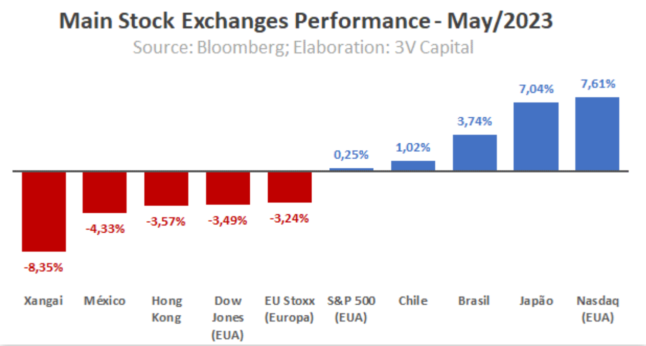
Economic Letter

May/2023

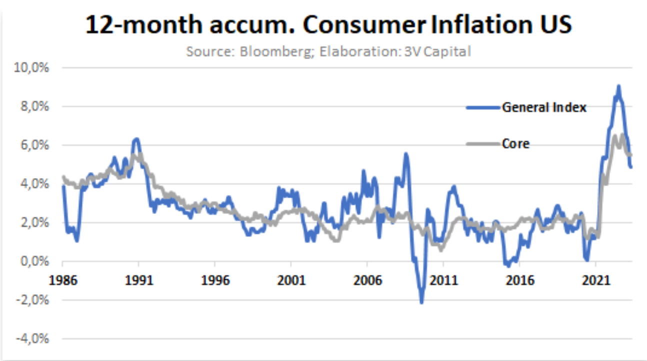
3V capital
Gestão de Recursos

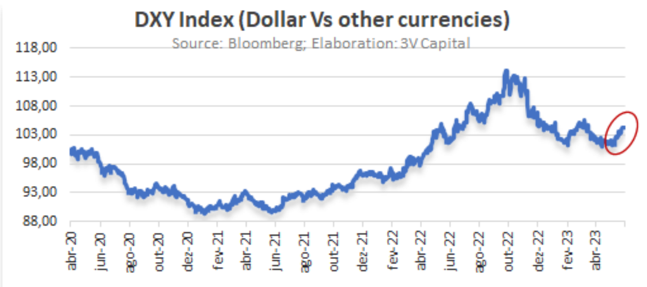
External Scenario

Global stock indices showed mixed performances in May, while there was a widespread increase in interest rates, with the US dollar gaining value against major currencies. The data collected during this period generated conflicting sentiments among resource allocators, who chose not to adopt significant directional positions. This reflects the prevailing uncertainty in global risk perception among investors and economic agents.



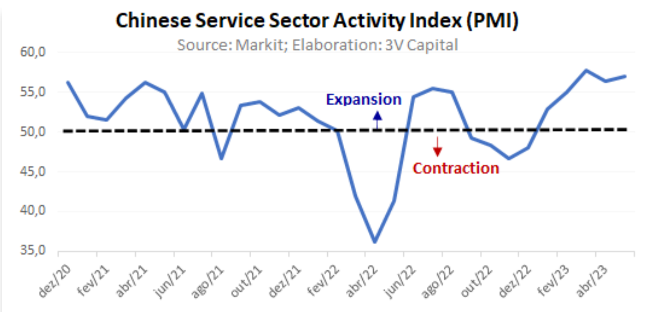
In the world's largest economy, the Federal Reserve announced a 25 basis points increase in its benchmark interest rate to a range between 5% and 5.25%, a move that came after the stabilization of banking stress in the country. Markets are pricing this as the final hike in the current interest rate cycle, which is interpreted as positive for the markets. Regarding economic activity, indicators remained, on average, optimistic. However, inflation has shown contraction in the overall index but some resilience in the core. Attention is now focused on the next interest rate decision in June.





In Europe, on the other hand, activity indicators have been going against what was observed in the US, with consumption slowing down in the Eurozone and the United Kingdom. Germany's quarterly GDP showed that the main country in the bloc entered a technical recession, with downward revisions being made. Additionally, inflation indices remain elevated, with negative emphasis on the UK, which inflation is at levels not seen since 1992. The European Central Bank (ECB) and the Bank of England (BoE) raised interest rates by 25 basis points to 3.25% and 4.5% respectively.

