BRAZIL MACRO

June 3, 2022

MACRO COMPASS

STRONG EMPLOYMENT, SOLID GDP, SOARING PRICES

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- Despite the better global risk sentiment triggered by the reopening of some key Chinese cities previously under lockdown, the USD/BRL pair closed the rolling week ended June 2 at 4.80 (a 0.6% loss), putting the BRL among the worst performers in a basket with the 31 most liquid currencies in the world. In our view, this underperformance possibly reflects some profit-taking after two consecutive weeks of strong gains. Furthermore, local yields (nominal rates) sold off all across the curve, with the back end likely mirroring the sell-off in U.S. Treasuries and possibly influenced by a perception of worsening fiscal risks following congressional debates about curbing energy prices via tax breaks and subsidies.
- Commodity prices moved sideways for the week, as the continued rise in energy commodities was offset by a sell-off in agricultural products. The Bloomberg Commodity Index in BRL terms increased 1.0% in the period. In USD terms, the index gained 0.4%, with the Agriculture Subindex down 2.2%, the Energy Subindex climbing 1.4%, and the Industrial Metals Subindex gaining 2.4%.
- On May 31, the Brazil Central Bank (BCB) unveiled the consolidated public sector's fiscal balance for April. The numbers show continued improvement in the fiscal performance, with a hefty primary surplus (BRL38.9 billion for the month, reaching 1.5% of GDP in 12 months), mainly owing to the positive revenue effects from price shocks (i.e., gains in terms of trade on higher commodity prices, as well as higher inflation). The nominal result widened for the month (reaching 3.9% of GDP in 12 months), mainly led by increased interest payments but also affected by a loss in FX swaps in April (due to a weaker BRL).
- Based on the IBGE's National Household Survey (PNAD), we estimate that the seasonally adjusted monthly unemployment rate stood at 9.4% in April (March: 10.3%), returning to single-digit territory for the first time since December 2015. The result shows that the labor market has continued to expand at a strong pace. An eventual overheating in wages could pose additional challenges for the disinflation process ahead as envisioned by the central bank.
- The GDP report points to a strong first quarter, mainly based on services consumption (due to the reopening) and net exports. Real GDP climbed 1.0% QoQ-sa in 1Q22, close to our estimate (+0.9% QoQ-sa) and below market consensus (+1.2% QoQ-sa), reaching levels 1.6% above the pre-pandemic mark (4Q19). The first quarter result stems mainly from the continued recovery in services, with tepid figures for industry (+0.1% QoQ-sa) and farm output (-0.9% QoQ-sa). The 1Q22 result implies a carryover of ~1.5% for the year, imparting a slight upside risk to our forecast of full year growth of 1.2%. Industrial output stayed virtually flat in April (0.1% MoM-sa). In the coming week, broad retail sales data will be released on Friday (June 10), and we expect a monthly gain of 0.3% MoM-sa.
- We expect May's IPCA (due on Thursday, June 9) to rise +0.62% MoM. That is a fairly high reading in seasonal terms, as the average headline for the month (since 2004) is 0.42% MoM. If our number is on the mark, we calculate that the sequential trend for the IPCA EX3 (core industrialized goods and core services) could accelerate further to 14.4% 3MMA-saar. In YoY terms we expect the headline to remain close to 11.9%, a slight decline from last month, meaning that the peak for this inflation cycle is likely behind us.

Most of the information in this report is up to the end of Thursday, June 02, 2022.

