Santander Macroeconomic Research

BRAZIL MACRO

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MACRO COMPASS

UNDERLYING INFLATION CONTINUES TO RAISE EYEBROWS

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- The USD/BRL pair closed the rolling week ended November 11 at 5.41, a 3.6% gain, standing as the best performer in a basket with 31 of the most liquid currencies in the world. In our opinion, the performance had mainly to do with a perceived "respite" on the domestic fiscal news cycle and an even higher terminal Selic rate projected by analysts for the cycle, despite some worrying inflationary developments abroad. Overall, the news flow also led to slightly reduced bets on a faster pace of hikes in December Copom, prompting the nominal yield curve to invert.
- On Tuesday (November 9), the Lower House passed in the second round, by 323 votes to 172, the so-called Precatórios Amendment (PEC 23/2021), a constitutional amendment that limits the annual settlement of judicial claims by the central government within the spending cap and changes the indexation of the federal expenditure ceiling. According to our calculations, the new legislation opens a space of about BRL110 billion for new spending within the constitutional ceiling in 2022, and is key for the government's will to start a new transfers program called Auxílio Brasil. The bill now heads to the Senate, where it is expected to be voted in the Senate's Constitution, Justice and Citizenship Committee (CCJ, in Portuguese acronym) around November 23-24 and analyzed at the floor of the upper chamber by early December.
- October's IPCA registered a 1.25% MoM change (10.67% YoY-exactly the same level of Dec-2015), much above the consensus (1.06%), our call (1.09%) and the BCB's estimate in the 3Q21 inflation report out late in September (0.45%). The 3MMA-saar trend of all groups remains at hefty levels, much above the target, and we see this as yet another unfavorable reading and remain cautious on the inflation outlook.
- Broad retail sales surprised to the downside by retreating 1.1% (market consensus at -0.1%) in September, bringing the index back to levels below its pre-pandemic mark (down 1.7%). Broad sales ended 3Q21 with a 1.7% drop. Moreover, the services sector also showed a disappointing performance, retreating 0.6% (consensus at +0.5%). Yet services revenues marked a solid 3Q21 growth (up 3.0%). In quarterly terms, these figures reflect the consumption shift toward a pre-pandemic pattern (i.e., out of goods and back into services) as the economy reopens, as well as the impact of inflation eating into household income (and spending on goods).
- The Brazilian Central Bank (BCB) will publish its monthly GDP proxy (IBC-Br) for September on Tuesday (November 16), capping the batch of the main economic indexes releases for the month. We expect a monthly stability in sequential terms (i.e., 0% m/m). Our tracking for 3Q21 GDP growth (official IBGE index) remains at 0.2% QoQ-sa and we see a little downside risk to our full-year estimate of 4.9%.

Most of the information in this report is up to the end of Thursday, November 11, 2021.

Figure 1. Brazil Macro Agenda for the Week of November 15-19, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
National Holiday	**--**	**--**	**Mon, 15-Nov**	**--**	**--**
Inflation: IGP-10 (% MoM)	FGV	Nov/21	Tue, 16-Nov	--	-0.31
IBC-Br Activity Index (% MoM)	**BCB**	**Sep/21**	**Tue, 16-Nov**	**0.0**	**-0.15**
IBC-Br Activity Index (% YoY)	BCB	Sep/21	Tue, 16-Nov	2.3	4.74

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario (Redux):** ***"Losing the Anchor"*** **–** November 05, 2021- Available on: https://bit.ly/Std-scenreview-redux-nov21

