Santander Corporate & Investment Banking

Macroeconomics Research

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Brazil Macro: Sectoral Analysis

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The Pandemic's Sectoral Impact in Brazil

- The impact of the pandemic on economic activity has been quite severe; however, already released data has been better than what was expected a few months ago. Nonetheless, this recovery has been quite heterogeneous from a sectorial point of view.

- Some segments have suffered significantly more — either due to lockdown measures that restrict movement or falling confidence. Other sectors have, from the beginning, shown resilience or even a positive response; among these we highlight agriculture and supermarket retailers.

- In contrast, sectors like food services, accommodations, cultural/recreational activities and personal services, in addition to being severely affected by the aforementioned restrictions have seen only a tepid recovery thus far. Moreover, these sectors have accounted for 40% of total dismissals in the period in June compared to the same period last year. More cyclical and credit-dependent sectors appear to be recovering faster.

- This sectoral dynamic suggests that the Brazil Central Bank's (BCB) liquidation and risk reduction measures have — thus far — not only prevented an explosion in defaults but have also allowed banks to cushion the negative impacts of the crisis, with credit playing an important anti-cyclical role.

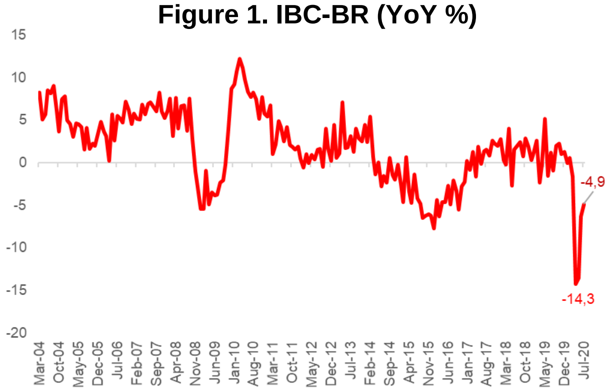
- In the long run, to consolidate this recovery, we believe that stringent fiscal discipline is needed to limit the fiscal legacy of emergency measures.

Introduction

The global spread of Covid-19 has led to a severe contractionary impact on GDP and employment worldwide. In Brazil, GDP fell 11.4% YoY in 2Q20, with job losses at ~10 million. However, the "short-term" recovery has been a surprise: the IBC-BR (monthly GDP proxy), which in April/May dropped 14% YoY, in July it was already down 5% YoY.

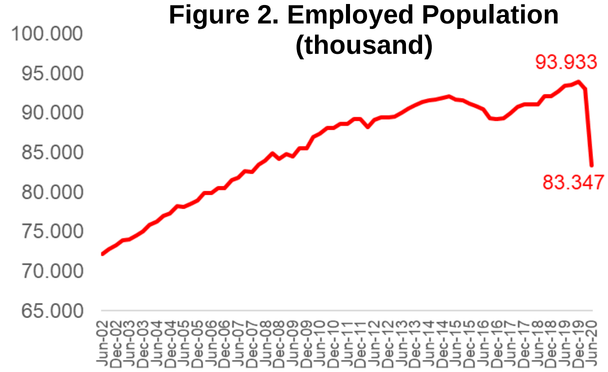
Additionally, leading indicators suggest that this recovery has continued into the third quarter: third quarter projections, based on the indicators available so far, range between -3.0% and -4.5% (equivalent to a sequential improvement of nearly 10% s.a.).

Figure 1. IBC-BR (YoY %)



Source: Brazil Central Bank (BCB)

Figure 2. Employed Population (thousand)



Source: Institute for Applied Economic Research (Ipea)

