

**BRAZIL MACRO**

April 22, 2022

MACRO COMPASS**SOARING COMMODITIES, BUOYANT BRL, QUICKENING INFLATION**

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- After having registered the best performance in the basket of the 31 most liquid currencies globally in 1Q22, the BRL continues to largely outperform in April, reaching USD/BRL of 4.62 on April 20, the strongest level since May 2020. Compared with April 7—when we released the last edition of this report—this means an additional strengthening of ~3%, despite lingering global risks such as the Russia-Ukraine war, uncertainties related to the outcome of the presidential race in France, the ongoing monetary policy tightening in the U.S. and the strengthening of the USD. In our view, the BRL outperformance stemmed from the continuing upward trend in commodity prices and prospects for a tighter monetary policy than previously indicated by the BCB on the heels of negative inflationary surprises of late.
- Commodity prices rallied in the past two weeks as developments related to the war in Eastern Europe continue to add risk to global supply. The Bloomberg Commodity Aggregate Index in BRL increased 2.0% for the period starting on April 7 up to April 20. In USD terms, the Index rose 4.9%.
- For the past two weeks the nominal yield curve sold off considerably, especially in the belly and the back end. Having the continued spike in commodity prices as a backdrop, this recent upshift in yields basically followed the impact of bitter IPCA inflation numbers (possibly reducing the BCB's conviction on its flight plan to end the cycle after a 100-bp hike in March) and the growing signs of a fast monetary-policy tightening in the U.S.
- We calculate that the "expanded" real wage bill fell 8.0% in 2021 mainly due to a normalization in the size of government transfers last year. For 2022, we expect a 3.2% increase, driven by the labor market recovery, an increase in the new welfare program (*Auxílio Brasil*) and the inflation correction in pensions. The real income gain is one of the factors propping up the economy in 2022, especially in the 1H22.
- Still on the activity side, last week brought mixed signals in the tertiary sector in February. Broad retail activity surprised positively by jumping 2.1% MoM-sa, topping market expectations (+1.1%) and showing widespread growth among retail activities. However, services' real revenue disappointed by retreating 0.2% MoM-sa, below market expectations (+0.7%) but with the weakness concentrated in a few segments. For the (still unpublished) February IBC-Br, we now estimate a gain of +0.5% MoM-sa (previously +0.4%), with our 1Q22 GDP tracking maintained at +0.3% QoQ-sa.
- Next week, the focus is on March labor market data. On Thursday (April 28), the Ministry of Labor will release the CAGED payrolls data, and our estimate is +282k, based on our (preliminary) seasonal adjustment (January: +216k). On Friday (April 29), the PNAD household survey is due: we estimate a 0.2 p.p. drop in the unemployment rate to 11.1% in our seasonally adjusted series. FGV will release the first batch of economic confidence data for April: consumer and industrial confidence data are due out on Monday (April 25) and Wednesday (April 27), respectively.

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

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- On the fiscal side, the Ministry of Economy gave details on the draft budget guidelines law (PLDO) for 2023, estimating for the central government a primary budget deficit target of BRL66 billion (0.7% of GDP), the tenth negative annual reading in a row. Next week is packed with fiscal policy publications and perhaps February public sector data (maybe alongside March figures), given a pause in the federal workers' strike.
- On inflation, the April IPCA-15 comes out on Wednesday (April 27), and we look for a gain of 1.90% MoM. This is a substantially high print in seasonal terms, pushing the trend to a hefty ~15% 3MMA-saar reading. In YoY terms, the headline should accelerate to +12.21%, highest level since late 2003. We estimate this will be the peak for the IPCA-15 in this cycle.
- With a recently announced two-week pause in a federal workers' strike, the backlog of unpublished macro reports may be addressed in coming weeks. The list of unpublished reports by the BCB includes the February data on balance of payments, fiscal policy, bank lending, and economic activity. The weekly Focus surveys of expectations among professional forecasters, whose latest numbers date from late March, are scheduled for publishing on Tuesday (April 26). These updated figures, especially on median IPCA forecasts for 2023, will provide guidance on eventual changes (or the maintenance) of the BCB's flight plan indicated in the last Copom communications—ending the tightening cycle with Selic at 12.75% after a 100-bp hike in May.

