Brazil Macro | April 2021

FISCAL POLICY

ÍTALO FRANCA
italo.franca@santander.com.br
+55 11 3553-5235

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01

Brief Overview

Summary

- We see fiscal risk continuing to increase in Brazil. In our view, as a result of the inflationary shock, the spending cap rule has lost part of its anchoring power. The focus now is on the sustainability of government debt.
- PEC emergencial was approved. Although important, this reform will not guarantee fiscal consolidation, and the debate in Congress concerning its approval showed the difficulty of approving tougher fiscal measures.
- Our estimates lead us to believe that a Selic rate above 7% would already be a sufficient condition to generate an unsustainable path of the public debt, leading to with a (possible) scenario of fiscal dominance. In our view, Brazil is flirting with this possibility.
- For this reason, we see this as a latent fiscal dominance scenario, which reinforces the importance of passing further fiscal reforms and maintaining fiscal discipline.
- We present our base fiscal Scenario. We still estimate a primary deficit close to 3.2% of GDP in 2021 and estimate gross debt falling this year, owing to another anticipated return of Treasury funding by BNDES and higher Nominal GDP.

Fiscal on a tightrope – opposite forces to find a balance

Budget gridlock
New welfare program
Popularity Level
Public Investment
Weak Employment Conditions
Regional Issues/Pressures
High inflation

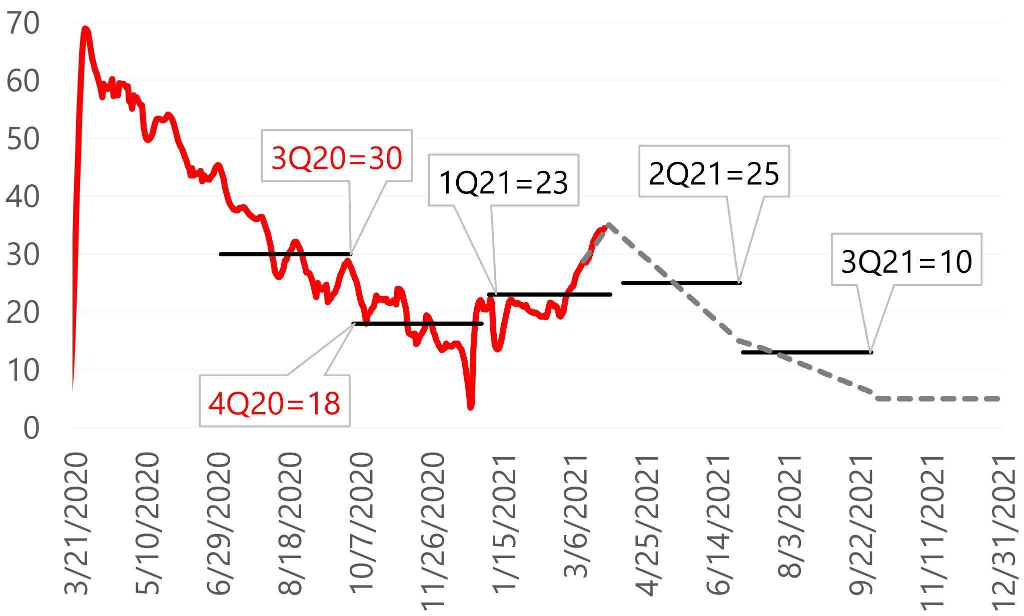
Fiscal outlook

Debt Dynamics
Spending cap
Financial Conditions
Government Financial Needs
Rating Agencies
Centrist Congress
Economic Team

Fiscal Scenario – The pandemic scenario is important for the fiscal outlook

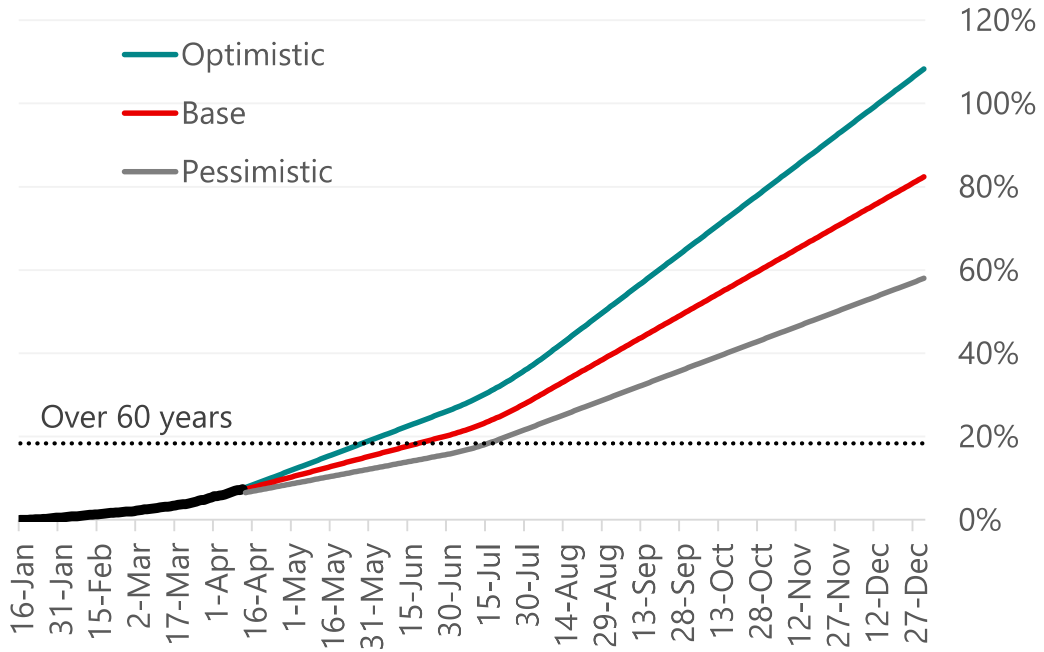
- The numbers suggest a gradual immunization of a large percentage of the population, allowing a continuing gradual relaxation of social distancing restrictions throughout the year, especially in 2H21. We believe this supports our assumption of a broader reopening of (socially integrated) services in the latter part of the year, and "normalization" by the end of it.

Google Mobility* (Jan/20=0) – 28dmma



Sources: Google, Santander
* Lockdown index

Brazil's Vaccination Plan - 2021



Sources: Ministry of Health, Santander.

Expected Timeline in 2021

March | April | May | June | July | August

- *2021 Budget*: Sanction Deadline: 22 April; Congress recess July 16
- *2022 Budget Guidelines*: Deadlines: Executive–April 15, Legislative–July 16
- *2022 Budget*: Deadline Executive: 31 August
- *Gov. Stimulus**: Pension Bonus Anticipation 50 billion | FGTS 12 billion
- *Emergency Aid*: 4 months – 46 million people – BRL 225 (avg)
- *Other Stimulus*: STD: BEm BRL10 billion – 4 million formal jobs – Pronampe: BRL6 billion
- *Vaccination*: Population over 60 years: Complete Vaccination
- *Copom Meetings*: **17-Mar** +75bps; **4-May** STD: +75bps; **16-Jun** STD: +50bps; **04-Aug** STD: +50bps; Dec-21: 5.5% p.y.
- *IPCA 12m*: **Mar-21** | 09-Apr STD 6.1%; **Apr-21** | 11-May STD: 7.0%; **May-21** | 09-Jun STD : 7.8%; **Jun-21** | 08-Jul STD: 8.0%; **Jul-21** | 10-Aug STD: 8.1%; **Aug-21** | 09-Sep STD: 7.7%; 2021e: +5.0%
- *GDP growth*: **4Q20** | 03-Mar +3.2%QoQ; **1Q21** | 01-Jun STD: +0.2%QoQ; 2021e: +3.0%
- *Unemployment*: **1Q21 avg** STD: 15.3%; **2Q21** STD: Unemployment 17.3 mi | rate: 16.9% not s.a (all-time high); **3Q21** STD: Unemploy 17.1 mi | 16.2%; Dec-21: 12.1%

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* Government fiscal neutral measures in 2021 - FGTS withdraws and anticipation of wage bonus

** BEm = Formal employment support program | Pronampe = loan subsidies to small companies

STD: Santander Forecast

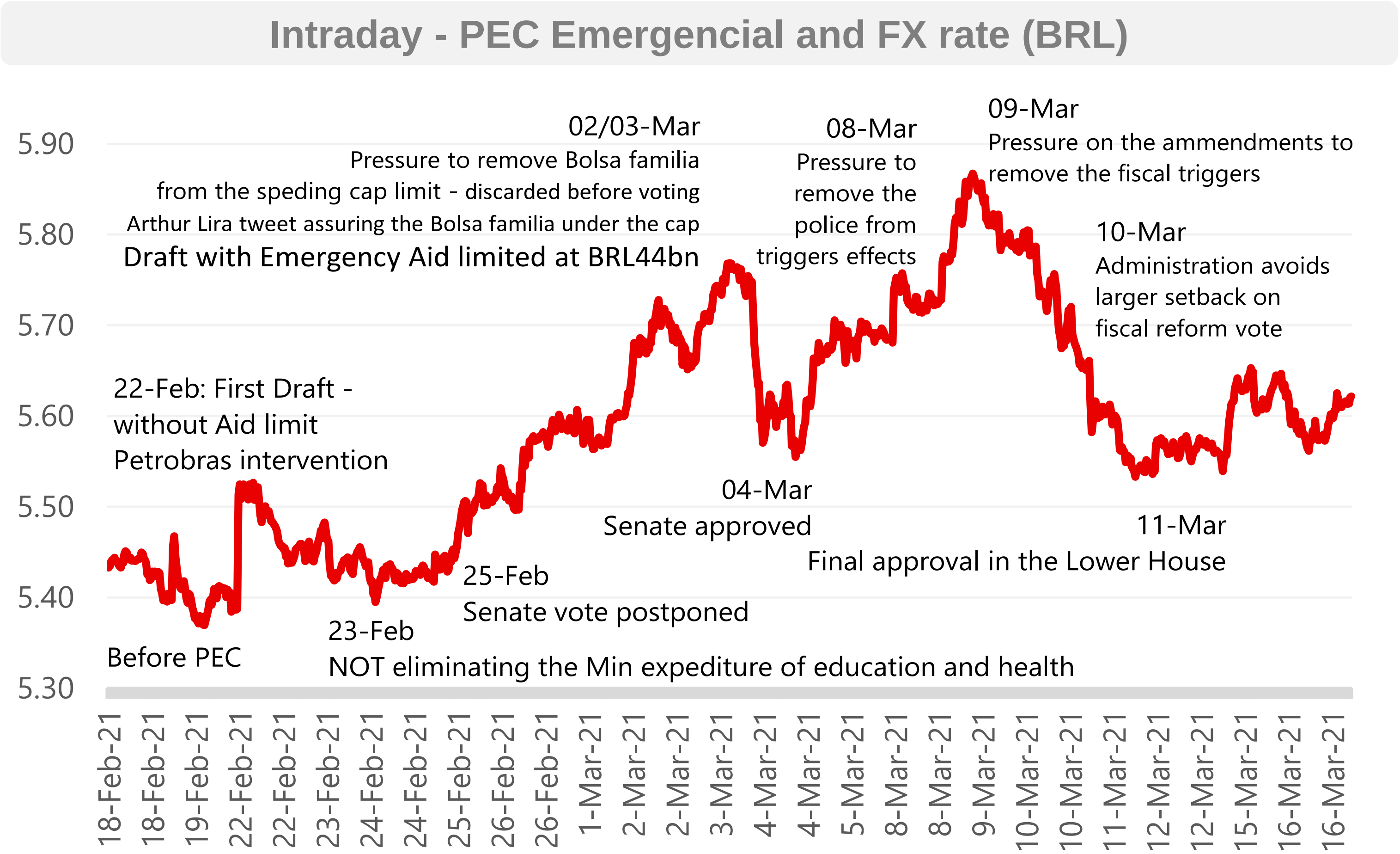
Source: Santander.

Fiscal Reform – PEC Emergencial

02

Market's reaction to PEC Emergencial

- The final text of PEC Emergencial saw a watering down of the Government's economics team's proposal
- During the voting process, there were risks of removing expenses from the spending cap and this affected the markets



Sources: Bloomberg, Santander.

Summary – PEC Emergencial

Main aspects of the reform

¬ Spending cap triggers for federal gov.

(Enacted when mandatory outlays / total expenses> = 95%)

¬ Fiscal triggers for states and municipalities

(Would be allowed when primary expenses surpassed 85% of current revenue)

¬ "Calamity Button/clause"

(Suspends fiscal rules during a public calamity decree)

¬ New Emergency Aid without conditionalities

(Extra-cap expenses limited to BRL 44 billion)

¬ De-earmarks federal funds surplus

(To use in debt management close to ~BRL150 billion)

¬ Reduction of tax breaks

(Send a plan in 6 month to slash tax breaks to 2% of GDP from 4%)

¬ Revoked Treasury Judicial claims borrowing lines for subnational entities.

