BRAZIL MACRO

June 25, 2021

MACRO COMPASS

A PACKED CALENDAR FOR THE WEEK

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- The BRL registered the second-best performance among major currencies in the rolling week ended June 24, gaining 1.9% vs the greenback with the USD/BRL pair reaching 4.91 at the end of the period. In our opinion, the move stemmed from the (even more) hawkish wording seen in documents released by the Brazilian Central Bank (BCB) in the last couple of days. The BCB signal also led the domestic yield curve to continue to flatten as compared with a week ago.
- In an eventful week for monetary policy (with Copom policy minutes, 2Q21 inflation report), we believe the BCB signaled a high probability for a faster pace of policy normalization, even as the authority forecasts a less fast GDP growth this year (vs. consensus). The monetary council announced the inflation target of 3.00% for 2024, keeping a gradual decline towards peer-levels.
- New COVID-19 infections continue to rise as Brazil surpassed a grim milestone with 500,000 casualties. The ICU occupancy rate is above 90% in seven states. The vaccination pace reached the mark of 1.3 million/day (above our baseline scenario) and we expect it to hold in the coming weeks.
- Our proprietary indicator (IGet) preview for June points to a deceleration of retail sales, but we still expect a quarterly expansion in 2Q21. Based on IGet, our tracking of broad retail sales for June stands at -2.1% MoM-sa. The consumer confidence index climbed by 6.2% in June, the third gain in a row, ending 2Q21 with quarterly growth of 3.4%.
- For the week, FGV will release next week the last batch of consolidated economic confidence data for June. Moreover, the May CAGED formal job survey is due on Monday (June 28), for which we expect a +71k net job creation (+189k sa, from +111.8k in April). On Wednesday (June 30), IBGE will release the PNAD household survey for April. We expect a 14.8% unemployment rate (14.5% sa, stable in comparison to March). IBGE will also release industrial production data for May on Friday (July 2), and we are looking for a monthly gain of 2.0% MoM-sa.
- The coming week is packed with fiscal policy publications. We expect another positive result from federal tax collection for May in the wake of the inflation effect and favorable impact from the terms of trade. In addition, the central government and consolidated public sector primary result releases are expected; both should reach a primary deficit close to BRL20 billion, according to our estimates.
- Besides the constructive signal provided by the US$3.8 billion surplus in the current account balance registered in May 2021, we believe the US$11.6 billion that we project for June 2021 trade data (due Thursday, July 1) should hint at another bold result of the Brazilian balance of payments this month.

Most of the information in this report is up to the end of Thursday, June 24, 2021.

Figure 1. Brazil Macro Agenda for the Week of Jun/28- Jul/02, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
New Loans (% MoM)	BCB	May/21	Mon, 28-Jun	2.0	1.5
Federal Debt Report (BRL billion)	STN	May/21	Mon, 28-Jun	--	**5.1**
Industrial Confidence (index)	FGV	Jun/21	Mon, 28-Jun	--	104.2
Formal Job Creation (thousands, nsa)	**CAGED**	**May/21**	**Mon, 28-Jun**	**71.0**	**120.9**
Formal Job Creation (thousands, sa)	**CAGED**	**May/21**	**Mon, 28-Jun**	**188.9**	**111.8**
IGP-M Inflation (% MoM)	FGV	Jun/21	Tue, 29-Jun	0.92	4.10
IGP-M Inflation (% YoY)	FGV	Jun/21	Tue, 29-Jun	36.18	37.04
Services Confidence (Index)	FGV	Jun/21	Tue, 29-Jun	--	88.1
Retail Confidence (index)	FGV	Jun/21	Tue, 29-Jun	--	93.9
Central Gov. Primary Balance (BRL billion)	STN	May/21	Tue, 29-Jun	-22.4	16.5
Nominal Budget Balance (BRL billion)	BCB	May/21	Wed, 30-Jun	--	**30.0**
Primary Budget Balance (BRL billion)	BCB	May/21	Wed, 30-Jun	-18.4	24.3
Net Debt (% GDP)	BCB	May21	Wed, 30-Jun	61.2	60.5
National Unemployment Rate (%, nsa)	**IBGE**	**Apr/21**	**Wed, 30-Jun**	**14.8**	**14.7**
National Unemployment Rate (%, sa)	**IBGE**	**Apr/21**	**Wed, 30-Jun**	**14.5**	**14.5**
Aggregated Business Confidence	FGV	Jun/21	Thu, 01-Jul	--	97.7
Trade Balance (USD billion)	SECINT	Jun/21	Thu, 01-Jul	11.6	9.3
Vehicle Sales (thousands)	Fenabrave	Jun/21	Thu, 01-Jul	--	188.7
Industrial Production (% YoY)	**IBGE**	**May/21**	**Fri, 02-Jul**	**29.9**	**34.7**
Industrial Production (% MoM)	**IBGE**	**May/21**	**Fri, 02-Jul**	**2.0**	**-1.3**

