BRAZIL MACRO

October 15, 2021

MACRO COMPASS

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UNWORRIED ABOUT THE EXTERNAL POSITION

- The USD/BRL pair closed the rolling week ended October 14 at 5.51, nearly stable, among the bottom performers in a basket of 31 of the most liquid currencies in the world. In our opinion, the performance was driven by global factors (higher inflation data, expected Fed policy) and lingering local uncertainties (fiscal policy risks). The BCB intervened moderately in the market, selling FX swaps. Once again, the nominal yield curve downshifted at both ends, in a bull-flattening pattern.
- The USDA forecast published on Tuesday (October 12) points to the highest-ever U.S. crop for soybean and the second-largest ever for corn. As a result, ending stocks for 2021-22 have been revised higher. While the grain market remains tight, larger-than-expected crop yields in key producers feed expectations for relief in food inflation ahead.
- The services sector's real revenue posted a positive figure in August (up 0.5% MoM-sa), in line with our estimate (+0.5%). The Services to Families segment continued to strengthen amid a shift of spending out of goods and into services as the economy reopens. The significant idleness in this segment leaves room for positive GDP contributions from the services sector ahead. The IBC-Br (sort of a monthly GDP proxy) retreated slightly (-0.15%), reflecting the softening of activity in goods-related sectors, and our 3Q21 GDP tracking stands at +0.3% QoQ-sa. All in all, the August activity numbers reinforce the downside risks to our current GDP projections (0.7% for 3Q21, +5.1% for full-2021).
- We estimate the current account balance (Friday, October 22) to have registered a US$1.0 billion deficit last month on the heels of a smaller trade surplus, distorted by imports of oil platforms that are merely of an accounting nature (for tax planning purposes). Nonetheless, we do not expect this reading to change markets' constructive view about the soundness of the Brazilian external position.

Most of the information in this report is up to the end of Thursday, October 14, 2021.

Figure 1. Brazil Macro Agenda for the Week of October 18-22, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Current Account Balance (USD billion)	BCB	Sep/21	Fri, 22-Oct	-1.0	1.7
Foreign Direct Investment (USD billion)	BCB	Sep/21	Fri, 22-Oct	5.4	4.4
Federal Tax Collection (BRL billion)	RFB	Sep/21	20 to 25-Oct	147.5	146.5

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario: *"The Inflation Factor…Again"* –** September 16, 2021- Available on: https://bit.ly/Std-scenreview-set21

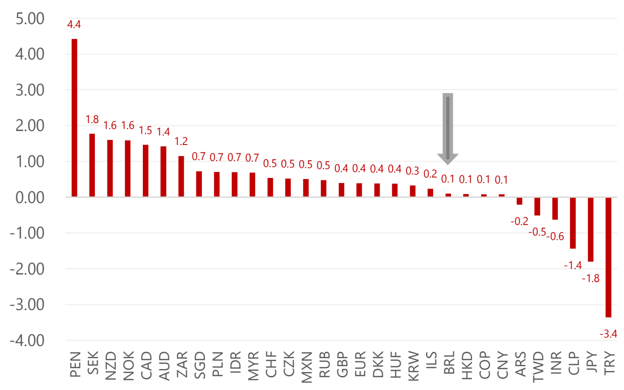
LOCAL MARKETS—FX

The USD/BRL pair closed the rolling week ended October 14 at 5.51, nearly stable, among the bottom performers in a basket of 31 of the most liquid currencies in the world. In our opinion, the performance was driven by a conjunction of global and local factors, and the underperformance occurred despite some targeted and moderate BRL support. The releases of the U.S. CPI and the Chinese PPI in recent days reinforced markets' fears regarding inflationary pressures. In addition, the minutes of the last FOMC meeting reinforced the general perception—with which we concur—that at its next meeting (due to be held in November) the U.S. monetary authority may announce the tapering of its asset-purchase program. Locally, the focus remains on the stalemate regarding the budget discussions (and the potential addition of new fiscal policy stimulus) for next year. No conclusion has been reached as yet, as the clock ticks (given the restrictions on new social programs in an election year). Altogether, the global and local factors weighed on the USD/BRL cross, which reached an intraday high of 5.57 sometime this week. That's when the BCB tendered US$2.0 billion through FX swaps that eased the pressure somewhat and allowed the pair to end close to the same level seen a week before.

