Santander Macroeconomic Research

BRAZIL MACRO

February 04, 2022

MACRO COMPASS

BRAZILIAN ASSETS KEEP RALLYING

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- The BRL continued to strengthen in the rolling week ended February 3 on the heels of the global weakening of the USD, continued strength in commodity prices, and some idiosyncratic factors (such as market views about Brazilian economic policy from 2023 onward). The USD/BRL closed the period at 5.29 (up 2.3%) and stood among the top-ten performers in the basket of the 31 most liquid currencies in the world. Mirroring the same optimism about future economic policy and a slower pace of hikes signaled in the Copom communiqué, the local yield curve rallied in recent days.
- Once again, the Copom hiked the Selic rate by 150 bps, to 10.75%, in line with market expectations. The takeaway was the change in short-term guidance, as the BCB signaled "a reduction in the pace of adjustment" for the March 15-16 meeting. However soft the tone was perceived in this communiqué (the minutes to be released next Tuesday could further influence that perception), we see the authority striving to reclaim the driver's seat regarding inflation expectations. Our outlook is now for a 100-bp Selic hike in March and a 50-bp move in May, but we maintain our terminal Selic rate estimate of 12.25%.
- According to BCB data published on January 31, the public sector posted a primary surplus of BRL64.7 billion (0.75% of GDP) in 2021, the first positive reading after seven years of red ink. The general government's gross debt fell to 80.3% of GDP in 2021 from 88.6% in 2020. But the debt ratio still tops the 74.4% reading from before the pandemic (i.e., end of 2019). The National Congress has returned from recess, but the time looks short to approve major legislation before the October general elections.
- The BCB released bank lending data for December, showing a slower but still strong growth in total loan balances 5.8% YoY (-4.8 p.p. from the growth registered in 2020). In the non-earmarked segment, new lending fell 5.3% MoM-sa for households and 7.9% MoM-sa for firms. Importantly, with the new data methodology, in October the household debt-service ratio stood at the highest level in the series: 51.2%. These figures imply upside for NPLs looking ahead.
- The January trade balance repeated the performance observed a year ago and registered a USD0.2 billion deficit, with the weak result reflecting temporary weather-related factors. Looking ahead, we see the slowdown in domestic demand, the weak BRL and the favorable commodities prices leading to a record-high trade surplus (USD76.4 billion) in 2022.
- Based on the December CAGED survey, we calculate that net seasonally adjusted formal job creation slowed to 206k (November: 263k), mainly due to the 3.6% MoM-sa increase in layoffs. We believe that the end of the emergency program of temporary job guarantees (BEm, in Portuguese) continued to weigh on payroll growth recently. Therefore, we look for a weakening trend in CAGED net job creation in the coming months. Industrial output climbed 2.9% MoM-sa in December, topping our expectations (+1.8%) and market consensus (+1.6%). That was the first positive performance since May 2021. December's result implied stability for 4Q21 but a solid carryover to 1Q22, which we think could mean a better contribution of industrial output to overall activity in the short term, despite the headwinds.
- The last batch of economic activity data for December is scheduled to be released next week. Retail sales data is due out on Wednesday (February 9), while services output data is due out on Thursday (February 10), and we expect mixed signals in December's figures: -0.5% MoM-sa for retail sales and +1.2% MoM-sa for services output. Moreover, on Friday (February 11) the BCB will release the IBC-Br, and we expect a slight increase of +0.1% MoM-sa (updated from stability, 0% MoM-sa). Our tracking to 4Q21 GDP growth was updated to +0.3% QoQ-sa (from +0.2% QoQ-sa).
- We expect the January IPCA (due on Wednesday, February 9) to rise 0.52% MoM. In YoY terms, this means +10.36%, a slight acceleration from the +10.06% change of December's IPCA. Compared to the December IPCA (+0.73% MoM), we expect the headline to decelerate in monthly terms, driven mostly by free-market prices (+0.72% MoM vs. +0.99% last month). In terms of broad underlying inflation measures, we estimate the EX3 core will remain around the high level of 8.1% 3MMA-saar. Despite a much tighter monetary policy, we continue to see difficulties facing the disinflation process ahead, and we forecast an above-consensus 6.0% IPCA for 2022 (consensus: 5.4%).

