Santander

Brazil Macro | July 2021

FISCAL POLICY

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

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01

Brief Overview

Summary - A Better Short Term, Caution on the Outlook

- We are "upgrading" our fiscal estimates due to a more persistent price shock (inflation and terms of trade). The primary deficit was revised to 1.9% of GDP in 2021 (from 3.0% of GDP) owing to "price help" on the revenue side. We are lowering our gross debt forecast for this year to ~82% of GDP.

- We still view the medium-term fiscal outlook with some caution and with significant risks for the fiscal consolidation process. Our fiscal numbers show significant sensitivity with respect to the duration of the commodity boom. In our scenario, the first key issue is that we believe that this recent price shock will be temporary, with the positive effect on revenue (and GDP deflator) fading in the coming period.

- Another important inflationary effect is that the constitutional spending cap has lost its capacity to add to the fiscal consolidation process, as compliance with the fiscal rule up to 2026 is now easier than before this recent price shock. We see the fiscal rule as a necessary but not sufficient condition to assure consistent fiscal consolidation. This is especially true if favorable macroeconomic conditions are no longer maintained.

- In our view, any additional shock that raises the neutral interest rate or reduces potential GDP growth could derail the expected debt convergence, given the limited room for a primary surplus much higher than 2% of GDP in the long term. Additionally, approving tougher fiscal measures seems increasingly challenging.

Fiscal background – Price shock impact

02

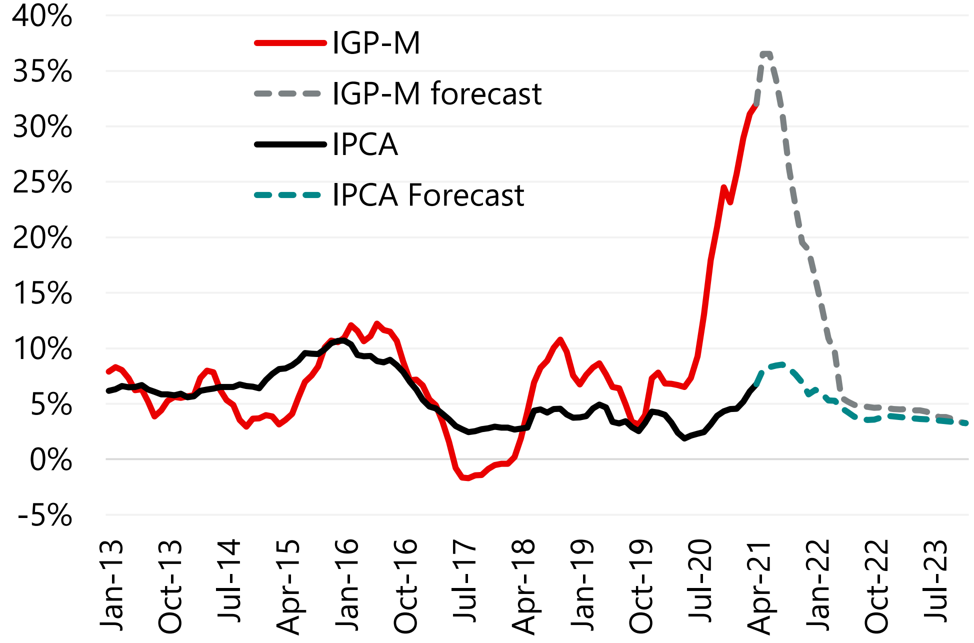
- On June 15, we published a report in which we explored the main impacts on the fiscal accounts by analyzing the pandemic's impact and the current favorable price shock effect (inflation and terms of trade), as well as discussing our outlook.

Click on the link: http://bit.ly/Std-special-fiscal-061521

Background – Inflation Shock and Activity Recovery in 2021

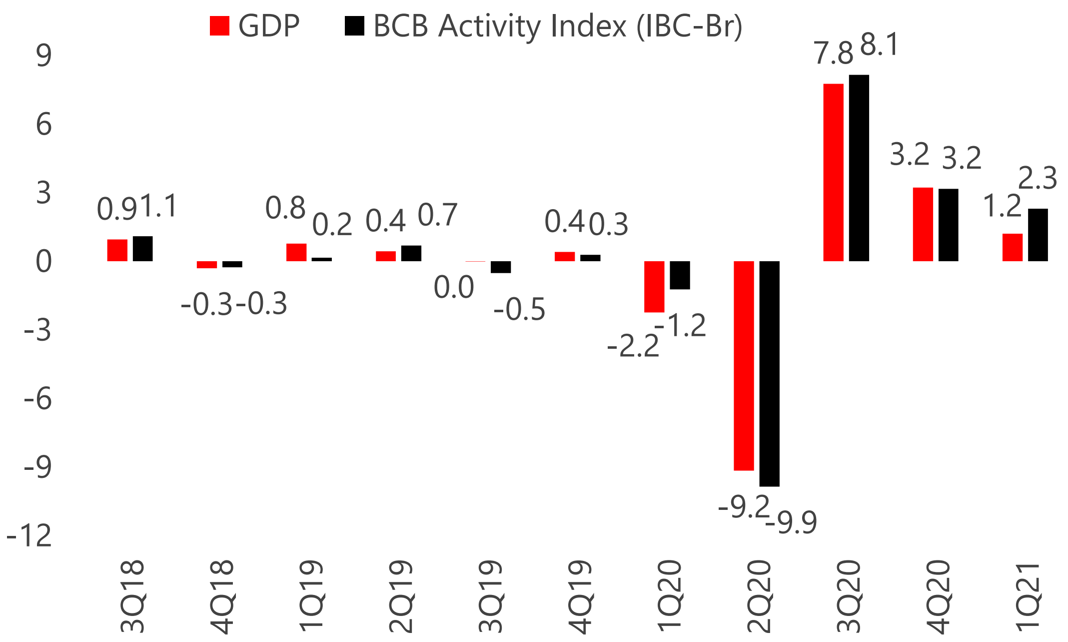
- We raised our 2021 GDP estimate to 5.1% from 3.6% following solid 1Q21 GDP growth and a more rapid recovery in mobility. In our view, the outlook for 2H21 has improved due to heightened expectations regarding the pace of economic reopening and support from higher commodity prices. The lingering positive effects from strong raw materials prices in conjunction with the outlook for a fully operational economy also motivated our upward revision for 2022 GDP to 2.0% from 1.5%.Inflationary shocks from the global recovery became more permanent and raised our forecasts.

Inflation – IGP and IPCA



Sources: FGV, IBGE, Santander.

GDP vs IBC-Br (sa, % QoQ)

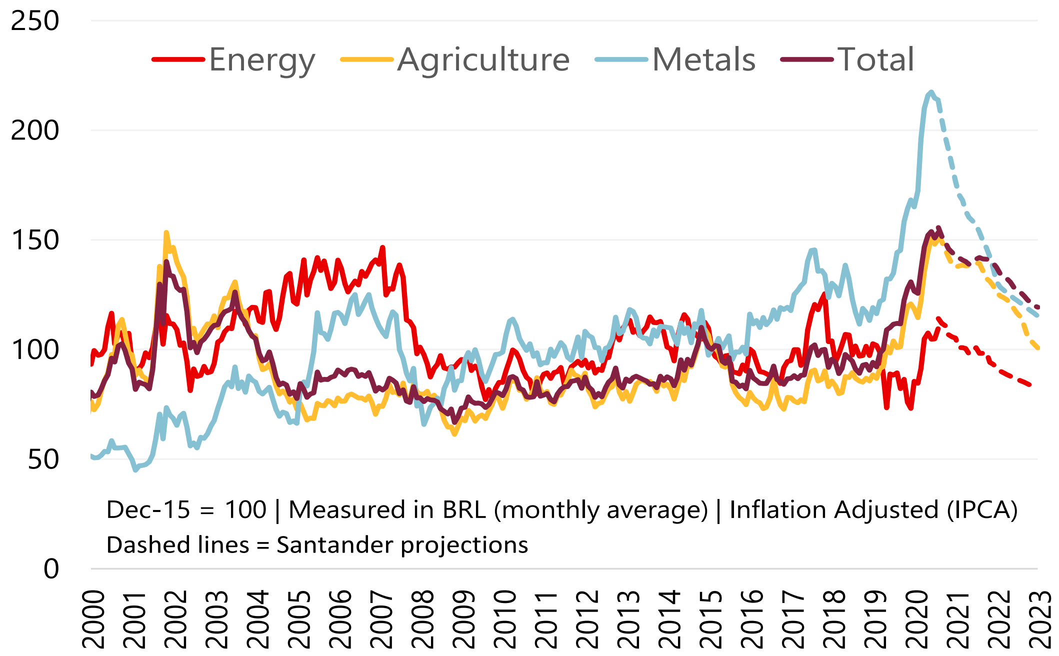


Sources: BCB, IBGE, Santander.

Background – Commodity Boom and Rise in Terms-of-Trade

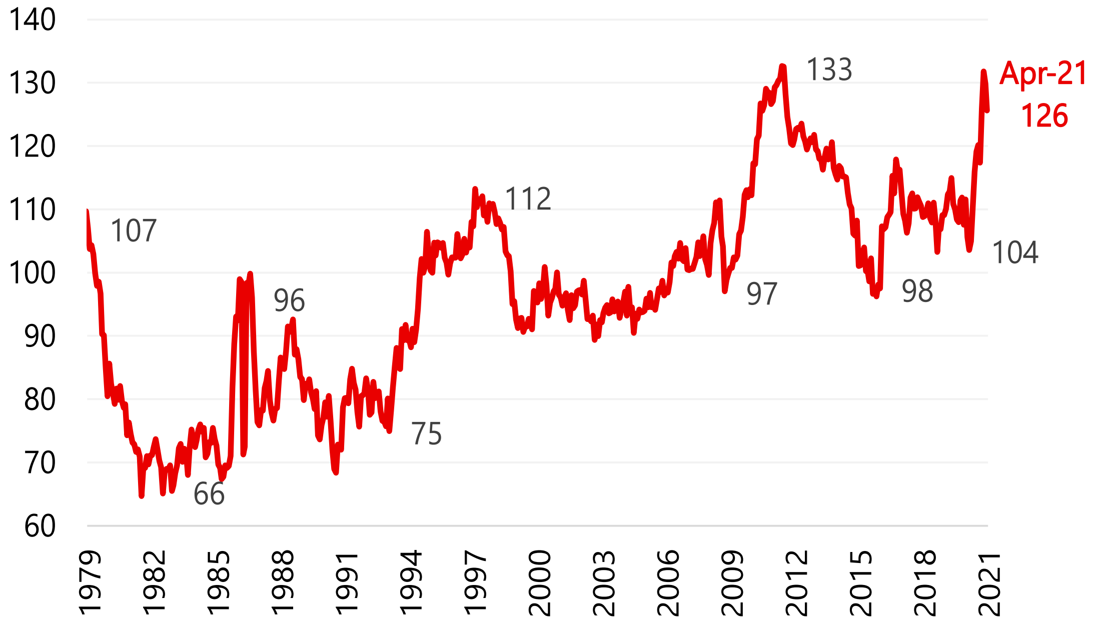
- The fact that the greater gain in terms of trade accompanies higher commodity prices helps to increase revenue for the largest companies related to the sector. It is important to emphasize that Brazilian GDP has a strong positive correlation with the commodity cycle, so the cycle's duration will be a key factor to observe. In our view, it will tend to cool down until 2023, which gives the government time to promote structural changes on the fiscal front.

CRB Commodity Index



Sources: Bloomberg, Santander.

Terms-of-Trade Index

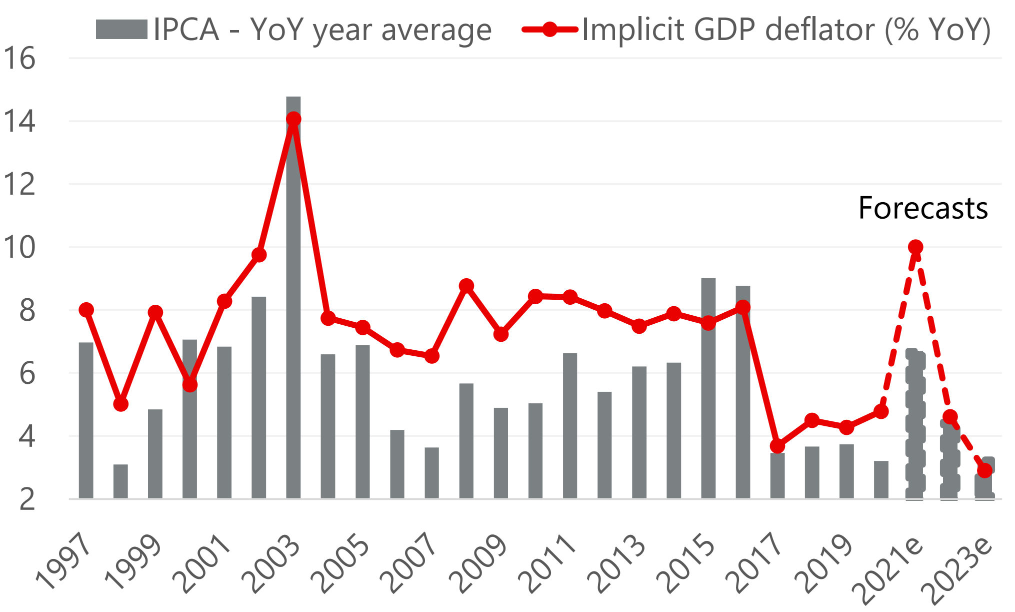


Sources: FUNCEX, Santander.

GDP Deflator Impact – Terms-of-Trade and Inflation Shock Effect

- One of the main effects of both higher inflation and activity recovery is higher nominal GDP, which consequently affects the debt-to-GDP ratio. At the beginning of the year, we estimated that nominal GDP would increase by 7% in 2021; our latest tracking points to a ~15% increase. The main effect was on the GDP deflator, which went from 4.0% to 10.0%, closely related to the commodity shock and an increase in the IPCA forecast from 3.6% (February) to 6.7% (July).