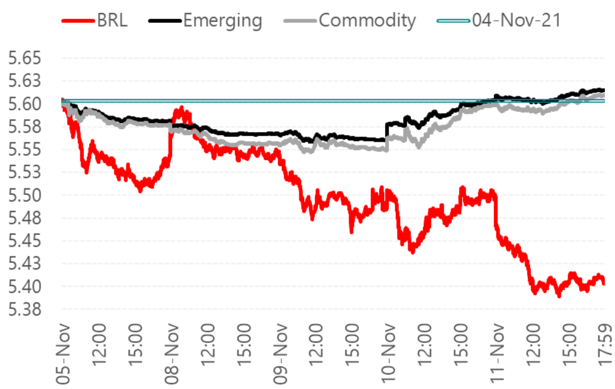
LOCAL MARKETS—FX

The USD/BRL pair closed the rolling week ended November 11 at 5.41, a 3.6% gain, standing as the best performer in a basket with 31 of the most liquid currencies in the world. In our opinion, the performance had chiefly to do with the domestic news cycle, which overcame worrisome developments abroad. The latter unveiled the extension of inflationary pressures worldwide as the PPI reading in China and the CPI number in the US came way above market median estimates and posting multi-decade highs. Those releases were reminders that the global inflationary shocks, while temporary in nature, are still alive and kicking. Accordingly, there was an increase in the uneasiness regarding a more hawkish approach by the FOMC in the coming months, which benefitted the USD–especially given the approval of more fiscal stimuli destined to the US infrastructure segment that should support the economic recovery ahead. This combination helped the USD to strengthen against major currencies, but that was not the case against the BRL. In our view, the approval by the Lower House of a constitutional amendment, rather than an open-ended package of public expenditures for 2022, brought some relief to markets regarding dynamics of the Brazilian government debt in the coming years. In tandem, economists' expectations for an even more hawkish monetary conduct by the BCB gained momentum on the heels of still pressured inflation readings in the short term and also contributed for the strengthening of the BRL in the last days. However, we insist that, while a tighter monetary grip should limit the weakening of the BRL in the coming weeks, the perceived reduction in the efficacy of the constitutional spending cap as a fiscal anchor, and the resulting increase in the fiscal risks, prevent the currency from strengthening substantially as compared with the current levels.

LOCAL MARKETS—Rates

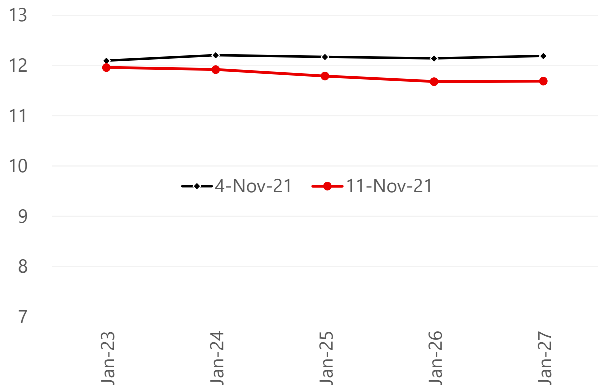
Nominal rates downshifted in recent days, in a strong bull-flattening movement that inverted the yield curve. Since last Thursday (November 4), the front end of the curve (Jan-23 DI future) decreased 14 bps to 11.96%, while the back end of the curve (Jan-27 future) decreased 50 bps to 11.69%. As a result, the curve's steepness in this segment fell 37 bps to -27 bps, meaning an inverted curve. At the front end, the rally came in despite a considerable upward surprise in inflation data (see details in Inflation section), as public remarks from BCB officials suggested a lack of eagerness to accelerate the pace of Selic hikes. Lower-than-expected retail sales data (see details in Economic Activity section) might have also contributed for the short yield to fall. Indeed, the curve was pricing in a 200-bps Selic hike for December last week and it fell to 182 bps now. At the long end, although the uncertainties regarding the fiscal consolidation process remain high, the market apparently read the partial advance of the "*Precatorios"* bill as a marginal relief (i.e., no open-ended stimulus), which translated in a reduction of the risk-premia in this segment of the curve. We remain considerably cautious about the fiscal outlook and we do not discard a new round of risk-premium building in the yield curve (and other assets).

Figure 2 – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, November 11, 2021.
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 Thursday, November 11, 2021.

