BANK OF COMMUNICATIONS BBM

Macro Monthly Letter

August 2024

Soft-landing or Hard-landing?

Cecilia Machado
Chief Economist

Luana Miranda
Senior Economist

Victor Cota
Analyst

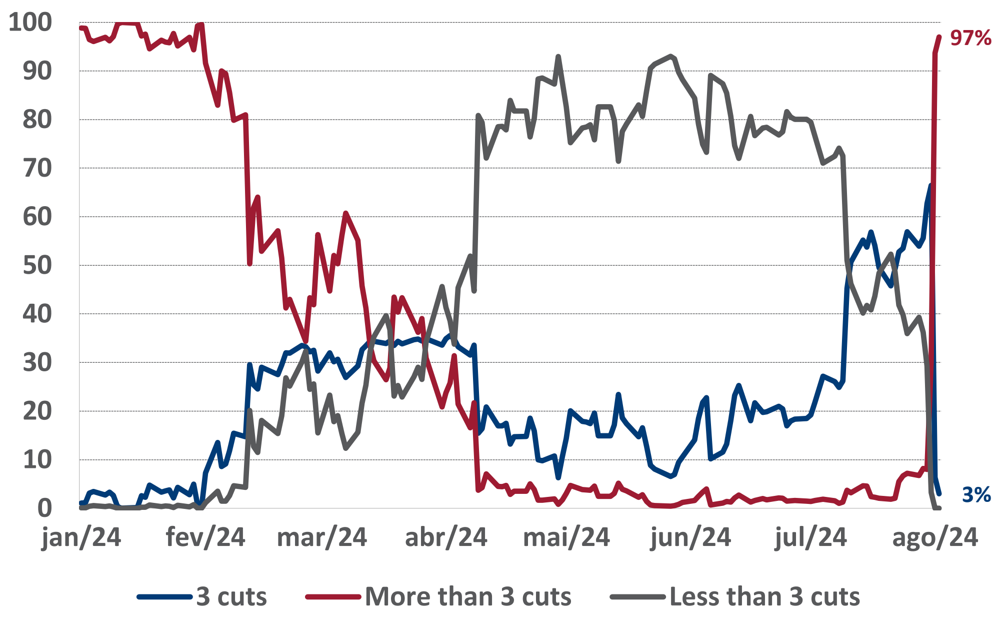
Oruan Perez
Intern

Bruno Oliveira
Intern

Francisco Albuquerque
Intern

After a highly uncertain start to the year due to doubts about the disinflation process in the United States – with modest progress at that point in the core rates and resilience in the labor market – the outlook has changed in light of the data for the past few months, confirming expectations that monetary easing will begin very soon. The markets are pricing in a rate cut of around 125 bps by year-end (Figure 1).

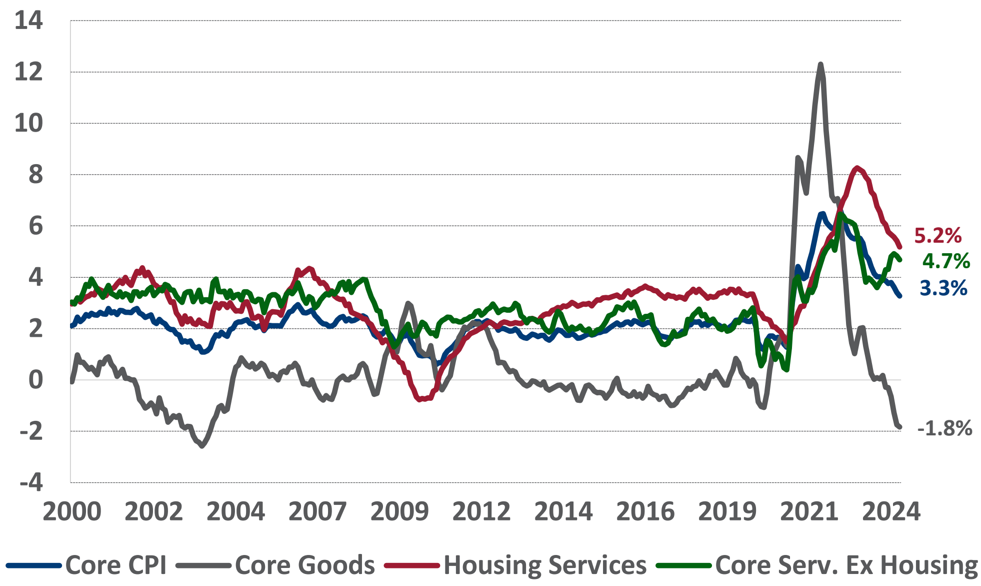
Figure 1: Market Expectations for Fed Funds Rate Cuts in 2024 (%)



Source: BOCOM BBM, CME Group

The last three CPI readings showed steady deceleration and were all below market expectations. In June, the first monthly deflation since May 2020 was accompanied by lower service inflation, showing a benign composition, with a response in the components that are most sensitive to the effects of monetary policy (Figure 2). Additional progress is still needed if the target is to be achieved, but the convergence assured so far is noteworthy: after reaching 9.1% in June 2022, the CPI is now on 3%.

