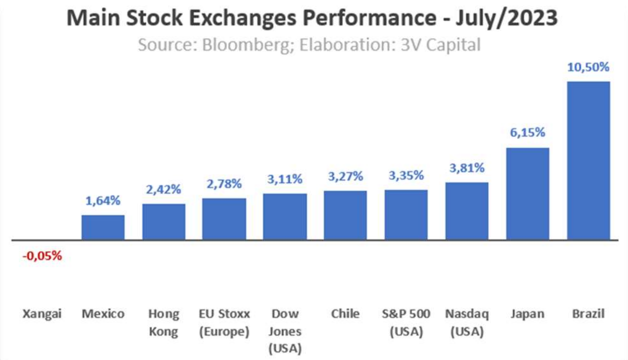
Economic Letter

July/2023

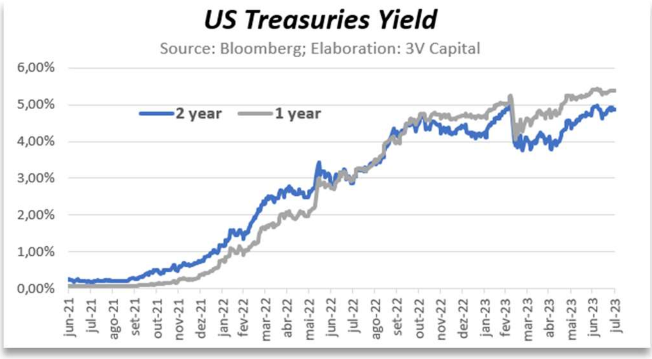
3V capital
Gestão de Recursos

External Scenario

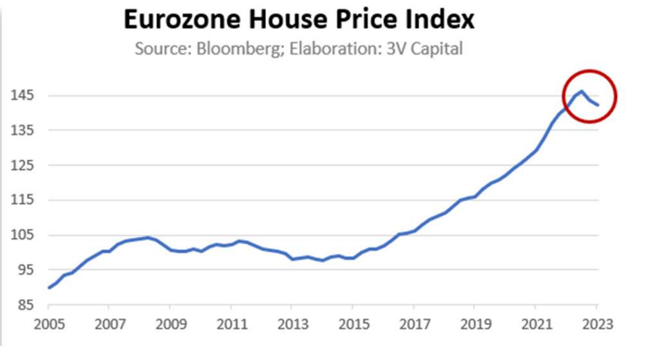
The second half of 2023 began with positive outcomes for risk assets around the world. There were strong increases in stock markets and stability in the bond market, accompanied by a weakening of the dollar. The more lenient stance adopted by several Central Banks regarding monetary policy management led investors to increase their exposure to risk in their portfolios.

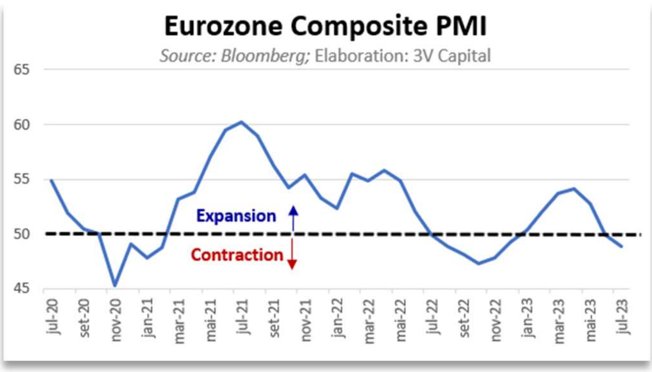


In the United States, the month of July marked the long-anticipated interest rate hike, pushing the *Fed Fund Rates*[1] to the highest level in the past 22 years. Although Jerome Powell and his team indicated in the previous meeting that they expect two interest rate increases by the end of this year, the markets are already pricing in the possibility that this might have been the last move by the American Central Bank in the near future. Recent inflation data indicates a shift in the approach of the institution, now adopting a more "data-oriented" strategy. In other words, the more deceleration observed in price indicators, the more likely a "soft-landing" scenario with less restrictive monetary policy becomes.

