APRIL - 2020

MONTHLY STATEMENT

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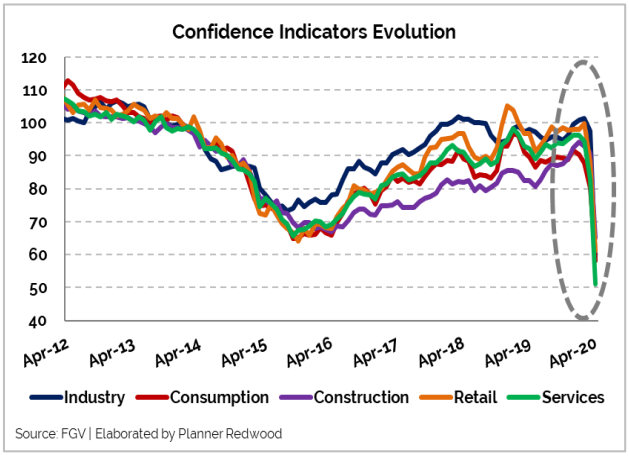
"Enough is enough!"

Common Sense / Popular Saying

Brazil is fast striding towards an institutional crisis of unprecedented magnitude since the beginning of the New Republic. The break-neck speed of intrusions, affronts and disrespect on all sides indicates the imperative need for cooling down, serenity and judgment. Although at this moment it is impossible and irrelevant to undo the sequence of errors made by each branch of government, the responsibility of the Commander-in-Chief requires alleviating the situation and putting the country back on track at least in a ceasefire. A truce. This necessarily means taking the lead in admiting past mistakes and inviting the heads of other branches to cooperate to find the best path for the country.

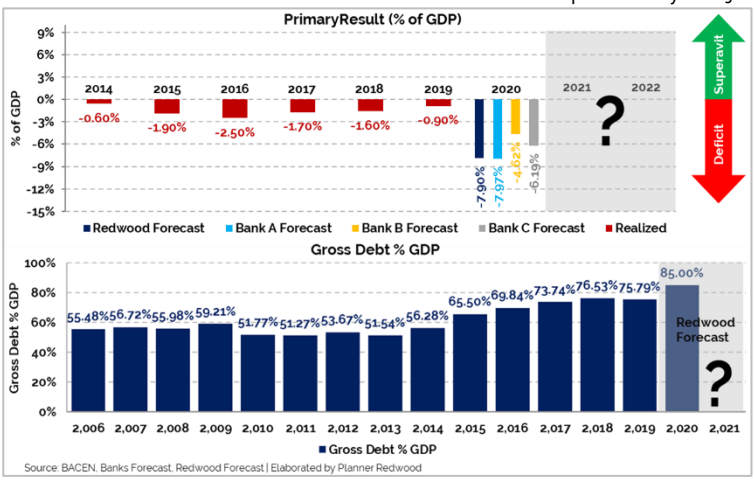
These are not normal times, a perfect storm is forming and the biggest loser will be the humble Brazilian people. We need to summon the three branches to unequivocally demonstrate unity and strength - even if only during the pandemic period -, to define less painful alternatives for the nation. The suggestion of a call towards unity may seem naive and utopian, but there seems to be no other left for a "harmonious" way out. The adverse outcome will lead us, in any rational hypothesis, to terrible economic and social setbacks.



The impulsive, irreverent and careless nature of the President has been his standard posturing since the beginning of his term. However, some more peculiar traits have emerged in this time of crisis, and have given rise to stances and definitions that should, at least, have been better managed at this time. The departure of Health Minister Mandetta was undoubtedly terrible news for Brazil, not only because of his performance and alignment with the best practices suggested in facing the pandemic, but also because of his absolutely untimely resignation. In the field of the second huge problem, the economy, Bolsonaro also found himself about to lose his "Economic Oracle", Paulo Guedes, due to the invention of a plan out of line with the premises of the new economic policy and without the endorsement of the head of the corresponding Department. Clear sign of discontent or, at least and in a romantic version, of misunderstanding the pillars of the new dynamic to be implemented in the economy. Really, a lack of control and/or wrong signals ... the President needs to make choices and, also, stand behind them, because the damage is being done and "understood" by the market, which prices in time and appropriately (country risk, Dollar, stock exchange, interest rates, etc.). Finally, he lost one of the few remaining pillars of support and image for his government, especially in the fight against corruption: Minister Sérgio Moro.

