

what's the  
opposite of  
charlatan?



honesty, ace, adept, authority,  
crackerjack, expert, maestro,  
master, past master,  
professional



# Brazil | Key Takeaways

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- Among the factors driving the currency lower has been the fear that the government will increase public spending ahead of next year's presidential election regardless of the likely inflationary consequences of such spending.
- Pressure for loose fiscal policy in Brazil is likely to persist and market's expectations is that the spending cap will be cast aside in the coming years.
- Impact of agricultural prices on inflation. The inflationary impact can disproportionately affects emerging markets and can contribute toward social unrest.
- The central bank picked up the pace of its rate hikes given the increase in its inflation projections.
- The Brazilian stock market index is the worst performer of the year.
- The BRL slipped further and, quarte to date, is second worst behind the Turkish Lira.
- The yield curve is now pricing in a double-digit policy rate in February, reaching 11.7% by end-2022.

# Brazil | Will Brazil break the spending cap?



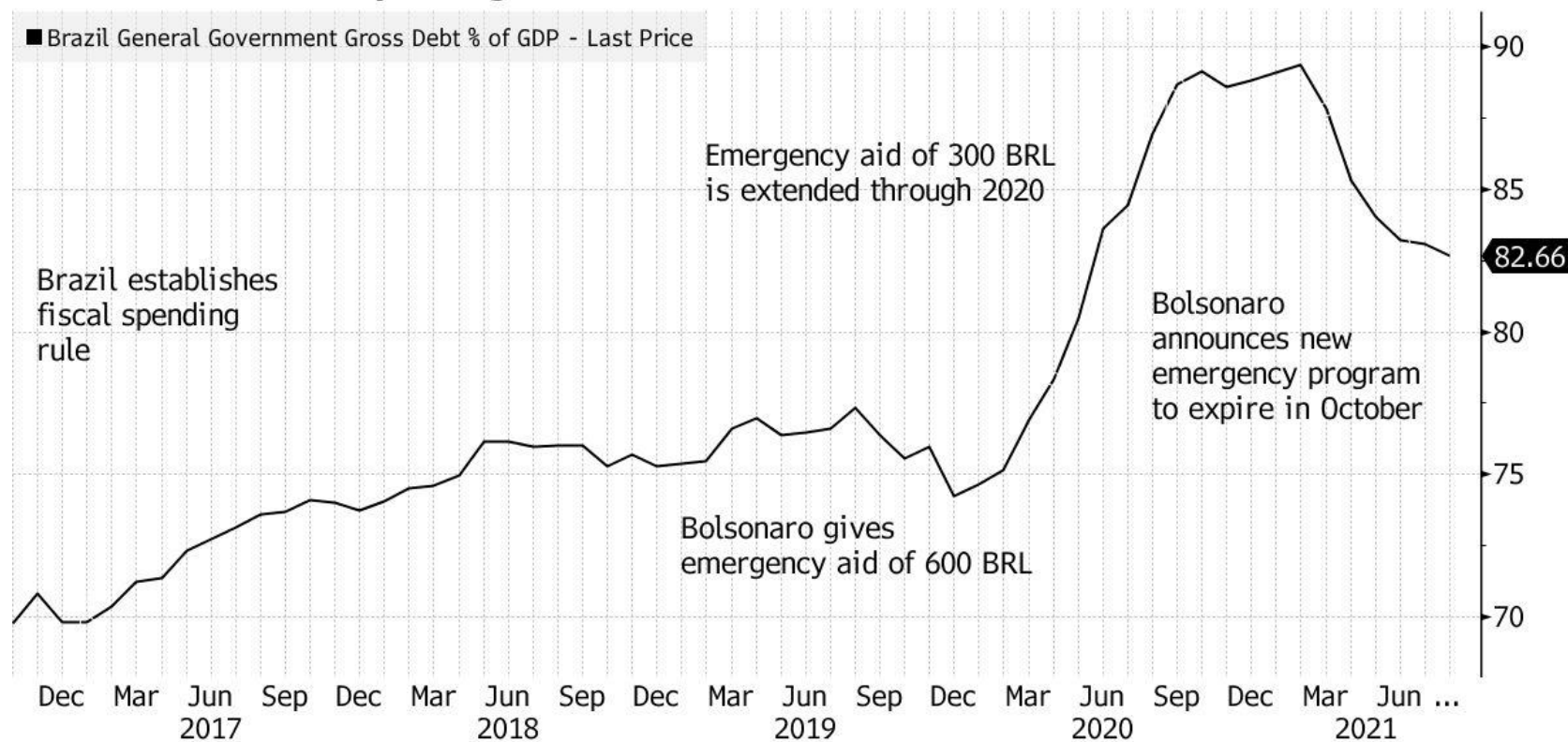
- The government of President Jair Bolsonaro recently announced an increase in government transfer payments that are not covered by the federal spending cap. As a result...

- The government is already testing the water with creative accounting to get around spending limits and this is likely to be a sign of things to come.
- One way to expand the limit for expenses is through a proposal of amendment to the Constitution (PEC) postponing the payment of Precatórios that was sent for consideration by the Plenary of the Lower House.
- Another is by changing the indexer of the ceiling of spending that, today, is corrected by the IPCA in 12 months until June of the previous year. The proposal is that the new indexer is calculated by the IPCA from January to December. If the changes are approved, it could create a budget space of R\$83bn for 2022.

