



## MACRO OUTLOOK

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June 2019

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»» BRAZIL: ANOTHER YEAR OF LOW GROWTH

»» GLOBAL: TRADE WAR STRIKES BACK

»» MARKETS: RECENT TRENDS

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## ANOTHER YEAR OF LOW GROWTH

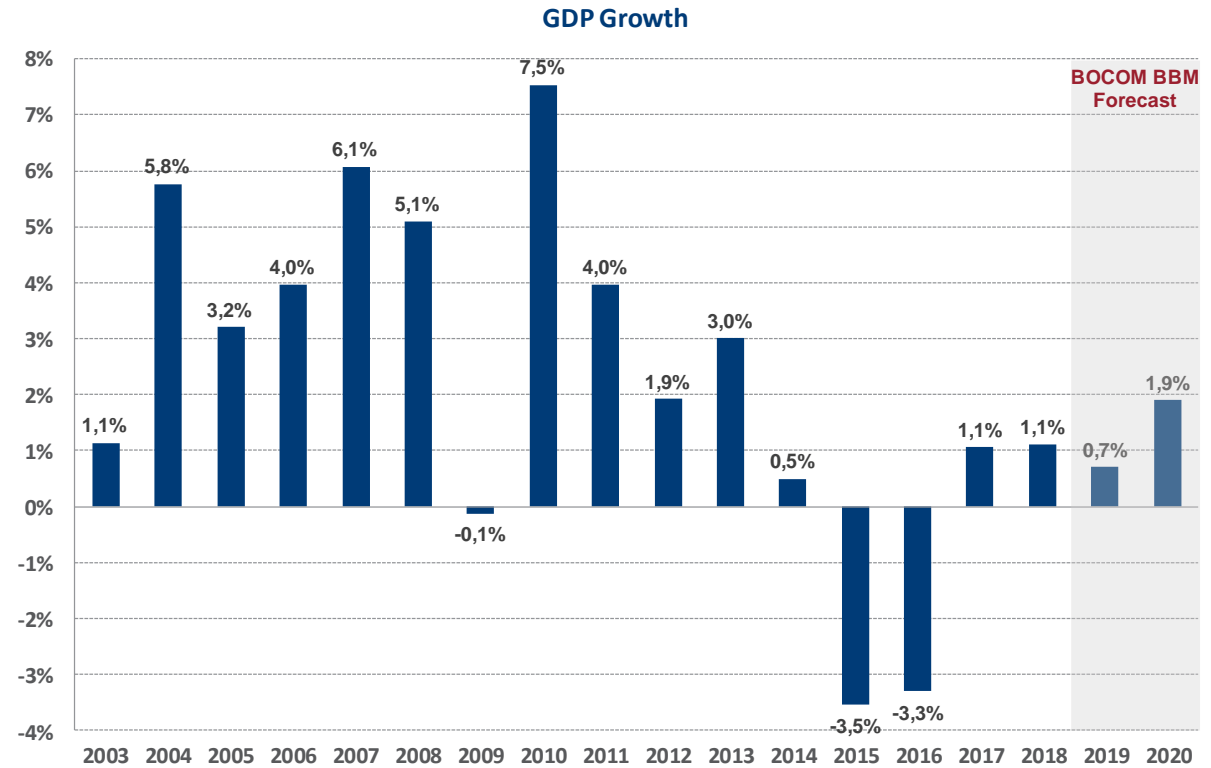
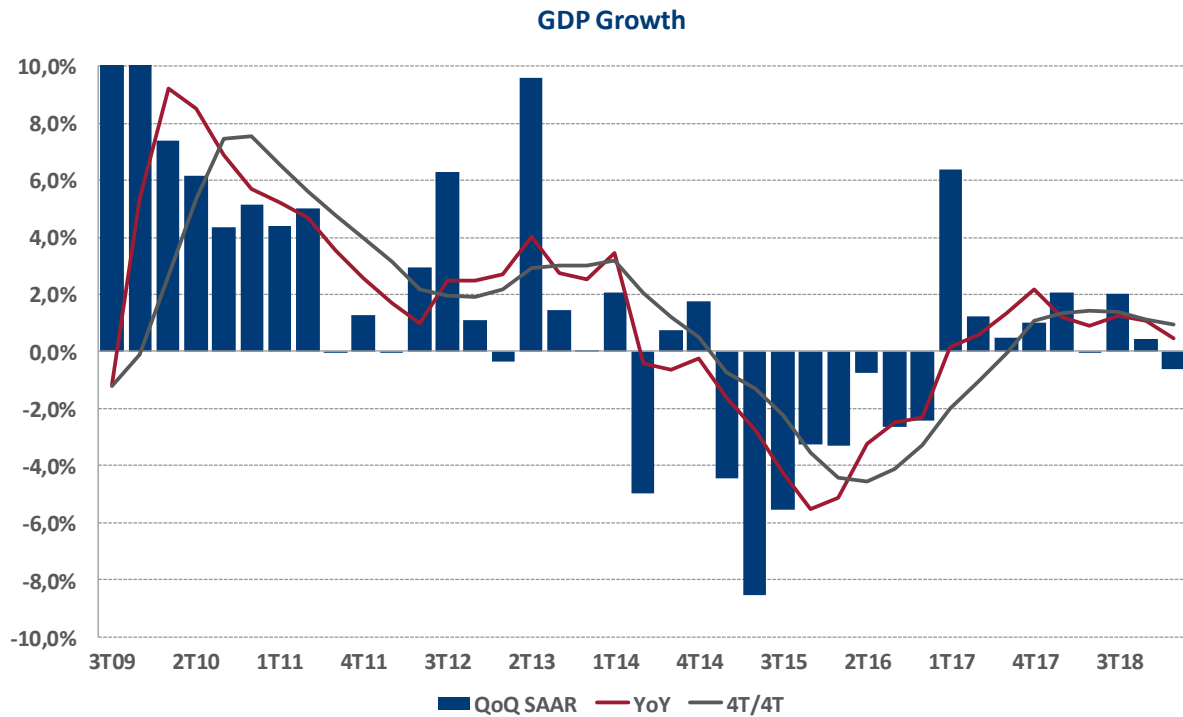
- »» Brazil's economic performance in 2019 now appears to be heading in the same direction as in previous years, with initial optimism giving rise to lower growth forecasts.
- »» Uncertainty regarding the reform agenda has been restraining growth.
- »» Without a reliable majority in Congress, the government will only manage to approve a diluted pension reform.
- »» A favorable inflation outlook, combined with low growth and pension reform approval, allows the Central Bank to lower interest rates in the second half of the year.

# BRAZIL: FORECASTS

<b>ECONOMIC FORECASTS</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019 F</b>	<b>2020F</b>
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,1%	1,1%	<b>0,7%</b>	<b>1,9%</b>
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	<b>3,9%</b>	<b>3,9%</b>
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	<b>5,50%</b>	<b>5,50%</b>
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	<b>11,7%</b>	<b>10,8%</b>
Trade Balance (US\$ bn)	3	-4	20	48	67	58	<b>56</b>	<b>44</b>
Current Account Balance (US\$ bn)	-75	-104	-59	-23	-10	-13	<b>-21</b>	<b>-38</b>
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,5%	-0,8%	<b>-1,0%</b>	<b>-1,7%</b>
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	<b>-1,5%</b>	<b>-1,2%</b>
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	<b>78,2%</b>	<b>79,5%</b>

