Brazil Macro | June 2023

Economic Activity

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SUMMARY

- **After a positive surprise in 1Q23, we are revising our GDP forecast for 2023 to +1.9% (previously: +1.0%)**, considering an even stronger-than-expected figure for farm output, its positive spillover to other sectors, and the effects on the services sector of greater labor market resilience (implying stronger growth for the real wage bill). Still, we continue to see signs of deceleration ahead, as more cyclical segments indicate a continued slowing trend owing to highly restrictive financial conditions. In addition, we expect the positive impact of the record summer crops to be limited to 1Q23 and the beginning of 2Q23.

- **With no major changes in our expectations for fiscal and monetary impulses, we maintained our GDP growth forecasts for 2024 and 2025.** Although we expect a gradual recovery throughout 2024, as financial conditions should become less restrictive, with easing monetary cycles both domestically and abroad, limited carryover from 2023 and the base effects from the one-off gain in farm output this year could limit growth next year: we forecast +0.5%. For 2025, we see the economy expanding at its long-term potential: +1.5%.

- **We are still seeing an overheated labor market, as the unemployment rate has remained at its lowest levels since mid-2015 (8.1%, seasonally adjusted), still largely influenced by a lower participation rate (labor supply).** We revised our labor market scenario, as we now assume that the participation rate will remain below its pre-pandemic historical average (~63%) at least until 2025. We now estimate an average unemployment rate of 8.2% in 2023 (previously: 9.2%), and 9.3% for both 2024 and 2025 (previously: 10.1% for both). We now forecast that the unemployment rate will probably remain below the structural level (NAIRU ~9.5% by 2024) until 2024.

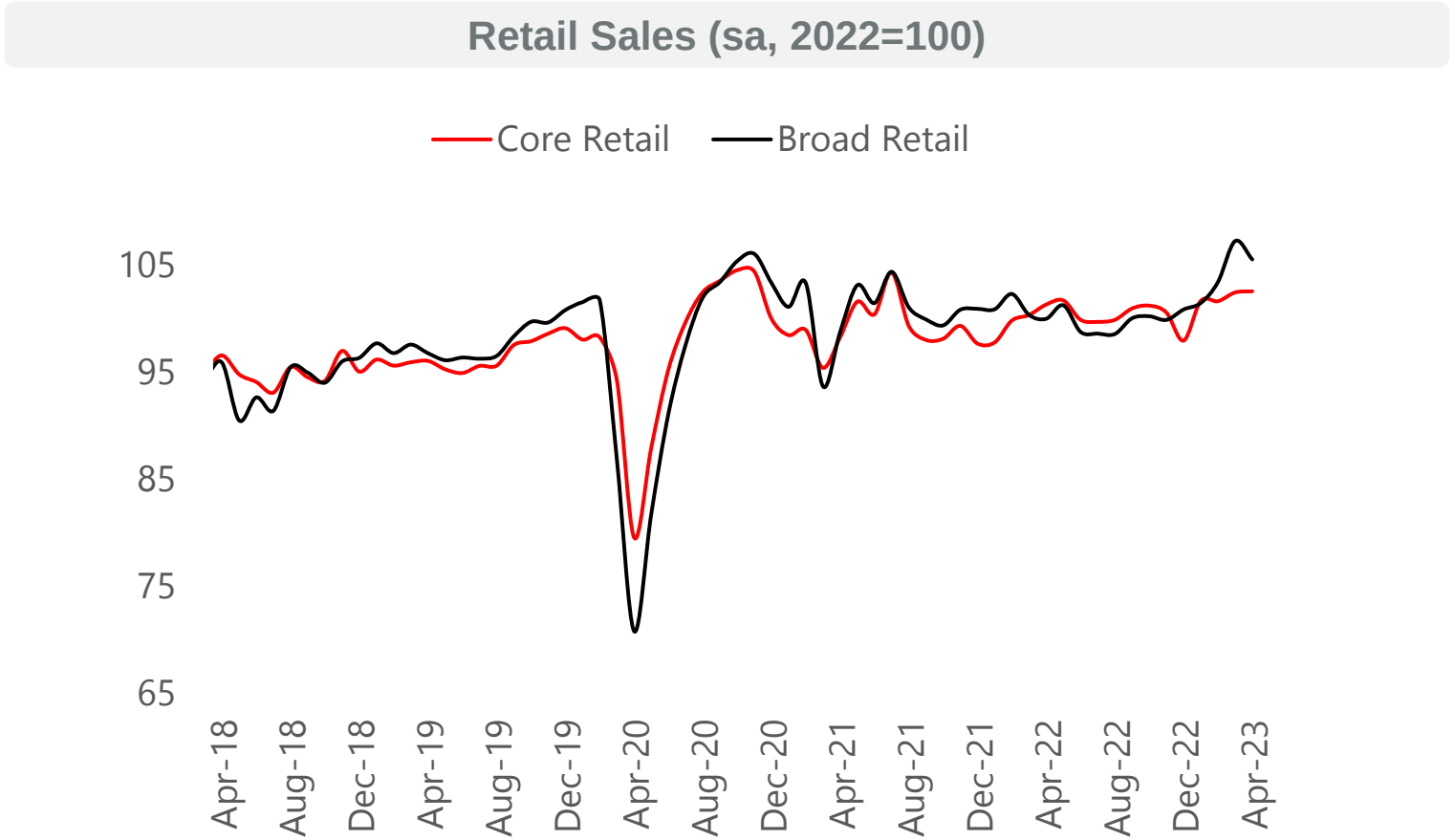
- **As we now consider a tight labor market for longer, we revised our 2023 “expanded” real wage bill growth forecast to 3.9% (previously: 3.1%).** We project 0.9% and 1.4% for 2024 and 2025, respectively (previously: 1.0% and 1.6%, respectively).

RETAIL SALES

01

After a Positive 1Q23, Broad Retail Sales Contracted in April

- The broad index decreased significantly, offsetting some of its recent gains, thanks to a weak performance from vehicle sales. Looking ahead, we expect retail activity to indicate a trend of tepid performances.

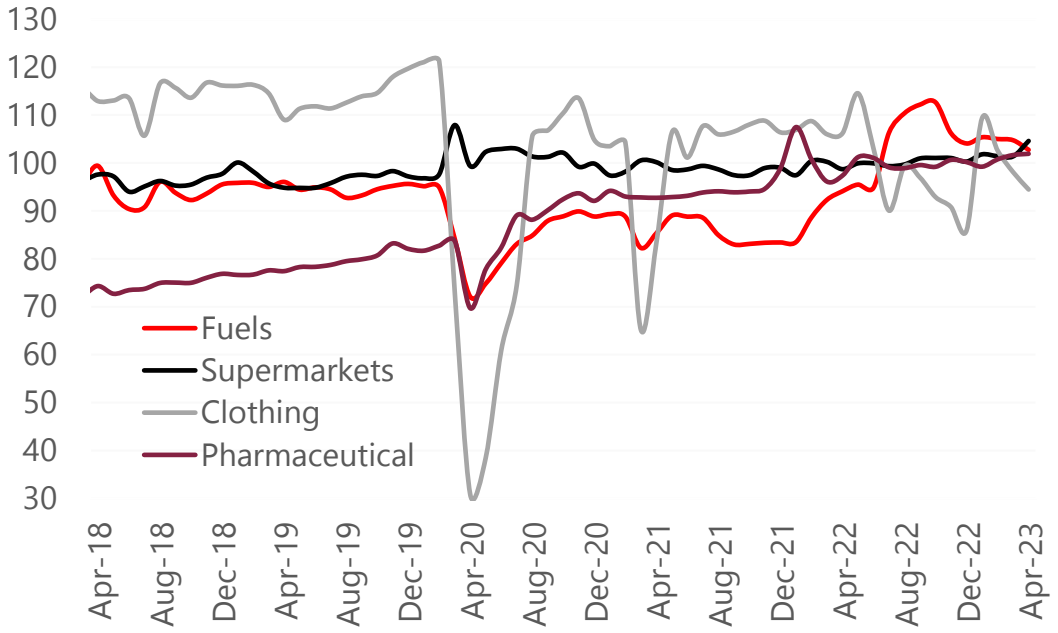


Sources: IBGE, Santander

Among Retail Activities, a Mixed Bag

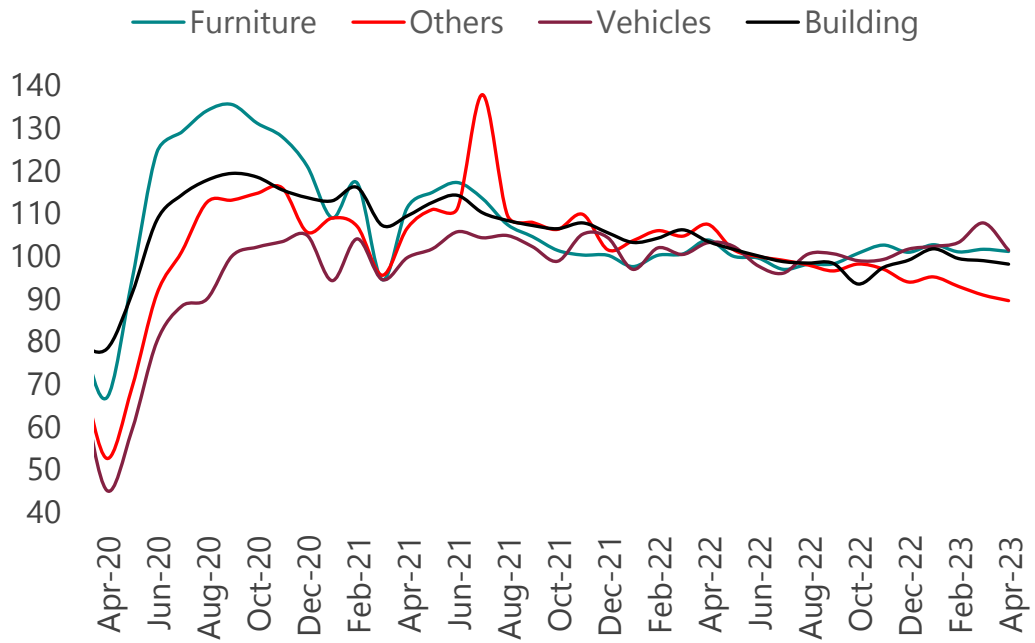
- We see a continued challenging environment for credit-led segments this year, owing to the critically restrictive levels of financial conditions. Income-led segments showed high volatility in the wake of government transfers and changes in taxation.

