BBVA Research

Brazil Economic Outlook

1Q20

January 2020

Creando Oportunidades

Main messages

The Brazilian economy will continue to recover gradually in the coming years. After having grown around 1.1% in 2019, GDP is expected to expand 1.9% in 2020 and 2.0% in 2021, when it will finally reach the level exhibited before the severe crisis of 2015-16.

The improvement of the global environment, the expansionary monetary policy in a context of inflation under control, the gradual increase in confidence, the reduction of the fiscal risk allowed by the recent approval of the social security reform, among other factors, will allow the growth pace to increase somewhat in the biennium 2020-21.

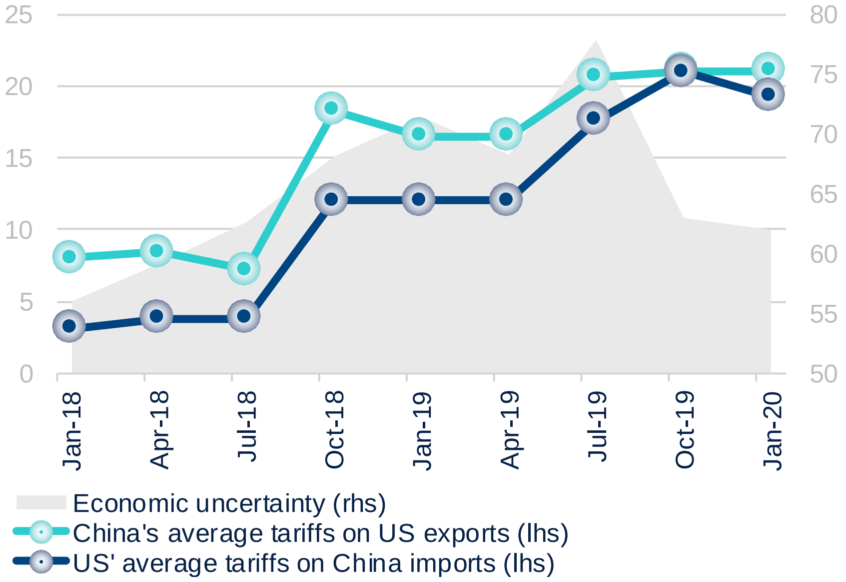
In order for Brazil to grow significantly above 2%, it is essential to implement structural reforms that increase productivity. Although there are signs that the current government intends to do so, there are many obstacles to finally making progress in this direction, such as political polarization and concerns about sparking social protests.

01

Global environment: the lower uncertainty paves the way for global growth stabilization

The trade agreement between the US and China has significantly reduced uncertainty, but not protectionism levels

TARIFFS AND ECONOMIC UNCERTAINTY*
(%, INDEX: 0 TO 100)

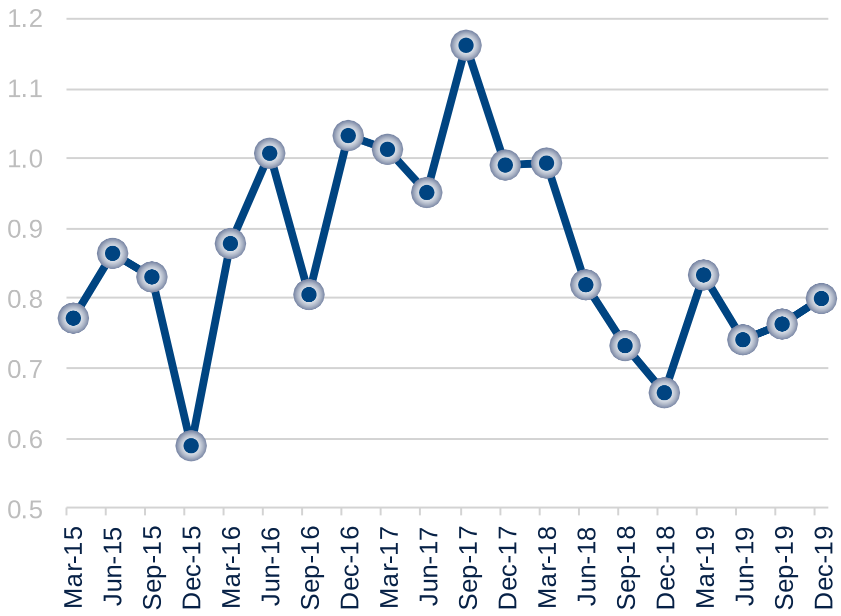


* Average tariffs at the beginning of each quarter. BBVA Research Index of Economic Uncertainty: tone of the news about economic uncertainty; quarterly average (except 1Q20: average until January 9, 2020).
Source: BBVA Research, PIIE

- US-China "phase one" trade deal is positive news, but partial:
  - Import tariffs will continue to be high despite the announced reductions.
  - We are still far from a definitive solution to structural problems.
- The risk of disorderly *brexit* in the short-term has disappeared, contributing to reduce global uncertainty, but it can resurface in the second half of the year.

Global growth has remained relatively low throughout 2019

WORLD GDP GROWTH*
(% Q/Q)

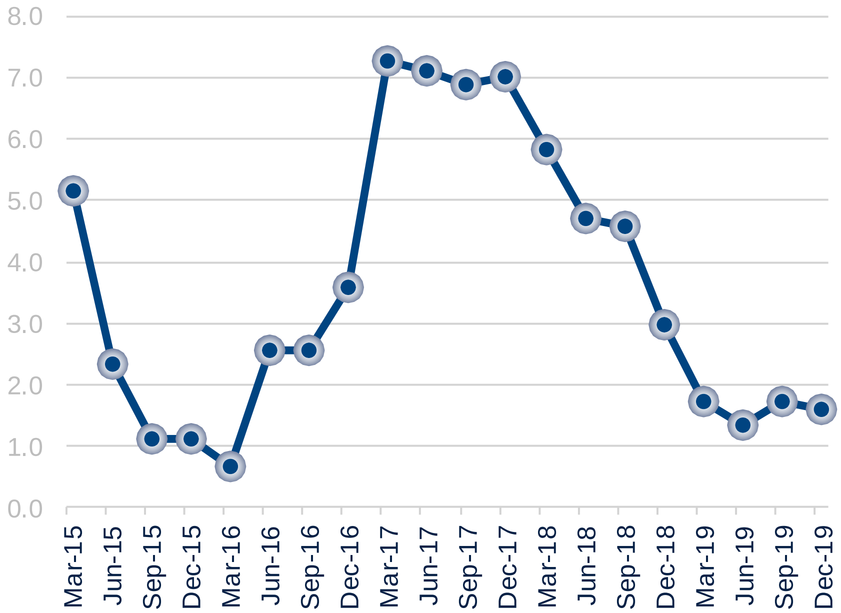


* Estimations based on BBVA-GAIN model.
Source: BBVA Research

- The world economy expanded around 0.75% in quarterly terms throughout 2019, below what was observed in previous years.
- In addition to the high uncertainty, the structural moderation of China and the cyclical slowdown of the US were behind the weak global growth in 2019.
- In any case, global growth has been slightly higher than expected in the second half of the year.