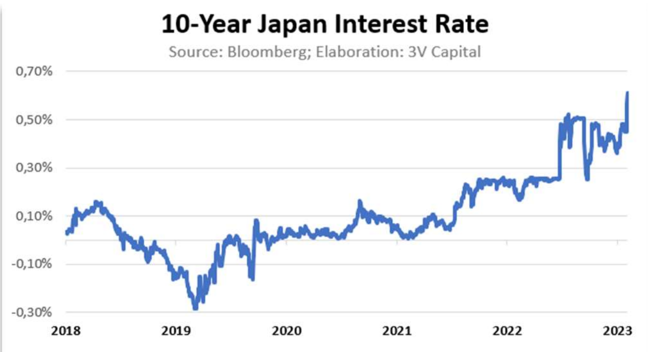


Similarly, the European Central Bank also raised interest rates this month, despite growing recession fears. Christine Lagarde's remarks follow the same data-driven approach, but with some modifications. Certainties are replaced by the possibility of more interest rate hikes in the future, which opens the door to maintaining rates going forward. The adverse effects of the tightening monetary cycle are already noticeable in everyday European life, with various activity indicators, such as housing prices, business loans, and industrial activity, showing contractions. If these trends continue, the chances of the ECB adopting a more *dovish*[2] stance increase.





In Asia, the Bank of Japan maintained ultralow interest rates but adopted measures to flexibilize its yield curve control policy. In its guidance, Kazuo Ueda stated that the 50-basis point fluctuation bands on the country's 10-year bonds are used more as "guides" than "strict limits." This demonstrates the Bank of Japan's concern about the current high inflation rates and sets the stage for potential future adjustments towards a more *hawkish*[3] tone. In China, much worse-than-expected industrial activity numbers put pressure on the Communist Party, which must consider applying further stimuli to the economy.



In summary, the improvement in most inflation indicators worldwide has allowed central banks to adopt a more flexible stance regarding the future of monetary policy management in their respective countries. In a short period, the rigid and definite stance that more interest rate hikes were forthcoming rapidly shifted. Now, the door for new adjustments is open, but they may not necessarily materialize. Simplistically, inflation indices and their respective cores are showing a steady deceleration, and this trend is likely to continue. Thus, the end of the current restrictive interest rate policies could become clearer and potentially occur sooner than expected.

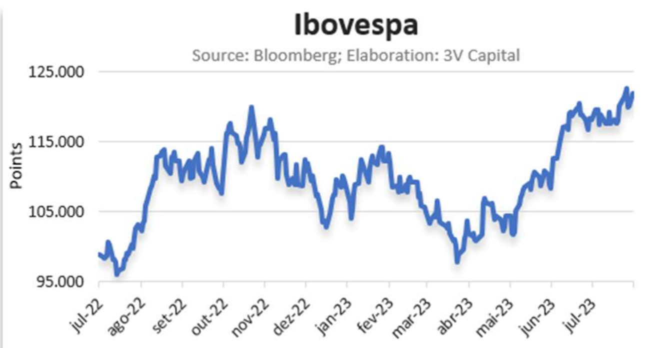
[1]Fed Fund Rates: the basic interest rate of the United States.

[2]dovish: a term used to refer to a less stringent bias of a particular central bank, aiming to lower interest rates.

[3]hawkish: a term used to refer to a more stringent bias of a particular central bank, aiming to raise interest rates.

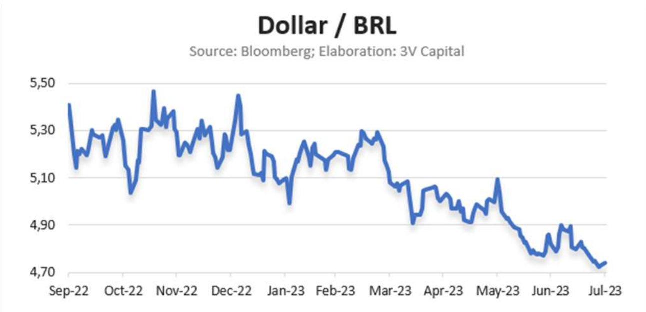
Domestic Scenario

Amid a less cloudy external environment, with major central banks nearing the end or already at the end of their tightening monetary cycles, Brazilian assets – like those of many other emerging markets – continued on a positive trajectory. This reflects the more consistent domestic disinflation process and progress on the new framework and Tax Reform in Congress.

