



Brazil Update (Politics, Economy, Financial Market)

May 2019

1. Politics Under Bolsonaro Administration

New Government's Initiatives

- The new government has been already addressing wide range of issues.

Public Sector	<ul style="list-style-type: none">• Reduction of ministries (29→21)• Announced reduction of 21,000 jobs (3.3% out of total federal servants) by July 2019• Replaced politicians with business professionals as CEO of Petrobras & public banks (BNDES, Caixa, Banco do Brasil)
Privatization	<ul style="list-style-type: none">• Appointed Tarcísio Freitas (veteran, privatization expert) as Minister of Infrastructure• Announced a goal to fund BRL 100 billion in 2019 by privatization, including PJs from previous administration.
Public Security	<ul style="list-style-type: none">• The president signed two bills; (1) anti-crime bill that increases penalties for firearm crimes. (2) a decree that loosens gun ownership rules
Pension Reform	<ul style="list-style-type: none">• Submitted reform proposal that generate expected savings of BRL 1.236 trillion (15% of annual GDP) in 10 years.

Source: Banco MUFG Brasil S.A. Economic Research

Pension Reform (1) Market Expectation

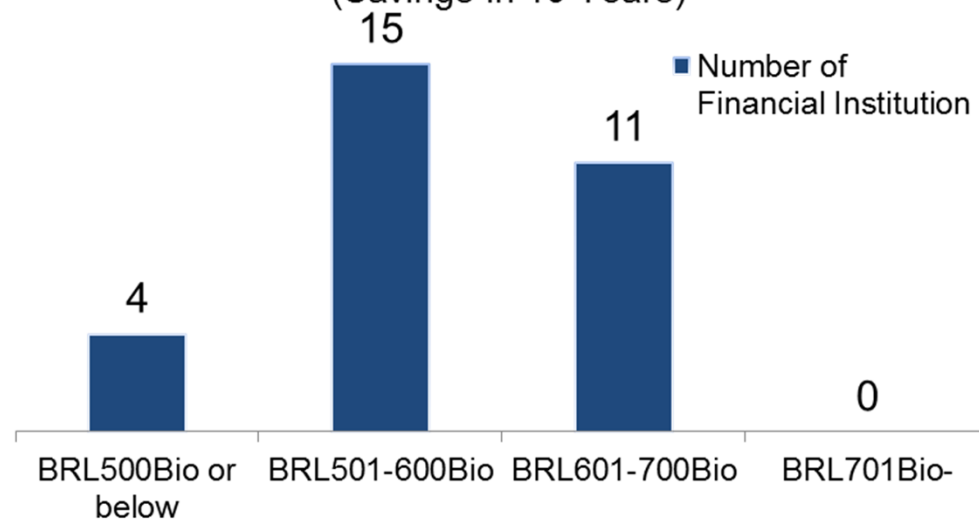
- Market participants expect that the government will achieve savings around 500-700Bio after series of legislative negotiations.

Estimated Savings by the government (BRL Billion)

Area	Savings in 10yrs
Changes in private-sector retirement rules	808
Change in public-sector retirement rules	225
Change in contributions (private sector)	-28
Change in contributions (public sector)	28
Changes in social assistance	204
Savings from civil retirement reform	1,236
Changes in military benefits	87
Savings from reform	1,323

Source: Ministry of Economy

Market Expectations for Pension Reform
(Savings in 10 Years)



Source: Bloomberg

April 23

Vote in Lower House Constitutional Affairs Committee (CCJC)

May7 – July

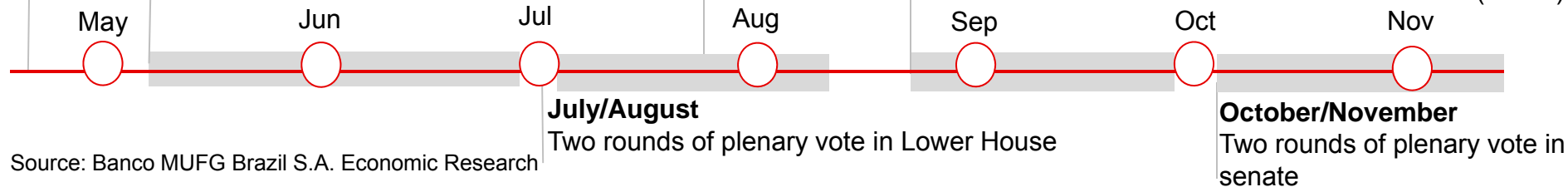
Lower House Special Committee

Late July

Congressional recess

Late August - September

Vote in Senate Constitutional Affairs Committee (CCJC)



Source: Banco MUFG Brazil S.A. Economic Research

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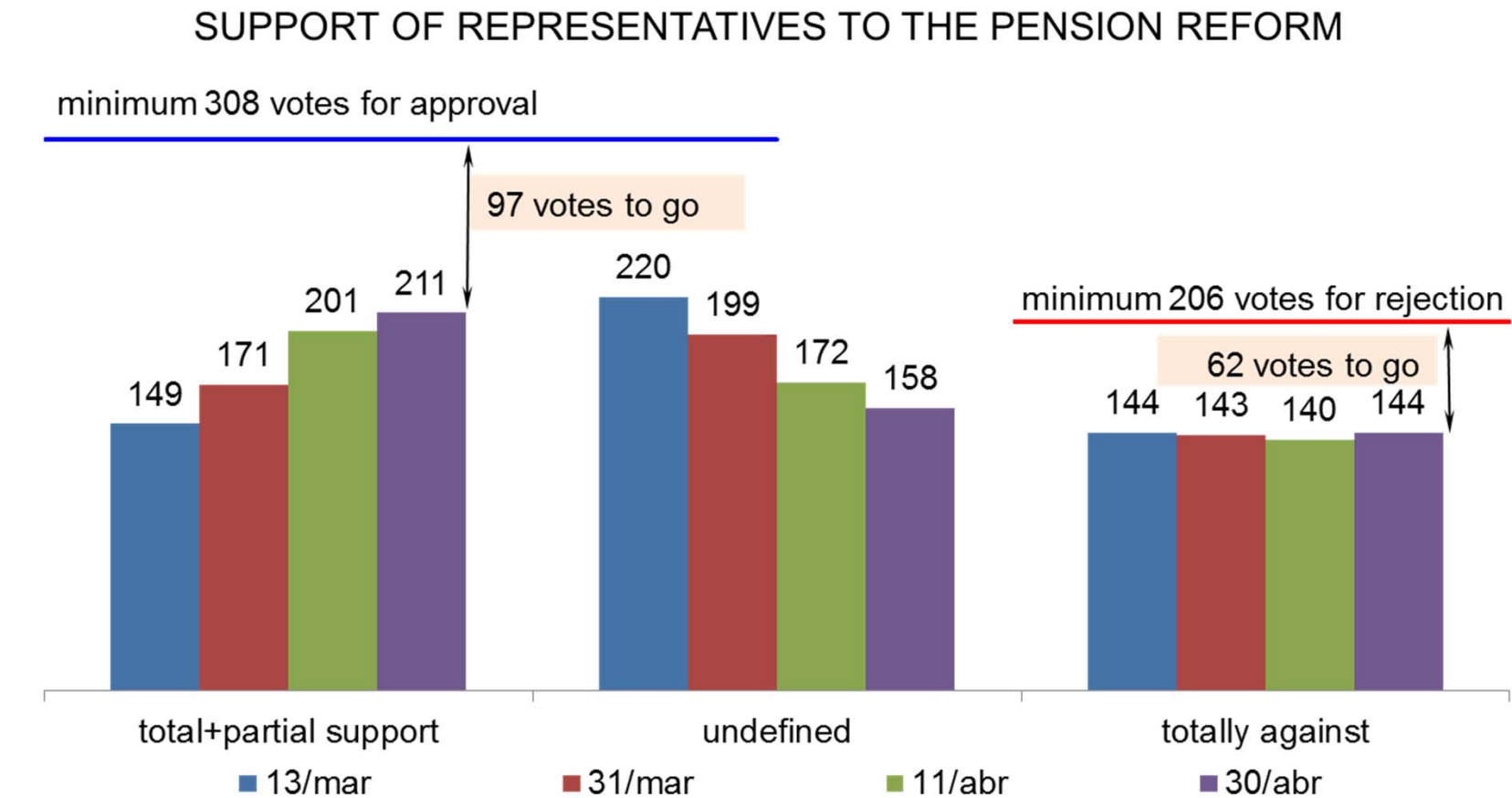
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Pension Reform (2) Progress of Legislative Negotiation

