pezco

May 2019

Macro View

Risk on or risk off? Global recession, trade talks and Brazil’s inertia

Is it time stay risk on or risk off? The IMF revised down its forecasts for the global growth, but some fresh indicators from the US economy and the performance of some commodity prices led us to think if the deceleration is effective. US stocks topped again, and the USD strengthened further.

It is expected the US-China trade talks to come to an end by sometime in May, but the journey until there will not be easy. In Europe, Brexit was postponed to late Oct19, as it seems both Britain and EU prefer delay it rather than face the consequences of a no-deal.

Turning to Brazil, the Pension Reform moved forward in its first stage at the Congress and its final approval has been on the spotlight. Governmental promises tied businessmen and market sentiment to it, which might be good in the future – if the reform is approved – but it means economic activity may stay stalled in the short term. Other themes, such as trade openness and tax reform would provide a short to mid-term relief to the economy.

Helcio Takeda

Managing Director, Head of Research

Frederico Turolla

Economic Research, Senior Partner

Leonardo Correia

Yan Nonato Cattani

João Ricardo Costa Filho

Ana Monteferrario

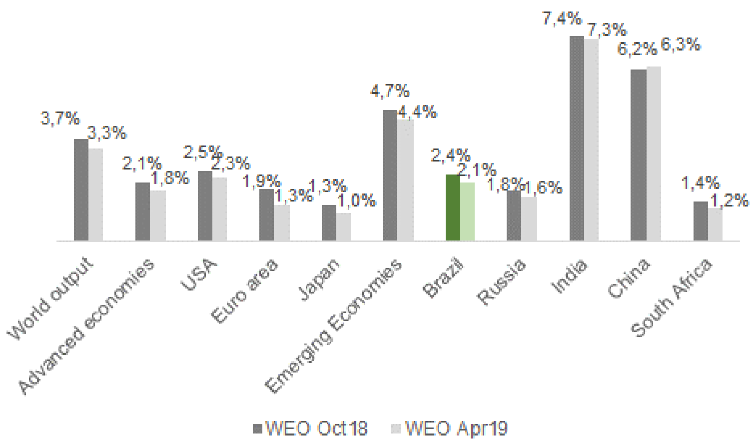
www.pezco.com.br

Macroeconomia & Análise Setorial
Email: economics@pezco.com.br
Telefone: (11) 3582 5509
Alameda Santos, 1293 – cj 61, Jardim Paulista, São Paulo, SP

Risk on or risk off? Global growth, trade talks and asset prices

The expectation for global growth has worsened since the end of the last year and fears of a global recession are still present in the forecasts. The IMF revised down its forecasts for the global growth in 2019 to 3.3% in the Apr19 edition on the WEO (against 3.7% expected in Oct18). The prospective scenario weakened for all the key economies, unless China.

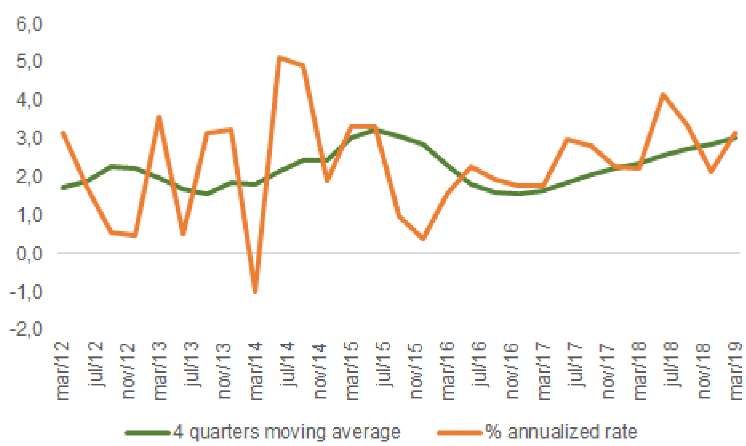
Chart 1. IMF forecasts (WEO)



