BRAZIL MACRO

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MACRO COMPASS

BRL Underperforms Amid a Sea of Local Concerns

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- Despite the favorable conditions in international markets (i.e., a risk-on environment) in the last few days, the BRL weakened (and underperformed its peers) on the heels of lingering concerns about the fiscal outlook (and the pandemic).
- Reflecting the same concerns, the nominal yield curve bear-steepened compared to a week before. At the front-end, the upward pressure in yields followed unfavorable underlying inflation data for March; at the back end, the latent fiscal risk continues to feed a hefty premium.
- New COVID-19 cases and casualties remain very high, but the 7-day averages seem to suggest a softening trend, possibly on the back of broad-based social distancing measures in place. The vaccination campaign is gaining traction, reaching a daily average of ~770k (slightly above our baseline scenario).
- On April 15, the Ministry of Economy released the budget guidelines (PLDO) for 2022, proposing a primary deficit target of BRL170.5 billion (1.9% of GDP), which will be the ninth negative annual reading, Meanwhile, the government still looks for a solution to the budget 2021 gridlock, with the deadline for a decision being April 22.
- In a recent report ("CAGED vs. PNAD: Which Labor Survey is Right?" – April 12, 2021), we take a deeper look at the ambiguous signals from labor market indicators (i.e., the Caged establishment survey and the PNAD household survey). We conclude that PNAD paints a more precise picture of the current labor market, with employment possibly at all-time lows and far from its trend. We also updated our estimates of the "expanded" real income (i.e., including extraordinary stimulus). We estimate that aggregate income has grown 2.2% in 2020 and expect a 6.2% drop for 2021.
- Tertiary activity indicators pointed to solid growth in February. Broad retail sales surprised positively, mainly driven by the credit-led segments. Real services revenues posted a strong expansion, with services to families leading the way. For March, the outlook is quite negative on the back of tighter mobility restrictions (necessary to curb the jump in Covid-19 infections), with our proprietary index (IGet) pointing to steep declines both in retail sales and services to families.
- For the coming week, the BCB will release the latest figures for its broad activity indicator (April 19), capping the batch of economic activity indexes for February. We look for a monthly growth of 0.9% MoM-sa, the tenth in a row, placing the economy 1.1% above the pre-crisis mark.

Most of the information in this report is up to the end of Thursday, April 15, 2021.

Figure 1. Brazil Macro Agenda for the Week of April 19-23, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IBC-Br Activity Index (% MoM)	**BCB**	**Feb/21**	**Mon, 19-Apr**	**0.9**	**1.04**
IBC-Br Activity Index (% YoY)	BCB	Feb/21	Mon, 19-Apr	-0.4	-0.46
Industrial Confidence Preview (index)	FGV	Apr/21	Thu, 22-Apr	--	104.2
2021 Budget: final deadline for sanction	**--**	**--**	**Thu, 22-Apr**	**--**	**--**
Federal Tax Collection (BRL billion)	RFB	Mar/21	19 to 23-Apr	123.8	127.8

Source: Santander Brazil.

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

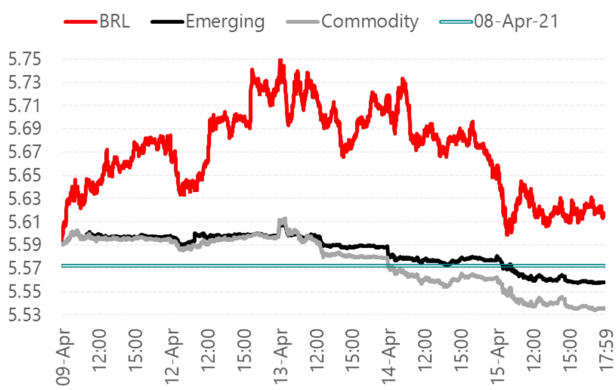
The international environment provided a constructive backdrop for risky assets in recent days. After all, despite sound updates on activity indicators for the US, the US yield curve has flattened a bit, which favored a risk-on approach by market participants. Additionally, economic releases about China and the Eurozone have also brought constructive evidence of improvements in the shape of the world economy, thus boosting the performance of emerging and commodity currencies since April 8.

