



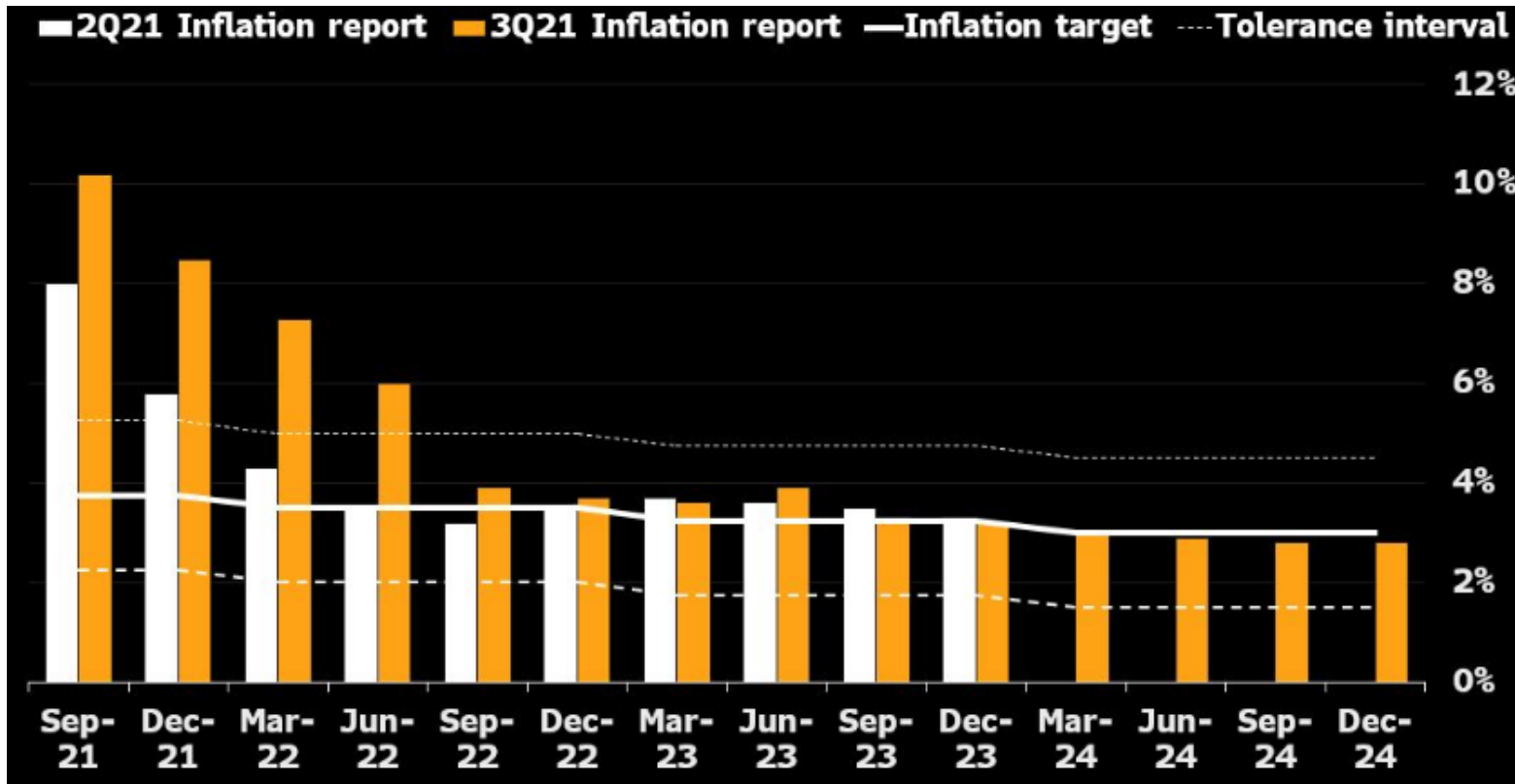
# Brazil | Key Takeaways

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- The elevated Selic is trying to offset the out-of-control inflation, however, this hawkish stance is a double-edged sword.
- Brazil's Central Bank intervening to ensure the smooth functioning of the market, is an attempt to curb the volatility mid-term.
- Fiscal uncertainties and political noise add downside risks to growth through next year.
- Implied Volatility for 1 month is around 16%.
- Plans to expand social programs ahead of next year's elections will continue to weigh on the BRL.
- USDBRL forward points skyrocketing.
- DXY is moving up to its highest level in a year, after the FED turned in another hawkish display.

