BRAZIL MACRO

July 8, 2021

MACRO COMPASS

BRAZILIAN ASSETS SELL OFF

Ana Paula Vescovi* and
Brazil Macroeconomics Team
anavescovi@santander.com.br
+5511 3553 8567

- The BRL has been the underperformer among major currencies, with the Brazilian FX rate ending the trading session of July 7 at USD/BRL 5.23, about 3.5% weaker than on July 1 (reference date for our previous report). The selloff follows the higher volatility in global markets and additional jitters about domestic politics. Concerns about the local policy outlook also prompted a (nearly parallel) selloff in nominal yields, despite the bull steepening seen in U.S. Treasuries in the same period.
- Our proxy for a nation-wide average ICU occupancy rate has declined to 69%, the lowest level since early February. That number compares to a previous peak of 92%. Additionally, the vaccination pace is holding up above 1 million/day, reaffirming a positive outlook for 2H21. This backdrop is allowing some local governments to ease mobility restrictions further.
- As widely expected, the government extended the Emergency Aid stipend for three months (until October). This means an additional BRL20 billion in extraordinary budget, not be subjected to the constitutional spending cap. We calculate the total “extra-cap” spending at BRL135 billion for 2021 (1.6% of GDP).
- June’s IPCA registered a 0.53% MoM change (8.35% YoY), above/below the market’s median expectation of 0.59% and our estimate of 0.55%. The headline trend remained at 9.0% in 3mma-saar terms, showing that upward inflation pressure remains strong. Underlying prices trends continue to run well above the BCB’s target, keeping the odds for a 100-bp Selic hike in August COPOM.
- The broad retail sales index climbed 3.8% MoM-sa, below median expectations (4.7%) and our estimate (5.5%). Despite the negative headline surprise, we see more widespread growth, as nine of the ten retail categories posted monthly gains, possibly reflecting the new round of fiscal stimulus (Emergency Aid).
- For the coming week, we will see the release of the last batch economic activity indicators for May. On Tuesday (July 13), IBGE will release the figures for the services sector. We expect a 1.3% MoM-sa growth for the services volume (22.8% YoY). On Wednesday (July 14), the BCB will release its broad activity index (IBC-Br), for which our tracking currently indicates a 1.1% MoM-sa expansion (16.1% YoY). All in all, the May numbers are expected to reaffirm a sequential recovery into 2Q21, past a pandemic-induced contraction in March.

Most of the information in this report is up to the end of Wednesday, July 07, 2021.

Figure 1. Brazil Macro Agenda for the Week of July 12-16, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Services Volume (% MoM)	**IBGE**	**May/21**	**Tue, 13-Jul**	**1.3**	**0.7**
Services Volume (% YoY)	IBGE	May/21	Tue, 13-Jul	22.8	19.8
IBC-Br Activity Index (% MoM)	**BCB**	**May/21**	**Wed, 14-Jul**	**1.1**	**0.4**
IBC-Br Activity Index (% YoY)	BCB	May/21	Wed,14-Jul	16.1	15.9
Inflation: IGP-10 (% MoM)	FGV	**Jun/21**	Fri, 16-Jul	--	2.32

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario:** ***"Improvement in The Short Term, Caution for The Medium Term" –*** Jul 01, 2021- Available on: http://bit.ly/Std-scenrev-070121

