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Some Like it Hot

How to play retail amid a hotter season under El Niño effects

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Latam Retail

Some Like it Hot

How to play retail amid a hotter season under El Niño effects

We are seeing increased attention and newsflow around the Super El Niño expected to take place in 2026-27, with most concentrating on the implications for Agro players. In this report, **we shift the focus to retailers,** as we see **three key transmission channels for our coverage: (1) Food inflation; (2) Weather Dynamics; and (3) Arboviral Diseases.** All in all, we see **increased food inflation as headwind for the sector though some could potentially benefit** from such effects: **ASAI** on marginally positive SSS trends, **apparel retailers** on favorable weather dynamics (with **LREN as our top pick**); and **pharmacies** on potentially higher HPC and services mix. In terms of timing, **we see effects beginning to be seen in 2H26, with some getting more pronounced in 2027.**

Why is everybody talking about Super El Niño? Last week, NOAA, the National Oceanic and Atmospheric Administration, indicated to a ~63% chance of a very strong El Niño during Nov-Jan. If this materializes, it would rank among the strongest El Niño events since 1950. Since this event usually leads to climate anomalies, it has direct implications for Agricultural production, which in turn affects food inflation, headline CPI and interest rates.

Shifting the focus to retail. Although the event is more relevant for Agribusiness, we also see potential implications for retailers through essentially three transmission channels, which are further detailed in this report:

- **Food inflation:** typically negative for retailers as (i) it reallocates share of wallet toward essential categories, crowding out discretionary spending; (ii) higher inflation pressures the still nascent easing cycle; and (iii) it adds more pressure to an already tight disposable income. However, it should marginally benefit food retailers' SSS trends.
- **Weather Dynamics:** El Niño should contribute to a faster trajectory to warmer temperatures in Q3, potentially providing a supportive backdrop for both transitional and in-season spring/summer collections into 2H. If this scenario materializes, we believe SSS could reach double-digit levels in 2H26 for apparel retailers, including LREN. Of note, there is a risk of excessive rainfall, particularly in the South and for 2027, which could progress into severe events.
- **Arboviral Diseases:** El Niño contributes to warmer temperatures and increased rainfall, which creates a favorable environment for mosquito proliferation. This may lead to a higher incidence of arboviral diseases (e.g., Dengue Fever), though the effect may come with a lag, as favorable conditions for mosquitoes tend to precede an increase in disease transmission. If this materializes, a higher HPC and services mix could marginally benefit SSS and gross margin dynamics for pharmacies in the South/Southeast regions.

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Setting the Stage: Where ENSO Stands

A potential Super El Nino in 2026-27

El Niño 101. El Niño is one phase of the El Niño Southern Oscillation (ENSO), the coupled ocean-atmosphere cycle that governs sea-surface temperatures (SSTs) in the tropical Pacific. During El Niño episodes, SSTs are anomalously warm; in the opposite La Niña phase, they are cooler than average. Between these two extremes lies a neutral state, with no significant temperature anomalies. These shifts are not confined to the Pacific — they reorganize atmospheric circulation and rainfall worldwide, and Brazil is among the most weather-sensitive economies affected, with measurable consequences for agricultural output, food prices and consumer demand. The event is often referred to as "Super" El Niño when SST anomalies in the Niño 3.4 region reach particularly high levels, typically above +2.0°C. While the event does not occur at regular intervals, it usually happens every 2-7 years, lasting 9 to 12 months.

It's happening: NOAA signals El Niño conditions in 2026-27. The National Oceanic and Atmospheric Administration (NOAA) has placed the system in El Niño conditions last week, with conditions expected to strengthen into the Southern Hemisphere's 2026-27 Summer. The data point to a ~63% chance of a very strong El Niño (Chart 1) during Nov-Jan. If this materializes, it would rank among the strongest El Niño events in the historical record going back to 1950 (Chart 2). The stronger the event, the more likely weather impacts could occur, though it does not necessarily mean bigger impacts.

