

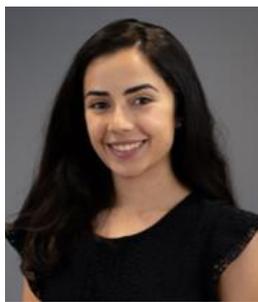


# XPnomics: The recent economic outlook

*March, 4th 2020*



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### Summary of the main estimates for 2020 and 2021

	2016	2017	2018	2019	2020 (E)	2021 (E)
GDP growth (%)	-3.3	1.3	1.3	1.1	1.8	2.5
IPCA (CPI, 12m, %)	6.3	3.0	3.8	4.31	3.0	3.6
SELIC rate (% p.y., end of period)	13.8	7.0	6.5	4.50	3.5	5.0
FX (BRL/USD, end of period)	3.26	3.31	3.87	4.03	4.50	4.4

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

(1) We are revising down our 2020 GDP growth forecast from 2.3% to 1.8% and revising up our 2021 forecast from 2.3% to 2.5%

(2) Regarding inflation, we revised down our forecast from 3.4% to 3.0% in 2020 and kept it unchanged at 3.6% for 2021.

(3) The lower growth with low inflation may make room for the Central Bank to resume the easing cycle, and now we believe the Selic rate will reach 3.5% in 2020 (eop). For 2021, we revised down the Selic (eop) from 6.00% to 5.00%.

(4) Finally, regarding the exchange rate, we believe the BRL will remain under pressure and eventually reaching 4,6 or 4,7 in the coming months. Therefore, we now estimate that the FX (eop) will reach 4.50 in 2020 and 4.40 in 2021.

## The recent economic outlook

*The deterioration of market expectations on the performance of the world's major economies due to the coronavirus phenomenon occurred very quickly, culminating yesterday in the Fed's inter-meeting and its decision to cut rates by 50 bp. Several central banks across the world appear to have the same understanding that there is an intense global slowdown underway and that further stimulus measures may be provided.*

*Financial conditions in several economies deteriorated considerably and it was certainly a fundamental factor that contributed to justify the Fed's action and confirm the BCs' understanding that there is an atypical condition in some economies.*

## Global outlook still quite uncertain

*However, it is noteworthy that, so far, little concrete evidence regarding this more intense slowdown has come from the corporate side. At a press-conference held right after the inter-meeting, Fed Chairman Jerome Powell was vague about what the institution sees in this regard, even claiming to have good corporate outreach. Powell only mentioned the negative impact on airlines and on the tourism industry and did not expanded it further. In addition, as far as we know, companies did not raise any red flag so far.*

*Some news from international and local media indicate that, in fact, the current coronavirus outbreak weighed on proper global supply chain functioning. Despite this, the size of such impact is still unclear. The February economic activity data (PMIs and confidence indexes), except for some Asian countries and Italy, did not hint for a major economic downturn, suggesting that the global economic slowdown could be more heterogeneous than expected. The OECD itself in its latest scenario review outlined greater concern for Asian countries.*

*Yesterday's G7 meeting did not deliver what the market expected: fiscal stimulus and coordinated actions by central banks to curb the crisis. The G7 (prudently) preferred not to rush and burn their degrees of freedom in the face of a slowdown with proportions still unknown. Central banks, however, took a different stance and actively endorsed for more stimulus. Such dissonance increases the degree of uncertainty in the world, insofar as it suggests that there is either lack of common understanding or informational asymmetry between central banks and ministries.*

*This picture, in our view, suggests that there is a very high expectation that central banks will (or are in charge of) restore(ing) economic growth. Ministries, on the other hand, are not under the same pressure. Perhaps this is because several economies lack fiscal instruments, given their high indebtedness, and, therefore, little is expected of them.*

*After the Fed inter-meeting decision and the dovish speeches delivered by several central banks, we observed a spiral of uncertainty growing and forecasts in Brazil and world-wide started plunging. The hypothesis that central banks have rushed or mis-dosed is yet to be tested. It will be up to the authorities to show more clearly the hard evidence that led them to act so quickly. The official economic data for February yet to be released in a few months will help to better understand this issue, but the data for March are already contaminated by the negative expectations, making it difficult to gauge what came first: the real slowdown in the economy or the slowdown triggered by greater pessimism.*

