Brazil Macro | July 2022

FISCAL POLICY

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Brief Overview

01

Summary – Back to Primary Deficit with Fiscal Stimulus

- We now foresee a primary budget deficit for 2022 (-0.2% of GDP, previously: +0.4%), on the back of higher fiscal stimulus (BRL166.2 billion or 1.6% of GDP). Tax breaks are totaling BRL85 billion for the federal government and BRL40 billion in subnational entities, according to our estimates. In addition, we have included the higher welfare programs) allowed by a recently approved constitutional amendment (PEC15/22), which will cost around BRL41.2 billion until the end of the year.
- In our view, the central government should register a 0.7% of GDP primary deficit this year, partly compensated by regional governments' surplus of 0.5%. We also see a worse budgetary outlook for next year, considering the effects of the fiscal stimulus in 2022: we updated our primary deficit forecast to -1.2% of GDP (prior: -0.6%).
- Additionally, we continue to foresee a deterioration in the nominal (headline) budget results due to higher debt costs (via Selic rate), implying a steep upward trajectory for government debt in the medium term. Our 2022 gross general government debt forecast went up to 79.9% of GDP (from 79.0%), virtually stable compared to 2021.
- For the long term, since we assume the commodity cycle will gradually fade, we continue to see a risky path toward debt stabilization, in a context of the reduced efficacy of fiscal rules, and social pressures to increase expenditures (especially for the next few years, in the context of persistent inflation pressures). We now estimate the gross debt will peak at ~98% of GDP in 2028 (from previously seen peak of 95%). Despite the breathing room on the fiscal side provided by this extended commodity cycle, the high level of mandatory expenses is a problem that needs urgent fixing (via economic reforms).

Back to Primary Deficit with Fiscal Stimulus

Short Term: Adding the Fiscal Stimulus

2022: Primary Deficit: -BRL20 bn (-0.2% GDP)

1. **Central Gov.:** -BRL70 bn (-0.7% GDP)
-BRL35 bn from Jun-22 estimate

1.1 **Expenditures***: PEC Auxílios* +BRL40bn, Pension:+BRL8bn, Culture outlays (vetos): BRL5 bn, No Wage rise: –BRL8bn, Others: +2bn

1.2 **Revenues**: Eletrobras +BRL25bn, BNDES Dividends: +BRL5 bn, Labor Market revenues: BRL 7 bn, PIS/Cofins Fuels BRL-20bn, Others: -BRL5 bn

2. **Regional Gov.:** +BRL50 bn (+0.5% GDP)
-BRL25 bn from Jun-22 estimate
LC194 (ICMS cap on essencial goods): -BRL40 bn, Activity: +BRL15 bn

Debt Liquidity Reserves Level

Comfortable levels (more than 9 months) to navigate the uncertainties

Gross Debt: 79.9% of GDP in 2022

2021: 80.3% of GDP (Virtually stable)
Nominal GDP: +12.1%.
Gradual increase in interest payments

Medium Term: Bumpy Road Ahead

Risks: Fiscal Stimulus by drop in revenue

BRL85 bn for Federal Gov. and BRL40 bn for regional government in 2022

Fiscal Accounts Unanchored

Inflation-effect: +1.5pp of GDP by 2026. Pressure to change the spending cap rule. We added a higher welfare program budget in our accounts (BRL120 bn per year)

Primary Surplus: 2026-27

Commodities (Revenues) vs. Expenditures inflation payback

Higher Nominal Deficit (Selic)

Nominal Deficit 2023: above 8.0% of GDP, with lower FX profits from Swap operations

Gross-Debt Peak Estimate

98% of GDP in 2030 (+3.0 pp from Jun-22)

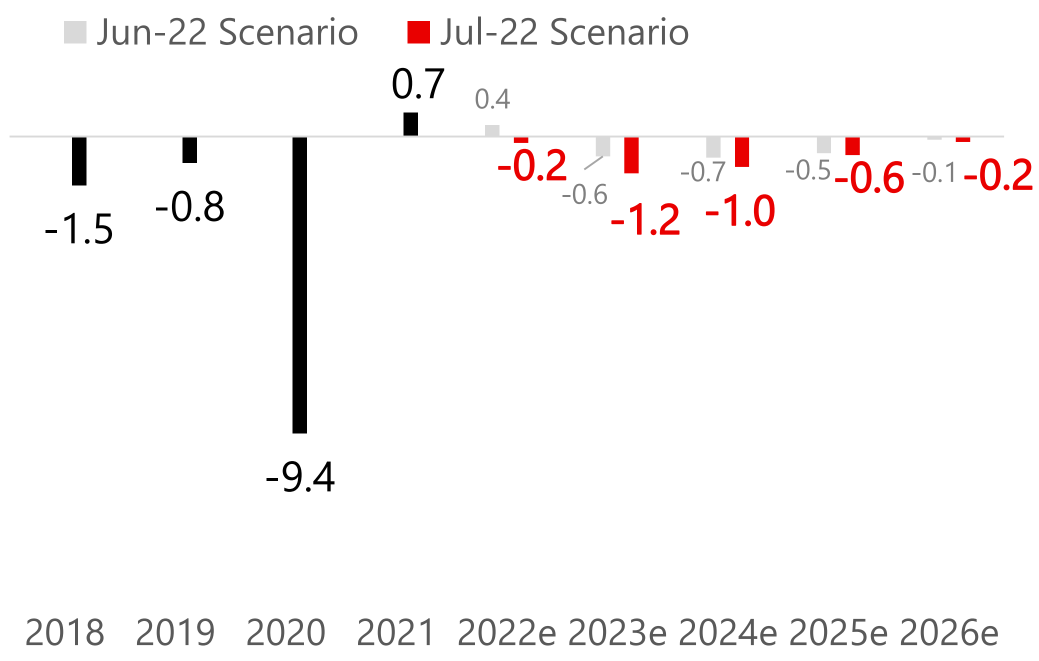
Debt-path: on the edge for convergence

~93% of GDP in 2040

Back to Primary Deficit with Fiscal Stimulus

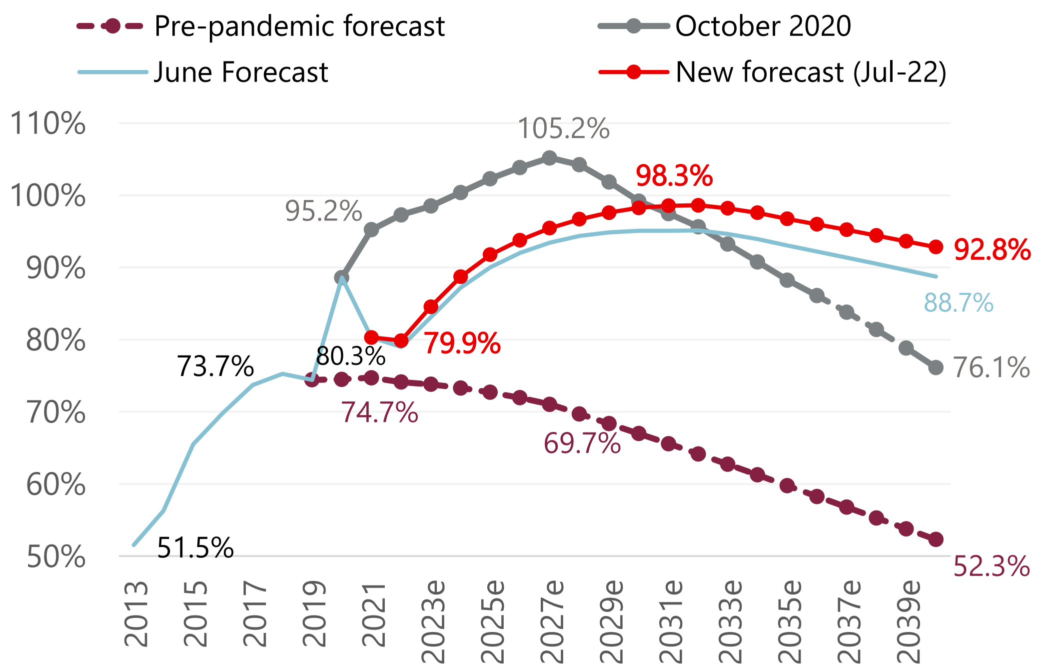
- We now see a primary deficit for 2022 on the heels of higher fiscal stimulus and the possibility to be maintained 2023 onwards.
- We estimate that federal net revenue will rise by 0.8 pp of GDP due to the positive shock related to terms of trade. The cyclical revenue is estimated in close to 1.0% of GDP that would appear during the disinflation process ahead.
- The price shock's impact directly accounts for 3/4 of the improvement in the debt-to-GDP.

Public Sector Primary Result (% GDP)



Sources: BCB, Santander.

Scenarios - Gross Debt Scenario (% GDP)



Sources: BCB, Santander

Fiscal Stimulus in Federal Gov. - The impact of recent measures

Revenues

Tax waiver measures in 2022	BRL billion	Permanent?	%GDP
Reduction of IPI federal tax by 35%	23.4	Yes	0.2%
Reduction of PIS/Cofins of Diesel, kerosene and	14.9	No	0.2%
Extension of payroll tax exemption*	9.2	?	0.1%
Reduction of import tax rates by 10%	6	Yes	0.1%
Soccer specific tax regime (TEC)	2.3	Yes	0.0%
Extension of PCD benefit	1.3	Yes	0.0%
ZPE expansion	1.2	Yes	0.0%
IOF reduction for credit support programs	0.8	Yes	0.0%
IRRF reduction on aircraft leasing	0.4	Yes	0.0%
Others	5	Yes	0.1%
PIS/Cofins Gasoline + Cide	17	No	0.2%
PIS/Cofins Etanol	4	No	0.0%
Total	85.5		0.9%
Total Temporary (Tax Break)	35.9		0.4%
Total Permanent	49.6		0.5%
Temporary Gains (Eletrobras + Extra Dividends)	36.6		0.4%
Net Impact on 2022	48.9		0.5%

* We consider as permament before the approval of a Tax Reform

Sources: Ministry of Economy, Santander.

