BRAZIL MACRO

May 28, 2021

MACRO COMPASS

A SOLID 1Q21 GDP, AGAINST ALL ODDS

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- In the rolling week ended May 27, the BRL stood amongst the top performers in the space of major currencies, gaining 0.9% vs the greenback to USD/BRL5.24. In our view, this move stemmed from the maintenance of a constructive international environment and the (hopes for) improvement in the domestic economic outlook. On the same drivers, the nominal yield curve flattened considerably, with a rally on the back end.
- The National Treasury published a revision of the Annual Borrowing Plan (PAF 2021), with a slight improvement in debt management targets. We learned that the central government recorded the best primary result since 2012 for the first four months of the year. Finally, April 2021 was marked by a high level of debt maturities, with redemptions registering a series record of BRL340 billion.
- Although lower than our estimate (USD6.5 billion), the USD5.7 billion current account surplus registered by the Brazilian current account balance in April features an improving trend we project to continue in the coming months. Incidentally, we project trade balance figures due next Tuesday (June 1) to unveil a USD9.8 billion surplus in May 2021, which — if confirmed — will translate into a USD62.6 billion surplus from USD50.4 billion in December 2020 on a 12M-to-date basis.
- May's IPCA-15 increased 0.44% MoM (7.27% YoY), well below the market's median expectation of 0.55% and also our call of 0.56%. The downside surprise was concentrated in one (extremely volatile) item. We continue to see the inflation outlook as quite unfavorable, with core measures and diffusion indexes still hovering in high levels.
- IBGE's March PNAD household survey indicated a stable unemployment in seasonally adjusted terms at 14.5%. The April 2021 CAGED survey also indicated a slower net formal job creation in seasonally adjusted terms (+34.7k in April, from +216.5k in March). In our view, the job market remains fragile, especially considering the pandemic's impact on informal workers.
- The surprisingly positive activity releases in 1Q21 highlighted some resilience of the economy amid the withdrawal of fiscal stimuli and the resurgence of the pandemic. These figures are consistent with a more positive reading for 1Q21 GDP growth (result is due on Tuesday, June 1), and we are raising our projection to +0.9% QoQ-sa (0.5% YoY) from +0.4% QoQ-sa (-0.2% YoY). For the coming week, the IBGE will also release the first batch of economic activity hard data for 2Q21. Industrial production is due out next Wednesday (June 2); we are looking for a slight monthly drop (-0.3% MoM-sa), highlighting a weak start of quarter.

Most of the information in this report is up to the end of Thursday, May 27, 2021.

Figure 1. Brazil Macro Agenda for the Week of May 31 - Jun 4, 2021

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Public Sector Primary Balance (BRL billion)	BCB	Apr/21	Mon, 31-May	18.2	5.0
Nominal Budget Balance (BRL billion)	BCB	Apr/21	Mon, 31-May	--	-44.5
Net Debt (% GDP)	BCB	Apr/21	Mon, 31-May	60.6	61.3
Retail Confidence (Index)	FGV	May/21	Mon, 31-May	--	84.1
Services Confidence (Index)	FGV	May/21	Mon, 31-May	--	81.7
Aggregated Business Confidence (Index)	FGV	May/21	Mon, 31-May	--	89.8
GDP (% YoY)	**IBGE**	**1Q21**	**Tue, 01-Jun**	**0.5**	**-1.1**
GDP (% QoQ)	**IBGE**	**1Q21**	**Tue, 01-Jun**	**0.9**	**3.2**
GDP 4-Quarter Rolling	**IBGE**	**1Q21**	**Tue, 01-Jun**	**-3.9**	**-4.1**
Trade Balance (USD billion)	SECINT	May/21	Tue, 01-Jun	9.8	10.3
Vehicle Sales (thousands)	Fenabrave	May/21	Tue, 01-Jun	--	175.1
Industrial Production (% MoM)	**IBGE**	**Apr/21**	**Wed, 02-Jun**	**-0.3**	**-2.4**
Industrial Production (% YoY)	**IBGE**	**Apr/21**	**Wed, 02-Jun**	**36.6**	**10.5**

