Santander Macroeconomic Research

BRAZIL MACRO

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MACRO COMPASS

A Sound External Position

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- In the rolling week ended May 20, the BRL stood as an intermediate performer among major currencies, gaining 0.5% vs the greenback to USD/BRL 5.28. We continue to see limited room for a substantial and lasting appreciation of the Brazilian currency, given the slow-moving agenda of macro/fiscal reforms.
- The yield curve flattened a bit in the same period, with the front-end sell-off reflecting upward revisions in inflation and activity forecasts (implying higher probability of a more hawkish BCB response).
- In Brazil, new COVID-19 infections are back on the rise. New cases and casualties remain at stubbornly high levels. Both *Butantan* and *Fiocruz* will receive vaccine supplies next week, though the uncertainty about the arrival of imported inputs continues to impart risks for the schedule of the National Immunization Plan.
- Federal tax collection was strong in April 2021, totaling BRL156.8 billion (+45.2% real YoY, on easy comparisons as April 2020 was the worst month for economic activity since the pandemic outbreak). For 2021, we expect a 6.0% YoY real growth, with a slight upward bias, considering a more intense inflation effect on revenues.
- Following March's drop, timely indicators of the tertiary sector show a sequential recovery across 2Q21. Our proprietary index (IGet) points to sequential gains in services to families and broad retail sales for both April and May. We believe this follows a faster-than-expected increase in mobility and the new round of Covid relief stimulus for low-income households.
- Another batch of labor market and real activity data comes out next week. On Thursday (May 27), IBGE will release the March PNAD household survey, while the April CAGED formal job payroll data is due out next Friday (May 28). FGV will also release the first batches of economic confidence data. Consumer confidence will be available next Tuesday (May 25), while industrial confidence is due out next Thursday (May 27).
- We expect April's IPCA (due on Tuesday, May 25) to rise 0.56% MoM, implying acceleration in annual terms to 7.39% YoY (from 6.17% YoY in March), its highest level since 2016. Headline inflation keeps moving further away from the upper bound of the BCB's target for 2021 (mid-target 3.75%, with ± 1.5% of tolerance) and we forecast IPCA 2021 at 5.9%.
- We expect April's balance-of-payments data to unveil that the Brazilian current account registered a USD6.5 billion monthly surplus in the period, while direct investments in the country should have totaled USD4.9 billion last month, according to our calculations. We expect these readings to underpin the sound external position for the Brazilian economy.

Most of the information in this report is up to the end of Thursday, May 20, 2021.

Figure 1. Brazil Macro Agenda for the Week of May 24-28, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Consumer Confidence (index)	FGV	May/21	Tue, 25-May	--	72.5
IPCA-15 Inflation (% MoM)	**IBGE**	**May/21**	**Tue, 25-May**	**0.56**	**0.54**
IPCA-15 Inflation (% YoY)	**IBGE**	**May/21**	**Tue, 25-May**	**7.39**	**6.17**
Construction Confidence (index)	FGV	May/21	Wed, 26-May	**--**	**85.0**
Federal Debt Report (BRL billion)	STN	Apr/21	Wed, 26-May	--	5.2
Current Account Balance (US$ billion)	BCB	Apr/21	Wed, 26-May	6.5	-4.0
Foreign Direct Investment (US$ billion)	BCB	Apr/21	Wed, 26-May	4.9	6.9
Industrial Confidence (index)	FGV	May/21	**Thu, 27-May**	--	103.5
National Unemployment Rate (%, nsa)	**IBGE**	**Mar/21**	**Thu, 27-May**	**14.5**	**14.4**
National Unemployment Rate (%, sa)	**IBGE**	**Mar/21**	**Thu, 27-May**	**14.2**	**14.3**
Central Gov. Primary Balance (BRL billion)	STN	Apr/21	Thu, 27-May	12.4	2.1
IGP-M Inflation (% MoM)	FGV	May/21	Fri, 28-May	3.95	1.51
IGP-M Inflation (% YoY)	FGV	May/21	Fri, 28-May	36.86	32.02
Formal Job Creation (thousands, nsa)	**CAGED**	**Apr/21**	**Fri, 28-May**	**206.0**	**184.1**
Formal Job Creation (thousands, sa)	**CAGED**	**Apr/21**	**Fri, 28-May**	**227.3**	**262.8**
New Loans (% MoM)	BCB	Apr/21	Fri, 28-May	2.0	0.8

