Santander
Macroeconomic Research

BRAZIL MACRO

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MACRO COMPASS

ACTIVITY SURPRISES TO THE UPSIDE

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

- The BRL broke a sequence of gains registered in previous weeks, standing among the bottom performers in an expanded basket of major currencies for the rolling week ended May 13. Inflation fears in the US and an accommodative tone of the Copom minutes were probably key factors behind the underperformance.
- New COVID-19 cases are slowly increasing (again), while casualties are slowly declining in Brazil. Both statistics remain at (uncomfortably) high levels. Reported delays in the arrival of imported inputs for vaccine production may push back the schedule of the National Immunization Plan, as the vaccine rollout loses steam (running just below 700k per day) recently.
- Our high-frequency (daily) trackers point to significant improvement in urban mobility and economic activity between late April and early May. The main risk for the reopening process continues to be the possibility of a resurgence in infections, given the still early stage of the vaccine rollout.
- Economic activity surprised positively in March, showing resilience amid the withdrawal of the fiscal stimuli and the resurgence of the pandemic. The BCB's broad activity index (IBC-Br) ended 1Q21 with solid growth and left a less negative carryover for 2Q21 than previously thought. Our tracking for 1Q21 GDP was updated to +0.6% QoQ-sa (from +0.4%), which suggests there is upside risk to our 2021 GDP estimate (currently at 3.0%).
- The IPCA registered a 0.31% MoM change (6.76% YoY) in April, just a tad above the market’s expectation of 0.29%. Underlying (core) measures continue to trend at high levels (~5%) and the diffusion index now stands well above the average for low-inflation years. These figures point to an unfavorable CPI composition. We revised our high frequency IPCA tracking up to 5.9% for 2021 (previously 5.6%) and to 3.9% for 2022 (previously 3.7%).
- We noted a more accommodative tone in the Copom minutes compared to the statement issued a week before, as the BCB seemed more confident that inflation would converge to mid-target next year even with a small degree of monetary stimulus. This view seems to contrast with the BCB’s own sanguine views for activity developments and a balance of risks for inflation still skewed to the upside.
- The coming week brings a very thin calendar of major macro releases in Brazil.

Most of the information in this report is up to the end of Thursday, May 13, 2021.

Figure 1. Brazil Macro Agenda for the Week of May 17-21, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Inflation: IGP-10 (% MoM)	FGV	May/21	Mon, 17-May	--	1.58
Federal Tax Collection (BRL billion)	RFB	Apr/21	20 to 25-May	--	137.9

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario: *"Anchoring Power Is Dwindling"* –** April 1, 2021- Available on: http://bit.ly/Std-scenario-Apr21

LOCAL MARKETS—FX

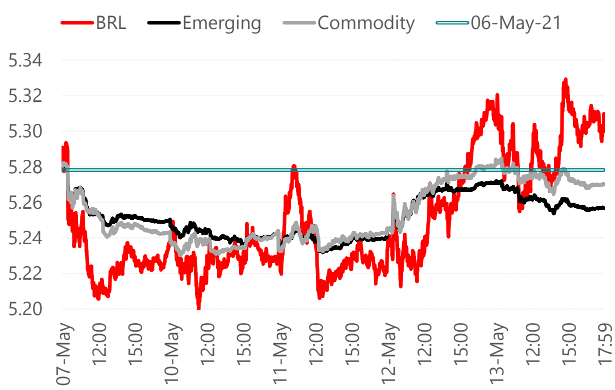
After two weeks of strengthening, the BRL failed to continue on this trend in the week ended May 13, as the USD/BRL cross climbed to 5.31 from 5.28 on May 6. The Brazilian currency was one of the bottom performers among the major currencies. In our view, the combination of a less constructive international news cycle and less supportive domestic developments justified the pause in the strengthening move. Abroad, the April US CPI reading came far higher than the market median estimate (4.2% versus 3.6% in YoY terms), which was taken by market participants as a sign that the FOMC might anticipate the removal of monetary policy stimulus. As a result, we saw the US yield curve becoming steeper than a week ago and the DXY index pointed to a strengthening of the greenback—i.e., a partial unwinding of the risk-on mode that prevailed in the previous weeks.

We believe these facts would have already sufficed to put pressure on the BRL in the last few days. However, on top of that, we also witnessed a less hawkish wording by the BCB in the minutes of the last Copom meeting (see details in the Monetary Policy section). Given that inflation expectations have been moving up and activity indicators have been better than expected as well—more details in the Economic Activity section—market participants seem to fear that the BCB may fall further behind the curve. We think this market impression may have contributed to the weakening BRL lately.

