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# The Challenges of the Global Outlook


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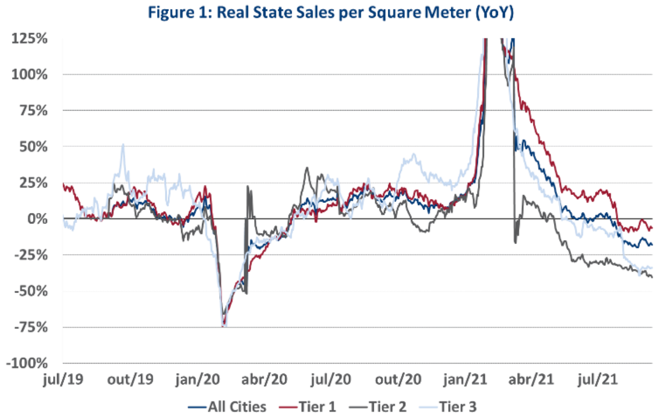
Adverse developments in major economies, especially China, the US and Europe, were the keynote in September. The collapse of Evergrande, a large Chinese property developer, fueled market volatility and was accompanied by fears of a slowdown in the world's second-largest economy. In the US, the labor market remained very tight, and a more contractionary monetary policy cycle began looking increasingly likely in 2022 and 2023. Even in Europe, where vaccine rollout and economic reopening had enabled activity to begin recovering satisfactorily, soaring prices of natural gas and electricity contributed to heightened inflation risks throughout the region.

In the case of China, a systemic crisis like the 2008-09 slump that followed the collapse of Lehman Brothers was rapidly ruled out because Evergrande operates almost entirely in the real estate sector, with scant links to banks and the Chinese financial system. However, the real estate sector accounts for a significant proportion of China's economic activity, and deceleration in the sector will affect the overall economy, as well as involving social risks, since many projects are in progress and may have to be shut down or drastically rescheduled.

The situation is made more complicated by priorities for payment of creditors, and rules limiting the extension of credit to highly leveraged companies in the sector (known as the three red lines). Real estate sales have fallen in response to the stricter rules, especially in smaller cities (Figure 1). Manufacturing value added has risen strongly in export-linked segments but fallen in industries that produce for the domestic market, such as automakers and construction. On the consumer side, retail sales continue to grow, but at a slower pace. Overall, the data shows a slightly sharper economic slowdown, with exports acting as the main driver of growth.

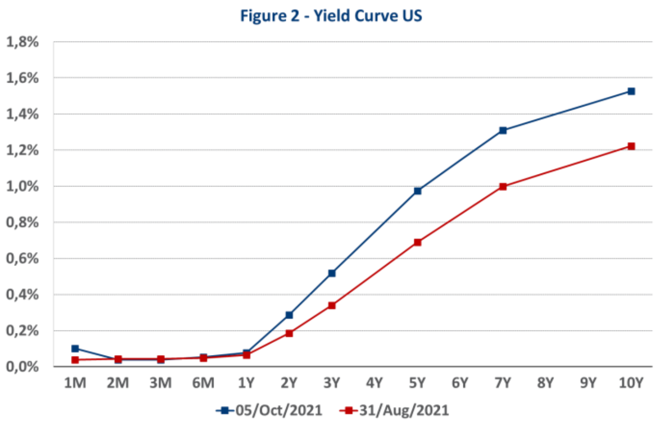
In the US, the FOMC's latest post-meeting statement said the economy had made progress toward the goals of monetary policy – price stability and maximum employment – and that continuing progress could be accompanied by a moderation in the pace of asset purchases, known as tapering. Analysts expect this to start still by this year. Fed Chair Jerome Powell said FOMC members foresaw tapering ending around the middle of 2022 if the economy continued to recover. Half of them expected the first rate hike in 2022, according to the projections released after the meeting. One or two hikes are possible already by next year.




Source: Bocom BBM, CEIC

In Europe, the price of natural gas jumped as inventories fell in response to stronger growth following economic reopening, colder winter weather, sporadic interruptions to the flow of gas from Russia, and lower-than-expected production of alternative energies. In China, restrictions on carbon emissions and falling imports of coal from Australia drove up the domestic price of coal and led to electricity supply problems.

