



THE COMMODITY FACTOR KEEPS BOOSTING BRAZILIAN ASSET PRICES

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- In the rolling week ended on March 31, the USD/BRL cross closed at 4.74. The Brazilian currency, strengthened nearly 2% against the USD and its performance stood among the top 5 in the basket with the 31 most liquid currencies in the world. The BRL movement this week was largely shaped by international events, having as backdrop a still constructive global risk sentiment. The BRL ended up as the best-performing currency in 1Q22 (up nearly 18% against the greenback), favored by a combination of higher interest rates, rising commodity prices, and a distance from the epicenter of current geopolitical tensions.
- The rally in the local yield curve kept going this week, with a massive bull-flattening movement in the 2s/5s segment. In our view, the market continued to adjust monetary policy expectations, as lower oil costs help reinforce the BCB's scenario (i.e., inflation convergence to mid-target in 2023 with oil prices at USD100/bbl and a terminal Selic of 12.75%). As an upshot, market participants now see lower probability of a hike at the June Copom meeting. The back end of the curve may also have been influenced by commodities, but conversely: a common view that material prices will remain high in the medium term is apparently leading to a perception of better economic fundamentals (including debt outlook), prompting a lower risk premium.
- As financial markets price in a higher probability of progress in Russia-Ukraine peace talks, and with the U.S. set to release part of its strategic oil reserves, commodity prices fell in USD terms. In Brazil, the BRL continued its appreciation, further feeding a downward movement in raw material costs in local currency. The Bloomberg Commodity Aggregate Index in BRL receded 5.4% in the rolling week ended March 31. In USD terms, the Index fell 3.7%.
- Federal tax collection had a positive performance in February, helped by the commodity cycle. The central government posted a primary deficit of BRL20.6 billion in February, which is usually an adverse month for the fiscal accounts. Nevertheless, the 12-month rolling federal primary result is close to balance, meaning one of the best showings since 4Q14. Elsewhere, the federal debt report showed that despite a comfortable liquidity position for the National Treasury, the debt profile continues to worsen, and the funding costs continue to rise on higher inflation and interest rates.
- Based on the February CAGED (establishment) survey, we calculate that seasonally adjusted payrolls stood at 200k, vs. 166k in January. The number of both hirings and layoffs increased, with the former up 3.8% MoM-sa and the latter up 2.1% MoM-sa. The three-month average now points to a payroll expansion of 185k jobs, down from 206k in January, meaning a likely loss of steam in the pace of new jobs at this stage. We calculate that the February seasonally adjusted jobless rate stood at 11.2%, down 0.3 p.p. from January, based on the IBGE's PNAD (household) survey. While employment continues to recover (also favored by the economic reopening), we maintain our view that it will lose momentum in coming months, due to the lagged effects of a tighter monetary policy stance.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.

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- Industrial production increased by 0.7% in February, after a 2.2% drop in January. In the breakdown, manufacturing was up by 0.6%, and mining was up by 5.3%. Moreover, February's figure implies a 0.0% carryover for 1Q22. We see GDP growing in 1Q22 (current forecast: 0.5% QoQ), owing mainly to a strengthening in farm output and a continued rebound of services dependent on social interaction.
- We expect March's IPCA (due on Friday, April 8) to rise 1.26% MoM. In YoY terms, this implies acceleration in annual terms to +10.91% (February: +10.54%), reinforcing our expectation that inflation may only start to come down in May. In terms of underlying inflation measures, we estimate the IPCA EX3 (core services and industrials) will stand around 11-12% 3MMA-saar, way above the upper target for headline IPCA in 2023 (5%).
- Note: Owing to a strike by federal workers, a few data releases previously scheduled for this week (e.g., balance of payments, bank lending, and fiscal statistics for the public sector, all for February) have been postponed, with no information yet on the date of rescheduling.

Most of the information in this report is up to the end of Thursday, March 31, 2022.

