BRAZIL MACRO

June 2, 2021

MACRO COMPASS

Ana Paula Vescovi* and
Brazil Macroeconomics Team
anavescovi@santander.com.br
+5511 3553 8567

PRICE PRESSURES SPREADING

- In April, the public sector posted the highest primary surplus since 2014 in real terms, at +BRL24.3 billion, boosted by the effect on revenue of a more persistent inflation shock—in both federal and regional terms. Meanwhile, gross government debt came in at 86.7% of GDP in April, a drop of 2.2 p.p. from March—on the heels of the increase in nominal GDP (-1.5 p.p. of impact).
- The US$9.3 billion trade surplus in May 2021 fell short of our estimate of US$9.8 billion, owing to lower-than-expected exports. The average of the last three months has been pointing to a robust annualized surplus (US$108.6 billion), which is above our current forecast for the full year (US$85.3 billion). Benefiting from a relatively cheap BRL, solid external demand, and high commodity prices, trade results will continue to support the balance of payments in the near future, in our view.
- The released GDP data confirmed our expectations of solid and resilient growth at the start of 2021, with the headline index climbing 1.2% QoQ-sa (1.0% YoY) in 1Q21, virtually placing the economy at the pre-crisis mark (4Q19). Moreover, this result implies a carryover of 4.9% to 2021 GDP, which implies upside risks to our current projection of 3.6%. In addition, IBGE has released industrial production data for April: the headline index retreated 1.3% MoM-sa, showing a weak figure at the start of 2Q21.
- For the coming week, IBGE will release tertiary sector data for April: we are looking for monthly growth of 3.7% and 0.8% for broad retail sales (due on June 8) and services volume (due on June 11), respectively.
- We expect May's IPCA (due on Wednesday, June 9) to rise +0.76% MoM, meaning an acceleration in annual terms to +8.0% YoY (from +6.8% YoY in April), the highest reading since 4Q16. Underlying measures should keep CPI under pressure, evidencing some spreading of inflationary pressures.

Owing to a national holiday in Brazil on Thursday, June 3, we are sending a special edition of our weekly report today (Wednesday, June 2).

Most of the information in this report is up to the end of Tuesday, June 1, 2021.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

U.S. investors' inquiries should be directed to Santander Investment Securities Inc. at (212) 583-4629 / (212) 350-3918.
* Employed by a non-US affiliate of Santander Investment Securities, Inc. and is not registered/qualified as a research analyst under FINRA rules.

Figure 1. Brazil Macro Agenda for the Week of Jun 7-11, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	**FGV**	**May/21**	**Tue, 08-Jun**	**3.53**	**2.22**
IGP-DI Inflation (% YoY)	FGV	May/21	Tue, 08-Jun	36.7	33.5
Core Retail Sales (% MoM)	IBGE	Apr/21	Tue, 08-Jun	0.1	-0.6
Core Retail Sales (% YoY)	IBGE	Apr/21	Tue, 08-Jun	20.0	2.4
Broad Retail Sales (% MoM)	**IBGE**	**Apr/21**	**Tue, 08-Jun**	**3.7**	**-5.3**
Broad Retail Sales (% YoY)	IBGE	Apr/21	Tue, 08-Jun	40.9	10.1
Vehicle Production (thousands)	Anfavea	May/21	Tue, 08-Jun	--	190.9
IPCA Inflation (% MoM)	**IBGE**	**May/21**	**Wed, 09-Jun**	**0.76**	**0.31**
IPCA Inflation (% YoY)	IBGE	May/21	Wed, 09-Jun	8.0	6.8
Services Volume (% MoM)	**IBGE**	**Apr/21**	**Fri, 11-Jun**	**0.8**	**-4.0**
Services Volume (% YoY)	IBGE	Apr/21	Fri, 11-Jun	**20.1**	4.5

Source: Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last scenario review[1].