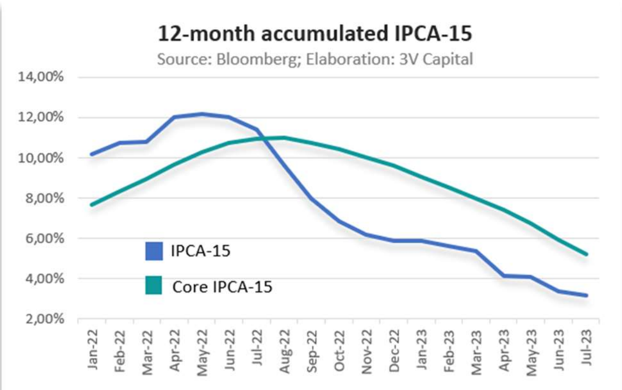


Even though the expectation of the start of the basic interest rate easing cycle in Brazil may reduce the impetus for Real appreciation, the

Fed's less hawkish stance keeps the dollar falling globally, along with the attractiveness of *carry trades*[4]. This favors foreign inflows into Brazil and the Brazilian currency, with a positive impact on inflation.



As observed in the July IPCA-15, greater deflation than anticipated increased the likelihood of more assertive action from the Copom (Central Bank of Brazil), especially since the average core inflation figures fell vigorously and the feared inflation of services decelerated more than expected. Equally significant, the diffusion index, which measures the spread of price increases across the economy, also receded. Hence, while it is certain that the Copom will commence the Selic rate cuts in August, there are doubts about the intensity of this move.



On the corporate side, Petrobras stood out once again, with a positive response to its recent announcement of a new shareholder remuneration policy, which was considered less drastic than feared. On the downside, dividend payments were reduced from 60% to 45% of cash flow, and equity acquisitions were included as investments, which might even nullify dividends for a quarter in the case of significant acquisitions, such as Braskem. Nonetheless, the new policy kept the door open for extraordinary dividend payments and a potential share buyback. As a result, Petrobras shares rose by 5.17% during the month (outperforming the Ibovespa, which advanced by 3.27% during the period).

Looking ahead, we believe that the end of monetary tightening in the United States, combined with China's government signaling stimulus measures, as well as the improved domestic economic environment with declining inflation and falling interest rates, should continue to have a positive impact on local assets (many of which are still undervalued relative to their intrinsic values). This trend might even favor the resurgence of Initial Public Offerings *(IPOs)*[5] on B3, the Brazilian stock exchange, which has not seen a public offering for two years.

However, alongside economic indicators, special attention must be given to the reform agenda, as legislative activities resume after the July recess. Following the approval of the tax reform in the Chamber of Deputies, concerns now revolve around the governance of the Consultative Council (which will manage the revenue of states and municipalities and has become a subject of dispute between affluent and less affluent states) and the lobbying efforts from various sectors for differentiated tax rates – the more exceptions there are, the higher the standard rate is likely to be.

[4]Carry trade: an operation that involves borrowing in a currency with a low interest rate (e.g., the dollar) and investing the obtained amount in a currency with a higher interest rate (e.g., the Brazilian Real), aiming to profit from the interest rate difference.

[5]IPO: Initial Public Offering, the process by which a company goes public and raises capital by offering shares to the market for the first time.

Indicators - returns (%)				
Rate/Index	Jun-23	Jul-23	2023	Last 12 m
CDI	1,07%	1,07%	7,64%	13,59%
Dólar (Ptax-V)	-5,43%	-1,61%	-9,13%	-8,61%
Ibovespa	9,00%	3,27%	11,13%	18,20%
IMA-B	2,39%	0,81%	12,27%	15,46%
IPCA	-0,08%	0,08%	2,95%	3,95%
IRF-M	2,12%	0,89%	10,59%	16,44%
S&P 500	6,47%	3,11%	19,52%	11,11%
Euro Stoxx	4,29%	1,64%	17,86%	20,58%
MSCI Emerging	3,23%	5,80%	9,47%	5,35%

*IPCA of July refers to Anbima's forecast

NOTICES