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CNI
Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

BRAZILIAN ECONOMY 2022-2023

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EXPECTATION OF LOWER GROWTH DUE TO CHALLENGES FOR 2023

High-interest rates will further penalize economic activities in 2023

By the end of 2022, the Brazilian GDP will grow more than CNI previously forecast at the end of 2021. According to the Brazilian Economy 2021-2022 Report, the growth rate forecast for the Brazilian GDP was 1.2%. However, by the end of 2022, it is expected to surpass this estimate with a much higher increase of 3.1%.

It's noteworthy to mention that the growth of the industry should decline compared to the GDP growth rate in 2022 The industry is expected to grow by 1.8% in 2022, driven by the construction industry, with a 7% growth, and by electricity and gas, water, and sewage, with a 7.9% growth. On the other hand, the manufacturing sector should face challenges such as a sharp rise in costs due to the pandemic and high-interest rates, resulting in a modest growth of only 0.1% by the end of 2022.

The services sector was instrumental in driving the Brazilian economy to exceed expectations in terms of growth. Throughout the year, the sector saw consistent improvement due to the rise in mobility, the recovery of consumer purchasing power, and the progress made in digitalizing the economy.

The increase in economic activity in the services sector has led to job market growth, increasing employment levels within and across all economic industries in 2022. Additionally, this trend has coupled with a rise in average income in 2022, something that did not occur in the previous year.

Furthermore, significant fiscal stimuli sustained consumer spending throughout the year. In the first half of the year, the early release of the Christmas bonus for INSS retirees and pensioners, the withdrawal of FGTS funds, and the resumption of the payment of the salary bonus supported consumer spending. In the second half of the year, the increased amount of the "Auxílio Brasil" relief program and other transfers, such as the aid to truck drivers and taxi drivers, will be the driving force behind consumer spending.

Since May 2022, inflation began to slow down significantly and also played a role in restoring consumer purchasing power and driving consumer spending.

However, for 2023, the challenge of continued high inflation and real interest rates remains. CNI anticipates that the growth rate of the services sector and the industry will slow down, despite the expectation of strong growth in the agricultural sector.

CNI estimates a 1.6% increase in the overall GDP and a 0.8% increase in the industry's GDP for 2023. The increases are due to the ongoing recovery of consumer income and the growth of the construction industry.

The factors that fueled GDP growth in 2022 will have a more moderated impact in 2023, such as a stable labor market and a continued improvement in consumer purchasing power. **However, the challenges will be more pronounced**, particularly concerning the high real interest rates. As a new development, there is the anticipation of stronger fiscal stimulus, but at the same time, lower growth in the global economy.

CNI anticipates that the growth in employment will continue throughout 2023, as the expected performance of the services sector, including the revival of trade, is to maintain the employment trend, albeit at a slower pace compared to 2022.

The expectation of robust growth in government expenditures also contributes to the 2023 growth prospects. However, there is a lingering

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fiscal uncertainty surrounding the extent of the expansion of the federal government's primary spending and how this growth will be allocated to the budget.

On the other hand, this fiscal expansion will result in a significant increase in public debt. As measured by the Gross Debt to GDP ratio, public debt is expected to rise again due to the substantial increase in government spending and a corresponding increase in interest expenses. **Moreover, the fiscal situation may also cause high volatility in the exchange rate and add pressure on the depreciation of the Brazilian real relative to foreign currencies, undermining the management of inflation.**

The expansionary fiscal policy aimed at boosting demand and the depreciating exchange rate is adding pressure on the cost of imported goods and will likely keep inflation as a key point of concern in 2023. **Inflation should decelerate only moderately in 2023 and end the year at 5.4%, above the inflation target of 3.25%.**

The slower deceleration of inflation should delay and reduce the pace of decrease in the basic interest rate, the Selic rate. The Selic rate should remain unchanged until September 2023, after which it may start a moderate decline, but still end the year with a value above two digits.

Finally, the external scenario also brings some concerns. Inflation will remain high worldwide in 2023, resulting in global economic activity and trade slowdown. It is noteworthy that the next year presents itself as a period of difficulties for Brazil's most important manufacturers' consumers in the international market, with monetary tightening in the US and Europe and an unfavorable macroeconomic environment in Argentina.

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1 ECONOMIC ACTIVITY

High-interest rates result in a decrease in the rate of economic activity in 2023

The main driver of growth in 2022, the service sector, should grow at a slower pace in 2023

The service sector was the main driver of Brazilian economic growth in 2022. The growth of the services sector, which is labor-intensive and represents more than two-thirds of the total GDP, was key in driving the job market and boosting the recovery of the wage bill, affecting the sector's demand.

However, part of the services sector's growth is due to the normalization of mobility after pandemic restrictions. Another part concerns the increased digital resource usage, a trend accelerated by the pandemic. The peak of both processes has passed, so they should not provide further stimulation of the same magnitude.

The industry faced two significant challenges in 2022: the first relates to high production costs and the second to high-interest rates.

Production costs have slowed down recently, mirroring the trend of international commodity prices. After hitting their peak in mid-April, these costs decreased in the latter half of the year. However, despite this slowdown, production costs remain at a substantially higher plateau than pre-pandemic ones, indicating ongoing pressure.

The second challenge was the high-interest rates. In retail, where income-sensitive activities are distinct from those more reliant on credit, a clear disparity in performance is evident. The income-sensitive retail activities showed more consistent growth and less severe downturns throughout the year, while the credit-sensitive activities performed poorly. The impact of high-interest rates was felt throughout 2022, particularly in the more credit-sensitive sectors of the retail industry.

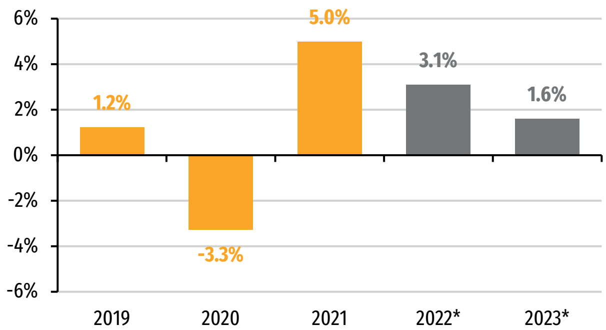
According to CNI, the GDP is projected to grow by 3.1% in 2022 with significant expansion in services and should face difficulties in the industrial sector. The Industrial GDP should increase by 1.8% due to the growth in construction and industrial services. The manufacturing industry should remain stable with a GDP variation of 0.1%.

For 2023, CNI anticipates a slowdown in the growth rate of the service and industrial sectors, but a significant increase in the agricultural sector.

The main drivers behind the reduction in growth rate will be the maintenance of strict monetary policy, resulting in double-digit interest rates throughout 2023, and ongoing high inflation. Adding to these challenges is the expectation of slower global growth[1].

GDP growth should be 1.6%, and industry GDP growth should be 0.8% in 2023.

Chart 1 - Projected growth rate of GDP in 2023
Total GDP and CNI projections
Annual growth rate



Source: CNT/IBGE
Preparation and forecasting*: CNI

[1] See External sector section.

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Despite the pressure of high costs and double-digit interest rates, the industry recorded production growth in 2022

Industrial production grew throughout 2022 despite challenges faced by the sector. CNI projects a 1.8% growth in total industry GDP for 2022.

The industry faced significant production obstacles in 2022 due to the lack and/or high cost of inputs and raw materials.

In the first quarter, the Russia-Ukraine conflict exacerbated this problem, which had already hindered the industry in 2021 and was on a path of relative improvement. In the second quarter of 2022, CNI's Industrial Survey data showed that the lack and/or high cost of raw materials totaled eight consecutive quarters as the industry's main challenge, mentioned by over half of industrial entrepreneurs.

However, this obstacle regarding inputs affected a smaller portion of the industry in the third quarter of 2022. The issue was reported by 38.1% of firms, which is a drop of 14.4% compared to Q2 of 2022, indicating an improvement in the situation.

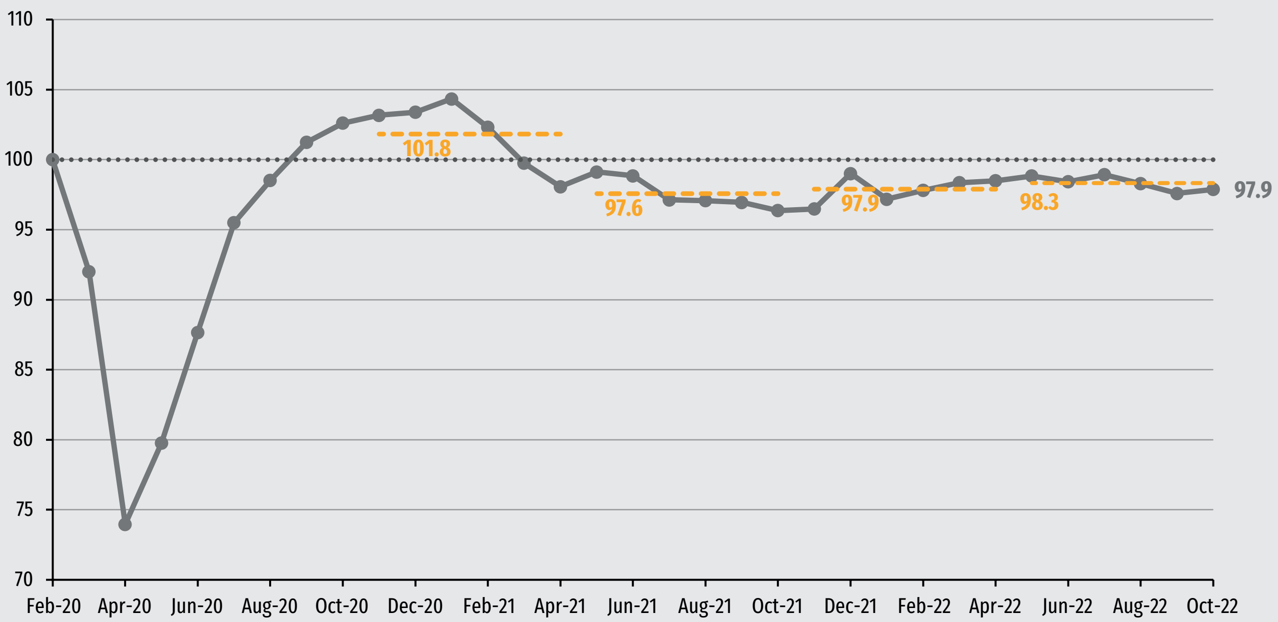
Nevertheless, it's important to note three challenges regarding the industrial sector's performance. First, the lack or high cost of inputs and raw materials remains a major challenge for the industry. Second, the standardization process varies among industrial sectors. And third, the adjustment of producer prices—in those sectors where it is evident—is happening at a higher level than before the pandemic.

In addition to cost-related obstacles, the industry was hit by double-digit interest rates throughout much of 2022, which hindered the establishment of new businesses and stifled growth in existing ones, ultimately impacting the overall economic dynamism.

Chart 2 - While some production barriers remain, physical production shows improvement throughout 2022

Industrial physical production index, with six-month moving averages

Index number (base: February 2020=100), without seasonal effect



Source: Monthly Industrial Survey (PIM/IBGE)

Prepared by: CNI

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Given these challenges, when comparing the physical production from January to October 2022 to the same period in 2021, there was a 0.8% decrease. This was due to the industry's strong performance at the start of 2021.

Nevertheless, the industry showed moderate growth throughout 2022. Industrial production grew by 0.4% in the six months from May to October 2022, compared to the previous six months (November 2021 to April 2022), in the series without seasonal effects. In summary, industrial physical production has improved in 2022 despite the challenges of increased costs and high-interest rates.

