Brazil Macro | August 2023

FISCAL POLICY

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Brief Overview

Evenly Balanced Risks for the Short term

1

Fiscal Consolidation: Evenly Balanced Risks for the Short term

- Our changes in the fiscal forecasts are only marginal in this scenario update. We are maintaining our forecast of a deficit of 1.0% of GDP and continue to see evenly balanced risks for the short term.
- On revenue, we see risks in both directions: we are observing a weaker cyclical performance in federal tax collection in the last data, with a still timid impact of the measures already adopted by the government to recompose the revenues. On the other hand, the administration should unveil additional measures to be approved in Congress, to close the budget gap for the 2024 Budget Proposal (to be submitted to parliament until August 31).
- Regarding the new fiscal framework, we believe it will have the final approval in the Lower House, meaning no significant change to our scenario, with challenges for its full implementation, in our view. Moreover, despite a small downward revision, we still project a deterioration in the nominal budget results ahead.
- As for the debt trajectory, while we are lowering our expectation for the gross debt by 0.3 pp to 77.0% of GDP, as we fine tune our forecasts with the team's new projections for inflation and FX rate, we continue to see rising government debt for the medium term. That implies a difficult path for debt stabilization ahead.

FISCAL POLICY – Short-term: Evenly Balanced Risks

Short Term: Changes on Both Directions

2023 Primary Balance: Fine Tuning

-BRL100 bn (-1.0% GDP) | Jun (e): -BRL105 bn (-1.0% of GDP)

Central Gov.: -BRL115 bn (-1.1% GDP) | -BRL5 bn from Jun (e)

Regional Gov.: +BRL15 bn (0.1% GDP) | **No change**

Revenues: Cyclical Effect (⇩), Labor Market (⇧)

Key-issue: Cyclical Reduction vs. Gov. Measures

Still-resilient Labor Market is helping in the short-term

Gov. Measures could help revenue result

For now, the measures are still showing timid results

The administration is advancing in altering tax incentives/breaks.

We consider a total of BRL50 bn for 2024

New Fiscal Framework - no impact to our scenario

It will be approved. We see challenges to its full implementation. Could maintain outlays at ~19% of GDP.

Positive Upgrades by Rating Agencies

Backward looking based on Reforms, Better Fiscal and Activity Numbers. Further upgrades still-challenging.

Medium Term: Risks Remain High

Risks: Additional Fiscal + Quasi-Fiscal Stimulus

In a scenario with a positive output gap.

We expect a gradual and limited quasi-stimulus.

Unpaid Debt – Judicial Claims

We see ~BRL80 bn unpaid by 2023 (not in Fiscal statistics)

Higher Nominal Deficit (Selic)

Nominal Deficit : above 8.0% of GDP ahead

Interest payments is pressuring at the margin.

Fiscal adjustment: above 2.0% of GDP

In a context of elevated pressure for social spending and natural difficulties to raise taxes

Debt-path: on the edge for convergence

~92% of GDP in 2040. Sensitivity with macro structural variables (such as Potential GDP, Neutral Rates, Deflator)

Risks for debt convergence

Long-term: Neutral interest rate above 5.0%, Potential GDP below 1.5%. Total Expenditures above 19% of GDP.

FISCAL POLICY: Gov. Measures + Activity vs. Cyclical Downturn + Drop in Oil Prices

- In the short-term we see evenly balanced risks for the primary result. We see positive and negative aspects affecting the revenues.
- Positive Effect: Gov. Measures + Activity Resilience in 1Q23 + Rise in Oil production. Negative: Commodity prices + Cyclical effect

Central Gov. Primary Result

2023 - BRL billion	2023 Budget (LOA)	1st Budget Review (a)	2nd Budget Review	3rd Budget Review (a)	% GDP	Santander (b)	% GDP	Δ (b) - (a)
Total Revenue	2,259	2,376	**2,367**	**2,366**	**22.1%**	**2,371**	22.8%	**4.8**
Collected by the Brazilian IRS	1,378	1,474	1,465	1,474	13.8%	1,475	14.2%	0.7
Net Social Security Revenues	595	598	593	584	5.5%	592	5.7%	7.9
Not Collected by the IRS	285	304	308	308	2.9%	304	2.9%	-3.8
Transfers by Revenue Sharing	453	460	456	457	4.3%	462	4.4%	5.2
Net Revenue	1,806	1,916	**1,911**	**1,909**	**17.8%**	**1,909**	18.3%	**-0.5**
Total Expenditure	2,034	2,023	**2,048**	**2,055**	**19.2%**	**2,024**	19.4%	**-30.5**
Social Security Benefits	865	859	865	867	8.1%	869	8.3%	1.5
Payroll - Public Servants	368	365	364	362	3.4%	365	3.5%	2.9
Other Mandatory Expenses	277	283	294	301	2.8%	286	2.8%	-14.7
Mandatory with Cash Control	329	323	330	330	3.1%	329	3.2%	-1.3
Discretionary Expenses	195	194	194	194	1.8%	175	1.7%	-18.9
Central Gov. Budget Gap		-107.6	-136.2	-145.3	-1.4%	-115.3	-1.1%	30.0
Nominal GDP	10,629	10,712	10,747	10,715		10,407		

Sources: Finance Ministry, Santander.

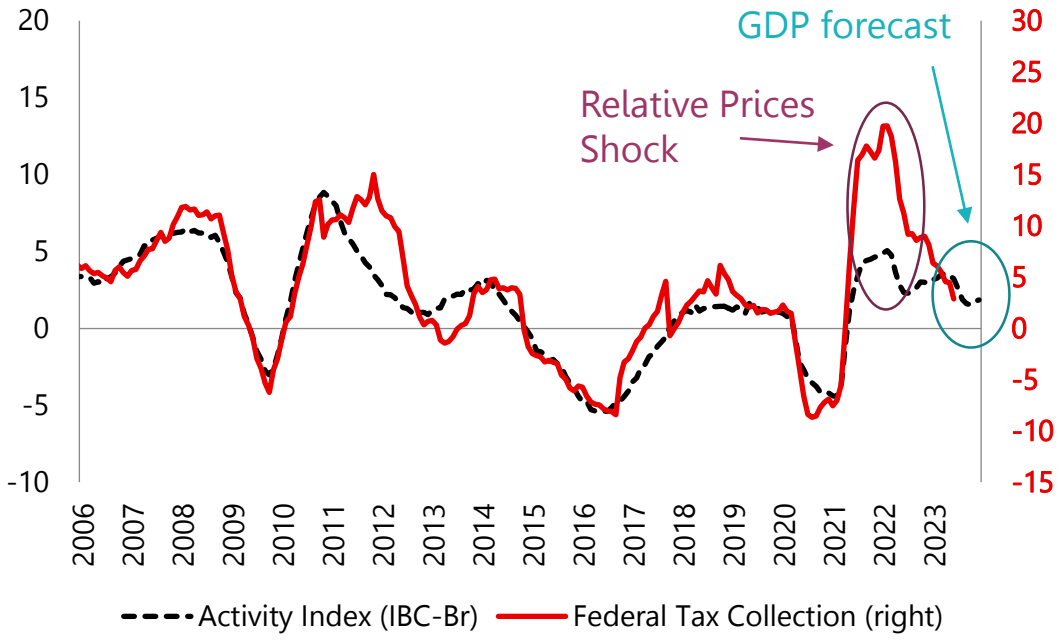
Estimates for 2023	Mar-23	May-23	Jul-23	Santander
GDP Growth (%)	1.6	1.9	2.5	1.9
Nominal GDP (BRL bn)	10,771	10,747	10,715	10,407
Implicit GDP Deflator (%)	6.3	6.3	5.4	3.0
IPCA (%)	5.3	5.6	4.9	4.9
IGP-DI (%)	3.9	2.1	-2.21	-3.4
FX year avg (BRL/USD)	5.20	5.11	5.01	4.99
Selic 12m (%)	13.5	13.2	13.1	13.4
Oil Price Avg (Brent USD)	83	77.6	78.17	85

Santander

FISCAL POLICY: Cyclical Slowdown in Revenues vs. Gov. Measures, Activity Resilience

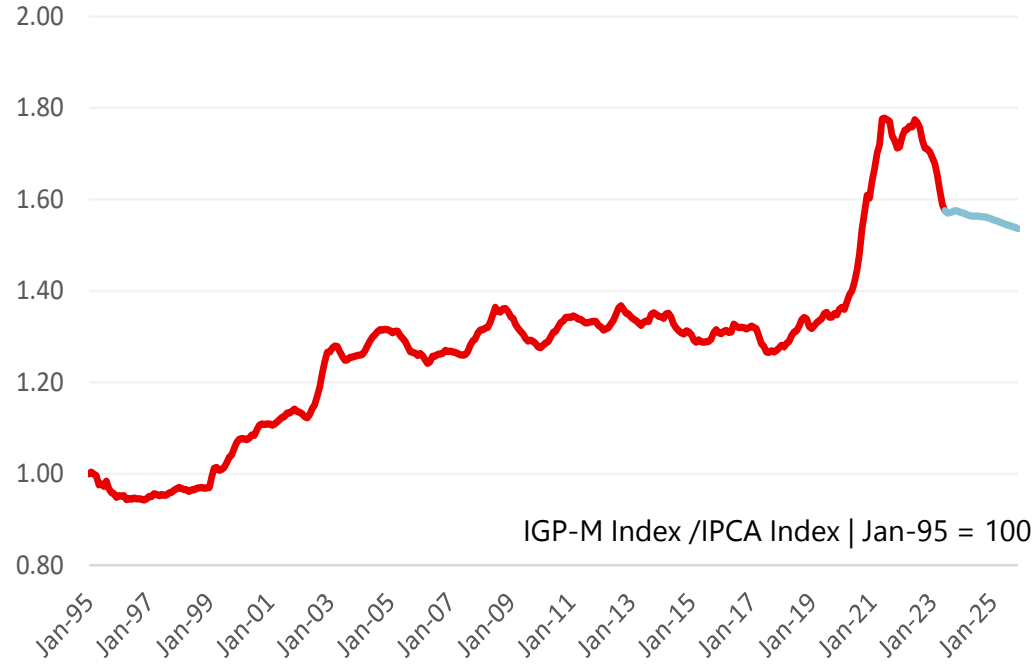
- We expect some softening in the federal tax collection growth ahead with the reduction in domestic activity and lower wholesale prices, the revenue result will be a key-element to the fiscal consolidation ahead, in context of expanding the outlays.
- For the coming months, we keep expecting a slowdown in the monthly growth (reducing the positive lagged effects), in a context of lower activity performance and commodities prices losing steam compared to 2022.

Activity and Tax Collection (12m - % YoY)



Sources: Brazilian IRS, BCB, Santander.

Relative Prices (IGP/IPCA)

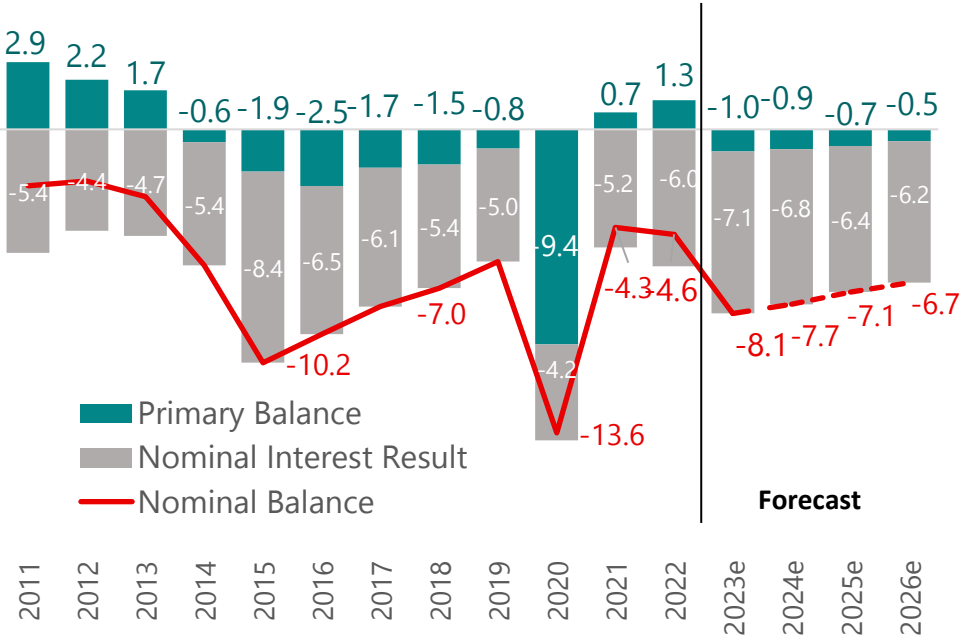


Sources: IBGE, FGV, Santander

FISCAL POLICY: A higher interest burden to weigh on the debt dynamics

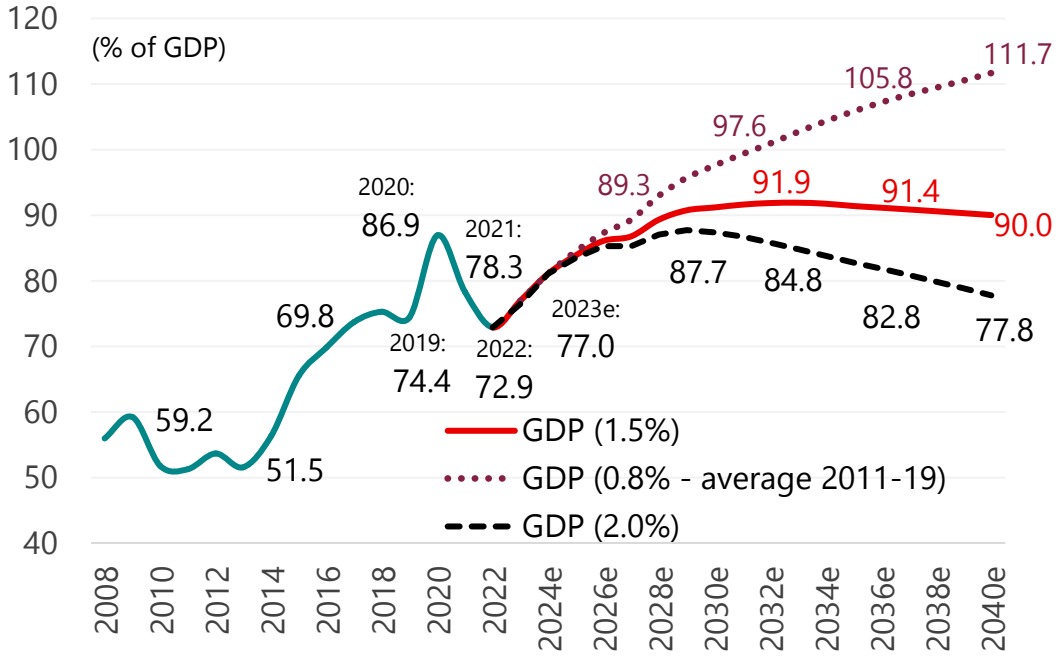
- Interest payments should continue to rise (Selic increase) with the nominal result showing strong deterioration, remaining close to 8.0% of GDP in the coming years. We reduced a tad the interest payment due to the lower issuance of National Treasury, using part of the liquidity reserves.
- We simulated scenarios for the debt trajectory: the main debate will be on the structural macroeconomic variables (GDP, Neutral Interest Rate and GDP Deflator).

Public Sector's Financing Needs (% GDP)



Sources: BCB, Santander.

Scenarios - Gross Debt Scenario (% GDP)



Sources: BCB, Santander

National Congress – Current New Legislation in Debate

Proposal	Summary	Status
New Fiscal Framework (PLP 93)	**The administration must approved a proposal to replace the constitutional spending cap for 2024**	**To be voted in Lower House**
VAT reform (PEC 45/2019, PEC 110/2019)	**Unifies federal, state, and city taxes, changing collection from production to consumption. The reform will feature an extended transition period and temporarily compensate subnational governments for revenue losses to give companies, states, and cities time to adapt to the new model.**	**Approved in Lower House. To be approved in Senate during 2H23**
Income tax reform	Expected to be proposed by the Lula administration in the second half of 2023, it updates income tax brackets, reducing taxation on low-income individuals . It will also modify corporate taxes, imposing dividends taxes while lowering corporate profits tariffs.	Awaits submission to Congress
Taxation of offshore income (MP 1171)	Raises the exemption threshold of personal income tax (IRPF) and rise the tax on wealthiest	Awaits joint committee
Changes to tax appeals court - Carf (MP 1060)	The proposal changes the Administrative Council of Tax Appeals (CARF), an administrative division of the Ministry of Finance that imposes fines on tax evaders, to restore the federal government's right to have a tie-breaking vote during trials. The economic team expects to collect 35 billion reais in revenue in 2023 with the measure, in addition to increasing future collection in tax conflicts. The proposal faces strong resistance from the private sector and centrist lawmakers, who are negotiating changes to the draft.	Awaiting referral to the Senate
Taxation on Exclusive Funds	Changes the tax regime of exclusive funds	Awaits submission to Congress
Changes to the SOE law (PL 2896/2022)	The proposal reduces the quarantine imposed on directors of political parties to become SOE directors from three years to 30 days. The bill was quickly approved in the lower house at the end of 2022, with the support of Speaker Arthur Lira, but faces opposition from the government, which fears being pressured to give up more positions in state-owned companies.	Approved in the lower house
Carbon Credit Market Framework (PL 412)	Creates the legal framework for the Brazilian Carbon Market, which regulates the purchase and sale of carbon credits.	Awaits vote at the lower house floor

2023 Macro Events

June

29
CMN – Setting 2026 Inflation Target
Maintained at 3.0%
End: Calendar-year target

30
TSE Judgment –
Bolsonaro lost his political rights

July

4
Senate – BCB Directors
Gabriel Galípolo for BCB Mon Pol. Director

5-7
Broad Tax Reform (VAT)
Approved in Lower House
Two rounds (>370 votes)

22
3rd 2023 Budget Review
Deficit revised to -1.4% of GDP

August

1
End of Parliamentary Mid-year Recess

2
Copom Meeting
13.25% | -50bps

11-30
New Public Investment Program (like former PAC)

14-25
LH: Final approval of Fiscal Framework
2024 Budget Guidelines
Senate: CARF, Tax Reform Debate Calendar

22-24
BRICs Meeting

28
MP 1171 (Offshore and Tax exemption) - Expires

31
2024 Budget Proposal
Deadline to send to Congress.
(+) Measures to rise revenues

September

1
2Q23 GDP release
0% QoQ | +2.2% YoY

20
Copom Meeting
(e) 12.75% | -50bps

22
4th 2023 Budget Review
Will 2023 Fiscal result improve?

1-30
Desenrola- Household indebtness program
2nd and most important phase of the program, aimed at those with an income of two minimum (R$ 2,640). BRL7 bn in Treasury guarantee.

October

17-19
IMF – World Economic Outlook

11
IPCA September
Return of YoY >5%

?
STF – Weber`s Retirement
Lula will indicate a new name to the Court

2H23
2022 Census Data

December?
Approval of 2024 Budget

November

1
Copom Meeting
(e) 12.25% | -50bps

9
IBGE 2024 Harvest Estimate

22
5th 2023 Budget Review

4Q23
Senate could approve the Broad tax reform

2H23
Lula's Hip replacement surgery

Additional Revenue Measures
Could be announced to comply to the new fiscal framework

December

5
3Q23 GDP release
-0.1% QoQ | +0.8% YoY
Expected series revision

13
Copom Meeting
(e) 11.75% | -50bps

22
Treasury Report – Debt Forecasts

20-
Year-end Recess Congress and Judiciary

31
End of two BCB directors' mandates
Mauricio Moura
Fernanda Guardado

Sources: BCB, STF, National Treasury, BCB, Santander

Macro Background

Data and Events

2

Materials: Idiosyncratic factors playing out in cooling commodity prices

- We are slightly upgrading our aggregate commodity index forecast for YE2023, while maintaining it for YE2024. Our forecast for Brent oil is at USD 85/bbl for YE2023 and USD 95/bbl for YE2024. Worth noting, supply issues persist for many materials, with the CRB Index still 36% above pre-pandemic levels. Going forward, we expect a gradual drop in global material costs in the coming years, as global demand softens and aggregate supply gradually catches up.

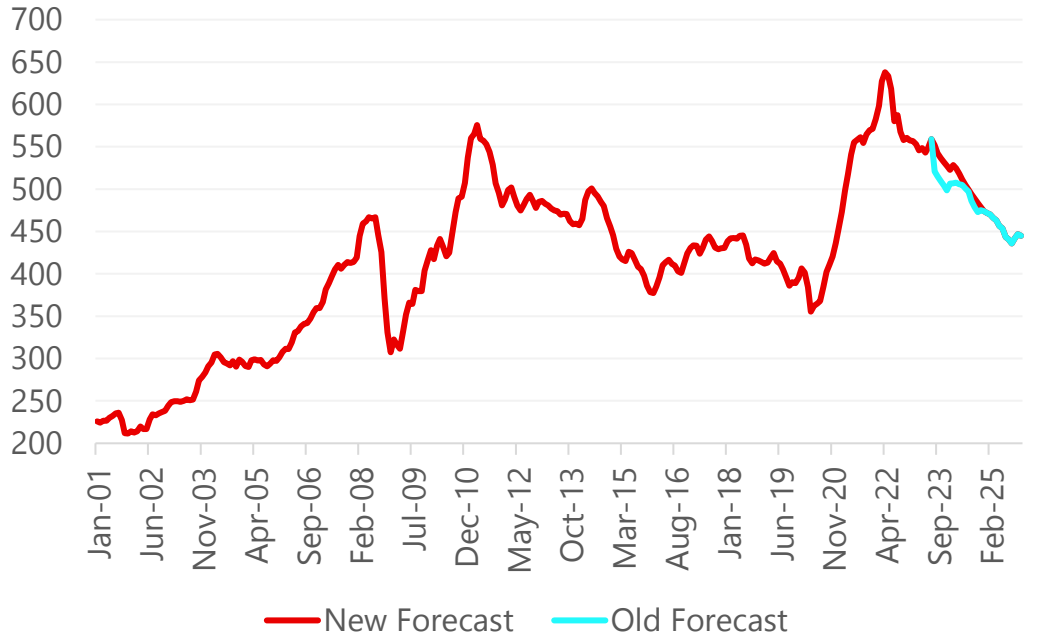
Our Forecasts for CRB Index – End of Period

YE	2021	2022	2023e	2024e	2025e
CRB Food	483	539	453 ↑	395 →	371 →
CRB Energy	1521	2078	1761 ↑	1724 →	1619 →
CRB Metal	1259	1010	1113 ↑	977 →	918 →
CRB	571	558	528 ↑	474 →	445 →

YE YoY	2021	2022	2023e	2024e	2025e
CRB Food	36%	12%	-16%	-13%	-6%
CRB Energy	31%	37%	-15%	-2%	-6%
CRB Metal	42%	-20%	10%	-12%	-6%
CRB	29%	-2%	-5%	-10%	-6%

Sources: Santander.

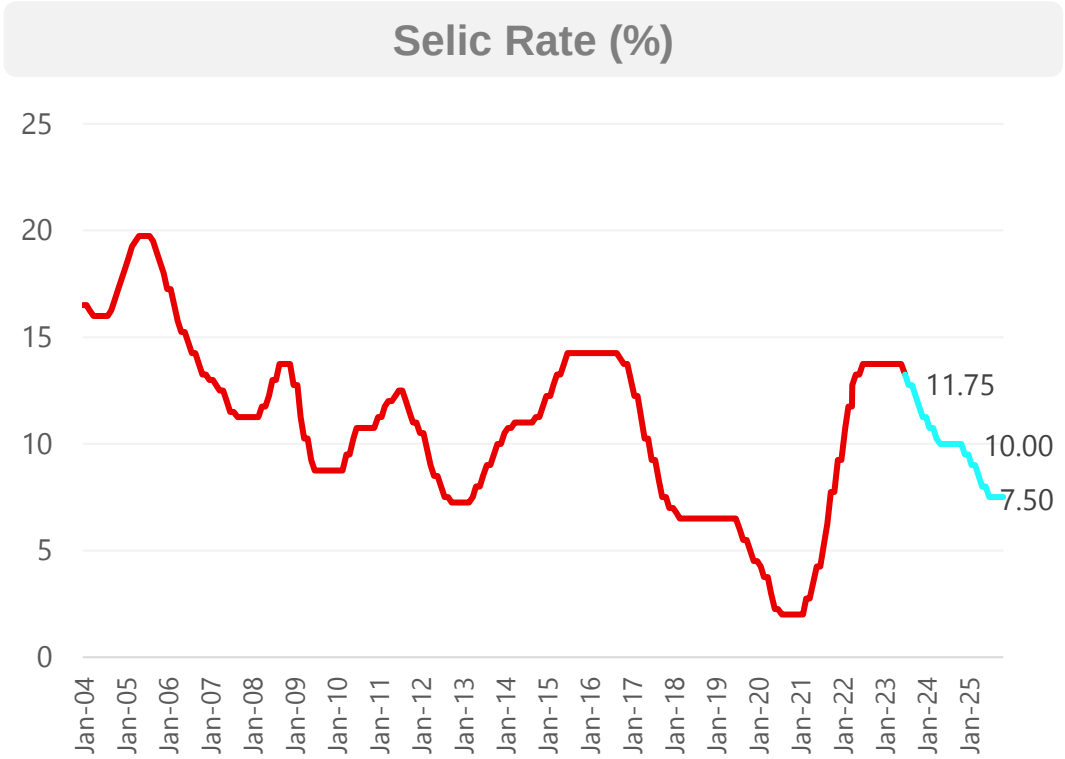
Our Forecasts for CRB Index – Monthly Averages



Sources: Bloomberg, Santander.

