BRAZIL MACRO

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MACRO COMPASS

PERSISTENT (AND SPREADING) INFLATIONARY SHOCKS

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- The BRL has weakened in recent days, though relatively in line with emerging currencies on Thursday, in response to the steepening U.S. yield curve and uncertainties around the outlook for the Brazilian fiscal framework. Likewise, the nominal yield curve showed considerable volatility for most of the week, but then stabilized a bit in the end. The front end is now pricing in a higher probability of a more hawkish Brazil Central Bank (BCB) stance at the next Copom meeting.
- Rising hospitalizations and a record death toll in Brazil have prompted many states to impose tighter mobility restrictions. In our view, this worsening of the virus will weigh further on economic activity in 1Q21. On the vaccine front, the federal government secured another deal for 138 million doses, but most of deliveries are expected only for 2H21. As of March 4, about 9.6 million doses have been administered in the country (with 2.3 million being second shots).
- The Senate passed a constitutional amendment (*PEC Emergencial*) setting up conditions and rules for an emergency fiscal regime. The legislation allows Emergency Aid to be extended with a total budget limit of BRL44 billion, and also creates “triggers” that may favor compliance with the constitutional spending cap for the medium term.
- The USD1.2 billion trade surplus in February 2021 offset the deficit in January. The data points to faster growth in export proceeds and slower growth in import outlays, which is compatible with our expectation for a USD78.4 billion trade surplus in 2021.
- Based on data from IBGE’s PNAD (household) survey, we calculate the seasonally adjusted jobless rate moved up to 14.8% compared to 14.6% in November—a new all-time high for the series. We expect the unemployment rate to rise significantly throughout 1H21 as the labor force returns to pre-pandemic levels and employment recovers a bit slowly.
- 4Q20 GDP expanded 3.2% QoQ-sa (consensus was 2.8%), which was a solid reading but not enough to fully offset the adverse impact of the pandemic (-1.1% in the YoY variation). GDP contracted 4.1% in 2020. The 4Q20 result implies a higher carryover (of 3.6%) for 2021, which could be partially mitigated by deteriorating economic activity in 1Q21 (our current estimate is -0.4%).
- For the coming week, a heavy schedule of activity indicators for January will be released. In the labor market, we expect January CAGED payrolls of +210k. IBGE will also release broad retail sales and services volume, for which we project weak numbers.
- We look for February’s IPCA to accelerate in monthly terms to 0.73% (5.1% YoY), highlighting the unfavorable short-term scenario for inflation. February’s IGP-DI will also be released and should post a still hefty monthly change of 2.27% MoM (29.4 % YoY), reinforcing the upward pressures coming from wholesale prices that are spilling over into consumer prices.

This report uses most information up to the end of Thursday, March 04, 2021.

Figure 1. Brazil Macro Agenda for the Week of March 8-12, 2021

Indicators	Source	Reference	Date	Santander Estimate	Prior
IGP-DI Inflation (% MoM)	FGV	Feb-21	Mon, 08-Mar	2.27	2.91
IGP-DI Inflation (% YoY)	FGV	Feb-21	Mon, 08-Mar	29.43	26.55
Household Debt-to-Income (%)	BCB	Dec-20	Tue, 09-Mar	52.0	51.0
Services Volume (% MoM)	**IBGE**	**Jan-21**	**Tue, 09-Mar**	**0.0**	**-0.2**
Services Volume (% YoY)	IBGE	Jan-21	Tue, 09-Mar	-5.5	-3.3
Formal Job Creation (thousands)	CAGED	Jan-21	Tue, 09-Mar	210	-68
IPCA Inflation (% MoM)	**IBGE**	**Feb-21**	**Thu, 11-Mar**	**0.73**	**0.25**
IPCA Inflation (% YoY)	**IBGE**	**Feb-21**	**Thu, 11-Mar**	**5.06**	**4.56**
Core Retail Sales (% MoM)	IBGE	Jan-21	Fri, 12-Mar	-0.5	-6.1
Core Retail Sales (% YoY)	IBGE	Jan-21	Fri, 12-Mar	-1.0	1.2
Broad Retail Sales (% MoM)	**IBGE**	**Jan-21**	**Fri, 12-Mar**	**-0.9**	**-3.7**
Broad Retail Sales (% YoY)	IBGE	Jan-21	Fri, 12-Mar	-2.0	2.6

