Brazil: Economic and Monetary Outlook

11 June 2019

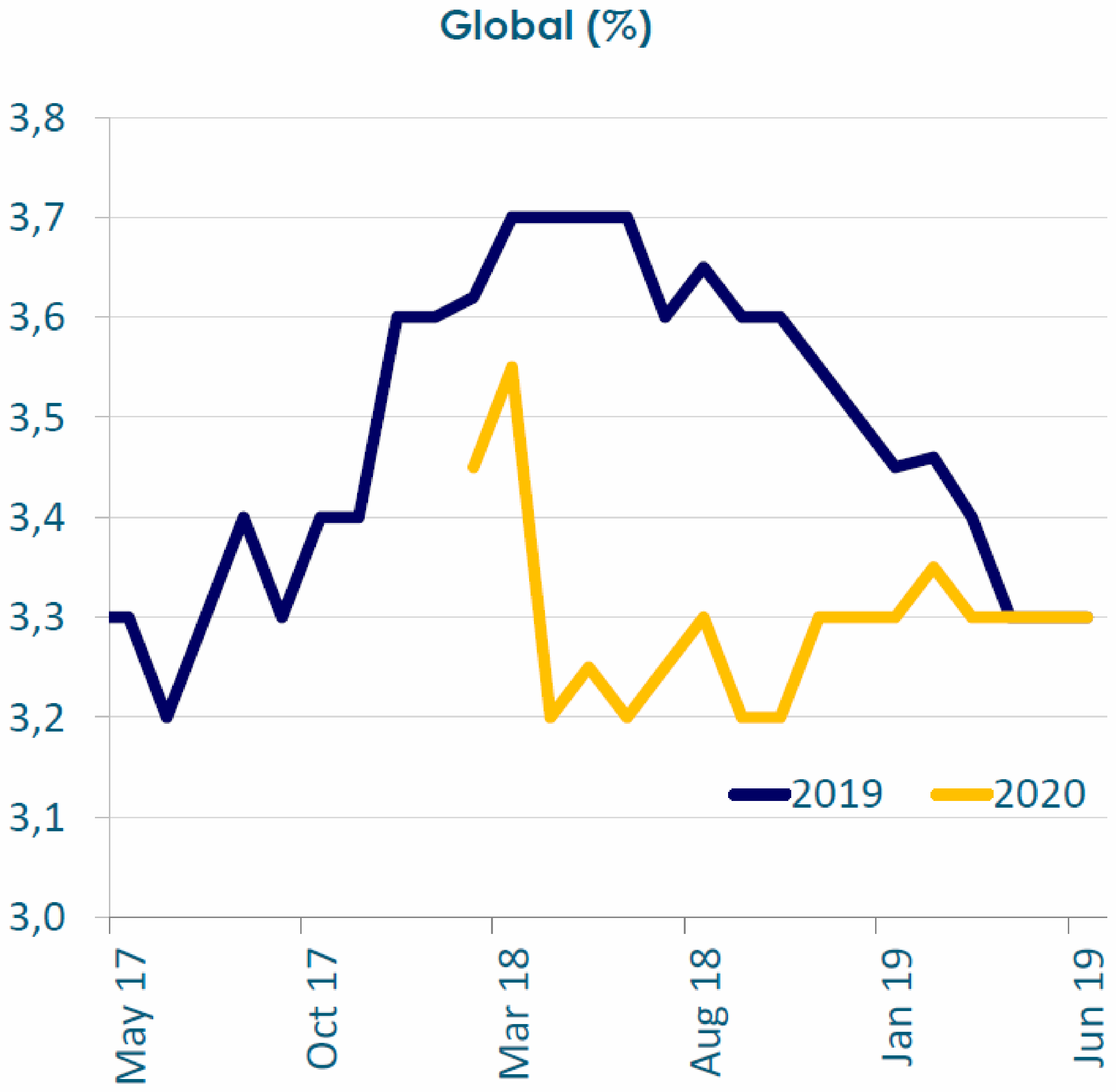
BANCO CENTRAL DO BRASIL

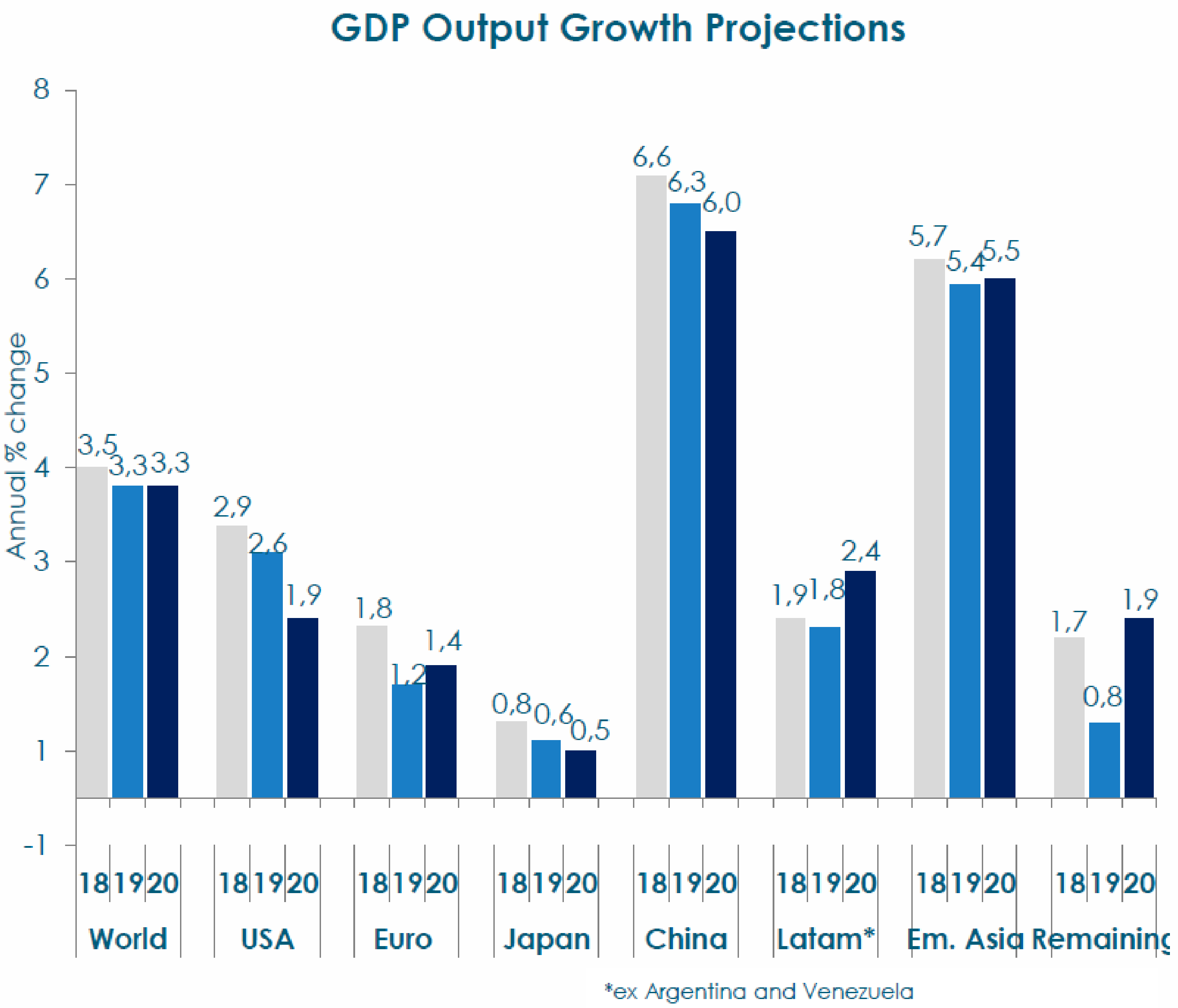
International Context

Global Outlook remains challenging

- Some risks have decreased:
  - the normalization of interest rates in some advanced economies*;*
  - The central banks of the major economies are revising to more flexible monetary policies than expected.
- Others have remained or increased
  - trade tensions;
  - global economic slowdown;
  - Risk aversion towards emerging economies;

Expectations of global growth

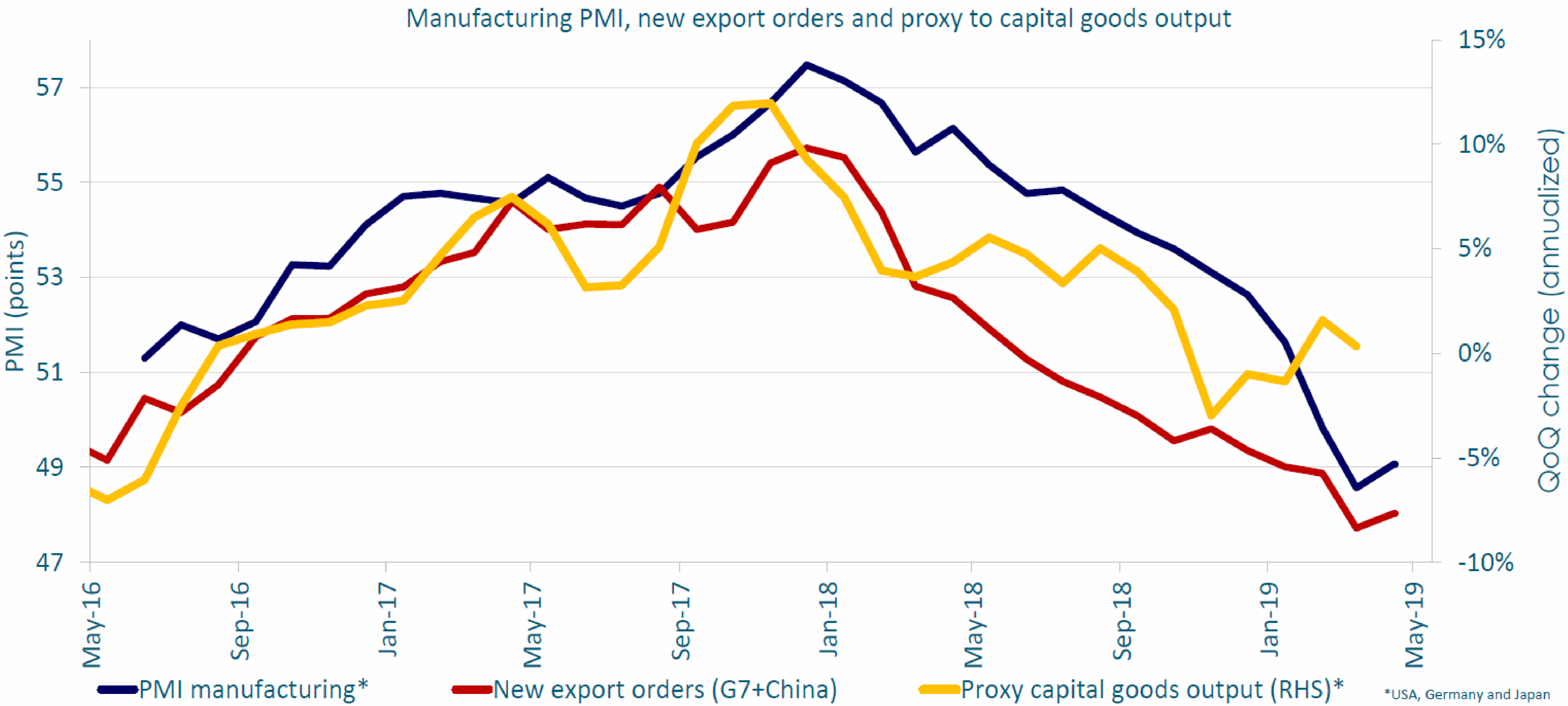




2019/2020: Projections

Sources: Bloomberg.

