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Scenarios for 2023 and 2024

Cecilia Machado
Chief Economist

Luana Miranda
Economist

Emanuelle Pires
Intern

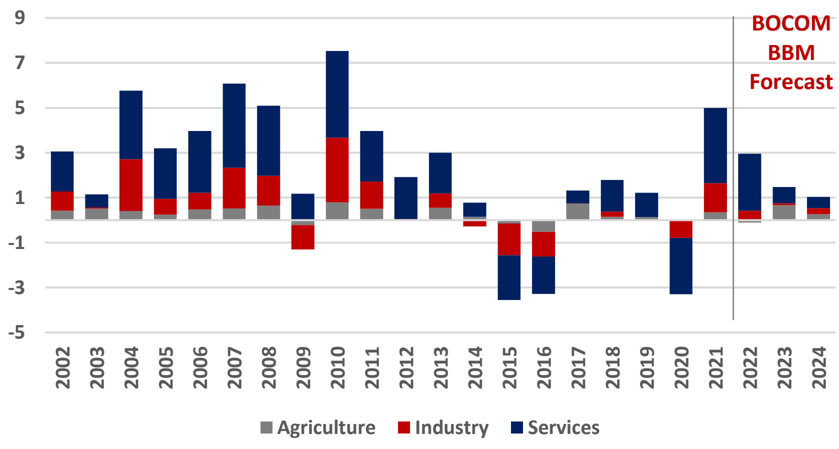
Taric Latif
Intern

Victor Cota
Intern

The approval of Constitutional Amendment 126/2022 at the end of the year, allowing the incoming government to breach the spending cap ("PEC da Transição"), provided clues to the new administration's economic policy in 2023. The measure makes room in the 2023 budget for BRL 145 billion of extra expenditure, guaranteeing disbursement of BRL 600 per family plus BRL 150 per child under the Bolsa Família cash transfer program, and BRL 23 billion for investment to be taken from the now extinct PIS/PASEP Fund. All told, the measure represents an increase of BRL 170 billion in expenditure. In what follows, we outline how this fiscal expansion affects our scenarios, revise our projections for 2023, and present our projections for 2024.

We expect 1.5% GDP growth in 2023, led by the agricultural sector (Figure 1). According to the National Food Supply Corporation (CONAB), grain output is set to rise 15%, more than in any year since 2017. Despite the positive outlook for agriculture, with possible spillover effects for other economic sectors, inasmuch as agribusiness in the broad sense influences the industrial sector's performance via production of machinery, as well as the provision of services relating to agriculture, there are climate-associated risks to grain production. The labor market and service sector show signs of deceleration, and the lagging effects of monetary tightening are expected to take place in both 2023 and 2024.

Figure 1: Sectorial Contribution to GDP Growth (annual, %)



Source: IBGE, BOCOM BBM

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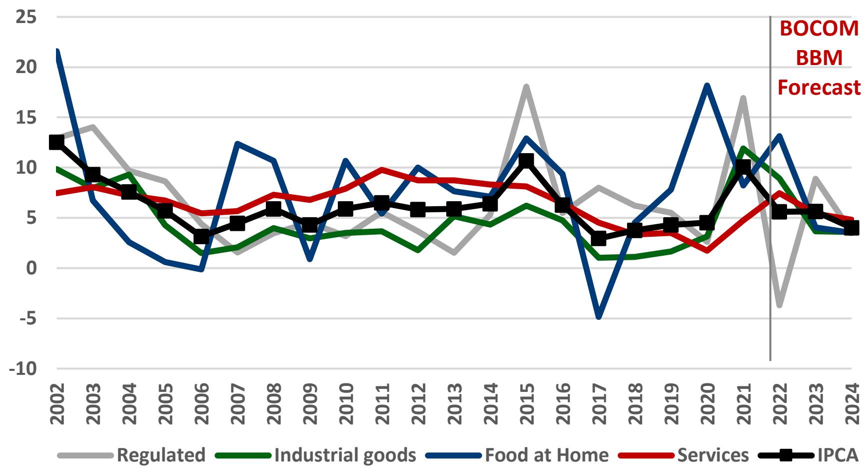
For 2024, we project 1% growth, led mainly by civil construction and public services (such as education and healthcare), which were a focus for attention under previous Workers Party administrations, but with a negative outlook for household consumption and private investment due to restrictive interest rates and uncertainty about the new fiscal framework.

Strong spending growth, set to reach about 2% of GDP in 2023, poses challenges to inflation convergence toward its intended target. Rising incomes stimulate aggregate demand and put upside pressure on prices. In light of these trends, our scenario assumes that the Selic rate will remain in restrictive territory for a longer period, and we expect it to be held at 13.75% until end-2023. There will be scope for cuts only in 2024, as inflation converges more clearly toward the target and expectations become anchored, allowing the Selic to reach 10% at end-2024.

