BRAZIL MACRO

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MACRO COMPASS

FEBRUARY ACTIVITY DATA IN THE LIMELIGHT

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- In the rolling week ended on April 7, nearly all major currencies weakened against the USD, and the BRL was no exception: the USD/BRL cross closed the period at 4.75, after having breached the 4.60ish level on Tuesday (April 5), meaning a 0.25% weekly loss of BRL vis-à-vis the greenback. Yet at week's end, the BRL stood among the top-10 performers in a basket with 31 of the most liquid currencies. It is possible that the BRL's outperformance (and relative resilience), even amid adverse market conditions and a stronger USD, reflects the positive expected effect of the commodity cycle on Brazil's economy, the high level of Brazilian interest rates, and an expanding share of EM portfolio allocation directed to Brazil.
- Reflecting (very moderately) the sell-off in global yields on the heels of hawkish monetary policy signals in DMs (namely, U.S. and Eurozone), the local yield curve (nominal rates) closed April 7 at only slightly higher levels than a week before, following a big rally in recent weeks.
- Materials prices had a mixed showing in a week when macroeconomic factors balanced out geopolitical developments. On the macro front, the confirmation of a tighter policy stance ahead from both the Fed and the European Central Bank (ECB) in this week's monetary policy minutes has driven U.S. Treasury yields and the USD higher, prompting downward pressures on commodity prices. That effect was likely offset by the continued developments related to the war in Eastern Europe, as Western countries step up sanctions against Russia due to allegations of possible war crimes.
- March's IPCA registered a 1.62% MoM change, significantly above our call (1.40%) and the consensus expectation (1.35%). In year-over-year terms, the IPCA accelerated to 11.3%, highest reading since late 2003, reinforcing the perception of a difficult disinflation scenario. The composition remains worrisome, as the core inflation average has trended at 11.4% 3MMA-saar in the last three months. All in all, the numbers confirm that the disinflation process will experience significant difficulties ahead. Our tracking points to 2022 IPCA at 7.5%.
- Next week is packed with economic activity releases, as IBGE is expected to publish the last batch of activity data for February. On Tuesday (April 12), the Services Sector survey comes out, and we estimate a 0.5% MoM-sa gain (January: -0.1%). On Wednesday (April 13), Retail Sales data is due: we estimate +0.8% MoM-sa for the broad index (January: -0.3%). February's IBC-Br (the BCB's broad activity index) was originally scheduled for Thursday (April 14) but may not be published owing to the strike by federal workers. In any case, our forecast is at +0.4% MoM-sa (January -1.0%).

Most of the information in this report is up to the end of Thursday, April 7, 2022.

Figure 1. Brazil Macro Agenda for the Week of April 11 to April 15, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Services Volume (% MoM)	**IBGE**	**Feb/22**	**Tue, 12-Apr**	**0.5**	**-0.1**
Services Volume (% YoY)	IBGE	Feb/22	Tue, 12-Apr	8.8	9.4
Core Retail Sales (% MoM)	IBGE	Feb/22	Wed, 13-Apr	0.1	0.8
Core Retail Sales (% YoY)	IBGE	Feb/22	Wed, 13-Apr	-1.0	-1.9
Broad Retail Sales (% MoM)	**IBGE**	**Feb/22**	**Wed, 13-Apr**	**0.8**	**-0.3**
Broad Retail Sales (% YoY)	**IBGE**	**Feb/22**	**Wed, 13-Apr**	**-2.0**	**-1.4**
IBC-Br Activity Index (% MoM)	**BCB**	**Feb/22**	**Thu, 14-Apr (?)**	**0.4**	**-1.0**
IBC-Br Activity Index (% YoY)	BCB	Feb/22	Thu, 14-Apr (?)	0.5	0.0
Net Debt (% GDP)	BCB	Feb/22	n.a.*	57.4	56.6
Primary Budget Balance (BRL billion)	BCB	Feb/22	n.a.*	-8.6	101.8
Current Account Balance (USD billion)	BCB	Feb/22	n.a.*	-1.6	-8.1
Foreign Direct Investment (USD billion)	BCB	Feb/22	n.a.*	11.2	4.7
Total Outstanding Loans	BCB	Feb/22	n.a.*	--	467.1
National Holiday – Good Friday	**--**	**--**	**Fri, 15-Apr**	**--**	**--**

