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Year of the Rat

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2020 will be the year of the Rat, the first of the 12 animals in the zodiac in the Chinese horoscope, and according to it Rat years are of renewals and new beginnings. From an economic perspective, the scenario for 2020 points to the renewal of the global growth cycle of the past few years, and the beginning of a more consistent growth cycle in Brazil.

After a year of global economic activity deceleration, we expect, for this new year, a slight recovery in the pace of economic growth, to 3.3% - an improvement due to a faster pace in emerging markets (ex-China). The world's largest economies, US and China, should present a more moderate growth rate, as their economies adapt to a scenario of permanent geopolitical tensions. The risks of a recession in the US, in the short term, seem to have been pushed aside, as the labor market remains very strong at the turn of the year and monetary policy remains stimulative, supporting domestic consumption. Nevertheless, the rise in tensions in the Middle East and the electoral dispute in the second half of the year could be sources of noise over the next quarters, increasing the uncertainty related to the robustness of the growth cycle.

In Brazil, the forecast is for a year of low inflation (for Brazilian standards), the consolidation of a long-awaited acceleration in growth, and interest rates in historically low levels. More specifically, we expect GDP to grow 2.1% - with upside risks – after three years of a slow 1.2% pace. The acceleration will come on the back of very healthy personal consumption and the rebirth of a robust investment cycle. However, we anticipate only a moderate decrease in the still high unemployment rate, a development which masks the real improvement in formal employment as formal jobs are being created and substituting informal ones.

A theme that we believe might receive attention in 2020 is the real level of the output gap and the rate of output growth consistent with the Brazilian economy's potential. With the 2015/16 recession followed by a tepid recovery, the level of investments remains almost 20% below pre-recession levels, and the Investment/GDP ratio has decreased to close to 17%. After such a protracted period of overall investment decrease and low public investments due to fiscal limitations, the quality of the remaining productive capital is therefore questionable. According to IBGE, between 2014 and 2017, thirty thousand industrial companies were shut down, a 7% decrease of the sector. If we use 2013 – the height of the previous growth cycle – as a benchmark, the decrease is closer to 11%. This data is not yet available for 2018, a year in which growth was again frustrated.

In this environment, in which the uncertainty surrounding the economy's potential growth rate and its productive capital are particularly high, and the economy's growth capacity will only become clear as the recovery takes shape, it is especially important from the point of view of the Central Bank to treat cautiously longer-term forecasts

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of inflation and growth. As a result, we believe that monetary policy should start to be normalized by the end of 2020, with the Selic rate reaching 6.5% by 2021. This movement would aim to ensure that the current benign inflation levels_are consolidated around the decreasing inflation targets over the next two years. In this scenario, we forecast the CPI to be around 3.7% until the end of 2021.

The reform agenda in Congress should remain as an important attention point, not only in the spirit of improving the country's fiscal perspectives and keeping the budget's "expenditure ceiling" viable, but also to improve the efficiency of public expenditure and create room for further public investments. We believe that the two most important reforms being considered in Congress are the "Emergency" Constitutional Amendment in the Senate (which is compatible with Amendment 438 currently being considered by the House) and the Administrative Reform, which have chances of being approved by the end of the first semester. In this environment, and given the improvement in the expected paths of Debt/GDP ratios, we expect credit ratings upgrades throughout the year. The investment grade will, however, still take some time to be obtained again.

ECONOMIC FORECASTS	2014	2015	2016	2017	2018	2019 F	2020F	2021F
GDP Growth (%)	0,5%	-3,5%	-3,3%	1,3%	1,3%	1,2%	2,1%	2,5%
Inflation (%)	6,4%	10,7%	6,3%	2,9%	3,7%	4,0%	3,7%	3,7%
Unemployment Rate (%)	7,1%	9,6%	12,6%	12,4%	12,2%	11,9%	11,1%	10,7%
Policy Rate (%)	11,8%	14,3%	13,8%	7,0%	6,5%	4,5%	4,75%	6,5%
External Accounts								
Trade Balance (US$ bn)	-4	20	48	67	53	47	37	40
Current Account Balance (US$ bn)	-104	-59	-23	-10	-42	-52	-61	-60
Current Account Balance (% of GDP)	-4,3%	-3,3%	-1,3%	-0,7%	-2,2%	-2,9%	-3,2%	-2,5%
Fiscal Policy								
Fiscal Primary Balance (% of GDP)	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-1,5%	-1,5%	-0,9%
Government Gross Debt (% of GDP)	57,2%	66,2%	69,4%	73,7%	76,5%	77,5%	78,5%	77,9%

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