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

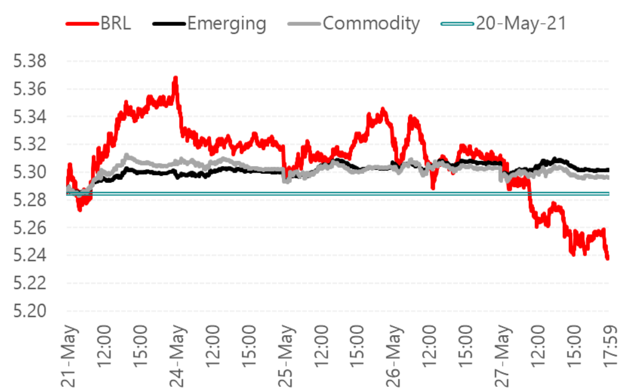
In the rolling week ended May 27, the BRL stood amongst the top performers in the space of major currencies, gaining 0.9% vs the greenback to USD/BRL5.24. In our opinion, the move stemmed from the maintenance of a relatively constructive international environment and a more optimistic conjectures (or hopes) for domestic growth and government debt outlook.

The risk-on mode has prevailed on the international front despite the resurgence of some concerns in the news cycle, such as imminent discussions on monetary policy tapering in the U.S. or credit restrictions in China and some profit-taking in the commodity markets. None of them was capable of changing dramatically the level of risk aversion in the week, with the VIX index — a gage of investor risk aversion — having receded to 16.7% from 20.7% on May 20. In tandem with that, the release of activity figures on the domestic front that reinforced the current wave of optimism regarding growth dynamics in 2021 — which could bring some respite to the fiscal situation – also helped the BRL to become the fourth best performer among major currencies in the period.

LOCAL MARKETS—Rates

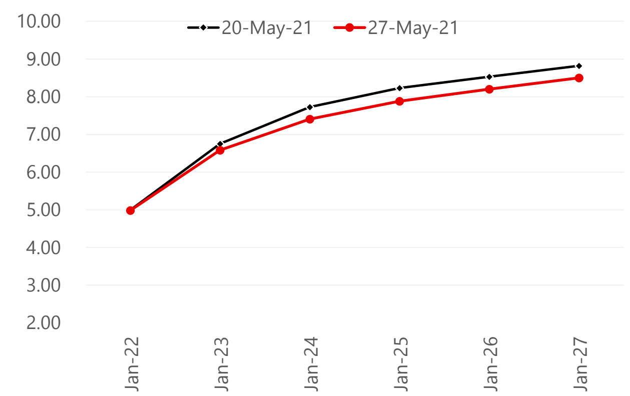
The nominal yield curve saw a remarkable flattening this week. Since last Thursday (May 21), the front end (Jan-22 DI future) fell 1 bps, to 4.98%, while the back end (Jan-27 DI future) fell 32 bps, to 8.50%. Hence, the steepness fell 31 bps, to 352 bps. At the front end, despite the downside surprise in May's IPCA-15 headline inflation, qualitative measures, as core inflation and diffusion, remained considerably unfavorable (see details at the Inflation section), so the market did not change much its (hawkish) view about short-term monetary policy. At the long end, although the fragile medium-term fiscal outlook remains in place, the market continued to take out part of the risk-premium embedded at longer yields. In our view, the recent movement is related to an improvement of the market consensus view regarding GDP growth, particularly the nominal GDP that should help the debt-to-GDP ratio to end the year at a lower level than previously expected. We read it more as a one-off effect (coming from an unfavorable cause: inflation), while the medium-term fiscal outlook remains quite risky and dependent on advancing the reformist agenda.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, May 27, 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, May 27, 2021.

COVID-19 MONITORING

In the U.S., the pace of vaccinations has been softening and is currently at 1.7 million/day (seven-day moving average), with nearly 49% of the population having received at least one dose. This figure stands at 56% in the U.K. and 35% in the European Union. In Britain, the June 21 final easing of lockdown is being discussed as the Indian COVID variant becomes the dominant strain in the country.