Expenditures

Expenditures	BRL billion	Permanent?	%GDP
Campo de Marte region (agreement)*	25	No	0.3%
Spending Cap Change*	113	Yes	1.2%
2x Auxilio Gas	2	No	0.0%
Transport for eldery (subsidy)	2.5	No	0.0%
Truckers voucher	5.4	No	0.1%
Taxi Drivers and Alimenta Brasil	2.5	No	0.0%
Ethanol (subsidy)	3.8	No	0.0%
New hypothesis: Increment in Auxílio Budget for 2023	30	Yes	0.3%
Complement to Auxilio Brasil (BRL600) 2022	26	No**	0.3%
Total	**184.2**		**1.9%**
Total Temporary	**41.2**		**0.4%**
Total Permament	**143.0**		**1.5%**
Net Impact on 2022	**180.2**		**1.9%**

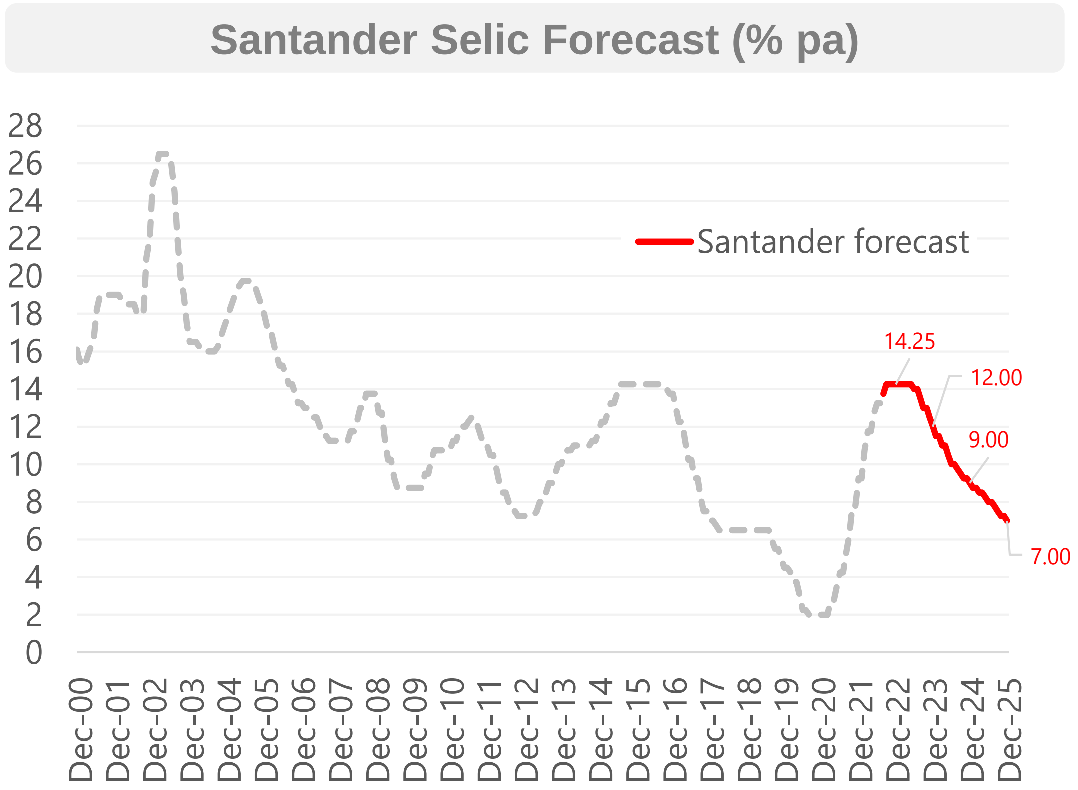
* Those are already included in our scenario before

** We include more BRL30 billion in the Welfare Program Budget 2023 onwards

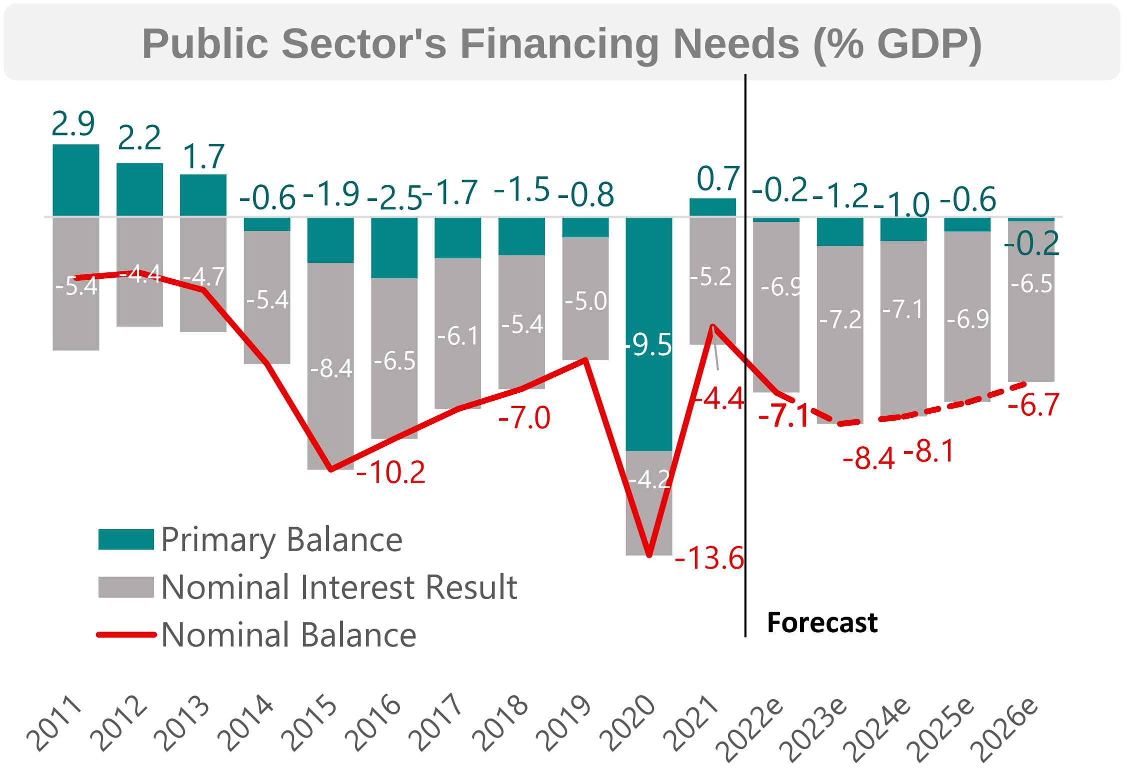
Sources: Ministry of Economy, Santander

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

- Our Selic rate forecast is 14.25% in YE2022. Our real interest rate estimate is at 4.0% per year in the long run (7.0% nominal).
- We continue to foresee a deterioration in the nominal (headline) budget results due to higher debt costs (in the Selic rate), implying a still steep upward trajectory for government debt in the medium term.



Sources: BCB, Santander

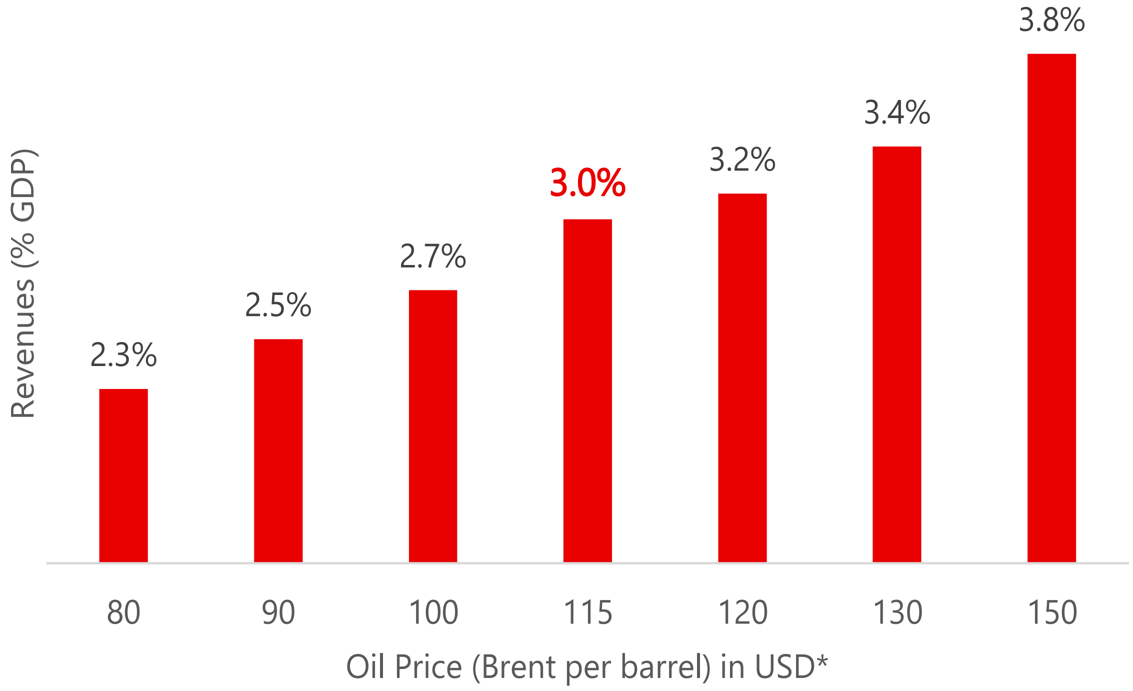


Sources: BCB, Santander.

Background – Oil revenues to help for some time

- We see oil-related direct revenue at around 3.0% of GDP in 2022 considering the consolidated public sector. We estimate oil revenue elasticity by an error correction model at around 0.8. In the Figure below, we explore the different scenarios for international oil prices, keeping the exchange rate at BRL5.30/USD in the average (Brent at USD115/bbl). If oil prices rise further, the fiscal result tends to be even more favorable, with the possibility of recording a primary surplus, as occurred in 2021.

