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MACRO OUTLOOK

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Macro Outlook

- Recession narratives have spread throughout markets in August. Activity continues to slowdown and US GDP printed its 2nd negative reading in a row amid the change from goods to services consumption. On the other hand, we see China recovering from the latest Covid wave with minor surges being fought with restriction measures. Regarding China, we continue to see weakness in economic data due to some Covid restrictions and the worrisome situation in Chinese housing market;

- Second quarter GDP surprised positively, with strong growth in industry and services, showing that economic activity remains resilient. July's industrial production increased by 0.6% compared to June, slightly above expectations. The labor market remains very strong, with the unemployment rate decreasing to 9.1% (NSA) in July;

- Our growth forecast for 2022 is at 2.7%. The projection considers the effect of the statistical carry-over of some activities, the recovery of the labor market and the expansion of Auxílio Brasil, which increase the disposable income of families and, consequently, their consumption;

- Our inflation forecast is at 6.1% in 2022 and incorporates federal and state tax cuts approved by Congress, as well as lower electricity readjustments. In 2023, our forecast is 4.8% with the maintenance of federal tax exemption on fuels and a lower inertia after successive revisions of the 2022 IPCA downwards;

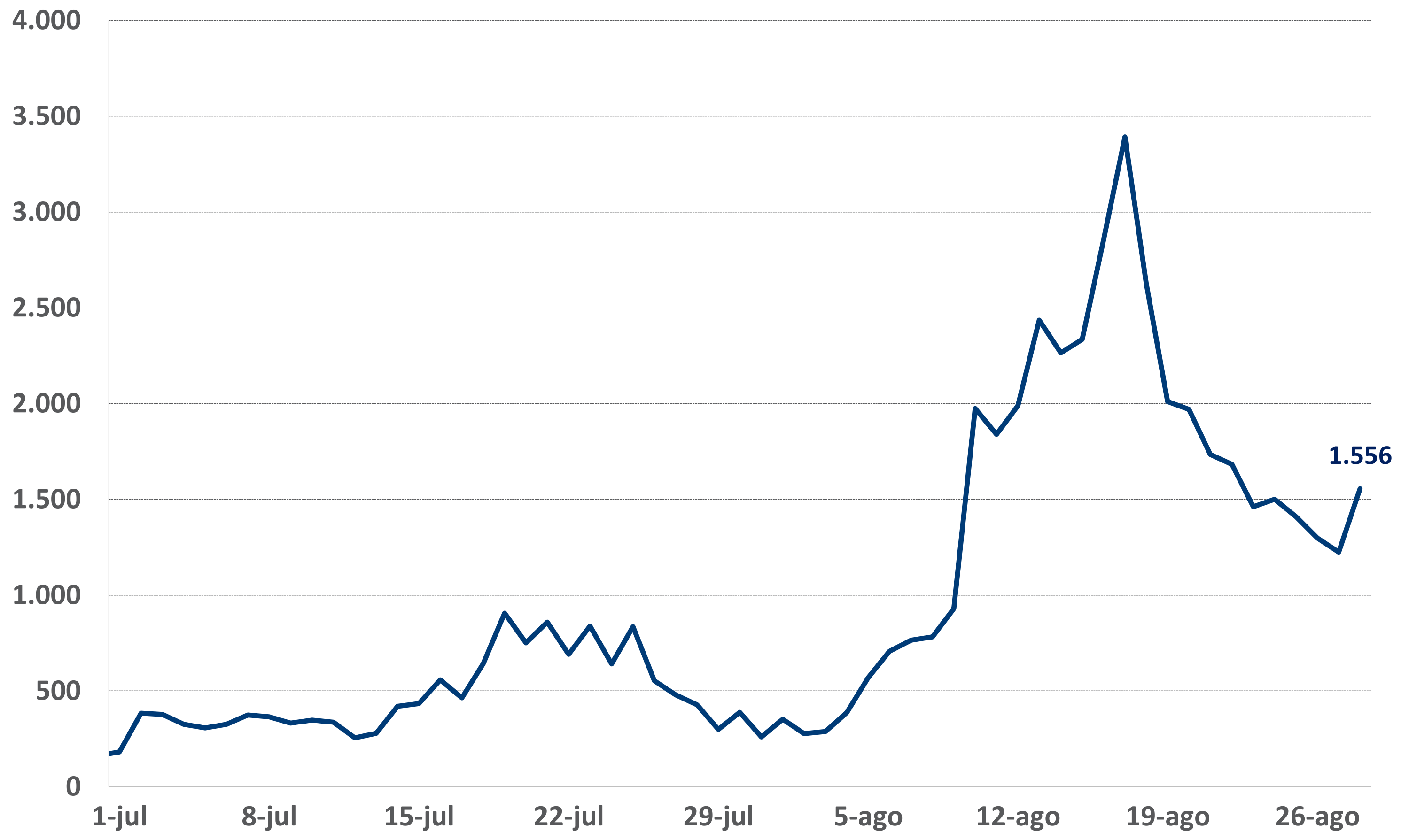
- Our projection for the Selic rate is 13.75% by the end of 2022, and 11.25% by the end of 2023, reflecting the Central Bank's plan to keep the monetary policy rate in contractionary territory for longer;

- The fiscal results have improved continuously with the increase in tax collection and the decrease in the Debt/GDP ratio. The results of local governments (states and municipalities) continue to contribute positively to this result. However, the changes approved by Congress are expected to have a high impact on revenues and expenditure.

China: Covid – 19

- Daily new domestic cases increased in the latest month;
- China is enforcing lockdown restrictions in areas around Beijing more intensively;

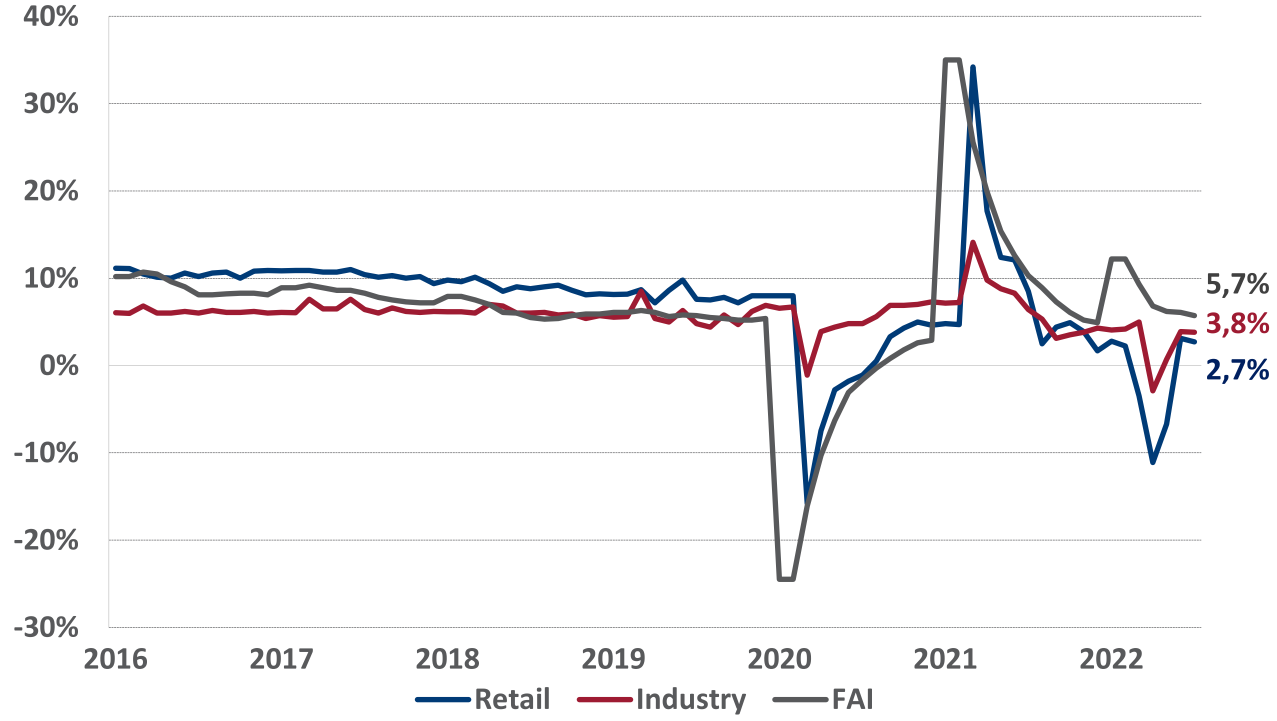
China: Covid - New Daily Domestic Cases

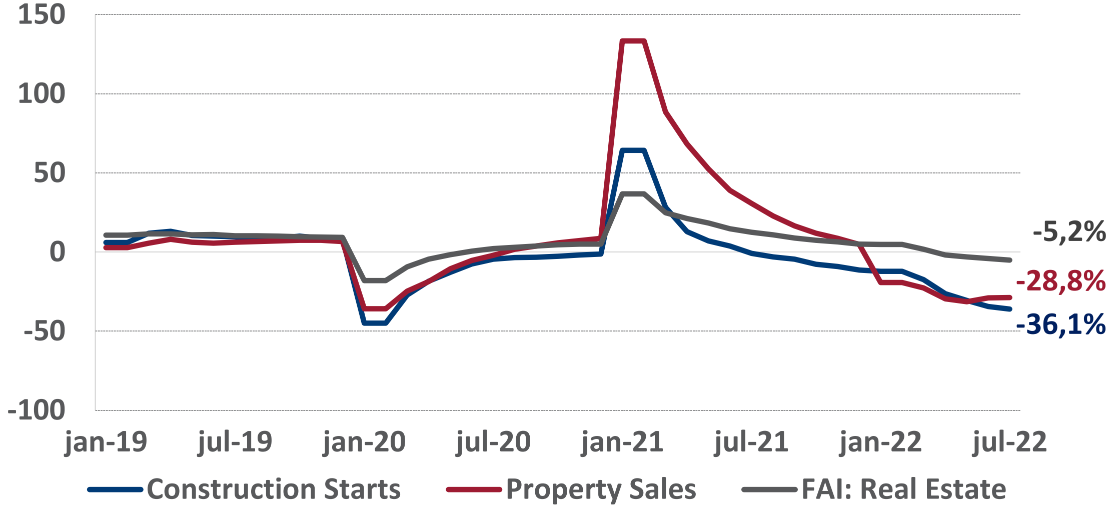


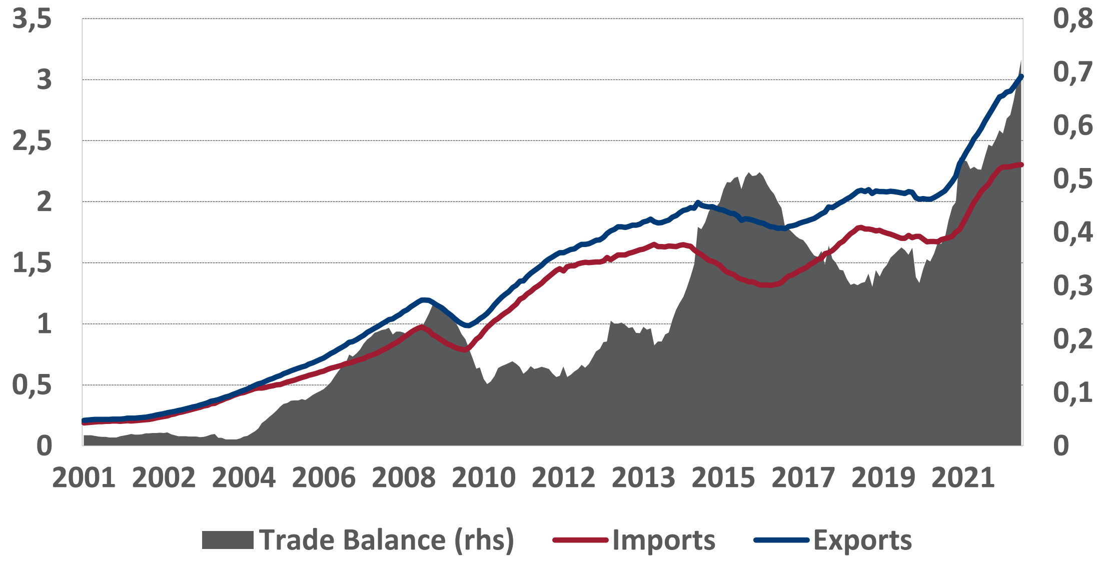
Source: CEIC, BOCOM BBM

China: Economic Scenario

- Activity:
  - below expectations as Covid controls dragged down growth;
- Real Estate:
  - property crisis deepened with homebuyers starting to boycott mortgage payments because of unbuilt house;
- Trade Balance:
  - strong export growth lifted its trade surplus to another record;