## **Brazil in this troubled global context**

*In this context, Brazil seemed to be a little more protected. The fact that it is a closed economy (a negative trait of the economy) could help reduce the exposure of the Brazilian economy to the harmful global effects. Market analysts, before the Fed's inter-meeting, seemed to have reached a consensus that Brazil's GDP growth would be only 0.2 percentage point lower due to the coronavirus effect. GDP growth forecast as measured by the official market analysts's survey also proved to be resilient to the negative newsflow.*

*The fact is that the Fed's decision seems to have posed pressure on other central banks and Brazil Central Bank was no exception. In a note issued yesterday, the BC signaled that it will resume the easing cycle and cut the Selic rate in March. The institution's doubt, at this moment, seems to be about the magnitude of the cut and about how low Selic can go in this cycle.*

*In this troubled scenario, we updated our main projections, given that the increase in uncertainty in the world and the slowdown of the main economies will have direct and indirect impacts on Brazil.*

### **GDP - 1.8% in 2020 and 2.5% in 2021**

*We believe that Brazil's growth will be lower in 2020 (from 2.3% to 1.8%). The global economic activity slowdown, which was not confirmed in February data, and the abrupt deterioration in financial conditions and expectations regarding global growth will weigh on Brazil's GDP growth. In addition, the growing perception that the slowdown in economic reforms will hinder the process of economic recovery also contributes, to a lesser extent, to a lower GDP in 2020. For 2021, we revised upwards our forecast of growth of 2.3% to 2.5% due to the monetary and other global stimulus that, possibly, will not be fully consolidated in 2020 and will end up underpinning the 2021 growth.*

*The overall conditions still point to a negative bias. In the domestic front, we see a very heterogeneous performance between sectors, persistent industrial stagnation and a marked slowdown in economic reforms. In the external front, the wave of uncertainty may become more severe, fueling expectations that global economies will take longer than expected to recover. In addition, trade war and geopolitical tensions may be in the spotlight again, regardless the global economic slowdown.*

### **Inflation - 3.00% in 2020 and 3.6% in 2021**

*We also revised down our inflation forecast in 2020 from 3.4% to 3.0% and kept our 2021 forecast unchanged at 3.6%. The global economic slowdown tends to have a non-negligible disinflationary effect in 2020 even though the supply shock effect is still uncertain. Although we see a benign inflation outlook for both 2020 and 2021, we believe 2021 inflation outlook remains a source of concern. The greater FX devaluation (see below), the low factor productivity and the stronger growth resumption in 2021 may challenge the monetary policy next year. The 4Q19 investment data confirms that Brazil's potential GDP growth remains low (approximately 1%). In addition, labor market and inflation data suggest that the neutral unemployment rate (NAIRU) may be around 10%. So, despite the benign inflation outlook, we still see structural issues that will challenge the BC in 2021 and 2022.*

## Interest - 3.50% in 2020 and 5.00% in 2021

The complexity of the environment increases the uncertainty regarding the BCB's next steps. We are under the assumption that the central bank will cut Selic rate by 50 bp in March followed by another 25 bp cut in an inter-meeting in April (scenario 1 below), bringing the Selic rate to 3.50% by the end of 2020. Following the recent Fed's action, we believe the BCB will opt for a punchy action in March too and suggest in its statement that another 25 bp cut is the next likely move. Expectations may deteriorate further in April (China's official GDP for 1Q 2020 will be released on April 16) and this may prompt the Central Bank to call an inter-meeting to announce the 25 bp cut. We also consider two alternative (dovish and hawkish) scenarios below and report the probability distribution across them.

### Scenario 1: base (55% probability)

- 2020 Selic (eop): 3.50%
- March: 50 bp cut
- April (extraordinary meeting): 25 bp cut

### Scenario 2: dovish (25% probability)

- 2020 Selic (eop): 3.25%
- March: 50 bp cut
- April (extraordinary meeting): 50 bp cut

### Scenario 3: hawkish (20% probability)

- 2020 Selic (eop): 3.75%
- March: 25 bp cut
- May: 25 bp cut

We revised down the 2021 Selic rate from 6.00% to 5.00%. The hiking cycle is expected to start at the September meeting, and we believe the BCB will deliver three 50 bp hikes (September, October and December meetings).

## Exchange rate - 4.50 in 2020 and 4.40 in 2021

Given the uncertainty and risk aversion world-wide and with the possibility that the Selic will remain lower for long, we believe the BRL will remain under pressure and will likely reach 4.60 or even 4.70 in the coming months. Our 2020 FX (eop) forecast is now at 4.50 (from 4.15) and 4.40 for 2021 (from 4.10).

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