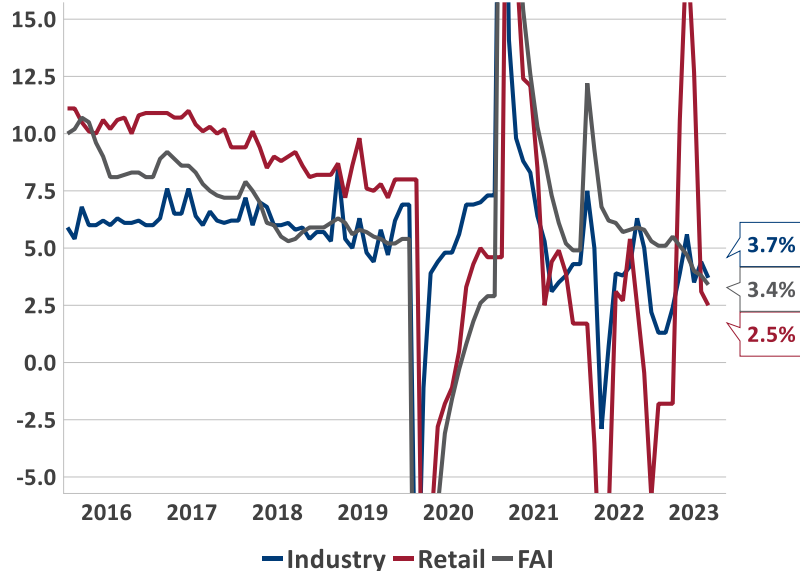**MACRO OUTLOOK**

Cecilia Machado
Chief Economist

September 2023

» Incoming data from developed economies points to a resilient activity and to a tight labor market that is beginning to show some signs of rebalancing. Inflation remains somewhat persistent, although July and June CPI data showed significant improvements. Altogether this should require a longer period of tight monetary policy, consistent with a gradual slowdown of economic activity ('soft-landing' scenario). Jerome Powell, chairman of the FOMC, reinforced that the US economy is facing a highly uncertain environment and that policy decision will remain data-dependent. Further tightening could turn out to be necessary, but markets antecipate that no more hikes will occur in this cycle;

» As for China, recent data has been showing a slowdown of economic activity. The main challenges concern a weak property sector contraction, a soft domestic demand and a large amount of debt. The government has announced several easing measures on property, monetary and fiscal policies that should sustain growth while China faces ongoing structural changes in its economy;

» In Brazil, economic activity has surprised positively. GDP advanced 0.9% QoQ (3.4% YoY) in Q2, well above the market expectation of 0.3% QoQ (2.6% YoY) and our forecast of 0.5% QoQ (2 .8% YoY). Sectors less sensitive to the economic cycle (agriculture and mining industry) contributed strongly to the excellent GDP result, but the services sector also surprised positively. As a result, we revised our forecast for this year from 2.3% to 2.9% and next year from 1.2% to 1.4%;

» Regarding monetary policy, the Central Bank of Brazil embarked on a monetary loosening cycle at its latest meeting, cutting the Selic policy rate by 50 bps. At that time, on August 2nd, the committee foresaw other cuts of the same magnitude (50 bps) in following meetings if the economic scenario turns out as expected. Since then, we could observe some improvements in inflation dynamics, including core components, but should not be enough to modify BCB's guidance. Furthermore, the labor market remains resilient and inflation forecasts for longer horizons did not show additional improvements. We maintain the Selic scenario at 11.75% at the end of 2023 and 9% in 2024;

» In the inflation scenario, our projection for 2023 is 4.8%. The sharp deceleration compared to the 2022 figures is mainly explained by industrial goods and food. For 2024, we maintain our forecast at 3.6%;

» In the fiscal scenario, the consolidated public sector recorded a primary deficit of BRL 35.8 billion in July, with the central government registering a deficit of BRL 32.5 billion, subnational governments a deficit of BRL 4.2 billion and state-owned companies a surplus of BRL 0.9 billion. Gross General Government Debt increase to 74.1% in July from 73.6% in June, as it was positively impacted by 'Interest settlements' (0.5 pp.) and net issuance (0.3 pp.), and partially offset by nominal GDP growth (-0.4 pp.).
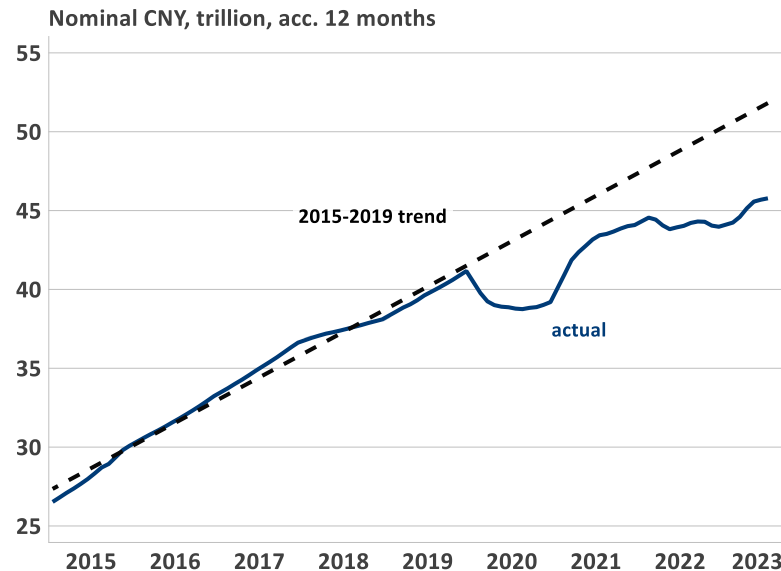
China: Activity

» July economic activity broadly missed market expectations on a YoY basis, :

» **Industrial production decreased** from 4.4% to **3.7%** YoY (exp 4.4%), due to softer growth in manufacturing activity (from 4.8% to 3.9% YoY) and mining output (from 1.5% to 1.3% YoY). A few exceptions worth mentioning are non-ferrous metals' smelting and chemicals rebounding;

» **Retail sales decreased** from 3.1% to **2.5%** YoY (exp 4.5%), slower growth started to show even in sectors that have outperformed this year such as restaurants and auto sales suggesting initial strength of pent-up demand after reopening is fading;

» **FAI declined** from 3.8% to **3.4% YTD YoY** (exp. 3.8%) with a broad slowdown in investments in infrastructure, manufacturing and real estate;

» The **national and 31-city unemployment rates remained relatively stable at 5.3%** and **5.4%**, respectively.
   » The disclosure of the unemployment rate among young people (age 16-24), as well as the rates for other age groups, has been suspended undermining the credibility of official data releases. This comes after youth unemployment reached its historical high level of 21.3% in June.
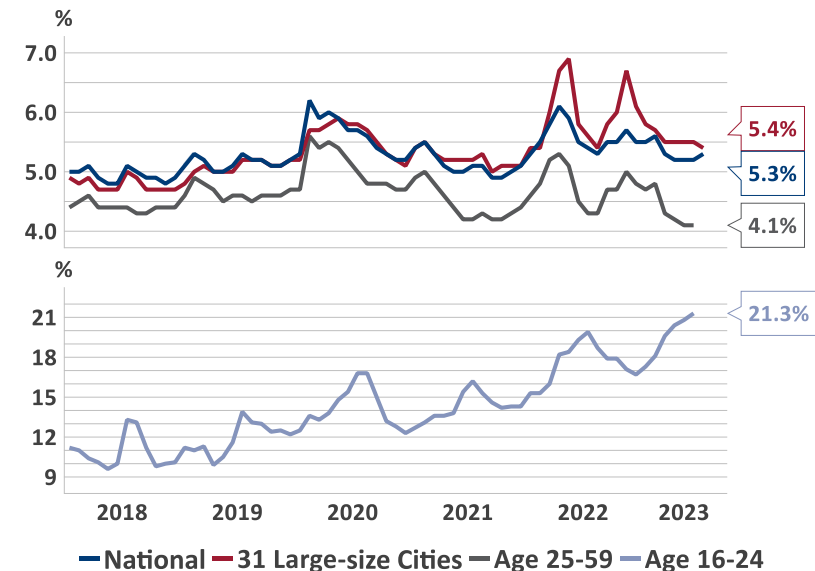
China: Activity (YoY, %)

Industry — Retail — FAI

China: Retail Sales

Nominal CNY, trillion, acc. 12 months

2015-2019 trend

actual

China: Unemployment Rate in Urban Areas

5.4%
5.3%
4.1%
21.3%

National — 31 Large-size Cities — Age 25-59 — Age 16-24
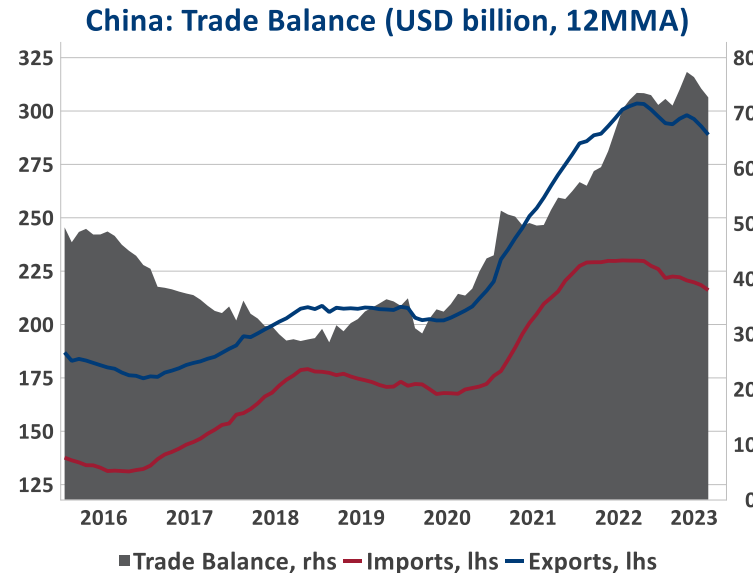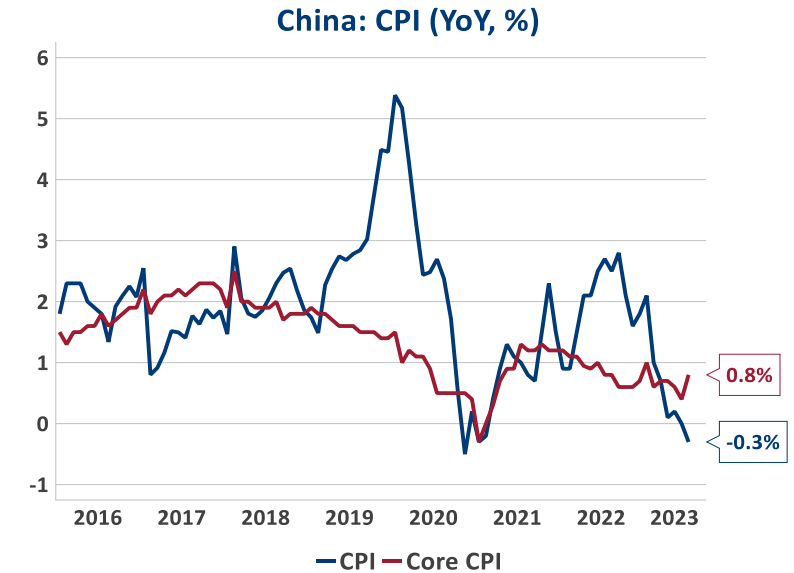
China: Economic Scenario

» In August, China's **PMI** shows that the divergence in recovery between the manufacturing and non-manufacturing is narrowing as the former is growing and the latter's losing strength;

  » The NBS manufacturing PMI rose from 49.3 to **49.7** (exp. 49.4) due to sluggish external demand and a recent pickup, albeit slow, in domestic demand;

  » The non-manufacturing sector continued expansionary but in the softest pace since the end of 2022, moving from 51.5 to **51.0**;

» **Exports** fell more than expected, from -12.4% to -**14.5% YoY** (exp. -12.5%), representing a broad slowdown in multiple products and destinations due to weaker external demand. However, strong shipments of green technology are helping to offset declines in other areas;

» **Imports** fell further from -6.8% to **-12.4% YoY**, mostly due to falling commodity prices, although in real terms the internal demand seems steady;

» **CPI** inflation rose by **0.2%** MoM (exp. -0.1%) moving from 0% to -**0.3%** YoY (exp. -0.4%), primarily caused by a sharp drop in food inflation due to base effects;

  » Goods deflation persisted, driven by falling food and fuel costs, while services prices generally increased, suggesting heterogeneity in demand's strength;
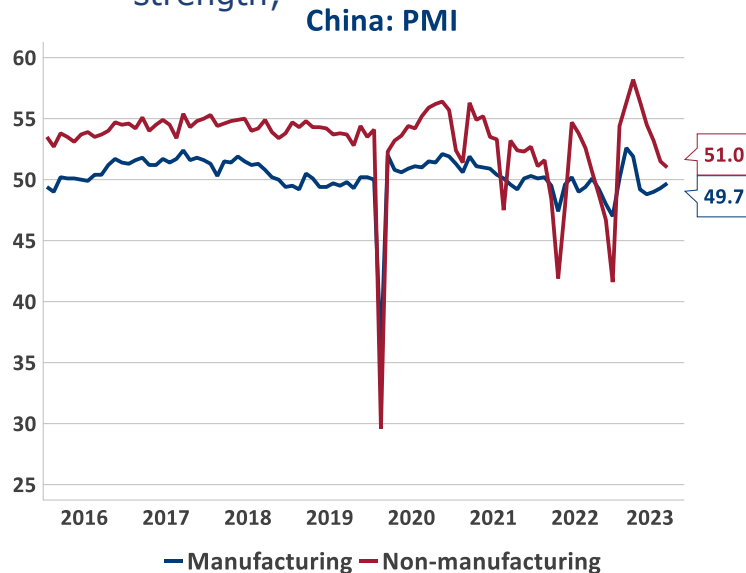
China: PMI

Manufacturing — Non-manufacturing

Source: BOCOM BBM, Macrobond, CFLP

China: Trade Balance (USD billion, 12MMA)

■Trade Balance, rhs — Imports, lhs — Exports, lhs

Source: BOCOM BBM, Macrobond, CCS

China: CPI (YoY, %)

— CPI — Core CPI
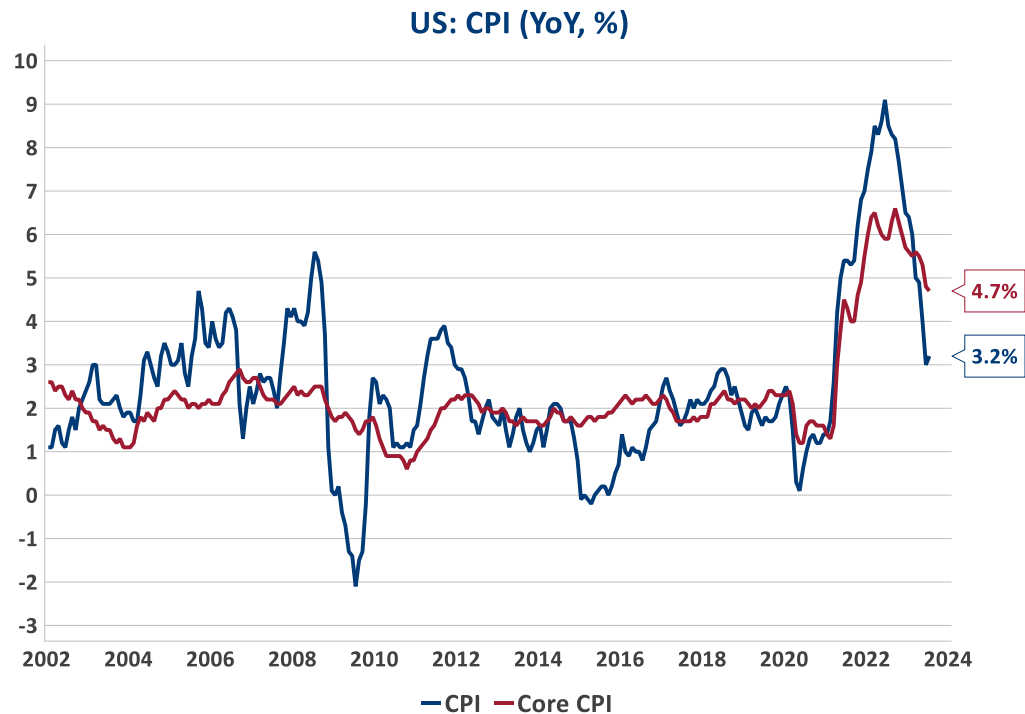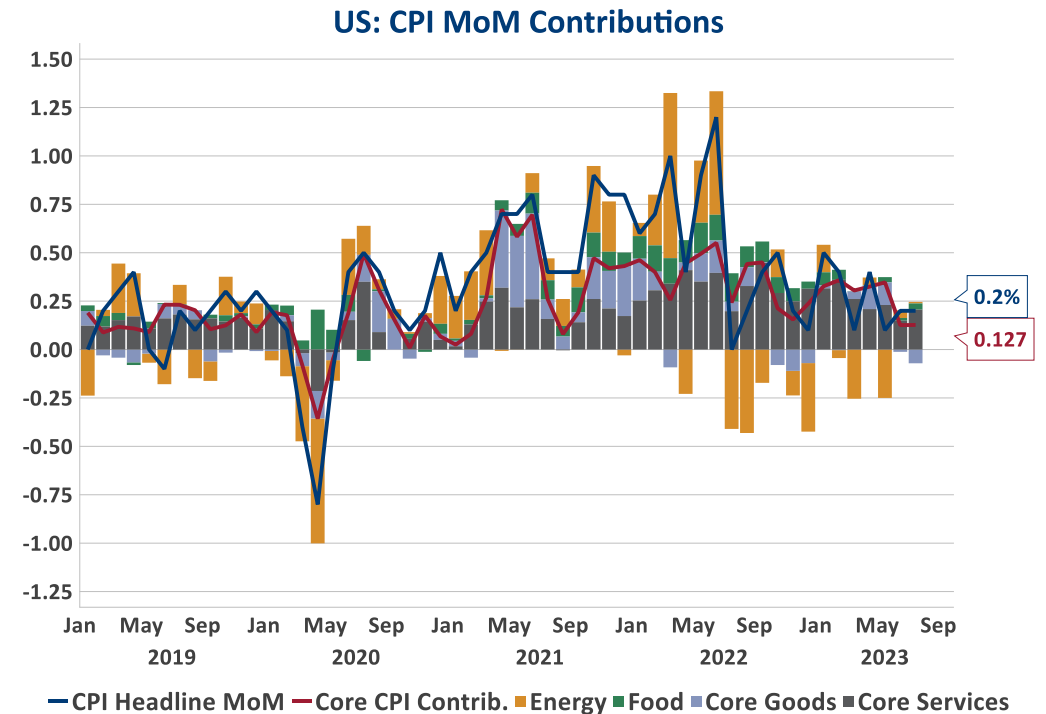
Source: BOCOM BBM, Macrobond, NBS

USA: Inflation

» July **headline CPI** arrived slightly below expectations, moving from 3.0% to **3.2%** YoY and rising by **0.17%** MoM (exp. 0.2%)
  » Energy prices rose (0.1% MoM) backed by a monthly rise in retail gasoline and diesel prices, although still down -12.5% YoY;
  » Food prices accelerated to 0.2% MoM, above the pace of the previous 4 months (avg. 0.08%), but way below the fast pace of late 2022 and early 2023 (avg. 0.6%);

» **Core CPI** increased **0.2%** MoM, reaching **4.65%** YoY (from 4.83):
  » **Core services** (0.35% MoM) pressured more fiercely the headline due to a pickup in services ex-housing (0.2% MoM), although OER and rent of primary residence continued to slowdown;
  » **Core goods** continued to show a monthly deflation (-0.33% MoM) with most components remaining well-behaved and used cars and trucks prices falling more sharply;

US: CPI (YoY, %)

US: CPI MoM Contributions

4.7%

3.2%

0.2%

0.127

— CPI — Core CPI

— CPI Headline MoM — Core CPI Contrib. ■ Energy ■ Food ■ Core Goods ■ Core Services
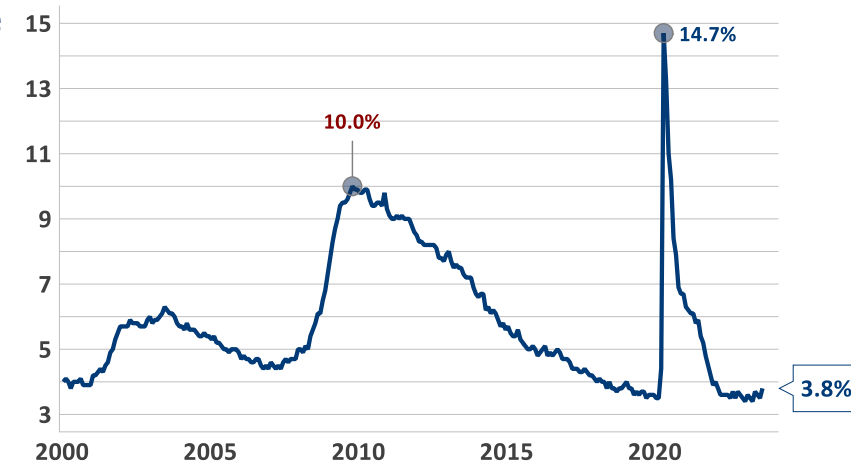
Source: BOCOM BBM, Macrobond, BLS
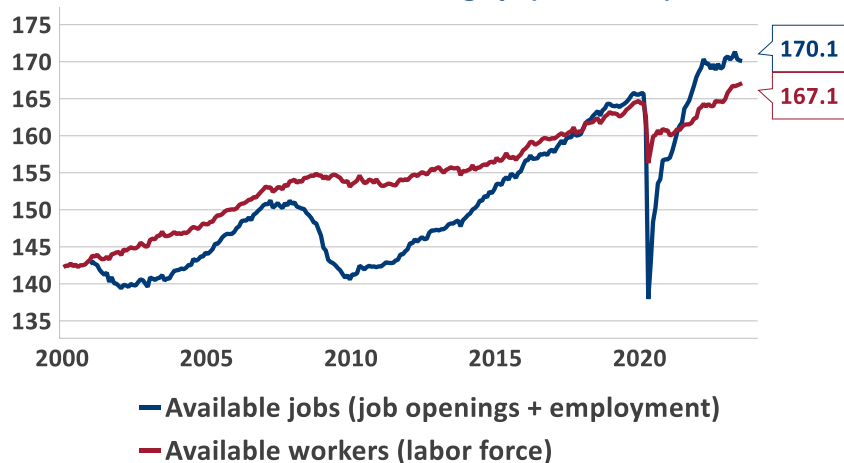
Source: BOCOM BBM, Macrobond, BLS

USA: Labor Market

» The US labor market showed a strong headline in August posting the creation of **187 thousand** jobs in the nonfarm payroll, although the household survey signaled an increase of the unemployment rate from 3.5% to **3.8%**;

