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FISCAL POLICY

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Brief Overview

01

Summary – Better Short Term, Still Challenging Outlook

- We improved our short-term figures on the heels of an extended commodity wave. We now forecast a balanced primary budget for 2022 (previously: -0.8%), on the back of higher (mostly commodity-related) revenue. In our view, the central government should register a 0.5% of GDP primary deficit this year, offset by regional governments' 0.5% of GDP primary surplus.

- Our public-sector oil-revenue estimate has risen to 3.0% of GDP, from 2.6% in February, reflecting our current hypothesis for Brent oil prices (+27%, to USD115/bbl in terms of yearly average). We see a higher probability of fiscal stimulus via tax breaks ahead (with BRL50 billion already granted for 2022, in our estimates), with the increase in the income threshold of tax brackets for personal income tax expected to add BRL15 billion to the amount of revenue losses. We include in our scenario the 5% increase of public servants wages in 2022, totaling BRL8 billion in our numbers.

- Additionally, we continue to foresee a deterioration in the nominal (headline) budget results due to higher debt costs (in the Selic rate), implying a still steep upward trajectory for government debt in the medium term. Yet, in the short run, this nominal result will be partially offset by the BCB's profit from FX swaps in 2022 (currently above BRL80 billion), on the heels of the stronger BRL. We also updated our GDP deflator estimate to 9.5% (from 8.7%) this year, reflecting the higher commodity prices (and resulting inflation). In light of this, our 2022 gross-debt to GDP forecast was reduced to 80.6% (from 84.8%), remaining virtually stable compared to 2021.

- For the long term, since we assume the commodity cycle will, by definition, not be permanent, we continue to see a risky path toward debt stabilization, in a context of the reduced efficacy of fiscal rules, and the social pressures to increase expenditures in a context of higher inflation. Despite the breathing room on the fiscal side provided by this extended commodity cycle, the high level of mandatory expenses is a problem that needs fixing as soon as possible (via economic reforms) in order to quell the fiscal risks in the medium to long run.

Fiscal – Commodities Still Help, Yet the Uncertainties Remain

Short term: better revenues

2021: Primary surplus back after 8 years
Led by Regional gov.: +BRL98 billion (1.1% of GDP).

2022: Primary Balance: balanced (0% GDP)

1. Central Government: -BRL45 bn (-0.5% GDP)
(+ Dividends and Commodities)

2. Regional Gov.: +BRL45 bn (+0.5% GDP)

Gross Debt: 80.6% of GDP in 2022
from 80.3% of GDP in 2021. We also updated our GDP deflator estimate to 9.5% (from 8.7%) this year, reflecting the higher commodity prices (and resulting inflation). The nominal result will be partially offset by the BCB's profit from FX swaps in 2022

Debt Liquidity Reserves Level
Good level (~11 months) to deal with the uncertainties.

Medium term: challenging outlook

Risks: Fiscal stimulus via tax breaks
BRL50 billion in fiscal stimulus and a demand for more 5% increase in public servants wages*

Less efficacy of fiscal rules
Inflation-effect: +1.5pp of GDP by 2026. Higher IPCA should open +BRL133 billion in 2023 under the cap.

Primary surplus outlook for 2025-26
Commodity-led revenues vs. inflation-led spending

Higher nominal deficit 2022 onward
In 2022, this the Selic-effect would be mitigated by higher revenues from swap operations of BCB.

Estimated peak for the gross debt
93% of GDP in 2029 (-4.0 pp from January)

Long term forecast close to the edge
85% of GDP in 2040

* Included in our Scenario

Background – Surfing a extended commodity wave

- Low inventories for most raw materials, coupled with idiosyncratic factors (e.g., adverse weather, past underinvestment, and high cost of production), have been feeding the commodity rally in 2022. The ongoing geopolitical shock coming from Eastern Europe aggravates further what was already materializing as supply-demand imbalances. As a result, our commodity price forecasts have been revised upward for all indexes for 2022 and 2023. On average, we pencil in a double-digit increase in the path for the headline CRB Index and its key components, as compared to our previous scenario, suggesting an extended commodity cycle.

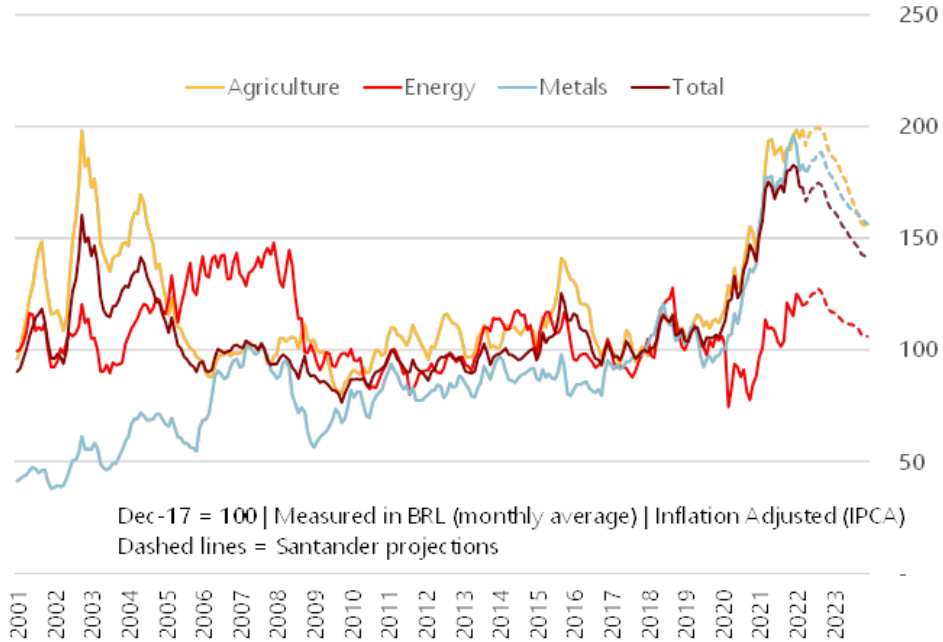
CBR Commodity Prices

YE	2019	2020	2021	2022e	2023e
CRB Food	331	355	483	542 ↑	488 ↑
CRB Energy	1647	1161	1521	1850 ↑	1809 ↑
CRB Metal	749	887	1259	1306 ↑	1171 ↑
CRB	401	444	571	606 ↑	570 ↑

YE YoY	2019	2020	2021	2022e	2023e
CRB Food	1%	7%	36%	12%	-10%
CRB Energy	2%	-30%	31%	22%	-2%
CRB Metal	-11%	18%	42%	4%	-10%
CRB	-3%	11%	29%	6%	-6%

Sources: BBG, Santander.

CBR Commodity Prices

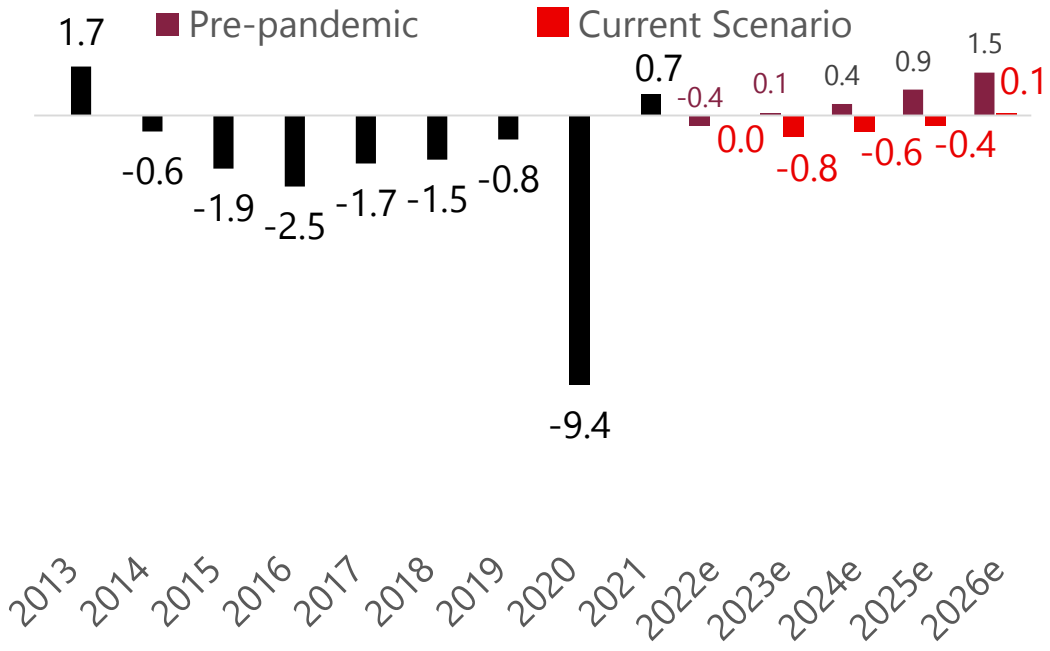


Sources: BBG, Santander.

Fiscal – Better Short Term, Still Challenging Outlook

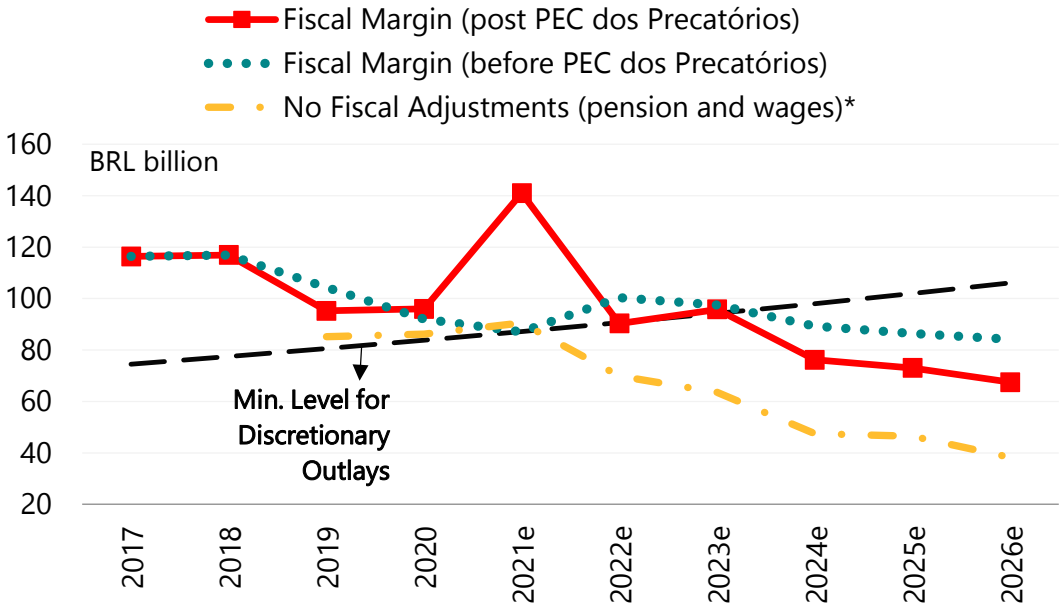
- *PEC dos Precatórios* affected our primary balance estimates with higher expenditures ahead,
- The final primary balance results will depend on the revenues result, we believe that part of the extraordinary revenues that "helped" in 2021 (corporate restructuring) will be lower 2H22 onwards. On the other hand, oil-revenues should increase with pre-salt and oil prices.

Public Sector Primary Result (% GDP)



Sources: BCB, Santander.

Fiscal Margin – BRL billion



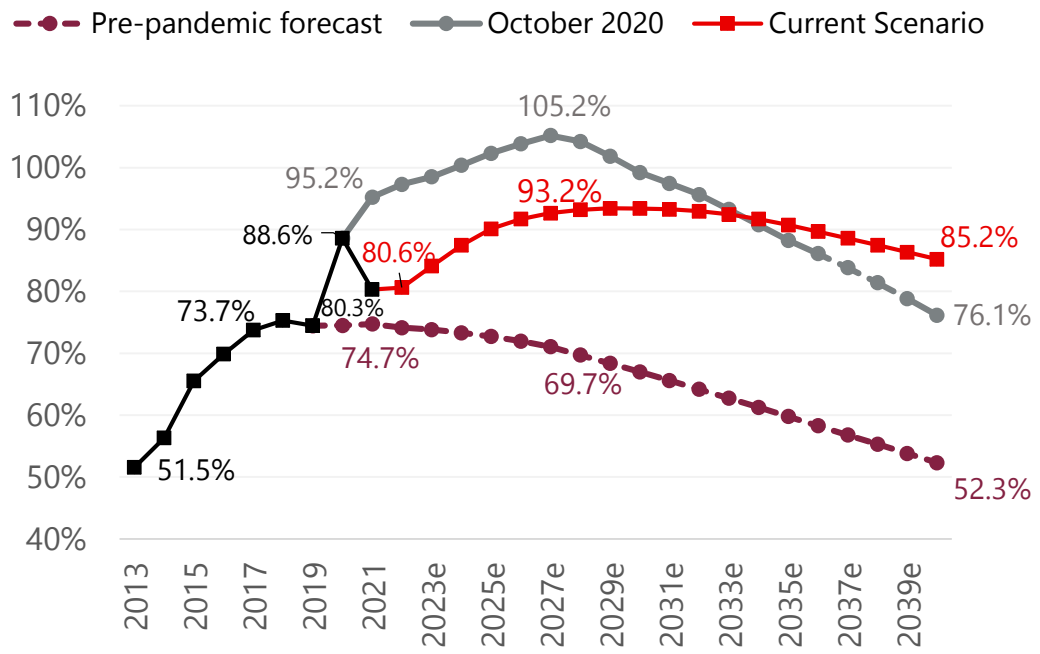
Fiscal Margin = Spending cap Max limit - Mandatory Outlays
* Simulation **WITHOUT** the approval of the PENSION REFORM and WITH PUBLIC SERVANTS WAGES readjusted by inflation

Sources: National Treasury, Santander.

Fiscal – A higher interest burden ahead, deteriorating the debt dynamics

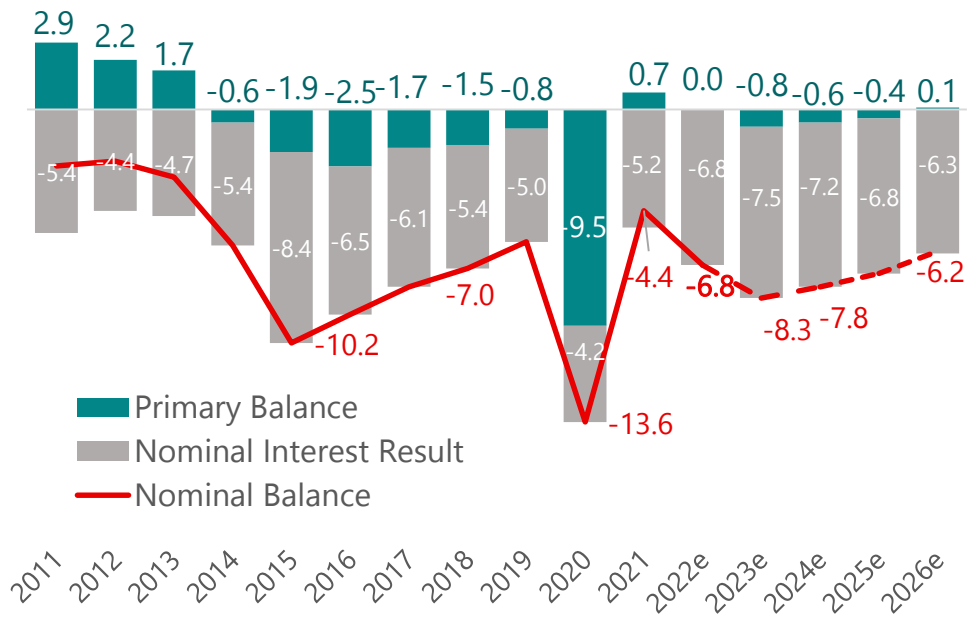
- Our Selic rate forecast is 13.25% in YE2022. Our real interest rate estimate is at 4.0% per year in the long run (7.0% nominal).
- We continue to foresee a deterioration in the nominal (headline) budget results due to higher debt costs (in the Selic rate), implying a still steep upward trajectory for government debt in the medium term. Yet, in the short run, this nominal result will be partially offset by the BCB's profit from FX swaps in 2022 (currently above BRL80 billion), on the heels of the stronger BRL.

Scenarios - Gross Debt Scenario (% GDP)



Sources: BCB, Santander

Public Sector's Financing Needs (% GDP)



Sources: BCB, Santander.