Most of the information in this report is up to the end of Wednesday, April 20, 2022.



Figure 1. Brazil Macro Agenda for the Week of April 25 to April 29, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Consumer Confidence (index)	FGV	Apr/22	Mon, 25-Apr	--	68.2
Construction Confidence (index)	FGV	Apr/22	Tue, 26-Apr	--	88.8
Industrial Confidence (index)	FGV	Apr/22	Wed, 27-Apr	--	104.2
IPCA-15 Inflation (% MoM)	IBGE	Apr/22	Wed, 27-Apr	1.90	0.95
IPCA-15 Inflation (% YoY)	IBGE	Apr/22	Wed, 27-Apr	12.21	10.79
Federal Debt Report (BRL trillion)	STN	Mar/22	Wed, 27-Apr	--	5.7
Services Confidence (Index)	FGV	Apr/22	Thu, 28-Apr	--	77.6
Retail Confidence (index)	FGV	Apr/22	Thu, 28-Apr	--	72.5
IGP-M Inflation (% MoM)	FGV	Apr/22	Thu, 28-Apr	1.69	1.74
IGP-M Inflation (% YoY)	FGV	Apr/22	Thu, 28-Apr	14.98	14.77
Formal Job Creation (thousands)	CAGED	Mar/22	Thu, 28-Apr	200	328
Formal Job Creation (thousands, sa)	CAGED	Mar/22	Thu, 28-Apr	282	216
Central Gov. Prim. Balance (BRL billion)	STN	Mar/22	Thu, 28-Apr	-2.0	-20.6
National Unemployment Rate (% nsa)	IBGE	Mar/22	Fri, 29-Apr	11.4	11.2
National Unemployment Rate (% sa)	IBGE	Mar/22	Fri, 29-Apr	11.1	11.3
Federal Tax Collection (BRL billion)	RFB	Mar/22	20 to 27-Apr	161.2	148.7
IBC-Br Activity Index (% MoM)	BCB	Feb/22	n.a.*	0.5	-1.0
Current Account Balance (USD billion)	BCB	Feb/22	n.a.*	-1.6	-8.1
Bank Lending Report	BCB	Feb/22	n.a.*	--	467.1
Primary Budget Balance (BRL billion)	BCB	Feb/22	n.a.*	-8.6	101.8

* Owing to a strike of federal workers, these data releases have been postponed with no specific publication date on schedule for now. However, with a two-week "truce" in wage negotiations recently announced, it is possible that this backlog of unpublished macro reports will diminish in the coming weeks.

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>



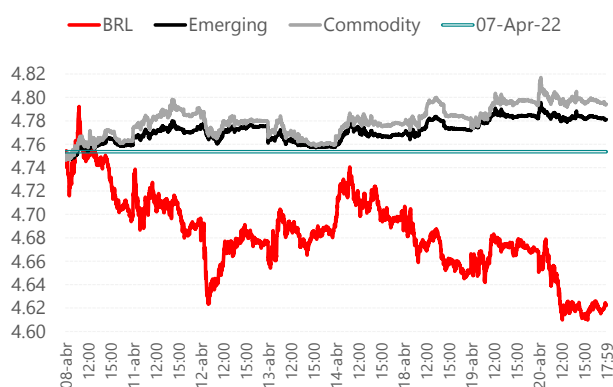
LOCAL MARKETS—FX

After having registered the best performance in the basket of the 31 most liquid currencies globally in 1Q22, the BRL continues to largely outperform in April, reaching USD/BRL of 4.62 on April 20, the strongest level since May 2020. Compared with April 7—when we released the last edition of this report—this means an additional strengthening of ~3%, despite lingering global risks such as the Russia-Ukraine war, uncertainties related to the outcome of the presidential race in France, the ongoing monetary policy tightening in the U.S. and the strengthening of the USD. In our view, the recent strengthening of the BRL had to do with the ongoing upward trend in commodity prices in tandem with the possibility of a tighter monetary grip than the BCB indicated in the last COPOM meeting, as inflation readings continued to surprise to the upside. While the combination of high local interest rates and commodity prices continues to suggest more strengthening of the BRL in the short term, we still expect the Fed tightening cycle to have a cooling effect on commodity prices and to narrow the differential to the Selic rate, which should contribute to some weakening of the BRL toward the end of 2022. We continue to forecast a USD/BRL of 5.00 for YE2022.

