



MACRO OUTLOOK

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» GLOBAL: OUTLOOK REMAINS COMPLEX

» MARKETS: RECENT TRENDS

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» BRAZIL: BENIGN ECONOMIC OUTLOOK AMID OLD CHALLENGES

» GLOBAL: OUTLOOK REMAINS COMPLEX

» MARKETS: RECENT TRENDS

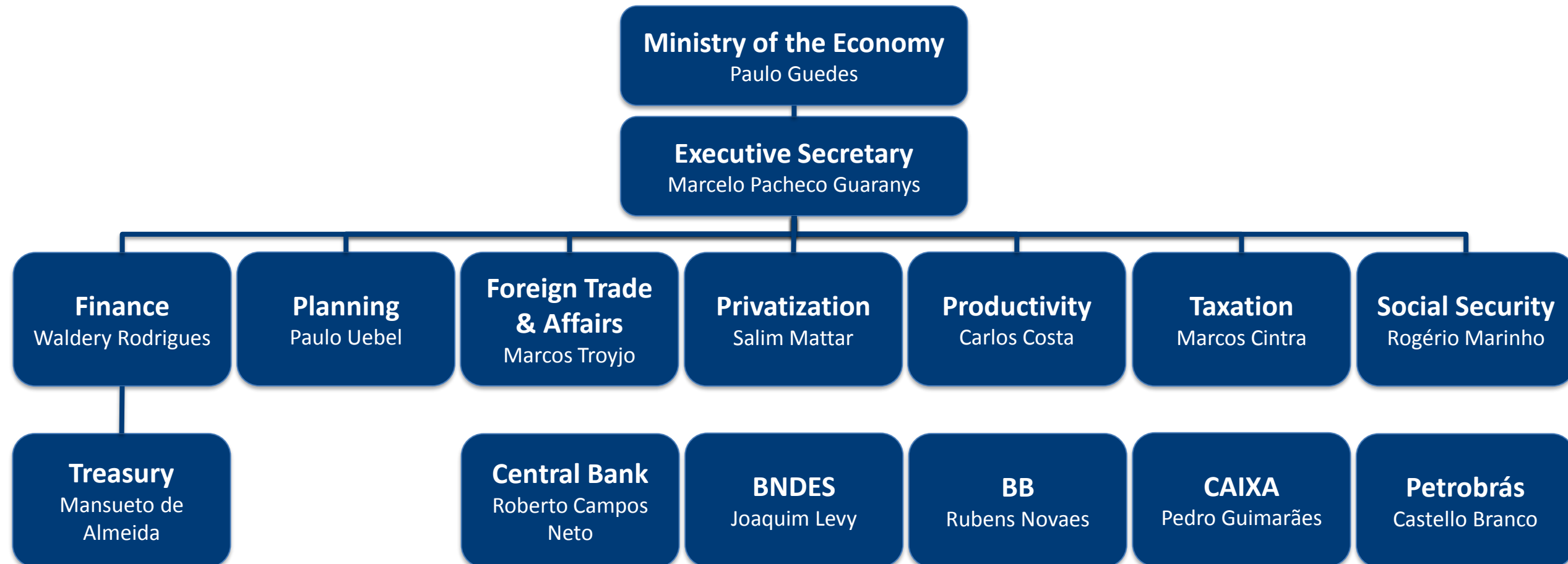
BENIGN ECONOMIC OUTLOOK AMID OLD CHALLENGES

- »» Growth should pick up with low inflation and stable Selic rate throughout 2019.
- »» Fiscal adjustment is incomplete: pension reform is urgent for the government to comply with the spending cap and stabilize public debt in the medium term.
- »» Policy direction is clear: Guedes and his economic team are committed to a liberal and reformist agenda. Main challenge is policy implementation.
- »» The new cabinet has little intersection with the political forces represented in Congress, raising questions about political coordination to approve the reform agenda.
- »» The global outlook also remains complex.

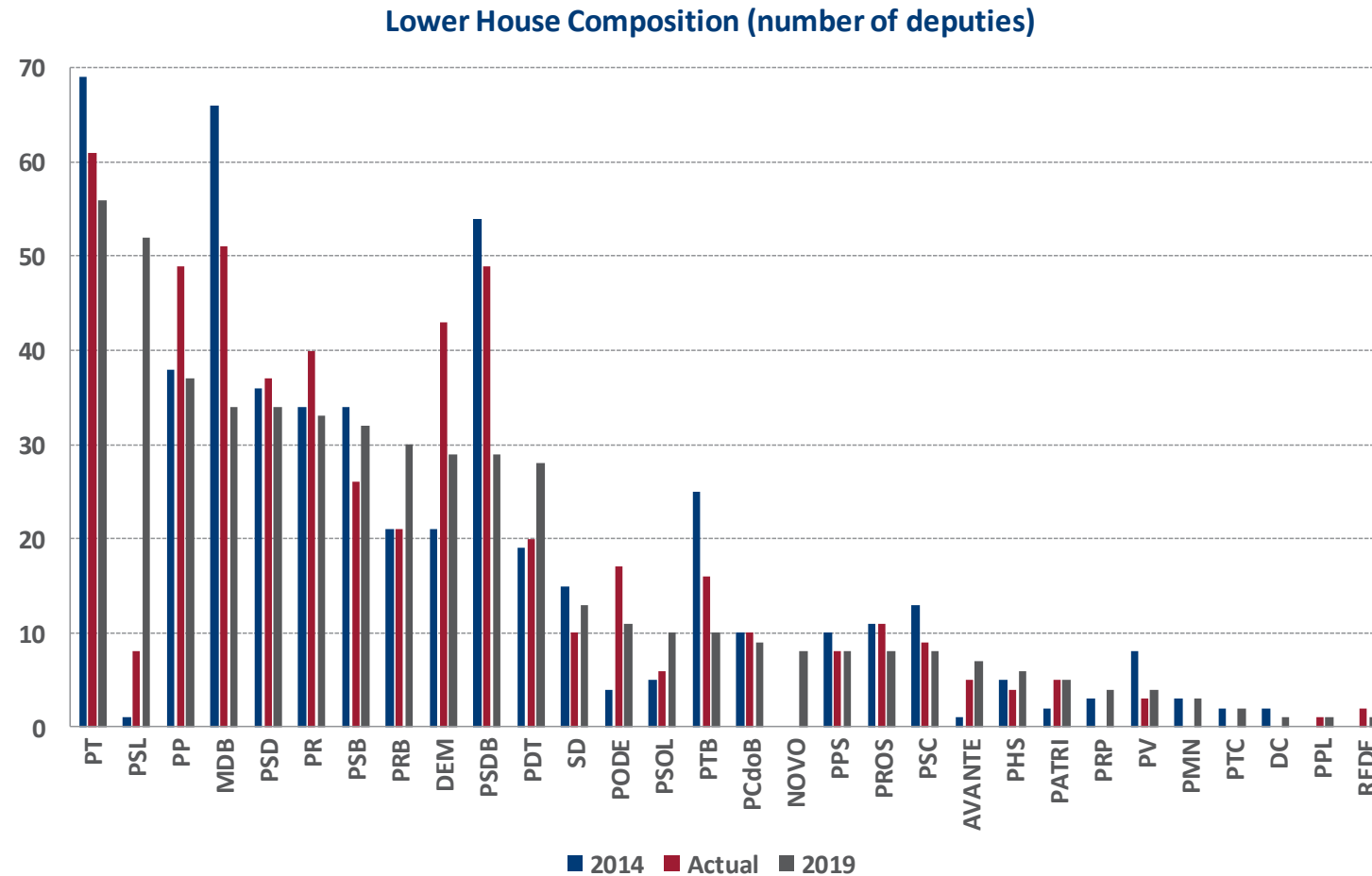
BRAZIL: FORECASTS

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018 F	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,2%	2,8%	3,0%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,8%	3,9%	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%	12,1%	10,6%	9,7%
Trade Balance (US\$ bn)	3	-4	20	48	67	62	50	39
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-12	-25	-42
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,6%	-1,1%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,8%	-1,3%	-0,4%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	74,4%	75,8%	76,2%

- » Policy direction is clear: Guedes and his economic team are committed to a liberal and reformist agenda. Main challenge is policy implementation.

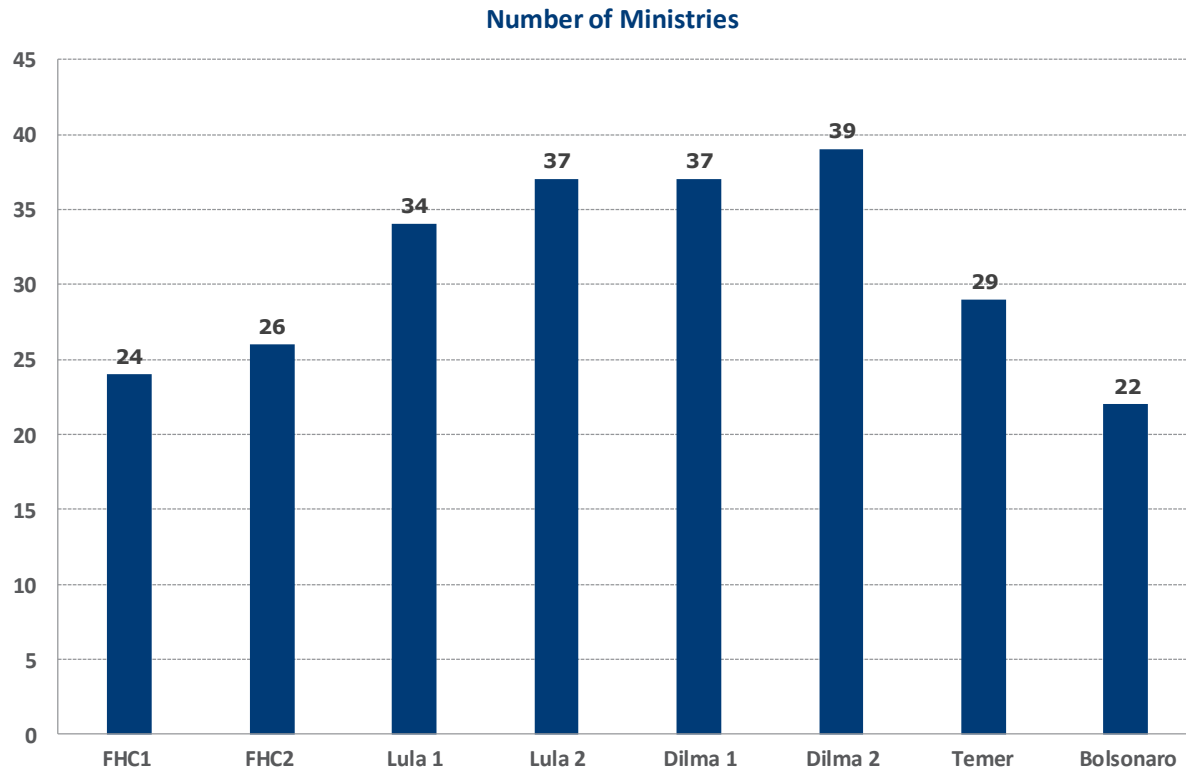


- » PSL became the 2nd largest party, but Congress remains deeply fragmented, with 30 parties represented in the Lower House.

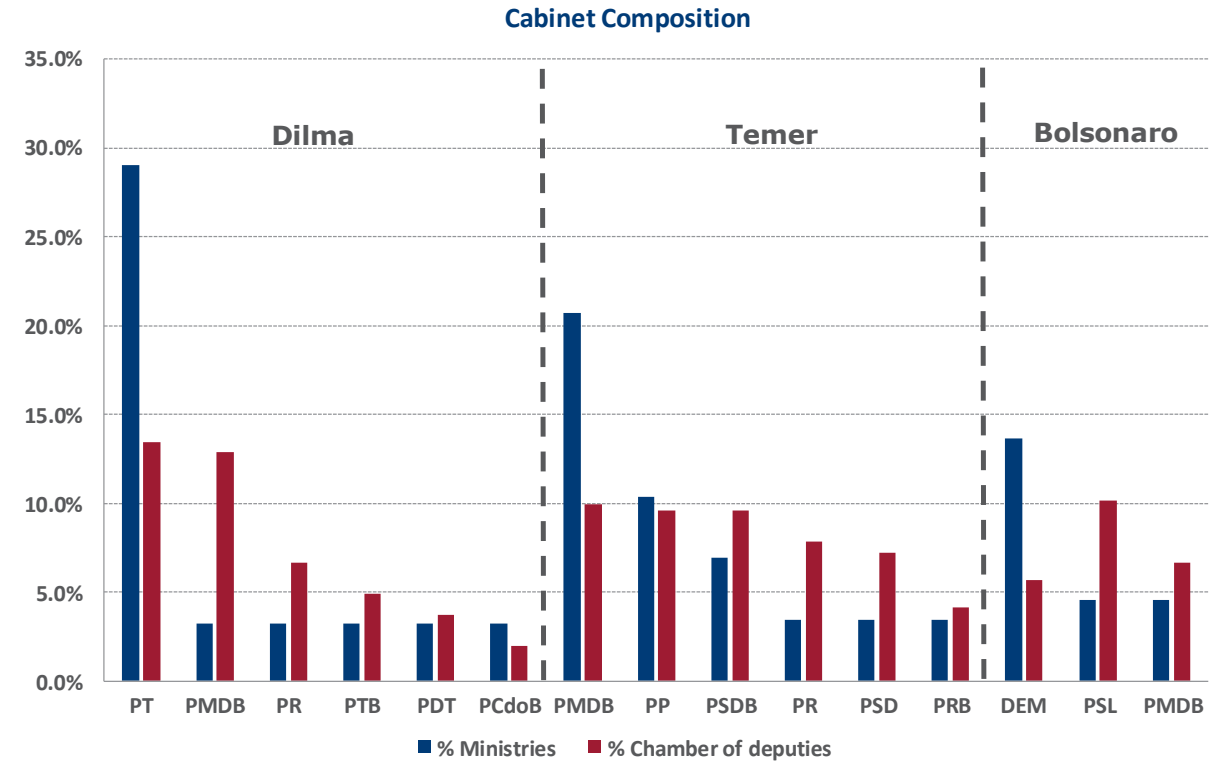


BRAZIL: POLITICS

» Cabinet will only have 22 ministries, the smallest in recent years.



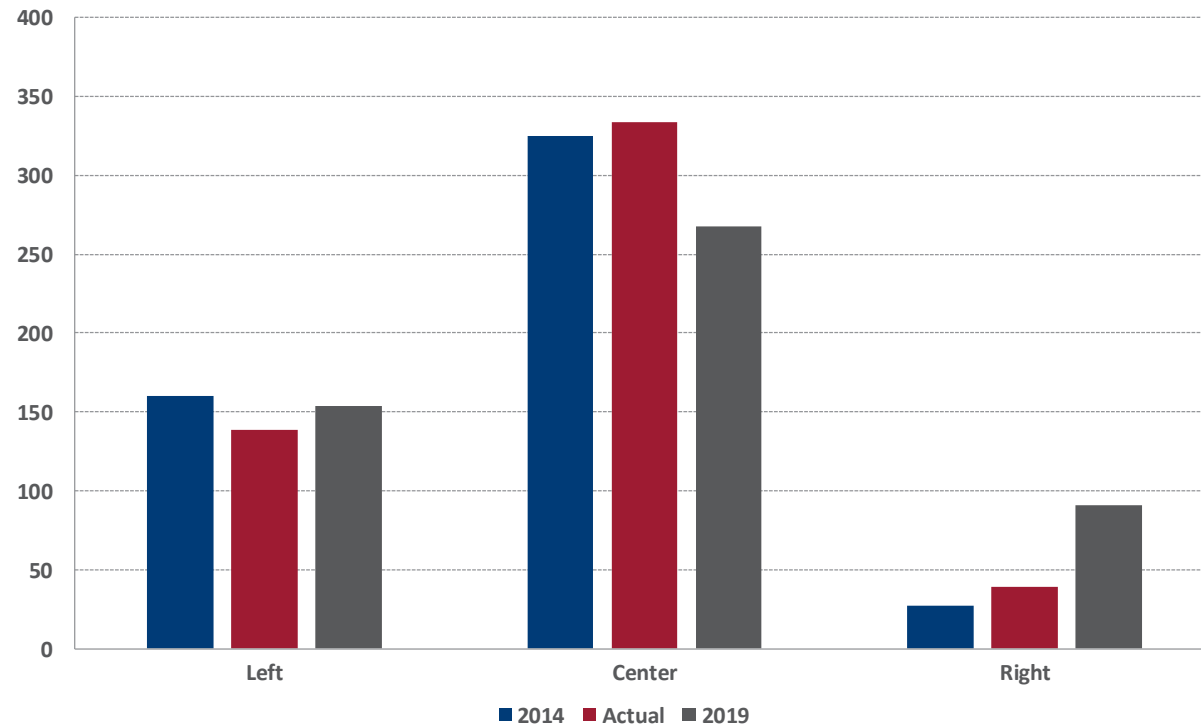
» The cabinet has little intersection with the political forces represented in Congress.



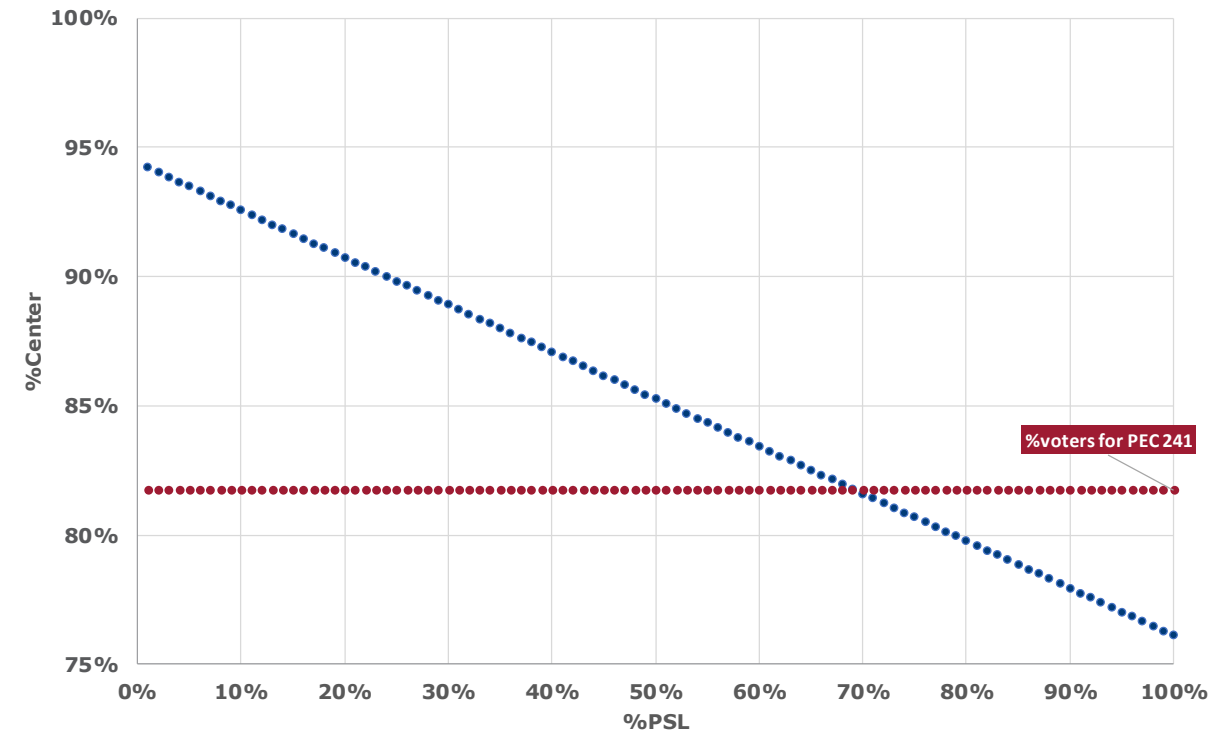
» The government will need to reach out to center parties to approve the reform agenda.