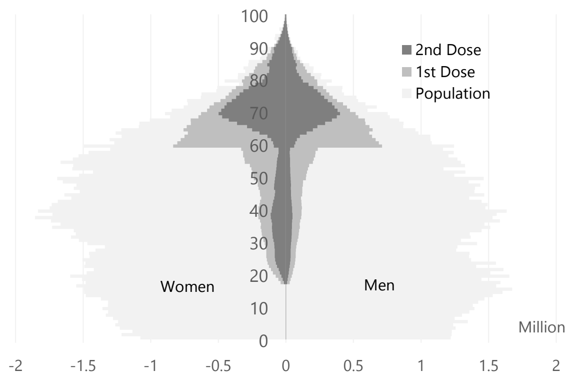
Brazil's Health Ministry submits new request for Covaxin imports. Anvisa, the National Drug Regulator, received on Monday (May 27) the request to import 20 million doses. The agency will have seven days to review. Meanwhile, the government's official schedule for vaccine deliveries revised June's figure to 44 million doses (from 52 million). As such, the uncertainty about the arrival of imported inputs continues to impart risks for the schedule of the National Immunization Plan.

In Brazil, new COVID-19 infections and casualties remain stubbornly high. The ICU occupancy rate is above 90% in eight states, an increase from six states last week (and a peak of 18 states in the worst phase). As of Wednesday (May 26), 65 million doses (out of 100 million delivered) had been administered in the country, with the pace of vaccination at 637k/day (seven-day moving average). **In spite of the slow rollout, we are still of the view that vaccinations will pick up again toward our baseline scenario of one million/day as deliveries continue to outpace vaccine administration, bringing vaccine inventories close to 35 million doses.**

Mobility slightly expanded at the margin. Our lockdown index (based on Google Mobility Report) has been posting a consistent downward trend since April, reaching 15.8 points (seven-day average, as of May 9, 2021). This improvement stemmed mainly from mobility increases in categories linked to economic activities, such as Workplace (which already stands at pre-pandemic marks) and Transit Station. After recently reaching 16.4 points (May 14, 2021), the lockdown index slightly decreased to 16.0 points (May 20, 2021), reflecting that despite mobility is still increasing, now the pace seems to be slower. Before a more disseminated vaccine rollout, the risk of increased infections continues to imply downside risks for mobility (and economic activity).

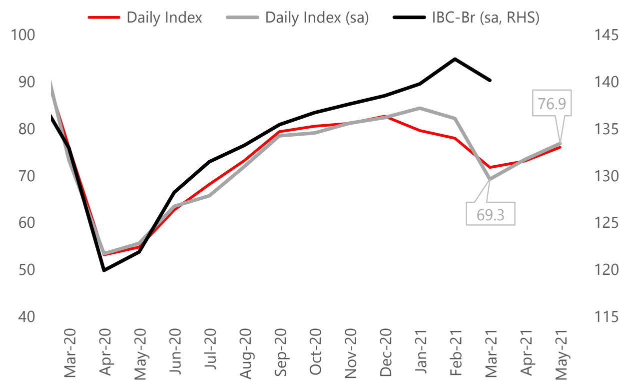
Our daily activity index continues to improve across 2Q21. The index — based on daily data on energy consumption, car sales, and mobility — has been improving since April, showing an upward trend in recent weeks. On monthly basis, after seasonal adjustments, the index expanded by 6.1% and 4.6% in April and May, respectively, not enough to fully offset March's retreat (-15.7%) and placing the index at readings still 6.5% below February-21.

Figure 3.A. – Vaccination by Age and Gender (May 26, 2021)



Sources: PNAD, dataSUS, @eliaskrainski, Santander.

Figure 3.B. – Daily Activity Index on Monthly Basis* (Feb/20=100)



Sources: Google, Apple, Fenabrave, ONS, Santander.
* Data are available until May 20, 2021. Seasonal adjustment was made using IBC-Br's seasonal factors.

FISCAL

The National Treasury published a revision of the Annual Borrowing Plan (PAF 2021), with a slight improvement in the debt management targets. We learned that the central government recorded the best primary result since 2012 for the first four months of the year. Finally, April 2021 was marked by a high level of debt maturities, with redemptions registering a series record of BRL340 billion.