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Figure 1. Brazil Macro Agenda for the Week of Jun 06 to Jun 10, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Vehicle Production (thousands)	Anfavea	May/22	Tue, 07-Jun	-	185.6
IGP-DI Inflation (% MoM)	FGV	May/22	Wed, 08-Jun	0.78	0.41
IGP-DI Inflation (% YoY)	FGV	May/22	Wed, 08-Jun	10.7	13.5
IPCA Inflation (% MoM)	**IBGE**	**May/22**	**Thu, 09-Jun**	**0.62**	**1.06**
IPCA Inflation (% YoY)	**IBGE**	**May/22**	**Thu, 09-Jun**	**11.9**	**12.1**
Core Retail Sales (% MoM)	IBGE	Apr/22	Fri, 10-Jun	0.0	1.0
Core Retail Sales (% YoY)	IBGE	Apr/22	Fri, 10-Jun	2.0	4.0
Broad Retail Sales (% MoM)	**IBGE**	**Apr/22**	**Fri, 10-Jun**	**0.3**	**0.7**
Broad Retail Sales (% YoY)	**IBGE**	**Apr/22**	**Fri, 10-Jun**	**1.6**	**4.5**
IBC-Br Activity Index (% MoM)	BCB	Mar/22	n.a.*	-	0.34
IBC-Br Activity Index (% YoY)	BCB	Mar/22	n.a.*	-	0.66
Bank Lending Report	BCB	Mar/22	n.a.*	-	471.1
Current Account Balance (USD billion)	BCB	Mar/22	n.a.*	-	-2.4
Foreign Direct Investment (USD billion)	BCB	Mar/22	n.a.*	-	11.8
Federal Debt Report (BRL trillion)	STN	Apr/22	n.a.*	-	5.6
Central Gov. Prim. Balance (BRL billion)	STN	Apr/22	n.a.*	29	-6.3
Formal Job Creation (thousands)	CAGED	Apr/22	n.a.*	276	136
Formal Job Creation (thousands, sa)	CAGED	Apr/22	n.a.*	183	232
Trade Balance (USD billion)	SECINT	May/22	n.a.*	3.8	8.2

* Owing to a strike of federal workers, these data releases have been postponed with no specific publication date scheduled for now.

Sources: Bloomberg, IBGE, Santander.

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

[1] **Santander Brazil – Scenario Review: *"A Bittersweet Scenario"* –** June 02, 2022- Available on: https://bit.ly/Std-scenreview-jun22

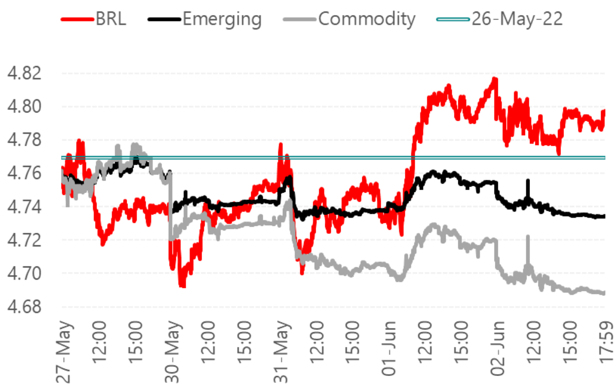
LOCAL MARKETS—FX

The USD/BRL pair closed the rolling week ended June 2 at 4.80 (a 0.6% loss), putting the BRL among the worst performers in a basket with the 31 most liquid currencies in the world, following some selling pressure late in the week. In our view, the BRL failed to follow the risk-on sentiment abroad triggered by the reopening of key Chinese cities that had been under lockdown. Since the DXY index closed the period relatively stable from a week ago, it is possible that the BRL's underperformance in recent days reflects some profit-taking after two consecutive weeks of strong gains. In sum, our assessment remains that there is limited room for a substantial and continuing strengthening of the BRL given persistent uncertainties on both the local and international fronts. We project USD/BRL closing the year at 5.15.

LOCAL MARKETS—Rates

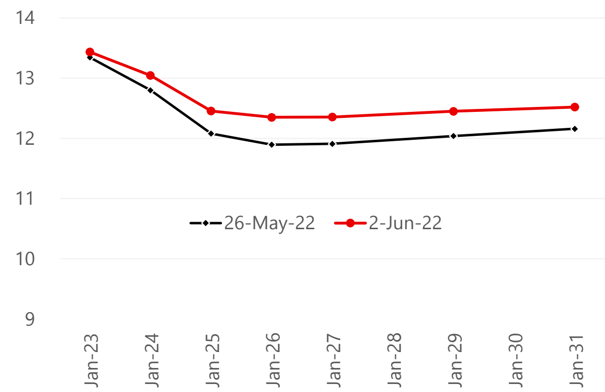
Local yields (nominal rates) sold off all across the curve. Since last Thursday (May 26), the front end of the curve (Jan-24 DI future) rose 24 bps, to 13.05%, while the back end of the curve (Jan-27 DI future) rose 45 bps to 12.36%. The curve's steepness in this segment increased 20 bps, reducing the inversion to -69 bps. In our view, the front end sold off despite ongoing discussions in Congress about tax cuts aimed at curbing energy (and other "essential") prices and preliminary discussions about energy subsidies for consumers outside the federal constitutional spending cap. At the long end, the movement may have been influenced by the sell-off in US Treasury yields, as well as possible concerns about the fiscal outlook given the substantial loss of revenue and increase in expenditures that could result from the initiatives to curb energy costs. We continue to believe that the BCB is close to the end of the hiking cycle, and with IPCA inflation likely off its peak in annual terms, we continue to see room for a steepening pattern in the local yield curve in coming months.