» PSL should be the first party embracing the reform agenda.

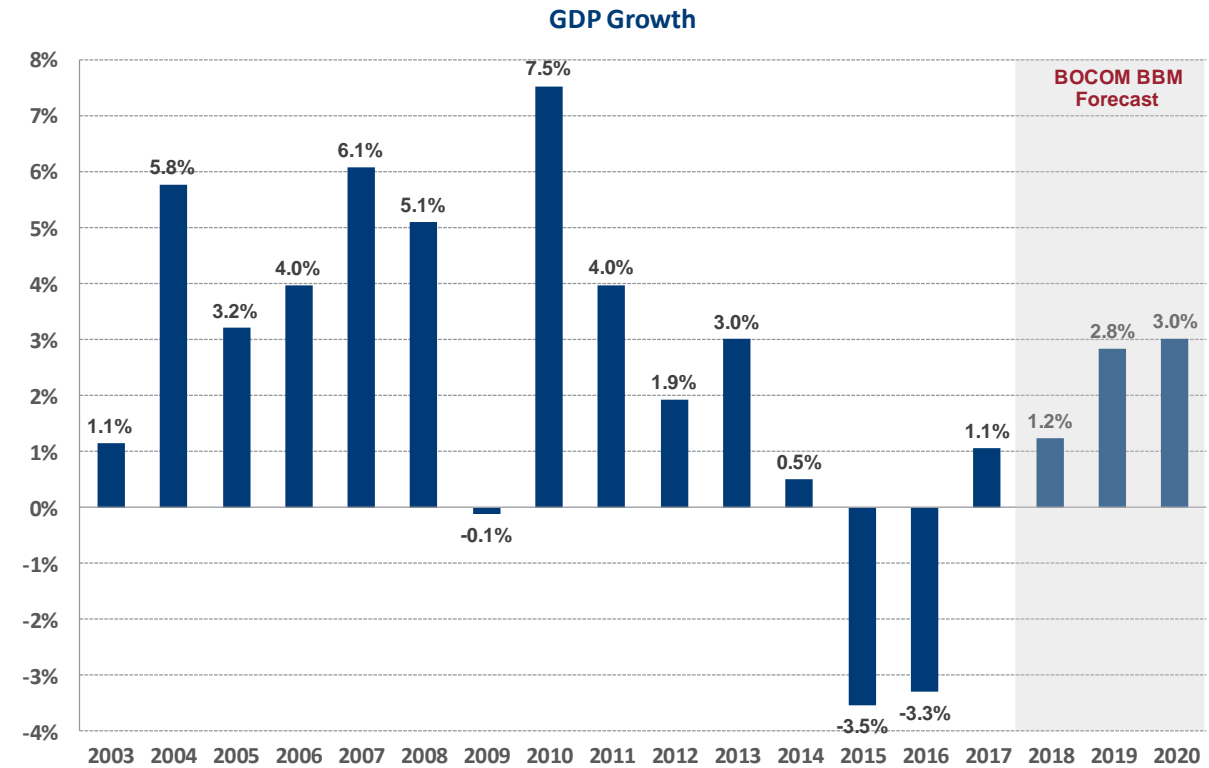
Lower House Composition



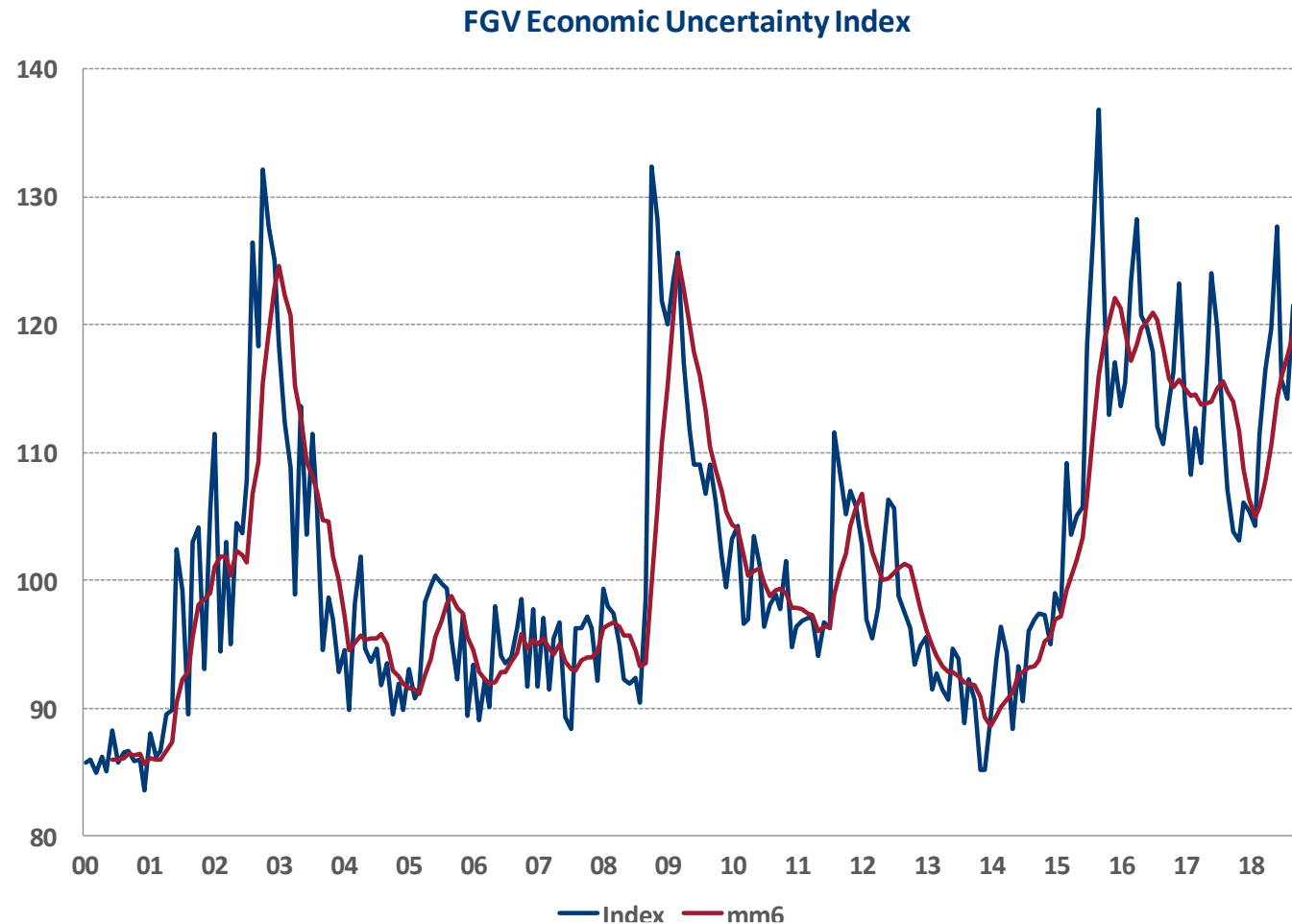
Constitucional Amendment



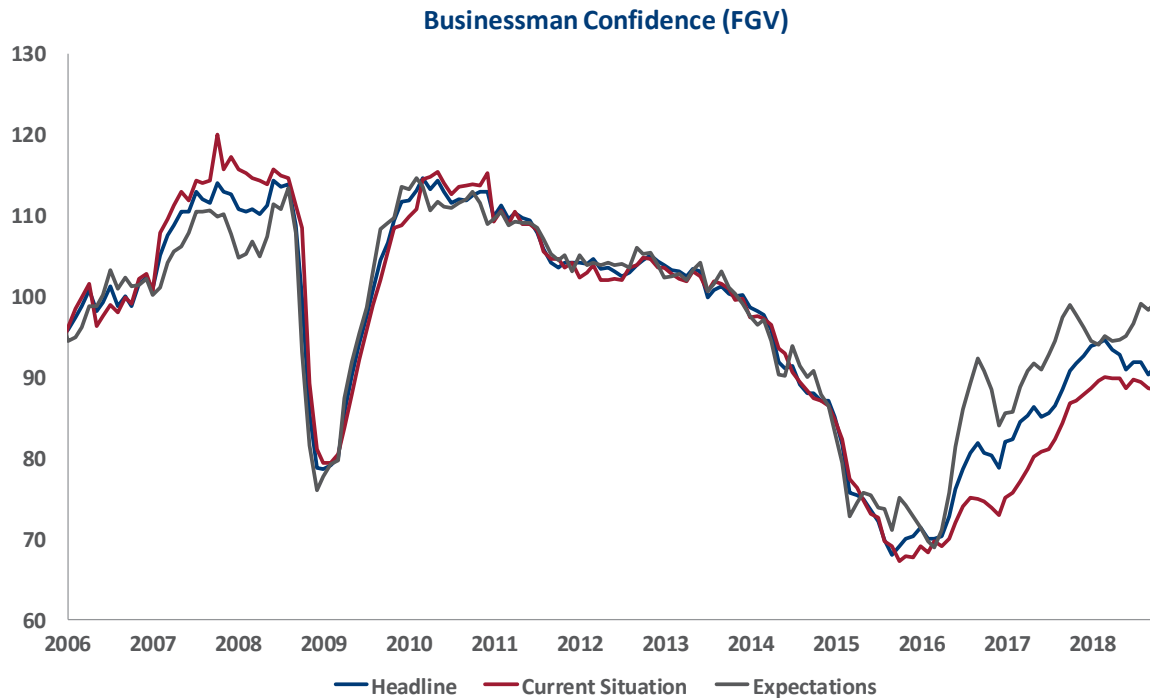
- » Benign economic outlook: growth should pick to 2.8% in 2019 and 3.0% in 2020:
 - » Headwinds are dissipating and economic uncertainty will decline
 - » Confidence and labor market are improving
 - » Monetary policy remains accommodative
 - » Banks are ready to support the recovery
 - » No domestic or foreign constraints to growth



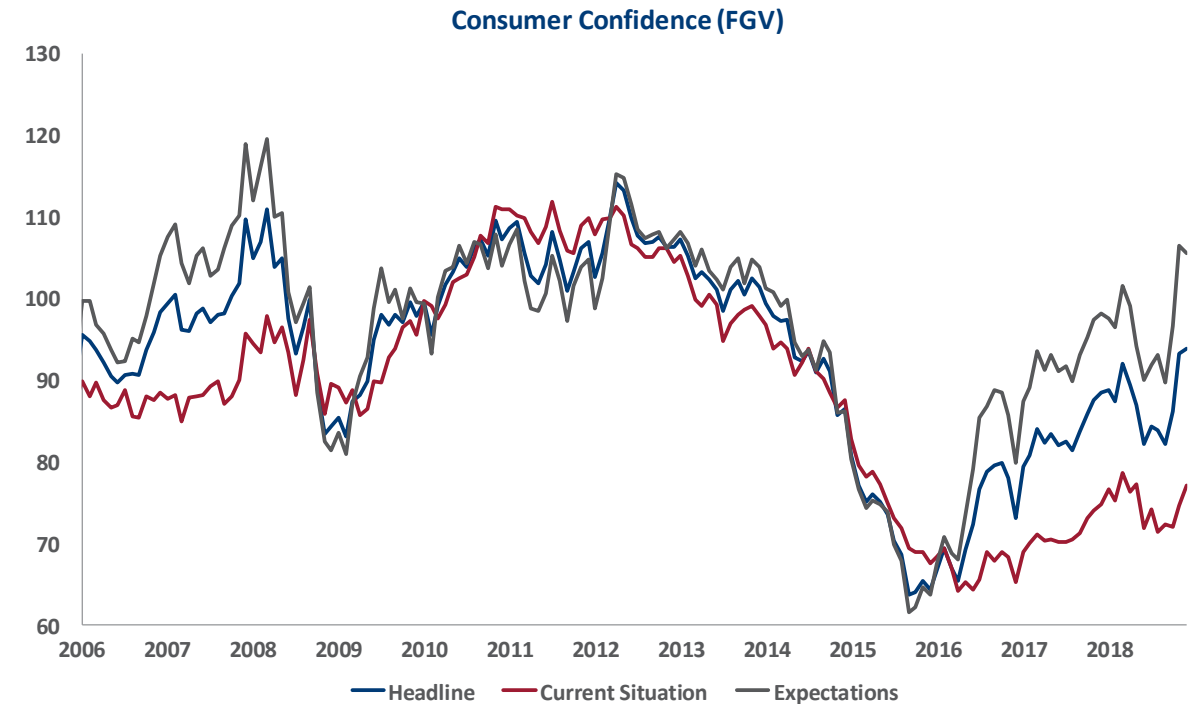
- » Higher economic uncertainty has restrained growth since 2015. It should slowly decline as the reform agenda moves forward, supporting growth in 2019 and 2020.



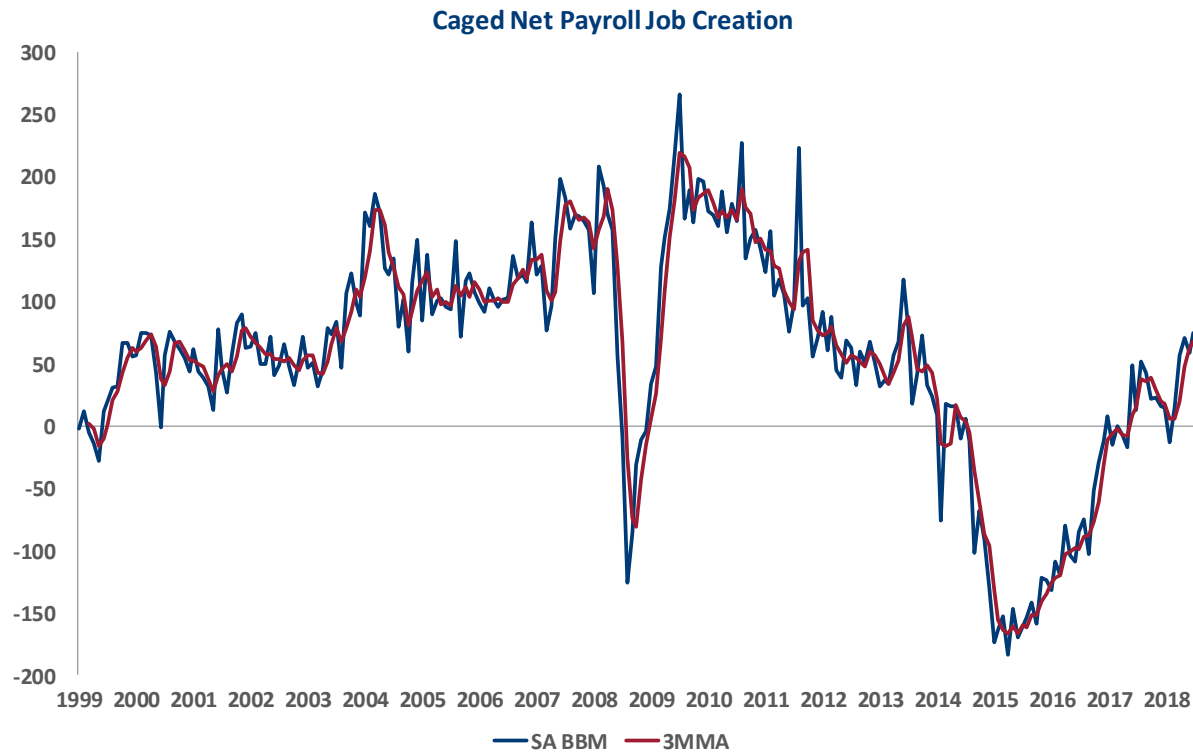
» Business confidence is starting to improve after pausing in 2018.



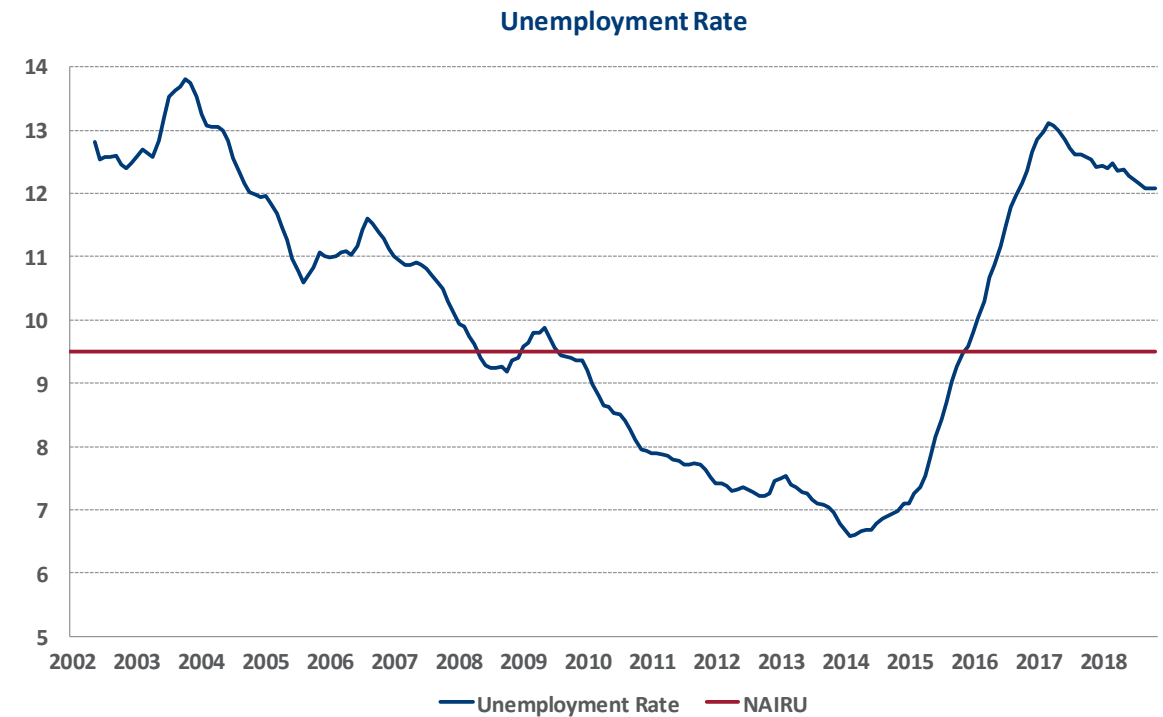
» Consumers are becoming more optimistic about the future.



