Santander
Corporate & Investment Banking

# ECONOMICS

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## Brazil Macro Compass

# A Cold Autumn for Economic Activity

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## What's New: Job Creation, Consumer Confidence

**May labor market indicators, released this week, corroborate preliminary 2Q data released so far, pointing to stalling economic activity**. Net formal job creation (Caged) added up to only 16k jobs in May, bringing the three-month seasonally adjusted and annualized pace to 220k jobs, significantly below the hiring trend of the past 12 months (around 400k jobs). The official unemployment rate, also released this week, contracted to 11.9% (from 12.0%) after seasonal adjustment — the unadjusted rate is at 12.3%, 40 bps lower than in the same period of 2018. A (slight) silver lining is in the participation rate, which rose to 62.1%, the highest in the new IBGE series (started in 2012).

**June FGV consumer confidence rose 2.2% m/m**, with all the improvement coming from the "future conditions" component that is more sensitive to easing financial conditions. The "current conditions" sub-index was unchanged in the month, in-line with other hard data indicators.

**June preliminary CPI inflation reading (IPCA-15) came in at 0.06% m/m (3.84% y/y)**, in-line with our estimate. Foodstuff prices fell 0.82% in the month, offsetting higher electricity bills (+0.64% m/m) and services (+0.25% m/m). 12-month core inflation remains around 2.5% (three-month annualized seasonally adjusted rate), comfortably below the Central Bank target midpoint.

**The Central Bank published its quarterly inflation report and minutes of last week's Copom meetings**, with no substantial changes with respect to what we already knew from reading the statement that followed the last rate decision. The substantial change in BCB's 2019 inflation forecasts was clarified, mostly due to a substantial revision in expected inflation for administered prices (to 3.9% from 5.6%). 2020 inflation forecasts stayed below the target midpoint in all scenarios presented. BCB also revised this year's GDP growth forecast to 0.8% (from 2.0%), in-line with current market consensus (0.87%).

**Monetary National Council changed the inflation target midpoint to 3.5% in 2022, as widely expected**. 2020 and 2021 target midpoints were confirmed at 4.0% and 3.75%, respectively.

## Upcoming Data: May Industrial Production

The wave of downward revisions to Brazilian GDP growth that has prevailed among market participants is likely to get extra fuel next week on the back of the release of industrial output data for May 2019. According to our projections, Brazilian factories are likely to have registered a decline of 1.1% in m/m seasonally adjusted terms. If confirmed, this estimate would translate into a downbeat carryover estimate for 2Q19, as it would point toward a 1.3% q/q sa contraction in the period — the third in a row. On top of confirming the dreary backdrop for the industrial sector, such a result would increase the likelihood of a negative GDP reading in 2Q19. If that happens, even the 0.8% forecast just released by the Brazilian Central Bank would become more of a hope than a simulation for the Brazilian economy in 2019. Accordingly, we expect mounting pressure on the Brazilian monetary authority for new cuts in the base interest rate over the coming weeks.

## Political Agenda: Special Committee Expected to Vote on Pension Reform (Again)

The Lower House special committee vote on the pension reform draft, initially expected to be concluded this week, was postponed due to lack of an agreement among the rapporteur, party leaders, and state governors. Rodrigo Maia, the House speaker, insists that a floor vote before the mid-year recess (which starts on July 18) is possible, but we keep



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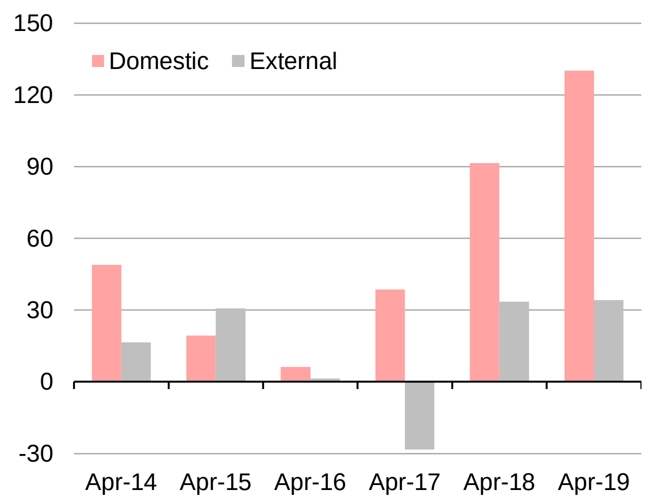
our view that the most likely scenario, given the short deadline and difficulties inherent in such complex consensus building, is that the vote will get pushed to August. According to Maia, an agreement to include states and municipalities in the reform will be tried until next Tuesday (July 2), so the report can be voted over the following couple of days and the reform can be ready for a floor vote starting on July 9.

