



INFLATION AND EMPLOYMENT TAKE THE MAIN STAGE

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

- Commodity prices rose in the rolling week ended May 19, driven by the energy complex. The Bloomberg Commodity Aggregate Index decreased 1.0% in BRL terms in the period, on the heels of the BRL rally. In USD terms, the index increased 3.1%, with the Agriculture Subindex up 2.0%, the Energy Subindex climbing 4.0%, and the Industrial Metals Subindex gaining 4.4%.
- Despite the continued uptrend in prices of raw materials, the local yield curve rallied on signs that the Brazil Central Bank (BCB) may be near the end of its tightening cycle (despite its own signals of some data-dependency in the next few steps), perceptions of possible policy-driven relief for certain (goods and services) prices, and a respite in global yields.
- In the rolling week ended May 19, the BRL broke a three-week streak of weakening and stood among the best performers in a basket with the 31 most liquid currencies in the world, with the USD/BRL pair closing the period at 4.93 (a 4.2% gain). The move took place on the heels of a USD weakness globally, rising commodity prices, and expected FX flows due to a possible privatization deal for Eletrobras, the state-owned electricity company.
- In a plenary decision, the budget watchdog (TCU, in Portuguese) on May 18 gave final clearance, in a 7-1 vote, for the privatization of Eletrobras. According to press sources, government officials could seek to expedite the stock sales before the summer vacation period in the Northern Hemisphere. We continue to see privatizations as a useful and necessary tool to improve productivity and investment (and therefore potential GDP) in the Brazilian economy.
- In a week empty of major data releases domestically, on May 16 the BCB unveiled the public sector's fiscal numbers for March. This publication came in with a delay, owing to the strike of some categories of federal workers. The numbers show a continued improvement in fiscal performance, mainly reflecting the positive revenue effect of price shocks (i.e., gains in terms of trade owing to higher commodity prices as well as higher inflation).
- On inflation, we expect May's IPCA-15 (due on Tuesday, May 24) to rise +0.45% MoM. Although higher than the implicit mid-target on a monthly basis (0.29% MoM, meaning 3.5% in annualized terms), such a number would be close to the usual seasonal pattern (since 2004, the average headline for the month is 0.42% MoM). If our number is on the mark, we calculate that the sequential trend for headline IPCA should see a slight deceleration to 14.6% 3MMA-saar from 15.6%. That is still a pretty high reading, however. In YoY terms, we expect the headline to remain stuck at 12.0%, the highest level since late 2003, which we still see as the peak for the inflation cycle.
- On activity, next week's highlight is the first snippets of April employment data. On Thursday (May 26), the Ministry of Labor will release CAGED payrolls data. Our estimate is +276k (nsa), meaning a print of +183k (March: +232k), according to our preliminary seasonal adjustment. Moreover, FGV will release the first batch of economic confidence data for May: the consumer confidence index is due out on Wednesday (May 25), while industrial confidence is due on Friday (May 27).

Most of the information in this report is up to the end of Thursday, May 19, 2022.

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

U.S. investors' inquiries should be directed to Santander Investment Securities Inc. at (212) 583-4629 / (212) 350-3918.

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Figure 1. Brazil Macro Agenda for the Week of May 23 to May 27, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IPCA-15 Inflation (% MoM)	IBGE	May/22	Tue, 24-May	0.45	1.73
IPCA-15 Inflation (% YoY)	IBGE	May/22	Tue, 24-May	12.0	12.0
Consumer Confidence (index)	FGV	May/22	Wed, 25-May	-	78.6
Federal Debt Report (BRL trillion)	STN	Apr/22	Wed, 25-May	-	5.6
Formal Job Creation (thousands)	CAGED	Apr/22	Thu, 26-May	276	136
Formal Job Creation (thousands, sa)	CAGED	Apr/22	Thu, 26-May	183	232
Construction Confidence (index)	FGV	May/22	Thu, 26-May	-	-
Industrial Confidence (index)	FGV	May/22	Fri, 27-May	-	-
Current Account Balance (USD billion)	BCB	Mar/22	n.a.*	-	-2.4
Foreign Direct Investment (USD billion)	BCB	Mar/22	n.a.*	-	11.8

* Owing to a strike of federal workers, these data releases have been postponed with no specific publication date scheduled for now.

