



BRAZIL MACRO

March 18, 2022

MACRO COMPASS

INFLATION AND COPOM MINUTES IN THE SPOTLIGHT

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- In the rolling week ended on March 17, after surpassing the 5.15 level at some point, the BRL closed at 5.04, thus weakening 0.4% against the USD in the period and standing out among the negative performers in the basket with the 31 most liquid currencies in the world. Yet, in our view, technical issues in the local markets and global risk sentiment on Thursday may have pared what we view as upward FX rate contributions from this week's monetary policy news (both in Brazil and in the U.S.). The local yield curve saw a slight bull steepening in the 2s/5s segment, notwithstanding the upward shift seen in U.S. Treasury yields.
- Amid the continuing Russia-Ukraine conflict, commodities retreated this week on the back of reported progress in peace talks. Still, we recognize that the outlook remains quite fluid, so that volatility is likely to remain high for some time. The Bloomberg Commodity Aggregate Index in BRL receded 0.2% in the rolling week ended March 17. In USD terms, the index fell 0.6% for the same period.
- The Copom once again hiked the Selic rate, but this time at a magnitude of 100 bps, taking the policy rate to 11.75%, the highest level since 2017. The decision was in line with expectations. In the statement, the BCB notes that an alternative scenario, assuming oil prices at USD100 per barrel at YE2022, leads to an IPCA estimate of 3.1% for next year (mid-target: 3.25%), assuming a terminal Selic of 12.75%. The authority interpreted this as a signal that an additional hike of 100 bps (already indicated by the BCB as a likely decision at the May 3-4 Copom) would be enough to bring 2023 IPCA down to mid-target. Yet the BCB bought itself flexibility to adjust the flight plan, and we believe further increases in inflation expectations will make the Copom tighten a bit further with a 50-bp move in June. Clearly, this last step is data dependent. On Tuesday the BCB will publish the Copom minutes, which may shed more light on the BCB's flight plan.
- According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 11.2% in the three months to January. The result was below both our estimate (11.5%) and the market consensus (11.3%). We calculate that the seasonally adjusted jobless rate stood at 11.2%, compared to 11.6% in December. We evaluate that this result (namely lower unemployment rate owing to a lower labor-market participation) was mainly due to the Omicron variant outbreak, as our monthly estimates for both the labor force and the employed population have posted sharp drops.
- Services' real revenue stayed virtually flat in January (-0.1% MoM-sa), with mixed figures among the components. Services to families were the lowlight (-1.4% MoM-sa), breaking a streak of nine consecutive gains, while transportation showed resilience (+1.4% MoM-sa) despite the weakening industrial output. Moreover, the proxy for monthly GDP (IBC-Br) tumbled in January (-1.0% MoM-sa), owing to the weak figures seen for the key sectors but also likely reflecting a softening in health and education services during the Omicron variant outbreak. We are slightly lowering our 1Q22 GDP growth tracking to +0.3% QoQ-sa (from +0.4% QoQ-sa). In the coming week, FGV will release the first batch of economic confidence data: consumer confidence is due out on Friday (March 25).
- We expect March's IPCA-15 (due on Friday, March 25) to rise 0.87% MoM. In YoY terms, this means +10.69%, slightly below February's reading (10.76%), reinforcing our expectation of a plateau in annual inflation until April 2022. In terms of underlying inflation measures, we estimate the IPCA EX3 (including core services and core industrials) will move at a pace of 11% 3MMA-saar, way above the upper target (5%). Despite a much tighter monetary policy, we continue to see headwinds facing the disinflation process ahead, and forecast 6.9% IPCA for 2022 (consensus: 6.4%).

Most of the information in this report is up to the end of Thursday, March 17, 2022.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.

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**Figure 1. Brazil Macro Agenda for the Week of March 21 to March 26, 2022**

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Copom minutes	BCB	Mar/22	Tue, 22-Mar	--	--
Bi-Monthly Federal Budget Review	MoE	Mar/22	Tue, 22-Mar	--	--
Consumer Confidence (index)	FGV	Mar/22	Fri, 25-Mar	-	77
IPCA-15 Inflation (% MoM)	IBGE	Mar/22	Fri, 25-Mar	0.87	1.00
IPCA-15 Inflation (% YoY)	IBGE	Mar/22	Fri, 25-Mar	10.69	10.76
Federal Tax Collection (BRL billion)	RFB	Feb/22	22 to 26-Mar	149.5	235.3

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Review¹.