**Figure 1. Brazil Macro Agenda for the Week of April 04 to April 08, 2022**

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	FGV	Mar/22	Wed, 06-Apr	--	1.50
IGP-DI Inflation (% YoY)	FGV	Mar/22	Wed, 06-Apr	--	15.35
IPCA Inflation (% MoM)	IBGE	Mar/22	Fri, 08-Apr	1.26	1.01
IPCA Inflation (% YoY)	IBGE	Mar/22	Fri, 08-Apr	10.9	10.5
Vehicle Sales (thousands)	Fenabreve	Mar/22	01 to 05-Apr	--	129.2
Vehicle Production (thousands)	Anfavea	Mar/22	06 to 07-Apr	--	165.9

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Review¹.

¹ Santander Brazil – Scenario Review: “Higher Inflation and Selic Forecasts, Despite the Stronger BRL” – February 24, 2022- Available on: <https://bit.ly/Std-scenreview-feb22>



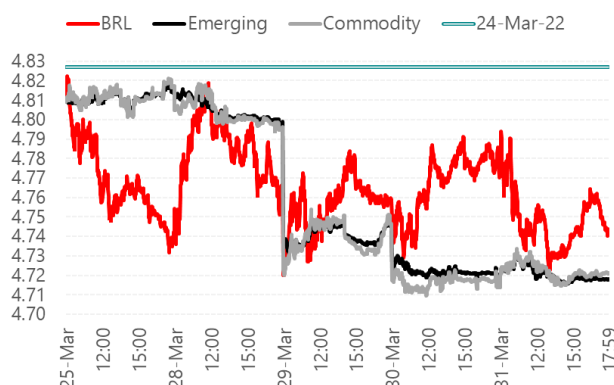
LOCAL MARKETS—FX

In the rolling week ended on March 31, the USD/BRL cross closed at 4.74. The Brazilian currency strengthening 1.8% against the USD and its performance stood among the top 5 in the basket with the 31 most liquid currencies in the world. This week's change in Brazilian FX was largely shaped by international events, having as backdrop a still constructive global risk sentiment. The BRL ended 1Q22 as the best-performing currency in the basket (up 17.6% against the greenback), favored by a combination of higher interest rates, rising commodity prices, and a distance from geopolitical tensions. The BRL's performance for the week seems to have overcome the effects of lower commodity prices in recent days, on the heels of market hopes for progress in the peace negotiations between Russia and Ukraine, U.S. President Biden's plan to use an unprecedented volume of U.S. oil reserves to curb fuel prices, and the introduction of new mobility restrictions in China (e.g., in Shanghai). The domestic news cycle has been relatively muted in recent days, with news on the shaping of presidential candidacies just before the deadline for party affiliations (and the quitting of executive positions) not affecting asset prices at all. In any case, we think the room for further BRL strengthening is narrow from now on, as we still see structural fiscal challenges and believe that commodity prices will probably level off.

LOCAL MARKETS—Rates

The rally in the local yield curve kept going this week, with a massive bull-flattening movement in the 2s/5s segment. In our view, the market continued to adjust monetary policy expectations, as lower oil costs help reinforce the BCB's scenario (i.e., inflation convergence to mid-target in 2023 with oil prices at USD100/bbl and a terminal Selic of 12.75%). As an upshot, market participants now see a lower probability of a hike at the June Copom meeting. The back end of the curve may also have been influenced by commodities, but conversely: a common view that material prices will remain high in the medium term is apparently leading to a perception of better economic fundamentals. Since last Thursday (March 24), the front end of the curve (Jan-24 DI future) fell 25 bps, to 12.06%, while the back end of the curve (Jan-27 DI future) fell 33 bps, to 11.22%. The curve's steepness in this segment fell 9 bps further, increasing the inversion to -83 bps. At the front end, the recent decline in oil prices could favor the BCB's scenario, in our view. Last week, the BCB's communications indicated that their flight plan includes just a final hike of 100 bps in May, with a terminal Selic of 12.75%. This policy dose is seen enough to bring IPCA down to the mid-target (3.25%) in 2023 with oil prices at USD100/bbl (and USD/BRL at 5.05). The options market is now pricing in a 59% probability of no hike in June, whereas that scenario was seen as having a probability of 24% last week. At the back end, despite a still challenging inflation and fiscal outlook domestically, yields fell considerably, apparently showing a tightening in risk premia due to a perception that higher commodities in the medium term can favor macro fundamentals, especially on the fiscal front. We maintain our view that with the hiking cycle nearing its end and with IPCA inflation close to its peak (in annual terms), the local yield curve soon could see a steepening pattern, as domestic challenges continue, and global interest rates have room to keep moving higher.