» In July, the jobs-workers gap narrowed from 3.2M to **3M**, signaling that labor supply and demand are gradually coming into better balance;

  » The job openings per unemployed person ratio moved down from 1.54 to **1.51;**

» August data showed average hourly earnings growth slowed from the rapid pace they posted in prior months, making the annual rate fall a bit from 4.4% to **4.3%** YoY;

  » This is important due to the positive correlation between wage inflation and inflation in services excluding housing & energy, which remains persistently high and is the main pressure in core inflation.
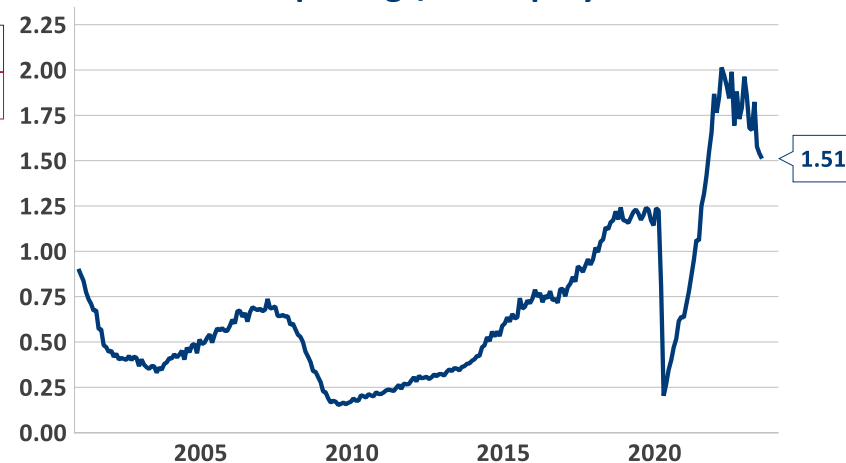
US: Unemployment Rate SA (%)

Source: BOCOM BBM, Macrobond, BLS
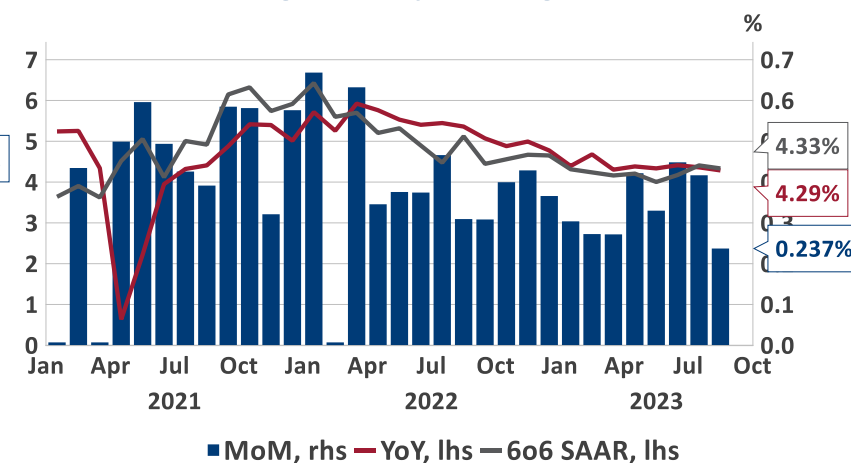
US: Jobs-workers gap (millions)

— Available jobs (job openings + employment)
— Available workers (labor force)

Source: BOCOM BBM, Macrobond, BLS

US: Job Openings/Unemployed Ratio

Source: BOCOM BBM, Macrobond

US: Average Hourly Earnings Growth (%)

■ MoM, rhs — YoY, lhs — 6o6 SAAR, lhs
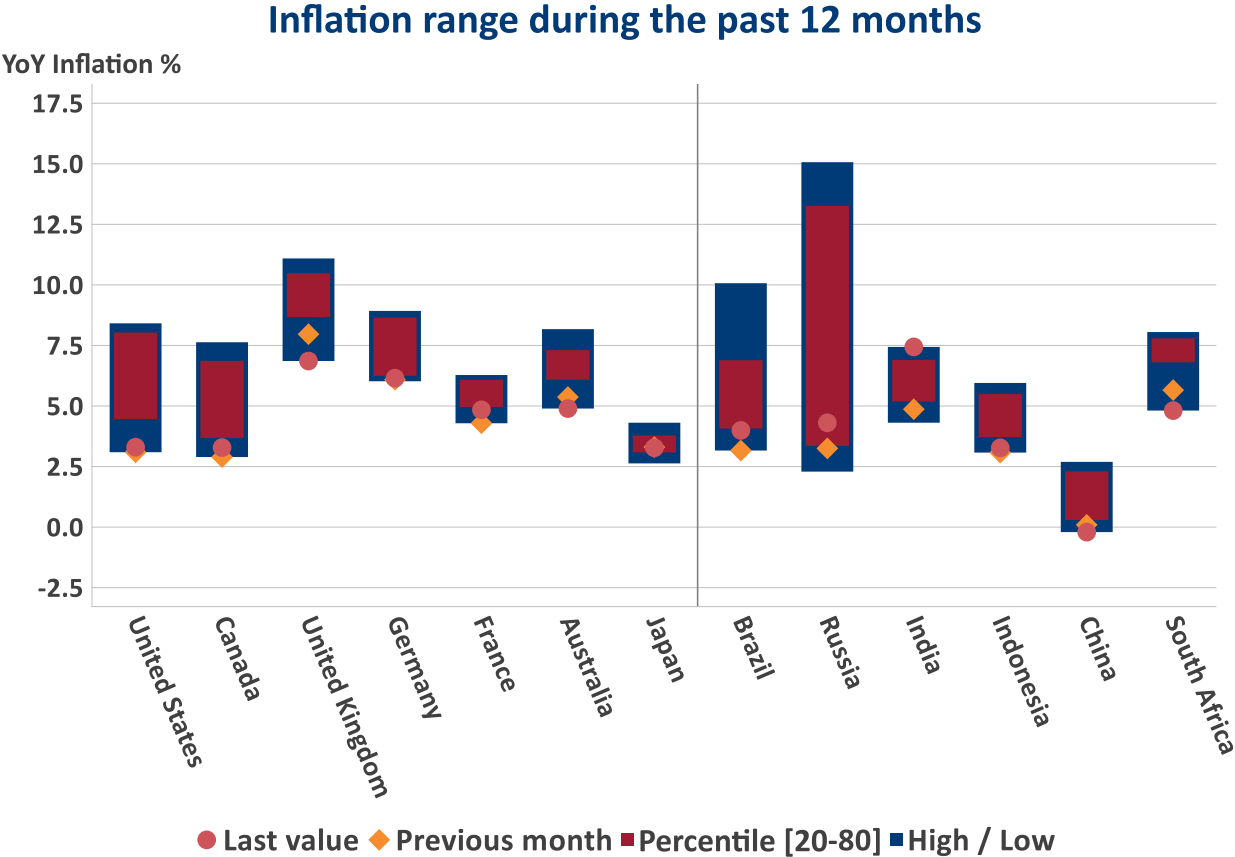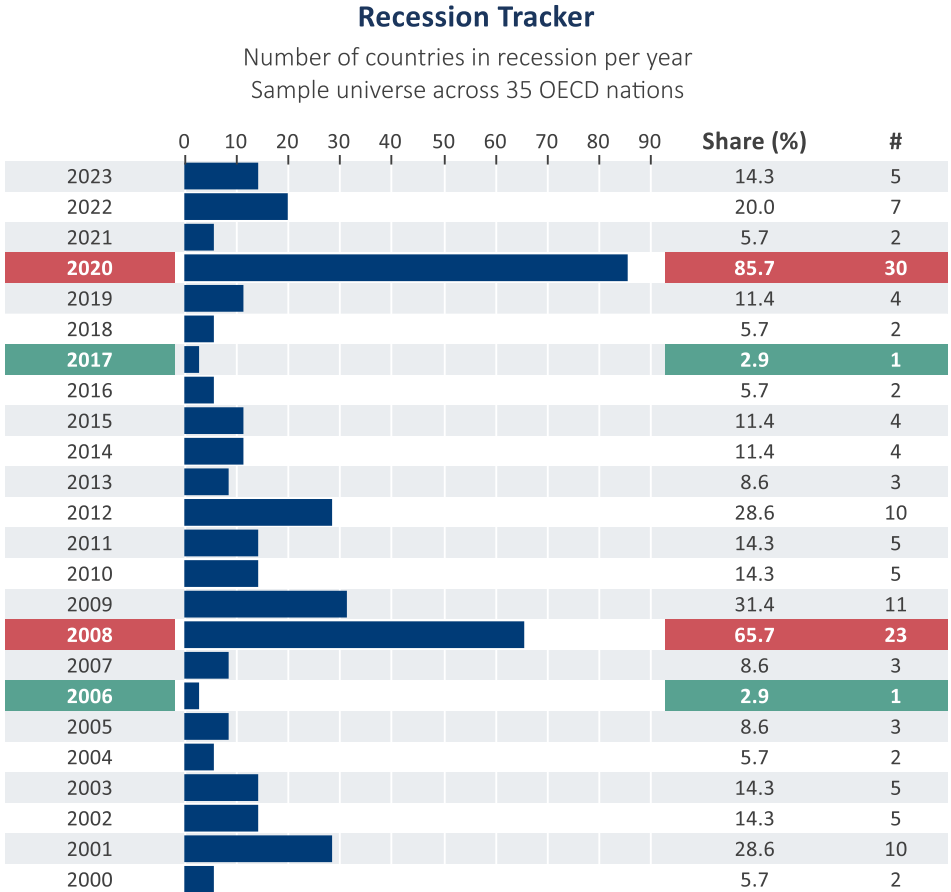
Source: BOCOM BBM, Macrobond

Global: Inflation & Activity

» For the first time in decades, inflation across emerging markets is not significantly higher than it is in developed markets;

» In order to bring inflation convergence back to their respective targets, many central banks tightened sharply their monetary policy over the past year resulting in a slowdown to economic activity across several countries, although some showed remarkable resiliency;

 » 4 OECD nations are showing a technical recession in 2023 (2 quarters of negative growth): Germany, Netherlands, Ireland, Poland & New Zealand.

Inflation range during the past 12 months

YoY Inflation %

● Last value ◆ Previous month ■ Percentile [20-80] ■ High / Low

Source: BOCOM BBM, Macrobond

Recession Tracker

Number of countries in recession per year
Sample universe across 35 OECD nations

Year	Share (%)	#
2023	14.3	5
2022	20.0	7
2021	5.7	2
2020	85.7	30
2019	11.4	4
2018	5.7	2
2017	2.9	1
2016	5.7	2
2015	11.4	4
2014	11.4	4
2013	8.6	3
2012	28.6	10
2011	14.3	5
2010	14.3	5
2009	31.4	11
2008	65.7	23
2007	8.6	3
2006	2.9	1
2005	8.6	3
2004	5.7	2
2003	14.3	5
2002	14.3	5
2001	28.6	10
2000	5.7	2

Source: BOCOM BBM, Macrobond, National Sources

» Monetary policy tightening cycle seems to be approaching its peak in several countries, and some have already started easing such as Chile and Brazil;

» The FOMC raised the Fed funds rate by 25bps in its July meeting, which the market expects to be the last hike of the cycle, even though the latest FOMC projections released in June hinted one additional hike could happen;

» Moreover, the FOMC staff is no longer forecasting a recession as their baseline scenario, which also reinforces the narrative of a 'soft-landing'.

10 Year Interest Rates (%)

US —— Germany —— Japan —— China
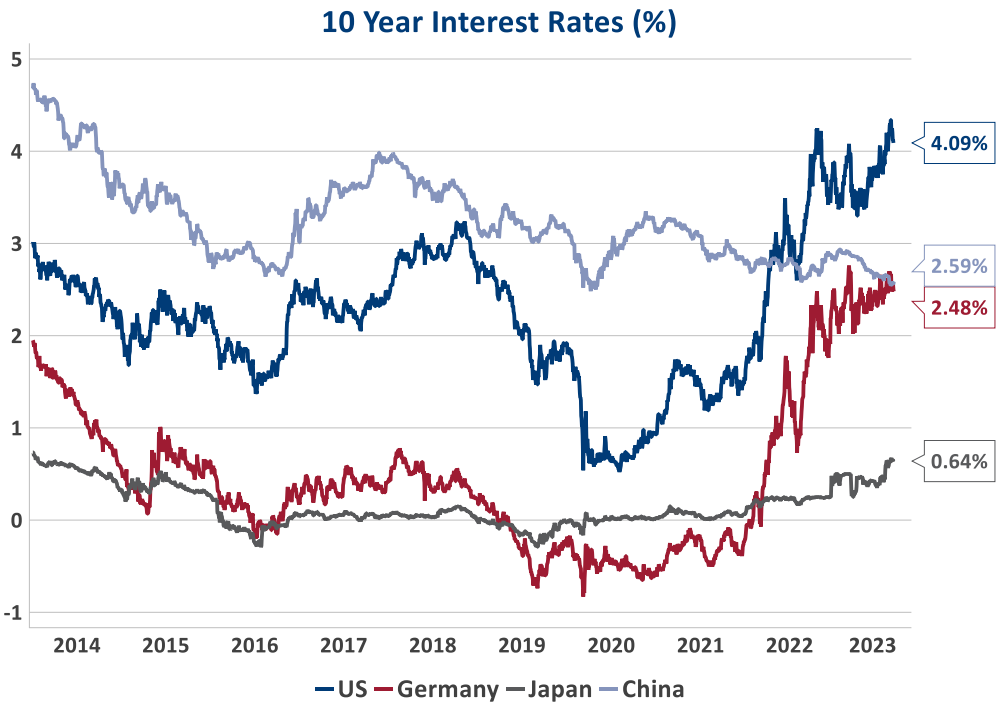
Source: BOCOM BBM, Macrobond, BUBA, JBT, CCDC

Central bank tracker: G20 & OECD Countries

	Key rate	Last decision		Last Move	Months since last hike	Months since last cut
Argentina	118.00	21.00	Hike	8/2023	1	34
Australia	4.10	0.25	Hike	6/2023	3	34
Brazil	13.25	-0.50	Cut	8/2023	13	1
Canada	5.00	0.25	Hike	7/2023	2	41
Chile	10.25	-1.00	Cut	7/2023	11	1
China	3.45	-0.10	Cut	8/2023	115	0
Colombia	13.25	0.25	Hike	5/2023	4	35
Costa Rica	6.50	-0.50	Cut	7/2023	10	1
Czech Republic	7.00	1.25	Hike	6/2022	14	40
Denmark	3.50	0.25	Hike	7/2023	1	23
Euro Area	4.25	0.25	Hike	8/2023	1	90
Hungary	13.00	1.25	Hike	9/2022	11	37
Iceland	9.25	0.50	Hike	8/2023	0	33
India	6.50	0.25	Hike	2/2023	7	39
Indonesia	5.75	0.25	Hike	1/2023	7	30
Israel	4.75	0.25	Hike	5/2023	3	41
Japan	-0.10	-0.20	Cut	1/2016	198	91
Mexico	11.25	0.25	Hike	3/2023	5	31
New Zealand	5.50	0.25	Hike	5/2023	3	42
Norway	4.00	0.25	Hike	8/2023	0	40
Poland	6.75	0.25	Hike	9/2022	12	39
Russia	12.00	3.50	Hike	8/2023	1	11
Saudi Arabia	6.00	0.25	Hike	7/2023	1	42
South Africa	8.25	0.50	Hike	5/2023	3	37
South Korea	3.50	0.25	Hike	1/2023	8	39
Sweden	3.75	0.25	Hike	7/2023	2	90
Switzerland	1.75	0.25	Hike	6/2023	2	104
Turkey	25.00	7.50	Hike	8/2023	0	6
United Kingdom	5.25	0.25	Hike	8/2023	1	41
United States	5.50	0.25	Hike	7/2023	1	42

Brazil: Forecasts

ECONOMIC FORECASTS	2019	2020	2021	2022	2023F	2024F
GDP Growth (%)	1.2%	-3.3%	5.0%	2.9%	2.9%	1.4%
Inflation (%)	4.3%	4.5%	10.1%	5.8%	4.8%	3.6%
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%	11.75%	9.0%
External Accounts						
Trade Balance (US$ bn)	27	32	36	44	60	42
Current Account Balance (US$ bn)	-68	-28	-46	-56	-39	-50
Current Account Balance (% of GDP)	-3.6%	-1.9%	-2.8%	-2.9%	-1.8%	-2.3%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-1.3%	-9.8%	-0.4%	0.6%	-1.0%	-0.9%
Government Gross Debt (% of GDP)	74.3%	86.9%	78.8%	72.9%	75.6%	79.0%

Source: BOCOM BBM

Brazil: Activity

» The monthly indicators of economic activity posted positive figures in June, despite the slowdown at the margin as tight monetary conditions acts in the economy. Service sector revenue and industrial production both had a modest increase of 0.2% MoM and 0.1% MoM, respectively, and broad retail sales recovered from its May's 1.1% MoM decrease showing a 1.2% MoM growth. Accordingly, IBC-Br increased 0.63% MoM in the month;

» Confidence indicators showed mixed signals for August, since there was an increase in retail sales, consumer and construction, while the industry and services confidence dropped at the margin.

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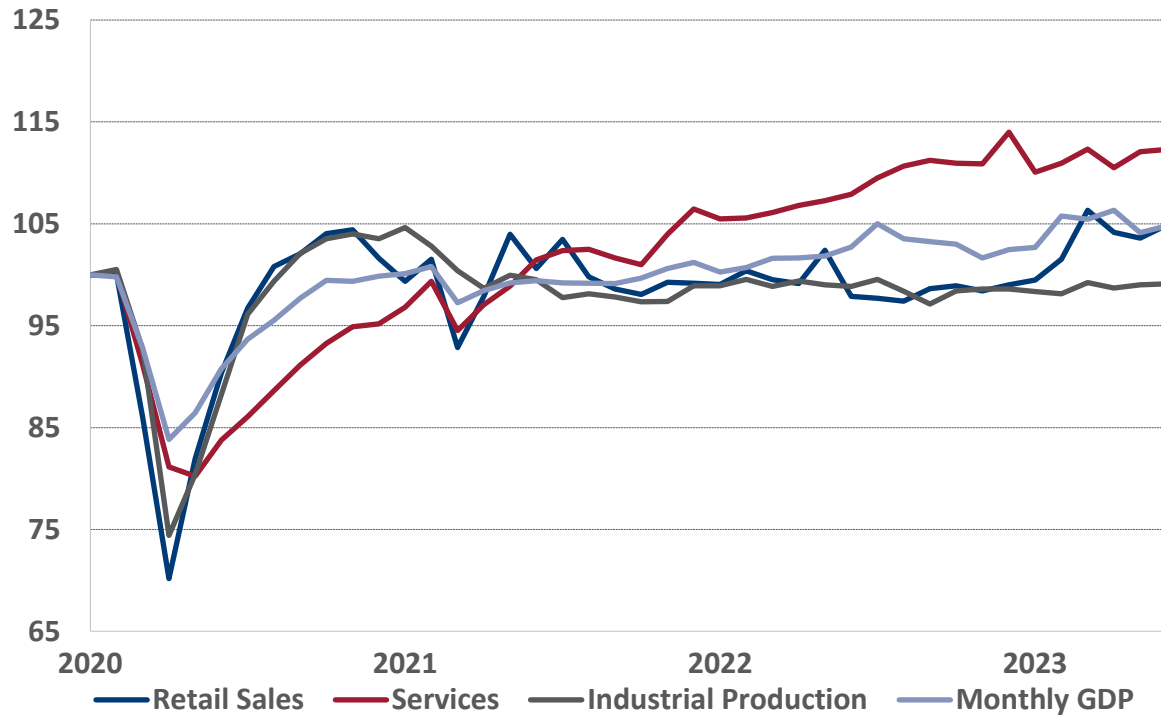
Brazil - Economic Confidence Index (Jan/20 = 100)

Source: BOCOM BBM, FGV
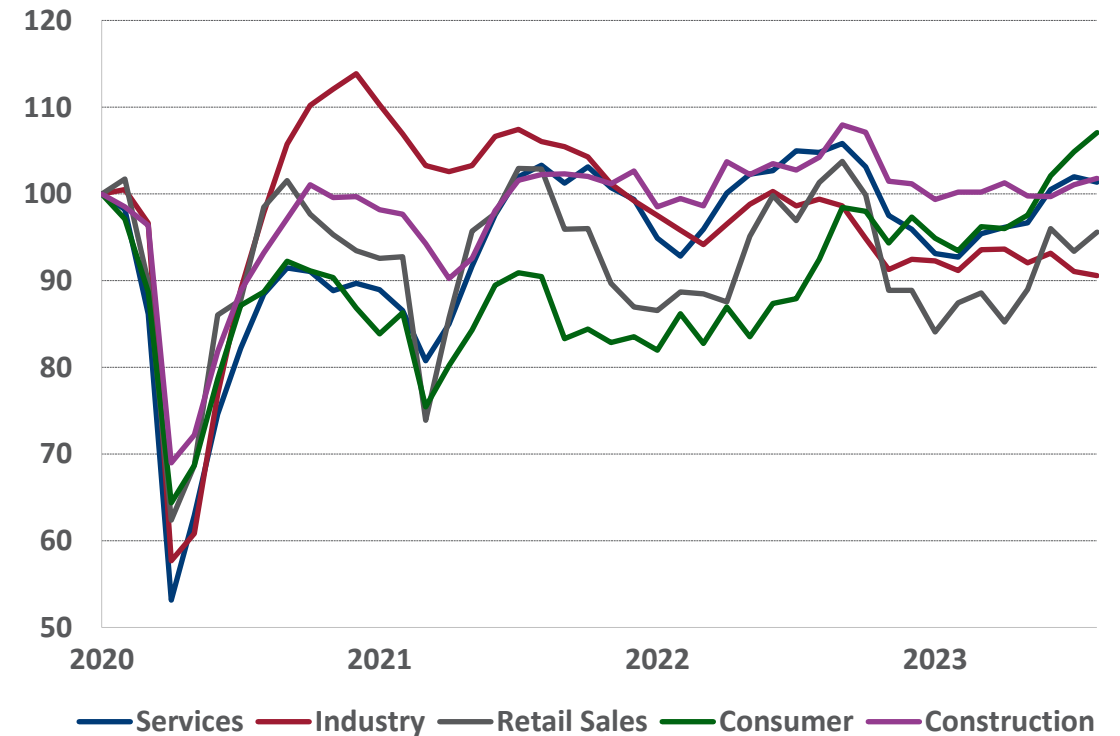
Brazil: Industrial Production

» Industrial production grew 0.1% MoM in June, above market expectations (-0.1% MoM), ending the quarter with a 0.4% QoQ growth;

» In the categories, 'Mining industry' grew 2.7% QoQ and 12.3% from Dec-Jun 2023. Other positive highlights in the recent period are 'Oil Derivatives and Biofuels' (9.0% QoQ and 8.9% in the first half of 2023) and 'Textile Products' which rose for the fifth time in the last six readings (1.2% MoM; 4.9% QoQ);

» On the other hand, the production of capital goods has dropped significantly, in line with high interest rates and elevated corporate indebtedness.