¬ Revokes “Lei Kandir” (transfers);

Our view

¬ It has brought some important regulatory advances

(Such as the end of Kandir Law, Financing the subnational judicial claims)

¬ Fiscal triggers will help to control expeditures

(That may favor compliance with the spending cap for the medium term)

¬ The PEC does not guarantee the fiscal consolidation

(To enact the triggers the discritionary expenses is expected to reach a "shutdown" level)

¬ Has not removed the fiscal risks,

(As subsequent implementation will depend on a favorable political environment)

¬ Risky stategy in changing the Constitution

(Emergency Aid could be done by provisional measure)

¬ It showed the difficulty in addressing the necessary reforms

(The final text saw a watering down of the Government’s economics team’s proposal)

¬ Easing fiscal rules during calamity period could create extra expenditures/fiscal stimulus

(The fiscal adjustments are only during calamity - not for 2 years in the original proposal)

¬ Tax breaks reduction without enforcement

(The tax incentive reduction plan has no enforcement rules)

Resumption of Emergency Aid (extra-cap stipend)

- The law allowed the implementation of a new round of emergency aid for four months, with a total budget limit of BRL44 billion.
- It will include 46 million beneficiaries from April to July, until the vaccination process advances in the risk groups.
- The calendar for withdrawing the benefit in 'cash' from the bank account runs until September

Summary of the New Emergency Aid

Total Budget - BRL 44 billion (from April to July)

Not included in Spending Cap and Primary Target

Beneficiaries - 45.8 million people

It was 57 million in Dec-20 and 67 million in Aug-20

¬ 28.6 million (Mainly informal workers)

¬ 6.3 million (Registered in the CadUnico)

¬ 10.9 million (Bolsa Família beneficiaries)

Values - three possibilities

¬ BRL 150 per month - 20 million of families (44% of total)

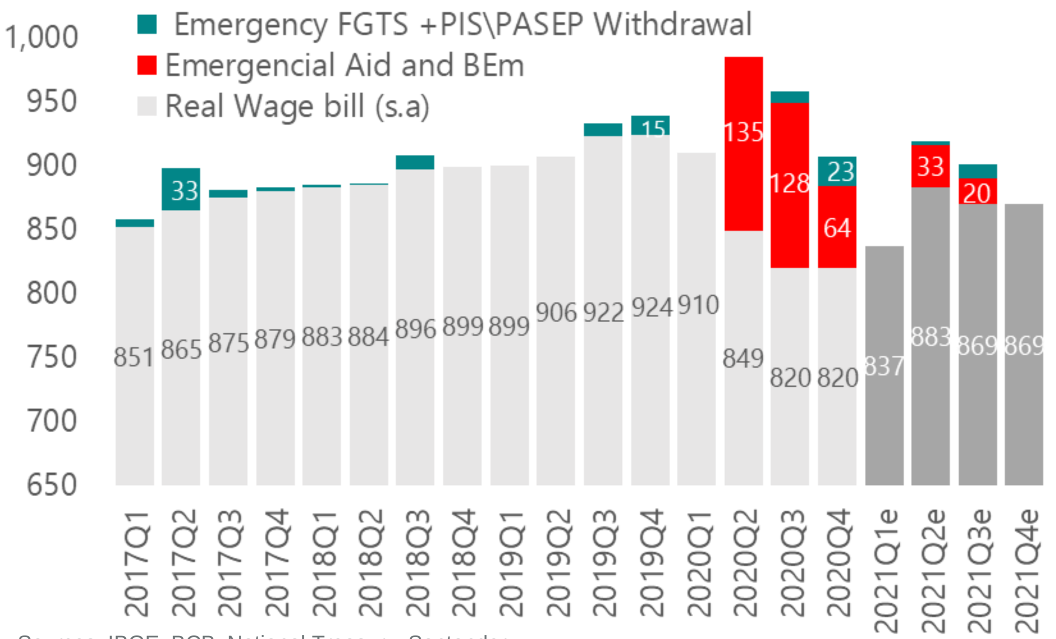
¬ BRL 250 per month - 16.7 million families (36%)

¬ BRL350 per month - 9.4 million Female breadwinners (20%)

Sources: Min da Cidadania, CAIXA , Santander.

CadUnico – Government registers database for social programs

"Expanded" Real Wage Bill (BRL billion)



Sources: IBGE, BCB, National Treasury, Santander

For 2021, we expect the "expanded" real wage bill to have a -6.2% full-year drop, a bit better than our previous scenario (-6.6%). As for the scenario without fiscal aid, we estimate a 1.8% growth for 2021, slightly below our last projection (+2.1%).

PEC Emergencial – some aspects

- Tax Breaks: there is no enforcements to reduce the fiscal incentives
- On the other hand, the de-eamarking of public funds will be important for debt management. It will be allowed to use almost BRL150 billion in the short run. It is also possible to use BRL35 billion of new flows until 2023.

Tax exemptions		
	BRL bn	% GDP
Total	**360**	**4.9%**
Tax waivers	320	4.3%
Credit-related	21	0.3%
With Primary Impact	19	0.3%
Exceptions	**210**	**2.8%**
Simples	75	1.0%
Entidades sem fins lucrativos	30	0.4%
Zona Franca	25	0.3%
Cesta Básica	17	0.2%
Fundos Const.	14	0.2%
Desenv. Regional	13	0.2%
FIES + prouni	6	0.1%
Others	30	0.4%
To Cut	**150**	**2.0%**

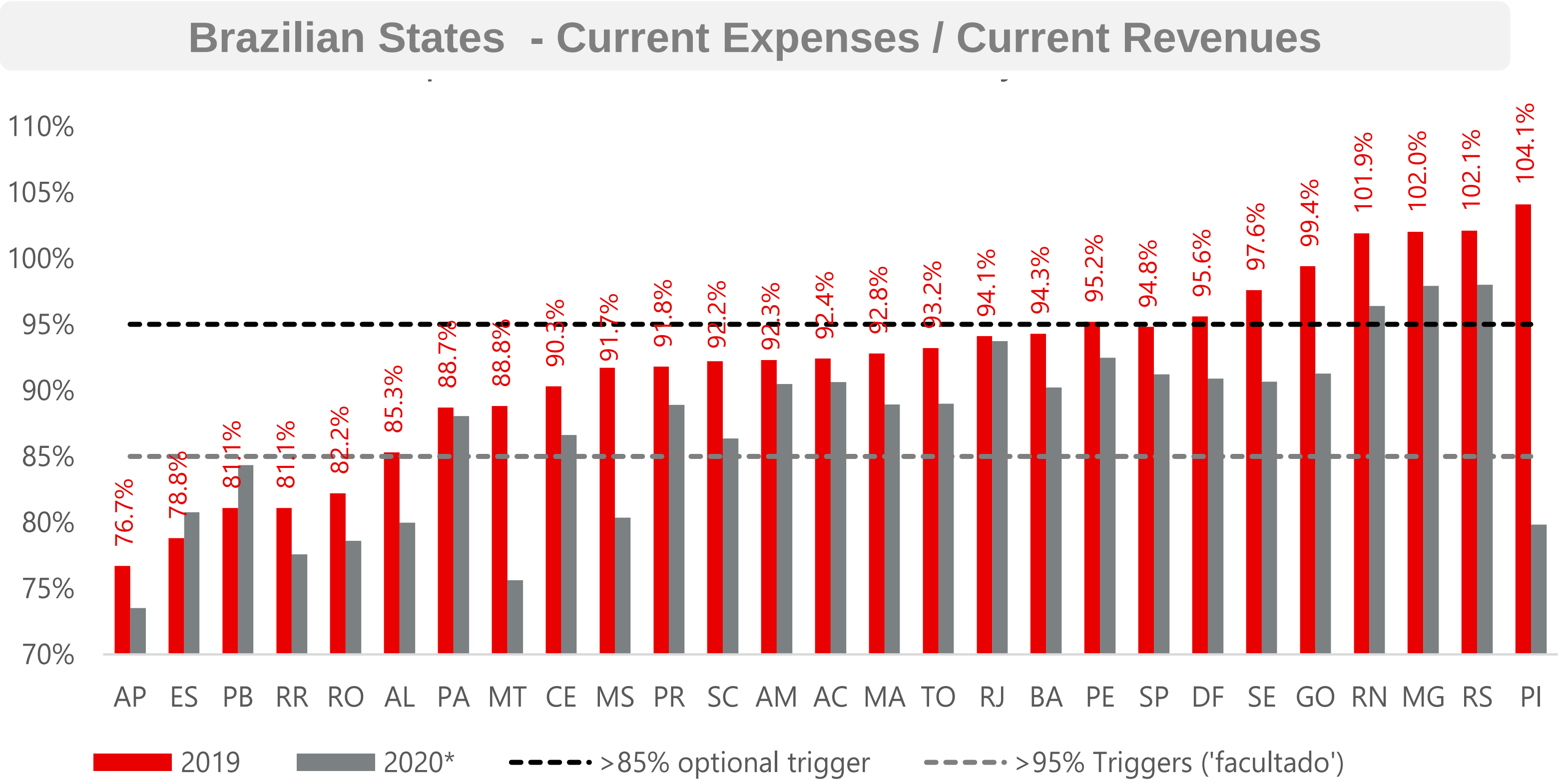
Source: Federal Revenue. Santander.

Public Funds' Surplus		
	BRL bn	% GDP
Total	**177.7**	**2.4%**
Social Fund	40.1	0.5%
FGE (exports)	28.9	0.4%
FNAC	23.1	0.3%
Marine Fund	15.7	0.2%
FCVS	12.7	0.2%
Fundaf (improvement of Inspection Activities)	12.3	0.2%
FUNSET (Traffic Safety and Education)	8.8	0.1%
FUST (Telecommunications)	5.6	0.1%
FDD (Defense of Diffuse Rights)	2.8	0.0%
FESR (Rural Insurance Stability)	3.3	0.0%
Naval Fund	2.4	0.0%
Others	22	0.3%

Sources: PLP 137/2020, Bloomberg.

Regional Governments result and triggers

- With 2019 data, seven states surpassed the 95% limit (DF, SE, GO, RN, MG, RS, PI).
- Considering preliminary data for 2020, only three would apply the triggers (RN, MG, RS).
- The 2020 numbers were probably affected by the impact of emergency aid on local economies (totaling BRL293 billion in 2020) – which improved tax collection – and transfers from the central government to offset the decline in tax collection (~BRL80 billion).
- Triggers in all states can reduce expenses in BRL16 billion/year.
- Penalty - not receiving credit guarantees from the union



* Preliminary, according to Treasury's Data
Sources: National Treasury, Santander

Spending Cap - Anchoring Power Is Dwindling

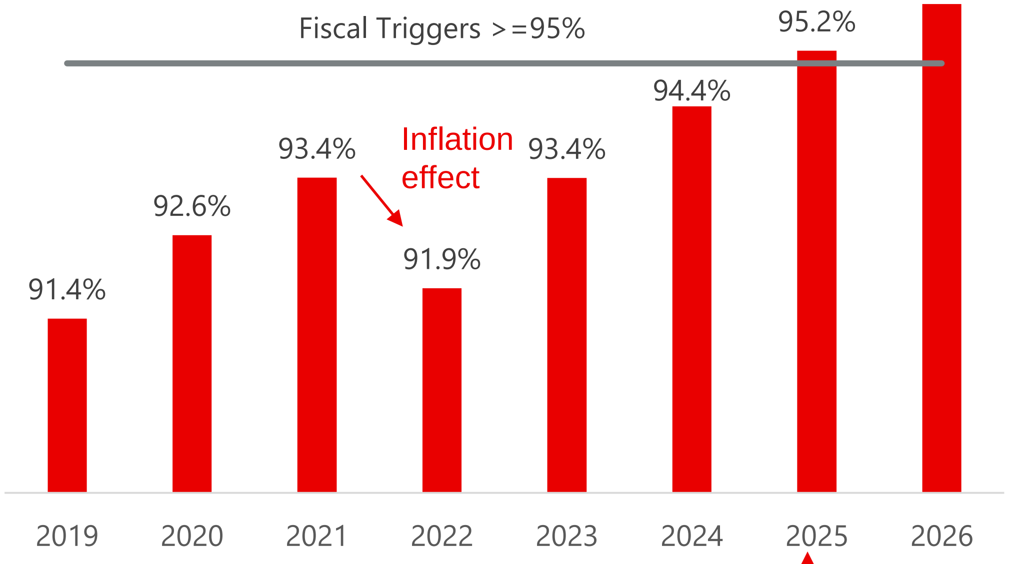
03

So the fiscal risk has decreased? Unfortunately, no…

- PEC Emergencial helps enacting the Fiscal triggers, yet the discretionary levels will be almost in a “shutdown” level
- The spending cap lost part of its anchoring power and Brazil still an elevated level of Financial Needs…

Federal Gov. - Mandatory Expenses/Total Expenses

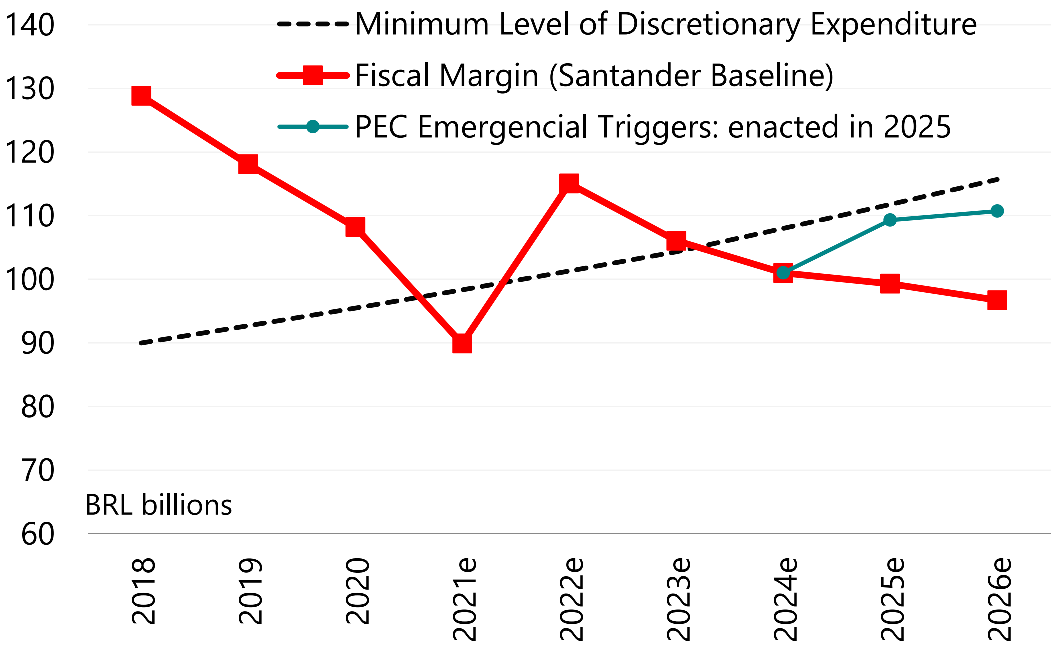
Simulation: to enact the triggers in 2021, will be necessary to reduce the discretionary expenses in BRL20 billion, which is already close to a minimum value to a proper function of public services)



Sources: National Treasury, IBGE, Santander.