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



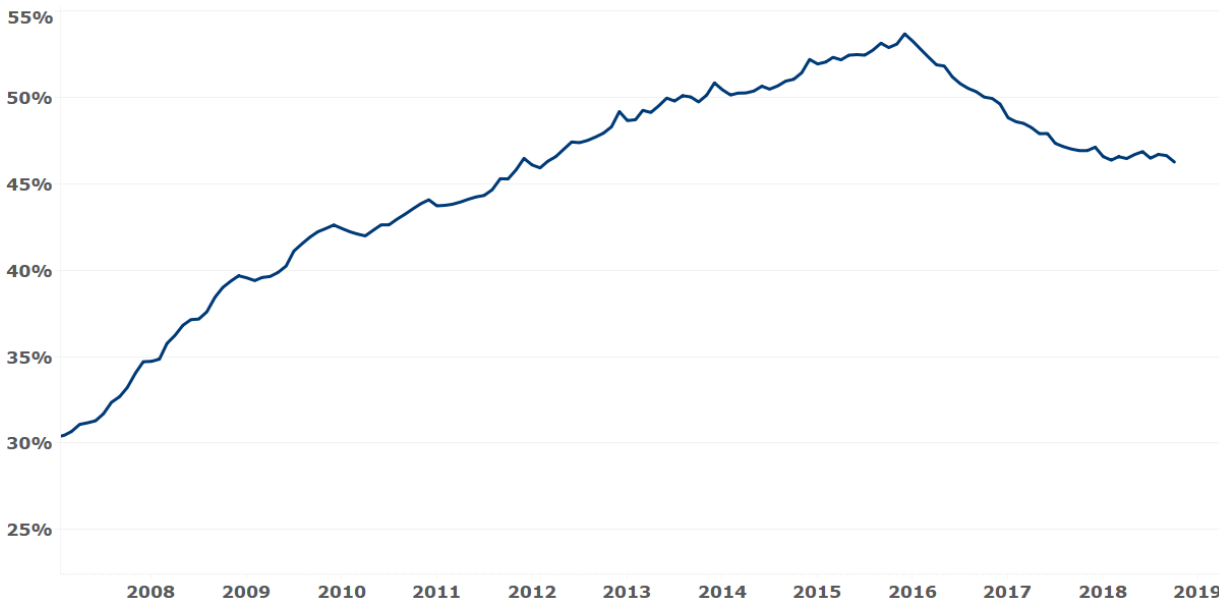
» Unemployment rate has room to continue falling gradually.



BRAZIL: ACTIVITY

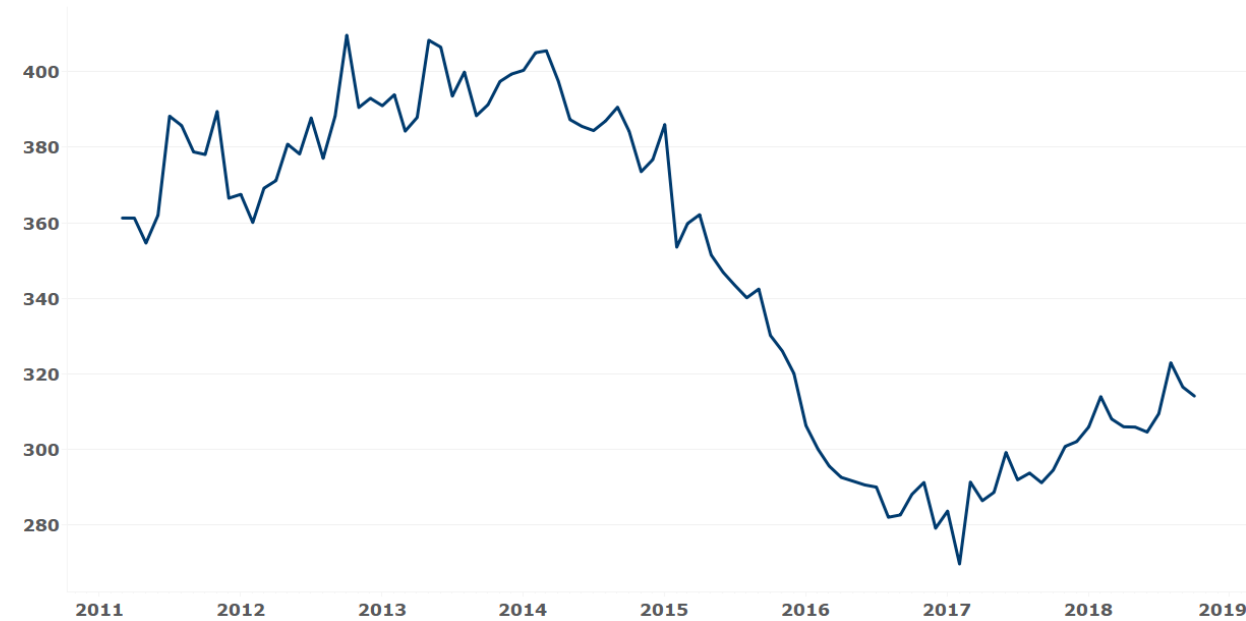
» Households and Corporates have deleveraged in the past 3 years.

Credit Stock % of GDP



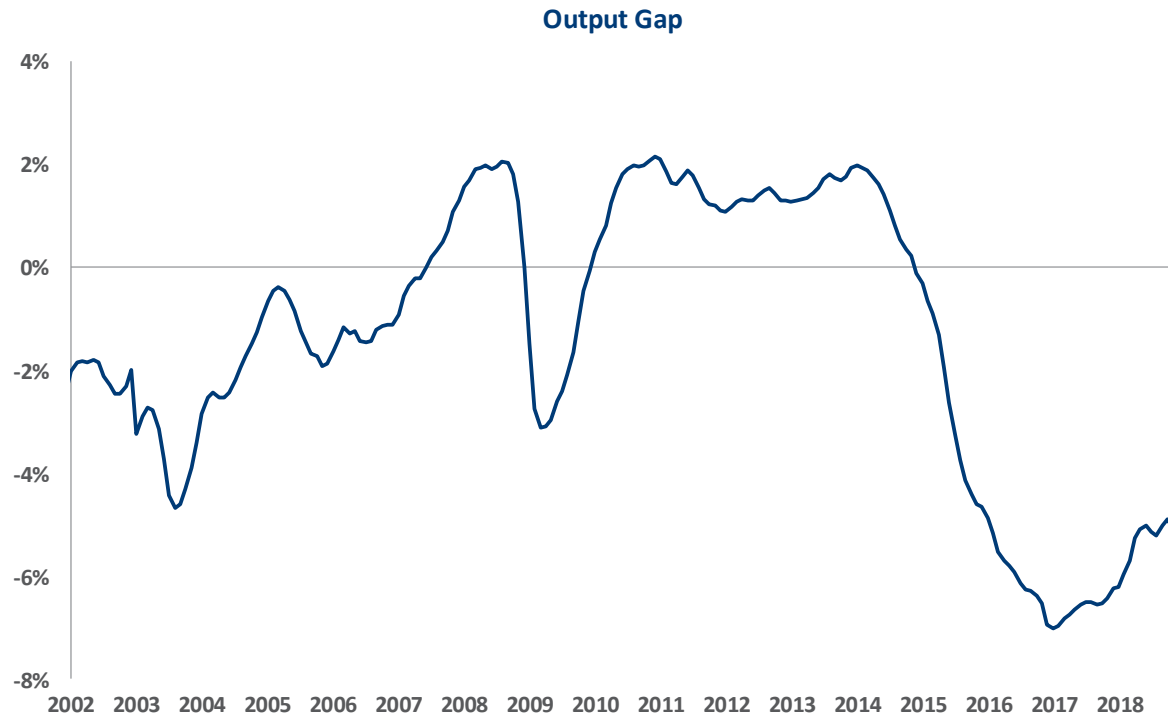
» Credit origination is improving and banks are ready to support the recovery.

Credit Flow: By Origin Level SA - R\$ Billion in real terms

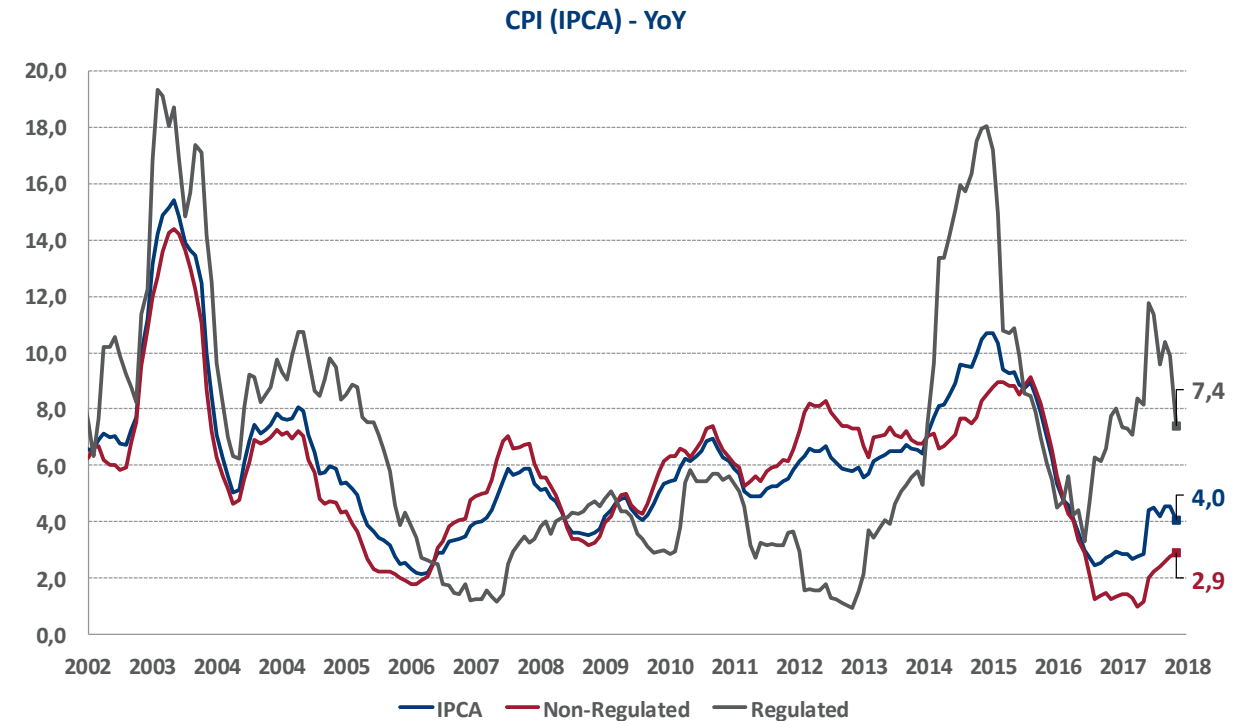


BRAZIL: INFLATION

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



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

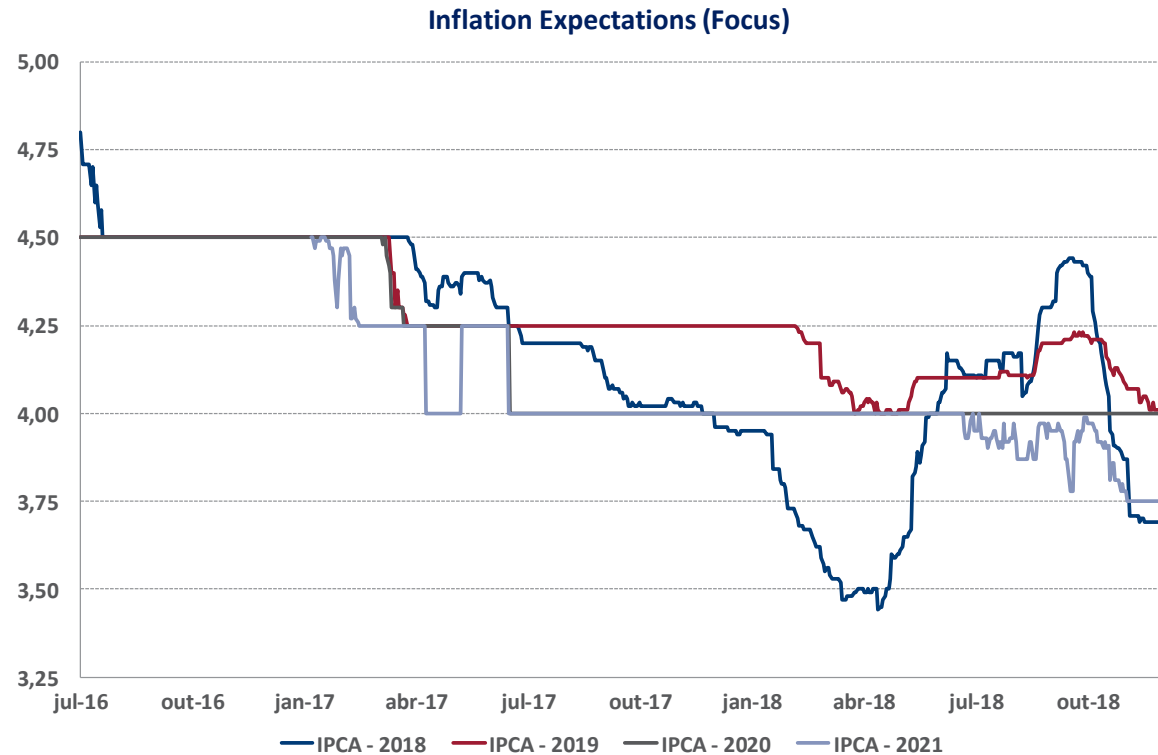


BRAZIL: INFLATION

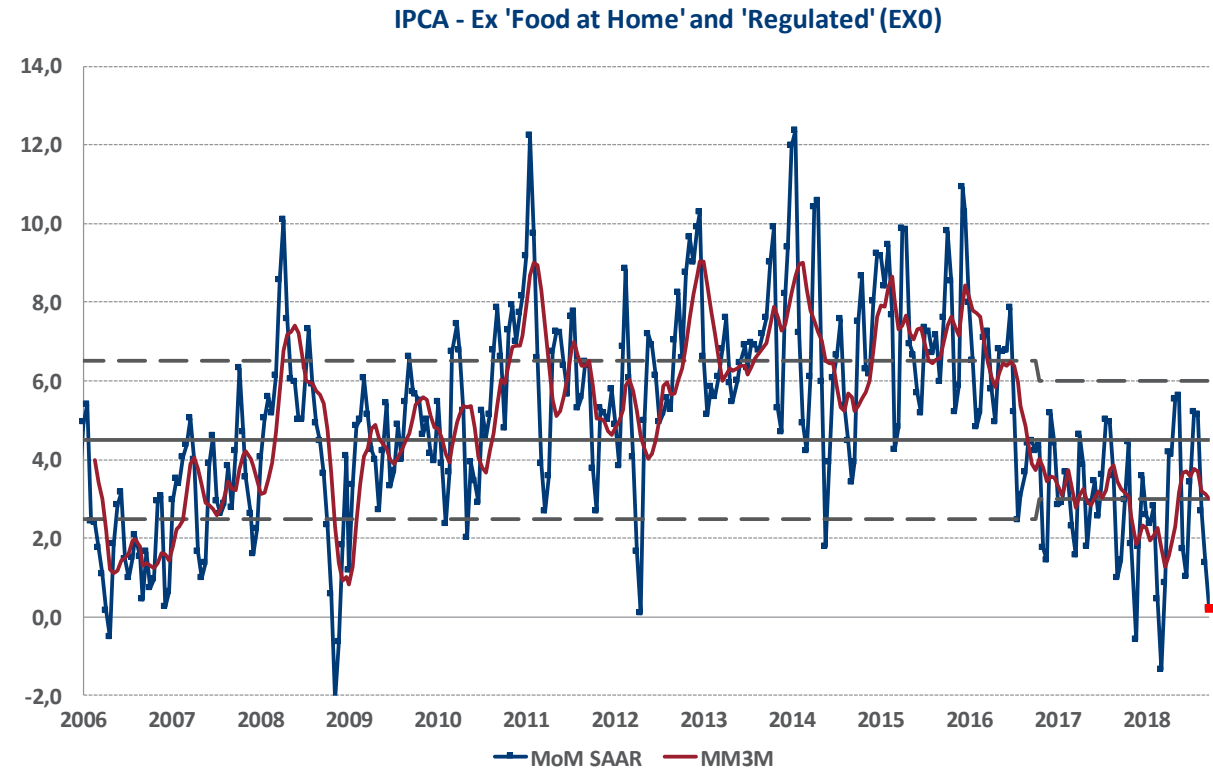
Baseline Scenario											
Exchange rate of 3.80 in 2018, 2019 and 2020											
Selic: 6.50% in Dec/18 and Dec/19; 8% in Dec/20											
	IPCA	Non-Regulated (74.7%)	Regulated (25.3%)	Core Inflation (59.0%)	Tradables Ex-Food (20.2%)	Services (35.8%)	Services-BBM (16.7%)	Food at Home (15.7%)	Output Gap	GDP	Selic
1T16	9,39%	8,96%	10,79%	7,26%	6,61%	7,50%	6,54%	15,31%	-5,5%	-4,3%	14,25%
2T16	8,84%	8,52%	9,91%	6,85%	6,87%	7,03%	5,86%	14,67%	-5,9%	-4,6%	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%	-3,5%	13,75%
1T17	4,57%	4,26%	5,59%	4,62%	3,18%	6,04%	4,52%	3,00%	-6,8%	-2,4%	12,25%
2T17	3,00%	2,89%	3,30%	3,91%	1,52%	5,72%	4,52%	-0,57%	-6,6%	-1,2%	10,25%
3T17	2,54%	1,40%	6,13%	3,37%	0,98%	4,99%	3,71%	-5,33%	-6,5%	-0,1%	8,25%
4T17	2,95%	1,35%	8,00%	3,12%	0,93%	4,52%	3,58%	-4,86%	-6,2%	1,0%	7,00%
1T18	2,68%	1,27%	7,06%	2,84%	0,65%	3,93%	3,21%	-4,29%	-5,7%	1,5%	6,50%
2T18	4,39%	2,02%	11,78%	2,55%	0,80%	3,14%	2,75%	0,11%	-5,0%	1,6%	6,50%
3T18	4,53%	2,57%	10,38%	2,66%	1,38%	3,22%	2,54%	2,23%	-5,1%	1,5%	6,50%
4T18	3,76%	2,84%	6,30%	2,27%	0,53%	3,37%	2,67%	4,95%	-5,3%	1,23%	6,50%
1T19	4,08%	3,29%	6,39%	2,31%	0,59%	3,53%	2,88%	6,93%	-4,7%	1,4%	6,50%
2T19	3,09%	3,09%	3,06%	2,66%	0,59%	4,13%	2,90%	4,63%	-4,0%	1,8%	6,50%
3T19	2,93%	3,13%	2,39%	2,39%	0,15%	3,81%	2,98%	5,66%	-3,3%	2,2%	6,50%
4T19	3,91%	3,63%	4,69%	2,91%	1,01%	3,97%	2,98%	6,10%	-2,7%	2,8%	6,50%
1T20	4,32%	4,11%	4,90%	3,33%	1,17%	4,43%	3,04%	6,76%	-2,2%	3,2%	7,50%
2T20	4,32%	4,24%	4,53%	3,30%	1,03%	4,56%	3,36%	7,31%	-1,9%	3,3%	8,00%
3T20	4,20%	4,22%	4,12%	3,28%	0,77%	4,64%	3,49%	7,43%	-1,6%	3,3%	8,00%
4T20	3,97%	3,96%	3,99%	3,21%	0,69%	4,57%	3,56%	6,29%	-1,4%	3,0%	8,00%

BRAZIL: INFLATION

» Inflation expectations below target in 2018 and 2019 and anchored thereafter.



