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MACRO COMPASS

EMPLOYMENT AND INFLATION IN THE LIMELIGHT

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

- The BRL outperformed all but one (CLP) of its peers in the rolling week ended January 20, closing at 5.44 (+1.7% versus the greenback). Keeping its high-beta pattern, the BRL was favored by the strength in commodity prices and better sentiment about global growth, especially following the new stimulus in China. On the domestic front, constructive conjectures about the political environment have also helped the Brazilian currency. The local yield curve underwent considerable volatility in recent days, with higher global yields driving a sell off that was later neutralized by constructive conjectures about local politics. At the end, the curve has moved little for the week, still showing a considerable inversion (i.e., negative steepness) between the 2024s and 2027s.
- The IBC-Br jumped 0.69% MoM-sa (+0.43% YoY) in November, slightly below our estimate of +0.8% MoM-sa. November's result stems mainly from the positive surprises seen in the tertiary sector, while a slight decrease in industry. We believe that a farm output rebound and a continued recovery in health and education services (not well captured in the monthly surveys) may have also contributed positively to the economy in the 4Q21. We have maintained our 4Q21 GDP growth tracking at +0.2% QoQ-sa.
- We expect weak figures for the tertiary sector for January, following a mixed picture seen in December, according to our proprietary indicators (from the IGet family). Mainly based on the IGet results, our tracking for broad retail sales points to a 1.6% MoM-sa retreat, while our tracking for services to families points to a slight growth of 0.1% MoM-sa in the first month of 2022.
- Labor market data is due to be released in the coming week. On Thursday (January 27), the December CAGED formal job creation data is due to be released, and our estimate stands at +130k seasonally adjusted (November: +275k). On Friday (January 28), the November PNAD household survey is due to be released and we project the unemployment rate at 12.0% in seasonally adjusted terms (down from 12.2% in October).
- We expect the January IPCA-15 (due on Wednesday, January 26) to rise +0.43% MoM. In YoY terms, this means 10.04%, a slight deceleration from the 10.42% change of December's IPCA-15. Compared to the December IPCA-15 (+0.78% MoM), the headline should decelerate in monthly terms, driven mostly by regulated prices (-0.33% MoM vs. +1.17% last month), particularly gasoline. In terms of broad underlying inflation measures, we estimate the EX3 core will continue to trend around 7.6% 3MMA-saar – still a hefty reading. Despite a much tighter monetary policy, we continue to see difficulties for the disinflation process ahead: we forecast 6.0% IPCA for 2022.

Most of the information in this report is up to the end of Thursday, January 20, 2022.

Figure 1. Brazil Macro Agenda for the Week of January 22 - 28, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Consumer Confidence (index)	FGV	Jan/22	Tue, 25-Jan	-	75.5
IPCA-15 Inflation (% MoM)	**IBGE**	**Jan/22**	**Wed, 26-Jan**	**0.43**	**0.78**
IPCA-15 Inflation (% YoY)	IBGE	Jan/22	Wed, 26-Jan	10.04	10.42
Current Account Balance (USD billion)	BCB	Dec/21	Wed, 26-Jan	-5.8	-4.5
Foreign Direct Investment (USD billion)	BCB	Dec/21	Wed, 26-Jan	3.5	2.5
Federal Debt Report (BRL trillion)	STN	Dec/21	Wed, 26-Jan	-	5.4
Industrial Confidence (index)	FGV	Jan/22	Thu, 27-Jan	-	100.1
Formal Job Creation (thousands)	**CAGED**	**Dec/21**	**Thu, 27-Jan**	**-181**	**324**
Formal Job Creation (thousands, sa)	**CAGED**	**Dec/21**	**Thu, 27-Jan**	**130**	**275**
Total Outstanding Loans	BCB	Dec/21	Fri, 28-Jan	-	-
National Unemployment Rate (%, nsa)	**IBGE**	**Nov/21**	**Fri, 28-Jan**	**11.5**	**12.1**
National Unemployment Rate (%, sa)	**IBGE**	**Nov/21**	**Fri, 28-Jan**	**12.0**	**12.2**
Retail Confidence (index)	FGV	Jan/22	Fri, 28-Jan	-	85.3
Services Confidence (Index)	FGV	Jan/22	Fri, 28-Jan	-	95.5
Central Gov. Prim. Balance (BRL billion)	STN	Dec/21	Fri, 28-Jan	-	3.9
Federal Tax Collection (BRL billion)	RFB	Dec/21	20 to 26-Jan	-	157.3

Sources: Bloomberg, IBGE, Santander.

