

STRETCHING THE PEAK (OF CPI) FOR THE CYCLE

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- The BRL closed the rolling week ending November 04 at 5.60, up 0.8% against the USD. The Brazilian currency stood among the top-performers in a basket with 31 of the most liquid currencies in the world, possibly on the heels of dovish DM central banks and a hawkish tone of the BCB. The nominal yield curve saw a parallel downward shift in recent days, trimming a small bit of a still hefty premia. We see limited traction for Brazilian assets for the near future, given initiatives that could further weaken the framework of the constitutional spending cap (Brazil's main fiscal anchor). In our view, these proposals add risks to the fiscal consolidation process.
- On November 4, the Lower House passed in first-round voting the PEC of *Precatórios* by 312 votes. That outcome was just above the 308 votes (out of 513 MPs) needed for approval. This piece of legislation increases the margin to accommodate expenses within the constitutional limit by ~BRL110 billion, paving the way for a new welfare program and other expenses. The second-round voting at the Lower House is scheduled for Tuesday (November 9). The change in the fiscal framework imply an even riskier path towards long-term debt stabilization, increasing the necessity for further structural reforms and a more robust fiscal anchor.
- The Brazilian Central Bank (BCB) published the minutes of the October 26-27 Copom policy meeting. Our impression is that the BCB maintained a hawkish tone, but with no overreaction, as the authority recognizes the risks of a possible de-anchoring of inflation expectations following recent fiscal policy signs. The authority claims that "the appropriate degree of monetary tightening is significantly more contractionary than that used in the baseline scenario"; we look for an 11.50% terminal Selic rate in 1Q22.
- Industrial production fell 0.4% in September and 1.7% in 3Q21. The third quarter figure reinforces our view that industry continues to be a short-term drag on overall activity, due to a shortage of inputs and higher costs. The shift of spending out of goods and back into services should be an additional drag on the sector throughout 2H21. We updated our IBC-Br tracking for September to +0.1% MoM-sa (from +0.3%).
- Next week, IBGE will release the tertiary sector data for September. Retail sales data are due out on Thursday (November 11), while the services sector's real revenue data are due out on Friday (November 12). We expect gains for both indexes (0.7% MoM-sa and 0.2% MoM-sa, respectively).
- We forecast the October IPCA (due on Wednesday, November 10) at +1.09% MoM. As opposed to what we projected a month ago, the September IPCA will probably not mean the peak of year-on-year IPCA inflation for this cycle—our October number implies annual inflation at 10.5% (September: 10.2%). All in all, we remain very cautious about inflation conditions and the outlook, especially for next year, amid rising idiosyncratic risks that could further lift inflation expectations (for key policy horizons).

Most of the information in this report is up to the end of Thursday, November 04, 2021.

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 November 8-12, 2021**

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	FGV	Oct/21	Mon, 08-Nov	--	-0.55
IGP-DI Inflation (% YoY)	FGV	Oct/21	Mon, 08-Nov	--	23.43
Vehicle Production (thousands)	Anfavea	Oct/21	Mon, 08-Nov	--	173.3
IPCA Inflation (% MoM)	IBGE	Oct/21	Wed, 10-Nov	1.09	1.16
IPCA Inflation (% YoY)	IBGE	Oct/21	Wed, 10-Nov	10.5	10.25
Core Retail Sales (% MoM)	IBGE	Sep/21	Thu, 11-Nov	-1.4	-3.1
Core Retail Sales (% YoY)	IBGE	Sep/21	Thu, 11-Nov	-5.5	-4.1
Broad Retail Sales (% MoM)	IBGE	Sep/21	Thu, 11-Nov	0.7	-2.5
Broad Retail Sales (% YoY)	IBGE	Sep/21	Thu, 11-Nov	-1.2	0.0
Services Volume (% MoM)	IBGE	Sep/21	Fri, 12-Nov	0.2	0.5
Services Volume (% YoY)	IBGE	Sep/21	Fri, 12-Nov	12.9	16.7

Source: Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last scenario review¹.