LOCAL MARKETS—Rates

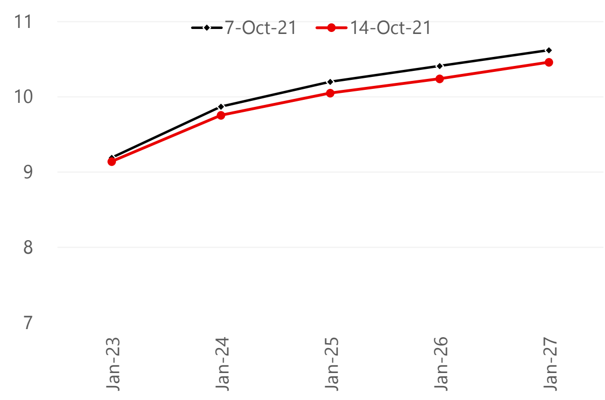
The nominal yield curve downshifted for the second week in a row, in a bull-flattening pattern. Since last Thursday (October 7), the front end of the curve (Jan-23 DI future) fell 5 bps to 9.14%, while the back end of the curve (Jan-27 future) fell 16 bps to 10.46%. As a result, the curve's steepness in this segment fell 11 bps to 132 bps. At the front end, the passage by the Lower House of new legislation for the states' VAT (ICMS) levied on fuel sales is seen as likely to prompt slight (albeit temporary) relief in fuel costs. This may have helped to cool down short-end yields, despite the changes that could potentially occur when the bill arrives in the Senate. At the back end, despite the continuing perception of uncertainty about the fiscal consolidation process, the market once again reduced a bit of the risk-premium at this segment of the curve. The tightening of longer U.S. Treasury yields probably contributed to the movement at this segment of the domestic curve, in our view.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, October 14, 2021.

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



Sources: Bloomberg, Santander.
Note: As of the close Thursday, October 14, 2021.

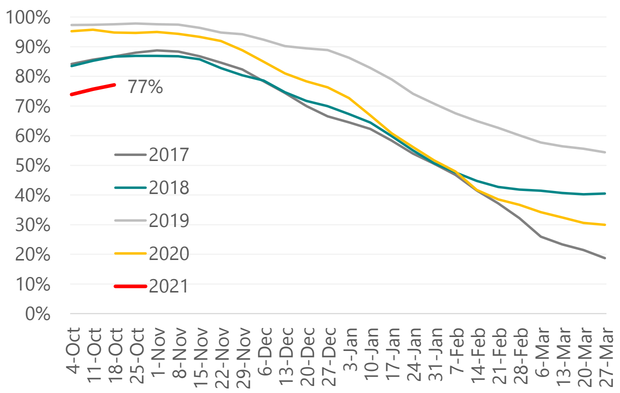
COMMODITIES

IEA's[2] monthly Oil Market Report says that a shortage of natural gas is boosting demand for oil. According to the agency's report published on Thursday (October 14), a massive switch away from gas and coal is prompting unseasonably high demand for oil products, deepening the supply deficit in crude markets. Meanwhile, European gas storage increased 1.5 p.p. from last week and is currently at 77%, significantly less than in recent years (90% on average at this time in the last five years). The week also saw Russian authorities reaffirming that the country was ready for dialog with EU on stabilizing markets and that it could supply as much gas as Europe needs. In our view, the production policy of OPEC+ will be the main factor influencing oil prices in the coming months. The next OPEC+ meeting is set for November 4.

USDA[3] raises ending stocks estimates for soybean and corn in the U.S. The WASDE[4] report published on Tuesday (October 12) forecasts a record soybean crop and the second-largest ever for corn in the U.S. As a result, ending stocks for 2021-22 have been revised higher: soybean inventories stand at 320 million bushels and corn at 1.5 billion bushels, meaning a stock-to-use ratio of 7.3% and 10.1%, respectively (the 10-year average is 8.4% and 12.0%, respectively). While the grain market remains tight, larger-than-expected crop yields could be a sign of relief for food prices ahead, following massive gains in recent months.

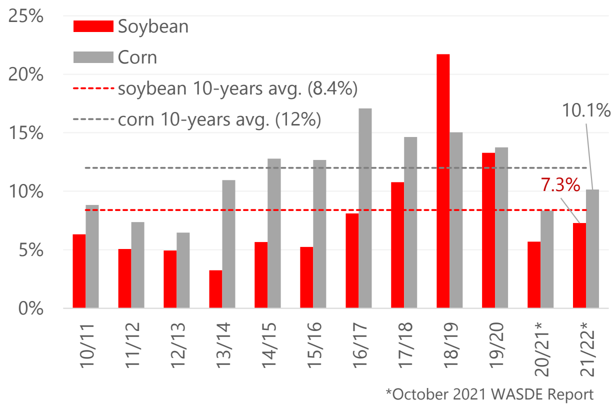
Higher speculative long positions in WTI crude oil. Money managers raised their net long WTI crude futures and options positions in the week to October 5, the CFTC[5] reported on Friday (October 8). The positions in futures and options rose by 18,115 contracts to 316,157. During that period, WTI crude futures climbed 6% on the back of growing concerns about a global energy crisis.

