Economic Activity

December 2020

Macroeconomic Research

Santander

Executive Summary

The releases of economic activity indicators for the last four months highlighted the gradual and heterogeneous pattern of recovery presented by the Brazilian economy. Reflecting the effects of the emergency aid and a shift of consumer spending out of services (directly affected by social distancing measures) and into goods, **retail sales led this process**, more than offsetting April's tumble and reaching multiyear highs; **industry has also presented a strong resumption** in activity, fully recovering from the drop caused by the pandemic earlier this year. On the other hand, **the services sector has been the laggard**, still running well below February's reading (pre-crisis mark).

Considering the development of the economic indicators at the end of the previous quarter and at the start of 4Q20, we see no evidence of a flat GDP, as we expected in our previous scenario. Indeed, the resumption in activity seen for key indicators (e.g., industrial production, retail sales, services sector) **reinforces the likelihood of solid sequential growth in 4Q20**, in our view.

Regarding the labor market, the low participation rate is concealing the actual speed of deterioration in labor market conditions: in a simple counterfactual exercise, if we assume the workforce at February's level, the unemployment rate would reach more than 20%. On the heels of the easing of social distancing measures, we expect the labor force and participation rate to reach pre-crisis levels in 2Q21. In this context, **a sharp increase in the unemployment rate is unavoidable**, in our view : we expect it to reach an annual average of 13.5% in 2020 and 15.9% in 2021, with a gradual decrease to 13.3% in 2022, as the services sector reaches full recovery. Regarding the unemployed population, after reaching 12.0 million at the end of 2019, we expect it to reach more than 17 million (2Q21), with a gradual decrease to 14.3 million in 2022. **The conclusion is that labor market idleness is expected to remain high in the coming years**, despite some uncertainty about possible increases in the economy's natural rate of unemployment after the pandemic.

In an analysis of the impact of emergency aid on the real wage bill, considering government stimulus to households during the pandemic, we forecast a 3.9% rise in the "expanded" (i.e., including social benefits) wage bill, adjusted for inflation for full year 2020. In a counterfactual simulation without the fiscal stimulus, we calculate a 6% drop in the real wage bill, so that the benefits more than offset the estimated cyclical drop caused by the pandemic. For 2021, we estimate the so-called fiscal cliff to lead to a drop of 6-8% in aggregate wages. In terms of GDP, the impact of the latter on the economy should be offset by the reopening process (especially in the services sector, the largest one in the Brazilian economy), in our view, prompting sort of a "mechanical" rebound.

In our baseline scenario, we expect that the social distancing measures will be eased gradually until around the middle of 2021, with the economy in "full operation" mode in 3Q21. We also assume that **the pandemic will generate neither generalized bankruptcies nor a labor market collapse**, with no severe and lasting supply constraints, thus keeping the economy relatively well positioned for a continued recovery in a socially stable environment.

Considering all this, we are revising our projections for real GDP growth to -4.1%, 2.9%, and 2.5% (from -4.8%, 3.4% and 2.6%) for 2020, 2021, and 2022, respectively.

Lucas Maynard

Santander Macro Research Team

ECONOMIC ACTIVITY – SHORT-TERM INFORMATION SET

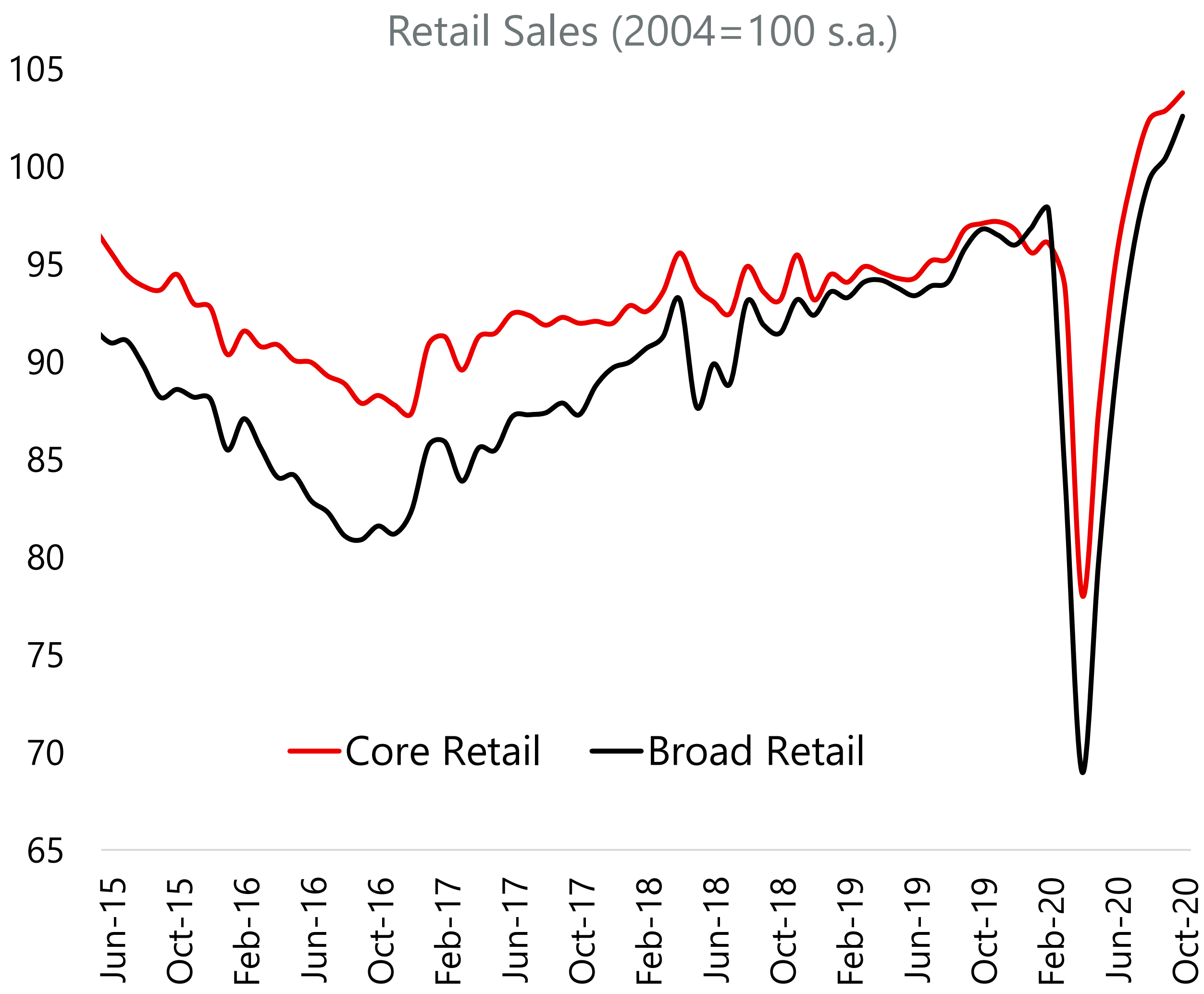
01

Retail Sales: V-Shape Resumption

- **Consumption** has been driving the recovery, with a pickup in on-line sales channels and following the increase in income transfers for groups with greater propensity to consume essential goods.

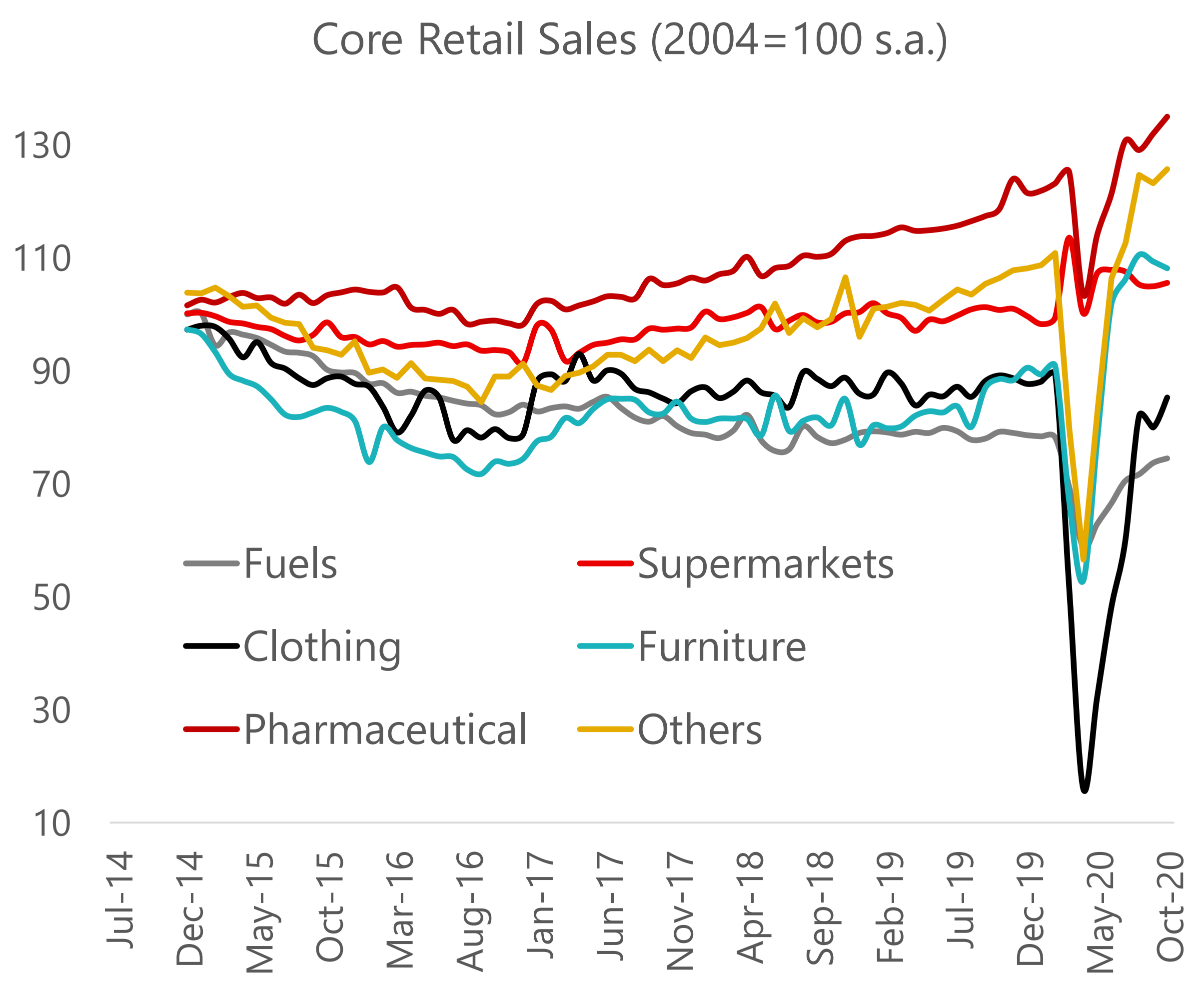
- Core retail sales has far surpassed the pre-crisis level, reaching multi-years high. Broad retail sales came in the sequence, driven by the sharp increase in **building materials** sales and the sequential recovery of **vehicle sales**.

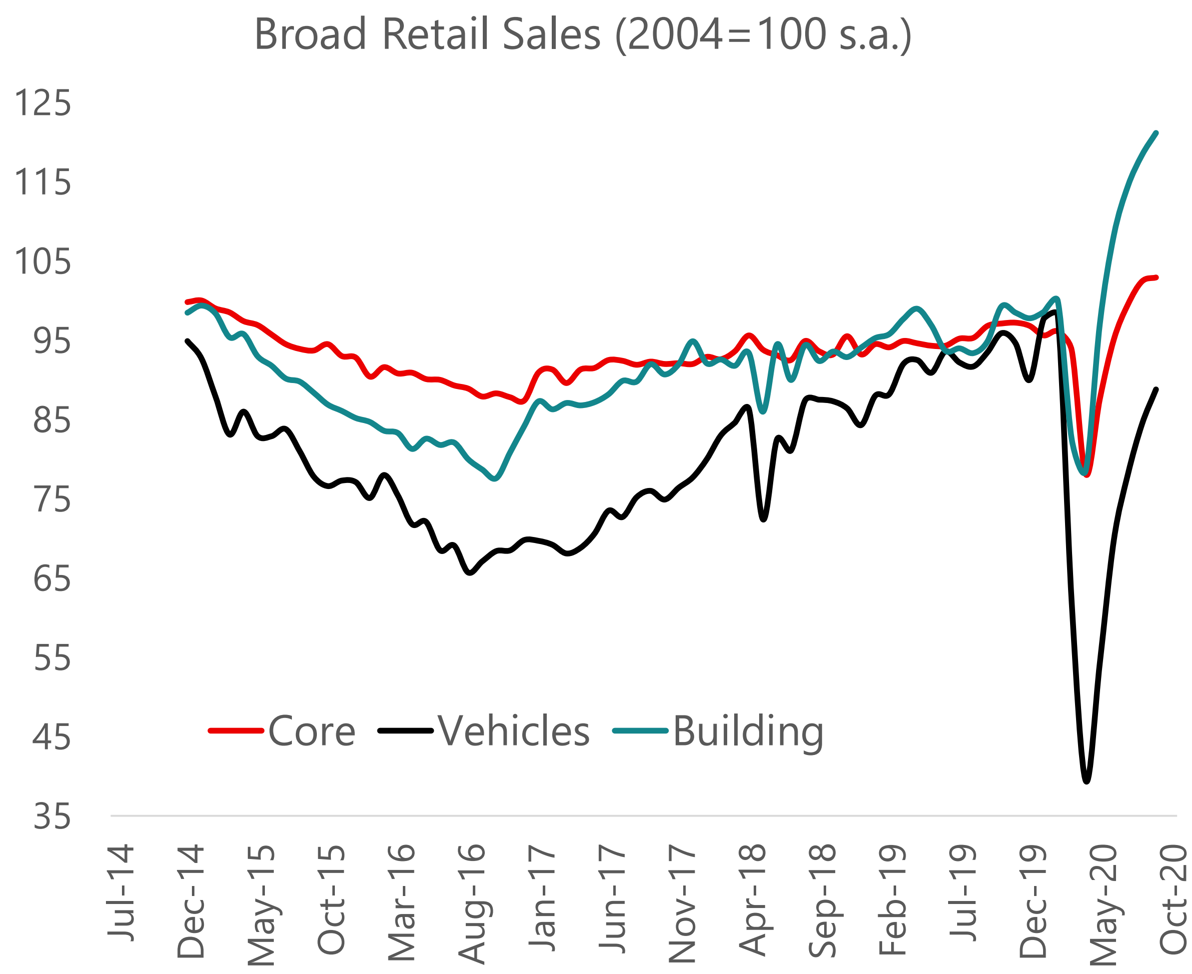
- We expect an accommodation move of retail sales in 4Q20, due to i) the reduction of the aid's value, ii) the decline in confidence and iii) inflationary pressures of essential goods, but we still see no evidence of quarterly sequential decline.



