A person's hands are shown holding a pencil, pointing at a financial report. The report features several charts and data points. The background is a blurred office setting with other people's hands visible, suggesting a collaborative work environment.

# The recent economic outlook Coronavirus' impacts intensifies and the scenario deteriorates

May 14th, 2020

# Executive Summary

## Summary of the main estimates for 2020 and 2021

	2018	2019	2020 (E)	2021 (E)
GDP growth (%)	1.3	1.1	-6.0	2.5
IPCA (CPI, 12m, %)	3.75	4.31	0.7	3.2
SELIC rate (% p.y., end of period)	6.50	4.50	2.25	3.00
FX (BRL/USD, end of period)	3.87	4.03	5.5	5.5

Source: IBGE, BCB, Bloomberg. Estimativas (E): XP Investimentos

- In Brazil, after March and April economic activity data surprised to the downside, we expect that the economic activity will suffer a considerable negative impact during the first half of this year. Therefore, we revised down our 2020 GDP forecast from -1.9% to -6.0% and maintained our 2021 forecast at 2.5%, although we recognize that the recovery pace will depend on the government measures effectiveness to combat the virus.*
- Due to the strong activity contraction followed by inflation deceleration (2020 IPCA forecast revised to 0.7%), now we believe that the Selic rate will reach 2.25% p.a. at the June meeting and stay flat until the 4Q21, when it may be raised to 3.00% p.a..*
- We've also revised our exchange rate forecast from R\$/US\$ 4.70 to R\$/US\$ 5.50 at the end of 2020 and from R\$/US\$ 4.60 to R\$/US\$ 5.50 at the end of 2021.*
- Finally, there is a relevant concern with the trajectory of cases and deaths caused by Covid-19 in Brazil. Our curve still does not seem to show signs of flattening and some cities have decreed a lockdown in May after the health system overload. The social pressure for a gradual economic reopening is increasing in several cities and the risk of uncontrol cannot be ruled out.*

# Most risks have become real

- *In our last economic outlook reviews, we highlighted some elements that could represent sources of risk to the Brazilian economic recovery. In the external front, we saw the possibility of a worsening pandemic and an increase in global uncertainty, and in the domestic front, we saw that i) the fiscal measures announced to minimize the COVID-19 effects could be limited in scope, that ii) the political tension could further deteriorate consumer and business confidence, and that iii) pressure for a gradual economic reopening could worsen the Brazilian economic and fiscal situation.*
- *In the external front, the economic downturn was in fact greater than expected and the 1Q20 GDP of the main world economies surprised to the downside. China's GDP was the only one that fell less than expected, but that was not enough to compensate for the USA and European weak numbers. Thus, the most pronounced deterioration in the economic conditions of the main economies in the world continues to bring negative bias to our numbers.*
- *In the domestic front, the fiscal measures announced by the government, despite pointing in the right direction, proved to be more limited than expected. As an example, the payment of the monthly voucher (approx. R\$ 98 billion in 3 months) had a less appropriate implementation, the PIS/Pasep withdrawals (approximately R\$ 20 billion) through FGTS funds is still in the implementation phase and is only scheduled for the beginning of June and the anticipation of the 2nd part of the 13th salary of INSS retirees and pensioners, despite the debate that this group could be classified as a vulnerable group, will also occur in June.*
- *Political risks have also been materialized. Since our last economic outlook review, Brazil has witnessed the resignation of two Ministers (Health and Justice) and the escalation of the conflict between the federal and local governments. In addition, it was speculated that the departure of the Minister of the Economy, Paulo Guedes, could happen after the tentative launch of the Pro-Brazil program (a post-pandemic economic recovery plan based on public expenditures) without the presence of any member of the economic team. Thus, political polarization has grown again and has further impacted business and consumer confidence. This context puts Brazil in the opposite direction from the rest of the world.*

# The recent economic outlook

## Summary of the main estimates for 2020 and 2021

	2018	2019	2020 (E)	2021 (E)
GDP growth (%)	1.3	1.1	-6.0	2.5
IPCA (CPI, 12m, %)	3.75	4.31	0.7	3.2
SELIC rate (% p.y., end of period)	6.50	4.50	2.25	3.00
FX (BRL/USD, end of period)	3.87	4.03	5.5	5.5

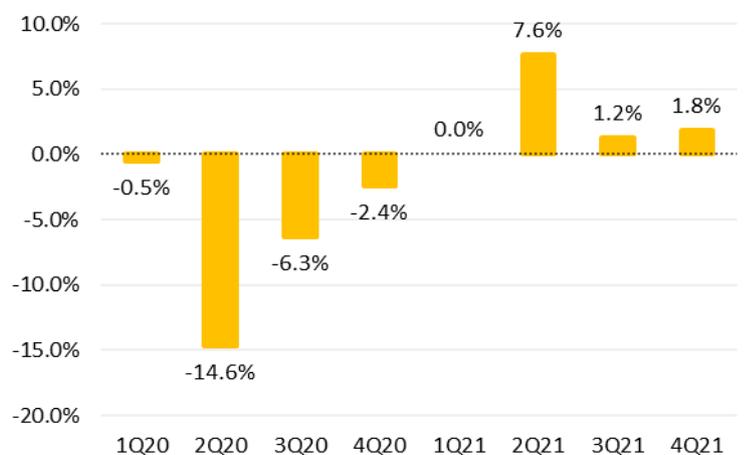
Source: IBGE, BCB, Bloomberg. Estimativas (E): XP Investimentos

