

Brazil Macro Compass

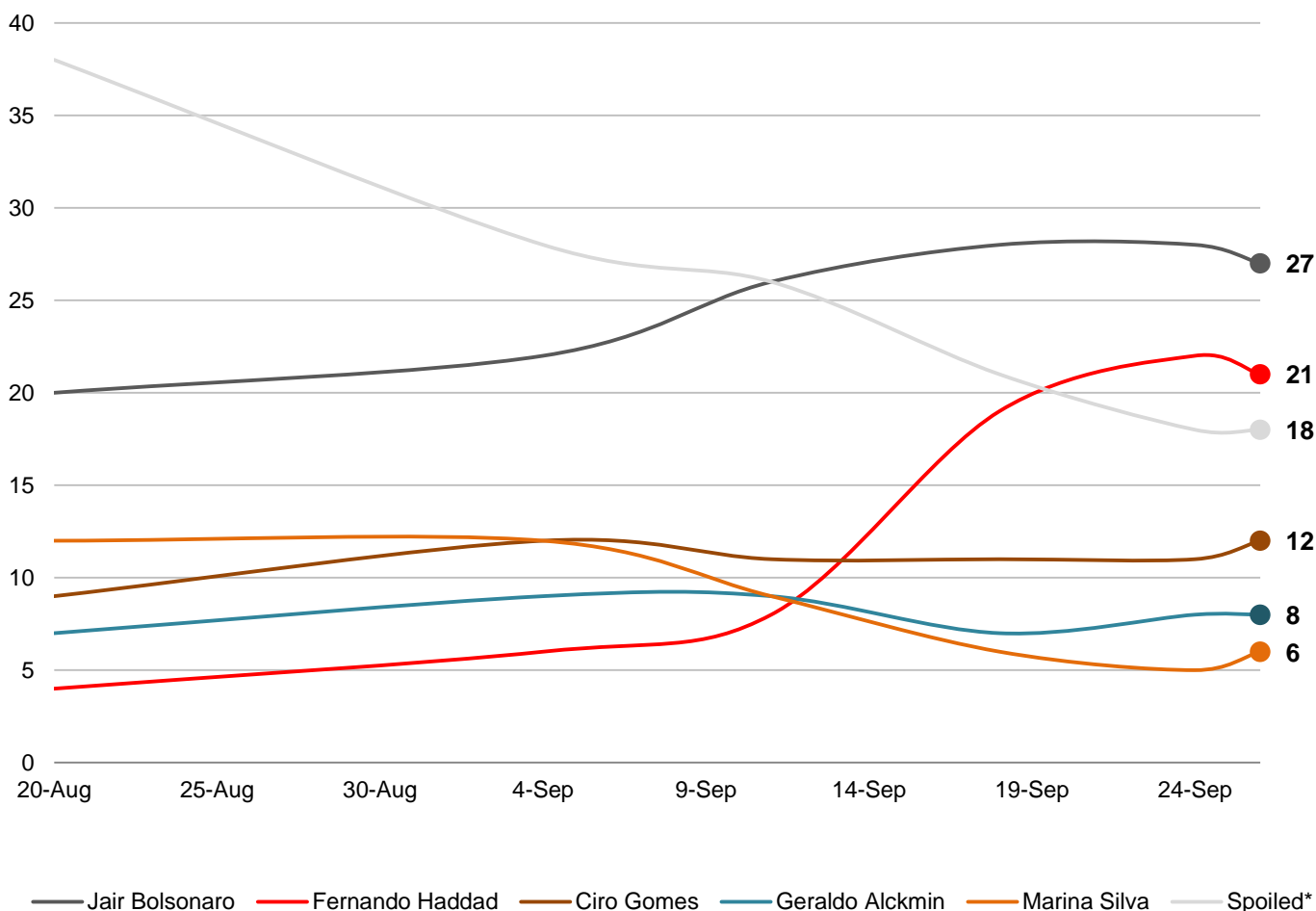
One Week to Go

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Political Agenda: Final Week of Campaigns

The electoral campaign enters its final week, with the two leading candidates for the presidency keeping a wide distance from the third place (see the chart below). So far, Ibope has filed polls to be released on Monday (October 1) and Wednesday (October 3), and both Ibope and Datafolha are likely to release other polls throughout the week. The most important debate among presidential candidates will be broadcasted by Globo TV on October 4. Voting takes place on Sunday, October 7.

