Santander Corporate & Investment Banking

ECONOMICS

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Brazil Macro Compass

Where Have All the Dollars Gone?

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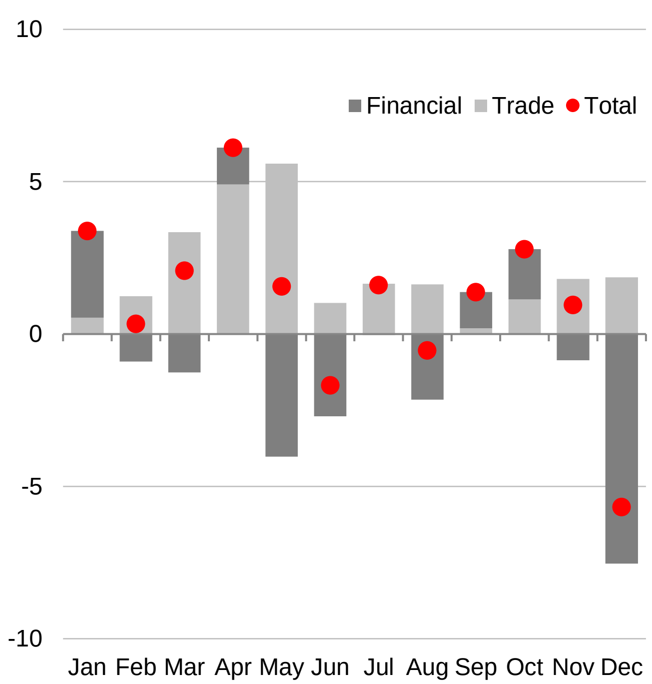
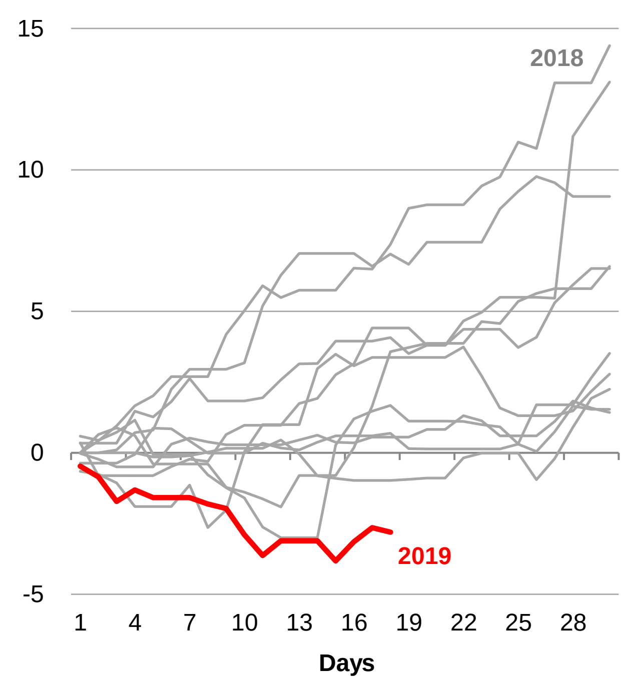
Chart of the Week: Foreign Flows

Our Chart of the Week looks at the seasonal pattern of FX flows to Brazil, using Central Bank data. Over the past 10 years, April has been by far the strongest month of the year for foreign currency inflows, averaging more than USD 6 billion. That is explained, in our view, mostly by soy farmers converting to *reais* the proceeds of the year's crop. (This effect repeats in May for trade flows, but a pattern of financial outflows nets out the total amount of foreign currency entering the country in that month). Partial data for the current month (until April 18) show a much different pattern, possibly contributing to the recent BRL underperformance: trade inflows are weaker (USD 1.8 billion month to date), and, on the financial account, outflows are adding up to USD 4.7 billion in the same period, resulting in a net outflow of USD 2.8 billion so far. One possible explanation on the trade side is that relatively low domestic rates are leading more producers to keep their revenues in offshore accounts; another one, applicable to the financial balance, is that rollover rates of maturing corporate external debt have been collapsing for a similar reason (with low domestic rates, it becomes relatively more attractive to find new funding in the domestic market), with the economic policy uncertainty contributing to scarce portfolio flows that could counterbalance that phenomena. Balance of payments data to be released next month should provide more data to test those hypotheses.

Brazil Foreign Exchange Flows by Calendar Month, 2009-2018 (USD billions)



April Cumulative Foreign Exchange Flows, 2009-2019 (USD billions)



Sources: Brazil Central Bank, Santander.

What's New: Higher Inflation, Fewer Jobs

April IPCA-15 came in at 0.72% m/m, above our forecast (0.68% m/m) and market consensus (0.67% m/m). Twelve-month inflation jumped to 4.71%, from 4.18% in the previous month. Most of the inflation acceleration can be explained by increases in administered prices, such as fuel and bus tariffs. Foodstuff prices are still rising, in-line with the seasonal pattern and our estimates. Although that result doesn't substantially change our expectations for future inflation, we're revising our forecasts to take into account the supply disruption in the protein chain caused by the African swine fever in China and other countries. This should add an upward bias to our 2019 and 2020 year-end inflation forecasts (currently at 3.5% and 4.0% y/y, respectively.

