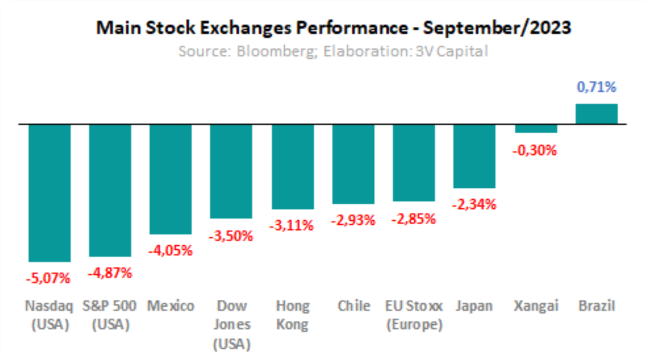
Economic Letter

September/2023

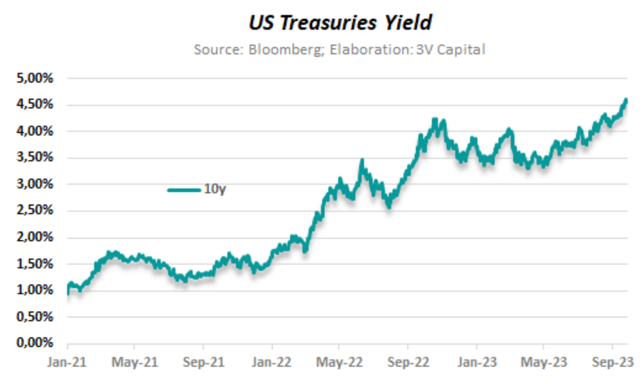
3V capital
Gestão de Recursos

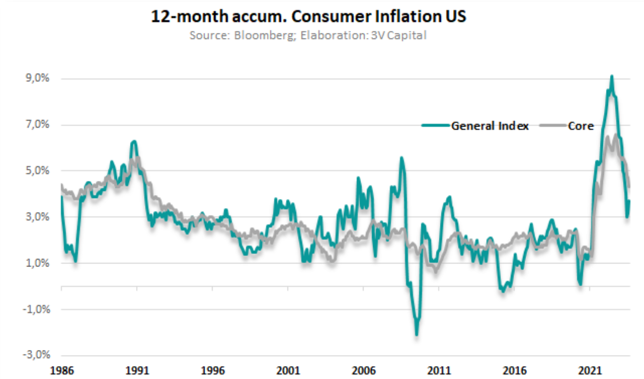
External Scenario

In September, there was a significant increase in risk aversion, leading to corrections in stock markets and a rise in yields across nearly all countries. Economies continued to show signs of robust activity, reinforcing the more *hawkish*[1] stance of major central banks. It becomes increasingly evident that interest rates are likely to remain high for a longer period than initially anticipated.

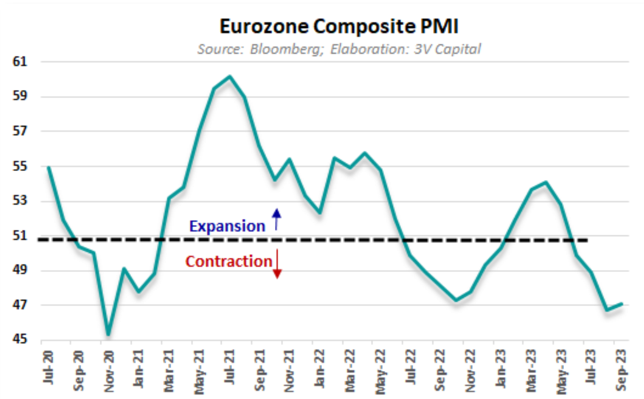


Economic activity indicators in the world's largest economy remained strong across various sectors, supporting optimistic GDP projections for the third quarter. However, inflation data presented mixed results: while the overall index rose due to higher oil prices, the core index decelerated during the period. As expected, the Federal Reserve made no changes to the basic interest rates, keeping them in the range of 5.25% to 5.5%. However, the market reflects the expectation that rates will remain elevated for a longer period than expected, with 10-year Treasury bond yields reaching nearly 4.7%.