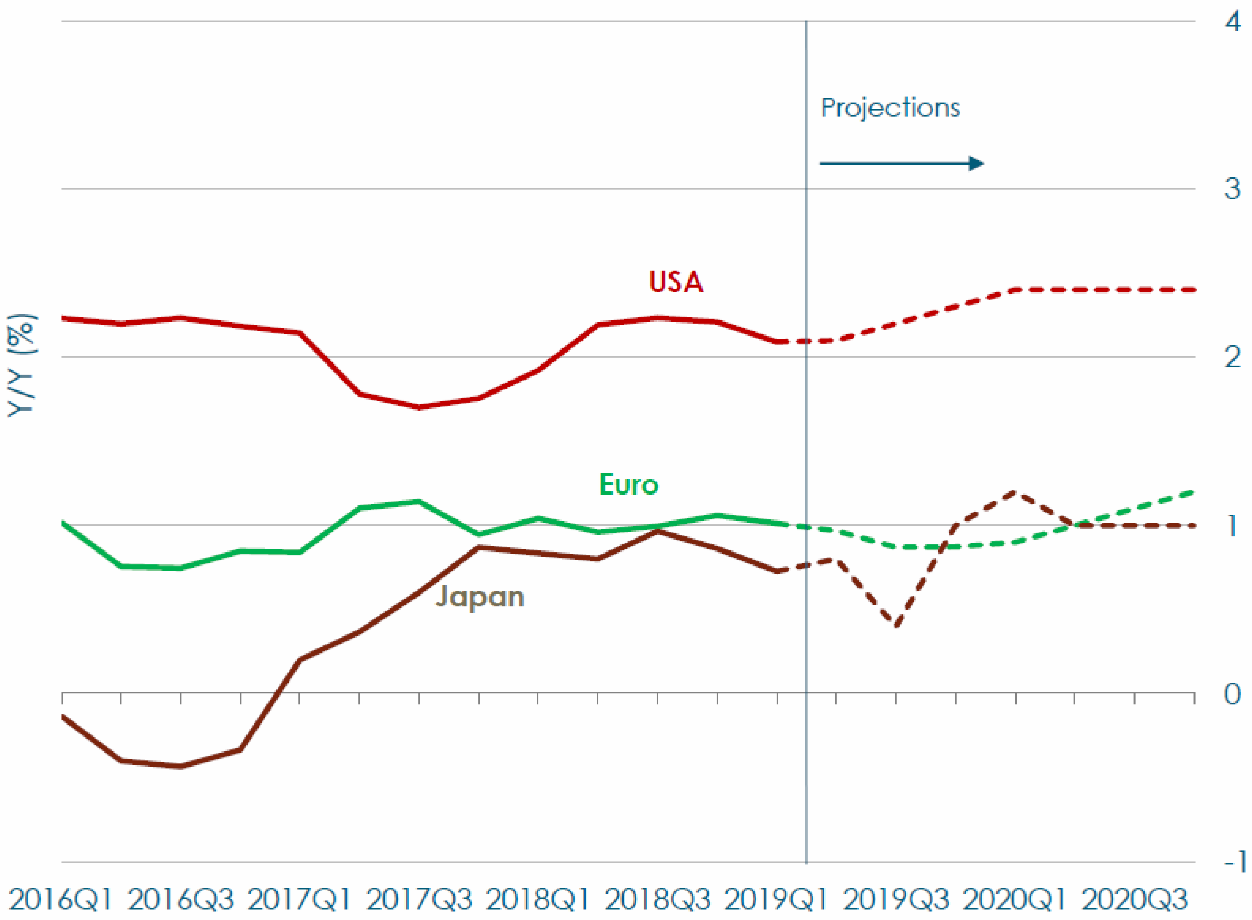
Global Indicators



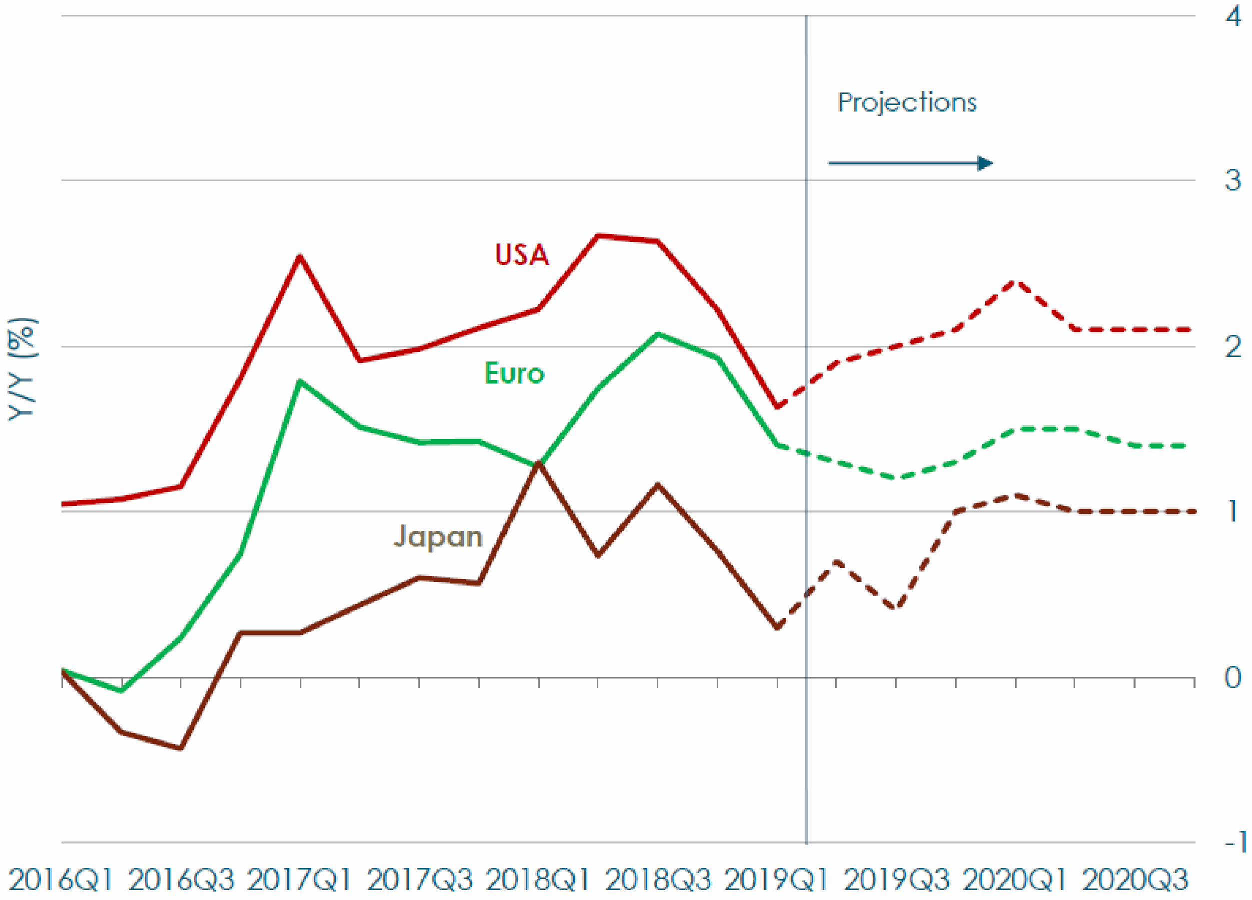
Source: Thomson Reuteurs and BCB

Inflation

Core

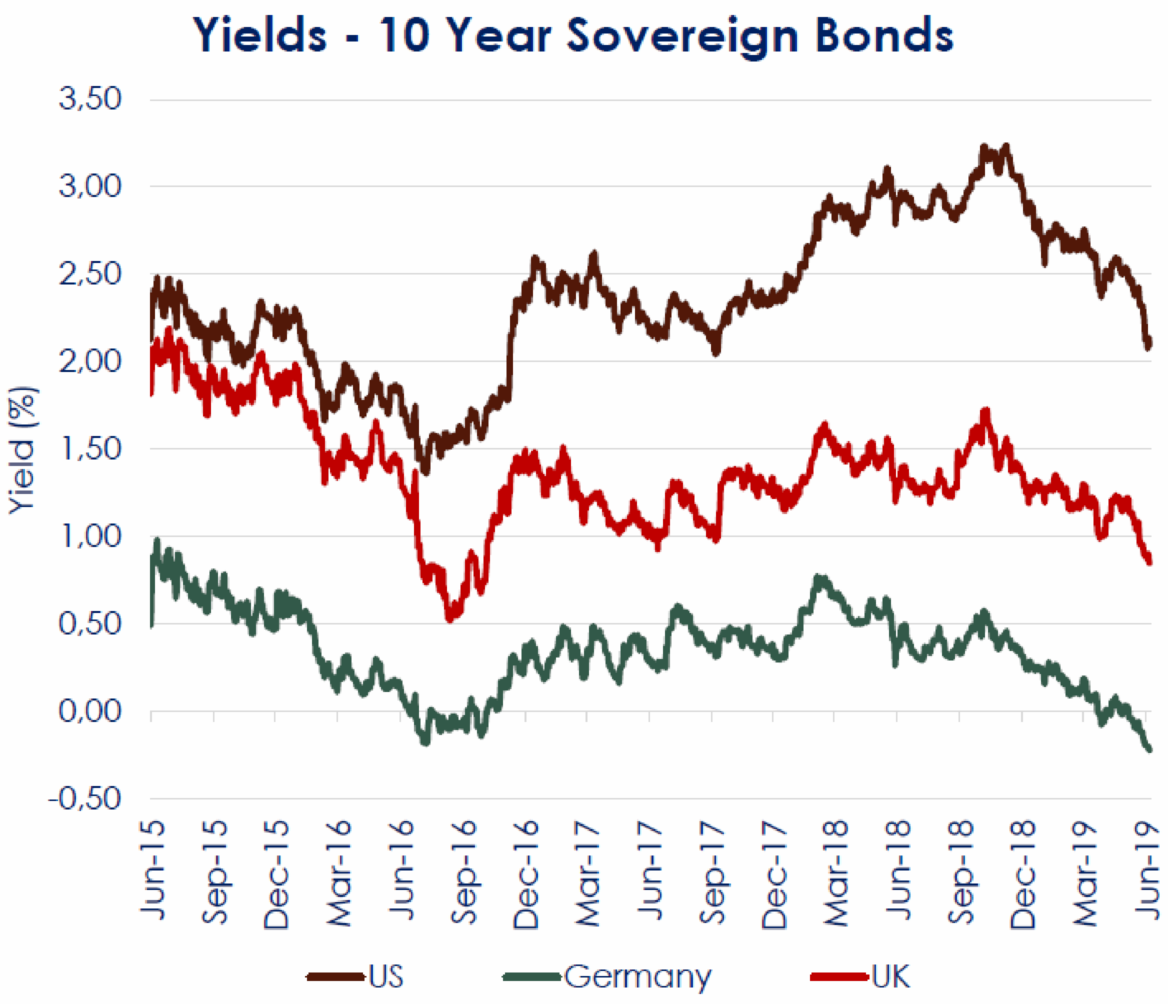


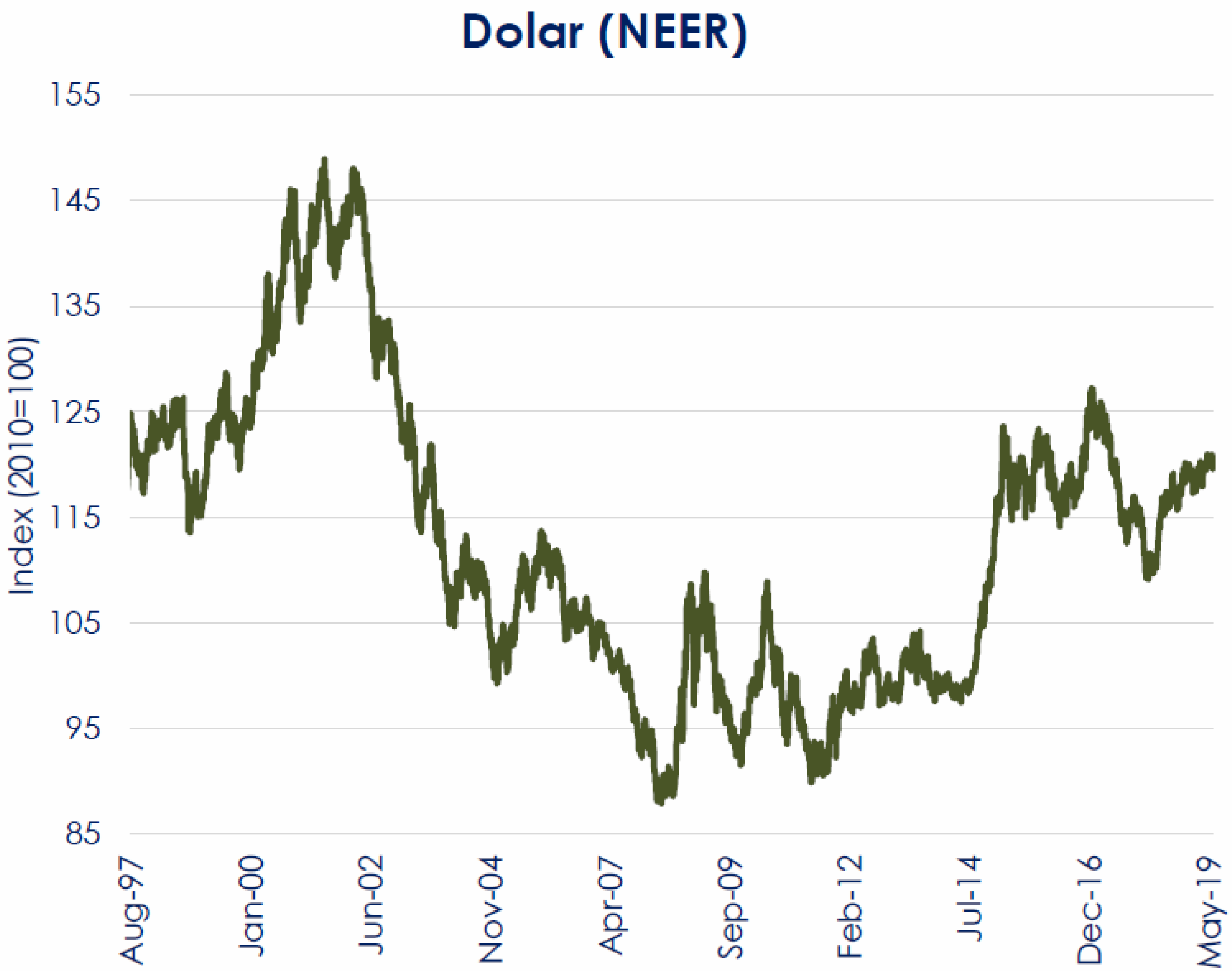
Headline



Source: Fed St. Louis, Eurostat, e-Stat and BCB/Derin

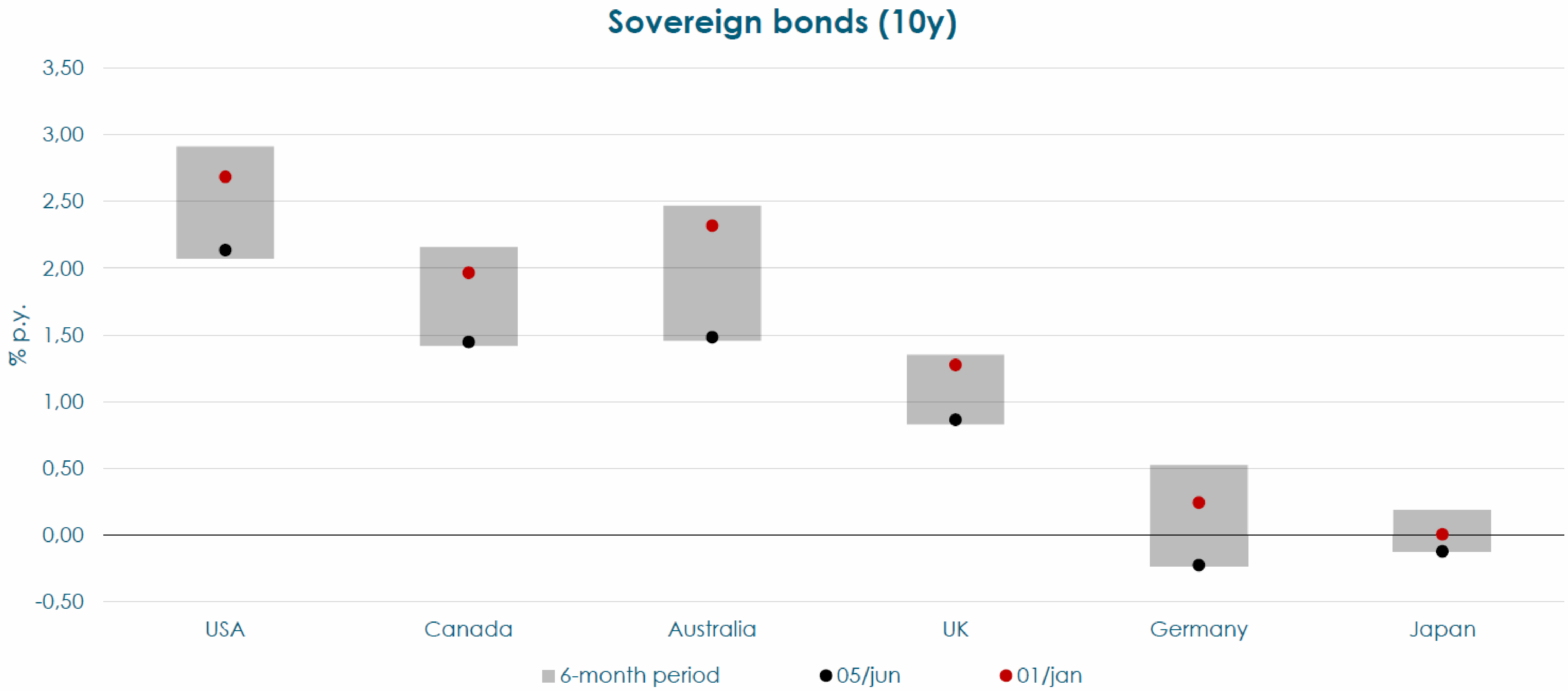
Global financial conditions





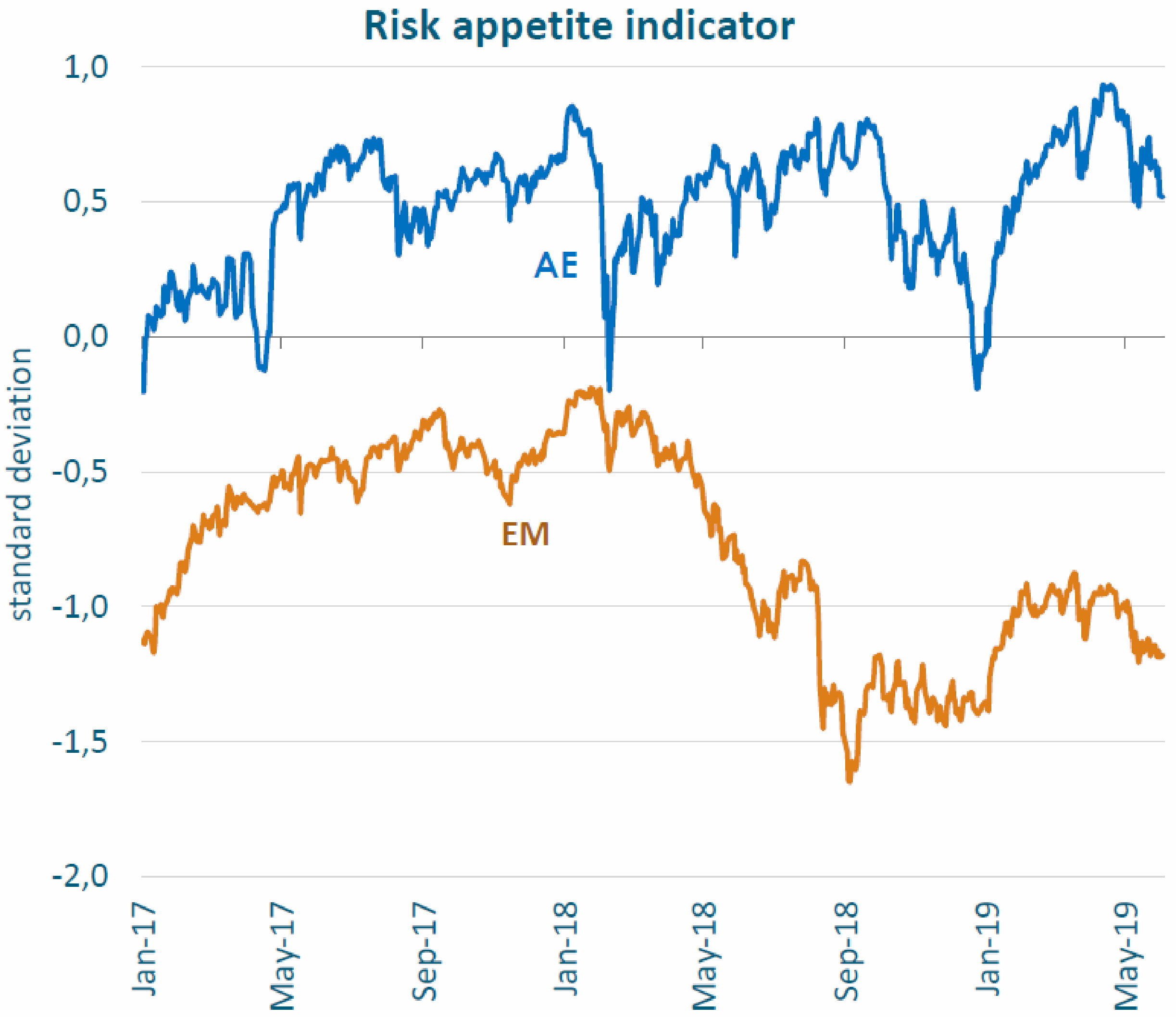
Sources: Reuters Datastream, BIS

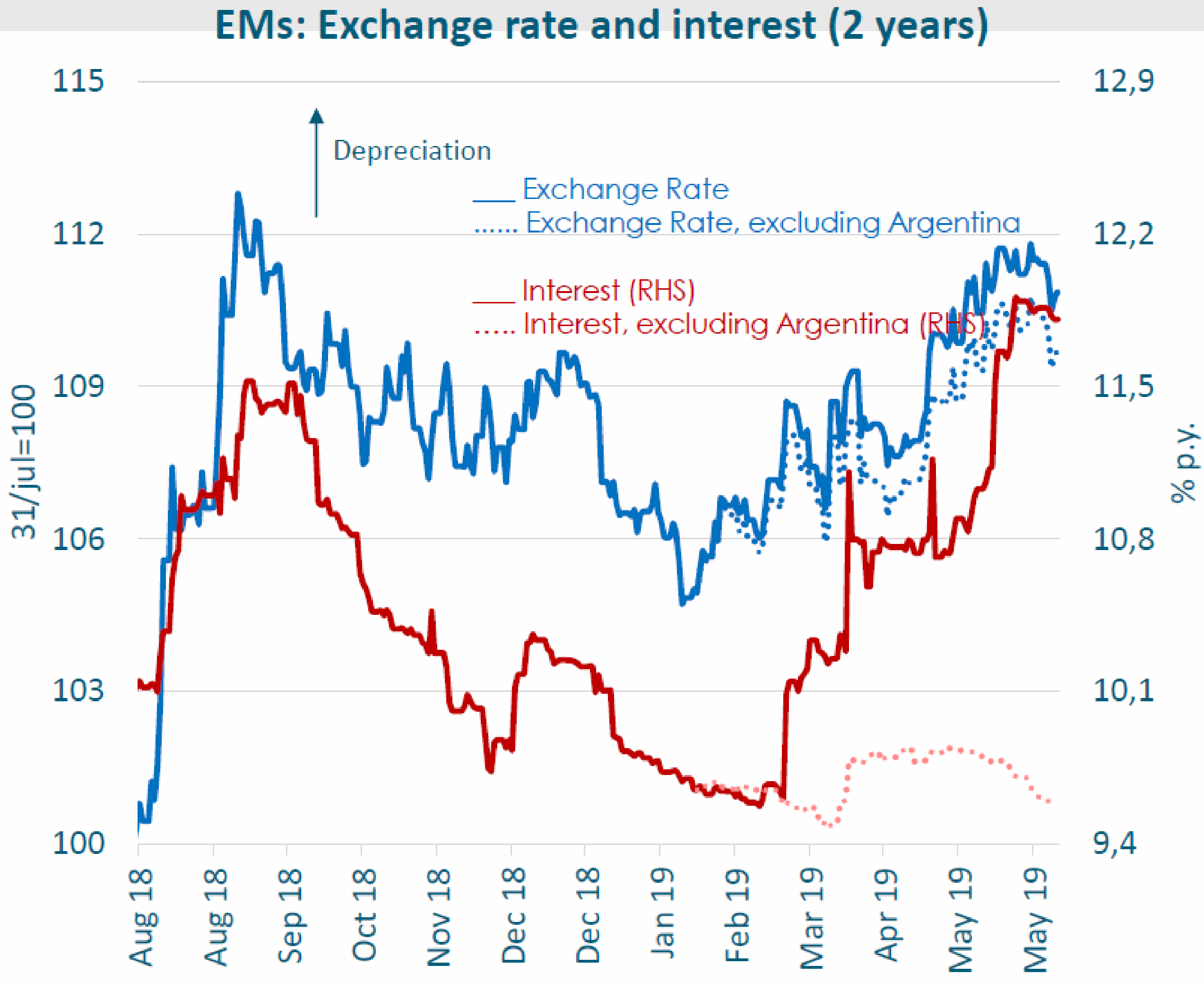
Central banks of the major economies are revising to more flexible monetary policies



Source: Bloomberg.

Emerging Markets





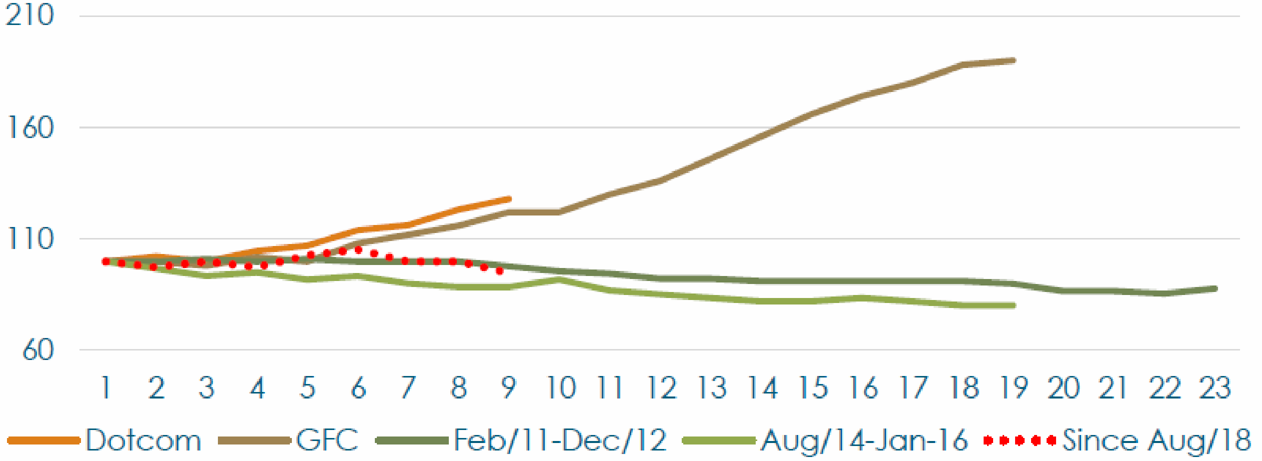
Average: Argentina, Brazil, Chile, Colombia, Mexico, South Africa, India, Indonesia, Russia and Turkey

