Itaú

Macroeconomic Research – Itaú

Economic Outlook

September 2023

Roadmap

1. Global economy
2. Brazil

Global

U.S. outperformance peaking but likely to continue

- Global: U.S. outperformance may be peaking but is likely to continue, sustaining the USD at current levels.
- U.S.: growth remains strong and continues to outperform the rest of the advanced world (2023 GDP to 2.3%, from 2.1% and 2024 to 1.2%, from 0.8%). With no signs of recession on the horizon, the Fed could indicate a final hike in November and keep rates higher for longer, coming close to achieving soft landing.
- Europe: ECB has likely ended its tightening cycle amid signals of core inflation peaking and weak activity. We see a weaker euro by the end of this year (down to 1.05 from 1.10) on the region's underperformance.
- China: GDP growth forecasts down to 4.9% (from 5.1%) for 2023 and 4.1% (from 4.3%) for 2024 as structural challenges remain.
- LatAm: more countries are likely to start easing, but maybe not so fast nor so soon.

Highlights

Global

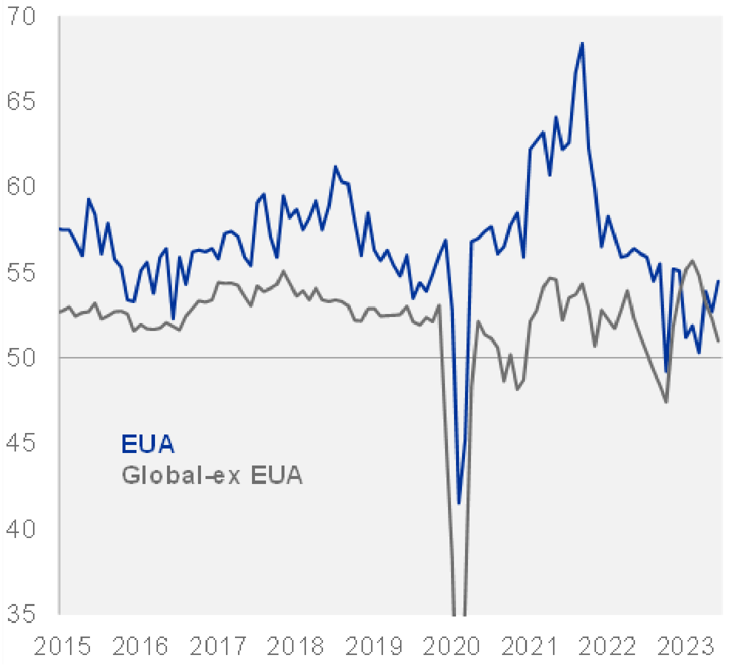
Our forecasts:

	2018	2019	2020	2021	2022	2023	2024
World	3.6	2.8	-2.8	6.3	3.4	3.0	2.9
USA	2.9	2.3	-3.4	6.7	2.1	2.3	1.2
Eurozone	1.8	1.6	-6.2	5.4	3.4	0.5	0.7
China	6.7	6.0	2.3	8.1	3.0	4.9	4.1
Fed Funds	2.25-2.5	1.50-1.75	0.00-0.25	0.00-0.25	4.25-4.5	5.50-5.75	4.75-5.00
10Y U.S. Treasury	2.8	2.0	0.9	1.5	3.9	4.0	3.5

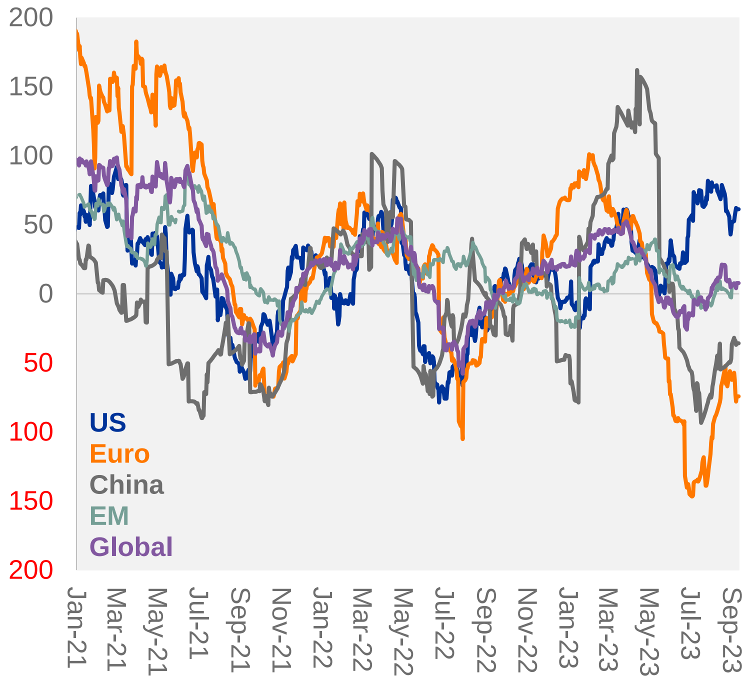
Source: IMF, Bloomberg, Itaú

Global: U.S. outperformance may be peaking but is likely to continue

Global services PMIs: US outperformance



Positive economic activity surprises in the US



U.S. growth outperformance compared to the rest of the world has likely already peaked, but such difference probably will not fade soon, helping to sustain a strong USD. 1

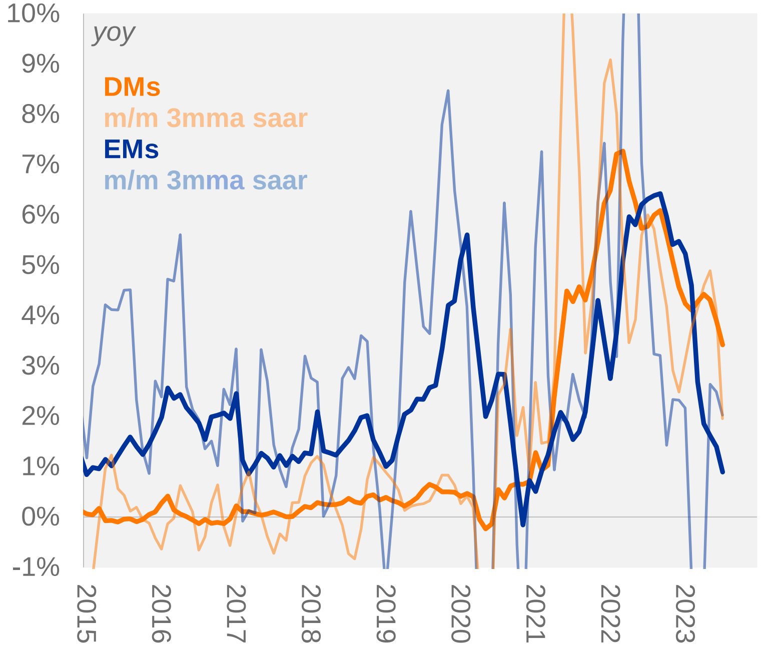
While this outperformance intensified in August, we think that it has already peaked, considering the very strong U.S. consumption data in July, which tends to moderate ahead. 2

