ECONOMIC REPORT

3RD QUARTER OF 2020

Brazilian National Confederation of Industry
THE FUTURE OF INDUSTRY

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CASH BOROW
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The current challenge is transitioning from recovery to resumption of growth

Within this context, the Tax Reform is a priority

The decrease of economic activity in March and April was stronger than expected at the beginning of the pandemic. However, so was the recovery of activities in the months that followed. With the relaxation of social distancing measures and stores reopening, the economy closed the second quarter of the year in recovery, making it clear that the worst of the crisis – April – is now in the past.

Industrial production experienced strong growth since May, as did retail sales. Other services, however, are still in a more initial recovery phase (a delayed one, since it started only in June), with emphasis on the services provided to families.

The pace of economic growth is expected to remain strong in the beginning of the third quarter, but likely to lose momentum over the last quarter, as it returns to the level prior to the pandemic. A drop of 4.2% in the GDP is expected for 2020 compared to 2019.

The emergency measures adopted by the Executive Government and the National Congress were – and still are – vital in this recovery process. In addition to strengthening the health system, the measures provide financial relief to companies, preventing bankruptcy and the disruption of production structures. Furthermore, the emergency aid not only prevented loss of income for the population, but, in practice, it also increased the income of the most vulnerable portion of the population.

Yet, the fiscal cost of the incentive measures adopted to fight the pandemic is enormous and, for this very reason, unsustainable. Albeit fundamental, the measures result in significant worsening of the fiscal scenario in Brazil, which was already complicated before the pandemic, and increase public debt to even higher levels.

Now, it is important that the government expressly commits to seeking balance of public accounts. Long-term interest rates are currently much higher than short-term interest rates, largely due to the fear of increased public debt and the possibility of a retreat in the search for rebalancing accounts.

Incentives need to be withdrawn without harming the recovery process. The reduction in incentives will have a significant contractionary effect. If done in a hurry, the recovery of domestic demand and employment may not be consolidated, which would interrupt the ongoing recovery.

Another concern is the course of inflation. The sharp variation in the industrial activity, with a fall in April followed by a vigorous and unexpected recovery in the subsequent months, led to an imbalance between the supply and demand for industrial inputs. This gap created a shortage of certain inputs, which affected the prices. Add to that the devaluation of the real, which increased prices of imported inputs. A significant increase is observed in the price of inputs, which are still dammed by the recession, but pressuring company costs. For now, it is difficult to tell apart lasting effects from what may be transient.

The recovery from the crisis has been taking on a "V" shape; however, a recovery from the effects of the crisis is not to be confused with resumption of economic growth. When the pandemic hit, the economy had not yet found its way back to growth after the previous crisis – a drop of more than 6% of GDP in two years, in 2015 and 2016, followed by growth of just over 1% in the subsequent years. 2019 was the fourth consecutive year closed with over 10 million unemployed people.

Industrial production has not maintained a growth pattern since 2010 and, at the beginning of this year, it was 14% below the average from 2010.

There is no guarantee of economic growth beyond the pre-pandemic level. Withdrawing incentives will once more evidence the range of issues that impairs the Brazilian economy and inhibits its growth. Therefore, it is necessary to work on transitioning from the withdrawal of incentives towards sustained growth. We need to pave the way for a return to growth.

For that, measures to increase Brazil's competitiveness, especially of the Brazilian Industry, should be intensified.

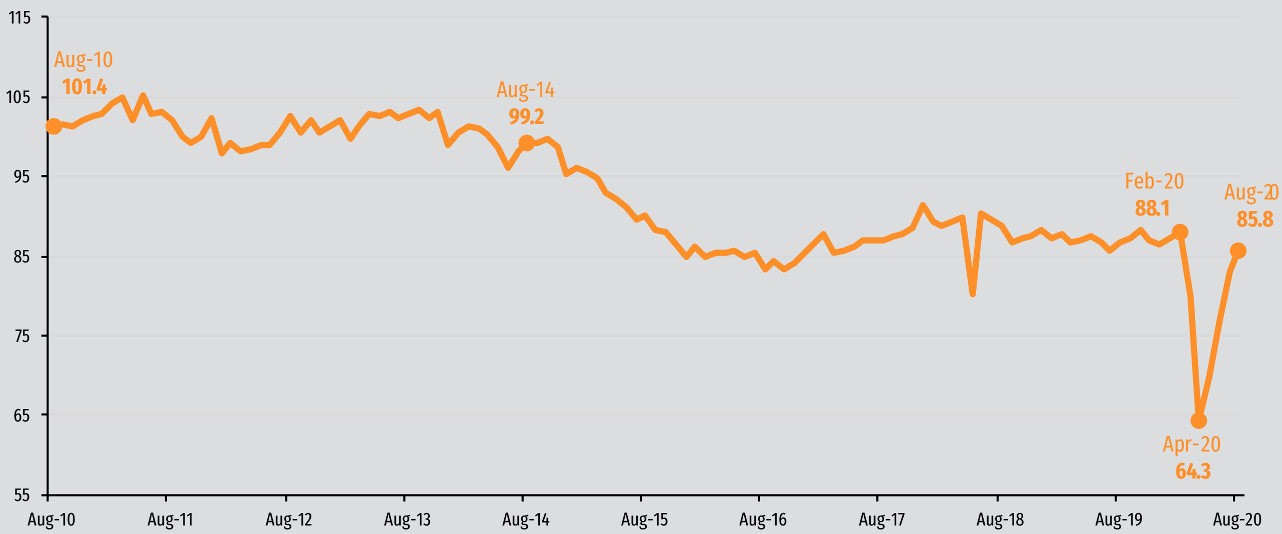
An upturn in the economic growth of the Brazilian Industry relies on reducing the Brazil Cost and increasing investments, focusing on productivity gains. Resuming the reform agenda will keep confidence high among agents and lessen uncertainties, serving as an additional aid in the transition phase.

Within this context, the Tax Reform is a priority. Making the Brazilian tax system simpler, more efficient, non-cumulative and in line with international good practices will cut some of the ties that limit competitiveness and distort the Brazilian production structure. Only then will the country be able to truly grow.

Graph 1 - V-shaped recovery, still with a long way to go until reaching the level from 2014

Industrial production*

Index number (base: 2012 average = 100)



* Seasonally adjusted series.
Source: PIM-PF/IBGE

1 ECONOMIC ACTIVITY

A recovery is in progress, but with risks for the end of the year

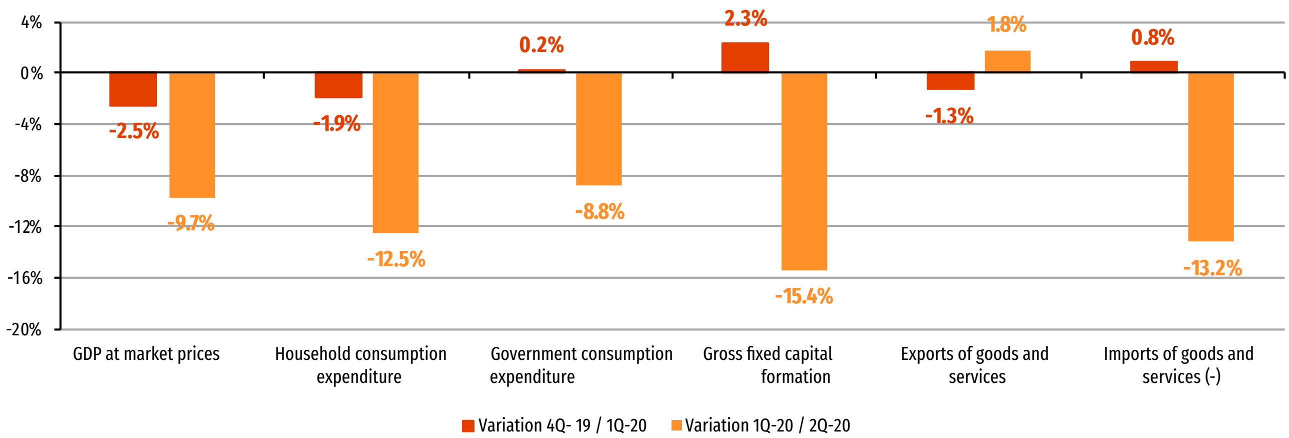
The recovery is not on the same stage among industrial sectors

The drop in the Gross Domestic Product (GDP) in the first half of 2020 evidences the impact of the Covid-19 pandemic on the Brazilian economy. After falling 2.5% in the first quarter of the year and 9.7% in the second quarter, the GDP closed the first half of 2020 with a drop of 11.9% compared to the last quarter of 2019.

In the first half of 2020, we saw a drop of 13% in the industrial GDP and of 11,7% in the services GDP. Only the agricultural sector presented growth (0.9%).

Graph 2 - GDP components

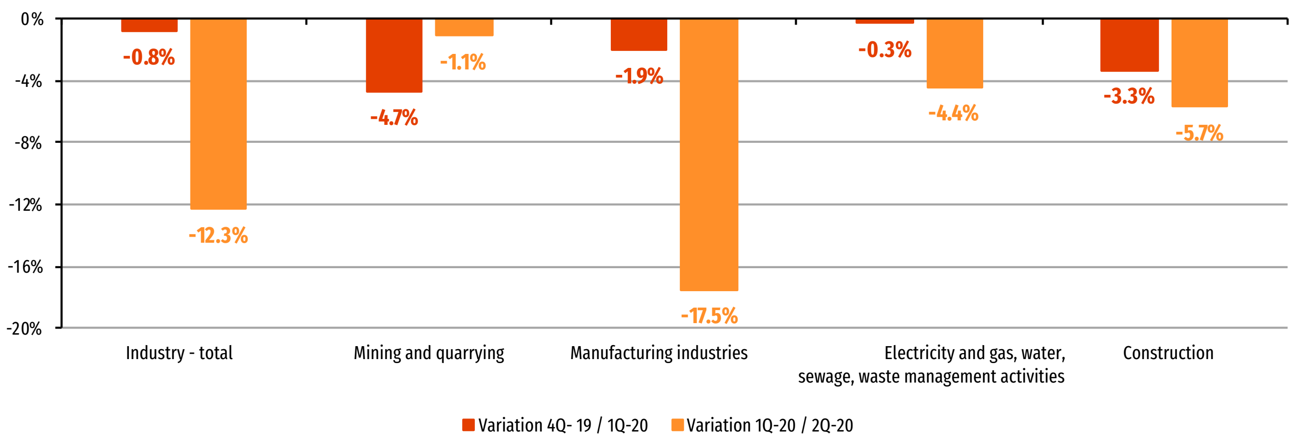
Variation compared to the previous quarter
Percentage (%)



Source: Contas Nacionais/IBGE

Graph 3 - Industrial GDP

Variation compared to the previous quarter
Percentage (%)



Source: Contas Nacionais/IBGE

The recovery is not on the same stage for Industry, Trade and Services

As of May, with some stores starting to reopen and the cash transferences granted by the federal government (the emergency aid), economic activity started on a consistent recovery path. Recovery has been more intense in trade and industry. Services have faced extra challenges in the recovery, which is no surprise once several activities in this sector are still restricted.

Retail sales (PMC/IBGE) were, in August 2020, 8.2% above that recorded in February, i.e. before the pandemic started. Reopening of stores was quick, after a sharp drop in April. Sales were favored mainly by the emergency cash transfers, which increased income of the poorest population – the portion of population more likely to consume. Other factors that have been boosting the recovery in sales are, in addition to the resumption of economic activities over the recent months, the spread of electronic commerce and a switch in the consumption of some services for goods.

Services started on a late recovery, recording fall not only in March and April, but also in May (PMS/IBGE). Most services recovered in June and July (accommodation and food services declined in July), although some of them are still well below the result recorded in February. Services, especially those provided to families, still have their activities restricted or interrupted due to the health crisis. Even in cases where there are no restrictions, families are also slightly afraid of the risk of contamination, which pushes demand down.