However, the BRL bucked the trend, ending the April 15 session on a weaker footing than a week ago (USD/BRL5.62 vs. 5.57, respectively). In our opinion, the uneasy domestic environment stemming from the continued budget gridlock was the main reason for that performance. Additionally, a shakier political backdrop also seems to weigh on the dynamics of the BRL in the last couple of days, amid increased market participants' discomfort with prospects for the progress of structural reforms in the near future. The type of solution for the budget imbroglio and developments related to the pandemic (and an eventual reopening of the economy) are likely to be the main drivers of BRL performance in the coming weeks.

LOCAL MARKETS—Rates

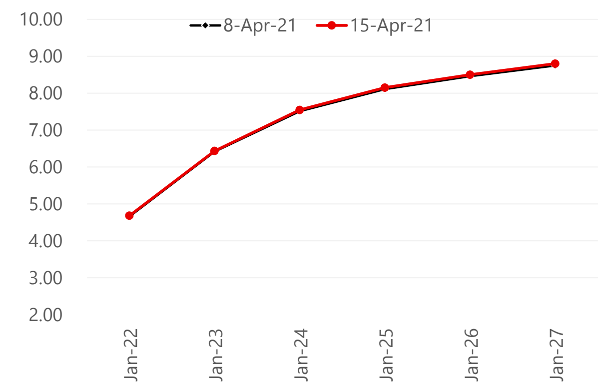
Despite a global risk-on mood, the domestic nominal yield curve bear-steepened. Since last Thursday (April 8), the front end of the curve (Jan-22 DI future) rose 2 bps to 4.68%, while the back end (Jan-27 DI future) rose 5 bps to 8.80%. Hence, the steepness edged up to 412 bps from 409 bps last Thursday (April 8). At the front end, despite a lower-than-expected IPCA inflation for March, the qualitative measures of the reading continued to signal an unfavorable outlook for inflation (refer to the inflation section) and the market keeps pricing in high probabilities of a more hawkish move by the BCB in the next Copom meeting (i.e., a hike of 100 bps). At the long end, the latent domestic fiscal risk, only enhanced by the budget gridlock, continues to lead to a higher premium.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, April 15, 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, April 15, 2021.

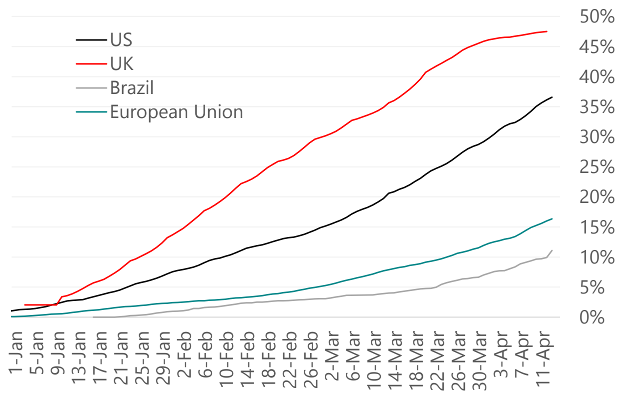
COVID-19 MONITORING

In the U.S., new cases are slowly rising. Most of the increase in driven by a few northern states, with Michigan standing out. The vaccination pace is currently at 3.3 million/day (7-day moving average), with nearly 36% of the population having received at least one dose. This figure stands at 47% in the U.K. and 16% in the European Union. New cases are rising in France and Germany, while in U.K. the downward trend continues. The effect of the reopening of non-essential activities in the latter should appear in coming days.

***Butantan* to receive more vaccine supplies for 5 million doses next week**. The institute is set to resume deliveries to the Ministry of Health in early May, fulfilling the first contract of 46 million doses. Another 54 million is expected until end of August. Meanwhile, *Fiocruz* is set to deliver 5 million doses this week. Lastly, 2 million Pfizer doses from 2H21 were brought forward to 2Q21.

