



BRAZIL MACRO

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MACRO COMPASS

LET THE DATA IN

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- In the rolling week ended on July 7, the USD/BRL cross neared the 5.50 level at one point (peaking at 5.46), but then strengthened back to 5.34, still resulting in a small loss of 1.6% for the period. This made the BRL an intermediate performer in the basket with the 31 most liquid currencies in the world. In our opinion, the eleventh-hour respite stemmed from news on the latest economic stimulus in China (Brazil's top export destination), which helped the BRL (at least temporarily) escape from its high-beta pattern in the context of a globally stronger USD.
- In a rather volatile week for Brazilian assets, nominal rates sold off (about ~10-15 bps across the curve) on the heels of a weakening global risk appetite and increased caution about the domestic fiscal outlook. We continue to believe that the worsening of fiscal risks is just another element conspiring to result in a probable steepening in the yield curve, in the context of peaking local inflation and interest rates, and amid a process of global yields trending higher.
- Commodity prices had a highly volatile week, selling off early on — owing to growing global recession fears — but seeing a respite at week's end, after the announcement of a new stimulus package in China. However, the Bloomberg Commodity Index stood in red-ink territory for the rolling week ended July 7. This means the fourth weekly decline, making it the longest losing streak since March 2020. In USD terms the index fell 1.7%; in BRL terms, the index rose +1.2% on the back of weakening Brazil FX.
- The Lower House's floor voting of the legislation aimed at boosting federal social spending was postponed to next Tuesday (July 12). That will imply BRL41 billion in expenses above the constitutional limit in 2022. Because it is a constitutional amendment, the legislation will be enacted directly after a probable House clearance (no presidential signing is required).
- Industrial output edged up 0.3% MoM-sa (+0.5% YoY) in May, recording the first positive YoY print since July 2021 and marking an encouraging streak of four consecutive gains. However, the index remains 1.1% below February 2020's (pre-COVID) reading. The Brazilian Central Bank's (BCB) monthly GDP proxy (IBC-Br) contracted by 0.44% MoM-sa in April (our estimate: -0.3%), following the 1.1% MoM-sa jump in March. Our 2Q22 GDP growth forecast was slightly upgraded to +0.6% QoQ-sa (from +0.5% previously), adding upside risks to our current 2022 GDP growth projection of +1.2%. For the coming week, IBGE will release tertiary sector data for May. We expect the services sector to expand 0.2% MoM-sa and broad retail sales to gain 0.4% MoM-sa. Moreover, the BCB will release its monthly GDP proxy (IBC-Br) for May, and we expect stability in sequential terms (0% MoM-sa).
- June's IPCA registered a 0.67% MoM change, in line with our call (0.69%) and a bit below the consensus expectation (0.71%). With this result, the headline trend saw slight relief, to 13.0% 3MMA-saar. In year-over-year terms, the IPCA rose to 11.9% (from 11.7%). The report reinforces our view that inflation has peaked in YoY terms, but the pace of disinflation is still uncertain, as recent fiscal decisions could lower short-term inflation but create more upward pressure on inflation in the medium term.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.

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- Following the end of the strike of BCB workers, the monetary authority is gradually normalizing the flow of data that has not been published for the last couple of months. As part of this process, the BCB has updated its weekly Focus report among professional forecasters. The latest numbers, dating from July 1, show the median IPCA forecast at 7.96% for 2022 (last update, from the Copom statement: 8.5%). For 2023, the most relevant monetary policy horizon currently, analysts now estimate IPCA at 5.01% (last update, from the Copom statement: 4.7%). The latter suggest upside risks for the BCB's inflation simulations going forward. In the last print, the BCB saw the IPCA at 4.0% assuming a Selic at 13.25% for YE2022 and 10.00% for YE2023. The BCB also calculated next year's inflation at 3.7% assuming an even Selic path at 13.25% all the way to the horizon. Median Selic rate expectations remained at 13.75% for YE2022 but increased to 10.50% for YE2023. Our bottom-line conclusion is that the Focus data (alongside the strong employment numbers of late and a new round of fiscal stimulus) imparts further upside risk for the terminal level of the Selic rate in this cycle (our call of 13.50% is under revision).

Most of the information in this report is up to the end of Thursday, July 07, 2022.