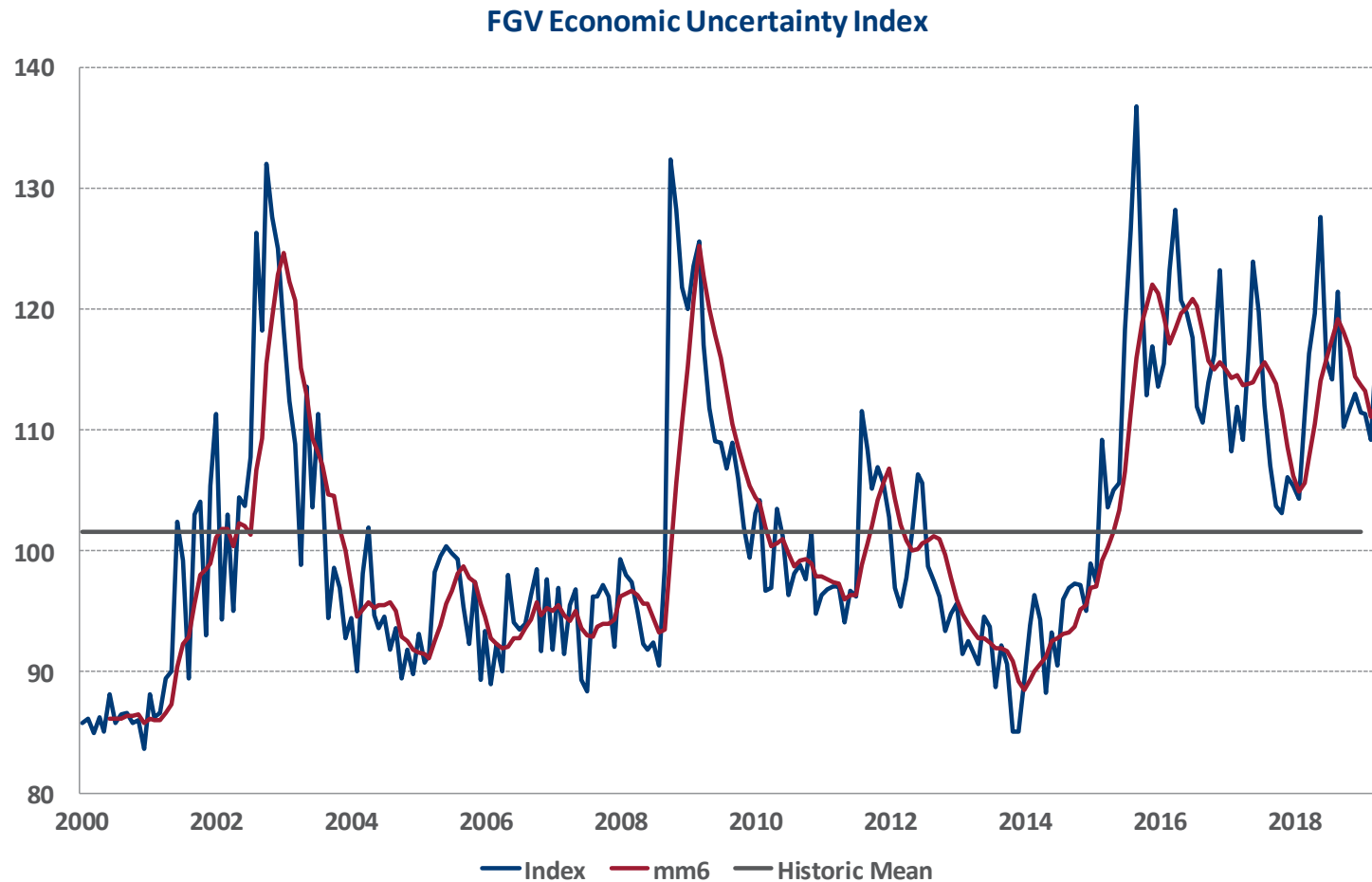
# BRAZIL: ACTIVITY

» GDP contracted slightly in the first quarter, confirming that the economy stagnated. We now expect growth to reach +0.7% in 2019.





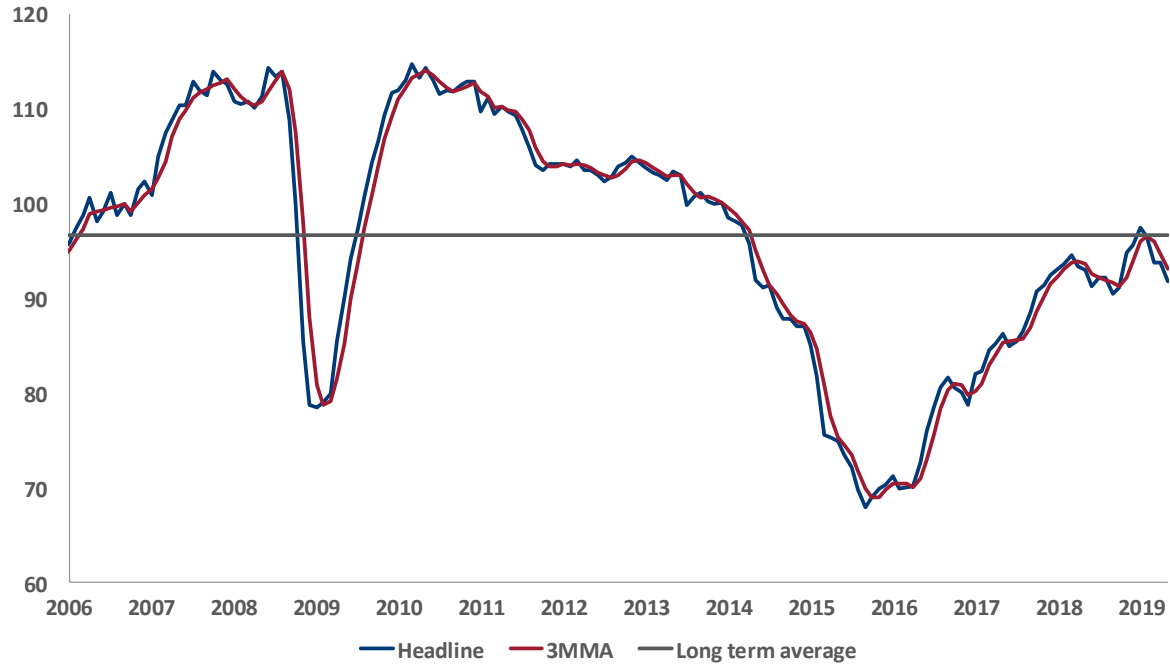
» The lack of clarity about the prospects for pension reform has kept economic uncertainty high, therefore restraining growth.



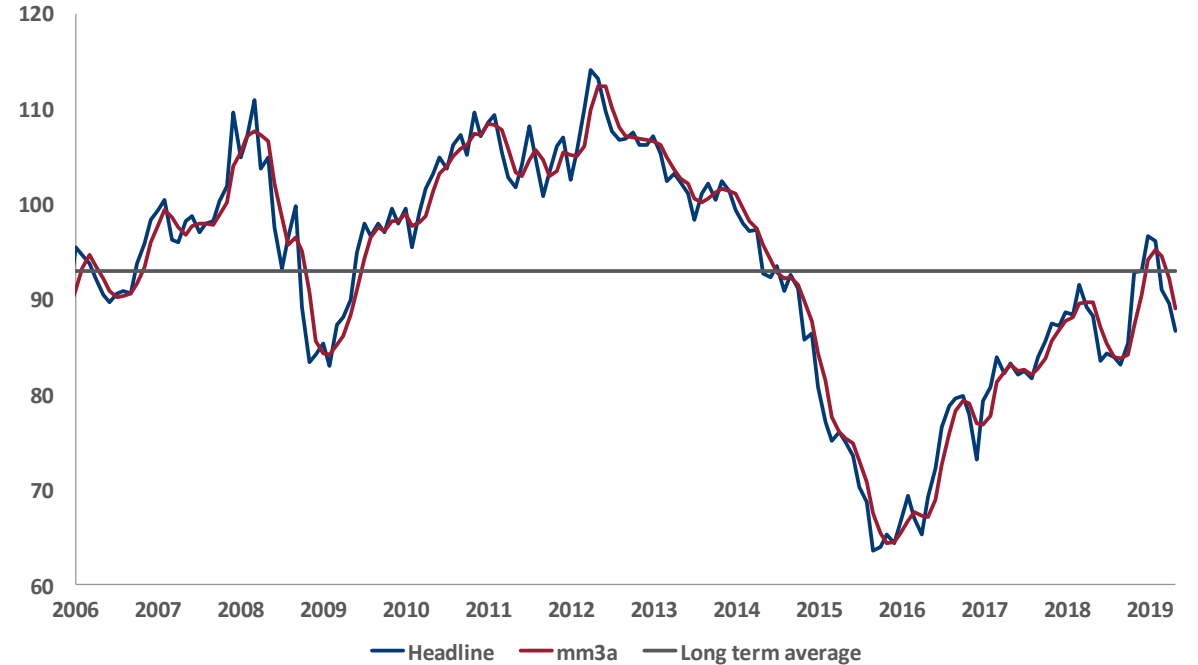
# BRAZIL: ACTIVITY

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

Business Confidence (FGV)



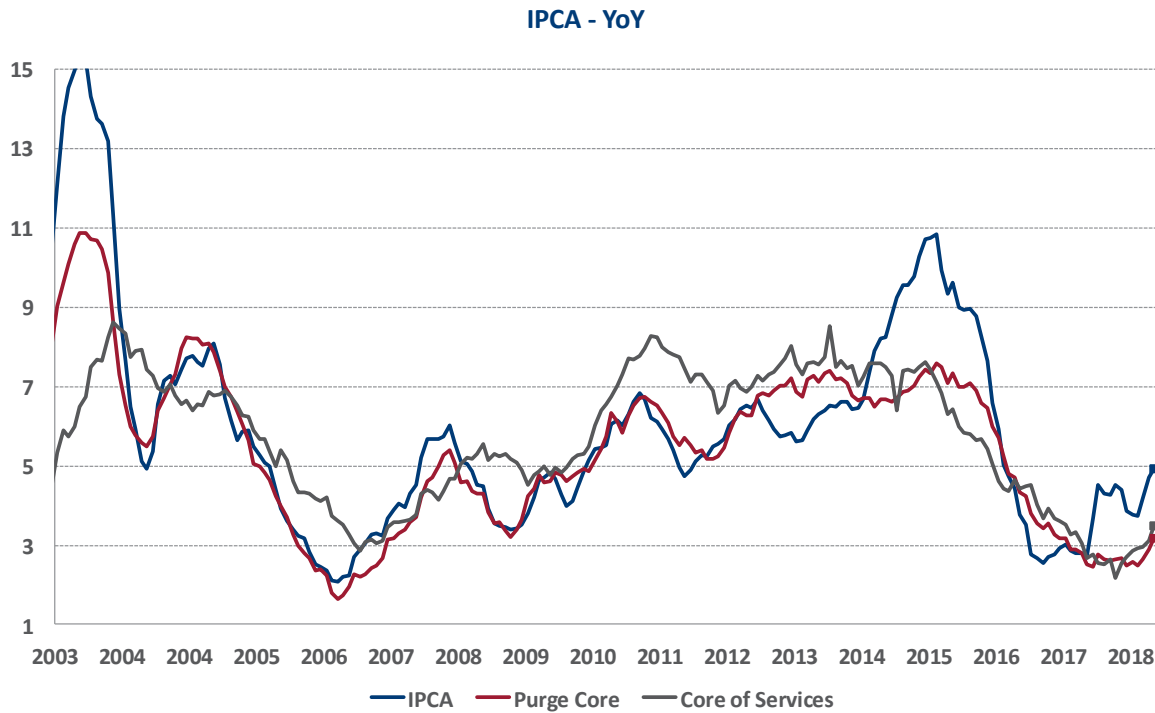
Consumer Confidence (FGV)