The triggers will be enacted in 2025 in our scenario

Margin and Discretionary Expenses



Fiscal Margin = Spending cap Max limit - Mandatory Outlays forecast

Sources: National Treasury, Santander.

Inflation helping to comply to the spending cap, decreasing its anchoring power…

- In 2022, the inflation shock will make room to accommodate BRL75 billion in new spending within the constitutional spending cap,
- Even with a real wage increase for government workers, compliance with the spending cap has become relatively easy until 2026,

Inflation Mismatch – 2022 Margin (BRL billion)

Margin for new expenses NET of gains in mandatory ones

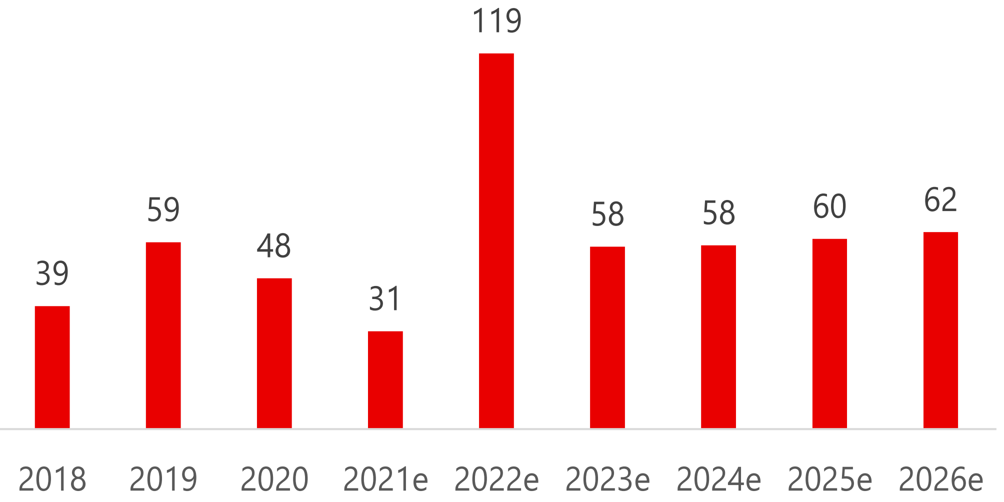
Increase in mandatory outlays: Minimum Wage (INPC 12m Dec)	Spending cap readjust 2022 (IPCA 12m Jun)				
	6.5%	7.5%	8.0%	8.5%	9.0%
3.8%	66.0	80.9	88.3	95.7	103.1
4.5%	60.4	75.2	82.6	90.1	97.5
5.5%	52.3	67.2	74.6	82.0	89.5
6.0%	48.3	63.1	70.6	78.0	85.4
7.0%	40.2	55.1	62.5	70.0	77.4

In the baseline Scenario the spending cap will increase in ~BRL120 billion next year

Sources: National Treasury, IBGE, Santander.

Spending Cap Margin increase – (BRL billion)

Readjusted by IPCA 12 month of June of the last year (t-1)



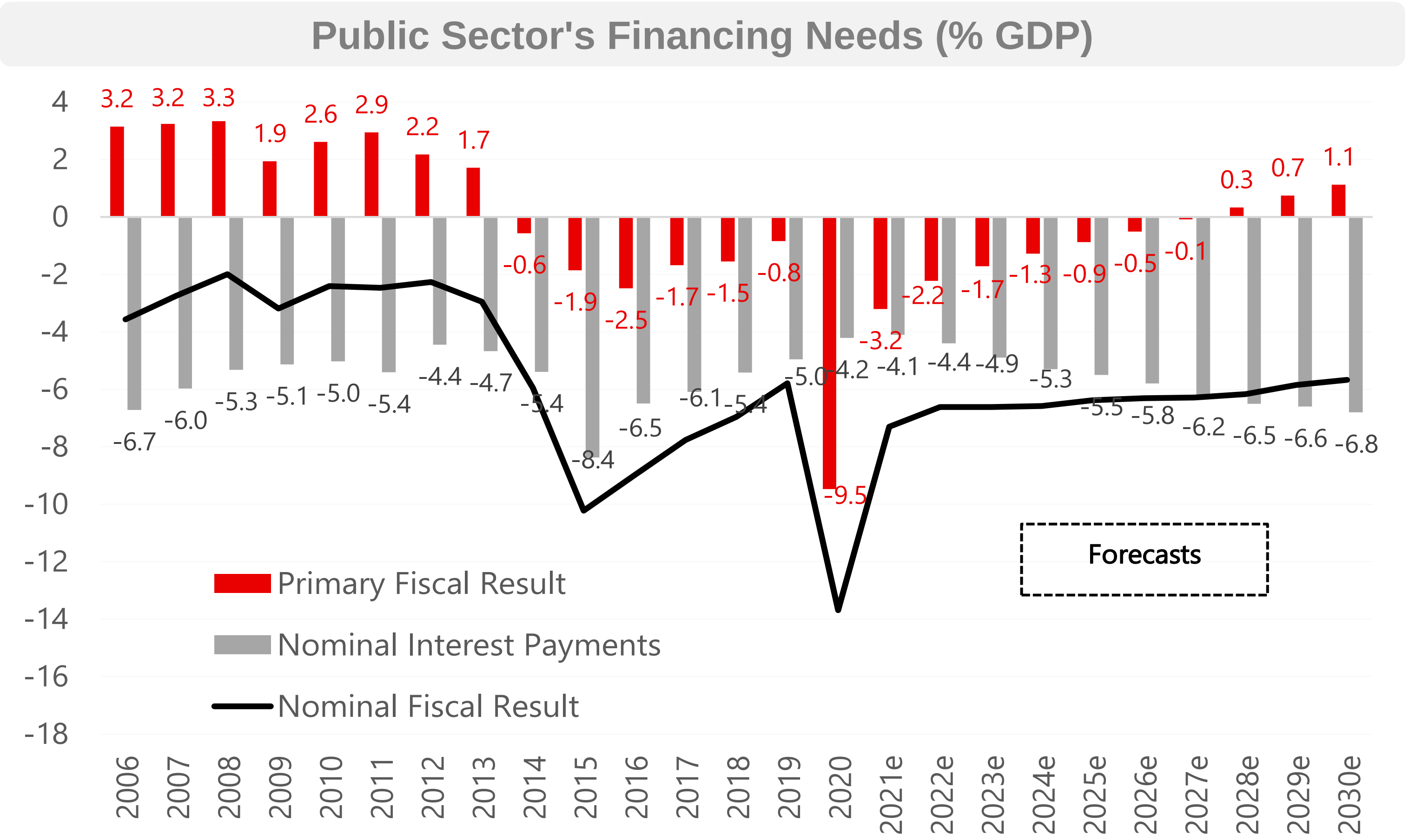
Sources: National Treasury, Santander.

Fiscal outlook and debt dynamics

04

Fiscal Balance – An Increase In Interest Payments After 2023

- We revised our nominal Selic rate to 7.0% from 6.0% in our last scenario revision (the neutral interest rate is now at 4.0% per year)
- This will contribute to increase the nominal deficit, specially after 2023.



Sources: National Treasury, BCB and Santander.

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Fiscal Accounts – Trajectories for the Brazilian Government Debt

- Public sector's primary balance (% GDP) required for the stabilization of the gross public debt-to-GDP ratio at **90%**
- The increase in the neutral interest rate hypothesis to 4.0% (from 3.0%) will increase the primary surplus required to stabilize the debt.
- The total fiscal adjustment needed to stabilize long term debt trajectory is 5.0% to GDP (from the 3.2% current deficit to a 1.8% steady-state surplus (the same size of the adjustment planned in 2016 during the approval of the spending cap).

- **Current cycle:**

. Real interest rate (ex-ante): ~0.5%,
. GDP is expected to grow 3.0% in 2021.

. Expected primary deficit (-3.2% of GDP) + BNDES payback should maintain the Gross/Debt virtually stable.

- **Steady-state:**

According to our hypothesis:
. Real interest rate at +4.0%
. Potential GDP at +1.8%,

. The primary surplus must reach +1.8% of GDP to maintain the gross debt stable.

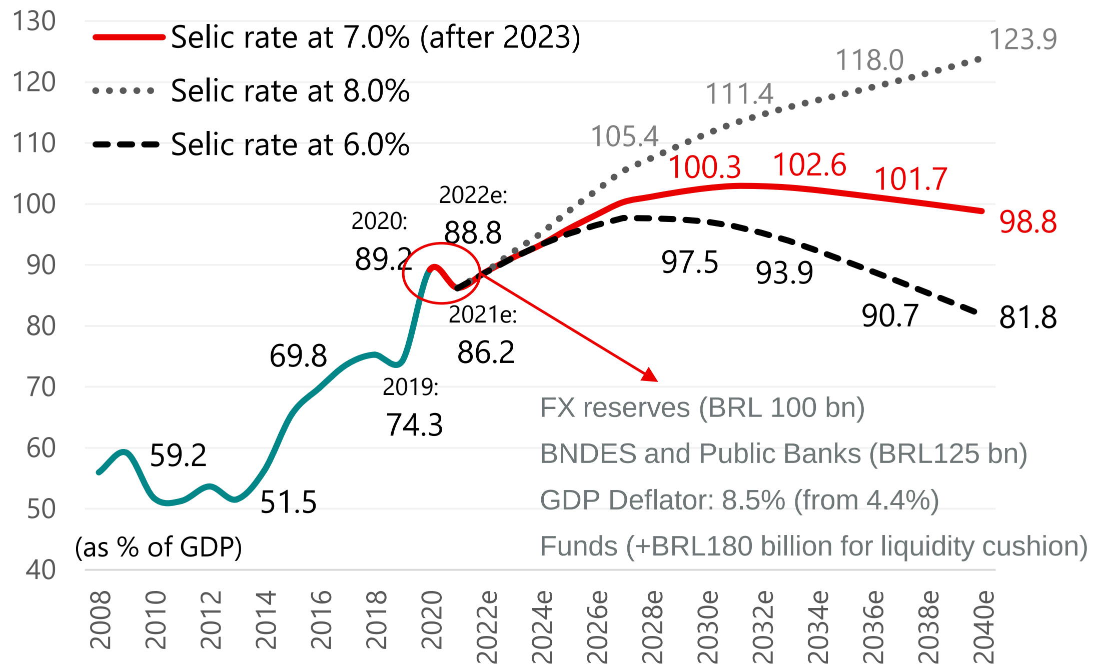
	Real Interest Rate							
GDP Growth	-1.0%	0.0%	1.0%	2.0%	2.5%	3.0%	4.0%	5.0%
1.0%	-1.8	-0.9	0.0	0.9	1.3	1.8	2.7	3.6
1.5%	-2.2	-1.3	-0.4	0.4	0.9	1.3	2.2	3.1
2.0%	-2.6	-1.8	-0.9	0.0	0.4	0.9	1.8	2.6
2.5%	-3.1	-2.2	-1.3	-0.4	0.0	0.4	1.3	2.2
3.0%	-3.5	-2.6	-1.7	-0.9	-0.4	0.0	0.9	1.7

Sources: BCB, Santander.

Debt Scenarios – sensitivity to small changes in the long run macro outlook

- **Increasing the odds of a fiscal dominance scenario (latent).** The spending cap lost part of its anchoring power (due to the inflation shock and extra-cap expenditures). In 2023, favorable conditions are expected to diminish: a favorable global scenario; debt issuance cost lower than the outstanding debt stock; and the depletion of parafiscal adjustment measures (BNDES, de-earmark public Funds, etc).
- Neutral interest rate and potential GDP outlook are extremely important for fiscal sustainability.

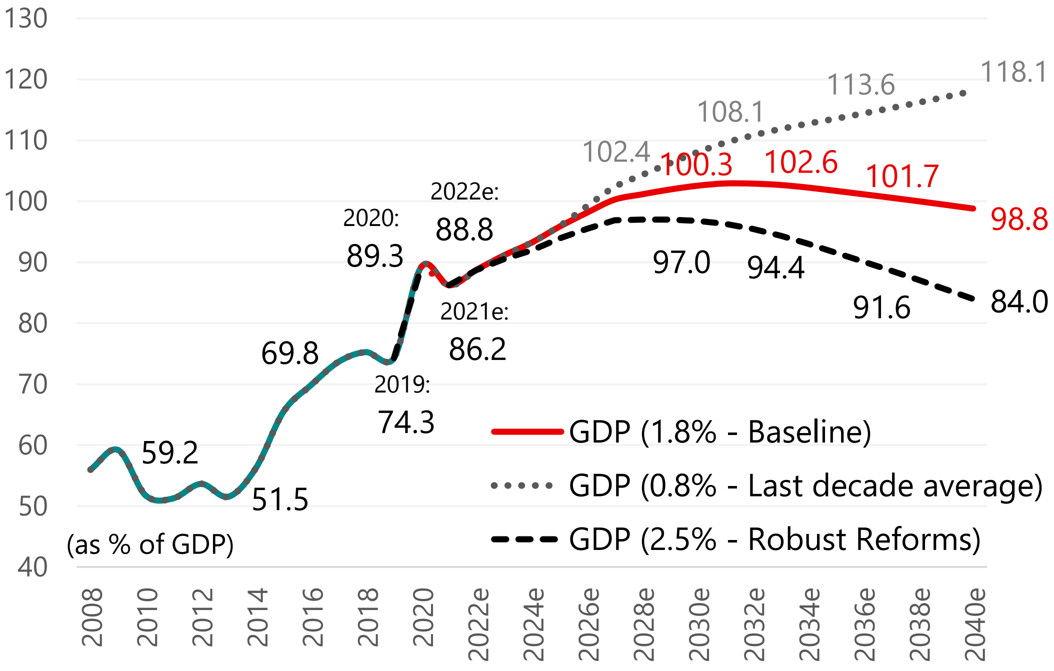
Government Debt – Simulations for Selic Rate Hypotheses



Sources: BCB, Santander

Debt issuances: we added a spread of + 1.0 pp in addition to the Selic rate in the models.