# Brazil | Massive country spending damage to policy credibility

## Fiscal Spending

Debt levels were improving before the announcement of renewed cash transfers

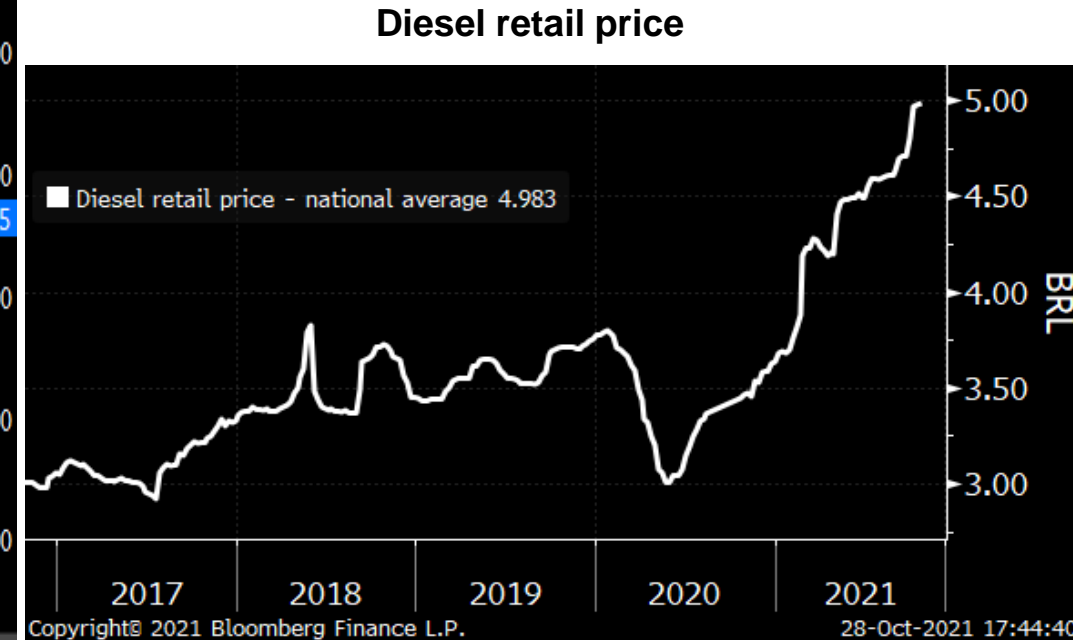


Source: Brazil central bank, Bloomberg

Bloomberg

- Brazil's massive budget policy response to its COVID-19-induced recession inflicted major damage to the country's public finances.
- Last year, as a result of a 17% of GDP increase in public spending, Brazil's budget deficit blew up to a record 10% of GDP. That in turn caused the country's public debt to rise to a record of almost 100% of GDP.
- That ratio far exceeded the 60% to 70% of GDP debt level that is generally considered the level that emerging market economies should not exceed to avoid a public debt crisis.

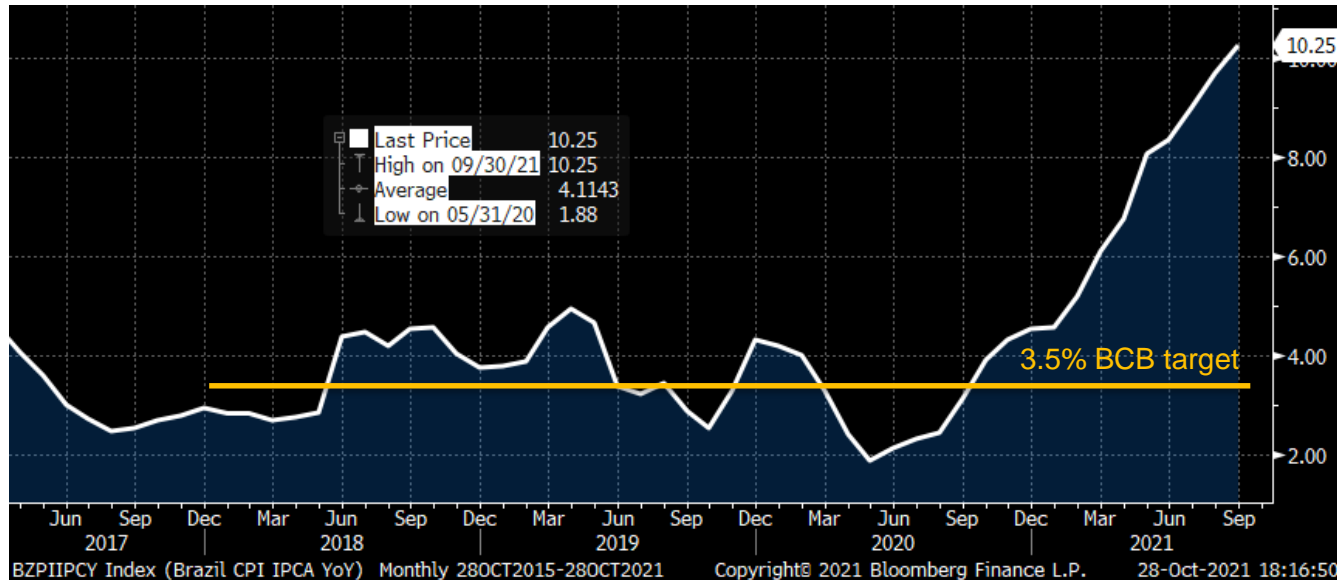
# Brazil | Very high level of agricultural commodity prices



- Although much has been discussed about the inflationary effect of rising fuel prices, we have to consider the high level of agricultural commodity prices. The inflationary impact here disproportionately affects emerging markets and can contribute toward social unrest.

# Brazil | Fiscal policy boosting aggregate demand

Inflation 12 months



- Annual inflation surged to 10.25% in September, and 10.34% in mid-October (the highest level for the month since 1995).
- As we saw, it's running high as a result of higher food and energy prices. However, more importantly, it is doing so also because of expansionary monetary and fiscal policy boosting aggregate demand to a level that is now running into supply bottlenecks.