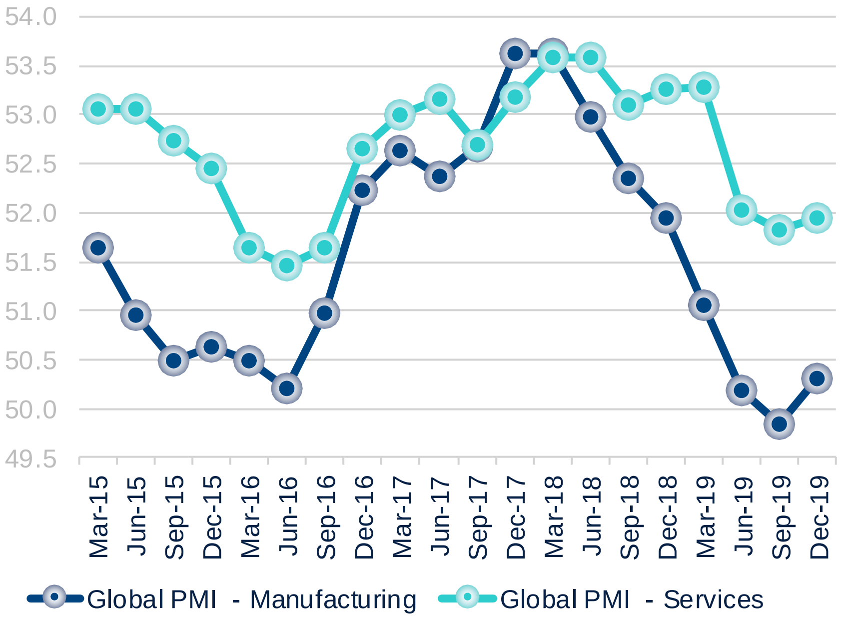
Signs of stabilization: the slowdown of both exports and services as well as the contraction in manufacturing seem to be over

EXPORTS*
(% Y/Y, ANNUAL GROWTH AVERAGE IN EACH QUARTER)



* 4Q19 average only includes Oct/19 and Nov/19 data.
Source: BBVA Research

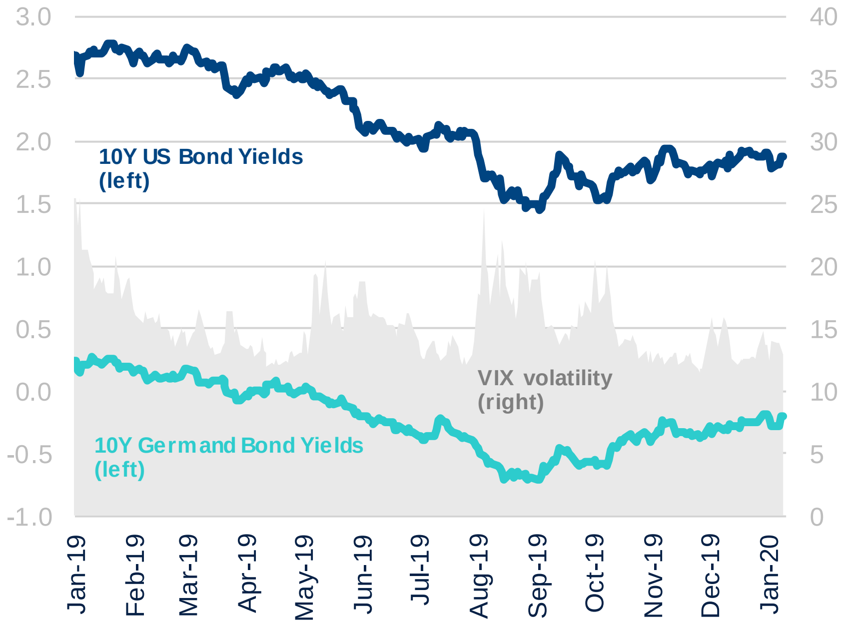
PMI INDICATORS
(HIGHER THAN 50: EXPANSION; LOWER THAN 50: CONTRACTION)



Source: BBVA Research based on Haver data

Financial markets exhibit a better mood

SOVEREIGN DEBT YIELDS AND EQUITY VOLATILITY
(%, INDEX)



Source: BBVA Research based on Haver data

- The recent improvement of the global environment has spurred some optimism in the financial markets:
  - Volatility reduction
  - Recovery of long-term rates
  - Stock Market improvement
  - Increased appetite for risk

The environment will favor a soft landing of global growth

LOWER TRADE TENSIONS

- **US-China positive but partial deal.**
- **Protectionism** will continue to be a source of concern, also in other regions.
- **A less disruptive *brexit***, at least in the short-term.

COUNTER-CYCLICAL POLICIES

- The expansionary tone of **monetary policy** will be maintained, following recent rate cuts.
- A limited **fiscal stimulus** in Europe and somewhat greater in China.

LIMITED FINANCIAL VOLATILITY

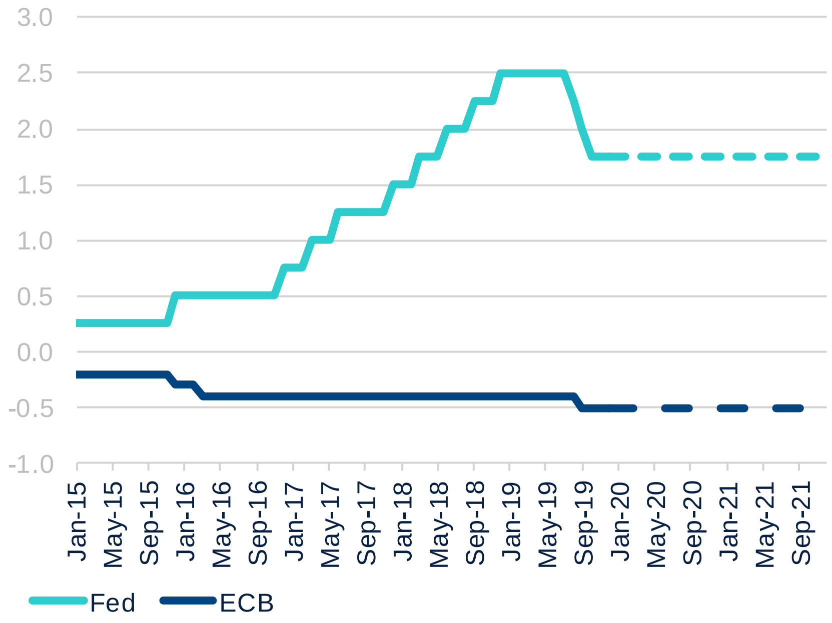
- Volatility will be limited by the **actions of central banks.**
- Some **appetite for risk.**

COMMODITY PRICES UNDER CONTROL

- **Oil prices** around 61 dollars in 2020-21
- Relative **weakness of demand** and **increase in the supply of non-OPEC countries.**

Pause at both the Fed and the ECB: no prospects for changes in interest rates on the horizon

FED AND ECB: INTEREST RATES*
(%, END OF PERIOD)

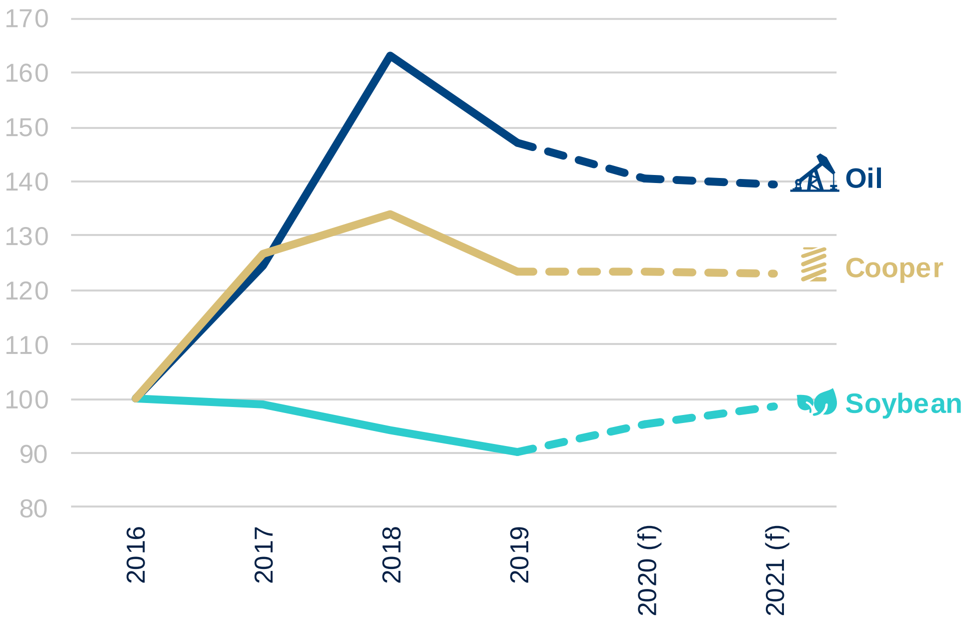


* In the case of the ECB, deposits interest rates. Forecasts from Jan/19 onwards.
Source: BBVA Research

- Fed: the relative resistance of the economy improves the balance of risks and generates the conditions for a long monetary pause.
- ECB: growth stabilization and the communication by the new presidency reinforce the expectations of interest rate stability.