Government Debt– Simulating for Trend GDP Hypotheses

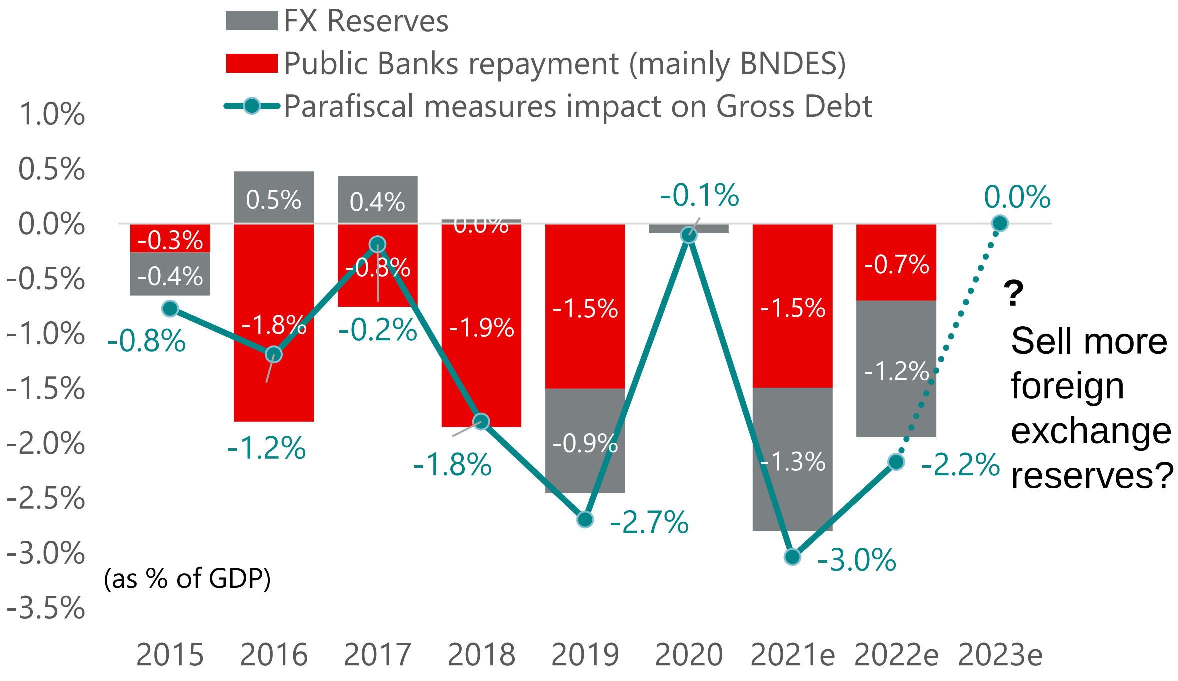


Sources: BCB, Santander.

Quasifiscal – the effects of these measures will weaken after 2023

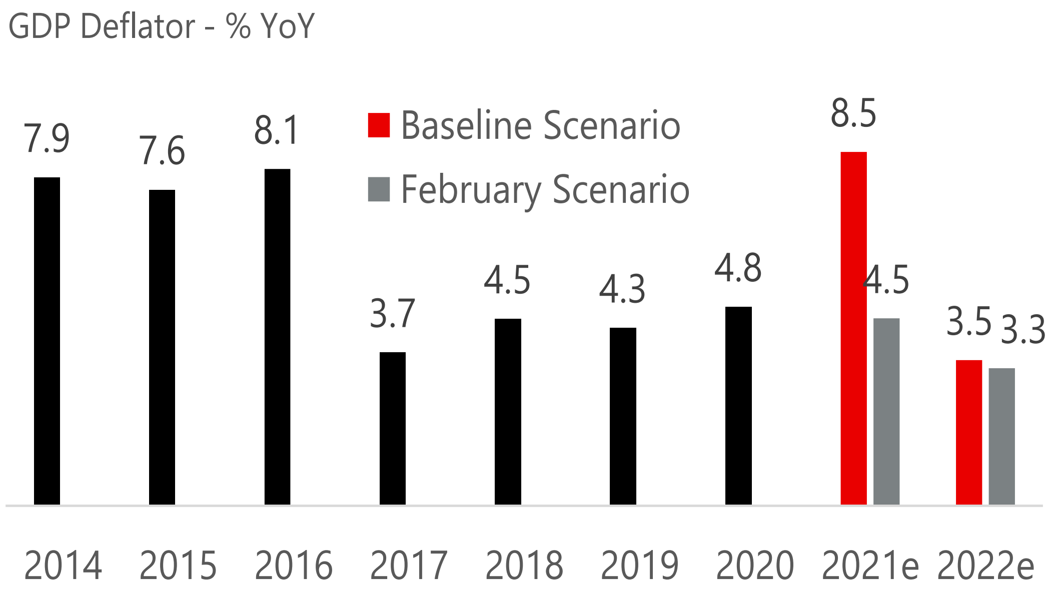
- BNDES is expected to repay the Treasury in BRL100 billion (it was paid already BRL38 billion) in 2021 and BRL55 billion in 2022.
- The Nominal GDP deflator (inflation shock) has also played an important role to reduce the Debt to GDP ratio.

Gross debt impact



Sources: BCB, BNDES, Santander

Nominal GDP – deflator increase

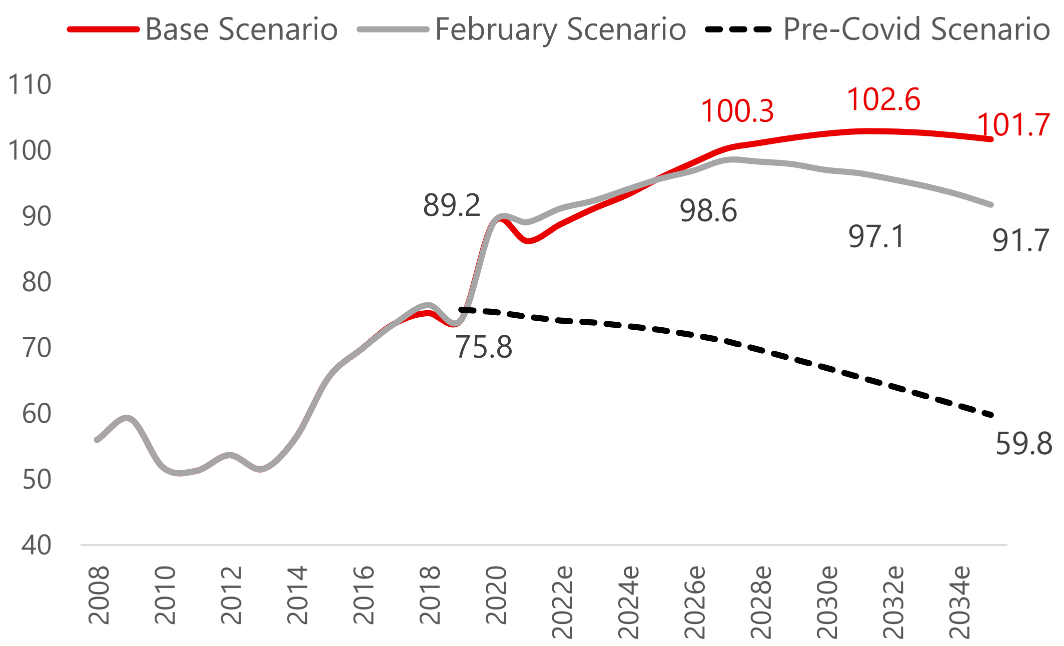


Sources: IBGE, Santander.

Fiscal Scenario - Brazil has the one of the largest Debt/GDP in EM countries

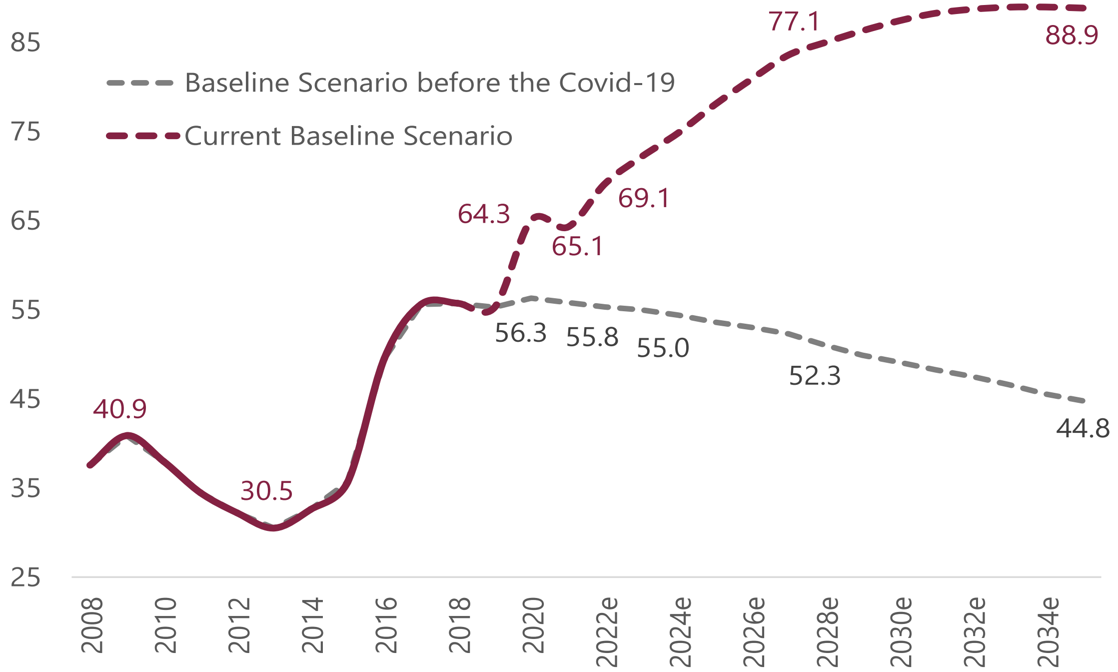
- Nominal GDP (denominator) accounts slightly shift down the debt numbers (-2p.p.) in 2020 —yet they do not change the challenging outlook.
- Net Debt is expected to continue to grow until reach and primary surplus in 2028 (in our scenario).

Gross Debt (% GDP)



Sources: National Treasury, IBGE, Santander.

Net Debt: Gross Debt – FX Reserves (% GDP)



Sources: National Treasury, IBGE, Santander.

The measures developments that would shape the outlook

- Beyond the question of vaccination, we believe certain measures and reforms are necessary to support the reduction of idiosyncratic risks. The fiscal agenda contains significant risks in its execution, in our view, so uncertainty will remain.

Positive Measures That Could Be Implemented	Potential Setbacks
Excluding the extra amendments and making more feasible the 2021 Budget law – maintaining the current fiscal framework	Possible creation of new mandatory expenses or removing from the spending cap limit
The new tax reform project, or CBS Law (Contribution on Goods and Services)	Permanent increases in the tax burden
Administrative reform	Approval of a new digital tax (CPMF)
Advances in the relevant privatizations and closing and selling Treasury dependent companies	Approval of federal measures that imply leniency or moral hazard with subnational fiscal adjustments
The continuity of the modernization of regulatory frameworks for infrastructure	Allocation of revenue not linked to public funds for other primary expenditures
A competitive auction for 5G for attracting investors	Paralysis of the reform agenda impacted by political disputes
Better pandemic management (more vaccines)	Salary increases for public servants
Reduce Tax exemption (4% of GDP)	Reduction in net revenue or greater transfers to states and municipalities

Source: Santander.

2021 Budget gridlock – A challenging adjustment

- Approximately BRL26 billion in mandatory expenses were shaved off (without a strong technical rationale) and reallocated in the amendments of the budget rapporteur
- The final deadline to come up with a solution to this stalemate is April 22, considering the possibility of presidential vetoes to the budget bill and later submission to Congress of a new proposal to rebalance the outlays allocated to lawmakers' projects.

Changes in expenditures – BRL billion

Description	LOA 2021 (1)	Bymonthly report (2)	Santander (3)	(2) - (1)	(3) - (1)
Social Benefits	690.9	712.9	710.4	22.0	19.5
Personal expenses	337.3	335.3	328.2	-2.0	-9.2
Wage Bonus and Unemployment Benefits	48.9	61.0	60.5	12.1	11.6
Social Assistance (BPC)	66.1	67.1	67.3	1.0	1.2
Extended Subsidies and proagro	8.5	13.6	12.4	5.1	3.9
RGPS - payroll tax break compensation	3.7	8.5	6.5	4.8	2.8
Kandir Law	4.0	4.9	4.9	0.9	0.9
Total	**1159.4**	**1203.3**	**1190.2**	**43.9**	**30.7**

Sources: Congress, Santander.

Summary of the gridlock in 2021 Budget

	Gov. Numbers	Santander Scenario
Adjust by parameters and new expenses (I)	20.4	12.0
Extra Amendments (II)	26.5	26.5
Necessary adjustment (I+II)	46.9	38.5
(-) Mantaining Wage Bonus payment in 2022 *	7.4	7.4
Adjustment without Wage Bonus	**39.5**	**31.1**
Contingency Reserve	35.1	35.1
Discretionary Expenses (no ammendments)	92	90

Sources: National Treasury, Santander.

