Economic Report

July 2023

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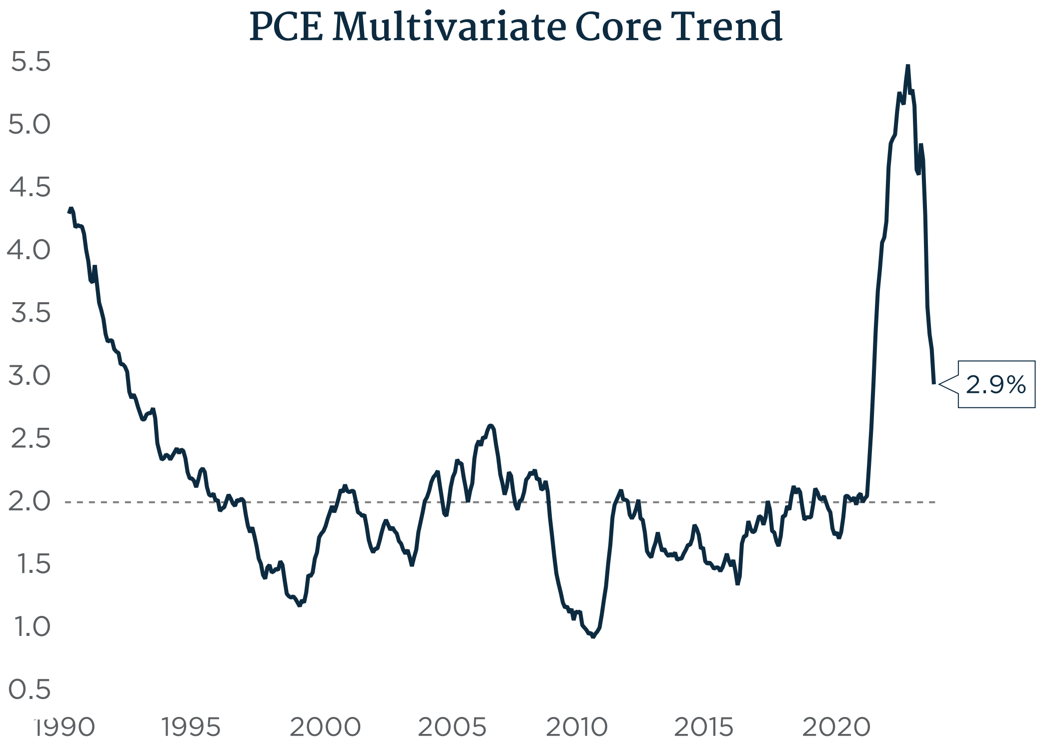
Inflation:
Inflation cores continue to run out of steam

Global Economy



*Updated to June 2023

The disinflation process is continuing in the US economy as is the case in most of the world, to a greater or lesser extent. We have also started seeing better data on core inflation more recently along with movements in more volatile items, such as falling commodity prices and a weak dollar.

The accompanying graph shows the multivariate core trend model (MCT) which measures the persistence of inflation in the 17 main sectors of the core of the consumer price index (CPI). This is the main inflation metric monitored by the Federal Reserve's monetary policy committee, the FOMC. It can be seen that this model shows a significant easing in inflation although it still remains above the target.

Source: Macrobond

China:
Economic data maintains surprise downward move

Global Economy

*Updated to 09/08/23

The Chinese economy is continuing to slow to the point where the consumer and producer inflation figures are already showing deflation in the 12 months to July. The picture for the economic data is the same, with the figures consistently coming in below expectations, particularly those related to the real estate market. The accompanying graph shows an index that varies in line with these surprises.

This series of negative surprises has led the Chinese authorities to take practical steps to increase their efforts to stimulate the economy, the effects of which are important for upholding commodity prices.

