Santander
Macroeconomic Research

BRAZIL MACRO

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MACRO COMPASS

CURRENT ACCOUNT DEFICIT AT A 13-YEAR LOW; CONSUMER INFLATION AT A 4-YEAR HIGH

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- The dovish message from the FOMC and the hawkish decision from the Brazilian Central Bank (BCB) seem to have lent support to the BRL this week, as the FX rate receded from the highs registered in previous days. As of Thursday's closing, the BRL was nearly at the same level as a week before, posting a performance in line with peers.
- The nominal yield curve flattened considerably this week, led by a hawkish COPOM decision at the front end, and a steady dynamics at the back end, despite the fiscal risks and higher US Treasury 10y yields.
- Brazil is probably seeing the worst days of the pandemic, amid record-high numbers of new cases and deaths. Also, 17 states report ICU occupancy rates above 90%. Increased vaccine supplies in coming weeks could mean a brighter near-term outlook for the country's immunization program. As of March 18, about 14.4 million doses have been administered in the country (with 3.8 million people having received their second shots).
- The COPOM raised the Selic (policy) rate by 75 bps, to 2.75%, in line with the more hawkish camp of market participants (traders and money managers, in general) and topping the forecasts of a vast majority of economists who looked for a 50-bp move (ourselves included). We are changing our YE2021 Selic rate forecast to 5.50% (from a previous 4.00%), incorporating an additional hike of 75 bps in May and four subsequent moves of 50 bps.
- The IBC-Br, BCB's activity indicator, surprised positively in January, consolidating a recovery as the index now sits 0.2% above the pre-pandemic level. January's CAGED survey posted a net formal job creation of +260k, topping the market consensus and our estimate (+189k and +210k, respectively). That was the strongest job creation for a January on record. We believe CAGED results may be reflecting underreporting of layoffs in recent periods, artificially elevating the net job creation figures.
- We look for March's IPCA-15 to accelerate sharply in monthly terms to +1.03% (+5.63% YoY) vs. +0.48% MoM (+4.57% YoY) in February, meaning a high seasonally adjusted print. The EX3 core may also accelerate on a trend basis, reinforcing the unfavorable scenario for inflation in the short term.
- We expect the current account balance to have registered a USD2.5 billion deficit in February. If confirmed, that will mean the lowest current-account deficit since Feb-08 (on a 12-month basis). Together with a USD7.0 billion inflow of direct investments in the country, we believe the data will continue to hint at a sound backdrop for the balance of payments.

This report uses most information up to the end of Thursday, March 18, 2021.

Figure 1. Brazil Macro Agenda for the Week of March 22-26, 2021

Indicators	Source	Reference	Date	Santander Estimate	Prior
Copom minutes	**BCB**	**Mar-21**	**Tue, 23-Mar**	**--**	**--**
Consumer Confidence (index)	FGV	Mar-21	Tue, 23-Mar	--	78
Retail Confidence (index)	FGV	Mar-21	Wed, 24-Mar	--	91
Federal Debt Report (BRL trillion)	Nat. Treasury	Feb-21	Wed, 24-Mar	--	5.06
Central Gov. Prim. Balance (BRL billion)	Nat. Treasury	Feb-21	Thu, 25-Mar	-28.5	43.2
Construction Confidence (index)	FGV	Mar-21	Thu, 25-Mar	--	92
Quarterly Inflation Report	**BCB**	**1Q21**	**Thu, 25-Mar**	**--**	**--**
IPCA-15 Inflation (% MoM)	**IBGE**	**Mar-21**	**Thu, 25-Mar**	**1.03**	**0.48**
IPCA-15 Inflation (% YoY)	IBGE	Mar-21	Thu, 25-Mar	5.63	4.57
Industrial Confidence (index)	FGV	Mar-21	Fri, 26-Mar	--	107.9
Current Account Balance (USD billion)	BCB	Feb-21	Fri, 26-Mar	-2.5	-7.3
Foreign Direct Investment (USD billion)	BCB	Feb-21	Fri, 26-Mar	7.0	1.8
Federal Tax Collection (BRL billion)	IBGE	Feb-21	22 to 25-Mar	121.5	180.2

Source: Santander Brazil.