Sources: IBGE and Santander

Retail Sales: Breakdown

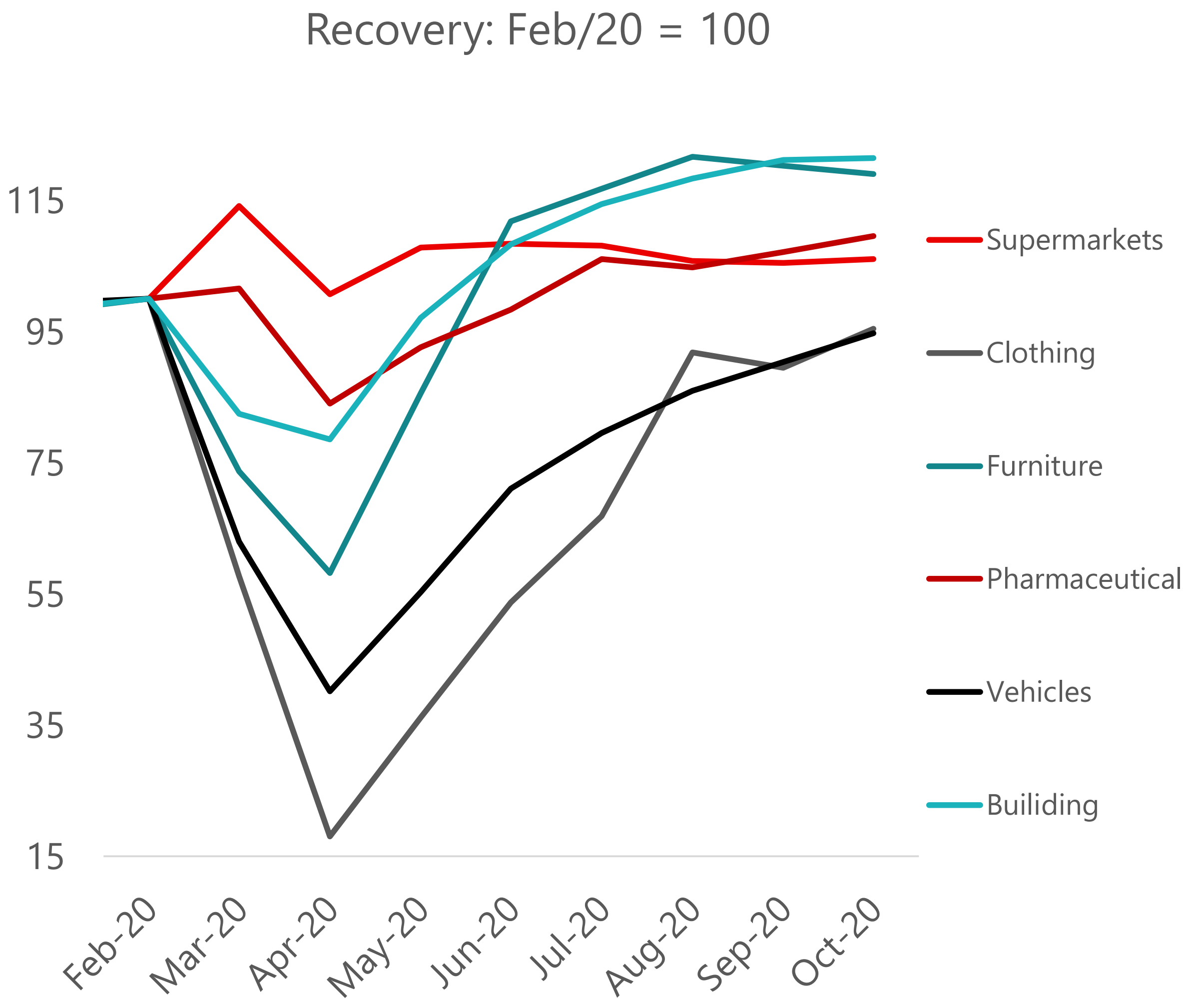




Sources: IBGE and Santander

Retail Sales: Recovery Evolving

- This more-than-established retail sales recovery can be analyzed highlighting the heterogeneous resumption among the main categories, breaking them down into three groups.
- The first one encompasses the categories that **benefited from the emergency aid and from the shift of household consumption** (from services towards goods). In this group, building and furniture have far surpassed their pre-crisis levels, and now are running at historically high levels.
- The second group comprises the categories that were more **resilient to the crisis**, such as supermarkets and pharmaceutical goods, with more moderate declines and showing steady recoveries, since both are considered **essential goods**.
- The third group encompasses **the most affected segments**, such as vehicles and clothing, considered **non-essential goods**, which recorded sharp declines due to the pandemic but are pointing to sharp increases in the previous months, getting closer to their pre-crisis levels

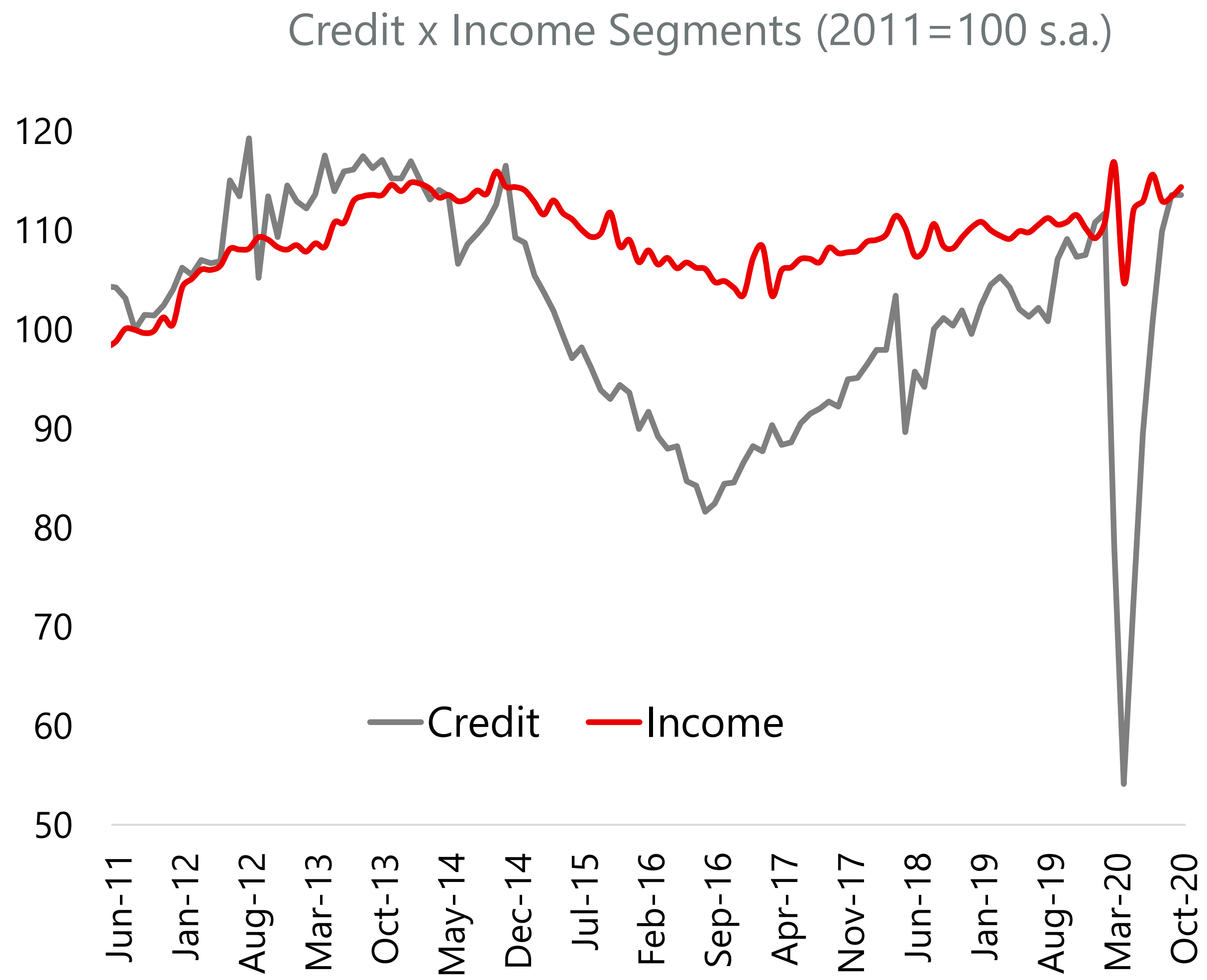


Sources: IBGE and Santander

Retail Sales: Sensitivity Analysis

- In a sensitivity analysis, the effect of income transferences is highlighted. Alongside the social distancing measures, the sized government transfers seem to have printed a clear pattern for household spending in recent months.

- In retail, sales of income-led segments (such as **supermarkets**, **pharmaceuticals**) fell significantly less than sales in the credit-led segments (e.g. **vehicles**). In comparison to February (pre-crisis), the index in April (worst moment of the crisis) for sales associated with credit concessions was -51.4% below, against -5.4% for the income-related.



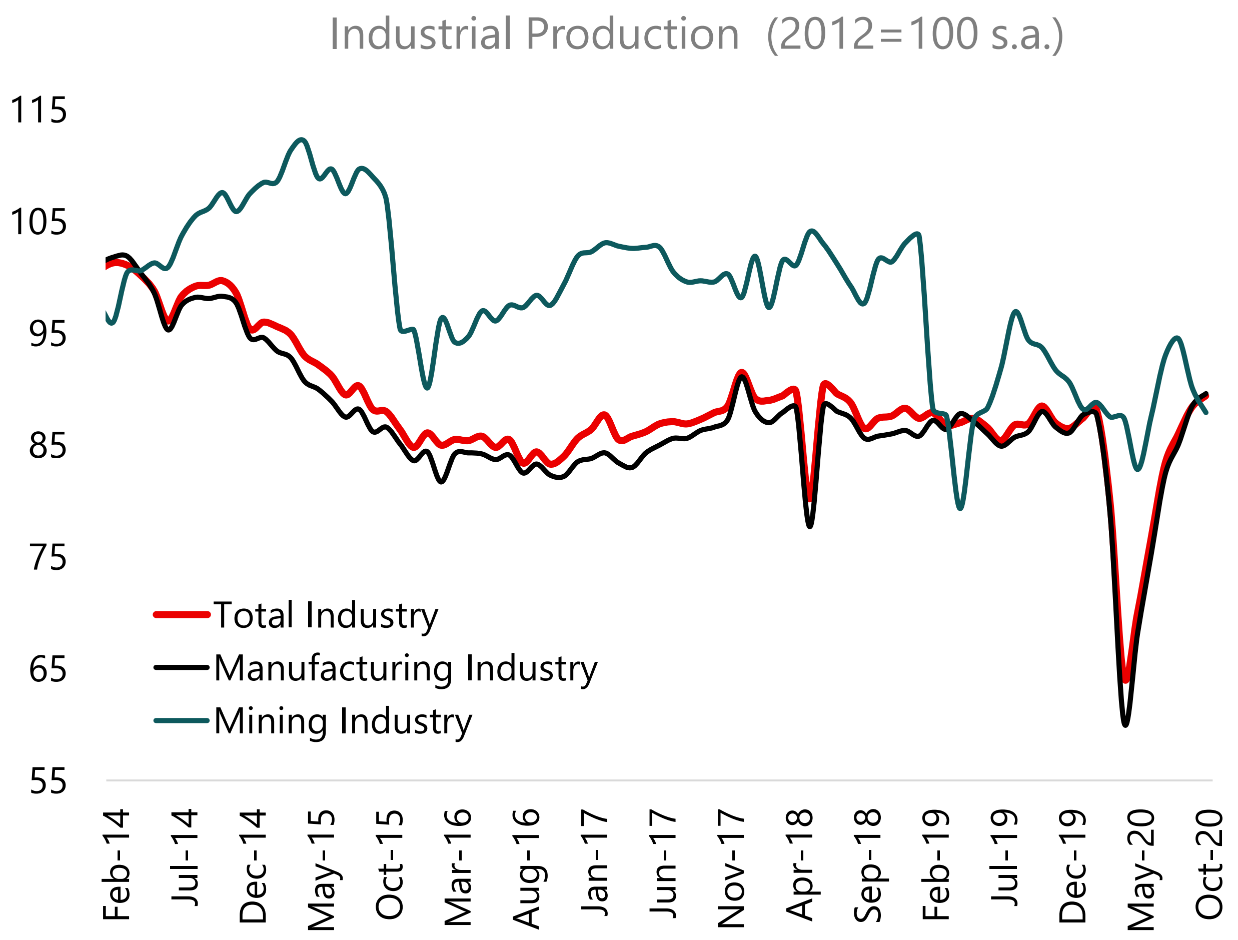
Sources: IBGE and Santander

Industrial Production: Slower V-Shape Resumption

- Industrial Production came recovering after the sudden stop seen in the worst moments of the crisis, yet not at the same speed seen in retail sales. The manufacturing industry has recovering in a fast trend, on the heels of the **emergency aid**, but also due to a **demand shift towards industrialized goods** and to imports substitution.

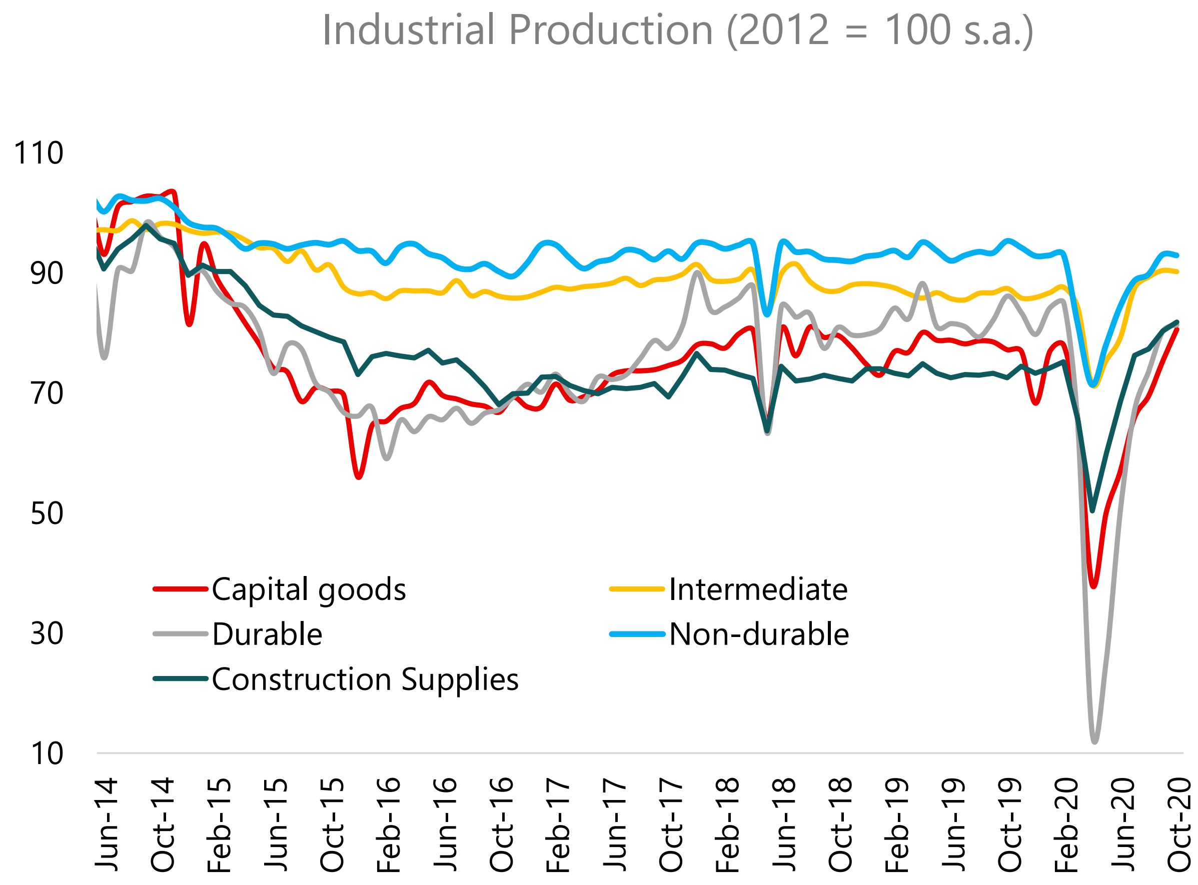
- **Intermediate goods** presented sharp increase and it was the first category to fully recover from the crisis. **Capital goods** have also surpassed pre-crisis level, while **consumer goods** are still the laggard in the economic resumption, especially due to durable goods.

