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MACRO OUTLOOK

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MACRO OUTLOOK

- In Brazil, the epidemiological situation has progressively improved in recent months, with a steady decline in cases and deaths. However, the Omicron variant brings new concerns, suggesting the beginning of a new wave of cases;

- Despite positive signs given by the labor market, economic activity has been losing momentum with the goods and services sector performing negatively;

- We maintain our GDP forecast to 4.4% in 2021 and revised down to 0.3% in 2022 due to interest rate hike cycle;

- Our inflation forecast is at 9.9% in 2021. In 2022, our projection is at 5% due to the inertia of service inflation and readjustments to be made;

- Our Selic rate projection was revised to 9.25% at the end of 2021 and to 11.25% at the end of 2022;

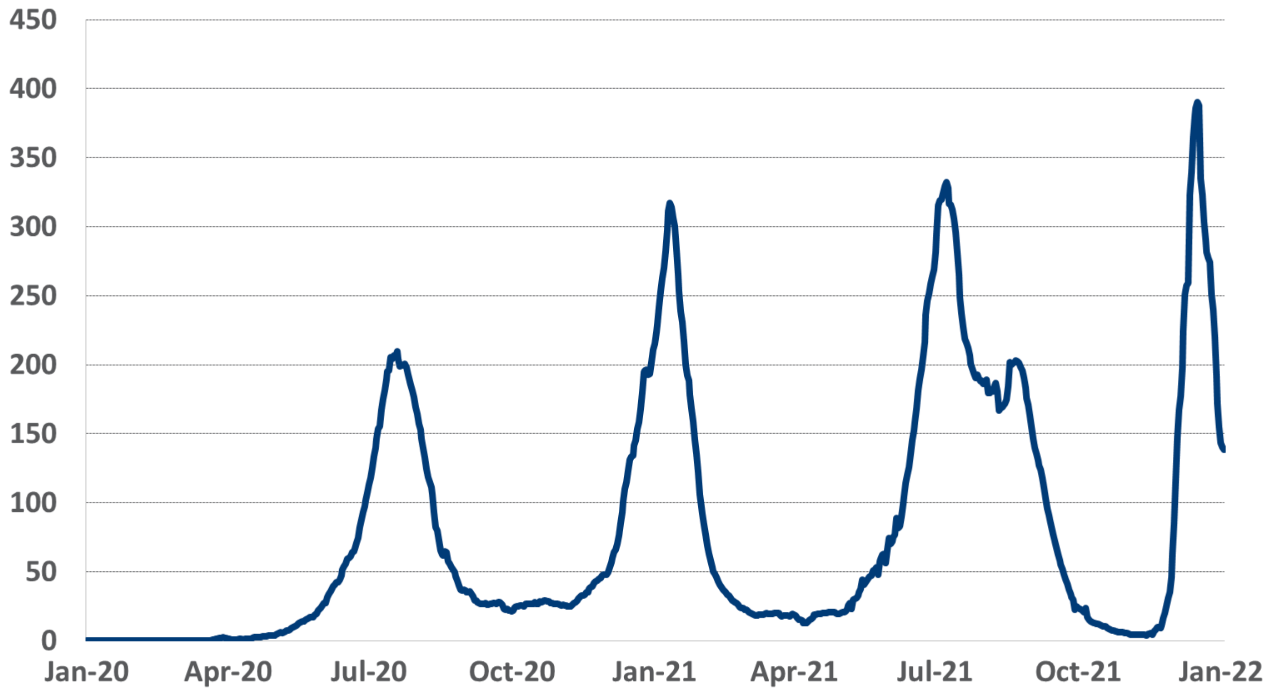
- A higher nominal GDP and a higher tax collection have contributed to a lower debt-to-GDP ratio in 2021;

- The casuistic change in spending cap rule compromises the credibility of the fiscal policy and raises concerns about possible fiscal deterioration from 2022 onwards.

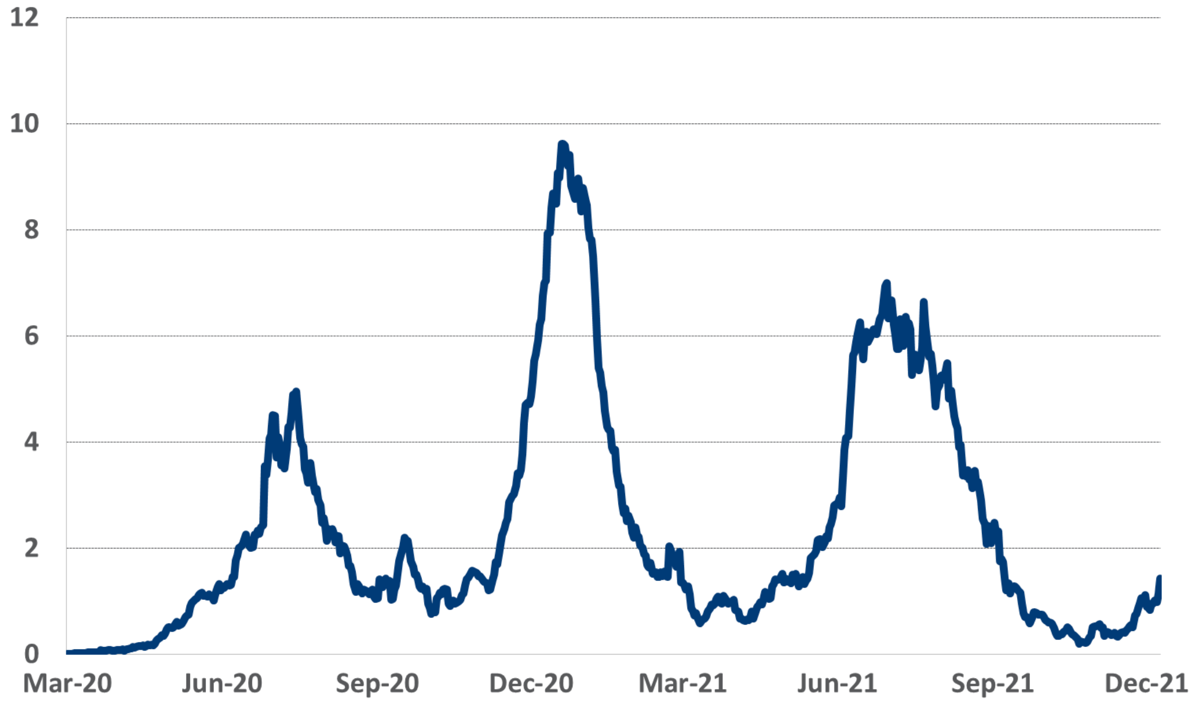
COVID-19 World - Omicron

- The new variant was indeed behind a new wave in South Africa. However, this wave seems to be much shorter than previous ones;
- Deaths, on the other hand, had only a modest increase, suggesting a milder disease.

New Cases by million of People - South Africa 7DMA



New Deaths per million People - South Africa 7DMA

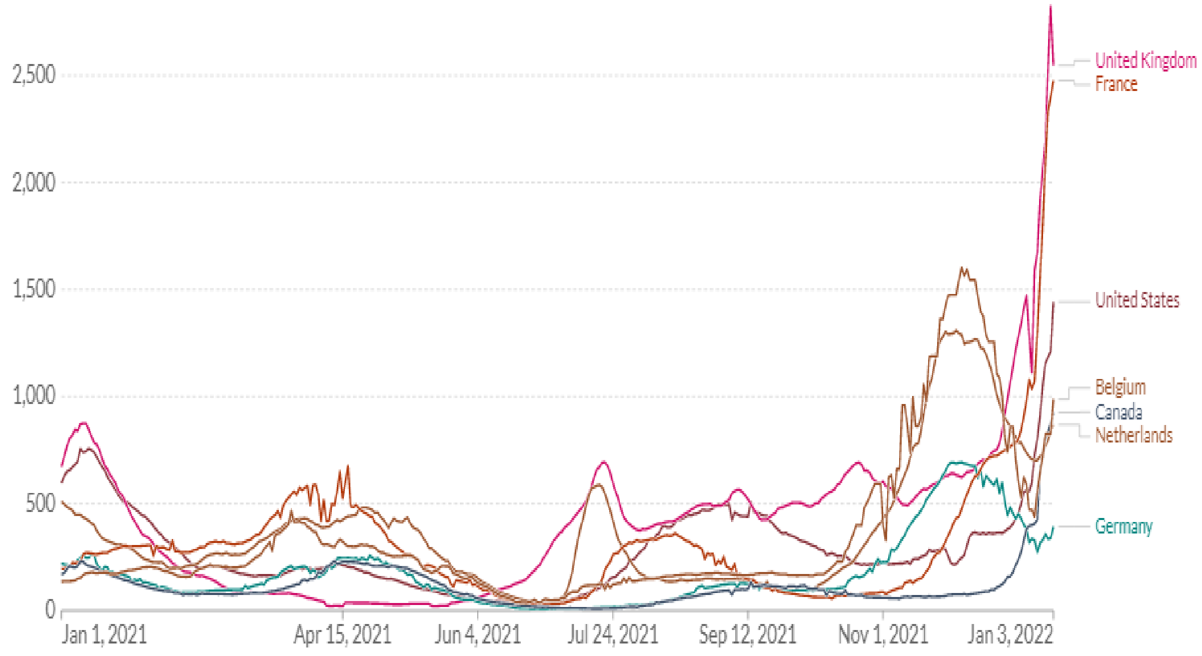


Source: OurWorldInData

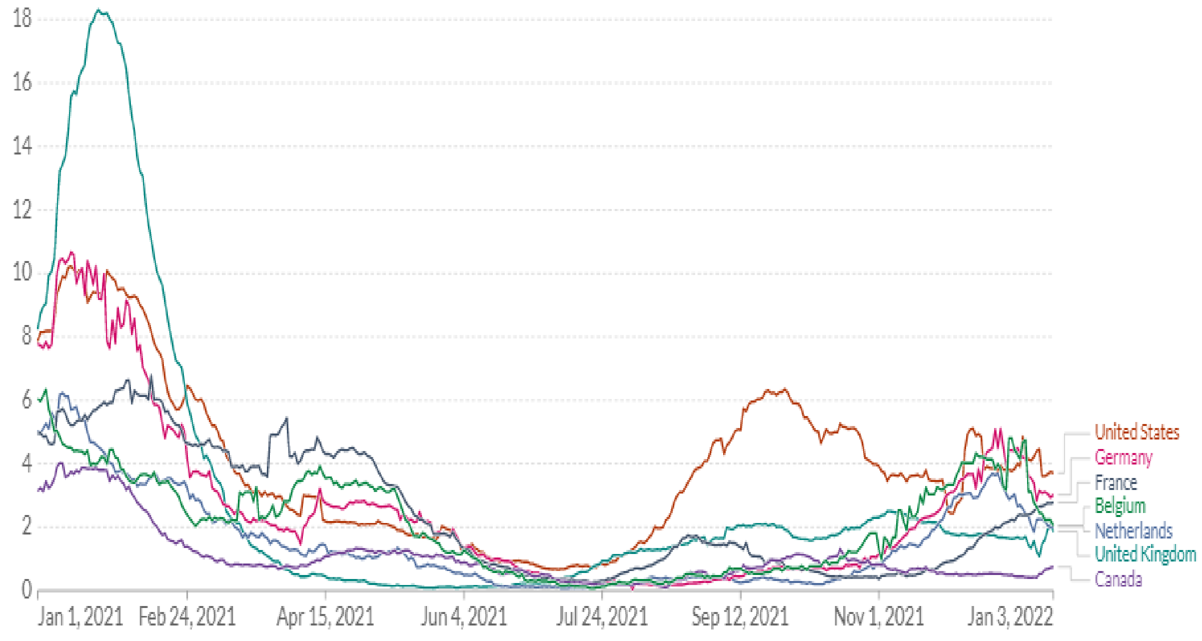
COVID-19 World - Omicron

- The variant has spread all over the world and seems to be related to spikes in new cases. In Europe, it arrived among a scenario of already increasing cases and most likely is contributing to it. In the US, it is linked to the new wave started in December 2021;
- Deaths, as seen in South Africa, had a low increase.

Daily new cases per million people - 7DMA



Daily new deaths per million people - 7DMA



Source: OurWorldInData

COVID-19 Brazil - Omicron

- The pandemic situation in Brazil has been improving for several months. Throughout December, however, the country suffered a blackout in data related to Covid-19, making the pandemic hard to track.
- Omicron has already arrived in Brazil and seems to be dominant in major cities, notably in São Paulo. Despite lack of government data, private laboratories have reported a considerable rise in positive Covid-19 test results in late December and early January, suggesting the beginning of a new wave.

Source: BOCOM BBM

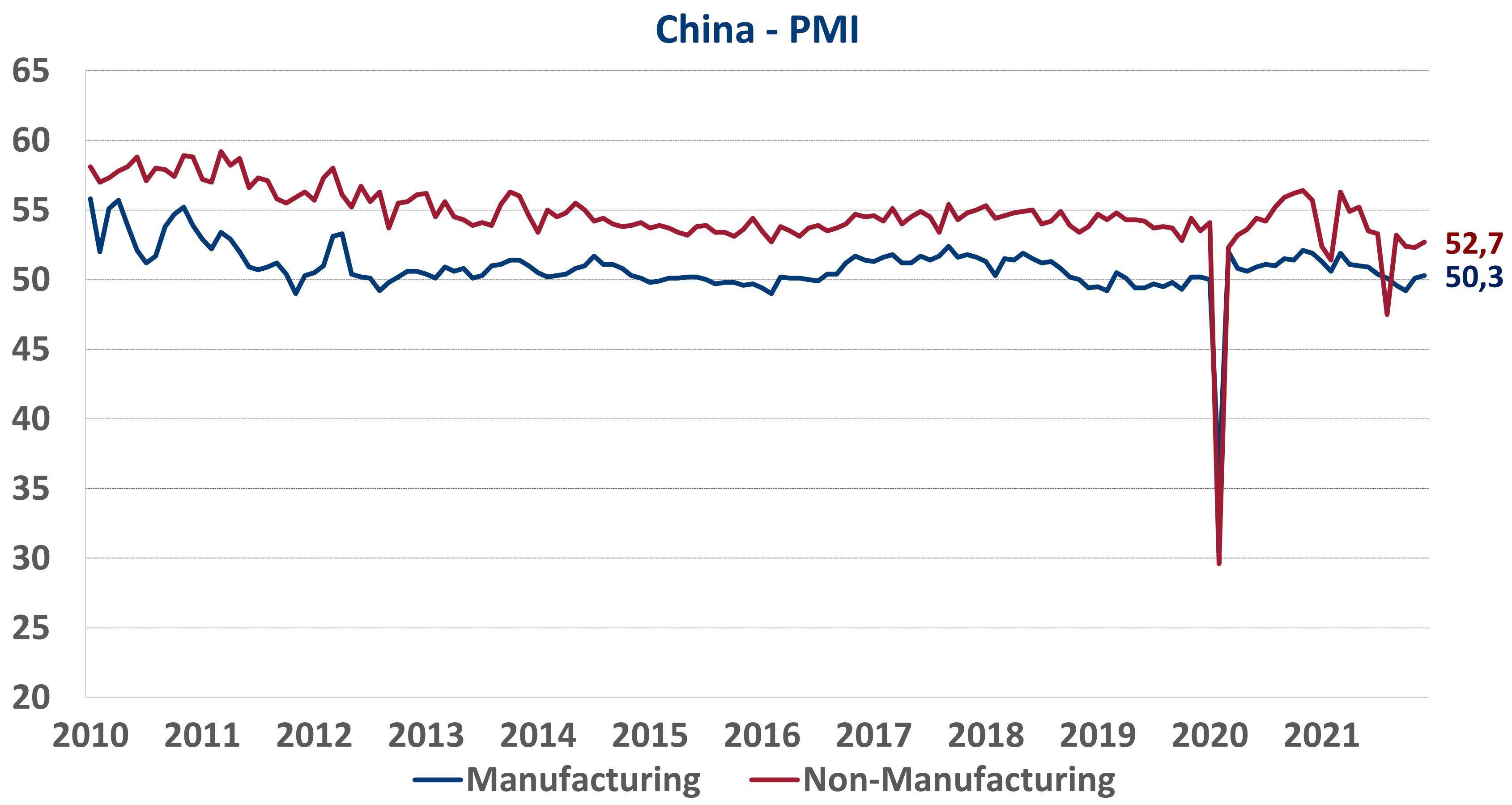
China: Activity

- Industry in China continued to rebound from disruptions caused by power shortage;
- China's zero covid policy is the key reason that's holding back a full recovery of retail sales.

