Brazil Macro | December 2021

FISCAL POLICY

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

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Summary - Unanchored and with a Riskier Path to Long-Term Debt Stabilization

- Our short-term fiscal estimates for 2021 continued to improve on the heels of the price-effect on revenues. Conditional on the execution of expenditures at the end of the year, a slight primary surplus is possible, which would be the first in nearly a decade.
- For 2022 onwards, however, we forecast a higher deficit, following a change in the current fiscal framework that will pave the way for a higher spending. We also observe a deterioration in the nominal balance reflecting higher inflation and Selic rate.
- As an upshot, for the gross debt, we anticipate a steeper upward trajectory for the medium term, with an increasingly risky path to a long-term stabilization.
- In our new scenario, the primary surplus will only be reached in 2027-28, four years later in comparison to the scenario without adding the effects of the *PEC dos Precatórios*. In addition, for the medium term, our forecasts indicate that the constitutional spending cap has lost its capacity to add to the fiscal consolidation process. In our view, the decision to raise spending and change the fiscal framework implies an even riskier path to a long-term debt stabilization (now seen at ~100% of GDP level, above the EM average of ~60% of GDP).

Brief Overview

01

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

2021: better results

Primary Balance: -BRL10 bn (-0.1% GDP)

1. Central Government (+ Dividends)

Deficit: BRL100 bn | -1.2% GDP
(from BRL115 bn | -1.3% of GDP)

2. Regional Gov. record (+ Oil-Revenues)

Surplus in 2021 of BRL90 bn | +1.0% GDP
(from BRL65 bn | 0.75% of GDP)

Gross Debt: 81.8% of GDP
(3/4 of the reduction due to price shock)
The cost is still contained (yet it is increasing)

Debt Liquidity Reserves Level
(Reaching more than BRL1 trillion, covers nearly 11 months of debt maturities)

Challenging outlook ahead

Unanchored: Spending Cap “Lifted”
Loose Fiscal anchor – Expenditures: +1.0pp of GDP in 2026

Primary Surplus: 2028-27
Postponed in 4 years. 2022 with higher deficit.

Higher Nominal Deficit (Selic)
Nominal Deficit 2022: 9.4% of GDP
Interest Accrual in 2022: BRL400 bn

Rise in Gross-Debt Peak Estimate
103% of GDP in 2031 (+9.0 pp from October)

Debt-path: on the edge for convergence
~98% of GDP in 2040

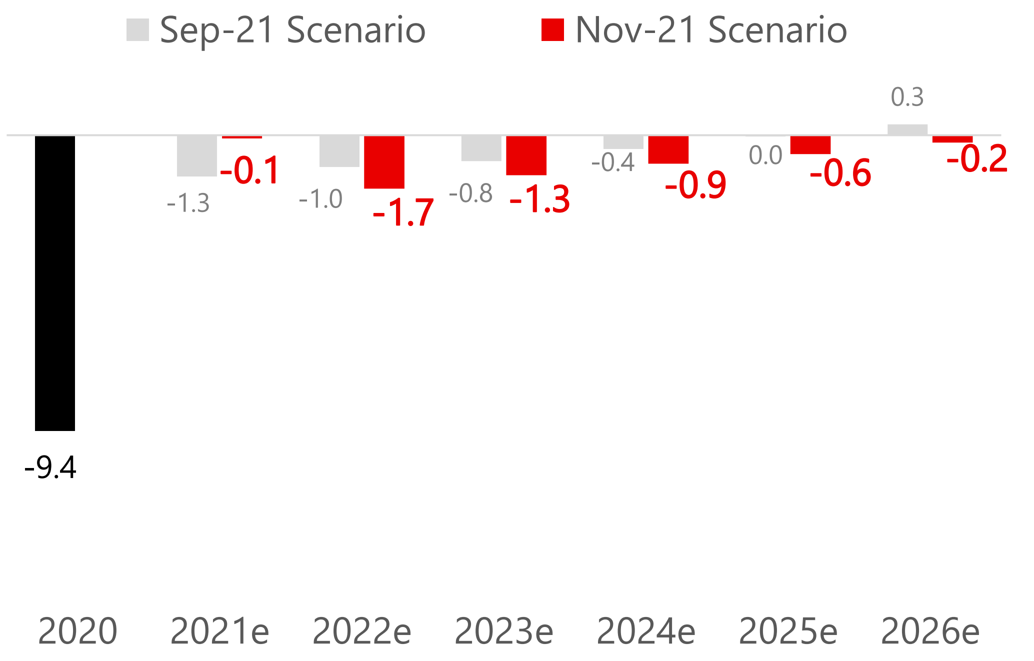
Fiscal Scenario

02

Fiscal – Better for the short term, worse for the medium/long run

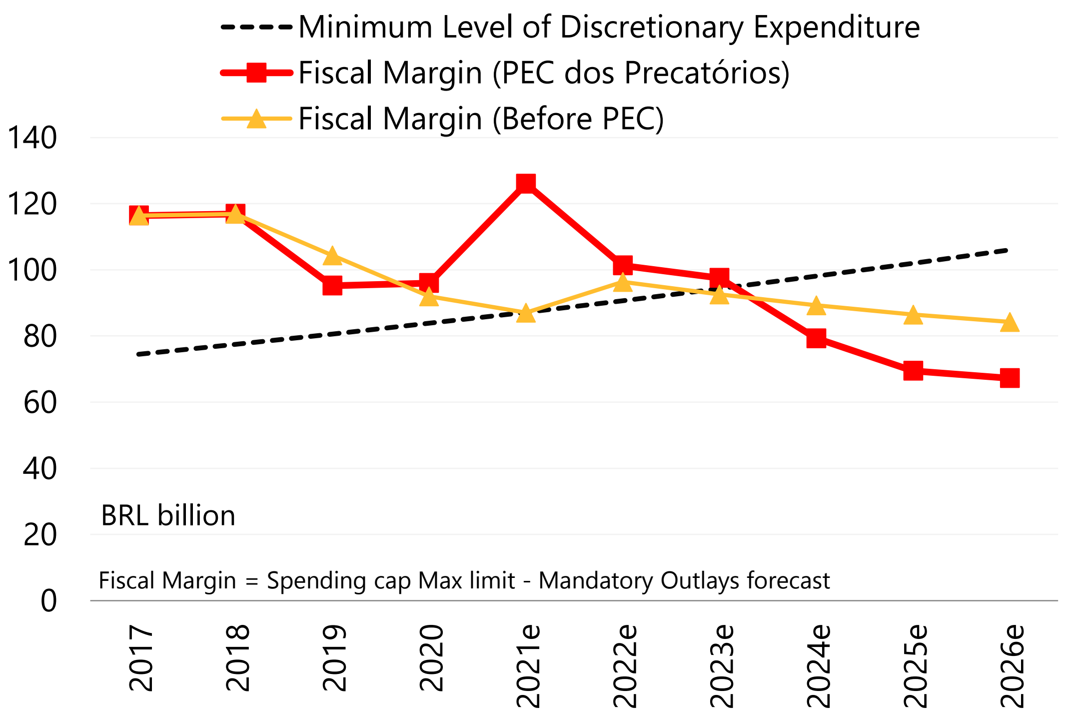
- *PEC dos Precatórios* affected our primary balance estimates with higher expenditures ahead,
- The final primary balance results will depend on the revenues result, we believe that part of the extraordinary revenues that “helped” in 2021 (corporate restructuring) will be lower 2022 onwards. On the other hand, oil-revenues should increase with pre-salt.
- In 2021, we could observe a slight primary surplus, depending on the execution of budget expenditures in the year-end.

Public Sector Primary Result (% GDP)



Sources: BCB, Santander.

Fiscal Margin – BRL billion

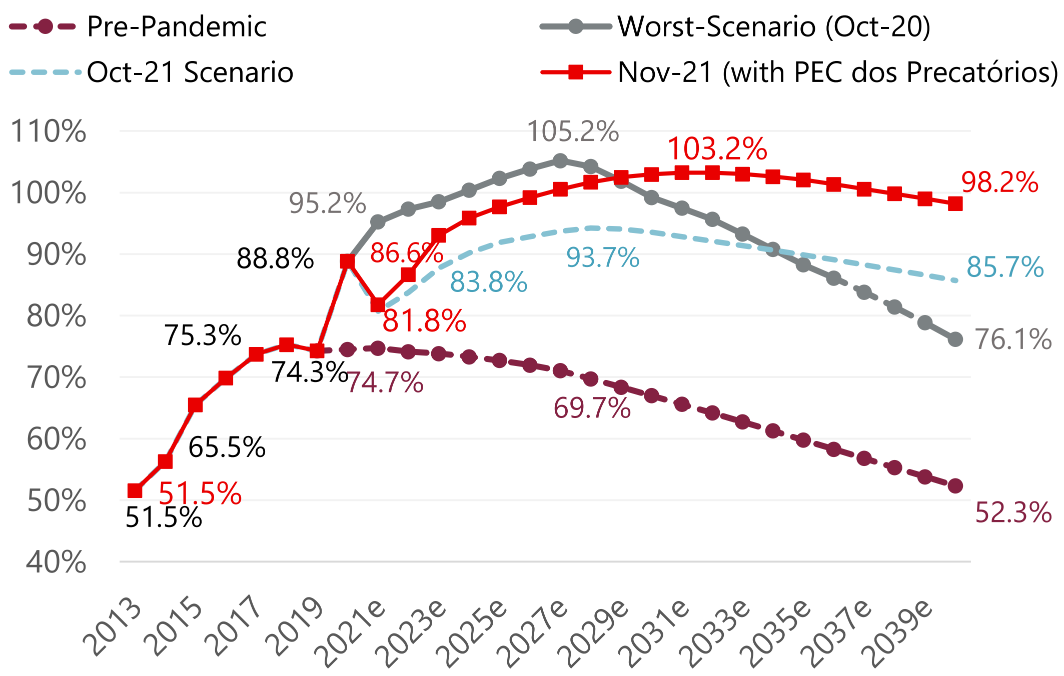


Sources: National Treasury, Santander.

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

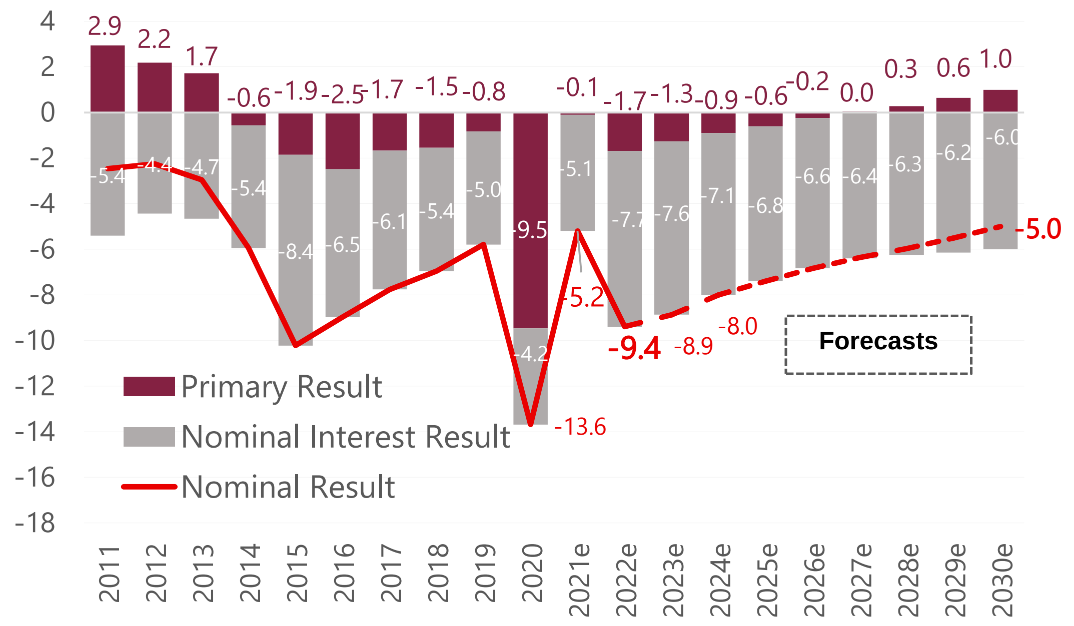
- We revised our nominal Selic rate to 12.25% in 2022. The neutral interest rate is at 4.0% per year in the long run.
- This will contribute to increase the nominal deficit, specially after 2022.
- The rise in the Selic rate is increasing the debt cost during the year, with higher interest accrual. The debt cost will increase to more than BRL400 billion a year.

Scenarios - Gross Debt Scenario (% GDP)



Sources: BCB, Santander

Public Sector's Financing Needs (% GDP)

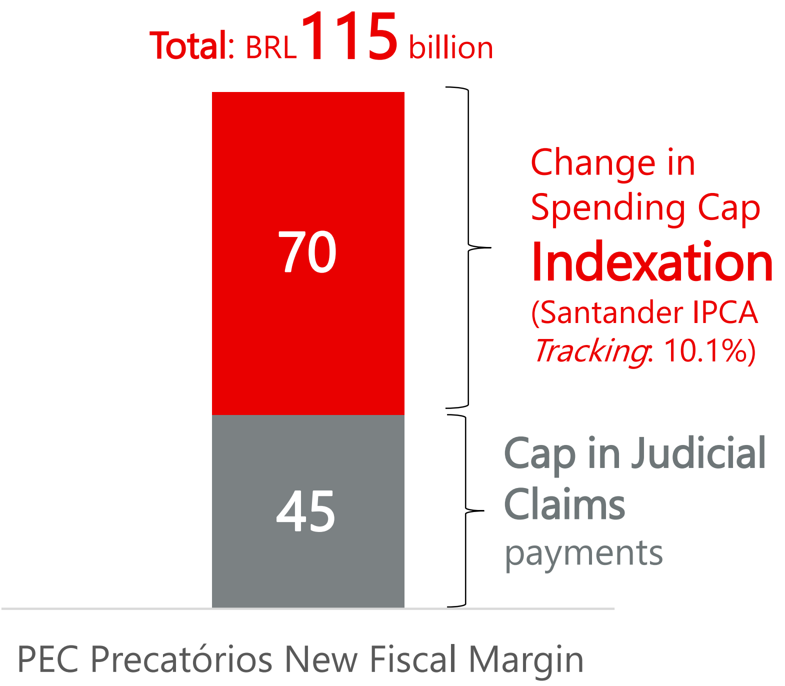


Sources: BCB, Santander.

Fiscal – The *Precatórios* amendment

- Our INPC forecast rose to 10.8%, this reduced the spending cap margin to -BRL39 billion, considering the full payment of judicial claims (*Precatórios*), and the budget without considering the *PEC dos Precatórios*.
- *PEC dos Precatórios* should open a fiscal margin of BRL115 billion considering our inflation forecast (IPCA: 10.1%)
- This value should be used to increase the new welfare program, increase in mandatory outlays (i.e. Pension Benefits) and others.