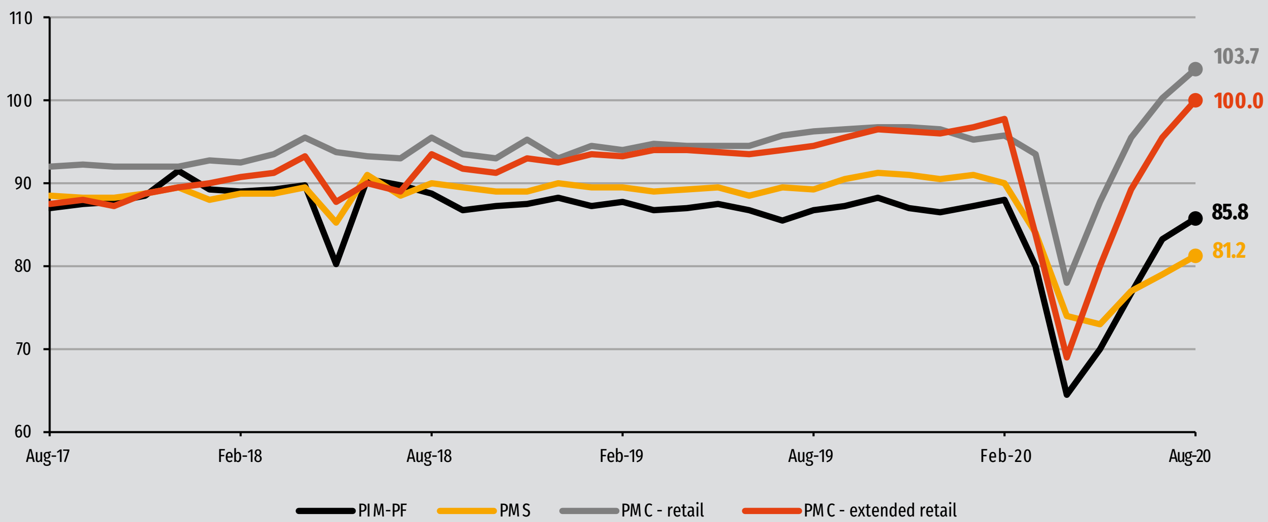
Services provided to families presented a drop of 41.9% in August, when compared to February. Among the most affected services, restaurants, hotels, gyms, catering and buffet stand out.

Transportation services, services auxiliary to transportation and mail, and professional, administrative and complementary services also experienced significant falls (11.1% and 13.7%, respectively). Within the first group, air and road collective passenger transport may be pointed out; in the second group, general cleaning services, travel, car rental, labor recruiting and staffing agencies can be pointed out.

Graph 4 - Quick recovery in the industry and retail sales

Industrial production, volume of services, retail sales and extended retail

Fixed base index (2003 average = 100); seasonally adjusted



Source: PIM-PF, PMC and PMS/IBGE

Part of the industry is still a long way from recovering losses of March and April

In the results to March and April, the industry recorded the largest proportional decrease due to the pandemic among the sectors of activity. Cash transfers allowed a recovery in consumption, and emergency credit measures and tax deferrals allowed the industry to resume operations, even after the sharp decline in revenues recorded in March and April.

Industrial production (PIM-PF/IBGE) fell 27% in March and April, but has been experiencing a fast recovery. Industrial production grew by 8.7% in May, 9.7% in June, 8.3% in July and 3.2% in August, after seasonal adjustment. As a result, industrial production in August is 2.6% lower than it was in February. The industry already operates at capacities close to levels prior the crisis.

The fall in industrial production was stronger in the manufacturing industry than in other industrial sectors. In the mining and quarrying and construction industries, production restrictions due to social isolation measures had less impact on the activity. In many cases, their production processes make it easier to avoid gatherings of people. In addition, the extractive industry benefited from the fact that China was experiencing a recovery while the pandemic crisis worsened in Brazil and, due to that, it was able to rely on foreign trade.

MANUFACTURING - Considering the Manufacturing Industry only, the fall in production in March and April reached 31.3% when compared to February. This industrial segment started to recover four months ago: with highs of 13.1% in May, 10.4% in June, 9.3% in July and 3.5% in August. Production in August was 2.9% lower than it was in February.

Yet, it is worth noting that the situation of sectors in the processing industry, as regards to production, are quite different four months after April, the worst moment of the pandemic. Sectors such as Food, Soap and detergents, cleaning preparations and others and Pharmaceutical Products reached a higher production level during the pandemic. Other sectors, such as the Motor Vehicles, Clothing, Leather and Other transport equipment, had significant falls in March and April and are still far from the level of production prior to the pandemic.

This is largely due to different consumer behavior regarding the consumption of durable and non-durable goods in the pandemic, especially during the period of more severe social distancing.

Regarding durable goods, it is more practicable to delay consumption, but this is complicated when talking about non-durable consumer goods. Also, in the case of non-durable consumer goods, many stores remained open. Ultimately, spending on durable goods often requires greater income planning and commitment, which is constrained in an environment of uncertainty and declining wages.

CONSTRUCTION - Similar to the manufactuing industry, the Construction Industry also shows recovery signs. The Construction Industry Survey (CNI) shows that the industry continues to record increasingly favorable performance after a sharp decline in activity in April. The level of activity and number of employees is on a recovery path, and the operating capacity used is once more at a level similar to that observed before the pandemic.

The production of typical inputs for civil construction (PIM-PF/IBGE) also evidences the sector's recovery. Production had been growing since April and, by July, it was higher than the level recorded before the pandemic, certainly influenced by emergency cash transfers. Moreover, the quarantine imposed on families also promoted a new relationship between people and their homes, including a higher incidence of remote work – with more time spent at home, many people made small renovations.

MINING AND QUARRYING - The mining and quarrying industry grew in June, July and August, after nine consecutive falls. Rises were of 5.3% in

June, 9.2% in July and 2.6% in August. It did not present the sharp drop experienced by the rest of the industry in April. Production in the extractive industry is 9.5% higher than it was in February, but 2.0% lower than in August 2019.

Recovery will be strong in the third quarter of 2020

In the latest Economic Report, we worked with three scenarios for the economy in 2020. A baseline scenario (a drop of 4.2% in the GDP in 2020), an optimistic one, in which the activity would experience a milder fall in March and April (of 0.9% in the GDP), and a pessimistic one, in which the drop in the activity during March and April would be more significant than in the baseline scenario, but with a slower and delayed recovery (a drop of 7.3% in the GDP).

The fall in March and April exceeded the estimate in our most pessimistic scenario. On the other hand, the recovery started earlier than expected in all scenarios (in May, compared to June presented the scenarios from the previous Report). Furthermore, the recovery in June was strong, in line with the estimate in the optimistic scenario.

Starting in July, a slower recovery rate is in line with the forecast in the baseline scenario. Therefore, the economy in August was close to the estimate in CNI's baseline scenario of the previous Report.

Data currently available on activity suggests a strong recovery in the third quarter. We revised our GDP growth estimate for the third quarter to 9.0% compared to the previous quarter, after seasonal adjustment – a percentage well above the original optimistic scenario. The industrial GDP is expected to grow 10% by the same comparison.

The industry is likely to maintain on a solid recovery pace in the third quarter. In the manufacturing industry, the recovery process should expand in sectors that started a late – or slower– recovery process, sectors producing durable goods and their inputs, as well as capital goods. The reasons for the recovery will be the same as those observed in May and June: the stimulus resulting from emergency aid, including cash transfers, low interest rates and the recovery of global economy.

In addition to particularly benefitting from the decrease in uncertainties, the construction industry is expected to maintain a recovery trend, also

driven by cash transfers and low interest rates. Finally, the extractive industry should continue to be stimulated by the global recovery, as the other countries overcome the most severe periods of the pandemic.

The service sector is likely to sustain a more modest growth until the end of the year, restricted due to the health aspects of the pandemic and – an albeit weakened – social distancing.

Recovery will be slower in the fourth quarter

By the end of the third and throughout the fourth quarter, the growth in economic activity is expected to slow down.

Until the end of 2020, safety measures will continue to limit a full return to work and some consumers will still be afraid to resume previous consumption habits – especially regarding services. The perception of risk and fear of contagion will still linger – to a greater or lesser extent – until a final solution is found.

We assume that the relaxation of social isolation measures will remain steady until 2021, with the gradual withdrawal of tax incentive measures.

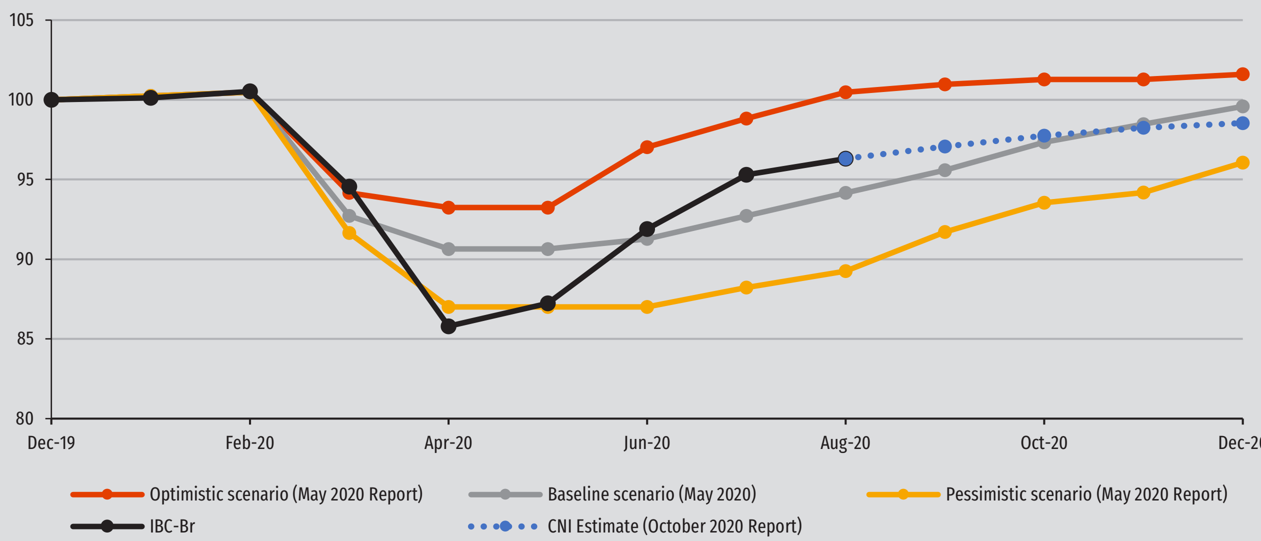
This scenario will reduce economy disruptions with bankruptcies or further worsening of the labor market.

The progressive reduction of tax incentives granted during the most acute moment of the crisis while transitioning to a sustained growth will evidence the structural barriers to sustained growth already faced by Brazil, such as the fiscal scenario, tax complexity, etc. The country was facing challenges to grow sustainably before the pandemic and, having made no significant progress in terms of competitiveness, i.e. the reform agenda, the economy will once more experience the same difficulties.

In addition, the reduction in direct cash transfers and partial anticipation of wages typically received in the second half of the year will limit consumption over the period and, consequently, the activity as a whole.

In this scenario, we expect the year to close with a fall of about 4.2% in the GDP, near the estimate in our baseline scenario. Industrial GDP would then close the year with a drop of 4.1%, falling sharply in the manufacturing industry (6.3%), but less so in the construction sector (4.5% drop). The mining and quarrying industry would close the year with 2.1% growth.