Amidst these obstacles, CNI anticipates that the manufacturing industry's GDP will end the year with a growth of 0.1%.

Construction industry reports a second year of robust growth

The growth of the industrial GDP in 2022 is fueled by the construction sector. A sector that has recorded its second year of robust growth, driven by factors such as low-interest rates in 2021, which led to a backlog of projects in 2022, and the expansion of the Green and Yellow House financing program.

The construction industry started 2022 with predictions of slowing down, following its 9.7% GDP growth in 2021. However, these expectations were adjusted upwards as the year progressed, due to the added boost from the expansion of the Green and Yellow House financing program. Steady demand and decelerating inflation also played a role in the sector's strong performance. The CNI forecasts that the construction industry will conclude 2022 with a growth rate of 7.0%.

The service sector should remain at high levels in 2023

The service sector was the main driver of Brazilian economic growth in 2022. CNI projects that the services GDP will end in 2022 with a growth of 3.9%.

Throughout the year, the sector saw consistent improvement due to factors such as increased mobility, the recovery of consumer purchasing power, and the progress made in digitalizing the services.

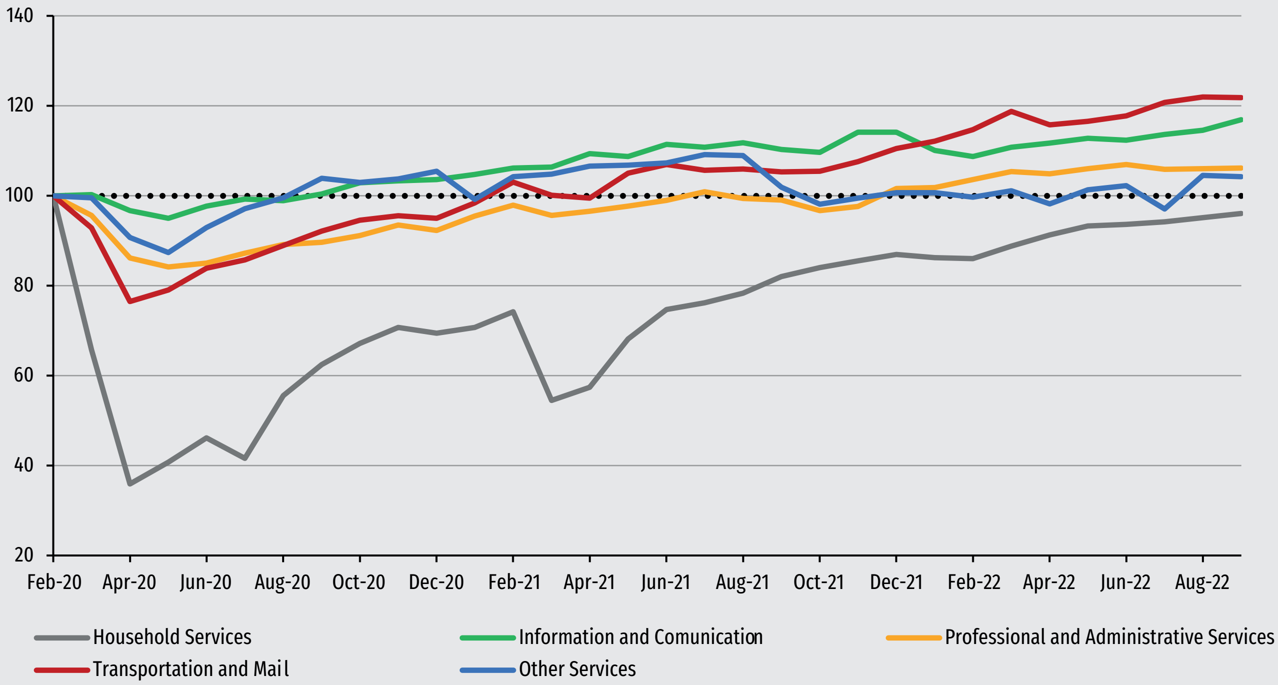
The rise in mobility resulted in increased transportation services, particularly in air travel. The heated-up activity in air transportation also indicates the revival of consumers' purchasing power, which has been facilitated by the recovery of employment and income, as well as the slowing of inflation.

This improvement in the labor market also accounts for the growth in household services in 2022, which, although advancing, are still making up for the losses incurred during the pandemic.

The service sector has also been fueled by the growing utilization of digital resources, a trend accelerated by the pandemic and tied to the progress in information technology services.

All service categories have surpassed their pre-pandemic levels, except for household services.

Chart 3 - All service categories have surpassed their pre-pandemic levels, except for household services
Service Provision Volume Index
Index number (base: February 2020=100), without seasonal effect



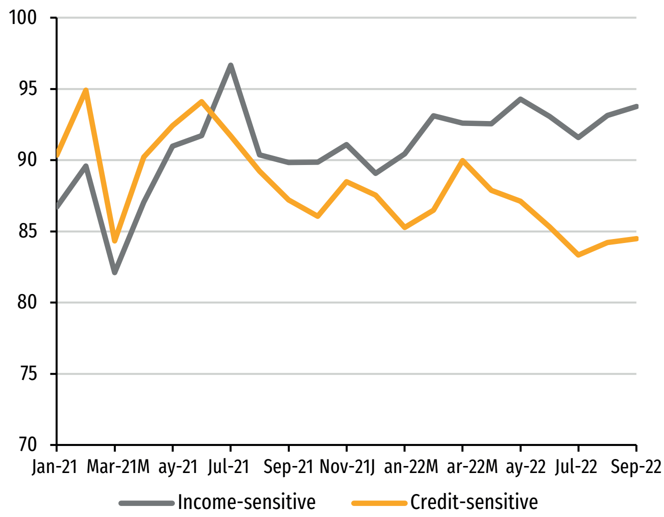
Source: Monthly Commerce Survey (PMC/IBGE)
Prepared by: CNI

The last quarter of the year, a critical period for retail, saw an improvement in income

In 2022, the retail industry was impacted by two opposing forces. While the recovery of purchasing power boosted retail sales, segments more reliant on credit suffered due to high-interest rates.

Overall, retail segments directly tied to income fluctuations, such as supermarkets, fuel, and wearing apparel, experienced significant increases or smaller decreases. In contrast, retail segments heavily dependent on credit financing, such as furniture, appliances, electronics, and automobiles, saw sharp decreases or limited growth.

Chart 4 - Difference in the performance of income-sensitive and credit-sensitive retail segments in 2022
Expanded retail sales volume based (on income and credit sensitivity)
Index number (2014 = 100), without seasonal effect



Source: PMC/IBGE
Prepared by: CNI

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The agricultural sector's GDP in 2022 was negatively impacted by crop failures and rising production costs

CNI predicts a 1.2% decrease in the agricultural sector's GDP for 2022.

The agricultural sector was affected by weather-related issues in 2021, leading to the reduced performance of crops, including soybeans. Despite this, the 2022 national cereal, legume, and oilseed crops are projected to reach a record 262.8 million tons, according to the Systematic Survey of Agricultural Production (LSPA/IBGE).

The decrease in the agricultural sector's GDP is also attributed to elevated production costs, reducing the sector's value-added in 2022, though this should stabilize in 2023.

Consumer market, investments, trade flows, and government spending

From the demand side, household consumption remains the main driver of GDP in the Brazilian economy, outpacing investment and the external sector. CNI projects a 4.0% increase in household consumption in 2022.

Household consumption should rise in the fourth quarter of this year due to the recovery of purchasing power throughout 2022. It's worth noting that this quarter is the most critical for commerce and that sales should mainly increase in lower-value, income-sensitive commercial segments.

In the fourth quarter of 2022, investments (Gross Fixed Capital Formation) should show a slight increase. Despite investments in infrastructure and a strong performance by the construction industry, high-interest rates have dampened investment prospects. As a result, investment growth is projected to only reach 1.0% in 2022, despite strong growth in 2021.

Finally, the external sector should make a positive, albeit small, contribution to GDP, based on its performance up until October. Exports and imports experienced significant growth in value in 2022, with imports showing an even stronger pace of growth, as outlined in the External Sector[2] section. However, prices were the most significant factor behind these figures, while quantity is what truly impacts GDP. There was moderate growth in both imports and exports in terms of quantity, with export volume growth expected to be higher, thus contributing positively to GDP.

[2] See External sector section.

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Outlook for 2023: The challenges that hindered more substantial progress in industrial production in 2022 are expected to continue in 2023

CNI forecasts a 0.8% growth in the industry's GDP for 2023, driven by the sustained recovery of consumer income, progress in infrastructure investments, and the continued growth of the construction industry. In summary, the factors that fueled GDP growth in 2022 will have a more moderated impact in 2023—such as a stable labor market and a continued improvement in consumer purchasing power—while the challenges will be more pronounced, particularly concerning high real interest rates. As a new development, there is the anticipation of stronger fiscal stimulus, but at the same time, lower growth in the international market.

CNI predicts that the sustained growth of the real wage bill will be the primary driver of growth in 2023. In addition to the continued growth of the service sector, the rise in the real wage bill will also benefit from a slight slowdown in inflation in 2023.

The second most influential factor for expected GDP growth is the substantial increase in public spending, particularly from the federal government, anticipated for 2023 as a result of the approval of the Transition PEC, which will add BRL 175 billion in spending to what is already outlined in the Draft Annual Budget Law (PLOA) for 2023.

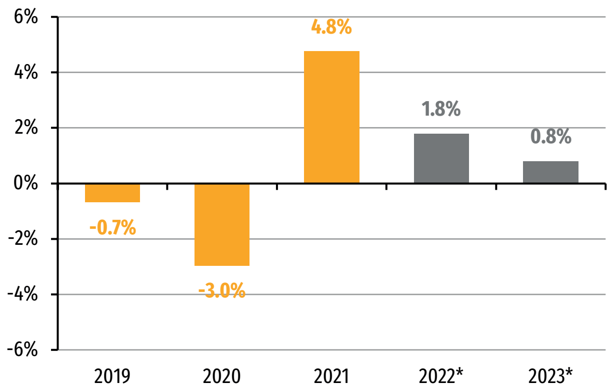
These two factors should offset the negative effects of high-interest rates and drive growth in household consumption and demand for industrial goods. Under this scenario, the manufacturing industry's GDP growth should be 0.3%.

The construction industry should maintain its growth trajectory in 2023, following two consecutive years of significant increases in 2021 and 2022. The long production cycle of the sector means that many construction projects initiated in recent years will continue to drive growth in early 2023.

The biggest obstacle to further growth should be high-interest rates. While the sector has specific financing criteria, the high-interest rate environment will inevitably slow down construction activity, leading to fewer new projects and a slowdown in the recent growth trend.

Despite this, the growth forecast for the construction industry in 2023 is 2.0%, a substantial increase even after two years of strong growth.

Chart 5 - Lower industrial growth rate is expected in 2023
Total GDP and CNI projections
Annual growth rate



Source: CNT/IBGE
Preparation and forecasting*: CNI

The service sector should slow down in 2023

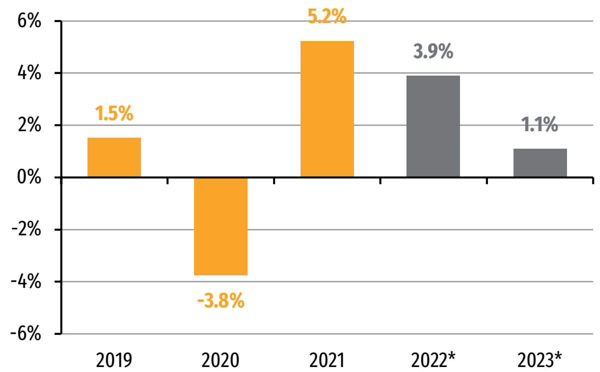
The service sector should maintain its high level of activity in 2023 but with a slower pace of growth. CNI projects a 1.1% growth in the services GDP.