Source: Macrobond

Monetary Policy:
COPOM starts cutting interest rates at a higher level than is compatible with the statement

Brazilian Economy

Balance of risks

Risk factors remain in both directions

Upward risks	Downward risks
"a greater persistence of global inflationary pressures"	"a greater than projected deceleration of global economic activity, particularly due to adverse conditions in the global financial system"
"a stronger than expected resiliency on services inflation due to a tighter output gap"	"an impact on global inflation larger than expected from synchronized monetary policy tightening"
~~"some residual uncertainty about the final fiscal framework to be approved by the National Congress "~~	~~"an additional reduction in the prices of international commodities measured in local currency"~~
~~"a larger or more persistent deanchoring of long-term inflation expectations"~~	~~"a slowdown in domestic credit concession larger than what would be compatible with the current stance of monetary policy"~~

The Central Bank's Monetary Policy Committee (COPOM) cut the interest rate by 50 basis points* in August. This was more than would have been consistent with the previous statement which foresaw a "parsimonious" start to the cycle of interest rate cuts. The decision was split, with four of the nine committee members advocating a cut of 25 bp. Of the members who have adopted this more combative approach to fighting inflation, two are due to finish their terms in December and have no prospect of being reappointed.

**1 basis points or 1 bp = 0.01% or 1/100 percentage point*

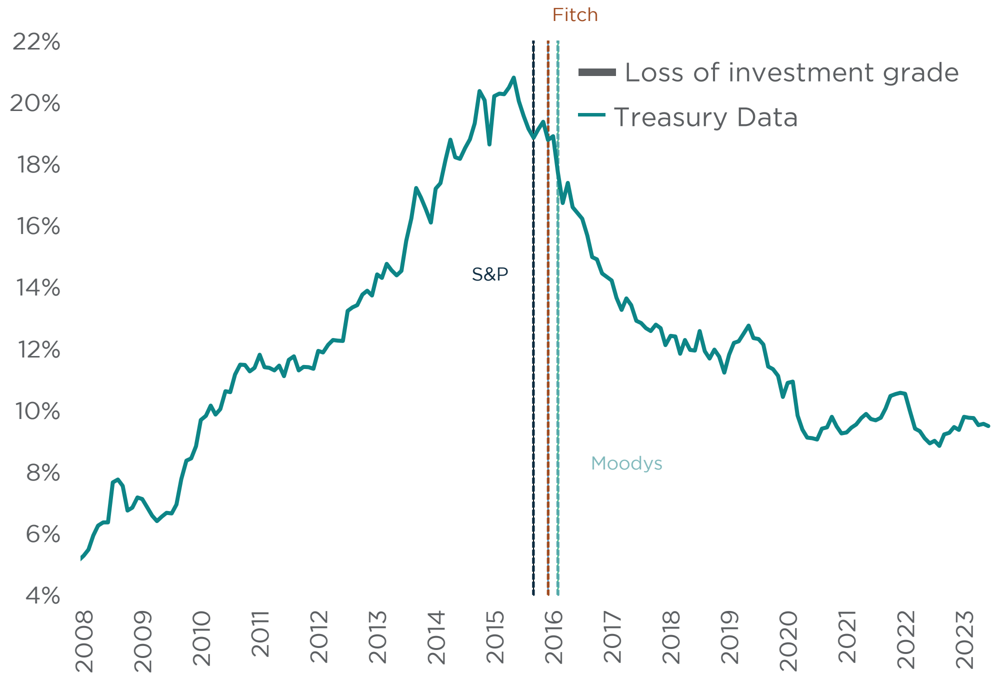
Source: Banco Central, Turim

Country risk:
Improved perception of risk reflected in revised rating

Brazilian Economy

Domestic debt held by foreign investors

Percentage of total



*Updated to June 2023

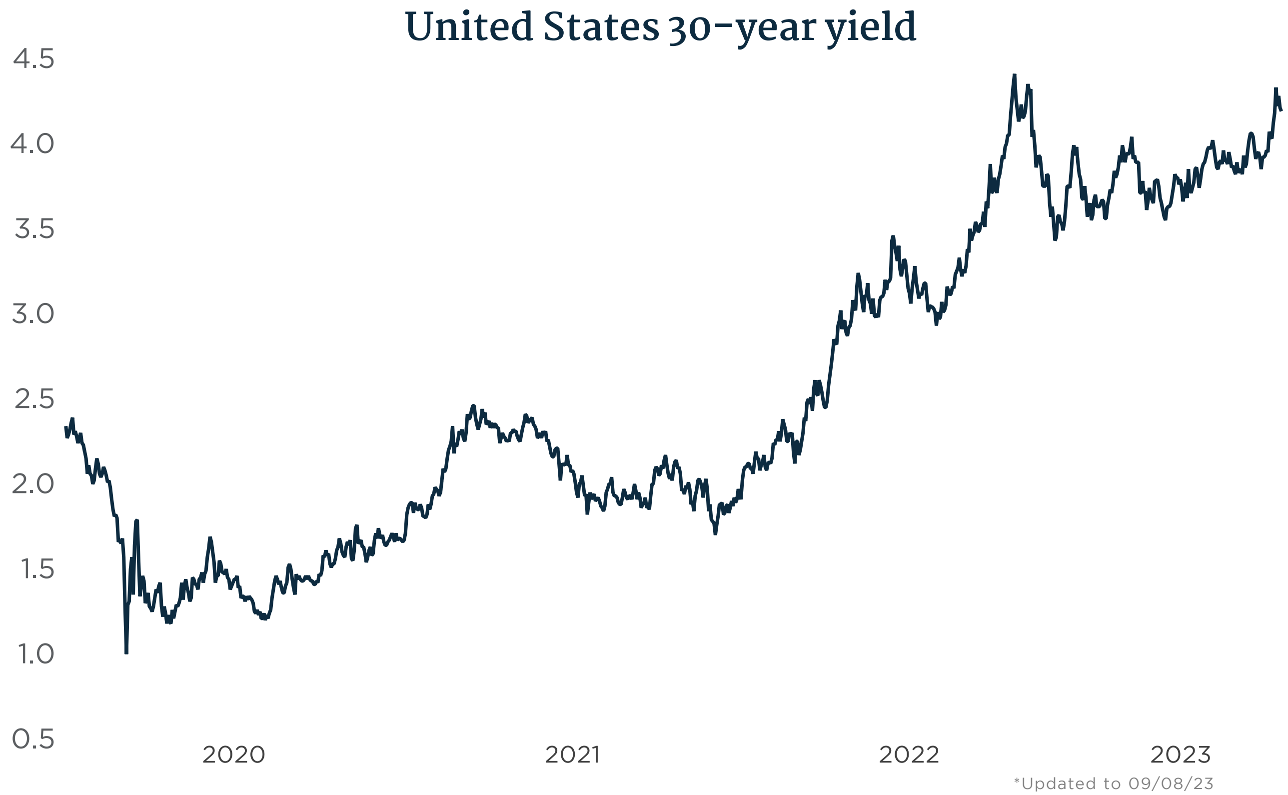
Fitch Ratings recently raised Brazil's risk rating from "BB-" to "BB", with a stable outlook. The agency said the rating reflected better-than-expected macroeconomic and fiscal performance amid successive shocks in recent years, proactive policies and reforms. Despite this move, it is still not clear whether the government has the ability to achieve the targets laid down in the new fiscal framework.

Despite the improvement, the current rating is two levels below the minimum regarded as "investment grade". This could free up a bigger flow of investment to Brazil since certain funds are banned from from investing in "speculative grade" securities. The accompanying graph shows there was a sharp drop in foreign participation in Brazil's government bond market after the country lost "investment grade" status.