Graph 5 - Stronger fall in the activity and faster than expected recovery
GDP and IBC-BR rise estimates
Index number (December 2019 base = 100)



Source: Central Bank of Brazil and CNI
Preparation and Forecasting: CNI

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2 EMPLOYMENT AND INCOME

A large part of formal jobs was preserved in the crisis

Labor force retracted and held up unemployment rate acceleration

The need to implement social isolation measures due to the Covid-19 crisis led to an expectation of strong deterioration of the Brazilian labor market over 2020. The restricted circulation of people had the potential to reduce, or even prevent, many economic activities, especially in the service sector, which concentrates 76.6% of the jobs in the Country, according to data from the 2018 Annual Report on Social Information (RAIS).

In view of this scenario, the federal government proposed support programs for employment and income maintenance based on two lines of action. For formal workers, a line of credit was created to cover payroll and potential suspensions or reduction of working hours and wages, with salaries fully or partially paid by the federal government. Financing of working capital was also implemented for the productive sector, so that companies would not close their doors. As to informal workers, an emergency aid was created for the most vulnerable population, in order to prevent an abrupt drop in household income.

Suspension or reduction of working hours and wages were widely adopted by the Service sector. This sector accounted for 50.6% (9.2 million agreements) of the 18.3 million agreements signed up to September. Trade and Industry also showed high adhesion levels, accounting for 24.9% (4.5 million) and 21% (3.8 million) of the agreements signed, respectively.

This was a critical measure to mitigate the negative effects of the crisis on employment, since it prevented dismissals and subsequent hiring costs, in addition to providing relief to the companies' cash flow. It also preserved employment relationships, preventing the loss of qualified labor, thus, promoting a faster upturn of economic activity and employment itself.

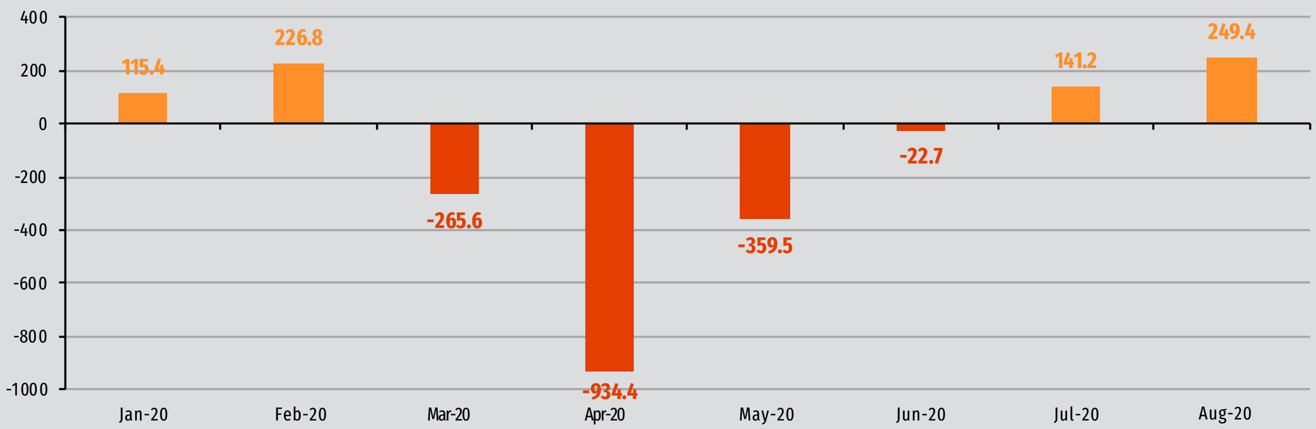
Even with these successful measures, many companies failed to maintain their entire staff or ended up closing their doors during the most acute moment of the crisis. Therefore, policies aiming at credit and improvement of the business environment are essential to allow a swifter reintegration of unemployed and discouraged workers into the labor market.

Caged records the creation of 391 thousand formal jobs in July and August

The General Register of Employed and Unemployed Persons (Caged/Ministry of Economy) recorded a positive net balance of 390.6 thousand formal jobs in July and August. This is the second consecutive month of job creation, after four months with more employees dismissed than hired. From January to August, the net balance of formal jobs was negative by 849.4 thousand jobs.

All sectors of the economy recorded positive net balance in July and August. The General Industry – manufacturing, mining and quarrying industries, utilities industry (water, sewage, waste management and decontamination activities, electricity and gas) – was the one that boosted this result the most, having created 146.5 thousand formal jobs. Next, came the construction (92.4 thousand jobs), trade (75.9 thousand), service (40.8 thousand) and agricultural (34.9 thousand) sectors.

Graph 6 - Formal jobs already show some recovery
Net balance of formal jobs
In thousands of people



Source: Caged/ME

Unemployment strikes 13.8% of the workforce in the quarter ended in July

The employed population, including formal, informal and self-employed workers, fell further in the quarter from May to July. The number of employed people fell to 82 million, a decline of 8.1% (7.2 million less) from the previous quarter, and 12.3% (11.6 million less) compared to the period from May to July 2019.

Protective health measures affected economic activities differently, with extra impact on the activities requiring greater circulation of people.

Employed workers decreased in eight of the ten groups of activities analyzed by the Continuous PNAD Survey and remained stable in two of them, when comparing the quarter ended in July with the quarter ended in April.

The number of people employed in the Accommodation and food sector fell 23.2%, with less 1.1 million people employed. The employment rate declined by 8% (-916 thousand people) in the Industry, 9.5% (-559 thousand) in Construction and 9.7% (-1.6 million) in Trade.

It is important to note that the Continuous PNAD Survey is a household sample survey, which intends to represent the entire Brazilian workforce, including informal and domestic workers, employers and unemployed people.

It is released every month and based on the moving quarter ended in the previous month.

Caged, on the other hand, is a census-based administrative record resulting from labor obligations fulfilled and released on a monthly basis, in order to monitor the evolution of the formal labor market. The statistical data in Caged is obtained from statements submitted by establishments every month, reflecting the movement of employees throughout the month.

Therefore, in addition to the difference in the research method and population considered, there is a time gap between the results; however, data follows a similar trend, indicating a better result is expected for the Continuous PNAD Survey in the coming months.

The decrease in the employed population was reflected in the unemployment rate. Measured by the National Household Sample Survey (Continuous PNAD Survey/IBGE), it reached 13.8% in the moving quarter ended in July, which stands for 13.1 million people unemployed. This rise represents an increase of 1.2 percentage point (p.p.) from the previous quarter (February to April, 12.6%) and 2.0 p.p. compared to the same quarter in 2019 (11.8%).

The rise in the unemployment rate has been contained by the increase in the number of workers outside the labor force, which reached 79 million, accounting for 8 million more people compared to the previous quarter and 14.1 million more compared to the same quarter in 2019. Despite the rise, the result from July was below the level recorded in June, when the population outside the labor force had grown by 10 million people. This points to a return of the population to the labor market, due to the recovery of economic activities and lower uncertainty levels regarding the health aspects of the pandemic.

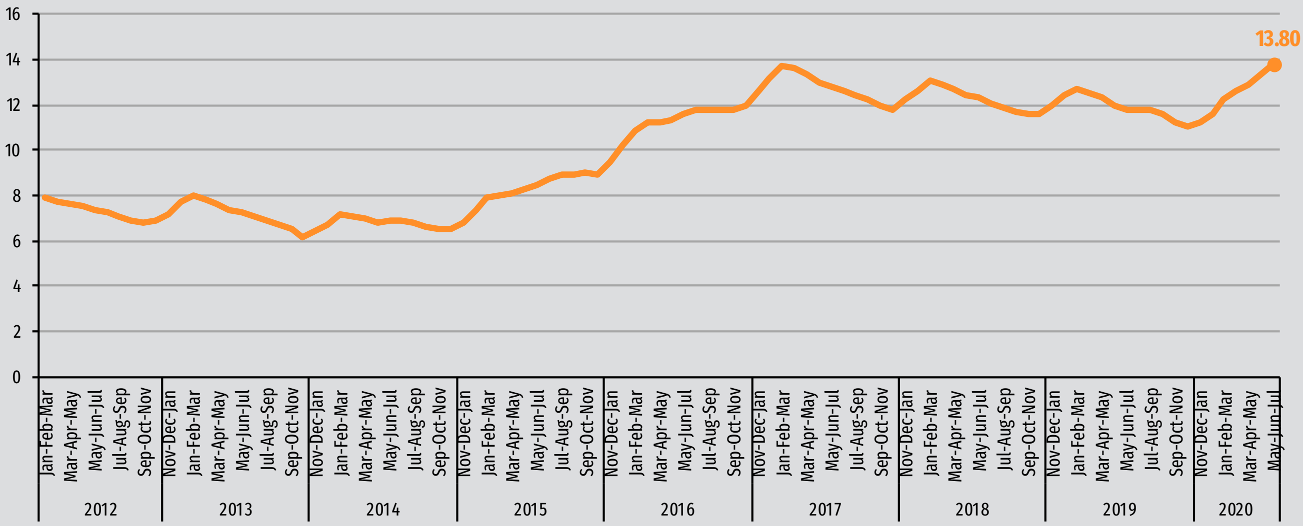
The number of discouraged workers, people who did not look for a job, but who are available and would like to work, increased significantly and reached 5.8 million people. It continues to rise, but less so than in the previous quarter: 771 thousand people were considered discouraged workers in the quarter ended in July, compared to 913 thousand in the quarter ended in June.

This growth in the number of discouraged people led to a fall in the (employed and unemployed) workforce, which reached 95.2 million people, a fall of 6.8% (6.9 million) compared to the previous quarter and 10.4% (11 million) compared to the same quarter in 2019.

Graph 7 - Unemployment rate increases in the moving quarter ended in July

Unemployment rate

% of workforce



Source: Monthly Continuous PNAD Survey/IBGE

Real total payroll decreases due to sharp drop in the employment rate

In the moving quarter ended in July, the real average income usually earned[1] by workers grew by 4.8% against the previous quarter and by 8.6% when compared to the same period in 2019. The real average income effectively earned by workers fell by 3.6% compared to the previous quarter (February to March) and by 1.2% in relation to the same period in 2019.

The average usual income tends to be similar to the effective income earned, after excluding seasonal effects, but recently there has been a gap between both variables, driven by two issues related to the pandemic crisis.

On the one hand, the average income is calculated based on the labor income of employed people and the fall in the employment rate was stronger for informal workers, who usually have lower wages than workers with formal contracts. This dynamic ended up changing the composition of the employed population, leading to an increase in the average income value.

On the other hand, individual agreements for wage reduction, allowed by the Employment and Income Maintenance Emergency Program, affected the income effectively earned, resulting in a negative variation of this indicator.

Due to the sharp drop in the employment rate over the period, falls were recorded in both the real total usual and effective payroll. The real total payroll usually earned by workers fell by 3.8% in the moving quarter ended in July compared to the previous quarter (February to March) and by 4.7% in relation to the same period in 2019. The real total income usually earned, in turn, recorded greater falls, of 11.5% compared to the previous quarter and 13.3% against the same quarter of 2019.