Source: BCB/Derin, Thomson Reuters and Bloomberg

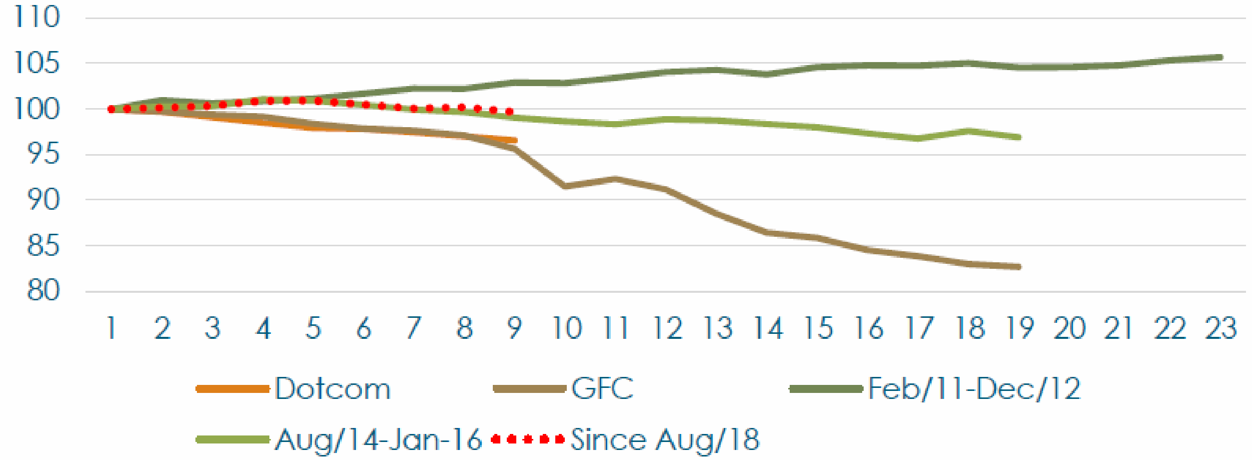
US Recessions and Slowdowns

Current behavior of macro variables consistent with a slowdown

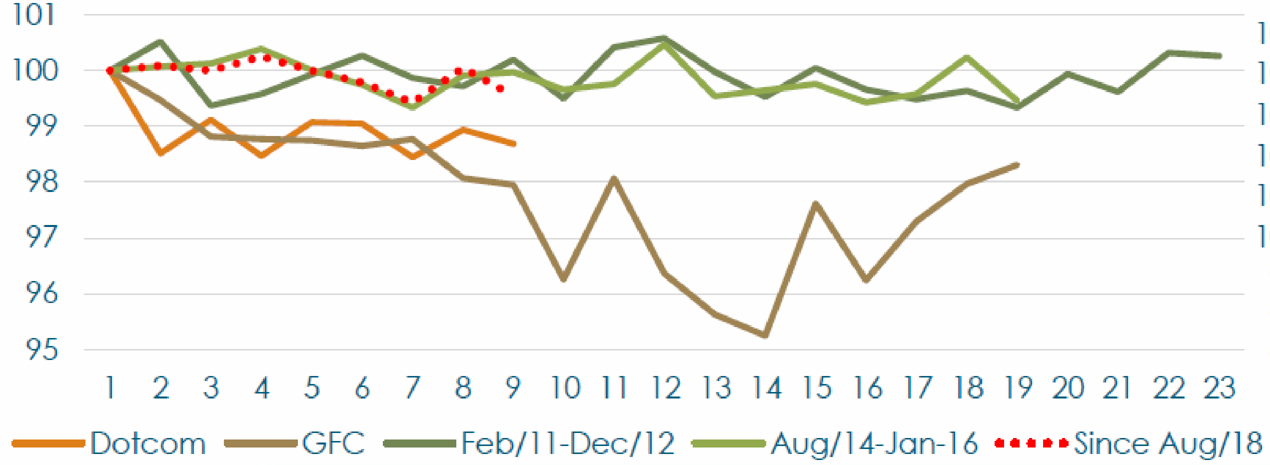
Unemployment Rate



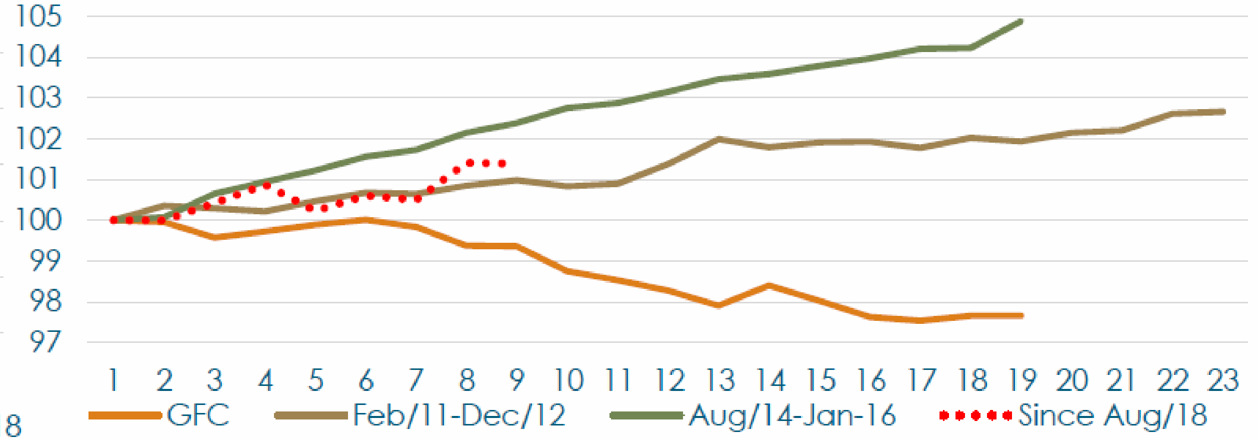
Industrial Production



CFNAI - Chicago Fed National Activity Index

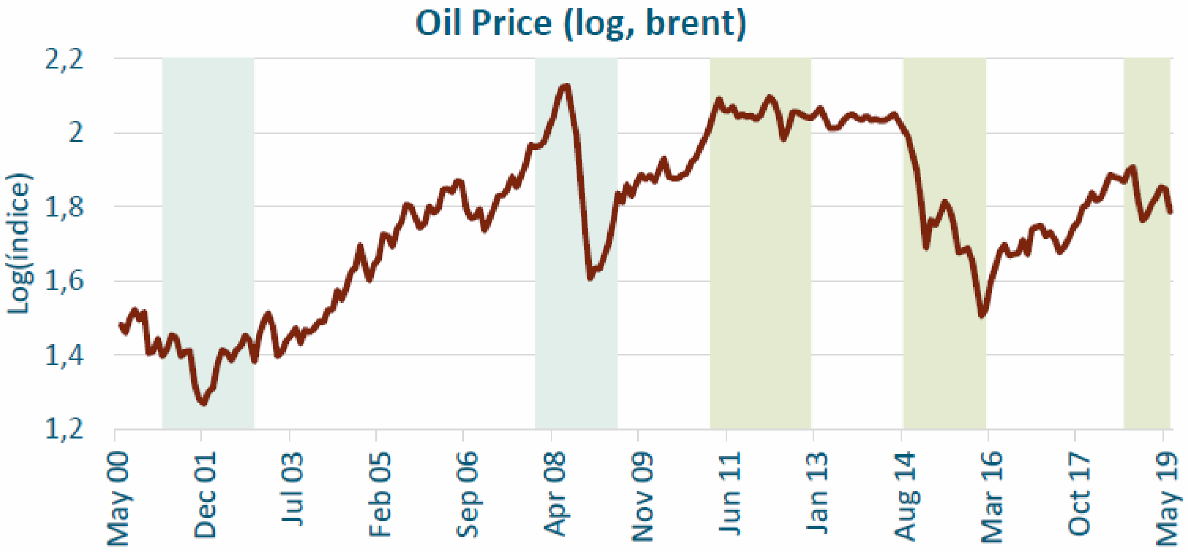


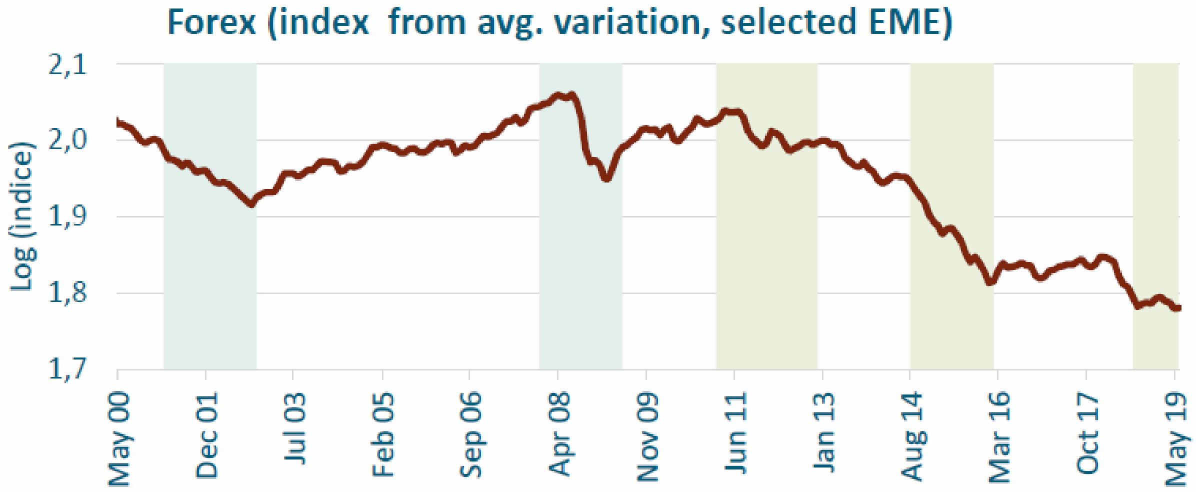
Consumption

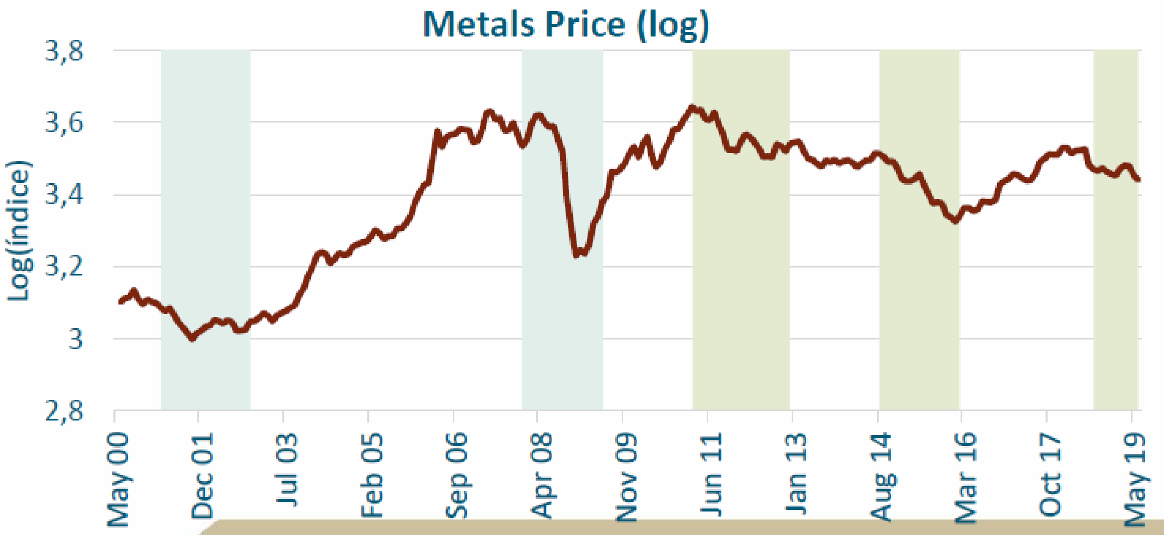


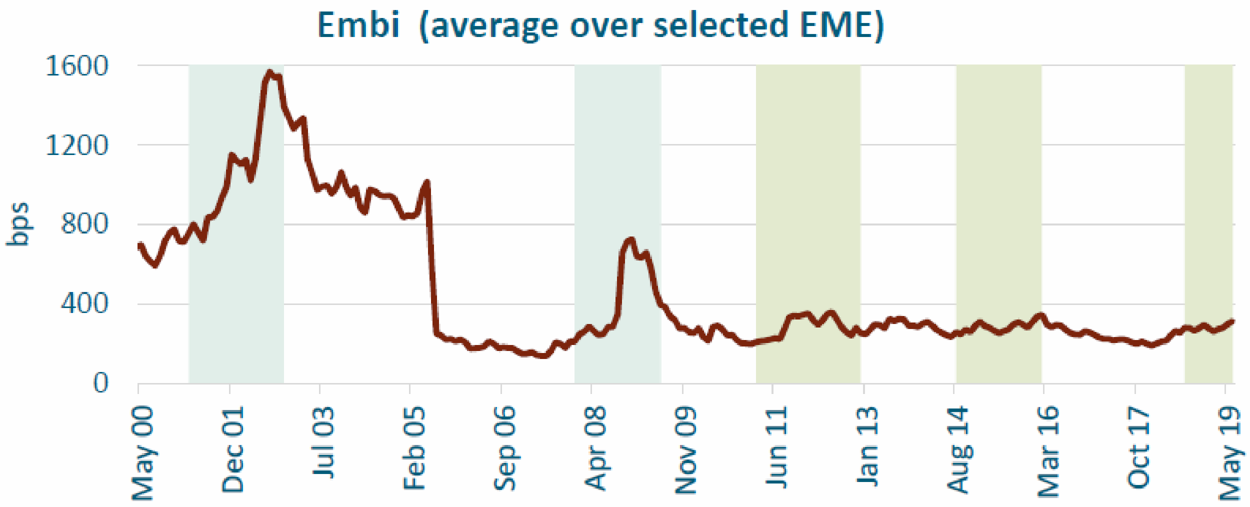
US Recessions and Slowdowns: EMEs and Commodities

Higher macro volatility during recessions and slowdowns



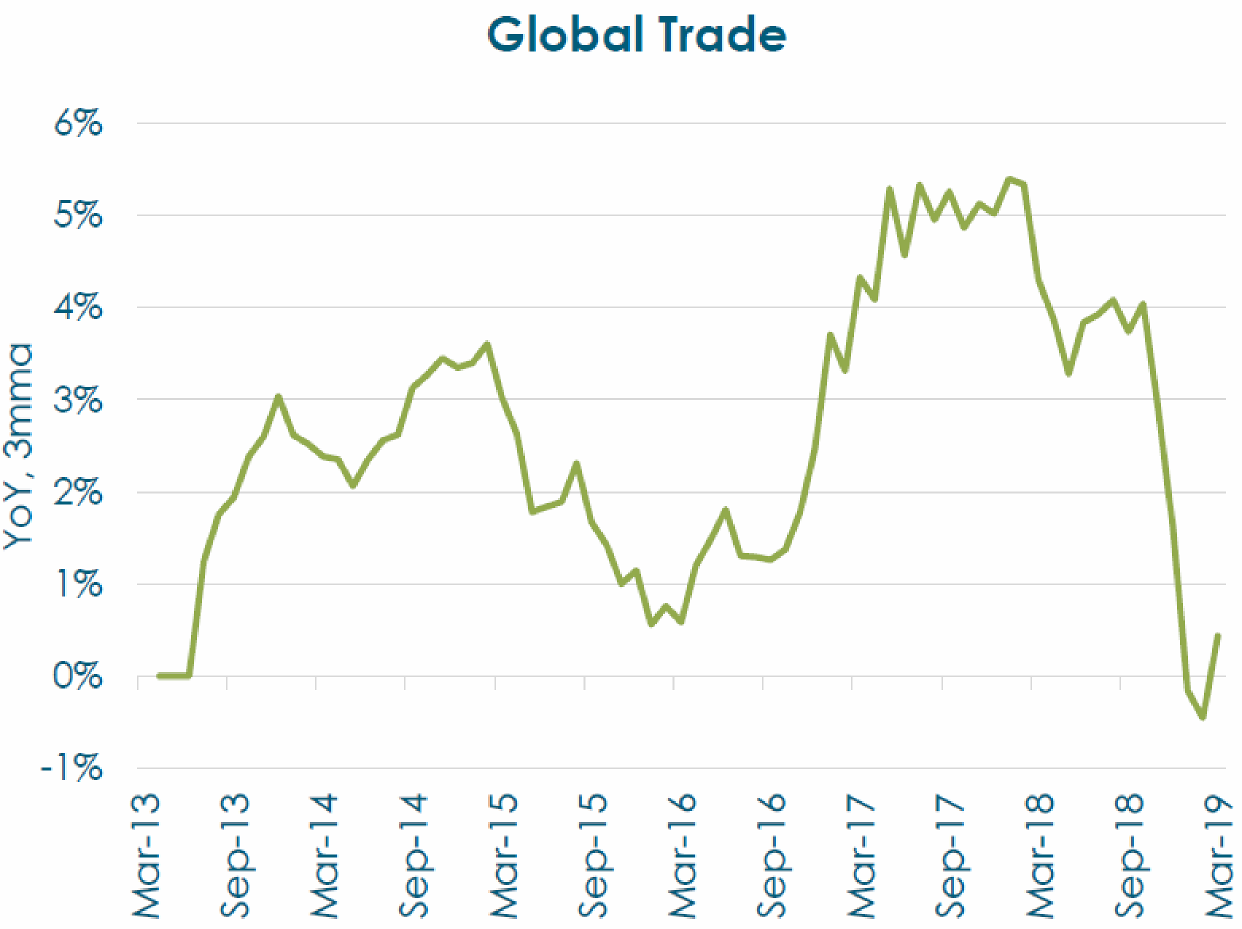


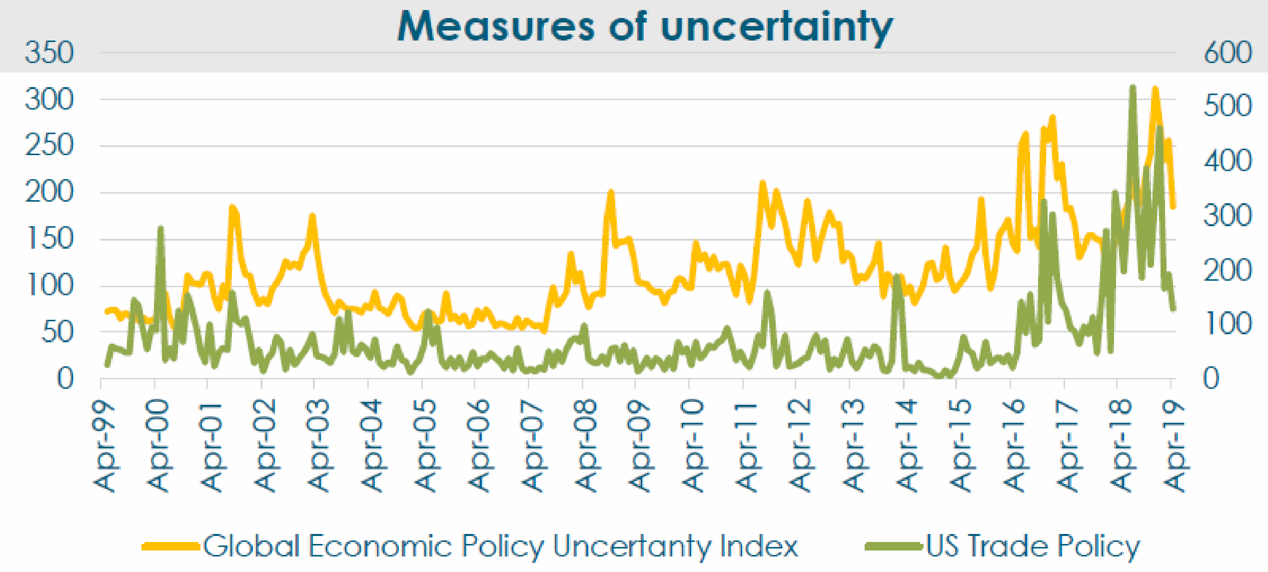


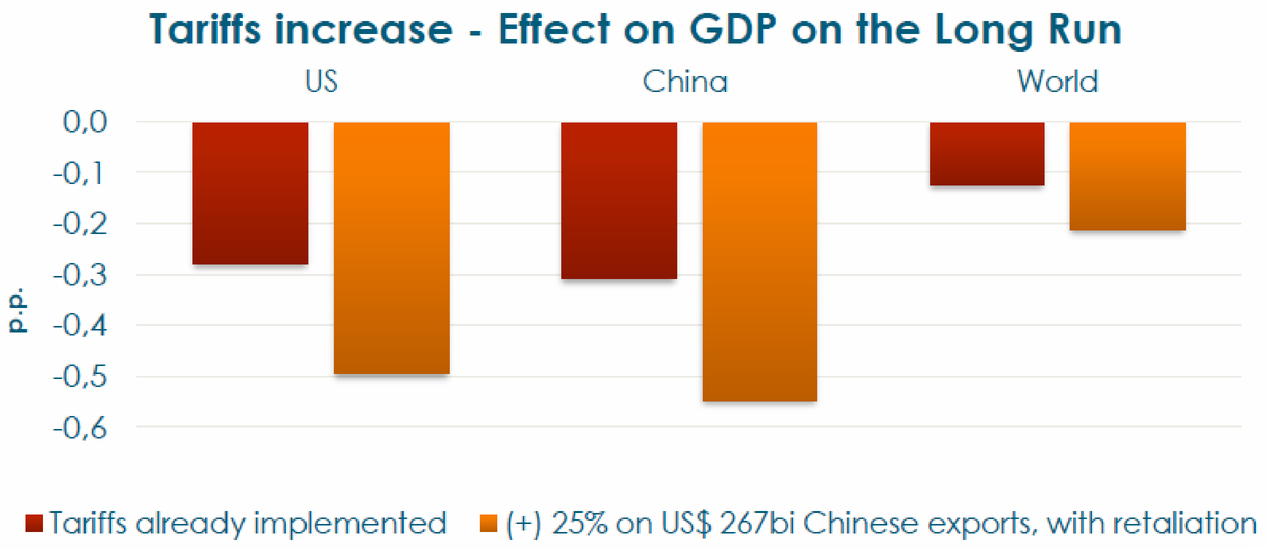


Fonte: Fed de St. Louis, Eurostat, e-Stat e Derin

Trade tensions







Source: Thomson Reuters, Economic Policy Uncertainty and IMF

Domestic Scenario

Economic growth continues to recover, but slower that projected

Possible explanations:

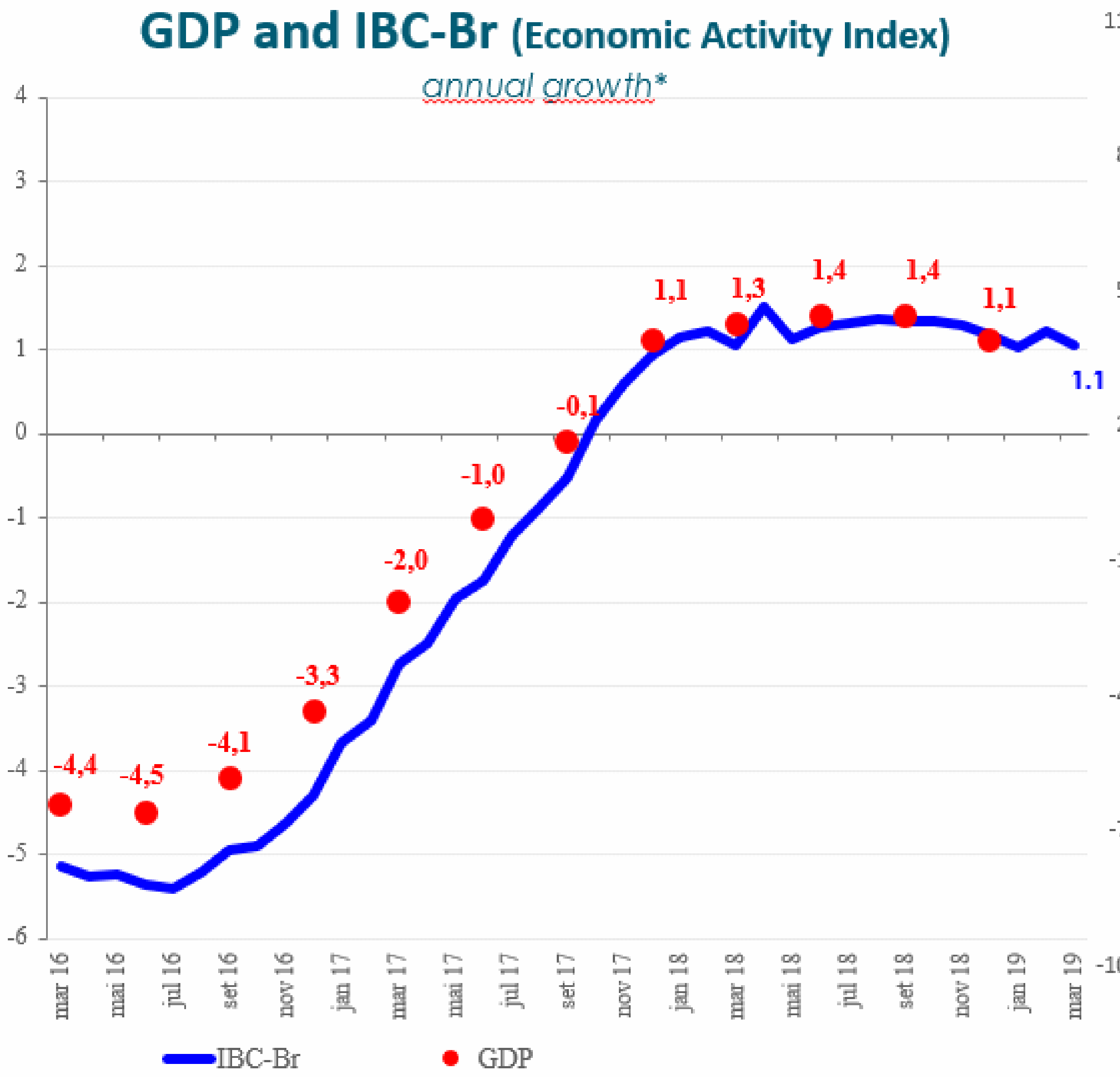
1) The Brazilian economy has experienced several shocks throughout 2018, including the temporary halt in the transportation sector in May, tighter financial conditions due to electoral uncertainty, and the adverse global environment for emerging economies.

