



MACRO OUTLOOK

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May 2019

CONTENT

»» BRAZIL: ANOTHER YEAR OF LOW GROWTH

»» GLOBAL: GROWTH WORRIES PERSIST AMID EASIER FINANCIAL CONDITIONS

»» MARKETS: RECENT TRENDS

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» MARKETS: RECENT TRENDS

ANOTHER YEAR OF LOW GROWTH

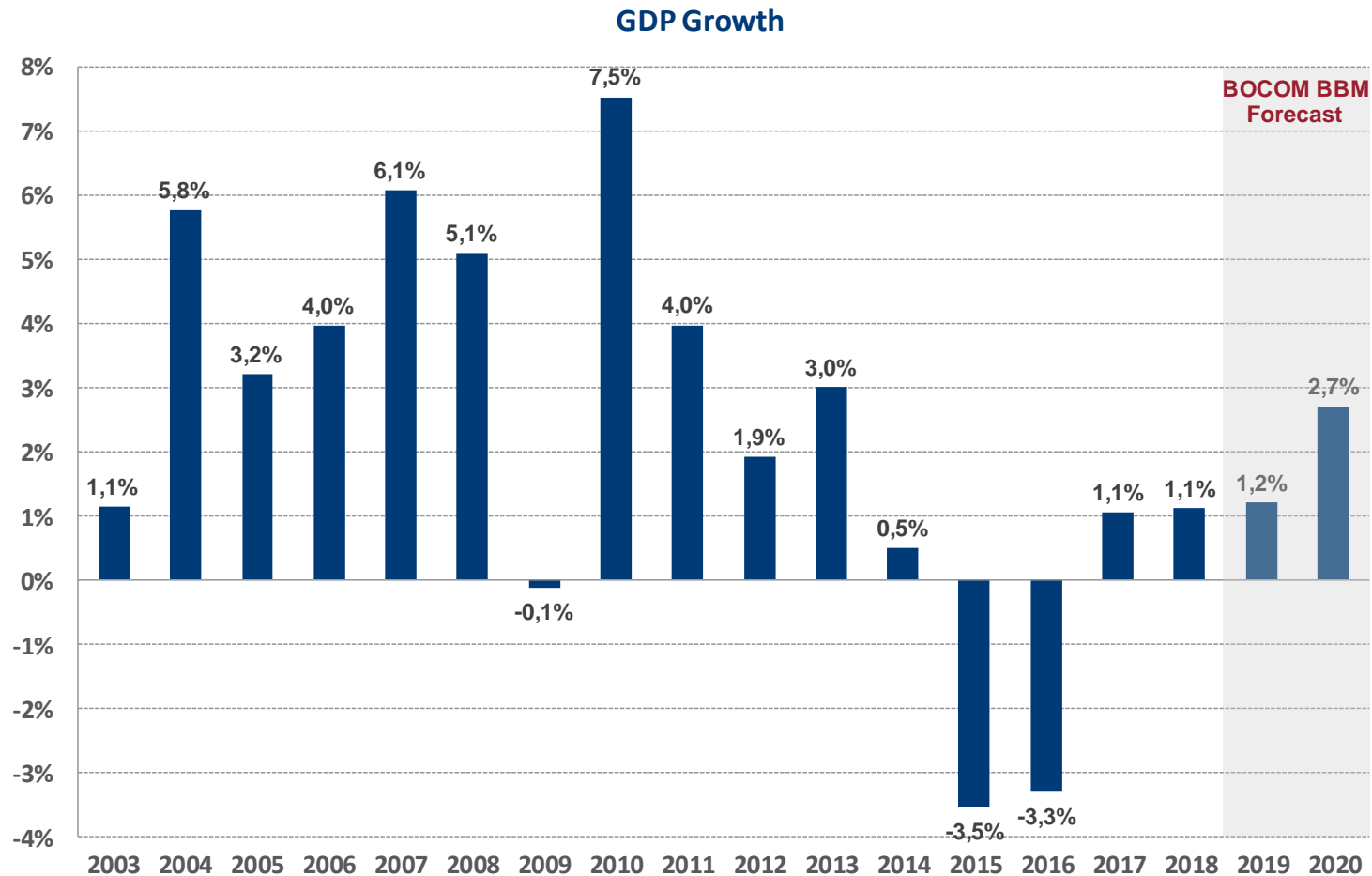
- »» Brazil's economic performance in 2019 now appears to be heading in the same direction as in previous years, with initial optimism giving rise to lower growth forecasts.
- »» The negative growth surprise is due in part to tighter financial conditions during the 2018 election campaign. However, the main factor is uncertainty regarding the domestic reform agenda.
- »» The government has not yet succeeded in building a reliable majority in Congress, undermining the foreseeability of the pension reform bill's approval.
- »» We continue to expect a faster pace of growth in 2020, but this depends on genuine progress with pension reform.

BRAZIL: FORECASTS

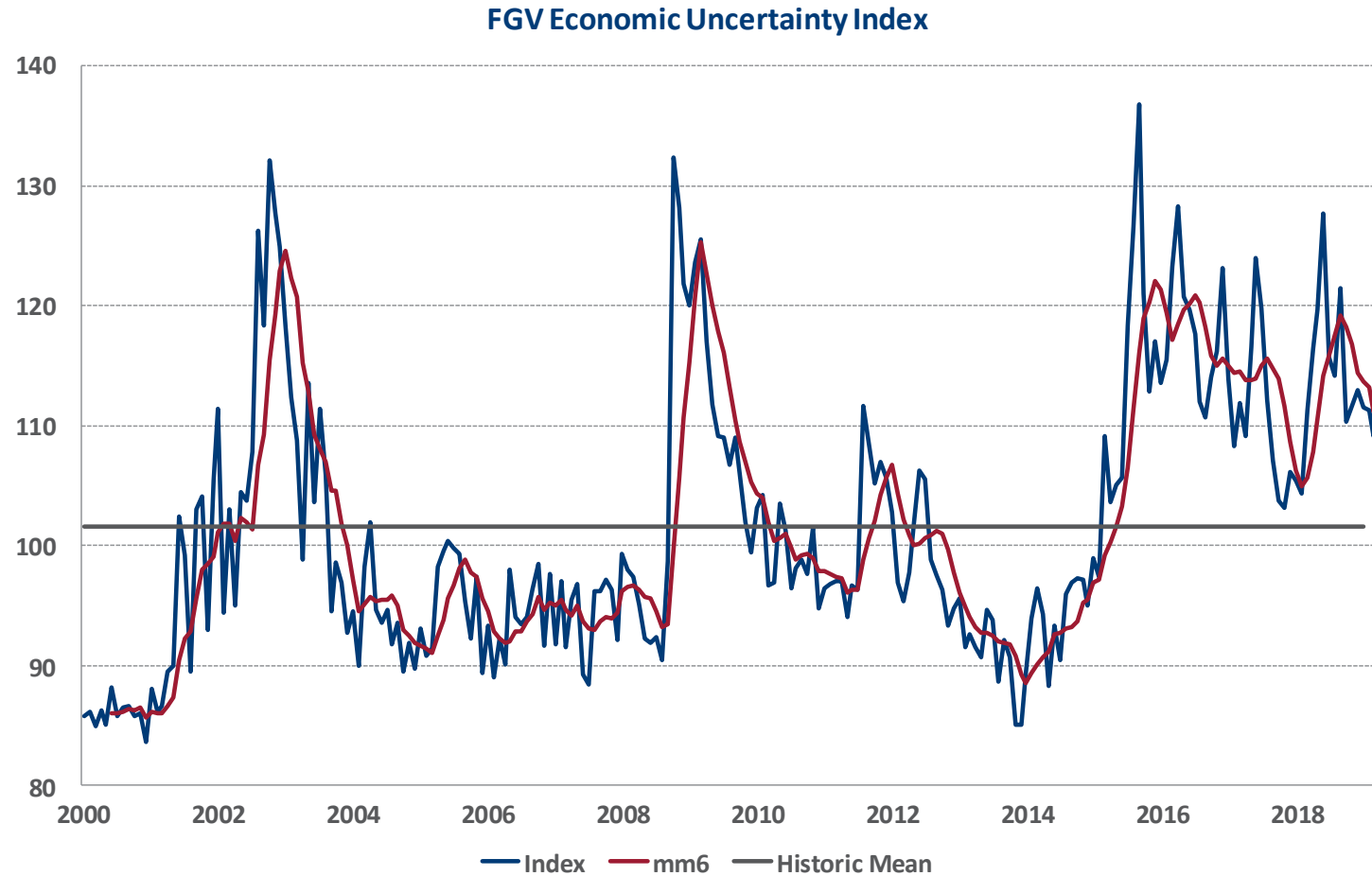
ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,1%	1,2%	2,7%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	4,0%	3,9%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	6,50%	6,50%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,5%	10,3%
Trade Balance (US\$ bn)	3	-4	20	48	67	58	56	44
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-13	-21	-38
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	-1,0%	-1,7%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,4%	-1,0%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	77,8%	78,7%

BRAZIL: ACTIVITY

»» The recovery has been slower than anticipated and until the prospects for pension reform become clear we are unlikely to see a faster pace of economic growth.



