

Macroeconomic Scenario

18 February 2020

Revision of 2020 Scenario

Summary

The macroeconomic scenario changed with the outbreak of the coronavirus, the weaker-than-expected economic activity and the more favorable inflation conditions. Under this new environment, we revised our macroeconomic scenario. One of the major movements was on GDP growth, which we are revising to 2.2% this year from our previous call of 2.8%. We keep our USDBRL forecast in the end of this year at 4.10, but we did some revision of BRL to weaker levels in the short-run, the average USDBRL moved slightly to 4.14 from 4.09. The forecast for IPCA inflation reduced to 3.1% from 4.0% influenced by the scenario of weaker economic activity and some unexpected positive events like heavy rainfall keeping green flag on electricity tariffs for longer. At last, now we expect Selic policy rate constant at 4.25% until the end of this year. See the changes summarized in the table I:

TABLE I --- CHANGES IN 2020 SCENARIO

	OLD	NEW	CHANGE
real GDP growth (%)	2.8	2.2	-0.6
exchange rate (USDBRL -- yearend)	4.10	4.10	0.00
exchange rate (USDBRL -- year average)	4.09	4.14	0.05
IPCA inflation rate (%)	4.0	3.1	-0.9
Selic interest rate (% -- yearend)	5.25	4.25	-1.00

Source: Banco MUFG Brasil S.A., a member of MUFG

GDP revision

The revision of GDP figures were driven by the disappointment of coincident indicators of the economic activity, the weak leading indicators and the impact of coronavirus on the global economy. Under this scenario, we revised our figures for the 4Q19 and 1Q20, leading to changes in the annual growth to 1.1% from 1.2% in 2019 and to 2.2% from 2.8% in 2020. The changes of quarterly figures are:

- **4Q19** --- the economic activity index released by the Central Bank posted a growth of 0.46% in the 4Q19 over the 3Q19, seasonally adjusted, but it was lower-than-previously

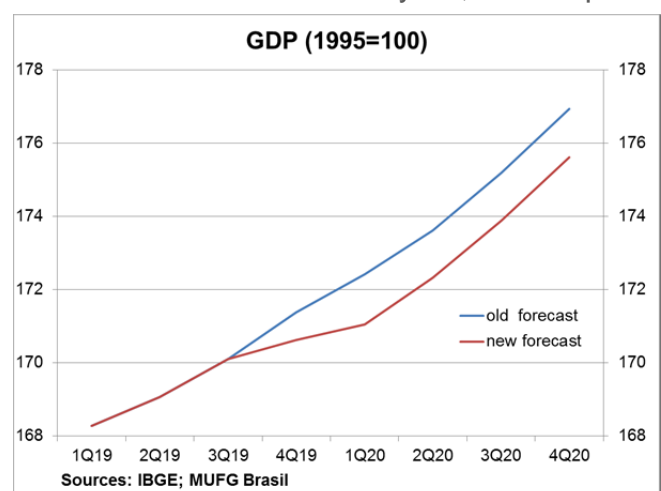
Macroeconomic Scenario

18 February 2020

expected as November and December figures disappointed, coming very weak. So, we change our call for 4Q19 GDP growth (to be released on March 04th) to 0.30% from 0.75%. Only this revision means that the carry-over for 2020 GDP was reduced by 0.35 percentage points, from 1.00% to 0.65%. Only this mathematical adjustment accounts for more than half of the 2020 GDP revision;

- **1Q20** --- the revision of these figures were motivated by the weak leading indicators and a first assessment of the impact of the coronavirus on the economy. Indeed, we can observe the deterioration on consumer and business confidence shown in January 2020 mainly with regards to the assessment on current situation. Regarding the coronavirus, the impact would be through several channels: i) lower exports not only to China, but to the world in general as global economy would be affected as a whole; ii) drop of income from the exporting sector as of lower commodity prices and iii) some bottleneck in sectors that rely on imported components as of difficulties in importing them from China. Regarding the impact on Brazil, it is estimated that for every cut on GDP growth in China by 1 percentage point (pp) leads to an impact of around -0.2 pp in Brazilian GDP. Our economist in China estimates a reduction of Chinese GDP between 1 and 2 pp, which would mean a negative impact on Brazil between 0.2 and 0.4 pp. As a result, 1Q20 GDP growth was revised to 0.25% from 0.60% over 4Q19, seasonally adjusted.