Therefore, we have revised our year-end EUR/USD forecast down to 1.05 (from 1.10) and our year-end DXY forecast up to 104.9 (from 100.9). 3

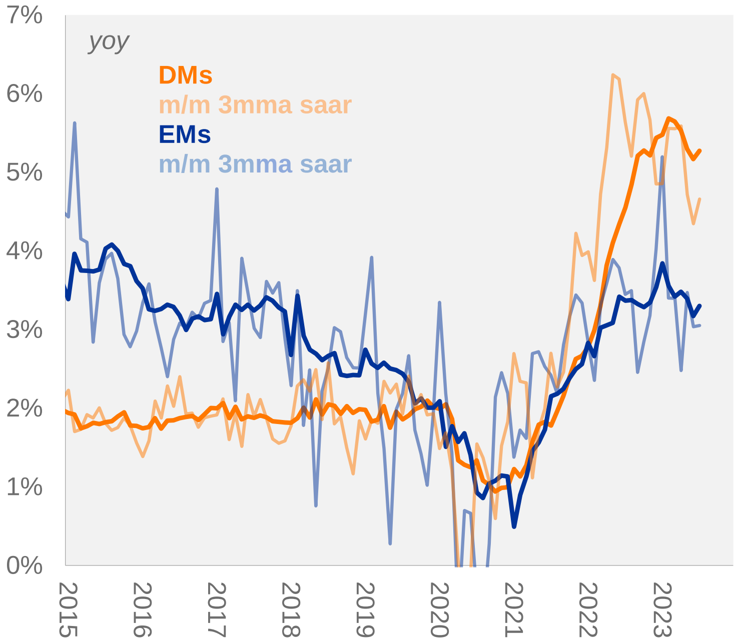
Source: Haver, BBG, Citi, Itaú

Global: EMs will likely continue their easing cycles, while DM approach the end of their tightening cycles

Core goods inflation decelerating fast



Services inflation decelerating slowly due to tight labor market



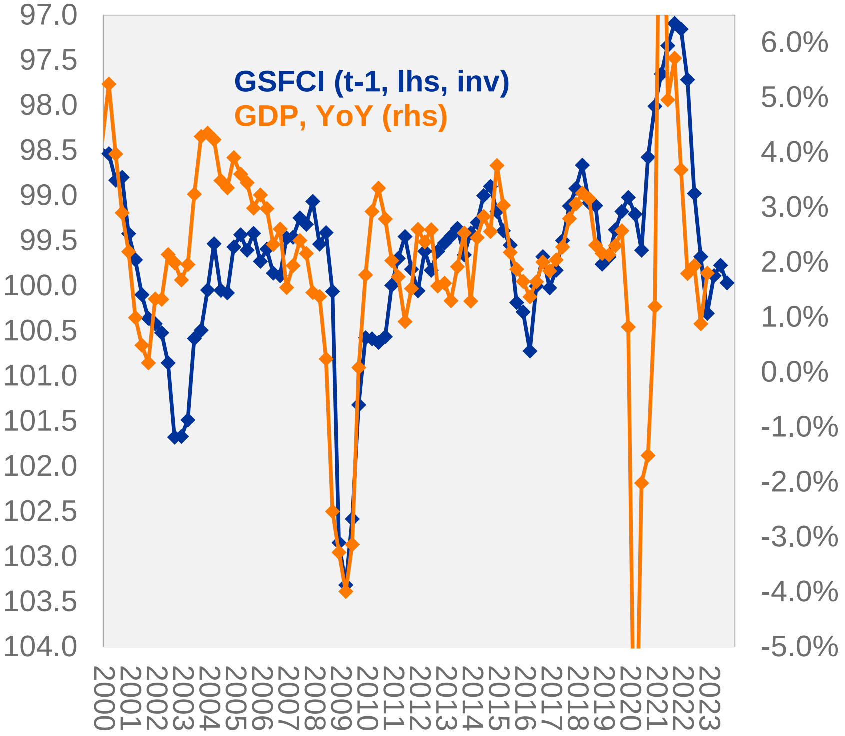
1. Inflation: goods inflation is slowing fast, and services inflation has started too, gradually, in a slow-moving process due to higher inertia and a strong labor market.

2. Overall, this global soft landing means that EM central banks will likely continue their easing cycles while DMs are more clearly reaching the end of their tightening cycles, despite some divergence among individual countries.

Source: Haver, BBG, Citi, Itaú

U.S.: Strong activity continues, indicating a possible new hike and no recession/cuts in sight

Financial conditions have tightened



1. Growth has been very strong at the margin, and the fundamentals show no recession in sight. We are therefore increasing our U.S. GDP growth forecasts to 2.3% (from 2.1%) for 2023 and 1.2% (from 0.8%) for 2024.

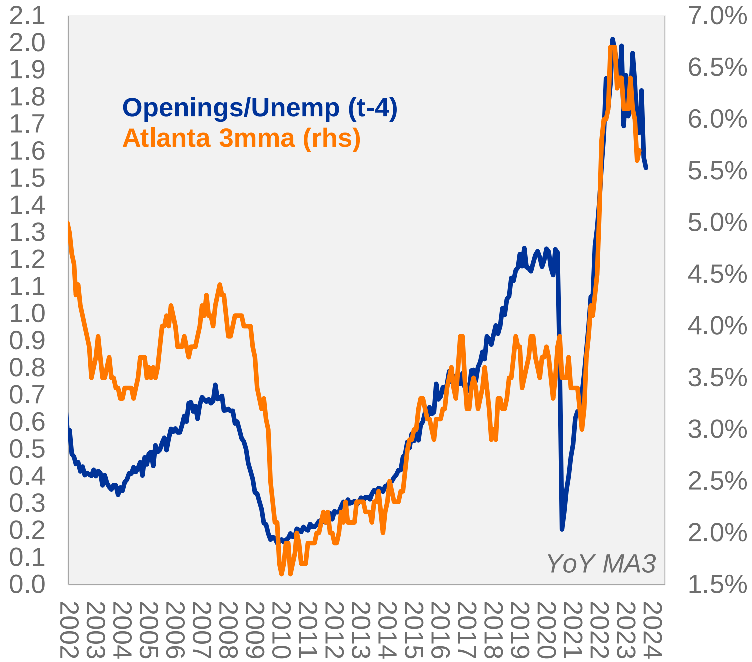
2. We expect 4.0% GDP SAAR in 3Q23. The main driver of activity is consumption (3.7% in 3Q23), despite some data volatility caused by temporary, corporate sponsored events and non-seasonal fluctuation in entertainment events attendance. The resilience in the July/August data indicates that 4Q23 growth is likely to be decent (we estimate 1.2% q/q saar growth).