¹ **Santander Brazil – Scenario Review: “Higher Inflation and Selic Forecasts, Despite the Stronger BRL”** – February 24, 2022- Available on: <https://bit.ly/Std-scenreview-feb22>



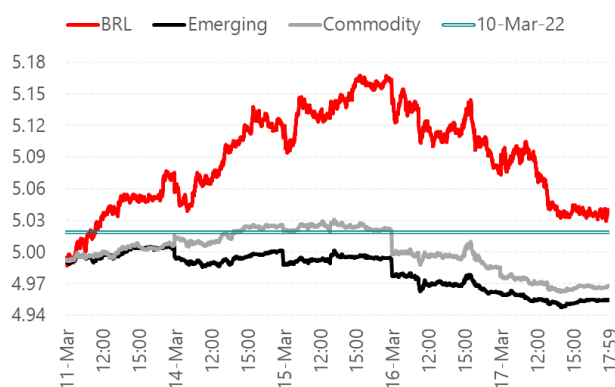
LOCAL MARKETS—FX

In the rolling week ended on March 17, the BRL closed at 5.04, thus weakening 0.4% against the USD in the period and standing out among the negative performers in the basket with the 31 most liquid currencies in the world. The relative stability of the BRL compared with a week ago concealed a more significant weakening of the currency in the last few days, when it reached USD/BRL5.17 in intraday terms (c. 3% weakening). Curiously, the improvement in its performance took place on the same day when markets were digesting the FOMC decision to start normalizing monetary policy in the U.S. and to hint at an eventual faster hiking pace in the coming meetings, which may lead the Fed funds target rate to a level higher than the neutral one (2.4% p.a., according to the Fed's estimates). On the same day, we also had the Copom meeting in Brazil, whose outcome was a 100-bps increase in the Selic rate to 11.75% p.a. and an indication that another hike of the same magnitude is the most likely decision at the next meeting to be held on May 4, 2022 (more details in the "Monetary Policy" section). Despite the extension of the tightening cycle, markets considered the wording seen in the Copom's post-decision statement as not notably contractionary. We expected the combination of both messages (from the FOMC and the Copom) to be detrimental to the BRL on Thursday, but the actual performance was the opposite, which suggests that technical features of the domestic FX market as well as global factors (e.g., Russia's bond payment) may have prevailed over the monetary policy messages in recent hours.

LOCAL MARKETS—Rates

The local yield curve saw a slight bear steepening in the 2s/5s segment following the Copom's decision to continue its tightening and the start of the hiking cycle by the Fed. Since last Thursday (March 10), the front end of the curve (Jan-24 DI future) rose 2 bps to 12.81%, while the back end of the curve (Jan-27 DI future) increased 3 bps to 12.17%. While the curve's steepness in this segment increased a bit, by 1 bp to -64 bps, the inversion remains in place. Locally, the Copom once again hiked the Selic rate, in line with analysts' expectations and the most likely scenario implicit in the yield curve (see details in the "Monetary Policy" section). Local yields price in a 100-bp move by the Copom in May and a 50-bp hike in June, which is in line with our revised scenario. Externally, the Fed started its hiking cycle and signaled hikes at all six remaining meetings this year. While U.S. Treasuries sold off (and bear-steepened) for the week, the effect seems to have been limited to local yields.

Figure 2. USD/BRL Intraday Trends

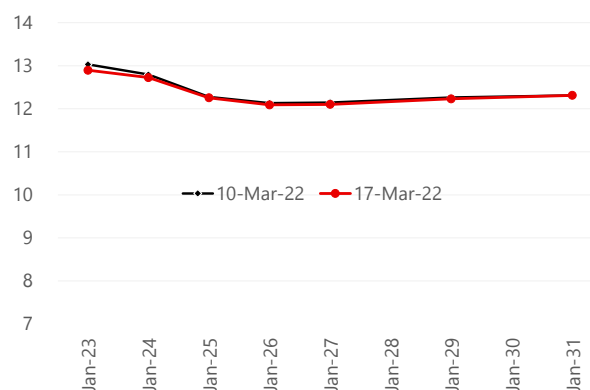


Sources: Bloomberg, Santander.

Note 1: As of the close on Thursday, March 17, 2022.

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, March 17, 2022.