Macro Background – A reduction in Selic Rate and higher growth for 2024

- Better growth outlook in 2024 given a less contractionary monetary policy.
- We saw a continuity of resilient employment conditions as of late, which should also continue to provide some support to domestic demand. For the remainder of 2023, we continue to forecast a slowdown in domestic demand and in cyclical components, stemming mainly from an expected global growth deceleration and continuing effects of a tight Brazil Central Bank (BCB) policy.



Sources: Brazilian Central Bank, Santander.

GDP Baseline Scenario			
	YoY	QoQ	Full Year
4Q22	1.9%	-0.1%	2.9%
1Q23	4.0%	1.9%	
2Q23	2.2%	0.0%	
3Q23	0.8%	-0.1%	
4Q23	0.7%	-0.3%	1.9%
1Q24	-0.5%	-0.1%	
2Q24	0.8%	0.6%	
3Q24	1.3%	0.3%	
4Q24	2.3%	0.7%	1.0%

Sources: IBGE, Santander. Santander estimates for 2Q23 onwards

New Fiscal Framework

We see challenges to its full implementation

3

Fiscal Policy: New Fiscal Framework Government Proposal Proposal

New Fiscal Framework Guidelines

1. Primary Balance Target - % GPD (bands of +/- 0.25pp)
2023: -0.5% | 2024: 0% | 2025: +0.5% | 2026: 1.0%

2. Commitment to the target bands up to 2026. Target will be set each year in the Budget Guidelines (LDO). That will be tested next year.

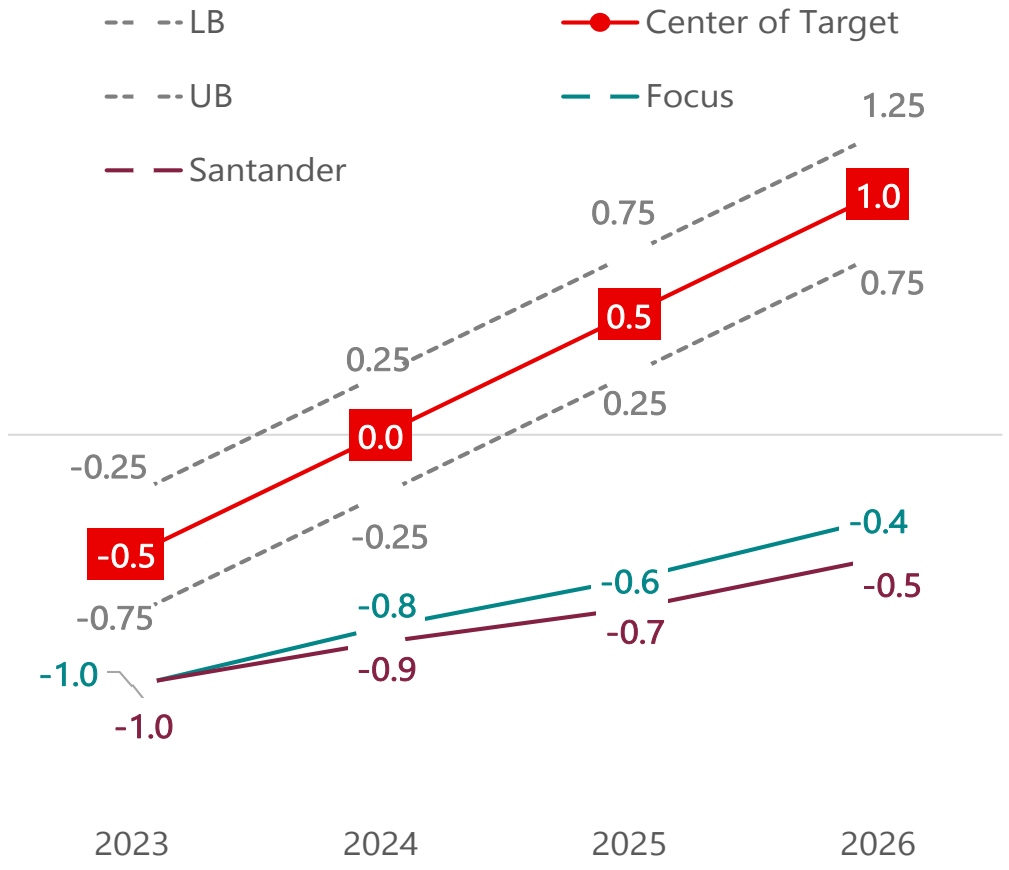
3. Outlays in the Spending Ceiling Real Limit between:
Update: IPCA + real update of [0.6%-2.5%]
Fundeb, FCDF not included into the outlays limit (Senate version)

4. Annual growth within the **expenditure growth range limited to 70% of the adjusted primary revenue** (without SOE Dividends, Concessions and Natural Resources) change in the last 12-months

5. Not compliance to the target: a drop in expenditure growth to 50% of revenue growth (t+2)

6. Investment outlays lower bound – 0.6% of GDP. Extra-bonus (limited to 0.25% of GDP) of the value above the ceiling of the primary target band

Primary Result - Target and Scenarios % GDP



Sources: Finance Ministry, Santander

Fiscal Policy: Lower House Rapporteur Changes

Rapporteur Changes - Draft

1. The draft was **stricter** than the original version,
2. We see **higher enforcement** (instruments for adjustments – triggers and use of budget freezes) in the text. At the same time, we see **loopholes** in the text to not contain the rise in total expenditures.
3. The rapporteur included more outlays inside the spending limit, such as Fundeb, nursing floor.
4. The rapporteur did **not impose any restrictions on minimum wage increases** above inflation. He also did not add provisions on criminal liability for government officials
5. If it the new rule is fully executed (highly depend on revenues increase) it would add a positive bias to our forecasts. The rule still needs permanent revenues above 1.5% of GDP.
6. Yet, we continued to see risks to its full implementation. We maintained our forecasts.

Triggers - Non-compliance with the Primary Target

Failure to meet fiscal goal	Triggers
1st year - not meeting the goal	• The creation of new public jobs that entail expenditure growth, • The restructuring of public careers that entail expenditure growth, • The creation of new assistance programs, • The creation of new mandatory expenditures, • The readjustment of current mandatory expenditures, • The increase of tax benefits.
Two consecutive years	• Government can't increase salaries nor hire new public workers, in addition to previous penalties

Sources: Finance Ministry, Santander

New Fiscal Framework - Efficacy Will Depend Largely on Revenue Performance

Main Aspects of the New Framework

Federal tax collection will be a key factor
- Dependency of Macro Parameters
- Cyclical Payback (?) and Commodities Prices

Necessity of increase in Net Revenues

In total revenue this amount could double if we observe a rise in taxes of which part is shared by subnational entities

Dependency of Macro Parameters:

Gov. Parameters: (permanent) increase in federal net revenue of 1.2% of GDP in 2024

Our scenario: it would be necessary for net revenue to increase by 2.3% of GDP in 2024

No increase: deficits of
-1.2% in 2023, -1.8% of GDP in 2024, -1.6% in 2025, -1.3% in 2026

Details and Global Overview

We do not expect major changes until the final approval, and the new fiscal rule should be approved in July

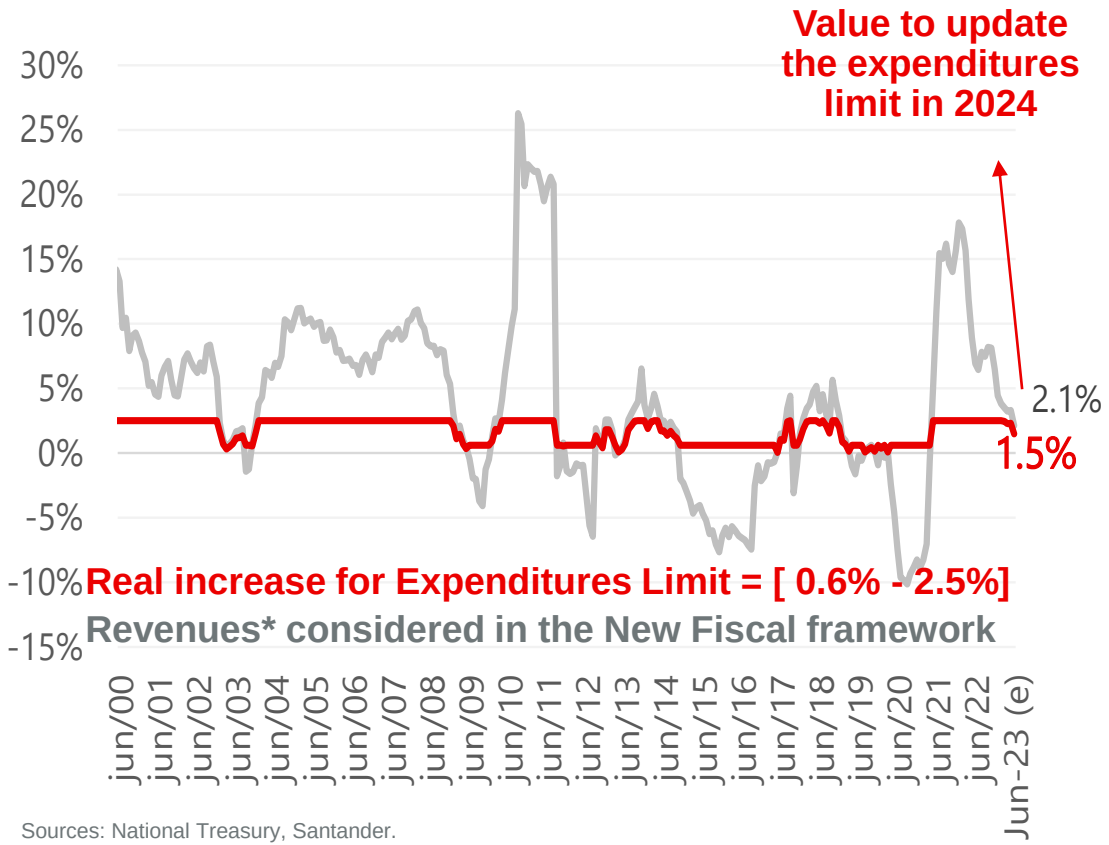
Uncertainty about the details:
- The level of expenditures limit increase in 2024
- Transition – new lower bound Education and Health
- The primary target will be set only in LDO (biding for 1 year)?

Some important aspects:
- Pursuit of reaching a primary surplus (Very Important)
- No new exceptions to the spending limit
- Use of past revenues (not using estimates)
- Reducing the size of outlays with a drop in revenues

Challenges:
- Diminish the adjustment by tax increase (outlays are linked)
- Floor for investments (corrected by inflation)
- Gradual drop in expenditures, with necessity to cut discretionary
- Congressional approval of tax burden adjustments
- Less enforcement for the approval of reforms
- Debt Convergency – depending on parameters

Fiscal Policy: New Fiscal Framework Proposal

Revenue - % YoY real values



Sources: National Treasury, Santander.

* Total Revenues (excluding: SOE Dividends, Concessions and Revenues from Natural Resources)

Expenditures – Gradual Decline

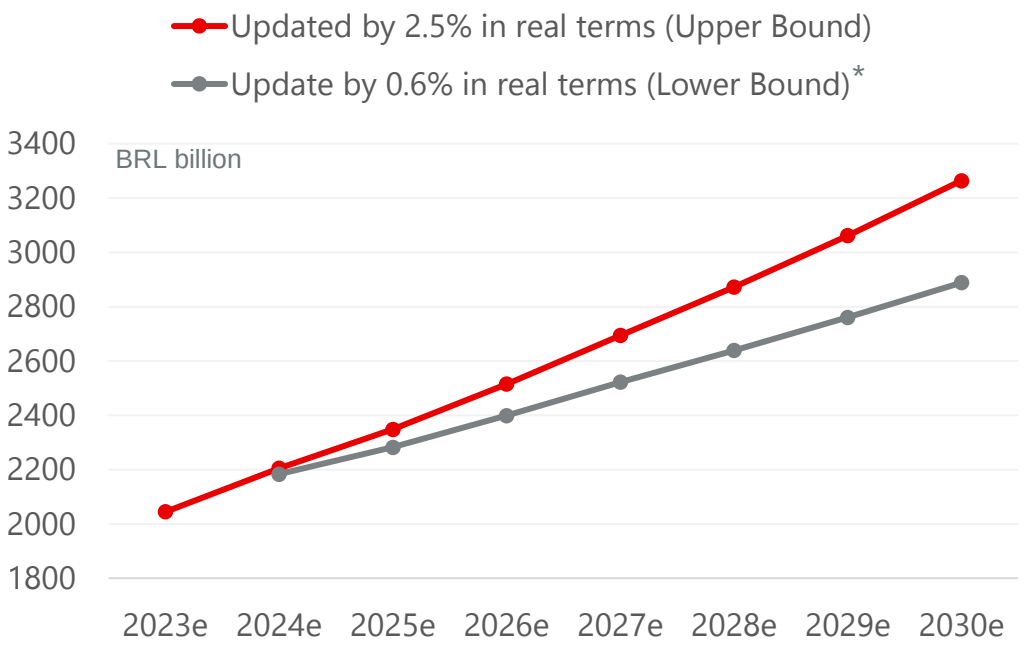
GDP	Net Revenue	Total Expenditure % YoY		Expenditures (% GDP) - 2023:18.9%	
		50%	70%	50%	70%
0.0%	0.0%	0.6%	0.6%	-0.1%	-0.1%
1.0%	1.0%	0.6%	0.7%	-0.3%	-0.2%
2.0%	2.0%	1.0%	1.4%	-0.4%	-0.3%
2.5%	2.5%	1.3%	1.8%	-0.4%	-0.3%
3.0%	3.0%	1.5%	2.1%	-0.5%	-0.4%
4.0%	4.0%	2.0%	2.5%	-0.6%	-0.5%

Nominal GDP = f(REAL GDP, IPCA + 1.0%)

Sources: Finance Ministry, Santander

Fiscal Policy: Expenditure Limit Simulation

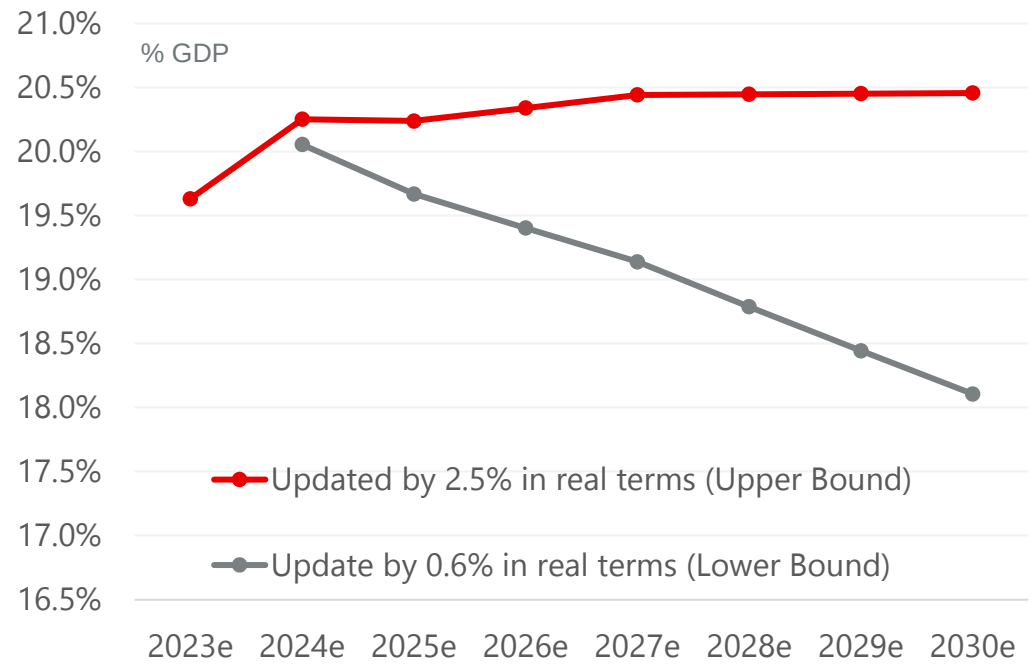
Simulation - Expenditure Limit



Sources: Finance Ministry, Santander

* For 2024 we only consider the increase of 1.5% without using the mechanism that could allow the expenditure limit to rise 2.5% in real terms.

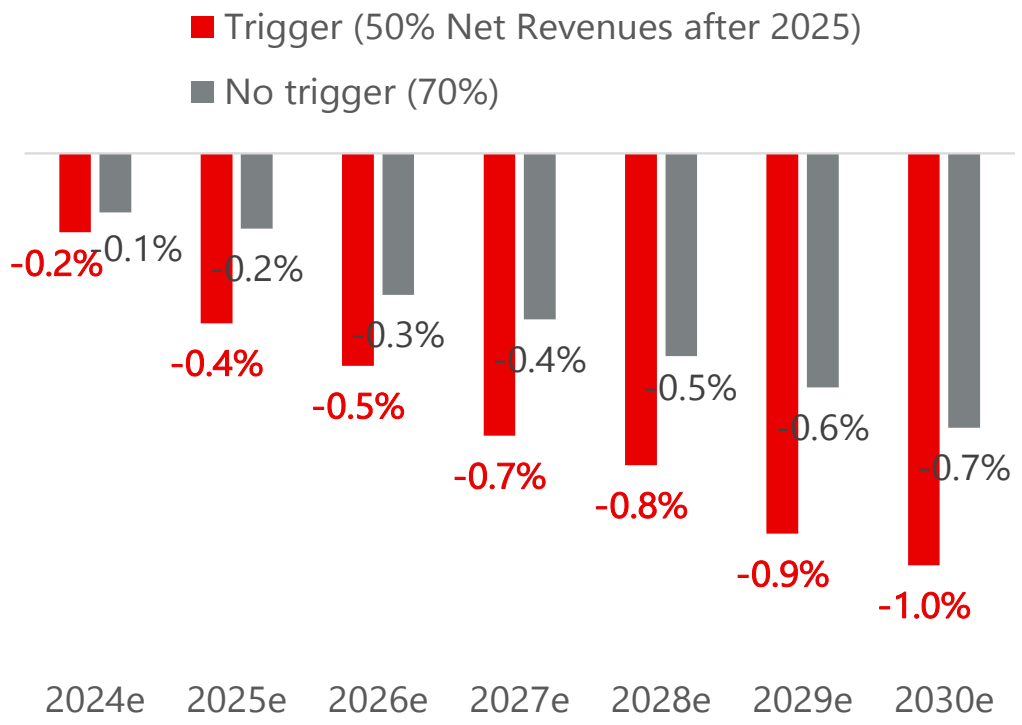
Simulation - Expenditure Limit



Sources: Finance Ministry, Santander

Fiscal Policy: Some challenges for 2024, yet 2025 will be more restrictive

Simulation - Expected cut in discretionary outlays



Some outlays will increase faster than the new limit

Sources: National Treasury, Santander.

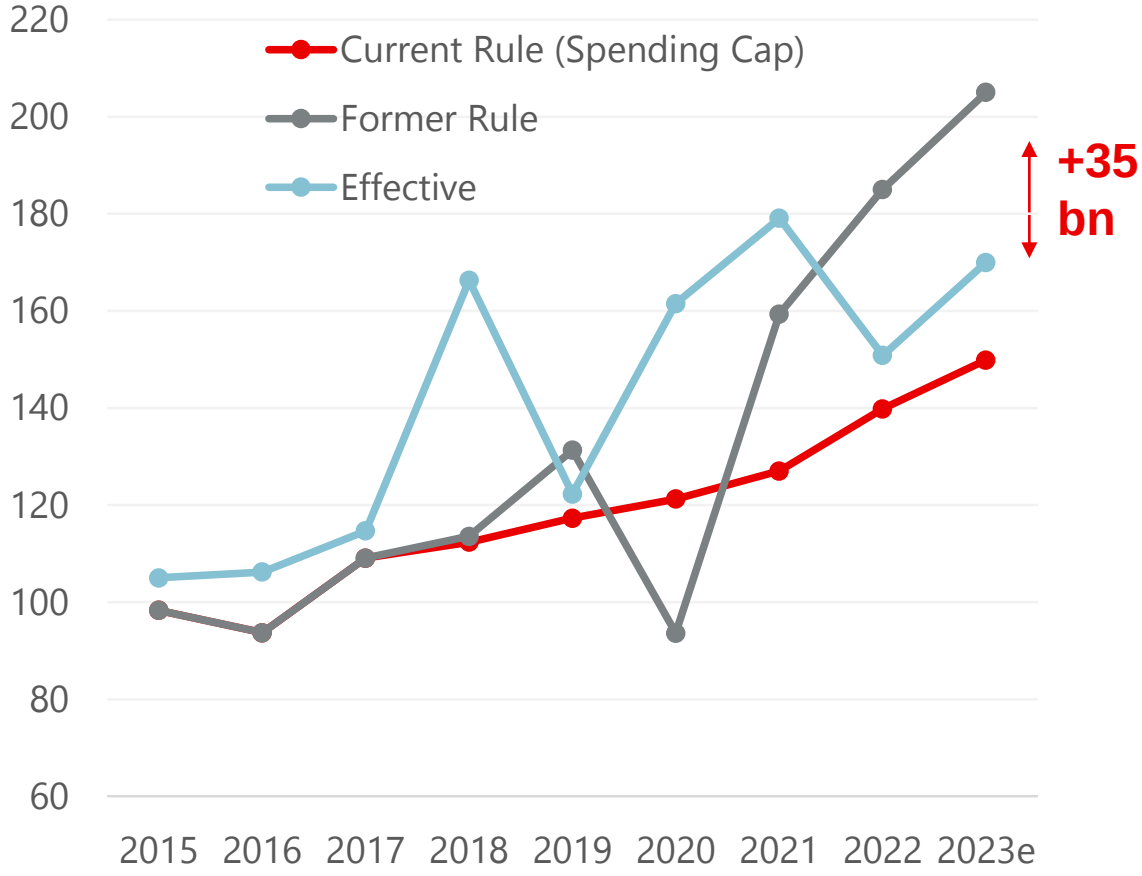
Education: 18% RLI | Health 15% RCL | Minimum Wage = IPCA + 2y GDP average

Public Servants wage = 8% | Welfare Program (Bolsa Família) = IPCA/2

Supposing no changes in the primary targets and the full-effect of the fiscal rule

Pension increase (vegetative): +2.5%

Health Outlays – Lower Bound – BRL bn



Sources: Finance Ministry, Santander

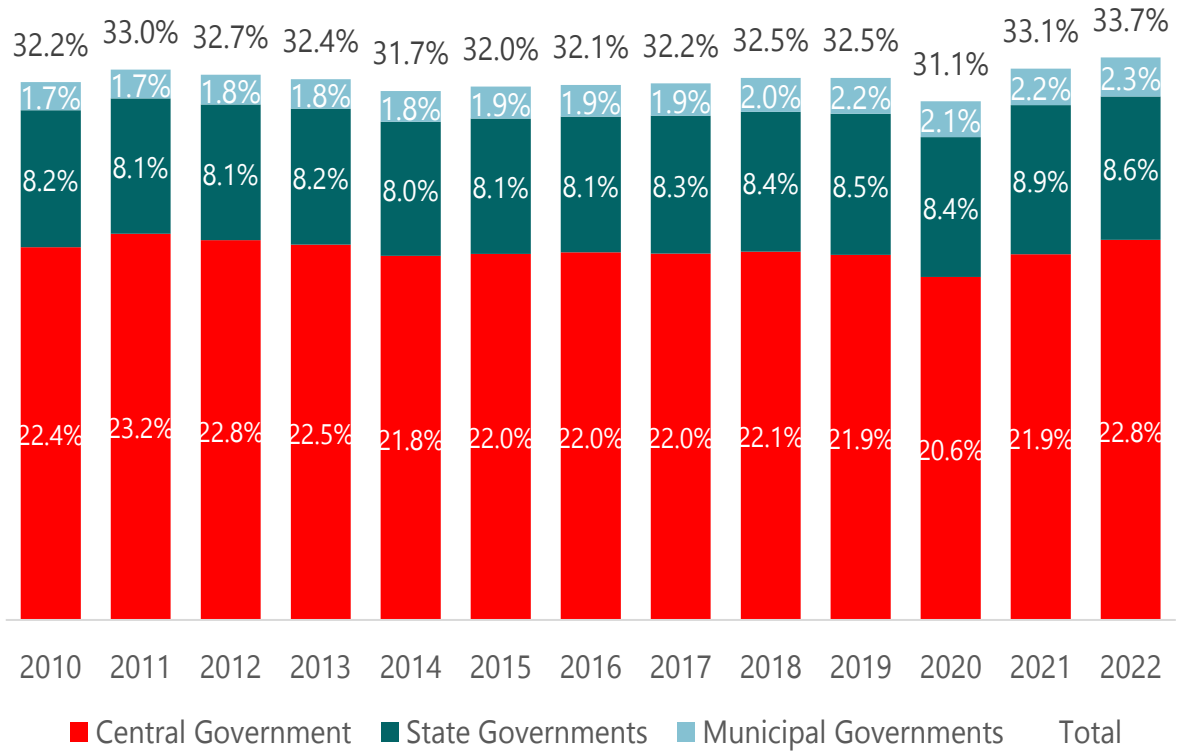
Santander

Fiscal Policy: Is it possible to raise revenues?