[1] **Santander Brazil - Macroeconomic Scenario: *"Monetary Stimulus Doomed to End Sooner"* –** May 20, 2021- Available on: http://bit.ly/Std-scr-review-may21

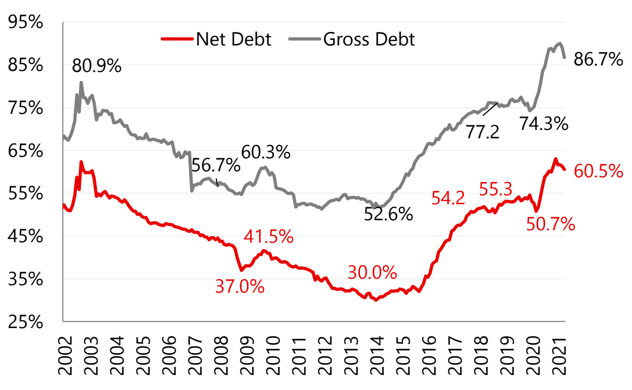
FISCAL POLICY AND POLITICS

In April, the public sector posted the best primary surplus result since 2014 in real terms, at +BRL24.3 billion, boosted by the impact on revenue of a more persistent inflation shock—in both federal and regional terms. Although the fiscal result was quite positive for the first four months of the year, some (possibly temporary) factors have helped support the fiscal result so far. The results occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of budget 2021), leading to an all-time low in the 12-month reading. Higher inflation and FX depreciation also helped the fiscal statistics from the standpoint of revenue. In addition, the regional government surplus remains high due to fiscal transfers and a robust recovery in activity in the last few months. We advise against extrapolating the most recent positive revenue surprises to the full year, although the current fiscal result for the year implies a positive bias to our forecasts. In our estimates, the public sector primary deficit should reach BRL250 billion in 2021 (3.0% of GDP). Meanwhile, gross debt came in at 86.7% of GDP in April, a drop of 2.2 p.p. from March—on the heels of the increase in nominal GDP (-1.5 p.p. of impact). At the same time, net debt was 60.5% of GDP, 0.4 p.p. lower on the same basis of comparison. We project gross debt to fall this year to 85.0% of GDP. See details in the link[2].

We calculate that pandemic relief expenses that were exempted from compliance with the constitutional spending cap (so-called "extra-cap" spending) totaled BRL16.1 billion in May, most of which was spending on the new emergency aid (i.e., federal transfers to low-income households, adding BRL9 billion) initiated in April. The expected expenses for the welfare program per month are lower than initially predicted by the government (BRL11 billion). However, we believe that the government will choose to use the remaining budget approved in the *PEC Emergencial* (BRL44 billion), probably using the excess amount to extend the program for one or two months (beyond July). Health expenses totaled BRL9.1 billion in the year up to May, out of a total budget of BRL20.7 billion. For the time being, the total of "extra-cap" expenses in the budget (including 2020 budget leftovers and new stimulus in 2021) is BRL101.5 billion. The reintroduction of the *Pronampe* program (credit support for SMEs) in 2021 is still under debate and, if approved, should add BRL5-10 billion to that tally, per our estimates. Consequently, in our estimates we consider extra-cap spending of close to BRL115 billion this year (~1.4% of GDP).

After months at a standstill, a joint congressional session voted on June 1 to override the presidential vetoes and budget bills, allowing the redirection of BRL 21.4 billion in mandatory expenditures. One of the pieces of legislation (PLN4), which accounts for the largest share of spending (BRL 19.7 billion), was submitted as part of the deal between the government and Congress, in order to solve the 2021 budget gridlock. PLN 4 redirects resources to cover expenses on social security, unemployment insurance, and subsidies that had been shaved off without technical support in the budget approved in March. We believe that the focus now will be on executing the budget and complying with the spending cap rule, which will require a great deal of fiscal discipline.

Figure 2.A. – Public Sector Debt (% GDP)



Sources: Brazilian Central Bank, Santander.