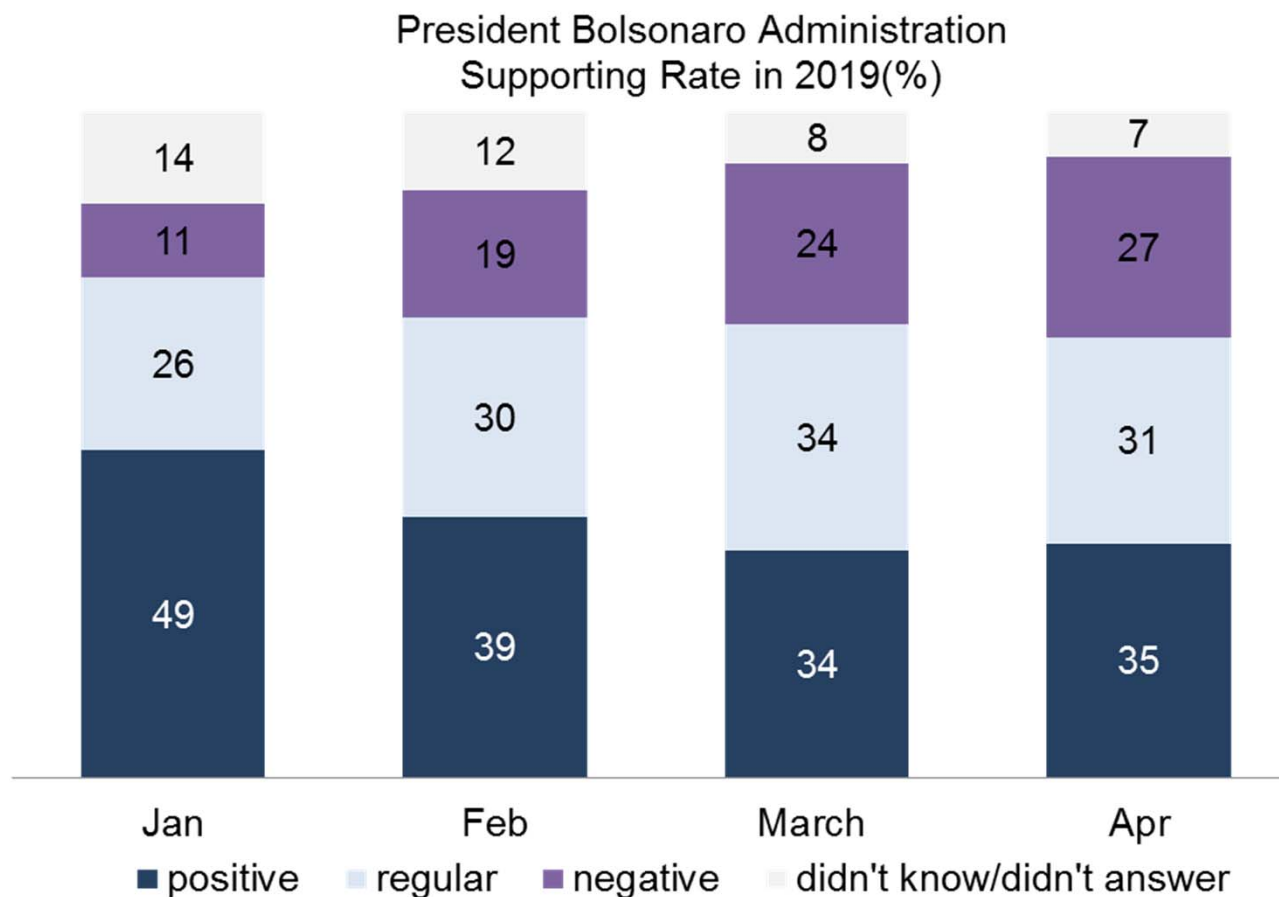
- Number of Lower House Representatives supporting the pension reform is increasing.



Source: Valor Econômico Newspaper

Supporting Rate of President Bolsonaro

- Declining the government supporting rate is a risk of pension reform.