However, none of these actions is contrary to the President's available alternatives. He can and should make any adjustments he deems necessary at his discretion. But the President should not shy away from his campaign promises, especially when it comes to delegating decisions to experts, thus empowering them to lead according to their agreed and widely publicized purposes, without interference, and above all to stay away from the nefarious *quid pro quo*. Nobody is irreplaceable, but no turbulence should scathe the administration's coherency and direction, because only then will its voters continue to believe and support the President and the government. The confidence indicators, as a rule a good lead indicator, leave no doubt as to the gravity of the situation. Its predictive power, although at times heterogeneous, has a direct impact on gross fixed capital formation, which in turn means pinning down future GDP. The President needs to "wake up" and get a clear picture of where we are. Enough is enough!

The crisis that is taking place in Brazil and in the world, brings with it uncertainties of such magnitude that keeps us distant from the confidence we have that we know how to use the appropriate tools to fight it. A challenge for science, politics and macroeconomics. The relief seen for some market segments in April is nowhere near to signaling an anticipation of a consistent recovery. The Ibovespa rose 10.25% in April, cutting the 30.39% plunge within the year. In the same way, interest rate movements were smoothed out, whose fluctuations registered, between the minimum and maximum of the month, 0.915 and 1.9 points for DI1F21 and DI1F25, respectively, closing at 2.79% and 6.55%. Brazil risk, measured by the 5-year CDS, did not follow the same path, and advanced to 307.43 points and, with some influence, affected the dollar rate that ended the month at BRL 5.427 - an increase of +4.39% only in April, with a 34.64% change in the year.



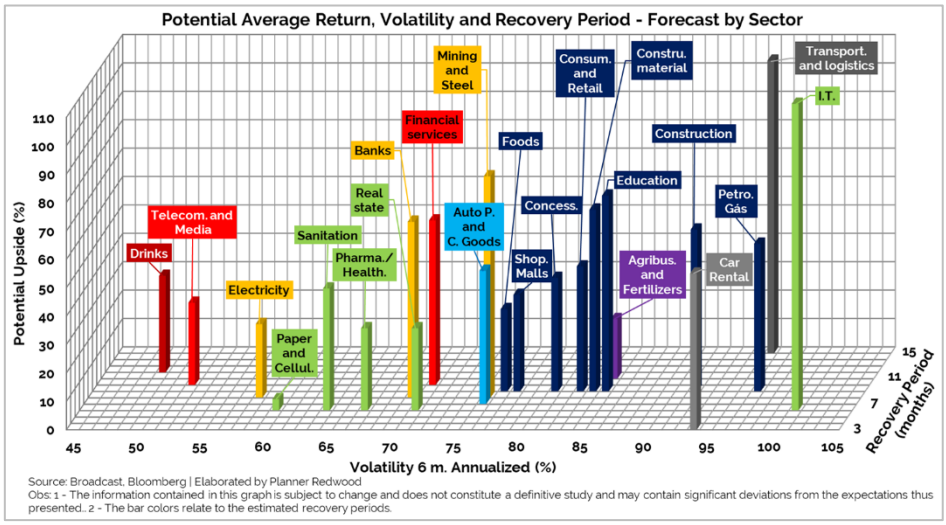
If there is no "good" time to face a pandemic, this moment was particularly difficult for Brazil. The process of adjusting public finances, the essential reforms for the Brazilian economy and the entire political environment were already beginning to weaken the prognosis for the end of last year. Covid-19 not only accelerated this degradation process, but also expanded and intensified everything that was underway. Thus, the elements for a general breakdown are present, although this is not yet our base scenario. The levels of uncertainty dominate, and the predictive exercise of macro variables is far too compromised. However, it is already possible to simulate, with some degree of confidence, where we are headed. Under our base hypothesis, we assume a gradual return of the economy starting from the second half of 2020, with a V-shaped recovery (or possibly a U). An alternative hypothesis, also credible and with some probability (depending fundamentally on the phase-out of the quarantine), the economic recovery would start only after the Q4 2020. Thus, in 2020, for the first case, we estimate a GDP of around -3.5%, while in the second case around -7.5%. In the first case we will face a recession, in the second case the chances of going to a depression are very high, that is, in the latter case the chances of an L-shaped recovery (much longer) are greater. The impacts on employment levels are also significant, in both cases.