All in all, we revised our GDP growth forecast to 2.2% from 2.8%. For next year, we keep our confidence at a sharper GDP growth of 3.5% assuming that the economic reforms will be in good progress this year thus restoring confidence by businessmen, and therefore resulting in sharper job creation in the formal labor market, which would boost household consumption. Furthermore, the scenario abroad might improve with the reduction of the uncertainties, considering that Coronavirus will



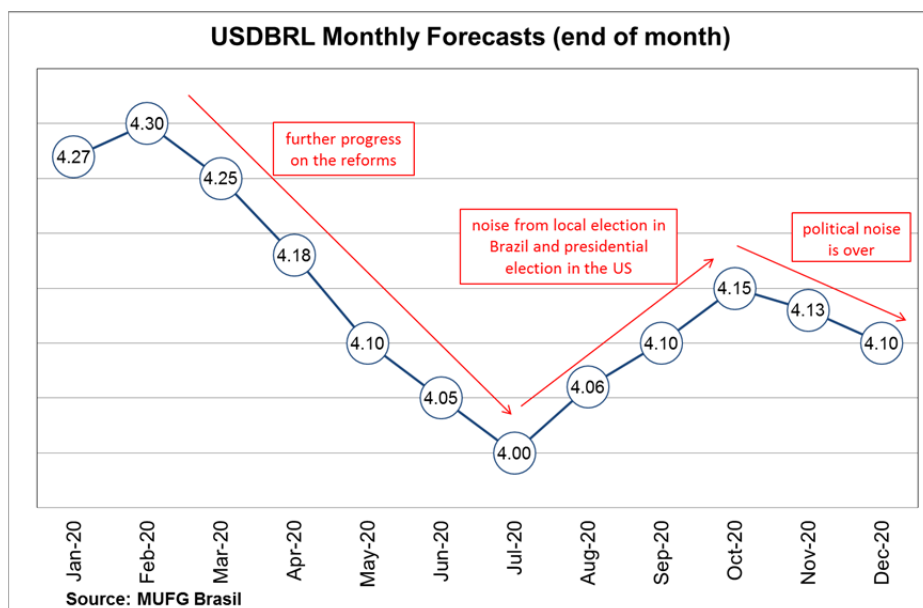
Macroeconomic Scenario

18 February 2020

be already controlled

FX rate

BRL has been under pressure amid the current high level of uncertainty abroad as of the concerns on the potential impact of the new coronavirus on the global economy, and therefore reflecting on the risk-off mood against EM currencies such as BRL. And, BRL has been among the worst EM currencies so far this year because of the low carry-trade compared to our peers and the reduction of funding abroad, once domestic funding became more competitive with the sharp cut of the Selic policy rate. However, although the scenario abroad is still quite gloomy, we assume that the coronavirus will be controlled during this year, and therefore those tensions abroad tends to ease and BRL might gradually appreciate back to 4.10 in the end of this year. Such strengthening might also be driven by the progress of the reforms and the faster economic growth.



Inflation

Inflation readings are coming better-than-expected, what made us revise down our call due to:

- o Lower-than-previously expected inflation figures for the 1st quarter influenced by the low food inflation, mainly benefitted by some deflation of meat prices. In the last quarter 2019, these prices soared 29.9% in the wake of the swine disease in China. Previous assumption was the maintenance of some hike in the beginning of 2020, but January

Macroeconomic Scenario

18 February 2020

reading for meat posted deflation, which continued now in February. Given its weight of almost 3% in the headline inflation, this item will push inflation down;