Source: IMF

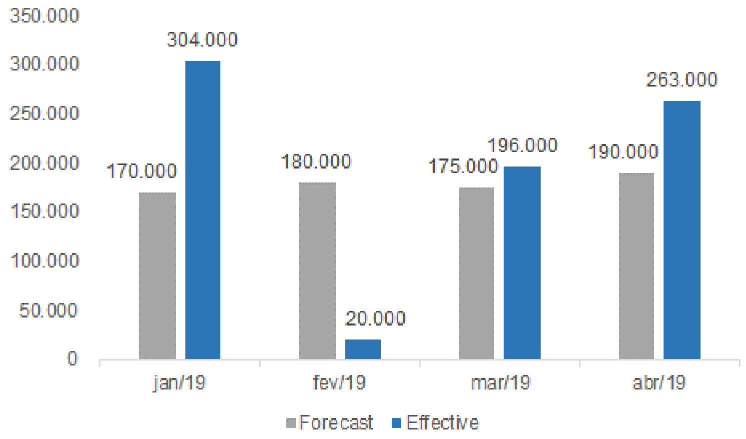
Conversely, available data seems to be less awful than anticipated, especially for the US economy. The US GDP grew at an annualized rate of 3.2% in the 1Q19, well above the 2.2% market consensus. Non-farm payroll has been stronger than expected as well, heading unemployment rate toward the lowest level since Dec69. And all of this under a benign scenario for inflation rate.

Chart 2. US GDP growth rate (% annualized rate)



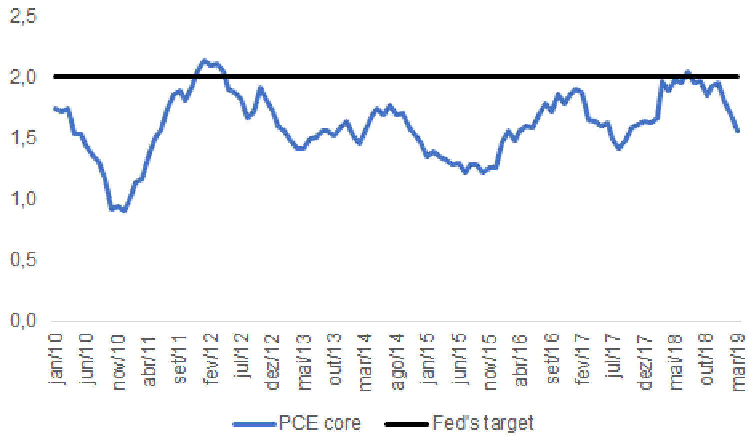
Source: Federal Reserve Bank of St Louis (FRED)

Chart 3. Changes in the nonfarm payroll (number of workers)



Source: Fred

Chart 4. PCE core (%, 12m basis)

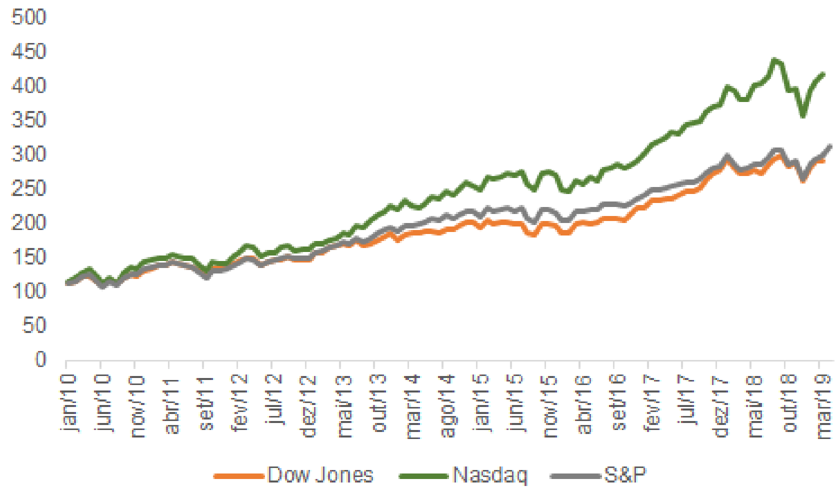


Source: Fred

On top of that, the Federal Reserve changed slightly its speech about the future steps regarding monetary policy – turning the reading more volatile. It is worth remembering that in Dec18, Fed signaled that the federal funds rate should be increased by 50 to 75 basis points in this year. In Jan19, they changed their mind to a possible non-increase in the whole year. Now, it depends on how the economy evolves.

