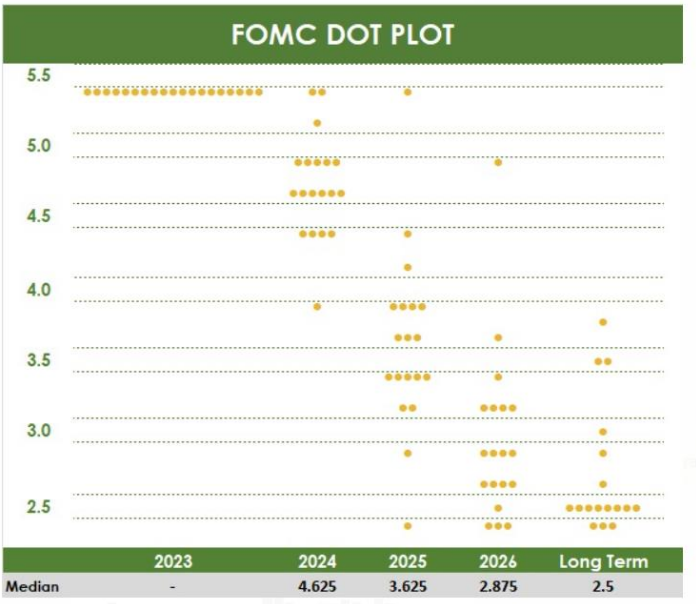
Reduction in global and domestic risks expected to result in a lower Selic rate in 2024

In this Special Report, we present our expectations for the macroeconomic scenario in 2024. In general, we maintain our more constructive view for both external and domestic environments, leading to continued growth and disinflation, a more appreciated exchange rate, and a lower level of the Selic rate at the end of the current monetary cycle.

Recently, the Federal Reserve (U.S. central bank) surprised by adopting a more dovish stance than anticipated, advancing the market's estimate for the start of monetary easing. Although the statement underwent few changes, it is noteworthy that the section mentioning that "inflation remained elevated" was replaced by one highlighting that there has been a "slowdown in the past year, although it remains elevated," indicating a greater conviction of inflation converging to the target. The dot plot, a chart showing Committee members' expectations for Fed Funds at the end of each year, pointed to a median of 4.6% in 2024 (compared to the expectation of 4.75%), predicting an additional 0.25 p.p. cut in 2025, reducing the rate to 3.625%.

We maintain our perspective that the Fed Funds reduction cycle will begin in May, although we acknowledge that the probability of starting in March has gained likelihood. The most recent speech by Fed Chair Jerome Powell reinforced the optimistic view for the U.S. economy, suggesting that activity should continue on a soft landing, and that core inflation persists in deceleration.

Graph 1 – FOMC Members' Expectations for Fed Funds (Dot Plot)



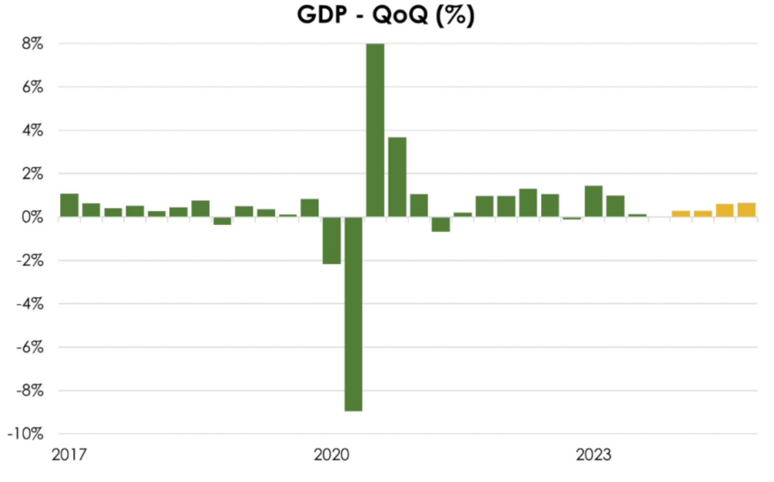
Source: Federal Reserve, Buysidebrazil

For China, we foresee economic growth between 4.0% and 4.5% of GDP in 2024, below the expected 5.0% advance for this year. This deceleration is not expected to lead to significant surprises for commodity prices next year, which should remain moderate, contributing to the maintenance of global disinflation. Internally, challenges in the real estate sector have been affecting confidence in the economy, with visible effects on domestic demand, while externally, activity continues to be impacted by reduced demand from the West and the ongoing geopolitical tensions with the U.S., leading to the depreciation of the renminbi.