Figure 2.B. – Extra-Cap Expenditures in 2021

BRL Billion - Accumulated	Mar-21	Apr-21	May-21	Total Budgeted	Executed
Emergency Aid (MP 1.037/2021)	0.7	9.7	18.6	44.9	**21.7%**
Health expeditures	3.7	5.1	9.1	20.7	**24.8%**
BEm - Employment Program (MP 935/220 and MP 1.044/2021)	0.4	0.6	2.1	11.7	**5.4%**
Turism Infraestructure (MP 963/2020)	0.4	0.4	0.4	1.9	19.8%
Vaccine Acquisition (MP 994, 1,004 and 1,015/2020)	3.5	4.6	6.4	22.3	20.7%
Accumulated Total	8.6	20.5	36.6	101.5	20.2%

Updated in 06/01/2021

Sources: National Treasury, Santander.

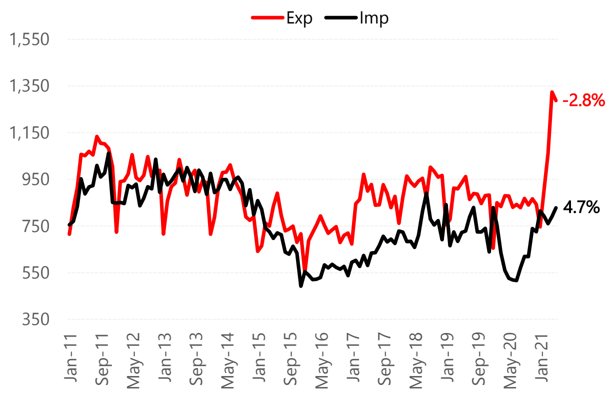
[2] **Santander Brazil Fiscal - "*Positive Results on The Heels of Higher Inflation*" –** June 01, 2021 - Available on: http://bit.ly/Std-Fiscal-010621

TRADE BALANCE

The Brazilian trade balance registered a US$9.3 billion surplus in May 2021, which was a tad smaller than our estimate of US$9.8 billion, as exports fell short of our expectation (US$26.9 billion vs. US$27.4 billion) while imports were in line with our estimate (US$17.7 billion). We believe the seasonally adjusted slowdown in the daily average exports recorded last month (2.8% MoM-sa vs. 24.9% in April) was a one-off MoM-sa. With respect to imports, the 4.7% MoM-sa expansion in the daily average has returned it to the same level as at the beginning of 2021. To be clear, we think the daily averages of both exports and imports should remain stable at the current level for a while longer. See details in the link[3]

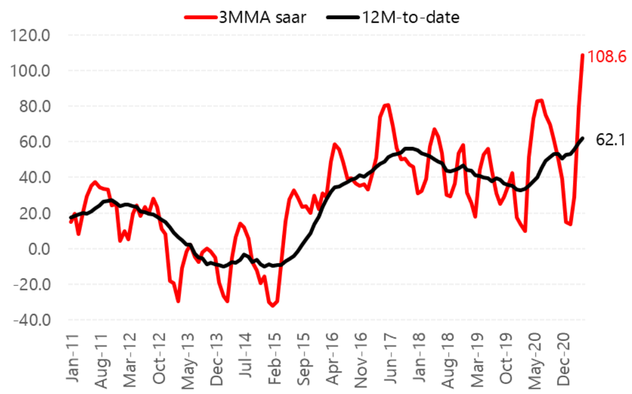
Given these trends, it should not be surprising that the trade balance surplus on a 12-month basis has continued its upward trend since early 2020 and that the average of the last three months has been pointing to a robust annualized surplus (US$108.6 billion), which is above our current forecast for this year as a whole (US$85.3 billion). What's more, given that market participants' median estimate for the trade surplus in 2021 is currently only US$68.0 billion, we believe consensus expectations will rise in the coming weeks, thus reinforcing the general perception that foreign trade should continue to support the balance of payments in the near future.

Figure 3.A. Trade Balance
(US$ million, daily average, s.a.)