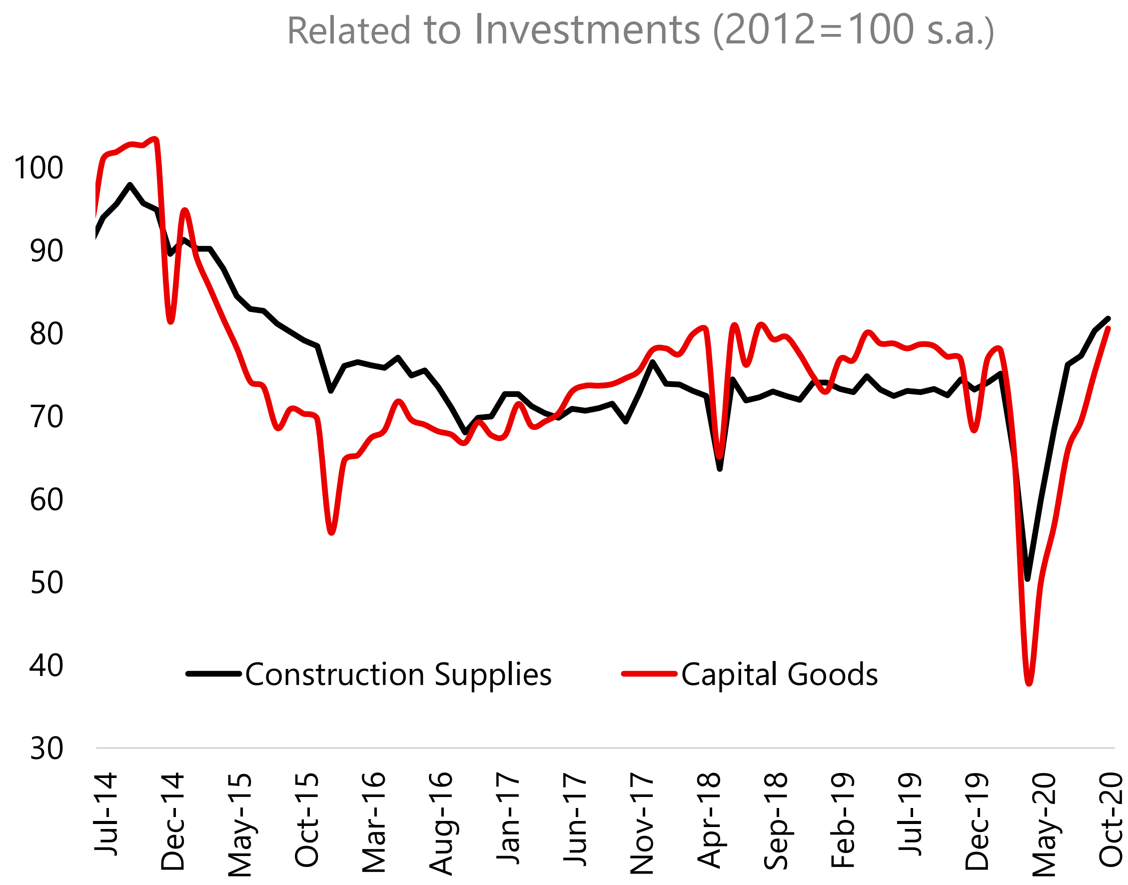
- **Construction supplies** is the main highlight in this recovery, running at levels almost 9% above February's reading. Together with capital goods, the behavior of these categories' points to **a possible rise in investments in the coming quarters, especially in an environment with looser financial conditions.**



Sources: IBGE and Santander

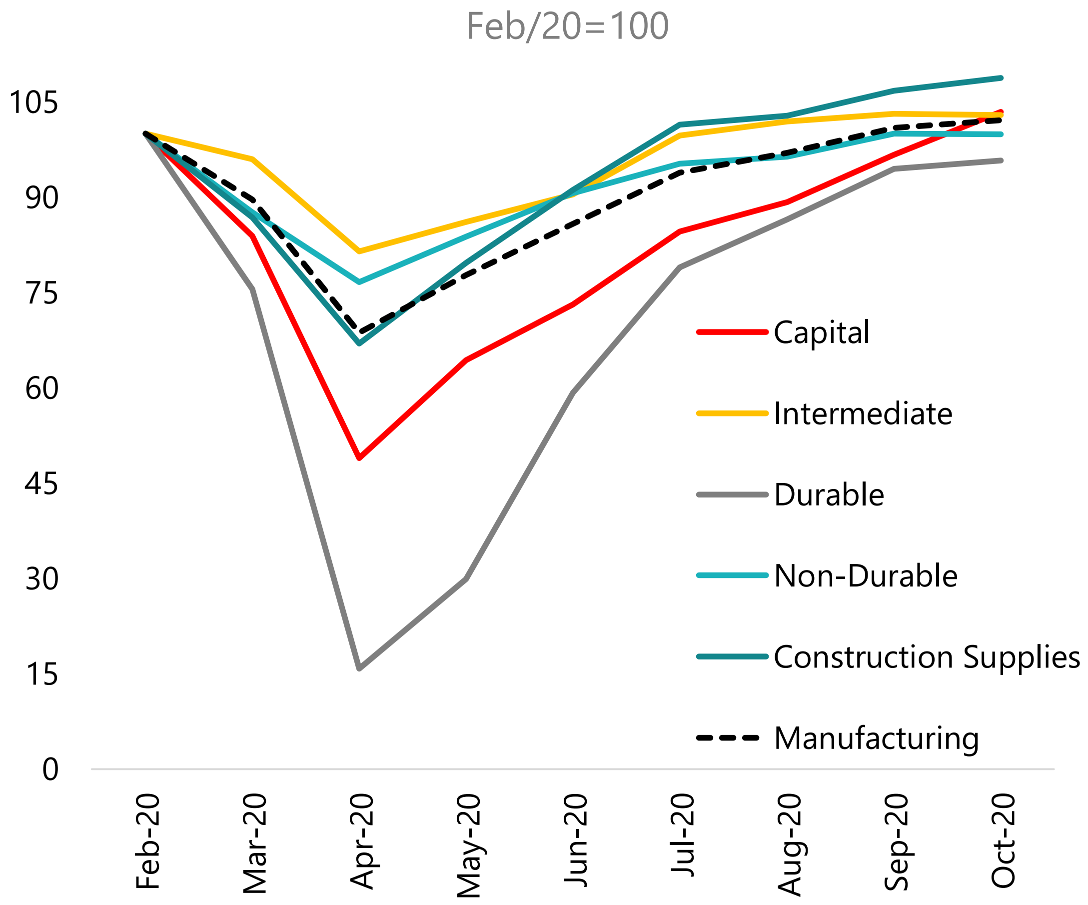
Industrial Production: Breakdown





Sources: IBGE and Santander

Industrial Production: Recovery Evolving

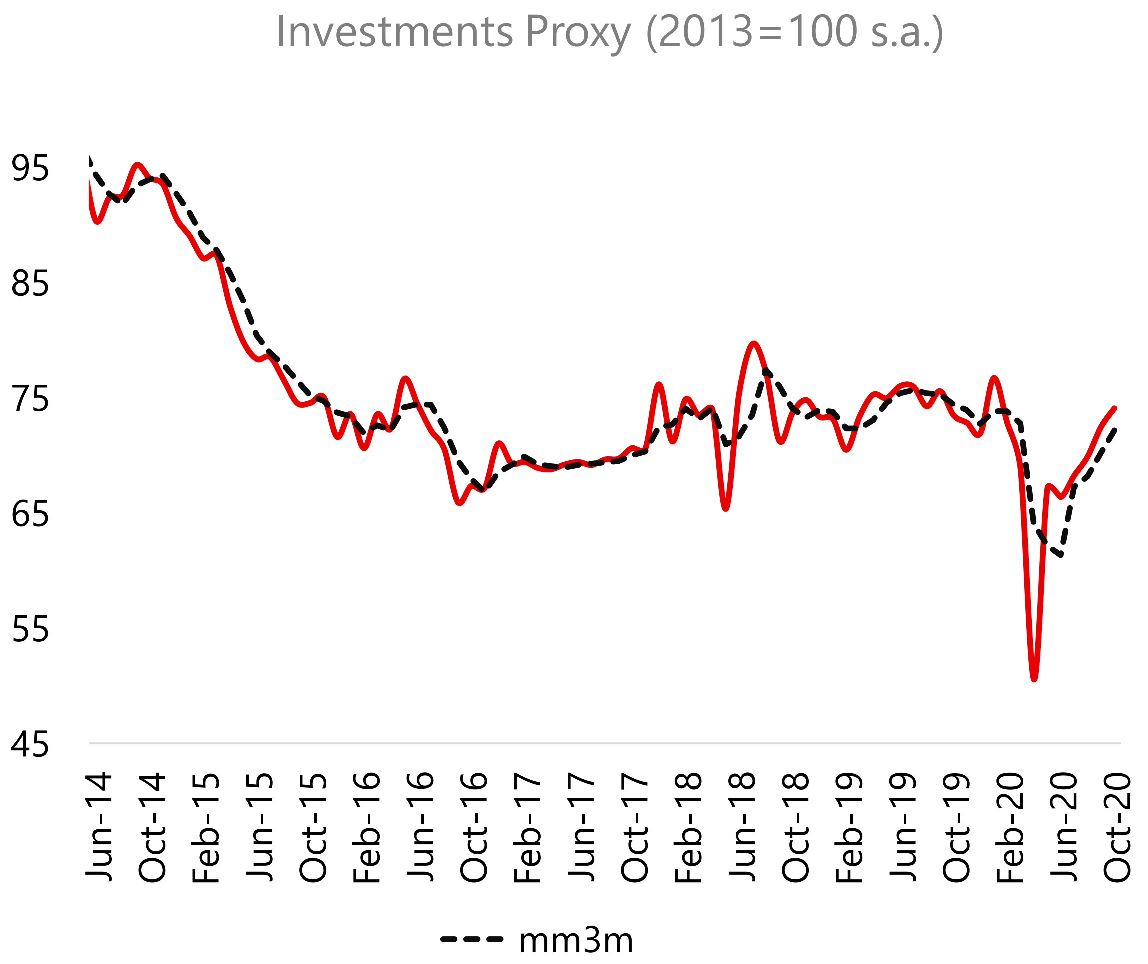


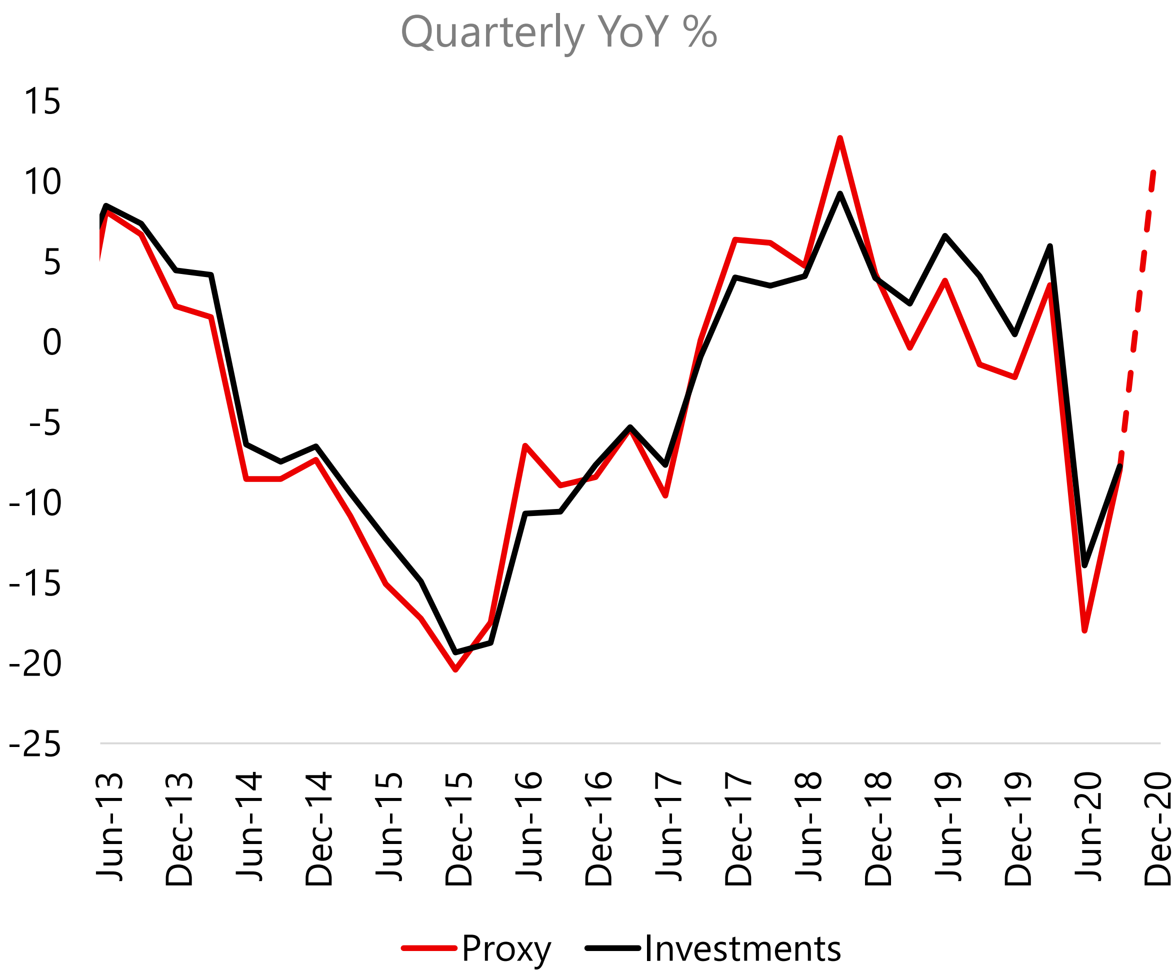
Oct-20	Drop %	MoM %	YoY %	Rec % *	Feb % **
Total	-27.5	1.1	0.3	-	1.4
Manufacturing	-27.5	1.2	1.0	-	2.2
Capital Goods	-39.8	7.0	2.1	-	3.5
Intermediate Goods	-16.2	-0.2	3.2	-	3.0
Consumer goods	-34.1	0.7	-4.5	99.1	-0.3
Durable	-71.5	1.4	-8.3	95.0	-4.2
Non-Durable	-21.7	-0.1	-3.4	99.5	-0.1
Construction Supplies	-24.8	1.8	10.4	-	8.8

* Percentage of the drop already recovered
** Variation relative to February's reading

Sources: IBGE and Santander

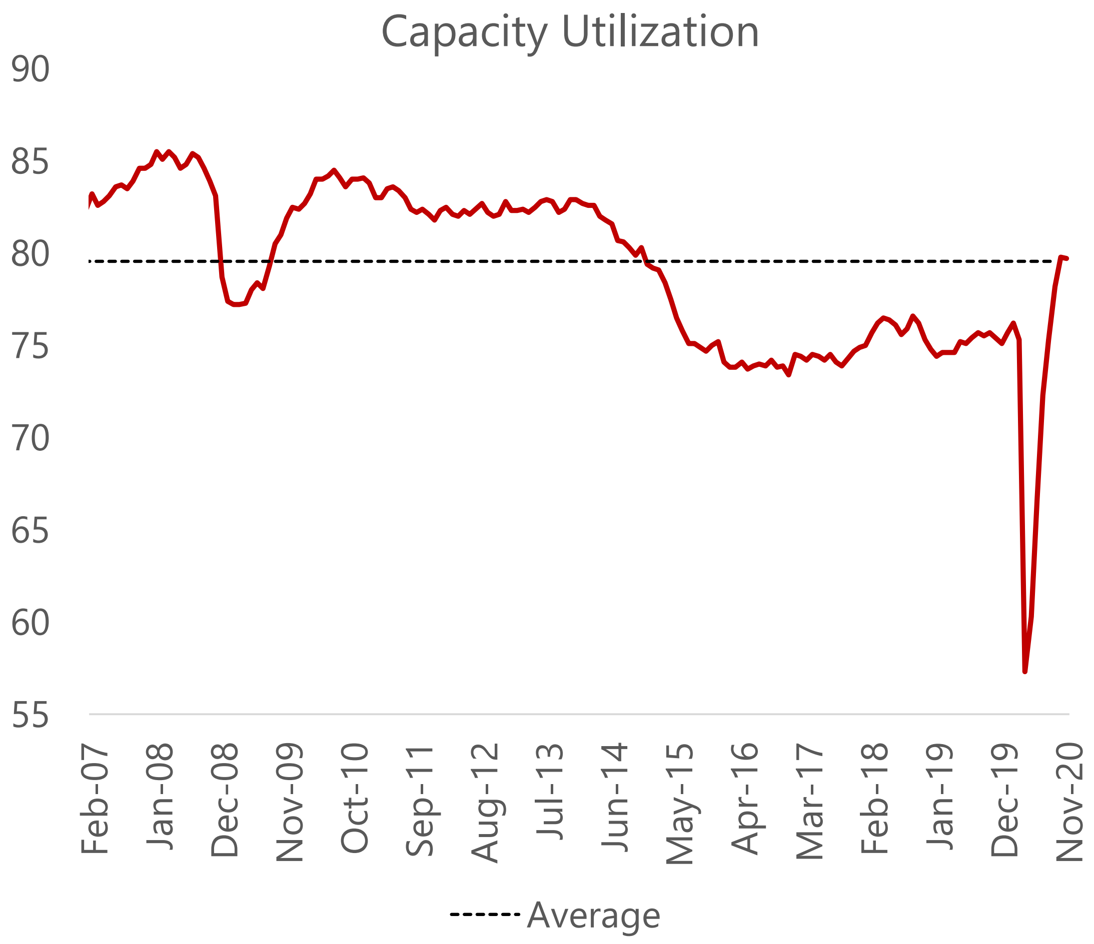
Industrial Production: Monthly Investments Proxy