For details on Santander's economic forecasts for Brazil, please refer to our last Scenario Update[1].
Also refer to our Macro Propositions for Brazil in 2022[2].

[1] **Santander Brazil – Scenario Update: *"Inflation Still a Concern"* –** January 20, 2022- Available on: https://bit.ly/Std-scenupdate-jan22

[2] **Santander Brazil – Macro Propositions 2022: *"Navigating the Uncertainties"* –** January 07, 2022- Available on: https://bit.ly/Std-Macroprop22

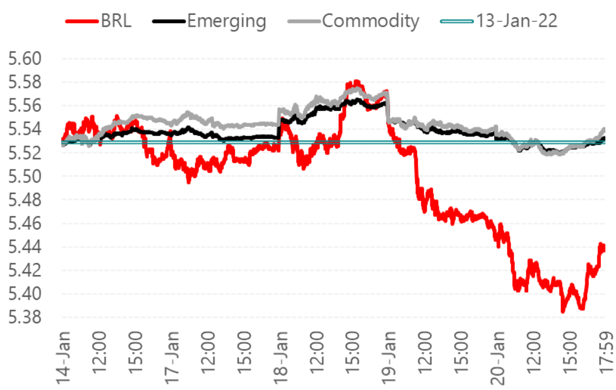
LOCAL MARKETS—FX

In the rolling week ended January 20, the BRL outperformed nearly the entire basket of 31 of the most liquid currencies in the world– the CLP was the lone exception – closing the period at 5.44 (up 1.7%). In our opinion, the move had to do with the recovery observed in commodity prices on the heels of stimulus granted by the Chinese government to support its economy. Encouraging signals regarding the evolution of the Omicron variant in some countries also contributed, reducing the fears of an impact in the world economic recovery ahead. The BRL continues to show its high beta pattern, outperforming (or underperforming) peers conditional on the risk-on (or risk-off) mood in the global markets. Regarding the domestic news cycle, we did not witness a concrete change in the economic environment that could justify the move, in our opinion. However, we believe that more constructive conjectures referring to the political environment may also have helped the BRL to outperform most currencies in the last few days. In our view, the latter reinforces the importance that the resumption of discussions about macroeconomic reforms will have for a significant and perennial strengthening of the BRL.

LOCAL MARKETS—Rates

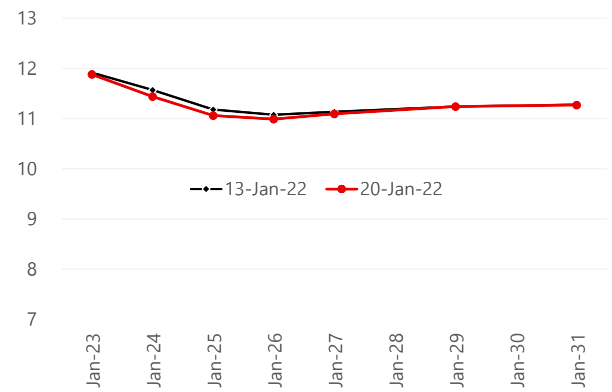
Similar to last week, which began with a sell-off and finished with a rally, the nominal yield curve observed a little bull-steepening for the week as a whole, but amid an intense volatility. Since last Thursday (January 13), the front end of the curve (Jan-24 DI future) fell 13 bps to 11.44%, while the back end of the curve (Jan-27 future) fell 4 bps 11.10%. While the curve's steepness in this segment increased by 9 bps to -34 bps, it remains considerably inverted. At the front end, in terms of Copom's market expectation, the curve continues to price in a 150 bps Selic hike for the next meeting (February 1-2) and 100 bps for the following meeting (March 15-16). At the long end, an early sell-off was driven by the upward movement in longer US Treasury yields, which was later offset by constructive conjectures about the political environment later in the week. However, we continue to see an environment of high uncertainties for the domestic economy, particularly regarding the fiscal consolidation process. Hence, we see space for domestic long-end yields to go higher and for the yield curve to steepen (probably after the Selic rate peaks).

Figure 2. USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, January 20, 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, January 20, 2022.

