BRAZIL MACRO September 24, 2021
MACRO COMPASS

A Busy Macro Calendar for the Week

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- The USD/BRL pair closed the rolling week ended September 23 at 5.30, posting a 0.9% loss, which was the fifth worst performance amid a basket of 32 of the most liquid currencies in the World. The performance was influenced by the international news cycle, amid worries about the Chinese real estate sector and the FOMC's hawkish tone. The domestic yield curve bull flattened for the period, with the front end paring expectations of a faster pace of tightening in the short term.

- The Copom once again hiked the Selic policy rate by 100 bps to reach 6.25%—a decision broadly in line with expectations. Given the inflation simulations and upwardly tilted balance of risks, it is possible that the current flight plan could include a terminal Selic rate just above 9%. The minutes from the Copom meeting will be released on Tuesday (September 28) and the Q3 inflation report will be published on Thursday (September 30)—these events may help the Brazilian Central Bank (BCB) further calibrate expectations.

- September's IPCA-15 registered a 1.14% MoM change (10.05% YoY), above our call and consensus, both at 1.04%. In particular, trend core gauges stood at 8.8% 3MMA-saar and the diffusion index at 70.3%, not far from an all-time high of 78% seen in 2015-16. The report confirms the unfavorable inflation conditions in the short term.

- According to preliminary numbers, our IGet Services indicator (our proprietary indicator, based on credit and debit card transactions) was nearly stable in September (up 0.2%), following a steep decline in August. Our tracking for the component of IBGE's monthly indicator of services to families points to a 0.4% MoM-sa growth. We expect positive GDP contributions from services as mobility returns towards "normality".

- Next week, another batch of labor market data is due to be released. On Tuesday (September 28), the Ministry of Labor will release the August CAGED net formal job creation data, for which we expect a deceleration to +255k-sa (+322k in July). On Thursday (September 30), IBGE will release the July PNAD household survey. We expect the unemployment rate to stand at 13.6%-sa (13.9% in June). Moreover, FGV will release the remaining economic confidence data for September. Industrial confidence is due out on Tuesday (September 28), while tertiary sector confidence is due out on Wednesday (September 29).

- Federal tax collection continued to recover in August, but we note some signs of softening. The Ministry of Economy published a revision of the official fiscal forecasts for 2021, showing a new reduction in the primary deficit estimate (to 1.6% of GDP). A potential agreement between Congress and the Ministry of Economy to reduce the judicial claims budget for 2022 was in the spotlight this week. The coming week is packed with fiscal policy publications for August, with the federal debt report and the budget results for the public sector.

- The August 2021 current account balance registered a US$1.6 billion surplus, a tad worse than our estimate (US$2.6 billion surplus), but not at all challenging our constructive view on the Brazilian sound external position. We expect the September 2021 trade surplus (Friday, October 1) of US$4.2 billion that we forecast for this month to highlight that foreign trade should keep the current account balance out of the list of markets' concerns.