¹ **Santander Brazil - Macroeconomic Scenario (Redux): "Losing the Anchor"** – November 05, 2021- Available on: <https://bit.ly/Std-scenreview-redux-nov21>



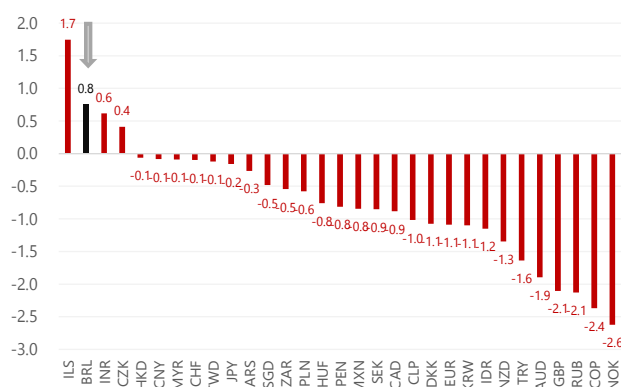
LOCAL MARKETS—FX

The BRL closed the rolling week ending November 04 at 5.60, up 0.8% against the USD. The Brazilian currency stood among the top-performers in a basket with 31 of the most liquid currencies in the world. In our opinion, with the USD/BRL still near historical highs, and amid fiscal policy initiatives that could further weaken the country's main fiscal anchor (the constitutional spending cap), one should not read too much into this week's outperformance. Firstly, given the high-beta pattern of the BRL, it is possible that the Brazilian FX rate was favored by the perception of dovishness from key central banks in recent policy decisions by the Federal Reserve and the Bank of England. A rally in soft commodities in the last few days—with agricultural products posting gains and bucking the selling trend seen in metals and mining—may also have lent some helping hand for the BRL, at least in terms of relative performance. If, on the one hand, we admit difficulty in extracting the signal of the actual global influence on this week's BRL performance, on the other, we insist in disassociating that with the evolution of economic fundamentals outside the interest rate. In fact, the only domestic factor that could have supported the BRL was the BCB hawkishness, as the Copom signaled an even tighter Selic rate policy in the minutes (see the "Monetary Policy" section). In any case, given the directions of fiscal policy as a new legislation changing the framework for the constitutional spending cap advances (see the "Fiscal Policy" section), we continue to see risks skewed to the upside for the short-term FX rate trends. In our view, Selic hikes may have limited effects on the BRL amid rising concerns about the government debt outlook.

LOCAL MARKETS—Rates

The nominal yield curve in recent days experienced a parallel downward shift, trimming just a small bit of a still hefty premia. Since last Thursday (October 28), the front end of the curve (Jan-23 DI future) decreased 31 bps to 12.10%, while the back end of the curve (Jan-27 future) decreased 28 bps to 12.19%. As a result, the curve's steepness in this segment increased 2 bps to 9 bps, meaning an almost perfectly flat curve. In our view, the weekly rally could well reflect more in terms of technical market factors than a relief about the macroeconomic and inflation outlook. Idiosyncratic risks remain high as the uncertainty about the fiscal consolidation process lingers on. The DI futures market continues to apparently price in Selic rate hikes between 175-200bps for December 2021, as well as moves around 175bps for February 2022 and between 125-150bps for March 2022. These prices may be partly reflecting some risk premium and not necessarily hikes of those magnitudes.

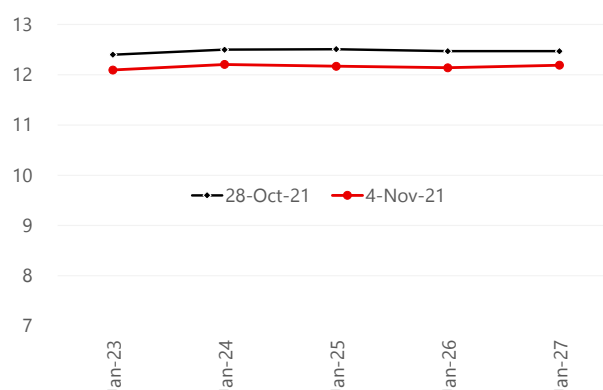
Figure 2 – FX Performance for the Rolling Week



Sources: Bloomberg, Santander.