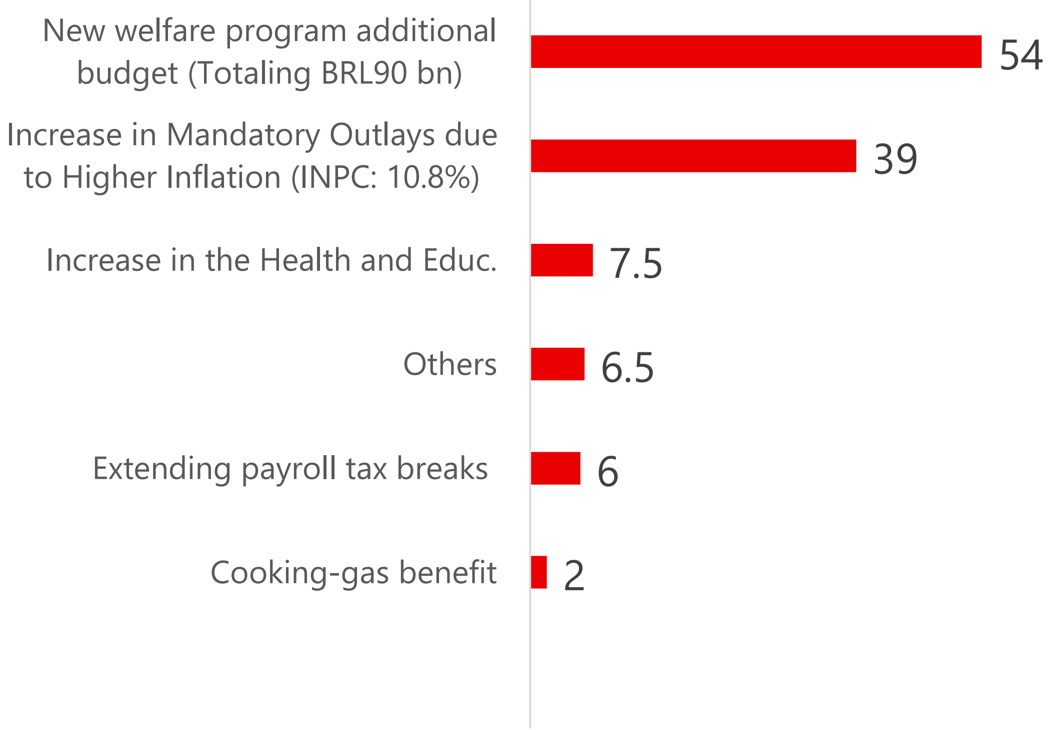
Fiscal Margin – *PEC dos Precatórios*



Sources: Ministry of Economy, Santander

IPCA 2021YE					
	8.5%	9.0%	9.5%	**10.1%**	11.0%
Fiscal Margin	44	51	59	70	82

Expected Expenditures – BRL billion



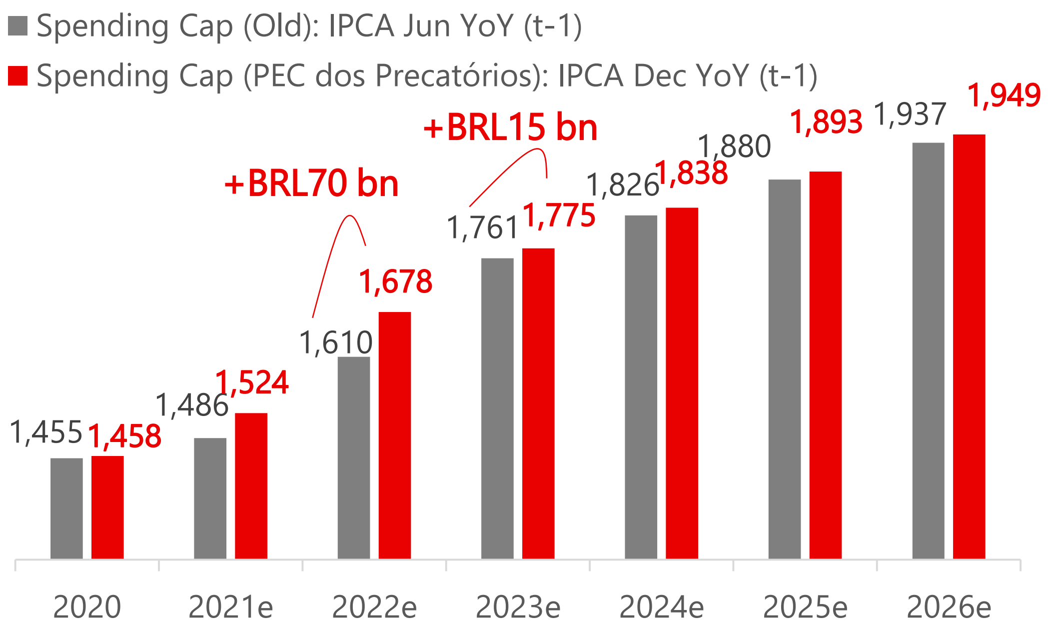
Sources: National Congress, Ministry of Economy, Santander

Budget for vaccine purchases (in the cap): BRL 14bn

Fiscal – *PEC dos Precatórios* will likely create the legal vehicle for the new welfare program

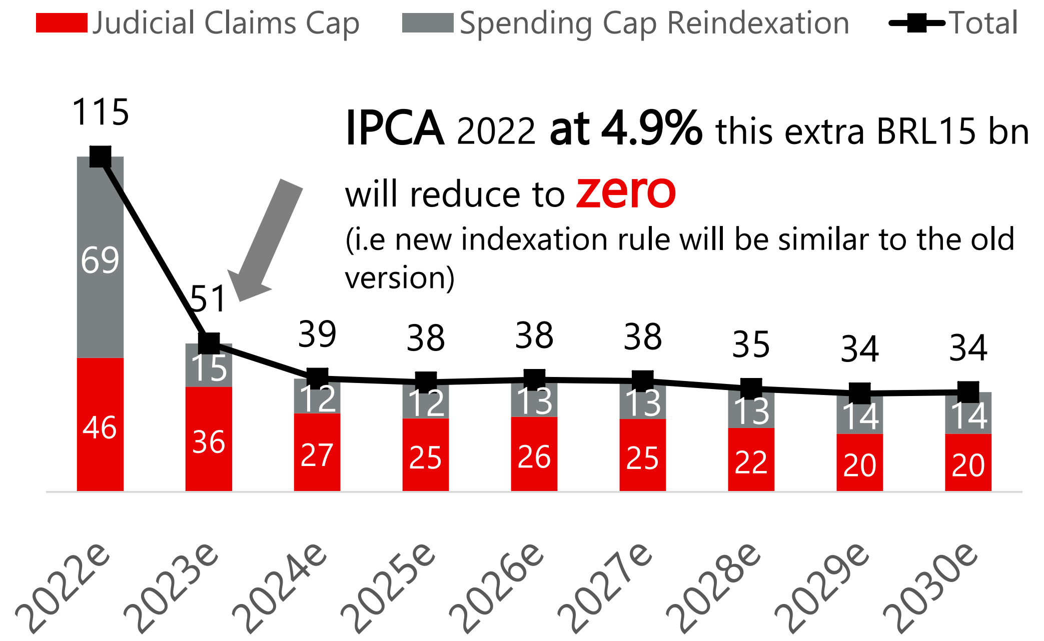
- PEC *dos Precatórios* current proposal would create an addition space of about ~BRL115 bn in the spending cap rule (BRL45 bn through court-ordered debt cap + BRL70 bn by changing the spending cap indexation rule)
- In this scenario, the fiscal margin for 2023 will be BRL15 billion higher, using our inflation forecasts.

Change in the index of Spending Cap Rule



Sources: Ministry of Economy, IBGE, Santander

Change in the index of Spending Cap Rule



Sources: Ministry of Economy, IBGE, Santander

- IPCA 12m Jun: 2021: 2.1% | 2022: 8.4% | 2023: 9.4%
- IPCA 12m Dec: 2021: 4.5% | 2022: 10.1% | 2023: 5.8%

Court-ordered Debt - *Precatórios*

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 BRL277 billion. These are the official provisions published in the Treasury's "General Budget Report".

Provisions	BRL billion	%
Fundef – ACP	90	32.5
Possessory Action	50	18.1
Indemnity related to readjustment, damages and loss of profits	32.6	11.8
Fundef	30.0	10.8
Fundef actions filed directly by federal entities	17.6	6.4
Prescription of Reimbursement to the Treasury – TCU	7.3	2.6
Fiscal Auditors – 28.9% readjustment	7.1	2.6
Indemnity for material damage	6.4	2.3
Wage Differences	5.3	1.9
Performance Bonus – RAV	4.3	1.5
Others	26.7	9.6
Total	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

- The administration unveiled a constitutional amendment proposal to stagger court-mandated debts (so-called "*Precatórios*"), after the official estimate soared to ~BRL90 billion.

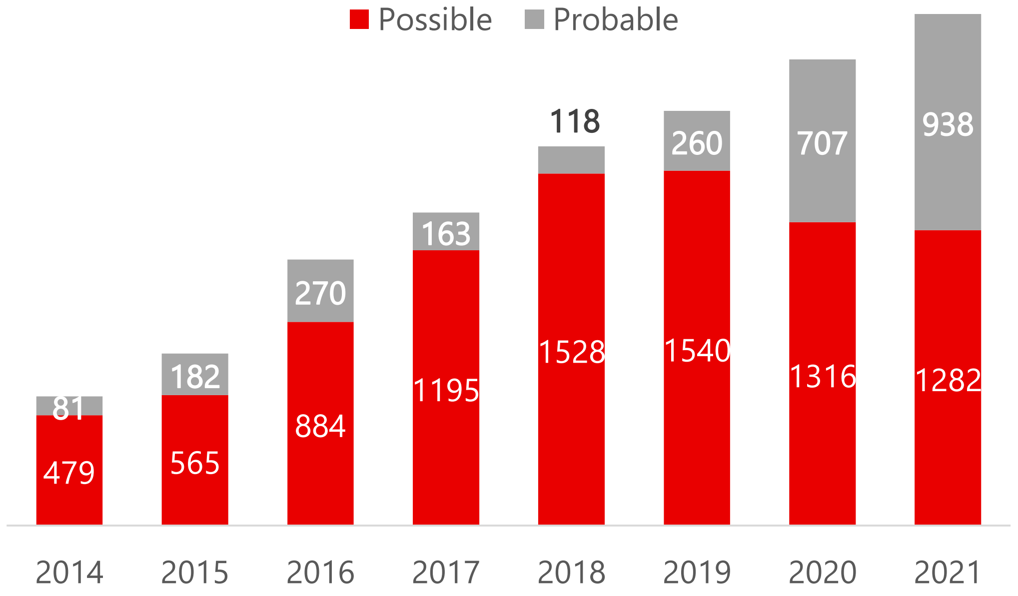
Judicial Claims Increase – BRL billion

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

BRL Billion | Nominal values



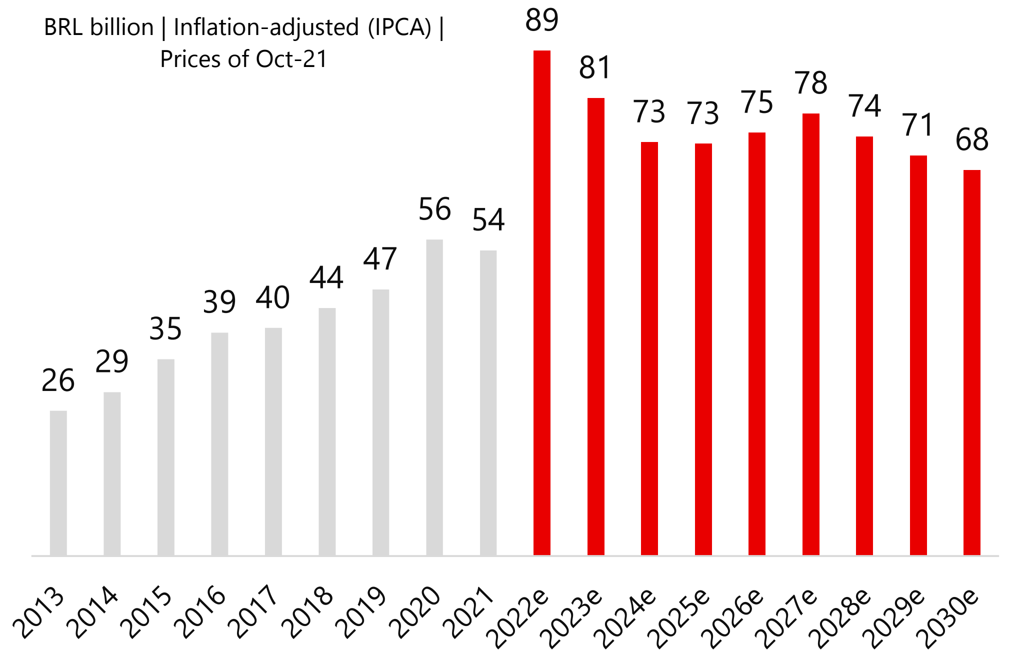
Sources: AGU, LDO 2020, National Treasury, Santander.

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

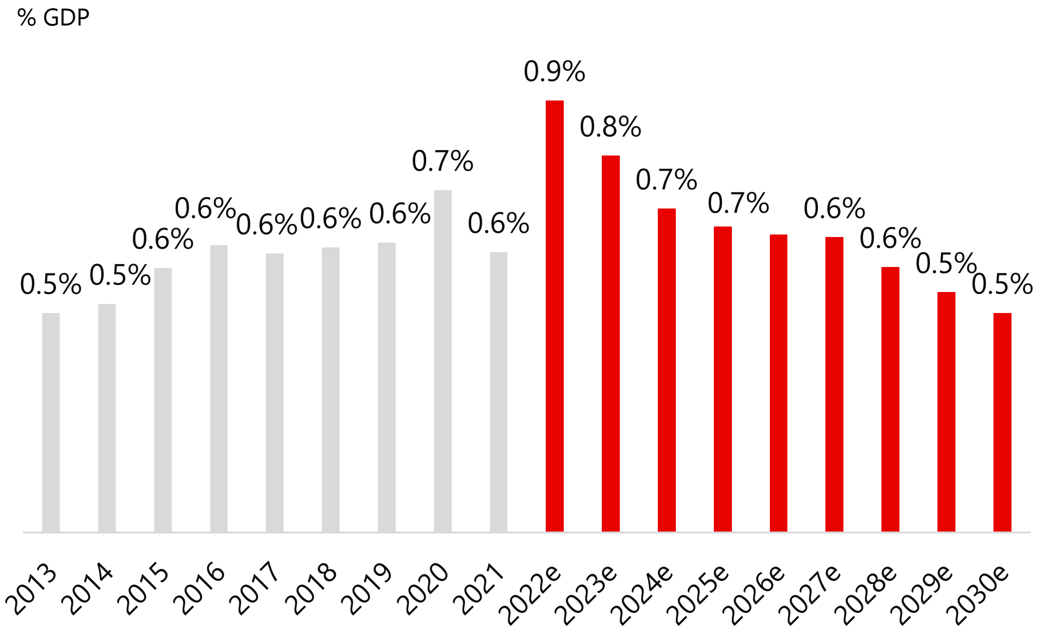
- We constructed a forecast based on the Budget Guidelines (LDO) probable judicial claim for next the years. In the short-run we see more pressure from the Fundef and those related to pension payments.
- Our preliminary estimate is only a preliminary "educated-guess" in view of the difficulty in estimating 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 2022, Santander