# Brazil | BCB less hawkish

## BCB Inflation Report Core Message



Source: Bloomberg

- Although the inflation remains out-of-control, Brazil's Central Bank delivered a somewhat less hawkish message.
- The bank will use all their tools to ensure inflation convergences to its targets, however policy markets are not compelled to overdo it just to prove they remain committed to that goal.



# Brazil | Selic a double-edged sword

Median - Aggregate	2021								2022								2023							
	4 weeks ago	1 week ago	Today	Weekly Trend *	Resp. **	5 working days	Resp. ***	4 weeks ago	1 week ago	Today	Weekly Trend *	Resp. **	5 working days	Resp. ***	4 weeks ago	1 week ago	Today	Weekly Trend *	Resp. **					
IPCA (%)	7.27	8.35	8.45	▲ (25)	134	8.52	63	3.95	4.10	4.12	▲ (10)	132	4.14	61	3.25	3.25	3.25	= (63)	104					
GDP (% growth)	5.22	5.04	5.04	= (2)	82	5.02	32	2.00	1.63	1.57	▼ (4)	81	1.50	31	2.50	2.30	2.20	▼ (1)	55					
Exchange Rate (R\$/US\$)	5.15	5.20	5.20	= (2)	111	5.27	35	5.20	5.23	5.24	▲ (2)	108	5.30	34	5.05	5.10	5.10	= (1)	79					
Selic Target (% p.a.)	7.50	8.25	8.25	= (1)	126	8.25	49	7.50	8.50	8.50	= (1)	123	8.50	49	6.50	6.75	6.75	= (1)	99					
IGP-M (%)	19.65	18.21	18.18	▼ (4)	79	18.60	24	4.91	5.00	5.00	= (1)	77	5.29	24	4.00	4.00	4.00	= (23)	60					
Regulated Prices (%)	11.31	13.30	13.50	▲ (5)	57	13.67	18	4.50	4.37	4.12	▼ (2)	53	4.07	18	4.00	4.00	3.90	▼ (1)	40					
Current Account (US\$ billion)	-1.15	-2.00	-2.00	= (1)	27	-2.00	9	-15.00	-16.50	-17.00	▼ (1)	25	-21.90	8	-25.40	-25.54	-25.00	▲ (1)	19					
Trade Balance (US\$ billion)	70.00	70.70	70.70	= (1)	27	68.80	9	62.00	63.00	63.00	= (3)	26	56.34	8	58.10	58.00	57.50	▼ (1)	16					
Foreign Direct Investment (US\$ billion)	54.00	50.00	50.00	= (1)	26	50.90	9	65.00	65.00	62.00	▼ (1)	24	60.00	8	70.59	70.00	70.00	= (1)	17					
Net Public Sector Debt (% of GDP)	61.30	61.00	61.00	= (2)	23	60.60	5	63.20	62.97	62.97	= (1)	22	63.02	4	64.95	64.40	64.45	▲ (2)	18					
Primary Result (% of GDP)	-1.74	-1.50	-1.50	= (1)	27	-1.37	6	-1.10	-1.00	-1.00	= (1)	26	-1.00	5	-0.70	-0.65	-0.55	▲ (2)	22					
Nominal Result (% of GDP)	-6.20	-6.10	-5.80	▲ (1)	23	-6.10	4	-6.30	-6.40	-6.36	▲ (1)	22	-6.32	3	-5.75	-5.50	-5.50	= (3)	19					

\* trend since the previous Focus Market Readout; the figures in parenthesis express the number of weeks with the same behavior \*\* respondents in the last 30 days \*\*\* respondents in the last 5 business days

!

- The elevated Selic is trying to offset the out-of-control inflation, however, the BCB's hawkish stance is a double-edged sword, because a high-interest rate can also be a handicap for economic growth (credit more expensive). Therefore, the market might be pricing in a potential slow down in the next years.

