

**BRAZIL MACRO**

June 11, 2021

MACRO COMPASS**HIGHER ACTIVITY, INFLATION, AND INTEREST RATES**

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- The BRL posted an intermediary performance among major currencies in the rolling week ended June 10, gaining 0.4% vs the greenback to USD/BRL 5.06. In our view, the drivers were the flattening of the U.S. yield curve, as well as a higher probability for a more hawkish reaction by the Brazilian Central Bank (BCB) following a better outlook for an economic recovery and worse inflation dynamics. These factors also explained the bear flattening observed in the domestic yield curve in the same period.
- In Brazil, new COVID-19 infections and casualties remain stubbornly high. The ICU occupancy rate is above 90% in eight states, stable from last week (18 states in the worst phase). On the vaccine front, several Brazilian states brought forward the schedule of COVID-19 vaccination to the general public.
- The government is considering extending its Covid-19 relief program for low-income households for two additional months. The emergency stipend, which costs about BRL 9 billion per month, is set to expire in July. Brazil's Economic Minister is planning to deploy the unused resources approved in *PEC emergencial* (BRL44 billion) for the welfare program extension due to lower-than-expected disbursements per month and an additional extraordinary budget (~BRL11 billion).
- Retail activity surprised positively in April on strong contributions mainly from credit-led segments. The broad measure of sales increased 3.8%, exceeding consensus estimates, following a decline of 5.0% in March. For May, our proprietary index (IGet) already points to sequential growth driven by the new round of emergency aid. Regarding the services sector data, the headline index slightly increased by 0.7%.
- The BCB's broad activity index (IBC-Br) comes out next week (June 14), capping the batch of main activity releases for April. We are looking for a monthly gain of 0.8% MoM-sa.
- May's IPCA slightly increased by 0.83% MoM (8.06% YoY), well above the market's median expectation of 0.71% and a bit above our call of 0.76%. Our worries regarding the inflation outlook keep growing, as qualitative measures remain notably unfavorable, with cores and diffusion rising, initial signs of a spreading primary shock to general prices.
- On Wednesday (June 16), the BCB is scheduled to announce its monetary policy decision. We expect the stimulus removal to proceed, with another Selic hike of 75bps to 4.25%. With economic activity on a better footing and inflation pressures rising and spreading, we believe the BCB will raise the tone and abandon the "partial normalization" language.

Most of the information in this report is up to the end of Thursday, June 10, 2021.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

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Figure 1. Brazil Macro Agenda for the Week of Jun 14-18, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IBC-Br Activity Index (% MoM)	BCB	Apr/21	Mon, 14-Jun	0.8	-1.6
IBC-Br Activity Index (% YoY)	BCB	Apr/21	Mon, 14-Jun	16.8	6.3
Inflation: IGP-10 (% MoM)	FGV	Jun/21	Tue, 15-Jun	2.10	3.24
Copom Meeting - Selic Rate (%)	BCB	--	Wed, 16-Jun	4.25	3.50

Source: Santander.

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

¹ Santander Brazil - Macroeconomic Scenario: *"Monetary Stimulus Doomed to End Sooner"* – May 20, 2021- Available on: <http://bit.ly/Std-scr-review-may21>



LOCAL MARKETS—FX

In our view, the performance of the BRL in the rolling week ended June 10 reinforced our assessment that a substantial and lasting strengthening of the Brazilian currency will require material (rather than circumstantial) developments on the fiscal front.

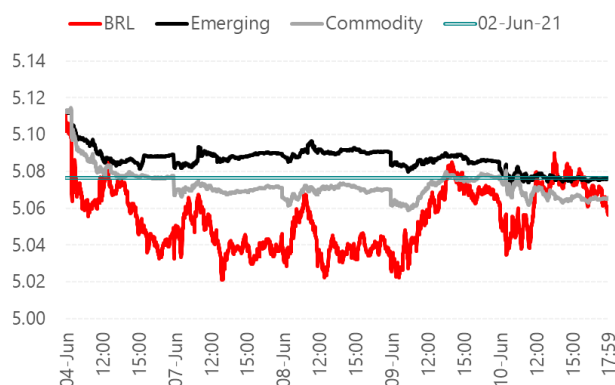
The USD/BRL pair failed to breach the 5.00 threshold, ending the period at 5.06, thus relatively stable as compared with the same level observed a week ago (USD/BRL5.08). The BRL registered an intermediate performance among major currencies, after standing as top performer in the previous two weeks. In our opinion, the stability stemmed from relatively supportive news for Brazil regarding the level of interest rates abroad and the mounting evidence that the BCB should carry out a full (rather than partial) normalization of its monetary policy (details in the Monetary Policy section).

