BRAZIL MACRO

July 2, 2021

MACRO COMPASS

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THE INFLATION FACTOR

- In a week when the USD registered gains versus all major currencies in the period, the BRL was the worst-performing (in the basket), closing the rolling week ended on July 1 at USD/BRL5.05 (-2.3%). Local markets have been watching political developments of late. The yield curve also steepened a bit, with some selling at the back end and a rally in the front end — the latter in hopes of a respite from inflation shocks.
- New COVID-19 infections are trending down in Brazil. In our view, the decline in casualties and hospitalizations suggest that vaccines might be starting to prevent severe cases, especially among the elderly (prioritized in the immunization schedule). The vaccination pace is holding up above 1 million/day, reaffirming a positive outlook for the 2H21.
- May fiscal data released this week showed budget results still boosted by the shocks in inflation and terms of trade. Federal tax collection posted a new monthly record. Regional governments' primary balances continue to surprise on the upside, reaching the all-time high in YTD real terms. Government debt metrics are going south for the short term.
- The US$10.4 billion trade surplus registered in June 2021 fell short of our projection (US$11.6 billion), but marked the largest monthly print on record. Notwithstanding the solid trade surplus, the gap between the balance of shipped goods (exports minus imports) and net FX inflows (in the commercial segment) continued to widen, reaching US$54.4 billion as of June 25, according to our estimates.
- According to the IBGE's Household Survey (PNAD) for April, the seasonally adjusted unemployment rate edged up (+0.1 p.p.) to 14.5%, as a higher participation rate offset the increase in (especially unregistered) employment. The Ministry of Economy's establishment survey (CAGED) for May posted a net seasonally adjusted payroll gain of 274k, another solid reading. In our view, while job market conditions remain fragile, the latest batch of jobs data points to an improvement, especially for sectors more dependent on social interaction. That is naturally a reflection of the reopening process.
- Industrial production climbed by 1.4% in May, breaking a sequence of three declines in a row. Despite the monthly growth, May's figure still implies a negative carryover to 2Q21. Next week, IBGE will release broad retail sales for May, and we are looking for a monthly gain of 5.5% MoM-sa.
- We expect June's IPCA (due on Thursday, July 8) to rise 0.55% MoM, meaning an acceleration in annual terms to +8.4% YoY (from +8.1% YoY in May), which would be the highest reading since September 2016. Underlying measures should remain under pressure, providing evidence of spreading inflationary pressures amid a large confluence of price shocks.

Most of the information in this report is up to the end of Thursday, July 01, 2021.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

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Figure 1. Brazil Macro Agenda for the Week of July 5-9, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	FGV	Jun/21	Wed, 07-Jul	--	3.4
IGP-DI Inflation (% YoY)	FGV	Jun/21	Wed, 07-Jul	--	36.53
Core Retail Sales (% MoM)	IBGE	May/21	Wed, 07-Jul	2.9	1.8
Core Retail Sales (% YoY)	IBGE	May/21	Wed, 07-Jul	19.0	23.8
Broad Retail Sales (% MoM)	**IBGE**	**May/21**	**Wed, 07-Jul**	**5.5**	**3.8**
Broad Retail Sales (% YoY)	IBGE	May/21	Wed, 07-Jul	29.0	41.0
Vehicle Production (thousands)	Anfavea	**Jun/21**	Wed, 07-Jul	--	192.3
IPCA Inflation (% MoM)	**IBGE**	**Jun/21**	**Thu, 08-Jul**	**0.55**	**0.83**
IPCA Inflation (% YoY)	**IBGE**	**Jun/21**	**Thu, 08-Jul**	**8.37**	**8.06**
Holiday in the State of São Paulo			**Fri, 09-Jul**		

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario:** ***"Improvement in The Short Term, Caution for The Medium Term"*** **–** Jul 01, 2021- Available on: http://bit.ly/Std-scenrev-070121