3. Financial conditions have tightened, indicating that growth could slow towards potential ahead. The strong fundamentals support growth, but the repricing in rates that happened since July has contributed to tighter financial conditions.

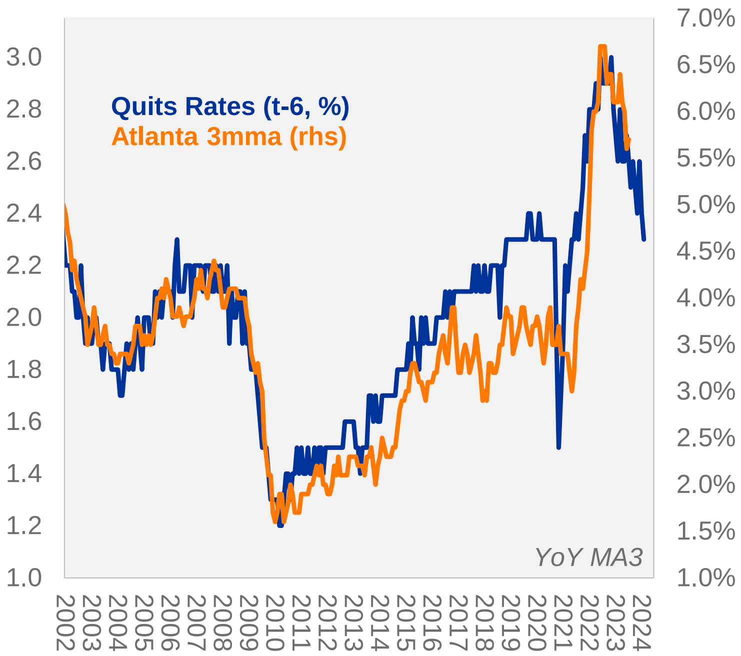
Source: GS, Haver, Itaú

U.S.: Strong activity continues, indicating a possible new hike and no recession/cuts in sight

Wages gradually decelerating with excess demand in job openings correcting ...



...with quits rate down

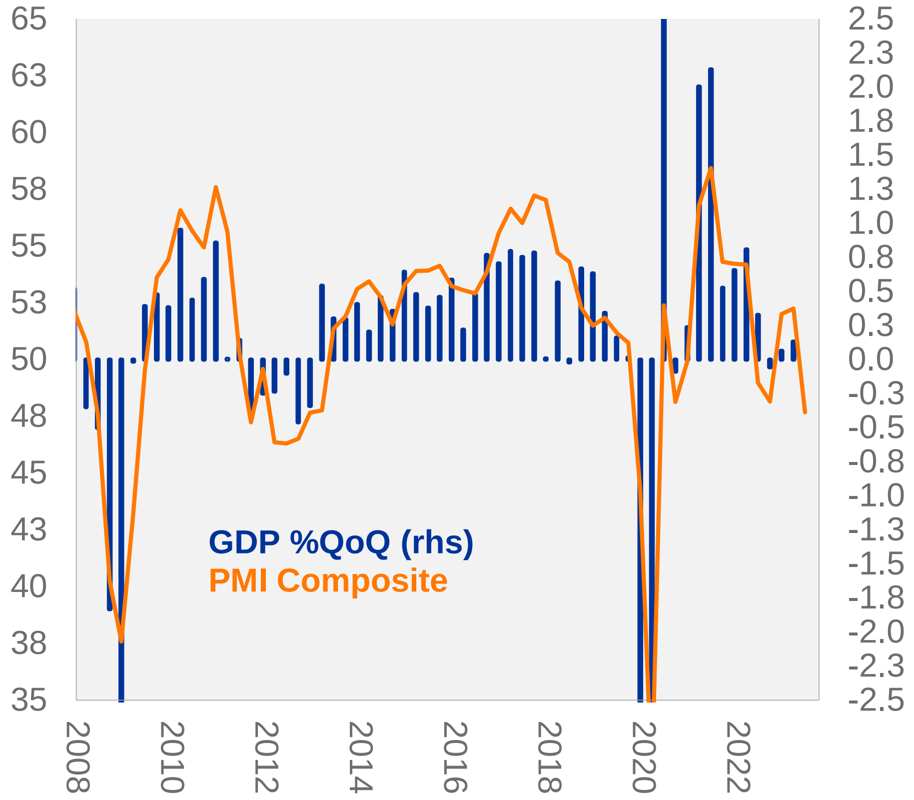


1. The labor market is rebalancing, with wages gradually decelerating.
2. Inflation is likely to remain contained in the short term, but we see upside risks next year. We expect Core CPI to maintain a 0.2% pace over the next couple of months before returning to 0.3% in 4Q23. This would be a contained path, with Core CPI reaching 3.5% by year-end.
3. A new Fed hike this year still looks a close call, but we reinforce our view that cuts are far away.

Source: Haver, Itaú

Europe: ECB likely to end the tightening cycle with inflation peaking and weak activity; EUR down on the region's underperformance

EZ PMI point toward 3QGDP < 0



We maintain our Eurozone GDP growth forecasts of 0.5% for 2023 and 0.7% for 2024. Activity data has remained on the weak side, with the PMI Composite weakening further in August, reinforcing the possibility of a negative GDP print in 3Q23. **1**

Inflation has remained stable at 5.3% with core inflation down to 5.3% (from 5.5%). **2**

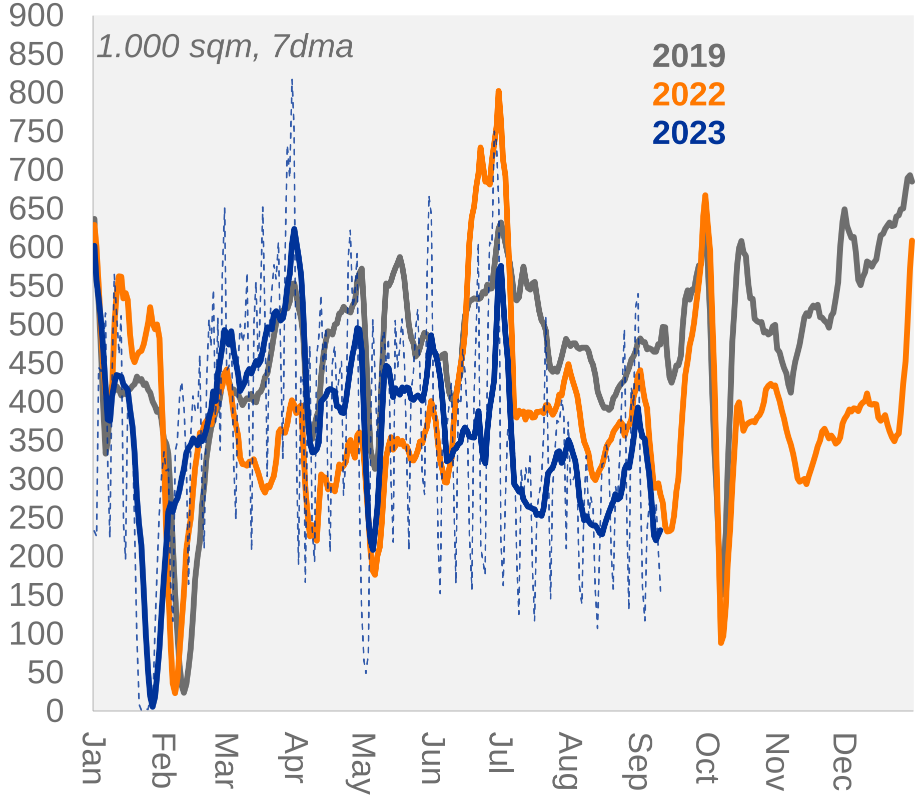
Amid these signs of peaking core inflation and weak activity, we expect the ECB to hold rates at 3.75% at its September meeting. However, we reckon that it is still a close call. **3**