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

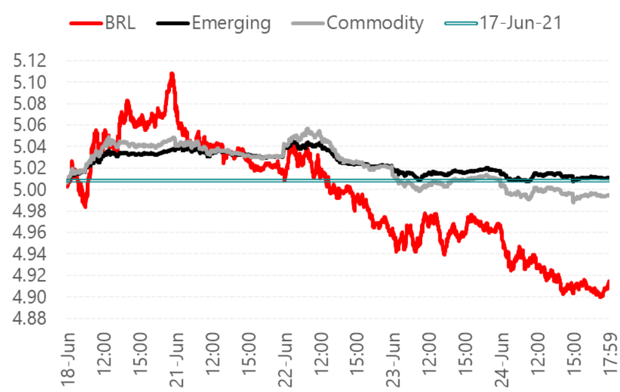
LOCAL MARKETS—FX

The BCB conveyed more hawkish signals in the last couple of days that helped the USD/BRL to breach the 5.00 threshold, thus reinforcing our view that the monetary policy should lead the BRL to strengthen in the short-term. The wording seen in the minutes of the last Copom meeting and in the quarterly inflation report (more details in the Monetary Policy Section) was a key driver for the currency. As we stated in our macroeconomic scenario review carried out last May (see details in the link[2]), the tighter monetary grip coupled with the (perceived) lower risks on the fiscal front should continue to exert a strengthening influence on the BRL in the short-run. However, we continue to expect discussions regarding the budget for 2022 and the proximity of presidential elections to limit the room for that strengthening over the medium run.

LOCAL MARKETS—Rates

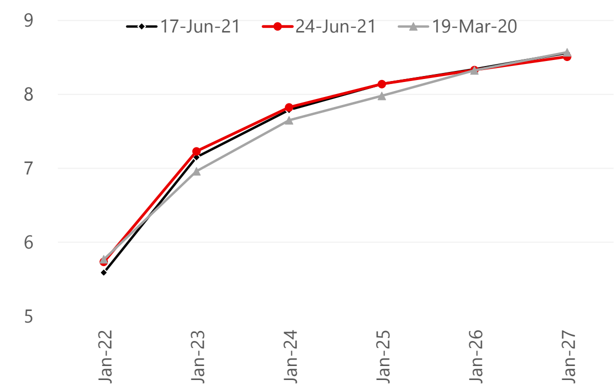
The nominal yield curve flattened for the sixth week in a row, with the slope reaching the lowest level since the pandemic began. Since last Thursday (June 17), the front end (Jan-22 DI future) rose 15 bps, to 5.74%, while the back end (Jan-27 DI future) fell 5 bps, to 8.51%. Hence, the curve's steepness in this segment fell 20 bps, reaching 278 bps – the flattest reading since March 19, 2020. The front end continues to move higher, with the Copom minutes this week seen as even more hawkish than the statement, signaling a faster removal of policy accommodation by the BCB (see details in the Monetary Policy section). At the long end, the market seems to remain anchored on the optimistic conjectures about the fiscal policy outlook, which we continue to see as a short-lived development.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, June 24, 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, June 24, 2021.