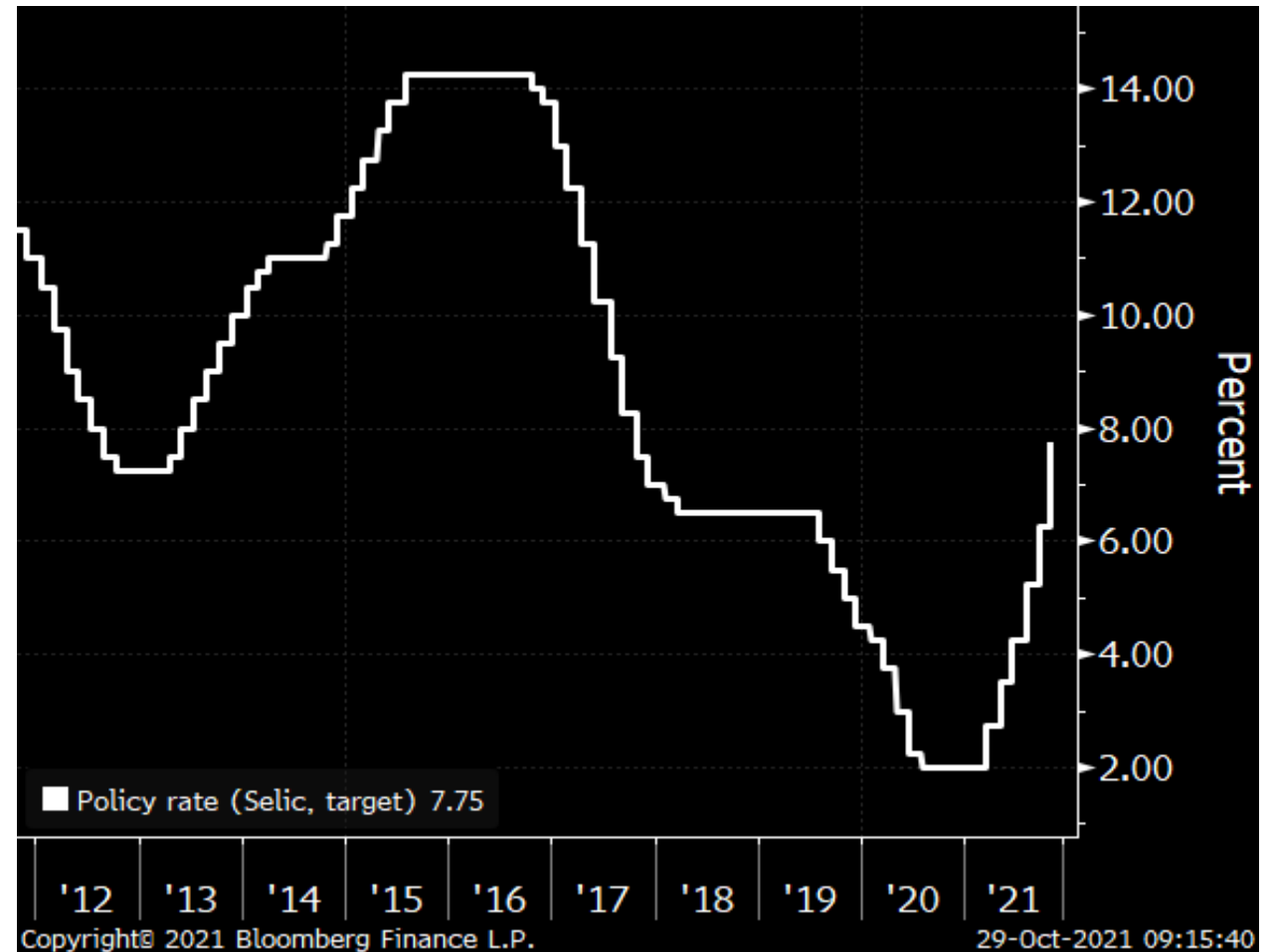


- Auxílio Brasil is likely transate into an additional rise in inflation.



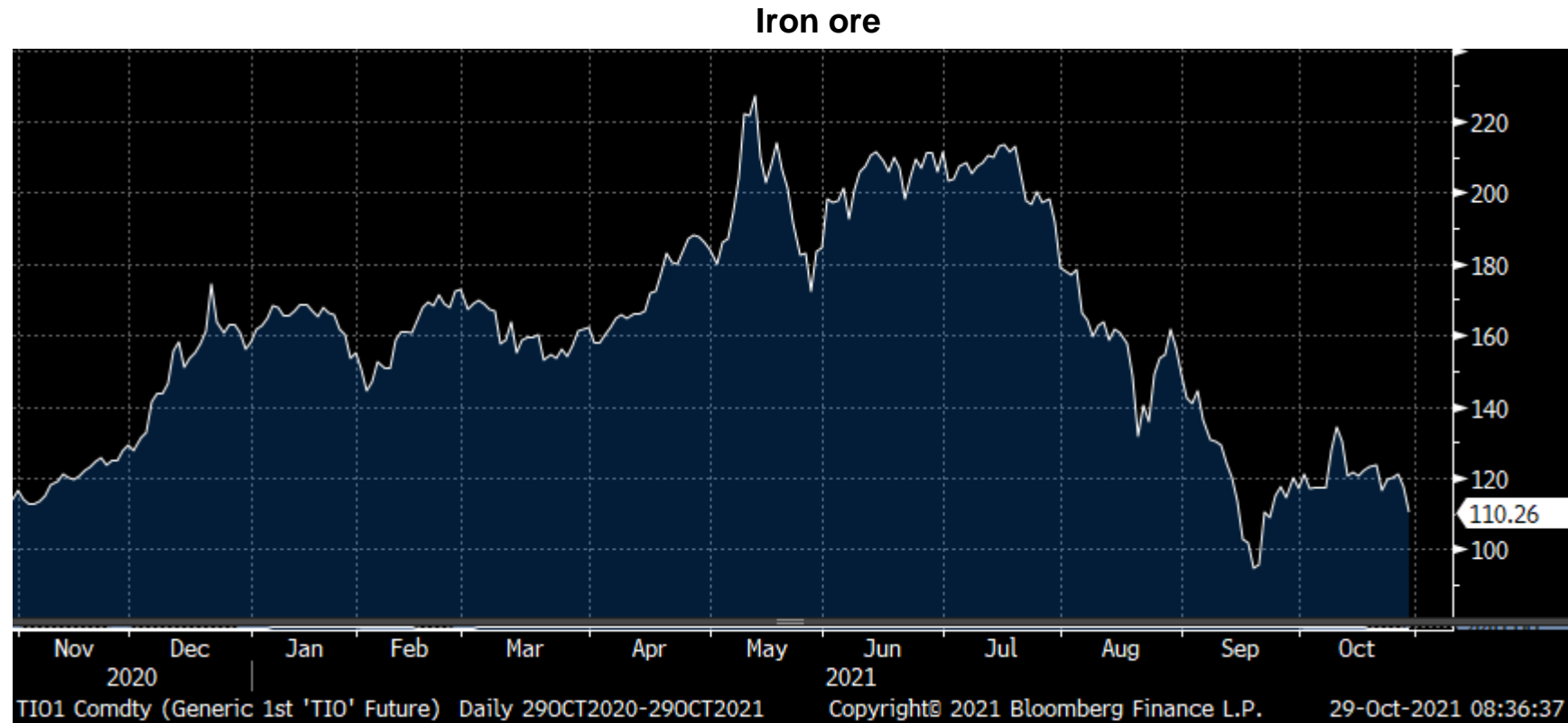
# Brazil | Given the increase in its inflation projections

- BCB delivered a hike of 150-basis-point its policy rate to 7.75% in its last meeting on Nov, 27<sup>th</sup>.
  - Another large increase in December can be expected.
  - Policy makers indicated this pace was adequate to ensure inflation converges to the target over 2022 and 2023.
- 
- ! • The BCB was careful in its treatment of the proposed changes to fiscal rules.