Income-led Segments (sa, 2022=100)



Sources: IBGE, Santander

Credit-led segments (sa, 2022=100)



Sources: IBGE, Santander

Retail Sales Breakdown

Retail Sales Breakdown										
		% MoM			% YoY			% QoQ		
Weights		Feb-23	Mar-23	Apr-23	Feb-23	Mar-23	Apr-23	Dec-22	Mar-23	Apr-23
60.8%	Core Retail Sales	0.0	0.8	0.1	1.1	3.3	0.5	-0.3	2.0	2.2
7.7%	Fuels	-0.4	-0.2	-1.9	19.9	14.3	8.7	-1.8	-2.4	-1.0
33.0%	Hypermarkets, supermarkets	-0.4	0.0	3.2	0.9	4.5	3.1	0.8	0.7	1.4
3.2%	Fabrics, clothing and footwear	-6.2	-4.4	-3.7	-8.9	-7.3	-11.0	-5.8	15.0	3.2
4.4%	Furniture and home appliances	-1.6	0.6	-0.5	-0.7	2.7	-2.4	3.8	0.4	-0.8
5.6%	Pharmaceuticals	1.5	0.9	0.3	-0.7	7.1	3.0	0.8	0.5	1.4
0.4%	Books, papers and magazine	5.2	0.9	1.0	-9.4	-8.0	-5.7	-6.0	-2.2	3.0
0.9%	Office equipment and supplies	-9.7	6.3	-7.2	-2.6	4.2	-5.8	1.2	1.7	-3.5
5.6%	Other personal items	-2.3	-2.2	-1.4	-12.9	-12.4	-18.0	-1.5	-3.5	-4.4
100%	Broad Retail Sales	1.9	3.7	-1.6	0.0	8.8	3.1	1.3	3.7	4.6
13.9%	Wholesale	-	-	-	-9.2	5.4	14.5	-	-	-
8.0%	Building Materials	-2.2	-0.5	-0.8	-5.7	-5.0	-7.6	-1.9	3.5	-0.5
17.2%	Vehicles	0.9	4.4	-5.9	-1.3	10.8	-1.9	0.9	4.5	3.0

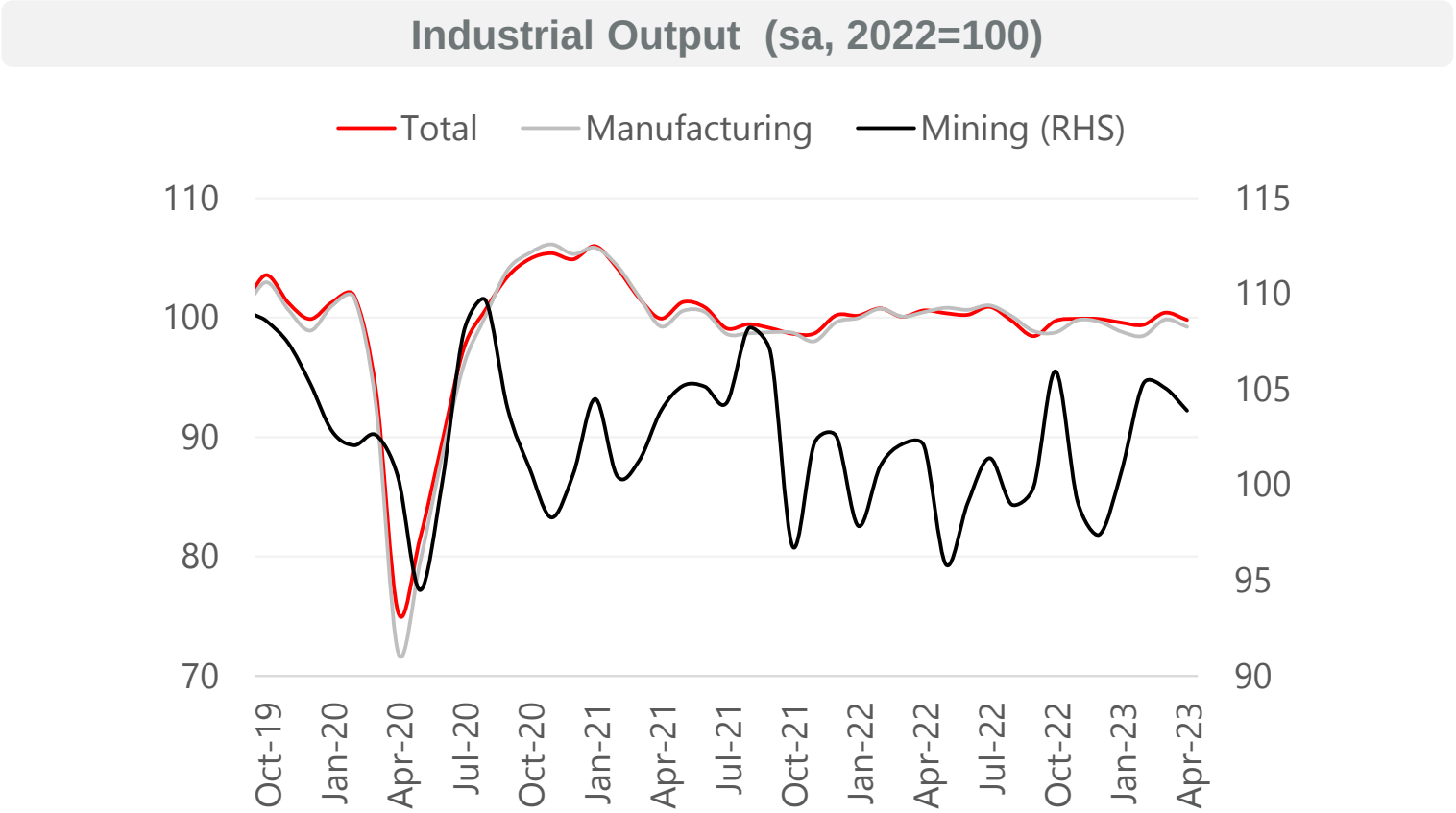
Sources: IBGE, Santander.
* For details, please see: https://bit.ly/Std-econact-061423

INDUSTRIAL PRODUCTION

02

Industrial Output Had a Negative Result in April

- The breakdown shows a negative impact from manufacturing following a positive figure in March, with mining also contracting once again. The diffusion index fell considerably from March's level. As financial conditions contractionary effects materialize, industrial output reacted with continued weakening, as the outlook remains challenging for cyclical industrial activities.

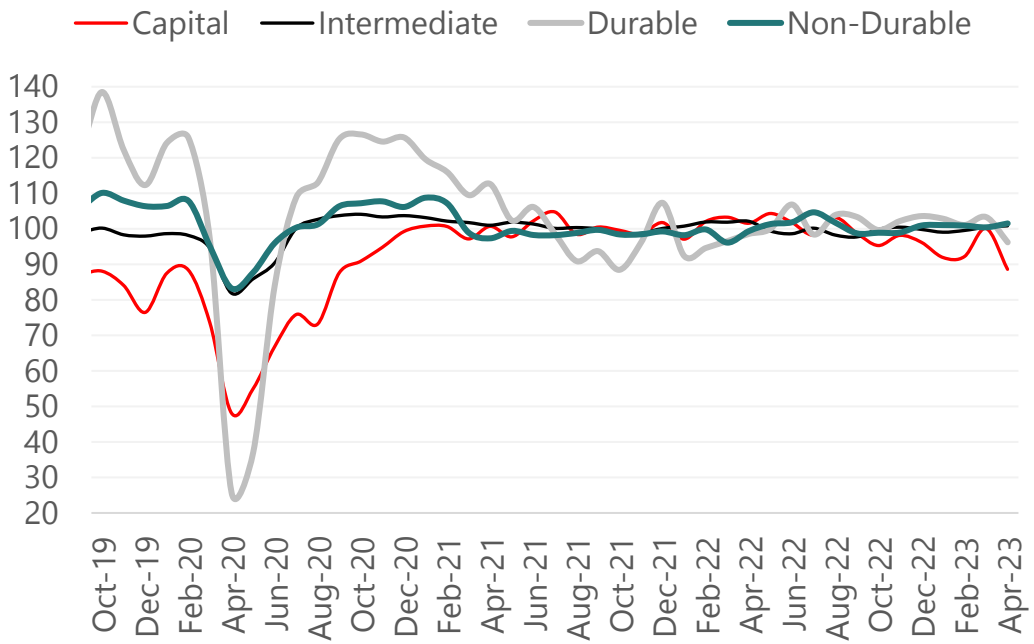


Sources: IBGE, Santander

Capital Goods Production was the Lowlight in April

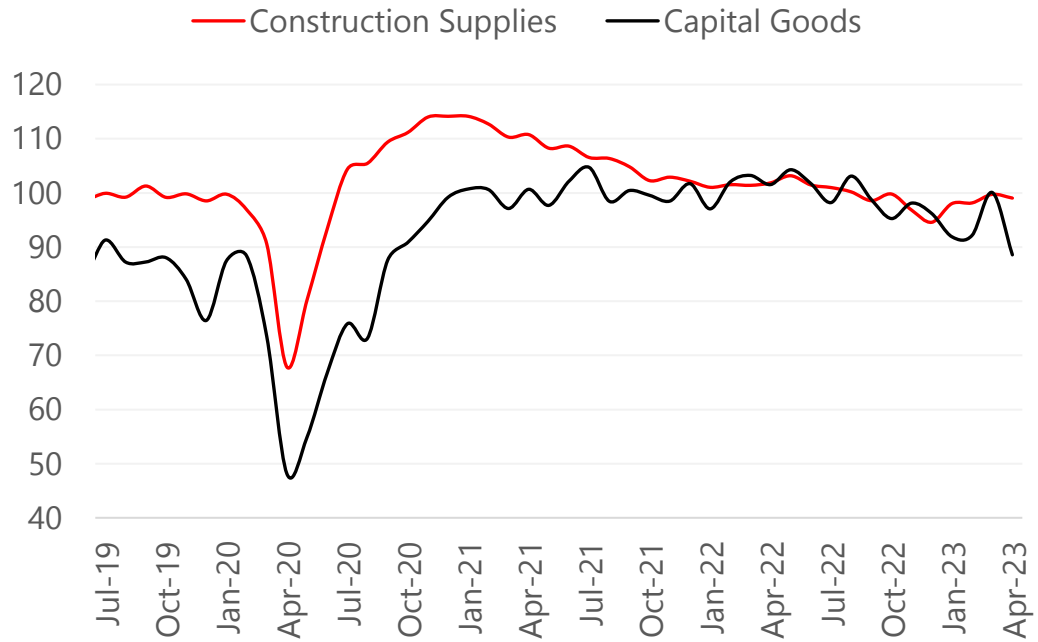
- Despite some volatility due to changes in emission rules for diesel engines, we see the capital goods production showing some deceleration. These elements bring additional concerns to investments amid an environment with rising interest rates.