Sources: SECINT, Santander.

Figure 3.B. – Trade Balance
(US$ billion)



Sources: SECINT, Santander.

[3] **Santander Brazil – External Sector:** ***"On the Rise"*** – June 1, 2021- Available on: http://bit.ly/Std-extsec-010621

ECONOMIC ACTIVITY

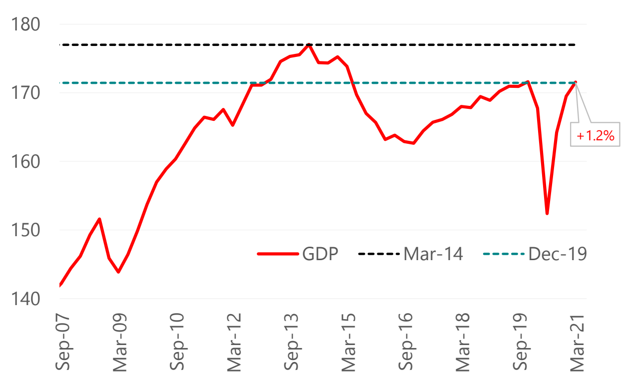
GDP data for 1Q21 confirmed expectations of solid and resilient growth at the start of this year. Brazilian GDP climbed 1.2% QoQ-sa (1.0% YoY) in 1Q21, slightly above our projection (0.9%) and market consensus (0.7%). On the supply side, the services sector expanded by 0.4% (our call: 0.8%), a widespread increase among most of the segments, albeit dragged down by public services and other services (-0.6% and +0.1%, respectively). Industry showed resilience by growing 0.7% (our call: 0.3%), as the drop in manufacturing (-0.5%) was offset by expansion in mining (3.2%). On the heels of the commodities price hike, agriculture contributed positively by growing 5.7%, generating the largest contribution to sequential growth. On the demand side, there were widespread positive surprises. Household consumption surprised to the upside by retreating only 0.1% (our call: -1.3%), despite the weak figures for broad retail sales and services to families in 1Q21. Investments came in positive, climbing 4.6% (our call: -0.1%), while imports expanded sharply (+11.6%).

This result implies a carryover of 4.9% to 2021 GDP and virtually places the economy at the pre-crisis mark (4Q19). We believe the already positive figures for the tertiary sector, along with the materialization of the first effects of the new round of emergency aid, point to better than expected activity in 2Q21. Moreover, although important services segments such as public services and other services are still at depressed levels, we expect them to recover as the economy reopens and the health crisis is surmounted. Therefore, these figures imply substantial upside risks to our current projection for 2021 GDP (3.6%). See details in the link[4].

April industrial production figures, which inaugurated the release of 2Q21 activity data, posted a weak start in the quarter. The headline index was down by 1.3%, stemming mainly from a decline in manufacturing (-2.2%), while mining industry expanded 1.6%. In our view, the decline in manufacturing reflects the lingering impact of the pandemic and the widespread shortage of inputs in the sector.

Looking ahead, IBGE will release tertiary sector data for April next week. We are looking for monthly gains of 3,7% (June 8) and 0,8% (June 11) for broad retail sales and services volume, respectively. In our view, the tertiary sector will contribute positively to activity in 2Q21, on the heels of mobility increases and the payment of the new round of emergency aid. For May, our proprietary index (IGet) already points to sequential growth for broad retail sales and services to families.

Figure 4.A. – GDP (sa, index 1995=100)



Sources: IBGE, Santander.

Figure 4.B. – GDP Breakdown

		4Q20		1Q21	
	Weights	% YoY	% QoQ	% YoY	% QoQ
GDP	100%	-1.1	3.2	1.0	1.2
Supply					
Taxes	14%	0.2	4.8	1.9	2.1
Agriculture	10%	-0.4	-1.5	5.2	5.7
Industry	17%	1.2	1.6	3.0	0.7
Services	58%	-2.2	2.7	-0.8	0.4
Demand					
Consumption	60%	-3.0	3.2	-1.7	-0.1
Government	18%	-4.1	0.9	-4.9	-0.8
Investments	19%	13.5	20.0	17.0	4.6
Exports	18%	-4.3	-1.1	0.8	3.7
Imports	-19%	-3.1	19.3	7.7	11.6

Sources: IBGE, Santander.