Chart 01: NOAA CPC ENSO Strength Probabilities, Based on Niño 3.4 index (Issued May 2026)

Weather seasons in the x-axis. Higher temperatures anomalies do not necessarily translate into higher weather and climate impacts

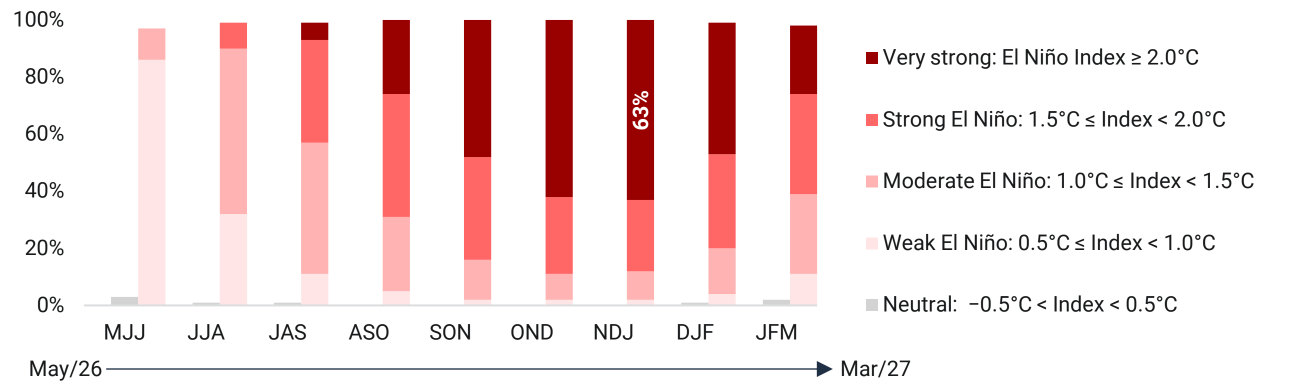
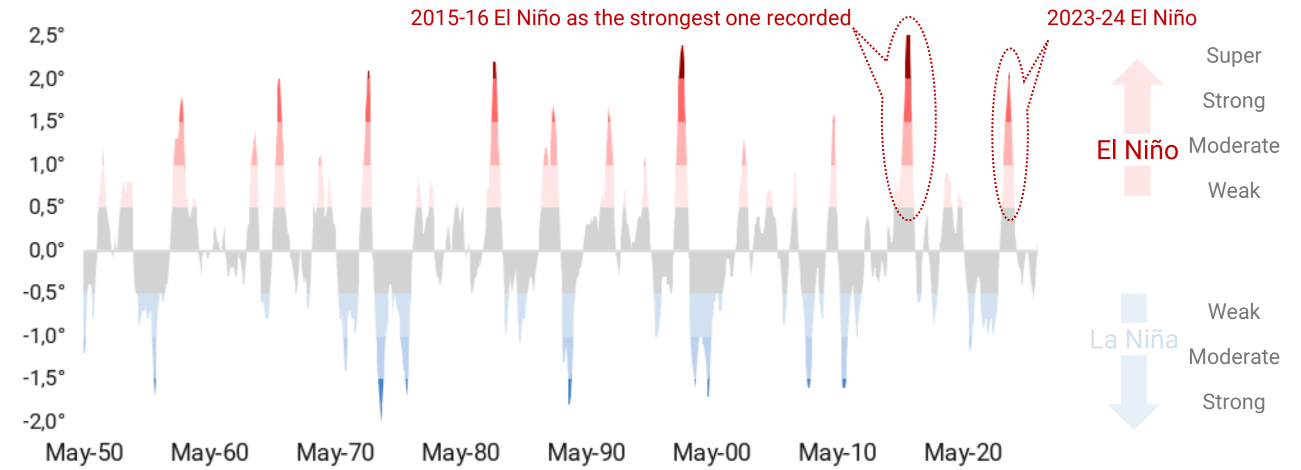


Chart 02: NOAA Oceanic Niño Index Region 3.4 Sea Surface Temperature Anomaly (C°)

2015-16 was a period of "Super" El Niño, while the last recorded El Niño happened in 2023-24



Source: INPE, NOAA, XP Research.

