Santander
Macroeconomic Research

BRAZIL MACRO

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MACRO COMPASS

DELTA FEARS ABROAD AND FISCAL RISKS LOCALLY BUMP THE FX RATE HIGHER

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- The USD/BRL pair closed in the rolling week ended on August 19 with a 3% loss, at 5.41, registering the worst performance among major currencies in the period. In our opinion, the sell-off follows mounting concerns with the dissemination of the Delta variant of COVID-19 around the globe, as well as rising uncertainties with the domestic fiscal outlook. These factors, alongside expectations of a hawkish BCB response to a worsening inflation outlook added to the bear-steepening trend seen in the local yield curve.
- Health conditions seem to have stabilized now in Brazil; infections and deaths have flattened out but remain below recent peaks. The Delta variant risks remain high, with a spreading seen in key regions of the country. Our proxy for a nationwide average of ICU occupancy is now close to 48%, the lowest level since January. The daily average of vaccinations reached 1.9 million shots (as of Wednesday, August 18), reaffirming our scenario of full immunization of adults by year-end.
- According to preliminary numbers, our IGet Services (our proprietary indicator, based on credit and debit card transactions) lost a bit of steam in August (down by 2.8%), breaking a sequence of gains. However, our tracking for the component of IBGE's monthly indicator of services to families still points to a sequential gain of 5.3% MoM-sa. We expect positive contributions to (sequential) GDP growth from services as mobility returns towards "normality".
- For the coming week, the focus will be on the first releases of economic confidence data (by FGV) for August. Consumer confidence is due out on Wednesday (August 25), while industrial confidence is due on Friday (August 27). July's CAGED formal job survey is also due on Friday, for which we expect another solid number (+348K, adjusting for seasonality), keeping this report at odds with the not-so-strong numbers from the PNAD household survey.
- We expect August's IPCA-15 (due on Wednesday, August 25) to rise 0.83% MoM or 9.2% YoY. This should be another sour CPI data release, with a deterioration of both level and composition. The negative highlight should be services inflation, with its core gauge accelerating to 7.8% 3MMA-saar. The EX3 core trend is to reach a hefty 8.6% 3MMA-saar, much above the mid-target for IPCA in 2022 (3.5%).
- We expect July external sector data (due Wednesday, August 25) to reaffirm a positive message regarding prospects for the balance of payments. For the month, we pencil in a low current account deficit (US$0.3 billion) and look for a sizeable volume of direct investments in the country (US$5.6 billion).

Most of the information in this report is up to the end of Thursday, August 19, 2021.

Figure 1. Brazil Macro Agenda for the Week of August 23-27, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Consumer Confidence (index)	FGV	Aug/21	Wed, 25-Aug	--	82.2
Federal Debt Report (BRL billion)	STN	Jul/21	Wed, 25-Aug	--	5.3
IPCA-15 Inflation (% MoM)	**IBGE**	**Aug/21**	**Wed, 25-Aug**	**0.83**	**0.72**
IPCA-15 Inflation (% YoY)	**IBGE**	**Aug/21**	**Wed, 25-Aug**	**9.24**	**8.59**
Current Account Balance (USD billion)	BCB	Jul/21	Wed, 25-Aug	-0.3	2.8
Foreign Direct Investment (USD billion)	BCB	Jul/21	Wed, 25-Aug	5.6	0.2
Construction Confidence (index)	FGV	Aug/21	Thu, 26-Aug	--	95.7
Industrial Confidence (index)	FGV	Aug/21	Fri, 27-Aug	--	108.4
Total Outstanding Loans (% YoY)	BCB	Jul/21	Fri, 27-Aug	--	--
Formal Job Creation (thousands, nsa)	CAGED	Jul/21	Fri, 27-Aug	325	309
Formal Job Creation (thousands, sa)	CAGED	Jul/21	Fri, 27-Aug	348	350
Federal Tax Collection (BRL billion)	RFB	Jul/21	20 to 25-Aug	155	137

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario: *"Advances in Controlling the Pandemic, Setbacks in Quelling Inflation"* –** Aug 12, 2021- Available on: http://bit.ly/Std-scenrev-081221