COMMODITIES

Amid the continuing Russia-Ukraine conflict, commodities retreated this week on the back of reported progress in peace talks. Still, we recognize that uncertainty is high and that volatility is likely to continue for some time. The Bloomberg Commodity Aggregate Index in BRL receded 0.2% in the rolling week ended March 17. In USD terms, the index fell 0.6%, with the Agriculture Subindex falling 0.5%, the Energy Subindex increasing 1.8%, and the Industrial Metals Subindex dipping 4.1%. In our view, the ongoing geopolitical shock adds to already tight markets for key commodities: low inventories for most raw materials coupled with idiosyncratic factors (adverse weather, underinvestment, and high cost of production) have been feeding the commodity rally early in 2022.

Oil rebounds above USD100 as Russian talks with Ukraine are scheduled to continue. Oil is rising again after retreating 25% in the past week. The war has disrupted oil flows, with the U.S. banning oil imports and Britain phasing them out by YE2022. The market is also weighing the impact of the resurgence of COVID-19 infections in China that prompted lockdowns in some cities, a headwind for demand, as it restricts mobility and manufacturing output.

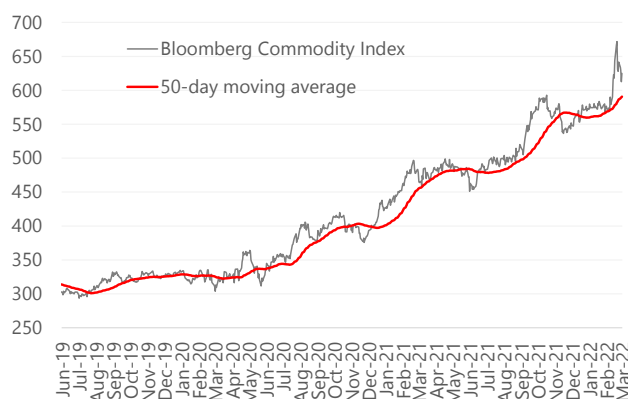
China increases U.S. corn imports as conflict hits Ukraine exports. Last week, China purchased 200k metric tons of American corn as part of efforts to mitigate the risks of supply shortages. The country had been purchasing the grain from Ukraine, but ports have been shut since Russia's invasion. The European Union faces the same problem, as the bloc relies on Ukraine for over half of its supply of corn.

Brazil wants fertilizers to be kept free from Russia sanctions. Amid fears of crop nutrients disruptions, the Brazilian Agriculture Minister argued during a United Nations FAO² event that restraining exports from key suppliers could hurt crop yields and boost food inflation. Conversely, the U.S. is leaning toward upping sanctions against Russia. The issue is key for Brazil, since the country relies heavily on imports: more than 85% of its fertilizer demand is met with foreign products. Russia and Belarus, both under economic sanctions, account for around 30% of the total use.

EIA³ reported an increase in U.S. crude stockpiles. On Thursday (March 16), the EIA reported that U.S. crude inventories increased by 4,345k barrels for the week ending March 11, above the market expectation of a 1316k barrel decrease. Still, considering the last five years, inventories are below the minimum level observed for this time of the year (total inventory was 416 million barrels as of March 11).

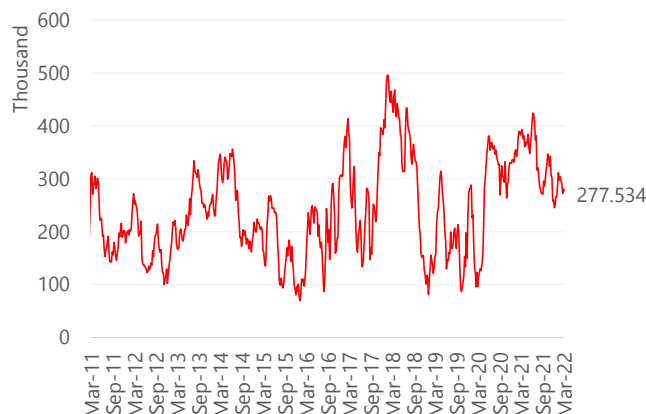
CFTC⁴ reported a decline in speculative long positions in WTI crude oil. Money managers reduced their net long WTI crude futures and options positions in the week ended March 8, the CFTC reported last Friday (March 11). The positions in futures and options decreased by 3,256 contracts to 277,543.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. CFTC NYMEX Crude Oil Managed Money Net Total (Number of contracts)



Sources: COT, Santander.