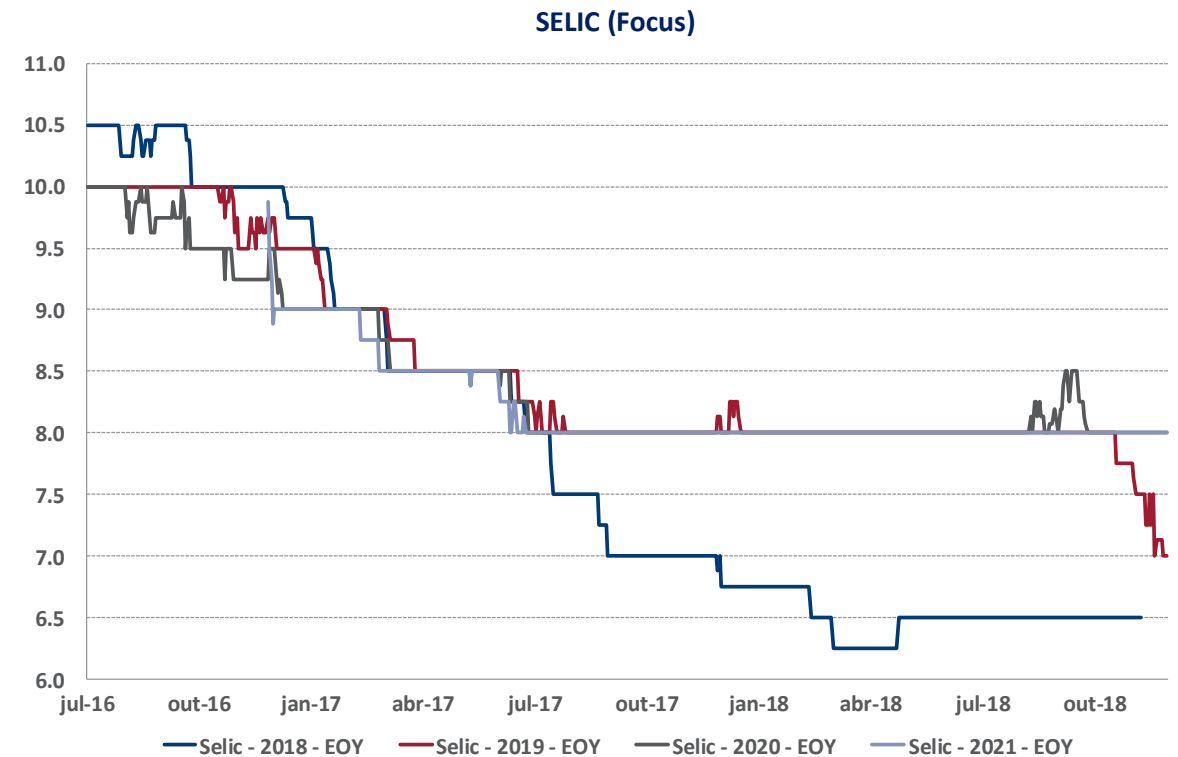
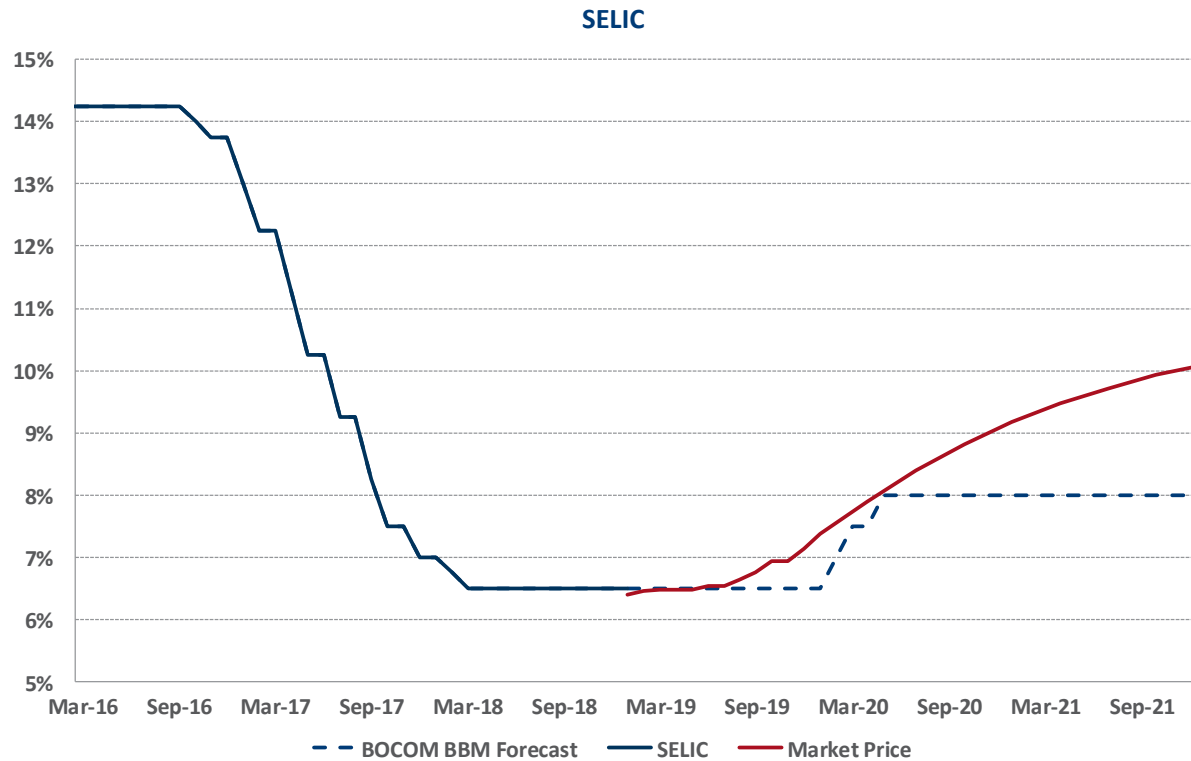
» Core inflation has been running at very low levels.



BRAZIL: MONETARY POLICY

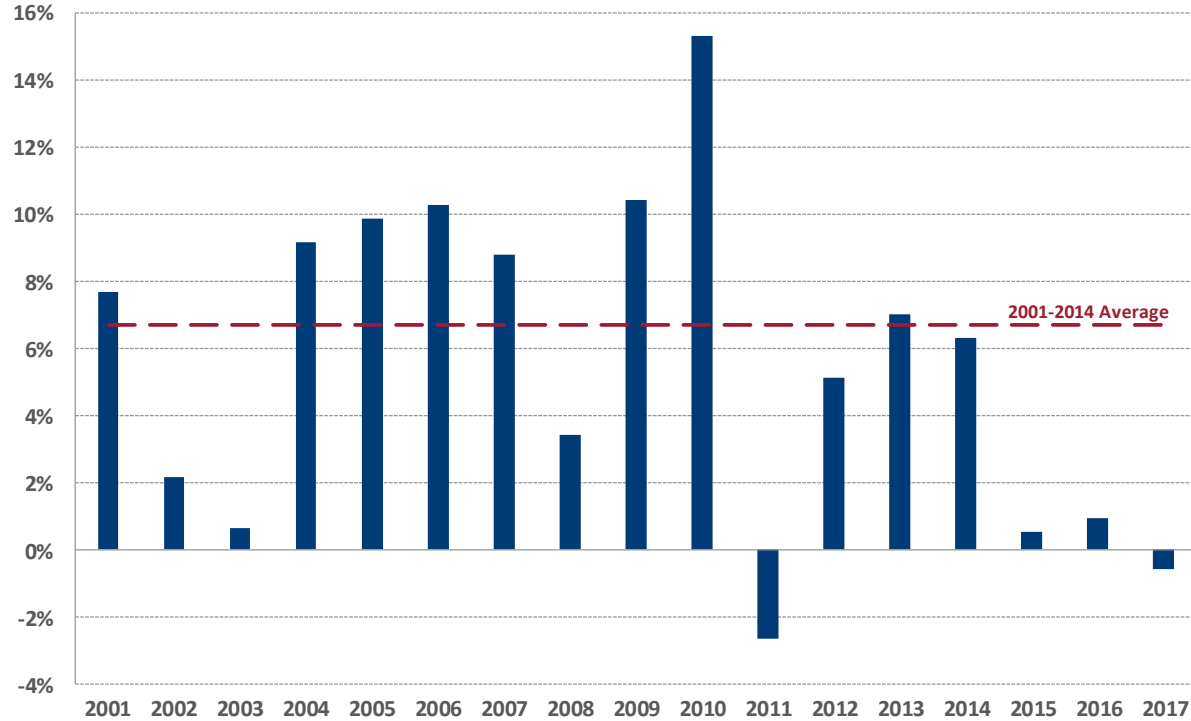
» Selic rate will remain stable in 2019 and normalize to 8.0% only in 2020.

» Economists are revising downward their Selic rate forecasts.

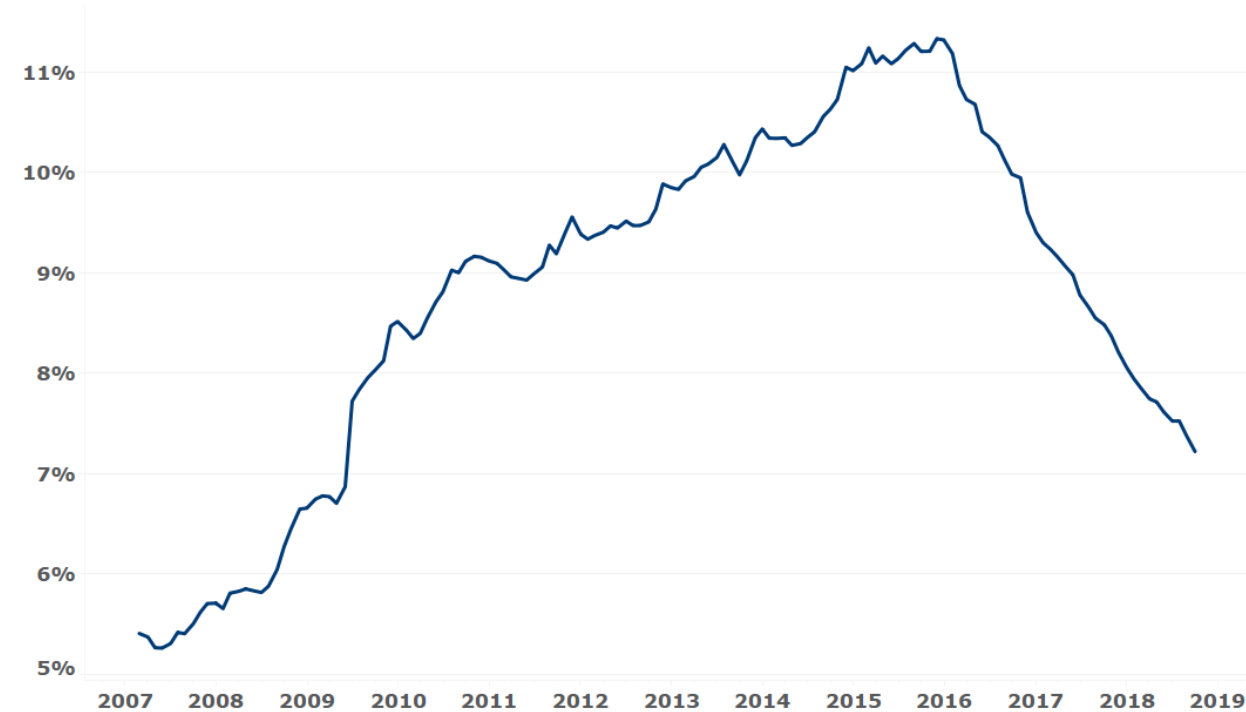


» Real government spending has stabilized for the first time, BNDES continues to retrench and TLP was approved: how far have those factors reduced the neutral interest rate?

Government Expenditures - Real Annual Growth

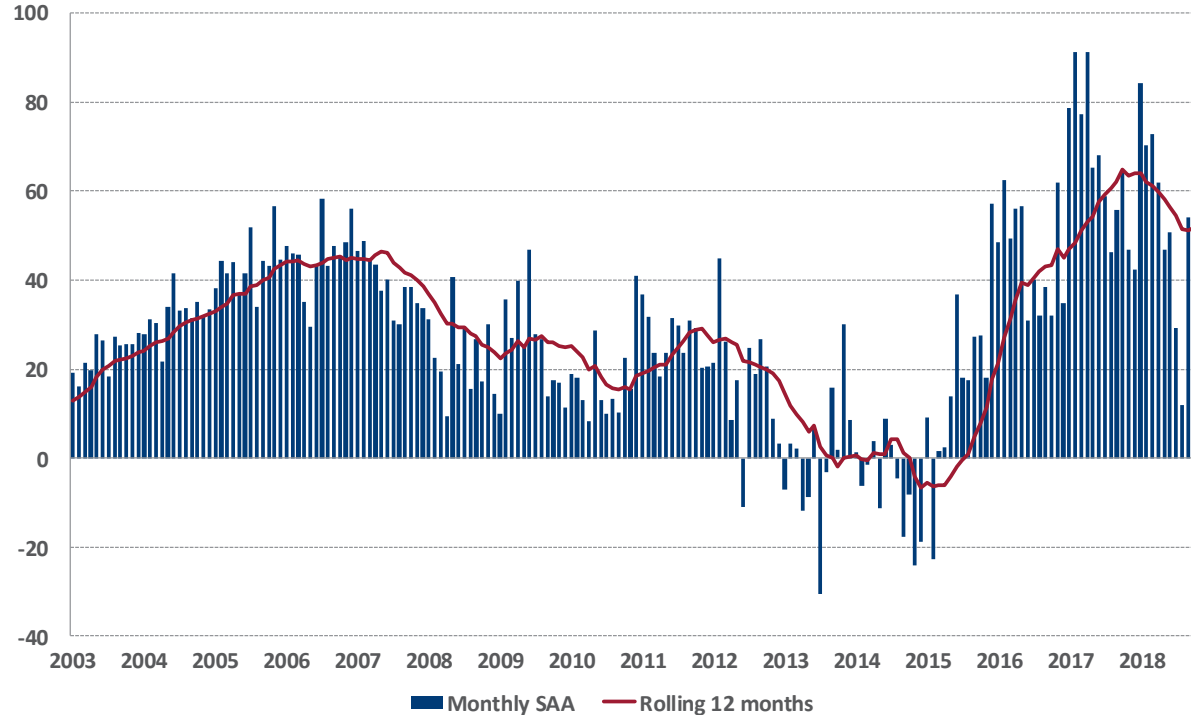


Credit Stock: By Origin (Earmarked) % of GDP BNDES

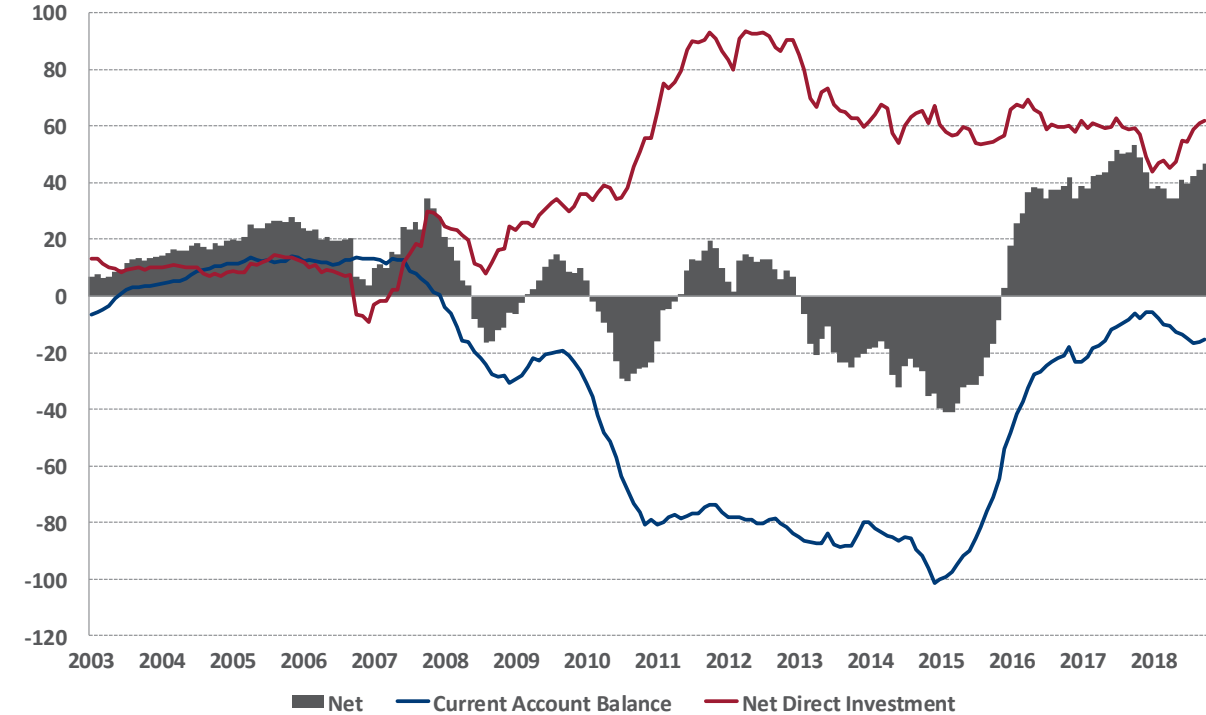


» Country has no external vulnerability: trade surplus remains large and FDI continues to overfinance the current account deficit.