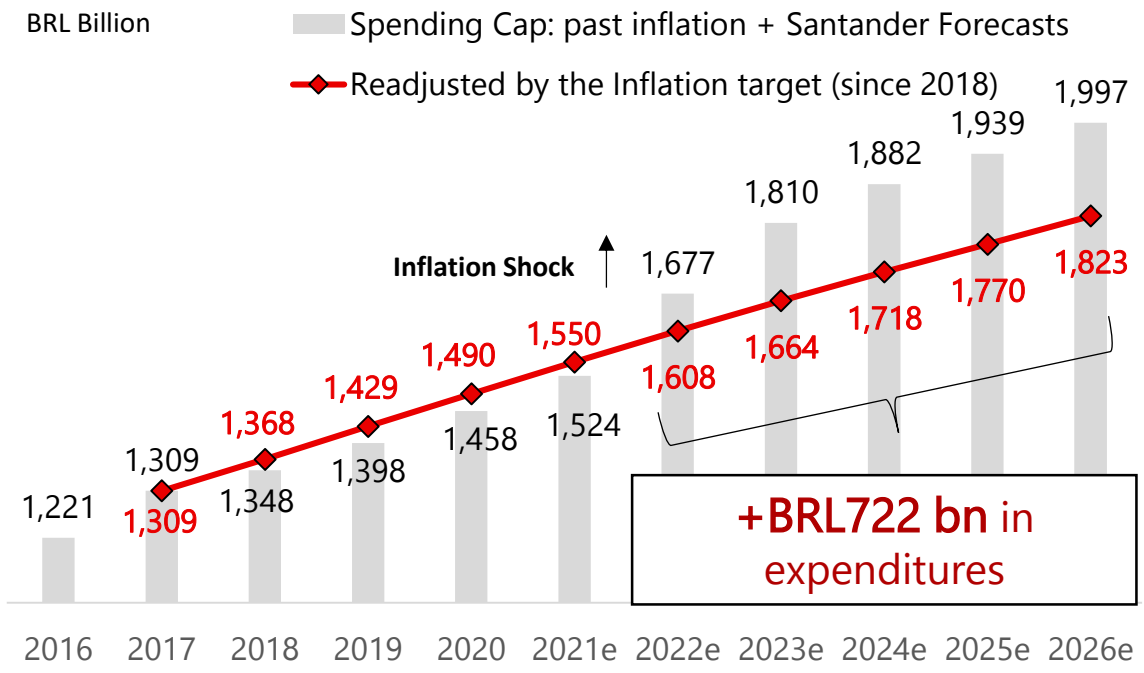
Spending Cap Rule – Lost part of its anchoring power

02

Fiscal – Spending cap rule was affected by the inflationary shock

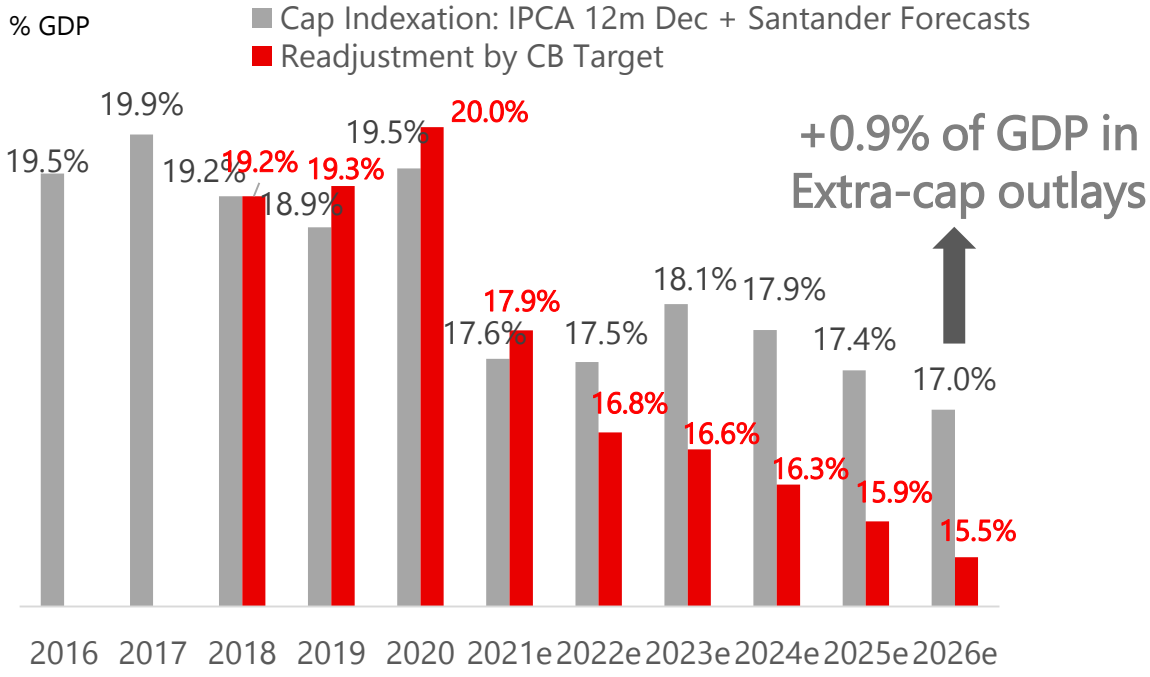
- We believe that the main fiscal anchor lost part of its anchoring power. We calculated more than BRL720 billion in expenditures, compared to the scenario that the spending cap rule is readjusted by the inflation target.

Spending Cap Max. Total Limit



Sources: BCB, Santander.

Change in the index of Spending Cap Rule

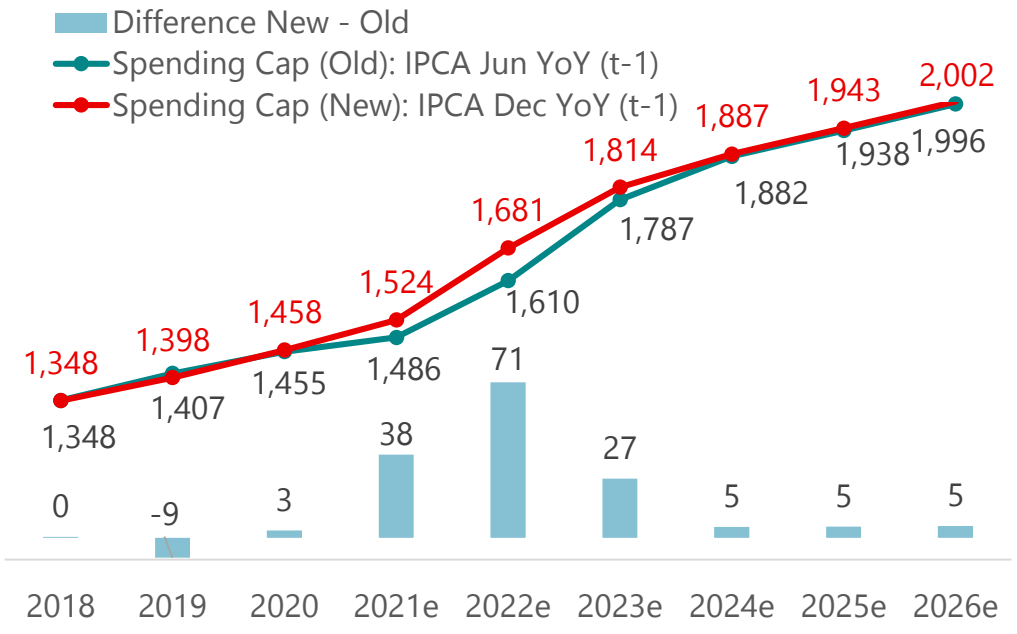


Sources: Ministry of Economy, IBGE, Santander

Fiscal – *PEC dos Precatórios* was the legal vehicle for the new welfare program

- PEC *dos Precatórios* created a margin of BRL113 bn in the spending cap rule (BRL46 bn through court-ordered debt cap + BRL67 bn by changing the spending cap indexation rule). It opened BRL71 billion space in 2022 (with extra BRL4 bn by some accounting changes) and should open a BRL27 billion in 2023, through the change in the indexation rule. If the inflation converges to the target in 2024, the two rules (former indexation in June 12m) could converge in 2024.

Change in the index of Spending Cap Rule



Sources: Ministry of Economy, IBGE, Santander

Indexation Rules - Spending Cap rule for 2023

Spending Cap Margin: Differece between the two types of indexations rules
(Old: IPCA Jun 12m , New: IPCA Dec 12m)

IPCA June 2022 YoY \ IPCA December 2022 YoY	5.0%	5.5%	7.0%	**7.9%**	8.5%	9.0%	9.5%
8.0%	22.6	31.0	56.1	71.2	81.3	89.7	98.0
9.0%	6.5	14.9	40.0	55.1	65.2	73.6	81.9
10.0%	-9.6	-1.2	23.9	39.0	49.1	57.5	65.8
11.0%	-25.7	-17.3	7.8	22.9	33.0	41.4	49.7
12.0%	-41.8	-33.4	-8.3	6.8	16.9	25.3	33.6
13.0%	-57.9	-49.5	-24.4	-9.3	0.8	9.2	17.6

Sources: Ministry of Economy, IBGE, Santander

Court-ordered Debt – *Precatórios* on the rise

03

National Treasury report - The provisions of court-debt orders liabilities

- In a report published on 10/06/2021, it included the provisions for judicial and administrative losses reported by the Attorney General of Brazil, totaling BRL307 billion. These are the official provisions published in the Treasury's "General Budget Report".

Provisions (BRL billion)	2021	2020	% total (2021)
Fundef	132.5	137.5	43.1
Minimum Income Program (Law10,834/2004)	54	-	17.6
Action possessive	50	50	16.3
Compensation to the sugar and alcohol sector	8.4	-	2.7
Prescription of Reimbursement to the Treasury – TCU	7.3	7.3	2.4
Fiscal Auditors – 28.9% readjustment	7.1	7.1	2.3
Indemnity for material damage	7.0	10.5	2.3
Wage Differences	5.8	5.3	1.9
Performance Bonus – RAV	4.3	4.3	1.4
Correction of inflationary purges	3.8	3.8	1.2
Indemnity related to readjustment, damages and loss of profits	-	32.6	-
Others	27.3	18.7	8.9
Total	307.5	277.0	100

Sources: National Treasury, Ministry of Economy, Santander

Fundef: is the discussion about lower transfers on the Fund for the Preservation, Development and Valorization of Primary Education in the States (Fundef), a skeleton belonging to the government of Fernando Henrique Cardoso. Expenses related to this liability increased by R$16 billion to a total court-ordered account in 2022

Outlook – Judicial Claims official estimate soared, the risks remains high

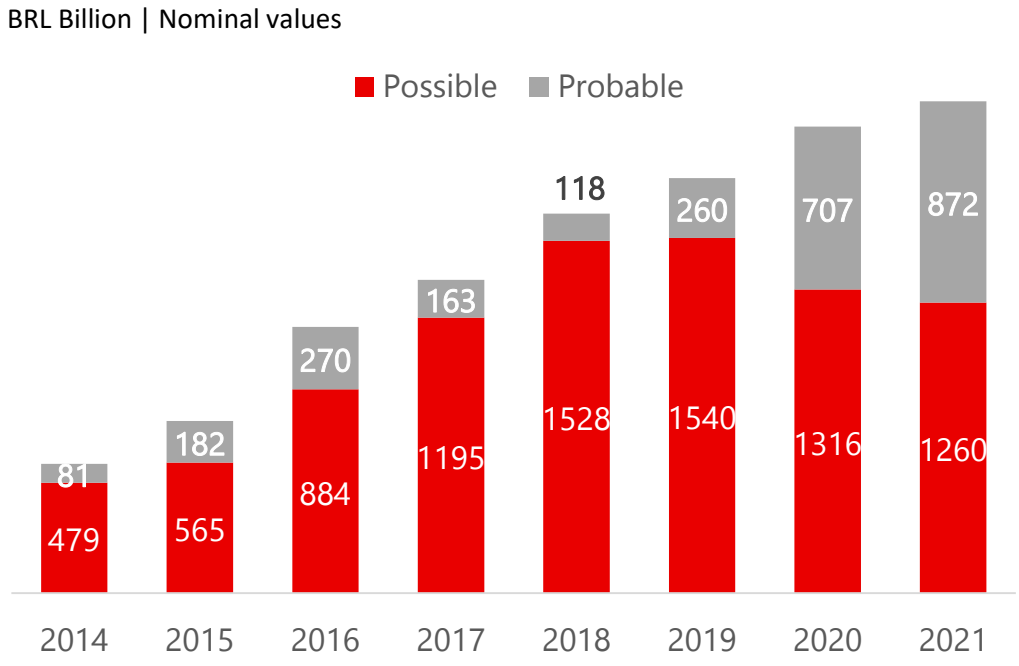
- Regarding probable judicial claims, the amount increased from BRL707.2 billion in 2020 to BRL871.9 billion in 2021, an increase of 23.3%. Claims of a tax nature correspond to 66.9% of the possible risk and 70.4% of the probable risk.

Judicial Claims Increase – BRL billion

BRL Billions	2021	2022
Personnel	**10.5**	**13.7**
Judicial Claims	7.3	10.5
RPVs (small value requisitions	2.1	1.9
Others	1.1	1.3
Pension Benefits	**22.6**	**30**
Judicial Claims	10.5	15.7
RPVs (small value requisitions	12.1	14.3
Continuing Benefits	**1.4**	**1.6**
Judicial Claims	0.2	0.3
RPVs (small value requisitions	1.2	1.4
Other cost capital expenses	**20.8**	**43.7**
Judicial Claims	17.7	40.3
RPVs (small value requisitions	1.9	2.3
Others	1.3	1.1
Total	**55.4**	**89.1**

Sources: National Treasury, MCM, Santander

LDO Judicial Claims: Probable and Possible Risk



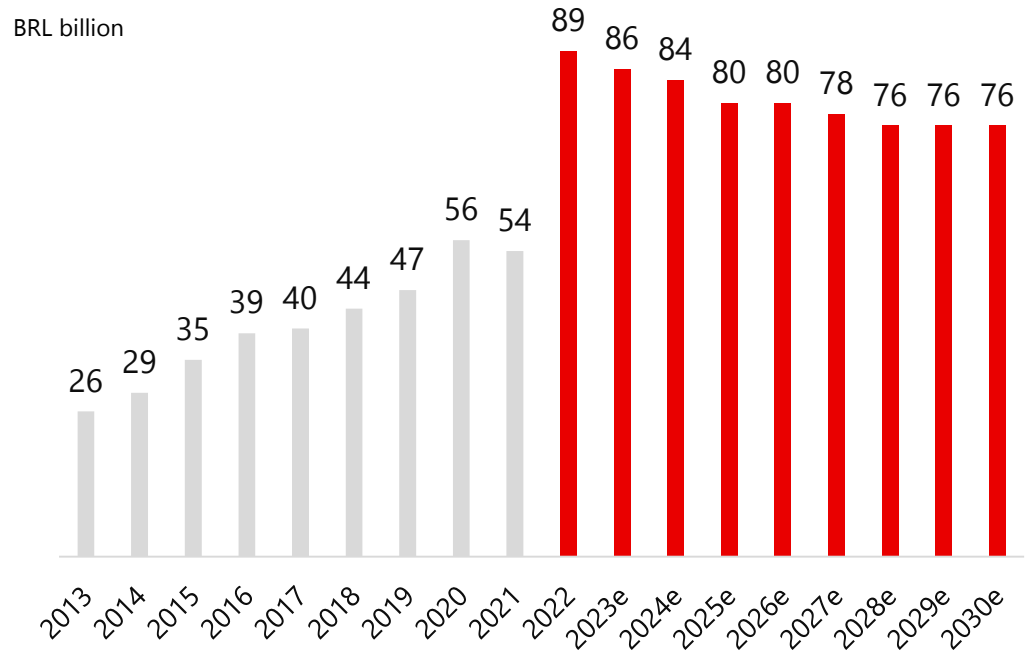
Sources: AGU, LDO 2020, Santander.

This judicial claims are included in the Budget Guidelines (LDO) as a potential and probable fiscal risks. Differently from the previous table from the “General Budget Report”, this numbers are the potential of liabilities in the Supreme Court judgments.