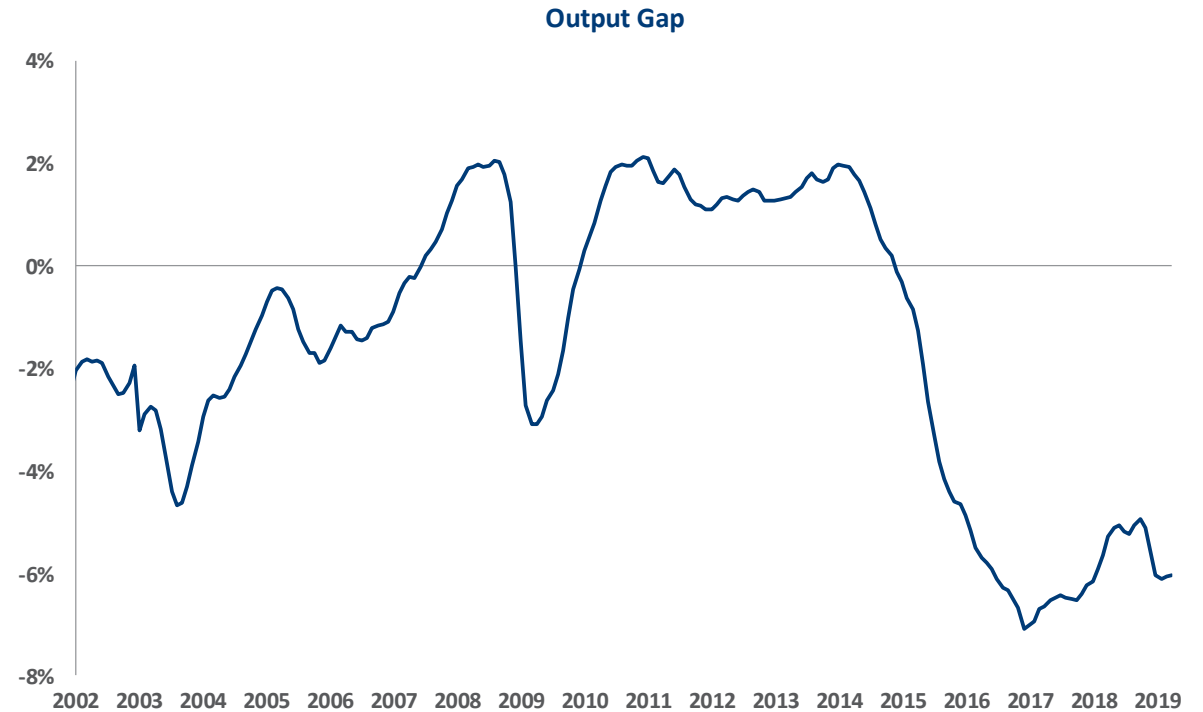


# BRAZIL: INFLATION

» Core inflation measures have been running at low levels.



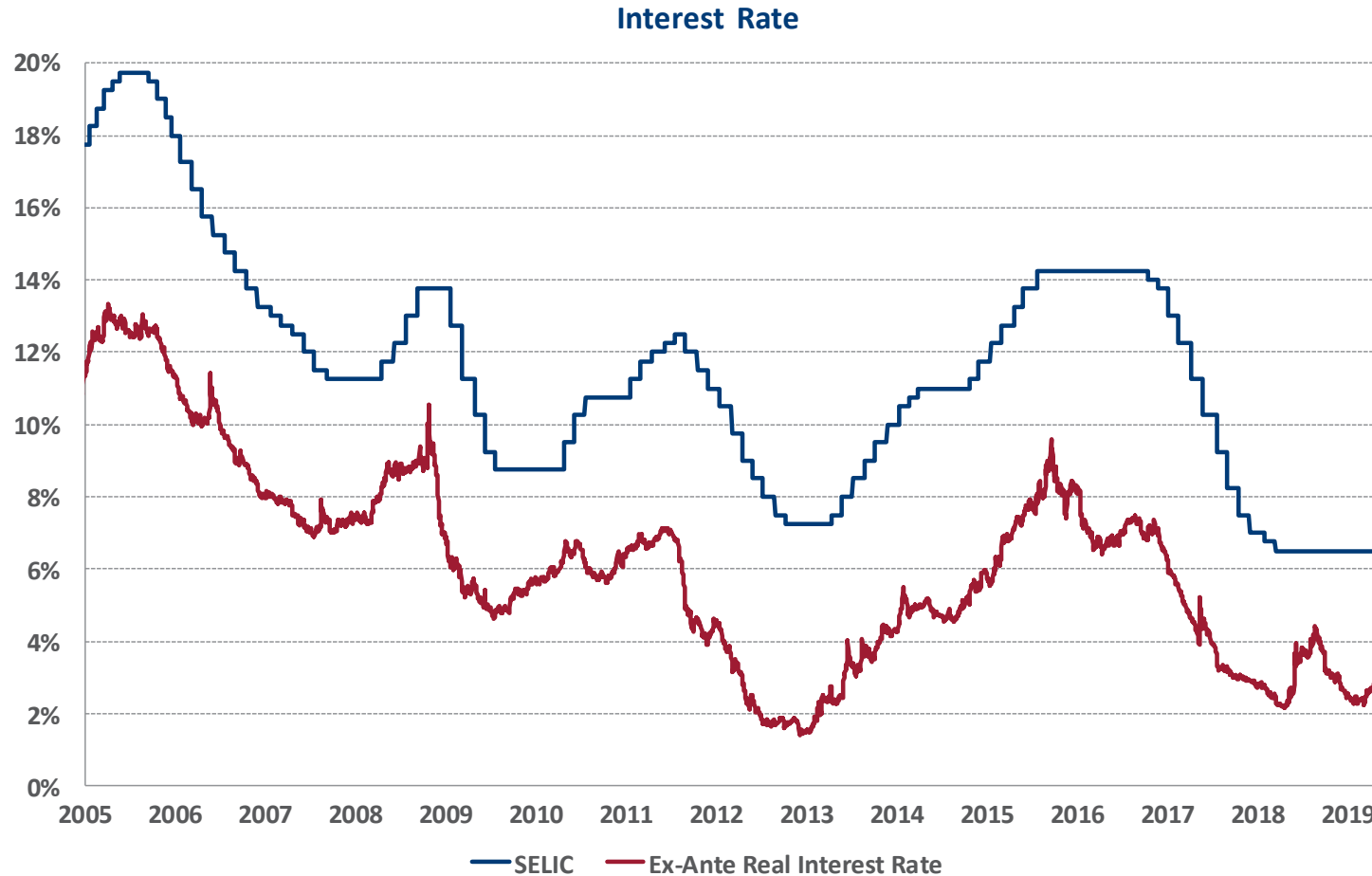
» The output gap remains large and continues to put downward pressure on inflation.



# BRAZIL: INFLATION

Baseline Scenario											
Exchange rate of 4.00 in 2019 and 2020											
Selic: 5.50% 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%
<b>4T16</b>	<b>6,3%</b>	<b>6,6%</b>	<b>5,5%</b>	<b>5,8%</b>	<b>5,2%</b>	<b>6,5%</b>	<b>4,8%</b>	<b>9,4%</b>	<b>-7,1%</b>	<b>-3,3%</b>	<b>13,8%</b>
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%
<b>4T17</b>	<b>2,9%</b>	<b>1,3%</b>	<b>8,0%</b>	<b>3,1%</b>	<b>0,9%</b>	<b>4,5%</b>	<b>3,6%</b>	<b>-4,9%</b>	<b>-6,2%</b>	<b>1,1%</b>	<b>7,0%</b>
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%
<b>4T18</b>	<b>3,7%</b>	<b>2,9%</b>	<b>6,2%</b>	<b>2,5%</b>	<b>1,1%</b>	<b>3,3%</b>	<b>2,6%</b>	<b>4,5%</b>	<b>-5,6%</b>	<b>1,1%</b>	<b>6,5%</b>
1T19	4,6%	4,0%	6,3%	2,7%	1,4%	3,6%	3,0%	8,7%	-6,1%	0,9%	6,5%
<b>2T19</b>	<b>3,8%</b>	<b>3,7%</b>	<b>4,1%</b>	<b>2,8%</b>	<b>0,9%</b>	<b>4,1%</b>	<b>2,7%</b>	<b>6,9%</b>	<b>-5,9%</b>	<b>0,9%</b>	<b>6,5%</b>
3T19	3,5%	3,4%	3,7%	2,3%	0,2%	3,5%	2,4%	7,7%	-5,6%	0,8%	6,0%
<b>4T19</b>	<b>3,9%</b>	<b>3,1%</b>	<b>6,0%</b>	<b>2,2%</b>	<b>0,3%</b>	<b>3,5%</b>	<b>2,1%</b>	<b>6,6%</b>	<b>-5,4%</b>	<b>0,7%</b>	<b>5,5%</b>
1T20	3,7%	2,9%	6,2%	2,3%	0,1%	3,6%	1,8%	5,0%	-5,0%	1,0%	5,5%
2T20	3,6%	3,1%	5,0%	2,6%	0,8%	3,6%	2,2%	4,6%	-4,5%	1,3%	5,5%
3T20	3,6%	3,3%	4,3%	2,8%	1,0%	3,7%	2,4%	4,8%	-4,2%	1,6%	5,5%
<b>4T20</b>	<b>3,9%</b>	<b>3,8%</b>	<b>4,3%</b>	<b>2,9%</b>	<b>0,9%</b>	<b>3,7%</b>	<b>2,5%</b>	<b>6,2%</b>	<b>-4,0%</b>	<b>1,9%</b>	<b>5,5%</b>