Note: As of the close on Thursday, November 4, 2021.

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



Sources: Bloomberg, Santander.

Note: As of the close Thursday, November 4, 2021.



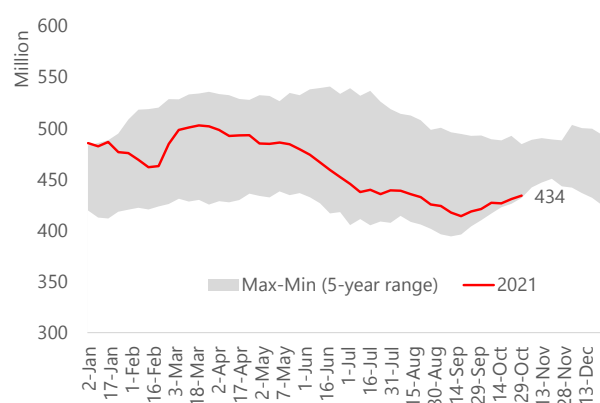
COMMODITIES

OPEC+ sticks to plan for gradual hikes in oil output. OPEC and its allies agreed on Thursday (November 4) to increase the cartel's oil production quota by 400k bpd. Additionally, members are not allowed to compensate for under-production of others (the group failed to meet the supply quota in October). The decision comes amid growing calls from key importing countries, such as the U.S., China and India for higher oil supply, with the organization claiming that the pandemic could still hurt demand. Following the decision, press sources indicated that the U.S. and other countries could release oil from their strategic stockpiles. The next meeting of OPEC+ will be on December 2nd.

EIA² reports an increase in U.S. crude stockpiles. The EIA reported on Wednesday (November 3) that U.S. crude inventories increased by 3,290k barrels for the week ending October 29, against the expectations for a 1,746k barrels increase. Despite the increase, inventories, at 434 million barrels, are still very close to the minimum level observed for this time of the year (considering the last 5 years).

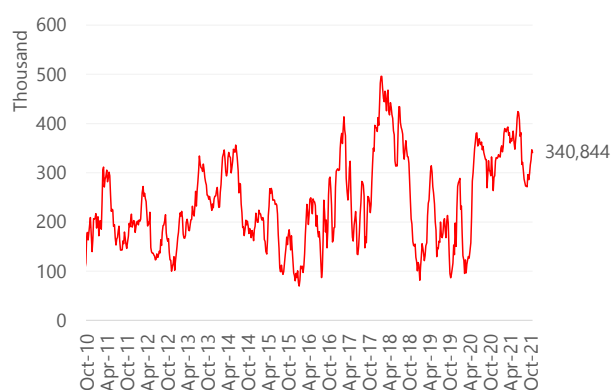
CFTC³ reports a decrease in speculative long positions in WTI crude oil. Money managers raised their net long WTI crude futures and options positions in the week to October 26, the CFTC reported on Friday (October 29). The positions in futures and options decreased by 5,992 contracts to 340,844.

Figure 4 – EIA U.S. Crude Oil Inventories (Barrels)



Sources: EIA, Santander.

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



Sources: COT, Santander.

² Energy Information Administration.

³ U.S. Commodity Futures Trading Commission.