LOCAL MARKETS—Rates

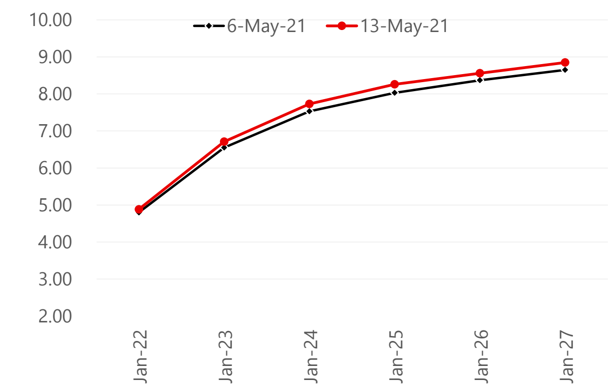
The nominal yield curve bear-steepened considerably for the second week in a row. Since last Thursday (May 6), the front end of the curve (Jan-22 DI future) rose 9 bps to 4.89%, while the back end (Jan-27 DI future) rose 20 bps to 8.85%. Hence, the steepness rose 11 bps to 397 bps. At the front end, despite a slightly more dovish tone in the Copom minutes if compared to the statement (see details in the Monetary Policy section), the qualitatively unfavorable reading for April's IPCA (see details in the Inflation section) and upward surprises in economic activity data (see details in the Economic Activity section) caused short-end yields to rise. At the long end, besides the risk-premium owing to a fragile medium-term fiscal outlook, the global scenario also contributed to the rise in yields, especially after the upside surprise in April CPI in the U.S.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, May 13, 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, May 13, 2021.

COVID-19 MONITORING

In the U.S., CDC provides new guidance for mask use for fully vaccinated people. The Center of Disease Control and Prevention (CDC) relaxed guidelines for wearing masks indoors in most places. The pace of vaccinations is currently at 2.1 million/day (7-day moving average), with nearly 45% of the population having received at least one dose. This figure stands at 52% in the U.K. and 29% in the European Union. New cases are still falling in most Western European countries as vaccination ramps up.

***Butantan* to stop vaccine production again, as supply deliveries come to a halt.** According to the institute, there is no clear date for when the next shipment of APIs (active pharmaceutical ingredient) for the Coronavac shot will be approved in China. *Fiocruz* production is also at risk, depending on new shipments scheduled for next week. Considering the entire manufacturing process of the vaccine, the shortage of inputs now means probable delays in deliveries expected for the end of June. Thus, the uncertainty about the arrival of imported inputs continues to suggest risks for the schedule of the National Immunization Plan.

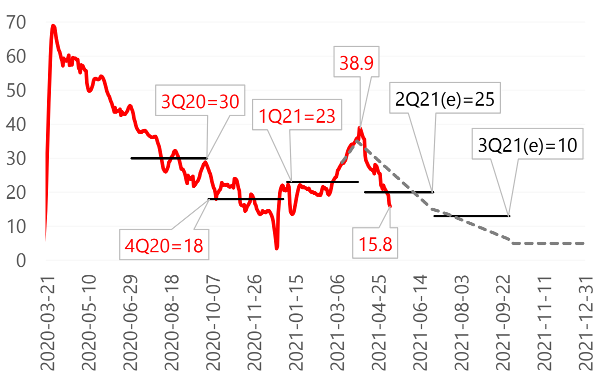
In Brazil, new COVID-19 cases are slowly increasing while casualties continue to decline. Both remain at high levels. The ICU occupancy rate is above 90% in 4 states, compared to 7 states last week (and a peak of 18 states in the worst phase). As of Wednesday (May 12), 55.5 million doses (out of 83 million delivered) had been administered in the country, with the most recent pace of vaccination at 705k/day (7-day moving average). Data from Brazil's Health Ministry showed an average of 61.3k new daily cases (7-day moving average) as of Wednesday (May 12), up 4.5% from last week, while daily casualties (7-day moving average) totaled 1,947, down 15.9% in the same period.

Mobility seems to be recovering much faster than expected. After starting April at high levels, close to the ones seen in June-2020 (~40 points), our lockdown index (based on Google Mobility Report) posted a consistent downward trend in recent weeks. After ending April running at 20.9 points (7-day moving average), the index recently reached 15.8 points (as of May 9, 2021). This improvement stemmed mainly from mobility increases in the Workplaces (which already stands at pre-pandemic marks) and Transit Station segments. These categories suggest a close link to economic activities and this recovery path bodes well for economic activity in 2Q21. However, the risk of increased infections should be monitored before a more disseminated vaccine rollout.