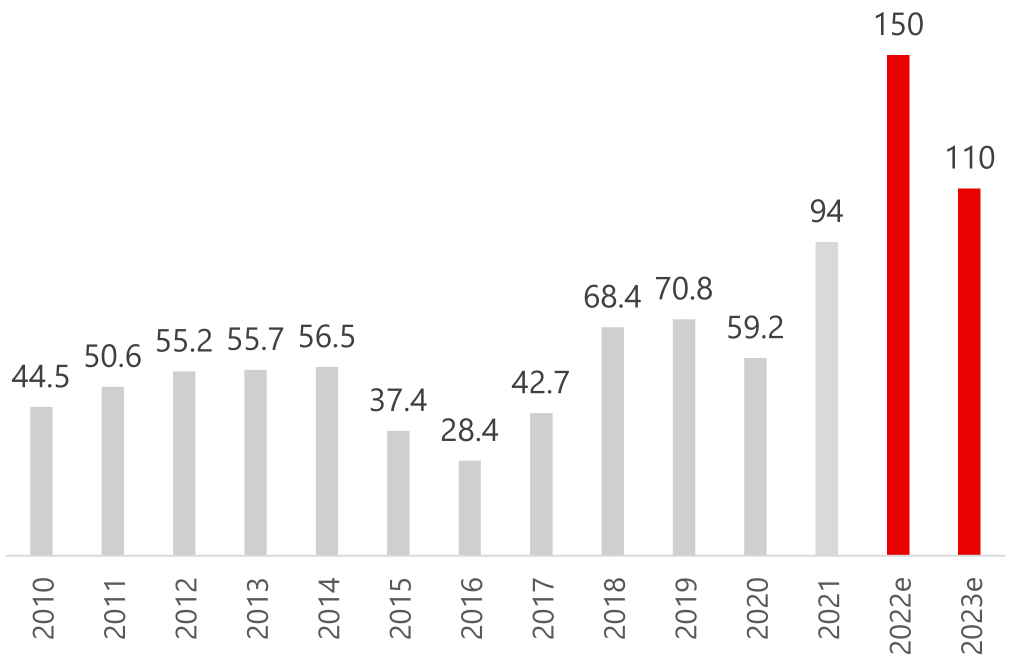
Consolidated Public Sector Oil Revenue – 2022



FX rate maintained at BRL5.30 for 2022

Sources: Confaz, Santander.

Revenues from Exploitation of Natural Resources (~85% oil-related)



Sources: National Treasury, Santander.

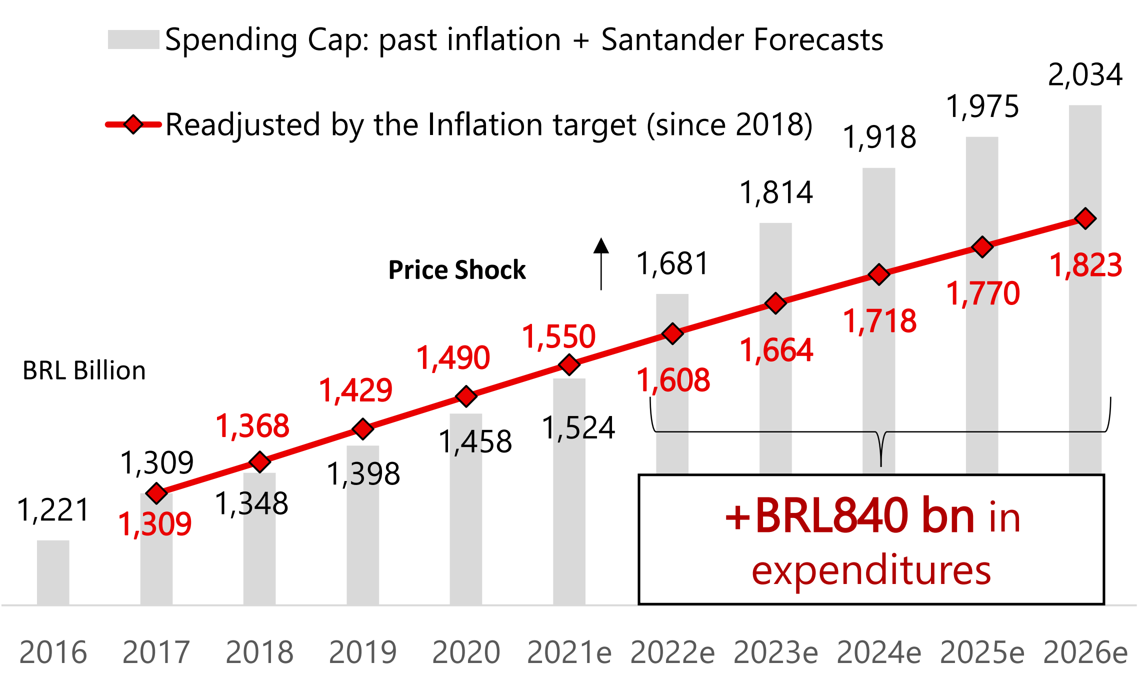
Spending Cap Rule – Lost part of its anchoring power

02

Fiscal – Spending cap rule was affected by the inflationary shock

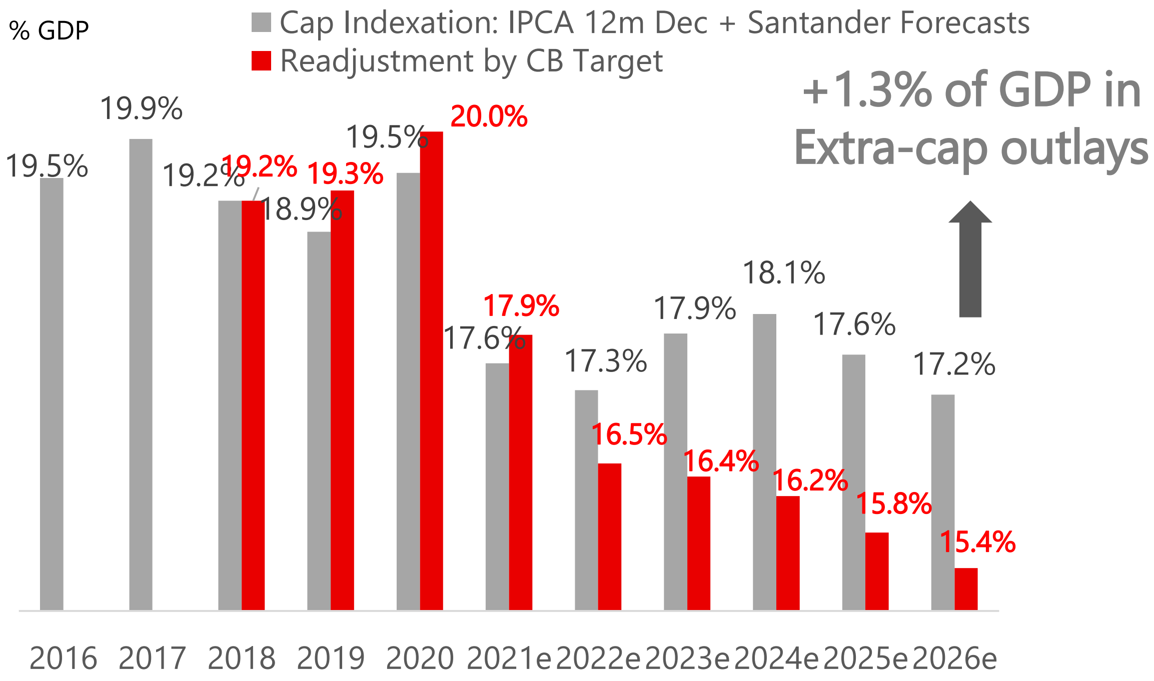
- We believe that the main fiscal anchor lost part of its anchoring power. We calculated close to BRL840 billion in expenditures, compared to the scenario that the spending cap rule is readjusted by the inflation target.
- Recent revision added more 0.5pp in the expenditure in 2026.
- The increase in the spending cap max limit for 2023 dropped by BRL26.9 billion (due to our reduction in IPCA numbers to 7.9%, from 9.5%)