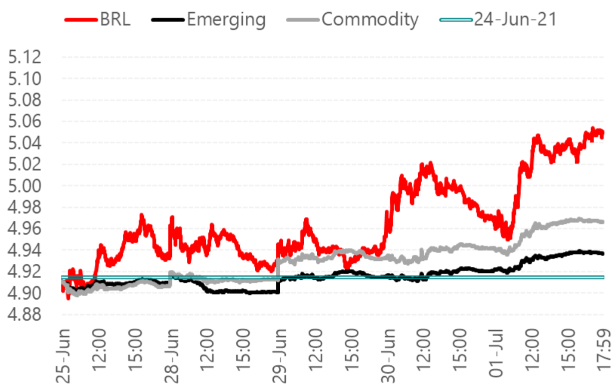
LOCAL MARKETS—FX

After a six-week streak of strengthening, when it breached the USD/BRL5.00 threshold for the first time since June 2020 and got close to USD/BRL4.90, the BRL closed the rolling week ended on July 1 as the worst performer among major currencies. Although the USD registered gains versus all major currencies in the period—as per the performance of the DXY index—we believe BRL weakening was magnified by an increased perception of political risks. We think this week's performance is a reminder of the frailty of the improvement observed in markets' perception of late, amid a continued high level of uncertainties and challenges that the Brazilian economy still faces, especially on the fiscal front. We reiterate that the lack of concrete progress on the reformist agenda and the maintenance of structural problems on the budgetary arrangement should limit the room for substantial and lasting BRL appreciation in the coming months. We forecast the USD/BRL pair to end 2021 at 5.05.

LOCAL MARKETS—Rates

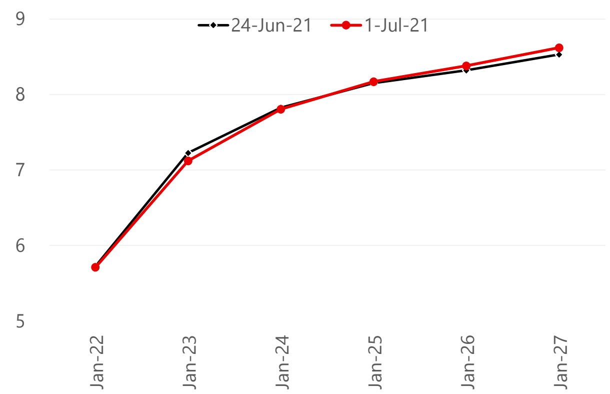
After six weeks of flattening, the nominal yield curve saw significant steepening. Since last Thursday (June 24), the front end of the curve (Jan-23 DI future[2]) fell 11 bps, to 7.12%, while the back end of the curve (Jan-27 future) rose 9 bps, to 8.62%. As a result, the curve's steepness in this segment rose 19 bps, reaching 149 bps. In our opinion, the front-end relief was driven by a lower-than-expected June's IGP-M inflation print (the first significant downside surprise in inflation releases in a while) and possibly also by some economists' view that the rise in electricity costs generated by higher tariff flag values in 2021 (decided by Aneel, the sector regulator, this week) might generate a downward payback in 2022 inflation. At the beginning of the week of June 21, the options market was pricing in an implied probability of a 75-bp Selic hike as low as 25%, with the probability of a 100-bp hike around 60%. After the IGP-M release and the Aneel's announcement, the probability of a 75-bp hike gained space, rising back to around 40% now, while the probability of a 100-bp hike fell to around 55%. Finally, at the long end, political frictions prompted the market to build back a bit of the risk-premium that had been reduced during the last six weeks. It is worth noting that our view regarding the fiscal outlook and the uncertainties around the sustainability of the debt-to-GDP trajectory are compatible with some rebuilding of risk-premium at the long-end of the curve.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, July 1, 2021.
Note2: For other currencies, we use USDBRL values as a base-index

Figure 2.B. – Brazilian Domestic Yield Curve (% p.a.)