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario:** ***"Monetary Stimulus Doomed to End Sooner"*** **–** May 20, 2021- Available on: http://bit.ly/Std-scr-review-may21

LOCAL MARKETS—FX

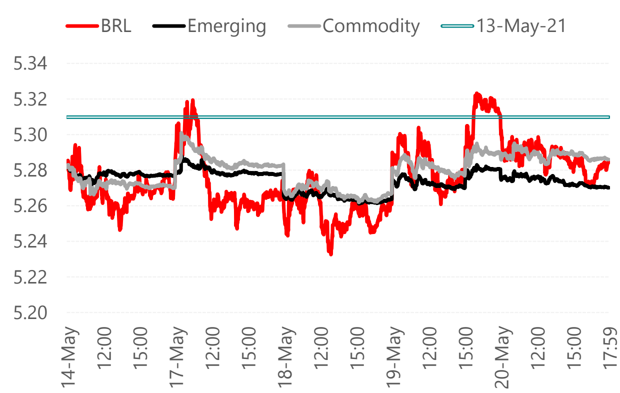
In the rolling week ended May 20, the BRL stood as an intermediate performer among major currencies, gaining 0.5% vs the greenback to USD/BRL 5.28. We continue to see limited room for a substantial and lasting appreciation of the Brazilian currency, given the slow-moving agenda of macro/fiscal reforms.

Yet we recognize that the bright side of the story is the fact that the absolute move took place regardless of the pause in the rising trend of commodity prices and the slightly more hawkish wording in the minutes of the last FOMC meeting. In our view, maybe a supporting factor for the BRL was the Lower House approval of the bill that paves the way for the privatization of the Brazilian state-owned electricity company. While that legislation needs to get through the Senate, we think it has good chances of being approved, and maybe this perception (if shared by the market) offset the apparently slowing pace of immunization against COVID-19. In our view, the USD/BRL should keep ranging between 5.20 and 5.30 in the coming days.

LOCAL MARKETS—Rates

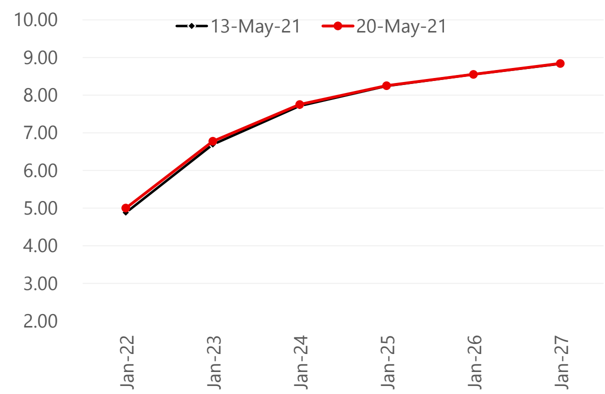
The nominal yield curve flattened this week. Since last Thursday (May 13), the front end (Jan-22 DI future) rose 11 bps to 4.99%, while the back end (Jan-27 DI future) fell 1 bp to 8.82%. Hence, the steepness fell 12 bps to 383 bps. At the front end, despite some relief in commodity prices, the reason behind the selloff is probably another round of upward revisions of analysts' forecasts for GDP and IPCA (refer to the BCB's weekly Focus Survey[2] among professional forecasters). The changes in forecasts imply higher perceived probability of a more hawkish BCB response. At the long end, although the fragile medium-term fiscal outlook remains in place, the market took out part of the premium added during the last two weeks; in our view a technical move (i.e., unrelated to fundamentals).