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Update¹.

¹ Santander Brazil – Scenario Update: “Surfing an Extended Commodity Wave” – April 14, 2022- Available on: <https://bit.ly/Std-scenupdate-apr22>



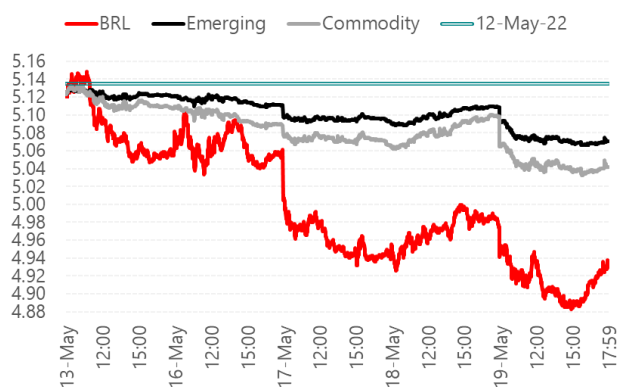
LOCAL MARKETS—FX

In the rolling week ended May 19, the BRL broke a three-week streak of weakening and stood among the best performers in a basket with the 31 most liquid currencies in the world. The USD/BRL pair closed the period below 5.00, at 4.93 (a 4.2% gain). Mounting fears of an economic deceleration in the U.S. appear to have weighed on the USD on a global scale, as indicated by the 2% decline recorded by the DXY index for the same period. This backdrop favored the positive performance of the BRL (a high-beta currency) in the period, and in our view this strengthening was likely reinforced by further gains in commodity prices. The prospect of FX inflows due to a possible sale of shares of Eletrobras (Brazil's state-owned electricity company) in the context of its privatization process may also have driven the Brazilian currency recently. The BRL0.25-0.30 range in which the USD/BRL pair oscillated in the period underpins our view that volatility in the Brazilian FX market should continue to be fairly high amid considerable uncertainties on both the local and international fronts.

LOCAL MARKETS—Rates

Local nominal yields rallied all across the curve this week, amid hopes for the end of the BCB's tightening cycle, possible government measures to curb prices, and a respite in global yields. Since last Thursday (May 12), the front end of the curve (Jan-24 DI future) fell 21 bps, to 12.96%, while the back end of the curve (Jan-27 DI future) slid 30 bps to 12.07%. The curve's steepness in this segment decreased a bit further, increasing the inversion (by 9 bps) to -89 bps. The rally along the curve seems to have been driven by signals from the BCB that the hiking cycle might be close to an end, even as BCB officials note that upcoming decisions (determining the terminal Selic level) are still somewhat data dependent. In our view, another source of downward pressure in the yield curve was signs of a decreased likelihood of new hikes in gasoline prices in the short term, given a shift in the focus toward the (narrower) gap between oil prices in BRL and domestic gasoline prices (instead of the wider gap between international and domestic gasoline prices). We also believe that discussions regarding possible policies and legislation aimed at curbing costs of fuel, electricity, telecommunications, and transport—which could drive short-term relief in inflation—could also have contributed to the decline in rates at the front end. At the back end, the rally was supported not only by this better mood seen on the front end, but also by the respite in longer U.S. Treasury yields. We continue to expect a steepening in the yield curve in the medium term, after the BCB stops hiking the Selic rate and the IPCA reaches a peak in annual terms. Upside risks for global rates could also favor this type of positioning, in our view.

Figure 2. USD/BRL Intraday Trends



Sources: Bloomberg, Santander.

Note 1: As of the close on Thursday, May 19, 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 on Thursday, May 19, 2022.