# Brazil | Labour Market is recovering



- Brazil's unemployment rate fell in the 3 months through July as the country's recovering economy created more new jobs.
- The jobless rate reached 13.7% in the period through July, from 14.1% in three months through June.

# Brazil | Water Crisis, Fueling Inflation

- Brazil's worst water crisis in nearly a century is fueling inflations that's echoing through the economy.
- Water crisis, unexpected electricity tariff readjustments are very impactful for inflation.
- Other factors: Currency weakness and a potential truckers' strike.



- Annual inflation running at an above-target 9.68% in August.
- IPCA-15, which measures the inflation in mid-September came to 10.05%

# Brazil | Boom of social programs

- As mentioned in Sep's presentation, the BRL at 5.10 level should be viewed with more caution, and **it was true!!**
- **Amid rising political pressure over fuel prices**, Petrobras's board approved the allocation of 300 million reais for the creation of a social program to help vulnerable families buying essential goods, such as cooking gas, as it's the company which sets the price not states or governors.
- **Lula ahead!** Brazil's former leftist leader Lula da Silva would win a 2022 presidential first round against the incumbent Bolsonaro 40% to 30%, according to a Poder360.

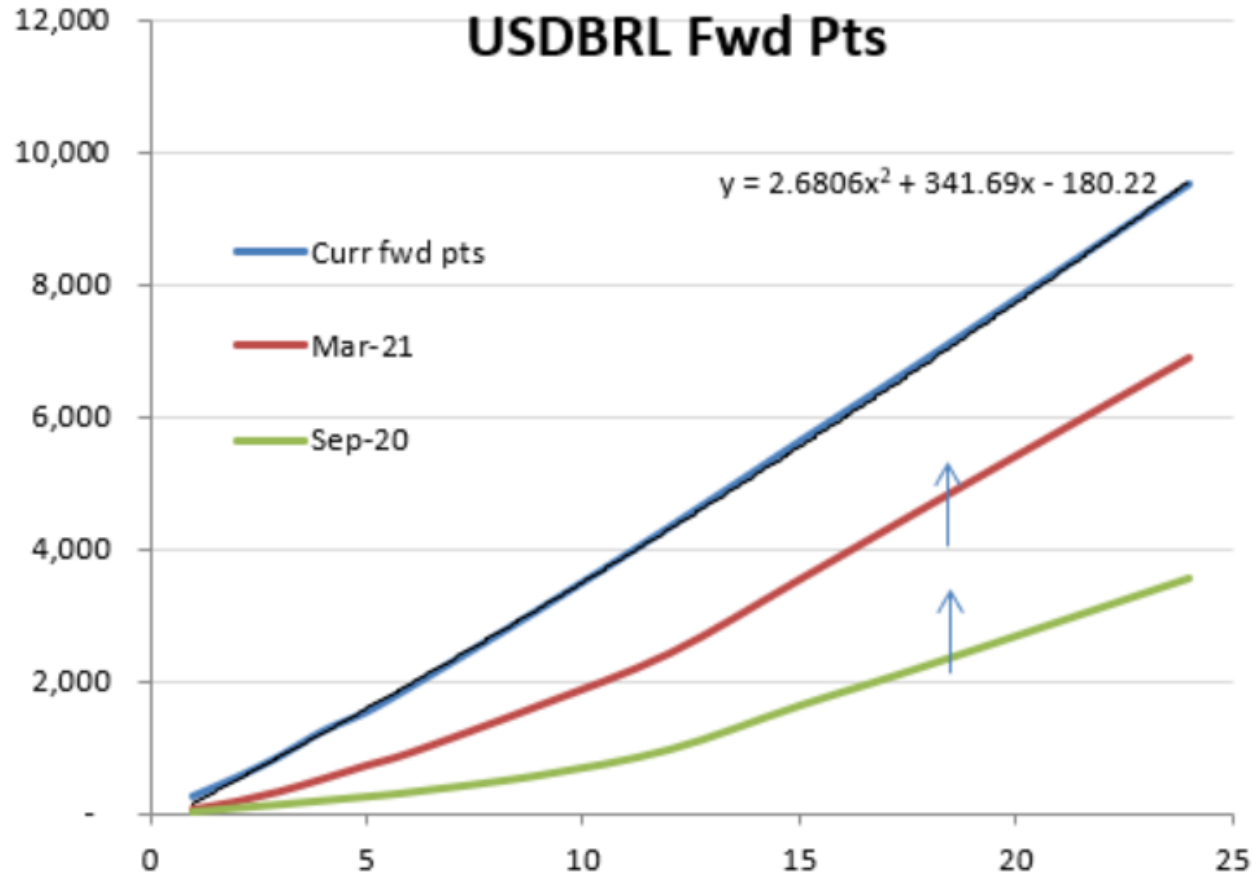


# Brazil | Dovish Fed Helped in the Last Minutes of August



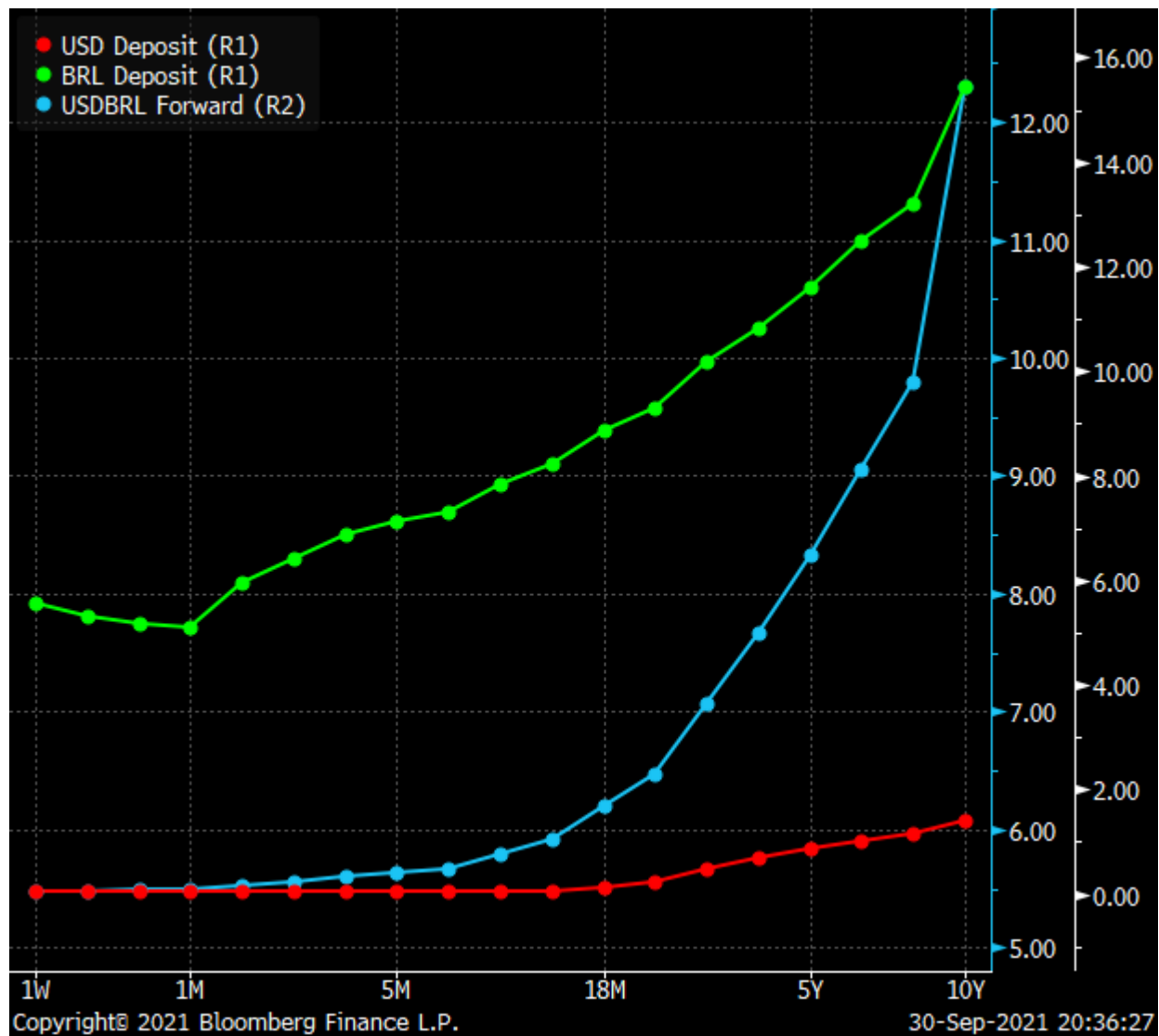


# Brazil | USDBRL Forward Curve

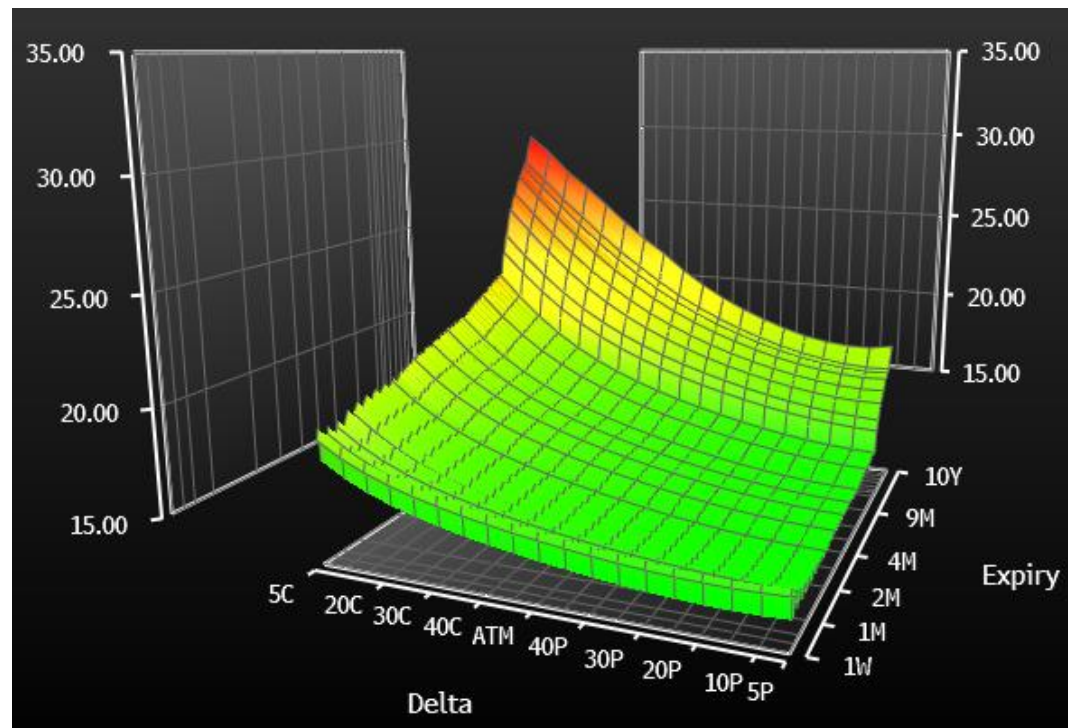


- The USDBRL forward points curve in three different moments. As you can see, the curve is getting steeper, which means that hedging costs have been rising rapidly (more than triple since the lows of 2020). Hedging cost here is understood as the interest rate differential. Last week the Brazil Central Bank hiked up the benchmark Selic rate by 100 basis points to 6.25%. Also, the bank said it expected to raise rates again by 100bps at its next meeting in October.