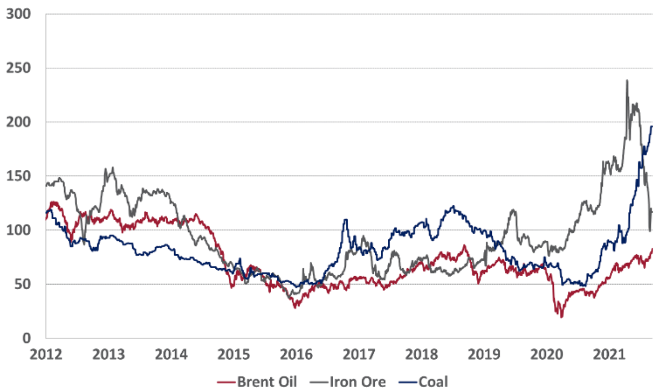
In the highly developed countries, the evidence shows that the rise in energy prices is contaminating current inflation. Surprisingly, it also correlates with the long-term implied inflation rate. With the Fed, Bank of England and other central banks reacting more to inflation risks, yield curves in the advanced countries were significantly adjusted (Figure 2).




Source: Bocom BBM, Bloomberg

Slower growth in China, global inflation risks and more contractionary monetary policy in the developed countries represent huge challenges for the emerging economies, especially commodity exporters. In response to China's deceleration, the prices of commodities intensively used by the construction industry, such as iron and steel, are falling, while the prices of commodities used as substitutes for natural gas, such as oil and coal, are rising (Figure 3).

Figure 3: Commodity Prices (USD)




Source: Bocom BBM, Bloomberg

For Brazil, falling prices of iron ore and slowing demand for this commodity are fueling risks. The improvement in the terms of trade – the ratio of export prices to import prices – has been important to the performance of the economy in 2021, as detailed in our July Macro Letter. Since then, iron ore has fallen from USD 200 to USD 120. Iron ore corresponds to roughly a third of Brazil's exports, and current prices are still sufficient to sustain high terms of trade, but their evolution continues to depend on the global outlook, and particularly China's.

The rise in the price of crude oils affects fuel prices, which are also impacted by local currency depreciation, reflecting fiscal risks, and contaminates the dynamics of inflation, which remains high, pertinent and diffused, justifying an even more contractionary monetary policy. We project a Selic rate of 8.25% by end-2021 and 9.5% in 2022. Higher interest rates in the advanced economies reduce global liquidity and emerging market borrowing capacity, so the rate at the end of the cycle may have to be even higher. Considering the prospect of higher global inflation, economic slowdown, and monetary tightening, we have revised down our growth projection for 2022 to 1.2%. Inflation forecasts were updated to 8.8% in 2021 and 4.1% in 2022.

| ECONOMIC FORECASTS | 2018 | 2019 | 2020 | 2021F | 2022F |
|---|---|---|---|---|---|
| GDP Growth (%) | 1,3% | 1,1% | -4,1% | 5,2% | 1,2% |
| Inflation (%) | 3,7% | 4,3% | 4,5% | 8,8% | 4,1% |
| Unemployment Rate, SA (eoy ,%) | 12,2% | 11,7% | 13,9% | 13,5% | 13,0% |
| Policy Rate (eoy, %) | 6,50% | 4,50% | 2,00% | 8,25% | 9,5% |
| External Accounts | | | | | |
| Trade Balance (US$ bn) | 53 | 48 | 51 | 69 | 46 |
| Current Account Balance (US$ bn) | -42 | -51 | -13 | -2 | -15 |
| Current Account Balance (% of GDP) | -2,2% | -2,8% | -0,9% | -0,1% | -0,9% |
| Fiscal Policy | | | | | |
| Fiscal Primary Balance (% of GDP) | -1,7% | -1,2% | -10,0% | -1,9% | -1,1% |
| Government Gross Debt (% of GDP) | 75,3% | 74,3% | 88,8% | 80,9% | 82,7% |