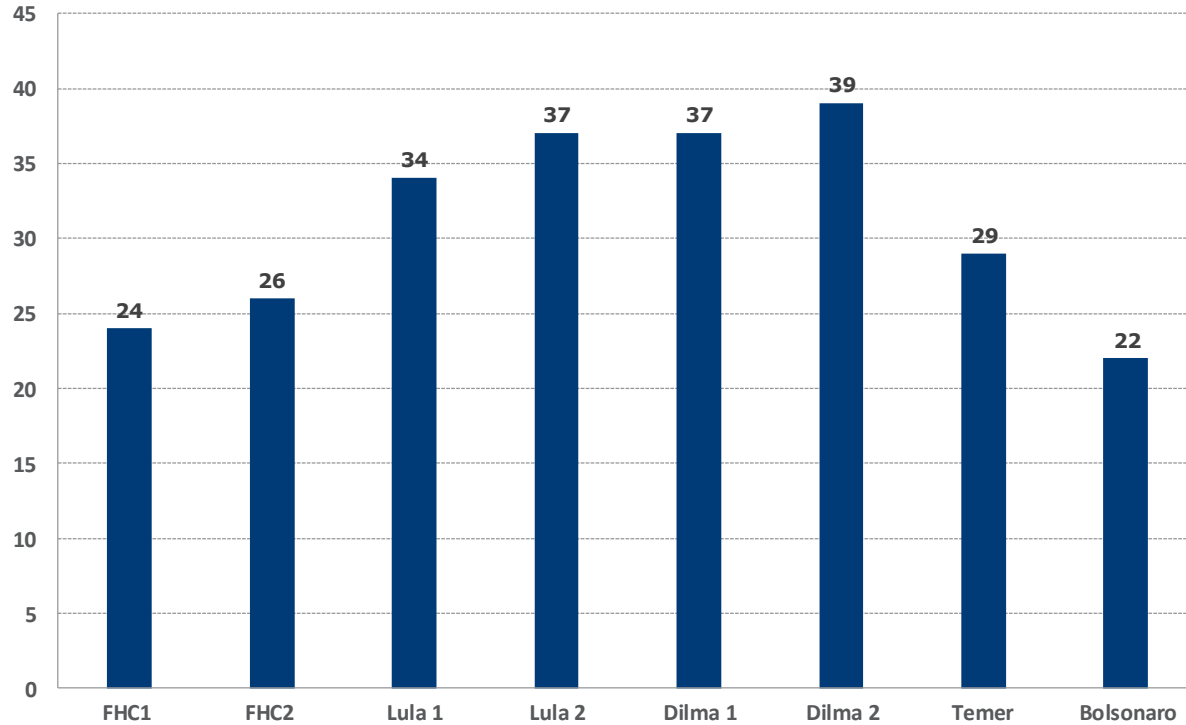


» Policy direction is clear: Paulo Guedes and his team will propose an ample and ambitious pension reform. Main challenge is policy implementation.