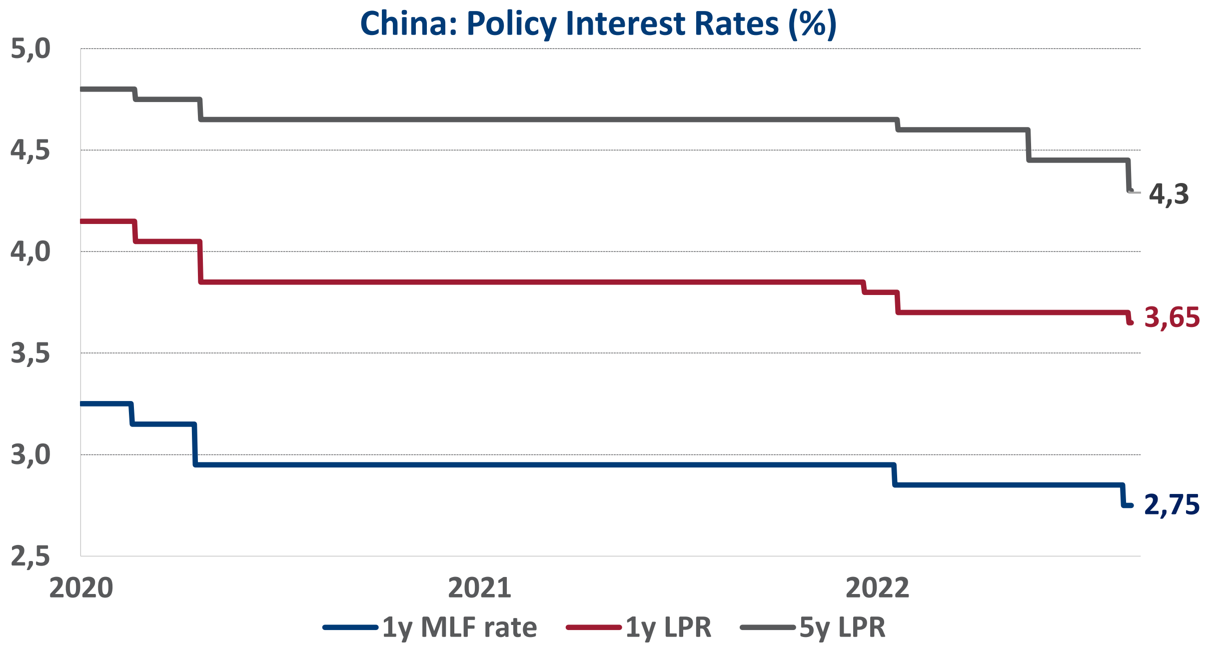


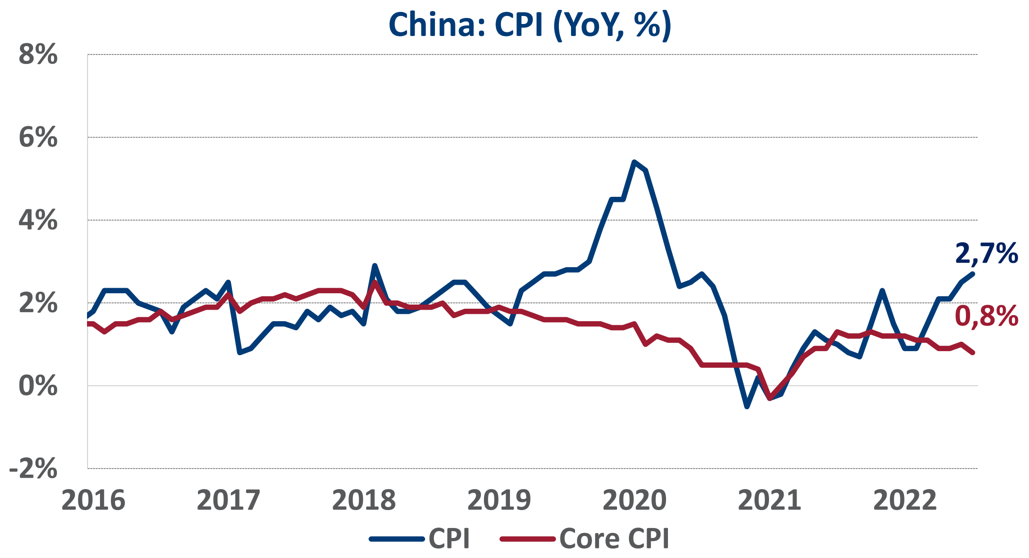


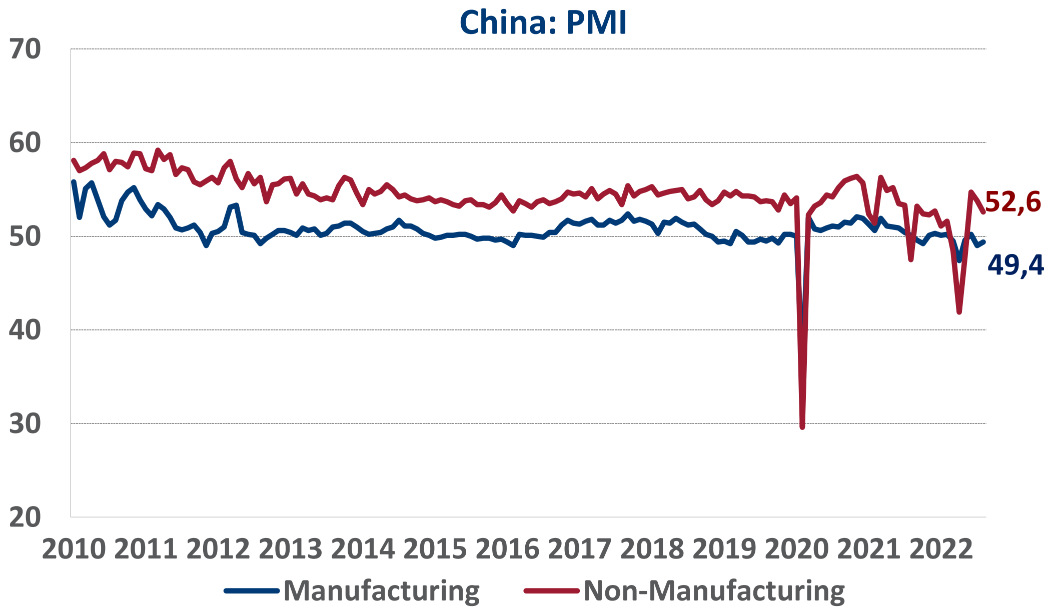
Source: CEIC, BOCOM BBM

China: Economic Scenario

- PMI:
  - PMI improved modestly; meanwhile non-manufacturing PMI fell to 52.6;
- Policy Interest Rates:
  - 1-year LPR lowered by 5bp to 3.65% and 5-year LPR by 15bp to 4.30% - to support long-term borrowing and in particular mortgages;
- CPI:
  - accelerated to the highest level in two years, largely due to surging pork costs;





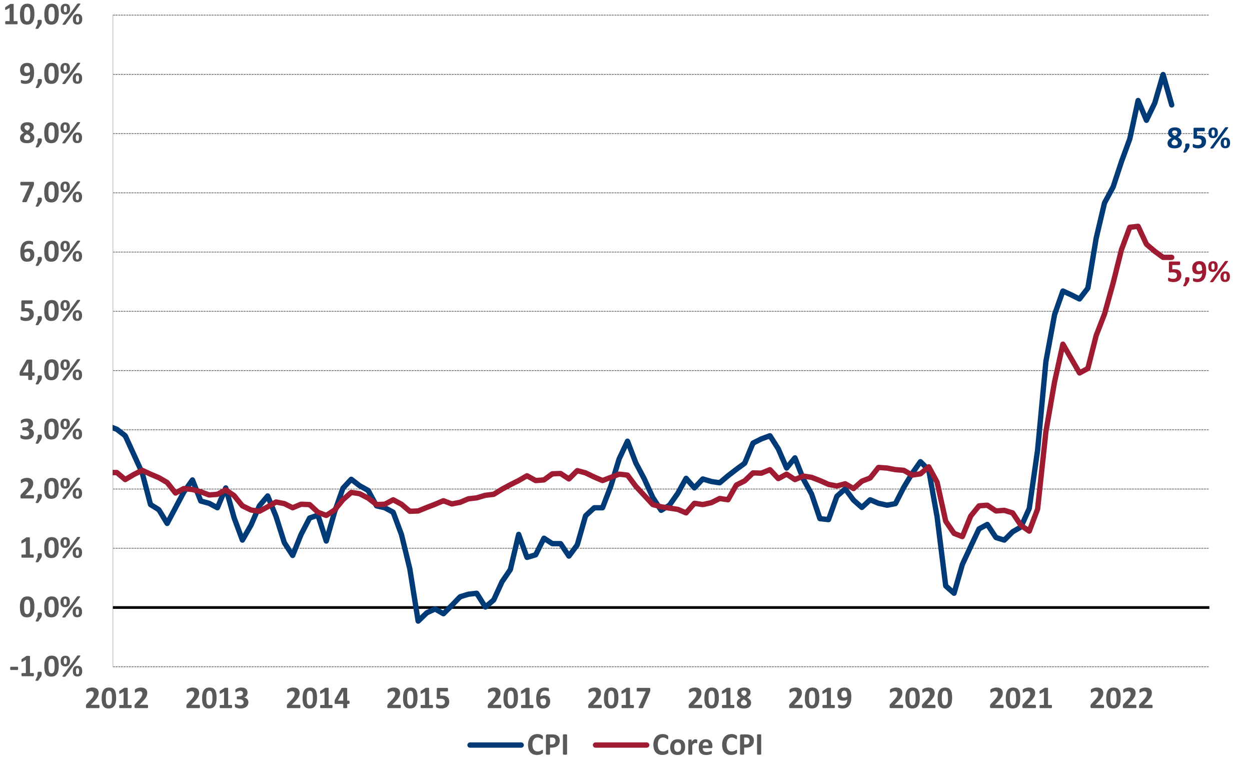


Source: CEIC, BOCOM BBM

USA: Inflation

- Inflation in the US decreased to 8.5% YoY. Gasoline and other fuels have helped to bring the headline down;
- Core CPI has also seen a positive reading in the last month, with industrial goods inflation cooling down as well as some services;
- Core PCE has further decreased to 4.6%.

US: CPI SA (YoY, %)



US: PCE SA (YoY, %)

Source: BOCOM BBM, BLS, BEA

USA: Labor Market

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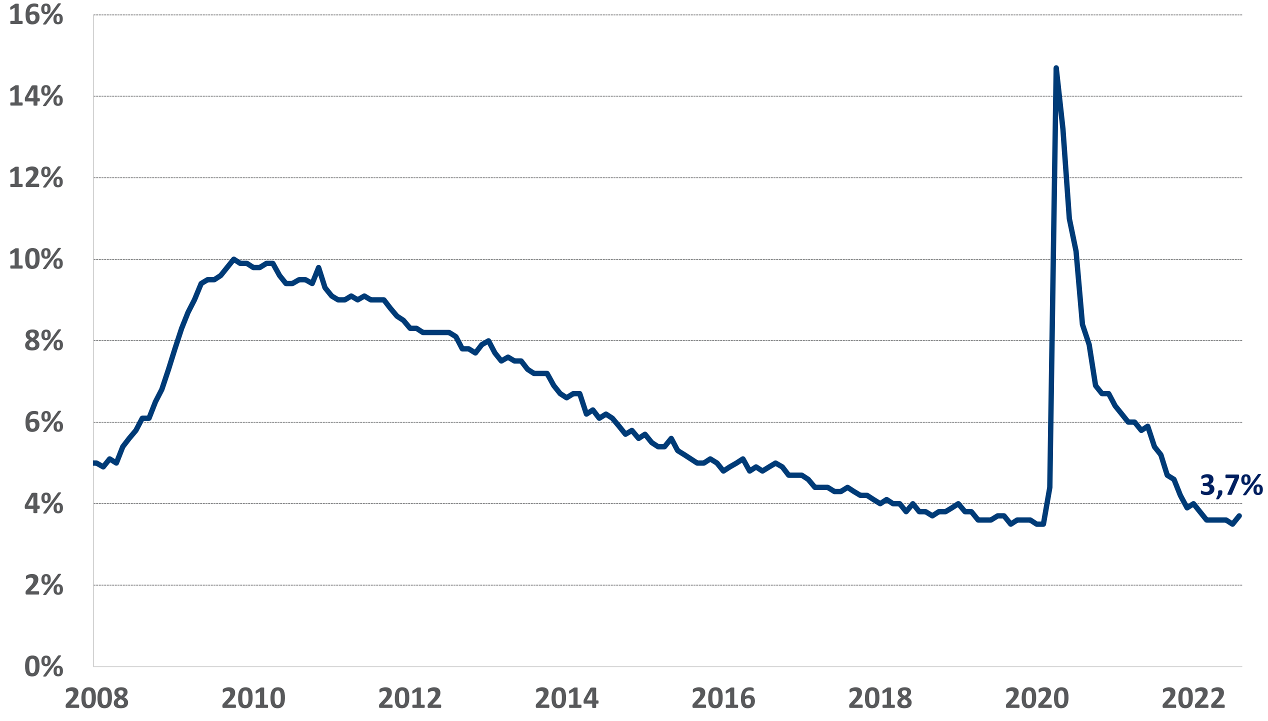
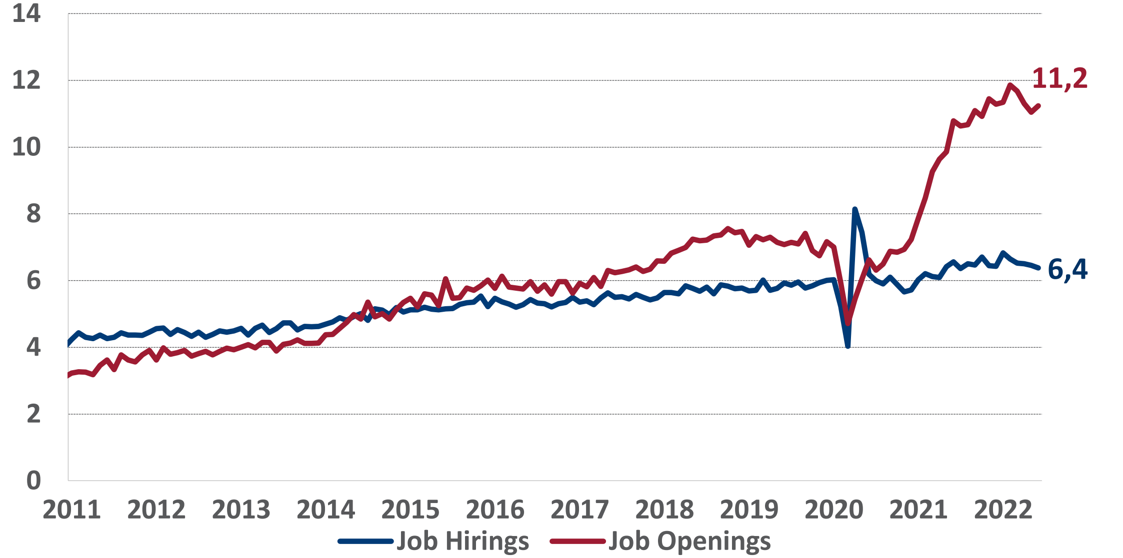
- In August, 315k jobs were created;
- However, the unemployment rate increased from 3.5% to 3.7%, due to the increase in participation rate from 62.1% to 62.4%;
- The number of job openings presented a considerable surprise, reaching 11.2 million openings, which is much above the 10.4 million expectation.

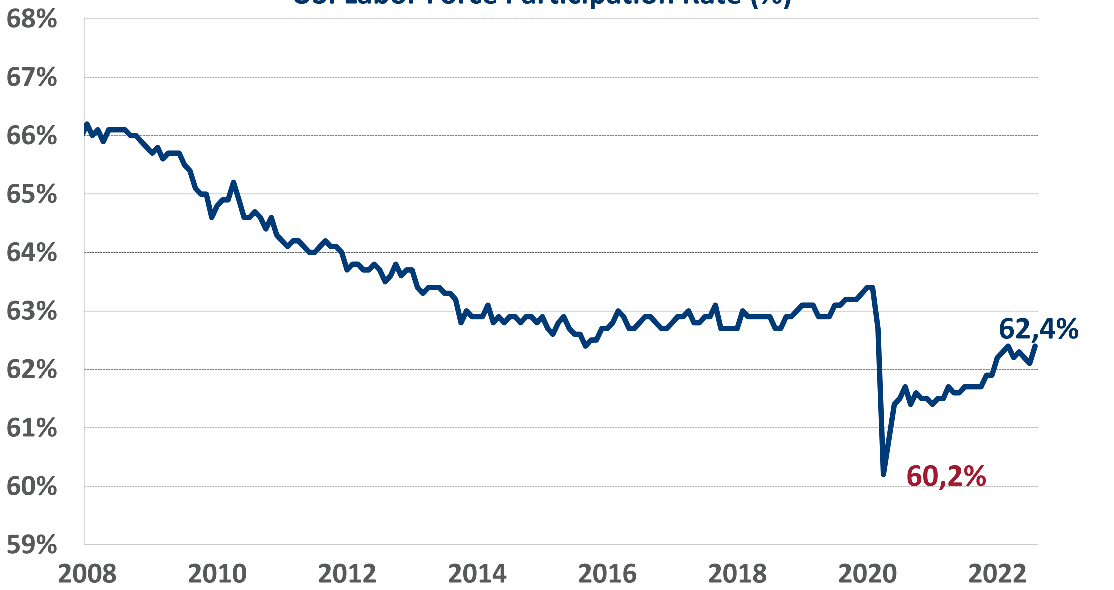
US: Unemployment Rate (%)



US: Job Openings and Hirings (Million)



US: Labor Force Participation Rate (%)



Source: BOCOM BBM, FED, BLS

Global: Interest Rates

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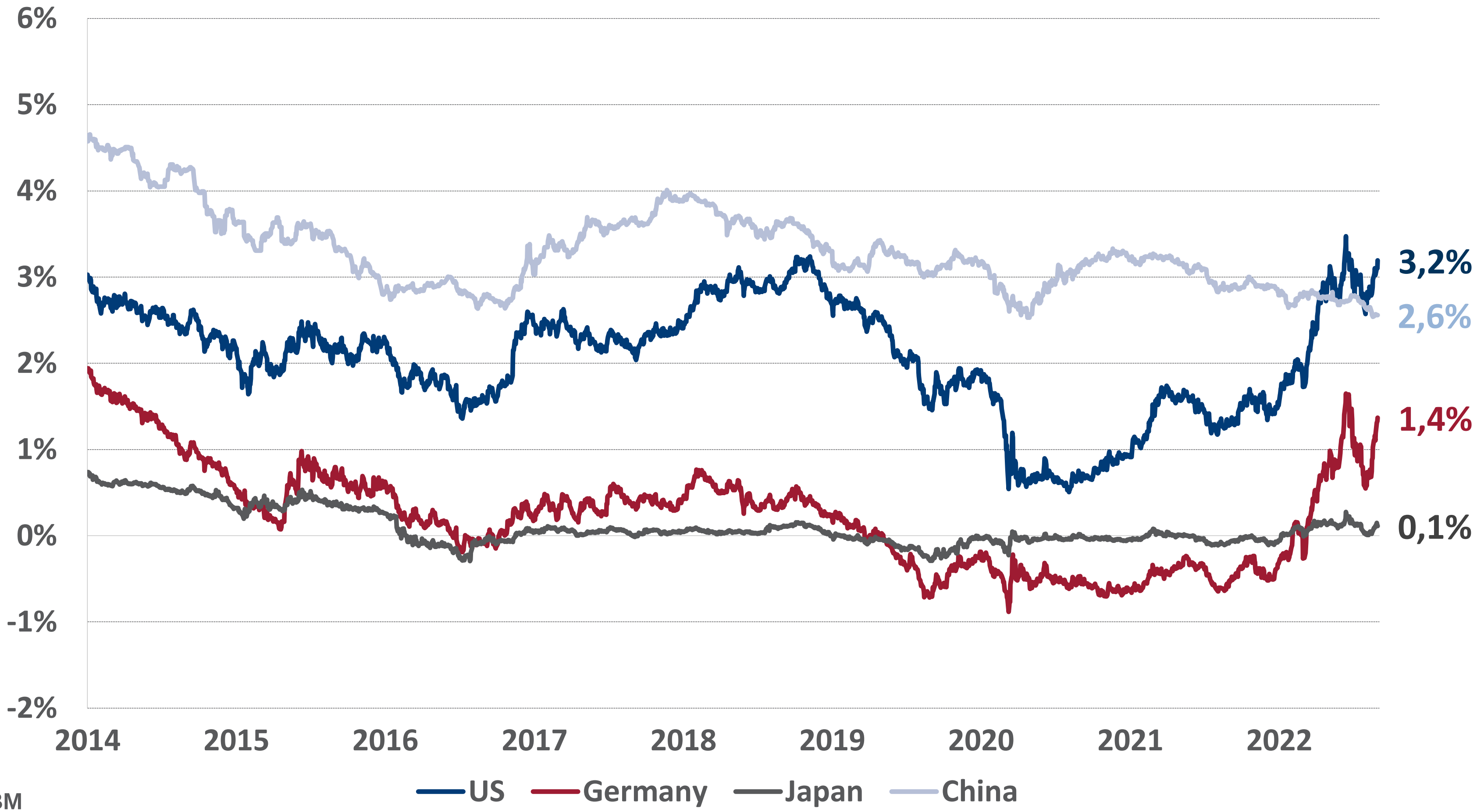
» Long-term interest rates of some major developed countries have gone down after recession narratives started. But inflation remains worrisome and activity data showed good signs in the last month, showing that Central Banks will likely keep tighten monetary policy to deliver inflation convergence to its target.