Spending Cap Max. Total Limit



Sources: BCB, National Treasury, Santander

Change in the index of Spending Cap Rule

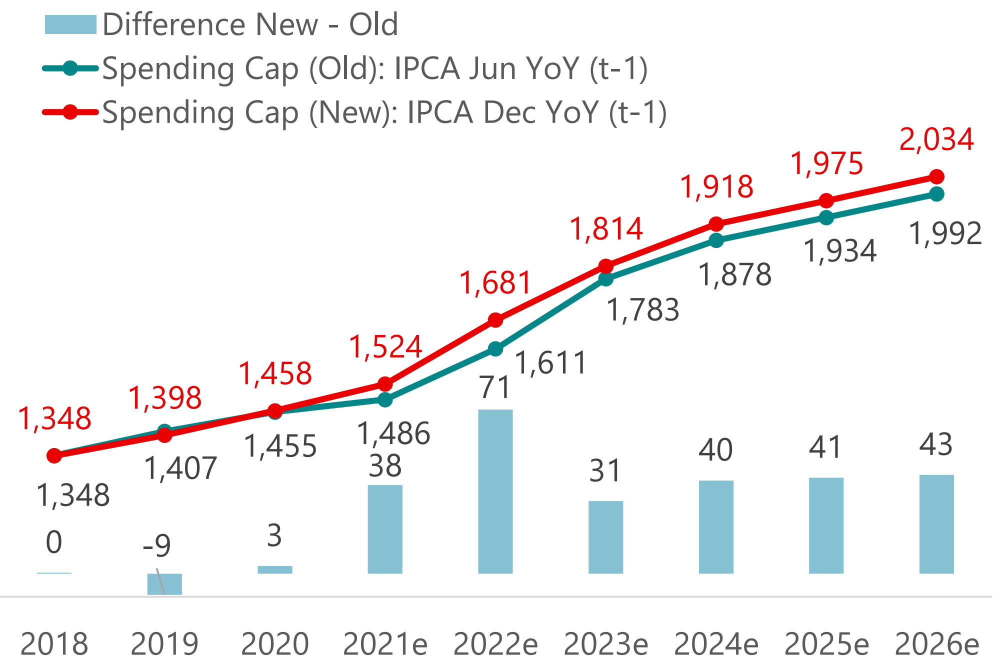


Sources: National Treasury, Santander

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

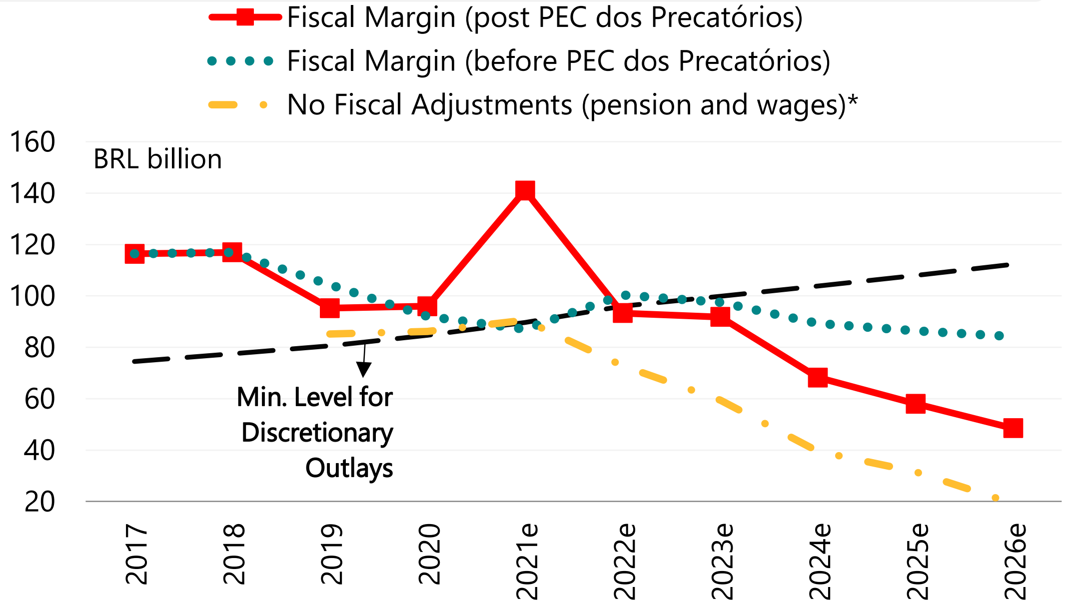
- PEC *dos Precatórios* created a margin of BRL113 billion in the spending cap rule (BRL46 billion through court-ordered debt cap + BRL67 billion by changing the spending cap indexation rule).
- Comparing to June scenario we see now an average of BRL20 billion per year in extra expenditure due to the indexation change in the fiscal rule

Change in the index of Spending Cap Rule



Sources: Ministry of Economy, IBGE, Santander

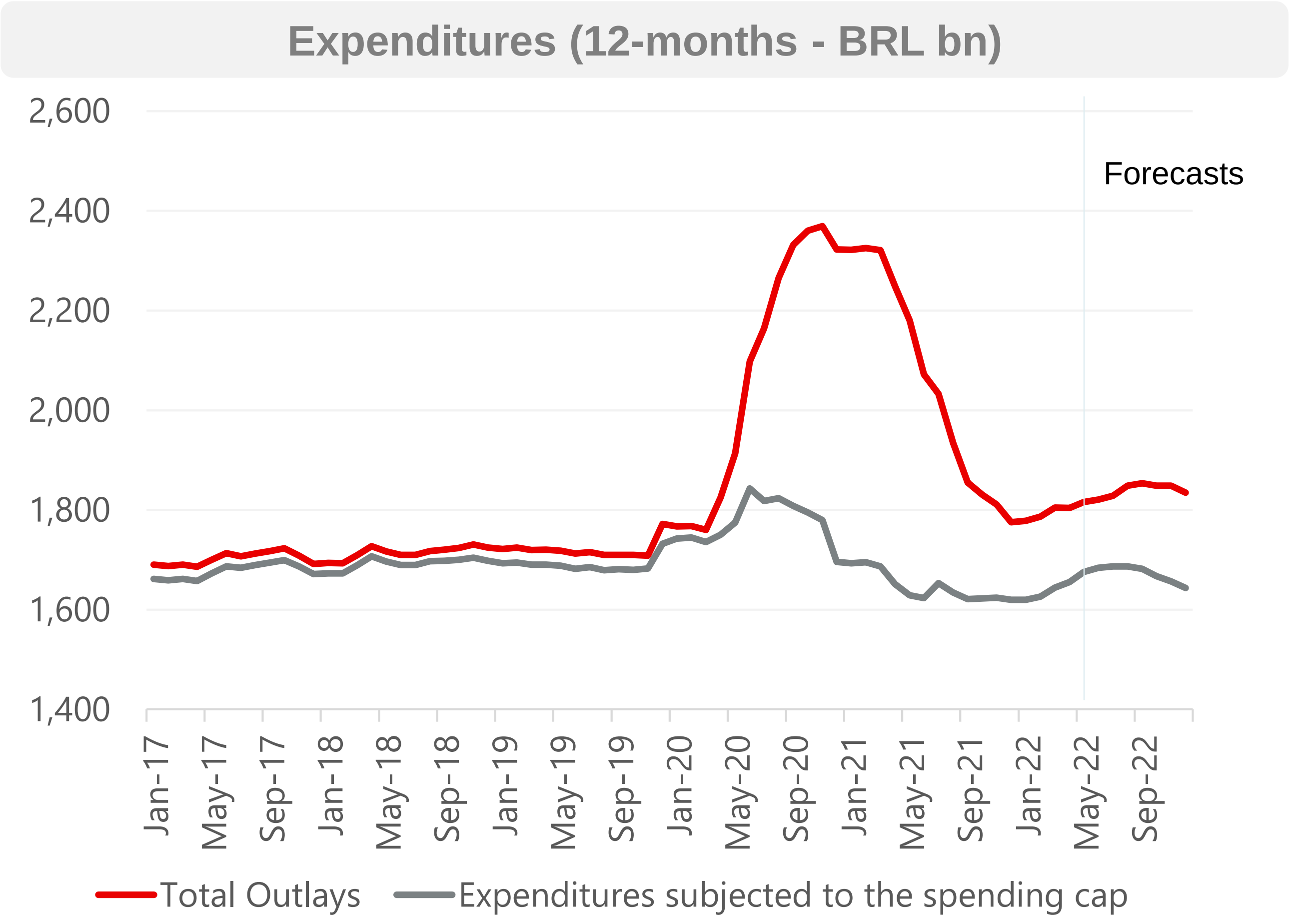
Fiscal Margin – BRL billion



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

Increase in the expenditures not subjected to the spending cap rule

- For a third year running, we have seen a constitutional amendment to increase fiscal stimulus outside the constitutional spending cap limit (for which we currently see no fiscal margin for additional outlays). This legislation would entail BRL42 billion in government spending outside the spending cap, up from an original estimate of BRL35 billion.



Sources: National Treasury, Santander.

Court-ordered Debt – *Precatórios* on the rise

03

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

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

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

Sources: National Treasury, Ministry of Economy, Santander

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

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

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

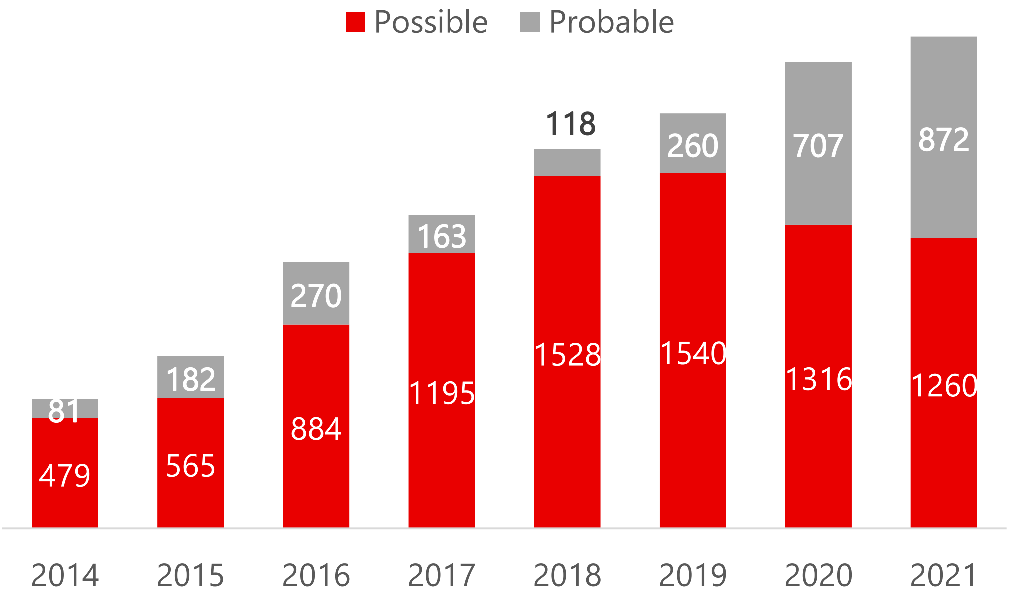
Judicial Claims Increase – BRL billion

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

Sources: National Treasury, MCM, Santander

LDO Judicial Claims: Probable and Possible Risk

BRL Billion | Nominal values



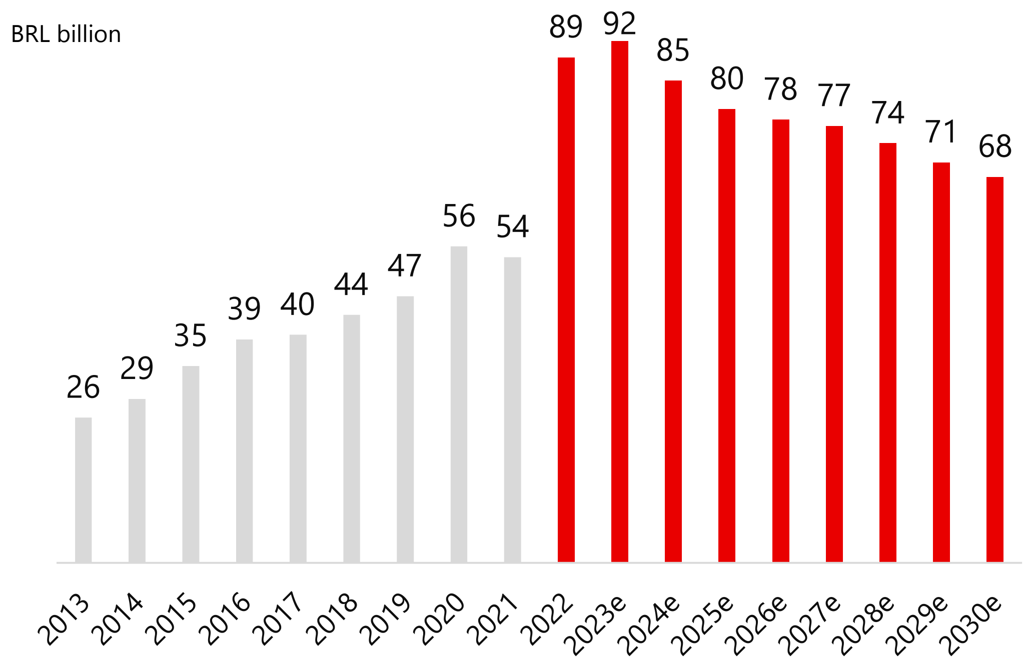
Sources: AGU, LDO 2020, Santander.