Sources: Bloomberg, Santander.
Note: As of the close Thursday, July 1, 2021.

[2] To better reflect the monetary policy horizon, we are now changing our analysis of the front end of the curve from the Jan-22 DI Future to the Jan-23 (last trade date at December 29, 2022).

COVID-19 MONITORING

Brazil's vaccination pace continues to hold up above the mark of 1 million/day. We expect the daily average pace of vaccination to stand at 1.5 million doses in the 2H21, as vaccine inventories remain high (43 million doses) and deliveries continue to outpace the vaccine administration.

In our view, the decline in both casualties and hospitalizations suggest that vaccines could be starting to take effect in preventing severe COVID-19 cases. Infections have been mostly affecting youngsters, who are less likely to develop serious illness. Still, new infections are now declining in Brazil. The ICU occupancy rate is above 90% in five states, a decrease from seven last week (18 states in the worst phase). Data from Brazil's Health Ministry showed an average of 55.3k new daily cases (7-day moving average) as of Wednesday (June 30), down 28.4% from last week, while daily casualties (7-day moving average) totaled 1,565, down 18.3% in the same comparison.

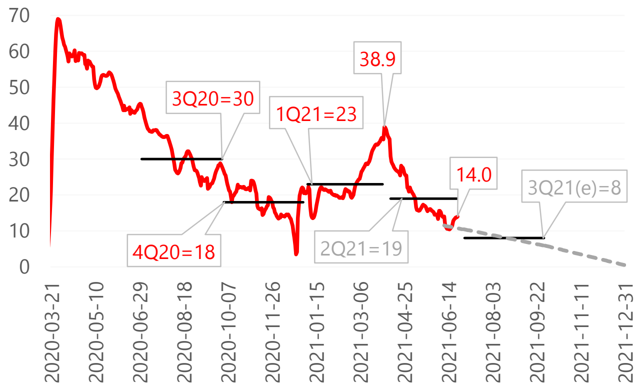
Mobility seems to be retreating recently. After starting the quarter at high readings, close to the level in June 2020 (~40 points, 7-day average), our lockdown index (using Google Mobility Report data) posted a consistent downward trend in the last few months, reaching 11.4 points (as of June 18, 2021). However, since this date, mobility seems to be retreating, with our lockdown index now moving up to 14 points (as of June 24, 2021). This move stems mainly from mobility decreases in Retail and Transit Stations; the Workplace segment still stands at pre-pandemic marks. This retreat does not seem to reflect a setback in the reopening process, but the pace of reopening now is moving slower than at the start of 2Q21.

Our daily activity index continues to improve across 2Q21. The index — based on daily data on energy consumption, car sales, and mobility — has been improving since the start of 2Q21, showing an upward trend in recent months. On monthly basis, adjusted for seasonality, the index expanded by 5.6% and 3.0% in April and May, respectively. For June, considering the available data (up to the 24th), the index has climbed 4.6%. Yet these gains are still not enough to fully offset March's retreat (-15.1%), placing the index at readings still 3.3% below February-21.

Figure 3.A. – Vaccination by Age and Gender (June 28, 2021)

by Sources: PNAD, dataSUS, @eliaskrainski, Santander.

Figure 3.B. – Lockdown Index*, Mobility Forecasts (Feb/20=0, 7-day average)



Sources: Google, Santander.
* This index is built as an average of selected segments from Google Mobility Report with inverted scales. Data are available until June 24, 2021.