[4] **Santander Brazil Economic Activity - "1Q21 GDP Growth Means Resilience of Activity" –** June 01, 2021 - Available on: http://bit.ly/Std-econact-010621

INFLATION

We expect May's IPCA (due on Wednesday, June 9) to rise 0.76% MoM, meaning an acceleration in annual terms to +8.0% YoY (from +6.8% YoY in April), posting another multi-year high.

Administered prices inflation should accelerate further to +2.10% MoM, in our view, fueled by electrical energy (because of the change in the tariff flag that raised costs to consumers) and gasoline. We also expect industrial goods to continue their upward monthly trend, rising 1.12% MoM, a substantial seasonal change that may accelerate the three-month annualized and seasonally adjusted moving average (3mma-saar) further to +11.5%, evidencing no sign of relief for industrials inflation. We forecast services prices to fall 0.27% MoM, reflecting deflation in airline tickets, residential rents, and vehicle insurance—which would be compatible with the 3mma-saar running at around +1.8%, a low level, but also compatible with core services at +3.7% 3mma-saar, a not so low level. Finally, we expect food-at-home to rise +0.28% MoM, keeping its 3mma-saar close to zero, in line with a deceleration in YoY terms until the end of the year.

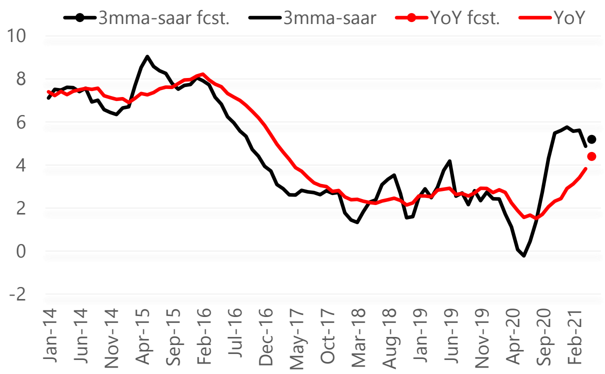
In terms of underlying inflation measures, the EX3 core should rise around +0.42% MoM, as per our projection, meaning a slight acceleration to +5.2% (from +4.9%) in the trend denoted by the seasonally adjusted quarterly annualized moving average (3mma-saar). This is a persistently high level—it would be the eighth month of the EX3 core running between +4.3% and +5.8% in 3mma-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022)—suggesting non-negligible risks of a spreading of primary shocks to general prices.

Figure 5.A. – May's IPCA-15 Forecast (%)

	MoM		YoY	
	May-21	Contrib.	Apr-21	May-22
IPCA	0.76	0.76	6.8	8.0
Administered	2.10	0.55	9.6	13.1
Free	0.28	0.21	5.8	6.2
Food-at-home	0.28	0.04	15.6	15.5
Industrial goods	1.12	0.26	6.9	8.1
Services	-0.27	-0.09	1.4	1.6
EX3 Core	0.42	0.42	3.8	4.4

Sources: IBGE, Santander.

Figure 5.B. – Core Inflation (IPCA EX3, %)



Sources: IBGE, Santander.

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research			
Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327
Global Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500
Fixed Income Research			
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Equity Research			
Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511 3553 1684
Electronic			
Bloomberg	SIEQ <GO>		
Reuters	Pages SISEMA through SISEMZ		

This report has been prepared by Santander Investment Securities Inc. ("SIS"; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. "Santander"), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. (“Santander Investment Bolsa”), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Ana Paula Vescovi*.

*Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

© 2021 by Santander Investment Securities Inc. All Rights Reserved.

Santander