We estimate an increase in judicial claims over the next years

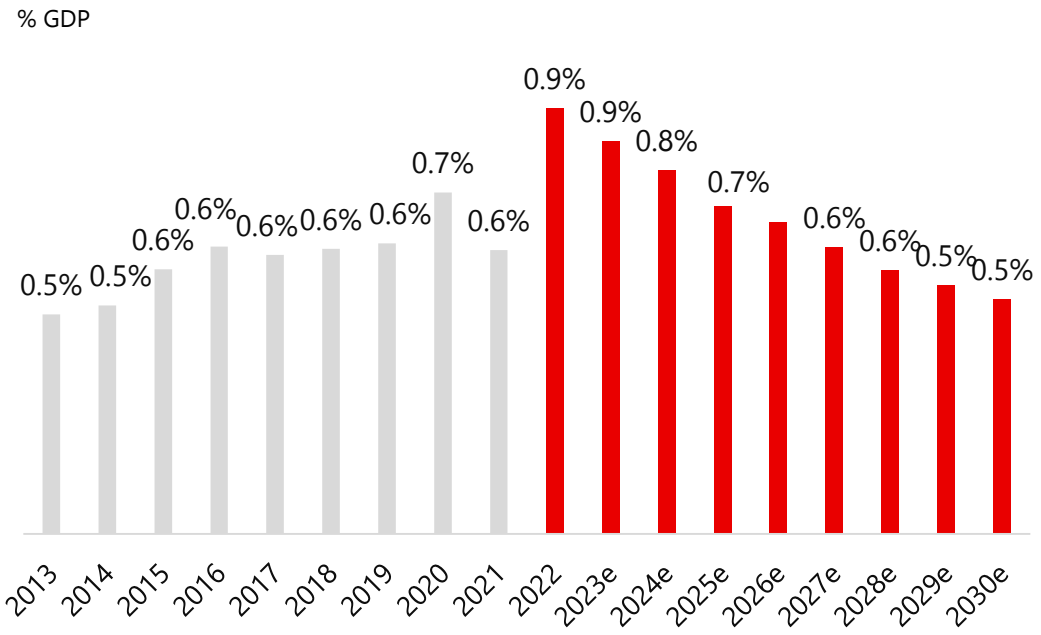
- We constructed a forecast based on the Budget Guidelines (LDO) probable judicial claim for next the years. In the short-run we see more pressure from the Fundef (educational fund) and those related to pension payments.
- Our preliminary estimate is only a preliminary "educated-guess" in view of the difficulty in estimating and the uncertainties related to the legal process. Either way, it has a relevant fiscal risk and requires a fiscal discipline in management to this increase.

Our Preliminary Estimates for judicial claims budget



Sources: LDO 2023, Santander

Judicial claims estimates



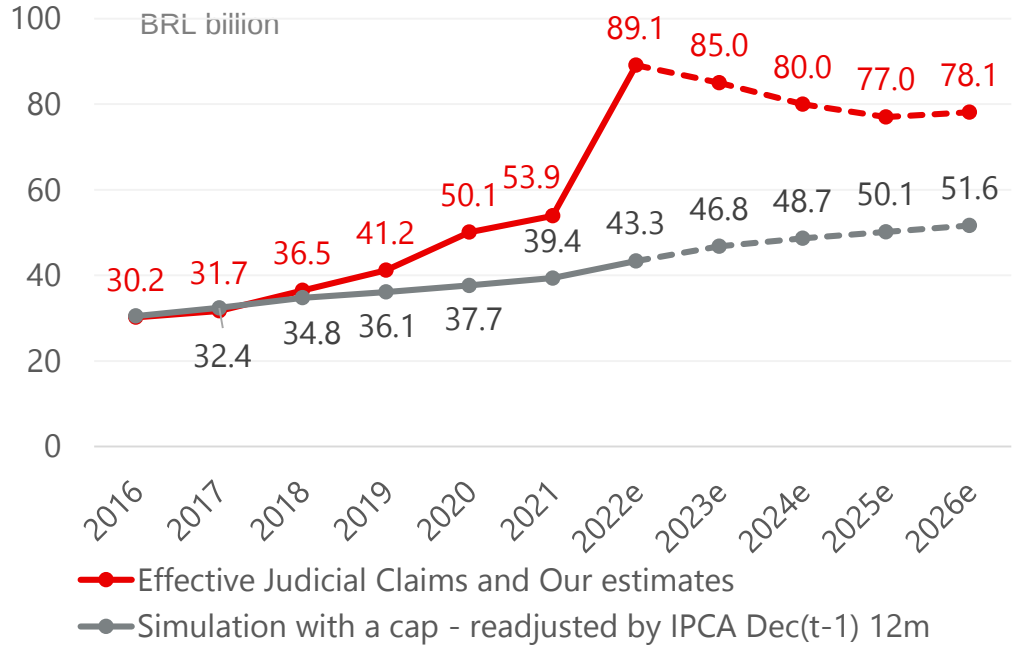
Sources: LDO 2023, Santander

Based on the PLDO 2023

Simulation – effects of creating a cap for the payment

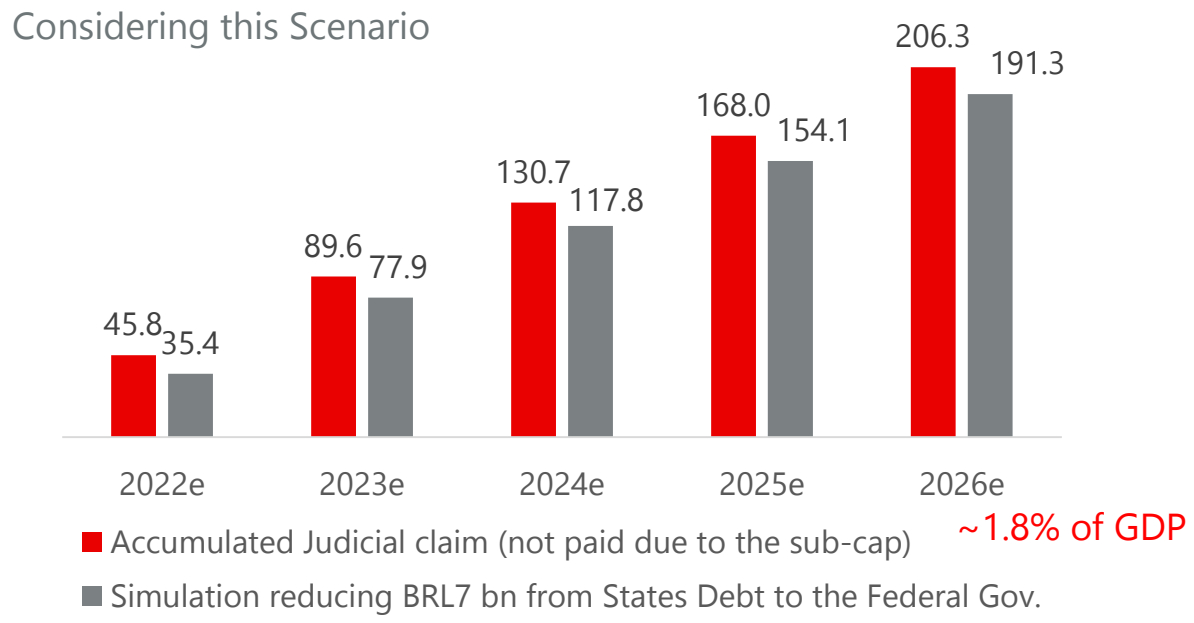
- In order to reduce the judicial claims payments, the government proposed to create a ceiling for these liabilities and postponing the remaining for the next few years (or paying outside the spending cap limit).
- Creating a cap since 2016 would reduce the judicial claim payments in 2022 to close to BRL43 billion, from the BRL89.1 billion official number.

Simulation - A limit for Judicial Claims payments



Sources: National Treasury, BCB and Santander.

Simulation with a cap – Accumulated judicial claims



Sources National Treasury, BCB and Santander.

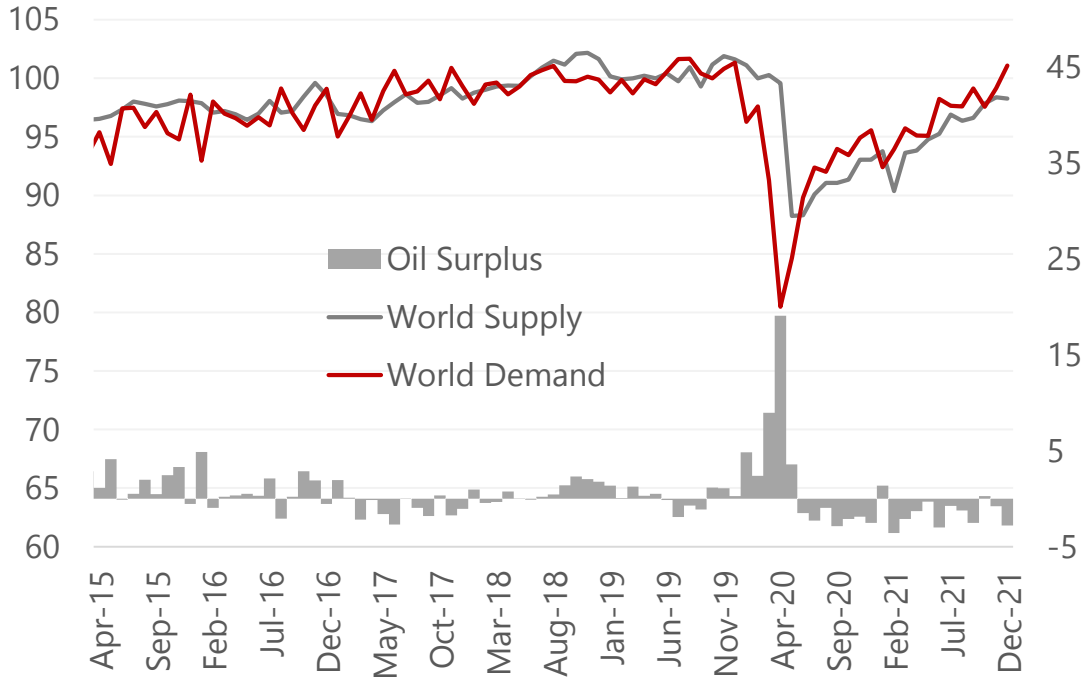
Special Report - Oil Global Outlook and Impact on Fiscal Scenario

04

Oil Balance - Global market deficit

- As the economy recovers from the coronavirus pandemic and as major oil producers' output falls, the global balance of supply and demand for oil has been consistently running at a deficit. As a result, global inventories are the tightest in at least seven years: U.S. crude inventories are already below 2011-15 levels, when Brent crude oil stayed above US$100/bbl. Similarly, OECD inventories are the lowest in seven years

World Oil Supply x Demand (mbd)



Sources: Bloomberg, Santander.

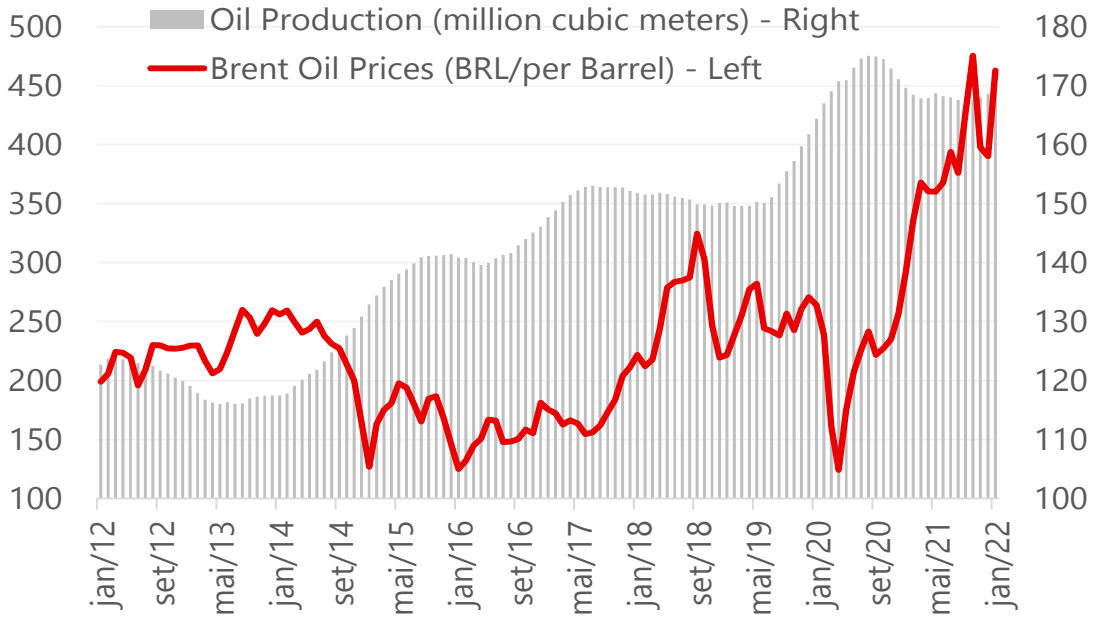
OECD Oil Stocks (million barrels)

Sources Bloomberg, Santander.

Oil and Fiscal – Higher production and the jump in revenues

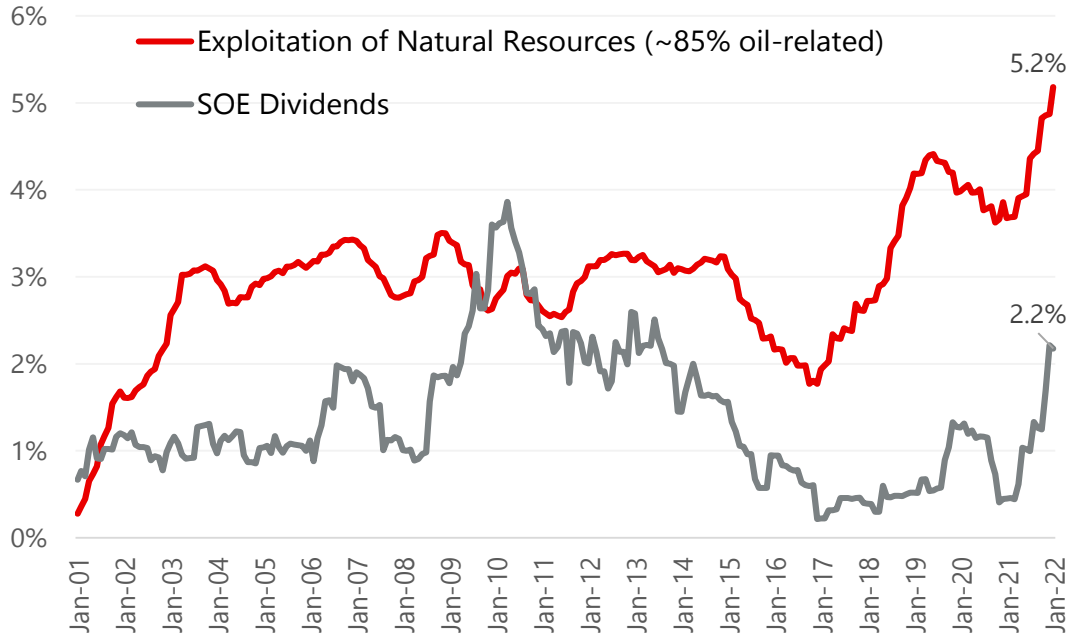
- For public accounts, oil revenues have been a notably positive factor, especially in 2021, and we expect this revenue to continue to help government revenue. As shown in Figure 8, oil production in Brazil has been increasing, especially pre-salt oil production. In 2021, a depreciated FX rate coupled with higher international oil prices (Brent) led to a robust revenue increase. For 2022, owing to the factors mentioned above, we expect revenue from oil to continue to be strong, leading to better primary balance numbers.

Brazilian Oil Prices and Production



Sources: MCM, ANP, Bloomberg, Santander.

Federal Tax Revenues (% of total Revenues)

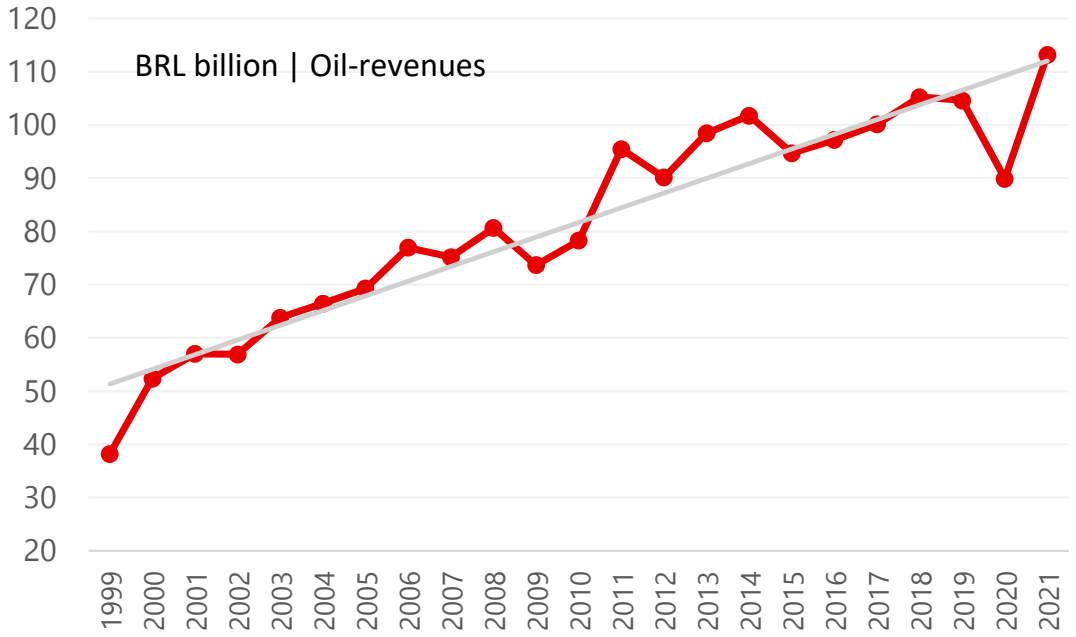


Sources National Treasury, Santander.