While the same rate of growth seen in 2022 is not expected, the trend towards increased use of digital resources is expected to continue. A concentrated increase is expected in household services in 2023, as this segment has not yet fully recovered to its pre-pandemic level and therefore has more room for growth. The sustained rise in purchasing power, driven by the continued recovery of the wage bill, should support this increase in service consumption.

As for retail, the expectation is that divergences in the performance of income and credit-sensitive activities will intensify in 2023, given the prospect of income growth, income transfer policies, and continued high-interest rates.

Advances are expected for retail segments that respond directly to income variations, while for retail segments that depend heavily on credit, difficulties are expected to continue throughout 2023.

Chart 6 - Projected slowdown in growth in the services sector by 2023
Services GDP
Annual growth rate



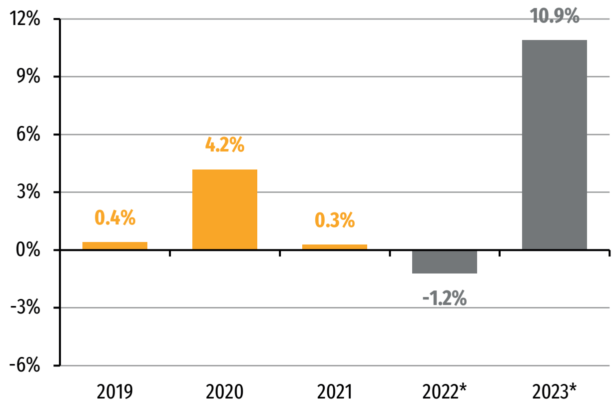
Source: CNT/IBGE
Preparation and forecasting*: CNI

The Agricultural sector should have a positive performance in 2023, driven by consistent crop production

The Agricultural GDP should grow by 10.9%, given a scenario of stable climate conditions. This robust expansion is due to the expectations of a significant increase in production in 2023, especially after a year of crop failure, and to the rise in productivity, that is, to the expansion of production being much higher than the increase in planted area.

According to the Brazilian Crop Monitoring Program of the National Supply Company (Conab), a record harvest of 313 million tons is expected for 2022/2023, 15.5% higher than the 2021/2022 harvest. Notable among the expectations are the growth in soy and corn production, which should grow 22.3% and 12.0%, respectively, with an increase of 4.2% and 3.4% in planted areas and an estimated crop of 154 million tons of soy and 126 million tons of corn.

Chart 7 - Expected growth in the agricultural and livestock production industry in 2023
Agricultural GDP
Annual growth rate



Source: CNT/IBGE
Preparation and forecasting*: CNI

Consumers are expected to have increased purchasing power but will face the challenges of high-interest rates and a weak global economy

Household consumption should experience a decrease in the early months of 2023, and it should experience a recovery in the second half of the year in line with the expected improvement in the labor market. It should be noted that the high levels of debt and defaults impact a significant portion of income, hindering growth in household consumption. As a result, household consumption is projected to have low growth in 2023 (1.1%), limited by the continued high level of the Selic interest rate.

Investment, measured as gross fixed capital formation, should have a modest performance in 2023, with growth at 0.8%, a slower pace compared to 2022. While the construction industry will provide a boost, it should be less robust than in the previous two years. This weakening trend in the construction industry is due to the current investment cycle that started in 2021, which has shown signs of slowing down in the latter part of 2022. One of the major contributors to this modest performance is the high-interest rate, which should continue in 2023. In addition to construction, investments should benefit from recent infrastructure concessions and the demand for machinery and equipment from the agricultural industry.

The external contribution to GDP, in turn, should once again be slightly positive in 2023. Exports are expected to see gains, particularly from the growth in export volumes of food and commodities, despite being impacted by the unpredictable global environment. Meanwhile, imports are projected to have a moderate increase as the slowing down of economic activity tends to curb imports of consumer goods, inputs, and capital goods.

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2 EMPLOYMENT AND INCOME

The improvement in the labor market should be slower in 2023

Growth in employment and real income was a notable feature of 2022

The labor market showed strong performance in 2022. There were steady increases in employment numbers and real wages during the first three quarters of the year.

The upward trend in employment should continue in the fourth quarter of 2022, with a projected growth of 0.8% compared to the previous quarter, according to the CNI. The labor market should show a 4.5% increase in employment in the fourth quarter of 2022 compared to the same quarter in 2021, leading to a projected unemployment rate of 8.4% at the end of 2022.

Real income mass saw a 4.8% growth in the first three quarters of 2022 compared to the same period in 2021. CNI predicts that the positive trend in real income growth will continue into the fourth quarter of 2022, resulting in an overall increase of 6.4% compared to 2021.

However, the labor market's performance should slow down in 2023 compared to its performance in 2022. According to CNI, the employment growth should slow down in the first half of 2023 and continue at a more modest pace in the latter half of the year compared to 2022. As a result, a 3.1% increase in employment is expected by the end of 2023 compared to the end of 2022.

The unemployment rate is projected to remain relatively steady during 2023. CNI projects an average unemployment rate of 8.9% and a decline to 8.6%, in the fourth quarter, by the end of 2023.

The low unemployment rate should drive real income growth in 2023, as workers will have more opportunities to seek higher-paying jobs.

As a result, the CNI projects a 3.7% increase in the real income mass in 2023 compared to the previous year, due to the anticipated increase in both the real average income and employment.

The employment rate should increase by 4.5% by the end of 2022

The labor market showed significant progress in 2022.

According to data from the Continuous National Household Sample Survey (PNADC) conducted by the IBGE, there was a creation of 6.3 million jobs between the third quarter of 2021 and the same quarter of 2022 regarding employment. This indicates an increase of 6.8%.

CNI forecasts a decrease in the rate of job creation in the last quarter of 2022, leading to an estimated growth of 4.5% in employment when compared to the fourth quarter of 2021, or a total of 4.4 million new jobs.

The increase in employment in 2022 was seen across various sectors. The services sector saw the strongest performance, with a growth of 5.2% in the first three quarters of the year. The services sector employs the largest number of people and its growth stimulates the labor market, leading to an increase in real income. The second-best performing segment was the industry, with a growth of 2.2% up to Q3.

This resulted in an unemployment rate of 8.7% in Q3 2022, reflecting the increase in employment. This is the lowest rate since the second quarter of 2015. It is also noteworthy that the unemployment rate decreased by 2.4 percentage points (pp) between Q1 and Q3 of 2022.

The informality rate declined as the unemployment rate dropped from 40.1% in Q1 to 39.4% in Q3 2022. This was due to stronger growth in the formal segment of the labor market[3], as the number of informal workers also increased. The creation of formal employment was positive every month, resulting in a 5.3% increase by September 2022, as reported by the Ministry of Labor's General Cadastre for Employed and Unemployed (Caged).

The decline in the informality rate was observed across all sectors, similar to the growth in employment.

The labor market in 2022 marked a recovery in real income

A notable positive aspect of the labor market is the growth in real average income. In 2022, the real average income began to make up for the losses caused by the pandemic in 2020. This was achieved through the relative increase in higher-paying jobs, wage adjustments, and the control of inflation starting in Q2 of 2022. Moreover, Caged data shows that the proportion of formal employees quitting their jobs on request has risen among total resignations, indicating that workers are moving to higher-paying, more desirable occupations.

The real average income saw a growth of 6.3% up to Q3 of 2022. The largest increase took place in Q3, when the real average income rose by 3.7% compared to Q2 2022, reflecting the impact of reduced inflation. The improvement in real average income was evident across all sectors and among both employees and employers. In Q3, this trend enabled the overall real wage bill to regain the losses sustained from 2020 to 2021.

The growth in employment and real average income led to a recovery of the overall real income. Between Q1 to Q3 of 2022, the overall real income increased by 4.9% compared to Q1 to Q3 of 2021.

CNI projects that the real wage bill will continue to expand in the fourth quarter of 2022, accumulating growth of 6.4% in 2022 compared to 2021.

[3] Includes employees in the private sector with a formal labor contract, employees in the public sector, employers, and self-employed individuals with a National Registry of Legal Entities (CNPJ).

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Outlook for 2023: Employment and income are expected to continue growing but at a slower pace

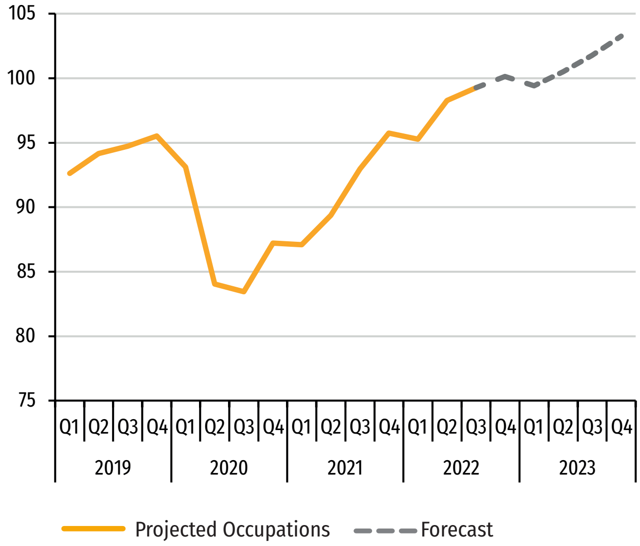
CNI predicts that the employment growth will continue until 2023. This is due to the expected performance of the services sector, including the recovery of trade, which should drive employment growth, albeit at a slower rate than in 2022, in line with the overall slowdown in the economy[4].

CNI projects employment to be relatively stable in the first semester of 2023 and to increase in the second semester of 2023. As a result, a 3.1% increase in employment is expected by the end of 2023 compared to the end of 2022.

The unemployment rate should remain low and stable throughout 2023 due to the anticipated slowdown of the economy. The projected average unemployment rate for 2023 is 8.9%, and it is estimated to reach 8.6% by the end of the year, in the fourth quarter.

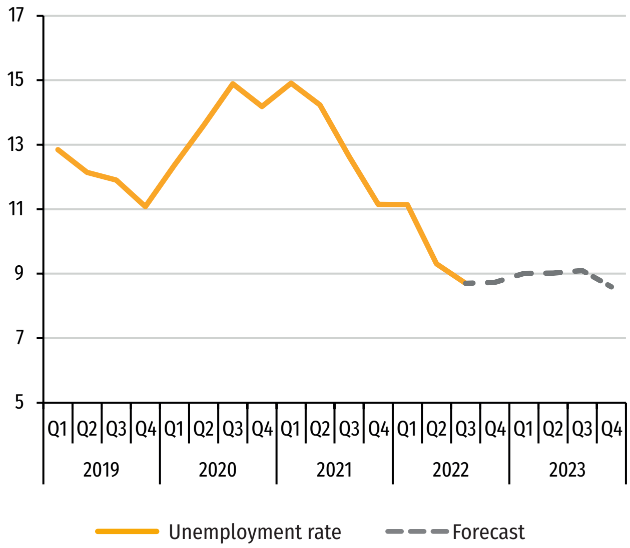
In 2022, the increase in real average income and the improvement of inflation dynamics[5] boosted real income. However, these factors are expected to be weaker in CNI's 2023 projections.

Chart 8 - The number of occupations should improve in the second half of 2023
Employment
Millions of people, per quarter



Source: PNADC – IBGE.
Preparation and forecasting: CNI.

Chart 9 - The unemployment rate will be relatively stable in 2023
Unemployment rate
In percent (%), per quarter



Source: PNADC – IBGE.
Preparation and forecasting: CNI.