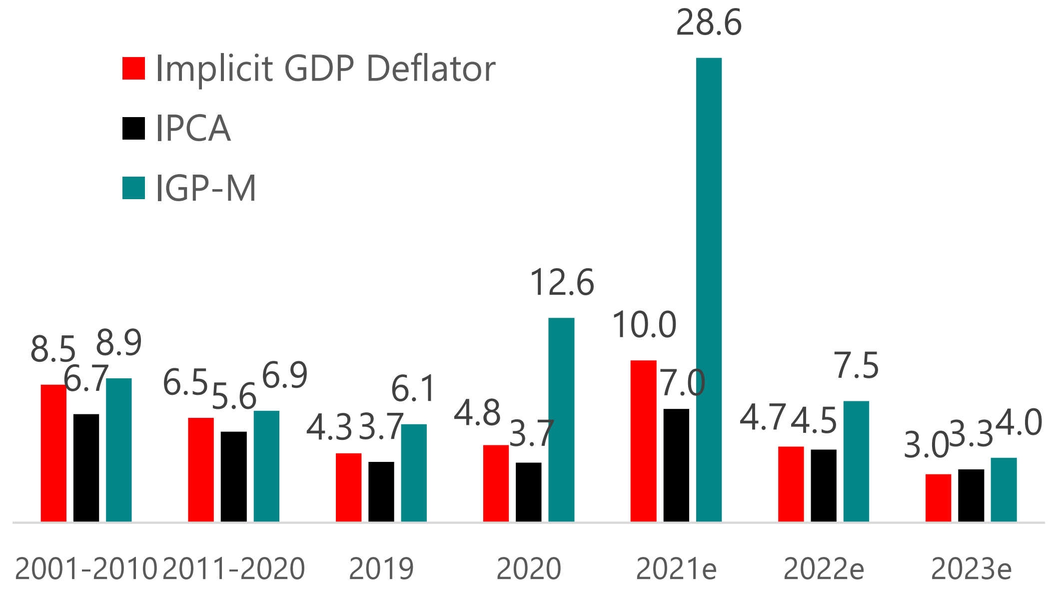
IPCA and GDP Deflator



Sources: IBGE, Santander.

IPCA, IGP-DI and GDP Deflator

YoY % | Annual average

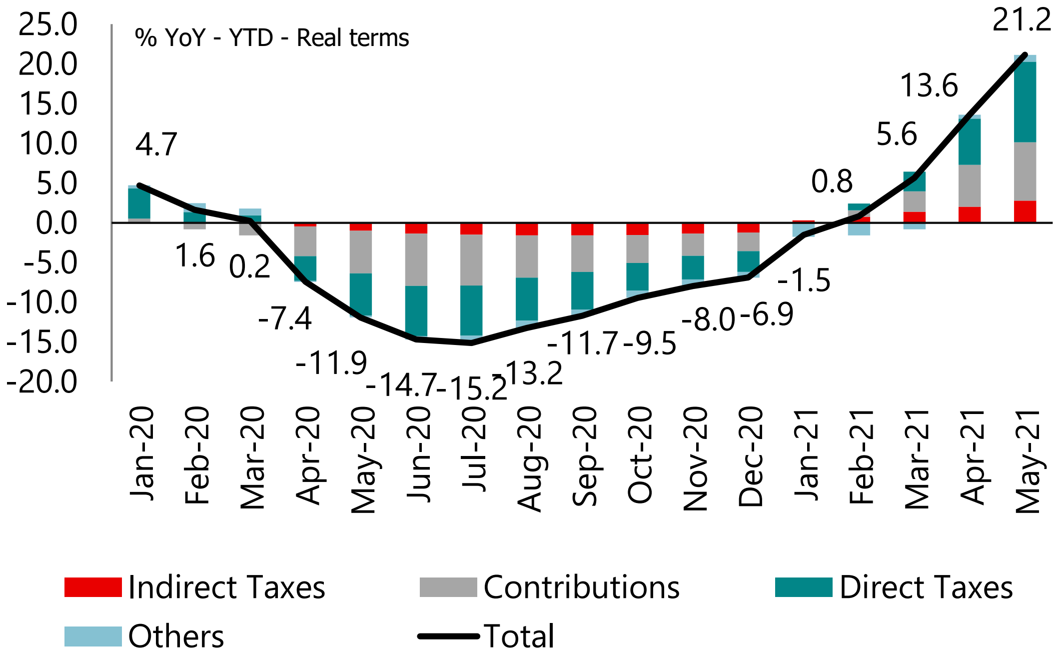


Sources: IBGE, FGV, Santander.

Revenues Impact – Inflation is Boosting Tax Collection in Federal and Regional Terms

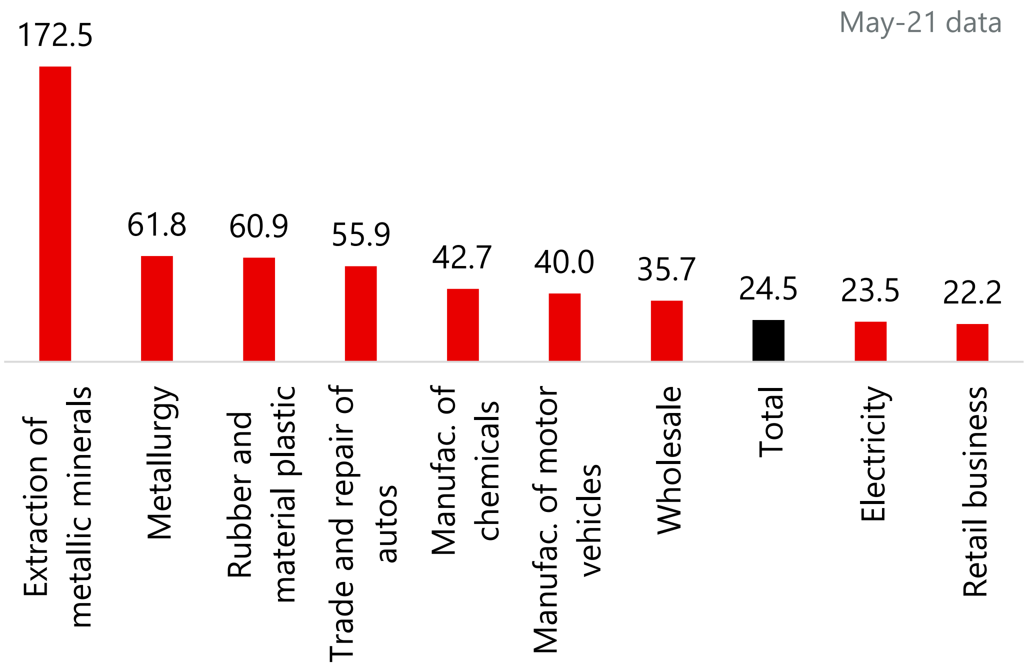
- Figure below shows a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the business sector, which have posted good results recently. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to metals.

Federal Tax Revenue: Year-to-date (%YoY)



Sources: Brazilian IRS, Santander.

Federal Tax Revenue by sectors YTD (%YoY)

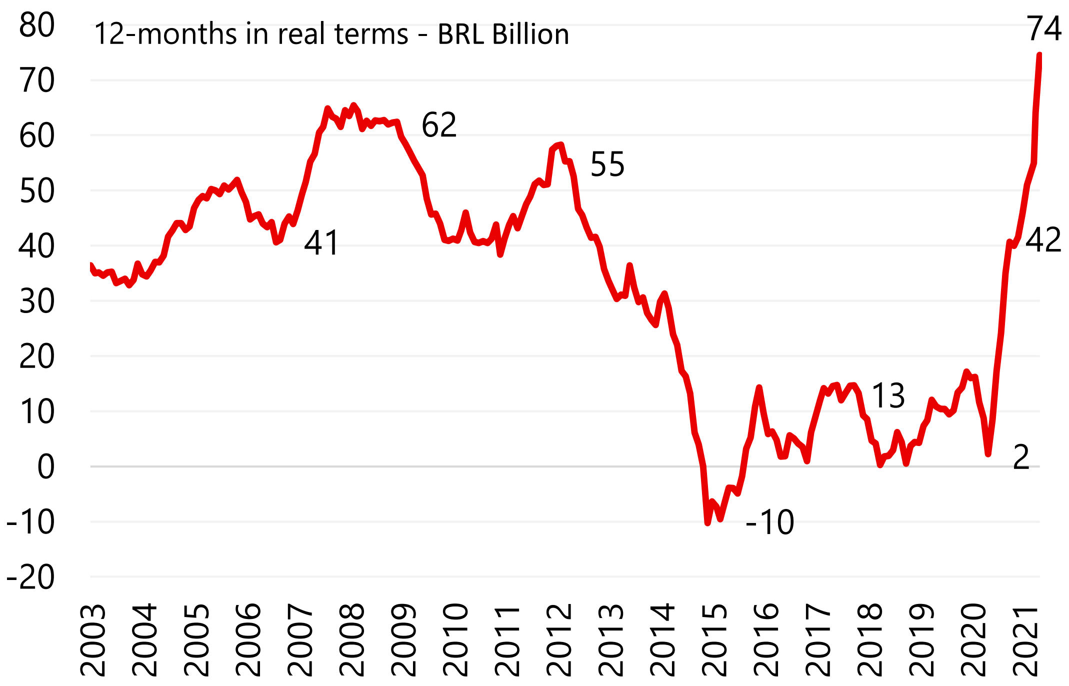


Sources: Brazilian IRS, Santander.

Revenues Impact – Inflation is Boosting Tax Collection in Federal and Regional Terms

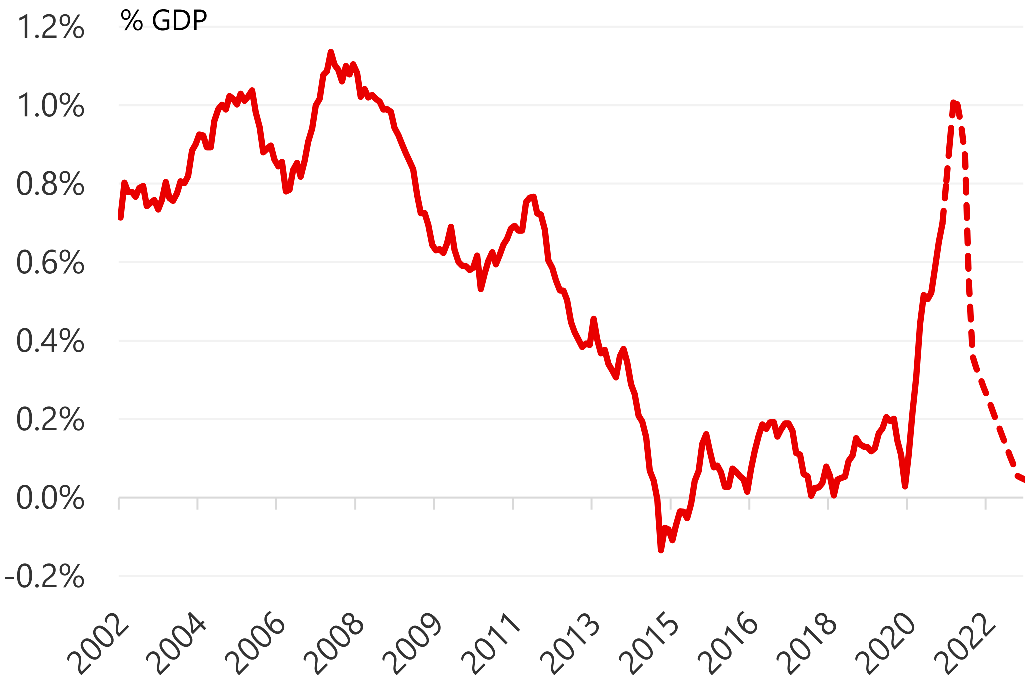
- In May, the regional governments' results were positive surprise again (+BRL5.2 billion compared to a deficit of -BRL4.8 billion in May 2020), probably affected by the lagged effects of the 2020-21 fiscal stimulus on local economies, added to the effect of the inflation shock on tax collection—and the activity recovery in the last few months. We also revised the regional government primary balance to BRL28 billion from BRL15 billion.

Regional Governments – Primary Result



Sources: BCB, Santander.

Regional Governments – Primary Result

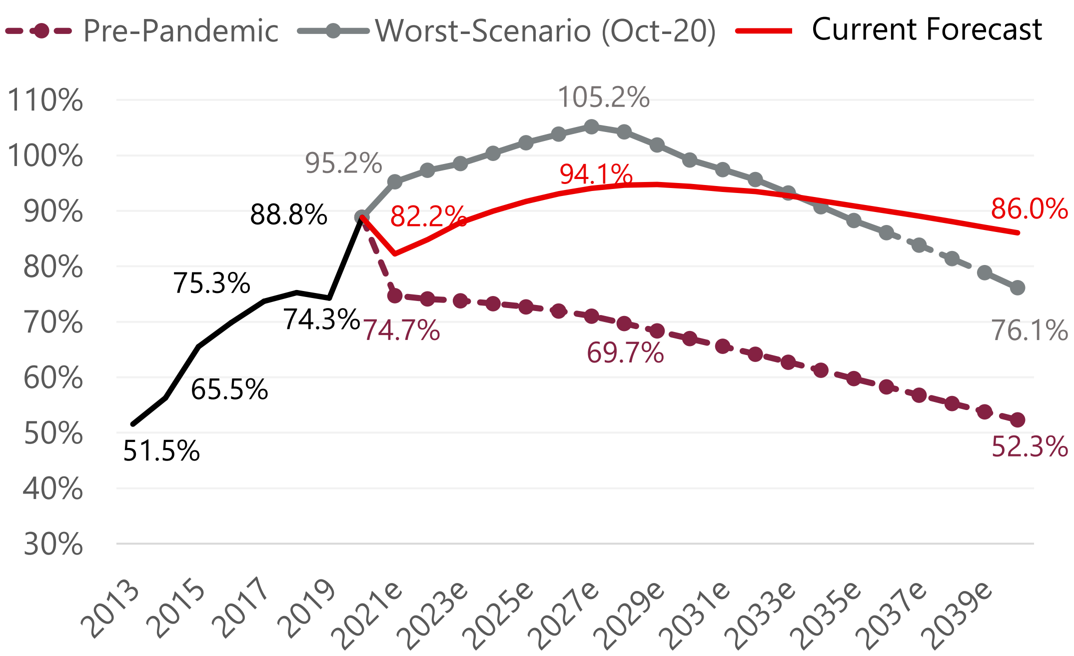


Sources: BCB, Santander.

