Soft Activity, Solid Inflation

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- The USD/BRL pair closed the rolling week ended November 18 at 5.56 (implying a 2.9% loss), and was the third-worst performer in a basket of 31 of the most liquid currencies in the world. In our opinion, the strengthening of the USD on a global scale and lingering uncertainties concerning the domestic fiscal policy explain the performance. The combination of a worsening inflation outlook and a grimmer fiscal picture contributed to a (bear-steepening) sell off in the local yield curve in recent days.
- A group of senators presented this week an alternative proposal for the *Precatórios*. Amendment (PEC). This new proposal temporarily removes all court-ordered debt payments from the spending cap restrictions in 2022, opening a fiscal space of BRL89 billion within the constitutional limit. The new proposal also keeps the spending cap indexation unchanged. In the proposal, the margin created by the new legislation would be only used for the new welfare program (BRL64 billion) and the increase in mandatory outlays due to higher inflation (e.g. pensions). In addition, the proposed bill would also extinguish the rapporteur's amendments in the budget (~BRL16 billion). According to our calculations, the bill approved in the Lower House opens space for about BRL120 billion of new spending within the constitutional ceiling in 2022 (estimate updated after the recent rise in our IPCA tracking for 2021). We anticipate a likely debate on the alternatives before a vote in the Senate's Constitution, Justice and Citizenship Committee (CCJ, in Portuguese acronym), scheduled for November 23-24. A floor vote in the upper chamber is expected in early December. Next week, the Federal Revenue Service could publish the October federal tax collection: we forecast a total of BRL173.2 billion, representing a 2.1% YoY growth.
- The IBC-Br - the BCB's monthly GDP proxy - retreated in September (-0.27% MoM-sa), capping a 3Q21 that was not as strong as previously thought. The quarterly results highlight the ambiguity between solid services spending and a weak demand for goods, as part of the reopening and "post-pandemic" normalization process. We are lowering our 3Q21 GDP tracking to +0.1% QoQ-sa (from +0.2%), with this positive figure reflecting our expectation of good GDP contributions from services segments that are still expected to profit on the reopening (e.g., Other Services and Public Services). These components are usually not well captured by timely activity indexes.
- On Friday (November 26), the Ministry of Labor will release the October CAGED net formal job creation data, for which we expect a seasonally adjusted deceleration to +126k (+221k in September). Across the week, FGV is expected to release the first batch of economic confidence data for November.
- We forecast the November IPCA-15 (due on Thursday, November 25) at +1.17% MoM. As opposed to what we projected a month ago, the October IPCA-15 will probably not mean the peak of year-on-year IPCA-15 inflation for this cycle—our November number implies annual inflation of 10.7% (October's was 10.3%). All in all, we remain cautious about inflation conditions and outlook, especially for 2022, amid rising idiosyncratic risks on the fiscal side that could further lift inflation expectations for key policy horizons.
- We estimate October 2021's current account balance (due on Thursday, November 25) to have registered a US$4.6 billion deficit on the heels of a shier trade surplus than in previous months and (seasonally) larger remittances of profits and dividends during the period. However, we do not expect the reading to change the general perception about the soundness of the Brazilian external position.

Most of the information in this report is up to the end of Thursday, November 18, 2021.

Figure 1. Brazil Macro Agenda for the Week of November 22-26, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Bi-Monthly Federal Budget Revision	MoE	Nov/21	Mon, 22-Nov	--	--
Consumer Confidence (index)	FGV	Nov/21	Wed, 24-Nov	--	76.3
Federal Debt Report (BRL trillion)	STN	Oct/21	Wed, 24-Nov	--	5.4
Construction Confidence (index)	FGV	Nov/21	Thu, 25-Nov	--	96.1
IPCA-15 Inflation (% MoM)	**IBGE**	**Nov/21**	**Thu, 25-Nov**	**1.17**	**1.20**
IPCA-15 Inflation (% YoY)	IBGE	Nov/21	Thu, 25-Nov	10.73	10.34
Current Account Balance (USD billion)	BCB	Oct/21	Thu, 25-Nov	-4.6	-1.7
Foreign Direct Investment (USD billion)	BCB	Oct/21	Thu, 25-Nov	4.0	4.5
Total Outstanding Loans (% YoY)	BCB	Oct/21	Fri, 26-Nov	--	--
Industrial Confidence (index)	FGV	Nov/21	Fri, 26-Nov	--	105.2
Formal Job Creation (thousands, nsa)	**CAGED**	**Oct/21**	**Fri, 26-Nov**	**217**	**313.9**
Formal Job Creation (thousands, sa)	CAGED	Oct/21	Fri, 26-Nov	126	221
Federal Tax Collection (BRL billion)	RFB	Oct/21	22- to 25-Nov	173.2	149.1