For details on Santander's economic forecasts for Brazil, please refer to our last scenario review[1]. For our key views and hypotheses for 2021, please refer to our macro propositions[2].

[1] **Santander Brazil - Macroeconomic Scenario: *"The Persistence of (Fiscal) Risks"* –** February 11, 2021- Available on: http://bit.ly/Sant-ScenRev-fev21

[2] **Santander Brazil - "Macro Propositions: Groundhog Year?"** – February 03, 2021- Available on: http://bit.ly/Sant-macro-prop-2021

LOCAL MARKETS—FX

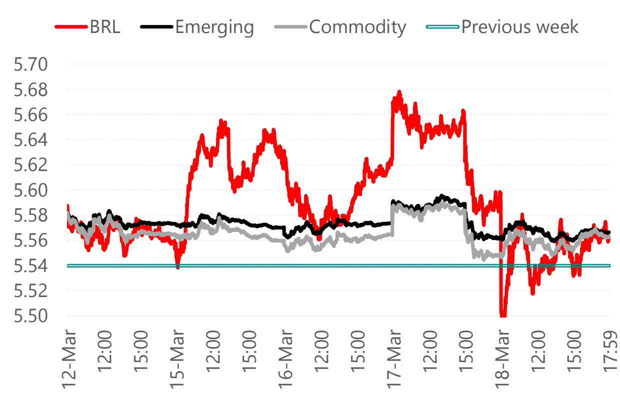
After having reached as high as USD/BRL5.68, the Brazilian FX rate ended the March 18 session at USD/BRL5.56, which was relatively close to the level observed on March 11 (USD/BRL5.54) and in line with emerging market peers. Part of the retreat from the highs that the BRL registered in the last couple of days had to do with the FOMC decision. The more dovish wording seen in the post-decision communiqué handed out by the US monetary authority and the soothing speech delivered by the FOMC chairman, Jerome Powell, were taken by market participants as a sign that the accommodative stance of the US monetary policy should remain intact for quite a while, which triggered a global wave of USD weakening that favored the BRL as well.

Another contribution to BRL strength came from the surprising decision carried out by the BCB. Instead of commencing the normalization of the monetary policy stance with a 50 bps hike, which was the consensual view amongst analysts, with which we concurred, the BCB increased the Selic target rate by 75 bps and indicated that (at least) a similar move is being considered for the next Copom meeting due to be held on May 5 (more details in the Monetary Policy section). This sterner-than-expected move and the ensuing indication was taken by market participants as evidence that higher yields in the domestic market may lure investors to face risks related to the fiscal policy conduct, thus thwarting the weakening trend that the BRL has registered recently. Although acknowledging that larger rewards usually lead market participants to run higher risks, we still believe the bulk of the BRL weakness is related to the fiscal front. Hence, the tighter monetary grip may hinder further weakness of the BRL, but its strengthening lingers on the approval of structural reforms to ensure the sustainability of the Brazilian public indebtedness.