Considering OECD data, Brazil's tax revenue was 31.6% of GDP in 2020, the 4th highest among emerging economies.

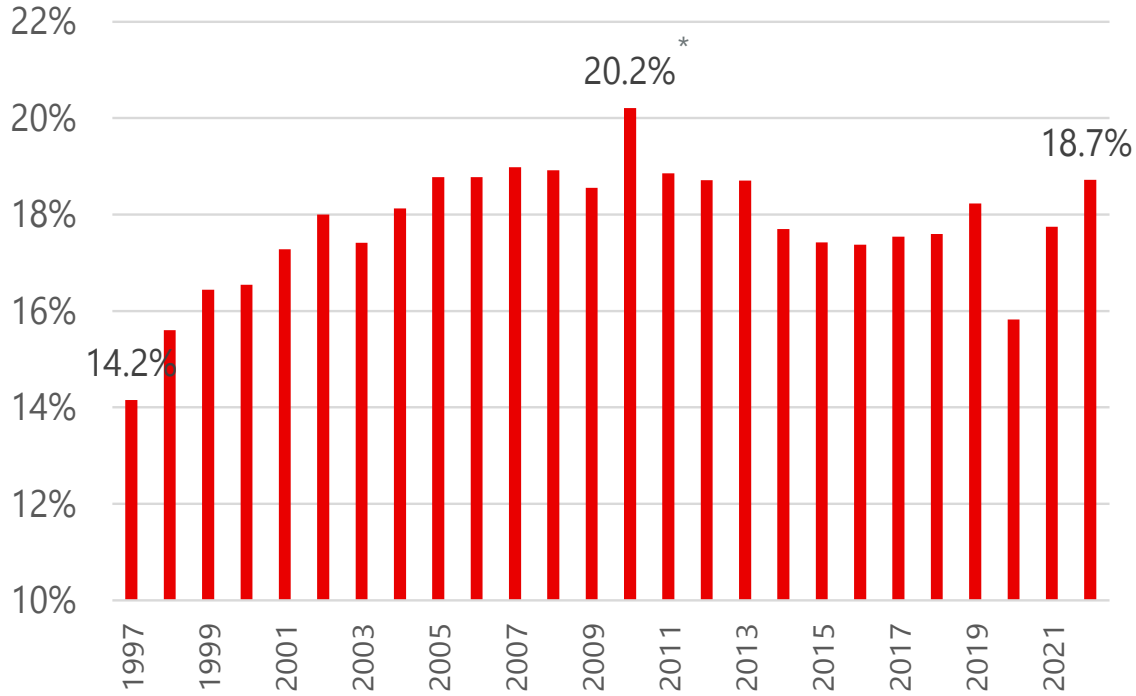
From 1990 to 2020: Brazil's tax revenue rose 3.9 pp, compared to LatAm (4.2 pp) and OCDE countries (2.7 pp).

Brazilian Tax Burden - % GDP



Sources: National Treasury, Santander.

Historical Net Revenues - % GDP



Sources: Finance Ministry, Santander

* 1.9% of GDP in extraordinary revenues

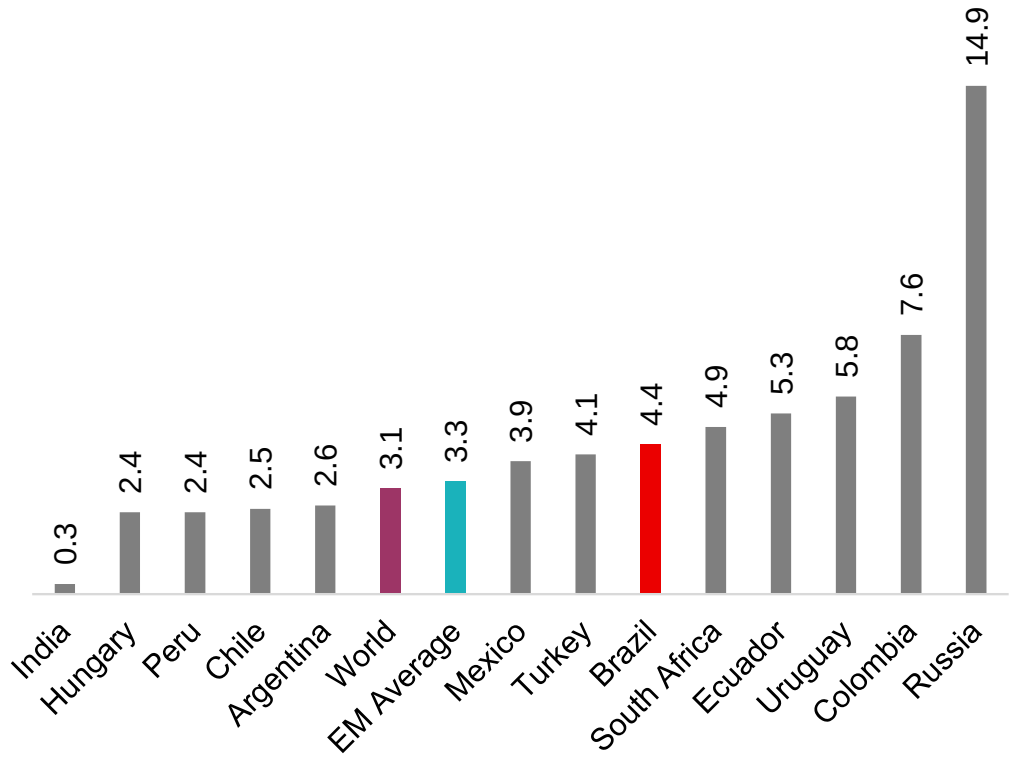
Brazil: Tax Relief Is 1.3 pp of GDP Higher Than Global Average

Fiscal Incentives expected for 2023 - % GDP

2023 Tax Incentives	BRL Billion	%	% of GDP
Simples Nacional	89	19.5%	0.9%
IRPF - Exempt Deductions and Earning	75	16.5%	0.7%
Zona Franca Manaus (Trade Zone)	55	12.1%	0.5%
Agriculture	52	11.4%	0.5%
Non-profit Org.	35	7.7%	0.3%
Savings and Credit Bonds - LCA, LCI, etc	19	4.2%	0.2%
Medicines and Medical Equip.	18	4.0%	0.2%
Employee Benefits	16	3.5%	0.2%
Regional Development	15	3.3%	0.1%
Automotive Sector	10	2.2%	0.1%
Payroll Tax Exemption	9	2.0%	0.1%
IT sector	8.6	1.9%	0.1%
Scientific Research and Tech.	7	1.5%	0.1%
Aircraft and Ships	5	1.1%	0.0%
Individual Enterpreneur (MEI)	5	1.1%	0.0%
ProUni	3	0.7%	0.0%
Others	34	7.5%	0.3%
Total	**456**	**100.0%**	**4.4%**

Sources: National Treasury, Santander.

2020's Tax Relief by Country - % GDP

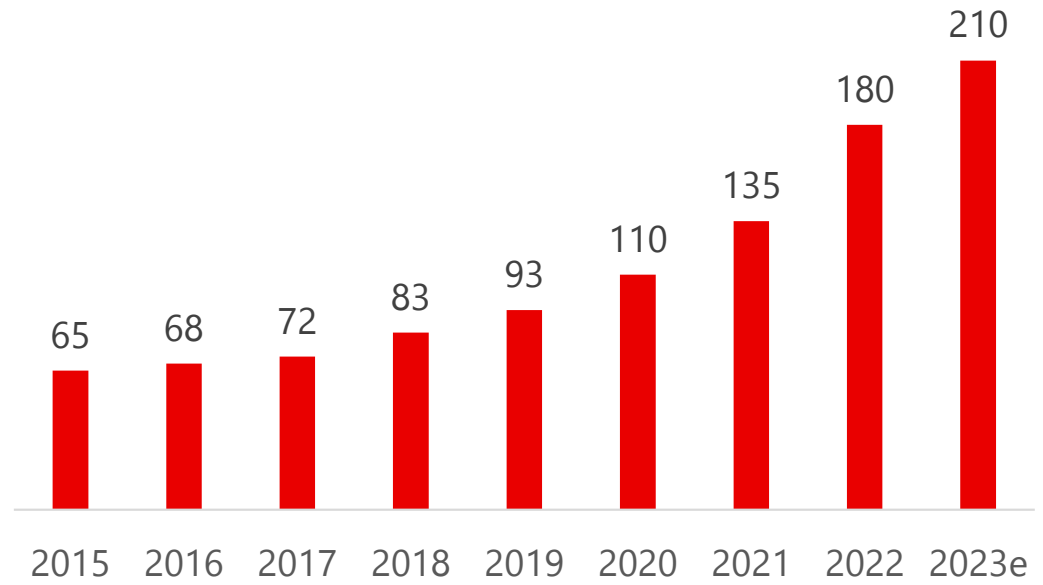


Sources: OECD, Santander

The measures to increase revenues are on Tax Breaks and Tax Basis Incentives

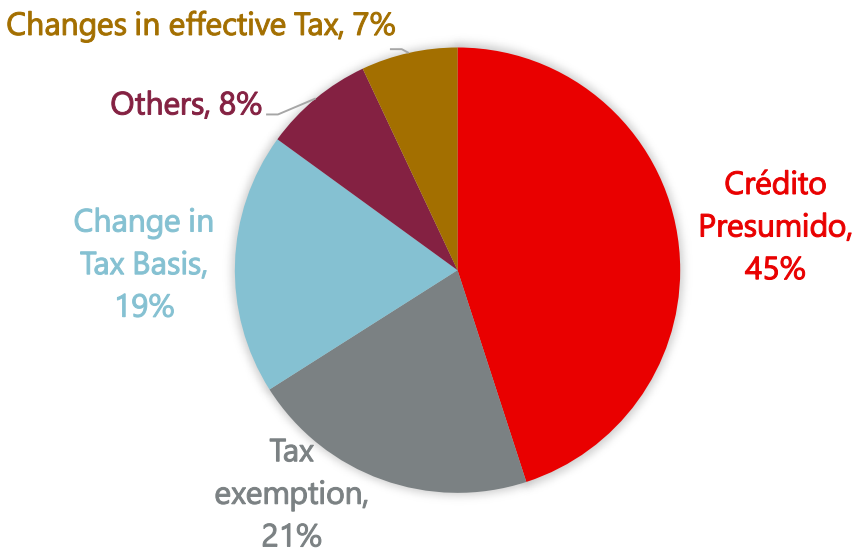
- A main proposal could be the use ICMS credit could only be deducted from the IRPJ and CSLL calculation base if it was earmarked for investments (tax benefits that require a contribution from the taxpayer, such as job creation or factory construction). According to Ministry of Finance projections, the measure might generate between R$85 billion and R$90 billion. Yet, recall that almost half of the revenues on IRPJ is transferred to states and municipalities, reducing its impact. According to our calculations, depending on the parameters (such as the effective rate and % of the funding subsidy) and removing the subnational transfers, **the total potential is reduced to an interval between BRL30-40 billion in a year.** Recently, the Supreme Court (STF) revoked the suspension of the ruling in favor of the federal government related to the use of VAT (ICMS) credits to reduce the corporate income tax basis (preserving "credito presumido"). We believe that potential increase in federal revenues could reach close to BRL20 billion annually. Among sectors, retailers would be more affected, but some may be able to mitigate the impact if they pass through this possible increase in the tax rate to consumers through higher prices.

Total ICMS (VAT) states tax breaks – BRL billion



Sources: National Treasury FEBRAFITE, Santander.

ICMS Tax Break Profile - 2021



Sources: National Treasury, Santander

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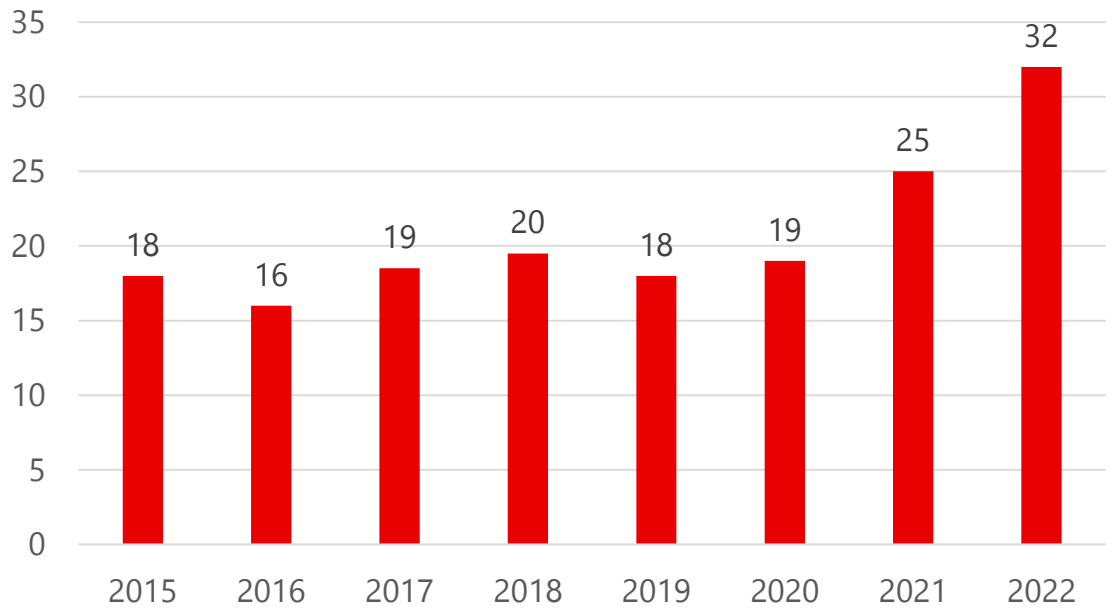
Exports to Tax Havens



Sources: SECEX, Santander.

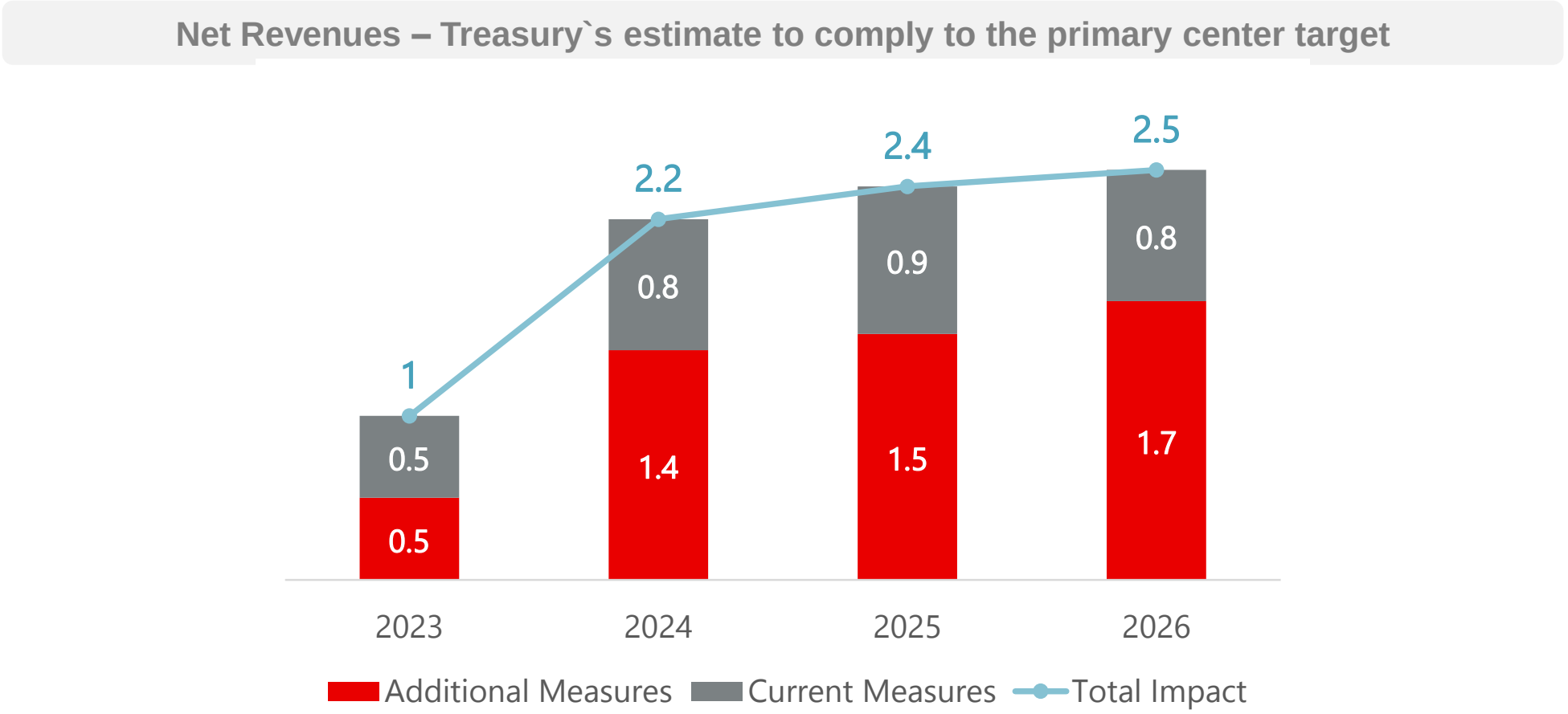
Transfer Price Taxation - BRL billion

	Transfer Price (intercompany)	Discount 10%	Discount 20%	Discount 30%
Public Sector (IRPJ+CSLL)	34%	5.9	11.9	17.8
	30%	5.2	10.5	15.7
	25%	4.4	8.7	13.1
Fed. Gov (IRPJ+CSLL)	34%	2.9	5.6	8.4
	30%	2.5	4.9	7.4
	25%	2.1	4.1	6.2

Sources: BCB,S, Santander

Treasury`s estimate to comply to the center of the primary target

- According to the National Treasury's Fiscal Projection Report, by 2026 revenue will need to grow by 2.5% of GDP.



Sources: National Treasury, Santander.

The measures to increase revenues are on Tax Breaks and Tax Basis Incentives

- We believe that the government will achieve BRL50 billion with the current measures, mostly impacting the 2024 result
- We see part of this compensating the cyclical reduction the central gov. net revenues, so we expect new measures to be announced

Measures BRL bn	Gov. Estimate	Santander	Status
CARF/Litigation	50	7	Litigation BRL2.5bn YTD - Carf to be approved in Senate
PIS/Cofins tax base (no use ICMS Credits)	30	25	Still low, should start rising in next months
Restrictions in ICMS tax benfits	90	15	Uncertain | It should take longer to happen
Transfer Pricing	23	11	Approved - Law 14.596/23
Tax on sporting bets	15	5	BRL2 billion in flow | BRL3 billion in regularization (one-off)
Offshore taxation	3	3	Provisional Measure
IRPF exemption (2 Min. wages) - in 2023	-3	-3	Provisional Measure
Imports (USD 50) exemption	-3	-3	Recently Regulated
Total	**205**	**60**	

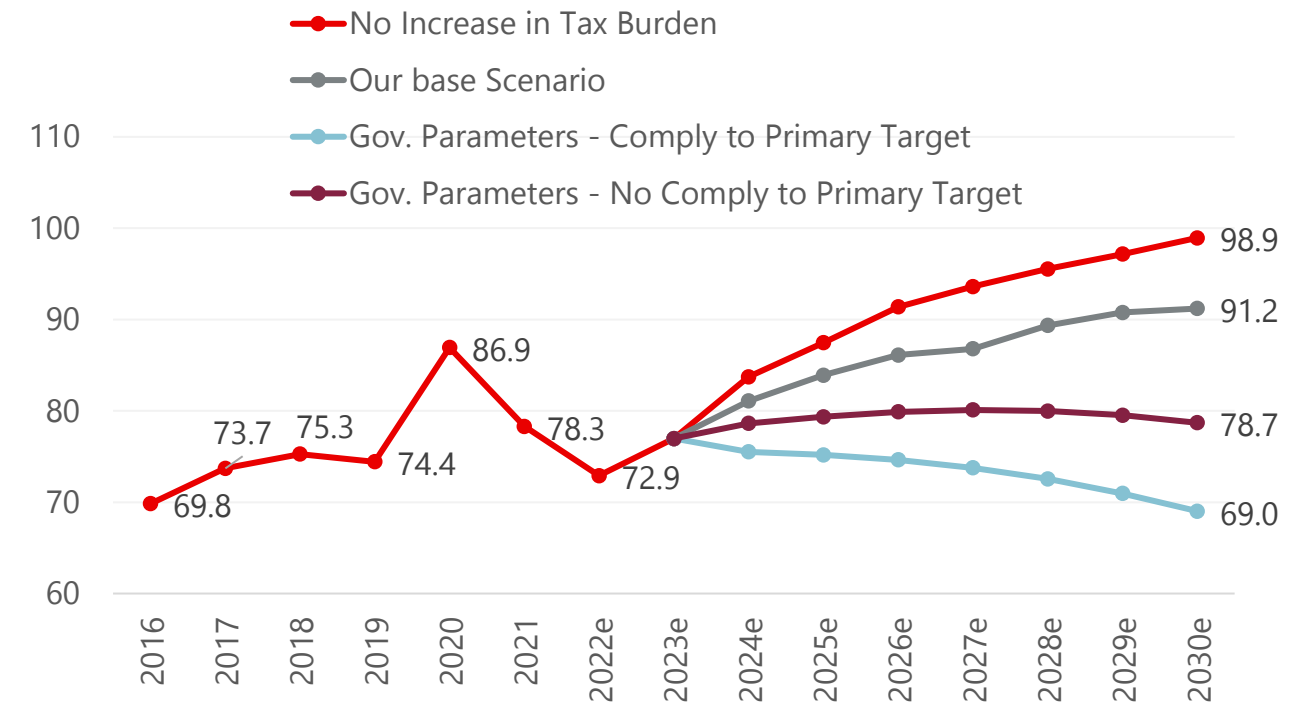
Measures in Debate	Gov. Estimate	Santander	Status
"Exclusive Funds" taxation - flow	14	10	Under Debate
End of JCP	-	8	Under Debate
Tax on Dividends (15%)	-	23-30	Should be followed by a reduction in IRPJ (34%)
Legalization of gambling ("Jogos de Azar")	40	35	Could take some time to collect new revenues
Eletronic Games legal framework	12	8	Need to be approved
Lottery "Raspadinha"	3	3	Need to be approved
Total	**69**	**64**	

Sources: Finance Ministry, Broadcast, Santander.

FISCAL POLICY: new framework will depend on revenues and short-term results

- The gross debt trajectory depends on the parameters and increase in revenues.
- In the short-term, the effect of positive results is losing steam.

Government Debt Simulation – The new framework will not guarantee the debt stabilization



Sources: BCB, Santander.

