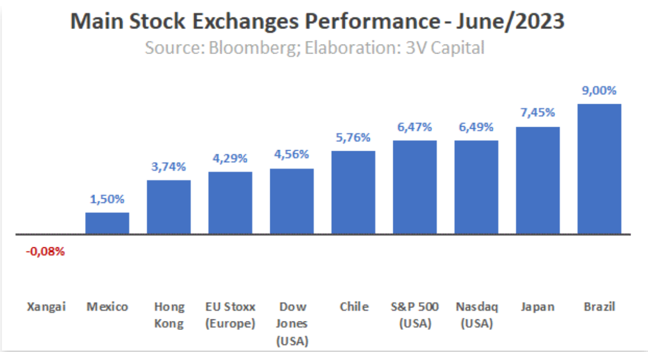
Economic Letter

June/2023

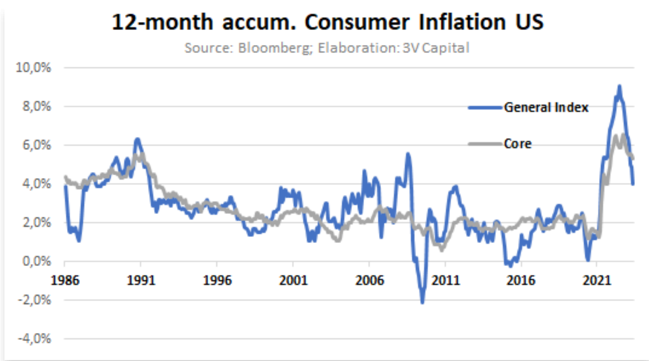
3V capital
Gestão de Recursos

External Scenario

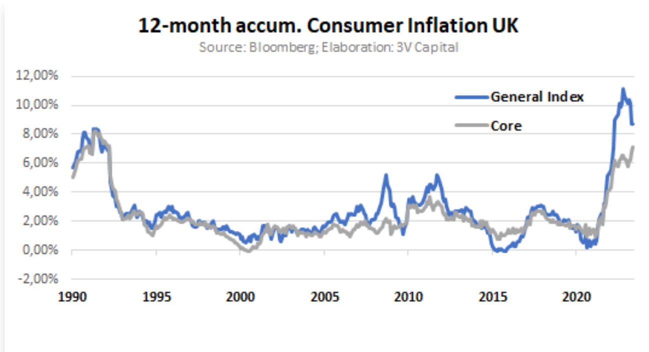
The month of June presented a quite unusual correlation among global assets, with stock markets around the world recording significant gains during the period while witnessing an opening in the yield curves. The optimistic movement was mainly due to the expectation that Central Banks in developed countries will adopt a more *dovish*[1] stance than previously signaled.



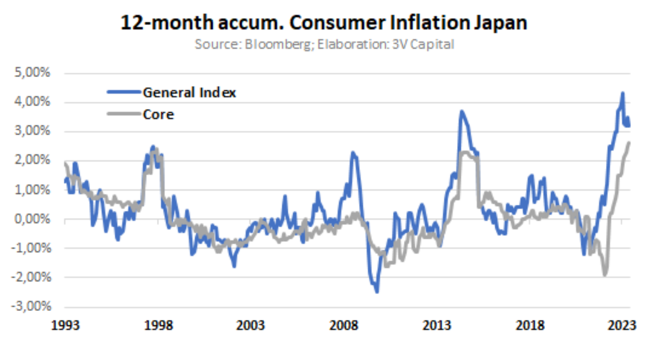
After inflation data contracted significantly – although core inflation showed some resilience – the United States paused its interest rate hikes for the first time in 15 months, with the Fed keeping the basic interest rate of the US economy in the range of 5% to 5.25% per year. Attention now turns to the upcoming activity and inflation indicators. So far, the market mostly prices in only one more 25 basis points increase in Fed Funds rate (while the Fed signals two more 25 basis points increases), however, a greater resilience in prices could change that expectation upward, which would be an adverse scenario for risk assets.