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

The USD/BRL pair closed at 5.67 on Thursday (March 4), below the 5.77 weekly high, but above 5.52 as of the close of a week ago (February 25). In our view, the sell-off stemmed from the steepening of the US yield curve and, more importantly, the noisy debate that took place in the Senate about a new COVID relief bill and the compensatory fiscal measures (see details in the Fiscal Policy section). As stated in our last scenario review (see link below[3]) we believe the trajectory of the BRL will largely hinge on prospects for the conduct of fiscal policy in the short/medium run, which explains the BRL strengthening in the aftermath of the Senate's decision underpinning the maintenance of the current fiscal framework.

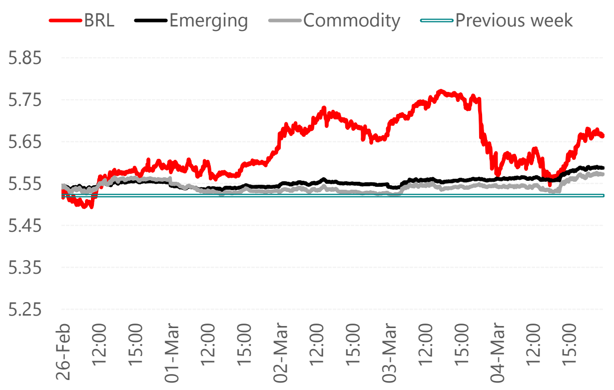
The BCB intervened four times last week by selling USD3.1 billion in the spot FX market and repeated this approach (last Tuesday and Wednesday) during the last few days by tendering USD4.1 billion—though nearly half of this amount was through sales of FX swaps. The USD/BRL breached the 5.70 threshold and diverged considerably from the trend of emerging and commodity currencies during most of the period, but moving relatively in line with them on Thursday afternoon. its peers. These interventions contrast with recent figures indicating net inflows in the spot FX market in January and February. See link below[4].

LOCAL MARKETS—Rates

The nominal yield curve flattened a bit in a highly volatile week. Since our last report, the front end of the curve (Jan-22 DI future) rose 17 bps to 3.83%, while the back end (Jan-27 DI future) fell 1bp to 7.83%. Hence, the steepness in this segment decreased from 418 bps to 400 bps since Thursday of last week (February 25). Both ends of the curse saw considerable volatility and traded much higher during some days last week. In the end, after the reduction of the probability of an imminent fiscal disruption following the final voting of *PEC Emergencial* at the Senate (see details in the Fiscal Policy section) the curve flattened a bit. At the front end, the market continues to price in a higher possibility of a more hawkish action by the BCB in the next Copom meetings – indeed our call is currently for a 50bps hike at the next meeting, with a non-negligible possibility of 75bps, depending on the fiscal scenario. At the long end, markets remained worried about the possible advance of a new round of income emergency aid without a concomitant approval of a measure to reduce expenses in the long-run, but the marginal reduction of that risk more recently allowed for some small relief in the market.

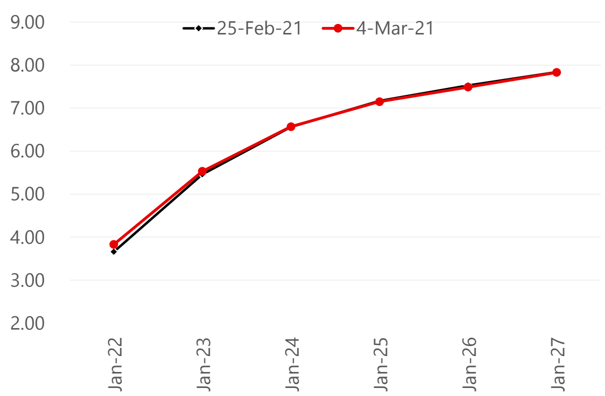
We continue to see the potential for rising volatility ahead amid lingering uncertainty about the next fiscal policy steps, especially as the pandemic worsens and leads to new social isolation measures, which could potentially increase uncertainty about the fiscal outlook.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the closing of Thursday, March 4, 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 closing of Thursday, March 04, 2021.