LOCAL MARKETS—Rates

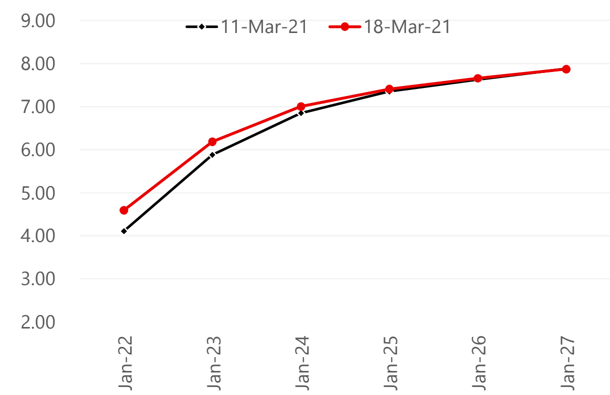
The nominal yield curve saw a considerable flattening this week. Since our last report (March 11), the front end of the curve (Jan-22 DI future) rose 48 bps to 4.60%, while the back end (Jan-27 DI future) fell 1 bp to 7.87%. Hence, the steepness in this segment decreased from 377 bps to 328 bps (-49 bps) since Thursday of last week (March 11). At the front end, Copom surprised most of economists and part of the market (traders/portfolio managers) and delivered a 75-bps hike on the Selic rate with a hawkish tone (see more in the Monetary Policy section), leading the market to price in a higher probability of faster interest-rate normalization. At the long end, despite markets remaining worried about the fiscal scenario for the medium/long-term—as, in our view, the approval of *PEC Emergencial* alone was not sufficient to guarantee to the markets a safe fiscal consolidation process ahead—and the upward trend in the US Treasury's 10y yield, the long end was basically steady. In that scenario, with fiscal risks in place but with markets more focused on the monetary policy trends, the curve might bear-flatten, although models show space for a steepening (as they tend to weigh the fiscal risk-related variables more, in our view).

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the close Thursday, March 18, 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, March 18, 2021.

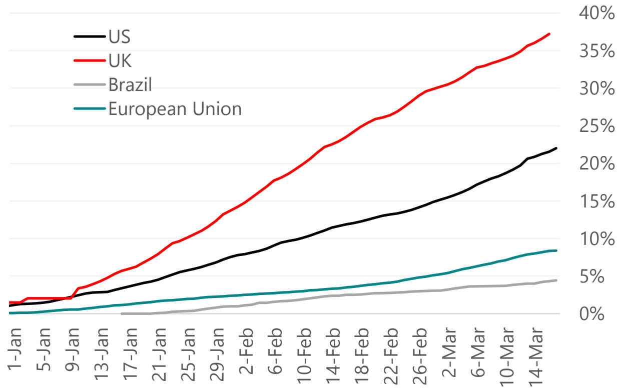
COVID-19 MONITORING

In the U.S., the easing of restrictions across several states in previous weeks is contributing to a flattening of the case curve. The fast spread of the British variant is likely another factor. The vaccination pace is currently at 2.5 million/day (7-day moving average), with nearly 22% of the population having received at least one dose. This figure stands at 37% in the U.K. and at only 8% in the European Union. Importantly, the latter saw major nations suspending the use of the AstraZeneca vaccine, dragging the process even further.

Amid the worst of the pandemic, Brazil hit record-high daily COVID new cases and deaths. The week saw 2,841 deaths on Tuesday (March 16, 2021) and 90,303 new cases on Wednesday (March 17, 2021), both record figures since the beginning of the pandemic. The ICU occupancy rate is above 90% in at least 17 states, 4 more than reported last week. Further restrictions have been announced across the country. The São Paulo state government announced an economic package—from meat tax relief to credit lines for bars and restaurants—in an attempt to provide some support for businesses. The risk here is that these new restrictions could spill over to 2Q21, weighing on tertiary activity.

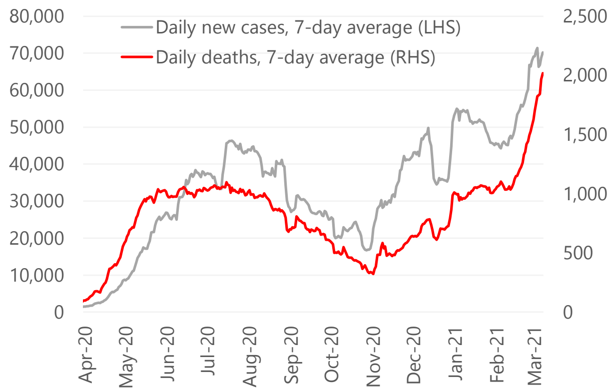
Fiocruz to receive supplies for 30 million doses in March, twice the expected number. If confirmed, this means a brighter near-term outlook for the country's vaccination program, as combined deliveries from *Butantan* and *Fiocruz* are expected to average over 1 million/day starting in April. On Wednesday (March 17, 2021), a Northeast states consortium closed a 37-million-dose deal with Sputnik V: 2 million are expected by April, 5 million by May, 10 million by June and 20 million by July. The full amount will be addressed to the National Immunization Plan, adding to the 10 million doses of Sputnik V that the Ministry of Health had previously secured. As of Thursday (March 18, 2021), 14.4 million doses[3] (out of 26 million available) had been administered in the country, with the pace of vaccination at 330k/day (7-day moving average). Data from Brazil's Ministry of Health reports an average of 70k daily new cases (7-day moving average) as of Wednesday (March 17, 2021), up 1.6% from last week, while daily deaths (7-day moving average) stood at 2,017, up 24% in the same comparison.