Most of the information in this report is up to the end of Thursday, September 23, 2021.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.
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Figure 1. Brazil Macro Agenda for the Week of September 27– October 01, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Construction Confidence (index)	FGV	Sep/21	Mon, 27-Sep	--	101.2
Federal Debt Report (BRL billion)	STN	Aug/21	Mon, 27-Sep	--	5.4
Total Outstanding Loans (% YoY)	BCB	Aug/21	Mon, 27-Sep	--	--
Formal Job Creation (thousands, nsa)	**CAGED**	**Aug/21**	**Tue, 28-Sep**	**340**	**317**
Formal Job Creation (thousands, sa)	**CAGED**	**Aug/21**	**Tue, 28-Sep**	**255**	**322**
Industrial Confidence (index)	FGV	Sep/21	Tue, 28-Sep	--	107
Copom minutes	**BCB**	**--**	**Tue, 28-Sep**	--	**--**
Services Confidence (Index)	FGV	Sep/21	Wed, 29-Sep	--	99.3
Retail Confidence (index)	FGV	Sep/21	Wed, 29-Sep	--	100.9
Central Gov. Prim. Balance (BRL billion)	STN	Aug/21	Wed, 29-Sep	-9.7	-19.8
Primary Budget Balance (BRL billion)	BCB	Aug/21	Wed, 29-Sep	-2.0	-10.3
Net Debt (% GDP)	BCB	Aug/21	Wed, 29-Sep	60.0	60.3
IGP-M Inflation (% MoM)	FGV	Sep/21	Thu, 30-Sep	--	0.66
IGP-M Inflation (% YoY)	FGV	Sep/21	Thu, 30-Sep	--	31.12
Quarterly Inflation Report	**BCB**	**3Q21**	**Thu, 30-Sep**	--	**--**
National Unemployment Rate (%, nsa)	**IBGE**	**Sep/21**	**Thu, 30-Sep**	**13.8**	**14.1**
National Unemployment Rate (%, sa)	**IBGE**	**Sep/21**	**Thu, 30-Sep**	**13.6**	**13.9**
Trade Balance (USD billion)	SECINT	Sep/21	Fri, 01-Oct	4.2	7.7
Vehicle Sales (thousands)	Fenabrave	Sep/21	Fri, 01-Oct	--	172.8

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario: *"The Inflation Factor…Again"* –** Set 16, 2021- Available on: https://bit.ly/Std-scenreview-set21

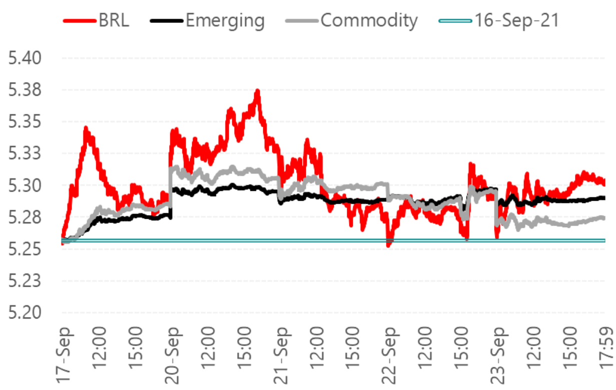
LOCAL MARKETS—FX

The USD/BRL pair closed the rolling week ended September 23 at 5.30, posting a 0.9% loss, which was the fifth worst performance amid a basket of 32 of the most liquid currencies in the World. In our opinion, the performance stemmed mainly from an adverse news cycle on the international front. The uncertainty regarding the solvency of players in the Chinese real estate sector raised fears about financial stability in China (and possible spillovers on a global scale). Additionally, the FOMC meeting last Wednesday ended up with a more hawkish outcome than the markets were waiting for, as the US monetary authority signaled greater support for a rate hike in 2022 (dot plot) and indicated a will to carry out a relatively fast monetary policy tapering. This combination does not bode well for risky assets, and the BRL responded accordingly.

LOCAL MARKETS—Rates

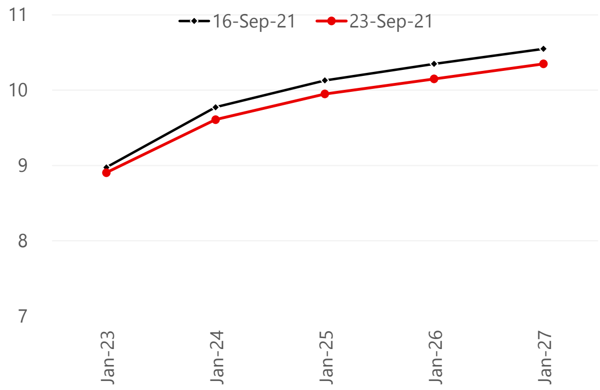
The nominal yield curve downshifted for the second week in a row, but this time with a bull-flattening pattern. Since last Thursday (September 16), the front end of the curve (Jan-23 DI future) fell 5 bps to 8.93%, while the back end of the curve (Jan-27 future) fell 17 bps to 10.38%. As a result, the curve's steepness in this segment fell 12 bps to 146 bps. At the front end, the market seems to have perceived the Copom's decision as a signal of lesser probability for a faster pace of interest-rate hikes in the short term (see more in the Monetary Policy section). At the back end, despite the perception that uncertainty about the political environment and the fiscal consolidation process remains high, the market slightly reduced the risk premium it has built during the last few weeks.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, September 23, 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, September 23, 2021.

