交通銀行 BANK OF COMMUNICATIONS BBM

Macro Monthly Letter

April 2024

Costless disinflation

Cecilia Machado
Chief Economist

Luana Miranda
Economist

Victor Cota
Analyst

Mariana Rodrigues
Intern

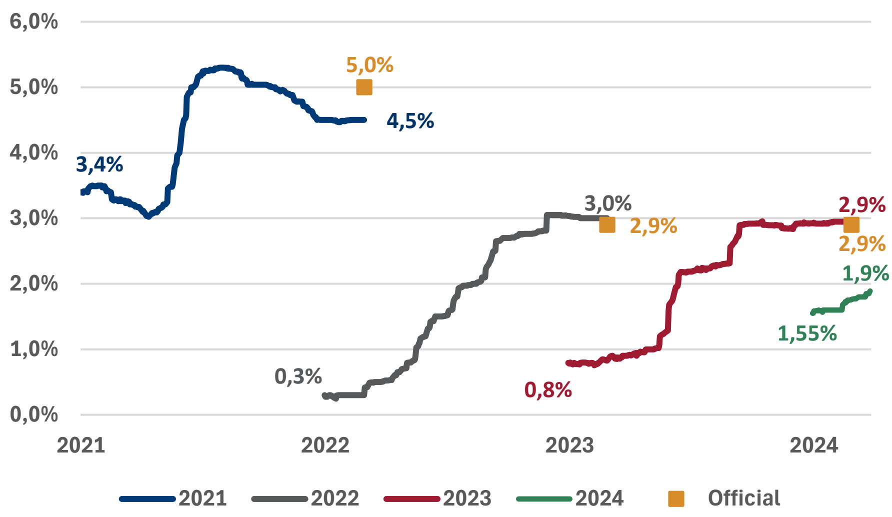
Oruan Perez
Intern

Bruno Oliveira
Intern

Francisco Albuquerque
Intern

This is the fourth consecutive year of regular upward revisions to the markets' projections for Brazil's economic growth. In the last three months alone, forecasts for 2024 have risen from around 1.5% to 2% (Figure 1) or thereabouts. The revisions are occurring despite an unfavorable outlook for agriculture, falling commodity prices, and the fact that the Central Bank's policy rate (Selic) is still in restrictive territory, albeit on a downward course. Current economic data shows that several sectors, such as services and retail commerce, continue to grow, with repercussions that reach the labor market, where both wages and employment are rising. How can this economic resilience be explained?

Figure 1: Market Expectations for the GDP Growth



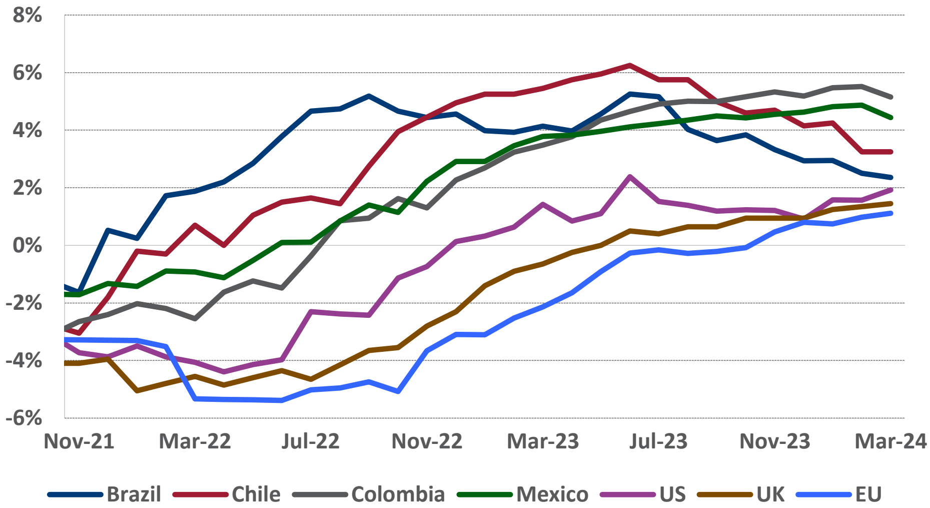
Source: BOCOM BBM, BCB

One explanation is the influence of the fiscal impulse, which was historically high in 2022-23 and is still having an effect in the current year owing to the court-ordered payment of almost BRL 100 billion in past-due federal debts (*precatórios*). Another driver is the new rule ensuring real annual adjustments of the minimum wage (based on inflation in the previous year plus GDP growth in the previous two years). This tends to increase household disposable income and private consumption, the main engine of economic growth in Brazil in recent years.

This report was prepared by Banco BOCOM BBM and is distributed free of charge with the sole purpose of providing information to the market. Any forecasts, estimates, and certain information contained herein may be based upon proprietary research and should not be interpreted as investment advice or recommendation. Although the information contained herein was prepared with utmost care and diligence, in order to reflect the data at the time in which they were collected, Banco BOCOM BBM cannot guarantee the accuracy thereof. Banco BOCOM BBM cannot be held responsible for any loss directly or indirectly derived from the use of this information or its contents, and the readers should make their own investment decisions. This report cannot be reproduced, distributed or published by the recipient or used for any purpose whatsoever without the prior written consent of Banco BOCOM BBM

Also relevant is the actual restrictiveness of monetary policy, in terms of the difference between the real interest rate and the neutral rate. The Monetary Policy Committee (Copom) uses a neutral rate of 4.5% in its inflation projections, whereas the median market estimate is 5%, according to a survey of financial analysts ("questionário Pré-Copom") conducted by the Central Bank in December 2023. Considering this metric, monetary policy in Brazil is about as tight as in the developed markets but less so than in other emerging markets (Figure 2).