Figure 2. USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, June 2, 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 on Thursday, June 2, 2022.

COMMODITIES

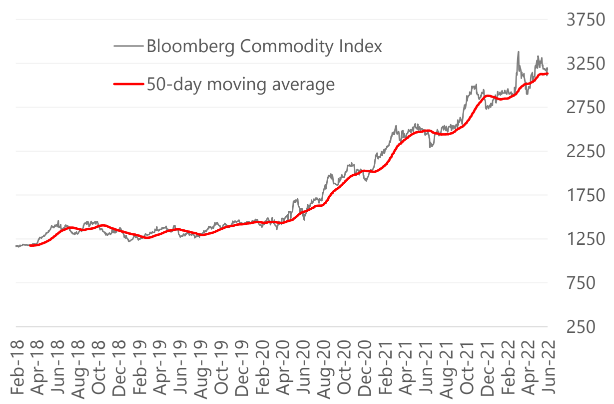
Commodity prices moved sideways for the week, as the continued rise in the energy complex was offset by a sell-off in agricultural products. The Bloomberg Commodity Index in BRL terms increased 1.0% in the period. In USD terms, the index gained 0.4%, with the Agriculture Subindex down 2.2%, the Energy Subindex climbing 1.4%, and the Industrial Metals Subindex gaining 2.4%.

EU agrees on a deal to partially ban Russian oil imports. The embargo is part of the EU's sixth package of sanctions that has been approved. The bloc aims to ban 90% of all Russian oil imports by the end of 2022, which will initially affect mostly seaborne imports (around 60% of the total), with a temporary exception for crude oil deliveries by pipeline for Hungary, Slovakia, and the Czech Republic — countries that rely heavily on Russian oil. As for Russian gas imports, most members still reject the idea of a ban, as the bloc is highly dependent on Russia for natural gas (the EU imports 40% of its gas from Russia).

OPEC+ agrees to increase oil production quotas for the coming months. The cartel has announced it will increase output by +648k barrels per day (bpd) in July and August, above the market's expectations of +430k bpd, following several months of pressure from consumers to help alleviate high energy prices. The quota increase will be divided proportionally among members, meaning little impact on countries that have been struggling recently to meet their quotas (e.g., Nigeria, Angola). Effectively, the increase in production will likely come from just a few members, such as Saudi Arabia and United Arab Emirates. As for Russia, according to IEA estimates, the country's production is falling short (of its quota) by 1.3 million bpd.

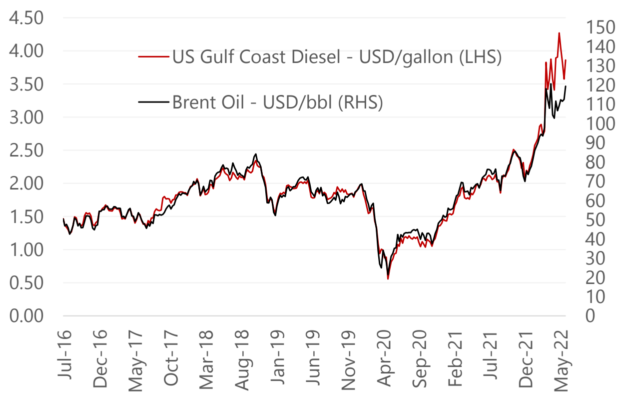
Grain prices continued to fall on better prospects for Ukrainian supply. Corn and wheat prices fell for the week (down 4% and 7%, respectively) amid optimism that Ukraine may soon be able to resume exports from the Black Sea. According to Ukraine's Grain Association, exports from the country could be as high as 30 million tons in 2022-23 provided it is successful in expanding its logistics capacities. Meanwhile, forecasts for better U.S. weather ahead for much of the Farm Belt and more rapid than expected progress in spring wheat planting (which has been delayed due to rains) also contributed to the price move. The USDA WASDE report is due to be released next week (June 10).