FISCAL

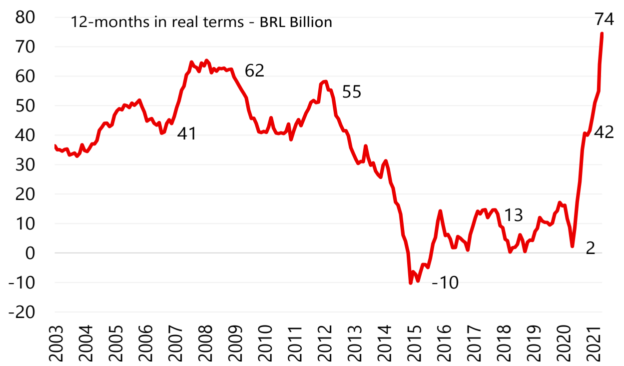
May fiscal data released this week showed another results still boosted by the price shock. Federal tax collection registered a new monthly record. Surplus of regional governments continues to surprise positively, reaching the all-time high in YTD real terms. Debt indicators posted a decline.

In May, federal tax collection (BRL142 billion) was close to our forecast and the market median, both ~BRL140 billion. In the month, it registered a 69.9% YoY real increase; it is worth noting that May 2020 was the worst result for tax collection, due to the pandemic impact. In YTD real terms, it was the best result of the historical series (1995). This result is “helped” by extraordinary revenues (BRL16 billion in the year), mostly related to M&A, IPO, and corporate restructuring. The impact of inflation and terms of trade on revenue prevailed in the latest results. In the breakdown, the positive result is due to a more robust corporate tax collection: +30.4% YoY. Considering sectors, federal tax collection from the wholesale sector rose +35.7% YoY (fiscal transfers and inflation effect) and tax collection from the extraction of metallic minerals rose +172.5% YoY, directly affected by the commodity boom, all in YTD real terms. In the coming months, we expect positive results, yet with some softening of tax revenue growth. For 2021, we recently revised our forecast to ~12.0% YoY real growth.

According to the National Treasury data published on June 30, the central government posted a primary deficit of BRL20.9 billion in May, better than our forecast and the market’s median estimate, both at -BRL22.4 billion. In YTD data, it was the best primary result since 2014. During the period, total revenue rose 24.7% YoY, on the heels of the positive result of federal tax collection and extraordinary revenue. The total expenditure dropped 17.3% YoY (-31.4% YoY in May), a key factor was the lower level of discretionary spending (-30.7% YoY in the year)—currently at the all-time low in 12-month nominal terms (BRL102 billion). In 12-month reading, the deficit reached BRL535 billion (6.3% of GDP). In turn, according to Brazilian Central Bank (BCB) data published on June 30, the public sector posted a primary deficit of BRL15.5 billion in May. In YTD terms, it showed the best real numbers since 2013. Surplus of regional governments continues to surprise positively, reaching an all-time high in YTD real terms. Debt indicators continue to show a decline. Gross debt-to-GDP reached 84.5% in May, a drop of 1.1 pp from the April. See details in the link[3]. Additionally, the National Treasury published (on June 28) the Monthly Debt Report for May. Debt issuances reached a monthly record of BRL156.8 billion, the ninth consecutive month over BRL150 billion (the average in 2019 was BRL63 billion/month). Non-residents posted a positive flow in May (+BRL14.5 billion, YTD: +BRL47.3 billion), with total participation reaching 9.9% as debt holders. The public debt liquidity reserve rose BRL67 billion in May (totals BRL1,036 billion), the current level is sufficient for 9.6 months of maturities.

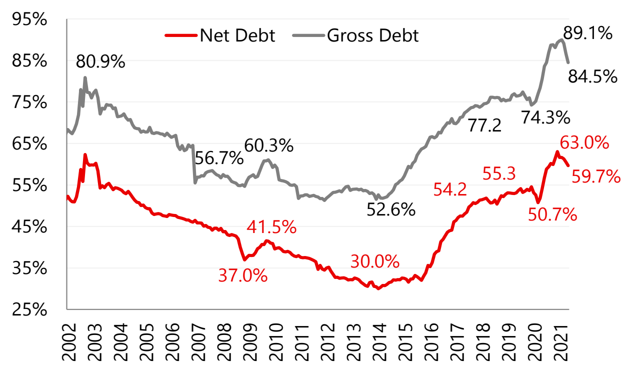
This week we published a report with the Equity Research team about the tax reform. See details in the link[4].