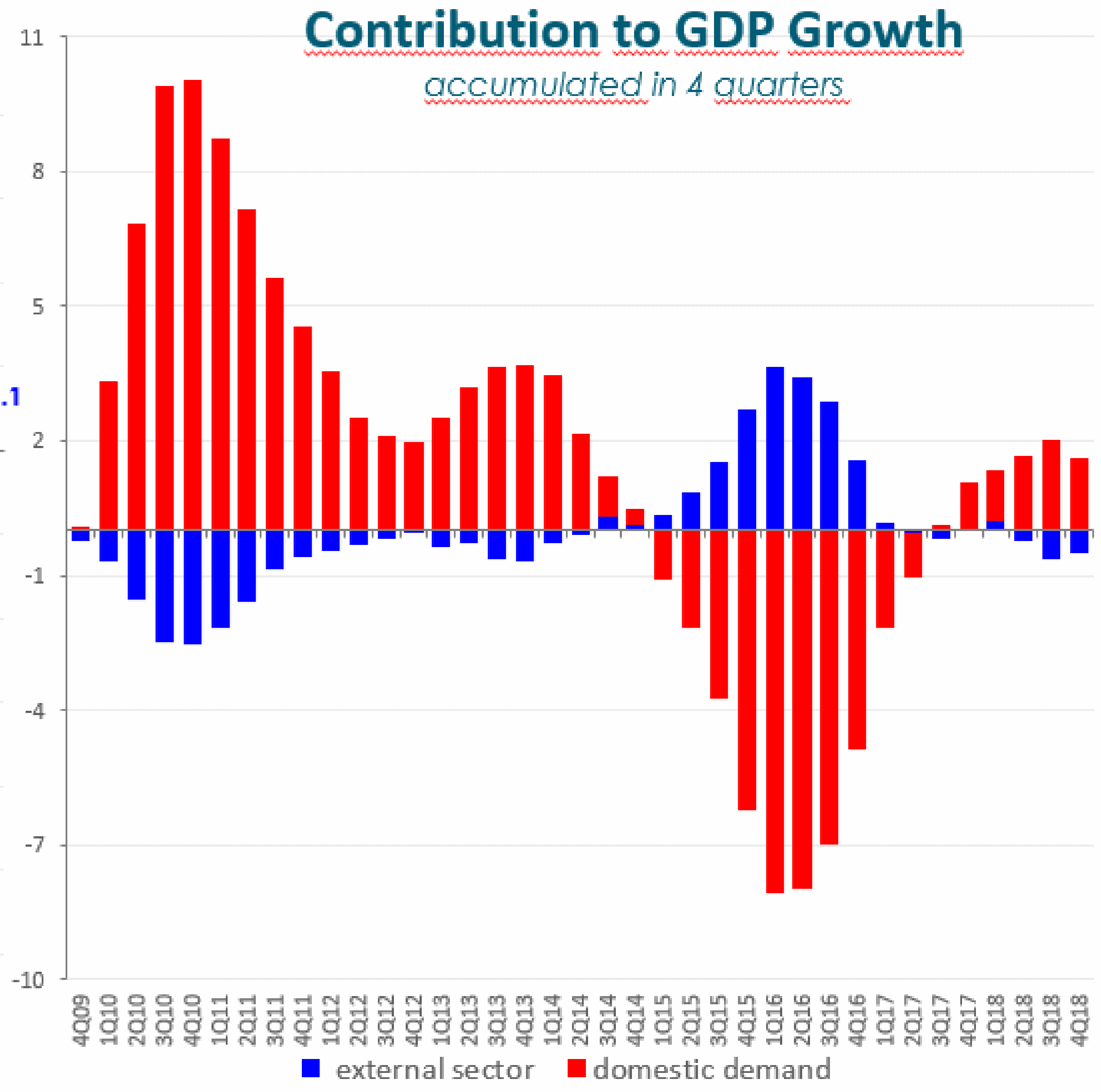
2) Uncertainties regarding reforms, notably those of fiscal nature, this year would postpone investment decisions.

Our scenario:

- gradual recovery will resume;
- high level of economic slack.

An acceleration in the pace of economic recovery to more robust levels will depend on an environment of reduced uncertainties regarding the approval and implementation of reforms.





*average of last 12 months/average of previous 12 months

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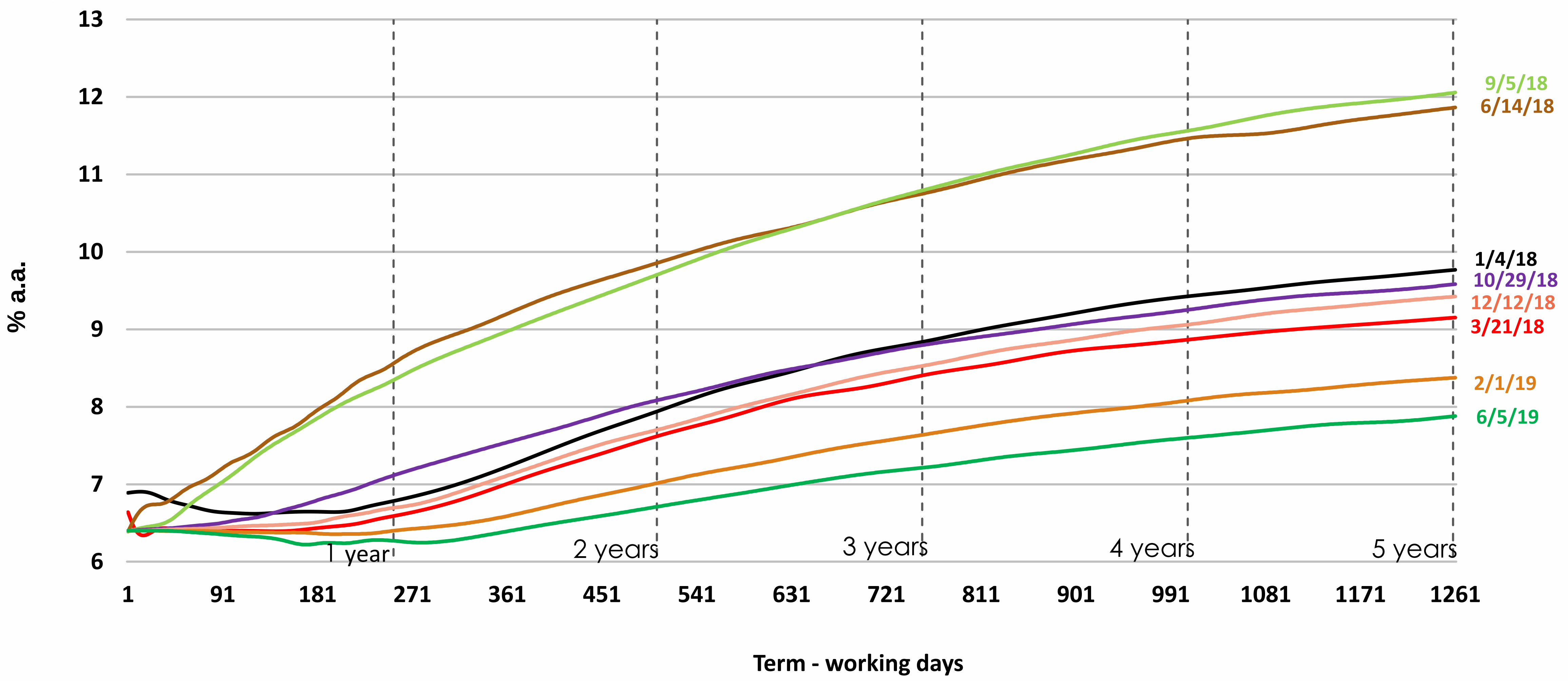
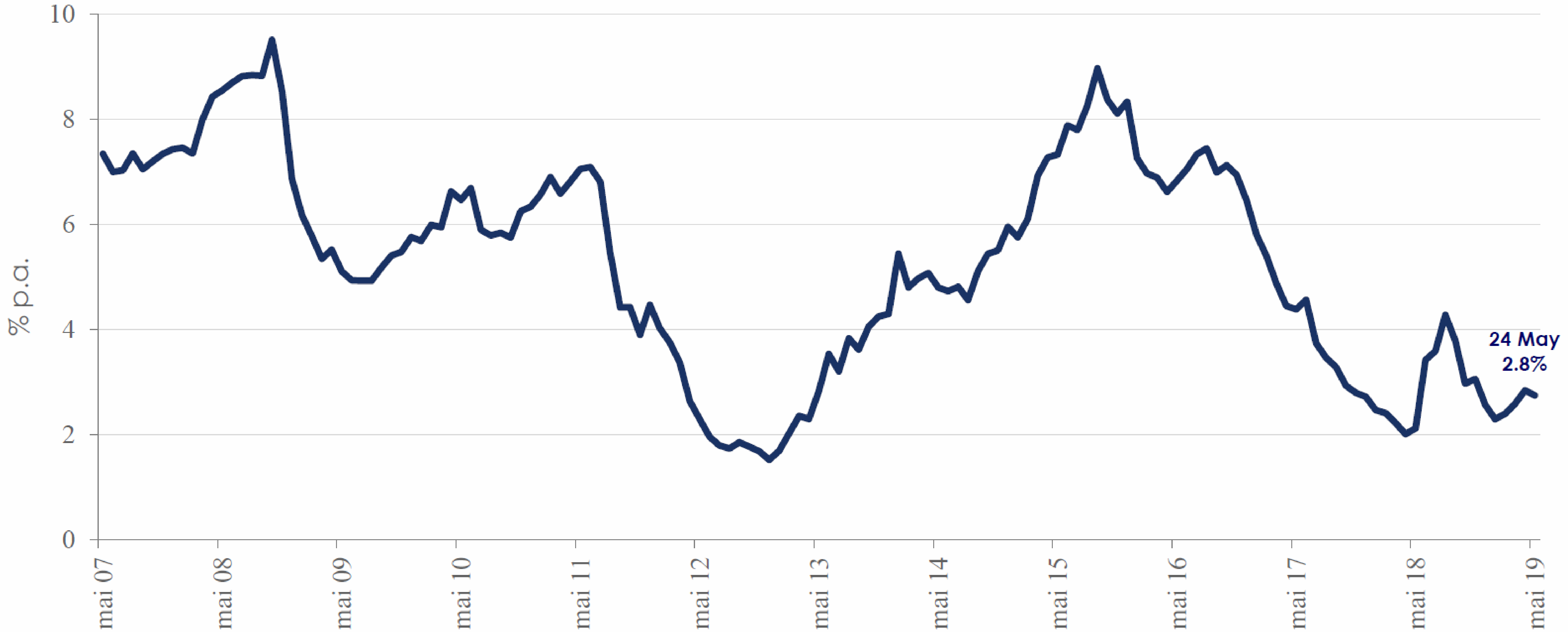
Interest rate Curve – DI (One-day Interbank Deposit Futures)



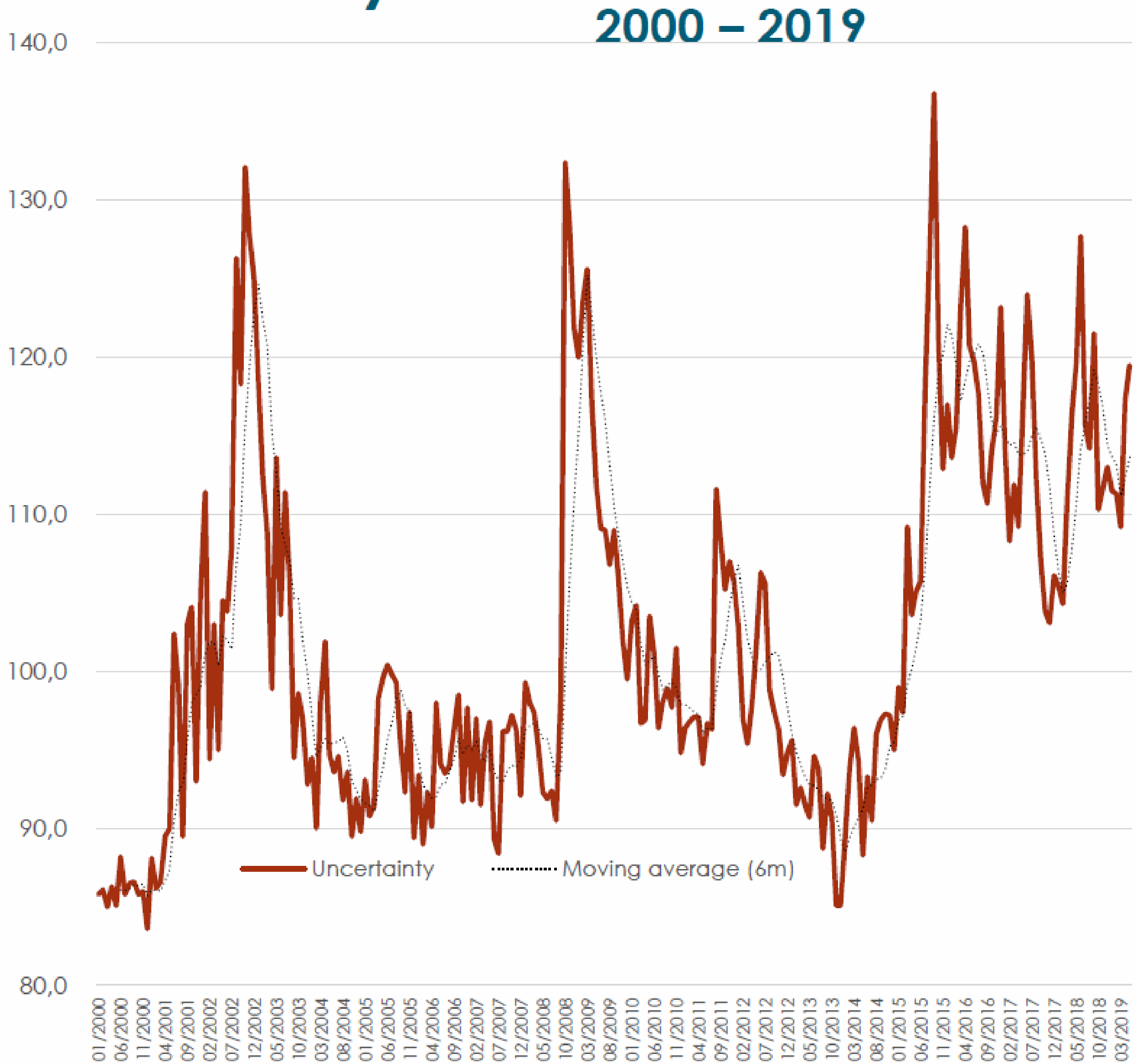
Sources: B3, BCB

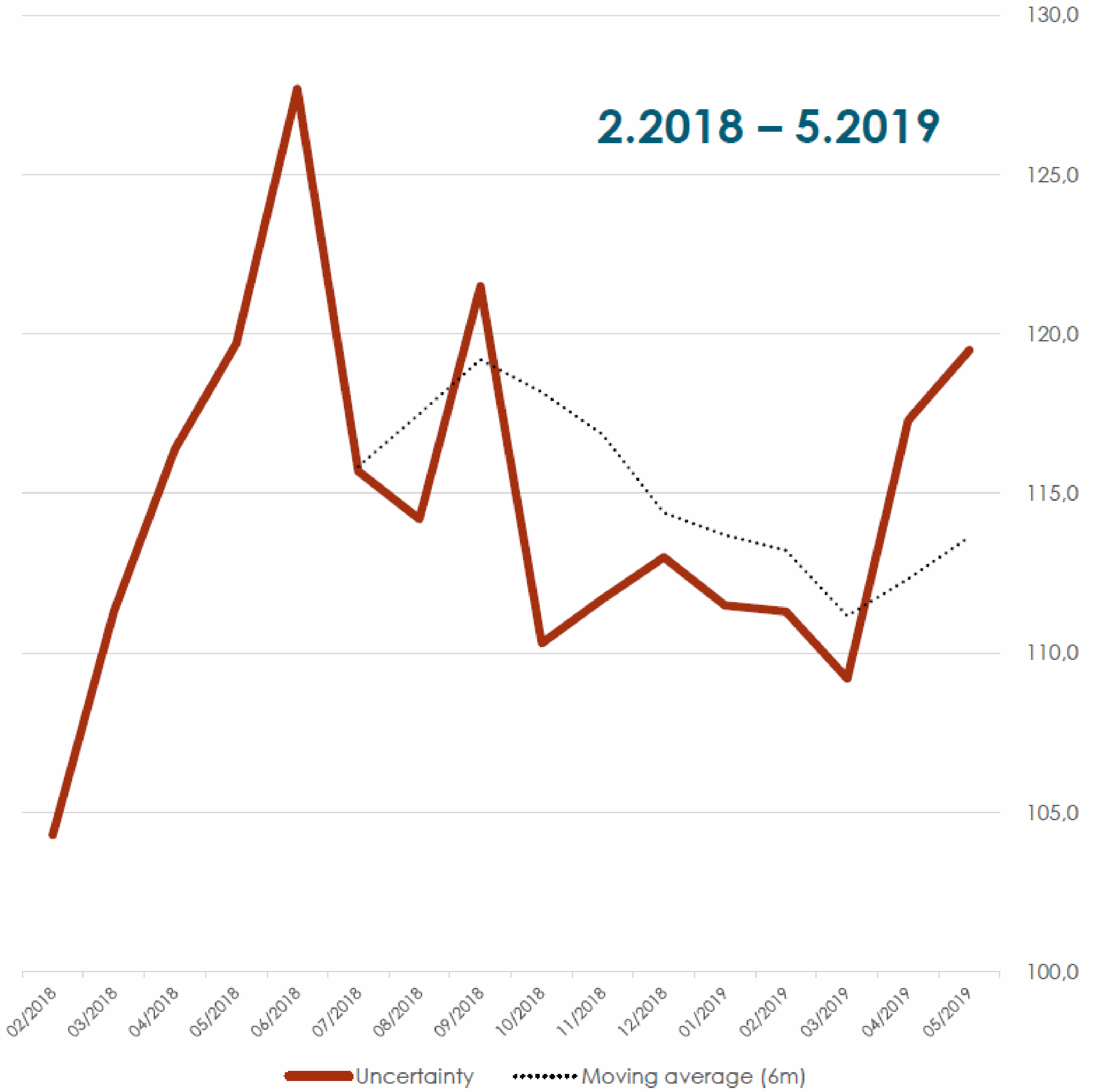
Real Interest Rate

360-day market rate discounted by the IPCA expected for the next 12 months (Focus)



