BRAZIL MACRO

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MACRO COMPASS

GRADUAL IMPROVEMENT IN THE JOB MARKET

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- With a relatively muted news cycle on the domestic front and higher volatility in global markets, the BRL reaffirmed its high-beta pattern being the worst performer among major currencies in the rolling week ending July 22. The softening of commodity prices and a rally in global rates prompted both the front and the back end of local yields to shift downward in the same period.
- Our proxy for a nationwide average of ICU occupancy continues to decline, now reaching close to 62%, the lowest level since early February, which compares to a peak of 92% in March. The vaccination rate continues to hold up at around 1.2-1.3 million/day on average, reaffirming a positive outlook for the control of the pandemic and the reopening of the economy in 2H21, in our view.
- Federal tax collection continued to recover in June, but we note some signs of softening. The Ministry of Economy published the official fiscal forecasts for 2021, showing a new reduction in the primary deficit estimate (to 1.8% of GDP). The coming week is packed with fiscal policy data releases for June: we expect a hefty primary deficit (above BRL60 billion) on the heels of higher expenditures.
- According to our proprietary indicator (IGet) preview, segments of the tertiary sector kept improving at the start of 3Q21, likely reflecting the increase in mobility and the new round of fiscal stimulus. Our tracking for broad retail sales and services to families in July stands at 1.8% MoM-sa and 1.9% MoM-sa, respectively.
- July's IPCA-15 registered a 0.72% MoM change (8.59% YoY), above the market's median expectation of 0.65% and our estimate of 0.61%. On average, the core inflation trend accelerated to 7.4% in 3mma-saar terms, showing that upward inflation pressure remains quite strong. With underlying prices trending well above the BCB's target, and with services costs notably picking up, we see a greater likelihood of a 100-bp Selic hike in August COPOM (as per our call).
- We expect the constructive market perception (including ours) about the soundness of the Brazilian balance of payments to be reinforced by the June data, due on July 27 (next Tuesday). We look for a current account surplus of US$3.0 billion, together with net (positive) inflows for both direct and portfolio investments.
- Another batch of labor market data is due out next week, with the numbers likely pointing to further progress on the path to recovery. On Wednesday (July 28), the Ministry of Economy will release the June CAGED net formal job creation data, for which we expect +267.6k (+322k sa). On Friday (July 30), the IBGE will release the May PNAD household survey: we expect the unemployment rate to stand at 14.4% (14.2% sa, -0.2 p.p. from April). Additionally, FGV will release some economic confidence numbers for July: consumer confidence is due on Monday (July 26), while industrial confidence is due on Wednesday (July 28).

Most of the information in this report is up to the end of Thursday, July 22, 2021.

Figure 1. Brazil Macro Agenda for the Week of July 26-30, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Consumer Confidence (index)	FGV	Jul/21	Mon, 26-Jul	--	80.9
Construction Confidence (index)	FGV	Jul/21	Tue, 27-Jul	--	92.4
Current Account Balance (USD billion)	BCB	Jun/21	Tue, 27-Jul	3.0	3.8
Foreign Direct Investment (USD billion)	BCB	Jun/21	Tue, 27-Jul	2.5	1.2
Industrial Confidence (index)	FGV	Jul/21	Wed, 28-Jul	--	107.6
Total Outstanding Loans (% YoY)	BCB	Jun/21	Wed, 28-Jul	17.0	16.2
Formal Job Creation (thousands, nsa)	**CAGED**	**Jun/21**	**Wed, 28-Jul**	**267.6**	**280.7**
Formal Job Creation (thousands, sa)	**CAGED**	**Jun/21**	**Wed, 28-Jul**	**322.0**	**262.5**
Federal Debt Report (BRL billion)	STN	Jun/21	Wed, 28-Jul	--	5.2
IGP-M Inflation (% MoM)	FGV	Jun/21	Thu, 29-Jul	1.13	0.6
IGP-M Inflation (% YoY)	FGV	Jun/21	Thu, 29-Jul	34.28	35.75
Retail Confidence (index)	FGV	Jul/21	Thu, 29-Jul	--	95.9
Services Confidence (Index)	FGV	Jul/21	Thu, 29-Jul	--	93.8
Central Gov. Prim. Balance (BRL billion)	STN	Jun/21	Thu, 29-Jul	-67.9	-20.9
Primary Budget Balance (BRL billion)	BCB	Jun/21	Fri,30-Jul	-64.2	-15.5
Nominal Budget Balance (BRL billion)	BCB	Jun/21	Fri,30-Jul	--	-37.4
National Unemployment Rate (%, nsa)	**IBGE**	**May/21**	**Fri,30-Jul**	**14.4**	**14.7**
National Unemployment Rate (%, sa)	**IBGE**	**May/21**	**Fri,30-Jul**	**14.2**	**14.4**
Net Debt (% GDP)	BCB	Jun/21	Fri,30-Jul	60.6	59.7

