

Brazil Macro Compass

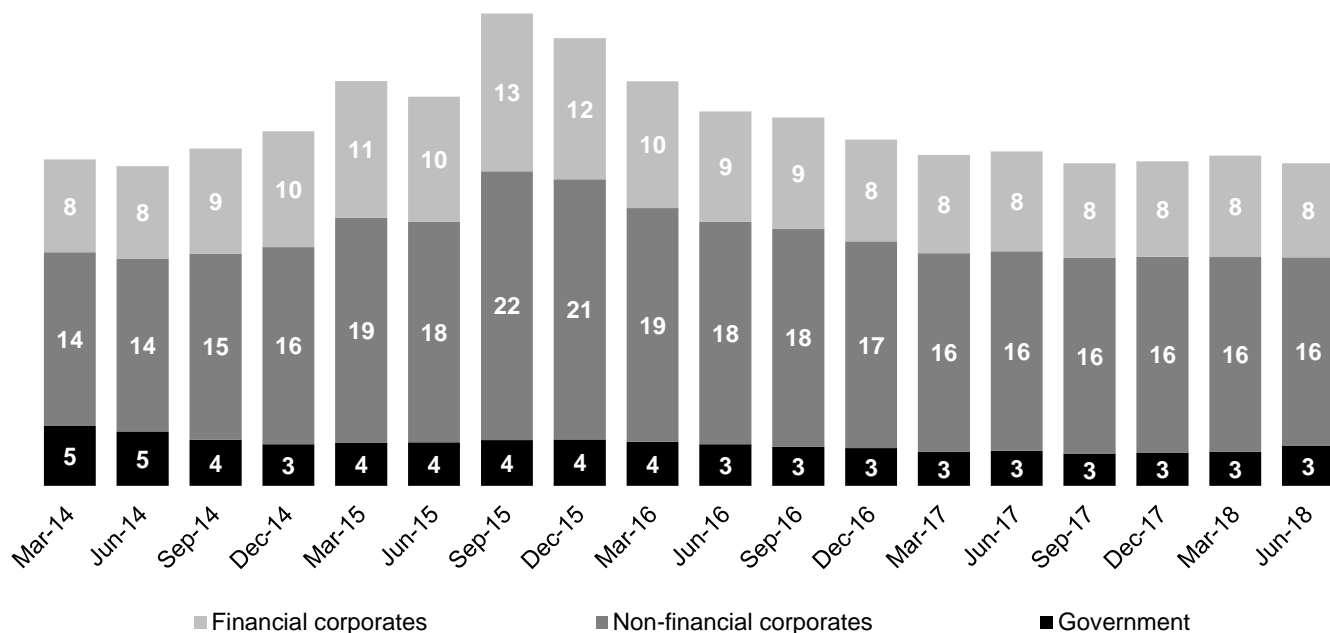
Leverage in Foreign Currency Stays Low

Luciano Sobral*
lusobral@santander.com.br
+5511 3553 3753

Chart of the Week: Low Leverage in Foreign Currency

This week, the Institute of International Finance released its Global Debt Monitor, updated with data up to 2Q18. As a share of GDP, debt denominated in foreign currency of Brazil's government and corporations was at the lowest level since 2Q14, adding up to 26.7%. Since the recent peak in 3Q15, Brazilian companies reduced their FX-denominated debt by 11.9% of GDP. The government continues to finance most of its debt internally, with a low (and falling) stock of foreign debt (considering international reserves, Brazil is actually an external creditor).

Brazil – Outstanding Debt Denominated in Foreign Currency, % of GDP



Sources: IIF, Santander.

Political Agenda: Some Key Appointments to the Economic Team

Also this week, the newly elected government completed most of the key appointments for its economic team. Roberto Campos Neto, previously head of markets for Americas at Santander, will replace Ilan Goldfajn as Central Bank Governor. Other two key members of the current administration announced that they will continue at their positions under Bolsonaro: Mansueto Almeida as secretary of the National Treasury and Carlos Viana de Carvalho as deputy governor for economic policy of the Central Bank. In a press release, Goldfajn congratulated the incoming government for Campos Neto's nomination and assured a smooth transition. He will remain in his position until the Senate approves the new nomination, probably before the end of this year.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.

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Eunício Oliveira, the president of the Senate, announced that the *cessão onerosa* (transfer of oil rights) bill will come to a vote on November 20. If approved, the bill would allow the federal government to auction exploration rights of oil fields in the pre-salt region. Oliveira affirmed that the fiscal revenue of the auctions should be between BRL120 billion and BRL130 billion, an amount that should be shared with states and municipalities.

What's New: Weaker-than-Expected Activity

September economic activity indicators released surprised to the downside last week. Core retail sales contracted 1.3% m/m, much worse than market consensus (flat in the month). The poor performance was widespread among most sectors, including those not included in the core indicator — the headline index, which includes auto and construction material sales, shrank 1.5% m/m.

