

Monthly Macro Letter

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Trade War Strikes Back

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The global outlook has remained highly challenging in 2019, with several factors moving in opposite directions. On one hand, the world economic slowdown proceeds, with the US, China and Europe all losing traction. On the other, the Fed has pivoted to a more dovish stance, putting the normalization of interest rates on hold and signaling that it will stop reducing its balance-sheet.

Global financial conditions improved during the first half, after the correction seen at end-2018. Despite the slowdown, the Fed's dovish pivot and the prospect of a US-China trade deal suggested the possibility of a soft landing for the world economy, benefiting asset prices in general. However, these hopes have been dampened in the last few weeks.

US-China negotiations were unexpectedly broken off, leading to another escalation of the trade war, which has now been extended into the high-tech arena. In addition, the US has opened up a new front in the trade war by announcing that it will impose tariffs on imports from Mexico.

The trade war escalation has significantly increased the risk of a global hard landing and revived the possibility of rate cuts by the Fed. The most alarming problem, however, is the lack of any short-term prospect of a reduction in tension on either front.

Turning to the domestic outlook, the performance of the Brazilian economy remains disappointing. GDP contracted 0.2% in the first quarter, and we have again revised down our growth forecast for 2019, which is now only 0.7%. The global economic slowdown is hardly helpful to Brazil in this context.

Inflation shows signs of decelerating, largely owing to the normalization of gasoline and food-at-home prices. The effect of the truckers' strike will exit the base for the IPCA in June, lowering 12-month inflation to about 3.5%, from 5.0%. The output gap also remains high, keeping core inflation well-behaved. We forecast 3.9% in 2019, making this the third consecutive year with below-target inflation.

In the political arena, tension between the executive and legislative branches appears to have diminished, improving the chances that pension reform will be passed by Congress before the midyear recess. Reflecting this improvement, the markets were calmer at end-May, with the stock exchange gaining, the USDBRL exchange rate falling, and the yield curve rallying.

However, lack of confidence and mistrust prevail in Brasília, the federal capital. Pension reform appears to have become a minimum agenda that will be achieved

with or without successful negotiations between the executive and legislative branches, but doubts remain about the size of the reform. Accidents and setbacks can still happen, and a minimum of dialogue is needed if the reform agenda is to move ahead.

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%	0,7%	1,9%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	3,9%	3,9%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	5,50%	5,50%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,7%	10,8%
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%	-1,5%	-1,2%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	78,2%	79,5%

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