Figure 4.A. – Regional Govt. – Primary Result



Sources: Brazilian Central Bank, Santander.

Figure 4.B. – Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

[3] **Santander Brazil Fiscal Policy - *“Another Set of Results Boosted by Price Shock”* –** June 30, 2021 - Available on: http://bit.ly/Std-fiscal-063021
[4] **Santander Brazil Macro - *“2nd Phase of Tax Reform: Main Aspects and Impact on Companies”* –** July 01, 2021 - Available on: http://bit.ly/Std-taxreform-070221

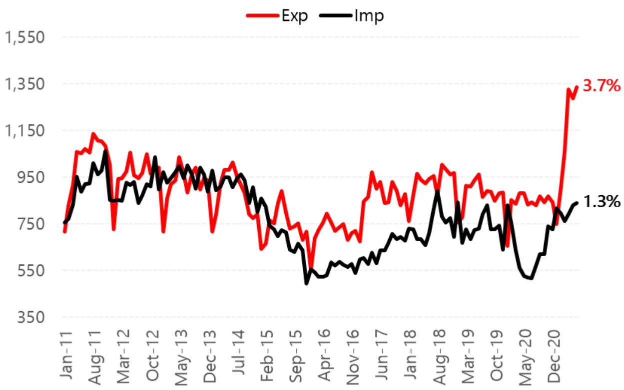
TRADE BALANCE

Although lower than projected, the US$10.4 billion trade surplus seen in June was the largest monthly trade surplus of the Brazilian history and add to evidence the country has a solid external position. However, this performance has not translated into larger FX inflows in the country, as exporters continued to hoard their hard-currency proceeds abroad.

While imports have come relatively in line with our estimates (US$17.7 billion vs. US$18.0 billion, respectively), exports have shown an odd deceleration in the last three days of June 2021, which may prove to be a temporary fluctuation. However, it may also be linked to the deceleration observed in the exports of soybeans, as they reached 46% of the crop expected for 2021. Usually, soybean producers sell approximately 65% of their crops abroad. Thus, the bulk of the contribution of soybeans to the trade balance might have fallen behind. However, it does not mean that export proceeds in general may collapse as other important items have shown great resilience. See details in the link[5].

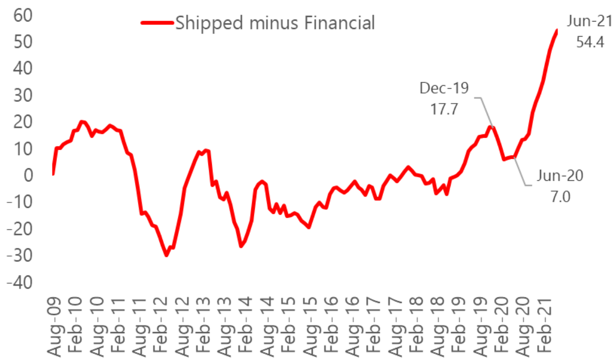
Despite our constructive view of trade balance dynamics, one item continued to attract our attention, which is the gap between the balance of shipped goods and their net financial transactions. Taking into account figures until June 25—the latest available data for the Brazilian spot FX flows—we can see that the rising trend that began in June 2020 has been extended, with this gap having reached US$54.4 billion compared with US$7.0 billion a year ago. We believe that part of this hoarded money is likely to be repatriated on the heels of the (expected) faster normalization of monetary policy in Brazil, but hitherto the interest rate hikes have been enough to lure exporters to do so. In our view, this is additional evidence that economic agents (even domestic ones) continue to be skeptical about the Brazilian economic outlook for the medium term.

Figure 5.A. – Trade Balance Composition (US$ million/working day, sa)



Sources: SECINT, Santander.