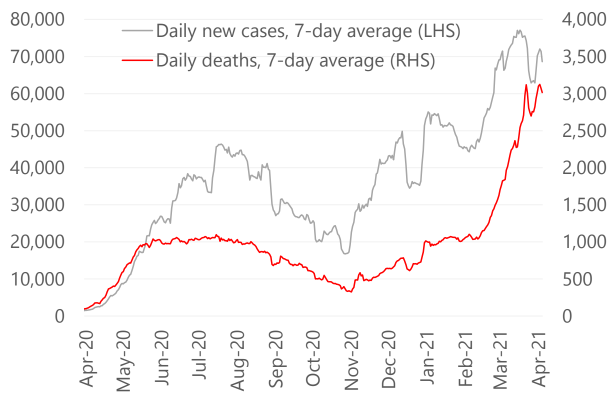
In Brazil, new COVID-19 cases and casualties seem to be softening, but are still at a still high level. The ICU occupancy rate is still above 90% in 16 states, compared to 18 states last week. As of Wednesday (April 14), 33 million doses (out of 54 million delivered) had been administered in the country, with the most recent pace of vaccination at 770k/day (7-day moving average), standing above our baseline scenario. Data from Brazil's Health Ministry reported an average of 68k new daily cases (7-day moving average) as of Wednesday (April 14, 2021), up 8% from last week, while daily casualties (7-day moving average) totaled 3,015, up 9% in the same comparison.

Figure 3.A. - People Who Received at Least 1 Shot (%)



Sources: Our World in Data, Santander.

Figure 3.B. - Daily COVID-19 Cases, Deaths in Brazil



Sources: Brazil Health Ministry, Santander.

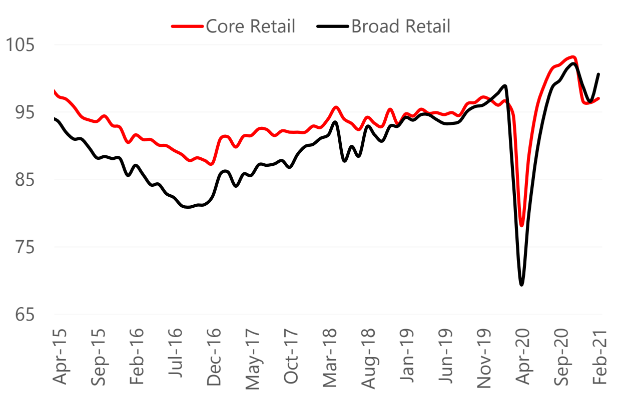
ECONOMIC ACTIVITY

Broad retail sales surprised positively in February. The headline index posted a 4.1% MoM-sa gain, considerably above market consensus of 1.8%. Regarding core retail sales (excluding auto and construction materials), the index was up 0.6% MoM-sa (consensus: 0.7%). Both indexes are above the pre-pandemic mark (February 2020). February's figure was mainly driven by sales in the credit-led segments. Furniture and Vehicles stood out by increasing 9.3% and 8.8%, respectively. Clothing posted a sharp increase (7.8%). In the details, six of the ten segments that form broad retail sales showed monthly growth. Looking ahead, we expect a sharp quarterly deterioration of retail sales in 1Q21, as the fiscal cliff materializes and given the setback in the economy's reopening process following the pandemic's resurgence. Based on our proprietary index for retail sales (IGet), our tracking for broad retail sales in March stands at -12.8% MoM-sa. See link below[2].

Services real revenue also surprised positively, surpassing the pre-crisis mark. The headline index posted a sequential increase of 3.7% MoM-sa (-2.0% YoY) this month, considerably above the consensus of -3.5% YoY. The index is now above the pre-crisis mark (+0.9%). Among subsectors, February's expansion was quite widespread, with the real revenue expanding in all the segments. The services provided to firms continued to improve, with Professional (3.3%) and Transport (4.4%) services making sequential gains. Services to Families also posted strong growth (up 8.8%), following two consecutive monthly declines, though the outlook for March is negative. We anticipate that a more consistent recovery in this segment is likely to take place only after the vaccination campaign makes further progress. Looking ahead, this result implies a carryover of 3.6% for 1Q21. In our view, given this figure, a quarterly contraction in 1Q21 is unlikely, even with strong anticipated deterioration in March, which is likely to be more concentrated in those segments more impacted by the increased social distancing spurred by the pandemic. We forecast nearly stable 1Q21 GDP (+0.2% QoQ-sa). The pandemic's steep upsurge in March led to tighter social-distancing measures on nationwide, causing a tertiary sector to take a severe hit. Even considering this scenario, we expect nearly stable 1Q21 GDP (+0.2% QoQ-sa), but with sequential deterioration in 2Q21 (-0.6% QoQ-sa). See link below[3].