Fiscal Scenario – Debt Forecasts Dropped Due to Effect of Inflation and Terms-Of-Trade

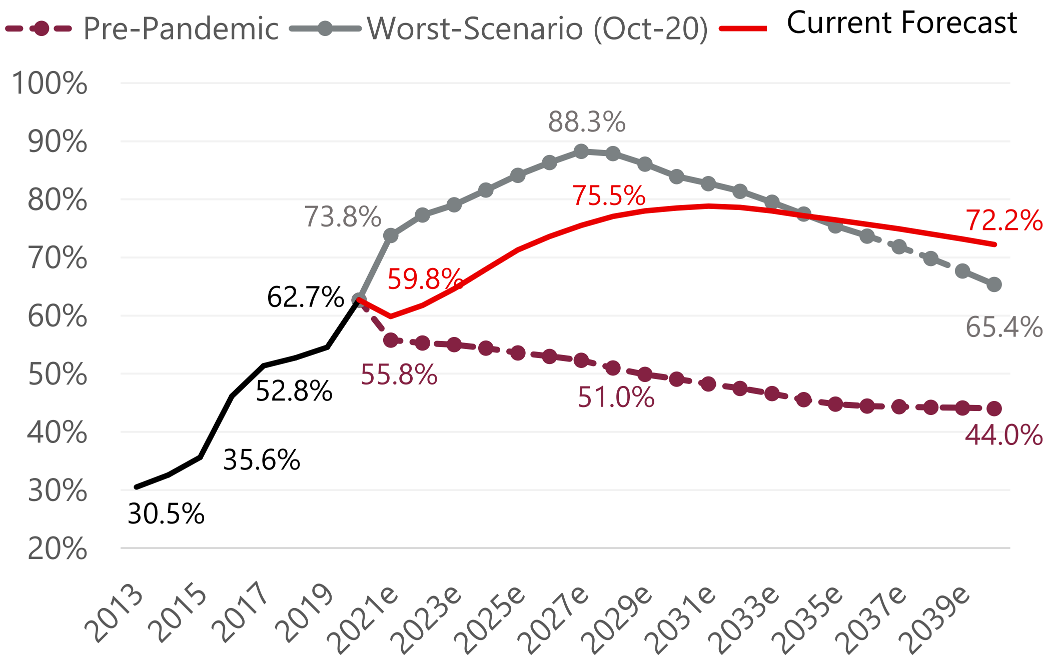
- In our most recent scenario, the impact of the inflationary shock is assumed to be more persistent and lasting than we initially expected. With that, tax collection grew and, especially, the projection of the GDP deflator rose significantly. The scenario became more positive, but there was still no structural change that would justify a reversal in the expectation of a deteriorating trend, unless the positive terms-of-trade shock is more lasting than we expect.

Gross Debt (% GDP)



Sources: BCB, Santander.

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

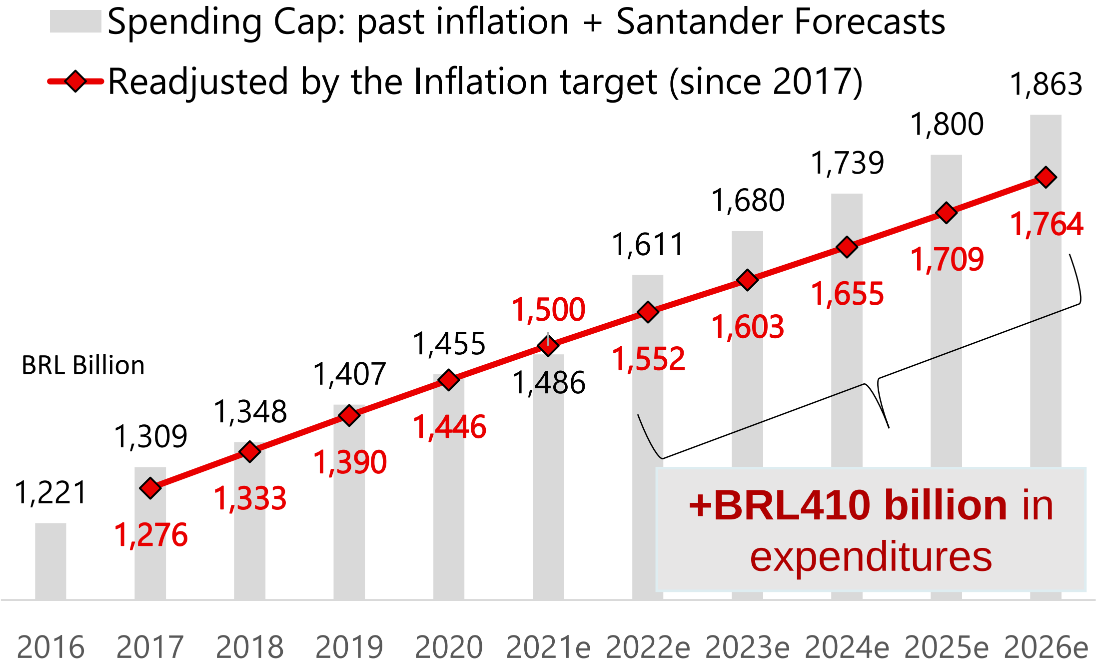


Sources: BCB, Santander.

Inflation side effects – Spending Cap has Lost Some of its Anchoring Power

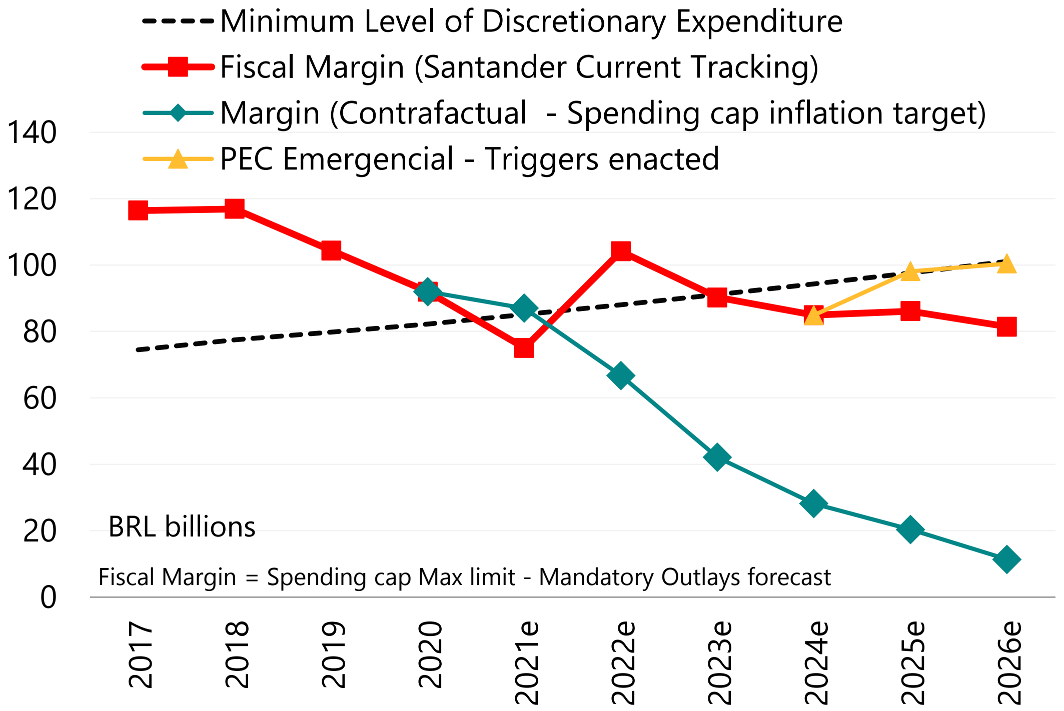
- Based on our forecasts, we see inflation converging to the mid-target only in 2023, and thus, compliance with the spending cap up to 2026 is now more feasible than before. In our view, an important consequence of the inflationary shock in 2020-2021 is that the spending cap has lost some of its anchoring power, and the fiscal rule is a necessary but not sufficient condition to assure consistent fiscal consolidation. We can see that compliance with the fiscal rule becomes much more feasible (as does the use of the fiscal triggers approved in PEC Emergencial), and even more so with the impact of lifting the ceiling.

Spending Cap Max. Total Limit



Sources: BCB, National Treasury, Santander.

Simulation Discretionary Outlays



Sources: BCB, National Treasury, Santander

Outlook - The Quest for the Primary Surplus and Expenditures Demand

- **The new welfare program will be intensely debated in coming months. We now consider a BRL50 bn budget. Any additional inflation shocks in the 2H21 (raising the IPCA forecast) could reduce the "legal margin'" for spending cap in 2022.**
- We note that if there is greater elasticity of revenue to GDP and higher growth, the primary surplus can be reached sooner than we currently expect. We maintain GDP growth close to 1.5% after 2023, a GDP deflator of 4.0%, and elasticity close to 1.1.

Santander Forecast - Expected Use of Spending Cap Margin in 2022 – tight margin

Use of BRL124 billion in 2022	BRL bn	%
Mandatory Outlays and Others		
Social Security Benefits (Pensions and BPC)	58	46.6%
Payroll - Public Servants (Career progression + Military: BRL6 bn)	10	8.0%
2021 Wage Bonus payment (Abono)	7.4	5.9%
Recomposition of Other Expenditures	16	12.9%
Subtotal	91.4	73.5%
Margin of Budget Allocation - BRL33 billion		
Payroll - Public Servants (+5.0% Nominal wage increase?)	14	11.3%
Extra Budget for the new Bolsa Familia (BRL50 bn: 17 m families, BRL250 per month)	15	12.1%
Others	4	3.2%
Subtotal	33	26.5%
TOTAL	124.4	100.0%

Simulation - Primary Surplus Simulation: When?

Elasticity: GDP-Revenues	GDP Growth 1.0%	1.5%	2.5%	3.0%
0.9	2038	2032	2029	2027
1	2031	2028	2027	2026
1.1	2028	2027	2026	2025
1.2	2027	2026	2025	2024
1.3	2026	2025	2024	2024

Assumptions: GDP deflator: 4.0% after 2023; Net revenue from the 2nd bimonthly government report; Santander expenses scenario.

Source: Santander.

Santander Sources: National Treasury, Santander

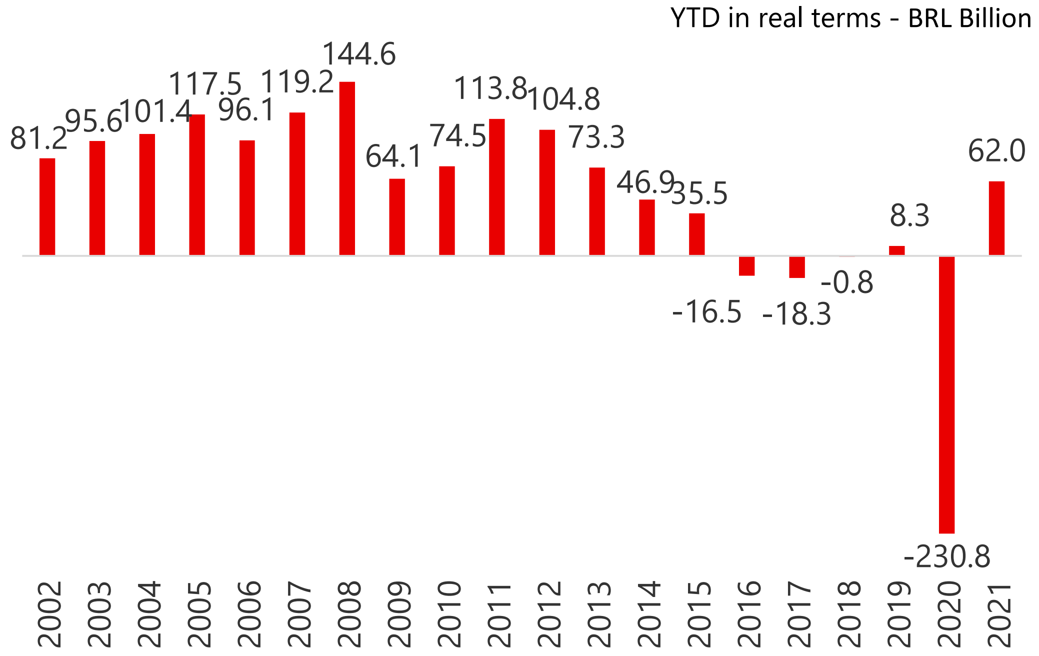
Fiscal Baseline Scenario – Primary Result and Spending Cap

03

Fiscal – Good Result in 2021, the 12-month Reading is Fading

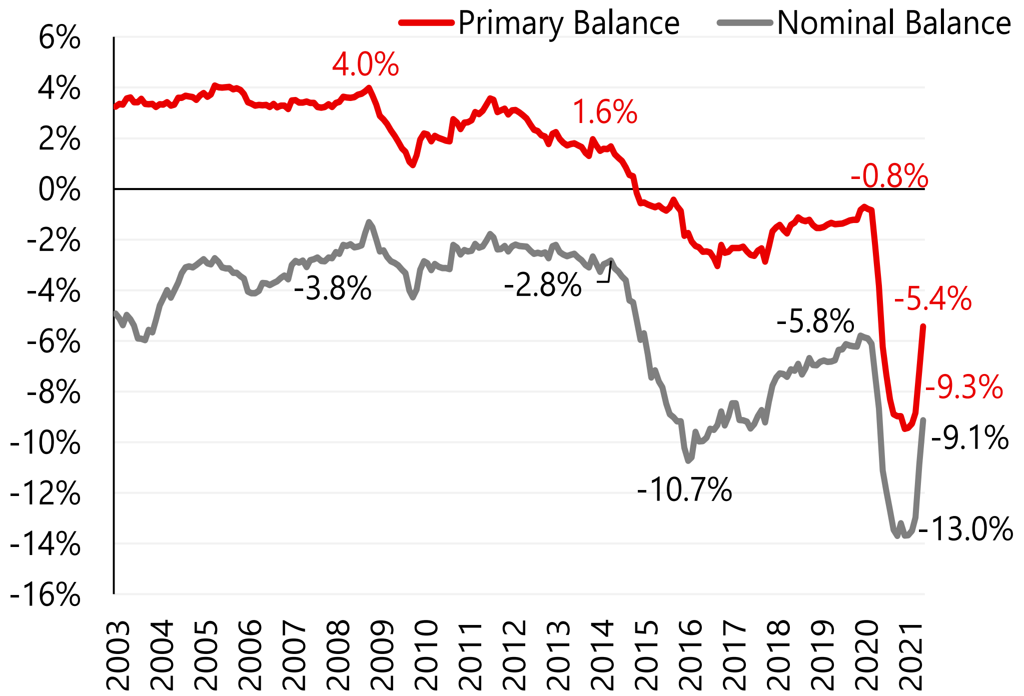
- In the accumulated result for the year, the consolidated public sector registered a surplus of BRL62.0 billion in real terms, compared to a deficit of BRL231 billion in the same period of 2020, mainly due to the massive fiscal stimulus last year. The emergency aid stipend this year was BRL8.9 billion in May, compared to BRL41 billion in 2020. It was the best result for the period in the BCB series since 2013.

Public Sector – Primary Result



Sources: BCB, Santander.