² Food and Agriculture Organization.

³ Energy Information Administration.

⁴ U.S. Commodity Futures Trading Commission.



MONETARY POLICY

The COPOM once again hiked the Selic rate, but this time at a magnitude of 100 bps, taking the policy rate to 11.75%, the highest level since 2017. The decision was in line with analysts' expectations and the most likely scenario implicit in the yield curve.

While the BCB recognizes the persistently unfavorable current inflation conditions and the deterioration in the inflation outlook owing to the supply shock generated by the Russia-Ukraine conflict, an alternative BCB scenario assuming nearly flat oil prices in real terms in 2023, at the level of USD100 per barrel at YE2022, leads to an IPCA estimate of 3.1% for next year, assuming a terminal Selic of 12.75%.

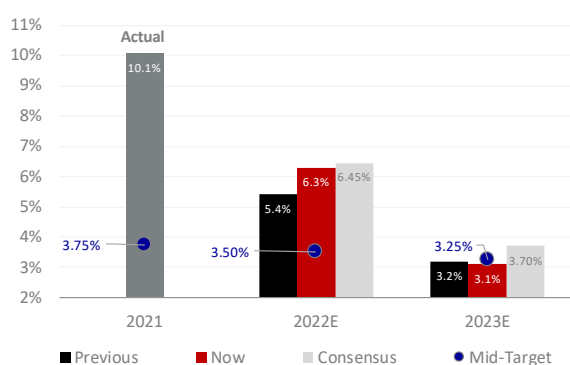
The authority interprets this as a signal that an additional hike of 100 bps — indicated by the authority as the likely decision at the May 3-4 policy meeting — could eventually suffice for the BCB's objective to bring inflation to the mid-target of 3.25% for the relevant policy horizon (2023 from now on). The asymmetry in the balance of risks (still tilted to the upside) is not seen as enough to warrant additional moves at this stage.

Nevertheless, the authority recognizes the extremely high level of uncertainty regarding the size and duration of the current shocks and continues to pledge to do what is necessary to achieve the mid-target in the relevant horizon. The BCB sought to make explicit its flexibility to change the flight plan and eventually “adjust the size of the monetary tightening cycle.” The BCB recognizes that the second-round effects (read: further increases in inflation expectations), which are admittedly the focus of BCB actions now (amid such supply shocks affecting commodity prices), may take a while to emerge.

In our view, these second-round effects may continue to materialize in the coming weeks, with further increases in inflation expectations probably making the BCB end the cycle at a slightly higher level than planned currently. Thus, we now take the opportunity to update our Selic rate projections (last revised on the eve of the start of Russia's invasion of Ukraine) and revise our expected terminal level to 13.25% (prior: 12.50%). We now expect two more hikes (of 100 bps in May and 50 bps in June). Our YE2023 forecast has also been raised. [See details in the link⁵.](#)

Next week, on Tuesday (March 22), the BCB is scheduled to publish the Copom minutes, which may shed more light on the BCB's flight plan.

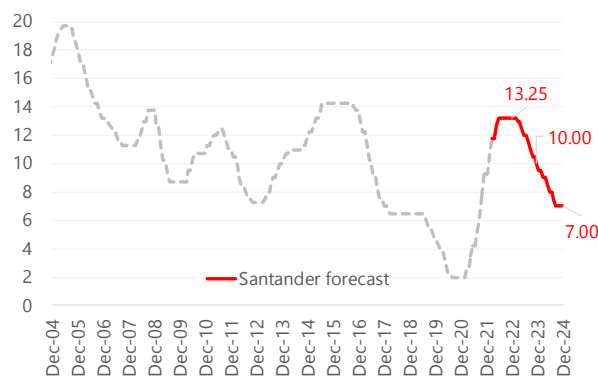
Figure 6. BCB's Inflation Simulation – Alternative Scenario (% annual)



Sources: Brazilian Central Bank, Santander.

Note: IPCA simulations assume Selic rate from the Focus survey and USD/BRL starting at 5.05 and evolving according to purchase power parity. Assumes oil price at USD 100 by YE2022 and a 2% change per year afterwards.

Figure 7. The Path for the Selic Policy Rate (monthly average, % p.a.)



Sources: Brazilian Central Bank, Santander.

