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China and the United States at different stages of the cycle

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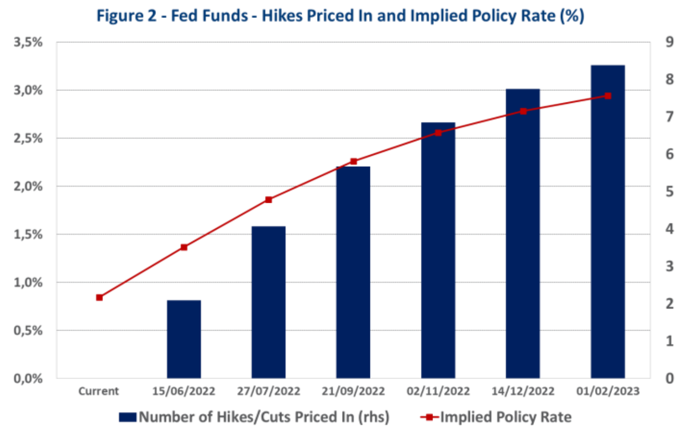
In response to the advance of vaccination, the generous fiscal and monetary stimulus measures implemented during the pandemic and the gradual regularization of global supply chains, several indicators of activity and inflation have improved to such an extent that they now point to overheating in a number of important developed and emerging economies.

In the United States, for example, unemployment has reached 3.6%, close to the rate seen before the pandemic, the lowest in 50 years. The tightness of the US labor market is also evidenced by the number of vacancies, which exceeds the number of job seekers by about 5 million. As for inflation, which for a long time reflected global supply chain bottlenecks and rising energy commodity prices, it is now clearly more inertial as part of a wage-price spiral. The FOMC recently decided to ratchet up the pace of monetary tightening, raising the target range for the fed funds rate by 50 bps, double the previous rate hike. The target range is now 0.75%-1%. The markets expect four more hikes of 50 bps until year-end, taking the target range to 2.75%-3% in December 2022 (Figure 1).

Figure 1 - US: CPI, PCE vs Unemployment Rate

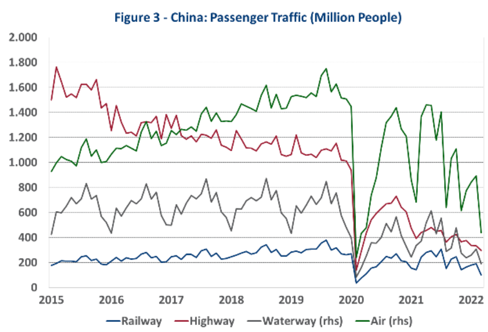
Source: BEA, BLS, Bocom BBM

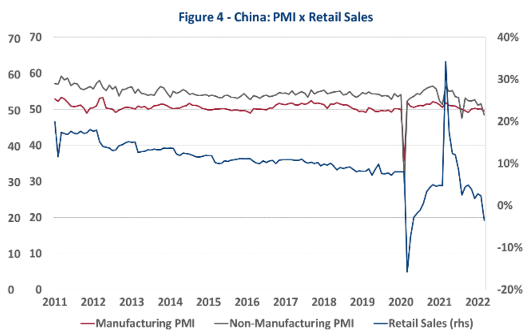
According to Fed Chair Jerome Powell, the tightening of financial conditions, which includes a reduction in the Fed's balance sheet as well as rate hikes, presents an opportunity to make the necessary adjustments without too much turbulence, thanks largely in his view to the healthy state of the US economy, which is deleveraged and close to full employment. However, successive supply shocks, such as commodity price rises due to the conflict between Russia and Ukraine, and global supply chain disruption due to lockdowns in China, entail risks (Figure 2).