EUR/USD forecast revised downward to 1.05 (from 1.10), based on the region's economic underperformance relative to the U.S. **4**

Source: Haver, Itaú

China: 2023 GDP down to 4.9% and 2024 to 4.1% as structural challenges remain

China daily property sales weak



1 Local policymakers have responded to the weakness in activity… In August, Chinese policymakers announced nationwide easing measures for the property sector, the first initiative of such kind since 2015.

2 However, there are no signs of improvement yet, and structural concerns remain. Our daily property sales tracker hasn't shown any rebound, despite the measures taken to boost demand (see chart).

3 We have lowered our GDP growth forecasts for China to 4.9% (from 5.1%) for 2023 and 4.1% (from 4.3%) for 2024. Considering the negative outlook for activity, we now expect USD/CNY to end 2023 at 7.30 (from 7.20) and our year-end iron ore price forecast has been lowered to USD 95/mt.

Source: Ceic, Itaú

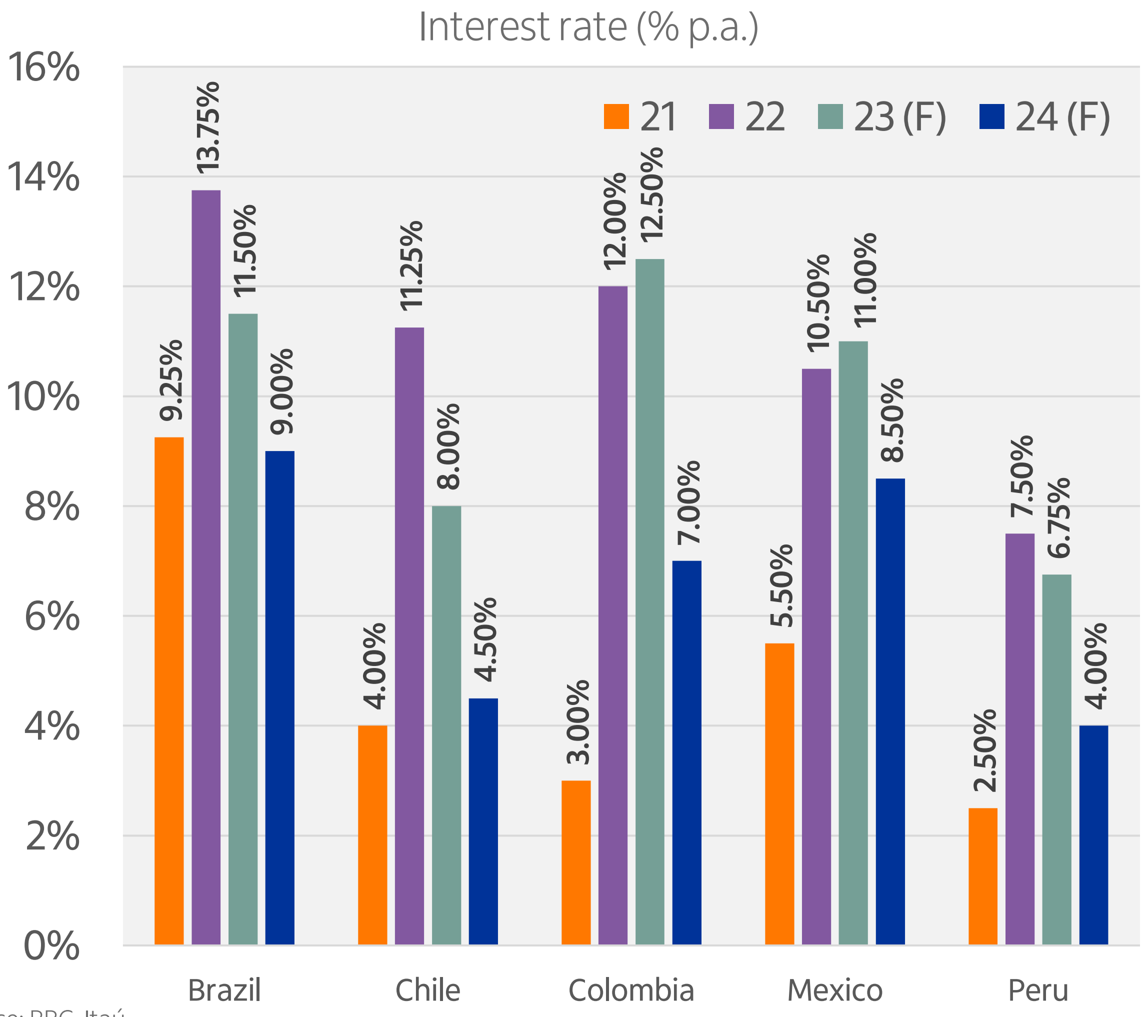
Global

Commodities forecasts:

	2019	2020	2021	2022	2023	2024
Brent Oil (USD/bbl.)	64	50	75	82	85	80
Iron Ore (USD/ton)	90	153	116	110	95	90
Corn (USd/bu)	383	437	592	656	450	400
Soy (USd/bu)	912	1207	1290	1474	1200	1100
Wheat (USd/bu)	540	604	790	757	600	600
Sugar (USd/lb)	13.3	14.7	19.2	20	24	16
Coffee (USd/lb)	130	123	235	166	180	170

Source: BBG, Itaú

LatAm: more countries are likely to start easing, but maybe not so fast nor so soon



Source: BBG, Itaú

1 The disinflation process continues, albeit with large surprises. While in Mexico, Chile, and Peru we maintained our 2023 yearend inflation calls, we increased our forecasts for Colombia and Argentina.

