

**Brazil Macro Compass****Mind the Gap: Following the Truckers' Strike, a Double-Digit Drop in Industrial Production**

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**Upcoming Data: The Truckers' Strike in Numbers**

May industrial production data will be released next week (July 4). **Our models point to a sharp drop in the month, marked by a nationwide truckers' strike: we expect -15% m/m change.** During the strike, several production chains were paralyzed due to a shortage of inputs — losses tend to be more permanent in sectors such as services, agriculture, and livestock, but the larger share of manufacturing should, in our view, rebound strongly in June. We expect the industry share in the national accounts to grow 2.8% this year (from 3.4% before the latest revision; for more information, see our report May 29, 2018 report, *Truck Strike: A Preliminary Assessment*).

**Inflation data should also continue to reflect the effects of the strike**, especially on foodstuff and fuel prices: we forecast June CPI inflation, out on July 6, at 1.17% m/m (4.3% y/y). However, the most recent high frequency data show some of those prices already normalizing, going back to pre-strike levels. We believe that July data will bring some relief, and that year-end inflation will stay below the target midpoint (although there is a slight upside risk to our forecast, at 3.5% y/y). This scenario should allow the Central Bank to keep a stimulative monetary policy (more in our "What's New" section below).

**What's New: Copom Minutes: Anchoring Is the Word**

**Brazil's Monetary Policy Committee (Copom) released the minutes of its latest meeting last Tuesday (June 26).** Compared to the statement that followed the decision of keeping the Selic rate unchanged at 6.5%, the document does not bring much news. Copom recognized that the risk of inflation staying significantly below the inflation target diminished, which is evidenced by raising inflation expectations (both from the market survey and Copom's proprietary models). The committee forecasts 12-month CPI inflation at 4.2% and 3.7% at YE2018 and YE2019, respectively (see the full set of forecasts in the table on the following page). The set of forecasts presented in the 2Q18 Inflation Report, published two days later, did not diverge from those levels, suggesting that the Central Bank (BCB) sees economic slack as an important mitigating factor for the exchange rate pass-through. BCB reduced its 2018 GDP growth forecast to 1.6% (from 2.6%).

The minutes' buzzword is "anchoring", as applied to inflation expectations — there are 8 references to it, versus 5 in May and only 3 in March (see the "Chart of the Week" on the following page). This, in our view, means that the single most important variable to follow for monetary policy prescription is the 2019 inflation forecast in the Focus survey, currently at 4.1% (up 10 bps from one month ago). As long as expectations remain anchored, Copom believes that shocks such as those derived from the recent market stress and supply disruptions from the truck drivers' strike are unlikely to affect core inflation, contribute to accelerate the convergence of headline inflation towards the target midpoint, and should be mitigated only by their second-order effects; Copom insists that there is no "mechanic relation between recent shocks and monetary policy".

The committee decided to partially abandon forward guidance amid higher uncertainty, so its next steps should be completely data-dependent. Currently, the economic outlook prescribes stimulative monetary policy and stable rates, but that may change quickly should risk aversion further deteriorates, contaminating mid-term expectations.

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We maintain our call that the Selic rate will remain unchanged until 2H19, noting that this scenario is conditioned to the election of a reformist president in October. Should a non-reformist win, probably market volatility will increase, the BRL will weaken, and 2019 inflation expectations will move above the target midpoint, triggering a reaction from Copom on its two final meetings this year (October 31 and December 12).

### Brazil's Central Bank Inflation Forecasts

#### 12-month inflation, end of period (%)

	Reference scenario	Market scenario	Selic @ 8.0%, USD @ 3.7 BRL	Selic @ 6.5%, USD @ 3.6 BRL
4Q18	4.2	4.2	4.2	4.2
4Q19	4.1	3.7	3.9	3.8
4Q20	4.1	3.7	3.7	4.1

#### Short term forecasts (% m/m)

June	1.06
July	0.27
August	0.20

Source: Brazil's Central Bank, 2Q18 Inflation Report.

**Brazil's Monetary Council set the 2021 inflation target midpoint at 3.75%, while keeping the 2020 one at 4.0%.** The interval of tolerance remained at 1.5% below/above the midpoint. This goes in line with the long term goal of converging Brazil's inflation target to a lower level, compatible with other mature inflation targeters. For more information, please see our May 9, 2018 report, *The Good Convergence*.

### Political Agenda: New Poll, Unchanged Picture

Ibope released a new presidential poll last Thursday (June 28). Its results are not much different from the latest Datafolha poll (see table below) – Ibope sees more voters inclined to vote blank/null and undecided, which subtracts a few points from most of the leading candidates (those pollsters use different methodologies, although both employ face-to-face interviews). On that sample, more than 40% did not declare vote to any candidate, which suggests that the race is still wide open. We believe that there will be no major changes in the electoral scenario until the final definition of candidates and coalitions (from July 20 to August 15).

