



BRAZIL MACRO

July 22, 2022

MACRO COMPASS

JOB MARKET IS SOLID (AND LIKELY OVERHEATING)

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

- In the rolling week ended on July 21, the USD/BRL cross breached the 5.50 barrier for the first time since January and closed at 5.50 (a loss of 1.4%). This means the Brazilian currency underperformed its peers, placing itself out as the second worst performer in the basket with the 31 most liquid currencies in the world. In our view, the BRL's move was related to both international and local factors, in a context of a fast monetary tightening in advanced economies and economic policy uncertainties in Brazil. In fixed income, nominal rates sold off once again, driven by the same factors as the FX, with the back end widening ~30 bps for the week.
- Commodity prices have rebounded following five consecutive weeks of decline. The Bloomberg Commodity Index rose 3.6% in the rolling week ended on July 21. The biggest contributor was the Energy Subindex, which climbed 7.9%. Metals gained 4.6%, while Agriculture was down 0.9%. In BRL terms, the Bloomberg Commodity Index rose 5.0%, as the currency depreciated for the week. The 50-day moving average of commodity prices in local currency (a better gauge of the potential for a pass-through to "real economy" prices) is down 2-3% from the peak seen late in June. For the year, that gauge is up ~30%, implying a limited cost-deflation process for now.
- Federal tax collection registered a solid performance in June, particularly thanks to the proceeds from the oil sector and taxes based on labor income. Tax revenues set a new monthly record with an 18% YoY real leap. We expect some positive results ahead, although at a slower pace. For 2022, we expect a 3% real growth for federal tax collection. The coming week is packed with fiscal policy publications for June: in a report due out on July 28 (Thursday), we look for a central government primary surplus of ~BRL15 billion. Our number accounts for BRL26 billion in dividends from state-owned companies and BRL26 billion in proceeds from the Eletrobras privatization deal. On July 29 (Friday), the Central Bank (BCB) is set to unveil public sector data; we expect a primary surplus of ~BRL24 billion. On July 27 (Wednesday), the Treasury is scheduled to publish the monthly debt report.
- Preliminary numbers from our proprietary indicators (the IGet "family") point to mixed signals from tertiary activities in July. IGet Services expanded 3.0% MoM-sa in the month, whereas IGet Retail Sales shrank 1.3% MoM-sa. June employment data is due out next week. On Thursday (July 28), CAGED payrolls data (the establishment survey) is to be released; our seasonally adjusted estimate stands at +221k (May: +231k). IBGE's PNAD household survey will be released on Friday (July 29), and we estimate a 0.4 p.p. drop to 9.1% in our seasonally adjusted unemployment rate series. Not only this is the lowest jobless rate since 2015, but it also likely means an overheated job market, given our estimates of structural joblessness at 10-11%. If this conclusion is true, such overheating would become an additional factor slowing the disinflation process and potentially increasing the necessary dose of tightening for the BCB to achieve its goal for 2023.
- We expect July's IPCA-15 (due out on Tuesday, July 26) to rise 0.11% MoM, lagging the average result for the month since 2010 (0.27% MoM). With this result, the trend rate for headline CPI should see substantial relief, falling to 8.2% 3MMA-saar (from 14.5% previously), shy of the annual change (~11.4% YoY). But this headline result is largely driven by the one-off impact of tax breaks on energy prices. For the coming months, we project further CPI deceleration in annual terms, as the tax cuts take full effect. However, more stimulus has been put in place and the composition of IPCA readings has been worrisome, implying a complicated disinflation ahead.