Most of the information in this report is up to the end of Thursday, February 03, 2022.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.
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Figure 1. Brazil Macro Agenda for the Week of February 5 - February 11, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	FGV	Jan/22	Mon, 07-Feb	1.44	1.25
IGP-DI Inflation (% YoY)	FGV	Jan/22	Mon, 07-Feb	16.10	17.74
Copom minutes	**BCB**	**Feb/22**	**Tue, 08-Feb**	**--**	**--**
IPCA Inflation (% MoM)	**IBGE**	**Jan/22**	**Wed, 09-Feb**	**0.52**	**0.73**
IPCA Inflation (% YoY)	**IBGE**	**Jan/22**	**Wed, 09-Feb**	**10.36**	**10.06**
Core Retail Sales (% MoM)	IBGE	Dec/21	Wed, 09-Feb	-1.4	0.6
Core Retail Sales (% YoY)	IBGE	Dec/21	Wed, 09-Feb	-5.0	-4.2
Broad Retail Sales (% MoM)	**IBGE**	**Dec/21**	**Wed, 09-Feb**	**-0.5**	**0.5**
Broad Retail Sales (% YoY)	**IBGE**	**Dec/21**	**Wed, 09-Feb**	**-4.0**	**-2.9**
Services Volume (% MoM)	**IBGE**	**Dec/21**	**Thu, 10-Feb**	**1.2**	**2.4**
Services Volume (% YoY)	IBGE	Dec/21	Thu, 10-Feb	10.0	10.0
IBC-Br Activity Index (% MoM)	**BCB**	**Dec/21**	**Fri, 11-Feb**	**0.1**	**0.43**
IBC-Br Activity Index (% YoY)	BCB	Dec/21	Fri, 11-Feb	0.3	0.69
Vehicle Production (thousands)	Anfavea	Jan/22	04 to 07-Feb	--	210.9

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Update[1]. Also refer to our Macro Propositions for Brazil in 2022[2].

[1] **Santander Brazil – Scenario Update: *"Inflation Still a Concern"* –** January 20, 2022- Available on: https://bit.ly/Std-scenupdate-jan22

[2] **Santander Brazil – Macro Propositions 2022: *"Navigating the Uncertainties"* –** January 07, 2022- Available on: https://bit.ly/Std-Macroprop22

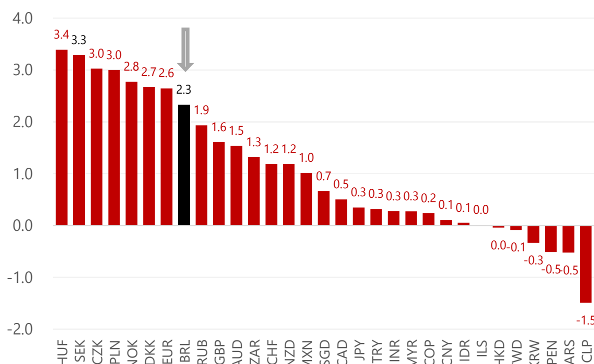
LOCAL MARKETS—FX

Despite the expectations of a faster policy normalization by the Federal Reserve, in the rolling week ended February 3, the USD weakened against most components (c.80%) of the basket of the 31 most liquid currencies in the world. The BRL took advantage of these dynamics and closed the period at 5.29 (up 2.3%), thus standing out among the top-ten performers in the aforementioned basket. In our opinion, part of the USD weakening had to do with the fact that monetary authorities around the globe (e.g., the BoE and the ECB) followed the FOMC's example and likewise adopted a hawkish tone for their policies. In addition, the continued uptrend in commodity prices and asset allocation flows into the domestic financial market helped the BRL to strengthen further. Last but not the least, constructive assumptions about local politics and future economic policy added to the set of reasons behind the BRL's favorable performance in recent days. Despite these positive short-term dynamics, we continue to see limited room for the BRL to strengthen in a sustainable fashion amid a still high level of uncertainty about economic policy and reforms in the future.

LOCAL MARKETS—Rates

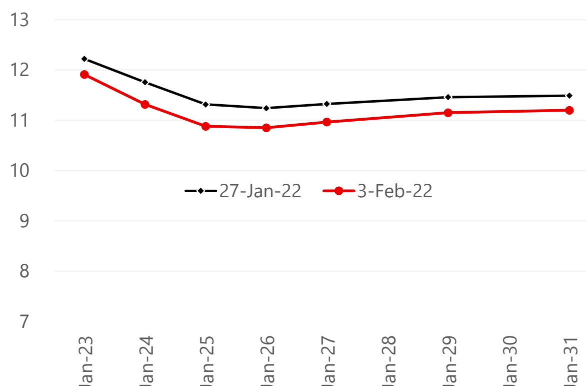
The local yield curve rallied in most segments in recent days, with the front-end rallying after the Copom statement signaled a slower pace of tightening and the back-end still reflecting positive assumptions about future economic policy, as in recent weeks. Since last Thursday (January 27), the front end of the curve (Jan-24 DI future) fell 44 bps to 11.32%, while the back end of the curve (Jan-27 DI future) decreased 36 bps to 10.97%. While the curve's steepness in this segment increased a bit, by 8 bps to -35 bps, the inversion remains in place. At the front-end, the movement was driven by the tone of the Copom's statement, interpreted by the market as softer than expected (see details in the "Monetary Policy" section) as the BCB calibrates policy toward the end of the cycle in the near future. At the back-end, just as in recent weeks, we think the rally was driven by constructive expectations about the political situation locally. Fundamentally speaking, we continue to see an environment of high uncertainties for the domestic economy, particularly regarding the fiscal consolidation process. All that said, we continue to see room for domestic yields to re-steepen, which could occur after both IPCA inflation and the Selic rate see a peak.

Figure 2. One-Week Nominal Currency Returns



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, February 3, 2022.

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



Sources: Bloomberg, Santander.
Note: As of the close Thursday, February 3, 2022.