Public Sector – 12m % GDP

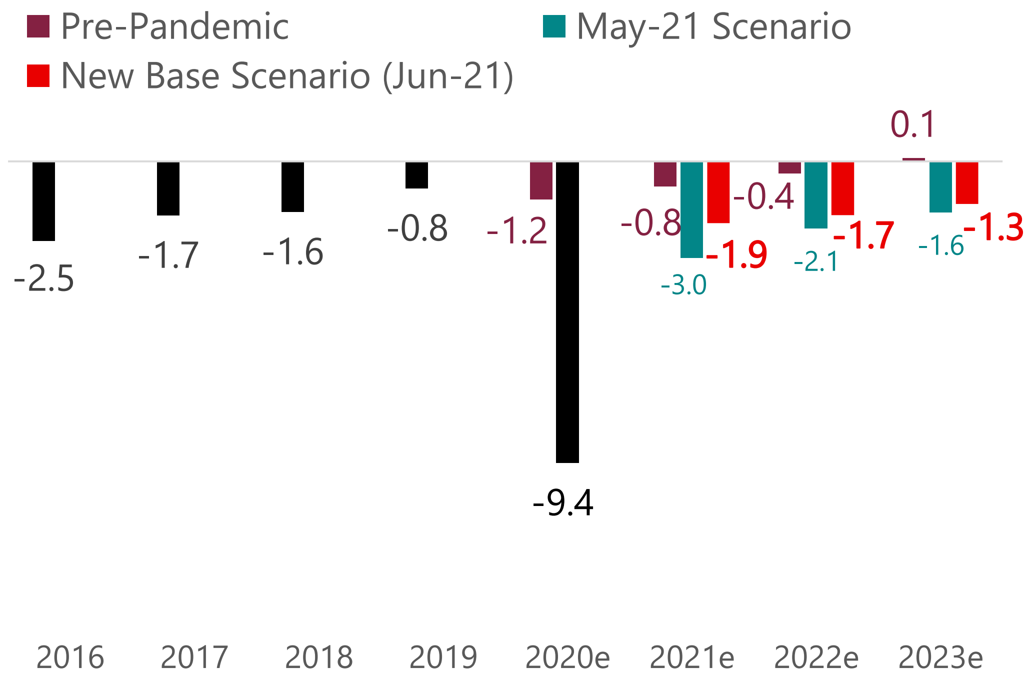


Sources: BCB, Santander.

Fiscal – Prices Shock Improved The Primary Result

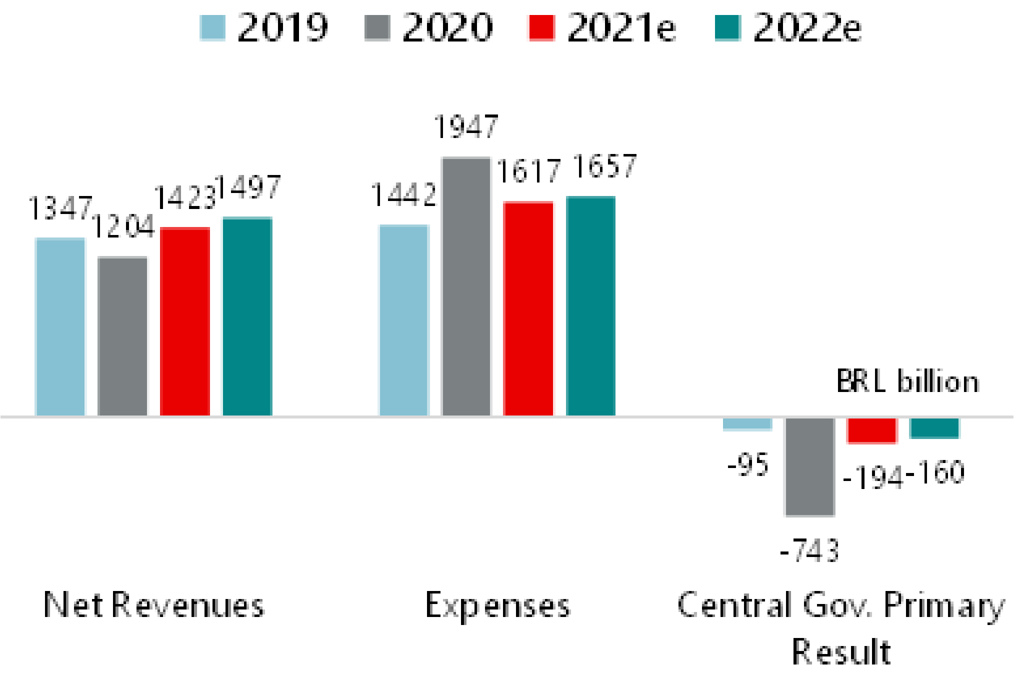
- Considering the terms-of-trade and inflation impact on the revenues we improved our forecasts for the primary result. Yet, a more persistent improvement will depend on the commodity boom.

Primary Result (% GDP)



Sources: BCB, Santander.

Primary Result (BRL billion)



Sources: BCB, National Treasury Santander.

Central Government – Revenues and Expenditures

Central Government's Primary Balance													
Fiscal Items (% of GDP)	2018	2019	2020	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Total Revenue	21.2	22.1	19.7	20.3	20.0	20.3	20.5	20.7	20.8	21.0	21.1	21.3	21.5
Revenues Collected by the Federal Revenue Office	12.9	12.8	12.1	12.9	12.8	12.9	13.0	13.1	13.1	13.2	13.3	13.4	13.5
Net Social Security Revenues	5.6	5.6	5.4	5.1	5.0	5.1	5.1	5.2	5.2	5.3	5.3	5.4	5.4
Revenues Not Collected by the Federal Revenue Office	2.7	3.7	2.2	2.3	2.2	2.3	2.4	2.4	2.4	2.5	2.5	2.5	2.6
Transfers by Revenue Sharing	3.7	3.9	3.5	3.7	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.5	3.5
Net Revenue	17.5	18.2	16.2	16.6	16.4	16.7	16.9	17.1	17.3	17.4	17.6	17.8	18.1
Total Expenditure	19.3	19.5	26.1	18.9	18.1	18.0	17.8	17.6	17.4	17.1	16.9	16.6	16.4
Social Security Benefits	8.4	8.5	8.9	8.2	8.2	8.3	8.3	8.2	8.2	8.2	8.1	8.1	8.1
Payroll	4.3	4.2	4.3	3.9	3.9	3.9	3.8	3.8	3.7	3.7	3.6	3.5	3.4
Other Mandatory Expenses	2.9	2.6	9.7	3.7	2.9	2.8	2.8	2.7	2.6	2.5	2.4	2.4	2.3
Mandatory Expenses with Cash Control	3.8	4.1	3.2	3.1	3.1	3.0	3.0	2.9	2.8	2.8	2.7	2.7	2.6
Discretionary Expenses	1.8	2.2	1.5	1.2	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.2	1.2
Central Government's Primary Balance	-1.8	-1.3	-10.0	-2.3	-1.8	-1.3	-0.9	-0.5	-0.1	0.3	0.7	1.2	1.7
Public Sector Primary Balance	-1.5	-0.8	-9.4	-1.9	-1.7	-1.3	-0.9	-0.5	-0.1	0.3	0.8	1.2	1.7
Nominal GDP (BRL billion)	7,004	7,407	7,448	8,561	9,143	9,587	10,130	10,693	11,288	11,915	12,578	13,277	14,015

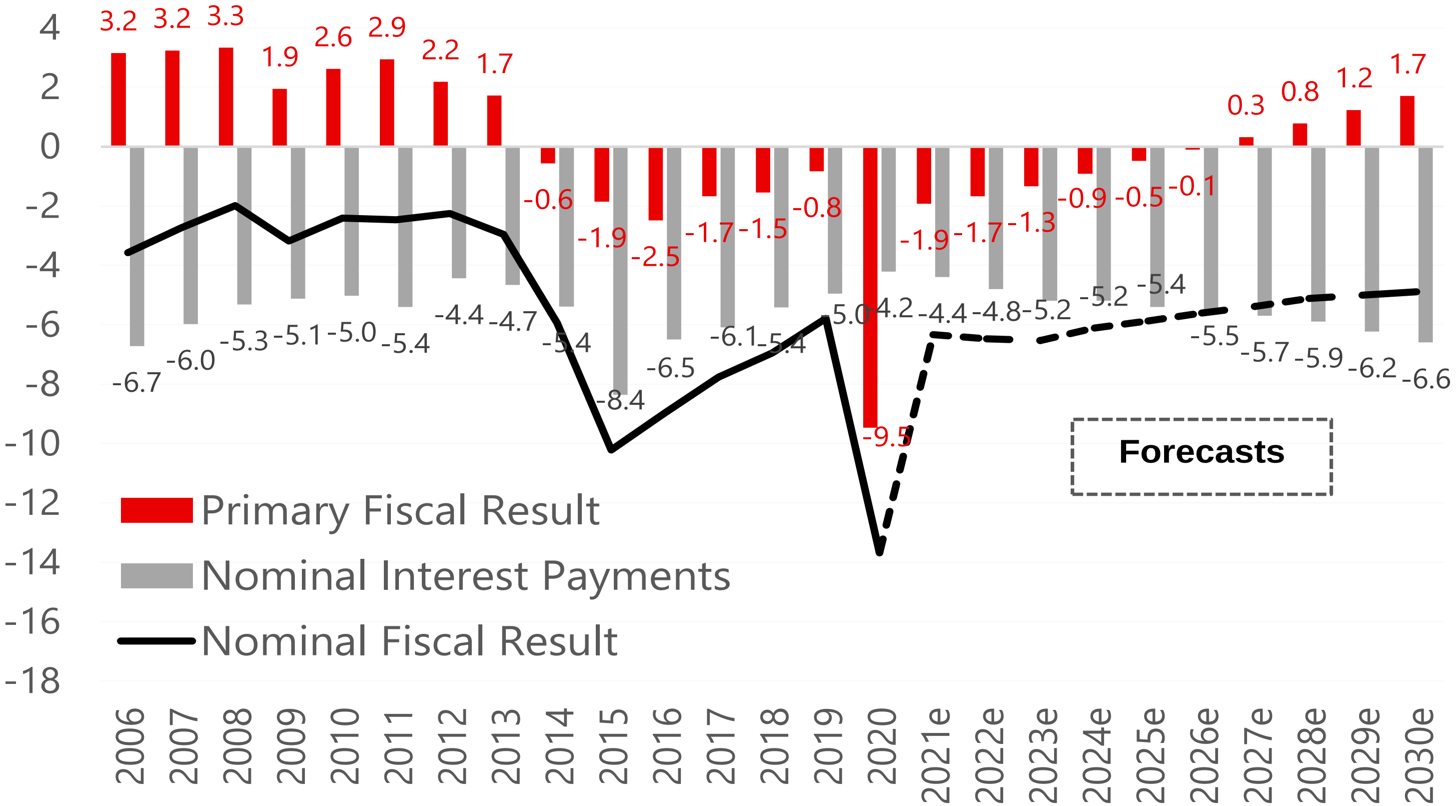
Sources: National Treasury, Brazilian Central Bank, Santander.

➔ **Main assumptions for the current baseline scenario:** our macro scenario for 2021, 2022 and 2023. **After 2024: (i)** Potential GDP growth = ~1.5%; **(ii)** Neutral real interest rate = 4.0%; **(iii)** Long-term inflation = 3.0%, GDP deflator = 4.0%; **(iv)** Compliance to the spending cap rule adjusted by inflation until 2030 **(v)** Structural reforms in 2023 to maintain the discretionary expenses close to 1.3% 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.

Fiscal Balance – An Increase In Interest Payments After 2022

- We revised our nominal Selic rate to 7.0% in 2021. We consider the neutral interest rate at 4.0% per year.
- The higher debt levels and neutral interest rate will contribute to increase the nominal deficit, specially after 2023.

Public Sector's Financing Needs (% GDP)



Sources: National Treasury, BCB and Santander.

Fiscal Risks – Size Of The Fiscal Stimulus And Leftovers

- The total size of the War budget expenses totaled BRL524 bn. This year is currently at BRL107 billion and could reach ~BRL130 bn
- For 2021, the leftovers (not subjected to the spending cap rule) from 2020 War Budget reached BRL30.9 bn. A total of BRL7 billion of leftovers related to the 2020 BEm program was cancelled.

Expected 2021 – Extra-cap expenditure

Covid related expenditures - 2021	BRL billion
Emeregency Aid (*PEC Emergencial*)	45
Extension of the Aid until October (3 months)	20
Vaccine Acquisition (2020 Leftovers)	22
Health Expenditures	20
2020 War Budget Leftovers	13
Pronampe 2021 (credit support for SMEs)	5
BEm 2021 (formal job suport program)	10
TOTAL	**135**
Estimate of final execution in 2021 (85%)	115

Sources: National Treasury, Santander.

Tracking 2021 – Extra-cap fiscal expenditures

BRL Billion - Accumulated	Apr-21	May-21	Jun-21	Total Budgeted	Executed
Emergency Aid (MP 1.037/2021)	9.7	18.6	27.4	44.9	**61.0%**
Health expeditures	5.1	9.1	9.7	15.9	**60.9%**
BEm - Employment Program (MP 935/220 and MP 1.044/2021)	0.6	2.1	4.0	11.7	**33.8%**
Turism Infraestructure (MP 963/2020)	0.4	0.4	0.4	1.9	20.3%
Vaccine Acquisition (MP 994, 1,004 and 1,015/2020)	4.6	6.4	8.0	27.8	28.8%
Pronampe (credit support for SMEs) (MP 1,053, 1,023)	0.0	0.0	0.0	5.0	0.0%
Accumulated Total	20.5	36.6	49.4	107.1	46.1%

Updated in 07/01/2021

Sources: National Treasury, Santander

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

Possible Fiscal Measures that Could be Implemented and its Impacts

Rolling Impact of some fiscal measures (% GDP)	2022	2023	2024	2025	2026	2027	2028	2029	2030
Revenues									
Tax Reform (PEC 45) - Preliminary	**0.3**	**0.5**	**1.1**	**1.5**	**2.5**	**3.8**	**5.1**	**6.5**	**8.1**
Limit on tax deductions (private health)	0.1	0.2	0.3	0.4	0.5	0.6	0.6	0.7	0.7
10% linear drop in tax exemptions / waivers	0.3	0.6	0.9	1.1	1.3	1.5	1.7	1.8	2.0
Changes in Personal Income Tax (Aliquot of 35% on earnings > BRL25k per month)	0.1	0.1	0.2	0.2	0.3	0.3	0.4	0.4	0.4
Profits & Dividends (Aliquot of 15%)	0.4	0.7	1.0	1.3	1.6	1.9	2.1	2.3	2.5
End of JCP payment deduction ("Interest on Equity Capital")	0.1	0.2	0.4	0.5	0.6	0.7	0.7	0.8	0.9
Eletrobras Capitalization (one-off)	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Exclusive Funds (one-off)	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Personal income tax exemption (BRL1,903 to BRL 2,500 per month)	-0.2	-0.5	-0.7	-1.0	-1.3	-1.5	-1.8	-2.1	-2.4
Expenditures									
Administrative Reform (Santander)	**0.0**	**0.1**	**0.1**	**0.2**	**0.3**	**0.4**	**0.5**	**0.6**	**0.8**
Min. Wage De-indexation (social benefits)	0.3	0.5	0.8	1.0	1.2	1.4	1.6	1.7	1.9
Freezing of social security benefits (above 3 Min. Wag)	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3
End of Wage Bonus 'Abono' (for formal workers)	0.2	0.4	0.6	0.7	0.9	1.0	1.2	1.3	1.4
End of Wage Bonus 'Abono' (above 1 Min. Wage)	0.1	0.2	0.3	0.3	0.4	0.5	0.5	0.6	0.7
Payroll tax exemption	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Public sector wage ceiling	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3
Extending grace period: unemployment insurance benefit	0.1	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1.0
Reduction of public servants' working hours (up to 25%)	0.1	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1.0

Source: IBRE, Santander.