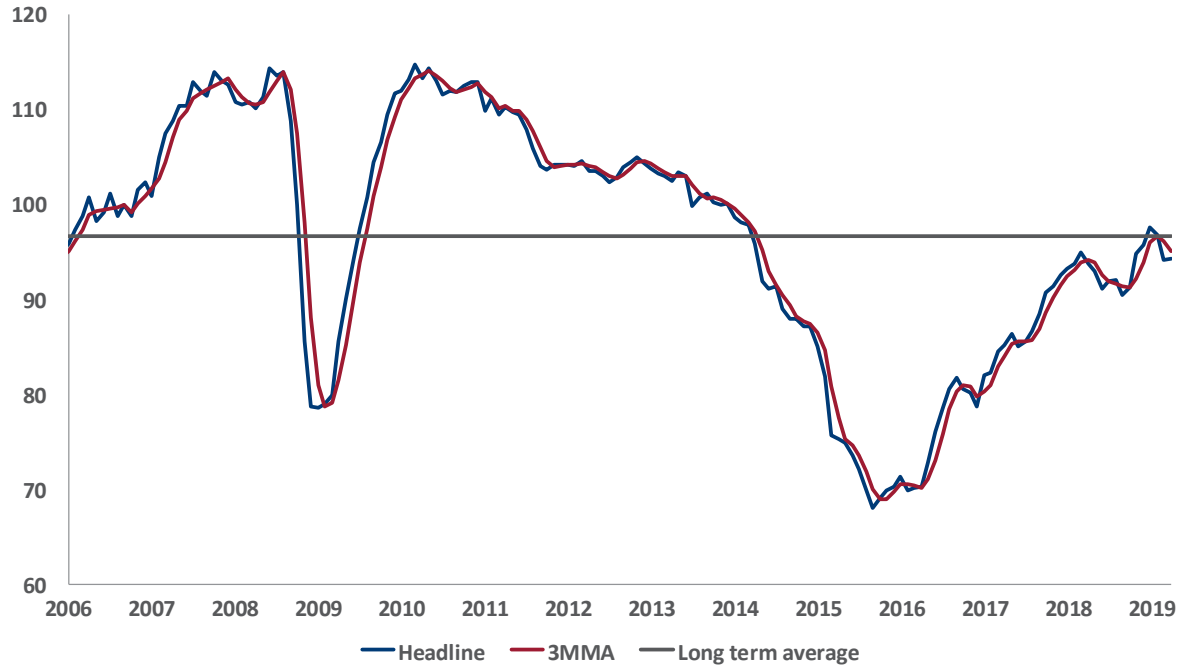
» The lack of clarity about the prospects for pension reform has kept economic uncertainty high, therefore restraining growth.



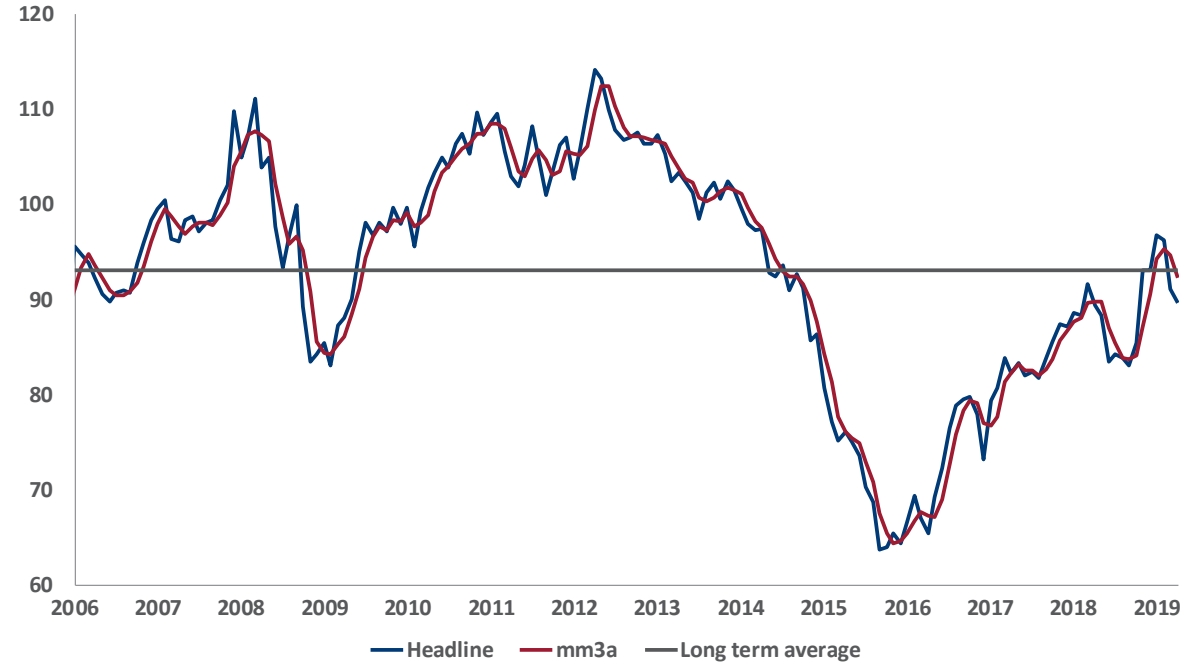
BRAZIL: ACTIVITY

» Business and consumer confidence improved after the election, but has lost steam in the past few months.

Business Confidence (FGV)

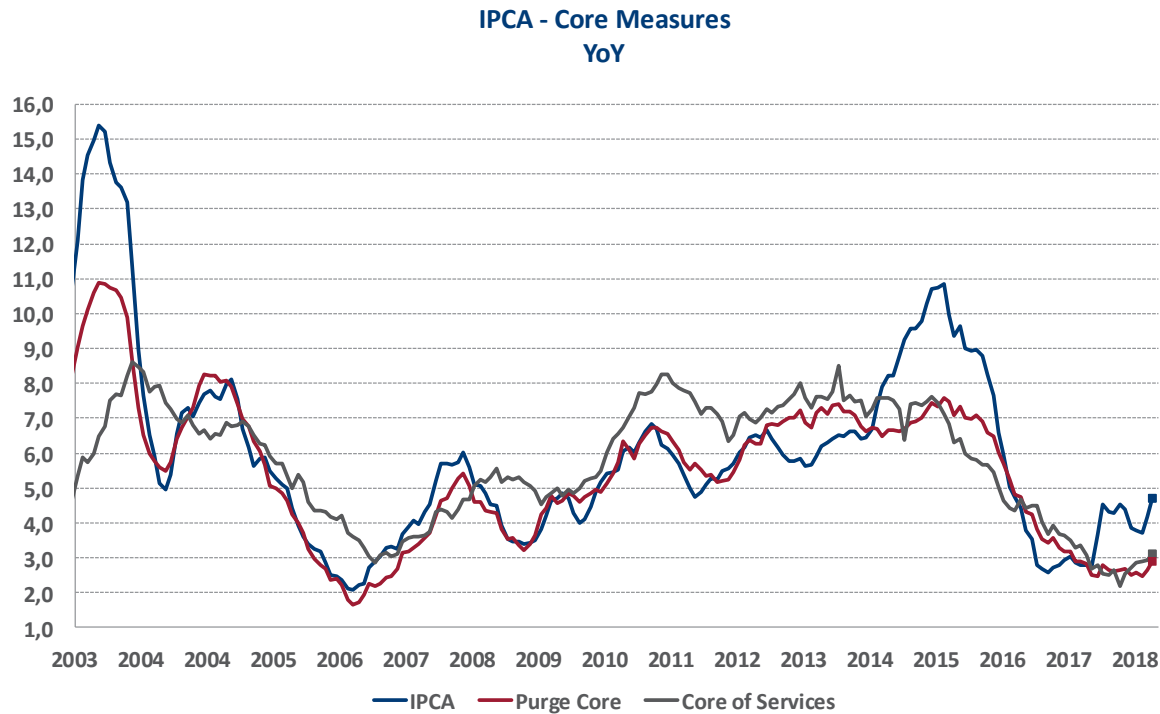


Consumer Confidence (FGV)

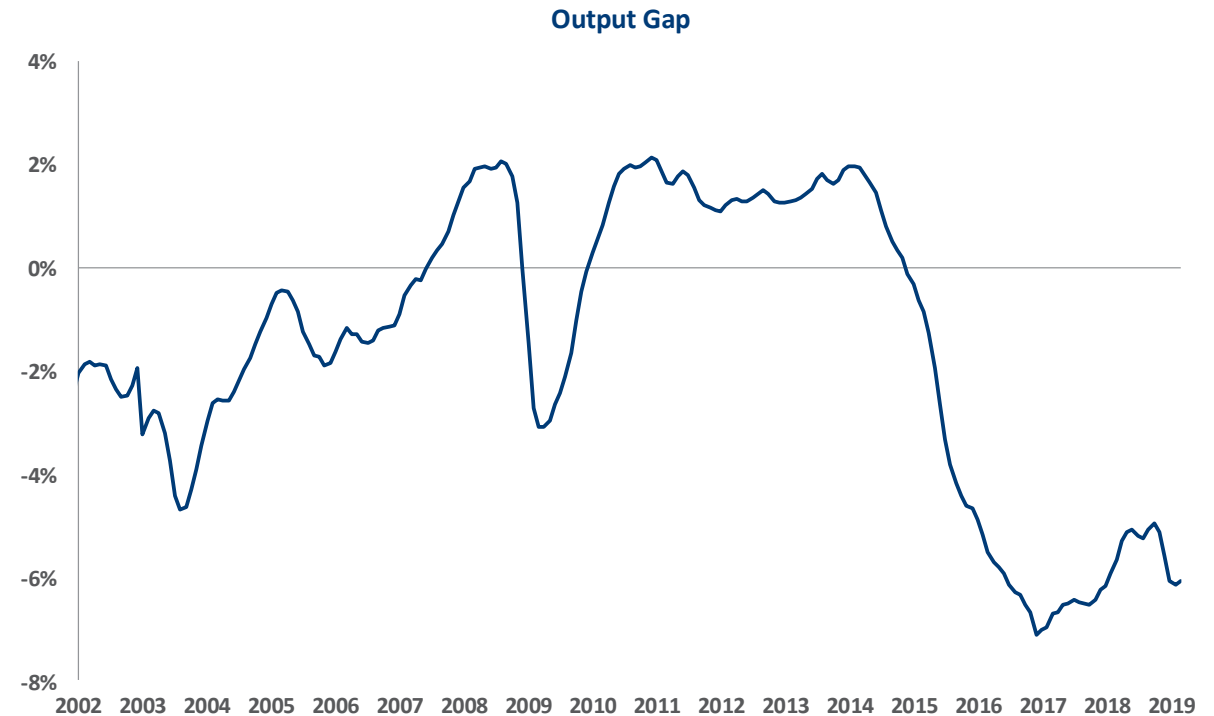


BRAZIL: INFLATION

» Core inflation measures have been running at low levels.



