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Brazil Macro Compass

Recovering (Part of) the Lost Output

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- **Notwithstanding some constructive news on the international front — specifically increased clarity on the outcome of U.S. presidential elections and promising trial results from a potential vaccine to fight COVID — on the domestic front, the lack of news on structural reforms, and statements by some government officials on possible scenarios in which fiscal stimulus is extended weighed on the BRL, which should end the week as the worst performer among its emerging market peers.**

- **The local yield curve has steepened in recent days, despite the respite from global markets earlier this week. The upward pressure in the back-end reflected the market's fiscal jitters, in our view. As key fiscal decisions are on hold, we expect volatility to remain high in the coming weeks and months.**

- **Retail sales ended the quarter consolidating the sharp recovery on the heels of the government income transfers while showing that the first signs of accommodation are on the way. The services sector benefitted from a breath of fresh air following the economy's reopening, but with a lagging and heterogeneous resumption. Finally, the IBC-BR underlines economic activity's sequential recovery and, based on this data, we updated our tracking for GDP in 3Q20 from +9.1% to +9.5% QoQ s.a. (-3.0% YoY).**

- **Our proprietary coincident index for retail sales (IGet) showed signs of accommodation in retail activity for the beginning of 4Q20, following the reduction of the value paid in the emergency aid. For October, the index weighted according to IBGE's core retail sales index posted a monthly increase of 0.2%, while the index weighted according to IBGE's broad retail index pointed to a decline of -0.1%.**

- **October data show that capital market issuances in 2020 are still bel the year-ago period. Fixed income, notably debentures, contributed the most to the overall decrease. On the other hand, equity issuances have been growing, for both IPOs and follow-on offerings. For real estate funds, the accumulated funding is also above 2019's volume.**

Local markets—FX: After having reached as low as USDBRL5.2250 at the start of the week following the conclusion of the U.S. presidential race — the Democratic Party's victory was taken as an omen for more favorable conditions on the international front and a globally weaker USD – and promising trial results for a vaccine against COVID-19, the BRL is likely to end the week as the worst performer among its emerging market peers (at the time of writing, the pair was quoted at USDBRL5.51).

Apparently, the reversal was triggered by the lack of news regarding structural reforms on the Brazilian front, as well as by statements by some government officials that resurrected concerns regarding the extension of the emergency support granted by the government this year into 2021. With discussions regarding the budget for the next year yet to be concluded, the extension may increase risks (and discomfort) regarding the trajectory of public expenditures and government debt in the future. As the municipal elections should prevent progress on the political front until the end of November, the currency should continue to be subject to these strong swings in the coming weeks, in our opinion.

Local markets—rates: At the time of writing (Friday around noon local time), the weekly change in nominal yields looked poised to indicate a bear-steepening pattern. In the front end, the Jan-22 DI future was trading at 3.38% (+3 bps from last Friday). In the back end, the Jan-27 DI future was trading at 7.56% (+29 bps from last Friday). This week's movement drove the steepness in this segment to ~418 bps, compared to ~392 bps in the previous week and ~150 bps before the arrival of the pandemic in Brazil (late February).

As the U.S. election outcome became clearer earlier in the week, the local yield curve saw some respite following the global rally in risk assets. Regarding COVID-19, despite the negative outlook due to rising cases and lockdowns currently in place in the Northern Hemisphere, the news cycle on a potential vaccine's promising efficacy apparently fed market optimism.

If the global environment has been favorable for Brazilian assets recently, discussions on the possibility of extending the emergency aid apparently prompted market jitters, taking a toll on local rates, especially in the back-end. As key fiscal decisions (see the fiscal policy section below) are on hold until this weekend's first round of municipal elections, a sense of uncertainty regarding the policy priorities means a perception of higher execution risk for the spending cap, still the main anchor for the Brazilian economy.

Hence, the yield curve can be thought to have considerable premium, in our view. However, this premium will not erode until the markets see clear signs of a credible fiscal consolidation process ahead, preferably via economic reforms.

