BRAZIL MACRO

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MACRO COMPASS

LOSING TRACTION IN 3Q21

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- The USD/BRL pair closed the rolling week ended November 25 at 5.56 (implying a 0.1% gain), and was the second-best performer in a basket of 31 of the most liquid currencies in the world. The relatively stable performance of the BRL in the period took place despite the strengthening of the USD on a global scale and reflected a perception of slightly less uncertainties concerning the changes in the fiscal legislation, in our opinion.
- The local yield curve saw a bull-flattening in recent days, as market participants apparently took recent statements by top BCB officials as favoring a 150-bp hike in the next Copom meeting.
- Federal tax collection continued to recover in October boosted by oil revenue, yet we note some signs of softening with activity-related revenue falling. The Ministry of Economy published a revision of official fiscal forecasts for 2021, showing a new reduction in the estimate for the primary fiscal deficit (to 1.1% of GDP from 1.6% of GDP, previously). The coming week is packed with fiscal policy data for October, and we expect budget results should register a positive seasonal primary surplus. Next week, *the PEC dos Precatórios* vote in the Senate's Constitution, Justice and Citizenship Committee (CCJ, in Portuguese acronym) is expected to be held.
- On Thursday (December 02), the IBGE will release 3Q21 GDP data, for which we expect +0.1% QoQ-sa growth. This tepid figure is in line with activity releases that have been not as strong as previously anticipated, especially in goods-related sectors. However, we still expect sequential growth, stemming mainly from our expectation of good GDP contributions from the services segments, which are still expected to profit on the reopening of the economy and which are usually not well captured by timely activity indices.
- On Tuesday (November 30), the IBGE will release the September PNAD household survey. The IBGE has announced that this release will bring a review on the entire unemployment time series. Based on the current series, we expect the seasonally adjusted unemployment rate to have reached 12.6% in that period (August: 13.0%). On Friday (December 03), the IBGE will release the industrial production for October, and we expect a sequential retreat of 0.3% MoM-sa, the fifth decline in a row. Lastly, FGV is set to release the last batch of economic confidence data for November.
- November's IPCA-15 registered a 1.17% MoM change (10.73% YoY, the same level of 4Q15-1Q16), in line with our call (1.17%) and also basically in line with the consensus (1.13%). Services surprised to the downside, while industrial goods surprised to the upside, but the main message continued the same: an unfavorable reading with underlying inflation still under upward pressure.
- While the US$4.5 billion deficit registered by the current account balance in October 2021 came in line with our estimate (-US$4.6 billion), the volume of direct investments in the country (US$2.5 billion) fell fairly short of our calculations (US$4.0 billion). However, figures did not alter the constructive perception about the Brazilian external position, in our view. Not even the US$1.4 billion trade deficit we expect for November 21 (due on December 1, Wednesday) should change that assessment as it should derive from some transitory hurdles.

Most of the information in this report is up to the end of Thursday, November 25, 2021.

Figure 1. Brazil Macro Agenda for the Week of November 29 - December 03, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
IGP-M Inflation (% MoM)	FGV	Nov/21	Mon, 29-Nov	0.15	0.64
IGP-M Inflation (% YoY)	FGV	Nov/21	Mon, 29-Nov	18.05	21.73
Services Confidence (Index)	FGV	Nov/21	Mon, 29-Nov	--	99.1
Retail Confidence (index)	FGV	Nov/21	Mon, 29-Nov	--	94.2
Central Gov. Primary Balance (BRL billion)	STN	Oct/21	Mon, 29-Nov	26.7	0.3
National Unemployment Rate (%, nsa)	**IBGE**	**Sep/21**	**Tue, 30-Nov**	**12.7**	**13.2**
National Unemployment Rate (%, sa)	IBGE	Sep/21	Tue, 30-Nov	12.6	**13.0**
Primary Budget Balance (BRL billion)	BCB	Oct/21	Tue, 30-Nov	33.7	12.9
Net Debt (% GDP)	BCB	Oct/21	Tue, 30-Nov	58.3	58.5
Aggregate Business Confidence (points)	FGV	Nov/21	Wed, 01-Dec	--	100.3
Trade Balance (USD billion)	SECINT	Nov/21	Wed, 01-Dec	-1.4	2.0
GDP (% QoQ)	**IBGE**	**3Q21**	**Thu, 02-Dec**	**0.1**	**-0.1**
GDP (% YoY)	**IBGE**	**3Q21**	**Thu, 02-Dec**	**4.4**	**12.4**
GDP 4-Quarter Rolling	**IBGE**	**3Q21**	**Thu, 02-Dec**	**3.9**	**1.8**
Industrial Production (% MoM)	**IBGE**	**Oct/21**	**Fri, 03-Dec**	**-0.3**	**-0.4**
Industrial Production (% YoY)	**IBGE**	**Oct/21**	**Fri, 03-Dec**	**-7.2**	**-3.9**
Vehicle Sales (thousands)	Fenabrave	Nov/21	01 to 03-Dec	--	162.4

Source: Santander.