Figure 3.A. People Who Received at Least 1 Shot (%)



Sources: Our World in Data, Santander.

Figure 3.B. Daily COVID-19 Cases, Deaths in Brazil



Sources: Brazil Ministry of Health, Santander.

[3] Out of the 14.4 million shots already administered, about 3.8 million refer to the second dose.

MONETARY POLICY

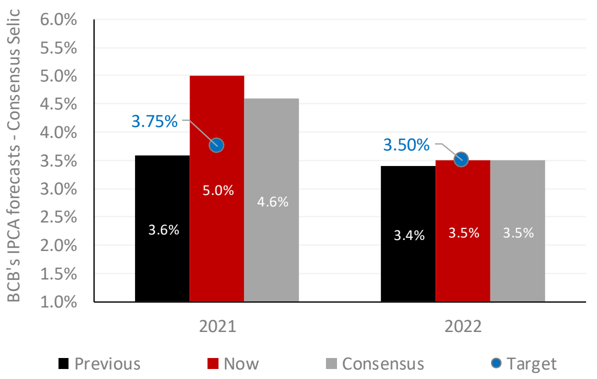
The COPOM raised the Selic (policy) rate by 75 bps, to 2.75%, in line with the more hawkish camp of market participants (traders and money managers, in general) and topping the forecasts of a vast majority of economists who looked for a 50-bp move (ourselves included). This decision kicks off what the authority is calling (at least for now) "a process of partial normalization" —meaning a reduction in (i.e., not necessarily a full removal of) the "extraordinary degree of monetary stimulus."

In the statement[4], the Brazilian Central Bank (BCB) justifies the faster pace with a belief that "a swifter adjustment has the benefit of reducing the probability of not meeting the inflation target in 2021, as well as of keeping longer horizon expectations well anchored." This strategy is seen as consistent with achieving the center target for next year, even though we (and apparently many other economists) believed that a 50-bp hike would also do the job.

The board expects to keep the pace of 75 bps for the next meeting, and the BCB models point to a Selic path of 4.50% for YE2021 and 5.50% for YE2022 as sufficient to keep 2021 IPCA below the upper target (5.25%) and the 2022 IPCA at the center target (3.50%), with FX rate at ~BRL5.70/USD. But an upwardly skewed balance of risks (owing to the fiscal concerns) suggests that this could be the least to expect for future tightening.

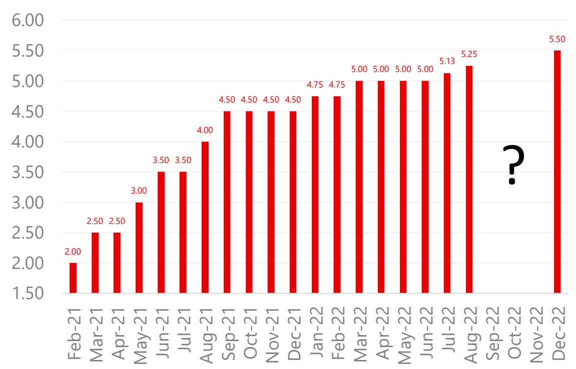
We changed our YE2021 Selic rate forecast to 5.50% (previous: 4.00%), incorporating an additional hike of 75 bps in May and four subsequent moves of 50 bps. We continue to anticipate a two-stage normalization process, with a pause in the process in 4Q21. See link below[5]

Figure 4.A. BCB's Inflation Simulations



Sources: National Congress, Santander.

