BRAZIL MACRO

July 29, 2022

MACRO COMPASS

LOCAL MARKET SPIRITS LIFTED BY THE FED, AWAITING NEXT WEEK'S COPOM

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- In the rolling week ended on July 28, the BRL rallied and outperformed all major peer currencies. This happened amid a risk-on mood in global markets following perceptions of a softer-than-expected tone from the Federal Reserve in this week's FOMC meeting. The rebound in commodity prices, partly led by idiosyncratic factors, likely added to this picture. In general, we believe the Brazilian currency once again put on display its high-beta pattern, as it gained ~6% for the week and reached the strongest level this month (USD/BRL 5.18).
- The better mood of global investors also spilled over into Brazilian fixed income, as nominal rates took the cue from the global drivers and recovered from a previous sell-off. The term structure underwent a massive bull flattening, with the belly and back-end yields tightening 50-70 bps for the week.
- Commodity prices rose for a second week in a row, driven by macro variables (namely, perceptions of a not so hawkish Fed) and idiosyncratic fundamentals. The Bloomberg Commodity Index — measured in USD — rose 3.8% for the rolling week ended on July 28. The rally was broad based: the Agriculture Subindex gained 6.0%, the Energy Subindex climbed 3.1%, and the Metals Subindex rose 4.2%. In BRL terms, the Bloomberg Commodity Index dropped 2.1%, as the currency rallied significantly for the week. The 50-day moving average of commodity prices in local currency is down 2.4% from the peak seen late in June. For the year, that gauge is up ~10%, implying a limited impact from a cost-deflation process for now.
- The Ministry of Economy unveiled the details of its third bimonthly budget review for 2022, estimating a primary fiscal deficit of BRL59.4 billion, little changed from the May review despite major revisions in revenue and expenditure forecasts. In June, the National Treasury liquidity reserves rose on the heels of lower debt redemptions and one-off factors. The central government posted a primary surplus of BRL14.4 billion in June, the best result for the month since 2011, driven mainly by extraordinary revenue.
- Based on the June CAGED (establishment) survey, we estimate seasonally adjusted payroll growth of 253k, with the trend monthly rate running at ~215K, way above the "neutral" level for the jobless rate (~100k). The number of hirings in June increased 0.2% MoM-sa, and layoffs decreased 0.4% MoM-sa. Based on IBGE's PNAD (household) survey, we estimate the June seasonally adjusted unemployment rate stood at 9.1%, down 0.4 p.p. from May, and the lowest level since August 2015. We maintain our view of an overheated job market, given our estimates of structural joblessness at 10-11%. On Tuesday (August 2), industrial output data for June are to be released, and we expect a monthly gain of +0.4% MoM-sa.
- Following a substantial influence from (one-off) energy tax cuts, July's IPCA-15 registered a 0.13% MoM change, in line with our call (0.11%) and a bit below the consensus expectation (0.16%). With this result, the headline trend slowed to 8.3% QoQ-saar (previously 14.5%). In YoY terms, the IPCA reached 11.39%, reinforcing our view that inflation has peaked, at least in terms of headline. The composition remained worrisome, though. For the medium term, we remain cautious about the pace of disinflation, given the expected reversal of some (gasoline) tax cuts in 2023, the overheating job market, and the effects of the recent round of fiscal stimulus. We updated our high-frequency tracking to 7.7% for IPCA 2022 (from 7.9%) but kept our IPCA 2023 estimate unchanged at 5.7% (mid-target: 3.25%; upper target: 4.75%).

- The Copom gathers next week and announces its monetary policy decision on Wednesday (August 3). For that meeting, we are aligned with the broad consensus that the Brazilian Central Bank (BCB) will hike the Selic rate (for the 12th time in a row in this cycle) by 50 bps to 13.75%. In what we expect will be the most interesting part of the statement, however, we believe the BCB may signal another rate increase (of flexible magnitude, 25 or 50 bps) for the September 20-21 policy meeting, a view that is clearly out of consensus right now. We believe the recent deterioration in the inflation outlook (on additional fiscal stimulus, an overheated job market, and still-rising inflation expectations) will require an additional dose of monetary tightening for the BCB to achieve its objective of bringing its IPCA estimate for 2023 “around the target”.

Most of the information in this report is up to the end of Thursday, July 28, 2022.