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. Price Gap: Crude Oil and Refined Products



Sources: Bloomberg, Santander.

FISCAL POLICY AND LEGISLATION

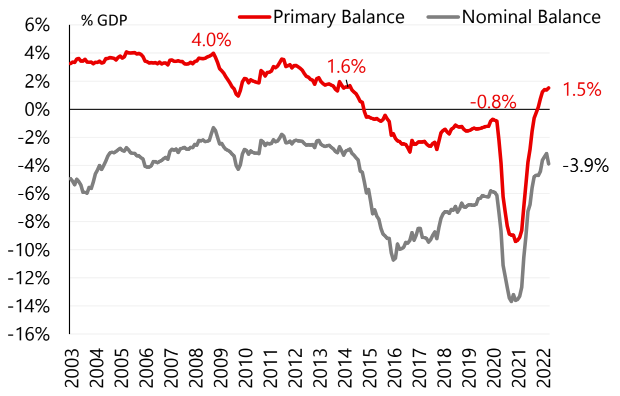
On May 31, the Brazil Central Bank (BCB) unveiled the consolidated public sector's fiscal balance for April. The numbers show continued improvement in the fiscal performance with a hefty primary surplus (BRL38.9 billion for April, reaching 1.5% of GDP in 12 months), mainly owing to the positive revenue effects from price shocks (i.e., gains in terms of trade owing to higher commodity prices, as well as higher inflation). The nominal result widened for the month (reaching 3.9% of GDP in 12 months), mainly led by increased interest payments but also affected by a loss in FX swaps in April (owing to a weaker BRL).

The public sector posted a primary surplus of BRL38.9 billion, close to our forecast (BRL40.0 billion) and better than the market's median estimate (BRL30.1 billion). This was the best result for the month in the historical series since this data has been collected. Regional governments' results remained robust, with a surplus of BRL10.3 billion, close to our call (BRL11 billion). The release by the National Treasury of central government results for April was postponed due to the strike by federal service employees.

No new date for the release has been scheduled as yet. We forecast a seasonal primary surplus of BRL29 billion, boosted by oil revenue. Using BCB methodology, the central government posted a seasonal primary surplus of BRL29.6 billion in the month. For 2022, our forecast points to a central government deficit of BRL35 billion (0.4% of GDP), based on an increase in expenditures and some softening in revenue growth in 2H22, yet the current activity and inflation numbers are adding a positive bias to the fiscal numbers, especially the most recent labor data that suggests the government could see additional revenue linked to employment. We forecast a new public sector primary surplus in 2022, totaling BRL35 billion (0.4% of GDP), vs. balanced (0.0% of GDP) estimated in April, considering a subnational primary surplus of BRL70 billion (0.8% of GDP). In April, interest payments soared and reached BRL79.9 billion, compared to -BRL5.7 billion in April 2021. The result of FX swap operations contributed less to mitigate the result in the month (loss of BRL15.4 billion, compared to a gain of BRL30.4 billion in April 2021, the first month of the year with a result below that of 2021).

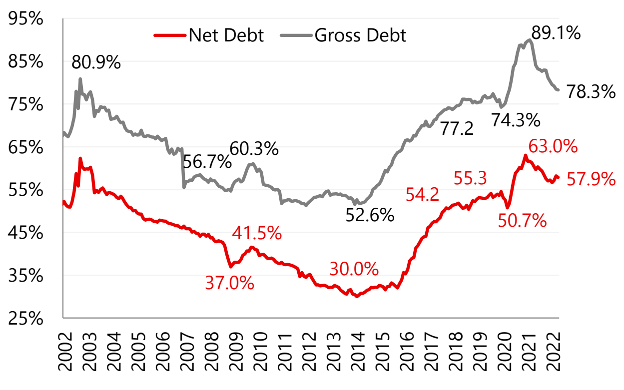
Debt results declined slightly. Gross debt dropped to 78.3% of GDP in April, compared to 78.5% in March. The result was affected by the positive primary surplus in the month and increased nominal GDP. Meanwhile, net debt reached 57.9% of GDP, compared to 58.2% of GDP in March. We lowered our 2022 gross debt forecast to 79.0% (from 80.6%), below the level at YE2021 (80.3%). We estimate that gross debt will peak at ~95% of GDP in 2028 (previously 93%), as we see the increase in debt cost resulting from a higher Selic rate counterbalanced by higher commodities prices. Our scenario contemplates a deterioration in the nominal (headline) budget results due to higher debt costs (owing to the Selic rate), implying a still steep upward trajectory for government debt in the medium term. Yet, in the short term, this nominal result will be partially offset by the BCB's profit from FX swaps in 2022 (currently close to BRL100 billion).