Figure 5.B. – Gap between shipped goods and financial settlements (US$ billion, 12M-to-date)



Sources: Brazilian Central Bank, SECINT, Santander.

[5] **Santander Brazil – External Sector:** ***"Short of Our Forecast yet Still the Peak"*** **–** July 1, 2021- Available on: http://bit.ly/Std-extsec-010721

CREDIT

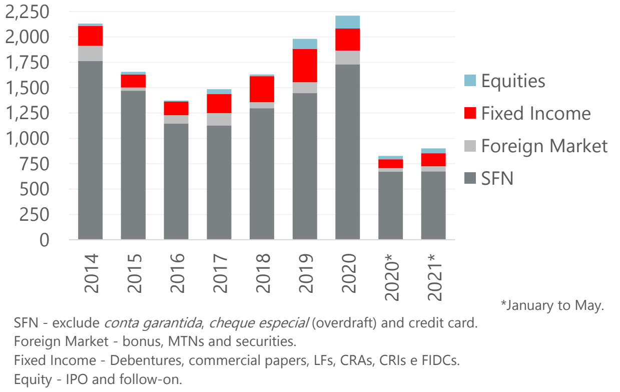
Total outstanding loans in the National Financial System (SFN, in the Portuguese acronym) posted inflation-adjusted growth of 7.5% YoY in May (to BRL4.2 trillion), up 7.8% YoY for households and 7.1% YoY for non-financial corporations. Total new loans adjusted for inflation and seasonality (using BCB methodology) decreased 2.8% in May, after a significant rise in April (+4.5% MoM-sa). See details in the link[6].

For households, the non-earmarked segment posted a decline of 2.7% MoM-sa, also an adjustment after a strong figure in April. In the earmarked segment, real estate financing remains high (+100% YoY), reflecting favorable financial conditions. For companies, there was a decline of 4.7% MoM-sa in May in the non-earmarked segment. In March, companies relied heavily on short-term credit for support amid activity restrictions imposed by local governments, so an adjustment for firms was also expected. In the earmarked segment, there was an increase of 6.8% MoM-sa, and we expect a new round of BRL5 billion in *Pronampe* (now a permanent program) to support firms in the coming months.

Considering total corporate financing[7] so far this year, through May vs. the year-ago period, issuances in the capital markets are 48% higher, while SFN concessions are now up 1%. As a result, total corporate financing is up 9% compared to the year-ago period.

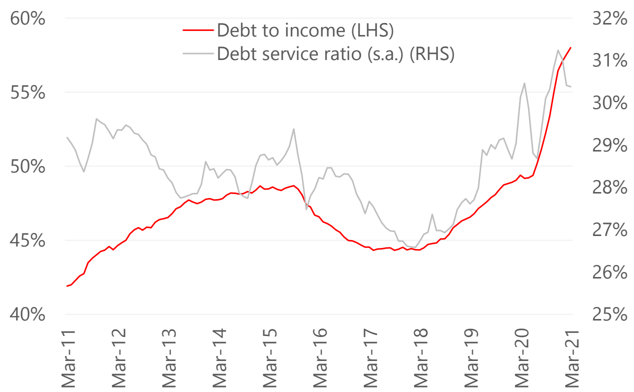
Still regarding non-earmarked loans, the seasonally adjusted default rate (% of 90-day past-due loans) came in at 4.2% and 1.7%, respectively, for households and corporations. Importantly, debt-to-income continues to rise, which we see as a risk for NPLs going forward.

Figure 6.A. – Total Corporate Financing (BRL billion, Inflation Adjusted)



Sources: Brazilian Central Bank, Anbima, Santander.

Figure 6.B. – Consumer Indebtedness (% of Expanded Aggregate Wages)



Sources: Brazilian Central Bank, Santander.

[6] **Santander Brazil Credit - *"Credit Still Supportive in May"* –** June 28, 2021- Available on: https://bit.ly/Std-credit-280621
[7] This calculation includes new loans in the SFN, debt and equity issues in the capital markets.