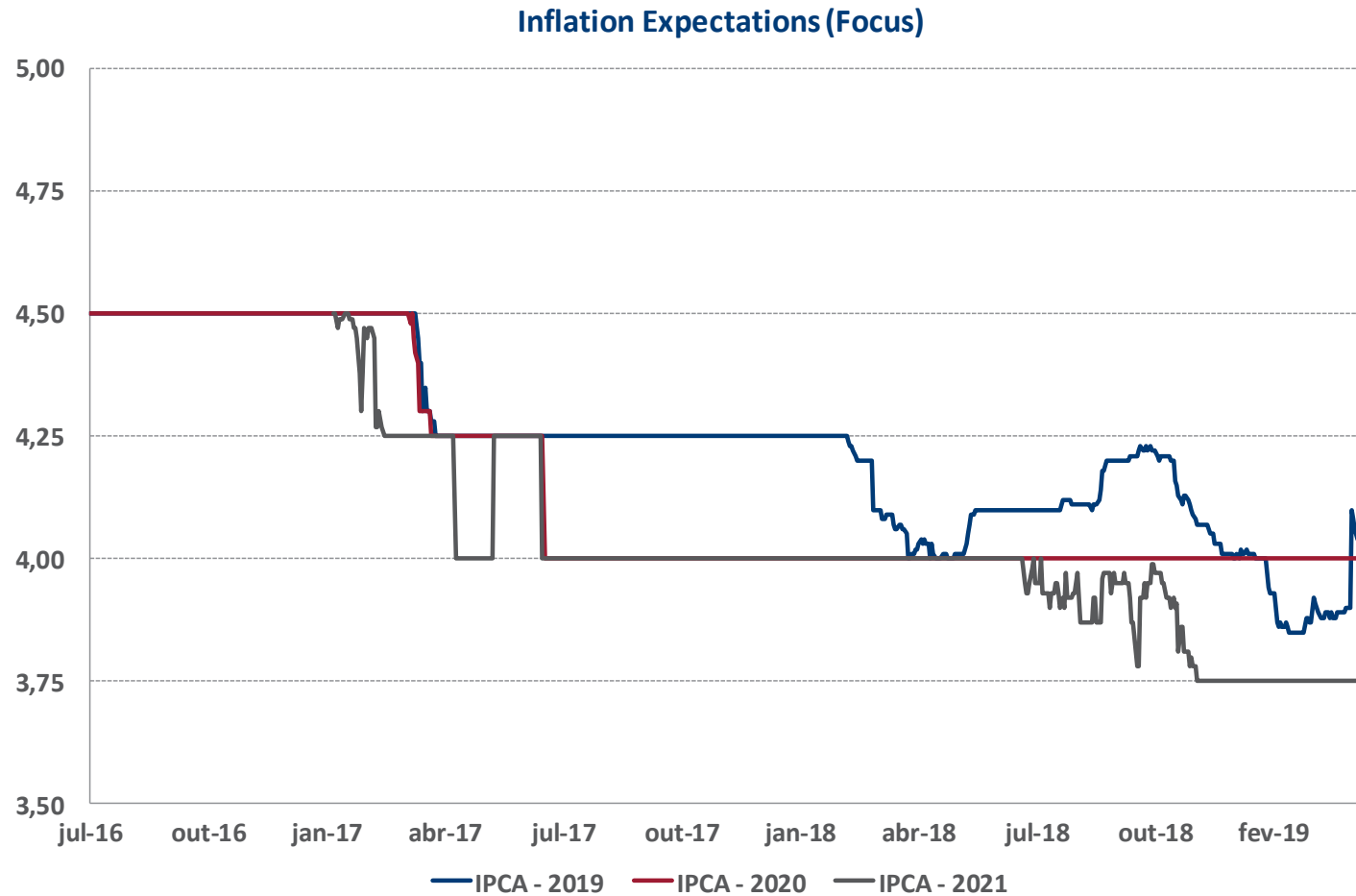
» The output gap remains large and continues to put downward pressure on inflation.



BRAZIL: INFLATION

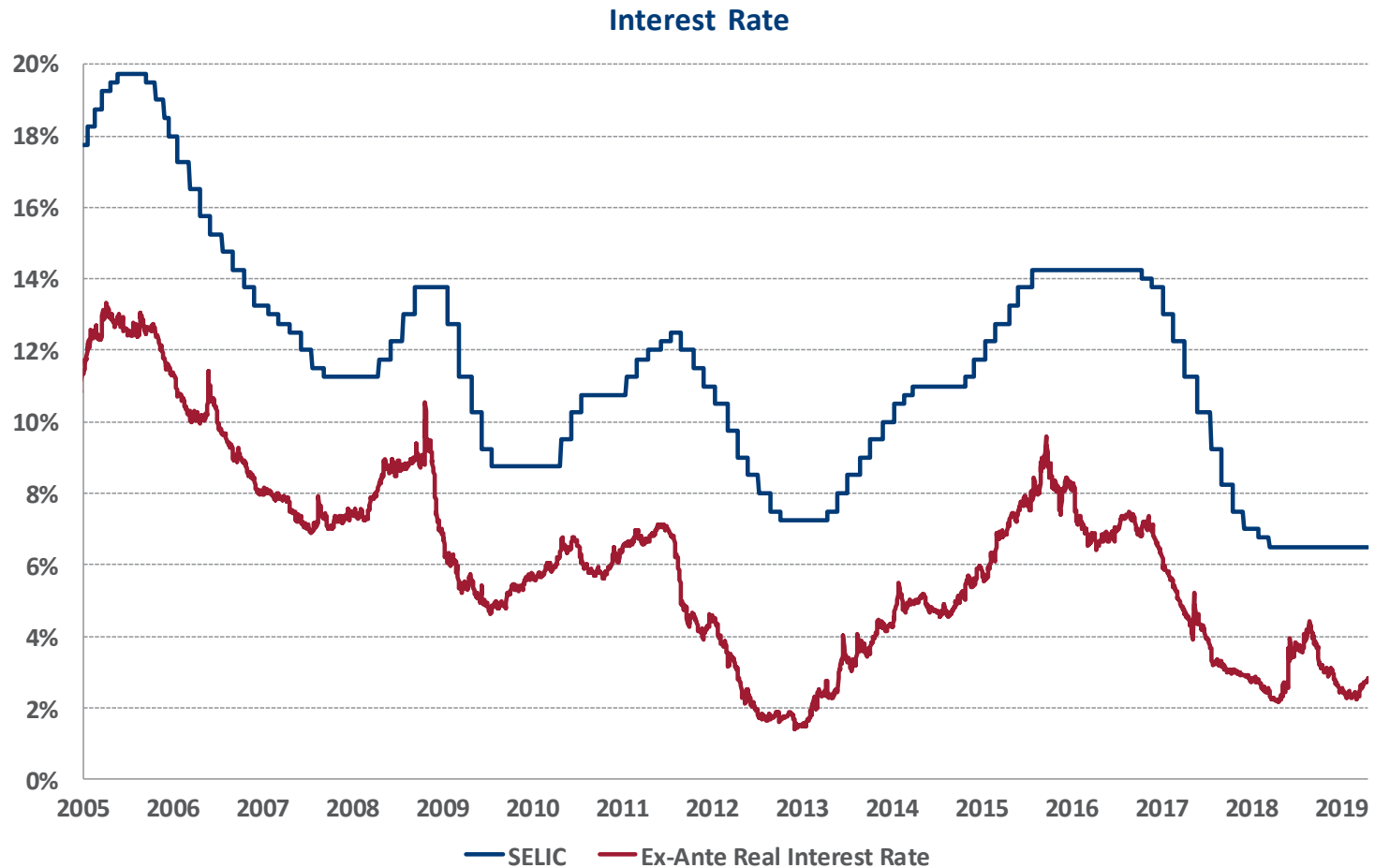
Baseline Scenario											
Exchange rate of 3.80 in 2019 and 2020											
Selic: 6.50% in Dec/18, Dec/19 and in Dec/20											
	IPCA	Non-Regulated (74.7%)	Regulated (25.3%)	Core Inflation (59.0%)	Tradables Ex-Food (20.2%)	Services (35.8%)	Core of Services-BBM (16.7%)	Food at Home (15.7%)	Output Gap	GDP	Selic
1T16	9,4%	9,0%	10,8%	7,3%	6,6%	7,5%	6,5%	15,3%	-5,5%	-4,4%	14,3%
2T16	8,8%	8,5%	9,9%	6,8%	6,9%	7,0%	5,9%	14,7%	-5,9%	-4,5%	14,3%
3T16	8,5%	8,7%	7,9%	6,7%	6,2%	7,0%	5,7%	16,1%	-6,3%	-4,1%	14,3%
4T16	6,3%	6,6%	5,5%	5,8%	5,2%	6,5%	4,8%	9,4%	-7,1%	-3,3%	13,8%
1T17	4,6%	4,3%	5,6%	4,6%	3,2%	6,0%	4,5%	3,0%	-6,7%	-2,0%	12,3%
2T17	3,0%	2,9%	3,3%	3,9%	1,5%	5,7%	4,5%	-0,6%	-6,5%	-1,0%	10,3%
3T17	2,5%	1,4%	6,1%	3,4%	1,0%	5,0%	3,7%	-5,3%	-6,5%	-0,1%	8,3%
4T17	2,9%	1,3%	8,0%	3,1%	0,9%	4,5%	3,6%	-4,9%	-6,2%	1,1%	7,0%
1T18	2,7%	1,3%	7,1%	2,8%	0,6%	3,9%	3,2%	-4,3%	-5,7%	1,3%	6,5%
2T18	4,4%	2,0%	11,8%	2,6%	0,8%	3,1%	2,8%	0,1%	-5,1%	1,4%	6,5%
3T18	4,5%	2,6%	10,4%	2,7%	1,4%	3,2%	2,5%	2,2%	-5,1%	1,4%	6,5%
4T18	3,7%	2,9%	6,2%	2,5%	1,1%	3,3%	2,6%	4,5%	-5,6%	1,1%	6,5%
1T19	4,6%	4,0%	6,3%	2,7%	1,4%	3,6%	3,0%	8,7%	-6,2%	1,0%	6,5%
2T19	3,7%	3,6%	4,1%	2,6%	0,8%	4,0%	2,5%	7,1%	-6,5%	0,9%	6,5%
3T19	3,5%	3,4%	3,9%	2,1%	0,1%	3,5%	2,3%	8,4%	-6,1%	0,7%	6,5%
4T19	4,0%	3,2%	6,2%	2,1%	0,4%	3,5%	2,1%	7,7%	-5,1%	0,9%	6,5%
1T20	3,8%	3,0%	6,2%	2,1%	0,2%	3,6%	1,8%	6,3%	-4,5%	1,3%	6,5%
2T20	3,7%	3,3%	4,8%	2,6%	1,2%	3,8%	2,4%	5,8%	-3,9%	2,0%	6,5%
3T20	3,6%	3,5%	3,9%	2,9%	1,6%	3,9%	2,6%	5,5%	-3,3%	2,7%	6,5%
4T20	3,9%	3,9%	3,8%	3,1%	1,3%	3,9%	2,6%	6,5%	-2,9%	3,0%	6,5%

» Inflation expectations are anchored around 4.0% in 2019 and 2020.



