MARCH - 2021

MONTHLY STATEMENT

PLANNER REDWOOD ASSET MANAGEMENT

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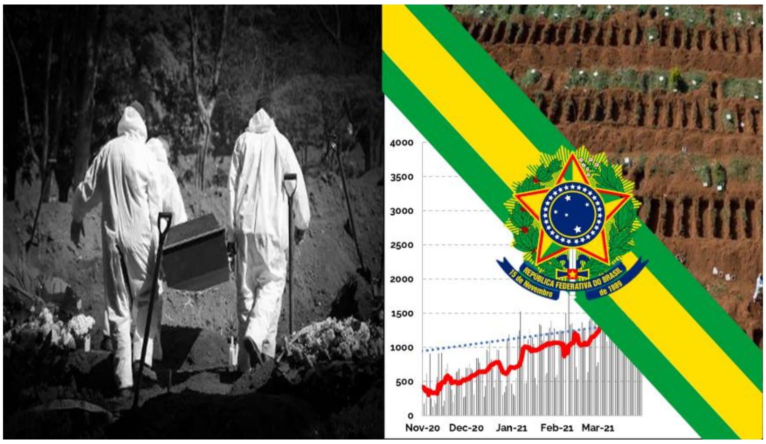
"A single death is a tragedy; a million deaths is a statistic."

Joseph Stalin – Former Soviet Prime Minister.

What is behind the sentence of former soviet dictator Joseph Stalin? How deeply does it relate to what we see today in how Brazil has fought the pandemic, notably by the federal government? The answer seems obvious, and transcends the bounds of reason. It should not matter where one lies across the ideological spectrum, for the harsh reality of the corpses exceeding 300-thousand mark should unite everyone against this situation. Realizing this truth, especially by the country's leader in charge, would free us from darkness, nihilism and the mental rigidity of assuming the obvious.

Our pandemic statistics is more than a multiple tragedy, it amounts to a moral catastrophe and a shame that humiliates us in deep recesses of our souls. Its extension reaches the limits of human rationality, with the trivialization of our greatest asset - life - and the vulgarization that, in fact, only a dumb or psychotic leader could embrace. The reflexes of this second wave of Covid-19 in Brazil can be much deeper than the first, it can be the last nail in our coffin.

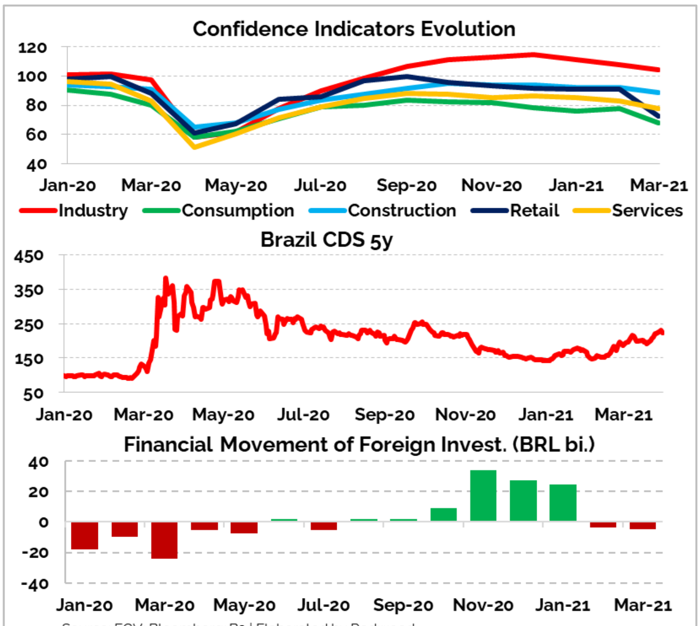


This assessment, of an essentially *political* nature, brings back the discussions about saving lives or the economy. This dilemma we already discussed (Paper: Brazil on the brink?) gets entangled, purposefully and without foundation, in the autonomy of the various levels of government in facing the pandemic. It seems we failed to have learned, or perhaps that is the intention, no matter how cruel, boorish or psychotic it may seem. This type leadership is wasting precious time for reaction and points, however, to an economic-sanitary outcome contrary to the idealized by the Italian economist Vilfredo Pareto's theory, namely: "***Pareto's pessimal***", a situation in which progress in economic deterioration would not correspond to any improvement in curtailing the pandemic. Last year is evidence of that, "we are proud" of a GDP of "only" -4.5%, with an expansion of the Gross Debt/GDP ratio from 75.8% to 90% and we are in the worst stage of the pandemic. What a beautiful management!

