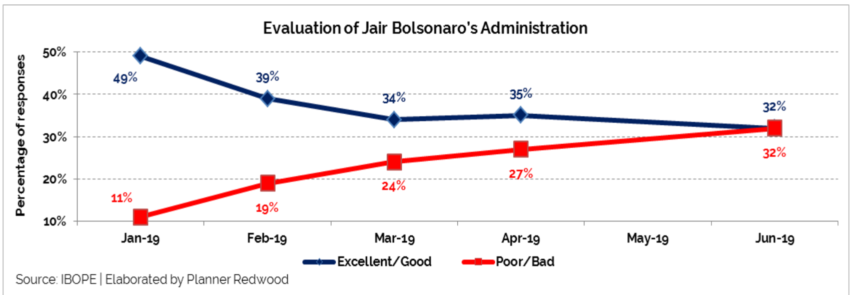
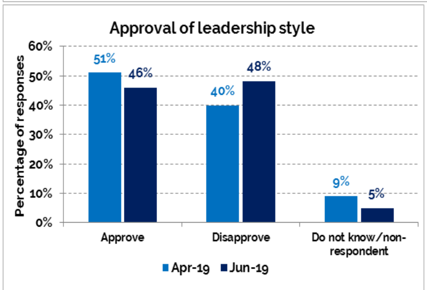
***"Hire character. Train skill."***

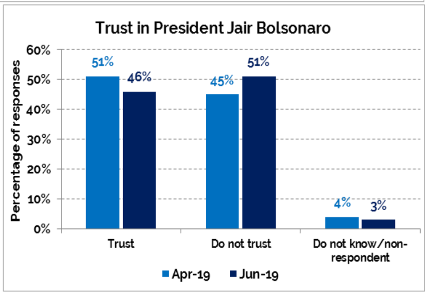
**Peter Schutz – former CEO of Porsche and Motivation Speaker**

There is no doubt that the structuring of cabinet is the soul of any successful political project, and that the fundamental points to be demanded from its members must be character and competence – necessarily in this order. Bolsonaro was successful in establishing the supporting tripod of his government in Ministers in the likes of Paulo Guedes, Sérgio Moro and General Santos Cruz – not necessarily in this order. It is understood as absolutely natural to entail movements, adjustments and corrections of course, which form part of the dynamics of management optimization.

However, it is not part of the normal rite and it scares the way the president has been dealing with the replacements of the top executives of his government. The resignations of Minister General Santos Cruz and BNDES Chairman Joaquim Levy by the president recently illustrate how a team should not be managed, whereas his role should be a model of leadership and good management skills and not as bullies, breaking chain of command (in the case of Levy, Guedes's deputy), and with no particular reasons and no transparency, as regards General Santos Cruz. A very important part of the tripod has collapsed, at a time when greatness of character, the loyalty of the long-time friend and, above all, the nationalist spirit of the General, combined with the firm intention to rebuild Brazil, is also confronted with accusations (though unfounded) against Minister Sérgio Moro, and the difficulties of approving the reforms which undermine the spirit and expectations of the economic team. None of this has gone unnoticed, and society, opinion makers and, most importantly, investors follow this move with close attention.