Source: BOCOM BBM, CEIC

China: PMI

- December manufacturing and non-manufacturing PMIs stayed in the expansionary territory, influenced by the increase in production and easing input prices pressures.



Source: BOCOM BBM, CEIC

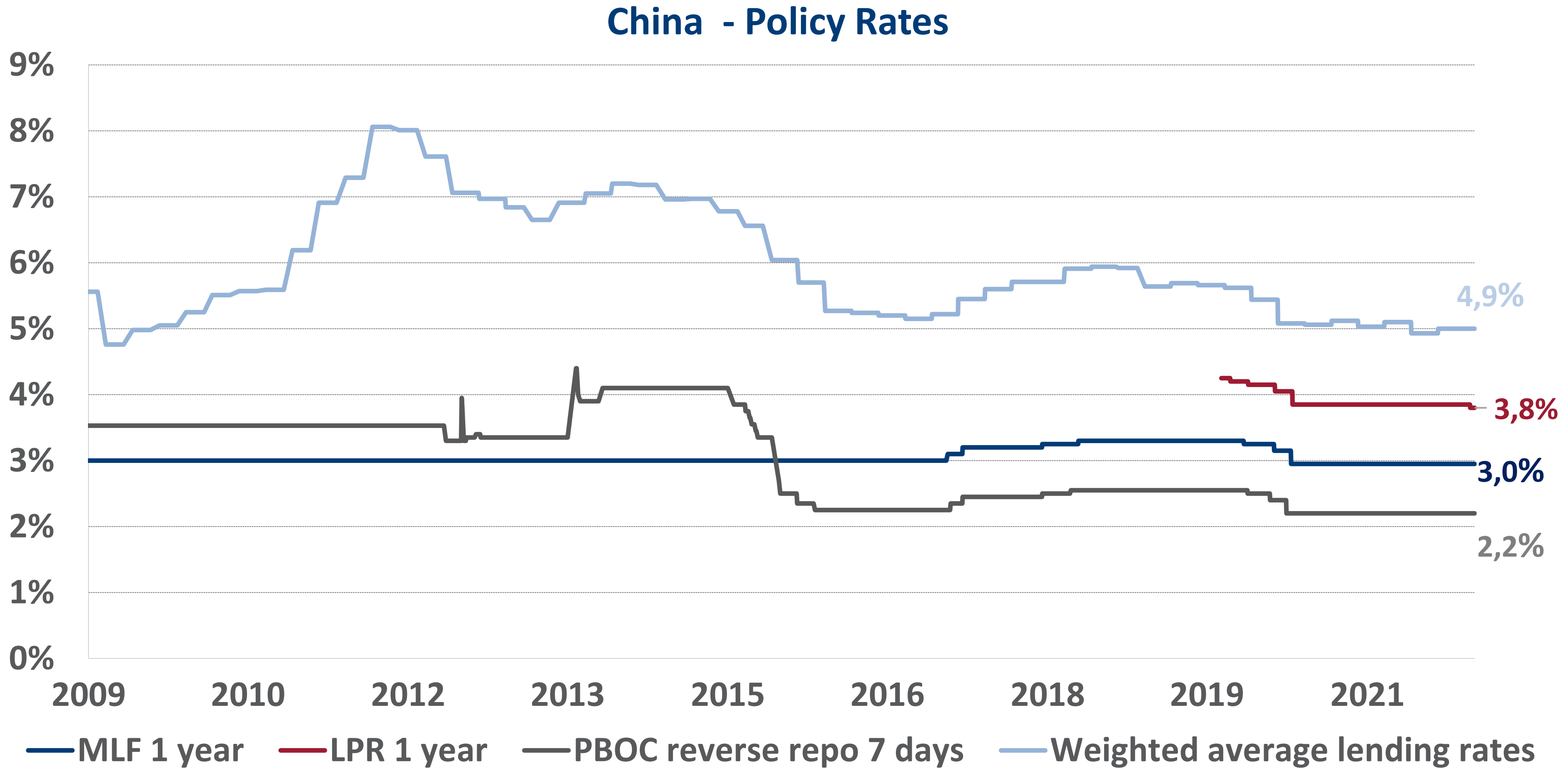
China: Inflation

- PPI finally slowed down in November, a sign that the government's efforts to tame soaring commodity prices and deal with power shortages over the past few months are having an effect;
- The consumer price index increased 2.3% YoY, the fastest pace since August 2020.

Source: BOCOM BBM, CEIC

China: Monetary Policy

- The Central Bank of China, PBOC, has reduced its lending benchmark (LPR 1 year) to support the economy that shows signs of slowdown;
- The PBOC reinforced that they will keep the monetary policy flexible and should continue to provide support to stabilize the economic growth.



Source: CEIC, Bocom BBM

USA: Inflation

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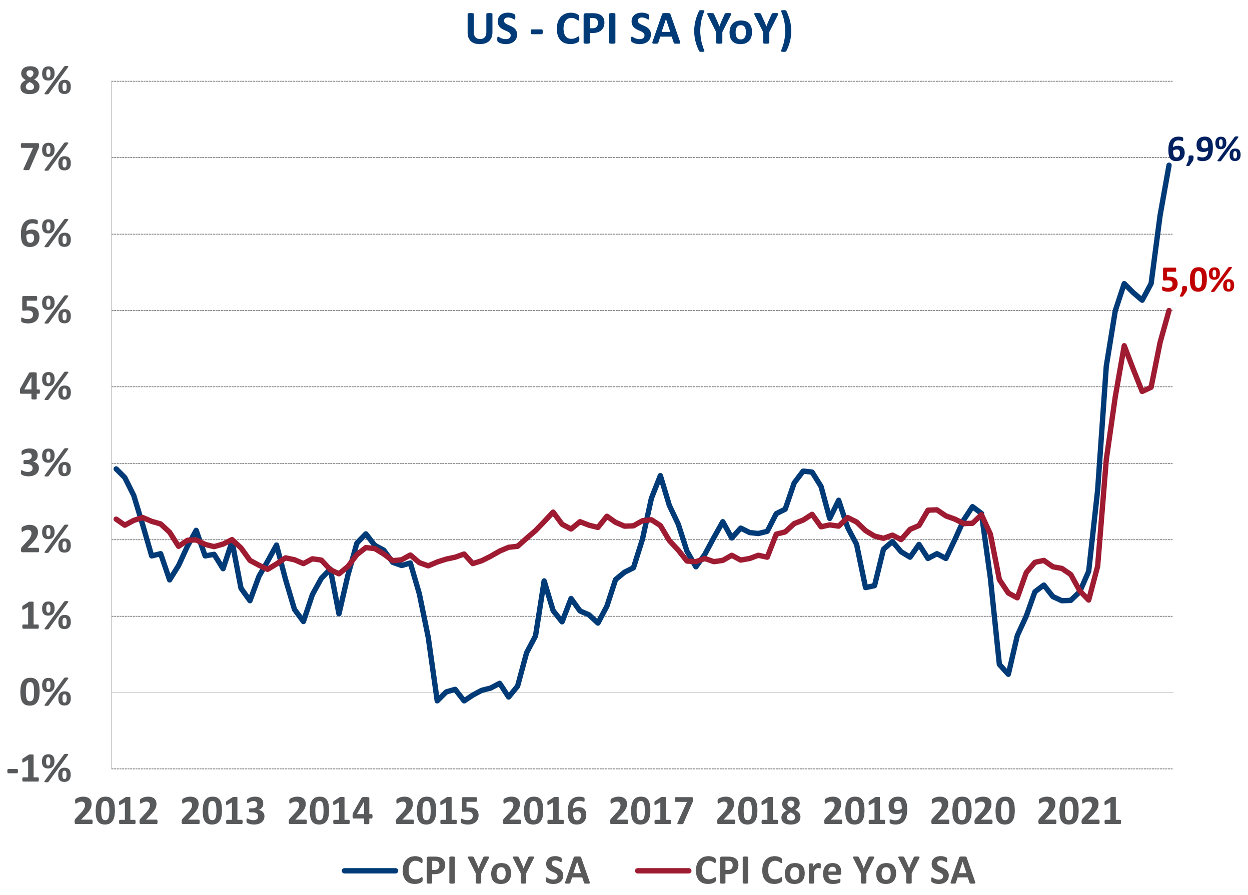
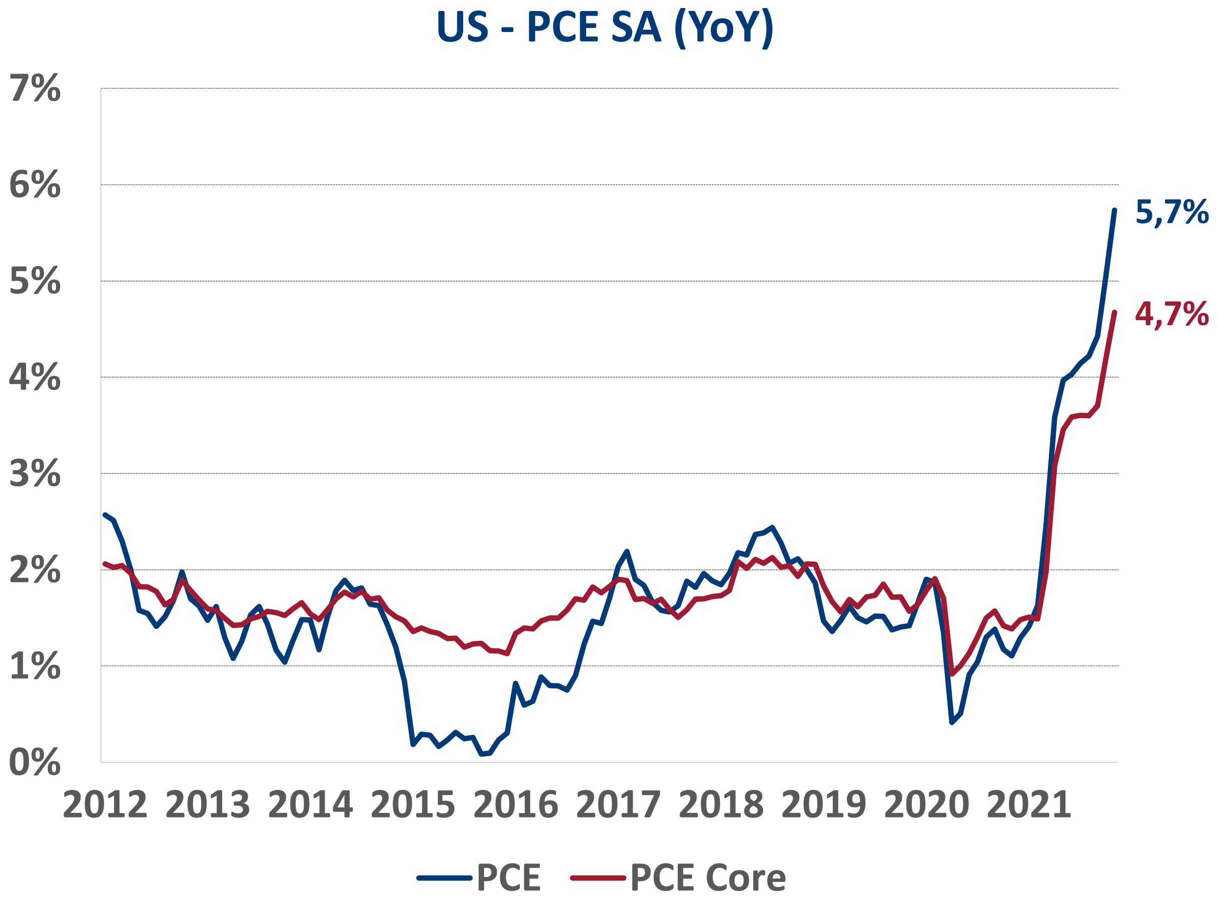
- US inflation accelerated in November and alongside a jump in salaries, pushed the FED to start tapering the bond purchases program.





Source: BOCOM BBM, FRED

US: Monetary Policy

- Amid inflationary pressures, the U.S. Central Bank (FED) decided to reduce the pace of asset purchases by $30 billion at its last meeting and now it is expected to end by March 2022;
- Projections for GDP and Inflation remained above long-term estimates.