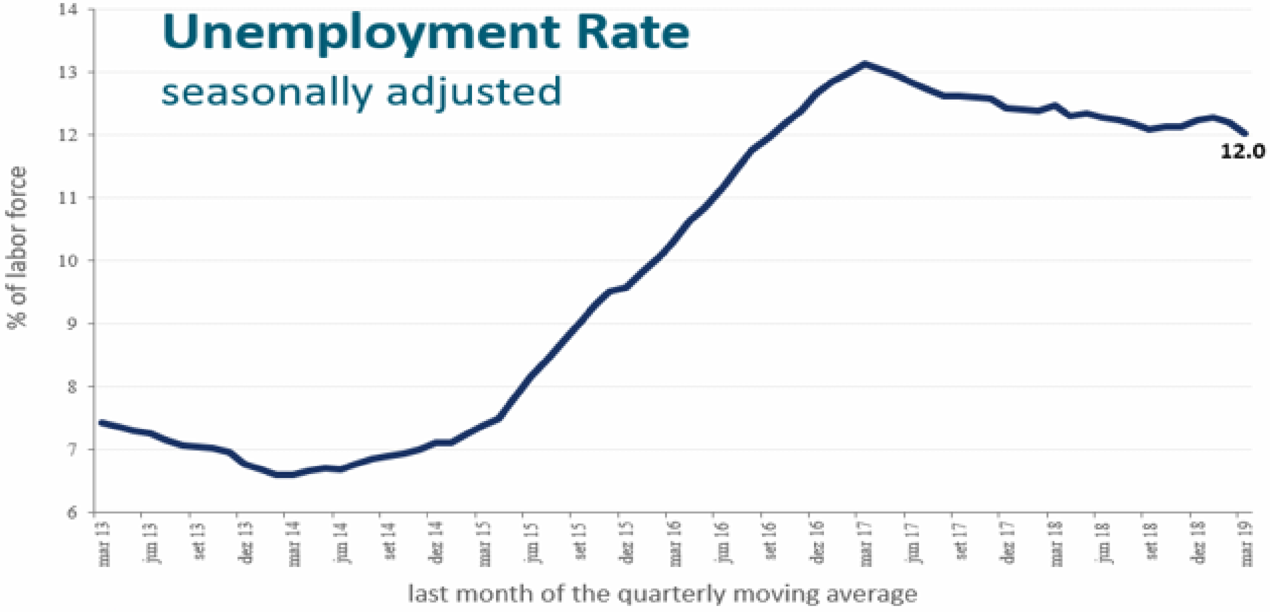
Uncertainty

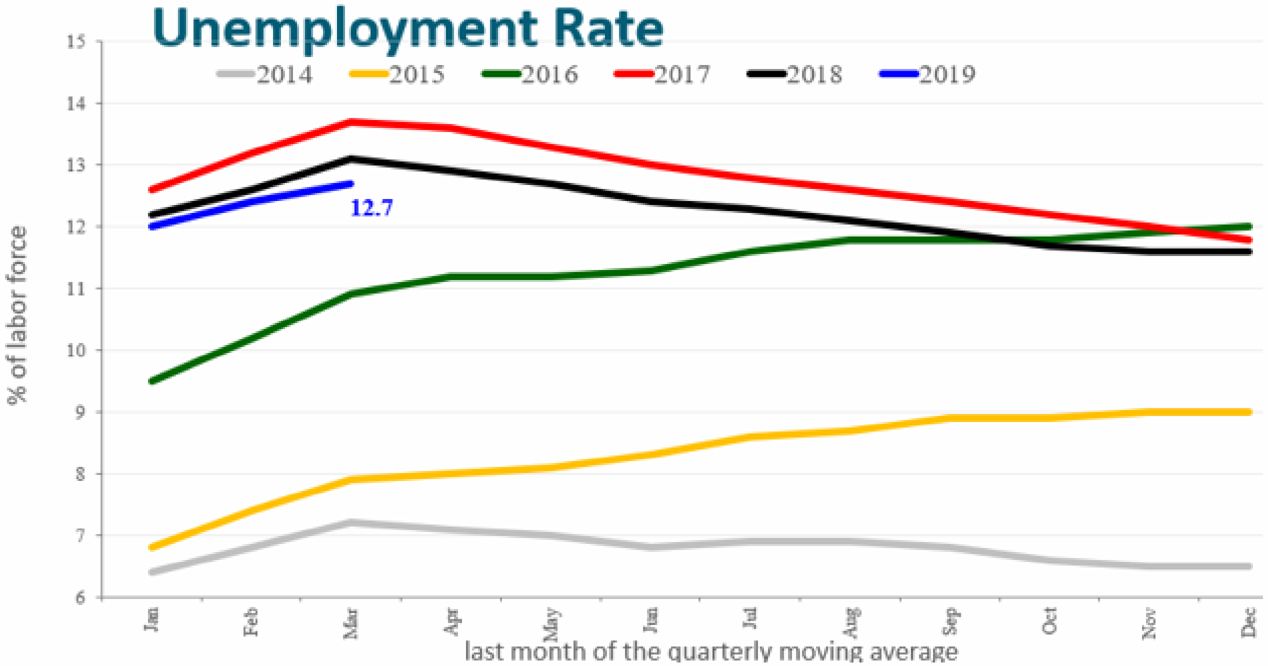


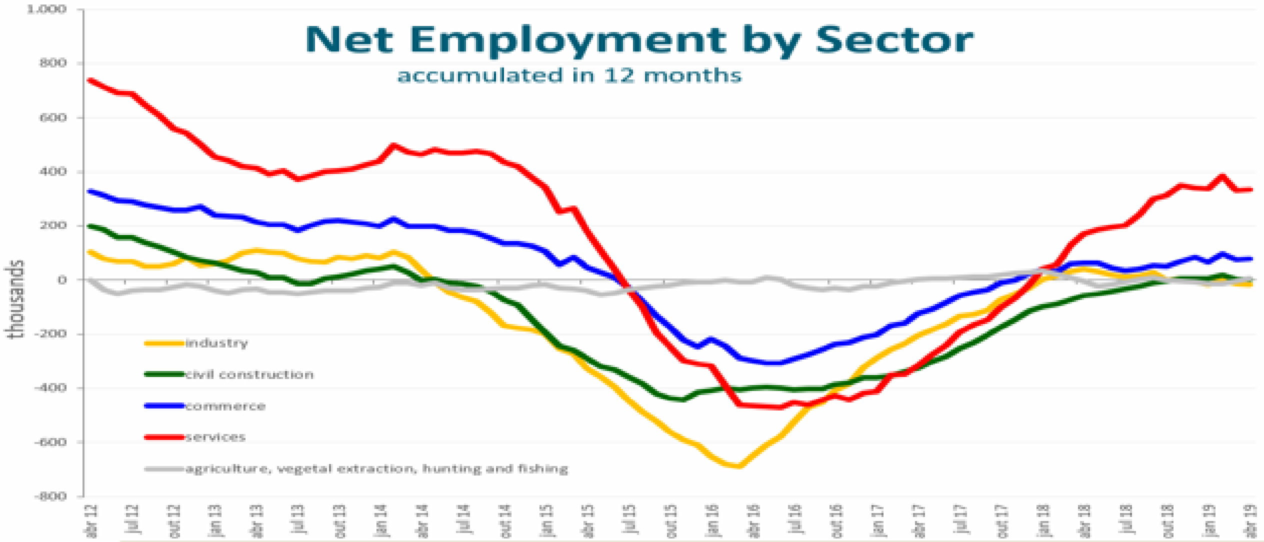


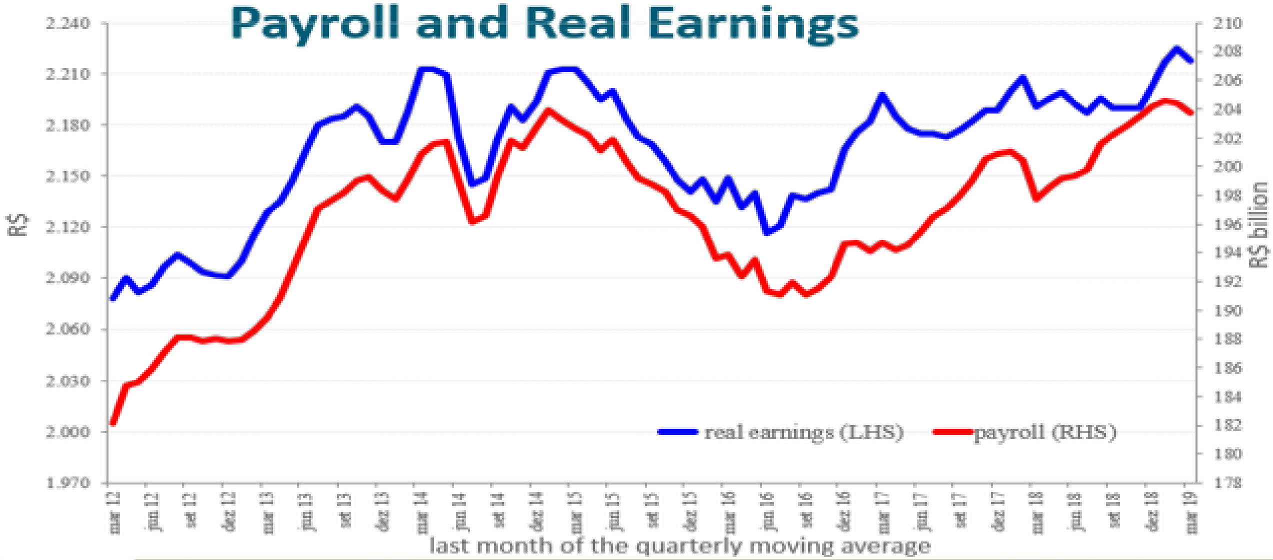
Source: FGV

Labor Market



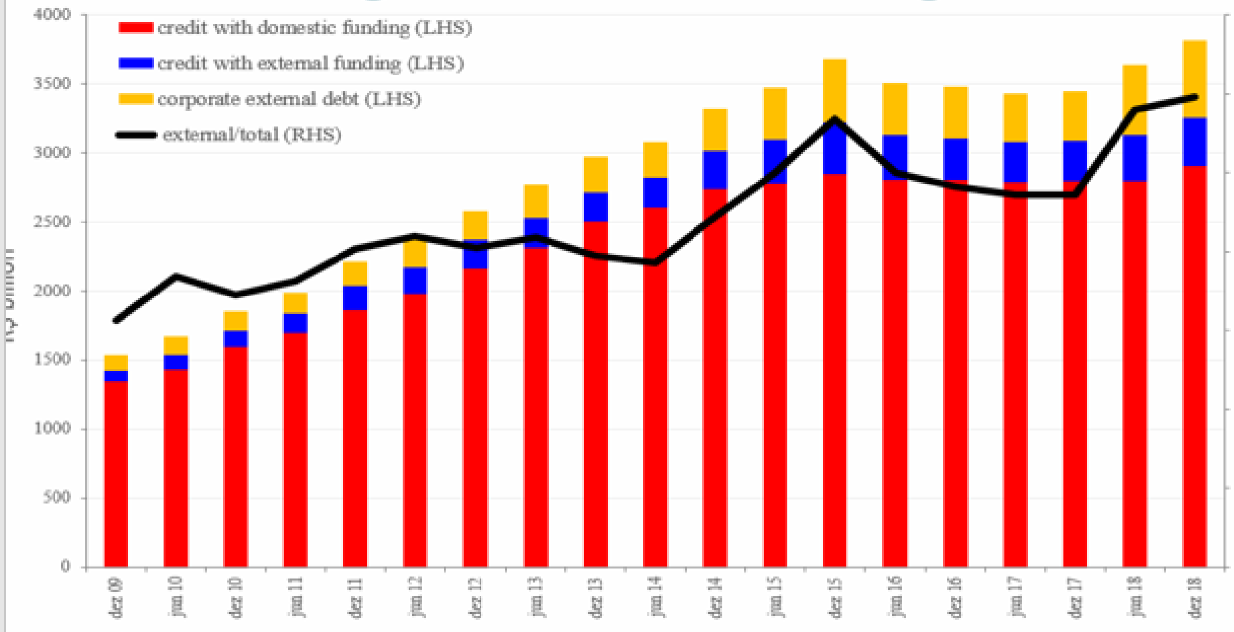






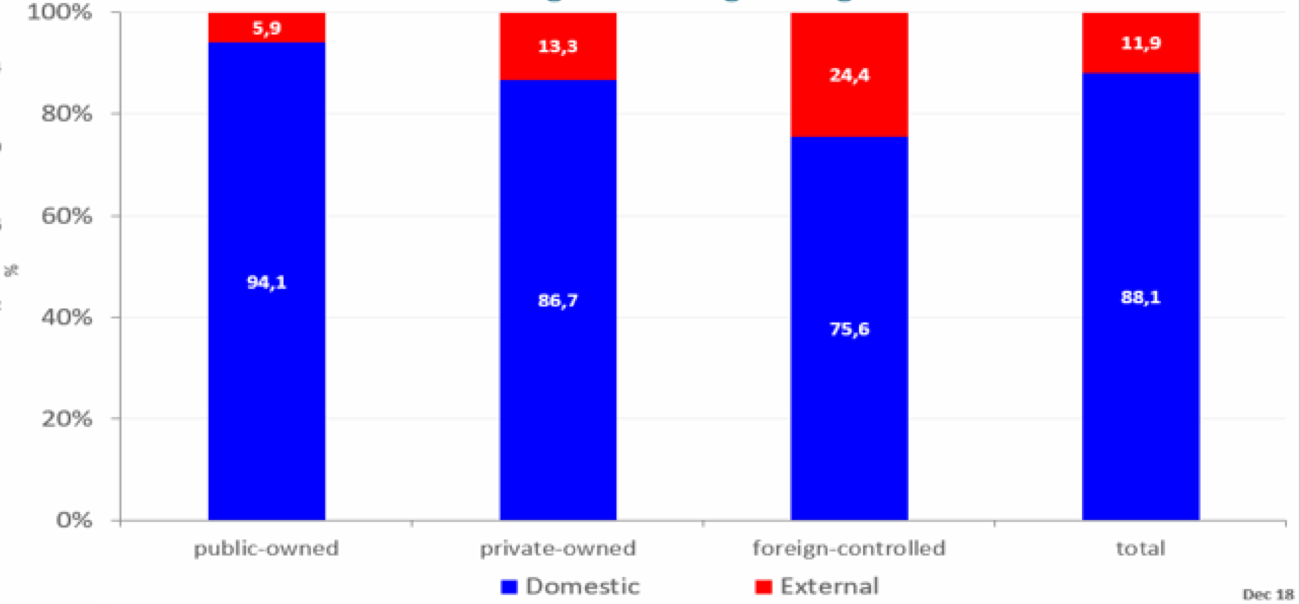
Source: IBGE (PNAD Contínua)

Credit Funding: Domestic and Foreign Sources

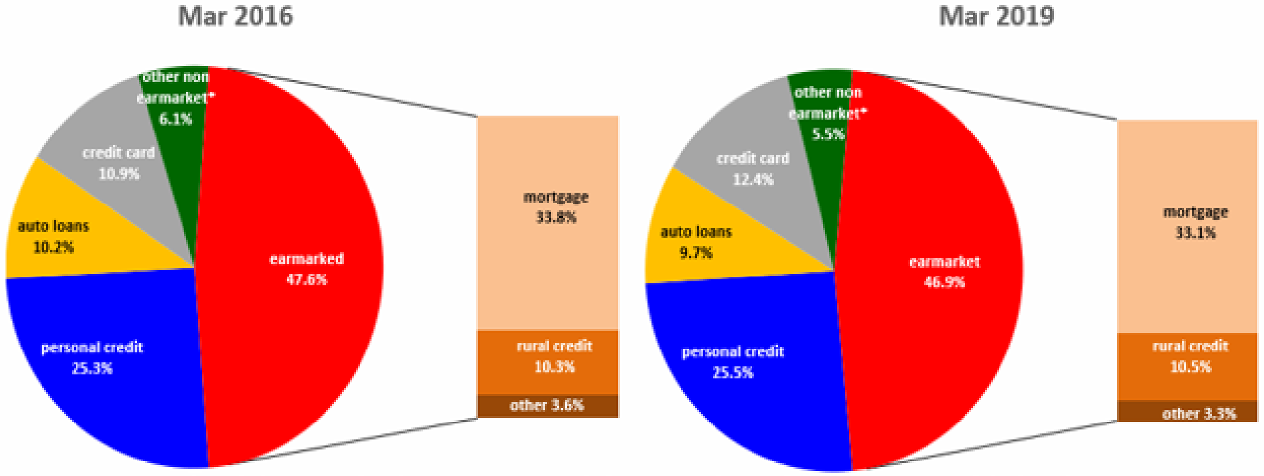


Credit by Bank Ownership

origin of banking funding

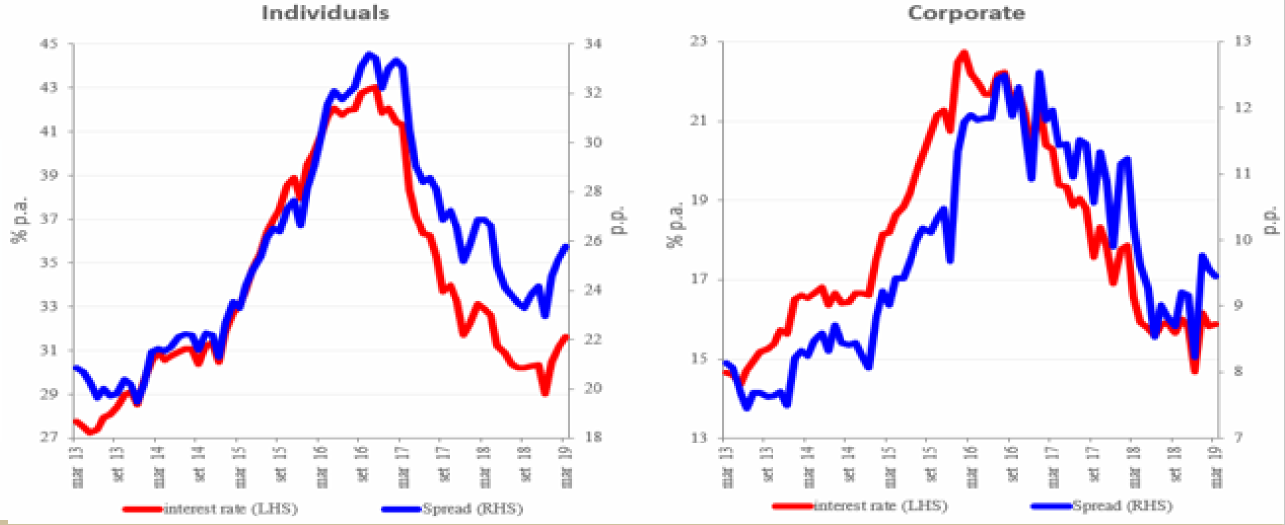


Consumer Credit Breakdown

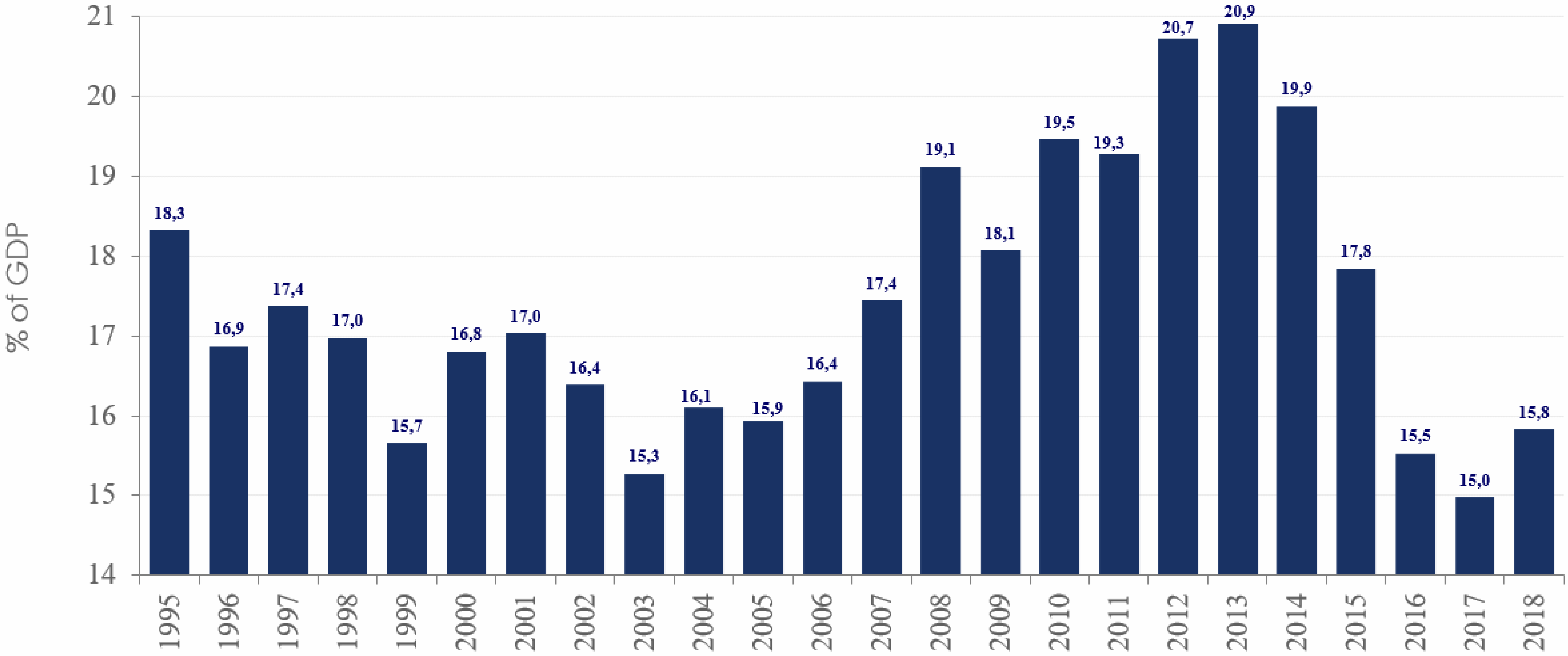


*It includes: Personal credit renegotiation, Overdraft, Leasing, Other goods financing, Discount of checks, Others

Credit Interest Rate and Spread



Investment Rate

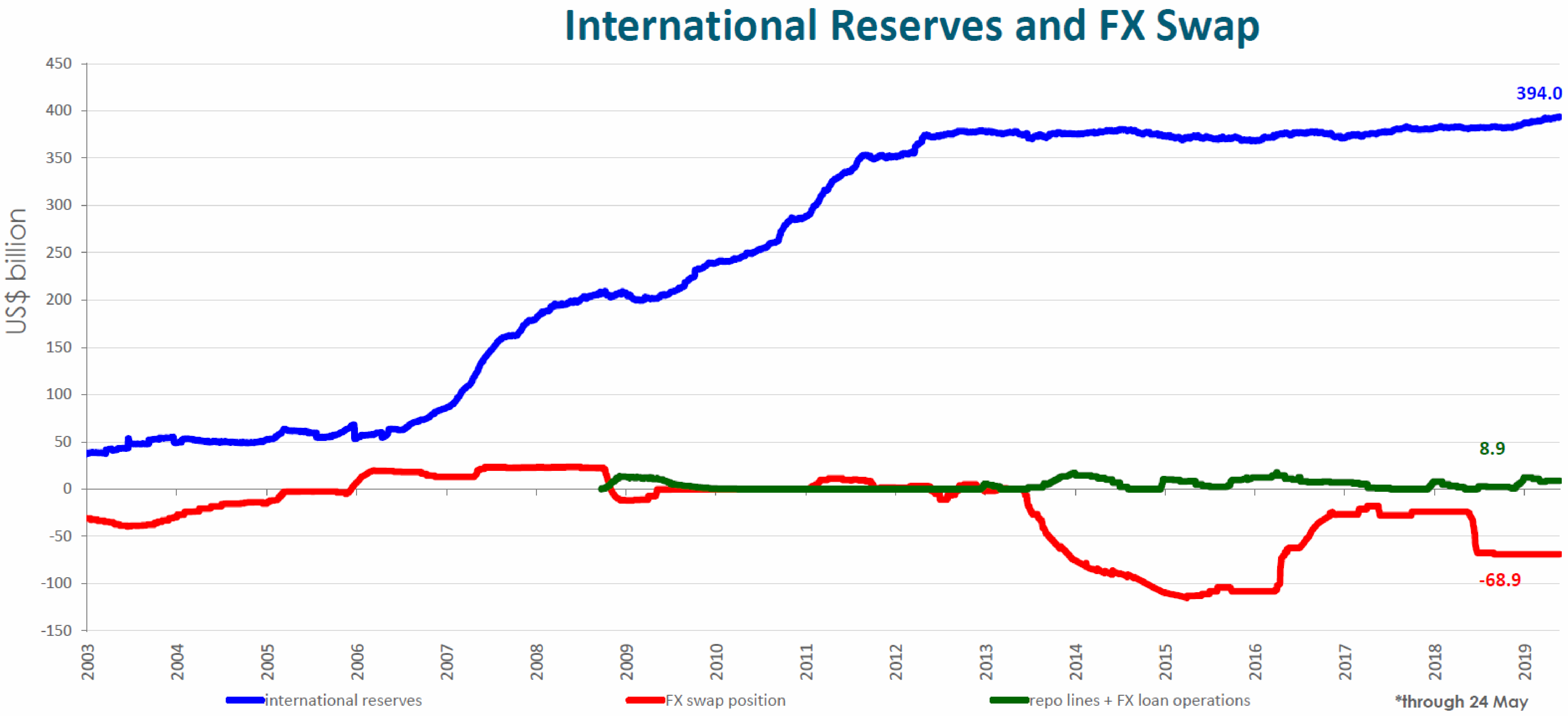


Resilience of the Brazilian economy

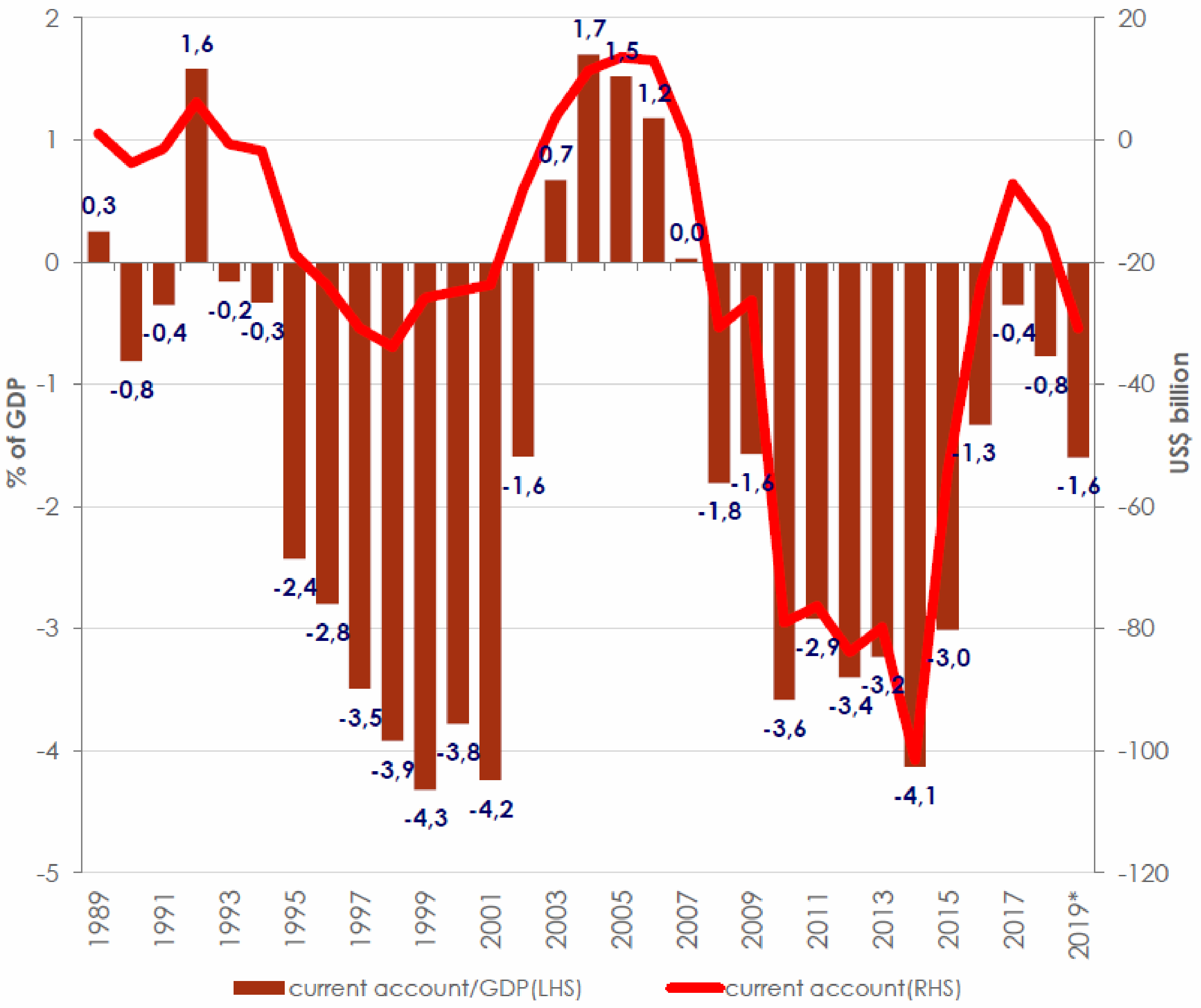
Brazilian economy has the capacity to withstand a setback in the international scenario and to absorb shocks, given its consistent policies and buffers:

- Anchored inflation expectations;
- Exchange rate flexibility;
- Robust balance of payments;
- Comfortable level of international reserves;
- Prospects of economic recovery.