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

[1] **Santander Brazil - Macroeconomic Scenario (Redux):** ***"Losing the Anchor"*** **–** November 05, 2021- Available on: https://bit.ly/Std-scenreview-redux-nov21

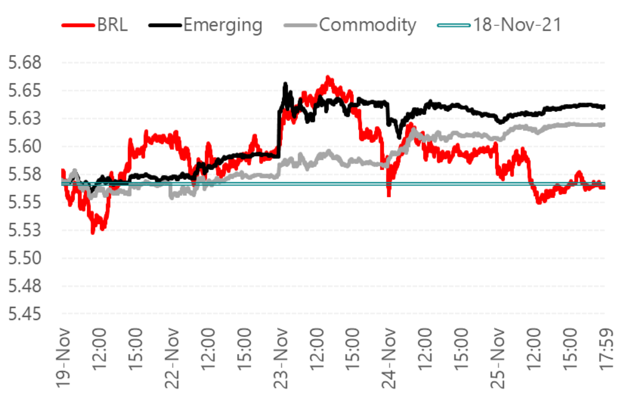
LOCAL MARKETS—FX

The BRL managed to deliver a relatively positive performance in the rolling week ended November 25, with the USD/BRL pair closing the period at 5.56 (implying a 0.1% gain), despite the strengthening of the USD on a global scale these days. Recent statements delivered by key members of the FOMC and the minutes of its last meeting reinforced the general perception that not only the tapering process is about to start, but also that the process is likely to be sped up in the coming months, which implies a higher probability for the start of a hiking cycle in the US somewhere in mid-2022 rather than late next year. That signal favored the USD vis-à-vis most currencies around the globe. The BRL was an exception and remained relatively stable (although at a fairly weak level) on the heels of progress in the negotiations regarding the so-called *PEC dos Precatórios* in the Senate, which marginally reduced uncertainties (i.e., the range of possible outcomes) in the domestic fiscal policy (more details in the Fiscal Policy section). We continue to believe that the key for a better currency outlook hinges on dissipating the haziness of the Brazilian fiscal outlook.

LOCAL MARKETS—Rates

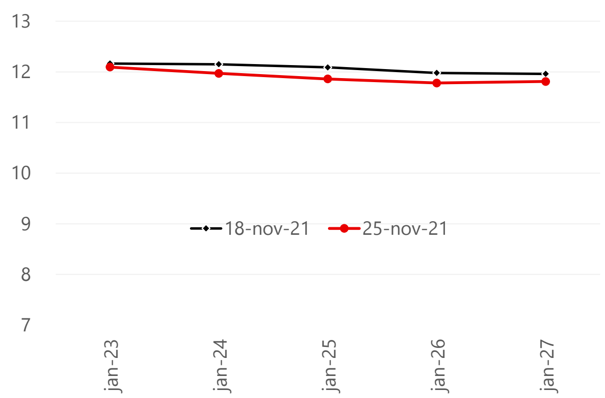
The nominal yield curve saw a relief rally in recent days, in a bull-flattening move that deepened the inversion of the curve. Since last Thursday (November 18), the front end of the curve (Jan-23 DI future) decreased 7 bps to 12.10%, while the back end of the curve (Jan-27 future) decreased 15 bps to 11.81%. As a result, the curve's steepness in this segment fell 8 bps, and went further into negative camp, reaching -29 bps and deepening the inversion of the curve. At the front end, public BCB statements were interpreted by the market as favoring a 150-bp hike in the next Copom meeting (we disagree with this interpretation). Also, the inflation print came in line with expectations after many upside surprises (see details in the Inflation section), potentially eliminating perceptions of tail risks for the announcement. Indeed, the probability implied in the options market for a 150-bps hike in the next Copom meeting rose again to 65%, after trading as low as 45% last week. Despite this movement, we continue to see rising an increased likelihood of faster and greater Selic hikes, with the new rounds of revisions of expectations in the BCB's Focus' weekly survey (out on Mondays) being key developments to watch. At the long end, we continue to see high uncertainties regarding the fiscal consolidation process, but the market reduced a bit of the risk-premia built in that segment of the curve during the last few weeks. And the rally happened even with 10-year US Treasuries yields going higher this week.