FISCAL POLICY AND LEGISLATION

We estimate that pandemic relief expenses, specifically those that were exempted from compliance with the constitutional spending cap (so-called “extra-cap” spending), totaled BRL11.8 billion in September. Most of that is related to the emergency aid stipends, totaling BRL8.0 billion. According to the government, nearly 3.8 million benefits were canceled or blocked since April, reducing the monthly disbursement by BRL0.8 billion and the number of beneficiaries to ~35 million. The emergency aid program is to end in October and the government plans to introduce a new welfare program (christened *Auxílio Brasil*) for November or December, which will touch ~17 million families. We estimate that close to 19 million people will not receive the benefit from November onwards. For the new welfare program, there is a total of BRL9.3 billion that had been budgeted for *Bolsa Família* that could be used this year. This leftover follows the migration of beneficiaries from Bolsa Família to the emergency aid program from April to October, which reduced the disbursements of the regular program. Additionally, the government increased the IOF tax in September to finance the welfare program, generating an expected revenue impact of nearly BRL2.2 billion. The new welfare program needs to be approved in Congress and enacted by December, given that increases in that class of expenditures are legally forbidden in election years. Health expenses totaled BRL19.3 billion this year up to October: the monthly cost decreased with the improvement in health conditions as the vaccination progresses. The monthly average spending on vaccines has been around BRL2.1 billion per month, reaching a total of BRL16.1 billion in 2021. We believe that part of the spending for the acquisition of vaccines can be extended to 2022, and we estimate a total cost around BRL5-10 billion, outside the spending cap. For the time being, the total of “extra-cap” expenses budgeted for 2021 is BRL135.6 billion, and the *PEC of Precatórios* could add BRL15 billion to that total. Our estimates consider the execution of extra-cap spending within BRL115-125 billion (~1.3-1.4% of GDP).

On November 3, the Lower House, in first-round voting, passed the *PEC of Precatórios* by 312 votes in favor (out of 513 deputies and compared to a minimum threshold of 308 votes for approval). That piece of legislation increases the fiscal margin to ~BRL110 billion to finance the new welfare program and accommodate other expenditures. The *PEC* (constitutional amendment, in the Portuguese acronym) limits yearly court-ordered debt payments within the spending cap and changes the indexing rule for the spending cap in order to make room for a revamped welfare program (named *Auxílio Brasil*) and other expenditures. In our view, the current proposal opens a budget margin of BRL110 billion for 2022, boosting the capacity to add spending within the constitutional cap. Thus, the government can accommodate the demand for new expenditures without “breaching” the rule. The decision for even more expenses and the change in the fiscal framework imply an even riskier path to long-term debt stabilization, given the necessity for further structural reforms and a more robust fiscal anchor. **The second-round voting of the *Precatórios* amendment at the Lower House is scheduled for Tuesday (November 9).**

Figure 6 – 2021 “Extra-Cap” Spending Tracker

BRL Billion - Accumulated	Aug-21	Sep-21	Oct-21	Total Budgeted	Executed
Emergency Aid (MP 1.037 and 1.056/2021)	44.3	52.5	60.5	64.9	80.8%
Health expenditures	14.2	17.8	19.3	26.1	68.4%
BEm - Employment Program (MP 935/220 and MP 1.044/2021)	7.6	7.7	7.7	11.7	66.0%
Turism Infrastructure (MP 963/2020)	0.5	0.5	0.5	1.9	26.0%
Vaccine Acquisition (MP 994, 1.004 and 1.015/2020)	11.7	13.8	16.1	26.2	52.7%
Pronampe (credit support for SMEs) (MP 1.053/2021)	5.0	5.0	5.0	5.0	100.0%
Accumulated Total	83.2	97.3	109.1	135.7	71.7%

Last update: 11/02/2021

Sources: National Treasury, Santander.