In the past few days, we believe that the news cycle pointed to an increased likelihood of the U.S. government granting a smaller-than-anticipated fiscal package this year, which would extend the currently low rate environment in that country. On the domestic front, given recent positive surprises with economic indicators and negative surprises with inflation indices (see details in the Economic Activity and Inflation sections), an increasing number of players anticipate a stronger monetary tightening cycle than the one currently indicated by the BCB, which also favors the BRL. Despite the help of these two forces, we believe that BRL stability suggests that fiscal uncertainties should still limit the room for a more intense strengthening of the Brazilian currency.

LOCAL MARKETS—Rates

The slope of the nominal yield curve was reduced for the fourth week in a row (accumulating an 80-bp reduction since May 14), this time in a bear-flattening move. Since last Thursday (June 3), the front end (Jan-22 DI future) rose 22 bps, to 5.33%, while the back end (Jan-27 DI future) rose 10 bps, to 8.44%. Hence, the steepness fell 12 bps, to 312 bps. At the front end, the upside surprise in May's IPCA headline with quite unfavorable qualitative measures (see details at the Inflation section) alongside stronger retail sales data (see details at the Economic Activity section) prompted the market, again, to price in a higher probability of more hawkish steps by the BCB during the next Copom decisions. At the long end, despite the fall of the 10-year U.S. Treasuries yield, the domestic long yield rose. In our view, this is probably a correction—that might continue—after a large rally during the last few weeks. The latter was prompted by a growing optimism regarding GDP growth and its consequence over the debt-to-GDP ratio, that will end the year lower than previously estimated. However, in our opinion, the notably fall of the longer yields during the last few weeks is not consistent with the challenging medium-term fiscal outlook, that still depends on the advance of the reformist agenda to guarantee the convergence of the debt-to-GDP ratio; hence, that is why we believe the upward correction might continue.

Figure 2.A. – USD/BRL Intraday Trends

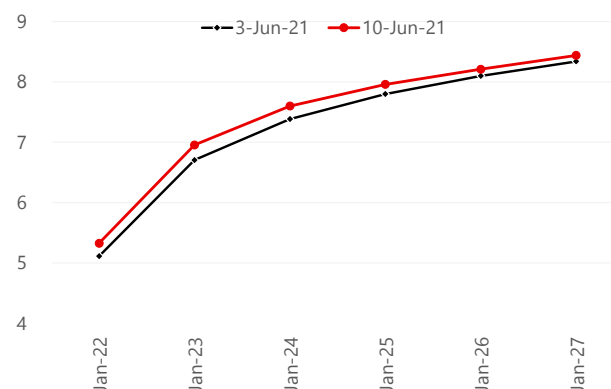


Sources: Bloomberg, Santander.

Note1: As of the close Thursday, June 10, 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, June 10, 2021.



COVID-19 MONITORING

Several Brazilian states brought forward the schedule of COVID-19 vaccination to general public. State governments are expanding vaccination to the general population in the age group from 18 to 59 years old. The new guidance comes as municipalities have reported decreasing demand in priority groups. In our view, this should boost the pace of vaccination in the coming weeks toward our baseline scenario of one million/day.

Anvisa approves (with conditions) imports of Sputnik V and Covaxin. Anvisa, the National Drug Regulator, authorized the import of 1 million doses of Sputnik and 4 million doses of Covaxin. More shipments could come depending on monitoring data from this initial amount. Yet the manufacturers still need to submit more documents for emergency use authorization. Meanwhile, the government's official schedule for vaccine deliveries revised June's figure to 38 million doses (from 44 million) and provided a first estimate of 35 million doses for July. As such, the uncertainty about the arrival of imported inputs continues to impart risks for the schedule of the National Immunization Plan.