Judicial claims estimates



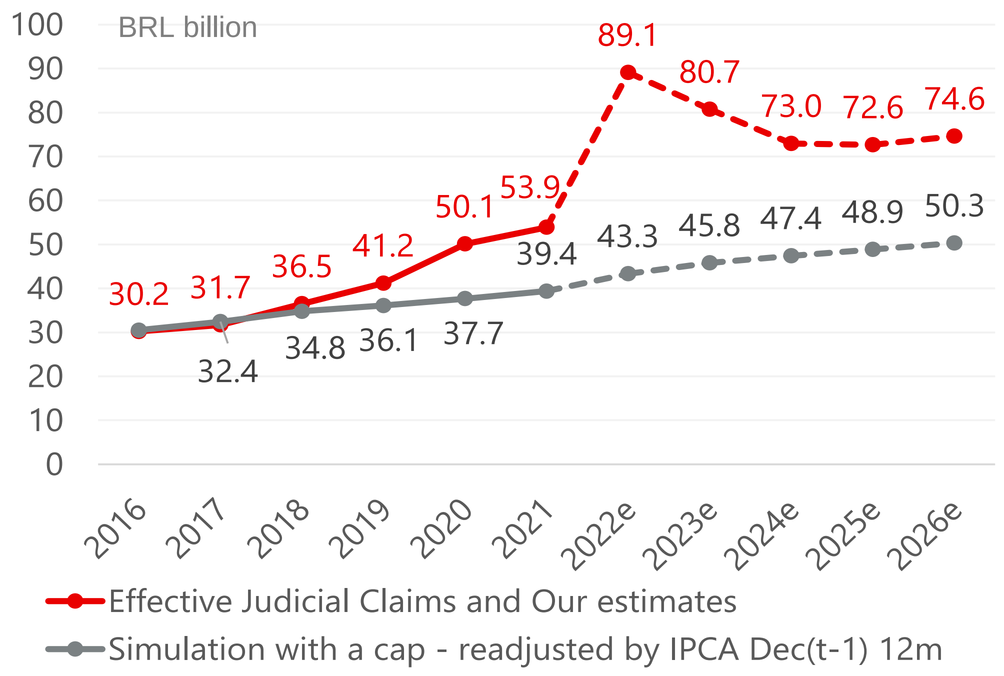
Sources: LDO 2022, Santander

Based on the LDO 2022 Tables 14 to 20

Simulation – effects of creating a cap for the payment

- In ordert 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.

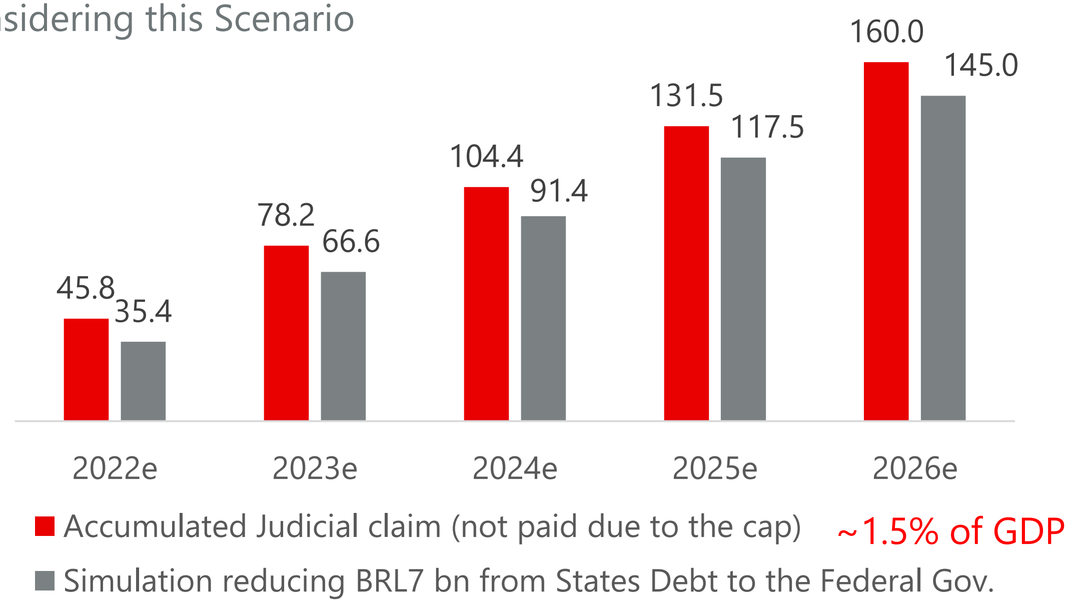
Simulation - A limit for Judicial Claims payments



Sources: National Treasury, BCB and Santander.

Simulation with a cap – Accumulated judicial claims

Considering this Scenario



Sources National Treasury, BCB and Santander.

New Welfare Program – named as *Auxílio Brasil*

04

New welfare program – *Auxílio Brasil*

- Regarding the fiscal transfers, the emergency aid program ended in October. Starting in November was the new welfare program, the Auxílio Brasil. The government stated that in 2022 Budget there will be ~BRL90 billion for the program.

Simulation: New welfare program – BRL billion

Expenses in BRL billion - Yearly Budget							
		Monthly Benefit (BRL)					
		190	300	400	415	500	600
Millions of Families	23	52.4	82.8	110.4	114.5	138.0	165.6
	21	47.9	75.6	100.8	104.6	126.0	151.2
	19	43.3	68.4	91.2	94.6	114.0	136.8
	17	38.8	61.2	82.0	85.1	102.0	122.4
	15	34.2	54.0	72.0	74.7	90.0	108.0
	13	29.6	46.8	62.4	64.7	78.0	93.6
	11	25.1	39.6	52.8	54.8	66.0	79.2

Sources: Federal Gov. Santander.

In Green: Bolsa Familia (former program) budget
In Red: current values in public debate (*Auxílio Brasil*)

New welfare program – *Auxílio Brasil*

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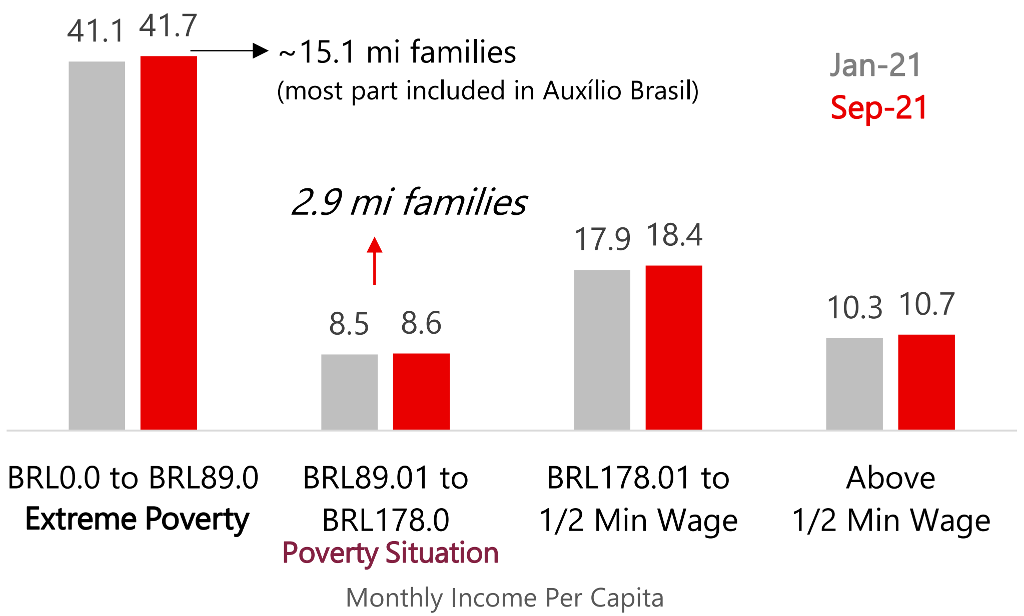
Cadastro Único – Gov. Database

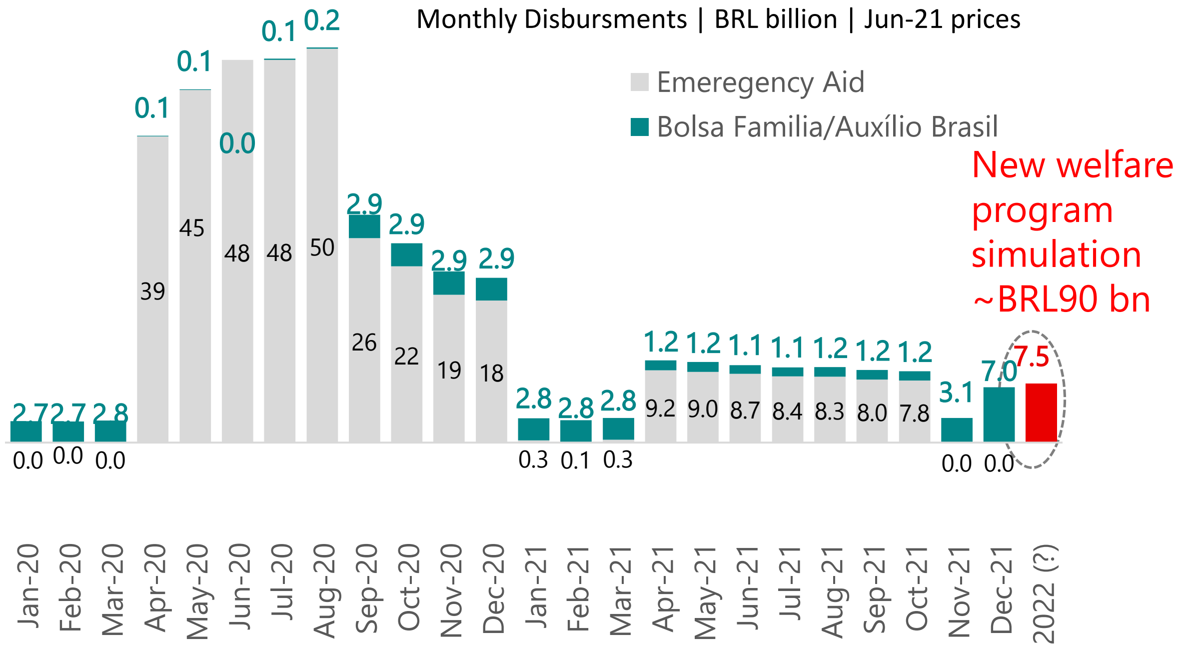
People Registered in *Cadastro Único* - Monthly Income Per Capita Intervals



These intervals could be updated in 2022, last time was in 2018.

Sources: Ministerio da Cidadania, Santander

Simulation: New welfare program – BRL billion



Sources: National Treasury, Santander.

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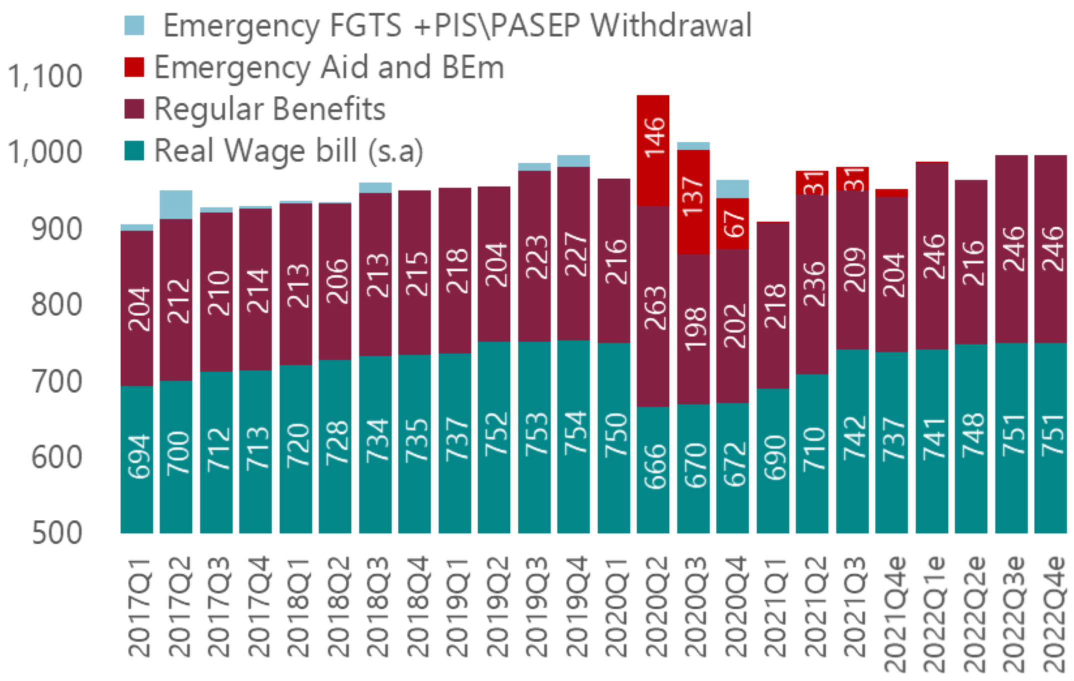
"Expanded" real wage bill will drop in 2021, with partial recovery in 2022

- Considering PEC of *Precatórios*, with the government transfers increase, the overall effect on the real wage bill is neutral. The effect of the new value of the welfare program and the revised value of regular transfers (impact of +1.3p.p.) barely offsets the negative impact of labor income due to inflation and monetary policy (-1.2p.p.). We now expect the "expanded" real wage bill to post 3.2% growth in 2022 (from 3.5% in our last review), already accounting for the PNAD series revisions. Considering the revised levels of inflation and the Selic rate for the alternative simulations, we estimate the growth of the "expanded" real wage bill as between 2.9% and 4.0%. We still consider these scenarios as compatible with an expansion of household consumption of around 1.0% in 2022.