- Also lower-than-previously expected inflation coming from monitored prices amid the significant rainfall in the latest months that contribute to increase reservoir levels and leading to lower pressure on electric energy and water & sewage. Thus, the energy supply through more expensive electricity price from thermoelectric plants might be lower this year, what means less additional cost for consumers. Additionally, the increase of bus tariffs is much lower than previous years because of local elections when there is no political incentive to adjust public transport tariffs. And the reduction of oil prices abroad as a consequence of the coronavirus dragging global growth;
- Downward revision of our GDP forecasts for this year leading to the maintenance of idle capacity at excessive levels for a longer time, and therefore lowering pressure on inflation through the consumption channel. In such scenario, the FX pass-through to inflation is quite limited, so the current weak currency is not a concern in terms of meeting the 4.0% inflation target this year.

All these items might produce a significant downward pressure on the headline, making us to revise our call to 3.1% from 4.0% for this year.

Selic Policy Rate

The Central Bank has cut the Selic policy rate to current 4.25% from 14.25% in September 2016. In the last minutes released by the monetary authority, the Central Bank indicated the interruption of the easing cycle given some uncertainties regarding the global economy, the progress of the reforms and the impact of the policy rate cuts already done in the economy. There is the possibility of the Central Bank resuming the policy rate cuts ahead, but in the middle of this year the focus of the Central Bank will be moving to achieve the 2021 target and the current scenario of market forecast is at the 2021 target of 3.75%. In such inflation and economic activity scenarios, Central Bank tends to keep Selic policy rate at 4.25% until the end of this year. However, as soon as we keep our scenario of stronger GDP growth next year

Macroeconomic Scenario

18 February 2020

(3.5%) and therefore a sharper reduction of idle capacity, Central Bank might start removing the monetary stimuli during the first semester of 2021.

Medium Term Scenario

Our changes were concentrated in the 2020 figures, what means that our assumptions for the medium term scenario are still valid. We consider a global environment improving from the current uncertainties. In the domestic front, the government will be able to progress on the reforms that coupled with the favorable financial conditions, low inflation and improved labor market will foster stronger economic growth driven by household consumption and investments. In such condition, BRL would be somewhat stable after the appreciation expected until the end of 2020.

TABLE II --- MACROECONOMIC DATA FORECAST

	2020	2021	2022	2023
real GDP growth (%)	2.2	3.5	3.5	3.5
exchange rate (USDBRL -- yearend)	4.10	4.05	4.10	4.15
exchange rate (USDBRL -- year average)	4.14	4.08	4.08	4.13
IPCA inflation rate (%)	3.1	3.8	3.5	3.5
Selic interest rate (% -- yearend)	4.25	6.50	6.50	6.50

Source: Banco MUFG Brasil S.A., a member of MUFG

CARLOS PEDROSO
Senior Economist
cpedroso@br.mufg.jp

MAURICIO NAKAHODO
Economist
mnakahodo@br.mufg.jp

Macroeconomic Scenario

18 February 2020

DISCLAIMER

The information herein is provided for information purposes only, and is not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities or other financial instruments. Neither this nor any other communication prepared by Banco MUFG Brasil S.A. and/or MUFG Bank, Ltd. (herein jointly as "MUFG") is or should be construed as investment advice, a recommendation to enter into a particular transaction or pursue a particular strategy, or any statement as to the likelihood that a particular transaction or strategy will be effective in light of your business objectives or operations. Before entering into any particular transaction, you are advised to obtain such independent financial, legal, accounting and other advice as may be appropriate under the circumstances. In any event, any decision to enter into a transaction will be yours alone, not based on information prepared or provided by MUFG. MUFG hereby disclaims any responsibility to you concerning the characterization or identification of terms, conditions, and legal or accounting or other issues or risks that may arise in connection with any particular transaction or business strategy. Note that MUFG may have issued, and may in the future issue, other reports that are inconsistent with or that reach conclusions different from the information set forth herein. Such other reports, if any, reflect the different assumptions, views and/or analytical methods of the advisors who prepared them, and MUFG is under no obligation to ensure that such other reports are brought to your attention. MUFG retains copyright to this report and no part of this report may be reproduced or re distributed without the written permission of MUFG expressly prohibits the distribution or re-distribution of this report to any parties, via the Internet or otherwise and MUFG, its head office, branches, subsidiaries or affiliates accepts no liability whatsoever to any third parties resulting from such distribution or re-distribution.