Figure 2 – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note 1: As of the close on Thursday, November 25, 2021.
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 Thursday, November 25, 2021.

COMMODITIES

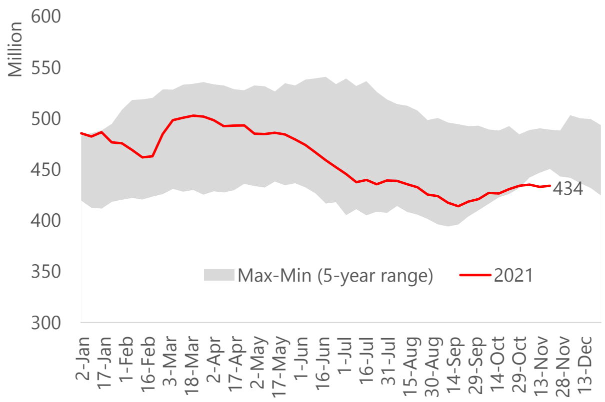
U.S. and other nations to release oil from emergency reserves. On Tuesday (November 23), the U.S. announced the release of 50 million barrels of oil from strategic reserves (equivalent of two and half days of U.S. demand) in coordination with China, India, South Korea, Japan and U.K. in an attempt to lower energy prices. In our view, these releases are not sufficient to address the structural deficit in oil markets as global inventories remain low and producers suffer from underinvestment. Next OPEC+ meeting is scheduled for December 2.

Brazil expects China to lift veto on Brazilian meat. According to government authorities, the Chinese decision to accept the import of Brazilian meat that had obtained sanitary certification prior to September 4 could be the first step toward the complete lift of the ban, expected now for December. Brazil suspended its beef exports to China in early September after two atypical cases of the mad cow disease were found.

EIA[2] reports an increase in U.S. crude stockpiles. On Wednesday (November 20), the EIA reported that U.S. crude inventories increased by 1,017k barrels for the week ending November 19, against the expectation of a 1,526k barrels decrease. As a result, considering the last five years, inventories are already below the minimum level observed for this time of the year (they bear 434 million barrels at the moment).

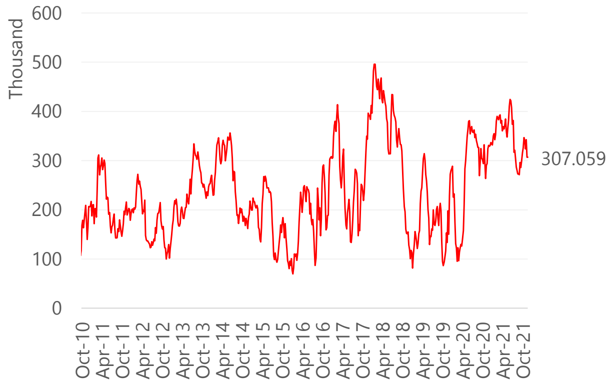
CFTC[3] reports a decrease in speculative long positions in WTI crude oil. Money managers reduced their net long WTI crude futures and options positions in the week ended November 16, the CFTC reported on Friday (November 19). The positions in futures and options decreased by 35,626 contracts to 307,059.

Figure 4 – EIA U.S. Crude Oil Inventories (Barrels)



Sources: EIA, Santander.

Figure 5 – CFTC NYMEX Crude Oil Managed Money Net Total (Number of contracts)



Sources: COT, Santander.

[2] Energy Information Administration.
[3] U.S. Commodity Futures Trading Commission.