[3] [3] **Santander Brazil - Macroeconomic Scenario: *"The Persistence of (Fiscal) Risks"* –** February 11, 2021- Available on: http://bit.ly/Sant-ScenRev-fev21
[4] [4] **Santander Brazil – External Sector: *"It's Been Some Time"* –** March 3, 2021- Available on: http://bit.ly/Sant-extsec-030321

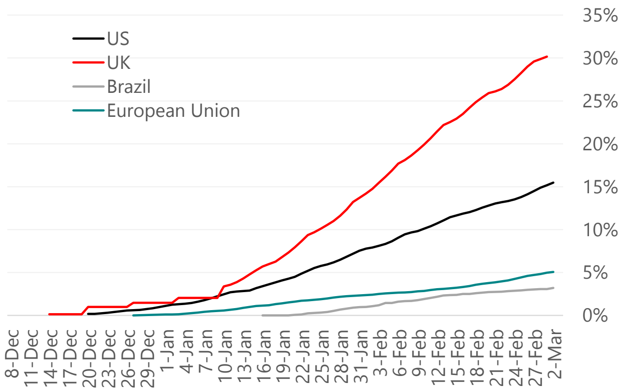
COVID-19 MONITORING

In the U.S., five states have announced rolling back mask mandates. A full reopening of business is underway in several states amid a fast vaccination pace of 2.0 million/day (7-day moving average), with nearly 16% of the population having received at least one dose. This figure stands at 30% in the U.K. and at only 5% in the European Union. New cases have been rising in Italy and France, but are relatively stable across other Western European countries.

Rising hospitalizations across Brazil and a record-high death toll prompted states to impose tighter restrictions. The ICU occupancy rate is above 90% in at least eight states, while Wednesday (March 3) the daily death toll was 1,910, the highest since the beginning of the pandemic. The entire state of São Paulo moved back to the red phase – where only essential services are allowed – adding to the night curfew (now from 8pm to 5am) imposed last week. These restrictions are expected to last until March 19. In our view, this worsening at a national level will likely weigh further on (tertiary) activity in 1Q21.

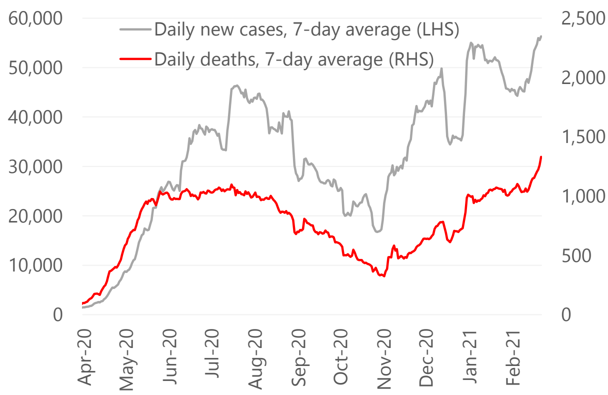
Federal government expected to secure another 138 million-dose deal. According to the Ministry of Health, 100 million doses from Pfizer and 38 million doses from Janssen may arrive this year, mostly during 2H. On Thursday (March 4, 2021), *Butantan* received supplies for 14 million doses. Importantly, the Lower House approved on Tuesday (March 2, 2021) a Law Proposal allowing states and municipalities to buy vaccines, provided they are granted official or emergency use from *Anvisa* (Brazil's national health watchdog). This has encourage states to pursue vaccine deals in parallel with the federal government. As of Thursday (March 4, 2021), 9.6 million doses[5] (out of 19 million available) have been administered in the country, with the pace of vaccination at 220k/day (7-day moving average). Johns Hopkins data for Brazil reports an average of 56k daily new cases (7-day moving average) as of Wednesday (March 3, 2021), up 14.2% from last week, while daily deaths (7-day moving average) stood at 1,331, up 18.4% 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.

