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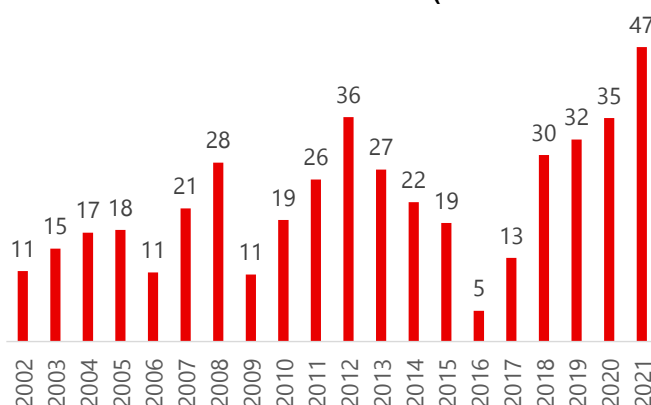
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A GOOD SCENE FROM A MOVIE YET TO COME

- In the first two months of the year, the results of the public accounts were positive, showing a good scene. However, we believe that yearly results (the movie) could be affected by increased public expenditures to mitigate the effects of the pandemic—the resumption of Emergency Aid will already add BRL44 billion in disbursements between April and July. On the revenue side, we expect moderation ahead, owing to the impact of a resurgence in COVID in particular.
- The consolidated public sector posted a primary deficit of BRL11.8 billion in February, better than our forecast (BRL19.4 billion) and the market's median estimate (BRL20.0 billion). In the accumulated result for the first two months, the consolidated public registered the best result in the Brazil Central Bank's (BCB) series (since 2002).
- Gross debt reached 90.0% of GDP in February 2021, an increase of 0.6 percentage points from January 2021. Meanwhile, net debt was 61.6% of GDP, 0.2 percentage points higher on the same basis of comparison.
- According to our forecasts, the deficit should decrease to BRL250 billion in 2021 (3.1% of GDP)—meaning a (rather risky) return to gradual fiscal consolidation after the large stimulus of 2020. We expect gross debt to remain virtually stable, however, assuming that the BNDES will repay the Treasury at least BRL100 billion and also that the government will comply with the spending cap.

According to data published today by the BCB, the consolidated public sector posted a primary deficit of BRL11.8 billion, better than our forecast (BRL19.4 billion) and the market's median estimate (BRL20.0 billion). In the accumulated result for the first two months, the consolidated public sector registered a surplus of BRL46.6 billion, compared to a surplus of BRL35.4 billion in the same period of 2020. It was the best result for the period in the BCB series (since 2002) – see Figure 1.

Figure 1 – Consolidated Public Sector Result (Jan-Feb – BRL billion)



Sources: Brazilian Central Bank, Santander.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE ATTACHED.

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The deficit reached BRL691.7 billion (9.2% of GDP) in the 12-month reading. The government's primary target for the year is currently at BRL247 billion (3.2% of GDP). The 12-month nominal deficit was BRL1.01 trillion (13.5% of GDP).

In February 2021, the main surprise once again was regional governments' results (+BRL10.5 billion compared to +BRL4.9 billion in February 2020). In the 12-month reading, regional governments posted a primary fiscal surplus of BRL48.7 billion (0.65% of GDP)—the best result since June 2012 as a percentage of GDP. In our view, regional governments' better results will be short lived. These results were probably affected by the impact of the fiscal transfers and the solid economic performance of 4Q20—which improved tax collection.

Given the considerable headwinds for the economy and tax collection, we expect a deterioration in the fiscal position of subnational entities—particularly states and municipalities—in 2021. Subnational entities will face the challenge of reestablishing fiscal equilibrium after these fiscal stimuli are over, in our view. In addition, the effect of the pandemic may affect local revenue, in a context of higher disbursement on health. This should increase pressure for new transfers from the federal government.

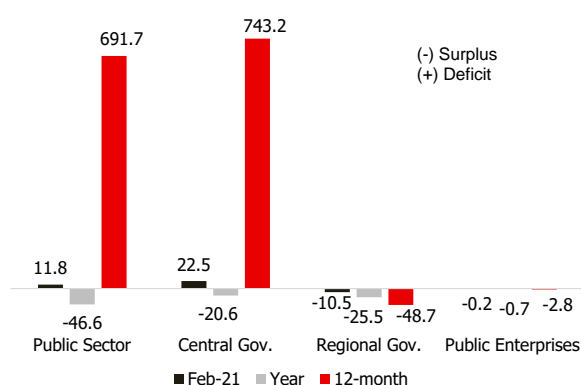
Additionally, according to the National Treasury data published on March 30, the central government posted a primary deficit of BRL21.2 billion in February 2021. A lower deficit to that recorded in the month in February 2020 (BRL 25.9 billion), and still reflects the solid GDP growth in 4Q20 and the recovery of corporative taxes, considering an inflation effect and a recovery in profit margin. Yet, we expect some moderation in coming months, especially owing to the impact of the pandemic relapse.