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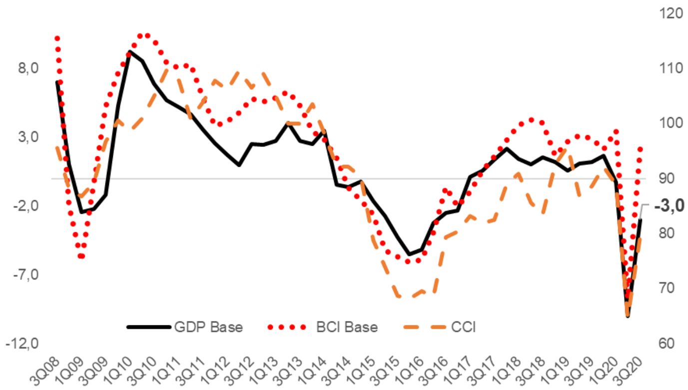
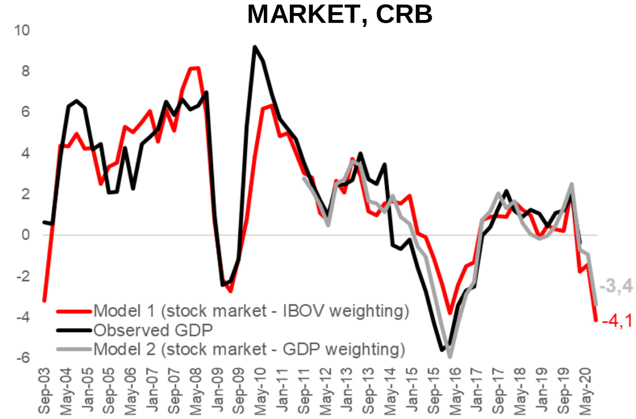
Figure 3. GDP X Confidence



Source: Brazilian Institute of Geography and Statistics (IBGE) and FGV´s Brazilian Institute of Economics (IBRE-FGV)

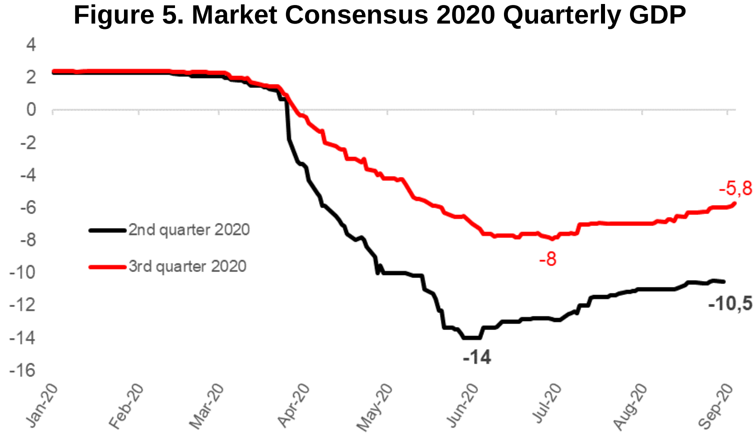
Figure 4. GDP X CDS, STOCK MARKET, CRB



Source: IBGE and Santander

If these leading indicators prove to be accurate, both 2Q20 and 3Q20 will post results that are significantly better than what was expected a few months ago: The 2Q20 decline fall of 11.4% YoY was slightly worse than recent consensus projections, but the market's more pessimistic projections reached -14%; and our 3Q20 projections are ~4%, whereas a few months ago the market projected an 8% YoY decline for 3Q20.

Figure 5. Market Consensus 2020 Quarterly GDP



Source: BCB

Post-Covid Onset Scenarios

Although a common shock sparked this current crisis, its effects have differed among economic sectors. The sectors most affected have been: (i) those that require a physical presence for consumption or use of the service; (ii) those considered "non-essential"; and (iii) those involved in global value chains.

Some sectors hurt more than others. Within expanded retail, for example, we see some consumer products are suffering more than others. Among sectors that have been hurt the most, we highlight accessories, clothing and footwear. Meanwhile, furniture and home appliances have been less affected. In addition, some products have performed better than what had been predicted in pre-Covid scenarios; among these we highlight pharmaceuticals and personal hygiene products.