Brazil 2018 Presidential Voting Intention (% of Total Votes)



*Spoiled: blank, null, undecided, no answer. Sources: Ibope.

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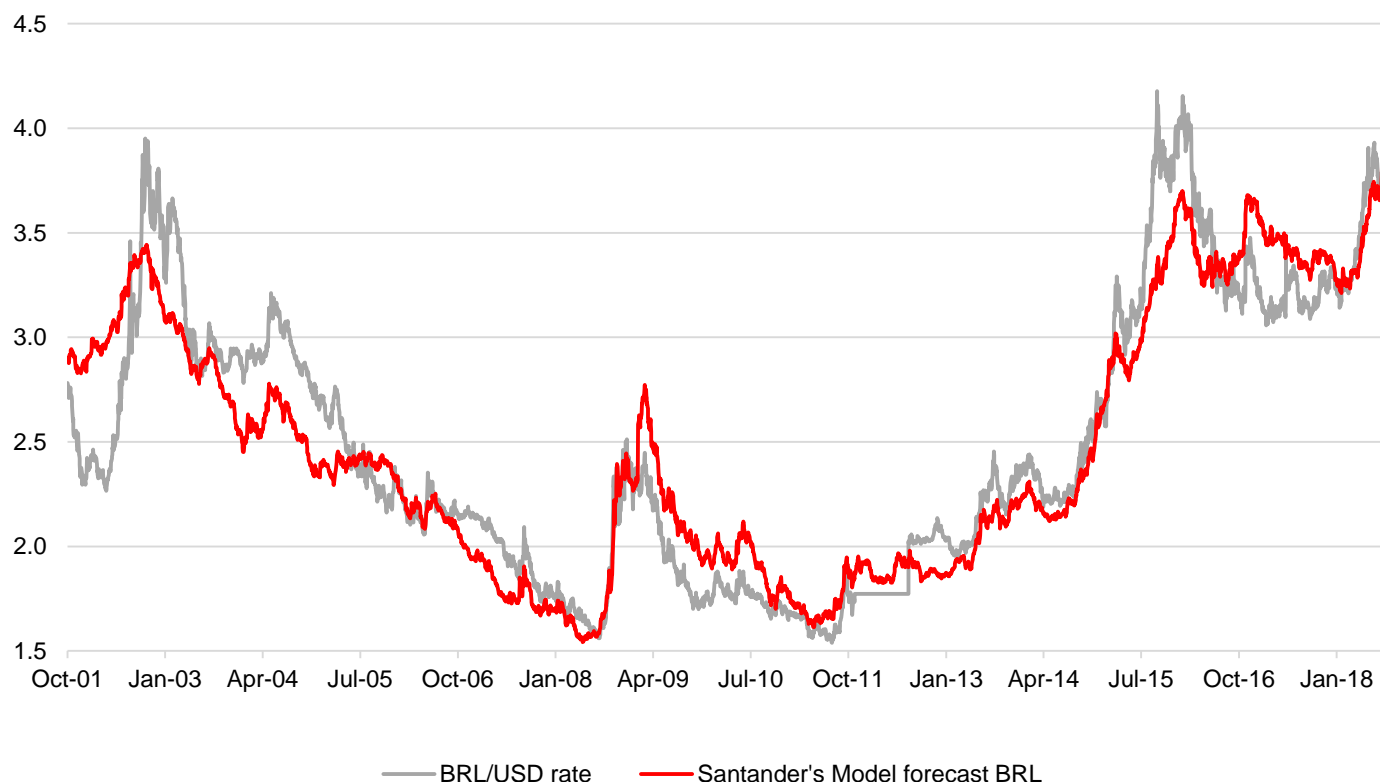
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Chart of the Week: FX Model

Our “Chart of the Week” compares the outcome of our FX model to actual market rates. Lately, there has been little difference between the two lines, which suggests that the currency is fairly priced relative to the CDS market and external conditions (see also “In-Depth Research” on the following page).

BRL/USD Rate vs. Model Forecast



Sources: Bloomberg, Santander estimates.