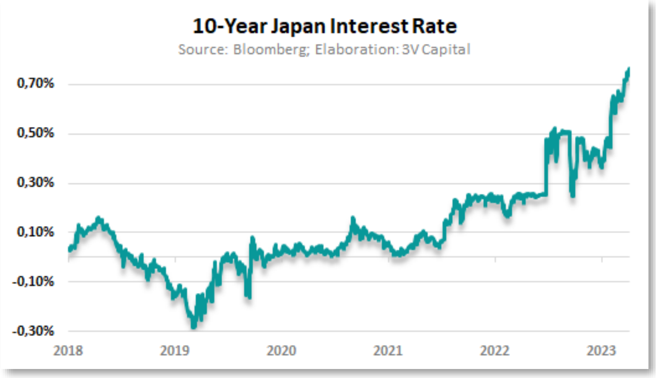




On the other hand, economic activity indicators in the Eurozone and the United Kingdom were not as favorable as those in the United States, with key growth indices contracting in September. On a positive note, inflation, both in the overall index and the core, decelerated in Europe, despite volatility in *commodity* prices. Finally, the European Central Bank raised its rate by 25 basis points to 4%, while the Bank of England surprised by keeping its rate unchanged at 5.25%.



In Asia, we observed significant improvement in Chinese indicators, both in terms of growth and production, positively impacting emerging markets. Although the situation in the real estate sector, mainly focusing on Evergrande, remains a concern, indications from Beijing suggest that the government led by Xi Jinping does not intend to allow it to become a larger problem than it already is. In Japan, the Central Bank maintained its negative interest rate policy, but the bond market is moving in the opposite direction, indicating that the *Yield Curve Control*[2] implemented in 2016 may be approaching its end.



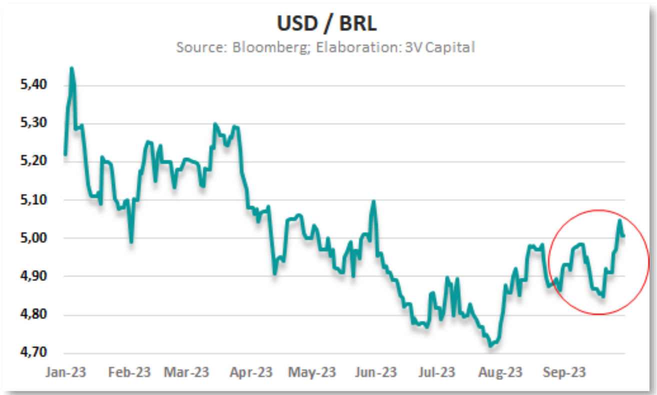
In summary, the standout feature of September was the bond market, with long-term bond yields from many countries playing a significant role in spreading risk aversion sentiment in the market. Bond yields had significantly tightened in August, partly driven by investor enthusiasm anticipating imminent interest rate cuts in various countries, with the prospect of an aggressive pace. However, the persistent threat of inflation continues to influence central bankers, who maintain a more *hawkish* stance in response. The determination to bring inflation back to target, at any cost, translates into higher interest rates for a longer period than initially anticipated.

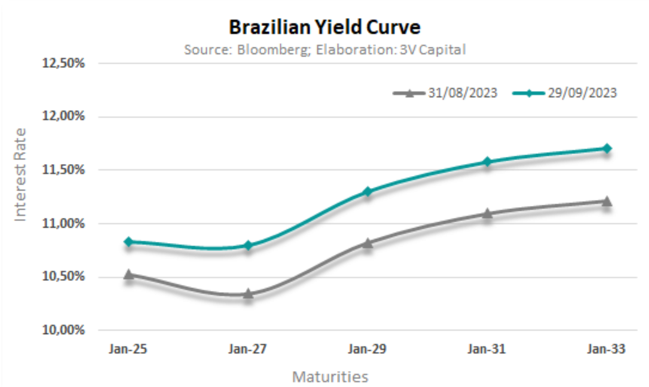
[1]hawkish: This term is used to refer to a more stringent stance of a specific central bank, indicating its intention to raise interest rates.

[2]Yield Curve Control: This is a Monetary Policy tool where the Central Bank acts to prevent or mitigate movements in the yield curve.