Figure 6. Coronavirus Impact

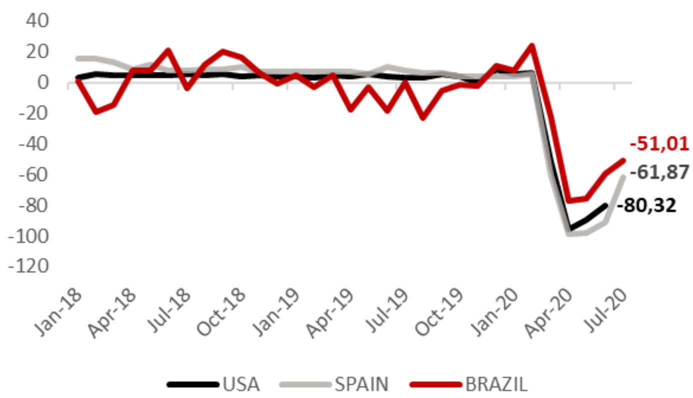
Sectors	Share in GDP	%YoY - 2Q2020	%YoY - 3Q2020	Employed Population - 2T2020	Δ% Employment - 2Q2020
COVID IMPACT - "Structural"	**25,17**	**-22,96**	**-19,05**	**32.290.333**	**-11,94**
IND - Apparel Manufacturing	0,28	-57,86	-37,78	1.275.676	-21,99
IND - Leather and Allied Product Manufacturing	0,20	-53,04	-34,13	366.975	-17,72
RET - Clothing, Furs, Shoes, Leather and Textile Goods	1,00	-62,14	-31,15	1.852.352	-18,29
RET - Stationery Products, Books, Newspapers and Magazines	0,24	-59,54	-26,19	174.750	-5,96
SERV - Accommodation and Food Services	3,91	-60,62	-51,61	4.001.778	-26,25
SERV - Arts, Entertainment, and Recreation / Other Personal Services	1,14	-48,06	-41,63	7.776.382	-23,36
SERV - Air Transportation	0,38	-70,66	-51,49	48.930	-34,17
SERV - Public Administration, Health Care and Public Educational Services	18,00	-8,62	-8,62	16.793.489	2,00
COVID IMPACT - "Cyclic"	**33,15**	**-22,56**	**-8,51**	**26.118.157**	**-12,09**
IND - Beverage Manufacturing	0,41	-20,24	16,39	138.053	-15,58
IND - Plastics and Rubber Products Manufacturing	0,44	-24,62	-3,23	401.925	-9,88
IND - Nonmetallic Mineral Product Manufacturing	0,44	-22,36	0,41	401.925	-22,75
IND - Primary Metal Manufacturing	0,68	-28,99	-10,20	227.175	-7,39
IND - Machinery Manufacturing	0,61	-32,07	-8,71	314.550	4,49
IND - Repair and Installation of Machinery and Equipment	0,16	-73,46	-19,33	227.175	-17,40
IND - Vehicles and Transport Equipment Manufacturing	1,25	-19,38	-34,45	471.825	-9,32
IND - Others	2,74	-24,70	-0,20	3.337.728	-10,19
IND - Construction	3,71	-19,17	3,44	5.329.880	-19,43
IND - Electricity, Gas and Water Supply	3,19	-9,44	0,02	768.901	-13,80
RET - Gasoline Stations	2,32	-40,98	-14,76	2.429.027	-11,68
RET - Furniture and Electronics	2,08	-20,97	-9,63	594.151	-5,96
RET - Computer and Telecommunication Equipment	0,75	-6,18	25,40	751.426	-15,76
RET - Other Personal and Domestic Products	0,14	-31,94	-5,23	174.750	-12,93
RET - Motor Vehicle and Parts Dealers	0,59	-19,54	5,54	174.750	-26,53
SERV - Administrative, Professional, Scientific, and Technical Services	11,03	-17,74	-15,27	6.990.006	-5,49
SERV - Transit and Ground Passenger Transportation	2,61	-23,23	-15,48	3.384.910	-13,09
SMALL/POSITIVE IMPACT	**41,68**	**1,14**	**3,12**	**21.564.169**	**-6,93**
AGRICULTURE AND ANIMAL PRODUCTION	5,18	2,60	2,50	7.968.607	-7,98
IND - Mining Extraction	3,01	0,91	-3,17	436.875	6,86
IND - Food Manufacturing	1,73	5,83	8,35	1.607.701	-3,87
IND - Paper Manufacturing	0,37	-2,36	-0,80	159.023	-14,42
IND - Coke and Refined Petroleum Products Manufacturing	1,28	-2,68	1,49	115.335	-8,73
IND - Soap and Detergents, Cleaning and Polishing Preparations, Perfumes and Toilet Preparations Manufacturi	0,16	5,45	8,61	152.033	-0,23
IND - Pharmaceutical Products and Pharmaceutical Preparations Manufacturing	0,29	-4,12	-7,90	192.225	26,15
RET - Health and Personal Care Stores	1,01	1,79	12,62	1.363.051	-8,31
RET - Building Material	0,82	-2,64	21,10	908.701	-9,44
RET - Food and Beverage Stores	4,73	6,93	7,82	4.788.154	-11,15
SERV - Information and Communication Services	3,42	-5,52	-2,39	1.310.626	3,72
SERV - Water Transportation	0,20	12,19	7,55	62.910	-26,40
SERV - Warehousing, Storage and Postal Service	1,12	-0,53	1,77	838.801	7,47
SERV - Other Services	8,43	-0,39	4,21	1.118.401	-8,81
SERV - Real Estate and Rental and Leasing	9,93	1,36	1,36	541.725	-8,90