COMMODITIES

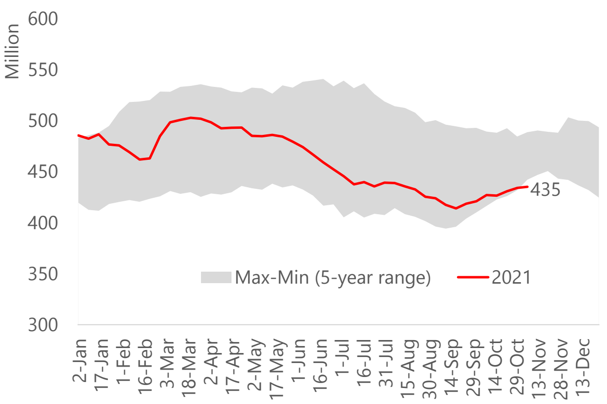
USDA report shows U.S. soybean crop forecast lower than expected. On Tuesday (November 9), WASDE report posted the U.S. soybean production forecast at 4,425 million bushels, below markets estimate of 4,483 million bushels. Still, it is poised to be the second biggest crop ever. U.S. soybean exports were trimmed amid disappointing sales to China, and could further be revised downward given that Brazilian soybeans are ahead of schedule. Meanwhile, corn production estimate was raised a bit and it is also poised to be the second biggest on record. All in all, stock-to-use ratio for 2021-22 has been revised to 7.8% (from 7.3%) for soybeans and 10.1% (unchanged) for corn. The 10-year average is 8.4% and 12.0%, respectively.

Russia claims gas will flow into EU storage this month. Gazprom said it is starting a plan to send gas to five EU storages in November. According to press sources, the company has booked extra pipeline capacity at the Ukraine border. Over the weekend, some injections were reported to German storages, albeit at low levels.

EIA[2] reports an increase in U.S. crude stockpiles. The EIA reported on Wednesday (November 6) that U.S. crude inventories increased by 1,002k barrels for the week ending November 5, below expectations for a 1,677k barrels increase. As a result, at 435 million barrels, inventories are still very close to the minimum level observed for this time of the year (considering the last 5 years).

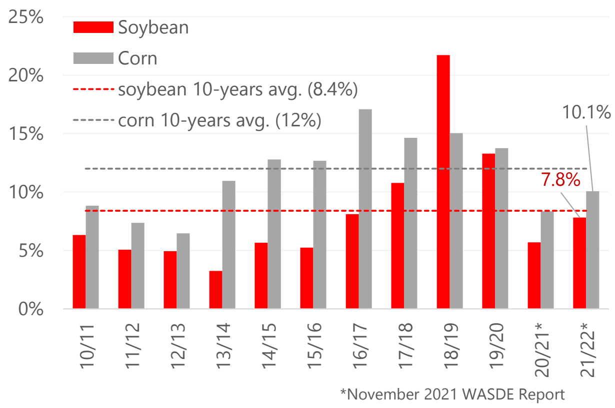
CFTC[3] reports another decrease in speculative long positions in WTI crude oil. Money managers reduced their net long WTI crude futures and options positions in the week to November 2, the CFTC reported on Friday (November 5). The positions in futures and options decreased by 17,141 contracts to 323,703.

Figure 4 – EIA U.S. Crude Oil Inventories (Barrels)



Sources: EIA, Santander.

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



Sources: COT, Santander.

[2] Energy Information Administration.
[3] U.S. Commodity Futures Trading Commission.

INFLATION

October's IPCA registered a 1.25% MoM change (10.67% YoY—exactly the same level of Dec-2015), much above the consensus (1.06%) and our call (1.09%). The headline accelerated to 14.4% 3MMA-saar (from 13.6%), highlighting that the upward pressure remained strong at the margin.

Most of the surprise came in industrial goods and regulated prices, but services also came above expectations. Industrial goods contributed +6 bps to the headline forecast error, with the trend remaining at the high level of 12.6% 3MMA-saar; the industrial's core gauge trend also continued at the hefty level of 8.5% 3MMA-saar. In regulated prices (+6 bps of deviation to the headline forecast error), medicines were a highlight, contributing +3 bps with the error, but, electrical energy and gasoline also surprised to the upside (contributing +2 and +1 bps to the headline forecast error, respectively). Services contributed +3 bps to the headline forecast error and its trend accelerated further to 9.5% 3MMA-saar (from 8.6%), reaching 2013-2016's levels. Services core gauge also accelerated, reaching 7.5% 3MMA-saar—still below 2013-2016's level, but a risky level, nonetheless. Finally, food-at-home came in line with expectations, meaning that its trend continued to hovering at the high level of 18% 3MMA-saar.

