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Leaving the ICU

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In May the developed economies began relaxing the social restriction measures imposed in the previous months to contain the pandemic. Although the risk of a second wave of infections remained a major concern for the near term, transmission curves continued to decline in the developed world, driving relief rallies on global markets. Nevertheless, the global economy was in shaky health as it left the ICU and will take several quarters to recoup the vigor and pace seen before the pandemic.

Initial data for May suggested the lowpoint of economic activity was the month of April. Industrial production and retail sales improved moderately in both the US and Europe, and the Chinese economy appeared to be close to returning to pre-crisis production levels, with consumption lagging a little. However, the drop in global activity and demand will limit the pace of China's economic recovery in the next months.

In the US, where the number of deaths from COVID-19 passed the 100,000 mark, economic reopening produced signs of improvement in activity in May. Even the labor market showed surprising signs of improvement, falling to 13.3% in the month. The government and Congress are discussing fresh fiscal measures to add to an effort already corresponding to 14% of GDP, in an attempt to limit the scale and duration of the negative effects of the pandemic on the economy. Nevertheless, street protests and social unrest in most major cities could delay somewhat the incipient recovery.

In Brazil, relaxation plans were announced for June in Rio de Janeiro and São Paulo, as well as several other major cities, even though the number of deaths did not appear to have peaked. High-frequency activity data showed modest improvements in May compared with April, but the magnitude of the contraction remained very substantial for some indicators, such as car sales (-74% year over year in May).

First quarter GDP showed a limited hit from the social distancing measures, as most of them were only adopted in the second half of March. Nevertheless, it contracted 1.5% compared with the fourth quarter of 2019, mainly owing to a fall in services, with agriculture expanding 0.9% in the quarter. We expect most of the negative impact on GDP in 2020 to be concentrated in the second quarter, projecting a contraction of 20% year over year, with the third quarter remaining weak and a recovery beginning only late in the fourth. We therefore adopted our pessimistic scenario as our benchmark, forecasting a 5.8% decline in GDP followed by a recovery in growth to 3.8% in 2021.

This month we expect another cut of 75 bps in the Selic rate, to 2.25% p.a. Given this year's fiscal deterioration and the high level of public-sector debt, well above those of Brazil's emerging-market peers, we do not believe it would be prudent to lower the rate further still, despite projections of well-behaved inflation. However, the political actors will need to make strong progress on the structural reform and fiscal consolidation agenda in order to guarantee public debt solvency and contribute to an environment of confidence in the stability of the economy. To this end it will be necessary to avoid additional expenditure or permanent programs before a new round of reforms leading to a reassessment of the federal budget and public spending priorities by all tiers of government.

ECONOMIC FORECASTS	2016	2017	2018	2019	2020F	2021F
GDP Growth (%)	-3,3%	1,3%	1,3%	1,1%	-5,8%	3,8%
Inflation (%)	6,3%	2,9%	3,7%	4,3%	1,6%	3,0%
Unemployment Rate, SA (eoy ,%)	12,6%	12,4%	12,2%	11,7%	14,8%	12,5%
Policy Rate (eoy, %)	13,8%	7,0%	6,5%	4,5%	2,3%	5,0%
External Accounts						
Trade Balance (US$ bn)	48	67	53	39	45	34
Current Account Balance (US$ bn)	-23	-10	-42	-51	-10	-34
Current Account Balance (% of GDP)	-1,3%	-0,7%	-2,2%	-2,8%	-0,9%	-2.2%
Fiscal Policy						
Fiscal Primary Balance (% of GDP)	-2,5%	-1,8%	-1,6%	-0,9%	-10,6%	-2,5%
Government Gross Debt (% of GDP)	69,4%	73,7%	77,2%	75,9%	94,0%	94,0%