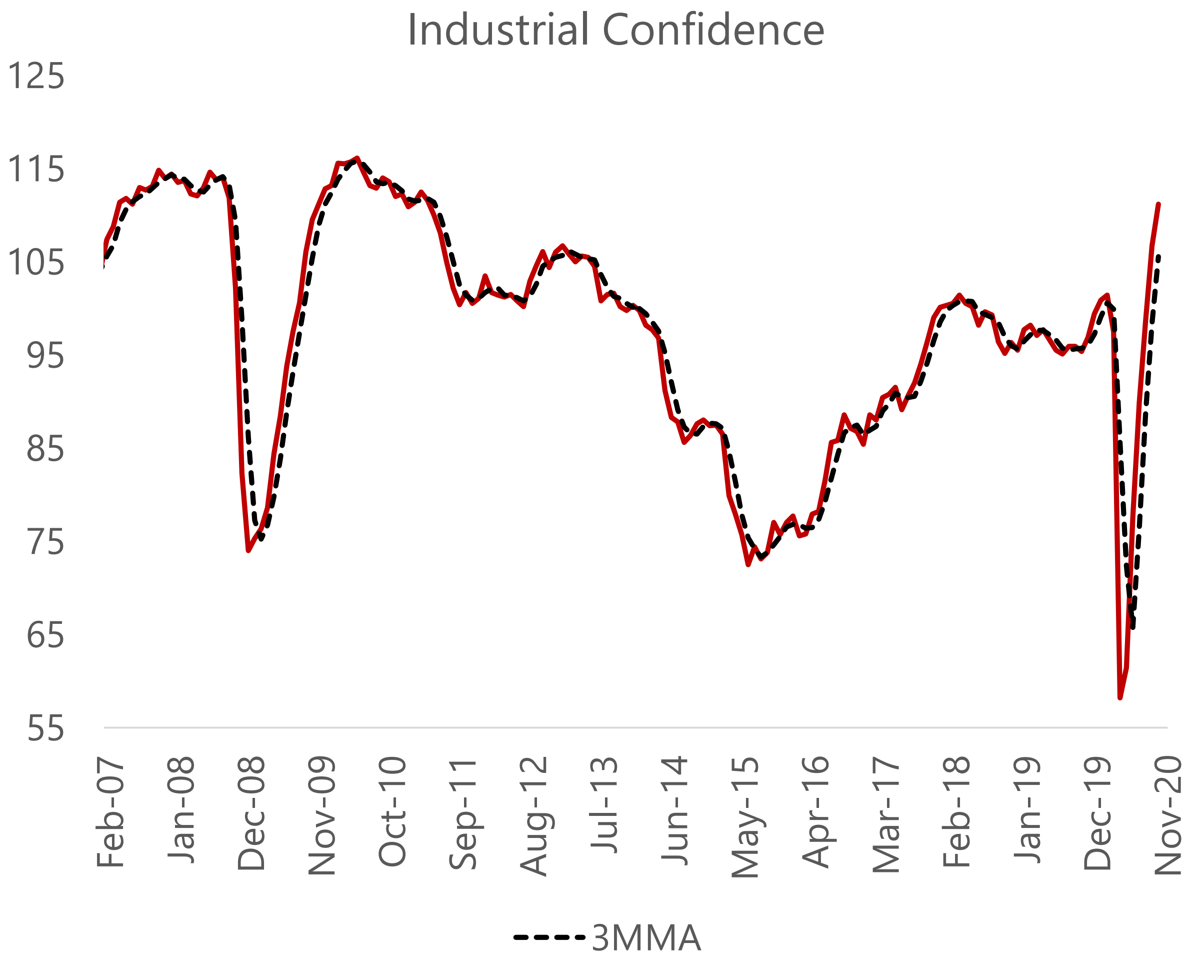




Sources: IBGE and Santander

Industrial Production: Confidence





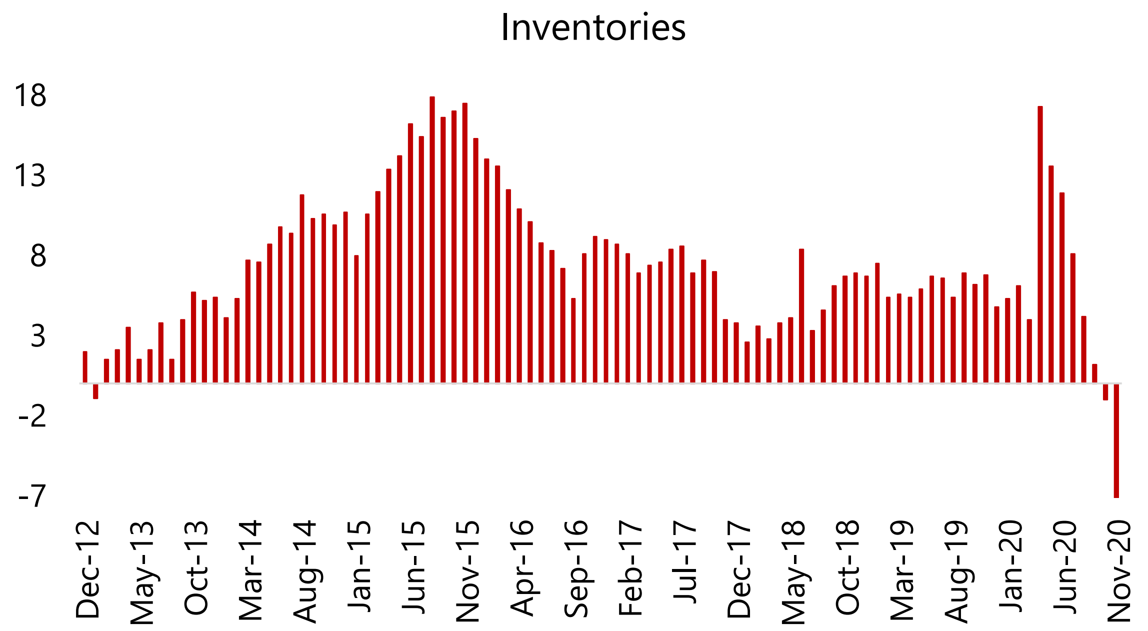
Sources: FGV and Santander

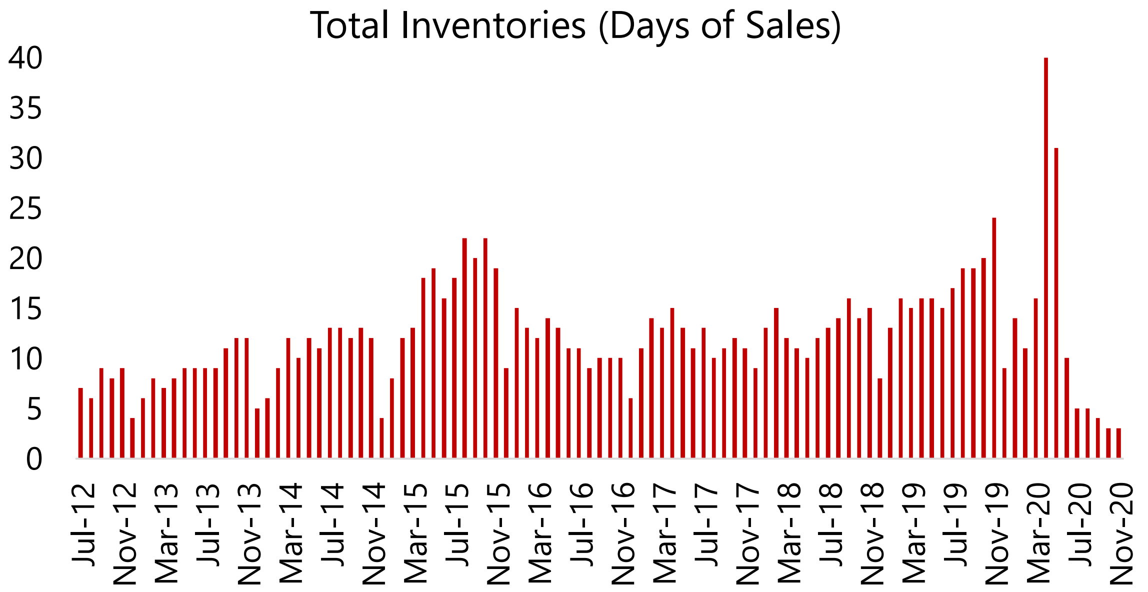
Industrial Production: Inventories

- Preliminary soft data points to continued improvement of industrial production: according to FGV, **industrial confidence** stands at the highest level since 2010, and **industrial capacity utilization** has far surpassed the pre-crisis level, registering a reading close to the historical average.

- Regarding the mismatch between industry and retails sales (as the former outgrew the latter quite markedly in recent months), it is important to note that inventories are running at lowest levels.

- Indeed, the **inventories surplus** (i.e., percentage of respondents that view inventories as excessive minus respondents reporting inventories as insufficient) reached an all-time low level. In terms of hard data, the **inventories of auto vehicles** (in days of sales) are also running at lowest levels. In our view, these figures are a tailwind for industrial production ahead.





Sources: FGV and Anfavea

Services: a Laggard and Heterogeneous Resumption

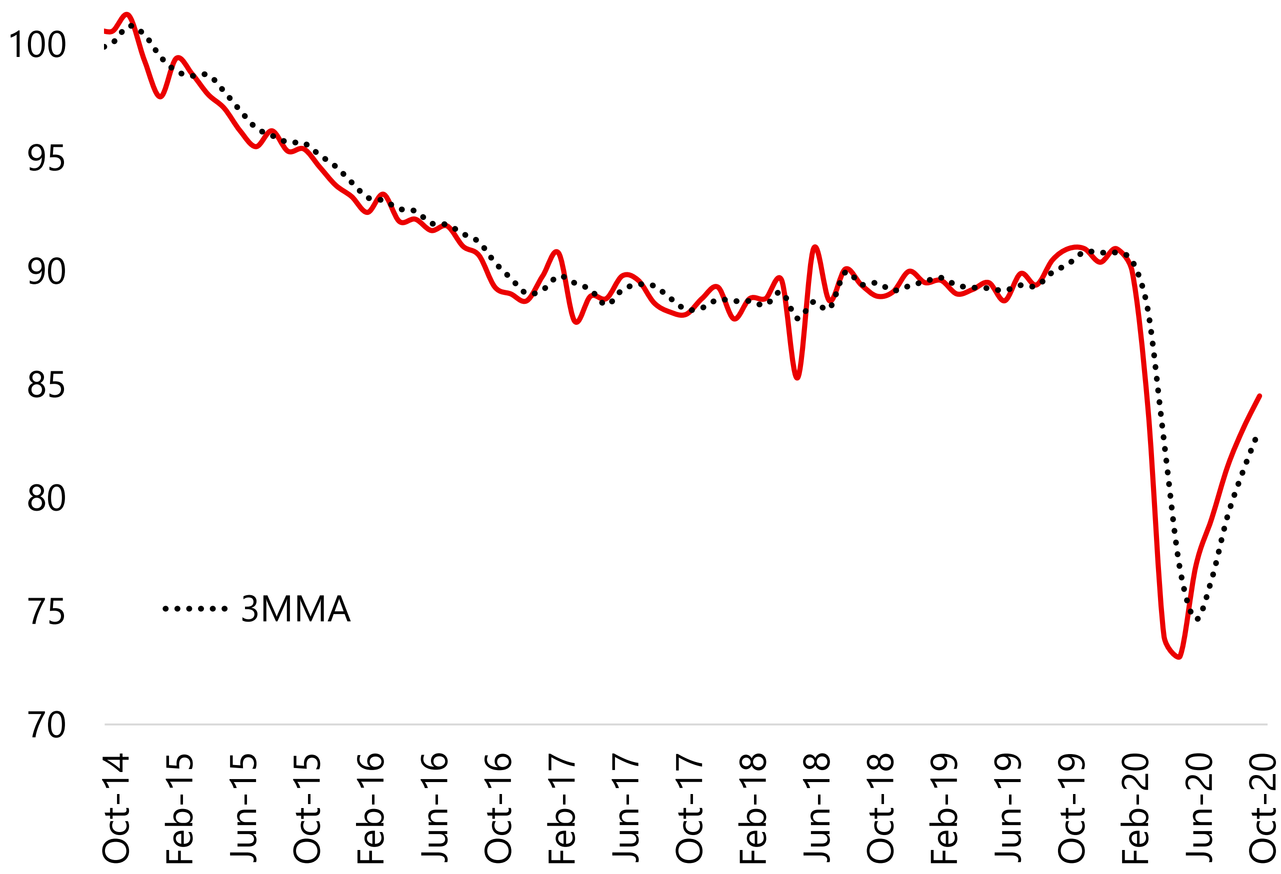
- The data confirm that the services sector has been deeply hit by the effects of the pandemic. The social distance measures adopted to avoid the spread of the crisis had a huge impact on the consumption of services.

- **Services to families** and **transport services** registered drops of 60% and 25%, respectively, but the pace of recovery has been quite heterogeneous. Amid a gradual reopening environment, Transport Services have pointing to consecutive monthly gains, while Services to Families is still laggard, quite far from the pre-crisis reading.

- **Information services** and **other services** (which includes health insurance, insurance brokers services, financial services etc.) have not been seriously hurt by the crisis, and have already recovered virtually all the losses registered in the period**.**

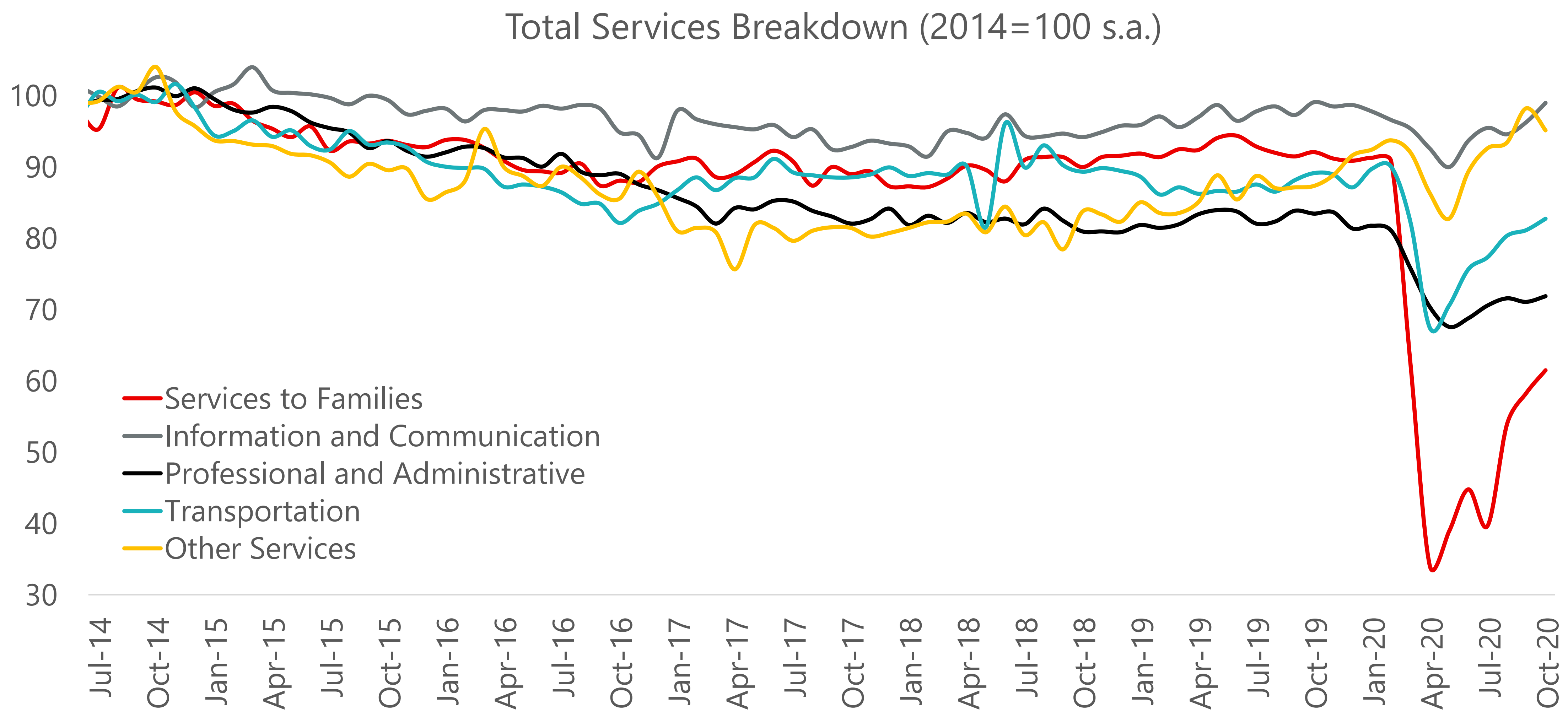
- All in all, these figures reinforce that the services sector is still the laggard in the economic recovery.

Total Services (2014=100 s.a.)