# Brazil | Iron Ore will continue to drop

- Iron ore is a red outlier in a green-hued commodities market.
- The staple is setting records on the way down as the fundamentals turn against keeping prices above \$100/ton.
- Mine supplies are booming, but Chinese demand is not as Beijing makes good on its vow to hold this year's steel production below last year's total.



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- Brazilian real is also suffering from the relative weakness of iron.
- The expected economic slowdown in China creates additional risks for the Brazilian economy.



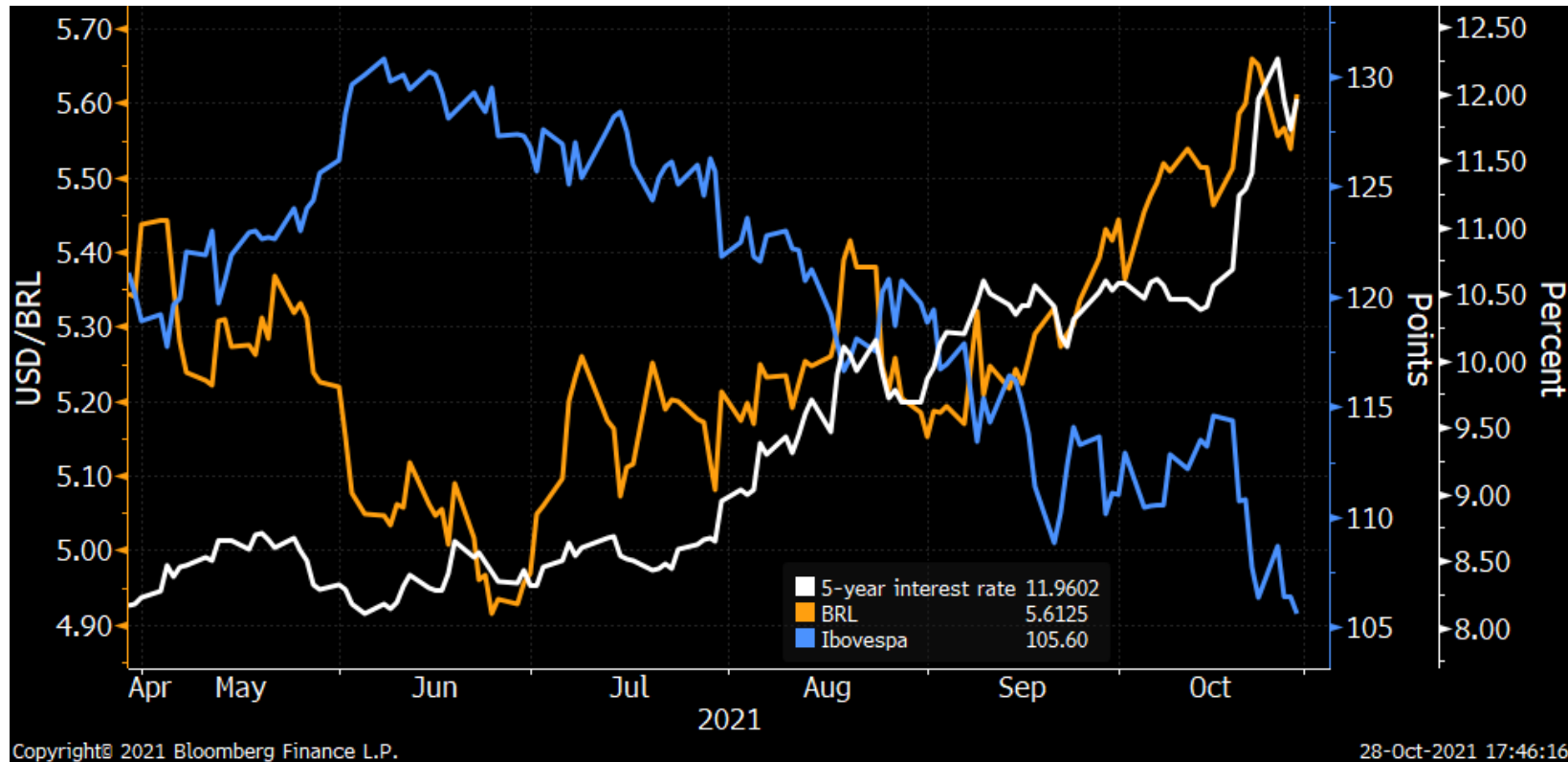
# Brazil | Senators recommend Bolsonaro face charges over Covid

Iron ore

- The committee formally approved on Tuesday (26<sup>th</sup>) a report calling for prosecutors to try Bolsonaro on charges ranging from charlatanism and inciting crime to misuse of public funds and crimes against humanity.
- The report is expected to fuel criticism of the divisive president, whose approval ratings have slumped ahead of his 2022 reelection campaign.