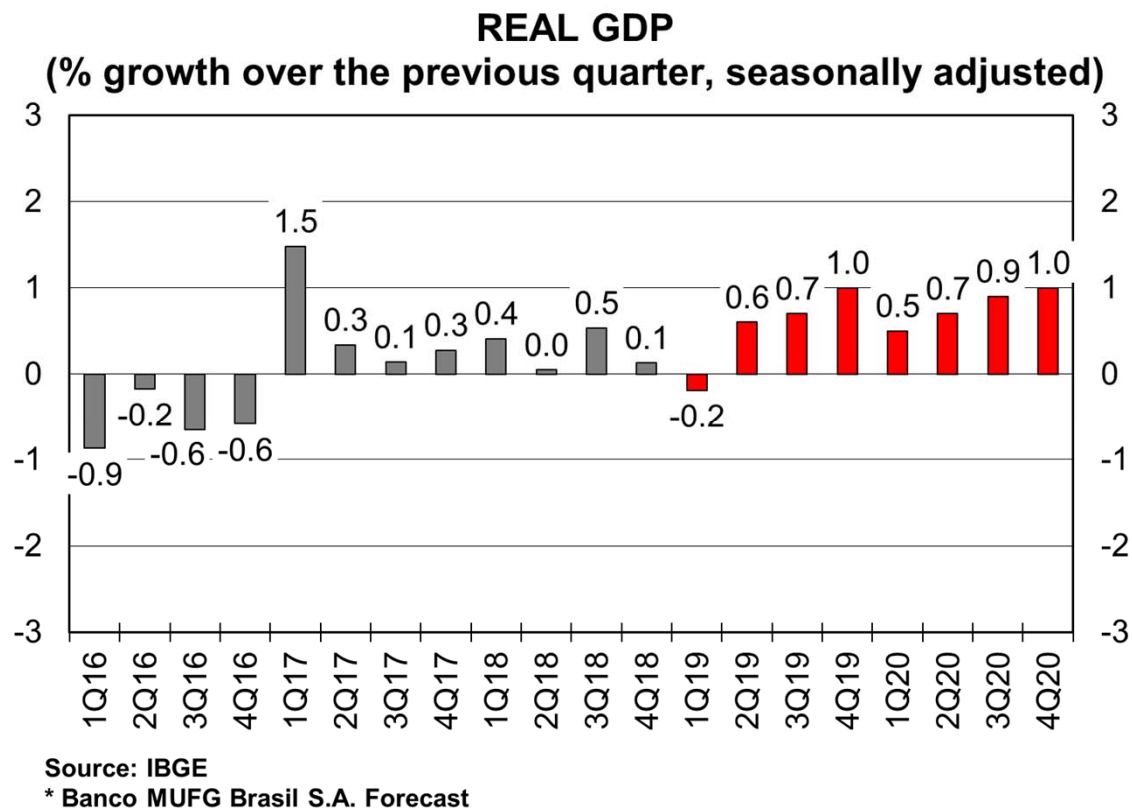


Source: IBOPE

2. Economic Environment

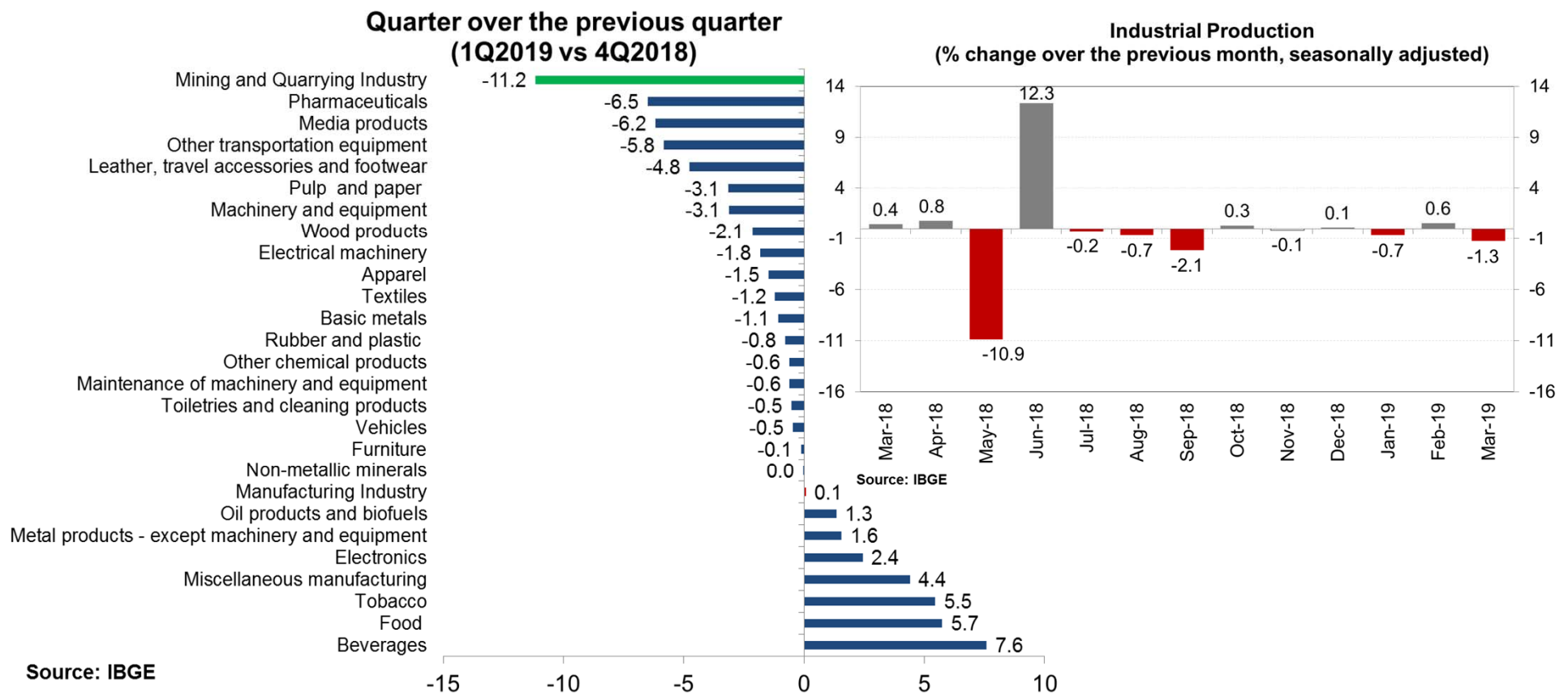
GDP Growth

- 1Q 2019 showed a weaker-than-expected activity performance due to supply shocks (Argentina Crisis, Brumadinho Iron ore dam collapse).
- We expect this decline as temporary, and expect moderate recovery from 2Q 2019 onwards.



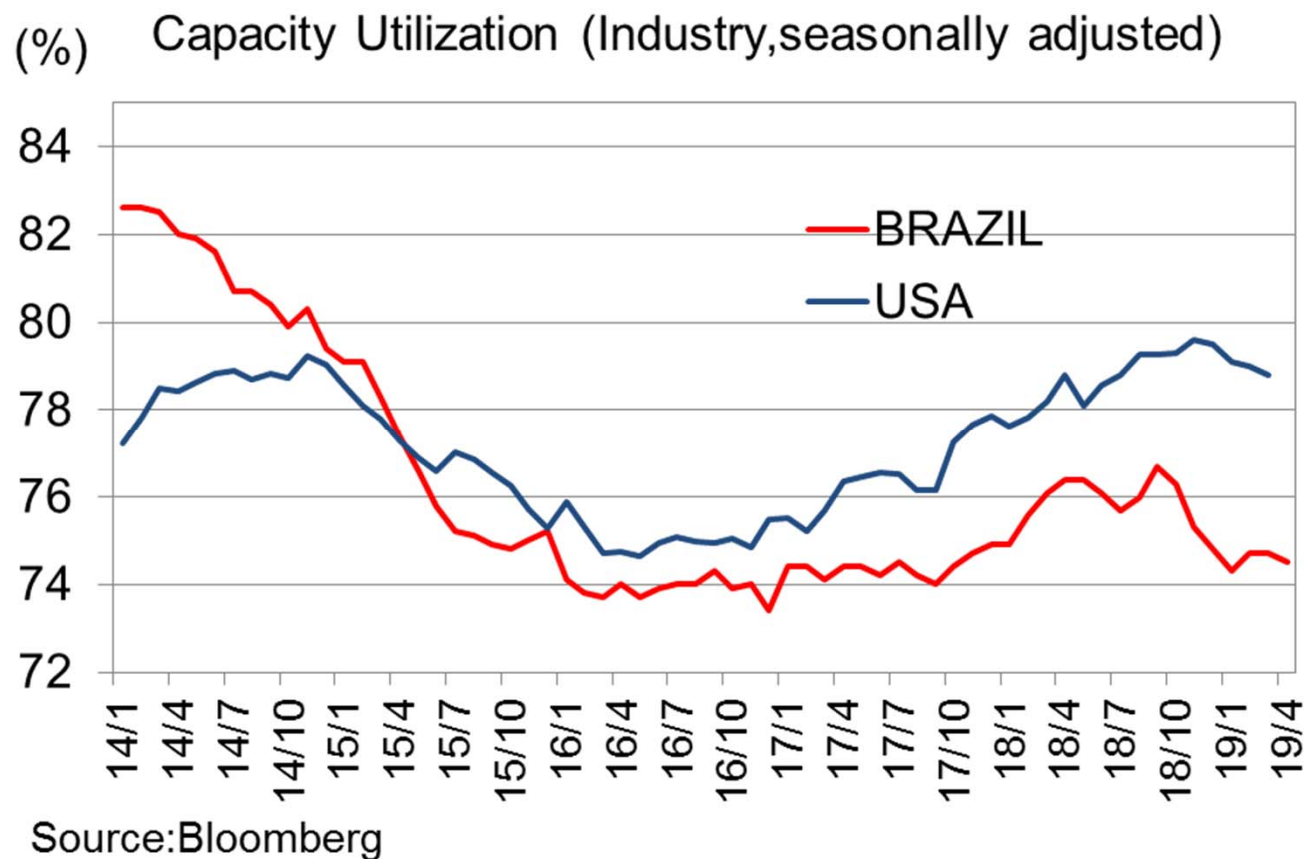
Industrial Production

- Vale's mines shutdown caused significant effect on Industrial Production in the 1Q19.
- However, in the last 12 months term, Industrial Production has been stable (-0.1%)