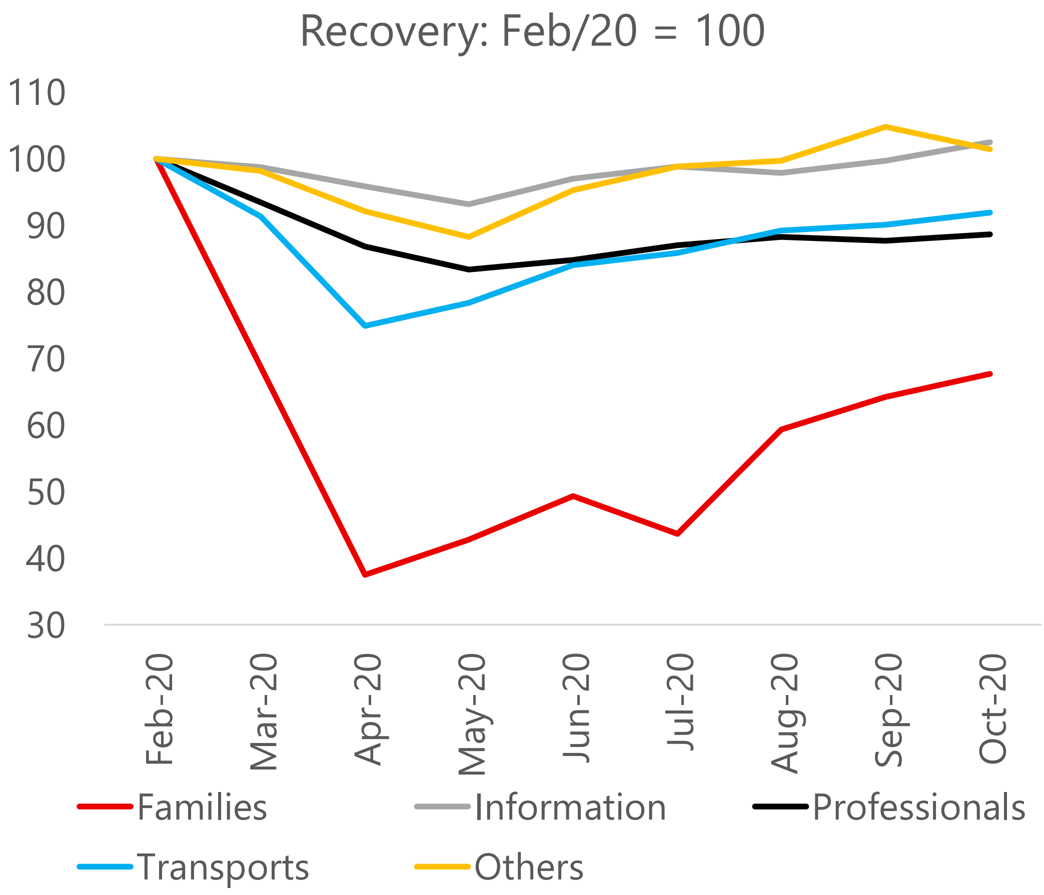
Sources: IBGE and Santander

Services: Breakdown



Sources: IBGE and Santander

Services: Recovery Evolving



Oct-20	Drop %	MoM %	YoY %	Rec % *	Feb % **
Total Services	-17.9	1.7	-7.4	65.8	-6.1
Services to Families	-62.4	5.5	-30.2	48.3	-32.3
Accommodation and Food Services	-65.6	7.8	-30.7	49.4	-33.2
Other Services Provided to Families	-46.3	-2.8	-27.3	35.5	-29.9
Information and Communication services	-4.1	2.8	0.0	-	2.5
Technology Services	-1.0	2.3	3.4	-	3.8
Telecommunication	-2.2	-0.2	-2.8	10.0	-2.0
Information Technology Services	-0.2	6.4	14.7	-	12.1
Audiovisual Services	-28.3	-1.1	-21.4	40.9	-16.7
Professional and Administrative services	-13.2	1.1	-13.5	14.0	-11.3
Professional Services	-3.1	2.0	-6.9	-	0.3
Administrative Services	-17.2	0.7	-16.0	21.8	-13.5
Transportation Services	-25.1	2.0	-8.1	67.7	-8.1
Ground Transportation	-28.9	1.7	-10.7	67.7	-9.3
Water Transportation	-1.3	1.1	9.0	-	-1.7
Air Transport	-81.1	0.2	-37.4	51.0	-39.8
Storage and Mail	-6.8	2.3	0.3	-	2.3
Other services	-7.9	-3.2	8.8	-	1.5

* Percentage of the drop already recovered.
** Variation relative to February's reading

Sources: IBGE and Santander

Labor Market

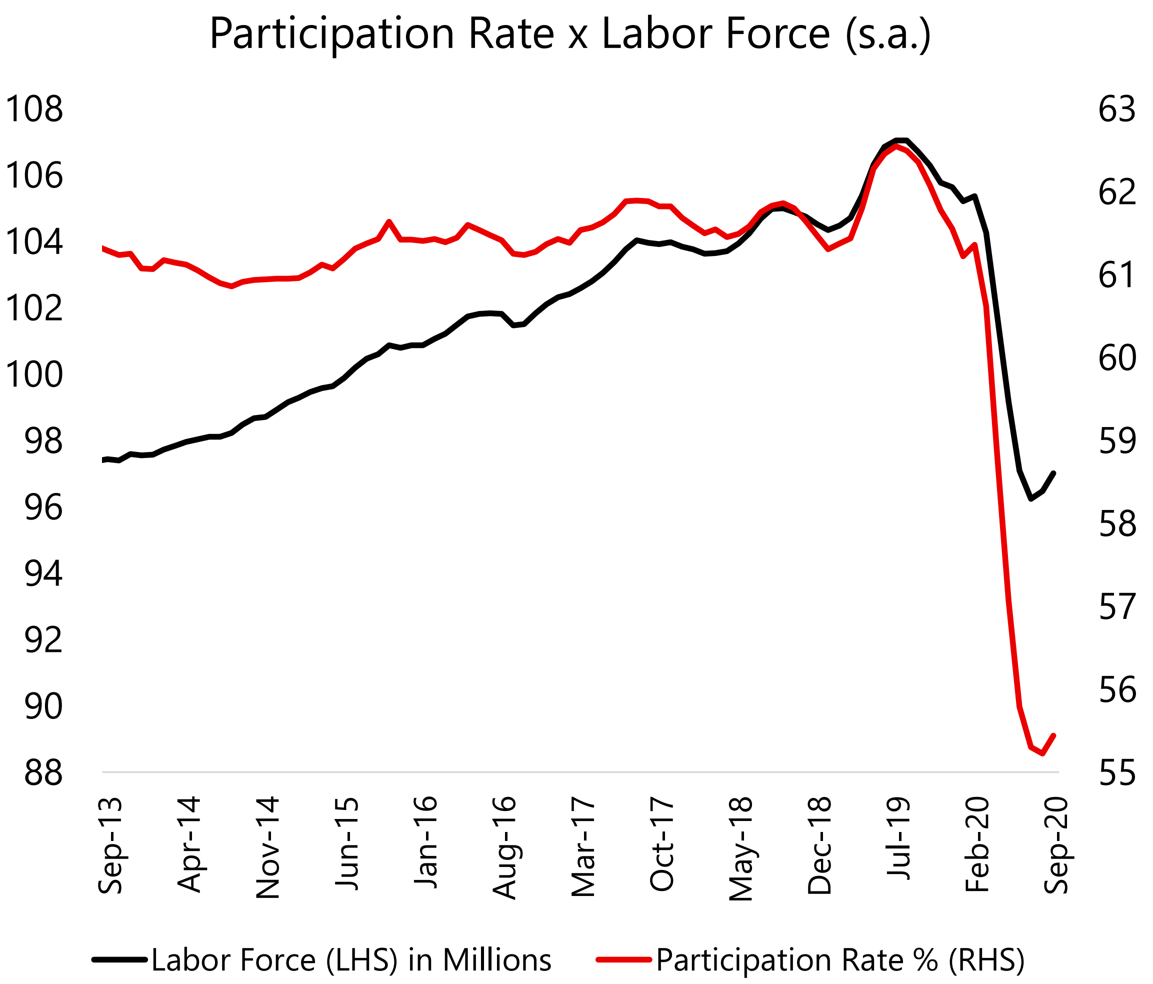
- The unemployment rate has reached its all-time high level, both in original and seasonally adjusted concepts. Despite that, **these figures seem to be ‘low’** if we consider the sudden stop observed in April and the deterioration of the services sector (that used to be as an economic cushion in previous crises).

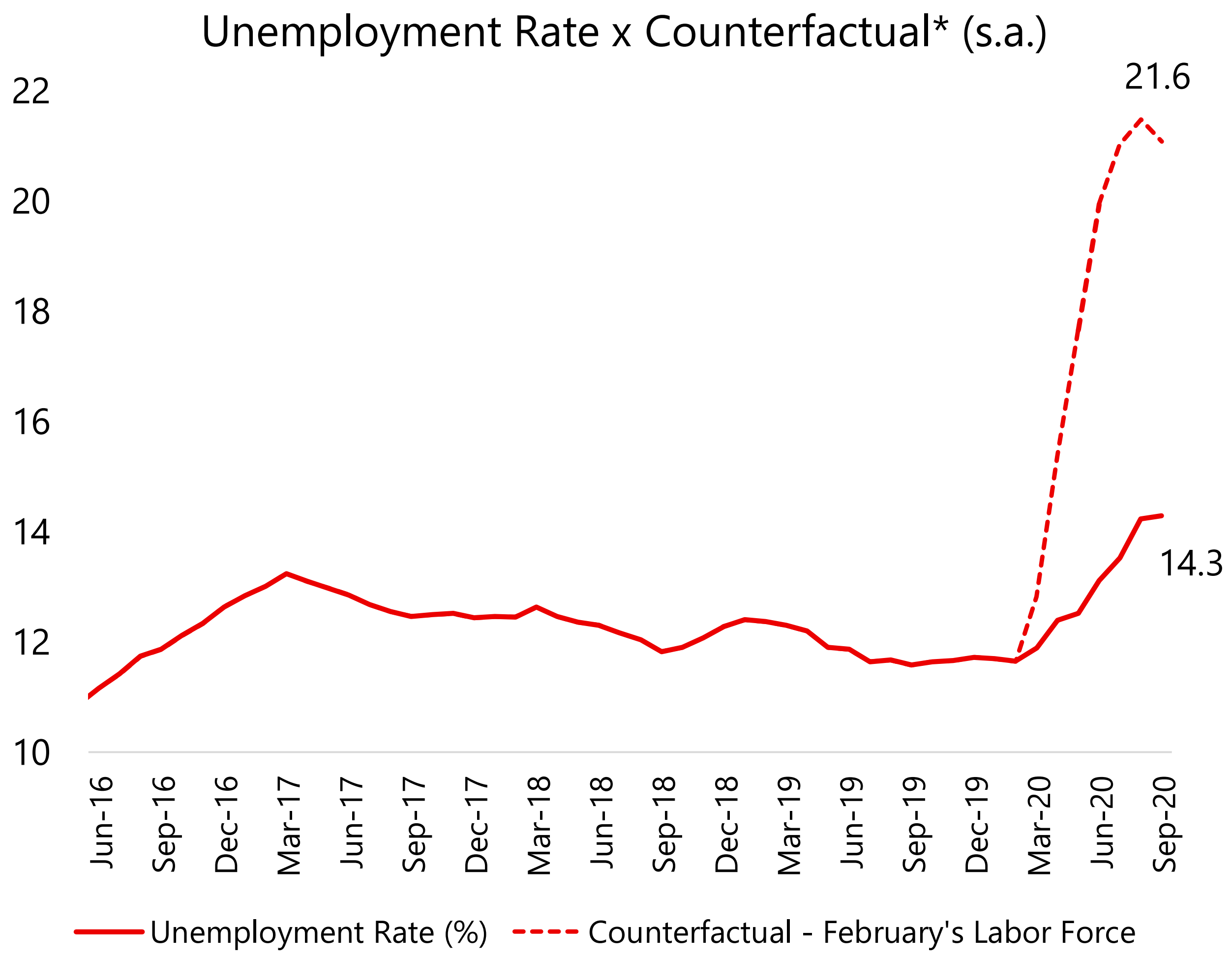
- Indeed, we should pay attention to the figure for **participation rate**, which reached all-time low levels due to the sharp drop recorded in the workforce. **This low rate is concealing the bad signal sent by the unemployment rate, from the standpoint of actual labor market conditions**. In a simple counterfactual exercise, if the workforce had remained stable at the same levels as in February, the unemployment rate would have reached more than 20%.

- Going forward, **we expect joblessness to grow in the coming months, following the gradual reopening of the economy** and the return of the workforce to pre-crisis levels.