# Brazil | Rates Soar, Stocks, Currency Plunge

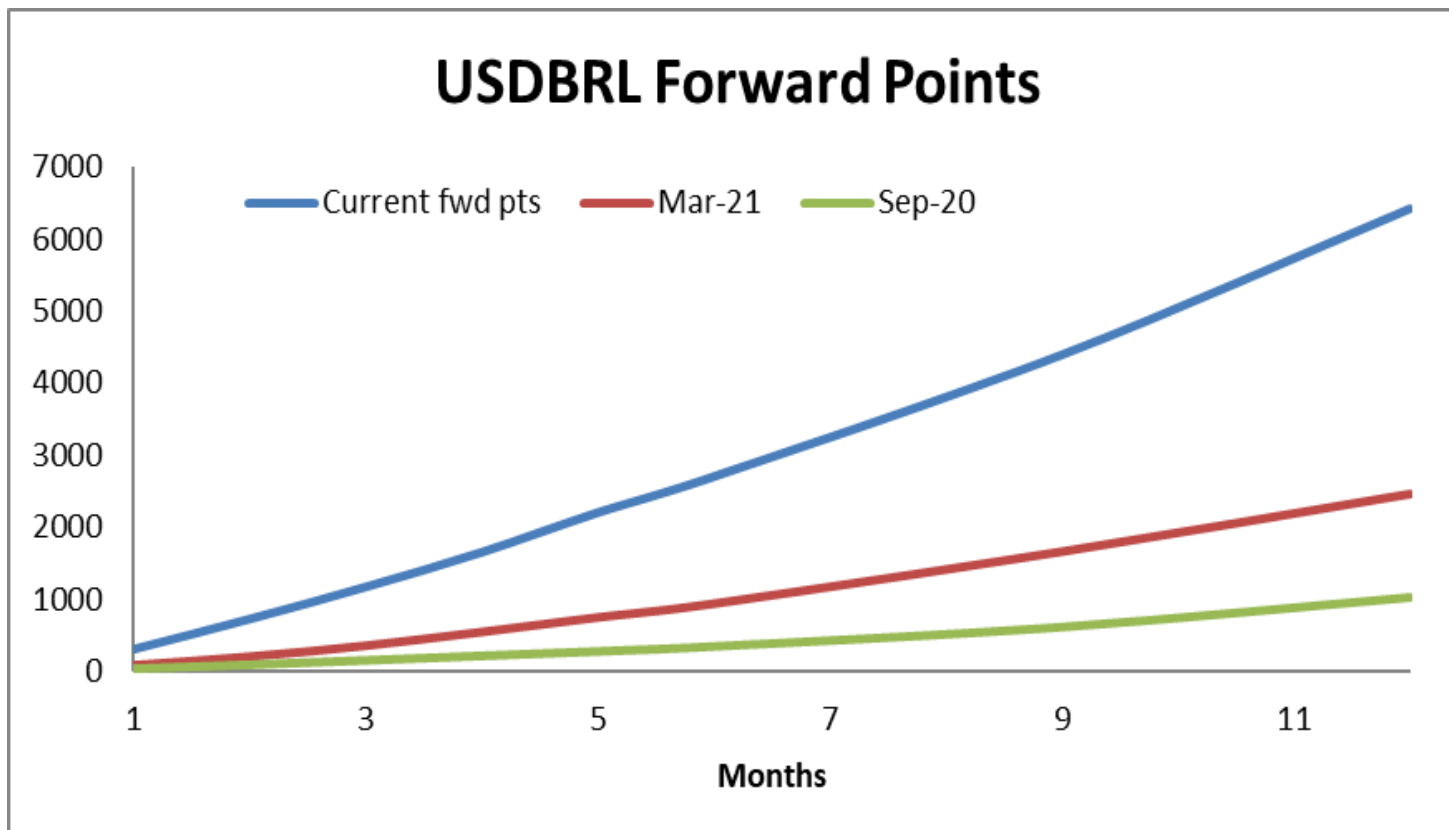


- As a result of the confluence of populist government movements, fiscal maneuvers, higher commodity prices, expected economic slowdown, as well as high interest rates:
  - a) **The Brazilian stock Market index is the worst performer of the year.**
  - b) **The currency slipped further.**
  - c) **The yield curve is now pricing in a double-digit policy rate in February, reaching 11.7% by end-2022.**