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario:** ***"Improvement in The Short Term, Caution for The Medium Term"*** **–** Jul 01, 2021- Available on: http://bit.ly/Std-scenrev-070121

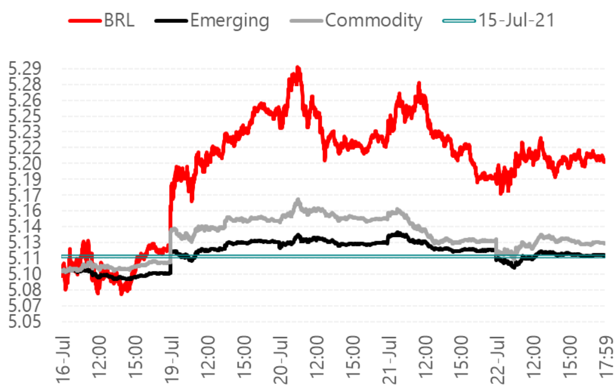
LOCAL MARKETS—FX

The USD/BRL pair climbed to 5.20 in the rolling week ended July 22 (a 1.8% loss in the period), thus being the worst performer among major currencies and underlining its high-beta nature. In our view, the domestic news cycle in the last several days has been relatively muted, given the empty macro calendar in recent days and a pause in Congressional activities amid a parliamentary recess. Therefore, it seems to us that the bulk of the price dynamics of domestic financial assets had to do with international conditions. Among them, we can point to the negative knee-jerk reaction to the agreement reached by the OPEC+ members that impacted oil prices negatively and triggered some risk-off behavior in global markets. Additionally, the increase in the dissemination of the Delta variant of the COVID-19 around the globe also renewed concerns and contributed to the risk-off seen at the beginning of the week. These factors provoked a general increase in the volatility of financial asset prices, which impacted currencies worldwide. However, the BRL was the one currency that suffered the most from these jitters, thus underlining its high-beta nature, which we think is somewhat related to its idiosyncratic issues (read: fiscal and political uncertainties).

LOCAL MARKETS—Rates

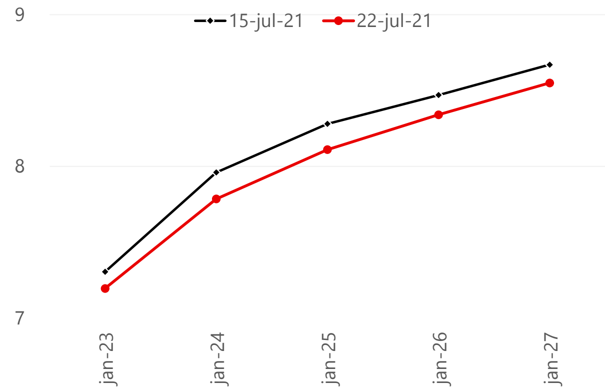
The nominal yield curve downshifted nearly in parallel in the last five business days, with the steepness staying basically stable. Since last Thursday (July 15), the front end of the curve (Jan-23 DI future) fell 11 bps to 7.19%, while the back end of the curve (Jan-27 future) fell 12 bps, to 8.55%. As a result, the curve's steepness in this segment fell just 1 bp to 136 bps. After OPEC's agreement to boost oil output on Sunday (July 8), the oil price had a sharp drop of 7% on Monday (July 9) that also drove other commodities to fall. In our opinion, this was the main driver for the decline in domestic short-end yields, as there were no important economic releases or any recent new BCB's communication. Indeed, the market is now pricing in a higher probability of a 75 bps Selic hike at the next COPOM meeting, outpacing the scenario of a 100 bps hike; the options market shows a 61% probability of a 75 bps hike (from 45% last Thursday, July 15), while the 100 bps hike now has just a 38% probability (from 54% last week). We continue to project that the BCB will decide on a 100 bps hike, as underlying inflation shows continued upward pressure with signs of the spread of primary shocks to general prices, therefore demanding a more hawkish approach by the BCB, with a quicker normalization of the interest rate. At the long end, the domestic long-end yield fell a bit, in line with the rally seen in longer US Treasury yields. A perceived reduction of political frictions could also have added to this movement.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, July 22, 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, July 22, 2021.