Industrial Production Index SA (Jan/20=100)

Legend: Overall Industry — Mining — Manufacturing

Industrial Production Index SA (Jan/20=100)
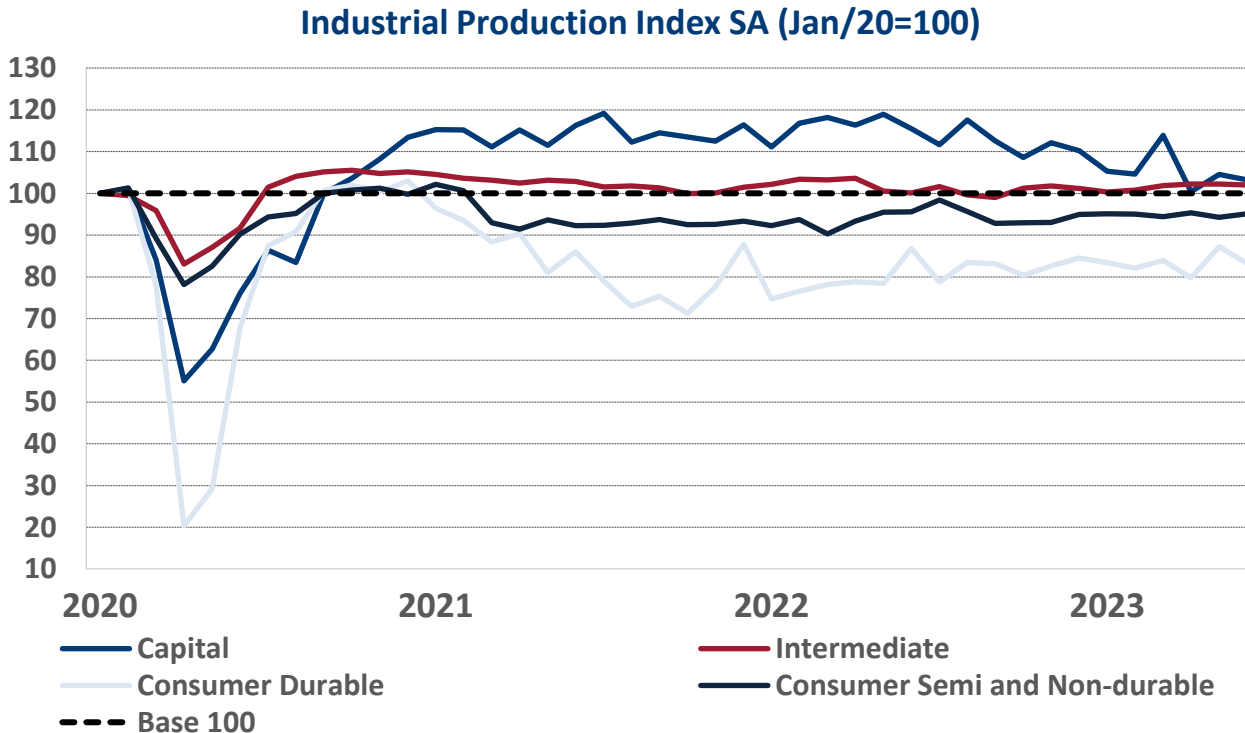
Legend: Capital — Intermediate — Consumer Durable — Consumer Semi and Non-durable — Base 100
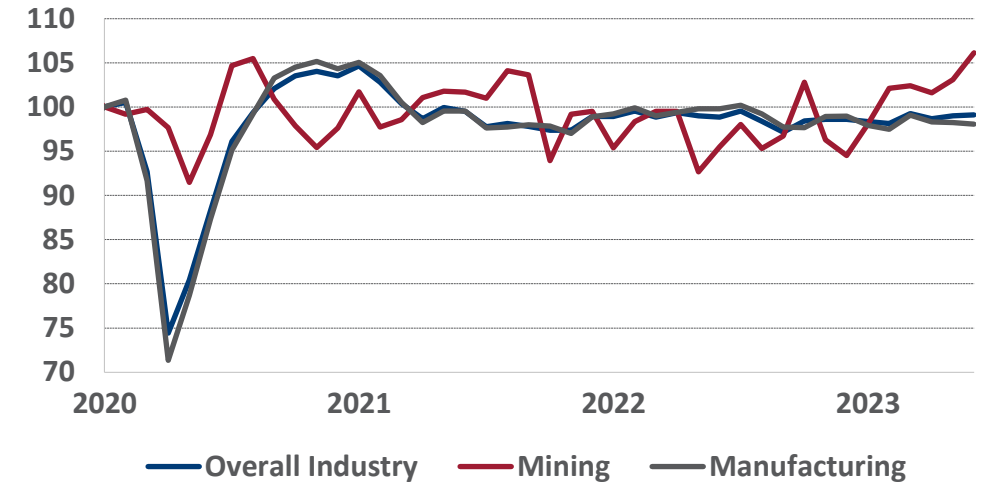
Industrial Production by Category - jun/2023 (YoY)

Category	Value
Consumer Durable	-3,9%
Consumer Semi and Non-Durable	0,1%
Industrial Production	0,3%
Intermediate	1,8%
Capital	-10,3%

Source: IBGE, BOCOM BBM
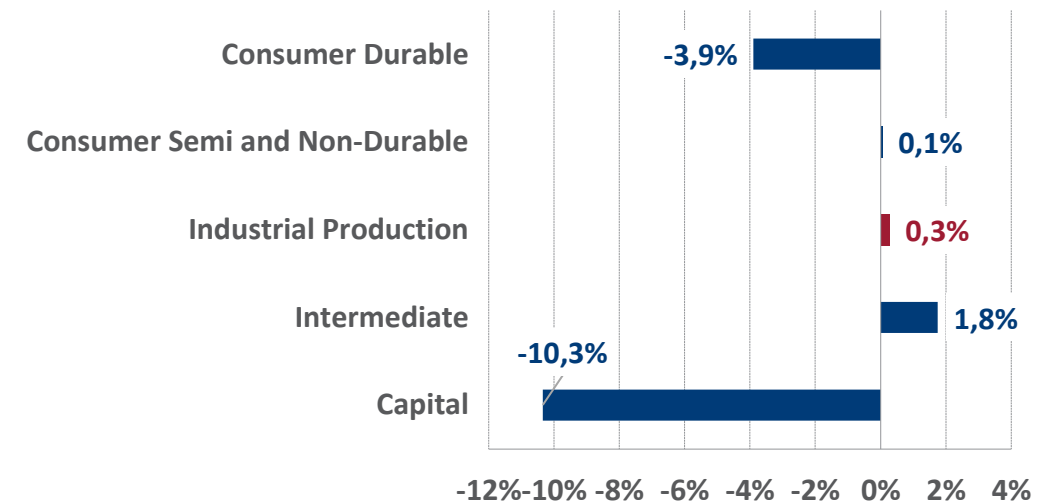
Brazil: Retail Sales

» Broad retail sales increased 1.2% MoM in June (1.7% QoQ). Meanwhile, core retail sales remained stable at the monthly comparation (-0.2% QoQ);

» 'Vehicles' continues to play an important role, with an increase of 8.5% MoM (+1.7% QoQ), in the wake of the government's fiscal measure to boost automotive sales;

» The category 'Wholesale specialized in food, beverage and tobacco products' once again made a positive contribution (21.2% YoY), owing to the significant drop in food inflation and the increased household disposable income;

» However, the current impulses on the sector activity (easing of inflation, higher household disposable income and government stimulus measures) should dissipate over the year.

Broad Retail Sales SA x Core Retail Sales SA
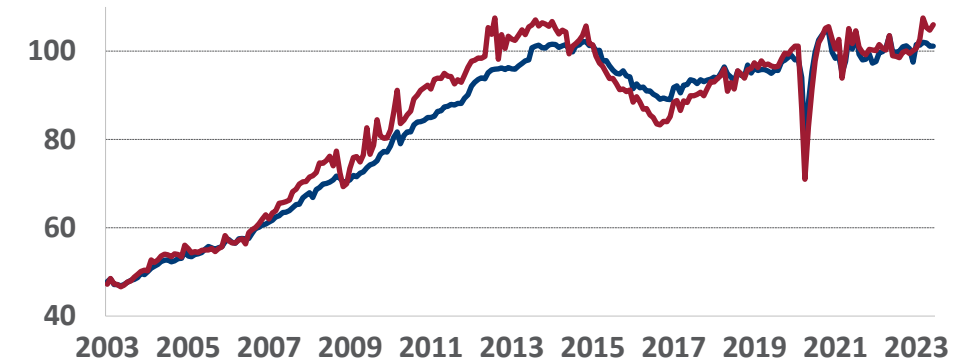
— Core Retail Sales   — Broad Retail Sales

Retail Sales - Index SA (Jan/20 = 100)

— Core Retail Sales   — Broad Retail Sales   — Fuel and Lubricants
— Vehicles and Parts   — Pharmaceuticals   — Clothing and Footwear
— Construction Materials

Retail Sales - YoY (jun/23)

Category	Value
Hypermarkets and Supermarkets	3,3%
Furniture	-5,6%
Appliance	8,2%
Wholescale specialized in food, beverage and tobacco	21,2%
Fuel and Lubrificants	9,9%
Pharmaceutical	3,8%
Furniture and Appliances	0,3%
Hypermarkets, Food and Beverages	3,1%
Core Retail Sales	-0,1%
Books and Magazines	-3,5%
Office supplies	-8,9%
Broad Retail Sales	8,3%
Vehicles and Parts	17,9%
Other	14,9%
Construction Materials	-2,7%
Clothing and Footwear	-6,3%

Source: IBGE, BOCOM BBM

Brazil: Services

» The services sector expanded 0.2% MoM, below market expectations (0.5% MoM). On a quarterly basis, the sector increased 0.5% QoQ;

» In the breakdown, 'Services to families' grew 1.9% MoM (+1.4% QoQ), the third expansion in a row. By the other hand, 'Transportation' fell 0.3% MoM, as its most volatile groups, 'Air Transportation' and 'Water Transportation', exhibited a weaker performance;

» Although it remains on a positive path, we expect a moderation on the performance of the sector on the following months.

Services Sector SA

Level — 3MMA

Services Sector SA (Jan20=100)

— Total Services — Families
—■— IT and Communication ---- Professional and Administrative

Services Sector

QoQ SAAR — YoY
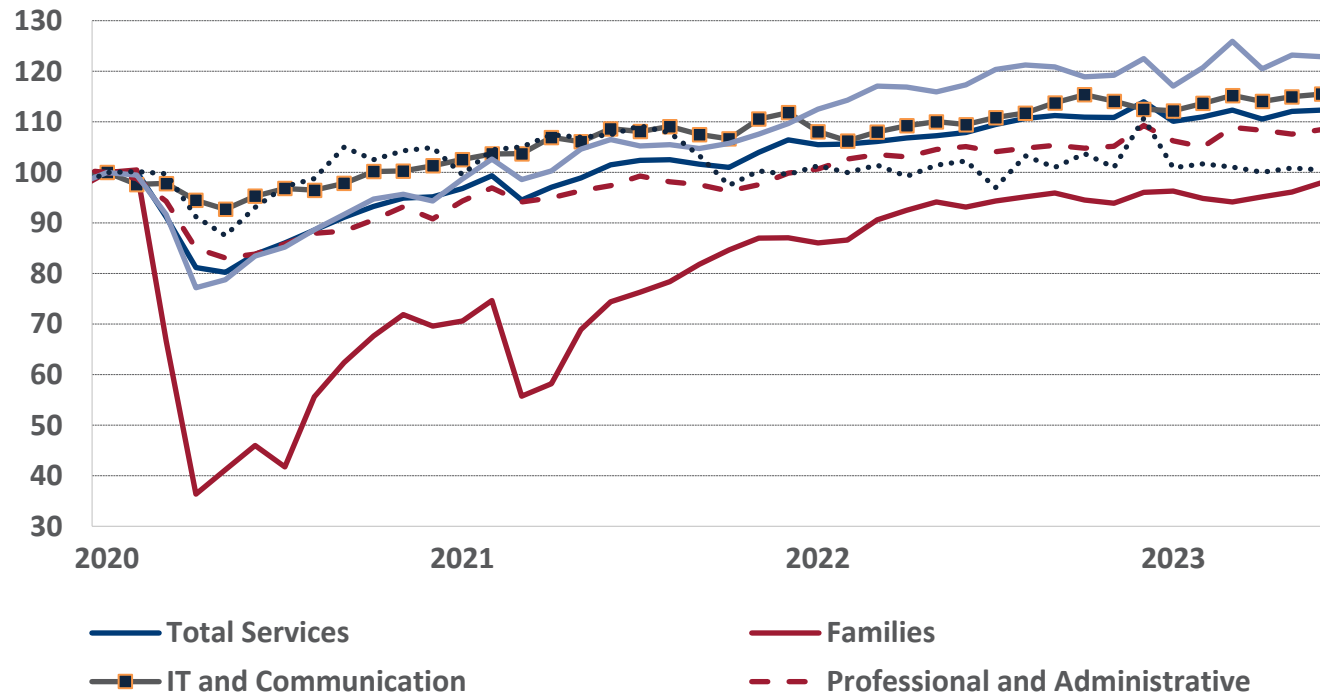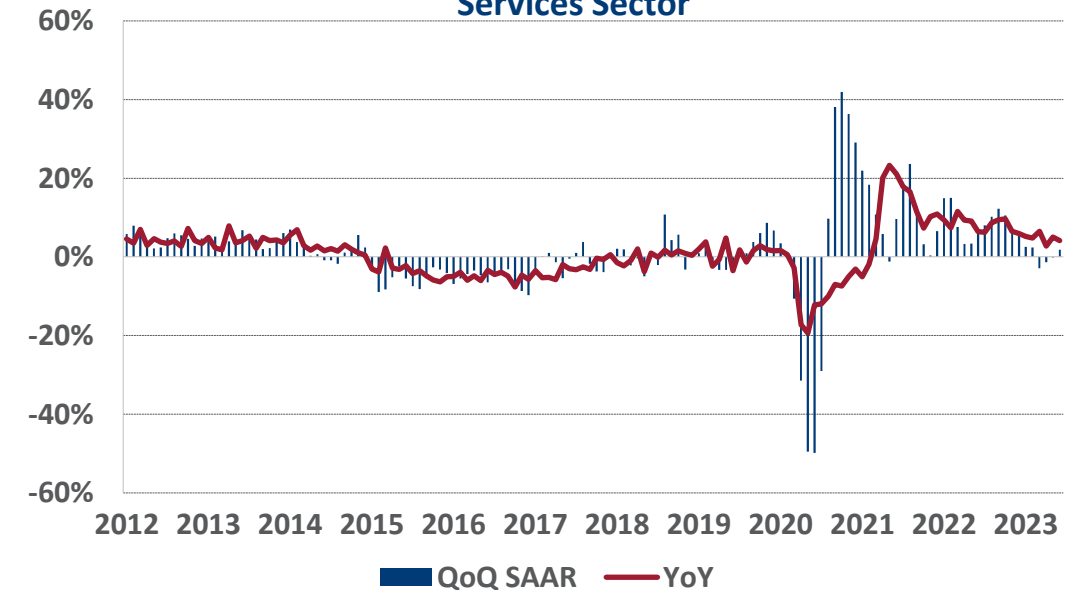
Brazil: Economic Activity

» Brazil's GDP surprised even the most optimistic expectations by growing 0.9% QoQ (3.4% YoY) in 2Q vs market expectation of 0.3% QoQ (2.6% YoY) and ours 0.5% QoQ (2.8% YoY).

	Official	Forecast	Official	Official	
	Q2 QoQ	Q2 QoQ	Q2 YoY	Q2 YoY	Carryover
GDP	**0.9%**	**0.5%**	**3.4%**	**2.8%**	**3.1%**
Agriculture	**-0.9%**	**-2.0%**	**17.0%**	**14.0%**	**18.4%**
Industry	**0.9%**	**0.8%**	**1.5%**	**1.5%**	**1.2%**
Mining	1.8%	1.8%	8.8%	8.7%	7.2%
Manufacturing	0.3%	0.6%	-1.7%	-1.4%	-1.2%
Electricity	0.4%	-0.5%	4.8%	3.6%	4.1%
Civil Construction	0.7%	0.3%	0.3%	-0.2%	0.1%
Services	**0.6%**	**0.4%**	**2.3%**	**2.0%**	**1.9%**
Retail	0.1%	1.0%	0.1%	1.3%	0.4%
Transports	0.9%	0.3%	3.4%	2.4%	3.2%
Information and Communication	0.7%	1.9%	3.8%	6.0%	2.5%
Financial Services	1.3%	0.1%	6.9%	4.0%	4.6%
Rents	0.5%	0.1%	2.8%	2.0%	2.0%
Other Services	1.3%	0.7%	2.4%	2.0%	2.0%
Public Administration	0.4%	-0.1%	1.6%	0.9%	0.8%
Demand Side					
Household Consumption	0.9%		3.0%		2.6%
Government Consumption	0.7%		2.9%		1.7%
Gross Fixed Capital Formation	0.1%		-2.6%		-2.4%
Exports	2.9%		12.1%		6.7%
Imports	4.5%		2.1%		0.3%

Source: BOCOM BBM, IBGE

Brazil: Economic Activity

» Sectors less sensitive to the economic cycle (Agriculture & Livestock and Mining Industry) largely contributed to the outstanding result;
» The primary sector's GDP fell only by 0.9% QoQ in 2Q, a small movement compared to the impressive expansion of 21.0% QoQ recorded for 1Q;
» The primary sector jumped ~18% YoY in the first half of 2023 and the mining sector ~8% YoY.

Agriculture and Livestock (Level SA)
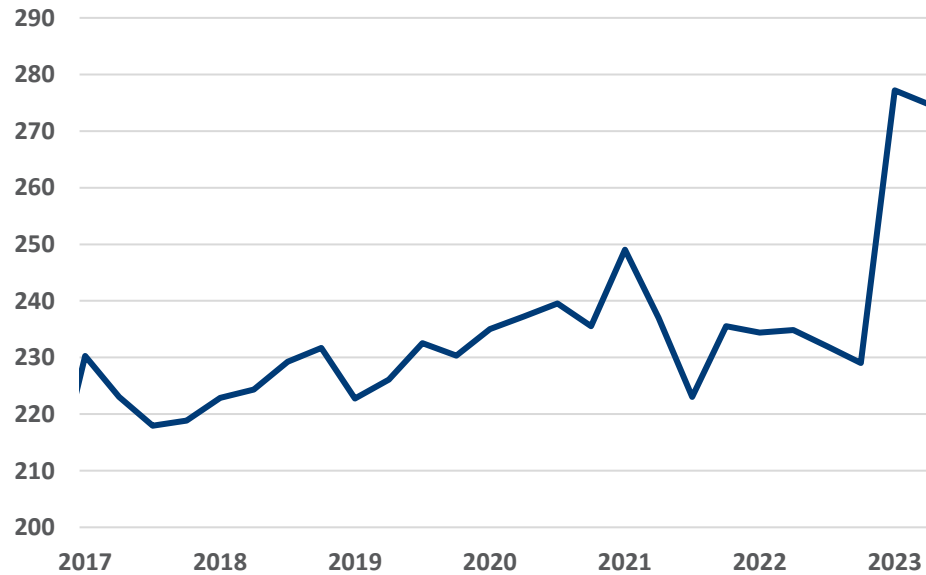
Mining Industry (Level SA)

Brazil: Economic Activity

» The services sector advanced 0.6% QoQ (2.3% YoY), marking twelve consecutive quarters of growth, all subsectors had positive results on a quarterly basis

» We highlight stronger-than-anticipated increase in Financial Services (1.3% QoQ), Other Services (1.3% QoQ), Public Services (0.4% QoQ) and Transports (0.9% QoQ)

Transports (Level SA)
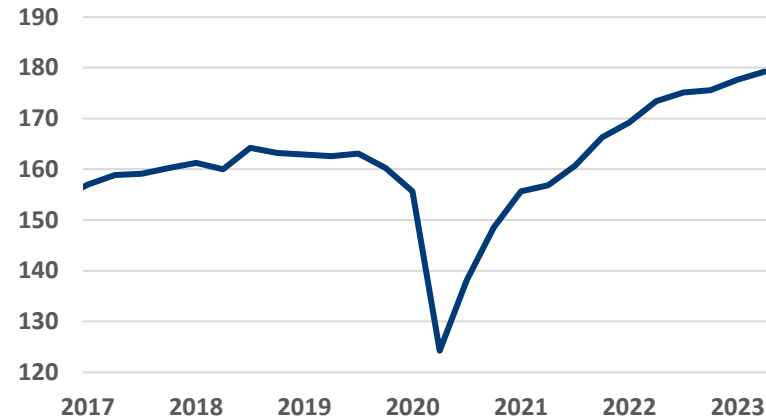
Financial Services (Level SA)
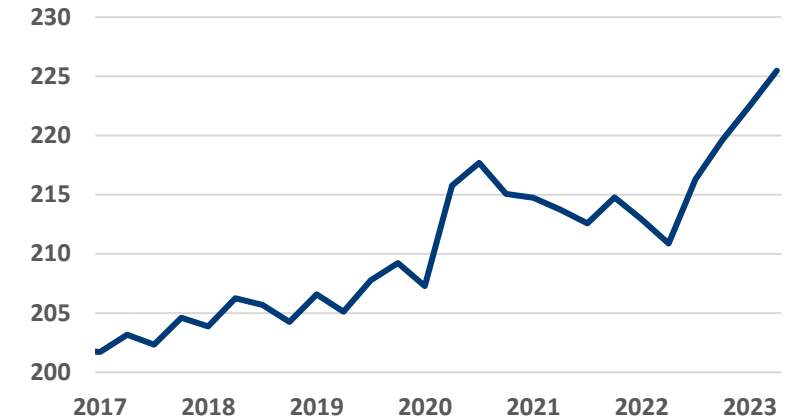
Other Services (Level SA)
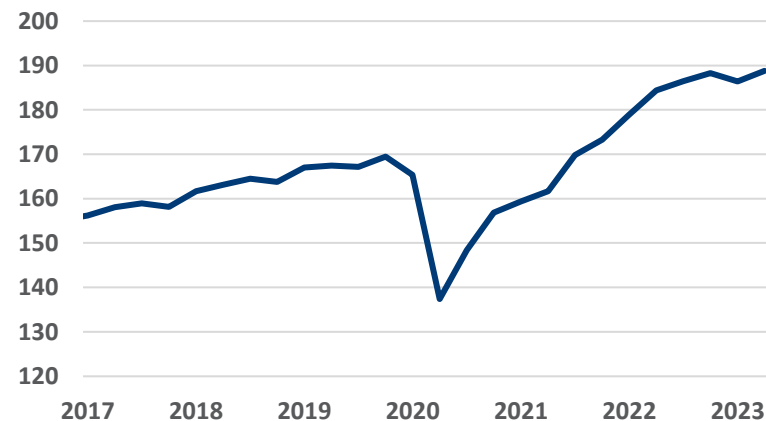
Public Services (Level SA)

