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.
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

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.

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* 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
Global growth has remained relatively low throughout 2019

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.

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

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

* 4Q19 average only includes Oct/19 and Nov/19 data.
Source: BBVA Research
Financial markets exhibit a better mood

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

Source: BBVA Research based on Haver data
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**: 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.

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

Source: BBVA Research
Better prospects for commodity prices, which, however, will remain relatively low

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

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

<table>
<thead>
<tr>
<th>Year</th>
<th>USA</th>
<th>Latin America</th>
<th>Eurozone</th>
<th>China</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>2.9</td>
<td>1.6</td>
<td>1.9</td>
<td>6.6</td>
<td>3.6</td>
</tr>
<tr>
<td>2019</td>
<td>2.3</td>
<td>0.6</td>
<td>1.2</td>
<td>6.1</td>
<td>3.2</td>
</tr>
<tr>
<td>2020</td>
<td>1.8</td>
<td>1.4</td>
<td>0.9</td>
<td>5.8</td>
<td>3.2</td>
</tr>
<tr>
<td>2021</td>
<td>2.0</td>
<td>2.1</td>
<td>1.2</td>
<td>5.5</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Source: BBVA Research
**USA: the prospects of a smooth deceleration ahead remain in place**

**GDP GROWTH (%)**

- **Actual**: 2.9% (2019), 2.3% (2018), 1.8% (2017)
- **Previous**: 2.9% (2019), 2.3% (2018)

- **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.

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(f) Forecast.  
Source: BBVA Research
China: growth slowdown, somewhat slower than expected

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

- 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.

GDP GROWTH (%)

- Actual
- Previous

2.7%
1.9%
1.2%
0.9%
1.2%
1.1%
0.8%

2017 2018 2019 (f) 2020 (f) 2021 (f)

(f) Forecast.
Source: BBVA Research
Reduction in the cyclical global risks, but not in the structural ones

- USA
  - Economic recession
  - Fall in bond prices due to higher inflation

- EUROZONE
  - Economic recession
  - Tensions in “peripheral” bond markets

- CHINA
  - Disorderly deleveraging

Riesgos transversales
- Protectionism and deglobalization
- Geopolitical tensions
- Secular stagnation in developed economies
- Climate change

+ Global severity - Changes in likelihood vs. last quarter
Brazil: reinforced recovery prospects
GDP will grow around 2% in 2020 and 2021, somewhat more than in previous years

**GDP GROWTH**

(Q/Q %)

- 2015: -3.6%
- 2016: -3.3%
- 2017: 1.3%
- 2018: 1.3%
- 2019 (f): 1.1%
- 2020 (f): 1.9%
- 2021 (f): 2.0%

(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)

**OUTPUT GAP (**)**

(% OF POTENTIAL GDP)

(*) Quarterly GDP in real 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 = 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

<table>
<thead>
<tr>
<th>Component</th>
<th>2019(f)</th>
<th>2020(f)</th>
<th>2021(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private consumption</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Public consumption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imports</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(*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
- Increase in confidence
- Relatively low inflation
- Expansionary monetary policy
- Recovery signs exhibited by incoming activity data
- Aprobación de la reforma de la seguridad social y menor riesgo fiscal
- Government’s apparent willingness to adopt economic reforms

Factors **constraining** growth

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

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

Source: BBVA Research, BCB, IBGE

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)

<table>
<thead>
<tr>
<th>Year</th>
<th>2019 (f)</th>
<th>2020 (f)</th>
<th>2021 (f)</th>
<th>2022 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>76</td>
<td>77</td>
<td>78</td>
<td>79</td>
<td>80</td>
</tr>
</tbody>
</table>

The fall in interest rates also favored the in the prospects for public debt.

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

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

(*) 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.
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.

(\textsuperscript{*}) Forecasts from Jan\textsuperscript{20} onwards.
Source: BBVA Research

(* \textsuperscript{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)

CURRENT ACCOUNT BALANCE (*)
(% DEL PIB)

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

(*) (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.
Brazil: forecast table
## Brazil forecasts

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019 (f)</th>
<th>2020 (f)</th>
<th>2021 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (%)</td>
<td>1.3</td>
<td>1.1</td>
<td>1.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Private consumption (%)</td>
<td>2.1</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Public consumption (%)</td>
<td>0.4</td>
<td>-0.6</td>
<td>-0.8</td>
<td>-0.3</td>
</tr>
<tr>
<td>Investment in fixed capital (%)</td>
<td>3.9</td>
<td>4.0</td>
<td>5.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Exports (%)</td>
<td>3.3</td>
<td>-3.4</td>
<td>1.3</td>
<td>4.2</td>
</tr>
<tr>
<td>Imports (%)</td>
<td>7.5</td>
<td>3.0</td>
<td>5.7</td>
<td>4.1</td>
</tr>
<tr>
<td>Unemployment rate (average, %)</td>
<td>12.3</td>
<td>12.0</td>
<td>11.0</td>
<td>9.8</td>
</tr>
<tr>
<td>Inflation (end of period, YoY %)</td>
<td>3.8</td>
<td>4.3</td>
<td>4.0</td>
<td>4.3</td>
</tr>
<tr>
<td>SELIC interest rate (end of period, YoY %)</td>
<td>6.50</td>
<td>4.50</td>
<td>4.25</td>
<td>7.25</td>
</tr>
<tr>
<td>Exchange rate (end of period)</td>
<td>3.88</td>
<td>4.11</td>
<td>4.00</td>
<td>4.00</td>
</tr>
<tr>
<td>Current account (% of GDP)</td>
<td>-2.2</td>
<td>-2.8</td>
<td>-2.5</td>
<td>-3.2</td>
</tr>
<tr>
<td>Public sector primary fiscal balance (% of GDP)</td>
<td>-1.6</td>
<td>-1.4</td>
<td>-1.1</td>
<td>-0.6</td>
</tr>
</tbody>
</table>

(f) = forecast.  
Source: BBVA Research