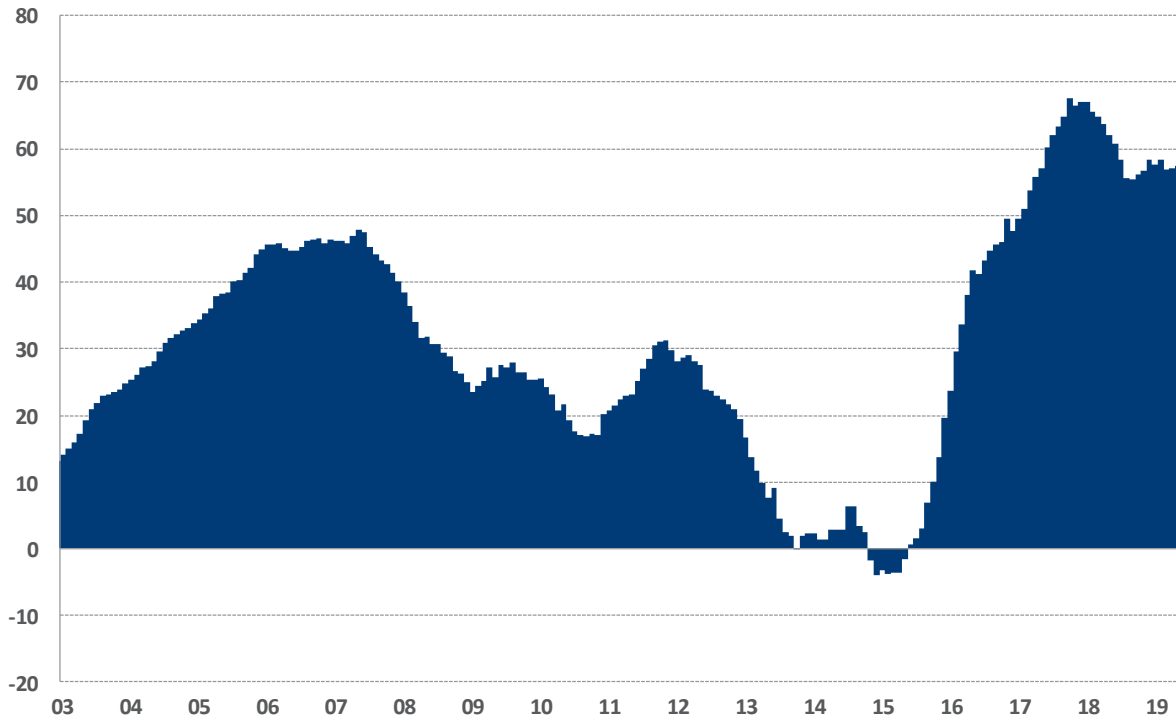
» A favorable inflation outlook, combined with low growth and pension reform approval, allows the Central Bank to lower interest rates to +5.5% in the second half of the year.