International Buffers



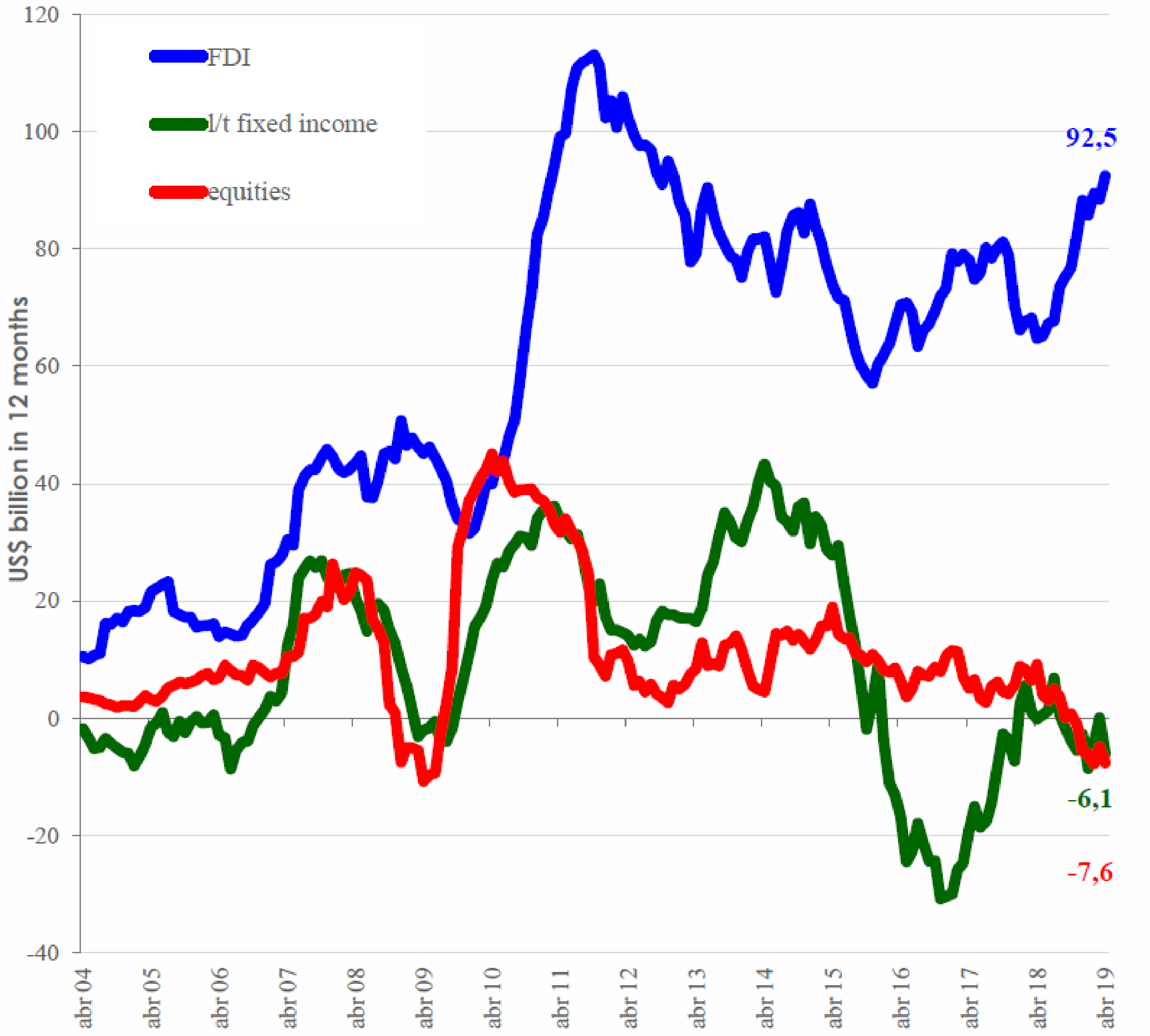
Current Account



From 1995 on, methodology according to BPM6

* BCB forecast

Net Foreign Investment Flow, by Category



Consistent policies toolkit

- Inflation targeting
- Fiscal consolidation
- Exchange rate flexibility
- Strong prudential policy
- Intensive banking supervision
- International insertion *(including Brazil's convergence to the OECD)*

NEXT STEPS

Central Bank autonomy	Bank resolution
Macro-prudential policy coordination	FX modernisation

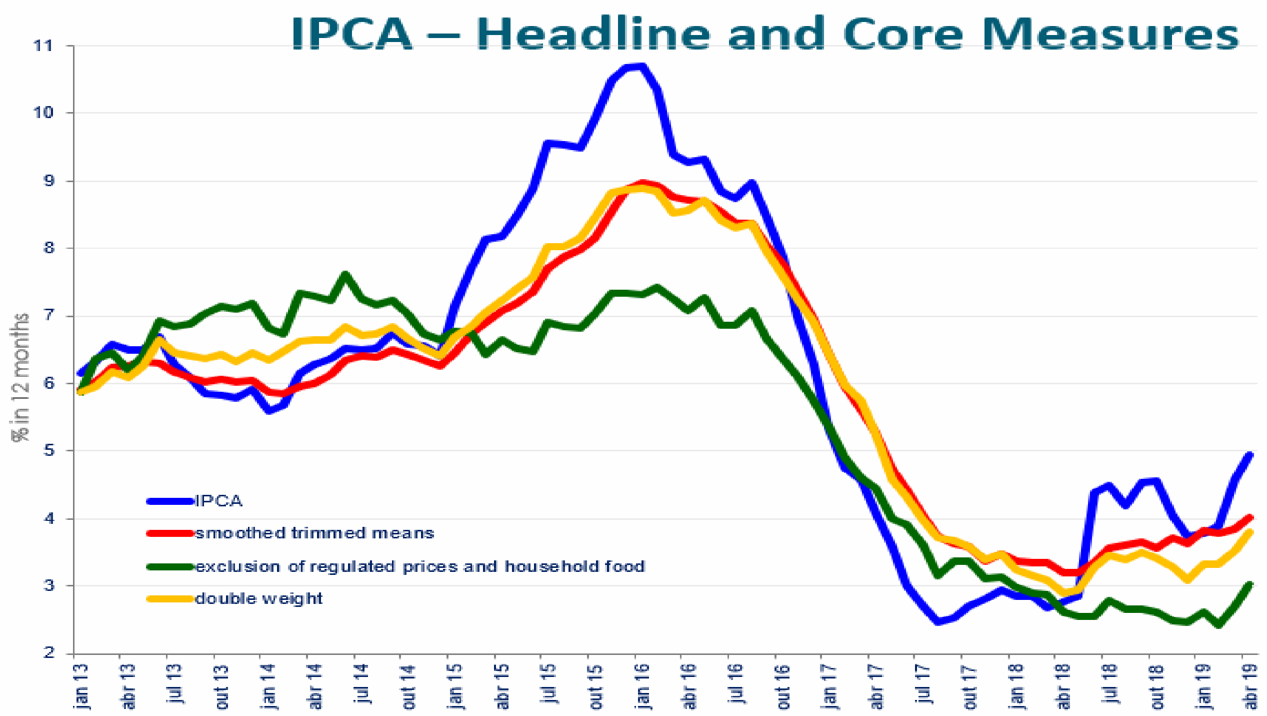
- New laws & regulations
- OECD Codes adherence

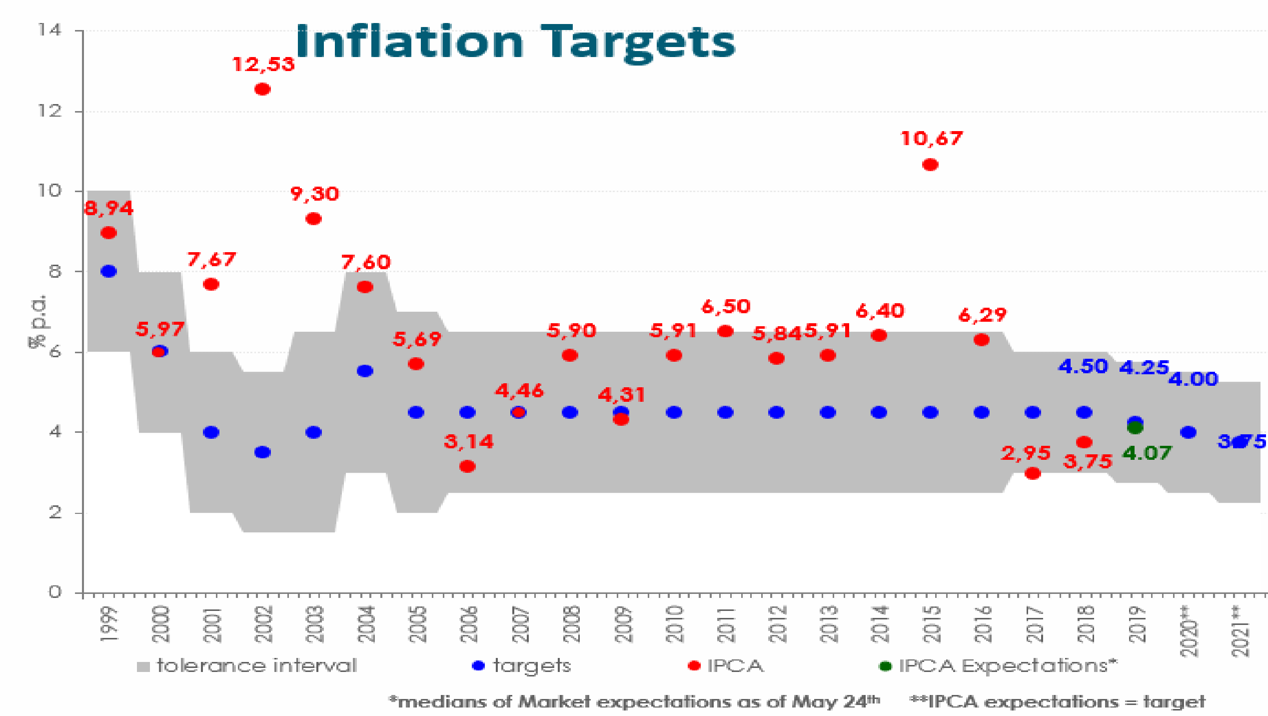
Monetary Policy

Inflation under control

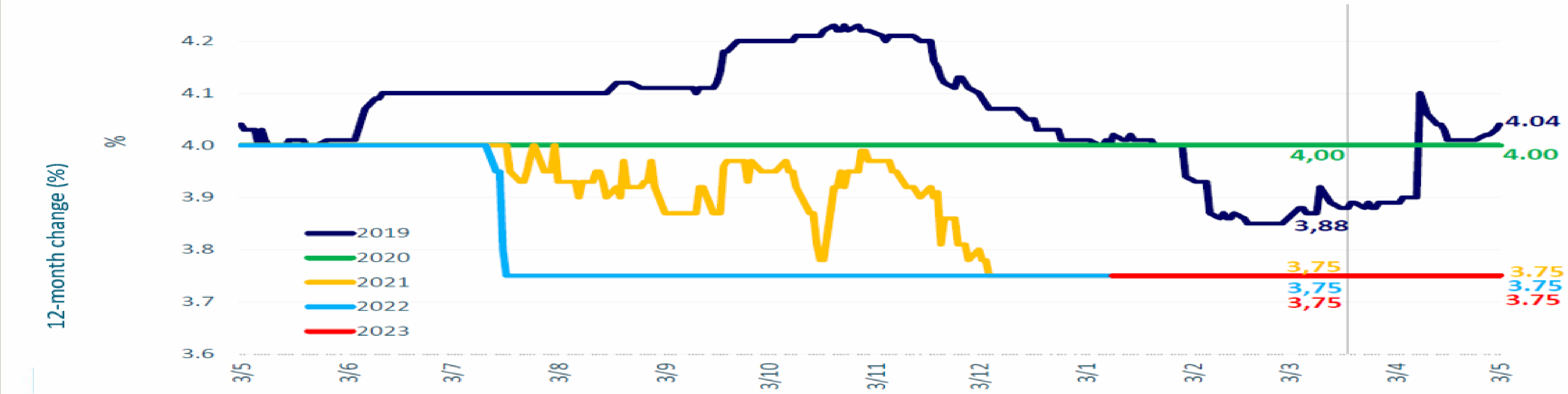
Inflation

- various measures of underlying inflation are running at appropriated levels, including the components that are most sensitive to the business cycle and monetary policy;
- inflation expectations for 2019, 2020 and 2021 collected by the Focus survey are, respectively, around 4.0%, 4.0% and 3.75%.

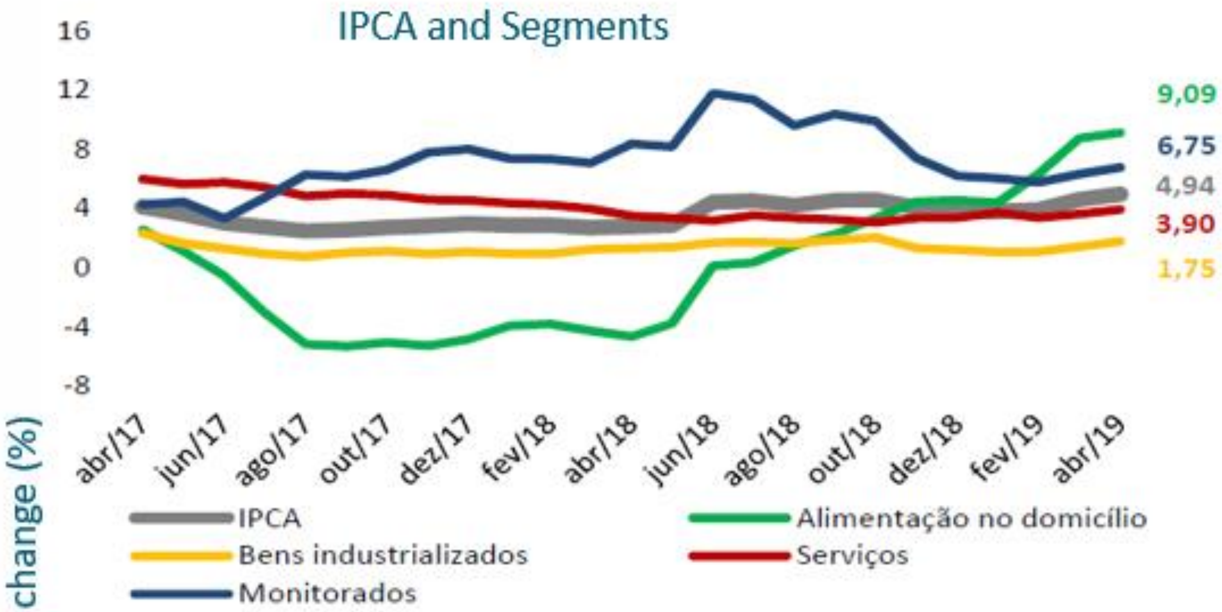


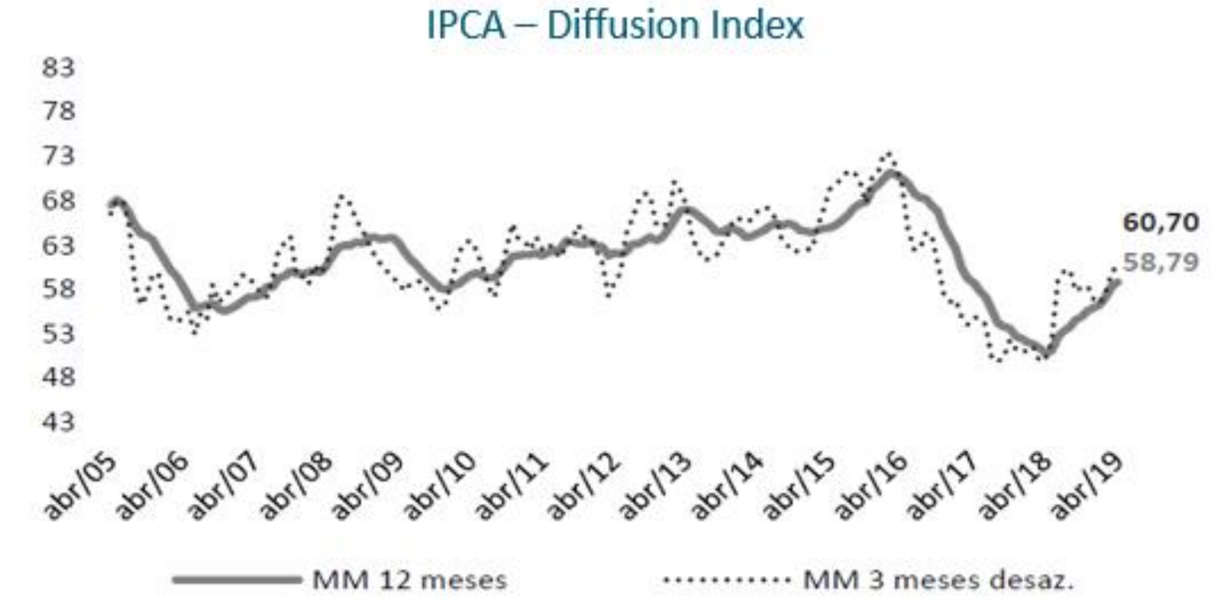


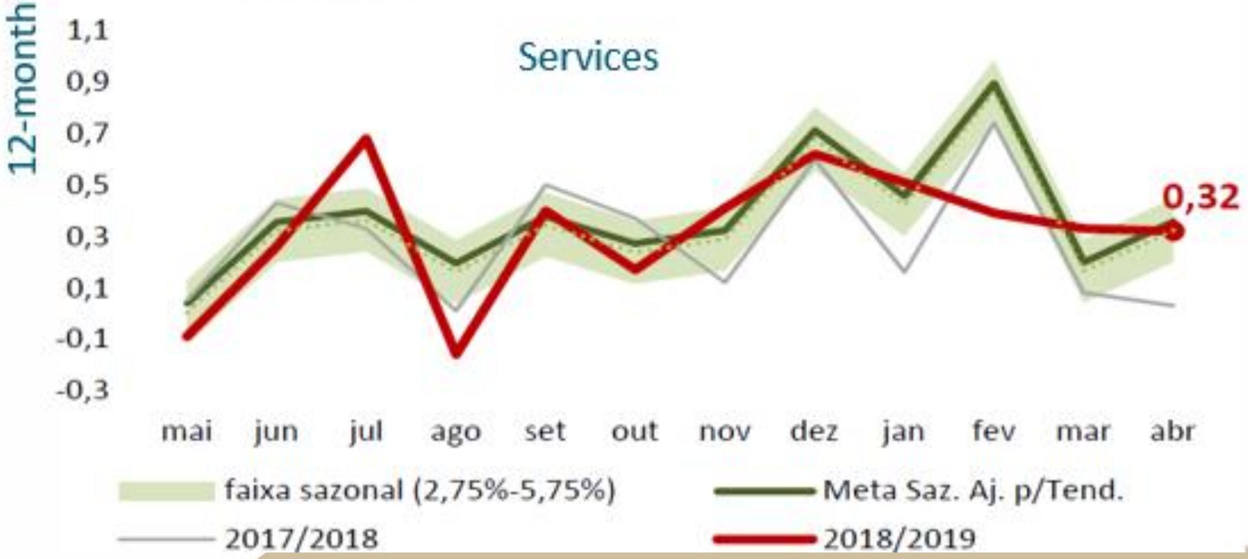
Evolution of Market Expectations for 2019-2023 IPCA

