Santander
Macroeconomic Research

# BRAZIL MACRO

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## MACRO COMPASS

# A TEPID START FOR THE BROAD ECONOMY IN Q3

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- The USD/BRL pair closed the rolling week ended September 9 at 5.21, posting a 0.4% loss, meaning an intermediate performance amid a basket of 32 of the most liquid currencies in the World. That apparently “neutral” FX performance hides a true rollercoaster ride in recent days on the heels of domestic uncertainties. Additionally, a worrisome IPCA report for August prompted the market to revise higher expectations for Selic hikes in the next Copom meetings, prompting a considerable bear-flattening in nominal yields.
- Despite the looming risks from the Delta variant, the pandemic numbers continue to gradually improve in Brazil. The 7-day average of infections stood at 17k as of Wednesday (September 8), down 21% from last week to the lowest level since November 2020. As for casualties, the 7-day average stood at 467, down 27% on the same comparison and the lowest level since December 2020. The downward trend is significant even if controlling for the impact of a national holiday on September 7.
- August’s IPCA registered a 0.87% MoM change (9.68% YoY), considerably above our call and consensus, both at 0.71%. In particular, core services advanced to 7.3% 3MMA-saar and the diffusion index rose to 74%, close to an all-time high of 78% seen in 2015-2016. The report confirms the unfavorable inflation conditions in the short-term and reaffirms a worsening outlook for the medium term.
- Broad retail sales surprised to the upside in July by expanding +1.1% MoM-sa, well above market consensus (-0.5%). However, according to our proprietary indicator (IGet), some segments of the tertiary sector dropped in August: the indexes for broad retail sales and services to families were down by 4.5% and 7.9%, respectively. But out trackers for the official IBGE data suggest a likely shift of consumer spending back into services.
- For the coming week, the BCB will release the IBC-Br (monthly GDP proxy) for July (due on September 15) and we expect a monthly retreat of 0.2% MoM-sa. IBGE will release the services sector data for July (due on September 14) and we expect monthly growth of 0.6% MoM-sa.

***Most of the information in this report is up to the end of Thursday, September 9, 2021.***

**Figure 1. Brazil Macro Agenda for the Week of September 13-17, 2021**

| Indicators / Events | Source | Reference | Date | Santander Estimate | Prior |
|---|---|---|---|---|---|
| **Services Volume (% MoM)** | **IBGE** | **Jul/21** | **Tue, 14-Sep** | **0.6** | **1.7** |
| Services Volume (% YoY) | IBGE | Jul/21 | Tue, 14-Sep | 16.9 | 21.1 |
| **IBC-Br Activity Index (% MoM)** | **BCB** | **Jul/21** | **Wed, 15-Sep** | **-0.2** | **1.1** |
| IBC-Br Activity Index (% YoY) | BCB | Jul/21 | Wed, 15-Sep | 3.8 | 9.1 |
| Inflation: IGP-10 (% MoM) | FGV | Sep/21 | Thu, 16-Sep | -- | 1.18 |

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario:** ***"Advances in Controlling the Pandemic, Setbacks in Quelling Inflation" –*** Aug 12, 2021- Available on: http://bit.ly/Std-scenrev-081221