In parallel, trade talks are getting deadline – a conclusion is expected in May. Nonetheless, investors look quite confident, with the key US stock market indices heading back to record levels and the VIX at the bottom. Yet, would this get sustained through May?

Chart 5. US stock market indices (2009 year =100)



Source: Fred

Meanwhile in Brazil: Some advances in reforms yet inertia in expectations…

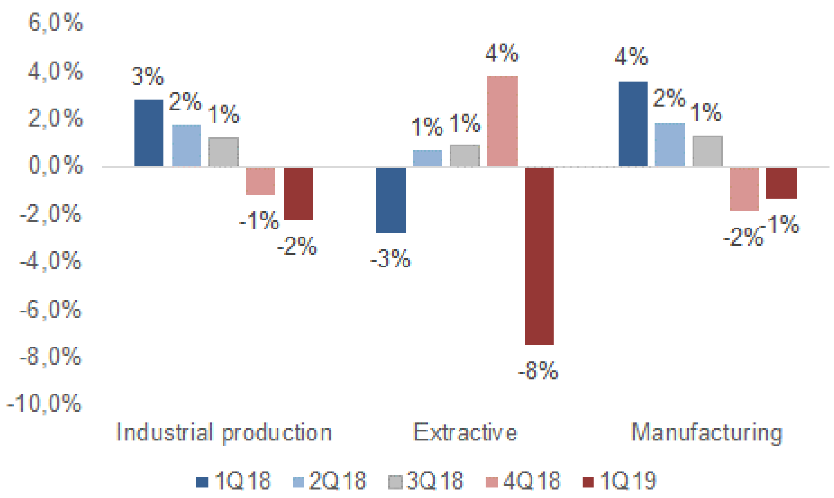
After the approval at CCJ, the pension reform bill will be under debate at special committees before its approval by the Congress. Meanwhile, President Bolsonaro released several small-scale measures to support the economy recovery. Amongst that, we spotlight the autonomy of the Central Bank and economic freedom act, which reduces bureaucracy in opening and functioning small business – easing the formation of startup companies.

In addition, a micro-tax reform proposal has been discussed at the Ministry of Economy and it is expected some federal tax to be merged (PIS and Cofins, for example) and the launch of a transaction tax, such as the extinguished CPMF.

Economic activity downward trend and unemployment

After mixed results in Feb19 (when retail sales showed stability while services fell), economic activity disappointed again. Industrial production fell 1.3% MoM in Mar19 and -0.7% QoQ in the 1Q19. On a YoY comparison, output fell 6.1% in Mar19 and -2.3% in the 1Q19. This weak performance in the industry was strongly affected by the Brumadinho mining accident and consequent interruption in the mining activity. Moreover, most of manufacturing industry remains rather weak, heavily dependent on the vehicle manufacturers.

Chart 6. Industrial production



Source: IBGE

In the face of such discouraging data, Pezco revised down its forecast for the GDP growth rate in 2019, from 2.4% to 2.2%. Pezco still remain bullish on the positive effects of the approval of the Pension Reform bill in the businessmen and market expectations and its spillovers to the economic activity, especially from the 2H19 onwards.

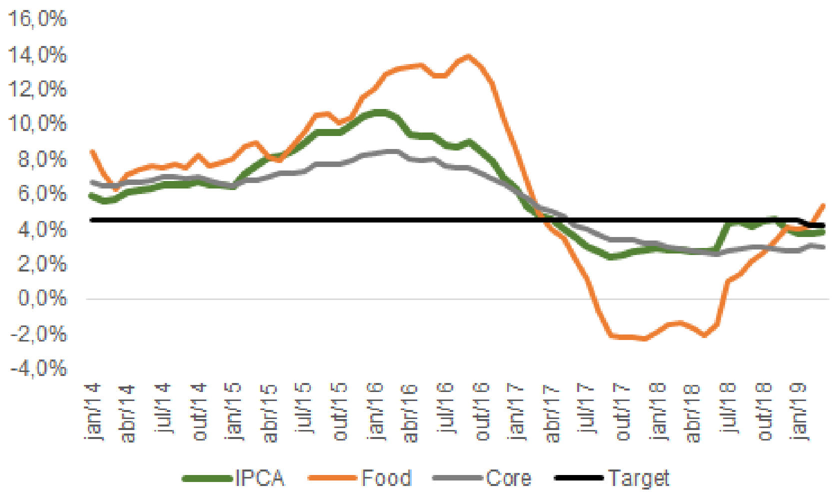
In the meantime, the stalled activity pressure nationwide unemployment rate, which reached 12.7% in 1Q19 versus 12.4% in Dec18-Feb19 quarter, but still below 13.1% in the 1Q18. The indicator still reflects the apathy in the labor market, also confirmed by the CAGED employment data, with a decrease of 43,000 formal jobs in Mar19. Breaking down this number, the largest falls were seen in public administration (-332,000), followed by construction (-228,000) and retail (-195,000).