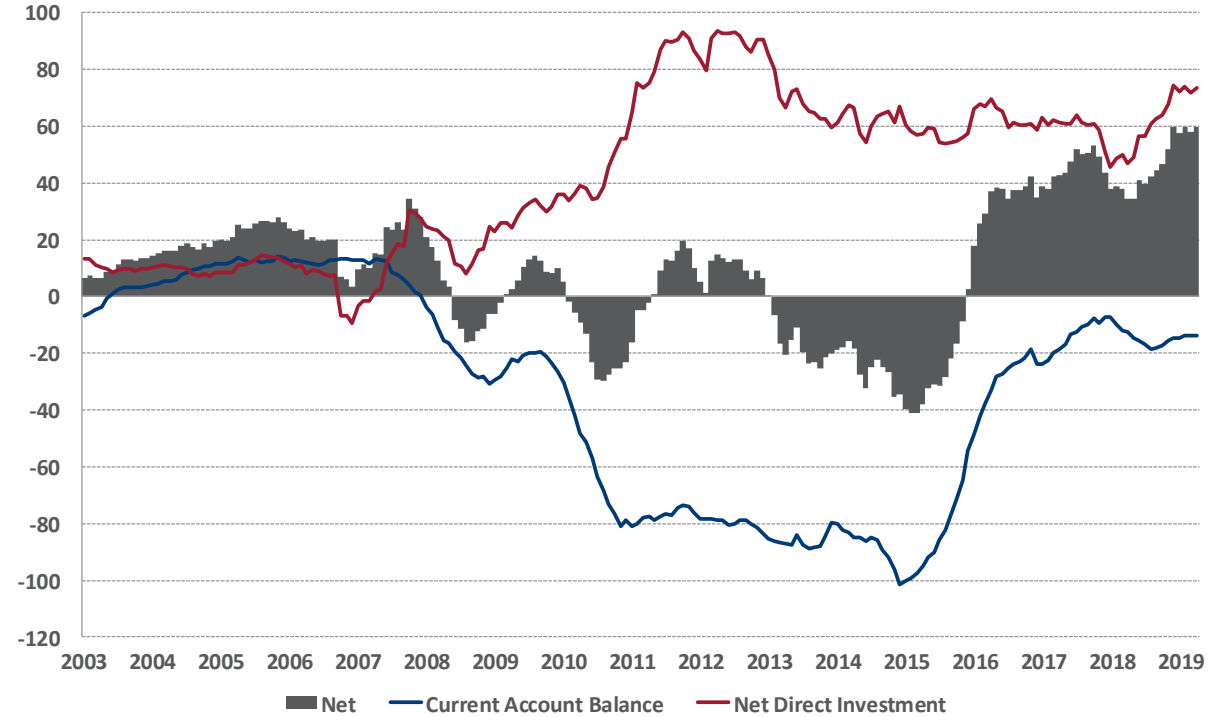
# BRAZIL: EXTERNAL

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

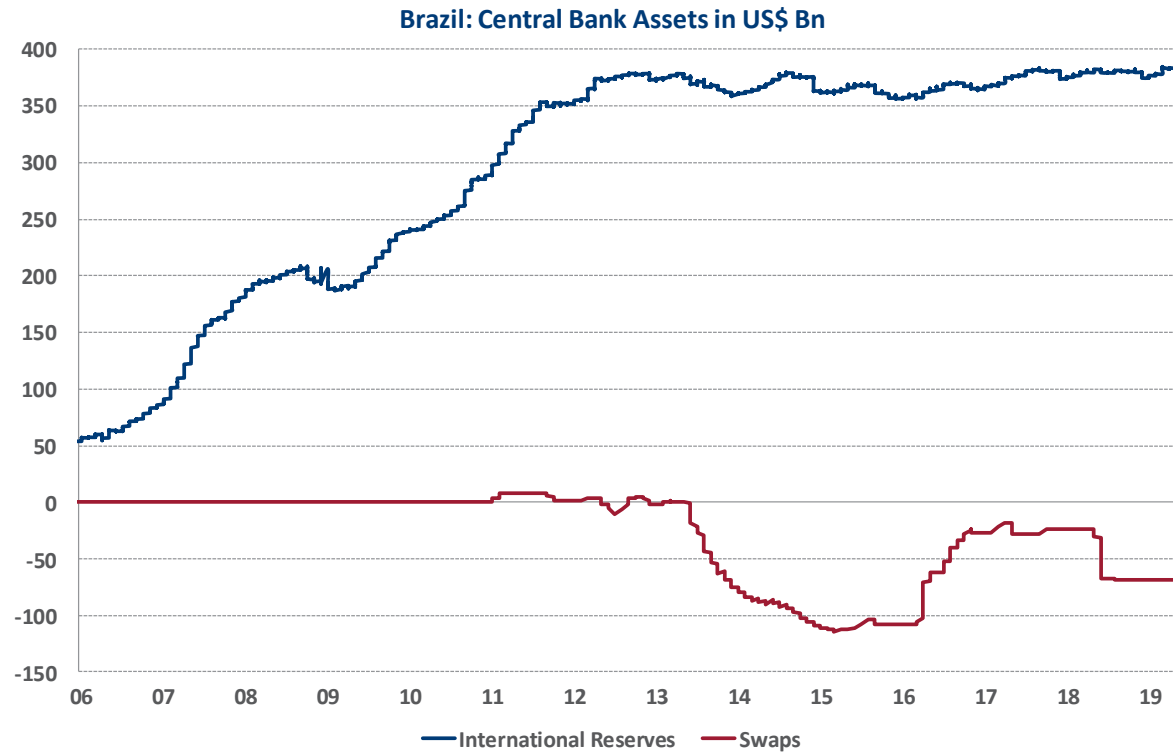
Trade Balance - US\$ Billion in 12m



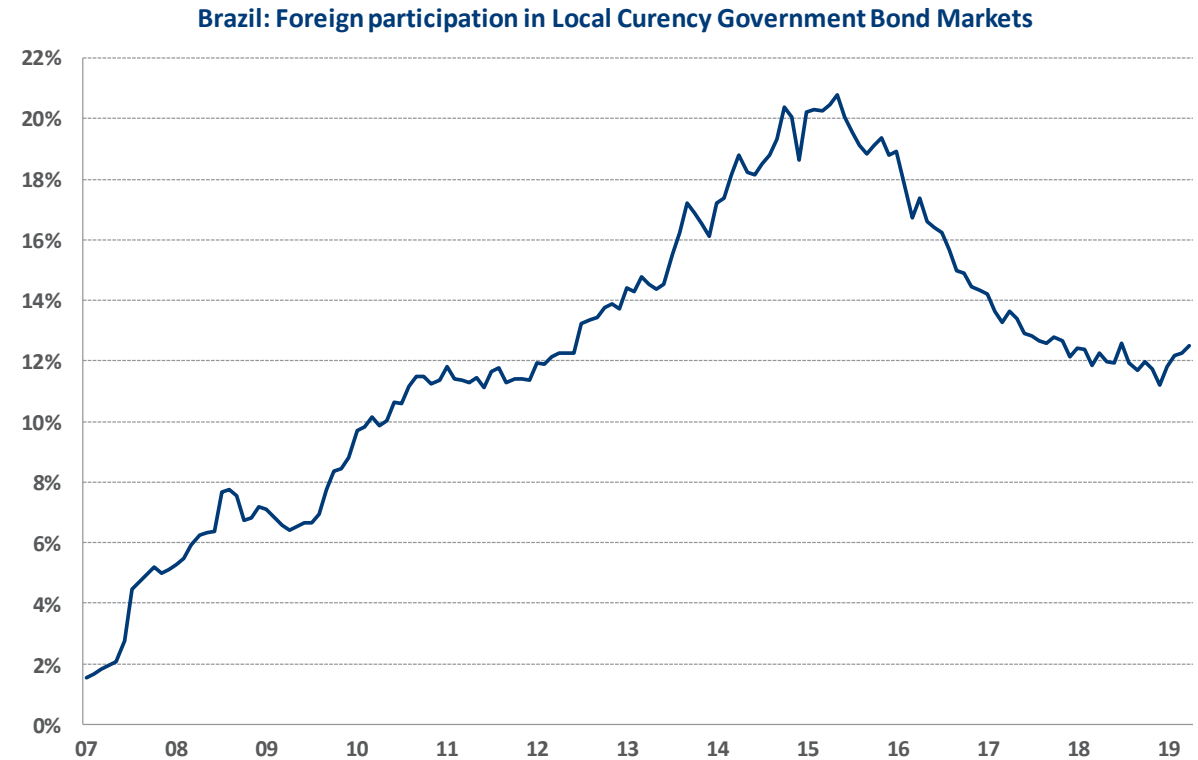
Current Account vs Net Direct Investment - US\$ Billion in 12m



» Central Bank holds substantial international reserves.



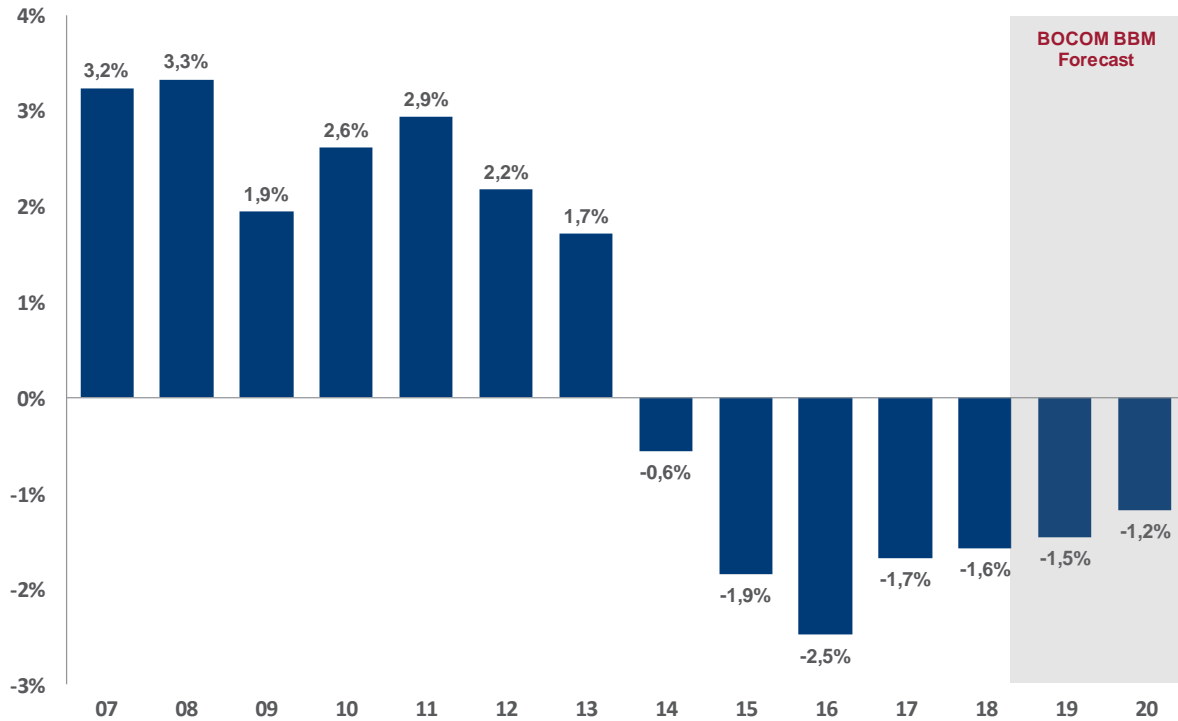
» Government domestic debt exposure to foreign investors continues to fall.



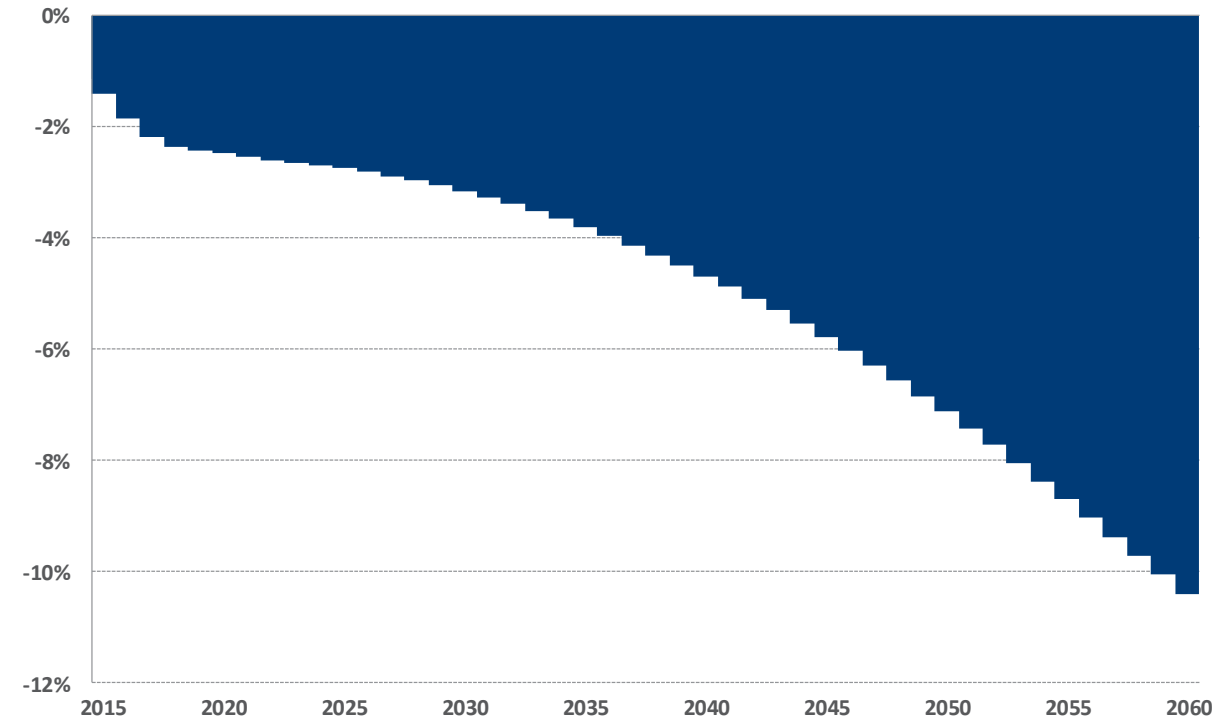
» Fiscal policy remains the main challenge: the country has run a primary deficit for 6 years.

» Social security deficit (RGPS) is rapidly increasing.