(I) Most part is the necessity to correct the expenses by the inflation increase in 2H20. Another expense is the Tech Fund (FNDCT +BRL4.8 billion).

* The wage bonus (Abono) postponement to 2022 was legally approved by Codefat

2021 Budget gridlock – usually the 1st bimonthly report comes after the Final Budget

- The final budget reduced the mandatory outlays to include more lawmakers amendments and also did not adjusted by the final inflation numbers (considering the inflation shock in the 2H20). The minimum wage estimate in Aug-20 was BRL1,067, compared to BRL1,088 in the final numbers (considered in the Bimonthly report).

			2021e				
BRL billion	2019	2020	Budget Law Proposal (PLOA) - Aug-20	Bimonthly Treasury Report Mar-21	Final Budget law (LOA) - Mar-21	Santander estimates	Difference Santander - LOA
Total Revenue	1,635.1	1,467.8	1,560	1,643.6	1,595.4	1,616.9	21.5
Revenues Collected by the Federal Revenue Office	946.1	899.5	975.0	1,025.3	1,009.0	994.0	-15.1
Net Social Security Revenues	413.3	404.8	417.5	431.6	410.5	433.1	22.6
Revenues Not Collected by the Federal Revenue	275.7	163.6	167.6	186.7	175.9	190.8	14.9
Transfers by Revenue Sharing	288.3	263.8	276.9	298.6	293.9	286.7	-7.2
Net Revenue	1,346.8	1,203.9	1,283.2	1,345.0	1,301.5	1,331.2	29.7
Total Expenditure	1,441.8	1,947.0	1,517	1,571.3	1,517	1,605.8	89.0
Social Security Benefits	626.5	663.9	704.4	712.9	704.4	710.4	6.0
Payroll - Public Servants	313.1	321.3	337.3	335.3	337.3	328.2	-9.1
Other Mandatory Expenses	195.2	720.1	224.2	272.1	224.2	315.3	91.2
Mandatory Expenses with Cash Control	307.0	241.7	250.9	250.9	250.9	251.8	0.9
Discretionary Expenses	164.2	108.2	96.1	96.1	96.1	103.5	7.4
Central Government's Primary Balance	-95.1	-743.1	-233.6	-226.3	-215.3	-274.7	-59.4

Sources: Congress, Santander.

An important difference for our scenario is that the Emergency Aid budget (BRL44 billion) is not included in the Government's numbers. It was not included because the *PEC Emergencial* removed it from the fiscal framework restrictions.

Fiscal Baseline Scenario

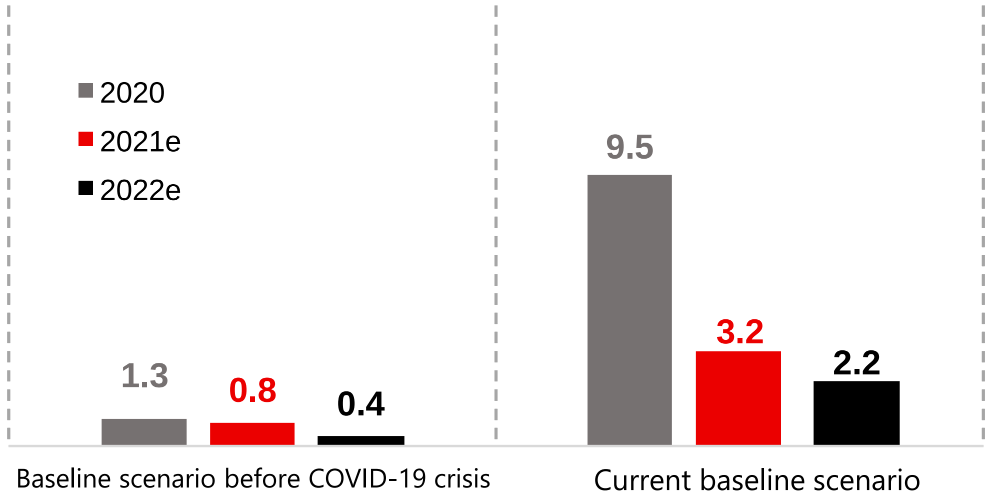
05

Fiscal Accounts – Public Sector's Primary Result

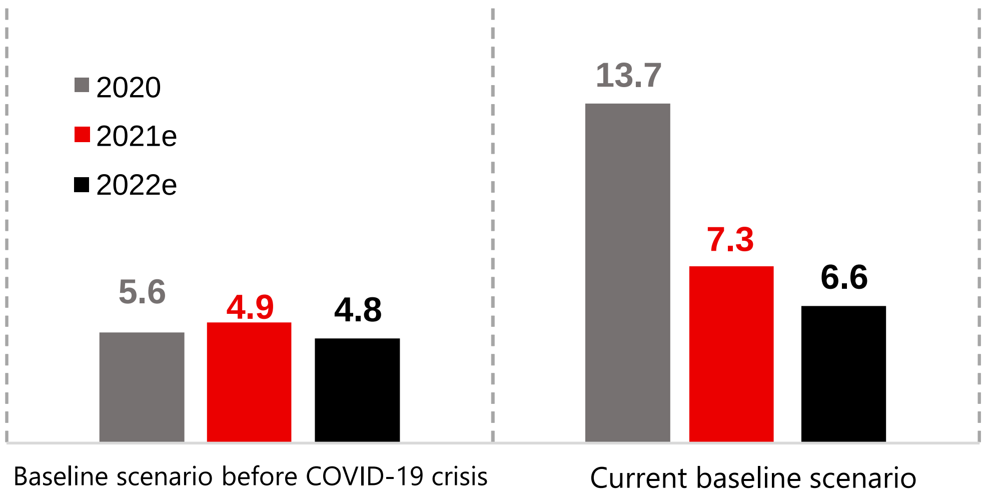
Public Sector's Primary Result in 2020, 2021 and 2022															
Fiscal Scenarios	GDP Growth (%)			Losses of Primary Revenue (BRL bn)			Expansion in Primary Spending (BRL bn)			Central Government's Primary Result (BRL bn)			Public Sector's Primary Result (BRL bn)		
	2020	2021e	2022e	2020	2021e	2022e	2020	2021e	2022e	2020	2021e	2022e	2020	2021e	2022e
Base Case Before the Pandemic	2.0	2.5	2.8	-	-	-	-	-	-	-105	-76	-45	-99	-68	-35
Current Base Case	-4.1	2.9	2.3	167	100	85	505	55	20	-745	-275	-200	-703	-265	-195

- Our baseline scenario considers the higher use of tax credit by private companies (ICMS exclusion of PIS/COFINS tax basis). In 2020, it totaled ~BRL170 bn, compared to BRL105 bn in 2019. We estimate this year could reach ~BRL150 billion. A higher use of tax credit remains a risk to the revenue forecasts (beyond the pace of activity recovery). We included a Refis program totaling BRL30 billion in 2021, related to pandemic tax breaks. We estimate a real increase of 5.0% in tax collection, after a drop of 6.9% in 2020. On the expenses side, the main risk are the extra-cap expenditures, which is currently estimated at BRL100 billion.
- Sources: National Treasury, BCB, Santander.

Public Sector's Primary Deficit (% GDP)



Public Sector's Nominal Deficit (% GDP)



 Sources: National Treasury, BCB, IBGE, Santander.

Central Government – Revenues and Expenditures

Central Government's Primary Balance														
Fiscal Items (% of GDP)	2017	2018	2019	2020	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Total Revenue	21.0	21.2	22.1	19.7	19.4	20.0	20.3	20.6	20.9	21.1	21.3	21.5	21.8	22.0
Revenues Collected by the Federal Revenue Office	12.7	12.9	12.8	12.1	11.9	12.3	12.5	12.6	12.7	12.8	12.9	13.0	13.0	13.1
Net Social Security Revenues	5.7	5.6	5.6	5.4	5.2	5.3	5.4	5.5	5.6	5.6	5.7	5.8	5.9	5.9
Revenues Not Collected by the Federal Revenue Office	2.6	2.7	3.7	2.2	2.3	2.4	2.5	2.5	2.6	2.7	2.7	2.8	2.9	3.0
Transfers by Revenue Sharing	3.5	3.7	3.9	3.5	3.4	3.5	3.5	3.6	3.6	3.7	3.7	3.8	3.8	3.9
Net Revenue	17.5	17.5	18.2	16.2	15.9	16.5	16.8	17.1	17.3	17.4	17.6	17.8	18.0	18.1
Total Expenditure	19.4	19.3	19.5	26.1	19.2	18.8	18.6	18.4	18.2	18.0	17.7	17.5	17.3	17.0
Social Security Benefits	8.5	8.4	8.5	8.9	8.5	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6
Payroll	4.3	4.3	4.2	4.3	3.9	4.0	3.9	3.9	3.8	3.8	3.6	3.5	3.4	3.3
Other Mandatory Expenses	3.0	2.9	2.6	9.7	2.8	2.7	2.7	2.6	2.6	2.5	2.4	2.4	2.3	2.2
Mandatory Expenses with Cash Control	3.7	3.8	4.1	3.2	4.0	3.5	3.3	3.2	3.2	3.1	3.1	3.0	2.9	2.9
Discretionary Expenses	1.8	1.8	2.2	1.5	1.3	1.5	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.3
Central Government's Primary Balance	-1.9	-1.8	-1.3	-10.0	-3.3	-2.3	-1.8	-1.3	-0.9	-0.6	-0.1	0.3	0.7	1.1
Nominal GDP (BRL billion)	6,585	7,004	7,407	7,448	8,354	8,811	9,284	9,763	10,267	10,796	11,353	11,939	12,555	13,203

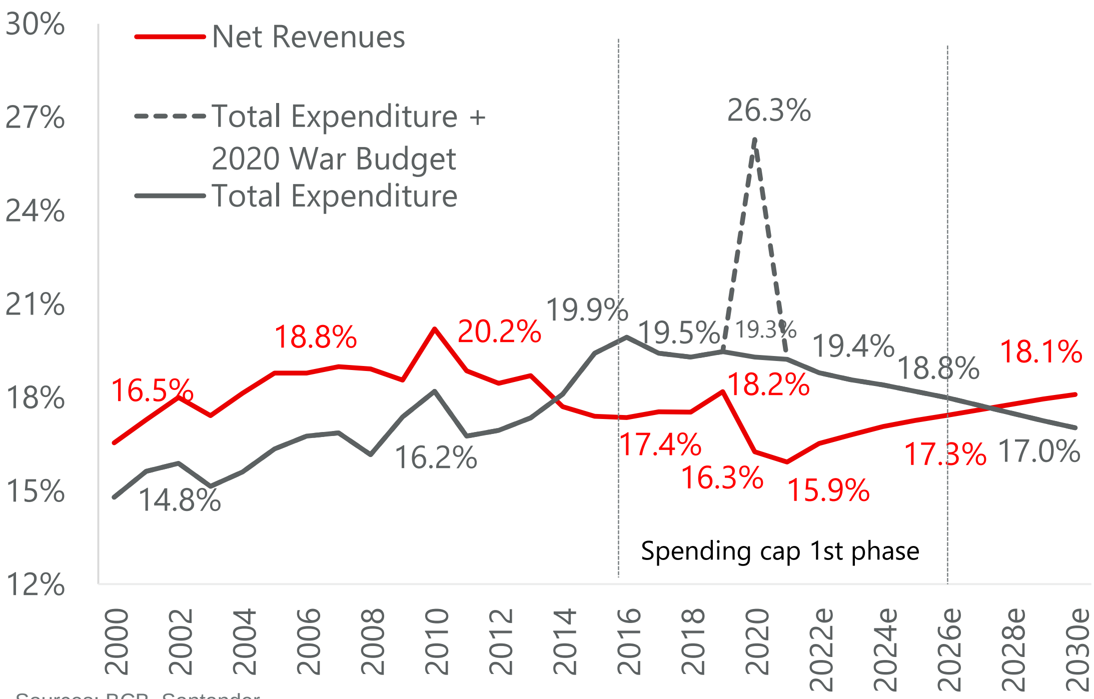
Sources: National Treasury, Brazilian Central Bank, Santander.

➔ **Main assumptions for the current baseline scenario:** our macro scenario for 2021 and 2022. **After 2023: (i)** Potential GDP growth = 1.8%; **(ii)** Neutral real interest rate = 4.0%; **(iii)** Long-term inflation = 3.25%; **(iv)** Compliance to the spending cap rule adjusted by inflation until 2030 **(v)** Structural reforms in 2023 to maintain the discretionary expenses close to 1.4% of GDP; **(vi)** Government will need to hire a lower number of public servants due to the digitalization of some public services**; (vii)** Pension reform will maintain the expenses almost stable in relation to GDP growth.

Central Government – Revenues and Expenditures

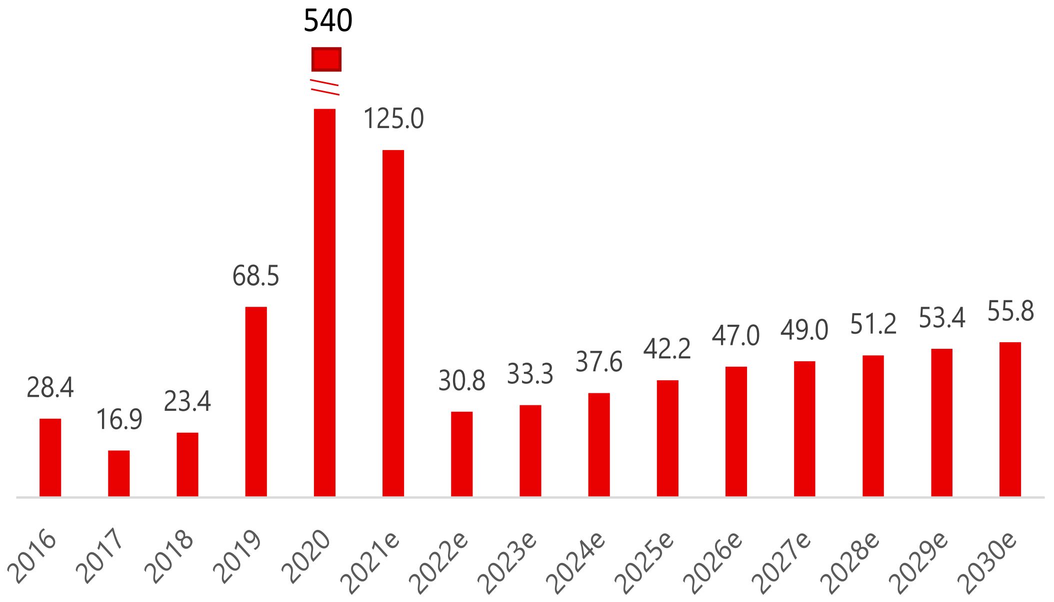
- According to the National Treasury the total COVID-19 expenses totaled BRL539.4 billion in 2020. In 2021 is reaching BRL100 billion.
- In 2020, considering the ordinary budget the total expenditure last year was almost stable at 19.3% of GDP (*Bolsa Família* included).