In Brazil, new COVID-19 infections and casualties remain stubbornly high. The ICU occupancy rate is above 90% in eight states, stable from last week (18 states in the worst phase). As of Wednesday (June 9), 75 million doses (out of 110 million delivered) had been administered in the country, with the pace of vaccination at 740k/day (seven-day moving average).

Mobility keeps improving, but at a slower pace. After starting the quarter at high levels, close to of June 2020's (~40 points, 7-day average), our lockdown index (using Google Mobility Report data) posted a consistent downward trend in the last few months, reaching 14.2 points (as of June 2, 2021). This improvement stemmed mainly from mobility increases in the Workplace (which already stands at pre-pandemic marks) and Transit Station segments, which suggests a close link to economic activities and this recovery path bodes well for economic activity in 2Q21. Despite mobility is still increasing, now the pace seems to be slower, and before a more disseminated vaccine rollout, the risk of increased infections continues to imply downside risks for mobility (and economic activity).

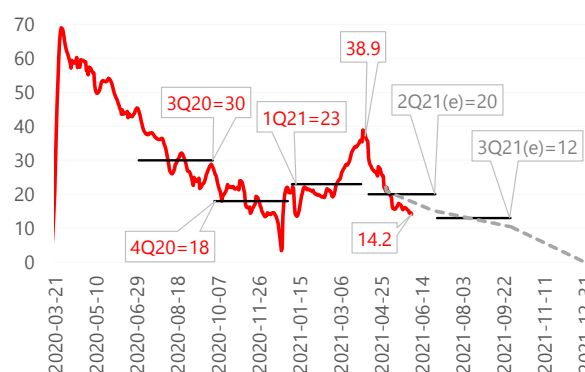
Our daily activity index continues to improve across 2Q21. The index — based on daily data on energy consumption, car sales, and mobility — has been improving since the start of 2Q21, showing an upward trend in recent months. On monthly basis, after seasonal adjustments, the index expanded by 6.1% and 4.7% in April and May, respectively, not enough to fully offset March's retreat (-15.7%) and placing the index at readings still 6.4% below February-21.

Figure 3.A. – Vaccination by Age and Gender (June 7, 2021)



Sources: PNAD, dataSUS, @eliaskrainski, Santander.

Figure 3.B. – Lockdown Index* and 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 2, 2021.



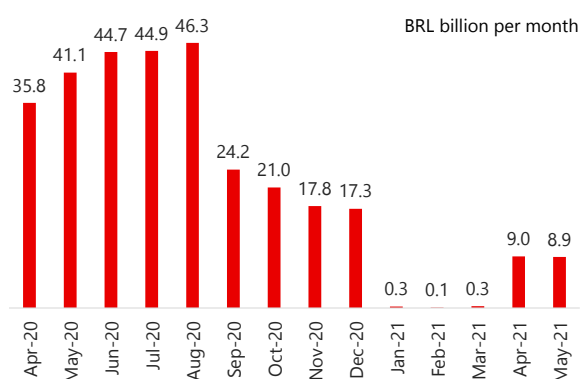
FISCAL

The minister of the economy said on June 8 that the government will renew its Emergency Aid program for “two to three months” (beyond July). 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 September. We were already considering this possibility of extending the welfare program², due to lower-than-expected disbursements from the Emergency Aid program in 2021. We explore below the main aspects of the welfare program this year.

A constitutional amendment (*PEC Emergencial*) was approved in March, the law allowed the implementation of a new round of emergency aid for four months (April to July), with a total budget limit of BRL44 billion – with a waiver for the compliance of the fiscal rules. Until May, spending on new emergency aid reached BRL18.4 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 expected by the government (~45 million people, considering the total resources available). In our view, 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 for two additional months (August and September). Additionally, the government must send to Congress a provisional measure requesting an extraordinary credit of ~BRL11 billion to complement the total amount necessary for this extension. As it is an extraordinary credit, this new amount will not be subjected to the spending cap constitutional rule (so-called “extra-cap” spending), which we estimate now at BRL126 billion for 2021 (1.5% of GDP). Furthermore, we believe that to extend the program it would not be necessary to approve a new constitutional amendment. On the other hand, the government must send another provisional measure in the coming weeks to extend the Emergency Aid program, and have enough time to operationalize the transfers, which take around 90 days, according to the government.