Source: IBGE

Historically, those sectors that are recovering quickly or have not been affected by the pandemic account for 75% of GDP. In addition, education and healthcare have historically accounted for 18% of GDP, and we expect the former to improve once schools reopen.

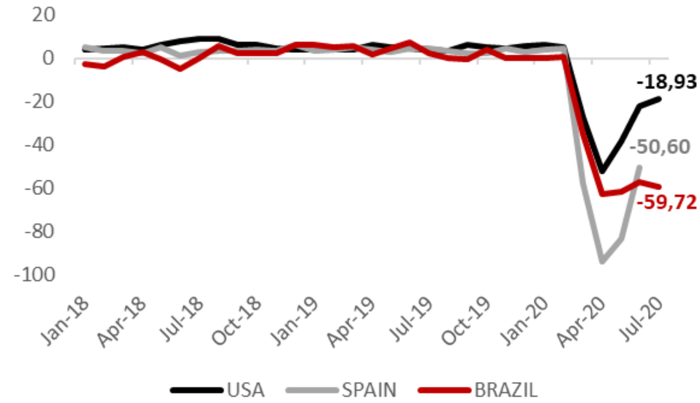
Thus, the more structural impact is concentrated on those sectors that account for about 7% of GDP; among these, we highlight air transport, accommodations, food service and drinking establishments, leisure, clothing and accessories. In addition to having intensely contracted, these have been recovering tepidly compared to other sectors and are not expected to accelerate growth until a successful vaccine is widely available. In an international comparison, the fact that these sectors have a lower weight in Brazil than in other countries (see Figure 10 on the following page, which illustrates this point) may explain part of the positive surprise regarding the impact on Brazil.

Figure 7. Air Transport (YoY %)



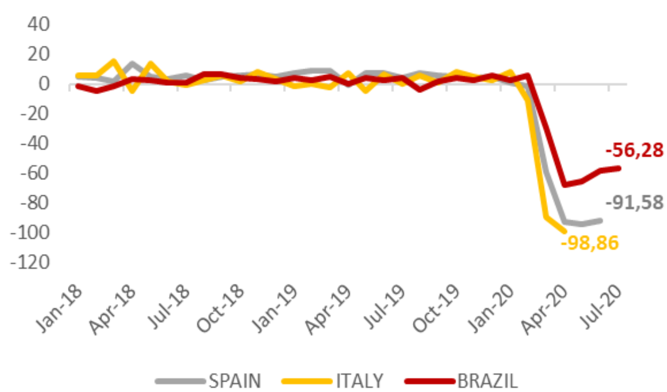
Source: IBGE; Instituto Nacional de Estadística (INE) and Federal Reserve

Figure 8. Food Services and Drinking Establishments (YoY %)