Better prospects for commodity prices, which, however, will remain relatively low

COMMODITIES: AVERAGE ANNUAL PRICES
(INDEX, 2016 AVERAGE = 100)



(f) Forecast.
Source: BBVA Research

- Moderate upward revision in forecast for commodity price, due to less pessimism about the global environment:
  - Oil: 2020 forecasts revised 8% up to 61 dollars.
  - Copper and soybean: 2020 forecasts revised 4% and 1% to the upside, respectively.
- Anyway, prices will remain under control given the relative robustness of supply in a context of lower demand.
- The escalation of tensions in the Middle East represents a risk: an oil price of $ 70 in 2020 would reduce world growth by one or two decimal points.

Global growth will converge to 3.2% in 2020 and 3.3% in 2021

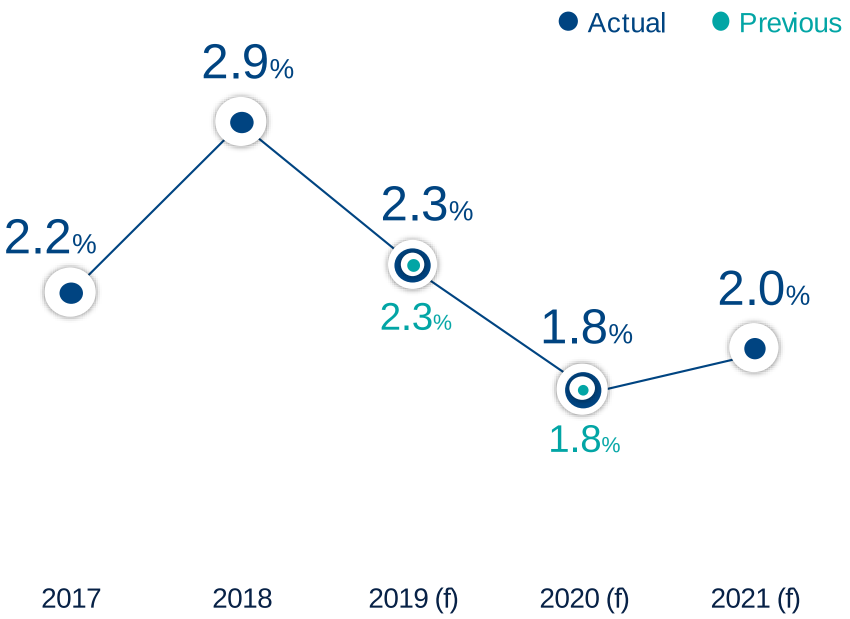
	USA	Latam	Eurozone	China	World
2018	2.9	1.6	1.9	6.6	3.6
2019	2.3	0.6	1.2	6.1	3.2
2020	1.8	1.4	0.9	5.8	3.2
2021	2.0	2.1	1.2	5.5	3.3

Upward revision
Unchanged forecast
Downward revision

Source: BBVA Research

USA: the prospects of a smooth deceleration ahead remain in place

GDP GROWTH
(%)

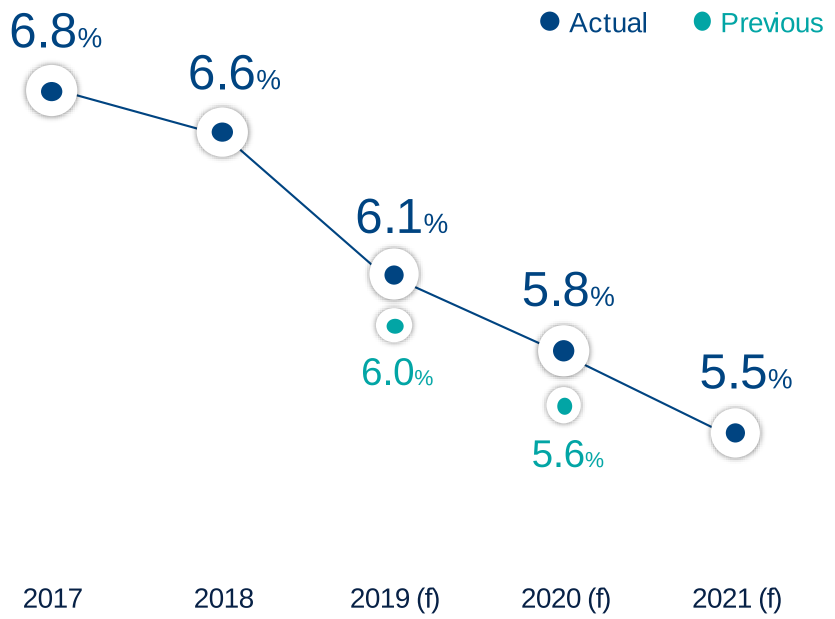


(f) Forecast.
Source: BBVA Research

- Private consumption shows strength, in contrast with the weakness of investment.
- Inflation will remain close to 2.0%, with more balanced risks.
- Probability of recession has declined.
- The 2020 presidential elections may increase political and geopolitical tensions.

China: growth slowdown, somewhat slower than expected

GDP GROWTH
(%)

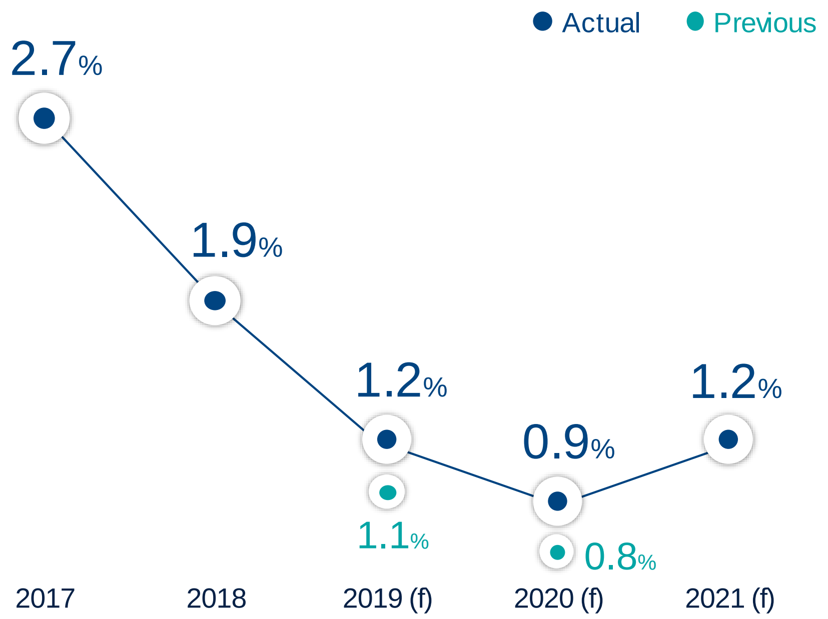


(f) Forecast.
Source: BBVA Research

- A generalized economic slowdown is still in place
- Upward revision of the forecast for 2019: the recent growth deceleration has been smoother than expected.
- Small upward revision of 2020 GDP growth forecast:
  - Improved relation with the US.
  - Greater willingness to increase the fiscal stimulus.
- Monetary stimulus: gradualism moving forward, in a context of temporarily high inflationary pressures.