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

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Services Volume (% MoM)	IBGE	May/22	Tue, 12-Jul	0.2	0.2
Services Volume (% YoY)	IBGE	May/22	Tue, 12-Jul	8.5	9.4
Core Retail Sales (% MoM)	IBGE	May/22	Wed, 13-Jul	0.4	0.9
Core Retail Sales (% YoY)	IBGE	May/22	Wed, 13-Jul	1.0	4.5
Broad Retail Sales (% MoM)	IBGE	May/22	Wed, 13-Jul	0.4	0.7
Broad Retail Sales (% YoY)	IBGE	May/22	Wed, 13-Jul	0.0	1.5
IBC-Br Activity Index (% MoM)	BCB	May/22	Thu, 14-Jul	0.0	-0.4
IBC-Br Activity Index (% YoY)	BCB	May/22	Thu, 14-Jul	2.8	2.2
Primary Budget Balance (BRL billion)	BCB	May/22	n.a.*	-26.5	39
Net Debt (% GDP)	BCB	May/22	n.a.*	58.4	58
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

* These data releases have been postponed in the context of the strike of BCB workers, and still have not been rescheduled, as yet.

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Review¹.

¹ Santander Brazil – Scenario Review: “A Bittersweet Scenario” – June 02, 2022- Available on: <https://bit.ly/Std-scenreview-jun22>



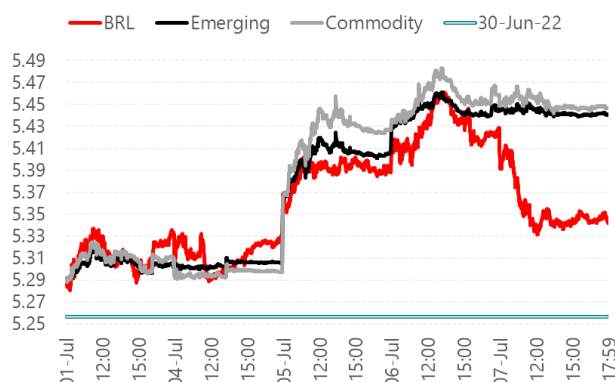
LOCAL MARKETS—FX

In the rolling week ended on July 7, the USD/BRL cross neared the 5.50 level at one point (peaking at 5.46), but then strengthened back to 5.34, still resulting in a small loss of 1.6% for the period. This made the BRL an intermediate performer in the basket with the 31 most liquid currencies in the world. In our opinion, the eleventh-hour respite stemmed from news on the latest economic stimulus in China. On Thursday morning (July 7), the Chinese government announced measures to support the infrastructure sector there, which helped the performance of commodity prices and led to some correction of the global strengthening of the USD seen in the last week. We believe the better (perceived) outlook for Brazil's main export destination helped the BRL (at least temporarily) escape from its high-beta pattern, in a period when the USD reached its strongest level in ~20 years (versus G10 currencies). The BRL stood out as a top performer in the trading session of July 7 and managed to end the period with a better performance than emerging and commodity currencies. For technical reasons, the BRL could have been a frontrunner in the recent global weakening against the USD, and, consequently, the room for further weakening of the BRL under current conditions (or economic expectations) could be limited.

LOCAL MARKETS—Rates

In a rather volatile week for Brazilian assets, nominal rates sold off (about ~10-15 bps across the curve) owing to a weakening global risk appetite and increased caution about the domestic fiscal outlook. Since last Thursday (June 30), the front end of the curve (Jan-24 DI future) rose 14 bps, to 13.52%, while the back end of the curve (Jan-27 DI future) rose 8 bps to 12.73%. The curve's steepness in this segment fell 6bps, with the inversion now reaching -79bps. The week-over-week changes conceal a good deal of volatility in recent days, as the recent improvement in risk appetite — on hopes that a new round of Chinese economic stimulus will pare downside risks for global activity — prompted a small rally later in the week, and that partly offset the impact of a souring mood among international investors. This bad mood follows fears of a recession that major central banks may have to produce so as to curb (multi-decade high) consumer inflation. On the domestic side, financial markets remain wary about the budgetary impact of a new round of fiscal stimulus (now seeing the last stages of the congressional approval process). We continue to believe that the worsening of fiscal risks is just another element conspiring to result in a probable steepening in the yield curve, in the context of peaking local inflation and interest rates, and amid a process of higher global yields.

