

Macro Monthly Letter

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Brazil Macroeconomic Scenario for 2022

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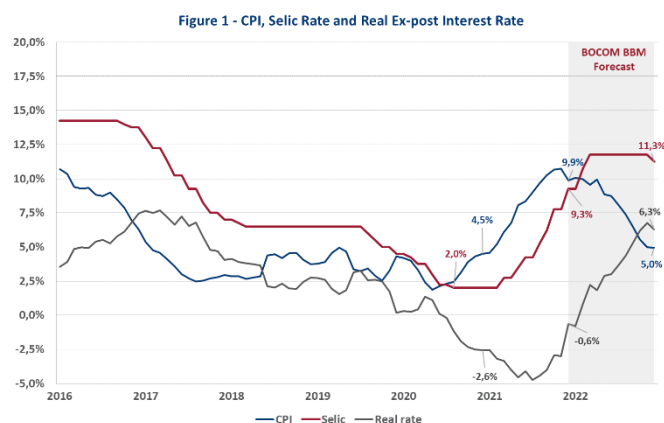
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With the advance of vaccination and economic reopening, 2021 saw activity recovering alongside high inflation due to both supply and production chain disruption and to the fiscal and monetary stimulus measures left in place for much of the year. Our forecast for GDP is 4.4% growth, thanks partly to the depressed base in 2020. Year-end inflation was set to reach 9.9%. In response, the Central Bank raised its policy rate (Selic) by 725 bps during the year, from 2% to 9.25% p.a., and is expected to remain in even more contractionary territory in 2022.



Source: Central Bank of Brazil, IBGE and Bocom BBM

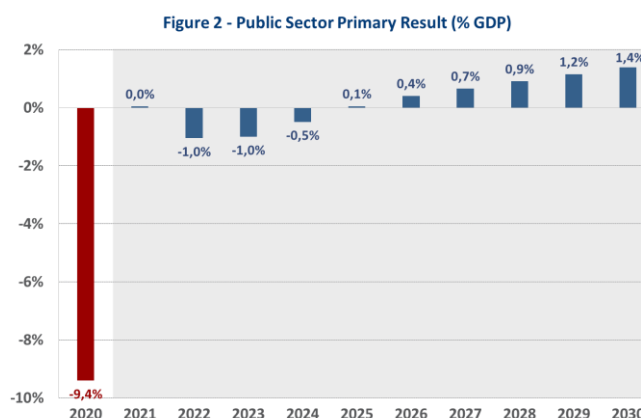
Normalization of activity and a tighter monetary policy will present the economy with daunting challenges in 2022. The high-frequency data for manufacturing, retail and other services points to an unfavorable outlook with distinct deceleration. Industrial production, which benefited from increased consumption of goods during the pandemic, will again face difficulties such as constraints on production capacity and competitiveness in the sector. In services, the sector most affected by social distancing and mobility restrictions, there is room for recovery, especially in public and families related services. Agriculture will also perform better, thanks to record projected crops. We forecast low but positive growth of 0.3% led by the primary and tertiary sectors in 2022.

On the demand side, consumption remains hampered by tighter financial conditions and loss of workers' wage purchasing power. Although job creation has improved in recent readings, unemployment remains high and this will dampen pressure for wage adjustments. Data from Dieese and Fipe show the difficulty of workers recovering real income and the tendency for wage adjustments to lag consistently behind

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inflation. Household debt has reached a staggering 49.4% of income, and interest rates for corporates and consumers are rising in response to the rise in Selic rate.