Figure 6. Consolidated Public Sector (12-month)



Sources: Brazilian Central Bank, Santander.

Figure 7. Public Sector Debt (12-month)



Sources: Brazilian Central Bank, Santander.

ECONOMIC ACTIVITY

The GDP report points to a strong first quarter, mainly based on services consumption (due to the reopening). Real GDP climbed 1.0% QoQ-sa in 1Q22, below market consensus (+1.2% QoQ-sa) and close to our estimate (+0.9% QoQ-sa). On the supply side, the results were a mixed bag. On the one hand, services continued to rebound and climbed 1.0% QoQ-sa, owing mainly to consolidation of the economy's reopening process. On the other hand, industry disappointed, posting a tepid 0.1% QoQ-sa gain, following a gloomy streak of three quarterly contractions. Moreover, farm output shrank 0.9% QoQ-sa, on the heels of weak soybean production. On the demand side, domestic demand was weaker than we expected, but the external sector contribution offset this somewhat. Household consumption climbed 0.7% QoQ-sa, while government spending posted a 0.1% QoQ-sa print. Investments disappointed, shrinking 3.5% QoQ-sa. Regarding the external sector, exports rose 5.0% QoQ-sa, while imports declined 4.6% QoQ-sa. The 1Q22 result implies a carryover of ~1.5% for the year, imparting a slight upside risk to our forecast of full year growth of 1.2%. See details in the link[2].

Stronger than expected labor market results in April. According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 10.5% in the three months to April, well below our estimate (11.0%) and the market consensus (10.9%). We calculate that the seasonally adjusted jobless rate decreased to 10.1% (March: 10.7%), as labor market participation increased to 62.6% (March: 62.0%). PNAD data is based on a three-month moving average, and we estimate that the monthly unemployment rate, according to our own seasonal adjustment, stood at 9.4% in April, compared to 10.3% in March. This result follows gains of +1.4% and +0.4% MoM-sa in the employed population and labor force, respectively. Our monthly estimate of the unemployment rate has returned to single-digit territory for the first time since December 2015. The usual real wage bill had a +1.2% MoM sa variation in April and stands 5.3% below the pre-crisis mark. All in all, the April PNAD result shows that the labor market has continued to expand rapidly. The release of the April CAGED formal job survey, originally scheduled for May 26, has been postponed twice by the Ministry of Labor and has no publishing date yet. See details in the link[3].

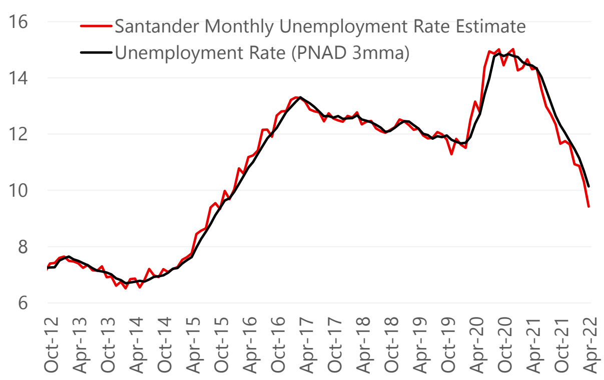
According to IBGE, industrial output stayed virtually flat in April (0.1% MoM-sa). This result, which was between our estimate (-0.2% MoM-sa) and market consensus (+0.2% MoM-sa), was owing to a tepid expansion in mining (+0.4% MoM-sa) along with virtual stability in manufacturing (+0.1% MoM-sa). In the coming week, broad retail sales data for April will be released on Friday (June 10), and we expect monthly growth of 0.3% MoM-sa.

Figure 8. GDP Growth Breakdown

		4Q21		1Q22	
	Weights	% YoY	% QoQ	% YoY	% QoQ
GDP	100%	1.6	0.7	1.7	1.0
Supply					
Farm Output	7%	-0.8	6.0	-8.0	-0.9
Industry	19%	-1.3	-1.2	-1.5	0.1
Services	59%	3.3	0.6	3.7	1.0
Demand					
Consumption	61%	2.1	0.7	2.2	0.7
Government	19%	2.8	0.9	3.3	0.1
Investments	19%	3.4	0.8	-7.2	-3.5
Exports	20%	3.3	-0.2	8.1	5.0
Imports	-19%	3.7	0.1	-11.0	-4.6

Sources: IBGE, Santander.