Source: IBGE; INE and Federal Reserve

Figure 9. Tourism (YoY %)



Source: IBGE; INE and Istituto Nazionale di Statistica (Istat)

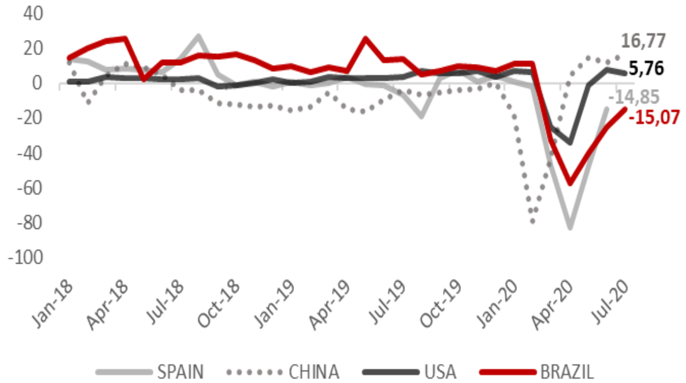
Figure 10. Tourism

	%GDP	Number of Jobs	% Jobs
Greece	20.8	846	21.7
Thailand	19.7	8054	21.4
Portugal	16.5	902	8.6
Mexico	15.5	7232	13.3
New Zeland	15	479	19.8
Spain	14.3	2878	14.6
Italy	13	3475	14.9
Turkey	11.3	2643	9.4
Australia	10.8	1653	12.8
Cuba	10.3	556	11
Chile	10	991	11.7
Venezuela	9.4	1191	9.7
Peru	9.3	1299	7.5
Argentina	9.2	1425	7.5
Germany	9.1	5668	12.5
UK	9	3939	11
USA	8.6	16826	10.7
France	8.5	2678	9.4
Brazil	7.7	7406	7.9
South Africa	7	1483	9.1
Canada	6.3	1670	8.8
Russia	5	4037	5.6
Colombia	4.9	1187	5.2
Paraguay	4.2	148	4.5

Source: World Travel & Tourism Council (WTTC)

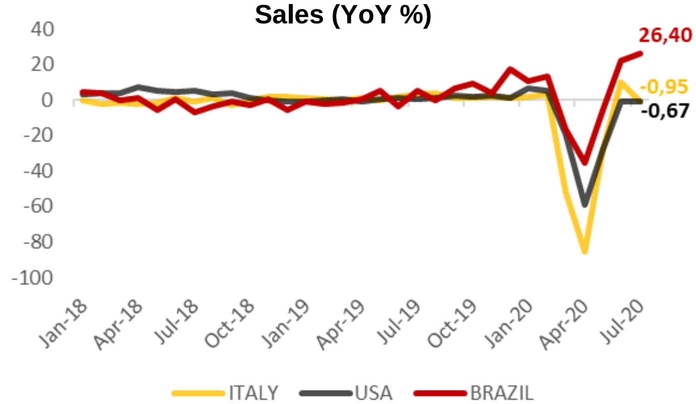
Among sectors that were initially strongly affected but are already recovering, those most connected to credit stand out (both in Brazil and rest of the world).

Figure 11. Vehicles Sales (YoY %)



Source: IBGE; INE; Federal Reserve and Bloomberg

Figure 12. Furniture and Home Appliance Sales (YoY %)



Source: IBGE; Istat and Federal Reserve

In the medium term, we expect labor market dynamics to be among the decisive factors in an eventual recovery. In this sense, we note that despite accounting for a relatively small percentage of GDP, these sectors —food, accommodations, cultural/recreational activities and personal services — have accounted for approximately four million of the 10million jobs lost (or 40% of this total). Hence, the importance of what will be the new normal variable for these sectors with respect to economic activity once this crisis is behind us: a level 40% below the pre-crisis, for example, would imply a loss of 3 million jobs (or R$35 billion in lost salaries relative to last year, assuming a linear impact).