[4] See Outlook for 2023 in the Activity section
[5] See the Inflation, Interest Rates, and Credit section

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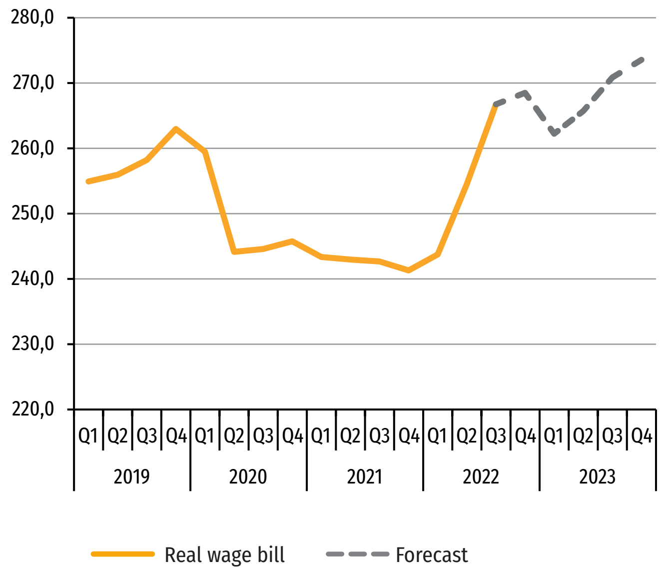
As in 2022, the stimulus for the expansion of the wage bill will also come from the services sector, enabling the growth of both occupations and income. But CNI's expectation is for a more moderate advance of the service sector in 2023[6].

Likewise, the stabilization of inflation at a high level throughout 2023 will not significantly contribute to real income gains.

The low unemployment and informality rates should support the widespread growth in real average income across sectors. Due to these reasons, the employment growth should contribute to the rise in the real income mass, though this growth will be less intense than the one seen in 2022.

CNI predicts a 3.7% increase in the real wage bill in 2023, with slower growth in the first half and a more consistent expansion in the second half.

Chart 10 - Real wage bill should grow 3.7% in 2023
Real Wage Bill
In billions of reais (BRL), per quarter



Source: PNADC – IBGE.
Preparation and forecasting: CNI.

[6] See Activity section

3 INFLATION, INTEREST RATES, AND CREDIT

Basic interest rates should remain high and end 2023 at 11.75% per annum

Despite high-interest rates, inflation is still forecast to be above the target in 2023

Inflation—as measured by the Broad National Consumer Price Index (IPCA)—is projected to end 2022 at 5.7%, higher than the 3.5% target set by the Brazilian Central Bank (BCB) for the year. For 2023, inflation should slow down moderately, ending the year at 5.4%, still above the inflation target of 3.25%.

The moderate deceleration of inflation is mainly due to the expected effects of the expansionary fiscal policy on demand in 2023. This slower pace of inflation reduction, in turn, should delay and reduce the intensity of the basic interest rate cycle, the Selic rate.

Based on this scenario, CNI anticipates that the Selic rate will remain at 13.75% per annum until September 2023 when it will start to be reduced, ending 2023 at 11.75% per annum.

With the Selic rate remaining at a higher level for longer and the lower growth forecast for economic activity, the credit market should slow down in 2023. This will follow the strong growth in 2022 when credit concessions should increase by 22.6% in nominal terms (12.3% in real terms, after adjusting for inflation). For 2023, the projection for credit concessions is a nominal growth of 6.7% (1.9% in real terms).

The IPCA index should end 2023 at 5.4%

Inflation, as measured by the IPCA, was 6.5% for the 12 months ending October 2022, which demonstrates a substantial slowdown compared to the peak of 12.1% in April 2022. The main cause of this deceleration was tax exemptions on electricity, fuel, and telephony, which significantly impacted the "Administered Products" group, resulting in a negative price variation from July to September.

Additionally, the partial normalization of global supply chains also contributed to stabilizing commodity prices and a slowdown in producer prices.

The current and expected price behavior of the four groups that make up the IPCA for 2023 are: Industrial, Managed, Food, and Services. However, it is noteworthy that the expansionary fiscal policy trend in 2023 may pose a challenge to curb inflation due to its effect on demand and subsequent pressure on prices.

The Industrial group's prices reached a high of 10.7% in the 12 months ending October 2022. Since May, these prices have been decelerating and are expected to continue this trend at the end of 2022 and throughout 2023. This is largely due to the lagged effects of the Selic rate on the demand for consumer durables, the progressive normalization of global supply chains, and the deceleration of the Broad Producer Price Index (IPA).

The IPA, which typically predicts the behavior of prices in the Industrial group, dropped from 20.6% in the 12 months ending December 2021 to 5.2% in the 12 months ending October 2022. The high Selic rate and the moderate deceleration of prices of imported products should contribute to the continued slowdown of the IPA as a whole.

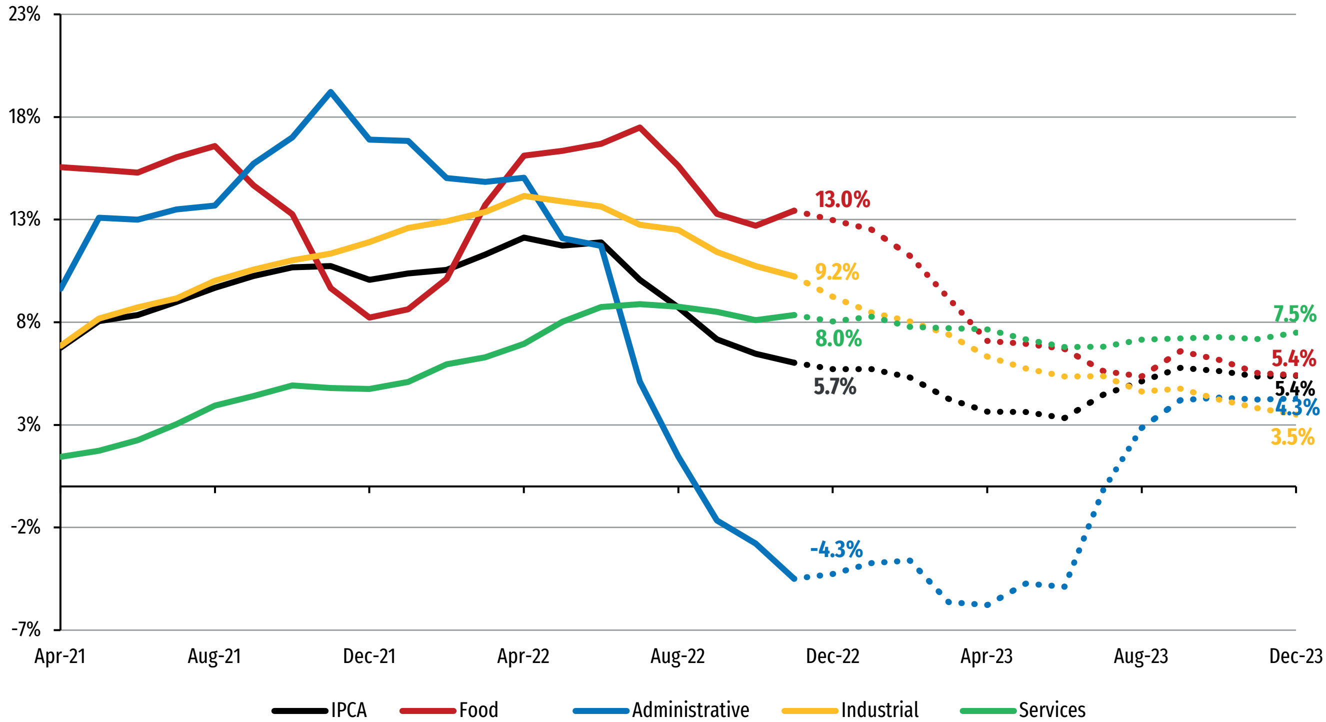
The prices of the Managed group—which were mainly responsible for the inflation downturn in 2022—decreased by 2.8% cumulatively over the 12 months ending in October. This group should continue to play a role in the containment of inflation until the end of 2022 and the beginning of the second half of 2023, when the impact of the tax breaks on the interannual variation of the IPCA ends. Starting in August 2023, the inflationary effects of increases in 2022 that imply readjustments in 2023 should become predominant in the Administered group and result in a positive variation in prices between August and December 2023.

The Food group's prices have accumulated a 12.7% increase over the past 12 months until October 2022, and a small acceleration in the pace of price increases in this group is expected until the end of 2022. However, the prices of this group should decelerate during the first half of 2023 due to the stabilization of agricultural commodity prices (in Reais) at high levels and the forecast of a record grain harvest in Brazil, according to data from the National Supply Company (Conab) for the 2022/23 harvest. This expectation of decelerating food prices should hold even in the presence of the projected impact of the fiscal expansion on food demand in 2023.

Prices in the Services group have accumulated an 8.1% increase over the last 12 months ending in October 2022, thus maintaining the pace of increase towards the end of 2022 and throughout 2023, due to the favorable labor market conditions in 2023 and the expansionary fiscal policy in 2023. The outlook is that the prices of this group will end December in 2023 with a 7.5% increase.

Taking into account the behavior of the four groups that make up the IPCA, inflation is estimated to be 5.7% in 2022, above the 3.5% inflation target for the year. For 2023, the estimate is 5.4%, also above the 3.25% target.

Chart 11 - Inflation should decelerate only moderately over 2023
Inflation rate by IPCA groups
Cumulative over 12 months, in %



Source: IBGE
Preparation and forecasting: CNI

The Central Bank should lower the Selic rate in the middle of 2023's second half

The latest increase in the Selic rate, to 13.75% p.a., was made by the Monetary Policy Committee (Copom) of the BCB in August 2022. This rate should remain at this level until the end of 2022—and for most of 2023—to align inflation expectations for 2024 with the 3.0% target. However, the 3.25% inflation target for 2023 is unlikely to be achieved.

Several factors are contributing to the maintenance of the Selic rate at 13.75% p.a. until September 2023.

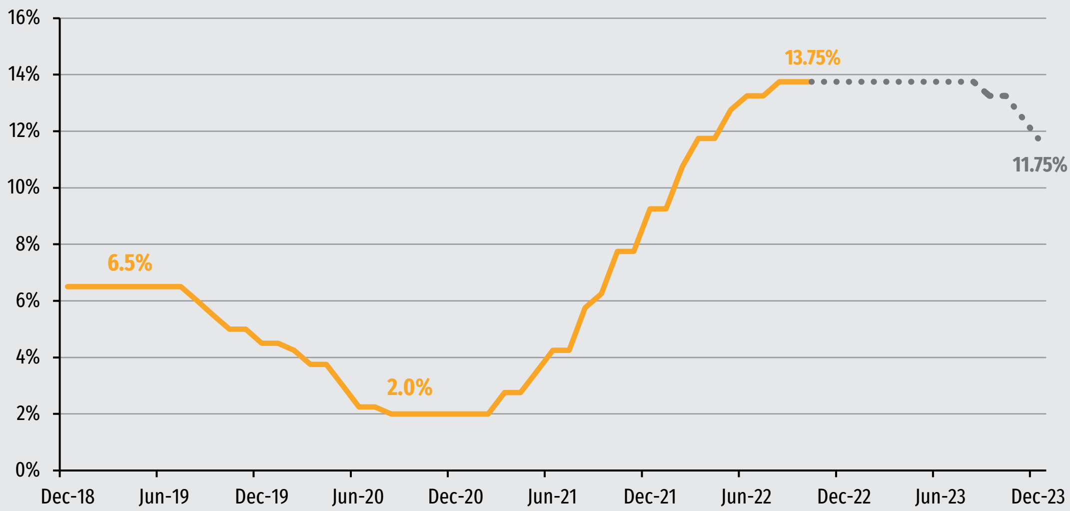
First, the tax breaks, although effective in reducing inflation, have a temporary effect on price evolution, which is a significant factor in explaining the limited deceleration of inflation from 2022 to 2023.