COMMODITIES

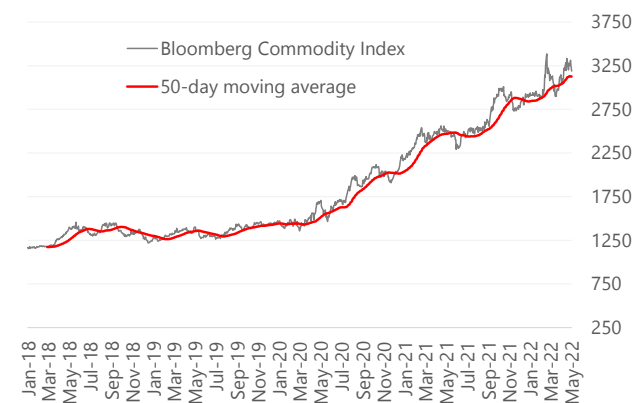
Commodity prices rose in the rolling week ended May 19, driven by the energy complex. The Bloomberg Commodity Aggregate Index in BRL terms decreased 1.0% in the period, on the heels of the BRL rally. In USD terms, the index increased 3.1%, with the Agriculture Subindex up 2.0%, the Energy Subindex climbing 4.0%, and the Industrial Metals Subindex gaining 4.4%.

Oil prices reach above USD110/bbl as China seeks to replenish its strategic reserves. As Western countries enforce sanctions and ban imports from Russia, China has been strengthening its energy ties with Moscow as it buys cheap Russian oil. These imports are to be used to refill China's strategic petroleum reserves, which have been used in times of disruptions such as last year. According to press reports², refiners in China have also been quietly buying Russian crude since Russia's invasion of Ukraine. Meanwhile, fuel prices in the U.S. continue to be high due to a lack of refining capacity. We expect imports from Asia (mainly India) to increase in the coming months, with major refineries in India postponing the maintenance season to cope with soaring demand.

Indonesia lifts palm oil export ban. The world's biggest shipper of edible oils will resume exports of crude palm oil and other refined products from May 23 (the ban was imposed beginning April 28). The ban's reversal should help alleviate global supply shortages as demand for its substitutes (sunflower oil, soybean oil) ease. Earlier in the week, India announced a ban on wheat exports in another case of food protectionism, but the impact of this was partly offset by estimates for Russian wheat crops approaching a record.

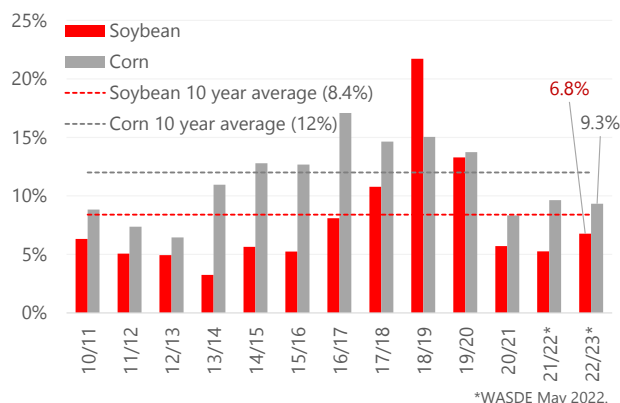
Iron ore and base metals prices trading sideways on concerns about weak global demand. Iron ore prices continued to decline, as lockdown jitters in China continue in key cities (given the country's zero-COVID policy). In an attempt to counter the economic slowdown, the Chinese government urged officials to use fiscal and monetary policies to stabilize employment and the economy. However, recent data show that in April, home prices fell for an eighth month running.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. US: Stock-to-Use Ratio in Grains - %



Sources: USDA, Santander.

² https://economictimes.indiatimes.com/news/international/business/chinas-independent-refiners-secretly-buying-russian-oil-at-steep-discount/articleshow/91308710.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst



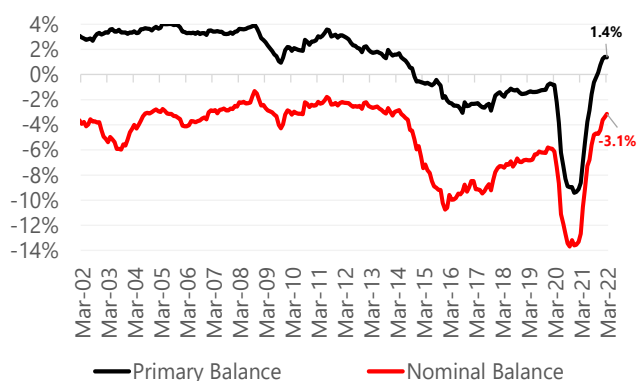
FISCAL POLICY AND LEGISLATION

On May 16, the Brazilian Central Bank (BCB) unveiled the public sector's fiscal numbers for March. This publication came in with a delay, owing to the strike by some categories of federal workers. The numbers show a continued improvement in fiscal performance, mainly owing to the positive revenue effects from price shocks (i.e., gains in terms of trade owing to higher commodity prices, as well as higher inflation).