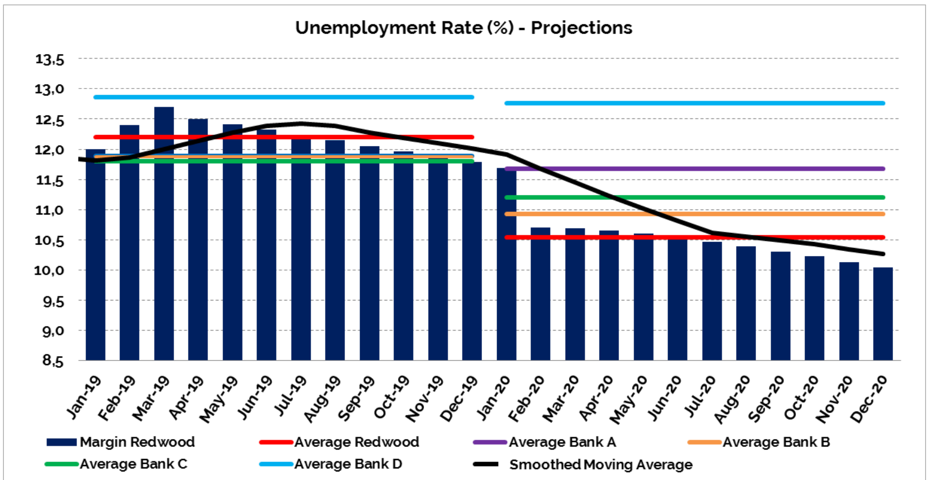




In this way, a reaction from the president is expected to realign his *modus operandi*, so that the substitutions of the members of his team, such as that of the General, are in some way justified by transparency and respect that both authorities and society require. After all, the motivation for his decisions should highlight the need for change and what they represent for the administration's goals. It was a brutal mistake. Let this episode serve as an example so that the president and his close advisors may be more united and aligned with the purposes and promises set during his campaign. It is necessary to get away from speculations and innuendos, perpetrated by false friends, idealizers and phony gurus, who only wear out and distort the efforts undertaken to realize the essential changes for the country. On this constant reaffirmation of intentions, unity and flight plan depends our economic recovery and job creation. Our evaluation of the first six months of the Bolsonaro administration offers countless important achievements and the net outcome seems positive, but some slips can significantly jeopardize this administration.

May mistakes be quickly recognized, and also may criteria for the revamping of his team remain always people's character and competence.

In the markets, the performance of the main indicators has improved sensitively this month. The Ibovespa closed up 4.06% at 100,967 points in June, while interest rates maturities DI1F20 and DI1F23 were representative of the whole downshift of the yield curve, closing the month at 5.99% and 6.66%, respectively. The Brazil risk, measured by the 5-year CDS, retracted 30 points in a clear movement of greater acceptance of the country risk and closed the month in 150 points. The Dollar (Ptax), in its turn, closed the month at BRL 3.8322, down toward a more "adequate" level with the other variables correlated, in line with our assessment and expectations.

If GDP is clearly faltering and with effective carry over to 2020, unemployment rates follow the same script. According to the chart, there is no way to disregard, to a greater or lesser extent, the alignment of the perspectives of various researchers, banks and consultants: we will remain in a double digit unemployment rate until 2020. The assessment takes on an even more dramatic tone when analyzing figures, such as the rise in the long-term unemployment rate, the under-utilization of the workforce (25% in the quarter through May), a record-breaking 4.905 million discouraged unemployed workers, and a 0.2% drop in workers' average incomes (BRL 2,289 in the quarter ended in May). The upswing, as we know, depends essentially on reforms, but fundamentally on the Social Security one. However, it seems that the current economic team (definitely not responsible for this situation) sees the extreme difficulty of not getting around the problem in the short term, and has launched studies (as we pointed out last month) relating to "palliative measures". These measures include the release of PIS/Pasep and active FGTS accounts, permission to rent real estate acquired via the federal subsidy program (Minha Casa Minha Vida), the new natural gas market itself and even sharper cuts in bank's reserve requirements at the Central Bank. The latter aim is to increase the supply of loans, but we consider that (i) banks may not necessarily do so (!) and (ii) our problem is encouraging borrowers and not credit availability.