BRAZIL: MONETARY POLICY

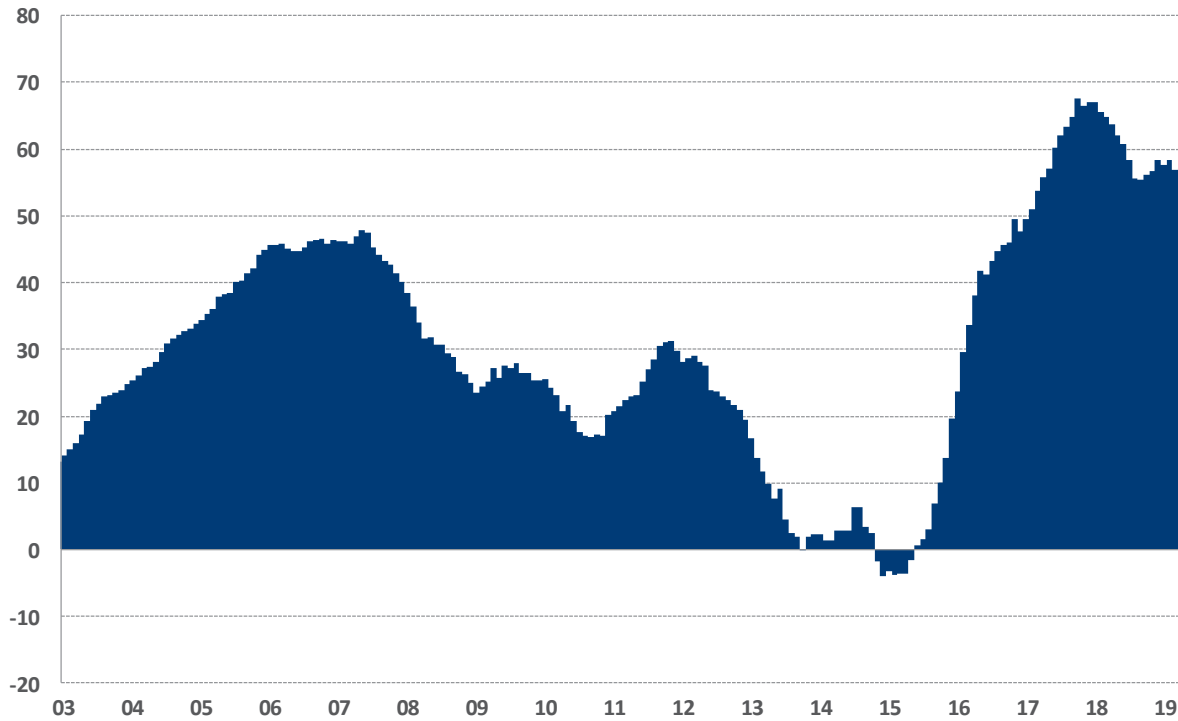
» The SELIC rate will remain stable throughout 2019 and additional interest rate cuts are unlikely for now.