Oil and Fiscal – Regional Governments revenue increase

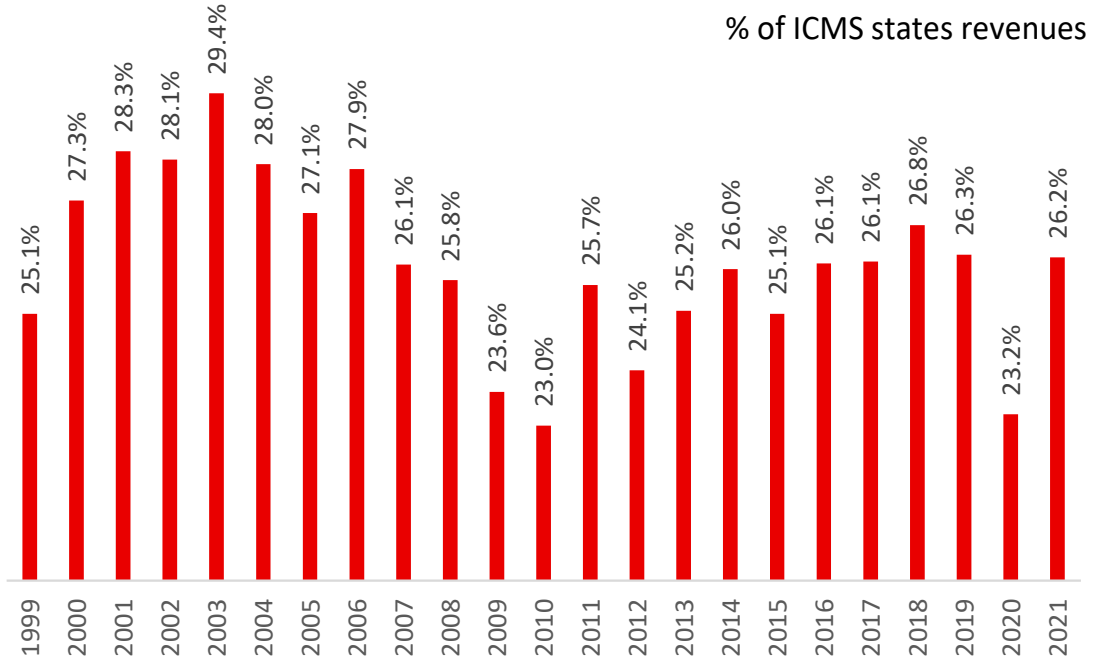
- The evolution of oil prices was a key element of this improvement in the public accounts of regional governments. ICMS tax collections related to oil were up 26% in 2021, in real terms. In other words, the states registered a strong recovery after the loss of revenue in 2020. We highlight that oil revenue corresponds to more than 20% of total ICMS, historically.

Brazilian Oil Prices and Production



Sources: Confaz, Santander.

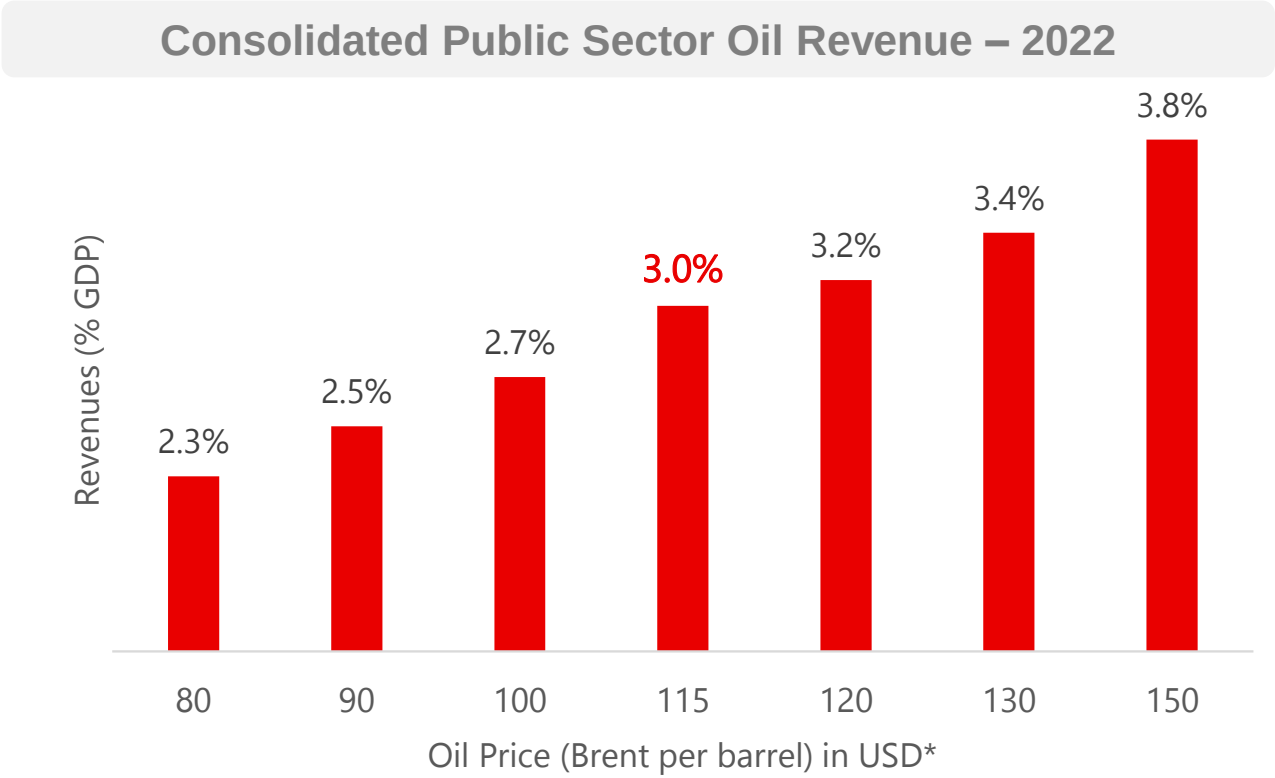
Regional Governments – Oil as % total



Sources National Treasury, Santander.

Oil and Fiscal – Total impact

- we see oil-related direct revenue at around 3.0% of GDP in 2022 considering the consolidated public sector. We estimate oil revenue elasticity by an error correction model at around 0.8. In the Figure below, we explore the different scenarios for international oil prices, keeping the exchange rate at BRL5.00/USD. If oil prices rise further, the fiscal result tends to be even more favorable, with the possibility of recording a primary surplus, as occurred in 2021.



FX rate maintained at BRL5.00 for 2022

Sources: Confaz, Santander.

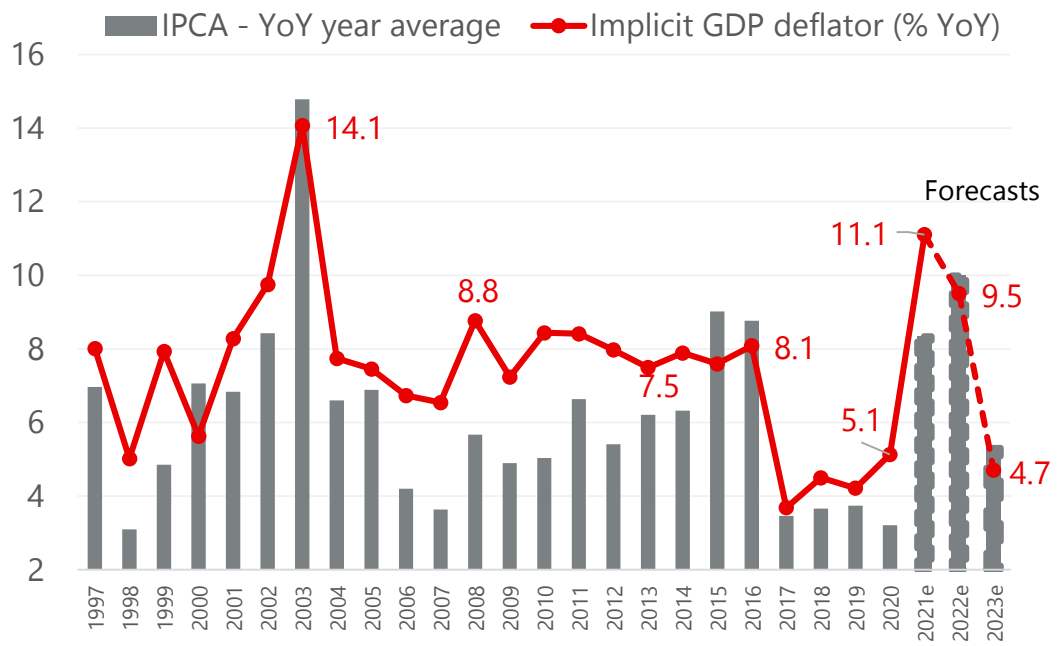
Fiscal Baseline Scenario – Primary Result and Simulations

05

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

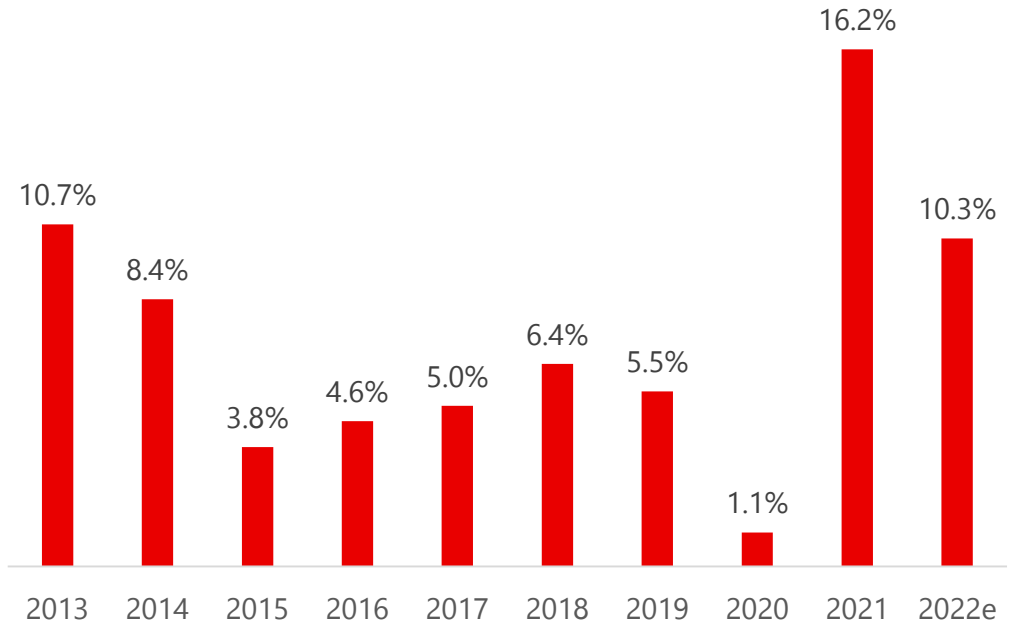
- Inflation played a significant role in improving public accounts in the short run. For 2021, in Mar-21 we estimated nominal GDP at 7%, but it ended the year with a 16.2% increase. The effect of the massive increase in the GDP deflator in the fiscal-statistics-to-GDP ratio. For 2022, we also revised upwards due to a more intense inflationary shock, we rose the estimate for 2022 GDP deflator from 8.7% to 9.5%. As a consequence the nominal GDP should rise 10.3%, according to our numbers.

IPCA and GDP Deflator



Sources: IBGE, Santander.

Nominal GDP Increase YoY

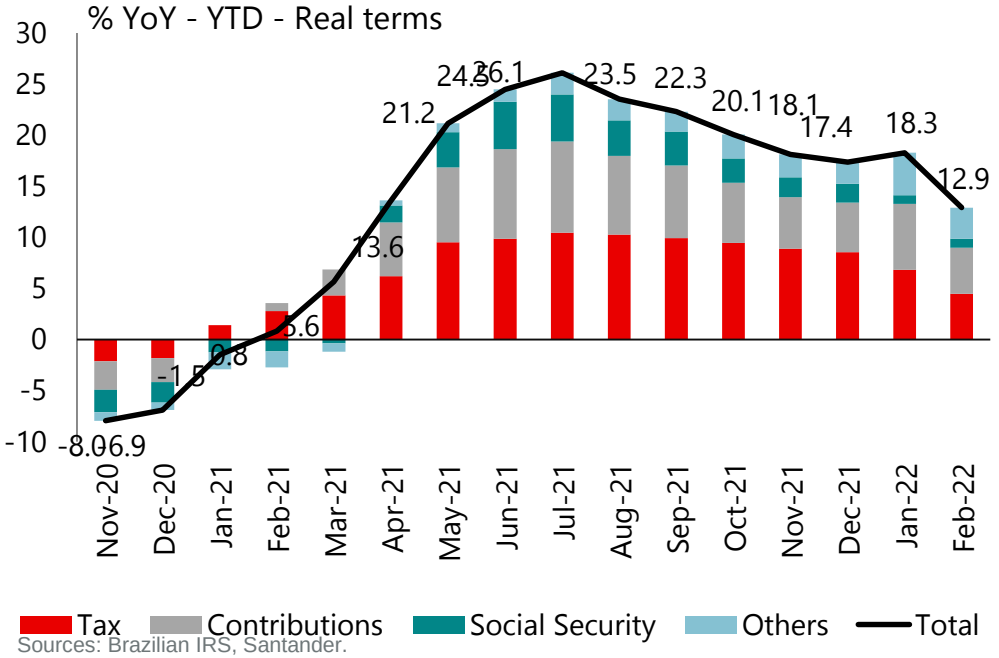


Sources: IBGE, FGV, Santander.

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

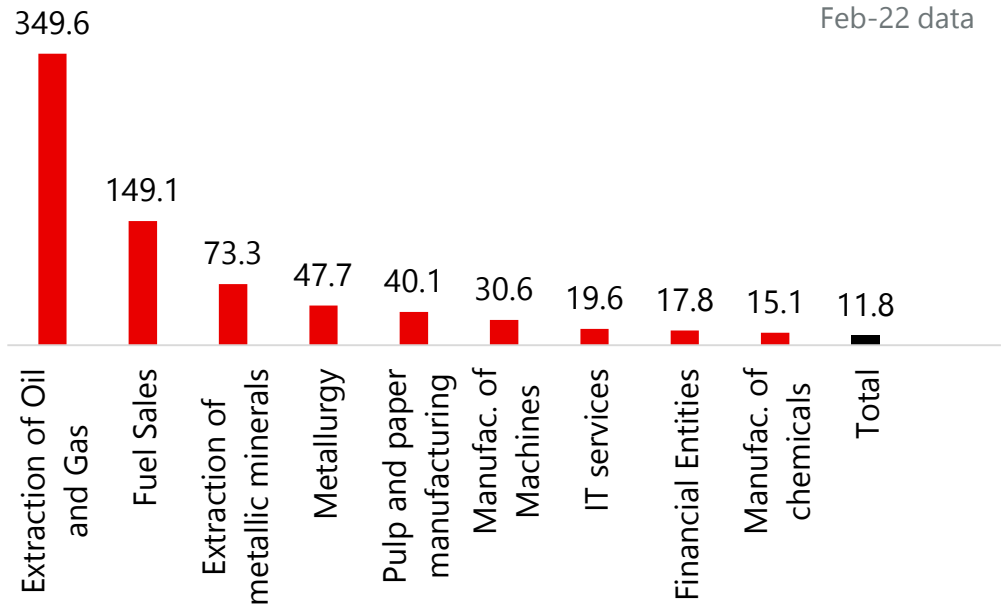
- We see a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the corporate sector, which have posted good results. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to metals.
- In our view, we expect revenue growth to slow down in 2H22 (still very positive), for the following reasons: i) Greater basis for comparison; ii) commodity prices losing steam; iii) normalization of the consumption basket - with more services (lower tax collection); iv) activity at a slower pace of growth after the crisis recovery.

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



Sources: Brazilian IRS, Santander.

