

Monthly Macro Letter

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Going viral

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The COVID-19 epidemic, which began in China in January, became global during the course of February. By the end of the month the number of people infected with the virus approached 90,000, with almost 3,000 deaths. China accounted for 92% of those infected and 95% of the deaths, but the virus has spread swiftly, and the number of cases soared in countries such as Italy and South Korea, with cases reported in more than 30 countries. The perception that the negative impact of the epidemic, via disruption of supply chains and falling consumption, will be both long-lasting and widespread led to a wave of downward revisions to global growth forecasts. The OECD now projects that World GDP will grow 2.4% this year, the lowest since 2009 and half a percentage point less than 2019 growth.

Although the Chinese economy was gradually returning to normal as March began, economic activity remained much slower than usual, pointing to a first-quarter contraction. Downward revisions to forecasts of Chinese and global growth fueled a marked rise in uncertainty, and this in turn drove a wave of risk aversion in financial markets. Stock exchanges fell sharply around the world, with the S&P 500 and the Euro Stoxx 50 losing 8.4% and 8.6% respectively throughout the month. Emerging-market currencies also suffered from a surge in demand for dollars, and the Brazilian Real depreciated almost 4.5%.

Governments and central banks reacted to the deteriorating outlook by announcing measures to support the global economy. China's central bank (PBoC) was the first to move, cutting its policy interest rate, providing liquidity for banks, and stimulating credit for small and medium enterprises. Fiscal policy also has a role to play, with spending on infrastructure set to rise, especially in smaller cities. In the US, in early March the Fed delivered a half-point rate cut to 1%-1.25% in a rare intermeeting decision, and other central banks – including Brazil's – have signaled they might follow suit in the weeks ahead. In Europe, where rates are already negative, fiscal expansion could be part of the response.

Taking into account the signal given by the Central Bank of Brazil, we now expect the Selic rate to be lowered by 25 bps to 4% at the March 18 meeting, where it should remain until the end of 2020. We now expect the normalization of the Selic rate to start only in 2021, reaching 6% p.a. throughout the year. The monetary authorities will want to argue for caution amid so much uncertainty, not least regarding the global growth outlook and the time it could take for a global recovery to get under way.

The COVID-19 epidemic may adversely affect the Brazilian economy through two main transmission channels: lower exports; and through disruptions in the supply of imported components, especially for appliances and automotive vehicles, which have China as their main supplier. Exports are set to fall due to both lower commodity prices and weaker demand from Brazil's main trade partners, especially China. The extent of the disruption in imports is still uncertain, and so far incipient. We have

revised down our 2020 GDP growth projection to 1.9%, based on the expectation that the impact of the shock will be limited. We will continue to closely monitor the evolution of the epidemic and its effects on Brazilian economy in the coming weeks.

ECONOMIC FORECASTS	2014	2015	2016	2017	2018	2019	2020F	2021F
GDP Growth (%)	0,5%	-3,5%	-3,3%	1,3%	1,3%	1,1%	1,9%	2,5%
Inflation (%)	6,4%	10,7%	6,3%	2,9%	3,7%	4,3%	3,3%	3,7%
Unemployment Rate, SA (%)	7,1%	9,6%	12,6%	12,4%	12,2%	11,7%	11,0%	10,7%
Policy Rate (%)	11,8%	14,3%	13,8%	7,0%	6,5%	4,5%	4,0%	6,0%
External Accounts								
Trade Balance (US\$ bn)	-4	20	48	67	53	39	37	40
Current Account Balance (US\$ bn)	-104	-59	-23	-10	-42	-51	-61	-60
Current Account Balance (% of GDP)	-4,3%	-3,3%	-1,3%	-0,7%	-2,2%	-2,8%	-3,2%	-2,5%
Fiscal Policy								
Fiscal Primary Balance (% of GDP)	-0,6%	-1,9%	-2,5%	-1,8%	-1,6%	-0,9%	-1,5%	-0,9%
Government Gross Debt (% of GDP)	57,2%	66,2%	69,4%	73,7%	77,2%	75,9%	77,0%	76,0%

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