Figure 2. USD/BRL Intraday Trends

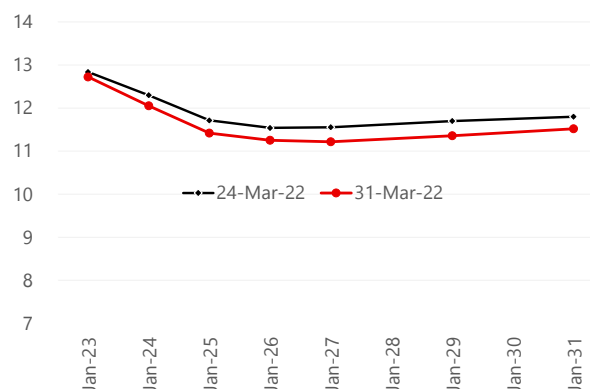


Sources: Bloomberg, Santander.

Note 1: As of the close on Thursday, March 31, 2022.

Note 2: For other currencies, we use USDBRL values as a base-index.

Figure 3. Brazilian Domestic Yield Curve (% p.a.)



Sources: Bloomberg, Santander.

Note: As of the close Thursday, March 31, 2022.



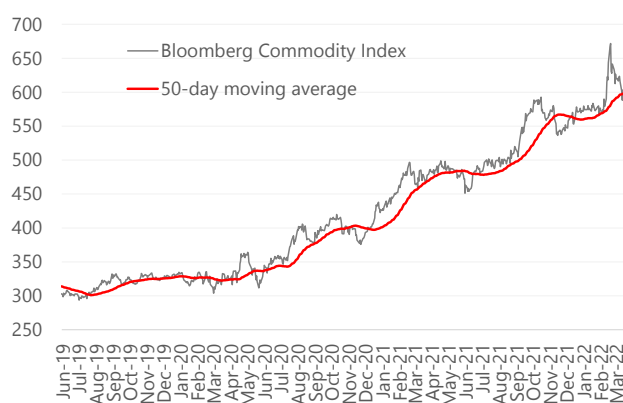
COMMODITIES

As financial markets price in a higher probability of progress in Russia-Ukraine peace talks, and with the U.S. set to release part of its strategic oil reserves, commodity prices fell in USD terms. In Brazil, the BRL continued its appreciation, further feeding a downward movement in raw material costs in local currency. The Bloomberg Commodity Aggregate Index in BRL receded 5.4% in the rolling week ended March 31. In USD terms, the Index fell 3.7%, with the Agriculture Subindex falling 2.8%, the Energy Subindex tumbling 6.0%, and the Industrial Metals Subindex retreating 3.8%. In our view, the ongoing geopolitical shock adds to already tight markets for key commodities: low inventories for most raw materials, coupled with idiosyncratic factors (adverse weather, underinvestment, and high cost of production). have been feeding the commodity rally early in 2022.

Oil drops on hopes for Russia-Ukraine talks. According to press sources², talks between the countries were “constructive”, though a promise to scale down military operations does not necessarily mean a ceasefire. In any case, some Western analysts and diplomats remain skeptical³. Adding to the bearish move, the U.S. announced that it will release 1 million barrels of oil a day from its Strategic Petroleum Reserves in the next six months. Effectively, the order means a release of 180 million barrels, the largest ever from the nation’s emergency reserve. Elsewhere, new lockdowns in Shanghai to control rising COVID-19 cases mean less demand for fuel in China, the world’s biggest importer of oil. We still see output shortages in the oil market, as global inventories are low, and producers (ranging from OPEC+ members to independent U.S. shale companies) struggle with the underinvestment of recent years.