Specifically on the fiscal front, our concerns are looming high. Since the beginning of this crisis, we have proposed massive spending to save lives, but at the same time, we have claimed the need for mapping out the uses and sources of fund. A way of "earmarking" them, as far as possible, the effects of this fight, mitigating the chances of contamination of financial accounts through a parallel oversight facility. The point here is very simple: to eliminate the possibility of jeopardizing the entire fiscal framework of the current liberal agenda. Emergency economic measures cannot become permanent. The Gross Public Debt/GDP ratio can easily reach 100% (slightly more than projected Debt and less GDP), but even worse than its sheer size, is the perception regarding its solvency. We are now rising on a rocket ship and we will come back down (if we ever!) by parachute.

On the other hand, our monetary policy seems to follow around the world Central Banks' trends, especially due to some expected "slack" between current and target inflation in 2020. Although our BACEN with a single mandate, the holistic view of the situation describes a cataclysmic trajectory, with GDP collapsing, unemployment exploding, monthly deflation and giant idleness with risks of definitive company crashes. Thus, the board is hesitating to adopt more extreme measures such as expansion of the monetary base or use of resources derived from exchange rate equalization, thus following a modus operandus that seems to reinforce the

"belief" in the endogeneity of the monetary base. The team will follow the Taylor Rule and others of the same nature and understanding. The Selic melts and the quantity of money adjusts. The effects on the yield curve and the exchange rate will soon be felt.

Finance, of course, will tag along. The aforementioned relief in April does not suppress the continuing pessimistic revisions of scenarios (inside and outside Brazil), and really point to just taking a breath. It is unlikely that markets will be continuously decoupled, either in any form of economic recovery. The economic team has presented important solutions, in the right direction, but in several points, when not timid, they proved to be slow. However, it will not be the end of the world and, for those with long-term investment possibilities, it is important to be liquid now for the opportunities that will soon appear in virtually all market segments. Reviewing of resource allocations will be mandatory and crucial for success in the risk-return-liquidity balance over time. In this way, the correct understanding and continuous "adjustment of fit" of the scenarios become crucial for the asset macro allocation management (and sequentially the micro allocation), whether for those with third party liabilities to be honored (more restricted risks - price, time, liquidity, etc.), or for those with a profit objective function (more elastic risk levels).



In the world, the script is not very different, but with emphasis on some countries that enabled themselves to manage this crisis from the start. South Korea is an example of this, but it will not go unharmed in a globalized world (for now!). Europe and the USA suffer a lot, and relations, in particular, with China tend to get worse - something to be seen in the 2H 2020. Internally, for the European bloc, the European Commission warns about other effects besides the falling economic activity, which tend to "deepen the bloc's internal divisions and threaten its stability". The concern is well-founded, as the risks of disagreement and, therefore, rupture are boiling, especially regarding the management of the ECB. On the US side, notably due to this year's presidential race, we will certainly see a deterioration in American relations with China, Russia, Iran and North Korea in various segments. With his economy in potential recovery, Trump will not fail to point fingers at those responsible, and reactions to this stance will have important impacts on the planet.

We are facing a global crisis, possibly unprecedent. Although the economic recovery is different for each country, everything indicates that we will have a "new normal". This new likely future situation will cover not only the political and economic camps (trade and business), but also and above all the collaboration between countries. Anyway, for now, we need to take care of our domestic problems. In this regard, the potential for inflaming multiple crises is salient and dangerously concentrated. We can cite a few: the consequences of the ex-Minister Moro's accusations, the constant "frying" (de-legitimization) of Minister Paulo Guedes, the opportunism with the fiscal bombs from the National Congress undermining public finances, the advance of the epidemic crisis and the President's test results (report) for Covid-19 infection and so on. So What? This is why President Bolsonaro must act quickly.

If the big picture has gone from "cautious optimism" to "prudent pessimism", we must double our attention!

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