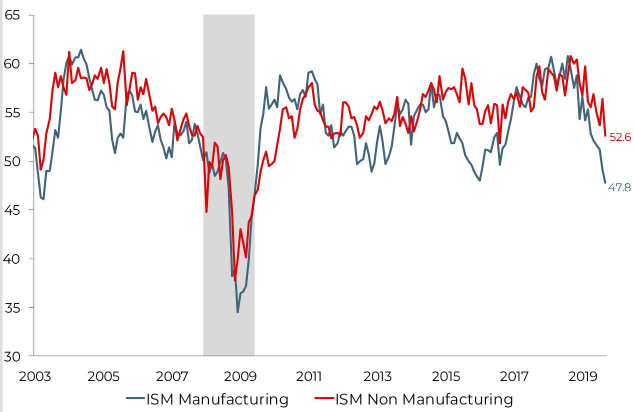
Blue Notes | Weekly | October 4, 2019

Weak dollar and better growth in Brazil support stronger BRL. Last week we have highlighted the good performance of the BRL despite volatile international markets. The BRL continued to gain against the dollar and closed the week at 4.06 on the back of weaker economic data in the US and positive surprises mostly from the industrial sector in Brazil. As we have written in last week´s Blue Notes, Brazil´s Central Bank (BCB) inflation forecasts with the BRL around 4.05 are still well below target levels, opening room for much lower Selic rates. Markets behavior was favorable despite an increase in political noise, that lead to some delay and watering down in the Social Security reform.

Economic weakness lead to weaker dollar. ISM and payroll data add to the view that consumption and the job market remain robust in the US. However, the risks towards more deterioration have increased further with worsening industrial activity and some initial indication of contamination to the services sector (chart). In all, the data reinforces the call for a 25bps rate cut in the October´s FED meeting. Further cuts will depend on a more pronounced deterioration in services and consumption.

US | ISM Manufacturing & Non-Manufacturing



In Brazil, industrial activity came in better than expected, but economic recovery ahead is driven by consumption. August´s industrial production came better than expected, growing 0.8%m/m in seasonally adjusted terms. Despite this improvement, total production is still 10% below 2015´s levels. Also, the fact that the surprise was concentrated in few sectors (iron ore and oil) hold back a more optimistic reading of the data. Capital good production (a good indicator of investments) fell again, reinforcing our view that the beginning of the economic recovery will be driven by private consumption, not investment. Next week´s data on retail sales and services will be on the spotlight and should consolidate the view that GDP in the 3Q19 should grow less than in the 2Q19 but negative prints seem unlikely at this point.

Politicians bargain over the budget and the Social Security reform. Disputes among federative entities (Federal, State and Municipal governments) over the revenues coming from the pre-salt oil field and between the legislative houses (Lower house and Senate) ended up leading to further delay and some watering down in the Social Security reform in the Senate.

All eyes in the trade war and economic activity releases. Markets put as uncertain if American and Chinese leaders will reach any agreement next week. Also, further data confirming the gradual recovery of economic activity should support the BRL without reducing chances of further Selic cuts ahead.