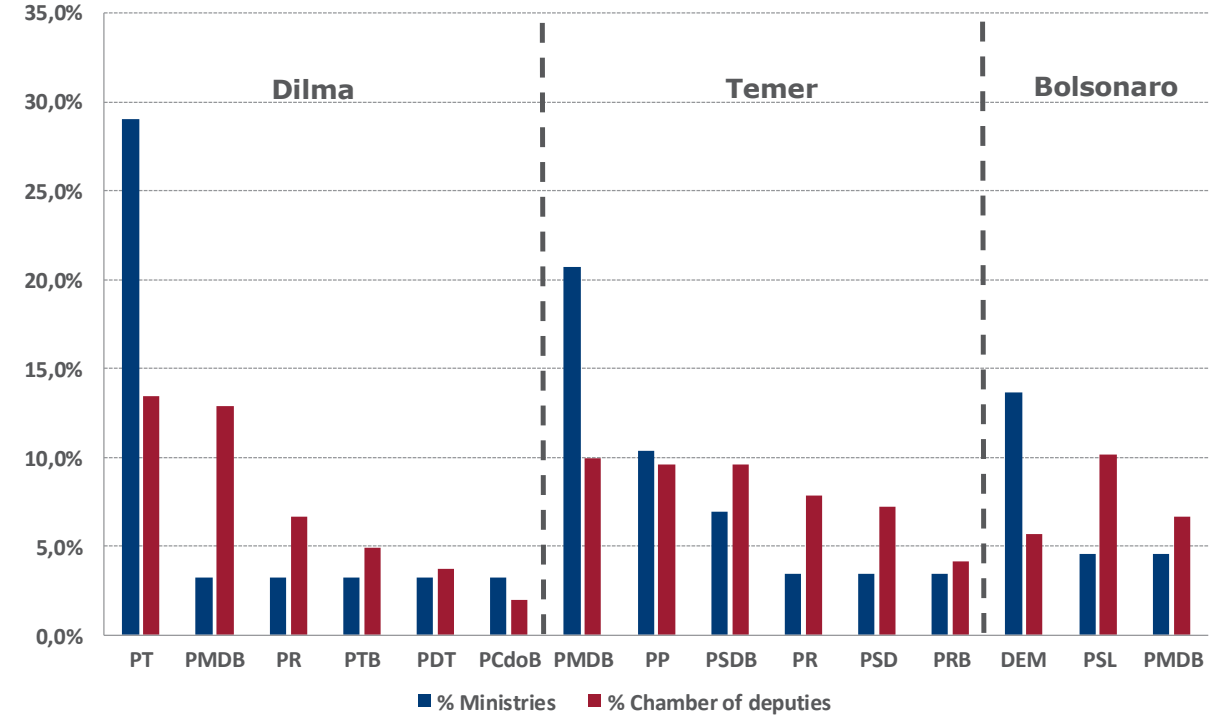


» There are questions about political coordination to approve the reform agenda: cabinet will only have 22 ministries and has little intersection with the political forces represented in Congress.

Number of Ministries



Cabinet Composition



BATTLE FOR PENSION REFORM IS ABOUT TO START

- » Paulo Guedes will propose an ample and ambitious pension reform, but main challenge is policy implementation.
- » There are questions about political coordination to approve the reform agenda, but Rodrigo Maia's reelection as lower house president is positive.
- » Growth should pick up with low inflation and stable Selic rate, but downside risks remain if the reform agenda stalls.

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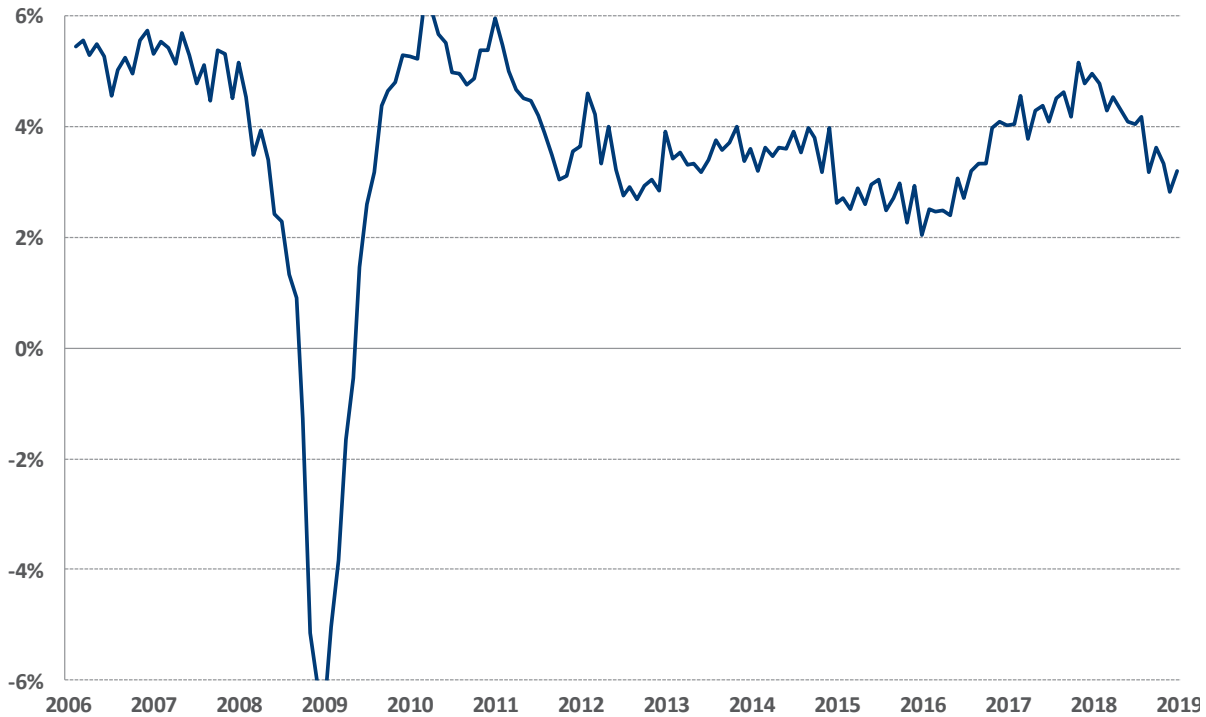
»» MARKETS: RECENT TRENDS