COMMODITIES

Commodities prices saw another bullish week. The Bloomberg Commodity Aggregate Index rose 3.0% in the rolling week ended February 3: the Agriculture Subindex rose 22% and the Energy Subindex gained (a whopping) 6.7%, whereas the Industrial Metals Subindex fell 0.3%. In our view, commodity strength continues to mirror the signs of less economic impact from the Omicron variant of COVID-19 compared to previous variants. Indications that economic stimulus in China will limit the downside risks for activity in the world's second largest economy have also helped. Additionally, idiosyncratic factors continue to feed the commodity rally early in 2022.

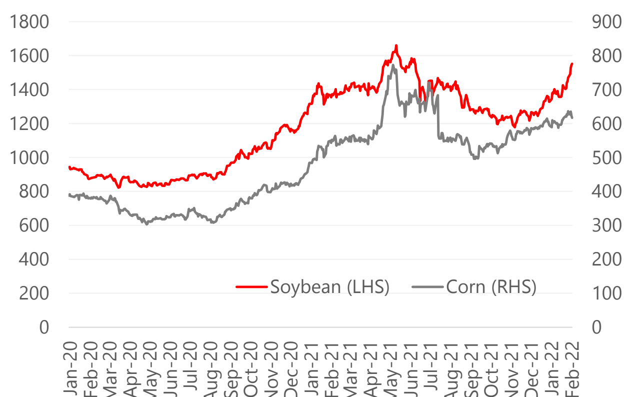
OPEC+ agrees to add more supply in March. As expected, the organization agreed to proceed with another output hike of 400,000 barrels a day in March. While the quota increase is welcome, the actual output increase is likely to fall short of being what is necessary to balance out the market, with many members already operating near full capacity. Brent crude oil fell 0.7% from last week to $89/bbl (still the highest level since October 2014). We still see the oil market in output deficit, as global inventories are low and producers (ranging from OPEC+ members to independent U.S. shale companies) struggle with underinvestment in recent years.

Soybeans extended their rally, as the outlook for the South American harvest continues to deteriorate. Soybeans climbed 6% from last week, with specialized think tanks further cutting their crop yield estimates recently. The harvest in Brazil is running at 15% *(of the crop area has been harvested)* (ahead of the five-year average of 9%, but still a low figure), so the forecasts are likely to change, in our view. If these estimates of smaller South American crops are correct, global supply of the grain would rely heavily on U.S. crops. As for demand, the week saw several flash sales of American soybeans to China for delivery during the 2021-22 marketing year and in 2022-23. We continue to see risks that the downward trajectory for grain prices will be gentler than previously thought, as global stocks will take longer to replenish from the drawdown of previous years. The USDA WASDE report is due to be released next week (February 9).

Brazilian iron ore shipments in January at the lowest level in six years. The above-average rainfall in southern Brazil halted operations in several mines in the first month of the year. Brazilian trade ministry data show iron ore exports down 13% YoY in January. Iron ore has strongly rebounded since December on expectations that consumption will pick up this year due to Chinese government stimulus to stabilize the economy.

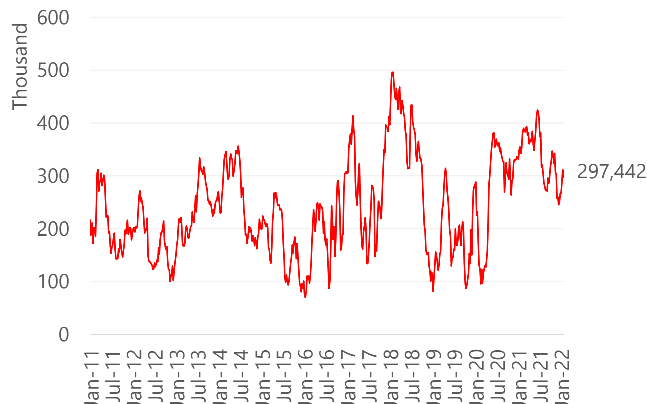
CFTC[3] reports a decrease in speculative long positions in WTI crude oil. Money managers decreased their net long WTI crude futures and options positions in the week ended January 25, the CFTC reported on Friday (January 28). The positions in futures and options decreased by 14,154 contracts to 297,442.

Figure 4. Chicago Board of Trade – Grains (USD cents)



Sources: CBOT, Santander.

Figure 5. CFTC NYMEX Crude Oil Managed Money Net Total (Number of contracts)



Sources: COT, Santander.

[3] U.S. Commodity Futures Trading Commission.

MONETARY POLICY

Once again, the Copom hiked the Selic policy rate by 150 bps, to 10.75%, in line with the consensus of macro analysts and the yield-curve pricing. This was the eighth move in the cycle, with the Selic reaching its highest level since 2Q17.

The takeaway in the Copom statement was the change in short-term guidance, as the BCB signaled "a reduction in the pace of adjustment" for the March 15-16 meeting, instead of pointing to a more specific (expected) outcome as on previous occasions. The authority refers to "the stage of the tightening cycle" and the policy lags argument to justify this action, probably with a view to calibrating the (nearing) end of the cycle.