# Brazil | Bearish long trend?

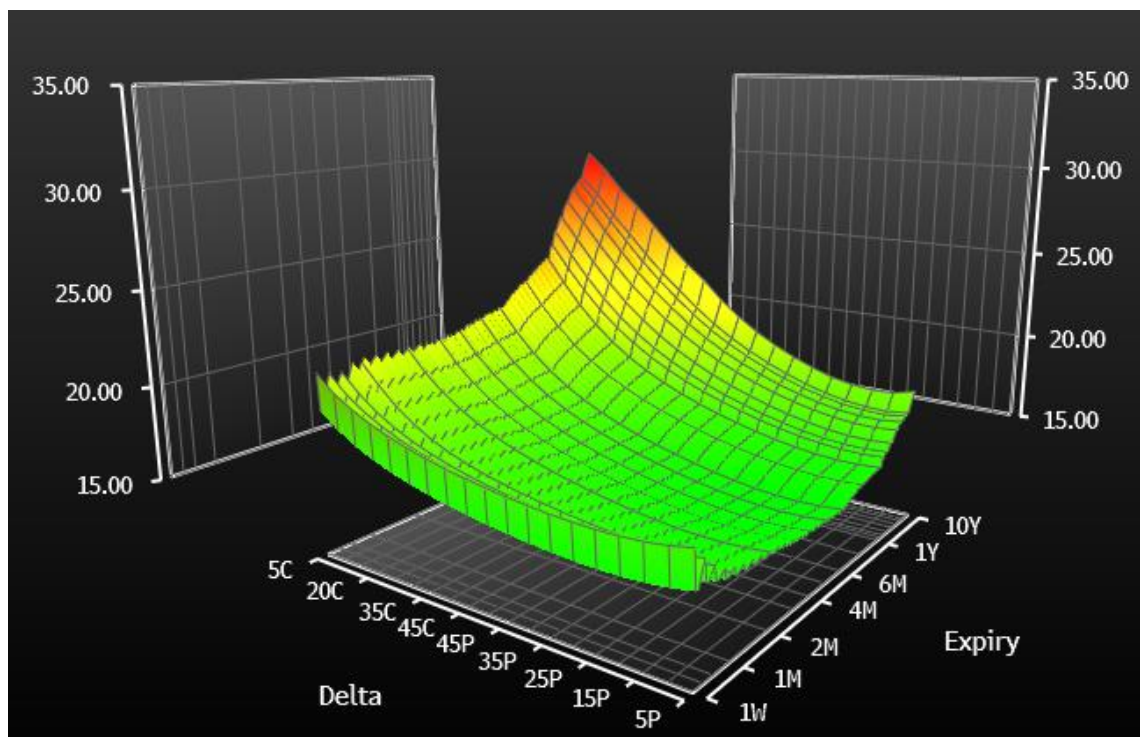


# Brazil | USDBRL Forward Curve

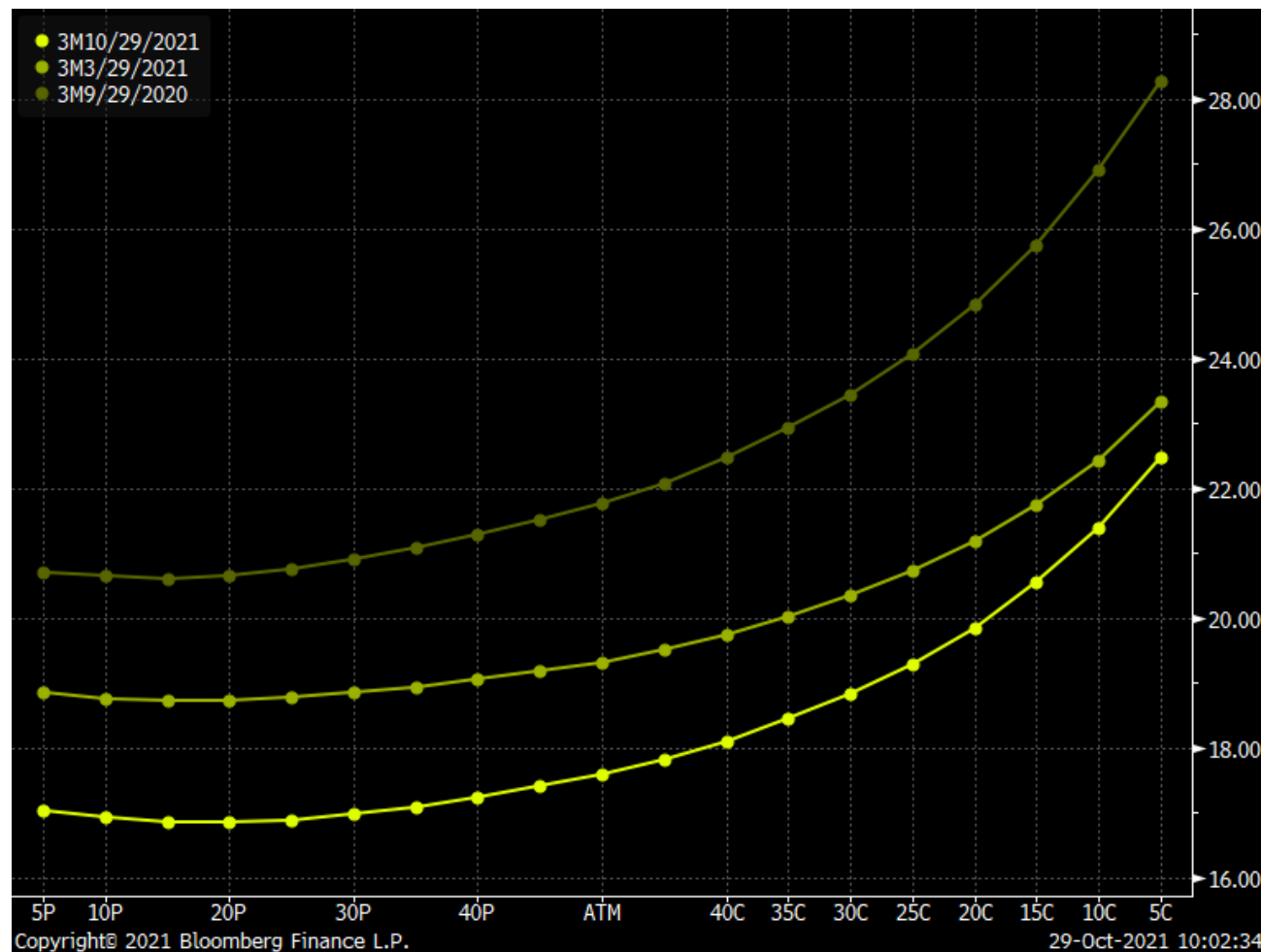


- The USDBRL forward points curve in three different moments. As you can see, the curve is getting steeper, which means that hedging costs have been rising rapidly (more than triple since the lows of 2020).
- **Hedging impact** here is understood as the interest rate differential