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, May 20, 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, May 20, 2021.

[2] https://www.bcb.gov.br/en/publications/focusmarketreadout

COVID-19 MONITORING

In the U.S., average COVID-19 cases are at their lowest in nearly a year. The pace of vaccinations has been softening and is currently at 1.8 million/day (7-day moving average), with nearly 47% of the population having received at least one dose. This figure stands at 54% in the U.K. and 32% in the European Union. New cases continue to fall in most Western European countries, as the bloc agrees to reopen borders to travelers who have been fully vaccinated.

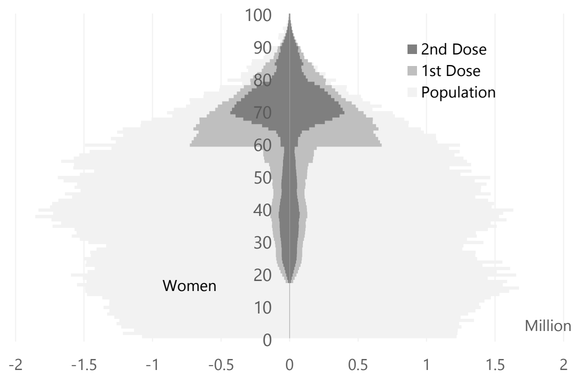
Fiocruz to receive more vaccine supplies for 12 million doses this weekend. The foundation is set to resume deliveries of the AstraZeneca vaccine to the Ministry of Health in late June. Meanwhile, *Butantan* will also receive supplies for 5 million doses of Coronavac next week. Despite the good news, the uncertainty about the arrival of imported inputs continues to impart risks for the schedule of the National Immunization Plan.

In Brazil, new COVID-19 infections are back on the rise. New cases and casualties remain at stubbornly high levels. The ICU occupancy rate is above 90% in 6 states, an increase from 4 states last week (and a peak of 18 states in the worst phase). As of Wednesday (May 19), 60 million doses (out of 95 million delivered) had been administered in the country, with the pace of vaccination decelerating to 595k/day (7-day moving average). Data from Brazil's Health Ministry showed an average of 64.6k new daily cases (7-day moving average) as of Wednesday (May 19), up 5.4% from last week, while daily casualties (7-day moving average) totaled 1,951, stable in the same period.

Mobility slightly retreated at the margin. After starting April at high levels, close to of June 2020's (~40 points, 7-day average), our lockdown index (based on Google Mobility Report) posted a consistent downward trend in recent weeks. The index recently reached 15.8 points (as of May 9, 2021), and this improvement stemmed mainly from mobility increases in the Workplace (which already stands at pre-pandemic marks) and Transit Station segments. These categories suggest a close link to economic activities and this recovery path bodes well for economic activity in 2Q21. The index slightly expanded at the margin a few days later, reaching 16.4 points on May 14, 2021, but this is not enough to reverse the trend. Before a more disseminated vaccine rollout, the risk of increased infections continues to imply downside risks for mobility (and economic activity).

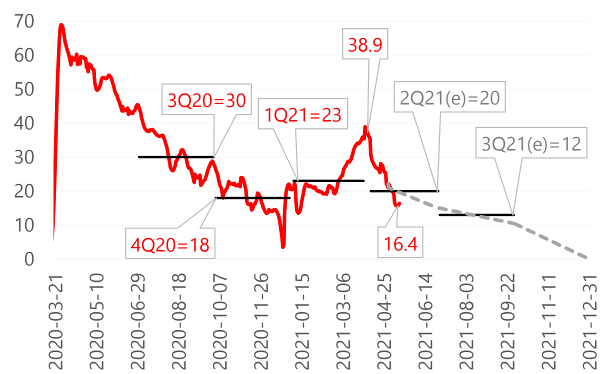
Our daily activity index continues to improve across 2Q21. The index—based on daily data on energy consumption, car sales, and mobility—has been improving since April, showing an upward trend in recent weeks. As of May 14, the index reached 76.1 points (7-day moving average), after starting the quarter at a local bottom of 69.1 points.