Figure 7 – 2022 Effects of *PEC of Precatórios*

2022		
Spending Cap Margin Changes:	BRL Billion	% GDP
Current Fiscal Margin (Inflation INPC Dec-21: 10%)	-28	-0.3%
PEC Precatórios Changes		
Capping Court-Ordered Payments to BRL40 bn (out of BRL89 bn)	50	0.5%
Changing the Fiscal Rule Indexation (by changing the YoY IPCA window from Jun to Dec)	60	0.6%
New Fiscal Margin (post PEC Precatórios)	110	1.3%
New Expenditures for the new margin		
Increase in Mandatory Outlays (Higher Inflation)	-28	-0.3%
New welfare program expansion (Total Budget BRL82 bn)	-47	-0.5%
750k Truckers Drivers BRL400 benefit	-4	0.0%
Others expenses- 2022 budget	-31	-0.3%
Total New Expenditures	-110	-1.2%
Primary Deficit Estimate (Preliminary)	155	1.7%

Sources: National Congress, Ministry of Economy, Santander.



MONETARY POLICY

The Brazilian Central Bank (BCB) published the minutes of the October 26-27 Copom policy meeting, when the authority accelerated the pace of hikes to 150bps, raising the Selic rate to 7.75%. Overall, our impression is that the BCB maintained a hawkish tone, but with no overreaction, in line with the statement and in proportion with the deterioration in the inflation outlook.

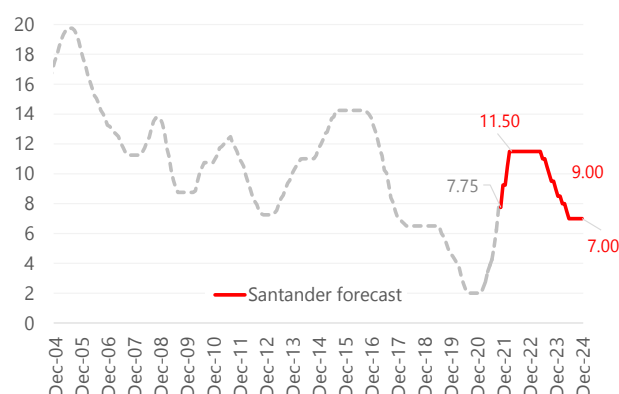
The Copom is particularly worried about a possible de-anchoring of inflation expectations on the heels of recent fiscal policy signs (of an imminent change in the constitutional spending ceiling framework, the main fiscal anchor as of now). The BCB points to greater upside risks for inflation, the neutral level of interest rate and, consequently, the total budget of hikes.

The BCB makes it clear that it has not given up achieving inflation's mid-target for 2022 – which the authority sees as necessary to avert further deterioration in expectations for longer (and increasingly important) policy horizons.

The authority claims that “the appropriate degree of monetary tightening is significantly more contractionary than that used in the baseline scenario”, as we calculate the BCB models suggest a need for a level of interest rate that reaches at least some 150bps above the scenario tested in the last BCB simulations (based on consensus forecasts in the week before the meeting).

We recently raised our estimate for the terminal Selic rate in the cycle to 11.50%, as we look for hikes of 150bps in December 2021, and subsequent moves of 125bps in February 2022 and 100bps in March 2022. We expect the interest rate to remain around this level at least until 2Q23, conditional on the fiscal policy developments. We recognize the uncertainty about economic policy and the difficulty to make forecasts at this juncture. For now, we sense there is still upside risk as per our terminal rate call. [See details in the link⁴.](#)

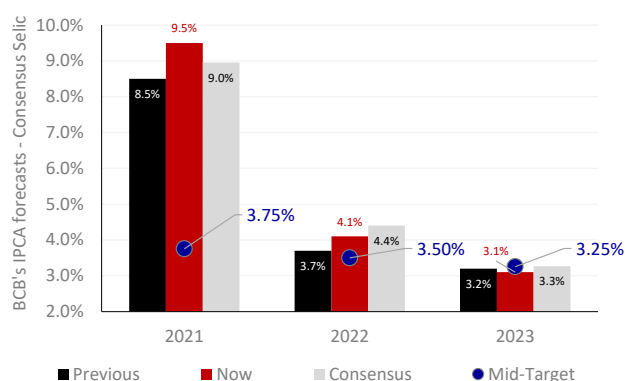
Figure 8 – Selic Path and Santander Forecast



Sources: Brazilian Central Bank, Santander.