COVID-19 MONITORING

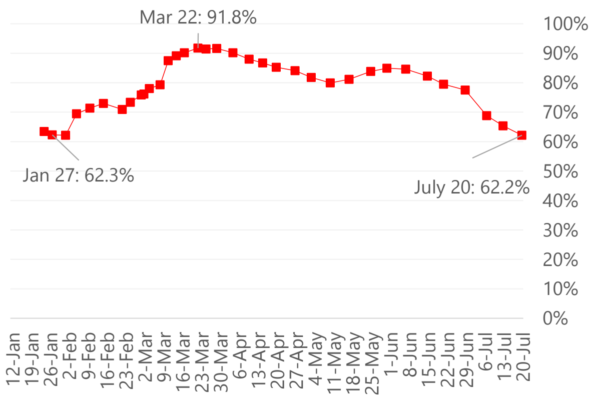
Brazil's vaccination pace remains around 1.2-1.3 million/day on average. We expect the daily average pace of vaccinations to stand at 1.5 million doses in 2H21, as vaccine inventories remain high (35 million doses) and deliveries are expected to remain above the levels of vaccine administration. On Monday (July 19), Pfizer announced it expects to deliver 1 million doses a day until August 1. It also reaffirmed its commitment to deliver 100 million doses by the end of September.

Our proxy for a nationwide average ICU occupancy rate[2] continues to decline, now reaching close to 62%, the lowest level since early February. That number compares to a previous peak of 92% (late March). As the pandemic gradually eases, we believe local governments will probably continue to lift restrictions further. Data from Brazil's Health Ministry showed an average of 38k new daily cases (7-day moving average) as of Wednesday (July 21), down 12% from last week, while daily casualties (7-day moving average) stood at 1,172, down 7% in the same period. See details in the link.[3]

Mobility continues to increase in 3Q21. The second week of July indicated an increase in mobility levels, with our lockdown index now moving to 4.4 points (as of July 20, 2021) from 6.9 points (as of July 8, 2021). If we exclude the 2020 Christmas period (December 22 to 24), this is the lowest level of our lockdown index since the pandemic began. This move stems from a mobility increase in all the main categories, with Retail as the highlight since our last update and Workplaces already returning to the pre-pandemic levels.

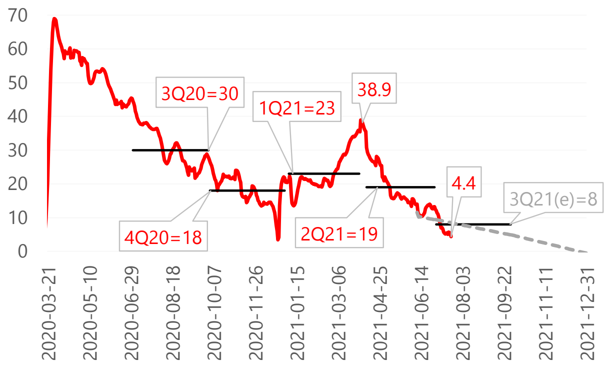
Our daily activity index started 3Q21 at a slower pace. The index—based on daily data on energy consumption, car sales, and mobility—has been improving since the start of 2Q21, showing an upward trend in recent months. On a monthly basis adjusted for seasonality, the index expanded by 5.6%, 3.0% and 4.2% in April, May and June, respectively. For July, considering a still-limited dataset (daily average up to the 20th), the index points to a drop of 1.4%-sa, placing the index about 5.0% below the mark of February 2021.