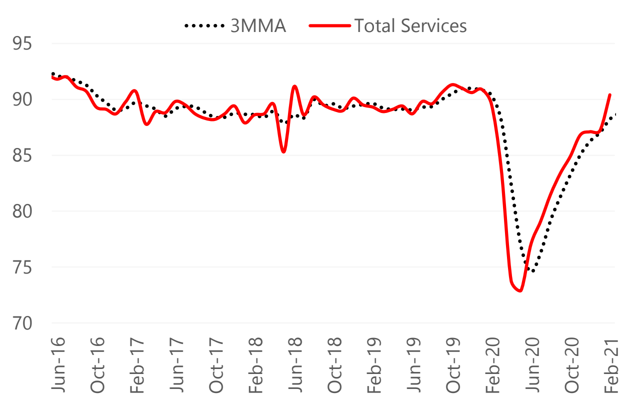
For the coming week, BCB will release its monthly broad activity indicator (April 19), capping the batch of economic activity indexes for February. We look for a growth of 0.9% MoM-sa, the tenth gain in a row, placing the economy 1.1% above the pre-crisis mark according to this indicator. For details on Santander's economic activity scenario, please refer to our latest chartbook[4].

Figure 4.A. – Retail Sales (sa, 2014=100)



Sources: IBGE, Santander.

Figure 4.B. –Services Real Revenue (sa, 2014=100)



Sources: IBGE, Santander.

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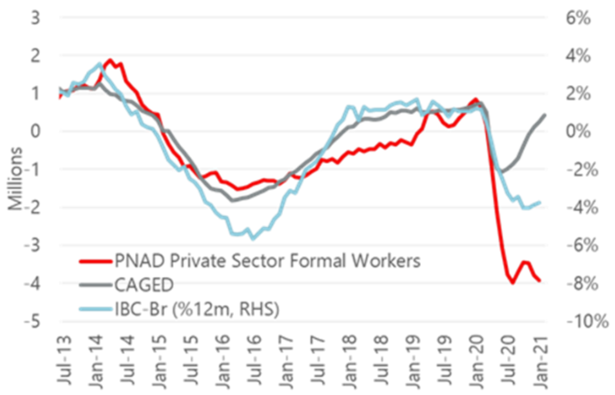
[2] **Santander Brazil Economic Activity -** ***"A Strong February Precedes a Worrisome March"*** **–** April 13, 2021 - Available on: http://bit.ly/STD-retail-feb21
[3] **Santander Brazil Economic Activity -** ***"Strong Growth in February"*** **–** April 15, 2021- Available on: http://bit.ly/Std-pms-feb21
[4] **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

LABOR MARKET

Since the beginning of the pandemic, the two main labor market surveys in Brazil, CAGED and PNAD, have shown notably divergent data in terms of performance. While CAGED indicates a robust and rapidly recovering labor market, along with dwindling slack, PNAD data still points to all-time-high unemployment, a low labor market participation rate, and a widening employment gap. In our view, both surveys have had pandemic-related issues that may be leading to biased results. On the one hand, CAGED may be underreporting layoffs due to the large number of firms going out of business. On the other hand, the PNAD survey is being carried out by phone, which may be overestimating unemployment. We consider that PNAD paints a more precise picture of the current labor market. Even considering that the "real" labor market numbers are somewhere close to the midpoint between the surveys, this would still imply a precarious situation, with employment possibly at all-time lows and far from its trendline. See link below[5].