Eurozone: slightly upward revision of growth forecasts, due to better than expected incoming data

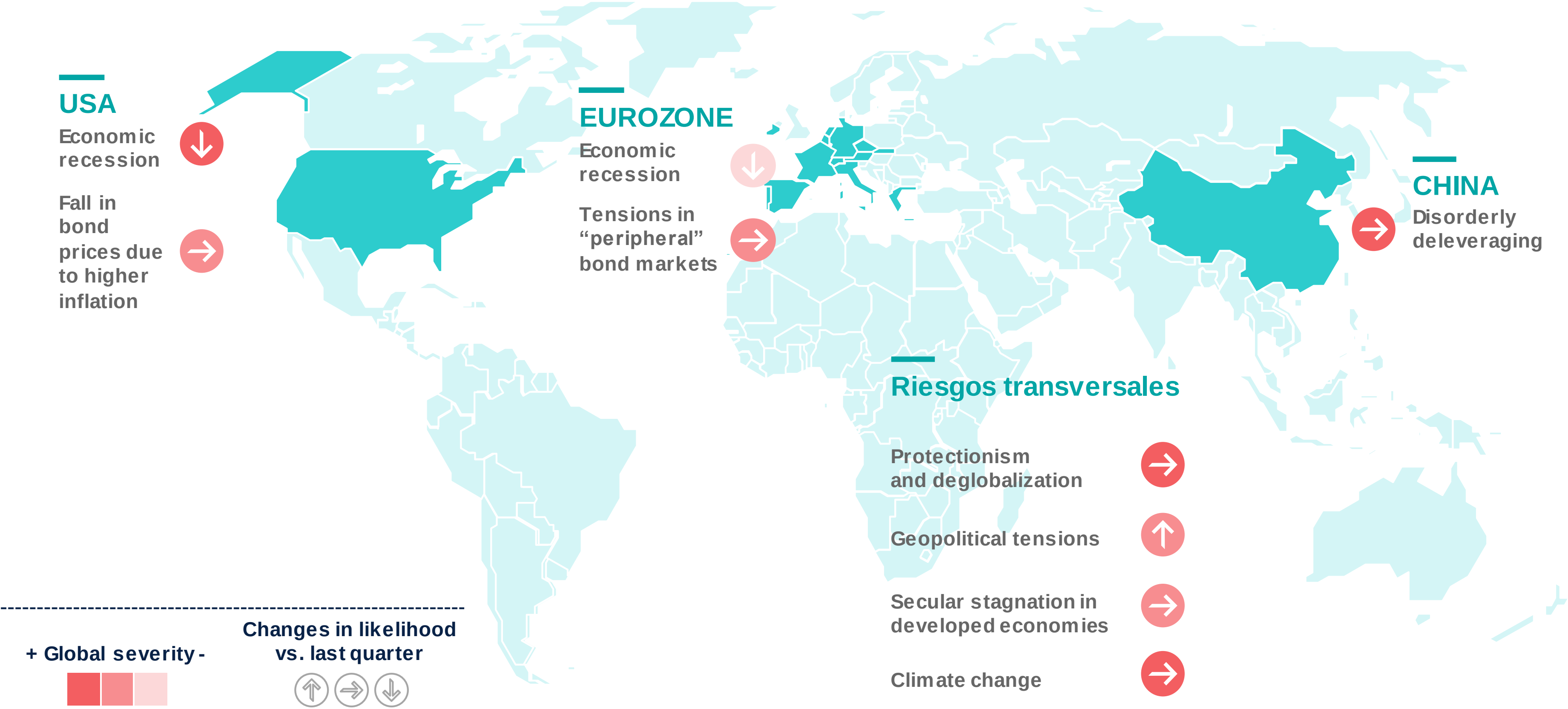
GDP GROWTH
(%)



(f) Forecast.
Source: BBVA Research

- Growth is stabilizing at low levels.
- The economic dynamism will increase from mid-2020, partly due to higher exports.
- The growth divergence among large countries will be reduced, mostly due to a better performance in Germany.
- Inflation will remain very low, despite the strong monetary stimulus and some fiscal support.

Reduction in the cyclical global risks, but not in the structural ones



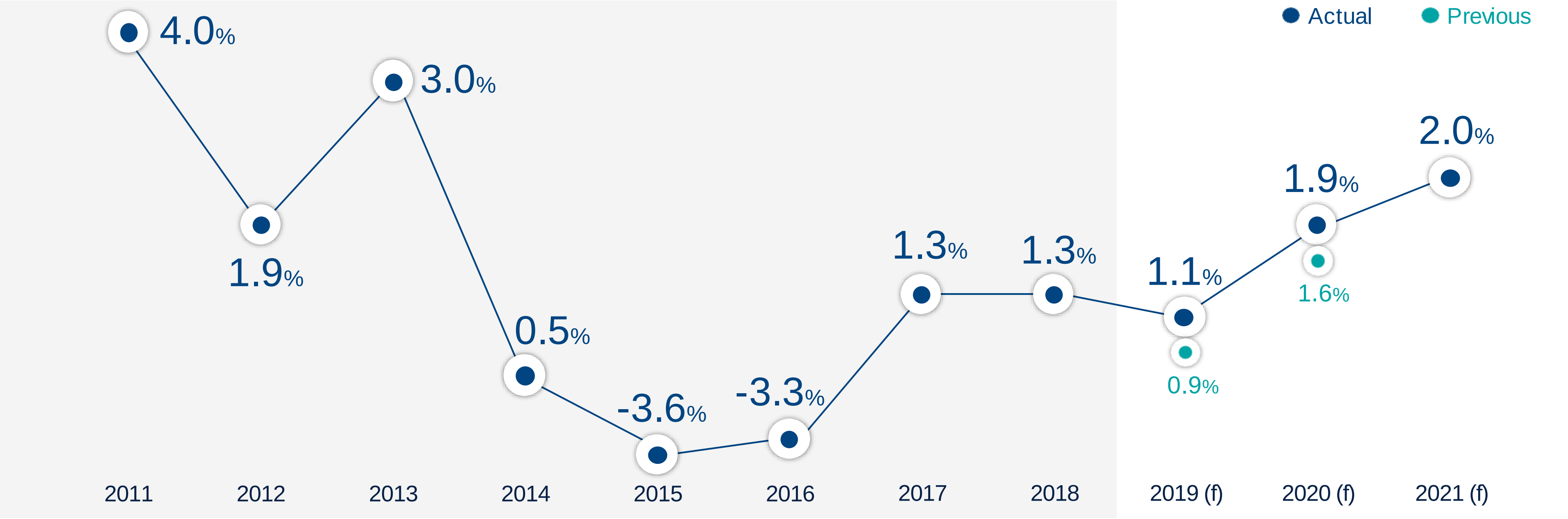
Research

02

Brazil: reinforced recovery prospects

GDP will grow around 2% in 2020 and 2021, somewhat more than in previous years

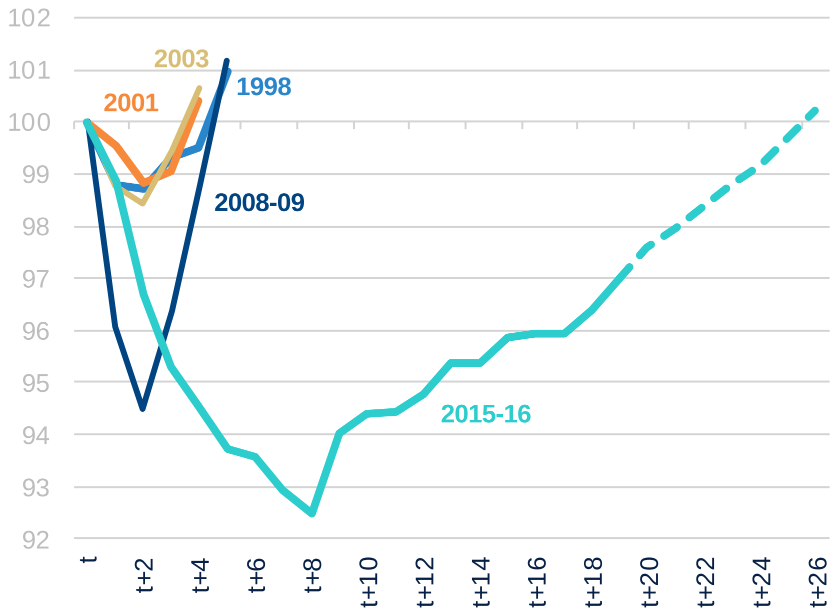
GDP GROWTH
(Q/Q %)