Federal Tax Revenue by sectors (%YoY)

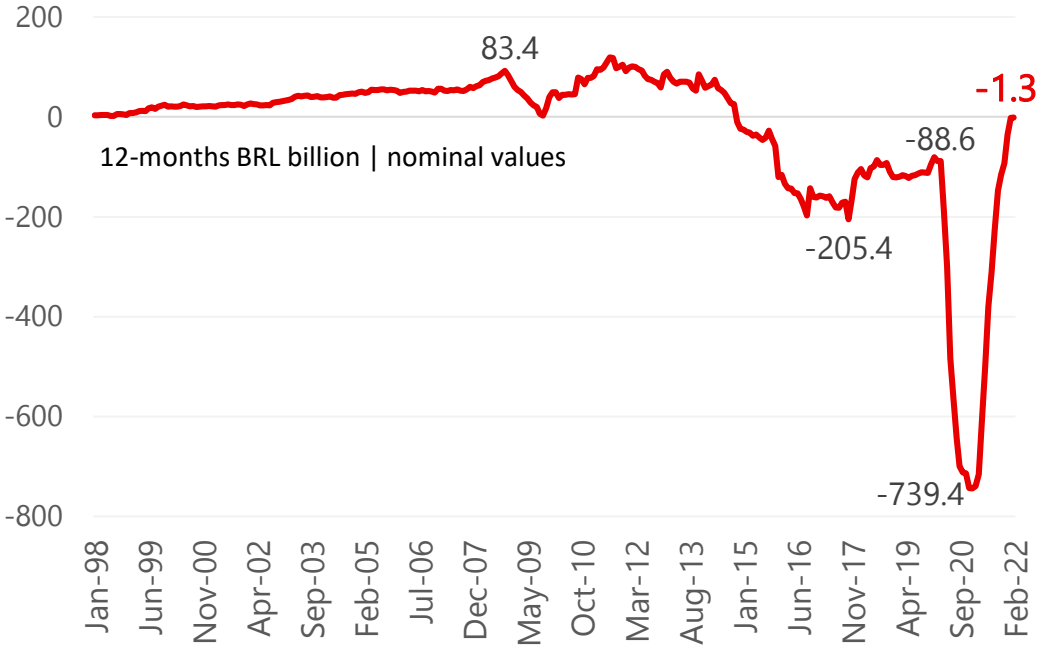


Sources: Brazilian IRS, Santander.

Public Sector Primary Result Improving with the Price-effect

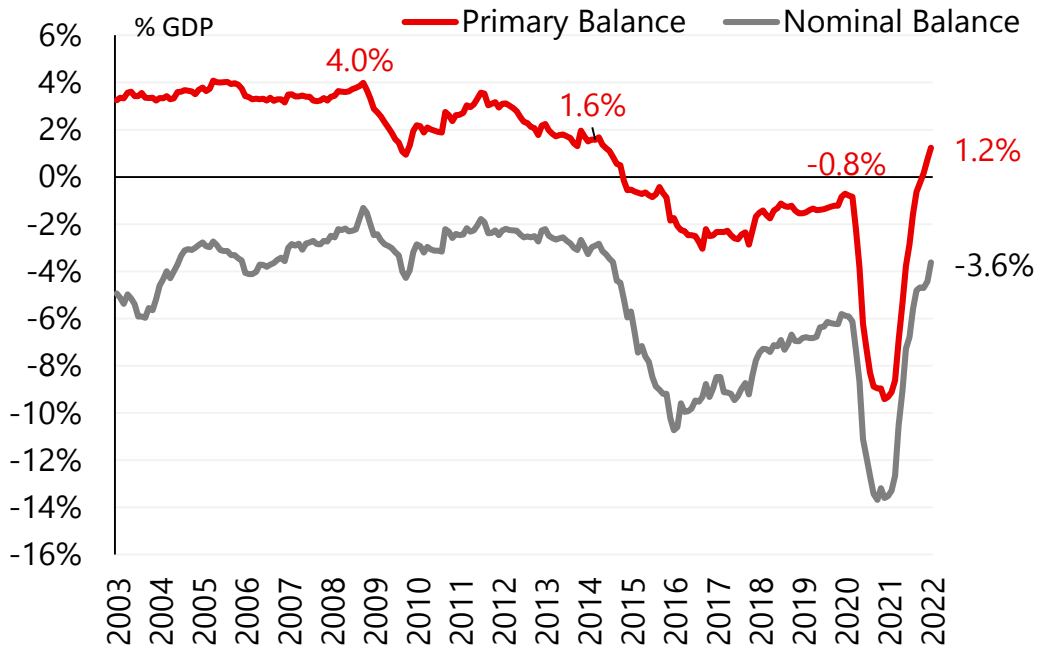
- The consolidated public sector posted a primary surplus of BRL101.8 billion in January, better than our forecast (BRL92.5 billion) and the market's median estimate (BRL81 billion). This was the best monthly result in the historical series (in part reflecting the favorable seasonality for the budget performance in the first month of each year). In 12 months, the public sector reached a primary surplus of BRL108 billion (1.2% of GDP), compared to BRL64.7 billion (0.75% of GDP) in December 2021. The fiscal result is maintaining a downward trajectory after a sharp reduction in fiscal stimulus in 2021and 2020 (close to 9.4% of GDP including both years).

Central Gov. – Primary Result



Sources: National Treasury, Santander.

Public Sector – 12m % GDP



Sources: BCB, Santander.

Fiscal – Unanchored with a riskier path to a long-term debt stabilization

Central Government's Primary Balance																
Fiscal Items (% of GDP)	2017	2018	2019	2020	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	Δ 26-17	Δ 30-17
Total Revenue	21.0	21.2	22.1	19.7	22.3	22.4	22.3	22.3	22.3	22.3	22.4	22.4	22.4	22.4	1.3	1.4
Revenues Collected by the IRS (1)	12.7	12.9	12.8	12.0	13.8	13.5	13.3	13.2	13.1	13.2	13.2	13.2	13.2	13.2	0.5	0.5
Net Social Security Revenues (2)	5.7	5.6	5.6	5.4	5.3	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	-0.2	-0.2
Revenues Not Collected by the IRS (3)	2.6	2.7	3.7	2.2	3.2	3.4	3.5	3.6	3.6	3.7	3.7	3.7	3.7	3.7	1.0	1.1
Transfers by Revenue Sharing	3.5	3.7	3.9	3.5	4.0	4.4	4.4	4.3	4.3	4.3	4.3	4.3	4.2	4.1	0.9	0.7
Net Revenue	17.5	17.6	18.2	16.1	18.2	17.9	17.9	18.0	18.0	18.0	18.1	18.2	18.2	18.2	0.4	0.7
Total Expenditure	19.4	19.3	19.5	26.1	18.6	18.4	18.8	18.7	18.4	17.9	17.8	17.6	17.3	17.1	-1.5	-2.3
Social Security Benefits (4)	8.5	8.4	8.5	8.9	8.2	8.2	8.6	8.5	8.4	8.3	8.3	8.2	8.1	8.0	-0.2	-0.4
Payroll (5)	4.3	4.3	4.2	4.3	3.8	3.6	3.6	3.7	3.6	3.5	3.5	3.5	3.5	3.4	-0.8	-0.9
Other Mandatory Expenses (6)	3.0	2.9	2.6	9.6	3.5	2.9	3.0	3.1	3.1	3.0	2.9	2.9	2.8	2.8	0.0	-0.2
Expenses with Cash Control (7)	1.9	2.0	1.9	1.8	1.7	2.5	2.4	2.3	2.1	2.0	2.0	1.9	1.9	1.8	0.1	-0.1
Discretionary Expenses (8)	1.8	1.8	2.2	1.4	1.4	1.3	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1	-0.6	-0.7
Central Gov. Primary Balance	-1.9	-1.7	-1.3	-10.0	-0.4	-0.5	-0.9	-0.7	-0.5	0.1	0.3	0.6	0.9	1.2	2.0	3.1
Public Sector Primary Balance	-1.7	-1.5	-0.8	-9.4	0.7	0.0	-0.8	-0.6	-0.4	0.1	0.3	0.6	0.9	1.2	1.8	2.9
Nominal GDP (BRL billion)	6,585	7,004	7,389	7,468	8,679	9,571	10,010	10,566	11,143	11,761	12,430	13,173	13,960	14,795	5,176	8,209

Notes and Hypothesis

(1) Elasticity: Revenues-GDP 2021: 1.7 | 2022: 1.12 | Long-term: 1.08. We see a slowdown in extraordinary revenues from 2021 to 2022. Approval of CBS (VAT) tax reform, modest increase of efficiency (0.2% of GDP). Potential GDP: 1.5% (until 2026), 2.0% (after 2026). Inflation: Center target (3.0%), GDP deflator (4.9%).

(2) Gradual recovery in the formal labor market and earnings. In 2022, we anticipate a more intense increase in informal jobs (post-pandemic).

(3) Oil revenues will increase with greater federal share in pre-salt, the reduction in prices in medium-term will be compensated with more production. We see more revenues from Concessions

(4) Pension Reform approved in 2019 will stabilize the expenditures as % of GDP in the long-term (even with the rapid aging of the population). In the short-run we eliminate the queue (repressed by the pandemic).

(5) Gradual increase in admissions (faster than the previous scenario, 70% instead of 55%) to the federal workforce ("normalization"). In the short-term (2024-25) decomposition of 80%, with wage increase of 3.0%. Nominal wage increase: 2.0% in the long-term. Long-term: digitalization effects contain the increase.

(6) Includes: higher payments in Court-ordered debt budget (including in the fiscal rule) – better management with a reduction in long-term, rise in federal contribution to Fundeb (Educational Fund), BPC (pension benefit).

(7) The main change was the increase in the new welfare program (*Auxílio Brasil*). 2022 budget: BRL90 billion (from BRL35 bn of the former Bolsa Família program). For 2023 onwards a more efficient and focalized welfare program (gradual reduction in outlays).

(8) Discretionary Expenses maintained close to 1.1% - a level that we consider enough to avoid a partial shutdown of public services, with and increase in investment with the reforms.

(9) Not consider an increase in Tax exemption (currently in Debate) from 2022 onwards.

Fiscal Risks – Income tax break and legislations

- We see a higher probability of fiscal stimulus via tax breaks ahead (with BRL50 billion already granted for 2022, in our estimates), with the increase in the income threshold of tax brackets for personal income tax expected to add to the amount of revenue losses.
- The legislations in Congress is also an relevant risk that could add more than BRL30 billion in new stimulus,
- There is also the debate regarding the increase in public servants wages. For each 1% it represents ~BRL5 billion in expenditures

Income Tax Overhaul - IRPF

Personal Income Tax Break (BRL)	Fiscal Impact (BRL billion)
1900 (Current)	0
2300	16
2500	20
3000	30
3500	42
4000	52
4500	60
5000	65

Sources: Brazilian IRS, Santander.

Fiscal Measures and its impacts

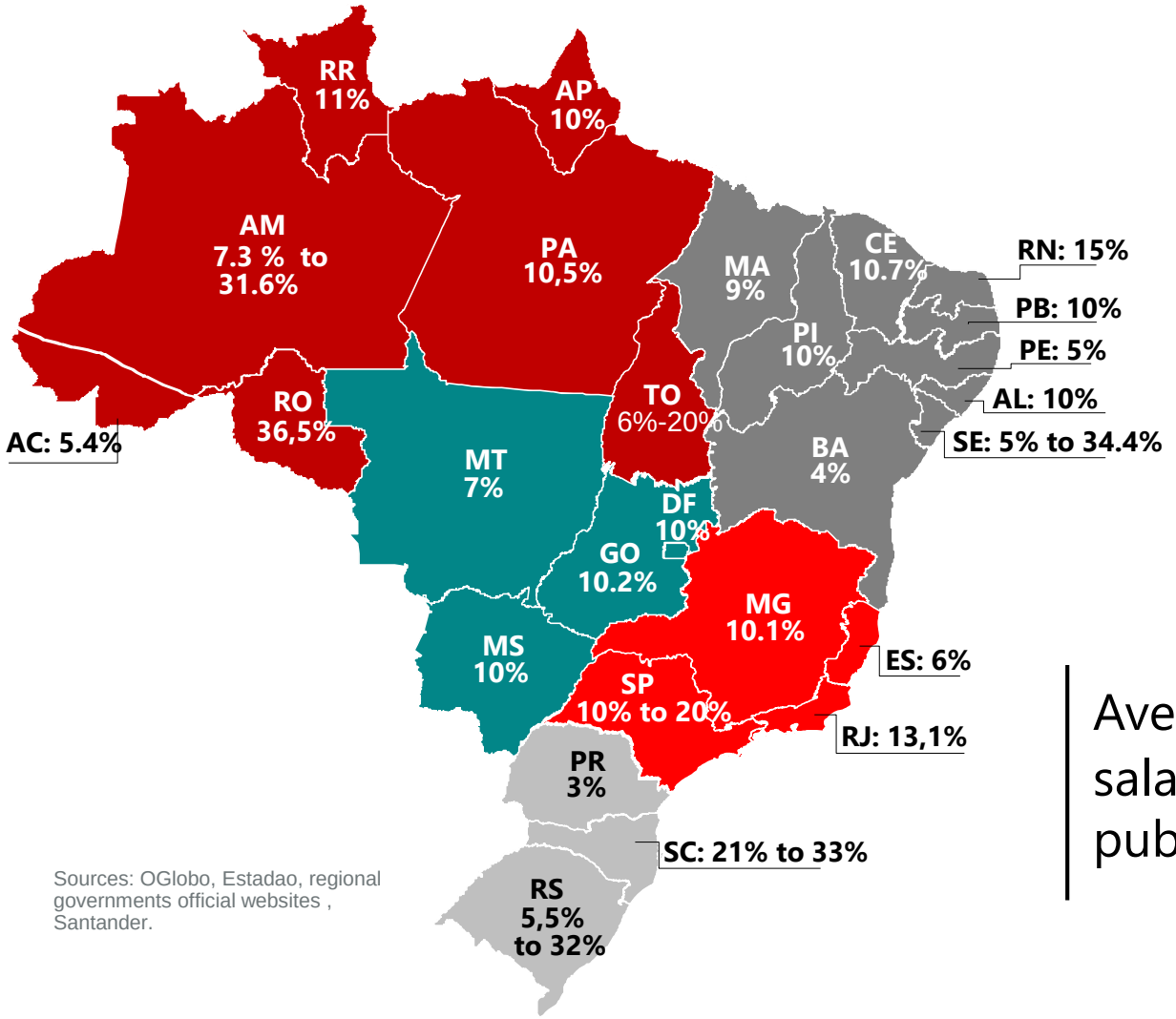
Measures	Fiscal Impact (BRL bn)
Subsidy for municipal public transport	5.0
Paulo Gustavo Law - Support for cultural sector	4.0
Salary floor community health workers	4.0
Aldir Blanc Law - Support for cultural sector	3.0
Assis Carvalho Law - aid to family farmers	3.0
Transfer to beneficiaries of the event sector emergency program (perse)	2.5
Financial aid to Santas Casa (Health)	2.0
PEC judicial quinquennium readjustments	3.7
1pp increase in public servants wages	2.7
Salary floor to nurses	0.5

Sources: Estadao, Marcos Mendes, Santander.

Fiscal Risks – Inflationary measures would represent higher expenditures ahead

- This year the regional governments started raising the public servants wages that would represent higher expenditures.

Regional governments wages increase by states in 2022



Sources: OGlobo, Estadao, regional governments official websites , Santander.