Tax reform estimate considers Borges (2020) impact on Potential GDP

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.

The Measures Developments That Would Shape The Outlook

- Beyond the vaccination rollout, 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.

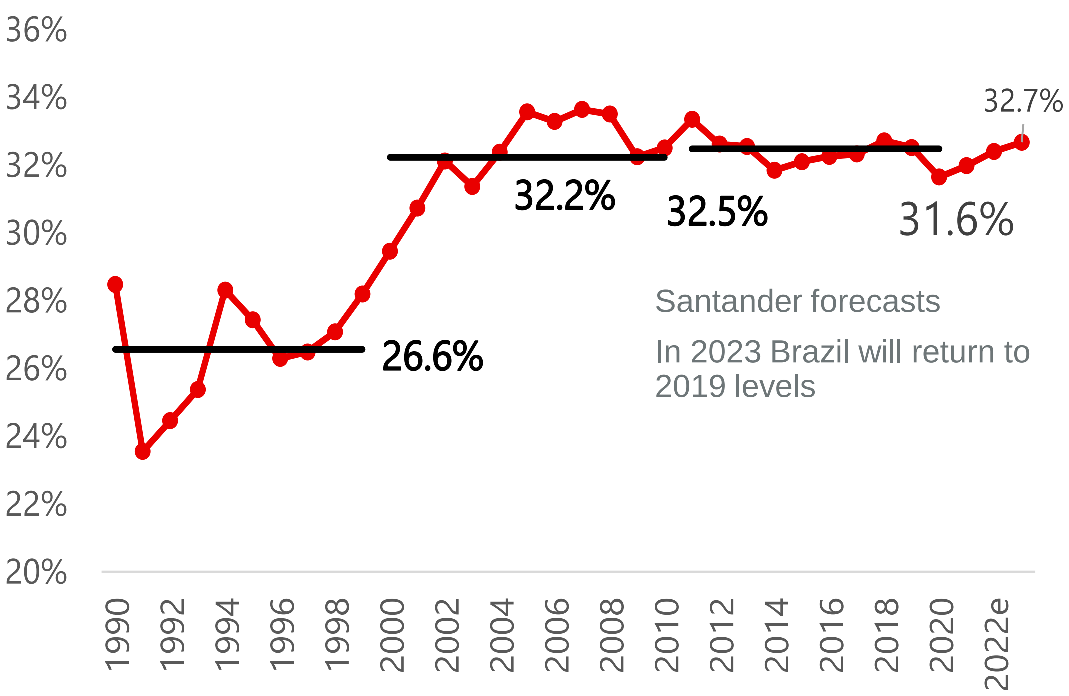
Positive Measures That Could Be Implemented	Potential Setbacks
2021 Budget law execution maintaining the current fiscal framework (spending cap)	Possible creation of new mandatory expenses or removing from the spending cap limit
Broad Tax reform, or CBS Law (Contribution on Goods and Services) with a single tax (original law sent by the government)	Permanent increases in the tax burden or increasing personal income tax exemption without compensation
Administrative reform (approving the career and salary regulations)	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
Limit to the so-called supersalaries (PL 6726/2016)	Salary increases for public servants
Reduction on Tax exemption (4% of GDP)	Reduction in net revenue or greater transfers to states and municipalities

Source: Santander.

Difficulty in the Fiscal Adjustment - Expenses or Revenues?

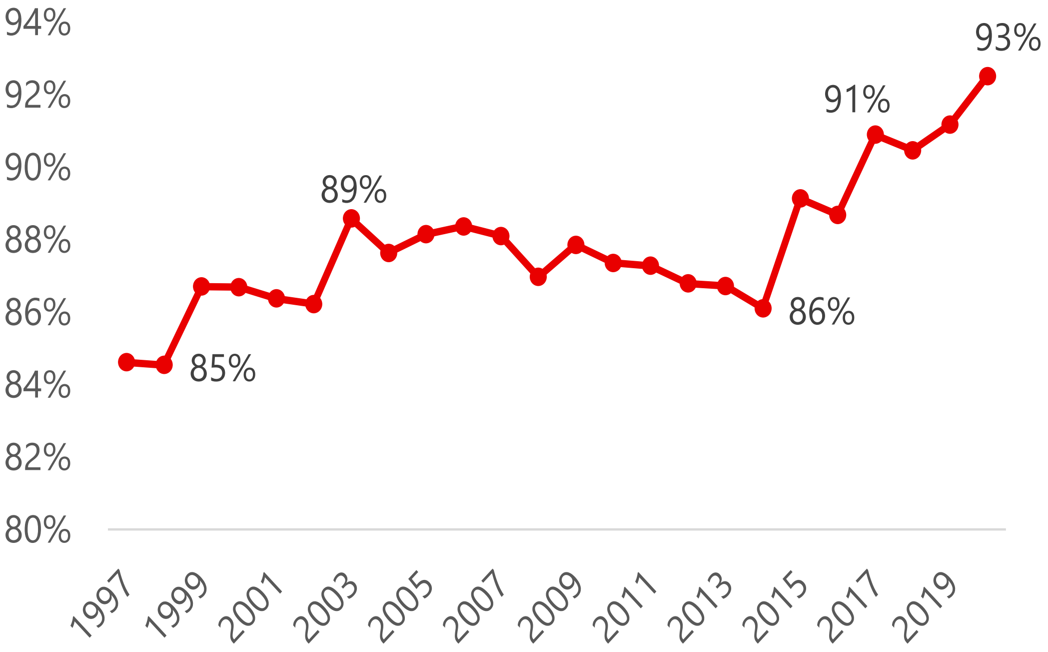
- There is a limit to increase taxes and to reduce the discretionary expenses.

Tax Burden (% GDP) – Is it possible to raise taxes?



Sources: IBRE, National Treasury, BCB and Santander.

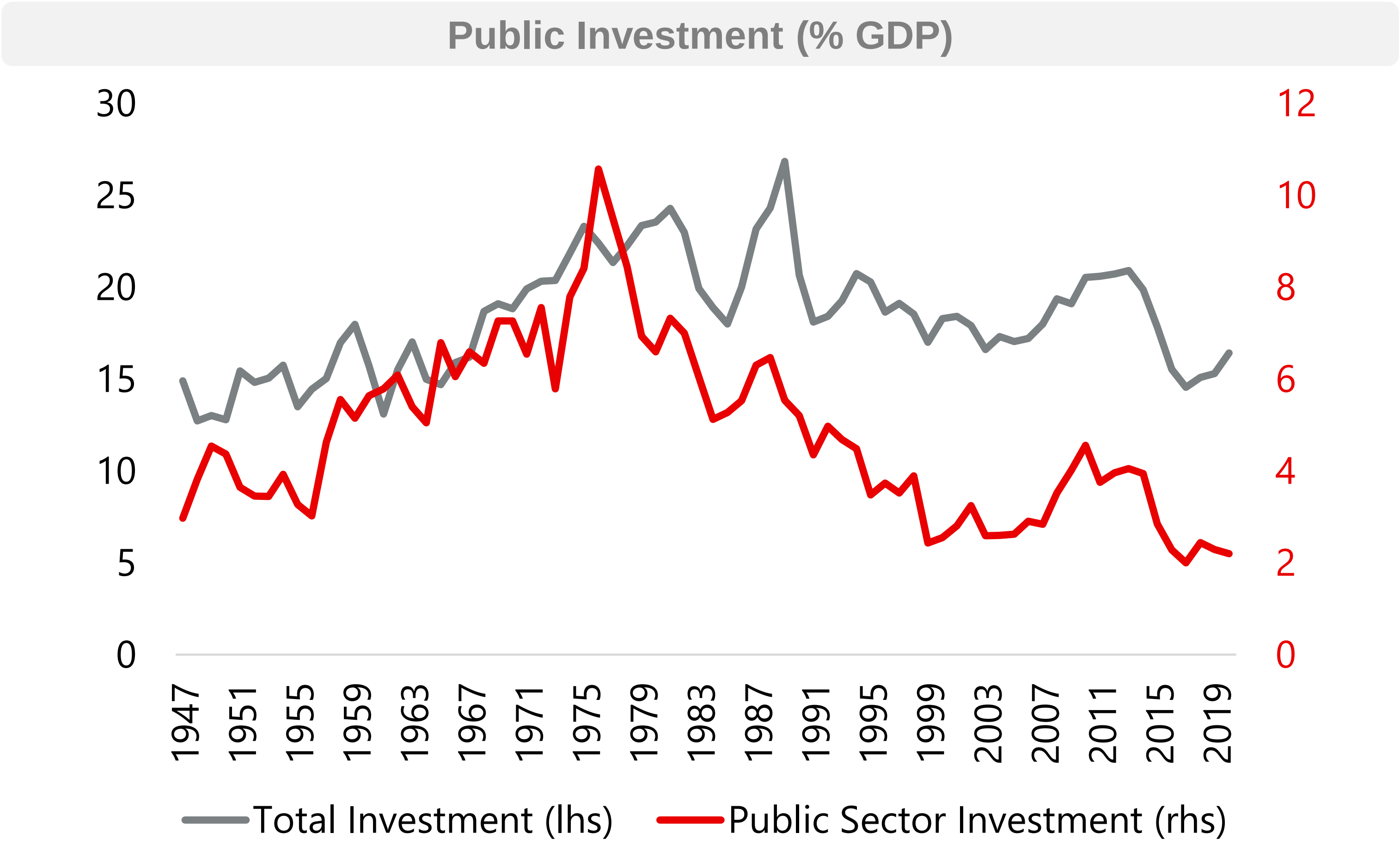
Mandatory Outlays / Total Expenses



Before 2008 there is no classification of discretionary expenses, we maintained the historical pattern among the expenses with flow control

Public Investment at low levels

- Part of the recent fiscal adjustment was made by a reduction on discretionary expenditures, mainly public investments.



Sources: IBRE, National Treasury, BCB and Santander.

04

Public Debt Scenario and Simulations

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.
- Not considering the effects of the cyclical recovery, the long-term outlook will require a remaining 3.0-3.5% of GDP primary fiscal adjustment, just to stabilize the ratio debt-to-GDP around the higher post-pandemic level of 85-90%.

Current cycle:

. Real interest rate (ex-ante): ~1.2%,
. GDP is expected to grow 5.1% in 2021.

. Expected primary deficit (-1.9% of GDP) + BNDES payback should maintain the Gross/Debt reduced due to price shock.

Steady-state:

According to our hypothesis:
. Real interest rate at +4.0%
. Potential GDP at +1.5%,

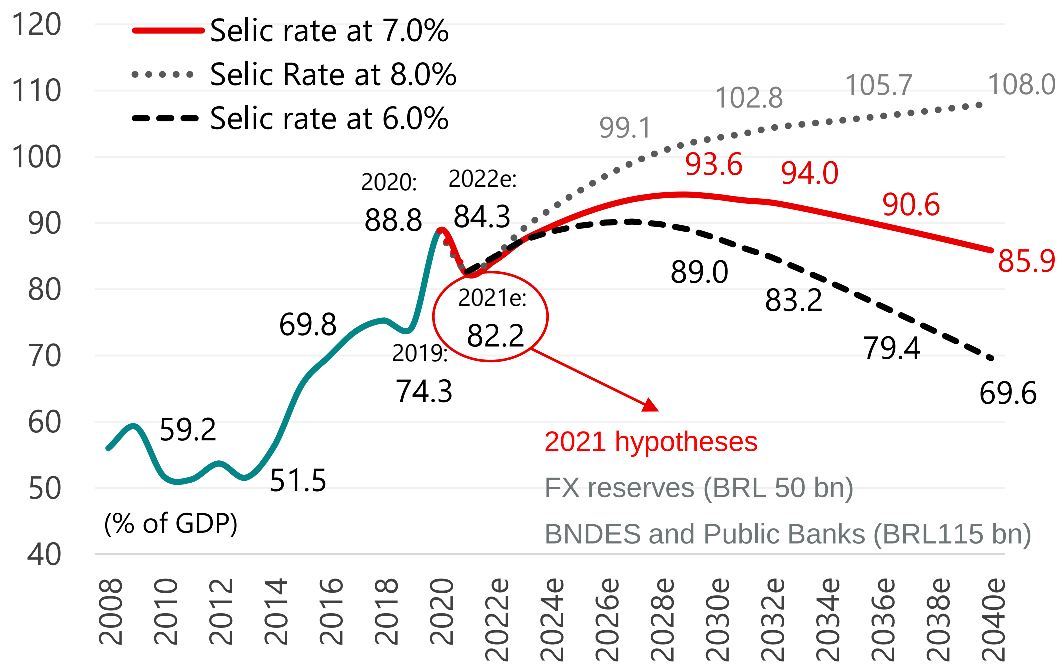
. The primary surplus must reach ~2.0% of GDP to maintain the gross debt stable.

		Real Interest Rate							
		-1.0%	0.0%	1.0%	2.0%	2.5%	3.0%	4.0%	5.0%
GDP Growth	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
	3.5%	-3.9	-3.0	-2.2	-1.3	-0.9	-0.4	0.4	1.3

Sources: BCB, Santander.