Figure 4.B. Consensus Selic Rate Forecasts



Sources: Brazilian Central Bank, Santander.
Note: Based on the weekly Focus report as of March 15, 2021 (refer to https://www.bcb.gov.br/en/publications/focusmarketreadout)

[4] Refer to the statement of the 237th COPOM meeting in English (https://www.bcb.gov.br/en/monetarypolicy/copomstatements).
[5] **Santander Brazil Monetary Policy - *"Harder (stance), Better (activity), Faster (pace), Stronger (shocks)"* –** March 18, 2021- Available on: http://bit.ly/Sant-copom-mar21

ECONOMIC ACTIVITY

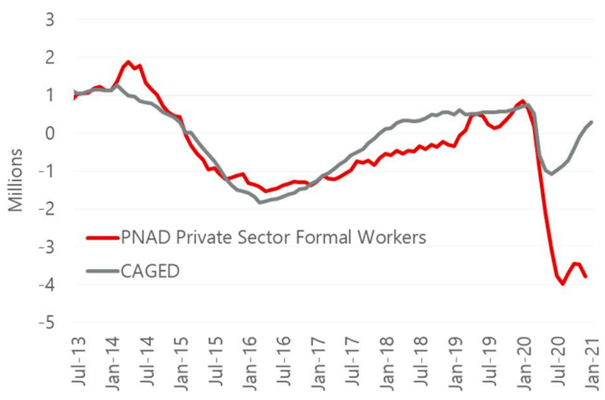
A positive surprise of economic activity at the start of 2021. The BCB's activity indicator (IBC-Br) posted an increase of 1.0% MoM-sa (-0.5% YoY), the ninth consecutive, and also above market expectations (0.4%). The January figure placed the economy 0.2% above the pre-pandemic period (February 2020), according to this indicator. This result is consistent with the underlying data showing growth in industrial production (0.4%) and services (0.6%) more than offsetting declines in broad retail sales (-2.1%). We still expect 1Q21 GDP to contract (our current estimate is -0.4% QoQ-sa) due to the reduction in government transfers to households and the adverse economic impact of the pandemic's relapse, but we believe that the January data (especially from services) imparts upside risks to this scenario. See link below[6].

The January 2021 CAGED survey posted a net formal job creation of +260k, above both the market consensus and our estimate (+189k and +210k, respectively). The figure stood at a considerably better level than the month's historical average of +51k, and above the all-time record for the month (+181k in 2010). In seasonally adjusted terms, formal job creation dropped to 240.3k from 374.3k in December. Therefore, CAGED had another strong result, despite some deceleration at the margin. (See link below)[7].

Over the past few months, CAGED data has shown much better results than IBGE's PNAD survey. We believe CAGED results may be experiencing underreporting in layoffs in the recent period, as the number of responding establishments is below its pre-pandemic average (closing firms may not be reporting layoffs before going out of business). Furthermore, the gap between new unemployment insurance claims and layoffs in CAGED is close to its all-time high (on a 12-month basis), indicating that the level of monthly layoffs should be higher than the figures suggest. Finally, the comparison between CAGED and PNAD data indicates that the difference between the job creation series cannot be explained by the informal sector only. The selection within PNAD data of private sector formal workers (population covered by CAGED) shows good long-term correlation with the CAGED series until the beginning of the pandemic, when the data provided by IBGE indicated a larger impact over employment (Figure 5.A). In our view, this is additional evidence of underreporting of layoffs in the CAGED data.

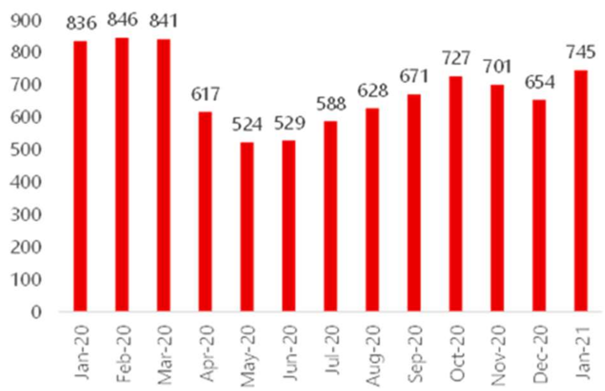
For the coming week, FGV will release the first batches of economic confidence data for March: the consumer index is due out on Tuesday (March 23), the retail index is due out on Wednesday (March 24) and the industrial index is due out on Friday (March 26).