(f) = forecast.
Source: BBVA Research, IBGE

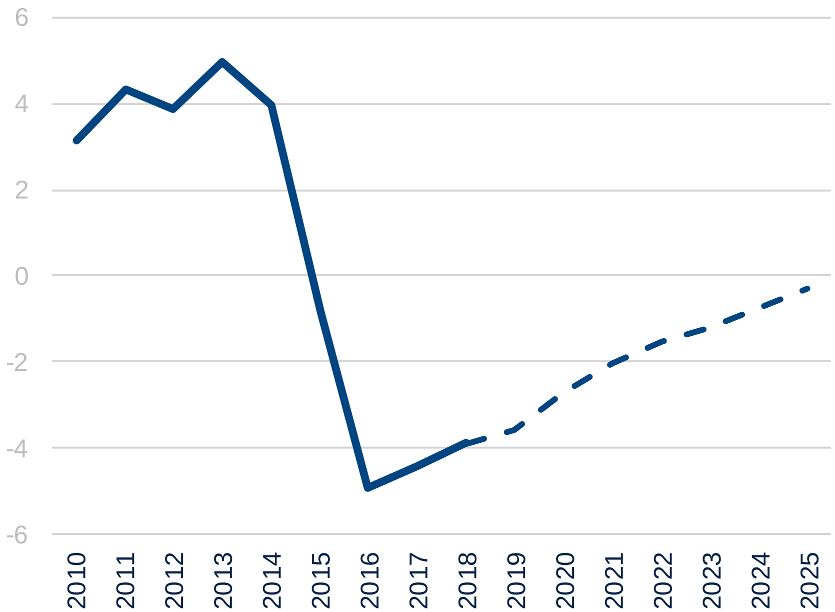
A particularly long recovery, after a particularly severe recession

GDP EVOLUTION DURING RECESSIONS (*)
(T = GDP LEVEL AT THE QUARTER BEFORE EACH RECESSION)



(*) Quarterly GDP in reat terms, seasonally adjusted. Beginning of the recessions (t + 1): 4Q98, 2Q01, 1Q03, 4Q08, 1Q15. For the 2015-16 crisis line, data from 4Q19 on are forecasts.
Source: BBVA Research, IBGE

OUTPUT GAP (*)
(% OF POTENTIAL GDP)

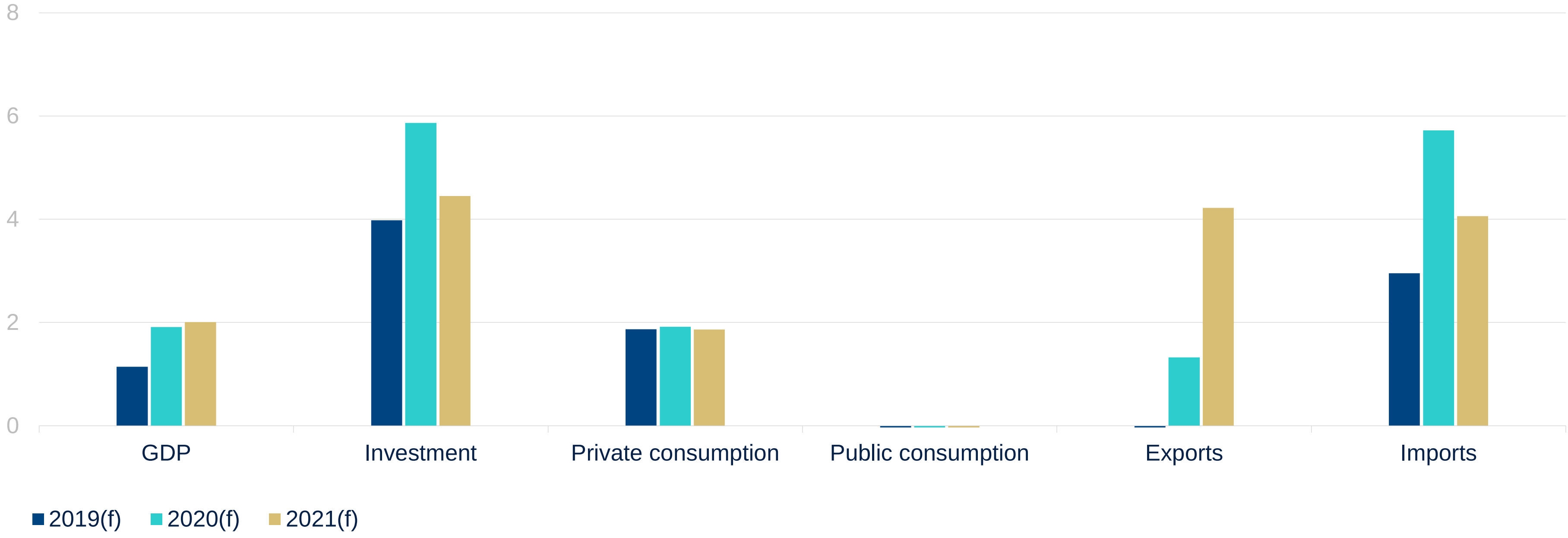


(*) Output gap = 100* (actual or forecast GDP – potential GDP)/ potencial GDP.
Source: BBVA Research

Investment will be the most dynamic component of GDP in the coming years

GROWTH OF GDP AND ITS COMPONENTS (*)

(%)



(*) (f) = forecast.
Source: BBVA Research, IBGE

The expected slow pace recovery is in line with the current balance of positive and negative factors

Factors supporting growth

- Improvement in global environment
- Recovery signs exhibited by incoming activity data
- Increase in confidence
- Aprobación de la reforma de la seguridad social y menor riesgo fiscal
- Relatively low inflation
- Expansionary monetary policy

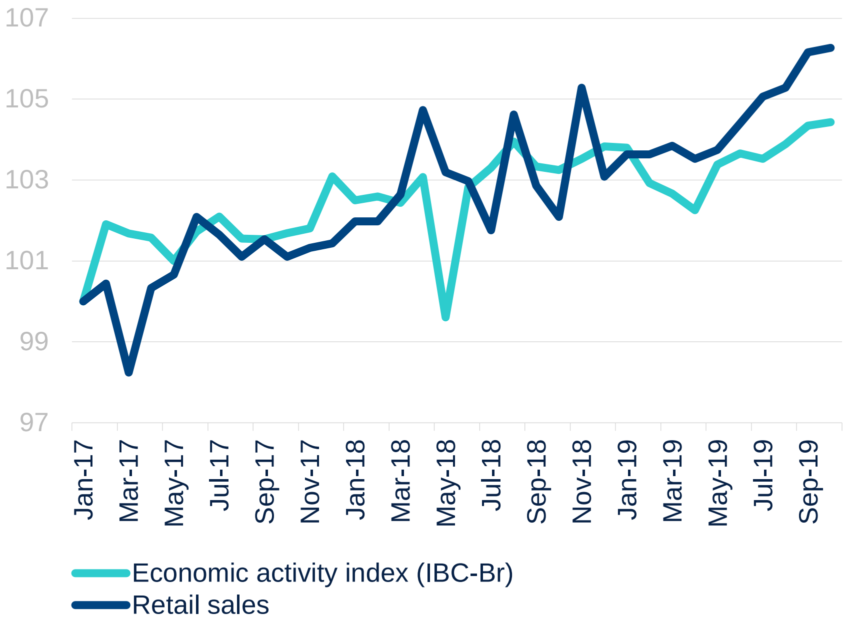
Factors constraining growth

- Weak global growth
- Relatively low commodity prices
- Recession in Argentina
- Scarce room for countercyclical fiscal policy
- Risk of protests and social unrest
- Low productivity

- Government's apparent willingness to adopt economic reforms
- Political risks and obstacles to the approval of economic reforms

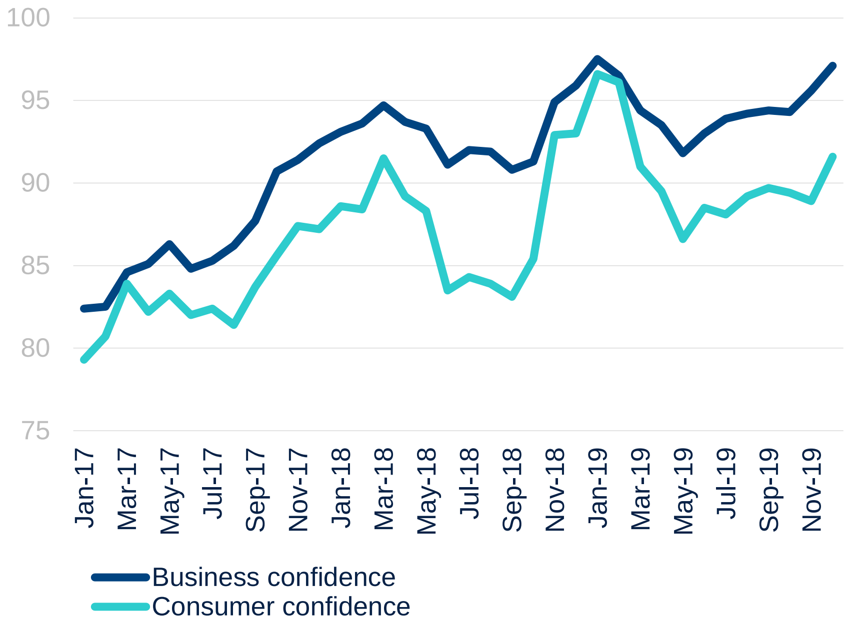
Activity indicators have surprised to the upside in recent months, contributing to drive confidence up