Most of the information in this report is up to the end of Thursday, July 21, 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 July 25 to July 29, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Current Account Balance (USD billion)	BCB	Mar/22	Mon, 25-Jul	0.2	-2.4
Foreign Direct Investment (USD billion)	BCB	Mar/22	Mon, 25-Jul	5.2	11.8
Consumer Confidence (index)	FGV	Jul/22	Mon, 25-Jul	-	79.0
Construction Confidence (index)	FGV	Jul/22	Tue, 26-Jul	-	97.5
IPCA-15 Inflation (% MoM)	IBGE	Jul/22	Tue, 26-Jul	0.11	0.69
IPCA-15 Inflation (% YoY)	IBGE	Jul/22	Tue, 26-Jul	11.36	12.04
Industrial Confidence (index)	FGV	Jul/22	Wed, 27-Jul	-	101.2
Bank Lending Report	BCB	Apr/22	Wed, 27-Jul	-	471.1
Federal Debt Report (BRL trillion)	STN	Jun/22	Wed, 27-Jul	-	5.7
Services Confidence (Index)	FGV	Jul/22	Thu, 28-Jul	-	98.7
Retail Confidence (index)	FGV	Jul/22	Thu, 28-Jul	-	97.9
IGP-M Inflation (% MoM)	FGV	Jul/22	Thu, 28-Jul	0.24	0.59
IGP-M Inflation (% YoY)	FGV	Jul/22	Thu, 28-Jul	10.11	10.70
Central Gov. Prim. Balance (BRL billion)	STN	Jun/22	Thu, 28-Jul	15.1	-39.4
Formal Job Creation (thousands)	CAGED	Jun/22	Thu, 28-Jul	234.0	277.0
Formal Job Creation (thousands, sa)	CAGED	Jun/22	Thu, 28-Jul	221.0	231.0
National Unemployment Rate (% nsa)	IBGE	Jun/22	Fri, 29-Jul	9.3	9.8
National Unemployment Rate (% sa)	IBGE	Jun/22	Fri, 29-Jul	9.1	9.5
Primary Budget Balance (BRL billion)	BCB	Jun/22	Fri, 29-Jul	24.4	38.9
Net Debt (% GDP)	BCB	Jun/22	Fri, 29-Jul	55.2	57.9

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: “Better Activity Expected in the Short Term, with Higher Interest Rates (Even) Longer” – July 14, 2022- Available on: <https://bit.ly/Std-scenupdate-jul22>



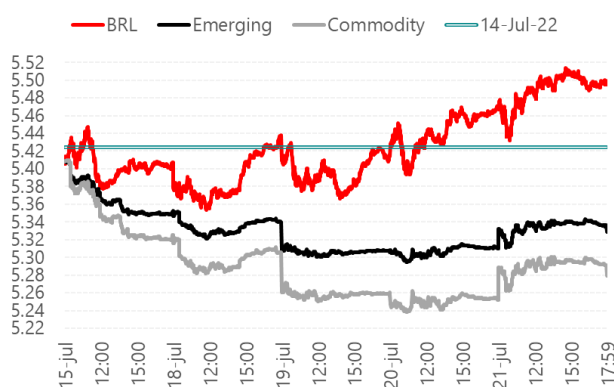
LOCAL MARKETS—FX

In the rolling week ended on July 21, the USD/BRL cross breached the 5.50 barrier for the first time since January and closed at 5.50 (a loss of 1.4%), thus underperforming its peers and standing out as the second worst performer in the basket with the 31 most liquid currencies in the world. In our view, the move was related to both international and local factors. Abroad, despite the positive developments regarding the resumption of the supply of Russian natural gas to European countries, the more hawkish decision (and wording) from the European Central Bank (ECB), in tandem with political jitters in Italy, weighed on investor sentiment. Market doubts regarding the future of economic policy in Brazil have also resurfaced of late, amid press reports on plans to extend fiscal stimulus and adopt a more “proactive” role in FX policy (i.e., interventions). All in all, the recent developments in the FX market reinforced our perception of limited room for BRL strengthening in the near term.

LOCAL MARKETS—Rates

Nominal rates sold off once again, with the back end widening ~40 bps for the week. Since last Thursday (July 14), the front end of the curve (denoted by the Jan-24 DI future) rose 12 bps, to 14.00%, while the back end (denoted by the Jan-27 DI future) rose 41 bps to 13.41%. The steepness in this segment increased 29 bps, reducing the inversion to -58 bps. We believe the sell-off is the result of both global and local factors. Abroad, the expectations for a more hawkish ECB outcome likely conspired for an increase in global yields. Locally, financial markets are concerned about the budgetary impact of the new round of fiscal stimulus, implying risks of even more persistent CPI pressures. Additionally, press reports of plans for new approaches to FX policy could also have played a part in this week’s move in yields. The options market prices in an even higher probability (90%, up from 80% last week) of a 50-bp Selic hike to 13.75% at the August 2-3 Copom policy meeting. For the September meeting, the probabilities are more evenly distributed, with traders seeing a 40% probability of a 50-bp hike to 14.25% (our scenario). Expectations of rate cuts for 2023 continue to fade in the local yield curve, given the fears of (even more) persistent inflation.