LOCAL MARKETS—Rates

For the past two weeks the nominal yield curve sold off considerably, especially in the back end. Since April 7 (our last edition), the front end of the curve (Jan-24 DI future) rose 51 bps, to 12.67%, while the back end of the curve (Jan-27 DI future) rose 49 bps, to 11.80%. The curve's steepness in this segment was basically stable at around -87 bps, still considerably inverted. At the front end, the March IPCA report was considerably adverse (both in terms of headline and composition), with the result of 1.62% MoM surprising the market by about +30 bps and showing underlying inflation trending at an annualized pace close to 11%. After this release, BCB Governor Roberto Campos Neto signaled in a speech a bit less conviction about the flight plan to deliver a 100-bp hike (to 12.75%) in May and stop the cycle there. Our forecast already reflects another 50-bps hike in June (ending the cycle at 13.25%). As a result, the front end of the curve sold off during the period, with the market pricing in another 50-bps hike for June: the probability of a no-hike outcome for that COPOM meeting fell to 27% now from ~60% in early April. At the back end, the sell-off in U.S. Treasuries (with the 10-year yield up 30 bps since April 7) helped push the long end higher. Discussions regarding more fiscal spending (i.e., wage hike for federal workers) might also have contributed to the sell-off by reinforcing the need to curb mandatory expenses via structural reforms. We maintain our view that the curve could soon show a steepening pattern, as the BCB is starting to signal that the hiking cycle is close to an end and the IPCA nears its peak in annual terms, in a context where domestic fiscal challenges remain in place and global interest rates are poised to keep moving higher.

Figure 2. USD/BRL Intraday Trends

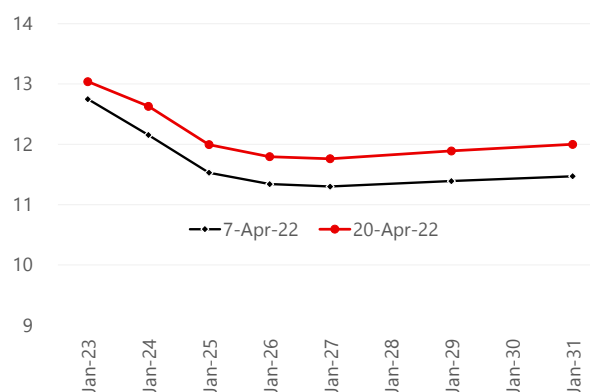


Sources: Bloomberg, Santander.

Note 1: As of the close on Wednesday, April 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 on Wednesday, April 20, 2022.



COMMODITIES

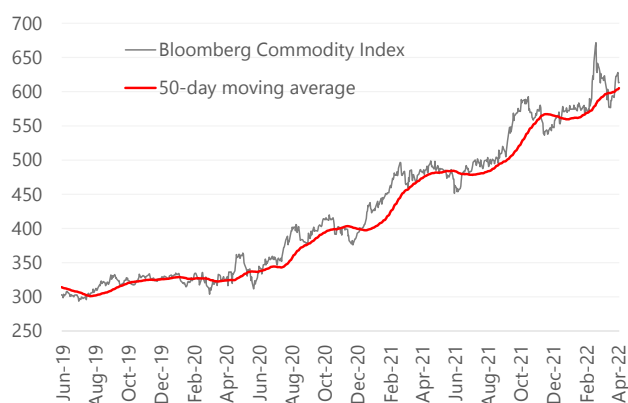
Commodity prices rallied in the past two weeks as developments related to the war in Eastern Europe continue to add risk to global supply. The Bloomberg Commodity Aggregate Index in BRL increased 2.0% for the period starting on April 7 up to April 20. In USD terms, the Index rose 4.9%, with the Agriculture Subindex rising 5.2%, the Energy Subindex gaining a hefty 9.0%, and the Industrial Metals Subindex retreating 0.2%.