GLOBAL OUTLOOK: A SLOWDOWN IS UNDER WAY

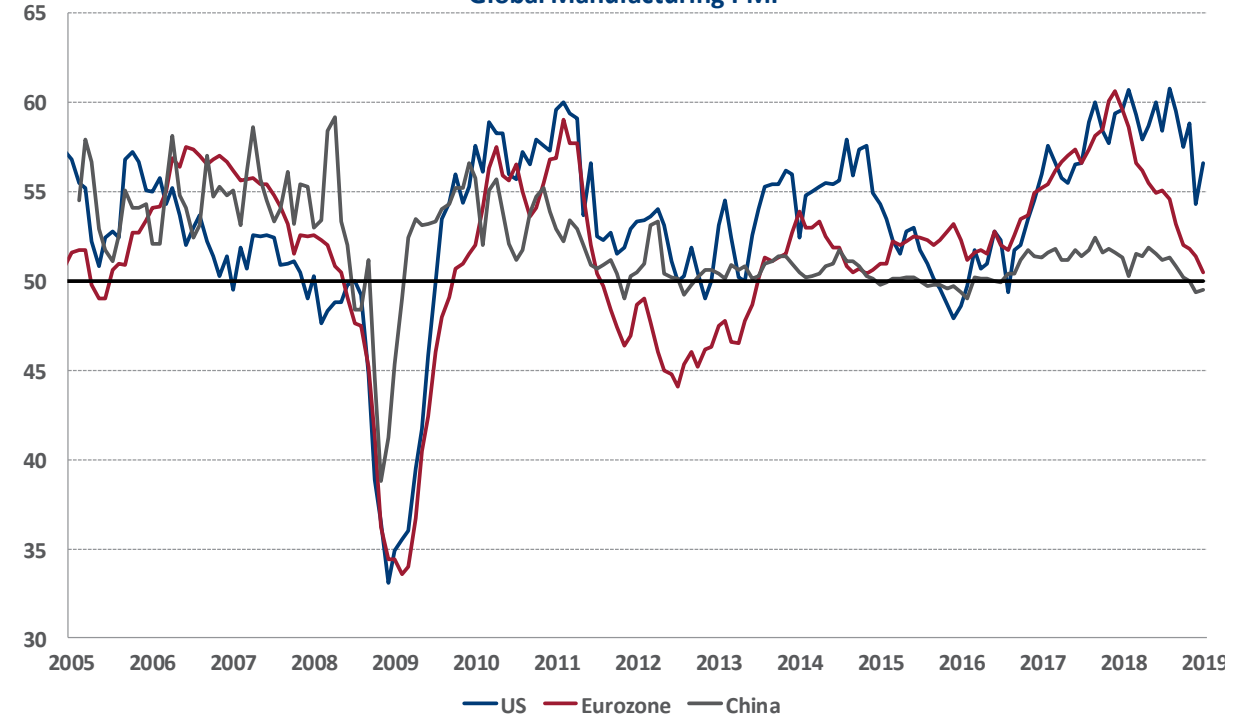
- » US: Growth is slowing down to 2.0% as the fiscal stimulus loses steam and tighter financial conditions begin to bite.
- » Europe: Brexit remains a source of uncertainty and growth has slowdown in many economies due to several shocks.
- » China: The economy decelerated at the end of the year and will slow further towards 6.0% in 2019.
- » EM: Slower global growth is negative for emerging countries, but financial conditions have improved since the FED changed its communication.

» Global growth is slowing down again and several downside risks remain: escalation of trade tensions, a greater-than-envisaged slowdown in China and hard Brexit.