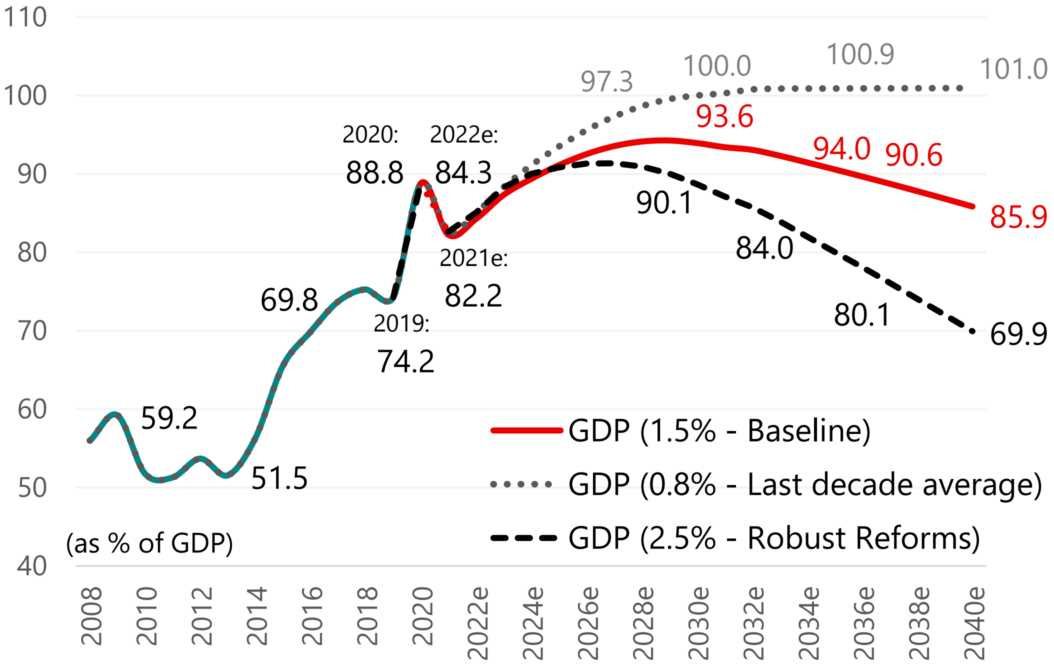
Debt Scenarios: Sensitivity to Small Changes in the Long Run Macro-outlook

Government Debt – Simulations for Selic Rate Hypotheses



Sources: BCB, Santander

Government Debt– Simulating for Trend GDP Hypotheses



Sources: BCB, Santander.

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

PEC Emergencial: Funds (+BRL140 billion for liquidity cushion in 2021)

2021 GDP Deflator: 10% – Inflation shock

2022 hypotheses: FX reserves (BRL50 bn) + BNDES and Public Banks (BRL70 bn)

2023-40: we changed the average GDP deflator: 4.0%, which is Inflation target + 0.8% (average difference of the last decade between IPCA and GDP deflator)

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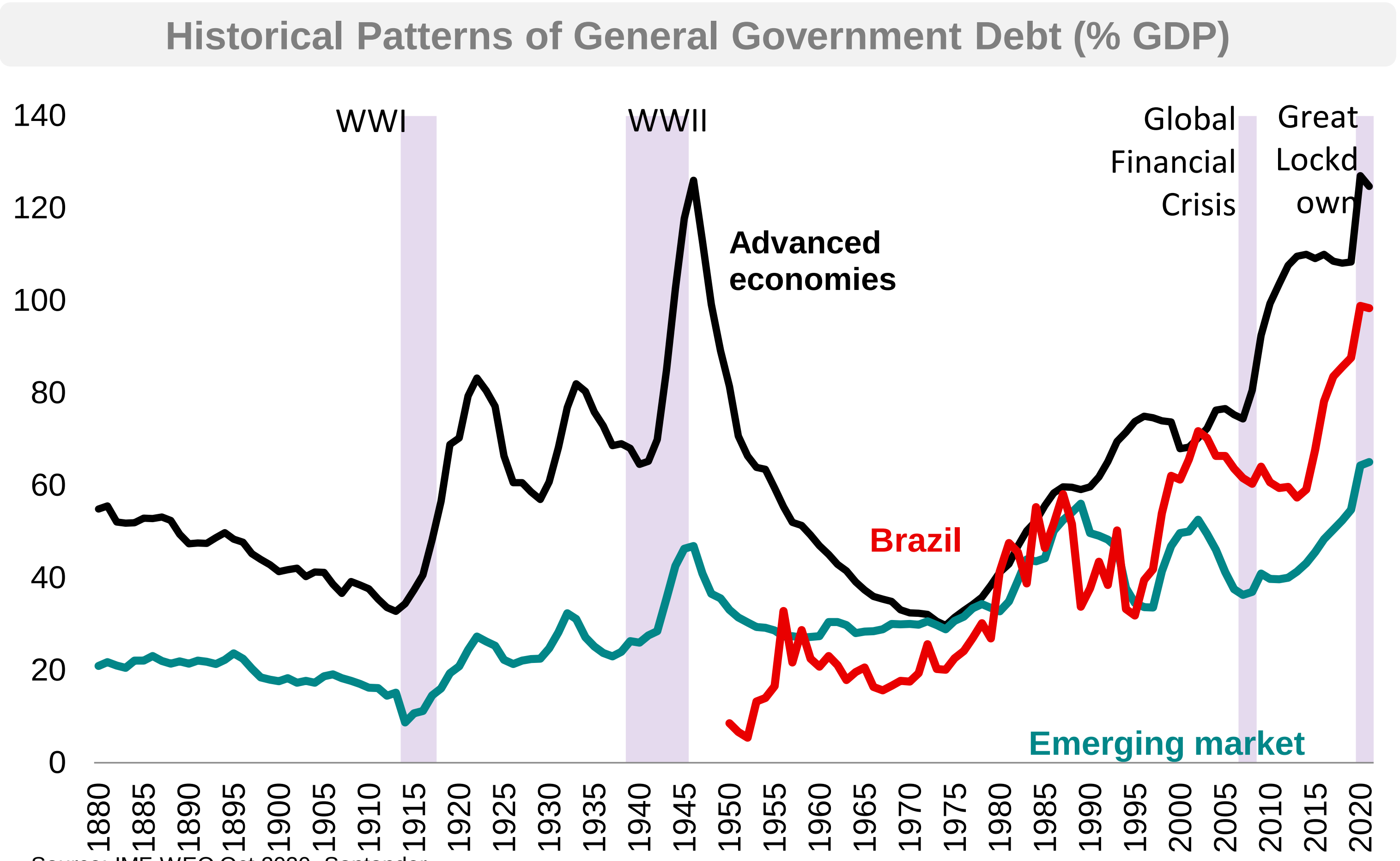
Brazilian gross debt approaches the level of advanced countries – International Comparison

- 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.

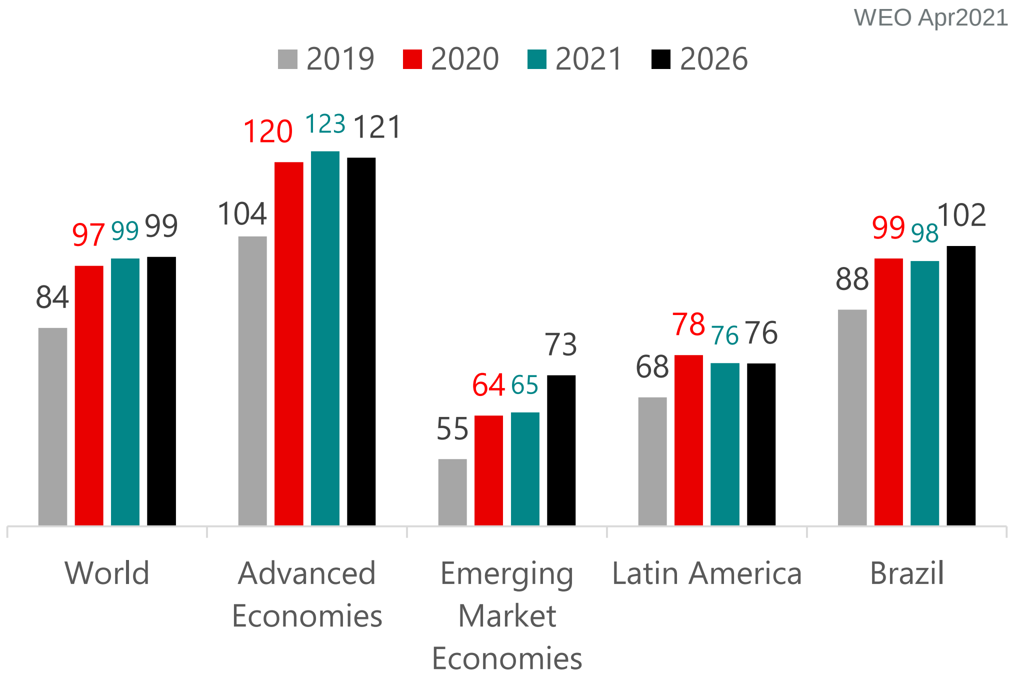


Source: IMF WEO Oct 2020, Santander
*Brazil we used th e IMF metodology

Fiscal Monitor – IMF Scenario

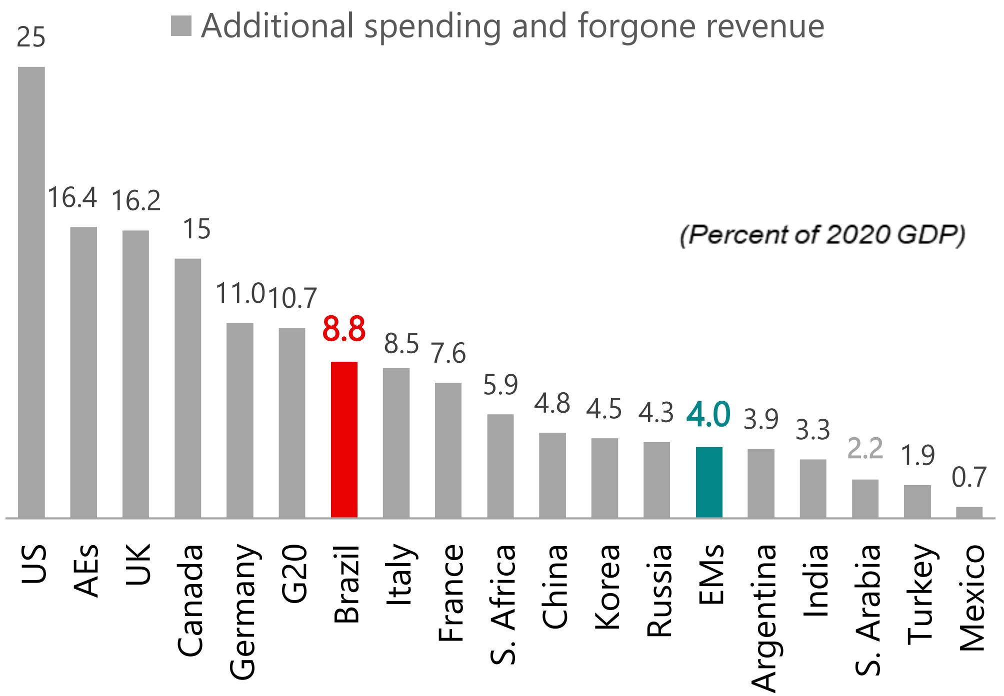
- According to data from both 2020 and 2021, Brazil's fiscal stimulus reached 8.8% of GDP, higher than the 4.0% of GDP for the average of emerging economies (EM).
- In short, the fiscal outlook presented by the IMF is close to our fiscal scenario and reinforces the importance of both measures and reforms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

IMF Gross Debt Forecasts (% GDP)



Sources: IMF, Santander.

Fiscal Stimulus in 2020-21



Sources: IMF, Santander.

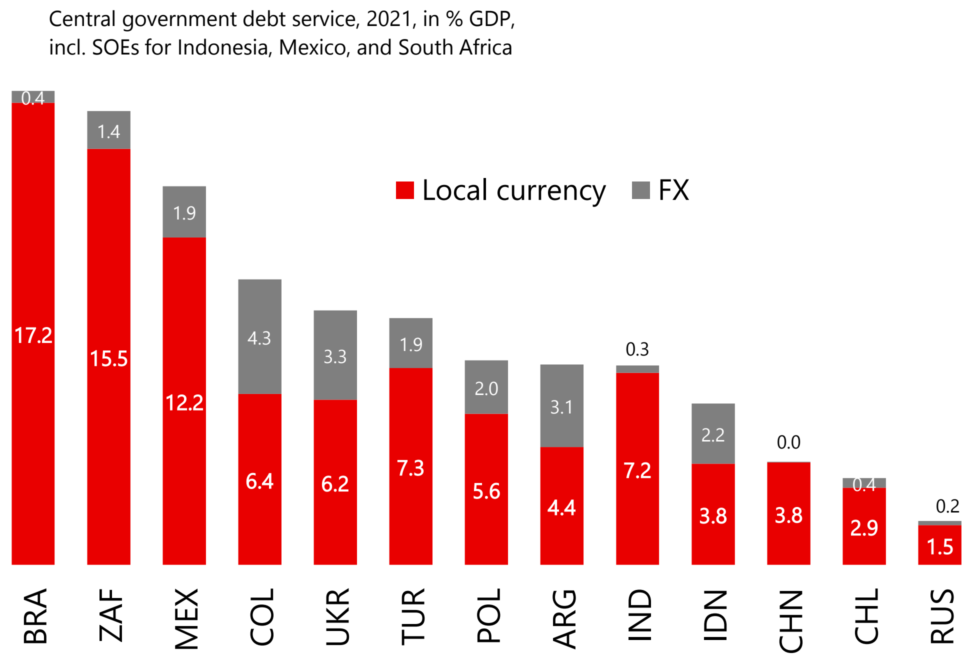
05

Debt Management

Fiscal Risks – Elevated Financial Needs

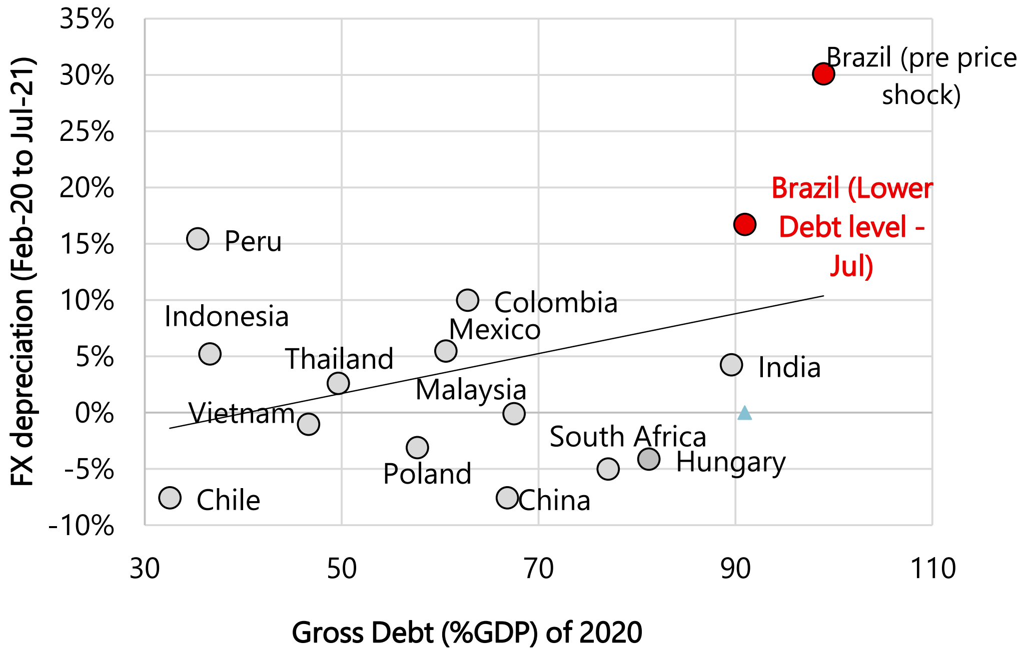
- Brazil has one of the largest gross debts among emerging countries and has significant financing needs.