In Brazil, domestic economic activity is expected to accelerate throughout 2024, although the annual GDP growth is projected to be lower. Besides the expected lower statistical carryover (0.8% to 0.3%), the record harvest is not expected to repeat next year, the effects of fiscal stimuli granted this year are likely to dissipate, and global activity is expected to continue a gradual slowdown. We project an increase of 2.9% and 1.5% in GDP for this year and the next, respectively. Nevertheless, it is worth noting that the expected quarterly trajectory by us is quite benign. In the quarter with the lowest growth, the rate is equivalent to the average observed between 2010 and 2019 (0.3% QoQ), with acceleration in the second half to a level higher than that recorded between 2017 and 2019. If this scenario materializes or there are positive surprises, discussions about a higher potential GDP, resulting from the impacts of macro and microeconomic reforms carried out in recent years, are likely to intensify.

Among the positive factors for growth next year, the strength of the labor market and the continuation of the interest rate cutting cycle stand out. Additionally, our estimates indicate a potential increase of 0.1 percentage points due to a higher number of working days compared to 2023, and up to 0.2 percentage points resulting from the full payment of the stock of court-ordered payments (precatórios) accumulated between 2022 and this year. Although the amount to be paid corresponds to about 0.9% of GDP, we are considering in our calculation only alimentary precatórios and those of higher priority, which can be converted into household consumption.

Graph 2 – Quarterly Variation of Brazilian GDP (%)



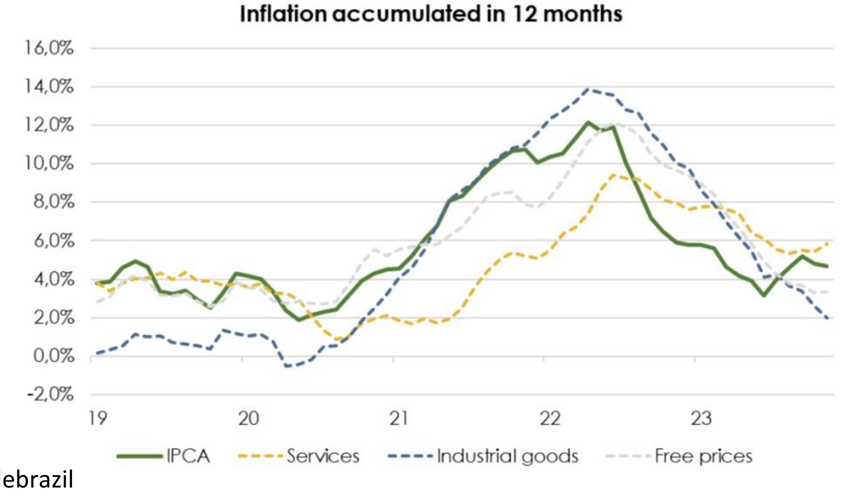
Source: IBGE, Buysidebrazil

Despite the robustness of the labor market, the indicators released so far do not point to additional inflationary pressures. Although the employed population has decelerated at a pace lower than initially expected, wage incomes have recently lost momentum after a temporary acceleration at the end of the third quarter. Other wage indicators have been pointing in the same direction, reinforcing our expectation that core disinflation is likely to continue next year.

In this sense, we maintain a constructive view on inflation in 2024, with the continuation of its deceleration process (to 3.8%). The effects of contractionist monetary policies in developed countries and the still weakened activity in China will support the disinflation of goods, aiding the accommodation of core inflation. Furthermore, the lower global demand tends to limit a significant rise in oil prices. Internally, the economic slowdown – already reflected in the interest rate cutting cycle – should also contain greater pressure on service prices. In this regard, although headline inflation is above the target midpoint, core inflation in 2024 is expected to be at the 3% target.

A point of attention, already incorporated into our scenario, is the price of food at home due to the inflationary impacts of the El Niño phenomenon. The climate at the beginning of the year will indicate the intensity of potential pass-through effects to the consumer. Nevertheless, we believe in a better performance of the exchange rate throughout the year, which is expected to counterbalance this effect.