Economic Categories (sa, 2022=100)



Sources: IBGE, Santander

Related to Investments (sa, 2022=100)



Sources: IBGE, Santander

Industrial Production Breakdown

Industrial Production Breakdown										
		% MoM			% YoY			% QoQ		
	Weights	Feb-23	Mar-23	Apr-23	Feb-23	Mar-23	Apr-23	Dec-22	Mar-23	Apr-23
Total Industry	100%	-0.2	1.0	-0.6	-2.4	0.9	-2.7	0.1	0.0	0.1
Mining	**15%**	**4.6**	**-0.2**	**-1.1**	**5.1**	**3.3**	**1.4**	**0.7**	**2.8**	**5.7**
Manufacturing	**85%**	**-0.4**	**1.4**	**-0.6**	**-3.7**	**0.5**	**-3.5**	**-0.6**	**-0.4**	**-0.2**
Capital Goods	6%	0.3	8.6	-11.5	-12.4	-0.5	-14.2	-3.5	-1.9	-1.9
Intermediate Goods	61%	0.5	0.9	0.4	-2.8	-1.1	-2.6	1.4	-0.4	0.5
Consumer goods	32%	-0.4	-1.2	1.1	0.5	5.7	-0.7	-1.7	0.7	-0.1
Durable	4%	-1.7	2.2	-6.9	2.1	11.1	-3.5	-3.5	-1.9	-1.9
Non-Durable	27%	-0.2	-0.5	1.1	0.2	4.7	-0.2	1.4	-0.4	0.5
Construction Supplies	**-**	**0.1**	**1.6**	**-0.7**	**-4.7**	**-0.9**	**-4.7**	**-2.9**	**1.6**	**2.6**

Sources: IBGE, Santander.

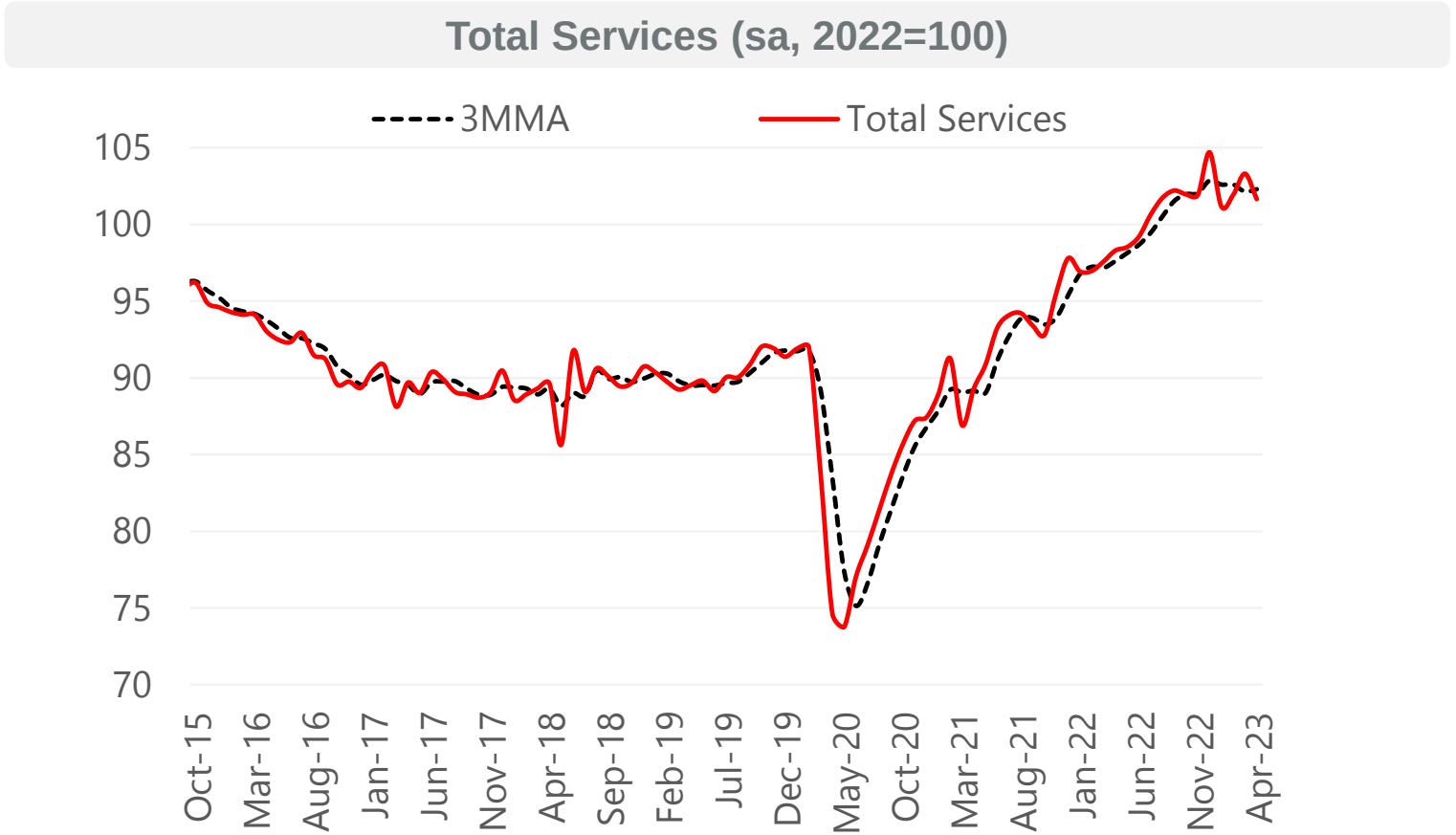
* For details, please see: https://bit.ly/Std-econact-060223

SERVICES

03

Services: High Volatility and a Deceleration Trend

- After a strong result in March, the services sector had a 1.6% MoM-sa tumble in April. The 3mma indicates a deceleration trend at the margin.

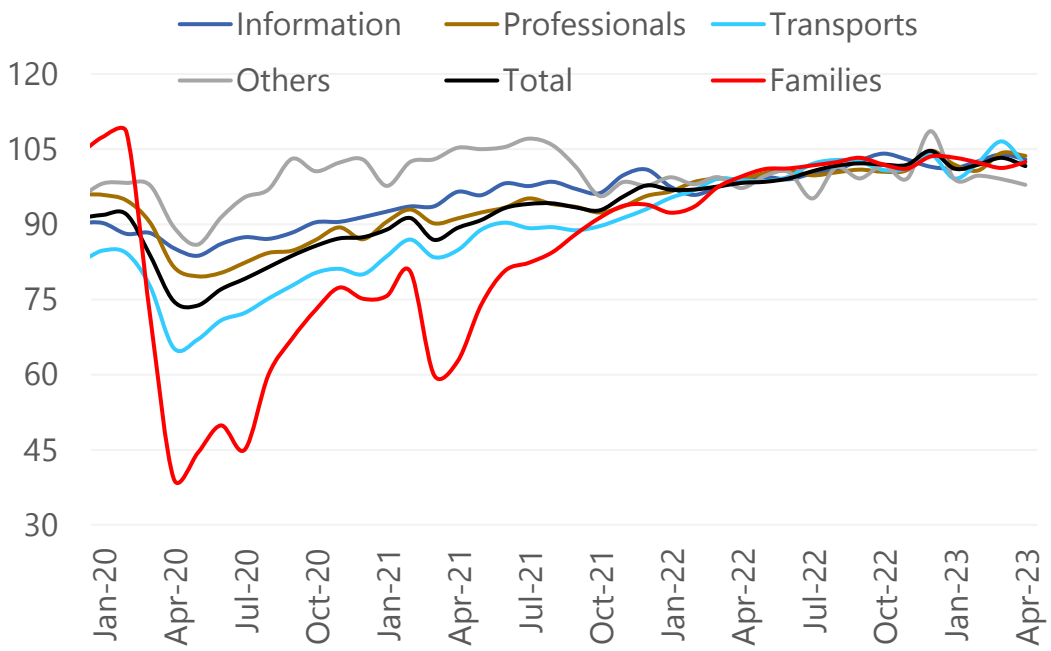


Sources: IBGE, Santander

Higher Volatility in Most Segments

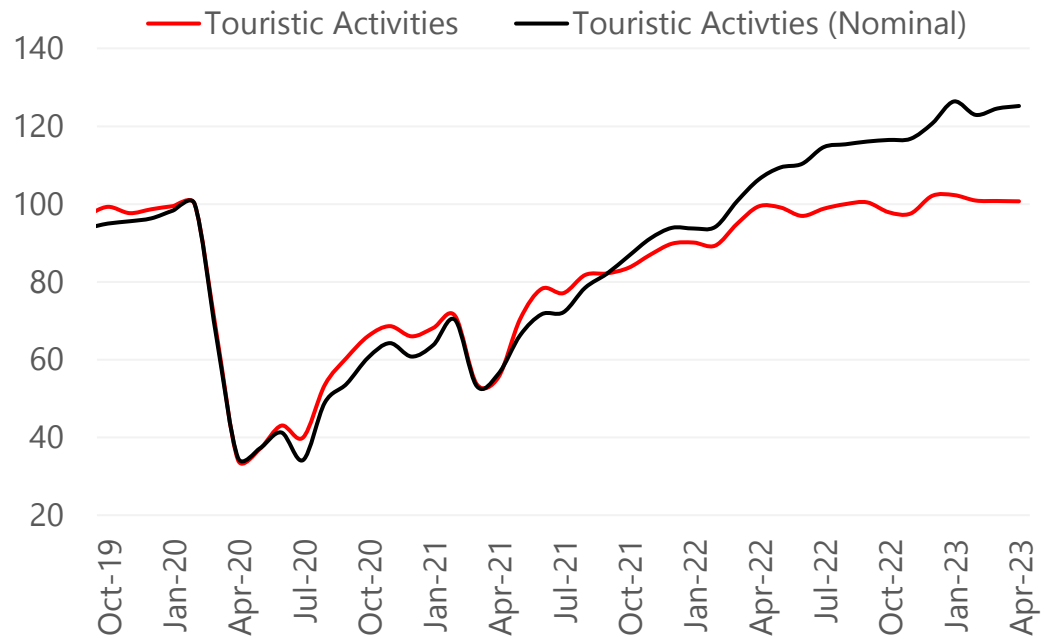
- Lately, the main services segments have been showing deceleration trends. However, we highlight that some of these segments have been showing higher volatility in the latest releases. In our view, most activities in the services sector tend to lose momentum as financial conditions remain highly restrictive.