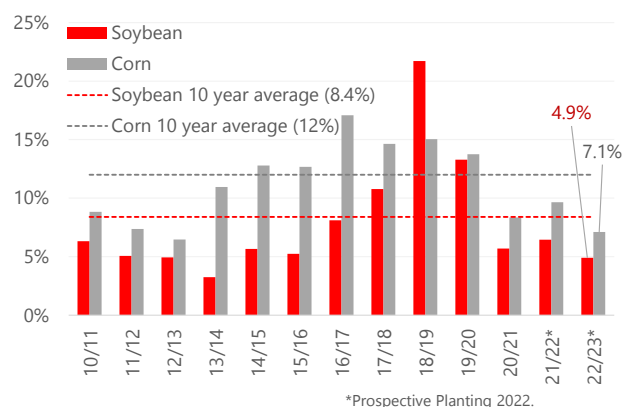
U.S. farmers are expected to plant more soybeans than corn. According to the USDA⁴ Prospective Planting Report, corn sowing for the 2022-23 marketing year is estimated at 89.5 million acres, down from 93.4 million last season and from the 92 million expected by the market. Conversely, soybean seeding is seen rising to 91 million acres, up from 87.2 million last season and the market’s estimate of 88.9 million. Higher fertilizer prices are likely behind this shift of resources: soybeans typically require just a quarter of the fertilizer that corn does. Additionally, the USDA Quarterly Grain Stocks showed U.S. corn stocks at 7,850 million bushels, below the market’s estimate of 7,880 million bushels, while soybean stocks were at 1,931 million bushels, above the market’s consensus of 1,908 million bushels. All in all, these numbers reinforce the perception of tight supply, so that any crop issue in the Northern Hemisphere’s planting season may prompt further moves in prices.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. US: Stock-to-Use Ratio in Grains - %



Sources: USDA, Santander.

² <https://www.cnbc.com/2022/03/29/oil-drops-on-ukraine-peace-talk-hopes-china-demand-fears.html>

³ <https://www.theguardian.com/world/2022/mar/31/peace-talks-between-russia-and-ukraine-to-resume-on-friday-says-negotiator>

⁴ United States Department of Agriculture.



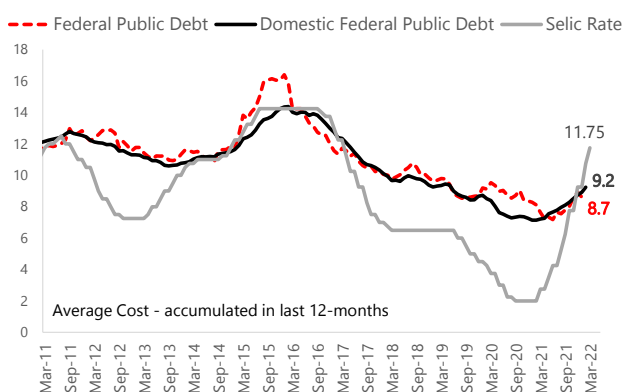
FISCAL POLICY AND LEGISLATION

Federal tax collection posted a positive performance in February, mostly driven by commodity prices. Revenue rose 5.3% YoY in real terms and saw the best result for the month since 1995. On March 28, the Brazilian internal revenue service published data for February. The monthly result (BRL148.7 billion) came close to our forecast (BRL149.5 billion). The result was affected by the same factors that led to a robust performance in 2021, such as activity recovery and a boost from the price effect (inflation and terms of trade), reflecting the rise in commodity prices. For the coming months, we continue to expect positive results for federal tax collection, but we expect an activity slowdown and a disinflation process, especially in 2Q22 and beyond, which could prompt a softening trend in government revenue. Thus, we forecast tax collection to rise ~1.0% YoY in real terms in 2022.

