



Macroeconomic Research – Itaú

Economic Outlook

September 2020

Global recovery continues in 2H20, while U.S. election risk is on the rise

- We expect the global recovery to continue in 2H20, with a decline in the COVID-19 mortality rate, vaccines on the horizon, continued fiscal and monetary support, and a positive inventory cycle in 2H20.
- The change in the Fed's framework will allow for ample monetary support for longer.
- With the approach of the U.S. election, signs of a competitive race could create some risks for the recovery.
- Latin America: reopening advances and central banks become more conservative.



Highlights



Roadmap

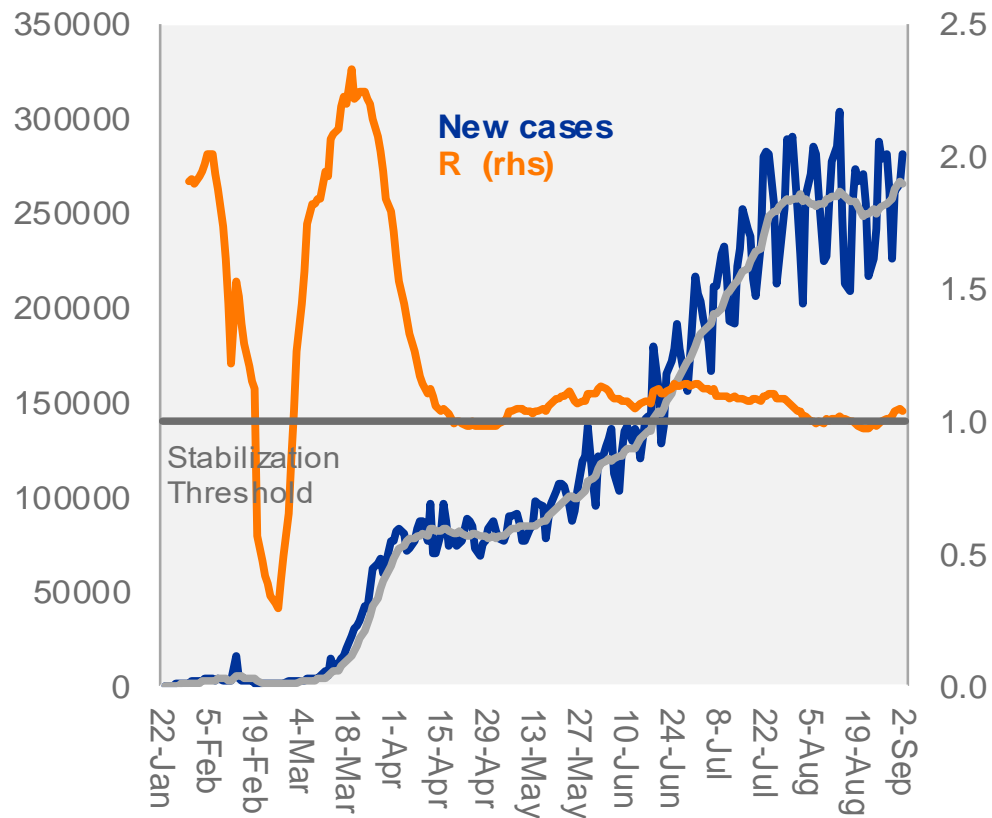
1. Global economy

2. Brazil

	2016	2017	2018	2019	2020	2021
World	3.3	3.7	3.7	1.8	-3.7	6.0
USA	1.6	2.4	2.9	2.3	-5.0	4.0
Eurozone	1.9	2.7	1.9	1.3	-7.0	6.0
Japan	0.5	2.2	0.3	0.8	-4.0	2.2
China	6.8	6.9	6.6	6.1	2.3	7.5

Global contagion continues, but mortality rate has declined and vaccines are on the horizon

Global contagion continues...



The global coronavirus contagion has plateaued at high level.

There has been an average of about 250,000 daily new cases across the globe since the end of August

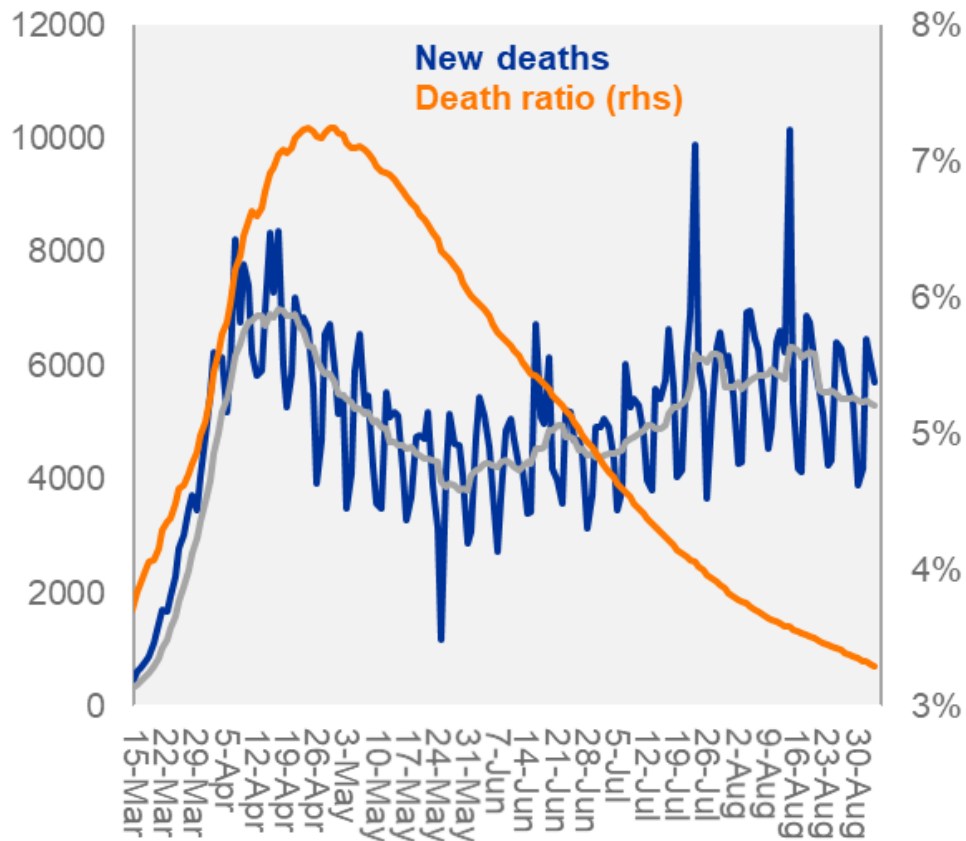
However, the mortality rate appears to have declined.