Financing needs in 2021 – (% GDP)



Sources: IIF, Santander.

Higher Debt and the effect on FX rates



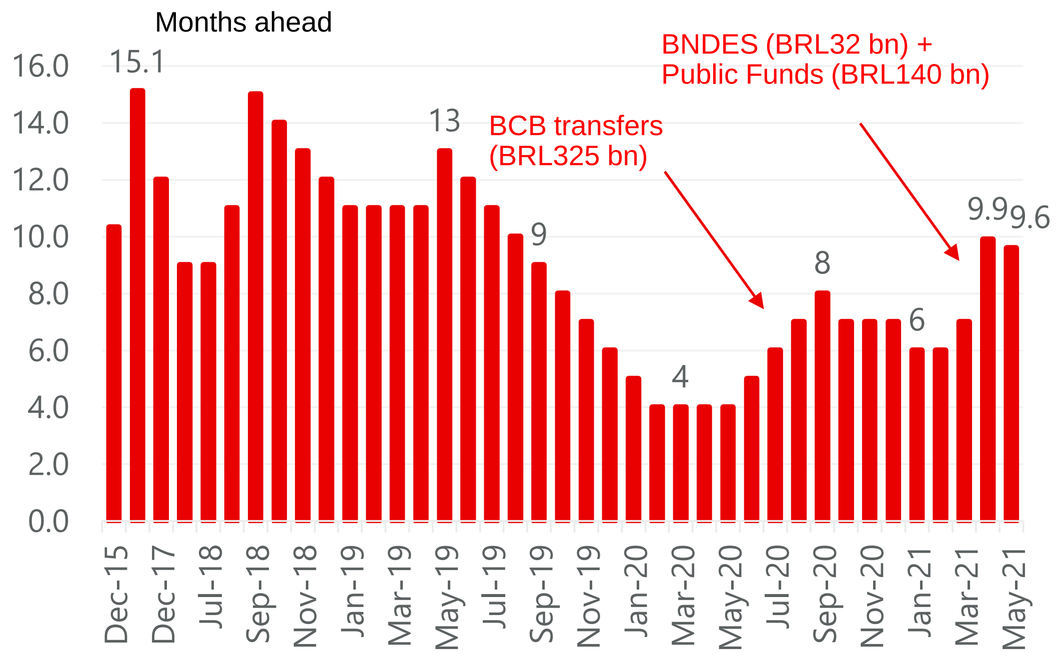
Sources: Bloomberg, Santander

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

Treasury's Cash Position Improved in the Last Few Months with Larger Auctions

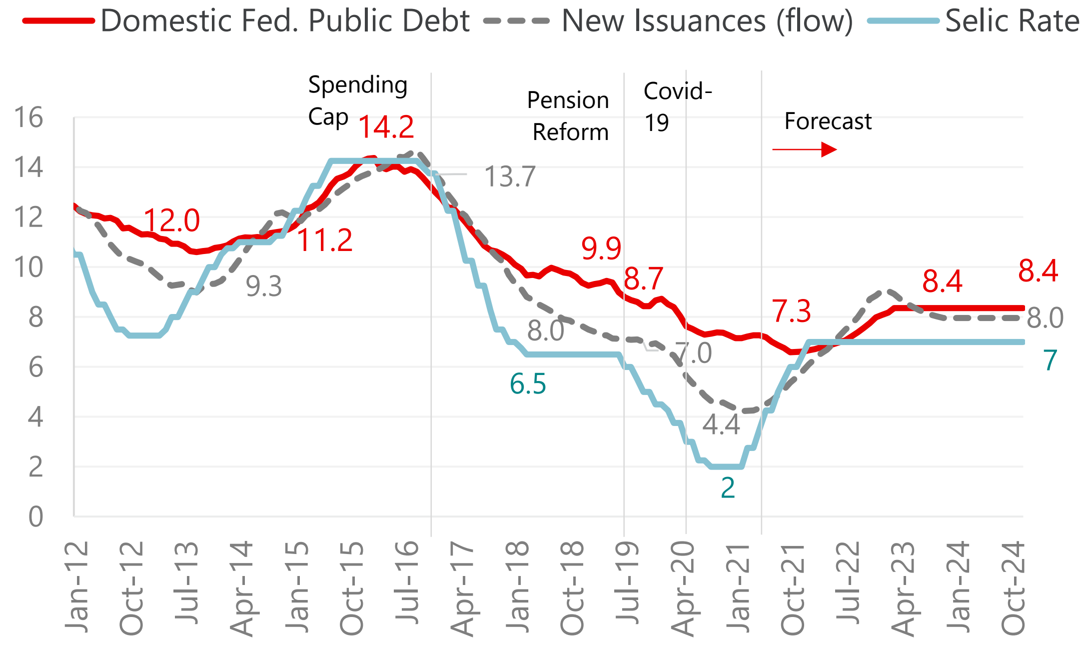
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels..

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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

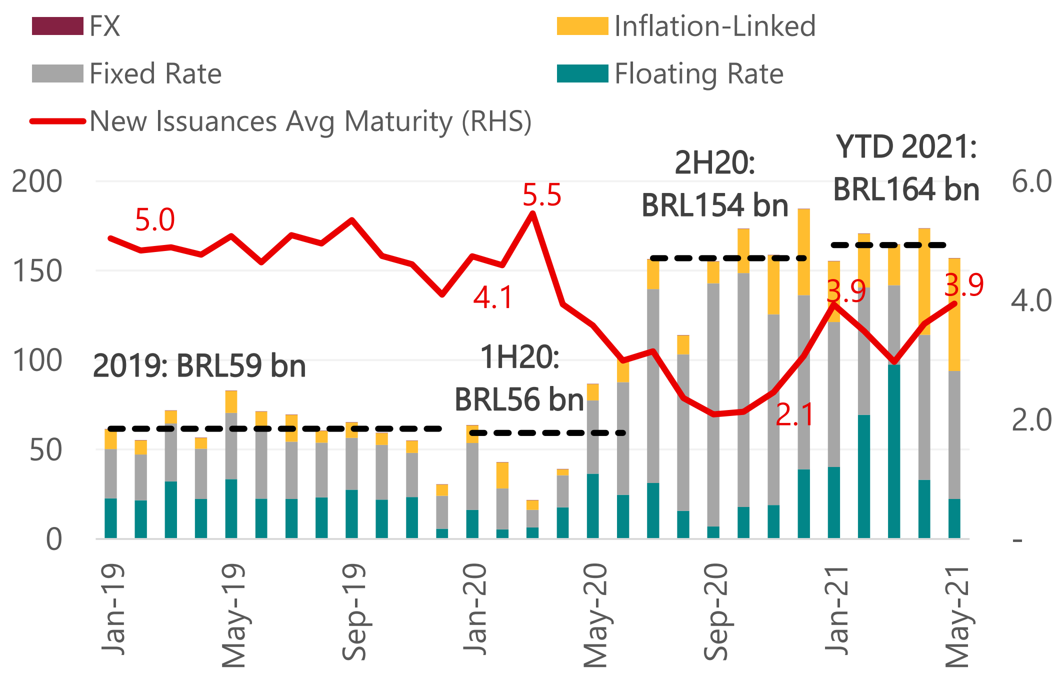


Sources: National Treasury, Santander.

Fiscal – The Increase in Selic Rate Will Pressure the Debt Issuances

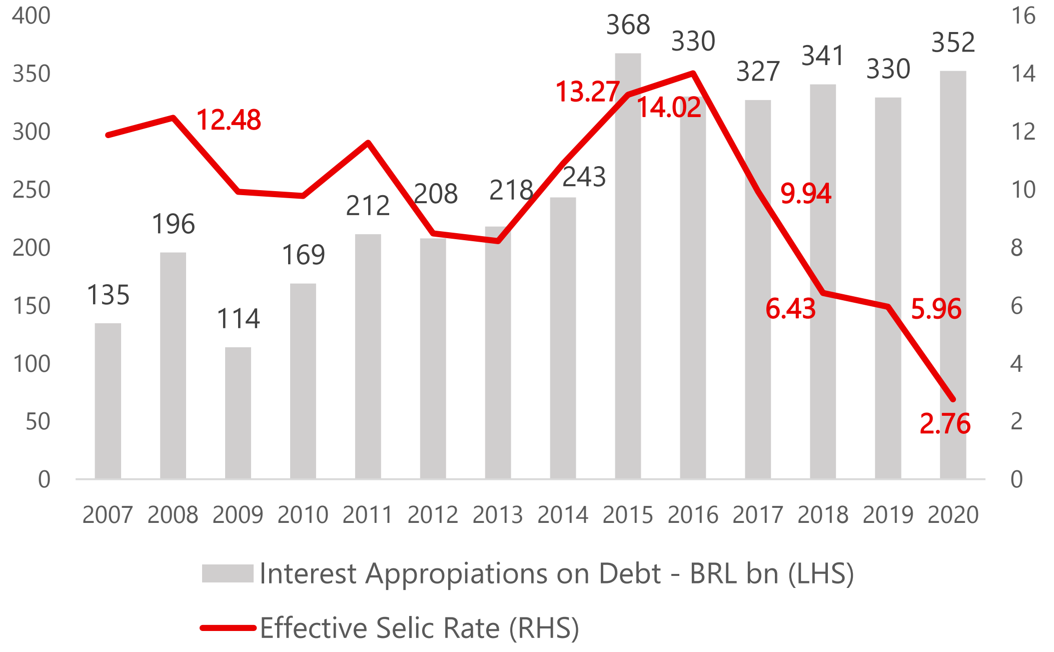
- Market conditions will be important for new debt issuances. The National Treasury is currently issuing more debt (>BRL30 billion per week) than the necessity of issuances per week (~BRL25 billion) in 2021.

Treasury Issuances



Sources: National Treasury, Santander

Selic Rate and Debt

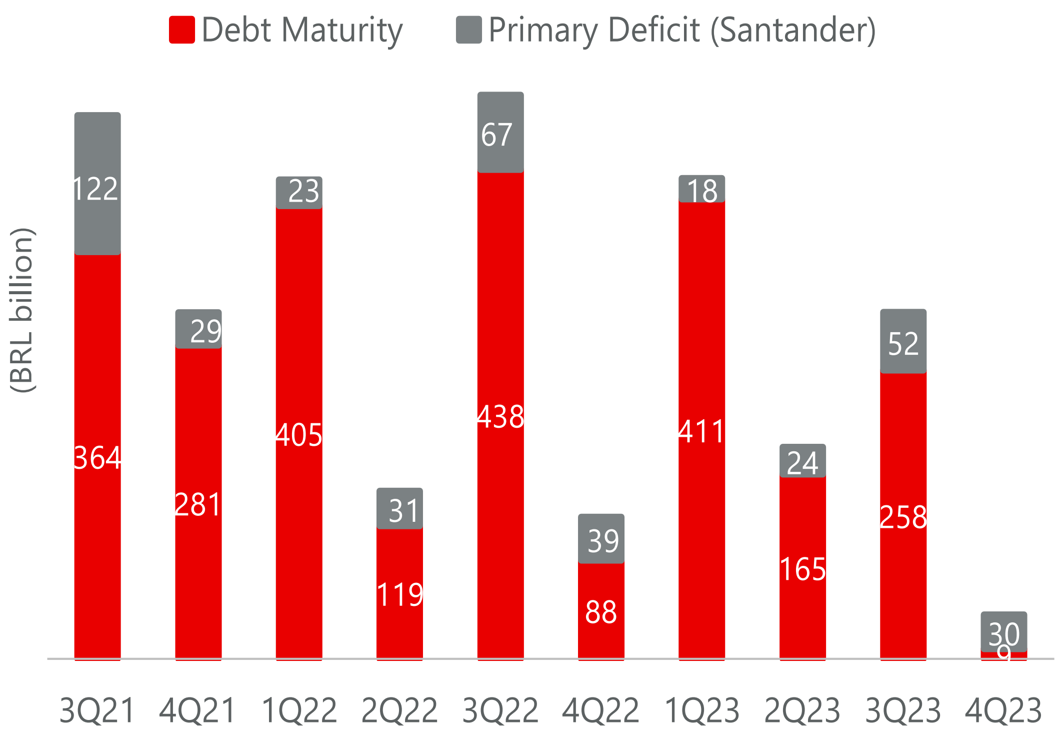


Sources: BCB, National Treasury, Santander.

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

- Despite the increase in liquidity reserves the debt maturity level is still challenging. Structural reforms will help to increase debt maturity and reduce the primary deficit.