Sources: IBGE and Santander

Labor Market

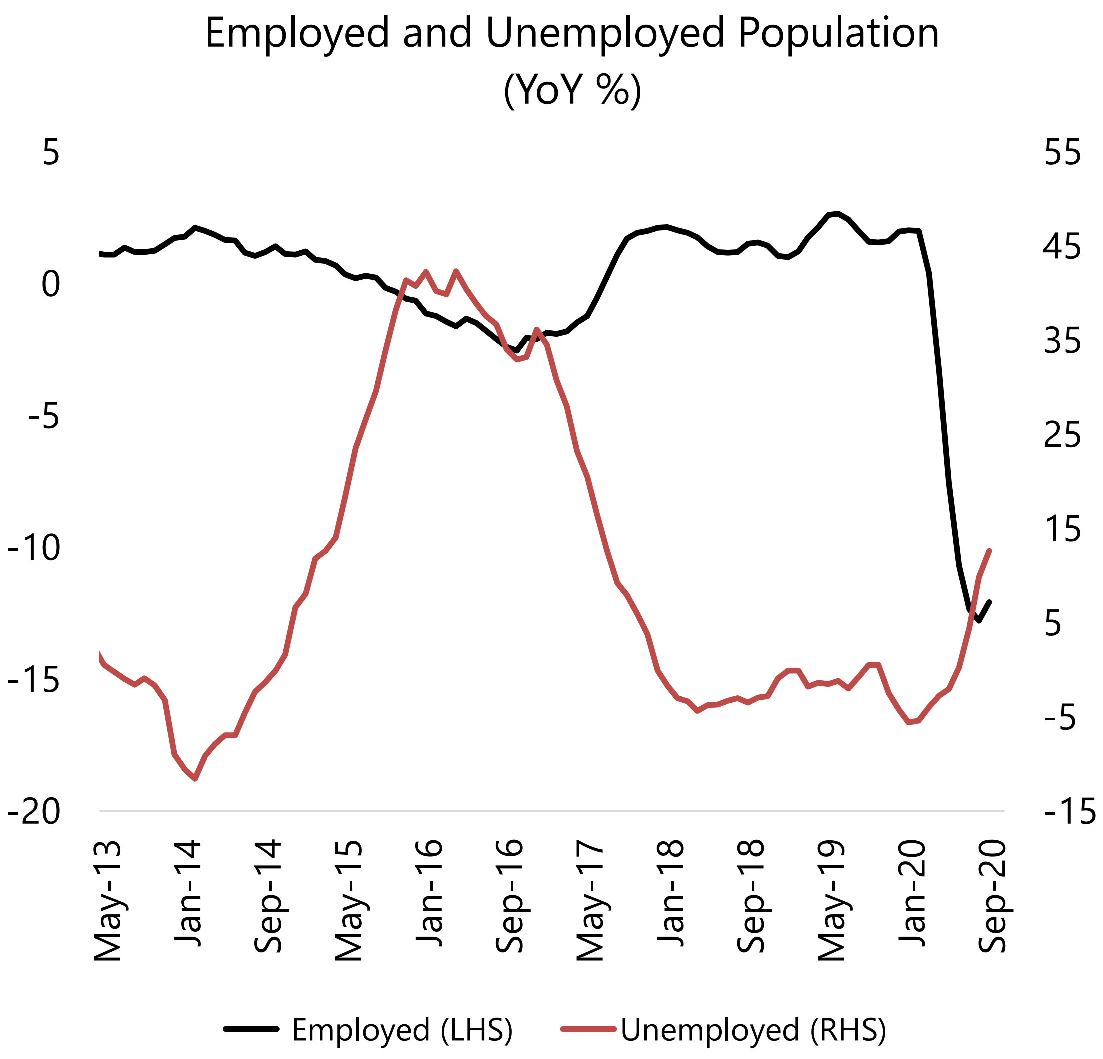


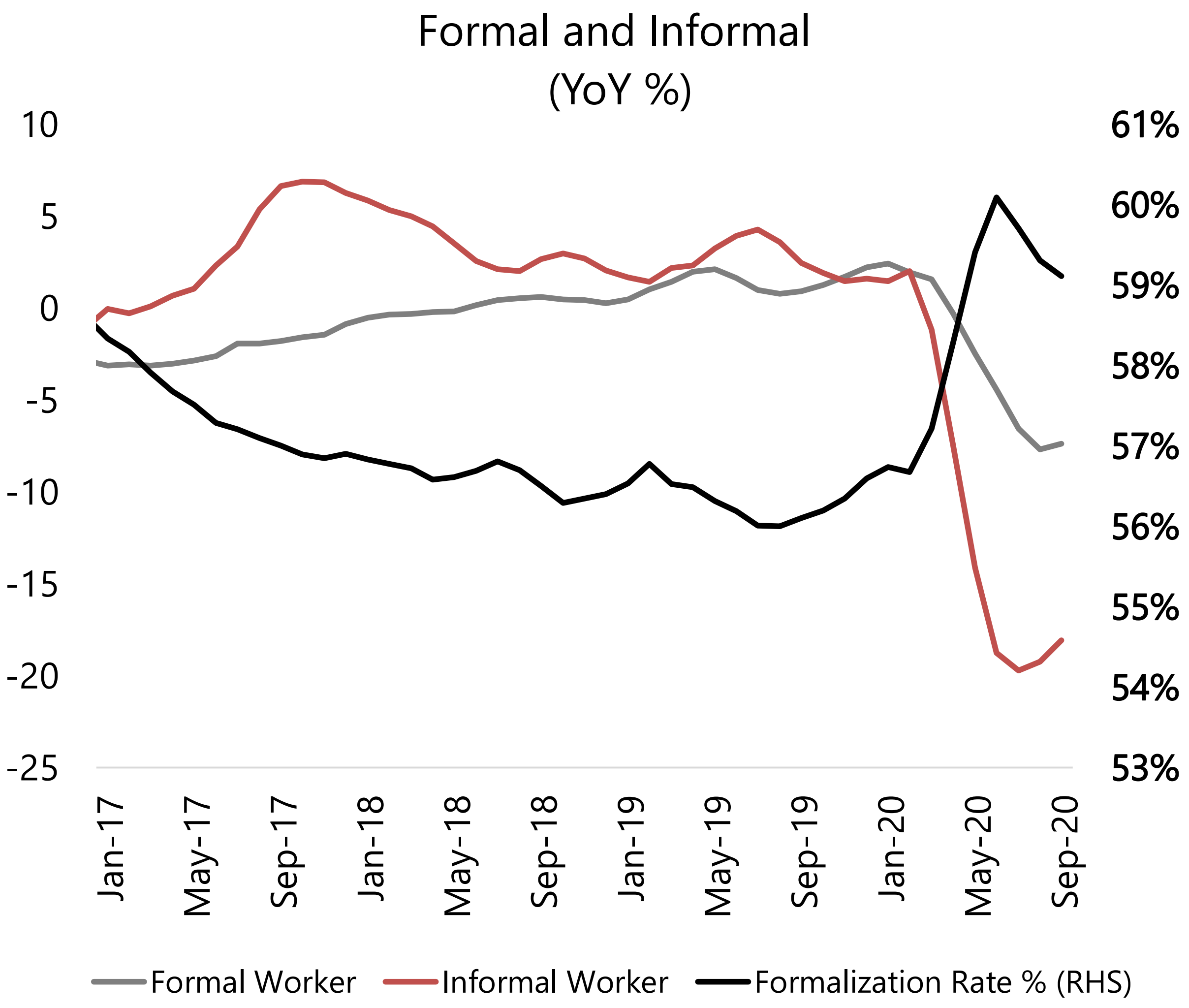


Sources: IBGE and Santander

* Assuming workforce stable at February’s level.

Labor Market





Sources: IBGE and Santander

GDP

- Following COVID-19's crisis impact on 2Q20, GDP pointed to a strong growth on 3Q20, on the heels of the massive and temporary income transference program.
- Despite this sharp increase, the recovery is still partial, with GDP down by 4.0% since 4Q19 (our pre-crisis mark).
- The composition points to a continued but heterogeneous improvement, with the goods-related sector pointing to a V-Shape recovery, while the services-related sector is in a slower pace of resumption. Indeed, Industry is only 1.1% below pre-crisis mark, while the Services Sector is still 5.1% down since 4Q19.

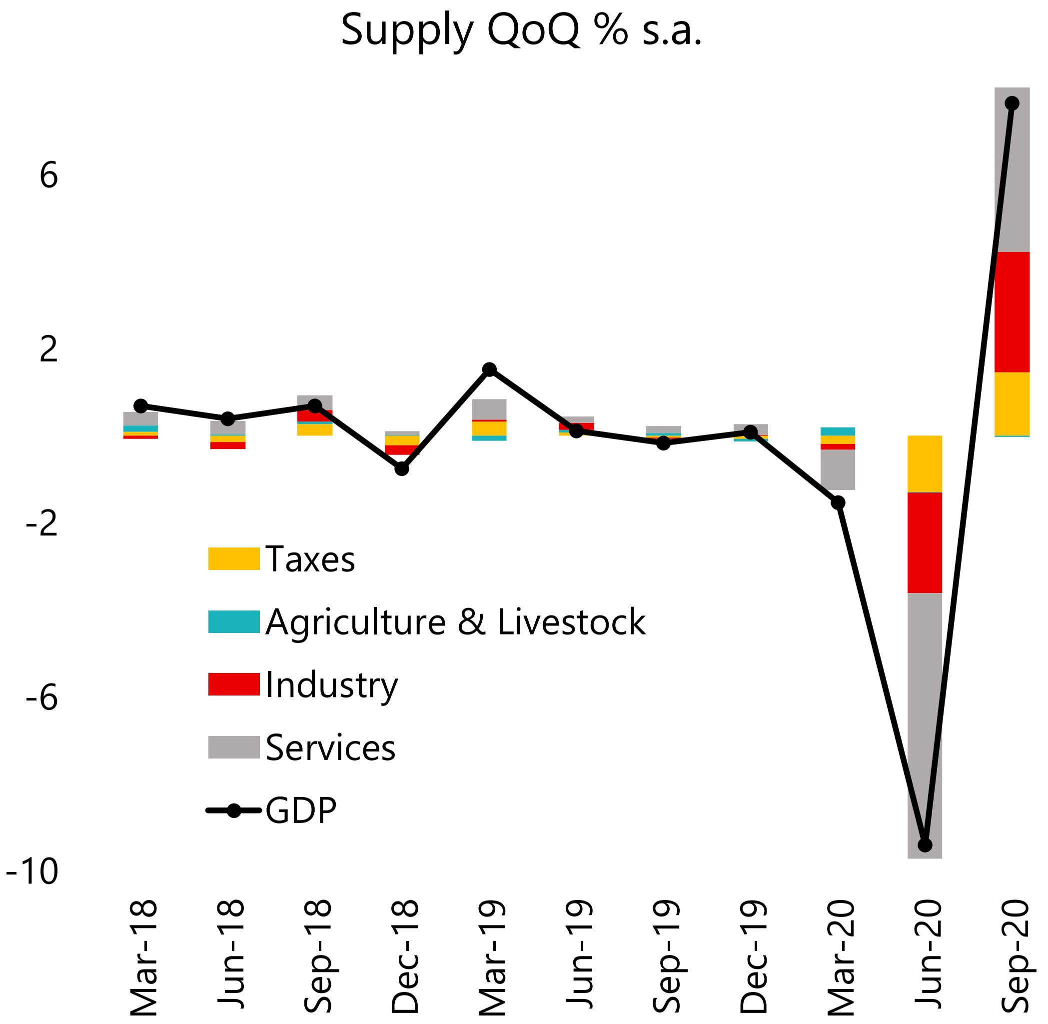
3Q2020		YoY	QoQ
GDP	100%	-3.9	7.6
Supply	Weights	YoY	QoQ
Taxes	10%	-5.1	10.4
Agriculture	7%	0.4	-0.5
Industry	18%	-0.9	14.8
Services	65%	-4.8	6.3
Demand	Weights	YoY	QoQ
Consumption	61%	-6.0	7.6
Government	22%	-5.3	3.5
Investments	15%	-7.8	11.0
Exports	19%	-1.1	-2.1
Imports	-15%	-25.0	-9.6
MEMO (Contribution)			
Inventories (proxy)	-1%	-1.3	-0.5
Domestic	97%	-6.0	7.2
External	3%	3.4	1.0

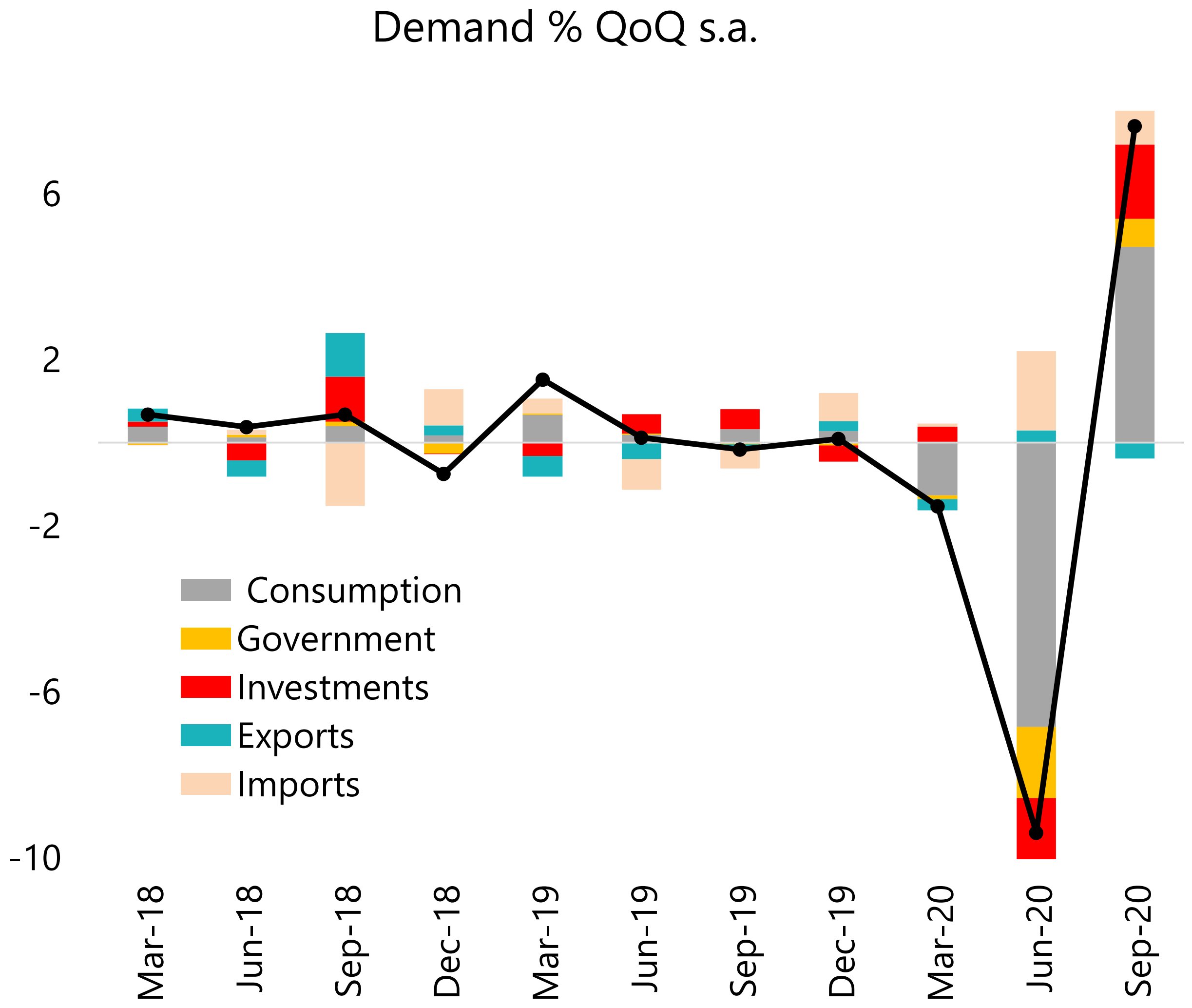
Rolling 4Q

2Q20	3Q20
-2.1	-3.4

Sources: IBGE and Santander

GDP: Breakdown

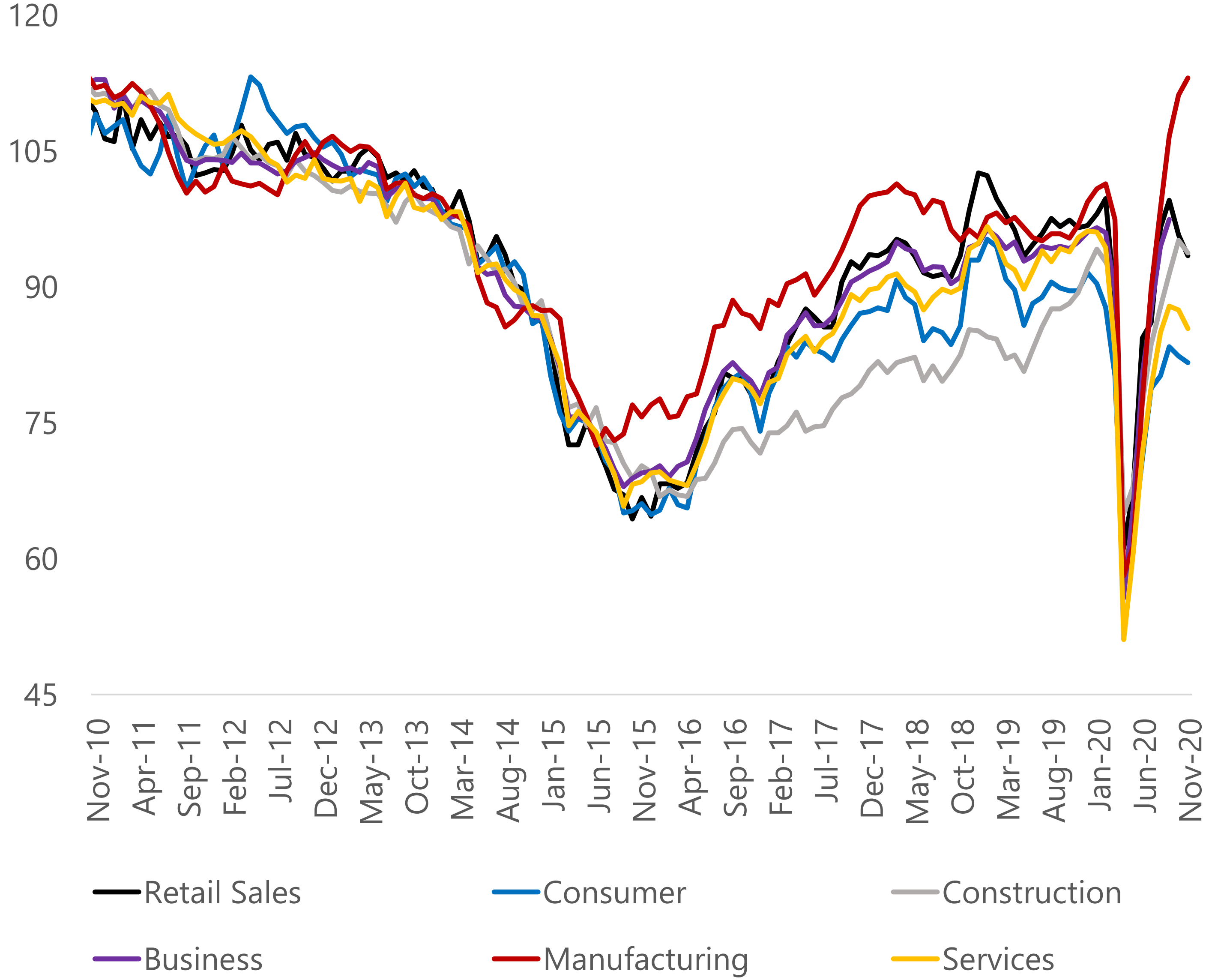




Sources: IBGE and Santander

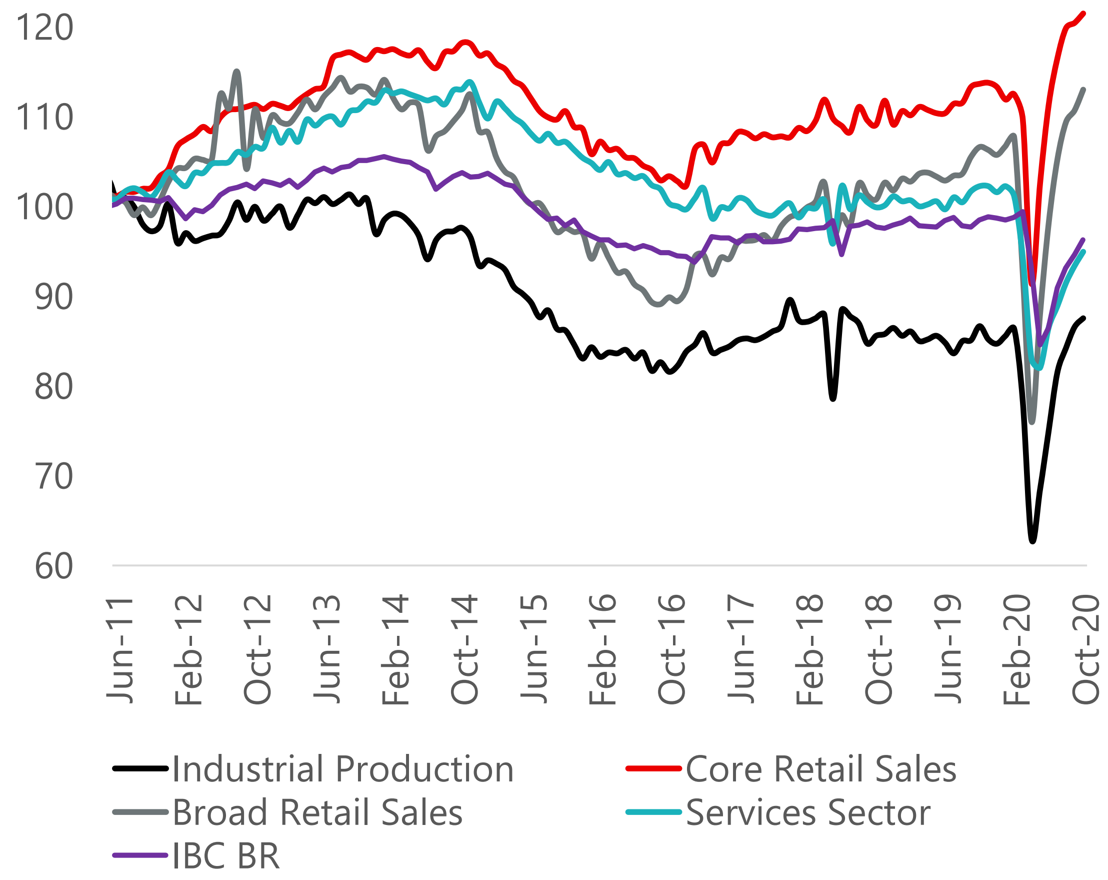
Economic Activity: Confidence

- FGV's soft data point to a heterogeneous development of confidence in 4Q20, with the sectors presenting mixed signals in the recent months.
- On one hand, industry confidence has pointing to sequential gains and already topping pre-crisis reading, on the heels of the **emergency aid**, but also due to a **demand shift towards industrialized goods** and to imports substitution.
- On the other hand, retail and consumer confidences should end 4Q20 with sequential decline, especially due to the reduction of the aid's value, the hike prices in essential goods and the deterioration in the employment outlook.
- It is possible that the very recent figures of confidence in the tertiary sector are slightly influenced by the second wave of Covid-19 contagion already in the making in Brazil. The latter has already resulted in slight rollbacks in the reopening process in some regions.