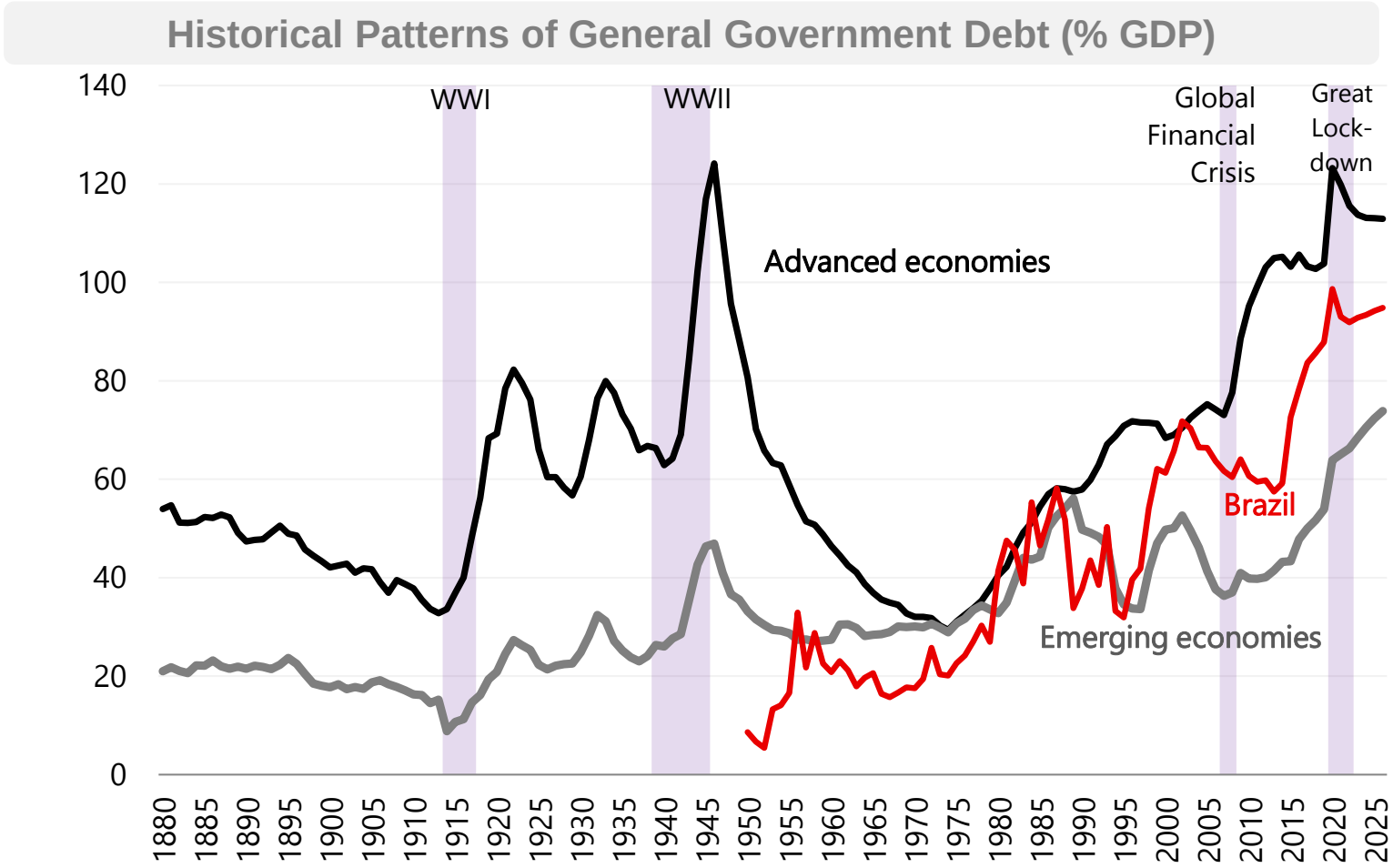
Average of **11.7%** of salary readjustments of public servants wages

Public Debt Scenario and Simulations

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.



Sources: IMF, Santander.

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%**
- We see the neutral interest rate hypothesis at 4.0%, this implies a larger primary surplus needed to stabilize the debt.
- Not considering the effects of the cyclical recovery, the long-term outlook will require a remaining 2.0-2.5pp of GDP primary fiscal adjustment, just to stabilize the ratio debt-to-GDP around the level of ~90% of GDP.

- **Current situation:**

. Real interest rate (ex-ante) 1-year: ~7.0%,
. GDP: 0.7% in 2022 and -0.3% in 2023

Liquidity reserves up to 11 months of debt maturities

Increase in debt cost (Selic + IPCA)

- **Steady-state:**

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

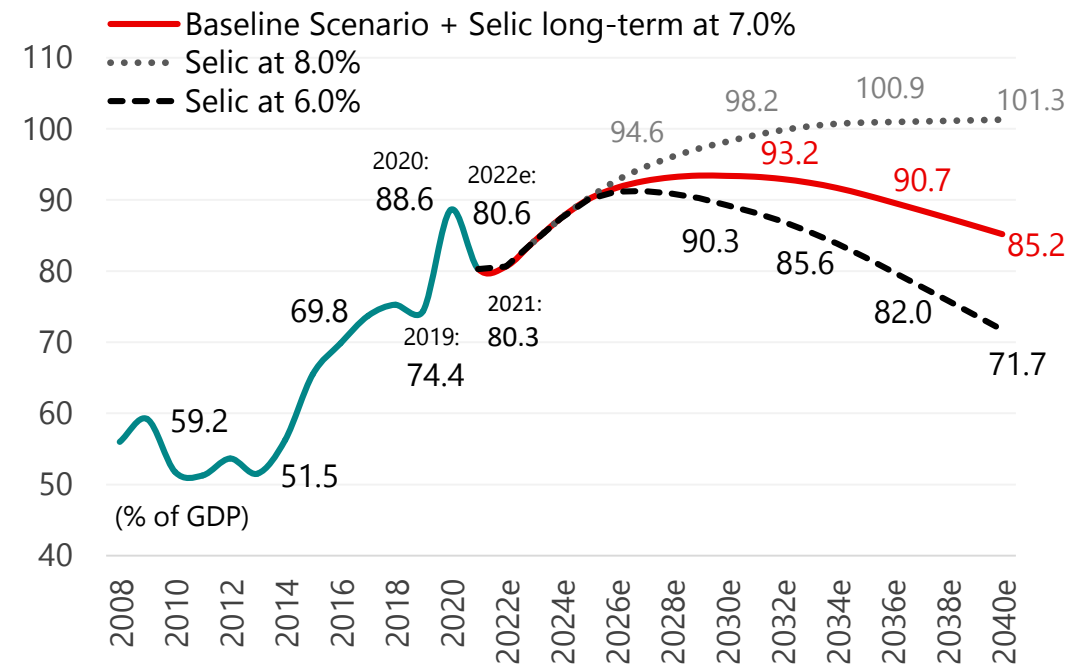
. The primary surplus must reach 1.8-2.2% of GDP to maintain the gross debt stable.

		Real Interest Rate						
		0.0%	*1.0%*	*2.0%*	*2.5%*	*3.0%*	*4.0%*	*5.0%*
GDP Growth	*0.0%*	0.0	0.9	1.8	2.2	2.7	3.6	4.5
	1.0%	-0.9	0.0	0.9	1.3	1.8	2.7	3.6
	1.5%	-1.3	-0.4	0.4	0.9	1.3	2.2	3.1
	2.0%	-1.8	-0.9	0.0	0.4	0.9	1.8	2.6
	2.5%	-2.2	-1.3	-0.4	0.0	0.4	1.3	2.2

Sources: BCB, Santander.

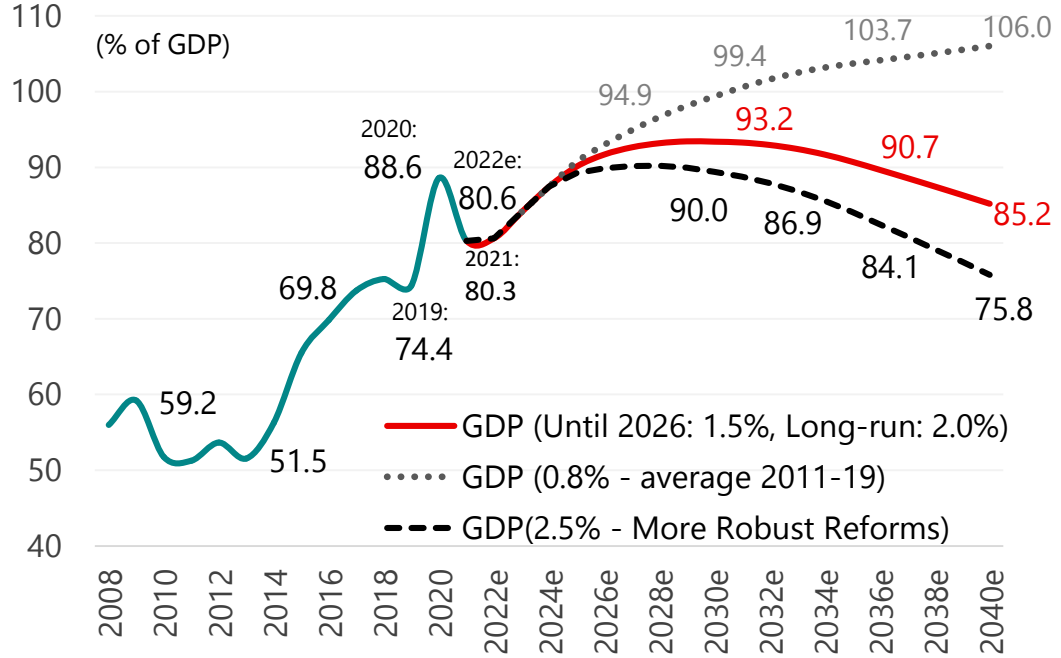
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

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 (+BRL150 billion for liquidity cushion in 2021 + BRL30 billion in 2022)

2022 GDP Deflator: 9.5% | GDP: 0.7% | Selic Rate: 13.25%

2022 hypotheses: BNDES and Public Banks (BRL50 bn)

2023-40: GDP deflator: 3.9%, which is Inflation target + 0.9%
(close to the average difference of the last decade between IPCA and GDP deflator)

Debt Management – Debt cost on the rise, liquidity reserves to navigate uncertainties

07

Annual Borrowing Plan 2022

- The National Treasury released (on January 26) the Annual Borrowing Plan (Portuguese acronym: PAF) for 2022. The total outstanding debt reached ~BRL5.73 trillion in February 2022 and could reach BRL6 trillion this year, according to the fiscal authority's plan. The average maturity is expected to remain close to ~4.0 years, according to the PAF. In the debt profile, the National Treasury stated that it intends to increase the floating-rate total relative to fixed-rate bonds.

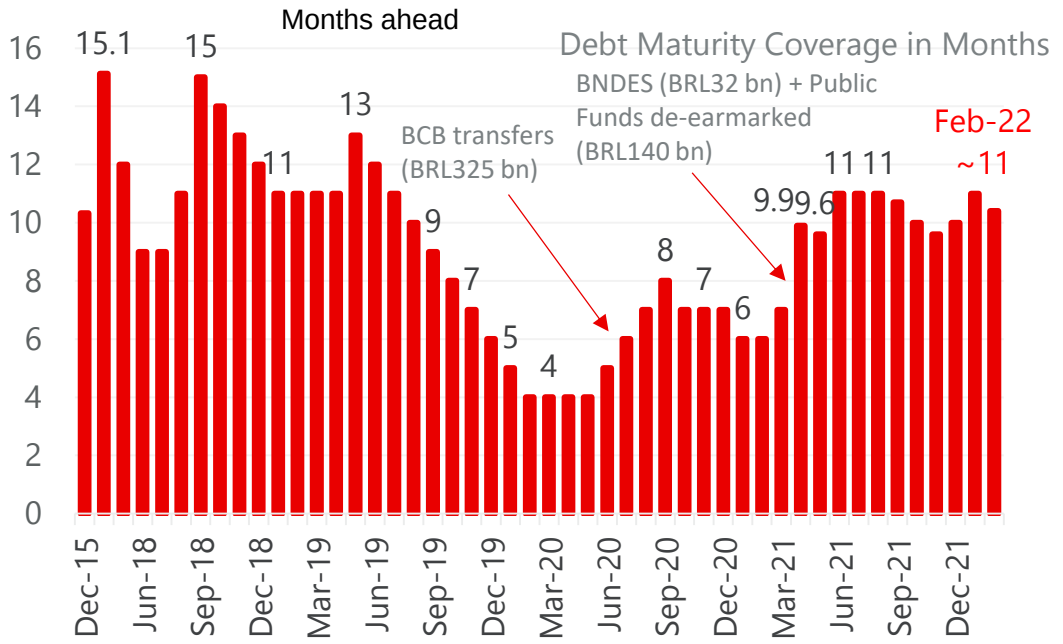
Annual Borrowing Plan (PAF 2022)									
	2020	2021	Feb-22	PAF 2022 range		PAF 2021 Revised (May21)		PAF 2021 (Jan-21)	
Outstanding volume (BRL billion)				Min	Max	Min	Max	Min	Max
Federal Public Debt	5,010	5,614	5,730	6,000	6,400	5,500	5,800	5,600	5,900
Composition (%)									
Fixed-rate	34.8	28.9	26.9	24	28	31	35	38	42
Inflation-linked	25.3	29.3	29.6	27	31	26	30	24	28
Floating-rate	34.8	36.8	39.1	38	42	33	37	28	32
FX	5.1	5.0	4.4	3	7	3	7	3	7
Maturity Structure									
% maturing in 12 months	27.6	21	23.4	19	23	22	27	24	29
Average maturity (years)	3.6	3.8	3.9	3.8	4.2	3.4	3.8	3.2	3.6

Sources: National Treasury; Santander

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

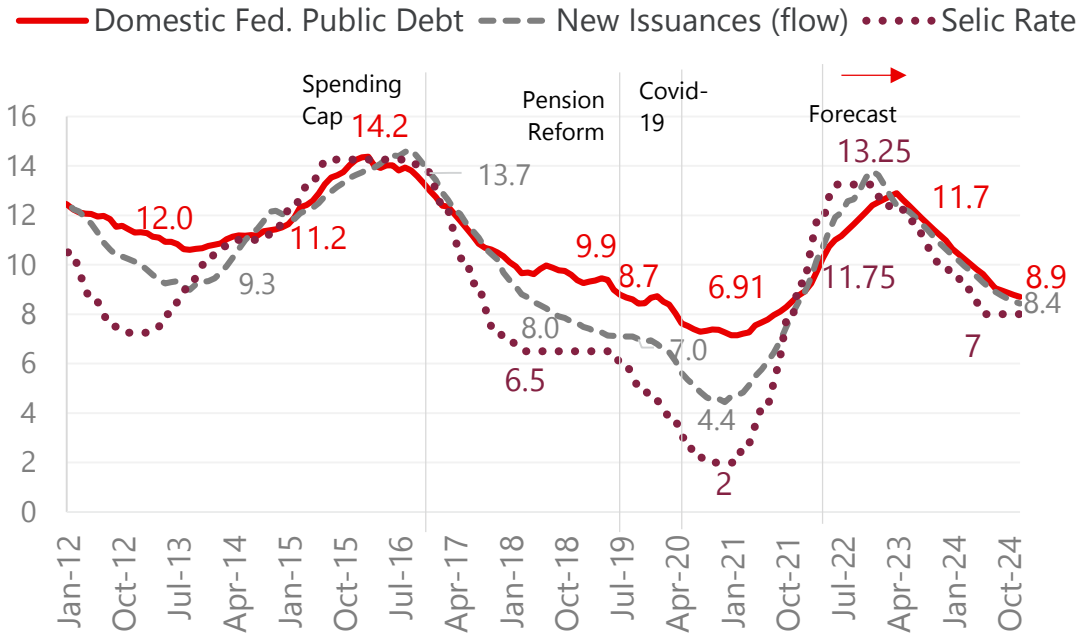
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels.
- The domestic debt cost continued to rise, due to both inflation and Selic increase (9.5% in the last 12m, +0.6pp).
- Debt liquidity cushion reduced in February (+BRL146 bn | Totaling BRL1,278 bn), equivalent of ~11 months of debt maturities. In addition, is expected the transfer of BCB results of BRL71 billion until March, increasing the debt cushion.

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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

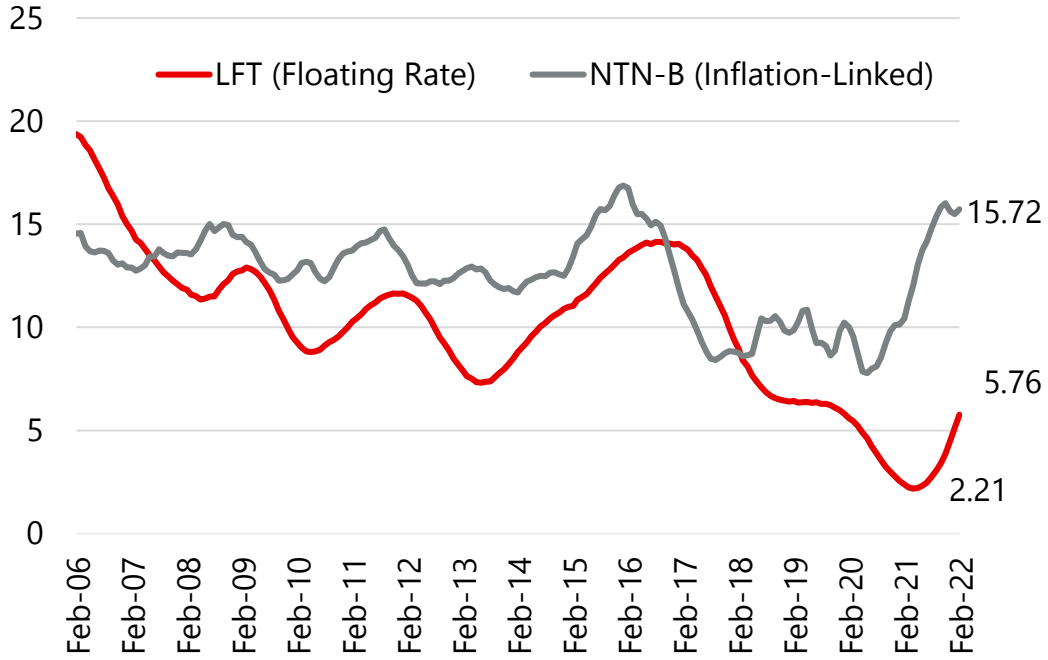


Sources: National Treasury, Santander.