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

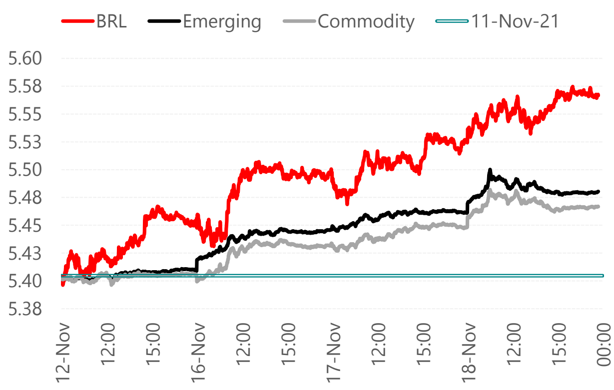
LOCAL MARKETS—FX

The USD/BRL pair closed the rolling week ended November 18 at 5.56, a 2.9% loss, and was the third-worst performer in a basket of 31 of the most liquid currencies in the world. In our opinion, the strengthening of the USD on a global scale and lingering uncertainties concerning the domestic fiscal policy accounted for the performance. On the heels of a relatively muted news cycle on both the domestic and international fronts, which bore an extremely light calendar of releases in the last days, the apprehension regarding the appointment of the FOMC chairman and tensions in the oil market were the highlights abroad. In Brazil, the discussions involving the constitutional amendment related to court-ordered debts (*PEC dos Precatórios*) and its implications for the budget in 2022 continued to capture the bulk of everyone's attention. The negotiations are proving difficult, which raises the probability perceived by the market of an open-ended amount of fiscal stimulus outside the constitutional spending cap. Under these circumstances, the BRL nearly erased previous gains and the USD/BRL pair got back to near 5.60. This reinforces our assessment that uncertainties on the domestic fiscal front should continue to limit any substantial strengthening of the BRL in the medium term.

LOCAL MARKETS—Rates

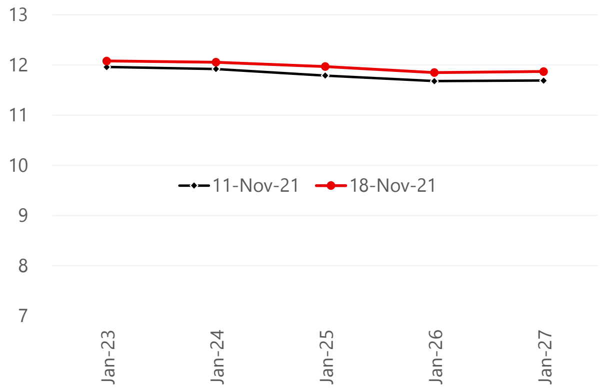
The nominal yield curve reverted part of last week's rally and shifted higher in a bear-steepening move. But the curve remains inverted. Since last Thursday (November 11), the front end of the curve (Jan-23 DI future) increased 20 bps to 12.17%, while the back end of the curve (Jan-27 future) increased 27 bps to 11.96%. As a result, the curve's steepness in this segment rose 7 bps, but remained negative (-20 bps), meaning an inverted curve. At the front end, there were no clear drivers for the yield to rise, but in our opinion the global inflationary news flow might be impacting the domestic curve. The probability implied in the options market continues to suggest that the BCB will rise the Selic rate by 150 bps in the next Copom meeting (61% probability of a 150-bps hike vs. 21% probability of 200 bps and 12% probability of 175 bps). Yet we continue to see rising chances for faster and greater Selic hikes. At the long end, we have been arguing that uncertainties regarding the fiscal consolidation process remain high. So, despite the recent rally, the trend is of a risk-premium building process at this segment of the curve—and this week we believe this trend prevailed. The rise of the 10-year US Treasuries yield might also have influenced the rise of the domestic long-end yield.

Figure 2 – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, November 18, 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 18, 2021.