* Owing to a strike of federal workers, these data releases have been postponed with no publication date rescheduled 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: *"Higher Inflation and Selic Forecasts, Despite the Stronger BRL"* –** February 24, 2022- Available on: https://bit.ly/Std-scenreview-feb22

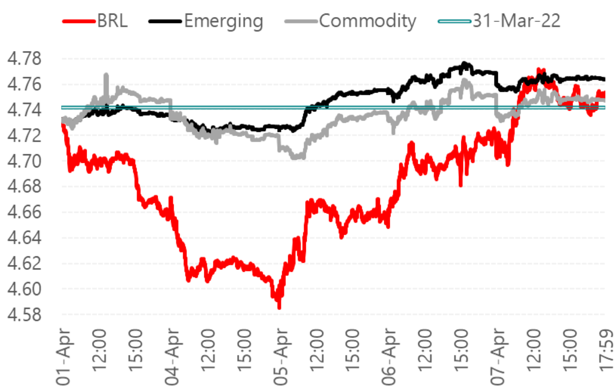
LOCAL MARKETS—FX

In the rolling week ended on April 7, nearly all major currencies weakened against the USD, and the BRL was no exception: the USD/BRL cross closed the period at 4.75, after having breached the 4.60ish level on Tuesday (April 5), meaning a 0.25% weekly loss of BRL vis-à-vis the greenback. In our view, the hawkish statements delivered recently by Fed officials and details provided in the minutes of the last FOMC meeting about the next steps for monetary policy in the U.S. reinforced markets' expectation that the U.S. monetary authority is likely to speed up the tightening pace at its next meeting, scheduled for May 2022. In addition, the minutes of the ECB have underpinned markets' perception that a tightening cycle will commence earlier than anticipated in Eurozone as well, notwithstanding the economic slowdown to be generated by the recent geopolitical developments. By the same token, the impact of the latest outbreak of the COVID-19 pandemic in China, which has led to much stricter lockdowns in that country, has already started to materialize, as the performance of PMI indices indicated last month. Although the domestic news cycle remained relatively subdued in the last few days—the political environment continues to be the focus—external influences weighed on the USD/BRL trajectory. It is possible that the positive expected impact of the commodity cycle on Brazil's economy, high Brazilian interest rates, and an expanding share of EM portfolio allocation directed to Brazil could explain the BRL's outperformance of late, even with adverse market conditions and a stronger USD.

LOCAL MARKETS—Rates

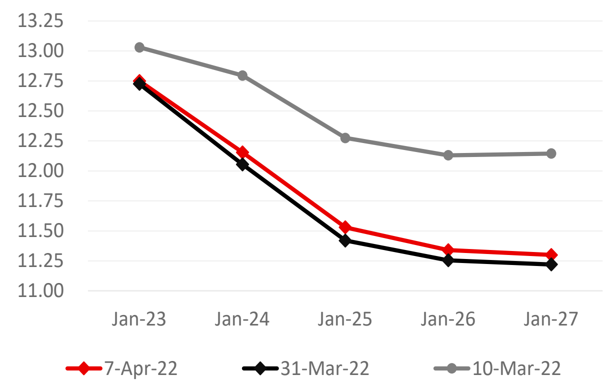
The local yield curve (nominal rates) closed April 7 at slightly higher levels than a week before, giving back a small part of the recent rally. Since last Thursday (March 31), the front end of the curve (Jan-24 DI future) rose 10 bps, to 12.16%, while the back end of the curve (Jan-27 DI future) gained 8 bps, to 11.30%. The curve's steepness in this segment fell a bit further (2 bps), widening the inversion to -85 bps. It is possible that technical factors may have played a role, after a big rally in recent weeks. But local rates also seem to have been driven by the current backdrop of a continued widening in global yields (especially U.S. Treasuries) in the wake of renewed hawkish signals from the policy minutes of both the Federal Reserve and the ECB. On the local news front, the highlight was the government's decision to anticipate the end of the "Hydrological Scarcity" electricity tariff (with a move to a "Green Flag", effective on April 16). We calculate this decision generates a downward CPI effect of about 100 bps, basically anticipating the start of the disinflation process (i.e., in terms of annual IPCA) in a couple of weeks. But our 2022 IPCA tracking remains unchanged at 7.5%, as this was already expected at some point this year. The options market prices in a roughly ~85% probability of a 100-bp hike in May and ~60 % probability of no hike in June. We maintain our view that with the hiking cycle nearing its end, and with IPCA inflation close to its peak, the local yield curve soon could see a steepening pattern, as domestic challenges continue and, in particular, as global interest rates look poised to keep moving higher.

