交通銀行 BANK OF COMMUNICATIONS BBM

Macro Monthly Letter

March 2023

Monetary and Fiscal Stimuli in Opposite Directions

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The news that Brazil’s economy contracted 0.2% in the fourth quarter of 2022 confirmed expectations of deceleration in all sectors, including those that had previously displayed resilience, such as services and household consumption. Although the service sector was the engine of growth in the year, expanding 4.2% in the 12 months of 2022, the loss of overall dynamism was reflected in the retraction of 0.2% in Q4 compared with the previous quarter. Similarly, household consumption grew only 0.3% in Q4, down from 1% in Q3 and 2% in Q2.

The numbers, which were in line with our projections, are a clear indication that the rise in the cost of credit due to a more restrictive monetary policy is having real effects on the economy, and that several drivers of consumption and services in 2022, such as continuous job creation, inflation-matching pay rises and post-pandemic economic reopening, may have run out of steam. Looking ahead, however, a more detailed breakdown of GDP growth offers a slightly more positive outlook for 2023.

First of all, despite weaker growth in the fourth quarter, carryover in the service sector fell moderately from 1% to 0.9% from the third to the fourth quarter of 2022. This means that if the sector stays at the same level seen in 2022 throughout 2023, it will grow 0.9% (Table 1). The top-performing categories were transportation, financial services, and information and communications technology, with carryover of 1,2%, 4.2% and 1.4%. The main negative surprise was public administration services, which performed so poorly that carryover was only -0.1%. Nevertheless, our projection for this category remains optimistic and takes into account the allocation of funds to health and public education stipulated in the new government's policy guidelines. It should be borne in mind that public administration services correspond to about 15% of GDP and are still 1% below the pre-pandemic level (Figure 1).

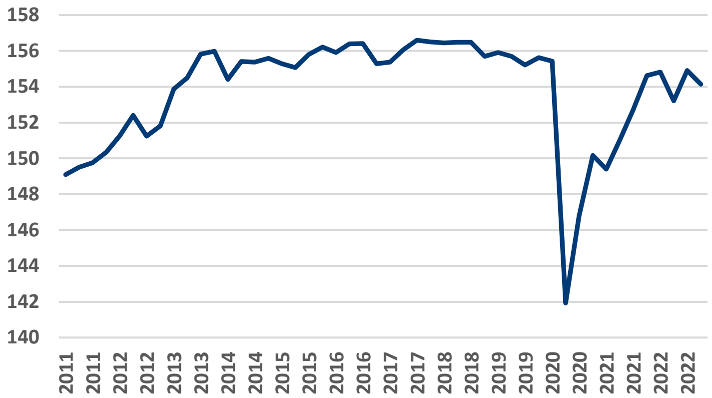
Secondly, high-frequency indicators based on credit and debit card transactions for the first two months of this year show a more resilient retail and service sector, with a partial reversal of the deceleration seen in the fourth quarter of last year. Only forthcoming readings can tell if this reversal is temporary, but a good start to the year in the sectors that should decelerate most will also contribute to stronger GDP growth in 2023.

Figure 1: GDP Carry-over for 2023 and BOCOM BBM Forecasts

	Carry-over	2023 Forecast
GDP	0.2%	1.5%
Agriculture	**-0.2%**	**8.0%**
Industry	**0.5%**	**0.2%**
Mining	2.4%	2.0%
Manufacturing	-0.7%	-0.9%
Electricity	0.2%	0.5%
Civil Construction	0.3%	1.5%
Services	**0.9%**	**1.2%**
Retail	-0.1%	-0.9%
Transports	1.2%	1.6%
Information and Communication	4.2%	3.3%
Financial Services	1.4%	1.9%
Rents	1.5%	1.6%
Other Services	2.1%	1.8%
Public Administration	-0.1%	1.3%

Source: IBGE, BOCOM BBM

Figure 1: Public Administration Services (Index SA)

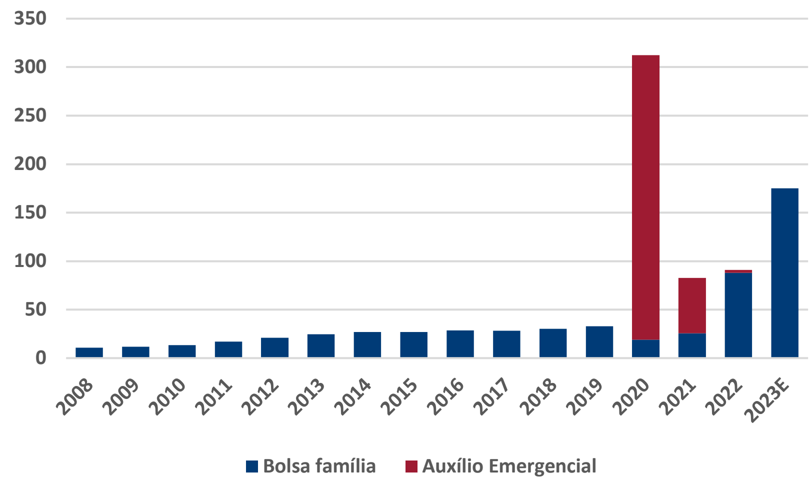


Source: IBGE, BOCOM BBM

Thirdly, the agricultural sector is expected to perform strongly this year, with favorable weather in producing regions contributing to bumper harvests.

All told, economic growth continues to be driven mainly by agriculture, with services and job creation decelerating gradually, and could be additionally favored by fiscal and quasi-fiscal stimuli announced by the government, such as an expanded conditional cash transfer program for low-income families (new "Bolsa Família", Figure 2), refinancing of household debts ("Desenrola"), and new funding instruments for public banks (such as tax-exempt bonds issued by BNDES, the national development bank). On the other hand, tighter financial conditions and a high level of household loan delinquencies, which reached 6.1% in the last reading (Figure 3) – the highest since 2016 – are factors acting in the opposite direction.

Figure 2: Government Transfers: Bolsa Família + Auxílio Emergencial (BRL Bn)



Source: Portal da Transparência, Tesouro Nacional, BOCOM BBM

Figure 3: Default Rate (%) - Non-Earmarked Credit to Households

Source: BCB, BOCOM BBM

In response to monetary tightening, 12-month inflation slowed to 5.6%, and the latest reading showed an improvement in some items, such as a fall in gasoline prices, and resilience in others, such as acceleration of the core average. According to the projections in the minutes to the Central Bank's last monetary policy meeting, inflation converges to the target under the scenario in which its policy rate (SELIC) is held steady for the entire relevant horizon, but since that meeting inflation expectations have continued to rise for longer horizons, and we therefore see little room for rate cuts in 2023.

The expectations channel, which directly affects current inflation and continues to serve as a key conditioning factor for the trajectory of interest rates, has not been helped by technically uninformed pressure for a higher inflation target and lower rates. There will be no scope for rate cuts until the government presents its proposal for a new fiscal framework, which it is unlikely to do for a few months. Our projections are shown below.

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%	5.8%	5.9%	4.0%
Unemployment Rate (eoy ,%)	11.1%	14.2%	11.1%	7.9%	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	44	43	35
Current Account Balance (US$ bn)	-68	-28	-46	-56	-48	-52
Current Account Balance (% of GDP)	-3.6%	-1.9%	-2.8%	-2.9%	-2.4%	-2.5%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-1.3%	-9.8%	-0.4%	0.6%	-1.1%	-0.9%
Government Gross Debt (% of GDP)	74.3%	86.9%	78.8%	73.5%	78.1%	83.3%