The course for 2021 may be different. In fact, it needs to be different. Protests by society, such as the Economists' Manifesto of March 21st 2021, had some effect, albeit due to "pressure". This manifesto contains four important points, the fourth of which is the idea of creating a Crisis-Management Committee, which was officialized afterwards. Unfortunately, the execution displayed an insurmountable bias and has in essence a main problem: the leadership of who leads it. A stillborn project. That is why, in the paper *There's still time to win by way of reason* on March 19th 2021, we argued in favor of launching a National Emergency Council (CNE) to assist the federal government, but sidestepping the "coordination" of the President. He simply has no credibility and no leadership skills to do so.

At the economic policy front, there are also many adjustments to be made. However, in this case the problems lie far from any technical issues of Paulo Guedes' team. In fact, the Minister needs to impose himself and use whatever remains of the President's respect for him to assert his opinions and decisions. If the Commander-in-Chief fails to grasp the impacts of his disagreements with and lack of support for the liberal agenda, let his attitudes be made clear that will put him out of the next election. It will work. It will be enough for now.

Financial markets, with the occasional exception of Ibovespa, continue to anticipate sharp perceptions of deterioration in the political and economic environment in Brazil. The pandemic and policy mix undermine progress on reforms, confuses guidelines and disperses any focus. Investors have been overly cautious and, although they understand current "noises", they shy away from any likely structural contamination. Thus, led by increases in VALE3 (8.15%), ITUB4 (9.69%), BBDC4 (16.46%), PETR4 (8.36%), ABEV3 (9.06%), IBOV closed the month at + 6.00%. In yield curve, interest rate continued to shift strongly upward, with ever higher rates. DI1F22 ended the month pulled by new bullish pressure in relation to February (3.74%), at 4.59%; and DI1F25 closed at 8.05%, with a 0.82 point-increase with respect to last month - or, 2.4 points over the last three months. The fluctuations between highs and lows also renew significant volatility, with DI1F22 going from 0.50 point in February to 1.165 point in March. DI1F25 shifted further up by 1.51 points in March. BACEN's "easy days" in this segment are over. Tagging along these interest rate concerns is Brazil risk, whose main indicator, the 5-year CDS, advanced 28.17 points, ending the month at 223.94 points. The Dollar, although less intense, as it cooled from its peak of BRL 5.855, ended March with a 3.02% change to BRL 5.697 (Ptax) – yet another devaluation of the Real, with important reflexes.

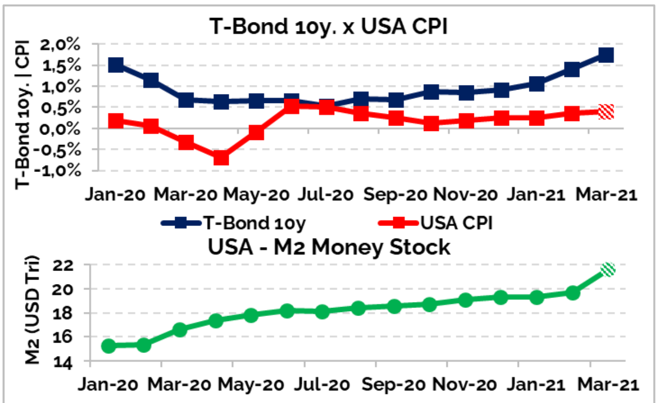


Source: FGV; Bloomberg; B3 | Elaborated by Redwood

The growing instability grows out of frustration with the "non-reforms" and the growing certainty that any resuming effort by Congress is increasingly distant. In addition, issues such as the Budget Bill that has not yet been finalized and elaborated with the care of a "reckless genius", always come to the fore as whispers of total disgrace. We're lucky we have checks and balances among the branches of government and the sirens in place, as in this case pointed out by the MPTCU. However, for the investor, this "key person" that we need so much remains, if not for "malicious agreement" by the Executive, the cumbersome attempt to come up with proposals that render the budget unworkable. The consequences are more of the same as we have seen in the financial market lately, namely: constant deterioration.