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

We estimate an increase in judicial claims over the next years

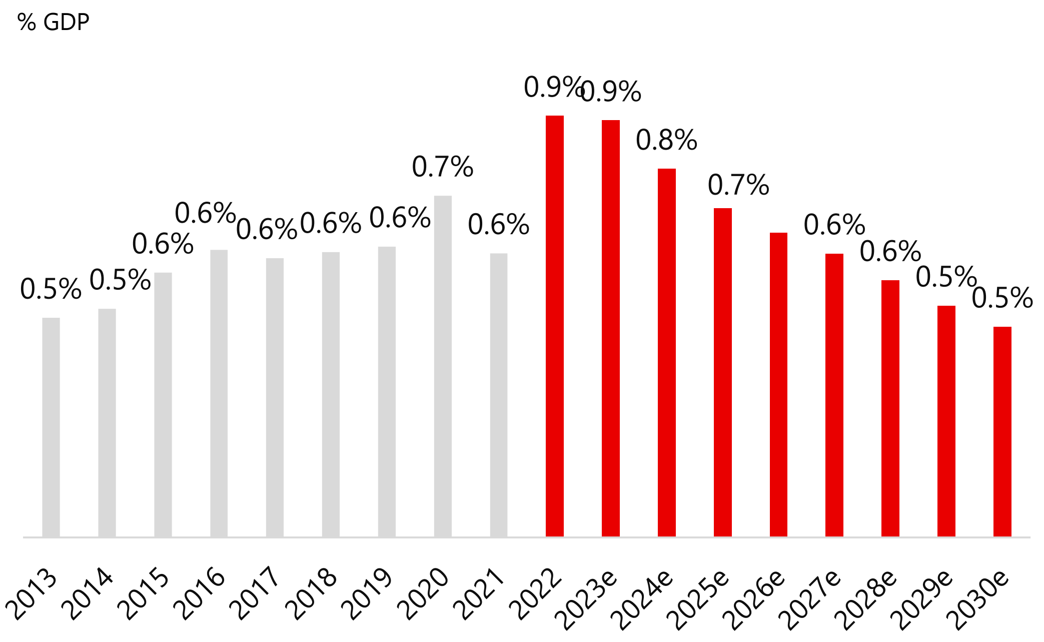
- We constructed a forecast based on the Budget Guidelines (LDO) probable judicial claim for next the years. In the short-run we see more pressure from the Fundef (educational fund) and those related to pension payments.
- Our preliminary estimate is only a preliminary "educated-guess" in view of the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

Our Preliminary Estimates for judicial claims budget



Sources: LDO 2023, Santander

Judicial claims estimates



Sources: LDO 2023, Santander

Based on the PLDO 2023

National Treasury estimates

- The National Treasury unveiled a report to explain the judicial claims payments for 2022,
- There is a risk of accumulating this expenditures over time, and with the increase in Selic rate this amount could be even higher.

Estimated Payments - Judicial Claims 2022

	Value BRL bn
Limit for payment of Judical Claims	19.9
RPVs	24.4
Other Sentences - Considered in the Expenditure Ceiling	2.7
Recomposition of canceled court documents - Law 13,463/17	0.5
Monetary Update of the claims to be paid with the limit	2.4
Claims in installments (with correction) - art. 100, §20, ADCT	4.2
Fundef judicial claims (rule 40% + 30% + 30%)	7.9
Total	**62.0**

Estimated without *"Encontro de Contas"* (debt cancelations)

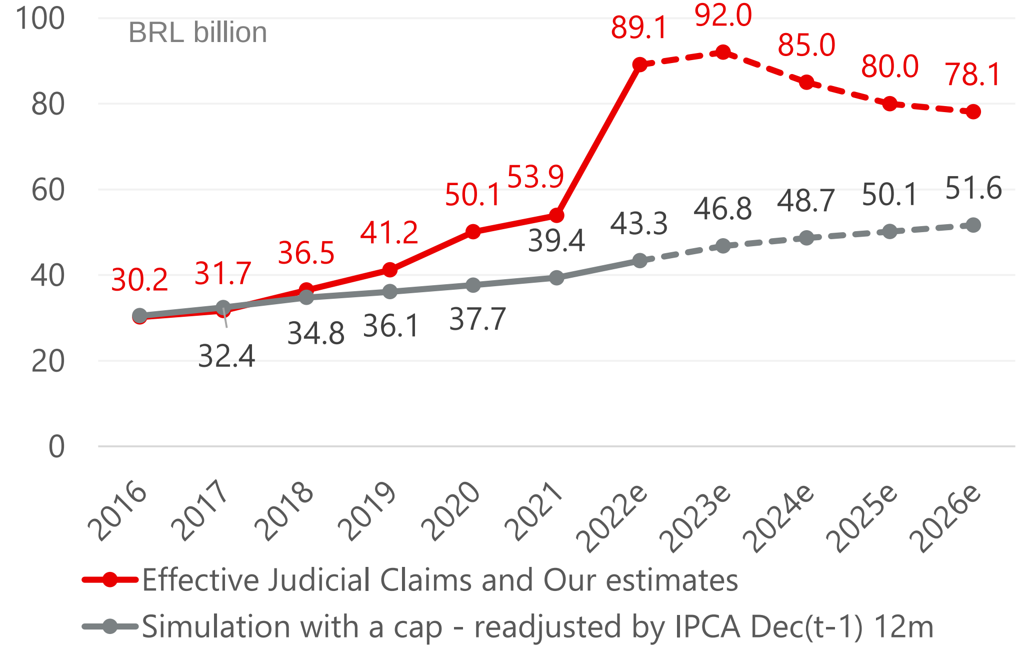
Item	2022	2023
Expected Judicial Claims	89.1	92.1
Subcap (PEC Precatórios)	40.5	43.1
Payments in the year	62.0	61.6
Precatórios unpaid (accumulated)	22.9	57.6

Sources: National Treasury, Santander

Simulation – effects of creating a cap for the payment

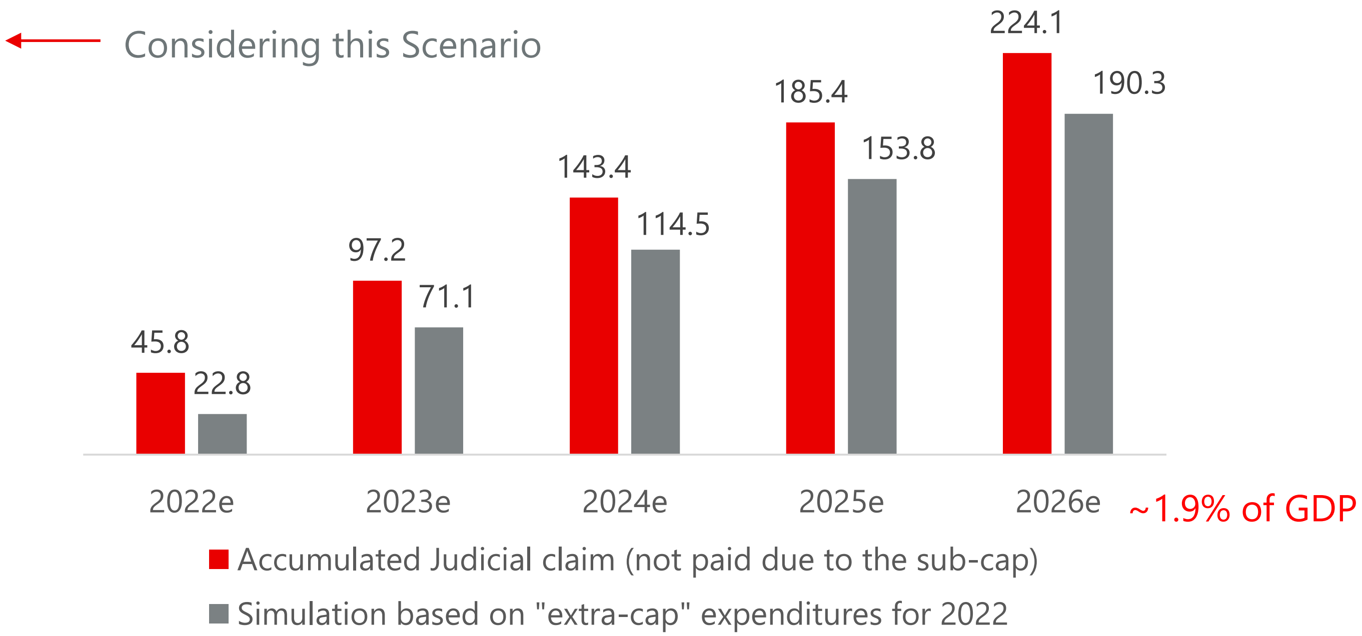
- In order to reduce the judicial claims payments, the government proposed to create a ceiling for these liabilities and postponing the remaining for the next few years (or paying outside the spending cap limit).
- Creating a cap since 2016 would reduce the judicial claim payments in 2022 to close to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

Simulation - A limit for Judicial Claims payments



Sources: National Treasury, BCB and Santander.

Simulation with a cap – Accumulated judicial claims



Sources National Treasury, BCB and Santander.