Figure 13. Impact on Employment

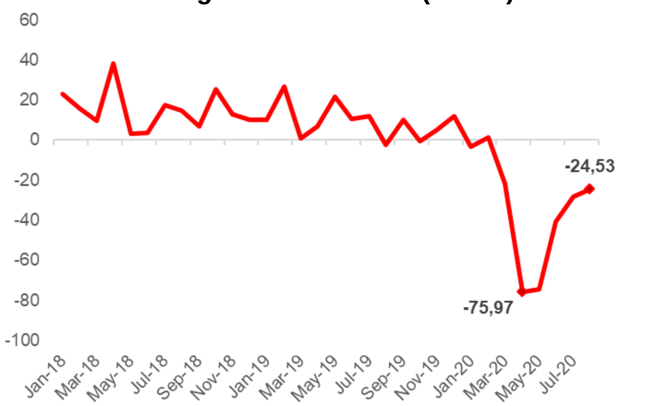
Sectors	IND - Textiles, apparel and related products	IND - Leather and related products	RET - Clothing, furs, shoes, leather and textile goods	RET - Stationery Products, Books, Newspapers and Magazines	SERV - Accommodation and Food Services	SERV - Arts, Entertainment, and Recreation / Other Personal Services	SERV - Air Transportation
Real Revenue 2Q20 (YoY)	**-57,89**	**-52,82**	**-62,37**	**-59,66**	**-60,19**	**-48,08**	**-70,53**
Job Loss (Jun20/jun19)	**359.593**	**79.007**	**414.725**	**11.076**	**1.424.340**	**2.369.717**	**25.400**
Simulation of Impact on Employment for Different Levels of "New Normal"							
-50	310.603	74.792	332.457	9.282	1.183.196	2.464.543	18.006
-40	248.483	59.834	265.966	7.426	946.556	1.971.634	14.405
-30	186.362	44.875	199.474	5.569	709.917	1.478.726	10.804
-20	124.241	29.917	132.983	3.713	473.278	985.817	7.203
-10	62.121	14.958	66.491	1.856	236.639	492.909	3.601
-5	31.060	7.479	33.246	928	118.320	246.454	1.801
Simulation of Impact on the Annualized Payroll for Different Levels of "New Normal"							
-50	4.986.333.083	1.366.713.075	6.943.915.906	202.039.709	21.533.412.664	34.850.200.508	1.045.386.377
-40	3.989.066.467	1.093.370.460	5.555.132.725	161.631.767	17.226.730.131	27.880.160.406	836.309.102
-30	2.991.799.850	820.027.845	4.166.349.543	121.223.825	12.920.047.598	20.910.120.305	627.231.826
-20	1.994.533.233	546.685.230	2.777.566.362	80.815.884	8.613.365.066	13.940.080.203	418.154.551
-10	997.266.617	273.342.615	1.388.783.181	40.407.942	4.306.682.533	6.970.040.102	209.077.275
-5	498.633.308	136.671.307	694.391.591	20.203.971	2.153.341.266	3.485.020.051	104.538.638

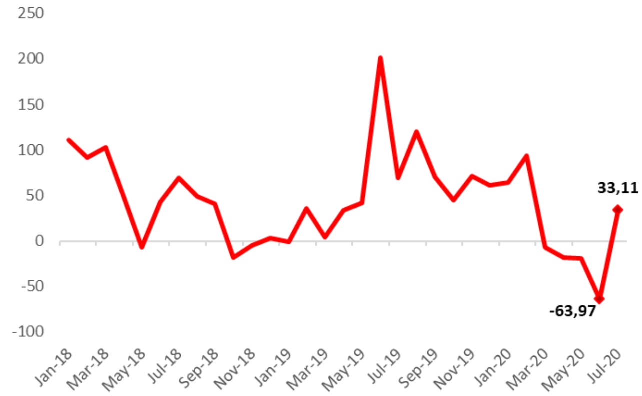
IND: Industry; RET: Retail; SERV: Services.
Source: Continuous National Household Sample Survey (Continuous PNAD)

The Role of Credit

Those sectors for which credit plays a significant role (e.g., real estate, vehicles, furniture and household appliances) are among those that are recovering more quickly, although their initial decline was steep. Even investments are recovering faster than expected, which, along with the search for liquidity, should keep companies' credit demand high.

