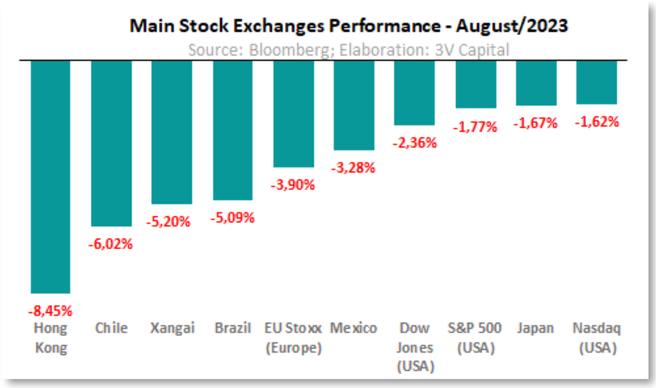
Economic Letter

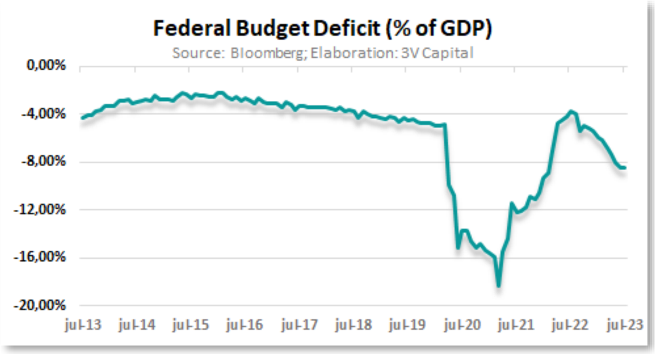
August/2023

External Scenario

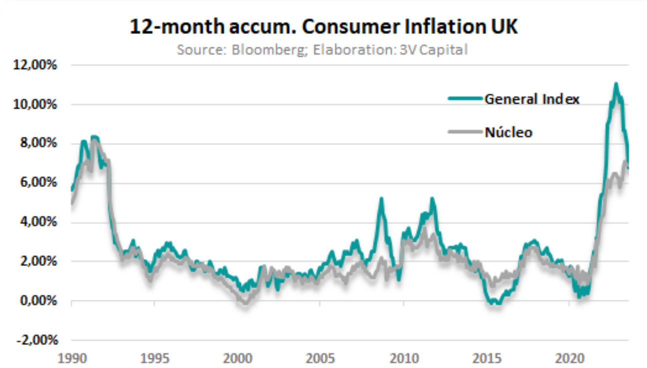
Throughout the month of August, corrections occurred in all equity markets, accompanied by an increase in long-term interest rates and the strengthening of the dollar against its major peers. These events were influenced by the statements of key central bankers, who maintained a more *hawkish*[1] tone during the important annual meeting held in Jackson Hole.

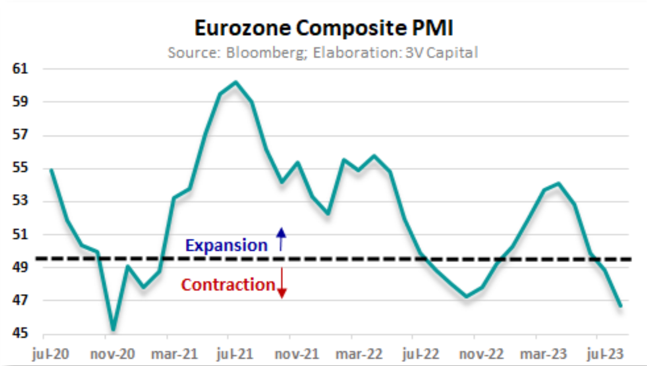


In the United States, strong economic data were observed in the month, stemming from consumption, production, and job creation above expectations. The primary event that dominated U.S. headlines was the downgrade of the long-term credit rating of the world's largest economy from AAA to AA+ by *Fitch*, which highlighted the deterioration in the country's fiscal conditions and governance metrics, aspects that are in line with Jerome Powell's speech, in which he suggests that the scenario of maintaining high-interest rates for a longer period may be necessary to converge inflation to the 2% target.