Brazil: Economic Activity

» On the demand side, Household Consumption Expenditure grew 0.9% QoQ, owing to the higher disposable income, while Government Consumption advanced 0.7% QoQ (2.9% YoY)

» Conversely, Gross Fixed Capital Formation was virtually flat after a tumble of -3.4% QoQ) in 1Q

» The External Sector contributed negatively, as the jump in Imports was bigger than the surge in Exports (4.5% QoQ vs. 2.9% QoQ)

Household Consumption (Level SA)
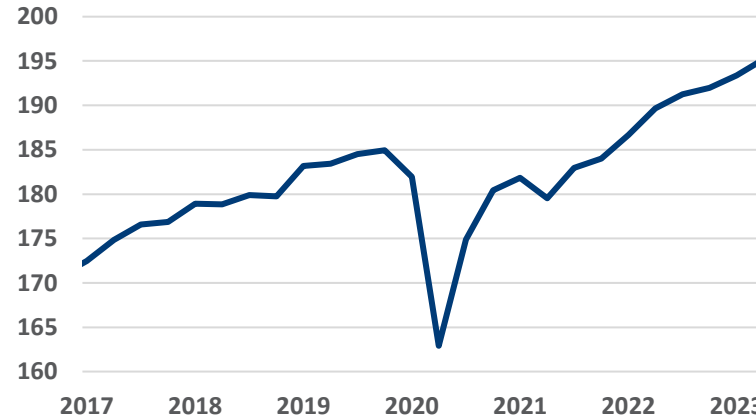
Government Consumption (Level SA)

Imports (Level SA)
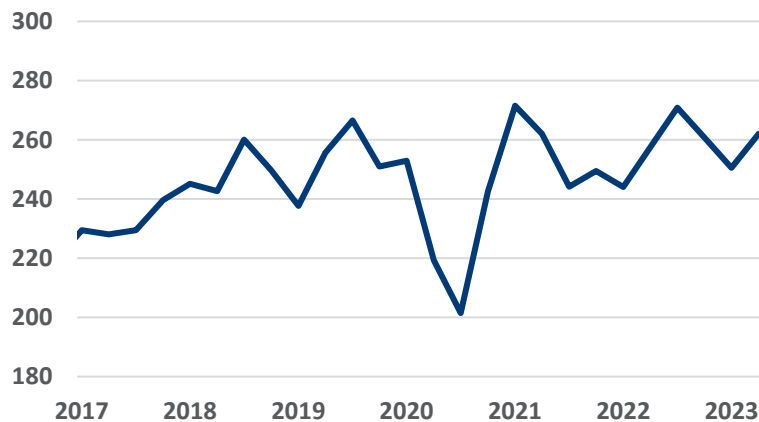
Gross Fixed Capital Formation (Level SA)

Exports (Level SA)

Source: BOCOM BBM, IBGE
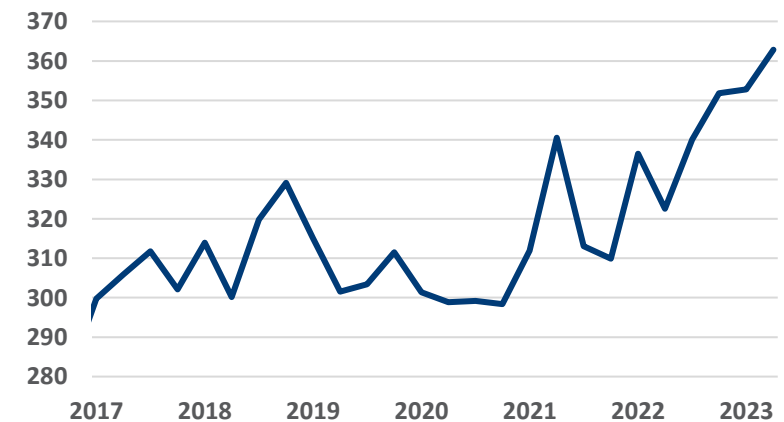
Brazil: Economic Activity

» After the Q2 GDP result, we revised our forecast for this year from 2.3% to 2.9%;

» The statistical carry for the year is at 3.1%;

» Today we contemplate stability in Q3, followed by a slight drop of -0.2% in the last quarter of the year;

» For 2024, we project a growth of 1.4%.

Forecasts				
	2023.III QoQ	2023.III YoY	2023	2024
GDP	**0.0%**	**2.2%**	**2.9%**	**1.4%**
Agriculture	**-5.0%**	**9.1%**	**14.3%**	**1.8%**
Industry	**0.7%**	**1.4%**	**1.6%**	**1.3%**
Mining	1.2%	7.4%	7.4%	3.9%
Manufacturing	-0.1%	-1.5%	-1.2%	-0.3%
Electricity	0.6%	4.3%	4.9%	4.1%
Civil Construction	0.6%	-0.4%	0.5%	1.2%
Services	**0.4%**	**1.6%**	**2.0%**	**1.5%**
Retail	0.1%	-0.2%	0.4%	0.3%
Transports	0.3%	2.5%	3.3%	2.7%
Information and Communication	1.0%	1.2%	2.8%	1.6%
Financial Services	1.1%	5.7%	5.4%	3.5%
Rents	0.9%	2.5%	2.7%	2.2%
Other Services	0.4%	1.1%	1.9%	0.6%
Public Administration	0.6%	1.2%	1.2%	1.7%

GDP Level SA

Source: BOCOM BBM, IBGE
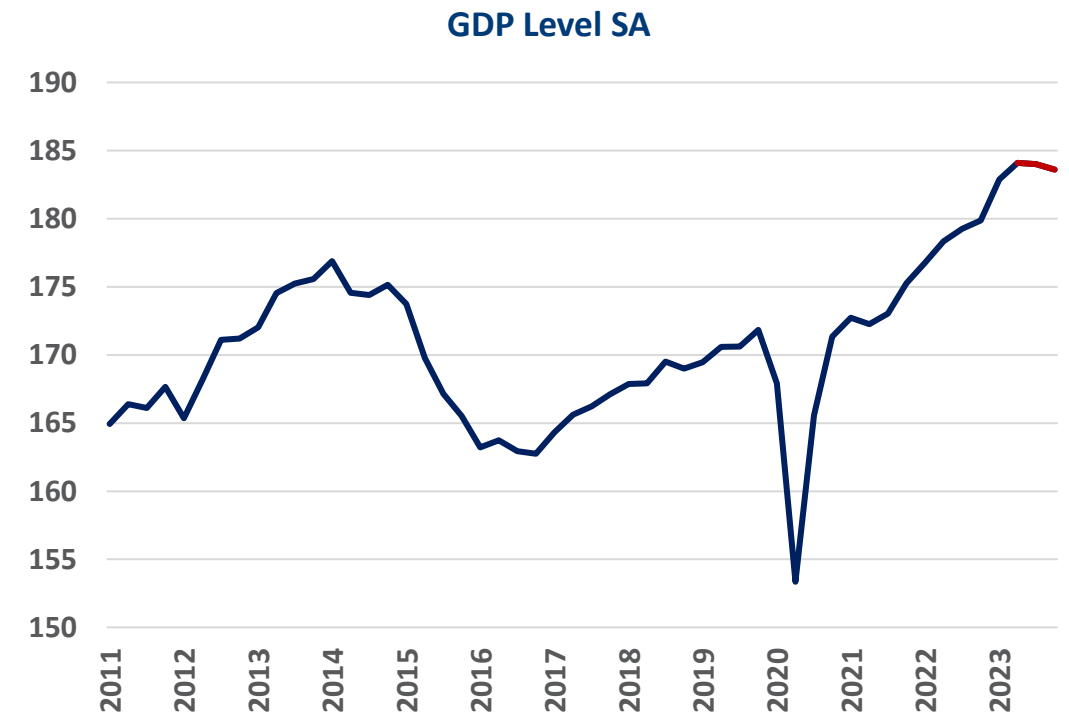
Brazil: PNAD

» The unemployment rate fell to 7.9% NSA in July, the lowest for this period since 2014;

» The employed population, in turn, showed a modest increase of 0.1% MoM;

» The labor force participation rate (61.7%) remains significantly below the pre-pandemic records, helping the unemployment rate to remain at lower levels;

» Regarding real labor earnings, a modest growth was observed on the month (0.1%), representing a deceleration at the margin;

» In this line, the real aggregate labor income increased 0.26% MoM and is 6.2% above July 2022.

Brazil - Unemployment Rate

YoY (lhs) — **Unemployment Rate (SA)**

Brazil - Employment Level SA
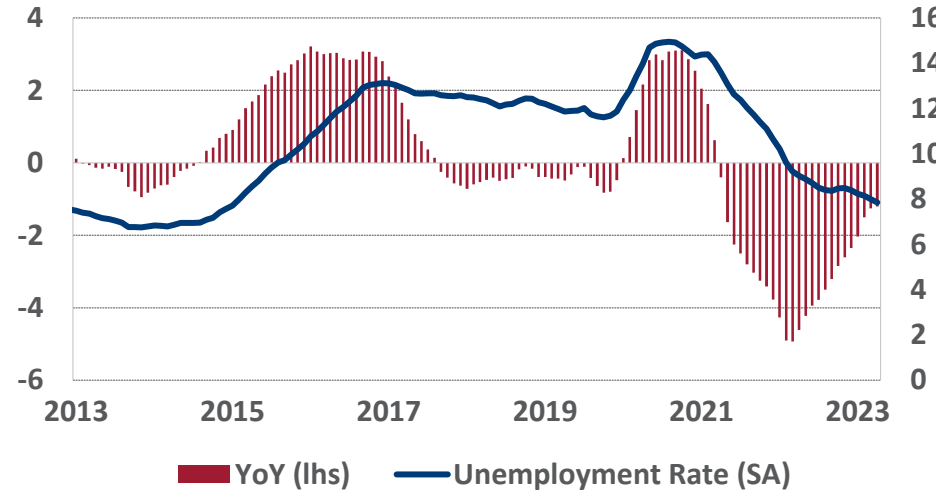
Formal/(Formal + Informal) — **Employment Level SA**
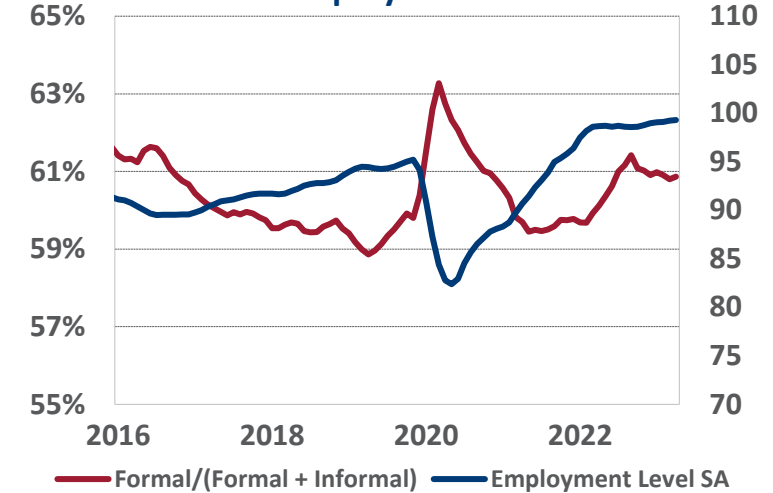
Brazil - Workforce Participation

Seasonally Adjusted — **Workforce Participation Rate**
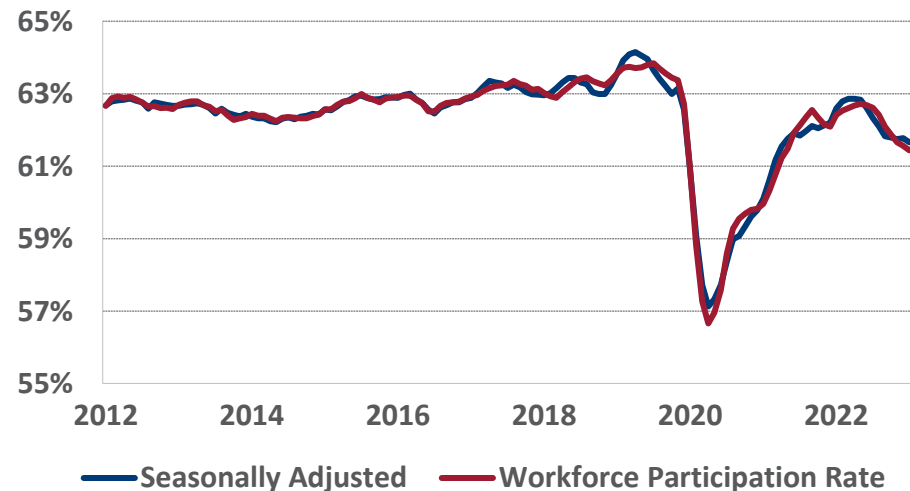
Brazil - Mean Real Wage and Real Wage Bill

Mean Real Wage — **Real Wage Bill**

Source: IBGE, BOCOM BBM, MTE
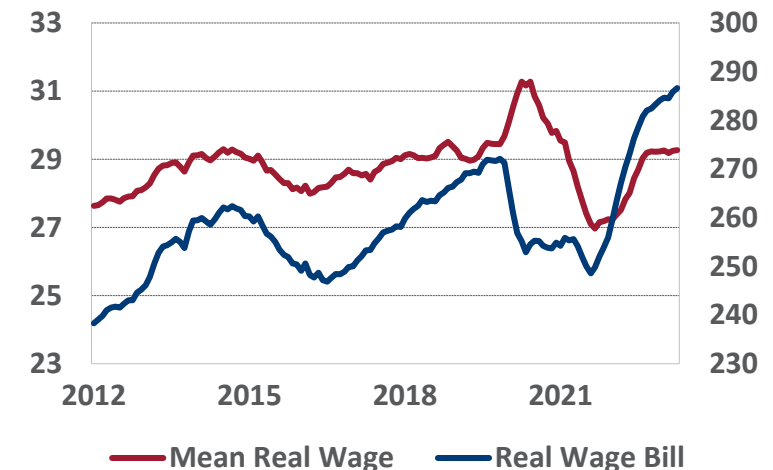
Brazil: Formal Labor Market

» In July, Caged registered a net creation of 142.7k formal jobs, below market expectations (145.0k);
» In our seasonally adjusted estimates, it registered a net creation of 98.8k;
» Overall, we continue to see a gradual deceleration in formal employment throughout 2023.

CAGED - Balance of Jobs (SA, Thousand)

Balance of Jobs (SA)　3MMA
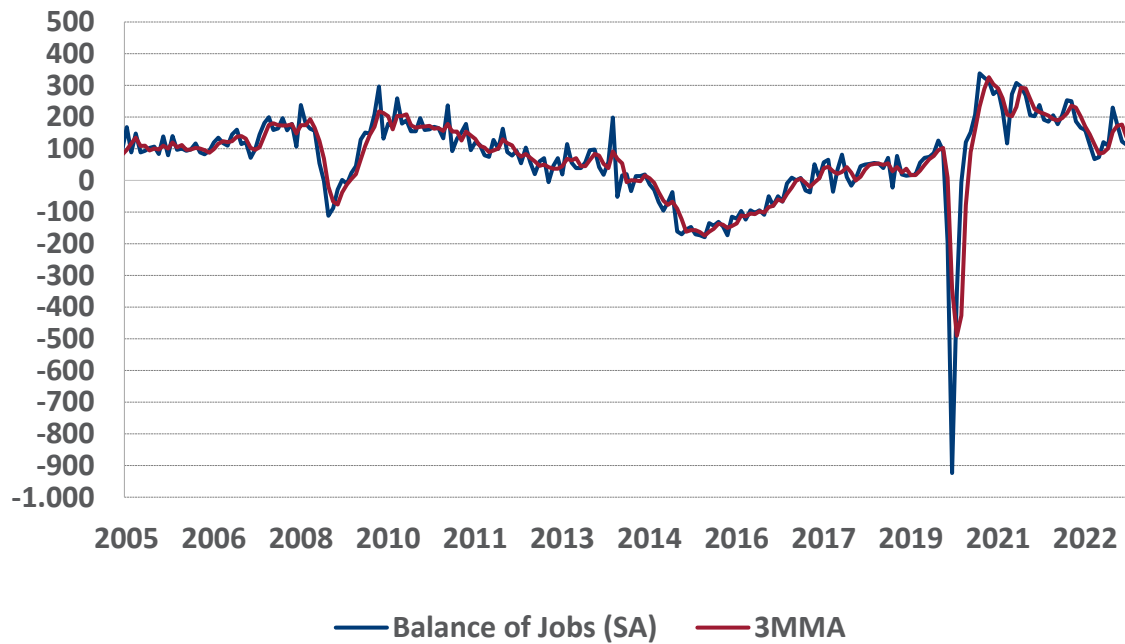
Net Payroll Job Creation - 12 Months (Thousand)
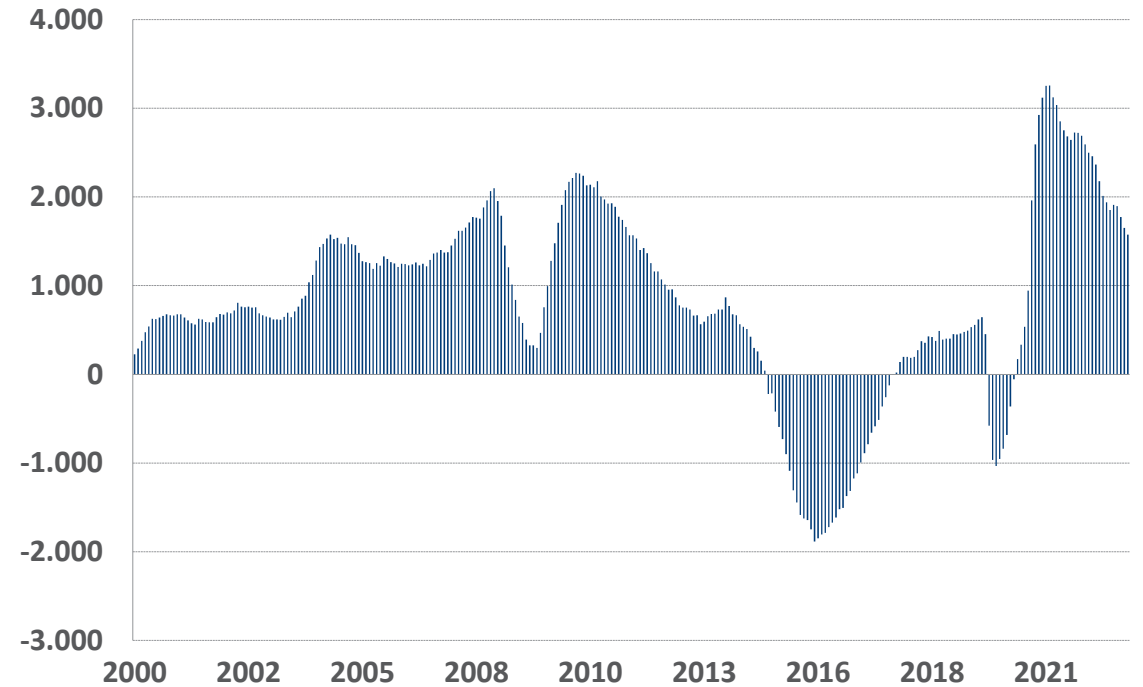
Brazil: Formal Labor Market

» The service sector remains the category with the largest number of jobs generated, with the record of net creation around 56.5 thousand jobs in July, although loosing strength at the margin. The results recorded in all sector continue showing a deceleration.

Brazil - Retail Net Payroll Job Creation (SA)

NET SA — MM3M

Brazil - Services Net Payroll Job Creation (SA)

NET SA — MM3M
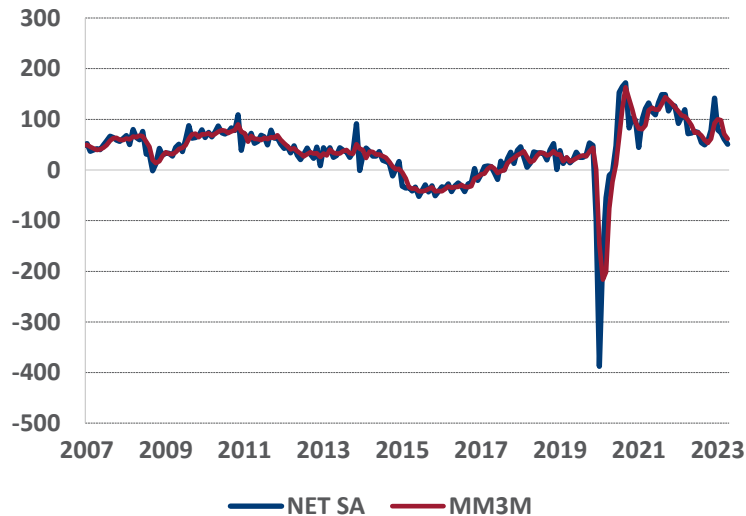
Brazil - Industry Net Payroll Job Creation (SA)

NET SA — MM3M
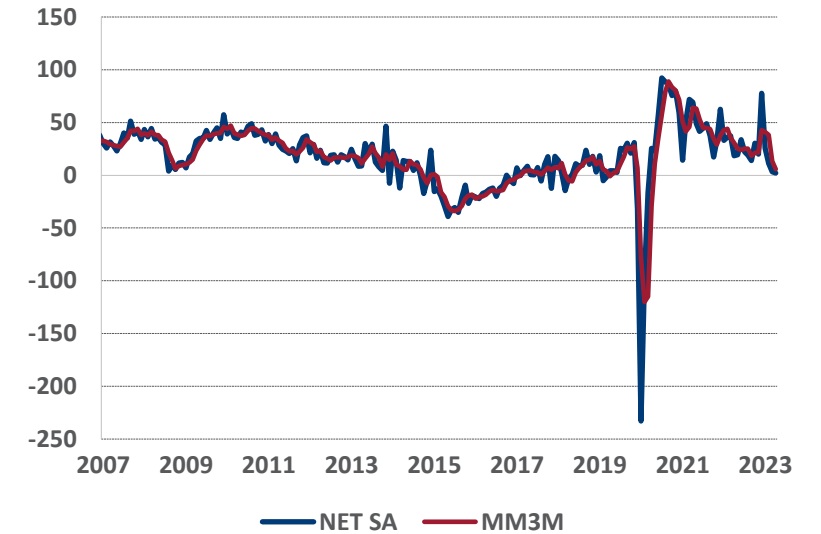
Brazil - Construction Net Payroll Job Creation (SA)

NET SA — MM3M

Source: BOCOM BBM, MTE

Brazil: Credit Statistics

» In July, total credit concessions grew 0.2% MoM in real terms;

» Non-earmarked credit concessions decreased -0.2% MoM to households and -5.4% to companies;

» By the other hand, earmarked credit advanced 17.8% MoM, driven by rural credit with the beginning of the 2023/2024 harvest.