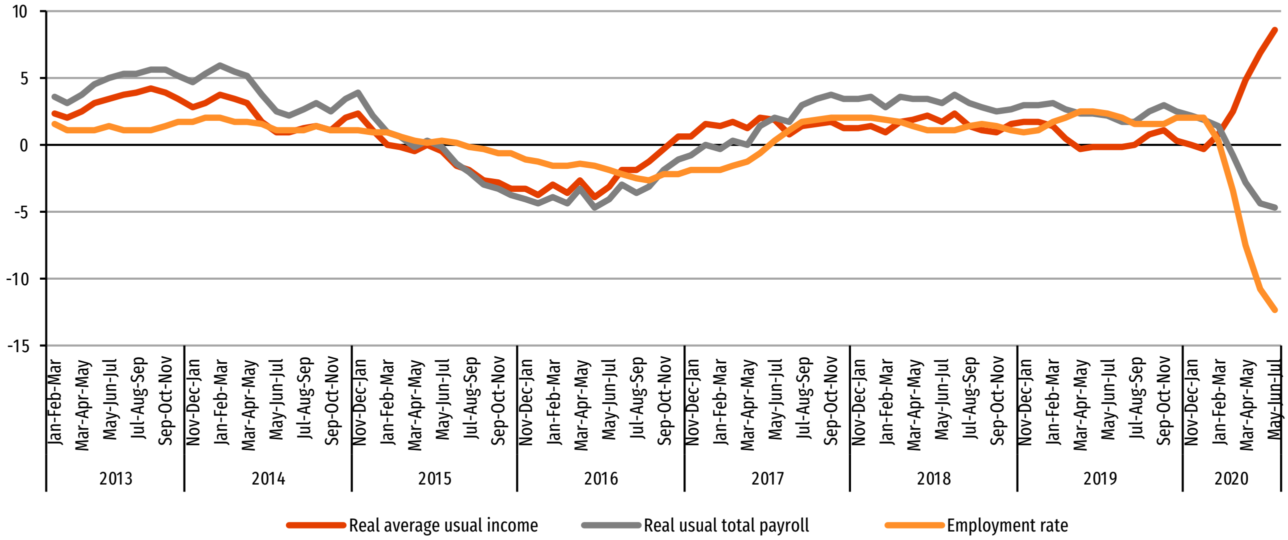
It is important to note that the total payroll includes only the income from work, not including income from other sources, such as unemployment insurance, compensations for the wage reduction agreement, emergency aid granted to the most vulnerable population, etc.

1 Usual income includes the amount monthly earned by employees, employers and self-employed workers, without any exceptional additions or discounts. For employees, the usual income excludes all amounts that are not continuous (Christmas bonus, overtime, annual bonus, annual profit sharing, salary advance, etc.) and do not consider occasional discounts (Christmas bonus advance, absences, etc.) (IBGE)

Graph 8 - Real Average Income, Real Total Payroll and Employment Rate

Variation compared to the same moving quarter of the previous year

In %

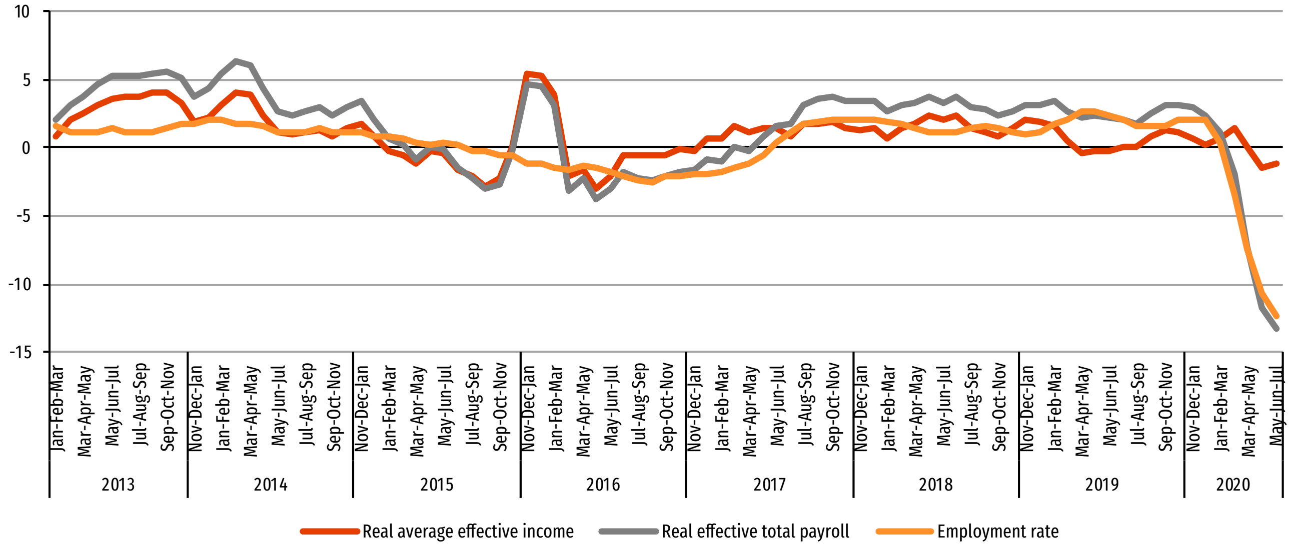


Source: Monthly Continuous PNAD Survey/IBGE

Graph 9 - Real Average Income, Employment rate and Total Payroll

Variation compared to the same moving quarter of the previous year

In %



Source: Monthly Continuous PNAD Survey/IBGE

The remainder of 2020 should continue on a path of employment recovery

The recovery in formal employment in July and August shows that informal jobs should also advance over the next months. During a resumption of economic activity, informal jobs tend to be the first to show some recovery, due to the absence of obligations related to the employment relationship. For the pandemic crisis, the difference is that the Service sector, which concentrates a significant share of the informal jobs, still faces some limitations to its activities and part of the workers in this sector are supported by the emergency aid. But with the reduction of the emergency aid and restrictions on activities, informal jobs should follow the same trend as formal jobs. In addition, the second half of the year is usually more positive for the job market, due to the seasonal hiring by the Industry, Services and Trade, which have greater demand due to vacations and the holiday season.

As to the balance of formal jobs, employment is expected to recover over the second half of the year, up to November. December typically records a negative net balance of jobs, which means that, despite the recovery in the second half of the year, the annual result for formal jobs will not be much different from the result observed until August, of about 850 thousand jobs shed.

However, the impact of seasonality on employment may change, since much of the consumption by the end of the year is related to economic activities involving greater circulation of people, such as events, eating out and accommodation. These activities may have their operation reduced when compared to 2019, due to the change in the demand and consumer behavior, which may require less hiring and, consequently, decrease the number of seasonal dismissals typical of that period of the year.

As to the balance of informal employment, a more robust recovery of economic activities will bring greater chances of success for people who wish to work, encouraging those outside the labor force (discouraged workers) to start looking for jobs again. With the emergency aid coming to an end in December, many informal workers will seek to re-enter the job market this year.

The return of a more significant part of the population to the labor force is likely to result in an increased unemployment rate. Even so, the challenges to re-enter the job market are expected to decrease over time.

CNI estimates an average unemployment rate of 13.5% in 2020, 1.6 percentage points above that recorded in 2019, when it affected 11.9% of the workforce.

3 INFLATION, INTEREST RATES AND CREDIT

Low Selic interest rate encourages demand and reduces the cost of credit

IPCA will close 2020 below the inflation target

The Covid-19 pandemic has deeply impacted economic activity, labor market and the prices of goods and services in Brazil. The change demanded an intense application of monetary, credit and fiscal policies in 2020, so as to create a support network for companies and jobs and also to protect the most vulnerable families.

Social isolation and the stoppage of many activities caused the general price level, measured by the Broad National Consumer Price Index (IPCA), to significantly fall and show negative variation in most of its components, which led inflation to fluctuate below the target center of 4% per year.

This inflation path and the projections for the coming months allowed monetary policy to respond quickly and robustly to the deterioration of economic activity and the labor market. Throughout the year, the Monetary Policy Committee (Copom) of the Central Bank of Brazil (BC) cut 2.5 percentage points of the basic interest rate, Selic, which reached 2% per year in September.
In addition to the high monetary stimulus, the BC also implemented different measures to release liquidity and reduce capital requirements (provision for default and losses), in order to stimulate credit supply and meet the strong demand.

Despite the increased liquidity, companies continued to face challenges to access the credit market. For this reason, the federal government and National Congress came up with a series of emergency programs based on risk sharing between financial institutions and the National Treasury or on the contribution of resources and operational restructuring of Guarantee Funds. These programs boosted the growth of credit to companies of different sizes and sectors of activity, being critical for many companies to survive and to maintain jobs in the most acute moment of the crisis.

IPCA remains below target, but shows signs that demand attention

From January to September 2020, the Broad National Consumer Price Index (IPCA) showed a favorable dynamic, fluctuating within the limits defined by the National Monetary Council (CMN). The IPCA recorded a growth of 1.34% in 12 months to September and of 3.14% in the 12-month period to September 2020.

The coming months do not seem to pose a risk to inflation control that could jeopardize the achievement of the inflation target for the year. However, there are warning signs in the dynamics of retail prices due to a rapid rise in producer prices already observed.

Of the four major groups that make up IPCA: Government-Regulated Prices, Food Prices, Industrial Prices and Service prices, the first two were the ones with the greatest impact on inflation in the year. Industrial and Services Prices, on the other hand, showed deflation in most months after the start of the pandemic crisis, as their demand was largely suppressed due to the social isolation measures.
However, they are already beginning to recover part of their prices with the gradual return of activities and resumption of demand.

Government-Regulated Prices, the group with the largest share of the IPCA, which had been falling since the beginning of the pandemic crisis, recorded rises in June and July due to fuel prices. In August, the Government-Regulated Prices again had negative variation (-0.20%); however, the gasoline price sustained an expressive growth of 3.22% in the month.

Food is the group drawing the most attention in 2020. Prices in this group increased by 7.09% in the year between January and September and 13.02% in the 12-month period to September. In March and April, at the beginning of the pandemic crisis, Food prices rose quickly due to the precautionary demand of families for food supplies. In the following months, with the demand returned to normal and inventories full, prices in the group increased at a slower pace.

However, they have increased further in the last two months, due to the effects of the dollar's rise on *commodity* prices (mostly priced in dollars).

Depreciation of the real also affects industrial prices, for it raises the costs of inputs imported by the sector and increases the competitiveness of Brazilian products against foreign products in the international market.

The impact of the devaluation of the exchange rate on inflation is already being reflected by other indices, such as the Broad Producer Price Index (IPA-M), which measures the variation in the prices of agricultural and industrial goods in the marketing stages prior to final consumption.

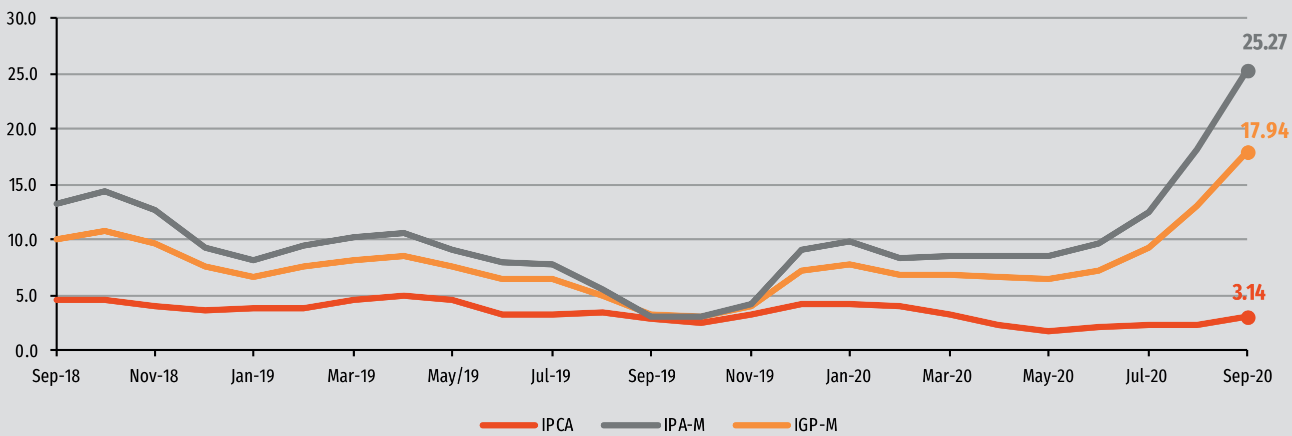
The IPA-M rose 5.92% in September. The index grew by 20.15% in the year and 25.27% in the last 12 months. This increase in wholesale prices has not yet fully translated into cost passed on to the consumer due to the restricted demand. But this is likely to occur shortly after a more robust recovery of the economy, impacting on consumer prices.