Figure 2. USD/BRL – Intraday Trends

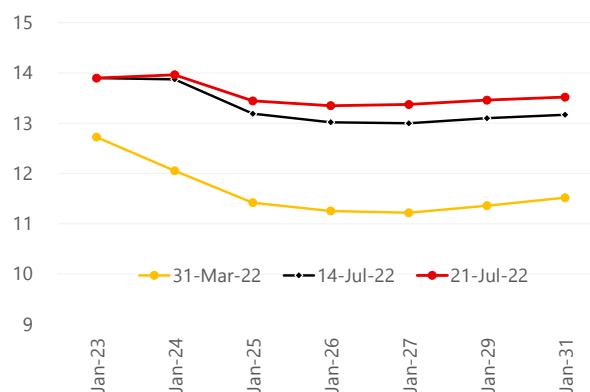


Sources: Bloomberg, Santander.

Note 1: As of the close on Thursday, July 21, 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, July 21, 2022.



COMMODITIES

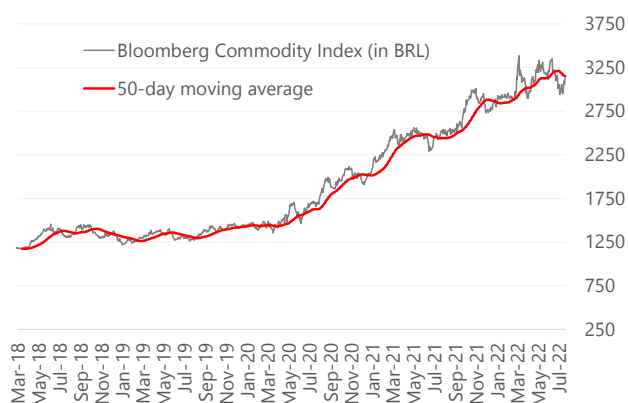
Commodity prices have rebounded following five consecutive weeks of decline. The Bloomberg Commodity Index rose 3.6% in the rolling week ended on July 21. The biggest contributor was the Energy Subindex, which climbed 7.9%. Metals gained 4.6%, while Agriculture was down 0.9%. In BRL terms, the Bloomberg Commodity Index rose 5.0%, as the currency depreciated for the week. The 50-day moving average of commodity prices in local currency (a better gauge of the potential for a pass-through to “real economy” prices) is down 2-3% from the peak seen late in June. For the year, that gauge is up ~30%, implying a limited impact from a cost-deflation process for now.

Brent oil prices rise back to USD 103/bbl this week. On Tuesday (July 19), the Brent oil price was at USD107/bbl on fears that the supply of Russian gas to Europe would not resume on Thursday, July 21. Later in the week, EIA data showed that U.S. gasoline inventories rose above consensus, signaling weaker than expected gasoline demand in the summer driving season. The commodity ended at USD103/bbl, up 4% for the week. Markets continue to struggle with recession fears and are anticipating a slowdown in global economic activity (and therefore lower oil demand). However, supply issues continue to loom, despite the resumption of gas flow from Russia to Europe. After a maintenance pause in operations at the Nord Stream pipeline, shipments returned to 40% of capacity, the same as before the maintenance. The restart brings some short-term relief, but uncertainty remains on whether the EU will be able to rebuild stockpiles of natural gas ahead of the winter. We believe supply constraints will again start to drive the price formation in the coming months, leading to an oil price rebound. Our forecast for Brent oil is USD115/bbl for YE2022.

Agricultural prices had a mixed showing, but corn and soybean prices both fell. In USD terms, wheat (+2%), coffee (+5%), and cotton (+4%) posted gains in the week, while corn (-5%) and soybeans (-10%) dropped on an improved U.S. weather outlook (maps are showing a wetter and cooler pattern for early August) and concerns about weaker demand from China (though recent shipments from the U.S. to China have been reported). In BRL terms, corn prices dropped 4%, and soybean prices fell 9%. Meanwhile, adding to the bearish move for grains (price-wise), talks between Russia, Turkey, and Ukraine concerning an export corridor in the Black Sea seem to be advancing — which is a positive development. We believe that stock-use ratios remain at historically low levels even with slowing demand, keeping grain prices high: thus, we still forecast a price rebound in the medium term.