In China, despite a slight slowdown, activity data continues to gain momentum. All sectors of the economy have shown improvement, with particular emphasis on new house prices, which have seen an increase for the third consecutive month after a steep decline. Increasing Chinese consumption is currently a focus for Xi Jinping, who aims to transition the country's economic model from investment-driven to consumption-driven.

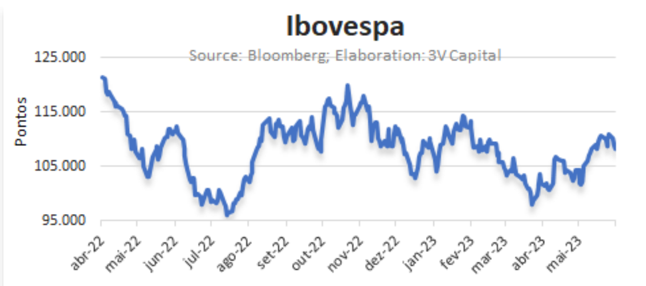


Inflation continues to show signs of cooling down, but with some resilience in core measures. The dynamics, particularly in the services sector, remain persistent in most economies worldwide and contribute to the current functioning of price indices. The United States, Europe, and the United Kingdom are expected to maintain their current more *hawkish*[1] stance, while China is likely to continue recent stimulus measures, benefiting emerging countries like Brazil.

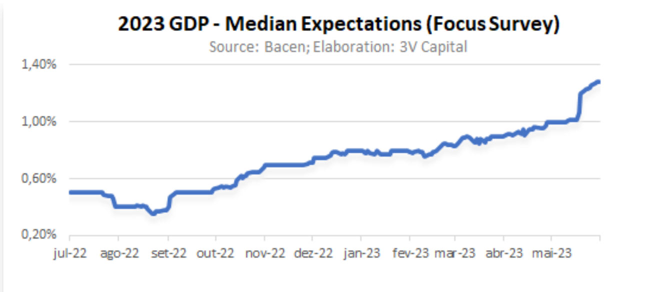
[1]hawkish: a term used to refer to a more strict bias of a central bank, whose intention is to increase interest rates

Domestic Scenario

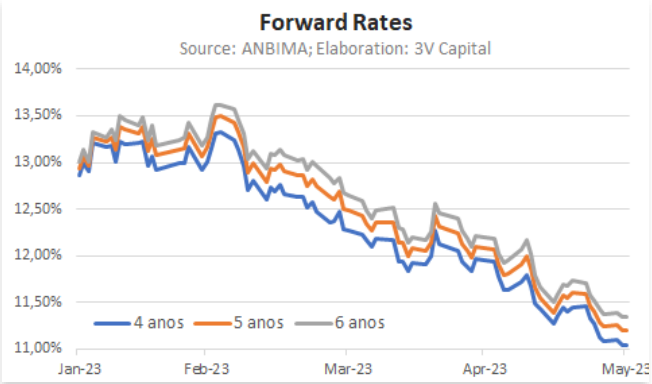
Despite repeated anti-reform signals from the government and a worsening political environment, the month of May was marked by improved sentiment and advancement of Brazilian assets. The good performance reflected not only the responsible stance of Congress in preventing setbacks but also the unexpected resilience of domestic activity in the face of the current interest rate level, lower fiscal risk perception, and new signs of disinflation.



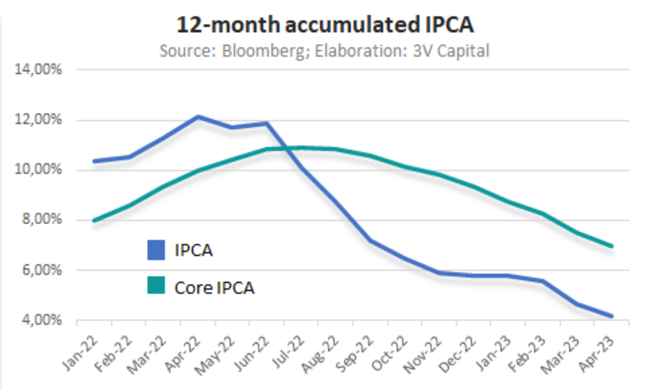
On the activity front, the positive dynamics of the labor market continue to have a positive impact on the resilience of household consumption, benefiting the trade and services sectors. However, it is the agribusiness sector that contributed the most to growth in the early months of the year, thanks to a strong harvest.