Additionally, the General Market Price Index (IGP-M), used as index for adjustments on rent, health plans, school fees, electricity and communications, rose 4.34% in September and 17.9% in the last 12 months. This increase in IGP-M also indicates a future cost pressure on Government-Regulated Prices, which may result in increases in the group's prices on IPCA.

Despite the risks, CNI estimates the IPCA will close 2020 at 2.57% per year, below the center of the inflation target for the year, of 4% per year, and 1.74 percentage point below the level recorded in 2019, when the index was at 4.31% per year.

Graph 10 - The rise of inflation measured by IPA-M and IGP-M may be more strongly reflected in consumer prices in the future

Broad National Consumer Price Index (IPCA), Broad Producer Price Index (IPA-M) and General Market Price Index (IGP-M)
12-month figure (%)

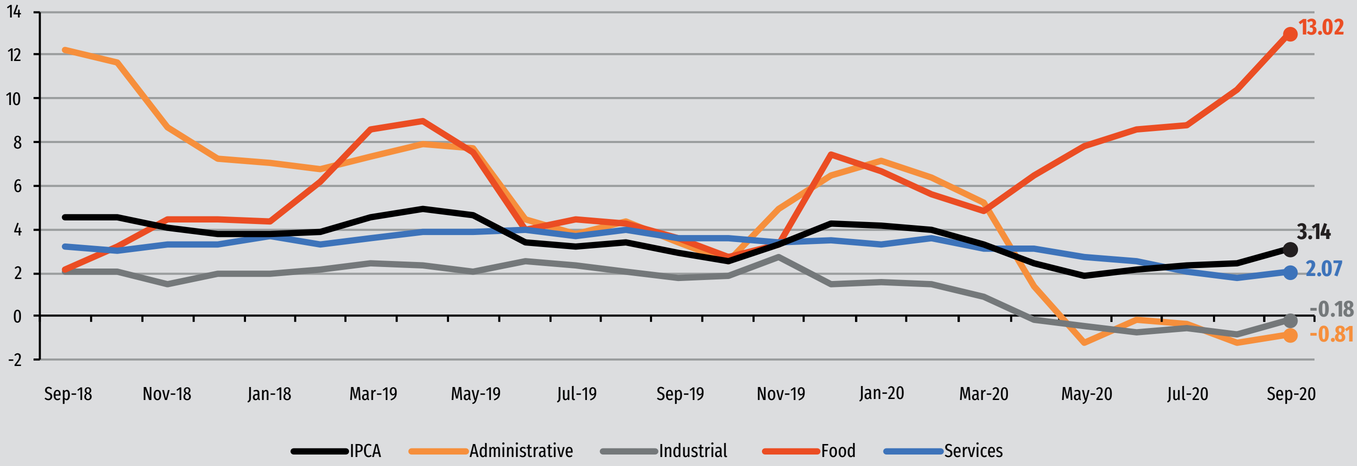


Source: IBGE and FGV

Graph 11 – Food prices rose quickly and reach an aggregate high of 13% in 12 months ending in September

Broad National Consumer Price Index (IPCA)

12-month figure (%)



Source: IBGE
Preparation: CNI

Selic rate at 2% stimulates demand, with no risk of reaching the inflation target

Throughout 2020, Brazilian monetary policy played an important role in stimulating demand and simplifying financing for the productive sector. The decrease in the Selic rate allowed lower rates for financing working capital, a line with greater demand during the pandemic crisis, typically offered at higher costs.

Between January and September, the Monetary Policy Committee (Copom) of the Central Bank of Brazil (BC) cut the basic interest rate from 4.5% p.a. to 2.00% p.a., a decrease of 2.5 percentage points. The monetary easing was possible due to the IPCA, which stayed below the center of the inflation target throughout the year.

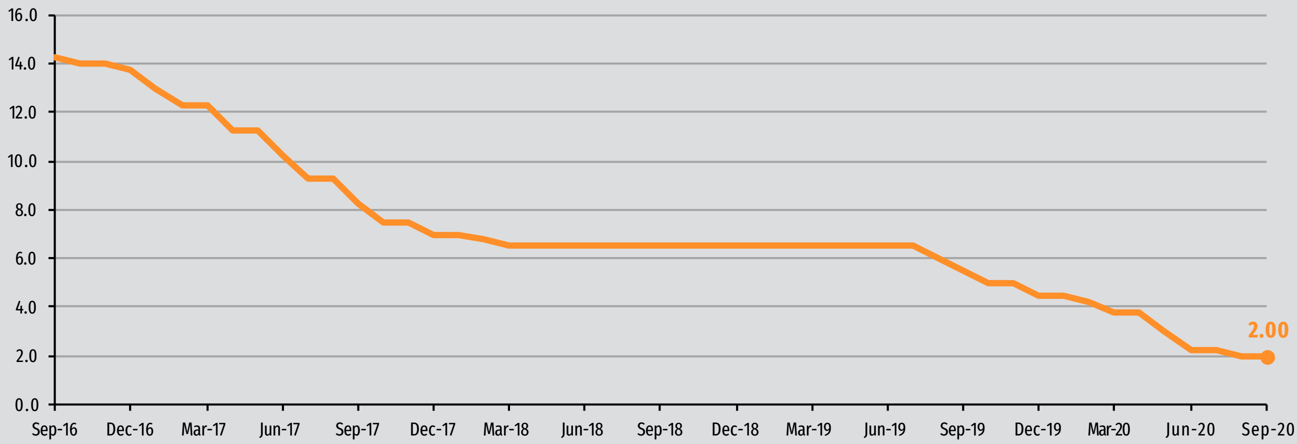
The bank spread and interest rates in the banking sector followed this drop in the Selic rate. The bank spread for legal entities fell from 9.6 percentage points in January to 6.9 percentage points in July. And the interest rate for legal entities went from 14.8% p.a. to 10.7% p.a., on the same basis of comparison.

Emergency programs, structured on the sharing of credit risk, had a relevant impact on this result. Default was the element that affected the cost of financial capital the most. The provisioning of financial institutions for the insolvency of individuals and legal entities accounts for about 37% of the bank spread, according to the BC (data from 2019).

The Copom indicated that there is still space for a new Selic cut this year, depending on the public account scenario and on an assessment of the future behavior of the inflation rate. But, based on CNI's analysis, the interruption of monetary easing will be maintained at the next two meetings, in October and December, and the basic interest rate will end 2020 at 2% p.a..

Graph 12 - Selic is expected to close 2020 at 2% per year

Selic target defined by the Copom
Final rate for the period (% p.a.)
In % p.a.



Source: Central Bank of Brazil

Credit grants record strong growth in 2020

Total credit grants recorded a sharp increase in 2020. The strong growth is due to the BC's capital and liquidity release measures, aiming at fostering the growth of credit supply by the financial market, and the implementation of emergency credit programs, which facilitated access to financing through risk sharing.

When comparing the 12-month period to August with the same period of 2019, credit to legal entities recorded an average growth of 12%, in real terms. Between 2019 and 2018, the growth was of 5.7%.

Non-earmarked credit to legal entities increased by 10.3% in the 12-month period to July, comparing the period between 2020 and 2019, against 7.25%, when compared to the period between 2019 and 2018. In turn, earmarked funds, had an average growth of 36.2%, comparing the period between 2020 and 2019, against a 12.6% decline, compared to the period between 2019 and 2018.

In addition to expanding the volume of credit, the average interest rate on operations contracted by legal entities decreased significantly over the year. The rate fell 4.1 percentage points (p.p.) in 12 months (from 14.9% p.a. in August 2019 to 10.8% p.a. in August 2020). For non-earmarked credit, the average interest rate dropped by 6.4 p.p. (from 18.8% p.a., in August 2019, to 12.4% p.a., in August 2020). For earmarked credit, the average interest rate dropped by 1.2 p.p. (from 8.6% p.a., in August 2019, to 7.4% p.a., in August 2020).

The decrease in the interest rate on financing in 2020 was possible thanks to the emergency credit programs and the expansionary monetary policy implemented due to the pandemic crisis. However, after the end special lines and the cycle of monetary easing, the Central Bank needs to boost its performance in other strategies to reduce costs and increase access to credit, included in Agenda BC #. These actions primarily aim at reducing the Brazilian banking spread, which remains one of the highest in the world.

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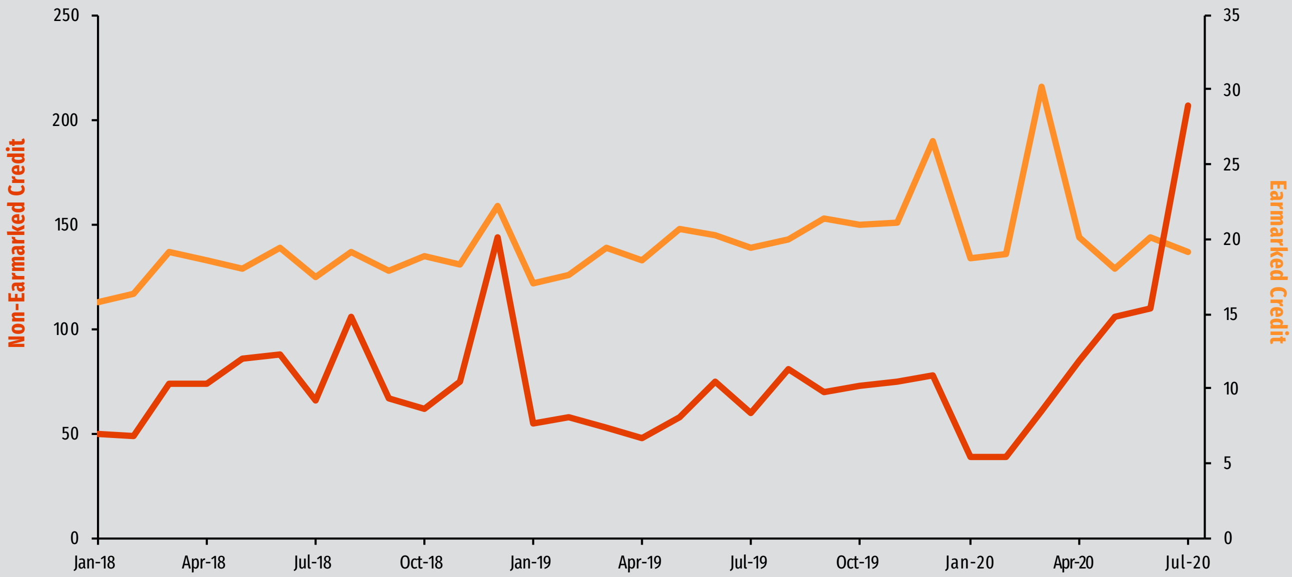
Graph 13 - Non-earmarked and earmarked credit record strong expansion in the year

Total credit to legal entities – Per type of credit

In R$ (billions)



Source: Central Bank of Brazil

4 FISCAL POLICY

Effects of the pandemic are reflected in the fiscal scenario

Increased expenses to fight the pandemic and reduced income lead to a growth in public debt

2020 will be marked by a strong fiscal expansion. Such expansion will be both due to the increase in expenses aiming at fighting the effects of the coronavirus crisis on health and the economy, as well as to a decrease in revenue, with the retraction of economic activity and measures to delay or exempt tax collection. Most of these factors had greater impact on results in the first half of the year; however, its effects will last until the end of the year.

