

**Brazil Macro Compass****Copom: Smooth Sailing for Now**

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**What's New: Copom Decision; Industrial Production**

**Brazil's Monetary Policy Committee (Copom) decided to maintain the Selic rate at 6.5% for the fourth straight meeting, following market consensus.** An accommodation in the global markets made the decision easier: in exchange rate volatility fell significantly since its last meeting (on June 20), and 2019 inflation expectations (in our view the most important indicator to watch until year end) remained well-anchored below the target midpoint. According to Copom's models, 2018 expected inflation stayed flat (at 4.2% y/y) from June, whereas the 2019 estimate rose 10 bps, to 3.8%. The committee sees evidence that the recent spike in inflation, following the May strikes, should be temporary, despite still suggesting some potential secondary effects.

The outlook for future decisions remains data-dependent: the base-case scenario "prescribes keeping the Selic rate at the current level", since the high level of economic slack (marginally more persistent, as the economic recovery is perceived as "at a more gradual pace than what was expected before the strike") still allows for stimulative monetary policy. We keep our view that a tightening cycle will start only on 2H19, by which time the output gap closing should look imminent. Rate hikes could come earlier than we are expecting should risks associated with elections trigger a new round of strong currency depreciation, moving 2019 expected inflation above the target midpoint. The next Copom meeting is scheduled for September 19.

**June industrial production data confirmed our expectation of a V-shaped recovery following the end to the May truckers' strike.** Production went up 13.1% m/m (3.5% y/y), with the seasonally adjusted index rebounding to its highest point since December 2017. Nevertheless, average production contracted 2.5% in 2Q18, interrupting a sequence of five consecutive quarterly increases. We expect a recovery in the coming quarters – our full-year 2018 forecast is 3.5% growth (down from 4.7% before our latest revision). With that, we expect 2Q18 GDP growth at 0.3% q/q, compatible with our 2.0% full-year growth forecast.

**Political Agenda: End of Party Conventions, Few Definitions Still Pending**

The window for party conventions closes on August 5, with only a few definitions pending for this weekend. This week's most significant developments follow: (i) the agreement between PT and PSB, whereby the latter committed not to support any presidential candidate and give up a state governorship candidacy in exchange for support of PSB's reelection bid in Pernambuco<sup>1</sup>; (ii) Geraldo Alckmin's decision to pick senator Ana Amélia (PP) as his vice presidential running mate; (iii) the alliance between Marina Silva's Rede and PV, adding Eduardo Jorge (a former congressman and 2014 presidential candidate) to Silva's ticket; (iv) MDB's convention confirming former finance minister Henrique Meirelles as its candidate; (v) the alliance between Podemos and PSC, with presidential pre-candidate Paulo Rabello de Castro giving up his candidacy to join forces with Alvaro Dias. The PT/PSB's move left PDT candidate Ciro Gomes with very limited possibilities for alliances (at the time of this report's publication, only a few small parties still had not defined who they plan to support). PT's president, Gleisi Hoffmann, stated that her party will formally invite Ciro Gomes to run as vice president on a ticket led by former president Lula, to be confirmed only on the day before the deadline for registration (August 15)<sup>2</sup>.

<sup>1</sup> See, for example, "Acordo entre PT e PSB nos estados isola Ciro e causa protesto nos diretórios," *Folha de S. Paulo*, August 1, 2018.

<sup>2</sup> "Gleisi diz que PT só definirá vice de Lula um dia antes de registrar candidatura," *Estado de S. Paulo*, August 2, 2018.

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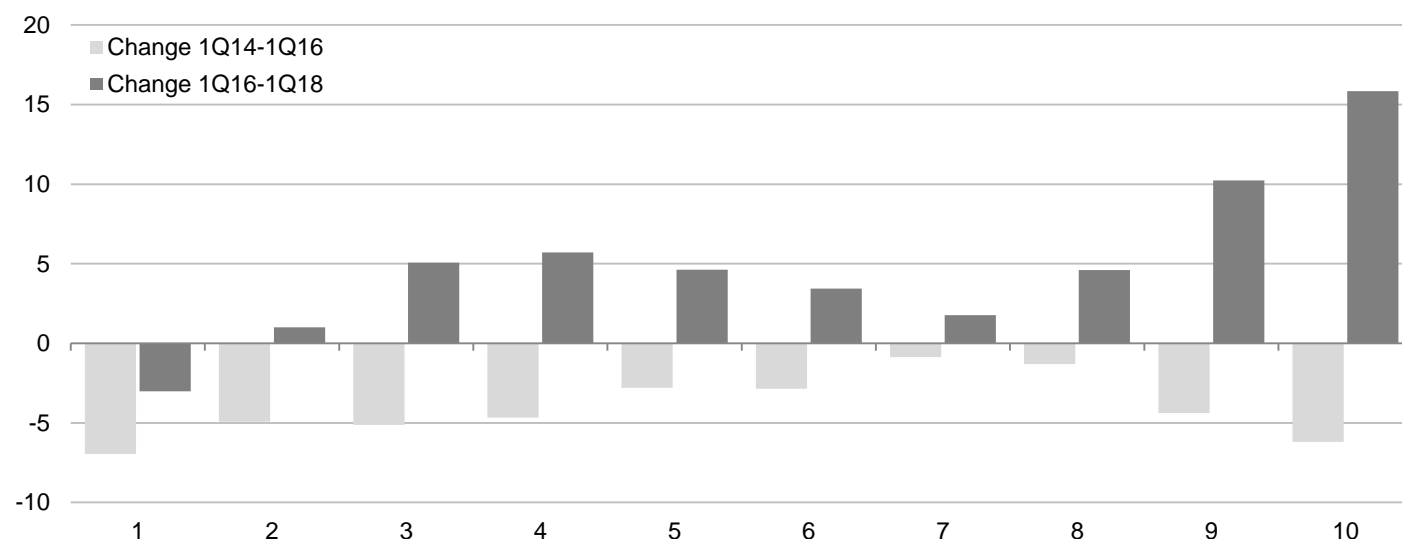