While the BCB left the range of options a little broader and "lighter" than we had expected, in practical terms we believe the concerns about a de-anchoring of inflation expectations will limit the range of possibilities for the next Copom meetings. In other words, we see the consensus Selic forecast of +100 bps for March and +25 bps for May as a lower bound for the next moves, especially given the upwardly skewed balance of risks for inflation. Judging from the BCB's inflation estimates, we conclude that the Copom's flight plan probably includes a terminal Selic rate close to (but no less than) 12%.

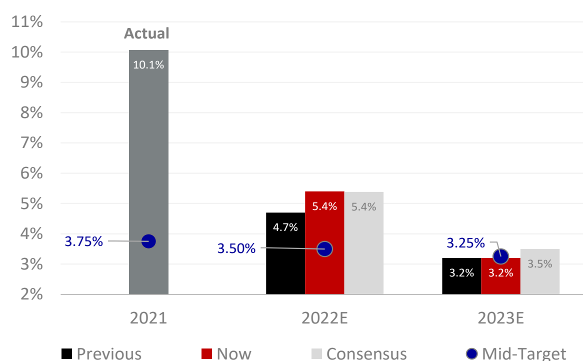
In our view, the softer-than-expected guidance for the future speed of tightening is (at least partly) offset by other hawkish elements in the statement—such as the BCB's pledge to further advance into restrictive territory and to continue with the disinflation process and re-anchoring strategy. The continued emphasis on the risks of de-anchoring inflation expectations (led by fiscal uncertainties) added to a cautious tone, as did the scenario assessment, downgrading external conditions and recognizing the deterioration in the inflation outlook.

So, however soft the tone is perceived as being in this communiqué (and the minutes could allow us to further recalibrate that), we continue to see the authority striving to reclaim the driver's seat in inflation expectations.

Following the message in the Copom statement, our outlook is now for a 100-bp Selic hike in March and another move of 50 bps in May (we previously expected a single 150-bp move in March). We maintain our terminal Selic rate estimate of 12.25% for this cycle and forecast stability until 1Q23. This means a notably tight monetary policy stance for the remainder of 2022. See details in the link[4].

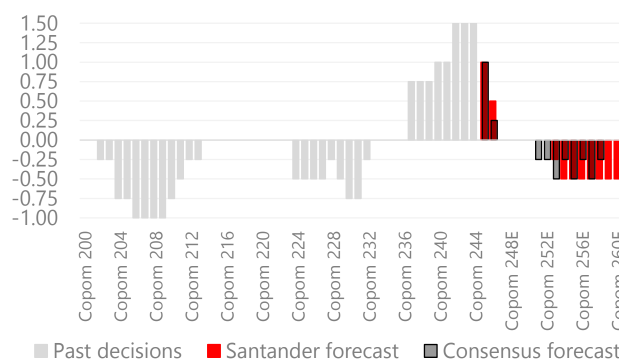
On Tuesday (February 8), the BCB publishes the Copom minutes, which may further calibrate the signals on its next steps.

Figure 6. BCB's Inflation Simulations (% annual)



Sources: Brazilian Central Bank, Santander.
Note: IPCA simulations assume Selic rate from the Focus survey and USD/BRL starting at 5.45 and evolving according to purchase power parity.

Figure 7. Selic Rate Moves in Copom Meetings: History and Forecast (in percentage points)



Sources: Brazilian Central Bank, Santander.

[4] **Santander Brazil – Monetary Policy: *"Copom Decision: Slower but Not Lower"* –** February 3, 2022- Available on: https://bit.ly/Std-Copom-feb22

FISCAL POLICY AND LEGISLATION

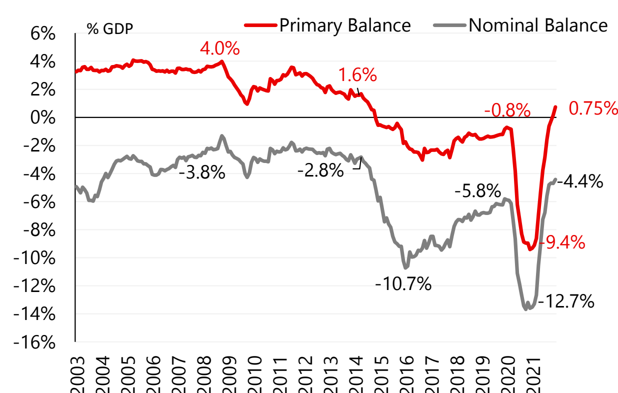
According to BCB data published on January 31, the public sector result reached a primary surplus of BRL64.7 billion (0.75% of GDP) in 2021, after seven years with the primary budget surplus in red ink. This result compares to a BRL703 billion (9.4% of GDP) deficit in 2020 (which was affected by the massive fiscal stimulus in that year) and -BRL61 billion (-0.8% of GDP) in 2019. Last year's result was boosted by the price shock effect (inflation and terms of trade) and activity recovery. The highlight was regional governments, with a primary surplus of BRL97 billion (1.1% of GDP), an all-time high in the full year result. Despite this good result, for this year we estimate a public sector primary deficit of BRL95 billion (1.0% of GDP), considering increased expenditures and some softening revenue growth—although a more lasting price shock effect on revenue could add a downward bias for the deficit estimate.