Figure 14. Vehicles (%YoY)

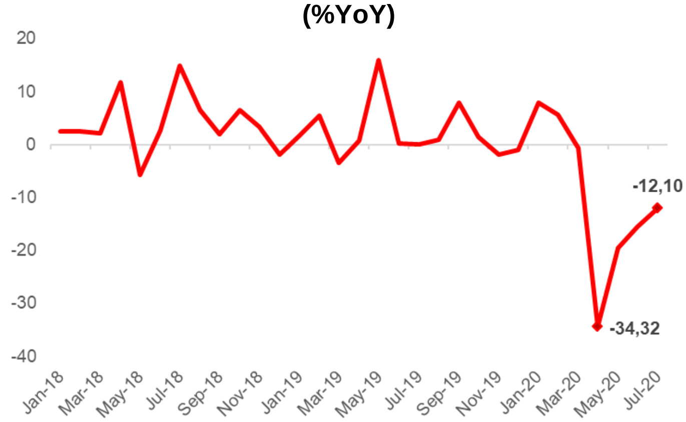




Source: National Federation of Motor Vehicle Distribution (FENABRAVE)

Source: Housing Union (Secovi-SP)

Figure 16. Gross Fixed Capital Formation (%YoY)

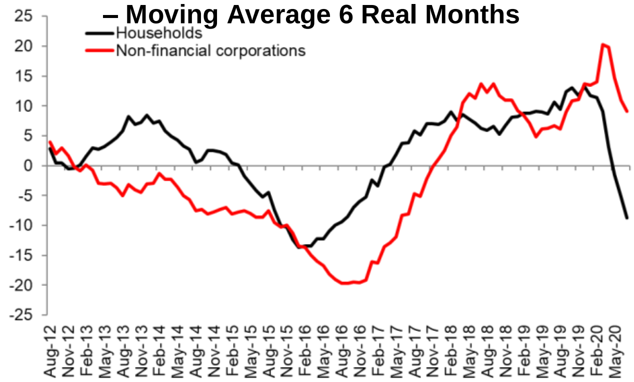


Source: Ipea

Credit estimates corroborate this sectoral view. Companies have increased demand for new loans since the beginning of the pandemic in March due to increased liquidity needs. Households, on the other hand, initially saw an abrupt drop in credit demand, owing to a drop in consumption, especially for some products that are typically purchased via credit (e.g., automobiles), but in recent months, demand has begun to normalize.

In fact, we see that credit, despite the risks, is playing its role as a recovery motor — especially for companies, which took R$130 billion more YoY in credit in 2020. In the case of households, credit decreased, though it is linked to demand rather than supply (i.e., a drop in concessions concentrated on the use of credit cards and overdrafts).

Figure 17. Concessions Growth Rate (% YoY) – Moving Average 6 Real Months



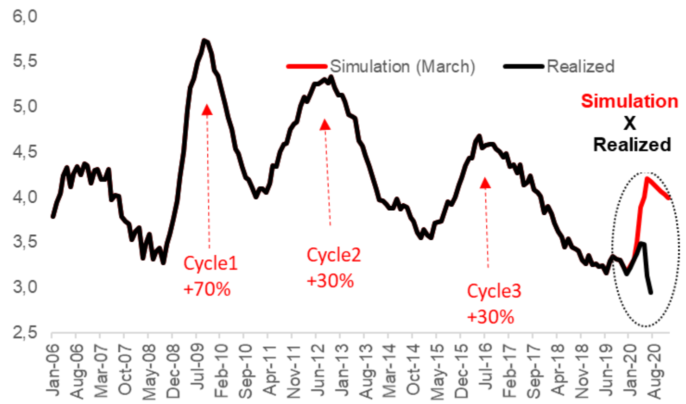
Source: BCB

	2019*	2020*	Diff
Non-financial corporations - total	853.580	987.020	**133.440**
Personal Credit - Households	57.192	66.760	**9.568**
Consigned	99.486	110.733	**11.247**
Vehicles - Households	57.936	48.508	**-9.428**
Credit Card - Households	614.089	582.653	**-31.436**
Bank Check - Households	191.147	154.531	**-36.616**
Real Estate - Households	48.160	54.571	**6.411**