Source: Bloomberg, Turim

Interest rates:
Stress in the long term curve

Markets

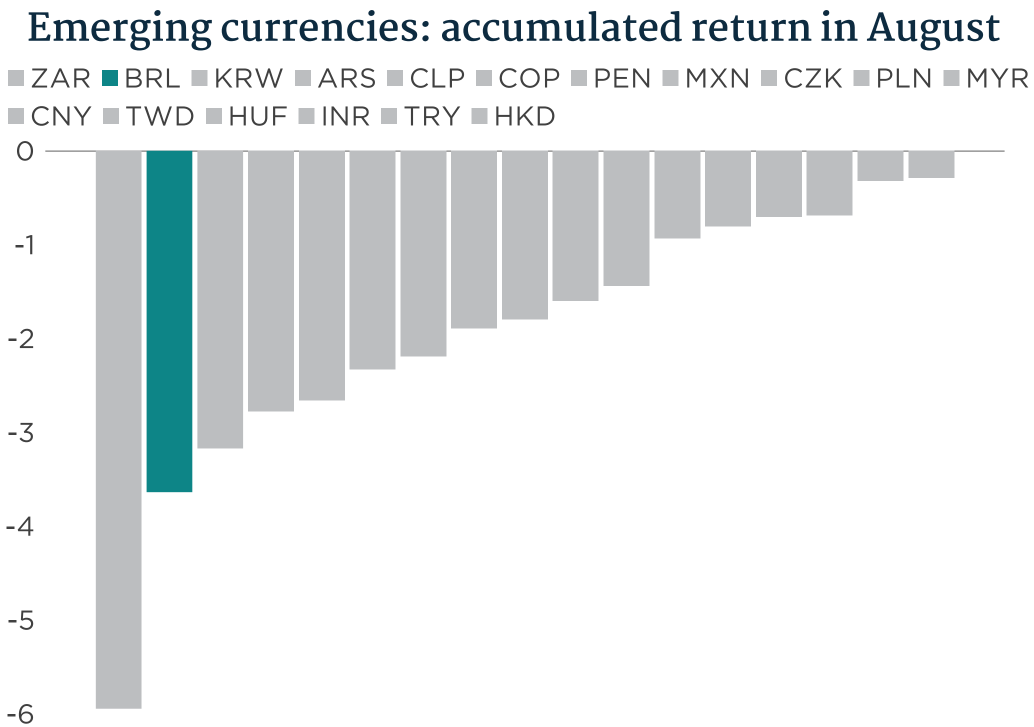


Longer-term US government bond rates, which are less sensitive to short-term monetary policy, opened as the US risk perceptions deteriorated along with the increase in the supply of government bonds to finance the high fiscal deficit. Another factor was the prospect of higher long-term interest rates in Japan which has been altering its monetary policy. The 30-year bond rose by around 40 bps in less than 10 days, registering its highest level since late last year.

Source: Macrobond

Exchange rate:
Opening of interest rates sparked some appreciation of the Dollar, toppling emerging market currencies

Markets



*Updated to 08/08/23

The interest rates movement also reflected in the foreign exchange market, providing support for a stronger dollar in early August. This movement helps explain the broader decline of a number of currencies which, like the Real, had been performing well since the beginning of the year, favored by the high interest rate differential (domestic interest rates - US interest rates) against a global backdrop of low volatility. This outlook is confirmed by the fact that a number of these currencies have already started or are about to start interest rate cut cycles in their respective countries.

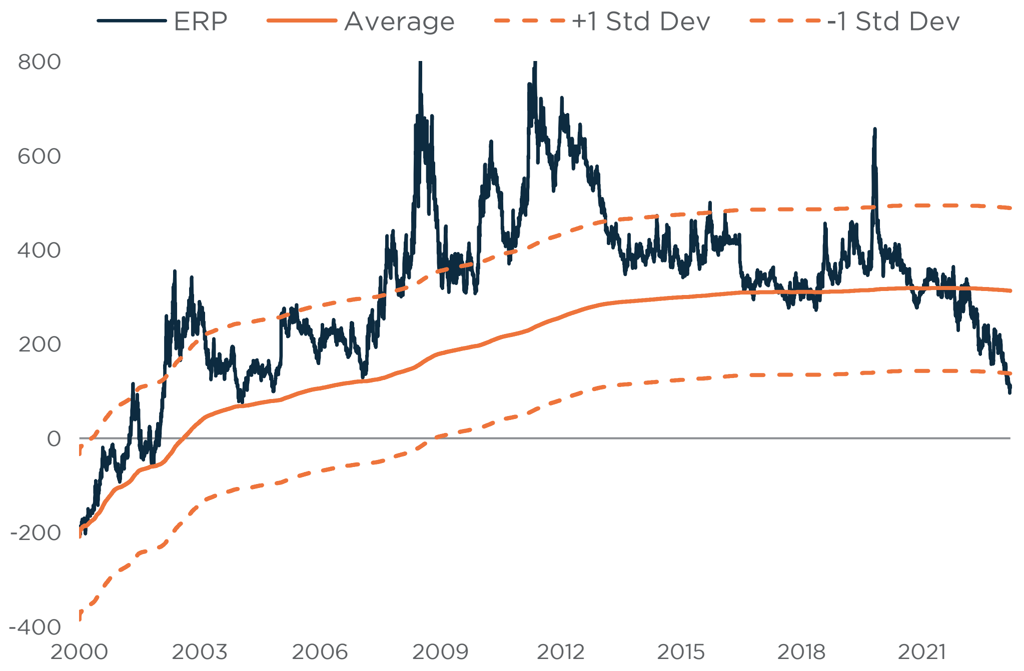
The accompanying chart shows the cumulative performance in August to the reference date of a set of emerging country currencies. It can be seen that the Real was one of the worst performers in the period although it did not differ very much from its peers.