Notes: Debt issuances: we added a spread of +1.0 pp in addition to the Selic rate in the models.
2023 GDP Deflator: 3.0% | GDP: 1.9% | Selic Rate (avg): 13.5% | BNDES zero | Voluntary Deposits 1.0% of GDP
2023-40: GDP deflator: 5.0% | Potential GDP: 1.5% | Neutral Selic Rate: 5.0%

Primary Target - Historical Series of Compliance to the Primary Target

Year	Primary Target		Changed Target		Final Result		Deduction Made by Gov.	Observations
	BRL bn	% GDP	BRL bn	% GDP	BRL bn	% GDP	R$	
2001	32.3	2.6%	28.1	2.3%	22.0	1.7%	0.0	The target was met with compensation with the excess primary of federal state companies.
2002	26.4	2.0%	29.2	2.3%	31.9	2.1%	0.0	The primary target was accomplished.
2003	32.0	2.3%	39.1	2.4%	38.7	2.3%	0.0	The primary target was accomplished.
2004	43.3	2.5%	43.3	2.5%	52.4	2.7%	0.0	The primary target was accomplished.
2005	44.5	2.4%	44.5	2.4%	55.7	2.6%	0.0	The primary target was accomplished.
2006	53.0	2.5%	53.0	2.5%	51.4	2.1%	2.8	The target was met with deductions.
2007	56.2	2.4%	53.0	2.1%	59.4	2.2%	5.1	The target was met with deductions.
2008	60.8	2.2%	60.8	2.2%	71.3	2.3%	7.8	The primary target was accomplished.
2009	68.5	2.2%	43.3	1.4%	42.4	1.3%	17.9	The target was met due to the economic crisis of 2008-09. Complied with the deduction.
2010	72.6	2.1%	76.3	2.1%	78.7	2.0%	22.1	The primary target was accomplished.
2011	81.8	2.1%	81.8	2.1%	93.0	2.1%	28.0	The primary target was accomplished.
2012	97.0	2.1%	91.0	2.1%	86.1	1.8%	39.3	The target was met with deductions.
2013	108.1	2.2%	108.1	2.2%	75.3	1.4%	35.1	The target was met with deductions.
2014	116.1	2.1%	116.1	2.1%	-20.5	-0.4%	161.7	The target was met with deductions.
2015	55.3	1.0%	-51.8	-0.9%	-116.7	-1.9%	66.9	The goal was met with compensation from federal state-owned companies and deduction.
2016	24.0	0.4%	-170.5	-2.8%	-159.5	-2.5%	0.0	The primary target was accomplished.
2017	-139.0	-2.0%	-159.0	-2.4%	-118.4	-1.8%	0.0	The primary target was accomplished.
2018	-129.0	-1.8%	-159.0	-2.2%	-116.2	-1.7%	0.0	The primary target was accomplished.
2019	-139.0	-1.8%	-139.0	-1.8%	-88.9	-1.2%	0.0	The primary target was accomplished.
2020	-124.1	-1.6%	-124.1	-1.6%	-745.3	-9.8%	0.0	The target was suspended due to the pandemic.
2021	-247.1	-3.2%	-247.1	-3.2%	-35.9	-0.4%	79.4	The primary target was accomplished.
2022	-170.5	-1.9%	-170.5	-1.9%	54.9	0.6%	40.5	The primary target was accomplished.

Sources: IFI, Santander.

Federal Tax Collection

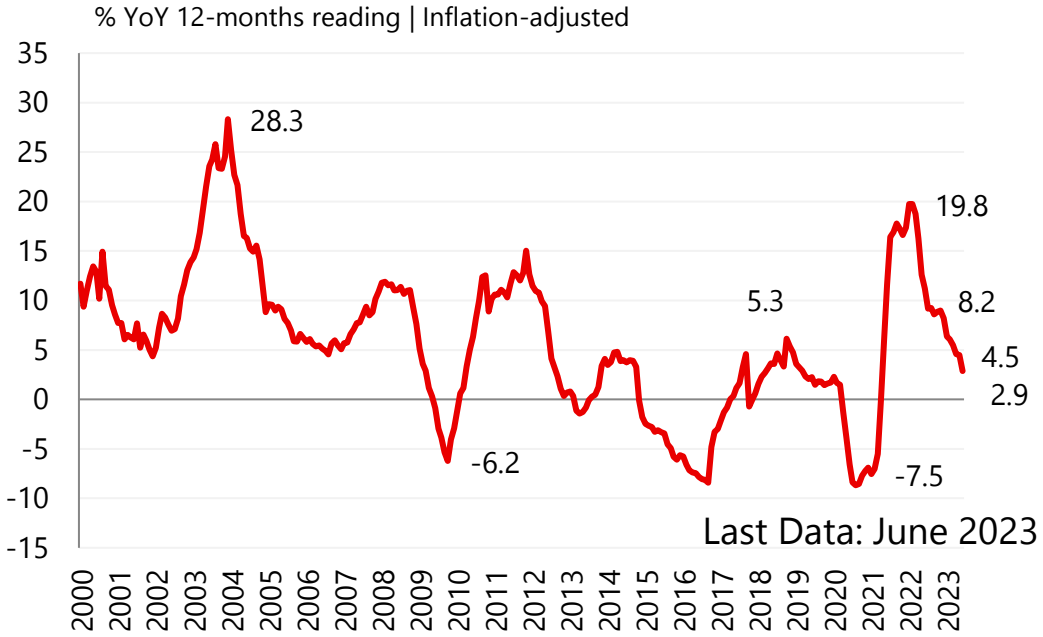
Moderation expected ahead

4

Revenues Impact – Price Effect + Activity Recovery

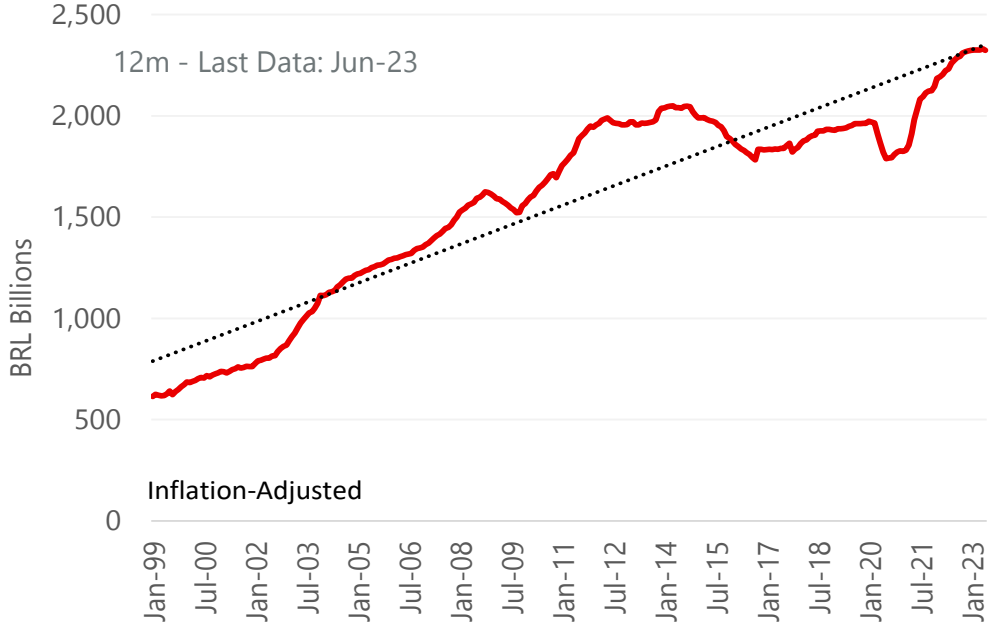
- We see a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the corporate sector, which have posted good results. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to metals & oil revenues.
- In our view, we expect revenue growth to slowdown ahead, 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;

Federal Tax Revenue – Losing Steam



Sources: Brazilian IRS, Santander.

Total Federal Tax Collection –

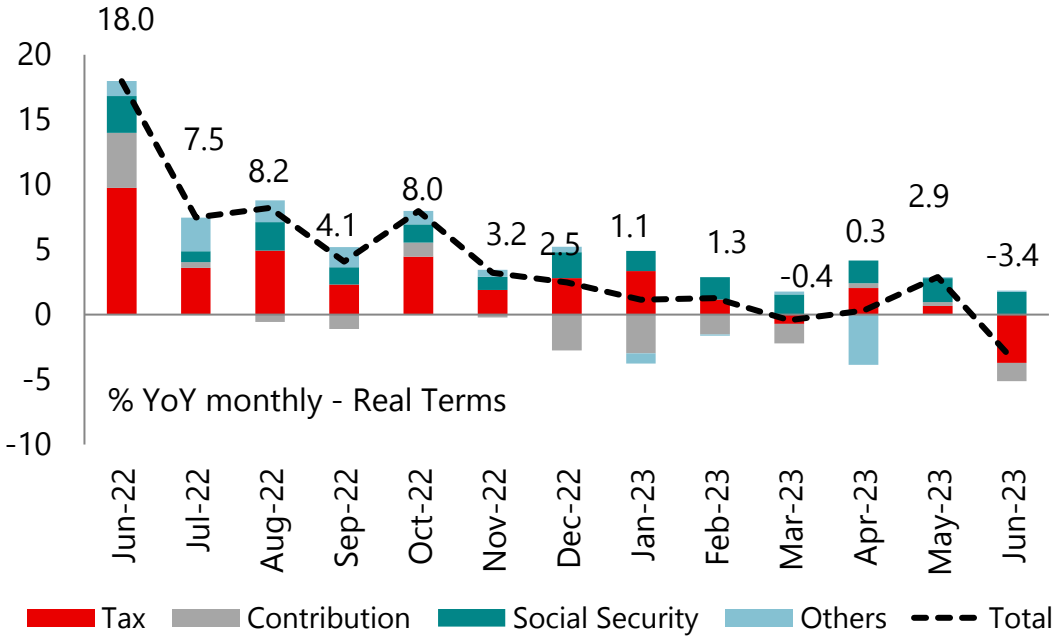


Sources: Brazilian IRS, Santander.

Now, federal tax collection is showing signs of losing steam

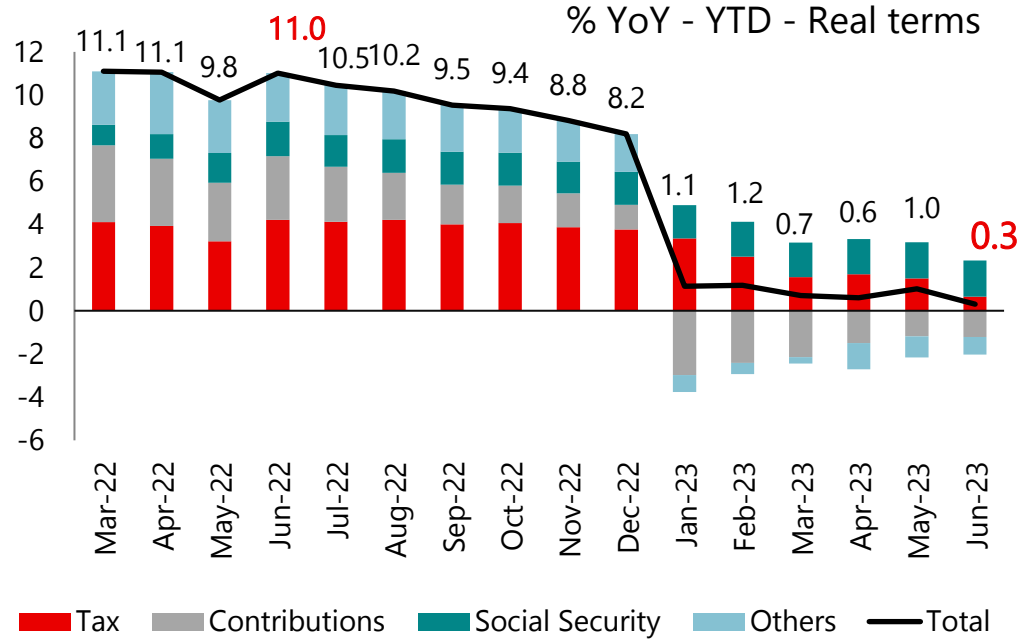
- In June, federal tax collection reached BRL180.5 bn, a tad higher than our forecast and market median, both close to BRL179.5 bn. This means a 3.4% YoY drop, considering a higher base (June 2022 performance), based on with revenues boosted by Oil and a more depreciated FX rate. We also observed BRL6 billion in atypical revenues (IRPJ/CSLL) last year. Excluding extraordinary revenues, the result was +0.6% YoY, a sharp drop from 4.9% YoY registered in May and 7.6% in April. In YTD terms, the tax collection reached 0.6% YoY in June, dropping from 1% YoY up to May.

Federal Tax Revenue: Monthly (%YoY)



Sources: Brazilian IRS, Santander.

Federal Tax Revenue: YTD (%YoY)

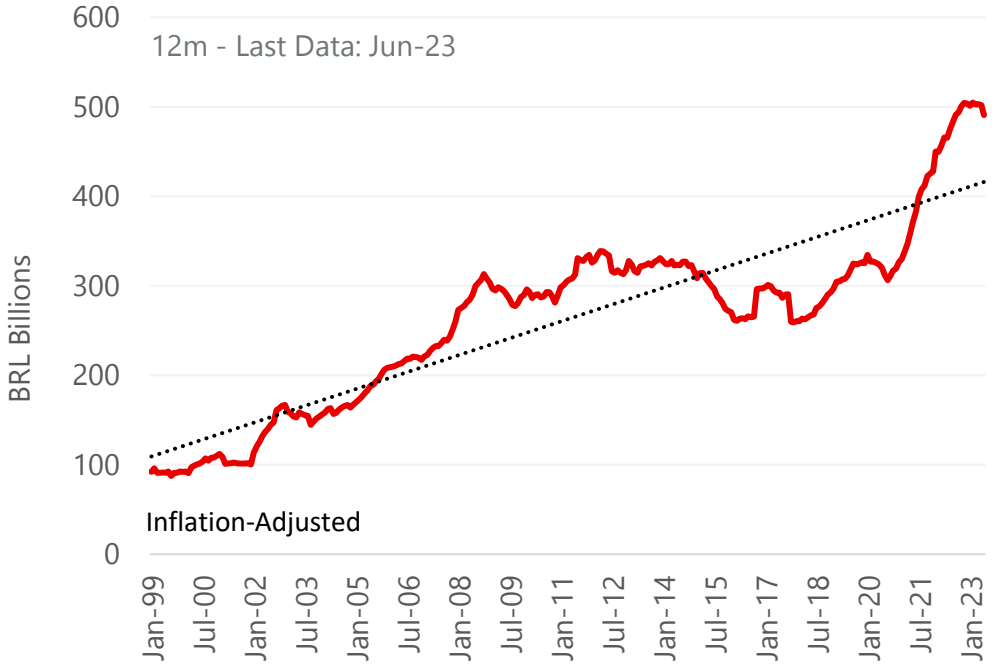


Sources: Brazilian IRS, Santander.

Labor Market: Still resilient and tax revenues presenting a good performance

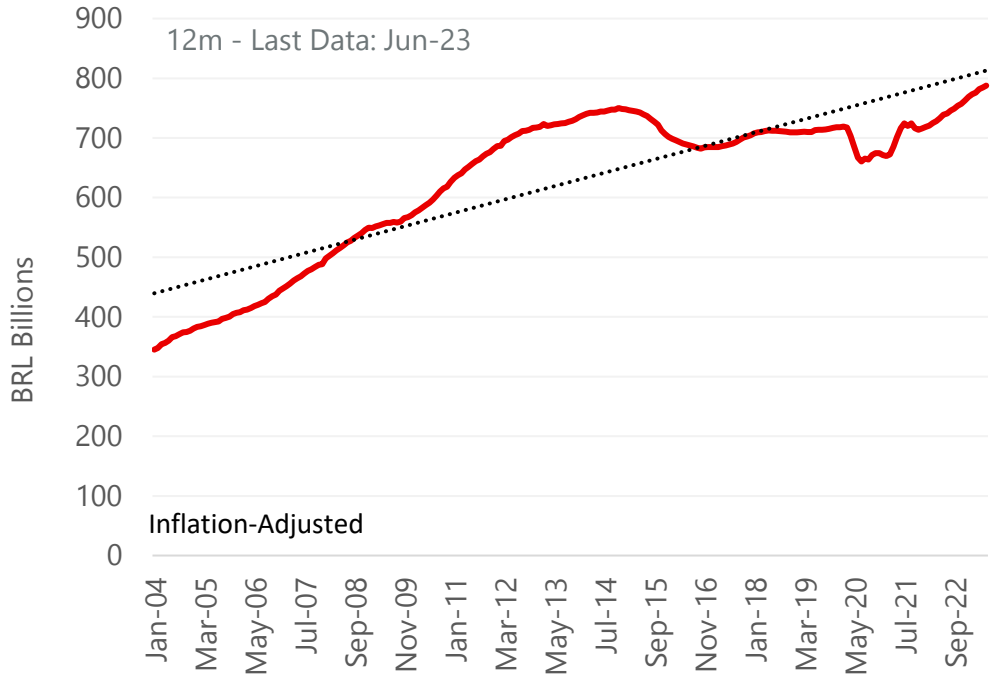
- We continued to observe a reduction in revenues linked to corporate profits (IRPJ/CSLL); the decrease was 16.4% YoY, removing the BRL6 billion atypical of June 2022. We continue to expect a weak result due to excellent results in 2022, boosted by commodity prices and activity recovery.
- On the other hand, we still have robust Social Security contributions (+6.7% YoY) with the real wage bill rising. We expect positive numbers related to the labor market ahead, yet for the year we continue to forecast a slowdown in domestic demand and in cyclical components.

Tax Collection linked to Corporate Revenues



Sources: Brazilian IRS, Santander.

Tax Collection linked to Labor Market



Sources: Brazilian IRS, Santander.

Primary Result and Debt

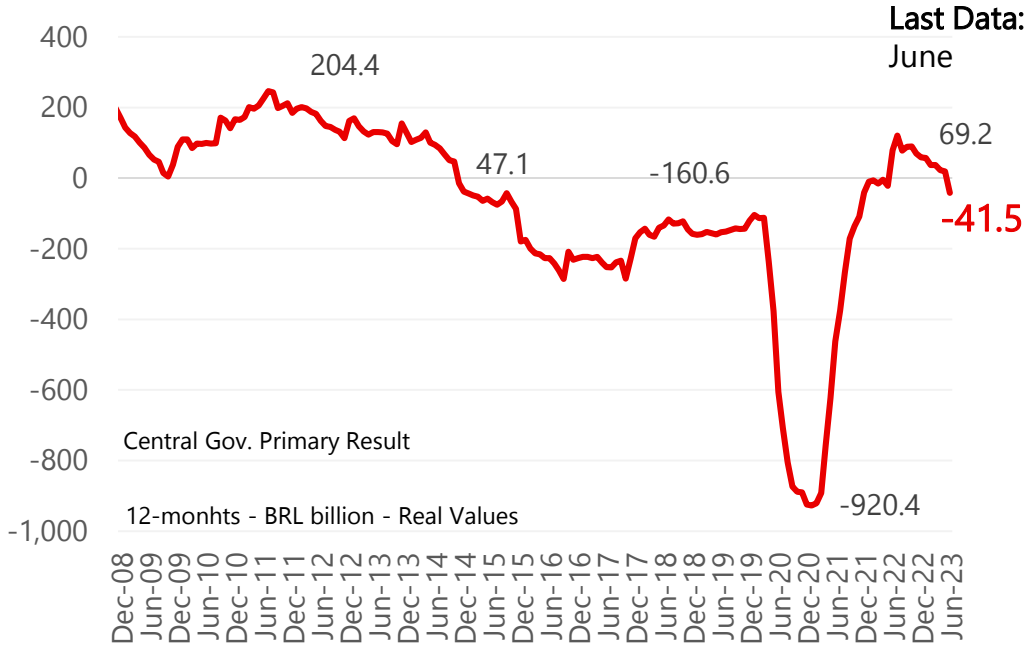
Back to a Primary Deficit in 12-months

5

Central Gov: Gradual Return to Primary Deficit

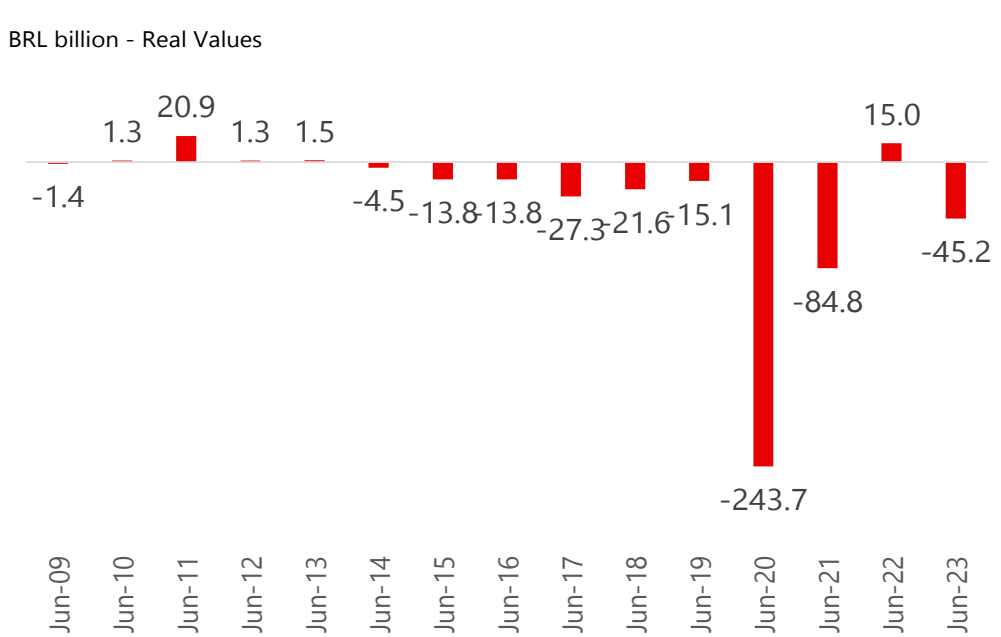
- In 12-month reading, the Central Government registered a *primary deficit* of BRL41.5 billion (0.4% of GDP), down from a surplus of +BRL18.2 billion (0.2% of GDP) registered in May and +BRL56.4 billion (0.5% of GDP) in January. For 2023, our forecast remains at -BRL 120 billion (-1.1% of GDP).

Central Gov. Primary Balance – 12m % GDP



Sources: National Treasury, Santander.

Central Gov. Result – BRL bn

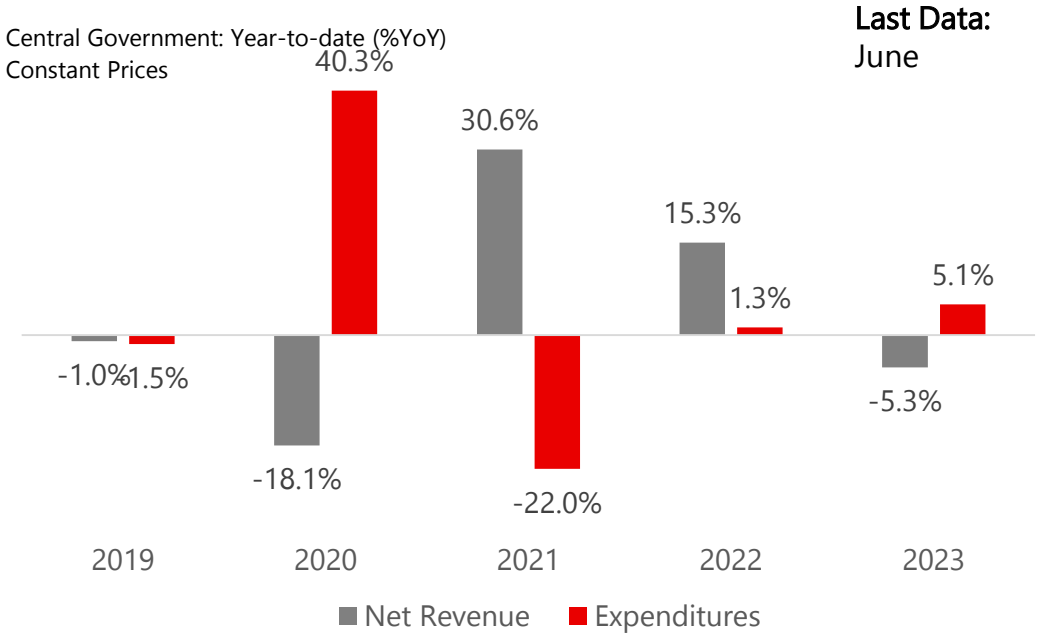


Sources: National Treasury, Santander.

