

Brazil Macro Compass
Last Rate Decision of 2018 Should Keep Selic at 6.5%

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

Upcoming Data: Last Rate Decision of 2018

Brazil's Central Bank Monetary Policy Committee (Copom) meets on Wednesday for the last time this year. We expect the Selic rate to be kept at 6.5%, with a reiteration of the signaling that, under current market and economic conditions, there is a small probability of a change in this level over the medium term. The inflation outlook looks even better than in October (see the table below and "What's New" on page 2 of this report), despite growing concerns about a reversion on benign global financial conditions. If our expectation is confirmed, the Selic rate will stay at 6.5% for at least 10 months, the second longest period (after the 14 months between July 2015 and September 2016, when the rate was at 14.25%) in Copom's history with a stable policy rate. The next Copom meeting is scheduled for February 6, 2019, probably still with Ilan Goldfajn as chair (the Senate approval of Roberto Campos Neto is expected to take place during February).

We continue to believe that inflationary pressures will remain contained throughout 2019, with a relatively stable exchange rate and a slowly narrowing output gap. With that in mind, we continue to forecast a flat Selic rate, at least until the end of 2019 (see our report *Risks for the Selic in 2019 Expected to Become Even Less Asymmetric*, from November 6, 2018, for more information).

Selected Financial and Economic Indicators, Changes Between Copom Meetings

Market prices	31-Oct	06-Dec	Change
BRL/USD rate	3.72	3.90	5.0%
5-year CDS	205	214	10 bps
1-year rate	7.03%	6.82%	-21 bps
1-year breakeven inflation	4.06%	3.41%	-65 bps
5-year rate	9.54%	9.46%	-8 bps
Crude oil WTI (USD)	65	50	-22.7%
<i>Crude oil WTI (BRL)</i>	243	197	-18.8%
CRB Food (USD)	336	333	-1.0%
<i>CRB Food (BRL)</i>	1,251	1,300	4.0%
Market expectations*	26-Oct	30-Nov	Change
2019 CPI inflation (12m, year-end)	4.22%	4.11%	-11 bps
2020 CPI inflation (12m, year-end)	4.00%	4.00%	0 bps
12-month CPI inflation, year ahead	3.91%	3.73%	-18 bps
2019 GDP growth	2.50%	2.53%	3 bps
2020 GDP growth	2.50%	2.50%	0 bps

*Median of expectations in the Focus weekly survey. Sources: Brazil Central Bank, Bloomberg, Anbima, Santander.

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

U.S. investors' inquiries should be directed to Santander Investment at (212) 350-0707.

* Employed by a non-US affiliate of Santander Investment Securities Inc. and is not registered/qualified as a research analyst under FINRA rules, is not an associated person of the member firm, and therefore may not be subject to FINRA Rules 2241 and 2242 and incorporated NYSE Rule 472 restrictions



Political Agenda: Transfer of Rights Stalled; Bolsonaro’s High Approval Rating

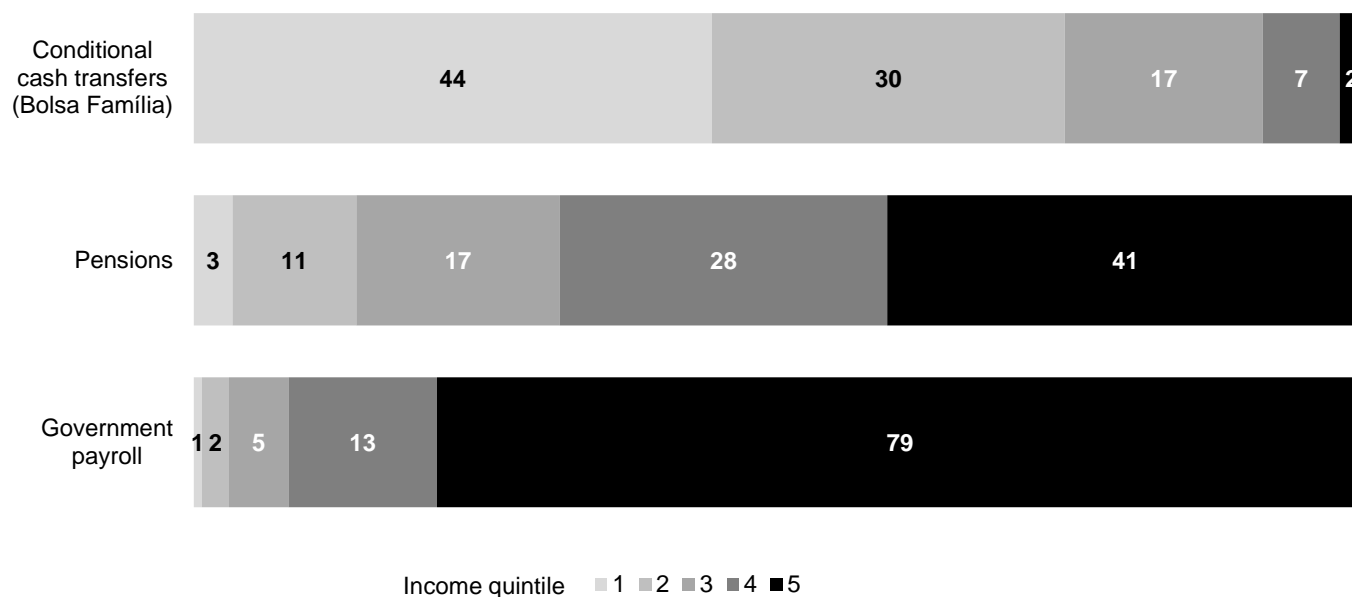
The transfer of rights (*cessão onerosa*) bill remains stalled in the Senate, as senators and the government could not reach an agreement that would allow the associated revenue to be distributed to states and municipalities and spent without breaching the constitutional spending cap. With only two weeks until the end of the legislative year, it is likely, in our view, that a final decision can be postponed to 2019.