[5] Out of the 9.6 million shots already administered, about 2.3 million refer to the second dose.

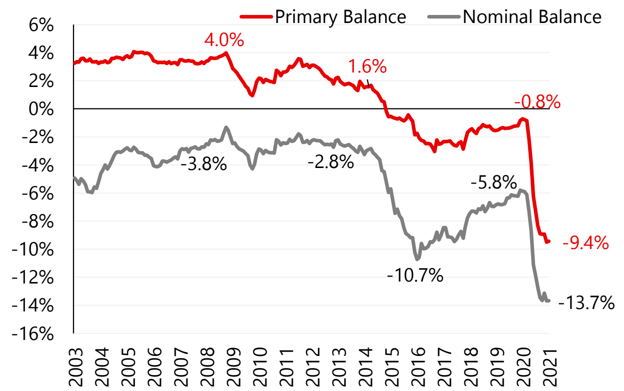
FISCAL POLICY AND POLITICS

On March 4, the Senate concluded the vote of the *PEC Emergencial*, a constitutional amendment that creates a legal framework for an emergency fiscal regime. There were more than 60 favorable votes in the first and second rounds (minimum to approve: 49 votes out of 81 Senate seats). All amendments to the bill were rejected. Until the approval of the final draft, there was pressures and some discussions about a hypothetical exclusion of outlays related to the Bolsa Familia entitlement program (BRL35 billion) from the spending cap limit this year, which could have significantly dented the credibility of the spending cap rule (Brazil's main fiscal anchor), and the entire fiscal regime. In the end, amid a big sell-off of Brazilian assets the government's economic team dissuaded parliament from its proposal. In the end, the approved legislation retained the core proposal, mainly the fiscal trigger regulation, which could allow the federal government to comply with the spending cap. The bill also limited the total budget to be allocated to the emergency aid extension at BRL 44 billion—which is a positive element, in our view. The *PEC Emergencial* now moves to the Lower House, which is expected to provide the final approval by the end of March. After the final approval in Congress, the government will send a provisional measure to define the parameters of the new welfare program.

On March 1, the government issued a provisional measure (MP 1034) that would reduce to zero the federal sales tax (PIS/Cofins) on diesel for two months and on LGP ("cooking gas") permanently. These measures will reduce federal tax collection by ~BRL3.8 billion in 2021, based on our estimates. To compensate for this tax break—and abiding by the Fiscal Responsibility Law—the administration has raised by 5pp the CSLL tax on financial institutions (from 20% to 25%), effective from July 1 and until December 31. In addition, tax exemptions on car sales to people with disabilities and to the petrochemical sector were extinguished. This bill will have to be debated in Congress within 120 days.

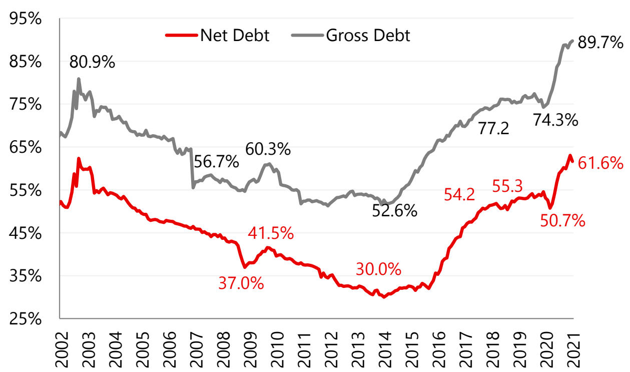
According to data published on February 28 by the BCB, the consolidated public sector posted a seasonally-driven primary surplus of BRL58.4 billion in January. This result is similar to that recorded for the month in January 2020, and reflects the recovery in activity in 4Q20 and the sharp reduction in fiscal stimuli. In the 12-month reading, the primary deficit reached BRL701 billion (9.4% of GDP), while the nominal deficit increased to BRL1.02 trillion (13.7% of GDP), which is an all-time high in the BCB series. Meanwhile, gross debt reached 89.7% of GDP in January 2021, an increase of 0.5pp from December 2020, while the net debt was 61.6% of GDP. According to our forecasts, the deficit should decrease to BRL250 billion in 2021 (3.1% of GDP)—meaning a (rather risky) return to gradual fiscal consolidation after the large stimulus of 2020. We expect gross debt to remain virtually stable, however, assuming the BNDES will repay the Treasury at least BRL100 billion and also the government will comply with the spending cap. See link below[6].