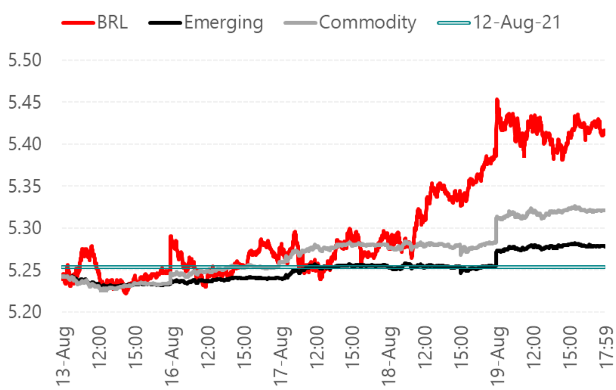
LOCAL MARKETS—FX

The BRL weakened 3.0% to USD/BRL 5.41 in the rolling week ended August 19, surpassing the 5.30 level for the first time since July 8 (on an intraday basis). The outcome led the BRL to register the worst performance among major currencies and, in our view, the move reinforced the high beta nature of the Brazilian currency, as well as the influence of idiosyncratic (fiscal) risk. From a week ago, the USD strengthened against all major currencies but two (JPY and CHF) on the heels of fears about the potential negative impacts of the dissemination of the Delta variant of COVID-19 on the world economic recovery. However, in addition to the unfavorable news cycle abroad, we also witnessed adverse circumstances arising on the domestic side, given the current discussions in Congress about further fiscal relaxation (both on the revenue and spending side). Consequently, this mix of developments amplified the weakness of the BRL against the USD, thus buttressing its high-beta nature and underpinning our assessment that there is limited room for the BRL to strengthen in the absence of structural improvements on the fiscal front.

LOCAL MARKETS—Rates

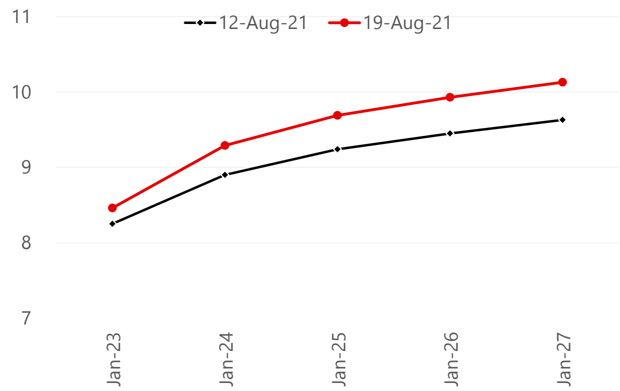
The nominal yield curve has shifted higher again, keeping a bear-steepening trend. Since last Thursday (August 12), the front end of the curve (Jan-23 DI future) rose by 21 bps to 8.46%, while the back end of the curve (Jan-27 future) rose 50 bps to 10.13%. As a result, the curve's steepness in this segment rose 29 bps to 167 bps. At the front end, the market seems to continue with a view that the deterioration on the inflation outlook might prompt the BCB to take an even more hawkish monetary policy stance. The probability of a 100-bps hike in Selic implied in the options market fell to 57% (from 75%), with the probability of a 125-bps hike gaining ground, moving to 26% now from 18% last week. At the back end, the continuation of the uncertainty regarding the path of fiscal policy and the risks for the fiscal consolidation process keep supporting the building of the risk premium at this segment of the curve.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, August 19, 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, August 19, 2021.