Figure 5.A. – Net Job Creation (12-month)



Sources: IBGE, CAGED, Santander.

Figure 5.B. – Responding Firms in CAGED Surveys



Sources: CAGED, Santander.

[6] **Santander Brazil Economic Activity -** ***"A Positive Surprise at the Start of 1Q21 to Give Way to a Drop Off in Feb and Mar"*** – March 15, 2021 - Available on: http://bit.ly/Sant-econact-150321
[7] **Santander Brazil Labor Market -** ***"A Bit Closer to Normal"*** **–** March 16, 2021 - Available on: http://bit.ly/Sant-labor-160321

INFLATION

IPCA-15 March data to show a sharp acceleration in monthly terms. In a month in which usually the seasonality points to a deceleration, IPCA-15 March—due out on Thursday (March 25, 2021)—should show a +1.03% MoM (+5.63% YoY) change vs. +0.48% MoM (+4.57% YoY) in February, reaffirming the unfavorable short-term scenario for inflation. This should be the highest YoY reading in 4 years. The strongest pressure should come from regulated prices (+2.59% MoM), with fuel price inflation (+10.90% MoM) being a major driver, responsible for more than a half of the headline variation. Industrial goods should also continue their upward trend and post a +1.07% MoM change, accelerating if compared to February and putting pressure on core measures. On the other hand, services should decelerate considerably, to +0.22% MoM, with the education cost effects from February not putting as much pressure any more. Additionally, on the brighter side, food-at-home should also decelerate in monthly terms to +0.30%—although we believe this movement is close to an end, as April should already see another acceleration of food inflation.

In terms of underlying measures, the EX3 core should rise around +0.42% MoM, per our projections, meaning an upward rebound for the trend (3mma-saar) after a slight relief in the previous reading, reinforcing the unfavorable outlook for inflation in the short term.

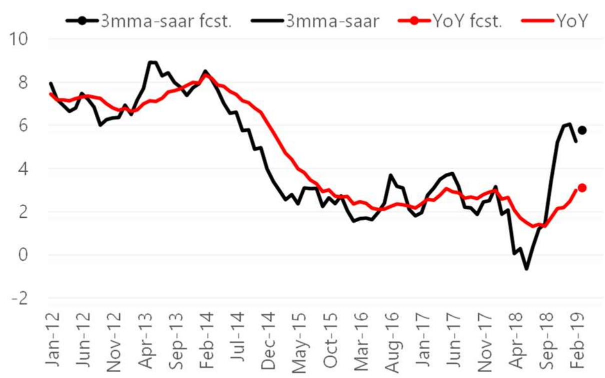
Looking ahead, despite an economy that keeps running well below its potential (especially in the services sector), we believe cost/supply related issues will put considerable upward pressures on IPCA 2021 inflation. Our official forecast (released on February 11, 2021) became quickly outdated, as our high-frequency tracking is hovering around 5.0%. For IPCA 2022 we still believe pandemic-related noises will have ended and the effect of the low demand will prevail in the determination of prices, taking the IPCA back to the middle of the-target range. On balance, however, we see the risks tilted to the upside, on the heels of the higher inertia coming from IPCA 2021 and the riskier fiscal scenario.

Figure 6.A – IPCA Monthly Forecast (%)

	MoM		YoY	
	Mar-21	Cont.	Feb-21	mar/21
IPCA	1.03	1.03	4.6	5.6
Administered	2.59	0.66	2.3	5.2
Free	0.50	0.37	5.4	5.8
Food-at-home	0.30	0.05	19.1	18.9
Industrial goods	1.07	0.25	4.1	4.8
Services	0.22	0.08	1.3	1.7
EX3 Core	0.42	0.42	3.0	3.2

Sources: IBGE, Santander.