Figure 3.A. – Vaccination by Age and Gender (May 10, 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 May 09, 2021.

MONETARY POLICY

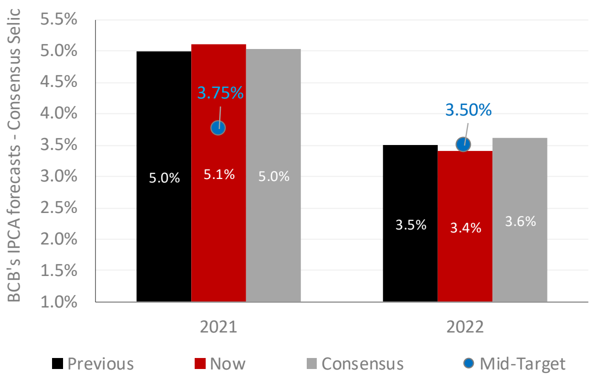
The BCB published the minutes from its May 4-5 Copom policy meeting, during which the authority once again raised the Selic policy rate by 75 bps, to 3.50%.

Overall, we noted a more accommodative tone compared to the statement (released in the previous week), as the BCB seemed more confident that inflation would converge to mid-target next year, despite the BCB's own sanguine forecasts for the activity developments and views of predominantly upside risks for inflation.

The authority affirmed that a full normalization path with continued Selic rate hikes (i.e., up to ~6.5%) would produce CPI projections considerably below the mid-target for 2022. Thereby, the BCB shows confidence that inflation convergence can occur next year with still a little degree of monetary stimulus (i.e., the policy rate below its structural level). Yet, amid perceived upside risks for inflation, the committee left the door open to alter its course of action "if there is a change in inflation projections or in the balance of risks."

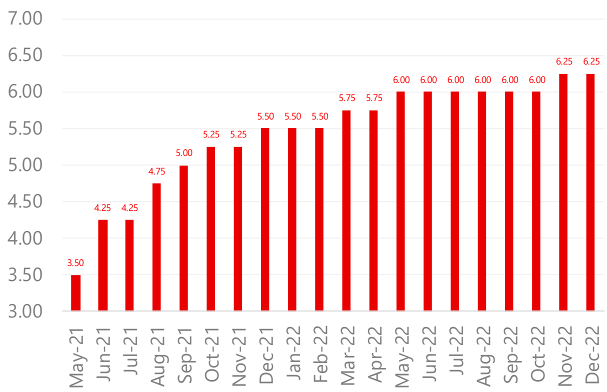
We believe it is unlikely that the constructive inflation scenario projected by the BCB will materialize, both in terms of inflation conditions and the consequent policy response, amid persistent cost pressures and fiscal uncertainties. Given the BCB's reaffirmed commitment to achieving the mid-point target for inflation next year (meaning flexibility to change its current flight plan of "partial normalization"), we believe that monetary policy is prone to normalize (toward our neutral rate estimate of 7.00% in nominal terms) sooner rather than later. See details in the link[2].

Figure 4.A. – BCB's Inflation Simulations



Sources: Brazilian Central Bank, Santander.
Note: BCB simulations assume Selic from Focus survey, USD/BRL starting at 5.40 and evolving according to purchase power parity.

Figure 4.B. – Path of Consensus Selic Forecasts



Sources: Brazilian Central Bank, Santander.
Note: Based on the BCB's weekly Focus survey as of April 30, 2021 (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).

[2] **Santander Brazil – Monetary Policy: *"Copom Minutes: Staying The Course…For Now"*** – May 13, 2021- Available on: http://bit.ly/Std-copom-110521

ECONOMIC ACTIVITY

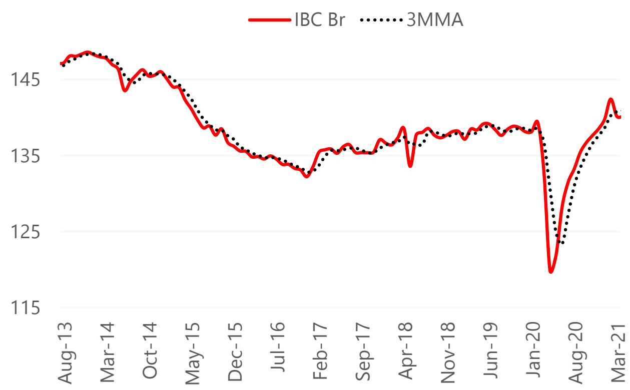
Supermarkets sales cushion retail's drop. The headline index retreated by 5.3% MoM-sa, a much better result than the sharp tumble expected by the market (-11.5%). March's resilient figure was mainly driven by supermarkets (up by +3.3%), which solid growth partially offset the sharp tumble in the credit-led segments. Clothing and Furniture stood out, retreating by 41.5% and 22%, respectively, while Vehicles also posted a sharp decrease (20%). In the details, nine of the ten segments that form broad retail sales showed monthly declines. In quarterly terms, the broad index ended 1Q21 with a contraction of 3.9%, following 3.2% growth in 4Q20. See details in the link[3].