COVID-19 MONITORING

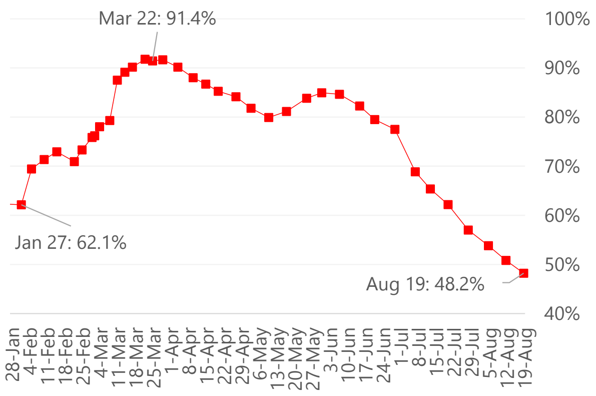
Brazil's vaccination reached a pace of 1.9 million doses a day on average as of Wednesday, August 18. We expect the average pace to hold at around 1.5 million throughout 2H21, as vaccine inventories remain high (44 million doses) and deliveries are expected to remain above the levels of vaccine administration. Despite this positive note, the Delta variant has been spreading in key regions, such as the state of Rio de Janeiro (where it accounts for 60% of new infections) and the metropolitan region of São Paulo (where it accounts for 23% of new infections).

Health conditions seem to have stabilized now in Brazil. Based on the last available data (August 19), our proxy[2] for a nationwide average ICU occupancy rate has fallen further to 48%, the lowest level in our series (begun in January). That number compares to a previous peak of 92% (late March). Data from Brazil's Health Ministry showed that the 7-day average of infections stood at 30k as of Wednesday (August 18), down 2% from last week; as for casualties, the 7-day average stood at 844, down 3% on the same comparison.

Urban mobility reaches the highest level since the pandemic's beginning. August's data so far indicates a solid recovery of mobility since last week, with our lockdown index now moving to 1.2 points (as of August 12, 2021) down from to 4.6 points (as of August 5, 2021). This move stems from increases in all of the main categories, with Retail posting the best figures since December 2020 and Transit Stations returning to the pre-pandemic levels for the first time; the Workplaces segment had already surpassed this mark in June. All in all, our index is trending at low levels, even considering last year's Christmas period (December 22 to 24), meaning a fast convergence to "normality", as vaccinations advance.

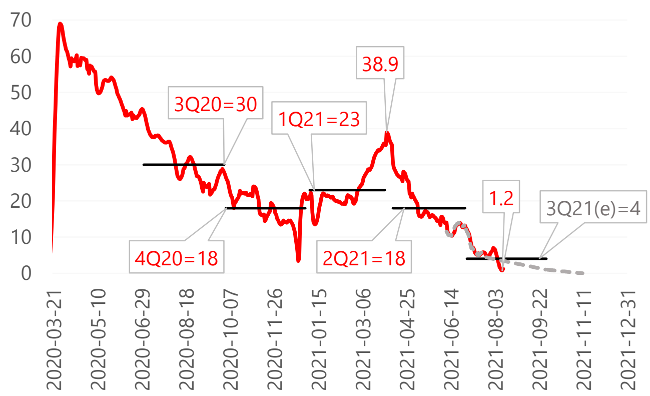
Our daily activity index has maintained a slower pace across 3Q21. The index—based on daily data on energy consumption, car sales, and mobility—showed an upward trend from April to June; on a monthly basis, and adjusted for seasonality, the index expanded by 5.6%, 3.0% and 4.2% in April, May and June, respectively. However, the index seems to have started 3Q21 at a slower pace, with a 0.8% drop in July and, considering the average so far in August (up to the 12th), we calculate a 0.6% expansion. The index is at levels 4.5% below February 2021 (i.e. before the pandemics resurgence seen earlier this year).

Figure 3.A. – Our Proxy for a Nationwide ICU Occupancy Rate (%)



Sources: @coronavirusbra1, Santander.

Figure 3.B. – Lockdown Index*, Mobility Forecasts (Feb/20=0, 7-day average)



Sources: Google, Santander.

* This index is built as an average of selected segments from Google Mobility Report with inverted scales. Data are available until August 12, 2021.

[2] The nationwide average proxy is a weighted average (by state population) of state ICU occupancy rates. Hence, it does not reflect the actual national occupancy rate = Total beds occupied in Brazil / Total beds available in Brazil.