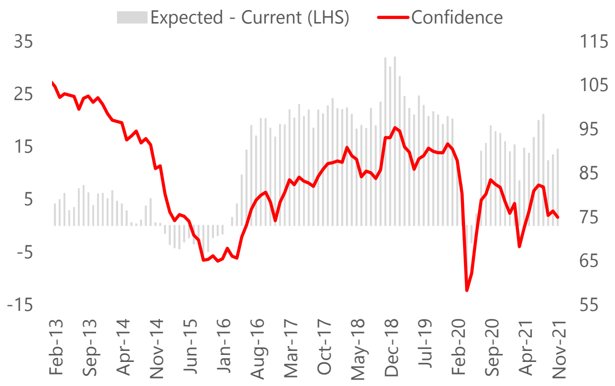
ECONOMIC ACTIVITY

Consumer confidence retreated in November (-1.8% MoM), marking the second weak figure in three months. This result gave back the previous gain (+1.3% in October) and reinforced the downward trend seen since September's plummet (-7.9%). November's figure continued to highlight the wide idleness regarding the pre-pandemic period: the headline index stands 14.7% below the readings seen in February 2020. In the breakdown, this result stemmed mainly from a decrease seen in the current situation component (-3.0%), with the expectations component also contributing negatively (-1.2%). The survey details indicate that the intention to purchase durable goods decreased 1.6%, the third drop in a row, which led the component to be almost 20% below the 2019 average level. Moreover, median expected annual inflation rose to 10% (from 9.0%). Regarding employment figures, expected employment index expanded 1.3%, the second gain in a row, but far from offsetting September's plummet (-10.4%). Additionally, the labor differential (i.e. percentage of respondents seeing jobs hard to get minus respondents seeing jobs easy to get) was up to 91.9 (from 90.2), the third increase in a row, which may suggest some headwinds to the job market ahead.

We expect a tepid GDP growth in 3Q21 (+0.1% QoQ-sa). September's release of IBC-Br capped a 3Q21 that was not as strong as previously anticipated and the quarterly results highlighted the ambiguity between solid services spending and weak demand for goods, as part of the reopening and "post-pandemic" normalization process. We lowered our 3Q21 projection to +0.1% QoQ-sa (from +0.2%), with this positive figure reflecting our expectations of good GDP contributions from segments, which are still expected to profit on the reopening and which are usually not well captured by timely indexes. If our projection is confirmed, this result would imply a carryover of 4.9% to 2021. The official data is scheduled to be out on Thursday (December 02) and it is worth noting that IBGE usually publishes important revisions in the historical GDP time series in its 3Q releases. It is not an easy task to anticipate the bias of such changes, so we do not take any specific view about these potential revisions. See details in the link[4].

On Tuesday (November 30), the September PNAD survey is due to be released. The IBGE has announced that this release will bring a review on the entire unemployment time series. Based on the current series, we estimate the unemployment rate at 12.7%, equivalent to 12.6% in our seasonally adjusted figure (August: 13.0%). Still on Tuesday, the Ministry of Labor will release the October CAGED formal job creation data. Our seasonally adjusted estimate is at +126k (September: +221k). On Friday (December 03), the IBGE will release the industrial production for October and we expect a sequential retreat of 0.3% MoM-sa, marking the fifth decline in a row. At last, FGV will release the last batch of economic confidence data for November: the tertiary sector confidence data are due out on Monday (November 29), while the aggregated business confidence is due out on Wednesday (December 01). **For details on Santander's activity outlook, please refer to our last chartbooks[5].**

Figure 6 – Consumer Confidence (sa, points)



Sources: FGV, Santander.

Figure 7 – GDP Projection Breakdown

	2Q21		3Q21e	
	% YoY	% QoQ	% YoY	% QoQ
GDP	12.4	-0.1	4.4	0.1
Supply				
Agriculture	1.3	-2.8	0.1	-0.5
Industry	17.8	-0.2	-0.1	-1.0
Services	10.8	0.7	6.5	0.7
Demand				
Consumption	10.8	0.0	3.9	0.6
Government	4.2	0.7	2.5	0.6
Investments	32.9	-3.6	18.0	-0.9
Exports	14.1	9.4	3.3	-11.2
Imports	20.2	-0.6	25.4	-5.3

Sources: IBGE, Santander.

[4] **Santander Brazil Economic Activity - *"Tepid GDP Growth Expected in 3Q21"* –** November 24, 2021 – Available on: https://bit.ly/Std-GDP-p-112421

[5] **Santander Brazil Economic Activity - *"Chartbook – Downgrading the Estimate for 2022 and 2023"* –** November 05, 2021 – Available on: https://bit.ly/Std-chart-econact-nov21

Santander Brazil Economic Activity - *"Chartbook – Household Indebtedness Expected to Slow Lending in 2022"* – November 09, 2021 – Available on: https://bit.ly/Std-chart-credit-nov21

INFLATION

November's IPCA-15 registered a 1.17% MoM change (10.73% YoY—the same level of 4Q15-1Q16), in line with our call (1.17%) and also basically in line with the consensus (1.13%). The headline trend remained at 14.1% 3MMA-saar, suggesting that the upward pressure remained strong at the margin.