COMMODITIES

Commodities had a positive week, with the Bloomberg Commodity Aggregate Index rising 2.7% in the rolling week ended January 20. The gains were across the board, as the Agriculture Subindex rose 4%, the Energy Subindex gained 1%, and Industrial Metals Subindex leapt 3%. In our view, the commodity strength in general mirrors the signs of lesser economic impact from the omicron variant of COVID-19, as well as the signal (implicit in recent rate cuts in China) that economic stimulus will limit the downside risks for activity in the World's second largest economy. Idiosyncratic factors risking future supply also somewhat contributed to the commodity rally.

Brent oil rises to $88/bbl on the back of macro fundamentals and supply constraints. Brent crude oil rose 5% from last week to $88/bbl, the highest level since October 2014. On Wednesday, the IEA[3] claimed that the oil market seems tighter than previously thought: demand is faring better than expected in spite of Omicron, and production is being impacted in key producing countries. We still see the oil market in output deficit, as global inventories are low and producers (ranging from OPEC+ members to independent US shale companies) struggle with underinvestment in previous years.

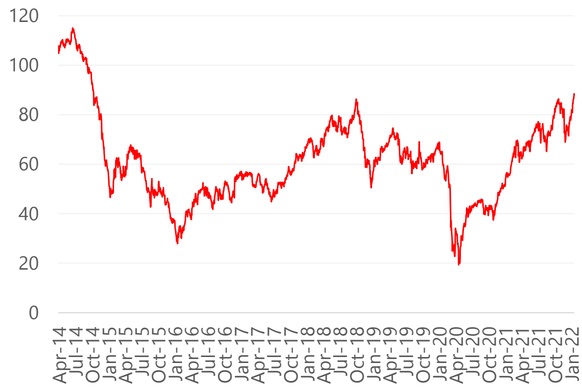
Agriculture commodities prices soar, accompanying the oil surge. Soybeans, corn and palm oil all climbed on expectations that the rally in oil prices will likely increase biofuel demand. Wheat also pulled up as tension between Russia and Ukraine (two major wheat exporters) risk a conflict that could disrupt supply. This shock adds to crop concerns in South America owing to dry weather conditions. As such, we still see risks that the downward trajectory for grain prices will be softer than previously thought (as global stocks will take longer to replenish from previous years drawdown).

Iron ore reached above $130 per ton as China reaffirms stimulus for the economy. Chinese lenders lowered borrowing costs after the PBOC cut policy rates. The central bank also continues to signal an easing bias. Policymakers' inclinations to boost growth via economic stimulus implies a brighter outlook for base metals demand, despite a still relatively cautious government approach in the property market.

EIA[4] reports an increase in US crude stockpiles. On Wednesday (January 19), the EIA reported that the US crude inventories increased by 515k barrels for the week ending January 14, above the market expectation of a -1,330k barrels decrease. As a result, considering the last five years, inventories are close to the minimum level observed for this time of the year (total inventory was 413 million barrels, as of January 14).

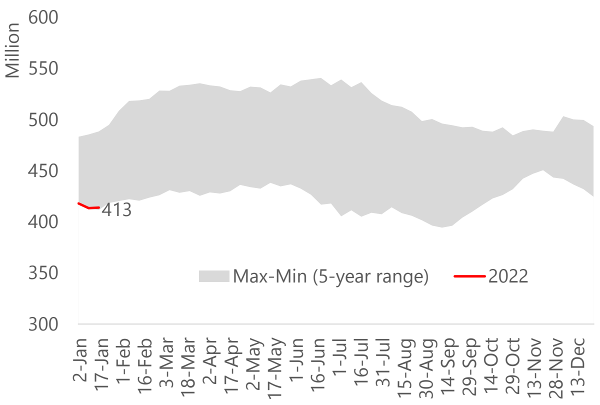
CFTC[5] reports an increase in speculative long positions in WTI crude oil. Money managers increased their net long WTI crude futures and options positions in the week ended January 11, the CFTC reported on Friday (January 14). The positions in futures and options increased by 21,449 contracts to 287,826.

Figure 4. ICE Brent Crude Oil (USD/Barrel)



Sources: ICE, Santander.

Figure 5. U.S. Crude Oil Inventories (Barrels)



Sources: EIA, Santander.

[3] International Energy Agency.
[4] Energy Information Administration.
[5] U.S. Commodity Futures Trading Commission.