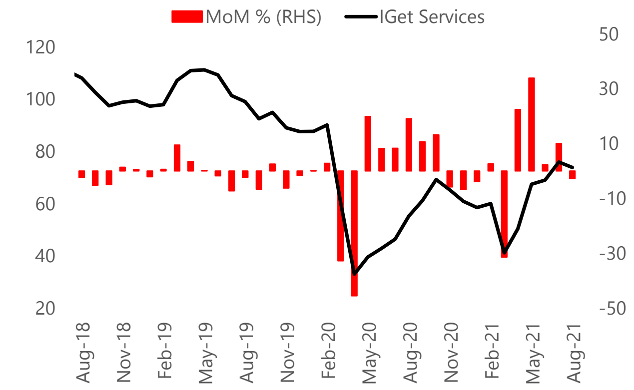
ECONOMIC ACTIVITY

Broad activity surprised to the upside in June, imparting a little upside risk to our current projection for a sequentially flat 2Q21 GDP. The headline index leapt 1.1% MoM-sa, above market consensus and our call (0.5% and 0.8%, respectively), but with May's figure being downward revised in the seasonally adjusted series (to -0.6% from -0.4%). Notwithstanding the positive surprise, June's figure was not enough to fully erase March's losses (-2.0%). June's result brought the economy back to levels above the pre-pandemic mark (up by 0.8% since February-2020), according to this indicator. This monthly growth likely stems mainly from the services output since industry and retail sales posted weak figures. Less cyclical activity sectors like agriculture and health services also could have contributed positively. Despite solid growth at the margin, it was not enough to avoid a virtually flat quarterly figure in 2Q21 (up by 0.1%). While in qualitative terms this is still in line with our expectations of a modest GDP figure in 2Q21, the result imparts a little upside risk to our current projection (0.0% QoQ-sa). See details in the link[3].

IGet Services decelerated in August. However, our tracking still points to sequential expansion. According to the preview for August, our proprietary index (IGet Services) retreated 2.8% MoM-sa, following a 10% MoM-sa growth seen in July. This result breaks a string of four months in positive territory. The August figure places the index at levels 18% below the pre-pandemic mark and almost 26% below the 2019 average. Despite the index's retreat at the margin, our tracking for the services to families (from the IBGE's monthly survey) still points to sequential expansion: we expect 5.3% MoM-sa growth (46.9% YoY), the fifth gain in a row (since the pandemic's resurgence in March 2021), which places the index at readings 16% below the pre-pandemic mark. One reason for this mismatch (i.e. between our index and the estimate for the official IBGE series) is the difference in the seasonal adjustment methods, which arises from the differences in the length of the histories of the times series. See details in the link[4].

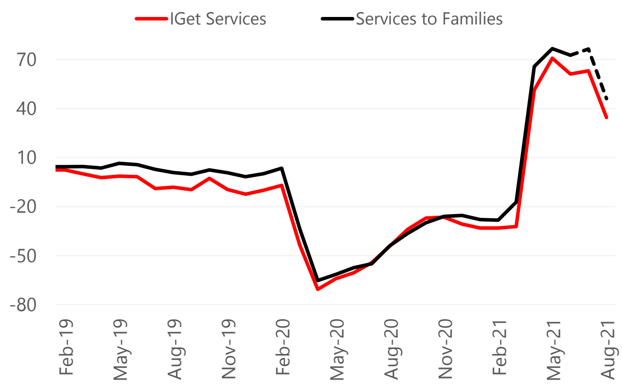
For the coming week, we focus on the first releases of the economic confidence data (by FGV) for August. Consumer confidence is due out on Wednesday (August 25), while industrial confidence is due on Friday (August 27). Job market numbers also take the limelight with the July CAGED's payroll report also due out on Friday, for which we expect a solid net job creation of +325K. According to our preliminary seasonal adjustment, this figure should come in at +348K, very close to the revised result for June (+350K), suggesting strong payroll growth, according to the establishment survey (still at odds with the signals from the household survey). **For details on Santander's activity outlook, please refer to our last chartbook[5].**

Figure 4.A. – IGet Services (sa, Jan-16=100)



Sources: Santander.

Figure 4.B. – IGet Services x Services to Families (nsa, YoY%)



Sources: IBGE, Santander.