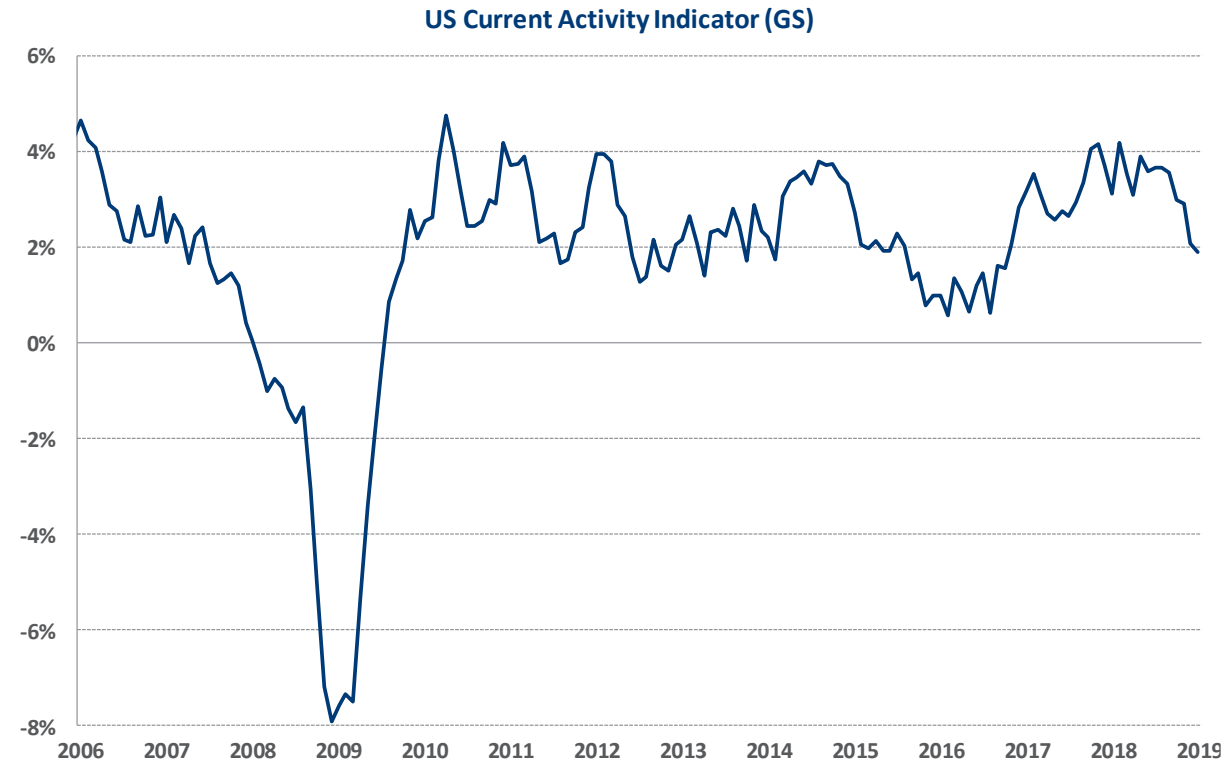
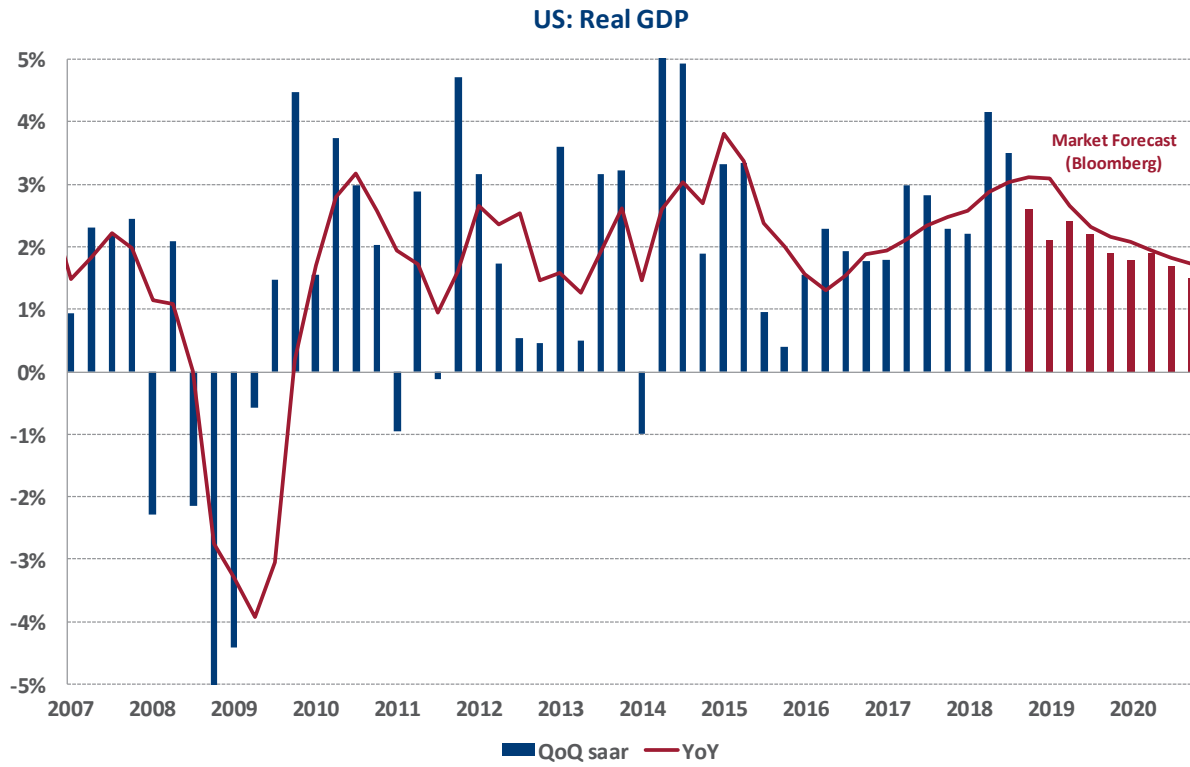
World Current Activity Indicator (GS)