Setting the Stage: Implications for Brazil

Droughts in northern regions and heavy rainfall/flood in the south

What are the weather implications for Brazil? The event's impacts should be more pronounced in later 2026 and early 2027. Given Brazil's continental dimension, there are different effects across regions:

- North/Northeast regions: typically associated to drier conditions in the northern and eastern Amazon and in the northern Northeast, particularly during 1H.
- South/Southeast regions: effects usually emerge in the Southern Hemisphere spring (in September). Winters tend to be milder-than-normal, with potential heatwaves. Importantly, there is typically a lag before temperatures effects materialize. For example, during the 2023-24 cycle, 2024 was warmer than 2023.
- South: increased likelihood of above-average rainfall. During the 2023 event, the region experienced severe rainfall episodes in Sept/23 and again in Apr-May/24, contributing to the Rio Grande do Sul floods.

Figure 01: El Niño in Brazil, Regions affected and impacts

Impacts vary by region. El Niño can intensify droughts in some areas and cause heavy rainfall and flooding in others

Source: INPE

Food inflation: a headwind, but supportive of food retail

Scanning the space for potential winners and losers

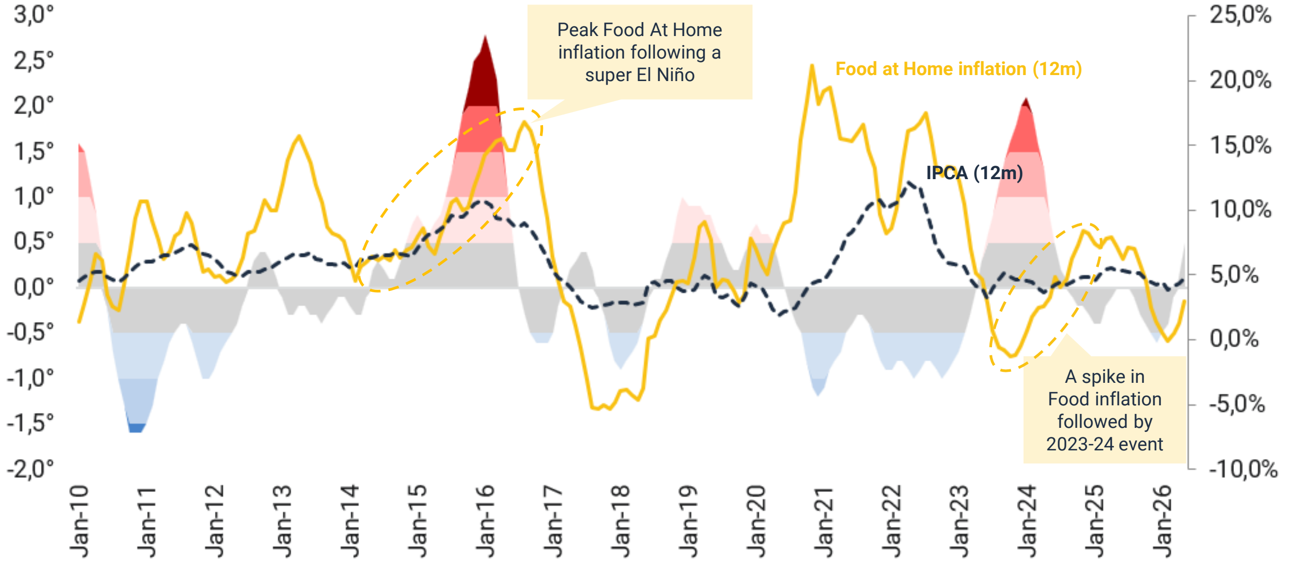
Understanding the potential implications for retailers. In our view, we see three main transmission channels between the El Niño event and retailers: (1) Food inflation; (2) Weather dynamics; and (3) Arboviral diseases. We further discuss each one in this section of the report, highlighting companies that are more exposed to each.