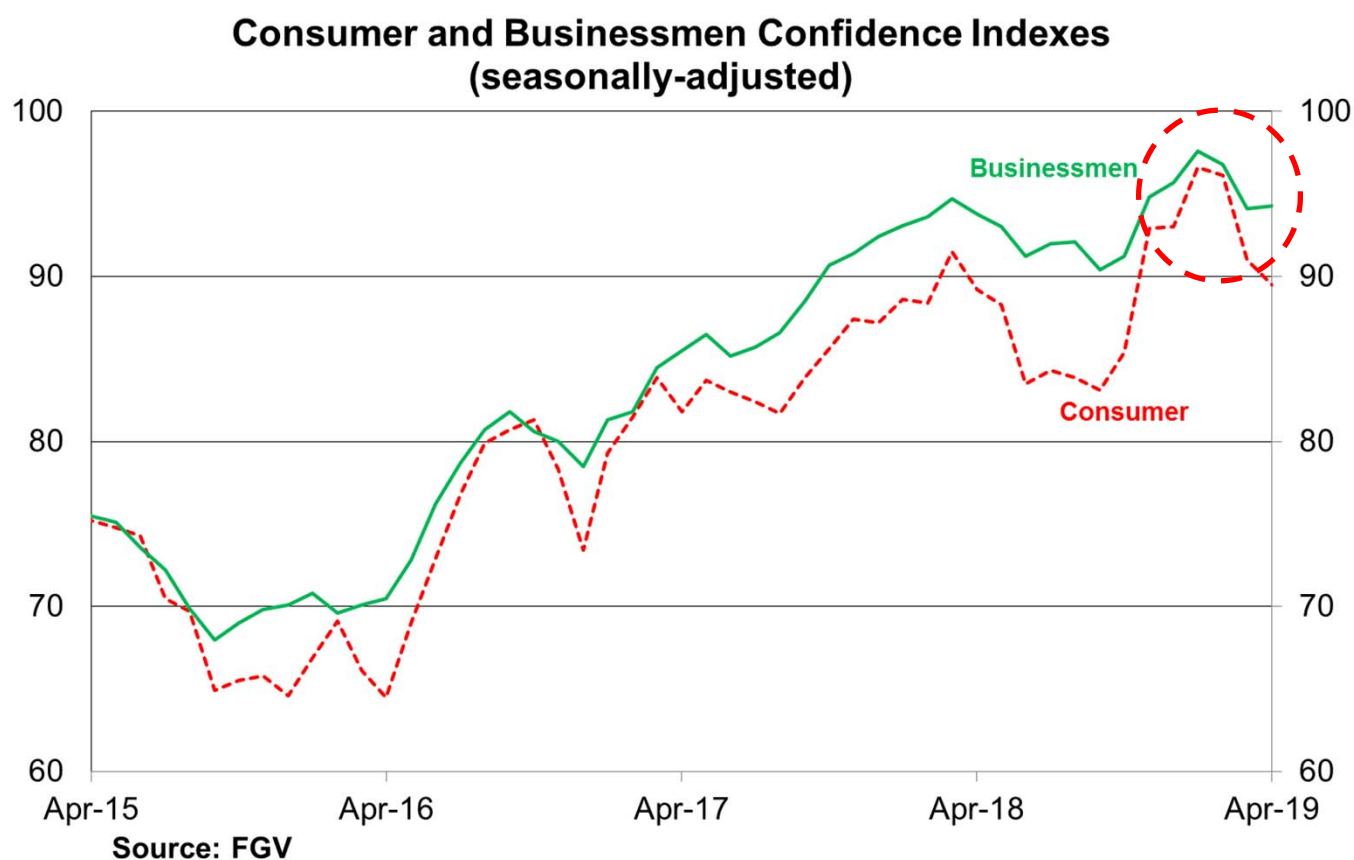
Capacity Utilization

- Currently, capacity utilization has been around 74% which is close to 2016-17 level.



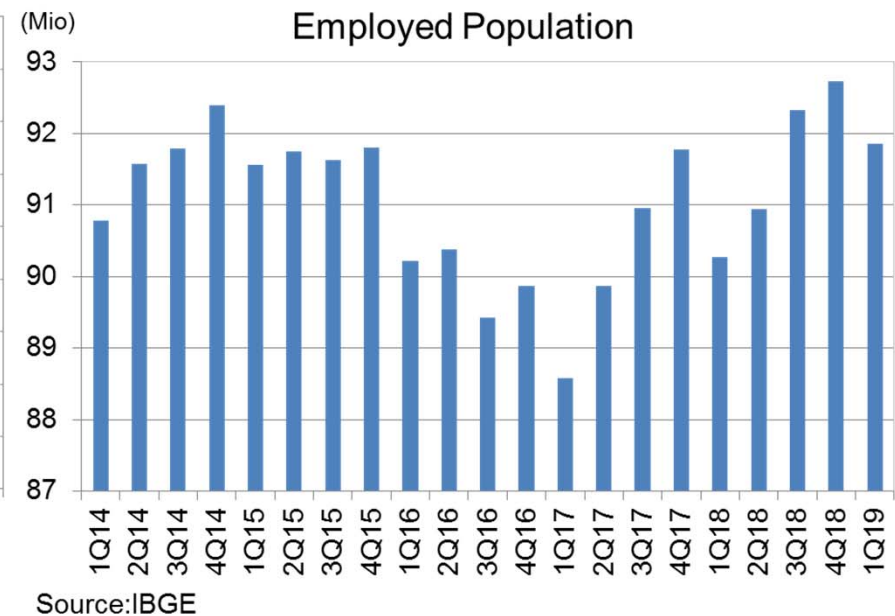
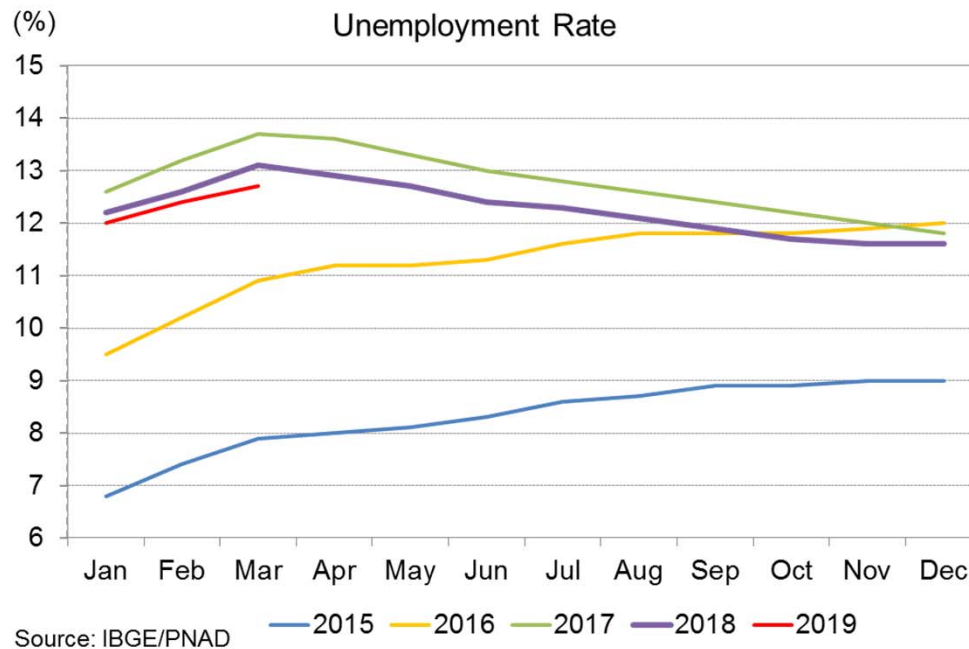
Consumer and Corporate Confidence

