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Brazil Macro Compass

…And the (Economic) Contagion Continues

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- **This week, local rates continued to price in increased expectations of the Brazilian Central Bank's (BCB) stimulus in the short end and put on higher premia in the long end. As an upshot, yields up to Jan'22 stand at record-low levels, with the yield curve steepening even further. We believe that premia in the back end might only start eroding once there are concrete signs that the massive budgetary stimulus (currently in the making) will actually be temporary.**
- **Risk aversion, fed by an escalation of the coronavirus outbreak (here and abroad) has brought Brazilian FX rate back to historical highs (at BRL5.25-5.30/USD). We expect the BRL to remain pressured in the near term, with the BCB only intervening to prevent dysfunctionalities but not to determine directions or trends.**
- **February's (hard) economic activity data, out this week, have been positive, confirming our expectations for the releases and views that the economy was on a gradual recovery before March lockdowns. However, these data are pre-coronavirus and tell us little about where the economy is heading in 2020.**
- **March's trade balance figures showed a positive outcome: a USD4.7 billion surplus (we had forecast a USD3.6 billion surplus). The positive surprise was entirely related to lower import outlays (USD14.5 billion, versus our estimate of USD15.2 billion), as export proceeds matched our calculations.**
- **Public sector accounts for February, released this week, will not be useful in evaluating the dynamics of Brazilian fiscal policy this year. In any case, the public sector recorded a primary deficit of BRL 20.9 billion in February, a result slightly better than our expectation and consensus. In 12 months, the primary deficit totaled BRL 58.5 billion (-0.80% of GDP), with a steep drop in the fiscal performance expected ahead.**

Local market conditions — rates: The two main recent trends in the local yield curve followed up this week: tightening in the short end to the belly and more steepening in the long end. Jan'21 futures tightened 31 bps (as of April 2 closing), to a new low of 3.18%, pricing in the Selic rate ending this year at around 3.25%. Jan'22s were the top performer in the period, plunging 38 bps — also a new all-time low, at 4.0%. Longer tenors underperformed, with Jan'25s tightening 6 bps and Jan'27s rising 6 bps. We still expect those trends to prevail in the short term, given the combination of plunging economic activity, slow inflation and fiscal uncertainty. Premia in the back end may only start eroding after concrete signs that the massive budgetary stimulus (currently in the making) will actually be temporary.

Local market conditions — FX: Despite several measures announced by the federal government to address the fallout from the coronavirus, the escalation of new cases and deaths both domestically and internationally—especially in advanced economies—has brought the FX rate back to its historical highs lately (around USD/BRL5.25). Unfortunately, the World Health Organization (WHO) forecasts point out to further deterioration in the coming months with respect to the pandemic, emerging market currencies like the BRL could remain under pressure, in our opinion, despite efforts from authorities to ease the depreciation trend. At the time of this writing, the BCB had already sold USD2.9 billion in the spot FX market for the week (or USD13.5 billion in year-to-date terms versus nearly 40% of the USD36.1 billion sold during 2019 as a whole), which indicates to us that BCB directives for intervening in the FX market to solely prevent dysfunctionalities from arising are real.

Trade balance: The trade balance registered a USD4.7 billion surplus for March, versus our expectation of a USD3.6 billion excess; thus leading to a USD6.1 billion positive result in year-to-date terms or USD45.1 billion surplus in 12-month-to-date terms (as compared with USD48.0 billion in December 2019). This positive surprise was entirely related to lower import outlays (USD14.5 billion versus our estimate of USD15.2 billion), as export proceeds matched our calculations (USD19.2 billion). Incidentally, were it not for an operation related to an import of oil platform and the outcome would have been USD0.3 billion—better than the actual result.

Adjusting for the number of working days in the period (22 in March 2020, compared with 19 business days a year ago), daily average exports contracted 4.7% in YoY terms, while daily average imports receded 4.5% in the same comparison. In year-to-date terms, daily average exports receded 3.8% in 1Q20, and daily average imports increased 2.6% in the same period. However, when we also factor out operations related to oil platforms—from both the export and import perspective—Brazilian export proceeds' daily average receded 6.1% YoY, whereas Brazilian import outlays declined in a similar fashion (6.5% YoY) in March. Regarding the comparison of 1Q20 with 1Q19, ex. platform-working-day-adjusted averages of exports and imports contracted 3.9% and expanded 1.3%, respectively.

Although these figures were compatible with our previous forecast for the trade surplus of US$38.3 billion in 2020, we believe the fallout from the pandemic has yet to materialize for Brazilian trade flows.

Economic activity: According to the Industrial Monthly Survey, industrial production grew 0.5% MoM (s.a.) in February 2020, higher than our estimate (-0.2%) and consensus (-0.4%). In a YoY comparison, output declined 0.5%. Despite the positive (sequential, monthly) result, industrial production for the quarter ended February down 1.0% QoQ.

The numbers indicate growth in many industrial sectors. The diffusion index (percentage of industrial categories with monthly growth in December) reached 49.9%, close to the historical average. We highlight the second consecutive month of strong growth in capital goods production, which increased 1.2% MoM. On the other hand, the production of consumer goods, both durable and non-durable, fell 0.7% MoM and 0.2% MoM, respectively.

