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2021: Expectations and Uncertainties

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The new year offers the prospect of a global recovery driven by monetary and fiscal incentives, and animated by the onset of vaccination campaigns in several countries. As 2021 began, the Brazilian economy was growing at a robust pace while facing an array of uncertainties and risks in the first half. Uncertainty regarding the immunization calendar was a particularly adverse factor. The positive external backdrop, alongside maintenance of the domestic fiscal regime, could fuel a continuation of the repricing of Brazilian assets in the months ahead, but this depends on far better political coordination than we have seen to date.

The impact of the pandemic on global economic activity, constituting a shock of a severity rarely experienced before, will dissipate during the course of 2021, but some consequences will persist for several years in emerging and developed markets alike. Levels of sovereign and corporate debt have soared as a result of the crisis, and their sustainability will be one of the long-term challenges facing the global economy. According to the IMF, the ratio of sovereign debt to GDP rose 20 percentage points (pp) to 124% in DM economies in 2020, and 9 pp to 61% in EM economies. Non-financial corporate debt rose 8 pp to 100% of global GDP, according to the IIF. The good news is that zero or negative interest rates are set to remain in place in most of the developed world for some years, allowing some tranquility with regards to the sustainability of the debt in the medium term.

China stands out in the global arena not only for its economic performance – we project 9% growth in 2021, up from 2% in 2020 – but also for the more modest injection of stimulus than in western countries. Monetary policy will continue to be "prudent, flexible, appropriate, precise and targeted" as mentioned by the PBoC, presumably meaning interest rates will remain at current levels throughout the year and that fiscal policy is unlikely to change direction abruptly. With zero or negative rates prevailing in western countries, a one-year yield of 3.85% will remain highly attractive for foreign investors in fixed income, especially in a setting of continuous local market opening, and this will boost capital flows into China and the renminbi (China's currency).

Despite favorable trends abroad, uncertainties haunt the Brazilian economy at the start of the year. The main question is how much progress can be made on fiscal consolidation and the structural reform agenda in the coming period, given that next year is a presidential election year. Noise on the spending cap and the possible rise in expenditure in an already compressed year diminished toward the end of 2020, which was a positive development. But 2021 began with a tight budget and pressure to spend could resurface in response to the lack of scope for discretionary spending by the federal government. Addressing the limitations of the federal budget and tax system and their impact on productivity in a predictable and definitive manner requires the creation of a political and social consensus. Most urgently, support is needed for the reform agenda already put before Congress. Unfortunately it is not yet clear whether satisfactory progress will be made on this structural reform agenda in the near term.

On the economic side, the main uncertainty is how the labor market will react to the end of the emergency income assistance scheme, bringing many workers back into the market just as the pace of COVID-19 contagion is accelerating again. While the emergency job maintenance program (known by its acronym BEM) and the like have succeeded in preserving jobs in the formal economy, the incomplete recovery of the service sector in the absence of vaccination will continue to affect workers in the informal economy intensely for several more months. Services in general, and retail in particular, are flexible parts of the economy as well as large employers, and in normal circumstances they more easily absorb unskilled or less skilled workers, but their partial recovery may lead to a rise in the unemployment rate just as government income support disappears, impacting consumer demand and hence economic activity in the first quarter.

Inflation will remain benign, although we still see asymmetric risks of price rises in 2021. A more consistent cycle of local currency appreciation is a potential counterweight to these risks. According to our projections, 12-month inflation will exceed 6% by mid-year and then slow to around 3.3% in the second half as the upside pressures seen in second-half 2020 cease to recur in the year-on-year comparison. We project inflation roughly in line with the 3.5% target in 2022. We therefore expect the Central Bank of Brazil to begin a cycle of normalization in August, raising the Selic policy rate to 3.5% by year-end, and continue hiking into 2022 towards a 5% Selic rate.

ECONOMIC FORECASTS	2016	2017	2018	2019	2020F	2021F
GDP Growth (%)	-3,3%	1,3%	1,3%	1,1%	-4,4%	3,6%
Inflation (%)	6,3%	2,9%	3,7%	4,3%	4,4%	3,3%
Unemployment Rate, SA (eoy ,%)	12,6%	12,4%	12,2%	11,7%	14,5%	13,6%
Policy Rate (eoy, %)	13,8%	7,0%	6,5%	4,5%	2,0%	3,5%
External Accounts						
Trade Balance (US$ bn)	48	67	53	48	51	58
Current Account Balance (US$ bn)	-23	-10	-42	-51	4	1
Current Account Balance (% of GDP)	-1,3%	-0,7%	-2,2%	-2,8%	0,4%	0,1%
Fiscal Policy						
Fiscal Primary Balance (% of GDP)	-2,5%	-1,7%	-1,7%	-1,2%	-11,3%	-2,8%
Government Gross Debt (% of GDP)	69,4%	73,7%	75,3%	74,3%	90,0%	90,0%