On one hand, inflation in services and food-at-home items surprised downward; on the other hand, inflation in industrial goods and regulated prices surprised upward. Industrial goods were the main upside surprise (contributing +9 bps to the headline error), with a concentration in groups/items such as apparel, perfume, and makeup products. In our view, this may be a short-term movement, as companies could have increased prices in order to then implement Black Friday sales discounts at the end of the month. Regardless of the reason, the trend of headline industrial goods made a new high at 14.1% 3MMA-saar (from 11.8%), while the trend of the industrials core gauge rose back to 9.7% 3MMA-saar, after a brief small relief to 7.4% last month. The resilience of industrial goods inflation continued to surprise and the lasting problems related to the supply chain disruption globally is a worry of ours. On the bright side, food-at-home contributed -6 bps to the headline error, with the bulk of it related to proteins. Although this downward surprise is welcomed, we are skeptical about its persistence, as we believe there is an upside risk for prices of animal proteins once China opens its market again to Brazil. Finally, the downward surprise in services inflation (-6 bps of contribution to the headline error) is the Pyrrhic victory, as it pushed the trend down to 8.3% 3MMA-saar from 9.6% last month, meaning a still hefty level. Moreover, the surprise was concentrated in food-service, car repair and airline tickets, which are volatile items. As a result, the core services trend did not show a relief as the headline did: it continued to hover around 7.2% 3MMA-saar.

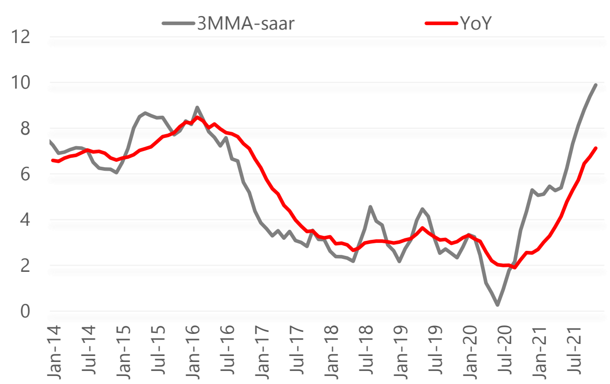
All in all, we see this as another unfavorable reading and we remain very cautious with the inflation outlook, as we continue to see the balance of risks tilted to the upside (specially with the recent rise in domestic risk factors and constant global shocks). Since the last release we have not pin pointed an inflation peak anymore, but we actually foresee a plateau, with inflation stalling at 10.5% until the end of 1Q22. We kept our high frequency tracking unchanged at 10.5% for IPCA 2021, 5.8% for IPCA 2022, and 3.5% for IPCA 2023.

Figure 8 – November's IPCA-15 Details (%)

	MoM			YoY	
	Nov-21	Santander	Dev.	Oct-21	Nov-21
IPCA-15	1.17	1.17	0.00	10.3	10.7
Administered	2.13	2.04	0.02	16.1	18.3
Free	0.82	0.85	-0.03	8.4	8.2
Food-at-home	0.50	0.88	-0.06	13.9	11.5
Industrial goods	1.76	1.39	0.09	10.4	11.4
Services	0.33	0.50	-0.06	4.9	4.8
EX3 Core	0.90	0.82	0.03	6.5	6.8

Sources: Brazilian Central Bank, Santander.

Figure 9 – Core Inflation Average (IPCA-15, %)



Sources: Brazilian Central Bank, Santander.