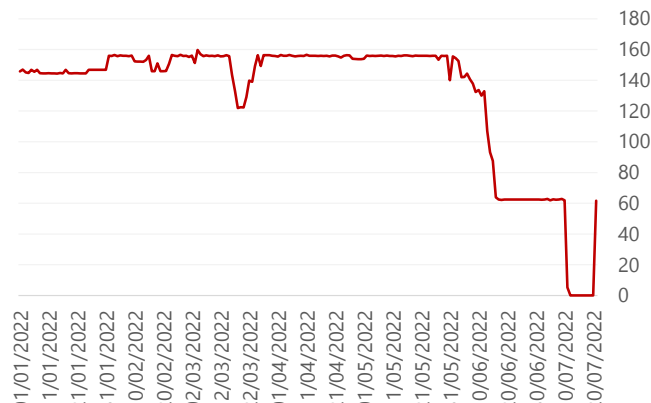
Iron ore continued to slip, falling 2% in the week. In China, COVID-related news (read: the probability of further lockdowns in major cities) continued to worsen at the margin, as new cases are near a two-month high. This possibly weighed on expected metals demand (and prices). Additionally, despite the recently announced stimulus, housing market turmoil in China, with mortgage boycotts, is clouding the prospects for metals demand. Iron ore prices are 40% off their March levels and 55% below the peak seen in May 2021. Looking ahead, we forecast a rebound in metals prices once the economy safely reopens (with reduced risks of new lockdowns) and as China implements more economic stimulus.

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. Gas Flow from Russia to Europe (MCM/d)



Sources: Bloomberg, Santander.



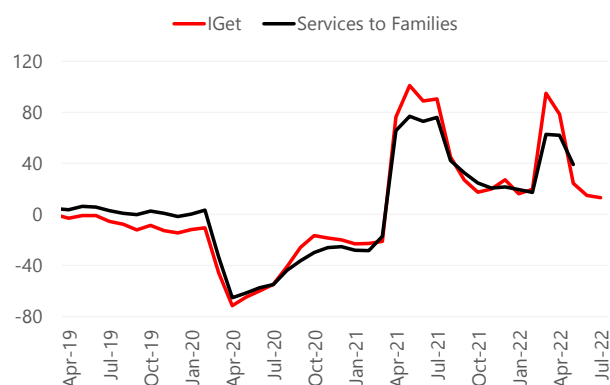
ECONOMIC ACTIVITY

Our (preliminary) proprietary data pointed to mixed signals from tertiary activities in July. Based on data available until mid-July, IGet Services expanded 3.0% MoM-sa in the month, fully offsetting the previous drop and virtually closing the gap with the pre-pandemic level (February 2020). Our tracking for services to families for July stands at +2.5% MoM-sa, considering a probable 0.5% MoM-sa retreat in June. Conversely, IGet Retail Sales shrank 1.3% MoM-sa in July, marking the fourth decline in a row. Our tracking for broad retail sales in July stands at -1.4% MoM-sa, considering a 0.6% fall in June. Following a strong GDP figure expected for 2Q22, we expect domestic activity to sour in 2H22 once the effects of tighter monetary policy start to kick in, but the fiscal stimulus recently approved by Congress could make this process more gradual. We have recently upgraded our 2022 GDP forecast to +1.9%, but we maintain our expectation of a recession next year: we look for a 0.6% contraction in 2023. [See details in the link².](#)

Labor market data for June is due out next week. On Thursday (July 28), the Ministry of Labor will release CAGED payrolls data. Our estimate is +234k (nsa), meaning +221k sa (May: +231k), according to our preliminary seasonal adjustment. On Friday (July 29), the PNAD household survey comes out: we estimate an unemployment rate of 9.3% nsa, meaning a 0.4 p.p. decline to 9.1% in our seasonally adjusted series. That is the lowest level since September 2015.

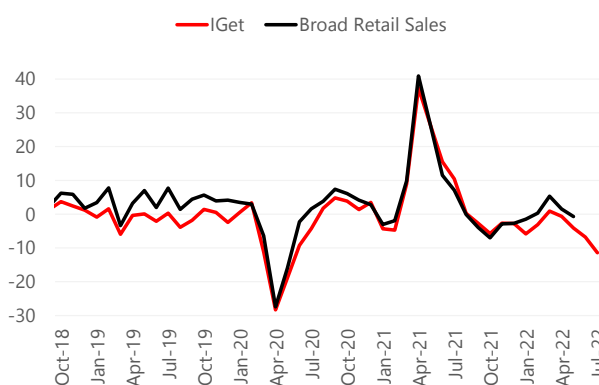
In the coming week, FGV will release economic confidence data for various sectors in July. Consumer confidence data is due out on Monday (July 25), while industrial and tertiary sector data are due out on Wednesday (July 27) and Thursday (July 28), respectively. [For details on Santander's economic outlook, please refer to our last reports³.](#)

Figure 6. IGet x Services to Families (nsa, YoY%)



Sources: IBGE, Santander.