At the margin there is a increase in debt cost related to Selic and Inflation

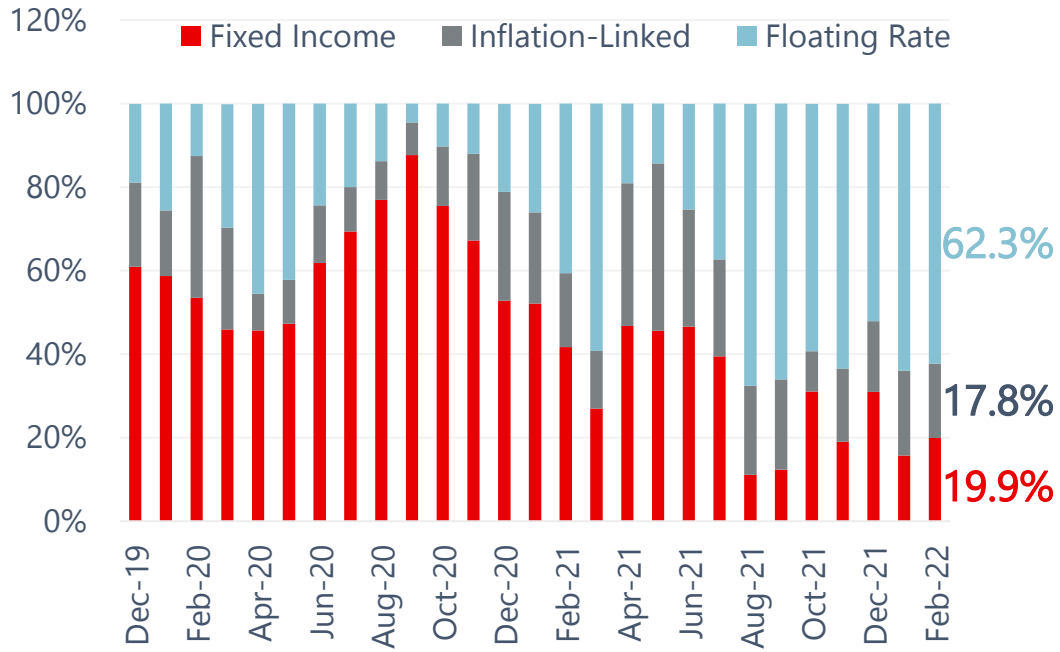
- The cost of domestic new issuances continued to rise, due to both inflation and Selic increase (9.5% in the last 12m, +0.5%pp). The average cost of the outstanding debt accumulated in 12m rose to 8.7% (from 8.6% in January). The NTN-B (inflation-linked bonds) cost in the last 12m reached 15.7% p.y. The cost of LFT (floating rate) in 12m increased to 5.8% (from 5.1% in Jan-22 and 4.5% in Dec-21), the Selic increase (currently at 11.75%) will add an additional pressure in debt costs in coming months..

Average Debt Cost in the last 12 M (Accum.)



Sources: National Treasury, Santander.

Participation in total issuances (%)

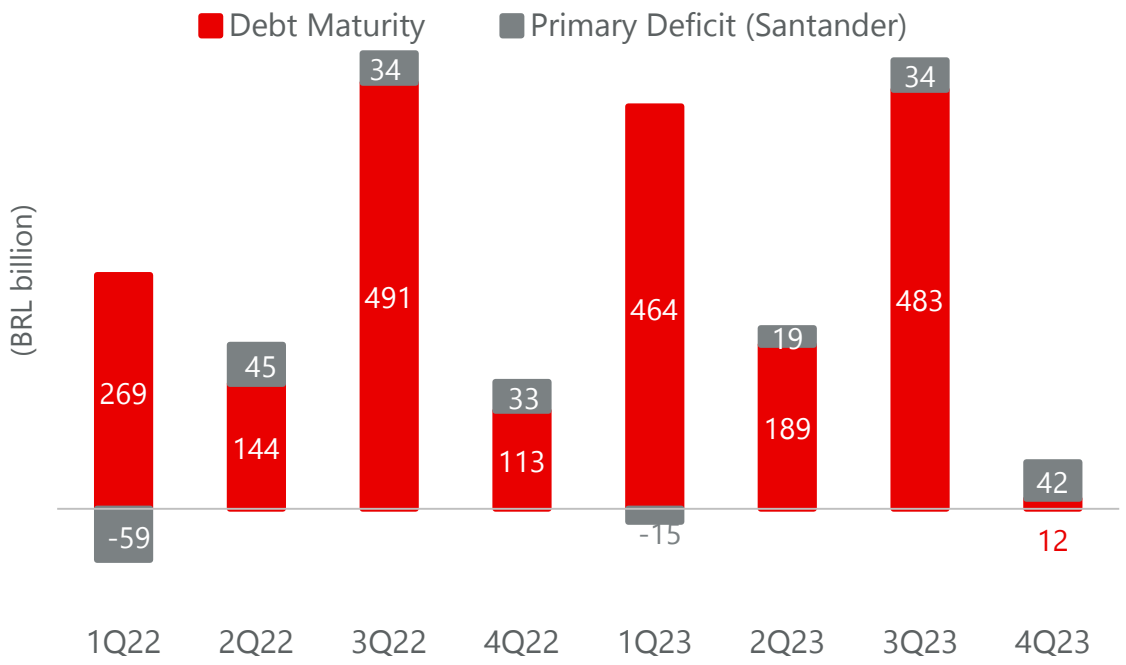


Sources: National Treasury, Santander.

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
1Q22	0.0	268.9	0.0	0.0	0.3	**269.2**
2Q22	125.7	-	16.7	-	1.3	**143.7**
3Q22	129.5	171.3	184.9	3.9	1.2	**490.7**
4Q22	93.4	-	16.3	-	3.0	**112.7**
1Q23	273.2	164.8	21.1	3.7	0.7	**463.5**
2Q23	3.9	0.0	183.7	0.0	1.4	**189.0**
3Q23	193.5	263.7	20.6	3.5	1.4	**482.8**
4Q23	0.0	0.0	10.7	0.0	0.8	**11.5**

Sources: National Treasury, Santander.

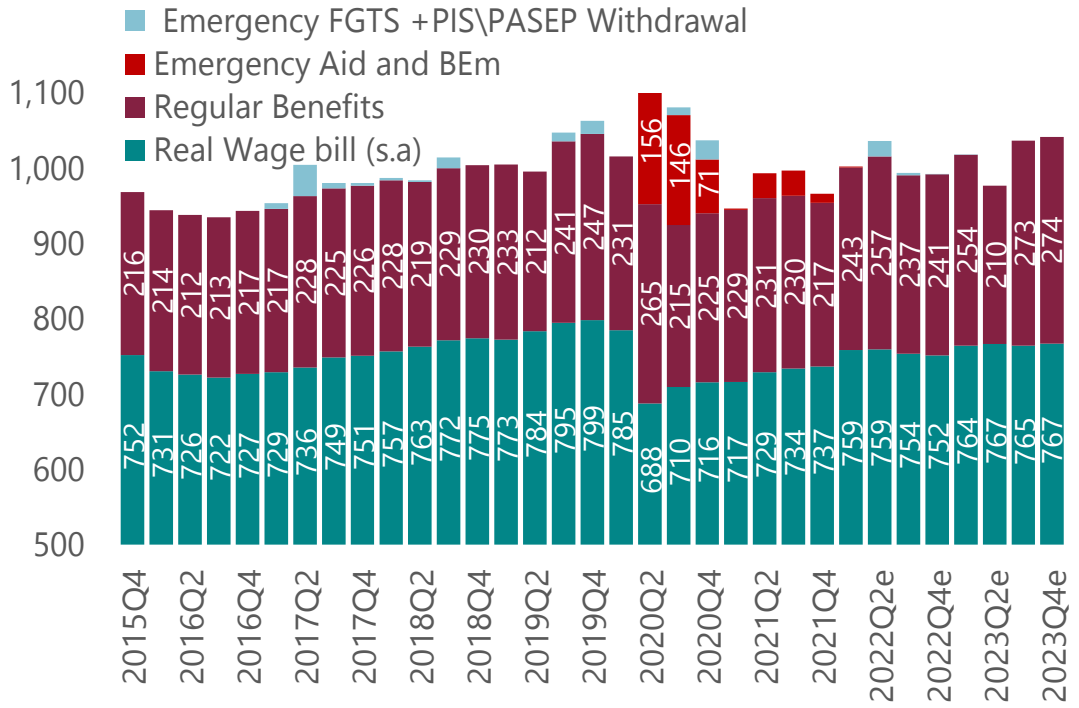
Special Report – Real Wage Bill: Update And Inflation Effect

08

Real Wage Bill – Update and Inflation-Effect

- The government has again anticipated the pension bonus payments from the fourth quarter to the second quarter. For the year, this change is neutral for full-year results, as it just changes the payments date.
- For 2022, we expect a 3.2% increase (BRL125 billion), driven by the labor market recovery, the increase in the new welfare program (from BRL35 billion in Bolsa Familia to BRL89 billion) and the inflation adjustments to pension benefits.

"Expanded" Real Wage Bill and Social Benefits
(in real terms, BRL billion)



Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

Annual Growth in "Expanded" Real Wage Bill
(average% in the period)

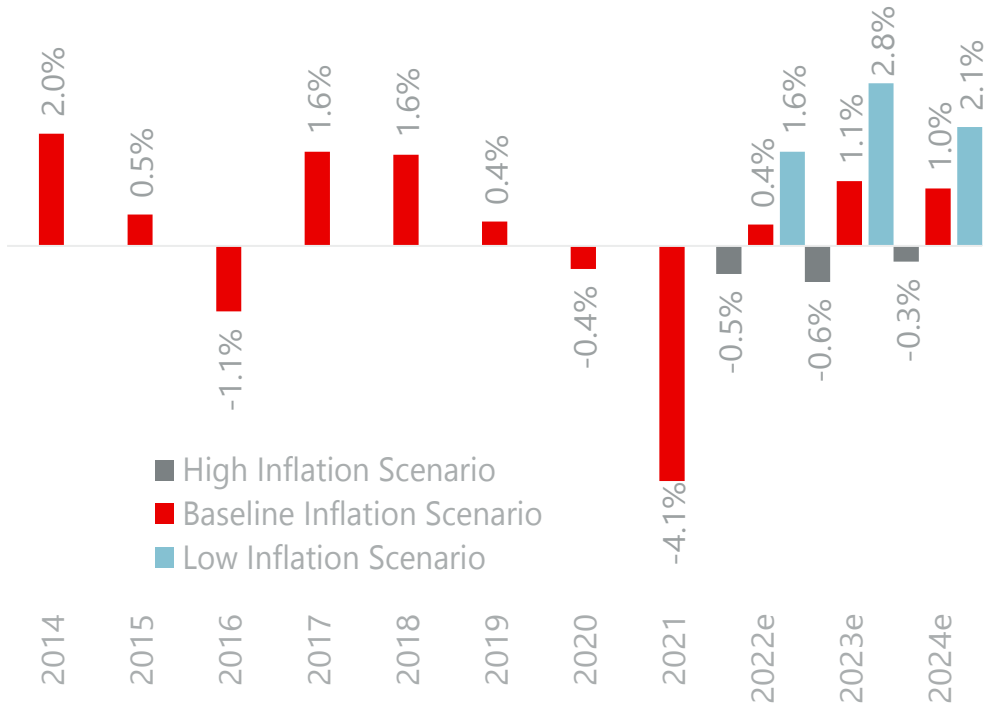
	2020	2021	2022(E)	2023(E)	2024(E)
Expanded Real Wage Bill (Low Inflation)	+3.1%	-8.0%	+4.6%	+2.2%	+2.8%
Expanded Real Wage Bill (Baseline Inflation)			+3.2%	+1.0%	+1.8%
Expanded Real Wage Bill (High Inflation)			+2.5%	-1.0%	+0.4%

Sources: National Treasury, Santander.

Real Wage Bill – Update and Inflation-Effect

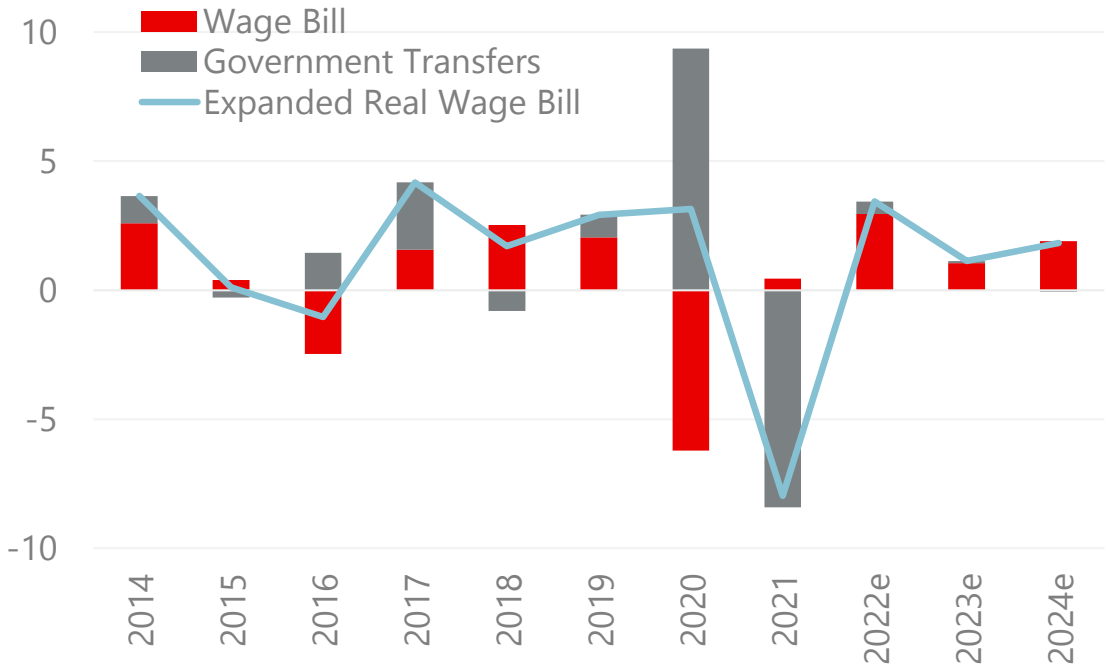
- Using our base-case scenario, we tested the sensitivity of the 2022 “expanded” real wage bill to variations in inflation. Higher inflation affects the real wage bill by reducing the real growth in average income. Our baseline scenario assumes 7.8% inflation for the 2022 IPCA (our current tracking), which is compatible with 0.6% growth in average real income. We simulated scenarios with 5.0% and 9.0% for the IPCA, which generated 1.7% and -0.3% variations in real average income, respectively.

Real Average Income (% Full Year)



Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

Contributions to Full-Year Growth (%)



Sources: National Treasury, Santander.

Fiscal Risks – Size Of The Fiscal Stimulus And Leftovers

- The larger part of the worsening of the recent fiscal result was the massive stimulus ("extra-cap" spending) related to Covid-19, which totaled 7.0% of GDP in 2020 and 1.4% in 2021. The trend is for the stimulus to decrease as the effects of the pandemic fade, yet Brazil has changed the fiscal framework to open up more space for spending.