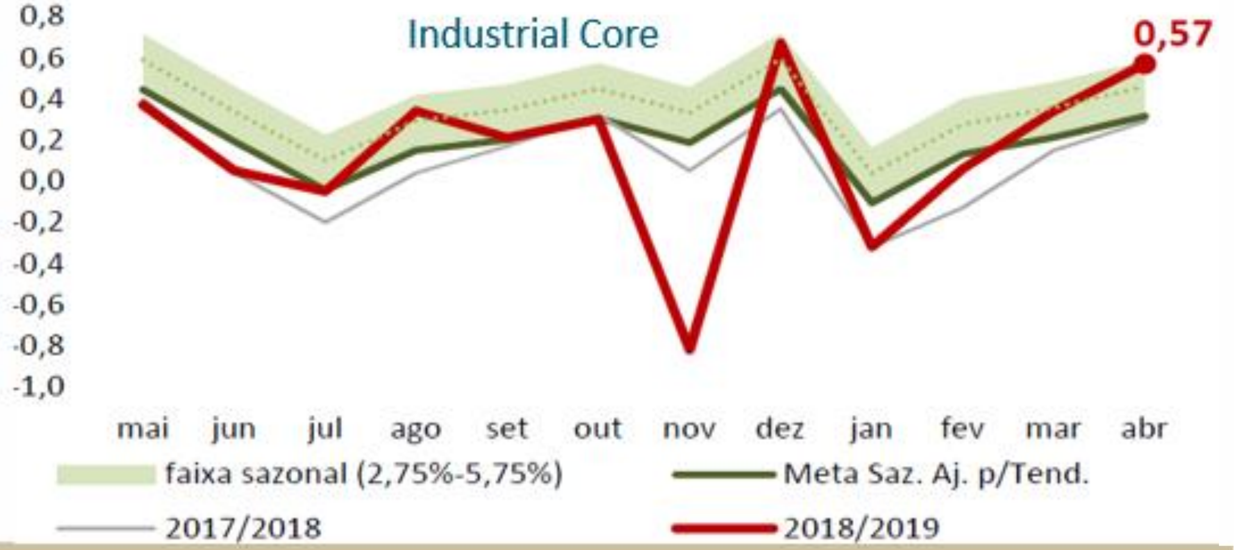


Consumer Prices (IPCA), Core and Diffusion Index

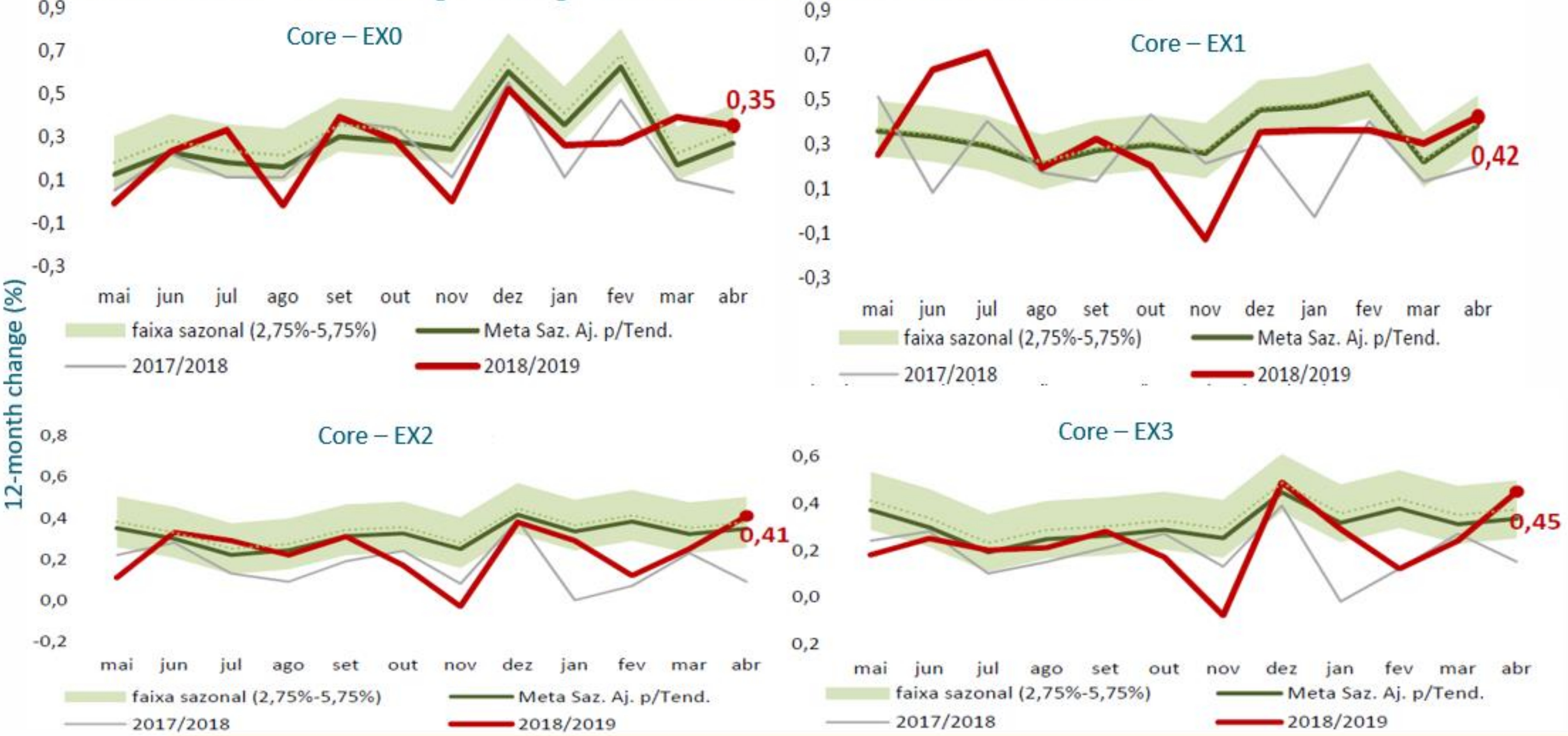








Consumer Prices (IPCA), Core and Diffusion Index



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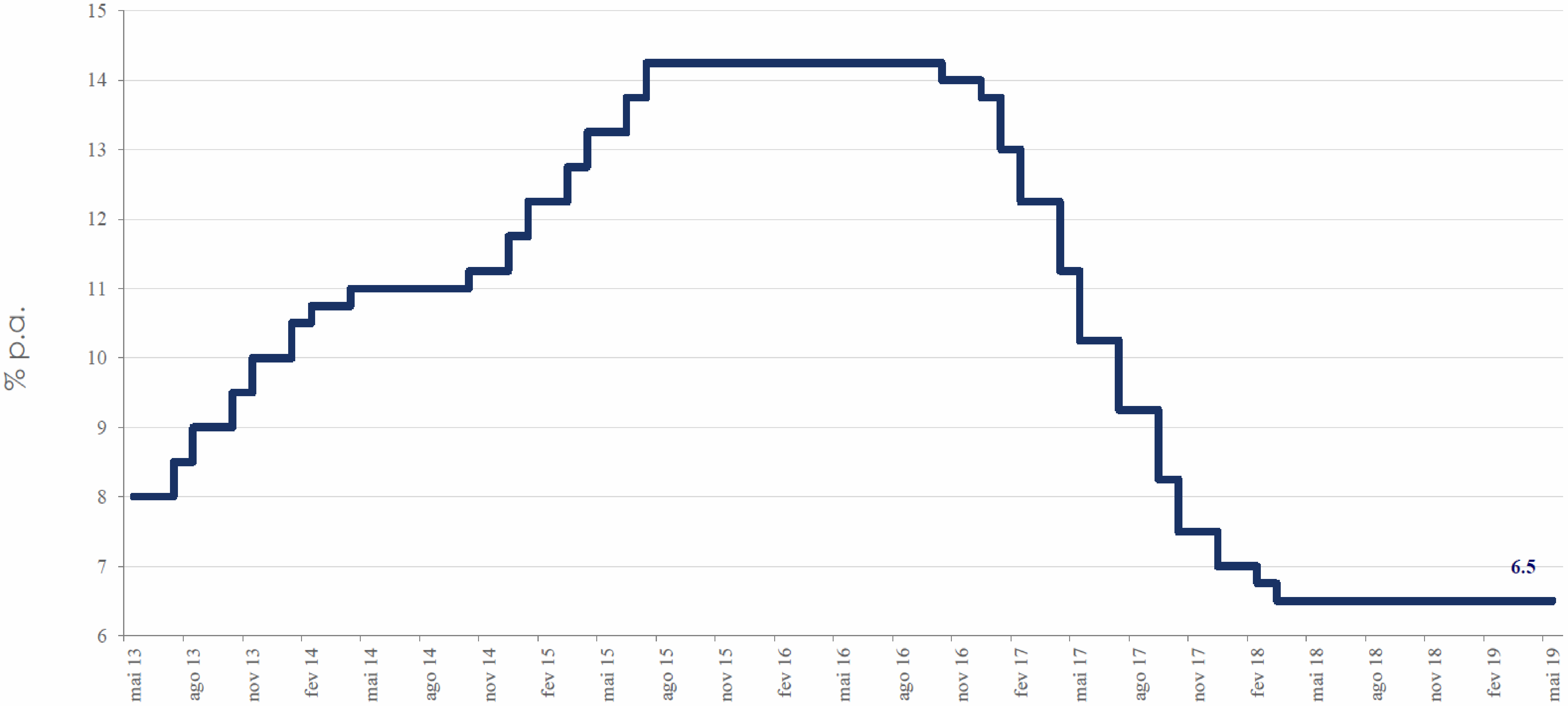
Selic Rate



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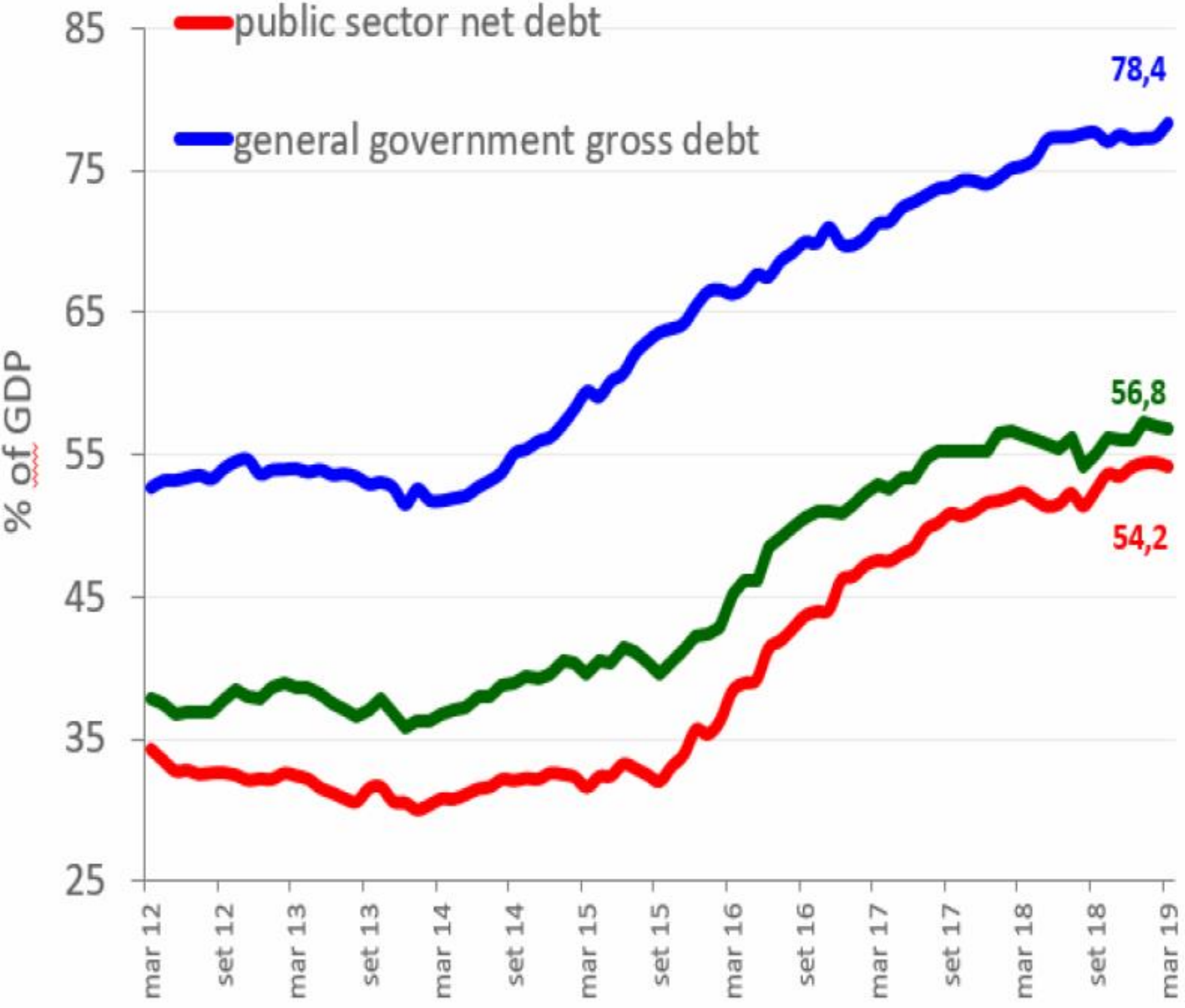
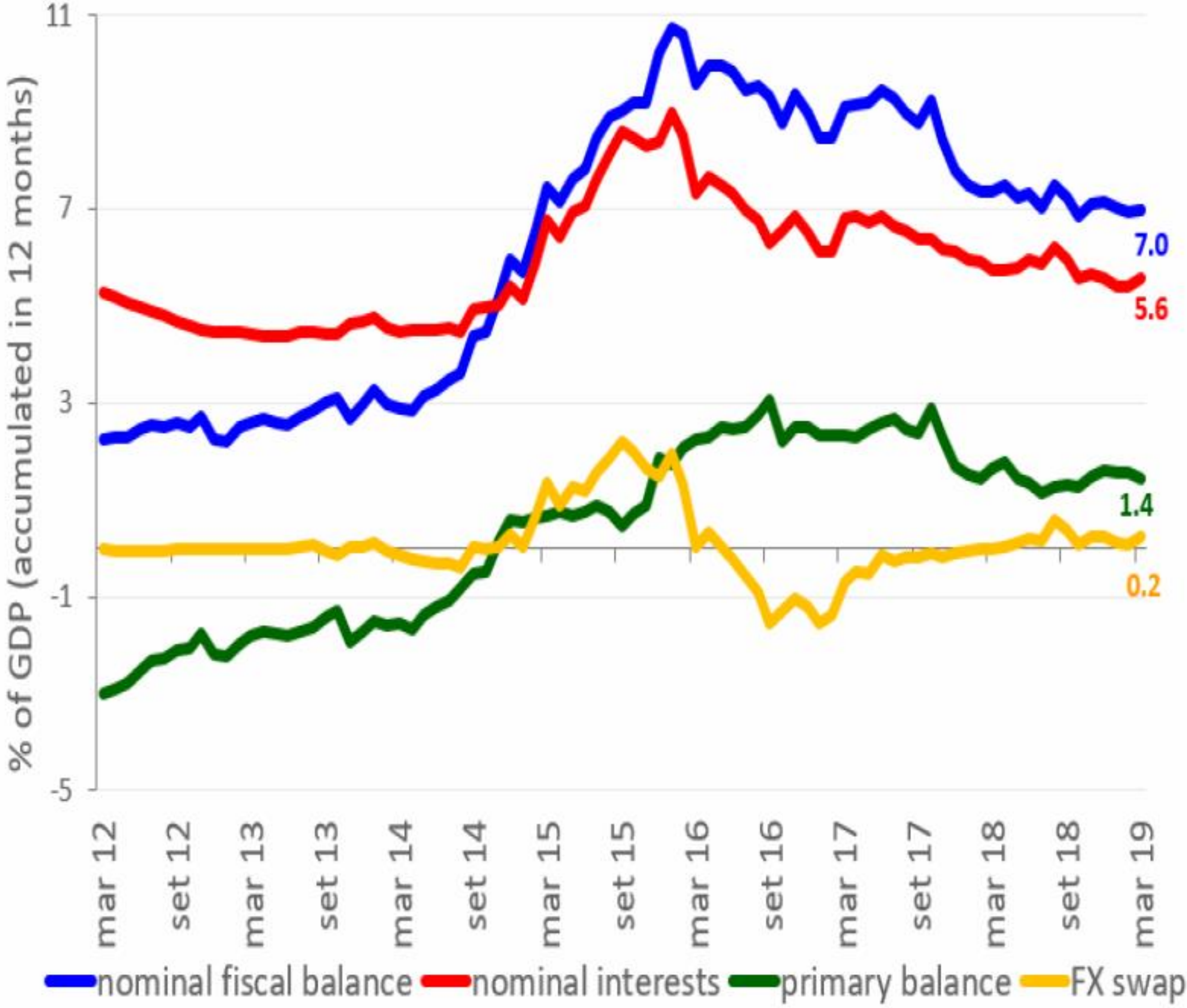
Fiscal Sector

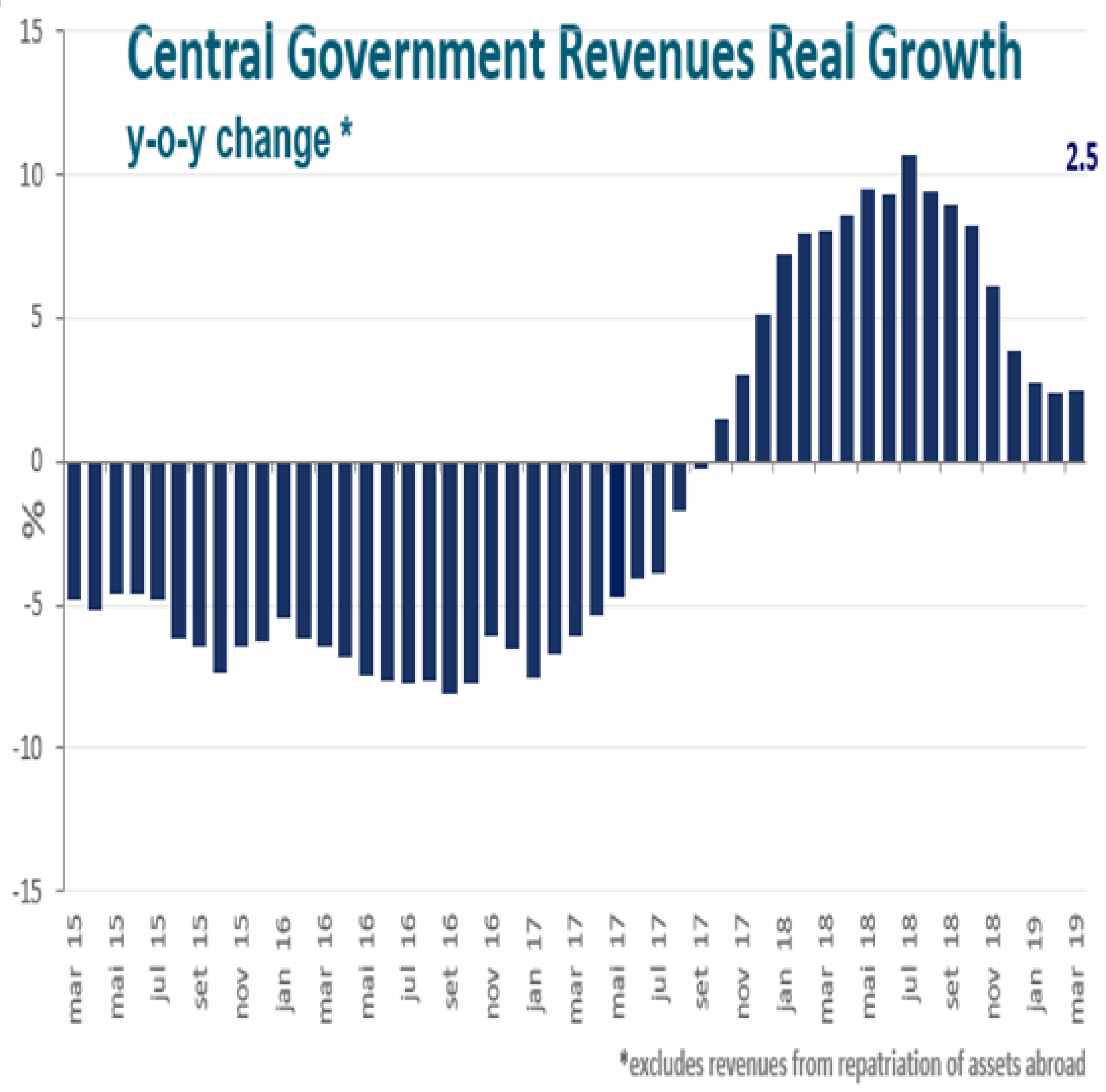
Public Debt



Fiscal Indicators



(-) = surplus; (+) = deficit


Central Government Revenues Real Growth
y-o-y change *
2.5
15
10
5
0
-5
-10
-15
%
mar 15
mai 15
jul 15
set 15
nov 15
jan 16
mar 16
mai 16
jul 16
set 16
nov 16
jan 17
mar 17
mai 17
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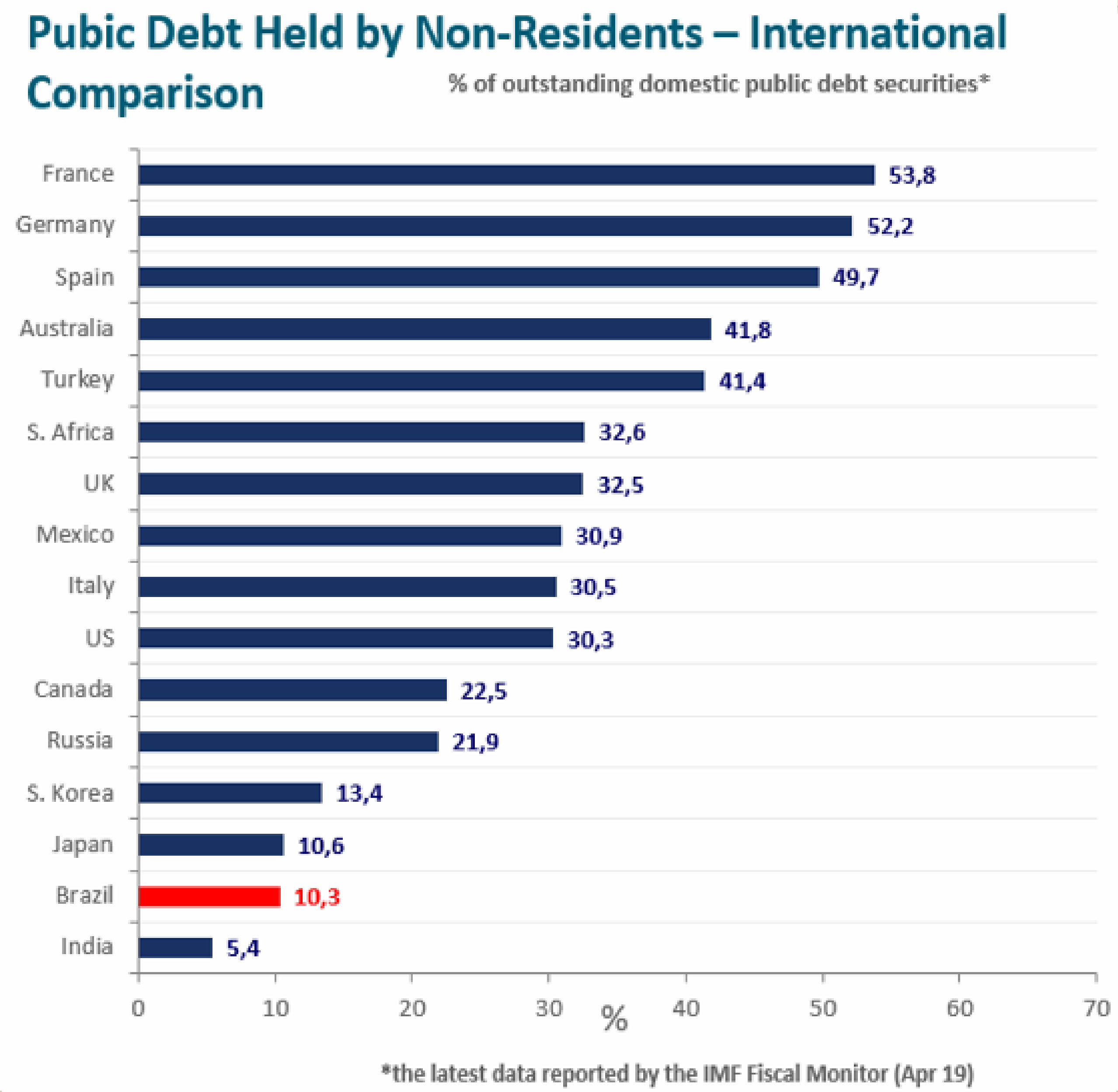
jan 19
mar 19
*excludes revenues from repatriation of assets abroad