Figure 4.A. Consolidated Public Sector (12m, % GDP)



Sources: Brazilian Central Bank, Santander.

Figure 4.B. Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

[6] **Santander Brazil Fiscal - *"Seasonally Driven Primary Surplus in January"* –** February 26, 2021-Available on: http://bit.ly/Sant-fiscal-260221

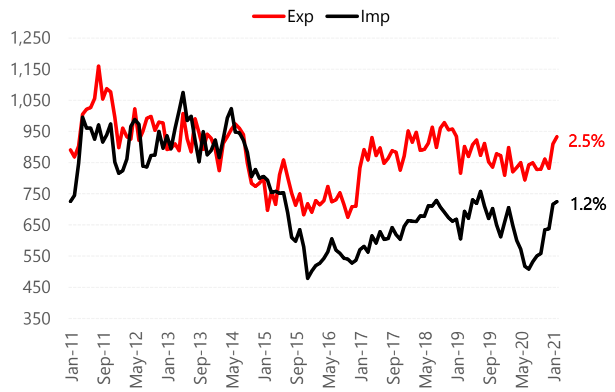
TRADE BALANCE

On the heels of stronger-than-expected exports and imports, in line with our estimates, the trade balance registered a USD1.2 billion surplus in February, which exceeded our expectation (USD0.7 billion) and compensated for the deficit observed in January.

On a 12-month-to-date basis, the USD50.3 billion surplus was quite close to the USD50.9 billion for the same period to December 2020. Curiously, the same picture can be seen if we strip out the oil-platforms deals from both exports and imports, although at a higher level (approximately USD62.0 billion). Although the performance last month of the 3-month moving average of seasonally-adjusted figures in annualized terms indicated a surplus of USD50.0 billion on the margin, we think its trajectory suggests a turning point may be soon materializing, which would favor our expectation for a USD78.4 billion trade surplus in 2021.

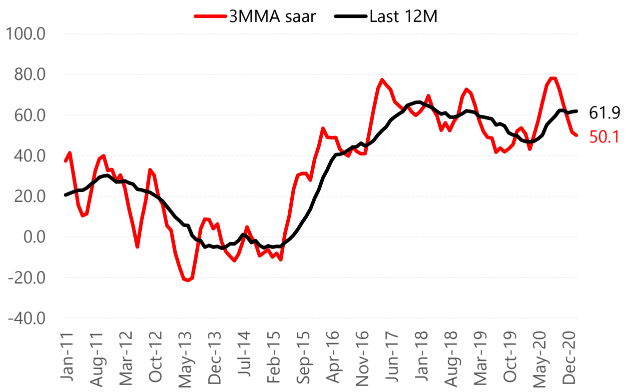
On top of the continuing sound performance in the exports of animal proteins and the beginning of the shipment of soybeans—which has been delayed by climatic and logistics issues—we also continue to see firm demand for other commodities, such as iron ore. As we expect commodity prices to remain on the rise during 2021, this combination of strong demand and favorable prices should lead export proceeds to outpace import outlays, especially as the latter has already shown signs of a slowdown on the heels of a more gradual expansion in the Brazilian economy in the last couple of months. See link below[7].

Figure 5.A. – Trade Balance Ex-Oil Platforms (USD million, daily average, sa)



Sources: SECINT, Santander.

Figure 5.B. – Trade Balance Ex-Oil Platforms (USD billion)



Sources: SECINT, Santander.