ACTIVITY INDEXES
(JAN/17 = 100, SEASONALLY ADJUSTED)



Source: BBVA Research, BCB, IBGE

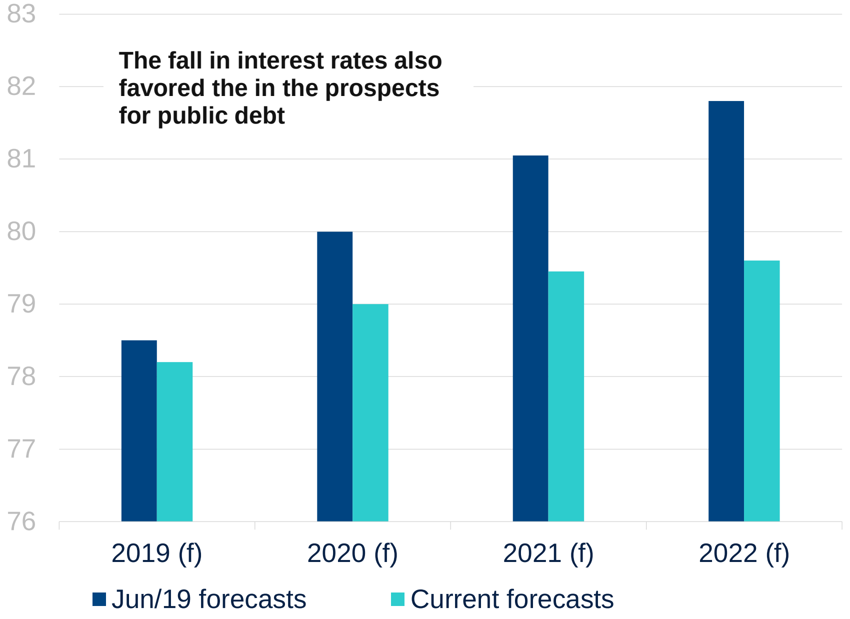
CONFIDENCE INDEXES
(JUN/10–JUN/15 AVERAGE=100, SEASONALLY ADJUSTED)



Source: BBVA Research, FGV

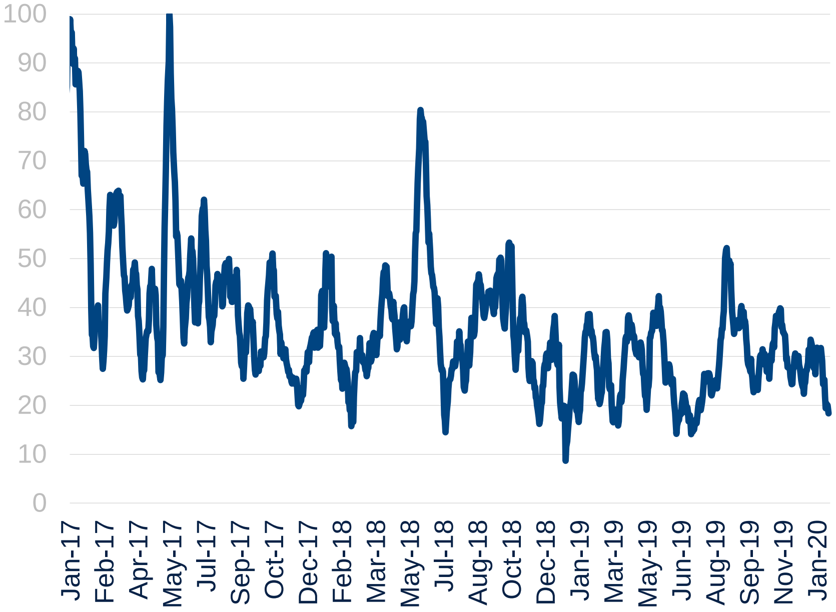
The approval of the social security reform improves the prospects for public accounts and reduces uncertainty

GROSS PUBLIC DEBT (*)
(% OF GDP)



(*) (f) = forecast.
Source: BBVA Research based on market consensus forecast (reports "Prima Fiscal" by the Ministry of Economy)

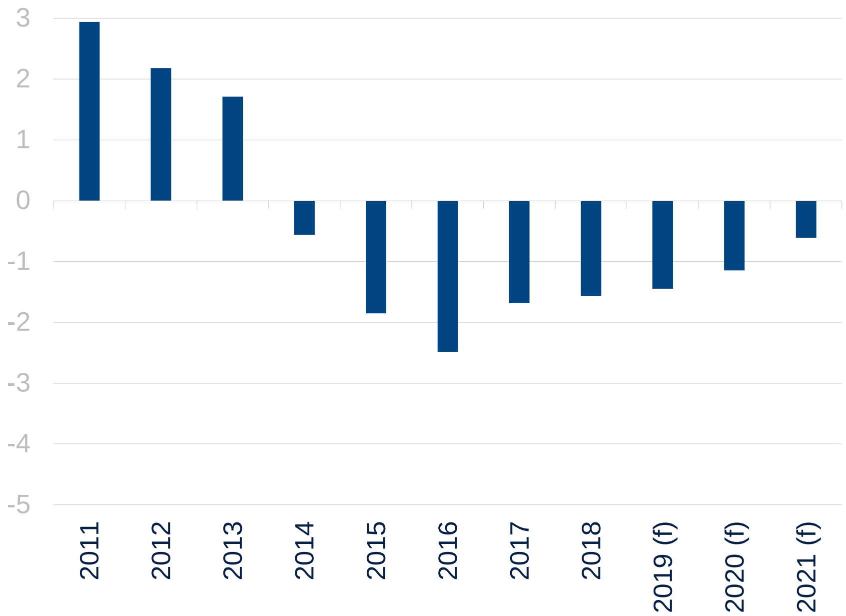
ECONOMIC UNCERTAINTY INDEX (*)
(INDEX FROM 0 TO 100)



(*) Tone of the news on economic uncertainty weighted by media coverage. 10-day moving average.
Source: BBVA Research

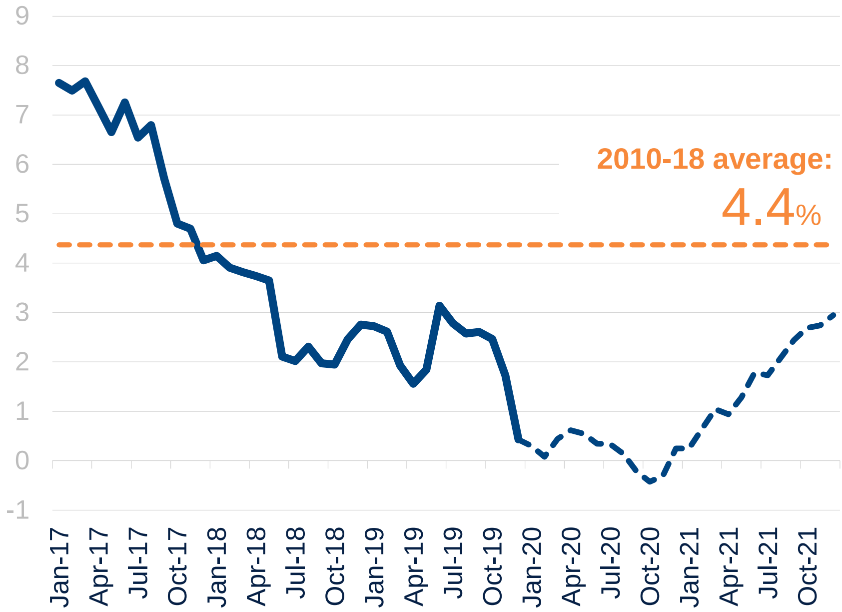
There will be no much room for countercyclical fiscal policy, despite the social security reform; support to activity will come from monetary policy