Figure 7. IGet x Retail Sales (nsa, YoY%)



Sources: IBGE, Santander.

² **Santander Brazil Economic Activity: "IGet Serviços Julho (Prévia): Serviços mostram alta em julho"** – July 19, 2022 – Available (in Portuguese) on: <https://bit.ly/Std-IGETser-p-jul22>

Santander Brazil Economic Activity: "IGet Julho (Prévia): Varejo segue enfraquecendo em julho" – July 20, 2022 – Available on (in Portuguese): <https://bit.ly/Std-IGET-p-jul22>

³ **Santander Brazil Special Report: "Nowcasting Brazilian GDP with LASSO"** – June 14, 2022 – Available on: <https://bit.ly/Std-special-051622>
Santander Brazil Special Report: "A Model to Forecast Probability of Recession in Brazil" – June 08, 2022 – Available on: <https://bit.ly/Std-special-060822>

Santander Brazil Special Report: "Resilience Factors for GDP Growth: What Has Changed Since January" – June 30, 2022 – Available on: <https://bit.ly/Std-special-GDP-062922>

Santander Brazil Economic Activity: "Chartbook: Further improvements in 2022, as 2023 remains challenging" – July 20, 2022 – Available on: <https://bit.ly/Std-chart-econact-jul22>



INFLATION

We expect July's IPCA-15 (due out on Tuesday, July 26) to rise 0.11% MoM, lagging the average result for the month since 2010 (0.27% MoM). With this result, the trend rate for headline CPI should see substantial relief, falling to 8.2% 3MMA-saar (from 14.5% previously), shy of the annual change (~11.4% YoY). But this result is highly driven by the one-off impact of tax breaks on energy prices.

Administered prices should be the main contributor to the monthly change, as we estimate a drop of 1.54% MoM. The tax cut measures implemented by the government will start to reach the price index, with fuels (-5.4% MoM), electricity (-3.8% MoM), and telecom (-1.4% MoM) being the most affected sectors. We forecast industrial goods to rise 0.48% MoM, meaning a deceleration to 13.2% 3MMA-saar (from 13.8% previously). If we are correct, the industrial goods trend (3MMA-saar) will run below the annual change of 13.7%. As for services inflation, we forecast the trend to decelerate to 11.5% 3MMA-saar (from 12.5% previously), but still considerably above the 8-9% 3MMA-saar level of the 2014-2016 period. We expect the services core gauge to post a new high in trend terms at 11.9% 3MMA-saar (from 11.2% previously), also above the high of 10.7% 3MMA-saar in mid-2015. Finally, we expect food-at-home to rise 1.32% MoM, which would mean a deceleration to 17.5% 3MMA-saar (from 23.0% previously).

The EX3 core (which accounts for services and industrial goods core inflation) is likely to rise 0.94% MoM, according to our forecasts, which should be enough to push the trend to 13.9% 3MMA-saar (from 13.2% last month), a new high in the cycle. If we are correct, July would be the 22nd 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).

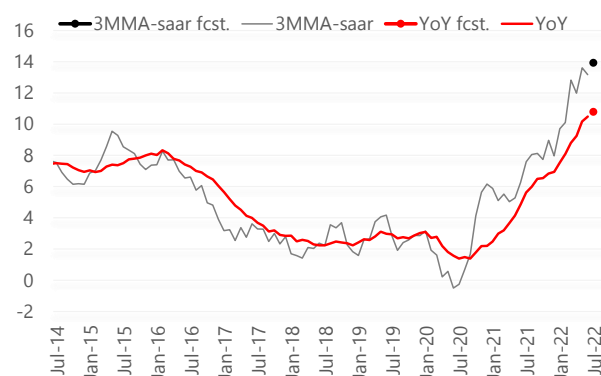
For the coming months, we project further CPI deceleration in annual terms, as fuel tax cuts and downward readjustments in electricity prices take full effect. However, the composition of IPCA readings has been worrisome, implying a slow deceleration ahead.

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

	MoM		YoY	
	Jul-22	Contrib.	Jun-22	Jul-22
IPCA-15	0.11	0.11	12.0	11.4
Administered	-1.54	-0.42	12.2	9.5
Free	0.71	0.52	12.0	12.1
Food-at-home	1.32	0.20	16.7	17.7
Industrial goods	0.48	0.11	14.0	13.7
Services	0.59	0.20	8.8	8.6
EX3 Core	0.94	0.33	10.5	10.8

Sources: IBGE, Santander.

Figure 9. Core Inflation – IPCA 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
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 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
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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