FISCAL POLICY AND LEGISLATION

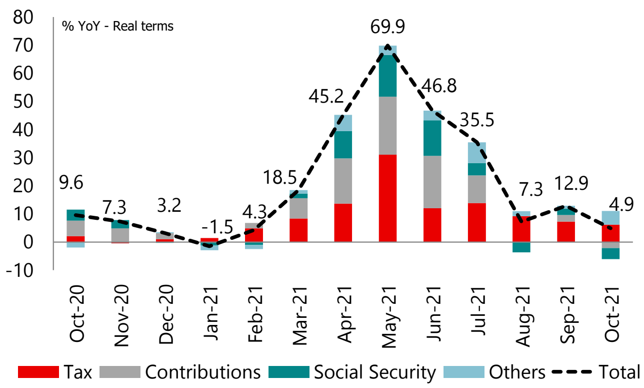
On November 22, the Ministry of Economy published its fifth bimonthly budget review for 2021. Official forecasts continued to show an improvement in the fiscal outlook this year, mainly due to higher revenue forecasts (+BRL58 billion), considering a rise in dividends from government-owned companies (BRL17.8 billion), higher income tax revenue (BRL14.6 billion, affected by the rise in inflation) and oil royalties' revenue (BRL5 billion). On the expenditure side, the government expects a rise in discretionary expenditures of BRL4.6 billion, reaching a total of BRL129 billion. Hence, the forecast for the central government's primary deficit dropped to BRL95 billion (1.1% of GDP), from BRL139.4 billion (1.6% of GDP) in September and BRL155.4 billion (1.8% of GDP) in July. We continue to anticipate a deficit of BRL115 billion in 2021 (1.3% of GDP).

In October, federal tax collection continued to expand, boosted by oil revenue. On November 24, according to data published by the Brazilian Internal Revenue Service (IRS), tax collection reached BRL178.7 billion (or +4.9% YoY real), above our forecast (BRL17.32 billion). The main surprise in relation to our forecast was the atypical IRPJ/CSLL revenue of BRL5 billion, probably related to corporate restructuring deals (M&A, IPOs). The October result was the second-best result for the month in the historical series. In YTD real terms, the rise is 20.1% YoY, and 10.8% YoY compared to 2019. Values this year are at an all-time high, "helped" by extraordinary revenue (BRL36 billion) and royalty revenue (BRL69.4 billion, +53% YoY). In the coming months, we expect positive results, yet we are observing some softening signs in the tax collection related to activity (consumption and labor market). For 2021, we forecast a ~17.5% YoY real rise.

October was marked by the increase in debt cost and high fixed rate bonds maturity. On November 24, the National Treasury published the Monthly Debt Report for October. Debt issuance reached BRL142.1 billion, close to the average of the last 12-month (BRL153 billion). Regarding bond issuance, floating rate bonds (59% of the total) stood out, totaling BRL86.7 billion. Fixed rate bonds were the highlight in the redemption standpoint, totaling BRL268 billion in the month, reflecting a large maturity of these bonds in the month. Non-residents posted a positive flow in October (+BRL12.5 billion, YTD: +BRL93.3 billion), with their total participation reaching 10.5% in bond holding. The percentage maturing in 12 months dropped to 21.5% of the total debt, from 24.3% in September, reflecting the issuance and maturity profile in October. The cost of new issuance rose to 7.5% pa from 6.9% pa in September (with IPCA and Selic increase), the average cost of debt rose to 8.0% pa, higher than September (-0.23 p.p.), The public debt liquidity reserve dropped BRL117 billion (it totals BRL1,010 billion) and the current level covers ~11 months of debt maturities. In our view, the outlook for debt management remains challenging for the medium-term, especially after the rise in Selic and IPCA estimates.

The coming week is packed with fiscal policy publications. On November 29 (Monday), the National Treasury publishes the central government primary result: we expect a seasonal primary surplus of BRL26.7 billion. On November 30 (Tuesday), the BCB unveils the consolidated public sector's fiscal balance: we forecast a primary surplus of BRL33.7 billion. On November 30, the *PEC dos Precatórios* is to be voted in the Senate's Constitution, Justice and Citizenship Committee (CCJ, in Portuguese acronym), thus opening room to go to the floor of the upper chamber by early December.

Figure 10 – Federal Tax Collection



Sources: Federal Revenue of Brazil, Santander.

Figure 11 – 2021 Bi-Monthly Budget Review

BRL Billion	Nov	Sep	Jul	Dif. Nov-Sep
Total Revenue	**1,913.3**	**1,855.5**	**1,816.3**	**57.8**
Revenues Collected by the IRS	1,187.6	1,165.7	1,156.0	21.9
Net Social Security Revenues	457.5	450.2	440.0	7.3
Revenues Not Collected by the IRS	268.2	239.7	220.1	28.6
Transfers by Revenue Sharing	357.7	347.7	339.9	10.0
Net Revenue	**1,555.6**	**1,507.9**	**1,476.4**	**47.7**
Total Expenditure	**1,651.4**	**1,647.3**	**1,631.8**	**4.1**
Social Security Benefits	709.9	709.9	705.9	0.1
Payroll - Public Servants	330.6	330.8	332.4	-0.2
Other Mandatory Expenses	334.4	336.2	328.6	-1.8
Mandatory Expenses with Cash Control	147.4	145.9	145.6	1.4
Discretionary Expenses	129.0	124.5	119.3	4.6
Central Government's Primary Balance	-95.8	-139.4	-155.4	43.7
Primary Target (LDO 2021)	-247.1	-247.1	-247.1	0.0

Sources: Ministry of Economy, Santander.