What's New: Copom Minutes

In the minutes of last week's meeting, Brazil's Central Bank highlighted that it sees asymmetric risks in the scenario, stating that the risks associated with: (i) the continuation of the process of adjustments and reforms; and (ii) risk perception of for emerging economies have increased since the August rate decision. It believes that the perception of continuity in the reform agenda (especially the fiscal reforms) affects expectations and current macroeconomic projections, and consequently, the balance of risks for inflation.

We have previously noted that an exchange rate sustainably weaker than BRL4.30/USD could drive CPI inflation above the target midpoint at some point in the near future and trigger a monetary policy response (see *Rely on Fundamentals and Carry On*, June 8, 2018). That said, in our opinion, the next Copom decision will depend on the breadth of the reforms, which is strongly linked to the presidential outcome three days before the meeting.

Upcoming Data: September Inflation, August Industrial Production

September CPI will be released on October 5. We expect monthly inflation at 0.36%, which would bring 12-month inflation to 4.4%. Headline inflation should be influenced by rising food and fuel prices (mainly ethanol). We expect 12-month inflation to decelerate to 3.9% by year end.

August industrial production will be out on October 2. We expect growth of 0.4% m/m (3.2% y/y).



In-Depth Research: New Exchange Rate Forecasts

In *BRL: Between Common and Idiosyncratic Factors* (September 26, 2018), we updated our exchange rate model and new year-end BRL/USD forecasts for 2018 and 2019 (to 3.80 from 3.50 and to 4.10 from 3.57, respectively). The model, which takes into account commodity prices, 10-year US rates, country risk, other EM currencies, and short-term interest rate differentials, estimates that the current BRL “fair value” is around 3.90/USD, which means that, at current market prices (4.03/USD), there is little to be explained by idiosyncratic factors not already implied in CDS spreads, such as risks associated with the elections (see also the “Chart of the Week” below). We also simulate the effect to the currency of deterioration in risk appetite, with 5-year CDS jumping to 400 bps. In that case, according to our model, the BRL/USD would jump to 4.50.

Number of the Week

66%

66% of the Brazilian respondents of a survey done by Digital News used social media as a source of news in the week before the interview, as reported by *Financial Times* (see ‘What We’ve Been Reading’ on page 3).

Quote of the Week

“It’s like everyone says here. We vote for this plant, for a dog, and even for a donkey. Isn’t it what Lula is telling us? Done. If they allow me, I’ll stay in his place in prison.”

— **Wilson Arailton da Silva**, a voter from the Pernambuco backcountry, in an interview with *Folha de S. Paulo* (September 25, 2018).

What We’ve Been Reading

- “Brazil Won’t Bounce Back Quickly After Election, Adviser Says,” by Samy Adghirni (*Bloomberg*, September 27, 2018). Persio Arida, Geraldo Alckmin’s top economic advisor, believes that the economy is in a worse shape than in 2002.
- “How To Heal The Brazilian Economy,” by Otaviano Canuto (*Seeking Alpha*, September 18, 2018). Canuto, an executive director at the World Bank, gives his recipe to put Brazil back on track.
- “How social media exposed the fractures in Brazilian democracy” by Joe Leahy and Andres Schipani (*Financial Times*, September 27, 2018). The elections as a meeting between discontent and deepening of social media penetration.
- “Fernando Haddad aims to be Brazil’s new Lula – but does anyone know who he is?,” by Dom Phillips (*The Guardian*, September 18, 2018). A profile of PT’s presidential candidate.
- “From Renegade General to VP Hopeful, He’s Brazil’s Military Champion,” by Catherine Osborn (*Ozy*, September 18, 2018). Meet General Hamilton Mourão, Jair Bolsonaro’s running mate.

Recent Publications (Available on Our Website)

- *BRL: Between Common and Idiosyncratic Factors* (September 26, 2018)
- *Copom: Hoping for the Best but Prepared for the Worst* (September 17, 2018)
- *Standby Mode* (September 12, 2018)
- *Worse Financial Conditions at the Margin Reinforce the Likelihood of Selic Remaining “Low for Long”* (August 30, 2018)
- *We’re Not in 2002 Anymore (Caution Advised, Though)* (August 28, 2018)



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