Fiscal policy: There was no legislative activity in Congress this week due to the proximity of the first round of municipal elections (November 15). There is a session scheduled to take place on November 18 to decide whether to overturn the presidential veto on the sanitation framework (a provision authorizing the extension of public sanitation contracts with state firms).

We believe that the formal proposals that intend to create a new welfare program (*Renda Brasil*), or expanding the current program (*Bolsa Familia*) and the fiscal triggers proposal (*PEC Emergencial*) to curb mandatory expenses will be unveiled only after the second round of the municipal election (November 29).

On November 9, we published a group of slides that detail our Fiscal Scenario – regarding our latest Scenario Review sent on October 28[1]. For details, refer to the link[2].

Credit: Anbima figures on capital markets activity for October show that new issuances totaled BRL 35 billion. Fixed income accounted for BRL13 billion, equities for BRL19 billion and real estate funds for BRL3 billion.

Considering total financing between January and October (BRL279 billion, inf. adj.), there was a decrease of 20% relative to the year-ago period. Fixed income, notably debentures, contributed the most to the overall decrease, as issuances for this debt instrument in 2020 are 45% lower than the year-ago period. The uncertainty triggered by the coronavirus prompted risk aversion, increasing debt cost for corporations and dragging down the upward trend of issuances observed up to the

[1] **Santander Macro Brazil Scenario Review – Waiting for the Fiscal Decisions** – October 28, 2020 - Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-macroeconomic-scenario-oct/20-10-30_174317_201028+santander+brazil+macro+scenario.pdf

[2] **Santander Macro Brazil Fiscal Policy - *Fiscal Policy slides - Analysis and Projections*** – November 09, 2020 - Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-kit-fiscal-policy-nov-2020/20-11-12_180616_fiscal+policy+-+november+2020+%28santander+macro+research%29.pdf

pandemic's outset. In line with banking credit, where working capital has been booming in the nonearmarked segment, so has working capital been leading the allocation of proceeds (36% in 2020 against 29% in 2019).

On the other hand, still in the same comparison, equity issuances in 2020 are 33% higher. In October, companies went public accounting for a volume of BRL 5.8 billion (inf. adj.), the highest in the year. Follow-on issuance volume also stood out, with BRL13 billion (inf. adj.), reinforcing equity funding's positive moment, probably on the back of a portfolio shift generated by historically low interest rates. For real estate funds, the accumulated volume of issuances in 2020 is 14% above year-ago period.

Economic activity: Our proprietary coincident index for retail sales (IGet) showed signs of accommodation on retail sales for the beginning of 4Q20, following the reduction of the value paid in the emergency aid and the shifting of the households consumption from goods toward services, as the reopening of the economy advances. For October, the index weighted, according to the core retail sales survey of IBGE, posted a monthly increase of 0.2%, while the index, weighted according to the broad retail survey, pointed to a decline of -0.1%. For details, refer to our report[3]

Data on retail sales released by IBGE disappointed the market's expectation of another substantial gain in September. The headline core index points to slight growth of 0.6% MoM s.a. (7.3% YoY), below the market consensus projection (1.4%). The broad retail sales number (including auto and construction) rose 1.2% MoM s.a. (7.4% YoY), versus 1.5% of the consensus. This positive result for September implies that the core number is up by 7.7% since February (and at an all-time high), while the broad number is 2.9% above pre-crisis reading. On the heels of the reduction of the aid's value, the decline in confidence, inflationary pressures of essential goods (e.g Food prices) and the shifting of the household's consumption from goods towards services, as the reopening of the economy advances, we expect an accommodation of retail sales in the coming quarter. For details, refer to our report[4]

Data on the services sector released by IBGE has confirmed market expectations of another gain in September. Relative to September 2019, the headline index posted a variation of -7.2%, a slightly better result than the market consensus (-7.8% YoY). After seasonal adjustments, the registered gain was 1.8% MoM s.a., marking the fourth consecutive gain after April's sharp drop and the bottom in May, though still not enough for a full recovery from the losses registered in the crisis, with the headline index still far below the pre-crisis level. In quarterly terms, the services sector ended 3Q20 registering a quarterly increase of 8.6%, not enough to offset the previous quarter's 15.5% decline. These figures highlight that despite recent improvement, the services sector is still the laggard in the economic recovery. For details, refer to our report[5]