Figure 3.A. – Vaccination by Age and Gender (May 17, 2021)



Sources: PNAD, dataSUS, @eliaskrainski, Santander.

Figure 3.B. – Lockdown Index* and 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 May 14, 2021.

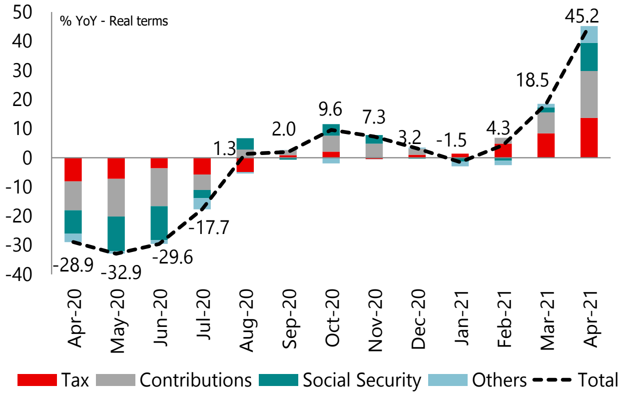
FISCAL POLICY AND POLITICS

On May 20, the Brazilian Internal Revenue Service (IRS) published federal tax collection data for April. It was the best result for the month in the inflation-adjusted series, totaling BRL156.8 billion (or +45.2% real YoY, on easy comps, as April 2020 was the worst month for economic activity since the pandemic outbreak), above our forecast (BRL136.2 billion) and the market median (BRL140.1 billion). On the back of this robust result, the year-to-date value reached the highest historical level of the series in real terms. This performance was driven by an extraordinary tax collection of BRL12 billion until April, mostly related to M&A activity, IPOs, and corporate restructuring. Recently, the effects of higher inflation (margin recovery by companies) and FX depreciation (higher revenues for commodity-exporting companies and higher value of import-related taxes) have bolstered tax collection. In April, we were expecting a slowdown in revenue growth, but we overestimated the possible downside effect of the increase in social mobility restrictions with the pandemic relapse—which had reached a peak in March. On the other hand, even with the positive result for the month, the seasonally adjusted figure (same methodology used for the IBC-Br activity index) pointed to a decline of 2.7% MoM in April. The same decline appears even when we adjust and smooth the intense drop of the series in 2020, as a consequence of the pandemic. Besides, the real increase compared to April 2019 in real terms is 3.2%YoY, a positive result (in our view); however, extrapolating these last surprises in federal tax collection for the full year continues to demand some caution. For 2021, we expect ~6.0% YoY real growth, with slightly upward bias due to the more intense inflationary effect.

We published a report (on May 20) that explores the possible fiscal impact of the change in methodology for calculating tax collection following a decision by the Supreme Court (STF). On May 13, the STF concluded its deliberations on the exclusion of ICMS state tax from the calculation basis for the PIS/Cofins federal taxes. The Court's decision does not lead us to modify our fiscal outlook and revenue forecasts. The government also will maintain its fiscal numbers, as its latest estimates already consider this decision's subsequent effect on the revenue stream. Our preliminary estimate for the net fiscal impact from the tax methodology change for the federal government is close to BRL180 billion. As we already considerer BRL120 billion over the next years, the STF's decision could potentially lead to a further government revenue reduction of BRL60 billion in our scenario (yet it would be diluted over the years). We further anticipate that this change in tax calculation methodology will reduce revenue flow by ~0.5% of GDP per year. If in the future the decision is expanded to include municipal taxes on services (ISS), tax compensation since 2017 could reach a maximum value of BRL30 billion, with a loss in the revenue flow of 0.1% of GDP per year. See details in the link[3].