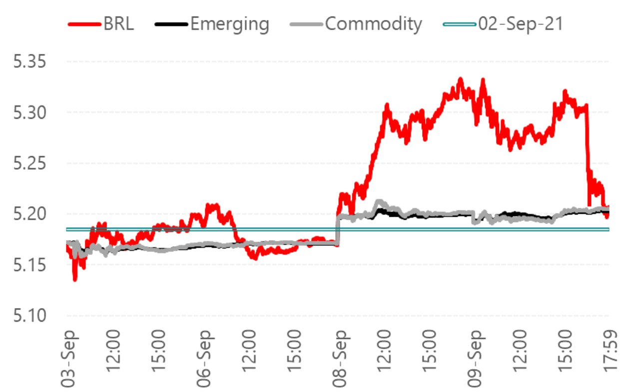
## LOCAL MARKETS—FX

**The USD/BRL pair closed the rolling week ended September 9 at 5.21, posting a 0.4% loss, meaning an intermediate performance amid a basket of 32 of the most liquid currencies in the World. Yet that apparently "neutral" performance hides a true rollercoaster ride seen in recent days.** While important events took place offshore, such as the ECB meeting and Chinese trade data, the international news cycle had limited (if any) influence in the local FX market this week, in our opinion. We believe the domestic factors played a key role for the BRL trend in recent days, with an escalation in the institutional tensions earlier this week seeing preliminary signs of easing in the latest hours. Amid such a high volatility, not even the positive outcome shown by net spot FX flows in August and early September was capable of spurring the BRL's performance (see details in the link[2].) All in all, this dynamic underpins our assessment that domestic idiosyncrasies (read it, fiscal and political ones) continue to limit the room for a strengthening of the BRL, despite the favorable terms of trade, still accommodative DM central banks and higher local interest rate. And we believe the idiosyncratic risk will continue to weigh on the currency performance for the medium term.

## LOCAL MARKETS—Rates

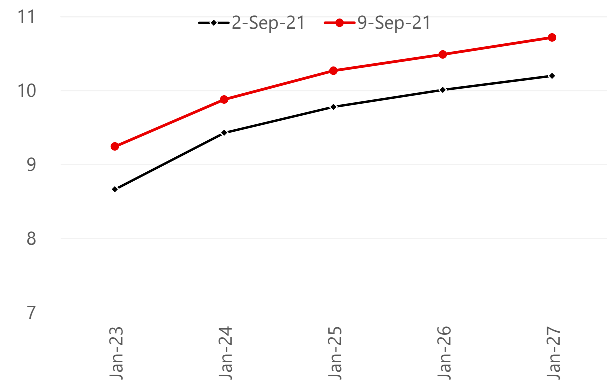
**The nominal yield curve once again shifted higher, but this time with a bear-flattening pattern.** Since last Thursday (September 2), the front end of the curve (Jan-23 DI future) has risen 58 bps to 9.25%, while the back end of the curve (Jan-27 future) has risen 52 bps to 10.72%. As a result, the curve's steepness in this segment fell 6 bps to 148 bps. At the front end, the considerable upside surprise in August's IPCA (see more on the Inflation section) prompted the market to price in a higher probability of a more hawkish move by the BCB. In the options market, a scenario of 100-bps hike, which boasted the highest implicit probability for many weeks, lost considerable ground, with prices now signaling a 25% probability, down from 75% last week. The 125-bps and 150-bps hike gained terrain—the 125-bps hike rose from 23% to 37% of probability, while the 150-bps hike rose from around 5% to 24%. At the back end, the perception of uncertainty about the political environment and the fiscal consolidation process pushed the market to add even more of a risk premium at this segment of the curve.

**Figure 2.A. – USD/BRL Intraday Trends**




Sources: Bloomberg, Santander.
Note1: As of the close Thursday, September 9, 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, September 9, 2021.

[2] **Santander Brazil – External Sector: *"A Buffer, Not a Boost"* –** September 8, 2021- Available on: https://bit.ly/Std-extsec-090821

## COVID-19 MONITORING

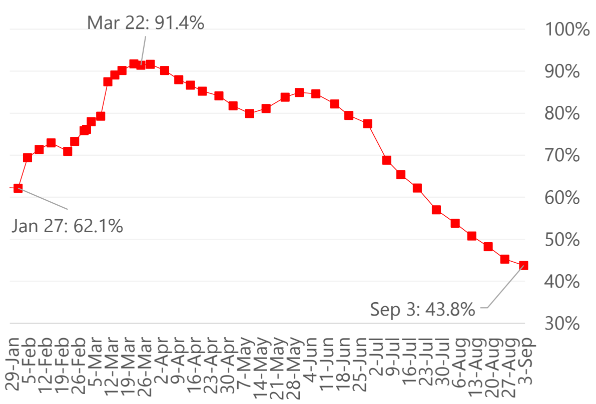
**After weeks running above our baseline scenario (1.5 million shots per day, on average), Brazil's daily vaccination pace eased to 1.3 million doses as of Wednesday (September 8), probably owing to the Independence holiday on September 7.** We expect the average pace to hold up throughout 2H21, as vaccine inventories remain high (59 million doses) and deliveries are expected to remain above the levels of vaccine administration.