Second, the expected fiscal expansion in 2023, while stimulating demand, could positively impact prices and influence the conduct of monetary policy.

Third, several core inflation[7] measures and the diffusion index[8] remain at higher levels compared to the low-inflation period between 2017 and 2019, despite recent declines. This suggests some resilience in inflation, which could limit further deceleration in the coming year.

Due to the stability of the Selic rate until September 2023, the *ex-ante* real interest rate, calculated as the difference between the Selic rate and the inflation forecast for the next 12 months, should continue to dampen economic activity. This is because it will remain above the neutral interest rate, which neither stimulates nor discourages economic activity, throughout the year. The ex-ante real interest rate surpassed the neutral interest rate in December 2021 and was 8.1% p.a. in November 2022.

Chart 12 - Strongly contractionary monetary policy throughout 2023
Base rate (Selic)
% p.a.



Source: Brazilian Central Bank
Preparation and forecasting: CNI

[7]Inflation indices not taking into account the most volatile components in the IPCA.
[8] Index to measure the proportion of IPCA items with positive adjustment.

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Based on this and the CNI's 2023 fiscal picture projection, the BCB should keep the Selic rate at 13.75% p.a. until mid-September 2023 before starting a cycle of cuts — given the likely convergence of inflation expectations in 2024 and 2025 to their respective targets — aiming at an end-of-year Selic rate of 11.75% p.a. The ex-ante real interest rate should end 2023 at 8.0% p.a.

Finally, it is worth noting that a more expansionary fiscal policy than the 2023 forecast could potentially delay the start of the Selic rate's downward cycle.

Credit growth should slow in 2023 after strong growth in 2022

Total loans to businesses and consumers grew 22.9% from January to October 2022 compared to the same period in 2021. In real terms, that is, disregarding the effects of inflation, concessions grew by 11.9%. This robust credit growth was a key factor in the 2022 economic growth.

Credit to companies grew 23.8% until October 2022 compared to the same period in 2021. In real terms, this growth was 12.7%. This growth rate should decline by the end of 2022, mainly due to the Selic rate's impact on credit costs.

For 2023, credit concessions to companies should grow at a slower pace, largely due to the high-interest rates and the slowdown of economic activity reducing demand for credit.

Although the corporate default rate with financial institutions rose from 1.3% to 1.7% of the corporate loan portfolio balance in 2022, it remains a manageable risk for credit growth in 2023.

Thus, credit to businesses should grow by 22.9% in 2022 and 7.7% in 2023. In real terms, the growth should be 12.6% and 2.8%, respectively.

Three factors should contribute to a stronger deceleration in credit for consumers, high default rates, high levels of income commitment and debt, and slower growth of real wage bill.

The default rate of consumers with financial institutions is relatively high, increasing from 3.0% of the credit portfolio balance in December 2021 to 3.9% in October 2022, which may prompt financial institutions to raise interest rates or impose restrictions on credit concessions.

Household income commitment to interest payments and debt repayment is at a record high of 28.7% in September 2022. Similarly, the level of consumer debt relative to income is close to the highest plateau in history, 49.9% in September 2022.

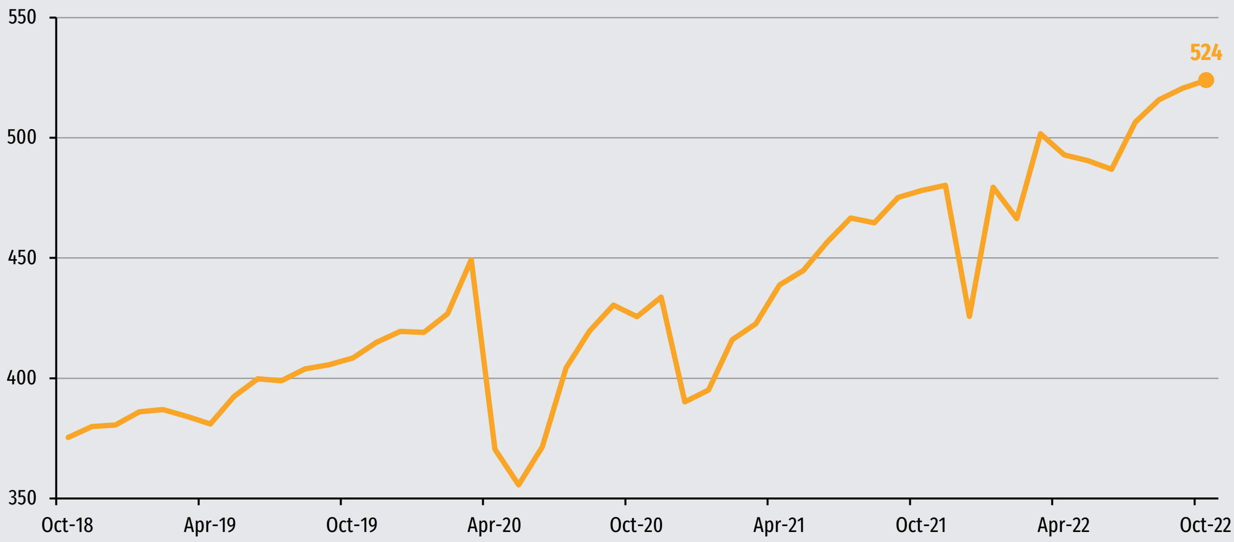
In addition, the expected slowdown in real wage bill growth in 2023 should also hamper consumer credit growth.

As a result, consumer credit should grow 21.8% in 2022 and 6.3% in 2023. In real terms, the growth should be 11.5% and 1.5%, respectively.

Additionally, it is worth noting that market interest rates for both companies and consumers have not risen as much as the Selic rate in this most recent cycle of rate increases, which began in February 2021. This becomes evident when compared to previous cycles, such as the one between April 2013 and April 2014, when market interest rates more closely followed the Selic's rate rise.

Based on this, CNI projects total credit to consumers and companies to grow 22.6% in 2022 and 6.7% in 2023. In real terms, the growth should be 12.3% and 1.9%, respectively.

Chart 13 - Strong credit growth in 2022 is unlikely to be repeated in 2023
Credit Concessions to Consumers and Enterprises - by type of resource (Free and Directed)
In BRL billions



Source: Brazilian Central Bank
Prepared by: CNI

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4 TAX POLICY

The high revenues and effective expenditure control resulted in a surplus for the federal government in 2022

The 2023 fiscal picture will change due to the implementation of an expansionary fiscal policy

The favorable fiscal picture in 2022 due to the significant growth in tax collection was influenced by the growth of economic activity, the recovery of the labor market, and non-standard collections from the exploitation of natural resources and privatizations. Effective control over the growth of federal spending, made possible by the Expenditure Ceiling, even with the adjustments made for larger income transfers in 2022, contributed to this outcome. As projected by CNI, the federal government should end 2022 with a primary surplus of BRL 75.1 billion (0.9% of GDP), the first since 2013.

However, the fiscal scenario for 2023 is uncertain. The elected government is working on a Proposed Amendment to the Constitution, the Transition PEC, to increase public spending on income transfers and other expenses outside the Expenditure Ceiling. The PEC would allow for an additional expansion of up to BRL 200 billion in the federal government's primary expenditures in 2023, above the Expenditure Ceiling.

The increase in federal government spending may have a short-term positive effect on GDP growth. The extent of the expansion—determined by the final version of the Transition PEC—may result in negative consequences for the Brazilian economy, such as inflation and devaluation of the Brazilian real. This could happen due to the pressure that the increase in aggregate demand would put on the price level and the market's perception of the sustainability of the Brazilian public debt. The rising price level will force the Central Bank to maintain higher interest rates longer, harming economic activity and long-term growth.

If the available budget for increased expenditures is exhausted, there will be a noticeable increase in the federal government's primary expenditures in real terms compared to 2022. However, a real drop in tax collection is expected in 2023 compared to 2022, due to the continued zero rate of PIS/Cofins and Cide on fuels, the reduction of exceptional revenues from the exploitation of natural resources, and the slower pace of economic growth. As a result, the federal government is projected to return to a primary deficit in 2023 (BRL 184.1 billion, equivalent to 2.1% of GDP).

The federal government's revenue surprised positively in 2022

Throughout 2022, the federal government's collection was positive in the three main revenue groups: those managed by the Federal Revenue of Brazil (RFB), INSS, and those not managed by the RFB.

By the end of 2022, the RFB-managed revenues, which represent direct tax collection, should show real growth of 7.7% compared to 2021, driven by economic growth. The reduction in some tax rates prevented an even greater growth in managed revenues, such as the zero rates of PIS/Cofins and Cide applied to gasoline, ethanol, compressed natural gas (CNG), diesel, aviation kerosene, and liquified petroleum gas (LPG), and a 35% reduction in IPI rates for several products.

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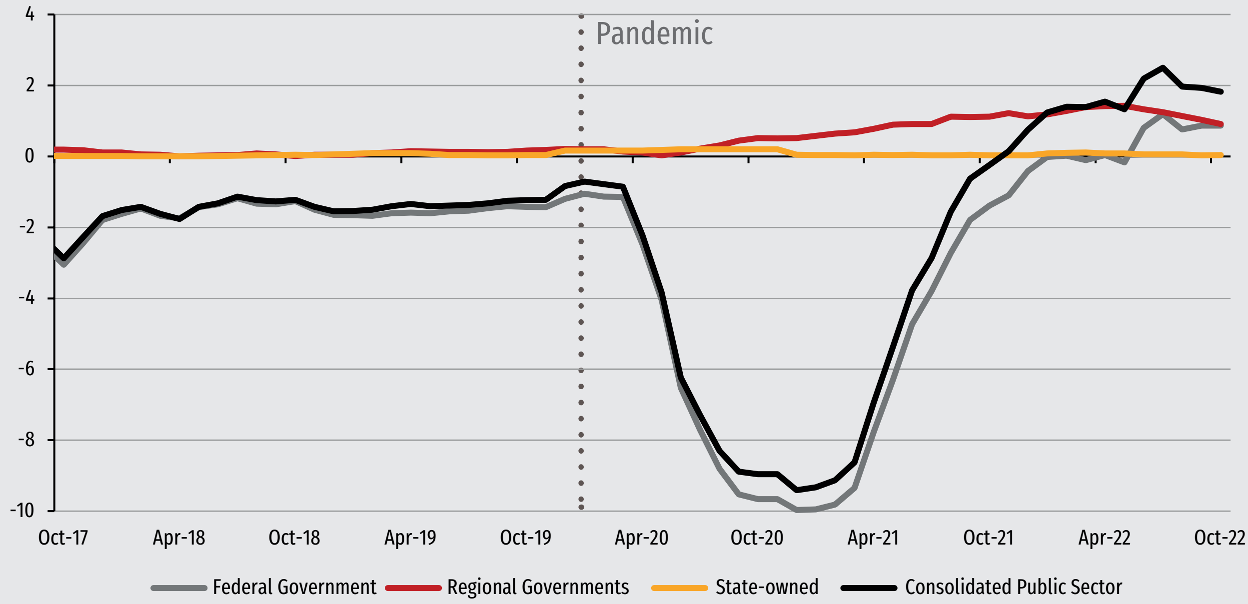
Chart 14 - The primary balance of all government levels showed a significant improvement in 2022

Primary balance by government level

Cumulative over 12 months (BRL billions)



Source: National Treasury Secretariat/Ministry of Economy

Prepared by: CNI

The INSS collection should end 2022 with real growth of 7.3%, reflecting the favorable labor market dynamics.