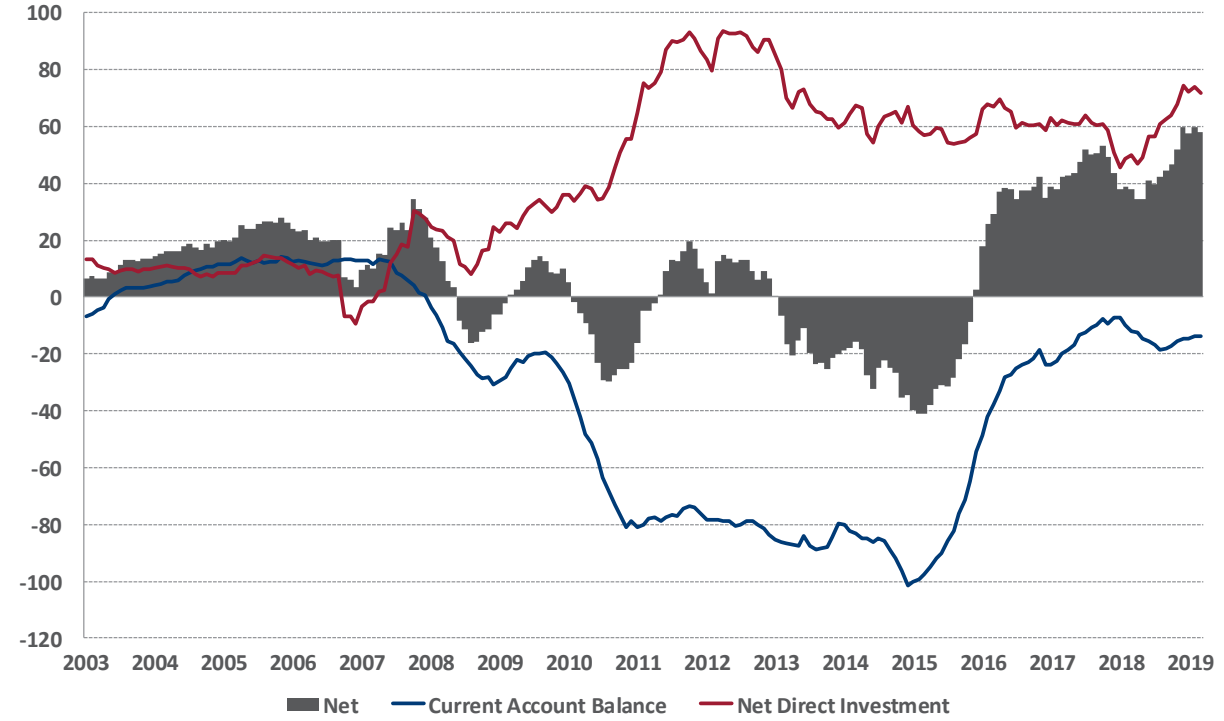
BRAZIL: EXTERNAL

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

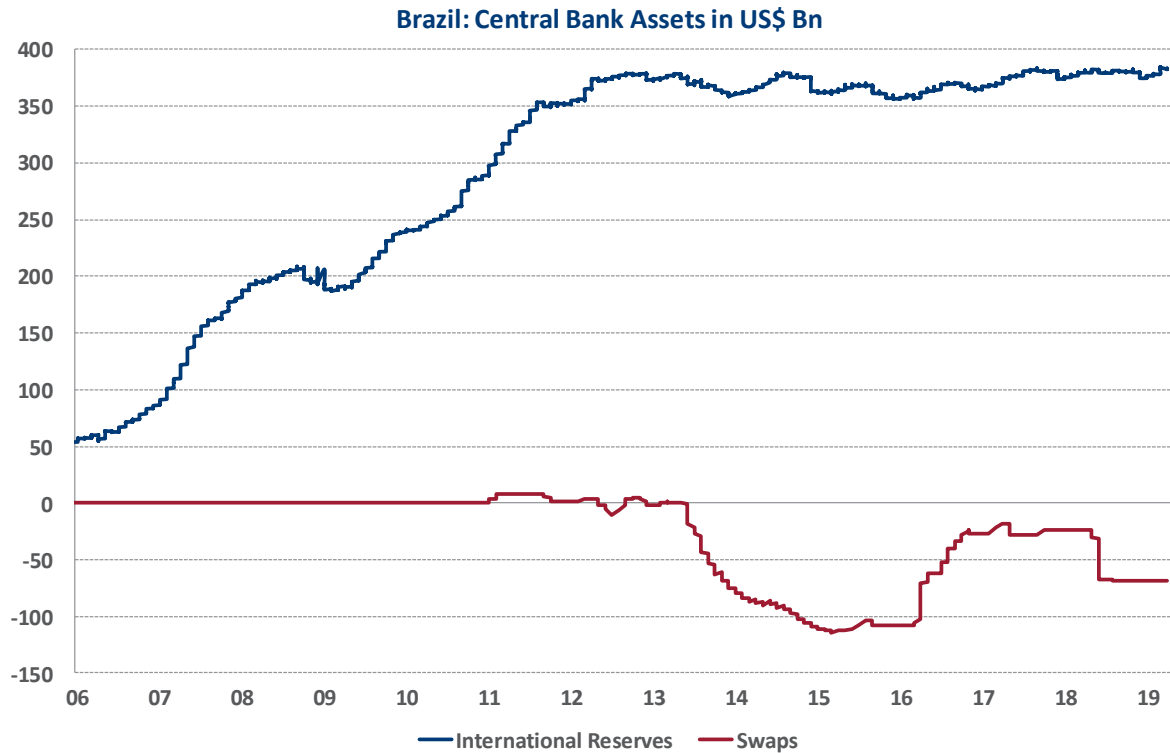
Trade Balance - US\$ Billion in 12m



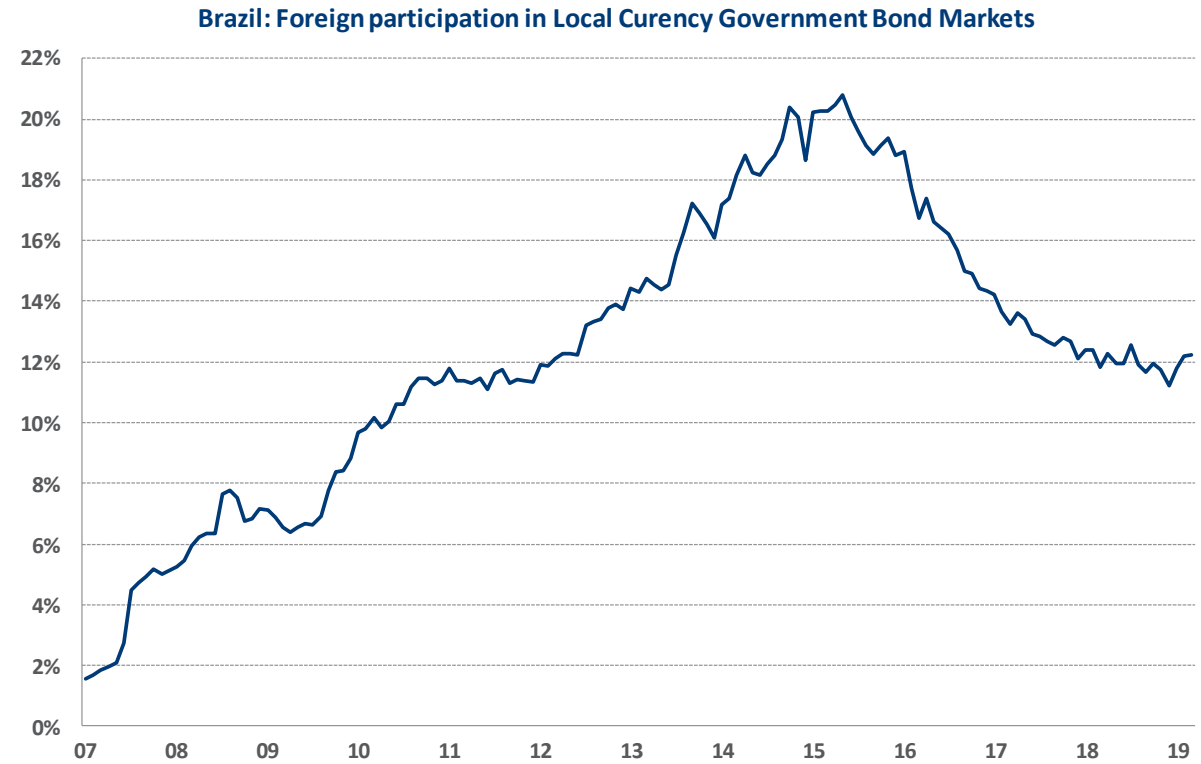
Current Account vs Net Direct Investment - US\$ Billion in 12m



» Central Bank holds substantial international reserves.



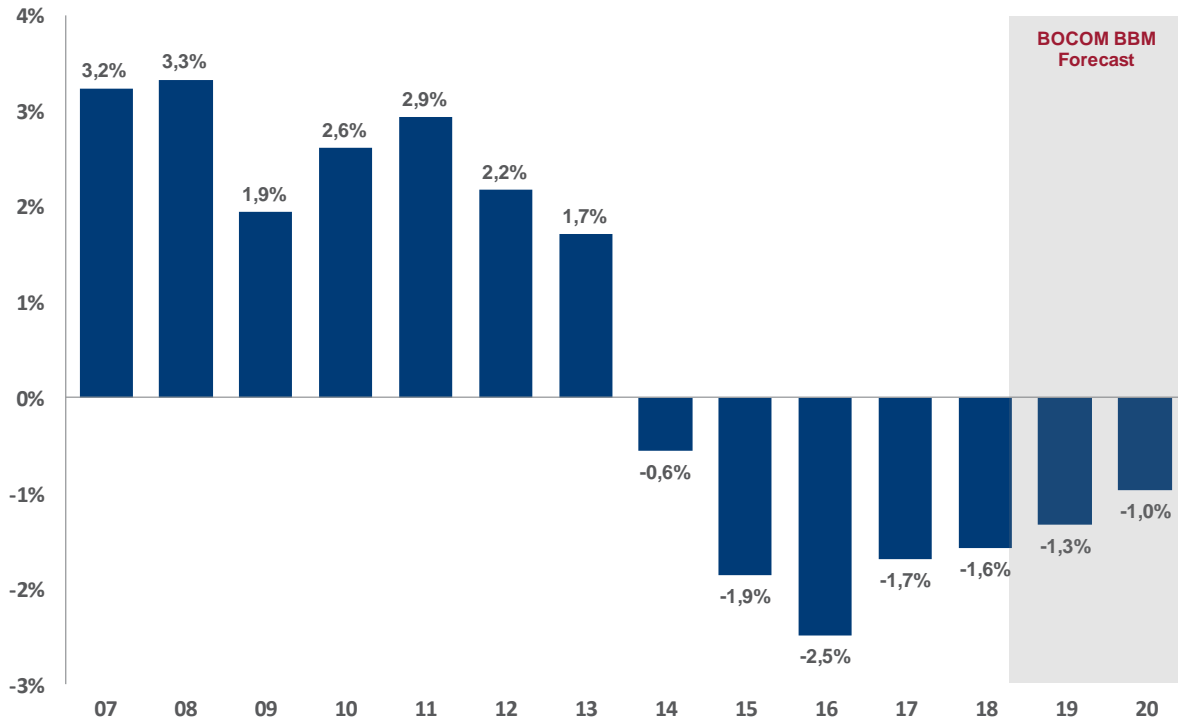
» Government domestic debt exposure to foreign investors continues to fall.



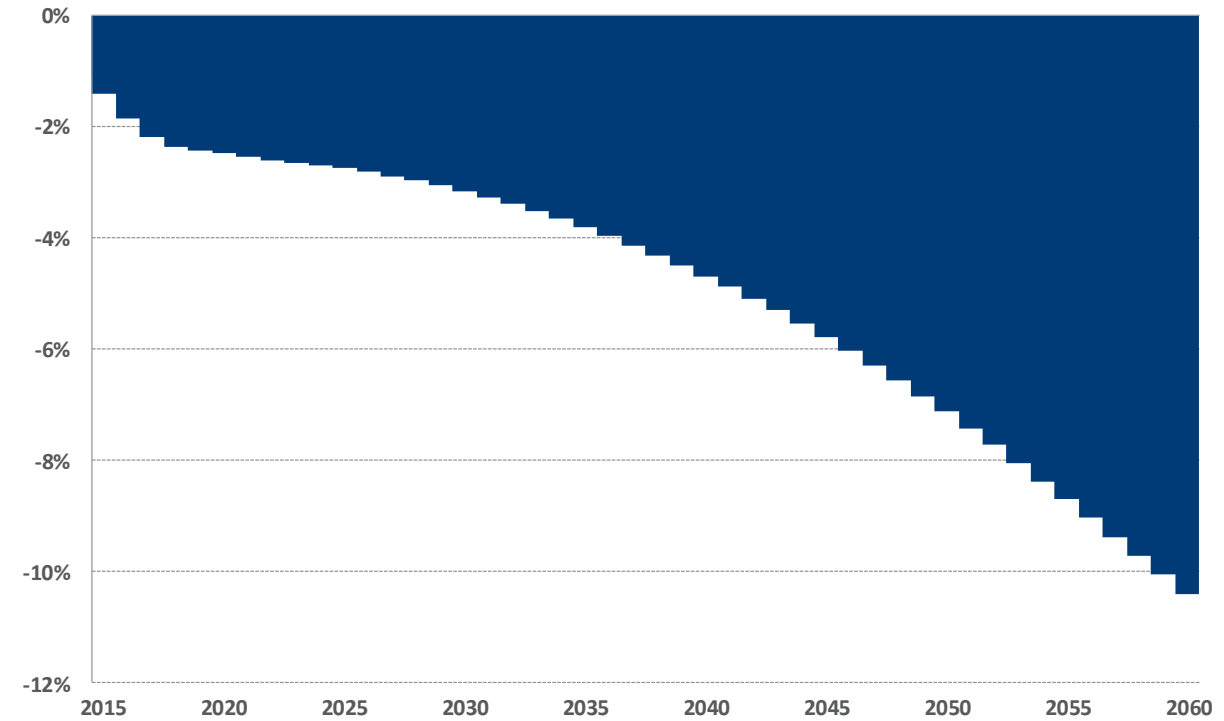
» Fiscal policy remains the main challenge: the country has run a primary deficit for 6 years.

» Social security deficit (RGPS) is rapidly increasing.