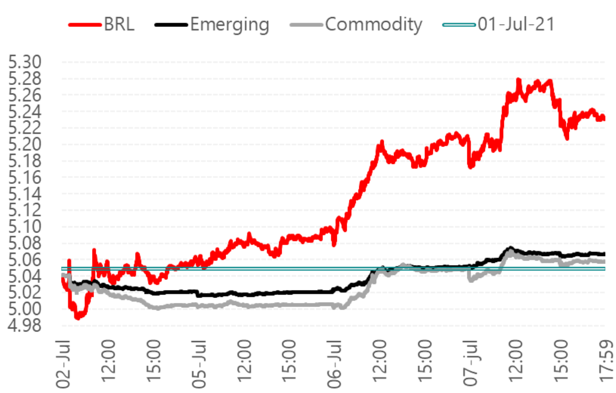
LOCAL MARKETS—FX

The substantial weakening of the BRL observed between July 7 and July 1 (reference date of the previous edition of this report) reinforced our view about the frailty of the recent improvement observed in market sentiment about fiscal risks in Brazil. The BRL registered the worst performance among major currencies during the period, as it closed at 5.23 from 5.05 on July 1 (3.5% weaker). We reckon that part of the move had to do with the higher volatility of asset prices on the international front, probably stemming from technical issues—in our view, the news cycle abroad was muted these days—but the trigger for the move seemed us to be the recent news flow and the resulting jitters on the domestic political front, which could potentially spill over in budget policies and the debt outlook. Therefore, notwithstanding the better-than-expected fiscal statistics in recent months, we believe the skepticism regarding the medium-term outlook is a factor that may not only hinder a perennial and substantial strengthening of the BRL, but it may also be a reason for some profit taking/stop-losses as observed in the last days.

LOCAL MARKETS—Rates

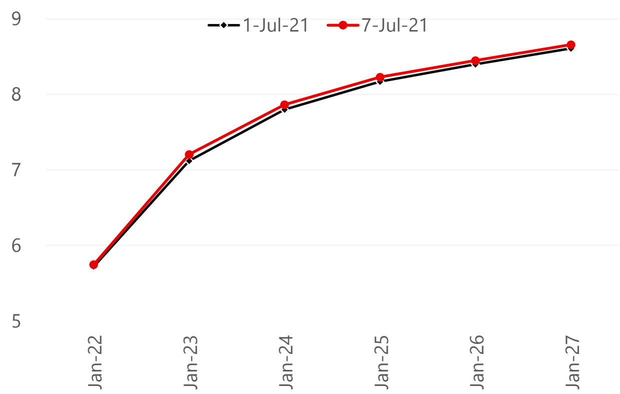
The local yield curve sold off (with yields going higher nearly in parallel), despite a remarkable bull flattening of US yields. Since last Thursday (July 1), the front end of the curve (Jan-23 DI future[2]) rose 8 bps to 7.20%, while the back end of the curve (Jan-27 future) rose 6 bps, to 8.67%. As a result, the curve's steepness in this segment fell 2 bps, reaching 147 bps. Despite lower-than-expected IGP-DI inflation for June and also weaker-than-expected retail sales data (see Economic Activity section for details), the front end of the curve rose. The movement was possibly influenced by the weaker BRL (reasons are detailed in the FX section), which could mean lesser downside risks for IPCA inflation, prompting the market to price in a higher probability of a more hawkish move by the BCB in the next COPOM meeting. Indeed, after reaching a minimum of 42% last Tuesday (June 29), the implied probability of a 100-bp Selic hike in the options market rose back to 55%, with the probability of a 75-bp hike falling from a maximum of 49% last week to 37% now. Finally, the domestic long-end yield rose a bit, detaching from the remarkable rally of the 10-year US Treasuries yield (15 bps lower when compared to last week's average), backed by the continuation of political frictions that support the re-building of some premium.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, July 7, 2021.
Note2: For other currencies, we use USDBRL values as a base-index

Figure 2.B. – Brazilian Domestic Yield Curve (% p.a.)



Sources: Bloomberg, Santander.
Note: As of the close Thursday, July 7, 2021.