Figure 1. Brazil Macro Agenda for the Week of August 01 to August 05, 2022

Indicators / Events	Source	Reference	Date	Santander Estimate	Prior
Trade Balance Monthly (USD billion)	SECINT	Jul/22	Mon, 01-Aug	-	8.8
Industrial Production (% MoM)	**IBGE**	**Jun/22**	**Tue, 02-Aug**	**0.4**	**0.3**
Industrial Production (% YoY)	**IBGE**	**Jun/22**	**Tue, 02-Aug**	**0.8**	**0.5**
Copom Meeting - Selic Rate (%)	**BCB**	**Aug/22**	**Wed, 03-Aug**	**13.75**	**13.25**
IGP-DI Inflation (% MoM)	FGV	Jul/22	Fri, 05-Aug	-0.27	0.62
IGP-DI Inflation (% YoY)	FGV	Jul/22	Fri, 05-Aug	-9.24	11.12
Vehicle Sales (thousands)	Fenabrave	Jul/22	01 to 03-Aug	-	178.1
Vehicle Production (thousands)	Anfavea	Jul/22	04 to 05-Aug	-	203.6

Sources: Bloomberg, IBGE, Santander.

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

[1] **Santander Brazil – Scenario Update: "Better *Activity Expected in the Short Term, with Higher Interest Rates (Even) Longer"* –** July 14, 2022- Available on: https://bit.ly/Std-scenupdate-jul22

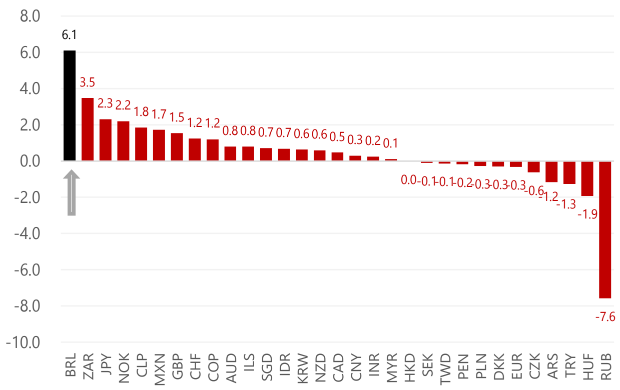
LOCAL MARKETS—FX

In the rolling week ended on July 28, the BRL rallied and outperformed peer currencies. This happened amid a risk-on mood in global markets following perceptions of a softer-than-expected tone from the Federal Reserve in the FOMC meeting. The rebound in commodity prices — partly related to "Fed-relief", partly related to idiosyncratic factors — may also have added to this picture. Amid a lack of key domestic drivers, we believe the Brazilian currency once again put on display its high-beta pattern, magnifying the effects of global market conditions. The USD/BRL cross fell to 5.18 (meaning a weekly BRL gain of ~6% vs. the greenback), with Brazil FX reaching its strongest level this month. In fact, the BRL was the top-performing currency for week, in a basket with the 31 most liquid currencies in the world. Given the risk of persistent inflation pressures in the U.S., we continue to see a high probability that the Fed may have to hike interest rates more than markets currently price in (i.e., a terminal rate around 3.25%). Thus, we could well be experiencing nothing but a bear-market rally (both here and abroad). Additionally, on the domestic side, we still identify numerous uncertainties regarding the future of economic policy. That said, we still see limited room for a more intense and sustained strengthening of the BRL throughout 2H22. We project the FX rate at USD/BRL 5.30 for YE2022.

LOCAL MARKETS—Rates

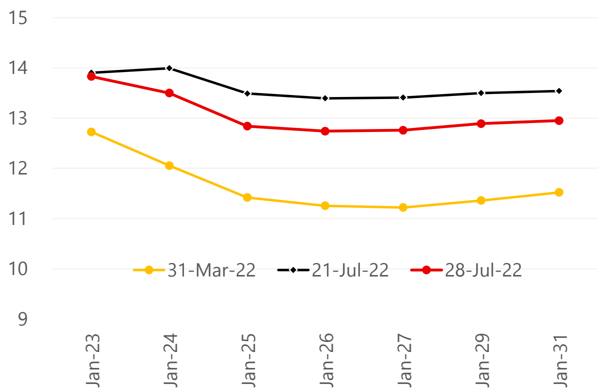
Nominal rates rallied sharply and bull flattened this week, mostly on the back of global drivers. Since last Thursday (July 21), the front end of the curve (denoted by the Jan-24 DI future) fell 49 bps to 13.50%, while the back end of the curve (denoted by the Jan-27 DI future) fell 65 bps to 12.76%. The curve's steepness in this segment fell another 16 bps, increasing the inversion to -74 bps. In the short end, July's IPCA-15 print helped as it came in at 0.13% MoM, a tad below expectations and with preliminary signs of easing in some components (see details in the Inflation section). On the back end, the rally in U.S. Treasuries yields after a less hawkish tone than expected from the FOMC meeting also contributed to push yields lower. The options market continued pricing in a 90% probability of a 50-bp hike at August's Copom meeting (in line with our call), but the probability of rate stability for the September meeting rose to 32% from 26% last week. In our view, this rally in local rates could be short-lived, as we foresee more tightening by the Fed than the market currently expects, and we envision the BCB signaling another hike for September. Fiscal risks also bring an upward bias to nominal yields in coming months, in our view.