"Expanded" Real Wage Bill (BRL billion)



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

	2020	2021(E)	2022(E) - Selic Rate Simulation 10.50%	12.25%	13.50%
Real Wage Bill **(No Fiscal Stimulus)**	-8.0%	+4.6%	+4.2%	+3.8%	+3.3%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL35bn)	+3.1%	-4.8%	+2.5%	+2.1%	+1.8%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL82bn)			+3.6%	+3.2%	+2.9%

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

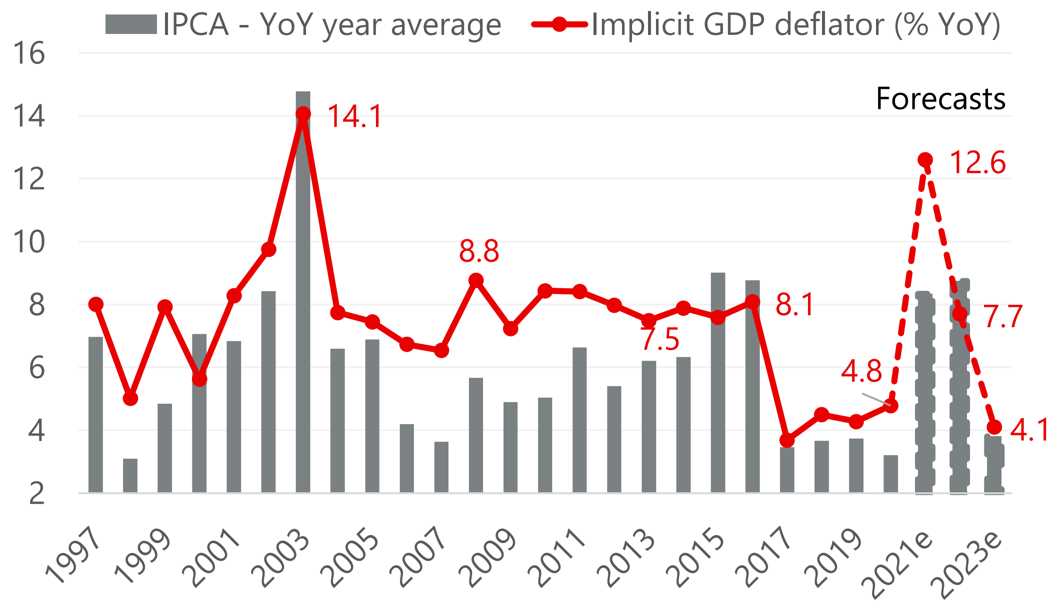
Fiscal background – Price shock impact

05

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

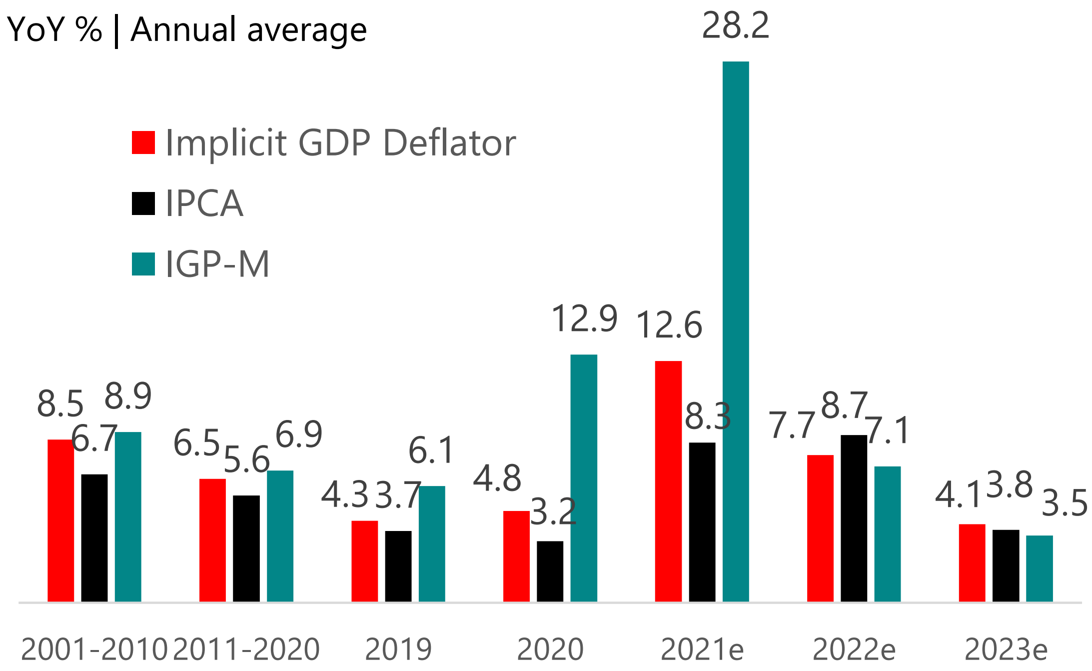
- One of the main effects of both higher inflation and activity recovery is higher nominal GDP, which consequently affects the debt-to-GDP ratio. At the beginning of the year, we estimated that nominal GDP would increase by 7% in 2021; our latest tracking points to a ~18% increase. The main effect was on the GDP deflator, which went from 4.0% to 12.6%, closely related to the commodity shock and an increase in the IPCA forecast from 3.6% (February) to 10.1% (in our latest tracking).

IPCA and GDP Deflator



Sources: IBGE, Santander.

IPCA, IGP-DI and GDP Deflator

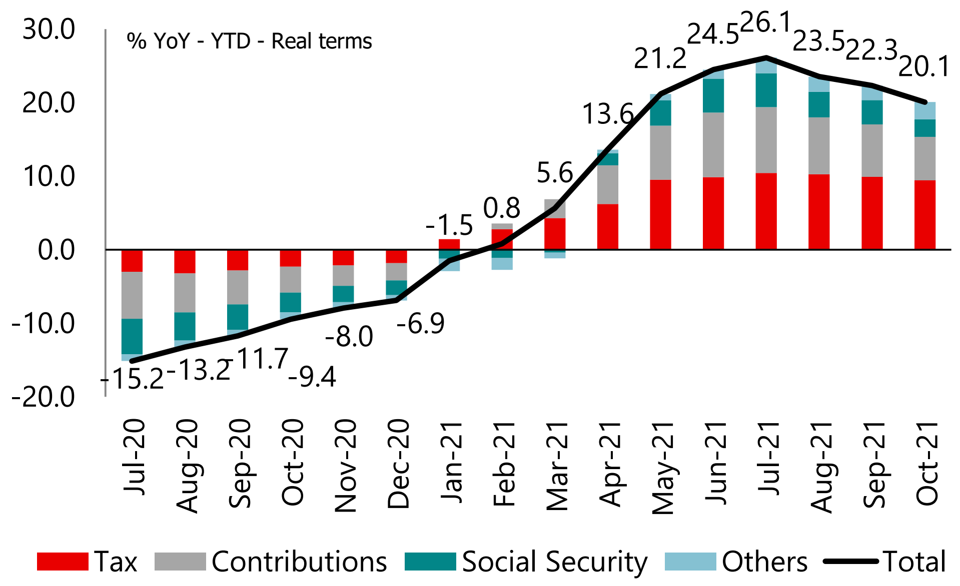


Sources: IBGE, FGV, Santander.

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

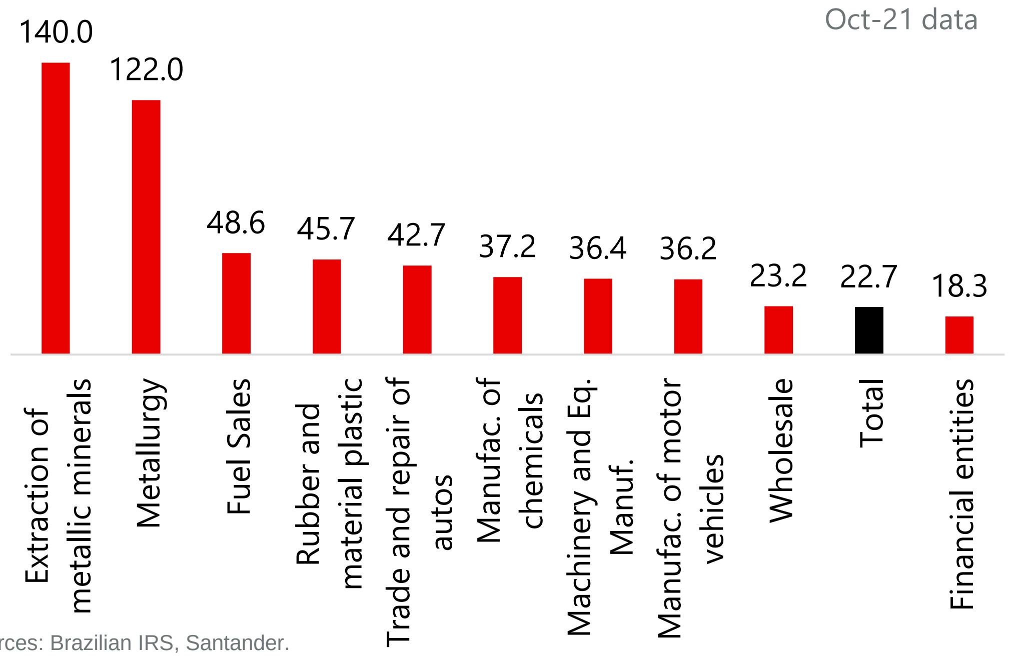
- We see a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the corporate sector, which have posted good results. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to metals.
- In our view, we expect revenue growth to slow down (still 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 YTD (%YoY)

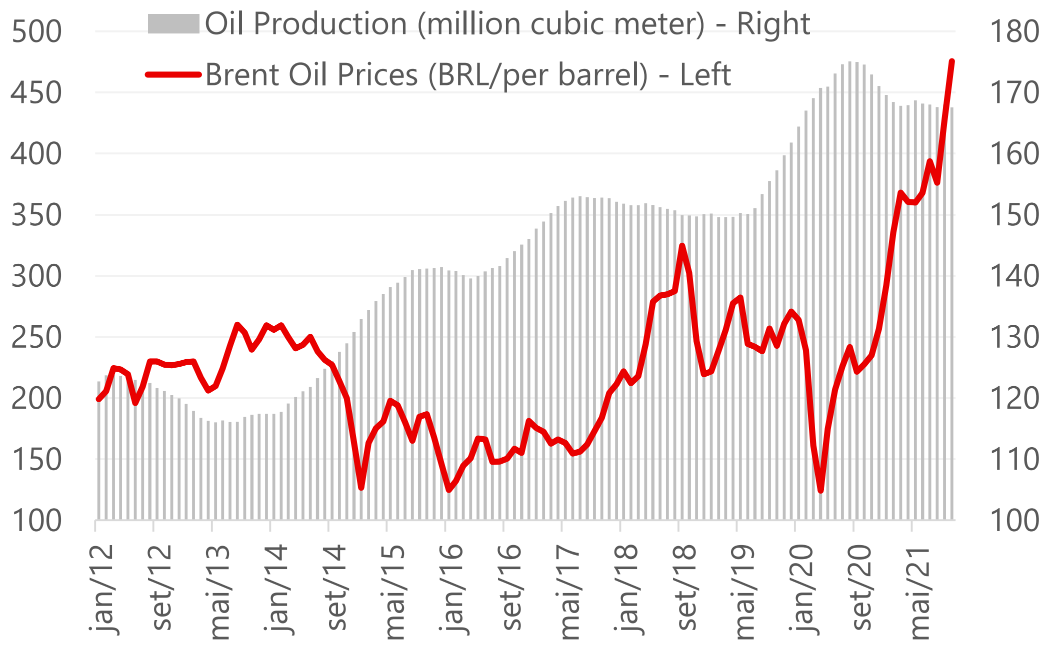


Sources: Brazilian IRS, Santander.

Revenues Impact – We also recently reviewed the royalties revenues

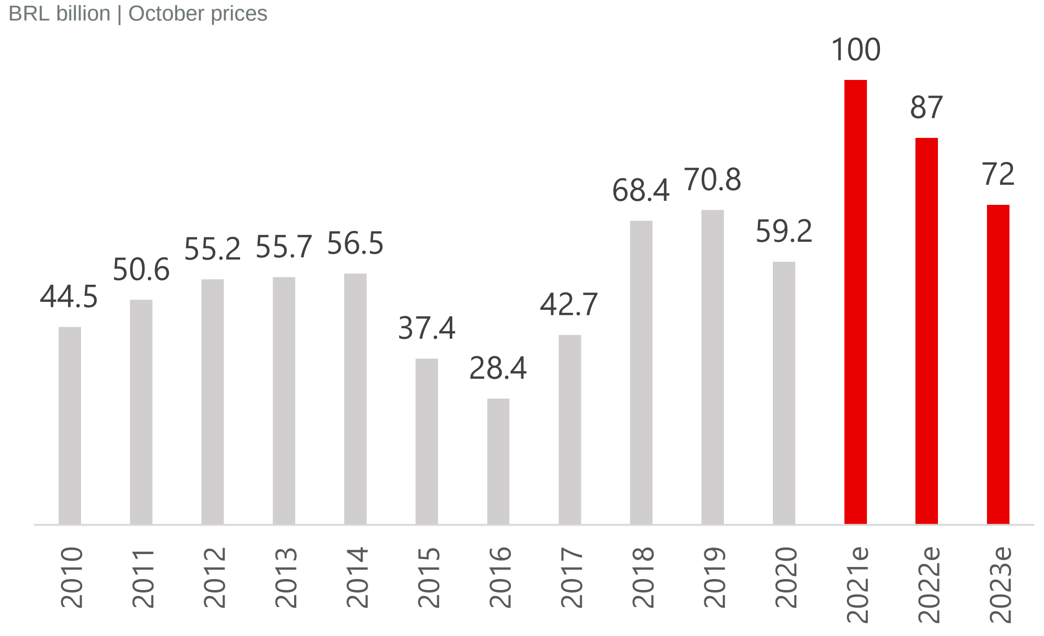
- Another important aspect was the recovery in royalty revenues. It rose ~BRL15 bn in October, considering the jump in commodities prices – with the oil prices above USD80/per barrel. In our last scenario revision, a key factor was the new royalty revenue estimates, owing to the recent price surge, mainly from oil and iron ore production. We forecast this revenue now at BRL100 billion, from BRL90 billion in October, which represents an increase of ~70% compared to 2020 and ~40% compared to 2019.

Oil Prices and Production



Sources: Bloomberg, ANP, Santander.

Revenues from Exploitation of Natural Resources

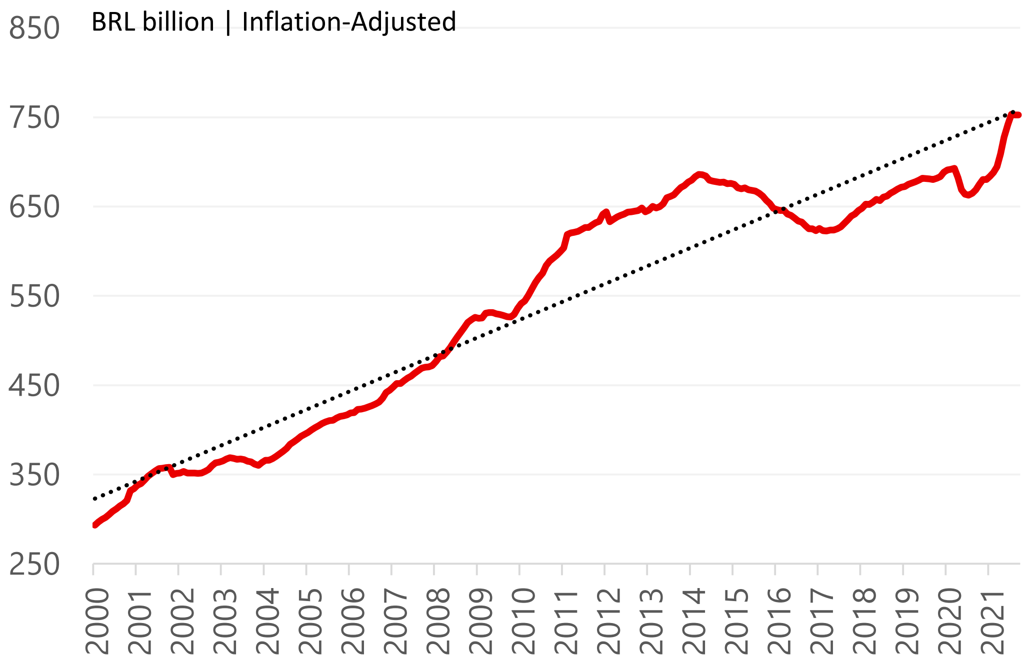


Sources: Bloomberg, Santander.