Concessions - Households SA (Real) - Mar/11 = 100

New Credit Operations SA (Real) - mar/11 = 100
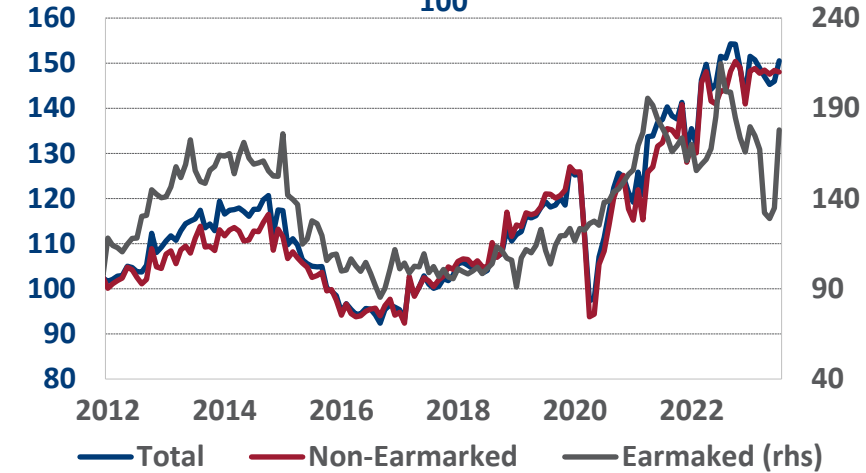
Concessions - Companies SA (Real) - mar/11 = 100

Source: BOCOM BBM, BCB
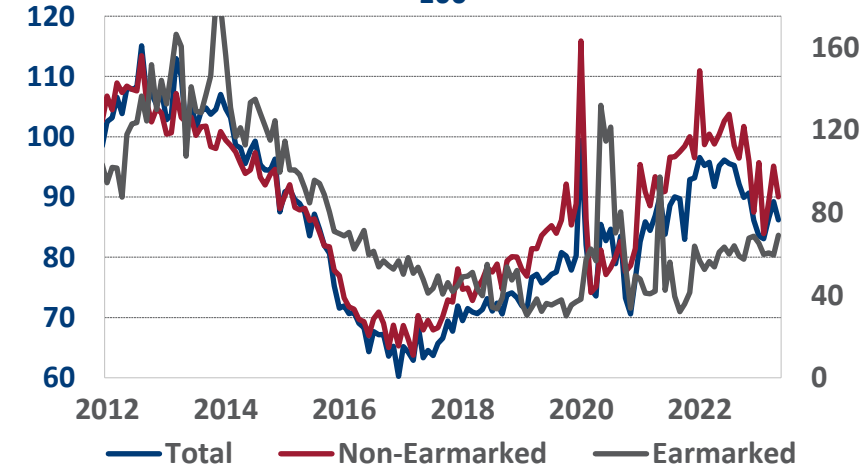
Brazil: Credit Statistics

» Lending rates to individuals fell modestly to 37.2%. To corporates, the lending rates were 19.8%;

» Non-earmarked default fell to 6.2% to households (from 6.3% in June), but for companies it increased to 3.3% (from 3.1% in June).

Non-Earmarked Default - Households (%)

2018 — 2019 — 2020 — 2021 — 2022 — 2023
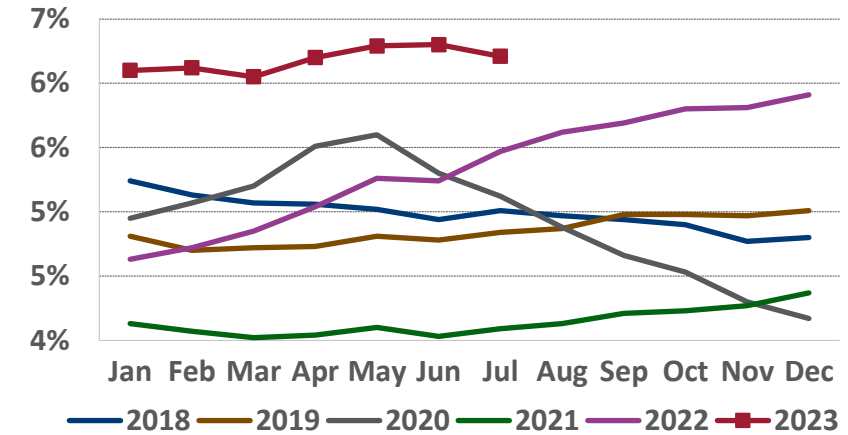
Interest Rates - Households (%)

— Old Series — New Series
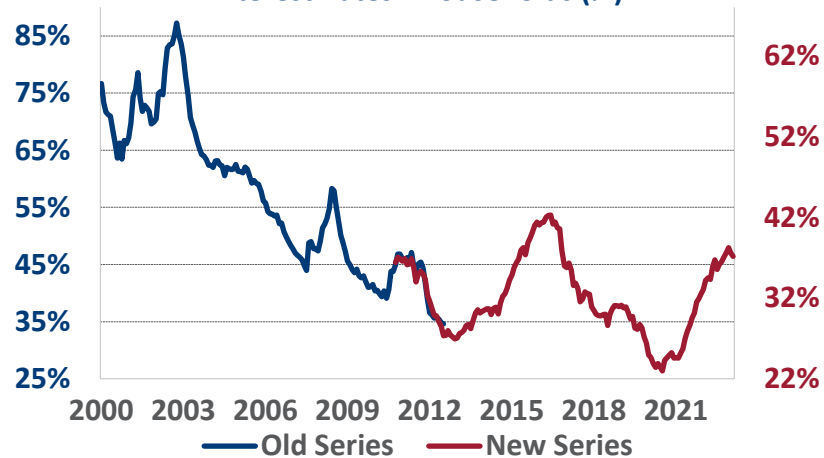
Interest Rates - Companies (%)

— Old Series — New Series
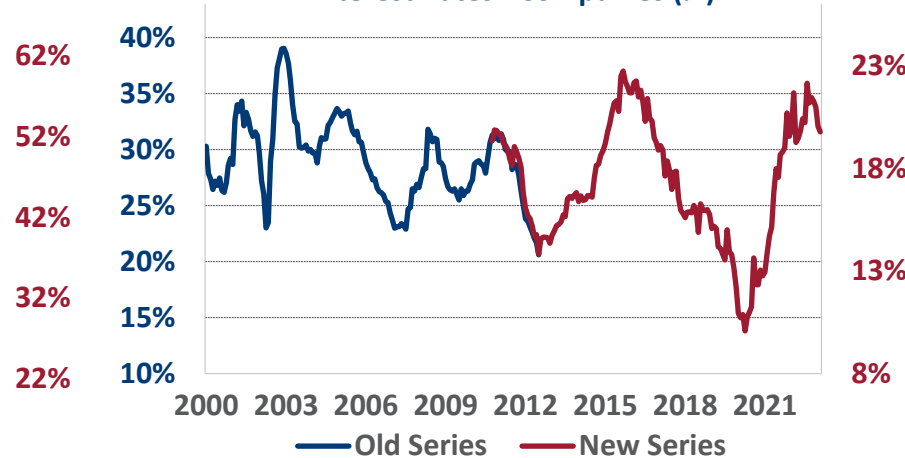
Non-Earmarked Delinquency - Companies (%)

2018 — 2019 — 2020 — 2021 — 2022 — 2023

Source: BOCOM BBM, BCB
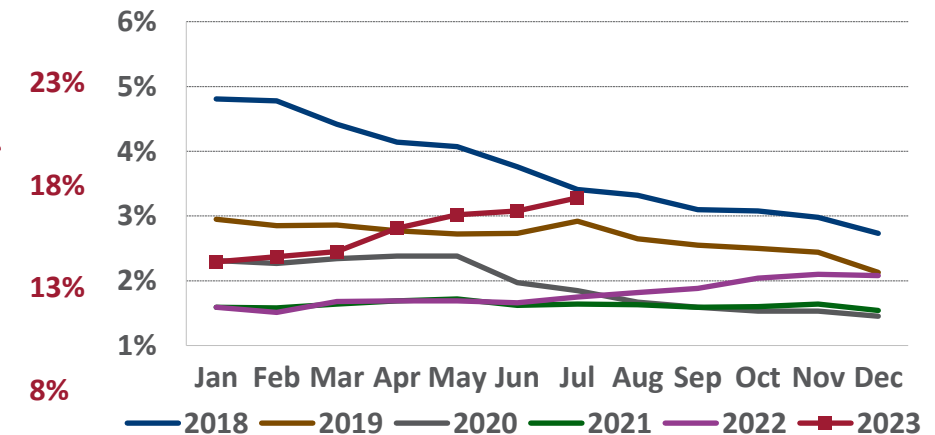
Brazil: Credit Statistics

» Household indebtedness fell to 48.3, the first fall after two consecutive increases;

» The income commitment to debt service, in turn, rose to 28.3%, the highest level of the historical series;

» The "Desenrola" Program started on the 17th of July, therefore having a limited effect on the data for the month of July.

Household Indebtedness (12M, %)

Income Commitment (SA, %)

Source: BOCOM BBM, BCB
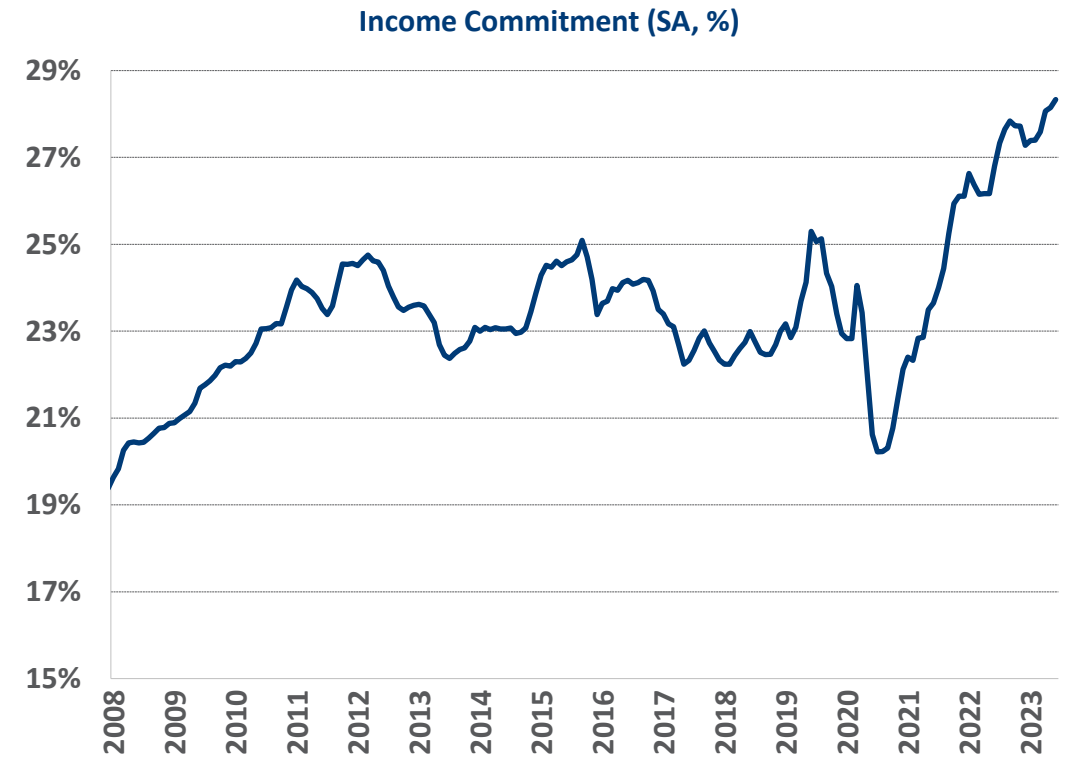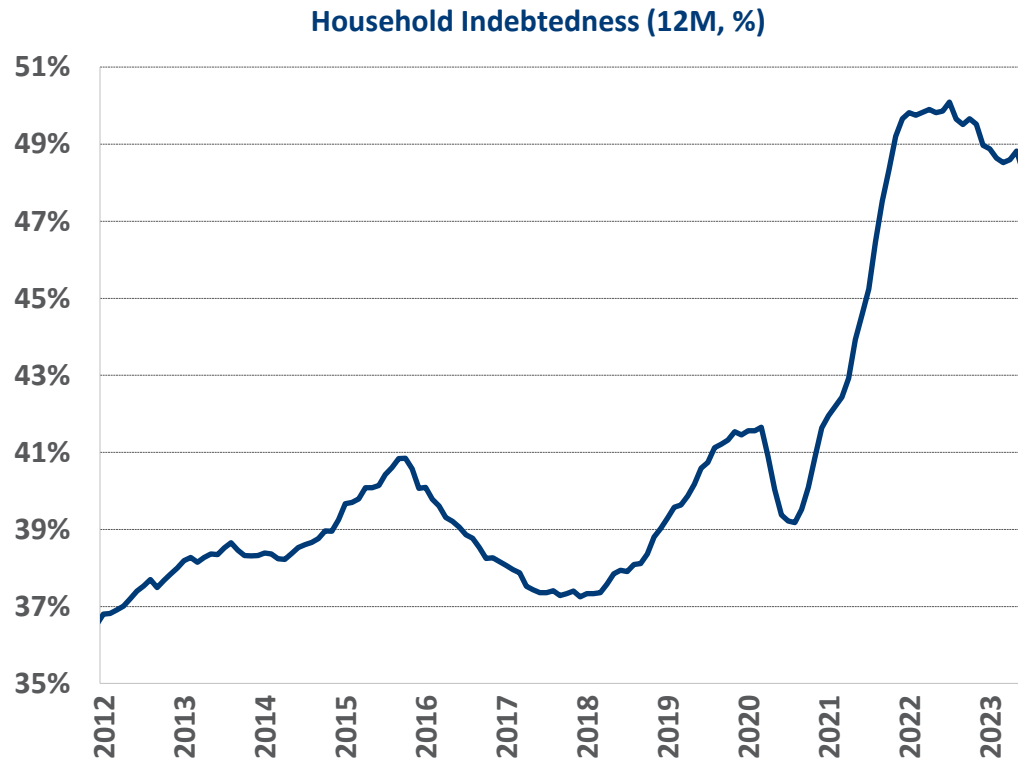
Brazil: Federal Tax Collections

» Total federal tax collection reached BRL 201.8 billion in July, representing a drop of 4.2% in real terms when compared to July 2022;

» The accumulated result in the year decreased 0.4% YoY in real terms;

» July's performance was influenced by the drop in the average price of commodities, the recent slowdown in economic activity and the decrease in inflationary levels.

Total Tax Collection (YoY Real, %)
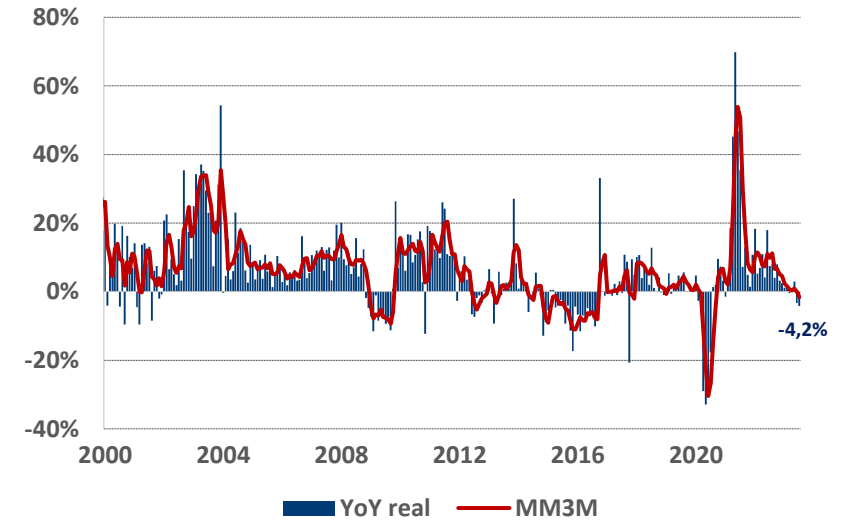
Total Tax Collection (BRL Bn, Real SA)
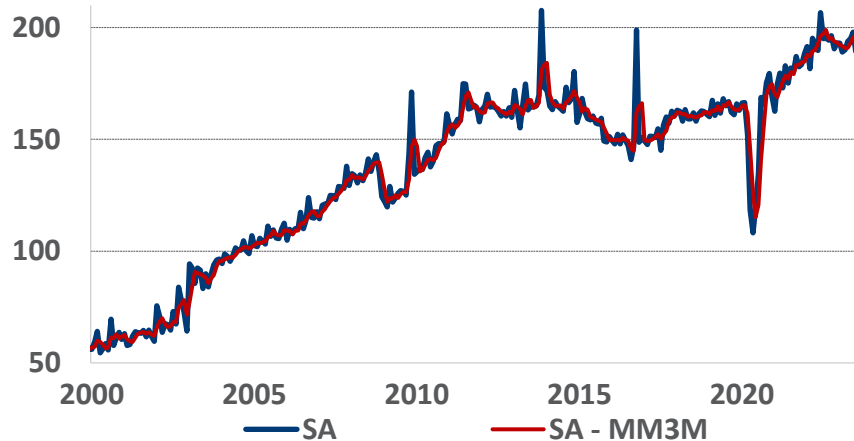
Total Tax Collection (YTD Real, %)
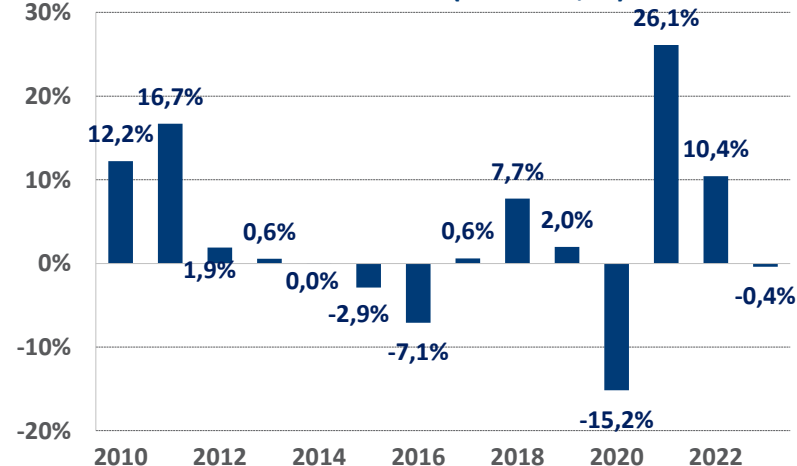
Total Tax Collection (% GDP)

Fonte: BOCOM BBM, RFB

Brazil: Central Government Primary Result

» In July, central government's primary balance posted a deficit of BRL 35.9 bn, below market expectations (BRL -33.2 billion);

» In the 12-months the Central government's primary balance accumulated a deficit of BRL 97.0 billion (0.9% of GDP);

» The net revenue fell 5.3% in real terms compared to July 2022. Tax revenues showed a fall of 3.7%, as its was largely influenced by the drop of 30.2% in corporate tax on profits (IRPJ/CSLL). Non-tax revenues also dropped (-32.4%), due to the decrease in the flow of concessions (-73.4%), dividends (-74.8%) and natural resources exploitation (-27.7%);

» Total spending surged 31.3% YoY in real terms. The main drivers were a rise in pensions and retirees' benefits (41.1%), the growth observed in unemployment insurance and wage bonus (150%), partially explained by a change in the disbursements' calendar, and the Bolsa Família program (80.6%).

C. G. Primay Budget Balance (%, GDP 12M)

Net Revenue (YTD Real, %)

Expenditure (YTD Real, %)
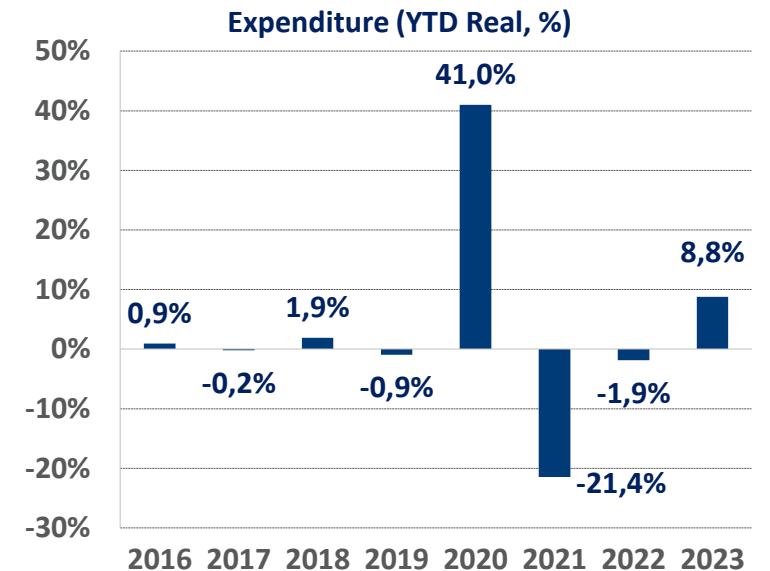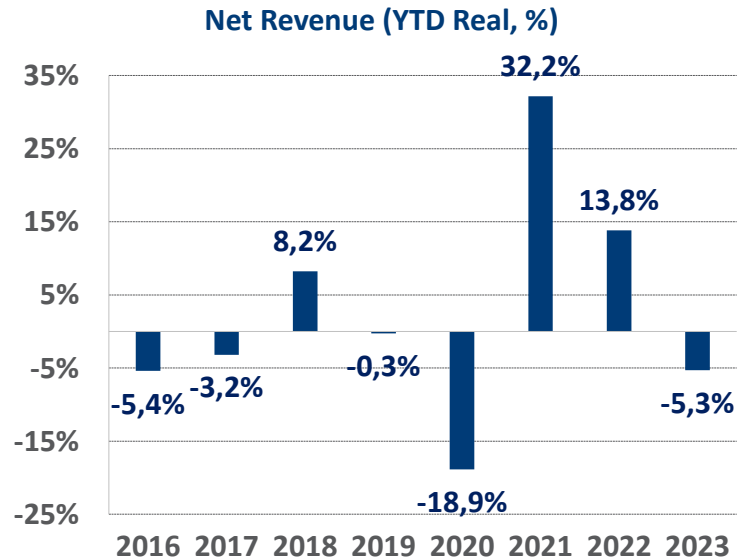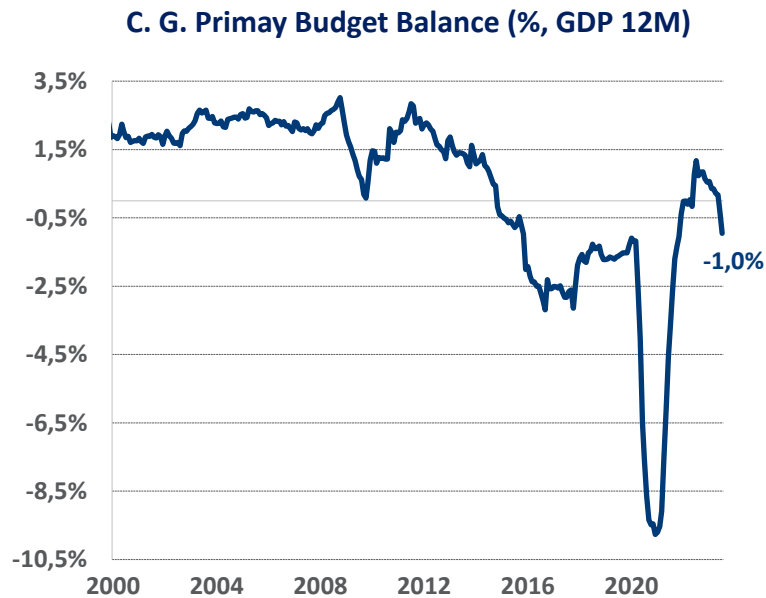
Brazil: Consolidated Public Sector Budget

» The consolidated public sector recorded a primary deficit of BRL 35.8 billion in July, the worst result for the month since 2020. The central government registering a deficit of BRL 32.5 billion, subnational governments a deficit of BRL 4.2 billion and state-owned companies a surplus of BRL 0.9 billion;

» Gross General Government Debt increase to 74.1% in July from 73.6% in June, as it was positively impacted by 'Interest settlements' (0.5 pp.) and net issuance (0.3 pp.), and partially offset by nominal GDP growth (-0.4 pp.).