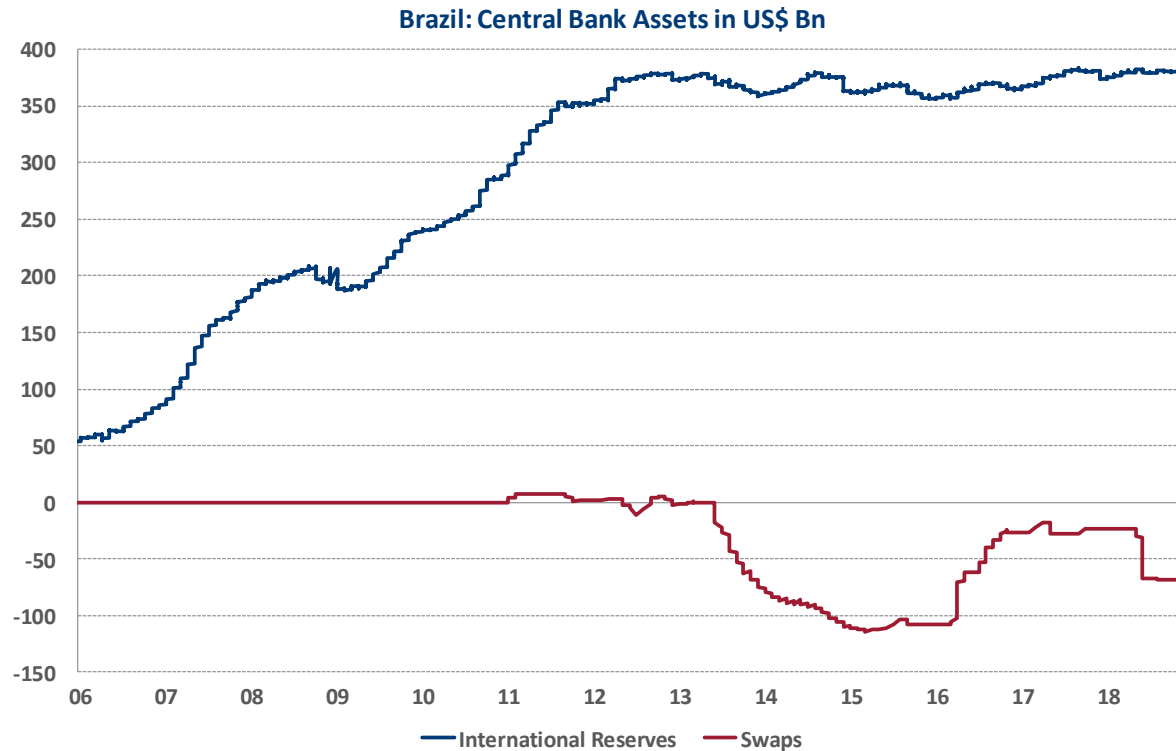
Trade Balance - US\$ Billion



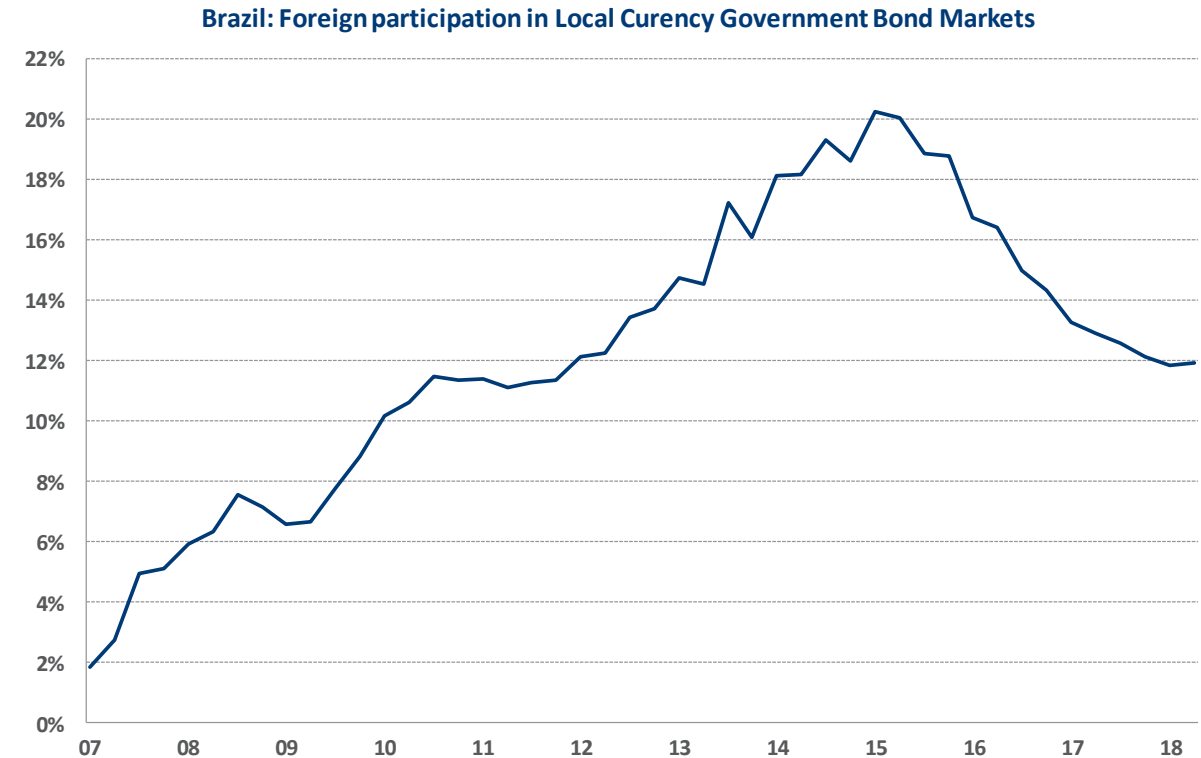
Current Account vs Net Direct Investment - US\$ Billion in 12m



» Central Bank holds substantial international reserves.



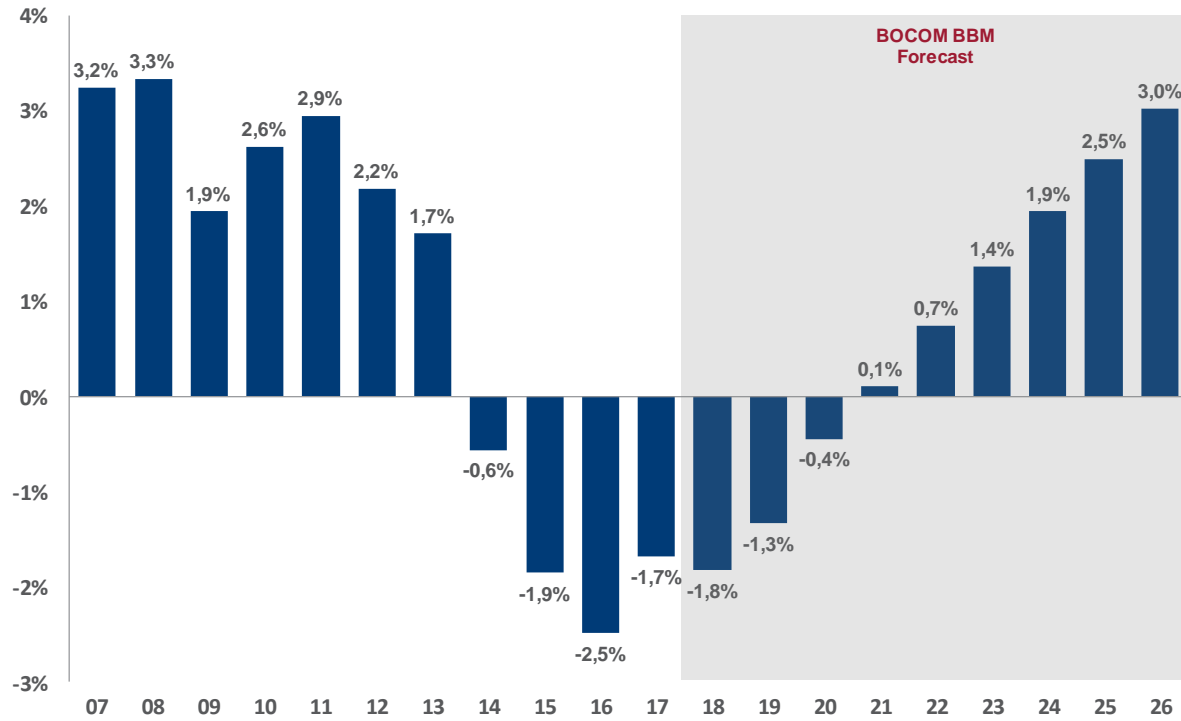
» Government domestic debt exposure to foreign investors continues to fall.



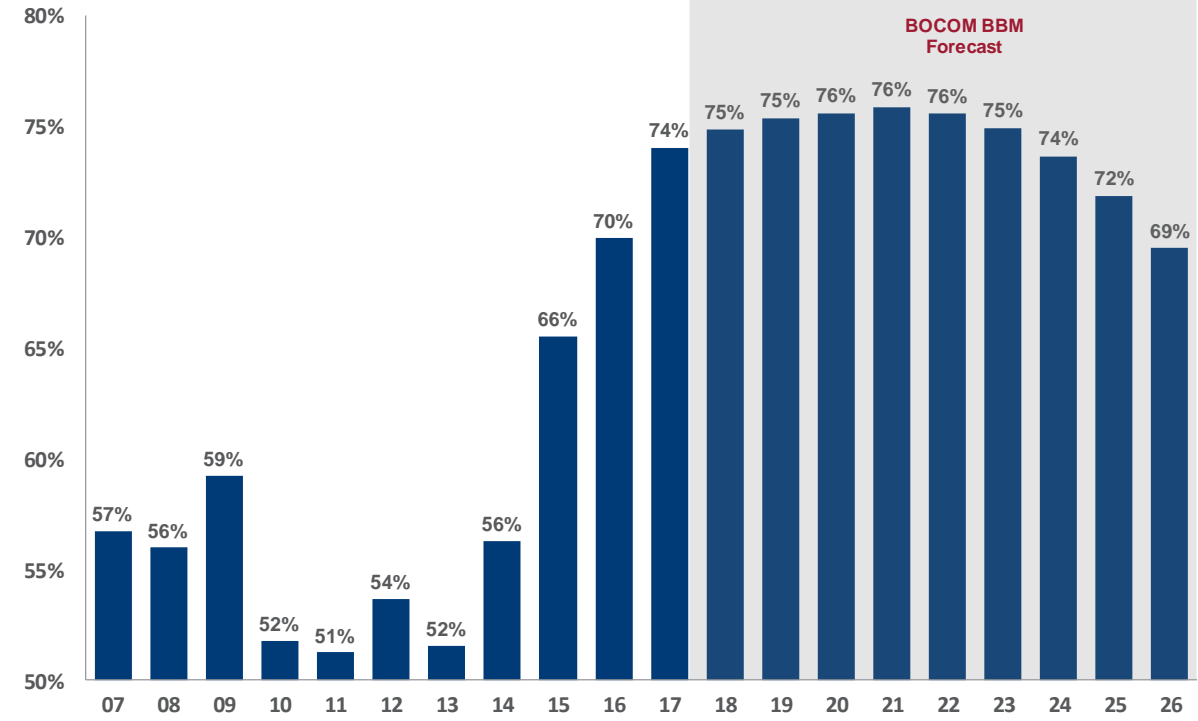
» Fiscal policy remains the main challenge: the country has run a primary deficit for 5 years.

» The spending cap could improve the primary balance and stabilize debt below 80%.

Public Sector Primary Balance - % GDP



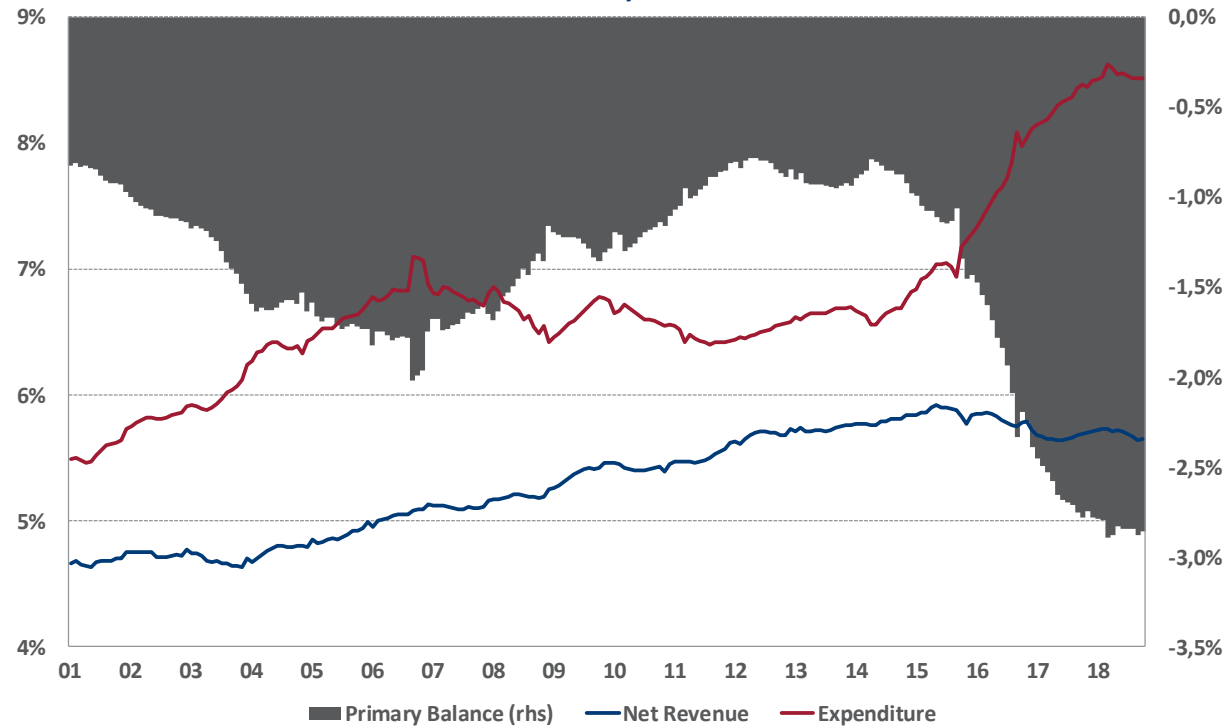
General Government Gross Debt - % GDP



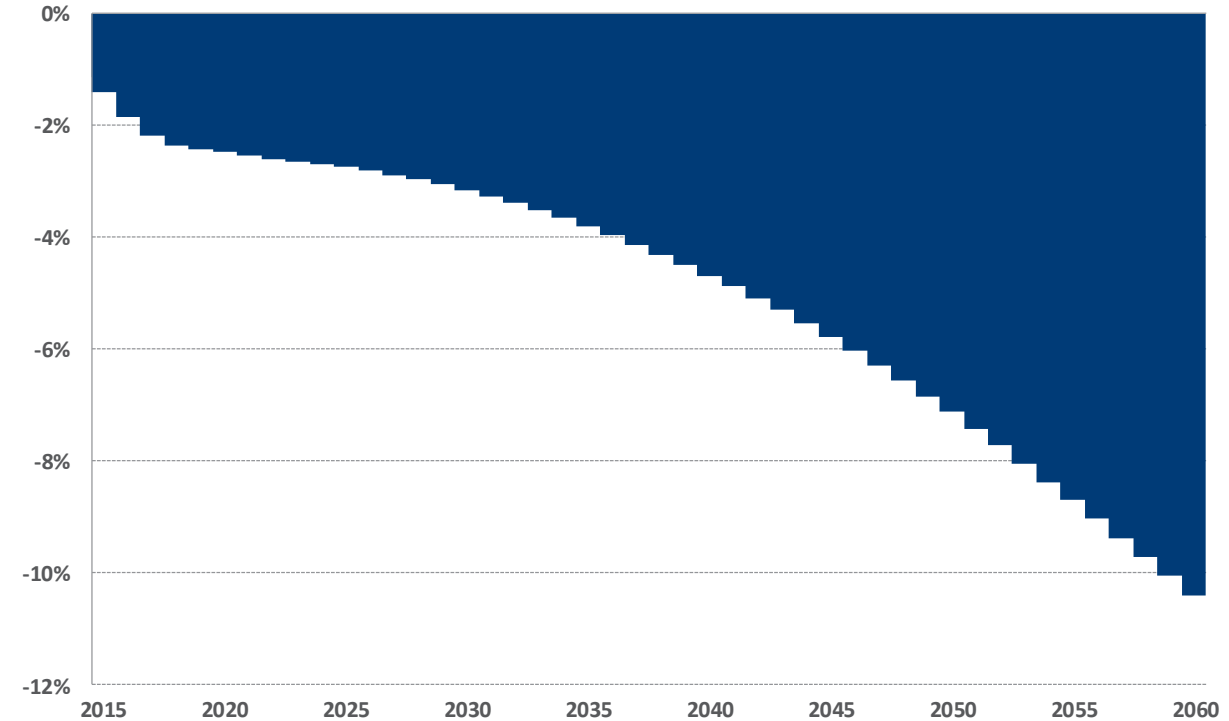
» Problem: social security deficit is increasing fast and has reached close to 3.0% of GDP.

» Demographics and a generous system create an unsustainable dynamics.