[7] **Santander Brazil External Sector - *"Turning Point"* –** March 1, 2021- Available on: http://bit.ly/Sant-extsec-010321

ECONOMIC ACTIVITY

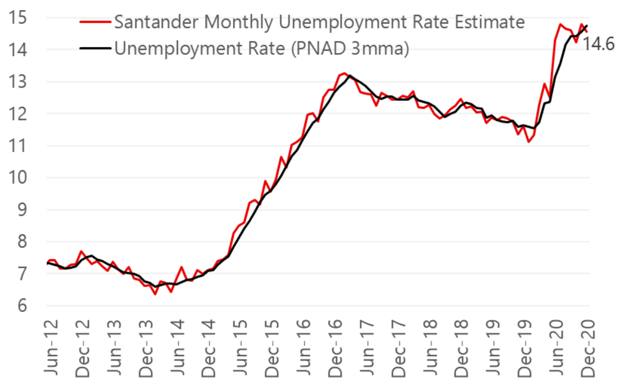
According to the IBGE's National Household Survey (PNAD), the unemployment rate stood at 13.9% in the three months to December, in line with our estimate. **We calculate that the seasonally adjusted jobless rate slightly increased to 14.8% compared to 14.6% in November**—a new all-time high for the series. The results showed seasonally adjusted gains of 0.1% and 0.3% in the employed population and labor force, respectively. The effective real wage bill posted a 10.0% YoY drop in November (data lagged one month relative to other PNAD series), even worse than October's 8.6% YoY drop. The 2020 average unemployment rate stood at 13.2%, well above the 2019 result (11.9%). This reflects the impacts of the pandemic, which were not entirely reflected in the 2020 data due to low labor market participation throughout the year. The 2H20 PNAD results were in line with our scenario, as both employment and the labor force had slight recoveries on the heels of some liftings in mobility restrictions, as well as the reduction in Covid-19 cases and deaths. Looking ahead, we expect the unemployment rate to rise significantly throughout 1H21, as the labor force returns to pre-pandemic levels and employment gradually recovers. See link below[8].

Following last quarter's strong rebound, 4Q20 GDP grew 3.2% QoQ-sa, which, though solid, was not enough to offset the pandemic's impact, with GDP reaching levels still 1.1% below the pre-crisis mark (4Q19). Regarding full-year figures, the 2020 contraction was 4.1% (in line with our estimate). The composition of 4Q20 growth shows a solid performance by non-farm sectors (supply), with services posting sequential gains (+2.7%), but still far from fully recovering to pre-crisis levels; industry (+1.9%) consolidated the recovery, sharply increasing in 2H20. On the demand side, we highlight strong investment growth (+20%) — though this could be contaminated by accounting effects from oil platform imports — and household consumption (+3.4%) subsequent to the payment of the emergency aid and the economy's gradual reopening. See link below[9].

The 4Q20 results imply a carryover of 3.6% for 2021, which could be partially offset by deteriorating economic activity in 1Q21, mainly in the tertiary sector, given the materialization of the fiscal cliff and the setback of the economy's reopening process following the resurgence of the pandemic. Our current estimate is -0.4%. See link below[10].

IBGE released on Friday (March 5) the industrial production report for January: the headline index grew 0.4%, consistent with our scenario of industrial production driven by inventory replenishment in 1H21. For the coming week, important economic activity indicators will be released. In the employment front, we expect January CAGED to post a 210k net formal job creation. IBGE also releases broad retail sales and the services volume for January, and we expect tepid monthly figures, at best (refer to the numbers on Figure-1).

Figure 6.A. – Unemployment Rate (% sa)



Sources: IBGE, Santander.

Figure 6.B. – GDP Breakdown

		4Q20		2020
	Weights	% YoY	% QoQ	% Year
GDP	100%	-1.1	3.2	-4.1
Supply				
Taxes	15%	0.2	5.2	-4.9
Agriculture	4%	-0.4	-0.5	2.0
Industry	17%	1.2	1.9	-3.5
Services	63%	-2.2	2.7	-4.5
Demand				
Consumption	64%	-3.0	3.4	-5.5
Government	21%	-4.1	1.1	-4.7
Investments	18%	13.5	20.0	-0.8
Exports	17%	-4.3	-1.4	-1.8
Imports	-17%	-3.1	22.0	-10.0

Sources: IBGE, Santander.

