




NOVEMBER - 2020

MONTHLY STATEMENT

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“Ideology is what I want to live”

Cazuza – Brazilian singer and composer

The municipal elections are over and the question is: will our leaders, especially the Commander-in-Chief, return to the country's fundamental agenda? Difficult to say; given that the left lost some space, Bolsonaro saw his “backed candidates” suffer a lot. On the other hand, Right and Center-Right, in theory a group more tuned in with the situation, seem to represent more than 50% of voters, which can bring good popularity to the President.

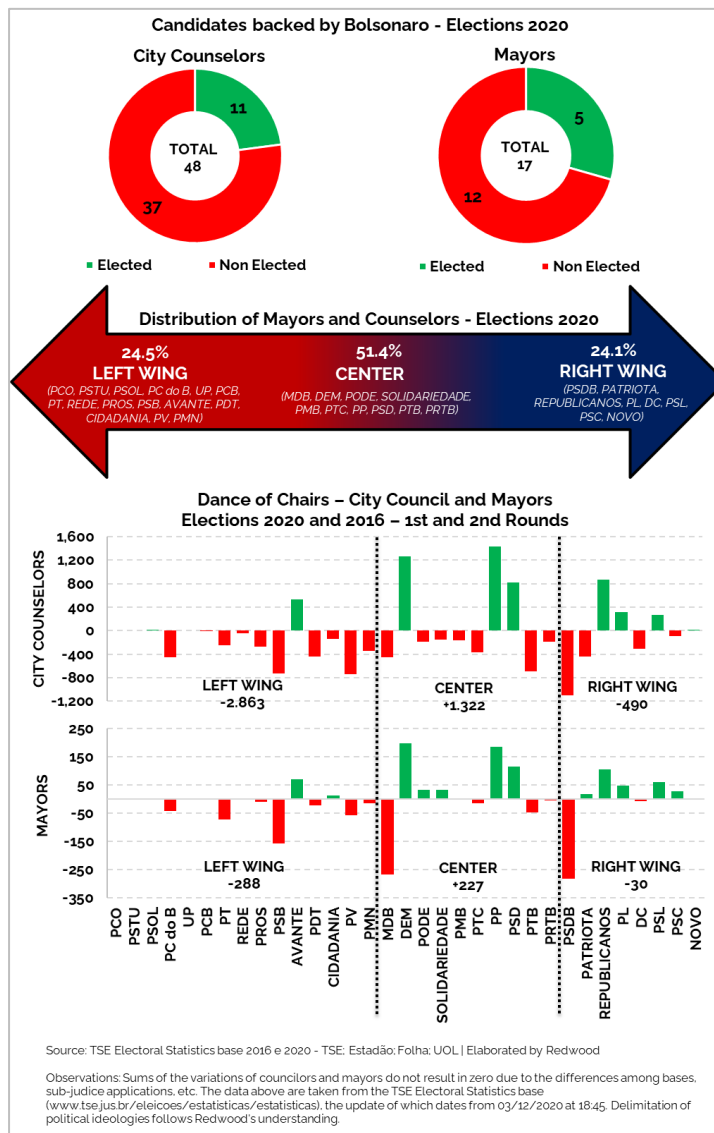
The elections, in any case, were more “civilized” from the point of view of polarization, and the result was possibly more representative of and sensitive to the real changes that the voter wants. If this is true, politicians will get the message and we can expect a series of shifts in the coalition scenarios and new understandings around the message that was set forth. This is a normalization that will do Brazil some good.

The analysis of possible political reformatting and its way forward is not easy to pin down, but for our understanding of the purposes of this Letter, regarding the economic and financial directions, understanding whether the President's support base is more solid or not does make a difference when it comes to achieving the necessary reforms (yes, we believe that the results of these elections will have an impact on Congress). So, let's take some examples, like the MDB, which despite having lost 266 municipal administrations, will still govern

778 cities. The PP conquered 185 cities and now totals 680 mayorships, while the PSD expanded in 115 and the DEM in 197 cities, now managing 653 and 465 cities, respectively. The PSDB, a once giant party, lost 282 mayorships, but still boasts power in 517 cities. Of the 5,570 municipalities, the so-called Rightwing and Center-Rightwing forces add up to

1,327 municipalities.

Therefore, although the President's candidates' losses were rampant, his new class and ally base seems to have fared better. This legitimizes his hold on power on two dimensions: (i) facing essential reforms, although diverse of an unpopular nature, and (ii) planning his re-election more easily. Will the Commander-in-Chief have the courage and determination to do so? Or will his newly exposed instincts prevent him from taking unpopular measures? Or is it that his experience and political background will keep him from trusting the Centrão? What will be the needed quid-pro-quo from now on? There is no doubt that



the time has come for the *nouveaux amis* to start collecting, starting with a ministerial reform in the coming months!