Source: Bloomberg

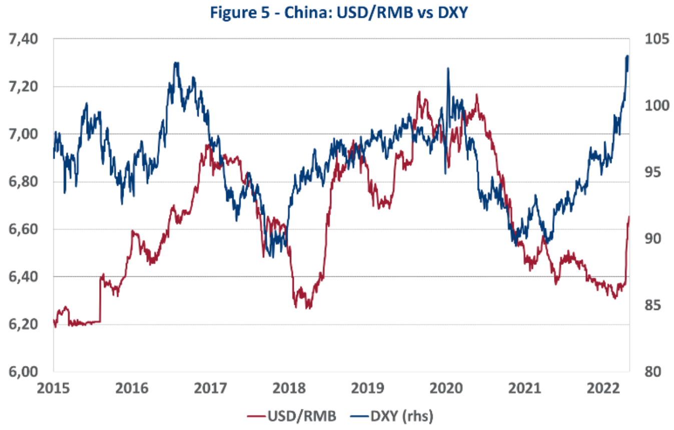
In contrast with the US, China displayed clear signs of deceleration, amplified by the strict lockdowns imposed on cities with cases of Covid-19. In Shanghai, case numbers surged to the highest level since the start of the pandemic, and mobility was severely limited (Figure 3). Despite vigorous first-quarter GDP growth, which surpassed expectations, data for March and April showed a sharp drop in activity, with a downtrend in retail sales, the PMI and real estate market indicators (Figure 4). Meeting the 5.5% growth target looks more and more of a challenge, which has justified a number of economic stimulus measures, such as expansion of investment in infrastructure projects, tax incentives, and an increase in the credit lines provided by local government.





Source: CEIC Data, Bocom BBM

The ongoing US monetary tightening cycle has considerably narrowed the spread between interest rates there and in China, limiting the scope for additional monetary stimulus measures by Beijing and leading to a net outflow of capital from China, with depreciation of the Chinese currency. The correction serves to bolster China's trade balance, which has been the main driver of Chinese growth in 2022 (Figure 5). While the zero-Covid lockdown policy tends to fuel the imbalances in global production and supply chains, adding to US inflationary pressures, on the other hand the tightening of international financial conditions limits China's capacity for monetary stimulus and means that the Chinese currency will continue to weaken.



Source: CEIC Data, Bloomberg

In Brazil, the latest meeting of the Central Bank's Monetary Policy Committee (Copom) raised its policy rate (Selic) by 100 bps to 12.75%. The committee anticipates a probable extension of the cycle, albeit with a smaller hike, at the June meeting, in light of acute international uncertainty, exchange-rate and commodity price volatility, and the inertial risks of current inflation. We expect a hike of 50 bps at the next meeting, taking the Selic to 13.25% at the end of the cycle. According to the Central Bank's weekly survey of analysts (*Focus*), inflation expectations continue to deteriorate, and new electricity price rises, alongside local currency depreciation and rising oil prices, continue to pressure inflation, making an extension of the monetary tightening cycle to another meeting after June a distinct possibility.

Our inflation projection is now 8.5% for 2022 and 4.2% for 2023. The growth outlook for 2022 has become more favorable thanks to a strong recovery by the labor market and service sector. We project growth of 0.9% in 2022 and 0.5% in 2023, with monetary policy remaining restrictive until at least the start of 2023.

ECONOMIC FORECASTS	2019	2020	2021	2022F	2023F
GDP Growth (%)	1,1%	-4,1%	4,6%	0,9%	0,5%
Inflation (%)	4,3%	4,5%	10,1%	8,5%	4,2%
Unemployment Rate (eoy ,%)	11,7%	13,9%	11,1%	11,8%	11,6%
Policy Rate (eoy, %)	4,5%	2,0%	9,3%	13,3%	9,0%
External Accounts					
Trade Balance (US$ bn)	48	32	36	68	45
Current Account Balance (US$ bn)	-65	-24	-28	-14	-40
Current Account Balance (% of GDP)	-2,8%	-0,9%	-1,8%	-0,8%	-2,6%
Fiscal Policy					
Central Government Primary Balance (% of GDP)	-1,2%	-10,0%	-0,4%	-0,4%	-0,6%
Government Gross Debt (% of GDP)	74,3%	88,8%	80,3%	77,8%	81,7%