ECONOMIC ACTIVITY

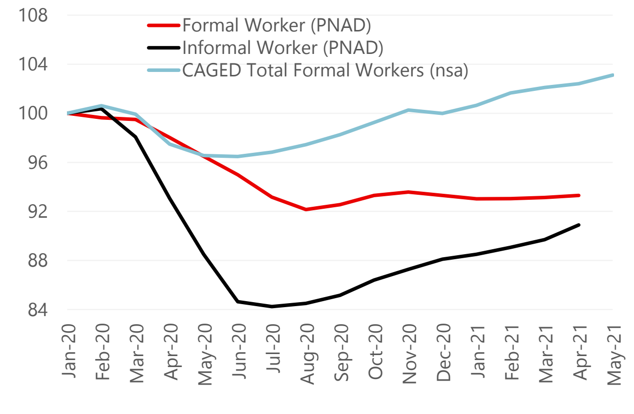
Latest batch of labor market data showed improvements. According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 14.7% in the three months to April (consensus: 14.7%; Santander estimate: 14.8%). After our seasonal adjustment, the jobless rate stood at 14.5%, a slight increase compared to the March level (14.4%). This near stability stemmed from increases of 0.7% MoM-sa in both the employed population and the labor force and indicated a resumption of the recovery in informal labor market. According to the May 2021 CAGED survey, net formal job creation stood at +280.7k (consensus: +152k; Santander estimate: +71k). We estimate that the seasonally adjusted figure increased to +274.3k in May, from +38.4k in April. This acceleration is probably due to the lifting of some social-distancing measures implemented in March, as well as a new round of the government's BEm program. The greatest contribution for the result came from the services sector. In our view, the job market remains fragile and with considerable slacks, especially considering informal workers, which the CAGED survey does not capture. However, the current batch of labor market data indicates an improvement for some sectors that are more dependent on social interactions, as shown by the growth of informal employment in PNAD data and the services sector job creation in CAGED. See details in the link[8].

Aggregated business confidence rises in June. According to FGV's confidence survey, the aggregated business confidence index was up by 4.6% in June, virtually reaching the 100-points neutral mark and marking the highest reading since 2013. In quarterly terms, June's figure implies a 4.9% QoQ-sa, fully offsetting the 3.4% drop seen in 1Q21. Among the sectors, the consumer index climbed 6.2%, likely reflecting the new round of emergency aid, but ending 2Q21 with a gain of 3.4% (-8.5% in 1Q21). Regarding industry, the index grew 3.3% for the month (-2.5% QoQ-sa). In the survey details, inventories surplus was up, reaching 1.5 points (0.1 in the previous month) and surpassing the zero-mark for the third month in a row. This is still a historically low level, but it may reflect that the inventory replenishment is in progress, after reaching the all-time low in December-2020 (-8.1 points).

Industrial production climbed in May. The headline index expanded by 1.4% MoM-sa, stemming both from manufacturing (up by 1.2%) and mining (up by 2.0%). This result broke a string of three declines but not enough to avoid an accumulated contraction of 3.4% since January-21. Moreover, May's figure implies a negative carryover for 2Q21 (-2.5%). We expect industry to be a short-term drag for activity, amid cost increases and widespread shortage of inputs.