2 Elections in Argentina in the spotlight, as Mexico is on track to elect its first female president. Following the outperformance of Javier Milei in the primaries in Argentina, all eyes are set on the first-round presidential election that takes place on October 22. Separately, in Mexico, the 2024 presidential contest begins to gain traction as the governing coalition selected Claudia Sheinbaum as their presidential candidate, and the main opposition coalition selecting PAN senator Xochitl Gálvez.

LatAm: compared scenario

World

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	3.4	**3.0**	3.0	**2.9**	2.8

Latin America and Caribbean

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	3.5	**1.5**	1.4	**1.0**	0.9

Brazil

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	2.9	**2.9**	2.5	**1.8**	1.5
BRL / USD (eop)	5.28	**5.00**	5.00	**5.25**	5.25
Monetary Policy Rate (eop,%)	13.75	**11.50**	11.75	**9.00**	9.50
IPCA (%)	5.8	**4.9**	5.1	**4.1**	4.3

Mexico

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	3.9	**3.0**	3.0	**1.3**	1.3
MXN / USD (eop)	19.50	**18.00**	18.00	**18.5**	19.0
Monetary Policy Rate (eop,%)	10.50	**11.00**	10.75	**8.50**	8.00
CPI (%)	7.8	**4.5**	4.5	**4.2**	4.2

Argentina

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	5.0	**-3.0**	-3.0	**-2.5**	-2.5
ARS / USD (eop)	177	**670**	615	**1250**	1100
BADLAR - (eop, %)	69.0	**140.0**	105.0	**95.0**	85.0
Reference rate (eop,%)	75.0	**145.0**	110.0	**100.0**	90.0
CPI (%)	94.8	**200.0**	160.0	**110.0**	90.0

Chile

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	2.4	**-0.3**	-0.5	**1.8**	1.8
CLP / USD (eop)	851	**850**	830	**850**	850
Monetary Policy Rate (eop,%)	11.25	**8.00**	7.25	**4.50**	4.50
CPI (%)	12.8	**3.9**	3.9	**3.0**	3.0

Colombia

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	7.3	**1.0**	1.3	**1.6**	1.6
COP / USD (eop)	4800	**4100**	4100	**4300**	4300
Monetary Policy Rate (eop,%)	12.00	**12.50**	12.25	**7.00**	7.00
CPI (%)	13.1	**9.3**	9.1	**4.5**	4.5

Peru

	2022	2023 Current	2023 Previous	2024 Current	2024 Previous
GDP (%)	2.7	**0.8**	0.8	**3.0**	3.8
PEN / USD (eop)	3.81	**3.70**	3.70	**3.80**	3.80
Monetary Policy Rate (eop,%)	7.50	**6.75**	6.75	**4.00**	4.00
CPI (%)	8.5	**3.8**	3.8	**2.8**	2.8

Source: Itau

Introduction

Brazil

Faster pace in sight

- We revised our GDP growth estimates to 2.9% from 2.5% for 2023 and to 1.8% from 1.5% for 2024. Household spending will likely continue to drive economic expansion in the context of a resilient job market. Our call for the unemployment rate remains at 8% for both 2023 and 2024.
- The approval and implementation of measures to rebuild government revenues will be key to the success of the fiscal framework and for the promised convergence of the primary budget result. We expect primary budget deficits of 1.0% of GDP in 2023 and 0.8% of GDP in 2024, with gross debt at 75% and 78% of GDP, respectively.
- We revised our inflation forecasts to 4.9% for 2023 (from 5.1%) and to 4.1% (from 4.3%) for 2024. So far this year, the disinflation process has been driven by tradable items (in the wake of inventory normalization and falling commodity prices in local currency). However, the latest readings have also shown greater price easing in non-tradable items (services).
- Our exchange-rate forecasts remain at 5.00 reais per dollar for 2023 and 5.25 for 2024. We see room for a less benign dynamic for the BRL throughout 2H23 because of the narrowing interest differential. We have revised our projection for this year's current account deficit to USD 40 billion, or 2.0% of GDP (from USD 35 billion, or 1.7% of GDP). For 2024, we now expect a deficit of USD 38 billion, or 1.7% of GDP (from a deficit of USD 35 billion, or 1.5% of GDP).
- In our view, the Brazilian Central Bank's monetary policy committee (Copom) is likely to announce a new 50-bp reduction in the Selic benchmark rate in September, while reiterating, for now, that there is unanimity on the committee to maintain this pace of easing and conveying that there is no room for considering a faster pace, in the short term. However, a more benign services inflation dynamics and the expected economic activity deceleration (to become more noticeable throughout the 2H23) should allow deeper cuts at the turn of the year (i.e, December), as well as a bigger easing cycle. We now expect the Selic rate to reach 11.50% p.a. by the end of 2023 and 9.00% by the end of 2024.

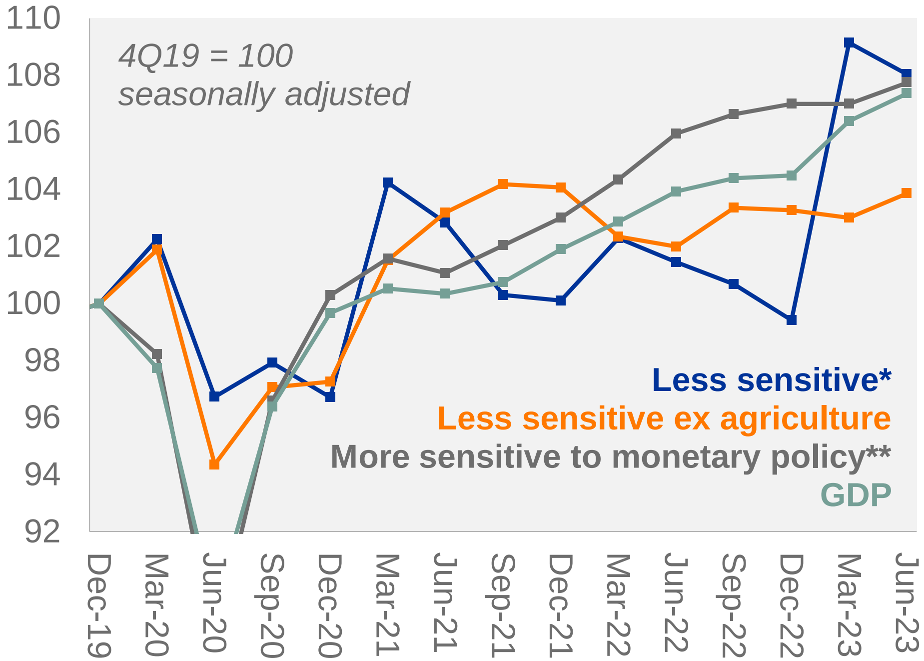
Brazil

Our forecasts:

	2017	2018	2019	2020	2021	2022	2023	2024
Economic activity								
GDP (%)	1.3	1.8	1.2	-3.3	5.0	2.9	2.9	1.8
Unemployment rate (%) – December	12.5	12.3	11.7	14.8	11.7	8.5	8.0	8.0
Inflation								
IPCA (%)	2.9	3.7	4.3	4.5	10.1	5.8	4.9	4.1
IGP-M (%)	-0.5	7.5	7.3	23.1	17.8	5.5	-3.7	3.4
Monetary policy								
SELIC rate (%, December)	7.00	6.50	4.50	2.00	9.25	13.75	11.50	9.00
SELIC rate (%, avg)	9.92	6.56	5.96	2.81	4.81	12.63	13.23	9.50
Public accounts								
Primary result (% GDP)	-1.7	-1.5	-0.8	-9.2	0.7	1.3	-1.00	-0.8
Gross debt (% GDP)	73.7	75.3	74.4	86.9	78.3	72.9	75.1	77.7
External sector								
BRL/USD (eop)	3.31	3.88	4.03	5.19	5.57	5.28	5.00	5.25
BRL/USD (avg)	3.19	3.66	3.95	5.16	5.40	5.17	5.00	5.12
Current account (% GDP)	-1.2	-2.9	-3.6	-1.9	-2.8	-2.8	-2.0	-1.7
Trade balance (USD bn)	56	47	35	50	61	62	80	60

Activity continues to deliver positive surprises

Services lead growth acceleration in sectors that are sensitive to monetary policy



*Agriculture, mining/extractive, utilities, public administration.
**Manufacturing, construction, retail, transportation, information technology, financial services, housing, other services.

In 2Q23, Brazil's GDP grew by a faster-than-expected 0.9% qoq/sa (3.4% yoy). Breaking down the GDP components, we observed a broad acceleration, observable in the sectors that are more sensitive to monetary policy (led by services) as well as in sectors that are the least sensitive (excluding agriculture). **1**

Following the positive surprise in the 2Q23 result, we have revised our 2023 GDP growth forecast to 2.9% from 2.5%. **2**

Nevertheless, we anticipate a decline of 0.2% qoq/sa in 3Q23 GDP, dragged down by agriculture, which is likely to continue to give back some of the strong gains seen in the first three months of the year. **3**

We have also lifted our call for 2024 GDP growth to 1.8% from 1.5%. **4**

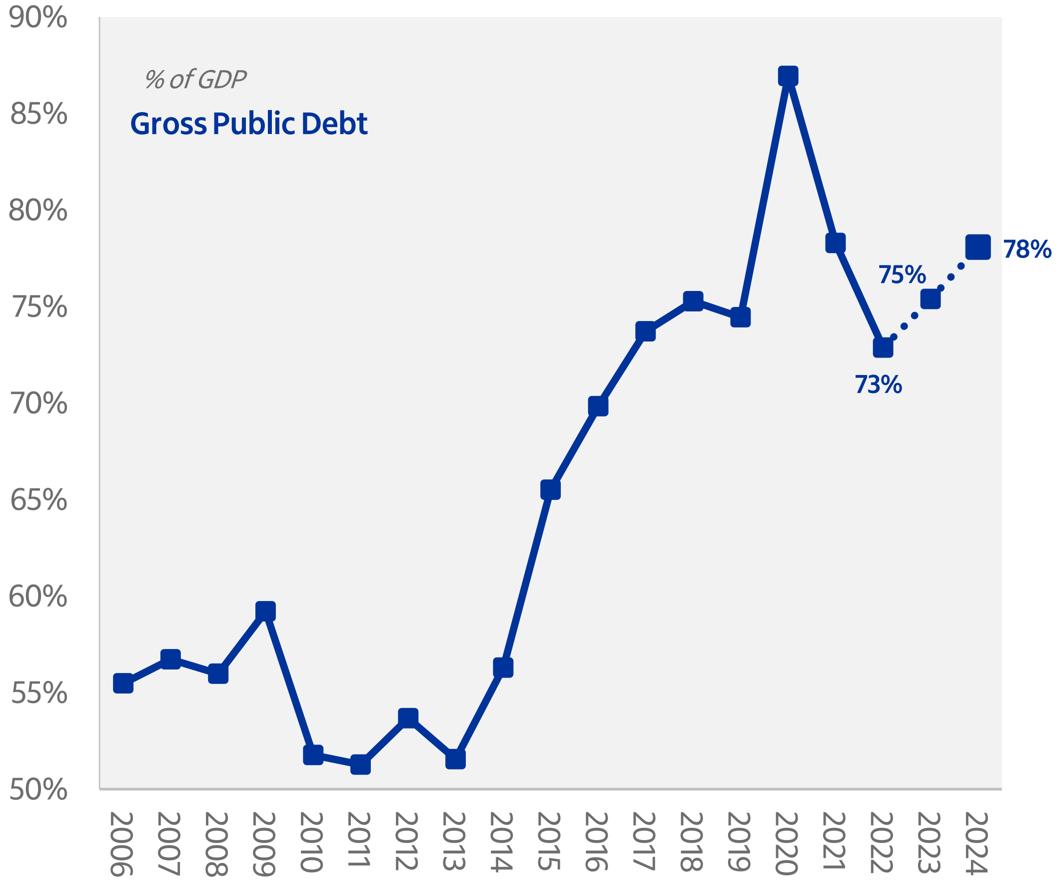
The job market remains resilient. The unemployment rate dropped again in July, to 7.8%, thanks to expanding employment in the formal and informal segments. Our unemployment rate forecast remains at 8% for both 2023 and 2024. **5**

Source: IBGE, Itaú

Brazil

Fiscal balance depends on successful revenue measures

Gross public debt



We expect primary budget deficits of 1.0% of GDP (BRL 110 billion) in 2023 and 0.8% of GDP (BRL 90 billion) in 2024. For this year, the agenda for extraordinary revenues from the renegotiation of tax debts and reductions in federal tax breaks has been disappointing at the margin but offset by better economic growth and spending increases that have been slightly smaller than the budget allows. 1

Next year, the confirmation of a scenario of gradual improvement in the primary budget may lead to a temporary relativization of the outlook for rising public debt in the future. According to our forecasts, gross debt will rise from 73% of GDP in 2022 to 75% of GDP in 2023 and 78% of GDP in 2024. 2