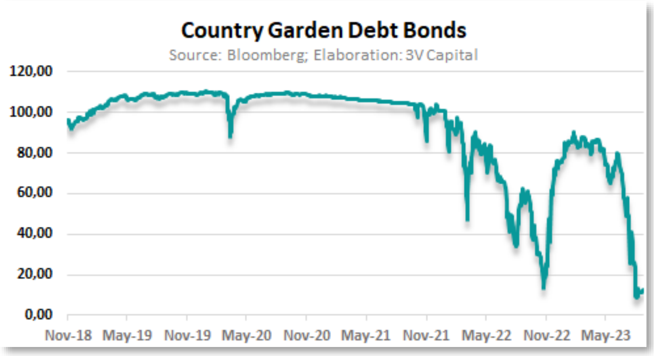


On the other hand, economic activity in Europe recorded a slight contraction, with composite *PMIs*[2] entering a deceleration territory. Similar to the United States, inflation in Europe continued to gradually decline, with a more pronounced drop in British data. Nevertheless, the Bank of England raised its interest rate by 25 basis points, bringing it to 5.25%, and signaled the continuity of this trajectory.





As for China, economic slowdown persisted and caught the attention of market participants. Government stimuli are being implemented at a considerably slow pace—the country's central bank reduced the main interest rate by only 15 basis points, fixing it at 2.5%, without showing any discernible impact on economic activity. Furthermore, the crisis in the real estate sector worsened even further, with Country Garden, one of the largest private real estate developers in the country, dangerously close to defaulting on its debt.



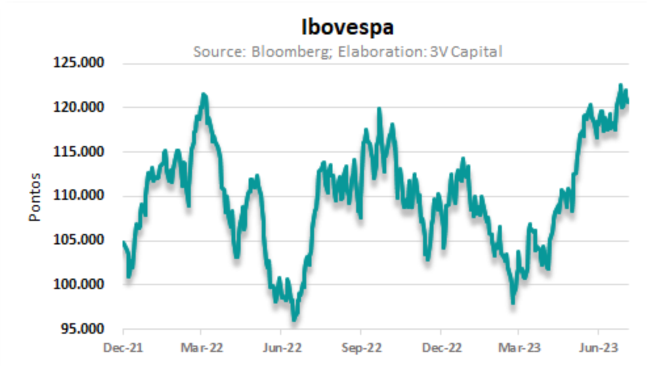
With the speeches of major central bankers still vigilant, the "higher for longer" approach is expected to keep interest rates at current levels for an indefinite period, until inflation worldwide returns to the target. Economic indicators continue to surpass expectations, raising doubts about the recession forecasted by economists and policymakers about a year ago. Thus, the central question that remains is whether it will be possible to achieve the inflation target in the current context, resulting in a soft landing for economies, or if an environment of even higher interest rates will be necessary to achieve this goal, risking a forced landing of economies.

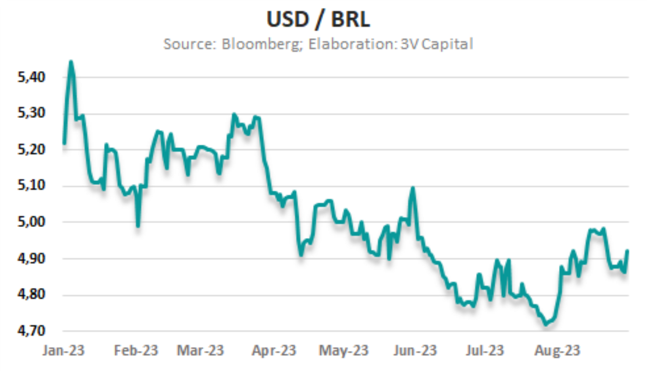
[1] *hawkish: a term used to refer to a more stringent bias of a central bank, whose intention is to raise interest rates.*

[2] *PMIs (Purchasing Manager's Index): is an indicator that measures the economic activity performance of a country.*

Domestic Scenario

In addition to the more clouded international environment with uncertainties about the Fed's next steps and concerns about the Chinese economic recovery, the domestic markets in August were also affected by some internal political noise and increasing skepticism about achieving the zero fiscal deficit target next year.