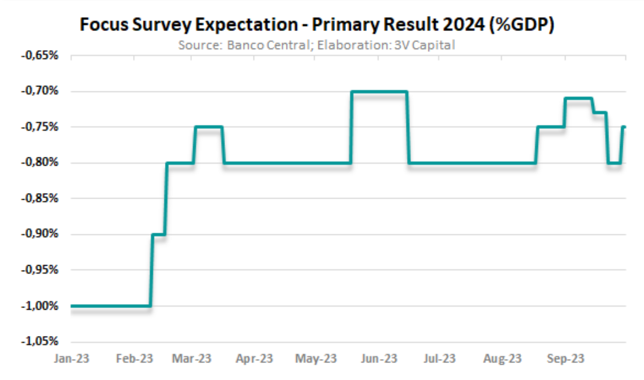
Domestic Scenario

Amidst recurring concerns that the Fed's interest rate hike cycle might not be over and the real estate crisis in China, uncertainties in the fiscal landscape here have added a fair share of caution, negatively impacting the Real and adding premiums to future interest rates.



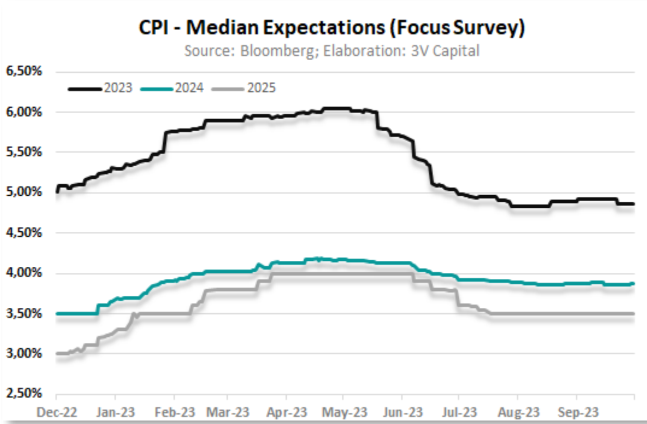


Even though the government has recently achieved some significant victories such as the new Carf law and the taxation on sports betting and it is committed to passing taxation laws on exclusive funds and offshore assets, the market's skepticism about the Treasury's goal of achieving a zero fiscal deficit next year is growing. With many expenses underestimated by the government—especially regarding Pension and Bolsa Família expenditures—and lacking robust extraordinary revenues from the sale of Eletrobras and last year's Petrobras dividends, balancing the budget seems challenging.



Despite this overcast environment, the current economic activity remains resilient, notably in the labor market, where a continuous decrease in unemployment rates and an increase in wage mass are observed—a phenomenon we believe stems from the structural reforms of recent years.

Regarding prices, despite August's IPCA being at the lower end of estimates, the market continues to project an overshooting of the Central Bank's inflation ceiling of 4.75% for this year (the third consecutive overshooting). For the years 2025 and 2026, projections remain above the 3% target, at around 3.50%. Thus, under this still challenging inflationary context combined with robust economic activity, worsened fiscal perceptions, a rising dollar, increased fuel prices, and a *hawkish* Fed, Copom maintained the pace of the Selic rate cut at 50 bps in September as widely expected (to 12.75% per annum). However, it dampened expectations of a possible acceleration of the pace this year to 75 bps by stating that this pattern would be maintained "in the upcoming meetings," namely in November and December.



Looking ahead, the attention domestically should continue to be focused on economic indicators and, primarily, on the progress of bills in Congress that could make a difference in improving public finances. A point that requires extra caution is the government's recent proposal to settle precatórios with extraordinary credits: by categorizing these obligations as financial expenses (rather than primary expenses), these expenditures would be excluded from the new fiscal framework's rule. We understand that this accounting practice could complicate the proper monitoring of public debt and increase risk premiums.

Indicators - returns (%)				
Rate/Index	Aug-23	Sep-23	2023	Last 12 m
CDI	1,14%	0,97%	9,93%	13,44%
Dólar (Ptax-V)	3,80%	1,74%	-4,03%	-7,38%
Ibovespa	-5,09%	0,71%	6,22%	5,93%
IMA-B	-0,38%	-0,95%	10,79%	11,05%
IPCA	0,26%	0,32%	3,56%	5,25%
IRF-M	0,76%	0,17%	11,62%	13,57%
S&P 500	-1,77%	-4,87%	11,68%	19,59%
Euro Stoxx	-3,90%	-2,85%	10,04%	25,81%
MSCI Emerging	-6,36%	-2,81%	-0,38%	8,79%

*IPCA of September refers to Anbima's forecast

NOTICES