[8] **Santander Brazil Labor Market - *"Stage Set for Labor Market Deterioration in 1H21"* –** February 26, 2021- Available on: http://bit.ly/Sant-labor-260221
[9] **Santander Brazil Economic Activity - *"Solid growth but only partial recovery"* –** March 3, 2021- Available on: http://bit.ly/Sant-econact-030321
[10] **Santander Brazil Economic Activity - *"Economic Activity Chartbook - Lingering impacts to slow the recovery"* –** February 23, 2021- Available on: http://bit.ly/Sant-econact-chart-fev21

INFLATION

IPCA February data should show an acceleration in monthly terms. While the movement is partly seasonal (owing to school tuition costs), the continued gains in annual CPI reinforces the unfavorable short-term scenario for inflation. On Thursday (March 11, 2021), IBGE is scheduled to release IPCA inflation for February. Monthly inflation should accelerate compared to January's reading, rising +0.73%, taking the annual change to +5.06% YoY, the highest reading in more than 4 years. The strongest pressure should come from regulated prices (+1.58% MoM), with fuel price inflation being a major driver. Industrial goods should continue the upward trend and post a 0.54% MoM change. Services should also register a 0.49% MoM change and continue the very gradual recovery. Finally, food-at-home should show a low monthly change of 0.05% MoM, however, we believe the deceleration trend for the group will end at this release, with March already accelerating again.

In terms of underlying measures, the EX3 core should rise around +0.30% MoM, per our projections, meaning a deceleration for the trend (3mma-saar) backed by weak services inflation, while rising industrial goods prices keep pressuring core inflation measures.

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 only in February 11, 2021 has already become outdated as our high-frequency tracking is hovering around 4.6%. 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. Accordingly, for now we maintain our forecast at 3.2%, although on balance, we see the risks clearly tilted to the upside, with the higher inertia coming from IPCA 2021 and the riskier fiscal scenario.

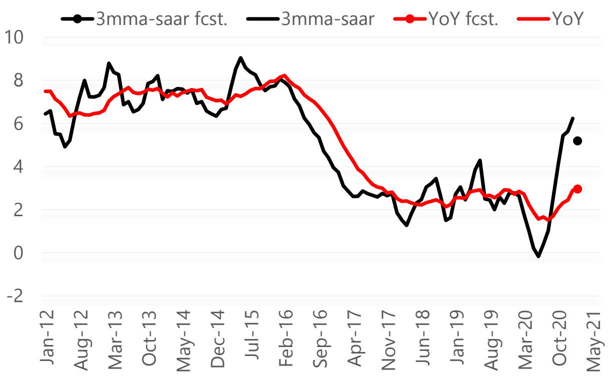
IGP-DI for February will also be released on Monday (March 8, 2021) and we expect a 2.27% MoM (29.43% YoY) change. Wholesale inflation both for the industrial and agricultural sectors should moderate if compared to previous readings, but headline IGP-DI will remain very high, reinforcing the pressures coming from the producers/wholesale level to the consumer level.

Figure 7.A – IPCA Monthly Forecast (%)

	MoM		YoY	
	Feb-21	Cont.	Jan-21	Feb-21
IPCA	0.73	0.73	4.6	5.1
Administered	1.58	0.41	1.8	3.7
Free	0.44	0.33	5.5	5.5
Food-at-home	0.05	0.01	19.2	19.2
Industrial goods	0.62	0.14	4.1	4.4
Services	0.49	0.18	1.5	1.3
EX3 Core	0.30	0.30	2.9	3.0

Sources: IBGE, Santander.

Figure 7.B. – Core Inflation forecast (IPCA EX3, %)



Sources: IBGE, Brazilian Central Bank, Santander.

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