Central Government's Accounts (% GDP)



Sources: BCB, Santander.

Extra-cap expenditure (BRL billion)



Sources: National Treasury, Santander.

Includes: Covid-19 expenditures in 2020-21, Constitutional extra-cap expenditures (such as Education Fund – Fundeb). Oil auction in 2019.

Possible Fiscal Measures that could be implemented and its impacts

Rolling Impact of some fiscal measures (BRL billion)	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Revenues										
Limit on tax deductions (private health)	0	10.0	20.3	30.5	40.8	51.0	61.3	71.6	82.0	92.4
10% linear drop in tax exemptions / waivers	0	27.0	54.5	82.1	109.6	137.2	164.7	192.2	219.8	247.3
Changes in Personal Income Tax (Aliquot of 35% on earnings > BRL25k per month)	0	6.0	12.1	18.2	24.4	30.5	36.6	42.7	48.8	55.0
Profits & Dividends (Aliquot of 15%)	0	25.0	51.8	79.3	107.6	136.8	166.8	197.6	229.4	262.1
End of JCP payment deduction ("Interest on Equity Capital")	0	8.0	17.3	26.7	36.5	46.5	56.8	67.4	78.2	89.4
Exclusive Funds (one-off)	0	10	0	0	0	0	0	0	0	0
Inheritance/Donation Tax (Aliquot from 8% to 30%)	0	30.0	60.9	92.7	125.5	159.3	194.1	229.9	266.8	304.8
Expenditures										
Min. Wage De-indexation (social benefits)	0	23.0	46.7	71.1	96.2	122.1	148.8	176.2	204.5	233.7
Freezing of social security benefits (above 3 Min. Wag)	0	3.5	7.3	7.3	7.3	7.3	7.3	7.3	7.3	7.3
End of Wage Bonus 'Abono' (for formal workers)	0	17.0	34.5	52.5	71.1	90.3	110.0	130.3	151.2	172.7
End of Wage Bonus 'Abono' (above 1 Min. Wage)	0	8.0	16.2	24.7	33.5	42.5	51.7	61.3	71.1	81.3
Payroll tax exemption	6.4	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Public sector wage ceiling	0	3.2	6.5	9.9	13.4	17.0	20.7	24.5	28.5	32.5
Extending the grace period for the unemployment insurance benefit	0	12.0	24.4	37.1	50.2	63.7	77.6	91.9	106.7	121.9
Reduction of public servants' working hours and wages (up to 25%)	0	10.0	20.3	30.9	41.8	53.1	64.7	76.6	88.9	101.6

Source: Santander.

Another possibility is the sale of public companies dependent on the National Treasury, which could generate extra BRL10 billion (one-off) in revenues, in addition to reducing expenses to maintain them.

Fiscal Risks – size of the fiscal stimulus and leftovers

- The total size of the War budget totaled BRL524 billion.
- For 2021, the leftovers (not subjected to the spending cap rule) from 2020 War Budget reached BRL37.9 billion

2020 War Budget Fiscal Measures (BRL billion)

Accumulated	Dec-20	Budget	Executed
Formal Employment program (MP 935)	33.5	51.5	65.0%
Bolsa Família expansion (MP 929)	0.37	0.37	100.0%
Emeregency Aid (MP 937)	**293.1**	322.0	**91.0%**
Transfers to regional governments (MP 939)	78.3	79.2	98.8%
Credit for payroll (MP 943)	6.8	6.8	100.0%
Energy Sector (MP 950)	0.9	0.9	100.0%
Ministry of Health and others	**44.9**	50.8	**82.4%**
Guarantees for credit measures (MP 977)	58.1	58.1	100.0%
Financing of Tourism Infrastructure (MP 963)	3.1	5.0	61.6%
Emergency Credit Program - "Maquininhas"	5.0	10.0	50.0%
Vaccine Acquisition	0.0	20.0	0.1%
Total	524.1	604.7	86.2%

Updated until 01/05/2021

Sources: National Treasury, Santander.

2021 – Extra-cap fiscal expenditure

BRL Billion - Accumulated	Jan-21	Feb-21	Mar-21	Apr-21	Budget	Executed
Bem - Employment Program (MP 935)	0.4	0.4	0.4	0.5	4.5	11.2%
Emergency Aid (MP 937)	**0.3**	0.4	0.7	6.7	**44.9**	**14.8%**
Ministry of Health and Others	**1.3**	1.5	3.7	4.0	**11.7**	**34.0%**
Turism Infraestructure (MP 963)	0.1	0.1	0.4	0.4	1.9	19.8%
Vaccine Acquisition	0.1	0.7	3.5	4.0	22.3	17.8%
Accumulated Total	2.2	3.0	8.6	15.5	85.2	18.2%

Updated until 04/12/2021

Includes Leftovers of War Budget (*Restos a pagar*)

Sources: National Treasury, Santander

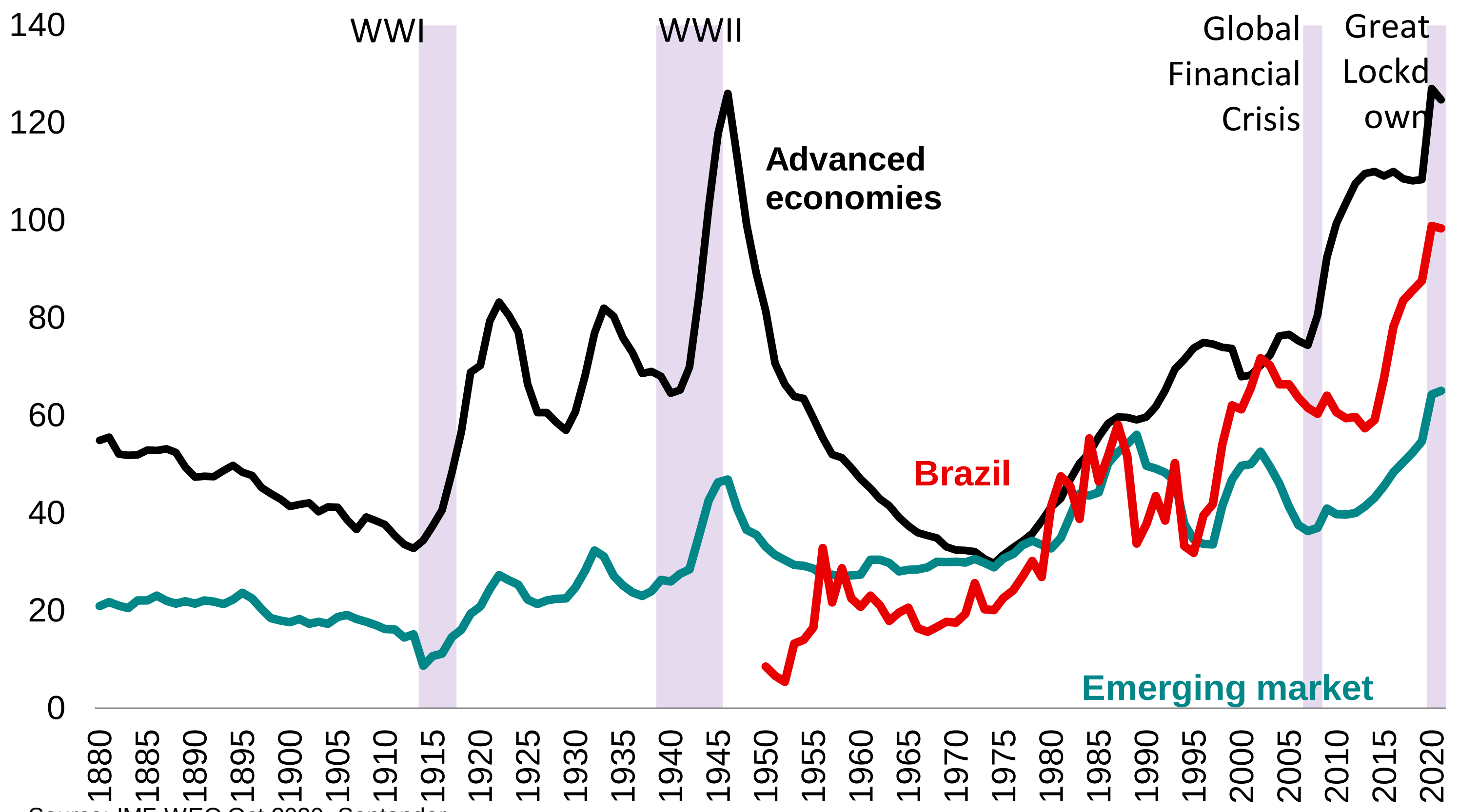
Fiscal background and risks

06

Brazilian gross debt approaches the level of advanced countries – International Comparison

- Brazilian government finances registered an unprecedented deterioration in 2020, affected by the government's measures to mitigate the economic and health effects of the pandemic.

Historical Patterns of General Government Debt (% GDP)

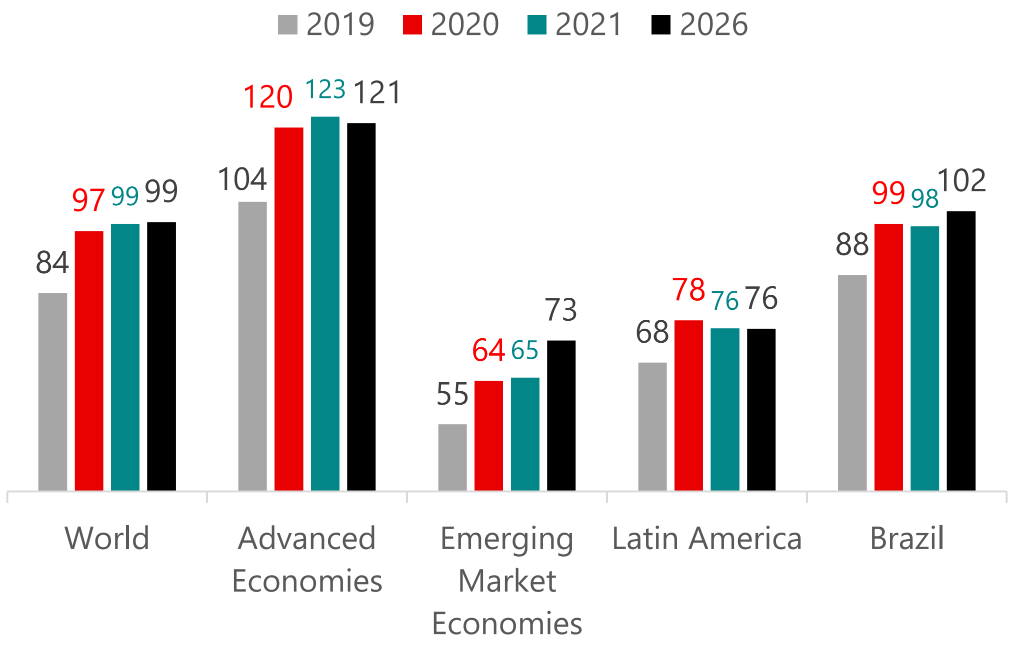


Source: IMF WEO Oct 2020, Santander
*Brazil we used th e IMF metodology

Fiscal Monitor – IMF Scenario

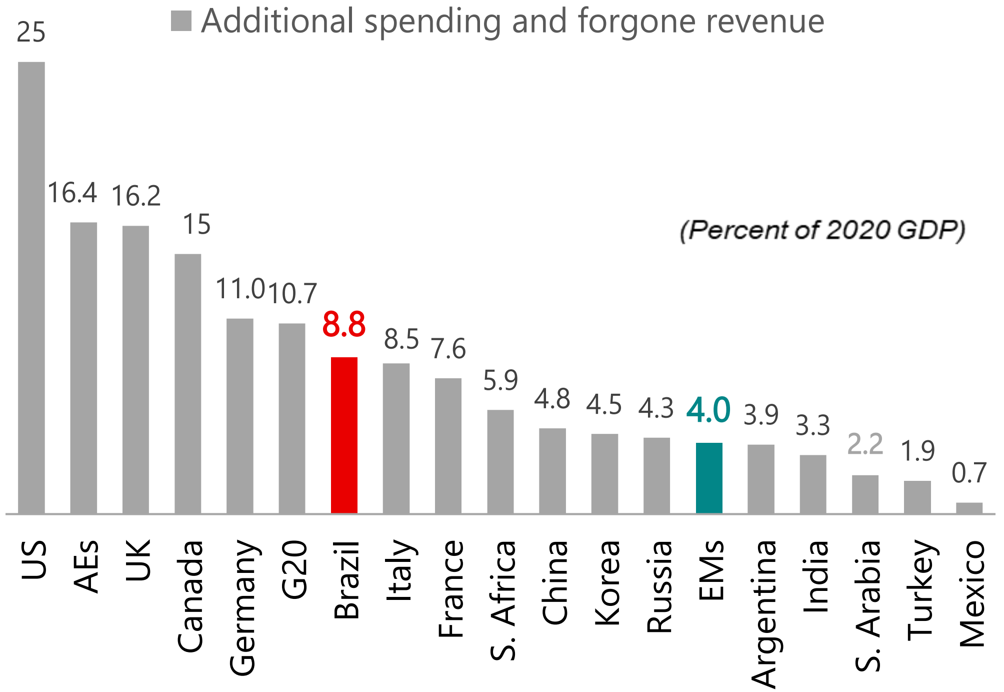
- According to data from both 2020 and 2021, Brazil's fiscal stimulus reached 8.8% of GDP, higher than the 4.0% of GDP for the average of emerging economies (EM).
- In short, the fiscal outlook presented by the IMF is close to our fiscal scenario and reinforces the importance of both measures and reforms to guarantee the credibility of the fiscal consolidation.