10 Year Interest Rates



Source: Bloomberg, BOCOM BBM

Brazil: Forecasts

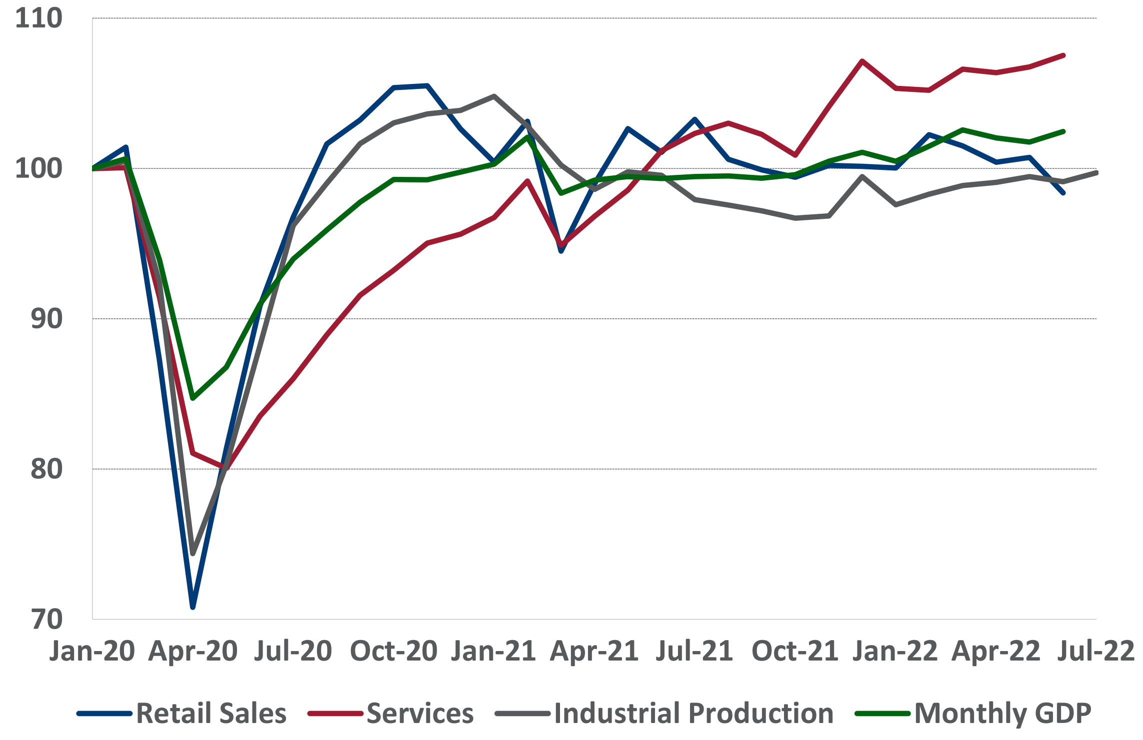
ECONOMIC FORECASTS	2019	2020	2021	2022F	2023F
GDP Growth (%)	1.1%	-3.9%	4.6%	2.7%	0.7%
Inflation (%)	4.3%	4.5%	10.1%	6.1%	4.8%
Unemployment Rate (eoy ,%)	11.7%	13.9%	11.1%	8.7%	8.5%
Policy Rate (eoy, %)	4.5%	2.0%	9.3%	13.75%	11.25%
External Accounts					
Trade Balance (US$ bn)	48	32	36	68	45
Current Account Balance (US$ bn)	-65	-24	-28	-25	-35
Current Account Balance (% of GDP)	-2.8%	-0.9%	-1.8%	-1.4%	-1.8%
Fiscal Policy					
Central Government Primary Balance (% of GDP)	-1.2%	-10.0%	-0.4%	0.2%	-0.8%
Government Gross Debt (% of GDP)	74.3%	88.8%	80.3%	77.7%	82.9%

Source: BOCOM BBM

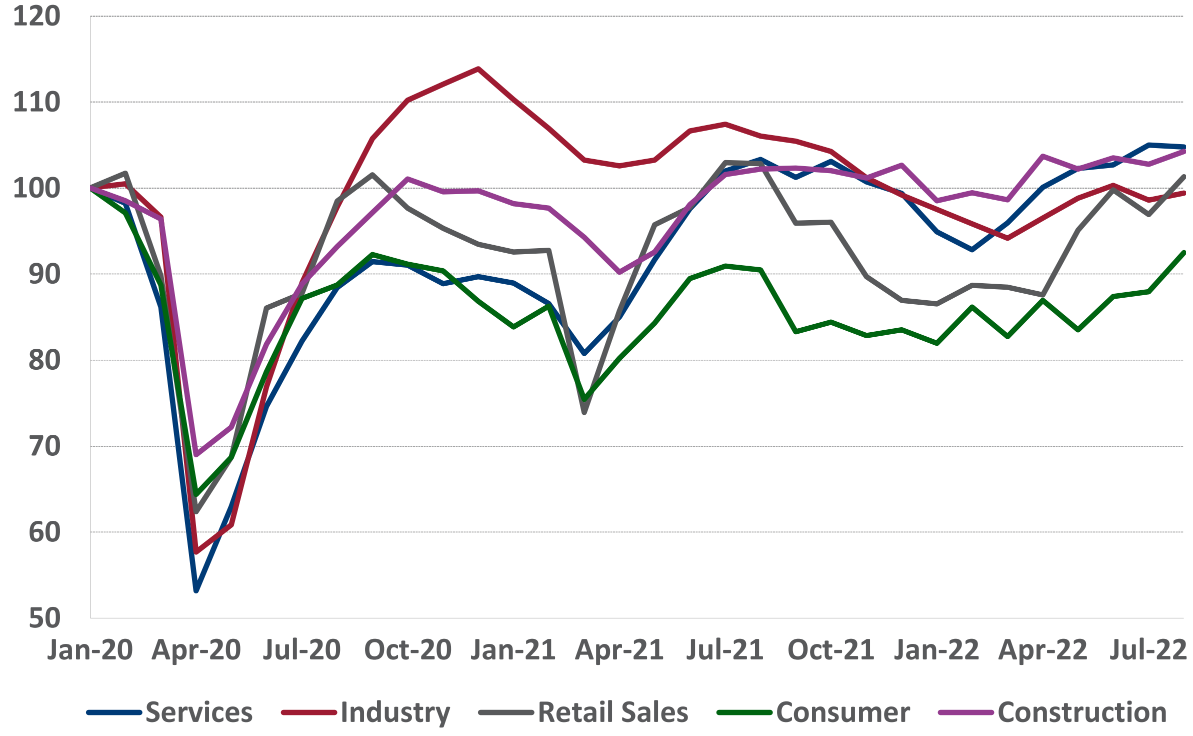
Brazil: Activity

- High activity frequency data shows mixed signals for 3Q22:
  - heated labor market;
  - more disposable income due to high employment and government transfers;
  - deceleration of confidence in the goods sector in July, with an improvement in August driven by expectations, but the current situation continued to deteriorate;
  - services confidence strong in July but stabilized in August;

Brazil - Economic Activity Indicators (Jan/20=100)



Brazil - Economic Confidence Index (Jan/20 = 100)



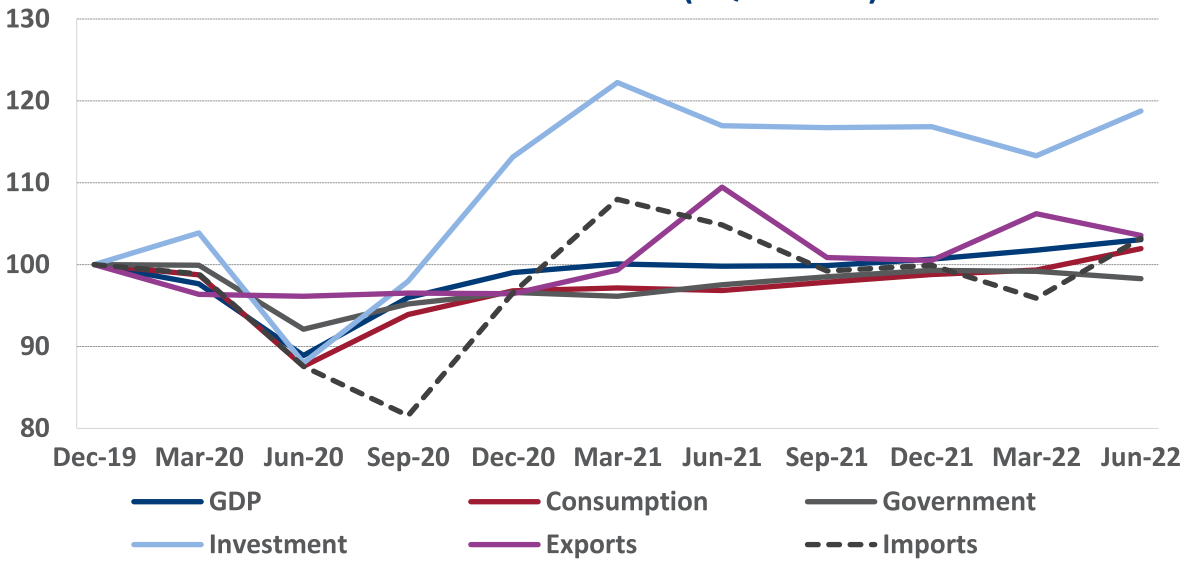
Source: BOCOM BBM, IBGE

Brazil: 2Q22 GDP

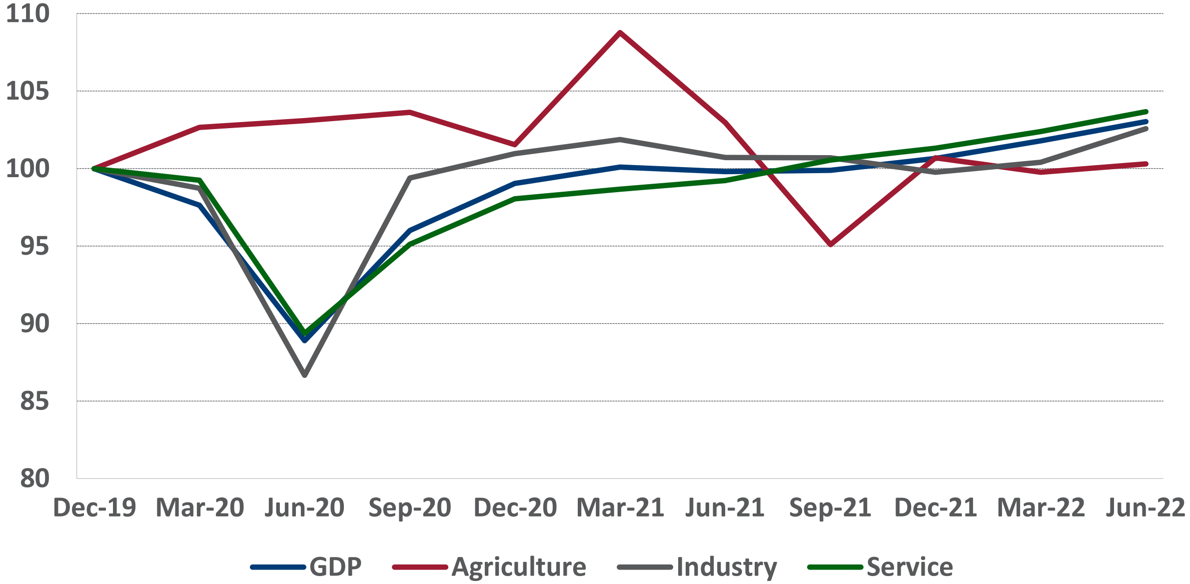
- Brazil's GDP increased by 1.2% QoQ and 3.2% YoY in 2Q22;
- On the demand side, highlight goes to household consumption, which grew 2.6% QoQ and 5.3% YoY and investment, which increased 4.8% QoQ and 1.5% YoY;
- On the supply side, the biggest contribution came from services which increased 1.3% QoQ and 4.5% YoY;

GDP Breakdown	QoQ SA	YoY	Carry-over
Agriculture	**0,5%**	**-2,5%**	**-1,7%**
Industry	**2,2%**	**1,9%**	**1,3%**
Mining	2,2%	-4,0%	-2,4%
Manufacturing	1,7%	0,5%	0,2%
Construction	2,7%	9,9%	7,0%
Electricity and gas, water, sewage and waste management	3,1%	10,8%	9,8%
Services	**1,3%**	**4,5%**	**3,4%**
Retail	1,7%	1,3%	1,3%
Transportation	3,0%	11,7%	8,8%
Communication	2,9%	4,6%	2,3%
Finance	1,4%	1,0%	0,4%
Other services	3,3%	13,6%	10,1%
Rent	0,3%	0,5%	0,6%
Public services	-0,8%	1,1%	1,0%
Taxes		**1,6%**	
GDP	**1,2%**	**3,2%**	**2,6%**
Household consumption	2,6%	5,3%	3,7%
Goverment expenditure	-0,9%	0,7%	0,7%
Investment	4,8%	1,5%	-0,7%
Exports (+)	-2,5%	-4,8%	1,6%
Imports(-)	7,6%	-1,1%	-1,6%

Demand - GDP SA (4Q19 = 100)



Supply - GDP SA (4Q19 = 100)

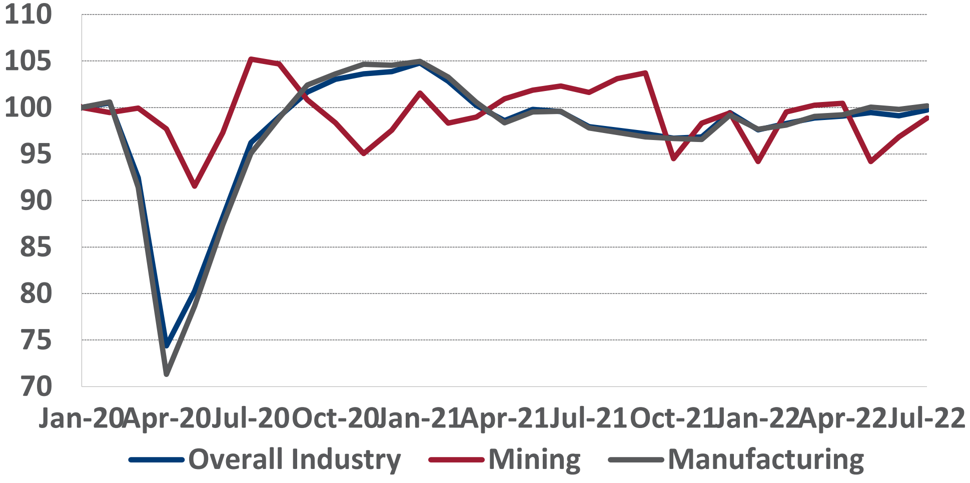


Source: BOCOM BBM, IBGE

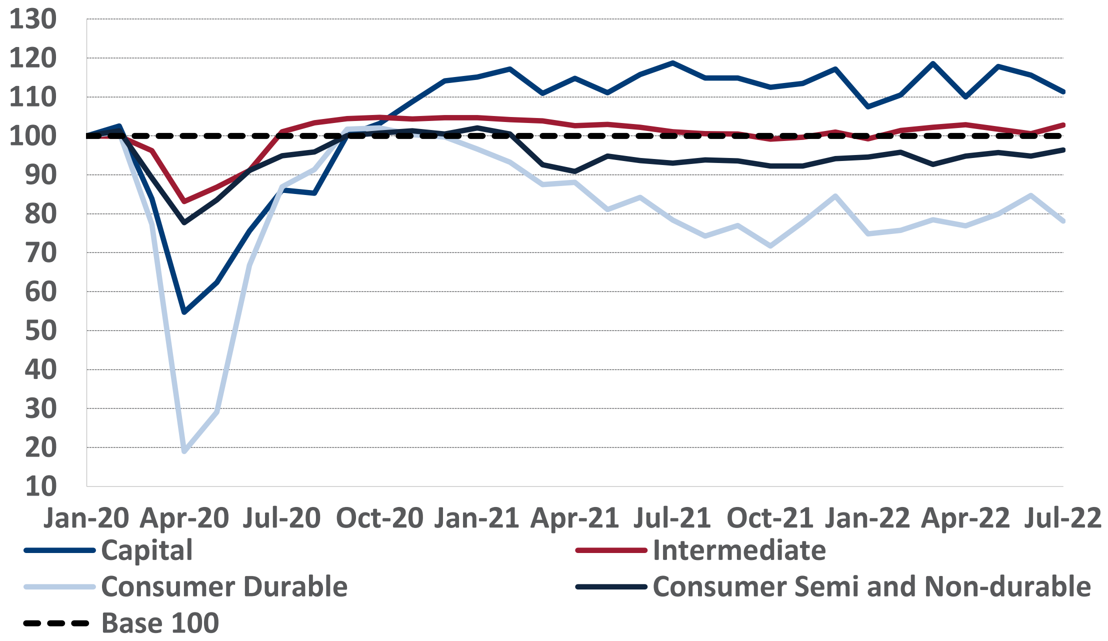
Brazil: Industrial Production

- Industrial production grew 0.6% MoM in July: positive contributions came from intermediate goods and semi and non-durable consumer goods (highlighting food products, oil derivatives and extractive industry);
- It's worth mentioning the sector is facing hardships:
  - Supply side: global inputs shortages in some sectors and higher interest rates
  - Demand side: consumption transitioning from goods to services