Fiscal Baseline Scenario – Primary Result and Simulations

04

Legislations - Summary of the Impact of the Proposals

- . We believe that the total impact, if all the measures are approved, would be BRL129 billion (1.3% of GDP) in full-year. For 2022, we included BRL65 billion impact of the legislation to cap the ICMS tax (VAT). There is still uncertainty in the overall impact and its effects, especially 2023 onwards. We believe that the impact on states accounts will be massive in 2023 without measures to compensate the impact, for this year the states can accommodate, in our view. The constitutional amendment (*PEC Auxílios*) will be limited to 2022, totaling BRL42 billion (0.4% of GDP) of impact. We added part of the increase in *Auxílio* Brasil for next year (from BRL89 billion to BRL120 billion).

Complementary Law – ICMS cap on Essential Goods

Fiscal Impact of Measures				
	2022		Full-Year	
	BRL bn	% GDP	BRL bn	% GDP
LC194 ICMS Cap (Impact)	65	0.7%	129	1.3%
1. Fuels ICMS Cap 17-18%	20	0.2%	40	0.4%
Gasoline	14	0.1%	28	0.3%
Diesel	5	0.1%	10	0.1%
Ethanol	1	0.0%	2	0.0%
2. Telecom cap	5	0.1%	10	0.1%
3. Eletricity	20	0.2%	40	0.4%
ICMS cap to 17-18%	5	0.1%	10	0.1%
Changing the ICMS base (TUSD/TUST)	15	0.2%	30	0.3%
4. Zeroing PIS-Cofins and CIDE Gasoline**	16	0.2%	32	0.3%
5. Zeroing PIS/Cofins Ethanol**	3.5	0.0%	7	0.1%
Total Impact	65	0.7%	129	1.3%

** Tax breack for the Federal Gov. (without compliance to Fiscal Resp. Law)

Sources: National Congress, Santander.

PEC *Auxílios* – Fiscal Stimulus

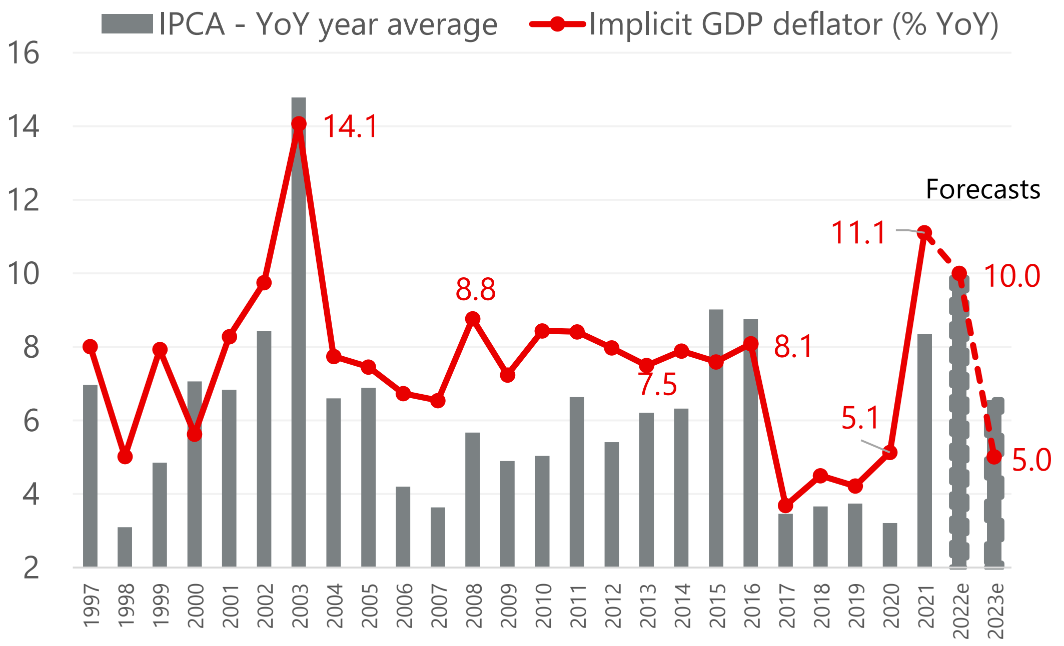
Expenditures	BRL billion	%GDP
Double Auxilio Gas Budget	2	0.0%
Transport for eldery (subsidy)	2.5	0.0%
Truckers voucher (1k benefit)	5.4	0.1%
Taxi Drivers voucher and Alimenta Brasil	2.5	0.0%
Ethanol (subsidy)	3.8	0.0%
Complement to Auxilio Brasil (BRL600) 2022	26	0.3%
Total	42.2	0.4%

Sources: National Congress, Santander.

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

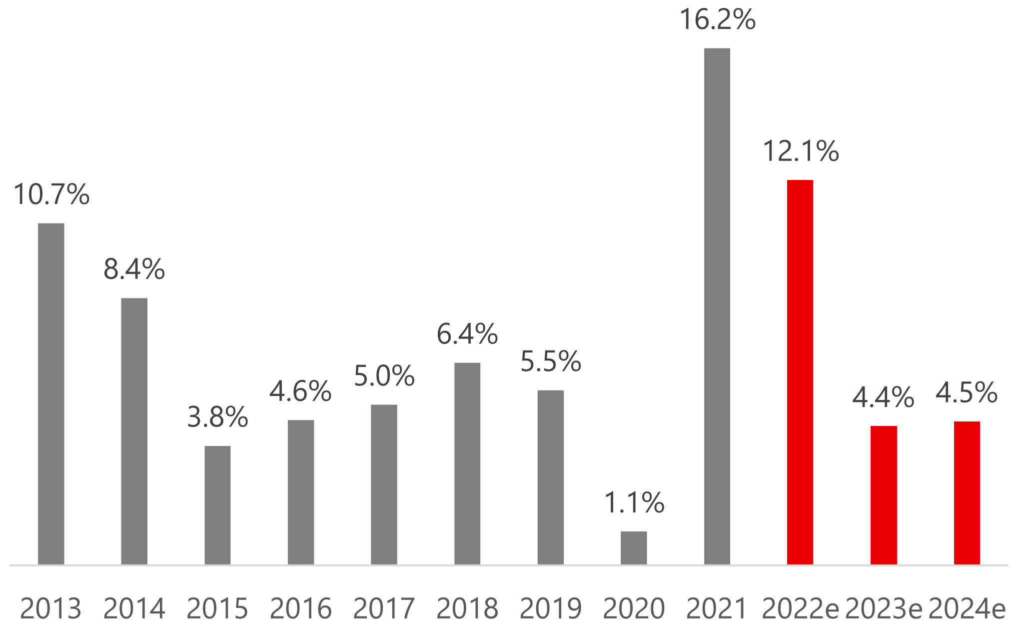
- Inflation played a significant role in improving public accounts in the short run. For 2021, in Mar-21 we estimated nominal GDP at 7%, but it ended the year with a 16.2% increase. The effect of the massive increase in the GDP deflator affected the fiscal-statistics-to-GDP ratio. For 2022, we also revised upwards due to a more intense inflationary shock, we rose the estimate for 2022 GDP deflator from 9.5% to 10%. As a consequence the nominal GDP should rise 12.1%, according to our numbers.

IPCA and GDP Deflator



Sources: IBGE, Santander.

Nominal GDP Increase YoY

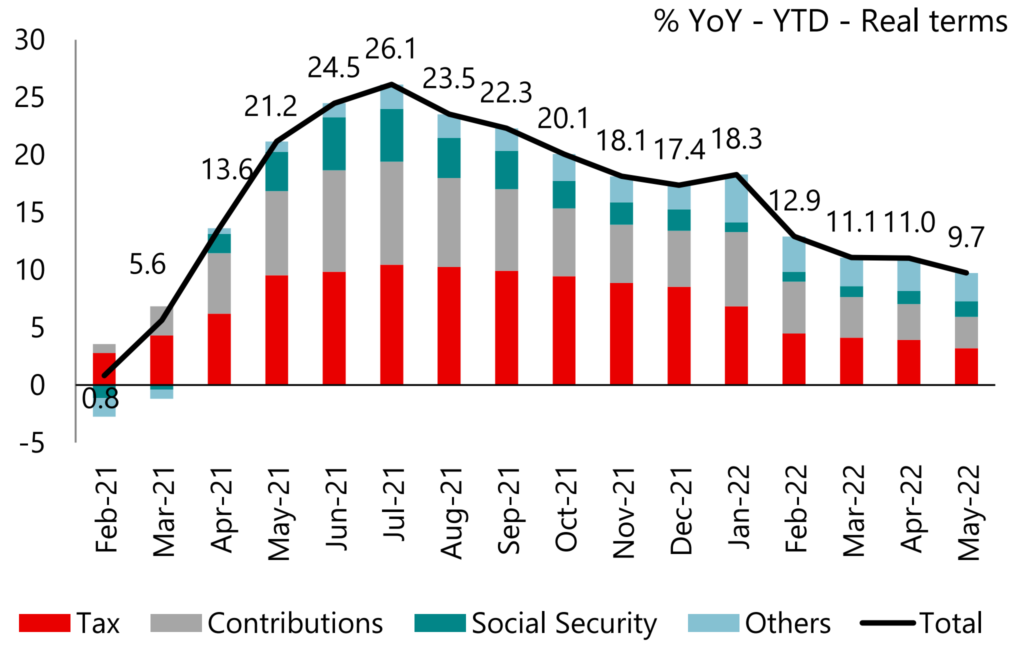


Sources: IBGE, FGV, Santander.