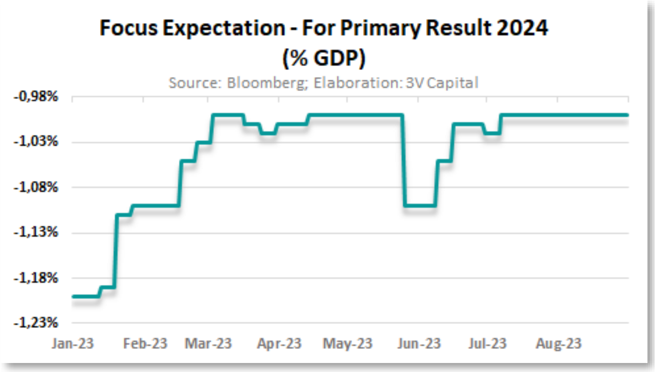




Although keeping the Fundeb and resources from the Constitutional Fund of the Federal District outside of the spending limit, the final approval of the new Fiscal Framework by the Chamber of Deputies with stricter rules than in the government's original proposal was considered positive, especially after the Senate's amendment that allowed conditional expenses in the Budget was excluded - therefore, they will continue to depend on annual approval by the Legislature to be executed. However, the rigidity of the country's spending structure combined with the lack of executive branch protagonism in cutting expenses, makes revenue dependence the Achilles' heel for achieving the 2024 target, especially with recent revenue results falling short of expectations.

In this regard, committed to increasing revenues, after many ups and downs, the government finally managed to pass the CARF bill that restores the tie-breaking vote in favor of the Revenue Department, as well as published a Provisional Measure to change the taxation of closed exclusive funds (making them subject to the same taxation as open funds) and sent a bill to the Legislature to tax offshore income recurrently.

Economically, despite the more benign inflation data of recent months, the 0.28% increase in the August IPCA-15 above consensus (+0.16%) was disappointing, even though service inflation - identified by the Central Bank as an important factor in determining the pace of easing - decelerated. With higher fuel prices and inflation expectations that have stopped improving, naturally, bets on a more aggressive interest rate cut at the next Copom meeting have fallen by the wayside. Additionally, this scenario is contributed to by Campos Neto drawing attention to the issue of "twin deanchoring," both in monetary and fiscal policy: currently, market projections for the IPCA in 2025 and 2026 point to inflation of around 3.5%, above the 3% target, while expectations for next year's public accounts are for a deficit of around 0.8% of GDP compared to a zero deficit target.



In the coming weeks, attention should continue to focus on inflation indicators, as well as economic activity, which continues to show strong resilience even in the face of tight economic conditions - a phenomenon that is explained, in our opinion, by the structural reforms of recent years. Furthermore, special attention should be given to the approval of revenue-raising measures in Congress necessary to meet the targets since the effective execution of the fiscal plan is *sine qua non* for an improvement in the country's credit rating by major rating agencies and for a sustained monetary easing cycle. For now, even with the government's political faction attempting to sabotage the Finance Ministry's commitment to achieving zero deficit in 2024, Minister Haddad has managed to advance his agenda. Still, it is essential to monitor how long the president's support will last for this commitment and its political cost to the government since a ministerial reform to appoint new Centrão ministers will be necessary to increase the government's base in the Legislature.

Indicators - returns (%)				
Rate/Index	Jul-23	Aug-23	2023	Last 12 m
CDI	1,07%	1,14%	8,87%	13,55%
Dólar (Ptax-V)	-1,61%	3,80%	-5,67%	-4,96%
Ibovespa	3,27%	-5,09%	5,47%	5,68%
IMA-B	0,81%	-0,38%	11,84%	13,76%
IPCA	0,08%	0,26%	3,26%	4,64%
IRF-M	0,89%	0,76%	11,43%	14,96%
S&P 500	3,11%	-1,77%	17,40%	13,97%
Euro Stoxx	1,64%	-3,90%	13,27%	22,17%
MSCI Emerging	5,80%	-6,36%	2,50%	-1,39%

*IPCA of August refers to Anbima's forecast

NOTICES

Autorregulação ANBIMA Gestão de Recursos

Autorregulação ANBIMA Gestão de Patrimônio