With the official beginning of the campaigns scheduled for August 16, the next week is likely to be the last for the Congress to move forward new legislation until the first round of voting. Among the relevant bills pending votes at the Lower House or Senate, in no particular order, are the credit bureau (*cadastro positivo*), central bank autonomy, auction of oil fields, and electronic trade note (*duplicata eletrônica*).

## Chart of the Week: An Uneven Income Recovery

Using data from the Brazilian quarterly household survey (PNAD), we calculated the changes in average real labor income by income deciles in two periods: between 1Q14-1Q16 (the two years leading up to the former president's impeachment), and 1Q16-1Q18. In the latter period, income gains were higher in the top two deciles, whereas the losses during 2014 and 2016 were more uniformly distributed. For the poorest 30%, the gains after 1Q16 still did not compensate the losses during the previous period.

### Brazil – Average Real Labor Income per Person by Income Deciles, Change (%)



Sources: IBGE, LCA, Santander estimates.

## Upcoming Data: Copom Minutes, July CPI

The minutes of this year's Central Bank meeting will be released next Tuesday. On the following day, IBGE releases July CPI. We expect a strong retracement from June's spike in foodstuff and fuel prices, bringing headline inflation to 0.22% m/m (from 1.26% m/m). With that, 12-month inflation should fall 2 bps, to 4.37% (see more about our inflation forecasts in "In-Depth Research" below).

On the economic activity side, we expect June core retail sales to have grown 0.3% m/m. This indicator did not suffer much from the May strikes and is likely to continue on a gradual recovery path, in our view.

## In-Depth Research: New CPI Estimates

*In The Power of Trade-Off* (August 2, 2018), we updated our year-end 2018 CPI inflation forecast, taking into account the observed and expected effects of the truckers' strike on prices. According to our estimates, the strike will eventually add 40 bps to our previous 12-month inflation projection, bringing it to 3.9% (below current market consensus, at 4.11%). We see negligible spillover to 2019, mostly owing to the Central Bank's credibility, the current economic slack, and the slow pace of the economic recovery limiting the pass-through of shocks to a broader basket of goods — 12-month core inflation should end this year at 2.2%, its lowest level since 1999. We expect this negligible spillover to become evident in the next few inflation releases, probably leading to downward consensus revisions. That taken into account, and assuming the election of a reformist president in October, we see plenty of room for the Central Bank to continue its stimulative monetary policy well into 2019: we still expect the Selic rate to stay at 6.5% until 2H19. We also have left our 2019 inflation expectation unchanged, at 4.0% y/y by year-end.



## Number of the Week

**147.3  
million**

According to the Supreme Electoral Court, 147.3 million people are registered to vote in Brazil this year, up 3.14% from the last general elections, in 2014.

## Quote of the Week

*I like when people underestimate me. That makes surprising them possible.*

— **Marina Silva**, presidential candidate, in an interview with *GloboNews* (July 31, 2018).

## What We've Been Reading

- “Are corporate bonds a bubble ready to burst?,” by Susan Lund and Eckart Windhagen (*Beyondbrics*, July 27, 2018). A new study from McKinsey Global Institute points to vulnerabilities in corporate credit in several countries, including Brazil.
- “Unlikely presidential frontrunner emerges in Brazil,” by Filipe Gruppelli Carvalho (*Eurasia Live*, July 26, 2018). Nice set of frequently asked questions about Jair Bolsonaro.
- “Can Brazil fix its democracy?,” by Geoff Dyer (*Financial Times*, July 31, 2018). A review of the newly released English edition of *Brazil: A Biography*, a history of the country's efforts on state building.
- “A brief history of Brazil's ‘centrists’ – and why they matter to the election,” by Mauricio Santoro (*The Brazilian Report*, July 31, 2018). Who are the potential kingmakers in the coming presidential election.
- “One in five Brazilians live in ‘news deserts,’ without newspapers, news sites and TV and radio stations,” by Carolina de Assis (*Journalism in the Americas Blog*, July 24, 2018). A data point to relativize the importance of media in Brazil's vast countryside.
- “Chocolate, bioterrorism and the birth of Brazilian funk,” by Megan Giller (*Engadget*, July 27, 2018). How politically motivated bioterrorism devastated an important cash crop in Bahia.

## Recent Publications (Available on Our Website)

- *The Power of Trade-Off* (August 2, 2018)
- *It's Not for a Lack of Credit – Part III: Delinquency, Way Better than it Seems* (July 20, 2018)
- *It's Not for a Lack of Credit – Part II: Companies* (July 20, 2018)
- *It's Not for a Lack of Credit – Part I: Individuals* (July 18, 2018)
- “*Lethal Weapon*”: *How Far Can the BCB Go with Swaps?* (June 15, 2018)



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