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

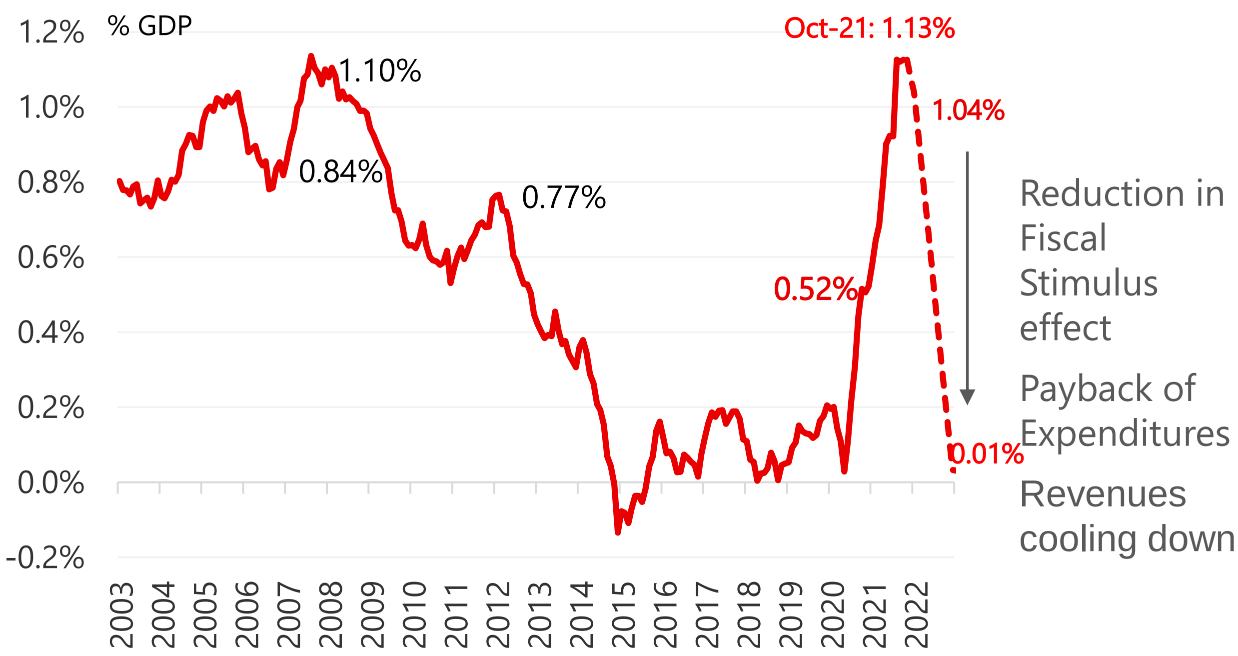
- In October, the regional governments' primary result continued to post positive numbers. The recent results were probably affected by the lagged effects of the 2020-21 fiscal stimulus on local economies, added to the effect of the price shock (terms-of-trade and inflation) on tax collection—and the activity recovery (formal sector) in the last few months.
- We believe that regional governments will face the challenge of reestablishing fiscal balance in the medium term after the end of fiscal and monetary stimuli, mainly, in our view, because of pressure to increase mandatory expenditures in the next year (for example, pressure to increase public servants' wages, after a period without a nominal increase).

Total Revenues 12m – Brazilian States



Sources: Confaz, Santander.

Regional Governments – Primary Result

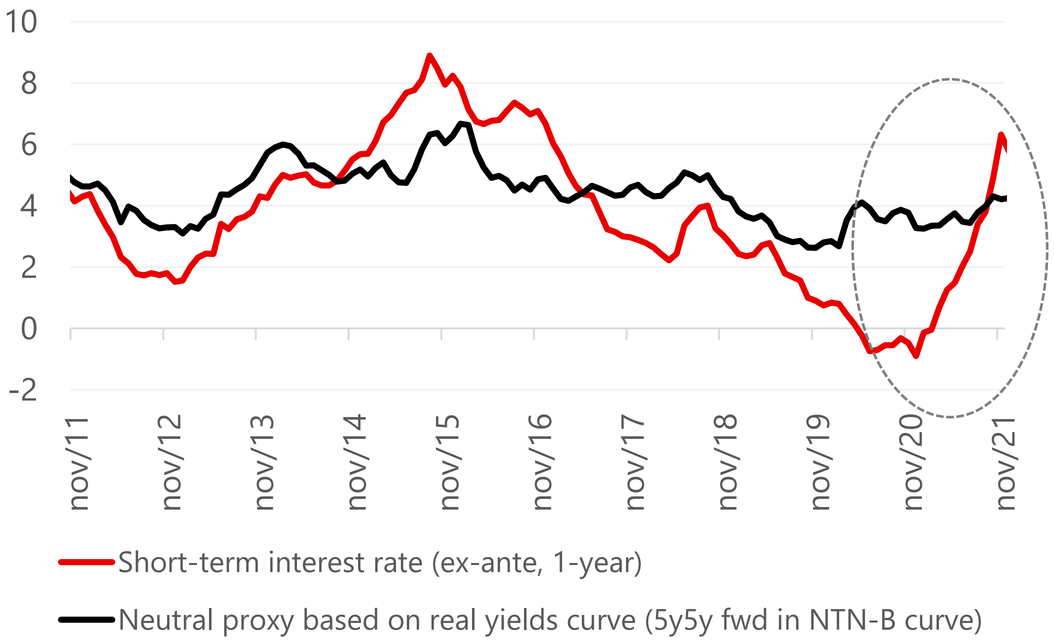


Sources: BCB, Santander.

On the other side, we see an increase in interest rates

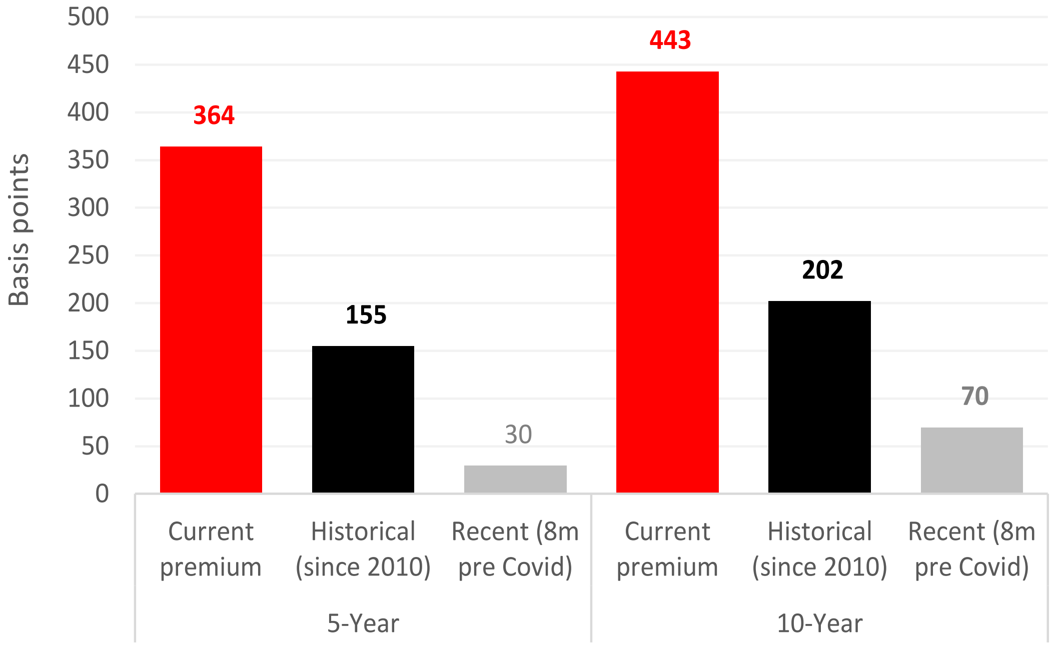
- As the BCB faces worsening inflation conditions and seek to curb expectations for the relevant policy horizons, we look for a faster and larger interest-rate adjustment in this cycle. We forecast the Selic rate forecast in 9.25% in 2021YE and 12.25% for 2023YE. A possible decline to the neutral level (which we assume at 7.00%) is to take place only after 2023.
- Despite the improvement in the short-term fiscal numbers, the risk related to the fiscal consolidation remains elevated, in our view.

Proxies for Short- and Long-Term Interest Rate



Sources: Bloomberg, Anbima, Santander.

Current rise in risk premium



Sources: Blooomberg, Santander.

Santander

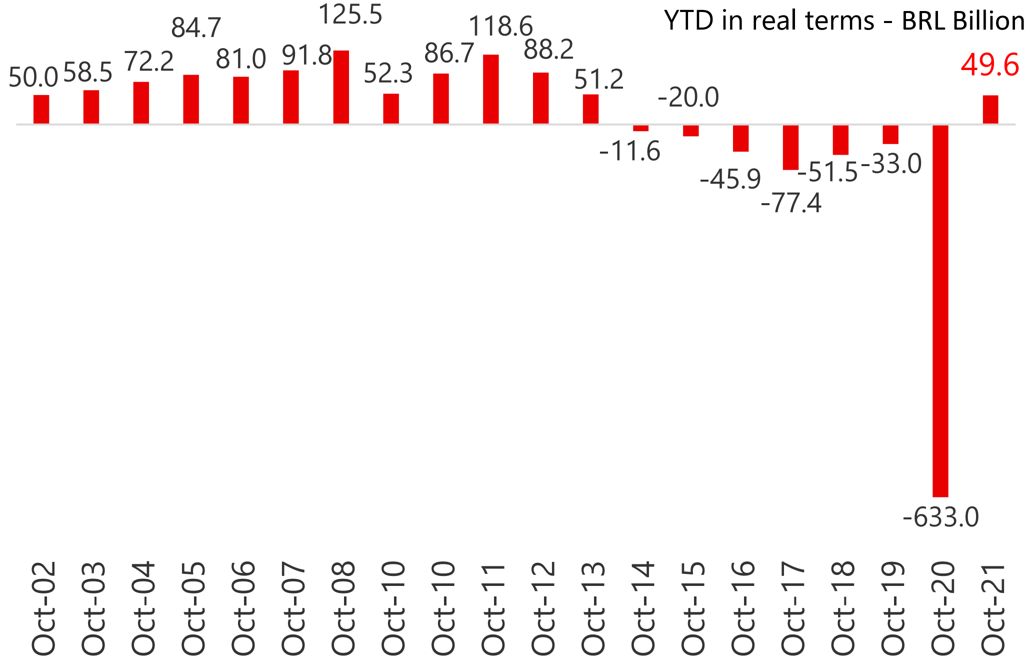
Fiscal Baseline Scenario – Primary Result and Simulations

06

Public Sector Primary Result Improving with the Inflation-effect

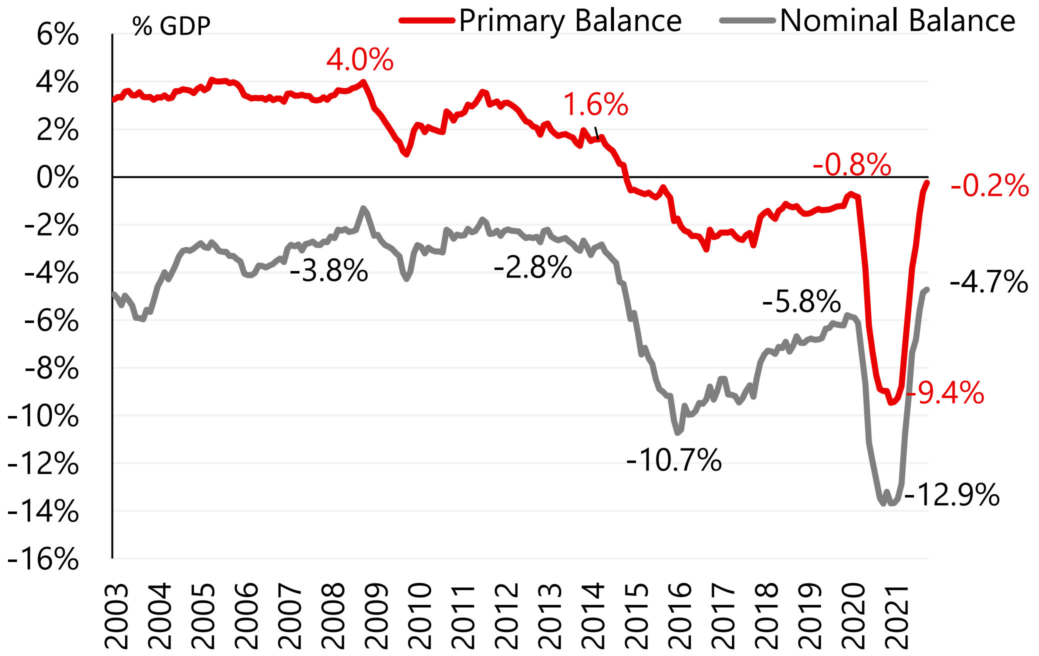
- In YTD terms, the surplus reached BRL49.6 billion (0.7% of GDP) in October, boosted by positive results in regional governments public accounts. In 2020, the deficit was BRL633 billion (10.4% of GDP) and BRL33.0 billion (0.5% of GDP) deficit in 2019.
- In the 12-month reading, the primary deficit reached BRL52.9 billion (0.6% of GDP) in September, compared to BRL130.3 billion (1.6% of GDP) in August, maintaining a downward trajectory after a sharp reduction in the fiscal stimulus in 2021 vs. 2020 (close to 9.2% of GDP summing up both years).