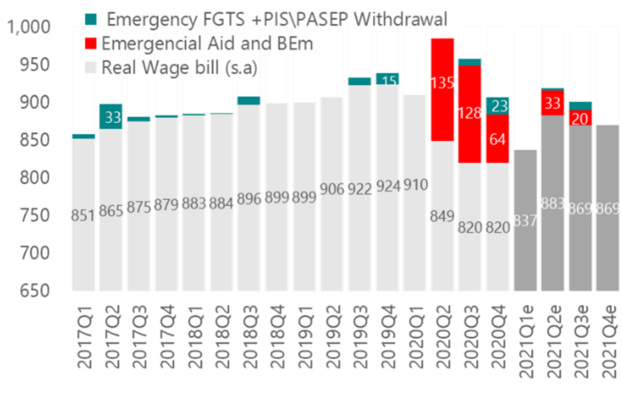
We updated our estimates of the "expanded" real wage bill, which includes social benefits, initially explored in two of our recent reports. See links below[6] [7]. We estimate that the "expanded" real wage bill had a 2.2% full-year growth in 2020, slightly below our last projection (+3.1%), reflecting the worse-than-expected performance in the labor market throughout 4Q20. When we disregard the effects of the extraordinary fiscal stimulus, we calculate a 6.9% drop in aggregate income, also below our previous estimate (-6.3%). For 2021, we expect the "expanded" real wage bill to decline by 6.2%, a bit better than our previous scenario (-6.6%). Stripping out the stimulus, we estimate a 1.8% growth for 2021, slightly below our last projection (+2.1%). Our labor market forecasts for 2021 have worsened of late, with employment recovery delayed due to new social distancing between 1Q21 and 2Q21, which should also impact the recovery in real wages. Our calculations take into account the Emergency Aid approved in the *PEC Emergencial*, totaling BRL44 billion in governmental transfers between April and July (versus BRL25 billion in our last update). Our numbers assume that *Bolsa Familia* program will return with slightly higher stipends (and for more beneficiaries) from August onwards. We also believe that the 'Emergency Employment and Income Maintenance Program' (BEm) will be reenacted in 2021, though at a smaller size than observed in 2020, with BRL10 billion provided to help 4 million jobs (versus BRL33.5 billion and over 10 million jobs in 2020). Other stimulus for consumer spending will come from new withdrawals from FGTS (mandatory savings) accounts (BRL12 billion) and the anticipation of yearend bonuses for retirees to May and June (BRL50 billion).

Figure 5.A. – Net Job Creation and IBC-Br (12m)



Sources: CAGED, IBGE, Santander.

Figure 5.B. – "Expanded" Real Wage Bill (BRL billion)



Sources: National Treasury, IBGE, Ministry of Economy, Santander.

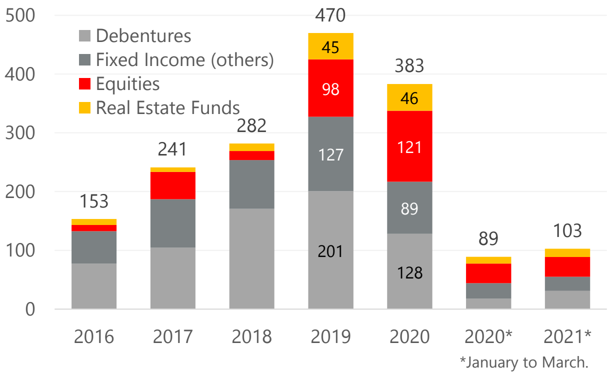
[5] **Santander Brazil Labor Market - *"CAGED vs. PNAD: Which Labor Survey is Right?"* –** April 12, 2021 - Available on: http://bit.ly/STD-pnad-caged-apr21
[6] **Santander Brazil Economic Activity - *"The Real Wage Bill and the Impact of Emergency Aid"* –** September 16, 2020 - Available on: bit.ly/Sant-rwb_Sep20
[7] **Santander Brazil Economic Activity - *"Labor Market – 2021 Thermometer"* –** February 04, 2021 - Available on: bit.ly/Sant-lbrmkt-040221

CREDIT

Anbima figures on capital markets activity for March show that new issuance totaled BRL53.1 million. Comparing the first quarter of 2021 with the same period of last year, there was an increase of 21.8%, though the base effect from the onset of the pandemic should be considered. Issuance in fixed income accounted for BRL28.2 billion; equities totaled BRL18.8 billion; and real estate funds came in at BRL5.9 billion.

The entire volume of BRL 18.8 billion in equities came from IPOs, **and is the largest monthly print in the historical data**. Ongoing offerings account for another BRL 6.2 billion. Looking at the allocation of proceeds of equity issues in the first quarter, 58% was allocated for asset acquisition and operational activity, as opposed to 17% in the first quarter of 2020. Bond issuance (*debentures*) accounted for BRL 14.3 billion, bringing the total in the first quarter to BRL 30 billion, almost two times the same period of last year. As for real estate funds, after a weak figure in February the volume of issues came in at BRL 5.9 billion, comparable to the level observed in 2020-end.