Having begun 2022 on 10.1%, inflation will reach 5.6% by year-end. Despite this significant disinflation, our scenario assumes that federal taxes on fuel will be reinstated in 2023, pressuring prices of regulated items. Furthermore, we expect higher inertia in service inflation because of fiscal expansion and slow, gradual adjustment of the labor market. Owing to these two factors, we have revised up our inflation projection for 2023 to 5.6% (Figure 2). Our projection for 2024 is 4%, reflecting the lagging effects of monetary tightening, set to persist for most of the year in 2023.

Figure 2: IPCA (annual, %)



Source: IBGE, BOCOM BBM

The fiscal outlook is highly sensitive to the new fiscal framework to be established in the course of 2023. Constitutional Amendment 126 gives the government until August 31 to send Congress a bill that replaces the existing framework, which is based on a spending cap. Tax revenue, which was strongly boosted by the post-COVID recovery, external growth and rising commodity prices, is expected to decelerate moderately in 2023 and 2024. In conjunction with spending growth in 2023, and assuming that spending continues to expand in 2024 (after allowing for

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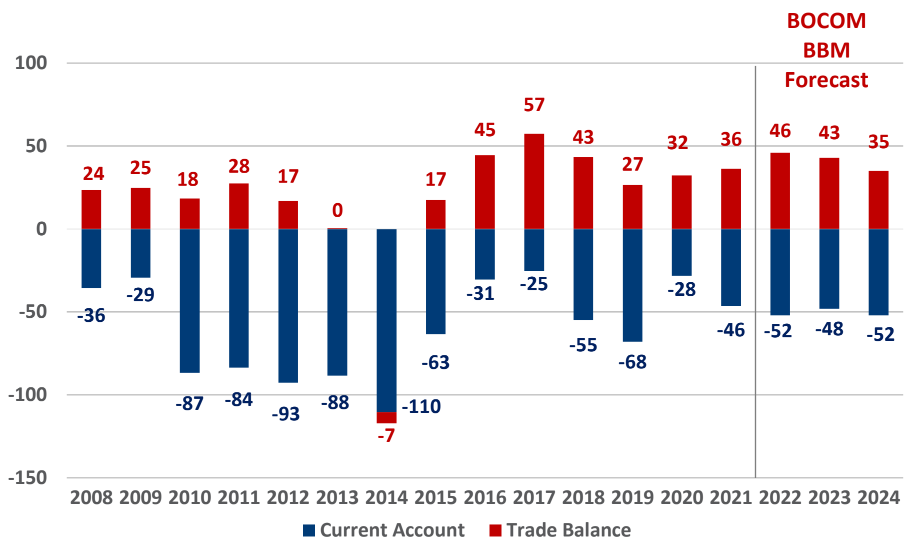
inflation), we expect the 2022 fiscal surplus to become a deficit corresponding to 1.1% of GDP in 2023 and 0.8% in 2024. Debt will rise to 79.9% in 2023 and 85.1% in 2024, and it will be crucial to establish fiscal rules that assure its sustainability (or raise taxes).

Finally, the outlook for the balance of payments remains healthy, thanks mainly to a significant trade surplus, set to reach USD 46 billion in 2022 and remain practically unchanged in 2023, as the economic slowdown in the developed world, with its impact on Brazilian exports, is counterbalanced by decreasing imports due to domestic deceleration (Figure 3). Although revisions to the balance of payments during 2022 revealed a much larger current-account deficit due to methodological changes to the measuring of freight, the strong inflow of foreign direct investment (FDI) guarantees comfortable financing of this deficit. FDI is estimated at about USD 90 billion in 2022, more than in any year since 2012. If fiscal sustainability is achieved and the structural reforms implemented in recent years are maintained, the flow of FDI is likely to persist, sustaining the favorable dynamics of the external accounts.

Figure 3: Current Account and Trade Balance (US$ Billion)



Source: BCB, BOCOM BBM

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ECONOMIC FORECASTS	2019	2020	2021	2022F	2023F	2024F
GDP Growth (%)	1,2%	-3,3%	5,0%	2,9%	1,5%	1,0%
Inflation (%)	4,3%	4,5%	10,1%	5,6%	5,6%	4,0%
Unemployment Rate (eoy ,%)	11,1%	14,2%	11,1%	8,2%	8,5%	9,0%
Policy Rate (eoy, %)	4,5%	2,0%	9,3%	13,75%	13,75%	10,0%
External Accounts						
Trade Balance (US$ bn)	27	32	36	46	43	35
Current Account Balance (US$ bn)	-68	-28	-46	-52	-48	-52
Current Account Balance (% of GDP)	-3,6%	-1,9%	-2,8%	-2,7%	-2,4%	-2,5%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-1,3%	-9,8%	-0,4%	0,7%	-1,1%	-0,8%
Government Gross Debt (% of GDP)	74,3%	86,9%	78,8%	74,7%	79,9%	85,1%

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