Broad qualitative measures still deteriorated further at the margin. The average of the main five core measures followed by the Brazil Central Bank (BCB) rose to 9.7% 3MMA-saar (from 8.9% before) and it is hovering above the target (and distancing further from it) for thirteen months now. This is evidence of spreading of the primary shocks (commodities, FX, supply chain disruption, etc.) to the general prices and the persistency at these high levels is risky. The "less negative" news is that diffusion saw some relief, falling to 62.9% (seasonally adjusted) from 65.4% previously—although this is still above the level of 50-55%, which is the one compatible with inflation close to the target.

All in all, we see this as another unfavorable reading and we remain cautious on the inflation outlook, continuing to see the balance of risks tilted to the upside (especially with the recent rise of domestic risk and with new global shocks constantly). We were cautiously expecting IPCA inflation to peak for the last three months (or more), but we are now expecting inflation to hover between 10.5-10.7% until the end of 1Q22, turning the peak into a plateau, pointing to a slower disinflation process ahead.

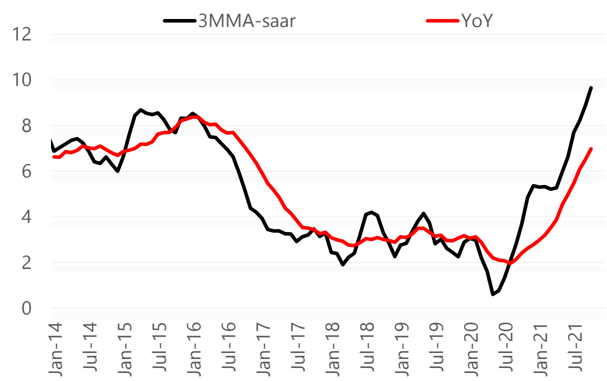
We have revised our high-frequency tracking to 10.5% (from 9.6%) for IPCA 2021, to 5.8% (from 5.2%) for IPCA 2022 maintained IPCA 2023 at 3.5%. It is worth remembering that the BCB's target is 3.75% for 2021, 3.50% for 2022 and 3.25% for 2023 (±1.50% tolerance interval for each year), and our forecasts are above the targets for all horizons and with upside risks. See details in the link[4].

Figure 6 – IPCA: Forecast Details (%)

	MoM			YoY	
	Oct-21	Santander	Dev.	Sep-21	Oct-21
IPCA	1.25	1.09	0.16	10.2	10.7
Administered	1.35	1.12	0.06	15.7	17.0
Free	1.21	1.07	0.10	8.3	8.5
Food-at-home	1.32	1.30	0.00	14.7	13.3
Industrial goods	1.40	1.13	0.06	10.6	11.1
Services	1.04	0.95	0.03	4.4	4.9
EX3 Core	0.92	0.87	0.02	6.4	6.6

Sources: Brazilian Central Bank, Santander.

Figure 7 – Core Inflation Forecast (EX3 %)



Sources: Brazilian Central Bank, Santander.

[4] **Santander Brazil Inflation - *"October's IPCA: Peak Turning Into a Plateau, with Slower Disinflation Ahead"* –** November 10, 2021 – Available on: http://bit.ly/Std-IPCA-oct21