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



Fixed Income (others): Commercial papers, LFs, CRAs, CRIs and FIDCs.

Sources: Anbima, Santander.

FISCAL POLICY AND POLITICS

On April 15, the Ministry of Economy released draft legislation for the Budget Guidelines for 2022 (PLDO) as the government still seeks a solution to the 2021 budget gridlock. Legally, the government must send to Congress (by April 15 of each year) the PLDO with fiscal guidelines for the subsequent year. In a regular year, Congress must approve the bill before the mid-year recess in July. Considering the content of the 2022 PLDO, next year should be the 9th consecutive year of primary deficit; the legislation also forecasts a negative result until 2024. The law establishes a primary deficit target of BRL170.5 billion for the central government. For 2023, the PLDO projects a deficit of BRL144.9 billion; for 2024, a deficit of BRL102.2 billion.

We anticipate a deficit BRL30 billion, higher than the primary balance target set by the 2022 PLDO (Figure 7.A.). In our scenario, total revenue is approximately BRL 11.3 billion below the PLDO estimate. A part of this difference could be explained by the GDP forecast: we estimate a 2.0% growth in 2022 compared to 2.5% by the government. On the expenditure side, we anticipate a 1.5% real increase in public servants' wages, while the PLDO proposes stability in real terms. Another difference is the level for the constitutional spending cap for 2022: the PLDO estimates this limit will grow by 7.1%, compared to 8.0% in our calculations, based on our inflation scenario (note: the 2022 spending cap is adjusted by annual IPCA as of June 2021). This means that government expenses could increase BRL12.8 billion more, meaning an extra space compared to PLDO, if our number is confirmed. Of course, these estimates will depend on the evolution of the economic outlook and political decisions in coming months. Yet, the PLDO highlights the challenging fiscal outlook. The bill also brings an official forecast for the government's gross debt at 87.2% of GDP for 2021 (2020: 88.8%), compared our estimate of 86.2% of GDP: the main difference is the nominal GDP forecast, as we anticipate a greater change in the GDP deflator (see Figure 7.B.). Meanwhile, as far as the 2021 budget goes, there has been virtually no progress in the negotiations between the executive and legislative branches to resolve the deadlock. In our view, if the current budget were sanctioned, the government would have to cut discretionary expenses by around BRL30 billion, out of the BRL92 billion budgeted. That is way below the value that we consider to be the minimum threshold for operational and other discretionary expenses to keep a proper functioning of government services (BRL85 billion). The final deadline to come up with a solution to this stalemate is April 22, considering the possibility of presidential vetoes to the budget bill and later submission to Congress of legislation to rebalance the outlays allocated to lawmakers' projects. The final agreement between the government and Congress should seek some combination of cuts in lawmakers spending amendments (*emendas parlamentares*) and a freeze in other discretionary expenses (*contingenciamento*).

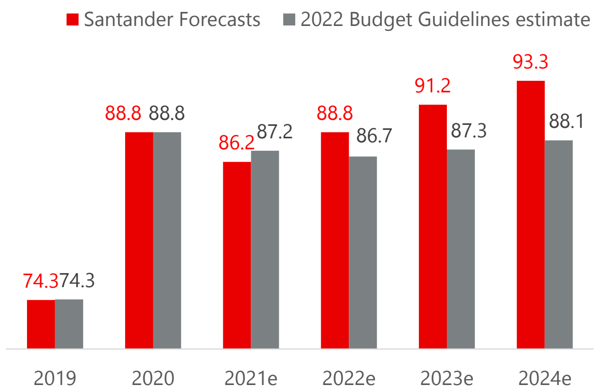
Finally, on April 14, we published a chartbook bringing details on our Fiscal Policy outlook, contemplated in our latest Scenario Review. We see fiscal risk continuing to increase in Brazil. In our view, the spending cap rule has lost part of its anchoring power, as a result of the recent inflationary shocks. The focus now is on the sustainability of government debt. See link below[8].