Figure 2. USD/BRL – Intraday trends

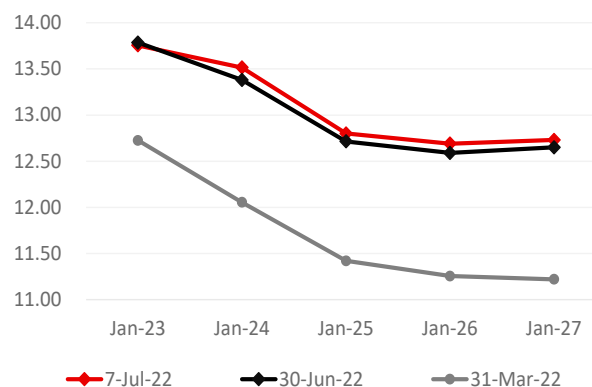


Sources: Bloomberg, Santander.

Note 1: As of the close on Thursday, July 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.



COMMODITIES

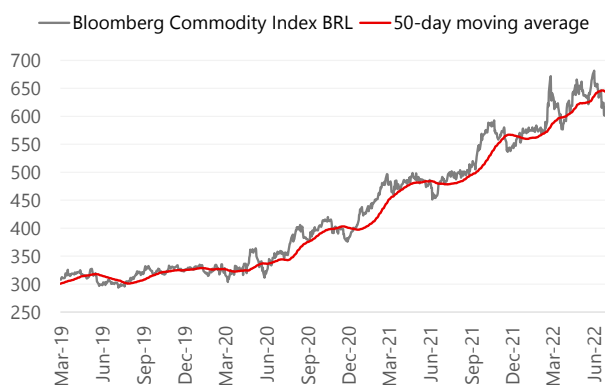
Commodity prices had a highly volatile week, selling off early on — on the heels of growing recession fears — but seeing a respite at week's end, after the announcement of a new stimulus package in China. However, the Bloomberg Commodity Index stood in red-ink territory for the rolling week ended July 7. This means the fourth weekly decline, making it the longest losing streak since March 2020. In USD terms the Bloomberg Commodity Index ended up falling -1.7%, with the greatest decline in subcomponents being in Agriculture (-4.8%), followed by the Industrial Metals Subindex (-2.7%). The Energy Subindex moved in the other direction (+1.6%). In BRL terms, however, the index rose 1.2% on the back of a weakening in the Brazilian currency (composition: Agriculture -2.1%, Metals +0.1%, and Energy +4.4%).

Brent oil prices traded below USD100 /bbl for a while, but swung back to USD105 /bbl. The growing fear of recession in the U.S. — and possibly globally — was the main theme early this week, pushing oil to trade below USD100 /bbl. However, by the end of the week, news about the latest economic stimulus in China pushed commodity prices higher, including oil. Additionally, the imbalance between spot supply and demand also helped lead to a recovery in oil prices: the time-spread (difference between first and second month oil futures contracts) is at the highest level since March, as inventories are running at minimum levels.

Agriculture commodity prices followed the same pattern as energy: a decline at the beginning of the week and then a rebound. Yet, unlike energy, the rebound was not enough to prompt gains for the week. Recession worries also were the main driver of the decline in agriculture commodity prices at first. During the rebound, however, the agricultural sector had another driver besides China's stimulus: weather forecasts have worsened, particularly for the U.S. and Europe, adding risks of further deterioration in the supply-demand imbalance that has driven prices higher of late.

In metals, despite being more linked to China's stimulus, the relief by the end of the week also was not enough to offset the initial decline in prices. Iron ore, particularly, was supposed to be one of the commodities that would benefit most from the announcement of China's economic stimulus. Nevertheless, even with Wednesday's and Thursday's recovery, the metal ended up at USD114.9/MT vs. USD119.4 /MT as of June 30.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. Time-Spread: Difference Between First and Second Month Oil Futures Contracts



Sources: Bloomberg, Santander.