**Health conditions keep gradually improving in Brazil, despite the risk from the Delta variant.** Based on the last available data (September 3), our proxy[3] for a nationwide average ICU occupancy rate has fallen further to 43%, the lowest level in our series (begun in January). That number compares to a previous peak of 92% (late March). Data from Brazil's Health Ministry showed that the 7-day average of infections stood at 17k as of Wednesday (September 8), down 21% from last week to the lowest level since November 2020; as for casualties, the 7-day average stood at 467, down 27% on the same comparison and the lowest level since December 2020. Controlling for the impact of this week's national holiday, the weekly declines in infections and deaths could strand around 10-15%, which is still meaningful.

**Urban mobility remains high.** September data thus far indicates an increase in mobility since last week, with our lockdown index now moving to 1.2 points (as of September 04, 2021) from 3.0 points (as of August 28, 2021)**.** This move stems mainly from an increase in mobility for the Transit Station and Retail segments, with both still remaining below the pre-pandemic readings. The Workplaces segment still shows high levels of mobility and has been running above the pre-pandemic mark since June. All in all, our lockdown index is trending at low levels, meaning a fast convergence to "normality" as vaccinations advance.

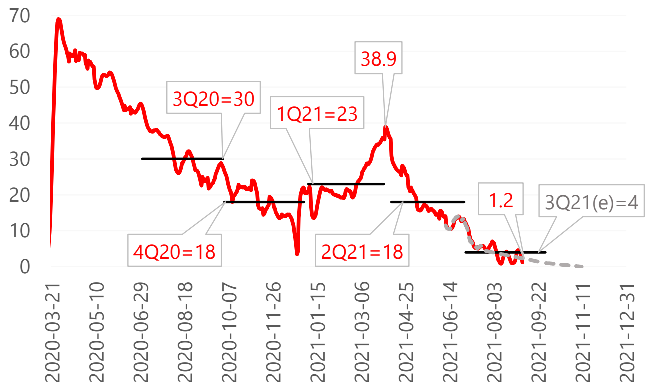
**Our daily activity index gained momentum in August.** The index—based on daily data on energy consumption, car sales, and mobility—showed an upward trend from April to June; on a monthly basis, and adjusted for seasonality, the index expanded by 5.6%, 3.0% and 4.2% in April, May and June, respectively. The index seems to have started 3Q21 at a slower pace, with a 0.8% drop in July. However, considering the daily average of August, we calculate a 1.7% expansion, more than offsetting the previous month's fall. With this figure, the index is 2.8% below February 2021 levels (i.e., before the pandemic's resurgence seen earlier this year).

**Figure 3.A. – Our Proxy for a Nationwide ICU Occupancy Rate (%)**




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 September 04, 2021.

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

## INFLATION

**August's IPCA registered a 0.87% MoM change (9.68% YoY), considerably above our call and consensus, both at 0.71%.** The headline remained at the high level of 11.1% in 3MMA-saar terms, implying that the upward pressure remains strong at the margin.

**The major upward surprise came from volatile items, but core-related groups also showed relevant upside surprises.** Food-at-home contributed +5 bps to the headline forecast error, while gasoline contributed +6bps—both volatile items. However, industrial goods also contributed to the forecast error with +2 bps, which left the 3MMA-saar measure at 11.5% (slightly below last month, but still a high level). Moreover, the core industrial goods also remained under upward pressure at 9.6% 3MMA-saar (from 10.1% in July). More importantly, services contributed +2bps to the headline surprise and accelerated to 6.7% 3MMA-saar (from 5.2% in July) and, the services core gauge accelerated even further, to 7.3% 3MMA-saar (from 6.4% in July).

