ECONOMICS

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Brazil Macro Compass

Not So Fast

Ana Paula Vescovi* and
Brazil Macroeconomics Team
anavescovi@santander.com.br
+5511 3553 8567

- **In November 2019, the performance of the services sector, retail sales and the IBC-BR (the Brazilian Central Bank's proxy for monthly GDP growth) repeated the pattern registered by the industrial sector in that period and frustrated expectations, thereby partially reversing recent optimism regarding the possibility of a more rapid economic recovery.**
- **After the spike shown by the IPCA in December 2019, we expect its mid-month preview for January 2020 (the IPCA-15) to be up 0.72% MoM, mainly due to a milder impact from the shock observed in animal protein prices in recent months.**

Economic activity: In our previous report, *Temporary Drivers of Inflation and Activity* (January 10), we commented that despite the frustration regarding the performance of the industrial sector in November 2019, we believed that a temporary stimulus—namely, the release of funds from private workers' mandatory saving accounts (FGTS)—should have led to robust retail sales during the same period. If correct, our confidence in the likelihood of Brazilian GDP rising 0.8% QoQ s.a. in 4Q19 would have remained intact, which would have been compatible with 1.2% FY growth for 2019. However, as announced last week, not only did retail sales fail to meet our expectations, the services sector did so as well.

While the narrower gauge of retail sales—which factors out the contribution of vehicles and auto-parts dealers and building materials stores—managed to grow 0.6% MoM s.a. (we estimated a 1.4% MoM s.a. expansion), its broader indicator contracted 0.5% MoM s.a., whereas we expected a 0.9% MoM s.a. increase. Regarding the former index, the furniture and home appliances segment disappointed us the most (+0.5% MoM s.a.), as we expected it to have benefited the most from the combination of extra income for consumers and Black Friday campaigns. This backdrop suggests that households may not be that confident in their own economic prospects, and chose to either save newly-freed resources or to use them to pay down debt. As for the broader gauge (the most important one from a GDP standpoint), vehicles and auto-parts dealers (-1.0% MoM s.a.) accounted for the bulk of the decline on the back of adjustments in inventories. However, the modest expansion of building materials stores (+0.1% MoM s.a.) has reduced our confidence in a more rapid recovery of this segment—as highlighted by its performance in 3Q19. In a nutshell, the retail sales performance in November has significantly impaired optimism regarding the possibility of a faster economic recovery materializing any time soon.

Unfortunately, the frustration was not limited to the performance of retail sales. The services sector also retreated in November (-0.1% MoM s.a.), with three out of the five categories having contracted. Among these categories, we highlight the poor performance of transportation services (-1.2% MoM s.a.), which reflects disappointing industrial production during the month and the challenges the entire production chain has faced recently.

As such, it was not a surprise that the IBC-BR saw a weak expansion in the period (+0.2% MoM s.a.), which confirms our belief that 4Q GDP growth is unlikely to have been as strong as we had previously thought. Hence, despite the disappointing pace of acceleration, it is important to note that the Brazilian economy is indeed gaining momentum and the cyclical recovery suggests considerably higher GDP growth in 2020.

Inflation: The IPCA—Brazil's official inflation index—accelerated to 1.15% MoM in December from 0.51% MoM in November, and was up 4.31% YoY, slightly above the target of 4.25% for 2019. We view this as a temporary spike resulting from the shock observed in animal protein prices due to the African Swine Fever (ASF) issue that affected Chinese pig herds. As such, we believe the performance of the IPCA-15 in January 2020 will be up only 0.72% MoM, which would represent an important deceleration, although not enough to bring the YoY change (4.35%) below the central bank's inflation target for 2020 (4.00%).

We expect the disinflation in January to be driven by foodstuffs and housing. We expect the former to have been favored by a smaller impact from animal protein prices, and the latter to have been driven by lower electricity prices. In this sense, the tracking for the IPCA in January is downward tilted. The main inflation monitors indicate a decline in protein and gasoline prices (the latter as a result of the 3% downward adjustment announced this week), which leads us to forecast a 0.34% MoM change for the IPCA in January.

Additionally, it is important to note that the IPCA-15 reading for January 2020—which contemplates price changes between December 12, 2019 and January 14, 2020—continued adopting the previous structure of category weights within the price index, as a result of the previous survey for the household consumption basket—the so-called POF (Portuguese acronym). Thus, it does not yet incorporate the downward bias of the recent revisions to the CPI basket for 2020, which reinforces our view that inflation is unlikely to be a thorny issue this year.

Recent Publications (Available on Our Website)

- *Brazil Macro Propositions for 2020* (January 13, 2020)
- *Macroeconomic Scenario: A Better Outlook* (December 13, 2019)
- *Macroeconomic Scenario: Better Days Ahead* (October 31, 2019)
- *Brazil Economic Activity: In Search of Growth* (August 29, 2019)
- *Brazil Fiscal Policy: Climbing the Cliffs In Bad Weather* (June 18, 2019)

CONTACTS / IMPORTANT DISCLOSURES

Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
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	598-1747-6805
Fixed Income Research			
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Luciano Sobral*	Senior Economist/Strategist – Brazil	lusobral@santander.com.br	5511-3012-6209
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Aaron Holsberg	Head of Credit Research	aholsberg@santander.us	212-407-0978
Equity Research			
Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Christian Audi	Head LatAm Equity Research	caudi@santander.us	212-350-3991
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Daniel Gewehr*	Head, Brazil	dhgewehr@santander.com.br	5511-3012-5787
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