Central Gov: Gradual Return to Primary Deficit

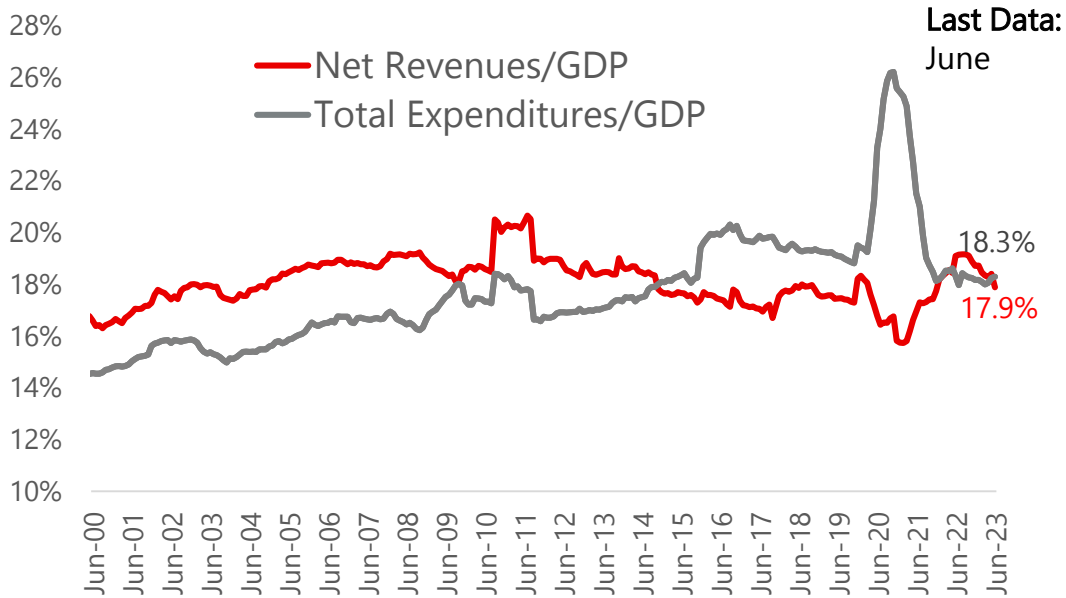
- In 1H23 data, net revenues had a real drop of -5.3% YoY. The result was affected by the lower level of federal tax collection performance, especially with a reduction in revenues related to commodity prices. On Expenditure side, we observed a rise of 5.1% YoY real, pushed by the rise in Mandatory Outlays with cash control (+39% YoY), which is mainly driven by the increase in the new welfare program,
- We continue to believe that the monthly result will lose steam ahead with the increase in expenses (already in the pipeline) and with a more modest increase in revenues (some measures starting to being more effective). We believe that the tax collection performance will be a key thermometer for the fiscal result this year, and it is highly correlated to the commodities prices

Central Gov. Primary Balance –



Sources: National Treasury, Santander

Revenue and Expenditures (%GDP)

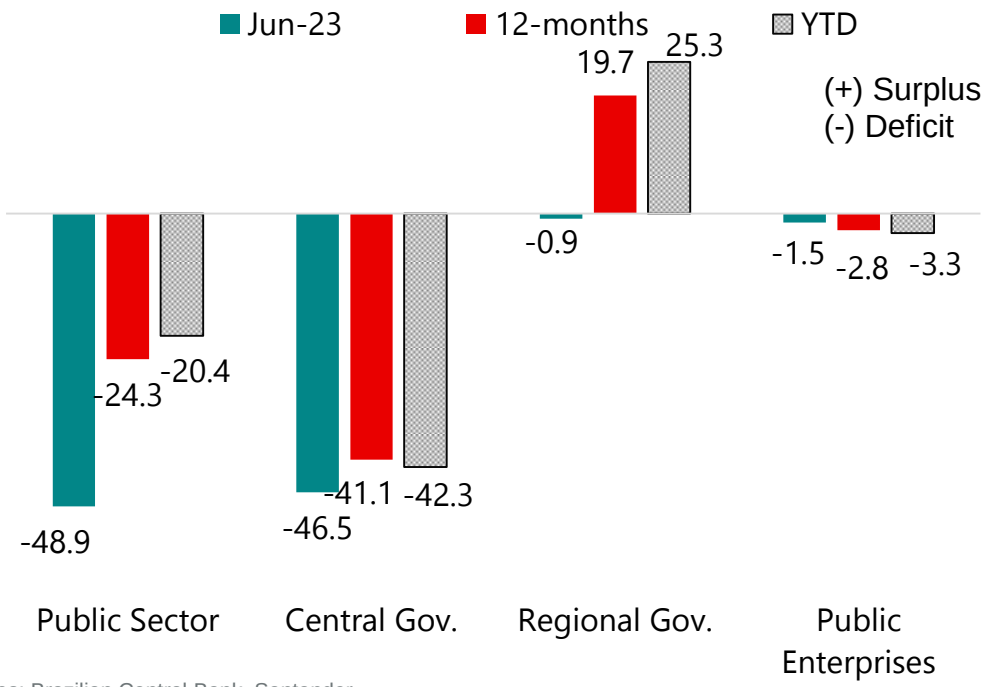


Sources: National Treasury, Santander

Public Sector Primary Result: Back to Negative Territory

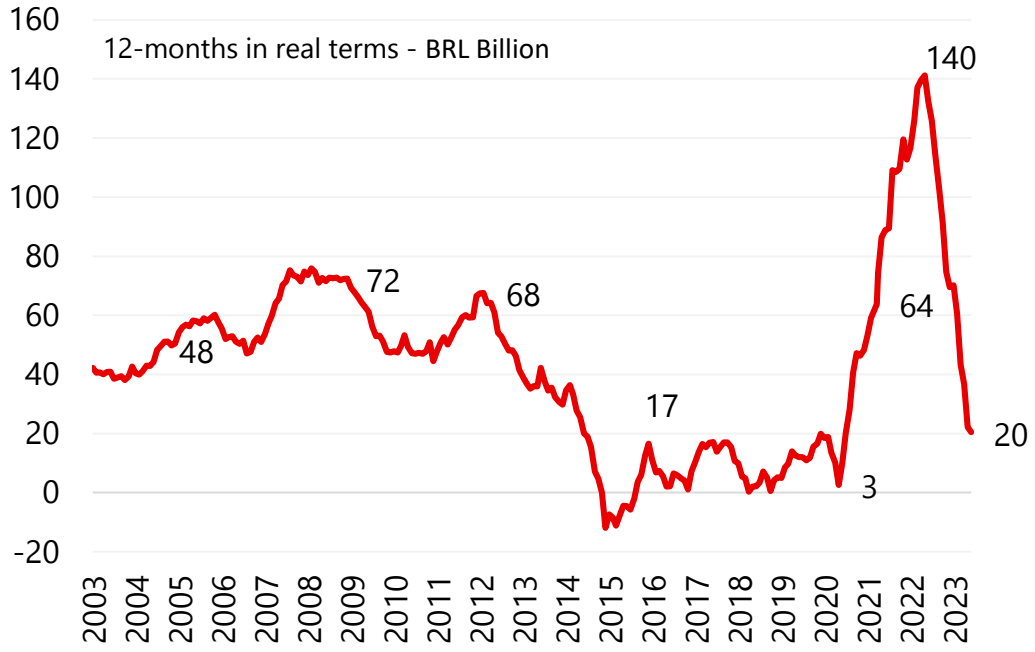
- In 12-month reading, the fiscal result of subnational entities registered a surplus of BRL19.7 bn (0.2% of GDP), the peak was in May-22 at BRL128.7 bn, 1.4% of GDP, and ended 2022 in BRL56 bn (0.7%). In the 12-month reading, the public sector primary result was back to the negative territory and reached a deficit of BRL24.3 billion (0.4% of GDP), after peaking at 2.4% of GDP (surplus) in Jul-22. The final result will be closely related to commodities price performance, in our view. The implementation of government measures to increase revenue could help achieve compliance with the new fiscal framework proposal.

Public Sector – Primary Result – BRL bn



Sources: Brazilian Central Bank, Santander.

Regional Gov. – Primary Result

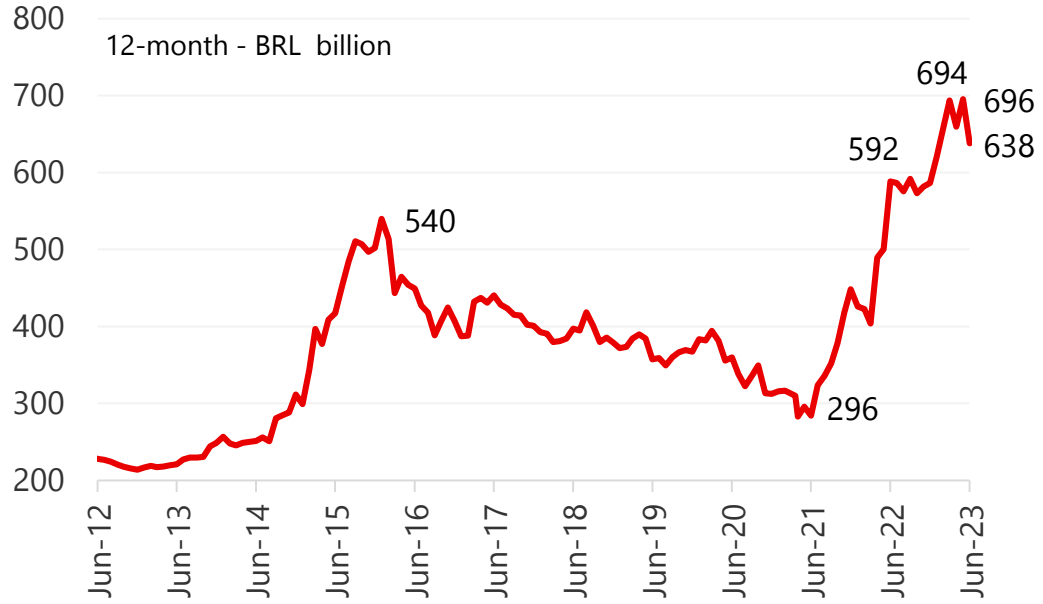


Sources: Brazilian Central Bank, Santander.

Increase in Interest Payments should pressure the debt ahead

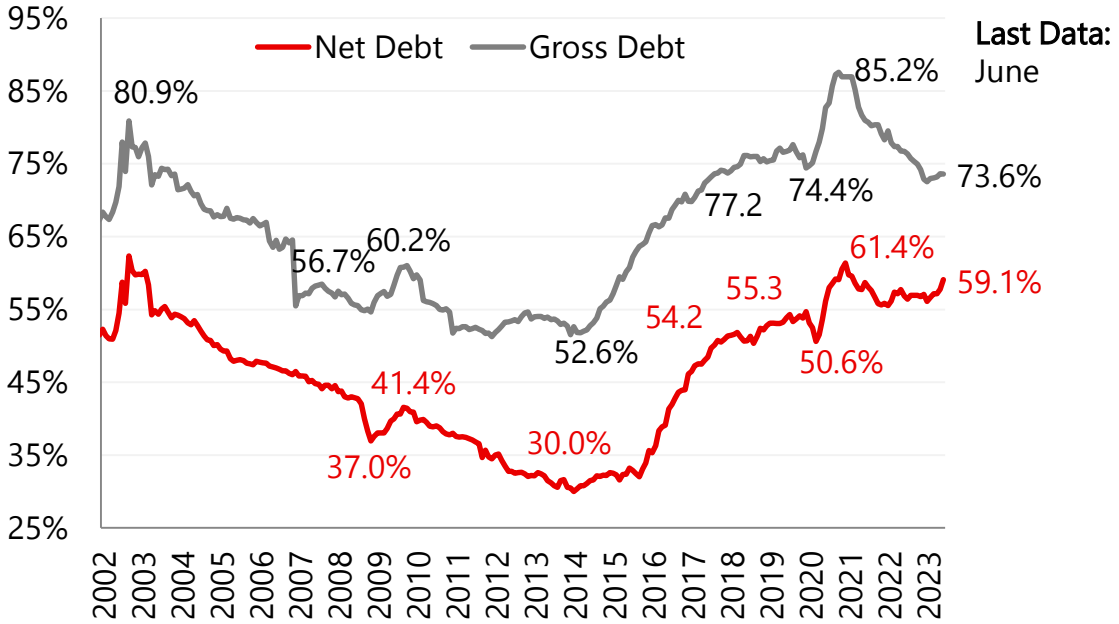
- Interest payments totaled BRL41 bn in June, compared to BRL98 billion in Jun-22. The result of FX swap operations contributed to this result (gain of BRL21 bn in June, compared to a loss of BRL40 bn in Jun-22). In the 12-month, *nominal deficit* totaled BRL662 bn (6.4% of GDP), compared to BRL460 bn (4.6% of GDP) in Dec-22.
- Debt indicators registered mixed results in June. Gross Debt stayed at 73.6% of GDP (flat in the month). Net debt went up to 59.1% of GDP (+1.3p.p.) on the heels of the more appreciated FX rate (+0.7 p.p.) and the primary deficit in the month (+0.5 p.p.). *Voluntary deposits* in the Central Bank (not included in debt statistics) increased to 1.1% of GDP (+0.1p.p.).

Nominal Interest Result – BRL billion



Sources: Brazilian Central Bank, Santander.

Public Sector Debt (12m % GDP)

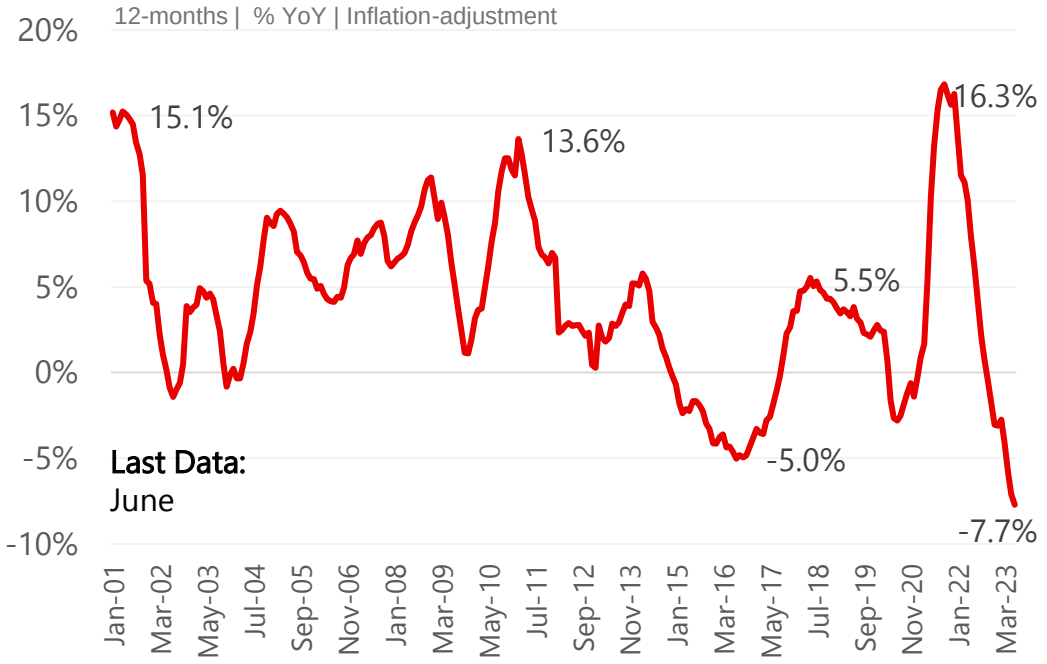


Sources: Brazilian Central Bank, Santander.

Fiscal Policy - Regional Government

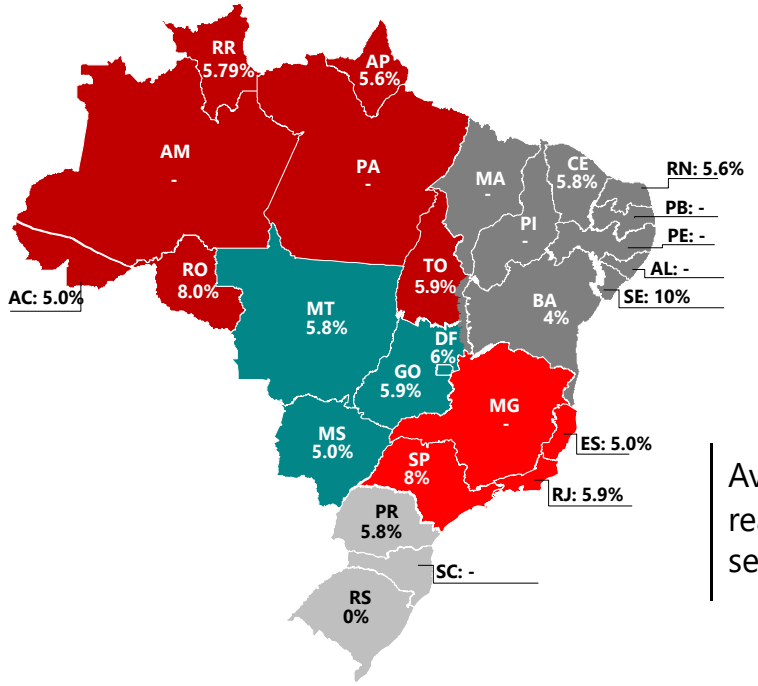
- The revenues of regional governments is reducing at the margin, we are seeing a drop of -4.1% YoY in real terms.
- We are observing the public servants' wages readjustment ~6% in the states, after increasing 11% in 2022. We also see pressure of the teacher's wage floor that was increased by 15% in the begging of the year.

Regional Gov. Revenues



Sources: Brazilian IRS , Santander.

Regional Gov. – Increases in Wages



Average of **6%** of salary readjustments of public servants' wages

Sources: Brazilian States, Santander.

FISCAL POLICY: Challenging Path to Reach A Sustainable Primary Surplus

Central Gov. Primary Balance																
Fiscal Items (% of GDP)	2017	2018	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	Δ 26-17	Δ 30-17
Total Revenue	21.0	21.3	22.1	19.3	21.7	23.3	22.8	22.9	23.0	23.1	23.3	23.3	23.2	23.2	2.1	2.2
Revenues Collected by the IRS (1)	12.7	12.9	12.8	11.8	13.4	14.0	14.1	14.0	14.0	14.0	13.9	13.8	13.6	13.5	1.3	0.8
Net Social Security Revenues (2)	5.7	5.6	5.6	5.3	5.2	5.4	5.7	5.7	5.7	5.7	5.7	5.7	5.7	5.7	0.0	0.0
Revenues Not Collected by the IRS (3)	2.7	2.8	3.7	2.2	3.1	3.9	3.0	3.2	3.3	3.5	3.6	3.8	3.9	4.0	0.8	1.4
Transfers by Revenue Sharing	3.5	3.7	3.9	3.5	4.0	4.6	4.4	4.4	4.2	4.1	4.0	4.0	3.9	3.8	0.7	0.3
Net Revenue	17.5	17.6	18.2	15.8	17.7	18.7	18.3	18.5	18.8	19.0	19.2	19.4	19.4	19.4	1.5	1.8
Total Expenditure	19.4	19.3	19.5	25.6	18.1	18.2	19.4	19.5	19.5	19.6	19.2	19.0	18.7	18.4	0.1	-1.0
Social Security Benefits (4)	8.5	8.4	8.5	8.7	8.0	8.0	8.3	8.6	8.6	8.6	8.6	8.6	8.5	8.5	0.2	0.1
Payroll (5)	4.3	4.3	4.2	4.2	3.7	3.4	3.5	3.6	3.7	3.8	3.8	3.8	3.7	3.6	-0.5	-0.7
Other Mandatory Expenses (6)	3.0	2.9	2.6	9.5	3.4	3.0	2.8	2.7	2.7	2.6	2.4	2.4	2.3	2.3	-0.4	-0.7
Expenses with Cash Control (7)	1.9	2.0	1.9	1.8	1.6	2.2	3.2	3.0	2.9	2.8	2.8	2.7	2.6	2.5	1.0	0.6
Discretionary Expenses (8)	1.8	1.8	2.2	1.4	1.4	1.5	1.7	1.6	1.6	1.8	1.7	1.7	1.6	1.6	0.0	-0.2
Central Gov. Primary Balance	-1.9	-1.7	-1.3	-9.8	-0.4	0.5	-1.1	-0.9	-0.8	-0.6	0.0	0.4	0.7	0.9	1.3	2.8
Public Sector Primary Balance	-1.7	-1.5	-0.8	-9.4	0.7	1.3	-1.0	-0.9	-0.7	-0.5	0.1	0.4	0.7	1.0	1.2	2.6
Nominal GDP (BRL billion)	6,585	7,004	7,389	7,610	8,899	9,915	10,407	10,931	11,672	12,499	13,321	14,197	15,130	16,125	5,913	9,539

Notes and Hypothesis

(1) Elasticity: Revenues-GDP 2021: 1.7 | 2022: 1.3 | 2023:0.94 | Long-term: 1.05. We see a slowdown in extraordinary revenues from 2023 onwards. Potential GDP: 1.5%. Inflation: 4.0%, GDP deflator 5.0%. (2) Recovery in the formal labor market and earnings (better short-term numbers), expected some softening ahead. (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—one of the key aspects to reach a sustainable primary surplus by the end of the decade. 4) A permanent fiscal waiver of BRL170 billion in 2023 onwards. We assume a fiscal rule that incorporates the waiver for 2023 as a permanent shift in expenditure limit (new fiscal framework). New rule will maintain expenditures limited to ~19% of GDP (close to the level before enactment of the former spending cap law). Real minimum wage increase (IPCA + average of last 2 years of GDP growth). Pension Reform approved in 2019 will stabilize the expenditures as % of GDP in the long-term (even with the rapid aging of the population, pressuring more after the end of the decade). In the short-run, the queue of the new pension benefits will be gradually reduced. (5) Gradual increase in admissions (70%) to the federal workforce ("normalization"). In the short-term (2024-25) decomposition of 80%, We included the +9% increase in 2023 and 2024, after that is decreasing gradually to 5% in Medium-term. Long-term: digitalization effects contain the increase (higher productivity). (6) Includes: higher payments in Court-ordered debt budget (sub-cap) – better management with a reduction in long-term, rise in federal contribution to Fundeb (Educational Fund), BPC (pension benefit). Court-ordered debts to accumulate to 1.6% of GDP by 2026, with the government negotiating future payments. (7) The main change was the increase in the welfare program (*Auxílio Brasil*). 2022 budget: BRL90 billion (from BRL35 bn of the former Bolsa Família). For 2023 onwards a more efficient and focalized welfare program with a total of BRL165 bn (gradual reduction in outlays after 2024). (8) Discretionary Expenses maintained at ~1.6% - a level that we consider enough to avoid a partial shutdown of public services, with and increase in investment. The new fiscal framework will not be biding for a drastic cut after 2025. 2026 we should observe a rise in the discretionary outlays, with a containment only in 2027. (9) Not consider a relevant increase in Tax exemption from 2023 onwards.

Public Debt and Simulations

A risky path toward debt stabilization

Lower GDP deflator in the short-term

6

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 **80%**
- We see the neutral interest rate hypothesis at 5.0%, 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 2.5p.p. of GDP primary fiscal adjustment, just to stabilize the ratio debt-to-GDP around the level of ~80% of GDP (in cyclical estimate). In the structural estimate, the adjustment is closer to 2p.p..

- **Current situation:**

. Real interest rate (ex-ante) 1-year: ~7%,
. GDP: 1.9% in 2023 and 1% in 2024

Liquidity reserves close to 9 months of debt maturities

Increase in debt cost (Selic + IPCA)

- **Steady-state:**

According to our hypothesis:
. Real interest rate at +5.0%
. Potential GDP at +1.5%,

. The primary surplus must reach >2% of GDP to maintain the gross debt stable.

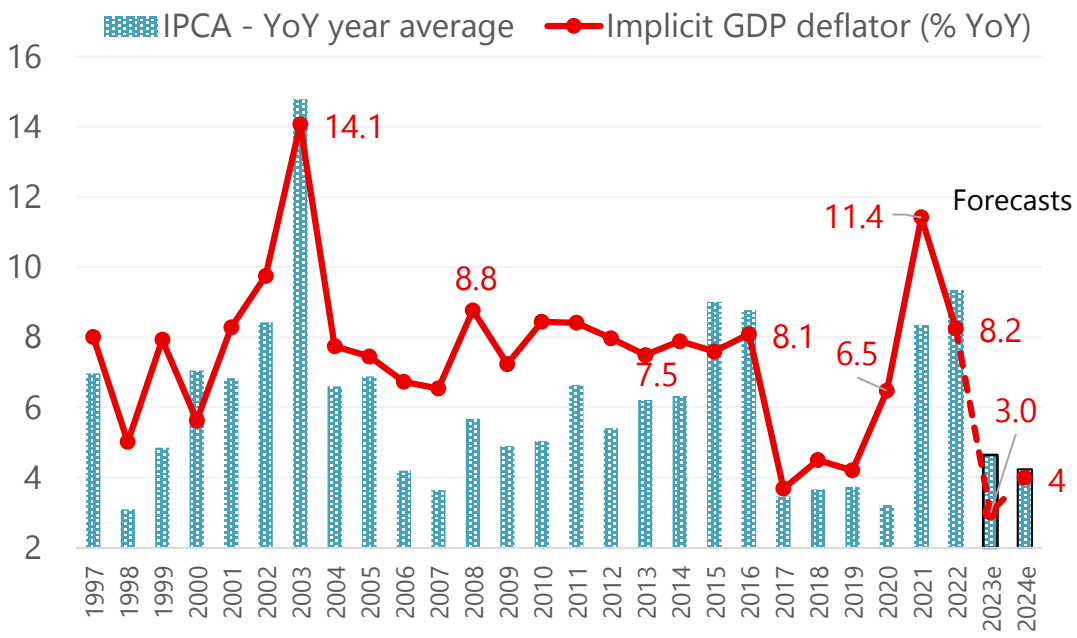
		Real Interest Rate						
		1.0%	*2.0%*	*3.0%*	*4.0%*	*5.0%*	*6.0%*	*7.0%*
GDP Growth	*0.0%*	0.8	1.6	2.4	3.2	4.0	4.8	5.6
	1.0%	0.0	0.8	1.6	2.4	3.2	4.0	4.8
	1.5%	-0.4	0.4	1.2	2.0	2.8	3.5	4.3
	1.8%	-0.6	0.2	0.9	1.7	2.5	3.3	4.1
	2.0%	-0.8	0.0	0.8	1.6	2.4	3.1	3.9
	2.5%	-1.2	-0.4	0.4	1.2	2.0	2.7	3.5

Sources: BCB, Santander.