Fiscal Stimulus Measures (BRL billion)

	2020			2021			2022		
In BRL billion - Accumulated	Dec-20	Total Budget	Executed	Dec-21	Total Budget	Executed	Apr-22	Total Budget	Executed
Bem - Employment program (MP 935)	33.5	51.5	65.0%	7.7	10.7	71.5%	0.0	0.2	0.0%
Expansion of Bolsa Família (MP 929)	0.4	0.4	100.0%	-	-	-	-	-	-
Emergency Aid (MP 937)	293.1	322.0	91.0%	60.7	63.9	94.9%	3.1	5.7	54.3%
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	42.7	50.8	84.0%	25.8	43.2	59.7%	7.1	10.5	67.5%
Guarantees for credit measures for SME (MP 977)	58.1	58.1	100.0%	5.0	5.0	100.0%	-	-	-
Financing of Tourism Infrastructure (MP 963)	3.1	5.0	61.6%	0.6	1.3	42.3%	-	0.7	-
Emergency Credit Program - "Maquininhas"	5.0	10.0	50.0%	-	-	-	-	-	-
Vaccine Acquisition	2.2	20.0	11.1%	21.8	26.2	83.4%	3.2	10	32.0%
Accumulated Total	524.0	604.7	86.7%	121.4	150.2	80.8%	13.4	27.1	49.4%

Updated until 4/26/2022

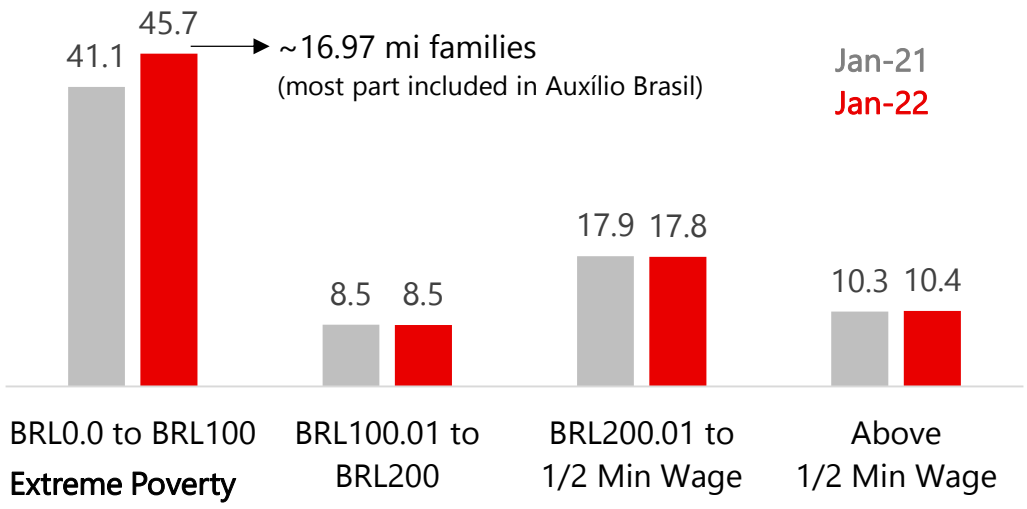
Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

- Regarding the fiscal transfers, the emergency aid program ended in October. The new welfare program *Auxílio Brasil* started in November, with the BRL400 benefit payments starting in December (post *PEC dos Precatórios*). The government stated that in 2022 Budget there will be ~BRL90 billion for the program.
- The current monthly average benefit of the welfare program is BRL 408, reaching 18 million families.

Cadastro Único – Gov. Database

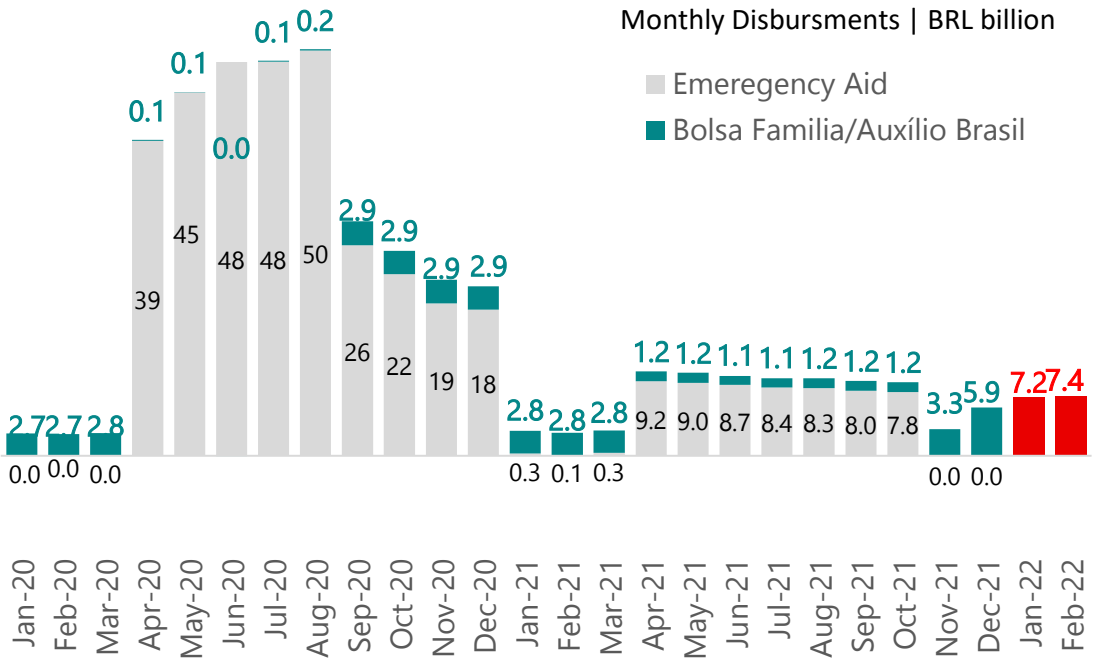
People Registered in Cadastro Único - Monthly Income Percapita intervals



Monthly income breackets to classify poverty situation were updated in Nov-21 by presidential decree in ~12%.

Sources: Ministerio da Cidadania, Santander

Welfare program – BRL billion

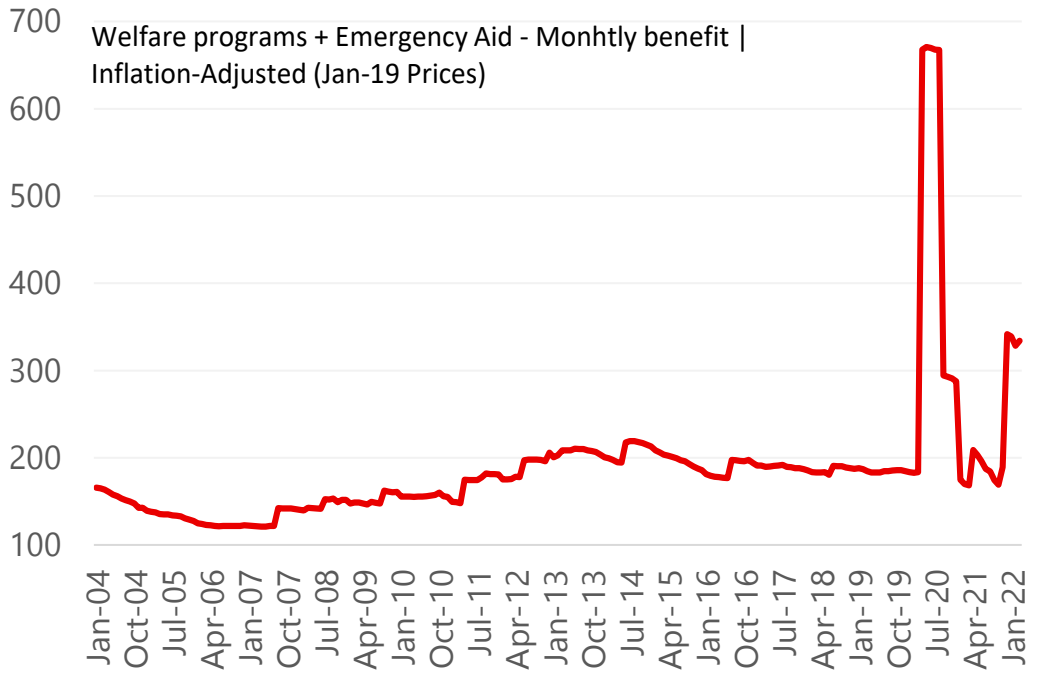


Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

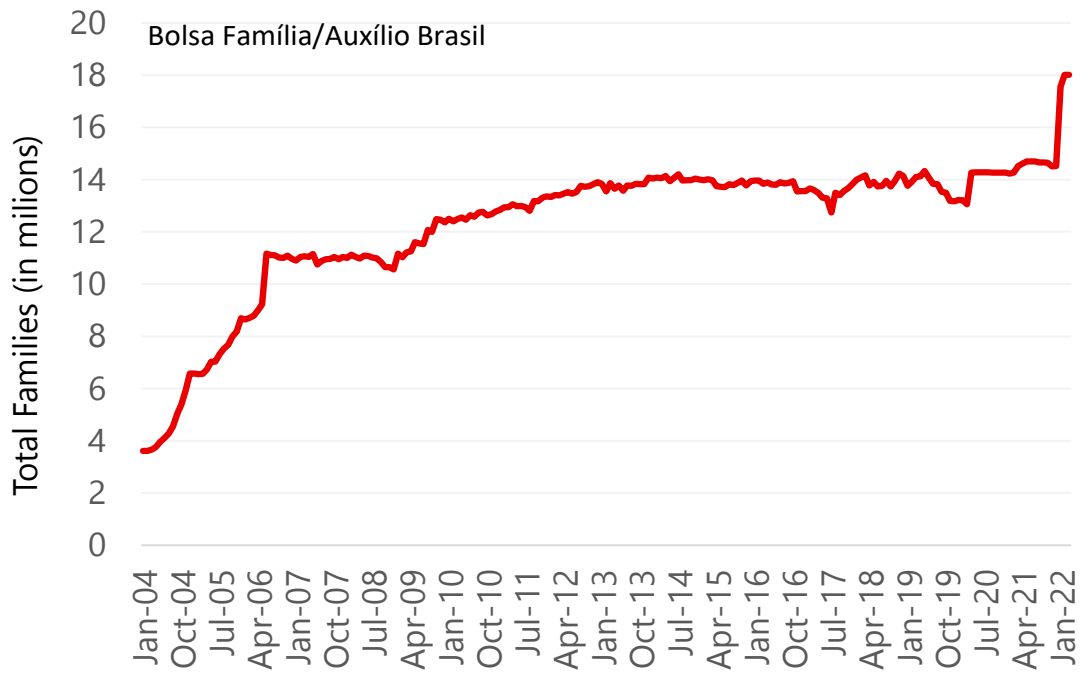
- Regarding the fiscal transfers, the emergency aid program ended in October. The new welfare program *Auxílio Brasil* started in November, with the BRL400 benefit payments starting in December (post *PEC dos Precatórios*). The government stated that in 2022 Budget there will be ~BRL90 billion for the program.
- The current monthly average benefit of the welfare program is BRL 408, reaching 18 million families.

Monthly Benefit Real Value



Sources: Ministerio da Cidadania, Santander

Number of Families – Welfare Program

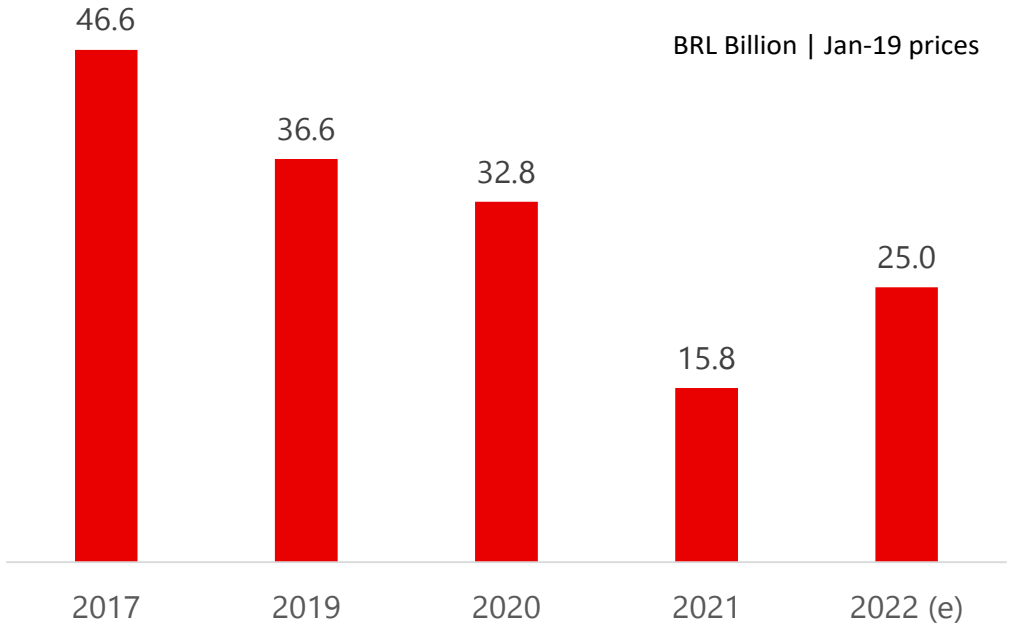


Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

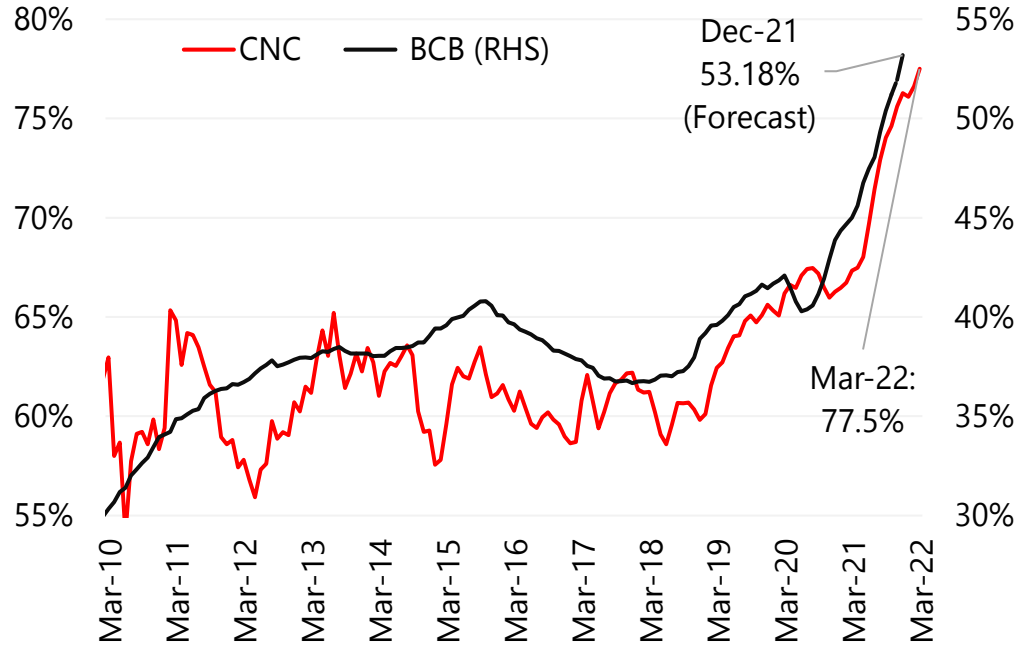
- We estimate that FGTS withdrawals will add 0.6 p.p. to the growth of the "expanded" real wage bill. However, compared to our last projection of 3.3% growth for the real wage bill, the increase in our inflation forecast from 6.0% to 7.8% practically nullified the expected growth from FGTS withdrawals. In other words, the 1.5 p.p. increase in inflation should offset the effect of the fiscal stimulus.

FGTS funds workers withdrawn



Sources: Caixa, MCM, Santander

Extended household Indebtedness (%)



Sources: National Treasury, Santander.

Tables - Forecasts

09

MACRO SCENARIO: Santander Brazil's Global Macro Assumptions – Summary

Global Macro Backdrop	2018	2019	2020	2021	2022E		2023E		2024E
Global GDP (%)	3.5	2.8	-3.5	5.9	3.7	↓	3.0	↓	3.0
China GDP (%)	6.7	6.0	2.3	8.1	5.2	↓	5.0	↓	5.0
US GDP (%)	3.0	2.2	-3.5	5.7	3.5	↓	2.0	→	1.5
US Inflation (CPI, %)	1.9	2.3	1.4	4.7	6.5	↑	2.8	↑	2.3
US Interest Rate (FFR, %)	2.50	1.75	0.25	0.25	3.00	↑	3.50	↑	3.50
US Interest Rate (UST10y, %)	2.7	1.9	0.8	1.8	3.1	↑	3.8	↑	3.0
Dollar Index - DXY	96	96	90	96	101	↑	100	↑	100
Commodity Prices - CRB	409	401	444	571	606	↑	569	↑	502

Sources: Bloomberg, Santander

- The forecasts refers to our latest Scenario Review

"SURFING AN EXTENDED COMMODITY WAVE"
(sent on April 14, 2022)

- **For the full report click on the link:**

https://bit.ly/Std-scenupdate-apr22

MACRO SCENARIO: Forecasts

Macroeconomic Variables		Previous		Current
GDP (%)	2022E	0.7	→	0.7
	2023E	-0.2	↓	-0.3
	2024E	1.5	→	1.5
IPCA (%)	2022E	6.0	↑	7.9
	2023E	3.7	↑	4.0
	2024E	3.0	→	3.0
Selic Rate (% end of period)	2022E	12.50	↑	13.25
	2023E	9.00	↑	10.00
	2024E	7.00	→	7.00
FX Rate - USDBRL (end of period)	2022E	5.40	↓	5.00
	2023E	5.25	↓	4.80
	2024E	4.90	↓	4.70
Current Account Balance (% of GDP)	2022E	-1.4	↑	-1.2
	2023E	-1.8	↑	-1.0
	2024E	-3.2	↑	-2.0
Primary Fiscal Balance (% of GDP)	2022E	-0.8	↑	0.0
	2023E	-1.1	↑	-0.8
	2024E	-0.9	↑	-0.6
Gross Public Debt (% of GDP)	2022E	84.8	↓	80.6
	2023E	89.0	↓	84.1
	2024E	92.2	↓	87.5

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

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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

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