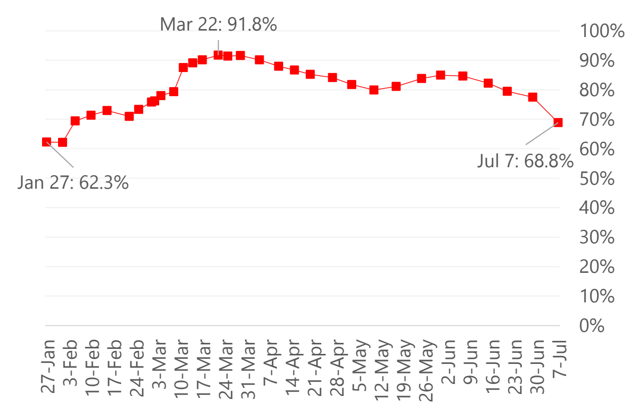
[2] To better reflect the monetary policy horizon, we are now changing our analysis of the front end of the curve from the Jan-22 DI Future to the Jan-23 (last trade date at December 29, 2022).

COVID-19 MONITORING

Brazil's vaccination pace continues to hold up above the 1 million/day mark. We expect the daily average pace of vaccination to stand at 1.5 million doses in 2H21, as vaccine inventories remain high (37 million doses) and deliveries continue to outpace vaccine administration. Importantly, *Butantan* announced it expects to fulfill its plan of 100 million doses produced by the end of August (the previous schedule called for the end of September). **Our proxy for a nation-wide average ICU occupancy rate[3] has declined to 69%, the lowest level since early February. That number compares to a previous peak of 92%.** For the first time in 2021, all Brazilian states have an occupancy rate below 90%. As pointed out last week, we believe that the decline in both casualties and hospitalizations suggests that vaccines could be starting to take effect in preventing severe COVID-19 cases, especially among the elderly (prioritized in the immunization schedule). To that effect, some local governments will probably continue to ease restrictions. That is the case for the state of São Paulo, where businesses will be allowed to operate until 11pm (effective July 9). Data from Brazil's Health Ministry showed an average of 49k new daily cases (7-day moving average) as of Tuesday (July 6), down 25% from last week, while daily casualties (7-day moving average) totaled 1,558, down 3% in the same period.

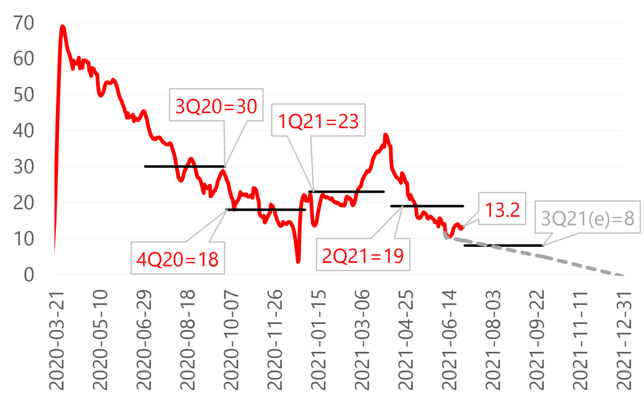
Mobility stable in the last update. After a retreat in mid-June, mobility levels have slightly increased, with our lockdown index now moving to 13.2 points (as of June 30, 2021). This move stems mainly from a mobility increase in Parks, while Workplaces, Groceries and Transit Stations experienced a decrease. Yet the Workplace segment still stands at the pre-pandemic mark. The pace of reopening continues to move lower versus the start of 2Q21. **Our daily activity index continued to improve in June, but not enough to avoid a sequential quarterly drop.** The index—based on daily data on energy consumption, car sales, and mobility—has been improving since the start of 2Q21, showing an upward trend in recent months. On a monthly basis, adjusted for seasonality, the index expanded by 5.6% and 3.0% in April and May, respectively. The dataset for June has been closed, and the index climbed 4.6%. Yet these gains are still not enough to fully offset March's retreat (of 15.1%), placing the index at readings still 3.3% below February 2021. With the June result, the index posted a 2.4% QoQ-sa drop in 2Q21.

Figure 3.A. – National Average ICU Occupancy (%)



Sources: @coronavirusbra1, Santander.