IMF Gross Debt Forecasts (% GDP)



Sources: IMF, Santander.

Fiscal Stimulus in 2020-21



Sources: IMF, Santander.

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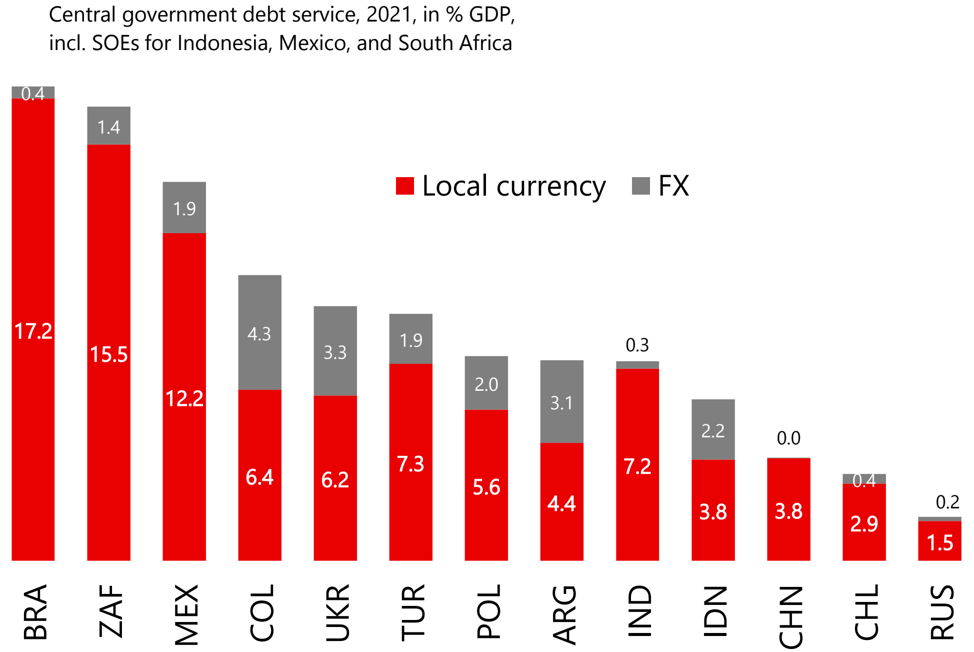
Fiscal Risks – elevated financial needs

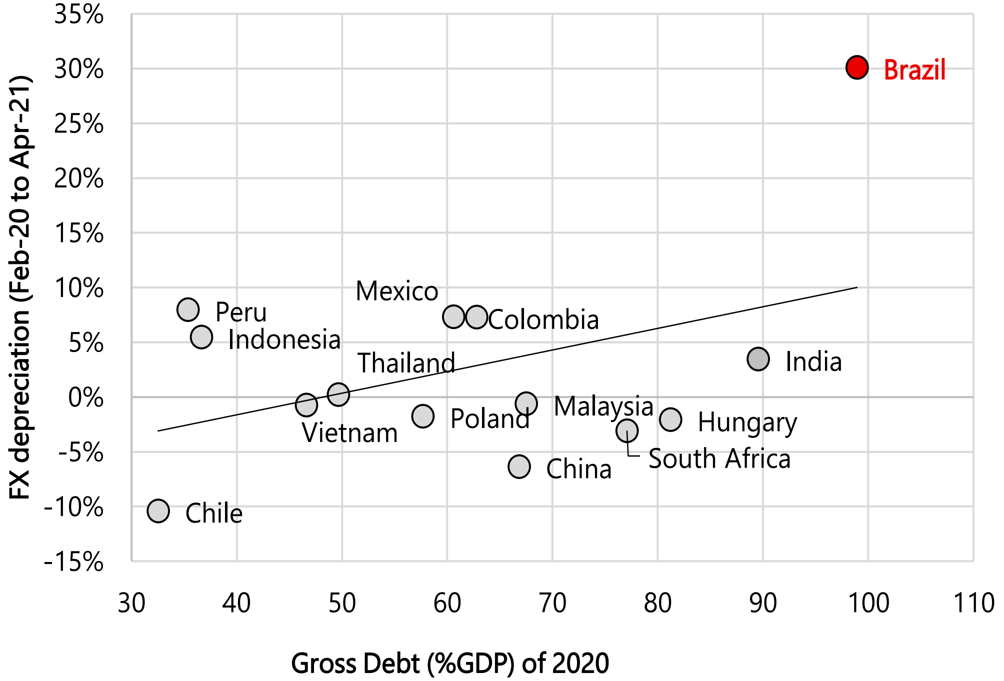
- Brazil has one of the largest gross debts among emerging countries and has significant financing needs.

Financing needs in 2021 – (% GDP)



Sources: IIF, Santander.

Higher Debt and the effect on FX rates



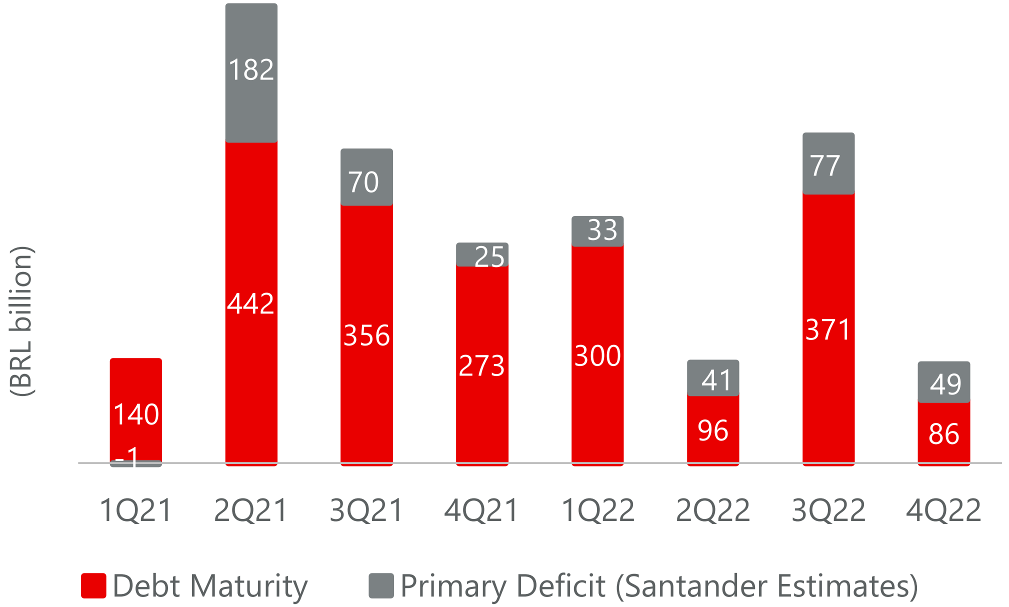
Sources: IIF, Santander

Jonathan and Sergi (2021)
IIF: Economic Views – EM Public Financing Needs (Feb 02, 2021)

Fiscal Scenario – The debt is at a higher level and with a shorter maturity

- Although the liquidity cushion of the treasury is BRL933 billion (covering debt rollover up for seven month), the amount of the year will exceed BRL1.21 trillion. An easy in the fiscal framework implies in a significant risk for the government debt management.

Debt maturity and Primary Deficit

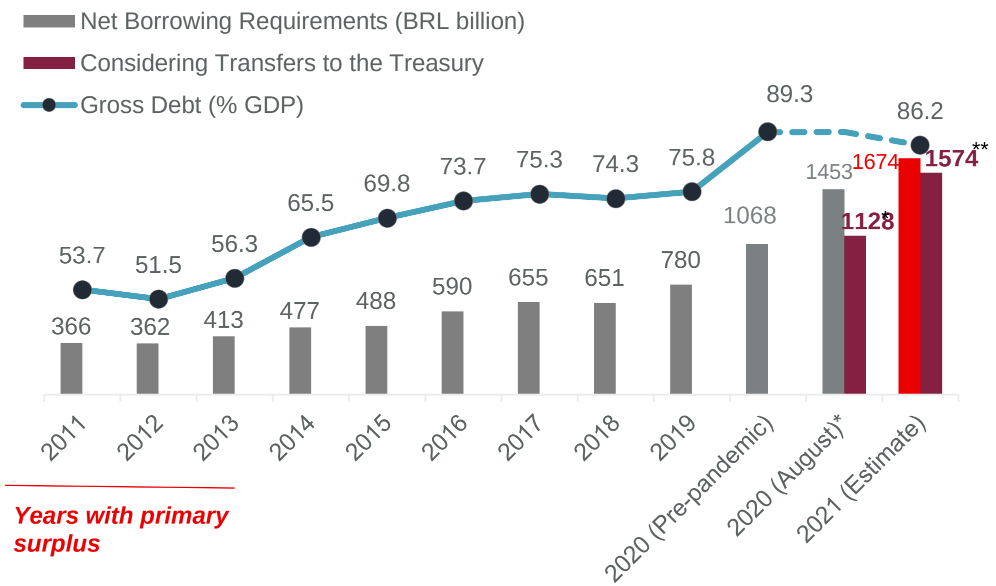


We anticipated the Wage and Pension bonus (BRL60 bn) to the 2Q21 –

Fiscal Stimulus without annual impact

Sources: National Treasury, Santander.

Net Borrowing Requirements and Gross Debt



* Transfer of Central Bank to the Treasury (BRL325 billion), allowed by law nº 13,820/2019

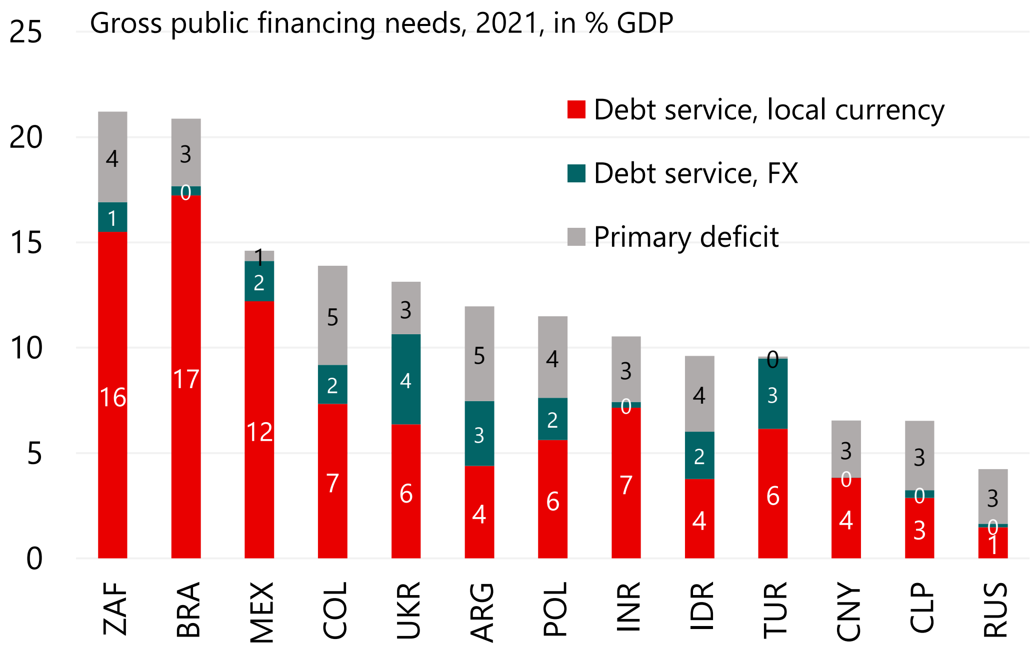
** BNDES transfer of BRL100 bn to the Treasury

Sources: National Treasury, Santander.

Financing needs have risen and probably the EM countries will increase rates

- Fiscal deficits in emerging markets swelled last year.
- Brazil and South Africa are the most vulnerable on all fronts, and need large cuts by the standards of past fiscal adjustments.