GDP Deflator Impact – Opposite effect in 2023 on lower IGP-M average

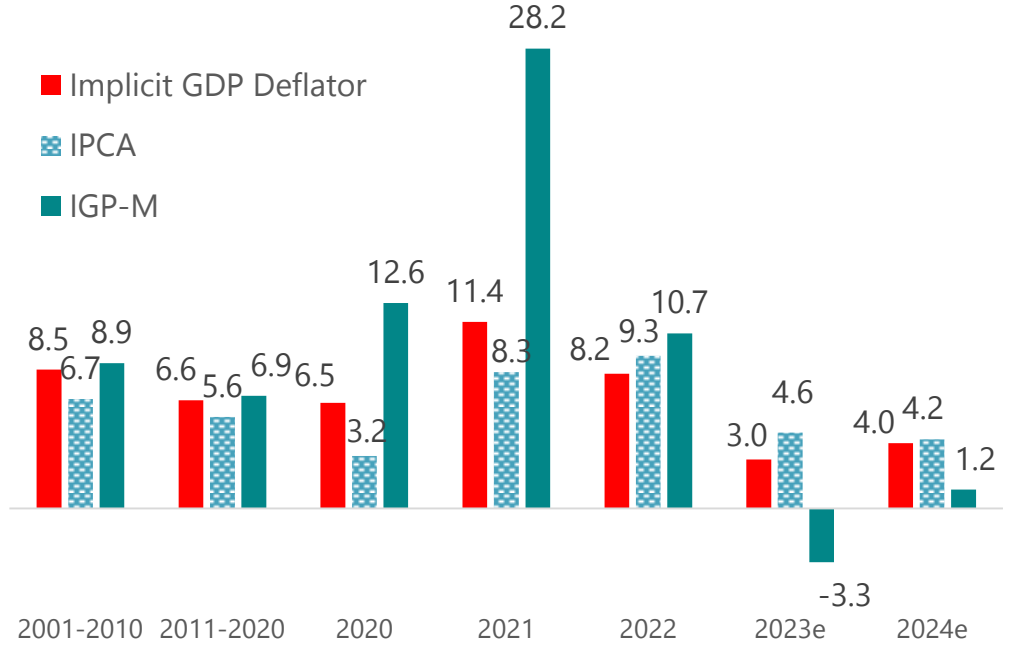
- After helping the increase in Nominal GDP, we estimate that the GDP Deflator will be lower than the IPCA numbers.
- Our GDP Deflator estimate is at 3.0% for 2023, considering lower IGP-M YoY average (reduced again to -3.3%, from -1.4% in June, and -0.3% in May.

IPCA and GDP Deflator



Sources: IBGE, Santander.

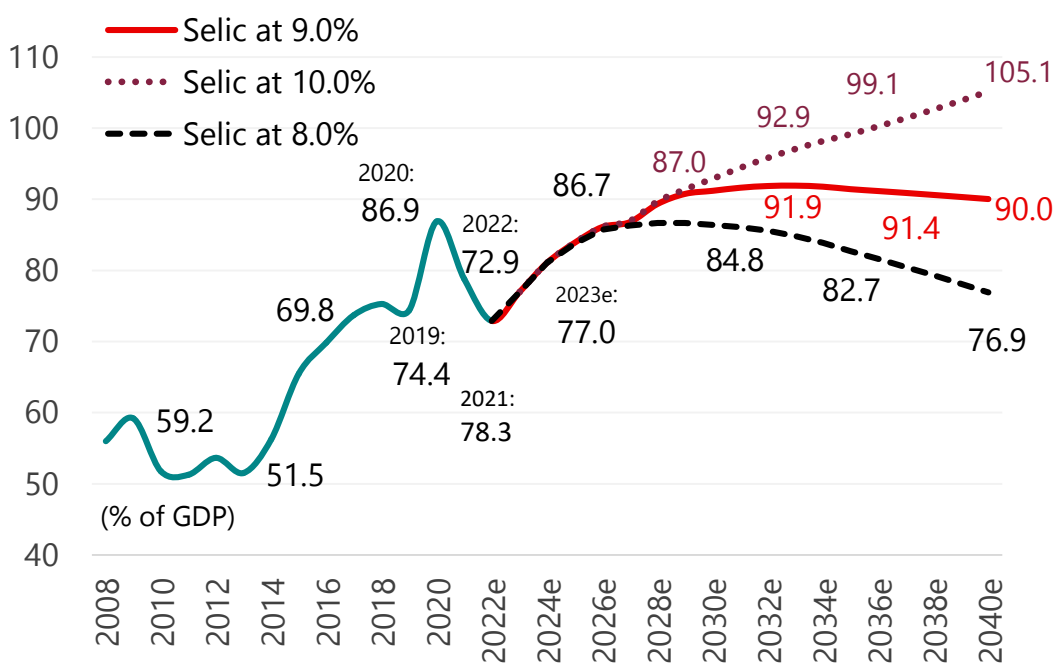
IPCA, IGP-DI and GDP Deflator



Sources: IBGE, FGV, Santander.

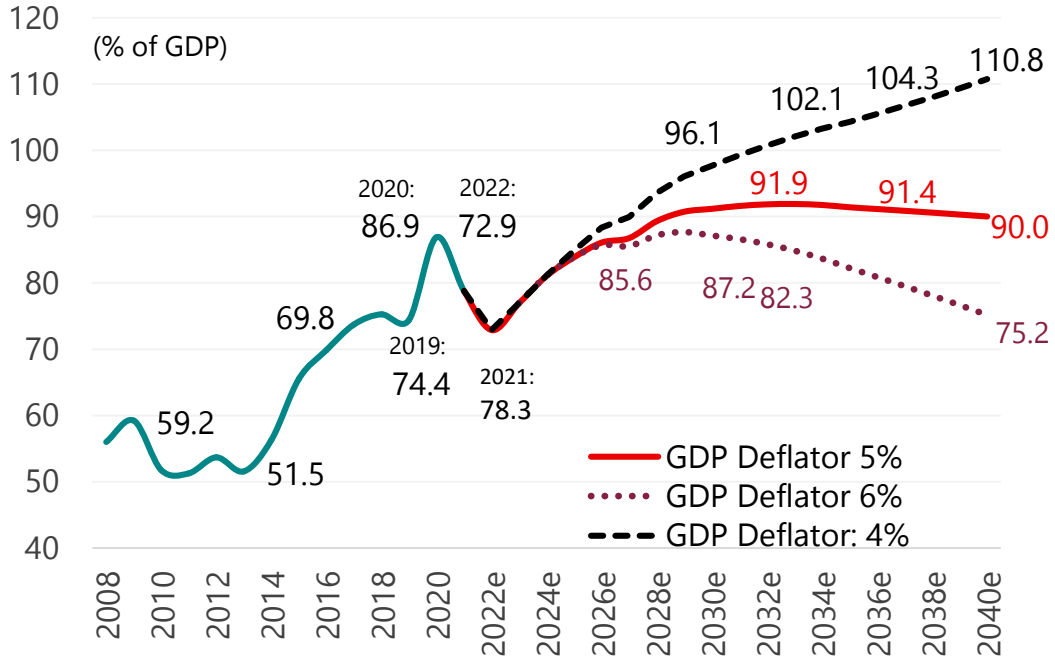
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

Government Debt – Simulations for Selic Rate Hypotheses



Sources: BCB, Santander

Government Debt– Simulating for GDP Deflator Hypotheses



Sources: BCB, Santander.

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

2023 GDP Deflator: 3.0% | GDP: 1.9% | Selic Rate (avg): 13.2% | BNDES zero | Voluntary Deposits 1.0% of GDP

2023-40: GDP deflator: 5.0% | Potential GDP: 1.5% | Neutral Selic Rate: 5.0%

Debt Management

Recently we observed a positive window for fixed-rate bonds issuance in June

Annual Borrowing Plan 2023

- On July 21, the National Treasury published its monthly debt report for June. Debt issuance remained high in the month, totaling BRL151 billion, compared to an average of BRL104 billion in the last 12 months. Issuance was concentrated in fixed rate (~58%) bonds, mainly due to higher demand given the expected monetary easing cycle ahead. Considering this, weekly bond issuances reached BRL28 billion through June, rising from BRL27 billion through May; this was the third consecutive month in which weekly bond issuances were above the level needed to keep liquidity reserves stable until the end of the year. For 2023, we estimate that ~BRL25.4 billion in issuances per week will be required.

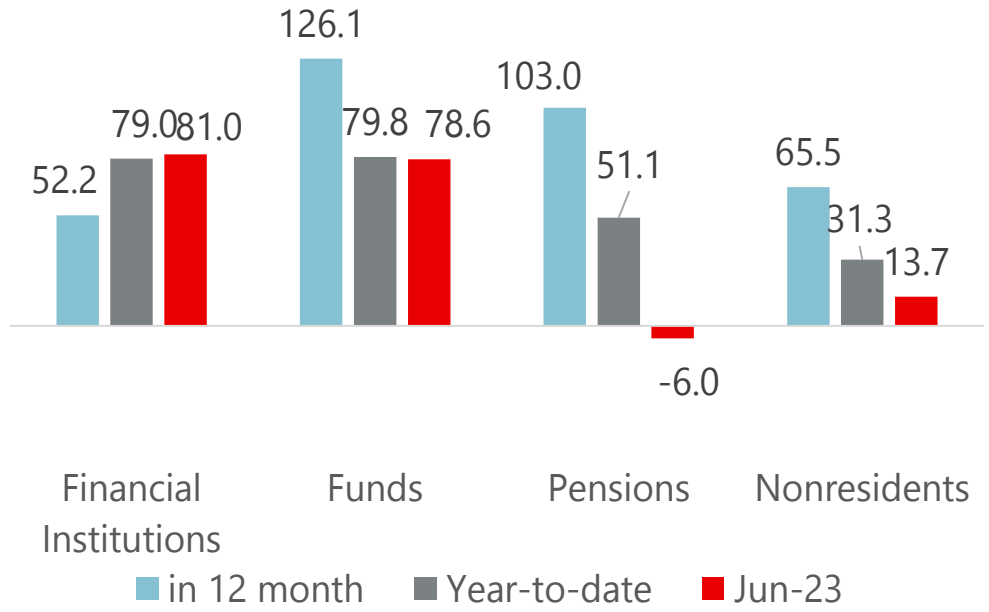
Annual Borrowing Plan (PAF 2023)									
	2020	2021	2022	May-23	Jun-23	PAF 2023 range		PAF 2022 range	
Outstanding volume (BRL billion)						Min	Max	Min	Max
Federal Public Debt	5,010	5,614	5,951	6,014	6,192	6,400	6,800	6000	6400
Composition (%)									
Fixed-rate	34.8	28.9	27.0	26.2	27.0	23	27	24	28
Inflation-linked	25.3	29.3	30.3	29.8	29.5	29	33	27	31
Floating-rate	34.8	36.8	38.3	39.7	39.5	38	42	38	42
FX	5.1	5.0	4.4	4.3	4.0	3.0	7.0	3	7
Maturity Structure									
% maturing in 12 months	27.6	21	22.1	20	19.7	19	23	19	23
Average maturity (years)	3.6	3.8	3.0	4.1	4.0	3.8	4.2	3.8	4.2

Sources: National Treasury; Santander

Debt Holders June's data

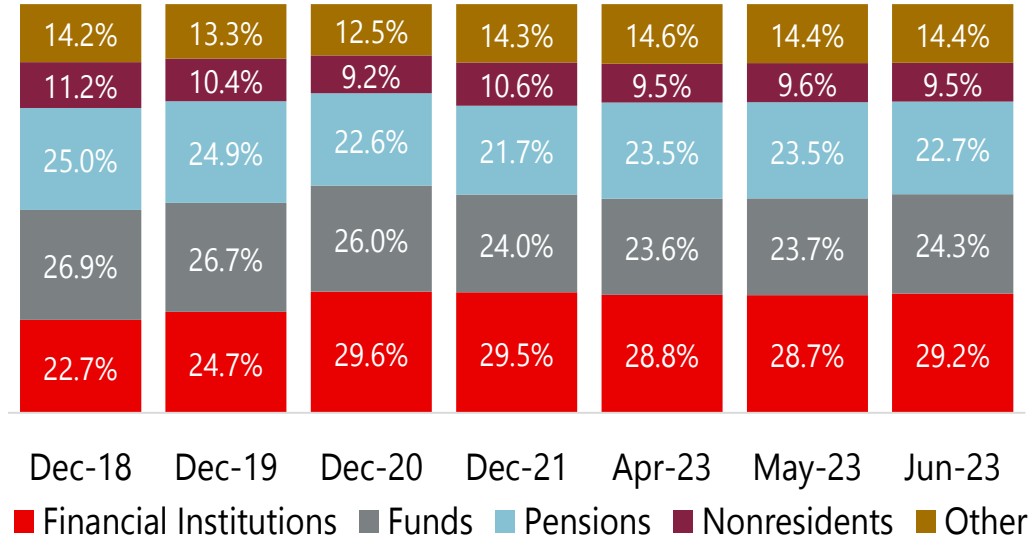
- Non-resident debt holders registered positive flow in June (+BRL13.7 billion), reaching BRL31.3 billion so far in 2023 and BRL65.5 billion in the last 12 months. The percentage of non-resident debt holders remained close to 9.5% in June vs. 9.4% in December 2022 and compared to 10.6% in December 2021. Financial institutions continue to be the main holders (29.2%, +0.5 p.p. in the month).

Change in Holders Debt Stock (BRL bn)



Sources: National Treasury, Santander.

Debt Holders - %

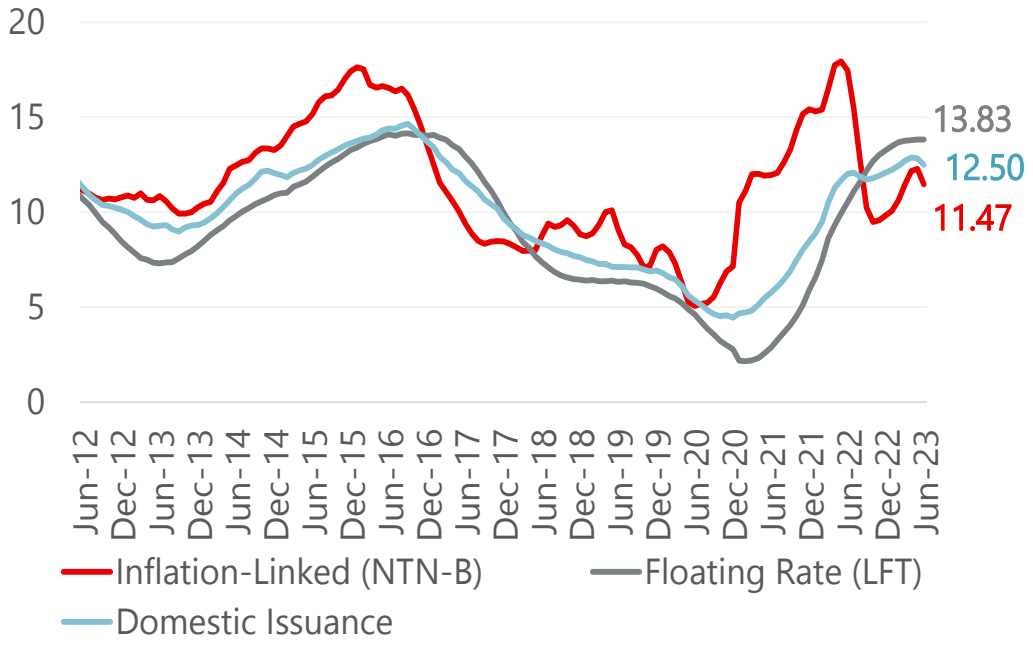


Sources: National Treasury, Santander.

Debt Cost of New Issuances - %

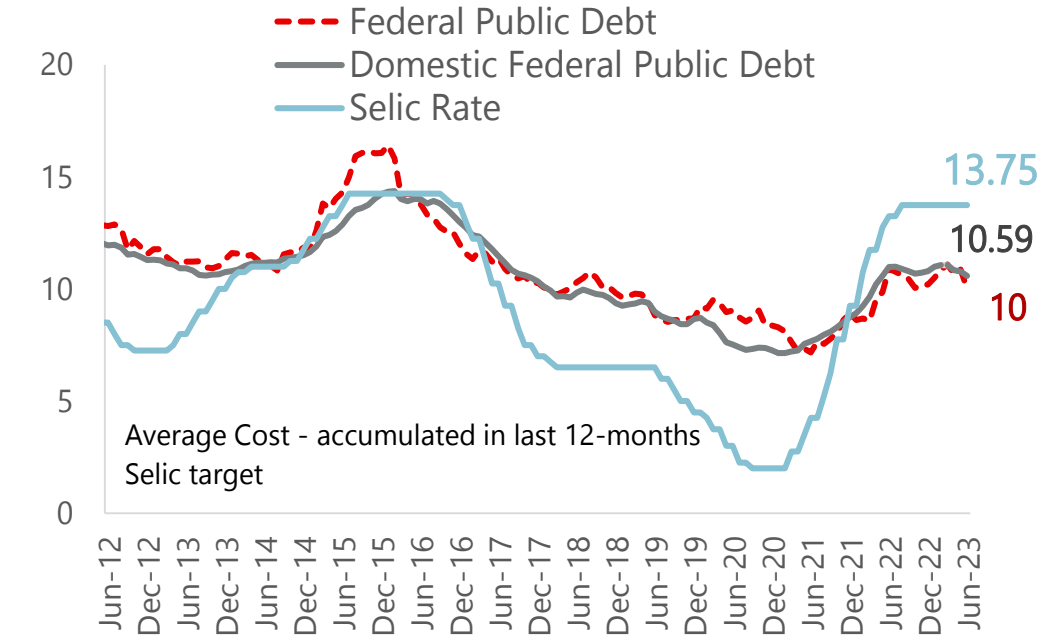
- Despite the start of the easing cycle the debt cost should continue at high level for a while

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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

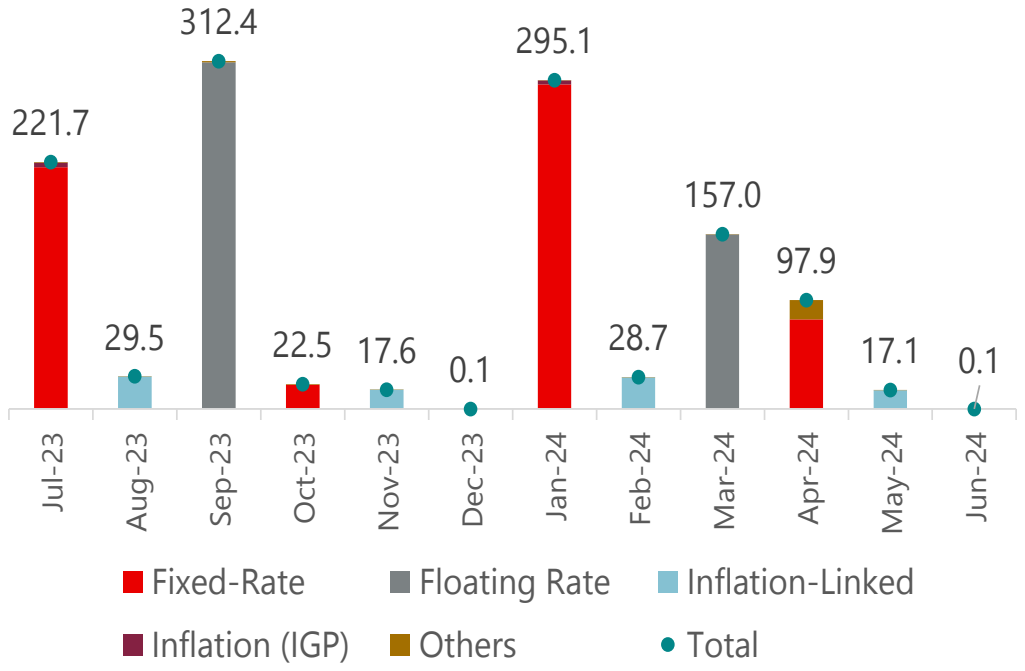


Sources: National Treasury, Santander.

Treasury's Cash Position at comfortable level to navigate the uncertainties

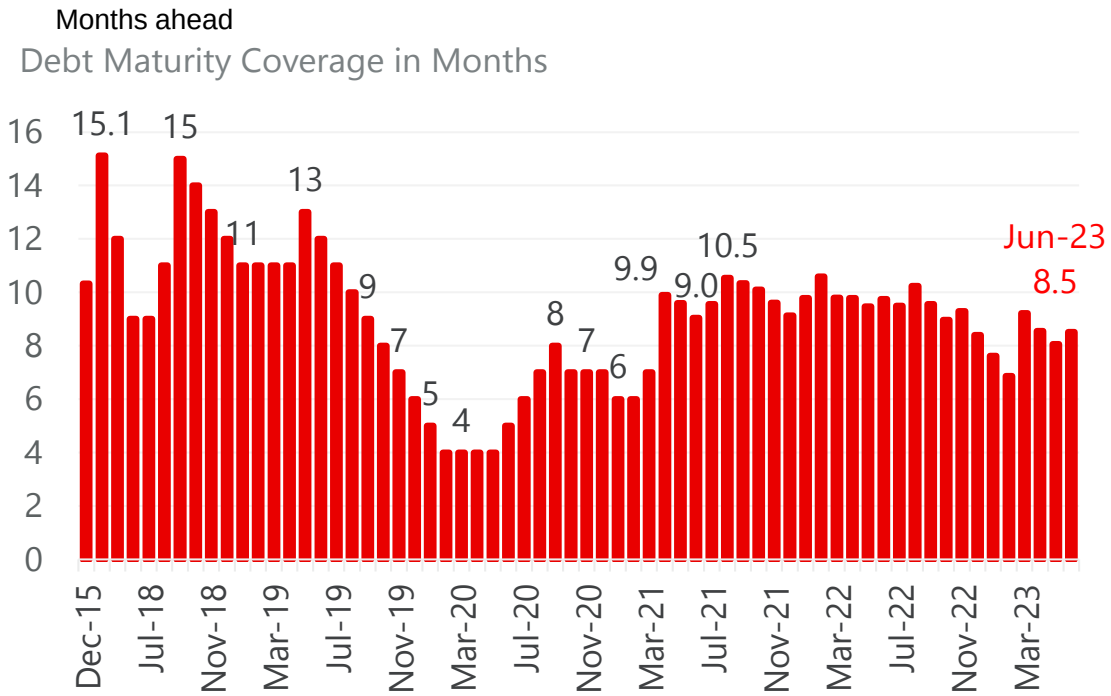
- Despite the increase in liquidity reserves the debt maturity level is still challenging. Structural reforms will help to increase debt maturity and reach a sustainable primary surplus.