Gross General Government Debt (% GDP)

Primary Budget Balance (% GDP 12M)

Primary Surplus: Central Government (% GDP 12M)

Primary Surplus: Subnational governments and SOEs (% GDP 12M)

Subnational Governments — SOEs

Source: BOCOM BBM, BCB
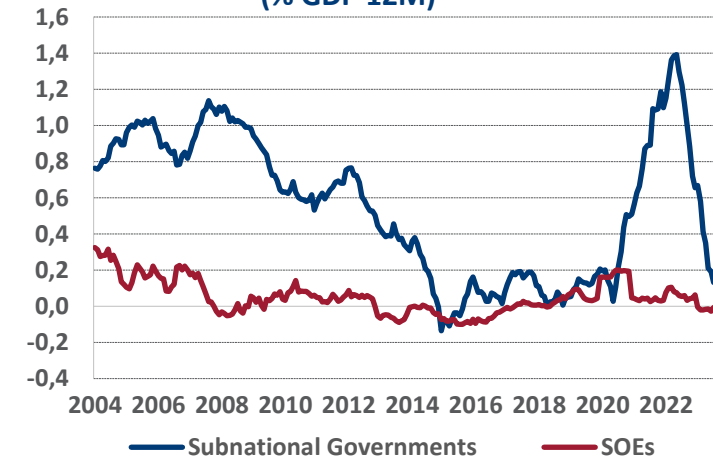
Brazil: New Fiscal Framework Approved in Congress

» The Lower House approved the proposal for a new fiscal framework, which kept some changes made by the Senate and rejected others:

  » Accepted the Senate's modification that removed Fundeb (Fund for Basic Education Development) from the spending limit, as it was in the previous spending cap;

  » Maintained the change proposed by the Senate that removed FCDF (Federal District Constitutional Fund) from the spending limit;

  » Rejected the removal of expenses with Science, Technology, and Innovation from the spending limit, which could be used by the government to increase spending through its reclassification;

  » Rejected the possibility that the government could include in the budget primary expense conditioned on the approval of additional credit by the National Congress (referring to the difference between the accumulated inflation in 12 months until June and until December);

    » This article would allow the government to include additional expenses of around BRL 32 billion in the 2024 budget, which could later be incorporated into the budget for the following year if the predictions were confirmed;

    » However, this measure was included in PLOA.

Brazil: 2024 Budget, Revenues

» On August 31, the government published the 2024 Budget Proposal (PLOA), considering the expenditure limit rising by BRL129 billion and BRL169 billion (1.5% of GDP) in revenues measures to close the budget gap;

» However, there is high uncertainty about the success of these initiatives given the need to approval in Congress, possible risk of judicialization and change of taxpayer behavior.

MEASURES FOR THE RECOVERY OF REVENUES PRESENT IN THE 2024 BUDGET					
	Govern estimated impact	Market scenario	Aproved	Sent to National Congress	Not sent to National Congress
IRPJ/CSLL on ICMS tax credits	35	30		■	
Carf	56	30	■		
Transaction of major theses in the Judiciary with PGFN	12	0			■
Transaction with IRS	30	0			■
Offshores	7	7		■	
Exclusive funds (flow)	6	10		■	
Exclusive funds (stock)	7	0		■	
JCP	10	7		■	
Esport beating	2	2			
Low value imports	3	0			■
Total	168	86			
Other Measures already approved					
Return of PIS Cofins on gasoline/ethanol	39	39	■		
PIS Confins on ICMS tax credits	58	17	■		
Transfer pricing	23	6	■		
Return of PIS Cofins on diesel	18	18	■		
Total	306	166			

» **Some risks:**

» **MP 1185 that disciplines ICMS subsidies,** not well received in the Congress for proposing the repeal of the existing framework on the subject, while the expectation was that the government would only regulate the decision of the STJ on the subject;

» The **taxation of exclusive funds**, in turn, should have the rate applied to the stock reduced from 10% to 6%;

» **Extinction of JCP** should suffer strong political resistance;

» **CARF's casting** vote provides for a series of discounts on fines and interest, in addition to the possibility of payment installments.

Source: BOCOM BBM, Ministry of Finance

Brazil: 2024 Budget, Expenditures

» **2023 Expenditure Limit Base: BRL 1964 bn**
» (+) IPCA 12m – June 2023 (3.2%): BRL 62 bn
» (+) New Fiscal Rule – Real Increase (1.7%): BRL 34 bn
» (+) IPCA Update in 2024 (4.9%): BRL 33 bn
» **2024 Expenditure Limit: BRL 2093 bn**

» **Risk:** the President vetoed a provision of the new fiscal rule that prohibited exceptions to the annual budget target. This veto was seen as potentially generating greater-than-expected spending
 » The government argue this change was focused on accommodating court-ordered debt payments that were already not subjected to the expenditure limit

Government Forecasts				
	2023		**2024**	
	R$ bn	% GDP	R$ bn	% GDP
1. Total Primary Revenue	2,366.3	22.1	2,709.5	23.7
2. Transfers by Revenue Sharing	457.1	4.3	518.3	4.5
3. Net Revenue from Transfers (1) - (2)	1,909.3	17.8	2,191.2	19.2
4. Primary Expenses	2,054.6	19.2	2,188.4	19.2
Mandatory	1,860.8	17.4	1,976.5	17.3
Executive Power's Discretionaries	193.9	1.8	211.9	1.9
5. Central Government Primary Result (3) - (4)	-145.4	-1.4	2.8	0.0
6. Fiscal Target	-238.2	-2.2	0.0	0.0

Expenses (% GDP)

19,2%

18,2%
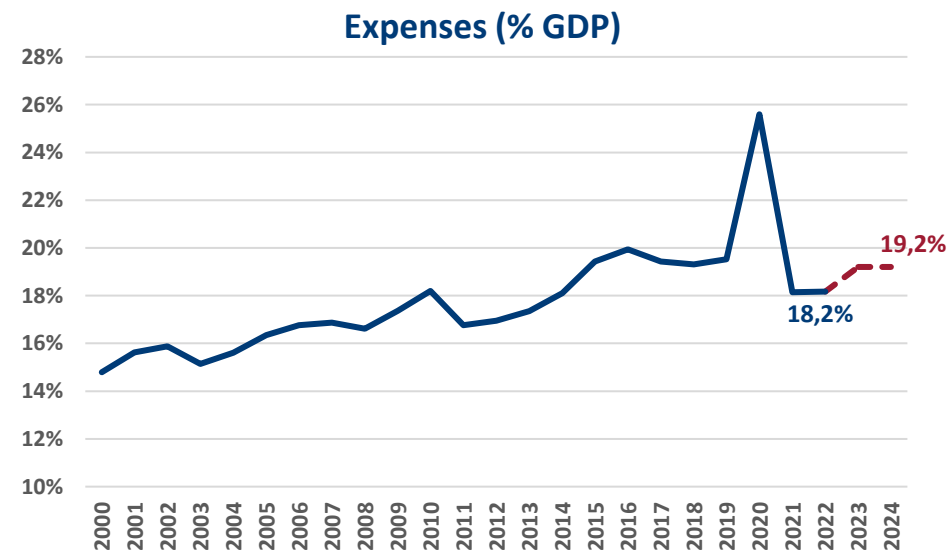
Brazil: Fiscal Scenario

» We have updated our expectation for the Central Government primary deficit from -1.1% in 2023 and -1.2% in 2024 to -1.0% in 2023 and -0.9% in 2024;

» **2023:** Reduction in expenses given the expected pooling (expenditures budgeted but not executed due to budget rigidities or technical difficulties) and extra revenues (our scenario considers 23 bn from PIS/PASEP fund, 16 bn from the return of PIS/COFINS on gasoline and ethanol, 15 bn PIS/Cofins on ICMS tax credits);

» **2024:** We do not consider expenditure contingency. In addition to the PIS/Cofins return on fuels, our baseline scenario now considers 80 bn in extra revenues.

Central Government Primary Result (% GDP)

Primary Result Forecast (% GDP)

Source: BOCOM BBM, National Treasury
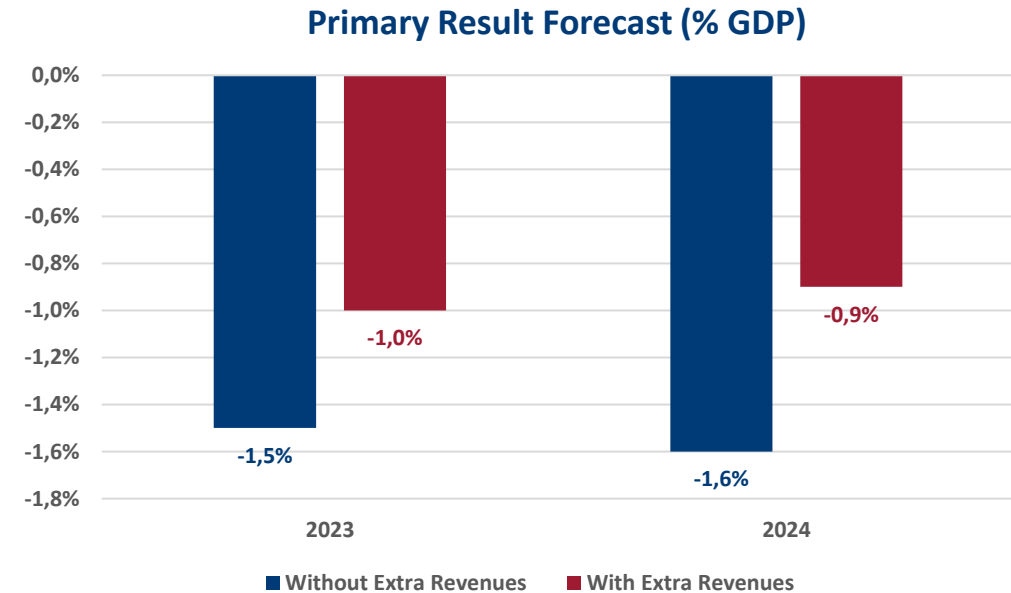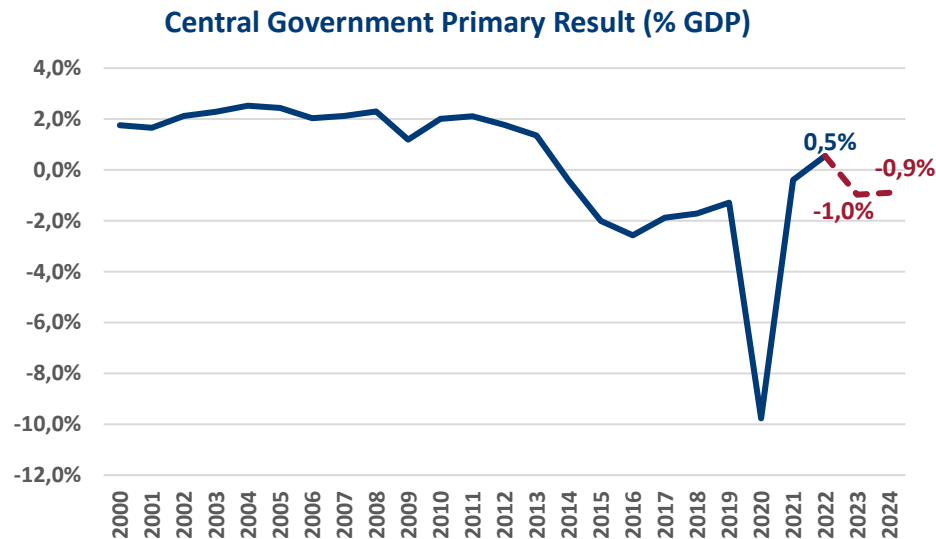
Brazil: Fiscal Scenario

» We have updated our expectation for the Gross Debt to GDP ratio from 76.6% in 2023 and 81.4% in 2024 to 75.6% in 2023 and 79% in 2024;

» Higher GDP growth, lower implicit rates, smaller primary deficit…

Baseline Scenario			
Inflation	**Real GDP**	**Deflator**	**Real Interest Rate**
2023 4.8%	2.9%	5.0%	5.7%
2024 3.6%	1.4%	4.8%	5.6%

Debt to GDP ratio
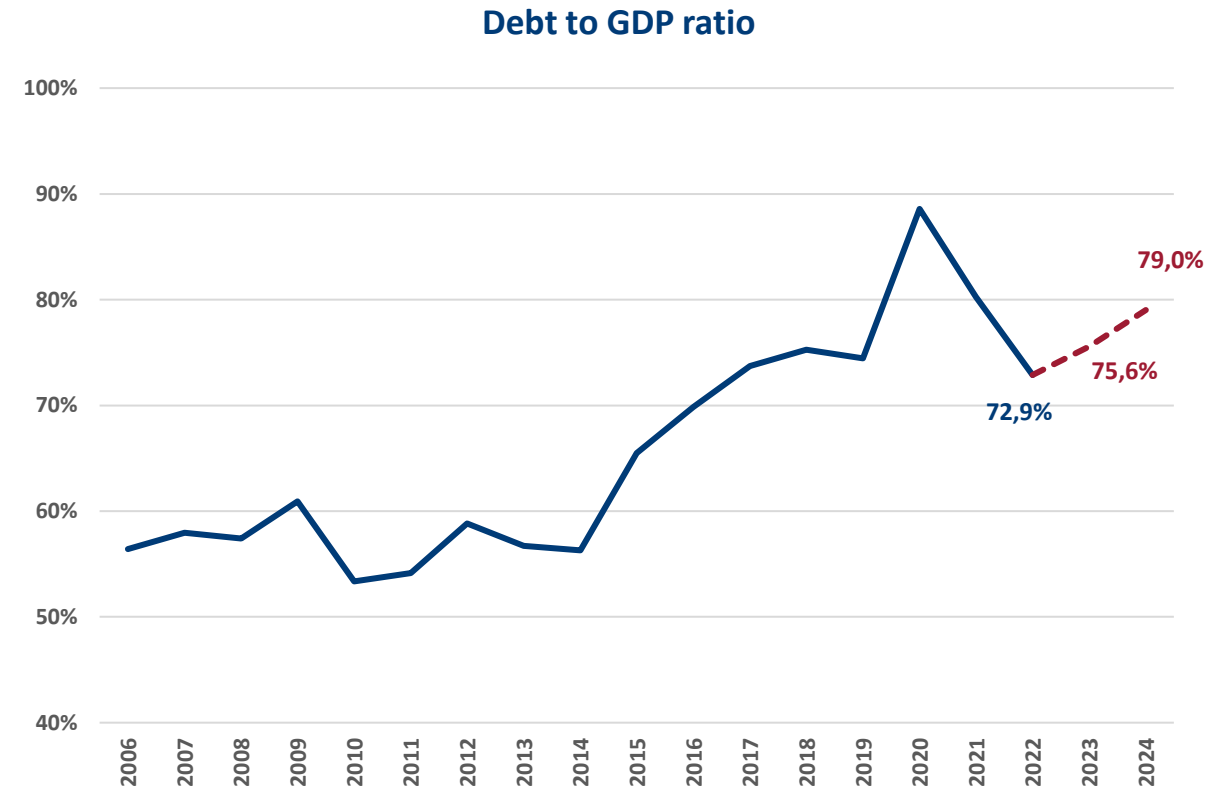
Brazil: Inflation 2023

» The August IPCA preview advanced 0.28% MoM (from -0.07% in July), well above the market consensus (0.17% MoM);

» The variation in 12 months rose to 4.24% in August, compared to 3.19% in July;

» The acceleration was driven by the end of vehicle price subsidies and temporary reductions in electricity tariffs, in addition to highly volatile items such as 'Personal Hygiene';

» The average of core inflation advanced to 0.34% in August and the 3-month moving average of seasonally adjusted annualized data was relatively stable at 4%;

» Underlying services advanced 0.27% MoM, below expectations and also below the result registered in the previous month.

IPCA (YoY, %)

Industrial Goods

Average of Cores

Core Services

Source: BOCOM BBM, IBGE
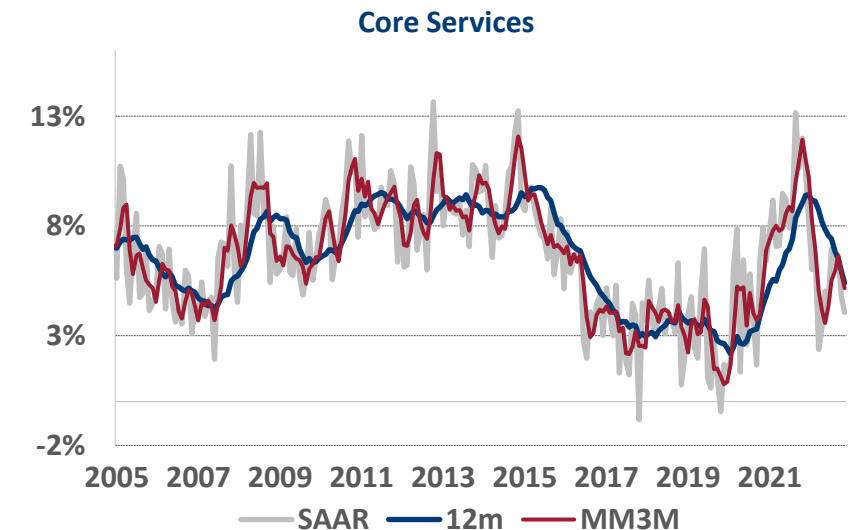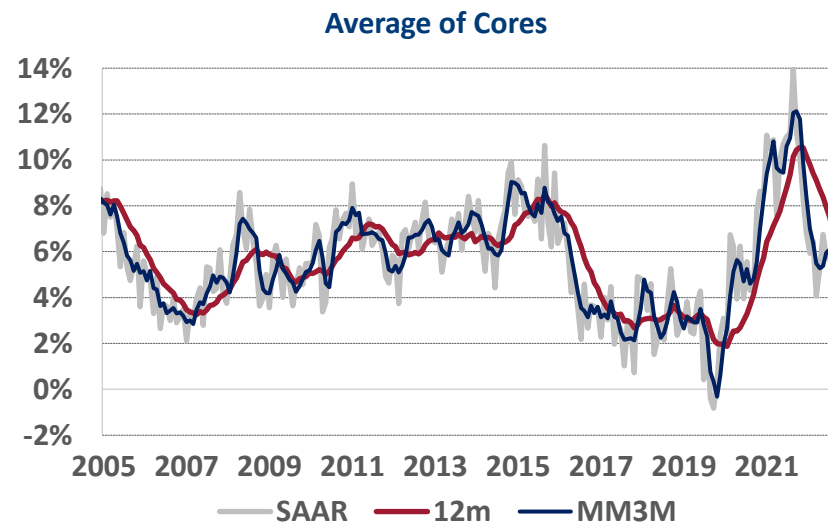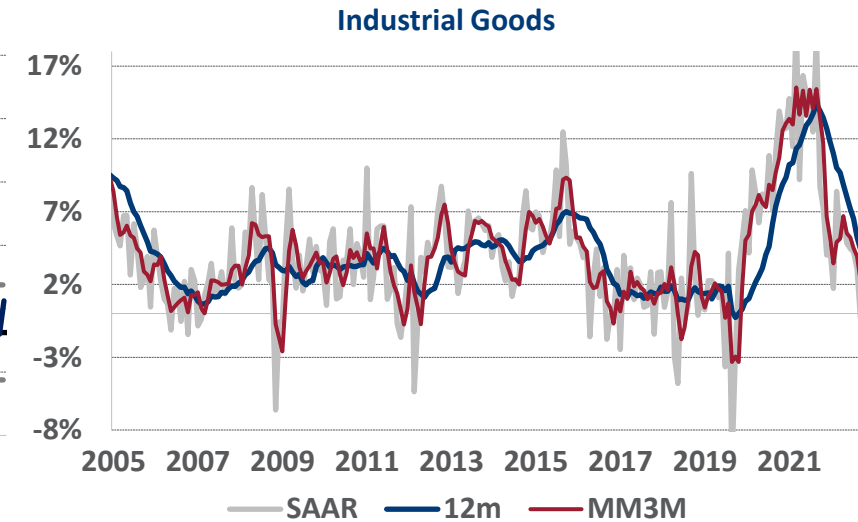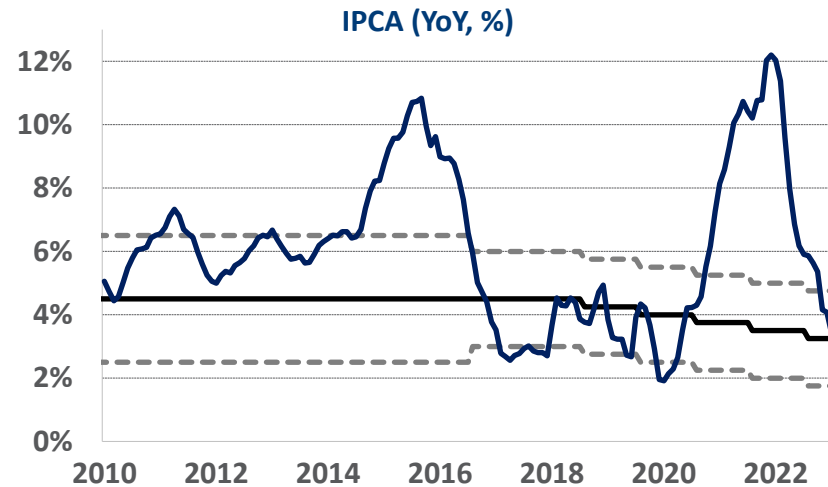
Brazil: Inflation 2023

» The price of industrial goods increased by 0.55% MoM, above expectations;

» The upward surprise was in durable goods (+0.85% MoM), mainly due to 'New Cars';

» Non-durable goods inflation (+0.66% MoM) was driven by the item 'Personal Hygiene', which has high volatility;