Figure 2. USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, April 7, 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, April 7, 2022.

COMMODITIES

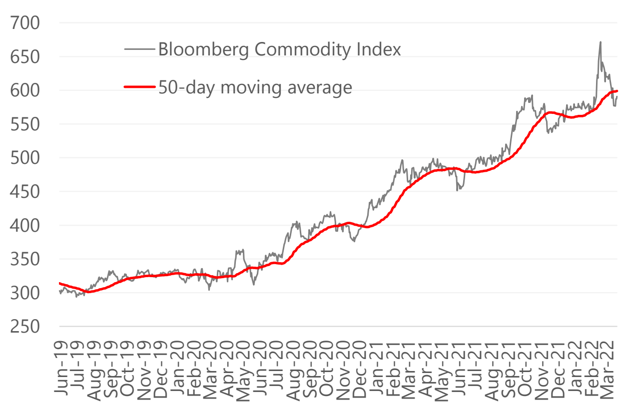
Materials prices had a mixed showing in a week when macroeconomic factors balanced out geopolitical developments. On the macro front, the confirmation of a tighter policy stance ahead by both the Fed and the ECB in this week's monetary policy minutes has driven U.S. Treasury yields and the USD higher, prompting downward pressures on commodity prices. That effect was likely offset by the continued developments related to the war in Eastern Europe, as Western countries step up sanctions against Russia due to allegations of possible war crimes. The Bloomberg Commodity Aggregate Index in BRL increased 0.7% in the rolling week ended April 7. In USD terms, the Index rose 0.4%, with the Agriculture Subindex rising 1.3%, the Energy Subindex gaining 1.2%, and the Industrial Metals Subindex retreating 0.1%. In our view, the ongoing geopolitical shock adds to already tight markets for key commodities: low inventories for most raw materials, coupled with idiosyncratic factors (adverse weather, underinvestment, and high cost of production), have been feeding the commodity rally in 2022.

E.U. proposed a ban on Russian coal but will not impose restrictions on Russian oil and gas for now. As part of a wider package of sanctions against Russia, the E.U. proposed banning the import of all types of coal from Russia, a ban that would take effect in mid-August. Around 45% of E.U. coal imports come from Russia. Given this high dependency, if the proposal is approved, some members asked for an extended wind-down period of four months, meaning Russia could still export for 120 days after sanctions were imposed. As European nations seek alternatives, other coal-exporting countries (Australia, Indonesia, South Africa) might benefit from the ban, in our view.

Brent oil dropped below USD100 due to release of additional barrels from the IEA. The International Energy Association (IEA) has announced it will release 60 million barrels from its members' emergency oil reserves (those of Japan, Mexico, and European countries, among others) as part of a coordinated effort between the U.S. and its allies to curb rising oil prices. While this provides short-term relief, we still see output shortages in the oil market, as global inventories are low, and producers (ranging from OPEC+ members to independent U.S. shale companies) struggle with the underinvestment of recent years.