Since 2013, this is the best result for general government for the first two months of a year. A key factor was the lower level of discretionary spending, which was 36% lower than in 2020 in real terms. The disbursement was only 1/18 of the budget for these expenses in 2021—since the final budget has not yet been approved during this period. For the coming months, we expect an increase in government spending, with Emergency Aid will represent an increase of ~BRL10 billion per month after April until June. There is also the possibility of a resumption of other fiscal stimulus programs (currently under debate), in an amount significantly lower than in 2020.

At the same time, the gross debt came at 90.0% of GDP in February (see Figure 5), an increase of 0.6 percentage points from January 2021. Meanwhile, net debt was 61.6% of GDP, a rise of 0.2 percentage points on the same basis of comparison. We expect both to deteriorate in the coming months—although at a slower pace. The increase in nominal GDP, considering the inflation shock, should also maintain the debt levels virtually stable,

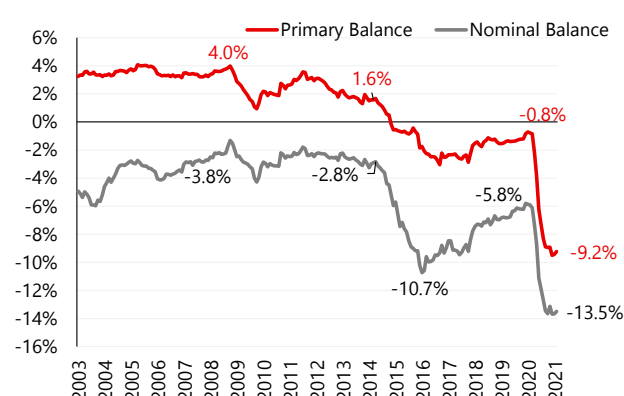
According to our forecasts (under revision), the primary deficit should reach to BRL250 billion in 2021 (3.1% of GDP)—meaning a (rather risky) return to gradual fiscal consolidation after the large stimulus of 2020. We expect gross debt to remain virtually stable, however, assuming that the BNDES will repay the Treasury at least BRL100 billion and also that the government will comply with the spending cap rule.

Figure 2 – Primary Result (BRL billion)

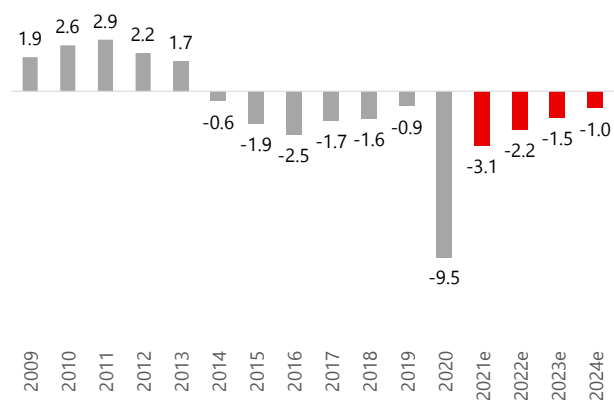


Sources: Brazilian Central Bank, Santander.

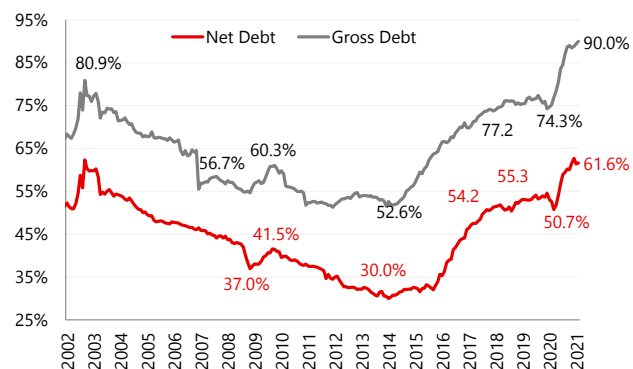
Figure 3 – Consolidated Public Sector (12m % GDP)



Sources: Brazilian Central Bank, Santander.

**Figure 4 – Primary Result Forecast (% GDP)**

Sources: Brazilian Central Bank, Santander.

Figure 5 – Public Sector Debt (12m % GDP)

Sources: Brazilian Central Bank, Santander.



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