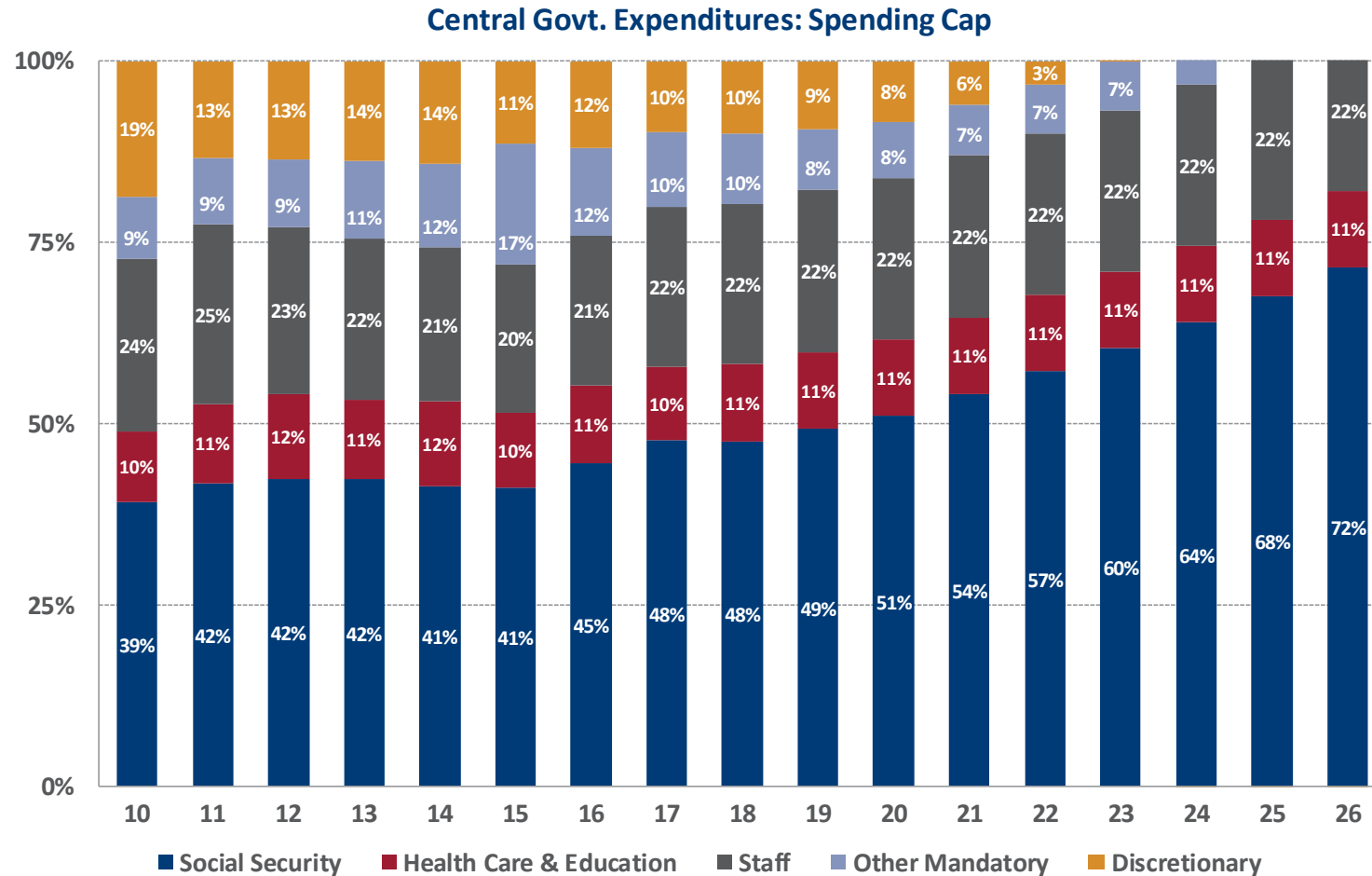
Public Sector Primary Balance - % GDP



Social Security Balance - % of GDP



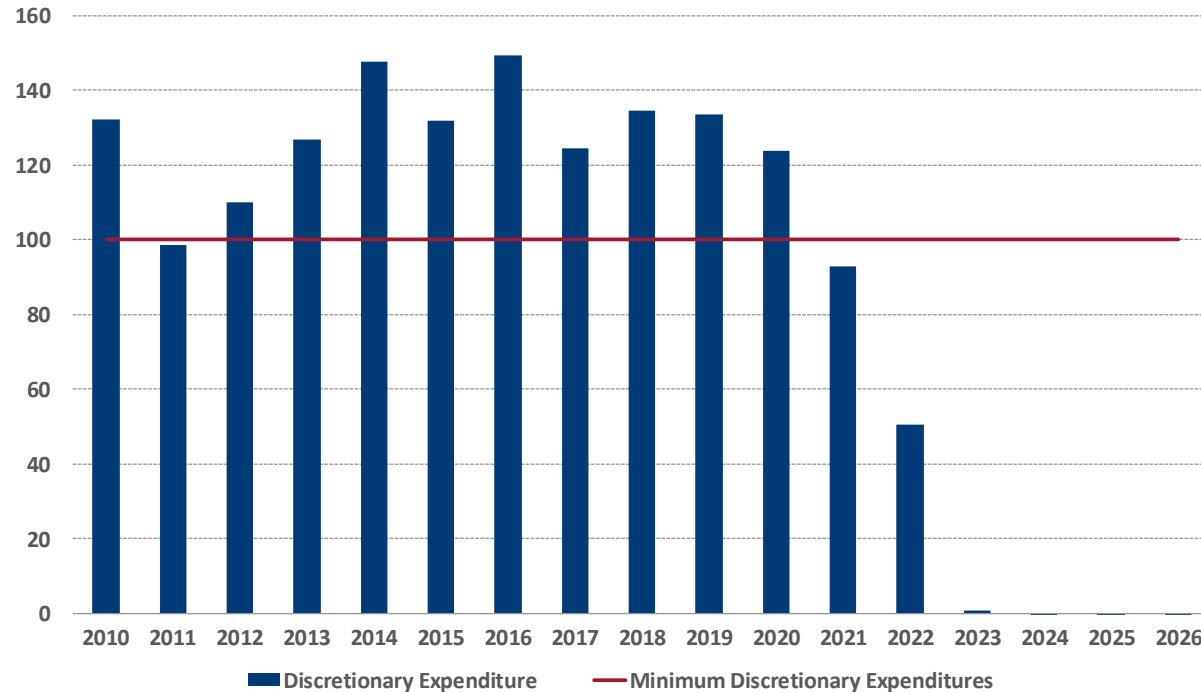
»» The government spends 50% of its budget with social security and 90% of it with mandatory spending. Without reforms, the spending cap becomes unsustainable in 2023.



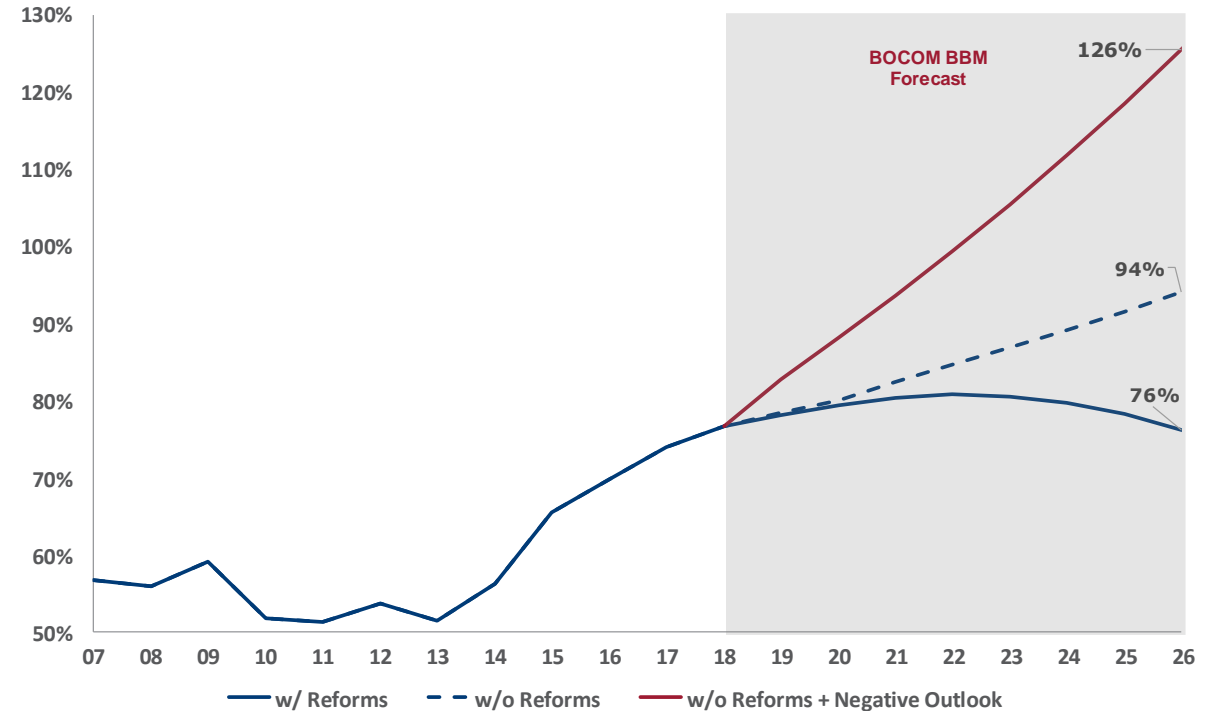
» The spending cap will be hard to sustain already in 2020.

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

Discretionary Expenditures
R\$ Billion



General Government Gross Debt - % GDP



» Pension reform has already been dehydrated and a long road still lies ahead.

Measure	BRL bn saved in 10y (2020 - 2029)	Current Situation	Positive Scenario	Baseline	Negative Scenario
Private sector	808	724 (90%)	724 (90%)	536 (66%)	348 (43%)
Retirement by age	128	128	128	96 (75%)	64 (50%)
Retirement by contribution time	433	433	433	325 (75%)	216 (50%)
Bereavement payment	112	112	112	84 (75%)	56 (50%)
Retirement by disability	79	79	79	60 (75%)	40 (50%)
Rural retirement	92	0 (0%)	0	0	0
Progressive contribution rates	-28	-28	-28	-28	-28
Social assistance	204	169 (83%)	85 (41%)	0 (0%)	0 (0%)
Salary Allowance	169	169	85 (50%)	0 (0%)	0
BPC	35	0 (0%)	0	0	0
Public servants (Federal)	225	225	126 (56%)	126 (56%)	0 (0%)
Restriction in access, parity and integrality / Transition rules	197	197	98 (50%)	98 (50%)	0
Progressive contribution rates	28	28	28	28	0
Public sector (Military)	10	10	10	10	10
Pension reform	97	97	97	97	97
Career restructuring	-87	-87	-87	-87	-87
Total	1247	1128 (90%)	945 (76%)	672 (54%)	358 (29%)
Total in % GDP	2,5%	2,2%	1,9%	1,3%	0,7%