Debt maturity - (BRL billion)



Sources: National Treasury, Santander

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

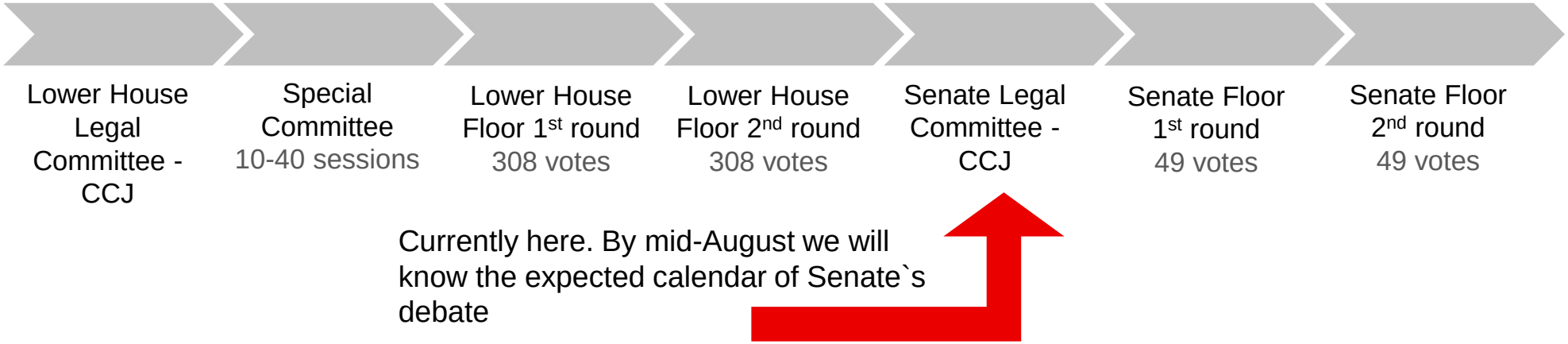
Tax Reform (VAT)

Currently in debate in Senate

8

Tax Reform: General Proposals

Legislative Process – Constitutional Amendment (PEC)



For Approval (3/5 of votes):

Total Number of Deputies: 513 (3/5 for the proposals to be approved; 308 votes)
Total Number of Senators: 81 (3/5 for the proposals to be approved; 49 votes)

Changes in the Senate return to the Lower House for a final review
There is no presidential veto for a PEC approved by Congress

Tax Reform: General Proposals

Consumption tax – How does it work currently?

	PIS/Cofins	IPI	ICMS	ISS
	Prog. Integração Social *Contr. Finan. Seguridade Social*	*Imposto sobre Produto Industrializado*	*Imposto sobre Circulação de Mercadorias e Serviços*	*Imposto sobre Serviços*
Who pays?	All goods and services	Industrialized goods	All goods and some services	Most services
Who charges?	Federal Government	Federal Government	States	Municipalities
Problems	1. Cumulative and non-cumulative systems operating together; 2. Subjectivity in interpreting what generates taxable credit; 3. Taxes benefits that are not clear.	1. Numerous categories and subcategories; 2. Lack of definitional parameters for the different rates. 3. Length of exemptions	1. 27 different laws, each with rates-related specifications; 2. Taxes benefits that are not clear; 3. Incentivizes competition between states.	1. More than 5,000 municipalities regulating the same tax; 2. Conflicts between municipalities and states.

Source: CCiF, OECD, Poder 360; Santander.

The Process of Changing the Tax System in Brazil

Brazil's Consumption Tax Is Highly Complex

In Brazil, there are 5 major consumption taxes, but most countries only use one: the goods and services tax, or VAT tax;

Federal government, states, and municipalities make their own laws to regulate taxation;

There is separation between taxes on goods (pay ICMS) and taxes on services (pay ISS), which encourages legal disputes;

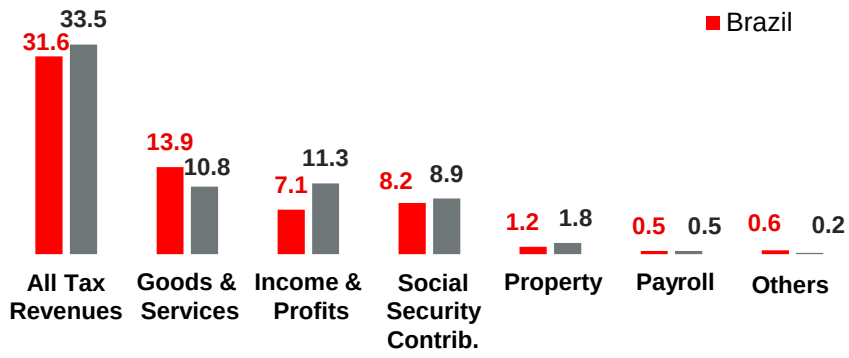
There are many tax exemptions and benefits;

There is cascading taxation and complexity in relation to tax credits generated.

Goods & Services Taxes Being Considered in Tax Reform

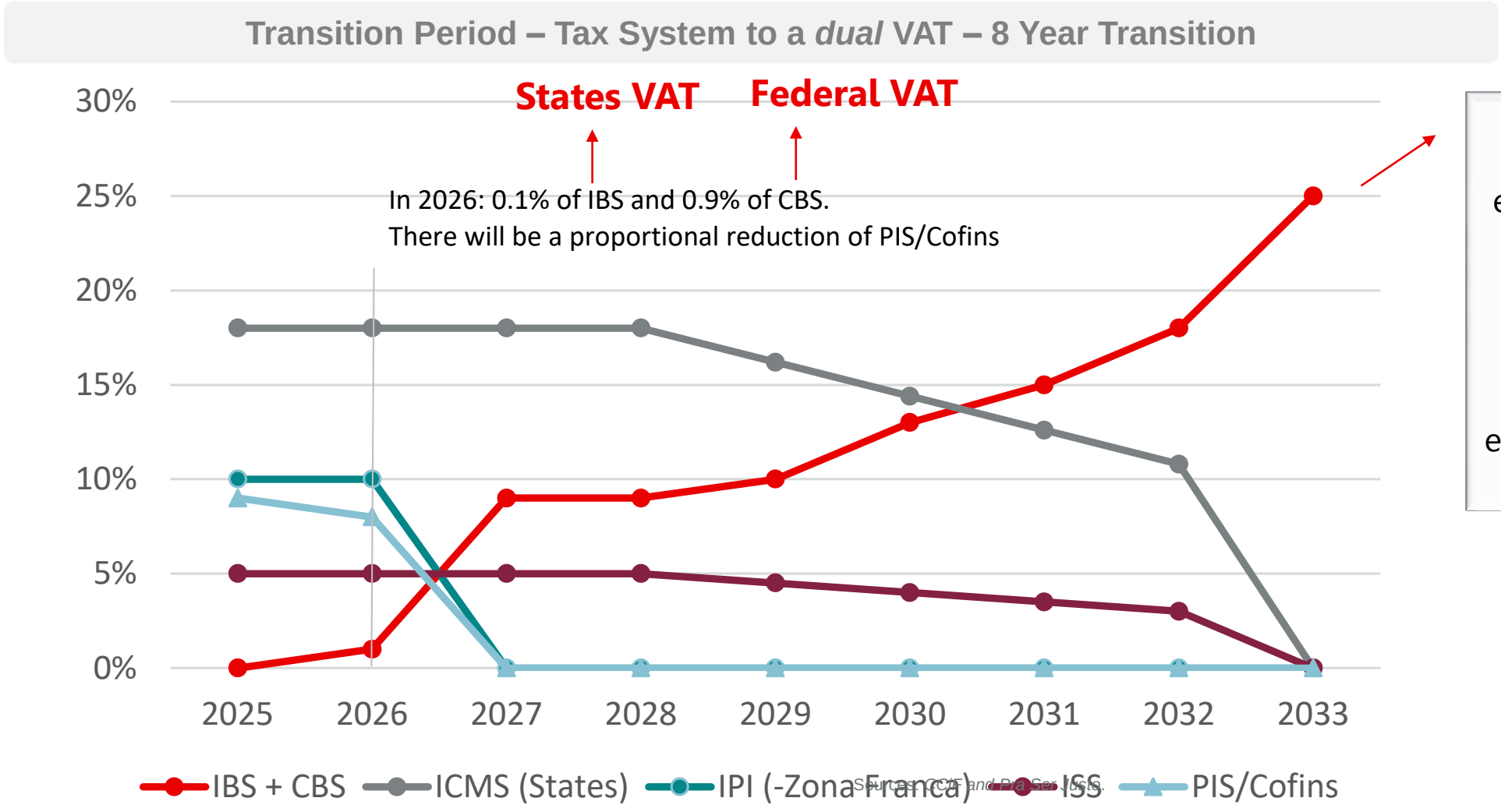
Tax	Federation	R$ billion	GDP %
ICMS	State	660	7.6
Cofins	Federal	270	3.1
ISS	Municipal	87	1.0
IPI	Federal	70	0.8
PIS	Federal	57	0.7
Total	**-**	**1144**	**13.2**

Share of Total Tax Revenue (2020)



Source: CCiF, OECD, Poder 360; Santander.

Tax Reform: General Proposals



The final value will depend on the exemptions and will be known only in next decade

In the end, depending on the exemption could be between 24-27%

Sources: National Congress, Santander

Finance Ministry Simulations On Tax Rates in Brazil

- Table below presents the “inside” and “outside” rates for a good or service subject to the collection of ICMS at the standard modal rate and the normal tax regime of PIS/Cofins. The situation described in the table corresponds to the usual taxation of electricity or of a typical industrial product, not subject to the collection of IPI.

Base rate in the current tax regime

	Value	Rate	
		"Inside"	"Outside"
A. Price with taxes	100		
B. ICMS (18% of A)	18.0	18.0%	24.2%
C. PIS/Cofins (9.25% of A-B)	7.6	9.25%	10.2%
D. Net Prices - no taxes (A-B-C)	74.4		
Total rate		27.25%	34.4%

Sources: Finance Ministry

For the official release (in Portuguese), access here:
https://bit.ly/Tax-Reform-MF

Finance Ministry Simulations On Tax Rates in Brazil

- Simulation of the rate in several scenarios considering changes in the exemptions and reduced rates for some

Estimated base VAT rates based on the text approved by the Lower House (%)

Scenario	Description	Feasible scenario			Conservative scenario		
		CBS	IBS	Total	CBS	IBS	Total
A	Base VAT rate	6.95	13.78	20.73	7.38	14.64	22.02
B	Scenario A+ Reduced rate of 50% for agriculture and basic food basket	7.51	14.89	22.39	7.98	15.83	23.81
C	Scenario B+ Reduced rate of 50% for private education and services	7.61	15.1	22.71	8.09	16.05	24.14
D	Scenario C+ Reduced rate of 50% for private health and services	7.82	15.51	23.33	8.3	16.47	24.77
E	Scenario D+ Reduced rate of 50% for other goods and services	7.95	15.76	23.7	8.43	16.72	25.15
F	Scenario E + Reduced rate of 40% of the base rate	8.19	16.24	24.43	8.69	17.23	25.92
G	Scenario F + Zero rate for half of the basic food basket	8.41	16.69	25.1	8.92	17.7	26.62
H	Scenario G + Other exemptions	8.53	16.92	25.45	9.05	17.95	27.00

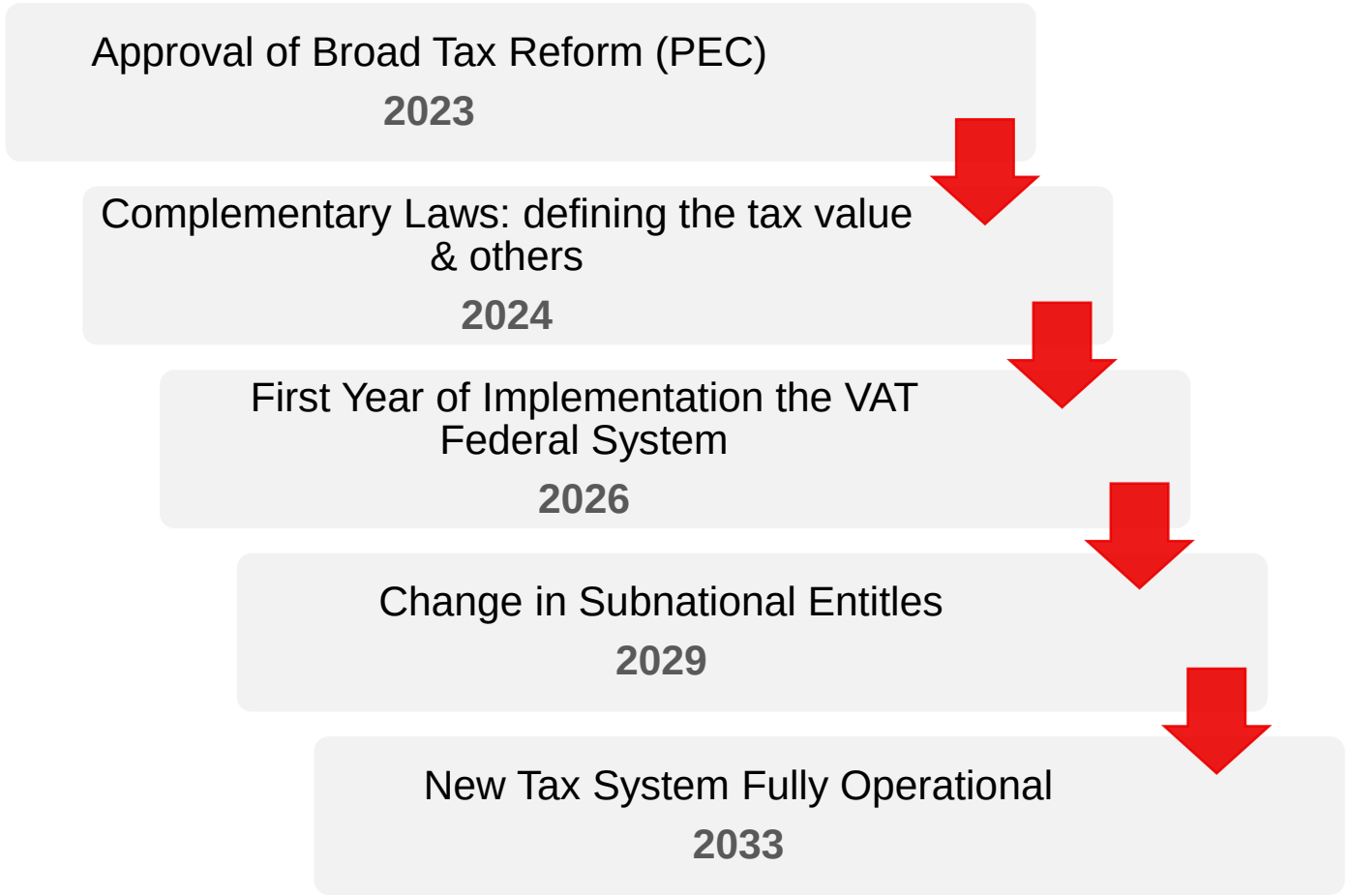
Sources: Finance Ministry

For the official release (in Portuguese), access here:
https://bit.ly/Tax-Reform-MF

The Process of Changing the Tax System in Brazil

- First, the constitutional amendment must be approved; after that, Complementary Laws must be approved (is expected four), with the VAT tax value and definition of specifics of the new system. Complementary laws: IBS Regulation; Federative Council (governance), Clearing (credits and debts), Regional Development Fund.

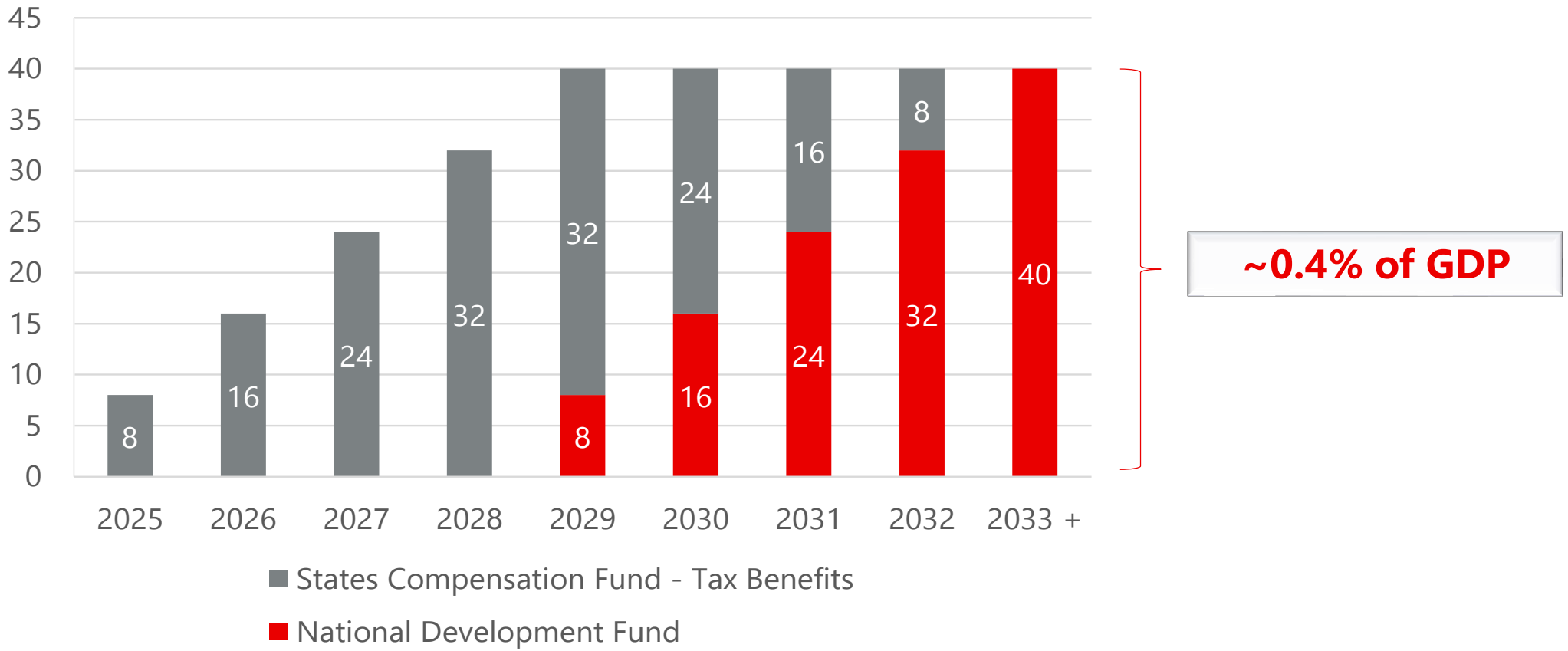
Possible implementation schedule



Tax Reform: Compensation Fund

- Creation of two funds financed by central government to compensate existing tax benefits (up to BRL40 billion or 0.4% of GDP annually, during and after transition). This value could increase during the Senate debate.

Federal Government will make the contributions to the Funds – BRL bn



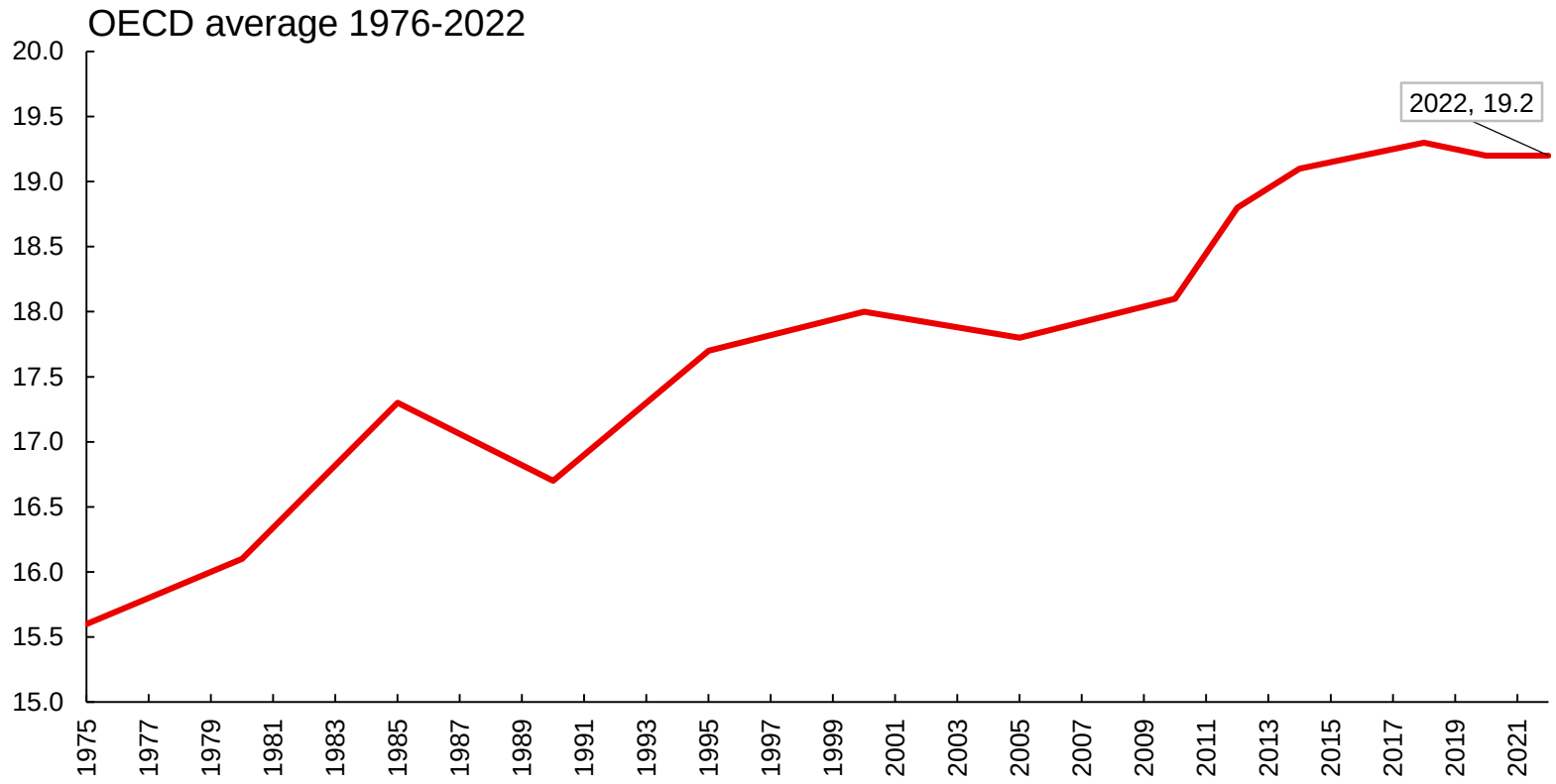
Sources: National Congress, Santander

Probably will not be subjected to the new fiscal framework expenditure limit

Tax Reform: Most Countries Have a Value-Added Tax

- Since the mid-1980s, VAT (value-added tax) has become the main consumption tax. More than 170 countries worldwide use this tax system.
- VAT system: consumption tax assessed on the value added in each production stage for a good or service. Every business along the value chain receives a tax credit for the VAT already paid. The end consumer does not, making it a tax on final consumption.

Evolution of Standard VAT Rates Globally



Sources: OECD

Brazilian Rating

Recent Changes and Data

9

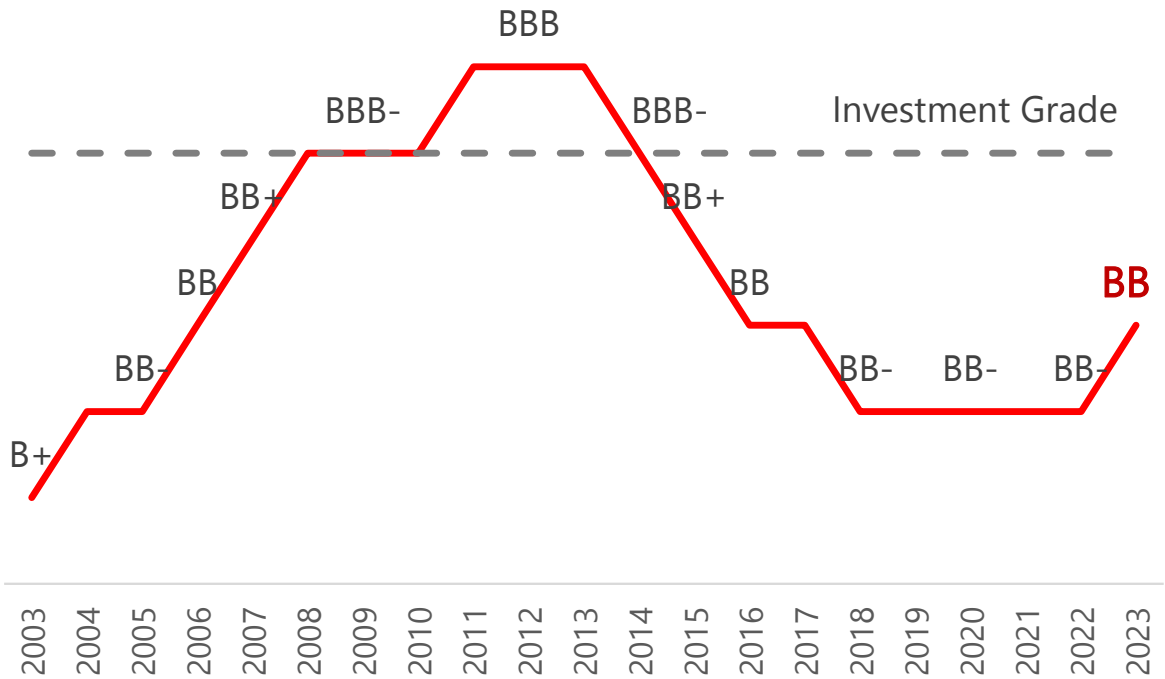
Brazilian Rating – Recently S&P upgraded the outlook to positive and Fitch rose to BB

S&P	Fitch	Moody's		Rating Grade Description
AAA	AAA	Aaa	Investment Grade	Highest Grade Credit
AA+	AA+	Aa1		Very High Grade Credit
AA	AA	Aa2		
AA-	AA-	Aa3		
A+	A+	A1		High Grade Credit
A	A	A2		
A-	A-	A3		
BBB+	BBB+	Baa1		Good Credit Grade
BBB	BBB	Baa2		
BBB-	BBB-	Baa3		
BB+	BB+	Ba1	Speculative Grade	Speculative Grade Credit
BB	BB	Ba2		
BB-	BB-	Ba3		
B+	B+	B1		Very Speculative Grade Credit
B	B	B2		
B-	B-	B3		
CCC+	CCC+	Caa1		Substantial Risks - In Default
CCC	CCC	Caa2		
CCC-	CCC-	Caa3		
CC	CC	Ca		
C	C			
SD	DDD	C		
D	DD			
	D			

BRAZIL

- On Wednesday (July 26), Fitch Ratings upgraded Brazil's credit rating to BB from BB- with a stable outlook. The country is still two notches below investment grade level. In the release, Fitch expects compliance with the primary target band proposed in the new fiscal framework. We still see challenges to achieve these targets due to the necessity for the government to take in more than 1.5% of GDP (at least) in permanent net revenue in the near future.