- After the Presidential elections in October 2018, Confidence Index improved significantly.
- Since the beginning of 2019, the confidence declined due to political uncertainties, but still remains at higher level.



Labor Market

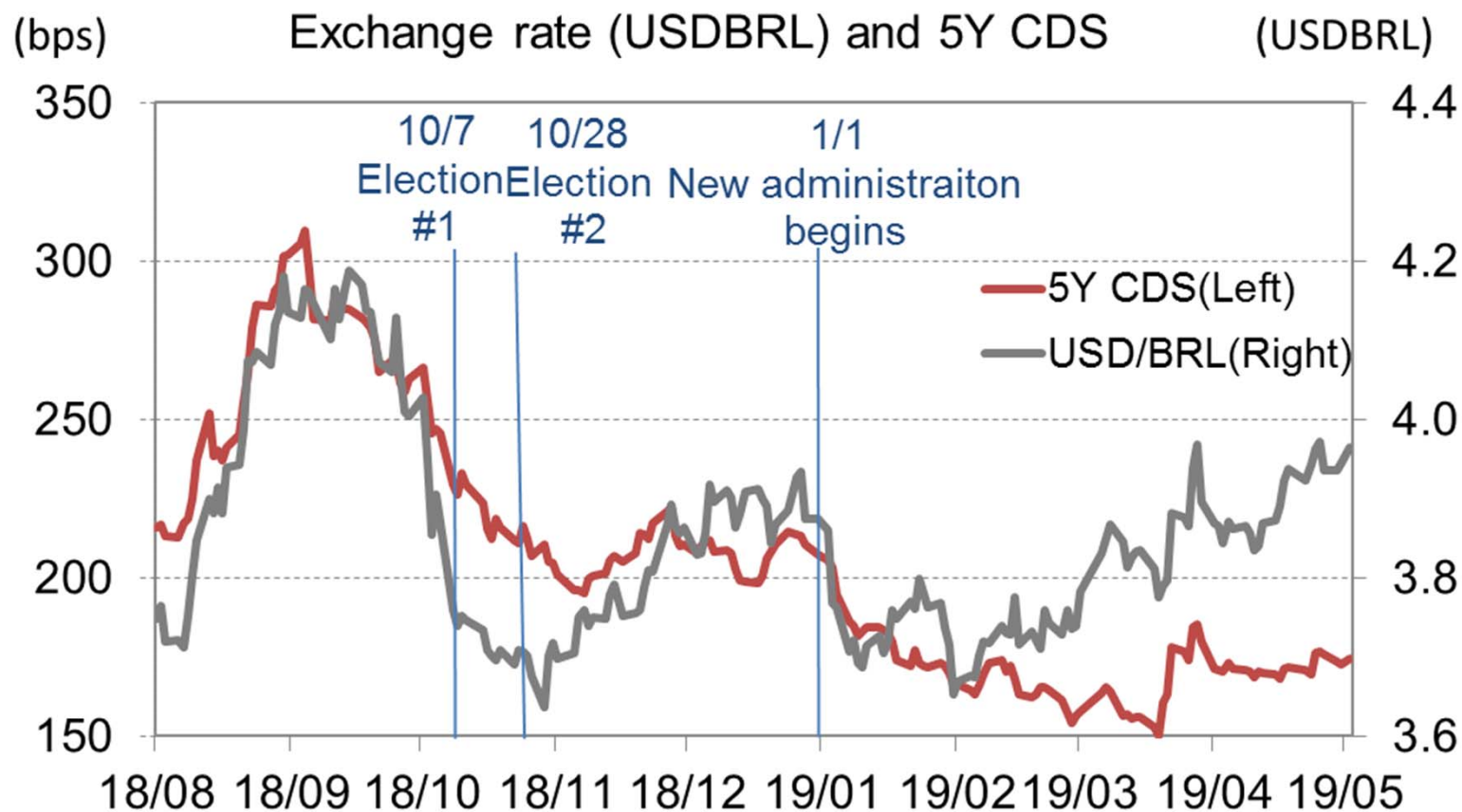
- Considering the seasonal cycle, unemployment rate is declining steadily while still remaining high compared to 2015.
- However, employed population is regaining to 2015 level.



3. Financial Markets

FX Market (USD/BRL)

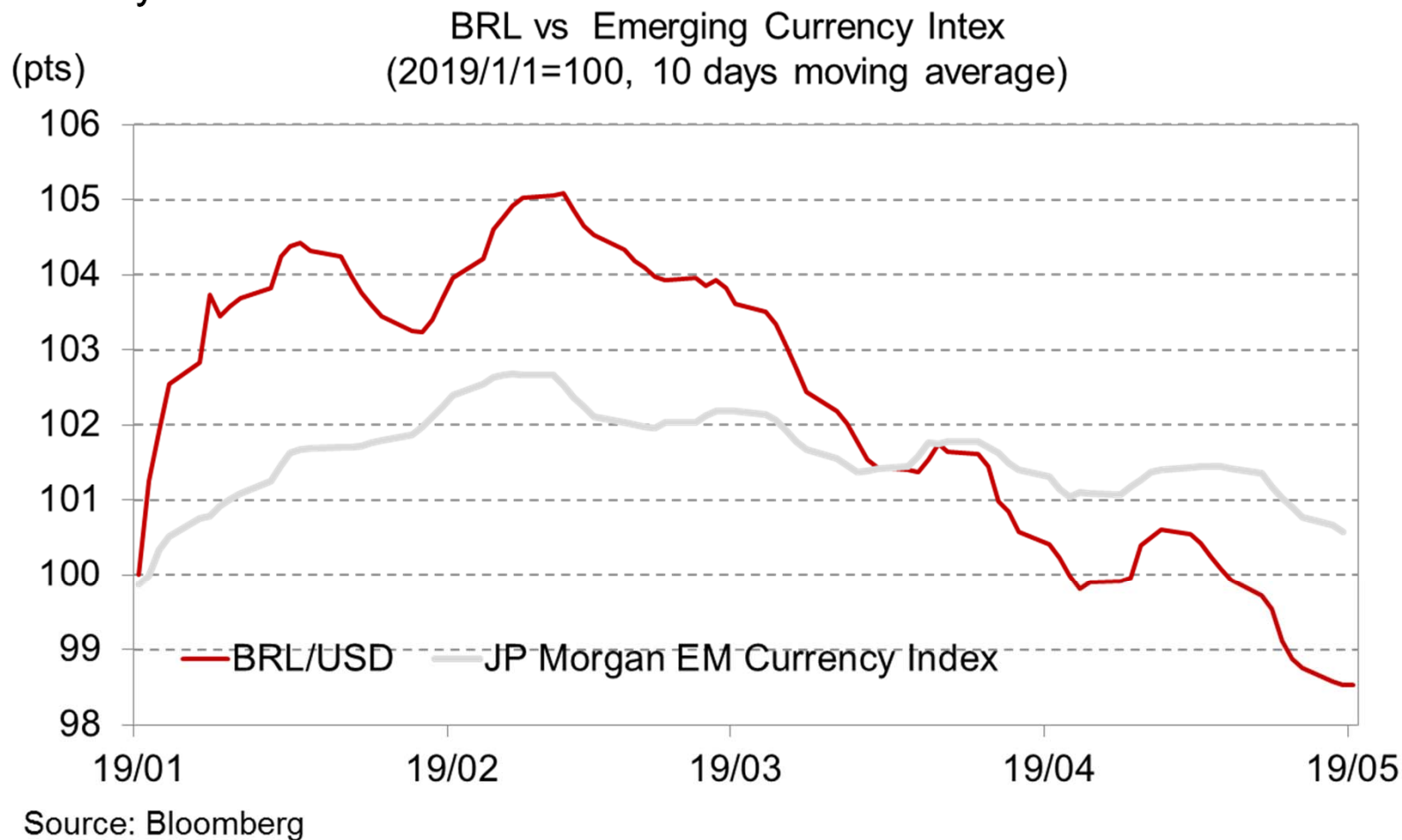
- Credit Default Swap (CDS) remains stable while USD/BRL is volatile.