We believe that this decline can be attributed to increased testing, better medical treatment, more efficient infrastructure at hospitals, and improved isolation measures among risk groups

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Global contagion continues, but mortality rate has declined and vaccines are on the horizon

... but deaths are slowly decreasing



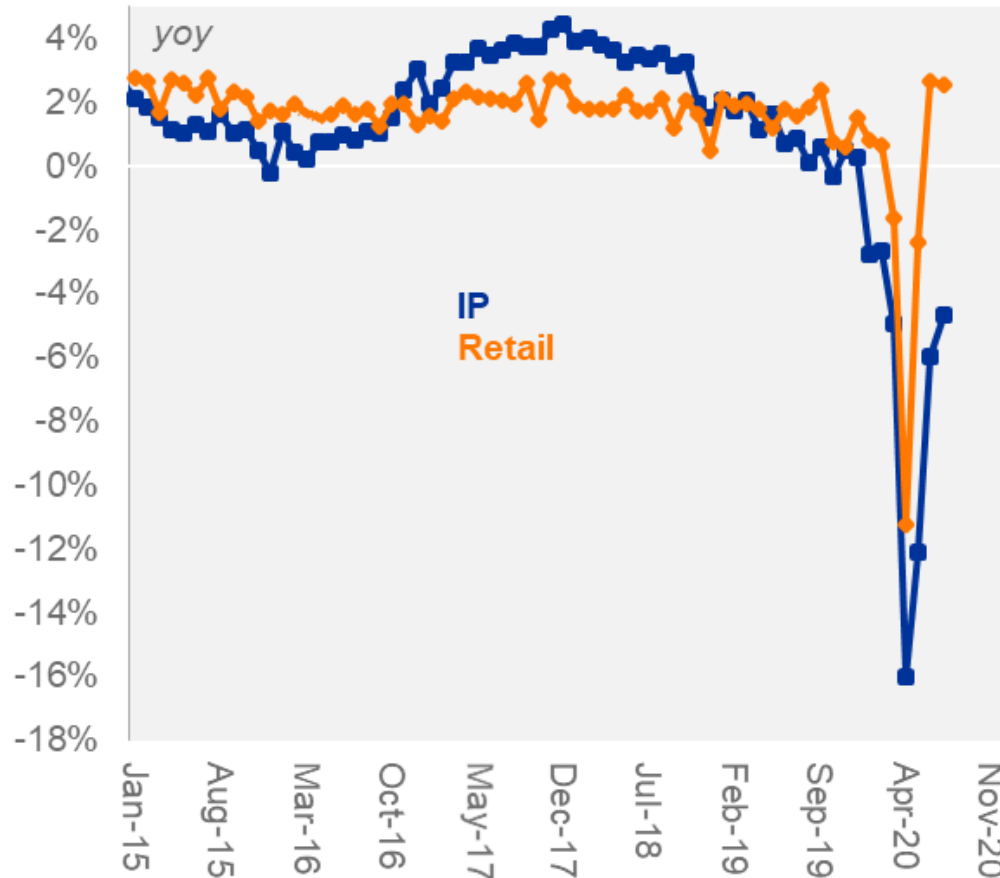
1 We believe that this combination of still-high contagion but reduced mortality rate allows for economies to remain open but prevents some sectors from resuming activity.

2 Vaccines, which are expected to be ready in 4Q20, will support a broader recovery of the economy.

3 A possible delay in the release would be the main obstacle to a global reopening and economic recovery.

Global recovery continues, helped by the positive inventory cycle in 2H20

Retail outperformance to foster inventory cycle



Global recovery continues in 2H20.

Following the strong recession in 1H20, economic activity is rebounding in 2H20, supported by fiscal stimulus and the reopening of economies.

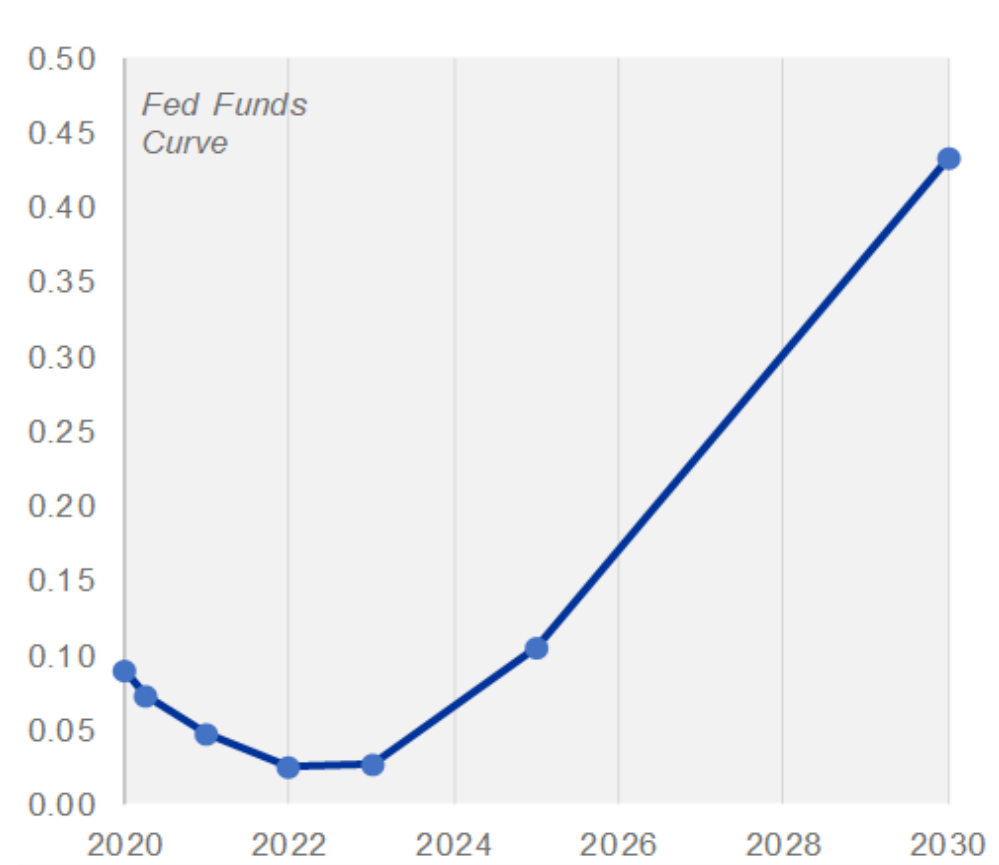
A positive inventory cycle has been boosting the manufacturing recovery in 2H20.