Corn prices rose to a decade high as a result of the war and weather-related uncertainties. The bushel is now standing above \$8.00, a level comparable to 2012 prices when drought decimated crops across the U.S. Midwest. This time around, the Russia-Ukraine conflict has hampered shipments from the region, a major hub of corn exports. Ukraine grain exports by railway have been an alternative, but its capacity is limited to 20% of normal seaborne trade. Adding to the rally, in Brazil the winter harvest (so-called *safrinha*) of corn is at risk given the below-average rainfall in the past few weeks. All in all, the perception of tight global balance remains, so that any additional crop issue in the Northern Hemisphere's planting season may prompt further moves in prices.

Soybean oil also rallies to a fresh new record. Dry weather in key growing regions of the bean, as well as disruptions in Argentina (a top exporter), added pressure to a global balance already impacted by the Russia-Ukraine war. Argentina port workers decided to go on a strike in the middle of the soybean and corn harvests, raising supply concerns as the country is dependent on the ports.

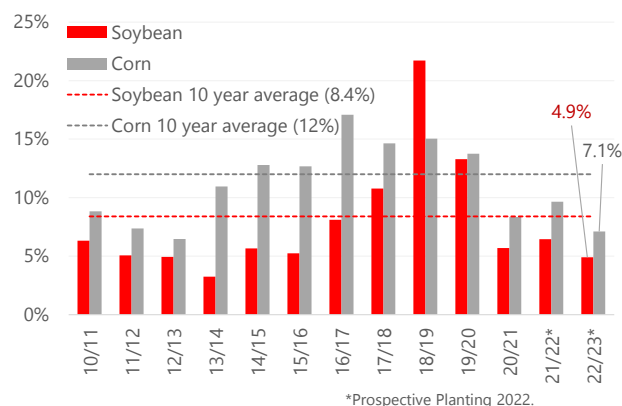
OPEC+ produced below its targets in March. Russian output began to decline following the sanctions imposed by the West. The country produced 10 million bpd in March, 300k bpd below its target and the lowest level since early 2021. While only the U.S. and the U.K. have banned purchases of Russian oil and its derivatives, other buyers have been looking elsewhere for supplies. Additionally, Libya's oil production has fallen by 500k bpd as a worsening political crisis closed the biggest oil field in the country. We still see output shortages in the oil market, as global inventories are low and producers (ranging from OPEC+ members to independent U.S. shale companies) struggle with the underinvestment of recent years.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

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



*Prospective Planting 2022.

Sources: USDA, Santander.



ECONOMIC ACTIVITY

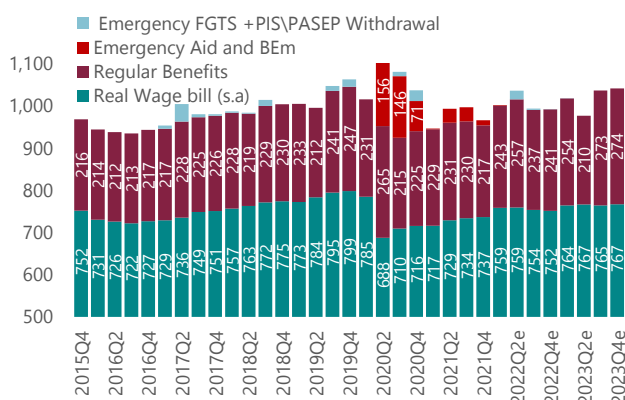
We have updated our estimates for the “expanded” real wage bill in Brazil. The measure encompasses workers’ salaries, pension contributions, and federal transfers. Since we last reviewed our estimates, the inflationary shock has significantly reduced the real income from jobs. We simulated the impact on the real wage bill of inflation forecasts and the effects of fiscal stimulus. We observed that the real wage bill showed an 8.0% drop in 2021. For 2022, we expect a 3.2% increase, driven by the labor market recovery, the increase in the new welfare program and the inflation adjustments to pension benefits. We simulated scenarios with 5.0% and 9.0% for the IPCA, which generated a range of +2.5% (9% IPCA) to +4.6% (5% IPCA). We consider the behavior of the labor market a key factor in our assessment of the recovery in domestic economic activity, and the inflation outlook is directly affecting the estimates. [See details in the link².](#)