Services to firms show resilience in March. The headline index fell by 4.0% (+4.5% YoY), considerably above market consensus of +2.2% YoY, but still taking the index close to pre-pandemic levels (-2.8% since February 2020). Among subsectors, those segments related to firms were resilient, while services to families suffered substantially, posting a steep decline (-27.0%), as expected, as this sector has been hard hit by social-distancing measures. In quarterly terms, the service sector ended 1Q21 with solid growth of 2.8%, which implies a carryover of -1.2% for 2Q21. See details in the link[4].

Solid quarterly growth of IBC-Br, with better than expected carryover for 2Q21. The headline index fell by 1.6% (6.3% YoY), above market consensus of -3.4% (our call: -3.4%) and the first drop since April 2020, breaking a string of ten increases. March's figure placed the economy at levels 0.6% above the pre-crisis mark, according to this indicator. This monthly drop reflects the declines in the tertiary sector (services: -4.0% and broad retail sales: -5.3%) and the drop seen in industrial production (-2.4%).In quarterly terms, the IBC-Br ended 1Q21 with solid growth of 2.3%. This result left a carryover of -0.4% for 2Q21; however, a positive start in 2Q21 could partially mitigate any negatives. April's consistent recovery of mobility and our proprietary index (IGet) already point in this direction. See details in the link[5].

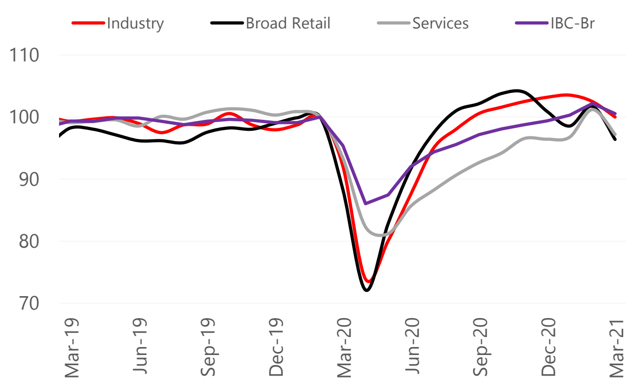
Activity's positive surprises of the last few months imply upside risks to our nearly stable 1Q21 GDP forecast (+0.2% QoQ-sa). Our tracking was updated to +0.6% QoQ-sa (from +0.4%). For 2Q21, rapidly increasing mobility, along with some positive activity figures for April also suggest a less intense contraction than we are currently forecasting (-0.6% QoQ-sa). **For details on Santander's economic activity scenario, please refer to our last chartbook[6].**

Figure 5.A. – IBC-Br Broad Activity Index (sa, 2003=100)



Sources: BCB, Santander.

Figure 5.B. – Economic activity breakdown (sa, February-20 = 100)



Sources: IBGE, Santander.

[3] **Santander Brazil Economic Activity -** ***"A Positive Surprise, Driven by Supermarkets"*** **–** May 07, 2021 - Available on: http://bit.ly/Std-econact-070521
[4] **Santander Brazil Economic Activity -** ***"Monthly Decline, with Quarterly Expansion"*** **–** May 12, 2021 - Available on: https://bit.ly/Std-econact-120521
[5] **Santander Brazil Economic Activity -** ***"Activity Positively Surprises in 1Q21"*** **–** May 13, 2021 - Available on: https://bit.ly/Std-econact-130521
[6] **Santander Brazil Economic Activity -** ***"Chartbook - Lingering Impacts to Keep Recovery at a Slow Pace"*** **–** April 13, 2021- Available on: http://bit.ly/STD-chartbook-Act-apr21