We maintained our forecasts for China at 2.3% in 2020 and 7.5% in 2021, for the Eurozone at -7.0% in 2020 and 6.0% in 2021, and for the U.S. at -5.0% in 2020 and 4.0% in 2021.

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New Fed framework allows for ample monetary support for longer

Larger monetary support expected



Under its new framework, the Fed will accommodate (rather than offset) inflation moderately above 2%.

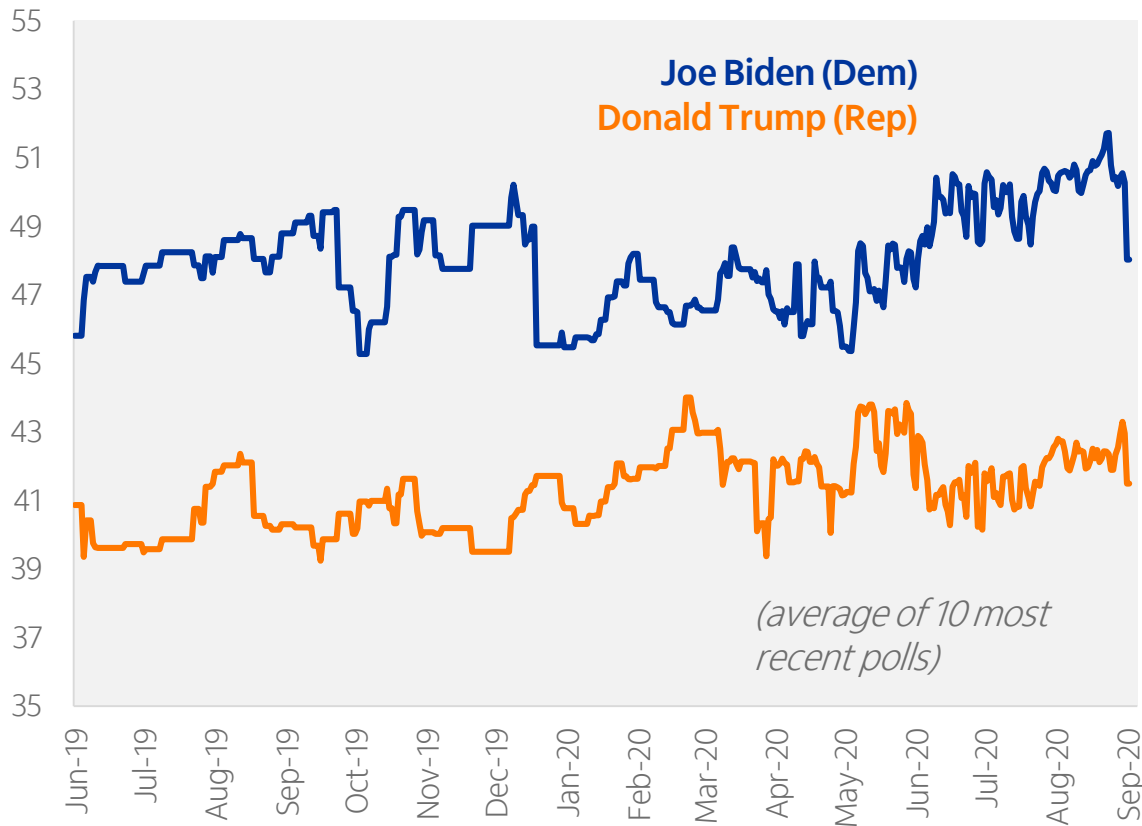
The new framework will therefore imply more ample monetary support ahead.

Indeed, the market is currently pricing in a Fed fund rate of nearly 0% until 2024.

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As the U.S. election approaches, signs of a more competitive race could create some risks for the recovery

Biden (Dem) is the favorite, but advantage retreated
(Polls result, %)



Source: Itaú

1 Trump could gather support to climb in the polls as virus concerns fade and social unrest unravels.

2 Moreover, polls suggest that social unrest in many American cities may have eroded support for the Black Lives Matter movement, which could weaken support for Biden.

3 A closer race implies a higher risk of a contested election and a delay in new fiscal stimulus.

4 Furthermore, a closer race could diminish the sense of urgency in a new round of fiscal stimulus, which remains stalled in Congress.