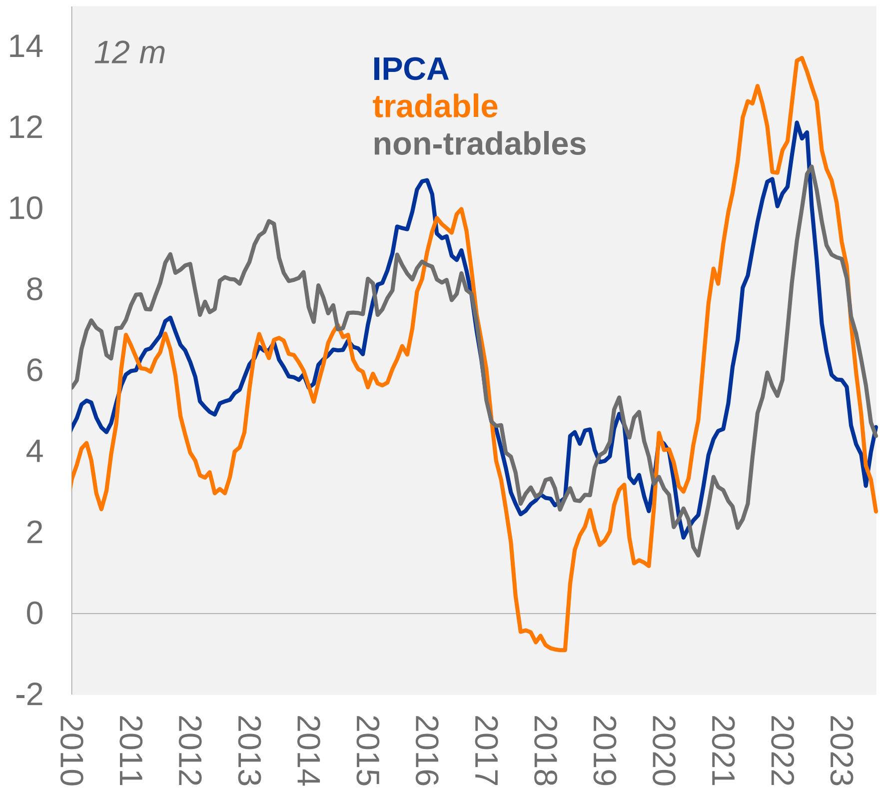
This scenario assumes the approval and implementation of revenue expansion measures with a total impact of 1.0% of GDP, through a package targeting tax break reductions, fiscal litigation, and tax planning loopholes. We note that the success of these initiatives is highly uncertain. 3

Source: BCB, Itaú

Brazil

More benign core dynamics and lower inflation in 2023 and 2024

Disinflation led by tradable goods, but the latest readings showed relief in non-tradables as well



1 We revised our forecast for consumer price index (IPCA) 2023 to 4.9% (from 5.1%), with a better breakdown.

2 On the one hand, our call for regulated prices has increased after Petrobras announced higher gasoline and diesel prices at refineries in mid-August. On the other hand, we reduced our estimate for market-set prices thanks to lower services inflation (thanks to less pressure in latest readings) and lower food and industrial items inflation (following the decline in commodity prices in local currency and the resolution of production bottlenecks). The risks to our forecast are symmetric.

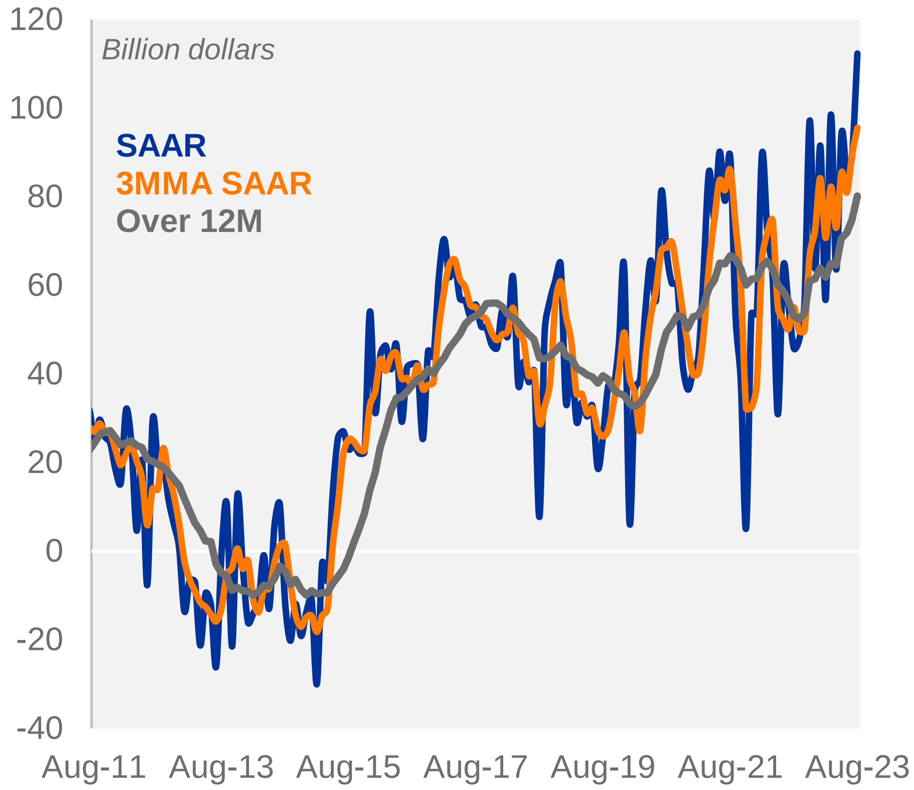
3 For 2024, we revised our inflation call to 4.1% (from 4.3%). The still-tight labor market should not allow additional relief on service inflation next year. The potential for further declines in commodity prices, growth in inventory levels or eventual compensations that reduce adjustments to electricity tariffs (such as government injections into the Energy Development Account - CDE) bring downside risk to this forecast.