Despite a comfortable liquidity position for the National Treasury, the government debt profile continues to worsen, and funding costs continue to increase. On March 30, the National Treasury published the Monthly Debt Report for February. Weekly bond issuances averaged BRL28.5 billion, above the financial needs to keep liquidity reserves stable until the end of the year (~BRL24.2 billion per week, according to our estimate), prompting the public debt liquidity reserve to rise by BRL145 billion to BRL1,278 billion, meaning almost 11 months of debt maturities. We expect the liquidity reserves to rise BRL71 billion by March due to the transfers from the Treasury of BCB operational results (not related to FX). The cost of new domestic issuance rose to 9.5% p.a. from 8.9% p.a. in January (in tandem with increases in IPCA and the Selic). In the last 12 months, the cost of debt has been increasing by an average of 0.4 p.p. per month, considering the monetary tightening by the BCB and high IPCA inflation. Floating rate bonds were the highlight from an issuances standpoint, totaling BRL67.8 billion in the month, reflecting anticipation of a large maturity of these bonds in March. Non-residents registered a negative flow of BRL17.7 billion in February, albeit totaling +BRL80.7 billion in the last 12 months, reducing their share as debt holders to 10.0%, compared to 10.5% in January. Financial institutions continue to be the main debt holders (29.5%). In our view, despite the comfortable levels of liquidity reserves to navigate the 2022 uncertainties, the outlook for debt management remains challenging for the medium term, especially after the rise in Selic and IPCA estimates. However, we think the length of the current cycle of high commodity prices could help ease the short-term headwinds somewhat.

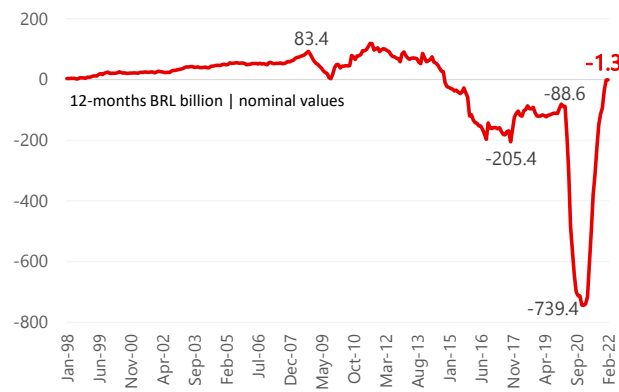
According to the data published by the Treasury on March 24, the central government posted a primary deficit of BRL20.6 billion in February. With this result, the 12-month rolling balance keeps running close to zero and is seeing its best performance since October 2014. Expenditures rose 6.5% YoY in real terms, with a higher-than-expected increase in health expenditures. Revenue rose 14.8% YoY, favored by extraordinary oil-related Transfer of Rights revenue (BRL11.2 billion). For 2022, our tracking points to a central government deficit of BRL50 billion (0.6% of GDP), based on an increase in expenditures and some softening in revenue growth. However, we see risks skewed to the upside because of commodity-driven revenue. **The release of the consolidated public sector data by the BCB, previously scheduled for March 31, was postponed (with no new date of release as yet) due to a strike by federal workers. We look for a deficit of BRL8.6 billion.**

Figure 6. Government Debt Cost and Selic Rate



Sources: National Treasury, Santander.

Figure 7. Central Government Primary Balance



Sources: National Treasury, Santander.