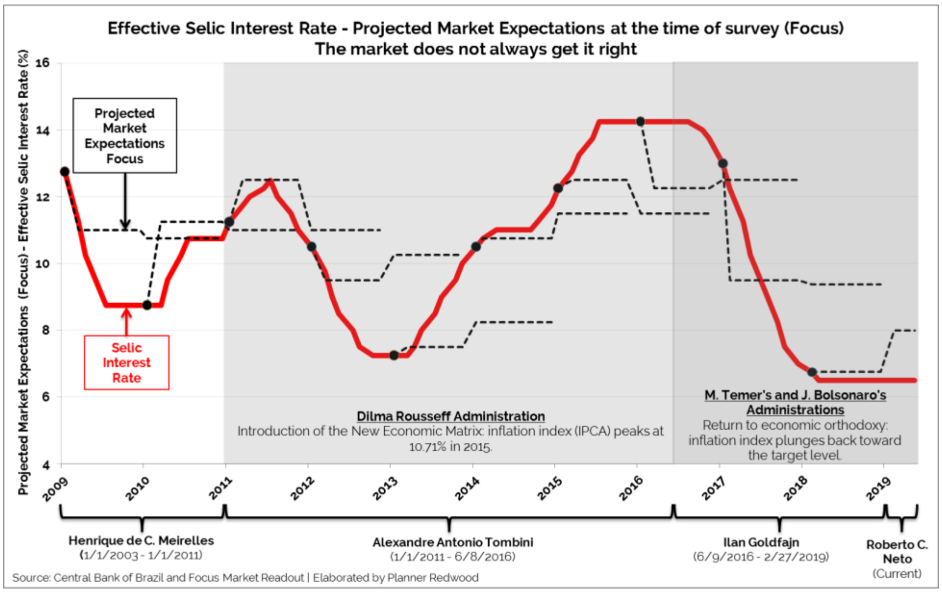


Source: PNAD and Rewood Projections | Elaborated by Planner Redwood

As for the monetary policy, this month the new inflation target for 2022 was set: 3.5% with a margin of (+ or -) 1.5%. This is a bold, necessary and timely measure, because it steers us towards a more decent and aligned level with the more structured foreign economies. The Central Bank (BACEN), which has conducted its interest rate policy in exemplary fashion, should not face greater obstacles in achieving this goal, albeit under challenging scenarios, Brazilian inflation is properly anchored. So much controlled that there is "room" for the BACEN, in this year alone, to reduce the Selic to "help" its secondary (although not explicit) mandate, so to speak: economic activity and unemployment.

On the fiscal front, the three main rules governing public finances - the golden rule, the expenditure cap, and the targeted primary surplus – continue to bother. As we got a supplementary budget credit that gave us some slack in order not to shut down essential services while also freeing the executive branch from major problems, the primary deficit remains a disaster. The public sector accounts accumulated, until May, BRL 6.97 billion, or 0.24% of GDP. States, municipalities and State-owned companies saved up to BRL 19.43 billion, but the Central Government's deficit (0.43% of GDP) of BRL 12.46 billion represented a significant setback.

With all the noise on the market that the BACEN will sharply loosen its monetary policy, the yield curve movement continued its downward trend. This assessment, combined with the more favorable scenario of further easing by the Fed and the ECB (American and European central banks, respectively), expanded and consolidated BACEN indicative interest rate (Selic) expectations below 6% this year – with some players pointing Selic at 5% in December. We at Redwood are somewhat at ease about this. All the technical issues aside, which involve and indeed regulate the economy in the medium term, no more energetic action should be implemented by BACEN prior to the approval of the Social Security reform. Thus, for the arbitrageurs on duty, the market has clearly factored into prices that this movement will materialize. The opportunities, therefore, are enormous for making profits.




In line with the expectations of the interest rate market, Ibovespa continued hitting its record high at 102,617 points (intraday on 24/6), with a 14.88% within-year accumulated gain. In dollars terms, it ended the month with 26,293 points, registering a rise of 6.36%. In any case, contrasting last month, there was a reversal of the result of purchases and sales of foreign investors, with net inflows in the order of BRL 400 million. BACEN continued to "act" in the FX market, but once again this market displays absolute independence and the currency floated at the mercy of the most "sensitive" variables of the moment: ended the month with quotation of BRL 3,832, varying -2.75% and volatility (3-month options contracts) at 13.23% – despite the worst net inflow for the month within a decades-long series. Curiously enough, BACEN stands by its interventions to offer hedge to market players in times of volatility, and to maintain a liquidity buffer for critical times. The significant reduction of the country risk by 30 points certainly influenced the US currency quotes, but also reflects the anxious "mood" of this market when it comes to possible unraveling outcomes of the Brazilian landscape - in absolute and relative terms, both compared to internal and external scenarios.

Overseas, the G-20 leaders' meeting (Osaka, Japan) took place this month, wherein Brazil was left with the unfortunate criticisms vocalized by leaders such as Macron and Merkel about our environmental policy, but also benefited from the fantastic announcement of the agreement between Mercosur and the EU. Amid strong international trade tensions, mainly caused by Trump, this Mercosur-EU agreement "signals" the opposite of what we have seen lately. In fact, this has hardly affected the US president who continues to push his agenda on trade: NAFTA (already "settled"), China (in a momentary truce), and Europe (dealing with new sanctions). Indeed, the meeting's *raison d'être* is to assess major global economic challenges, and this year eyes were on world trade, digital transformation, climate and energy, as well as on inequality.

During his stay in the region, President Trump "seized" the opportunity to propose a meeting with President Kim Jong-un in the Demilitarized Zone between the two Koreas, and became the first US president in power to visit the country. He made history. Diplomacy as interpersonal skills, via Twitter? Modern times!

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