Figure 7.A. – 2022 Budget Guidelines

BRL billion	2022e: 2022 Budget Guidelines - Apr-21	2022e: Santander estimates	2022e: Difference Santander - PLDO
Total Revenue	**1,772.5**	**1,761.2**	**-11.3**
Revenues Collected by the Brazilian IRS	1,103.1	1,096.4	-6.7
Net Social Security Revenues	475.0	467.8	-7.2
Revenues Not Collected by the Brazilian IRS	194.4	200.1	5.7
Transfers by Revenue Sharing	312.9	314.8	1.9
Net Revenue	**1,450.6**	**1,446.4**	**-4.2**
Total Expenditure	**1,621.0**	**1,646.6**	**25.6**
Social Security Benefits	762.9	756.6	-6.4
Payroll - Public Servants	346.3	354.7	8.3
Other Mandatory Expenses	346.7	351.6	5.0
Mandatory Expenses with Cash Control	165.1	189.2	24.0
Discretionary Expenses	96.7	120.0	23.3
Central Government's Primary Balance	-170.5	-200.3	-29.8

Sources : Ministry of Economy, Santander.

Figure 7.B. –Gross General Govt. Debt (% GDP)



Sources: Ministry of Economy, Santander.

[8] **Santander Brazil – Fiscal Policy:** ***"Chartbook: On a Tightrope 2.0—Flirting with Fiscal Dominance"*** – April 15, 2021- Available on: https://bit.ly/Std-chartbook-fiscal-apr21

INFLATION

The IPCA for March (released Friday, 9 April) came in lower than expected, rising 0.93% MoM (6.10% YoY), which was below the median market expectation of 1.03% and further below our forecast of 1.08%.

Despite the headline surprise, the core measures continued to increase, in particular, we highlight the rising trend in core services. Therefore, in our view, although the downside surprise suggests some slight cooling for the next headline release (April), in terms of qualitative measures, inflation still remains a concern for the medium-term. See link below[9].

We revised our short-term forecasts, for April to 0.35% (from 0.47%), for May to 0.54% (from 0.32%), and for June to 0.16% (from 0.37%). For April the reduction was based on the surprises of March's release with fuels and medicines coming lower than expected. For May we changed the tariff flag forecast for electricity prices to Red1 from Yellow, with June remaining Red1.

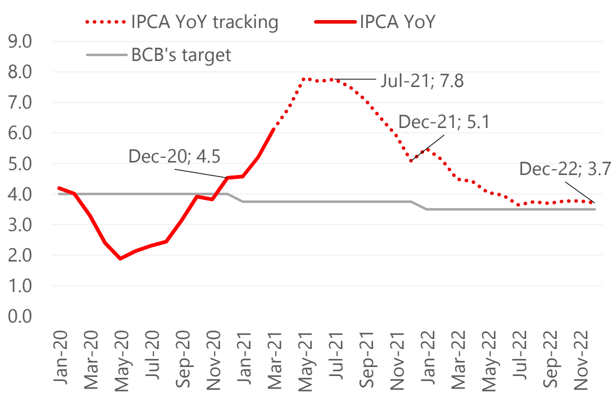
We also revised the year-end tracking from 5.0% to 5.1% (and risks remain tilted to the upside), on the back of more electricity cost pressures for the year, given a difficult outlook for hydro plants given an insufficient rainfall during the last season (making us change our expectations for the tariff flag for December from Green to Yellow). Therefore, we believe there are sufficient sources to exert continued upwards pressure on inflation (commodity prices rising, a depreciated BRL, supply chain disruptions) this year. For IPCA 2022 we kept our forecast of 3.7%.

Figure 8.A. – IPCA Monthly Result (%)

	MoM		
	Mar-21	Santander	Dev.
IPCA	0.93	1.08	-0.15
Administered	2.81	2.97	-0.04
Free	0.28	0.44	-0.12
Food-at-home	-0.17	0.02	-0.03
Industrial goods	0.82	1.28	-0.11
Services	0.12	0.07	0.02
EX3 Core	0.41	0.47	-0.06

Sources : IBGE, Santander.

Figure 8.B. – IPCA YoY (%) Tracking



Sources: IBGE, Santander.

[9] **Santander Brazil – Inflation:** ***"IPCA March: Lower than Expected, but Not Enough to Change the Unfavorable Outlook"*** – April 12, 2021- Available on: http://bit.ly/Std-ipca-mar21

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