On the other hand, Europe, and particularly the United Kingdom, continue to experience less encouraging inflation dynamics than the Americans, accompanied by equally disappointing GDP data. The Eurozone entered a technical recession in the first quarter and maintained such discouragement in the second, while the UK continues to face the highest inflation level since 1992. In this context, both the European Central Bank and the Bank of England maintained a cautious tone in order to ensure that inflation returns to the 2% target regardless of the impact on activity.



Meanwhile, in the world's second-largest economy, the highly anticipated reopening fell short, and recent data did not show the economic acceleration expected by the market, with both retail and industrial data indicating contraction. Japan, on the other hand, continues to impress with its low-interest-rate policy. Despite the surge in inflation, the Bank of Japan chose to maintain its expansionary monetary policy.

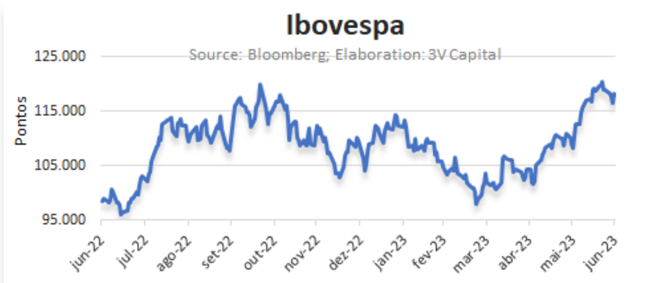


In summary, the big question that persists is how long interest rates will continue to rise. The adverse effects of high inflation rates are already evident, particularly in society's daily life, which demonstrates dissatisfaction with the economic management of these countries and the current upward trend in interest rates. Even after the correction of commodity prices, the traditional 2% targets still seem far from being achieved. In this scenario, it is extremely important to continue monitoring price indicators and, above all, the core components that comprise them.

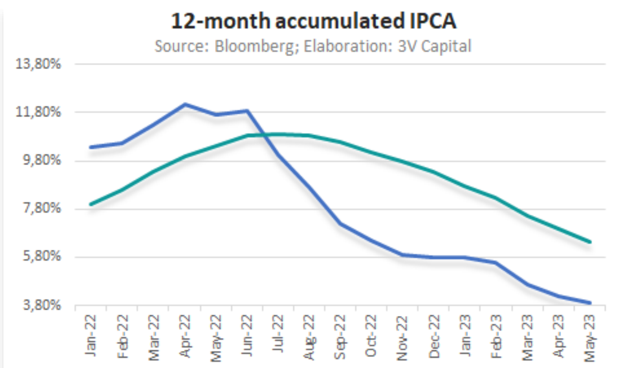
[1]*dovish:* *a term used to reference a less stringent bias of a particular central bank, whose intention is to lower interest rates.*

Domestic Scenario

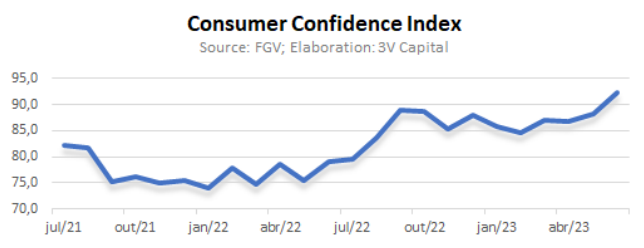
Under a more relaxed domestic environment and the expectation of a beginning of interest rate cuts starting in August, Brazilian assets maintained their recovery momentum in the month of June.