PRIMARY FISCAL RESULT (*)
(% OF GDP)



(*) (f) forecast.
Source: BBVA Research, BCB

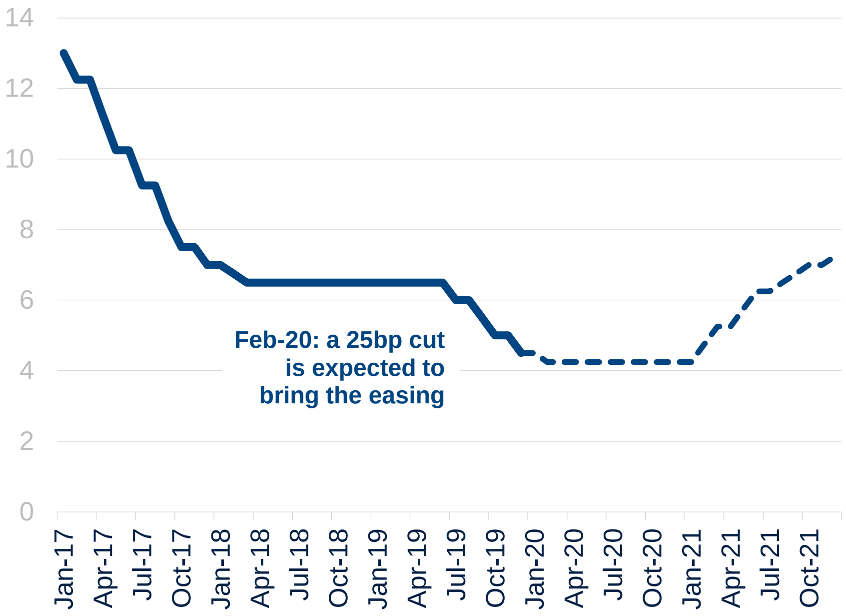
REAL INTEREST RATE: SELIC RATE (*)
(%)



(*) Ex-ante real rate. Forecasts from Jan/20 onwards.
Source: BBVA Research

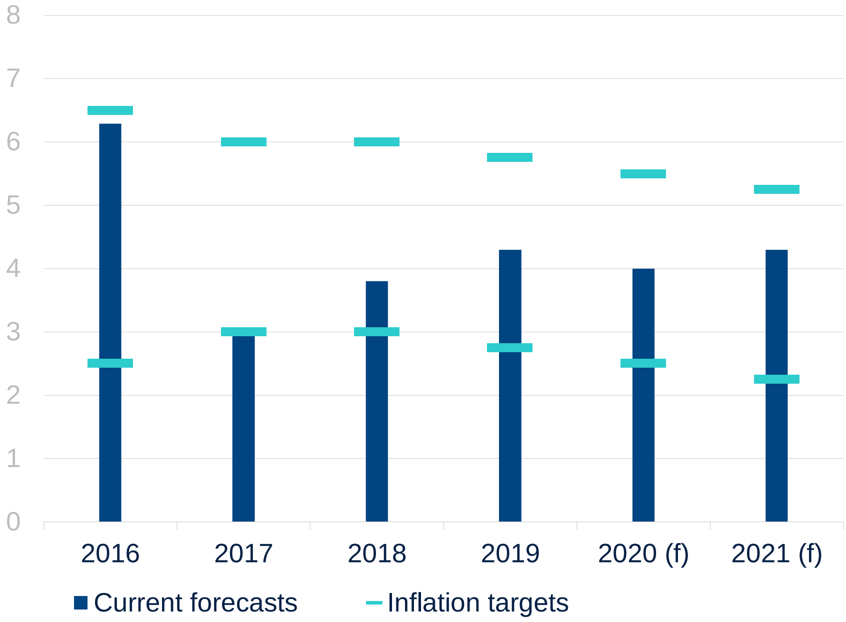
The easing cycle is soon coming to an end; the SELIC rate will then be kept unchanged until 2021, when it will be raised to control inflation

NOMINAL INTEREST RATE: SELIC RATE (*)
(%)



(*) Forecasts from Jan/20 onwards.
Source: BBVA Research

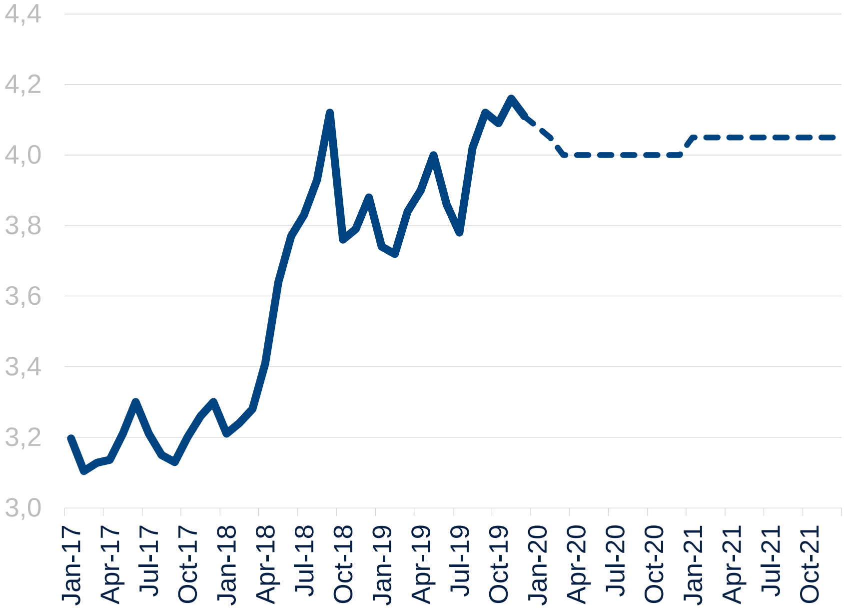
INFLATION: IPCA (*)
(Y/Y %; END OF PERIOD)



(*) (f) = forecast.
Source: BBVA Research

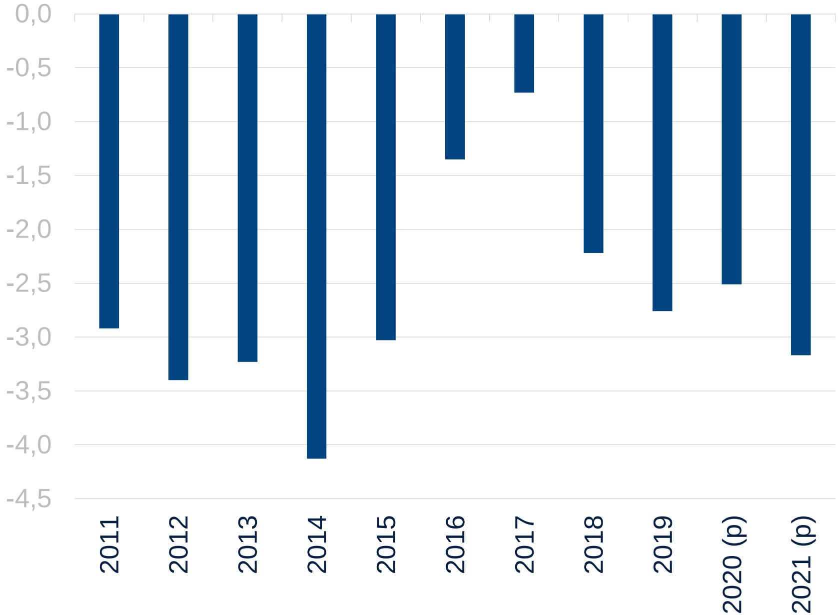
The economic recovery process will create room for a slight exchange rate appreciation and a gradual increase in the current account deficit

NOMINAL EXCHANGE RATE
(BRL/USD)