COVID-19 MONITORING

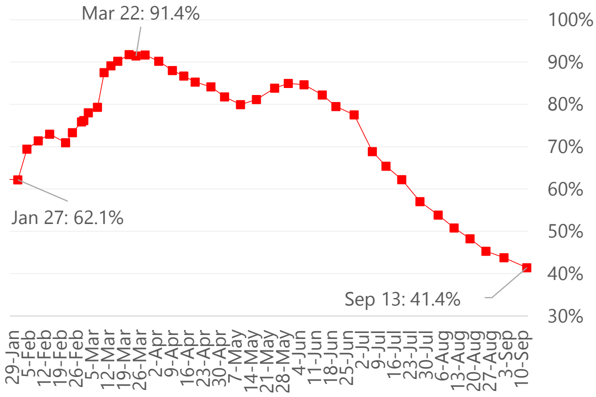
Brazil's daily vaccination rate has decreased slightly to an average of 1.4 million doses, as of Wednesday (September 22). We expect the average pace to hold up close to that number throughout 2H21, as vaccine inventories remain high and deliveries are expected to remain above the levels of vaccine administration.

With nearly 37% of the population now fully immunized, infections and deaths apparently remain at tamer levels despite an unusually large adjustment on the weekend. Local health authorities from Rio de Janeiro state reported a backlog of cases (92k), with 40% of those reportedly having occurred in 2020. While the remaining cases are from 2021, the authority reinforced that the data revision does not change the current epidemiological scenario in the state. Data from Brazil's Health Ministry showed that the 7-day average of infections stood at ~35k as of Thursday (September 23), up 133% from last week and 101% from two weeks before (owing to the backlog of cases). As for casualties, the 7-day average stood at ~531, down 10% from a week ago but up by 13% compared to two weeks ago.

Urban mobility shows recovery and is virtually back to the pre-pandemic levels. September's data so far indicates a virtual return of urban mobility to pre-pandemic readings, with our lockdown index now moving to 0.5 points (as of September 17, 2021) from 3.0 points (as of September 11, 2011). This move stems mainly from a solid increase of mobility in the Transit Station segment, with Retail and Parks segments still showing some idleness regarding the pre-crisis mark. The workplaces segment still shows high levels of mobility and has been running above the pre-pandemic mark since June. We expect the index to consistently stand at "normal" levels ahead, as vaccinations advance.

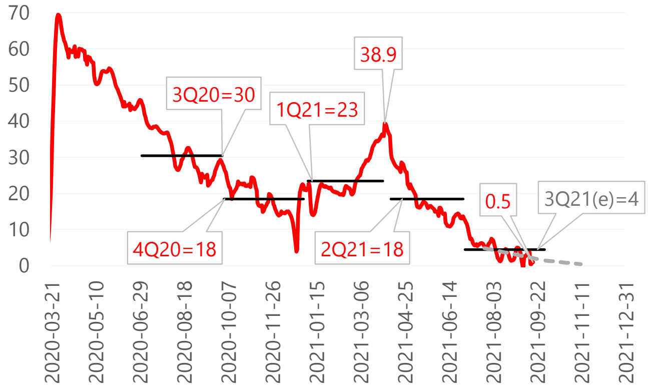
Our daily activity index seems to have gained momentum in September. The index—based on daily data on energy consumption, car sales, and mobility—seems to have started 3Q21 at a slower pace, with a 0.8% drop in July, but August's figure showed a solid 1.7% expansion, more than offsetting the previous month's fall. Considering the average so far in September (up to the 17th), we calculate a strong 4.1% expansion, fully offsetting March's losses and placing the index 1.1% above February 2021 levels (i.e., before the pandemic's 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 September 17, 2021.