INFLATION

June's IPCA registered a 0.67% MoM change, in line with our call (0.69%) and a bit below the consensus expectation (0.71%). With this result, the headline trend saw slight relief, to 13.0% 3MMA-saar. In year-over-year terms, the IPCA reached 11.89%, which reinforces our view that the April reading (of 12.13% YoY) was the peak in this cycle.

Compared to our forecast, surprises to the downside came in regulated prices (-7 bps contribution for the headline forecast error), particularly in electricity and fuels, as the recent tax cuts approved by the Congress had a faster impact than we anticipated. Small upside surprises were scattered between services (+2 bps of contribution for the headline forecast error), industrial goods (+2 bps of contribution for the error) and food-at-home (+2 bps of contribution for the error).

Trend-wise, industrial goods saw its first material relief since the end of 2020, reaching 13.5% 3MMA-saar (from 15.4%); its core gauge also cooled down a bit, going to 15.8% 3MMA-saar (from 17.7% previously). Food-at-home and regulated prices also decelerated in trend terms at the margin. We expect the inflation from those three groups—more related to volatile prices—to continue to decline from now on. On the negative—but expected—side, services continued to accelerate, reaching 13.3% 3MMA-saar (from 11.0%), with the core going to 11.8% 3MMA-saar (from 10.8%). This group is still lagging the other sectors upward price adjustments and should still accelerate for a few more months until it reverts to a deceleration.

In qualitative terms, the report was unfavorable from the monetary policy standpoint, although we highlight some marginally positive news. Some core gauges decelerated in trend terms and the average of the main five cores seem to be no longer accelerating at the margin (although it continued at the high level of 13% 3MMA-saar). Moreover, the diffusion index fell to 71.1% s.a. (from 75.5% previously), even as this still means a high dissemination of inflation pressures, from a historical perspective.

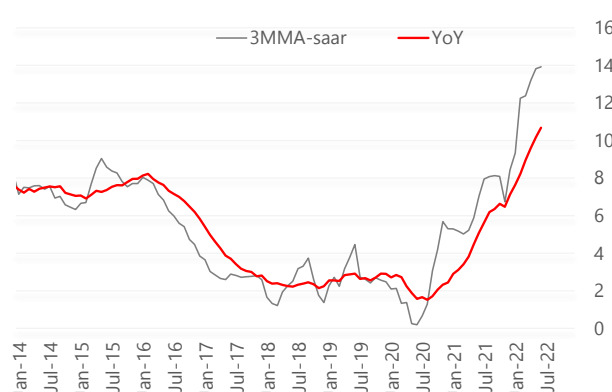
All in all, we believe the report reinforces our view that inflation has peaked in YoY terms, and the recent tax cut measures approved by Congress give us even more confidence in that regard, as the tax cuts will push prices downward in the short term. For the medium term, however, we remain cautious about the pace of deceleration, as some taxes are likely to be reinstated next year; besides that, the tax cut measures, and the new round of income aid (fiscal expansion,) could support demand and thereby keep upward pressure on inflation in the medium term.

Figure 6. June's IPCA Details (%)

	MoM			YoY	
	Jun-22	Santander	Contrib.	May-22	Jun-22
IPCA	0.67	0.69	-0.02	11.7	11.9
Administered	0.48	0.74	-0.07	12.1	11.7
Free	0.74	0.67	0.05	11.6	11.9
Food-at-home	0.63	0.52	0.02	16.3	16.7
Industrial goods	0.58	0.51	0.02	14.0	13.7
Services	0.90	0.85	0.02	8.0	8.7
EX3 Core	1.01	0.83	0.06	10.2	10.7

Sources: IBGE, Santander.

Figure 7. Core Inflation – IPCA EX3 (%)



Sources: IBGE, Santander.