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

COVID-19 MONITORING

Brazil's vaccination pace picks up to nearly 1.3 million/day. We expect the pace of vaccination to hold above our baseline scenario of one million doses administered a day as vaccine inventories remain high (39 million doses) and deliveries outpace vaccine administration. Meanwhile, the U.S. shipped on Thursday (June 24) 3 million doses of the Johnson & Johnson vaccine to Brazil as part of the 80 million dose donation plan from the White House.

New COVID-19 infections continue to rise as Brazil surpassed a grim milestone with 500,000 casualties. On Wednesday (June 24), new cases hit single-day record of 115k. The ICU occupancy rate is above 90% in seven states, a decrease from nine last week (18 states in the worst phase). Data from Brazil's Health Ministry showed an average of 77.3k new daily cases (7-day moving average) as of Wednesday (June 23), up 7.0% from last week, while daily casualties (7-day moving average) totaled 1,916, down 5.3% in the same comparison. See details in the link[3].

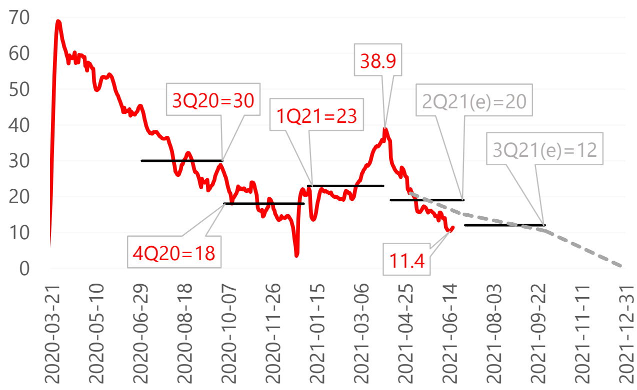
Mobility keeps improving, but at a slower pace. After starting the quarter at high readings, close to the level in June 2020 (~40 points, 7-day average), our lockdown index (using Google Mobility Report data) posted a consistent downward trend in the last few months, reaching 11.4 points (as of June 18, 2021). This improvement stemmed mainly from mobility increases in the Workplace (which already stands at pre-pandemic marks) and Transit Station segments, which suggests a close link to economic activities, and this recovery path bodes well for economic activity in 2Q21.

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 the start of 2Q21, showing an upward trend in recent months. On monthly basis, adjusted for seasonality, the index expanded by 6.1% and 4.7% in April and May, respectively. For June, considering the available data (up to the 18th), the index has climbed to 4.4%, not enough to fully offset March's retreat (-15.7%), placing the index at readings still 2.2% below February-21.

Figure 3.A. – Vaccination by Age and Gender (June 21, 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 June 18, 2021.

[3] **Santander Brazil – Covid Monitor – June 22, 2021- Available on: https://bit.ly/Std-COVID-220621**

MONETARY POLICY

In an eventful week for monetary policy (with Copom policy minutes, 2Q21 inflation report), we believe the BCB signaled a high probability for a faster pace of policy normalization, even as the authority forecasts less rapid GDP growth this year (vs. consensus). The monetary council announced the inflation target of 3.00% for 2024, keeping a gradual decline towards peer-levels.

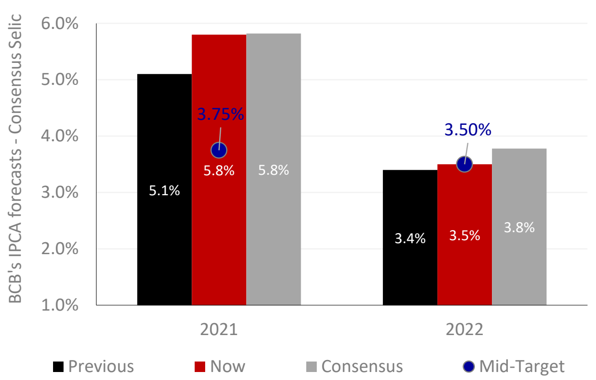
The BCB published the minutes from its Jun 15-16 COPOM policy meeting, when the authority raised the Selic rate by 75 bps (for a third time in a row) to 4.25% p.a. Overall, the BCB struck a more hawkish tone, even compared to the policy statement. The Committee clarified that it considered a bolder move (i.e., a 100-bp hike) for the June meeting—signaling an inclination to step up the pace, conditional on services trends and inflation expectations—and showed greater flexibility and willingness to do whatever it takes to curb the second-round effects of ongoing inflation shocks. In our view, the BCB took the opportunity to emphasize its policy flexibility (despite the transparency about pre-communicating its intended policy steps) and reinforcing its commitment to bringing inflation back to mid-target next year. See details in the link[4].