[3] **Santander Brazil Economic Activity - *"Broad Activity Surprised to Upside in June "* –** August 13, 2021 - Available on: https://bit.ly/Std-Econact-081321
[4] **Santander Brazil Economic Activity - *"Tracking Sinaliza Crescimento Sequencial dos Serviços às Famílias"* –** August 18, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGETser-p-ago21
[5] **Santander Brazil Economic Activity - *"Chartbook – A Brighter Outlook for Mobility and Services"* –** August 18, 2021 - Available on: https://bit.ly/Std-chart-econact-aug21

INFLATION

We expect August's IPCA-15 (due on Wednesday, August 25) to rise 0.83% MoM, meaning an acceleration in annual terms to +9.2% YoY (from +8.6% YoY in July). Our forecast implies a fresh new multi-year high, with the trend denoted by the seasonally adjusted quarterly annualized moving average accelerating to 11.1% 3MMA-saar.

Compared to the July IPCA (+0.93% MoM), August data should moderately slow in monthly terms, mainly driven by a deceleration of services to 0.33% MoM (from 0.70%), because the high volatile item of airline tickets should fall 6.5% MoM, coming from +35.6% MoM in the last reading. Despite this deceleration in services in monthly terms, this is a high seasonal change that should push the trend up to 6.9% 3MMA-saar, from 5.0%. Moreover, analyzing the core services gauge (that excludes airline tickets among other volatile services items), the measure should also accelerate in 3MMA-saar terms to 7.8%, from 6.2%.

Regulated prices should also contribute to the deceleration of IPCA-15 in monthly terms, because electricity inflation will soften as the effects of the Red 2 flag increase in costs start to fade. However, food-at-home might accelerate in monthly terms to 1.33% MoM, an unusually high seasonal change, caused by a recent weather-related shock impacting fresh-food items. This should push food-at-home inflation to 14.0% 3MMA-saar (from 11.0% last month), leaving the trend measure close to the 12-month change (16% YoY), signaling some resiliency at a high level. Finally, a bright side of this report might be industrial goods, for which we project a rise of 0.65% MoM. Despite being seasonally high (the average for August is closer to 0.20% MoM), this change is consistent with a deceleration to 10.7% 3MMA-saar, from 12.2%. It is worth highlighting, however, that it might be too soon to call it a peak for industrial goods inflation, as we continue to see supply-chain disruptions getting worse (e.g., major global ports and some important factories shutting down because of the advance of the COVID-19 Delta variant). Furthermore, the core gauge for industrial goods should show some resiliency, moving at 10.0% 3MMA-saar (from 10.4% previously), still an unfavorable level.

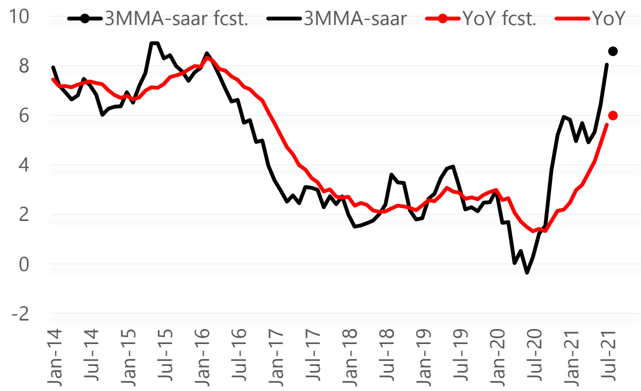
Finally, in terms of broad underlying inflation measures, the EX3 core should rise around +0.50% MoM, as per our projection, meaning an acceleration to 8.6% 3MMA-saar. This is the eleventh month of the EX3 core running above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022)—signaling a risky spread of primary shocks to general prices. All in all, we project this should be another unfavorable IPCA reading, with a deterioration of both the level of inflation and its composition.

Figure 5.A. – August's IPCA-15: Forecast Details (%)

	MoM		YoY	
	Aug-21	Contrib.	Jul-21	Aug-21
IPCA-15	0.83	0.83	8.6	9.2
Administered	1.38	0.37	12.9	13.4
Free	0.63	0.46	7.1	7.8
Food-at-home	1.33	0.20	15.3	16.1
Industrial goods	0.65	0.15	9.0	9.1
Services	0.33	0.11	2.9	3.8
EX3 Core	0.50	0.50	5.6	6.0

Sources: IBGE, BCB, Santander.