Global Manufacturing PMI



»» **US growth is slowing down to 2.0% as the fiscal stimulus loses steam and tighter financial conditions begin to bite.**



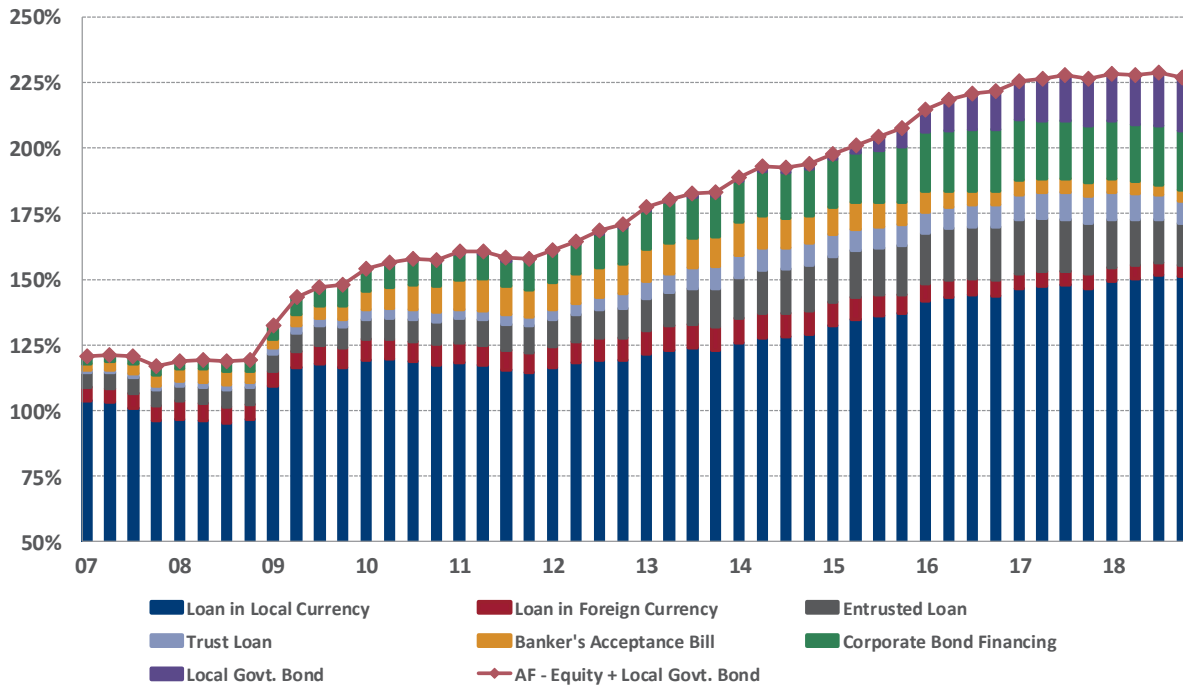
» GDP growth has been trending down in recent years and recent data points to a slowdown to below 6.0% in the short term.