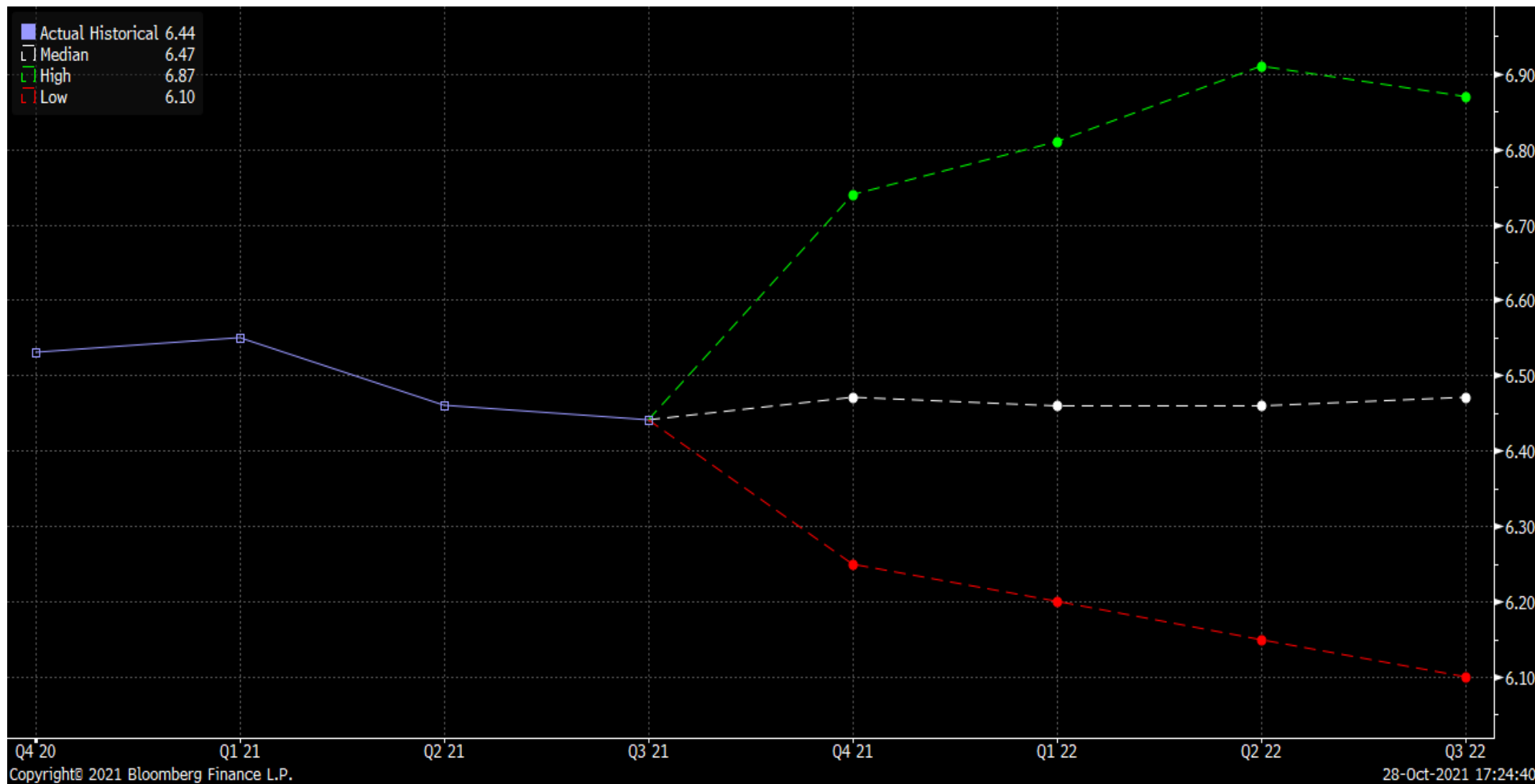
# Brazil | VOL Surface



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 | BRL Forecasts





# Macro | Overview

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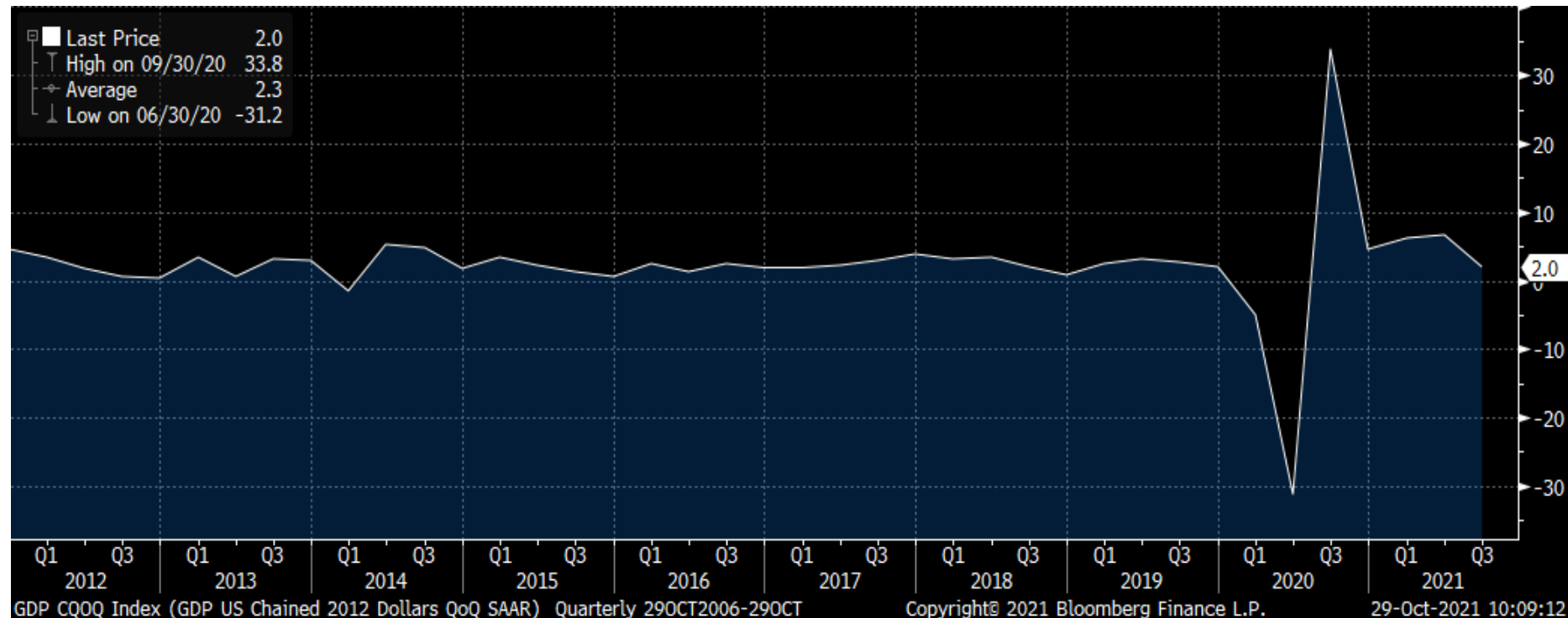




# Macro | The Fed's dangerous game

- The Federal Reserve is playing a dangerous game in their ability to ignore and constantly undermine high sustained inflation, referring to such price behaviour as transitory. Policymakers are now navigating between their own senses of patience and risk, and a U.S. economy stymied by disrupted supply chains, slow hiring, weaker consumer demand and poor Q3 Gross Domestic Product (GDP) readings, raising concerns over the Fed's next move.