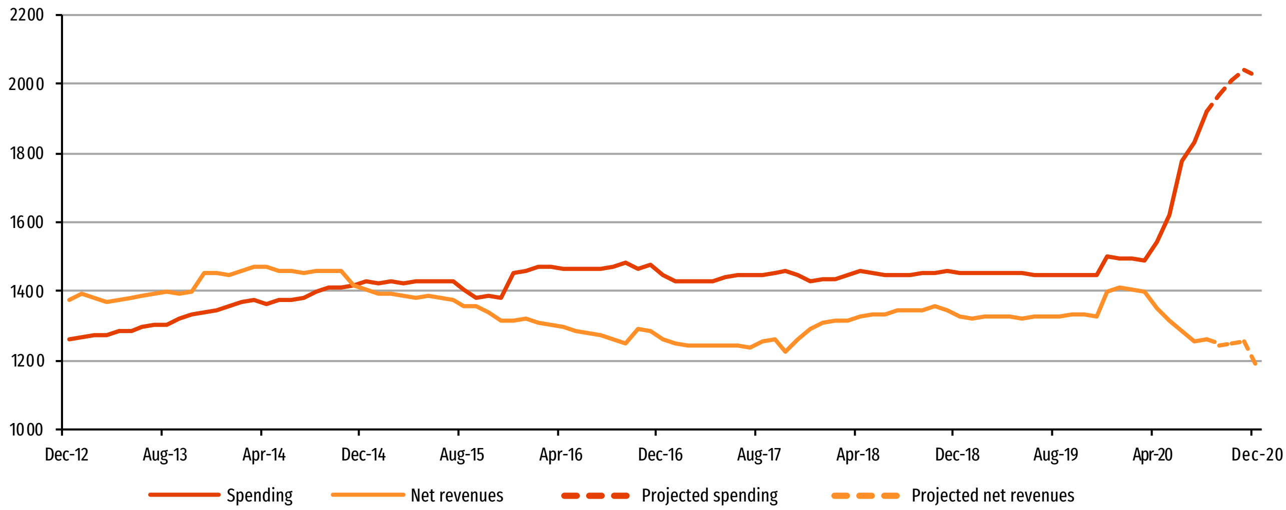
Throughout 2020, extraordinary credits have been the main tool used to enable the payment of expenses to mitigate the effects of the crisis. This situation includes the emergency aid to the most vulnerable population, assistance to states and municipalities and other expenses related to public health. Once the state of calamity was declared, the fiscal rule in place (spending cap) proved to be flexible enough to accommodate the use of extraordinary credits for these expenses. In addition, the approval of PEC 10/2020, known as the War Budget PEC, allowed setting apart spending to fight the pandemic within the general budget of the Federal Government, eased the criteria for increasing such spending and exempted the government from compliance with the other fiscal rules.

The fiscal measures adopted by the federal government were and still are essential to handle the effects of the crisis. However, these measures lead to an intense worsening of the fiscal situation and increased public debt, which was already at a high level. Therefore, it is essential that these measures are restricted to 2020 only and that the government indicates its commitment of returning to the fiscal adjustment model.

Graph 14 - 2020 will be marked by a strong increase in expenses and a drop in revenues

Evolution of federal government primary spending and net revenues

*12-month figure - R$ Billion in Dec-20**



Source: National Treasury Secretariat/Ministry of Economy and CNI
Prepared by: CNI

Increased spending focuses on measures to fight the crisis

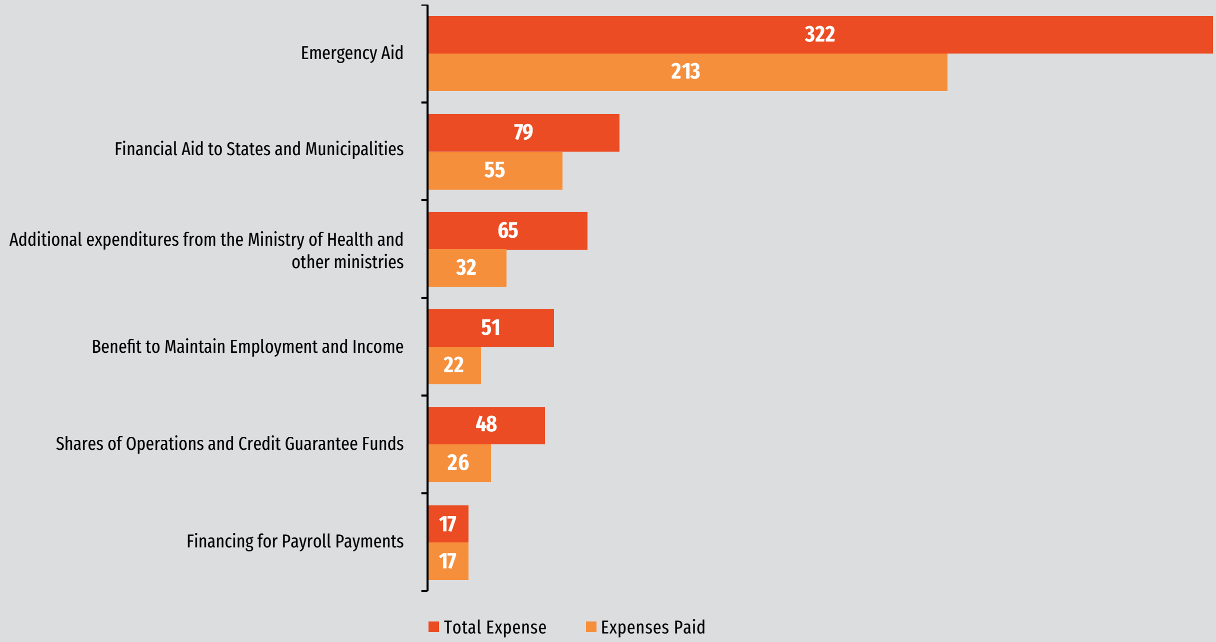
Federal government expenses had real expansion (IPCA deflator) of 45.2% in the first eight months of the year, compared to the same period in 2019. This increase is due to a significant allocation of resources to mitigate the effects of the pandemic on public health and the economy, as shown in the graph below.

The federal government net revenue, in turn, dropped by 16.1% in the year to August, compared to the same period in 2019. Revenues managed by the Federal Revenue Service had a real decrease of 15.0%. The tax exemption and deferral measures, in addition to the reduction in economic activity, were mainly responsible for this decline. Social security revenues, influenced by the delay on the payment of social security contributions and the fall in the total payroll, recorded a real increase of 12.8% from January to August 2020, in relation to the same period in 2019. The measures that led to reduction in these revenues were concentrated between April to June and caused a drop in revenues in the period of nearly R$ 90 billion, which accounts for 71% of the fall in revenues in the period.

Graph 15 - Coronavirus expenditures total more than R$ 430 billion until September 2020

Main federal government expenditures to mitigate the pandemic effects

(R$ Billion)



Source: National Treasury Secretariat/Ministry of Economy
Prepared by: CNI

Aid to states and municipalities offsets drop in regional government revenues

Regional government revenues presented real increase of 2.3% in the year until August, compared to the same period in 2019. This increase was only possible thanks to the transfer of R$ 55.2 billion from the federal government, in assistance to states and municipalities over the period. Without these resources, regional revenues would have fallen by 7.0%. It is worth stressing that in recent months, revenues from the good and services tax (ICMS), the main source of funds for regional governments, have increased. In August, revenues from this tax showed real growth of 3.1%, compared to the same month in the previous year.

Regarding the expenses of regional governments, CNI estimates that this variable has recorded a real increase of 1.2% in the year until August, compared to the same period in 2019. The increase in expenses related to fighting the pandemic is the main factor behind the increase in expenses. The growth in revenues more than offset the increase in expenses in the period, leading regional governments to a primary surplus of R$ 27.1 billion in the year to August.

The federal government's primary deficit is responsible for the increased public debt

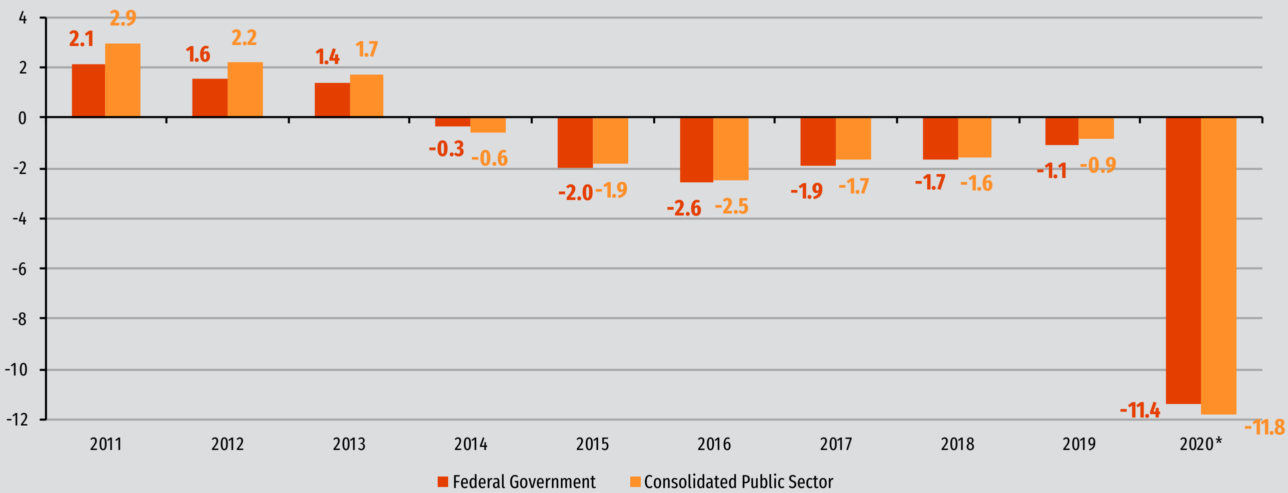
The significant worsening in the federal government's primary result, although accompanied by a surplus from regional governments, raised the primary deficit of the consolidated public sector to R$ 611.3 billion (8.50% of GDP), in the last 12-month period ended in August 2020. In December 2019, the negative result was of R$ 61.8 billion (0.85% of GDP).

The 0.58 percentage point reduction in nominal interest expenses was not enough to contain the effects of the increased primary deficit on the nominal result, which rose from 5.91% of GDP in December 2019 to 12.98% in August 2020, in the result from the 12-month period. In addition to the expansion in the nominal deficit, the devaluation of the real also contributed to an increase in the Gross Debt/GDP ratio. When devaluation of the real occurs, the Central Bank incurs losses in currency swap operations. In addition to that, part of the public debt is in dollars, therefore, the devaluation raises the value in reais of that portion of the debt. In August 2020, the Gross Debt/GDP ratio reached 88.8%.

Graph 16 - Interruption in the reduction trend of primary deficit reduction in 2020

Primary result for the federal government and consolidated public sector

12-month figure (% of GDP)



Source: Central Bank of Brazil and CNI
Prepared by: CNI

Impacts of measures to fight the pandemic will be mitigated by the end of the year

Much of the measures to fight the effects of the pandemic on public health and the economy had greatest impact in the first eight months of the year. In any case, this will not prevent the significant worsening of the fiscal scenario and increase in public debt for the rest of 2020.

Federal government spending will continue to grow, albeit at a slower pace, until the end of the year. The extension of the emergency aid until December will lead to additional expenses of R$ 72.6 billion, in addition to the R$ 236.9 billion that have been allocated to the benefit up to September. Altogether, CNI estimates that the expenses associated to controlling the crisis caused by the coronavirus exceed R$ 550 billion, or 7.7% of the GDP. In addition, a 2.4% increase in social security expenses is expected. Personnel expenses, in turn, are likely to decline by 0.6% in the year.

CNI estimates that federal government spending will grow by 34.5% in real terms in 2020. This increase would amount to 38.8% if the portion paid to Petrobras under the auction for onerous assignment of pre-salt acreage for oil exploration in December 2019 was disregarded.

As to revenues, CNI estimates a fall of 11.9% in real terms in 2020. For this estimate, extraordinary revenues from the auction for onerous assignment of pre-salt acreage in December 2019, which affects the annual comparison of the variable, were disregarded. The loss of revenue will be seen in all groups: revenues managed and not managed by the Federal Revenue Service and social security revenues. The improvement in economic activity in the second half of the year and the end of tax deferral measures that were in effect up to the middle of the year will allow recovering some of the revenue managed by the Federal Revenue Service this year. Still, CNI expects these revenues to decrease by 10.2% in real terms in 2020.