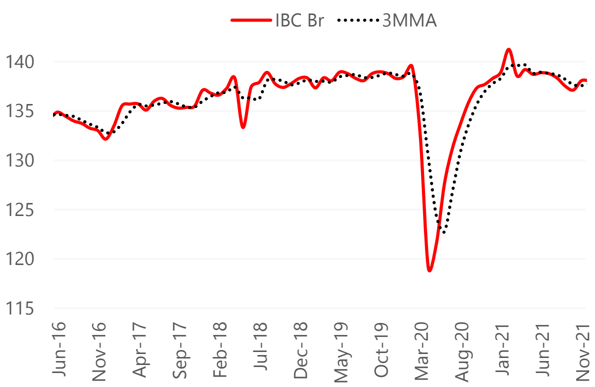
ECONOMIC ACTIVITY

Broad activity jumps in November, breaking a string of four negative results. This result was mostly in line with our estimate of +0.8% MoM-sa (+0.8% YoY) and market consensus of +0.7% (+0.5% YoY) and placed the economy 1.0% below the pre-pandemic mark (February 2020), according to this indicator. Among the key sectors, November's result stems mainly from the positive surprises seen in the tertiary sector (+0.5% for broad retail sales and +2.4% for services output), while industry slightly decreased 0.2%. We also understand that farm output rebound (after the sharp drop seen in 3Q21) and continued recovery of health and education services (not captured in the monthly surveys) may have also contributed positively. In quarterly terms, this result implies a -0.33% carryover to 4Q21 (-0.86% from October's release), in line with the key sectors. According to our calculations, November's results imply carryovers of -1.3% for industry, -2.1% for broad retail sales and -0.3% for services output to 4Q21. Despite these still weak quarterly figures, we are keeping our 4Q21 GDP growth tracking at +0.2% QoQ-sa. Our growth thesis for GDP this quarter rests mainly on good contribution coming from services segments that still show strong idleness compared to the pre-crisis period (e.g., Other Services and Public Services) and that are not well captured by timely activity indexes, along with a farm output rebound. See details in the link[6].

We expect weak figures for the tertiary sector in January, with a mixed picture for December, according to our proprietary indicator (IGet). Mainly based on IGet, our tracking for broad retail sales points to a 1.6% MoM-sa (-5.6% YoY) retreat in January and a 0.5% MoM-sa (-4.0% YoY) drop in December. Moreover, our tracking for services to families points to a slight gain of 0.1% MoM-sa (+25.0% YoY), following a solid growth of 2.2% MoM-sa (+24.3% YoY) in December. See details in the link[7].

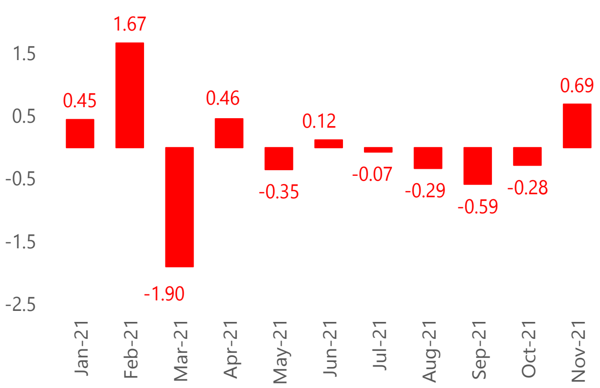
Next week, another batch of labor market data is due to be released. On Thursday (January 27), the Ministry of Labor will release the December CAGED formal job creation data. Our estimate is at -181k nsa, following the seasonal pattern of net job destruction in December. The estimate is equivalent to +130k sa, according to our preliminary estimates (November: +275k). On Friday (January 28), the November PNAD household survey is due to be released. We estimate the unemployment rate at 11.5%, equivalent to 12.0% in our seasonally adjusted figure (October: 12.2%). Moreover, FGV will release the first batch of economic confidence data for January. The consumer confidence is due out on Tuesday (January 25) and the industrial confidence is due out on Thursday (January 27), while the tertiary sector data are due out on Friday (January 28). For details on Santander's activity outlook, please refer to our last chartbook[8] and our most recent special report[9].

Figure 6. IBC-Br (sa, 2003=100)



Sources: BCB, Santander.

Figure 7. IBC-Br (sa, MoM%)



Sources: BCB, Santander.