Source: Bloomberg

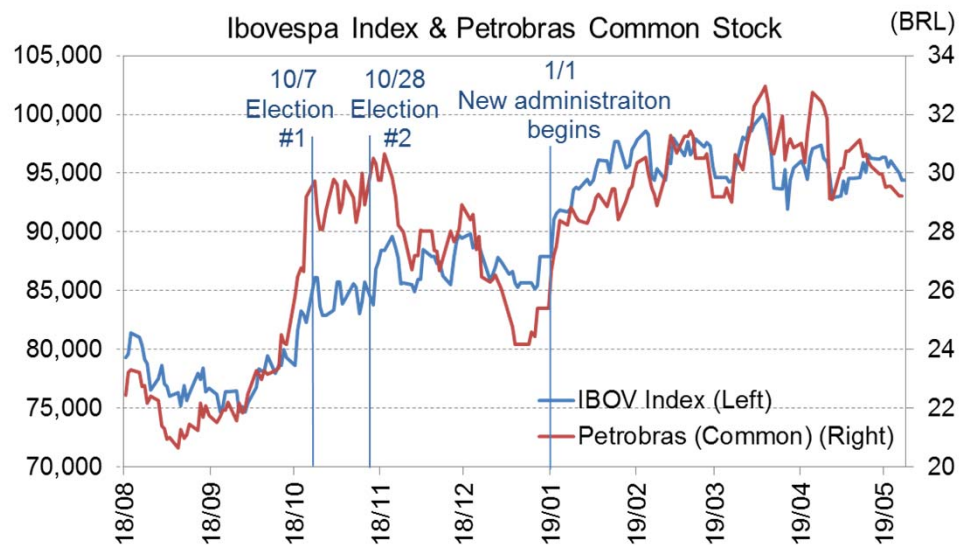
FX Market

- BRL has been underperforming against emerging currencies from February 2019.

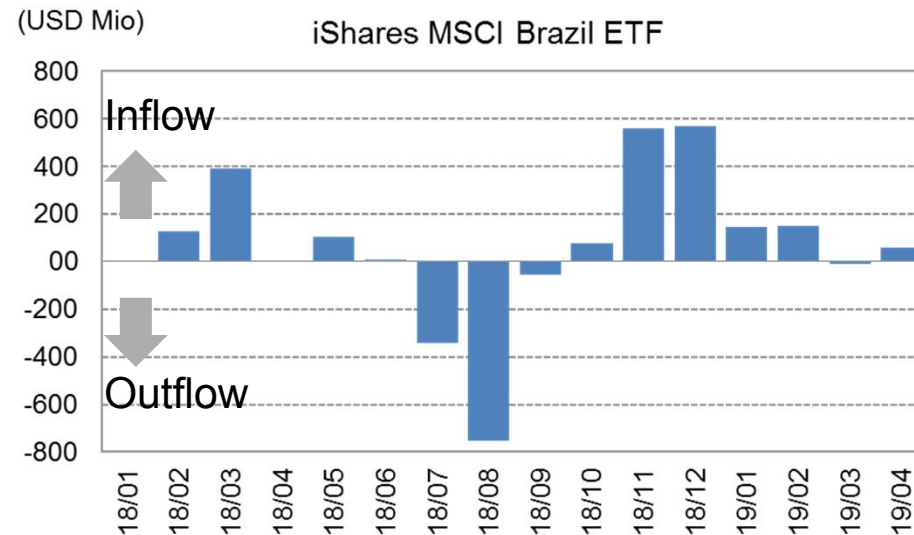


Equity Market

- Ibovespa index renewed its historical high in March.
- Foreign investors are cautious on investing in Brazilian equity since January.



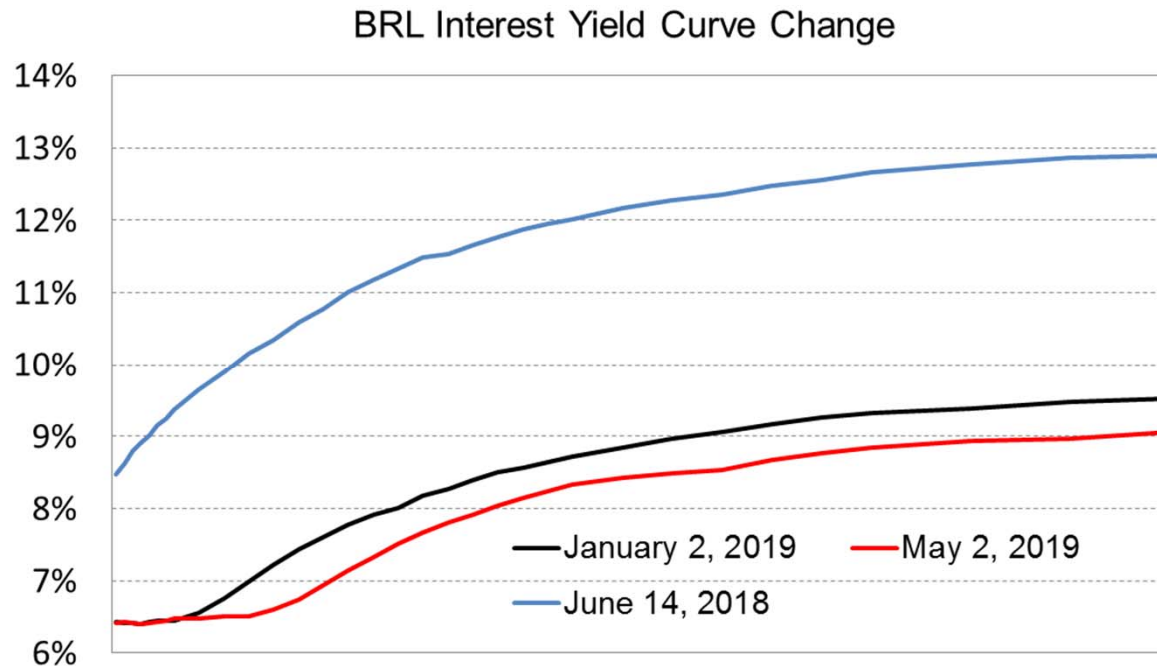
Source: Bloomberg



Source: Bloomberg

Interest Rate

- The yield curve indicates significant decline over a year. This is due to
 - 1) Increased stability in political circumstance
 - 2) Low inflation and Selic rate
 - 3) Slower than expected pace of economic recovery