Percent

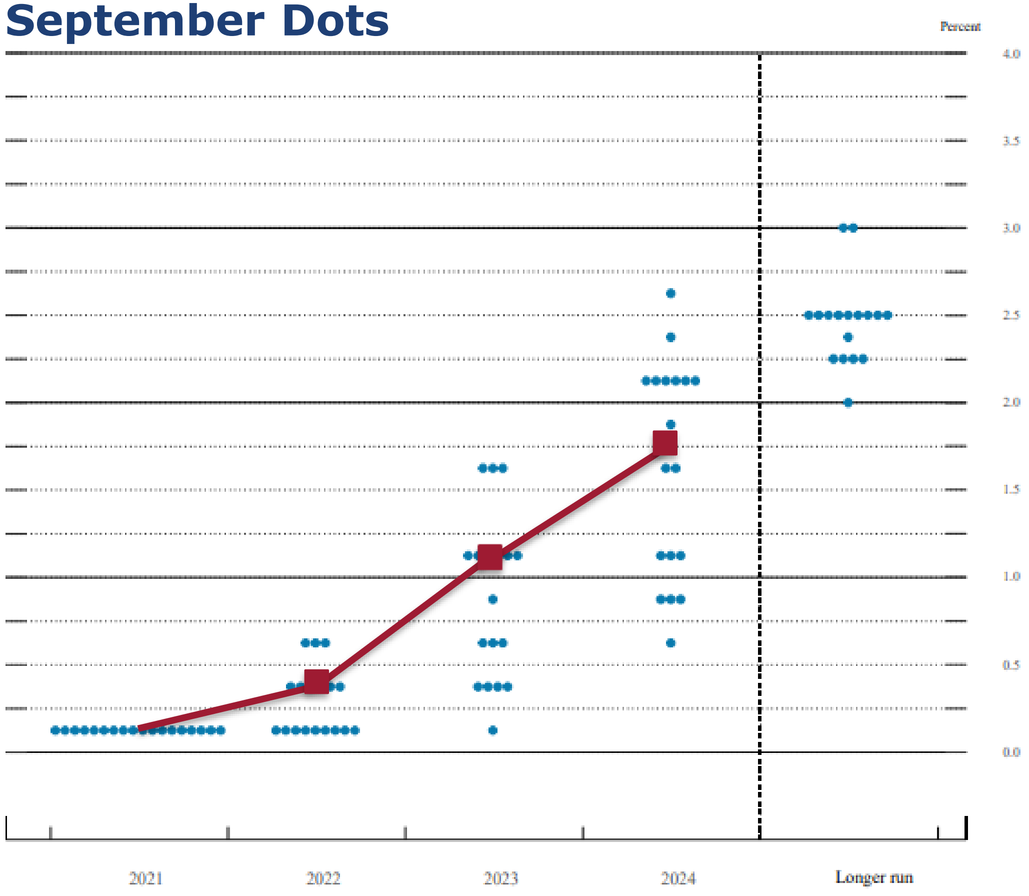
Variable	Median[1]					Central Tendency[2]					Range[3]				
	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run	2021	2022	2023	2024	Longer run
Change in real GDP	5.5	4.0	2.2	2.0	1.8	5.5	3.6–4.5	2.0–2.5	1.8–2.0	1.8–2.0	5.3–5.8	3.2–4.6	1.8–2.8	1.7–2.3	1.6–2.2
September projection	5.9	3.8	2.5	2.0	1.8	5.8–6.0	3.4–4.5	2.2–2.5	2.0–2.2	1.8–2.0	5.5–6.3	3.1–4.9	1.8–3.0	1.8–2.5	1.6–2.2
Unemployment rate	4.3	3.5	3.5	3.5	4.0	4.2–4.3	3.4–3.7	3.2–3.6	3.2–3.7	3.8–4.2	4.0–4.4	3.0–4.0	2.8–4.0	3.1–4.0	3.5–4.3
September projection	4.8	3.8	3.5	3.5	4.0	4.6–4.8	3.6–4.0	3.3–3.7	3.3–3.6	3.8–4.3	4.5–5.1	3.0–4.0	2.8–4.0	3.0–4.0	3.5–4.5
PCE inflation	5.3	2.6	2.3	2.1	2.0	5.3–5.4	2.2–3.0	2.1–2.5	2.0–2.2	2.0	5.3–5.5	2.0–3.2	2.0–2.5	2.0–2.2	2.0
September projection	4.2	2.2	2.2	2.1	2.0	4.0–4.3	2.0–2.5	2.0–2.3	2.0–2.2	2.0	3.4–4.4	1.7–3.0	1.9–2.4	2.0–2.3	2.0
Core PCE inflation[4]	4.4	2.7	2.3	2.1		4.4	2.5–3.0	2.1–2.4	2.0–2.2		4.4–4.5	2.4–3.2	2.0–2.5	2.0–2.3	
September projection	3.7	2.3	2.2	2.1		3.6–3.8	2.0–2.5	2.0–2.3	2.0–2.2		3.5–4.2	1.9–2.8	2.0–2.3	2.0–2.4	
Memo: Projected appropriate policy path															
Federal funds rate	0.1	0.9	1.6	2.1	2.5	0.1	0.6–0.9	1.4–1.9	1.9–2.9	2.3–2.5	0.1	0.4–1.1	1.1–2.1	1.9–3.1	2.0–3.0
September projection	0.1	0.3	1.0	1.8	2.5	0.1	0.1–0.4	0.4–1.1	0.9–2.1	2.3–2.5	0.1	0.1–0.6	0.1–1.6	0.6–2.6	2.0–3.0

Source: BOCOM BBM, FED

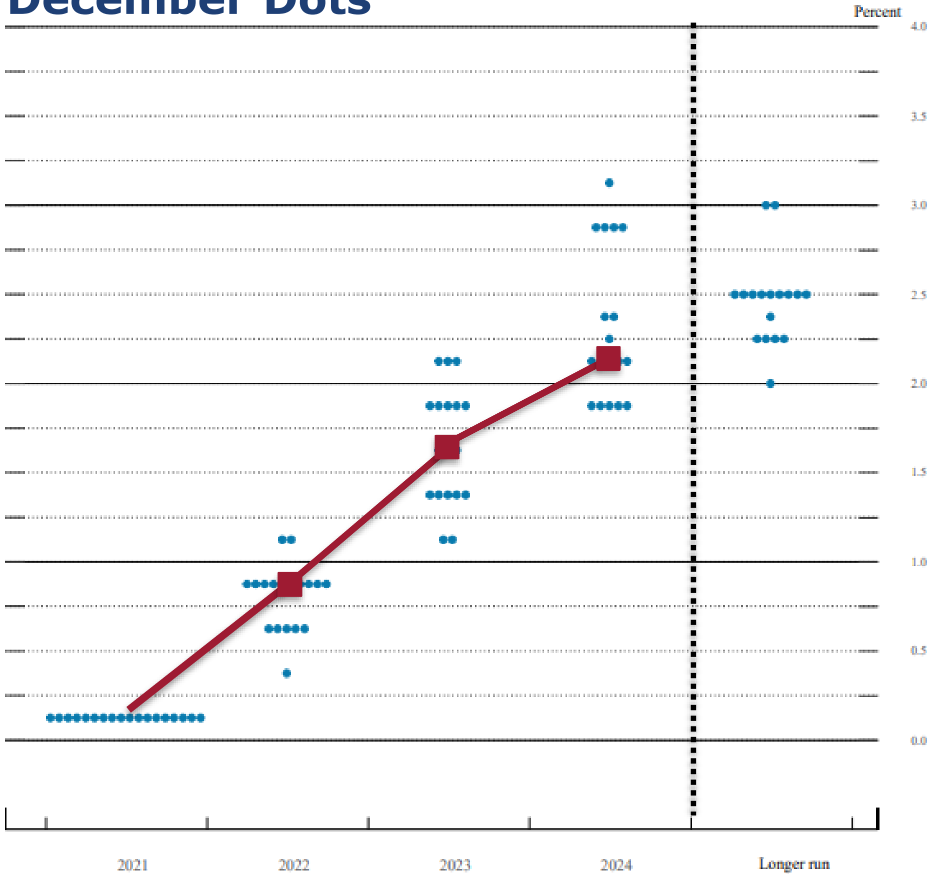
US: Fomc

- In a scenario where the economy is showing strong recovery and inflation projections suggest above target numbers, Fed Dots showed considerable movement;
- Since September, Fed Dots have moved up from one to three hikes in 2022 and the minutes pointed to greater probability of the first hike to take place in March;
- In 2023 and 2024, the December median is pricing three and two hikes, respectively.

September Dots

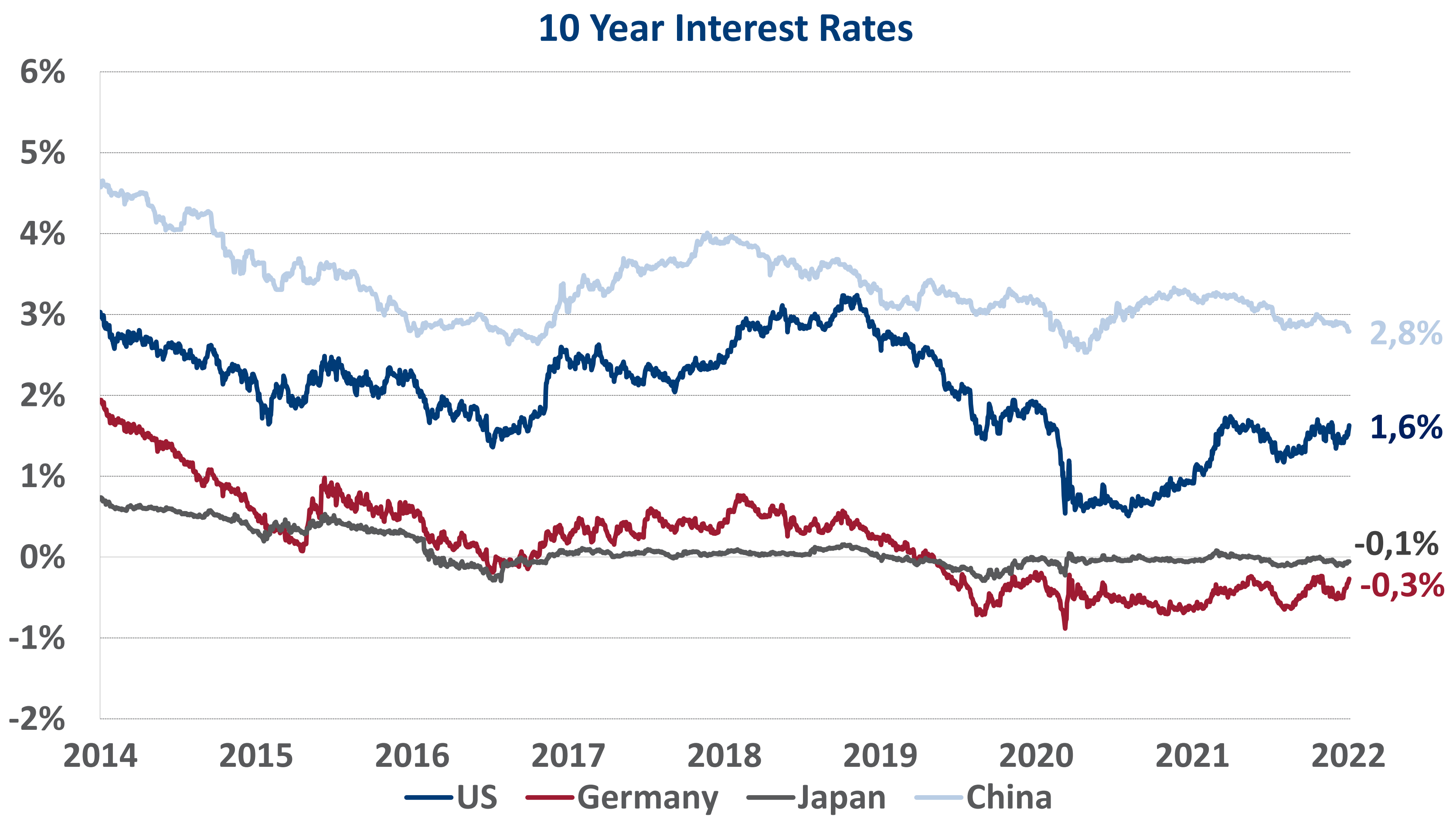


December Dots



Global Interest Rates

» Changes in monetary policy of the principal Central Banks affect long-term interest rates, increasing it.



Source: Bloomberg, BOCOM BBM

Global: Negative Interest Rates

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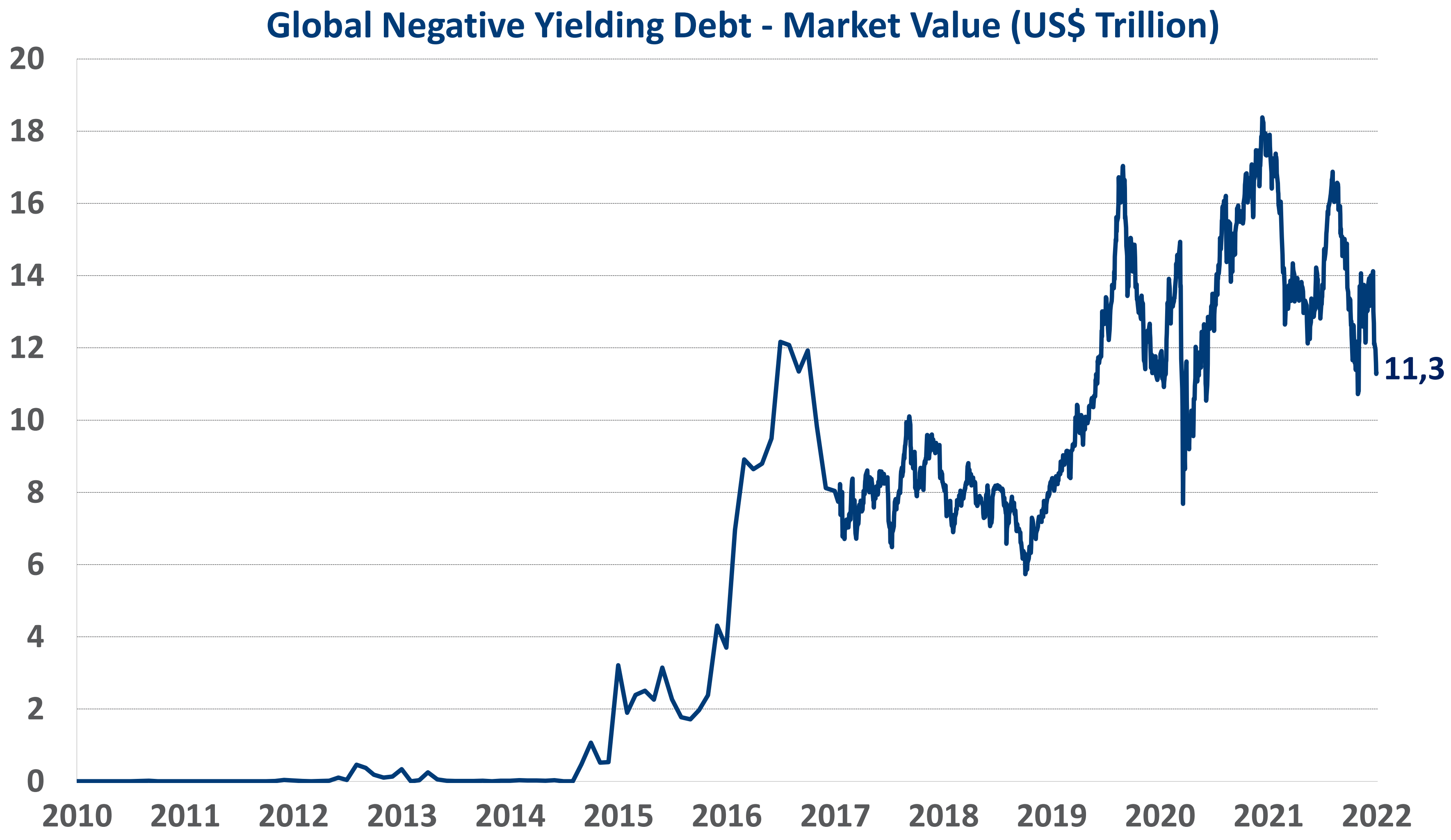
» The volume of negative-yielding debt kept its downward trend amid a restrictive monetary policy (gradual reduction of monetary stimulus).