In December, we continued to witness a rise in the interest account, which reached BRL54.4 billion in the month, compared to BRL24.0 billion in December 2020. The result was affected by both higher inflation numbers and the Selic rate, leading to a rise in the cost of debt. In 2021, the nominal deficit reached 4.4% of GDP, compared to 13.6% of GDP in 2020 and 5.8% of GDP in 2019. For 2022, we expect the nominal deficit to be higher than 8.0% of GDP.

Regarding the debt statistics, gross debt declined to 80.3% of GDP in 2021, compared to 88.6% in 2020 and 74.4% of GDP in 2019. The result for the year was below the estimate at the beginning of last year, about three quarters of which can be explained by the price effect. In this context, nominal GDP, as measured by the BCB, rose 16.2% in 2021, vs. our forecast at the beginning of 2021 of ~7%. Meanwhile, net debt reached 57.3% of GDP, compared to 62.5% of GDP in 2020 and 54.7% of GDP in 2019. We expect gross debt to increase this year, to 85.1% of GDP, considering the increase in public sector nominal deficit. In this number, we expect the BNDES to repay the Treasury ~BRL50 billion. See details in the link[5].

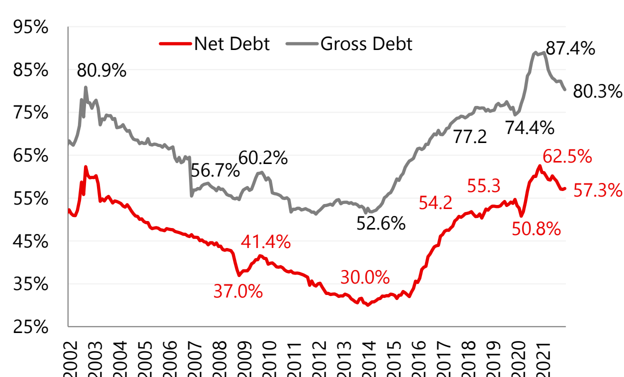
On February 2, the National Congress returned from recess, but we think the time is short to approve new legislations before the elections in October. We believe that the main agenda in the short term could involve tax exemptions. One of the key legislative items that is likely to be discussed is the possibility for the government to cut taxes on fuel, especially to reduce diesel prices, without implementing compensation measures in order to comply with the fiscal responsibility law. If the PIS/Cofins (sort of a VAT tax) on diesel is cut to zero, this would imply a tax break of BRL20 billion. Congress will also analyze the possibility of overturning the presidential veto related to the new tax amnesty program PLP 46/21 (named "*Relp*") for small businesses under Simples (a special tax regime). This legislation would renegotiate ~BRL50 billion in tax debt, by our estimate. In addition, we think the Senate could propose a bill to increase the personal income tax break bracket (currently at ~BRL1,900), which could imply a fiscal impact above BRL20 billion. We have not yet included the approval of these measures in our fiscal scenario, but we believe that in the end all the measures approved could imply a revenue loss of ~BRL50 billion for the federal government.

Figure 8. Consolidated Public Sector (12m % GDP)



Sources: Brazilian Central Bank, Santander.

Figure 9. Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

[5] **Santander Brazil Fiscal: *"Primary Surplus Is Back After Eight Years"* –** January 31, 2022- Available on: https://bit.ly/Std-fiscal-013122

CREDIT

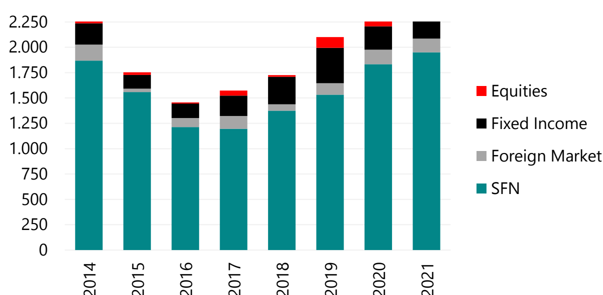
In December, total outstanding loans in the National Financial System (SFN, in the Portuguese acronym) posted inflation-adjusted growth of 5.8% YoY (-4.8 p.p. from the growth registered in 2020) to BRL 4.7 trillion. For households, loans were up 9.7% YoY; for non-financial corporations, they were up 0.9% YoY. The nominal growth rate of total outstanding loans increased to 16.5%, up 0.9 p.p. from 2020. In addition, credit to corporations rose to 11.1% from 10.6%, while the volume of credit to households continued to accelerate, rising to 20.8% from 19.7%, the highest figure in the historical series.

New loans adjusted for inflation and seasonality (BCB methodology) recorded a significant decrease, -10.3% in December. For households, the non-earmarked segment posted a decrease of 5.3% MoM-sa. This performance is composed mainly of total personal credit (-11.5% MoM-nsa) and other goods purchased (-6.8% MoM-nsa). In the earmarked segment, households posted a substantial decline (-10.8% MoM), with real estate financing falling as well (-4.05% MoM-nsa), but with rural credit rising (4.0% MoM-nsa). For companies, there was a decrease of 7.9% MoM-sa in December in the non-earmarked segment. The earmarked segment registered a decrease of 4.4% MoM-sa.