Figure 3.B. – Lockdown Index*, Mobility Forecasts (Feb/20=0, 7-day average)



Sources: Google, Santander.
* This index is built as an average of selected segments from Google Mobility Report with inverted scales. Data are available until June 30, 2021.

[3] The national average is a weighted average (by state population) of state ICU occupancy rates. Hence, it does not reflect the actual national occupancy rate = Total beds occupied in Brazil / Total beds available in Brazil.

FISCAL POLICY AND POLITICS

As widely expected, the government extended the Emergency Aid stipend for three months (until October), through a presidential decree published on Monday (July 5). The decree is effective immediately and will not need congressional confirmation. According to government officials, a decision to extend the aid is contingent on the expected advance of vaccination rollout in the country. The government stated that it expects the entire adult population to have been vaccinated with a first dose by the end of 3Q21. In our fiscal projections, we were already considering the possibility of extending the welfare program (totaling seven months in 2021), due to lower-than-expected disbursements from the Emergency Aid program in recent months. This new extension of the welfare program will require an additional BRL20 billion in extraordinary budget expenditures, meaning this new amount will not be subjected to the constitutional spending cap rule. Counting on this new initiative, we now estimate the total "extra-cap" spending at BRL135 billion for 2021 (1.6% of GDP).

This number already takes into account that the government will use the expected final remaining balance (~BRL8 billion) of the budget approved in the *PEC Emergencial*, in order to extend the program up to October. Until June, spending on new emergency aid reached BRL27.4 billion. This means that the federal transfers to low-income families are totaling ~BRL9 billion per month. That is, the monthly disbursements for the social program are lower than initially planned by the government (BRL11 billion per month). The program is currently reaching ~39.2 million people, a number lower than originally expected by the government (~45 million people, considering the total resources available).

With the end of the Emergency Aid program, we believe that the government will draft a revamped new welfare program during that period, to also add part of the beneficiaries of the emergency stipend that are not included in *Bolsa Família*. A new version of this flagship program could cost an additional BRL15 billion per year (this year's budget for the program was BRL35 billion), and would be subject to the spending cap in coming years. We believe that there will be political pressure for a higher budget, so the government needs to limit the total amount budgeted for the new program. For 2021, the extra spending (subject to the spending cap limit) after November is feasible due to the savings of the original *Bolsa Família* 2021 budget (of ~BRL18 billion), with migration of its beneficiaries to emergency aid during the months of April to October, which should be partially used to increase the social program in 4Q21. The new welfare program needs to be approved by Congress and enacted by December, given that increases in these types of expenditures are legally forbidden in election years.

For details on Santander's fiscal policy scenario, please refer to our last chartbook[4].

Figure 4.A. – 2021 "Extra-Cap" Spending Tracker

BRL Billion - Accumulated	Apr-21	May-21	Jun-21	Total Budgeted	Executed
Emergency Aid (MP 1.037/2021)	9.7	18.6	27.4	44.9	**61.0%**
Health expeditures	5.1	9.1	9.7	15.9	**60.9%**
BEm - Employment Program (MP 935/220 and MP 1.044/2021)	0.6	2.1	4.0	11.7	**33.8%**
Turism Infraestructure (MP 963/2020)	0.4	0.4	0.4	1.9	20.3%
Vaccine Acquisition (MP 994, 1,004 and 1,015/2020)	4.6	6.4	8.0	27.8	28.8%
Pronampe (credit support for SMEs) (MP 1,053, 1,023)	0.0	0.0	0.0	5.0	0.0%
Accumulated Total	20.5	36.6	49.4	107.1	46.1%

Updated in 07/01/2021

Sources: National Treasury, Santander.

Figure 4.B. – Expected "Extra-Cap" Expenses

Covid related expenditures - 2021	BRL billion
Emeregency Aid (*PEC Emergencial*)	45
Extension of the Aid until October (3 months)	20
Vaccine Acquisition (2020 Leftovers)	22
Health Expenditures	20
2020 War Budget Leftovers	13
Pronampe 2021 (credit support for SMEs)	5
BEm 2021 (formal job suport program)	10
TOTAL	135
Estimate of final execution in 2021 (85%)	115

Sources: National Treasury, Santander.