BALANCE OF PAYMENTS

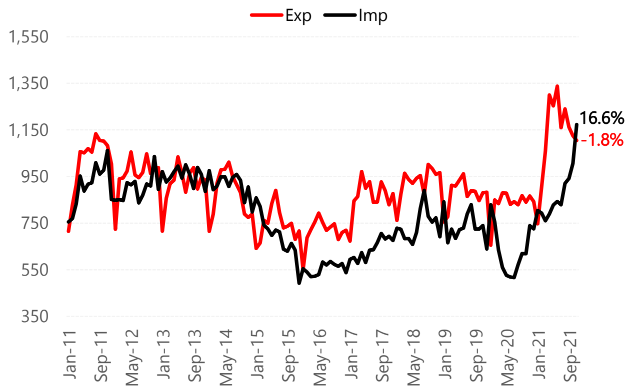
The highlight of October's balance of payments data was the negative surprise in direct investments in the country for the period, which fell short of our estimate (US$2.5 billion vs. US$4.0 billion). The current account deficit came about in line with our calculations (at US$4.5 billion deficit), thus reinforcing the perception of solid external position of the Brazilian economy.

As expected, (seasonally) larger remittances of profits and dividends in tandem with a smaller trade surplus and a deficit in the services account weighed on the current account balance in October, thus leading it to a US$4.5 billion deficit in the period. That reading stood pretty close to our estimate of a US$4.6 billion deficit. On a 12-month basis, the deficit climbed to US$26.7 billion last month from US$24.5 billion in December 2020, already accounting for the BCB's semiannual revisions of the historical series (which takes place in July and November). Notwithstanding the upward shift in the level of the current account deficit, its favorable dynamics remained unchanged, in our view.

The financial account has also been reviewed and indicated that the volume of direct investments in the country tallied US$49.2 billion on a 12-month basis, lower than the US$50.8 billion that we had calculated. Nonetheless, it is important to note that, on top of the data revision, the net inflow of US$2.5 billion was smaller than the US$4.0 billion we estimated for the period based upon preliminary figures provided by the BCB in mid-October. Despite the frustration for October, direct investment is still enough to finance the current account gap, thus underpinning the soundness of the Brazilian external accounts.

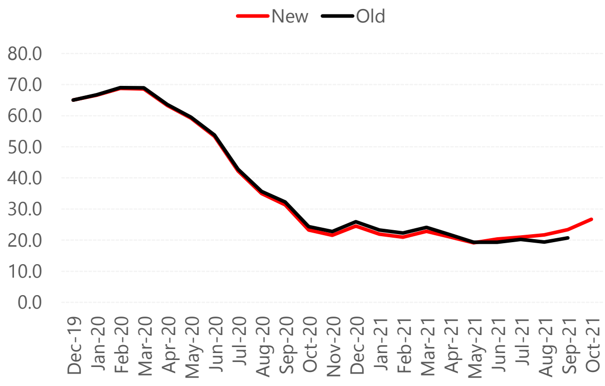
On December 1 (Wednesday), the Foreign Trade Secretariat will release November's trade data and we expect a US$1.4 billion deficit in the period, on the heels of a hefty increase in import outlays and a slight decline in export revenue (in seasonally adjusted terms). Considering the fact that the increase in imports has been concentrated in intermediate goods, we believe this spike in imports may have to do with problems in the domestic supply chain, which we expect to be overcome in the future. Conversely, given the prospects that foreign demand should remain upbeat and that commodity prices will remain at high levels, we think export revenue is to show resiliency in the near future. As a result, we remain confident the trade balance should provide sizeable surplus in annual terms in coming years, notwithstanding the monthly deficit expected for this month.

Figure 12 – Trade Balance Components (USD million/working day, sa)



Sources: SECINT, Santander.

Figure 13 – Current Account Balance Revision (USD billion, 12m)



Sources: Brazilian Central Bank, Santander.

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