Source: Bloomberg

4. Economic Outlook

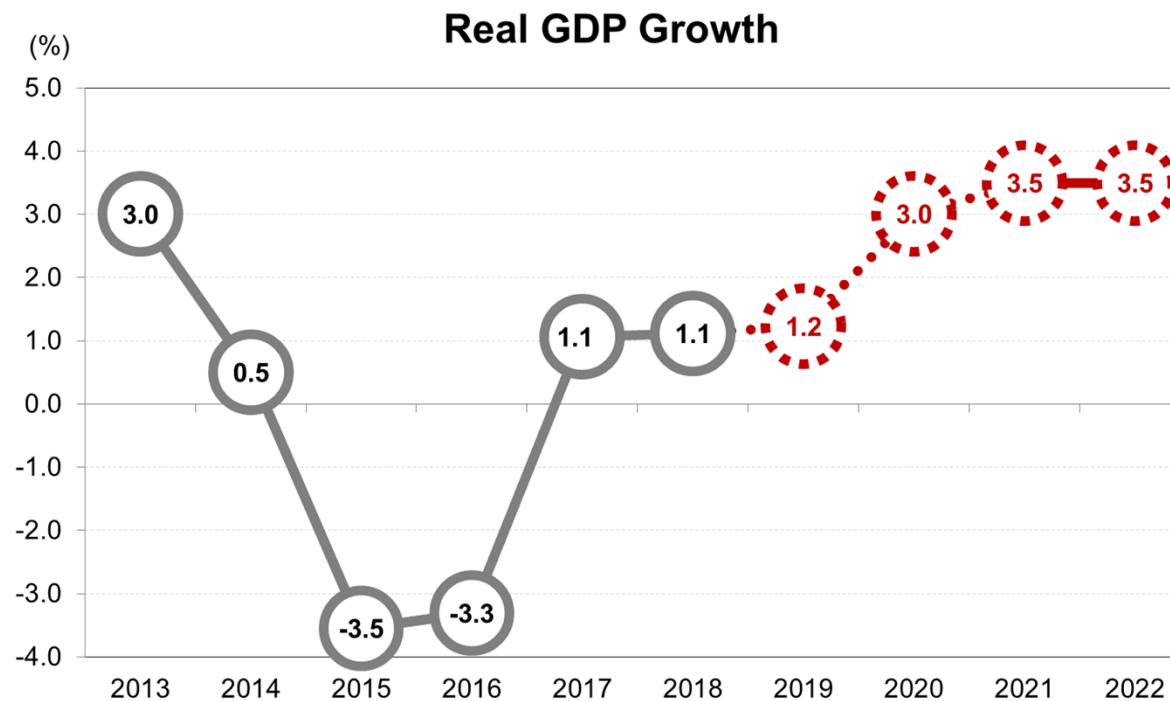
Economic Outlook: Overview

	2018	Forecast			
		2019	2020	2021	2022
real GDP growth (%)	1.1	1.2	3.0	3.5	3.5
USDBRL (year end)	3.87	3.85	4.00	4.05	4.10
USDBRL (year average)	3.65	3.85	3.93	4.03	4.08
IPCA inflation rate (%)	3.75	4.00	4.00	3.75	3.75
Selic interest rate (%) (yearend)	6.50	6.50	8.00	8.00	8.00

Source: Banco MUFG Brasil S.A.

Macroeconomic Scenario (1) GDP

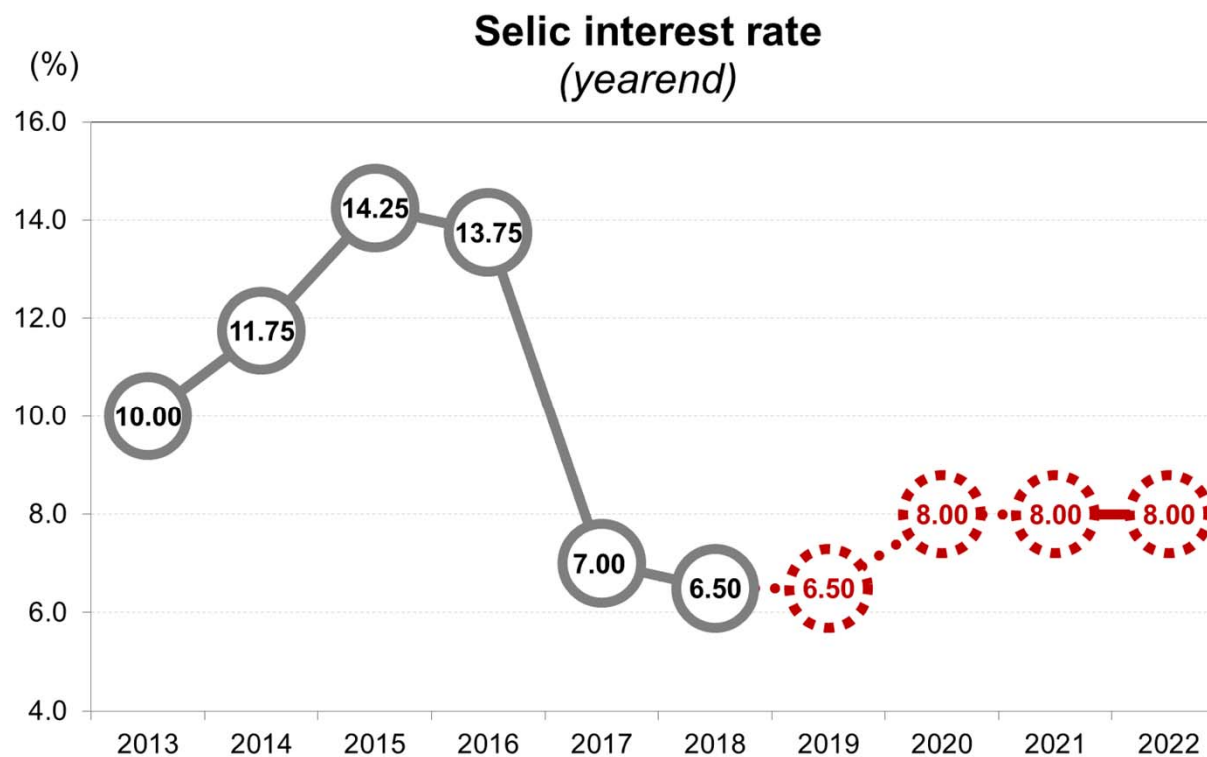
- We expect a gradual speed up of GDP growth in the next years in the wake of stronger pace of household & investment consumption driven by
 - (1) Moderate inflation
 - (2) Lower interest rates
 - (3) Gradual reduction of unemployment rate