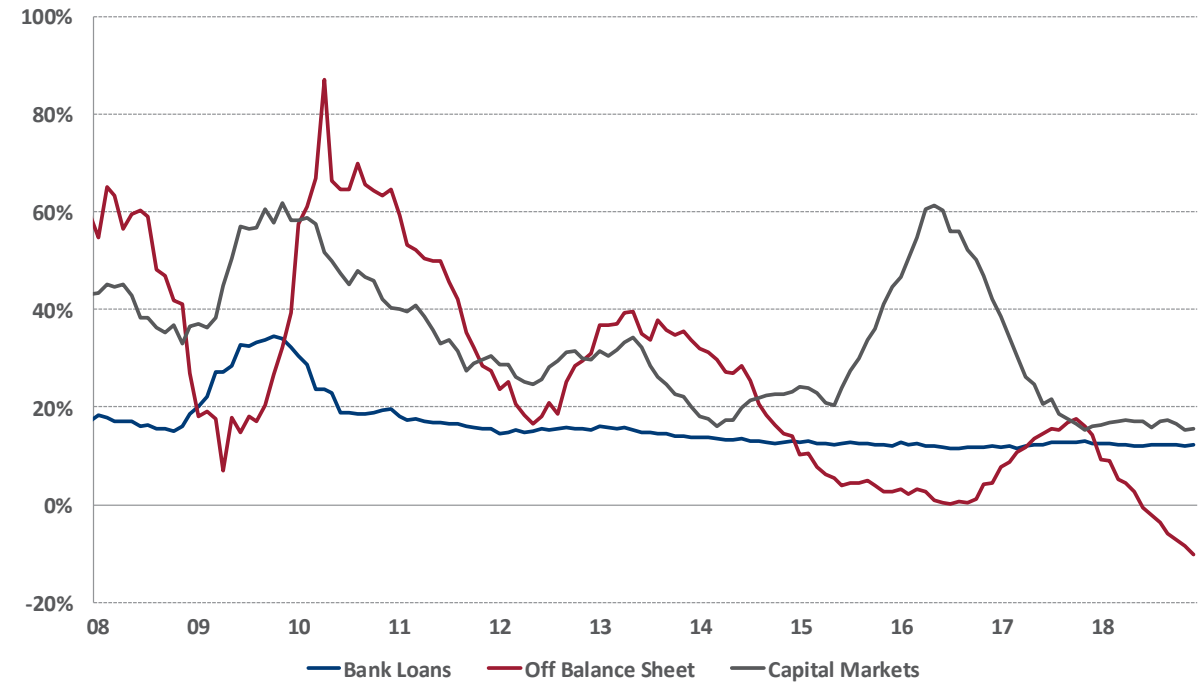
» China's government has pushed for tighter financial regulation to stabilize debt.

» Shadow banking has slowed significantly, but banks continue to expand their portfolio.

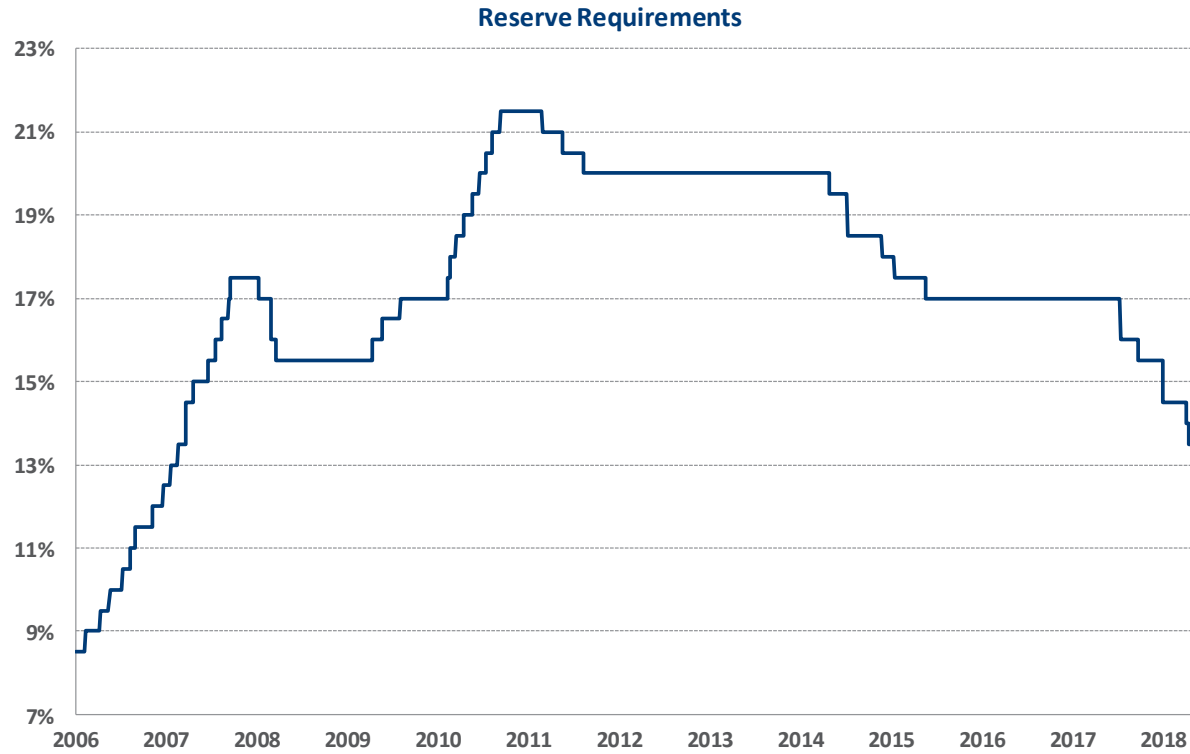
Aggregate Financing (AF) - Equity + Local Govt. Bond
% gdp, accumulated 4q