Source: IIF, BOCOM BBM

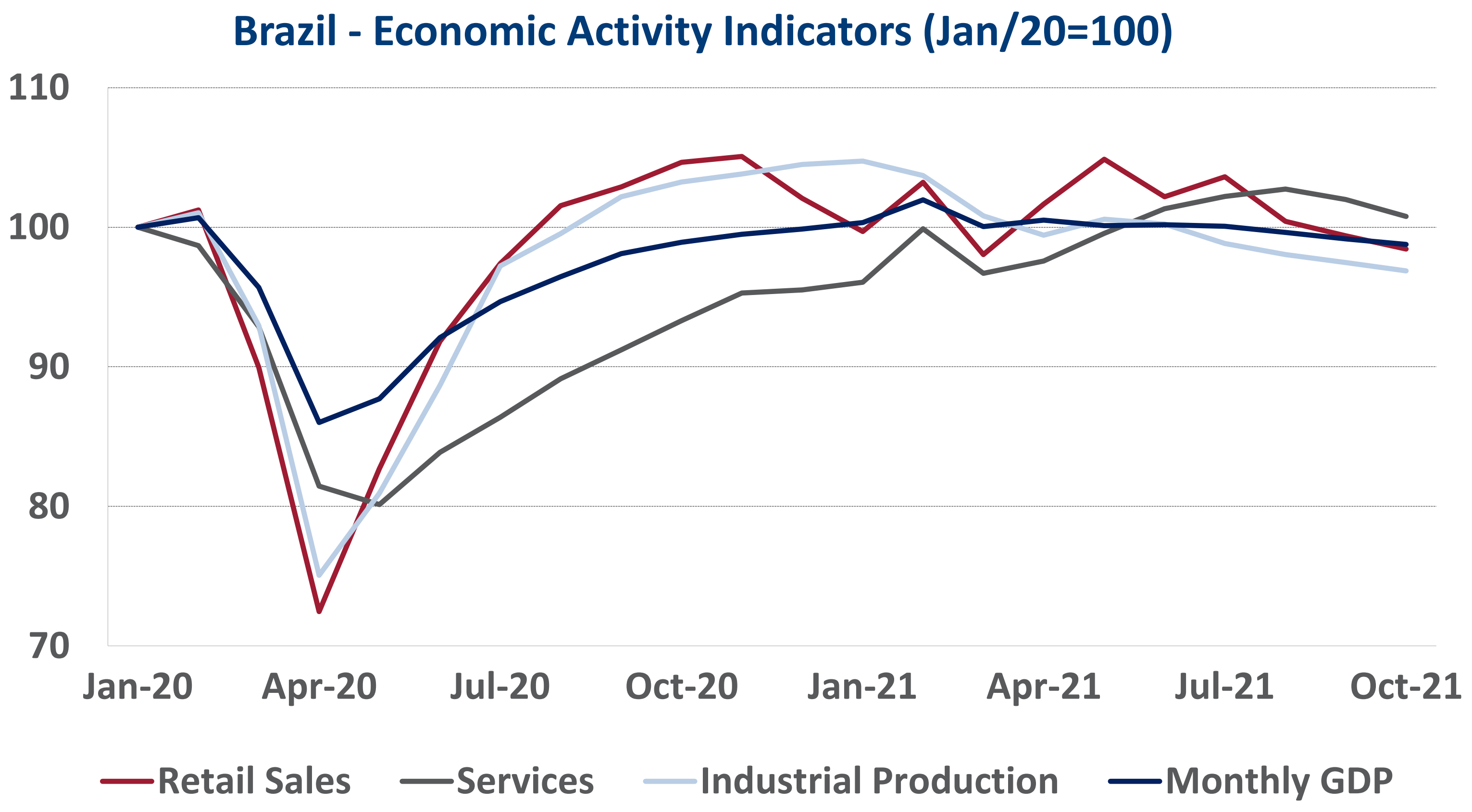
Brazil: Forecasts

ECONOMIC FORECASTS	2018	2019	2020	2021F	2022F
GDP Growth (%)	1,3%	1,1%	-4,1%	4,4%	0,3%
Inflation (%)	3,7%	4,3%	4,5%	9,9%	5,0%
Unemployment Rate, SA (eoy ,%)	12,2%	11,7%	13,9%	12,2%	13,2%
Policy Rate (eoy, %)	6,50%	4,50%	2,00%	9,25%	11,25%
External Accounts					
Trade Balance (US$ bn)	53	48	51	34	49
Current Account Balance (US$ bn)	-51	-65	-24	-29	-23
Current Account Balance (% of GDP)	-2,2%	-2,8%	-0,9%	-1,7%	-1,3%
Fiscal Policy					
Fiscal Primary Balance (% of GDP)	-1,7%	-1,2%	-10,0%	-1,1%	-1,3%
Government Gross Debt (% of GDP)	75,3%	74,3%	88,8%	81,0%	82,0%

Source: BOCOM BBM

Brazil: Activity

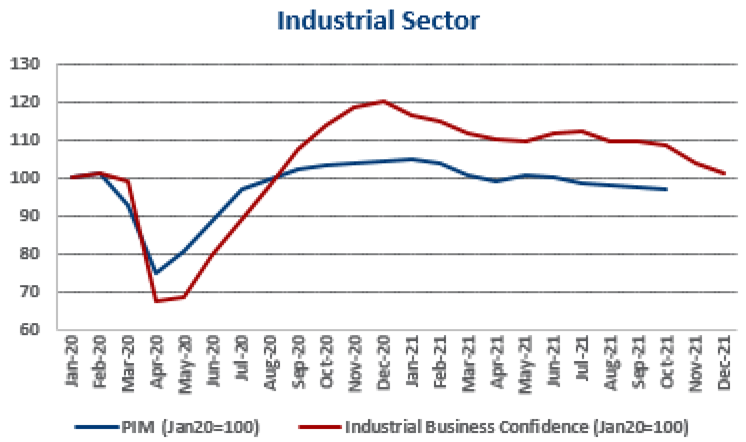
- October's high frequency data showed incipient evidence of a challenging 4Q21, with goods and services sectors performing negatively.

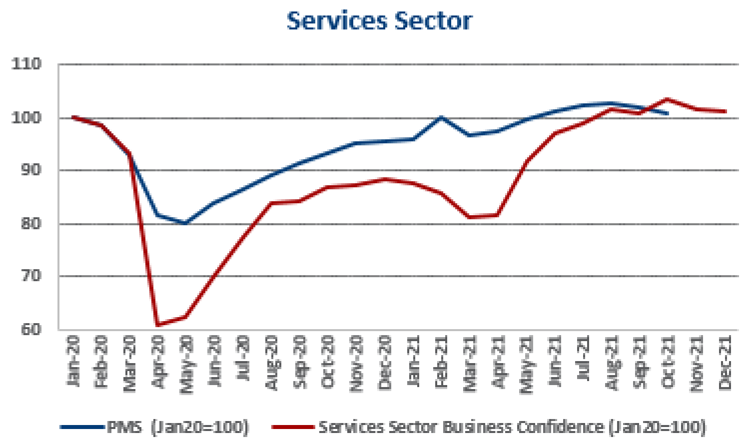


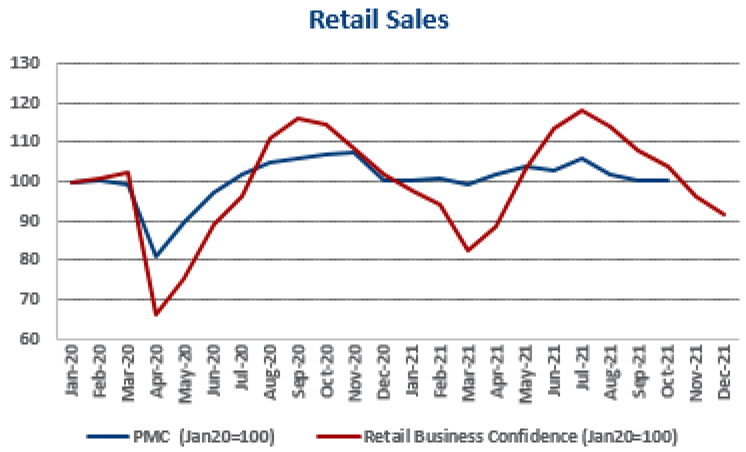
Source: BOCOM BBM, IBGE

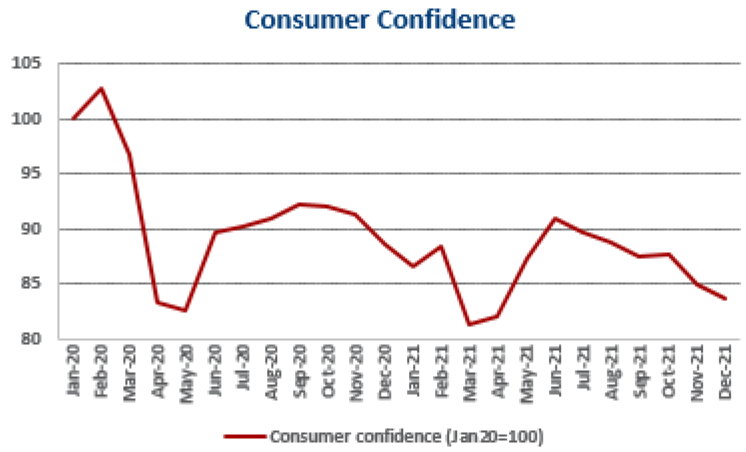
Brazil: Activity

» Sectorial confidence and consumer confidence indicators kept their downward trend, reinforcing a negative outlook of the economic activity in 4Q21.





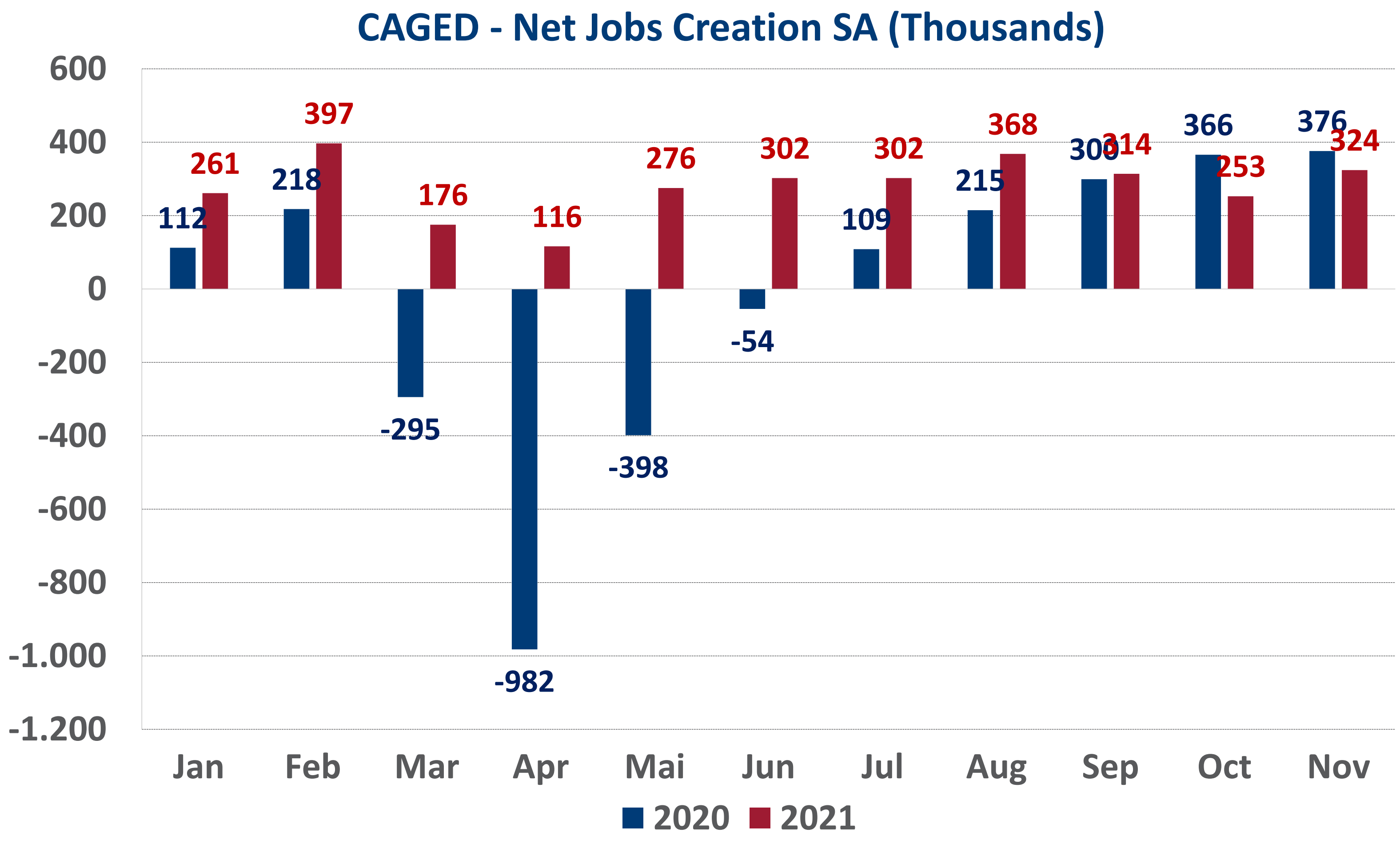




Source: BOCOM BBM, IBGE, FGV

Brazil: Labor Market (Caged)

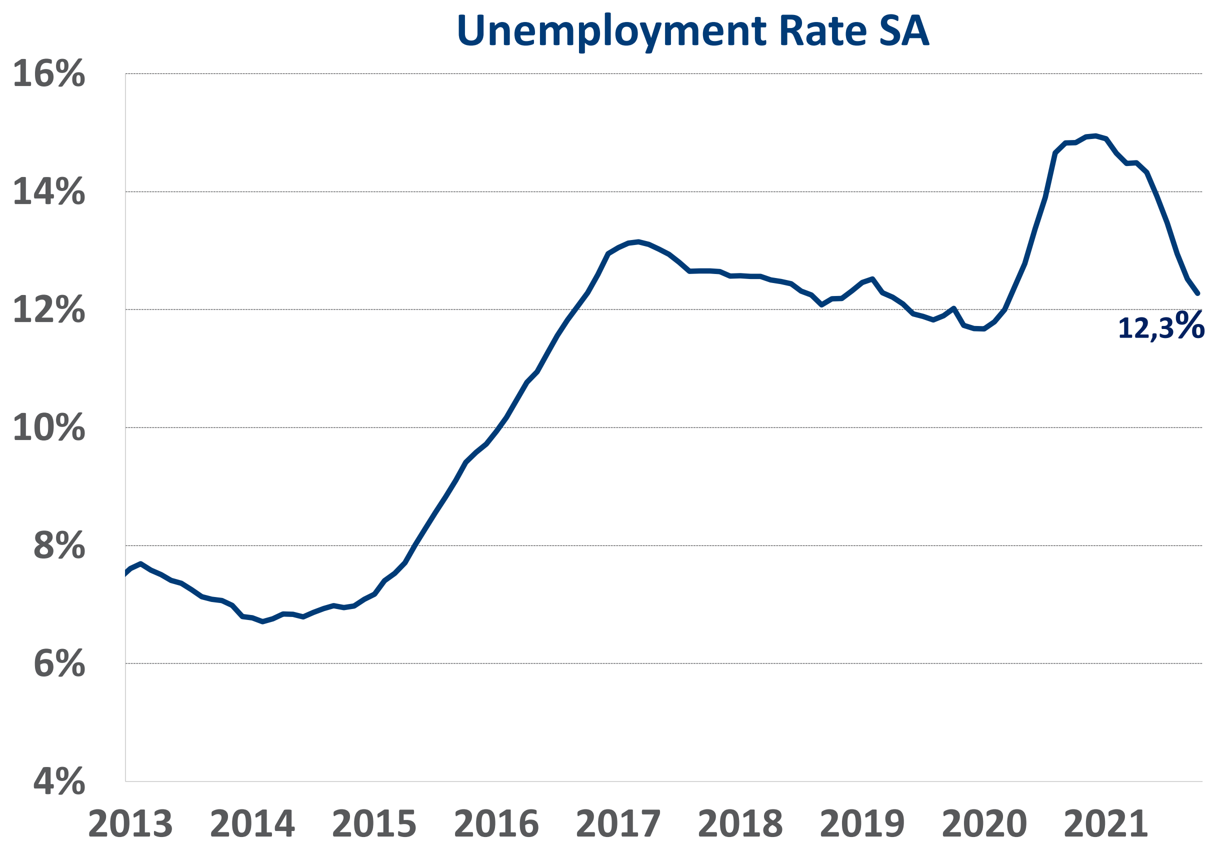
In November, formal net jobs creation remained positive, concentrated on the services and retail sectors, while the creation of new jobs in the industry sector slowed.