Considering total corporate financing through 2021 (new loans in the SFN, debt and equity issues in the capital markets) vs. the year-ago period, issuances in the capital markets were 56.1% higher, while SFN concessions were up 6.4%. As a result, total corporate financing was up 13.41% compared to the year-ago period.

Still regarding non-earmarked loans, the seasonally adjusted default rate (% of 90-day past-due loans) was at 4.4% (+0.2 p.p. from 2020) and 1.5% (stable vs. 2020), respectively, for households and corporations. Importantly, with the new methodology, the household debt-service ratio reached the highest point in the series, 51.2%, in October; excluding real estate financing, household debt-service was at 32%. In addition, the debt-to-income ratio rose to 27.9% in October; excluding real estate financing, the debt-to-income ratio was 25.6%. We see these figures as a risk for delinquency ahead. See details in the link[6].

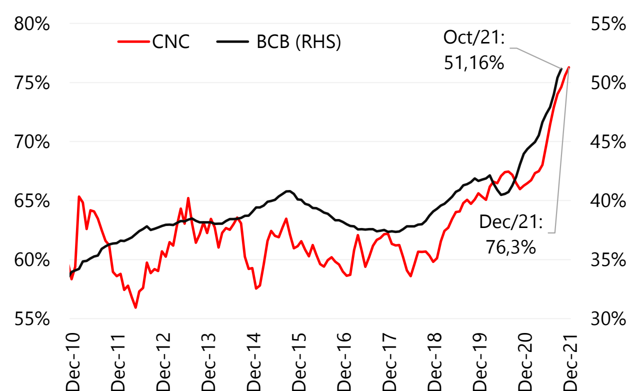
Figure 10. Total Corporate Financing (BRL billion, Inflation adjusted)



SFN - exclude *conta garantida, cheque especial* (overdraft) and credit card.
Foreign Market - bonus, MTNs and securities.
Fixed Income - Debentures, commercial papers, LFs, CRAs, CRIs e FIDCs.
Equity - IPO and follow-on.

Sources: Brazilian Central Bank, Anbima, Santander.

Figure 11. Household Debt-to-Income and Debt Service Ratio (%)



Sources: Brazilian Central Bank, Santander.

[6] **Santander Brazil Credit: *"2021 Ends with Strong Credit Growth"* –** January 28, 2022- Available on: https://bit.ly/Std-credit-012822

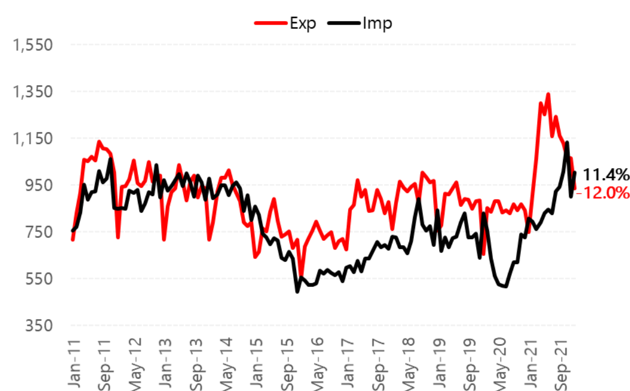
TRADE BALANCE

The January trade balance repeated the performance observed a year ago and registered a US$0.2 billion deficit, with the weak result reflecting temporary weather-related factors. Looking ahead, we see the slowdown in domestic demand and favorable commodities prices leading to a record-high trade surplus: we forecast a US$76.4 billion surplus in 2022 vs. US$61.0 billion in 2021.

The January 2022 trade balance repeated the performance observed a year ago and registered a US$0.2 billion deficit, as both exports revenue and imports outlays registered equivalent increases (US$ 4.7 billion) over their amounts recorded in January 2021. From the exports' revenue standpoint, the positive highlights were sales of soybeans and oil, which accounted for nearly 50% of the increase observed in YoY terms, with both prices and volumes showing positive variations vs. January 2021. On the other hand, iron ore stood out as a negative item, as both price and volume showed negative variations in the same terms. Regarding imports outlays, the items that showed the biggest expansion in absolute terms were oil (both crude and refined) and natural gas, which also accounted for nearly 50% of the increase in YoY terms. See details in the link[7].