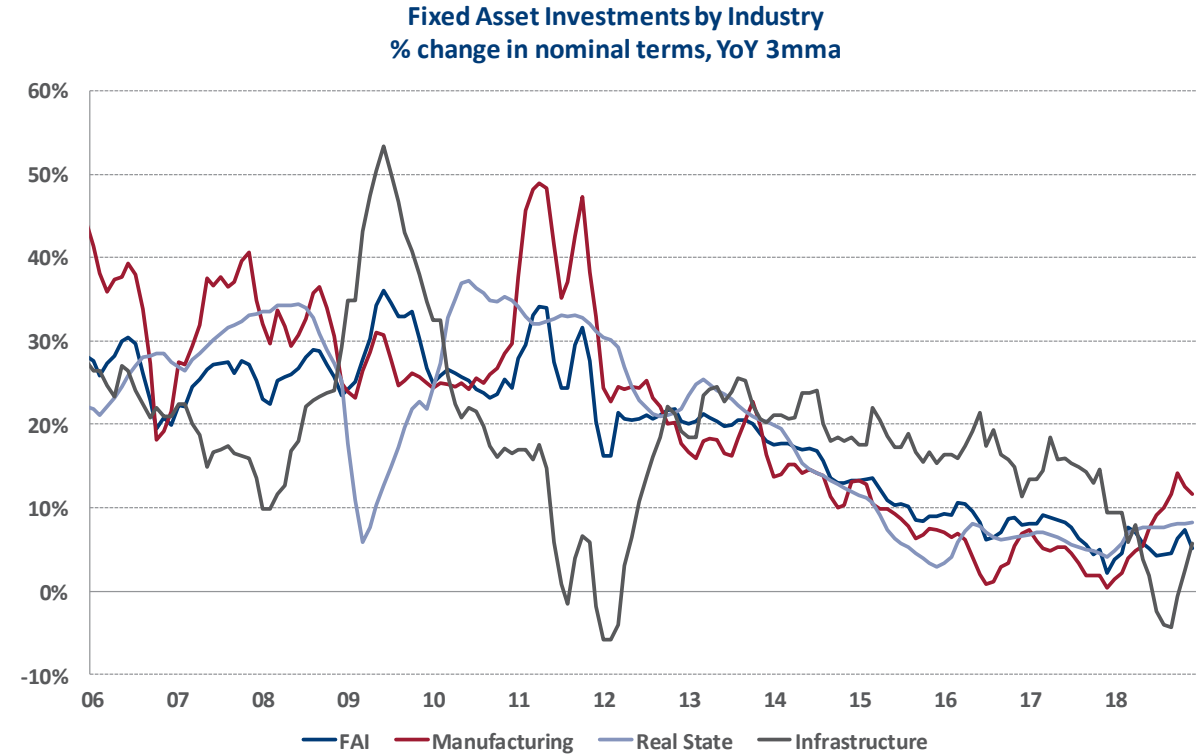
Aggregate Financing
% change in nominal terms, YoY



» Slower growth has pushed the government to increase liquidity provision.