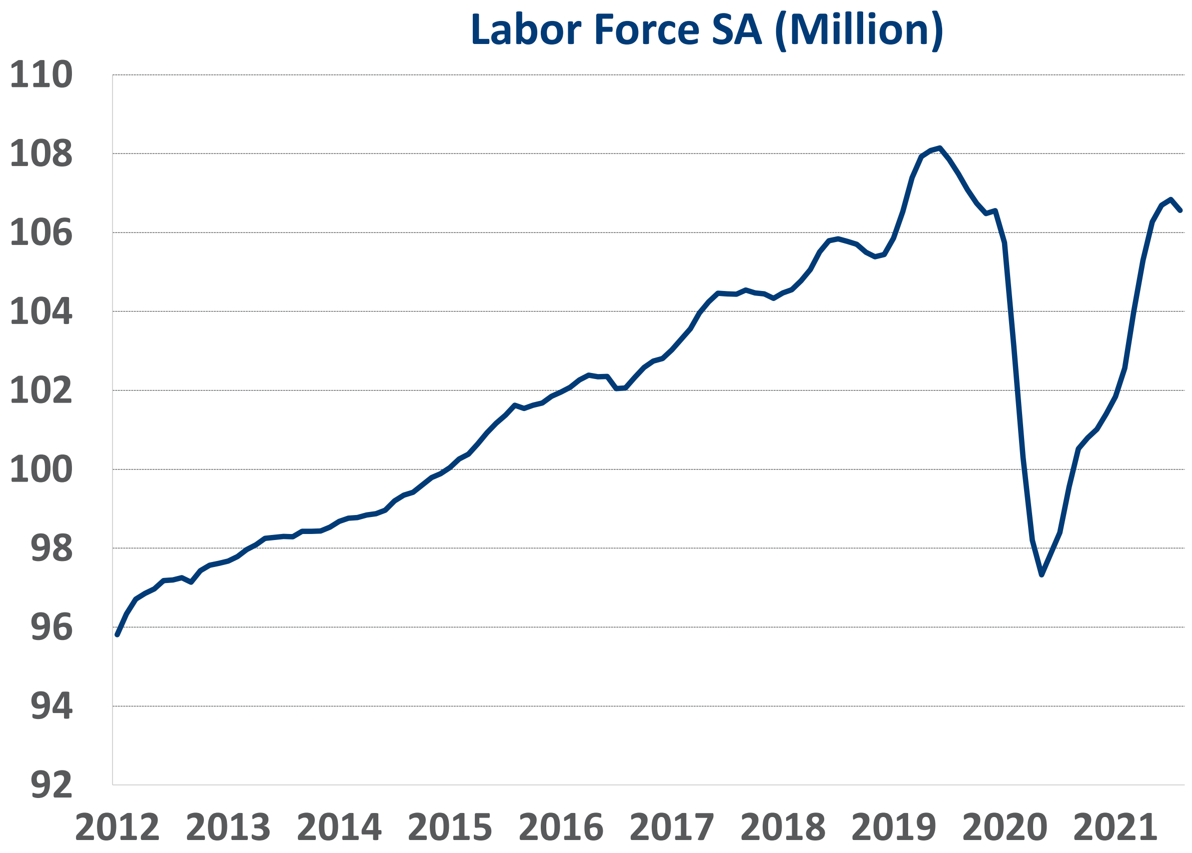


Source: BOCOM BBM, MTE

Brazil: Labor Market (PNADC)

- The unemployment rate continued its downward trajectory as the employed population increases;
- PNADC's employment data still does not reflect the recent worsening of economic activity as it is released with some delay.

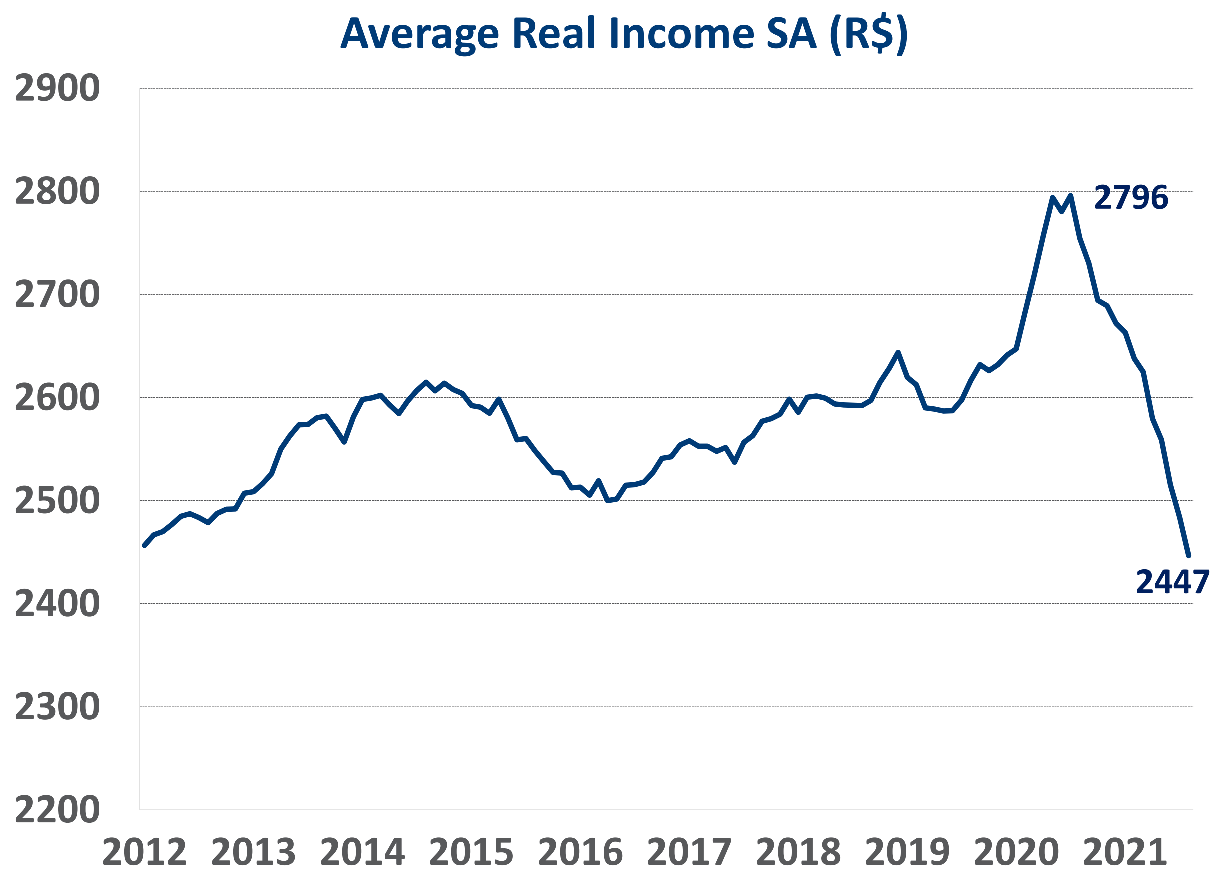


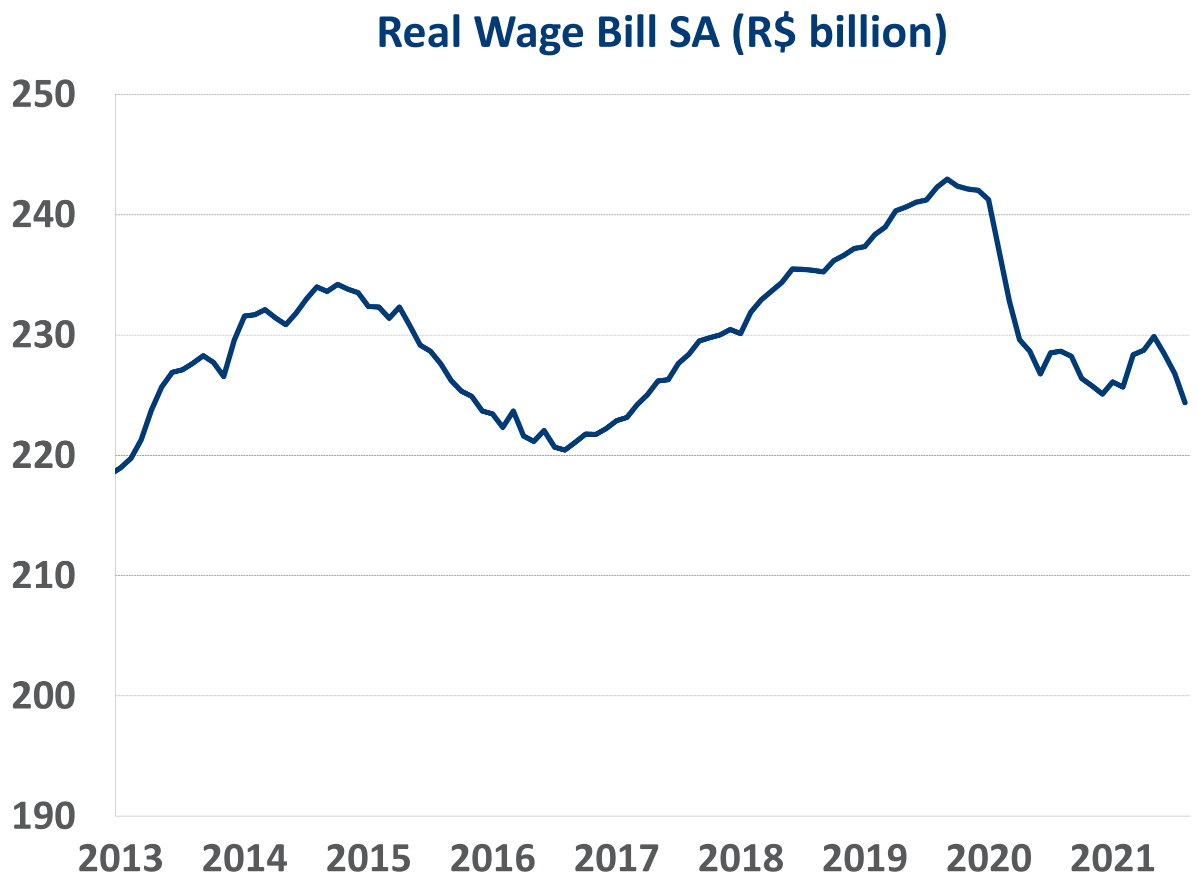


Source: BOCOM BBM, IBGE

Brazil: Labor Market (PNADC)

- The average real income and real wage bill remained depressed;
- Persistent fall in income measures due to inflation and the composition effect of the market (more jobs with lower wages).





Source: BOCOM BBM, IBGE

Brazil: Inflation

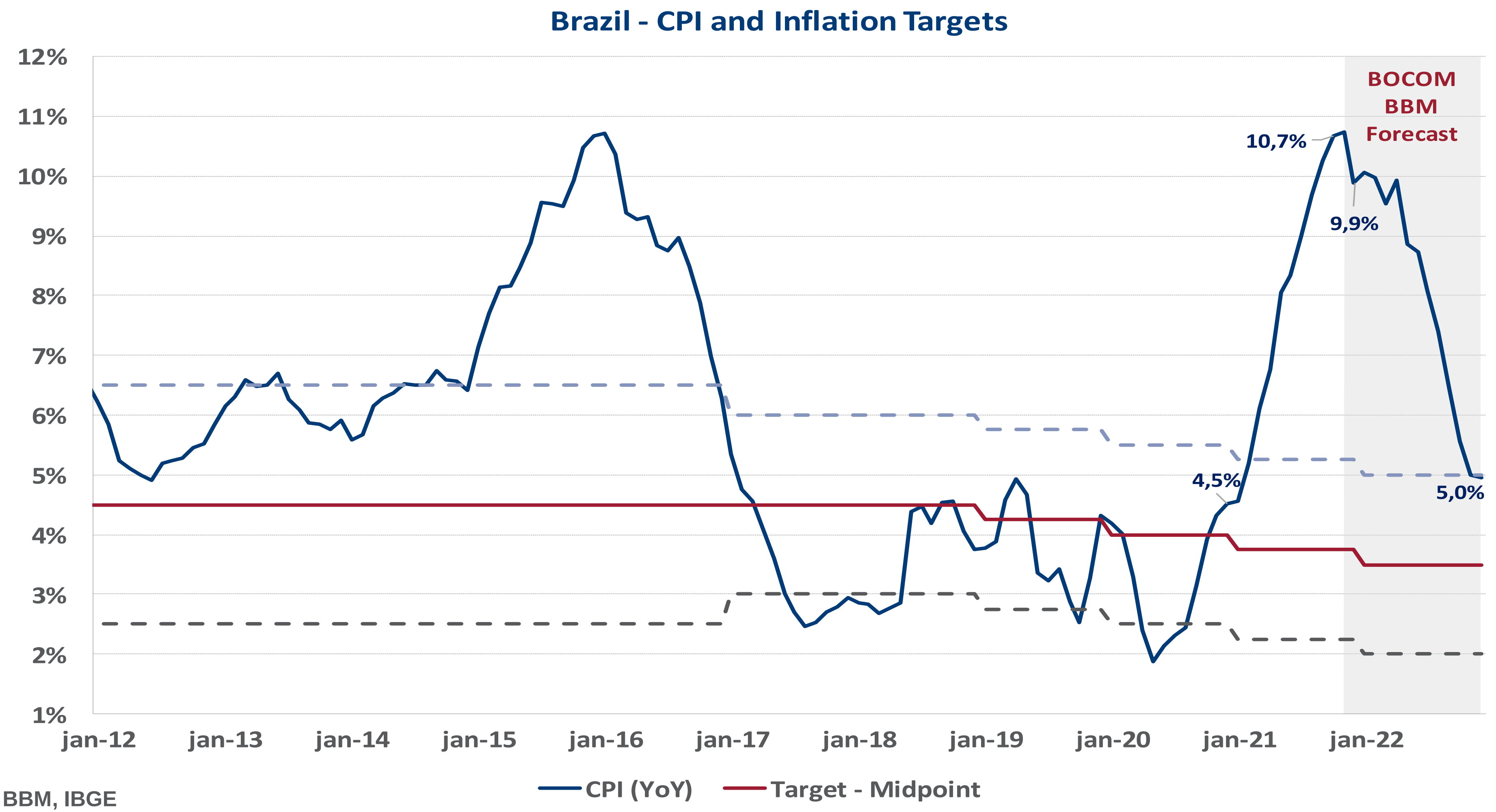
- The industrial goods inflation shock, stronger services, non processed food inflation, new electric energy flag tariffs, gasoline and other fuels added pressure to 2021 CPI;
- Inflation in 2021 reached its peak in November;
- In 2022, services sector continued recovery will add pressure in CPI.