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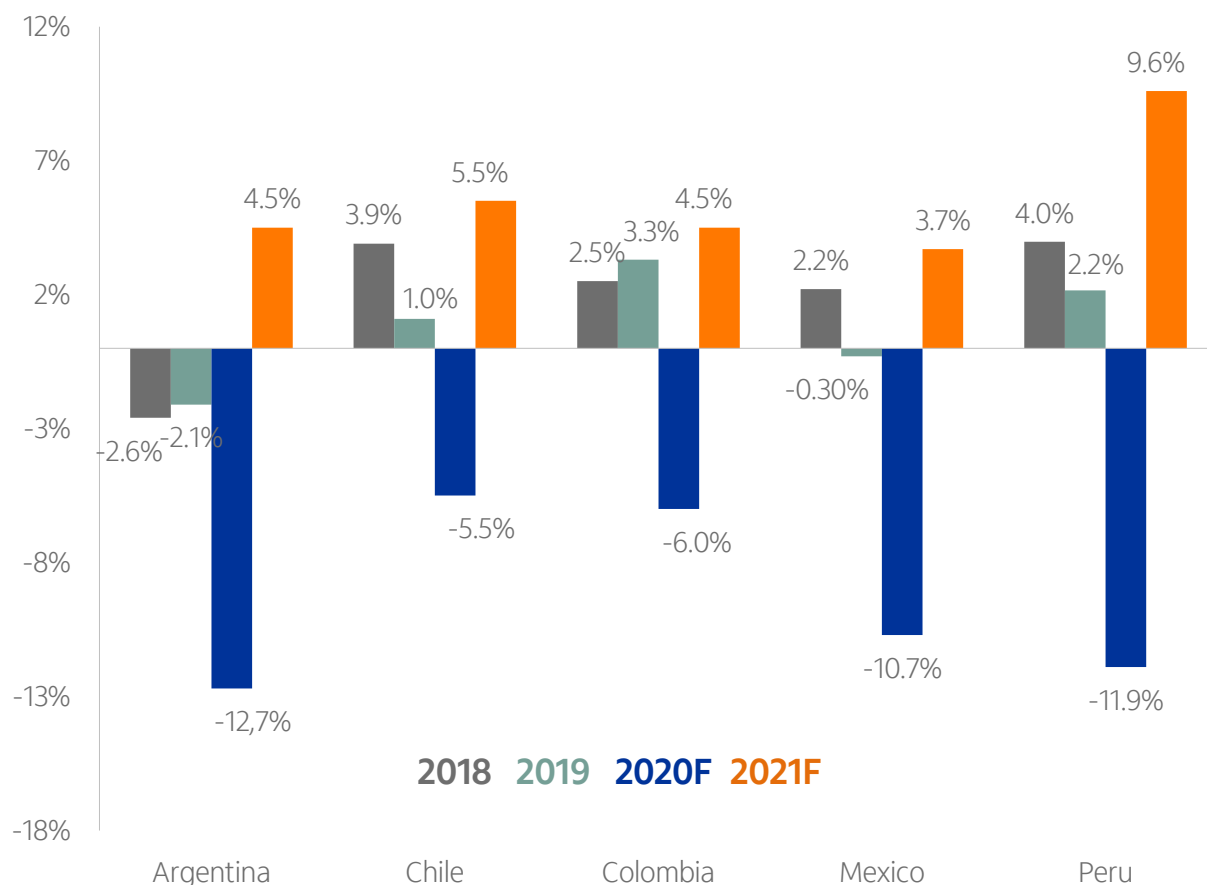
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LatAm: reopening advances and central banks become more conservative

GDP Growth



Source: Haver Analytics and Itaú

1 While the COVID-19 contagion in the region remains high, improvements in the number of new cases and/or new deaths in many countries has allowed for a relaxation of social distancing measures.

2 Despite recent gains, the region's currencies remain far below year-end 2019 levels.

3 Even in the face of wide negative output gaps, central banks see less room for further monetary policy easing.

4 In Argentina, the government announced that it successfully restructured 99% of its foreign law debt and is has begun negotiations with the IMF for a new package (to roll over existing commitments with the Fund).

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Peru

	2018	2019	2020F	2021F
GDP - %	4.0	2.2	-11.9	9.6
PEN / USD (eop)	3.37	3.32	3.50	3.40
Reference rate (eop) %	2.75	2.25	0.25	0.25
CPI	2.2	1.9	0.5	1.2

Mexico

	2018	2019	2020F	2021F
GDP - %	2.2	-0.3	-10.7	3.7
MXN / USD (eop)	19.65	18.93	21.0	21.0
Reference rate (eop) %	8.25	7.25	4.25	3.50
CPI	4.8	2.8	3.8	3.2

Colombia

	2018	2019	2020F	2021F
GDP - %	2.5	3.3	-6.0	4.5
COP/ USD (eop)	3254	3287	3,650	3,650
Reference rate (eop) %	4.25	4.25	2.00	2.00
CPI	3.2	3.8	2.0	3.0

Chile

	2018	2019P	2020F	2021P
GDP - %	3.9	1.1	-5.5	5.5
CLP / USD (eop)	694	753	800	770
Reference rate (eop) %	2.75	1.75	0.50	0.50
CPI	2.6	3.0	2.3	2.9

Argentina

	2018	2019	2020F	2021F
GDP - %	-2.6	-2.1	-12.7	4.5
ARS/ USD (eop)	37.8	59.90	86.00	127.00
Reference rate (eop) %	59.3	55.0	38.0	38.0
CPI	47.6	53.8	37.0	50.0

Waiting for a fiscal solution

- There are signs of improvement in coronavirus contagion and risks of a second wave seem contained. The number of new deaths has started to recede somewhat, even with the flexibilization of social isolation measures. This, coupled with advances in vaccine trials, could aid the economic recovery.
- However, there are lingering uncertainties surrounding the fiscal risk. We expect primary budget deficits of 11.7% of GDP in 2020 and 2.5% of GDP in 2021. Next year's deficit includes higher social spending, partially offset by tax increases.
- Economic activity continues to recover from the sharp declines registered earlier in the pandemic. We maintained our GDP forecasts at -4.5% for 2020 and +3.5% for 2021.
- We also maintained our year-end exchange rate forecasts at 5.25 BRL/USD for 2020 and 4.50 BRL/USD for 2021. Appreciation from current levels requires reduced fiscal uncertainties.
- We revised our inflation forecast for 2020 to 2.0% from 1.7%, to incorporate sharper increases in food prices this year. We maintained our estimate for 2021 at 2.8%, but given the slack in the labor market, there are downside risks.
- We expect the Selic rate to remain at 2.0% p.a. until at least the end of this year. For 2021, we maintained our call at 3.0% p.a. for year-end. Going forward, monetary policy will also depend on the fiscal outlook.