Source: BCB, IBGE, Itaú

Brazil

Continuing strength in the trade balance supports the BRL

A robust trade balance this year



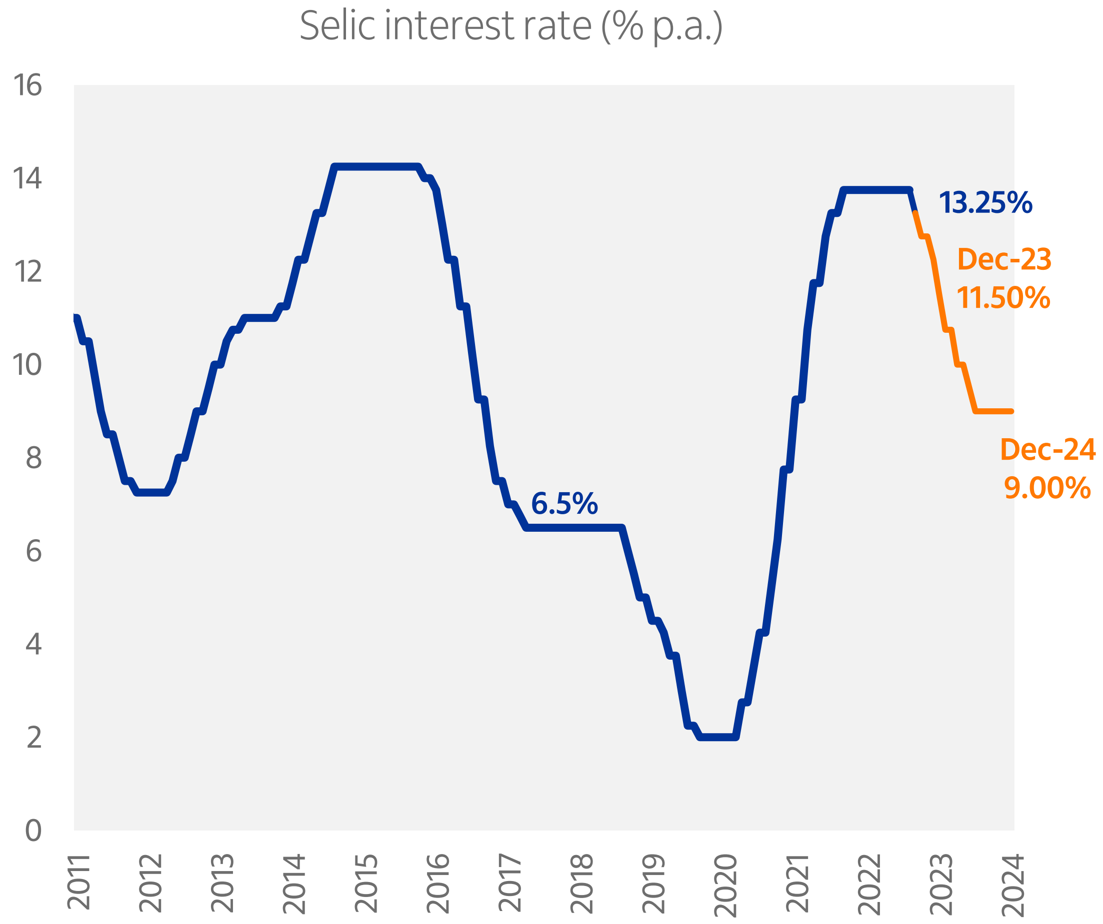
We maintain our year-end exchange-rate forecasts of 5.00 reais per U.S. dollar in 2023 and 5.25 in 2024. We see room for dynamics that are not so benign for the BRL in the second half of the year, with a narrowing interest rate differential, given the beginning of the easing cycle in the Selic benchmark rate and a possible residual increase in U.S. rates, with the external scenario supporting the dollar on a global level thanks to still-robust economic activity in that country. 1

Even with a more benign view on the trade balance, we revised our forecast for this year's current account deficit to USD 40 billion, or 2.0% of GDP (from USD 35 billion, or 1.7% of GDP). The revision follows thicker profit and dividend outflows (USD 50 billion, vs. a previous projection of USD 37 billion). In the opposite direction, we now expect a trade surplus of USD 80 billion, vs. USD 70 billion previously. 2

We have also revised our forecast for the 2024 current account deficit to USD 38 billion (deficit of 1.7% of GDP) from USD 35 billion (deficit of 1.5% of GDP). 3

Source: MDIC, Itaú

Monetary policy: faster pace in sight



1 The Copom will likely reduce again the Selic rate by 50 bps at its September meeting, to 12.75% p.a.

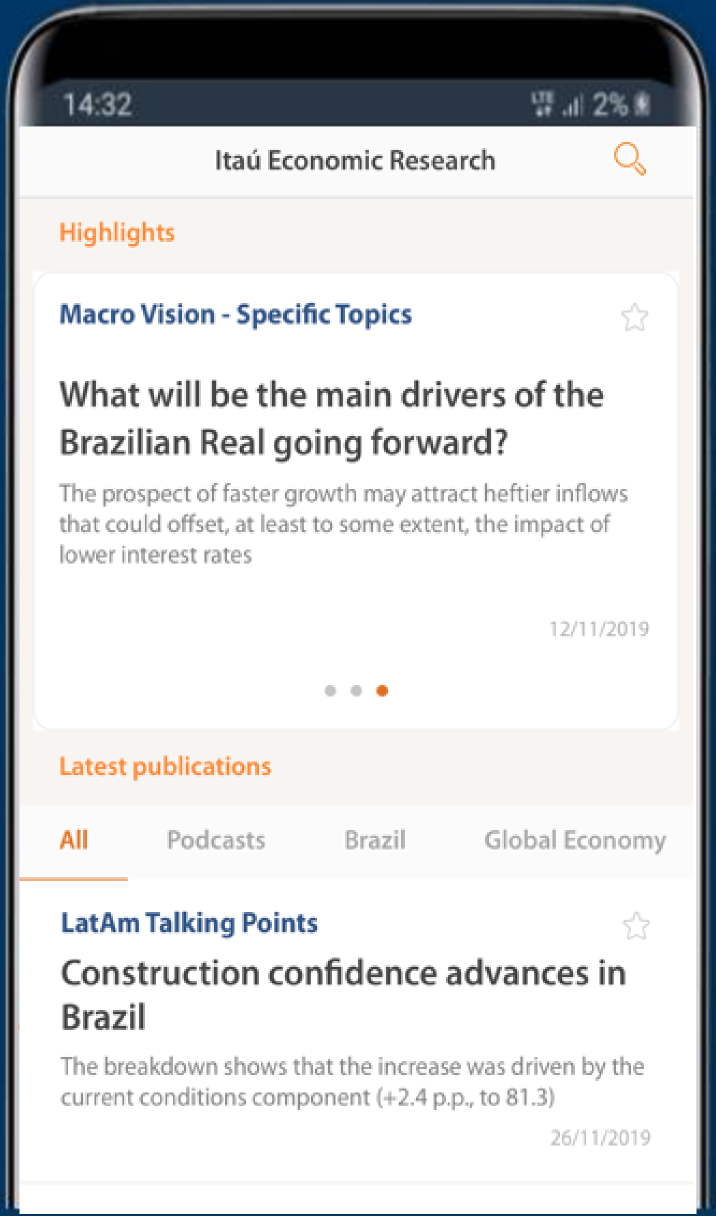
2 At its last meeting, the Copom stated that there is unanimous support for maintaining the 50-bp pace in future decisions. The authorities set a relatively high bar for accelerating the easing process, at the least in the short term. The prerequisites would be a stronger re-anchoring of expectations, a faster widening of the output gap or substantially lower service inflation.

3 Since the last meeting, the evolution of the information set has been mixed. Thus, for the time being, the committee is unlikely to be open to a discussion of accelerating the easing cycle.

4 However, more benign service inflation dynamics, as well as the expected deceleration of economic activity (to be more noticeable throughout the 2H23) should allow acceleration of the easing pace starting at the December meeting.

5 We now expect the Selic rate to end 2023 at 11.50% p.a. (from 11.75%). For 2024, we revised our call for a Selic rate of 9.00% p.a. at year-end, still consistent with the Copom's indication that it expects to keep monetary policy in (marginally) contractionary territory throughout the cycle.

Source: BCB, BBG, Itaú



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