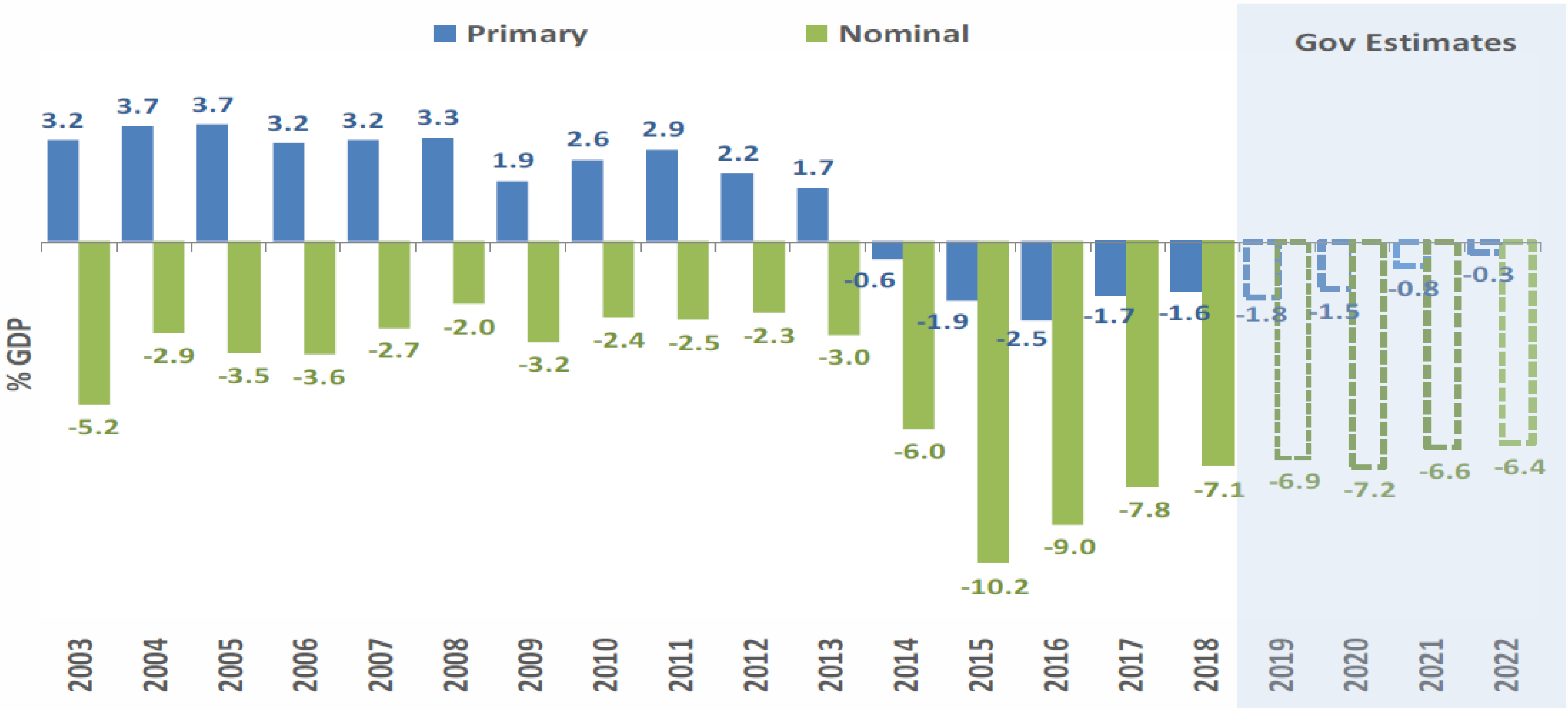

Pubic Debt Held by Non-Residents – International Comparison
% of outstanding domestic public debt securities*
France 53,8
Germany 52,2
Spain 49,7
Australia 41,8
Turkey 41,4
S. Africa 32,6
UK 32,5
Mexico 30,9
Italy 30,5
US 30,3
Canada 22,5
Russia 21,9
S. Korea 13,4
Japan 10,6
Brazil 10,3
India 5,4
0
10
20
30
%
40
50
60
70
*the latest data reported by the IMF Fiscal Monitor (Apr 19)

Fiscal trend

Budget rigidity and lack of reform coupled with unfavorable business cycle led to fiscal deficit.

In 2018, the private social security deficit (INSS) was of BRL 198 bn representing 183% of the public sector deficit (BRL 108 bn).

The current reforms (detailed on the following slides) contribute to revert the trend for the fiscal balance

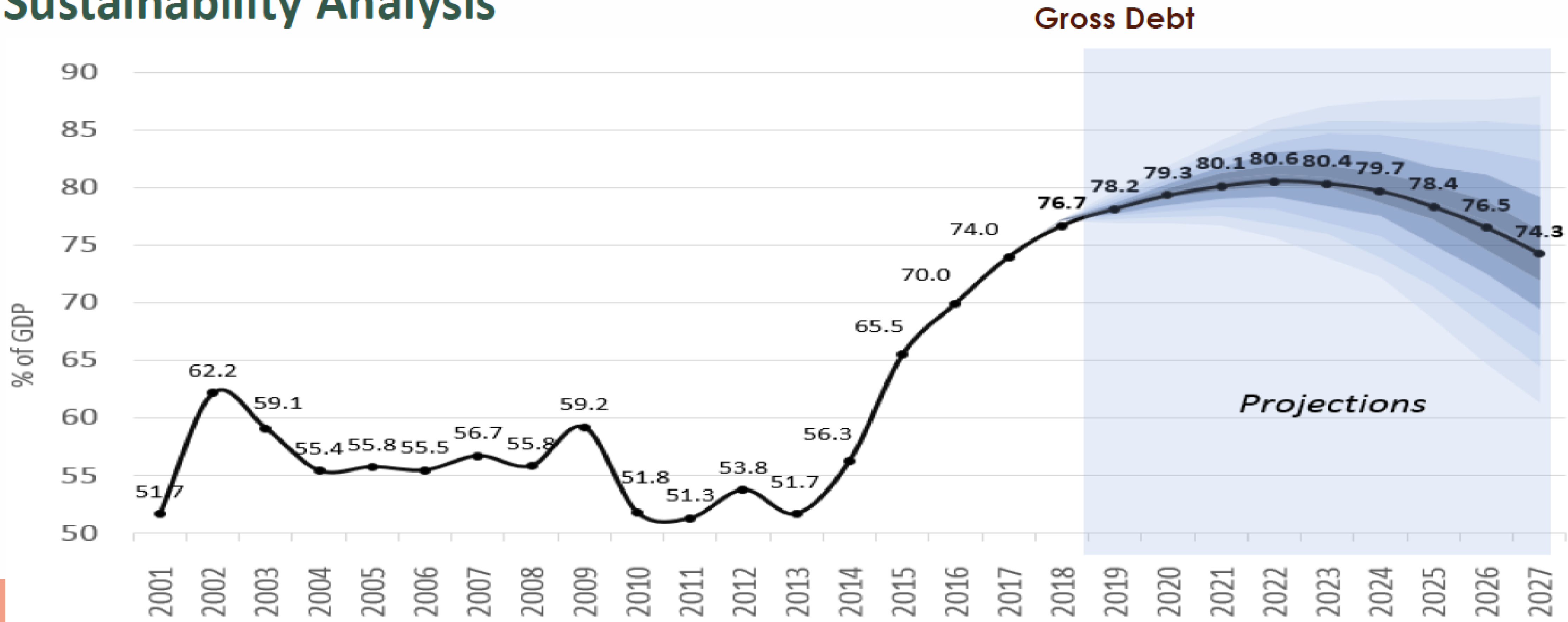


Source: Central Bank
Projections: 2020 Budgetary Guidelines Law (LDO)

Primary Balance	2018		2019		2020		2021		2022	
	BRL bn	% GDP	BRL bn	% GDP	BRL bn	% GDP	BRL bn	% GDP	BRL bn	% GDP
Central Government	-116.2	-1.69	-139	-1.9	-124.1	-1.58	-68.5	-0.81	-31.4	-0.35
Subnational Government	3.5	0.05	10.5	0.1	9	0.11	7.25	0.09	5.3	0.06
State-owned companies	4.4	0.06	0.06	0	-3.81	-0.05	-4.04	-0.05	-4.24	-0.05
Public Sector	-108.3	-1.57	-132	-1.8	-118.91	-1.51	-65.29	-0.77	-30.34	-0.33

Source: 2020 Budgetary Guidelines Law (LDO)
The projections are made based in a real GDP growth of 2.7% in 2020, 2.6% in 2021, 2.5% in 2022

Debt Sustainability Analysis



BNDES prepayment

Paid:
2015: BRL 30,5 bn
2016: BRL 100 bn
2017: BRL 50 bn
2018: BRL 130 bn (BRL 30bn paid in March, BRL 30bn in June and BRL 70 bn in August)

Source: Central Bank. Forecasts: National Treasury

The BNDES prepayments reduce the Gross Debt by the same magnitude of the settled amount.

Between 2015 and 2018, BNDES will have made a prepayment to the National Treasury of BRL 310 billion, **reducing Gross Debt by 5.0% of GDP.**

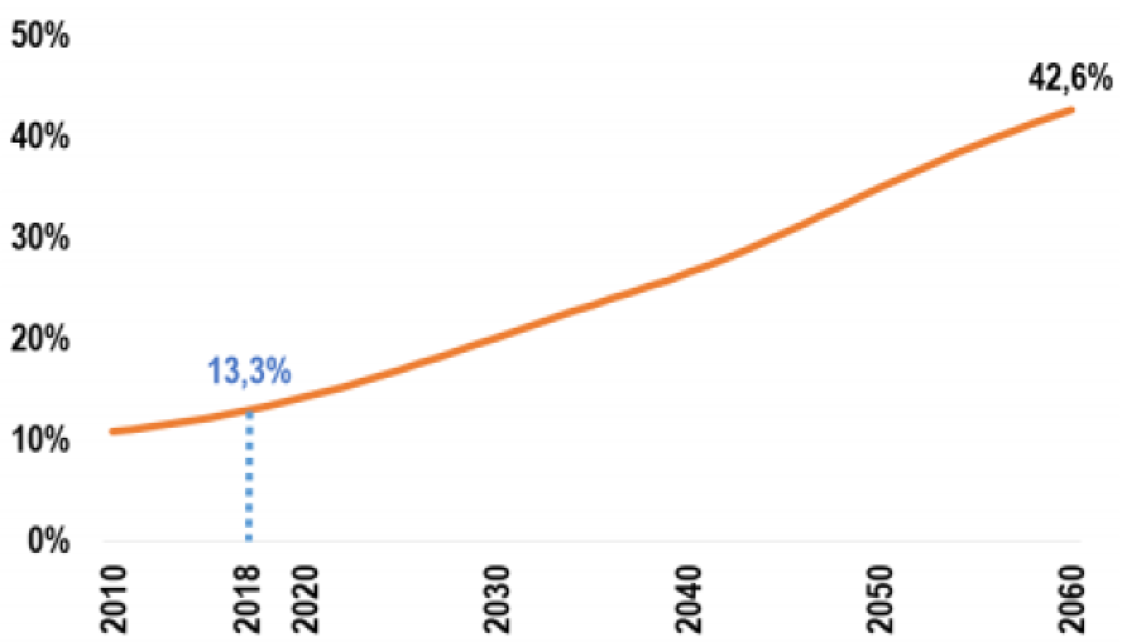
The forecast for Gross Debt is sensitive to the degree of approval of the reforms under discussion in the National Congress.

Social Security Reform - Justifications

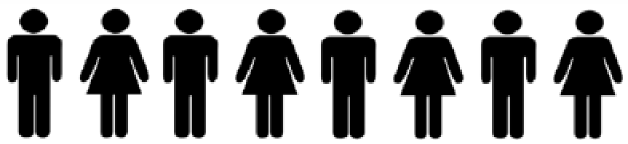
- Reduction in fertility rate
- Increase in the expectation of survival at 65 years old
- Increase in the share of elderly in the total population

Brazilian demographic transition indicates unsustainability of social security spending under current rules

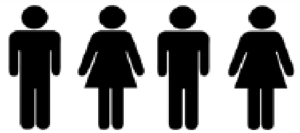
Ratio between population aged 65+ and 15-64 years old



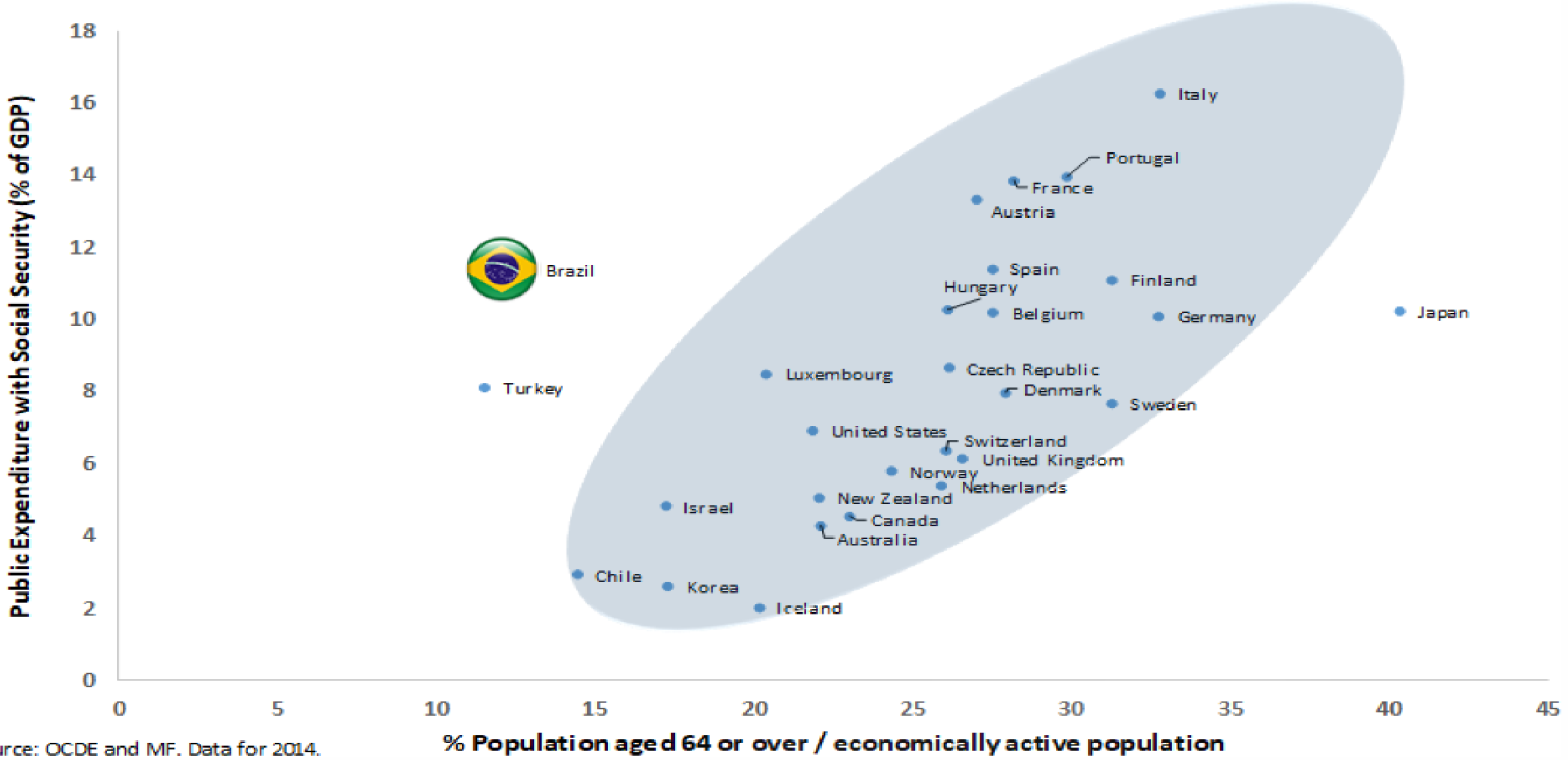
In 2015, 8 people worked for every person aged 65 years and older



In 2040, 4 people will work for each person aged 65 years and older



Welfare Expenditures - International Comparison



Source: OCDE and MF. Data for 2014.

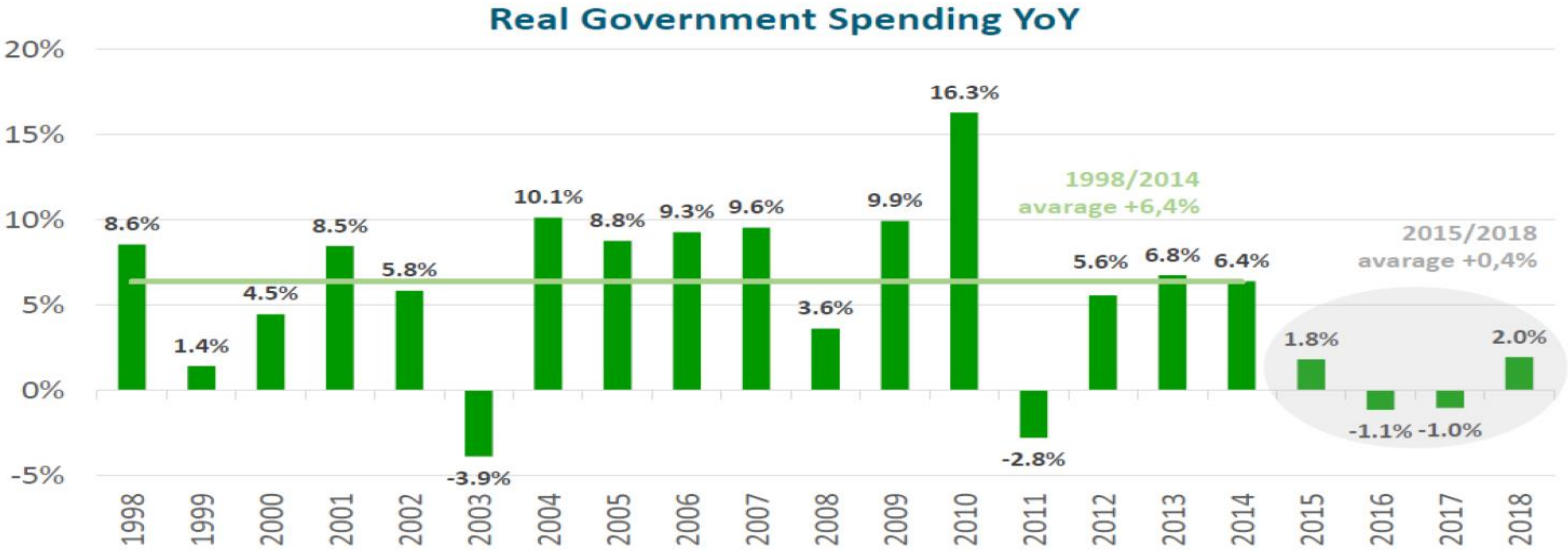
Social Security Reform - Key Features and Positive Impacts

Social security reform savings could reach up to BRL 1,2 trillion.

Savings (BRL bn, 2019 PV)	4 years	10 years
New rules for private sector (RGPS)	83	715
New rules for Public system (RPPS)	34	174
Change in contribution rates (RGPS)	-10	-28
Change in contribution rates (RPPS)	14	29
Change in social benefits (wage bonus, BPC)	41	182
Total savings from constitutional amendment	161	1072
Military system	28	92
Total	189	1165

The Pension Reform Will Consolidate the New Fiscal Order

- The real growth of Government spending has exceeded the economic growth most of the time during the last two decades.
- Since 2015, there is a new fiscal regime which has increased the power of monetary policy



Thank you!

Tiago Couto Berriel

Deputy Governor for International Affairs and Corporate Risk Management