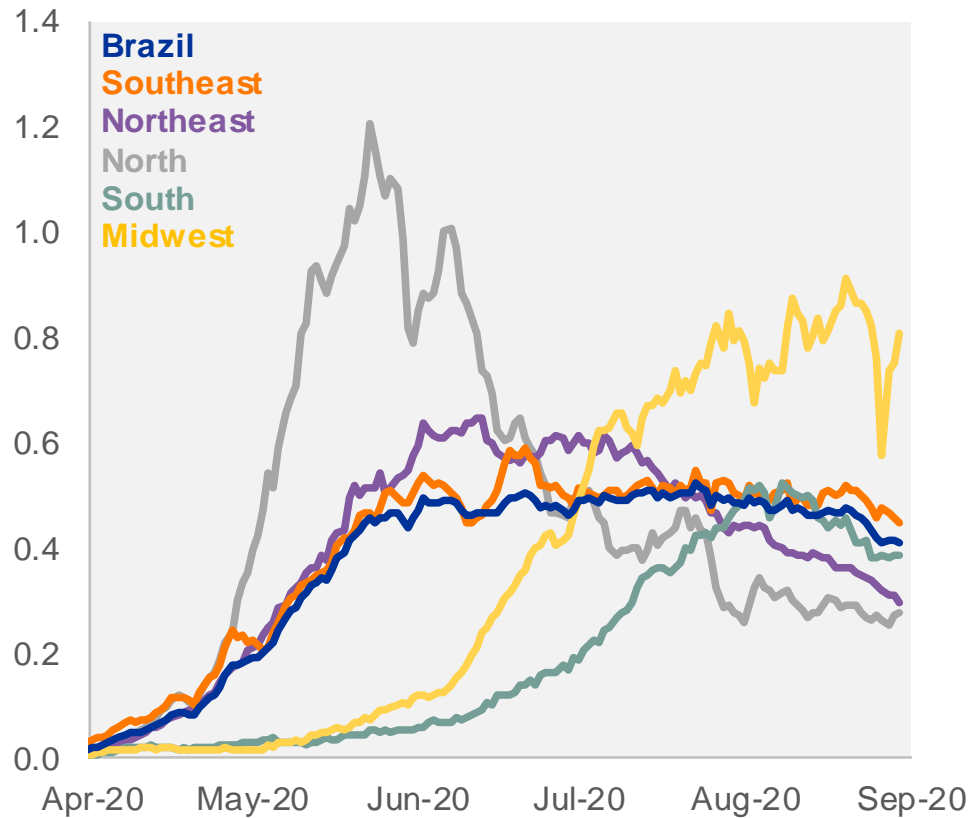
Highlights

Our forecasts:

	2016	2017	2018	2019	2020F	2021F
Economic Activity						
GDP(%)	-3.3	1.3	1.3	1.1	-4.5	3.5
Unemployment (%) – December (PNAD cont.)	12.7	12.4	12.2	11.6	16.6	16.2
Inflation						
CPI (%)	6.3	2.9	3.7	4.3	2.0	2.8
Monetary Policy						
SELIC Rate (%)	13.75	7.00	6.50	4.50	2.00	3.00
Fiscal						
Primary Surplus (% GDP)	-2.5	-1.7	-1.6	-0.9	-11.7	-2.5
Balance of Payment						
Exchange Rate – (eop)	3.26	3.31	3.88	4.03	5.25	4.50
Current Account (% GDP)	-1.3	-0.7	-2.2	-2.8	-0.1	0.2

Coronavirus: uncertainties recede with gradual reopening and incipient signs of improvement

Pace of coronavirus deaths (new deaths per 100,000 inhabitants, 7-day average)



Source: Ministry of Health, Itaú

The number of new daily deaths started to decline in late August, after plateauing for about three months at around 1,000 deaths per day.

The improvement stems from a downtrend in the regions most affected initially, such as the North, Northeast and Southeast, and stabilization in the South and Midwest after two months of rising cases and hospital utilization rates.

The controlled hospital utilization rates allow for the continuation of the gradual reopening of the economy with relative safety.

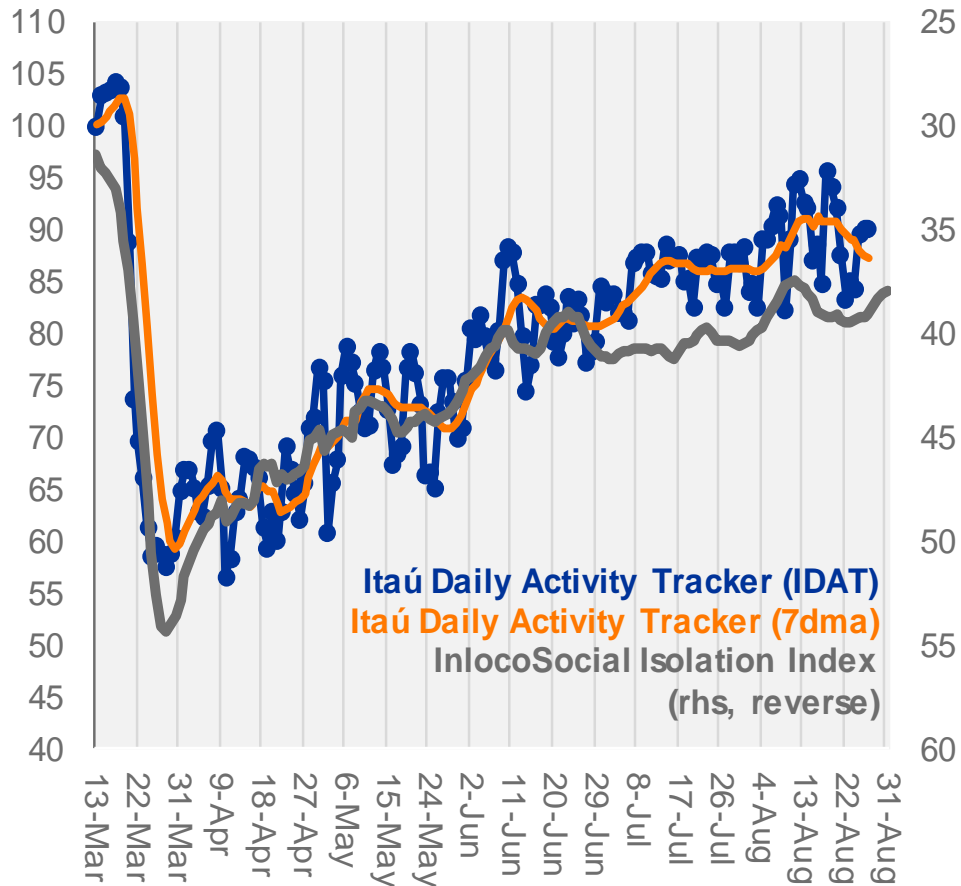
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Recovering activity

Economic activity recovering



We maintained our GDP growth forecasts for this year (-4.5%) and the next (+ 3.5%).