**Broad qualitative measures deteriorated further at the margin, reinforcing our view of an unfavorable inflation outlook for the short term.** The average of the five core measures followed by the BCB rose to 8.1% 3MMA-saar (from 7.8% in July and is not only hovering above the target, but has been distancing further from it, for eleven months now. This is evidence of the spreading of the primary shocks (commodities, FX, supply chain disruption, etc.,) to the general prices and the persistency at these high levels is risky. Also in the same tone, the diffusion index, which is a leading indicator of annual inflation, reached a new recent high of 74% (seasonally adjusted)—close to the all-time high of 78% (in 2015-2016) and evidencing the risks of even higher inflation for the year end. The diffusion is also another sign of the spreading of shocks.

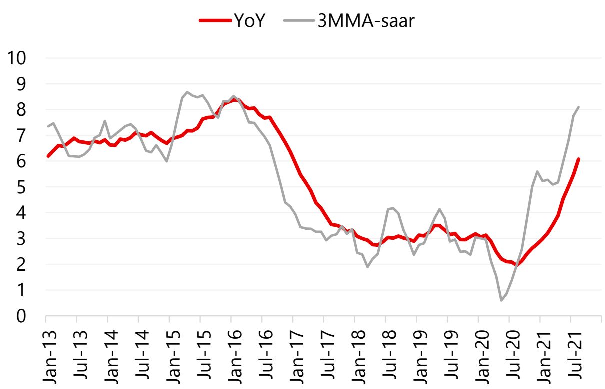
**Our worries regarding the inflation outlook keep piling up for two key reasons:** (i) We see a large backlog of prices at the wholesale level that should still come to the consumers; and (ii) we are seeing the second-order effects (primary shocks spreading to general prices) getting stronger, which could worsen once the economy picks up as the pandemic starts to fade (especially in services). IPCA forecasts are currently under revision, with an upside potential, particularly because inertia seems to be gaining traction making it more difficult for the recent shocks to fade quickly. See details in the link[4].

**Figure 4.A. – August's IPCA Details (%)**

| | Aug-21 | Santander | Contrib. | Jul-21 | Aug-21 |
|---|---|---|---|---|---|
| IPCA | 0.87 | 0.71 | 0.16 | 9.0 | 9.7 |
| Administered | 0.95 | 0.68 | 0.07 | 13.5 | 13.7 |
| Free | 0.84 | 0.71 | 0.09 | 7.4 | 8.3 |
| Food-at-home | 1.63 | 1.28 | 0.05 | 16.0 | 16.6 |
| *Food-at-home core* | 1.13 | 1.22 | 0.00 | 9.7 | 10.4 |
| Industrial goods | 1.02 | 0.92 | 0.02 | 9.2 | 10.1 |
| *Industrial goods core* | 0.59 | 0.58 | 0.00 | 7.4 | 7.9 |
| Services | 0.39 | 0.34 | 0.02 | 3.0 | 3.9 |
| *Services core* | 0.64 | 0.52 | 0.02 | 6.0 | 6.6 |
| EX3 Core | 0.62 | 0.55 | 0.03 | 5.6 | 6.2 |

Source: Brazilian Central Bank, Santander.

**Figure 4.B. – Average Core Inflation (IPCA %)**




Source: Brazilian Central Bank, Santander.

[4] **Santander Brazil Inflation - *"August IPCA: A Major Upward Surprise Reinforces the Difficult Inflation Outlook"* –** September 9, 2021 - Available on: http://bit.ly/Std-IPCA-augl21