Figure 3.A. – European Gas Storage Utilization - %



Sources: Bloomberg, Santander.

Figure 3.B. – US: Stock-to-Use Ratio in Grains - %



Sources: USDA, Santander.

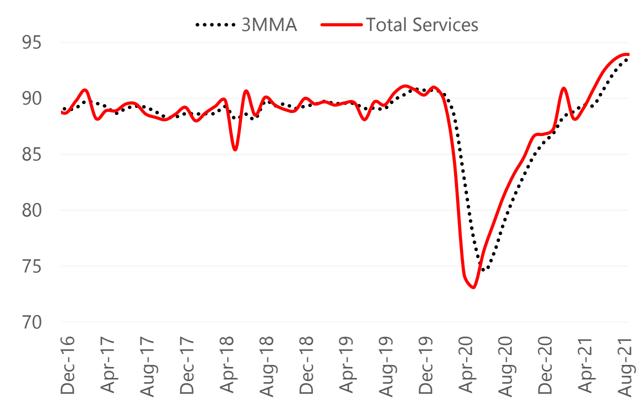
[2] International Energy Agency.
[3] United States Department of Agriculture.
[4] World Agricultural Supply and Demand Estimates.
[5] U.S. Commodity Futures Trading Commission.

ECONOMIC ACTIVITY

The services sector's real revenue posted a positive figure in August. The headline index rose 0.5% MoM-sa (+16.6% YoY), in line with our estimate (+0.5%) and the fifth gain in a row, with the index not only widening the gap over the pre-pandemic mark (up by 4.6% since February-2020) but also reaching its highest reading since 2015. In quarterly terms, this result implies a 3.3% carryover for 3Q21, reinforcing our view that the services sector should play a major role in the economic recovery in 2H21, amid a shift of spending into services as the economy reopens. In the details, Service to Families and Air Transports were the highlights, continuing their rebound. The former posted a healthy expansion of 4.1% MoM-sa (+42.3% YoY), the fifth gain in a row and slightly above the 40.7% YoY growth forecasted by our proprietary index (IGet Services)[6]. However, the segment still shows significant idleness, recording a 17.4% gap relative to the pre-crisis mark. This gap leaves room for positive contributions to GDP growth from the services sector. The Transports segment was up by 1.1%, stemming mainly from a steep rebound of Air Transports (up 7.4%), while Ground Transports, highly correlated with industrial production, posted virtual stability (-0.1%). With the exception of Professional services (down 0.4%), all the remaining subsectors contributed positively. In comparison to the pre-crisis mark, only the Services to Families subsector continues to show significant idleness, with the remaining subsectors standing close to or well above their pre-pandemic readings. See details in the link[7].

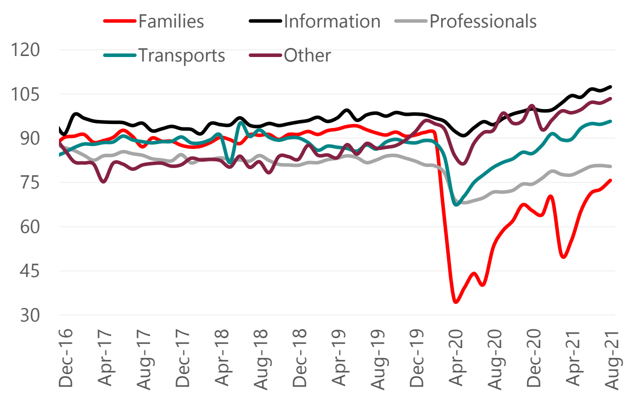
The IBC-Br (sort of a monthly GDP proxy) slightly retreated in August. The BCB's broad activity index retreated 0.15% MoM-sa**,** capping the batch of activity data releases for the month. After this feeble figure, we are maintaining our 3Q21 GDP tracking at +0.3% QoQ (last revision from +0.5%), which imparts downside risks to our current 3Q21 GDP forecast (+0.7%) as well as our 2021 GDP estimate (+5.1%). It is worth noting that IBGE usually publishes important revisions of the historical GDP series in its 3Q21 release. It is not an easy task to anticipate such movements, so we do not assume any previous hypothesis about these revisions. For details on Santander's activity outlook, please refer to our last chartbooks[8].