The BCB also published the 2Q21 inflation report, shedding more light on the authority's macroeconomic forecasts and policy discussions. Despite the less bullish GDP projections by the BCB, as compared to the street, we sense the inflation report did not strike a much different tone compared to the minutes.

In a separate event, the CMN (National Monetary Council, in Portuguese acronym) announced the (IPCA) inflation targets for the next three years, with the novelty being the decision for 2024, as the council decided to set it at 3.0%, with the very same tolerance band of 1.5 p.p. either way. By keeping a reduction of 0.25 p.p. per year (2022 target was reaffirmed at 3.50%; for 2023, 3.25%), Brazil will now have a similar target as some EM peers, which is a welcome objective. While the high BCB credibility should help to consistently achieve these targets, additional fiscal reforms (on the spending side) will probably be necessary for the maintenance of such low inflation levels in the long run. See details in the link[5].

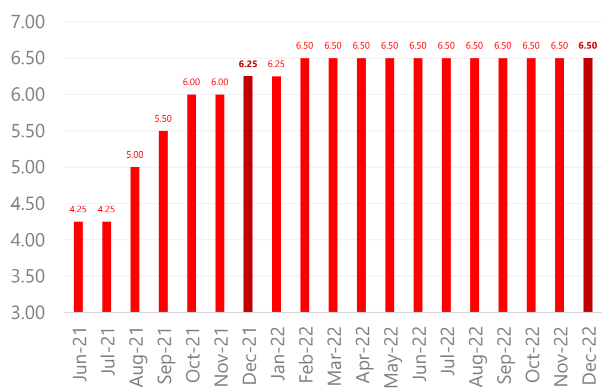
We continue to see increased probability of faster hikes for the upcoming Copom meetings, with risks tilted towards a much-sooner policy normalization. We project a Selic rate of 6.50% at 2021YE and 7.00% early in 1Q22. We also see greater probability that the BCB chooses to take a slightly tight policy stance at some point (meaning a Selic slightly higher than neutral).

Figure 4.A. – BCB's Inflation Simulations



Sources: Brazilian Central Bank, Santander.
Note: Selic from Focus survey; USD/BRL at 5.05, evolving with PPP.

Figure 4.B. – Consensus Selic Rate Forecasts



Sources: Brazilian Central Bank, Santander.
Note: Based on the BCB's weekly Focus survey as of June 11, 2021.

[4] **Santander Brazil Monetary Policy - *"Whatever It Takes"* –** June 22, 2021 – Available on: https://bit.ly/Std-Copom-min-jun21
[5] **Santander Brazil Monetary Policy - *"BCB still poised to speed up hikes (…)"* –** June 24, 2021 – Available on: https://bit.ly/Std-Inflation-Rep-2q21