In 2Q20, GDP retreated by 9.7% qoq/sa.

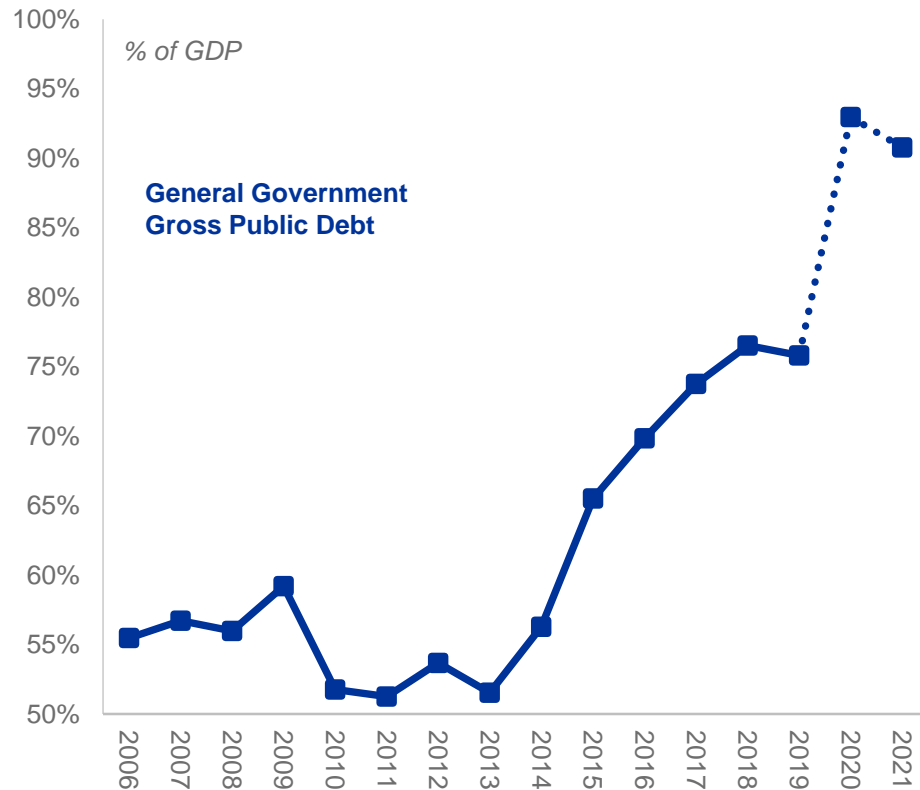
The recovery process thereafter will be driven by low interest rates, easing social isolation measures, a rebound of the global economy and fiscal stimulus from emergency aid.

The risk of fiscal unsustainability, in turn, is a negative factor for economic activity.

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Still-high fiscal uncertainties

Sharp increase in public debt and greater fiscal risks



Source: BCB, taú

We revised our primary deficit estimate for 2020 down to 11.7% of GDP (BRL 850 billion) from 11.0% of GDP (BRL 800 billion), and maintained our deficit forecast for 2021 at 2.5% of GDP (BRL 200 billion).

For 2021, we anticipate an increase in social spending of around 0.9% of GDP (BRL 67 billion) and in the tax burden of 0.2% of GDP (BRL 20 billion).

To offset the increase in social spending, our scenario assumes adjustments in legislation to facilitate the activation of spending-cap triggers with automatic correction of mandatory expenses.

Gross debt is expected to reach 93% of GDP in 2020 and 91% of GDP in 2021, up from 76% of GDP in 2019 (see graph).

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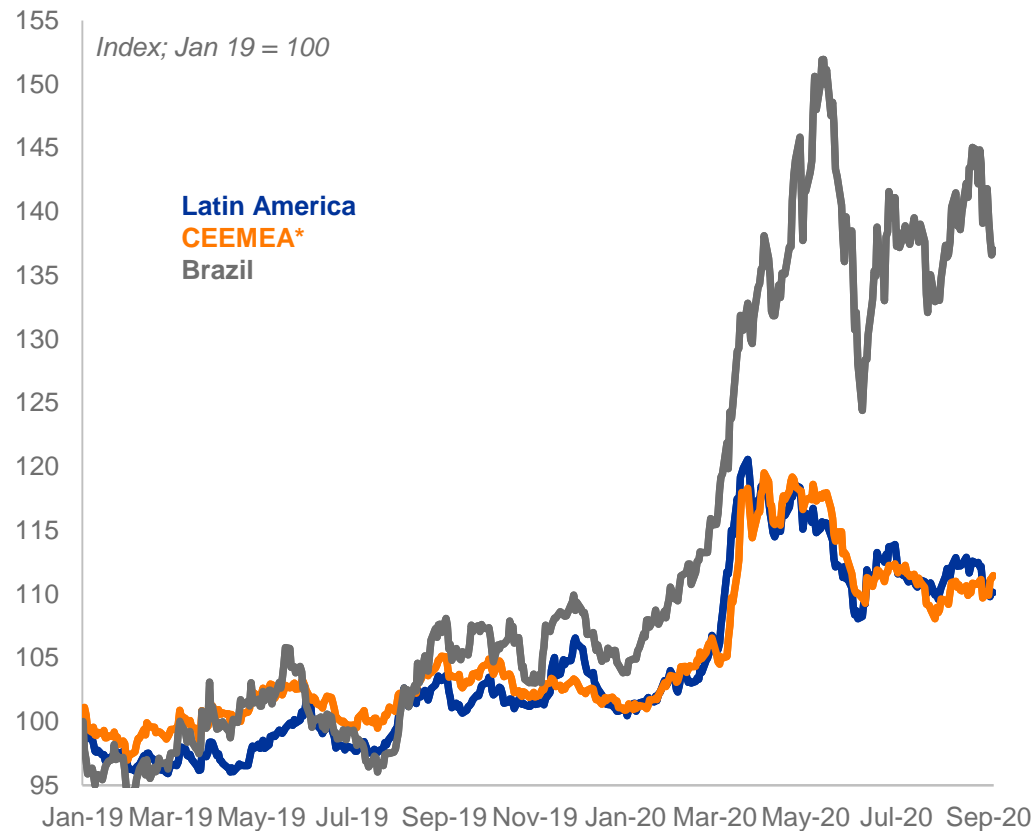
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Fundamentals suggest a stronger currency, but there are still downside risks