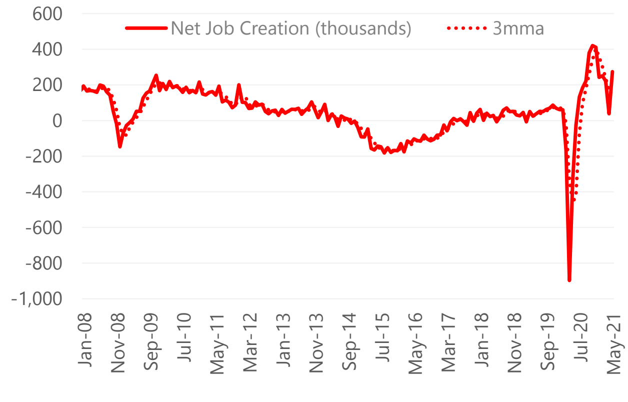
For the week, IBGE will release on Wednesday (July 7) broad retail sales data for May. We are looking for a monthly gain of 5.5% MoM-sa. We expect this figure to reflect more an expansion in income-led segments than a gain in credit-led segments, given the weak figure seen for credit to households in May.

Figure 7.A. – Employed Population (sa, Jan-20=100)



Sources: IBGE, Ministry of Economy, Santander.

Figure 7.B. – Net Formal Job Creation (sa)



Sources: Ministry of Economy, Santander.

[8] **Santander Brazil Labor Market - *"Strong CAGED Result in May, as Informal Sector Recovers in April PNAD"* –** July 1, 2021- Available on: http://bit.ly/Std-lbrmkt-070121

INFLATION

We expect June's IPCA (due on Thursday, July 8) to rise 0.55% MoM, meaning an acceleration in annual terms to +8.4% YoY (from +8.1% YoY in May) — the highest level since September 2016.

In monthly terms, the main contribution for the deceleration compared to May will come from regulated prices, mostly driven by a (short-lived) relief in electricity prices. On free-market prices, the main relief should come in industrial goods inflation, that could decelerate to 0.74% MoM (from 1.28% in May) — although it is still a high seasonal print, sufficient to keep the three-month annualized and seasonally adjusted moving average (3mma-saar) around 11-12%. Services should decelerate just a bit in monthly terms, to 0.25% MoM, which is compatible with an acceleration in 3mma-saar terms to the still low level 2.6%. However, core services should rise 0.49% MoM a high seasonal print that would maintain the measure hovering around 4.2% in 3mma-saar terms — a not so low level. Finally, food-at-home should rise just 0.09%, basically in line with the seasonal pattern.

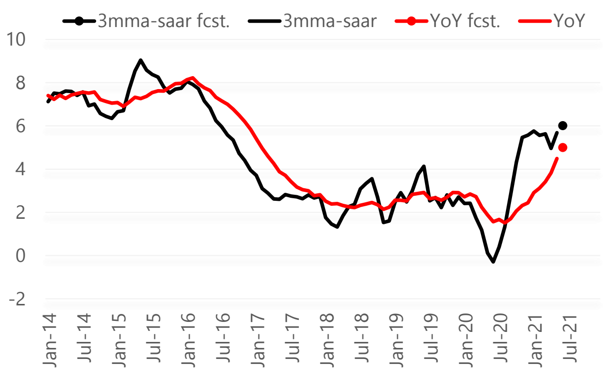
In terms of underlying inflation measures, the EX3 core should rise around +0.46% MoM, as per our projection, meaning an acceleration in the trend denoted by the seasonally adjusted quarterly annualized moving average (3mma-saar) from the already high level of 5.7% in the last reading to 6.0% in June. This is a persistently high level—it would be the ninth month of the EX3 core running above +5.8% in 3mma-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022)—suggesting a spreading of primary shocks to general prices.

Figure 8.A. – June's IPCA-15 Forecast (%)

	MoM		YoY	
	Jun-21	Contrib.	May-21	Jun-21
IPCA	0.55	0.55	8.1	8.4
Administered	1.07	0.28	13.1	13.3
Free	0.37	0.27	6.3	6.7
Food-at-home	0.09	0.01	15.4	15.0
Industrial goods	0.74	0.17	8.3	8.7
Services	0.25	0.09	1.7	2.3
EX3 Core	0.46	0.46	4.5	5.0

Sources: IBGE, Santander.

Figure 8.B. – Core Inflation (IPCA EX3, %)



Sources: IBGE, Santander.

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