MONETARY POLICY

The COPOM has once again hiked the Selic policy rate by 100 bps to reach 6.25%—a decision broadly in line with expectations (after BCB remarks last week dissuaded the markets away from expectations of an acceleration in the tightening cycle).

It looks like a pace of 100 bps per meeting now might be the cruise speed in the BCB's flight plan. In the statement, the COPOM indicated that "at the present stage of the tightening cycle, this pace is the most appropriate to guarantee inflation convergence to the target at the relevant horizon and, simultaneously, allow the Committee to obtain more information regarding the state of the economy and the persistence of shocks."

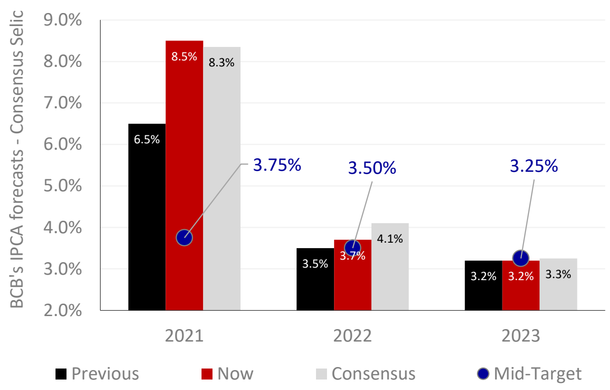
The latter part of this phrasing signals that the total budget of rate hikes may likely be the adjusting variable should economic and inflation conditions bring surprises to the BCB's scenario. In fact, BCB officials reaffirmed the message that, at least for now, "the COPOM's baseline scenario and balance of risks indicate as appropriate to advance the process of monetary tightening further into the restrictive territory."

While the BCB's current message does not necessarily hint at a certain endpoint for the cycle (as has been the case in previous occasions), we sense the COPOM's flight plan could include a terminal Selic rate at 9% or slightly above. According to the BCB's own inflation models, with the FX rate starting at 5.25 (and moving along with PPP afterward), a path of Selic rate hikes (as projected by market economists) to 8.25% for YE2021 and 8.50% for YE2022 (with a 25-bp hike in February 2022) would produce disinflation from a beefy reading of 8.5% in 2021 (previously: 6.5%; upper target: 5.25%) toward a reading of 3.7% for IPCA inflation for the main policy horizon now (2022). This forecast rose 0.2 p.p. from the last meeting, and now slightly tops next year's mid-target of 3.5%.

In our view, the bar is high for the BCB to change the speed of rate hikes ahead, as it apparently believes this is a fast-enough pace at this juncture. The adjusting variable for surprises in the scenario is likely the budget of total hikes. For now, given the inflation simulations and upwardly tilted balance of risks, it is possible that the current flight plan could include a terminal Selic rate somewhere between 9.00-9.50%. But this is true only if the scenario evolves in line with the BCB's expectations, and especially if inflation forecasts remain tame for 2023. While for now we still do not foresee the Selic rate reaching double-digit territory in this cycle, we continue to perceive upside risks as per our forecast of terminal rate at 8.5%. See details in the link[2].

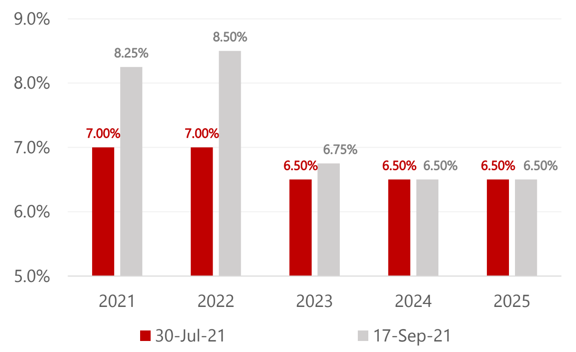
The minutes from that Copom policy meeting will be released on Tuesday (September 28) and the Q3 inflation report will be published on Thursday (September 30). These events provide other opportunities for the BCB to calibrate its communication in order to guide the market expectations.