Public Sector – Primary Result



Sources: BCB, 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	2021e	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	21.6	21.3	21.6	21.9	22.1	22.3	22.4	22.5	22.6	22.8	1.3	1.8
Revenues Collected by the IRS (1)	12.7	12.9	12.8	12.1	13.4	13.2	13.2	13.2	13.2	13.3	13.2	13.2	13.2	13.2	0.6	0.5
Net Social Security Revenues (2)	5.7	5.6	5.6	5.4	5.1	5.1	5.3	5.4	5.5	5.5	5.6	5.6	5.7	5.8	-0.2	0.1
Revenues Not Collected by the IRS (3)	2.6	2.7	3.7	2.2	3.0	3.0	3.1	3.3	3.4	3.5	3.6	3.7	3.8	3.8	0.9	1.2
Transfers by Revenue Sharing	3.5	3.7	3.9	3.5	4.0	4.0	4.0	4.0	4.0	4.0	4.0	3.9	3.9	3.9	0.5	0.4
Net Revenue	17.5	17.6	18.2	16.2	17.7	17.3	17.6	17.9	18.2	18.3	18.5	18.6	18.7	18.9	0.8	1.3
Total Expenditure	19.4	19.3	19.5	26.1	18.8	18.9	19.0	18.9	18.8	18.6	18.4	18.4	18.1	17.9	-0.8	-1.5
Social Security Benefits (4)	8.5	8.4	8.5	8.9	8.1	8.2	8.3	8.3	8.3	8.3	8.2	8.2	8.2	8.2	-0.2	-0.3
Payroll (5)	4.3	4.3	4.2	4.3	3.8	3.7	3.7	3.6	3.5	3.5	3.4	3.3	3.3	3.2	-0.8	-1.1
Other Mandatory Expenses (6)	3.0	2.9	2.6	9.7	3.8	3.6	3.6	3.6	3.7	3.6	3.6	3.6	3.5	3.3	0.6	0.3
Expenses with Cash Control (7)	1.9	2.0	1.9	1.8	1.8	2.3	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.1	0.3	0.2
Discretionary Expenses (8)	1.8	1.8	2.2	1.5	1.3	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	-0.7	-0.7
Central Gov. Primary Balance	-1.9	-1.7	-1.3	-10.0	-1.2	-1.7	-1.3	-1.0	-0.6	-0.2	0.0	0.3	0.6	0.9	1.6	2.8
Public Sector Primary Balance	-1.7	-1.5	-0.8	-9.4	-0.1	-1.7	-1.3	-0.9	-0.6	-0.2	0.0	0.3	0.6	1.0	1.5	2.6
Nominal GDP (BRL billion)	6,585	7,004	7,407	7,448	8,734	9,472	9,841	10,348	10,913	11,508	12,136	12,799	13,498	14,234	4,923	7,649

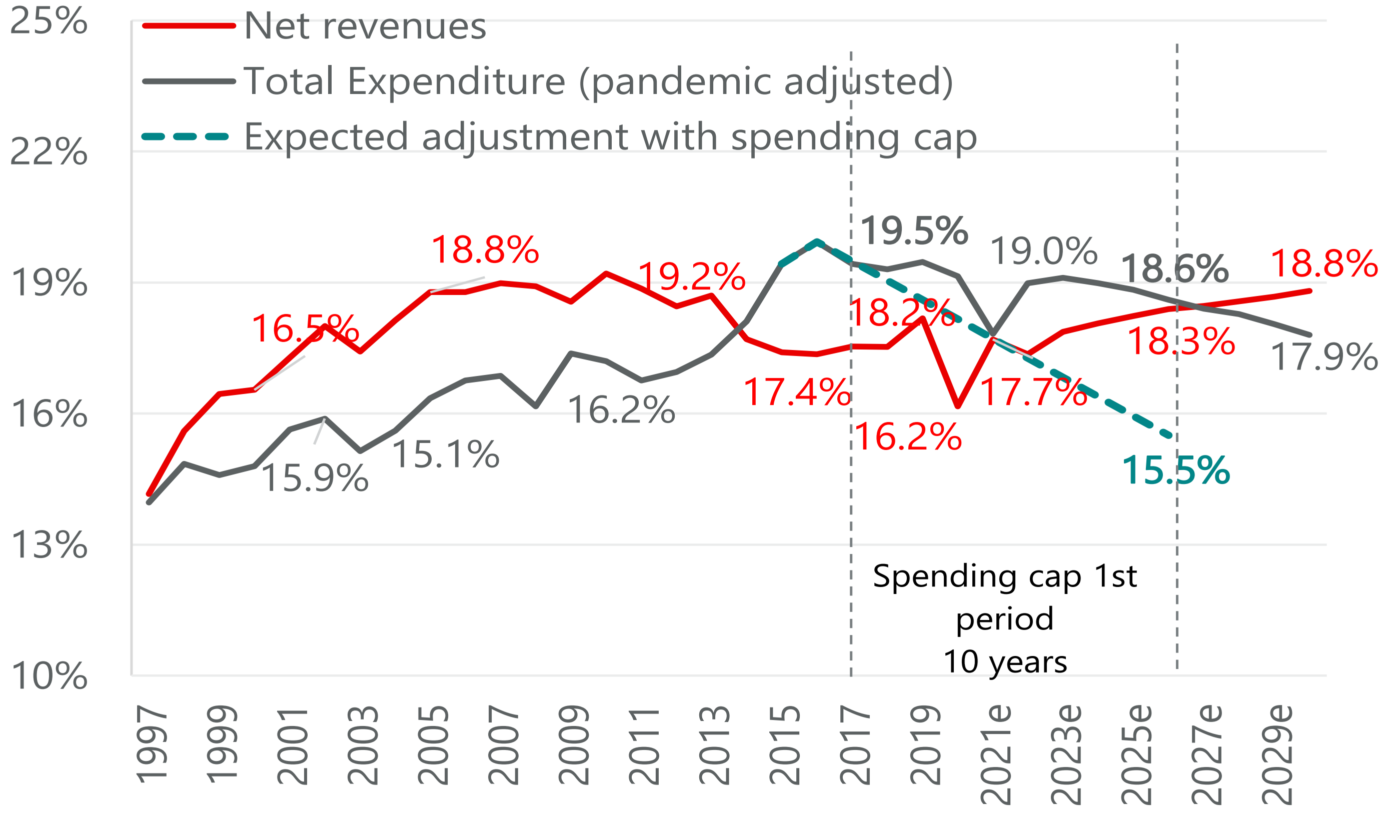
Notes and Hypothesis

(1) Elasticity: Revenues-GDP 2021: 1.7 | 2022: 1.1 | Long-term: 1.06. We see a slowdown in extraordinary revenues from 2021 to 2022.
(2) Gradual recovery in the formal labor market and earnings
(3) Oil revenues will increase with greater federal share in pre-salt
(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)
(5) Gradual increase in admissions to the federal workforce ("normalization"). Long-term: lower levels of admission (digitalization) + wages readjusted by inflation.
(6) Includes: the increase in Court-ordered debt budget, 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)
(8) Discretionary Expenses maintained close to 1.1% - a level that we consider enough to avoid a partial shutdown of public services;

Fiscal Balance – Revenues and Expeditures

- We improved our estimate of the structural long-term revenue gain based on favorable terms of trade, with a once-and-for-all increase of 0.35 pp of GDP per year (compared to 0.1 pp of GDP in July).
- In our scenario, the surplus will only be reached in 2027-28, four years later in comparison to the scenario without adding the effects of the PEC dos *Precatórios*. In addition, for the medium term, our forecasts indicate that the constitutional spending cap has lost its capacity to add to the fiscal consolidation process.

Central Gov. Balance (% GDP)



Sources: National Treasury, BCB and Santander.

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Fiscal Risks – Size Of The Fiscal Stimulus And Leftovers

- The total size of the War budget (2020) expenses totaled BRL524 billion. This year we estimate at ~BRL125 bn.
- We anticipate that the government will maintain the expenditure in Vaccine Acquisition (as a 2021 Leftover – not considered in the spending cap) of BRL10 billion for 2022.

2020 War Budget Fiscal Measures (BRL billion)

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

Updated until 01/05/2021

Sources: National Treasury, Santander.

Tracking 2021 – Extra-cap fiscal expenditures

BRL Billion - Accumulated	Sep-21	Oct-21	Nov-21	Total Budgeted	Executed
Emergency Aid (MP 1.037 and 1.056/2021)	52.5	60.5	60.5	64.9	93.2%
Health expenditures	17.8	19.3	20.2	28.5	71.0%
BEm - Employment Program (MP 935/220 and MP 1.044/2021)	7.7	7.7	7.7	11.7	66.0%
Turism Infraestructure (MP 963/2020)	0.5	0.5	0.5	1.9	27.6%
Vaccine Acquisition (MP 994, 1,004 and 1,015/2020)	13.8	16.1	19.1	26.2	73.1%
Pronampe (credit support for SMEs) (MP 1,053/2021)	5.0	5.0	5.0	5.0	100.0%
Accumulated Total	97.3	109.1	113.1	138.2	81.9%

Last update: 12/09/2021

Sources: National Treasury, Santander

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

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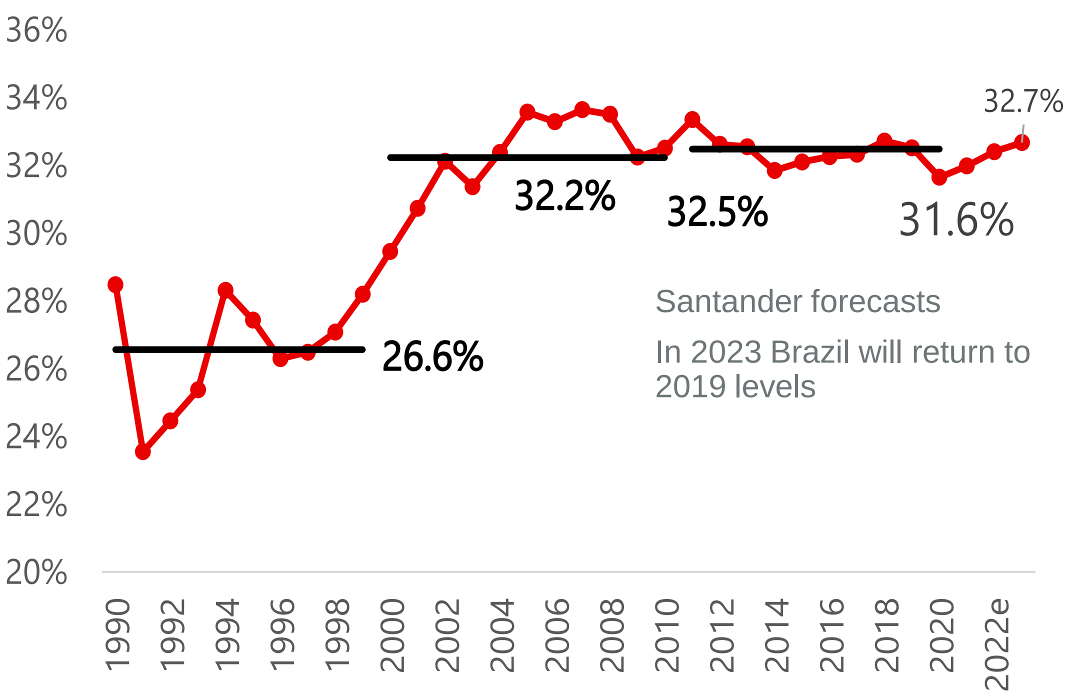
Difficulty in the Fiscal Adjustment - Expenses or Revenues?

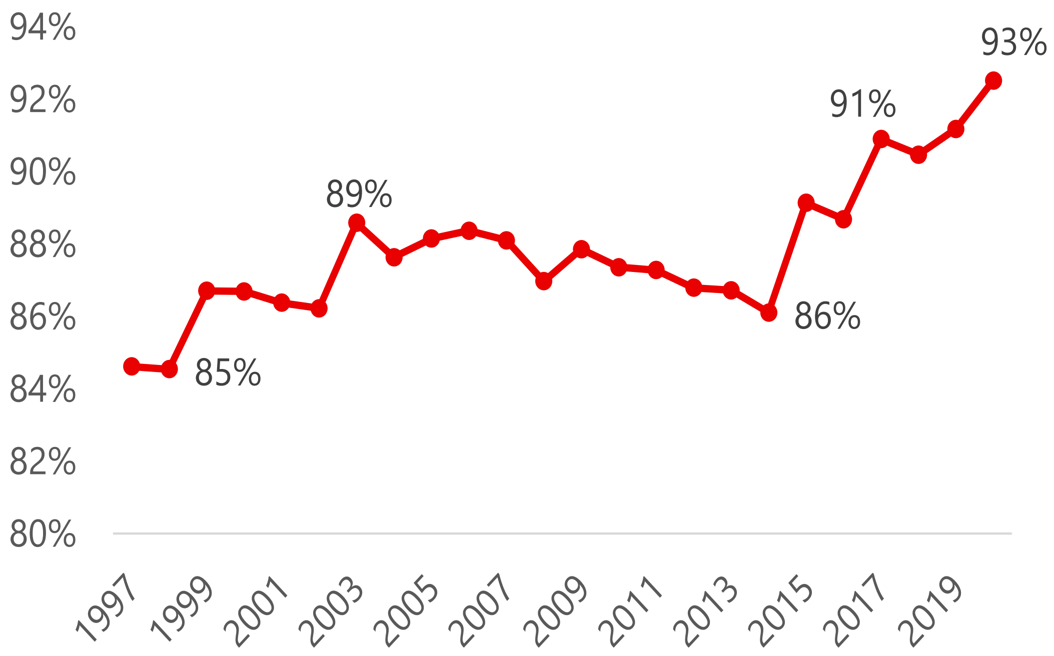
- There is a limit to increase taxes and to reduce the discretionary expenses.

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



Sources: IBRE, National Treasury, BCB and Santander.