In addition to the scenario described above, there is also the certainty that the big losers in this election, notably the PT with no state capital mayorship, will reorganize to face economic measures and structural reforms. They will also do it to oppose Bolsonarism in 2022. That's the way to go; long live democracy!

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The financial market, in the opposite direction of what we expected and still expect (thus far), in November, advanced positively by “contradicting” economic fundamentals, expectations and realignments of Brazilian politics and economy. Thus, Ibovespa closed the month at + 15.9% in the highest monthly spike of the year, accumulating now only -5.84% within the year. In yield curve, interest movements have not cooled down and continue with very different dynamics from the stock market movement, anticipating the worsening of public finances, and charging significant premiums, especially for the longest maturities. DI1F21 ended the month at the same levels as in October (1.96%) at 1.928%; and DI1F25 closed at 6.78%, with an additional increase of 0.04 points compared

to last month. The slope is also accompanied by a greater oscillation for longer maturities, but slightly less than last month, with 0.026 and 0.44 points for DI1F21 and DI1F25, respectively. The

Brazil risk, as measured by the 5-year CDS, in line with the stock market's performance, plunged to 166 points, a 24% change. In this line, the final Dollar quote (Ptax) ended the month at BRL 5.3317 - an important rise of the Real, interrupting the devaluation trend, recording an accumulated annual loss of 32.28% by November.

What was designed to be peaceful and different from Europe and the USA, the curve of new cases of Covid-19 and deaths (to a lesser extent) seems to point to a second wave in Brazil. If this scenario is confirmed, the economy, which is gradually reopening and returning to “normal”, will certainly motivate restrictive measures and, with them, the cooling of the economic gear that, although timid, was starting to show positive signs. With this, at least two things will be certain: (i) stronger gradualism in the economic recovery and, (ii) the need for continued “emergency” aid for the population. Obviously, we will need to find a middle ground, as Brazil cannot take another fiscal stance like the recent one and the population cannot be left in the dark if

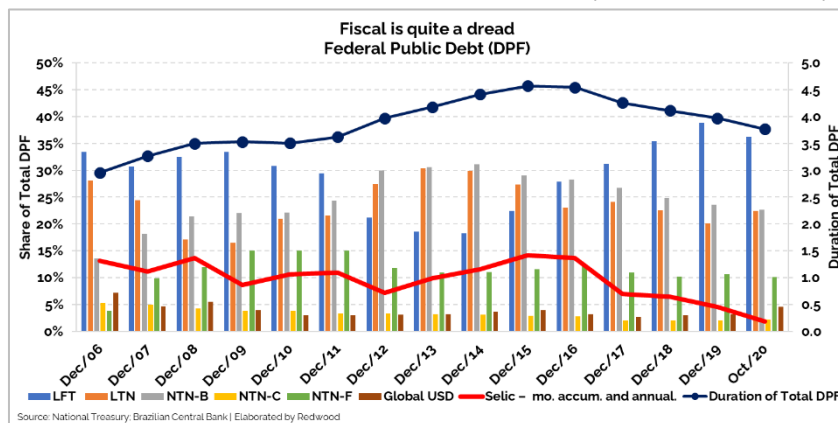
limitations are imposed. We need to learn from the recent experience, especially at the federal level, in the coordination and pooling of specific public policies with the States. In confirming a second wave of Covid-19, there is no room for populist agenda and excesses of any kind.

The economic recovery is the central point, without it we will not solve our problems. However, for this recovery to happen, we need to do our homework, which means returning to Paulo Guedes' original agenda and facing the serious problems of public finances. The fiscal chart on the side apparently (statically) is not scary, but if combined with the dynamics of deterioration with Debt/GDP ratio hiking toward 100% mark (this year +20 % points), with no progress in reforms, privatizations and spending without greater

scrutiny, the situation changes completely. Adding harm to foul, a possible adverse external financial shock (2nd wave of Covid in Europe and USA without the same level of fiscal stimulus), and a

possible setback in our economic reopening, and we will face distrust and the return of vulnerability. Risk aversion lives next door, and this is what most afflicts us. We are playing with fire, we are flirting with enormous danger, because the simple observation of greater fiscal rigidity and the financial market will be the first to shift positions. The economic consequences will then lead to even tougher measures, with severe impacts on the population.