Figure 4.A. – BCB's Inflation Simulations



Sources: Brazilian Central Bank, Santander.
Note: BCB simulations assume Selic rate from the Focus survey and USD/BRL starting at 5.25 and evolving according to purchase power parity

Figure 4.B. – Median Selic Rate Forecasts (Annually)



Sources: Brazilian Central Bank, Santander.
Note: Based on BCB's weekly Focus survey with professional forecasters (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout).

[2] **Santander Brazil Monetary Policy - *"Scanning the Scene as It Moves at Cruise Speed"* –** September 23, 2021 - Available on: https://bit.ly/Std-COPOM-sep21

INFLATION

September's IPCA-15 registered a 1.14% MoM change (10.05% YoY), above the market's median expectation of 1.03 % and our call of 1.04%. The headline trend accelerated to 12.5% in 3MMA-saar terms in September from 11.8% in August, showing that the upward pressure at the margin remains strong.

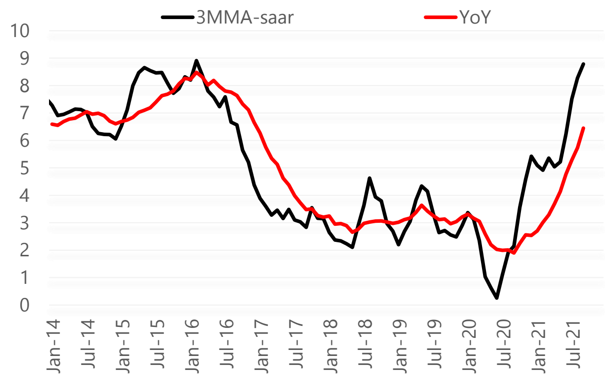
Qualitative measures were, once again, notably unfavorable, with core trends and diffusion index still on high levels. The average of core measures rose 8.8% in 3MMA-saar terms. This is the twelfth month the core measures run above the BCB's mid-target in 3MMA-saar terms (headline CPI target is 3.75% for 2021 and 3.50% for 2022)—signaling a risky spread of primary shocks to general prices. All in all, we still see an unfavorable outlook for short-term inflation.

Figure 5.A. – September's IPCA-15 Details (%)

	Sep-21	Santander	Dev.	Aug-21	Sep-21
IPCA-15	1.14	1.04	0.10	9.3	10.1
Administered	1.49	1.36	0.03	13.5	14.8
Free	1.01	0.93	0.06	7.8	8.4
Food-at-home	1.51	1.41	0.01	16.0	15.5
Industrial goods	1.11	1.00	0.03	9.4	10.3
Services	0.74	0.68	0.02	3.8	4.5
EX3 Core	0.61	0.60	0.01	6.0	6.5

Sources: Brazilian Central Bank, Santander.

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



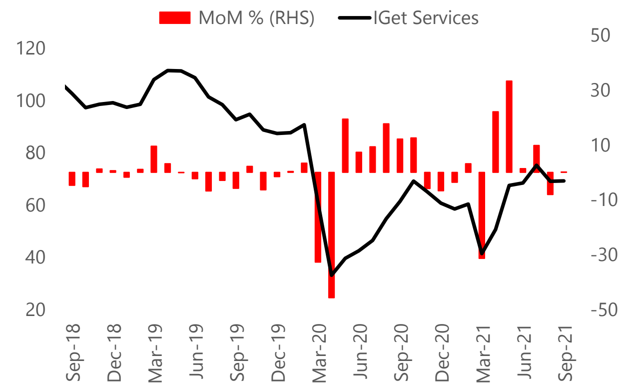
Sources: Brazilian Central Bank, Santander.

ECONOMIC ACTIVITY

IGet services marked a feeble end of 3Q21, with our tracking pointing to a slight sequential expansion. According to preliminary numbers, IGet Services expanded slightly in September (up 0.2%), a virtual flattening if we consider the steep decline seen in August (down 8.1%). That result had broken a string of four months in positive fieldIn quarterly terms, despite the weak figures seen for August and September, the headline index at end-3Q21 climbed a steep 14.4% (2Q21: 16.4%), which also reflects a weak basis of comparison. Moreover, regarding the impact of the sanitary crisis, September's figure still places the index at levels 24% below the pre-pandemic mark and almost 31% below the 2019 average. In line with the tepid figure seen for IGet, our tracking for the services to families (a component of the IBGE's monthly survey) points to a slight expansion of 0.4% MoM-sa (29.1% YoY). We still expect positive contributions to (sequential) GDP growth from services as mobility returns towards "normality". See details in the link[3].