The National Treasury released (on May 26) a revision of the PAF 2021. In the debt profile, the fiscal authority intends to expand the total share of LFT (floating rates) and NTN-B (inflation-linked) securities in the debt composition, in line with the current demand profile for bonds, in view of the rise in both inflation and the Selic rate. In contrast, the value expected for fixed-rate securities has decreased (see Figure 4.A.). The estimate for average maturity showed a slight improvement, due to the new composition of debt issuances predicted by the Treasury (NTN-B has greater average maturity). In addition, the total level of the outstanding debt dropped BRL100 billion, on the heels of a record issuance until April (BRL672 billion), the BNDES repaying the Treasury BRL100 billion in 2021 (until April it totals BRL38 billion), as well as the possibility of using de-earmarked public funds (allowed by the PEC *Emergencial*), which increased liquidity reserves (+BRL140 billion) and improved debt management. In our view, although the outlook for debt management improved in the short-run, it remains challenging in the medium-term, and it continues to depend on maintaining the current fiscal framework, the level of liquidity reserve, as well as favorable market conditions.

Additionally, the National Treasury published (on May 26) the Monthly Debt Report for April 2021. The month was marked by a record level of debt redemptions, which totaled BRL340 billion, driven by LTN Abril-21 maturities of BRL284 billion. April was the monthly peak in securities maturities of 2021. The new debt issuances reached BRL173 billion, the third largest value in the series in nominal terms. As the final result, the total outstanding debt fell 2.6% in April. Yet, we believe that the debt level should continue to rise in the coming months. The public debt liquidity reserve (or debt cushion) decreased BRL150 billion in April (totals BRL969 billion). The current level of reserve is sufficient for 9.9 months of future maturities.

Finally, the central government posted a primary surplus of BRL16.5 billion in April 2021. In year-to-date data, it was the best primary result since 2012 for the period. During the period, total revenue rose 16.6% YoY, considering the positive result of federal tax collection (boosted by inflation and FX depreciation) and extraordinary revenues, while the total expenditure dropped 12.2% YoY (-34.4% YoY in April). On the expenditure side, a key factor was the lower level of discretionary spending (-35.2% YoY in the year)—currently at the all-time low in 12-month nominal terms (BRL98.5 billion). In 12-months reading, the deficit reached BRL646 billion (7.9% of GDP). For 2021, we estimate a central government primary deficit of BRL265 billion (3.1% of GDP). In our view, the primary result could be slightly better, due to our upward bias on the domestic activity and a more intense effect of inflation on federal tax collection, both rising the revenues. However, in our view, extrapolating the last positive surprises in revenues for the full year continues to demand some caution. On May 31, the Brazil Central Banks (BCB) will publish the consolidated public sector fiscal balance: we anticipate a monthly primary surplus of BRL18.2 billion for April.

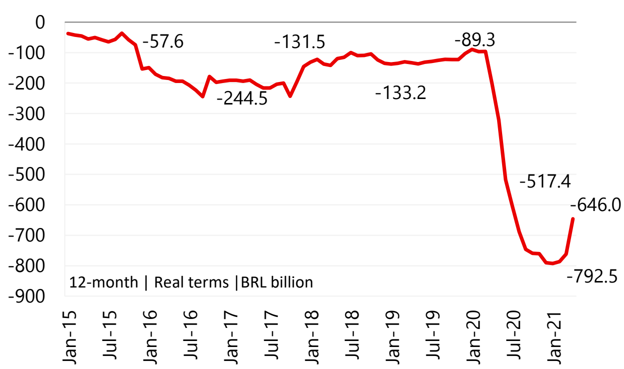
Figure 4.A. – Annual Borrowing Plan (PAF) 2021

Indicators	2020	PAF 2021 ranges		PAF 2021 revised	
		Min	Max	Min	Max
Outstanding Debt (BRL billion)	5009	5600	5900	**5500**	**5800**
Composition (% of Debt)					
Fixed-rate	34.8	38.0	42.0	**31.0**	**35.0**
Inflation-linked	25.3	24.0	28.0	**26.0**	**30.0**
Floating-rate	3.8	28.0	32.0	**33.0**	**37.0**
FX	5.1	3.0	7.0	**3.0**	**7.0**
Maturity Structure					
% maturing in 12 months	27.6	24.0	29.0	**22.0**	**27.0**
Average maturity	3.6	3.2	3.6	**3.4**	**3.8**

PAF = Annual Borrowing Plan.

Sources: National Treasury, Santander.

Figure 4.B. – Central Gov. Primary Fiscal Balance



Sources: National Treasury, Santander.