Figure 4.A. – Total Services (sa, 2014=100)



Sources: IBGE, Santander.

Figure 4.B. – Services Sector Breakdown (sa, 2014=100)



Sources: IBGE, Santander.

[6] **Santander Brazil Economic Activity - *"IGet Serviços – Serviços Terminam o Trimestre com Queda"* –** October 06, 2021 – Available (in Portuguese) on: https://bit.ly/Std-IGETser-set21
[7] **Santander Brazil Economic Activity - *"A Positive Figure for Services in August"* –** October 14, 2021 - Available on: https://bit.ly/Std-Econact-101421
[8] **Santander Brazil Economic Activity - *"Chartbook – Downgrading the Estimate for 2022"* –** September 20, 2021 – Available on: https://bit.ly/Std-chart-econact-set21

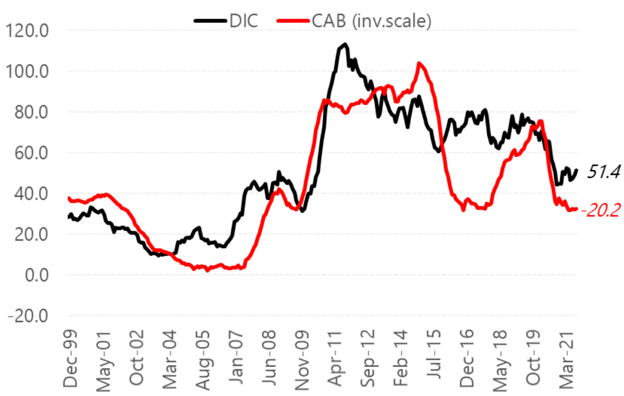
BALANCE OF PAYMENTS

The September 2021 current account balance should have registered a US$1.0 billion deficit, according to our calculations, which—if confirmed—will translate into a US$20.2 billion deficit on a 12-month basis (1.3% of GDP). However, we do not expect this negative reading to change the outlook for a near-zero gap this year (and next) as well as the markets' constructive view about the soundness of the Brazilian external position, as the services and primary income deficits remain subdued.

The trade surplus we expect to be shown in September 2021 balance of payments should be fairly smaller than the US$4.3 billion unveiled by the Foreign Trade Secretariat earlier this month due to methodological features. The former factors in imports of oil platforms that are accounting adjustments rather than genuine purchases abroad, whereas the latter neglects these operations. As a result, we estimate this more modest contribution to the trade balance than in the previous month to be the main reason for the US$1.0 billion current account deficit in the period (US$20.2 billion on a 12-month basis), especially as the services and primary income accounts should have been close to the subdued levels of previous readings. Therefore, despite the negative print, structural dynamics of the current account balance do not seem to us to have changed, and we continue to anticipate a shrinkage in the current account deficit on a 12-month basis through the end of this year.

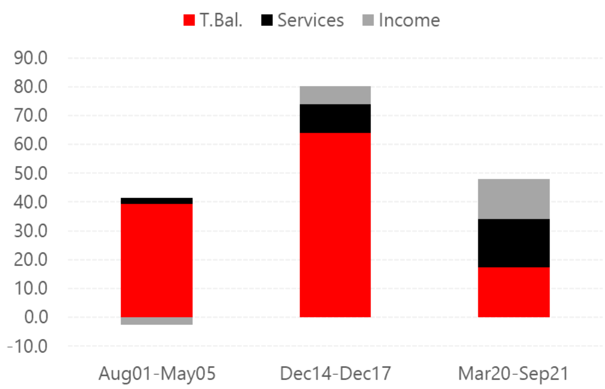
In addition to still comfortable prospects regarding the current account balance, we also expect the financial account to indicate the country has plenty of funding sources to finance it. According to preliminary figures provided by the BCB, we calculate the volume of direct investments in the country should have tallied US$5.4 billion in September, which—if confirmed—will translate into net inflows of US$51.4 billion on a 12-month basis (more than enough to finance the current account deficit in the same terms). Last, but not least, still based upon BCB's preliminary data, foreigners should have continued to purchase financial assets in the domestic market for the sixth month in a row, thus reinforcing the availability of resources to fund the Brazilian external financing needs. In sum, we expect the Brazilian balance of payments to remain outside the list of reasons that could eventually explain the weakness of the BRL.

Figure 5.A. – Current Account Balance vs. Direct Investment in the Country (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 5.B. – Current Account Adjustment Cycles (USD billion)



Sources: Brazilian Central Bank, Santander.

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