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Heat waves

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With the approach of summer in the southern hemisphere, the global and local outlooks also appeared to be headed for rising temperatures, both political and economic. In the global economy, the expected US-China "Phase 1" trade deal – which would halt the global trade slowdown – has yet to materialize, leaving the destiny of the December tariff hikes uncertain. Mass protests in Chile, alongside similar events in Peru and Colombia, weighed on the region's currencies. Nevertheless, global economic activity continued to expand. In Brazil, the economic recovery became more evident, and localized inflationary pressures led us to revise up our 2019 inflation projection to 3.7%.

Globally, and especially in the US, economic data continued to bring good news in the quarter, reinforcing the perception that the basic scenario is still of moderate growth, not a recession. The US economy appeared set to continue growing at about 2% until year-end, and the expected deceleration in 2020 will occur in the context of a tight labor market, which should limit the fall in consumption. However, the US-China trade dispute remains a concern and the much anticipated trade agreement has yet to be finalized. Market volatility has been fueled by the two sides' conflicting statements on the negotiations, highlighting the importance of a deal to the outlook for growth next year. The Hong Kong protests added a complicating factor to the deal, especially after Congress passed the Human Rights and Democracy Act, triggering warnings by the Chinese administration.

The uncertainty surrounding the trade agreement was intensified by political instability in several South American countries, especially Chile, where mass unrest raged during the month. The region's currencies depreciated sharply: the Chilean peso plunged almost 9% in the month, the Colombian peso lost 4%, and the Peruvian sol fell 2%. The Brazilian real dropped 5.5% against the US dollar, owing both to the impact of depreciation in neighboring countries and also to a deterioration in its own balance of payments. Following the inclusion of new data sources, the Central Bank of Brazil has been revising the external accounts, and the current-account deficit is now close to 3% of GDP instead of the previously announced 1.3%. Although the deficit is still easily financed, FDI downward revisions (from 5% to 4.3% of GDP), and smaller inflows of foreign portfolio investment point to a less comfortable balance-of-payments position in 2020.

The good news was the consolidation of a better growth pace of GDP. Third-quarter growth was 0.6% compared with the previous quarter, above expectations, suggesting a pick up in pace over the first half of the year. With the recovery in investment and the consistency of private consumption being the main drivers of growth, the high-frequency indicators suggest that growth proceeded at this stronger pace in the closing months of 2019, leading us to revise up our 2019 forecast to 1.2% (from 0.9% previously). Our projection for 2020 is now 2.1%, with a possible pickup in the investment rate. The benign inflation outlook for the coming quarters, alongside historically low interest rates, reinforces expectations of a more predictable and sustained recovery cycle going forward.

In this context, the Central Bank should proceed with the previously suggested 50 bps cut in the Selic rate in December. We expect it to end the easing cycle with a final cut of 25 bps at the February meeting, taking the Selic to 4.25% p.a. However, we acknowledge the reasonable probability that the monetary authorities might decide against this last rate cut given the faster pace of the recovery and in response to uncertainty about the economy's reaction, in line with the "Brainard principle" discussed in our last letter.

ECONOMIC FORECASTS	2013	2014	2015	2016	2017	2018	2019 F	2020F
GDP Growth (%)	3,0%	0,5%	-3,5%	-3,3%	1,3%	1,3%	1,2%	2,1%
Inflation (%)	5,9%	6,4%	10,7%	6,3%	2,9%	3,7%	3,7%	3,6%
Policy Rate (%)	10,00%	11,75%	14,25%	13,75%	7,00%	6,50%	4,50%	4,25%
Unemployment Rate (%)	6,8%	7,1%	9,6%	12,6%	12,4%	12,2%	11,4%	10,9%
Trade Balance (US$ bn)	3	-4	20	48	67	53	42	35
Current Account Balance (US$ bn)	-75	-104	-59	-23	-10	-42	-52	-50
Current Account Balance (% of GDP)	-3,0%	-4,3%	-3,3%	-1,3%	-0,7%	-2,2%	-3,1%	-3,0%
Fiscal Primary Balance (% of GDP)	1,7%	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,5%	-0,9%
Government Gross Debt (% of GDP)	51,7%	57,2%	66,2%	69,4%	74,0%	76,7%	78,3%	79,3%