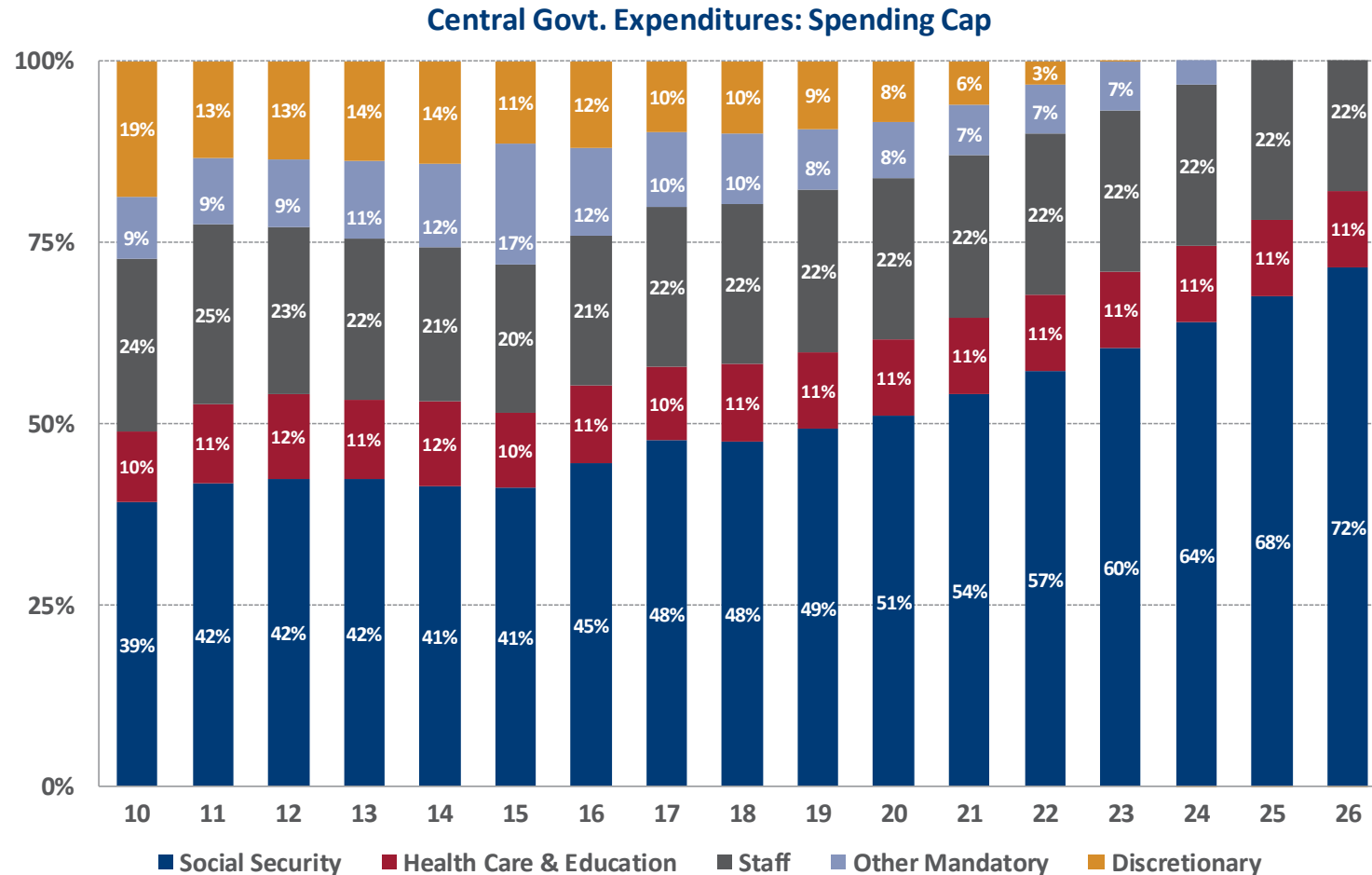
Public Sector Primary Balance - % GDP



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.

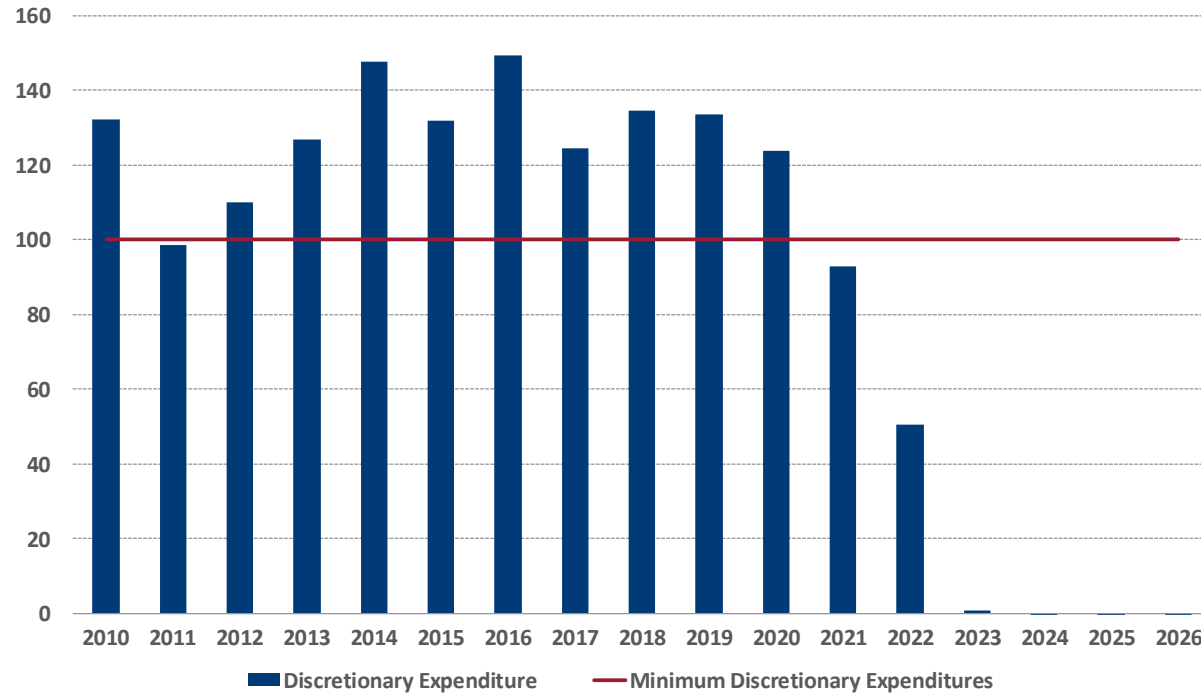




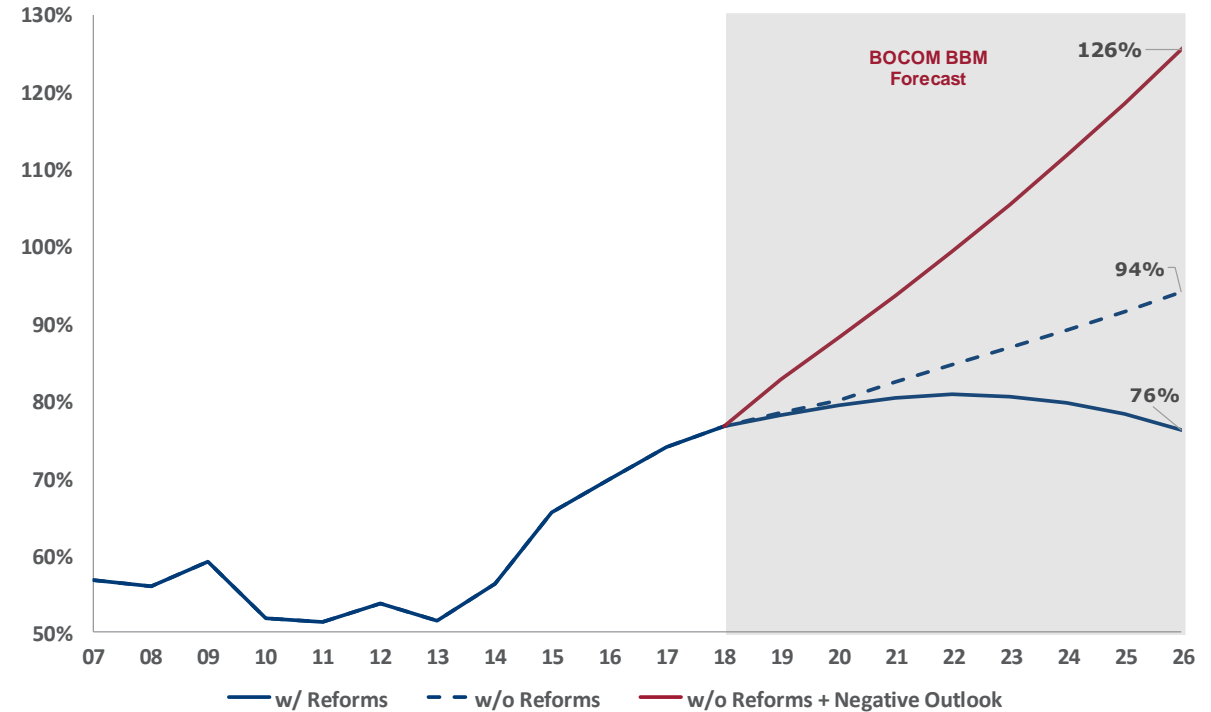
» The spending cap will be hard to sustain already in 2020.

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

Discretionary Expenditures  
R\$ Billion



General Government Gross Debt - % GDP



## PENSION REFORM CALENDAR

- »» May 7: First session in the Special Commission
  - »» May 30: Amendments' deadline
  - »» June 7-11: Samuel Moreira (rapporteur) presents his report
  - »» Late June: Commission debates and votes the report
  - »» Early July (before the recess): Lower House vote?
- »» Our expectation is that reform approval will only occur in the 3<sup>rd</sup> quarter, with savings of BRL 670bn in 10 years.

# BRAZIL: FISCAL

Measure	BRL bn saved in 10y (2020 - 2029)	Current Situation		Positive Scenario		Baseline		Negative Scenario	
<b>Private sector</b>	<b>808</b>	<b>724</b>	<b>(90%)</b>	<b>724</b>	<b>(90%)</b>	<b>536</b>	<b>(66%)</b>	<b>348</b>	<b>(43%)</b>
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	
<b>Social assistance</b>	<b>204</b>	<b>169</b>	<b>(83%)</b>	<b>85</b>	<b>(41%)</b>	<b>0</b>	<b>(0%)</b>	<b>0</b>	<b>(0%)</b>
Salary Allowance	169	169		85	(50%)	0	(0%)	0	
BPC	35	0	(0%)	0		0		0	
<b>Public servants (Federal)</b>	<b>225</b>	<b>225</b>		<b>126</b>	<b>(56%)</b>	<b>126</b>	<b>(56%)</b>	<b>0</b>	<b>(0%)</b>
Restriction in access, parity and integrality / Transition rules	197	197		98	(50%)	98	(50%)	0	
Progressive contribution rates	28	28		28		28		0	
<b>Public sector (Military)</b>	<b>10</b>	<b>10</b>		<b>10</b>		<b>10</b>		<b>10</b>	
Pension reform	97	97		97		97		97	
Career restructuring	-87	-87		-87		-87		-87	
<b>Total</b>	<b>1247</b>	<b>1128</b>	<b>(90%)</b>	<b>945</b>	<b>(76%)</b>	<b>672</b>	<b>(54%)</b>	<b>358</b>	<b>(29%)</b>
<b>Total in % GDP</b>	<b>2,5%</b>	<b>2,2%</b>		<b>1,9%</b>		<b>1,3%</b>		<b>0,7%</b>	