This week, the BCB published its monthly activity indicator for September, capping the batch of activity indexes releases for that month. The IBC-Br posted a gain of 1.3% MoM s.a. (-0.8 YoY), above the market consensus of 1.0% MoM s.a. (even with August's number revised upward). However, the index is still 2.5% below February's reading. This positive result is consistent with the sequential resumption of activity seen for other key sector-based indicators in September (e.g., industrial production, retail sales, services sector), but in quarterly terms, the IBC-Br posted a growth of 9.5% in 3Q20, still not enough to offset the sharp drop of -10.2% in the previous quarter. In a preliminary exercise based on the YoY correlation of IBC-Br and the GDP, we are updating our tracking for 3Q20 GDP to 9.5% QoQ s.a. (-3.0% YoY) from 9.1%. For details, refer to our report[6]

Next week: On Sunday (November 15), the first round of municipal elections will be held. In cities with more than 200,000 voters (95 cities out of a total of 5,570), if no one candidate wins 50% plus one of the valid votes, there will be a second round on November 29.

The macro calendar is quite thin. On the fiscal side, the Brazilian internal revenue service will publish the federal tax collection information for October 2020. Our estimate is BRL150.5 billion, which would mean an increase of ~7.5% compared to October 2019, in real terms. The result will be impacted by the receipt of the deferred tax for the month of May (BRL15 billion

[3] **Santander Macro Brazil Economic Activity – *IGET de Outubro – Uma acomodação em curso*** – November 11, 2020 – Available (in Portuguese) on: https://cms.santander.com.br/sites/WPS/documentos/arq-iget-outubro/20-11-12_193920_201111+iget+outubro.pdf

[4] **Santander Macro Brazil Economic Activity – Retail Sales– *A consolidated Sharp Third-Quarter Recovery*** – November 11, 2020 – Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-fast-retail-sales-a-consolidated/20-11-12_181445_201110+pmc+set.pdf

[5] **Santander Macro Brazil Economic Activity – Services Sector – *A Breath of Fresh Air for the Services Sector*** – November 12, 2020 – Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-fast-a-breath-of-fresh-air/20-11-13_133821_201112_pms_set.pdf

[6] **Santander Macro Brazil Economic Activity – IBC Br – *A Sequential Improvement in Economic Activity*** – November 13, 2020 – Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-fast-a-sequential-improvement/20-11-13_180733_201113+ibc+br+set.pdf

in our estimative), this was a measure to mitigate the Covid-19 effects in the second quarter. The performance of tax collection has been recovering gradually driven by the better performance of economic activity.

On Monday (November 16), FGV will release IGP-10's inflation for November. We expect an increase of 3.46% MoM, meaning a deceleration compared to October's IGP-DI (3.68% MoM). Despite the deceleration, it is still a very high monthly print. Moreover, wholesale agricultural prices (important leading indicator to the food group of IPCA inflation) should even go on the opposite direction and accelerate a bit – while industrial wholesale prices should drive the net deceleration of the full index. Looking ahead, we continue to believe that IGPs will cool down throughout 2021, also allowing for a deceleration in IPCA.

MACRO AGENDA

Indicator	Reference	Date	Estimate	Prior
IGP - 10 Inflation (%MoM)	Nov/20	Mon, 16-Nov	3.46	3.20
CNI Industrial Indicator (points)	Oct/20	Wed, 18-Nov	--	50.40
Federal Tax Collection (BRL billion)	Oct/20	Nov 16-20	150.5	119.8

Sources: Bloomberg and Santander.

For details on our Brazil economic forecasts, please refer to our latest scenario review[7].

[7] **Santander Macro Brazil Scenario Review – Waiting for the Fiscal Decisions** – October 28, 2020 - Available on: https://cms.santander.com.br/sites/WPS/documentos/arq-macroeconomic-scenario-oct/20-10-30_174317_201028+santander+brazil+macro+scenario.pdf

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