Revenues Impact – Price Effect + Activity Recovery

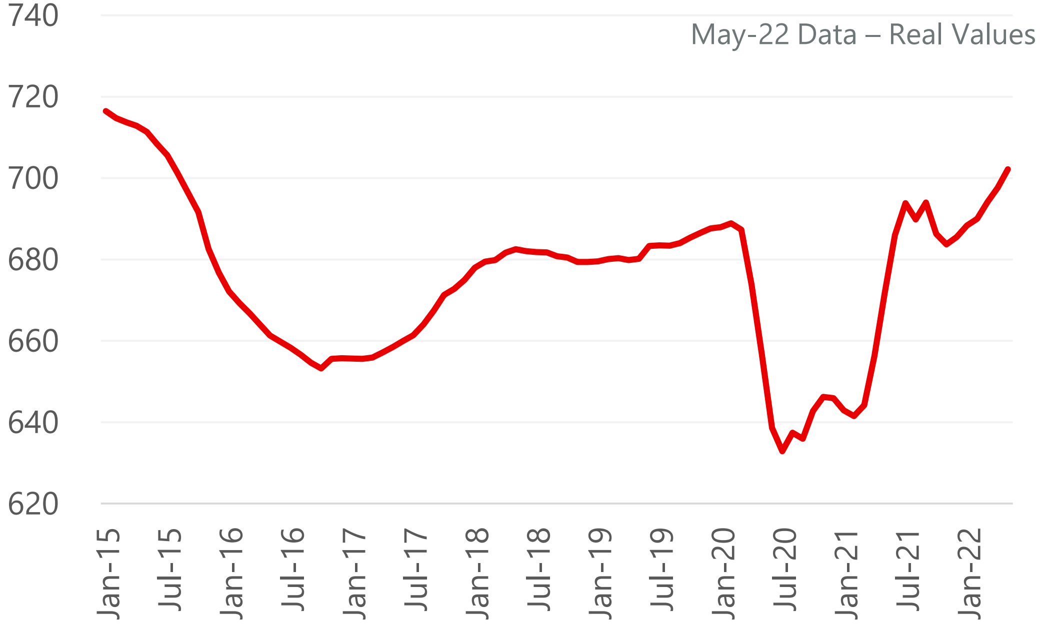
- We see a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the corporate sector, which have posted good results. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to metals.
- In our view, we expect revenue growth to slow down in 2H22 (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; v) Oil prices impulse with Russian-Ukraine conflict

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



Sources: Brazilian IRS, Santander.

Tax Revenue linked to the Labor Market (12m bn)

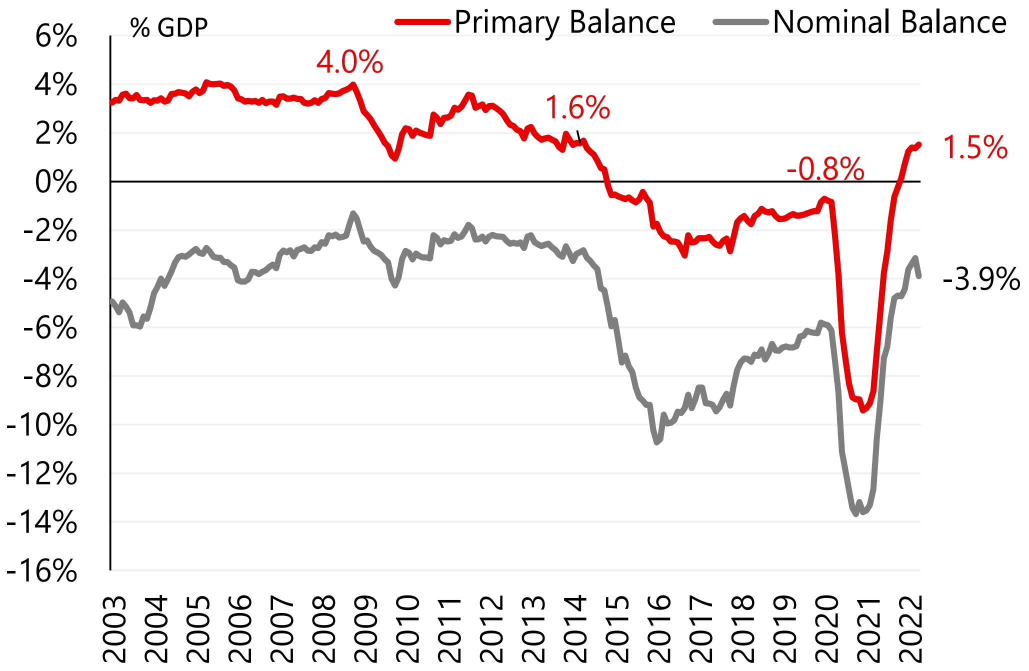


Sources: Brazilian IRS, Santander.

Public Sector Primary Result Improving with the Price-effect

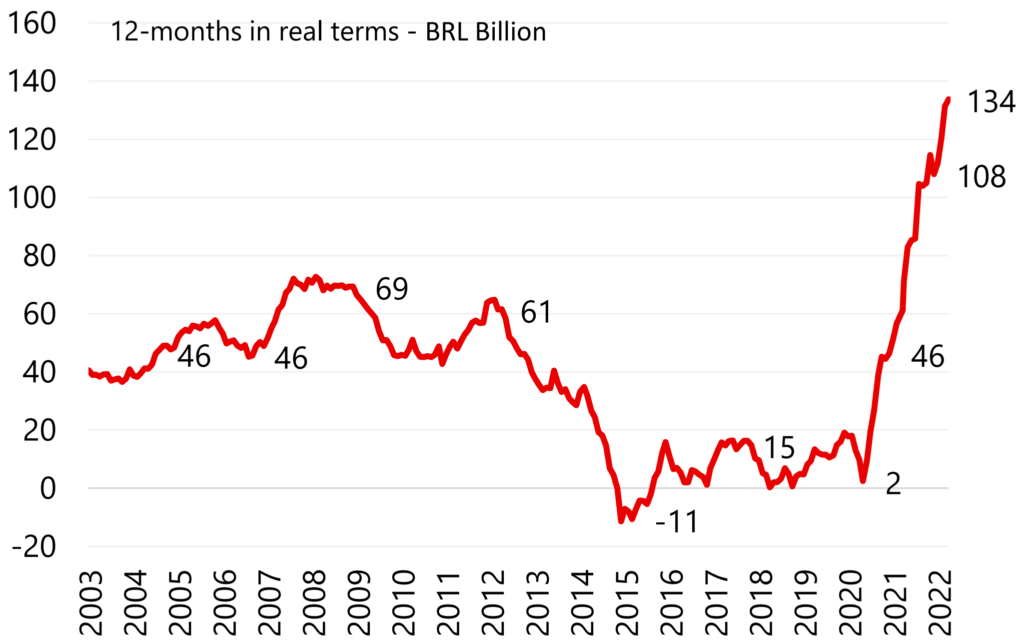
- According to BCB data published today, the consolidated public sector posted a hefty primary surplus of BRL38.9 billion in April, close to our forecast (BRL40 billion) and better than the market's median estimate (BRL30.1 billion). This was the best result for the month in the historical series. In 12 months, the public sector reached a primary surplus of BRL137.4 billion (1.5% of GDP), compared to BRL122.8 billion (1.4% of GDP) in March and BRL64.7 billion (0.75% of GDP) in December 2021.

Public Sector – 12m % GDP



Sources: Brazilian Central Bank, Santander.

Regional Gov. – Primary Result

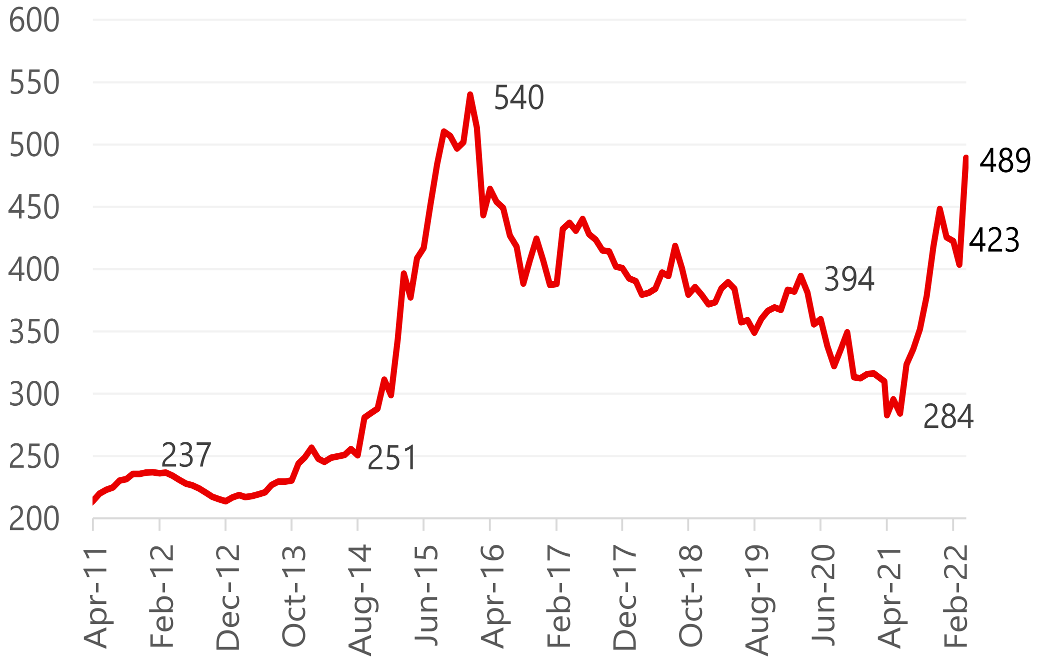


Sources: Brazilian Central Bank, Santander.

