

## Macro Monthly Letter

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### Choices

**Fernanda Guardado**  
Chief Economist

**Serge de Valk**  
Economist

**Anna Saraiva**  
Intern

**Giovanni Machado**  
Intern

**Pedro Alves**  
Intern

As the last quarter of the year began, the attention of the global economy focused on the last lap of the US presidential race and the swiftly advancing second wave of the Covid-19 epidemic in Europe. Brazil made no progress on the reform agenda in October owing to the unofficial recess caused by the proximity of municipal elections, and to a lack of consensus regarding contentious items and new spending programs.

The 2020 US election promises to be historic. First because of the large numbers who voted early (almost 100 million, or about three-quarters of all the votes cast in the 2016 election), and second because of the exceptionally high turnout. The volatility that always comes with a presidential election was fueled by uncertainty about the counting of postal votes, and by allegations of fraud and corruption in electoral procedures by President Trump, creating the prospect of a prolonged and disputed vote count. The results available at the time of writing point to the election of Joe Biden as the new American president with a republican majority in the Senate, which is bound to limit the changes proposed by the democrat.

In Europe, the second wave of the pandemic that began as summer faded in the northern hemisphere proceeded with no sign of decelerating. Although the trend in deaths are below that seen in the first wave in France, Germany, Italy and Spain, these countries opted for restrictive measures in response to the surge in cases and numbers of occupied ICU beds. East European countries such as Poland, Czech Republic and Bulgaria fared worse, with hospitalizations and mortality rising compared with the second quarter. While the measures announced to control the second wave were less draconian than those introduced in the spring, they will unquestionably have had a negative impact on economic activity, reinforcing the plunge in mobility indicators caused by fear of infection. As a result, fourth-quarter economic growth projections for Europe began to be revised down in the direction of a contraction.

In Brazil, high-frequency data for manufacturing and retail sales continued to surprise positively, suggesting that the momentum remained positive at the start of the fourth quarter. We revised up our growth projection for the year to -4.6% (from -5.1% previously), and now expect a more modest improvement to +3.1% in 2021. Alongside the positive surprises regarding economic activity, inflation also surpassed expectations, owing largely to rising prices of food and other tradables such as gasoline. We revised up our forecast for the 2020 IPCA to 3.1%, followed by 3.2% next year. It is worth noting that both projections are below the midpoint of the Central Bank of Brazil's target band for the respective years, and that core inflation remains benign. Moreover, core rates will be negatively impacted by depressed activity in the service sector in forthcoming quarters. However, we see a risk of inflation accelerating in response to a possible movement to replenish margins by industries that have benefited from the pandemic, especially furniture and

appliances, as well as others that may be affected by local currency depreciation in the year.

On the fiscal front there was little progress during the month, with the reforms stalled and politicians focusing on the municipal elections. One of the most pressing problems is the very small amount of time left to pass the Budget Guidelines Law (LDO) and the Budget itself after the elections, let alone the reforms that require constitutional amendments (PECs). A rush to find solutions for a new cash transfer program before the ongoing emergency income assistance scheme expires in January could produce noise and volatility in December. As noted in previous Monthly Letters, reluctance on the part of politicians to move forward toward the right choices undermines confidence regarding future sovereign solvency, driving up the cost of borrowing to finance the debt and reducing the incentive to invest in Brazil. Progress on the reforms is therefore crucial, especially Tax Reform and Constitutional Amendment 186 (known as "PEC Emergencial", regulating the spending cap, among other austerity measures), so that Brazil can embark on a process of more sustainable and lasting growth.

<b>ECONOMIC FORECASTS</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020F</b>	<b>2021F</b>
<b>GDP Growth (%)</b>	-3.3%	1.3%	1.3%	1.1%	-4.6%	3.1%
<b>Inflation (%)</b>	6.3%	2.9%	3.7%	4.3%	3.1%	3.2%
<b>Unemployment Rate, SA (eoy, %)</b>	12.6%	12.4%	12.2%	11.7%	16.4%	15.8%
<b>Policy Rate (eoy, %)</b>	13.8%	7.0%	6.5%	4.5%	2.0%	3.5%
<b>External Accounts</b>						
<b>Trade Balance (US\$ bn)</b>	48	67	53	39	61	58
<b>Current Account Balance (US\$ bn)</b>	-23	-10	-42	-51	11	2
<b>Current Account Balance (% of GDP)</b>	-1.3%	-0.7%	-2.2%	-2.8%	0.8%	0.1%
<b>Fiscal Policy</b>						
<b>Fiscal Primary Balance (% of GDP)</b>	-2.5%	-1.8%	-1.6%	-0.9%	-11.9%	-3.0%
<b>Government Gross Debt (% of GDP)</b>	69.4%	73.7%	77.2%	75.9%	93.0%	94.2%