Figure 9. Monthly Unemployment Rate (sa)



Sources: IBGE, Santander.

[2] **Santander Brazil Economic Activity: "*All in All, Strong 1Q GDP Data (Again)*"** – June 02, 2022 – Available on: https://bit.ly/Std-GDP-1Q22
[3] **Santander Brazil Labor Market: "*Monthly Unemployment Rate Estimate Back to Single-Digit Territory*"** – May 31, 2022 – Available on: https://bit.ly/Std-labor-053122

INFLATION

We expect May's IPCA (due on Thursday, June 9) to rise +0.62% MoM. That is a fairly high reading in seasonal terms, as the average headline for the month (since 2004) is 0.42% MoM. If our number is on the mark, we calculate that the sequential trend for the IPCA EX3 core should accelerate further to 14.4% 3MMA-saar from 13.4%. In YoY terms we expect the headline to remain close to 11.9%, a slight decline from last month, meaning that the peak for this inflation cycle is likely behind us.

Compared to April's IPCA (+1.06% MoM), we expect the headline to decelerate sharply in monthly terms, driven by regulated prices (-0.37% MoM vs. +0.55% last month). We project that gasoline (+1.10% MoM vs. +2.48% in April) will contribute a bit to the relief as the last price hike fades away. Electricity (-7.73% MoM vs. -6.27% in April) will also contribute, as we expect the reduction in the tariff flag (to "Green" from "Hydrological Risk") to continue to show effects in this reading.

We expect market-set price inflation to decrease in monthly terms from April. While we expect food-at-home to decelerate (+0.68% MoM vs. +2.59% last month), we see services as a source of concern, as inflation in the sector should continue to accelerate (+0.94% MoM vs. +0.66% last month). Meanwhile, we expect industrial goods inflation to remain high (+1.25% MoM).

As for the broad underlying inflation measures, we see the IPCA EX3 core (which includes core services and industrials) rising 1.15% MoM. This is a high reading, which should bring the sequential trend to a hefty 14.4% 3MMA-saar (previously 13.4%). Thus, we believe May will be the 20th consecutive month in which the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.50% for 2022 and 3.25% for 2023).

We still project a slow deceleration of annual inflation in the next readings, but the level and composition of recent IPCA readings have been worrisome, implying additional risks that further tilt the balance of risks upward for both 2022 and 2023.

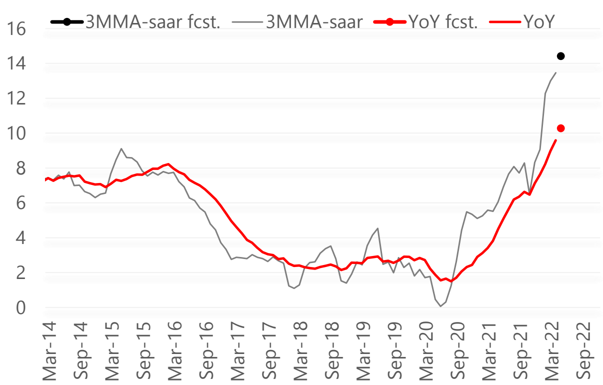
On Monday (May 30), May's IGP-M registered a 0.52% MoM change (10.7% YoY). See details in the link[4].

Figure 10. May's IPCA Details (%)

	MoM		YoY	
	May-22	Contrib.	Apr-22	May-22
IPCA	0.62	0.62	12.1	11.9
Administered	-0.37	-0.10	15.0	12.3
Free	0.99	0.72	11.1	11.8
Food-at-home	0.68	0.10	16.1	16.6
Industrial goods	1.25	0.29	14.2	14.2
Services	0.94	0.32	6.9	8.1
EX3 Core	1.15	0.41	9.6	10.3

Sources: IBGE, Santander.

Figure 11. Core Inflation IPCA EX3 (%)



Sources: IBGE, Santander.

[4] **Santander Brazil Inflation: "*May's IGP-M: Oil Related Items Rising Once Again*"** – May 30, 2022 – Available on: https://bit.ly/Std-IGPM-may22

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