The November wave of *Barômetro Político Estadão-Ipsos*, a monthly approval survey of politicians, suggests that Jair Bolsonaro may start his presidential term with high popularity ratings. According to the survey, 61% of the population approves the way he has been working in the country, a surge from 44% in October.

Chart of the Week: Robin Hood in Reverse

Our Chart of the Week comes from a recent Ministry of Finance report on the achievements in the reform agenda between 2016 and 2018 and perspectives for the next presidential term¹. A study of the ministry’s Secretary of Economic Policy estimated how three types of government transfers are allocated among income quintiles: 41% of pension spending and 79% of government payroll spending go to the top quintile, which suggests that pension and public sector reforms may have large, favorable distributive effects, in addition to the first-order fiscal impact.

Brazil – Share of Incidence of Government Transfers (% of Total by Type) by Income Quintiles



Sources: Ministry of Finance estimates.

What’s New: Low Inflation, Weak Industrial Production

November CPI inflation came in 8 bps below our forecast, at **-0.21% m/m (4.0% y/y)**. Falling electricity tariffs (-4.0% m/m) and gas prices (-3.1% m/m) subtracted, respectively, 16 bps and 14 bps from headline inflation. Yearly core inflation continued to decelerate – to 2.8%, from 2.9% in October and 3.2% one year ago. **We expect monthly inflation at 0.2% in December, which implies an adjustment in our year-end 12-month inflation forecast to 3.8% (from 4.0%)**. Slower-than-expected price increases contribute to our view that the Central Bank should keep the Selic rate at the current level for a long period (see “Upcoming Data” on page 1 of this report).

October industrial production surprised to the downside, at 0.2% m/m (130 bps below our forecast). Production

¹ *Reformas econômicas em 2016-2018 e perspectivas para o próximo mandato presidencial*. Brazil’s Ministry of Finance, November 2018.



of intermediate goods contracted 0.3% in the month, offsetting the growth in capital goods (+1.5% m/m) and consumption goods (+0.2% m/m). With that result, industrial production should grow at around 2% in 2018, a slowdown from 2017 (2.6% growth).

We adjusted our 2018 GDP growth forecast to 1.3% (from 1.5%), reflecting the revision on IBGE's time series (2016 growth was revised to 3.3%, from 3.5%; 2017 growth was revised to 1.1%, from 1.0%) – 3Q18 growth was in line with our expectations, as we noted last week. 4Q18 national accounts will be released only on February 28, 2019.

In-Depth Research: What to Watch in 2019

In *Economic and Political Calendar: What to Watch in Brazil in 2019* (December 5, 2018), we present a list of potentially market-moving events scheduled for the rest of 2018 and the whole of 2019. Following an easy January, February should be an eventful month, with the elections for the leadership of both Congress houses and the start of the legislative year.

Number of the Week

12.7%

Despite a relief in November (see "What's New" on page 2 of this report), gasoline prices to the Brazilian consumer are still up 12.7% year-to-date, according to IBGE data.

Quote of the Week

"We have four years to guarantee the future of our children and grandchildren. We cannot arrive terrorizing [the Congress]."

— **Onyx Lorenzoni**, incoming president's chief of staff, in an interview with *Folha de S. Paulo* (December 3, 2018).

What We've Been Reading

- "Is It Finally Getting Easier to Do Business in Brazil?," by Otaviano Canuto (*Americas Quarterly*, November 27, 2018). Canuto comments on Brazil's rise in the World Bank Doing Business ranking.
- "Brazil's New Government Tries to Cut Toxic Pork From Politics," by Simone Preissler Iglesias and Samy Adghirni (*Bloomberg*, December 4, 2018). Bolsonaro's "new way" of whipping Congress votes in favor of reforms has been raising skepticism from analysts and representatives.
- "Bolsonaro's bid to kick-start Brazil economy destined to disappoint," by Yerlan Syzdykov (*Financial Times*, November 29, 2018). Syzdykov is negative on Brazilian assets before markets start putting pressure on the new government for deep structural reforms.
- "Study: election reforms in Brazil might have saved children's lives. Here's how," by Kelsey Piper (*Vox*, December 3, 2018). New research shows that a reduction in electoral fraud led to better health outcomes in some municipalities.

Recent Publications (Available on Our Website)

- *Economic and Political Calendar: What to Watch in Brazil in 2019* (December 5, 2018)
- *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)



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@santander.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@santander.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@santander.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

Electronic Media

Bloomberg	SIEQ <GO>
Reuters	Pages SISEMA through SISEMZ

This report has been prepared by Santander Investment Securities Inc. (“SIS”; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. “Santander”), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. (“Santander Investment Bolsa”), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Luciano Sobral*.

*Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

© 2018 by Santander Investment Securities Inc. All Rights Reserved.