Figure 2. Comparative Weekly FX Performance



Sources: Bloomberg, Santander.
Note: As of the close on Thursday, July 28, 2022.

Figure 3. Brazilian Domestic Yield Curve (% p.a.)



Sources: Bloomberg, Santander.
Note: As of the close on Thursday, July 28, 2022.

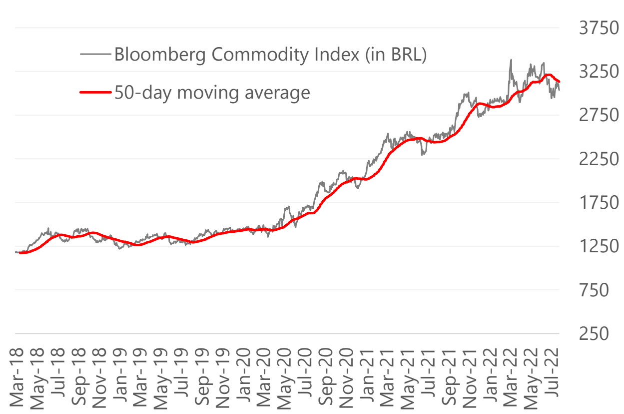
COMMODITIES

Commodity prices rose for a second week in a row, driven by macro variables (namely, perceptions of a not so hawkish Fed) and idiosyncratic fundamentals. The Bloomberg Commodity Index — measured in USD — rose 3.8% for the rolling week ended on July 28. The rally was broad based: the Agriculture Subindex gained 6.0%, the Energy Subindex climbed 3.1%, and the Metals Subindex rose 4.2%. In BRL terms, the Bloomberg Commodity Index dropped 2.1%, as the currency rallied significantly for the week. The 50-day moving average[2] of commodity prices in local currency is down 2.4% from the peak seen late in June. For the year, that gauge is up ~10%, implying a limited impact from a cost-deflation process for now.

Brent oil prices continue to rise, now hovering above USD 107/bbl. On Wednesday (July 27), EIA data showed that U.S. oil inventories are drawing down below consensus, which provided support for oil prices. Still, markets continue to struggle with recession fears and are anticipating a slowdown in global economic activity (and therefore lower oil demand). On Thursday (July 28), oil prices receded following the lower-than-expected U.S. GDP data for 2Q22, and with EIA data on U.S. gasoline demand showing a figure still below the five-year average. In Europe, Russia halved (to 20% from 40% of full capacity) the amount of gas flow through Nord Stream 1, blaming the move on sanctions-related problems with the turbines. Uncertainty remains on whether the EU will be able to rebuild stockpiles of natural gas before winter. We believe supply constraints will again start to drive \price formation in the coming months, leading to a rebound. Our forecast for Brent is USD115/bbl for YE2022. **Corn and soybeans rallied in the week on the heels of adverse weather.** In USD terms, corn (+8%) and soybeans (+11%) rallied on concerns that excess heat and dry weather in August (an essential month for crop development) may hurt American crop yields. The areas experiencing droughts have been increasing for both grains: for corn, it is up to 30% of the planted areas; for soybeans it has reached 25% of the planted area (these numbers were 19% and 11%, respectively, two weeks ago). In Europe, similar weather is also a risk for sunflowers. Meanwhile, last week Russia, Turkey, and Ukraine signed a deal to restart export shipments from the Black Sea. However, there is the challenge of finding seafarers (maritime crew) willing to work on the ships stranded in Ukrainian ports. With stock-use ratios poised to remain at historically low levels, even with slowing demand, we continue to forecast high grain prices ahead and still forecast a rebound in the medium term. **Iron ore rose a hefty 21% this week on optimism, further supported by the housing sector in China.** According to press sources, the PBoC will issue low-interest loans to state banks in an attempt to increase leverage and help developers complete property projects. Additionally, the Chinese government will launch a real estate fund to help property developers deal with the current debt crisis and restore confidence in the sector. Moreover, prospects of a slower pace of monetary tightening by the Fed likely played a part in lifting sentiment in the metals markets. Iron ore prices are now 26% off their March levels and 43% below the peak seen in May 2021. Looking ahead, we forecast a rebound in metals once the economy safely reopens and China adds stimulus.