In order to reverse it, Government has considered put forward the proposal that may allow new withdrawals in the PIS/Pasep individual accounts, in order to provide some glimpse of a relief to the economy. The expectation is that the measure, if adopted, may inject BRL 9 billion to BRL 10 billion into the economy.

Rise in inflation yet tamed

IPCA-15 rose 0.72% in Apr19, above the median market expectations (0.67%). In the 12 months, inflation rose from 4.18% para 4.71%. Fuel (gasoline) and food prices pushed inflation up. Yet, the core inflation has remained under a relatively stable trend and we forecast that the inflation may remain in a benign trajectory, despite the pressures derived from the beforementioned volatile items. The inflation expectations have remained well anchored and the economy has shown an idle capacity. Pinning that, we expect the interest rate to be kept at 6.5% in 2019.

Chart 7. IPCA (Food, fuel and the core)

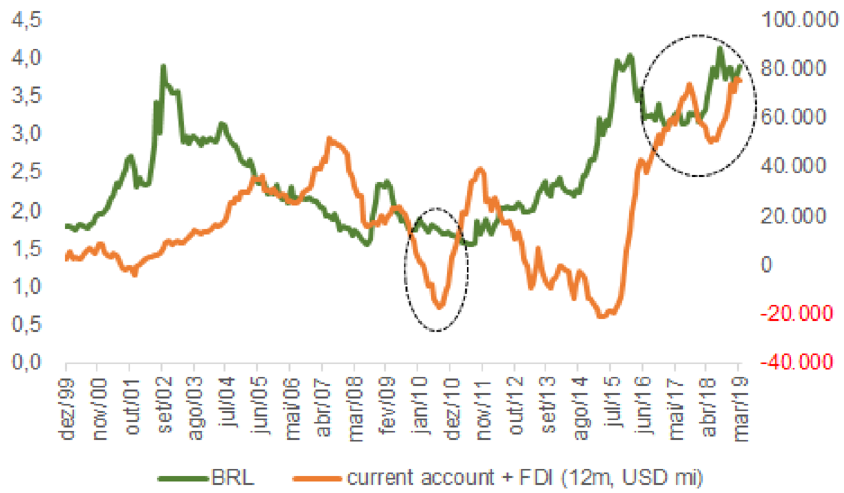


Source: IBGE

Market is expecting...

The USD appreciated further, rising from BRL/USD 3.87 to BRL/USD 4.00 between Mar19 and Apr19. The international scenario remains volatile with China-US trade disputes, rising concerns on a slowdown in the global economy. Besides, the local environment has not been supportive for the BRL as well. However, fundamentals on the external sector (current account + foreign direct investment) has peaked in a 12m basis.

Chart 8. BRL (BRL/USD) versus current account + foreign direct investment (12m basis, USD mi)



Source: Valor Pro

Despite the volatility in the short-term, investors remain relatively optimist, maintaining a premium price over the DI. Ibovespa had a slight rise, accumulating 1.75% increase in the Year to end of Apr19. The index was strongly influenced by some positive developments derived from the Pension reform that was approved by the Constitution and Justice Commission and was sent to the Special Committee to be evaluated and financial and the retail positive Balance sheets.

Macroeconomia & Análise Setorial | Email: economics@pezco.com.br | Telefone: (11) 3582 5509
Alameda Santos, 1293 – cj 61, Jardim Paulista, São Paulo, SP