# CONTENT

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»» GLOBAL: TRADE WAR STRIKES BACK

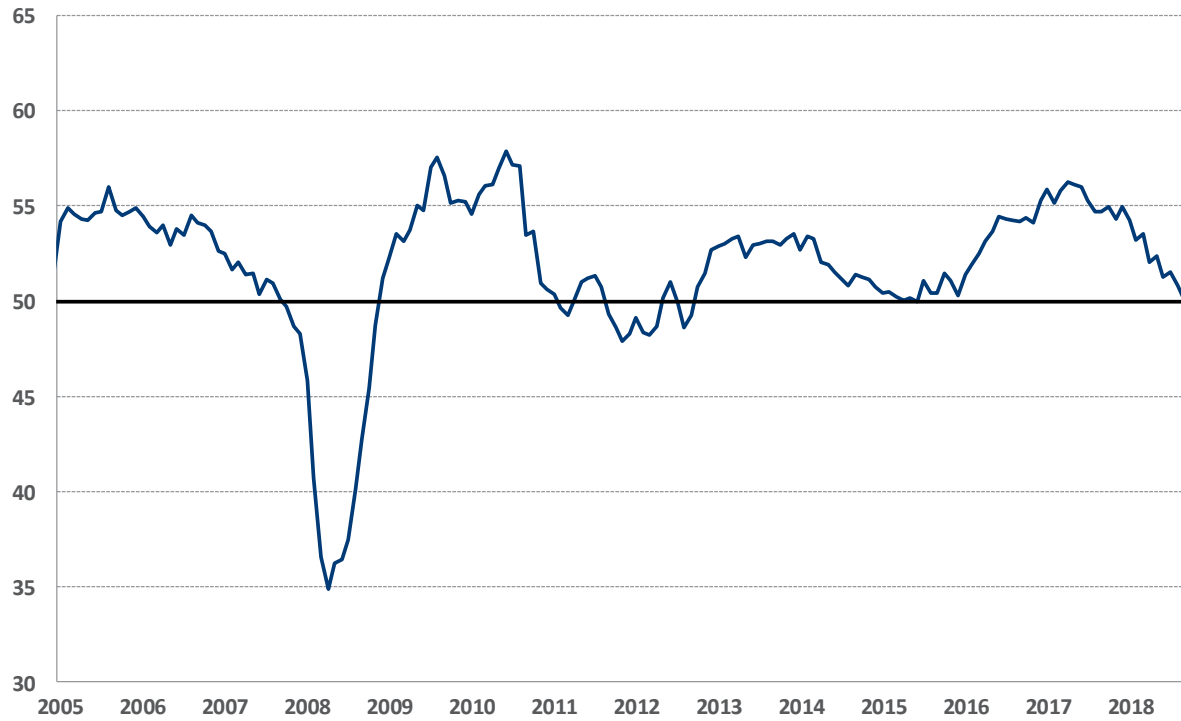
»» MARKETS: RECENT TRENDS

## TRADE WAR STRIKES BACK

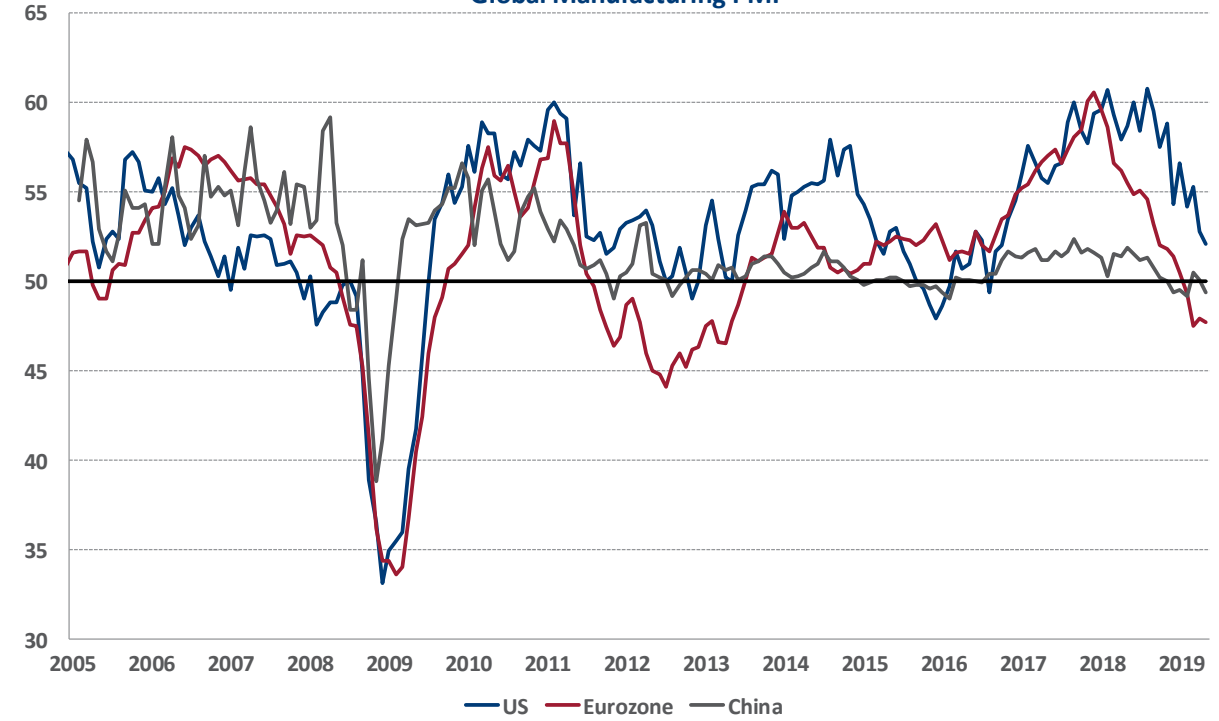
- » May 10: Trump raised tariffs on \$200bn of imports from China from 10% to 25%.
- » May 20: Trump blacklisted Huawei.
- » May 31: Trump promised a 5% tariff on imports from Mexico on June 10 (tariffs will increase to 25% if illegal immigration is not interrupted).
- » 28-29/Jun: Trump meeting with Xi at G20 meeting in Japan.
- » July: US implements 25% tariffs on remaining \$300bn of imports from China.

» Trade war escalation increase the risk of a significant slowdown of the global economy.

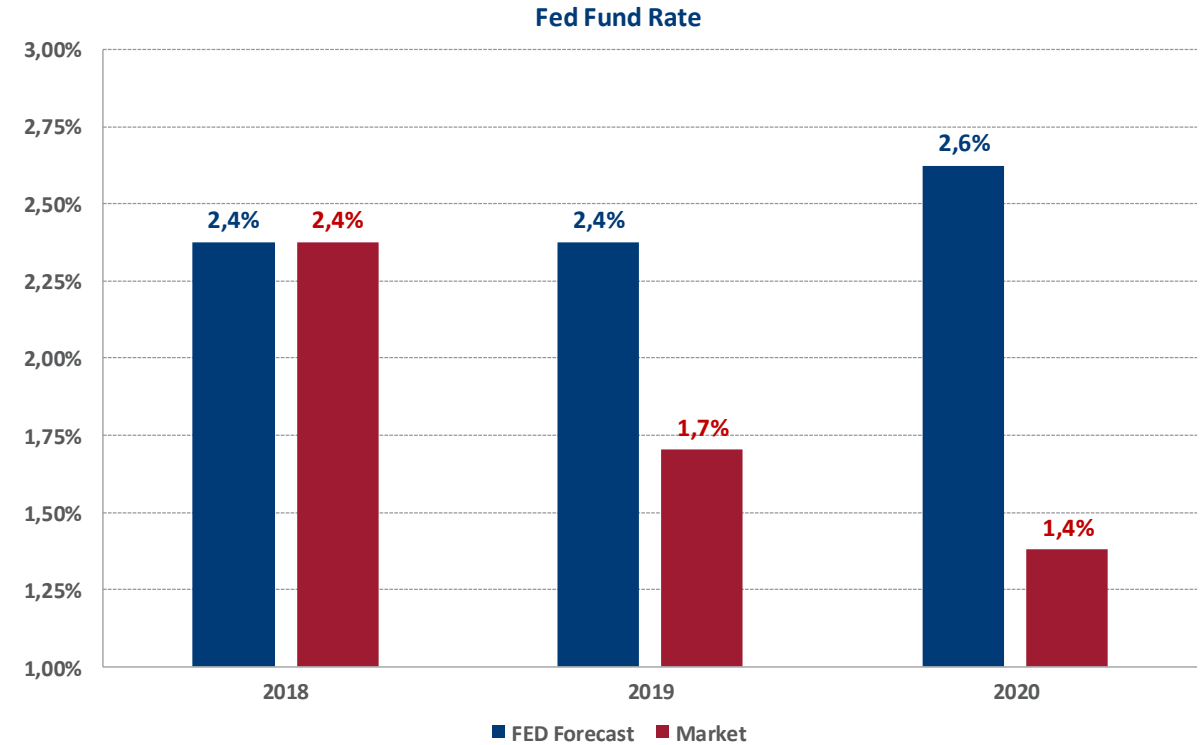
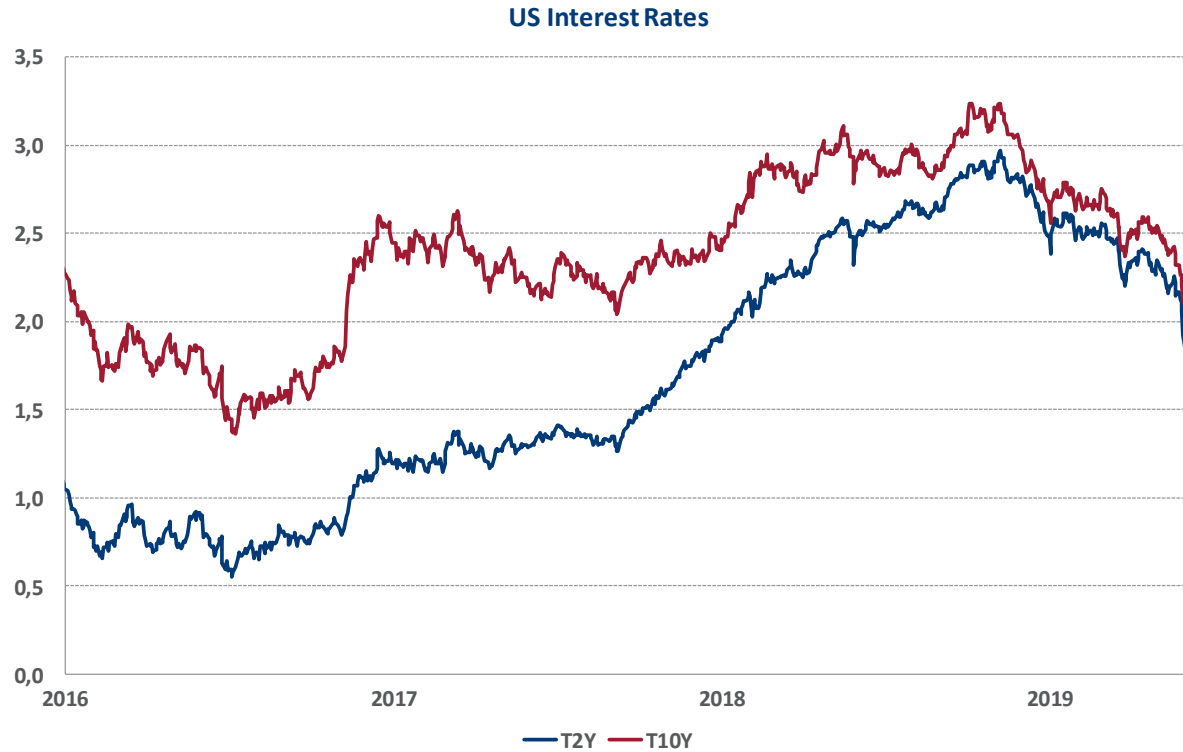
Global Manufacturing PMI