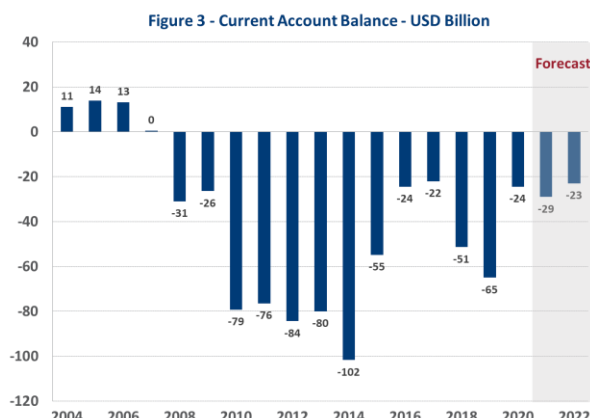
While weaker activity should afford inflationary relief, food and energy commodity prices will remain highly volatile, and there may be pressure for wage hikes that fuel inflation inertia. We expect much tighter control of fuel prices in 2022, as stimulus programs are withdrawn and growth slows down in the advanced countries. As for the exchange rate, local currency depreciation has already reached levels at which it helps contain inflation, but there will be risks during the year due to the presidential election and possible further changes to the fiscal regime. Inflation inertia, especially in the service sector, which continues to recover, will keep inflation above the target this year. We project 5% for the IPCA in 2022.



Source: Central Bank of Brazil and Bocom BBM

In the fiscal arena, passage of the constitutional amendment known as PEC dos Precatórios (PEC 23/2021) allows more room for spending in 2022, and we have revised up our projection of the debt-to-GDP ratio accordingly. We expect a primary surplus to return only in 2025. In 2022, there is also a risk that low growth due to the rise in interest rates will produce negative surprises in tax revenue as companies make less profit.

The external sector will remain with a positive outlook due to low domestic growth in the context of world recovery. Exports are expected to continue performing well, while imports will lose momentum with the domestic economic slowdown. In services, the trade balance will present some recovery compared with 2021 and 2020, but the size of the deficit will remain below the level seen in previous years. With regard to primary income, the economic slowdown will reduce the amount of profit and dividend remittances abroad. We therefore expect the current-account deficit to remain lower in 2022.



Source: Brazilian Central Bank and Bocom BBM

Monetary policy remains contractionary, and the Central Bank has signaled concern over both convergence of inflation to the target and the re-anchoring of inflation expectations, since the median forecast for 2023 remains above the target according to its weekly survey of professional forecasters (Focus). We expect it to raise the Selic by another 150 bps at the next meeting, followed by 100 bps at the second meeting of the year, taking the policy rate to 11.75% at the end of the cycle. We believe there should be room for rate cuts later in the year, starting with 50 bps, so that the year-end Selic could be 11.25%.

Regarding the external outlook, we are monitoring two important risk factors for the Brazilian economy. First, international financial conditions also remain contractionary, owing mainly to the unfavorable dynamics of inflation in the United States and the prospect of rate hikes by the Fed in 2022. Second, deceleration of the Chinese economy has implications for global growth, and particularly for Brazil, as China is its most important trade partner. The omicron variant presents fresh challenges for the Chinese economy, as the authorities are expected to persist with the zero tolerance policy regarding the pandemic.

Our projections for 2022 are shown below.

ECONOMIC FORECASTS		2018	2019	2020	2021F	2022F
GDP Growth (%)		1,3%	1,1%	-4,1%	4,4%	0,3%
Inflation (%)		3,7%	4,3%	4,5%	9,9%	5,0%
Unemployment Rate, SA (eoy, %)		12,2%	11,7%	13,9%	12,2%	13,2%
Policy Rate (eoy, %)		6,50%	4,50%	2,00%	9,25%	11,25%
External Accounts						
Trade Balance (US\$ bn)		53	48	51	34	49
Current Account Balance (US\$ bn)		-51	-65	-24	-29	-23
Current Account Balance (% of GDP)		-2,2%	-2,8%	-0,9%	-1,7%	-1,3%
Fiscal Policy						
Central Government Primary Balance (% of GDP)		-1,7%	-1,2%	-10,0%	-1,1%	-1,3%
Government Gross Debt (% of GDP)		75,3%	74,3%	88,8%	81,0%	82,0%

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