ECONOMIC ACTIVITY

The surprisingly positive activity releases in 1Q21 highlighted the resilience of the economy, amid the withdrawal of fiscal stimuli and the resurgence of the pandemic. In our view, these figures are consistent with the upward revision of our 1Q21 GDP growth projection to +0.9% QoQ-sa (0.5% YoY) from +0.4% QoQ-sa (-0.2% YoY). If our projection proves accurate, this result would imply a carryover of 4.5% to 2021 GDP and place the economy at levels 0.4% below the pre-crisis mark (4Q19). Moreover, we believe the already positive figures for the tertiary sector in 2Q21, along with the materialization of the first effects of the new round of emergency aid, point to better than expected activity in 1H21. Therefore, these figures imply solid upside risks to our current projection for 2021 GDP (3.6%), likely above the 4% mark. See details in the link[2].

IBGE's March PNAD household survey indicated a 14.7% unemployment rate in the three months to March, slightly above both our estimate (14.5%) and market consensus (14.6%), marking a new all-time high in the non-seasonally adjusted series. We calculate that the seasonally adjusted jobless rate remained stable, at 14.5%, compared to the February level, following increases of +0.2% MoM sa in both the employed population and the labor force. The labor market participation rate stood at 56.1% (sa), also stable compared to the February result and remains depressed. Still on the labor market front, the April 2021 CAGED survey indicated that net formal job creation stood at +120.9k (consensus: +161.8k; Santander's estimate: +206.0k). After consecutive all-time records from September 2020 to February 2021, it is the second consecutive CAGED result that is not an all-time high for the month. We estimate that the seasonally adjusted, net formal job creation decreased to +34.7k in April, from +216.5k in March. In our view, the job market remains fragile, especially considering the pandemic's impact on informal workers, which the CAGED survey does not capture. Despite having pandemic-related issues in the survey, the PNAD is still the only indicator capturing the current precariousness of the informal labor market, which is accountable for over 40% of all jobs in normal times. Therefore, in our view, the labor market still has notable slacks that should lessen only with a more consistent recovery in mobility. See details in the link[3].

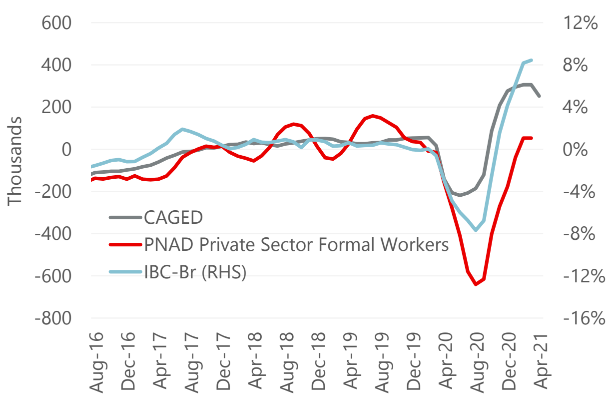
For the coming week, the IBGE will also release the first batch of economic activity hard data for 2Q21. Industrial production is due out next Wednesday (June 2); we are looking for a slight monthly drop (-0.3% MoM-sa), highlighting a weak start of quarter for the sector. In our view, industry will continue to suffer from the lingering impact of the pandemic and from the widespread shortage of inputs in manufacturing, still creating something of a drag on the recovery. **For details on Santander's economic activity scenario, please refer to our last chartbook[4].**

Figure 5.A. – GDP Projection Breakdown

		4Q20		1Q21e	
	Weights	% YoY	% QoQ	% YoY	% QoQ
GDP	100%	-1.1	3.2	0.5	0.9
Supply					
Taxes	15%	0.2	5.2	1.0	0.2
Agriculture	4%	-0.4	-0.5	4.1	5.0
Industry	17%	1.2	1.9	2.4	0.3
Mining	16%	-6.7	-4.7	-2.0	2.6
Manufacturing	55%	5.0	4.9	5.2	-0.8
Construction	15%	-4.8	-0.4	-3.0	0.5
Utilities	14%	1.5	-1.2	3.0	1.3
Services	63%	-2.2	2.7	-0.3	0.8
Demand					
Consumption	64%	-3.0	3.4	-3.1	-1.3
Government	21%	-4.1	1.1	-1.1	2.2
Investments	18%	13.5	20.0	8.8	-0.1
Exports	17%	-4.3	-1.4	0.9	3.7
Imports	-17%	-3.1	22.0	0.5	5.6

Sources: IBGE, Santander estimates.