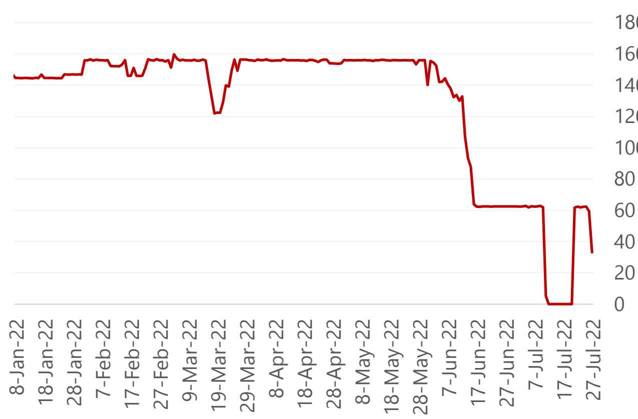
For details on Santander's commodities outlook, please refer to our last chartbook[3].

Figure 4. Bloomberg Commodity Index in BRL



Sources: Bloomberg, Santander.

Figure 5. Gas Flow from Russia to Europe (MCM/d)



Sources: Bloomberg, Santander.

[2] A better gauge of the potential for a pass-through to "real economy" prices.

[3] **Santander Brazil Commodities:** ***"Chartbook - Macro Headwinds Intensify as Imbalances Persist"*** **–** July 26, 2022 – Available on: https://bit.ly/Std-chart-cmdty-jul22

FISCAL POLICY AND LEGISLATION

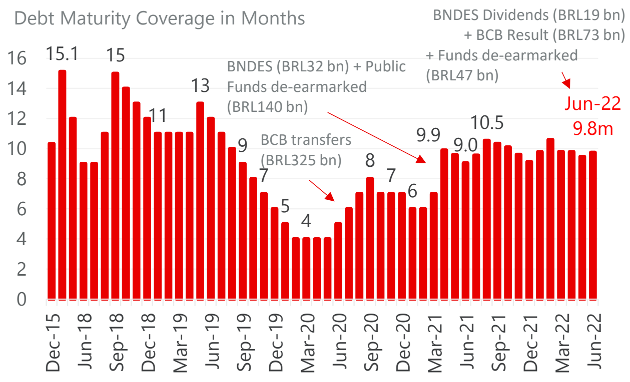
On July 25, the Ministry of Economy detailed its third bimonthly budget review for 2022. The document showed higher revenue forecasts (+BRL59 billion, compared to the budget review released in May). This rise in expected revenue mostly relates to higher extraordinary revenue (BRL45 billion, mostly from BRL26 billion from the Eletrobras privatization and BRL19 billion in dividends from BNDES). The government froze another BRL2.8 billion in expenses (totaling BRL12.7 billion this year, mainly in discretionary outlays) in order to comply with the constitutional spending cap. This confirms a tight fiscal margin. We believe that new changes in expenses allocation should be made for the proper functioning of some public services. The official forecast for the central government's primary gap dropped to BRL59.4 billion (0.6% of GDP), from BRL65.5 billion in May. We forecast a central government deficit of BRL70 billion for 2022 (0.7% of GDP), with risks tilted to the upside due to the government's calls for higher dividend payments by SOEs in 2022.

In June, the National Treasury's liquidity reserves rose on the heels of lower debt redemptions and one-off events. On July 27, the National Treasury published the Monthly Debt Report for June. In YTD terms, weekly bond issuances averaged BRL21 billion, above the financial needs to keep liquidity reserves stable until the end of the year (~BRL20 billion, according to our estimate). The public debt liquidity cushion rose by BRL113 billion, reaching BRL1,221 billion, reflecting the net issuances (helped by a lower level of redemptions) in the month and some important one-offs: (i) the proceeds from the BCB's 2021 operational profit, amounting to BRL73 billion; (ii) the de-earmarking of resources from public funds, amounting to BRL47 billion; and (iii) additional dividends from BNDES, totaling BRL19 billion. The level of the Treasury's liquidity reserves now covers ~9.8 months of debt maturities. The cost of new domestic issuances rose to 12% p.a. from 11.7% p.a. in May (in tandem with increases in the IPCA and the Selic rate). Non-residents registered a positive flow of BRL1.6 billion in June, leading the YTD total to -BRL65.7 billion, even as their share of debt holdings fell to 8.9% from 10.6% in December 2021. In our view, despite the comfortable levels of liquidity reserves to navigate the uncertainties for the remainder of 2022, the outlook for debt management remains challenging for the medium term. However, we think the current cycle of high commodity prices could somewhat help ease the short-term headwinds.

According to the data published by the Treasury on July 28, the central government posted a primary surplus of BRL14.4 billion in June. It was the best performance for the month since 2011, driven by substantial extraordinary revenue (amounting to ~BRL50 billion). Expenditures dropped 14.5% YoY in real terms (on lower extra-cap outlays), with a rise in discretionary outlays (+BRL12 billion) due to higher disbursement set by the Congress. Revenue rose 47% YoY, particularly thanks to taxes based on labor-income and oil-led proceeds, as well as proceeds from BNDES dividends and the Eletrobras privatization.