Food Inflation

Inflation as the most direct channel. The first and foremost direct impact of El Niño on our coverage is through food inflation. As discussed by our Agro Team (see here), the event should translate into lower crop yields and, thus, lower supply, while higher input costs should further pressure agricultural commodities. The fastest passthrough should appear in fresh products and in items more exposed to fertilizers and oil (e.g., meats, dairy, baked goods, edible oils). This has a direct read-through to food inflation and headline CPI, which, in turn, should further pressure an already tight purchasing power.

The bulk of the impact possibly lands in 2027. Price effects should become more pronounced in 2027, as cost pressures take time to move through the supply chain to the shelf, with a lag of a few months between the ENSO start and the inflation acceleration (Chart 03). However, its early signs should already be visible in 2026, with our macro team expecting food at home to accelerate across quarters, reaching +7.3% yoy in Dec/26 (+6% for Q4's avg.). This compares to a ~3% level in Q2.

Chart 03: NOAA ONI index Region 3.4 Sea Surface Temperature Anomaly (C°) x Brazilian CPI (right axis)
2015-16 was a period of "Super" El Niño, while the last recorded El Niño happened in 2023-24



Bad news for retail… Accelerating food inflation is typically negative for retailers as, it reallocates share of wallet toward essential categories, crowding out discretionary spending. At the same time, higher inflation pressures the still nascent easing cycle, with our Macro team revisiting its outlook and now expecting SELIC rate to reach 14% by YE26. This dynamic further pressures consumers' purchasing power, fueled by households' already elevated indebtedness levels, while also delaying a more meaningful recovery in credit availability.

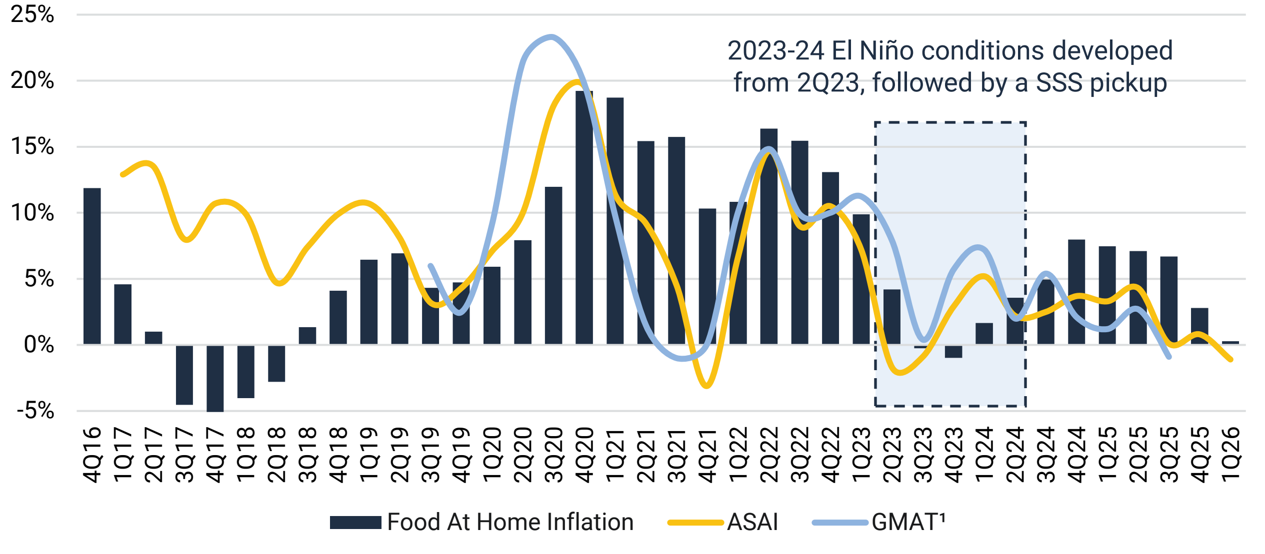
Source: NOAA, IBGE and XP Research.