[4] **Santander Brazil Fiscal Policy - *"CHARTBOOK - Fiscal Policy: A Better Short Term, Caution On The Outlook"* –** July 07, 2021- https://bit.ly/Std-chart-fiscal-jul21

INFLATION

June's IPCA registered a 0.53% MoM change (8.35% YoY), below the market's median expectation of 0.59% and basically in line with our call of 0.55%. The headline trend remained at the high level of 9.0% in 3mma-saar terms, showing that the upward pressure at the margin remains strong.

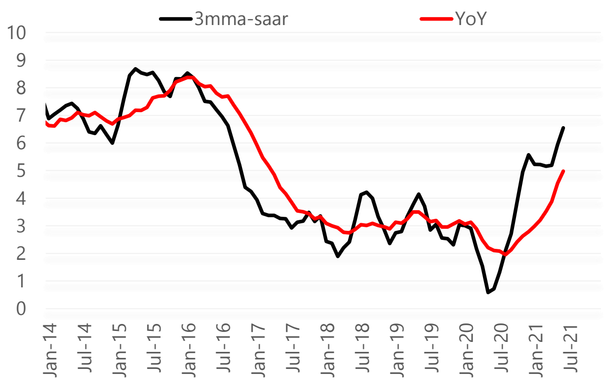
Qualitative measures were, once again, notably unfavorable, with core trends and diffusion index still upwardly pressured. The average of core measures advanced from the already-high level of 5.9% to 6.5% in 3mma-saar terms. The cores have been hovering above 4.5% for nine months, a notably high level that in our view is a sign of a spreading of the primary shocks to general prices. Also in that regard, the diffusion index—a leading indicator for annual headline inflation—stood at 66.8% (seasonally adjusted), a reading we see compatible with IPCA around 9.0% YoY a few months from now. The latter is based on the historical relationship between the diffusion index and headline CPI, which reinforces the risk of the spreading of primary shocks to general prices.

Figure 5.A. – June's IPCA Details (%)

	MoM			YoY	
	Jun-21	Santander	Contrib.	May-21	Jun-21
IPCA	0.53	0.55	-0.02	8.1	8.3
Administered	0.81	1.07	-0.07	13.1	13.0
Free	0.43	0.37	0.04	6.3	6.8
Food-at-home	0.33	0.09	0.04	15.4	15.3
Industrial goods	0.79	0.74	0.01	8.3	8.8
Services	0.23	0.25	-0.01	1.7	2.2
EX3 Core	0.55	0.46	0.09	4.5	5.1

Sources: IBGE, Santander.

Figure 5.B. – Core Inflation (IPCA EX3, %)



Sources: IBGE, Santander.

ECONOMIC ACTIVITY

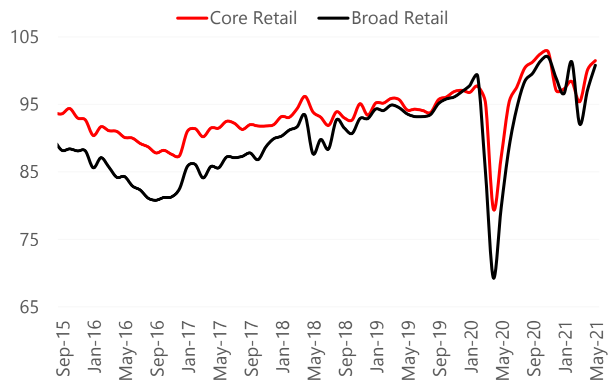
Retail activity negatively surprised in May but still posted solid growth. The broad retail index climbed 3.8% MoM-sa, below median expectations (4.7%) and our call (5.5%). This positive figure comes on the heels of the previous increase (+5.4% in April, revised up from +3.8%). Regarding the core index (which excludes auto sales and building materials), the index expanded 1.4% — also below both market consensus and our expectation (+2.3% and +2.9%, respectively). Zooming in on the details, we see a widespread growth, despite the negative headline surprise. Nine of the ten retail categories posted monthly gains, with income-led segments driving May's growth (+1.6% MoM-sa), as credit-led segments also posted solid expansion (+0.9% MoM-sa). The supermarket segment was primarily responsible for the negative surprise, as the 1.0% MoM-sa growth was insufficient to offset April's drop (-1.4%) despite the introduction of a new round of the Emergency Aid. We highlight growth in clothing (+16.8%), fuels (+6.9%), and building (+5.0%). Vehicles posted 1.0% MoM-sa growth, after considerable gains in April (+20.3%). See details in the link[5].