⁵ Santander Brazil Monetary Policy: “A Plan Amid the Uncertainty” – March 16, 2022 – Available on: <https://bit.ly/Std-COPOM-mar22>



ECONOMIC ACTIVITY

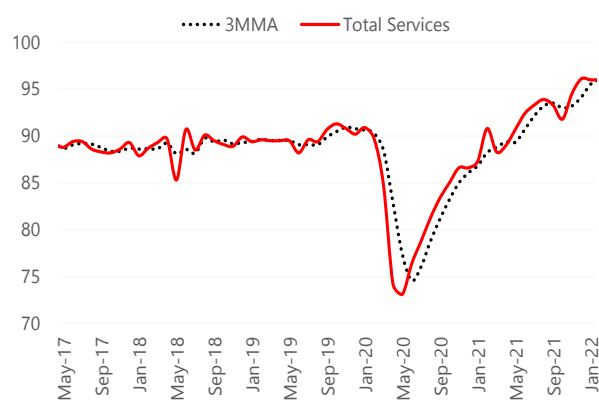
Services virtually stayed flat in a January contaminated by the Omicron outbreak. The headline index decreased 0.1% MoM-sa, coming in below market expectations of +0.3% MoM-sa and our estimate of +0.6% MoM-sa, but with an upward revision in December. This slight decline came after two solid figures (+2.9% and +1.7% in November and December, respectively) and placed the headline index 7.0% above the pre-pandemic benchmark (February 2020). The details point to mixed figures among the components. Services to families broke a streak of nine consecutive gains, decreasing 1.4% MoM-sa and likely reflecting the Omicron variant outbreak in the month. On the bright side, transportation showed resilience, expanding 1.4% MoM-sa, the third gain in a row and mainly attributable to ground transportation (+2.1%) despite the weakening industrial output. Regarding 1Q22, we calculate a statistical carryover of 2.0% QoQ-sa (+0.4% QoQ-sa in 4Q21), which suggests a continued positive contribution of cyclical services to overall activity this quarter. [See details in the link⁶.](#)

Monthly GDP proxy tumbled in January. The IBC-Br retreated 0.99% MoM-sa (0% YoY), considerably below the market consensus of -0.2% MoM-sa and our call of 0% MoM-sa, but with the series being considerably upward revised (mostly in 4Q21). This figure placed the economy 0.63% below the pre-pandemic mark, according to this indicator. Among key sectors, we saw a sharp tumble in industrial output, while the tertiary sector posted tepid figures. We understand that health and education services (not integrally captured by timely activity indexes) may have suffered more than expected from the Omicron variant outbreak, contributing to January's negative print. Moreover, this figure may be a sign of weak farm output in January amid Brazil's drought in the South. We are slightly lowering our 1Q22 GDP growth tracking to +0.3% QoQ-sa (from +0.4% QoQ-sa). We forecast GDP growth of 0.7% in 2022 and a 0.2% contraction of real activity in 2023. [See details in the link⁷.](#)

Unemployment rate below expectations in January. According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 11.2% in the three months to January (Santander estimate: 11.5%, market consensus: 11.3%). According to our seasonal adjustment, the jobless rate stood at 11.5% (December: 11.9%), and the labor market participation rate stood at 61.6% (December: 61.9%). All PNAD data is based on three-month moving averages, and we estimate that the monthly unemployment rate stood at 11.2% (sa), compared to 11.6% in December. This result followed -1.5% and -1.9% MoM-sa variations in employed population and the labor force, respectively. We evaluate that this result (namely lower unemployment rate owing to a lower labor-market participation) was mainly due to the temporary impact of the Omicron variant outbreak. The usual real wage bill had a +0.5% MoM-sa variation in January and is now 7.4% below the pre-crisis mark. We expect the seasonally adjusted unemployment rate to rise throughout 2022, as the impact of a tight monetary policy start to kick in.

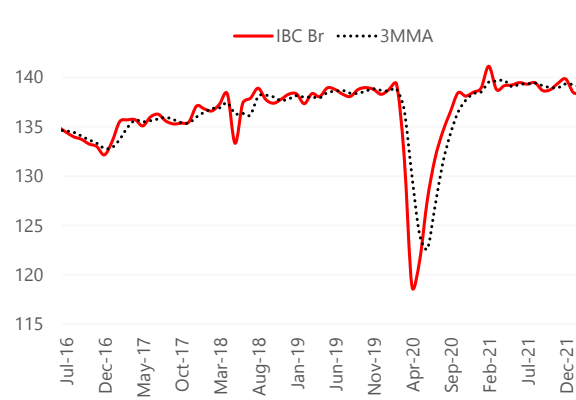
In the coming week, FGV will release the first batch of economic confidence data for March: the consumer confidence is due out on Friday (March 25). [For details on Santander's activity outlook, please refer to our last chartbook⁸.](#)

Figure 8. Total Services (sa, 2014=100)



Sources: IBGE, Santander.