Food inflation: a headwind, but supportive of food retail

Scanning the space for potential winners and losers

… though marginally positive for food retail. Food retail, and particularly the Cash&Carry segment, is inherently exposed to food inflation dynamics, given its commodity-driven nature and pricing transparency. As such, food inflation is a key driver of pricing, typically passing it through to the shelf, directly supporting SSS and top line trends. That said, real income growth has lagged food inflation virtually since the pandemic, which, combined with other structural headwinds (e.g., the rise of betting and GLP-1 consumption shifts), has resulted in sustained volume pressure. As a result, while higher food inflation should remain marginally positive for the segment, we expect part of the benefit to be offset by continued volume decline contraction and /or down trade moves. In this sense, we see ASAI as the best positioned to benefit from this trend, though keeping in mind that disposable income is a constraint (more on our recent update here).

Chart 04: Food retail's SSS dynamics vs. food inflation at home inflation



Source: IBGE, Company's reports, XP Research. 1. Considers Only Mix Atacarejo data

Temperatures: favorable dynamics for apparel

Scanning the space for potential winners and losers

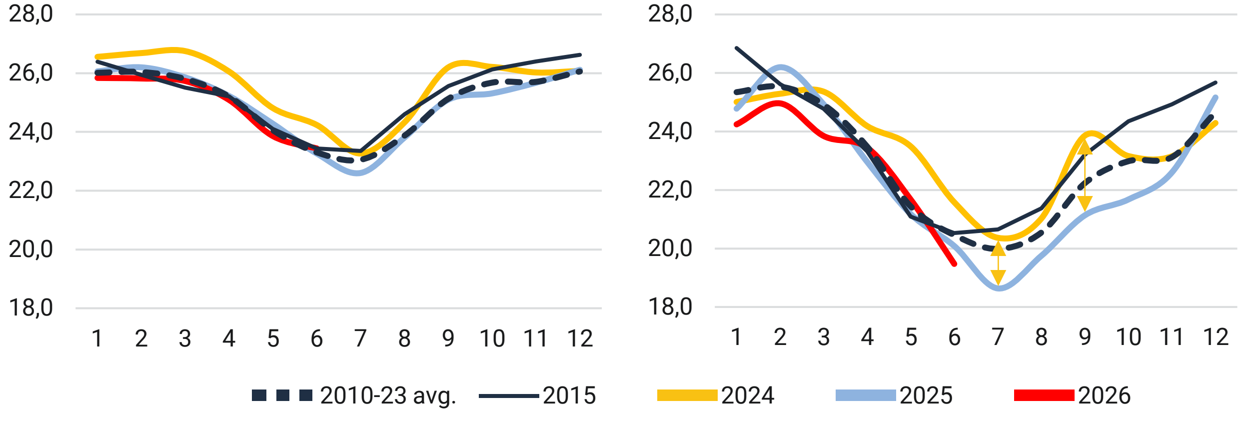
Weather Dynamics

Apparently favorable weather dynamics. El Niño points to a shorter, milder winter, which could support a cleaner transition into the spring collection by shortening the markdown window and freeing space for full-price spring product. Still, the core of the season should remain intact: June and July are likely to stay cold, supporting winter sell-through during the most relevant months, with El Niño effects emerging only in late winter and peaking in spring, possibly creating very favorable dynamics for this year's winter collection and transition into summer/spring.

Lagged temperate effects (~3 months). During the strong 2015-16 event, sea-surface temperature anomalies entered El Niño territory in April, while temperatures in Brazil began to deviate from historical averages only around three months later (see 2015 line in Chart 05). If the same pattern holds in 2026, warmer temperatures should materialize in August-September, reinforcing our positive view on current winter sales and supporting a more favorable spring transition.

Earnings momentum building. As discussed in our recent sector update (link), current weather dynamics are favorable for apparel retailers, with a colder late fall / early winter supporting a solid Q2 despite somewhat tough comps. Looking ahead, downward anomaly readings point to a cold June and possibly July (see figures 02 and 03 on next page), in the South and Southeast regions of Brazil (~60% of store footprint for CEAB/RIAA, and ~73% of LREN) - a setup that should favor winter inventory sell-through, which normally happens from March to June in retail (figure 04).