Figure 3.A. – Nationwide Average ICU Occupancy Proxy (%)



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 July 20, 2021.

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[2] The nationwide average proxy is a weighted average (by state population) of state ICU occupancy rates. Hence, it does not reflect the actual national occupancy rate = Total beds occupied in Brazil / Total beds available in Brazil.
[3] **Santander Brazil Covid Monitor –** July 22, 2021 - Available on: https://bit.ly/Std-COVID-220721

FISCAL POLICY AND POLITICS

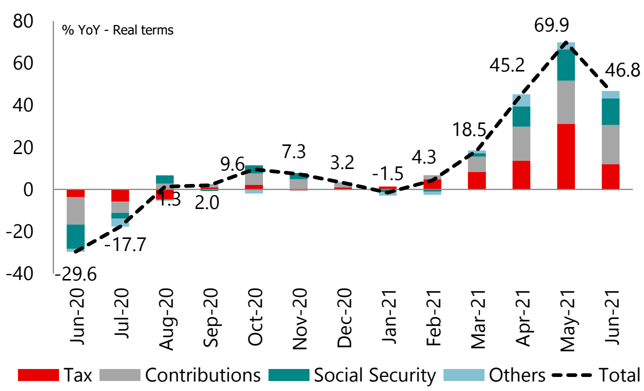
In June, federal tax collection continued to recover, but we expect a softening in coming months. On July 21, according to data published by the Brazilian Internal Revenue Service (IRS), tax collection reached BRL137.1 billion (or +46.8% YoY real), slightly lower than our forecast (BRL141.2 billion) and the market's expectation (BRL140 billion). In the year, it was the first downside surprise. The June result was the best result for the month since 2011. Compared with June 2019, the increase was +3.3% YoY. In YTD real terms, the increase is 24.5% YoY and 6.2% compared to 2019. The 2021 values are an all-time high, "helped" by extraordinary revenues (BRL20 billion), mostly related to M&A, IPO, and corporate restructuring. The impact of inflation and terms of trade on revenues continues to prevail. In the breakdown, we see robust tax collection by companies +34.5% YoY. In addition, we observed a recovery in royalties (mainly from oil exploration) with a real increase of +26.8% in 2021. In the coming months, we expect positive results, yet with some softening in tax revenue growth. For 2021, we forecast a ~12.0% YoY real growth.

On June 19, President Bolsonaro suggested that the average monthly benefit of the new welfare program (replacing *Bolsa Familia*) will be raised by around 50%, from BRL196 to BRL 300. It is worth mentioning that administration's maximum budget room (subjected in the spending cap constitutional rule) for a revamped welfare program in 2022 is ~BRL30 billion in 2022 (i.e., the welfare program could reach BRL65 billion, compared to the 2021 *Bolsa Familia* budget of BRL35 billion), according to our estimates. In the end, we anticipate a new average benefit ~BRL 270/month to 17 million beneficiaries (from 14 million of *Bolsa Familia*), totaling BRL55 billion/year. The new welfare program needs to be approved by Congress and enacted by December, given that increases in this type of expenditure are legally forbidden in election years.

On July 22, the Ministry of Economy published its third bimonthly review of budget 2021. The official forecasts continued to show an improvement in fiscal outlook this year, mainly due to higher revenue forecasts, considering the rise in oil revenues (royalties) and new forecasts for inflation (IGP-M: 17.4%, +2.2p.p) and GDP growth (5.3%, +1.8p.p). On revenue side, the government increased the net revenues forecast in BRL43 billion. On the expenditure side, the government expects a total of extra-cap expenditures of BRL124.9 billion (+BRL25 billion compared to May projection). In light of this, the central government's primary deficit forecast decreased to BRL155.4 billion (1.8% of GDP), from BRL187.7 billion in the last report (May). We continue to anticipate a deficit of BRL195 billion in 2021 (2.3% of GDP).