Total Services Breakdown (sa, 2022=100)



Sources: IBGE, Santander

Touristic Activities (sa, 2022=100)



Sources: IBGE, Santander.

Services Sector Breakdown

Services Breakdown									
	% MoM			% YoY			% QoQ		
	Feb-23	Mar-23	Apr-23	Feb-23	Mar-23	Apr-23	Dec-22	Mar-23	Apr-23
Total Services	0.8	1.4	-1.6	4.8	6.5	2.7	1.3	-0.7	-0.3
Families	**-0.9**	**-1.1**	**1.2**	**10.4**	**3.3**	**2.9**	**-0.3**	**0.1**	**-0.6**
Accommodation and Food	-0.7	-2.9	3.7	11.8	3.4	1.7	-0.9	0.9	0.0
Other Services to Families	-5.1	5.6	3.5	2.7	2.9	10.0	1.5	-1.6	-0.6
Information	**1.4**	**1.4**	**-1.0**	**6.9**	**6.6**	**4.0**	**1.6**	**-0.2**	**1.3**
Technology	0.5	1.5	-1.2	7.5	6.5	4.4	1.5	-0.4	0.8
Audiovisual	1.9	4.1	-4.2	2.8	7.5	1.7	1.7	1.1	0.6
Professional	**-1.1**	**3.5**	**-0.6**	**2.0**	**6.0**	**4.0**	**1.6**	**0.3**	**0.4**
Professional	-0.6	1.4	3.6	6.1	4.6	11.0	0.3	1.9	2.4
Administrative	-0.3	2.2	-2.5	1.3	6.8	0.9	1.8	1.0	0.1
Transportation	**3.2**	**4.1**	**-4.4**	**5.3**	**8.6**	**2.0**	**-0.5**	**0.7**	**2.1**
Ground Transportation	1.7	4.1	-3.5	10.7	13.8	6.8	-0.2	2.3	2.9
Water Transportation	-0.7	1.1	-2.0	9.6	17.1	8.5	-0.2	2.1	0.1
Air Transport	4.7	2.7	-2.5	4.2	-7.5	-16.7	-4.1	3.7	3.9
Storage and Mail	5.4	6.7	-6.7	-3.8	2.0	-2.2	0.5	-3.7	0.7
Other Services	**0.7**	**-0.7**	**-1.1**	**0.6**	**0.5**	**-0.9**	**4.7**	**-3.8**	**-3.3**
Sewage	-	-	-	**3.6**	9.1	2.2	-	-	-
Financial	-	-	-	**-5.9**	-4.7	-8.3	-	-	-
Rents	-	-	-	**12.4**	15.9	12.8	-	-	-
Other	-	-	-	**11.8**	13.9	5.3	-	-	-
Touristic Activities	-1.4	-0.1	-0.1	14.2	6.3	1.4	-0.6	2.2	0.1

Sources: IBGE, Santander.

* For details, please see: https://bit.ly/Std-econact-061523

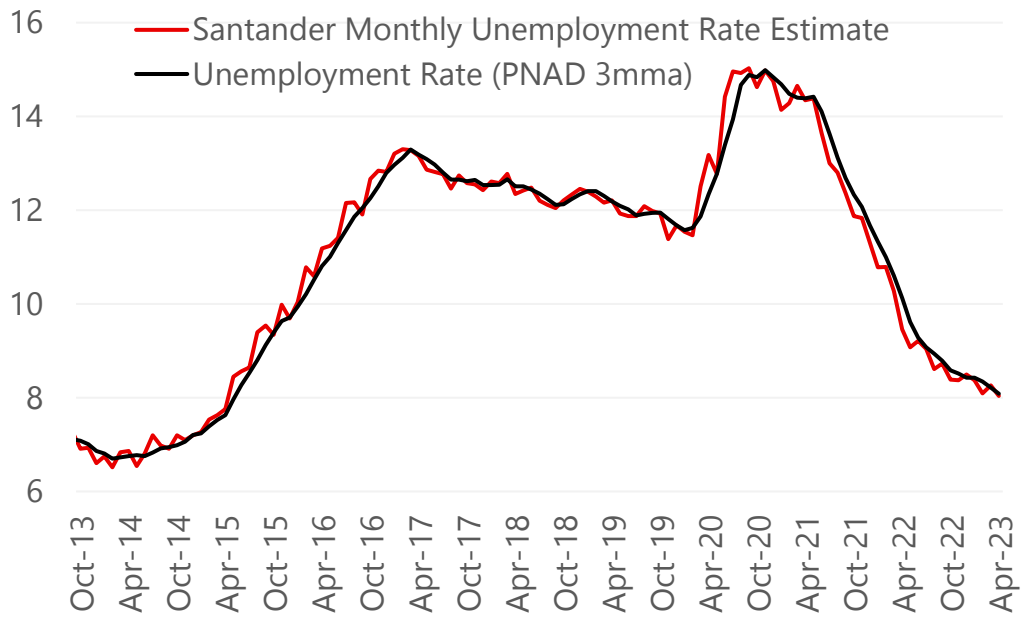
LABOR MARKET

04

Labor Market Remains Overheated

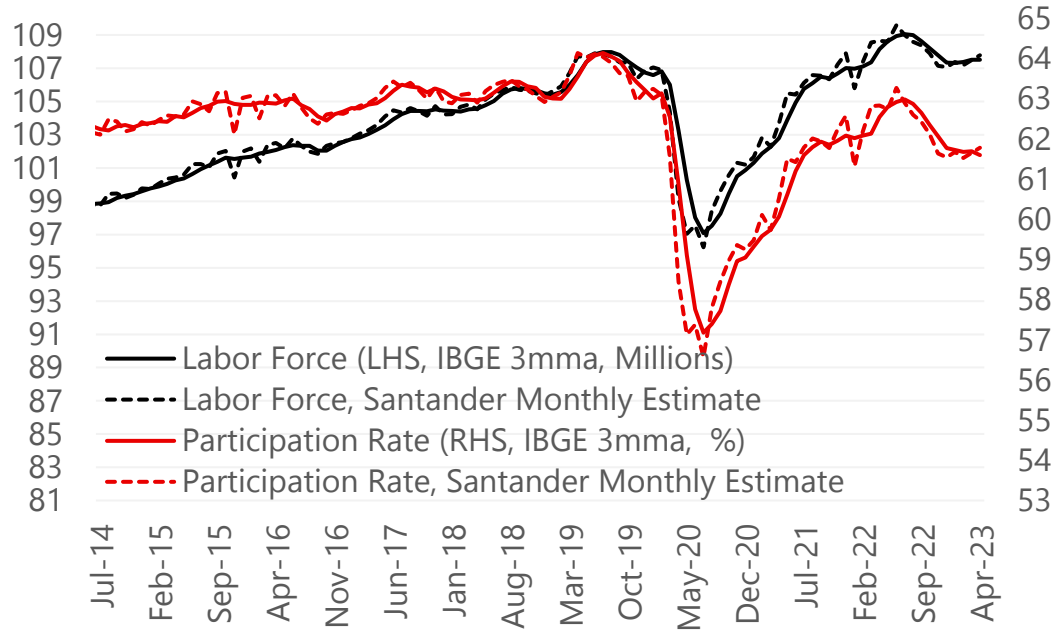
- The PNAD survey continues to show a likely overheated job market. In our assessment, the unemployment rate remains low more because of a reduction in the participation rate than because of employment growth.

Unemployment Rate (sa)



Sources: IBGE, Santander.

Labor Force and Participation Rate (sa)

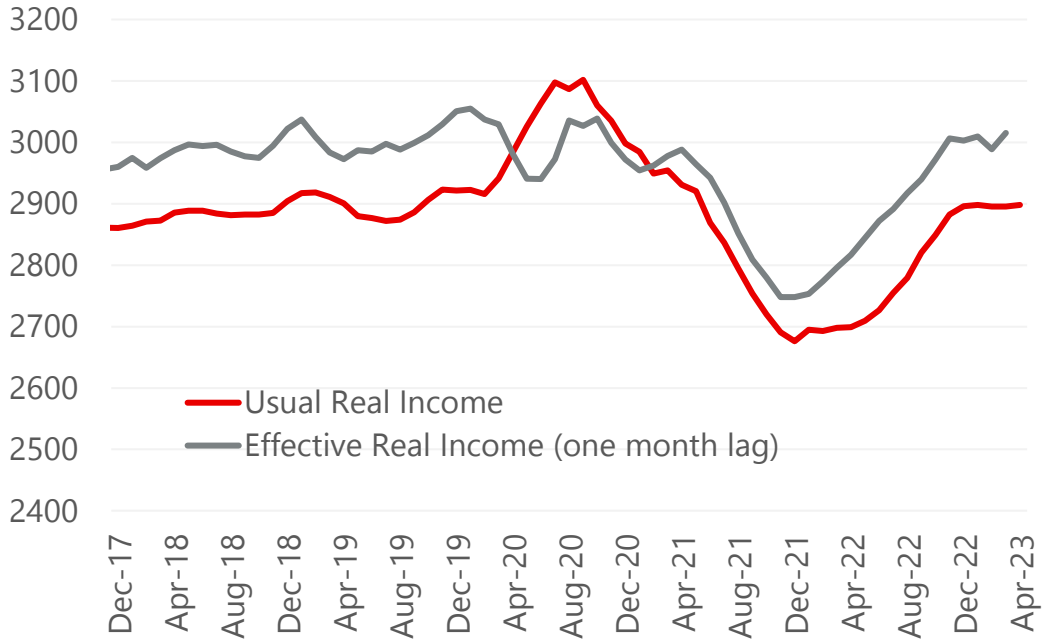


Sources: IBGE, Santander.