Chart 05: Brazil (left)[1] and Southeast region (right) average temperatures per month considering capital cities



Source: SAMET/INPE and XP Research. 1. Calculated as the avg. Temperatures from the 27 Brazilian capitals

Temperatures: favorable dynamics for apparel

Scanning the space for potential winners and losers

Figure 02: GEFS Ensemble Mean Temperature Anomaly (C°); 1-7 Days, estimated on June 16th

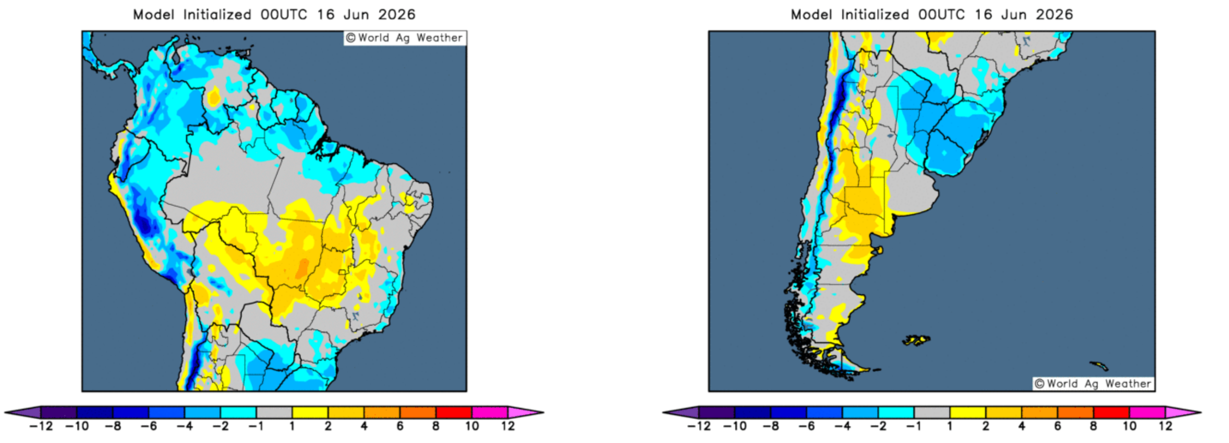
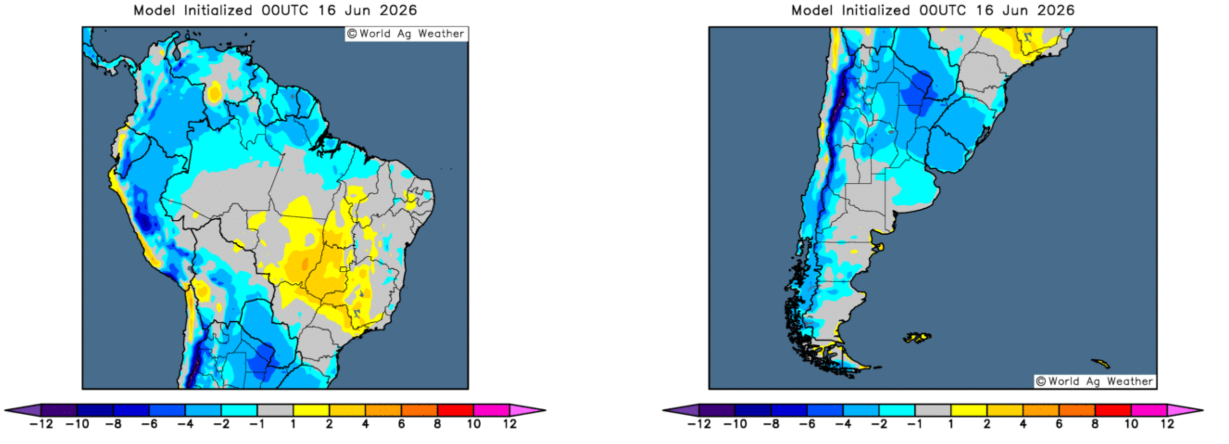


Figure 03: GEFS Ensemble Mean Temperature Anomaly (C°); 8-14 Days, estimated on June 16th