- The recovery process in Brazil tends to be slower than the observed in the main world economies. The activity suffers a strong negative shock and the expectation for the coming months is a significant deflation. The high level of uncertainty about all variables implies a constant economic outlook review, and the short-term indicators have a relevant weight.
- After March and April economic activity data surprised to the downside, we expect the economic activity to suffer a considerable negative impact in the first half of this year. Therefore, we revised down our 2020 GDP forecast from -1.9% to -6.0% and maintained our 2021 forecast at 2.5%, although we recognize that the recovery pace will depend on the government measures effectiveness to combat the virus.

### GDP: 2020 and 2021 forecasts

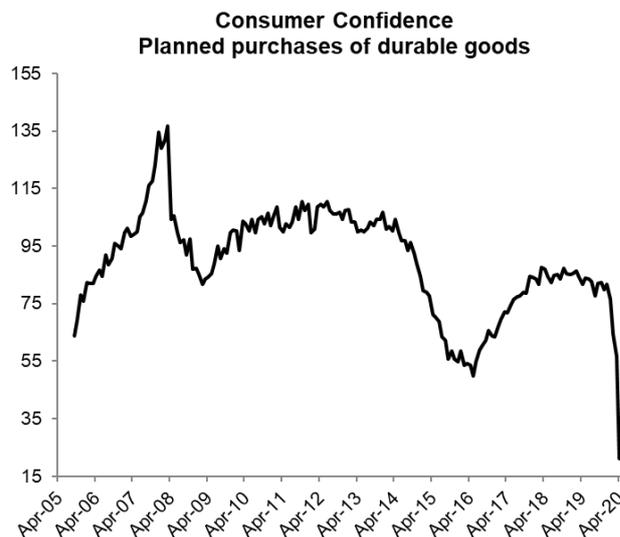
	YoY	QoQ
<b>1T20</b>	-0.5%	-2.5%
<b>2T20</b>	-14.6%	-12.6%
<b>3T20</b>	-6.3%	10.3%
<b>4T20</b>	-2.4%	3.6%
<b>1T21</b>	0.0%	1.5%
<b>2T21</b>	7.6%	-7.1%
<b>3T21</b>	1.2%	3.8%
<b>4T21</b>	1.8%	3.9%

### Brazil GDP: 2020 and 2021 forecast (% YoY)



Source: IBGE, XP Inc.

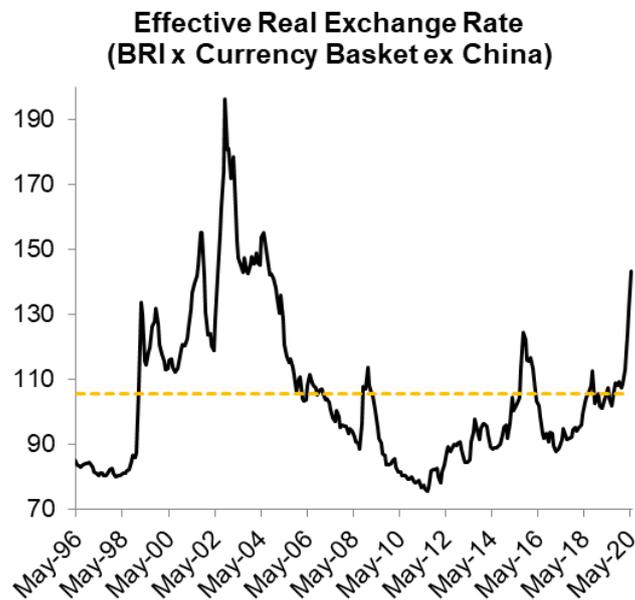
- Regarding inflation, mainly because of the significant worsening of economic activity data, we revised down our IPCA forecast from 2.5% to 0.7% in 2020, well below the BCB target and with a considerable core inflation deceleration. Even with the exchange rate depreciation of almost 40% in this year, we've observed an intense deflation of durable and semi-durable goods, probably due to liquidations made by retail companies that need cash. Our understanding is that the demand shock caused by the pandemic will take longer to return to normal levels, as indicated by April Consumer Confidence:



Source: FGV

- In this scenario, the BCB adopted a more dovish tone at its last meeting and reduced the Selic rate by 75bps to 3.0% p.a., signaling the possibility of an additional cut at the June meeting. We believe the BCB will deliver another 75bps rate cut, bringing Selic rate to 2.25% p.a. and, although the Committee signals that the next cut may be the last one, it recognizes a reasonable probability that an additional action could be taken due to high uncertainty. For 2021, the Selic rate may remain stable throughout the year, rising to 3.0% p.a. from October on.
- In addition, we revised our exchange rate forecast from R\$/US\$ 4.70 to R\$/US\$ 5.50 at the end of 2020 and from R\$/US\$ 4.60 to R\$/US\$ 5.50 at the end of 2021. As the Central Bank pointed out in the statement released shortly after the last monetary policy decision, the country's fiscal situation requires a lot of attention. The pandemic is expected to lead the primary deficit to exceed 10% of GDP in 2020, causing a sharp rise in gross debt (approx. 90%). However, it is necessary to emphasize that a large part of the expenses with the pandemic have been restricted to 2020 so far and the lower interest rate scenario will have a relevant contribution to maintain the sustainable trajectory of gross debt, albeit at a high level.

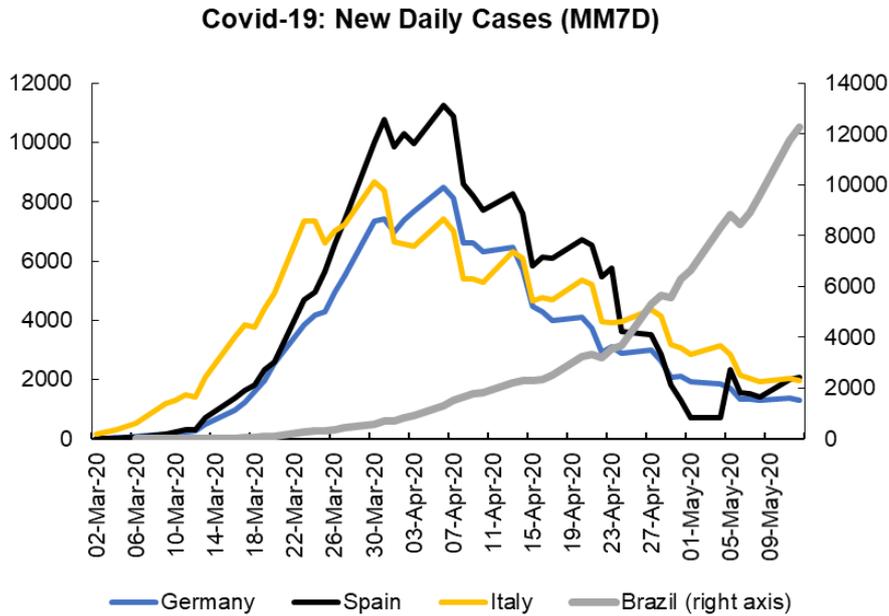
- We understand that the strong BRL depreciation to the range between 5.5 - 6.0 R\$ / US\$ already take into account this worsening economic outlook. In a historical perspective, the real effective exchange rate is at the same level as it was in 2004. However, the macroeconomic situation, although delicate, is much more sustainable than it was 16 years ago.



Source: MCM

- Finally, in addition to the fiscal risks, there is a relevant concern with the trajectory of cases and deaths caused by Covid-19 in Brazil. Most states initially opted for a partial restriction, against the direction taken by other economies, that saw in the lockdown the best alternative to contain the disease spread at the beginning. It is worth mentioning that the few States that had a positive performance in the Monthly Services Survey for March (ie, the restriction measures were not respected or did not exist) were the first ones to decree full lockdown, as the health system was collapsing (Amazonas and Maranhão, for example).

- Our curve still does not seem to show signs of flattening (only in a few places), with more cities decreeing a lockdown in May after the health system overload. Social pressure for a gradual economic reopening is increasing in several cities and the risk of uncontrol cannot be ruled out. One of the worst scenarios for the economy would be a new quarantine after an unsuccessful reopening or a second wave of contagion. The next 4 weeks will be crucial in determining the country's success or failure in fighting the virus.



Source: John H.

# Disclaimer

*This material was prepared by XP Investimentos CCTVM S.A. ("XP Investimentos" or "Company") and should not be considered as a research material for the purposes of article 1° of CVM Instruction 598/2018. All opinions, projections and estimates constitute the judgment of the author as of the date of transmission and these, plus any other information contained herein, are subject to change without prior notice. The Company does not support or oppose any political parties, political campaigns, candidates, or public officials. Furthermore, XP Investimentos is not permitted to give corporate funds, property or other resources to political parties or candidates and will not reimburse any shareholders, directors, officers, employees, and licensors for such contributions or expenditures. XP Investimentos and its affiliates, parents, shareholders, directors, officers, employees, and licensors will not be liable (individually, jointly, or severally) to you or any other person as a result of your access, reception, or use of the information contained in this communication.*

*Past performance is no guarantee of future results. Therefore, nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. This report is published solely for information purposes, it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. This material (including any attachments) is confidential, may contain proprietary or privileged information and is intended for the named recipient(s) only.*