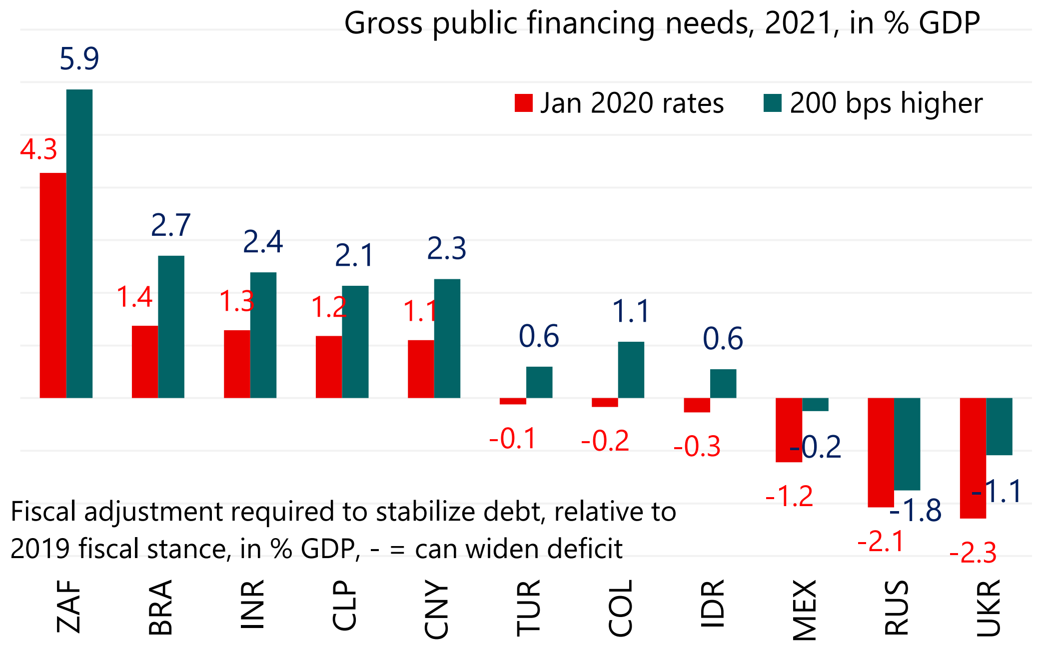
Gross financing needs have risen



Sources: IIF, Santander.

Jonathan and Sergi (2021)
IIF: Economic Views – EM Fiscal Vulnerability (Mar 09, 2021)

Higher rates would wipe out fiscal space



Sources: IIF, Santander

Jonathan and Sergi (2021)
IIF: Economic Views – EM Fiscal Vulnerability (Mar 09, 2021)

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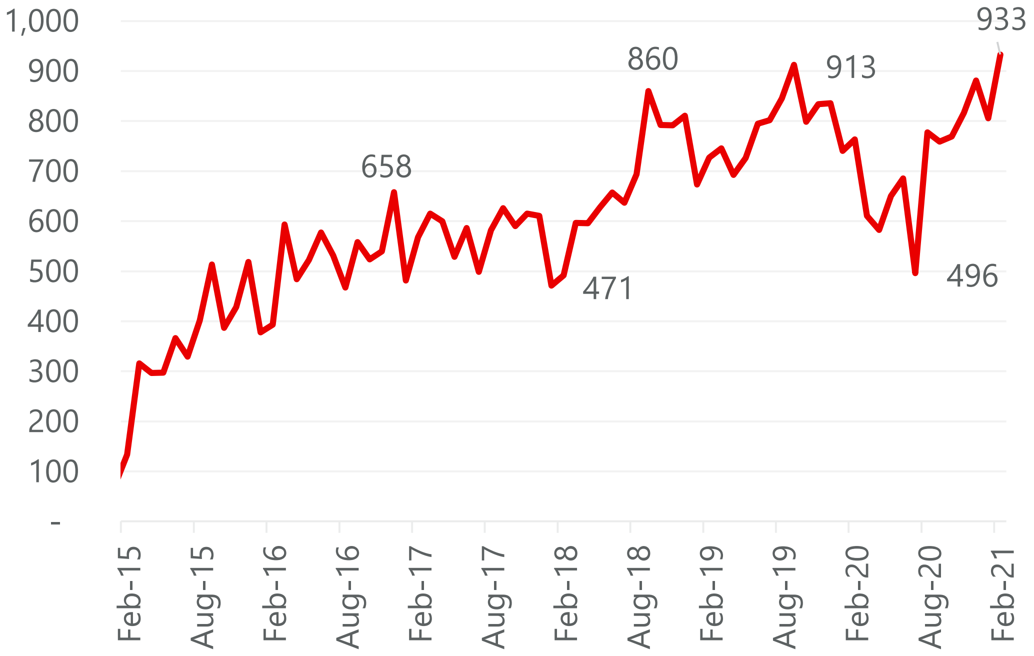
Treasury’s cash position improved in the last few months with larger auctions

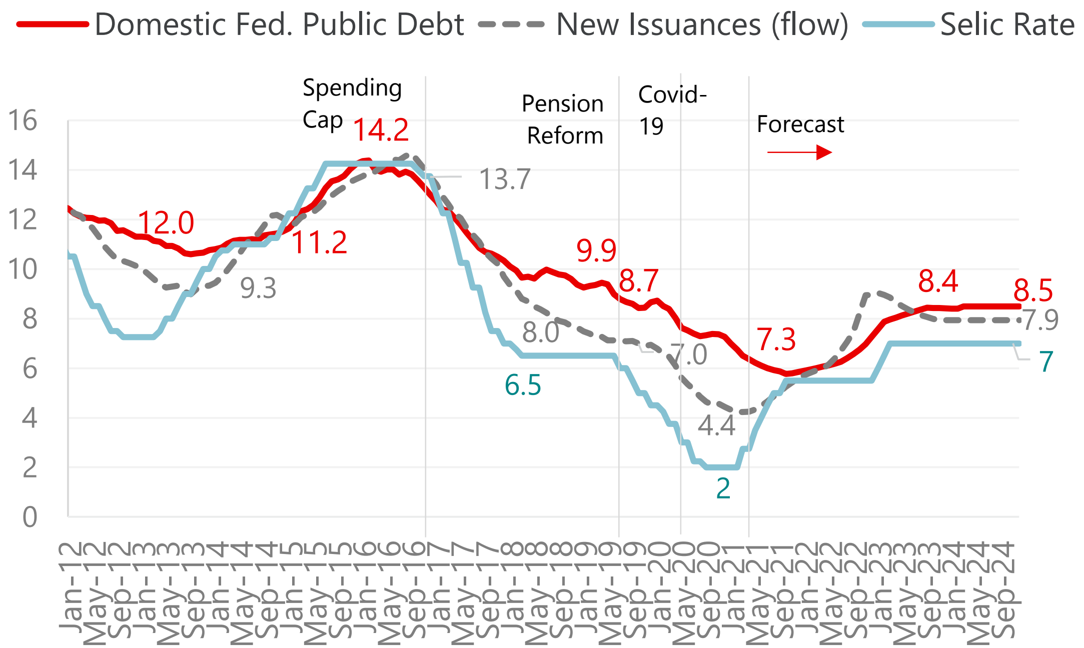
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels..

Cash “Liquidity Cushion”



Sources: National Treasury, Santander.

Average cost of Federal Debt - 12 months – (%)

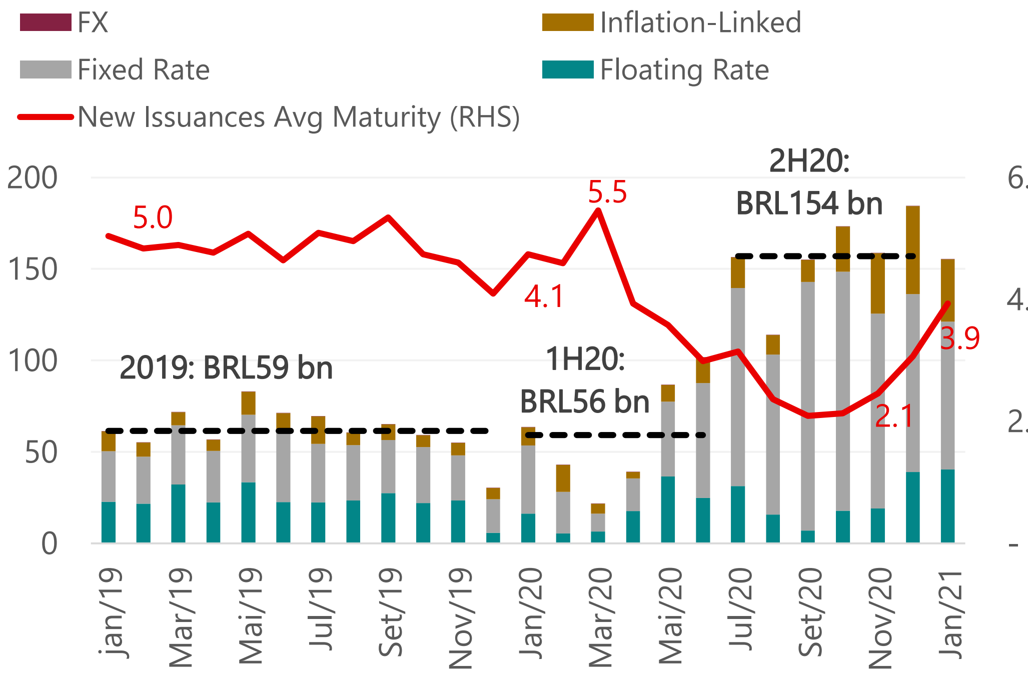


Sources: National Treasury, Santander.

Fiscal – the increase in Selic rate will pressure the debt issuances

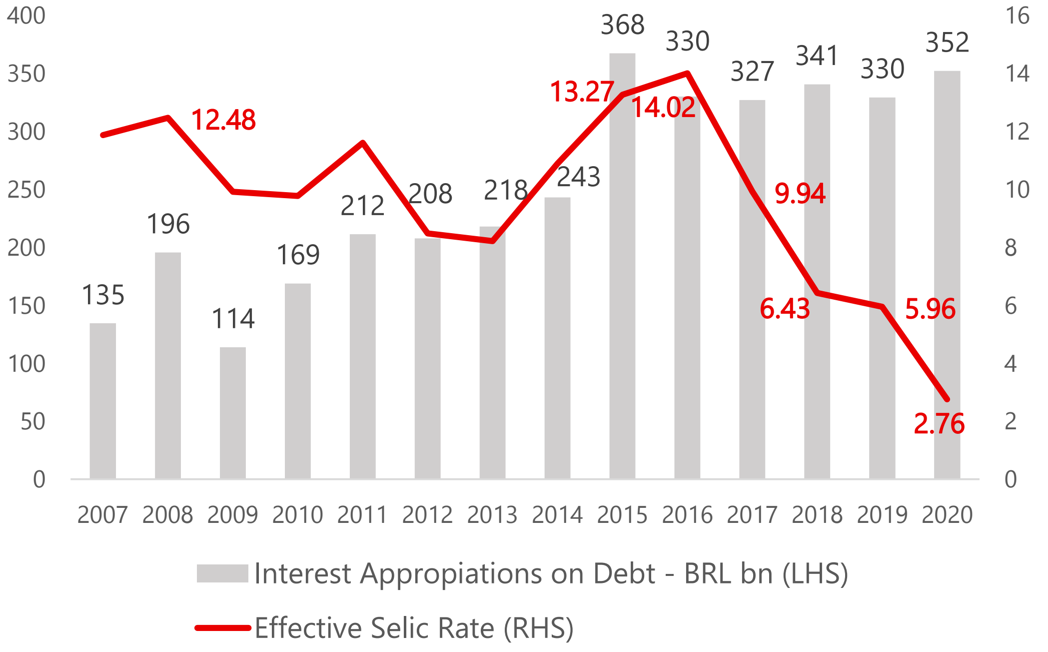
- Market conditions will be important for new debt issuances. The necessity of issuances in 2021 is ~BRL30 billion per week.

Treasury Issuances



Sources: National Treasury, Santander

Selic Rate and Debt



Sources: National Treasury, Santander.

MACRO SCENARIO: FORECASTS

Macroeconomic variables		Previous		Current
GDP (%)	2021E	2.9	↑	3.0
	2022E	2.3	↓	2.0
	2023E	1.8	→	1.8
IPCA (%)	2021E	3.6	↑	5.0
	2022E	3.2	↑	3.7
	2023E	3.3	→	3.3
Selic Rate (% end of period)	2021E	4.00	↑	5.50
	2022E	4.50	↑	6.00
	2023E	6.00	↑	7.00
FX Rate - USDBRL (end of period)	2021E	5.20	↑	5.25
	2022E	5.40	↑	5.55
	2023E	5.20	→	5.20
Current Account Balance (% of GDP)	2021E	1.2	→	1.2
	2022E	0.5	→	0.5
	2023E	-0.2	→	-0.2
Primary Fiscal Balance (% of GDP)	2021E	-3.1	↓	-3.2
	2022E	-2.2	→	-2.2
	2023E	-1.5	↓	-1.7
Gross Public Debt (% of GDP)	2021E	89.1	↓	86.2
	2022E	91.2	↓	88.8
	2023E	92.4	↓	91.2

- For our latest Scenario Review 'ANCHORING POWER IS DWINDLING' (sent on April 1, 2021).
- **Click on the link:** http://bit.ly/Std-scenario-Apr21

Sources: IBGE, FGV, The National Treasury Secretariat, BCB and Santander.

Thank you.

Our purpose is to help people and businesses prosper.

Our culture is based on believing that everything we do should be:

Simple Personal Fair

Santander

Brazil Macroeconomic Research Team

Ana Paula Vescovi
Chief Economist
anavescovi@santander.com.br
+55 (11) 3553-8567

Mauricio Oreng
Head of Research & Strategy
mauricio.oreng@santander.com.br
+55 (11) 3553-5404

Jankiel Santos
Economist – External Sector
jankiel.santos@santander.com.br
+55 (11) 3012-5726

Ítalo Franca
Economist – Fiscal Policy
italo.franca@santander.com.br
+55 (11) 3553-5235

Tomas Urani
Economist – Global Economics
tomas.urani@santander.com.br
+55 (11) 3553-9520

Daniel Karp Vasquez
Economist - Inflation
daniel.karp@santander.com.br
+55 (11) 3553-9828

Lucas Maynard
Economist – Economic Activity
lucas.maynard.da.silva@santander.com.br
+55 (11) 3553-7495

Felipe Kotinda
Economist - Credit
felipe.kotinda@santander.com.br
+55 (11) 3553-8071

Raissa Freitas
Business Manager
raifreitas@santander.com.br
+55 (11) 3553-7424

Gilmar Lima
Economist – Modeling
gilmar.lima@santander.com.br
+55 (11) 3553-6327

Gabriel Couto
Economist – Special Projects
gabriel.couto@santander.com.br
+55 (11) 3553-8487

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