Sources: FGV and Santander

Economic Activity at the Start of 4Q20 in October



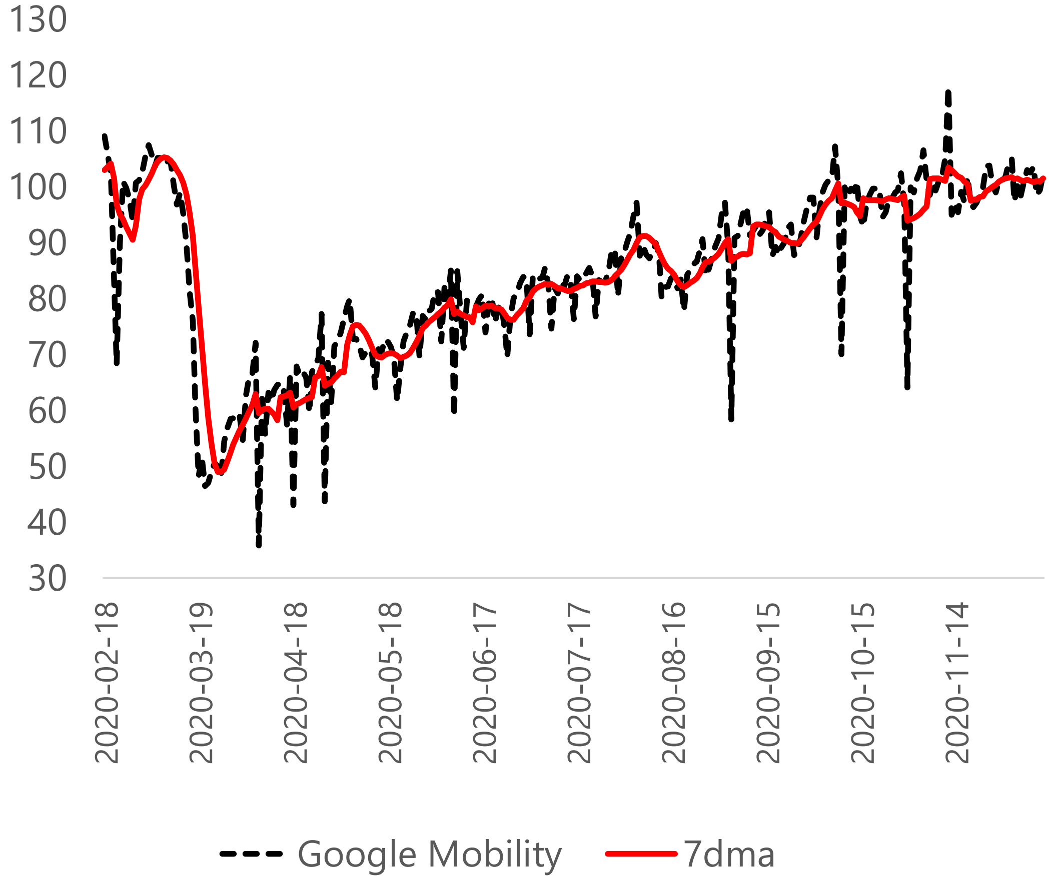
Oct-20	Drop %	MoM %	YoY %	Feb % *	Carry 4Q %
Industrial Production	-27.0	1.1	0.3	1.4	4.1
Core Retail Sales	-18.7	0.9	8.3	8.0	2.2
Broad Retail Sales	-29.4	2.1	6.0	4.9	4.2
Services Sector	-17.9	1.7	-7.4	-6.1	4.1
IBC-Br	-14.9	0.9	-2.6	-2.4	2.5

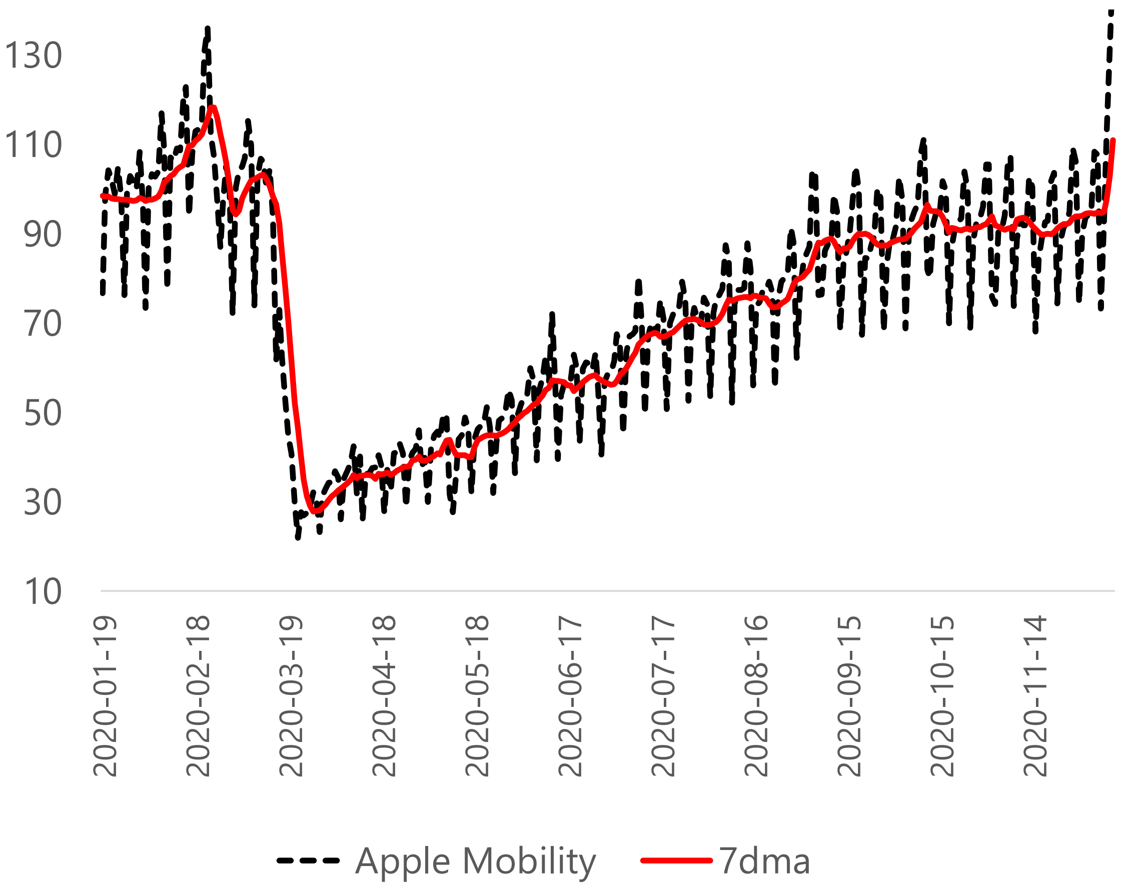
* Variation relative to February's reading

Sources: IBGE, BCB and Santander.

Sources: IBGE and Santander

High-Frequency Indicators: Mobility



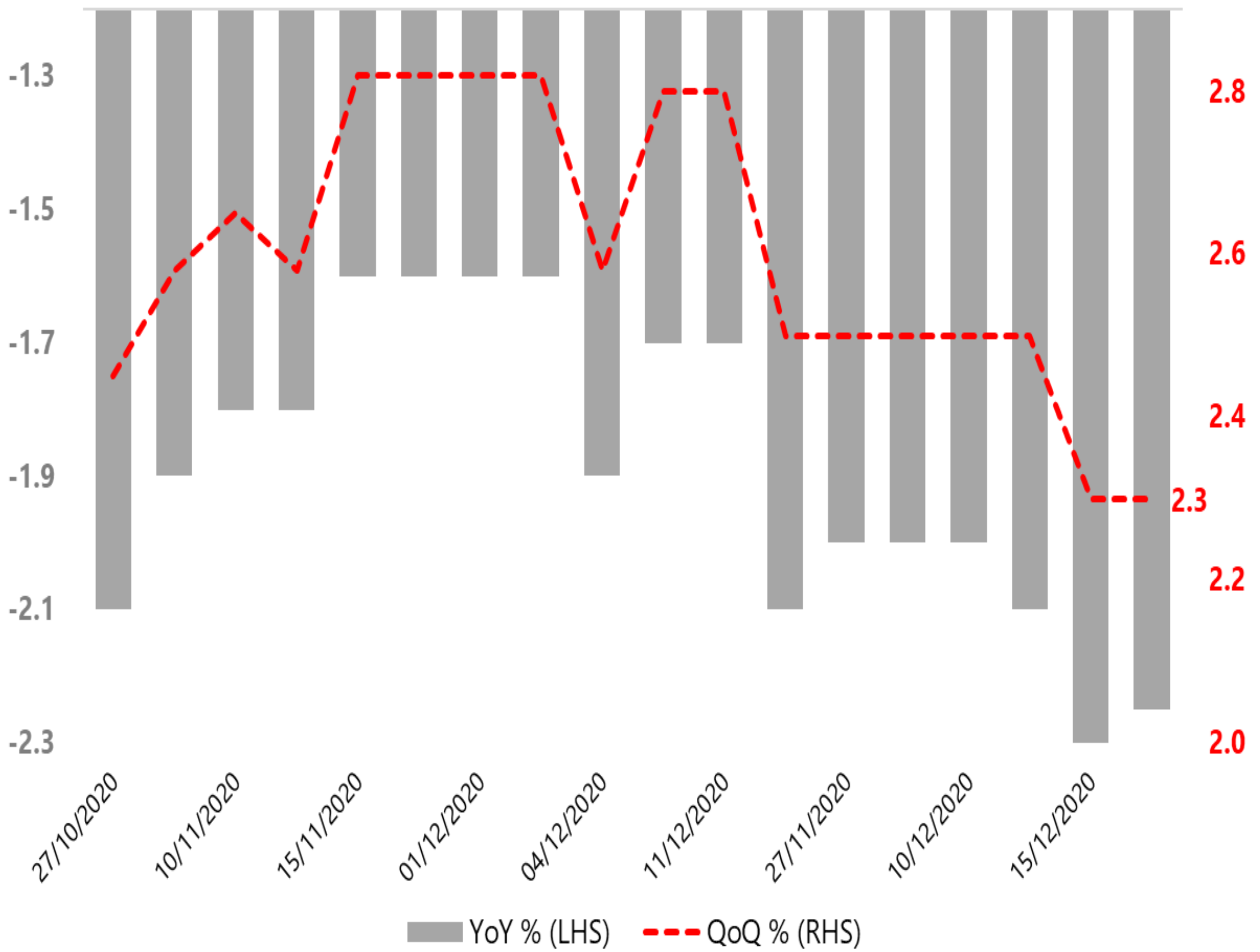


Sources: Google, Apple and Santander

GDP: Tracking 4Q20

➢ In our previous scenario, we were forecasting a flat GDP in 4Q20: 0% QoQ s.a.

		Date	YoY %	QoQ % (s.a.)
October 20	FGV Survey	27/10/2020	-2.1	2.5
	Auto Production (ANFAVEA)	04/11/2020	-1.9	2.6
	Road Flow Gross (ABCR)	10/11/2020	-1.8	2.7
	Corrugated Fiberboard (ABPO)	14/11/2020	-1.8	2.6
	Cement (SNIC)	15/11/2020	-1.6	2.8
	Steel Production (IBS)	16/11/2020	-1.6	2.8
	Intermediate Goods Imports	01/12/2020	-1.6	2.8
	Industrial Energy Consumption (EPE)	03/12/2020	-1.6	2.8
	Industrial Production	04/12/2020	-1.9	2.6
	Broad Retail Sales	10/12/2020	-1.7	2.8
	Services	11/12/2020	-1.7	2.8
	IBC BR	14/12/2020	-2.1	2.5
November 20	FGV Survey	27/11/2020	-2.0	2.5
	Auto Production (ANFAVEA)	04/12/2020	-2.0	2.5
	Road Flow Gross (ABCR)	10/12/2020	-2.0	2.5
	Corrugated Fiberboard (ABPO)	14/12/2020	-2.1	2.5
	Cement (SNIC)	15/12/2020	-2.3	2.3
	Steel Production (IBS)	16/12/2020	-2.3	2.3



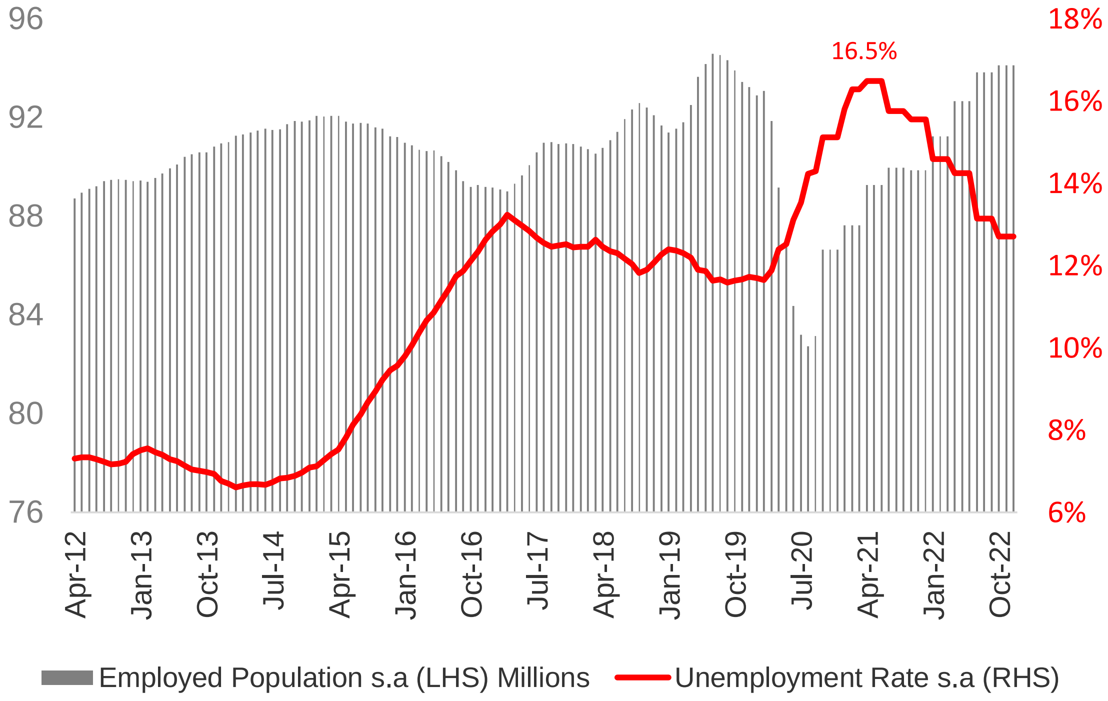
Sources: IBGE and Santander

ECONOMIC ACTIVITY – BASELINE SCENARIO

02

Labor Market: Projections

- Amid the gradual reopening of the economy, if the low participation rate is concealing the actual speed of deterioration in labor market conditions, following the gradual recovery of the workforce to the pre-crisis level we should expect a spike in joblessness.
- We expect that the workforce will be back to February's reading level in the second quarter of 2021, basically due to two factors: i) **progress in the reopening process** and ii) **withdrawal of fiscal stimuli**. In this context, a sharp increase in the unemployment rate is unavoidable: we expect it to reach an all-time high mark of 16.5%.
- On the other side, the **recovery of employment is a much slower process**, especially due to the absence of dynamism in the domestic labor market, and it will take place no early then 2Q22, **as the services sector reaches full recovery.**
- Given this dynamic, we expect **a gradual decline of unemployment rate** from the spike reached in 2Q2021 to a 12.7% rate in the end of 2022.