Figure 5.B. – Net Job Creation and IBC-Br (6m, sa)



Sources: IBGE, CAGED, BCB, Santander.

[2] **Santander Brazil Economic Activity - *"GDP Preview: Expected Solid Growth in 1Q21 Means Resilience"* –** May 27, 2021 - Available on: http://bit.ly/Std-gdppreview1Q21
[3] **Santander Brazil Labor Market - *"Almost No PNAD News; CAGED Decelerates"* –** May 27, 2021 - Available on: http://bit.ly/Std-labor-270521
[4] **Santander Brazil Economic Activity - *"Chartbook – Positive Surprises with Risks On The Upside"* –** May 25, 2021- http://bit.ly/Std-chart-econact-may21

INFLATION

May's IPCA-15 increased 0.44% MoM (7.27% YoY), well below the market's median expectation of 0.55% and also our call of 0.56%. The headline accelerated from 7.7% in April 2021, to 8.6% on a 3mma-saar basis, showing that the upward pressure at the margin remains strong.

The downside surprise was concentrated in one (extremely volatile) item. Airline tickets fell 28.85% MoM, while we were expecting -0.50%; this surprise alone contributed -12 bps to the headline forecast deviation. Other relevant downside surprises came from residential rents (-3 bps of deviation to the headline) and vehicle insurance (-2 bps of deviation).

Despite the major downside surprise, we see the number as quite unfavorable in qualitative terms. Even with the downside surprise in headline services, core services rose at a 3.5% 3mma-saar, a persistent high level at the margin. Moreover, industrial goods surprised considerably to the upside and rose further to 10.1% in 3mma-saar terms, showing there is no sign of relief at the margin yet; in YoY terms, the group increased 7.4%, the highest since 2005.

Cores remained stable at a high level in 3mma-saar terms, and the diffusion index (seasonally adjusted) was also quite high. The average of cores followed by the BCB accelerated from 3.6% YoY to 4.1% and the 3mma-ssar remained stable at 5.0% suggesting upward pressures remain strong at the margin. Additionally, the diffusion index (seasonally adjusted) – a leading indicator of inflation -- rose from 56.9% to 72.3%, a level not seen since 2015-2016 when inflation was hovering around 10% YoY.

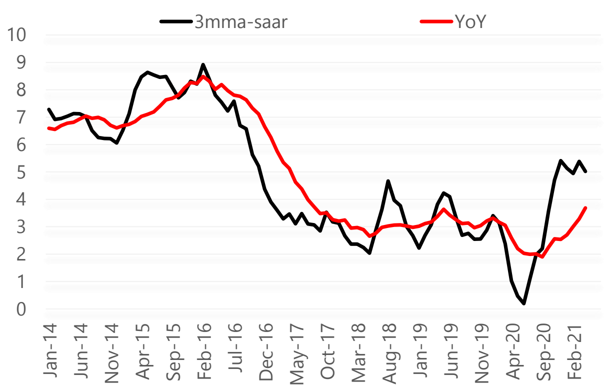
We continue to worry about short-term inflation, as shocks remain strong and persistent at the margin, and as the distortion of relative prices continue to indicate considerable pressure coming from the producer level to still reach the consumer. Despite the downside surprise from this reading, we maintained our IPCA 2021 and year-end 2022 forecasts unchanged, at 5.9% and 3.9%, respectively. Our IPCA 2021 is above the upper bound of the tolerance interval of the BCB's target (mid-target 3.75%, ±1.50%), and our IPCA 2022 is above the mid-target (3.50%, ±1.50%). We were seeing the balance of risks as more symmetric around our year-end forecasts, but this qualitatively worse reading makes us lean again toward more upside risks. See link below[5].