» Semi-durable goods were in line with projections.
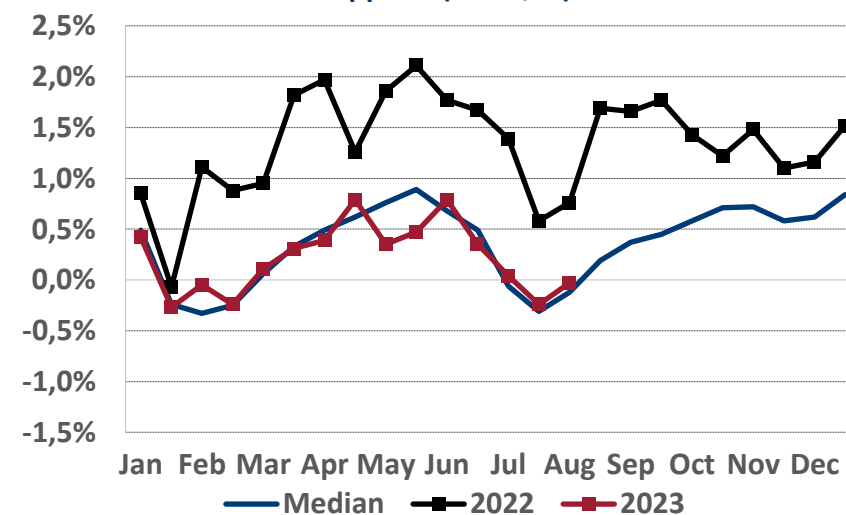
Industrial Goods (MoM, %)
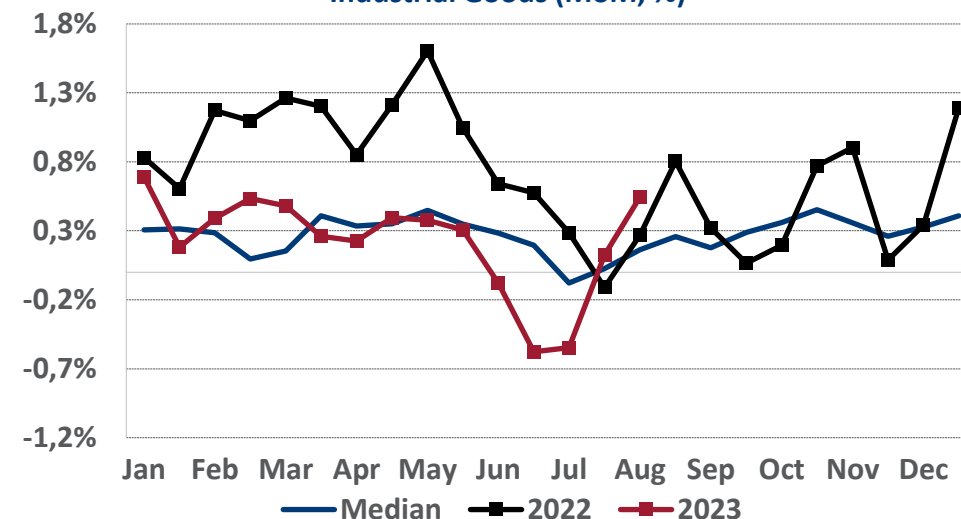
**Durable Goods (MoM, %)**
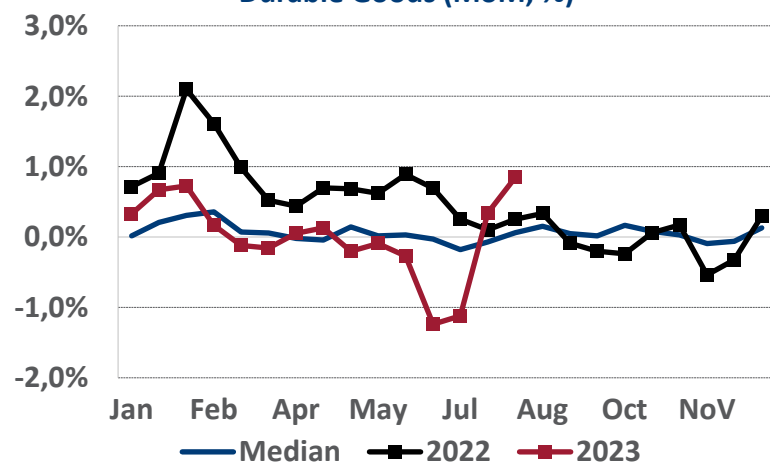
Non-Durable Goods (MoM, %)

Apparel (MoM, %)

Source: BOCOM BBM, IBGE
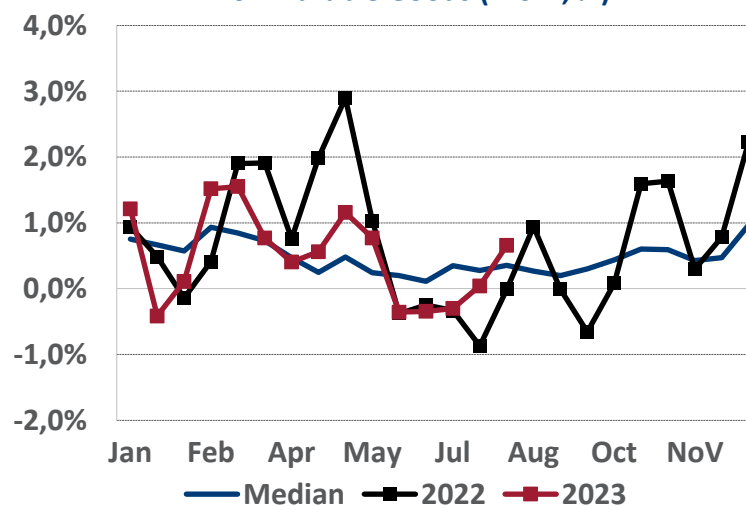
» Food at home recorded a deflation of 0.99% MoM, continuing the downward trend;

» Although deflation was smaller than our forecasts, the outlook for the category in 2023 remains favorable, in line with continued wholesale deflations, especially in beef.

Food at Home (MoM, %)

IPCA x Food at Home (12M)

Source: BOCOM BBM, IBGE
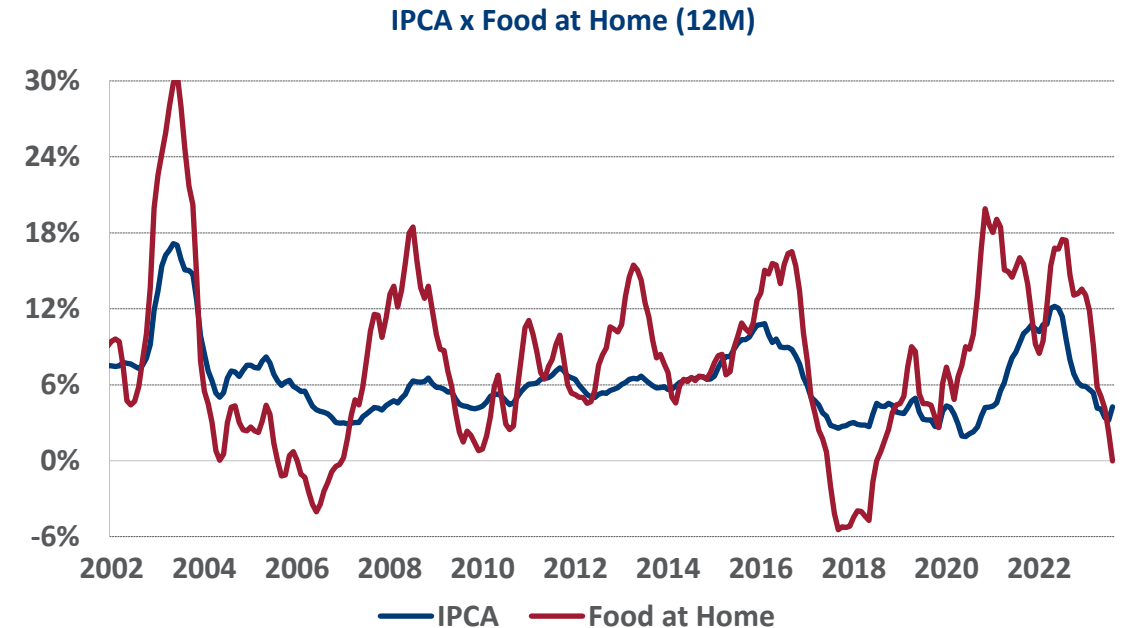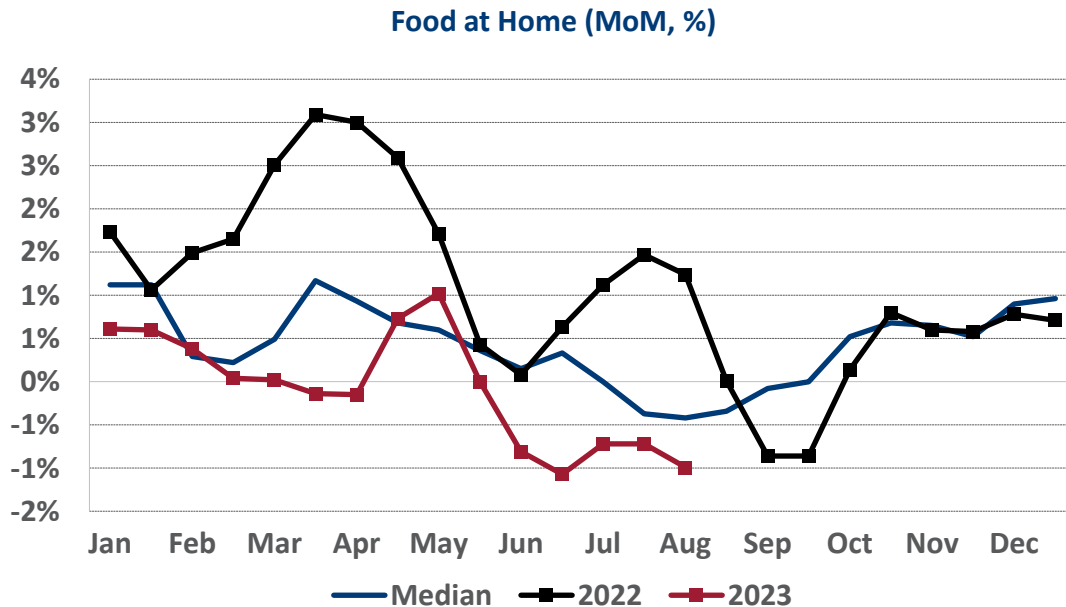
Brazil: Inflation

» Our projection for the year 2023 is 4.8%. The strong deceleration compared to the 2022 numbers is mainly explained by industrial goods and food;

» For 2024, we maintain our forecast at 3.6%.

IPCA (%, annual)

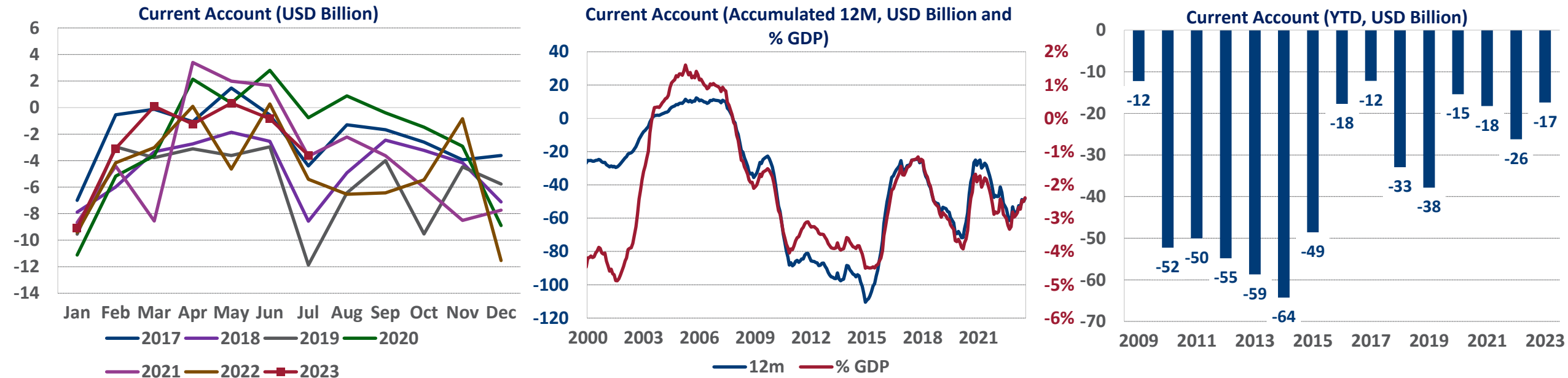|	Weight	2019	2020	2021	2022	2023	2024
Regulated	**26.6**	**5.5**	**2.6**	**16.9**	**-3.8**	**10.1**	**4.0**
Industrial goods	**23.6**	**1.7**	**3.2**	**11.9**	**9.5**	**2.1**	**2.2**
Durable goods	10.3	0.0	4.5	12.9	6.1	0.2	-
Semi-durable goods	5.9	0.6	-0.1	10.2	15.7	2.9	-
Non-durable goods	7.3	4.4	4.0	11.9	9.5	4.0	-
Food at home	**15.7**	**7.8**	**18.2**	**8.2**	**13.2**	**-0.9**	**2.8**
Services	**34.1**	**3.5**	**1.7**	**4.8**	**7.6**	**5.5**	**4.7**
Food away from home	5.6	3.8	4.8	7.2	7.5	5.6	4.5
Related to minimum wage	5.2	2.9	1.5	3.3	6.3	5.1	5.9
Sensitive to economic activity	8.2	2.4	0.2	5.1	6.3	6.5	4.8
Inertial	15.0	4.3	1.6	4.2	8.8	5.0	4.3
IPCA		**4.3**	**4.5**	**10.1**	**5.8**	**4.8**	**3.6**

Brazil: Monetary Policy

» The Central Bank of Brazil embarked on a monetary loosening cycle at its latest meeting, cutting the Selic policy rate by 50 bps. At that time, on August 2nd, the committee foresaw other cuts of the same magnitude (50 bps) in following meetings if the economic scenario turns out as expected. Since then, we could observe some improvements in inflation dynamics, including core components, but should not be enough to modify BCB's guidance. Furthermore, the labor market remains resilient and inflation forecasts for longer horizons did not show additional improvements;

» We maintain the Selic scenario at 11.75% at the end of 2023 and 9% in 2024.

CPI, Selic Rate and Real Ex-post Interest Rate (YoY, %)
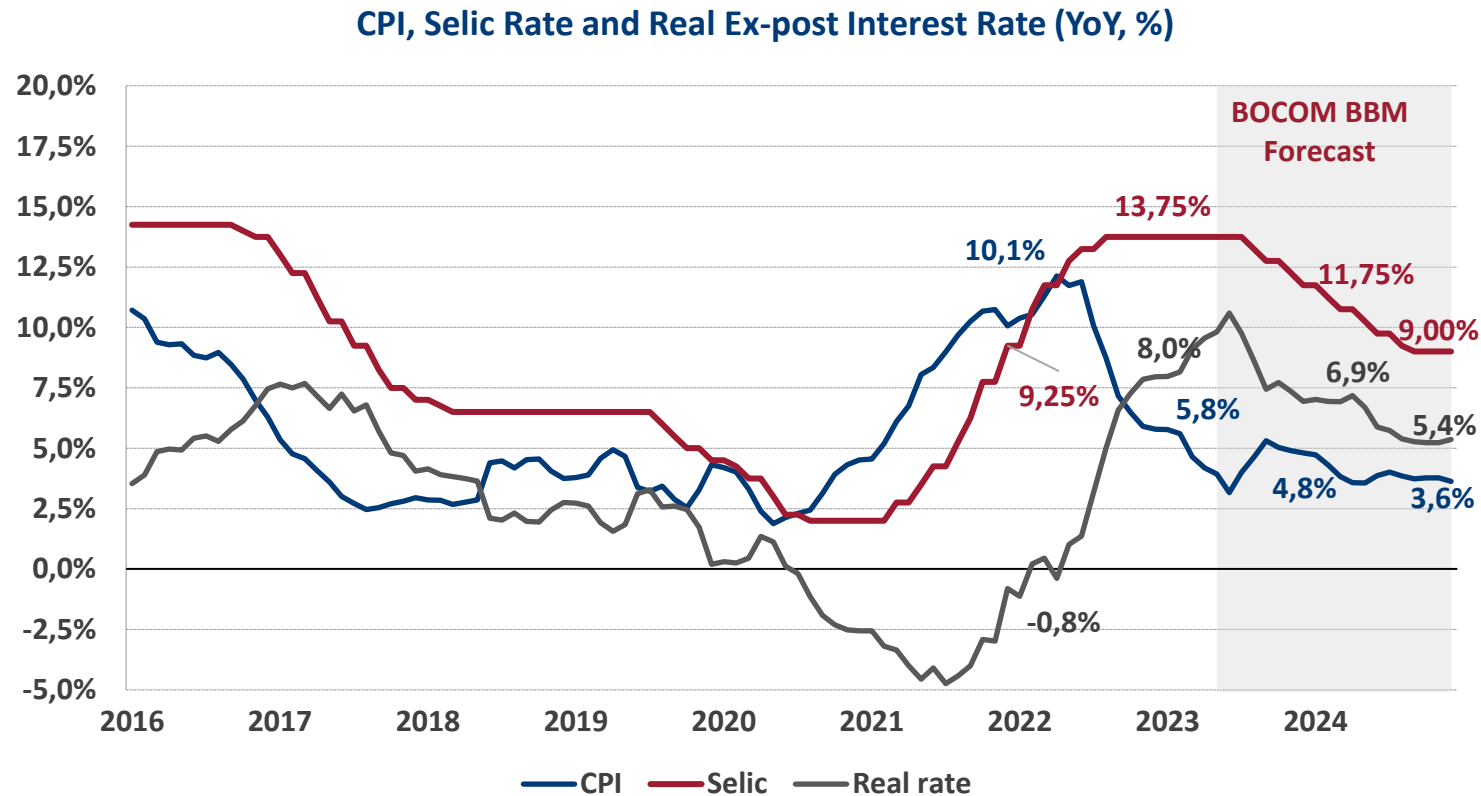
Brazil: Balance of Payments

» The Brazilian current account posted a deficit of USD 3.6 billion in July, roughly in line with the market forecast (USD -3.9 billion);

» It came above the deficit of USD 5.3 billion recorded in July 2023;

» The current account balance stood at USD -51.1 billion in the 12-month rolling sum up to July (-2.52% of GDP).

Current Account (USD Billion)

Current Account (Accumulated 12M, USD Billion and % GDP)

Current Account (YTD, USD Billion)

Brazil: Balance of Payments

» The merchandise trade balance showed a surplus of USD 7.2 billion in July, well above the amount of USD 4.1 billion in 2022. With that, it totaled USD 59.2 billion in the 12-month rolling sum, up from USD 56.1 billion in June;

» The performance of 'Imports' (-15.7% YoY to USD 21.9 billion) continues to reflect the deceleration in the domestic economy, meanwhile the external demand for primary goods remains firm (-3.3% to USD 29.2 billion).

Balance on Goods (USD Billion)
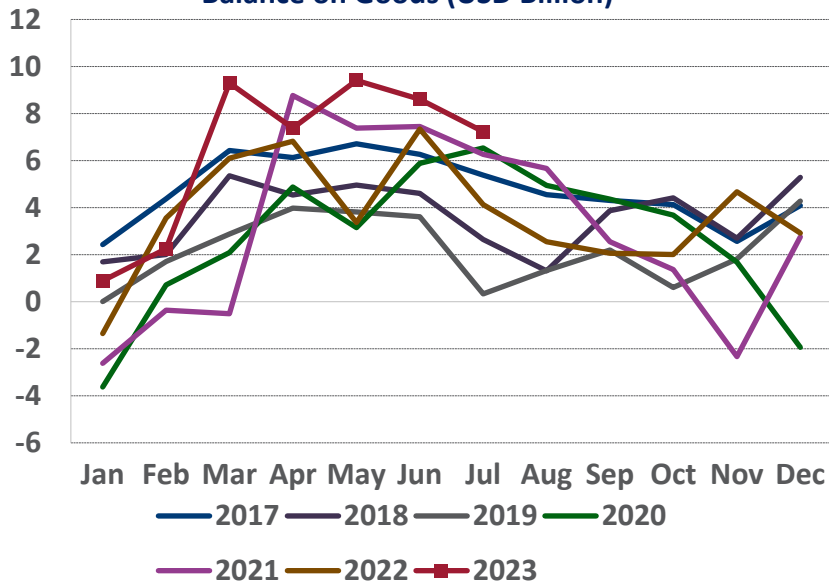
Balance on Goods (Accumulated 12M, USD Billion and % GDP)
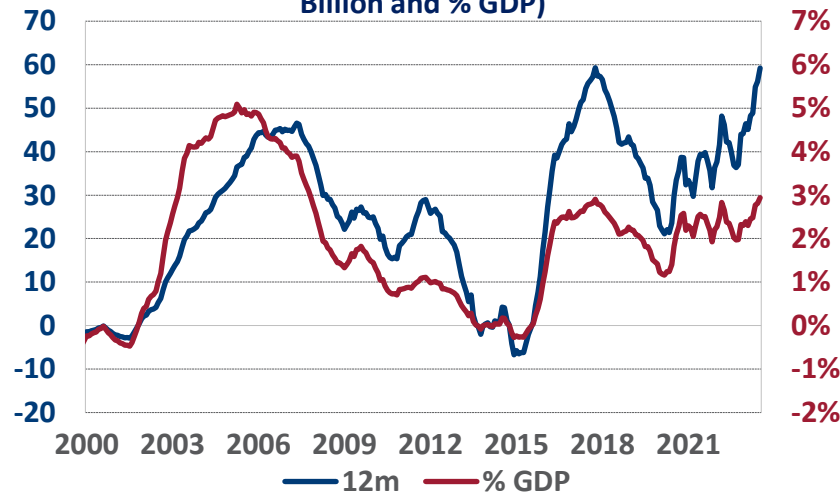
Balance on Goods (YTD, USD Billion)

Source: BOCOM BBM, BCB
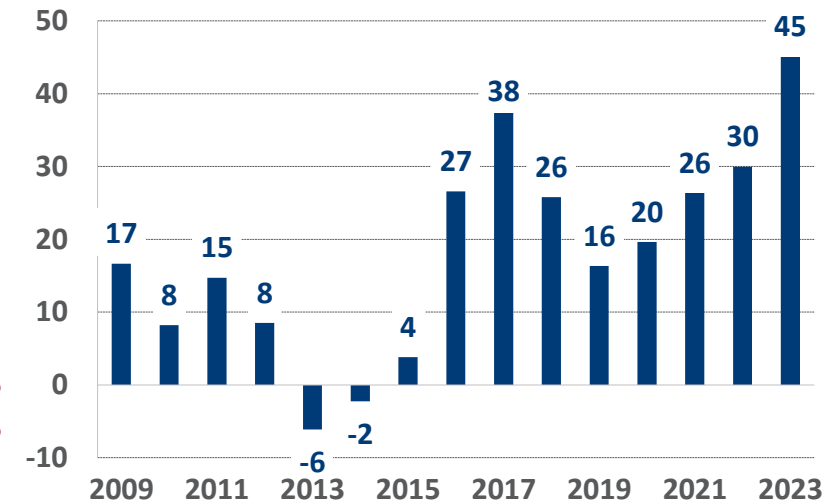
Brazil: Balance of Payments

» The deficit in the Primary Income account amounted to USD 7.7 billion in July 2023, up to the record in July 2022 (USD -6.6 billion);

» The result reflects higher net expenses with profits, dividends and interest rates, which is a result of higher gross expenses on intercompany transactions and rising international interest rates;

» The deficit in the Services account remains stable on a yearly basis (USD -3.2 billion), since lower expenses with freight was offset by higher expenses with international travel.