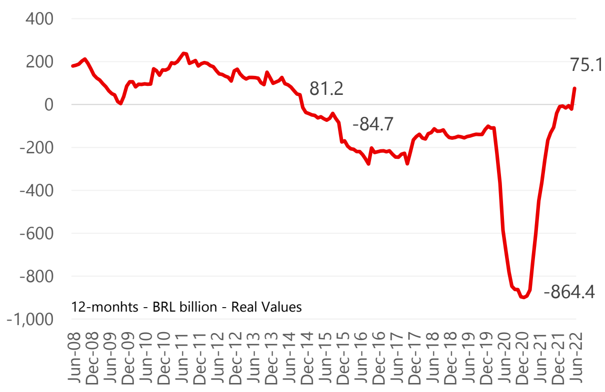
For details on Santander's fiscal policy outlook, please refer to our last chartbook[4].

Figure 6. National Treasury's Liquidity Reserves



Sources: National Treasury, Santander.

Figure 7. Central Government Balance Budget (12m)



Sources: National Treasury, Santander.

[4] **Santander Brazil Fiscal Policy:** ***"Chartbook - Back to Primary Deficit with Fiscal Stimulus"*** **–** July 14, 2022 – Available on: https://bit.ly/Std-chart-fiscal-jul22

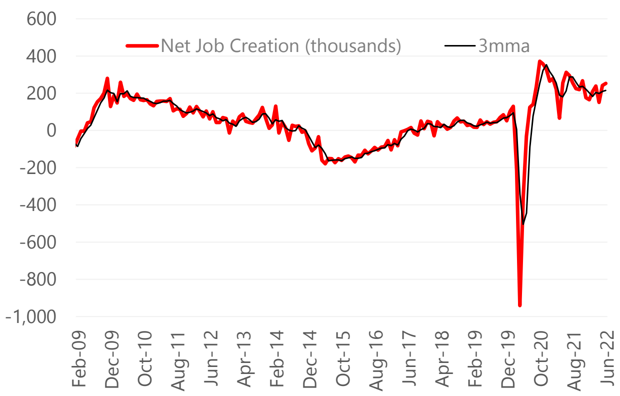
ECONOMIC ACTIVITY

The labor market maintained good momentum in June. According to the June CAGED survey, net formal job creation stood at 278k (consensus: 240k; Santander: 234k). Using our own seasonal adjustment, we estimate net formal job creation accelerated to 253k, from 242k in May. The number of hirings rose 0.2% MoM-sa, while layoffs fell 0.4% MoM-sa. The three-month average now points to a pace of payroll expansion of 215k jobs per month, compared to 210k in May. The trend for monthly formal job gains stands way above the "neutral" level for the unemployment rate (we estimate just below 100k per month). The current rate of payroll growth is equivalent to an annualized pace of over 2.5 million jobs, close to the numbers observed in 2010 (2.1 million) and 2021 (2.8 million). In both years, the labor market was rebounding from shocks that had prompted considerable job losses previously (2008-09 recession and 2020 pandemic). In our view, the June CAGED result showed a still strong pace of payroll expansion.

According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 9.3% in the three months to June, showing a continuing decline. The result was in line with our estimate and the market consensus (both at 9.3%). We calculate that the seasonally adjusted jobless rate stood at 9.1%, a decrease compared to the May level (9.5%) and the lowest level since August 2015. The seasonally adjusted labor market participation rate stood at 63.0% (May: 62.8%). PNAD data is based on a three-month moving average, and we estimate that the monthly unemployment rate figure stood at 9.1% (sa) in June, compared to 8.9% in May. This result followed +0.8% and +1.0% MoM sa variations in employed population and the labor force, respectively. Therefore, the slight increase of the unemployment rate at the margin was due to an improvement in the participation rate, as the employed population posted another hefty result. The usual real wage bill had a +1.7% MoM sa gain in June and is now 1.8% below the pre-crisis mark (February 2020). All in all, the June results show that the labor market remained strong and likely overheated, as job creation remained strong and the unemployment rate touched seven-year lows once again. We maintain our expectation of a deceleration in employment growth throughout 2H22, as the effects of a tighter monetary policy on economic activity start to kick in, but we acknowledge a downside risk for our unemployment rate projections.