Mitsubishi UFJ Financial Group, Inc. is one of the world's leading financial groups. Headquartered in Tokyo (Japan) and with over 360 years of history, MUFG has a global network with over 1,800 locations in more than 50 countries. The Group has over 150,000 employees and offers services including commercial banking, investment banking, trust banking, securities, credit cards, consumer finance, asset management, and leasing.

Banco MUFG Brasil S.A.

Av. Paulista, 1.274

São Paulo - SP - Brazil

Ombudsman Toll-free (and DDG): 0800 770 4060

Email: ouvidoria@br.mufg.jp

© 2018 Banco MUFG S.A. All rights reserved. The MUFG logo and name is a service mark of Mitsubishi UFJ Financial Group, Inc., and is used by Banco MUFG S.A. with permission.

DISCLAIMER

As informações contidas neste documento servem apenas para fins de informação e não devem ser usadas como ou consideradas oferta ou solicitação de oferta para vender ou comprar ou contrair assinatura de instrumentos financeiros. Nenhuma comunicação elaborada pelo Banco MUFG Brasil S.A. e/ou MUFG Bank, Ltd. (em conjunto doravante "MUFG") é ou deve ser interpretada como conselho de investimento, recomendação para entrar em uma transação específica ou seguir uma estratégia específica, ou qualquer afirmação sobre a probabilidade de essa transação ou estratégia específica ser eficaz em vista de seus objetivos de negócios ou operações. Antes de entrar em uma transação específica, é recomendável obter assessoria independente financeira, legal, contábil ou de outra natureza, conforme adequado às suas circunstâncias. Toda e qualquer decisão de entrar em uma transação será exclusivamente sua, não baseada em informação elaborada ou fornecida pelo MUFG. O MUFG por meio desta se exonera de qualquer responsabilidade perante você envolvendo a caracterização ou identificação de termos, condições, questões legais, contábeis ou outras ou riscos que podem surgir em conexão com qualquer transação ou estratégia de negócios específica. O MUFG pode ter distribuído ou pode distribuir no futuro relatórios inconsistentes com ou que chegam a conclusões diferentes da informação aqui apresentada. Esses outros eventuais relatórios refletem diferentes hipóteses, visões e/ou métodos analíticos dos profissionais que os prepararam e o MUFG não tem obrigação de garantir que esses outros relatórios cheguem até você. O MUFG tem direito autoral sobre este relatório e nenhum trecho pode ser reproduzido ou redistribuído sem autorização por escrito. O MUFG expressamente proíbe a distribuição ou redistribuição deste relatório a terceiros via Internet ou outro meio. O MUFG, sua sede, agências, subsidiárias e afiliadas não aceitam qualquer obrigação perante terceiros resultantes de referida distribuição ou redistribuição.

O Mitsubishi UFJ Financial Group, Inc. é um dos maiores grupos financeiros do mundo. Sediado em Tóquio (Japão), e com mais de 360 anos de história, o MUFG é uma rede global com mais de 1.800 escritórios e está presente em mais de 50 países. O Grupo tem mais de 150.000 funcionários e oferece serviços de banco comercial, banco de investimento, trust, corretora, cartões de crédito, financiamento ao consumidor, gestão de ativos e leasing.

Banco MUFG Brasil S.A.

Av. Paulista, 1.274

São Paulo - SP - Brasil

Ouvidoria DDG: 0800 770 4060

Email: ouvidoria@br.mufg.jp

© 2018 Banco MUFG Brasil S.A. Todos os direitos reservados.

O nome e o logotipo MUFG são marcas de serviço do Mitsubishi UFJ Financial Group, Inc., e são usadas pelo Banco MUFG Brasil S.A. com permissão.