COMMODITIES

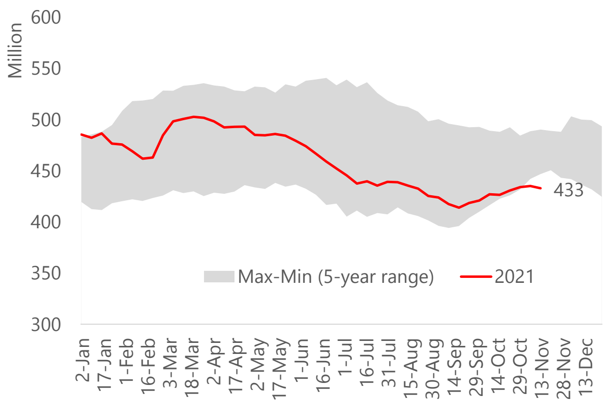
U.S. asks other countries to consider tapping strategic oil reserves. The U.S. asked some of the largest oil consuming nations (China, India, Japan) to consider releasing oil reserves in an attempt to lower energy prices. The action follows unsuccessful calls for higher oil output from OPEC+ members. China has already been selling from its SPR[2] but Japan is unlikely to do the same as its government claimed its stockpiles are meant as a buffer against supply shocks and emergencies.

Russia seeks Nord Stream 2 approval with subsidiary in Germany. Natural gas prices in Europe rose this week after the Nord Stream 2 gas pipeline's permit was suspended until the company creates a new subsidiary in Germany to comply with EU laws. According to a Bloomberg model, temperatures across northwest Europe are set to return to seasonal levels, just a bit above the historical average, at the beginning of December, which could ease concerns of a more severe energy supply crunch.

EIA[3] reports a decrease in U.S. crude stockpiles. The EIA reported on Wednesday (November 13) that U.S. crude inventories fell by 2,101k barrels for the week ending November 12, against expectations for a 1,074k barrels increase. As a result, at 433 million barrels, inventories are already below the minimum level observed for this time of the year (considering the last 5 years).

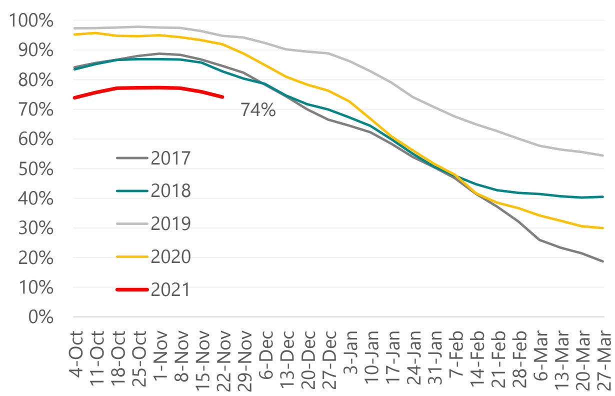
CFTC[4] reports an increase in speculative long positions in WTI crude oil. Money managers reduced their net long WTI crude futures and options positions in the week to November 9, the CFTC reported on Friday (November 12). The positions in futures and options increased by 18,982 contracts to 342,685.

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



Sources: EIA, Santander.

Figure 5 – European Gas Storage Utilization (%)



Sources: Bloomberg, Santander.

[2] Strategic Petroleum Reserve.
[3] Energy Information Administration.
[4] U.S. Commodity Futures Trading Commission.

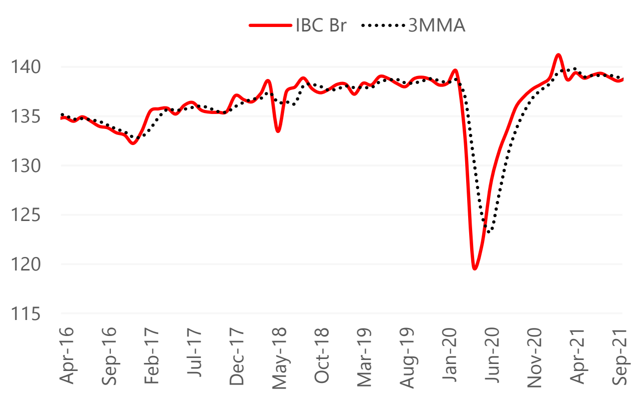
ECONOMIC ACTIVITY

The Brazil Central Bank's (BCB) broad activity indicator (IBC-Br) retreated in September (-0.27% MoM-sa), marking a 3Q21 not as strong as previously thought. This monthly result came in line with market consensus (-0.3%) and placed the economy 0.7% below the pre-pandemic mark (February 2020), according to this indicator. Moreover, the index stands 1.9% below the recent spike reached in February 2021. In quarterly terms, the IBC-Br ended 3Q21 with a slight decline (-0.14%), result of tepid and heterogenic activity output seen this period: the goods-related sectors (industry and broad retail sales) retreated 1.7%, while the more cyclical services expanded 3.0%. 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. Additionally, September's figure of IBC-Br implies a negative carryover of -0.28% for 4Q21, in line with the negative carryovers calculated to the key-sectors: -0.5% for industry, -1.8% for broad retail sales and -0.3% for the services sector to 4Q21. See details in the link[5].