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 flagship program Bolsa Familia could cost an additional BRL15 billion per year (this year budget was BRL35billion), and would be compliant with the spending cap in coming years. We believe that there will be a 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 September is feasible due to the savings of the original Bolsa Família 2021 budget of ~BRL15 billion, with migration of its beneficiaries to emergency aid during the months of April to September, 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 increases to this type of expenditures is legally forbidden in election in years.

Figure 4.A. – Emergency Aid Disbursements



Sources: National Treasury, Santander.

Figure 4.B. – Expected “Extra-Cap” Expenditure 2021

Covid related expenditures - 2021	BRL billion
Emergency Aid (<i>PEC Emergencial</i>)	45
Extension of the Aid until September (extra)	11
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	126

Sources: National Treasury, Santander.

² See our last week Macro Compass report: <http://bit.ly/Std-macrocomp-020621>



CREDIT

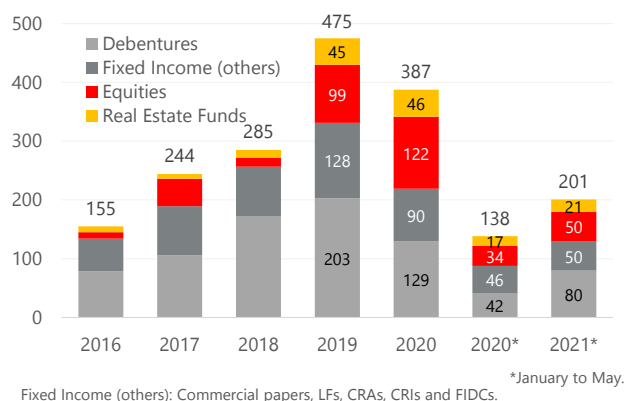
Anbima figures on capital market activity for May show that new issuances totaled BRL54.9 billion. Comparing issuances YTD to May 2021 versus the year-ago period, there was an increase of 45%. Debentures issuances led with BRL23.3 billion; fixed income accounted for BRL17 billion; equities totaled BRL10.2 billion; and real estate funds came in at BRL4.2 billion.

Once again, debentures issuances of BRL23.3 billion accounted for the largest share of the issuances in the month (42%). Looking at the allocation of proceeds of debentures in 2021 until May, we see that 31% was allocated for working capital as opposed to 42% in the same period of 2020. The allocation was not informed for a significant share (25%) of the proceeds, well above the 1% average of previous years.

In our view, new offerings are likely to remain high as vaccines allow the reopening process to continue. In equities, half of the BRL10.2 billion volume came from IPOs. In real estate funds, total YTD issuances account for BRL21 billion, 55% above the same period of 2020.

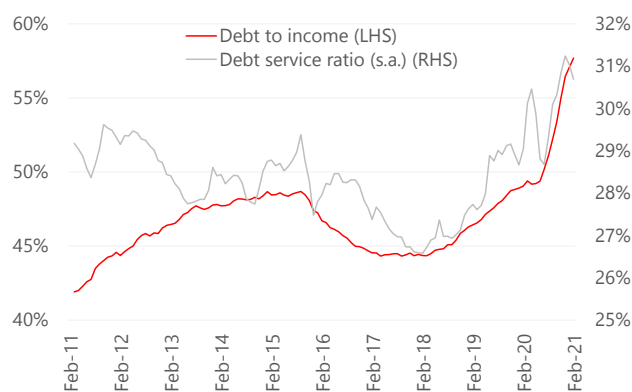
Consumer indebtedness on the rise. BCB data for February show household debt to income at 57.7%, up 0.6 p.p. from January (+8.6 p.p. from February 2020), with the historical average standing at 44%. The household debt service ratio was 30.7%, down -0.3 p.p. from January (+1.7 p.p. from February 2020), with the average standing at 27.9%.