Baseline Scenario (YoY)						
	IPCA	Regulated	Non-Regulated	Services	Food-at-Home	Industrial Products
19 Q4	4,3%	5,5%	3,9%	3,5%	7,8%	2,1%
20 Q1	3,3%	4,8%	2,9%	3,1%	5,1%	2,6%
20 Q2	2,1%	2,6%	2,8%	2,1%	9,0%	1,3%
20 Q3	3,1%	2,1%	3,8%	1,1%	15,4%	1,8%
20 Q4	4,5%	2,6%	5,5%	1,7%	18,2%	3,2%
21 Q1	6,1%	7,0%	6,1%	1,6%	17,6%	5,5%
21 Q2	8,3%	13,0%	7,0%	2,2%	15,3%	8,8%
21 Q3	10,2%	15,8%	8,5%	4,4%	14,7%	10,6%
21 Q4	9,9%	17,2%	7,5%	4,7%	8,2%	11,1%
22 Q1	9,6%	13,0%	8,4%	6,5%	9,5%	10,5%
22 Q2	8,8%	9,6%	8,5%	7,6%	9,4%	9,3%
22 Q3	6,5%	6,7%	6,5%	6,7%	4,9%	7,1%
22 Q4	5,0%	4,2%	5,2%	5,6%	5,0%	4,9%

Source: BOCOM BBM, IBGE

Brazil: Inflation

- 2021 CPI forecast at 9.9% with maximum point in November;
- For 2022, CPI forecast at 5% due to persistence of services inflation and inflationary shocks.



Source: BCB, BOCOM BBM, IBGE

Brazil: Inflation

- **Inflation forecast is at 9.9% and the principal factors accountable for the CPI above upper limit are:**

1. Wholesale inflation passthrough to industrial goods still very elevated;
2. Stronger recovery of the services sector;
3. Fuels inflation;
4. Hydrological scarcity flag in December.

- **In 2022, the 5% projection is mainly caused by the casuistic change in the ceiling cap rule, which impacted expectations. Further risks to 2022 CPI are:**

Upside risks:

1. Wholesale inflation passthrough to industrial goods elevated until the end of the year;
2. Higher persistence of services inflation due to expectations and inertia;
3. New Covid variants impact on the supply chain;
4. Another commodities rally with the BRL still depreciated, with fuels and food at home prices increasing;

Downside risks:

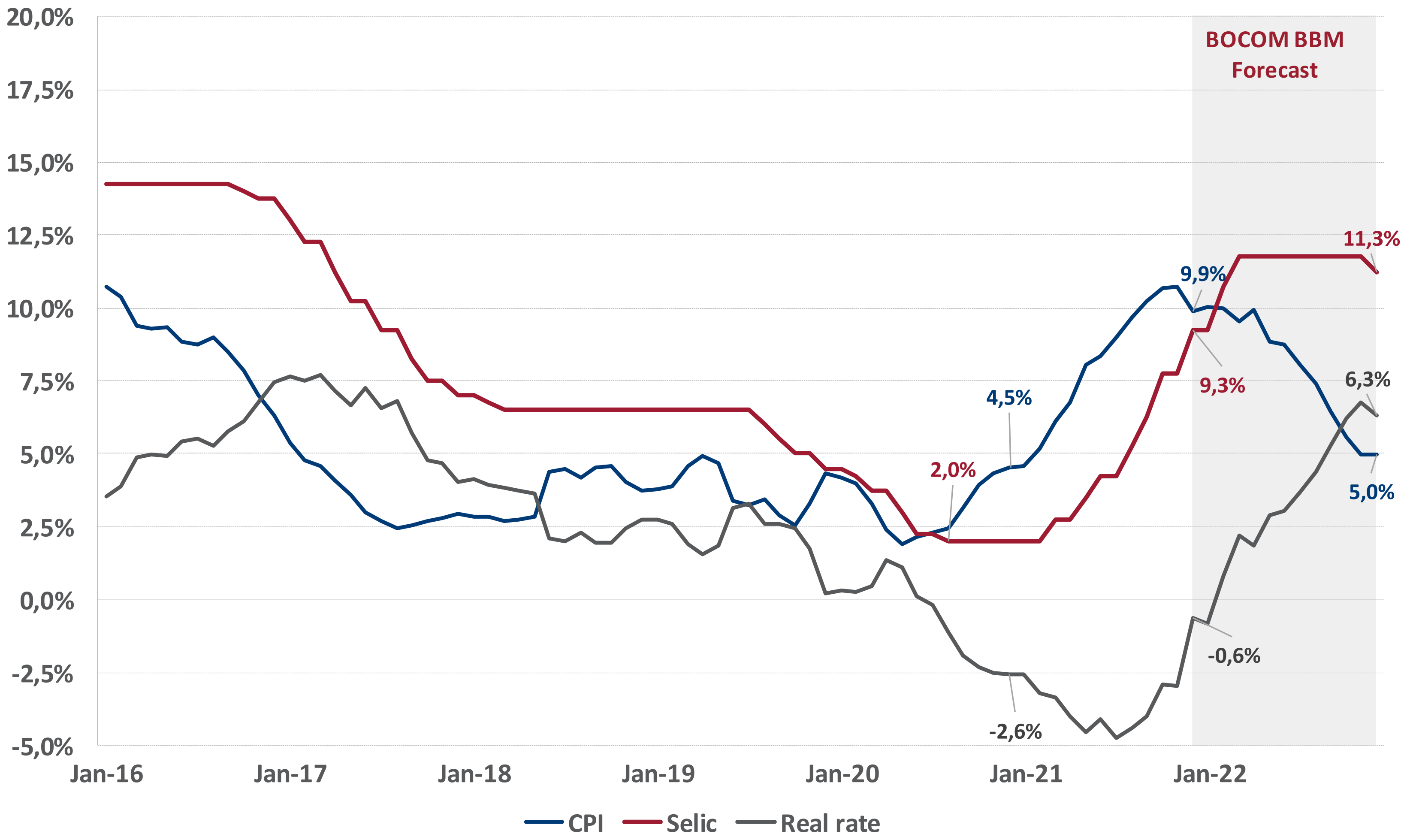
1. Activity decline and high unemployment start playing a larger role due to the high interest rate;
2. Hydrological crisis finished with green flag in December 2022;
3. End of supply chain disruption before expectations.

Source: BOCOM BBM

Brazil: Interest rates

- Scenario: Copom hikes Selic by 150 bps in the next meeting and 100 bps in March, finishing the hike cycle with 11.75%;
- We believe the central bank will reduce in 50 bps the interest rate still in 2022, finishing the year at 11.25%.

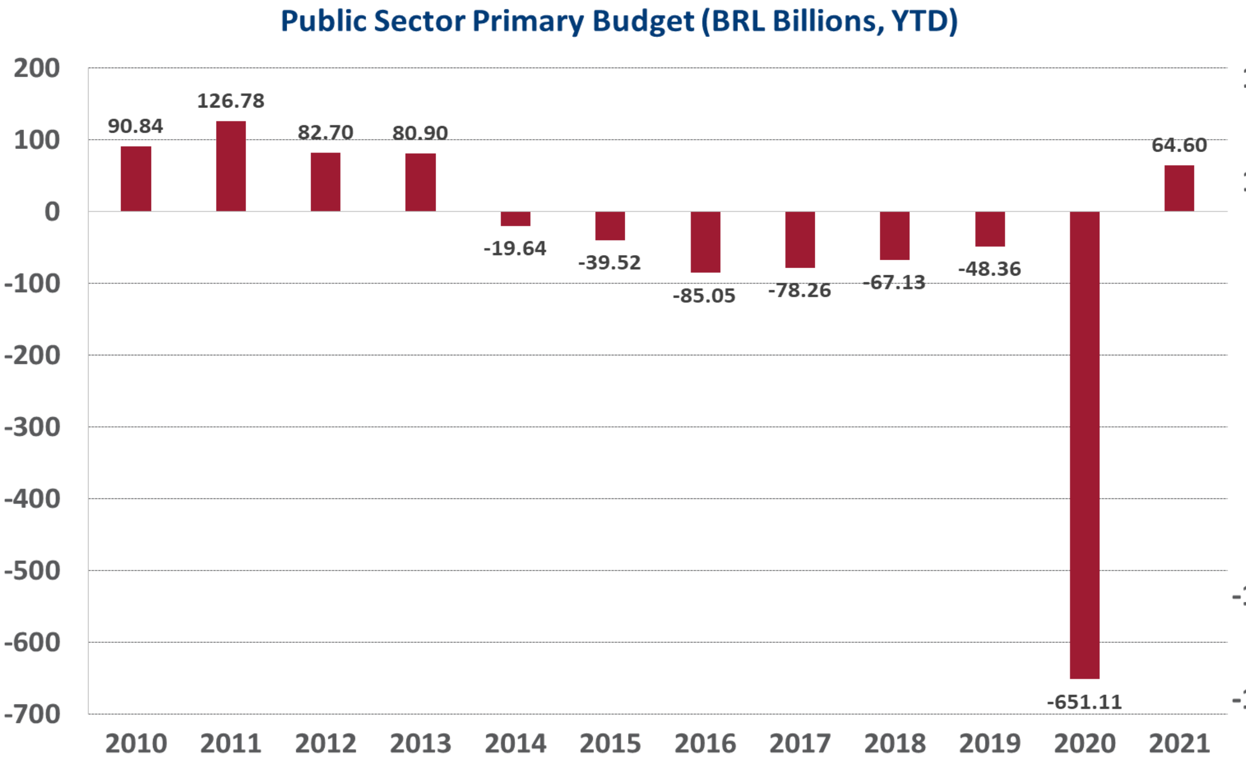
Brazil - CPI, Selic Rate and Real Ex-post Interest Rate

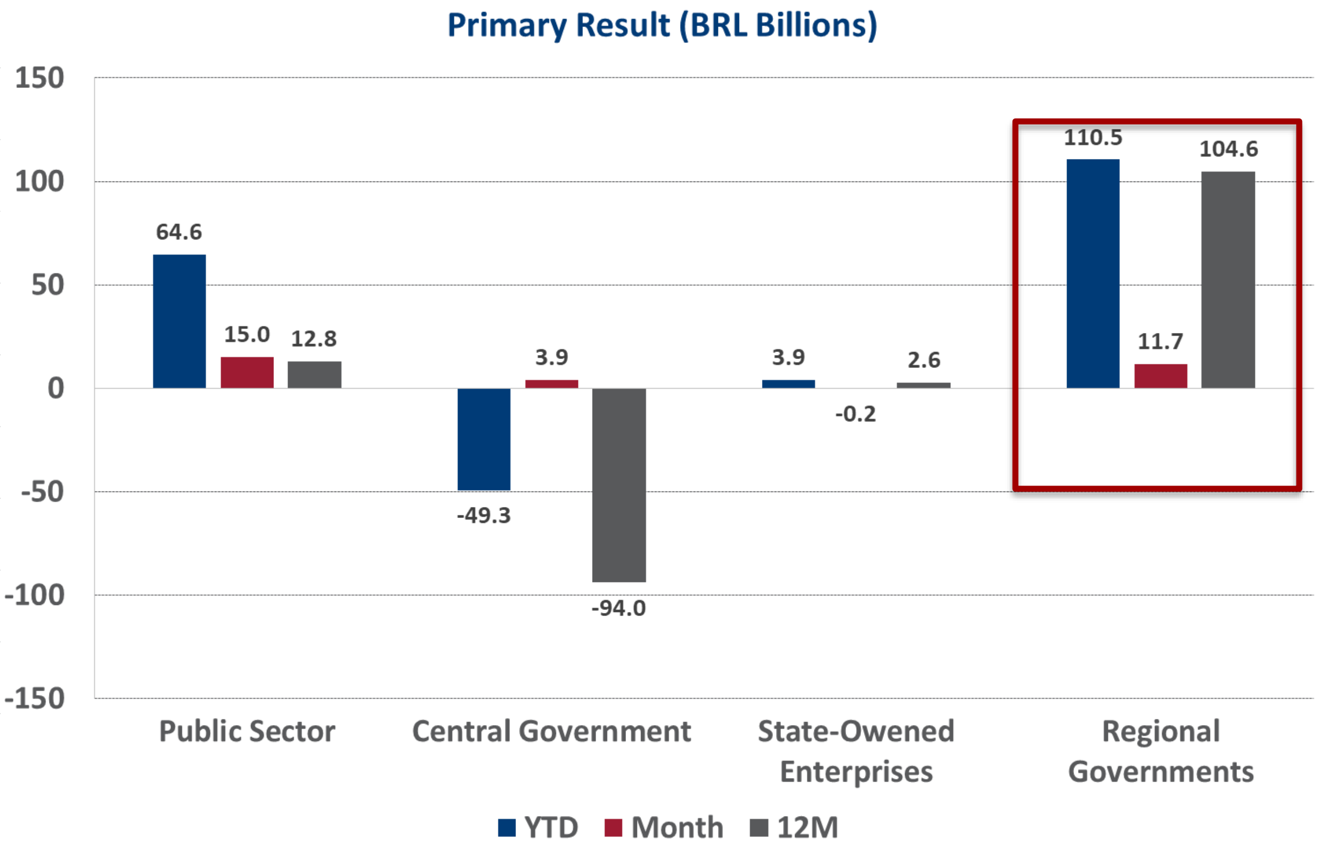


Source: BCB, BOCOM BBM, IBGE

Brazil: Fiscal - Public Sector

- 2021's good results were boosted by more revenue and less expenses;
- Positive primary result of the public sector this year reflects the good performance of regional governments.