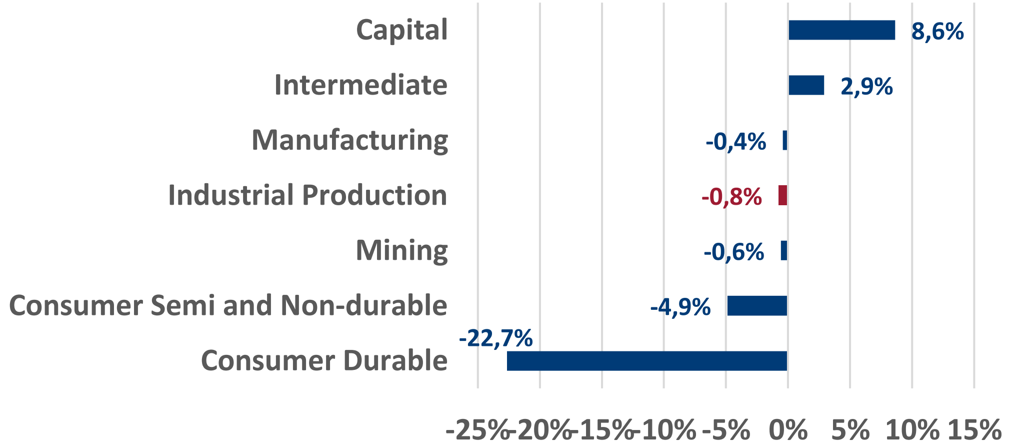
Industrial Production Index SA (Jan/20=100)



Industrial Production Index SA (Jan/20=100)



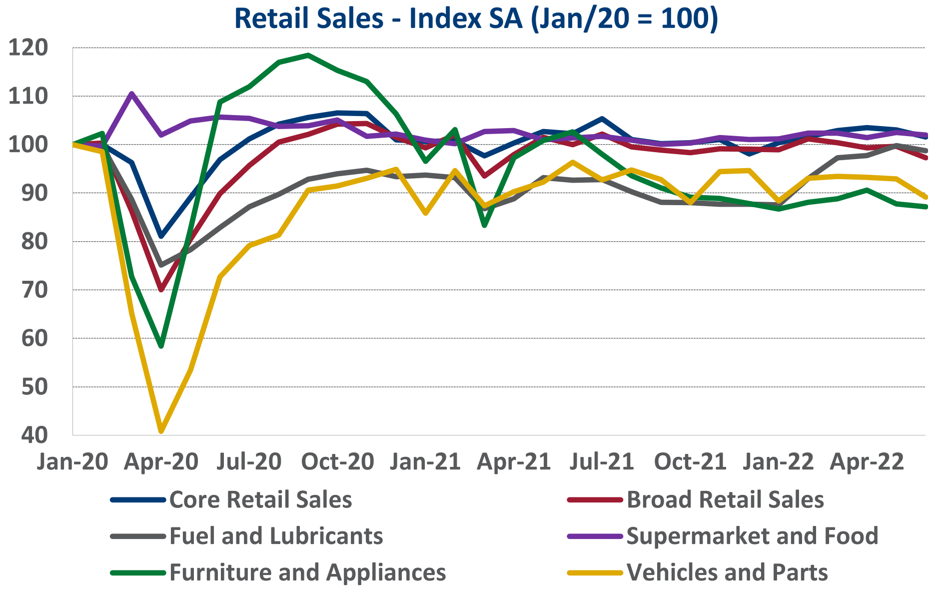
Industrial Production - Distance to pre-pandemic (Jul/22)

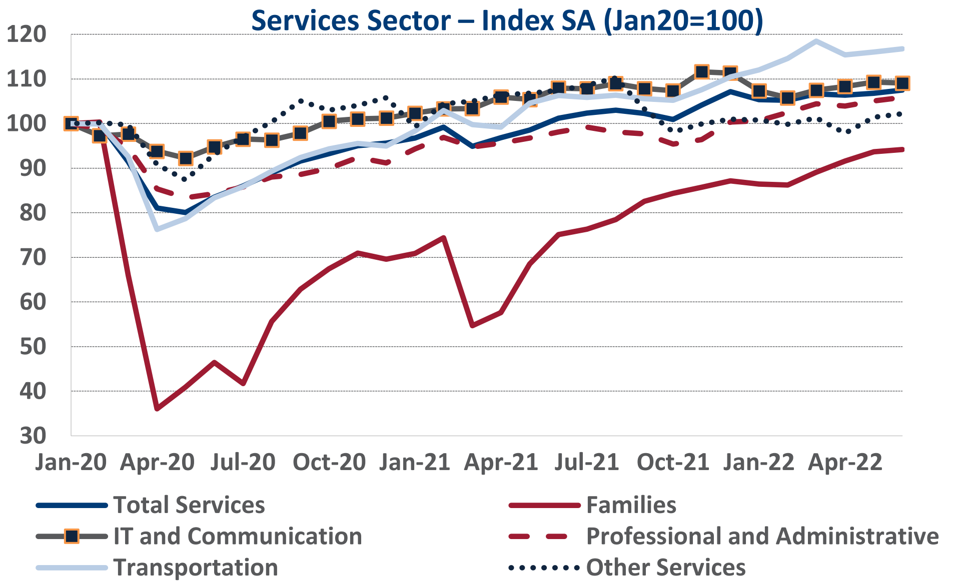


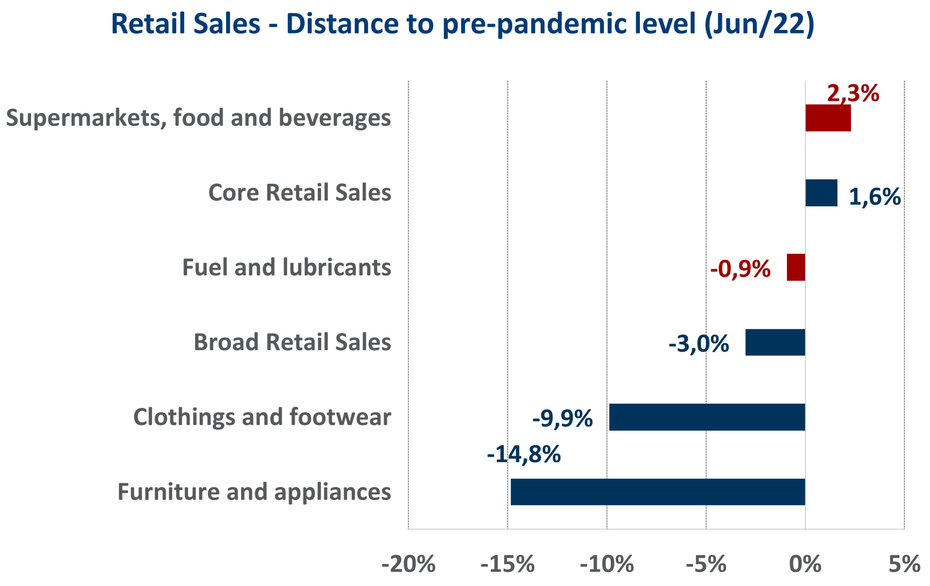
Source: IBGE, BOCOM BBM

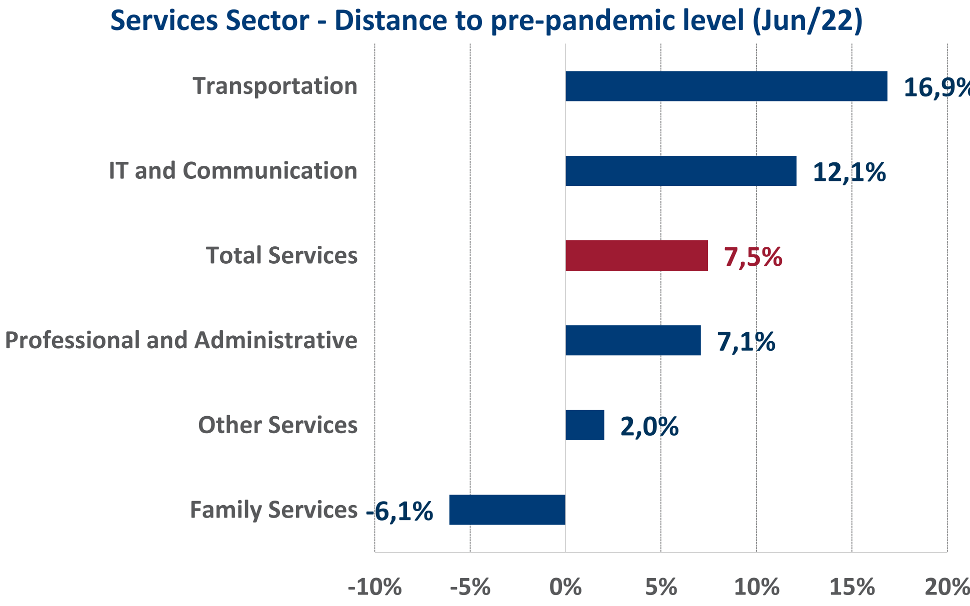
Brazil: Retail Sales and Services Sector

- In June, **broad retail sales** decreased by **-2.4%** MoM, mainly affected by the decrease in vehicles sales (-4.1% MoM);
- The **services** sector posted another surprisingly positive result of **0.7%** MoM (market expectations was 0.5%);
- The services sector is now 7.5% above pre-pandemic levels, while broad retail sales is 3.0% below.





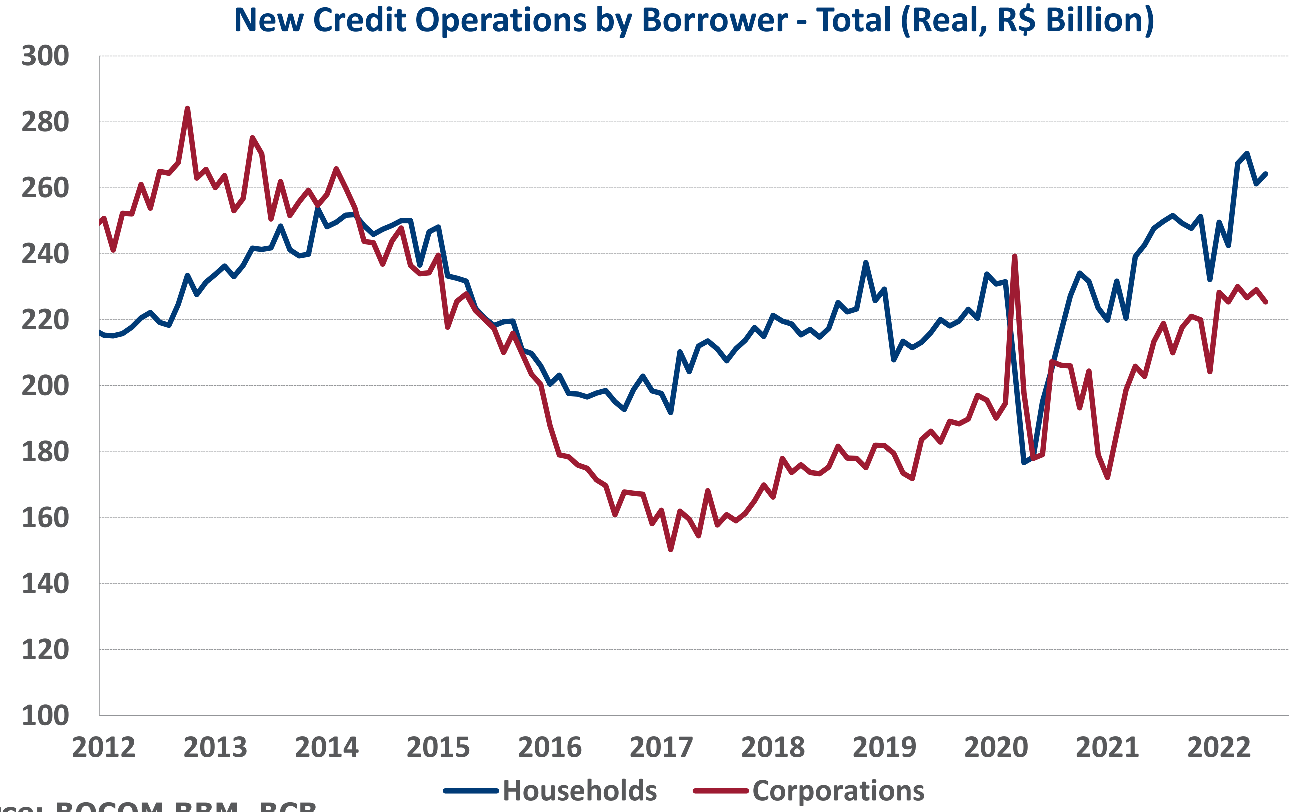


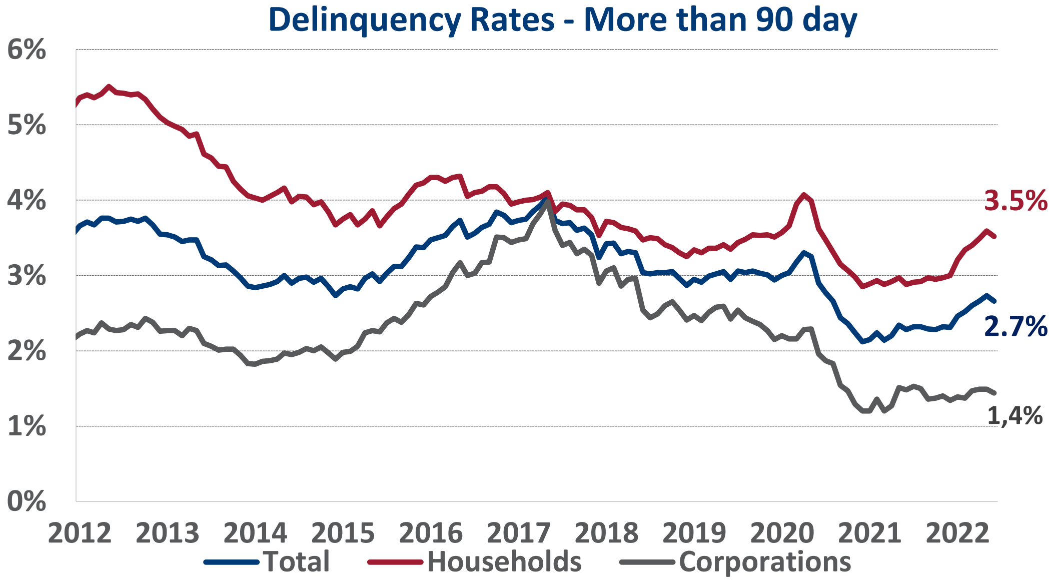


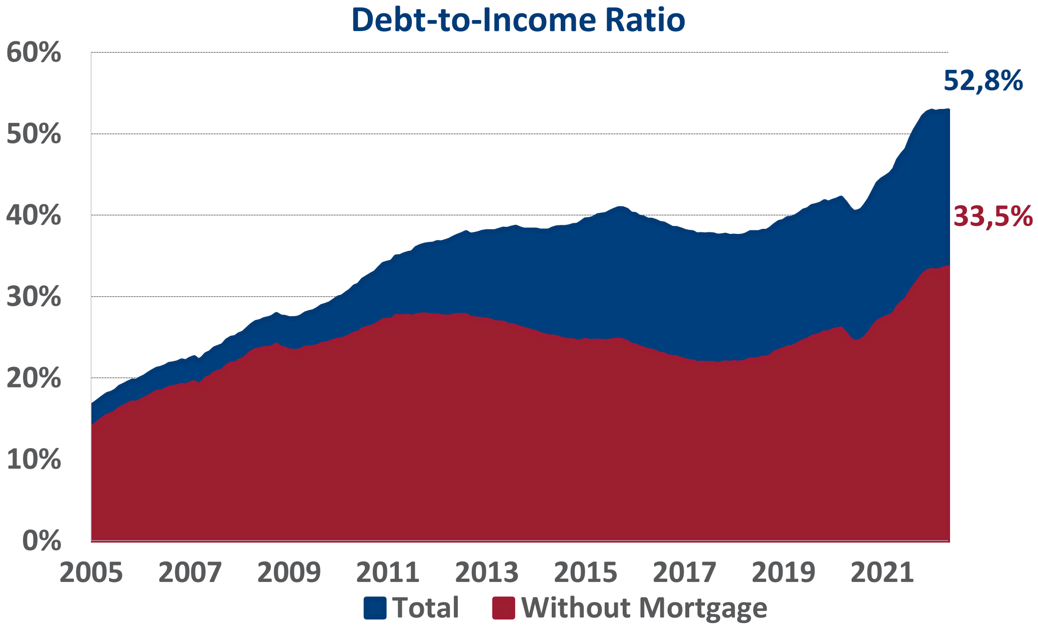
Source: IBGE, BOCOM BBM

Brazil: Credit

- **In June, new loans decreased by 0.7%**, with loans to companies falling -0.9% MoM and to households increasing by 1.8% MoM;
- Delinquency rates still low but trending up: tight monetary policies and increased family's indebtedness.