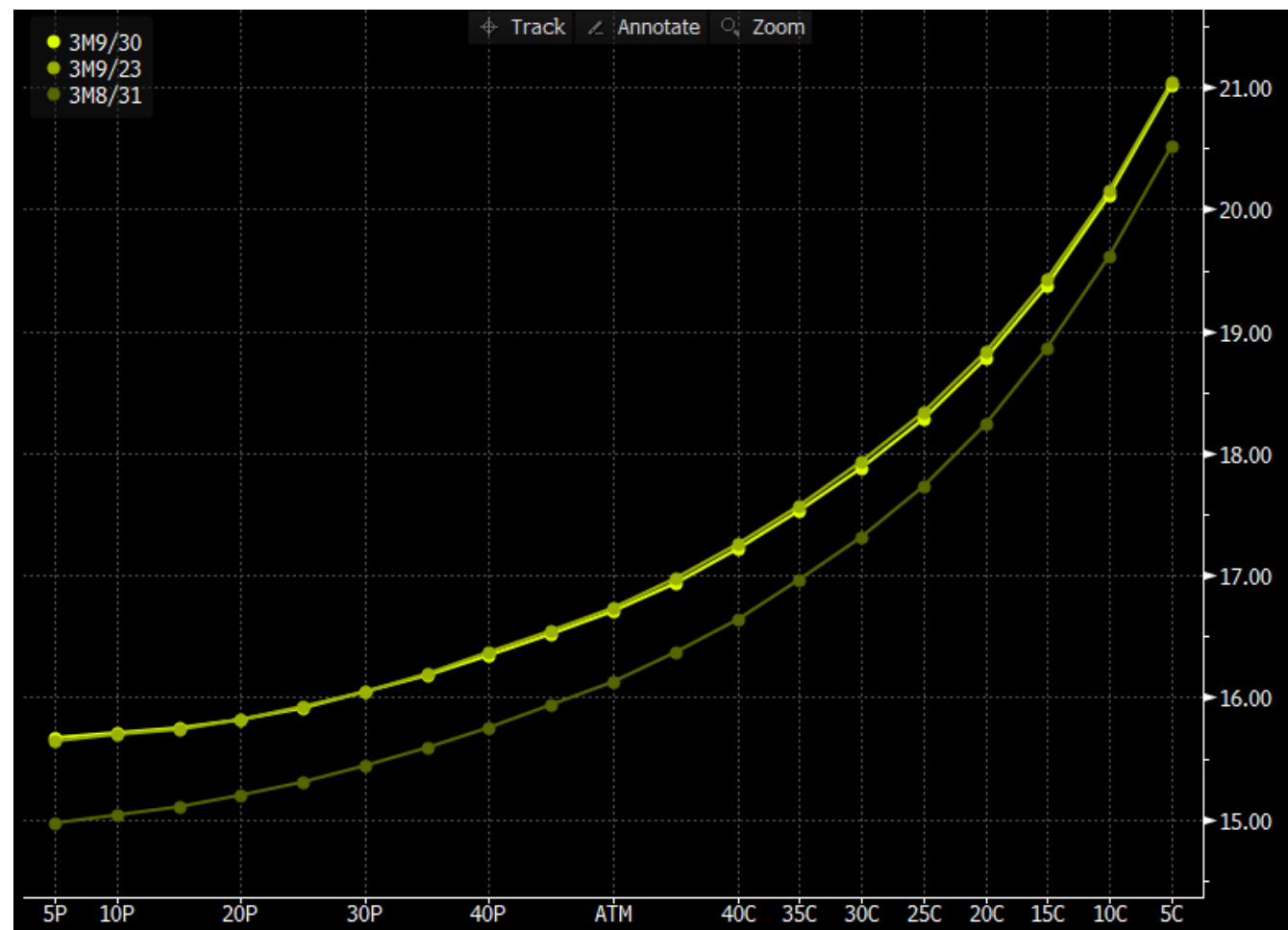
# Brazil | USDBRL Forward Curve



# Brazil | VOL Surface



5 Delta Calls for 3 months is more expensive than a 5 Delta Puts for 3 months. That really is just a function of what the market is doing at the moment with the currency expecting to depreciate even more due to domestic factors!



# Brazil | Outlook and Main Risks

BRL depreciating



BRL appreciating



**Inflation:** Brazil is facing another month of surging inflation as higher energy costs add to constraints in global supply chains.

**Selic:** BCB may need to raise the Selic meaningfully above 8.25% if it intends to tighten policy and lower inflation.

**Commodities.** China's economic slowdown, which could add pressure on commodity prices.

**Political risk.** The prospect of political polarization between Lula and President Jair Bolsonaro ahead of 2022 Presidential elections.

**Institutional conflicts:** The political trend has improved from negative to neutral. The main factor for the change was the decrease in institutional conflicts.