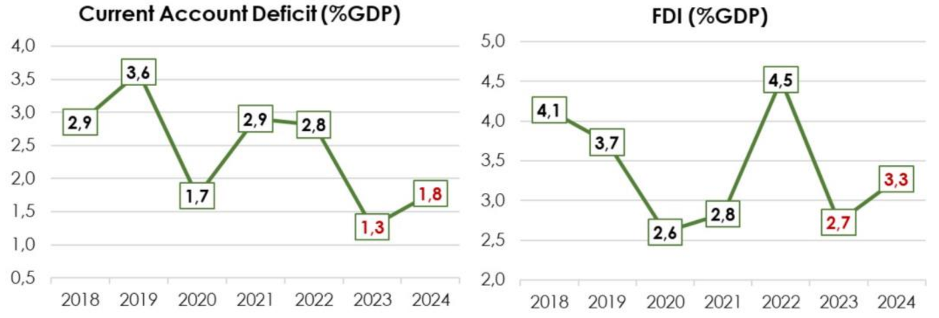
Graph 3 – Consumer Price Inflation (IPCA) Accumulated in 12 Months (%)



Source: IBGE, Buysidebrazil

We also emphasize our positive view on external accounts. The highlight is the trade balance, which, although slightly weaker than this year, is expected to remain robust. Exports, less favored by crops compared to 2023, will be offset by some correction in domestic grain prices, the historically high balance of the oil trade, which is expected to remain strong, and weaker imports. This will favor the trade flow, even as exporters continue to externalize some resources. From a financial perspective, we expect: (i) the downward cycle of Fed Funds favors the flow of portfolio investments to emerging markets, considering the likely "risk-on" movement, (ii) foreign direct investment exceeds that of this year, and (iii) the accommodation of fiscal risks favors Brazil's country risk. This perspective and our technical tools indicate, therefore, an exchange rate in the range of R$ 4.80 in the first half of 2024 (depreciating at the end of the year due to the unfavorable seasonality of the foreign exchange flow) and a current account deficit of 1.8% of GDP by the end of the year – with a positive bias.

Graph 4 – Balance of Payments (% GDP)



Source: BCBE, Buysidebrazil

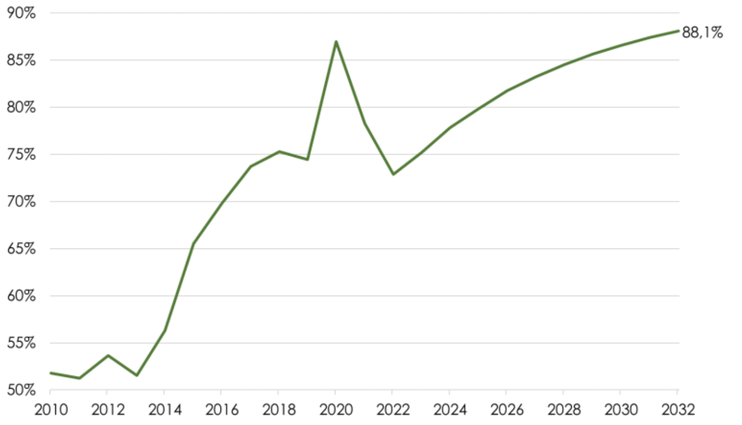
Regarding fiscal policy, despite the growing primary deficit in 2023, we believe that the fiscal balance for the year was positive. Despite the observed challenges throughout the year, significant progress has been made. The new fiscal framework was approved, reducing the risk of an explosive trajectory for public debt. The main measures to boost revenue in the coming year have been approved or are on the verge of approval in the National Congress, and the payment of the stock of court-ordered payments (precatórios) accumulated since 2022 (about R$ 95 billion) has been addressed. In addition, the decision to maintain the primary target was relevant to preserve the credibility of the fiscal framework in its first year.

In the short term, we still anticipate moderation in revenues due to the lower international prices of commodities (especially the recent drop in oil prices) and the gradual slowdown in economic activity, while expenses are expected to remain under pressure, especially due to the increases contracted by the Transitional Constitutional Amendment (PEC da transição) and the acceleration of pension expenditures.

We maintain our view that the fiscal scenario will remain challenging next year, but we continue to believe that public accounts will have a better outcome than expected by the market. We project a deficit in the primary result of the Central Government of R$ 72.2 billion (0.6% of GDP), less intense than the R$ 90.0 billion forecast by the market, reflecting the expectation of higher revenues from tax measures. While there are negative risks, such as the continued acceleration of pension expenditure growth and less budgetary restraint, on the other hand, new revenue sources may surprise on the upside (we are considering revenues below those estimated by the Treasury), and the commonly observed hoarding of discretionary expenses (on average, 11% of the budgeted amount is not spent) may contribute to a less negative result.