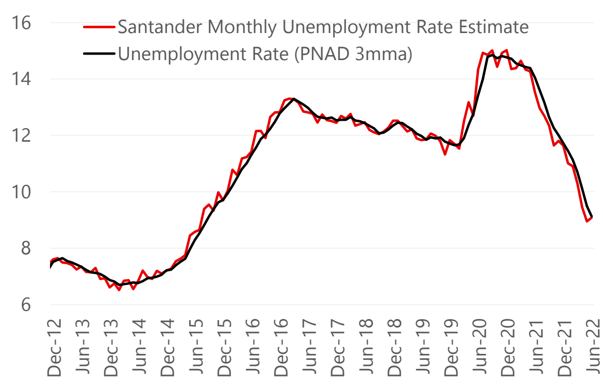
In the coming week, on Tuesday (August 2) the IBGE will release industrial output data for June. We expect a slight monthly gain of +0.4% MoM-sa. Our 2Q22 GDP growth remains at +0.8% QoQ-sa, and our 2022 GDP growth forecast stands at +1.9%, with risks skewed to the upside. For 2023, we expect a 0.6% retreat of real activity. **For details on Santander's economic outlook, please refer to our last reports[5].**

Figure 8. Net Formal Job Creation (sa)



Sources: Ministry of Labor, Santander.

Figure 9. Unemployment Rate (sa)



Sources: IBGE, Santander.

[5] **Santander Brazil Special Report: "*Nowcasting Brazilian GDP with LASSO*" –** June 14, 2022 – Available on: https://bit.ly/Std-special-051622
Santander Brazil Special Report: "*A Model to Forecast Probability of Recession in Brazil*" – June 08, 2022 – Available on: https://bit.ly/Std-special-060822
Santander Brazil Special Report: "*Resilience Factors for GDP Growth: What Has Changed Since January*" – June 30, 2022 – Available on: https://bit.ly/Std-special-GDP-062922
Santander Brazil Economic Activity: "*Chartbook: Further improvements in 2022, as 2023 remains challenging*" – July 20, 2022 – Available on: https://bit.ly/Std-chart-econact-jul22

CREDIT

After the end of the strike at the Brazilian Central Bank, the authority released the credit April data. Total outstanding loans in the National Financial System (SFN, in the Portuguese acronym) in April posted inflation-adjusted growth of 4.16% YoY (the smallest number since February 2020), reaching BRL4.8 trillion. For households, loans were up 8.71% YoY; for non-financial corporations, they were down 1.71% YoY. The nominal growth rate of total outstanding loans increased to 16.80%.

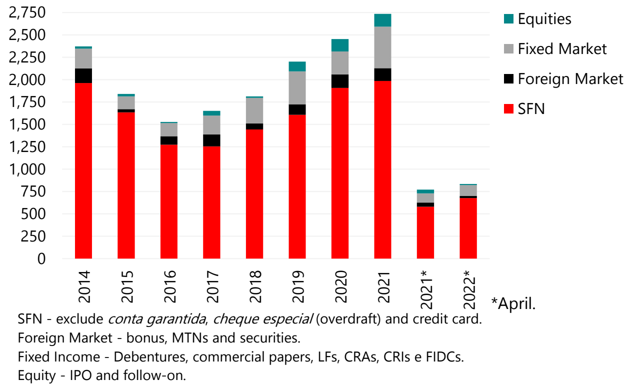
New loans adjusted for inflation and seasonality (BCB methodology) recorded a decrease of 1.2% in April from March's figure (+7.3% MoM-sa in March 2022). For households, the non-earmarked segment posted an increase of 1.7% MoM-sa. We highlight the rise in total personal credit (14-7% MoM-sa), but credit cards presented a decline (-4.5% MoM-sa). In the earmarked segment, households posted a decrease, 2.3% MoM-sa. Real estate financing also fell (-10.9% MoM-sa), but rural credit and others showed a positive variation (6.3% MoM-sa and 2.5% MoM-sa, respectively). For companies, there was a decrease of 11.9% MoM-sa in April in the non-earmarked segment, with total working capital showing a negative variation (-6.9% MoM-sa), the third decline in a row. The earmarked segment also decreased, falling 13.7% MoM-sa, with new operations in BNDES Funds, which also fell 2.16% MoM-sa.

Considering total corporate financing YTD through April 2022 (new loans in the SFN, debt and equity issues in the capital markets) vs. the year-ago period, issuances in the capital markets were 17% smaller, with SFN concessions up 16.7%. As a result, total corporate financing was up 8.4% compared to the year-ago period.

Still regarding non-earmarked loans, the seasonally adjusted default rate (% of 90-day past-due loans) continued to rise, to 5.0% for households (the last time it was greater than 5.0 was in July 2020), while for corporates it was 1.7% (same from March 2022). Importantly, with the new methodology, household debt-to-income reached 52.7% in March 2022; excluding real estate financing, household debt-to-income was at 33.2%. In addition, the debt service ratio reached 27.7% in March; excluding real estate financing, the debt service ratio was 25.6%. We see these figures as a risk for delinquencies as the economy recovers. See details in the link[6].