Mandatory Outlays / Total Expenses



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

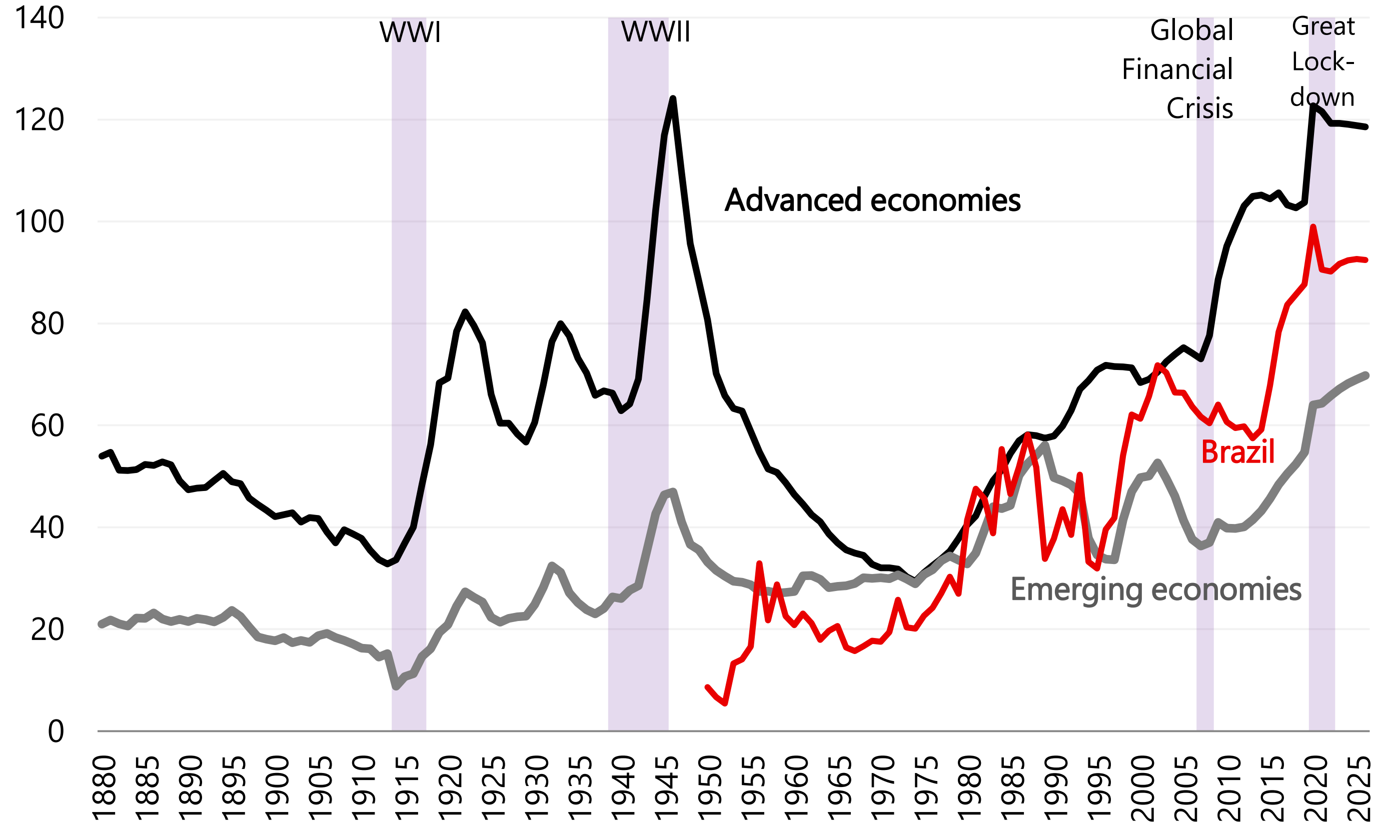
Public Debt Scenario and Simulations

07

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

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

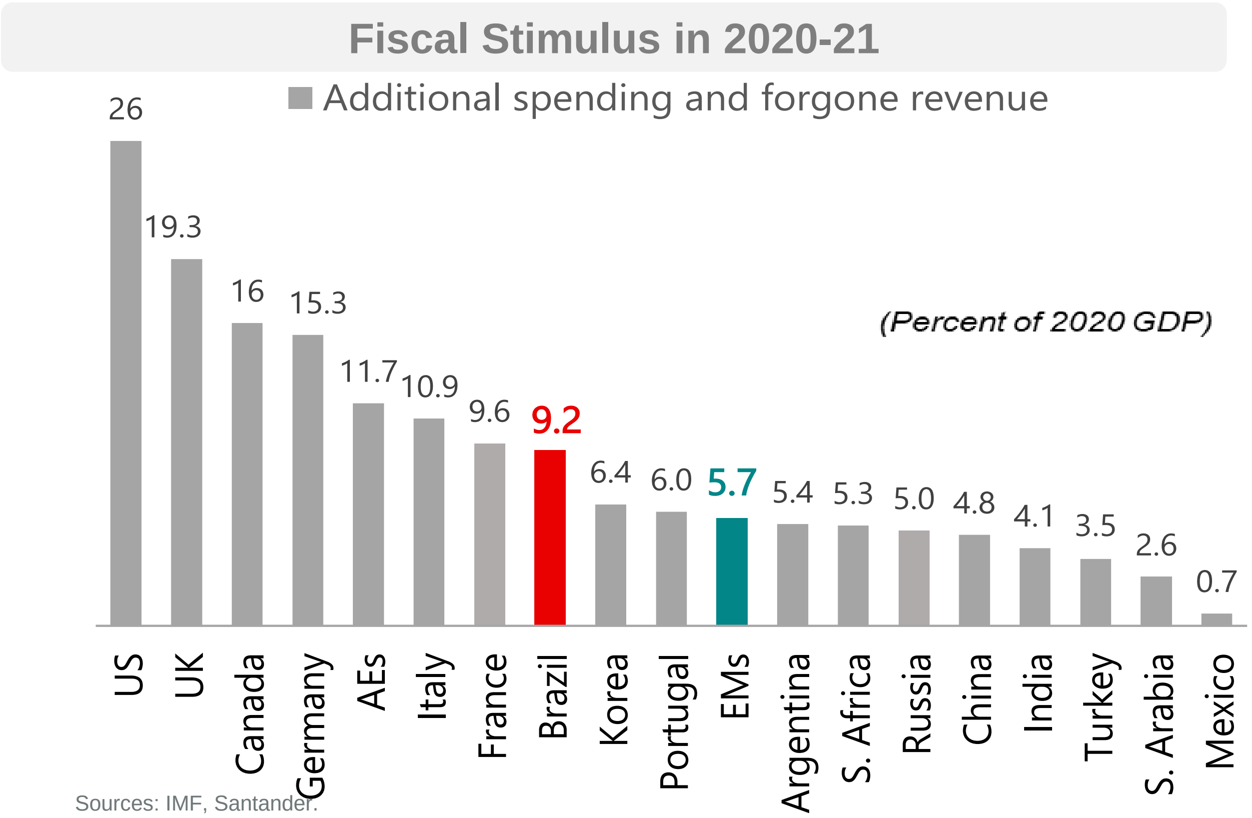
Historical Patterns of General Government Debt (% GDP)



Sources: IMF, Santander.

Fiscal Monitor – IMF Scenario

- According to data from both 2020 and 2021, Brazil's fiscal stimulus reached 9.2% of GDP, higher than the 5.7% of GDP for the average of emerging economies (EM).
- In short, the fiscal outlook presented by the IMF is close to our fiscal scenario and reinforces the importance of both measures and reforms to guarantee the credibility of the fiscal consolidation.



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 2.5-3.0% of GDP primary fiscal adjustment, just to stabilize the ratio debt-to-GDP around the higher post-pandemic level of ~90% of GDP.

Current situation:

. Real interest rate (ex-ante) 1-year: ~5.6%,
. GDP is expected to grow 4.7% in 2021

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%,

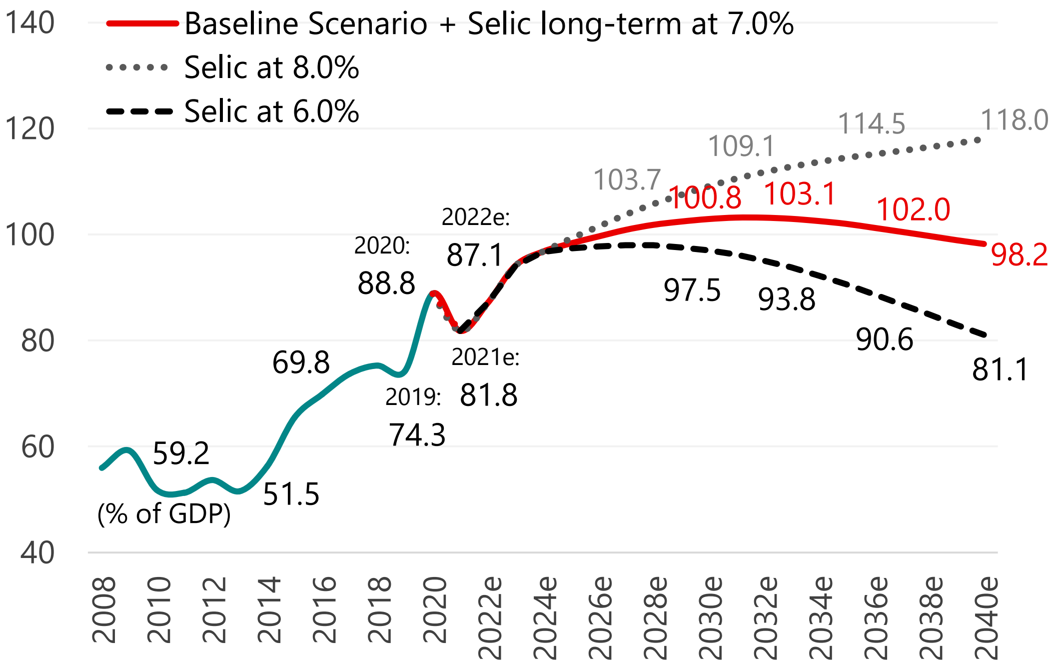
. The primary surplus must reach 1.8-2.2% of GDP to maintain the gross debt stable.

	Real Interest Rate							
GDP Growth	-1.0%	0.0%	1.0%	2.0%	2.5%	3.0%	4.0%	5.0%
1.0%	-1.8	-0.9	0.0	0.9	1.3	1.8	2.7	3.6
1.5%	-2.2	-1.3	-0.4	0.4	0.9	1.3	2.2	3.1
2.0%	-2.6	-1.8	-0.9	0.0	0.4	0.9	1.8	2.6
2.5%	-3.1	-2.2	-1.3	-0.4	0.0	0.4	1.3	2.2
3.0%	-3.5	-2.6	-1.7	-0.9	-0.4	0.0	0.9	1.7
3.5%	-3.9	-3.0	-2.2	-1.3	-0.9	-0.4	0.4	1.3

Sources: BCB, Santander.

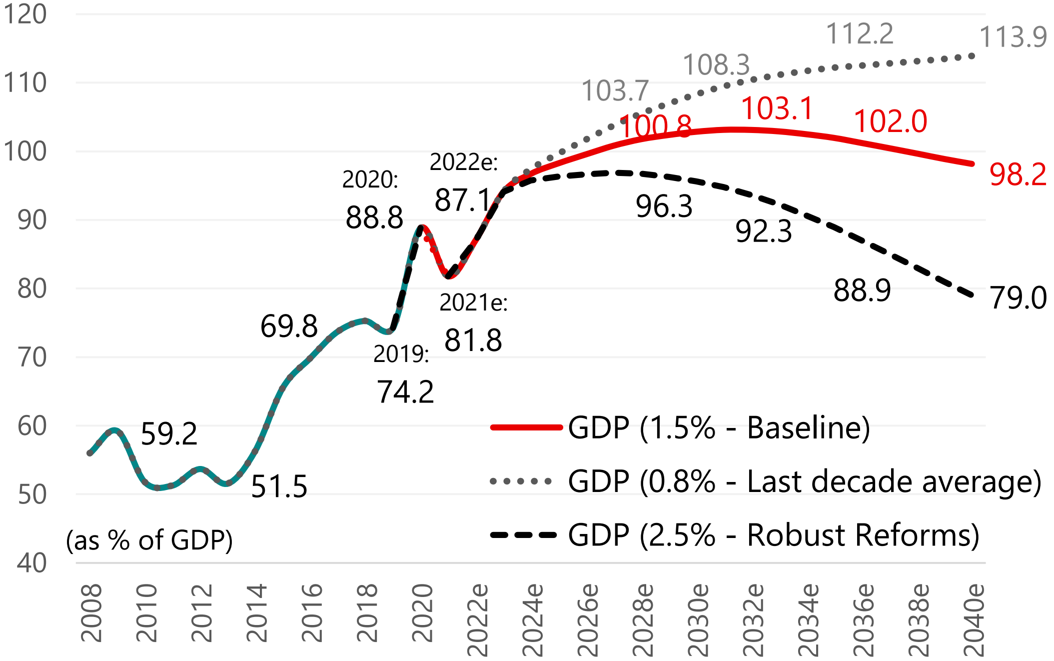
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

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)

2021 GDP Deflator: 12.6% | GDP: 4.7% | Selic Rate: 9.25%

2022 hypotheses: BNDES and Public Banks (BRL70 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)

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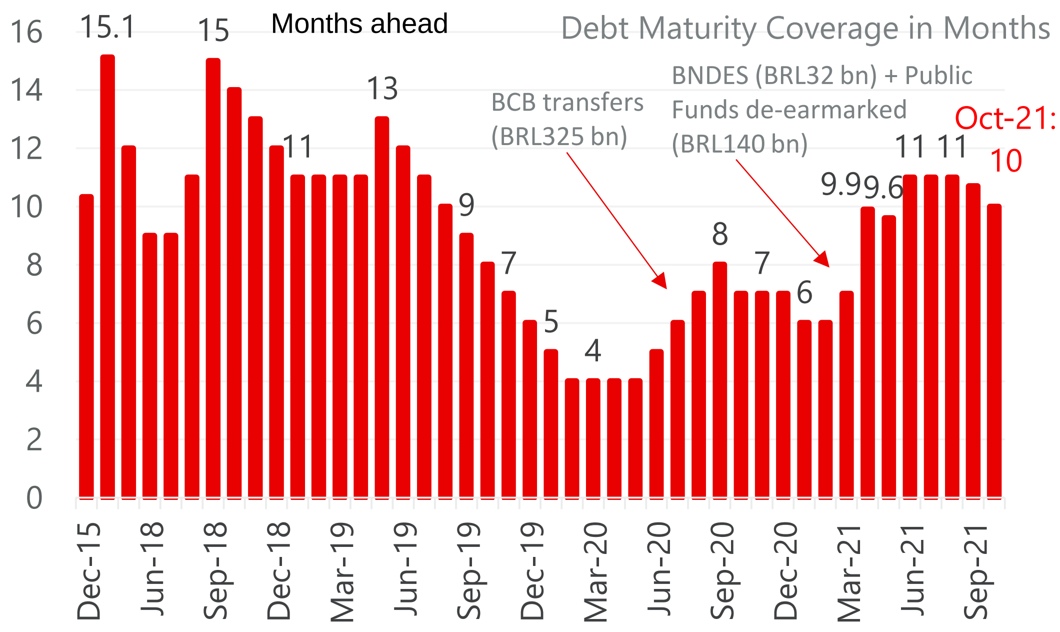
Debt Management

08

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

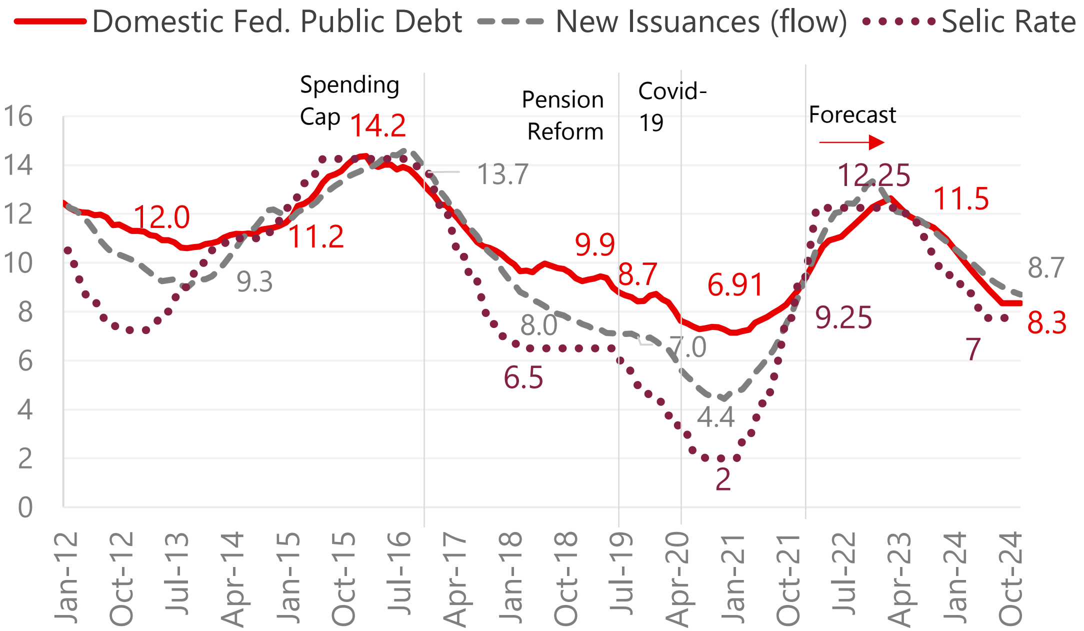
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels.
- We observe an increase in the cost of debt issuance (part due to Selic rate and part long maturity issuances – especially with inflation-linked bonds). In the short-run the cost level of new issuances is still below the outstanding debt average cost, yet this should reverse ahead.