Global Manufacturing PMI



» US interest rates are falling to accommodate the trade war shock and a FED interest rate cut is now on the radar.





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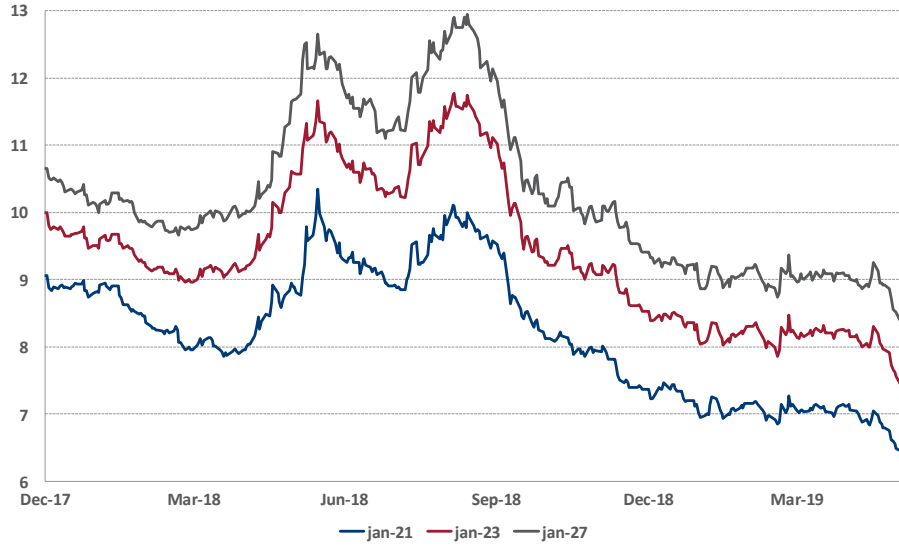
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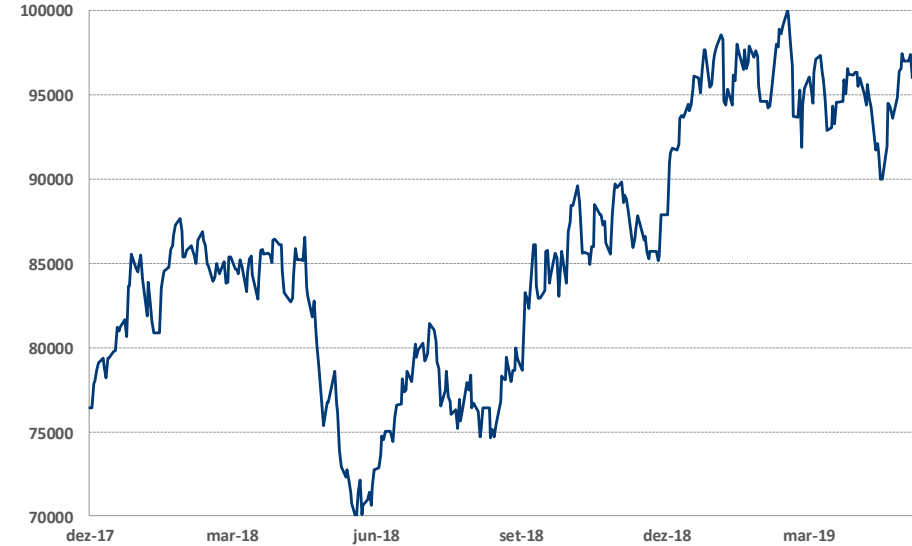
»» MARKETS: RECENT TRENDS

# BRAZIL: MARKETS

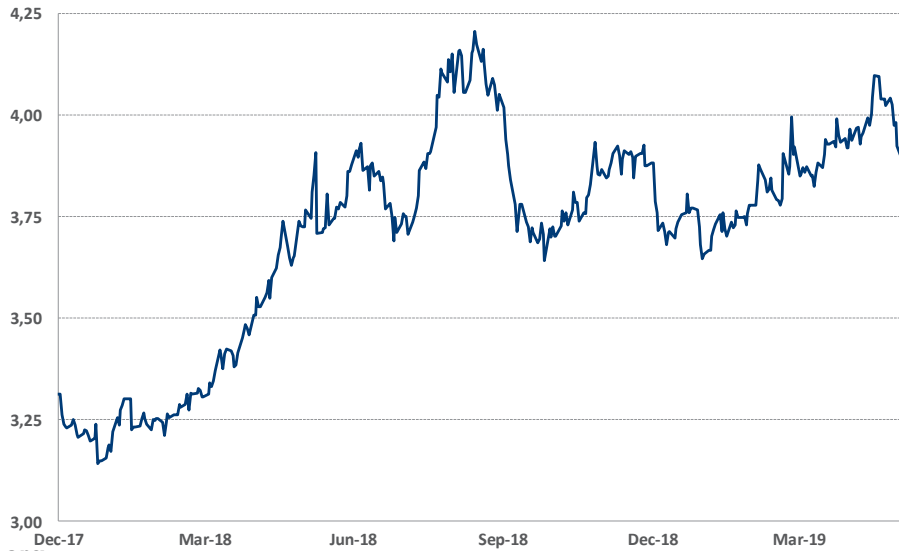
Spot Nominal Interest Rate (DI Curve)



Ibovespa



BRL Currency



CDS 5 Years



# GLOBAL: MARKETS

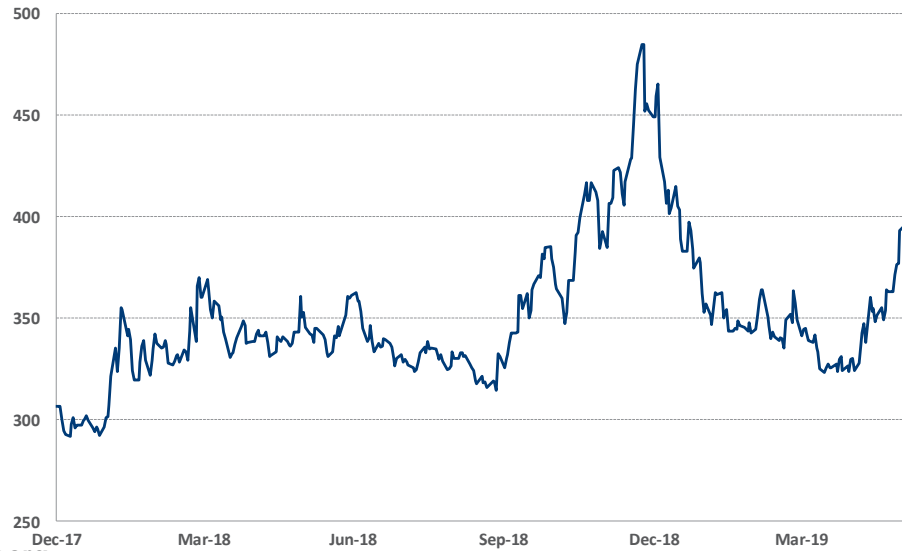
SPX Index



VIX Index



CDX High Yield Spread



Nominal Dollar Trade Weighted (FED)



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