Source: Bloomberg

Equities:
Share prices look compatible with "Goldilocks" outlook

Markets

ERP S&P 500



*Updated to 07/08/23

The US stock market remains relatively resilient. Judging by asset prices, it is reasonable to assume that this market is pricing in a "Goldilocks" scenario, i.e. an economy that is neither too "hot" nor too "cold". In other words, a situation in which inflation converges towards targets but without any sharp fall in activity.

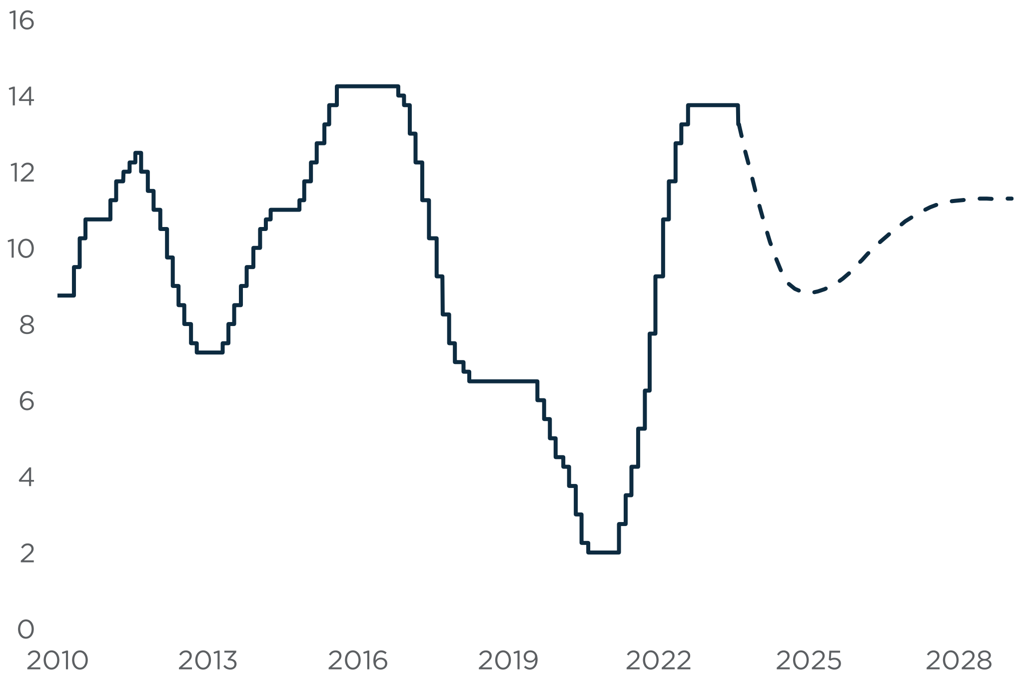
Although this may be an optimistic view, its likelihood has been growing as the figures for activity remain relatively well sustained while inflation has been running at a more benign pace.