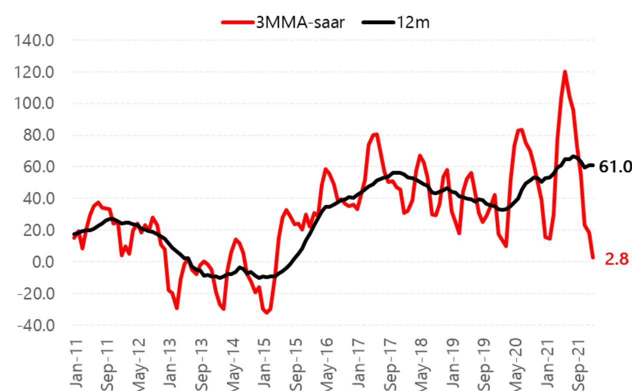
The average of the last-three-month annualized surplus (3MMA-saar) of US$2.8 billion is far lower than our forecast of a US$76.4 billion surplus for 2022 as a whole. However, as we have mentioned previously, there are transitory forces influencing both exports revenue and imports outlays that we believe will fade, thus improving the 3MMA-saar reading soon—such as the resolution of the bottlenecks in the domestic supply chains and the *normalization of the operations of mining producers*. In addition, we expect the weakness of the BRL, the gradual expansion of the Brazilian economy, and the maintenance of robust demand for commodities to lead the country to register another sizeable surplus this year.

Figure 12. Trade Balance (US$ million/working day, sa)



Sources: SECINT, Santander.

Figure 13. Trade Balance (US$ billion)



Sources: SECINT, Santander.

[7] **Santander Brazil – External Sector – Data Analysis: *"Equal but Different"* –** February 1, 2022- Available on: http://bit.ly/Std-extsec-020122

ECONOMIC ACTIVITY

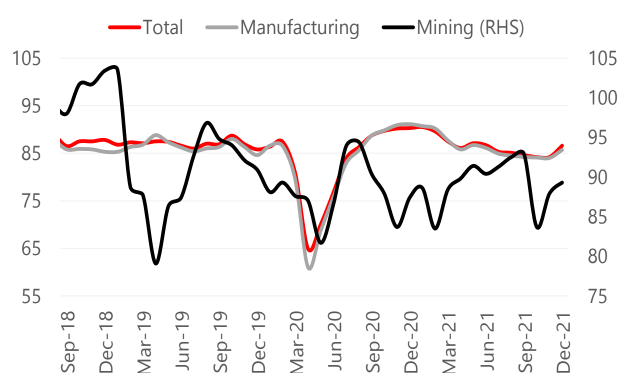
According to the December CAGED survey, net formal job creation stood at -265.8k (vs. consensus at -175k and Santander's estimate of -181k). The result followed the seasonal pattern of net job destruction in December, but surprised on the downside. After our seasonal adjustment, we calculate that net formal job creation decelerated to 206k, from 263k in November. The number of hirings decreased 0.2% MoM-sa, while layoffs increased 3.6% MoM-sa. After a positive surprise in November, CAGED numbers have resumed a deceleration at the margin. We believe that the end of the formal employment program ("Emergency Benefit for Income and Employment Preservation", or BEm) continued to affect the data, as the layoffs series renewed its recent highs in seasonally adjusted terms. Each month, fewer workers are included in the program's temporary job guarantee as the waiver periods for layoffs of the program's beneficiaries gradually expire. Therefore, we expect the deceleration in CAGED net job creation data to continue in the coming months. See details in the link[8].

Continued widespread weakening of economic confidence in January. Aggregated business confidence shrank 2.7% MoM-sa in January, marking the third decline in a row and reaching 91.6 points—below the 100-point neutral threshold—and placing the index 5.9% below the pre-pandemic mark. This result summarizes a widespread decline among the sectors, as declines were seen for consumers (-1.9%), industry (-1.7%), and the tertiary sector (-0.5% and -4.5% for retail and services, respectively). See details in the link[9].

Industrial output topped expectations in December (vs. consensus at +1.6% MoM-sa and Santander's estimate of +1.8% MoM-sa). December's result (+2.9% MoM-sa) was the first growth print since May 2021 but was enough to offset the frustration with October's and November's data, placing the index at the highest reading since June 2021. Vehicles contributed the most (+1.23 p.p.), and the diffusion index reached 77% (vs. 50% in November). Moreover, December's figure implied both quarterly stability (0% QoQ-sa) and a +1.9% QoQ-sa carryover to 1Q22, suggesting short-term relief of industrial output for overall activity. See details in the link[10].

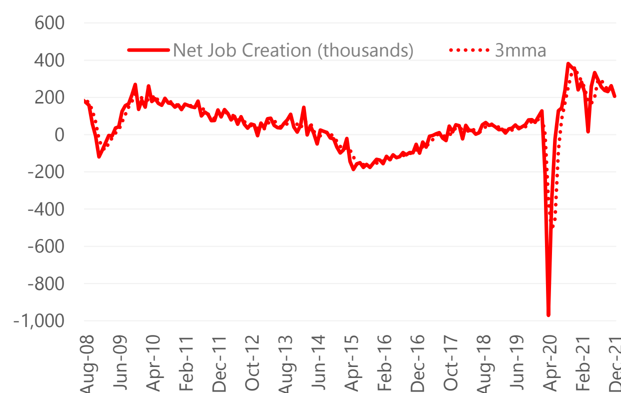
Next week, the focus is on the releases of the last batch of economic activity data for December. On Wednesday (February 9) and Thursday (February 10), IBGE will release the tertiary sector data for December (retail sales and services revenue, respectively), and we expect mixed signals. We see broad retail sales shrinking by 0.5% MoM-sa sequentially and forecast sequential growth of 1.2% MoM-sa for services output. Moreover, the IBC-Br will be released on Friday (February 11), and we expect a slight increase of 0.1% MoM-sa (updated from stability, 0% MoM-sa). Our tracking to 4Q21 GDP growth was updated to +0.3% QoQ-sa (from +0.2% QoQ-sa). For details on Santander's activity outlook, please refer to our last chartbook[11].