Looking ahead, our proprietary indicator (IGet) points to a sequential drop of broad retail sales in June, mainly driven by supermarkets and clothing. Moreover, according to Fenabrave, vehicle sales also dropped in June. Based on this information set, our tracking of broad retail sales for June stands at -0.6% MoM-sa (15.4% YoY). For core retail sales, our tracking indicates near stability (+0.1% MoM-sa). See details in the link[6].

Services to families seem to have grown additionally in June. According to our proprietary indicator (IGet), services to families expanded in June, mainly in the first half of the month. Our tracking of services to families for June stands at +1.4% MoM-sa and +86.1% YoY. See details in the link[7].

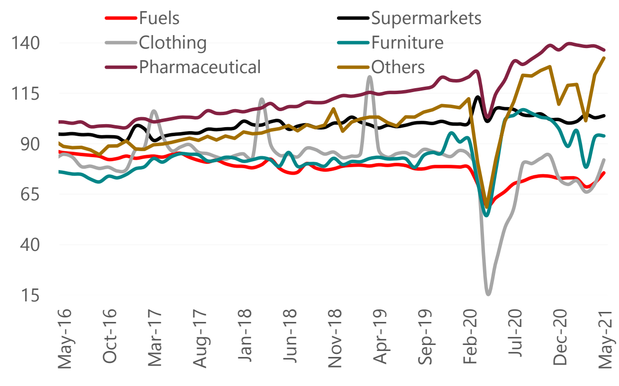
For the coming week, we will see the release of the last batch economic activity indicators for May. On Tuesday (July 13), IBGE will release the May figures for the services sector. We expect a 1.3% MoM-sa growth for the services volume (22.8% YoY). On Wednesday (July 14), the BCB will release its broad activity index (IBC-Br), for which our tracking currently indicates a 1.1% MoM-sa expansion (16.1% YoY). **For details on Santander's activity outlook, please refer to our last chartbook[8].**

Figure 6.A. – Retail Sales (sa, 2014=100)



Sources: IBGE, Santander.

Figure 6.B. – Core Retail Sales (sa, 2011=100)



Sources: IBGE, Santander.

[5] **Santander Brazil Economic Activity - *"Widespread Retail Sales Growth despite Negative Headline Surprise"* –** July 07, 2021 - Available on: https://bit.ly/Std-Econact-070721

[6] **Santander Brazil Economic Activity - *"Varejo desacelera em junho"* –** July 05, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGET-jun21

[7] **Santander Brazil Economic Activity - *"Serviços continuam crescendo em junho"* –** July 05, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGETser-jun-21

[8] **Santander Brazil Economic Activity - *"Chartbook – Better Outlook Due to Mobility and Commodities"* –** July 6, 2021 - Available on: https://bit.ly/Std-chart-econact-jul21

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research			
Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327
Global Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500
Fixed Income Research			
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Equity Research			
Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511 3553 1684

Electronic	
Bloomberg	SIEQ <GO>
Reuters	Pages SISEMA through SISEMZ