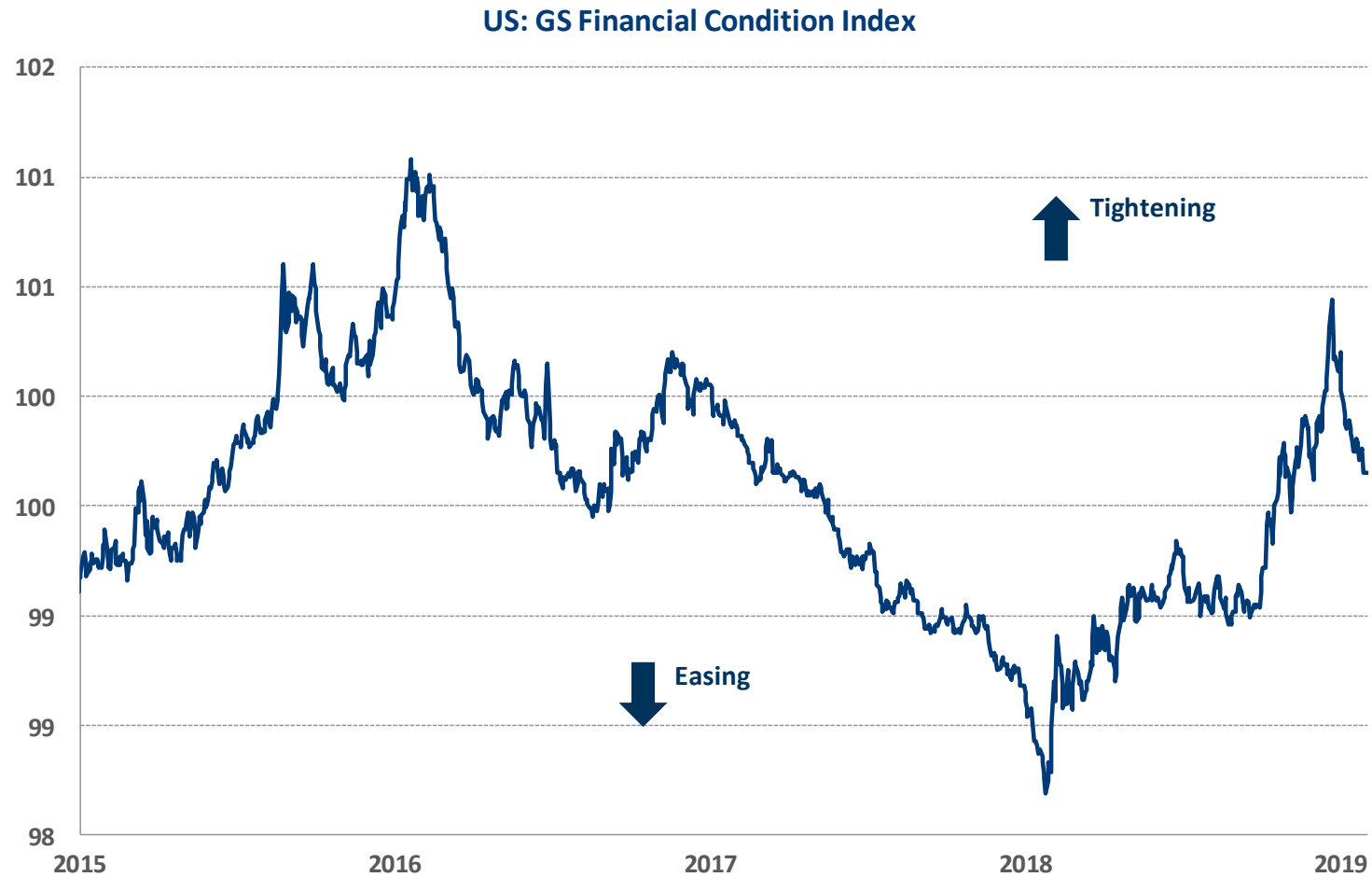
» Fiscal policy is also turning more proactive through higher infrastructure spending.



- » Will the US-China reach a deal?
 - » December 1: Trump and Xi agreed on truce.
 - » December 11: China reduces import tariffs on U.S. autos to 15% from 40%.
 - » January 7-9: Talks in Beijing.
 - » January 30-31: Talks in Washington.
 - » March 1: Deadline for a deal.



- » EM: Slower global growth is negative for emerging countries, but financial conditions have improved since the FED changed its communication.



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BRAZIL: MARKETS

Spot Nominal Interest Rate (DI Curve)



Ibovespa



BRL Currency



CDS 5 Years



GLOBAL: MARKETS

SPX Index



VIX Index



CDX High Yield Spread



Nominal Dollar Trade Weighted (FED)



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