The public sector posted a primary surplus of BRL4.3 billion, once again better than the market's median estimate (-BRL0.7 billion). The March result was largely led by the continued strength in regional governments' revenues. Altogether, states and municipalities posted a primary surplus of BRL11.9 billion. The central government recorded a deficit of BRL7.8 billion, whereas state-owned companies posted a primary balance of +BRL0.2 billion for the month. As percentage of GDP, this is the one of the best consolidated fiscal performances for March since 2014. The result for 1Q22 paints a similar picture, with the year-to-date surplus of 4.7% of GDP, the best reading since 2008. In 12 months, the public sector posted a primary surplus of BRL123 billion (1.4% of GDP), compared to BRL65 billion (0.7% of GDP) in December 2021. States and municipalities account for the bulk of this result (1.4% of GDP), as the 12-month deficit of the central government (0.1%) is canceled out by a small surplus for government firms (+0.1%). The 12-month rolling nominal deficit slid further to 3.1% of GDP, the narrowest since May 2014. In addition to the improvement in the primary balance, the tightening in the headline budget deficit follows the positive effects of BRL appreciation early this year (via the BCB's FX swap transactions). The gross government debt statistics have also been influenced by the FX trend of late, with the reading dropping a bit further to 78.5% of GDP (YE2021: 80.3%). While some core measures of government indebtedness are still higher than before the pandemic, the numbers are far off the peaks seen in late 2021: we calculate that net public sector debt stripped out of loans to government banks stood at 63.6% of GDP in March—up 4.0 p.p. from the pre-pandemic level but 6.1 p.p. off the recent peaks. We also estimate that gross general government debt deducted from FX reserves was 59.7% of GDP as of March—up 6.3 p.p. from the pre-pandemic level but 3.7 p.p. off the recent peaks. Given that the official (PTAX) FX closed the month at USD/BRL 4.74, part of the FX effects on both nominal deficit and debt statistics are about to fade if the currency stabilizes at current levels (~4.90). Our fiscal scenario for 2022 accounts for a balanced full year consolidated primary budget and gross debt of 80.6% in December. Recent developments—especially the likely greater support from commodities for both real activity and government revenue—generate an upward bias for our budget estimate and a slight downward bias for our debt estimates in the short term. In any case, while we welcome the recent improvement in the fiscal trends, the usual fluidity of commodity cycles reminds us that one should not lose sight of key budgetary and macroeconomic reforms that are still necessary to make the recent improvements more of a permanent (instead of a purely cyclical) development. Curbing mandatory expenses and fostering productivity and investment (e.g., via tax and administrative reforms, trade openness, concessions, and privatizations) continue to be essential items on the agenda, in our view.

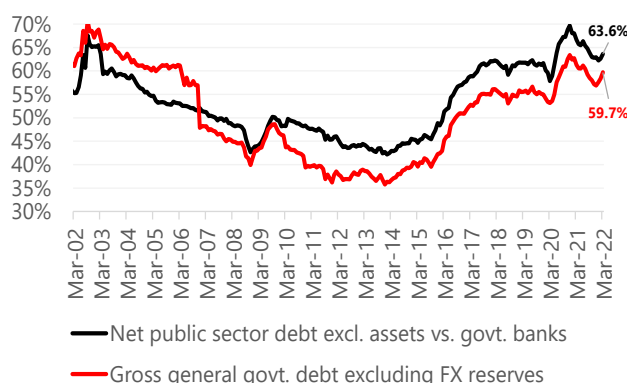
For details on Santander's fiscal policy outlook, please refer to our last chartbook³.

Figure 6. Consolidated Budget (12m, % GDP)



Sources: Brazilian Central Bank, Santander.