Figure 5.B. – Core Inflation (IPCA-15 - EX3 %)



Sources: IBGE, BCB, Santander.

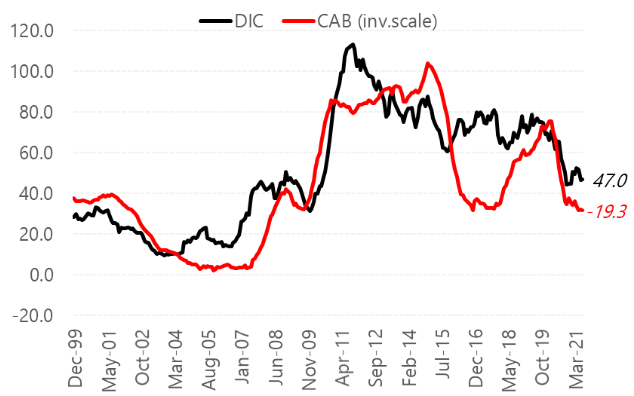
BALANCE OF PAYMENTS

We expect the July current account to post a US$0.3 billion deficit—the report is due on Wednesday (August 25). Our forecast reflects a disappointing trade surplus and a seasonally large deficit in the primary income account for the period. On the financial accounts, preliminary figures point to a sizeable volume of direct investments in the country last month, which should keep the markets' constructive assessment of the Brazilian balance of payments unchanged.

The July 2021 trade surplus fell short of our forecast and should be an important reason for the US$0.3 billion deficit we project the current account balance to have registered in the period. After more robust trade surpluses in previous months, we believe this fluctuation is normal and preliminary figures for August 2021 bolster our sanguine view for the trade surplus this year. See details in the link[6]. The seasonal concentration of interest payments in July is another factor that we believe to have weighed on the current account last month. Last but not least, remittances of profits and dividends are commonly larger in this period too. In our opinion, seasonal accounting factors (end of fiscal quarters) together with seasonal interest payments usually lead to larger deficits in the primary income account in July. And this is what we expect to see this time around

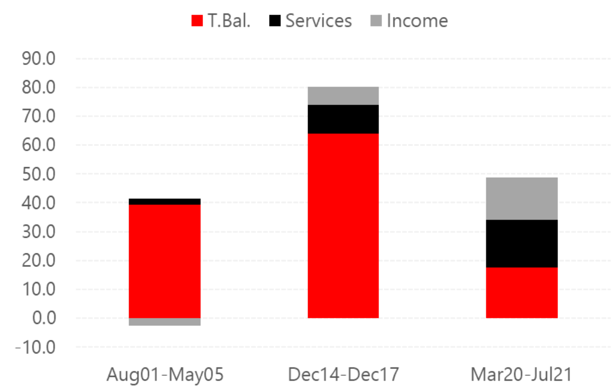
All in all, we think this report should not change markedly the constructive perception that markets share about the soundness of the Brazilian external position, particularly if our estimate for the volume of direct investments in the country proves right. Based upon preliminary figures provided by the BCB, we calculate a net inflow of US$5.6 billion in July, which will translate into a US$47.0 billion inflow on a 12-month basis. That is more than twice the US$19.6 billion current account deficit we expect to see in the twelve months to July, which underpins our view that the country should continue to face a fairly comfortable situation to meet its external financing needs.

Figure 6.A. – Current Account vs. Direct Investments (USD billion, 12-month)



Source: Brazilian Central Bank, Santander.

Figure 6.B. – Current Account Adjustment Cycles (USD billion)



Source: Brazilian Central Bank, Santander.

[6] **Santander Brazil – External Sector:** ***"Lower Than Expected July Trade Surplus, But Not a Concern Given Forecast Increases Ahead"*** **–** August 2, 2021- Available on: https://bit.ly/Std-extsec-020821

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