The gravity of the situation has led some economists to invoke ghosts from the past (yes, ghosts, because they don't exist!) as the thesis that we are entering fiscal dominance territory. The phenomenon “happens” when the BACEN does not raise SELIC (to honor its single mandate to control inflation) because this increases the fiscal imbalance (more interest is paid), the Dollar skyrockets and inflation increases. It is the fiscal destroying the effectiveness of monetary policy! Although the current situation is completely different from the past experience (namely, 2002 and 2015), the essence does not change and



is worth re-reading the paper (entitled [Fiscal Dominance or Dominance of the Absurd?](#)).

BACEN's Monetary Policy has never had to be so tuned in now as it was in more recent periods. Inflation shows its true colors, but its definition and greater acceptance state: generalized AND constant price increases. "We don't have" both... yet. Monitoring, therefore, is essential, especially with the above discussion on the fiscal impacts. The dose has fallen, however, on what is not his objective mandate, that is, economic performance, but whose policy reflexes are straightforward. Thus, recalibrating basic interest rates now (Selic) with the recovering economy and rising unemployment, becomes a challenge. With this, we return to the treatment of public finances, keeping expenditures under the Cap and tackling all pending reforms. Failure to accomplish all these claims will not confirm the reversal of the current situation, and inflation, now seen as transitory, may settle in. Managing this expectation is more and more difficult,

and BACEN will have no alternative but to increase the Selic rate earlier than we imagined. The exchange rate policy has BACEN "striving" in its daily intrusion into the market, but the appreciation of the Real does not seem to be due to its merits. There are no changes in our fundamentals for this, much less the performance of BACEN. In fact, everything indicates that the Dollar is devalued in all markets by the "new" international environment with the election of Joe Biden in the USA (expectations of new stimuli) and the real promise of an effective vaccine against Covid-19. The inflow of USD 6 billion to the B3 may also have stirred expectations and contributed to the appreciation of the Real.

Financial markets seem to "fluctuate" at the mercy sometimes of a paradigm shift, which seems to occur in the USA with repercussions in the world, sometimes of internal pessimism about politics that tends to harm the economy. The fact is that this pull-and-stretch game is bound to come to realization soon. Not least, among the various sectors of the market, the yield curve, although it may still shift up

significantly, already shows a large gap with respect to other sectors. We do not focus here on short-term interest of 2%, but on long-term interest (at least 10 years), which is in fact the effective interest for cash flow discounts and other investments. Thus, it remains to be seen who is wrong... skepticism about public finances and their consequences, or the exuberant optimism of new and massive fiscal stimulus around the world in a new flood of liquidity. We have no doubt that our scenarios weigh more in favor of greater adversity, given the current direction of things.

One of the factors that can change the allocation of probabilities to a better scenario will be the coming to fruition of the various vaccines. The developed world will certainly benefit before the emerging and other countries

will do, but it will also dictate the pace, logistics and effectiveness of vaccines, since with the 2nd wave of Covid-19 in Europe and the USA, every effort will be spent to so much.

However, even though vaccines are widely applied, a good part of 2021 will live with Covid worldwide. This reality seems indisputable, and with it comes all the stress of the economic recovery with the generation of jobs and income. So far there is a huge disconnect between the benefits earned by the markets and those in the economy. Although the real economy as a rule can respond with "vigor" after hitting rock-bottom, any take-off seems to be short-lived, as in particular certain incentives are first captured by the market. For the real economy, complementary measures are needed (Europe, Asia and Emerging Countries), although more flexible economies like the US tend to have faster and more persistent responses. China, unlike the rest of the countries, seems to be a step ahead and can advance robustly as early as 2021. Europe, apart from all its political problems, knowing how to better manage this 2nd wave of Covid and the ECB's "overactivity", may surprise. In the US, it will depend on the outcome of the elections, as Trump and Biden have very different proposals and perspectives.

Vaccine	Effectiveness Rate	Logistics and Production	Distribution in Brazil	Unit price (or range)
PFIZER + BioNTech	95%	-70°C	No deals with Federal Administration	BRL 106
MODERNA*	94.5%	-20°C	No deals with Federal Administration	BRL 136 - BRL 201
ASTRAZENECA + OXFORD UNIVERSITY**	62% - 90% according to dosage	2°C - 8°C	15 million doses until Dec/20 + 15 million until Dec/21	BRL 16 - BRL 22
SPUTNIK V	92%	2°C - 8°C	Deal between Paraná state govt and Gamaleya Institute	BRL 54
CORONAVAC	-	2°C - 8°C	Deal between São Paulo state govt and Sinovac - 46 million doses	BRL 56

*During transport it is possible to store it in refrigerators for up to one month
**Partnership with Fiocruz to produce 70 million doses by early 2021
Source: BBC; G1 | Elaborated by Redwood

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