BRL vs. EM peers



*includes countries in Central and Eastern Europe, Middle East and Africa.

Source: BBG, Itaú

We maintained our year-end forecasts for the exchange rate at 5.25 BRL/USD for 2020 and 4.50 BRL/USD for 2021.

There are two main risks to our call of FX appreciation.

The first is related to the evolution of public accounts. In the event of significant fiscal deterioration, resulting in increased capital outflows, exchange rate depreciation is likely to be more intense than we forecast.

The second risk is related to changes brought on by provisional measure 930/2020 in terms of taxing overseas investments, which may lead to net dollar purchases of USD 15-20 billion by year-end.

The latest figures confirm that the current exchange rate level, combined with contracting economic activity, has led to an intense, rapid, widespread adjustment of the current account deficit.

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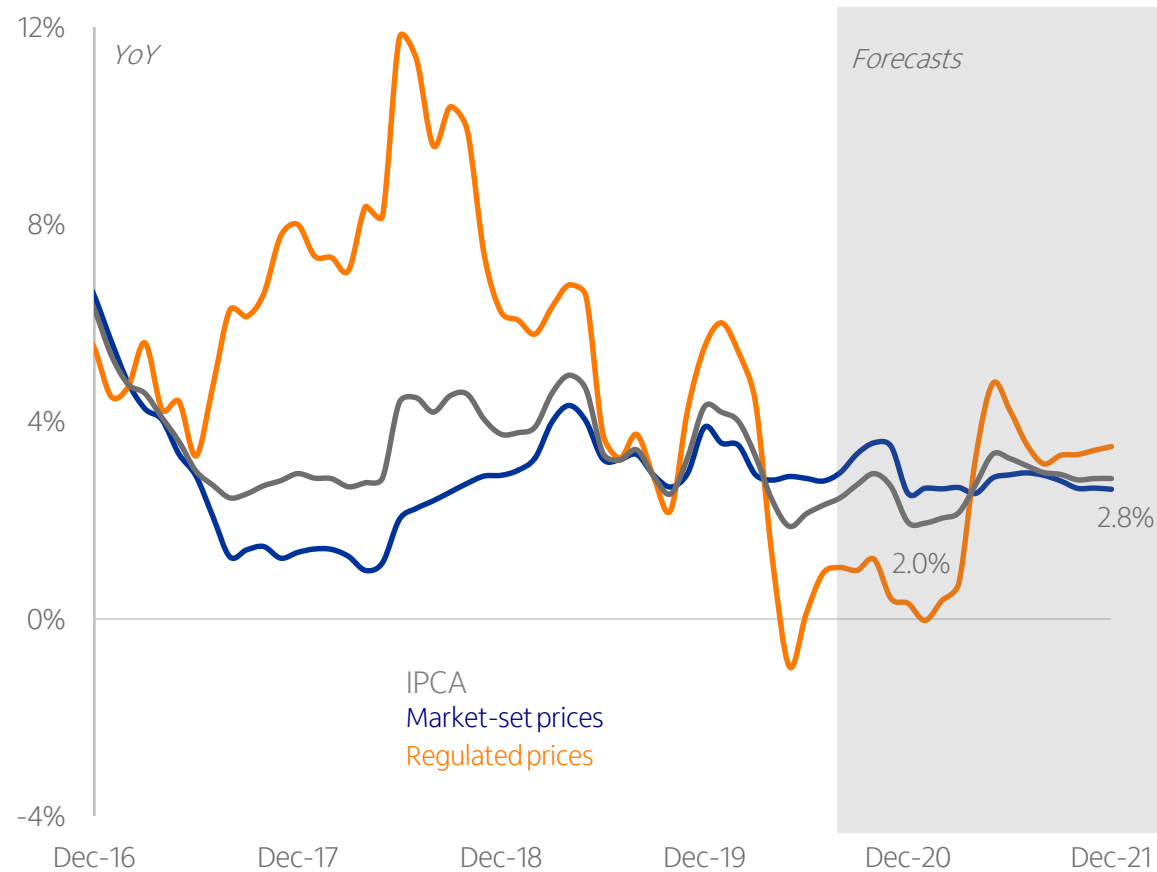
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Inflation: additional pressure on food prices in 2020 and downside bias for 2021 due to labor market slack

IPCA breakdown



Source: IBGE, Itaú

1 We revised our 2020 inflation forecast to 2.0% from 1.7%. After incorporating additional pressure on food prices following the recent hike in agricultural commodities, adverse weather and continued robust demand for these products.