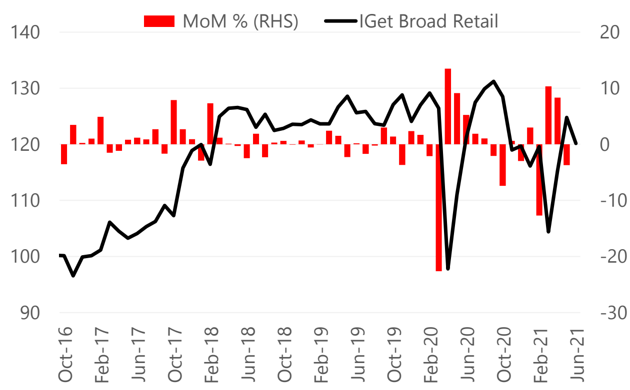
ECONOMIC ACTIVITY

Broad retail sales slow in June but rise in 2Q21. According to our proprietary indicator (IGet) preview, broad retail sales retreated in June (-3.7%), after two gains in a row following March's tumble. Based on IGet, our tracking for broad retail sales currently stands at +6.6% and -2.1% for May and June, respectively, implying a quarterly climb of 5.1% and fully erasing the first quarter's losses (-3.6%). This quarterly growth, along with the expansion seen for services to families (anticipated by IGet Services), reinforces our view that the tertiary sector will play an important role in 2Q21 economic activity, albeit dragged by the industry and agricultural sector. See details in the link[6] [7].

Consumer confidence expands in 2Q21, but not enough to fully give back the first quarter's tumble. According to FGV, consumer confidence expanded in June (up by 6.2%), stemming both from the current situation component (up by 4.2%) and the expectation component (up by 7.2%). June's figure was the third gain in a row, placing the headline index at the highest reading since November-2020 on the heels of mobility increase and the payment of the new round of emergency aid. In quarterly terms, the consumer confidence ended 2Q21 climbing by 3.4%, but not enough to fully give back the first quarter's tumble (-8.5%).

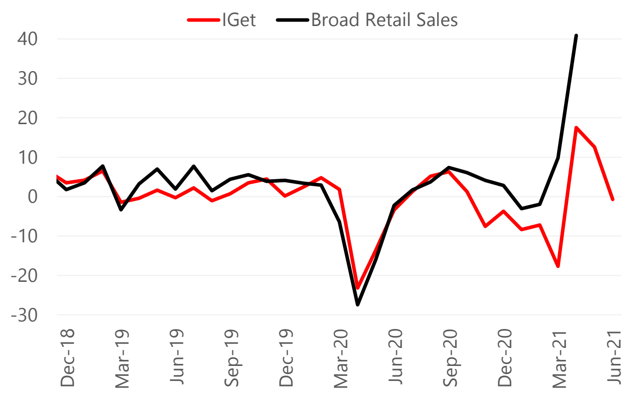
Looking ahead, the IBGE will release industrial production data for May on Friday (July 2). We are looking for a monthly gain of 2.0% MoM-sa, breaking a string of three declines but not enough to offset the almost 5% of contraction accumulated since February-2021. Moreover, FGV will release next week the last batch of consolidated economic confidence data for June: industrial confidence is due on Wednesday (June 28), while aggregated business confidence is due on Thursday (July 1). Regarding labor market data, the May CAGED formal job survey is due on Monday (June 28), for which we expect a +71k net job creation. Our preliminary seasonal adjustment points to +189k, an acceleration from April's revised result of +111.8k. On Wednesday (June 30), IBGE will release the PNAD household survey for April. We expect a 14.8% unemployment rate which, according to our preliminary seasonal adjustment, would represent stability at 14.5% in comparison to March. **For details on Santander's activity outlook, please refer to our last chartbook[8].**

Figure 5.A. – IGet Broad Retail (sa, 2016=100)



Sources: Santander.

Figure 5.B. – IGet x Broad Retail Sales (nsa, YoY%)



Sources: IBGE, Santander.