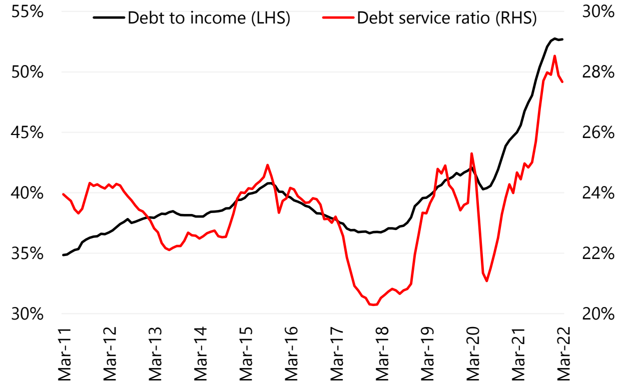
For details on Santander's economic outlook, please refer to our last chartbook[7].

Figure 10. Total Corporate Financing (BRL billion, Inflation adjusted)



Sources: BCB, Santander.

Figure 11. Household Debt-to-Income and Debt Service Ratio (%)



Sources: BCB, Santander.

[6] **Santander Brazil Credit: "*Delinquencies Still Not Sparking a Credit Slowdown*"** – July 27, 2022 – Available on: https://bit.ly/Std-credit-apr22
[7] **Santander Brazil Economic Activity - Credit: "*Chartbook: Delinquencies Still Not Sparking a Credit Slowdown*"** – July 28, 2022 – Available on: https://bit.ly/Std-chart-credit-jul22

INFLATION

July's IPCA-15 registered a 0.13% MoM change, in line with our call (0.11%) and a bit below the consensus expectation (0.16%). With this result, the headline trend saw relief, with a decline to 8.3% 3MMA-saar (from 14.5%). In YoY terms, the IPCA reached 11.39%, reinforcing our view, at least in terms of headline inflation, that the worst is behind us now and the peak has already been reached.

Compared with our forecast, services surprised to the upside (+9 bps contribution to the headline forecast error), mainly because the expected effect of the tax cut for communication items did not yet appear in the reading. Still, a few services items related to salaries/more inertial items (such as rents +0.95% MoM and housekeepers +1.25% MoM) surprised to the upside, which is more worrisome. Conversely, industrial goods and food-at-home surprised to the downside (contributing -3 bps and -5 bps to the headline forecast error, respectively), and regulated prices were in line with our expectations.

In our view, this reading was marginally better than last month's, with some positive points: the relief in the headline trend to 8.3% 3MMA-saar (from 14.5%); the diffusion index seeing relief for the second time in a row, reaching 71.1% (from a peak of 76.4% in May, though this still means a high dissemination of inflation pressures from a historical perspective); the average of core gauges ticking down to 12.5% 3MMA-saar (from 13.2%); and industrial goods experiencing a more significant cool-down, to 11.4% 3MMA-saar (from 14.5%). Food-at-home also trended down, to 17.0% 3MMA-saar (from 23.2%).

Of course, many of the short-term positives relate to the tax cut measures approved by Congress, while services inflation is still a concern. For the medium term, however, we remain cautious about the pace of deceleration, as some taxes are likely to be reinstated next year. Moreover, the tax cut measures and the new round of income aid (fiscal expansion) could support demand, thereby keeping upward pressure on inflation in the medium term. We updated our high-frequency tracking to 7.7% for IPCA 2022 (from 7.9%) and kept IPCA 2023 unchanged, at 5.7%. See details in the link[8].

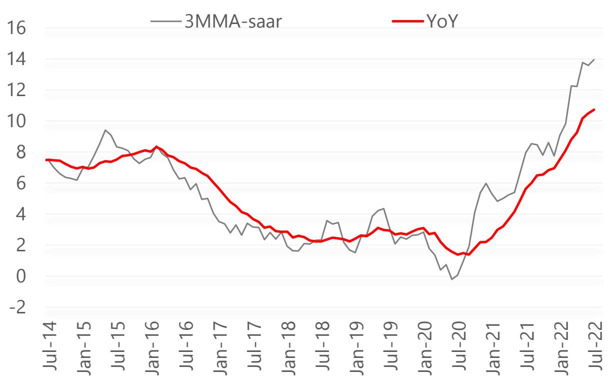
On Thursday (July 28), July's IGP-M registered a 0.21% MoM change (10.0% YoY). See details in the link[9].

Figure 12. July's IPCA-15 Details (%)

	MoM			YoY	
	Jul-22	Santander	Dev.	Jun-22	Jul-22
IPCA-15	0.13	0.11	0.02	12.0	11.4
Administered	-1.50	-1.54	0.01	12.2	9.5
Free	0.72	0.71	0.01	12.0	12.1
Food-at-home	1.12	1.32	-0.03	16.7	17.5
Industrial goods	0.28	0.48	-0.05	14.0	13.5
Services	0.84	0.59	0.09	8.8	8.9
EX3 Core	0.87	0.94	-0.02	10.5	10.7

Sources: IBGE, Santander.