ECONOMIC ACTIVITY

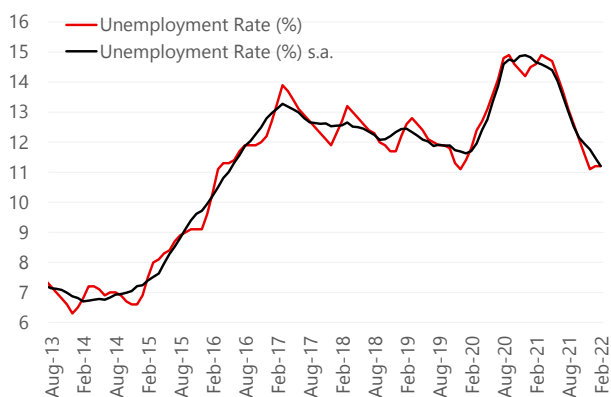
Positive surprise in February net formal job creation. According to the February CAGED survey, net (unadjusted) formal job creation stood at 328.5k (vs. consensus 220k, Santander estimate 180k). After our seasonal adjustment, we calculate that net formal job creation decelerated to 200.2k, from 165.8k in January. The number of hirings increased 3.8% MoM-sa, while layoffs increased 2.1% MoM-sa. The three-month average now points to a payroll expansion of 184.6k jobs, from 206.3k in January. We still think that the deceleration trend observed in CAGED data since mid-2021 continues, as the 3mma net job creation decreased once again.

February unemployment rate below expectations. According to the IBGE's National Household Survey (PNAD), the unemployment rate was 11.2% in the three months through February. The figure was below both our estimate (11.3%) and the market consensus (11.4%). We calculate that the seasonally adjusted jobless rate stood at 11.2%, a 0.3 p.p. decrease from January's level. The labor market participation rate stood at 61.7% (sa), stable compared to the January level and 1.3 p.p. below the pre-pandemic level (February 2020). All PNAD data is based on a three-month moving average. We estimate that the monthly unemployment rate stood at 11.0% (sa) in February, compared to 11.2% in January. This result followed +1.0% and +0.8% MoM-sa variations in the employed population and the labor force, respectively. After January's sharp drop in both the employed population and the labor force due to the outbreak of the Omicron variant of COVID-19, both series partially recovered in February, still leaving room for further volatility in March. The average usual real income showed a +0.2% MoM-sa variation, the second consecutive increase. We maintain our view that growth in the employed population will decelerate in the coming months, and we expect the participation rate to return to levels closer to those before the pandemic. Therefore, we expect the seasonally adjusted unemployment rate to start increasing again soon. [See details in the link⁵.](#)

Lower confidence in most sectors in March. Weak figures were released for goods-related sectors like industry (-1.8%) and retail (-0.2%), as well as for the consumer and construction confidence indexes (-4.0% and -0.9%, respectively). Services bucked the trend and printed positive growth (+3.4%), driven mainly by the current assessment (+5.0%), but also with a positive number for expectations (+1.8%). In our view, this is probably a reflection of the improvement in public health conditions and the consequent reopening of services activity, with the latter expected to return to pre-pandemic levels later this year. Maybe reflecting the greater weight of services in GDP, FGV's aggregate business confidence index posted a 0.8% growth. This was the first gain in five months, but the headline still runs in "contractionary territory" (i.e., at 91.8 points, below the 100-point mark).

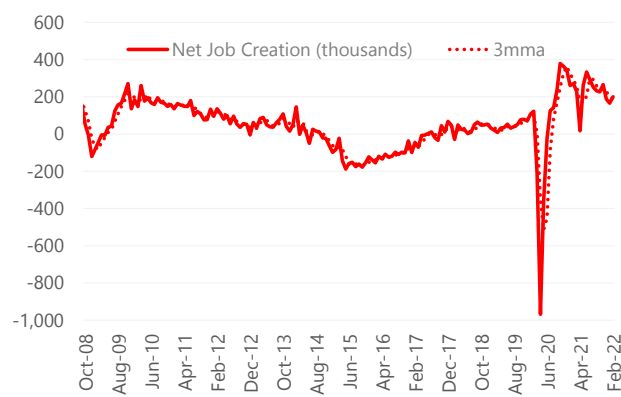
Industrial production increased in February. The headline index expanded by 0.7% MoM-sa, after a 2.2% contraction in January. In the breakdown, manufacturing was up by 0.6%, and mining was up by 5.3%. Moreover, February's figure implies a 0.0% carryover for 1Q22. We see GDP growing 0.5%QoQ in 1Q22, owing mainly to a strengthening in farm output and a continued rebound in services. [For details on Santander's activity outlook, please refer to our last chartbook⁶.](#)

Figure 8. Unemployment Rate



Sources: IBGE, Santander.