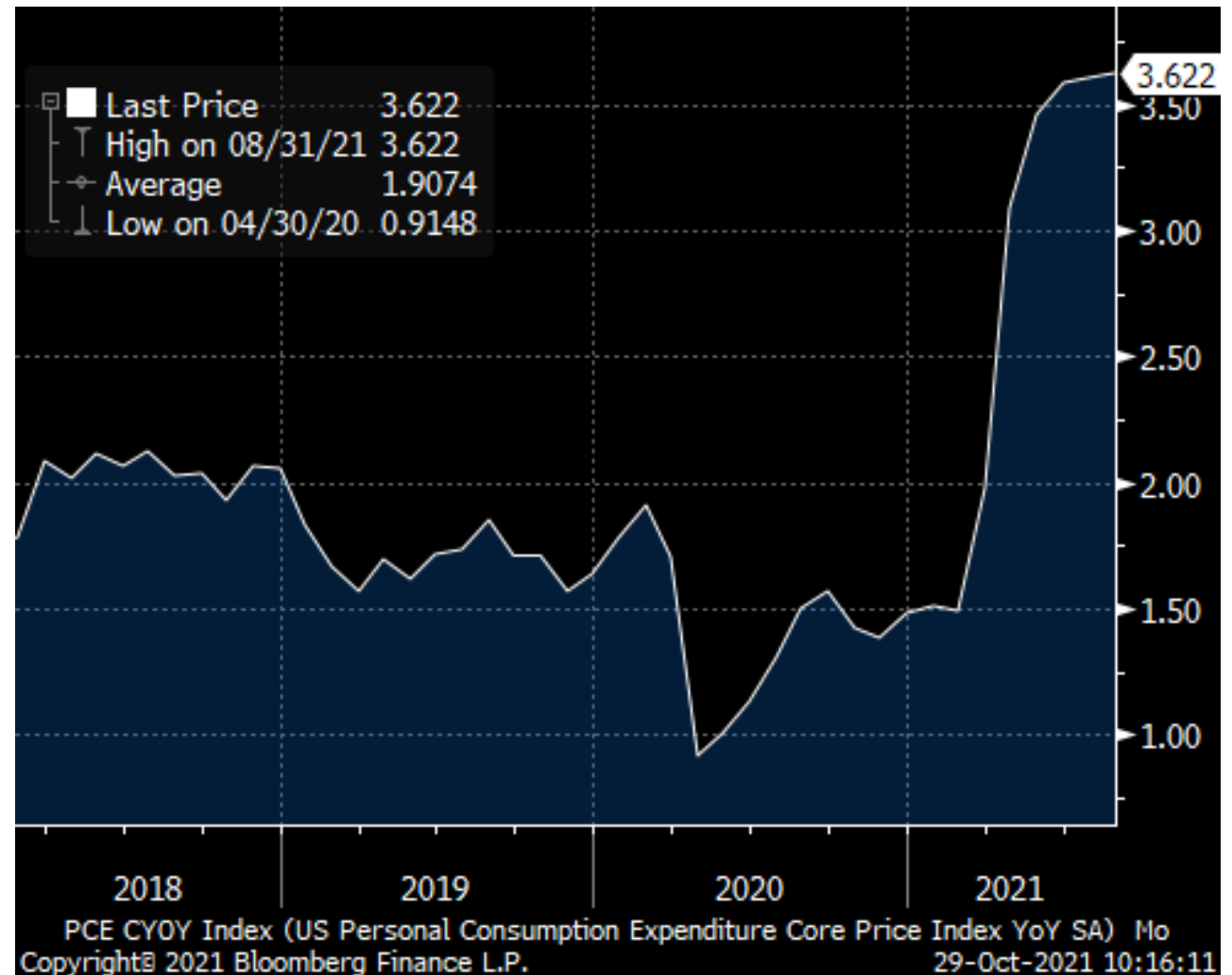
U.S. Gross Domestic Product Quarterly



# Macro | Sharp slowdown in consumer expenditures

- Politycmakers raised significant concerns around the sharp slowdown in consumer spending, one of the reasons behind the disappointing growth figures during this quarter.
- However, continuing supply-chain restrictions, labor shortages and commodity price increases are set to make the fall and winter as uncomfortable for consumers as the summer.

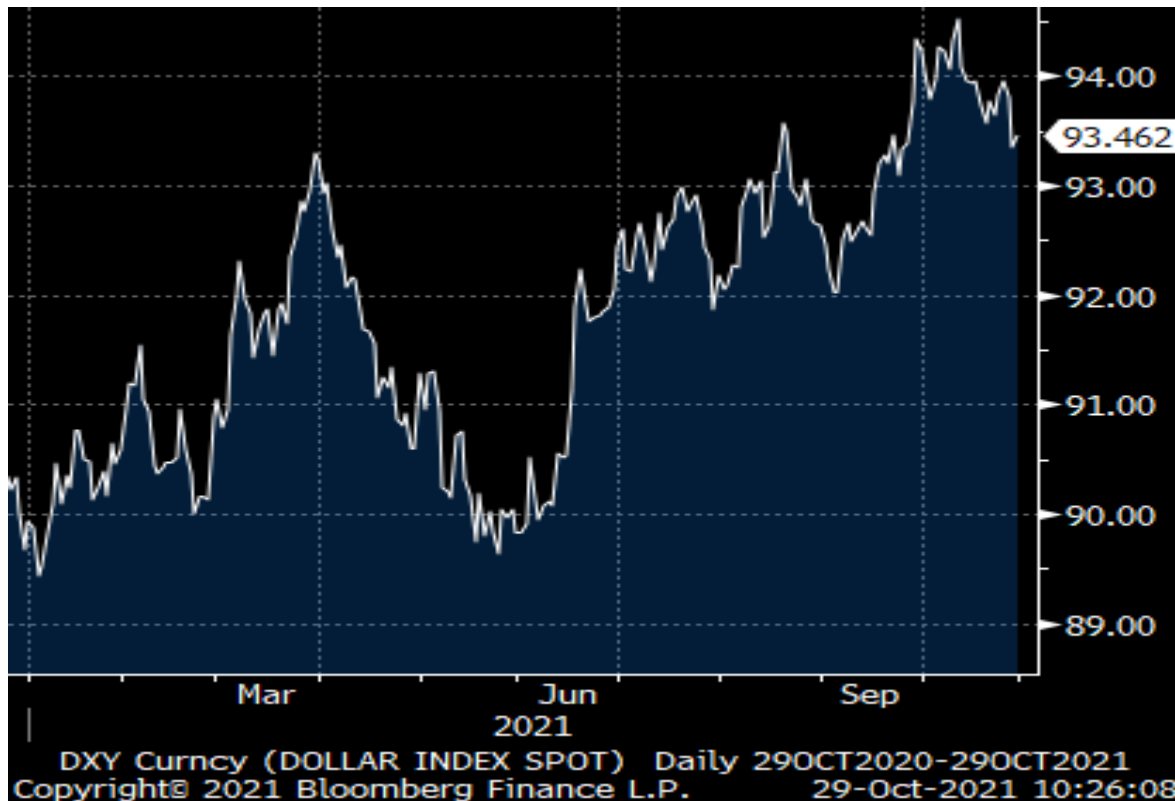
Personal Consumption Expenditure price index



# Macro | DXY stays strong

- The greenback remained subdued against most of its peers during the course of the month.
- However, stocks continue to reach new all time highs with S&P hitting 4,569 and looking to close the month with strong momentum to break over once more.

U.S. Dollar Index



S&P500 Index



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