The revenues not managed by the Federal Revenue of Brazil (RFB) should show real growth of 31.4% in 2022, compared to 2021, due to the extraordinary collections from the exploitation of natural resources and the privatization of Eletrobrás. The federal government's net revenue should experience real growth of 9.3% in 2022 compared to 2021.

A real growth of 1.2% is expected in federal government expenditures in 2022 compared to 2021. Social security expenses are estimated to show real growth of 2.6% in 2022. Additionally, the growth in expenses in 2022 was also influenced by the resumption of the salary bonus payment and the increase in income transfer initiatives, such as Auxílio Brasil and Benefício de Prestação Continuada (BPC). It is noteworthy that the expenditure growth figure does not include the expenses related to the Campo de Marte[9], which were only recorded as primary expenditures for accounting purposes.

[9] Campo de Marte is a Brazilian airport located in the north of the City of São Paulo. The airport area was the subject of litigation in 1958 when the municipality filed a repossession action against the Federal Government. In exchange for the ownership of Campo de Marte, the federal government forgave the debt owed by the Municipality of São Paulo. For accounting purposes, the value of the Municipality of São Paulo's debt was recorded as primary expense for the federal government and primary revenue for the municipality.

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With the significant revenue expansion and controlled expenditure growth in 2022, the federal government should have its first primary surplus since 2013. The Brazilian National Industry Confederation (CNI) estimates that the federal government will end 2022 with a surplus of BRL 75.1 billion (0.9% of GDP), compared to the 2021 deficit of BRL 38.8 billion (0.41% of GDP).

The fiscal picture of the regional governments remains positive, even with the loss of ICMS collection

The fiscal picture of the regional governments (states and municipalities) has shown significant improvement in recent years and 2022 has been no different. In 2022, the growth rate in regional government revenues has more than offset the growth in spending by these entities. In this period, the expansion in economic activity and transfers from the federal government has impacted revenue growth. On the other hand, the increase in expenses is due to growth in personnel expenses, higher cost expenses, and increased investments. Between January and September 2022, regional governments accumulated a primary surplus of BRL 91.1 billion. This result already incorporates the BRL 24 billion in revenues related to Campo de Marte received by the municipality of São Paulo.

However, by the end of 2022, the impact of legislative changes that reduced the collection of ICMS[10] tax and increased expenses will be more acutely reflected in the primary balance of regional governments, resulting in a decrease in their surplus, which should reach BRL 63.0 billion (0.7% of GDP) in 2022. In 2021, the surplus was BRL 97.7 billion (1.1% of GDP).

The public sector will end 2022 with a primary surplus and debt reduction

The primary balance of the consolidated public sector, which encompasses the federal government, regional governments, and state-owned companies, should show a surplus of BRL 141.1 billion (1.6% of GDP) in 2022. This takes into account the expected surpluses of BRL 75.1 billion from the federal government, BRL 63.0 billion from regional governments, and BRL 3.0 billion from state-owned companies.

Despite the improvement in the primary balance having a positive impact on the public sector's nominal result, interest expenses have the opposite effect, being strongly influenced by the rising cycle of the Selic rate, which is set to start in 2021. In 2022, interest expenses are estimated to increase by 1.02 percentage points of GDP, causing the nominal result to result in a deficit of BRL 457.4 billion (4.7% of GDP), compared to the nominal deficit of BRL 383.7 billion (4.4% of GDP) in 2021.

Despite the nominal result's negative impact on public debt, two factors work towards reducing the Gross Debt-to-GDP ratio in 2022: the nominal growth of GDP and the return of BRL 45.0 billion from BNDES to the National Treasury. The CNI, therefore, estimates that the Gross Debt-to-GDP ratio will decline from 80.3% in 2021 to 76.1% of GDP in 2022.

[10] LC 194/2022 determined a maximum ICMS tax rate on fuels, electricity, transportation, and telecommunication services, items with a significant weight in the states' ICMS tax revenues.

Outlook for 2023: Even with an uncertain budget, the trend is for a strong increase in federal spending in 2023

The uncertainties surrounding the 2023 federal government budget mainly involve the extent of the primary spending growth and the allocation of the spending. As per the Transition PEC (PEC 32/2022) filed on November 28, expenses related to the Auxílio Brasil will remain outside the limits of the Expenditure Ceiling from 2023 to 2026. The cost of maintaining the Auxílio Brasil at BRL 600 and the additional BRL 150 per child under 6 will be BRL 175 billion in 2023.

Additionally, the PEC draft also allows for expenses for socio-environmental projects, expenses of federal institutions funded through their resources, and investments equivalent to up to 6.5% of the excess revenue from the previous year to be exempt from the limits of the Expenditure Ceiling. It is estimated that the expenses exempt from the Expenditure Ceiling, besides the Brazil Aid, will amount to approximately BRL 25 billion. This brings the total expenses excluded from the Expenditure Ceiling to an estimated BRL 200 billion in 2023. It is worth noting that the adjustment formula for the Expenditure Ceiling will remain unchanged (adjustment based on the previous year's inflation, measured by the IPCA).

By removing the Auxílio Brasil and the aforementioned expenses from the Expenditure Ceiling, there will be room for a BRL 130 billion increase in other expenses that are subject to the ceiling. This is because the 2023 budget includes BRL 105 billion for Auxílio Brasil (keeping the benefit at BRL 400) and BRL 25 billion for the other expenses, but if these expenses are exempt from the Ceiling, as specified in the Transition PEC, this amount can be used to increase other expenses within the limit of the Expenditure Ceiling. However, the PEC draft does not specify how this amount will be spent. The correction of the minimum wage, from BRL 1,302 to BRL 1,320, as foreseen in the 2023 Budget Law Project (PLOA), should represent only a small part of the available budget space.

According to the scenario projected by CNI, all the budget space created for increased spending will be utilized. It is worth noting that CNI's projected 2023 Expenditure Ceiling is lower than the one considered in the 2023 PLOA due to CNI's lower inflation expectation compared to the budget projection. As a result, CNI estimates the 2023 Expenditure Ceiling to be approximately BRL 25 billion lower than what is projected in the PLOA.

Based on these assumptions, CNI forecasts a real growth of 10.0% in the federal government's primary expenses in 2023 compared to 2022, excluding the expenses related to Campo de Marte in the comparison.

On the federal revenue side, the RFB's estimated revenue is projected to fall by 1.8% in real terms due to the preservation of zero rates for PIS/Cofins and Cide on fuels, aviation kerosene, vehicular natural gas, and liquefied petroleum gas. The budget proposal submitted to Congress forecasts a tax collection loss of BRL 52.9 billion in 2023 due to this tax break. The slower growth in economic activity results in lower growth of managed revenue collections compared to 2022.

The non-managed revenues should decrease by 25.6% in real terms, due to the reduction in extraordinary revenues from natural resource exploitation and privatizations. Conversely, the INSS collection should grow by 2.9% in real terms, reflecting the positive performance of the labor market in 2022 and expected for 2023.

As a result, the federal government's net revenue is expected to decline by 5.1% in real terms in 2023 compared to 2022. In this scenario of rising expenses and declining revenues, the federal government is forecasted to have a primary deficit of BRL 184.1 billion (2.1% of GDP) in 2023.

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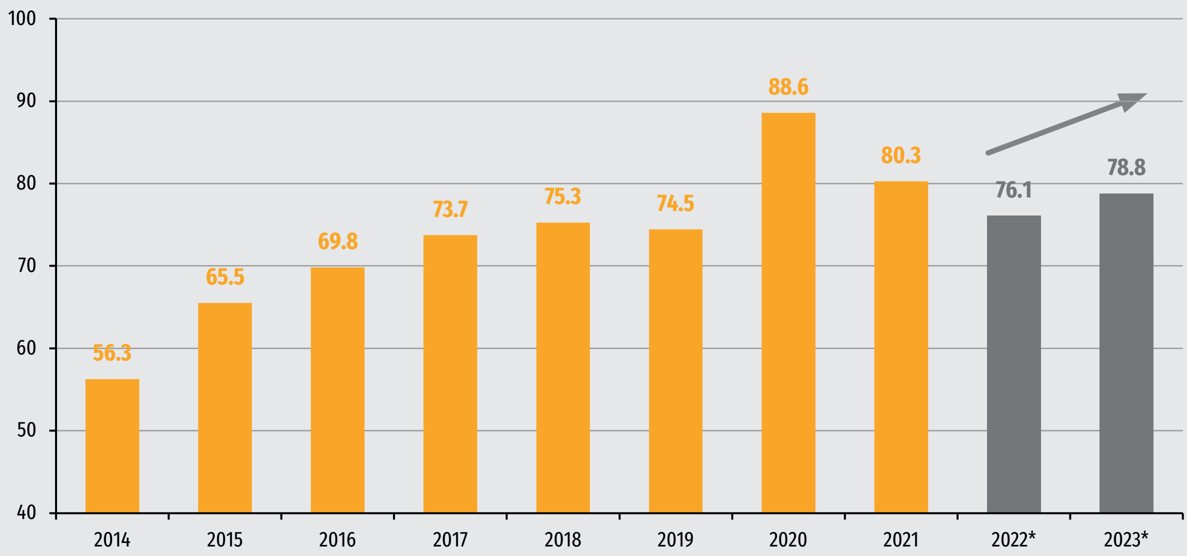
The regional governments, impacted by a reduction in ICMS collection and an increase in expenses, mainly due to salary adjustments in 2022, should experience a significant decline in the primary surplus observed in recent years. This is projected to result in the regional governments having a surplus close to BRL 12.0 billion (0.1% of GDP) at the end of 2023. State-owned companies, on the other hand, are anticipated to end 2023 with a deficit of BRL 3.0 billion (0.03% of GDP). As a result, the consolidated public sector should register a deficit of BRL 175.1 billion (2.0% of GDP), a significant worsening compared to the expected primary surplus in 2022.

Interest expenses are also expected to continue growing, reflecting the high Selic rate over the next year. These expenses should grow by 0.42 percentage points of GDP in 2023 compared to 2022. As a result, the nominal deficit of the consolidated public sector should increase, driven by the worsening of the primary balance and the rise in interest expenses, reaching a deficit of BRL 862.8 billion (8.3% of GDP). Despite this, the nominal deficit in 2023 is not worse than the one recorded in 2020, which was impacted by extraordinary expenses related to the pandemic.

With a significant increase in the nominal deficit in 2023, the public debt, as measured by the Gross Debt/GDP ratio, will once again grow, reaching 78.8%, even with the return of BRL 24 billion from BNDES to the National Treasury.

Chart 15 – Gross Debt/GDP ratio should rise again in 2023
Public Sector Gross Debt Trend
% of GDP



Source: Brazilian Central Bank and CNI* projections
Prepared by: CNI

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5 EXTERNAL SECTOR

Both exports and imports are expected to decline in 2023 but the trade balance should remain unchanged from 2022

The shocks experienced in 2022 have impacted the economy, leading to a global slowdown in 2023

The year 2022 was characterized by several significant events: the Russia-Ukraine conflict; a rise in commodity prices that caused global inflation; an energy crisis in Europe; and a slowing of the Chinese economy. The impact of the Russia-Ukraine conflict has transcended borders, affecting the commodity market and global supply chains and putting upward pressure on international prices. This has contributed to persistent inflation in several countries, with residual inflation from 2022 carrying over into 2023.

The measures adopted by the world's largest economies to curb persistent inflation involved adopting tighter monetary policies, resulting in slower global economic growth. According to the International Monetary Fund (IMF), global growth is projected to decrease from 3.2% in 2022 to 2.7% in 2023.

Despite the unfavorable international scenario, Brazil's foreign sector performed favorably in 2022 with exports and imports experiencing significant growth due to rising global prices.