[6] **Santander Brazil Economic Activity - *"Varejo Desacelera no Final do Trimestre"* –** June 21, 2021 – Available (in Portuguese) on: https://bit.ly/Std-IGET-p-jun21
[7] **Santander Brazil Economic Activity - *"Serviços Seguem Mostrando Crescimento"* –** June 17, 2021 – Available (in Portuguese) on: https://bit.ly/Std-IGETser-previa-jun-21
[8] **Santander Brazil Economic Activity - *"Chartbook – Positive Surprises with Risks On The Upside"* –** May 25, 2021 - Available on: http://bit.ly/Std-chart-econact-may21

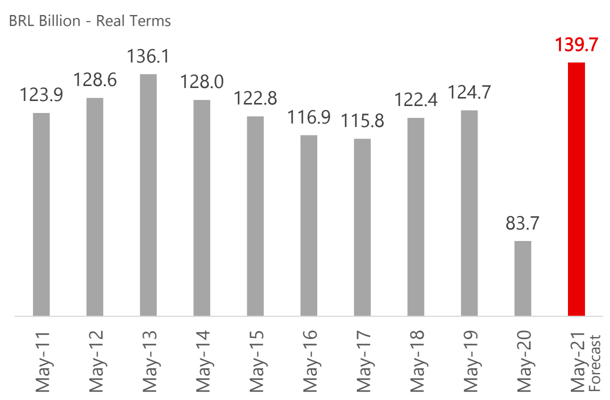
FISCAL

The coming week is packed with fiscal policy publications. In the next few days (no date set) the release of federal tax collection data for May is expected by the Federal Revenue of Brazil. We expect another robust result with a monthly record in real terms, in line with the recent monthly trend, driven by the effects of higher inflation (margin recovery by companies), favorable terms-of-trade, and a depreciated FX level (with higher revenues for commodity-exporting companies and higher value of import-related taxes). In May, we expect a higher collection of the annual Individual Income Tax (IRPF, in the Portuguese acronym) since May was the last month for paying this tax, while in 2020 it was until June. Our forecast is BRL137.9 billion, which represents a real rise of 67%YoY; it is worth noting that May 2020 was the worst result for tax collection due to the pandemic impact, representing a low basis of comparison. In turn, compared with the result of May 2019, the increase will be 12% in real terms. For 2021, we recently revised our forecast to ~12.0% YoY real growth, due to the more intense inflationary effect and the commodity boom. See details in the link[9].

On June 28 (Monday), the National Treasury will publish the Monthly Debt Report for May, which will unveil data regarding debt issuances, debt costs, the liquidity reserves, among others. On June 29 (Tuesday), the fiscal authority is expected to publish the central government primary deficit of May. We expect a deficit of BRL22.4 billion in the month, on the heels of the positive result of tax collection, refunds to the Treasury of irregular payments of 2020 Emergency Aid and also the return of resources from the Pronampe 2020 program (credit support for SMEs). On the expenditure side, we anticipate Covid-19 related disbursements of BRL16.1 billion in the month. In our view, discretionary spending should have remained at low levels, despite the budget approval in April; disbursements are still contained due to the fact that some public services are still being affected by pandemic restrictions. For the coming months, we expect expenditures to accelerate (budget approval, pension bonus payments, etc.), and some moderation in the pace of revenue growth. On June 30 (Wednesday), the BCB will publish the consolidated public sector's fiscal balance for May 2021, which encompasses the federal government, regional governments and state-owned companies. We anticipate a primary deficit of BRL18.4 billion.

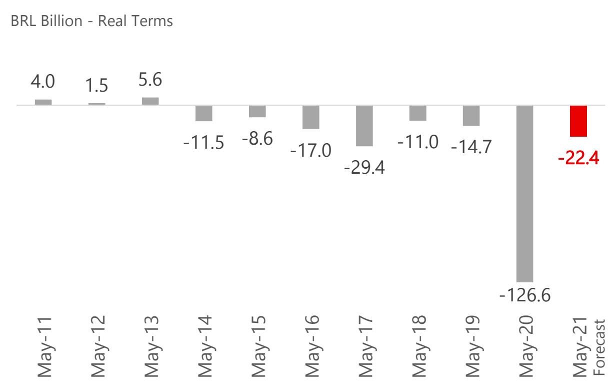
The Lower House approved the Voluntary Deposits legislation (PL 3877/2020) by 425 votes. The text now goes to presidential sanction. The idea is to allow the central bank to collect excess liquidity reserves (with similar repo remuneration) and reduce repo operations (adding to 15.6% of GDP), which increases the country's gross debt, as they are backed by government bonds. In our view, the impact of reducing the Central Bank gross debt statistic will be limited. The maximum of the repo operations related to Banks are close to 5-6% of GDP, yet not all of this amount should be turned on voluntary deposits, in our view. Our preliminary estimate is a gradual 1.0 to 1.5pp in reduction in the gross to debt-to-GDP ratio.