Regarding 3Q21 GDP growth, we are lowering our tracking to +0.1% QoQ-sa (from +0.2%). Our expectation of a 3Q21 positive figure stems mainly from expectations of good growth contribution coming from services segments that still show wide idleness compared to the pre-crisis period (e.g., Other Services and Public Services, that account for 30% of total GDP) and that are not well captured by timely activity indexes. Indeed, the Services to Families segment of IBGE's monthly survey (which captures bars, restaurants, leisure activities and other mobility-related activities) highly correlates with these idled segments, and it expanded 17.2% in 3Q21 (+4.2% in 2Q21). It is worth noting that IBGE usually publishes important revisions in the historical GDP series in its 3Q21 release. It is not an easy task to anticipate such movements, so we do not take any specific view about these potential revisions.

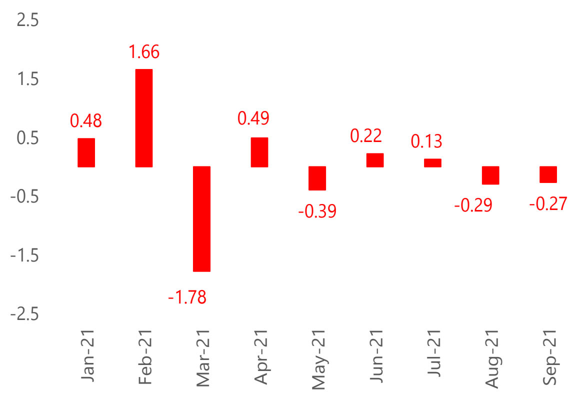
For the coming week, the Ministry of Labor will release on Friday (November 26) the October CAGED net formal job creation data, for which we expect a +217k result. According to our preliminary seasonal adjustment, this would represent a deceleration to +126k (+221k in September). Moreover, FGV will release the first batch of economic confidence data for November: the consumer confidence data is due out next Wednesday (November 24), while the industrial confidence data is due out on Friday (November 26). **For details on Santander's activity outlook, please refer to our last chartbooks[6].**

Figure 6 – IBC-Br (sa, 2003=100)



Sources: Brazilian Central Bank, Santander.

Figure 7 – IBC-Br (sa, MoM%)



Sources: Brazilian Central Bank, Santander.

[5] **Santander Brazil Economic Activity - *"3Q21 Not as Strong as Previously Though"* –** November 16, 2021 – Available on: https://bit.ly/Std-Econact-111621

[6] **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

INFLATION

We expect the November IPCA-15 (due on Thursday, November 25) to rise +1.17% MoM. Contrary to what we expected a month ago, November's IPCA-15 should not have been the peak of year-on-year IPCA-15 inflation, as our estimate implies a pickup to 10.7% YoY (from 10.3% in the previous month). In terms of trends for headline IPCA—the three-month moving average seasonally adjusted and annualized—in our view it should remain at the high level of 14.1% 3MMA-saar.

Compared to the October IPCA-15 (+1.20% MoM), November data should remain basically stable in monthly terms. On the one hand, services should contribute to a deceleration, passing from 1.03% MoM in October to 0.50% in November, but with an important contribution from the volatile item of airline tickets (coming from +34.3% MoM in October to -4.00.0% now). Despite this monthly deceleration, the trend should remain almost stable around 9.0% 3MMA-saar. Moreover, the core services gauge should rise 0.63% MoM (basically the same change of October, 0.66%), meaning that its trend will also remain at the hefty level of 7.6% 3MMA-saar. The other group that should decelerate in monthly terms is food-at-home, rising 0.88% MoM (from 1.54% last month), with a deceleration of the trend to the still-high level of 17% 3MMA-saar. On the other hand, industrial goods should accelerate to 1.39% MoM (vs. 0.98% last month), keeping the trend at 12.2% 3MMA-saar. Finally, administered prices should also accelerate in monthly terms to 2.04% MoM, mainly driven by gasoline prices.