Figure 14. Industrial Production Index (sa, 2012=100)



Sources: IBGE, Santander.

Figure 15. Net Formal Job Creation (sa)



Sources: Ministry of Labor, Santander.

[8] **Santander Brazil Labor Market:** ***"Slower Employment Growth at the Margin, with Lower Real Wages"*** **–** January 31, 2022- Available on: https://bit.ly/Std-labor-013122
[9] **Santander Brazil Economic Activity:** ***"Continued Widespread Weakening in January"*** **–** February 01, 2022- Available on: https://bit.ly/Std-econact-020122
[10] **Santander Brazil Economic Activity:** ***"Industrial Output Topped Expectations in December"*** **–** February 02, 2022- Available on: https://bit.ly/Std-econact-020222
[11] **Santander Brazil Economic Activity:** ***"Chartbook – Maintaining the Main Growth Drivers for 2022"*** **–** February 01, 2021 – Available on: https://bit.ly/Std-chart-econact-feb22

INFLATION

We expect the January IPCA (due on Wednesday, February 9) to rise +0.52% MoM. In YoY terms, this means 10.36%, a slight acceleration from the 10.06% change of December's IPCA. Compared to the December IPCA (+0.73% MoM), the headline is likely to decelerate in monthly terms, driven mostly by free-market prices (+0.72% MoM vs. +0.99% last month). In terms of broad underlying inflation measures, we estimate the EX3 core will continue to trend around the high level of 8.1% 3MMA-saar.

We expect January IPCA (due on Wednesday, February 9) to rise +0.52% MoM. In YoY terms, this means 10.36%, a slight acceleration from the 10.06% change of December's IPCA. In terms of trends for the headline—as measured by the seasonally adjusted and annualized three-month moving average—we expect it to ease to 6.7% 3MMA-saar from 8.7%, after a peak of 13.1% in September 2021. However, in YoY terms we believe inflation will continue hovering around 10.0% until April 2022, meaning a "plateau" at a high level for some time.

Compared to the December IPCA (+0.73% MoM), we expect the headline to decelerate in monthly terms, driven mostly by free-market prices (+0.72% MoM vs. +0.99% last month). We also project services to decelerate in monthly terms (0.58% MoM vs. 0.79% previously). With this monthly result, we expect the trend to decelerate to 4.5% 3MMA-saar (from 6.3%), but this relief could be short-lived, as we forecast further acceleration of the trend at least until mid-year. We expect industrial goods to decelerate in monthly terms (0.57% MoM vs. 1.41% previously), enough to keep the trend hovering around 12.3%. Finally, we estimate food-at-home will accelerate to 1.28% MoM (from 0.79% last month), with the trend accelerating to 4.4%.

In terms of broad underlying inflation measures, we estimate the EX3 core will rise +0.85% MoM, which would represent stability in the trend around 8.1% 3MMA-saar—still a high level. This will be the 17th 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 remain cautious regarding the inflation outlook, especially after the recent rise in fiscal risks, which could push expectations even higher and make inertia even stronger, posing difficulties for the disinflation process ahead.

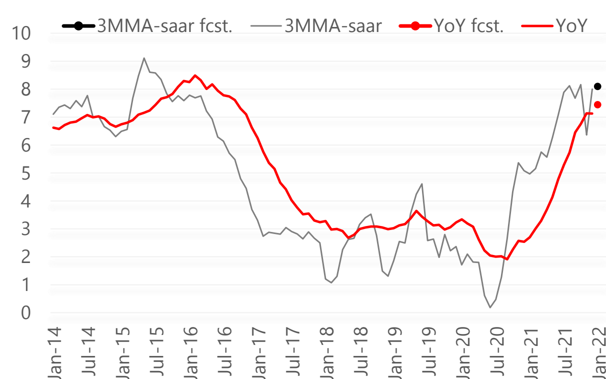
Despite a much tighter monetary policy, we continue to see difficulties for the disinflation process ahead, and we forecast an above-consensus 6.0% IPCA for 2022 (consensus: 5.4%).

Figure 16. January's IPCA Details (%)

	MoM		YoY	
	Jan-22	Contrib.	Dec-21	Jan-22
IPCA	0.52	0.52	10.1	10.36
Administered	-0.02	-0.01	16.9	17.2
Free	0.72	0.52	7.7	8.0
Food-at-home	1.28	0.19	8.2	8.5
Industrial goods	0.57	0.13	12.0	12.0
Services	0.58	0.20	4.8	5.3
EX3 Core	0.85	0.30	7.1	7.4

Sources: IBGE, Santander.

Figure 17. Core Inflation EX3 (%)



Sources: IBGE, Santander.

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