Concurrently with this more encouraging economic moment, the approval of the final text of the new framework in the Chamber of Deputies with stricter rules was well received. Despite being dependent on revenue increases, the final design reduced uncertainties and, at least in the short term, dispelled the scenario of public debt explosion. In addition to keeping health and education expenses within the limit, the removal of the mechanism from the text that allowed expenditure growth in the ceiling next year, regardless of revenue, is highlighted as positive.

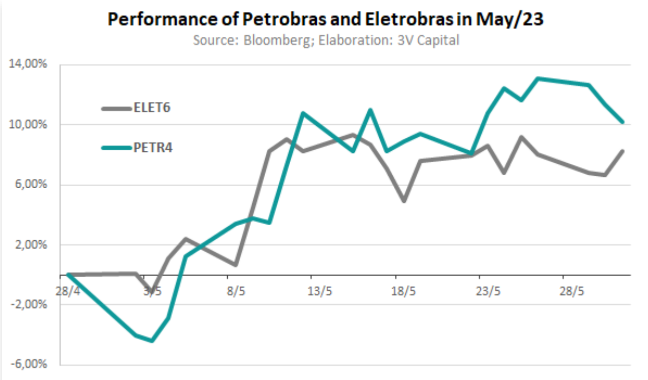


Regarding prices, although April's inflation disappointed by showing a smaller decline than expected, the IPCA-15 (mid-month consumer price index) positively surprised with a decrease in core inflation, an important sign that inflation seems to have resumed its deceleration pace. This resulted in a new wave of downward revisions for this year's IPCA and confirmation from the President of the Central Bank, Campos Neto, about the improvement in long-term inflation expectations (one of the essential conditions for the beginning of the easing cycle).



Given this more relieved context, the market received without much turmoil the appointment of Gabriel Galípolo as Director of Monetary Policy at the Central Bank. As the current executive secretary and "number 2" at the Ministry of Finance, his appointment is seen by some agents as an attempt by the government to interfere in the direction of monetary policy in a battle against high interest rates. However, in the first interviews after the announcement, the economist sought to dispel speculations about potential conflicts and reaffirm his good relationship with Campos Neto and the current board of directors. In summary, we understand that it will not be easy, for now, to contrast the technical body of the institution and change monetary policy with just one vote.

In the corporate sphere, although the government has been trying to reverse the privatization of Eletrobras approved by the Legislature and the Court of Auditors last year, the unequivocal opposition from the main leaders of Congress brought some relief. In the case of Petrobras, the market's positive reaction after the announcement of the new pricing policy drew attention. According to the company's president, Jean Paul Prates, the aim is to bring fewer price adjustments and volatility. Although the strategy is less transparent and the increased government interventionism has been disliked, the fact that there will not be a complete abandonment of the external price and that the company will not return to subsidizing fuels was received with relief.



Indicators - returns (%)				
Rate/Index	Apr-23	May-23	2023	Last 12 m
CDI	0,92%	1,12%	5,37%	13,48%
Dólar (Ptax-V)	-1,57%	1,90%	-2,33%	7,76%
Ibovespa	2,50%	3,74%	-1,28%	-2,71%
IMA-B	2,02%	2,53%	8,76%	10,47%
IPCA	0,61%	0,36%	3,09%	4,07%
IRF-M	1,10%	2,20%	7,34%	14,73%
S&P 500	1,46%	0,25%	8,86%	1,15%
Euro Stoxx	1,03%	-3,24%	11,19%	11,32%
MSCI Emerging	-1,34%	-1,90%	0,22%	-11,06%

*IPCA of April refers to Anbima's forecast

Looking ahead, we see room for the economic situation to continue evolving favorably, with the recent surge in agricultural supply potentially bringing additional relief to food prices and providing all the necessary conditions for the Central Bank to soon begin the interest rate cut cycle amidst fiscal improvement. Special attention should be given to the CMN (National Monetary Council) meeting in June, which may discuss the revision of the inflation target, as well as the progress of the new framework in the Senate.