The coming week is packed with fiscal policy publications. On July 28, the National Treasury will publish the Monthly Debt Report for June. On July 29, the Treasury is expected to publish the central government primary deficit of June: we expect a deficit of BRL67.9 billion, on the heels of: (i) anticipation of year-end bonuses for pensioners (~BRL22 billion); (ii) payment of judicial claims (~BRL20 billion); (iii) extraordinary budget related to the pandemic (BRL12.8 billion); and higher discretionary expenses (BRL10 billion). On July 30, the BCB will publish the consolidated public sector's fiscal balance for June. We anticipate a primary deficit of BRL64.2 billion.

Figure 4.A. – Federal Tax Collection



Sources: Brazilian Internal Revenue Service, Santander.

Figure 4.B. – New Welfare Program Yearly Budget

Expenses in BRL billion					
	Monthly Benefit (BRL)				
Millions of Families	190	250	270	300	350
23	52.4	69.0	74.5	82.8	96.6
21	47.9	63.0	68.0	75.6	88.2
19	43.3	57.0	61.6	68.4	79.8
17	38.8	51.0	55.1	61.2	71.4
15	34.2	45.0	48.6	54.0	63.0
13	29.6	39.0	42.1	46.8	54.6
11	25.1	33.0	35.6	39.6	46.2

2020 Budget: BRL 30 billion | 2021: BRL35 billion
Maximum limit for 2022 subjected to the spending cap:
(2021 Budget: BRL35 billion + Fiscal margin: BRL30 billion)
In green = current situation | In red: possible outcomes

Sources: National Treasury, Santander.

INFLATION

July's IPCA-15 registered a 0.72% MoM change (8.59% YoY), above the market's median expectation of 0.65% and our call of 0.61%. The headline trend accelerated to 10.1% in 3mma-saar terms, showing that the upward pressure at the margin remains strong.

Qualitative measures were, once again, notably unfavorable, with core trends and diffusion index still under increasing (upward) pressures. The average of core measures advanced from the already-high level of 6.2% to 7.4% in 3mma-saar terms. The cores have been hovering above 4.5% for nine months, a notably high level that in our view is a sign of a spreading of the primary shocks to general prices. Also in that regard, the diffusion index (seasonally adjusted, as per our own calculation)—a leading indicator for annual headline inflation—stood at 64.8%, a reading we see as compatible with IPCA around 8.0% YoY a few months from now. The latter is based on the historical relationship between the diffusion index and headline CPI, which reinforces the risk of the spreading of primary shocks to general prices.

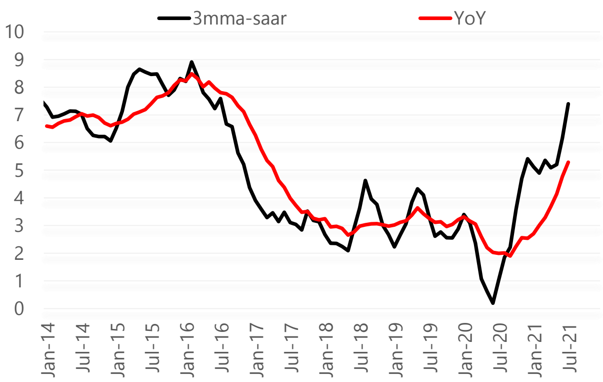
All in all, with the last COPOM minutes showing that the BCB is likely to pay even more attention to underlying inflation numbers (especially services trends) when it comes to deciding on adjustments in the interest rate, we believe the July IPCA-15 report bolsters the likelihood of a 100-bp hike in the Selic rate at August's policy COPOM meeting, per our forecast.

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

	MoM			YoY	
	Jul-21	Santander	Contr.	Jun-21	Jul-21
IPCA-15	0.72	0.61	0.11	8.1	8.6
Administered	0.90	0.96	-0.02	13.3	12.9
Free	0.65	0.48	0.13	6.4	7.1
Food-at-home	0.47	0.41	0.01	14.5	15.3
Industrial goods	0.69	0.58	0.02	8.3	9.0
Services	0.71	0.45	0.09	2.2	2.9
EX3 Core	0.65	0.51	0.14	4.9	5.6
Average of cores	0.60	-	-	4.8	5.3

Sources: IBGE, Santander.