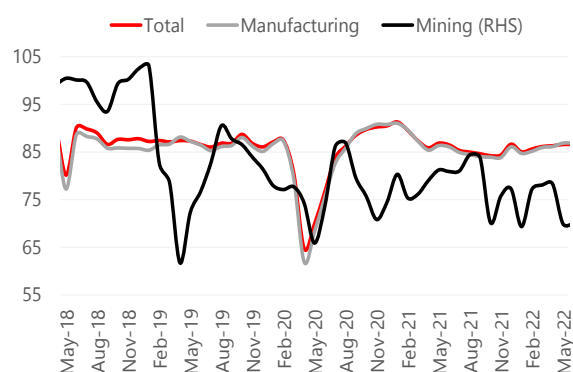
ECONOMIC ACTIVITY

Industrial production expanded for the fourth month in a row. The headline index edged up 0.3% MoM-sa in May, in line with our expectations (+0.3%) and below market consensus (+0.6%). Compared to the same month of 2021, industrial output inched up 0.5% YoY, marking the first positive YoY print since July 2021. May's figure marked an encouraging streak of four consecutive gains; however, the index remains 1.1% below February 2020's reading (our pre-pandemic mark). This result reflected the continued strengthening of manufacturing (+0.8% MoM-sa), the fourth gain in a row, at the same time as mining tumbled at the margin (-5.6% MoM-sa). The diffusion index rose to 73% (vs. 62% previously), with 19 of 26 industrial activities surveyed growing at the margin. Following the tepid start to the quarter, May's figure implies a solid 1.0% carryover to 2Q22, suggesting a continued positive contribution from industry to overall activity in the short term. [See details in the link².](#)

BCB's monthly GDP proxy shrank at the start of 2Q22. The IBC-Br inched down 0.44% MoM-sa in April (slightly below our estimate of -0.3%), following a 1.09% MoM-sa jump in March. Compared to the same month of 2021, broad activity gained 2.2% YoY in April, following 2.6% YoY growth in March. Despite the slight decline at the margin, April's figure implies a 0.5% carryover to 2Q22, reinforcing the likelihood of new sequential growth of broad activity in 2Q22. Our 2Q22 GDP tracking was slightly upgraded to +0.6% QoQ-sa (from +0.5%), which implies significant upside risks to our 2022 GDP growth forecast of +1.2%. [See details in the link³.](#)

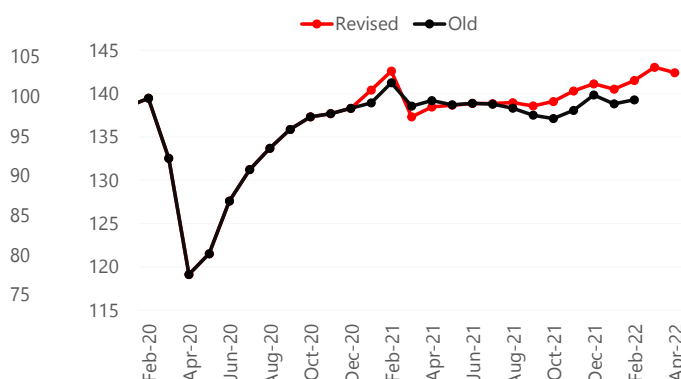
In the coming week, IBGE will release the tertiary sector data for May. The services sector's real revenue data is scheduled to be released on Tuesday (July 12), and we expect growth of 0.2% MoM-sa. Broad retail sales data is due out on Wednesday (July 13), and we expect an increase of 0.4% MoM-sa. Moreover, the BCB will release its monthly GDP proxy (IBC-Br) for May on Thursday (July 14), and we expect stability in sequential terms (0% MoM-sa). [For details on Santander's economic outlook, please refer to our last chartbook⁴.](#)

Figure 8. Industrial Output (sa, average 2012=100)



Sources: IBGE, Santander.

Figure 9. IBC-Br (sa, average 2003=100)



Sources: BCB, Santander.

² Santander Brazil Economic Activity: "A Mixed Bag for Industry in May" – July 5, 2022 – Available on: <https://bit.ly/Std-econact-070522>

³ Santander Brazil Economic Activity: "A Tepid Start to 2Q22" – July 7, 2022 – Available on: <https://bit.ly/Std-econact-070722>

⁴ Santander Brazil Economic Activity: "Chartbook – Upward Revisions in 2022, Concerns Regarding 2023 Intensify" – June 14, 2022 – Available on: <https://bit.ly/Std-chart-econact-jun22>

Santander Brazil Special Report: "A Model to Forecast Probability of Recession in Brazil" – June 08, 2022 – Available on: <https://bit.ly/Std-special-060822>

Santander Brazil Special Report: "Resilience Factors for GDP Growth: What Has Changed Since January" – June 30, 2022 – Available on: <https://bit.ly/Std-special-GDP-062922>



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