Figure 2: 1 Year Real Interest Rate Minus Neutral Rate



Source: BOCOM BBM, Central Banks, Bloomberg

Another argument relates to possible productivity gains due to the structural reforms passed by Congress in recent years. A number of important reforms have been implemented since 2017, including creation of the TLP ("long-term rate", a new non-subsidized interest rate charged on capex loans by BNDES), reforms of the labor laws and of the social security and tax systems, Open Finance, and a new framework law on guarantees and security interests, among others. The improvement in the business environment due to these structural changes will be reflected in an increase in potential economic growth, but it is too early to know whether the gains have already materialized.

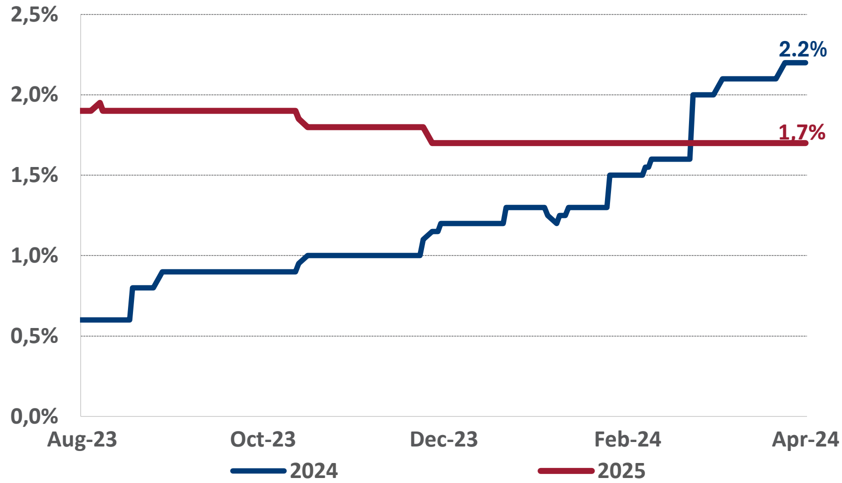
Considering the strong dynamism of the Brazilian economy in the first quarter of this year, it is reasonable to wonder whether the process of disinflation will continue in the months ahead, and at what pace, especially in the most cyclical sectors, such as services. Indeed, some members of the Copom have already acknowledged that a slower pace of monetary loosening may prove appropriate as the current cycle comes to an end.

Increasing uncertainty about the global outlook is also a factor considered by the Copom in its assessment of the balance of risks. In the United States, the FOMC's projections indicate three rate cuts during 2024. They may possibly start in June,

This report was prepared by Banco BOCOM BBM and is distributed free of charge with the sole purpose of providing information to the market. Any forecasts, estimates, and certain information contained herein may be based upon proprietary research and should not be interpreted as investment advice or recommendation. Although the information contained herein was prepared with utmost care and diligence, in order to reflect the data at the time in which they were collected, Banco BOCOM BBM cannot guarantee the accuracy thereof. Banco BOCOM BBM cannot be held responsible for any loss directly or indirectly derived from the use of this information or its contents, and the readers should make their own investment decisions. This report cannot be reproduced, distributed or published by the recipient or used for any purpose whatsoever without the prior written consent of Banco BOCOM BBM

judging from the levels priced in by the market. But as in Brazil, inflation in the US also remains above the target (2.0% in the Fed's case), and recent upside surprises, especially in services, reinforce suspicions that the disinflation process may be slow. Moreover, the strong dynamism of the US economy (Figure 3), which can be explained largely by supply-side factors, such as supply chain regularization and an increase in the supply of labor driven by mass immigration, provides some comfort that the Fed will not start cutting rates aggressively, and this tends to limit the scope for monetary loosening.

Figure 3: US GDP Growth Forecast (Bloomberg Consensus)



Source: BOCOM BBM, Bloomberg

It is possible that the disinflation process in Brazil will continue despite the resilience of economic activity and uncertainty about the global outlook, but considering that the neutral interest rate is not observable, that potential growth is hard to measure and that the start of US monetary loosening may be postponed, caution is advisable. We therefore maintain our projection for the end-2024 Selic on 9.5%. Our other projections for the Brazilian economy are show in the table below.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024F	2025F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	1.7%	2.0%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	3.7%	4.0%
Unemployment Rate (eoy ,%)	14.7%	11.7%	8.3%	7.4%	8.4%	8.5%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	9.50%	8.75%
External Accounts						
Trade Balance MDIC (US$ bn)	50	61	62	99	87	78
Trade Balance (US$ bn)	32	36	44	81	67	58
Current Account Balance (US$ bn)	-28	-46	-48	-29	-34	-43
Current Account Balance (% of GDP)	-1.9%	-2.8%	-2.5%	-1.3%	-1.5%	-1.8%
Fiscal Policy						
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.8%	-0.8%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.3%	77.8%	79.8%

This report was prepared by Banco BOCOM BBM and is distributed free of charge with the sole purpose of providing information to the market. Any forecasts, estimates, and certain information contained herein may be based upon proprietary research and should not be interpreted as investment advice or recommendation. Although the information contained herein was prepared with utmost care and diligence, in order to reflect the data at the time in which they were collected, Banco BOCOM BBM cannot guarantee the accuracy thereof. Banco BOCOM BBM cannot be held responsible for any loss directly or indirectly derived from the use of this information or its contents, and the readers should make their own investment decisions. This report cannot be reproduced, distributed or published by the recipient or used for any purpose whatsoever without the prior written consent of Banco BOCOM BBM