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



Sources: IBGE, Santander.

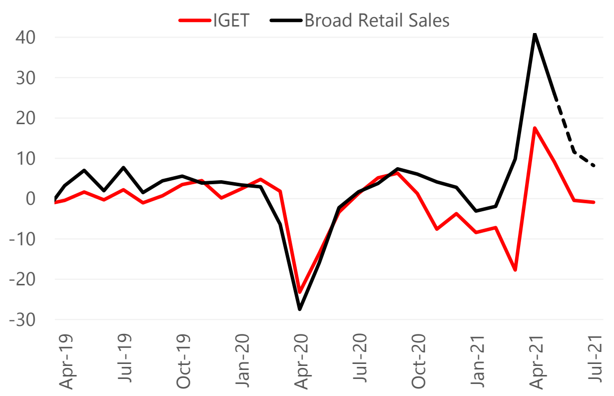
ECONOMIC ACTIVITY

Retail activity is set for a positive start in 3Q21. According to our proprietary indicator (IGet) preview, July's retail activity should keep improving: our broad index increased 3.1% MoM-sa this month, the fourth gain in a row, while our core index (which excludes building material and vehicle sales) climbed 4.0%. July's broad figure highlights an acceleration over June (1.0% growth) and places the index at the highest reading since October 2020. Regarding our expectations for official releases, our tracking for broad and core retail sales in June stands at -2.0% MoM-sa (11.6% YoY) and +0.7% MoM-sa (8.9% YoY), respectively. Indeed, according to Fenabrave, light vehicles sales retreated in June, which reinforces our view. For July, our tracking for broad retail sales points to an expansion of 1.8% (8.2% YoY), while our expectations for core retail sales point to near stability, -0.1% MoM-sa (5.5% YoY). See details in the link[4].

Services to families keep improving amid the increase in mobility. According to July's preview, IGet Services climbed 11.8%, the fourth gain in a row and highlighting an acceleration over June (1.5% growth) on the heels of an increase in mobility. July's figure places the index at the highest reading since February-2020, running 9% below the pre-crisis mark and 23% below the 2019 average. Regarding our expectations for official releases, our tracking for services to families in June stands at 6.4% MoM-sa (66.5% YoY), while for July we expect an expansion of 1.9% MoM-sa (70.8% YoY). See details in the link[5].

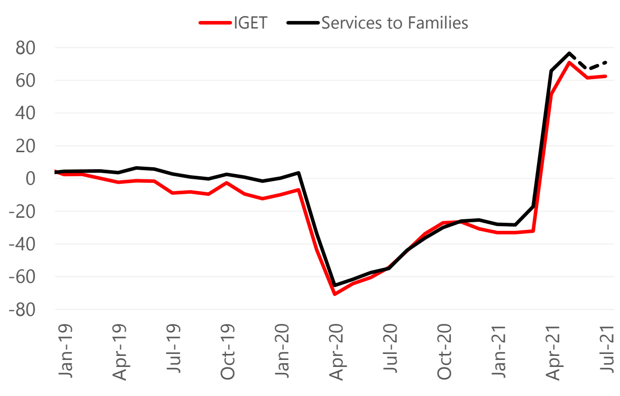
For the coming week, we will see the first releases of the economic confidence data from FGV and the latest batch of employment data. Consumer confidence is due out on Monday (July 26) while industrial confidence is due out on Wednesday (July 28). The tertiary sector confidence data is due out on Thursday (July 29). Labor market releases are also due next week, and the numbers should point to further progress on a path to recovery, in our view. On Wednesday (July 28), the Ministry of Economy will release the June CAGED net formal job creation data, for which we expect +267.6k. According to our preliminary seasonal adjustment, this would represent an acceleration to +322k, from +262.5k in May. On Friday (July 30), the IBGE will release the May PNAD household survey. We expect the unemployment rate to stand at 14.4%, which, according to our preliminary seasonal adjustment, would lead to a drop to 14.2%, from 14.4% in April. **For details on Santander's activity outlook, please refer to our last chartbook[6].**

Figure 6.A. – IGET x Broad Retail Sales (nsa, YoY%)



Sources: IBGE, Santander.