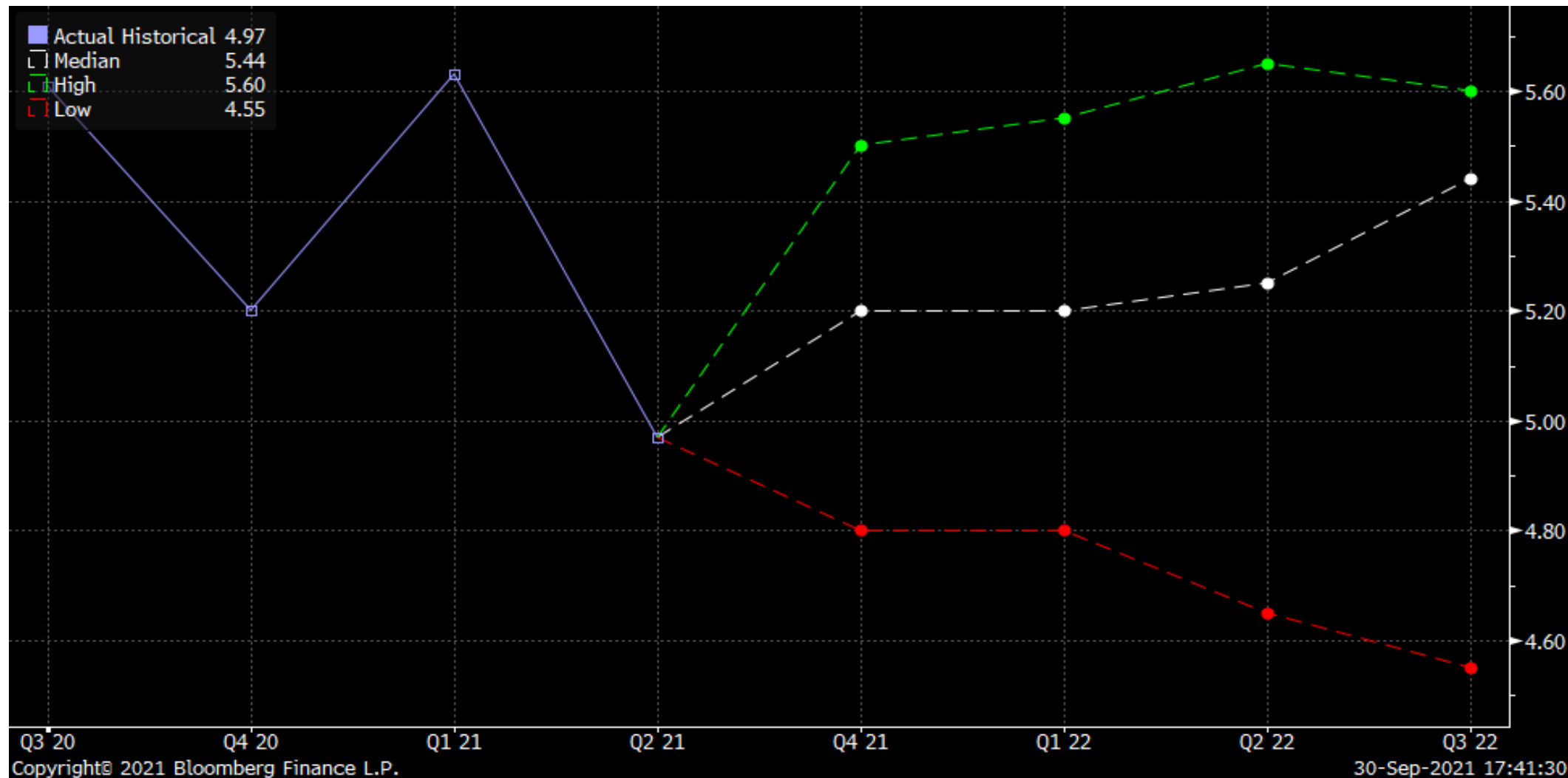
**Public management is in neutral mode:** Despite the fact that a large number of members of the first level of government were tested positive for Covid-19, thus, reducing our leadership metric, the government managed to reassess an apparently mistaken decision.

**BCB's interventions:** Brazil's Central Bank started this week to intervene to ensure the smooth functioning of the market, an attempt to curb the volatility mid-term.