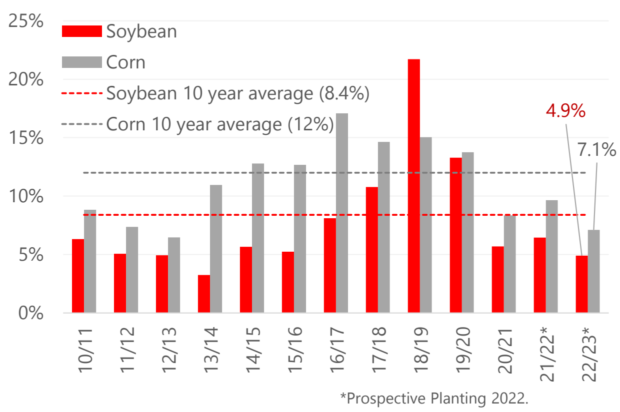
Conab cut soybean exports estimate. In its monthly report, Brazil's national supply company (Conab) reduced its forecast for Brazil's 2022 soybean exports to 77 million tons (from 80.2 million tons), following rising crushing margins domestically. Conab's estimate for local processing of the oilseed was raised to 46.5 million tons (from 42.9 million tons). Conversely, the forecast for corn exports was raised to 37 million tons (from 35 million tons) as the Russia-Ukraine conflict shifted China's demand for the grain to the U.S. and Brazil. All in all, the perception of a tight global balance remains, so that any crop issue in the Northern Hemisphere's planting season could prompt further moves in prices.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. US: Stock-to-Use Ratio in Grains - %



Sources: USDA, Santander.

INFLATION

March's IPCA registered a 1.62% MoM change, significantly above our call (1.40%) and the consensus expectation (1.35%). In year-over-year terms, the IPCA accelerated to 11.3%, highest reading since 4Q03, reinforcing the perception of a difficult disinflation scenario. As for the headline trend at the margin, it remained basically stable at 11.4% 3MMA-saar.

The main upside surprise was in administered prices, contributing with 17bps to the headline error. More specifically, gasoline prices rose 6.95% MoM. In free prices, there was an upside surprise in services (mostly inertial ones). Food-at-home also contributed for the forecast error.

Broad qualitative measures worsened at the margin. The average of the main core measures accelerated from 10.0% to 11.4% 3MMA-saar. The diffusion index receded a bit, now at 74% (seasonally adjusted), compatible with YoY inflation running at around 10% a few months from now.

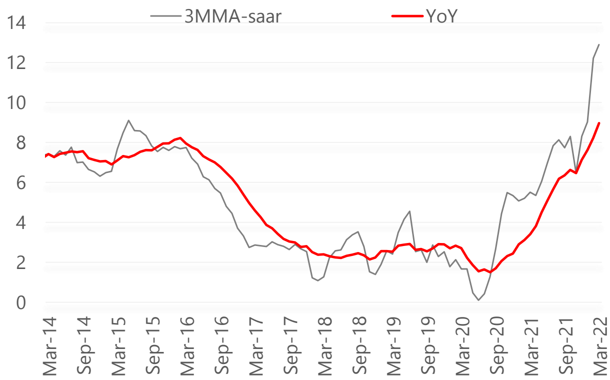
All in all, this reading reinforces our concerns about the inflation outlook. We still forecast that a clear peak should come around May 2022, but the level and composition of inflation are likely to remain sources of concern, keeping the balance of risks tilted to the upside for our year-end tracking (now running at 7.5%).

Figure 6. March's IPCA Details (% annual)

	MoM			YoY	
	Mar-22	Santander	Dev.	Feb-22	Mar-22
IPCA	1.62	1.40	0.22	10.5	11.3
Administered	2.65	2.03	0.17	15.0	14.8
Free	1.24	1.17	0.05	9.0	10.0
Food-at-home	3.09	2.82	0.04	10.1	13.7
Industrial goods	1.21	1.43	-0.05	13.0	13.4
Services	0.45	0.26	0.07	5.9	6.3
EX3 Core	1.10	1.02	0.03	8.2	9.0

Sources: IBGE, Santander.