#### Datafolha and Ibope – Vote Intention in the First Round of Presidential Elections (% of Total Votes)

Candidate	Datafolha 10-Jun-18		Ibope 28-Jun-18
	Min	Max	
Jair Bolsonaro	19	19	17
Marina Silva	14	15	13
Ciro Gomes	10	11	8
Geraldo Alckmin	7	7	6
Alvaro Dias	4	4	3
Fernando Haddad	1	1	2
Others	1	7	7
Blank/null/none	28	28	33
Doesn't know	4	6	8

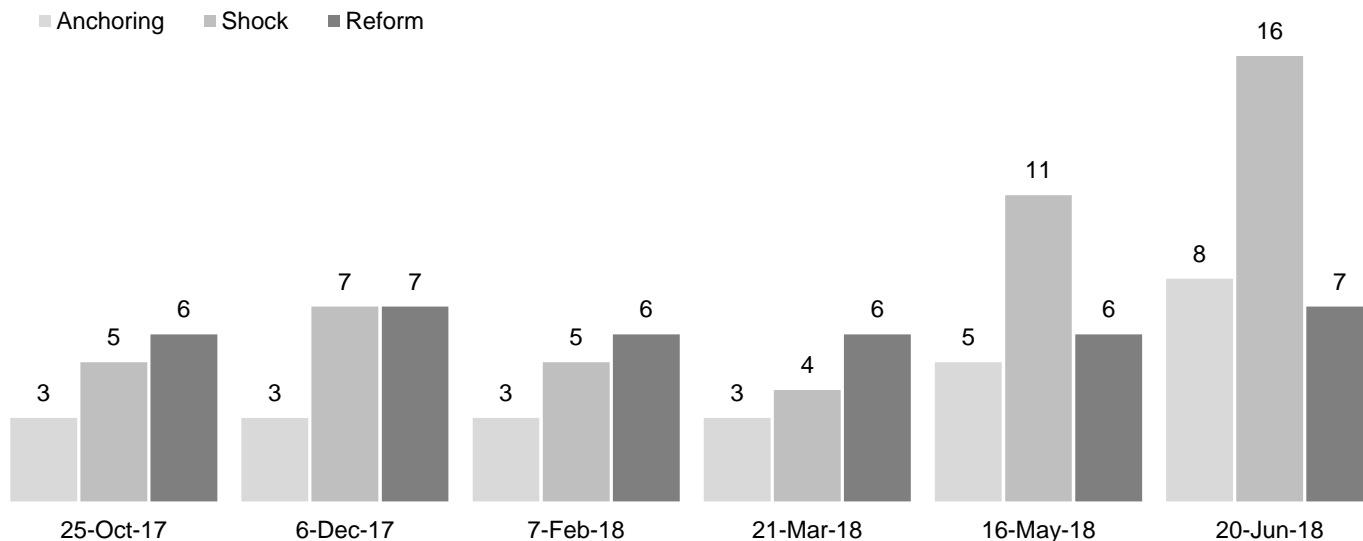
Considering scenarios with Fernando Haddad as PT candidate. Sources: Datafolha, CNI, Santander.



## Chart of the Week: Shocks, Anchoring, and Reforms

The importance of keeping inflation expectations well anchored around the target midpoints was made evident in the latest Copom minutes (see “What’s New on the previous page): references to ‘anchoring’ and derivatives were made 8 times in June, from 5 in May. Not surprisingly, references to “shock” also grew, whereas the emphasis on “reforms” have been more or less constant.

### Number of References in Copom Minutes to...



Sources: Brazil's Central Bank, Santander.

## Number of the Week

# 41.8 million

About 41.8 million TV sets in Brazil were tuned to the Brazil versus Costa Rica match on June 22, according to Kantor Ibope. Globo TV claimed that that was the most watched soccer match in the country since Brazil versus France, in 2006.

## Quote of the Week

*When it comes to populism, the ideological spectrum bends around until the left and right meet at the intolerant, policy-free extreme.*

— **Christopher Sabatini**, lecturer at Columbia University's School of International and Public Affairs, for *Foreign Policy* (see 'What We've Been Reading' below).

## What We've Been Reading

- “Latin America’s Center Cannot Hold If It Doesn’t Exist,” by Christopher Sabatini (*Foreign Policy*, June 22, 2018). Sabatini draws interesting parallels between Andrés Manuel López Obrador and Jair Bolsonaro’s presidential candidacies, and the possible collapse of traditional parties in both countries.
- “The Brazilian Truckers’ Strike: How WhatsApp Is Changing the Rules of the Game,” by Michael Fox (*Truthout*, June 15, 2018). The strike was a showcase for the power of the messaging app and decentralized mobilization.
- “All Eyes Are on Neymar, but It’s Coutinho Who Is Leading Brazil,” by Rory Smith (*The New York Times*, June 26, 2018). A good account of Brazil’s top soccer stars.



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- “For a second you’d be mistaken into thinking that Neymar and Messi were from Lyari,” by M Bilal Hassan (*Dawn*, June 26, 2018). The “Little Brazil” in Pakistan celebrates soccer’s biggest party.

### **Recent Publications (Available on Our Website)**

- *“Lethal Weapon”: How Far Can the BCB Go with Swaps?* (June 15, 2018)
- *Rely on Fundamentals and Carry On* (June 8, 2018)
- *Truck Strike: A Preliminary Assessment* (May 29, 2018)
- *Copom Capitulates to Changing Balance of Risks* (May 16, 2018)
- *Monetary Policy: The Good Governance* (May 9, 2018)
- *Infinite (Trade) War: Does It Matter for Brazil?* (May 2, 2018)



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