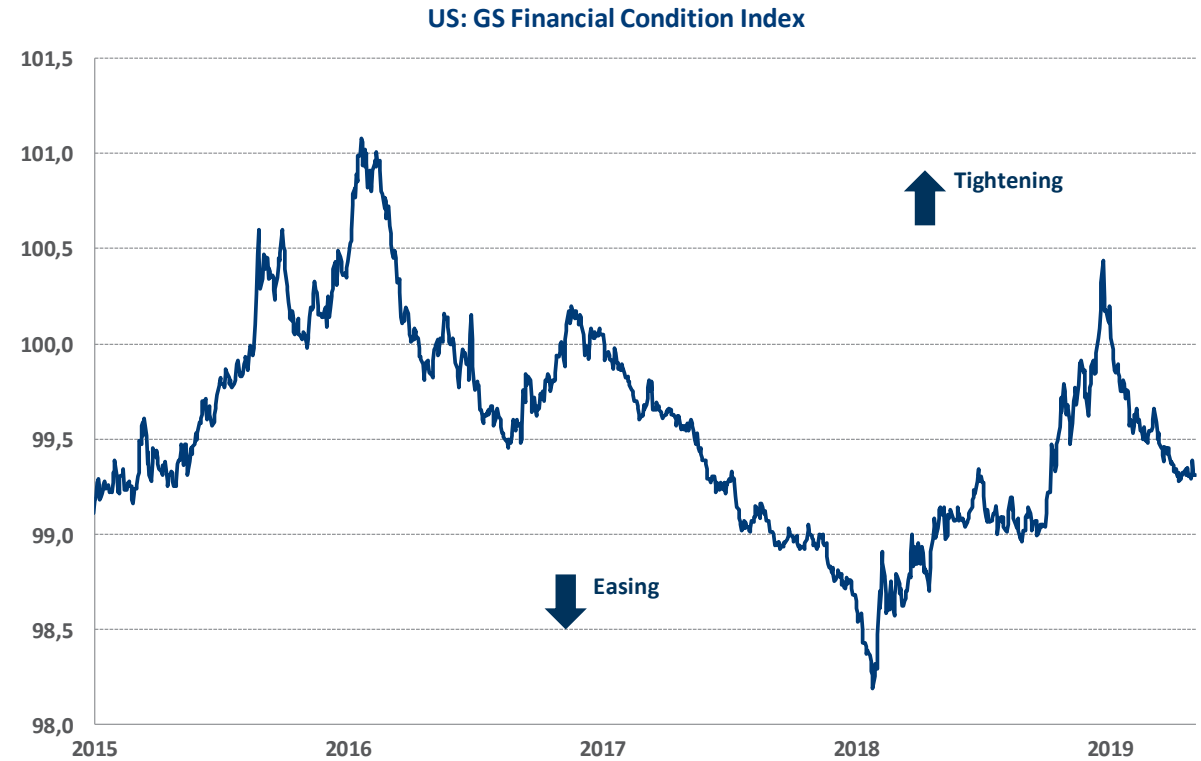
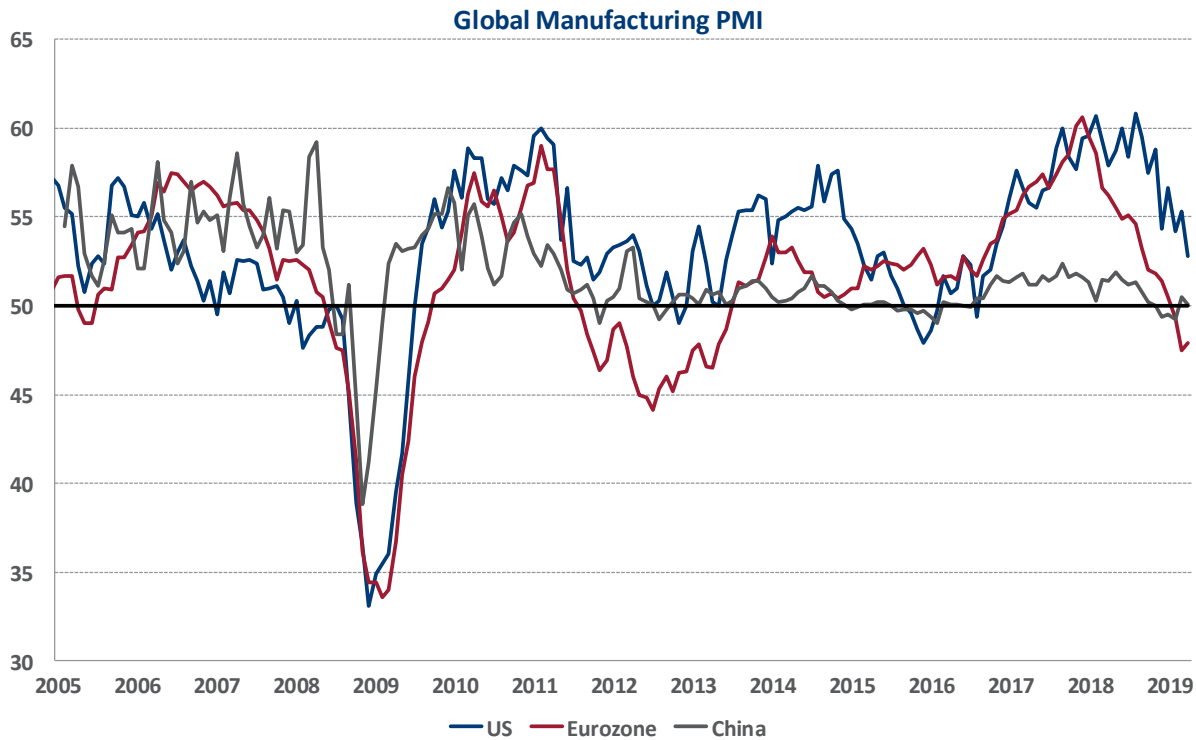
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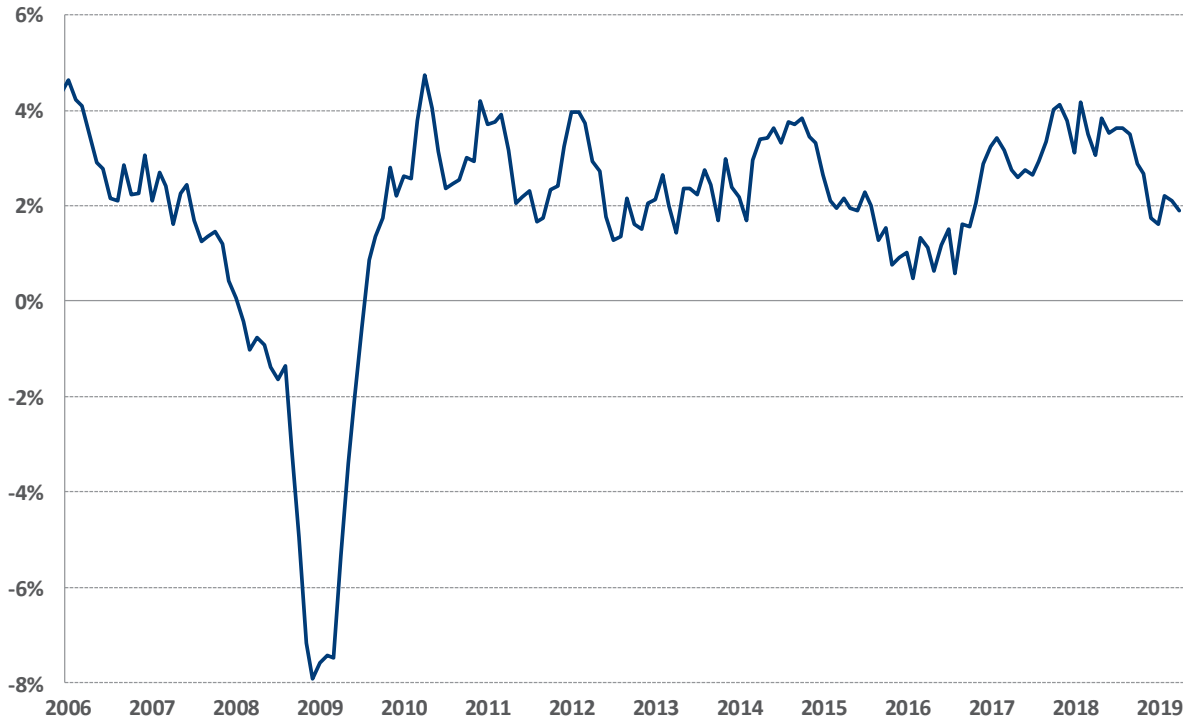
»» MARKETS: RECENT TRENDS

» Growth worries persist amid easier financial conditions: Europe remains weak, but US and China appear to have stabilized.

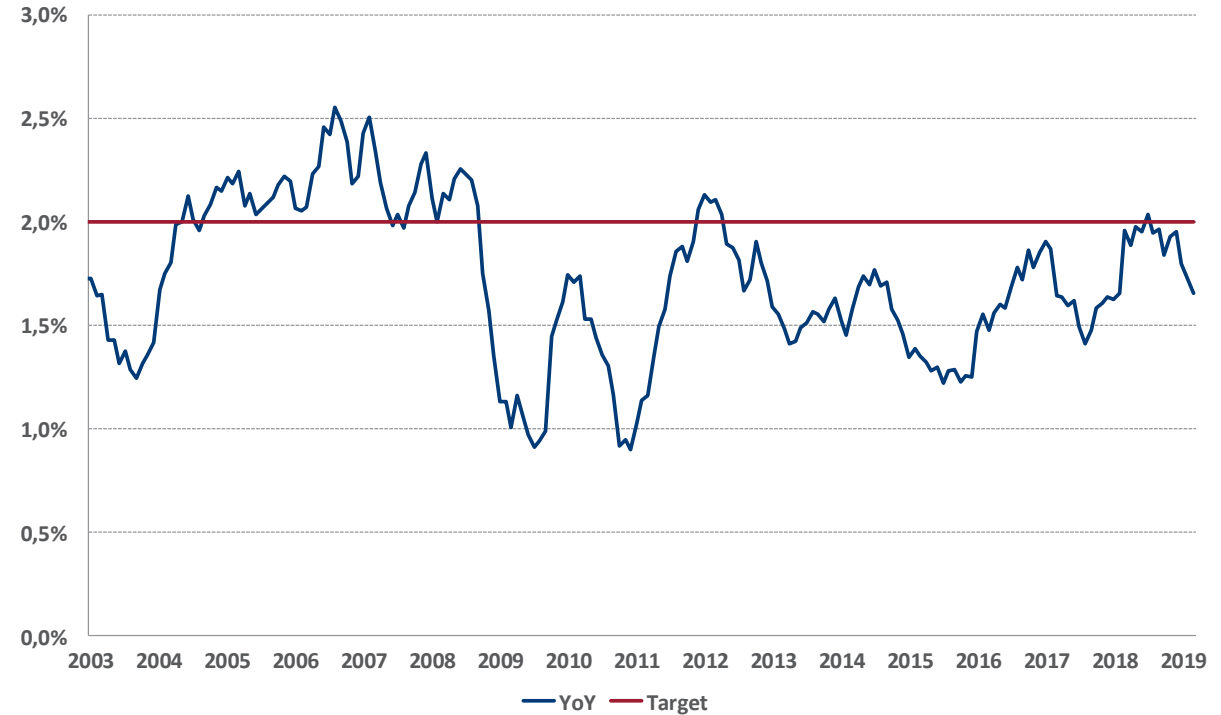


» US growth appears to have stabilized, but inflation is slowing again, allowing the FED to keep a dovish stance.