Regarding social security revenues, in the second half of the year, a lower adhesion to wage reductions provided by Provisional Decree 935/2020, will also contribute to an increase in total payroll and, consequently, allow a recovery of part of this revenue.
The end of the deferral of the employer's contribution on payroll also had positive impact on social security revenues in comparison with the first half of the year. For 2020, these revenues are estimated to fall by 7.7% in real terms, compared to 2019.
It is worth noting that these estimates consider that all deferred taxes will be partially paid in 2020.

Revenues not managed by the Federal Revenue Service will continue to be mainly influenced by the drop in oil prices, which has a direct bearing on revenues from financial compensations for mineral exploration. Even disregarding the effect of extraordinary revenues from 2019, a real drop of 22.9% is expected for this variable in 2020, compared to the previous year.

With these results, the federal government and its state-owned companies will close 2020 with a primary deficit of R$ 827.0 billion (11.44% of GDP), a significant increase compared to the deficit of R$ 78.6 billion (1.08% of GDP) seen in 2019.

In regional governments, the level of economic activity will allow a recovery, albeit partial, of revenues from the good and services tax (ICMS), their main source of revenue. Transfers received from the federal government will also be greatly impacted by the decline in revenues from exploitation of natural resources. In addition to these factors, transfers from the federal government as emergency aid to states and municipalities will total R$ 79.2 billion by the end of the year, offsetting the drop in revenue from other sources of funds.

Regarding the spending of regional governments, the measures announced by the federal government provided a significant fiscal relief by interrupting the repayment of debts with the federal government and approving new credit operations, which will allow states to make new expenditures in healthcare and in other areas to fight the coronavirus. As a result, these entities are likely to have a deficit of R$ 33.0 billion in 2020 (0.33% of GDP as estimated by CNI).

The primary result of federal and regional governments should lead the consolidated public sector to a deficit of R$ 850.6 billion (11.77% of GDP) in 2020. In 2019, this result recorded a deficit of R$ 61.8 billion (0.85% of GDP).

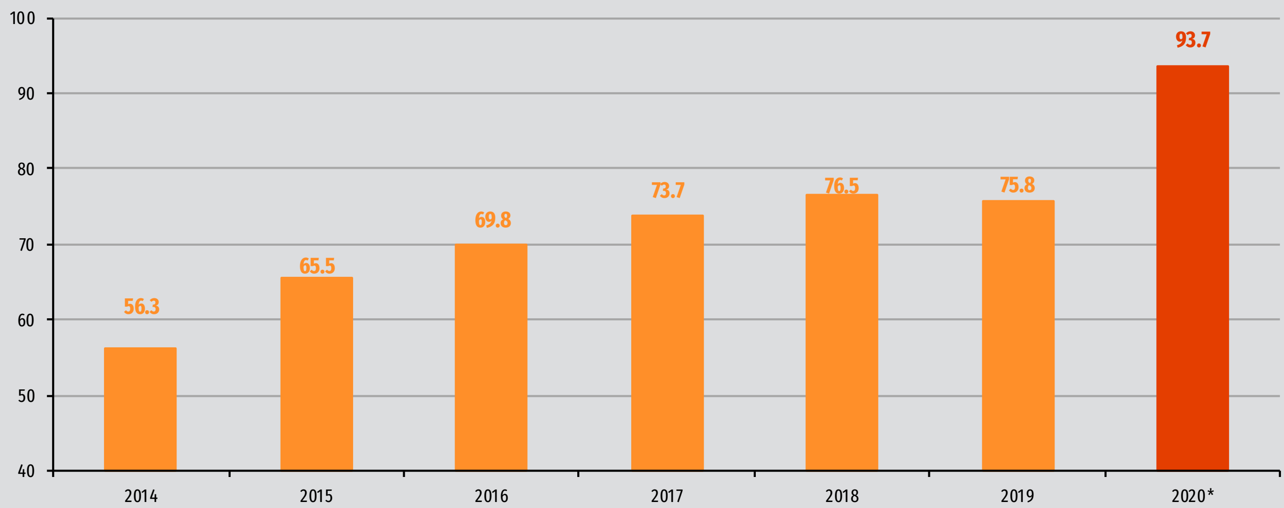
The decreased Selic rate will contribute to a reduction of 0.57 percentage point in interest spending in 2020. Even so, the strong increase in the public sector's primary deficit will lead to a nominal deficit of R$ 1,175.5 billion (16.26% of GDP) in 2020, well above the deficit of R$ 429 billion (5.91% GDP) recorded in 2019. This increase in the nominal deficit will be reflected in the Gross Debt/GDP ratio, which will rise from 75.8% in 2019 to 93.7% by the end of 2020.

If, on the one hand, the measures to mitigate the crisis were and continue to be essential, on the other hand, they lead to a great worsening of the fiscal scenario and increased public debt. The increase in indebtedness caused by the pandemic is not the greatest risk in itself, but rather the uncertainty of the post-crisis period. Public debt will start 2021 at an unsustainable level for an emerging economy like Brazil. Therefore, it is even more imperative to restore the long-term debt reduction trend.

Continued spending on the pandemic or a lack of commitment to fiscal adjustment will worsen perception of the country's fiscal sustainability, which will result in higher interest rates to finance public debt, increasingly raising the costs to cover additional debts.
Furthermore, the loss of confidence in the country would discourage investment. As a consequence, Brazil would find it more difficult to grow. In this context, compliance with the fiscal rules and returning to the fiscal adjustment model are essential.

Graph 17 - Gross Debt/GDP Ratio above 90% in 2020

Course of the public sector's gross debt
(% of GDP)



Source: Central Bank of Brazil
*CNI Estimate

2021 Budget

The 2021 Annual Budget Bill (PLOA) provides a significant reduction in the primary deficit for 2021, when compared to 2020. This fall is basically explained by the atypical result in 2020, which was strongly influenced by the coronavirus pandemic. PLOA 2021 estimates a primary deficit of R$ 237.3 billion, or 3.1% of GDP, in the public sector.

The bill provides for a real growth of 4.0% in net revenue and a real decline of 22.4% in total expenses. For the Spending Cap to accommodate the increased mandatory expenditures in 2021, a 10.5% reduction in non-mandatory expenses will be required, which will affect investments. It should be noted that this trend has been repeated for many years.

Within mandatory expenditures, personnel and social security expenditures will increase by 0.9% and 0.8% in real terms, respectively. The effects of the pension reform will only be observed in the upcoming years. However, it is necessary to advance with a reform that controls personnel expenses, as those recorded a real increase of 8.6% from 2015 to 2019.

5 FOREIGN TRADE SECTOR

Current account deficit decreases due to the effects of the pandemic

Scenario for industry exports is challenging

Real is the most depreciated currency among emerging markets

EXCHANGE RATE - The real/dollar exchange rate maintained a fast depreciation trend until May, determined mainly by adverse international conditions, due to the shock of the Covid-19 pandemic on the world economy.
The real/dollar exchange rate reached R$ 5.94/US$ 1 in mid-May, the highest value since July 1, 1994, when the Real was introduced. Despite decreasing in June, reaching R$ 4.89/ US$ 1, it lost value again in the following months, closing September at R$ 5.40/US$ 1, on the average of the month.

Real was one of the most depreciated currencies during the most acute moment of the crisis (April/ May). Between January and May 2020, the real depreciated 23.9% against a broad currency basket, according to data from the BIS (Bank for International Settlements) on the real effective exchange rate. Real recorded the sharpest drop (i.e., depreciation) among 60 currencies, 22 of which are from emerging countries.

Alongside the real, other emerging currencies stood out with the greater depreciations: Mexico (-18.0%), South Africa (-17.7%) and Russia (-10.2%).

In the first months of the year, there was a massive flight of capital from emerging economies, due to greater risk aversion and the search for safer assets by international investors, common in other crisis. However, the scale and speed of capital outflow was what drew attention.

With regard to the outflow of capital from Brazil, the fall in portfolio investments (both stocks and bonds) held by non-residents in March stands out. The deficit in the portfolio investment account held by non-residents increased from US$ 2.8 billion in February to US$ 22.4 billion in March, according to data from the Central Bank. In April, a recovery started to be seen in these flows. The deficit fell from April to June, month that recorded surplus (US$ 5.5 billion). After a deficit of US$ 1.0 billion in June, August recorded a surplus of US$ 2.1 billion.

Graph 18 - Exchange rate reached R$ 5.94/US$ 1 in May
Daily exchange rate - in R$/US$

Source: Central Bank of Brazil

The countries' central banks acted to minimize the effects of the crisis, reducing interest rates and increasing liquidity. In the United States, the economy's basic interest rate came close to zero. Despite the measures, liquidity conditions remained tight for emerging economies, as the risk appetite remained low.

The worst impact of the crisis has already passed in the main world economies, but uncertainties are still high. Despite the increased liquidity in financial markets, risk appetite has not yet reached pre-crisis levels, given the increased uncertainty, which reduces the availability of resources for emerging countries.

In the domestic scenario, uncertainties related to the medium-term reform agenda (such as the tax reform, already under discussion) and to the fiscal consolidation process, factors that affect confidence and investment attraction, stand out.

Based on the increased uncertainties in the external scenario, which reduce risk appetite, as well as in the domestic scenario, which affect the regaining of investor confidence, an exchange rate of R$ 5.11/US$ 1 in 2020 average is expected.

Industry exports face extra challenges with the pandemic

TRADE BALANCE - The Brazilian trade balance (goods) recorded surplus of US$ 36.3 billion in the year until August, a growth of 12.8% compared to the same period in 2019, according to data from the Ministry of Economy. However, the improvement was due to the decrease in imports (-12.3%), accompanied by a minor drop in exports (-7.0%), considering the daily average. In the period, exports amounted to US$ 138 billion and imports to US$ 102 billion.

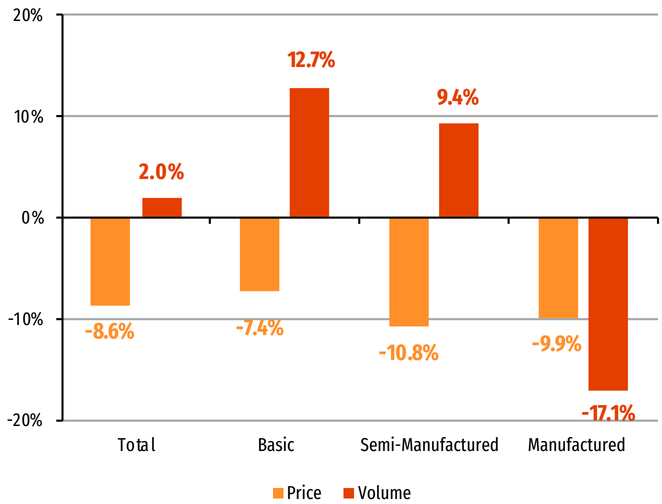
Only the exports of basic products did not drop in the year until August compared to the same period in 2019 (4.2% increase, in the US$ value, based on the daily average). Exports of semi-manufactured and manufactured products were 2.3% and 25% lower, respectively, considering the daily average[2].

The analysis in terms of price and quantity helps to shed a light on the behavior of exports. All product classes recorded fall in prices. Regarding basic products, the increase in export volume outweighed the unfavorable price behavior. Only manufactured products presented reduction in the export volume and prices.

Graph 19 - Only manufactured products recorded reduction in the volume exported in the year

Price and volume of total Brazilian exports and per product class

Variation between the average indices from January-August/2019 and January-August/2020 (%)



Source: FUNCEX.