According to the PNAD household survey, the national unemployment rate stood at 11.6% (of the economically active population) in the three months to February, 0.8 p.p. lower YoY, suggesting (what could have been) an acceleration in the speed of the YoY fall in unemployment.

Regarding the composition of this job recovery, we see signs of improvement. Firstly, the data shows a (slight) acceleration in the pace of employment expansion in the past few months, with a YoY increase of 2.0%. This rate exceeds the economically active population (PEA) expansion rate of 0.9%. The labor market participation rate has been stable, close to the historical average (62.0%). Second, the informal jobs rate reached 40.6% of the employed population compared to 41.1% in the previous quarter. In terms of wages, the survey shows real income as stable. The real wage bill (adjusted for inflation) grew at a clip of 6.2% YoY.

Altogether, this week's economic reports (for February) indicate that Brazil was still on the path of a gradual recovery in the first part of 1Q20. Nevertheless, all the economic activity data that has been released is pre-coronavirus crisis, thus failing to add much to the analysis of Brazil's growth trajectory in 2020.

Fiscal policy: As published by The National Treasury Secretariat last Monday (March 30), the central government registered a primary deficit of BRL25.9 billion in February 2020, in line with our expectation (-BRL25.2 billion) and worse than market consensus (-BRL22.7 billion). This result came after January's robust primary surplus (BRL44.1 billion), which could be mostly attributable to atypical and temporary factors (e.g., the sharp expansion of tax proceeds in the wake of asset sales by state-owned companies, as well as a slow pace of expenditure execution, following discussions by the executive and legislative branches on the management of a share of the federal budget).

The absence of significant non-recurring revenue (total revenue fell 2.9% YoY in February, in real terms), combined with larger transfers to regional governments (expansion of 9.6% YoY in real terms, influenced by the aforementioned one-off proceeds of the previous month) were the main reasons behind the more pronounced central government's primary deficit in February 2020, compared to the same month last year (-BRL18.2 billion). Furthermore, primary spending resumed growth last month, albeit moderately (0.5% YoY in real terms), in contrast to January's low pace of execution (-3.3% YoY in real terms).

According to BCB data released last Tuesday (March 31), the consolidated public sector, which includes the federal government, states, municipalities and state-owned companies, posted a primary deficit of BRL20.9 billion in February, slightly better than our expectation (-BRL 23.9 billion) and market consensus (-BRL 21.5 billion). The disaggregated figures for public entities were as follows: -BRL 26.6 billion for the federal government; +BRL5.2 billion for regional governments (responsible for the discrepancy between our forecast and actual results, since we expected a lower primary surplus in the month of BRL2.6 billion); and +BRL0.7 billion for state-owned companies. The public sector's primary deficit totaled BRL58.5 billion in the 12 months to February 2020 (-0.80% of GDP).

We acknowledge that February data are not useful in evaluating the dynamics of 2020 fiscal accounts, given: (i) the significant emergency fiscal measures announced by the government in order to soften the economic hit stemming from the coronavirus outbreak, combined with (ii) weakening domestic GDP (implying tumbling tax revenue) and a sharp reduction in international oil prices (negatively affecting royalty payments to the federal administration). Therefore, the public sector's primary deficit will increase significantly in the coming months (especially between April and June).

Next week: On the inflation front, on Wednesday, the IBGE (Brazil's statistics bureau) is scheduled to release the CPI for March (IPCA). Our calculations indicate a 0.14% MoM increase, implying a 3.37% YoY change if our estimate proves right. We estimate lower administered prices (e.g., for gasoline, due to downward adjustments in February and March, and for electricity, due to the lack of additional fee usually charged in dry periods—the so-called "green flag"), but higher "Food at Home" prices due to the lockdown impact in staple basket products.

Moreover, February retail sales and services revenue will hit the wires next week. First, we expect the core retail sector to fall 1.0% MoM. Regarding the broad retail sales, which include building materials sales and autos and auto part dealers, we forecast a 1.1% MoM decrease, specifically due to the expectation of a sharp monthly fall on the vehicles sales. For services sector, we estimate a 0.3% drop.

MACRO AGENDA

Indicator	Estimate	Consensus	Prior
IPCA Mar20 (%MoM)	0.14%	- -	0.25%
IBGE Retail Sales Survey Feb20 (%MoM sa)	-1.0%	- -	-1.0%
IBGE Broad Retail Sales Survey Feb20 (%MoM sa)	-1.1%	- -	0.6%
IBGE Services Sector Survey (%MoM sa)	-0.3%	- -	0.6%

Source: IBGE

Recent Publications (Available on Our Website)

- *FX Compass – BRL: It's more than solely the Covid-19* (March 26, 2020)
- *FX Compass – BRL: They Have Not Got It (Yet)* (February 20, 2020)
- *Macroeconomic Scenario: Still on Track, but More Gradually* (February 14, 2020)
- *FX Compass – BRL: We Hope They'd Got It* (January 23, 2020)
- *Brazil Macro Propositions for 2020* (January 13, 2020)

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