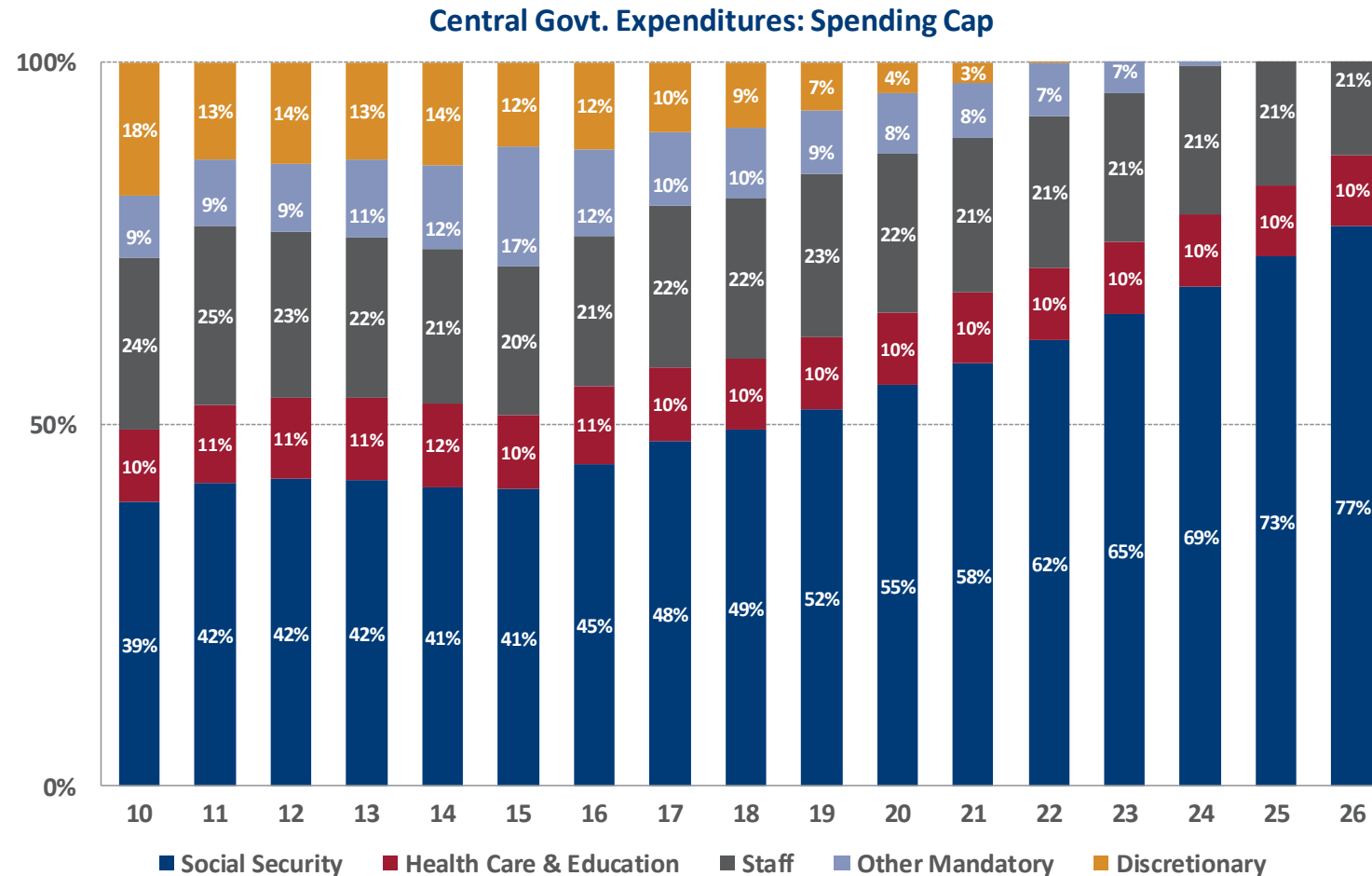
Social Security - % GDP 12M



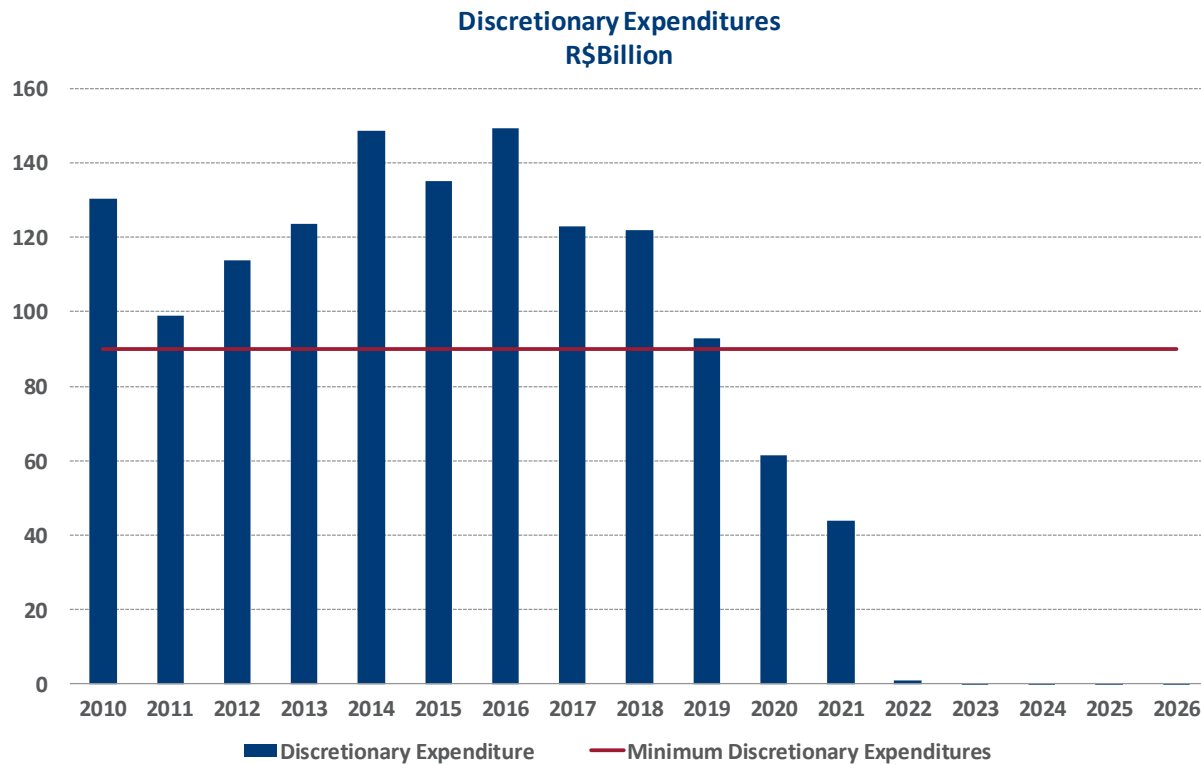
Social Security Balance - % of GDP



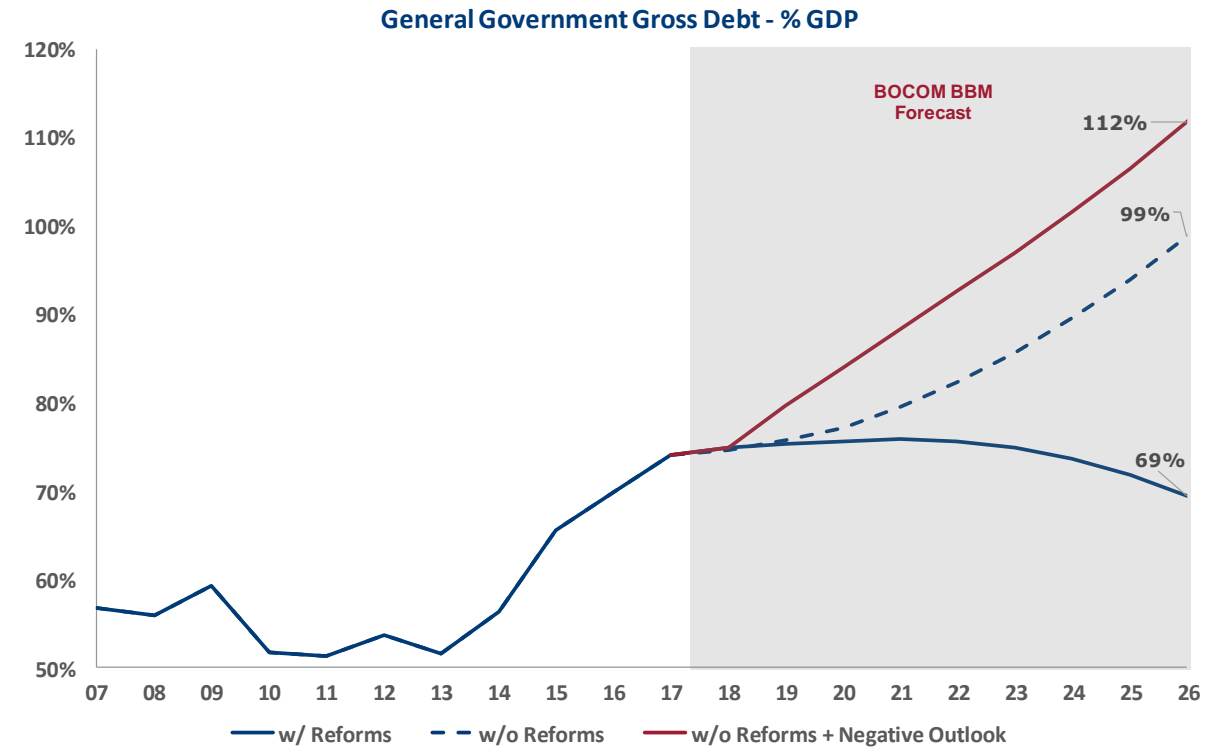
» The government spends 50% of its budget with social security and 90% of it with mandatory spending. Without reforms, the spending cap becomes unsustainable in 2022.



» The spending cap will be hard to sustain already in 2020.



» Without reforms, government debt could reach more than 100% by 2026.



BENIGN ECONOMIC OUTLOOK AMID OLD CHALLENGES

- » Growth should pick up with low inflation and stable Selic rate throughout 2019.
- » Fiscal adjustment is incomplete and downside risks remain if the reform agenda stalls.
- » Bolsonaro will need to embrace Guedes's reformist agenda and take the lead in negotiating with Congress.
- » Will the new way of doing politics work? This is the greatest uncertainty of all.

CONTENT

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» GLOBAL: OUTLOOK REMAINS COMPLEX

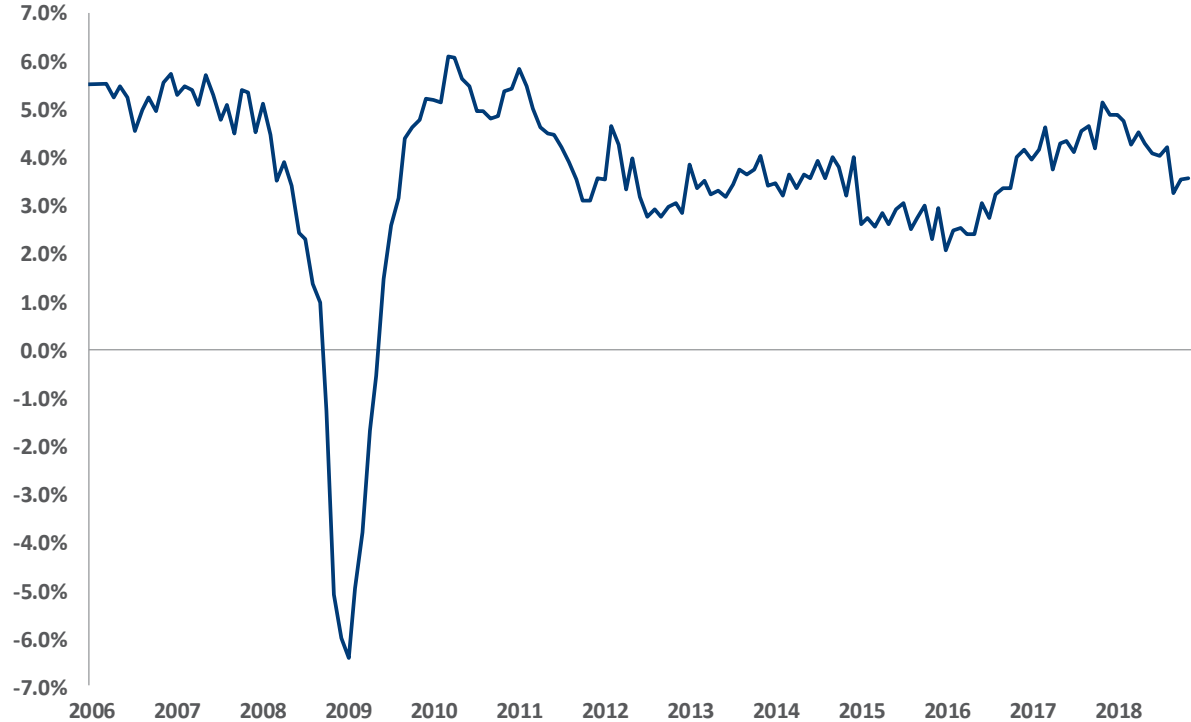
» MARKETS: RECENT TRENDS

GLOBAL OUTLOOK REMAINS COMPLEX

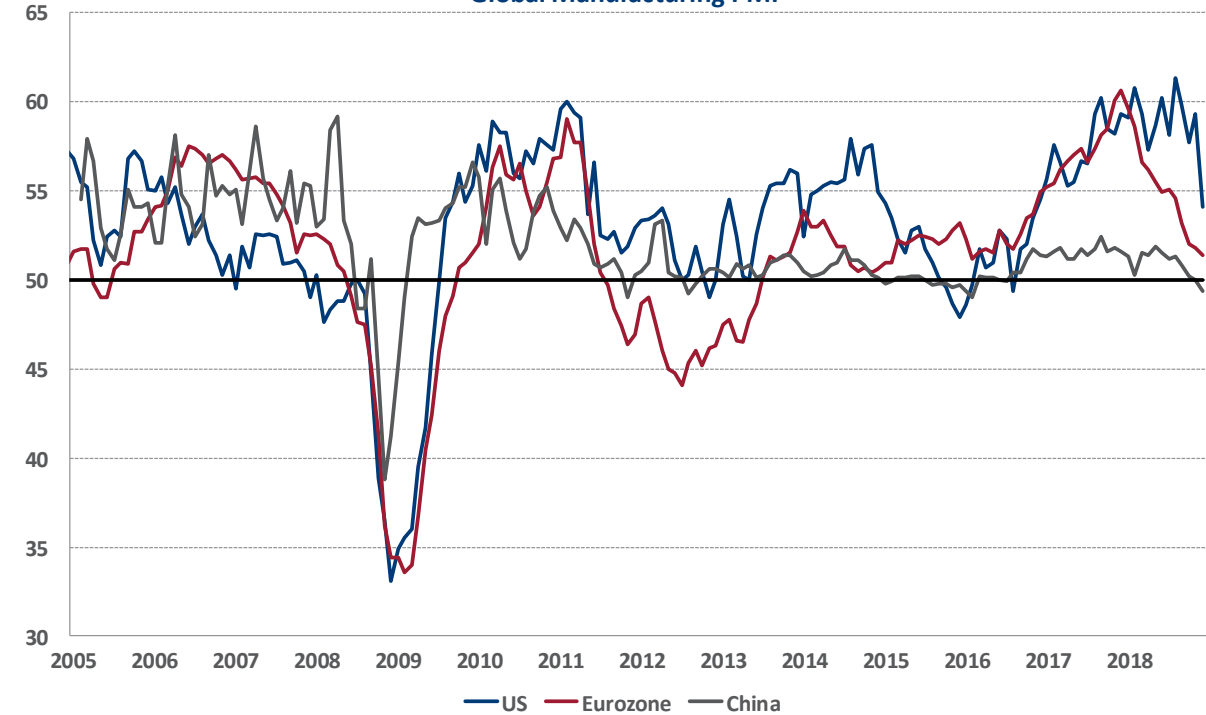
- »» Global growth is slowing and is less synchronized.
- »» Financial conditions are tightening and global liquidity is shrinking.
- »» US interest rate curve is inverting: is a recession coming?
- »» China in the spotlight: downward pressures amid a complicated external environment.

» Global growth strengthen in 2017 and early 2018. However, it is slowing down again and has become less synchronized and more dependent on the US.

GS World Current Activity Indicator



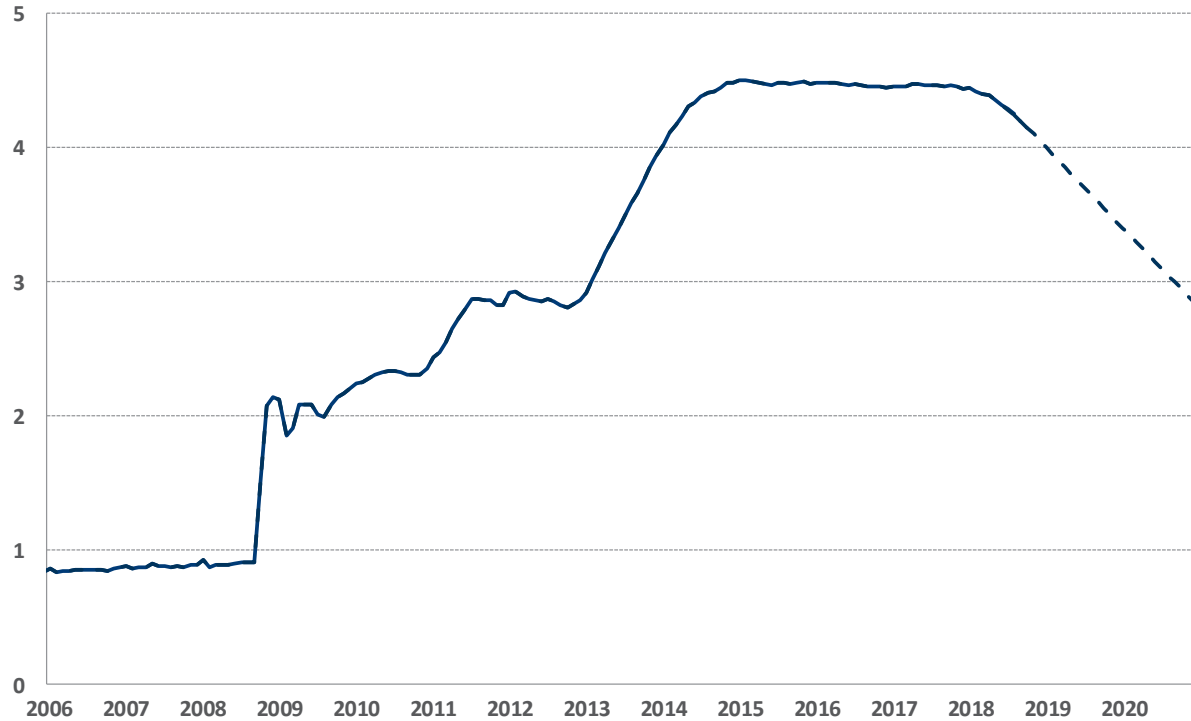
Global Manufacturing PMI



GLOBAL: FINANCIAL CONDITIONS

» FED balance sheet is shrinking, reducing global liquidity.