Fitch Rating – Historical of Brazilian Credit Rating



Sources: Fitch Rating, Santander.

Santander

International Comparison – Main Economic Data

2022										
	BBB+	BBB	BBB-	BB+	BB	BB-	Brazil	B+	B	B-
Government Finance	(Investment Grade)						(BB-)			
General government gross debt (%GDP)	53.6	55.2	66.5	48.1	41.5	52.7	88.2	79.0	65.5	66.2
General government net debt (%GDP)	14.6	40.0	41.0	61.7	25.4	56.1	58.4	81.6	53.9	86.1
General government primary net lending/borrowing (%GDP)	-2.5	-1.2	-4.7	1.9	0.8	-1.3	0.8	-2.2	-1.6	0.2
General government net lending/borrowing (%GDP)	-3.8	-3.5	-8.1	0.2	-0.8	-4.2	-5.8	-5.3	-4.7	-1.8
General government revenue (%GDP)	29.8	26.7	25.1	29.3	26.9	21.0	31.8	23.6	25.6	23.6
General government total expenditure (%GDP)	33.7	30.3	33.2	29.1	27.7	25.1	37.6	28.9	30.3	25.4
External Sector										
Current account balance (%GDP)	-0.2	-1.1	-6.0	5.6	-1.6	-2.1	-1.5	-7.1	-7.3	1.5
Total reserves minus gold (Billions US$)*	91.1	72.4	320.1	52.4	11.1	83.0	354.6	3.6	17.5	10.8
Economic Activity										
GDP, constant prices (% Change)	4.8	4.1	5.8	4.8	4.5	4.2	2.8	5.4	4.6	4.9
Inflation, end of period consumer prices (% Change)	8.4	10.3	10.6	8.5	6.3	8.4	6.0	6.3	15.8	9.2
Gross national savings (%GDP)	25.1	22.8	24.4	30.1	20.8	23.4	17.3	20.6	17.1	21.4
Total investment (%GDP)	25.3	24.3	30.3	24.7	22.4	25.7	18.8	26.7	24.9	22.6
Social										
GDP per capita, current prices (PPP)	22,052	28,172	23,195	14,756	25,156	13,075	17,684	15,732	15,879	8,108

Sources: IMF, World Bank, Santander.

Long path to Recover the Investment Grade

- On average, the countries took 6-7 years to recover the investment grade status.

Country	Downgrade year	Year of the investment grade recovery	Perspective when it recovered Investment Grade
Uruguay	2002	2013	•Uruguay's five-year average GDP growth at 5.6% is well above the 'BBB' median and its medium-term prospects remain favorable. •Social and political stability, strong institutions and relatively high per capita income are characteristics that are fully in line with investment- grade sovereigns. •Prudent fiscal management has led to a decline in government indebtedness and a significant improvement in debt composition in recent years.
Colombia	2000	2011	•Track record of prudent economic policies demonstrated resilience to external and domestic shocks, as well as the improvement in its external credit metrics. •Colombia's five-year average growth is expected to equal 4.2% in 2011, above the 3.1% of the 'BBB' median. •Colombia is also likely to maintain broad macroeconomic stability with inflation slightly above 3% in 2011 and 2012.
Indonesia	1997	2011	•Indonesia's cyclical resilience to large external shocks points to sustainably high trend growth over the medium term. •A more favourable assessment of Indonesia's economic strength is underpinned by gains in investment spending, improved prospects for infrastructure development following key policy reforms, and a well-managed financial system.
Romania	2008	2011	•The upgrade reflects Romania's progress in recovering from the effects of the financial crisis, evident in a return of GDP growth, a strong export performance, narrowing in the current account deficit and reduction in its budget deficit

Sources: S&P, Santander.

International Comparison

Higher debt than others EMs

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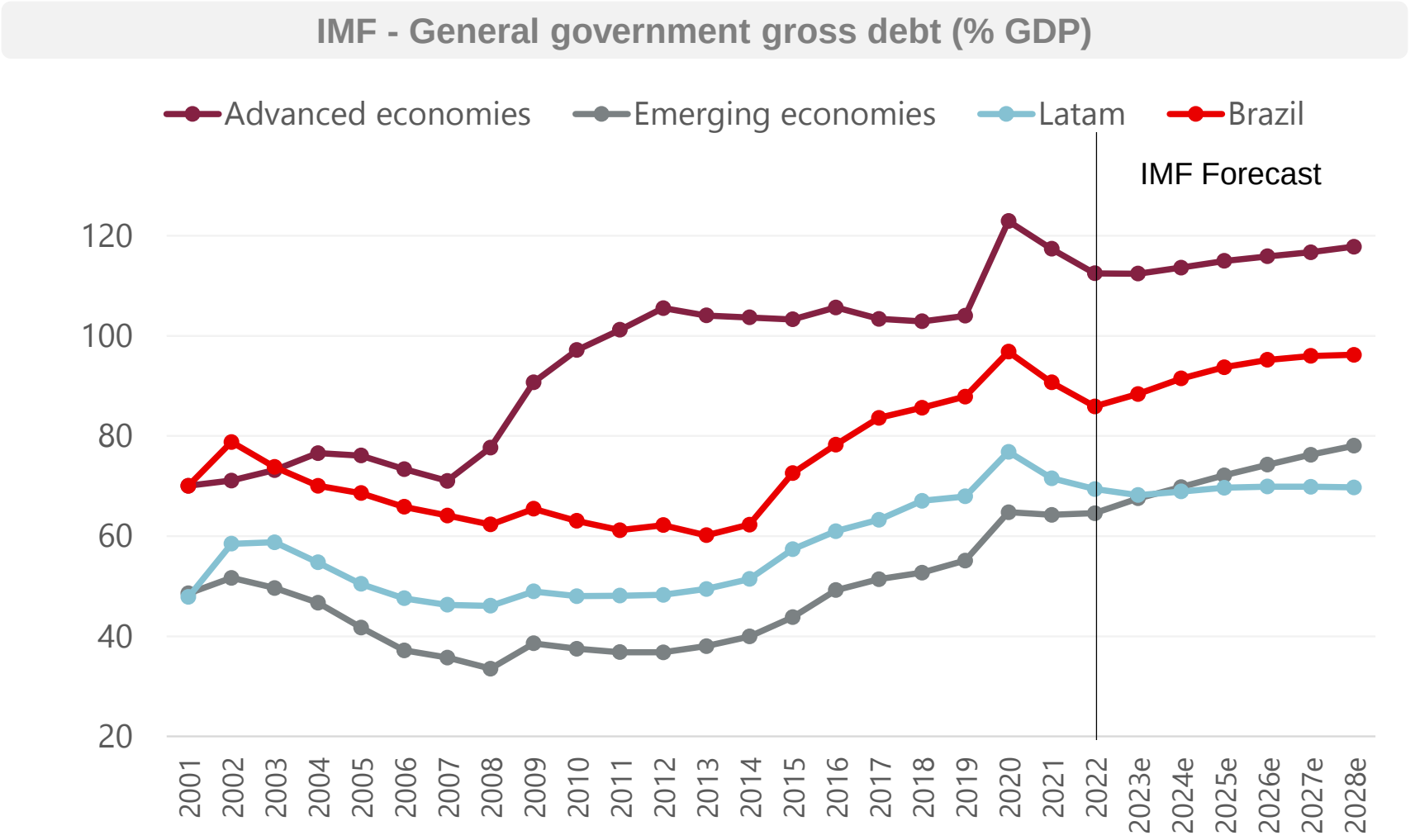
International Comparison – IMF Gross Debt Forecast

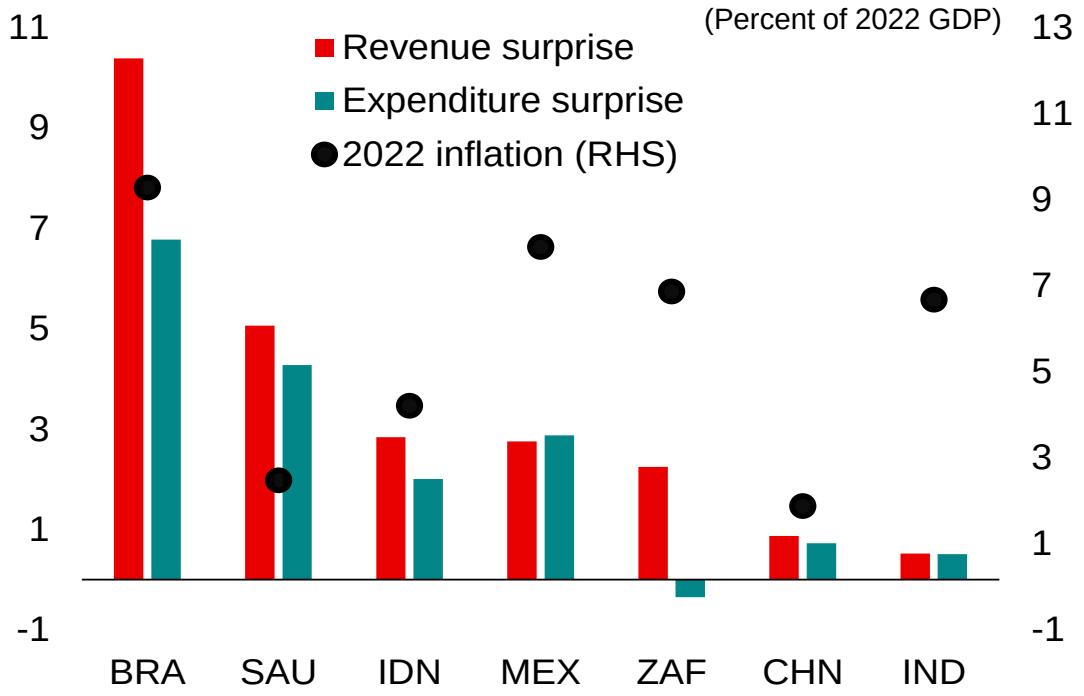


Sources: IMF, Santander.

IMF – Fiscal Monitor selected charts

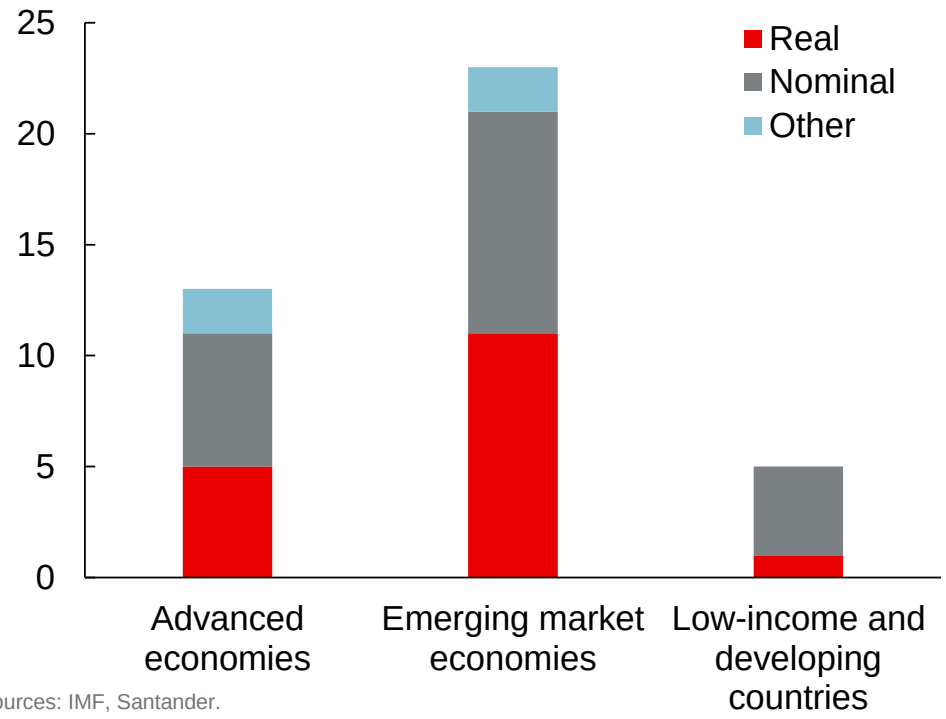
- IMF: “In 2022, most governments enjoyed positive revenue surprises, stemming in part from tax buoyancy related to inflation surprises. On average, these revenue surprises amounted to 3.1 percent of GDP in advanced economies and 2.5 percent in emerging market economies. Commodity exporters (for example, Australia, Brazil, Saudi Arabia)”
- Ceilings on real spending growth are relatively more frequent in emerging market economies than in other groups of economies

What Share of Revenue Surprises Was Saved?



Sources: IMF, Santander.

Countries with National Expenditure Rules

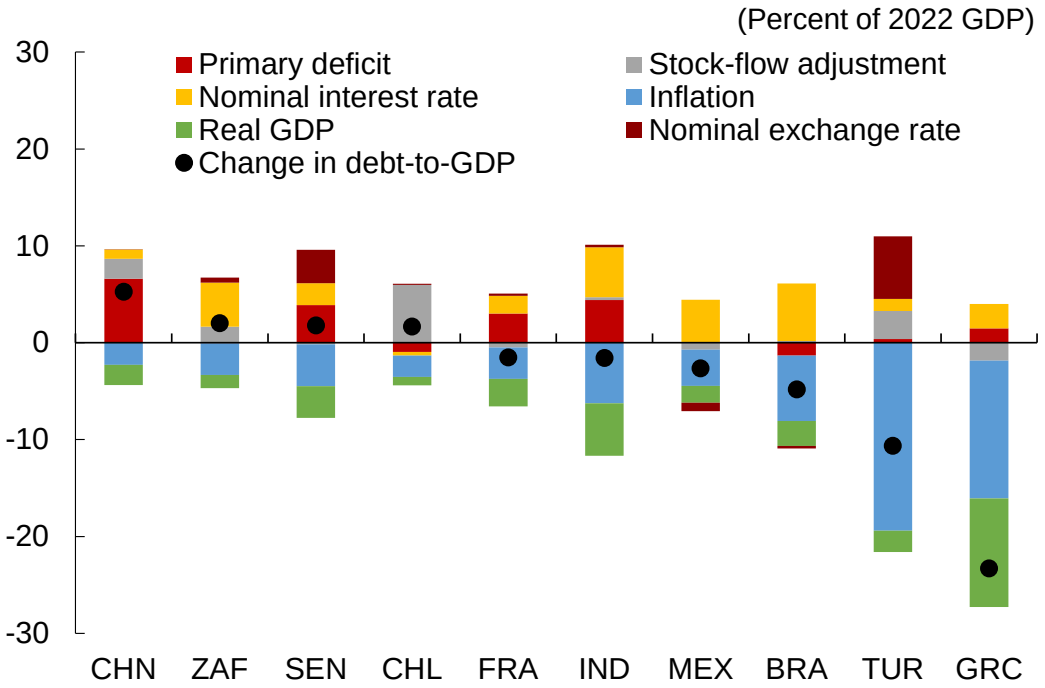


Sources: IMF, Santander.

IMF – Fiscal Monitor selected charts

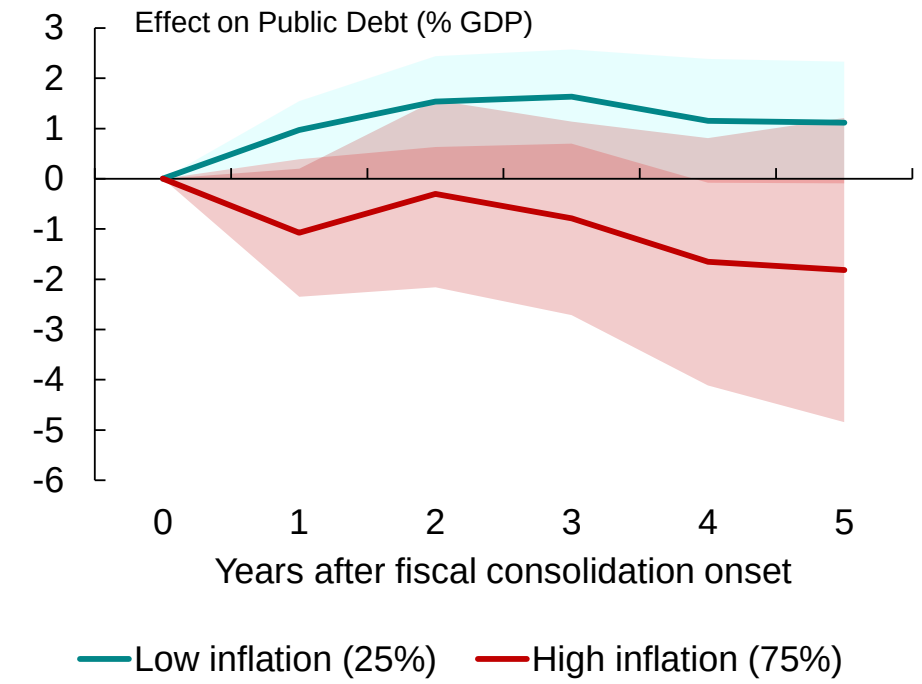
- The effect of current monetary tightening on fiscal accounts

Drivers of Annual Change in General Government Debt, 2022



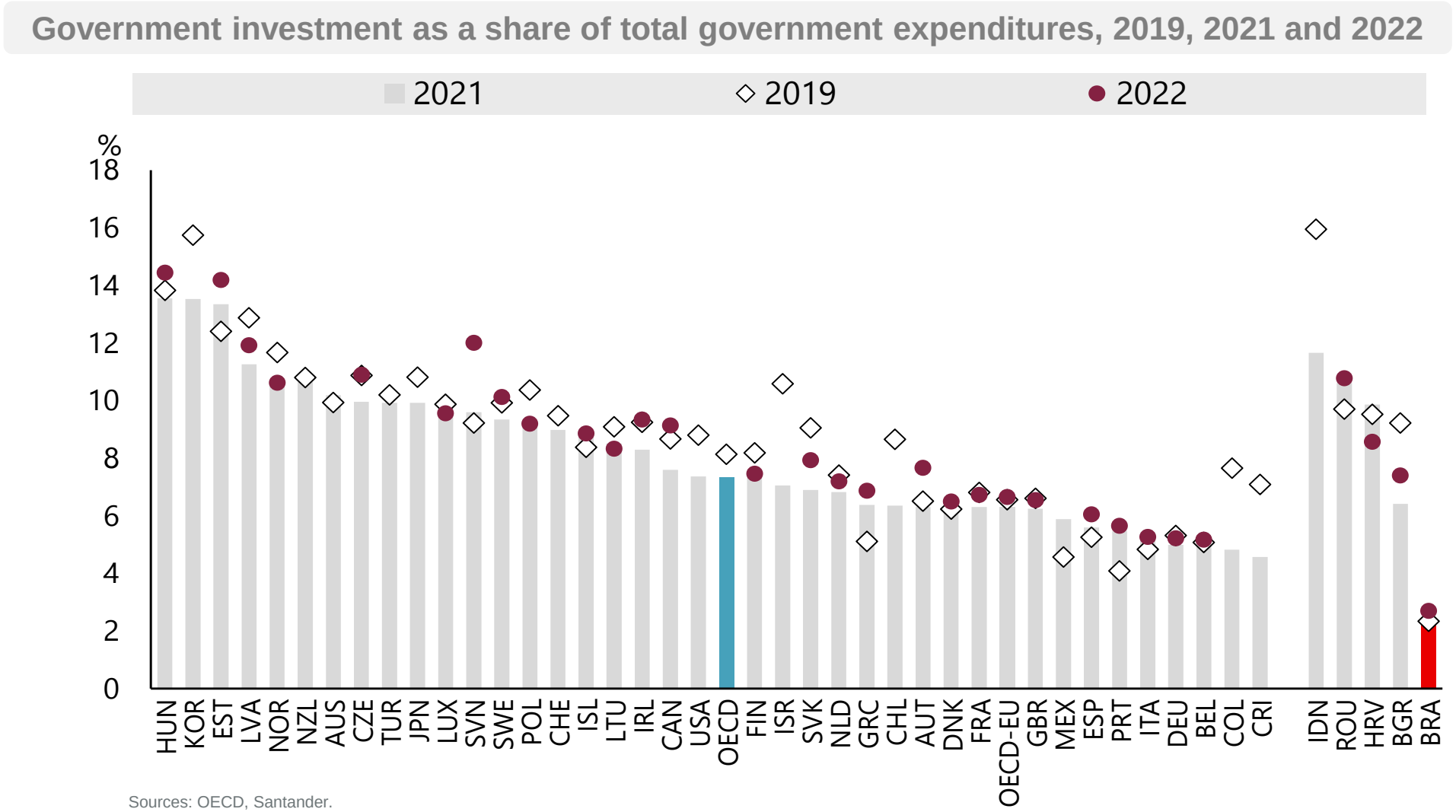
Sources: IMF, Santander.

Effects of Fiscal Consolidation: High Inflation versus Low Inflation



Sources: IMF, Santander.

Comparison – Gov. Investment as a Share of Total Government Expenditures



Sources: OECD, Santander.

Tables – Forecasts

SCENARIO UPDATE - Better Growth Outlook in 2024
Given a Less Contractionary Monetary Policy

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MACRO SCENARIO: Forecasts

Macroeconomic Variables		Previous		Current
GDP (%)	2023E	1.9	→	1.9
	2024E	0.5	↑	1.0
	2025E	1.5	→	1.5
IPCA (%)	2023E	5.2	↓	4.9
	2024E	3.9	→	3.9
	2025E	4.5	→	4.5
Selic Rate (% end of period)	2023E	12.25	↓	11.75
	2024E	10.50	↓	10.00
	2025E	7.00	↑	7.50
FX Rate - USDBRL (end of period)	2023E	5.40	↓	5.20
	2024E	5.50	↓	5.35
	2025E	5.55	↓	5.40
Current Account Balance (% of GDP)	2023E	-2.6	↑	-2.5
	2024E	-2.9	↑	-2.7
	2025E	-2.8	↑	-2.7
Primary Fiscal Balance (% of GDP)	2023E	-1.0	→	-1.0
	2024E	-1.0	↑	-0.9
	2025E	-0.8	↑	-0.7
Gross Public Debt (% of GDP)	2023E	77.3	↓	77.0
	2024E	81.6	↓	81.1
	2025E	84.6	↓	83.9

Source: Santander. Note: The arrows denote the direction of changes since our previous scenario publication (as of June 16, 2023)

The forecasts refers to our latest Scenario Update

"Better Growth Outlook in 2024 Given a Less Contractionary Monetary Policy"
(sent on August 04, 2023)

For the full report click on the link:

https://bit.ly/Std-sceupdate-Aug23

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

Global Macro Scenario	2018	2019	2020	2021	2022	2023E	2024E	2025E
Global GDP (%)	3.5	2.8	-3.5	5.9	3.4	2.4	2.2	2.8
China GDP (%)	6.7	6.0	2.3	8.1	3.0	5.3	5.1	5.0
US GDP (%)	3.0	2.2	-3.5	5.7	2.1	1.8	-0.1	1.8
US Inflation (Core PCE, %)	2.1	1.6	1.5	4.9	5.0	3.8	2.5	2.0
US Interest Rate (FFR, %)	2.50	1.75	0.25	0.25	4.50	5.50	4.00	2.50
US Interest Rate (UST10y, %)	2.7	1.9	0.8	1.8	3.9	3.6	3.2	3.0
Dollar Index - DXY	96	96	90	96	104	102	100	100
Commodity Prices - CRB	409	401	444	571	558	528	474	445

*Core PCE is referred to the y/y variation for Q4.

Source: Santander

The forecasts refers to our latest Scenario Update

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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:

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Santander

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