For the medium and long term, the gross debt as a proportion of GDP is expected to continue to rise, albeit at decreasing rates. In this regard, additional measures would be necessary for a more rapid stabilization of the debt, especially on the expenditure side, which, according to the new rule, grows in real terms.

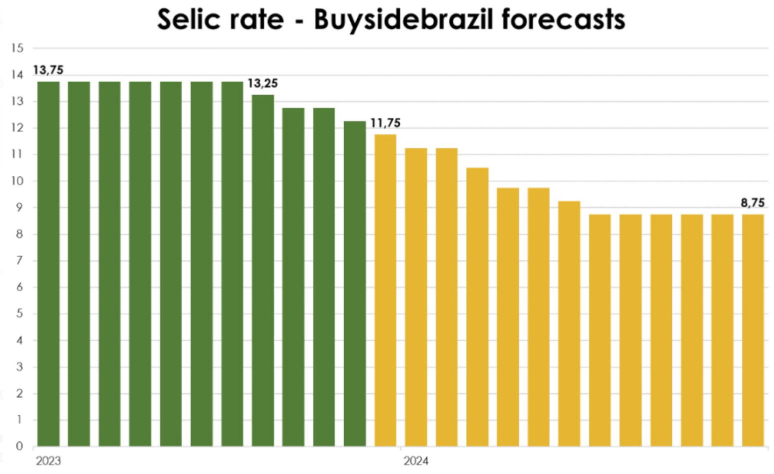
Graph 5 – Gross Debt/GDP (%) – Recalculated by Buysidebrazil after nominal GDP revision



Source: BCB, Buysidebrazil

Finally, considering our more favorable expectations for the global and domestic environments, we have reduced our forecast for the Selic rate at the end of 2024 from 9.25% to 8.75%. Despite the lack of complete convergence in inflation expectations and the signal of maintaining the pace of interest rate cuts in the upcoming meetings, we believe that the scenario described so far is consistent with an acceleration of the pace of monetary easing by 0.75 p.p. starting from March. Additionally, in the transition from the first to the second quarter, the relevant horizon for the Copom will be mostly 2025, favoring a faster pace of reduction, especially in a context of a more appreciated exchange rate impacting the inflation models of the central bank.

Graph 6 – Selic Rate (%) – Buysidebrazil Scenario



Source: BCB, Buysidebrazil

MACROECONOMIC FORECASTS	2018	2019	2020	2021	2022	2023	2024
GDP (%)	1,8	1,2	-3,3	5,0	2,9	2,9	1,5
Unemployment rate (average, %)	12,4	12,0	13,8	13,2	9,3	8,0	8,1
IPCA (CPI, %)	3,7	4,3	4,5	10,1	5,8	4,50	3,80
Selic Rate (eop, %)	6,50	4,50	2,00	9,25	13,75	11,75	9,25
USDBRL (eop)	3.87	4.03	5.20	5.58	5.22	4,90	4,90
Current Account Balance (USD bn)	-51,5	-65,0	-28,2	-46,4	53,6	-28,2	-36,1
Current Account Balance (% GDP)	-2,7	-3,5	-1,9	-2,8	-2,8	-1,4	-1,8
Trade Balance - BCB (USD bn)	43,4	26,5	32,4	36,4	44,2	81,3	71,0
Foreign Direct Investment (USD bn)	78,2	69,2	37,8	46,4	87,2	58,3	75,0
Foreign Direct Investment (% GDP)	4,2	3,7	2,6	2,8	4,5	3,0	3,8
Central Government Primary Result (BRL bn)	-120,2	-95,1	-743,3	-35,1	54,1	-215,8	-72,2
Central Government Primary Result (%GDP)	-1,7	-1,3	-9,8	-0,4	0,5	-2,0	-0,6
Public Sector Primary Result (BRL bn)	-108,3	-61,9	-703,0	64,7	126,0	-134,8	-59,2
Public Sector Primary Result (% GDP)	-1,5	-0,8	-9,2	0,7	1,3	-1,3	-0,5
Gross Public Debt (% GDP)	75,3	74,4	86,9	78,3	73,5	75,2	77,8