FED Balance Sheet - US\$ tn

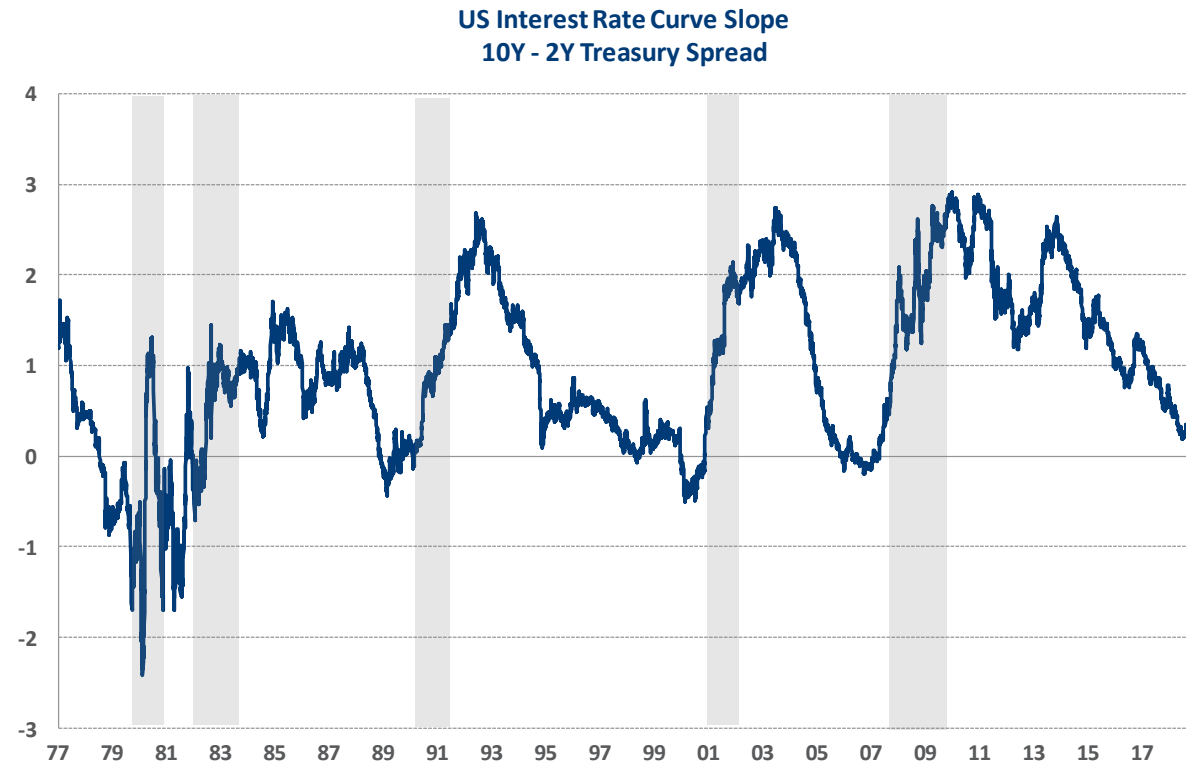


» US financial conditions have tighten more than expected.

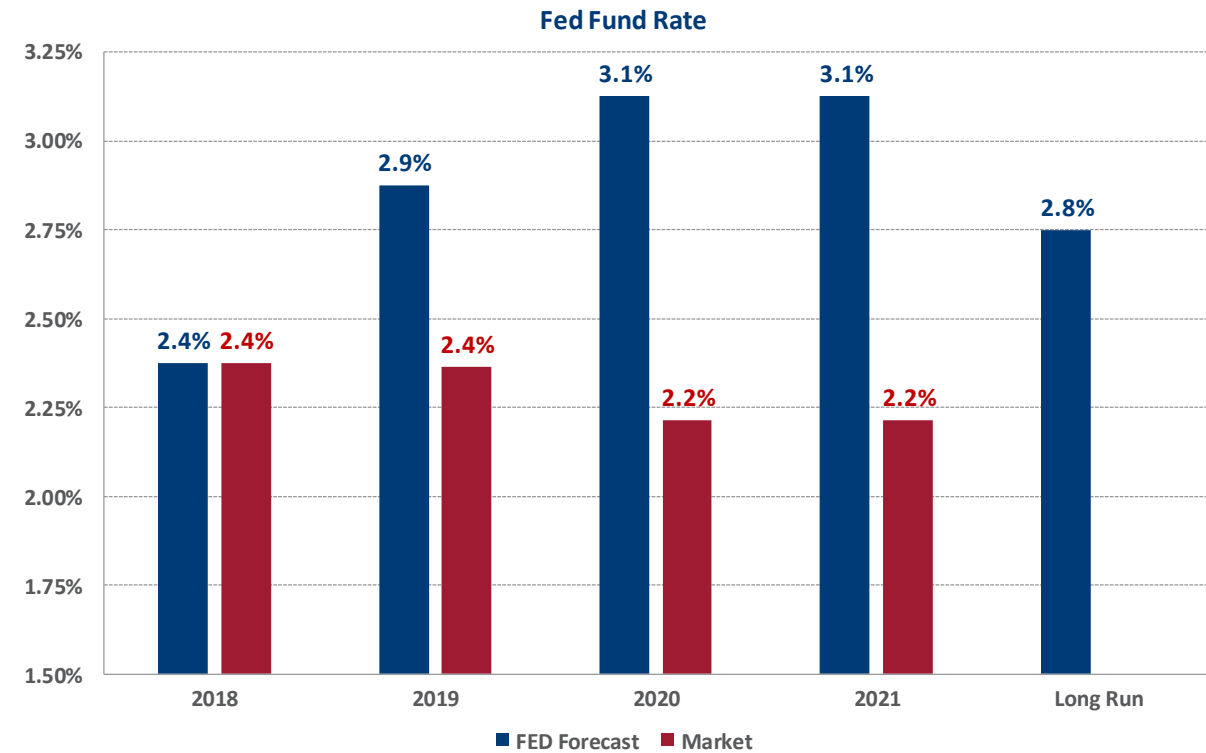
GS US Financial Condition Index



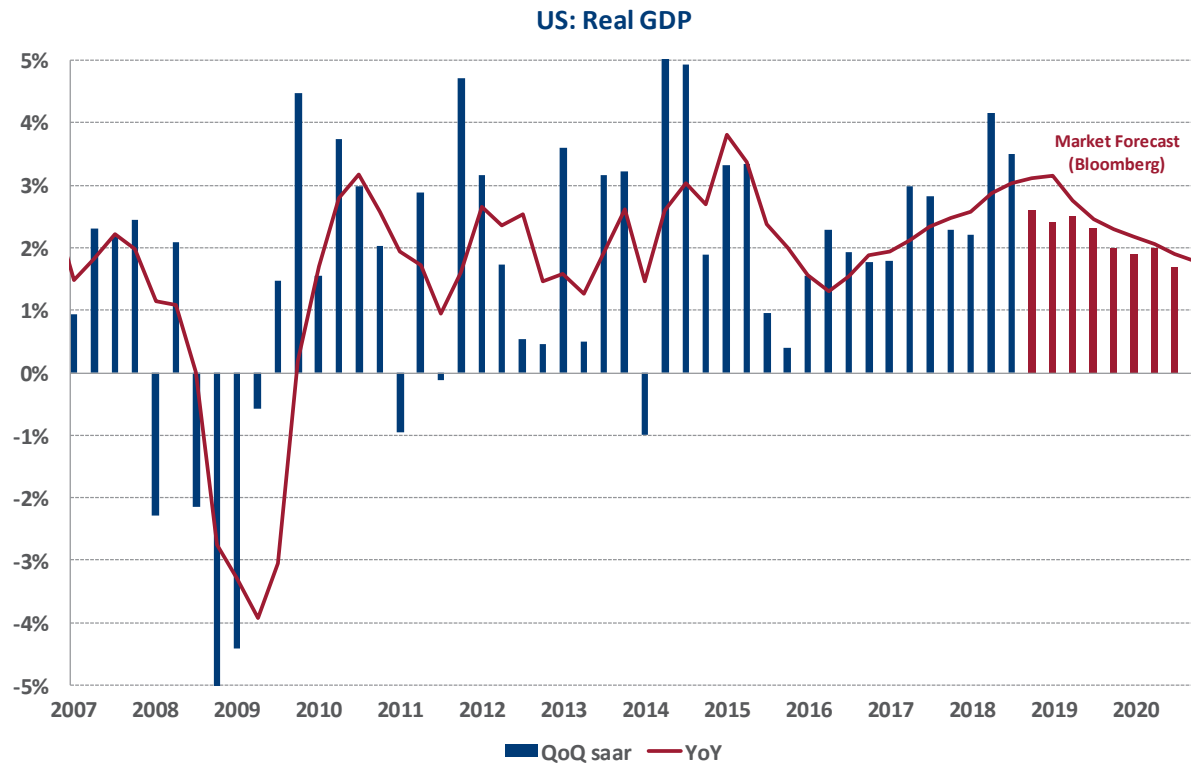
» US interest rate curve is inverting: is a recession coming?



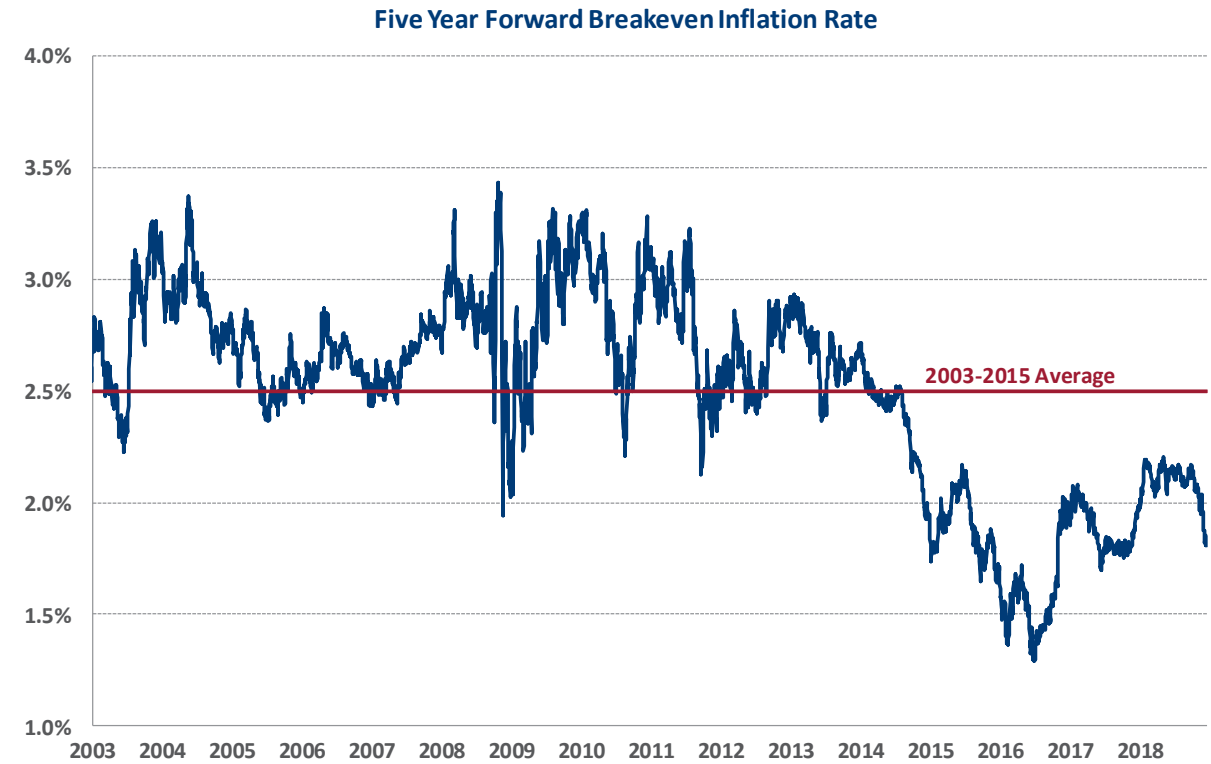
» Markets are saying the FED should end its interest rate hiking cycle.



» GDP growth will slow down from 3.0% in 2018 to below 2.0% in late 2019.



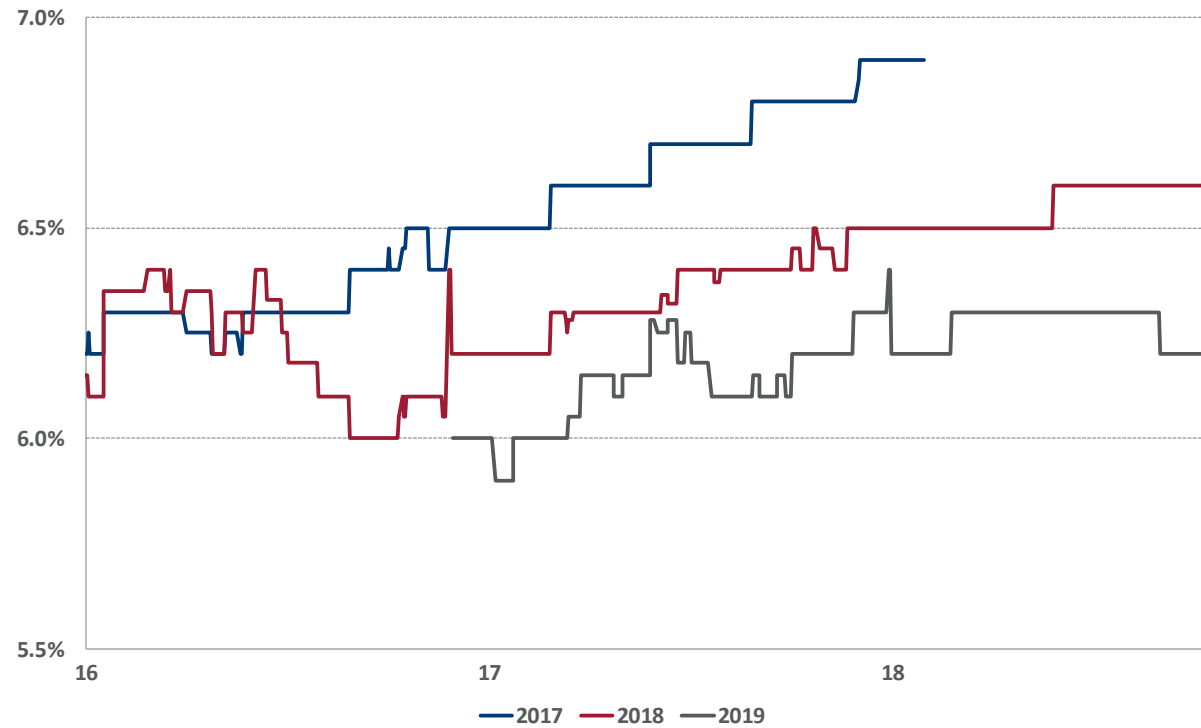
» Inflation expectations remain below historical levels, allowing the FED to be patient.



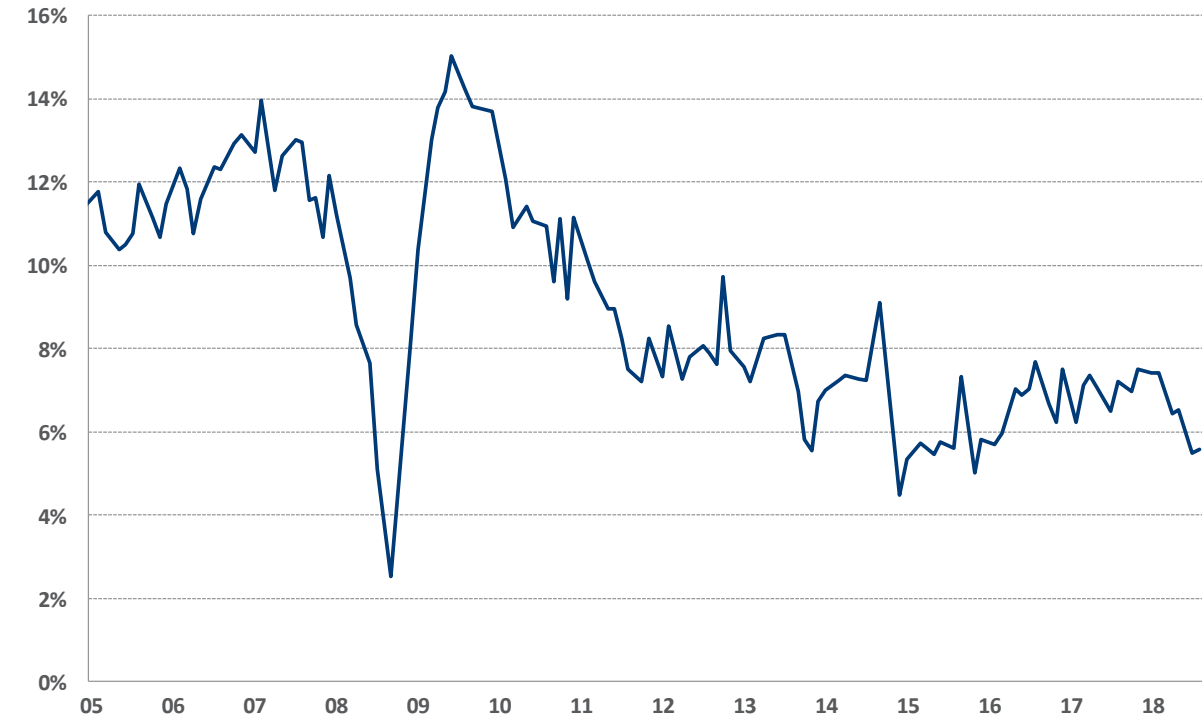
» Growth surprised to the upside in 2017 and 2018, but will slow towards 6.0% in 2019.

» Recent data is already pointing to a slowdown.