After an uninspiring 2H25, a potentially strong 2H26 ahead. Last year, an unusually prolonged and intense winter left apparel retailers short on winter inventory, ultimately weighing on performance, particularly in Q3. This year, however, we expect a more normalized temperature trajectory, with El Niño potentially providing a supportive backdrop for both transitional and in-season spring/summer collections. This dynamics should be further amplified by easy comps in 2H. If this scenario materializes, we believe SSS could reach DD-levels across the sector, including LREN (not yet reflected in our estimates). Such outcome would likely support the delivery of LREN's top line guidance, something we believe remains largely unpriced by the market. We, thus, remain constructive on the segment, with LREN as our top pick.

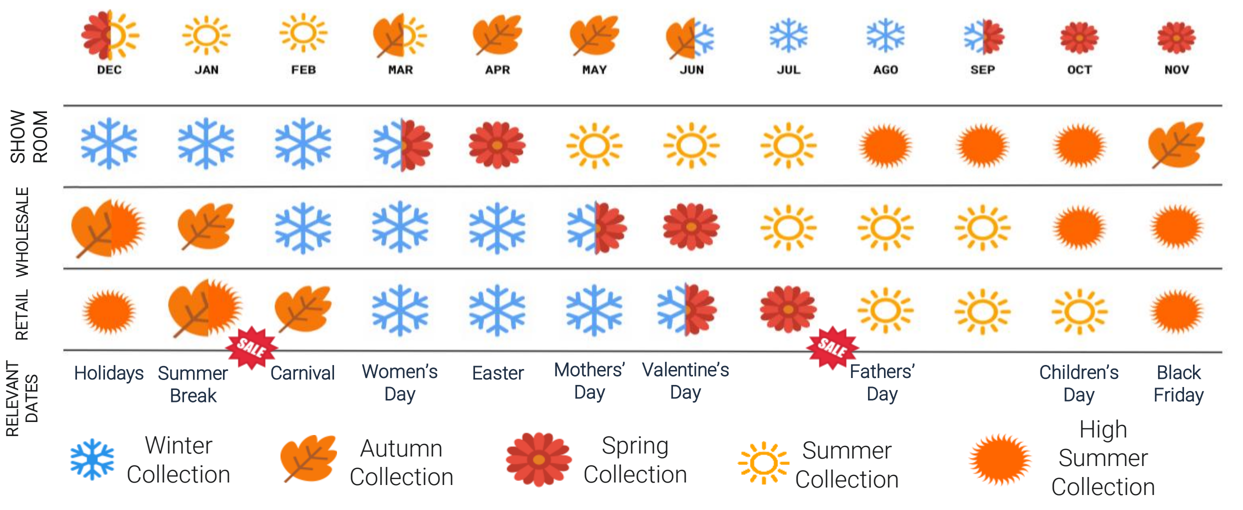
Not only positives. El Niño increases the risk of excessive rainfall, particularly in the South and for 2027. The 2023-24 cycle showed how extreme events (e.g., RS floods in May/24) can disrupt economic activity.

Source: World Ag Weather GEFS and XP Research.