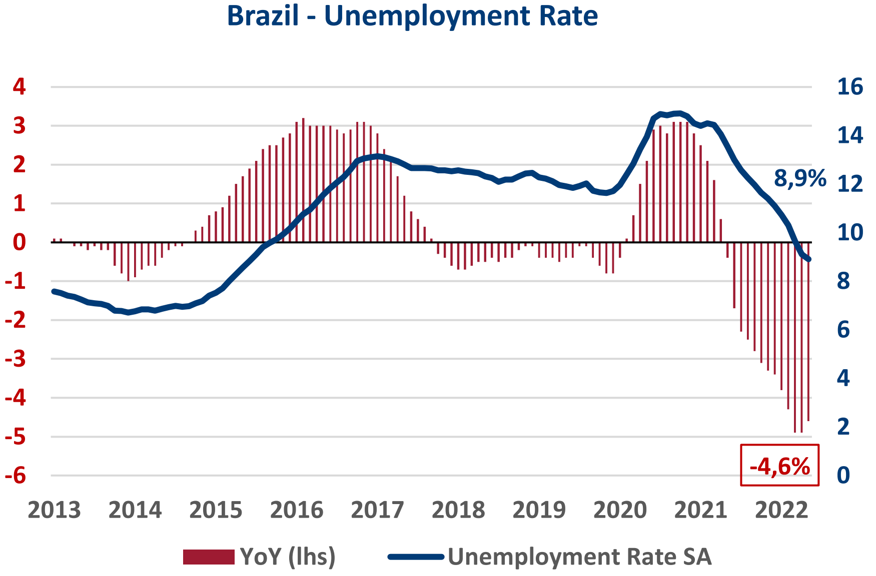


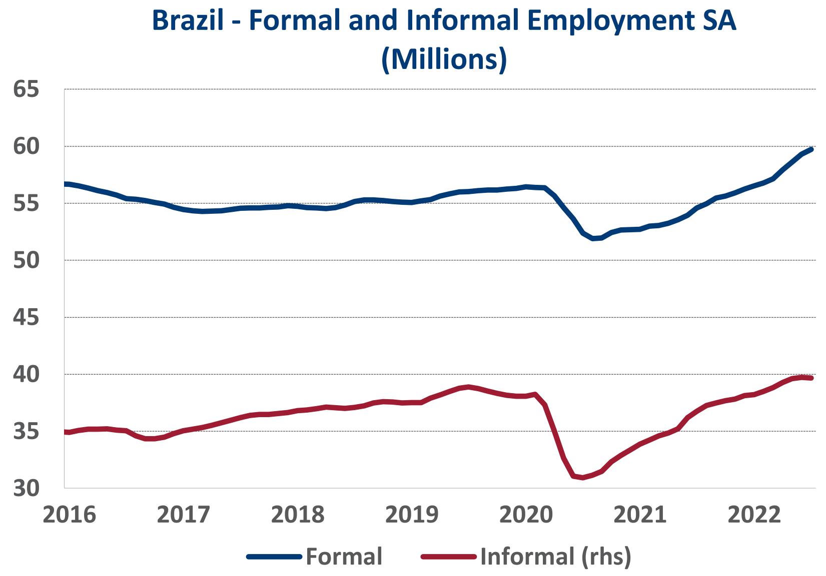


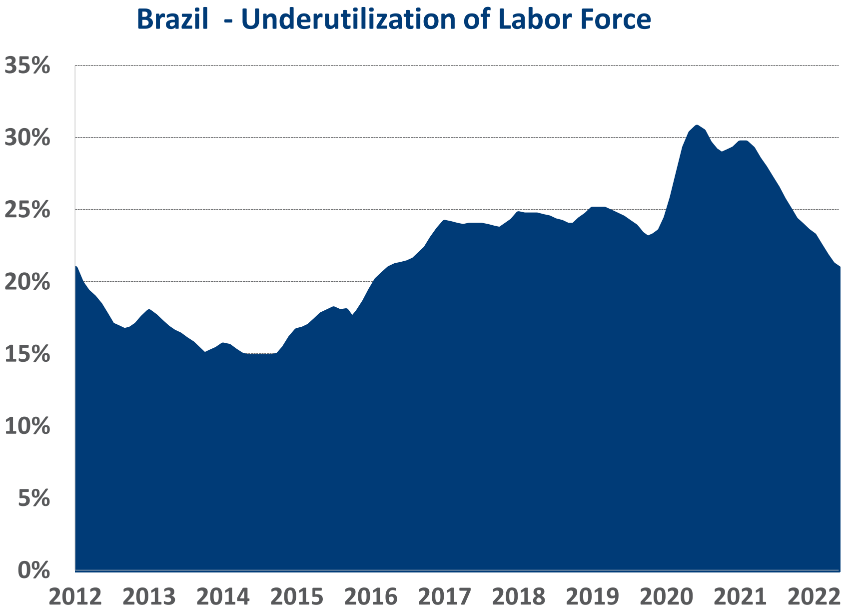
Source: BOCOM BBM, BCB

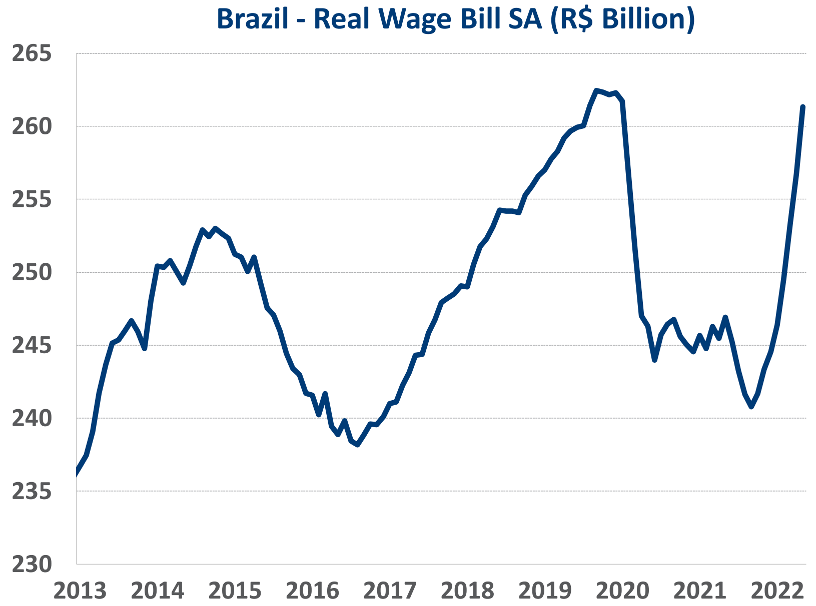
Brazil: Labor Market

- The labor market kept improving in July, on the heels of the normalization process:
  - The unemployment rate fell from 9.1% to **8.9%** (9.3% to **9.1%** NSA) with the recovery of both formal and informal jobs;
  - The underutilization of labor force continues to fall and is now at **20.9%**;
  - Real wage bill is quickly picking up due to the increasing number of employed population, however it's woth noting that average real wage is still stable.
    - Real wage bill is now 0.4% below it's pre-pandemic level;









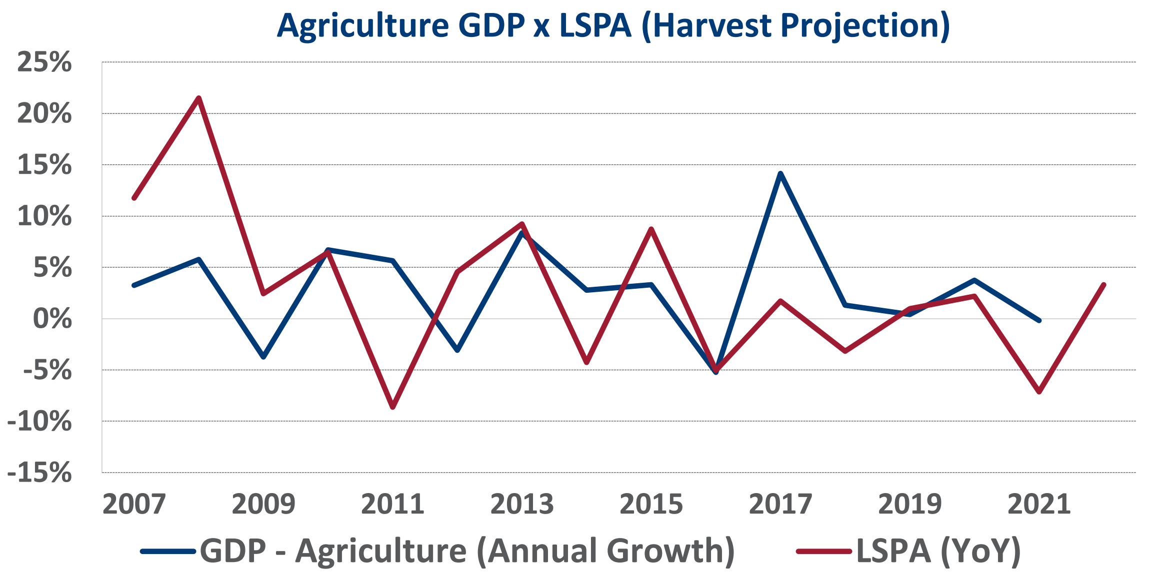
Fonte: IBGE, Bocom BBM

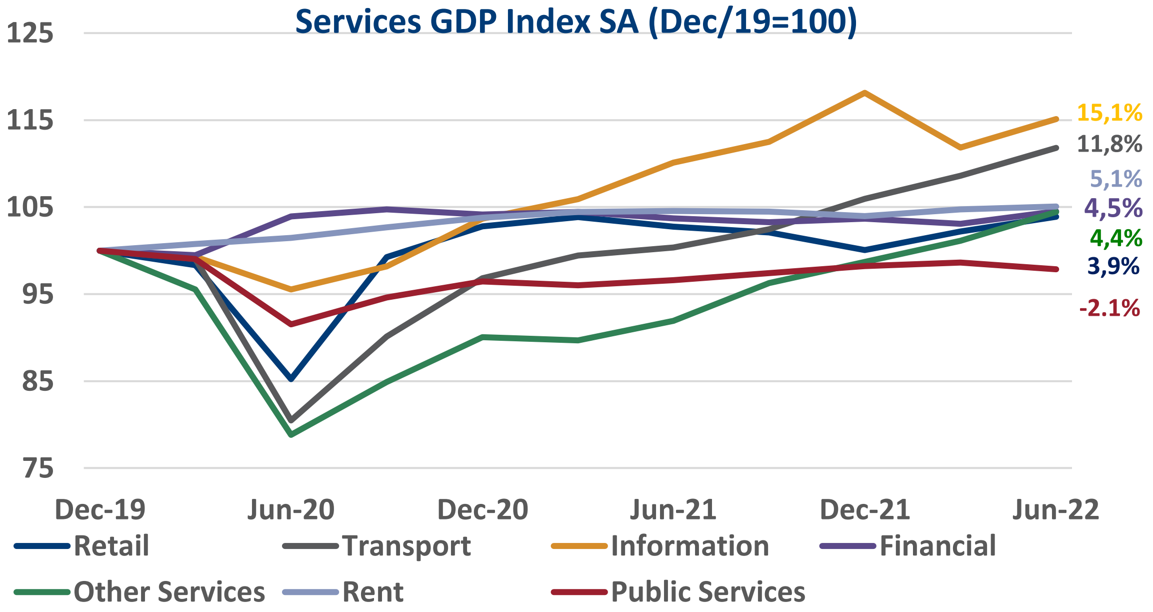
Brazil: 2022 GDP Scenario

- We expect a **negative contribution of the agriculture output** in the 2022 GDP, due to the downward revision of this year's crops projection (LSPA) such as soybeans (-12.0%) and rice (-8.5%) and the negative surprise in 2Q22;

- **We revised up our industry GDP projections** due to a better-than-expected 2Q22 result which pushed its carry-over effect to 1.3%:
  - There have been some improvements regarding the supply chain bottlenecks;
  - On the other hand, we recognize there's a downside risk regarding a different demand composition which favors services consumption rather than goods.

- **We expect services output to continue increasing,** due to the improvements in labor market conditions, increased government cash-transfers and the use of circumstantial savings that rose during the pandemic**;**
  - low unemployment and fiscal stimulus translates to stronger household disposable income, which also increase household consumption;
  - It's expected that activity loses strength in 2H22: global and domestic uncertainty, elevated interest rates, mounting fiscal risks, high household indebtedness, rising delinquency rate, a soft consumer confidence index and the dissipation of the economic reopening positive effects.



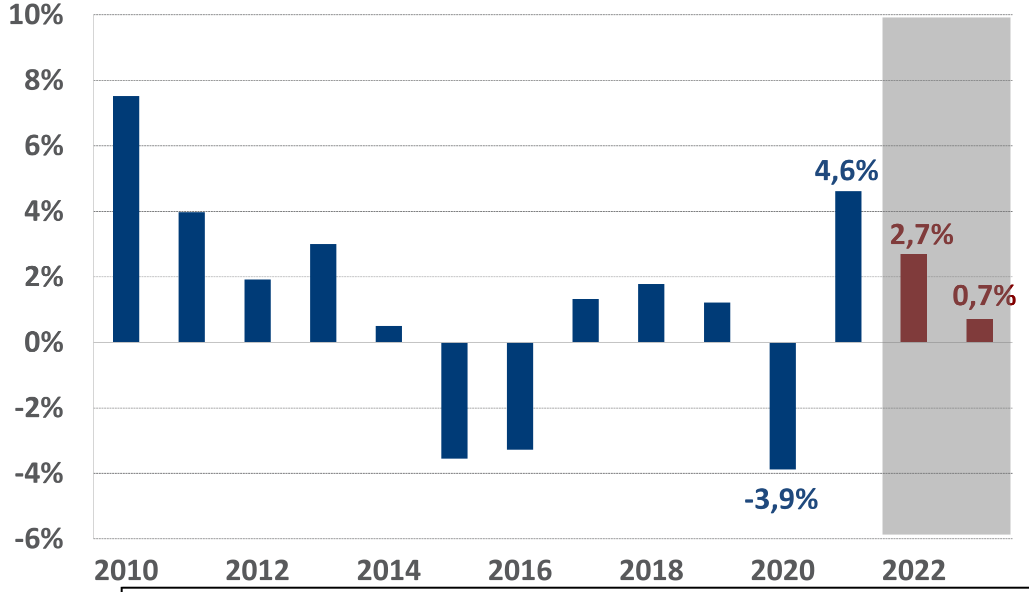


Source: BOCOM BBM, IBGE

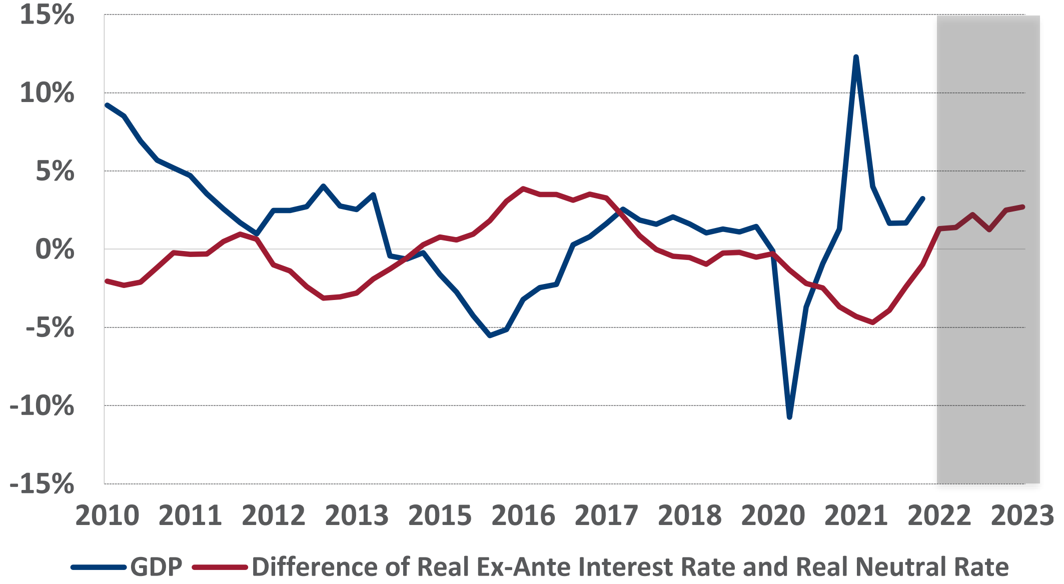
Brazil: GDP Scenario

- **Our 2022 GDP projection is now at 2.7%:** positive contribution from services and industry sectors;
  - the negative impact of the tight monetary policy should be seen in the 2H22, but the high carry-over effect should dampen this slowdown;
- **We revised up our 2023 GDP projection is at 0.7%:**
  - The better outlook for 2022 GDP pushed the carry-over effect for 2023 to 0.6%;
  - However, some factors limit further GDP growth in 2023: Restrictive monetary and fiscal policies + labor market stabilization + global recession decreasing commodities prices;