	2019	2020e	2021e	2022e
Unemployment Rate *				
Average	11.9	13.5	15.9	13.3
End of Period	11.7	15.1	15.6	12.7
Unemployed Population **				
Average	12.6	13.5	16.8	14.3
End of Period	12.4	15.4	16.6	13.7

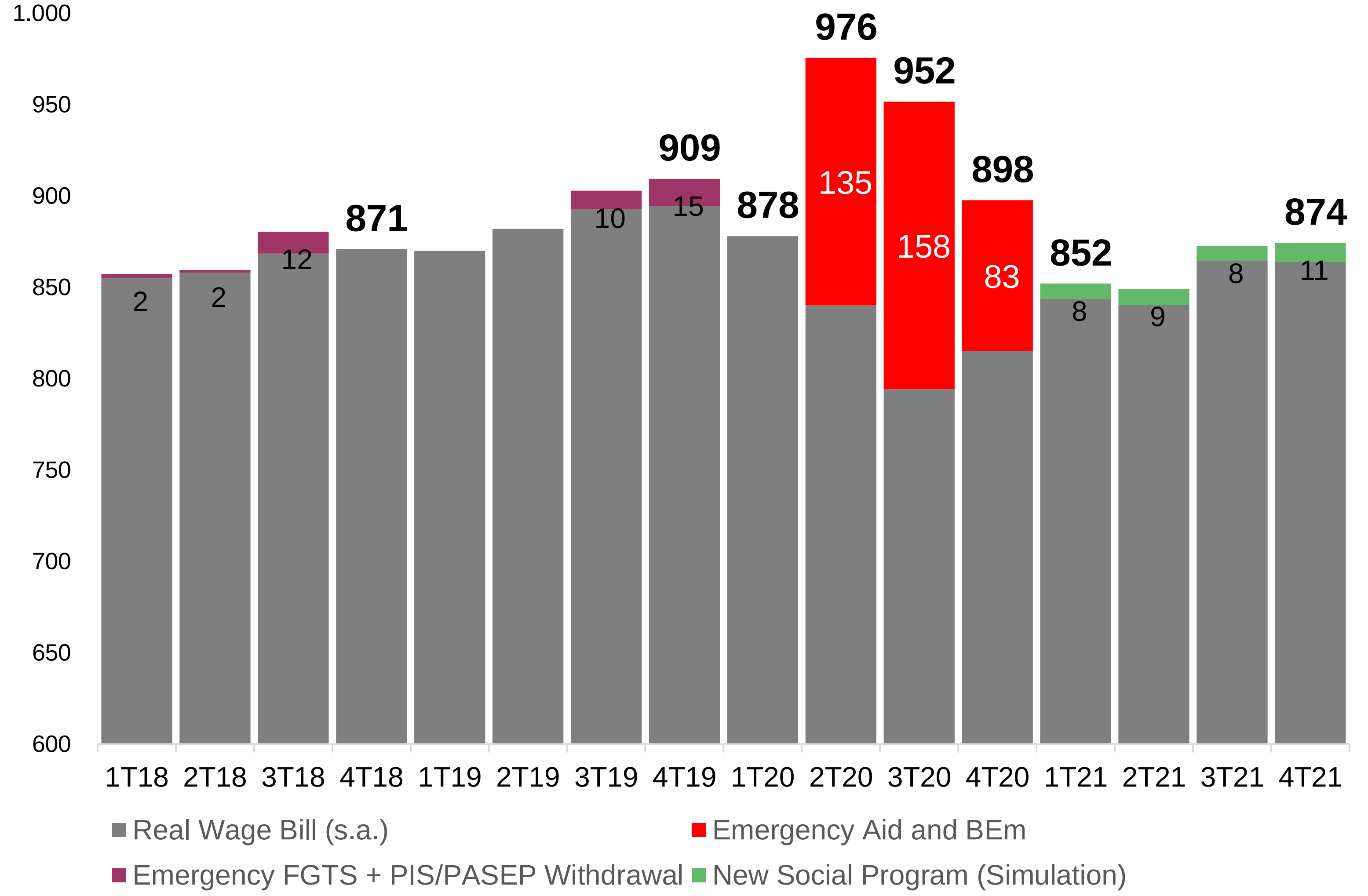
* in %

** in Millions

Sources: FGV and Santander

Labor Market: Projections

"Expanded" Real Wage Bill and Social Benefits (in real terms, BRL billion)



- In our analysis, the benefits more than offset the estimated cyclical drop caused by the pandemic in 2020. The question that arises is how will be the impact of this drop of 7.8% in real wage bill on economic activity through consumption channel.
- We expect this withdrawal of stimulus in 2021 to be compensated by the gradual reopening of services to a sort of "normality" by mid-2021.

	2020(E)	2021(E)	
Wage Bill (Without Fiscal Aid)	-6.0%	+2.6%	
		Hyphotetical New Social program*	
		Without	*With*
Wage Bill (With Fiscal Aid)	+3.9%	-7.8%	-6.9%

Sources: BCB, IBGE, Nacional Treasury, Santander

GDP

GDP Projections					
Baseline Scenario					
	2018	2019	2020e	2021e	2022e
Total GDP	**1.8**	**1.4**	**-4.1**	**2.9**	**2.5**
Agriculture & Livestock	1.3	0.6	1.5	1.2	1.2
Industry	0.7	0.4	-3.7	3.8	1.6
Services	2.1	1.7	-4.9	2.9	3.0
Household Consumption	2.4	2.2	-4.3	2.1	3.1
Government Consumption	0.8	-0.4	-5.2	3.8	1.0
Investments	5.2	3.4	-5.3	4.8	4.4
Exports	4.1	-2.4	1.2	9.5	-0.3
Imports	7.7	1.1	-10.6	17.8	15.4
Memo (contribution)					
Domestic Absorption	2.5	1.8	-4.7	2.9	3.0
External Sector	-0.5	-0.5	1.7	-1.0	-2.5
Inventories	-0.2	0.1	-1.0	1.0	2.1

Baseline Scenario			
	YoY	QoQ	Full Year
4Q20	-1.2%	2.8%	-4.1%
1Q21	-1.5%	-0.4%	
2Q21	10.3%	0.1%	
3Q21	3.0%	0.6%	
4Q21	0.6%	0.3%	2.9%
1Q22	2.4%	0.6%	
2Q22	3.9%	0.6%	
3Q22	1.9%	0.5%	
4Q22	1.9%	0.4%	2.5%

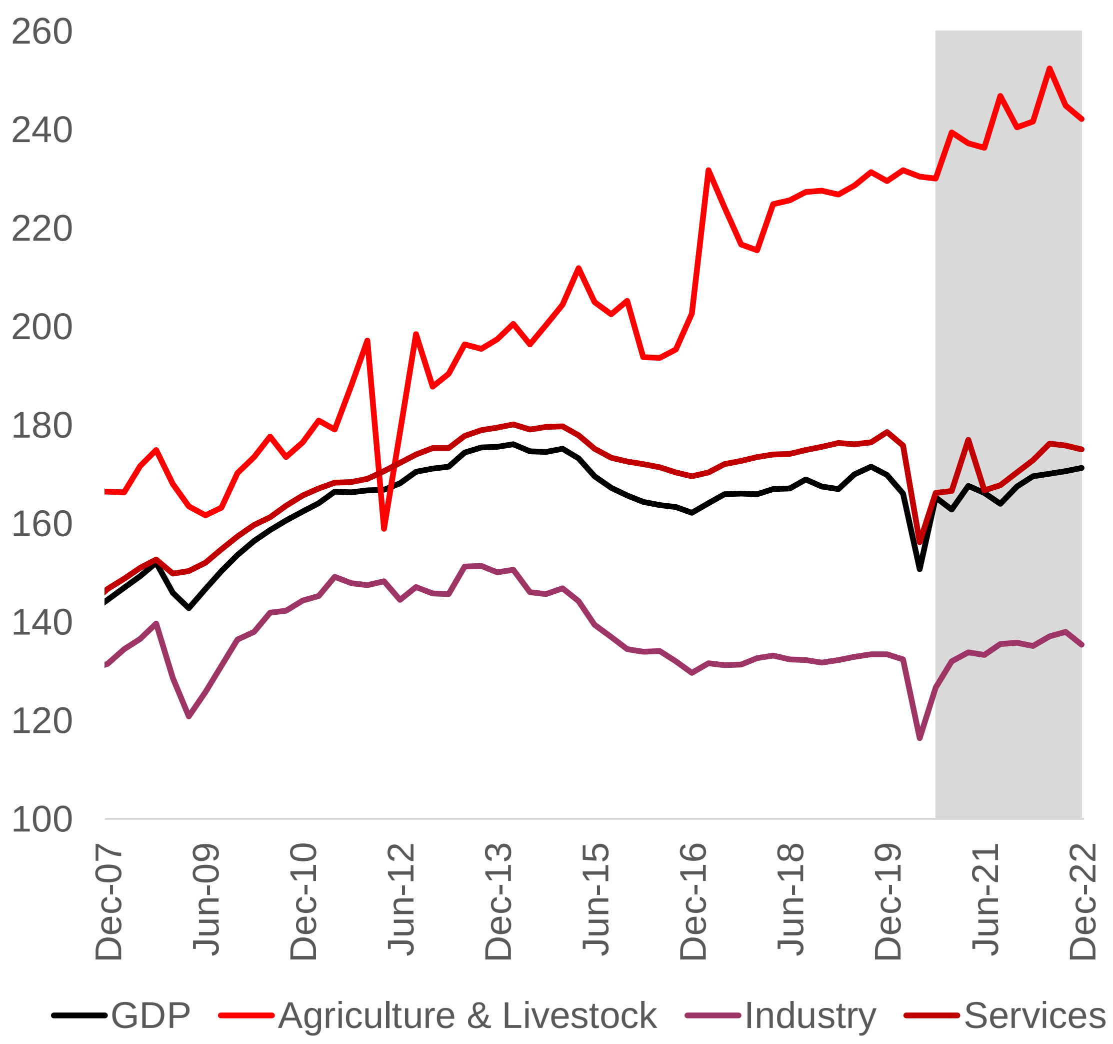
Sources: IBGE and Santander

GDP

- In our baseline scenario, we envision that the GDP will go back to the pre-crisis level in 2Q2022, while the wide output gap will be closed only at the end of 2023. On the supply side, we expect a recovery of industry, with **a deceleration of manufacturing** on the heels of the withdrawal of fiscal stimuli, and with inventories recomposition contributing positively to growth. Mining showed some resilience in the crisis, and we expect maintenance of its usual pace of development. **Building is another important source of** growth, in an environment with easier financial conditions, with real state credit pointing to growth.

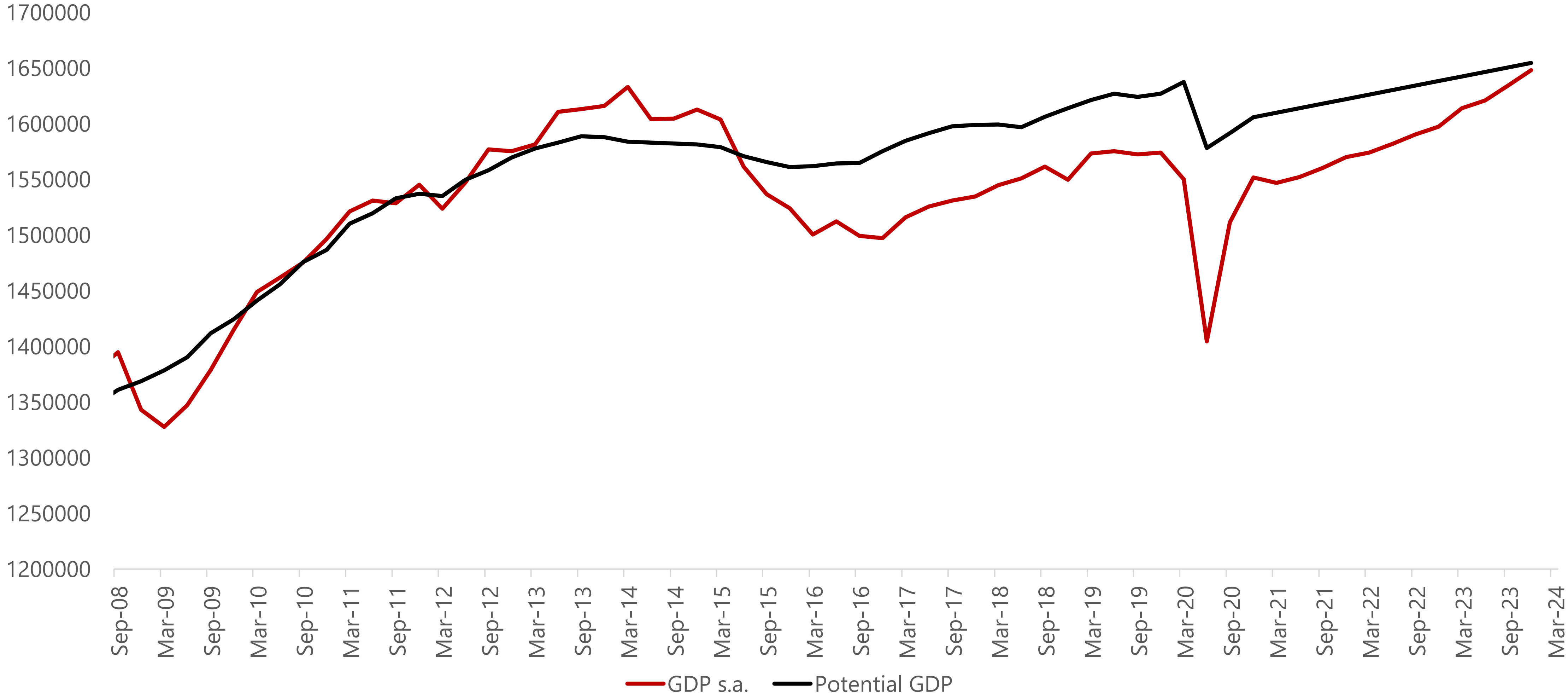
- The **services sector should accelerate in 2021**, in the wake of the reopening of the economy. Indeed, as mobility advances, the services that need social interaction (such as services to families) should get closer to pre-crisis development. **Transports sector** should benefit from advances in mobility, but also from the development of industry. **Education and health sectors** should accelerate in an environment with higher social interaction.

GDP Breakdown (s.a. 1995=100)



Sources: IBGE and Santander

GDP: Output Gap



Sources: IBGE and Santander

Macro Scenario: Projections

Macroeconomic variables		Previous	Current	Alternative
GDP (%)	2020	-4.8	-4.1	-4.1
	2021	3.4	2.9	1.4
	2022	2.6	2.5	1.1
IPCA (%)	2020	3.3	4.5	4.5
	2021	2.9	3.0	6.5
	2022	3.2	3.2	7.5
Selic Rate (% end of period)	2020	2.00	2.00	2.00
	2021	2.00	2.50	6.00
	2022	4.00	4.50	9.00
FX Rate - USDBRL (end of period)	2020	5.30	5.10	5.10
	2021	4.60	4.60	6.70
	2022	4.15	4.15	6.70
Current Account Balance (% of GDP)	2020	-0.2	-0.7	-0.7
	2021	-0.2	-0.7	1.3
	2022	-1.4	-1.9	4.3
Primary Fiscal Balance (% of GDP)	2020	-12.4	-10.4	-10.4
	2021	-3.3	-3.1	-4.4
	2022	-2.4	-2.3	-3.6
Gross Public Debt (% of GDP)	2020	94.9	91.7	91.7
	2021	95.3	91.6	95.7
	2022	97.4	93.6	97.6

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