Average Real Income Shows Strong Recovery

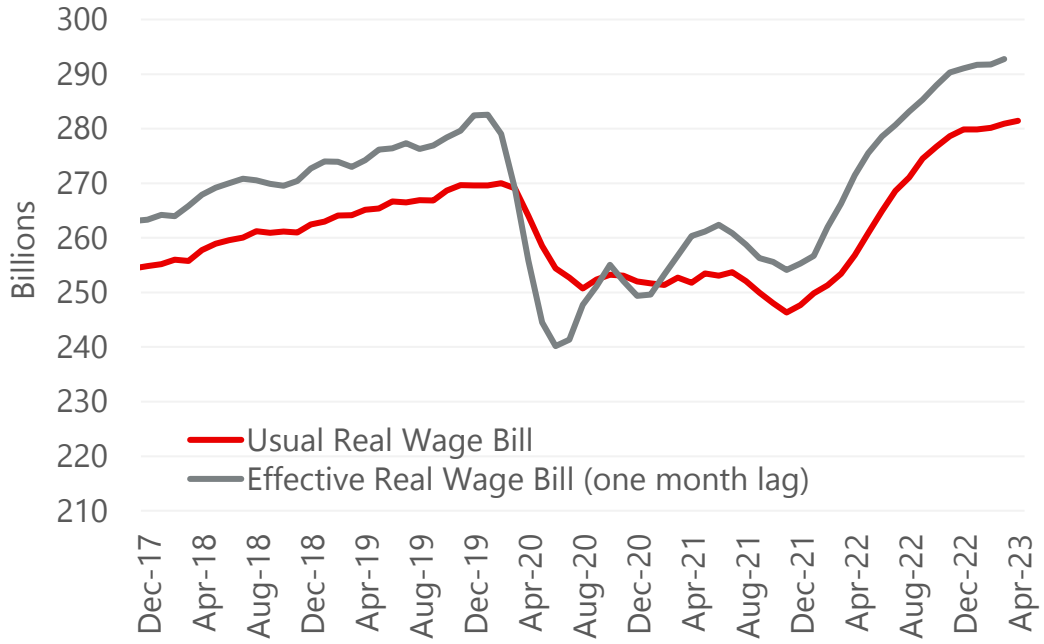
- The effective real average income posted a +0.9% MoM sa variation in March (data lagged one month relative to other PNAD series), while usual real average income posted a +0.1% MoM-sa variation in April. Both real wage bill series continue to benefit from the positive impact of a recovering trend in average real wages.

Average Real Income (BRL, sa)



Sources: IBGE, Santander.

Real Wage Bill (BRL, sa)

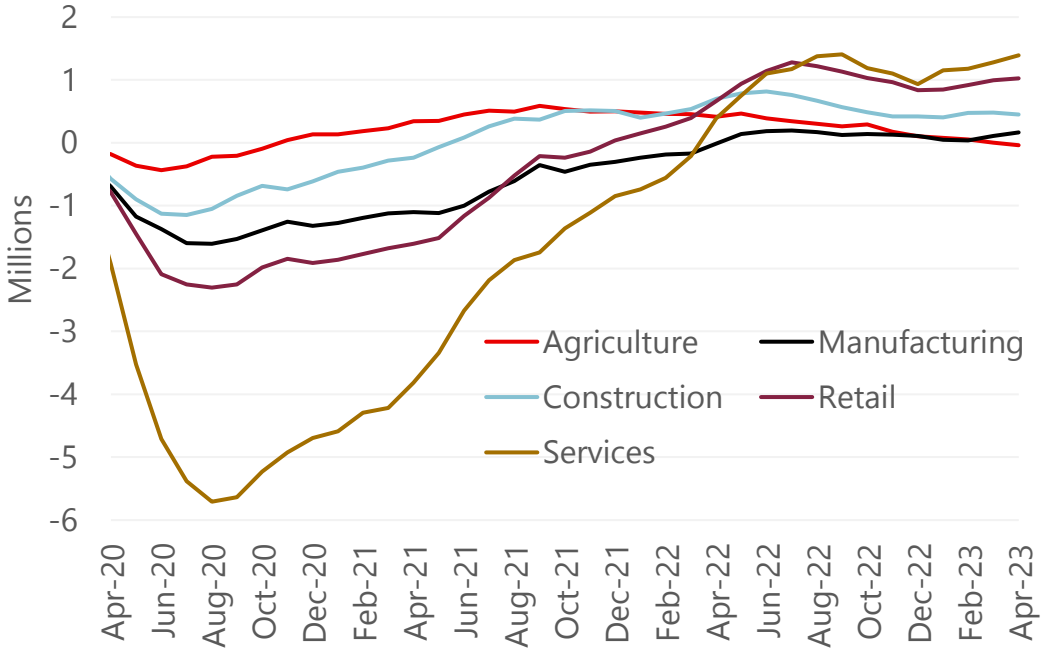


Sources: IBGE, Santander.

All Main Sectors Above the Pre-Crisis Mark

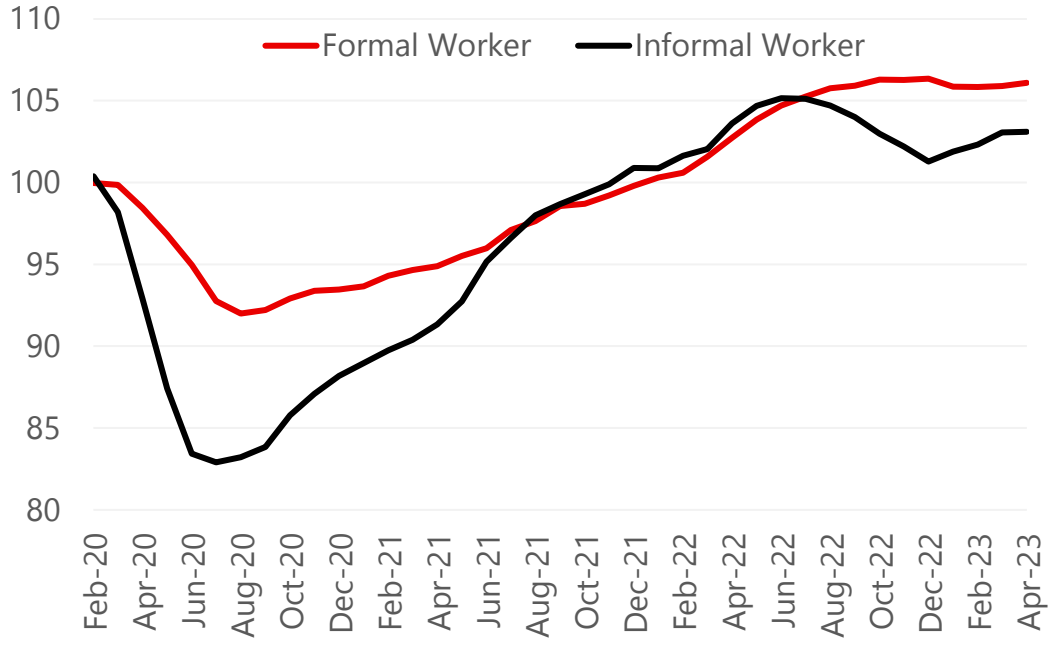
- Accommodation/food and Transportation were the highlights for job creation in April, while agriculture and construction both posted contractions at the margin. In our view, more cycle-sensitive sectors tend to signal deceleration or stability in employment ahead, due to tight financial conditions.

Post-Pandemic Accumulated Job Losses (sa)



Sources: IBGE, Santander.

Employment by Position (sa, Jan-20=100)

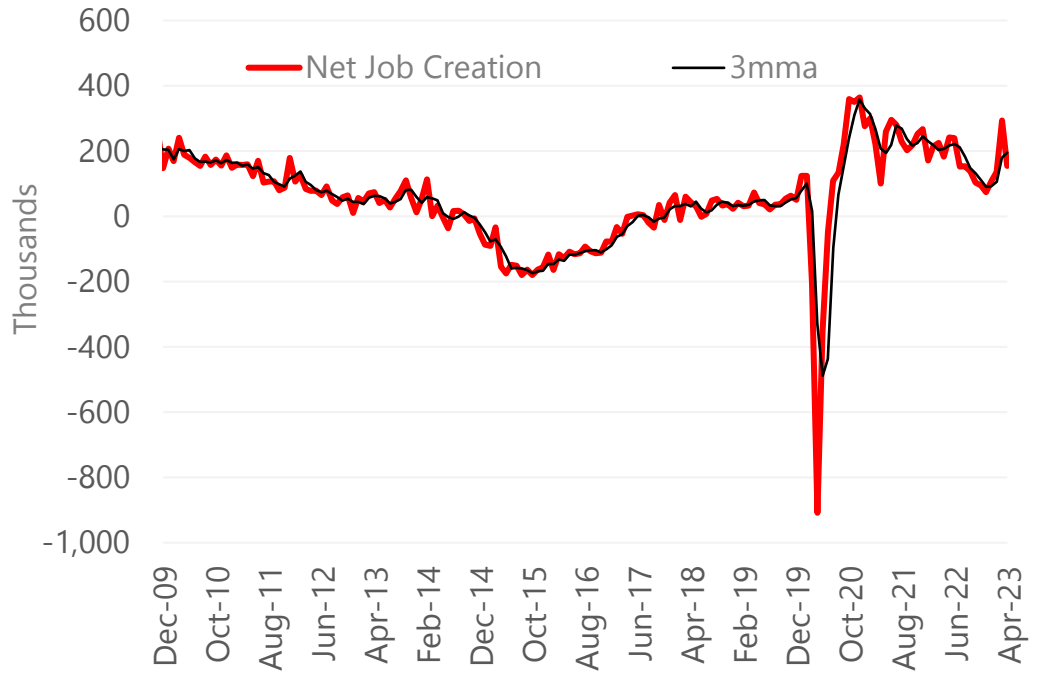


Sources: IBGE, Santander.