This trend should persist throughout the year. The Brazilian National Confederation of Industry (CNI) predicts that the monthly average exchange rate in December 2022 will be BRL 5.39/USD and the annual average will be BRL 5.19/USD. The trade balance is projected to decline by 9.0% compared to 2021, reaching USD 55.9 billion, and current transactions will show a deficit of USD 43.2 billion, down from USD 46.4 billion in 2021.

The uncertainties and risks that emerged in 2022 should persist into the next year. Due to the decline in international trade, the Brazilian foreign sector is projected to exhibit lower results in export and import values in 2023, primarily driven by the adjustment in global commodity prices and the decrease in the global economic activity level.

CNI's projection for foreign trade in 2023 predicts a monthly average exchange rate of BRL 5.45/USD in December 2023, with an annual average of BRL 5.33/USD. The trade balance should remain positive at USD 55.9 billion, which is the same as in 2022. This positive trade balance is not enough to compensate for the projected deficit in the balance of services and income in 2023, resulting in a negative current account balance of USD 40.8 billion, equivalent to 2.4% of the GDP projected by CNI for 2023.

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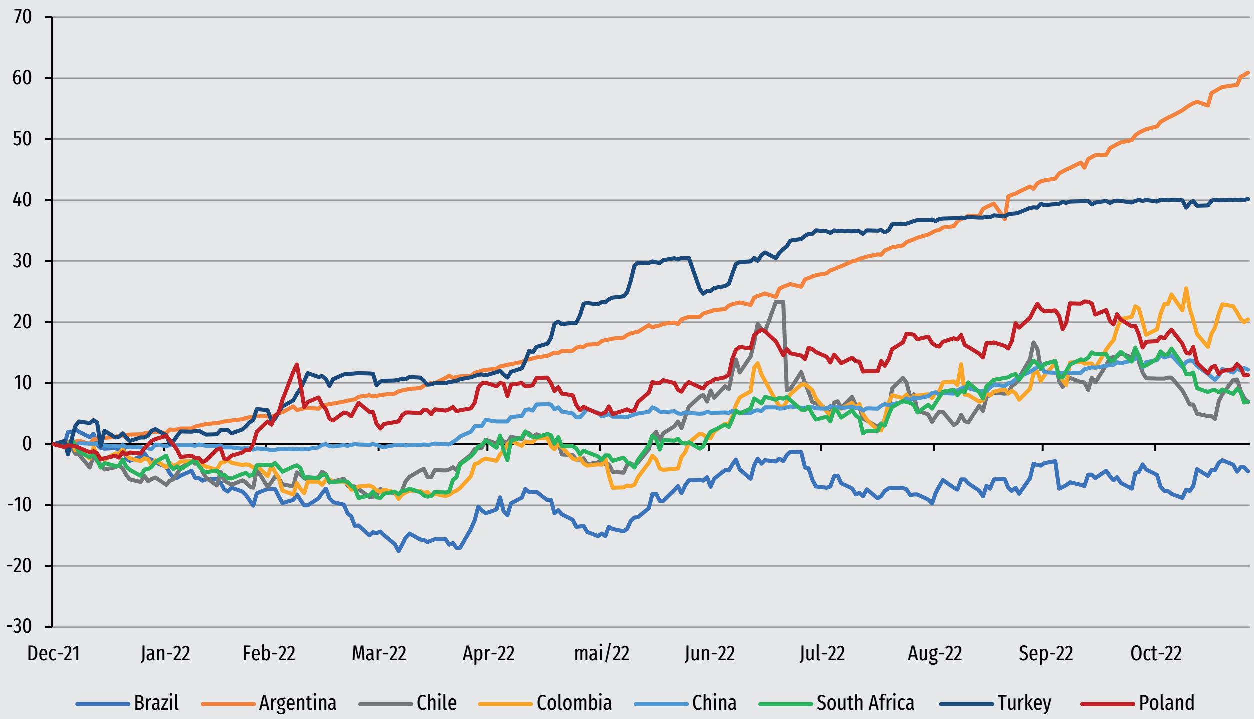
The Brazilian Real appreciated in 2022, in contrast to the currencies of other emerging countries

In December 2022, the average monthly exchange rate should be BRL 5.39/USD in Brazil, a decrease of 6.5% compared to the BRL 5.65/USD of December 2021. Compared to the end of 2021, the exchange rate appreciated by nearly 4.6% until November 25, 2022, while the currencies of other emerging or developing countries depreciated.

The Central Bank's actions to combat inflation are the primary reason for the exchange rate not depreciating throughout the year. Being one of the first countries to raise the basic interest rate, Brazil has one of the highest real interest rates in the world, which has deterred capital outflows.

The uncertainties of fiscal policy and the electoral process in the second half of 2022 impacted the appreciation cycle of the Real. CNI projects an average exchange rate of BRL 5.39/USD for December 2022 and BRL 5.19/USD for the year 2022.

Chart 16 - Real appreciated while other emerging currencies depreciated in 2022
The year-to-date variation of exchange rates of emerging or developing countries
Daily closing exchange rate from 12/31/2021 to 11/25/2022, in (%)



Source: Central Banks of selected countries.
Prepared by: CNI.

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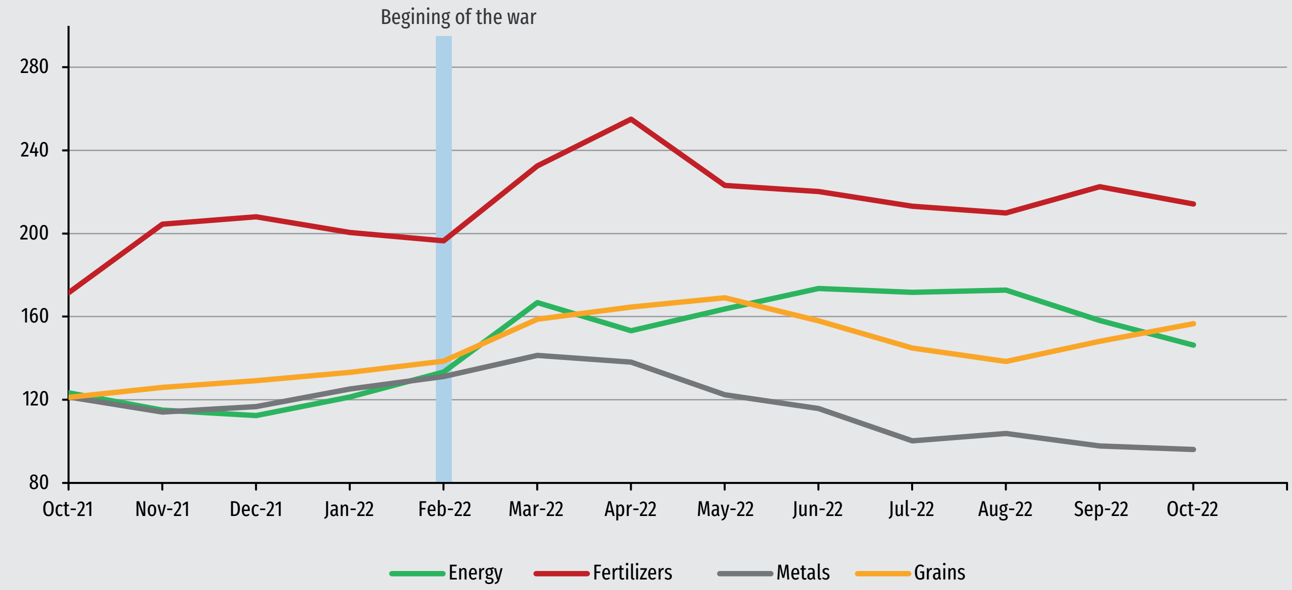
By the end of 2022, exports will equal and imports will exceed 2021's total

From January to October 2022, Brazilian exports reached a total value of USD 281 billion, the same as at the end of 2021. As shown in Chart 17, although international prices have begun to ease, the prices of commodities that are relevant to Brazil's export agenda, such as oil, corn, wheat, and soy[11], remain at levels that are higher compared to recent years. This led to a 19.0% increase in export value compared to the same period in 2021.

Imports reached a total of USD 229 billion from January to October 2022, representing a 32.3% increase compared to the same period in 2021. This corresponds to approximately $10 billion more than the total import value for 2021. As depicted in Chart 17, the high international prices of imported products by Brazil, such as petroleum fuel oils, manure, and fertilizers, had a significant impact on the results analyzed in the period.

Chart 17 - Prices of agricultural *and energy commodities* are higher than in the pre-war period in Ukraine
The variation of *commodity* prices - energy, fertilizers, metals, and grains
Index (2010 = 100)



Source: World Bank.
Prepared by: CNI.

[11] These products, combined, make up approximately 35% of Brazil's exports in the year ending October 2022.

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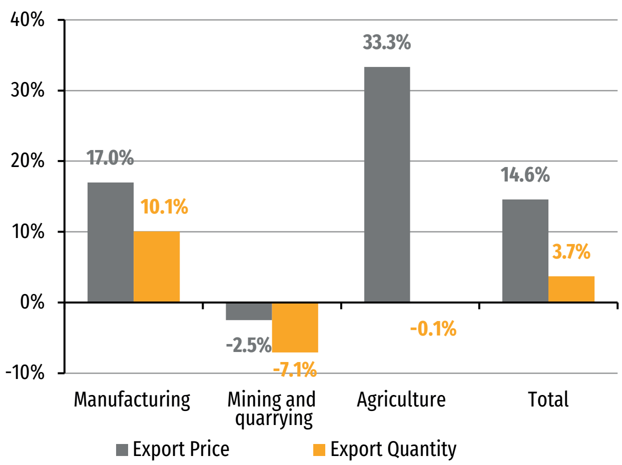
The higher rate of growth of imports compared to exports caused a reduction in the trade balance. From January to October, there was a trade balance surplus of USD 52 billion, an 11.7% decrease compared to the same period in 2021. Prices played a more important role in explaining the values reached in 2022 compared to quantities.

In exports, the manufacturing industry saw an increase in both prices and quantities from January to October 2022 compared to the same period in 2021.

For total imports, prices were even more important in explaining the 2022 result than in the case of exports. All categories of goods—agriculture and cattle raising, manufacturing industry, and mining and quarrying industry—registered price increases.

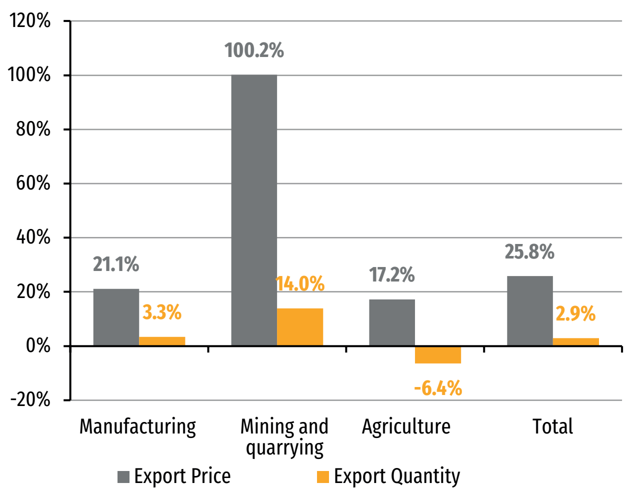
Based on the performance of the foreign sector until October, CNI projects that exports will close the year at USD 334.3 billion and imports will reach USD 278.4 billion, resulting in a trade balance of USD 55.9 billion.