Temperatures: favorable dynamics for apparel

Scanning the space for potential winners and losers

Figure 04: Optimal Timing for Collections' launches and sales



Arboviruses: increased mix of HPC and services

Scanning the space for potential winners and losers

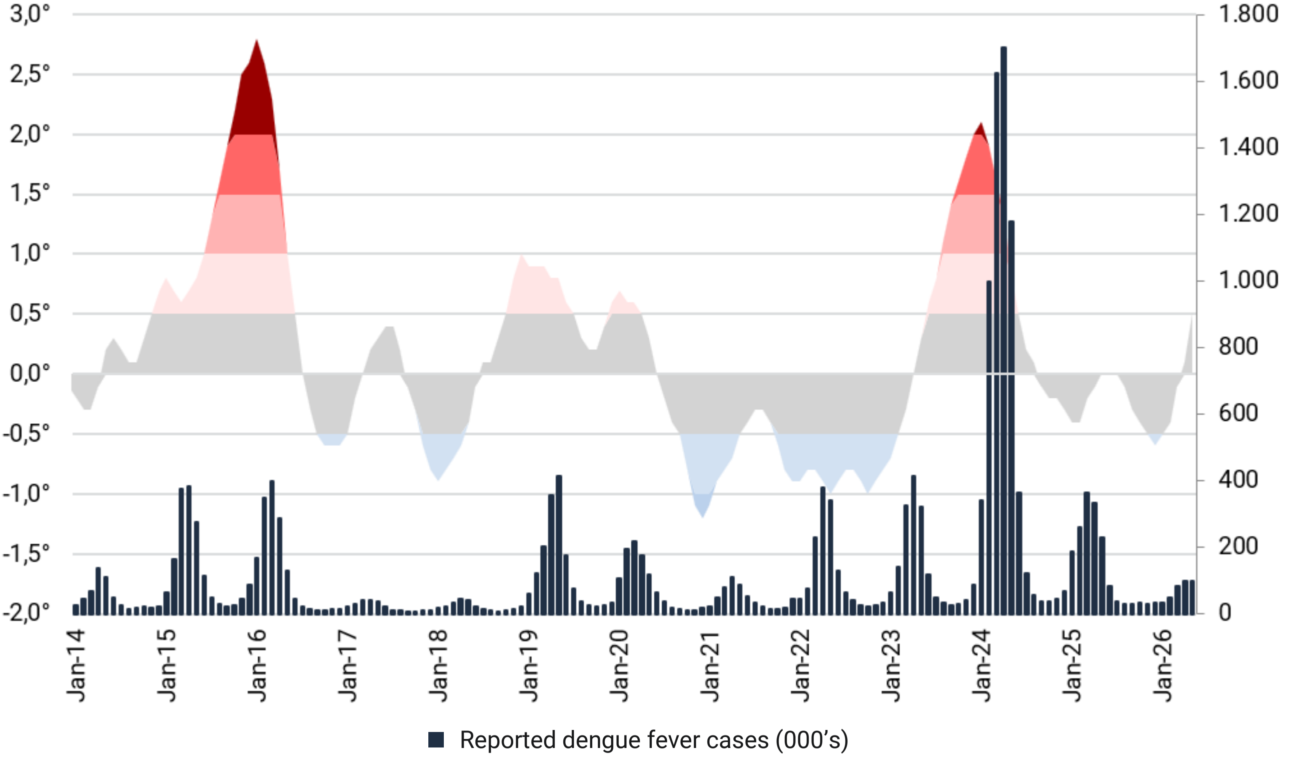
Arboviral Diseases

A less obvious effect, but evidence suggests a correlation. As discussed above, El Niño contributes to warmer temperatures and increased rainfall, mostly in Brazil's South region. This creates a favorable environment for mosquito proliferation, which, in turn, could increase the incidence of arboviral diseases, most notably Dengue Fever. The effect may come with a lag, as favorable conditions for mosquitoes tend to precede an increase in disease transmission. Notably, following the 2023–24 El Niño event, Brazil experienced a surge in dengue fever cases, with around 65% of reported cases concentrated in the Southeast region (RD's core) and 18% in the South region (Panvel's core).

Mitigating factors exist. Among the initiatives that could reduce this risk, we note: (i) wider Dengue fever vaccination, although scale remains limited by supply; and (ii) greater awareness, with consumers more vigilant in reducing standing water.

Implications for pharmacies. We see three potential impacts for pharmacies located in these regions: (i) increased demand for repellents; (ii) increased demand for tests; and (iii) increased demand for vaccines. This could marginally benefittop line trends, but mainly gross margin mix, given the higher margins of HPC and services. Of note, HPC and Services categories represent between 25-35% of pharmacies' sales, with repellents being a fraction of it.

Chart 06: NOAA ONI index Region 3.4 SST Anomaly (C°) x Reported Dengue Fever cases



 Source: NOAA, Ministério da Saúde/SVSA - Sistema de Informação de Agravos de Notificação - Sinan Net and XP Research.

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