Figure 6.A. – May's IPCA-15 details (%)

	MoM			YoY	
	May-21	Santander	Dev.	Apr-21	May-21
IPCA-15	0.44	0.56	-0.12	6.2	7.3
Administered	1.06	1.12	-0.02	8.1	11.3
Free	0.22	0.36	-0.10	5.5	5.9
Food-at-home	0.50	0.40	0.02	15.1	15.0
Industrial goods	0.99	0.70	0.07	6.3	7.4
Services	-0.38	0.13	-0.18	1.5	1.6
EX3 Core	0.45	0.41	0.04	3.7	4.1
Average of cores	0.37	-	-	3.7	4.1

Sources: IBGE, Santander.

Figure 6.B. – Average Core Inflation (%)



Sources: IBGE, Santander.

[5] **Santander Brazil Inflation - *"IPCA-15 May: Don't Get Fooled by Lower than Expected Headline"* –** May 25, 2021 – http://bit.ly/Std-IPCA15-250521

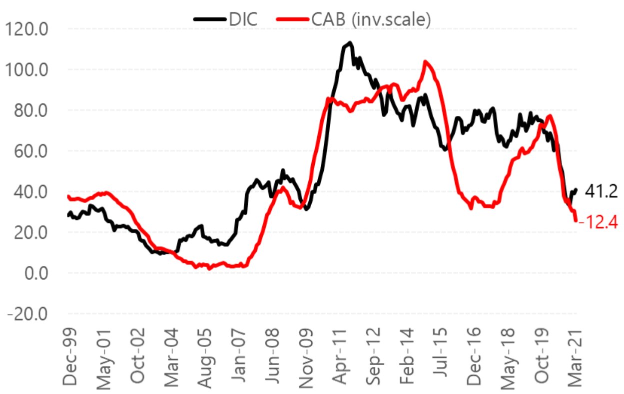
BALANCE OF PAYMENTS

The USD5.7 billion surplus registered by the Brazilian current account balance in April 2021 fell short of our estimate (USD6.5 billion) as well as of the market median forecast (USD6.1 billion) on the heels of larger imports than indicated by data of the Foreign Trade Secretariat and bigger interest payments than suggested by the schedule provided by the Brazilian Central Bank. **Notwithstanding lower than expected, the result did not change our appraisal that the Brazilian current account balance should deliver an annual surplus in 2021 – we project a USD4.9 billion surplus this year** (see details in the link[6]).

Besides the maintenance of subdued deficits in the services and primary income accounts stemming from low — by historical standards — tourism outlays and remittances of profits and dividends, we expect the Brazilian trade balance to register sizeable surpluses for a while on the heels of favorable commodity prices and the solid economic recovery in key trading partners, such as China. Incidentally, **we project trade figures that will be released next Tuesday (June 1) to unveil a USD9.8 billion surplus in May 2021**, which — if confirmed — will lead to an indication of USD110.5 billion surplus according to the 3MMA-saar figures. The level is fairly higher than our forecast of USD85.3 billion for 2021.

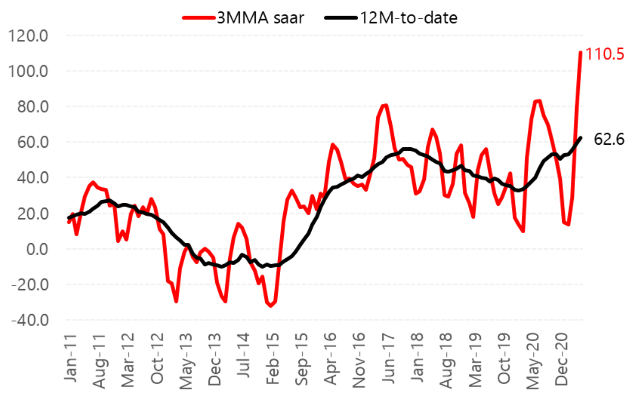
In addition to these good news, the financial account also indicated that direct investments in the country (DIC) continued to recover on a 12M-to-date basis and that foreigners' acquisitions of Brazilian financial assets on the domestic market are back. In sum, the Brazilian balance of payments continues to be a source of positive news.

Figure 7.A. – Current Account Balance vs. DIC (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

Figure 7.B. – Trade balance (USD billion)



Sources: Brazilian Central Bank, SECINT, Santander.

[6] **Santander Brazil – Data Analysis - External Sector:** ***"A (Tiny) Yellow Light"*** – May 26, 2021- Available on: http://bit.ly/Std-extsec-260521

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