China GDP Forecast (Bloomberg)



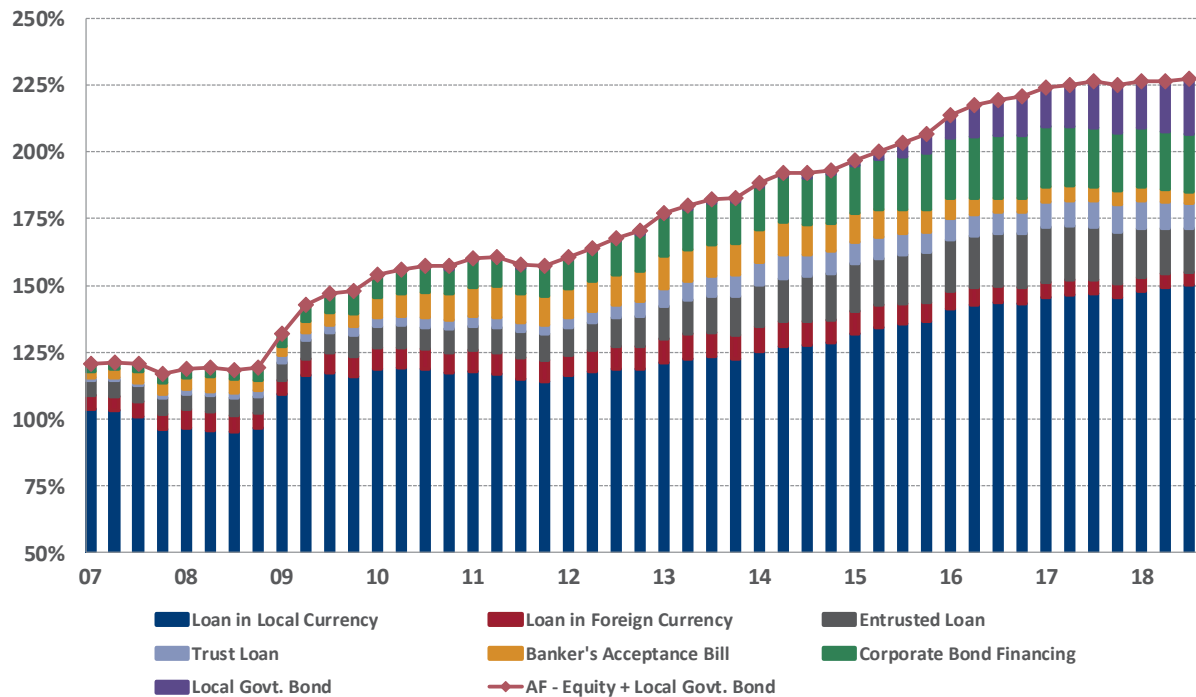
China: GS Current Activity Indicator



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

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

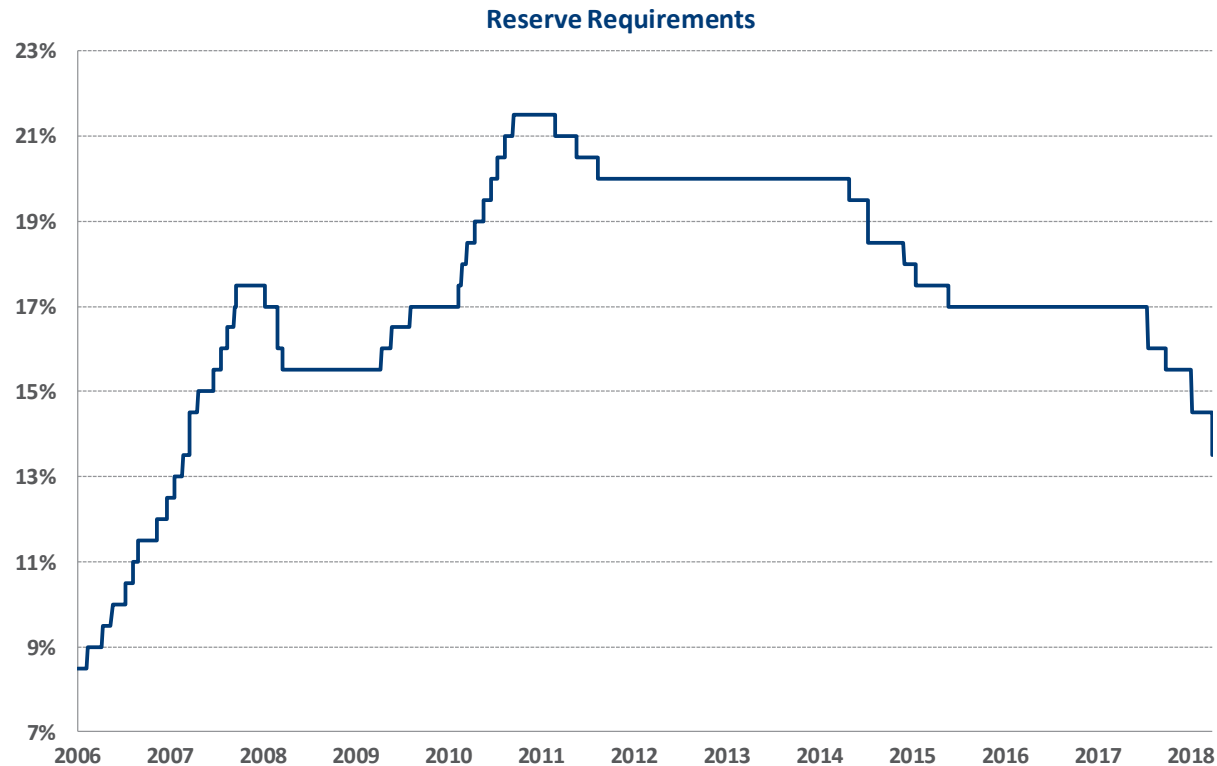
Aggregate Financing (AF) - Equity + Local Govt. Bond
% gdp, accumulated 4q



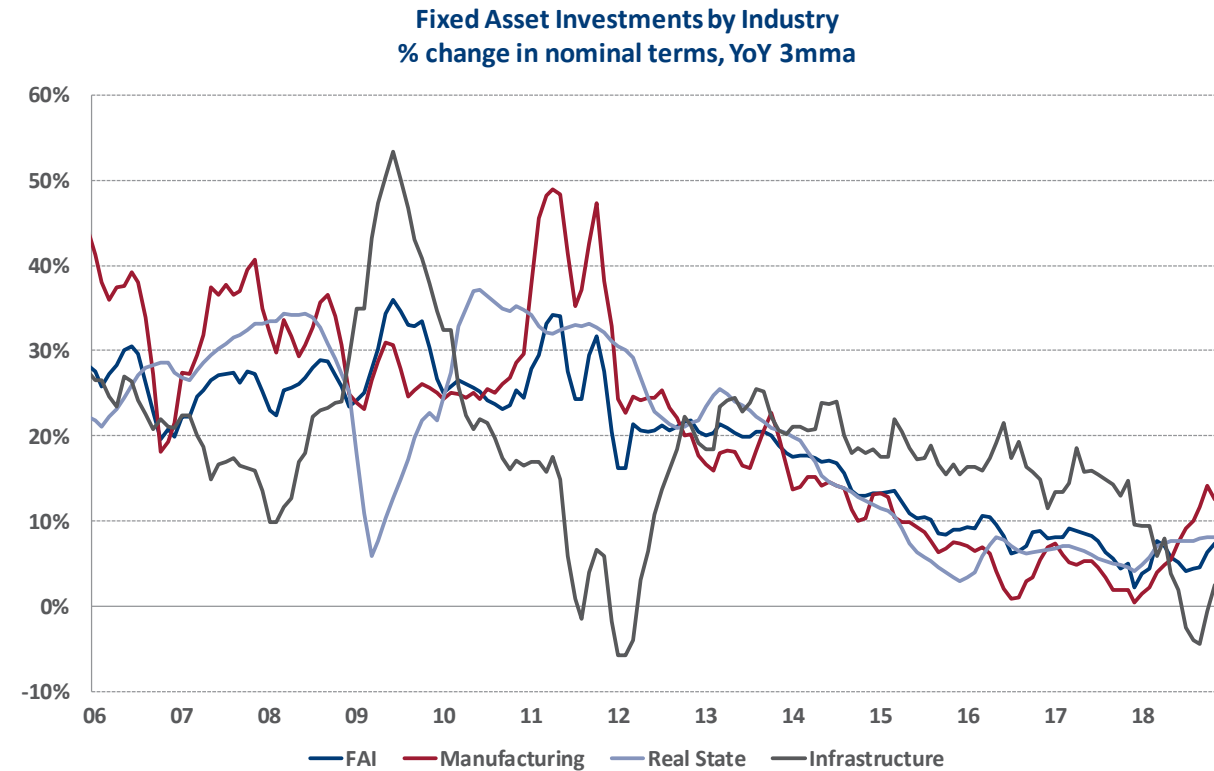
Aggregate Financing
% change in nominal terms, YoY



» Trade tensions have forced the government to increase liquidity provision.



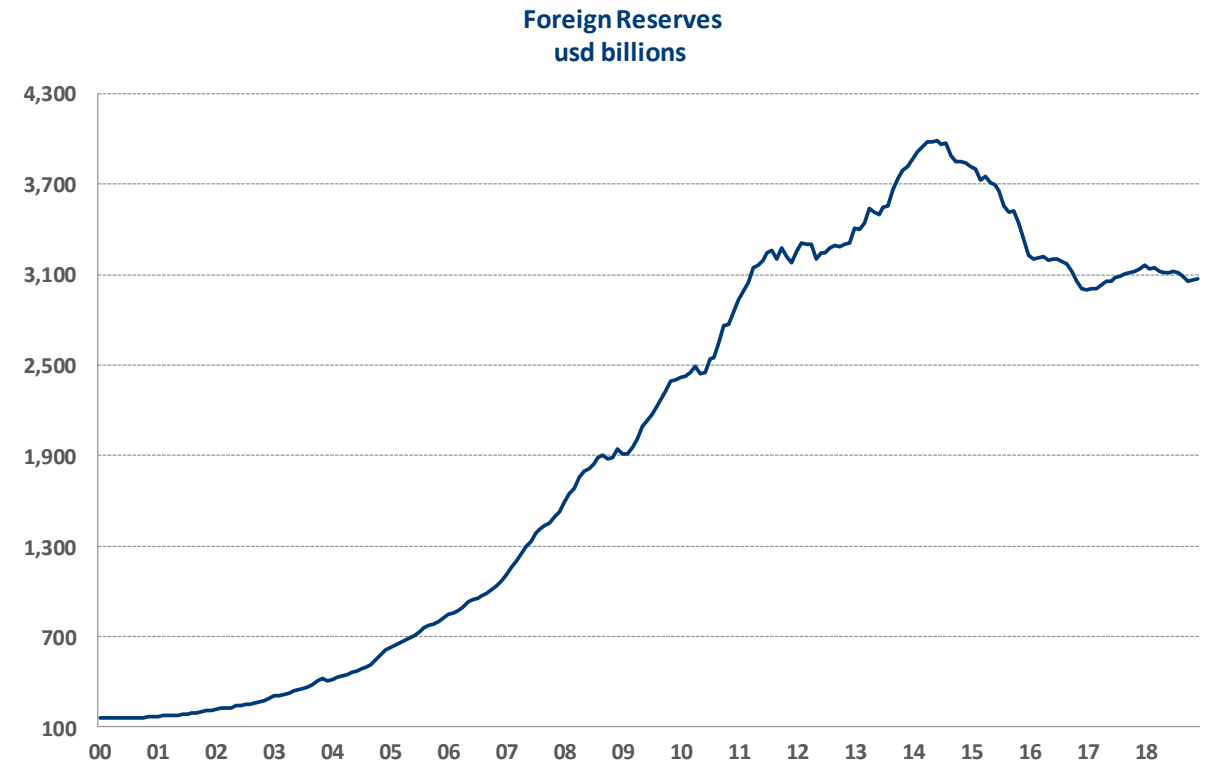
» Fiscal policy is also turning more proactive through higher infrastructure spending.



» The CNY has weakened again, but remains below 7.0.

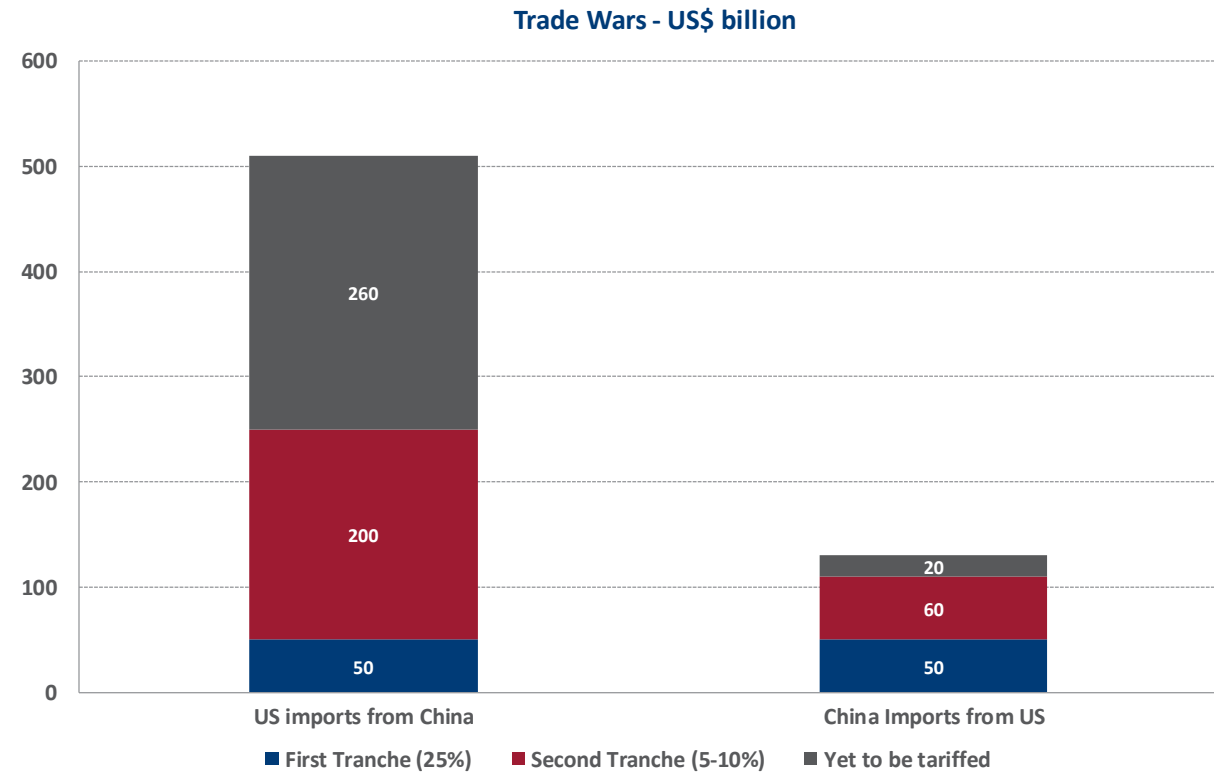


» Foreign reserves have stabilized, indicating less pressure on the capital account.



» Will the US-China reach a deal?

- » December 1: Trump and Xi agreed on truce.
- » December 6: Huawei CFO arrest gains publicity
- » December 11: China agrees to reduce tariffs on U.S. autos to 15% from 40%.
- » December 12: Huawei CFO is released on bail.
- » January 7: US-China trade talks.
- » March 1: Deadline for a deal.



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BRAZIL: MARKETS

Nominal Interest Rate (DI Curve)



Ibovespa

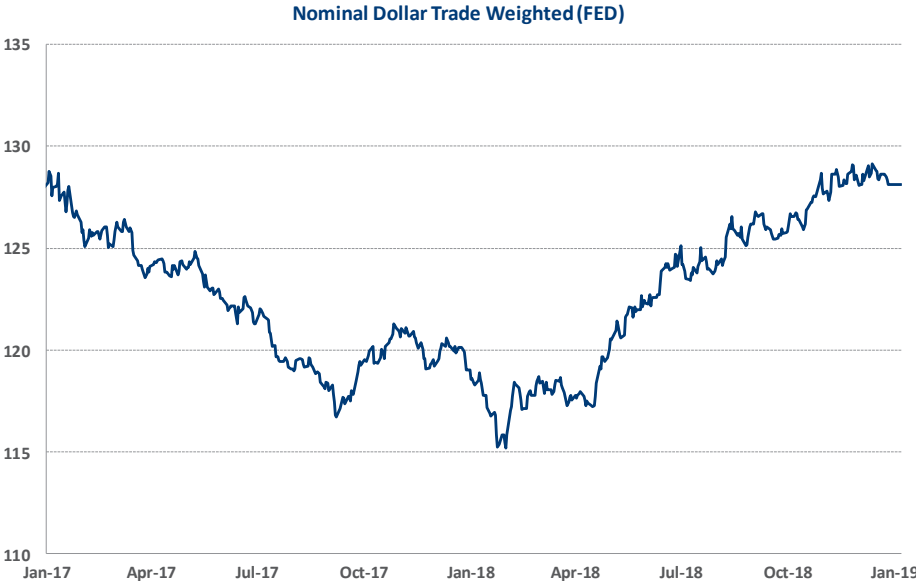
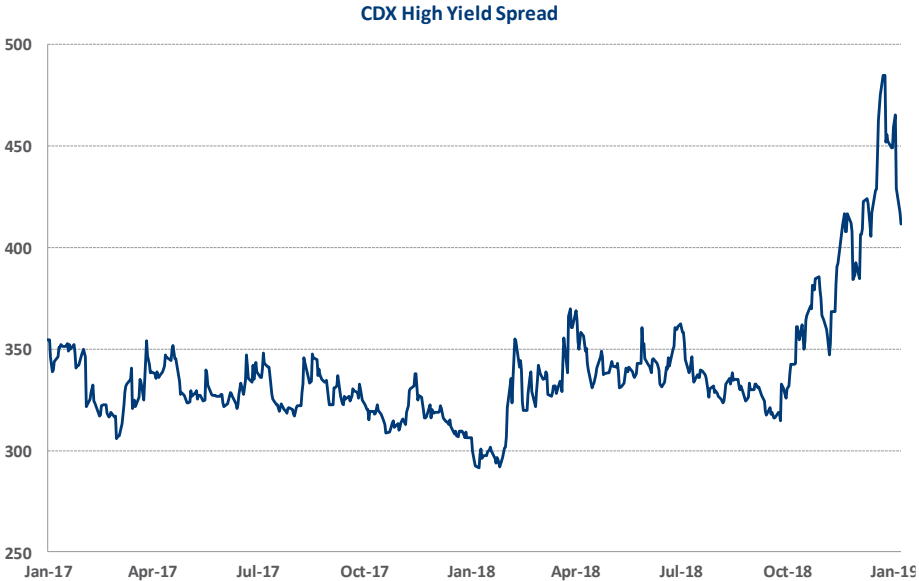
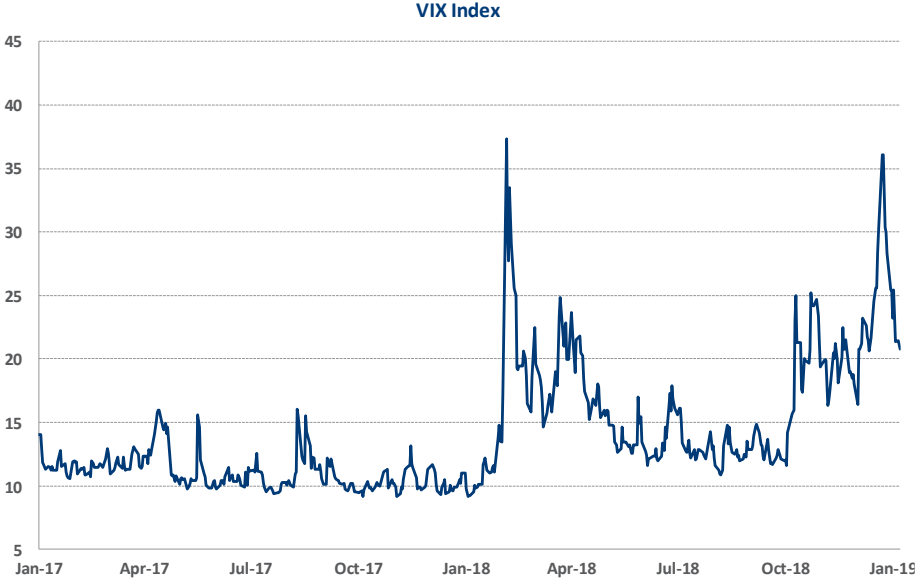


BRL Currency



CDS 5 Years





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