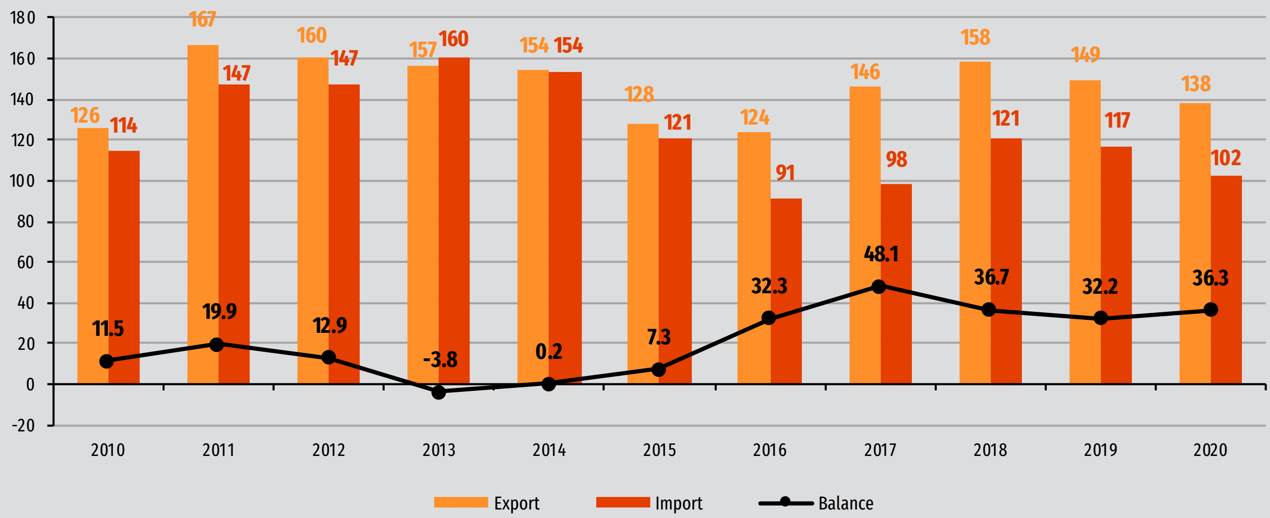
2 Less than half of Brazilian exports were industrialized products, which accounts for the sum of semi-manufactured and manufactured goods (41%), according to data from 2020. Exports of basic products represented 59% of the total export.

The forces that have hampered industry exports since 2018 have been intensified by the pandemic. Argentina – the second largest market for Brazilian manufactured products – has been in recession for two years and expects an additional decline of almost 10% in its GDP[3].
Another factor is the rise in trade tensions between the United States and China, observed since 2018, which has impacted global economic growth. Global growth fell from 3.6% in 2018 to 2.9% in 2019, and is expected to decline by 4.9% in 2020.

As regards to imports, all categories of goods recorded reduction in the imported volume[4] in the year until August, accompanied by a drop in prices, compared to the same period in 2019. In the case of durable consumer goods, the imported volume dropped by 39.8%, while the price index fell by 3.8%. Fuel imports may also be pointed out, with the second largest drop in the volume index (-10.7%), and the biggest fall in the price index (-27.9%). Intermediate goods, which account for more than half of total imports (60%), recorded falls of 6.9% in the imported volume and 6.2% in the price.

Given the global recession expected for 2020, with declines of 4.9% in global economy and 11.9% in the world trade of goods, according to the IMF, Brazilian exports face a challenging horizon until the end of the year, especially the industry. The improved performance in exports of basic products is not strong enough to prevent the fall in exports compared to 2019. Imports, in turn, will likely continue to fall compared to 2019, considering the expected decrease in domestic activity for the year. A trade balance for goods of US$ 56.4 billion is expected in 2020, according to CNI's estimate, with exports falling by 6.5%, to US$ 210.7 billion, and imports declining by 13%, to US$ 154.3 billion.

Graph 20 - Improvement in the trade balance mainly due to the fall in imports
Exports, imports and trade balance in the year to August
In US$ billions



Source: Secex.

3 Between 2017 and 2019, Argentina's GDP shrank 4.6% and its imports of manufactured goods (in US$) fell by 30.1%, according to data from the World Development Indicators of the World Bank and UNCTAD's COMTRADE database. For 2020, a 9.9% drop in Argentina's GDP is expected, based on the IMF estimates.
4 It is worth noting that capital goods recorded a 9.2% growth in the volume imported over the period, without discounting fictional imports from oil platforms (bookkeeping operation). However, when discounting the platforms, the result is a 7.3% drop in the imported volume, accompanied by a reduction of -0.1% in the price index.

Deterioration of external accounts is halted by the effects of the pandemic; the deficit should continue to decrease until the end of the year

EXTERNAL ACCOUNTS - The deterioration of external accounts observed since the beginning of 2018 was interrupted by the pandemic in March 2020. The current account deficit fell to US$ 25 billion in the year until August, according to data from the Central Bank.

In February 2020, before the first effects of the pandemic, the current account deficit was at US$ 56.5 billion (in the 12-month period to February). The deficit has been decreasing since March 2020 and already accumulates a 55.8% drop when compared to February, considering the last 12-month period. In relation to the same period in 2019 (12-month period to August 2019), the deficit declined by 46.2%.

The main contributions were from the trade and services balances. The deficit in the services balance fell from US$ 34.6 billion in February 2020 to US$ 25.6 billion in August 2020, considering the last 12-month period, a reduction of 26.1%. In relation to the same period in 2019, the deficit in the services balance is 27.4% lower.

The highlights in the services balance are the reduction of the deficit in international travel and transportation, reflecting social isolation measures, which had border restrictions on several countries, and the decline in the activity. The comparison between February and August 2020 shows a reduction of 49% in travel (from US$ 11 billion to US$ 5.6 billion) and of 29% in transportation (from US$ 5.9 billion to US$ 4.2 billion), considering the values for the last 12-month period up to the reference months.

The trade balance, in turn, recorded a US$ 45.2 billion surplus in August 2020, a growth of 25.3% in relation to February 2020, considering the values for the last 12-month period. Despite the increase, this surplus is still lower than the result recorded in the same period in 2019 (in the 12-month period to August 2019): US$ 47.1 billion.

Primary and secondary incomes also contributed to reducing the current account deficit. In primary revenues, the deficit fell from US$ 34.6 billion in February 2020 to US$ 46.9 billion in August 2020, considering the balance in the last 12-month period, a reduction of 21.8%. In relation to the same period in 2019 (12-month period to August 2019), the deficit declined by 21.2%.

Primary incomes present flows associated to the production process, financial assets and natural resource rentals, among residents and non-residents. The drop in the remittance of profits and dividends abroad is noteworthy, due to the issues faced by companies as a result of the pandemic. The deficit fell from US$ 14.9 billion in February 2020 to US$ 7 billion in August 2020, considering values in the last 12-month period up to the reference months.

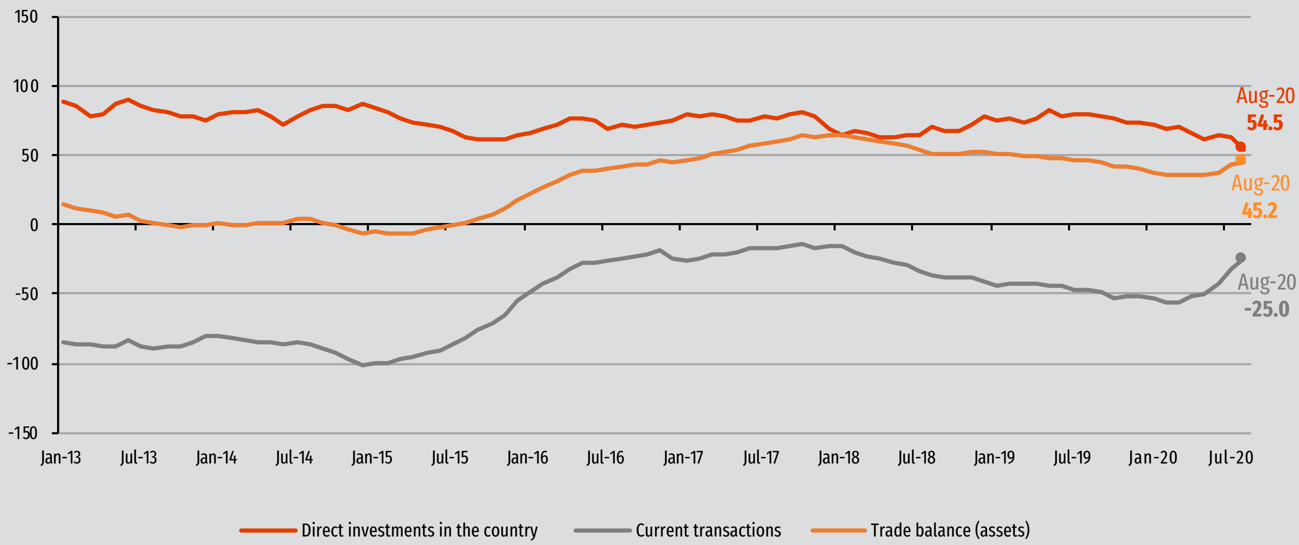
In secondary incomes, which show current transfers between residents and non-residents (e.g. between governments), the surplus increased from US$ 1.9 billion in February 2020 to US$ 2.3 billion in August 2020, considering the values in the 12-month period up to the reference months. In the same period in 2019 (12-month period to August 2019), it presented a surplus of US$ 1.2 billion.

It is worth point out that the pandemic also affected direct investments in the country, which finance the current account deficit. Direct investments in the country were of US$ 68.5 billion in 12-month period to February 2020, increasing to US$ 70.3 billion in March. Between March and August 2020, investments decreased by 22.5%, considering the values from the 12-month period up to the reference months.

Even with the fall, direct investment in the country reached US$ 54.5 billion in the last 12-month period to August, more than enough to offset the US$ 25 billion current account deficit.

At the end of the year, the deficit in the services balance is expected to keep falling, as the deficit in international travel and transportation will continue to decline in relation to 2019, as well as the remittance of profits and dividends abroad. The trade balance surplus, in turn, should continue to grow, mainly due to the fall in imports. As a result, the current account deficit will likely stay around 13.5 billion, which accounts for 1.2% of GDP, based on CNI estimate.

Graph 21 – Current account deficit is expected to fall further by the year end
Current account balance, trade balance and direct investments
In US$ billions



Source: Central Bank of Brazil.

6 PERSPECTIVES FOR THE BRAZILIAN ECONOMY

	2018	2019	2020 current estimate
ECONOMIC ACTIVITY			
GDP (annual variation)	1.3%	1.1%	**-4.2%**
Industrial GDP (annual variation)	0.5%	0.5%	**-4.1%**
Manufacturing industry GDP (annual variation)	1.5%	0.1%	**-6.3%**
Mining and quarrying industry GDP (annual variation)	0.8%	-1.1%	**2.1%**
Construction industry GDP (annual variation)	-3.8%	1.6%	**-4.5%**
Unemployment rate (annual average - % of labor force)	12.2%	11.9%	**13.5%**
INFLATION			
Inflation (IPCA - annual variation)	3.75%	4.31%	**2.57%**
INTEREST RATE			
Nominal interest rate (average rate in the year)	6.56%	5.96%	**2.81%**
Nominal interest rate (end of the year)	6.50%	4.50%	**2.00%**
Real income rate (*ex-post* average annual rate and defl. IPCA)	2.80%	2.1%	**-0.09%**
PUBLIC ACCOUNTS			
Primary result (% of GDP)	-1.57%	-0.85%	**-11.77%**
Nominal result (% of GDP)	-7.08%	-5.91%	**-16.26%**
Gross public debt (% of GDP)	76.50%	75.80%	**93.70%**
EXCHANGE RATE			
Nominal exchange rate- R$/US$ (December average)	3.88	4.11	**5.20**
Nominal exchange rate- R$/US$ (year average)	3.65	3.94	**5.11**
FOREIGN TRADE SECTOR			
Exports (US$ billion)	239.2	225.4	**210.7**
Imports (US$ billion)	181.2	177.4	**154.3**
Trade balance (US$ billion)	58.0	48.0	**56.4**
Current account balance (US$ billion)	-41.5	-50.9	**-13.5**

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