GDP – Annual Growth (%)



GDP x Monetary Policy Stance - YoY



GDP Projections 2022

GDP Breakdown	Weights	2019	2020	2021	2Q22 QoQ	2Q22 YoY	2022 Annual Growth
Agriculture	6,9	0,4	3,8	-0,2	0,5	-2,5	-1,6
Industry	18,9	-0,7	-3,4	4,5	2,2	1,9	1,7
Services	59,4	1,5	-4,3	4,7	1,3	4,5	3,9
Total GDP		1,2	-3,9	4,6	1,2	3,2	2,7

Source: BOCOM BBM, IBGE

Brazil: Inflation

- In 2022, inflationary pressure focused on non-regulated prices, as tax cuts and the drop in oil prices on the international market reduced inflation of regulated items. Food at home shows high inflation, especially due to the commodity shock and weather conditions at the beginning of the year, however a relief is foreseen for the coming months. Inflation for industrial goods was pressured by bottlenecks in the global production chain, but it already shows strong relief in the second half. Services, on the other hand, has accelerated in line with the mobility recovery;
- For 2023, economic activity and a stronger labor market should keep service inflation at a higher level, causing inflation to stay above the target. However, industrial goods and food prices should experience less inflationary pressure due to the base effect and accommodation in commodity prices. The lower inertia arising from 2022, after successive downward revisions, is also a factor that helps to moderate expectations for 2023.

Baseline Scenario (YoY)						
	IPCA	Regulated	Non-Regulated	Services	Food at Home	Industrial Products
20 Q4	4.5%	2.6%	5.2%	1.7%	18.2%	3.2%
21 Q1	6.1%	7.0%	5.8%	1.6%	17.6%	5.5%
21 Q2	8.3%	13.0%	6.7%	2.2%	15.3%	8.7%
21 Q3	10.2%	15.7%	8.3%	4.4%	14.7%	10.6%
21 Q4	10.1%	16.9%	7.7%	4.8%	8.2%	11.9%
22 Q1	11.3%	14.9%	10.0%	6.3%	13.7%	13.4%
22 Q2	11.9%	11.7%	11.9%	8.7%	16.7%	13.6%
22 Q3	7.3%	-2.3%	10.8%	8.9%	14.4%	11.3%
22 Q4	6.1%	-4.3%	9.7%	9.0%	12.4%	8.9%
23 Q1	4.6%	-4.0%	7.6%	8.7%	7.4%	6.0%
23 Q2	3.6%	-2.8%	5.7%	7.0%	5.0%	4.0%
23 Q3	5.5%	7.2%	4.8%	6.0%	3.5%	3.9%
23 Q4	4.8%	6.1%	4.4%	5.0%	4.7%	3.2%

Source: BOCOM BBM, IBGE

Brazil: Inflation

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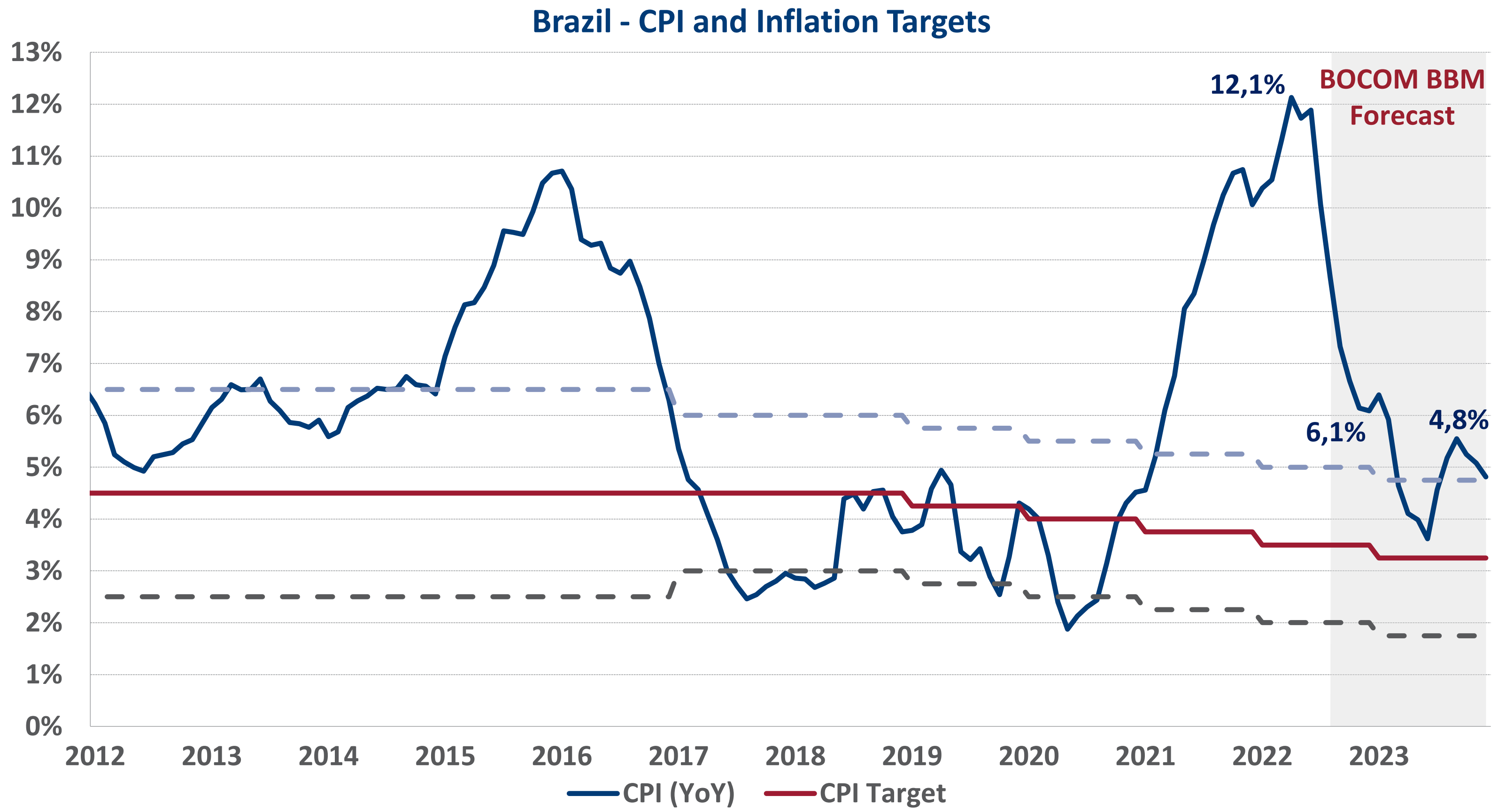
- Our 6.1% forecast for 2022 takes into account the impact of PIS/Cofins tax credits on electricity readjustments, federal and state tax cuts, high persistence of services inflation, high food and industrial goods inflation , due to the effects of the war, and the green flag for electricity;
- In 2023, the forecast is 4.8%, above the target. On the one hand, we see the deterioration of expectations, the persistence of services inflation and less idleness in the economy due to the strength of the labor market. On the other hand, we see less inertia from 2022, the maintenance of federal tax exemptions on fuel and better-behaved industrial inflation;



Source: BCB, BOCOM BBM, IBGE

Brazil: Inflation

- **In 2022, the forecast of 6.1% takes into account the impact of PLP 18/22, which limited the ICMS on electricity, telecommunications and fuel to 17% and exempted PIS/Cofins on fuel until December. On the other hand, inflation expectations, the strong inertia of services inflation and the impact of the Russia-Ukraine war, which pushed up commodity prices, still leave the number high.**

- **In 2023, the 4.8% forecast considers the maintenance of the PIS/Cofins exemption on fuels (as indicated in the PLOA), lower inertia of services inflation after downward revisions in 2022, inflation expectations above the target, readjustments of some regulated items that are impacted by the effort to contain some readjustments this year. In addition, the strength of the labor market has made the output gap less negative, which shows the resilience of demand.**

- The main risks in the scenario for inflation are:

Upside risks:

1. The government's fiscal policy may continue to boost demand and lessen the effect of contractionary monetary policy;
2. In 2023, inertia could be greater than estimated and make the disinflation process even more difficult;
3. Warmer and drier weather in the northern hemisphere could harm next year's crops, increasing demand for Brazilian food. In addition, the high cost of natural gas in Europe could put pressure on fertilizer prices.

Downside Risks:

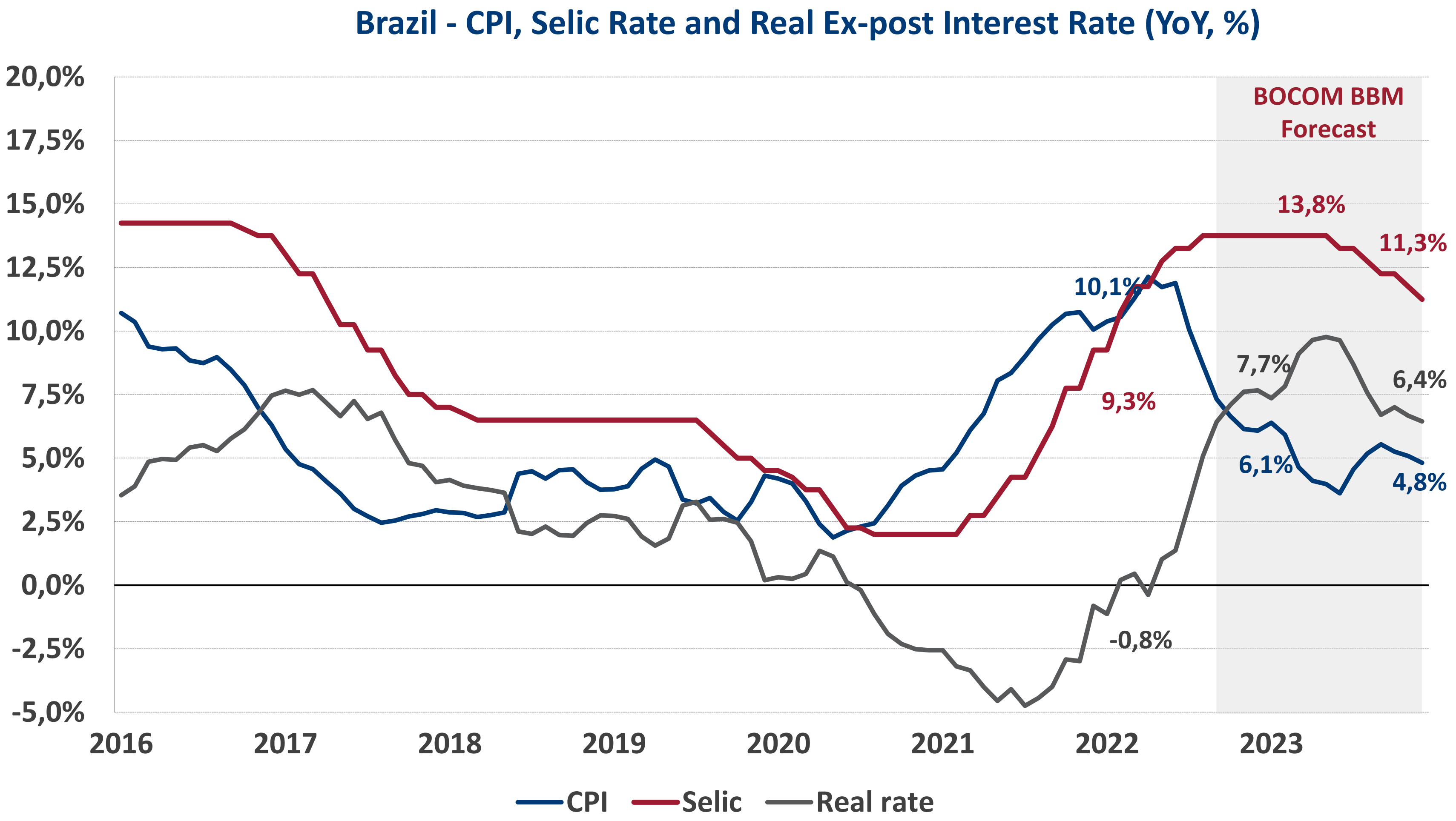
1. Commodity price declines may continue for a long time, impacting gasoline, diesel, industrial goods and food prices;
2. Lower inflation in 2022 could significantly reduce inertia for 2023

Source: BOCOM BBM

Brazil: Interest rates

交通銀行 BANK OF COMMUNICATIONS BBM

- The decrease of commodities prices in the last month, the deflation in July, August and possibly in September, and the downside revisions in 2022 and 2023 forecasts favors the end of the cycle at 13.75%;



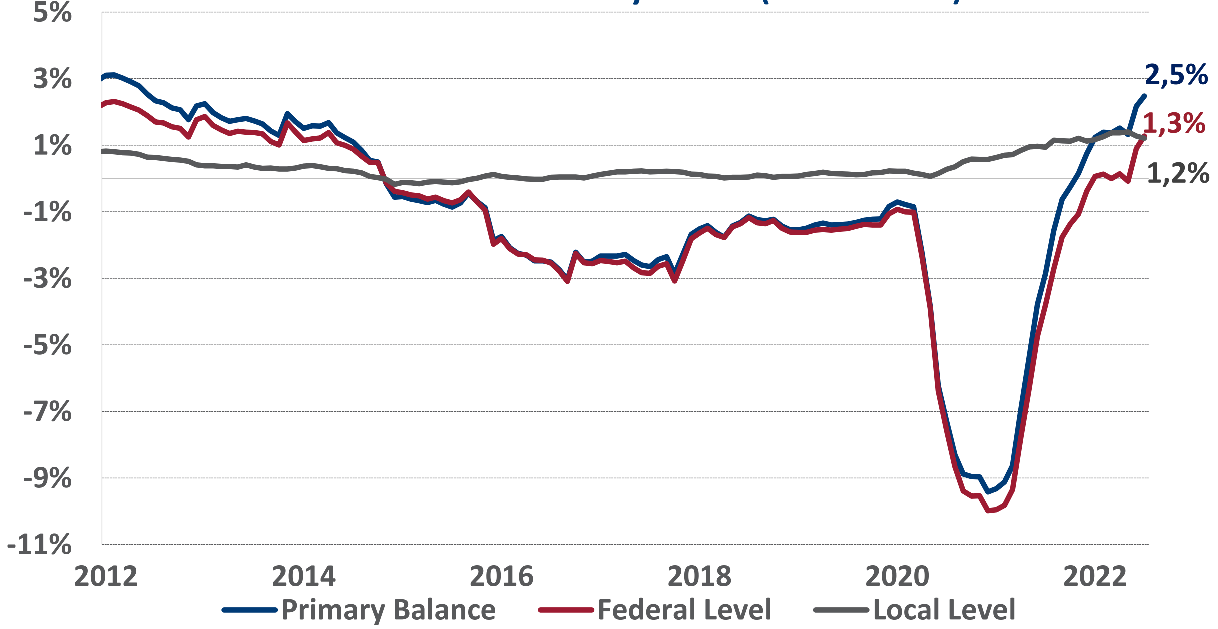
Source: BCB, BOCOM BBM, IBGE

Brazil: Fiscal Results

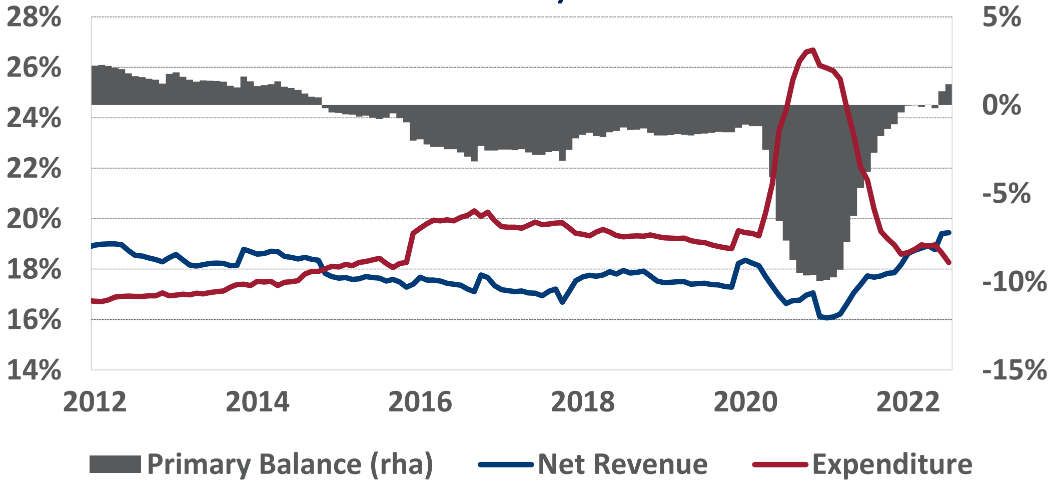
- In July, tax collection (BRL 202.6 bn) was close to the market median;
    - 7.5% YoY real increase and 10.4% YoY in YTD terms;
- The consolidated public sector reached a primary surplus of BRL 20.4 bn;
    - the best result for July in recorded data;
- The central government registered a primary surplus of BRL 19.3 bn;
    - short-term fiscal numbers remain solid;