(*) Forecasts from Jan/20 onwards.
Source: BBVA Research

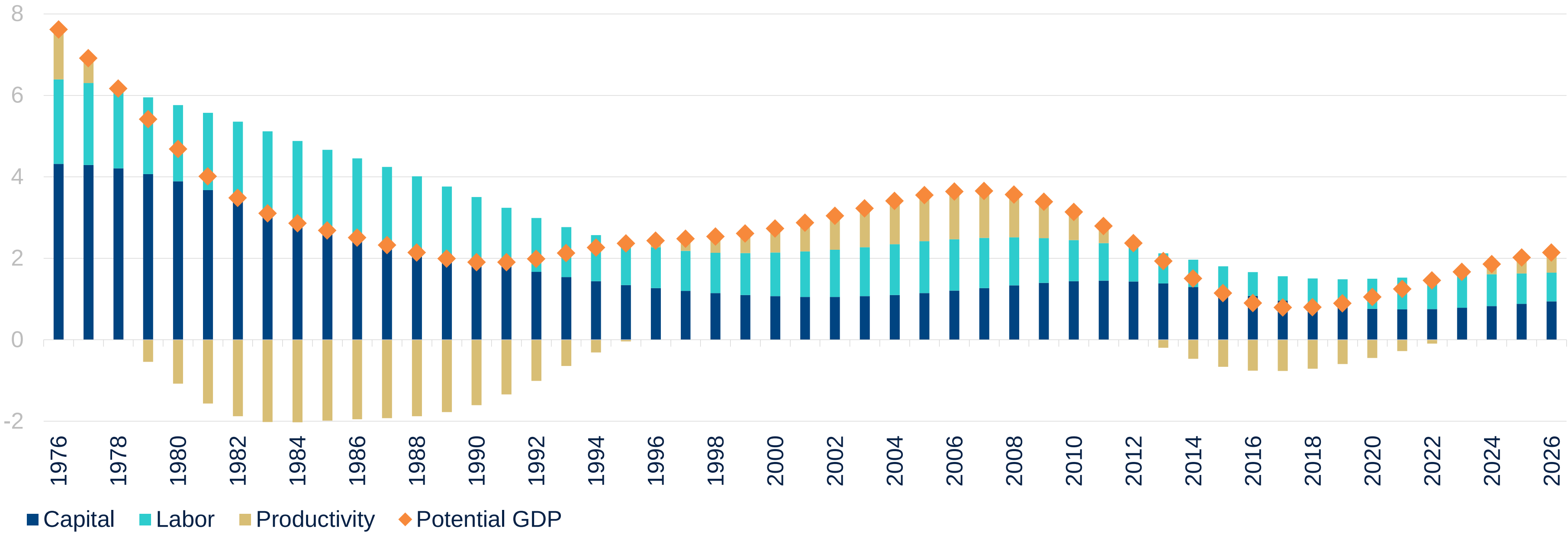
CURRENT ACCOUNT BALANCE (*)
(% DEL PIB)



(*) (f) = forecast.
Source: BBVA Research

Structural reforms are key to increase productivity and allow the economy to grow significantly more than 2%

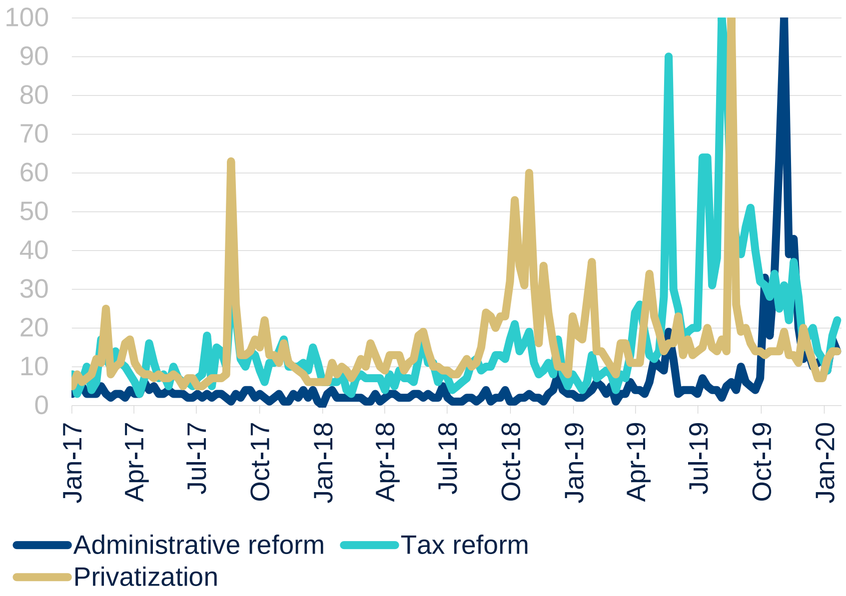
POTENTIAL GDP: CONTRIBUTION BY COMPONENTS
(P.P.)



Source: BBVA Research

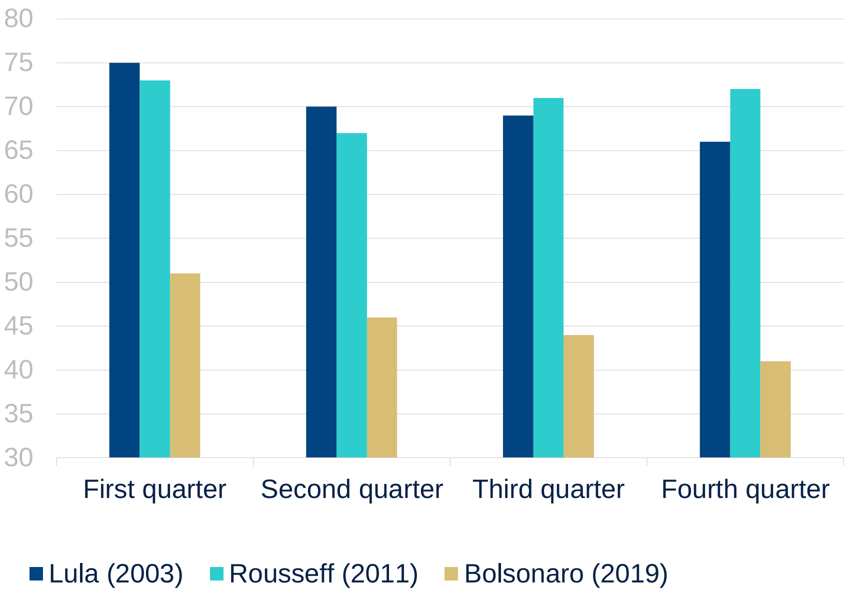
The government seems willing to implement reforms, but political polarization and a fear of protests are two of the many obstacles

PRIVATIZATION AND ADMINISTRATIVE AND TAX REFORMS: WEB SEARCHES (*)
(INDEXES FROM 0 TO 100)



(*) Google searches about the terms "administrative reform", "tax reform" and "privatization".
Source: BBVA Research based on Google Trends data.

GOVERNMENT APPROVAL DURING THE FIRST YEAR OF THE PRESIDENTIAL MANDATE
(%)



Source: BBVA Research based on CNI data.

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03

Brazil: forecast table

Brazil forecasts

	2018	2019 (f)	2020 (f)	2021 (f)
GDP (%)	**1,3**	**1,1**	**1,9**	**2,0**
Private consumption (%)	2,1	1,9	1,9	1,9
Public consumption (%)	0,4	-0,6	-0,8	-0,3
Investment in fixed capital (%)	3,9	4,0	5,9	4,5
Exports (%)	3,3	-3,4	1,3	4,2
Imports (%)	7,5	3,0	5,7	4,1
Unemployment rate (average, %)	**12,3**	**12,0**	**11,0**	**9,8**
Inflation (end of period, YoY %)	**3,8**	**4,3**	**4,0**	**4,3**
SELIC interest rate (end of period, YoY %)	**6,50**	**4,50**	**4,25**	**7,25**
Exchange rate (end of period)	**3,88**	**4,11**	**4,00**	**4,00**
Current account (% of GDP)	**-2,2**	**-2,8**	**-2,5**	**-3,2**
Public sector primary fiscal balance (% of GDP)	**-1,6**	**-1,4**	**-1,1**	**-0,6**

(f) = forecast.
Source: BBVA Research