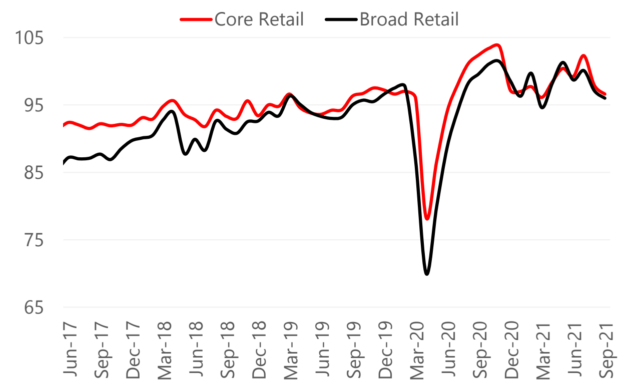
ECONOMIC ACTIVITY

Widespread decline in retail activity in September. Broad retail sales surprised to the downside by retreating 1.1%, below market consensus (-0.1%) and our estimate (+0.3%). Core retail sales (ex Building material and Vehicle sales) also surprised to the downside (-1.3%). September's figures brought both indexes back to levels below their pre-pandemic marks, down 1.7% and 0.4% since February-2020, respectively. Zooming in on the details, both credit and income-led segments dragged down retail activity, reflecting the impact of inflation eating into household income and the recent deceleration in credit granting. Supermarkets (-1.5%), Vehicles (-1.7%), and Furniture and home appliances (-3.5%) were the lowlights, with negative contributions of -0.45, -0.41, and -0.26 p.p., respectively, to the broad activity result. The Other retail segment continued to weaken by retreating 2.2% (down 19.5% in August), fully giving back July's steep (and unexpected) growth (up 23.3%). Looking ahead, based on IGet data (our proprietary indicator)[5], we have updated our tracking for broad retail sales in October to 0.8% MoM-sa (from +1.5%), marking a positive start to 4Q21. However, we still expect tepid figures for goods-related sectors, in the wake of the shift in spending out of goods to services as the economy reopens, reinforced by inflation eating into household income and disruptions in the supply chain. See details in the link[6].

The services sector retreated 0.6% in September. This result broke a string of five consecutive gains since the pandemic's resurgence seen earlier this year but still places the index 3.7% above the pre-pandemic mark. In quarterly terms, the index ended 3Q21 expanding 3.0% (2.1% in 2Q21), which highlights a solid contribution of cyclical services to overall activity in 3Q21. Services to Families were (again) in the spotlight (up 1.3%), ending 3Q21 with a healthy 17.2% growth (4.2% in 2Q21) and still showing wide idleness compared to the pre-pandemic mark (down 16.2%), which leaves room for positive contributions from the services sector to overall activity in 4Q21 and in 2022. The ambiguity between solid services spending and weak demand for goods seen in 3Q21 reflects the gradual normalization of health and mobility conditions, favoring the reopening of services and implying a more normal balance between spending in services and goods. See details in the link[7].

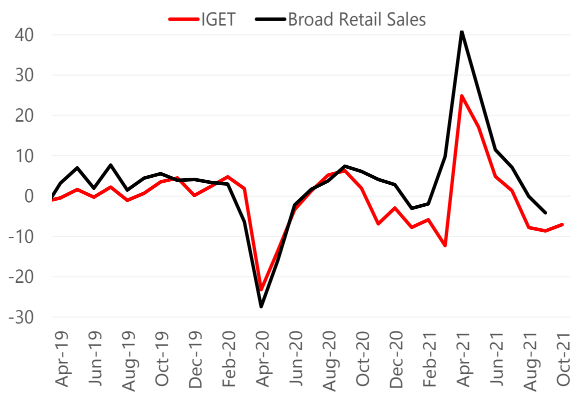
The BCB will publish its monthly GDP proxy (IBC-Br) for September on Tuesday (November 16). This release will cap the batch of the main economic indexes releases for the month and we expect a monthly stability. Moreover, we are maintaining our tracking for 3Q21 GDP growth at +0.2%, reflecting expectations of solid growth of services, mainly those segments that show wide idleness. **For details on Santander's activity outlook, please refer to our last chartbooks[8].**

Figure 8 – Retail Sales (sa, 2014=100)



Sources: IBGE, Santander.

Figure 9 – IGet x Broad Retail Sales (nsa, YoY%)



Sources: Santander.

[5] **Santander Brazil Economic Activity - *"IGet: Varejo mostra começo positivo de 4T"* –** November 05, 2021 – Available (in Portuguese) on: https://bit.ly/Std-IGET-out21

[6] **Santander Brazil Economic Activity - *"Widespread Decline in Retail Activity in September"* –** November 11, 2021 – Available on: https://bit.ly/Std-Econact-111121

[7] **Santander Brazil Economic Activity - *"Services Retreated at the end of 3Q21"* –** November 12, 2021 – Available on: https://bit.ly/Std-Econact-111221. The report will be available on the link around @3pm ET.

[8] **Santander Brazil Economic Activity - *"Chartbook – Downgrading the Estimate for 2022 and 2023"* –** November 05, 2021 – Available on: https://bit.ly/Std-chart-econact-nov21

Santander Brazil Economic Activity - *"Chartbook – Household Indebtedness Expected to Slow Lending in 2022"* – November 09, 2021 – Available on: https://bit.ly/Std-chart-credit-nov21

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