Source: Bloomberg

Interest rates:
Curve reacts to start of cut in interest rates

Markets

Selic and market projection



*Updated to 07/08/23

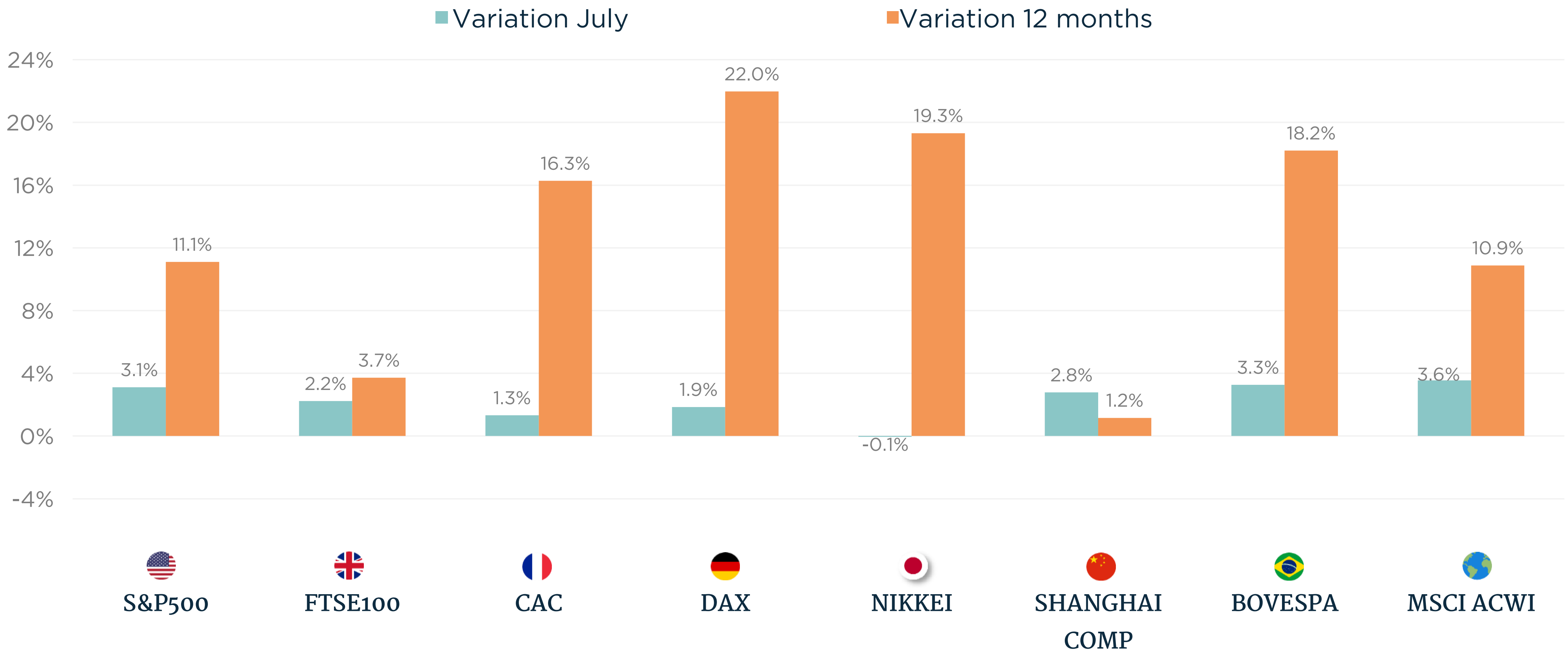
The yield curve in Brazil is pricing in the Selic, the country's basic interest rate, at close to 9% by the end of the cuts cycle being implemented by the Central Bank. If the bank cuts only up to the neutral level, estimated at 4.5% in the COPOM minutes for the June decision, and inflation at target, the built-in premium seems close to the average of recent years.

However, it is worth noting that the last four cycles when rates were cut were considerably more intense – i.e. they resulted in lower rates – than the market had projected initially.

Source: Bloomberg

Stock markets

Markets



Indexes

	Variation July	Value on 31/07/2023	Variation in 2023	Variation 12 months
COMMODITIES				
OIL WTI	15.8%	81.80	1.9%	-17.1%
GOLD	2.4%	1,965.09	7.7%	11.3%
CURRENCIES (IN RELATION TO THE US$)				
EURO	0.8%	1.10	2.7%	7.6%
GBP	1.0%	1.28	6.2%	5.5%
YEN	1.4%	142.29	-7.9%	-6.3%
REAL	1.3%	4.73	11.7%	9.5%
INDEXES				
S&P500	3.1%	4,588.96	19.5%	11.1%
FTSE100	2.2%	7,699.41	3.3%	3.7%
CAC	1.3%	7,497.78	15.8%	16.3%
DAX	1.9%	16,446.83	18.1%	22.0%
NIKKEI	-0.1%	33,172.22	27.1%	19.3%
SHANGHAI COMP	2.8%	3,291.04	6.5%	1.2%
BOVESPA	3.3%	121,942.98	11.1%	18.2%
MSCI ACWI	3.6%	707.11	16.8%	10.9%

*Amounts and Results in local currency

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