Figure 5.A. – Issuances in Domestic Markets (BRL billion, CPI adjusted)



Sources: Anbima, Santander.

Figure 5.B. – Consumer Indebtedness (% of Expanded Aggregate Income)



Sources: Brazilian Central Bank, Santander.



ECONOMIC ACTIVITY

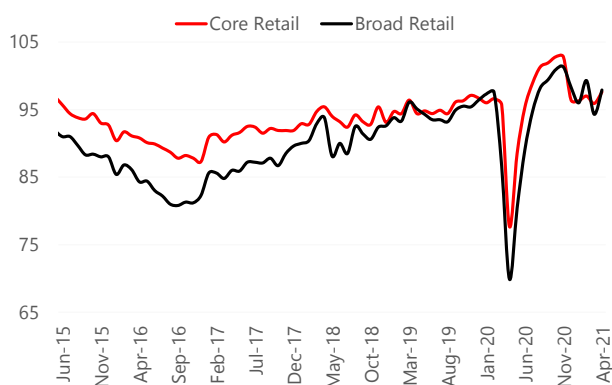
Broad retail sales surprised positively in April, marking a solid start of 2Q21. The headline index climbed by 3.8% MoM-sa, beating market consensus (2.1%) and in line with our call (3.7%). Regarding core retail sales (ex auto and building materials), the index was up by 1.8%. Looking at the details, this growth was widespread: nine of ten retail segments posted monthly gains, more than offsetting Supermarkets's retreat (-1.7%). Credit-led segments were the main driver of this growth, fully giving back March's losses. [See details in the link³.](#)

Going forward, our proprietary indicator (IGet) already points to a sequential growth of broad retail sales in May, mainly driven by Supermarkets, on the heels of the payment of the new round of emergency aid. Moreover, Fenabreve's data show that vehicle sales expanded this month. Based on this information set, our tracking of broad retail sales for May stands at +6.6% MoM-sa (30.9% YoY). [See details in the link⁴.](#)

Services sector data underlines a tepid start of 2Q21. The headline index slightly expanded by 0.7% (19.8% YoY) in April (our call: +0.8%), far from fully offsetting March's retreat (-3.1%). The highlight was the segment of services to families, with 9.3% MoM-sa growth (our call: +10.9%), albeit not enough to fully give back the previous drop (-28% in April). Looking ahead, IGet also points to a gain of momentum of services to families in May, following the faster-than-expected increase in mobility seen in 2Q21. [See details in the link⁵.](#)

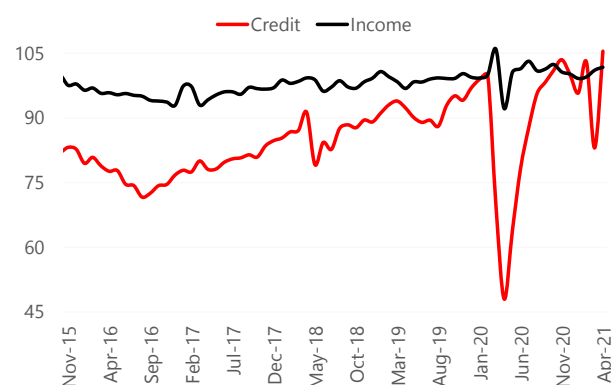
The BCB's broad activity index (IBC-Br) comes out next week (June 14), capping the batch of the main activity releases for April. We are looking for a monthly gain of 0.8% MoM-sa. Regarding our GDP scenario, we are updating our tracking for 2021 GDP to 4.8% (3.6% from last scenario review), given the positively surprisingly releases of 1Q21 GDP and the timely activity indicators. We highlight that the agricultural sector may partially give back its 1Q21 positive contribution, which, along with the expected weak outcome of the industry, should create something of a drag on the recovery in 2Q21. [For details on Santander's economic activity scenario, please refer to our last chartbook⁶.](#)

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



Sources: IBGE, Santander.