Formal job creation disappointed in March, with net destruction of more than 40k jobs in the month. March unemployment rate, to be released in the eve of the Labor Day holiday, should confirm this weak and uneven recovery in the labor market: we expect the unemployment rate to stay flat (from February) at 12.2%, after seasonal adjustments.

Upcoming Data: March Industrial Production, April Trade Balance

We expect March industrial production, to be released next week, to have contracted 0.8% m/m in March. That would lead this indicator to the second consecutive quarterly contraction (-0.3% q/q in 1Q19, following -1.3% q/q in 4Q18), on the back of disappointing figures from the auto industry. April auto sales data, to be released soon, should provide an initial indicator of where the sector is heading into 2Q19.

We expect a USD 7 billion trade surplus in April, the highest monthly surplus since June 2017. If our estimates are correct, year-to-date trade surplus will be at USD 7.2 billion, 3.6% lower than in the same period of 2018 and in-line with our full year estimate of a USD 44.3 billion trade surplus.

Political Agenda: Pension Reform Moves Forward

The report on the Pension Reform at the Lower House Constitutional Committee (CCJ) was approved by a wide margin (48-18), following an agreement between center parties and the government to modify some points of the reform, none that imply in lower fiscal savings should the reform be implemented. All but one representative from the "Centrão" parties voted in favor of the report, with the other "no" votes all coming from left/center-left parties such as PT, PDT, and PSB. The Speaker of the House, Rodrigo Maia, expedited the set-up of the special committee to work on the reform, to be chaired by Marcelo Ramos from the Republican Party (PR, from the "Centrão") and reported by Samuel Moreira (PSDB). This committee is expected to start its sessions on May 8, and a report must be presented after up to 40 sessions, a period in which committee members can propose changes to the original draft. We expect the committee to vote on the final report only after the midyear recess, by mid-August, with the reform then ready to go a floor voting. Due to the Labor Day holiday on Wednesday, next week should be an empty one in Brasília.

In-Depth Research: GDP Growth Forecast Revisions

In our most recent report, *No News Is Bad News* (April 22, 2019), we revised our 2019 and 2020 GDP growth forecasts to 1.3% and 2.5%, respectively (from 2.3% and 3.0%). The recent deterioration in consumer expectations caused, in our view, by a disappointingly weak job market seems to be the main driver for a slower expansion in household consumption, practically the sole driver of growth in an environment with no space for stimulative fiscal policy, flat demand for exports, and no additional monetary impulse. The poor evolution of job creation also led us to re-estimate the path of confidence for the following quarters, which should contribute to slower growth into 2020.

Despite this weak scenario for growth, we maintain our view that the Central Bank will keep the Selic rate unchanged for a long period. Uncertainties regarding the fiscal consolidation process (especially the pension reform) should, in our view, lead to a cautious approach to monetary policy in the next few months. Once those uncertainties are solved favorably, assuming our scenario of approval of the pension reform on 3Q19 (see our report *Pension Reform—The Moment of Truth: From Intentions to Bargaining*, March 28, 2019), improving financial conditions should make additional monetary impulse unnecessary, with growth accelerating at the margin.

Number of the Week

48

48 representatives voted in favor of the report on the pension reform at the Lower House Constitutional Committee, 14 more than the simple majority required for the report to be approved.

Quote of the Week

"*I did an ideological re-reading. Today, I am a center politician. From the economic point of view, I am a liberal.*"

— **Representative Marcelo Ramos,** a former member of the Communist Party (PCdoB), now at the Republican Party (PR), in an interview with *Estadão* (April 26, 2019). Ramos will chair the pension reform special committee at the Lower House.

What We've Been Reading

- "Building Opportunities for Growth in a Challenging World," coordinated by Eduardo Cavallo and Andrew Powell (*IDB 2019 Latin American and Caribbean Macroeconomic Report*, April 15, 2019). IDB defends that the region should use the window of opportunity of globally low rates to attract private investment and boost their infrastructure.
- "Bolsonaro Took Aim at China. Then Reality Struck," by Richard Lapper (*Americas Quarterly*, April 23, 2019). Brazil's economic ties with China are too deep and too important to be affected by ideology, argues Lapper.
- "14 must-reads in Brazilian literature for every book lover," by Gustavo Ribeiro (*The Brazilian Report*, April 23, 2019). A primer to Brazil's rich literary production.
- "A 'Twin Peaks' Plot Point Featuring a Parrot Came to Life in Brazilian True Crime," by Ephrat Livni (*Quartz*, April 25, 2019). Both in fiction and reality, talking birds are tricky pets for criminals to own.

Recent Publications (Available on Our Website)

- *Economic Activity: No News Is Bad News* (April 22, 2019)
- *Will Credit Be Enough to Revive Consumption?* (April 1, 2019)
- *Monetary Policy: Low for (Much) Longer* (March 29, 2019)
- *Pension Reform—The Moment of Truth: From Intentions to Bargaining* (March 28, 2019)
- *Is Monetary Policy Stimulative for Consumption?* (March 6, 2019)
- *Lower Inflation Forecast for 2019* (February 28, 2019)

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