Note: Monthly Averages

Figure 9 – BCB's Inflation Simulations



Sources: Brazilian Central Bank, Santander.

Note: Simulations assume Selic from the Focus survey and USD/BRL starting at 5.60 and evolving according to purchase power parity.

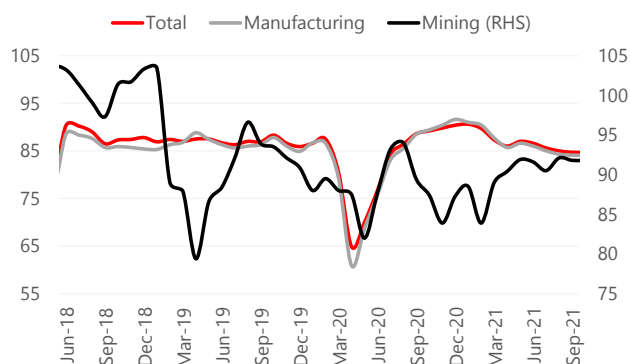


ECONOMIC ACTIVITY

Industrial production retreated (again) in September, marking the third consecutive quarterly fall. The headline index was down 0.4% in September, slightly below market consensus (-0.2%) and marking the seventh decline in eight months. September's figure stems from decreases in both manufacturing (down 0.2%) and mining (down 0.3%) and places industrial output 3.2% below the pre-pandemic mark (February 2020). Looking at the breakdown, investment-related categories were the lowlights, with capital goods and construction supplies retreating 1.6% and 2.4%, respectively. Intermediate goods (which account for nearly 60% of industrial output) showed virtual stability (down 0.1%). Conversely, consumer goods expanded 0.7%, but with durable goods retreating for the ninth month in a row (down 0.2%). September's drop was not widespread, with our diffusion index increasing to 56% (44% in August). Following two quarterly declines (down 0.7% and 3.0% in 1Q21 and 2Q21, respectively), the third quarter's figure (-1.7%) reinforces our view that industry continues to be a short-term drag on activity, still suffering from a shortage of inputs, further affected by the impact of the drought on electricity generation. Our IBC-Br tracking for September was updated to +0.1% MoM-sa (from +0.3%), imparting downside risks to our 3Q21 GDP growth projection (+0.3%), but we still expect a positive figure, mainly driven by the resumption of activity in the services sector. [See details in the link⁵.](#)

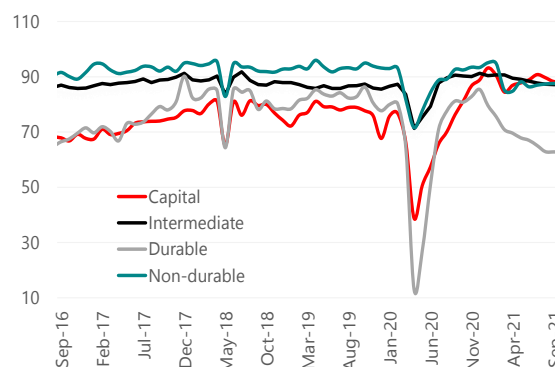
Next week, IBGE will release the tertiary sector data for September. Retail sales data are due out on Thursday (November 11), while the service sector real revenue data is due out on Friday (November 12). We expect both indexes to increase in September, with monthly growth of 0.7% MoM-sa and 0.2% MoM-sa, respectively. If these results are confirmed, retail sales would end 3Q21 retreating 0.9% QoQ-sa, while the service sector real revenue would end 3Q21 expanding 3.3% QoQ-sa. The numbers will likely continue to reflect the return of spending in services (out of goods), which was an expected part of the process of economic normalization as control over the pandemic becomes solid. **For details on Santander's activity outlook, please refer to our last chartbook⁶.**

Figure 10 – Industrial Production Index (sa, 2012=100)



Sources: IBGE, Santander.