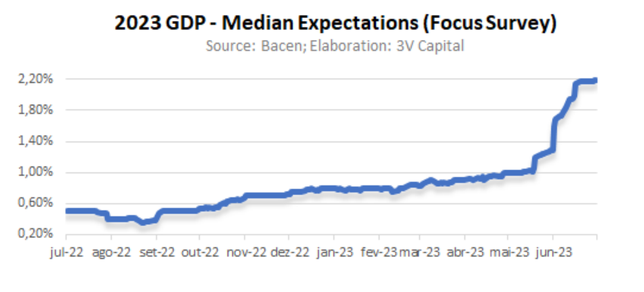


While the statement from the last Copom meeting was disappointing as it indicated imminent easing, the meeting minutes released at the end of the month corrected the more *hawkish*[2] interpretation and explicitly stated that a majority had finally formed in favor of a monetary policy inflection at the next meeting. Amidst a consistent decline in current prices and better anchoring of inflation expectations, the appreciation of the exchange rate stands out, driven by continuous surpluses in the Brazilian trade balance and improved fiscal perception. With the easing cycle set to begin in August, the remaining question is about the pace of the rate cuts.



Regarding growth, despite the lagged effects of monetary policy, the economy continues to show resilience, largely supported by a robust labor market, which brings favorable winds for household consumption.

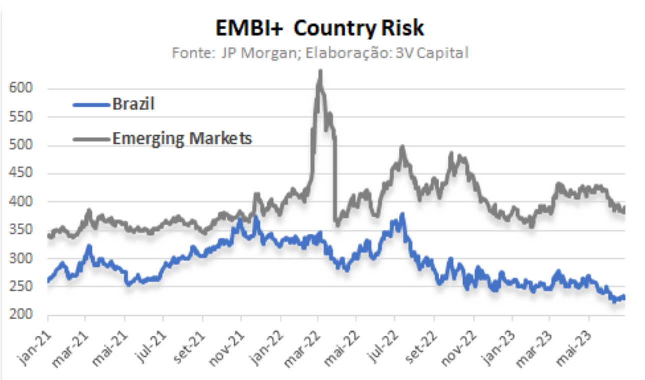




Looking ahead, despite ongoing political noise surrounding economic matters, whether it's interference in state-owned companies or pressure from the President on the Central Bank, we view the progress of the reformist agenda in Congress as positive - especially the fiscal framework and tax reform - as well as some victories for Minister Haddad over the more radical wing of his party. In this sense, although the Central Bank has indicated a "parsimonious process" of reducing the Selic rate (suggesting a cut of only 25 bps), we believe that the recent relief provided by the CMN in not raising the inflation targets brings non-negligible chances that the loosening cycle will start more aggressively, with a 50 bps cut.

However, even with the Fed determined to raise rates further and the possibility of a more pronounced rate cut trajectory here, we understand that the *carry trade*[3] will still remain attractive, favoring foreign inflows and the Brazilian currency.

In light of the more favorable economic scenario for emerging markets - which, in general, raised rates earlier to counter the elevated global inflation outlook and are now beginning the easing process, ready to reap the economic benefits - and, at the same time, the more challenging geopolitical context for several of them (such as Russia, which is engaged in war, and Turkey, which has been experiencing institutional setbacks), we believe that Brazil stands out as a good investment opportunity for foreign investors, with assets significantly discounted compared to their intrinsic values.



[2]*hawkish:* *a term used to reference a more stringent bias of a particular central bank, with the intention of raising interest rates*

[3]*Carry trade:* *an operation that involves borrowing in a currency with a low interest rate (such as the dollar) and investing the obtained funds in a currency with a higher interest rate (such as the real), in order to profit from the interest rate differential*

Indicators - returns (%)				
Rate/Index	May-23	Jun-23	2023	Last 12 m
CDI	1,12%	1,07%	6,50%	13,54%
Dólar (Ptax-V)	1,90%	-5,43%	-7,64%	-8,00%
Ibovespa	3,74%	9,00%	7,61%	19,83%
IMA-B	2,53%	2,39%	11,37%	13,52%
IPCA	0,23%	-0,08%	2,87%	3,16%
IRF-M	2,20%	2,12%	9,62%	16,74%
S&P 500	0,25%	6,47%	15,91%	17,57%
Euro Stoxx	-3,24%	4,29%	15,96%	27,33%
MSCI Emerging	-1,90%	3,23%	3,46%	-1,12%