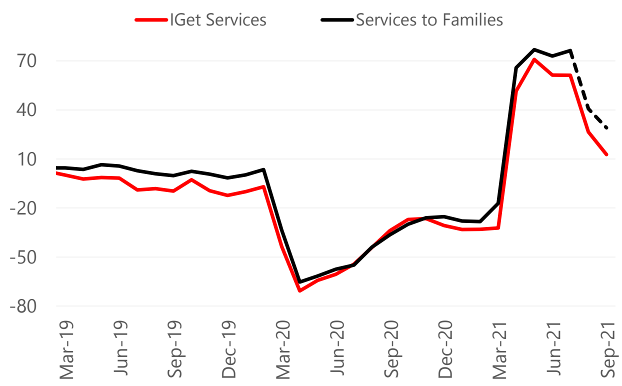
Next week, another batch of labor market data is due to be released. On Tuesday (September 28), the Ministry of Labor will release the August CAGED net formal job creation data, for which we expect a +340k result. According to our preliminary seasonal adjustment, this would represent a deceleration to +255k (+322k in July). On Thursday (September 30), IBGE will release the July PNAD household survey. We expect the unemployment rate to stand at 13.8%, which indicates a drop to 13.6% in seasonally adjusted terms (13.9% in June). Moreover, FGV will release the remaining economic confidence data for September. Industrial confidence is due out on Tuesday (September 28), while tertiary sector confidence is due out on Wednesday (September 29). **For details on Santander's activity outlook, please refer to our last chartbook[4].**

Figure 6.A. – IGet Services (sa, Jan/2016=100)



Sources: Santander.

Figure 6.B. – IGet Services and Services to Families (nsa, YoY%)



Sources: IBGE, Santander.

[3] **Santander Brazil Economic Activity - *"Serviços Mostram Estabilidade"* –** September 23, 2021 – Available (in Portuguese) on: https://bit.ly/Std-IGETser-p-set21
[4] **Santander Brazil Economic Activity - *"Chartbook – Downgrading the Estimate for 2022"* –** September 20, 2021 – Available on: https://bit.ly/Std-chart-econact-set21

FISCAL POLICY AND LEGISLATION

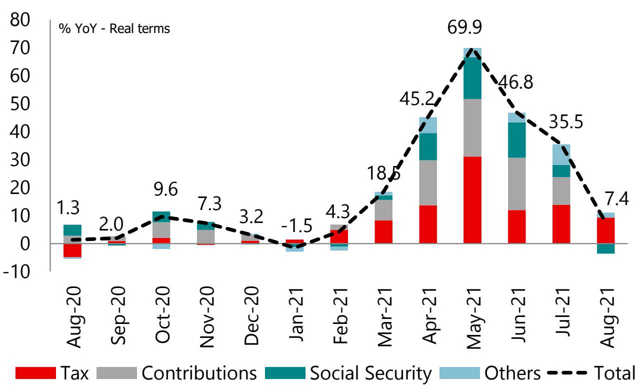
In August, federal tax collection continued to recover, yet at a slower pace. On September 23, according to data published by the Brazilian Internal Revenue Service (IRS), tax collection reached BRL146.5 billion (or +7.3% YoY real), close to our forecast (BRL145.2 billion) and the market's expectation (BRL146.6 billion). The August result was the best result for the month in the (inflation-adjusted) historical series. Compared with August 2019, the increase was +8.8% YoY (meaning an annual clip of 4.3%). In YTD real terms, the rise is 23.5% YoY and 7.2% YoY compared to 2019. This year's values are at an all-time high, "helped" by extraordinary revenues (BRL29 billion), mostly related to M&A and corporate restructuring. The revenue effects of a cyclical economic rebound, as well as the higher inflation and terms of trade continue to unfold. In the breakdown, we see robust tax collection by companies +41.8% YoY. In addition, we observed a recovery in royalties (mainly from oil exploration) with a real increase of +49.4% in 2021. In the coming months, we expect positive results, yet with some softening in tax revenue growth. For 2021, we forecast a ~15% YoY real rise.