2021

2022

# Brazil | BRL Forecasts





# Macro | Overview

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Hawkish wave



Economic Growth

U.S. Treasury yield

Inflation

Evergrande

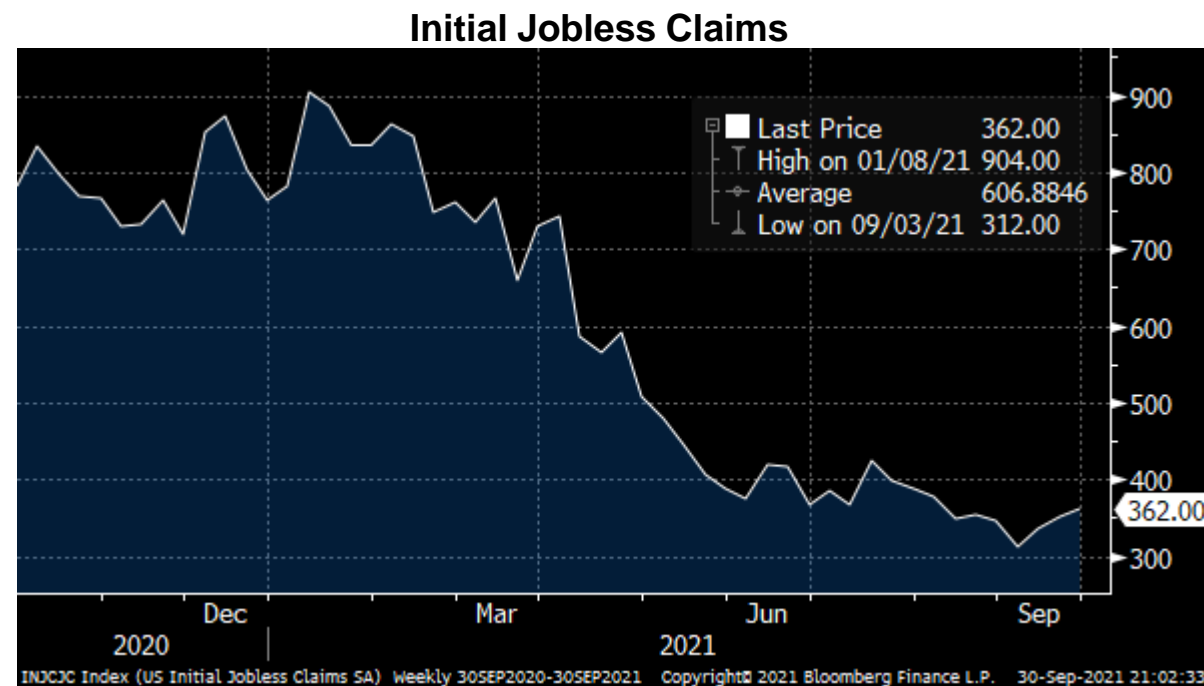
# Macro | Unfolding a hawkish wave

- The Federal Reserve hinted at imminent tapering expected to be announced in their upcoming meeting in November while the market prepares expectations towards rate hikes in 2022 and 2023. The hawkish shift in stance induced a significant rise in U.S. treasury yields from 1.30% to 1.56% in a matter of days while Jerome Powell, Chairman of the Fed said at his congressional hearing that inflation is now more concerning than earlier this year.



# Macro | Small steps

- ! Unemployment keeps making small progress towards recovery as disappointing job reports suggested that summer growth drivers were offset by the impact of the delta variant on the economy.



- Initial Jobless Claims report indicated that 362,000 Americans filed for unemployment benefits in a week compared to analyst consensus of 335,000. Continuing Jobless Claims declined from 2.82 million (revised from 2.85 million) to 2.8 million.

# Macro | DXY stays strong

- The U.S. dollar stays strong as traders bet that Fed will soon have to cut its asset purchase program as inflation remains elevated due to high commodity prices and problems in the global supply chain.



# Macro | Long standing Evergrande's effect

- Aside from internal drivers, we witnessed across the month a dampened sentiment after China's authorities and top executives announced that Evergrande, the second-largest real estate developer in the world, was missing upcoming interest payments for its outstanding debt valued around USD 288 billion.

- China Evergrande Group operates as a multi-industry and digital technology enterprise. The company owns real estate development, new energy, property service, network, health, and other industries. The company mainly conducts businesses in China.





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