Flash note
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Brazil - Buy Equities and USD denominated bonds. Constructive in the BRL.

Fiscal noise down? Bonds & Fx remain resilient

The disclosure of a worse-than-thought GDP contraction in 20Q2 (-11.4% y/y or -9.7% q/q) was muted by the administration's announcement that the Coronavoucher will be cut in half and extended until yearend and that they will unexpectedly introduce in Congress now a new constitutional amendment bill to tackle future civil service expenditure rises (Administrative Reform), both appeasing the market. Without more concrete fiscal advancements, the yield curve steepened but just by a few basis points, keeping broadly stable the price of bonds.

Meanwhile, the BCB's Copom interrupted a long easing cycle and held the Selic policy rate at its historical low of 2.00% p.a. The Committee considered adequate to use forward guidance as additional monetary policy tool, provided the current fiscal regime is maintained and long-term inflation expectations remain well anchored. In our view, the authority has concluded the easing cycle and will remain low for long. We still see the Selic ending 2020 at 2.00% p.a., and the policy rate at 3.00% by end 2021

The BCB also decided to bring forward the traditional month-end FX line auctions, which resulted in some volatility for the BRL (that passed from 5.25 to 5.3885, depreciating by 1.3% from the previous Friday close. Despite volatility, we still see the USDBRL trading at 5.5 by yearend (with some research firms having a more constructive view, fixing the BRL-USD pair at 5.25 by year end). Looking beyond, these same researchers see the currency at 4.90 by end-2021.

The BCB also published its monthly GDP proxy, which posted a third positive gain in July (2.1% m/m). IBC-Br now stands -6.5% below pre-pandemic levels, recovering 55.5% of the fall observed in Mar-Apr20. This report, and other set of activity data, have skewed the risks to 20Q3 GDP estimates to the upside, currently at 4.6% q/q (or -7.6% y/y).

Mobility

Broad retail sales jumped by 7.2% m/m in July (last reading) and is now only 2.0% below pre-pandemic levels. Core sales (ex-vehicle, ex-construction), which had suffered significantly less in the pandemic, is clearly on a V-shaped recovery path and grew by 5.2% m/m, standing 5.3% above Feb20 level. But, the service sector disappointed in July and growth slowed down to 2.6% m/m (previous: 5.2%), being more severely hit and still struggling in the reopening phase. In August, IPCA receded to 0.24% m/m (July: 0.36%), bringing the year-on-year reading to 2.4% y/y (BCB´s 2020 target lower bound: 2.5%). The education group contributed the most to the headline slowdown, while the food and beverage group picked up and should pressure the IPCA ahead.

Underlying inflation readings remain in muted and below-target (which is structurally positive for the currency) as underlying services, a group of demand-sensitive prices slowed to 2.3% y/y (from 2.5%).

Covid: Daily infections in a downward trend

On 18 September, Brazil reported the third largest amount of accumulated infections in the globe (4,495k from 4,282k the previous Friday) but still the second largest number of fatalities (135,793 from 130,396 a week before). All said, Brazil is moving around 30k daily cases of infections. This figure is well below the 60k daily cases that we saw in early August, and the trend has been one of constant moderation. This, together with the good news that the number of active cases has dropped from 806k to 500k current cases.

Financial market outlook

Equities – iBovespa: OVERWEIGHT . Target 100,000. Exit 110,000

Bonds – Govies Local: MARKETWEIGHT (Target yield 7.5%. Spread 650)

Bonds – Govies USD: OVERWEIGHT (Target yield 4%. Spread 300)

FX – BRL/USD: MARKETWEIGHT (Mid-term target 5.50)