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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

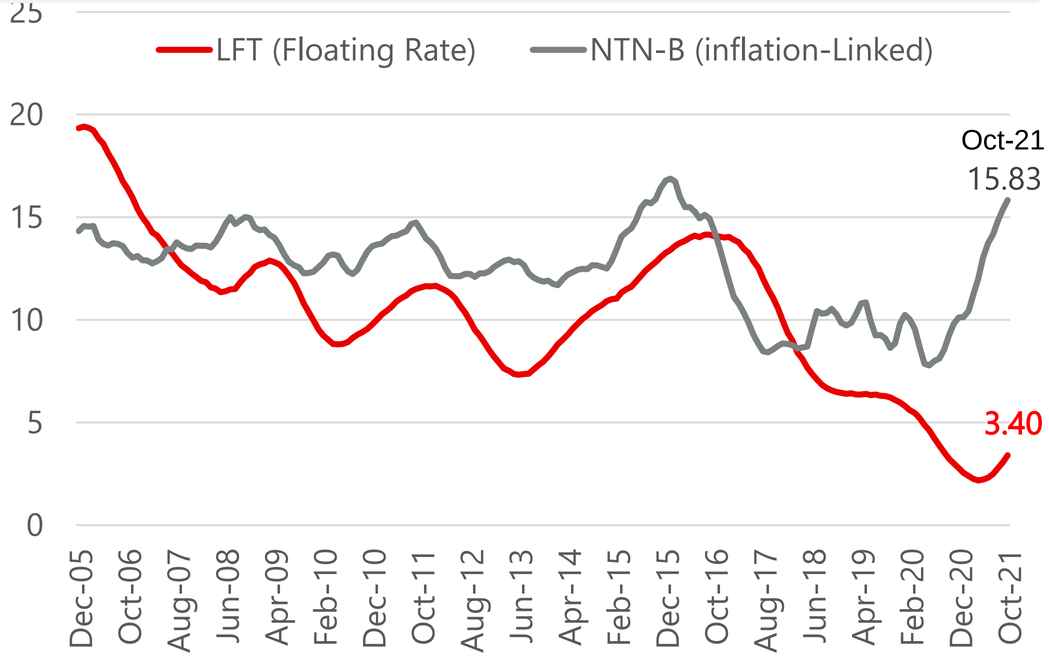


Sources: National Treasury, Santander.

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

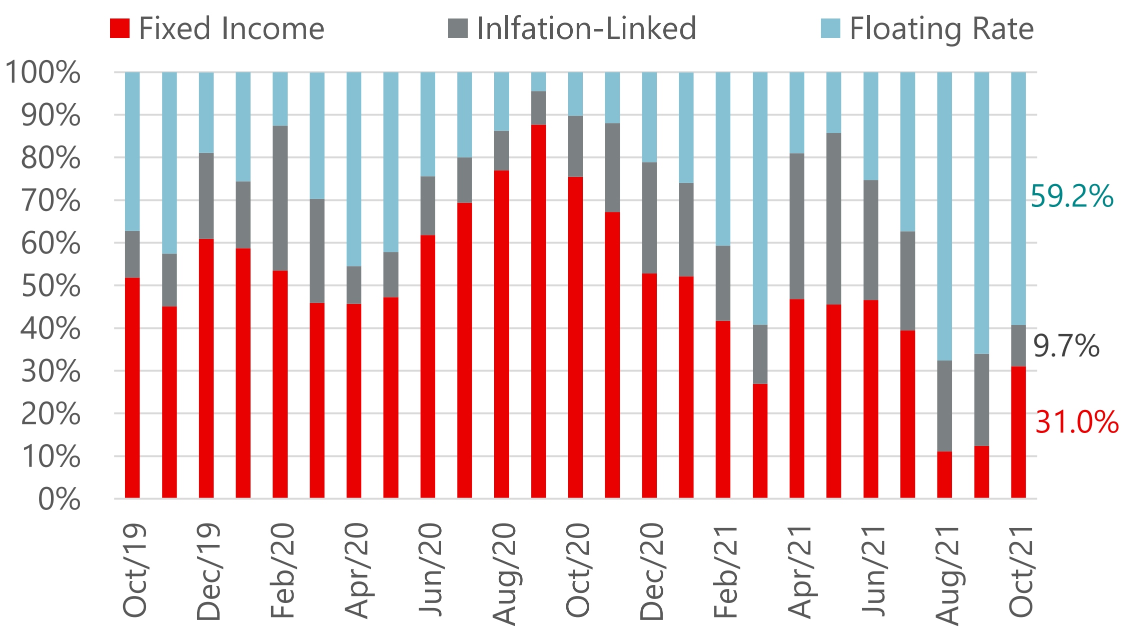
- In October, the debt cost continued to rise, due to both inflation and Selic increase. The average cost of the outstanding debt accumulated in 12m rose to 8.02% (from 7.46% in September). New issuances cost rose to 7.5% p.y, +0.6p.p from September.
- The NTN-B (inflation-linked bonds) cost in the last 12m rose to 15.8% p.y. (+5.7pp since Jan-21). The cost of LFT (floating rate) in 12m increased to 3.4% (from 2.55% in January), the Selic increase (currently at 9.25%) could 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 (%)

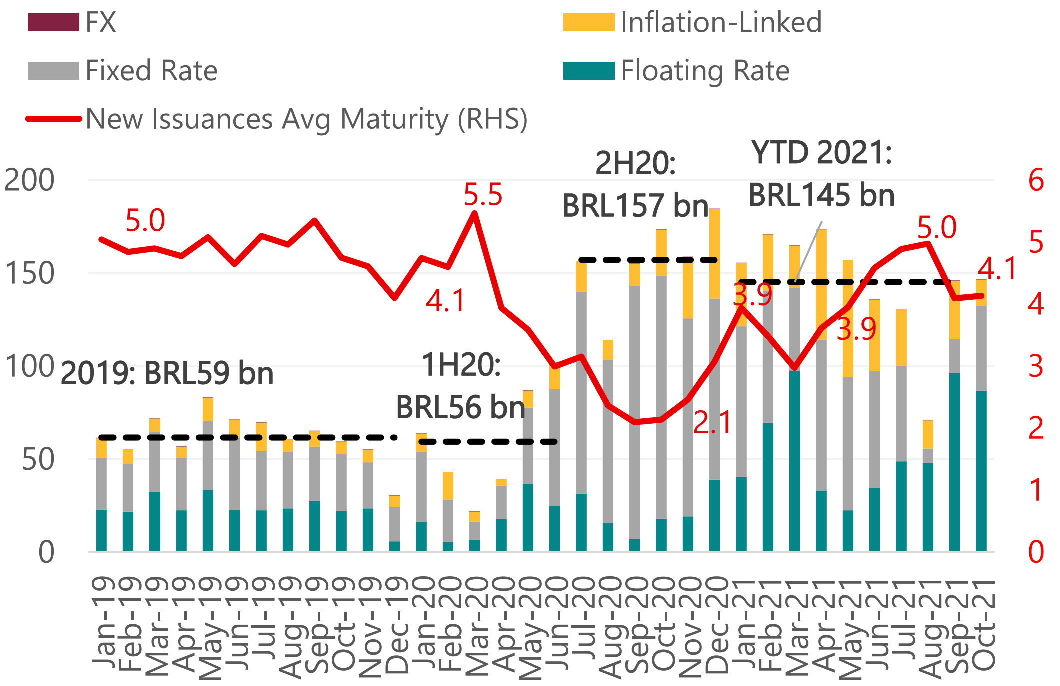


Sources: National Treasury, Santander.

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

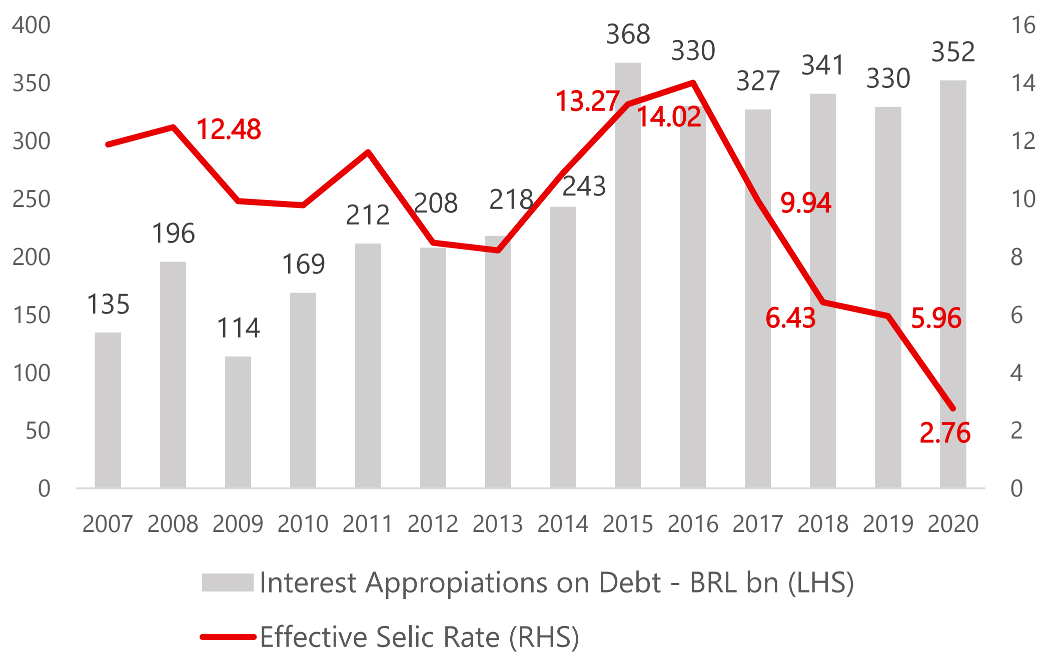
- Market conditions will be important for new debt issuances. Weekly bond issuances reached ~BRL34.4 billion until October, yet above to a required financial need until the end of the year of ~BRL1.9 billion/week.

Treasury Issuances



Sources: National Treasury, Santander

Selic Rate and Debt

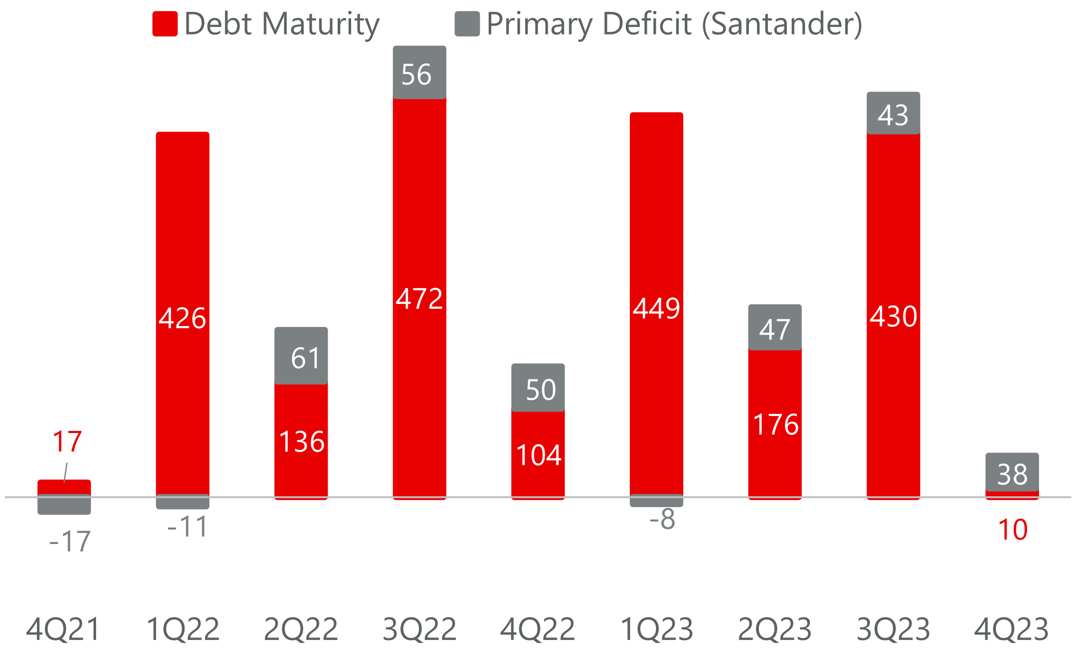


Sources: BCB, National Treasury, Santander.

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

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

Debt maturity - (BRL billion)



Sources: National Treasury, Santander

Profile by categories - (BRL billion)

Quarter	Fixed Rate	Floating Rate (selic)	Inflation-Linked	FX-Exchange	Other	Total
4Q21	0.0	-	15.2	-	1.7	**16.9**
1Q22	134.9	261.3	24.8	3.8	1.3	**426.0**
2Q22	119.5	-	14.9	-	1.3	**135.7**
3Q22	125.2	166.5	175.3	3.6	1.1	**471.6**
4Q22	86.6	-	14.6	-	2.8	**104.0**
1Q23	265.1	160.4	19.3	3.4	0.7	**448.9**
2Q23	0.0	0.0	174.7	0.0	1.4	**176.1**
3Q23	176.0	230.6	18.9	3.3	1.3	**430.0**
4Q23	0.0	0.0	9.3	0.0	0.8	**10.1**

Sources: National Treasury, Santander.

MACRO SCENARIO: Forecasts

Macroeconomic variables		Previous		Current
GDP (%)	2021E	4.9	↓	4.7
	2022E	1.0	↓	0.7
	2023E	0.0	↓	-0.2
IPCA (%)	2021E	9.6	↑	10.5
	2022E	5.2	↑	5.8
	2023E	3.5	→	3.5
Selic Rate (% end of period)	2021E	9.25	→	9.25
	2022E	11.50	↑	12.25
	2023E	9.00	→	9.00
FX Rate - USDBRL (end of period)	2021E	5.50	→	5.50
	2022E	5.70	→	5.70
	2023E	5.20	→	5.20
Current Account Balance (% of GDP)	2021E	0.0	↓	-1.3
	2022E	0.0	↓	-0.7
	2023E	-1.6	↓	-2.0
Primary Fiscal Balance (% of GDP)	2021E	-0.3	↑	-0.1
	2022E	-1.7	→	-1.7
	2023E	-1.3	→	-1.3
Gross Public Debt (% of GDP)	2021E	81.2	↑	81.8
	2022E	87.5	↓	87.1
	2023E	94.6	↓	94.1

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

*By the time of writing, the 3Q21 GDP data had not come out, with the date of release scheduled for the same day as the publishing of this piece. The 4.7% estimate to 2021 GDP considered a -4.1% drop in 2020.; however, our current estimate stands at +4.6%, taking into account the actual 3.9% drop calculated to 2020.

- **The forecasts refers to our latest Scenario Review**

"HIGHER FISCAL (AND INFLATION) RISKS WEIGH ON THE GROWTH OUTLOOK" *

(sent on December 02, 2021)

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

https://bit.ly/Std-scenreview-dec21

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Brazil Macroeconomic Research Team

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

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

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

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

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

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

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

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

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

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

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

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