Brazil: Total Tax Collection (% GDP 12M)

Brazil: Public Sector Primary Result (% GDP 12M)



Brazil: C. G. Net Revenue and Expenditure (% GDP 12M)

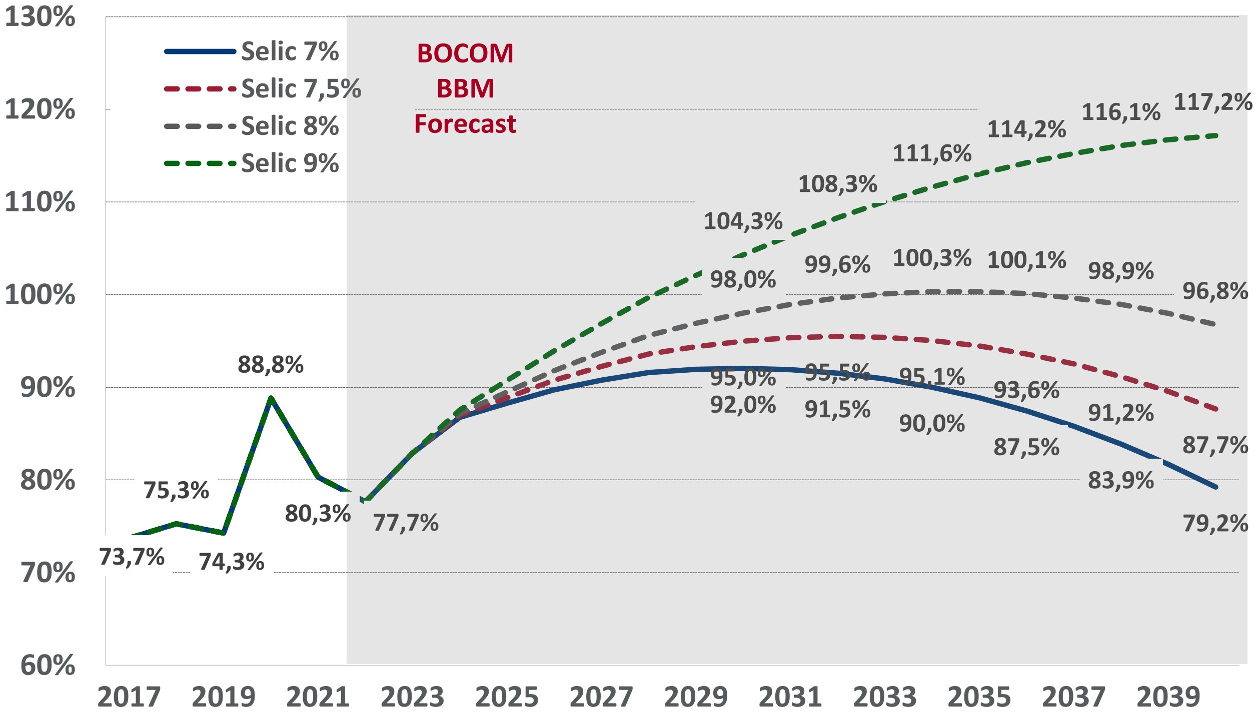


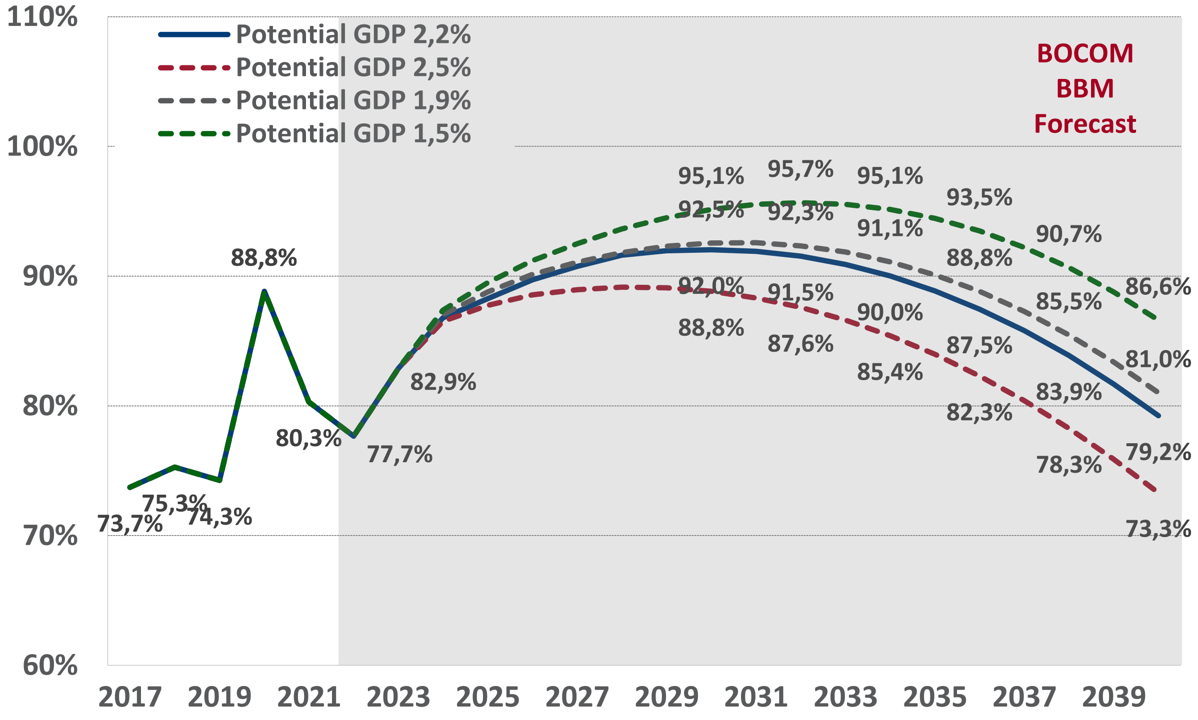
Source: BOCOM BBM, Tesouro Nacional, BCB, Receita Federal

Fiscal: Debt to GDP

- In our base scenario, we currently expect a 77.7% result for the debt to GDP ratio in 2022;
- The trajectory of the debt changes depending on the potential GDP and Selic scenarios.

Other Hypothesis:	
Long Term Selic Rate	7%
Implicit Selic Rate	7.75%
GDP Deflator	3.5
Long Term CPI	3%
Potential GDP Growth	2.2%

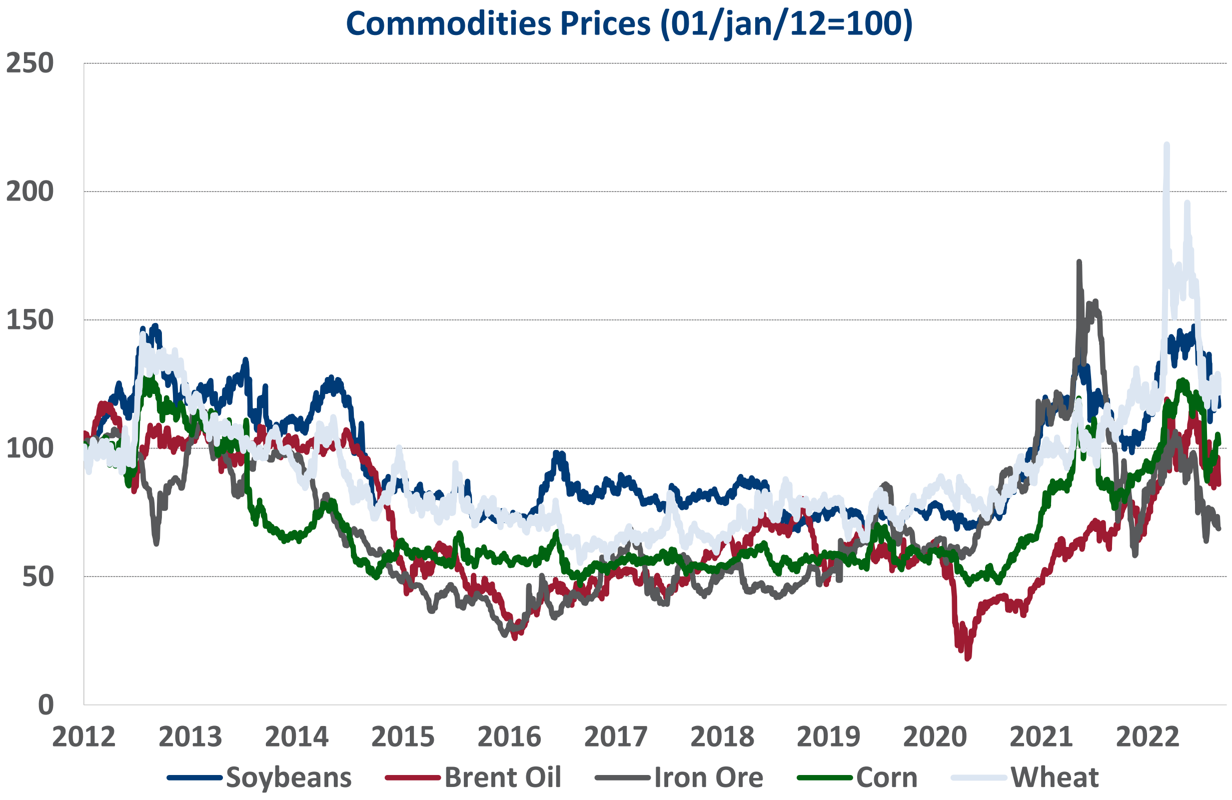


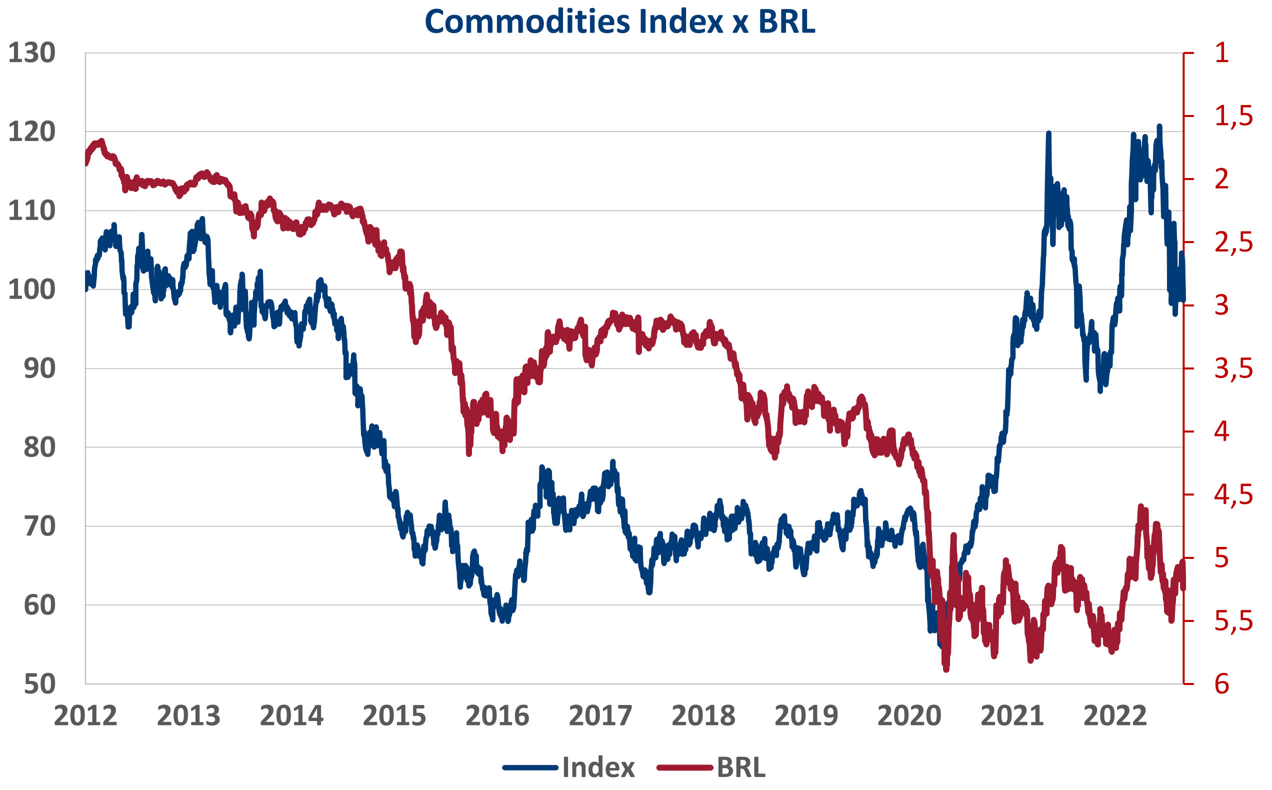


Fonte: BOCOM BBM

Brazil: External Sector

- The price of the main commodities exported by Brazil is a relevant factor for the BRL, but the uncertainty about global growth and fiscal risk offset this force.