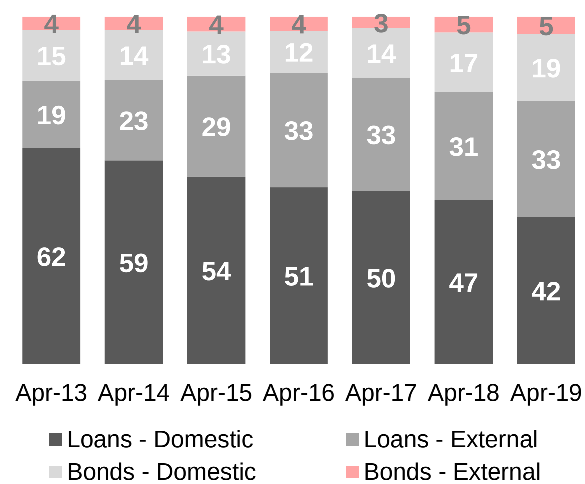
## Chart of the Week: Corporate Credit

Our "Chart of the Week" explores a new database compiled by the Brazil Central Bank on broad credit aggregates, adding to bank loans data on capital markets. We built a rough proxy for issuance (simply changes in the outstanding amount of bonds, the only information made available), noticing that over the past three years the market for BRL-denominated corporate debt has been booming, dwarfing external launches. The mix of corporate financing has changed substantially, with domestic bank loans losing share to external loans (intercompany, presumably) and domestic capital markets. This may be a consequence of low market rates/still high bank spreads, the crowding-in effect of public banks (mostly BNDES) substantially reducing lending and a change in the mix of companies looking for leverage, with large Brazilian corporates (e.g., construction companies) deleveraging or restructuring while headquarters of multinationals step in to keep their operations in the country afloat.

**Net Bond Issuance Proxy – 12m Changes in Bond Outstanding Amount (BRL billion)**




**Credit to Brazil Corporates, Share of Outstanding (%)**




Sources: Brazil Central Bank, Santander.

## Number of the Week

**62.1%**

Brazil's labor force participation rate rose to 62.1% in May, the highest in the new IBGE unemployment data series, started in 2012.

## Quote of the Week

"*It's no use for Paulo Guedes to pout. What is good is to approve a realistic [pension] reform, even if more modest.*"

— **Representative Aguinaldo Ribeiro,** the majority floor leader at the Lower House (*Estadão*, June 22, 2019).

## What We've Been Reading

- "As the G-20 approaches, policy uncertainty weighs on emerging markets," by Meral Karasulu (*Invesco Blog*, June 25, 2019). The lack of a trade deal between China and the US would keep policy uncertainty damaging EM asset price prospects, argues the author.
- "The new macroeconomics of populism," by David Lubin (*Financial Times*, June 15, 2019). According to Lubin, contemporary populist leaders prefer running tight fiscal policies to avoid vulnerability to foreign economic interference rather than spend irresponsibly like their predecessors.
- "The Political Economy of Social Security Reform," by Michael J. Boskin, Diego J. Perez, and Daniel S. Bennett (*NBER Working Paper* 25985, June 2019). A cutting edge treatment of the feasibility of different options of social security reform, using US data.
- "Netflix's 'The Edge of Democracy' – Not Just For Beginners," by Brian Winter (*Americas Quarterly*, June 26, 2019). A critical view of the recently released documentary that has been shaping Brazil's image overseas.

## Recent Publications (Available on Our Website)

- *Fiscal Policy: Climbing the Cliffs in Bad Weather* (June 18, 2019)
- *Economic Activity and Credit: Highway to Heaven?* (June 7, 2019)
- *Is It Time to Upgrade Core Inflation Measures?* (May 21, 2019)
- *Inflation—Year of the Pig: Good Fortune?* (April 30, 2019)
- *Economic Activity: No News Is Bad News* (April 22, 2019)

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