The economic recovery, therefore, is on a slippery slope. Although formal employment shows signs of recovery, failure to manage the health crisis takes its toll, in any case. With falling confidence indicators and the recovery of the economy to pre-pandemic levels, the so-called V-shaped comeback, does not seem to be consolidated because the mobility restrictions of this second wave will have a direct impact on overall activity. Businesses fail to push through, and the truth is that no one knows how long it will last. The first battle to be won is on the sanitary front, and this is done with mass vaccination, so we can get back to work. All efforts in this direction, all of them. We must not underestimate the impact of this second wave in our public finances, as "only" BRL 44 billion as emergency aid will not do. We may be on the verge of a new state of calamity, which means spending +10% of GDP ... many people will "cheer". Again, the last nail.

In monetary policy, inflation went center stage and set the tone. Inflation forecasts moved from 3.86% at the beginning of the year to close to 5% in the latest poll. Invariably, starting the anticipated and intensified tightening of the monetary cycle means the scenario changed and much, for the worse. Today, in order to reach the end of the year with a near-zero real interest rate, and thus issuing the necessary (minimum) guidance, we will need a Selic rate of 5%. We trust the effects of Monetary Policy, but we know that its transmission mechanism (for better or for worse) takes some time to play out. Thus, in line with our projections about the behavior of BACEN's team, we see a much stronger attitude towards hiking interest rates at the next meetings, and some easing out at the last Copom meetings of the year. In the Exchange Rate Policy, if the Central Bank follows the route of the above interest-rate analysis, it may see some downturn by the Dollar, but the fiscal and the international scenario are still "playing" against it; these are sufficient reasons to maintain its usual interventionism.



Source: FRED; Bloomberg | Elaborated by Redwood - Redwood Proj. CPI; M2 - Mar-21

On the fiscal front, the sustainability of public finances also hinges on the sanitary aspect, the key point that unites all of our current problems. In this environment, strengthening the commitment to fiscal anchors is mandatory, but, "surprisingly", what we have seen are daily attacks in the opposite direction. The setup of the Budget Bill 2021 is proof of this. Any uncertainty in budget negotiations has a strong correlation with fiscal uncertainty, because if it eventually needs credit supplementation, we will see an increase in the "fiscal risk premium". This, in turn, will have an impact on macro variables with reflexes on economic policy.

As a matter of fact, muddling through the year 2021 will be a huge challenge. And this exercise will be fundamental to preserve the confidence of our creditors, since only with a strong message (and attitudes) of credibility towards fiscal convergence, will we be able to demonstrate a clear path for fiscal consolidation. This "persuasion" starts here, domestically, especially in the understanding between the Executive and the Legislative branches. The Brazilian gross public debt, which was already around 51% of GDP in 2013, reached 90% of GDP in February. Occasionally, the smaller deficit observed in February (much of it due to States fiscal outcomes) did not curb the country's debt growth. Thus, in general, the recent trajectory is simply unsustainable; it is a recipe for total economic breakdown. Our problem has always been the fiscal one, but it has become a cornerstone. That is why the mindset of the current team and economic policy needs to prevail.

Overseas, economies face the Coronavirus crisis and have very positive prospects for economic activity. The international landscape, especially for developed countries, points to a 2021 of absolute recovery, but with the parsimony of those who learn from their past. Health surveillance has become a mantra, and measures to support society are a fundamental lever in this recovery. The harmony and coordination between the monetary and fiscal policies associated with health and other policies seems to have found its linchpin.

However, not everything is a bed of roses. The advances in stimulus packages have different impacts on each country. In this way, the benefits of a stronger recovery now (necessary) will find costs soon thereafter. Not least (and for other reasons as well), the projections for 2022 are largely more restrained in all economies. Packages such as USD 1.9 tri and the latest proposed USD 3.0 tri (USD 2.3 tri for infrastructure already quite advanced), will invariably come at the price of inflation over there, with consequences for the rest of the world. Janet Yellen thinks otherwise. It is not what the market factors into prices. Attention, the market is usually right!

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