The volume of services fell 0.3% m/m, in line with our forecast (-0.2%). The sector continues to lag the overall economic recovery, probably due to recent poor confidence and job market indicators.

Finally, IBC-Br, the monthly GDP proxy, rose 0.7% y/y, 30 bps below our forecast. The indicator rose 1.7% q/q, which corresponds, after adjusting for different seasonal adjustment methods, to GDP growth of 0.8% q/q in 3Q18, in line with our forecast of 1.5% for the full year.

Upcoming Data: November IPCA-15

On November 23, IBGE releases its preview of November inflation. We expect the index to shrink 0.03% in the month, reflecting falling fuel prices and electricity tariffs (see our *Brazil Macro Compass* of November 9, 2018 for more details). We forecast year-end CPI inflation at 4.3% y/y and 3.8% y/y in 2018 and 2019, respectively.

Number of the Week

**BRL
120
billion**

Eunício Oliveira, the president of Brazil's Senate, claimed that the auctions for oil exploration rights that may follow the approval of a bill could raise government revenue of BRL120 billion. See "Political Agenda" above for more details.

Quote of the Week

"The elites should be blamed for what happens in South America. They have always lived for themselves and ignored social inequality."

— **General Augusto Heleno**, appointed by the incoming government as head of the Institutional Security Cabinet, in an interview with *Valor* (November 13, 2018).

What We've Been Reading

- "What the Hell Happened to Brazil? (Wonkish)", by Paul Krugman (*The New York Times*, November 9, 2018) and "Improving Krugman – a Story About Brazil," by Mark Dow (*Behavioral Macro*, November 11, 2018). Krugman attributes Brazil's economic slump to a mix of bad luck (falling terms of trade) and bad policies (austerity); Dow's rebuttal downplays the role of commodity prices and stresses the importance of policy credibility.
- *Household Debt and Recession in Brazil*, by Gabriel Garber, Atif Mian, Jacopo Ponticelli, and Amir Sufi (NBER Working Paper No. 25170, October 2018). Mentioned by Krugman in the article recommended above. The authors use a detailed database of credit operations to understand the recent patterns of household debt expansion in Brazil.
- *From Known Unknowns to Black Swans: How to Manage Risk in Latin America and the Caribbean* (Semiannual Report – Office of the Regional Chief Economist, The World Bank, October 2018). The World Bank sees Brazil GDP growth accelerating to 2.2% in 2019 (from 1.2% this year).
- "Forecasting Is Fallible, Yet Necessary," by Mark Cliffe (*Project Syndicate*, November 9, 2018). Permanent demand for predictions makes economic forecasts unavoidable, despite all their known shortfalls.
- "Brazil at the crossroads" by Liz Mineo (*The Harvard Gazette*, November 1, 2018). An interview with Scott Mainwaring, a professor for Brazil studies at Harvard Kennedy School, about the presidential election outcome.



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- “Right Flank, March,” by Consuelo Dieguez (*Piauí*, September 2016) and “The Guarantor,” by Malu Gaspar (*Piauí*, September 2018). Recent translations to English of excellent long-form profiles of, respectively, Jair Bolsonaro and Paulo Guedes.

Recent Publications (Available on Our Website)

- *Risks for the Selic in 2019 Expected to Become Even Less Asymmetric* (November 6, 2018)
- *20 Charts that Explain Brazil’s New Political Power Structure* (October 29, 2018)
- *Brazil Post Elections: Honeymoon and Marriage* (October 25, 2018)
- *Brazil – Risk Premium: Apples and Oranges* (October 9, 2018)
- *BRL: Between Common and Idiosyncratic Factors* (September 26, 2018)



CONTACTS / IMPORTANT DISCLOSURES

Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Sergio Galván*	Economist – Argentina	sgalvan@santanderio.com.ar	54-11-4341-1728
Maurício Molan*	Economist – Brazil	mmolan@santander.com.br	5511-3012-5724
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Diana Ayala	Economist – Colombia, Peru	diana.ayala@santander.us	212-407-0979
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Marcela Bensión*	Economist – Uruguay	mbension@santander.com.uy	5982-1747-5537

Fixed Income Research

Diana Ayala	Macro, Rates & FX Strategy – Latin America	diana.ayala@santander.us	212-407-0979
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderio.com.ar	5411-4341-1065
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
David Franco*	Macro, Rates & FX Strategy – Latin America	david.franco@santanderCIB.co.uk	44-207-756-6633
Aaron Holsberg	Head of Credit Research	aholsberg@santander.us	212-407-0978

Equity Research

Christian Audi	Head LatAm Equity Research	caudi@santander.us	212-350-3991
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderio.com.ar	5411-4341-1564
Nicolas Schild*	Head, Chile	nschild@santander.cl	5622-336-3361
Valder Nogueira*	Head, Brazil	jvalder@santander.com.br	5511-3012-5747
Cecilia Jimenez*	Head, Mexico	mcjimenez@santander.com.mx	5255-5269-2228

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