Figure 13. Core Inflation – IPCA EX3 (%)



Sources: IBGE, Santander.

[8] **Santander Brazil Inflation: "July's IPCA-15: Tax Cut Measures Start to Take Effect"** – July 26, 2022 – Available on: https://bit.ly/Std-IPCA15-jul22
[9] **Santander Brazil Inflation: "July's IGP-M: A Commodity Driven (Sell-Off) Slowdown"** – July 28, 2022 – Available on: https://bit.ly/Std-IGPM-jul22

MONETARY POLICY

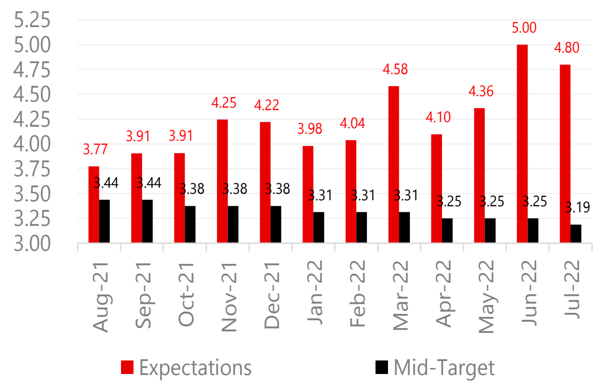
The Copom gathers next week and announces its monetary policy decision on Wednesday (August 3). For that meeting, we are aligned with the broad market consensus that the BCB will hike the Selic rate (for the 12th consecutive time in this cycle) by 50 bps, to 13.75%.

In what we expect will be the most interesting part of the statement, we believe the BCB could signal another rate increase (of flexible magnitude, 25 or 50 bps) for the September 20-21 policy meeting — a view that is clearly out of consensus, at least for now. In our view, the adverse evolution of the inflation outlook since the last Copom (June 14-15), in a context of greater than usual uncertainty, could prevent the BCB from committing to the end of the cycle at this stage.

Our view is based on the belief that there has been marked deterioration in the inflation outlook since the June Copom meeting. The approval of new rounds of fiscal stimuli, the narrower economic slack due to a tighter job market, and the brisk gain in inflation expectations for 2023 could not only lead to higher inflation forecasts by the authority (for the relevant policy horizon) but could also prompt upward asymmetry in the balance of risks.

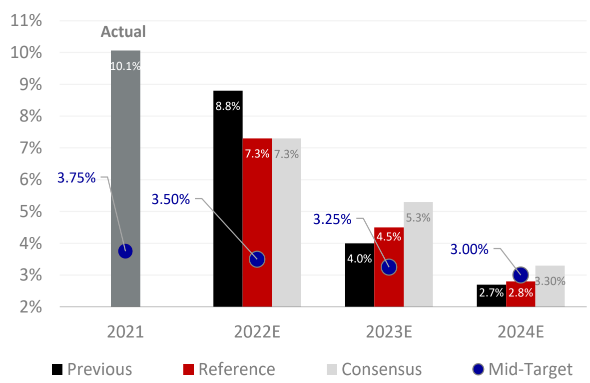
In turn, we believe these developments could increase the "budget" of Selic hikes necessary for the BCB to achieve its goal of bringing its 2023 IPCA estimate "around the target" (i.e., below 4%, at least). We expect the BCB to maintain its ("smoothing interest rate") strategy laid out in the last Copom meeting, where the authority signaled it would likely keep the Selic rate higher for longer. As for our interest-rate outlook, we continue to expect an additional tightening of 50 bps (probably at the September meeting), with interest rates reaching 14.25% and staying at this level up to 2Q23. After that, we expect gradual Selic cuts toward 12.00% for YE2023 and 9.00% for YE2024. See details in the link[10].

Figure 14. Calendar-Adjusted IPCA Estimates, Target (18 months ahead)



Sources: IBGE, Santander.
Note 1: IPCA expectations and target adjusted for the weight of each calendar-year as a policy horizon. For 3Q22, this means 75% for 2023, 25% for 2024.
Note 2: Figures for the end of month. For July 2022, last data available for the 22nd.

Figure 15. Our "Educated Guess" for the BCB's IPCA Forecasts in the Reference Scenario



Sources: Santander.
Note: Assumes Selic rate as per the Focus report.

[10] **Santander Brazil Monetary Policy: "*COPOM PREVIEW: No Time to Shut the Door (On Future Hikes)*"** – July 28, 2022 – Available on: https://bit.ly/Std-COPOM-p-aug22

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