Figure 6.B. – Credit-Led and Income-Led Segments (sa, 2011=100)



Sources: IBGE, Santander.

³ **Santander Brazil Economic Activity - "Solid Start of 2Q21 for Retail Sales"** – June 08, 2021 - Available on: <http://bit.ly/Std-econact-080621>

⁴ **Santander Brazil Economic Activity - "IGet Maio: Varejo Segue em Recuperação"** – June 08, 2021 – Available (in Portuguese) on: <http://bit.ly/Std-IGET-may21>

⁵ **Santander Brazil Economic Activity - "IGet Maio: Serviços Seguem em Recuperação"** – June 10, 2021 – Available (in Portuguese) on: <https://bit.ly/Std-IGETser-mai21>

⁶ **Santander Brazil Economic Activity - "Chartbook – Positive Surprises with Risks On The Upside"** – May 25, 2021- <http://bit.ly/Std-chart-econact-may21>



INFLATION

May's IPCA registered a 0.83% MoM change (8.06% YoY), well above the market's median expectation of 0.71% and a bit above our call of 0.76%. The headline accelerated from 8.6% in April to 9.1% in 3mma-saar terms, showing that the upward pressure at the margin remains strong.

The upside surprises came in core-related groups. Industrial goods rose 1.28% MoM, contributing +4 bps to the headline forecast error. The 3mma-saar measurement of industrial goods accelerated further to the high level of 12.3%. Furthermore, still on core-related groups, although services fell 0.15% MoM, this was a smaller decline than we were estimating (-0.27%), so the group also contributed +4 bps to the headline forecast deviation. In terms of trend, services remained at a low level, but advanced to 2.0% 3mma-saar (from 1.6%). More importantly, the core of services stayed at a higher level, accelerating from 3.9% to 4.2% 3mma-saar. Finally, food-at-home (-1 bp of contribution to the headline error) and regulated prices (zero contribution to the error) came in basically in line with our forecast.

Qualitative measures were notably unfavorable, with cores and diffusion rising. The average of core measures advanced from the already high level of 5.1% to 5.8% in 3mma-saar terms. The cores have been hovering above 4.5% for eight months, a notably high level that in our view is an initial sign of a spreading of the primary shocks to general prices. Also in that regard, the diffusion index—a leading indicator of inflation YoY—rose 66.1% to 68.8% (seasonally adjusted), compatible with the IPCA at around 9% YoY five months from now, as per their historical relationship, which reinforces the risk of the spreading of primary shocks to general prices.

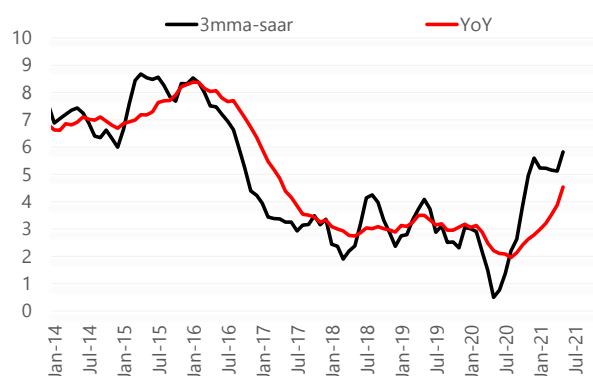
Our worries regarding the inflation outlook keep growing, as shocks continue to be strong and persistent at the margin and as the distortion of relative prices continues to indicate there is considerable price pressure from producers still reaching consumers. We are revising our high-frequency tracking to 6.1% for IPCA 2021 (from 5.9%) and to 4.1% for IPCA 2022 (from 3.9%). Moreover, we continue to see upside risks for both years, particularly from energy prices but also from industrial goods and services. [See details in the link⁷.](#)

Figure 7.A. – May's IPCA Details (%)

	MoM			YoY	
	May-21	Santander	Contrib.	Apr-21	May-21
IPCA	0.83	0.76	0.07	6.8	8.1
Administered	2.11	2.10	0.00	9.6	13.1
Free	0.38	0.28	0.07	5.8	6.3
Food-at-home	0.23	0.28	-0.01	15.6	15.4
Industrial goods	1.28	1.12	0.04	6.9	8.3
Services	-0.15	-0.27	0.04	1.4	1.7
EX3 Core	0.52	0.42	0.09	3.8	4.5

Sources: IBGE, Santander.