Figure 7. Core Inflation IPCA EX3 (% annual)



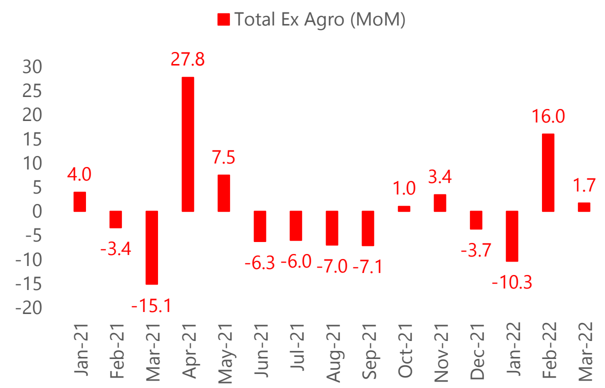
Sources: IBGE, Santander.

ECONOMIC ACTIVITY

Vehicle sales increased sequentially in March. According to Fenabrave, vehicle sales (ex-agro machinery, including motorcycles) reached 257k units in March, meaning a 2.1% YoY increase (from -7.8% in February). With our own seasonal adjustment methodology, we calculate that vehicle sales increased 1.7% MoM-sa. According to this metric, vehicle sales are still running 16% below the pre-pandemic mark (average of December 2019 to February 2020). If we exclude farm machinery and motorcycle sales, the gap between pre-pandemic readings and the current level is even larger (-39%). In the breakdown, Light Vehicles (more related to consumption) increased 1.7% MoM-sa, with Autovehicles down 6.3%, while Light Commercials were stable, and Motorcycles were up 11.5%. Moreover, Heavy Vehicles (more related to investments) contributed negatively (-1.2%). However, March's figure stemmed mainly from a decrease in Semi-Trailers (-6.5%), as the Bus and Truck segments expanded 14.6% and 0.2%, respectively. Light Vehicles remained below the pre-pandemic mark (-16.8%), while Heavy Vehicles were up by 18.8%.

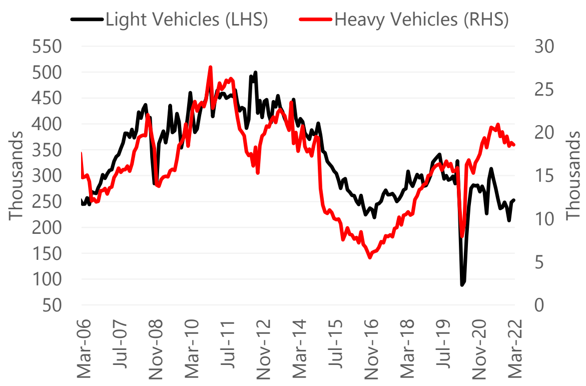
Next week is packed with economic activity releases. IBGE is expected to release the last round of economic activity data for February. On Tuesday (April 12), IBGE's Services Sector survey is due to be released, and we estimate a 0.5% MoM-sa gain (+8.8% YoY), after a 0.1% MoM-sa drop in January. On Wednesday (April 13), the Retail Sales data is due: we estimate a 0.8% MoM-sa increase for the broad index (-2.0% YoY), after a 0.3% MoM-sa drop in January. Finally, on Thursday (April 14) the BCB was scheduled to release February IBC-Br, the broad activity index. However, due to the strike of federal workers, it is possible that this publication will also be postponed, as was the case for other releases from the BCB, such as fiscal and external sector data. In any case, we forecast a gain of +0.4% MoM-sa (+0.5% YoY), compared to -1.0% MoM-sa in January. **For details on Santander's activity outlook, please refer to our last chartbook[2].**

Figure 8. Vehicle Sales (sa)



Sources: Fenabrave, Santander.

Figure 9. Vehicle Sales (sa)



Sources: Fenabrave, Santander.

[2] **Santander Brazil Economic Activity:** ***"Positive Surprises Reinforce Resilience Outlook for 2022"* –** March 14, 2022 – Available on: https://bit.ly/Std-chart-econact-mar22

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