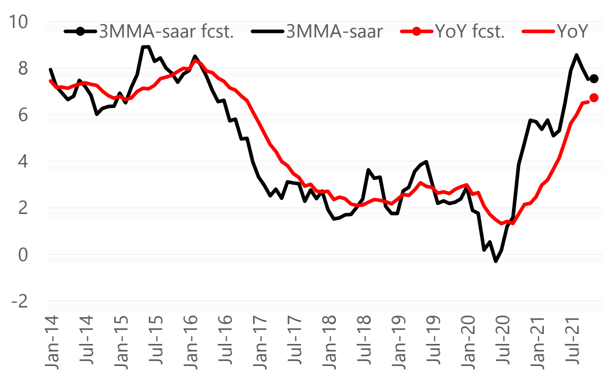
In terms of broad underlying inflation measures, we estimate the EX3 core will rise around +0.82% MoM, which would represent a steady trend of around +7.5% 3MMA-saar, an unfavorable level. This will be the fourteenth month the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022). We remain cautious regarding inflation, especially after the recent rise of domestic risk that might push expectations even higher and turn inertia stronger, resulting in a more difficult disinflation process.

Figure 8 – IPCA-15: Forecast Details (%)

	MoM		YoY	
	Nov-21	Santander	Oct-21	Nov-21
IPCA-15	1.17	1.17	10.3	10.7
Administered	2.04	0.55	16.1	18.2
Free	0.85	0.62	8.4	8.2
Food-at-home	0.88	0.13	13.9	11.9
Industrial goods	1.39	0.32	10.4	11.0
Services	0.50	0.17	4.9	5.0
EX3 Core	0.82	0.29	6.5	6.8

Sources: Brazilian Central Bank, Santander.

Figure 9 – Core Inflation Forecast (EX3 %)



Sources: Brazilian Central Bank, Santander.

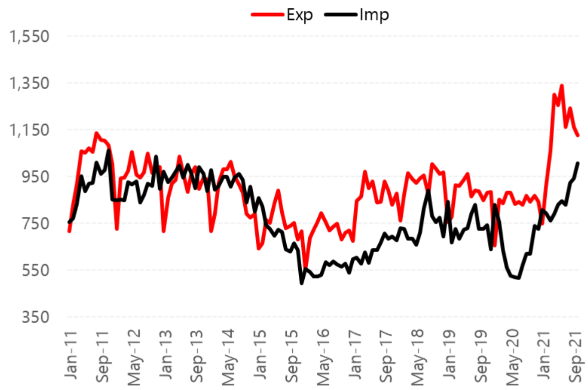
BALANCE OF PAYMENTS

Due to (seasonally) larger remittances of profits and dividends and a shier trade surplus than in previous months, we estimate the October 2021 current account balance to show a US$4.6 billion deficit on Thursday (November 25). As we expect the volume of direct investments in the country to have tallied US$4.0 billion in the same period, we believe our constructive view about the Brazilian external position should remain unchanged.

Although export revenue continues to run at high levels, import outlays have gained some steam recently, with the bulk of the increase related to intermediate goods, which seems us a response to problems in the supply chain on the domestic front. This was the case in October 2021, which resulted in a shier trade surplus than in previous months. We believe this development should help to partially explain the US$4.6 billion deficit we estimate for the current account balance last month. However, we think trade surpluses should return to higher echelons in the coming months, given the weakness of the BRL, the fairly gradual economic recovery and our expectation that problems in the supply chain will subside, which should take away some of imports' steam ahead.

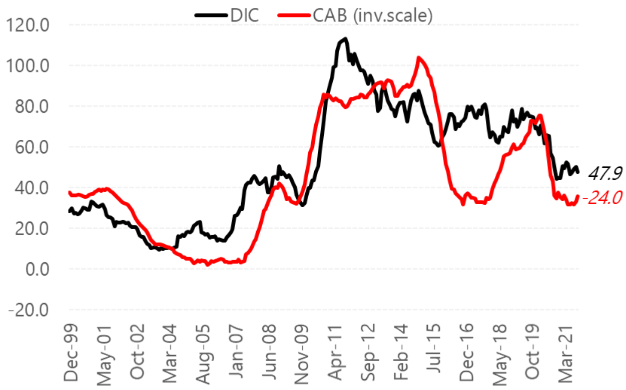
In addition to the shier trade surplus in October 2021, we also estimate the seasonal increase that remittances of profits and dividends present in the period should have also negatively weighed on the current account reading last month. In our view, once again the slow recovery and the weakness of the BRL should prevent remittances from entering into a consistently upward trend, thus not meaning a structural reversal in the adjustment cycle that the current account balance is going through. Incidentally, the maintenance of a subdued deficit in the services account should serve as additional evidence for our assessment that the structure of the current account balance remains unchanged. If we add to that the fact that direct investments in the country continue to flow and to comfortably finance the current account deficit, we believe markets will keep a constructive view about the Brazilian external position.

Figure 10 – Trade balance components (USD million/working day, sa)



Sources: SECINT, Santander.

Figure 11 – Current account balance vs. direct Investments in the country (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

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