Figure 7.B. – Average Core Inflation (%)



Sources: IBGE, Santander.

⁷ Santander Brazil Inflation - "IPCA for May: Upward Pressures Keep Piling Up" – June 9, 2021 – Available on: <http://bit.ly/Std-IPCA-may21>



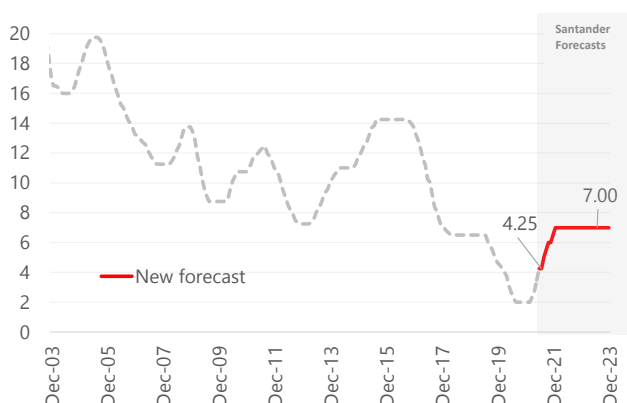
MONETARY POLICY

On Wednesday (June 16), the BCB is scheduled to announce its monetary policy decision. We expect the stimulus removal to proceed, with another Selic hike of 75 bps, to 4.25%. This is broadly in line with analyst consensus and is the most likely outcome priced into the yield curve (~70% probability, with a perceived ~30% probability for a 100-bp move).

Since the last Copom meeting, the evolution of the baseline scenario features a stronger-than-expected cyclical recovery in economic activity, as well as more intense, lasting, and widespread price pressures than initially expected. We believe these elements will be mirrored in both the scenario assessment and inflation projections: despite the continued BRL rally since the last meeting in May, we believe the BCB models will point to a higher bar (in terms of policy tightening necessary) to bring IPCA inflation back to the center of the target for the key policy horizon, 2022. In our view, this will be accompanied by a discontinuation of the “partial normalization” language. For the subsequent meeting (i.e., August), we believe the BCB will signal the intention to proceed with a similar pace of adjustment of 75 basis points.

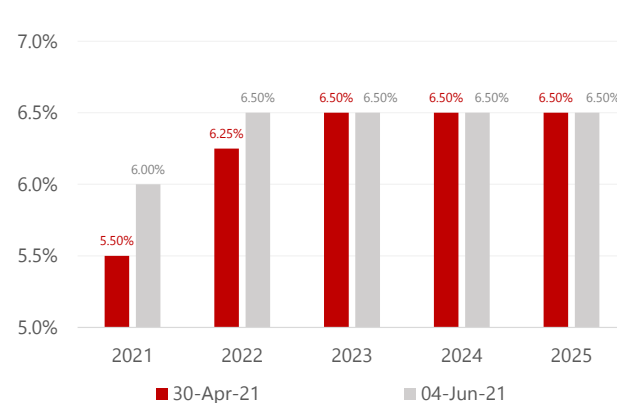
Our scenario projects a Selic rate of 6.50% at the end of this year (neutral level, according to BCB estimates). We then expect a hike in January 2022, taking the Selic to what we see as its possible terminal level for this cycle (7.00%). That is consistent with what we see as preliminary evidence of a neutral interest rate of around 4% in real terms. [See details in the link⁸](#).

Figure 8.A. – Selic Rate Path (% p.a.)



Sources: Brazilian Central Bank, Santander.

Figure 8.B. – Median Selic Rate Forecasts (% p.a.)



Sources: Brazilian Central Bank, Santander.

Note: As per the latest BCB Focus report, released on June 4, 2021.

⁸ Santander Brazil Monetary Policy - “Raising the Tone” – June 11, 2021 – Available on: <https://bit.ly/Std-COPOM-p-jun21>



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