Debt maturity - (BRL billion)



Sources: National Treasury, Santander

Profile by categories - (BRL billion)

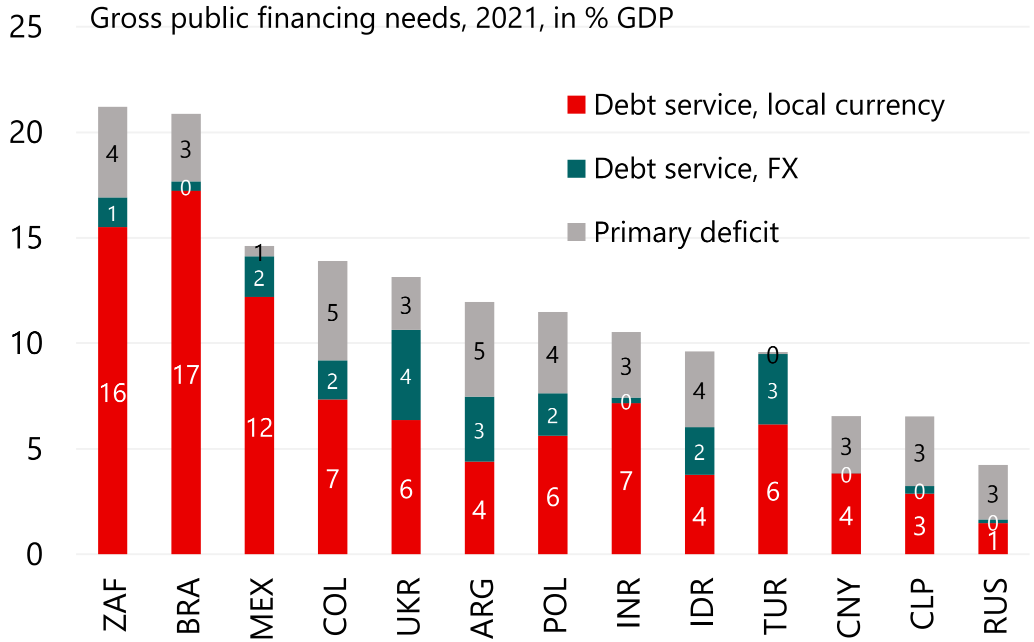
Quarter	Fixed Rate	Floating Rate (selic)	Inflation-Linked	FX-Exchange	Other	Total
3Q21	106.7	231.5	21.2	3.7	1.2	**364.4**
4Q21	264.7	-	13.7	-	2.3	**280.7**
1Q22	124.0	256.0	20.7	3.5	1.2	**405.4**
2Q22	104.4	-	13.4	-	1.2	**119.0**
3Q22	114.1	157.7	161.7	3.4	1.0	**437.9**
4Q22	72.4	-	13.1	-	2.6	**88.1**
1Q23	234.3	157.7	15.7	3.2	0.6	**411.5**
2Q23	0.0	0.0	163.8	0.0	1.3	**165.1**
3Q23	130.3	108.3	15.3	3.1	1.2	**258.1**
4Q23	0.0	0.0	8.2	0.0	0.8	**8.9**

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.

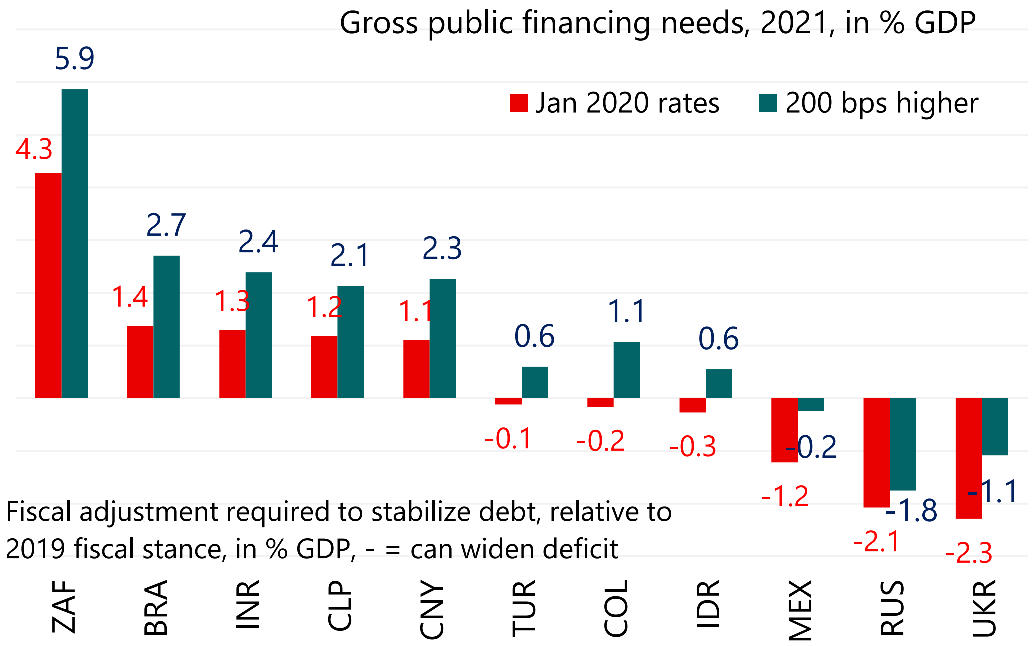
Gross financing needs have risen



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)

2^{nd} Phase of Tax Reform

06

- On July 1, we published a report with the Equity Research team about the tax reform.

Click on the link: http://bit.ly/Std-taxreform-070221

Summary - 2ND PHASE OF TAX REFORM: MAIN ASPECTS

- On June 25, the Economy Minister delivered to the Lower House the first draft of the income tax reform bill (PL 2337/2021), considered to be the second phase of the Tax Reform (the first was the proposal to merge federal taxes (PIS and Cofins) into a VAT.

- The highlights of the second phase proposal are: i) raise the tax exemption threshold for personal income tax up to BRL2,500/month from BRL1,903/month and update the tax brackets; ii) cut the corporate income tax rate to 22.5% from 25% in 2022 and 20% from 2023 onwards. These would be fiscally compensated by: i) a 20% tax on dividends (currently not taxed in Brazil); ii) tax on investments (e.g. the stock of investment funds of high-net-wealth individuals and real estate funds); and iii) an end to the tax break generated by Interest on Equity payments (JCP, acronym in Portuguese).

- The proposal is an ordinary bill that requires only an absolute majority by one vote to be approved in each house of Congress. In a scenario where the new legislation is approved this year, most of the legislation would only take effect in 2022 due to the "principle of annuality". In our view, from a revenue standpoint, the proposal seems to bring permanent increases in federal tax collection, given the gains from the tax on dividends and the end of the deduction of interest on equity (JCP), which more than offset the changes in the income tax for individuals, according to our estimates.

Main Measures in the 2nd Phase of the Tax Changes

Focus	Measure
Personal income tax (IRPF)	**Exemption for income up to BRL2,500/month from BRL1,903/month and New tax brackets**
	16 million people will be exempt from the income tax (+5.6 million compared to the current threshold)
	Simplified tax form will be limited for income up to BRL40,000/year
	Permission to update value of real state
	Profits and dividends taxed by 20% (currently dividends are not taxed in Brazil)
	Dividends: exemption for below BRL20,000/month for SME
Investment	New rules for taxation of selling of assets with intermediaries offshore
	Payments will be done on a quarterly basis
	IRPJ and CSLL tax collection will be on a quarterly basis. Deduction of losses in up to 3 quarters
	Single tax rate of 15% for investment funds in the year. The end of the "come-cotas" taxation in May
	Equities: tax rates in investment in 15%
	Simplification of the calculation method of IRPJ and CSLL taxes to reduce costs
	End of exemption of income distributed by real state funds (FII) to individual investors
Corporate tax (IRPJ)	**Cut to corporate income tax rate from 25% to 22.5% in 2022 and 20% from 2023 onwards**
	Deferred payment for companies' partners will not be deducted as operational expenditure
	The end of the tax break generated by interest on equity (JCP, acronym in Portuguese) payments
	New rules for the enterprise organization and taxation of capital gains with selling of shares

Sources: Ministry of Economy, Santander

Federal Revenue Impact of the Proposal – Government Estimates

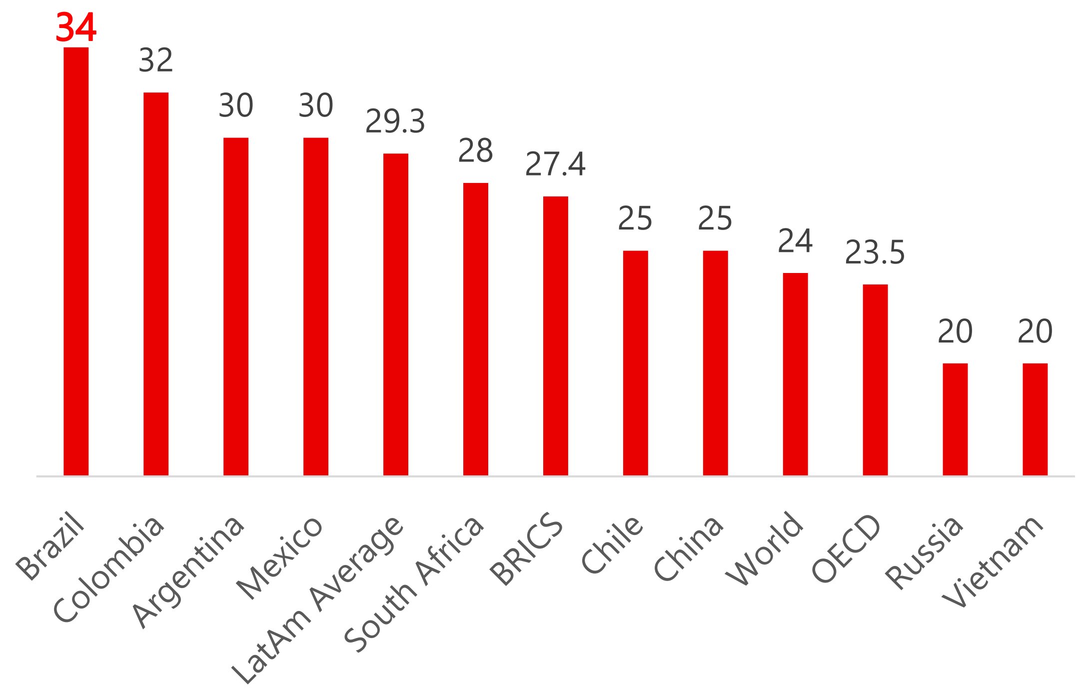
Federal Revenue Impact of the Proposal - Gov. Estimates			
BRL Billion	2022	2023	2024
Changes in Personal Income tax	-13.5	-14.5	-15.4
Changes in Corporate Income Tax	-18.5	-39.2	-41.5
Taxation of exclusive/closed funds (stock)	14.5	-	-
Dividends (tax: 20%)	18.5	54.9	58.2
End of interest on equity (JCP)	2.8	7.2	7.6
Others	-2.8	-8.1	-8.3
Total	**1.0**	**0.3**	**0.6**

Sources: Federal Revenue of Brazil, Santander

Tax rates - Global comparison

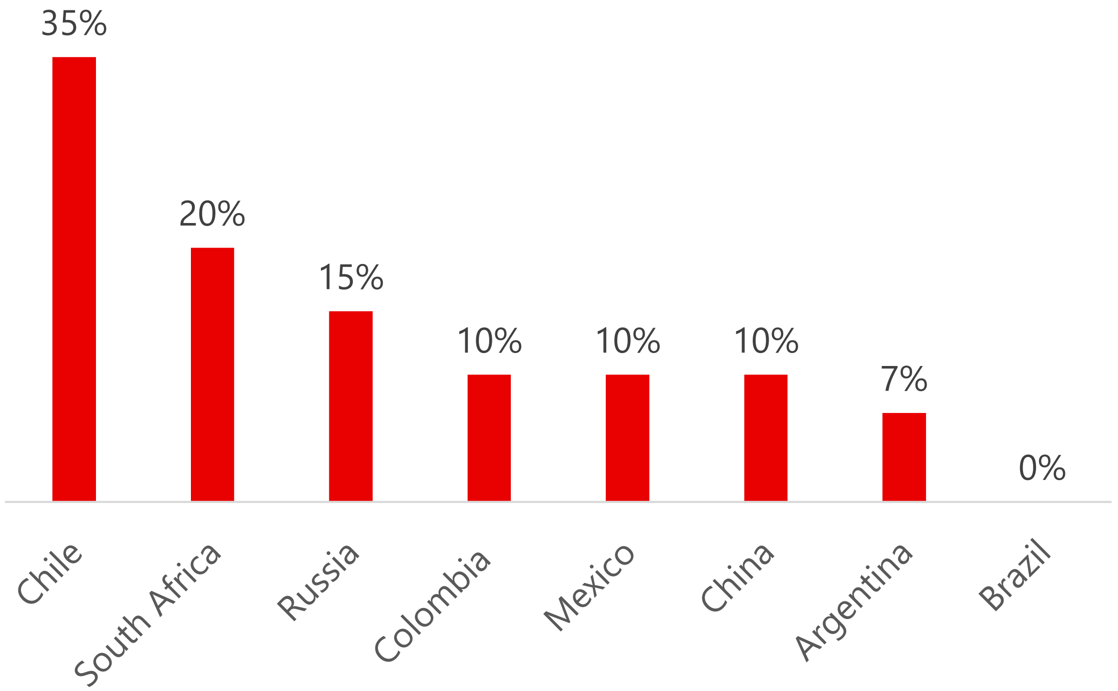
- The law proposal intention is to converge the similar taxes in the EM contries

Average Corporate Taxes (2020)



Sources: Tax Foundaton

Dividends - Withholding Tax Rates



Sources: S&P

MACRO SCENARIO: BASELINE SCENARIO

Macroeconomic variables		Previous		Current
GDP (%)	2021E	3.6	↑	5.1
	2022E	1.5	↑	2.0
	2023E	1.8	↓	1.5
IPCA (%)	2021E	5.9	↑	6.7
	2022E	3.9	↑	4.0
	2023E	3.3	→	3.3
Selic Rate (% end of period)	2021E	6.50	↑	7.00
	2022E	7.00	→	7.00
	2023E	7.00	→	7.00
FX Rate - USDBRL (end of period)	2021E	5.25	↓	5.05
	2022E	5.55	→	5.55
	2023E	5.20	→	5.20
Current Account Balance (% of GDP)	2021E	0.3	↓	-0.5
	2022E	0.2	↓	-0.8
	2023E	-0.5	↓	-1.0
Primary Fiscal Balance (% of GDP)	2021E	-3.0	↑	-1.9
	2022E	-2.1	↑	-1.7
	2023E	-1.6	↑	-1.3
Gross Public Debt (% of GDP)	2021E	85.0	↓	82.2
	2022E	87.6	↓	84.3
	2023E	90.0	↓	87.2

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

- For our latest Scenario Review 'IMPROVEMENT IN THE SHORT TERM, CAUTION FOR THE MEDIUM TERM' (sent on July 01, 2021).
- Click on the link: http://bit.ly/Std-scenrev-070121

Thank you.

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

Simple Personal Fair

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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 and Commmodities
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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