Figure 9. IBC-Br (sa, average 2003=100)



Sources: BCB, Santander.

⁶ Santander Brazil Economic Activity: "Mixed Services Output Figures" – March 16, 2022 – Available on: <https://bit.ly/Std-econact-031622>

⁷ Santander Brazil Economic Activity: "Monthly GDP Proxy Tumbled in January" – March 17, 2022 – Available on: <https://bit.ly/Std-econact-031722>

⁸ Santander Brazil Economic Activity: "Positive Surprises Reinforce Resilience Outlook for 2022" – March 14, 2022 – Available on: <https://bit.ly/Std-chart-econact-mar22>



INFLATION

We expect March's IPCA-15 (due on Friday, March 25) to rise 0.87% MoM. In YoY terms, this means +10.69%, slightly below February's IPCA-15 (10.76%), reinforcing our expectation of a plateau in annual inflation until May 2022. In terms of underlying inflation measures, we estimate the EX3 (core services and industrials) will rise to around 11% 3MMA-saar, way above the upper target (5%).

Compared to February's IPCA-15 (+0.99% MoM), we expect the headline to decelerate in monthly terms, driven mostly by free-market prices (+0.91% MoM vs. +1.32% last month). We believe services are likely to decelerate in monthly terms (0.58% MoM vs. 1.36 % previously). With this monthly result, we expect the services trend to accelerate to 8.1% 3MMA-saar (from 6.7%), and we forecast further acceleration at least until mid-year. We expect industrial goods to also decelerate in monthly terms (+0.79% MoM vs. +1.17% previously), enough to keep the trend hovering around 14.7% 3MMA-saar. Finally, we estimate food-at-home rising to 1.86% MoM, with the trend accelerating to (a whopping) 18.5% 3MMA-saar.

In terms of broad underlying inflation measures, we estimate the EX3 core is likely to rise 0.74% MoM, which would represent a quickening trend to ~11% 3MMA-saar. If correct, March would be the 19th consecutive month in which the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (our headline CPI target is 3.50% for 2022 and 3.25% for 2023). We still project that a clear peak should come around May 2022, but the level and composition of inflation are likely to remain sources of concern, just as the latest shock from commodities prices is a new risk, keeping the balance of risks tilted to the upside (i.e., higher inflation).

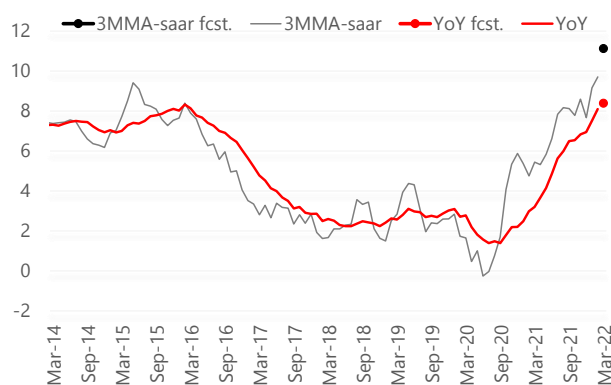
Despite a much tighter monetary policy, we continue to see challenges for the disinflation process ahead, and we forecast an above-consensus 6.9% IPCA for 2022 (consensus: 6.4%).

Figure 10. March's IPCA-15 Details (% annual)

	MoM		YoY	
	Mar-22	Contrib.	Feb-22	Mar-22
IPCA-15	0.87	0.87	10.8	10.7
Administered	0.75	0.20	16.4	14.2
Free	0.91	0.66	8.8	9.5
Food-at-home	1.86	0.28	9.5	11.5
Industrial goods	0.79	0.18	13.0	12.7
Services	0.58	0.20	6.0	6.5
EX3 Core	0.74	0.26	8.1	8.4

Sources: IBGE, Santander.

Figure 11. Core Inflation EX3 (%annual)



Sources: IBGE, Santander.



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