Profits and Dividends (USD Billion)

Services (USD Billion)

Services (Accumulated 12M, % GDP)
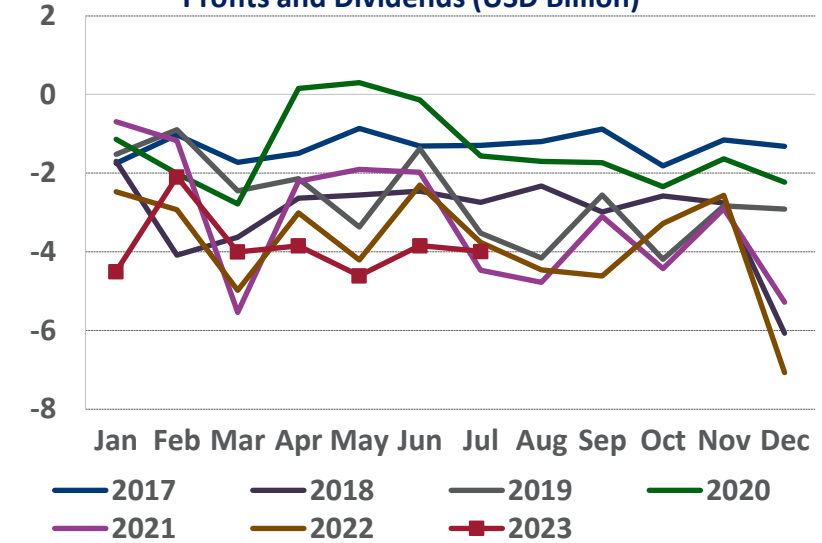
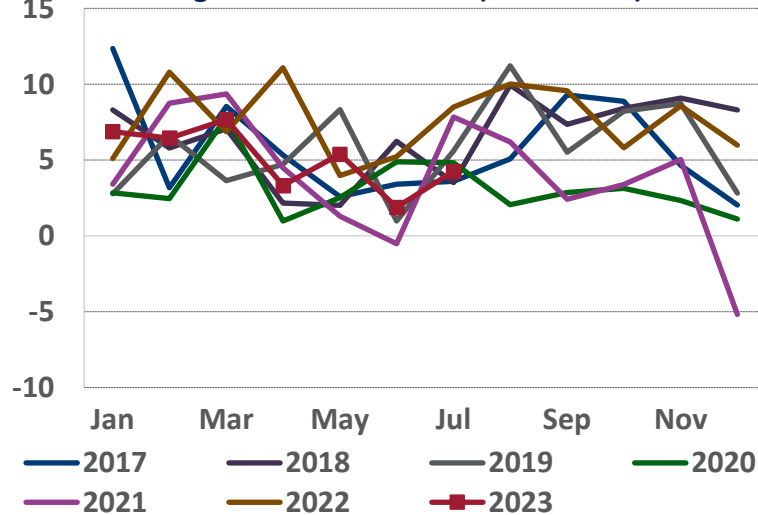**Primary Income (Accumulated 12M, USD Billion)**

Source: BOCOM BBM, BCB
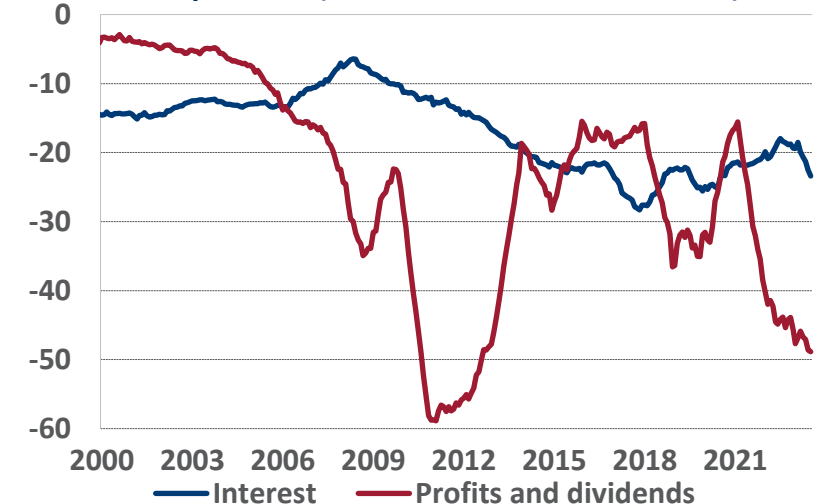
Brazil: Balance of Payments

» Inflows in FDI once again came below expectations. It amounted to USD 4.24 billion in July, below USD 7.2 billion recorded one year earlier;

» The FDI totaled USD 71.7 billion based on the 12-month rolling sum up to July (3.54% of GDP), down from USD 74.6 billion up to June (3.74% of GDP) but better than the result seen in July 2022 (USD 61.0 billion);

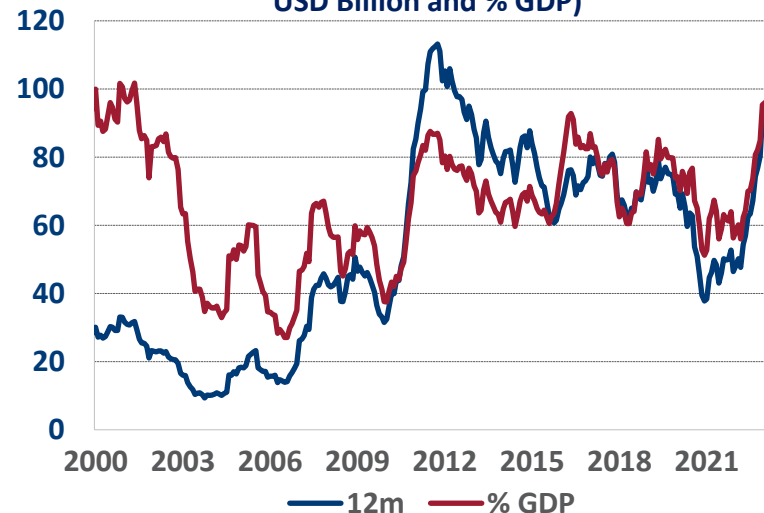» Despite the lower-than-expected result, it does not change the scenario of solid Brazilian external accounts.
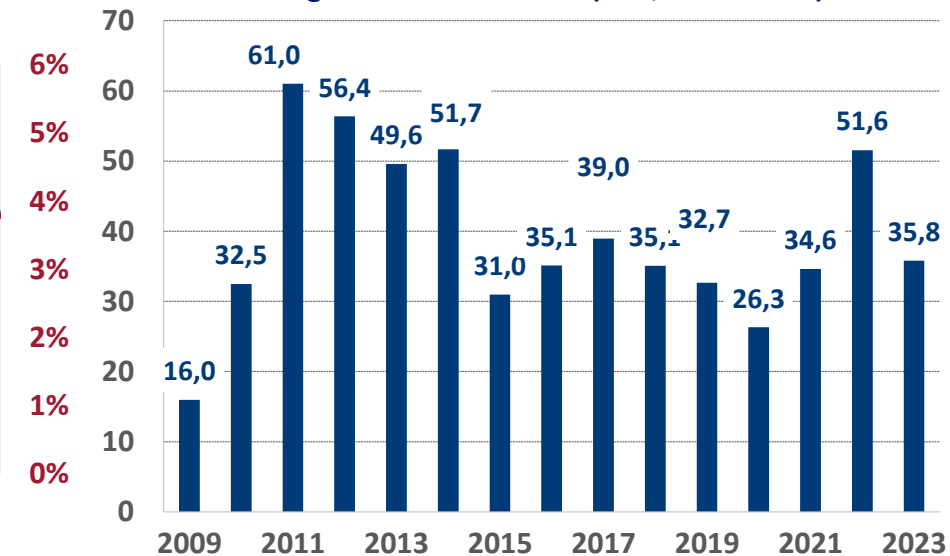
Current Account Balance and FDI (YTD, USD Billion)

Legend: Current Account | Foreign Direct Investment | Balance
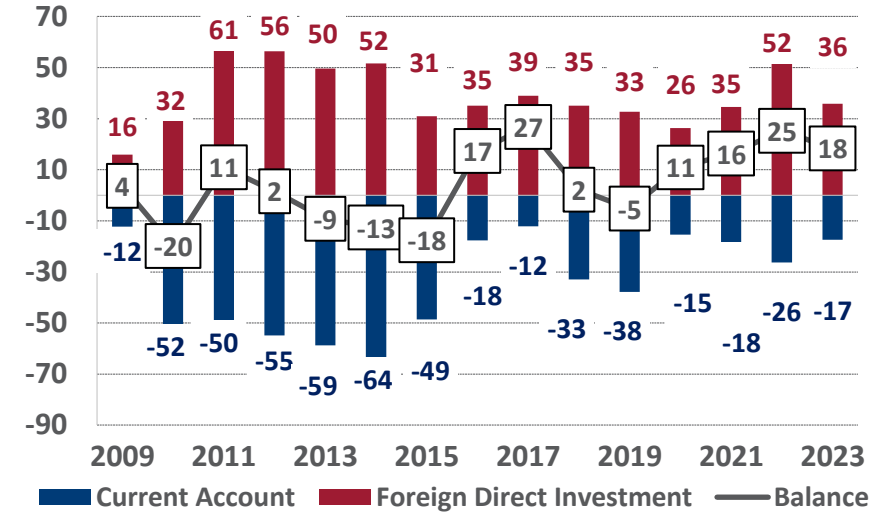
Foreign Direct Investment (USD Billion)

Legend: 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023

Foreign Direct Investment (Accumulated 12M, USD Billion and % GDP)

Legend: 12m | % GDP

Foreign Direct Investment (YTD, USD Billion)

Values: 16,0 (2009); 32,5; 61,0 (2011); 56,4; 49,6 (2013); 51,7; 31,0 (2015); 35,1; 39,0 (2017); 35,1; 32,7 (2019); 26,3; 34,6 (2021); 51,6; 35,8 (2023)

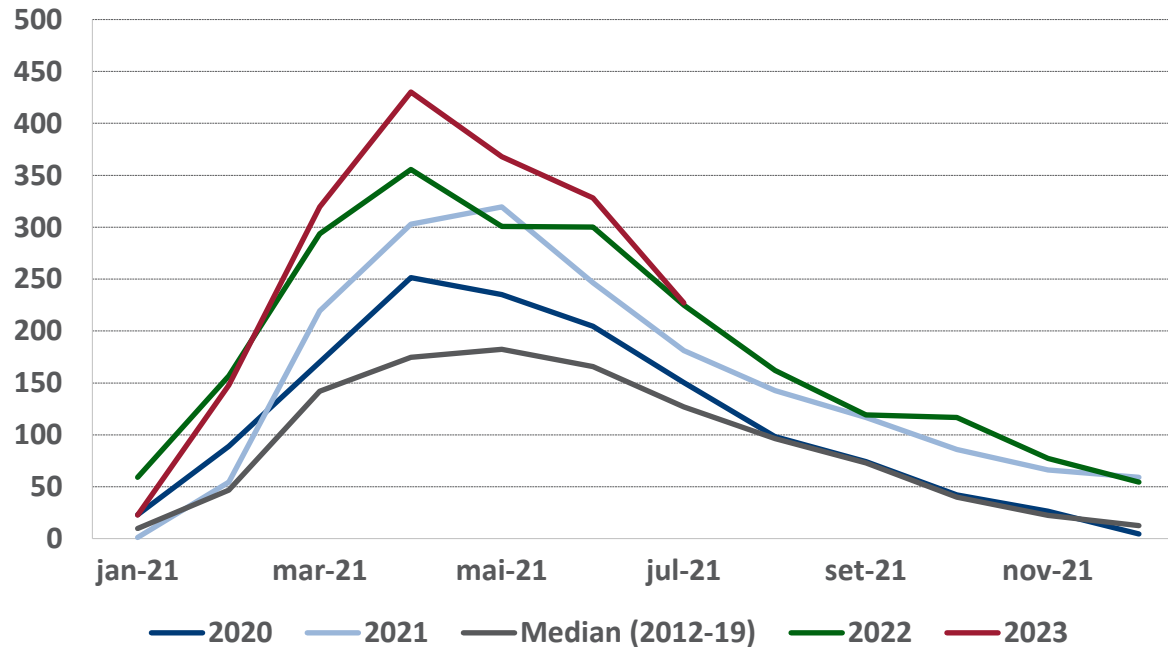Source: BOCOM BBM, BCB

Brazil: External Sector

» The reduction in the interest rate differential and the reduction in the level of foreign direct investment entering the country, alongside the recent fiscal uncertainties, pressured the Brazilian currency throughout the month of August.
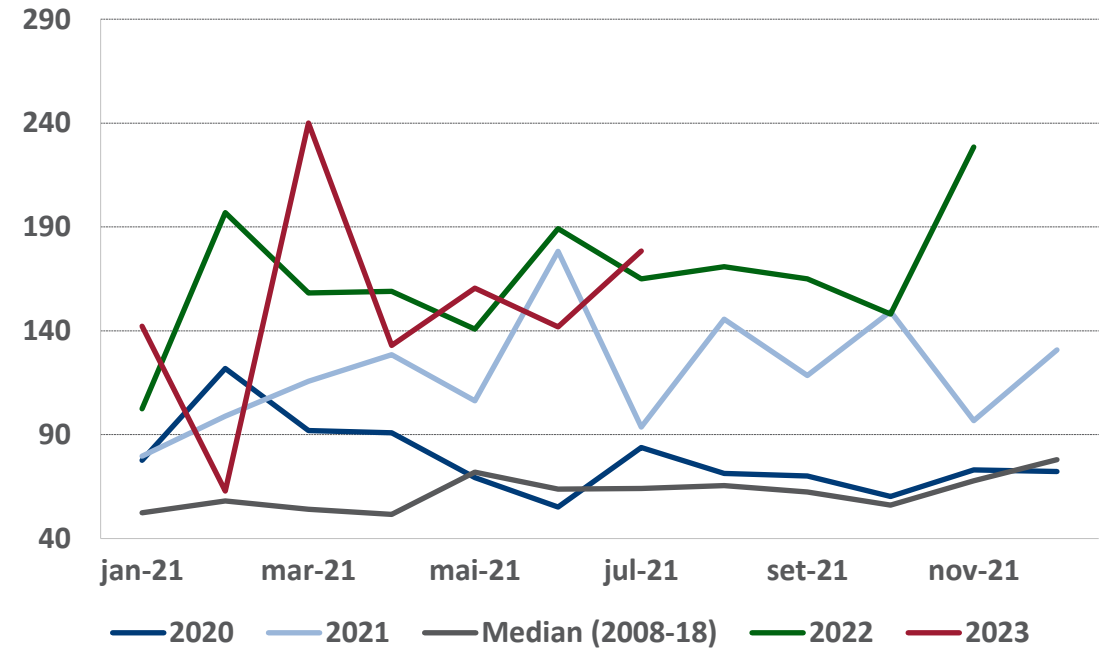
Foreign Direct Investment (YTD, USD Billion)

Interest Rate Differential x BRL

— Exchange Rates   — Selic - Fed Funds Effective Rate

Terms of Trade x BRL

— Exchange Rates   — Terms of Trade

Source: BOCOM BBM, Bloomberg, Funcex, BCB
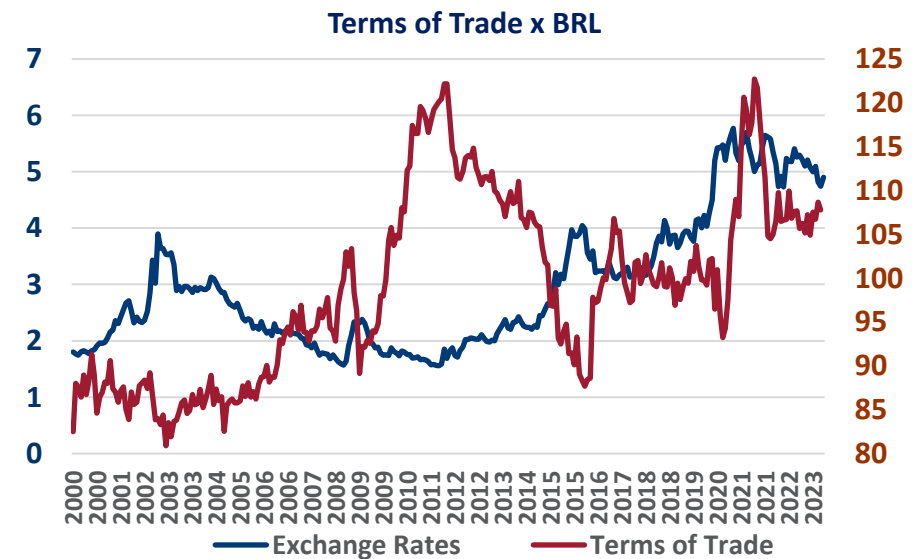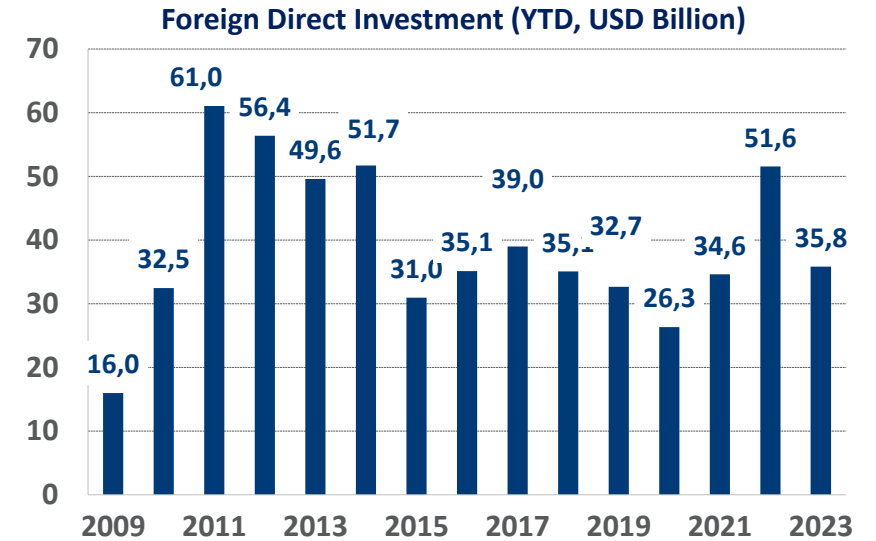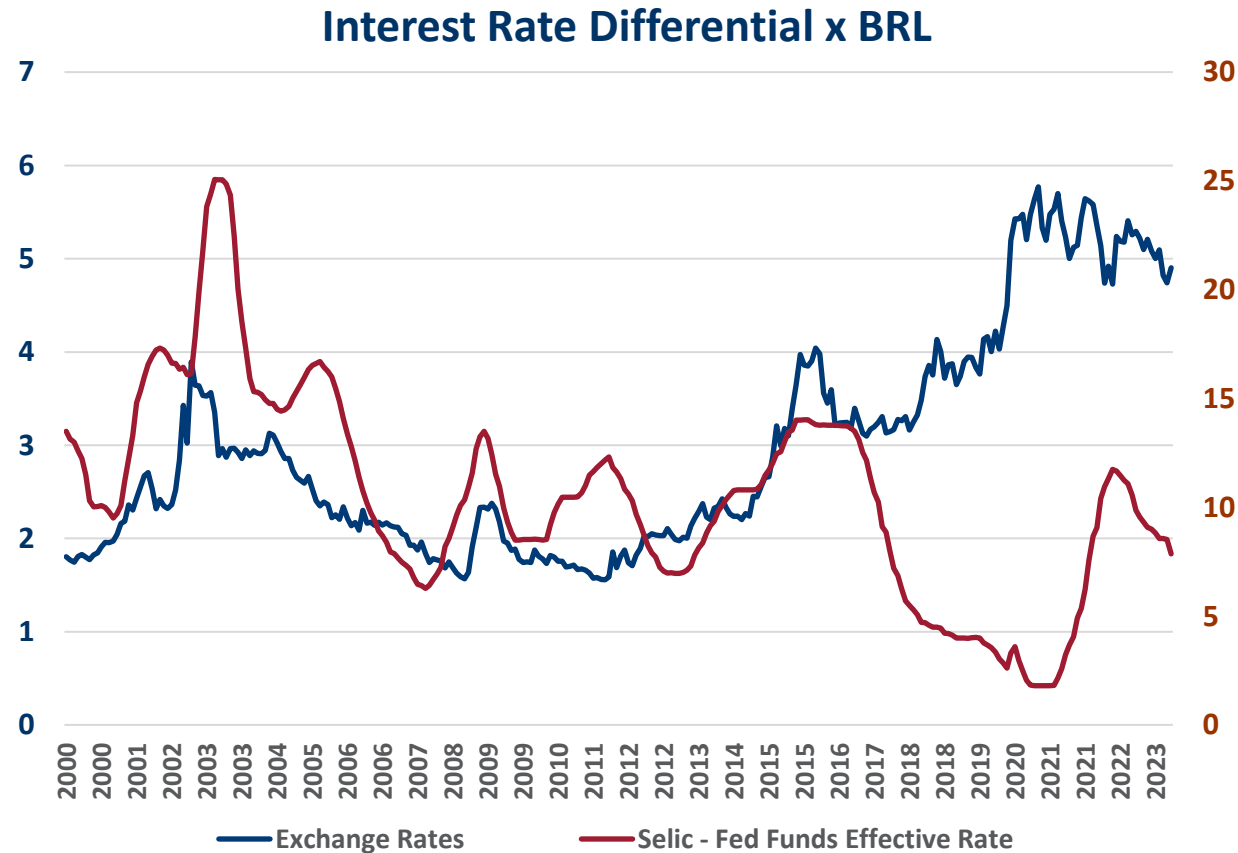
Brazil: External Sector

» In July, the trade balance recorded the highest surplus for the month in the entire historical series;
» The record soybean harvest is the main factor driving the trade balance this year.

Brazil BoP: Soybeans Exports
US$ Million Daily Average

Legend: 2020 | 2021 | Median (2012-19) | 2022 | 2023

Brazil BoP: Crude Oil Exports
US$ Million Daily Average

Legend: 2020 | 2021 | Median (2008-18) | 2022 | 2023

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