Monthly Payroll Expansion Influenced by March's Strong Result

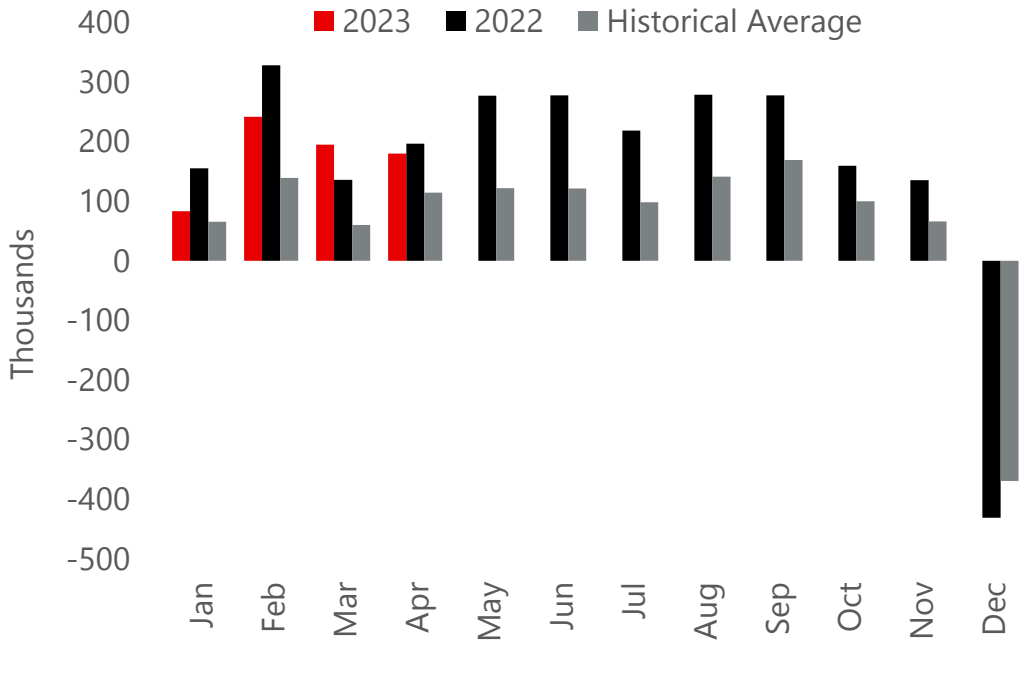
- According to the April 2023 CAGED survey, net formal job creation stood at +180k. After our seasonal adjustment, net formal job creation decelerated to 154k, from 293k in March. The three-month average now points to payroll expansion of 194k jobs, from 179k in March.

CAGED Net Job Creation (sa)



Sources: Ministry of Labor, Santander.

Net Job Creation and Historical Average

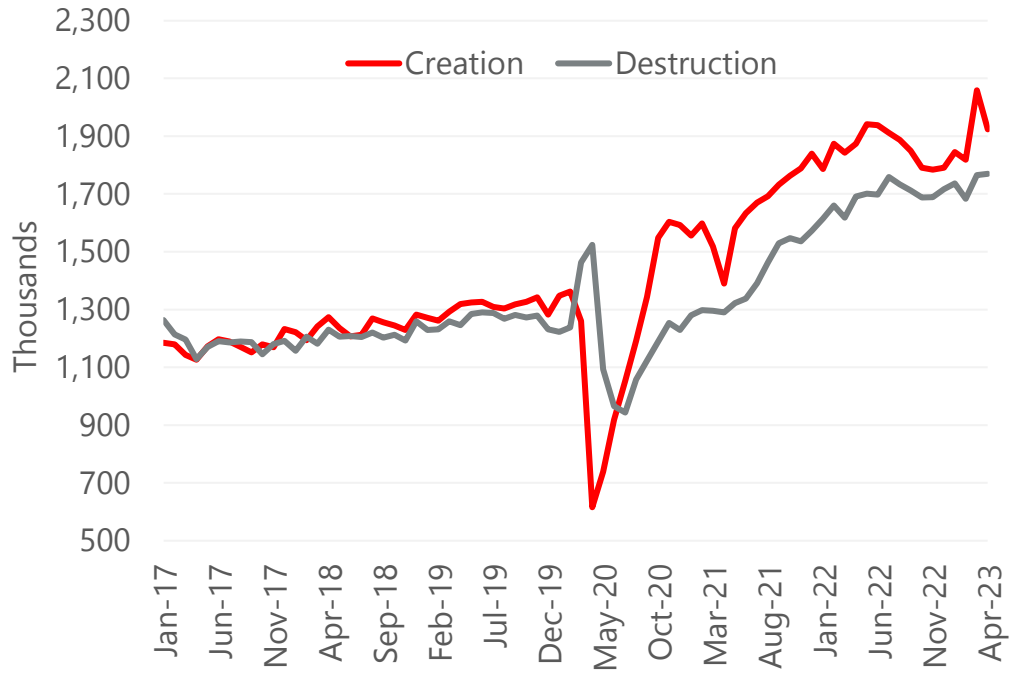


Sources: Ministry of Labor, Santander.

CAGED: Net Job Creation Still Above Joblessness-Neutral Level

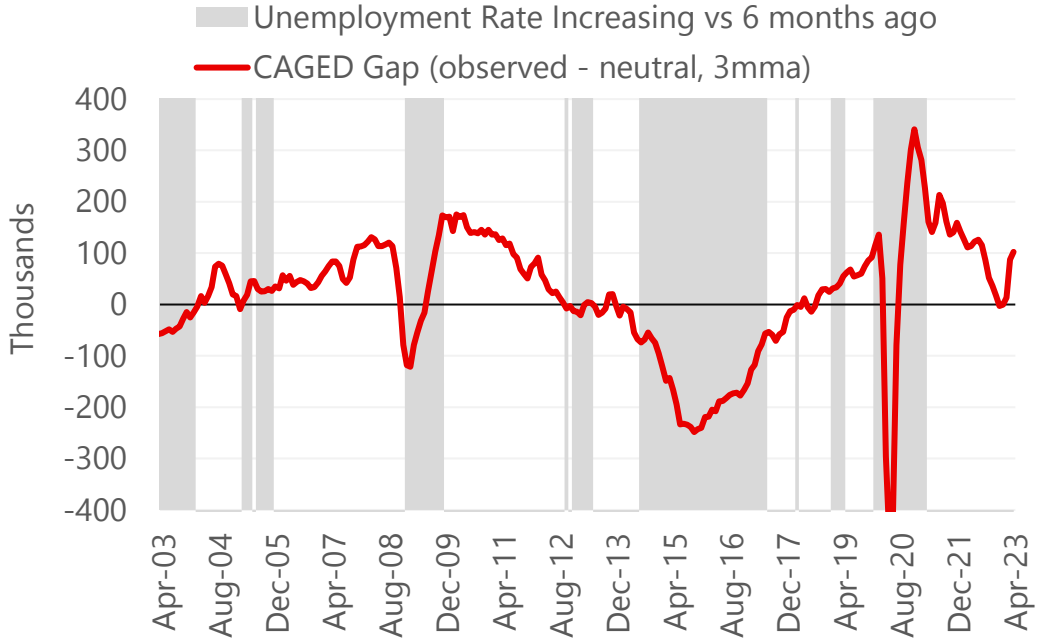
- The number of hirings had a -6.6% MoM-sa variation, while layoffs had a +0.2% MoM-sa variation. CAGED results stayed slightly above our estimate for the joblessness-neutral level. We estimate that the 3mma of CAGED's gap to the joblessness-neutral level (~100k) stood at +102k (+87k in March). In the past three months, the gap has increased considerably.

CAGED: Creation and Destruction (sa)



Sources: Ministry of Labor, Santander.

Net Job Creation Gap (sa)



Sources: Ministry of Labor, IBGE, Santander.

April 2023 PNAD Results

PNAD Breakdown	s.a.			% MoM-sa*			% YoY*		
	Feb-23	Mar-23	Apr-23	Feb-23	Mar-23	Apr-23	Feb-23	Mar-23	Apr-23
Unemployment rate (%)	8.3	8.2	8.1	-0.1	-0.1	-0.1	-2.6	-2.3	-2.0
Participation rate (%)	61.7	61.7	61.6	0.0	0.0	-0.1	-0.5	-0.5	-1.0
Labor force (millions)	107.4	107.5	107.5	0.0	0.1	0.0	0.1	0.0	-0.7
Employment	98.4	98.7	98.8	0.1	0.3	0.1	3.0	2.7	1.6
Unemployment	9.0	8.8	8.7	-0.9	-1.4	-1.5	-23.2	-21.1	-19.9
Formalization Rate (%)	58.1	57.9	57.9	-0.1	-0.2	0.0	1.1	0.8	0.9
Formal Workers (millions)	57.1	57.1	57.3	0.0	0.0	0.2	5.0	4.1	3.2
Informal Workers (millions)	41.2	41.5	41.6	0.4	0.7	0.0	0.4	0.8	-0.6
Average usual earnings (BRL)**	2,896	2,895	2,898	-0.1	0.0	0.1	7.5	7.3	7.4
Average effective earnings (BRL)**	2,989	3,016	-	-0.7	0.9	-	7.2	8.0	-
Usual wage bill (BRL bn)**	280.2	280.9	281.5	0.1	0.3	0.2	11.4	10.8	9.6
Effective wage bill (BRL bn)**	291.7	292.7	-	0.0	0.3	-	10.5	10.2	-

* For rates, change is in percentage points.

** In real terms

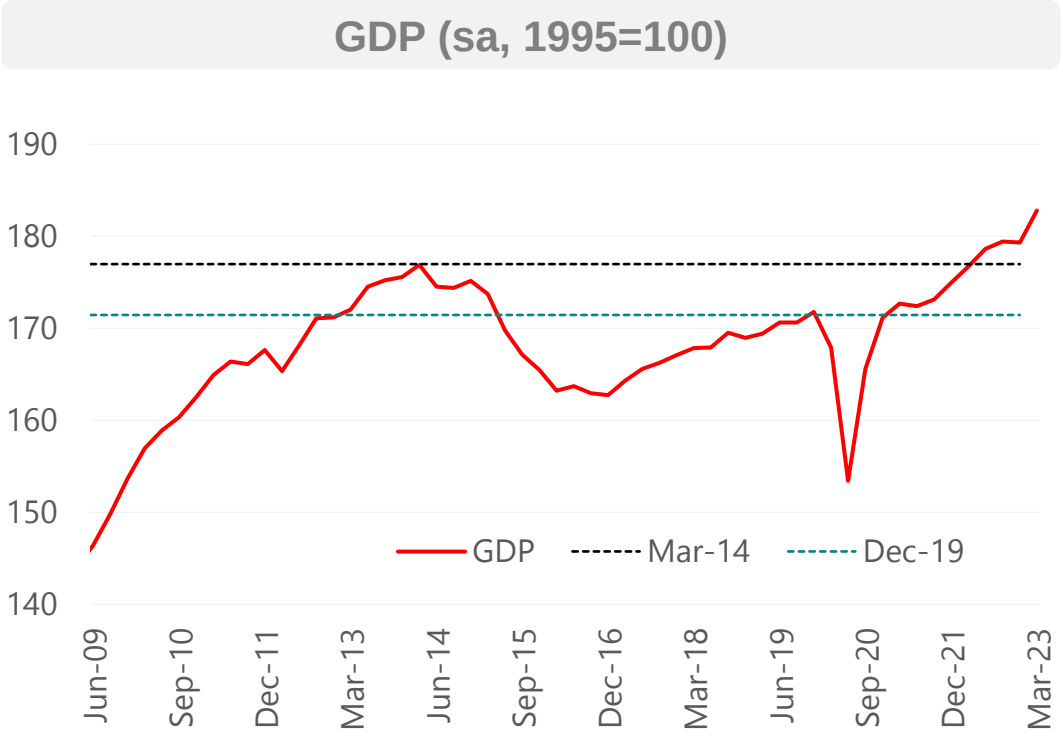
Sources: IBGE, Santander.