Source: Banco MUFG Brasil S.A., Economic Research Forecast

Macroeconomic Scenario (2) Selic Policy Rate

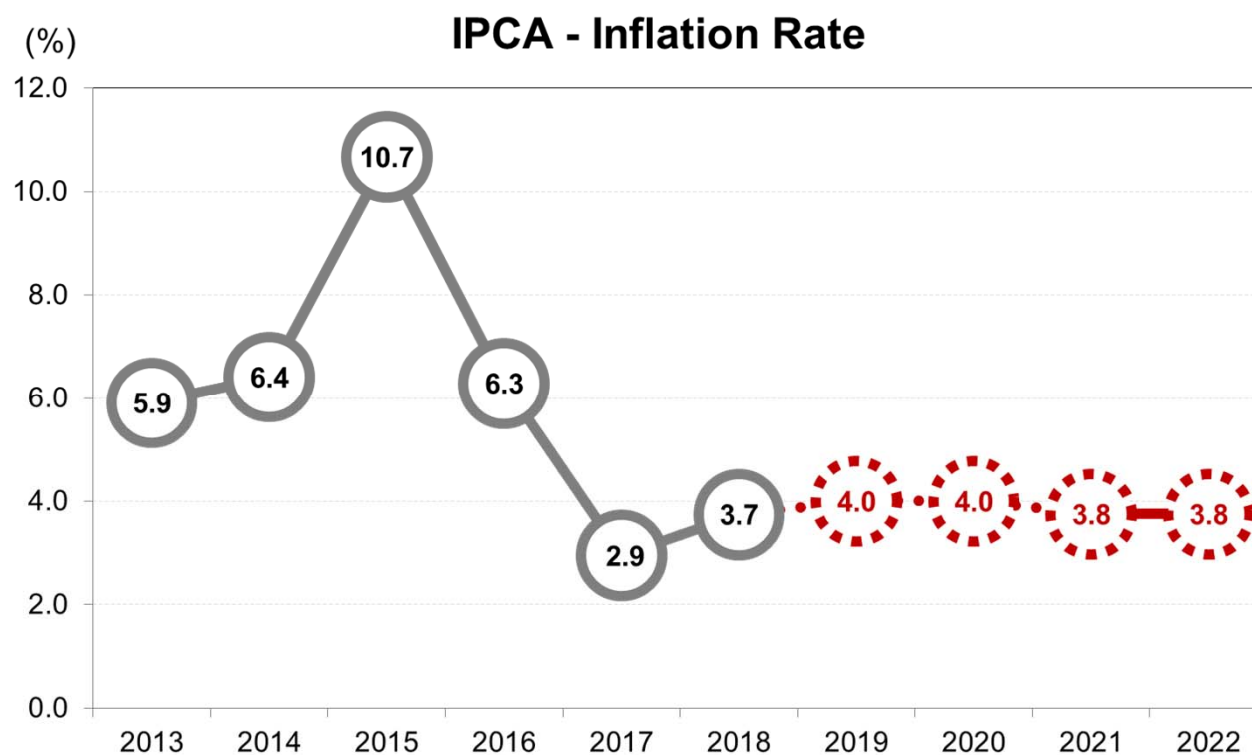
- Economic growth in 2020 will trigger the withdrawal of monetary easing in the second half of 2020.



Source: Banco MUFG Brasil S.A., Economic Research Forecast

Macroeconomic Scenario (3) Inflation

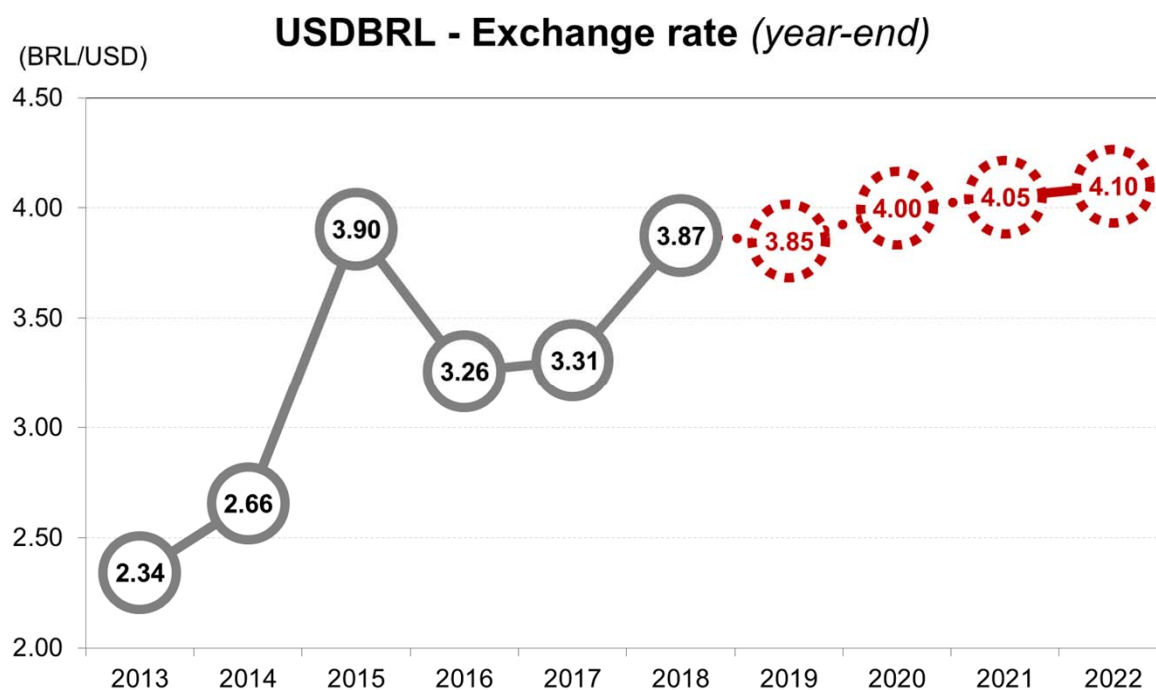
- We expect an inflation below the target for 2019, reaching 4.00%
- For 2020 and 2021, we forecast a well anchored inflation to the targets of 4.00% and 3.75%, respectively.



Source: Banco MUFG Brasil S.A., Economic Research Forecast

Macroeconomic Scenario (4) FX Rate

- Fiscal: difficulties to reach the primary deficit target and uncertainties on pension reform influenced on BRL depreciation
- Real Effective Exchange Rate (REER): lower inflation in Brazil reduces the inflation difference between Brazil and our trading partners
- Monetary conditions: reduction of local interest rates and lower liquidity abroad



Source: Banco MUFG Brasil S.A., Economic Research Forecast

Financial Market: What Traders Are Looking At

	Politics	Economy
Domestic	<ul style="list-style-type: none">▪ Pension Reform▪ “Tweet Risk”▪ Government losing public support (Lack of coordination within the Government)	<ul style="list-style-type: none">▪ Stagnant economic fundamentals (Low inflation, Low GDP)▪ No hikes on Selic rate by 2020
International	<ul style="list-style-type: none">▪ U.S. China Trade negotiations▪ Argentine Presidential Election▪ Brexit	<ul style="list-style-type: none">▪ FRB rate cut▪ Chinese Economy▪ Commodity Market

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Banco MUFG Brasil S.A.

Av. Paulista, 1.274

São Paulo - SP - Brazil

Ombudsman Toll-free (and DDG): 0800 770 4060

Email: ouvidoria@br.mufg.jp

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CARLOS A. D. PEDROSO

Senior Economist

cpedroso@br.mufg.jp

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Av. Paulista, 1.274

São Paulo - SP - Brasil

Ouvidoria DDG: 0800 770 4060

Email: ouvidoria@br.mufg.jp

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MAURICIO NAKAHODO

Economist

mnakahodo@br.mufg.jp