Services output disappointed in February with another drop. Services output decreased 0.2% MoM-sa, below market expectations (+0.7%) but remaining 5.4% above the pre-pandemic benchmark (February 2020). Zooming in the details, information services were the lowlight (-1.1% MoM-sa), while services to families failed to offset previous drop and posted virtual stability (+0.1% MoM-sa). On the upside, transportation (+1.9%) and professional services (+1.3%) strengthened at the margin. Despite the negative print, February’s figure still implies a positive carryover to 1Q22 (+0.4% QoQ-sa), meaning cyclical services continued to contribute positively to overall activity in the period. [See details in the link³.](#)

Retail activity posted strong and widespread growth in February. Broad sales jumped 2.1% MoM-sa, topping market expectations (+1.1%) and surpassing the pre-pandemic reading by 1.1%. Core retail sales (which excludes building material and vehicles sales) jumped 1.1% MoM-sa, also beating market consensus (+0.4%) and surpassing the pre-crisis benchmark by 0.9%. Zooming in on the details, eight of ten retail activities expanded at the margin. February’s prints imply carryovers of +1.8% QoQ-sa and +1.2% QoQ-sa to 1Q22 for broad and core retail indexes, respectively. These figures may suggest short-term relief in terms of the impact of goods-related sectors on overall activity. [See details in the link⁴.](#)

For the coming week, labor market data for March is on schedule. On Thursday (April 28), the Ministry of Labor will release the CAGED formal job creation data, and our estimate is 200k nsa. This forecast is equivalent to +282k sa, according to our preliminary seasonal adjustment (February: +216k). On Friday (April 29), the PNAD household survey is due: we estimate an unemployment rate of 11.4% nsa, meaning a 0.2 p.p. decrease to 11.1% in our seasonally adjusted series. Moreover, FGV will release consumer confidence and industrial confidence data on Monday (April 25) and Wednesday (April 27), respectively. [For details on Santander’s activity outlook, please refer to our last chartbook⁵.](#)

Figure 6. “Expanded” Real Wage Bill (BRL billion)



Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

Figure 7. Annual Growth in “Expanded” Real Wage Bill

	2020	2021	2022(E)	2023(E)	2024(E)
Expanded Real Wage Bill (Low Inflation)			+4.6%	+2.2%	+2.8%
Expanded Real Wage Bill (Baseline Inflation)	+3.1%	-8.0%	+3.2%	+1.0%	+1.8%
Expanded Real Wage Bill (High Inflation)			+2.5%	-1.0%	+0.4%

Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

² Santander Brazil Labor and Fiscal: “Real Wage Bill: Update and Inflation Effect” – April 13, 2022 – Available on: <https://bit.ly/Std-SPECIAL-041322>

³ Santander Brazil Economic Activity: “A Negative Surprise for Services in February” – April 12, 2022 – Available on: <https://bit.ly/Std-econact-04122022>

⁴ Santander Brazil Economic Activity: “A Stronger Result, With Widespread Growth” – April 13, 2022 – Available on: <https://bit.ly/Std-econact-041322>

⁵ Santander Brazil Economic Activity: “Resilience in 2022, but with Concerns Regarding 2023” – April 19, 2022 – Available on: <https://bit.ly/Std-chart-Econact-apr22>