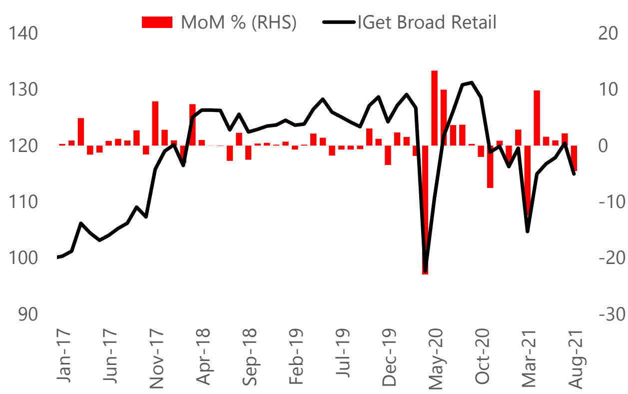
## ECONOMIC ACTIVITY

**Broad retail sales surprised to the upside in July, marking positive start to 3Q21.** The headline index was up by 1.1% MoM-sa, well above market consensus and our call (both at -0.5%). This result marks a positive start to 3Q21, with July's figure implying a 0.7% carryover for 3Q21. Regarding the core index (which excludes building materials and vehicle sales), sales were up 1.2% (consensus at +0.5%). Both indexes remain above the pre-pandemic level, up by 2.8% and 5.9% since February 2020, respectively. See details in the link[5].

**According to our proprietary index (IGet), some segments of the tertiary sector posted a contraction in August. But our trackers for IBGE data seem to point to a gradual shift of consumer expenses out of goods and back into services, consistent with a "normalization" trend in urban mobility.** The indexes weighted according to the IBGE's monthly surveys for broad retail sales and services to families were down by 4.5% and 7.9% in August, respectively, following an expansion in July (up 2.2% and 11.7%, respectively). These figures highlight a quarterly deceleration in comparison to 2Q21 when the broad retail sales index posted a 4% monthly average gain and the index for services to families leapt at an average monthly growth of 12%. Services to families still show considerable idleness, with a 21% gap to the pre-pandemic mark and a 30% gap in comparison to the 2019 average. This means room for a grater GDP contribution for the coming quarters. See details in the link[6].

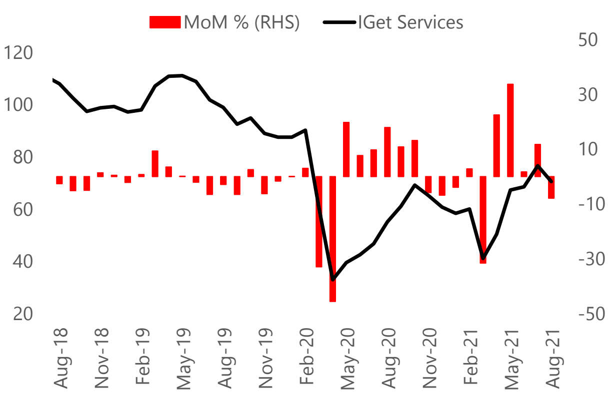
**On Wednesday (September 15), the BCB will release the IBC-Br (GDP monthly proxy) for July: we have recently updated our tracking to -0.2% MoM-sa from +0.2%, meaning a tepid start for the broad economy in 3Q21.** But the final estimate for the GDP proxy will also hinge on some information expected to arrive this week: on Tuesday (September 14), IBGE will release the services sector data for July. We expect a sequential monthly gain of 0.6% MoM-sa, which implies a carryover of 2.3% for 3Q21. **For details on Santander's activity outlook, please refer to our last chartbook[7].**

**Figure 5.A. – IGet Broad Retail (sa, 2016=100)**




Sources: Santander.

**Figure 5.B. – IGet Services (sa, 2016=100)**




Sources: Santander.

[5] **Santander Brazil Economic Activity -** ***"A Positive Surprise at the Start of 3Q21"*** **–** September 10, 2021 - Available on: https://bit.ly/Std-Econact-091021 (the file will be available in the link at @3pm ET)
[6] **Santander Brazil Economic Activity -** ***"Serviços Aparentam Desacelerar no 3T21"*** **–** September 8, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGETser-ago21
**Santander Brazil Economic Activity -** ***"Varejo Aparenta Acomodação no 3T21"*** **–** September 8, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGET-ago21
[7] **Santander Brazil Economic Activity -** ***"Chartbook – A Brighter Outlook for Mobility and Services"*** **–** August 18, 2021 - Available on: https://bit.ly/Std-chart-econact-aug21

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