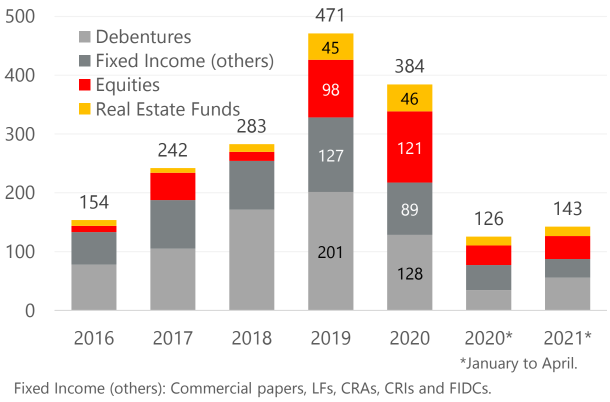
CREDIT

Anbima figures on capital markets activity for April show that new issuance totaled BRL39.6 billion. Comparing issuances so far this year (up to April) versus the year-ago period, there was an increase of 20.4%. Bond issuance (debentures) stood out with BRL24.3 billion; fixed income accounted for BRL7.8 billion; equities totaled BRL5.4 billion; and real estate funds came in at BRL2.1 billion.

Debentures issuance of BRL 24.3 billion accounted for the largest share of issuance during the month (61%). The bonds issued by a mining company (BRL11 billion) represented almost half of it, amid a month that saw a consistent surge in iron ore prices. Looking at the allocation of proceeds of debentures in 2021 until April, we see that 44% was allocated for working capital and debt refinancing, as opposed to 71% in the entire year of 2020.

In equities, the BRL5.4 billion volume came from follow-on offerings, as there were no IPOs. The worsening of the pandemic contributed to a more uncertain economic outlook, in our view weighting on financing decisions. Still, total equity issuance in 2021 was 24% above the year-ago period.

Figure 6.A. – Issuance in Domestic Markets (BRL billion, CPI adjusted)



Sources: Anbima, Santander.

INFLATION

The IPCA for April registered a 0.31% MoM change (6.76% YoY), just a tad above the market's median expectation of 0.29% and well above our 0.24%. The upside surprises came in administered prices (+7bps)—mostly in gasoline (+4bps) and medicine (+3bps)—and on industrial goods (+8bps). Surprises to the downside were food-at-home (-3bps) and services (-5bps).

In terms of underlying measures, the reading was still unfavorable, with the average of cores decelerating to 5.0% (from 5.1%) in 3mma-saar terms, a very slight movement and a still very high level. Moreover, the diffusion index rose from 58.7% to 65.2% (seasonally adjusted) showing a spreading of inflation between IPCA items.

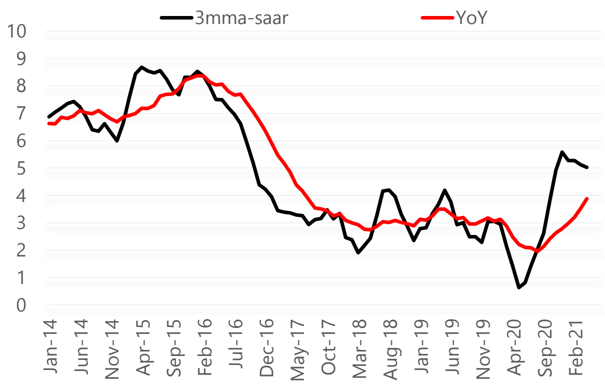
With the short-term revisions to our forecasts, our IPCA 2021 year-end track is revised upwards to 5.9% from 5.6%. It is worth highlighting that the BCB target is 3.75%, with the upper bound of the tolerance interval at 5.25%. For IPCA 2022, we also revised our high-frequency tracking to 3.9% from 3.7%, mainly because of higher food inflation inertia. Additionally, risks remain to the upside for IPCA 2022, in our view, given each time greater inertia from 2021 onward and the risky fiscal outlook for the medium-term. See link below[7].

Figure 7.A. – April's IPCA Forecast (%)

	MoM			YoY	
	Apr-21	Santander	Contrib.	Mar-21	Apr-21
IPCA	0.31	0.24	0.07	6.1	6.8
Administered	0.38	0.12	0.07	7.0	9.6
Free	0.28	0.28	0.01	5.8	5.8
Food-at-home	0.47	0.67	-0.03	17.6	15.6
Industrial goods	0.53	0.16	0.08	5.5	6.9
Services	0.05	0.18	-0.05	1.6	1.4
EX3 Core	0.37	0.35	0.02	3.4	3.8

Sources: IBGE, Santander.

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



Sources: IBGE, Santander.

[7] **Santander Brazil Inflation - *"IPCA April: No Improvement on the Qualitative Outlook for Inflation"* –** May 10, 2021 - Available on: http://bit.ly/Std-ipca-110521

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 Vasquez*	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
Henrique Navarro*	Head, Brazil	havieira@santander.com.br	5511-3012-5756
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