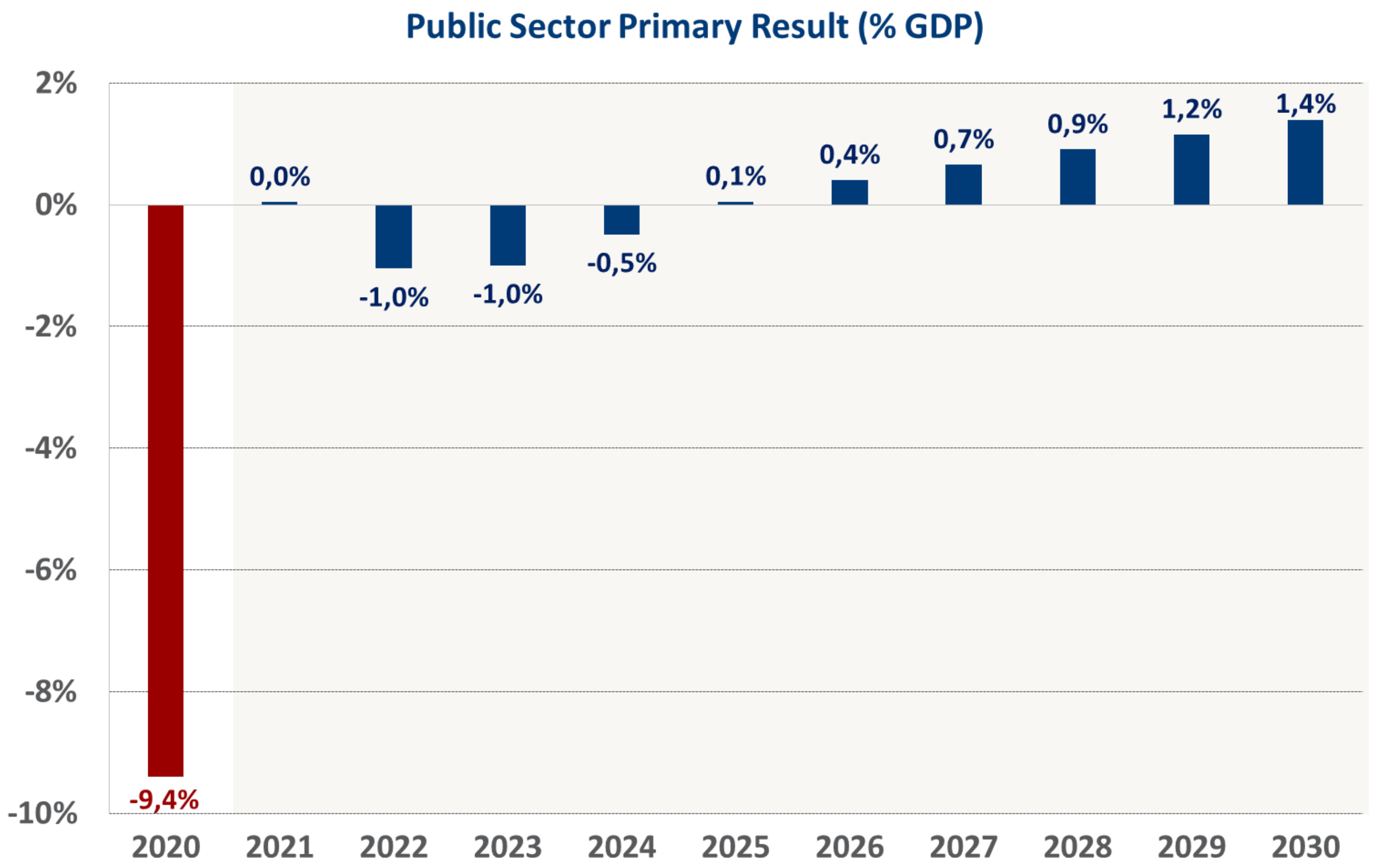




Source: BOCOM BBM, Brazilian Central Bank

Brazil: Fiscal - Public Sector

» Our current projections for the Public Sector Primary Result indicate a surplus from 2025 onwards.

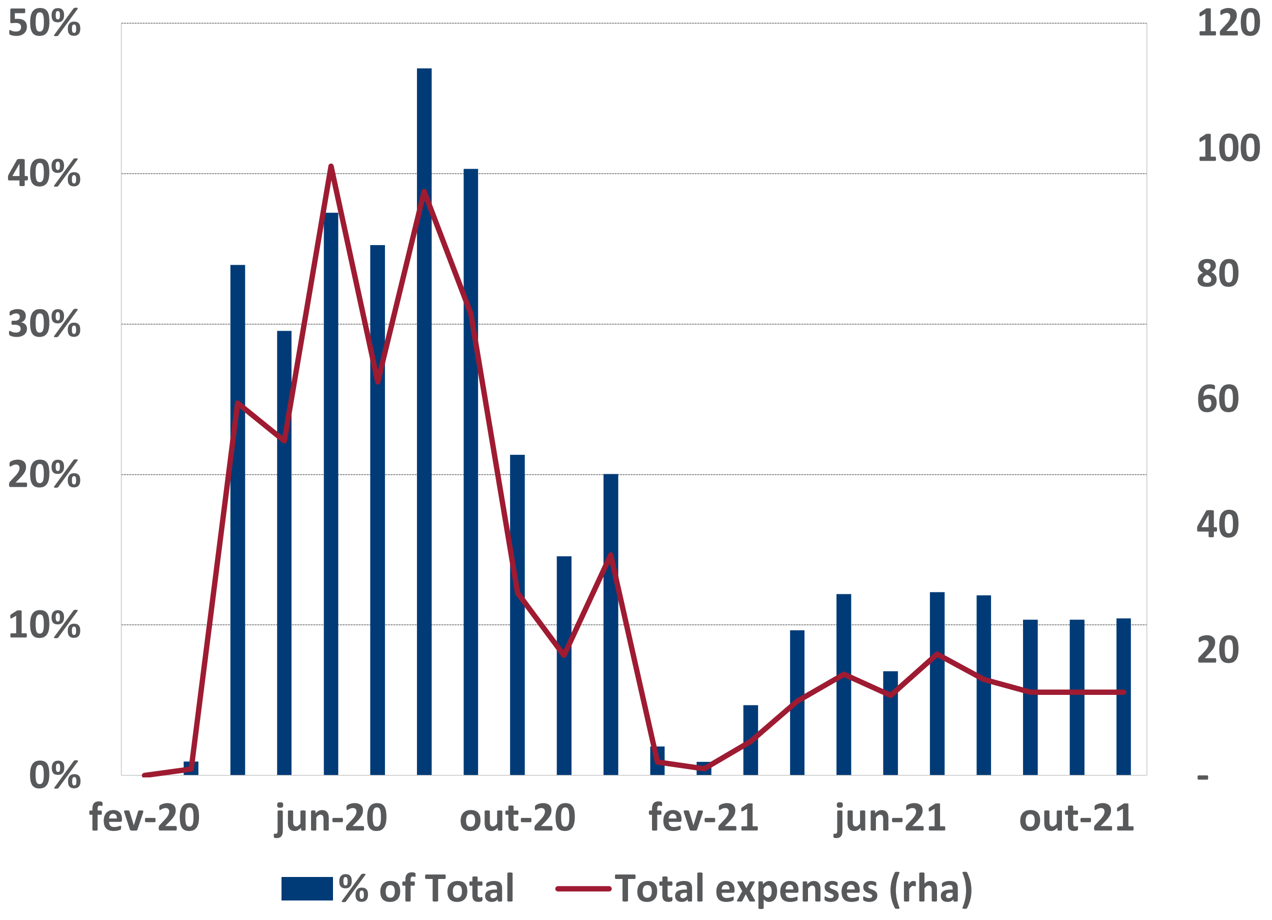


Hypothesis:	
Long Term Selic Rate	7%
Potential GDP	2.2
Elasticity for PIB and Total Revenue	1
Increase Spending Cap 2023 to 2026	0.5%
Increase Spending Cap after 2026	1%

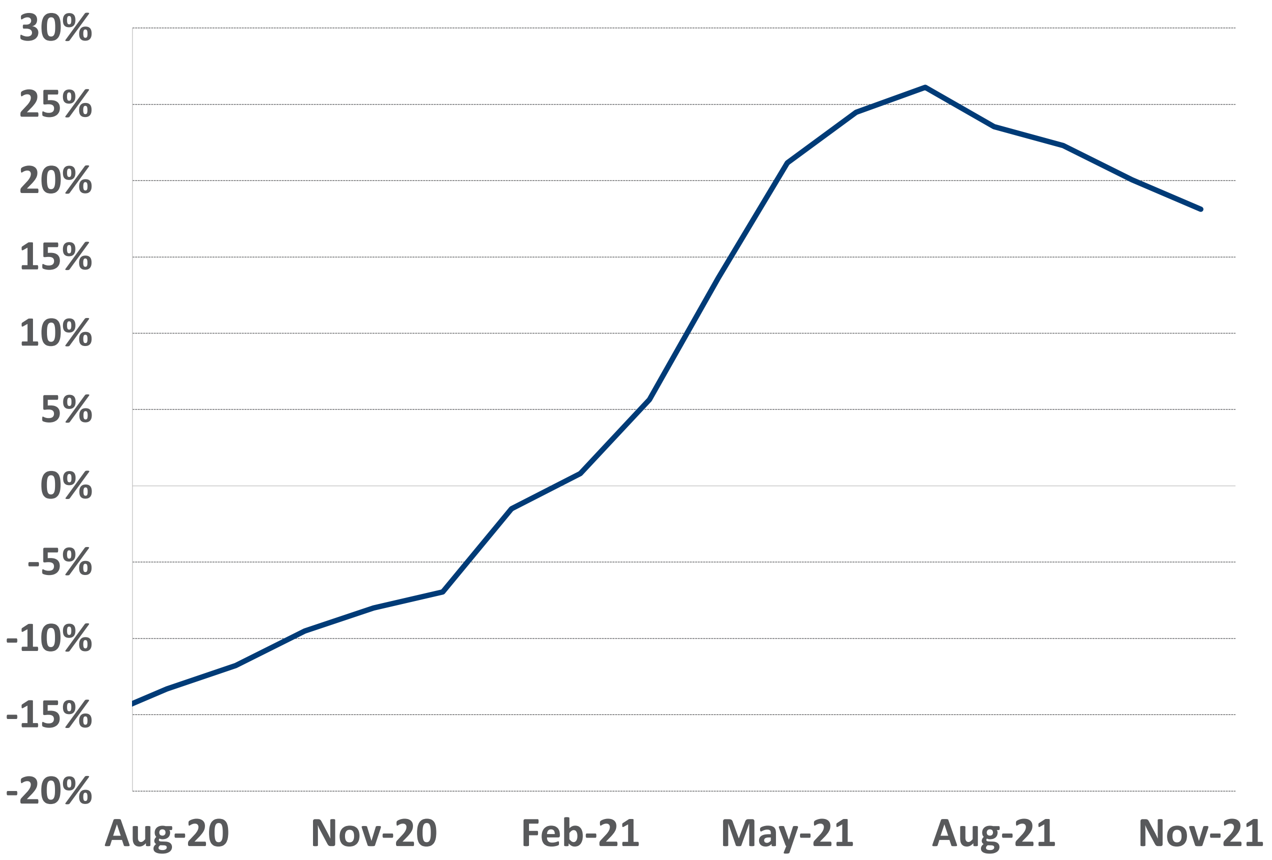
Brazil: Fiscal – Central Government

- Throughout 2021, Central Government's result was driven by both less expenses related to the covid-19 pandemic and positive tax revenue surprises.

Covid-Related Expenses



Real Tax Collection (YTD YoY)



Source: BOCOM BBM, TN

Brazil: Fiscal – Court-Ordered debts

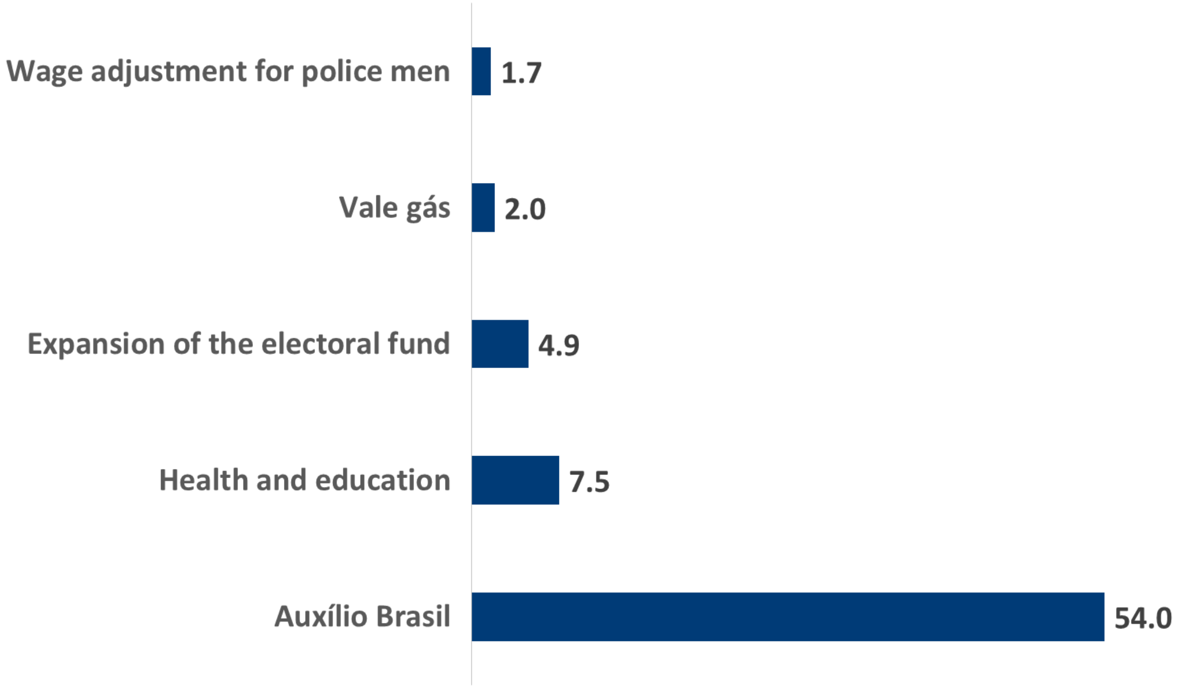
- Considering the impact of the IPCA (corrects the cap) and INPC (corrects expenditures) on the spending cap, we expect a BRL 33 bn in fiscal space in 2022 opened by the new calculation rule. Another BRL 47 bn will be opened in fiscal space with the Court-Ordered debts subcap;

- The space will be filled with extra expenses listed in the annual budget bill (LOA 2022), approved in December.

