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Recovery and Scars

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The second half of 2020 began with an advancing global recovery that reflected the gradual process of economic reopening in many countries. The initial recovery turned out to be faster than expected but the economic scars left by Covid-19 will last a long time. A return to the level of global activity seen before the pandemic is unlikely before late 2021, while unemployment will rise and many industries will continue to face difficulties.

Recent developments in the US exemplify the risks still posed by the pandemic: high frequency indicators of consumer spending and employment are losing momentum as the number of cases rises in the South and Southwest. This deceleration is partly due to the reversal of quarantine easing measures in some localities, but it is also due to the decreased mobility caused by the fear of infection. In light of the still high unemployment rate and the coming end of the income support programs launched during the pandemic, the US economic recovery is faltering.

European countries have reopened their economies more securely and cautiously, although in late July new outbreaks of coronavirus disease were seen in Spain, Luxembourg and other countries, fueling concern that fresh waves could force the authorities to reimpose social distancing.

In Brazil the contagion curve has not yet shown signs of consistent deceleration, largely owing to significant regional disparities. However, economic activity continues to recover in most parts of the country, and a cycle of upward revisions of the more pessimistic 2020 GDP forecasts has already begun. The emerging consensus forecast is now approaching our own, which is a 5.8% contraction. A complete recovery is also unlikely in Brazil, with unemployment remaining high and lasting damage to various segments of services and retail. With the BCB’s cut in interest rates to 2%, we now expect rates to remain at this level until July of 2021, when the BCB will embark on a tightening cycle to end the year with rates at 4.0%.

The greatest threat to the recovery, besides the virus, continues to be the fiscal and political agenda. As the end of emergency income support approaches, discussions on the program that will replace Bolsa Família (conditional cash transfer) remain messy, while pressures for increased public spending remain elevated. Continuation of the emergency income in its current form is impracticable from the fiscal standpoint, and the delay in presenting a permanent and fiscally viable solution fuels uncertainty regarding the future of the government’s accounts. Maintenance of the spending cap and clear signaling that a reform agenda is back on the cards are indispensable to bolster confidence and economic foreseeability in the context of the high level of public debt (95% of GDP) and persistent primary deficits.

One positive sign is the resumption of the tax reform debate in Congress. This reform could potentially simplify the Brazilian taxation system and produce efficiency gains for the productive sector over time. A constitutional amendment (PEC 45) under discussion by a select committee in Congress would reformulate federal, state and municipal taxes, with more potential benefits for the economy than a proposal sent by the federal administration, which would simplify and unify only PIS and COFINS. We believe tax reform could advance in Congress this year, even if it is not completely approved.

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%	1.8%	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%	2.0%	4.0%
External Accounts						
Trade Balance (US$ bn)	48	67	53	39	56	34
Current Account Balance (US$ bn)	-23	-10	-42	-51	1	-19
Current Account Balance (% of GDP)	-1.3%	-0.7%	-2.2%	-2.8%	0.1%	-1.3%
Fiscal Policy						
Fiscal Primary Balance (% of GDP)	-2.5%	-1.8%	-1.6%	-0.9%	-11.5%	-3.1%
Government Gross Debt (% of GDP)	69.4%	73.7%	77.2%	75.9%	95.0%	95.0%