FISCAL POLICY AND LEGISLATION

On April 19, the Ministry of Economy disclosed details on the draft legislation for the 2023 Budget Guidelines (PLDO, in Portuguese). The government forecasts a primary deficit for the central government for the tenth year in a row; the legislation also accounts for a primary budget deficit until 2024. The law establishes a primary deficit target of BRL65.9 billion for the central government in 2023. For 2024, the PLDO encompasses a deficit of BRL27.9 billion; a surplus of BRL33.7 billion is seen for 2025. We anticipate a deficit BRL85 billion for 2023, higher than the primary balance target set by the PLDO. On the expenditure side, a significant difference between our forecast and the official numbers is the level of the constitutional spending cap for 2023: the PLDO estimates this limit will grow by 6.5%, compared to 7.9% in our calculations, based on our own inflation outlook⁶. This means that government expenses could increase BRL25.2 billion more, meaning an extra space compared to PLDO, if our number is confirmed. Another important element is that the government has not accounted for “extra-cap” payments of judicial claims (“*Precatórios*”) when it comes to setting the primary balance target, despite the fact that the debt cancellations allowed by *PEC dos Precatórios* will affect the primary balance statistics (we estimate this expenditure at BRL20 billion for 2023). Additionally, the so-called “budget rapporteur amendments” (RP09), which totaled BRL16.8 billion in 2022, have not been considered in the PLDO. We believe that Congress will seek to include this type of spending in the final voting of the bill. All in all, we believe that the government will face difficulties in accommodating spending demands in the 2023 budget proposal, so that the PLDO highlights a challenging fiscal outlook for next year. Another downside risk comes from the real activity assumptions, as the government forecasts a 2.5% real GDP growth for 2023 (our estimate is -0.3%), meaning that revenues could eventually be revised down in the future steps of the budgeting process.

On April 20, the International Monetary Fund (IMF) released its Fiscal Monitor report, which reinforced the challenging outlook for the fiscal accounts in Brazil, despite better numbers compared to the last estimates. The IMF predicts that Brazilian gross debt/GDP⁷ will reach 94% in 2027 (+6.4 p.p. from 2019). The IMF estimates that the gap between Brazilian debt with emerging economies, on average, will diminish to +19 p.p. in 2027 from +28 p.p. of GDP in 2021. However, the distance from advanced economies’ average indebtedness should fall to -18 p.p. in 2027 from -27 p.p. in 2021. The IMF only foresees a primary surplus in Brazil in 2025, similarly to our view.

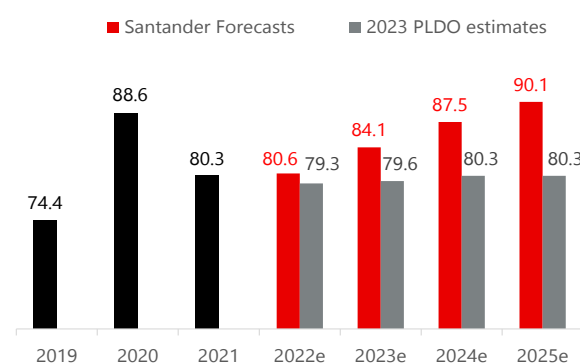
With a pause in the strike of federal workers, the unpublished fiscal policy publications could be out next week, alongside a new (up to date) batch of information. March federal tax collection should be published by the Brazilian Revenue Service sometime next week, and we anticipate the best result for the month in the inflation-adjusted series, totaling BRL161.2 billion (or +5% YoY, in real terms) on the heels of higher commodity prices (especially oil). On April 27 (Wednesday), the National Treasury will publish the Monthly Debt Report for March. On April 28 (Thursday), the fiscal authority publishes the central government primary result: we expect a deficit of BRL2.0 billion in March. On April 29 (Friday), the BCB might unveil the consolidated public sector’s fiscal balance for both February (still in delay) and March. To be confirmed.

Figure 8. 2023 Budget Guidelines Proposal

BRL billion	2023 Budget Guidelines	2023e	
		Santander estimates	Difference Santander - PLDO
Total Revenue	2,230.0	2,237.4	7.4
Transfers by Revenue Sharing	429.4	429.1	-0.3
Net Revenue	1,800.9	1,808.3	7.4
Total Expenditure	1,866.8	1,893.0	26.2
Social Security Benefits	849.5	860.2	10.7
Payroll - Public Servants	356.4	365.8	9.4
Other Mandatory Expenses	423.9	421.4	-2.5
Expenses Subject to Financial Programming	237.0	245.7	8.7
Discretionary Expenses	108.2	120.0	11.8
Central Gov. Primary Balance	-65.9	-84.7	-18.8
Spending cap Limit	1,789.1	1,814.3	25.2
IPCA Dec % YoY - 2022	6.5	7.9	1.4

Sources: Ministry of Economy, Santander.