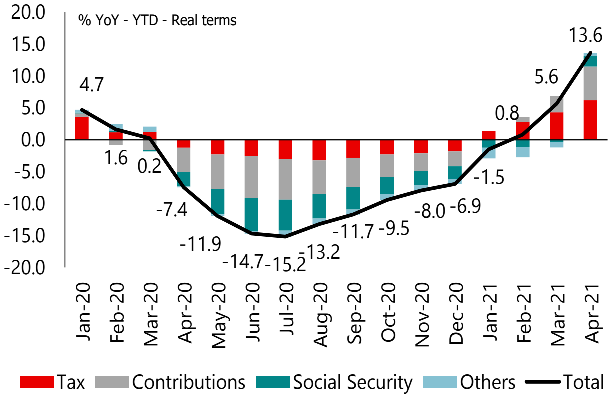
On May 27, the National Treasury is expected to publish the central government result for April. We expect a surplus of BRL12.4 billion, mainly from the rise in federal tax collection and dividend income from government companies. On the expenditure side, we expect a return to the Treasury of BRL5 billion related to Pronampe (SME loan subsidies from 2020) and BRL12 billion extra-cap expenditures related to the pandemic.

Figure 4.A. – Federal Tax Collection - monthly



Sources: Brazilian Internal Revenue Service, Santander.

Figure 4.B. – Federal Tax Collection - YTD



Sources: Brazilian Internal Revenue Service, Santander

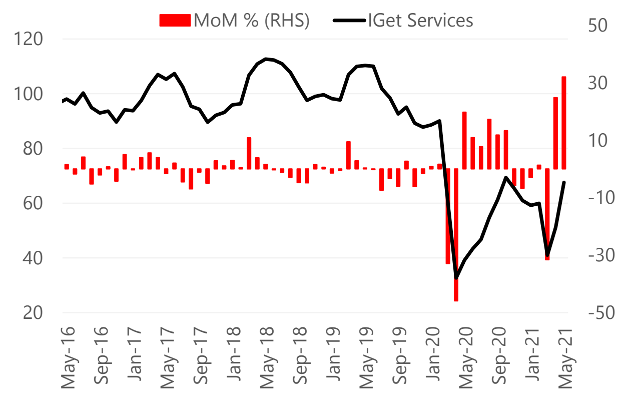
[3] **Santander Brazil – Fiscal Policy: *"Supreme Court Decision on Tax Methodology: A Middle Ground"*** – May 20, 2021- Available on: http://bit.ly/Std-special-icms

ECONOMIC ACTIVITY

Segments of the tertiary sector continue to recover in 2Q21. Following March's retreat, broad retail sales and services to families expanded in April and May, according to the preview of our proprietary indicator (IGet). These results likely reflect the faster-than-expected increase in mobility seen since April and the new round of emergency aid (which started to be paid at the end of April, with effects in May). For retail sales, we highlight May's climb, which was mainly driven by Supermarkets. In addition to the payment of the emergency aid (which benefits Supermarkets since Food is an essential good), the fast increase of Grocery's mobility (Google Mobility Report) this month reinforces the likelihood of sequential growth in retail sales in May. For services to families, these figures stem mainly from the Accommodation and Food segment, which highly correlates with mobility. See details in the link[4].