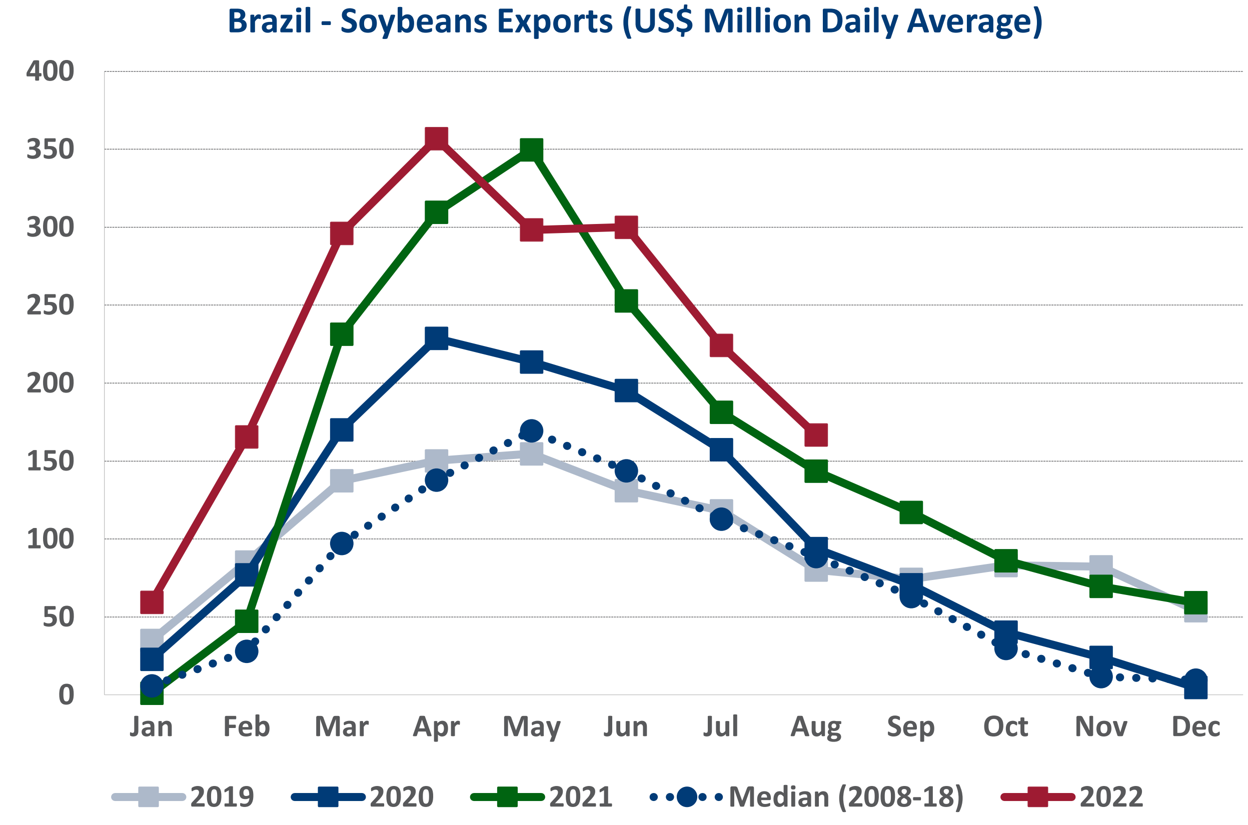


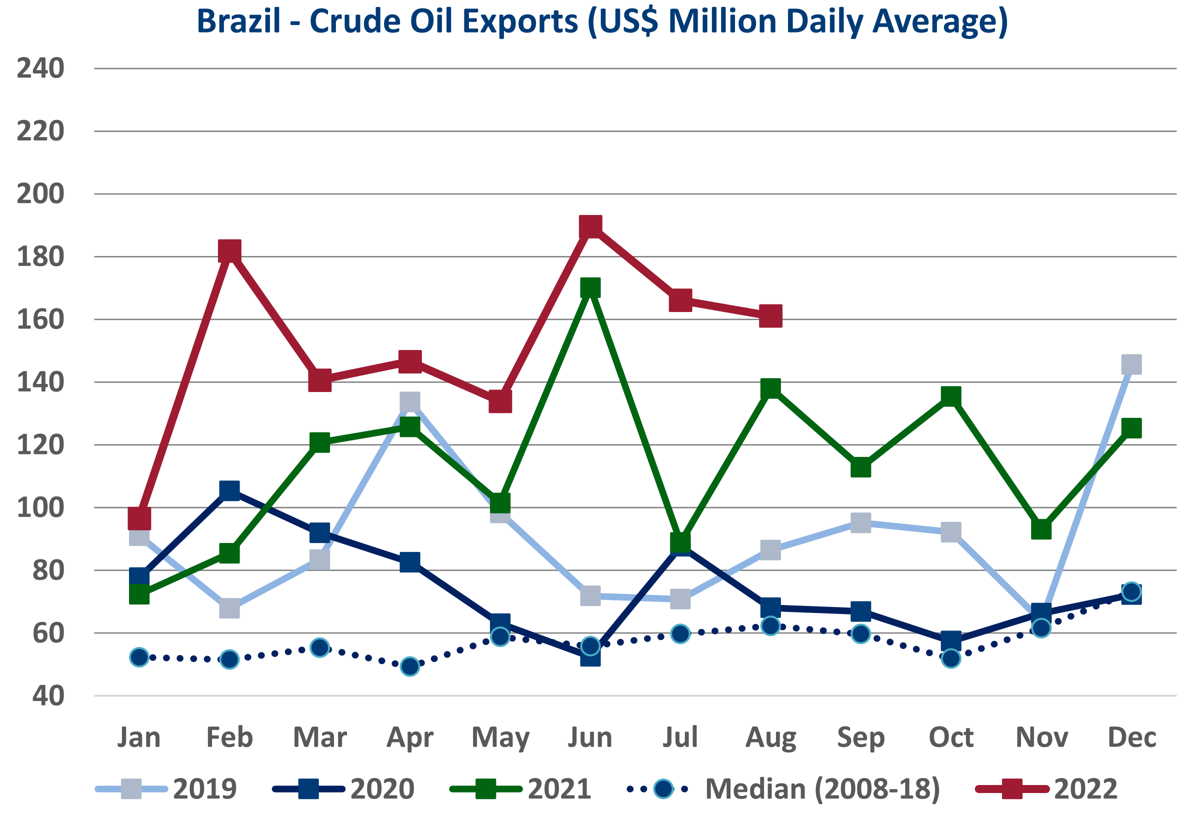


Source: Secex, BBG, BOCOM BBM

Brazil: External Sector

- Trade balance continues to be favored by high prices of commodities that should keep the country's exports high in the coming months;

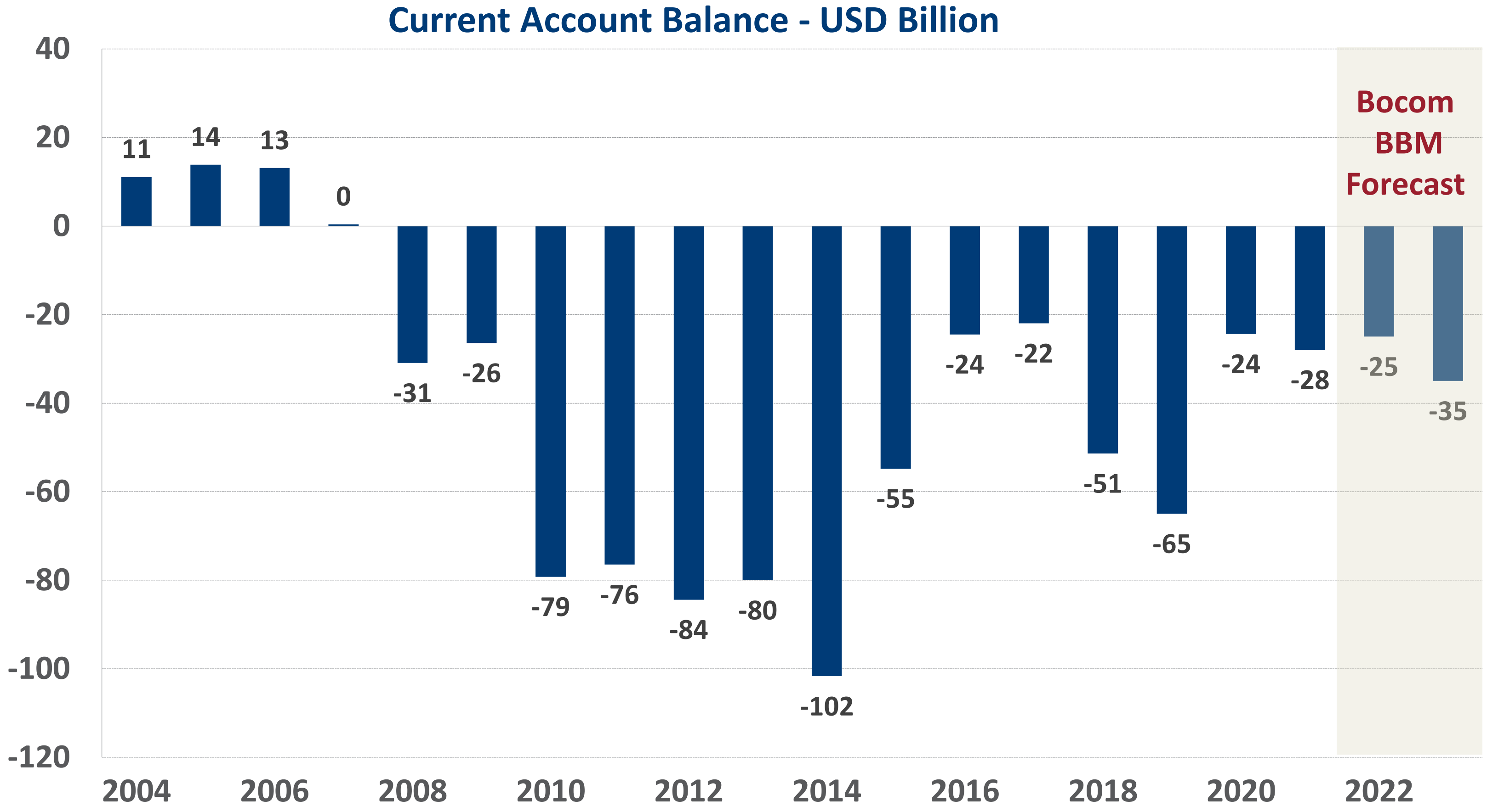




Source: Secex, BOCOMBBM

Brazil: Balance of Payments

- Current account is expected to display similar results as in 2020 and 2021, considering still elevated commodity prices;
- Our current account forecast is at USD -25 billion in 2022. In spite of expecting solid results of Brazilian exports this year, we also expect higher deficit of services and higher profits sent abroad due to a better outlook of activity.



Source: BCB, BOCOM BBM

Brazil: Presidential Elections

BANK OF COMMUNICATIONS BBM

Fiscal Proposals:

Major Presidential Fiscal Proposals for 2023			
	Lula	Bolsonaro	Cost (% of GDP)
Income Tax Reform (IR)	Yes	Yes	-
Auxílio Brasil BRL 600	Yes	Yes	0,53
Maintain the tax exoneration of federal taxes on fuels	Yes	Yes	0,48
Real minimum wage increase (1%)	Yes	No	0,06
Recompose discretionary budget	Yes	No	0,63
Precatórios	Yes	Yes	0,58
Compensation to States	Yes	Yes	0,1
Additional Spending Scenario for 2023			
	Optimistic	Bolsonaro with spending exogenous to Executive	Lula with BRL 200 - 400 bn
BRL bn	105	175	240
% of GDP	1,01%	1,69%	2,31%

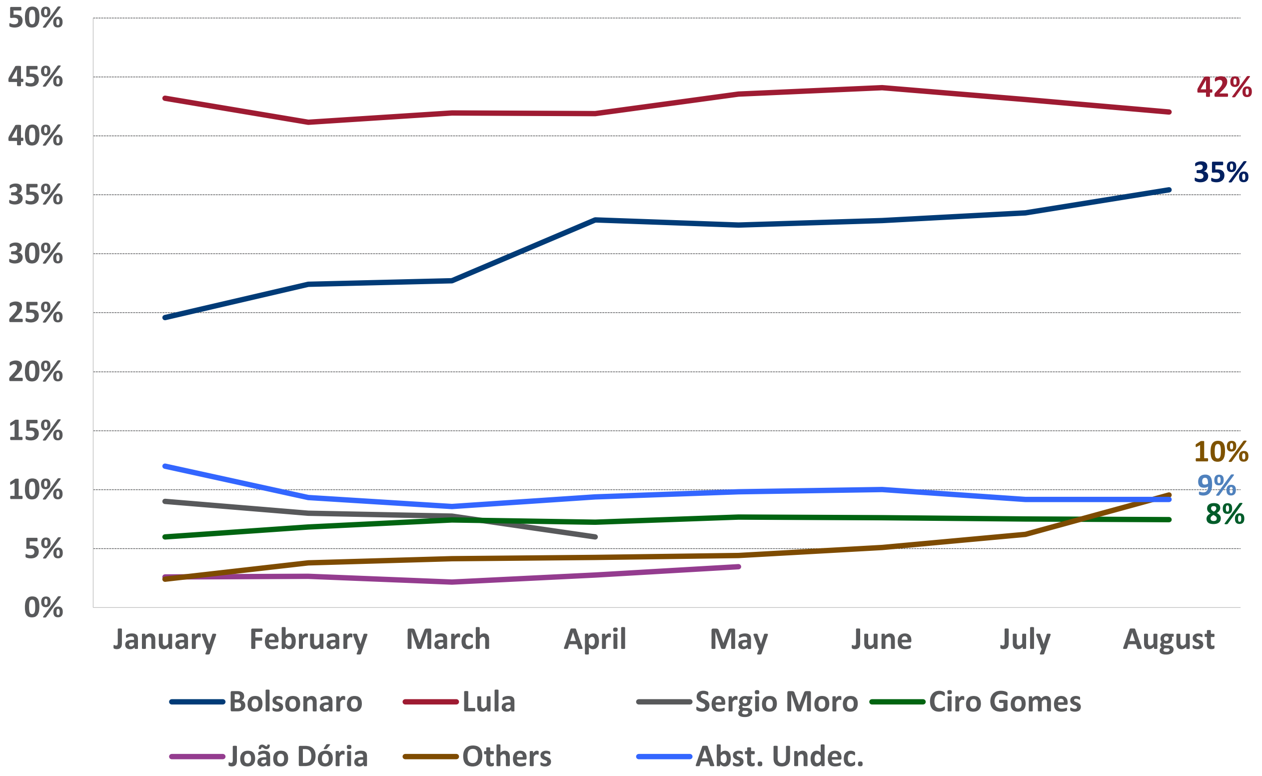
Major Presidential Fiscal Proposals for 2024 onwards		
	Lula	Bolsonaro
Privatizations	No	Yes
Concessions	Yes	Yes
Fiscal Rule	1. Expenditure target starting at 19% of GDP and falling back to 18% in a 4-year horizon 2. Increase in tax burden (2% of GDP) via tax reform	If debt < 60% of GDP --> IPCA +2 - 2.25% If debt between 60 and 75% of GDP --> IPCA +1 - 1,5% If debt > 75% of GDP --> Follows the current rule

Source: IBRE, BOCOM BBM

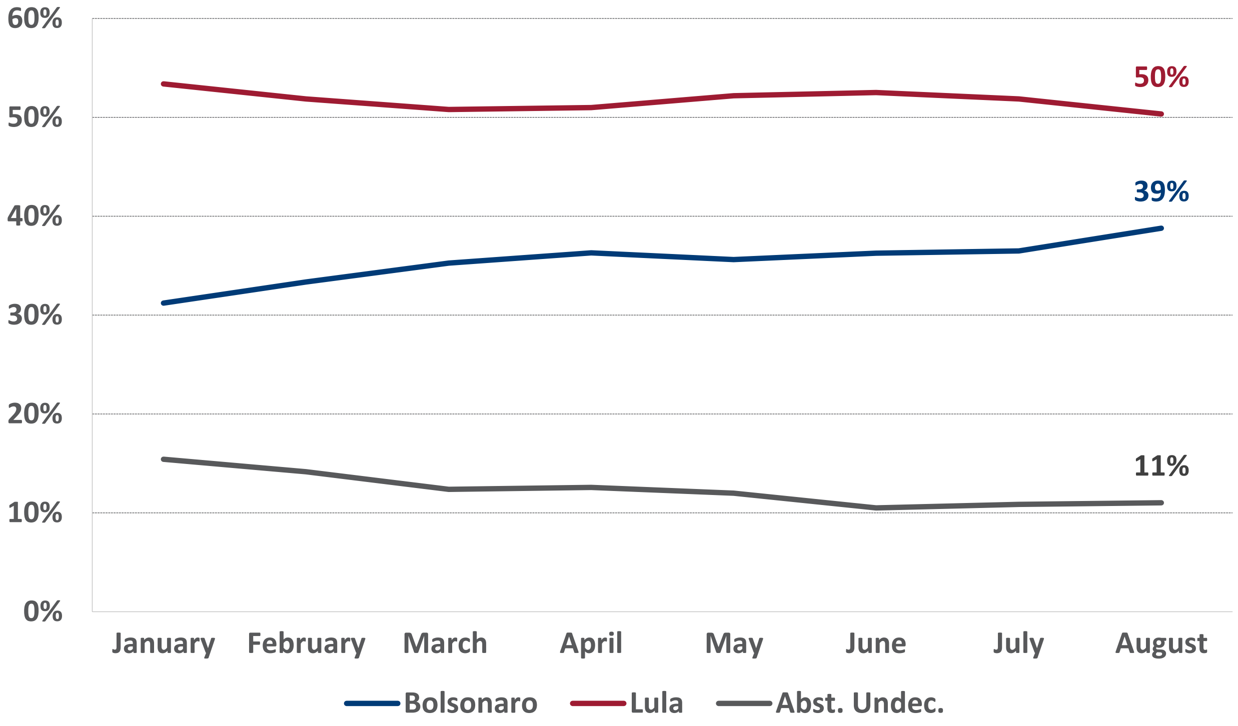
Brazil: Presidential Elections

- Improvement in Bolsonaro's voting intentions, and a decrease in Lula, but he is still in the lead;
  - In the second round, Lula is 11 p.p. ahead Bolsonaro;

Brazil: Voting Intentions - Polling Aggregation (%)



Brazil: Voting Intentions - Second Round Polling Aggregation (%)



Source: DataFolha, BTG/FSB, Exame/Ideia, PoderData, Quaest/Genial, XP/Ipespe, Paraná Pesquisas, Modal/Futura, CNT/MDA, GERP, Ranking, BOCOM BBM

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