Figure 9. Gross General Govt. Debt (% GDP)



Sources: Ministry of Economy, Santander.

⁶ Note: the 2022 spending cap is adjusted by annual IPCA as of December 2022.

⁷ Note: the IMF methodology posted a gap of nearly 13 p.p. vis-à-vis official BCB statistics for last year, as the IMF calculations encompass the Treasury bonds directly issued in the name of the BCB (which uses those for purposes of monetary policy) not allocated to repo operations.



INFLATION

April IPCA-15 comes out on Wednesday (April 27), and we look for a gain of 1.90% MoM. This is a substantially high print in seasonal terms, pushing the trend to a hefty ~15% 3MMA-saar reading. In YoY terms, the headline should accelerate to +12.21%, highest level since late 2003. We estimate this will be the peak for the IPCA-15 in this cycle.

Compared to March IPCA-15 (+0.95% MoM), we expect the headline to accelerate in monthly terms, driven by regulated prices (+3.69% MoM vs. +0.65% last month). The main driver in regulated prices should be gasoline (+10.00% MoM), as this print should mark the full impact of last upward price adjustment. Free-market prices inflation should accelerate mildly to +1.24% MoM (vs. +1.06% last month). Food prices should post another hefty change at around +2.83% MoM, a bit above March print (+2.51% MoM). Industrial goods should remain relatively stable, rising +1.22% MoM (vs. +1.26% last month). Finally, services might accelerate a bit to +0.57% MoM (vs. +0.31% in March). If we are right in our Services IPCA forecast, its trend pace is unlikely to accelerate further (remaining around 8.0% 3MMA-saar).

In terms of broad underlying inflation measures, we estimate the EX3 core will rise 0.97% MoM, which would represent a quickening trend to ~13% 3MMA-saar. If correct, March would be the 20th consecutive month in which the EX3 core has run above the BCB's mid-target in 3MMA-saar terms (our headline CPI target is 3.50% for 2022 and 3.25% for 2023).

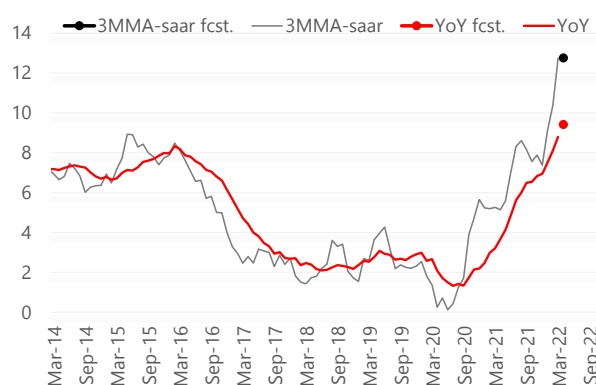
We still see inflation peaking in May, but the level and composition of recent IPCA readings have been worrisome, as the latest shock from commodities prices implies additional risks that further tilt the balance of risks to the upside, both for 2022 and 2023.

Figure 10. April's IPCA-15 Details (% annual)

	MoM		YoY	
	Apr-22	Contrib.	Mar-22	Apr-22
IPCA-15	1.90	1.90	10.8	12.2
Administered	3.69	0.99	14.1	16.5
Free	1.24	0.91	9.6	10.7
Food-at-home	2.83	0.42	12.3	15.2
Industrial goods	1.22	0.28	13.2	14.1
Services	0.57	0.20	6.2	6.6
EX3 Core	0.97	0.34	8.8	9.5

Sources: IBGE, Santander.

Figure 11. Core Inflation IPCA EX3 (% annual)



Sources: IBGE, Santander.



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