GDP

05

A Strong GDP Print, But a Weaker Breakdown

- After GDP lost steam in 2H22, 1Q23 data pointed to a hefty +1.9% QoQ-sa (+4.0% YoY) figure, on the heels of an even stronger-than-expected number for farm output , which jumped an astonishing 21.6% QoQ-sa, reflecting the record volume of summer grain crops. Although the agricultural result led to a spillover into other sectors, the breakdown was less positive, showing a clear deceleration for more cyclical sectors.



Sources: IBGE, Santander.

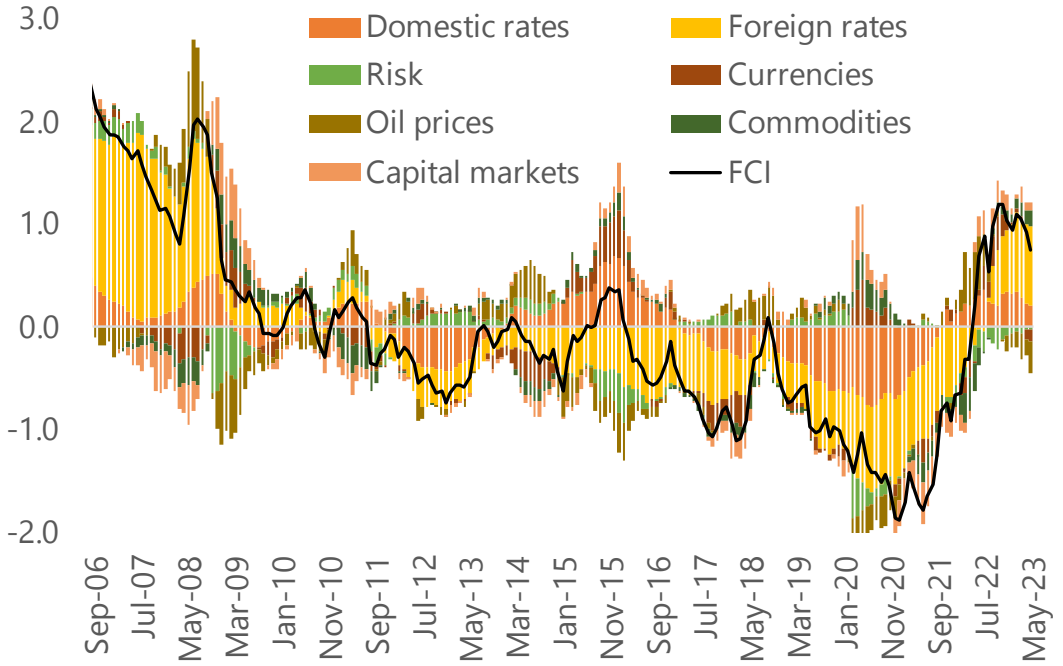
"Agricultural Sector Leads Strong 1Q23 GDP Growth" – June 01, 2023 – Available on: https://bit.ly/Std-GDP-1Q23

		1Q23e		1Q23		2022	4Q19*
		% YoY	% QoQ	% YoY	% QoQ	%	%
GDP	100%	3.0	1.2	4.0	1.9	2.9	6.4
Supply							
Taxes	15%	2.0	-0.8	3.0	-0.8	2.1	4.6
Farm Output	**7%**	**9.5**	**7.5**	**18.8**	**21.6**	**-1.7**	**21.0**
Industry	**19%**	**2.9**	**0.7**	**1.9**	**-0.1**	**1.6**	**3.5**
Mining	23%	9.3	3.5	7.7	2.3	-1.7	2.2
Manufacturing	51%	0.8	0.6	-0.9	-0.6	-0.3	-1.6
Construction	14%	1.9	-0.5	1.5	-0.8	6.9	14.7
Utilities	12%	0.7	-0.2	6.4	1.7	10.1	13.5
Services	**59%**	**2.8**	**0.4**	**2.9**	**0.6**	**4.2**	**6.6**
Retail	21%	1.8	0.8	1.6	0.3	0.8	3.5
Transports	6%	6.3	1.8	5.1	1.2	8.4	10.9
Information	5%	10.5	0.8	6.8	-1.4	5.4	22.3
Financial	9%	5.0	0.0	4.6	1.2	0.4	6.0
Other Services	23%	5.5	0.4	4.3	-0.5	11.1	10.4
Rents	14%	2.5	0.2	2.8	0.3	2.5	8.1
Public Services	24%	-0.6	-0.1	0.4	0.5	1.5	-0.1
Demand							
Consumption	**61%**	**5.4**	**1.5**	**3.5**	**0.2**	**4.3**	**4.1**
Government	**19%**	**1.7**	**0.7**	**1.2**	**0.3**	**1.5**	**2.4**
Investments	**19%**	**3.2**	**-1.7**	**0.8**	**-3.4**	**0.9**	**14.8**
Exports	**20%**	**7.0**	**-0.4**	**7.0**	**-0.4**	**5.5**	**12.3**
Imports	**19%**	**1.6**	**-7.4**	**2.2**	**-7.1**	**0.8**	**-1.9**

Financial Conditions Still Restrictive

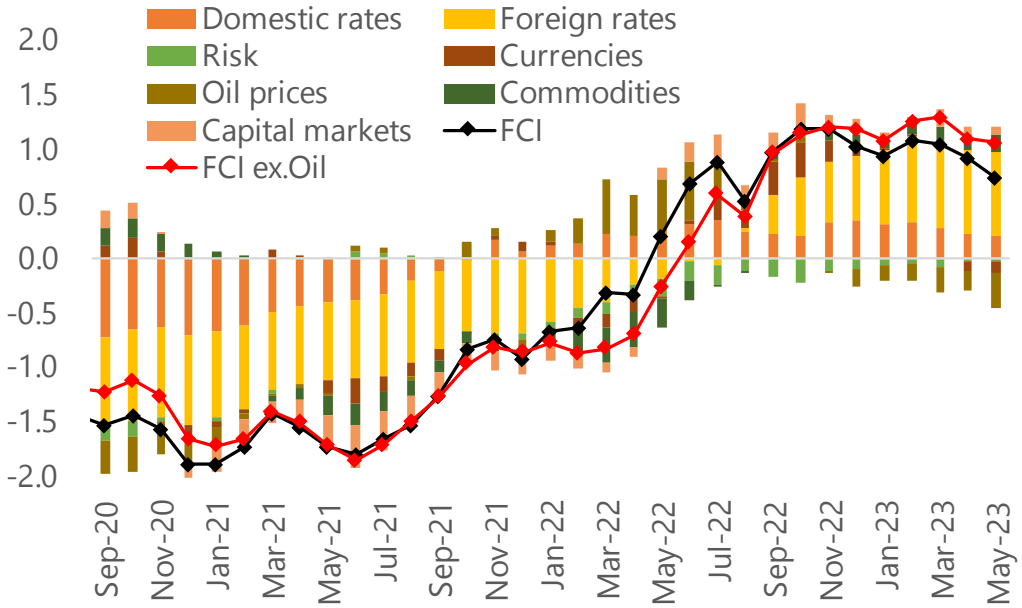
- Our proxy points out that financial conditions remain strongly restrictive, reflecting unfavorable elements in most components. The negative outlook for financial conditions suggests that cyclical activities will remain compromised in the short and medium term.

Santander's FCI Proxy (2006 to 2023)



Sources: Bloomberg, Santander.

Santander's FCI Proxy (2020 to 2023)



Sources: Bloomberg, Santander.

BASELINE SCENARIO

06

GDP: Key Hypotheses, Basic Description and Risks

- Main hypothesis: The effects of a tight monetary policy stance will continue to weigh on economic activity in 2023. We assume the positive impact from farm output will be limited to 1Q23 and that no further weather problems hit the main crop harvests in 2023 and 2024. In the face of higher consumer debt and higher NPLs, we expect a slowdown in credit in 2023, reversing part of the strong growth of the last three years, but in line with more restrictive financial conditions. Our scenario does not assume a major, dysfunctional credit crunch.

- After 1Q23's strong result, we see a tepid outlook for 2Q23, as the effects of the record-volume summer grain crops fade, and financial conditions remain highly restrictive. In this context, we expect the more cycle-sensitive sectors to continue to lose momentum, as contributions from the agricultural sector will probably be negative for the rest of the year. Our quarterly GDP path is as follows: stability in 2Q23 (+0.0% QoQ-sa) and sequential declines for 2Q23 to 1Q24 (on average, -0.2% QoQ-sa per quarter). We expect a gradual recovery in quarterly results throughout 2024, as we believe financial conditions will loosen in tandem with easing monetary cycles both domestically and abroad.

- **Upside risks:** Stronger than expected real household income amid a more resilient job market and a greater impact of government transfers on consumption. Resilience in commodity prices could favor investment. The program for household debt renegotiations (*Desenrola*) could mean slight upside risk for new loans to households in the short term.

- **Downside risks:** Stronger than expected inflationary resilience, leading the BCB to keep a tight policy stance for even longer. Weather problems dampening farm output. A dysfunctional evolution in the local credit market, potentially requiring BCB intervention with macroprudential measures, leading to a more intense than expected activity slowdown.