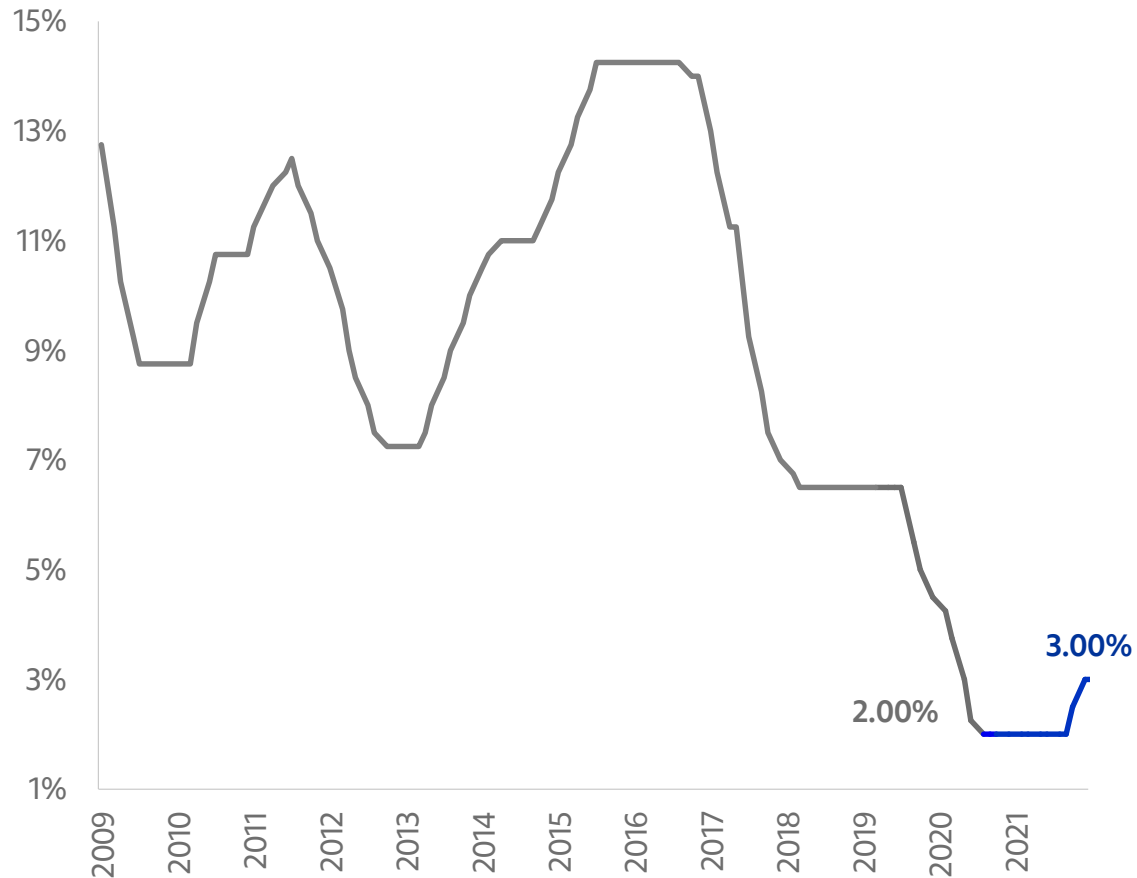
2 We maintained our 2021 forecast at 2.8%.

3 Several factors contribute to the extension of the benign inflation dynamics. Favorable inertia, anchored expectations and substantial spare capacity in the economy continue to exert downward pressure, particularly on underlying service inflation metrics.

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Monetary policy: stable Selic rate amid fiscal uncertainties

Selic % p.a.



Source: BBG, Itaú

1 We expect the Central Bank Monetary Policy Committee (COPOM) to keep the Selic base rate at its all-time low of 2.00% p.a. at the next meeting, and probably for the rest of the year.

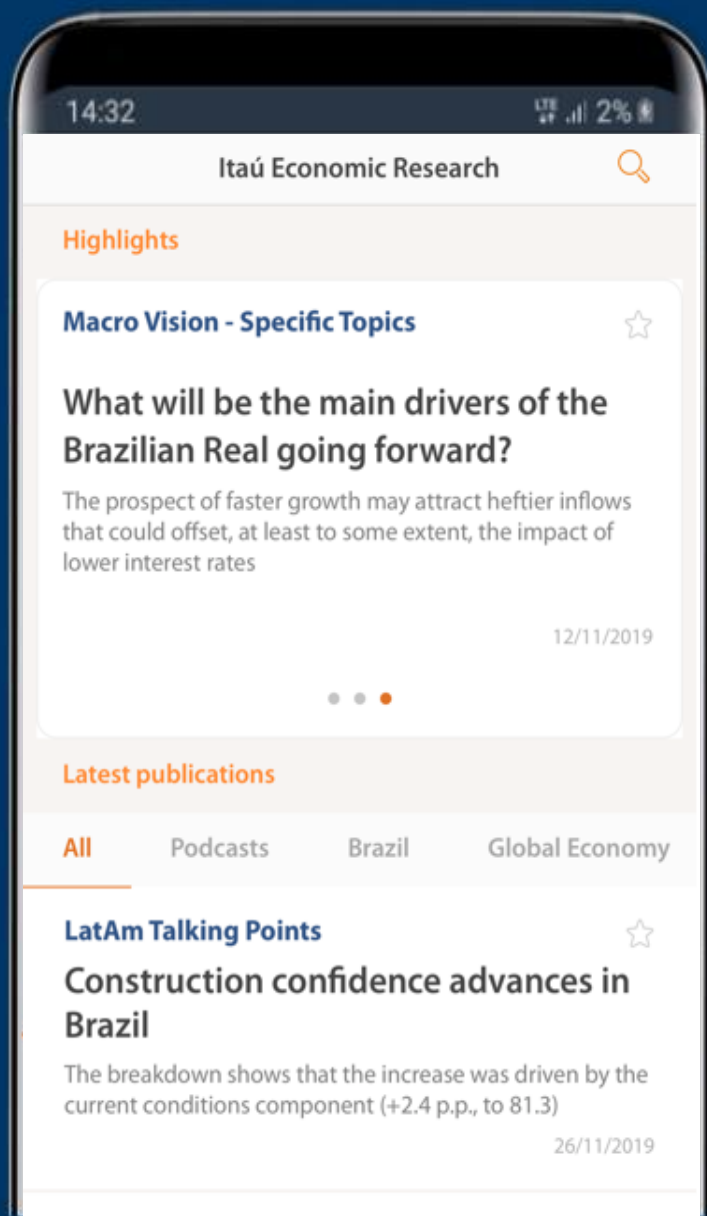
2 The committee's communication suggests that authorities will not change the base rate until there is greater clarity on the fiscal outlook.

3 For 2021, we maintain our Selic rate forecast at 3.0% p.a. for year-end but understand that the monetary policy stance will depend on the fiscal outlook.

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