Figure 9. Net Formal Job Creation (sa)



Sources: Ministry of Labor, Santander.

⁵ Santander Brazil Labor Market: "Positive Surprises for Labor Market in February" – March 31, 2022 – Available on: <https://bit.ly/Std-labor-033122>

⁶ Santander Brazil Economic Activity: "Positive Surprises Reinforce Resilience Outlook for 2022" – March 14, 2022 – Available on: <https://bit.ly/Std-chart-econact-mar22>



INFLATION

We expect March's IPCA (due on Friday, April 8) to rise 1.26% MoM. In YoY terms, this implies acceleration to +10.91% (February: +10.54%), reinforcing our expectation that inflation may only start to come down in May. In terms of underlying inflation measures, we estimate the IPCA EX3 (core services and industrials) will decrease a bit to 11.6% 3MMA-saar, way above the upper target for 2023 (5%).

Compared to February's IPCA (+1.01% MoM), we expect the headline to accelerate in monthly terms, driven mostly by regulated prices (+2.03% MoM vs. +0.12% last month). The main driver in regulated prices will be gasoline, as we expect to see much of the recent price rise appearing in CPI in this release. In free-market prices, we forecast services to decelerate in monthly terms to 0.25% MoM (vs. 1.36% MoM), as the seasonal impact of higher education fees is expected to fade. Industrial goods should also decelerate a bit, to 0.84% from 1.11% MoM, per our projections. In our view, the negative highlight in free-market prices will be food-at-home, which could accelerate to 2.82% MoM (vs. 1.65% last month)—with weather conditions affecting the supply of some fresh food items.

In terms of broad underlying inflation measures, we estimate the IPCA EX3 core is likely to rise 0.82% MoM, which would imply a trend of ~11.6% 3MMA-saar. If we are correct, March would be the 19th consecutive month in which the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (our headline CPI target is 3.50% for 2022 and 3.25% for 2023).

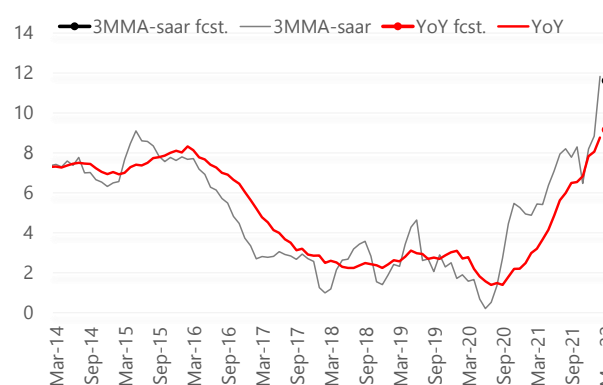
We still project that a clear inflationary peak should come around May. However, the level and composition of inflation are likely to remain sources of concern, with the latest shock from commodities prices being a new risk that keeps the balance of risks tilted to the upside (i.e., higher inflation).

Figure 10. March's IPCA-15 Details (% annual)

	MoM		YoY	
	Mar-22	Contrib.	Feb-22	Mar-22
IPCA	1.26	1.26	10.5	10.9
Administered	2.03	0.55	15.0	14.2
Free	0.97	0.71	9.0	9.7
Food-at-home	2.82	0.42	10.1	13.4
Industrial goods	0.84	0.19	13.0	13.0
Services	0.25	0.09	5.9	6.1
EX3 Core	0.82	0.29	8.2	8.7

Sources: IBGE, Santander.

Figure 11. Core Inflation EX3 (% annual)



Sources: IBGE, Santander.



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