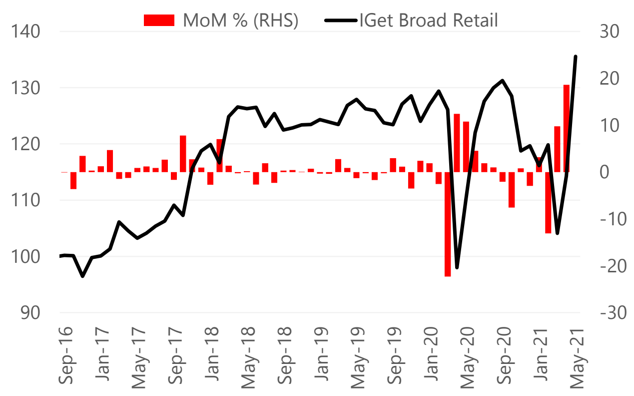
For the coming week, FGV will release the first batches of economic confidence data. Consumer confidence will be available next Tuesday (May 25), while industrial confidence is due out next Thursday (May 27). There will also be another batch of labor market data. On Thursday (May 27), IBGE will release the March PNAD household survey, for which we expect a 14.5% unemployment rate. According to our preliminary estimates, this means the seasonally adjusted unemployment rate should stay close to the February figure (14.2% in March, from 14.3% in February), depending on the employment and labor force behaviors. The April CAGED formal job payroll data is due out next Friday (May 28), and we expect a +206k net job creation, probably leading to a deceleration in the seasonally adjusted figures (to around +227k in April from +263k in March, according to our preliminary estimates).

Figure 5.A. – IGet Services (sa)



Sources: Santander.

Figure 5.B. – Broad IGet (sa)



Sources: Santander.

[4] **Santander Brasil Atividade Econômica - *"Um Trimestre Aparentemente Promissor"* –** May 19, 2021 - Available (in Portuguese) on: http://bit.ly/Iget-serv-previa-mai21

INFLATION

We expect May's IPCA-15 (due on Tuesday, May 25) to rise +0.56% MoM, meaning an acceleration in annual terms to +7.39% YoY (from +6.17% YoY in March), another multi-year high.

After a short-lived relief in administered-price inflation in last April's IPCA, the group should resume its upward pressure and rise 1.12% MoM, pushed by electrical energy (because of the change in the tariff flag that raise costs to consumers) and medicines. Industrial goods should continue to rise in our view, by +0.70% MoM, a high seasonal change that might keep the three-month annualized and seasonally adjusted (3mma-saar) moving average also at a high level (almost stable at 9.2%). Service prices should rise around +0.13% MoM, which despite seeming low, would mean an acceleration in 3mma-saar terms. Finally, food-at-home should rise +0.40% MoM, continuing its deceleration in 3mma-ssar terms.

In terms of underlying inflation measures, the EX3 core should rise around +0.41% MoM, as per our projection, meaning a deceleration to 4.6% (from 4.8%) in the trend denoted by the seasonally adjusted quarterly annualized moving average. Despite the loss of steam lately, that is still a high level, in our view, given next year's inflation mid-target of 3.50%.

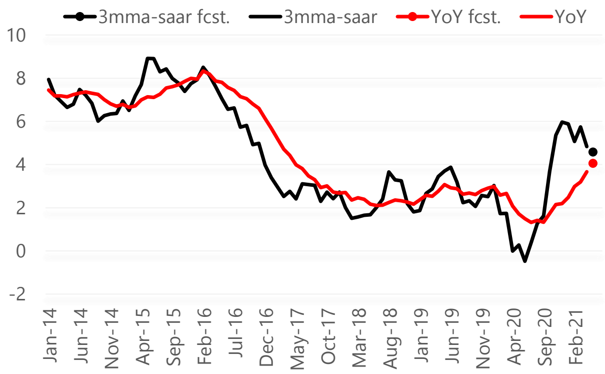
It is worth highlighting that April's IPCA should be the highest YoY change since 2016, and the acceleration in annual terms should continue until a peak of more than 8% YoY, by our estimation, around mid-year (between May to July). After that, IPCA inflation should decelerate until reaching our forecast of 5.9% YoY in December 2021, above the upper bound of the BCB target (mid-target 3.75%, with ± 1.5% of tolerance).