Source: BCB

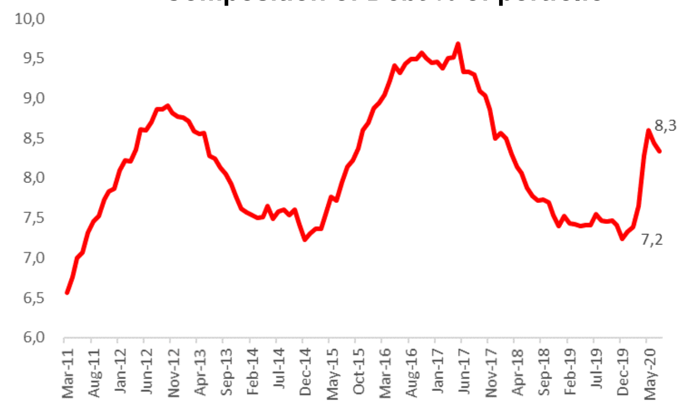
We also expect defaults to rise less than originally expected. Renegotiations explain part of this relatively positive evolution, potentially implying increased future default. However, even jointly analyzing defaults and renegotiations, the increase is less than that observed in previous recessions. Thus, one of the risks spawned by the pandemic —a rapid escalation in defaults, followed by a credit supply shortage, which should have intensified the recession and made the recovery even more difficult — apparently did not materialize.

Figure 19. Private Banks' Defaults (over 90 days)



Source: BCB

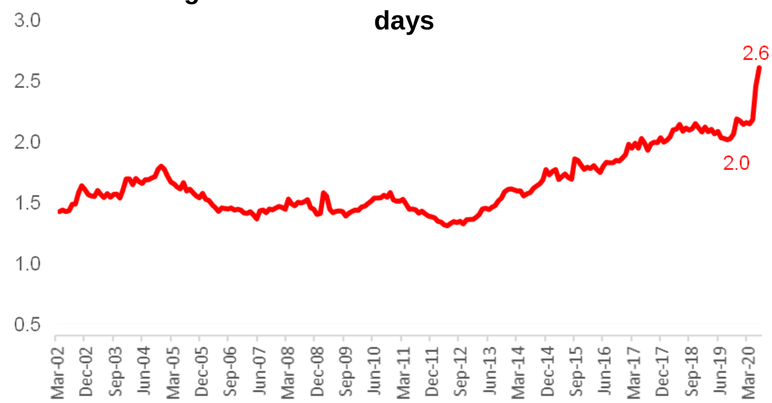
Figure 20. Free Individuals: Over 90 days + Composition of Debt % of portfolio



Source: BCB

The increase in banks' provisioning, which significantly affected results, was much higher than the observed increase in defaults so far, indicating a healthy financial system that is prepared to continue contributing to the recovery.

Figure 21. Private Banks: LLP/ Over 90 days



Source: BCB

Conclusions

The drop in economic growth wrought by the pandemic appears less steep than what was initially anticipated. Also, the recovery has been faster despite quite heterogeneous impacts across sectors.

Those sectors most subject to contamination (e.g., social events and air transport) have modestly recovered so far. On the other hand, credit-related sectors, which sharply declined, are leading the recovery.

Apparently, risks related to the credit market were not realized: despite a fear of lack of liquidity for companies and rising defaults, credit has grown significantly thus far whereas defaults have not, suggesting a healthy financial system that is ready to continue contributing to a resumption in economic growth.

However, we must highlight that long-term dynamics strongly depend upon the government's ability to deal with the fiscal problem — a problem that was already a challenging pre-pandemic and has only intensified as a result of the necessary but expensive, emergency measures. Bringing public debt back to a sustainable trend, in our view, is a necessary condition for GDP to resume the process of recovering potential growth in the medium and long term.

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