Figure 7. Government Debt Gauges (% GDP)



Sources: Brazilian Central Bank, Santander.

³ Santander Brazil Fiscal Policy: “Better Short Term, Still Challenging Outlook” – April 27, 2022 – Available on: <https://bit.ly/Std-chart-fiscal-apr22>



INFLATION

We expect May's IPCA-15 (due on Tuesday, May 24) to rise +0.45% MoM. Although higher than the implicit mid-target on a monthly basis (0.29% MoM, meaning 3.5% in annualized terms), such a number would be close to the usual seasonal pattern (since 2004, the average headline for the month is 0.42% MoM). If our number is on the mark, we calculate that the sequential trend for the headline IPCA should see a slight deceleration to 14.6% 3MMA-saar from 15.6%. That is still a pretty high reading, however. In YoY terms, we expect the headline to remain stuck at 12.0%, the highest level since late 2003, which we see as the peak for the inflation cycle.

Compared to April's IPCA-15 (+1.73% MoM), we expect the headline to decelerate sharply in monthly terms, driven by regulated prices (-1.68% MoM vs. +3.23% last month). We project that gasoline (+0.50% MoM vs. +7.51% in April) will contribute slightly less than half of the relief—as the last price hike will basically have faded—and electricity (-13.85% MoM vs. +1.92% in March) will contribute the other part, as we expect the reduction in the tariff flag (to “Green” from “Hydrological Risk”) to start to show in this reading. We expect market-set price inflation to be relatively stable in monthly terms. On the one hand, we project food-at-home decelerating (from +3.00% MoM last month to 1.89% currently), but on the other hand, industrial goods (+1.49% MoM vs. 0.87% last month) and services (+0.76% MoM vs. 0.59% in April) should accelerate, offsetting the relief in food costs.

Although we expect the services and industrial goods headline inflation trend to accelerate further, we see the EX3 core (which includes core services and industrials) as likely to rise 1.05% MoM. This is still a high reading, keeping the sequential trend at a hefty 13% 3MMA-saar. Thus, we believe May will be the 20th consecutive month in which the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.50% for 2022 and 3.25% for 2023).

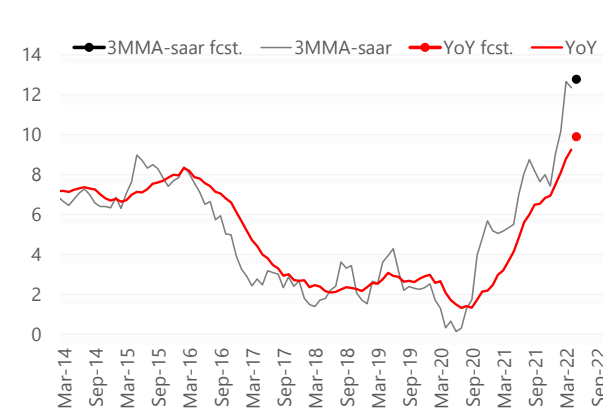
We still project a deceleration of annual inflation in the next readings, but the level and composition of recent IPCA readings have been worrisome, implying additional risks that further tilt the balance of risks upward for both 2022 and 2023.

Figure 8. May's IPCA-15 Details (%)

	MoM		YoY	
	May-22	Contrib.	Apr-22	May-22
IPCA-15	0.45	0.45	12.0	12.0
Administered	-1.68	-0.45	16.0	12.9
Free	1.23	0.90	10.6	11.7
Food-at-home	1.89	0.29	15.4	17.0
Industrial goods	1.49	0.34	13.7	14.3
Services	0.76	0.26	6.7	7.9
EX3 Core	1.05	0.37	9.2	9.9

Sources: IBGE, Santander.

Figure 9. Core Inflation IPCA-15 EX3 (%)



Sources: IBGE, Santander.



CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research

Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Orenge*	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 – Commodities	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Fabiana Moreira*	Economist – Credit	fabiana.de.oliveira@santander.com.br	5511-3553-6120
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
Rodrigo Park *	Economist – Argentina	rpark@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 Orenge*	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
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511-3553-1684
Murilo Riccini*	Head, Chile	murilo.riccini@santander.cl	56 22336 3359

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