Figure 11 – Economic Categories (sa, 2012=100)



Sources: IBGE, Santander.

⁵ Santander Brazil Economic Activity - *"Weak Figure (Again) for Industrial Output"* – November 4, 2021 – Available on: <https://bit.ly/Std-Econact-110421>

⁶ Santander Brazil Economic Activity - *"Chartbook – Downgrading the Estimate for 2022 and 2023"* – November 5, 2021 – Available on: <https://bit.ly/Std-chart-econact-nov21>



INFLATION

We expect the October IPCA (due on Wednesday, November 10) to rise +1.09% MoM. Contrary to what we expected a month ago, September's IPCA was probably not the peak of year-on-year IPCA inflation, as our number is consistent with a pickup to 10.5% (from 10.2% in the previous month). In terms of trends for headline IPCA—the three-month moving average seasonally adjusted and annualized—should also accelerate, from +13.5% 3MMA-saar in September to +13.8% in October.

Compared to the September IPCA (+1.16% MoM), October data should slightly decelerate, mainly driven by regulated prices (+1.09% MoM vs. +1.93% in September) because the impact of the exceptional Red 2 Hydro Scarcity tariff flag in electricity prices will have faded almost entirely. Free prices, on the other hand, should accelerate (1.08% MoM vs. 0.88% last month), mainly driven by services. In particular, we estimate the services core gauge will accelerate from 7.2% to 7.8% 3MMA-saar. The acceleration in services inflation is a source of concern as the group has high inertia, making the disinflation process that we envision ahead more difficult (or stickier). Food-at-home should continue under pressure at the margin with the trend steady at 20% 3MMA-saar. Finally, on a more positive note, industrial goods should continue the deceleration process—although still at high levels—with the headline decreasing from 11.9% to 11.3% 3MMA-saar and its core gauge from 8.4% to 7.6% 3MMA-saar.

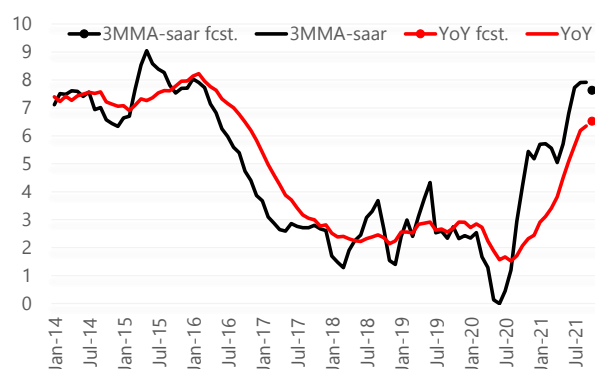
In terms of broad underlying inflation measures, we estimate the EX3 core will rise around +0.82% MoM, which would represent a small deceleration but to a still hefty level of +7.6% 3MMA-saar (from +7.9%). It is worth noticing that the composition of the deceleration is not favorable as it is mainly driven by the industrials core gauge, while the stickier group of services is accelerating. This will be the thirteenth month the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022). We remain cautious regarding the inflation outlook, especially after the recent rise of domestic risk that might push expectations even higher, and that might turn inertia stronger, resulting in a more difficult disinflation process.

Figure 12 – IPCA: Forecast Details (%)

	MoM		YoY	
	Oct-21	Contrib.	Sep-21	Oct-21
IPCA	1.09	1.09	10.2	10.5
Administered	1.09	0.30	15.7	16.7
Free	1.08	0.79	8.3	8.4
Food-at-home	1.30	0.20	14.7	13.2
Industrial goods	1.13	0.26	10.6	10.7
Services	0.96	0.33	4.4	4.8
EX3 Core	0.82	0.29	6.4	6.5

Sources: Brazilian Central Bank, Santander.

Figure 13 – Core Inflation Forecast (EX3 %)



Sources: Brazilian Central Bank, Santander.



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