US Current Activity Indicator (GS)

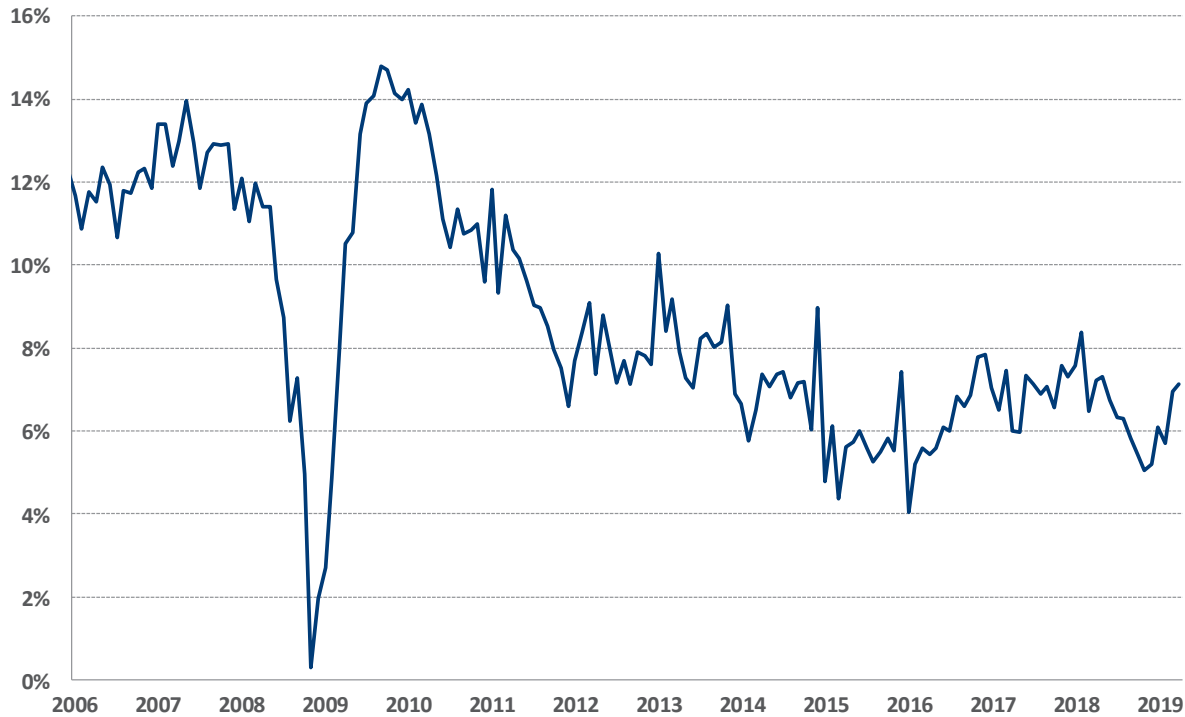


Core PCE Deflator



»» China also shows signs of stabilization, but tension around trade negotiations appears to be moving higher again.

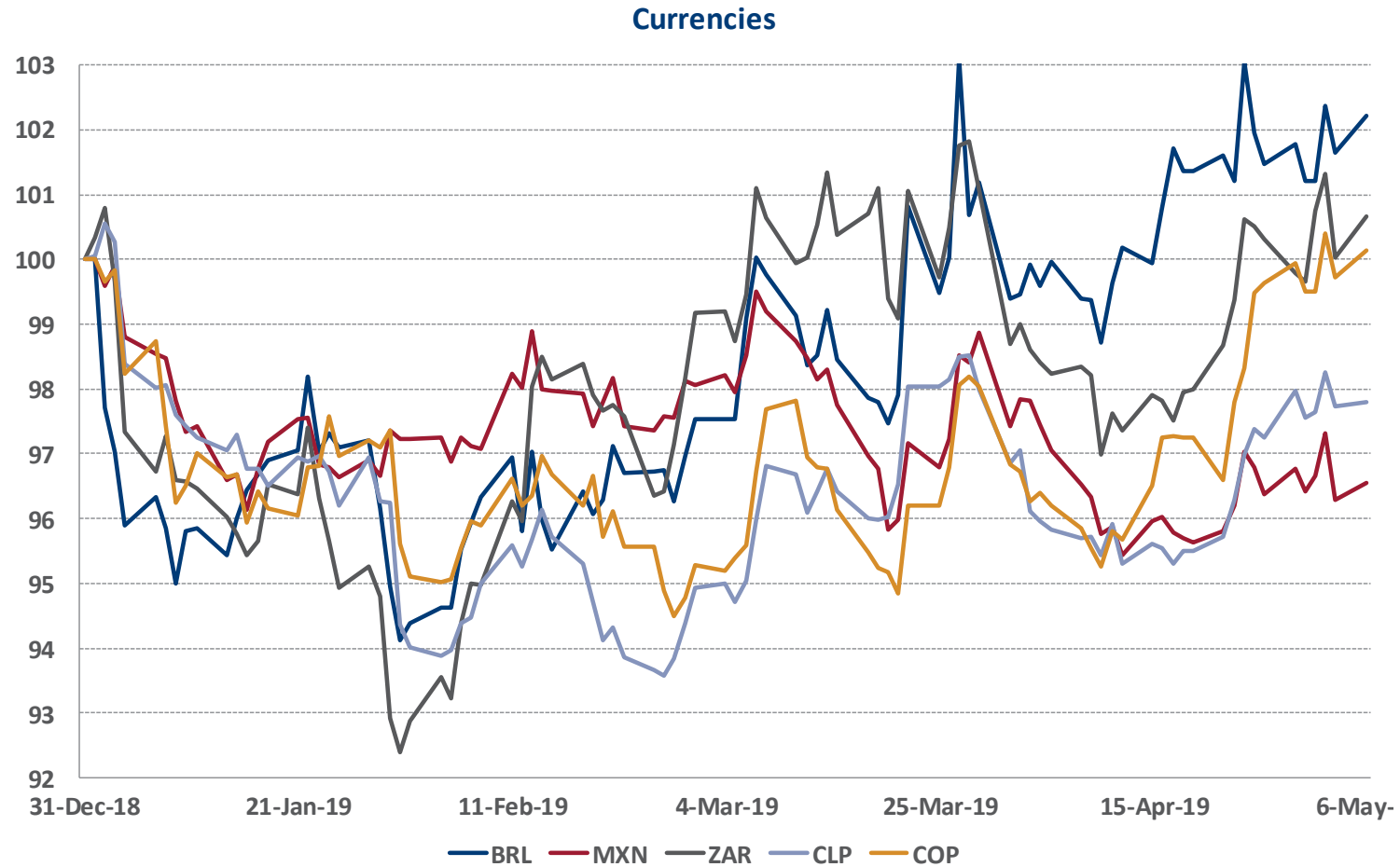
China Current Activity Indicator (GS)



CNY x Shanghai Stock Exchange



» Easier global financial conditions support emerging markets, but global growth worries continues to generate volatility.



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BRAZIL: MARKETS

Spot Nominal Interest Rate (DI Curve)



Ibovespa



BRL Currency



CDS 5 Years

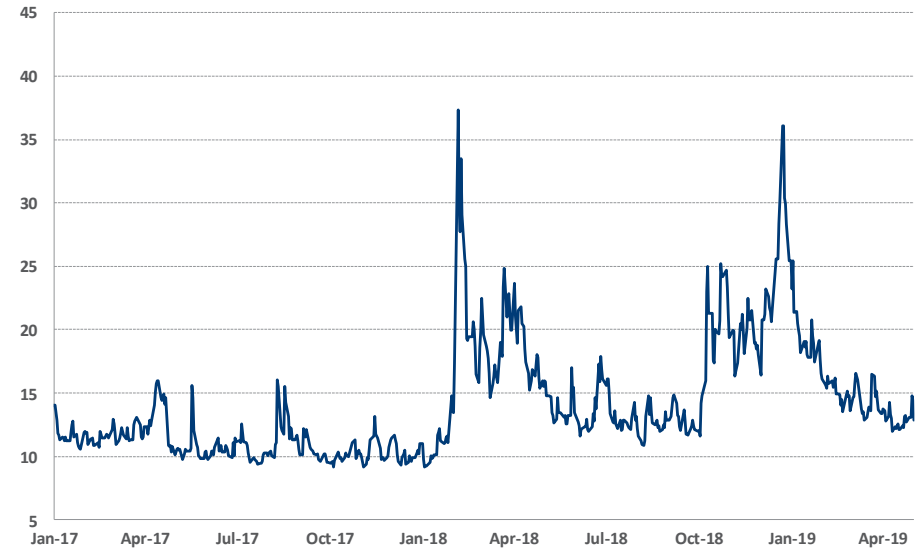


GLOBAL: MARKETS

SPX Index



VIX Index



CDX High Yield Spread



Nominal Dollar Trade Weighted (FED)



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