Figure 6.B. – Core Inflation Forecast (IPCA EX3, %)



Sources: IBGE, Brazilian Central Bank, Santander.

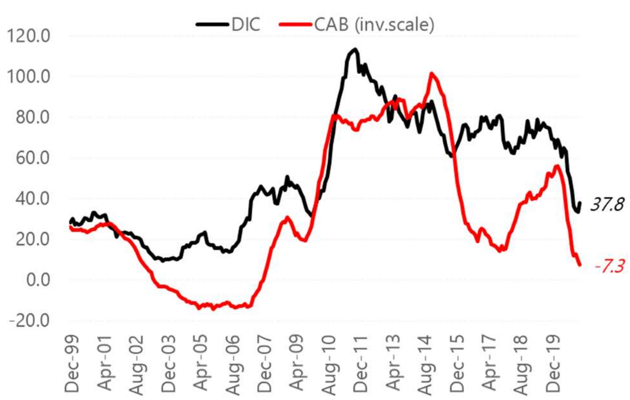
BALANCE OF PAYMENTS

We expect the February balance of payments data—due to be released next Friday, March 26—to keep sending a reassuring message. According to our calculations, the current account balance should have registered a USD2.5 billion monthly deficit, which—if confirmed—will have meant further improvement in its trajectory on a 12M-to-date basis. It is worth noting that the enhancement could have been stronger than the one we expected, were not it for the meager trade surplus registered in the period, which still had to do with imports of oil-platforms that are not actual trade-related deals but rather accounting transactions derived from changes in tax legislation.

In the absence of this influence, we calculate the current account deficit in 12M-to-date basis could have receded to USD5.9 billion (down from USD7.3 billion on a 12M-to-date basis). That would be the lowest current account deficit since 1Q08. Incidentally, we expect the same influence on the March 2021 trade balance as preliminary figures indicate imports of oil-platforms that totaled USD3.6 billion in the first fortnight of this month. Notwithstanding this technical caveat, the fact is that the path for the current account balance to register an annual surplus this year remains unchanged (we expect it to reach USD17.4 billion in 2021).

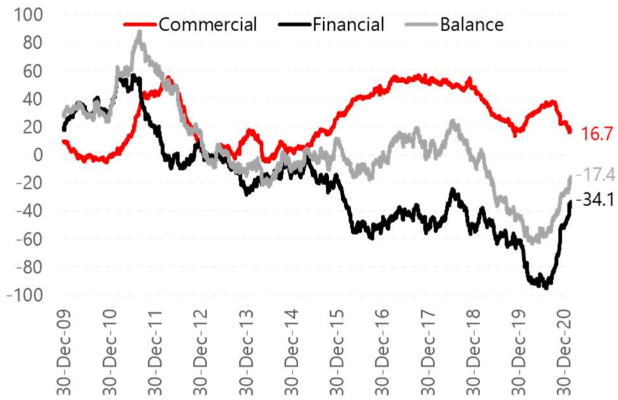
In addition to this favorable picture, we also expect the volume of direct investments in the country (DIC) in February 2021 to have reached USD7.0 billion, which—if confirmed—may have marked the end of a downward trend on a 12M-to-date basis that started in October 2019. That is, the combination of dwindling current account deficits and increasing volumes of direct investments in the country should continue to suggest a quite comfortable situation as far as the Brazilian external financing needs are concerned. Moreover, it also helps to explain the improvement that the country has observed in spot FX net flows of late, which should to ease the pressure on the Brazilian currency. Despite this auspicious backdrop in its external sector data, the Brazilian currency has remained under severe pressure of late, which we believe has to do with the skepticism regarding the conduct of its fiscal policy. In the absence of progress on this front, it seems hard to anticipate a significant and perennial easing of that pressure.

Figure 7.A. – Current Account Balance vs. Direct Investments in the Country (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

Figure 7.B. – Brazilian Spot FX Net Flows (USD billion, 12M-to-date)



Sources: IBGE, Brazilian Central Bank, Santander.

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