Figure 6.A. – Federal Tax Collection - May



Sources: Federal Revenue of Brazil, Santander.

Figure 6.B. – Central Gov. Primary Result - May



Sources: National Treasury, Santander.

[9] **Santander Brazil Fiscal Policy - *"Fiscal Accounts: Pandemic Impact, Price Shock Contribution, and Outlook"* –** June 15, 2021 - Available on: http://bit.ly/Std-special-fiscal-061521

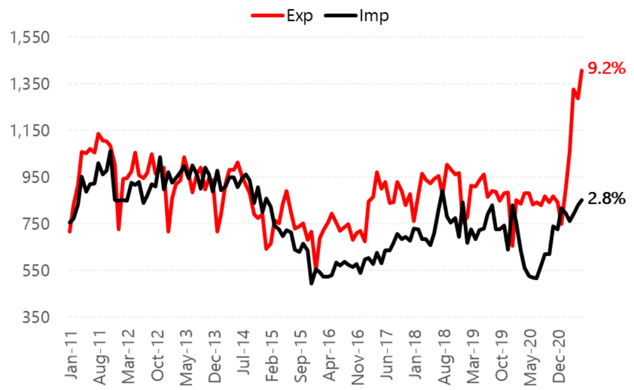
TRADE BALANCE

We expect June trade balance to register a US$11.6 billion surplus, which should contribute to the current account balance this month recording another sizeable surplus (as occurred in May) and allowing the Brazilian economy to continue to boast a solid external position.

According to our calculations, we project June trade data due on Thursday (July 1) to unveil an US$11.6 billion surplus, which, if confirmed, will translate into a US$67.2 billion surplus on a 12M-to-date basis from a US$39.9 billion surplus a year ago. In our view, the outcome should stem from a substantial increase in exports coupled with a more modest expansion in imports, which should reflect the positive shock we have witnessed in the Brazilian terms of trade and its gradual economic recovery. We calculate the daily average export revenue should increase 9.2% MoM on a seasonally adjusted basis, while the daily average import outlay should expand 2.8% on the same basis.

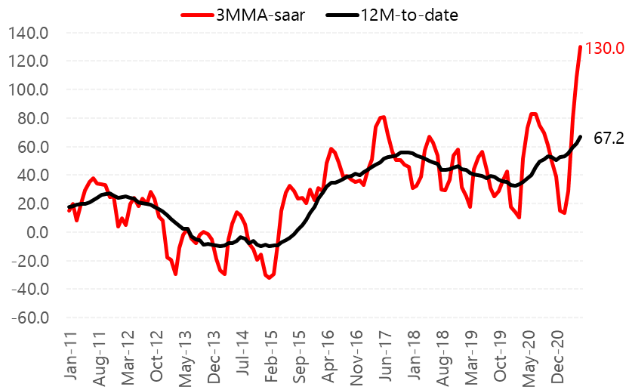
What's more, besides indicating the sound recovery that the trade balance has registered recently, these figures will be compatible with a US$130.0 billion surplus on an annualized basis if we take into account their seasonally adjusted averages of the last three months. The level is higher than our forecast for an US$85.3 billion surplus in 2021, but it is important to note that the seasonal pattern of exports is unfavorable in the second half of any given year. Thus, some retreat in the 3MMA-saar gauge is already contemplated in our forecast. However, it does not change the fact that the Brazilian external position should remain fairly robust for more than a while.

Figure 7.A. – Trade Balance (US$ million/working day, sa)



Sources: SECINT, Santander.

Figure 7.B. – Trade Balance (US$ billion)



Sources: SECINT, Santander.

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