GDP Path and Breakdown

GDP Baseline Scenario			
	YoY	QoQ	Full Year
4Q22	1.9%	-0.1%	2.9%
1Q23	4.0%	1.9%	
2Q23	2.2%	0.0%	
3Q23	0.8%	-0.1%	
4Q23	0.7%	-0.3%	1.9%
1Q24	-0.5%	-0.1%	
2Q24	0.3%	0.4%	
3Q24	0.6%	0.1%	
4Q24	1.5%	0.5%	0.5%

Sources: IBGE, Santander.

GDP Projections						
	2019	2020	2021	2022	2023e	2024e
GDP	1.2	-3.3	5.0	2.9	1.9	0.5
Farm Output	0.4	4.2	0.3	-1.7	11.5	1.5
Industry	-0.7	-3.0	4.8	1.6	0.9	0.3
Services	1.5	-3.7	5.2	4.2	1.3	0.5
Household	2.6	-4.6	3.7	4.3	1.6	0.5
Government	-0.5	-3.7	3.5	1.5	1.8	2.3
Investments	4.0	-1.7	16.5	0.9	0.6	0.1
Exports	-2.6	-2.3	5.9	5.5	5.5	1.5
Imports	1.3	-9.5	12.0	0.8	1.1	1.0

Sources: IBGE, Santander

Lower Participation Rate Has Led Us to Reduce our Unemployment Rate Estimates

- The labor market has continued to post multi-year lows for the unemployment rate and remains overheated, in our view.

- We continue to project an increase in the unemployment rate throughout 2023, as we expect a continuation of the contractionary effects of monetary tightening, but we now expect the job market participation rate to remain short of its historical average (~63%) at least until 2025. We estimate the unemployment rate moving toward 8.5% throughout 2023, considering the lower participation rate. For 2023, our average unemployment rate forecast is at 8.2% (previously: 9.2%), while for both 2024 and 2025 we reduced our forecast to 9.3% (previously: 10.1%).

- **Upside risks:** Faster than expected growth in employment, on the heels of further positive surprises on labor intensive services.

- **Downside risks:** Stronger inflationary pressures leading the BCB to adopt an even tighter monetary policy stance in the medium term.

	2020	2021	2022	2023e	2024e
Unemployment Rate *					
Average	13.8	13.2	9.3	8.2	9.3
End of Period (s.a.)	14.8	11.7	8.4	8.6	9.5
Unemployed Population **					
Average	13.8	13.9	10.0	8.9	10.3
End of Period	15.0	12.5	9.2	9.4	10.5

* in %

** in Millions

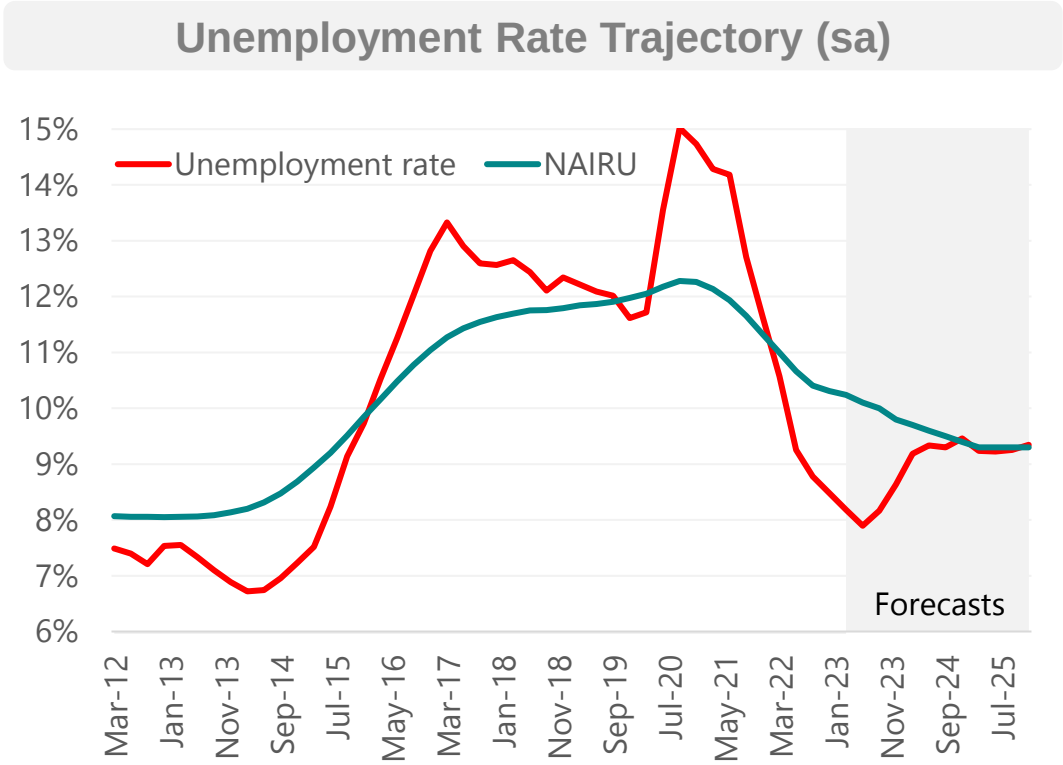
Sources: IBGE, Santander.

Job Market to Remain Tight Until 2024

- We also revised our assumption for the level of structural unemployment in the coming years (mainly 2025), which we now expect to be in the 9.0-9.5% range (previously: 10%). Therefore, we project that the unemployment rate will not reach its neutral level before 2024.

		May-23	Jun-23
Unemployment Rate (avg)	2023	9.2	8.2
	2024	10.1	9.3
	2025	10.1	9.3
Unemployment Rate (YE, sa)	2023	10.1	8.6
	2024	10.2	9.5
	2025	10.1	9.4
Unemployed (YE, Millions sa)	2023	11.2	9.4
	2024	11.4	10.5
	2025	11.4	10.4

Sources: IBGE, Santander.

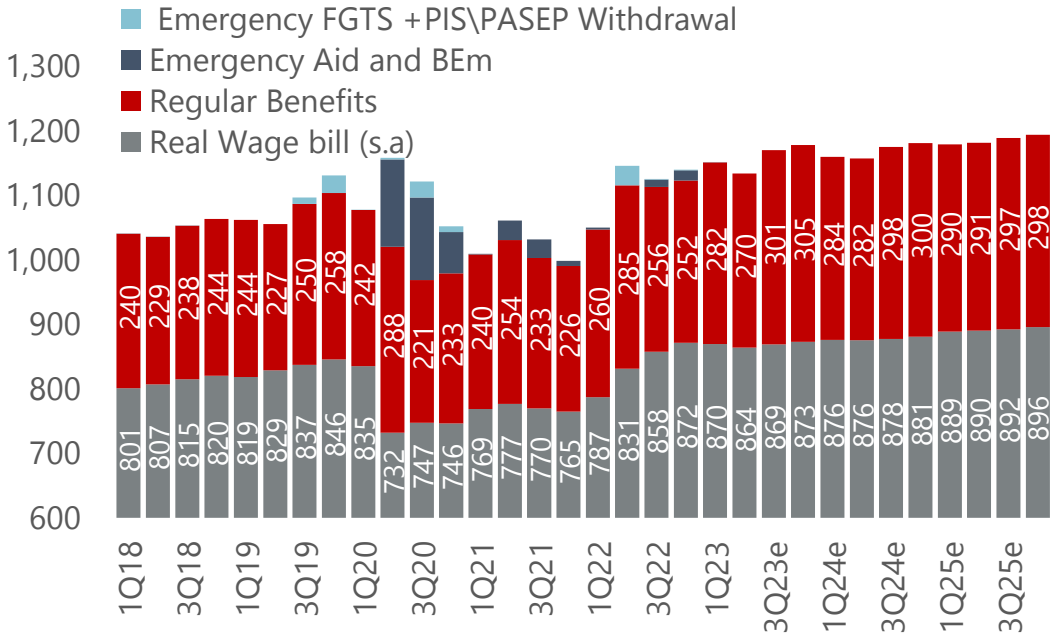


Sources: IBGE, Santander.

“Expanded” Real Wage Bill: Better Figures for 2023

- We raised our projections for the “expanded” real wage bill (a statistic that aggregates labor income with government transfers and social programs) in 2023. Once again, we increased our forecast for average real wages, now considering that the labor market will remain tight for longer. We project that the “expanded” real wage bill will grow 3.9%, 0.9%, and 1.4% in 2023, 2024, and 2025, respectively (previously: 3.1%, 1.0%, and 1.6%, respectively). We maintained our estimate for long-term “expanded” real wage bill growth at +1.4%.

“Expanded” Real Wage Bill (BRL billion)



Sources: National Treasury, IBGE, Ministry of Economy, Santander.

	2022	2023(E)	2024(E)	2025(E)	Long-Term
Real Wage Bill	+8.7%	+3.8%	+1.0%	+1.6%	+1.4%
Real Wage Bill (With Government Transfers)	+8.7%	+3.9%	+0.9%	+1.4%	+1.4%

Sources: National Treasury, IBGE, Ministry of Economy, Santander.

MACRO SCENARIO: Forecasts

Macroeconomic Variables		Previous		Current
GDP (%)	2023E	1.0	↑	1.9
	2024E	0.5	→	0.5
	2025E	1.5	→	1.5
IPCA (%)	2023E	6.0	↓	5.2
	2024E	3.9	→	3.9
	2025E	4.5	→	4.5
Selic Rate (% end of period)	2023E	13.00	↓	12.50
	2024E	11.00	→	11.00
	2025E	8.00	→	8.00
FX Rate - USDBRL (end of period)	2023E	5.40	→	5.40
	2024E	5.50	→	5.50
	2025E	5.55	→	5.55
Current Account Balance (% of GDP)	2023E	-3.1	↑	-2.6
	2024E	-3.4	↑	-2.9
	2025E	-3.1	↑	-2.8
Primary Fiscal Balance (% of GDP)	2023E	-1.1	↑	-1.0
	2024E	-1.1	↑	-1.0
	2025E	-0.9	↑	-0.8
Gross Public Debt (% of GDP)	2023E	77.8	↓	77.3
	2024E	81.9	↓	81.6
	2025E	85.0	↓	84.6

Sources: Santander | Note: Our previous forecasts date from May 05, 2023 (Scenario Update: "Fine Tuning This Year's GDP Estimate").

The forecasts refers to our latest Scenario Review

"Favorable Supply Shock Improves Policy Trade-off"
(sent on June 16, 2023)

For the full report click on the link:

https://bit.ly/Std-scenreview-jun23

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Our culture is based on believing that everything we do should be:

Simple Personal Fair

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