[6] **Santander Brazil Economic Activity - *"Broad Activity Jumps in November"* –** January 17, 2022 – Available on: https://bit.ly/Std-econact-011722
[7] **Santander Brazil Economic Activity - *"IGet: Serviços desaceleram na margem"* –** January 19, 2022 – Available (in Portuguese) on: https://bit.ly/Std-IGETser-p-jan22
Santander Brazil Economic Activity - *"IGet: Varejo segue enfraquecendo na margem"* – January 20, 2022 – Available (in Portuguese) on: https://bit.ly/Std-IGET-p-jan22
[8] **Santander Brazil Economic Activity - *"Chartbook – Lowering (Again) Our GDP Estimates"* –** December 8, 2021 – Available on: https://bit.ly/Std-chart-econact-dec21
[9] **Santander Brazil Economic Activity - *"Special Report – Resilience Factors for 2022 GDP Growth"* –** January 14, 2022 – Available on: https://bit.ly/Std-special-011422

INFLATION

We expect January IPCA-15 (due on Wednesday, January 26) to rise +0.43% MoM. In YoY terms, this means 10.04%, a slight deceleration from the 10.42% change of December's IPCA-15. In terms of trends for the headline—as measured by the seasonally adjusted and annualized three-month moving average—should ease to 7.7% 3MMA-saar from 10.5%, after a peak of 13.6%. However, in YoY terms we believe inflation will continue hovering around 10.0% until April 2022, meaning a "plateau" at a hefty level for some time.

Compared to the December IPCA-15 (+0.78% MoM), the headline should decelerate in monthly terms, driven mostly by regulated prices (-0.33% MoM vs. +1.17% last month), particularly gasoline, which should decline by 2.0% MoM (versus +3.28% last month). However, there is a relevant upside risk in regulated prices coming from the annual auto ownership tax (IPVA). Services should also decelerate in monthly terms (0.33% MoM vs. 0.70% previously), but with airline tickets—a highly volatile item—will be contributing with the major part of the deceleration. With this monthly result, the trend should decelerate to 3.2% 3MMA-saar (from 6.5%), but this relief should be short-lived as we envision further acceleration of the trend at least until mid-year. Industrial goods should accelerate in monthly terms (0.90% MoM vs. 0.65% previously), enough to keep the trend hovering around 12.6%. Finally, food-at-home should accelerate to 1.29% MoM (from 0.46% last month), but the trend is to slow to 2%.

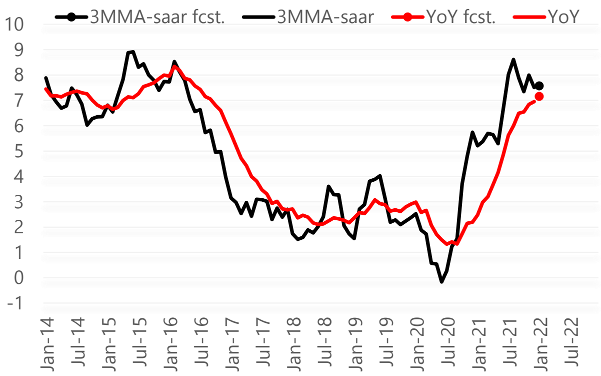
In terms of broad underlying inflation measures, we estimate the EX3 core will rise +1.04% MoM, which would represent stability in the trend around 7.6% 3MMA-saar - still a hefty level. This will be the sixteenth consecutive month that the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.50% for 2022 and 3.25% for 2023). We remain cautious regarding the inflation outlook, especially after the recent rise in fiscal risks, which might push expectations even higher and make inertia even stronger, posing difficulties for the disinflation process ahead.

Figure 8. December's IPCA Details (%)

	MoM		YoY	
	Jan-22	Contrib.	Dec-21	Jan-22
IPCA-15	0.43	0.43	10.4	10.0
Administered	-0.33	-0.09	18.2	16.6
Free	0.71	0.51	7.8	7.8
Food-at-home	1.29	0.19	9.2	8.7
Industrial goods	0.90	0.21	11.6	11.7
Services	0.33	0.11	4.8	4.9
EX3 Core	1.04	0.37	6.9	7.2

Sources: IBGE, Santander.

Figure 9. Core Inflation EX3 (%)



Sources: IBGE, Santander.

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research			
Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	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
Juan Cerruti *	Senior Economist – Argentina	jcerruti@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 Oreng*	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
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511-3553-1684
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