On September 22, the Ministry of Economy published its fourth bimonthly review of budget 2021. The official forecasts continued to show an improvement in fiscal outlook this year, mainly due to higher revenue forecasts (+BRL39 billion), considering the rise in oil royalties' revenues (BRL7.7 billion) and dividends from government-owned companies (BRL7.9 billion). On the expenditure side, the government expects a total of extra-cap expenditures of BRL134 billion (+BRL9 billion, mainly on public health outlays). In light of this, the central government's primary deficit forecast dropped to BRL139.4 billion (1.6% of GDP), from BRL155.4 billion (1.8% of GDP) in July. We continue to anticipate a deficit of BRL150 billion in 2021 (1.7% of GDP).

On September 21, Senate Speaker Rodrigo Pacheco outlined in a public statement a potential deal to limit the payments of court-ordered debts ("*Precatórios*") in 2022. The potential agreement with the Ministry of Economy and Lower House speaker is that the total payments of judicial claims could be capped at 2016 inflation-adjusted levels for 2022 (~BRL40 billion). The remaining BRL49 billion budgeted for next year, could either be renegotiated or punted to 2023 onwards. On September 22, the Lower House launched a special commission to debate and change the constitutional amendment proposal (PEC 23/2021) originally sent by the government. The committee is expected to have at least 10 sessions (40 sessions is the maximum). We expect an intense debate over the proposal before a voting on the House floor.

The coming week is packed with fiscal policy publications. On September 27, the National Treasury will publish the Monthly Debt Report for August. On September 28, the Treasury is expected to publish the central government primary deficit of August: we expect a deficit of BRL9.7 billion, on the heels of: (i) more revenues related to dividends payments (~BRL7 billion); (ii) extraordinary budget related to the pandemic (BRL14.5 billion); and higher discretionary expenses (BRL10 billion). On September 30, the BCB will publish the consolidated public sector's fiscal balance for August. We anticipate a primary deficit of BRL2.0 billion, counting on a BRL7.5 billion surplus from regional governments (the state of Rio de Janeiro should have received the payment of the public water company privatization that occurred in April).

Figure 7.A. – Federal Tax Collection



Sources: Brazilian Internal Revenue Service, Santander.

Figure 7.B. – 2021 Bi-Monthly Budget Review

BRL billion	Sep-21	Jul-21	Dif.
Total Revenue	1,855.5	1,816.3	39.3
Revenues Collected by the Federal Revenue Office	1,165.7	1,156.0	9.7
Net Social Security Revenues	450.2	440.0	10.2
Revenues Not Collected by the Federal Revenue	239.7	220.1	19.6
Transfers by Revenue Sharing	347.7	339.9	7.8
Net Revenue	1,507.9	1,476.4	31.5
Total Expenditure	1,647.3	1,631.8	15.5
Social Security Benefits	709.9	705.9	3.9
Payroll - Public Servants	330.8	332.4	-1.5
Other Mandatory Expenses	336.2	328.6	7.7
Mandatory Expenses with Cash Control	145.9	145.6	0.3
Discretionary Expenses	124.5	119.3	5.1
Central Government's Primary Balance	-139.4	-155.4	16.0
Primary Target (Budget Guidelines - LDO)	-247.1	-247.1	0.0
Spending Cap Margin	-0.3	2.8	-3.1

Sources: National Treasury, Santander.