Figure 6.A. – May's IPCA-15 Forecast (%)

	MoM		YoY	
	May-21	Contrib.	Apr-21	May-21
IPCA-15	0.56	0.56	6.2	7.4
Administered	1.12	0.29	8.1	11.4
Free	0.36	0.27	5.5	6.0
Food-at-home	0.40	0.06	15.1	14.8
Industrial goods	0.70	0.16	6.3	7.1
Services	0.13	0.05	1.5	2.1
EX3 Core	0.41	0.41	3.7	4.1

Sources: IBGE, Santander.

Figure 6.B. – Core Inflation (IPCA EX3, %)



Sources: IBGE, Santander.

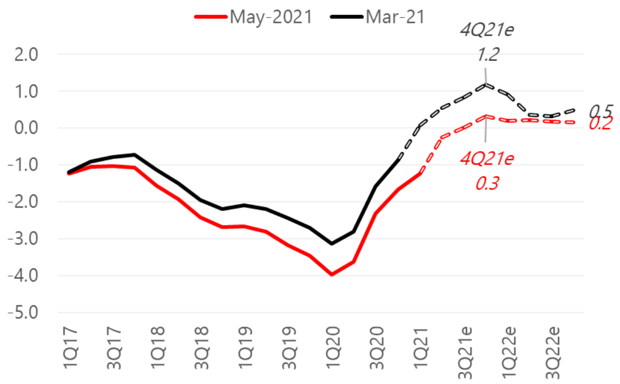
BALANCE OF PAYMENTS

Next Wednesday (May 26) the BCB is due to release data on the Brazilian balance of payments in April 2021. We expect them to reinforce our perception that this should not become a source of concern anytime soon. After all, **despite the methodological change in trade statistics introduced in early April, which resulted in a downward shift in the current account balance time series—and, consequently, in the final levels of its projected trajectory—we continue to expect current account surpluses in 2021 and 2022** (see details in the link[5]).

With regard to April's data, we project the current account balance to have registered a US$6.5 billion monthly surplus stemming from a robust performance of foreign trade and relatively low—by historical standards—deficits in the services and income accounts (still impacted by the gradual recovery of the Brazilian economy). Incidentally, preliminary figures for May 2021 indicate that the Brazilian trade balance should also be strong, and should contribute to another current account surplus, thus underpinning our expectation for the continuation of an improving trend.

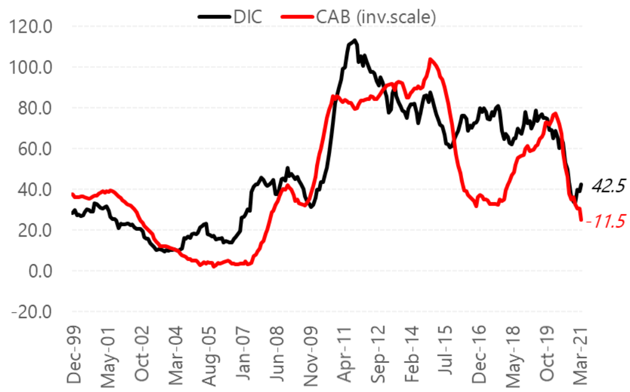
Besides a positive current account, we also expect direct investments in the country to have amounted to USD4.9 billion last month, which will have kept it in an upward trend on a 12-month basis. That is, on top of the current account improvement in the current account balance, we expect the country to receive an increasing volume of direct investments, which may ease a potential reduction of financial assets in the domestic market (portfolio flows). All in all, we believe external sector data should continue to partially counterbalance uncertainties related to the Brazilian fiscal balance.

Figure 7.A. – Current Account Balance (% of GDP, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 7.B. – Current Account, Direct Investment (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

[5] **Santander Brazil - Macroeconomic Scenario:** ***"Monetary Stimulus Doomed To End Sooner"*** **–** May 20, 2021- Available on: http://bit.ly/Std-scr-review-may21

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