Figure 6.B. – IGET x Services to Families (nsa, YoY%)



Sources: IBGE, Santander.

[4] **Santander Brazil Economic Activity - *"Varejo Começa o Trimestre com Crescimento"* –** July 21, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGET-p-jul21
[5] **Santander Brazil Economic Activity - *"Serviços Começam o Trimestre com Crescimento"* –** July 20, 2021 - Available (in Portuguese) on: https://bit.ly/Std-IGET-ser-p-jul21
[6] **Santander Brazil Economic Activity - *"Chartbook – Better Outlook Due to Mobility and Commodities"* –** July 6, 2021 - Available on: https://bit.ly/Std-chart-econact-jul21

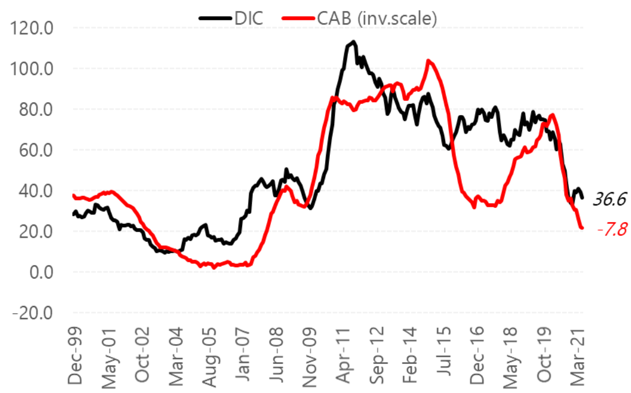
BALANCE OF PAYMENTS

In our view, the soundness of the Brazilian external position should be reaffirmed by the release of June balance of payments data on July 27 (next Tuesday). We project the current account balance to have recorded a US$3.0 billion monthly surplus, which, if confirmed, will translate into a new reduction of the deficit on a 12-month basis to US$7.8 billion from US$8.4 billion in the previous reading, thus extending the downward trend that we have observed since March 2020.

Before one thinks the shrinkage of the current account deficit has chiefly to do with the robust performance of the trade balance, we clarify that the bulk of the process stemmed from the improvement in the primary income account. The remittance of profits and dividends and the volume of interest payments has declined substantially in the period, due to the negative economic cycle (explaining the former) and the lower level of foreign currency debt presented by the Brazilian corporate sector (explaining the latter). As a result, we calculate the improvement in the primary income account balance to account for US$27.1 billion out of the US$63.3 billion decline observed in the annual current account deficit between June 2021 and March 2020, compared with a US$19.4 billion contribution from the trade balance and the US$15.9 billion contribution from the services account.

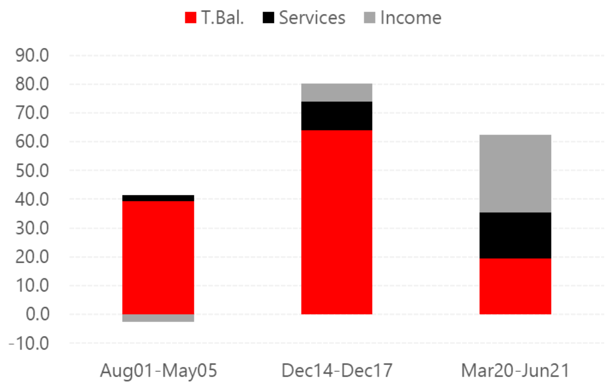
In addition to these favorable developments on the current account balance dynamics, we also expect to see constructive news related to the financial account last month. According to preliminary figures provided by the BCB, the country registered net inflows on both the direct and portfolio investments for a third month running.

Figure 7.A. – Current Account Balance vs. Direct Investment (USD billion, 12M)



Sources: Brazilian Central Bank, Santander.

Figure 7.B. – Current Account Adjustment Cycles (USD billion)



Sources: Brazilian Central Bank, Santander.

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