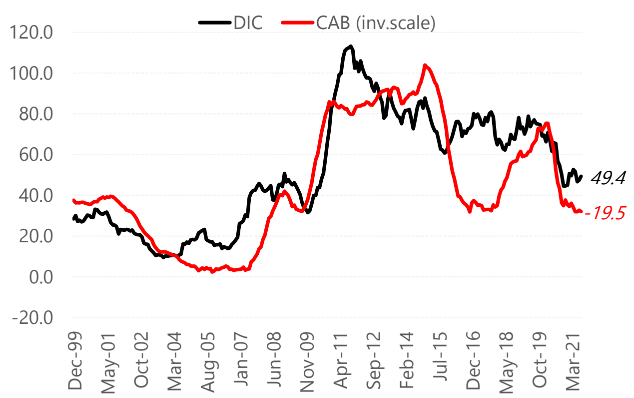
BALANCE OF PAYMENTS

We think the US$4.2 billion trade surplus that we forecast for this month should buttress the soundness of the Brazilian external position, despite the fluctuation the figure will bring—if confirmed—on a 12-month basis. The current account surplus was a bit worse than expected in August 2021 (US$1.6 billion vs. our forecast of US$2.6 billion), but the numbers still indicate that the Brazilian balance of payments remains fairly solid.

The US$1.6 billion surplus registered last month fell short of our estimate (US$2.6 billion surplus), which led to a US$19.5 billion deficit on a 12-month basis (1.2% of GDP). While the trade balance outcome in August 2021 fell short of what we expected (US$5.6 vs. US$6.1 billion), the US$1.6 billion deficit in the services account overcame what we calculated (US$1.4 billion deficit) and the US$2.6 billion deficit in the primary income came slightly stronger than what we thought (US$2.4 billion deficit). Regarding the latter, remittance of profits and dividends reached US$1.8 billion and net interest payments tallied US$0.8 billion, which compared with our estimates of US$1.4 billion and US$1.0 billion, respectively. In addition to current account figures, we also learnt that the volume of direct investments in the country amounted to US$4.5 billion last month, while foreign investments in financial assets reached US$1.2 billion in the same period. As a result, the country saw net inflows of US$49.4 billion and US$43.7 billion, respectively, on a 12-month basis, which is an indicative of the comfortable situation that Brazil bears as far as external funding sources are concerned. All in all, regardless of the outcome of August current account balance, we continue to see the Brazilian balance of payments absent of the list of markets' concerns.

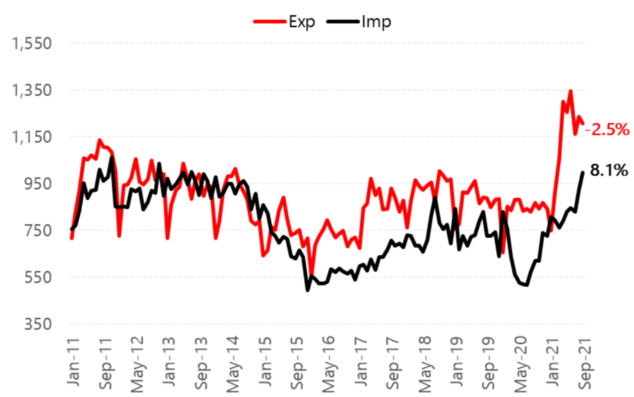
As one can perceive in the breakdown of August 2021 current account outcome, a robust performance in trade balance is key for favorable prospects regarding the balance of payments. That is what we expect the US$4.2 billion trade surplus to hint at in September 2021 (due on Friday, October 1), even though—if confirmed—our forecast implies a US$65.9 billion surplus on a 12-month basis, which means a pause in the upward trend seen in these terms. According to our calculations, the slowdown should stem from a substantial increase in import outlays, as we expect their daily average to expand 8.1% MoM-sa in the period, while exports daily average should decline 2.5% MoM-sa. Despite the drop, we see exports daily average (in seasonally adjusted terms) remaining at a relatively high level. On the other hand, as fertilizers account for the bulk of the expansion in import outlays and the Brazilian economy continue to recover in a gradual fashion, we believe the increase in import outlays may prove to be a temporary uptick. Therefore, we still expect trade balance to be supportive for the Brazilian external position.

Figure 8.A. – Current account balance vs. Direct investments in the country (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

Figure 8.B. – Exports vs. Imports (USD million, daily average, sa)



Sources: SECINT, Santander.

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