Figure 2: Main Components of Core CPI (% YoY)

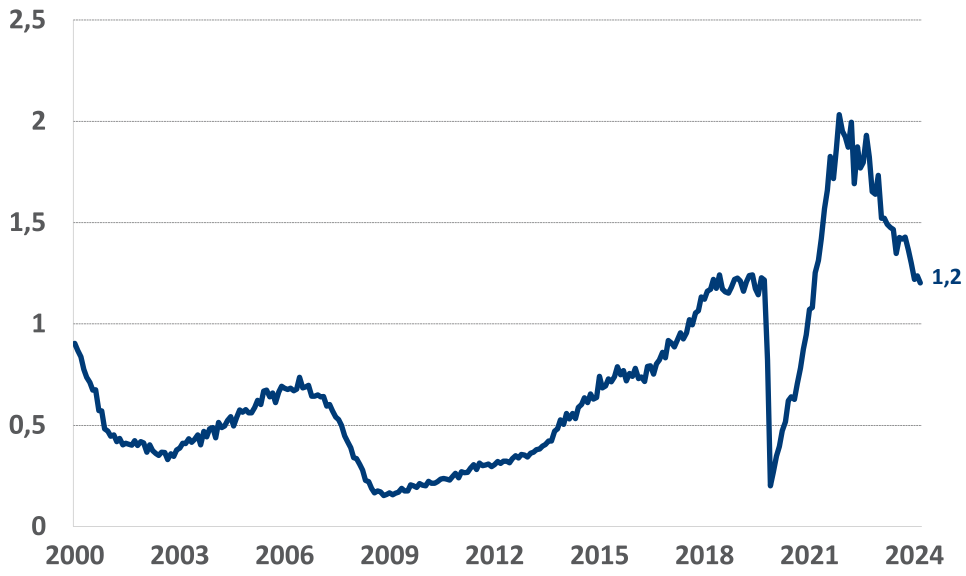


Source: BOCOM BBM, BLS

US inflation has improved in parallel with the emergence of a more balanced labor market. A set of indicators shows a level of tightness comparable to that seen in the pre-pandemic period, as exemplified by the vacancies-to-unemployment ratio (Figure 3). In the last few years, the workforce participation rate has recovered, especially among workers aged 25-54, thanks largely to the sharp rise in immigration. At the same time, the number of people in paid work has risen more slowly and the unemployment rate has climbed to 4.3%, the highest since 2021 and well above the 3.4% low of April 2023. This is because adjustments on the demand side have also intensified, alleviating the pressure from wage growth and contributing additionally to the fall in inflation.

In line with the contractionary monetary policy and the looser labor market, economic activity has also grown more moderately. In 2023, real GDP growth was 2.5%, above the potential rate of growth estimated by the FOMC and above the markets' initial expectations. In 2024, the data shows a slight loss of momentum in household consumption, which accounts for almost 70% of GDP in the US. Non-residential investment remains resilient, reflecting the expansionary fiscal policy and the effects of nearshoring, which prioritizes local industry, while investment in real estate have fallen faster, unsurprisingly considering the tight financial conditions. Projections for this year point to GDP growth of around 2.3%, which is still healthy, albeit slower than the growth seen in 2023.

Figure 3: Job Openings per Unemployed Ratio



Source: BOCOM BBM, BLS

The increasing likelihood of a soft landing, with inflation converging to the target and no recession, has helped make the external outlook more favorable. However, it became somewhat less certain after the latest jobs report showed a sharper-than-expected deceleration.

There are also sources of uncertainty in the US presidential race. In the first half of July, voter intention polls and the betting market suggested that Trump was more likely to win the November election, but since Biden dropped out and endorsed Harris as the Democrats' nominee for presidential candidate, the polls and bets have been more balanced. The importance of the outcome to the global economy will be significant, indicating the probable fiscal, immigration and trade policies for the next four years. All this could add inflationary pressures to the US economy.

The external outlook also includes the effects of the rate cuts implemented by other developed-economy central banks, such as the ECB and BoE. The risk of persistent inflation remains high in these countries, where the pace of monetary easing will almost certainly be cautious.

The prospect of monetary easing in the advanced economies benefits emerging-market countries by narrowing the interest-rate differential, thereby alleviating exchange-rate pressures and hence inflation. In contrast, a hard landing could fuel global risk aversion. In Brazil, however, the deteriorating domestic fiscal outlook has been front of stage, driving up inflation expectations and the exchange rate. In addition, the labor market remains sound and economic activity resilient, making the output gap tighter. In light of these trends, we have revised up our inflation projection for 2024 from 3.9% to 4.1% and our GDP growth projection from 2.1% to 2.2%, while leaving our projections for 2025 unchanged. Our other projections are shown in the table below.

ECONOMIC FORECASTS	2019	2020	2021	2022	2023	2024F	2025F
GDP Growth (%)	1.2%	-3.3%	4.8%	2.9%	2.9%	2.2%	1.9%
Inflation (%)	4.3%	4.5%	10.1%	5.8%	4.6%	4.1%	4.1%
Unemployment Rate (eoy ,%)	11.1%	14.2%	11.1%	7.9%	7.4%	7.8%	7.9%
Policy Rate (eoy, %)	4.5%	2.0%	9.3%	13.8%	11.75%	10.50%	10.50%
External Accounts							
Trade Balance MDIC (US$ bn)	35	50	61	62	99	90	95
Trade Balance (US$ bn)	27	32	36	44	81	86	91
Current Account Balance (US$ bn)	-68	-28	-46	-48	-31	-35	-36
Current Account Balance (% of GDP)	-3.6%	-1.9%	-2.8%	-2.5%	-1.3%	-1.6%	-1.5%
Fiscal Policy							
Central Government Primary Balance (% of GDP)	-1.3%	-9.8%	-0.4%	0.5%	-2.1%	-0.7%	-0.9%
Government Gross Debt (% of GDP)	74.4%	86.9%	77.3%	71.7%	74.4%	77.3%	80.0%