Fiscal Space after PEC dos Precatórios

BRL Billions	2022
Cap and expenses correction [A]	33
Court-ordered debts	
Due to 2022 [B]	89
Subcap [C]	42
Outside cap [D = B - C]	47
Net Space [A + D]	80

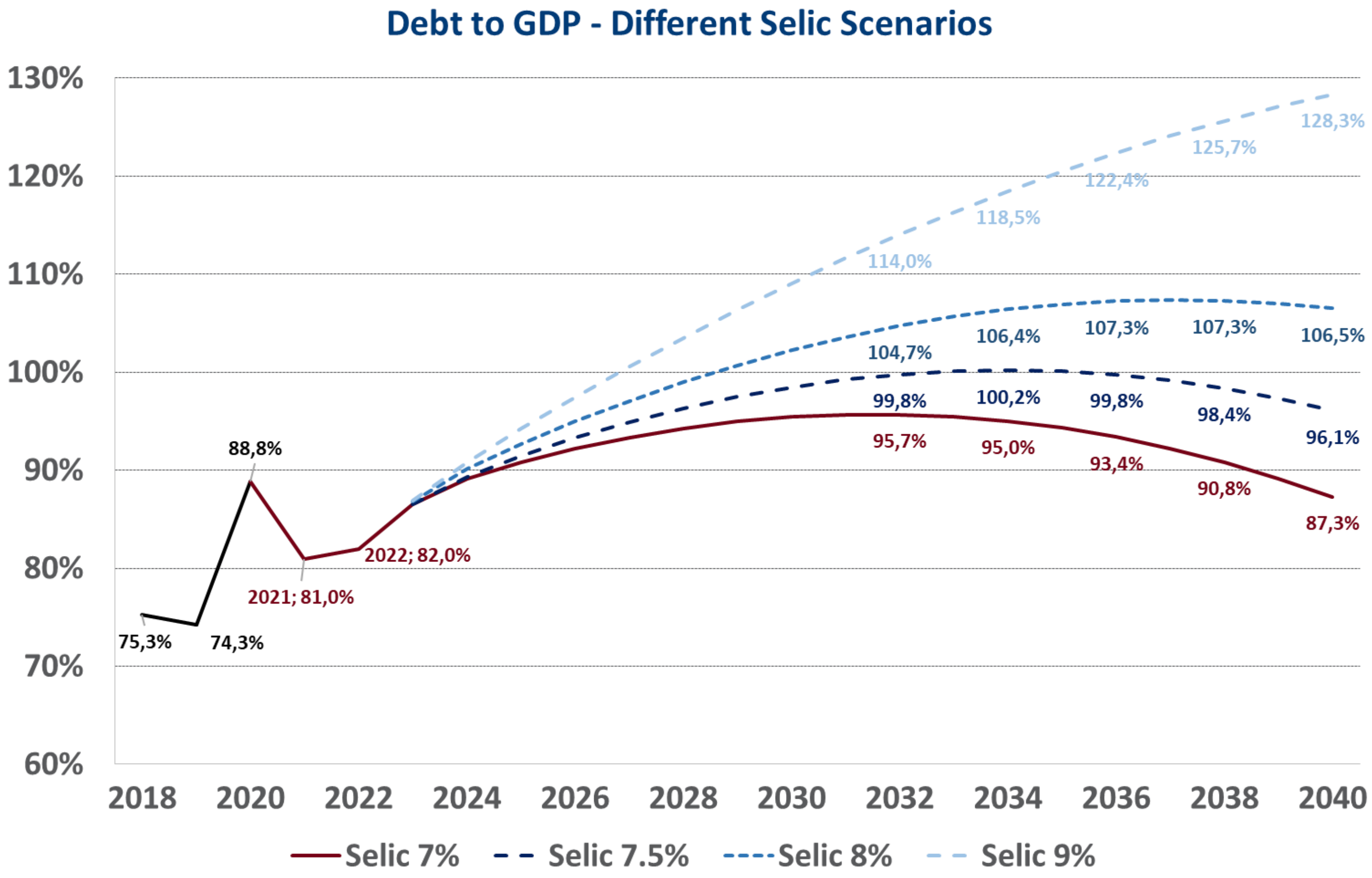
Extra Expenditures in LOA 2022 (BRL bn)



Source: BOCOM BBM, TN

Brazil: Fiscal - Debt trajectory

- Debt to GDP ratio already has a worrisome trajectory in our baseline scenario and any increase in the long-term Selic rate could considerably endanger debt sustainability.

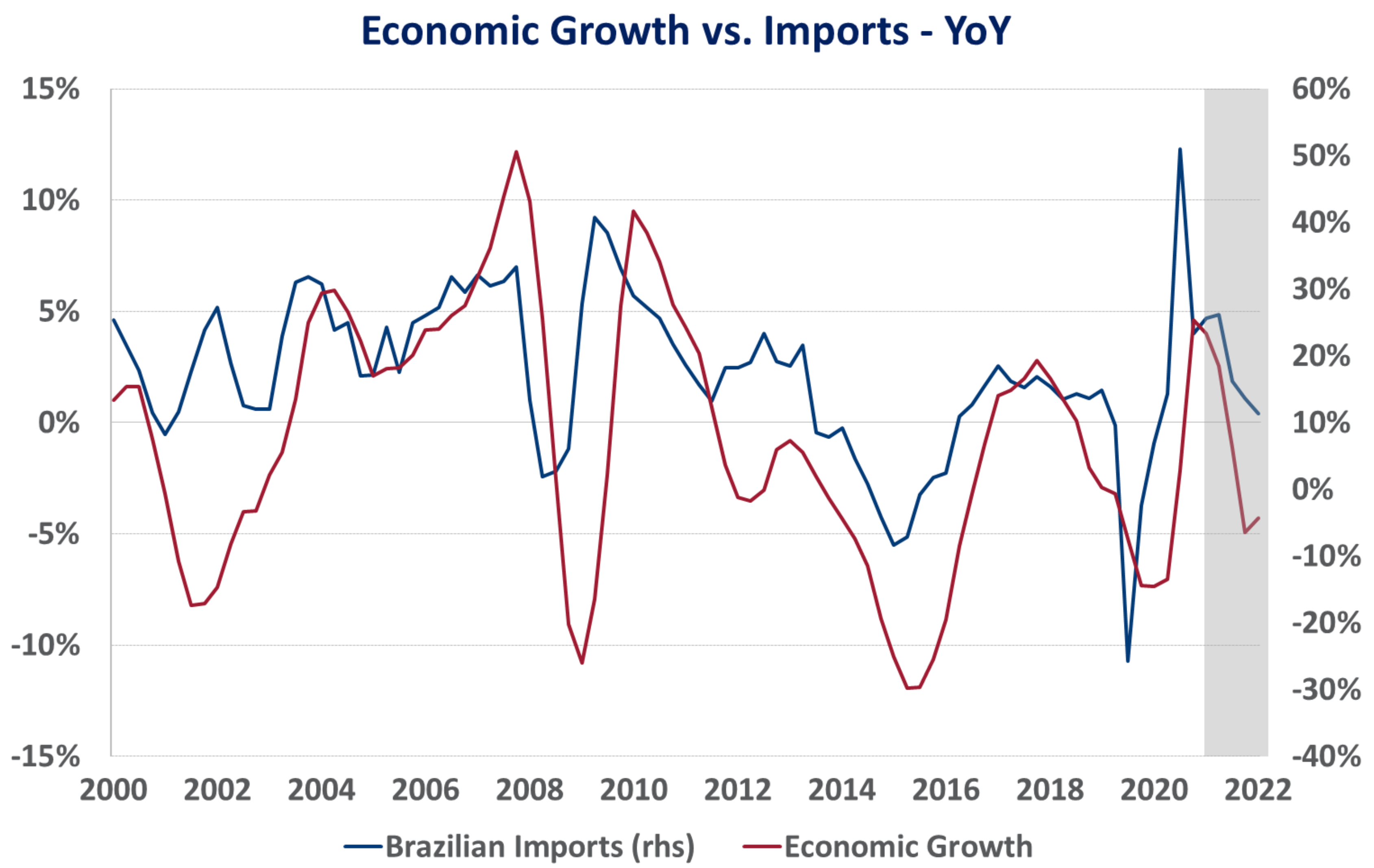


Other Hypothesis:	
Potential GDP	2.2%
Increase Spending Cap 2023 to 2026	0.5%
Increase Spending Cap after 2026	1%
GDP Deflator	3.4%
Long Term CPI	3%

Source: BOCOM BBM

Brazil: Trade Balance

» The expectation of low GDP growth in Brazil will reduce imports in 2022.



Source: BCB, BOCOM BBM

Brazil: Trade Balance

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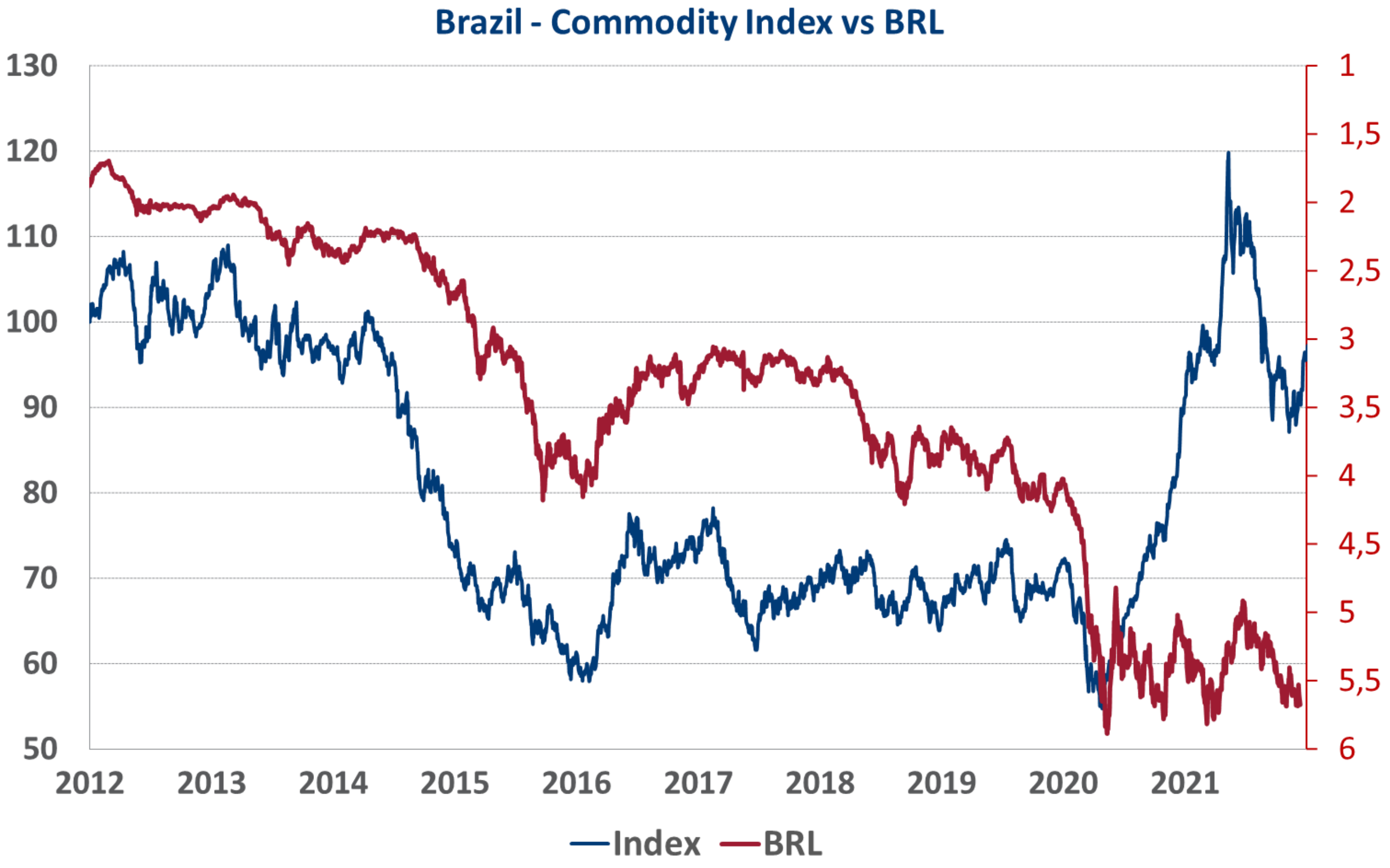
» At the same time, economic recovery throughout the world will continue to keep exports strong in 2022 and thus will help the current account to continue stronger than in the years before the pandemic.

Source: BCB, BOCOM BBM

Brazil: External Sector

» Commodity index reversed its downward trend and started to increase , while the BRL remains relatively stable at depreciated level.



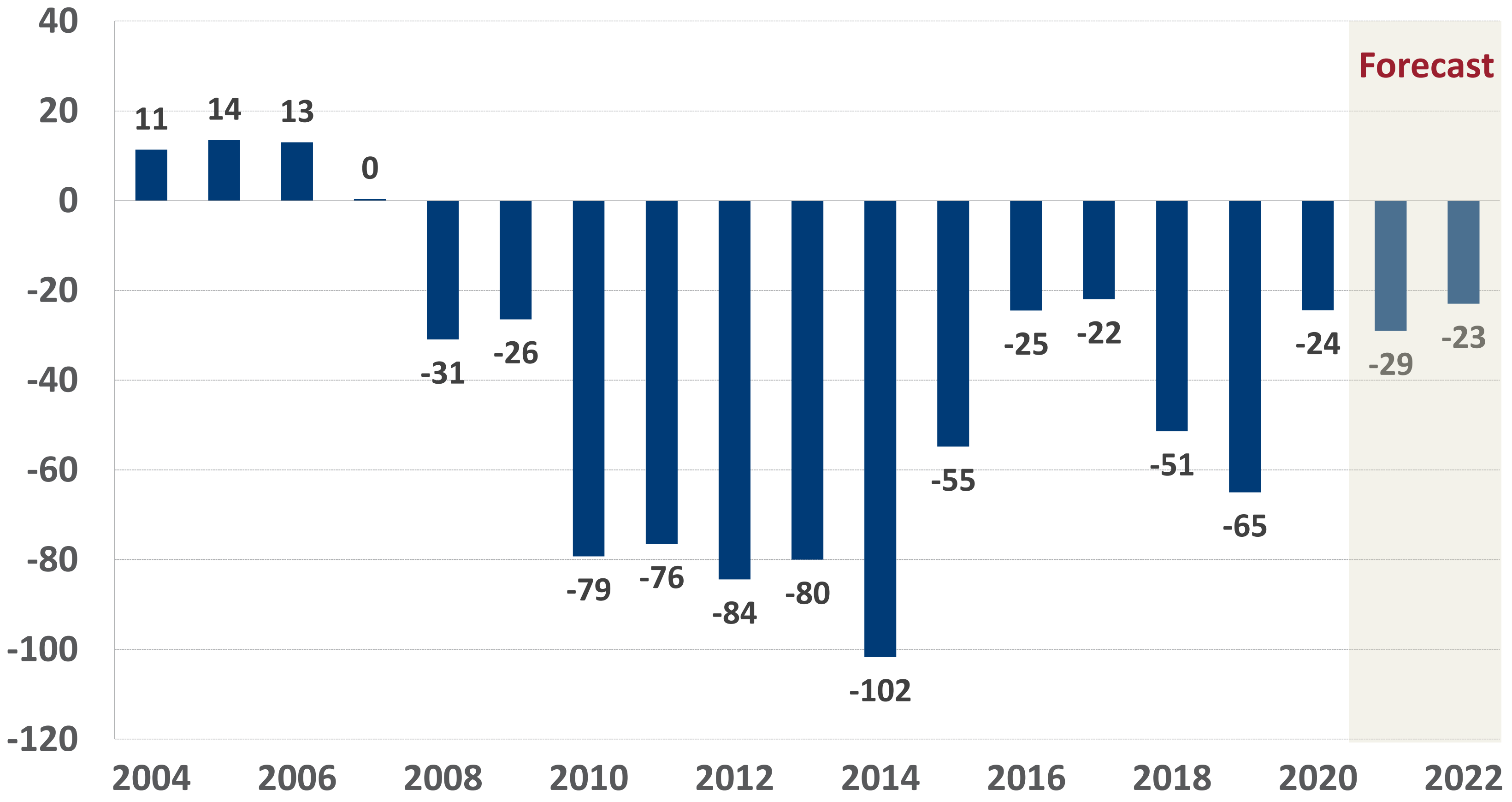
Source: Bloomberg, BOCOM BBM

Source: BCB, BOCOM BBM, MDIC

Brazil: Balance of Payments

- The trade balance is the main driver of the current account improvement in 2021, but Repetro operations and downfall of some commodities prices and the blockage to some exports pushed the value down;
- The 2022 expectation is that the improvement in comparison to 2019 and 2018 will continue due to still elevated prices of commodities and a depreciated BRL, but mainly because of a weak economic growth expected to 2022.

Current Account Balance - USD Billion



Source: BCB, BOCOM BBM

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