Chart 18 – Manufacturing shows an increase in both prices and the number of exports
Price and volume of Brazilian exports by economic activity
Percentage variation (%) among the average indexes from January to October in 2021 and 2022



Source: Ministry of Economy
Prepared by: CNI

Chart 19 - Increases in import prices across all sectors
Price and volume of Brazilian imports by economic activity
Percentage variation (%) among the average indexes from January to October in 2021 and 2022



Source: Ministry of Economy
Prepared by: CNI

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Direct investment in the country shows a consistent increase and more than compensates the current account deficit

From January to October 2022, the current account deficit totaled USD 44.0 billion. This is higher than the deficit recorded during the same period in 2021, which was USD 30.1 billion. The increase in the deficit is primarily due to a rise in the services deficit, driven by the travel and transportation industries. Taking into account the increases in negative balances in common deficit accounts and the decrease in positive trade balances, CNI projects a current account deficit of USD 43.2 billion for 2022, equivalent to 2.5% of GDP as projected by CNI.

Despite the current account deficit, the net inflow of direct investment into the country has remained consistently high, financing the deficit. Accumulated figures through October 2022 were USD 73.9 billion, a 59% increase from the same period in 2021.

According to the Organization for Economic Cooperation and Development (OECD), FDI flows have declined globally in 2022 due to the impact of worldwide crises. Despite this trend, Brazil was ranked as the third most attractive country for FDI by June 2022, behind only the United States and China[12].

The growth can be attributed to both internal and external factors. Internal factors that contribute to this growth include a seven-fold increase in intercompany loans between September 2021 and September 2022. External factors include recessionary expectations in major economies and challenges in emerging markets such as Argentina, Russia, and Turkey.

Thus, the external financing need (NFE for its acronym in Portuguese), calculated by the difference between the current account deficit and direct investment in the country, was negative by USD 30.0 billion until October 2022. CNI forecasts that there will not be a substantial shift in the current account deficit by the end of the year, and the growth in net inflows of direct investment in the country will be ample to counteract the deficit in 2022.

[12] OECD. *FDI in Figures October 2022: global FDI flows up overall by 20% in the first half of 2022, but this masks a 212% drop in the second quarter*. Available at https://www.oecd.org/investment/investment-policy/FDI-in-Figures-October-2022.pdf

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Outlook for 2023: The world economy will experience slower growth in 2023 than in 2022

According to the International Monetary Fund (IMF), global growth will slow down in 2023. The IMF projects China will have a higher annual growth rate next year. However, economies such as Brazil, the United States, and India, as well as regions including Latin America, Europe, and ASEAN[13], are expected to experience lower growth rates, supporting the forecast for a slowdown in the global economy in 2023.

The World Trade Organization (WTO) concurs with the IMF's assessment that world import growth in 2023 will be 1.0%, a decrease of 2.5 percentage points (pp) compared to 2022. The WTO's outlook predicts a decline of 1.0% in imports from Latin America and 0.4% in Europe, while imports from the United States should increase by 0.8%, from the Middle East by 3.4%, and from Asia by 4.2%.

In the coming year, international demand should decline due to the decrease in economic activity in major economies compared to 2022. Monetary tightening should occur in major industrialized and economically developed economies, as inflation has persisted in the US and Europe despite the increase in basic interest rates by monetary authorities throughout 2022.

In Europe, high energy prices resulting from the Russia-Ukraine conflict may endanger household spending and increase production costs. The tightening of monetary policy in the United States may impact interest-sensitive expenditures, such as rents, financing, and investments.

The direction of China's "covid zero" policy remains uncertain. Due to the obstacles posed by new variants and cases of COVID-19, the country may still need to impose restrictions on production and mobility. Despite these challenges, China should perform better in 2023 compared to 2022, with growth projected to be 4.4% by the IMF, compared to 3.2% in the previous year.

This growth, while slightly higher than the previous year, is still far from the level above 8% achieved in 2021, but it is above the world average for 2023. The increase in China's growth may contribute to a rise in the export volumes of grains and meats to the country.

However, fiscal uncertainties may bring changes to the exchange rate

Regarding the exchange rate, the international scenario points to continued demand for dollars, given the persistence of the Russia-Ukraine conflict and the expected retraction in the level of activity on the European continent. Thus, the international demand for dollars tends to keep emerging currencies undervalued.

On the other hand, the expectation is a favorable interest differential for the entry of capital in Brazil, which contributes to the appreciation of the exchange rate. The scenario is of higher international interest rates for all of 2023 and, in the Brazilian case, of inflation showing small signs of a slowdown and the beginning of a smooth reduction of the Selic rate starting in September 2023[14]. Nevertheless, Brazil will continue with high real interest rates and, thus, with a more attractive interest differential than many other emerging countries, promoting capital inflows and generating stimuli that limit the devaluation of the Real.

[13] The Association of Southeast Asian Nations (ASEAN) is a bloc made up of Brunei, Cambodia, Singapore, Philippines, Indonesia, Laos, Malaysia, Myanmar, Thailand, and Vietnam.
[14] See section Inflation, interest, and credit.

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The main factor that should influence the exchange rate in the domestic arena in 2023 is the fiscal situation. In the scenario projected by CNI, the Transition PEC may lead to a real growth of 10.0% in the federal government's primary expenditures compared to 2022. Added to this are the expectations of discussions about changes in fiscal rules that may occur next year, which leads to the expectation of an increase in Brazil Risk rating and greater exchange rate volatility until the first quarter of next year. As long as fiscal risks remain latent, there will be few periods of sustainable currency appreciation in 2023.

CNI's projections indicate that the exchange rate for December 2023 will be BRL 5.45/USD on the month's average, and BRL 5.33/USD on the year's average, due to the scenario of greater fiscal risk and sustained demand for dollars, supplanting the stimulus for appreciation brought by the interest differential. Compared to the average R$/USD exchange rate in 2022 projected by CNI, this is a devaluation of 7.4%.

Forecasts for foreign trade in 2023 are not positive

The forecasts are not positive for Brazilian foreign trade in 2023, as they count on small drops in the values of exports and imports. Fuel and food prices should remain high, but lower than in 2022.

According to a survey by the National Supply Company (Conab), the Brazilian production of grains should reach a record of 313 million tons in the 2022/23 harvest, an increase of about 15.5% compared to the 2021/22 harvest. This scenario could benefit Brazilian grain exports.

Export volumes should increase due to the positive results expected for the 2023 harvest.

Besides soybeans, there will be increases in the volumes shipped of corn, given the continued strong external demand that, together with higher Brazilian production, tends to result in a 16.9% increase in shipments, according to Conab. Additionally, the record wheat harvest should also contribute to the increase in exported volumes.

Exports of manufactured goods, on the other hand, are more subject to the expected external scenario, which is more adverse for many of the main trading partners of Brazilian manufactured goods. The expectation is that sales will slow down, without a significant increase in the quantities shipped.

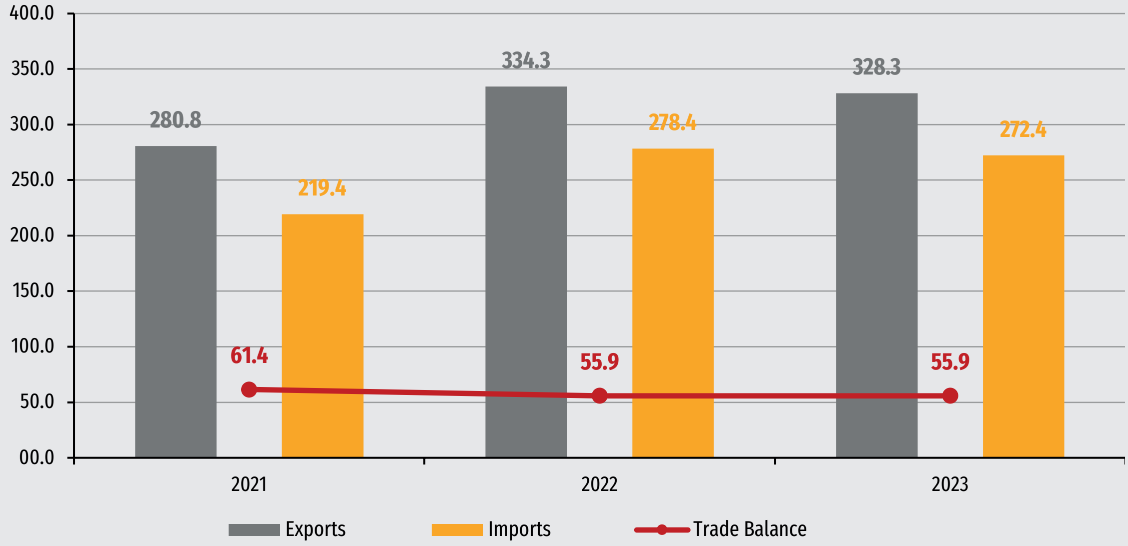
Concerning imports, in addition to a price slightly below the 2022 average, a moderate drop in volumes is also expected due to the slowdown in domestic activity compared to 2022. With this, it is expected that there will be a decrease in the import of intermediate goods; a reduction in the import of capital goods, given the increase in the cost of internal and external financing; and stability in the import of consumer goods.

In this scenario, CNI projects that Brazilian exports will reach USD 328.3 billion in 2023, a drop of 1.8% compared to 2022. In imports, CNI projects USD 272.4 billion in 2023, a drop of 2.2% compared to the amount imported in 2022. Therefore, the trade balance would be USD 55.9 billion, the same value projected for the end of 2022.

Regarding current transactions, CNI projects a deficit of USD 40.8 billion in 2023, a result that corresponds to 2.4% of the GDP projected by CNI for 2023. This result will occur due to the trade balance remaining at the same level as in 2022, which will remain lower than the sum of the services and income accounts, both of which are in deficit.

Foreign direct investments in Brazil should maintain, in 2023, the pace observed in 2022. The reasons to maintain the pace of investments lie in external conditions, where the investor sees few stable emerging economies to invest in as well as some attractive domestic conditions.

Chart 20 - Balance projection for 2023 should remain in line with 2022
Exports, Imports, and Trade Balance - 2021 and projections for 2022 and 2023
In billions of dollars



Source: Ministry of Economy
Prepared by: CNI

	2020	2021	2022 (forecast)	2023 (forecast)
ECONOMIC ACTIVITY				
GDP (annual variation)	-3.3%	5.0%	**3.1%**	**1.6%**
Industrial GDP (annual variation)	-3.0%	4.8%	**1.8%**	**0.8%**
Manufacturing GDP (annual variation)	-4.7%	4.5%	**0.1%**	**0.3%**
Construction Industry GDP (annual variation)	2.1%	10.0%	**7.0%**	**2.0%**
Unemployment rate (Annual average - % of PEA)	13.8%	13.2%	**9.3%**	**8.9%**
INFLATION				
Inflation (IPCA - annual variation)	4.5%	10.1%	**5.7%**	**5.4%**
INTEREST RATE				
Nominal Interest Rate				
(average rate for the year)	2.9%	4.5%	**12.6%**	**13.5%**
(end of the year)	2.0%	9.25%	**13.75%**	**11.75%**
PUBLIC ACCOUNTS				
Primary balance (% of GDP)	-9.4%	-0.8%	**1.6%**	**-2.0%**
Nominal result (% of GDP)	-13.6%	-4.4%	**-4.7%**	**-8.3%**
Gross Public Debt (% of GDP)	88.6%	80.3%	**76.1%**	**78.8%**
EXCHANGE RATE				
Nominal Exchange Rate - BRL/USD				
(December average)	5.15	5.65	**5.39**	**5.45**
(average for the year)	5.16	5.39	**5.19**	**5.33**
EXTERNAL SECTOR				
Exports (USD billion)	209.1	280.8	**334.3**	**328.3**
Imports (USD billion)	158.8	219.4	**278.4**	**272.4**
Trade balance (USD billion)	50.4	61.4	**55.9**	**55.9**
Current Account Balance (USD billion)	-28.2	-46.4	**-43.2**	**-40.8**

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