Public Sector Primary Result Improving with the Price-effect

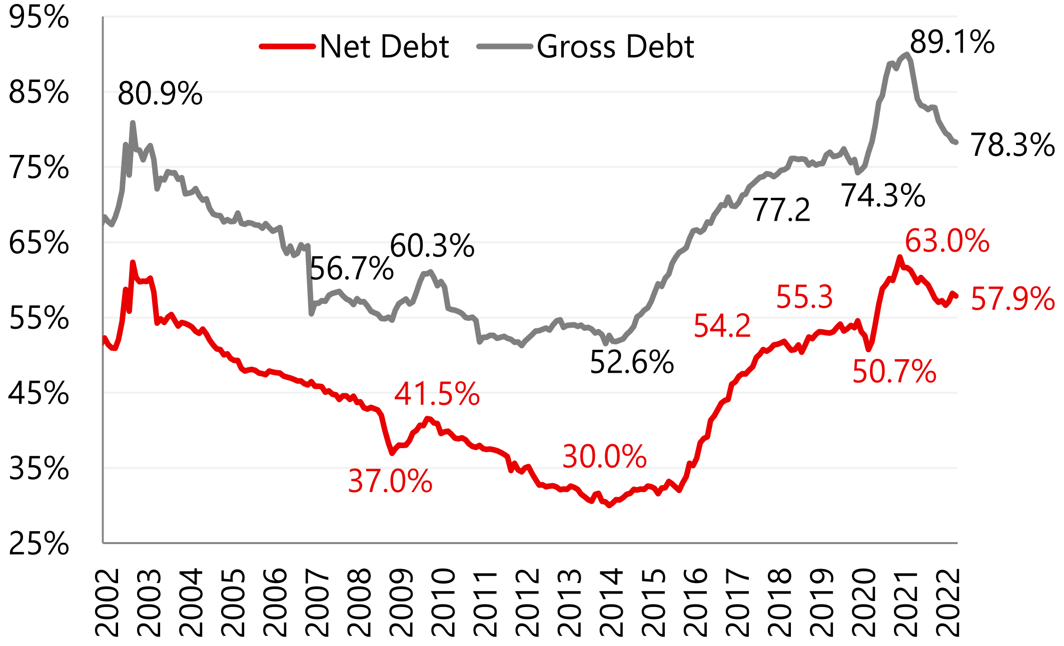
- In April, interest payments soared and reached BRL79.9 billion, compared to -BRL5.7 billion in April 2021. The result of FX swap operations in the period contributed to this result (loss of BRL15.4 billion in the month compared to a gain of BRL30.4 billion in April 2021). It was the first month of the year in which the result was lower than last year. In the 12-month reading, the nominal budget balance reached BRL352 billion (3.9% of GDP), compared with BRL383 billion (4.4% of GDP) in December 2021.

Nominal Interest Result – BRL billion



Sources: Brazilian Central Bank, Santander.

Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

Fiscal – Short-term relief with price shock, challenges ahead

Central Government's Primary Balance															
Fiscal Items (% of GDP)	2018	2019	2020	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	∆ 26-17	∆ 30-17
Total Revenue	21.2	22.1	19.7	22.3	22.6	22.0	22.3	22.4	22.5	22.6	22.6	22.6	22.6	1.5	1.6
Revenues Collected by the IRS (1)	12.9	12.8	12.0	13.8	13.4	12.8	12.8	12.9	12.9	12.9	12.9	12.9	12.9	0.2	0.2
Net Social Security Revenues (2)	5.6	5.6	5.4	5.3	5.6	5.5	5.6	5.6	5.7	5.7	5.7	5.7	5.7	0.0	0.1
Revenues Not Collected by the IRS (3)	2.7	3.7	2.2	3.2	3.7	3.7	3.9	3.9	3.9	3.9	4.0	4.0	4.0	1.3	1.3
Transfers by Revenue Sharing	3.7	3.9	3.5	4.0	4.6	4.3	4.2	4.2	4.2	4.2	4.2	4.1	4.1	0.8	0.6
Net Revenue	17.6	18.2	16.1	18.2	18.0	17.7	18.1	18.2	18.3	18.4	18.5	18.5	18.6	0.7	1.0
Total Expenditure	19.3	19.5	26.1	18.6	18.7	18.8	19.1	18.9	18.5	18.4	18.2	17.9	17.7	-0.9	-1.7
Social Security Benefits (4)	8.4	8.5	8.9	8.2	8.1	8.4	8.5	8.5	8.5	8.5	8.4	8.3	8.2	0.0	-0.2
Payroll (5)	4.3	4.2	4.3	3.8	3.5	3.5	3.6	3.5	3.5	3.5	3.5	3.4	3.4	-0.8	-0.9
Other Mandatory Expenses (6)	2.9	2.6	9.6	3.5	3.5	3.4	3.6	3.5	3.4	3.3	3.3	3.2	3.1	0.4	0.1
Expenses with Cash Control (7)	2.0	1.9	1.8	1.7	2.1	2.3	2.2	2.1	2.0	2.0	1.9	1.9	1.8	0.1	-0.1
Discretionary Expenses (8)	1.8	2.2	1.4	1.4	1.5	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.1	-0.6	-0.6
Central Gov. Primary Balance	-1.7	-1.3	-10.0	-0.4	-0.7	-1.2	-1.0	-0.6	-0.2	0.0	0.3	0.6	0.9	1.7	2.8
Public Sector Primary Balance	-1.5	-0.8	-9.4	0.7	-0.2	-1.2	-1.0	-0.6	-0.2	0.0	0.3	0.6	0.9	1.5	2.6
Nominal GDP (BRL billion)	7,004	7,389	7,468	8,679	9,729	10,154	10,613	11,192	11,803	12,484	13,231	14,021	14,860	5,218	8,274

*IRS - Brazilian Internal Revenue Service

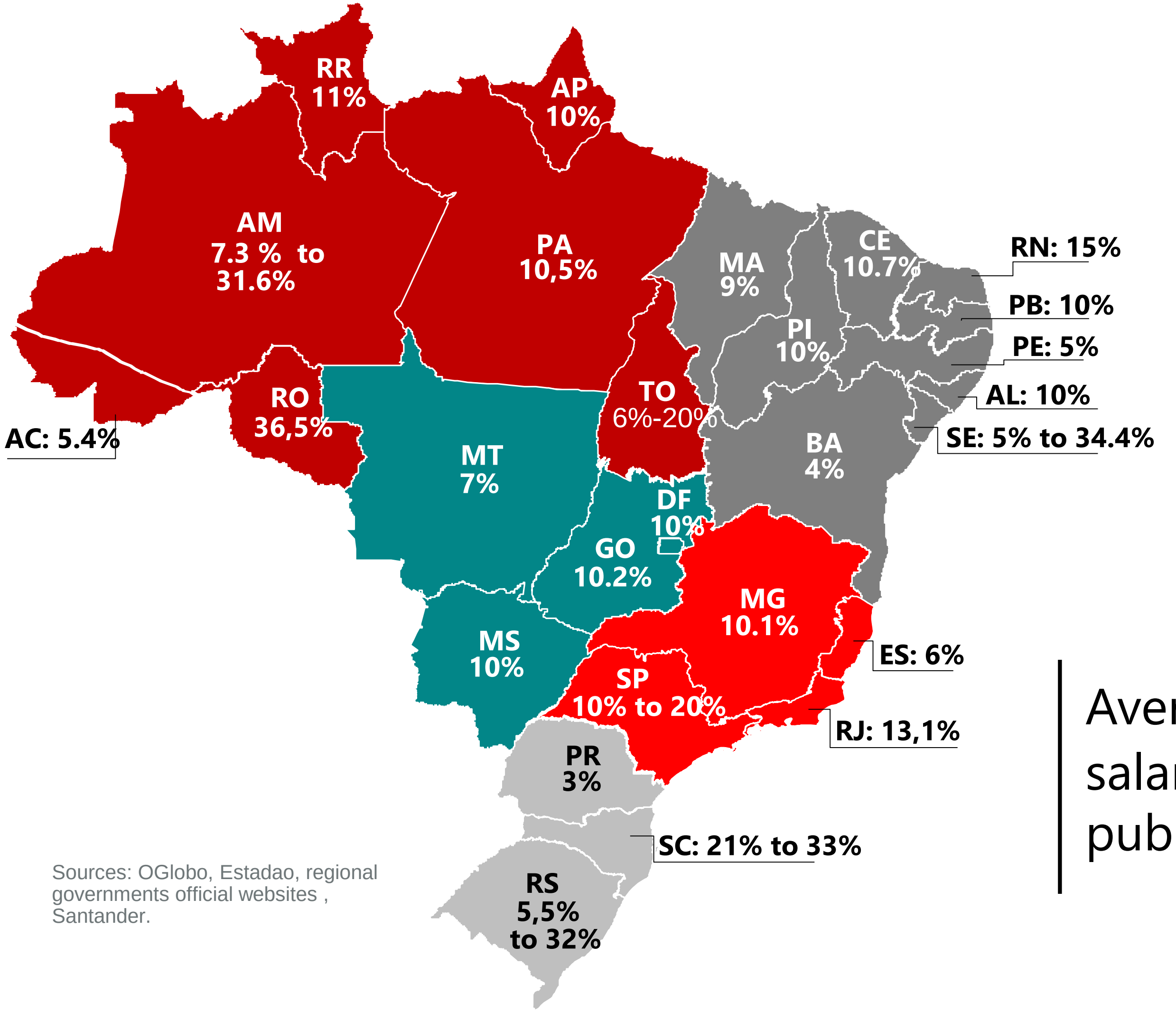
Notes and Hypothesis

(1) Elasticity: Revenues-GDP 2021: 1.7 | 2022: 1.2 | Long-term: 1.06. We see a slowdown in extraordinary revenues from 2023 onwards. Potential GDP: 1.5% (until 2026), 2.0% (after 2026). Inflation: Center target (3.0%), GDP deflator (3.9%).
(2) Faster recovery in the formal labor market and earnings (better short-term numbers).
(3) Oil revenues will increase with greater federal share in pre-salt, the reduction in prices in medium-term will be compensated with more production. We see more revenues from Concessions.
(4) Pension Reform approved in 2019 will stabilize the expenditures as % of GDP in the long-term (even with the rapid aging of the population). In the short-run we eliminate the queue (repressed by the pandemic).
(5) Gradual increase in admissions (faster than the previous scenario, 70% instead of 55%) to the federal workforce ("normalization"). In the short-term (2024-25) decomposition of 80%, We included the 5% increase in mid-2023, after that is decreasing gradually to 2% in Medium-term. Long-term: digitalization effects contain the increase.
(6) Includes: higher payments in Court-ordered debt budget (including in the fiscal rule) – better management with a reduction in long-term, rise in federal contribution to Fundeb (Educational Fund), BPC (pension benefit).
(7) The main change was the increase in the new welfare program (*Auxílio Brasil*). 2022 budget: BRL90 billion (from BRL35 bn of the former Bolsa Família program). For 2023 onwards a more efficient and focalized welfare program (gradual reduction in outlays), yet with an increase to BRL120 billion (maintaining part of the temporary increase of PEC1/22)
(8) Discretionary Expenses maintained close to 1.1% - a level that we consider enough to avoid a partial shutdown of public services, with and increase in investment with the reforms.
(9) Not consider an increase in Tax exemption from 2022 onwards.

Fiscal Risks – Inflationary measures would represent higher expenditures ahead

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

Regional governments wages increase by states in 2022



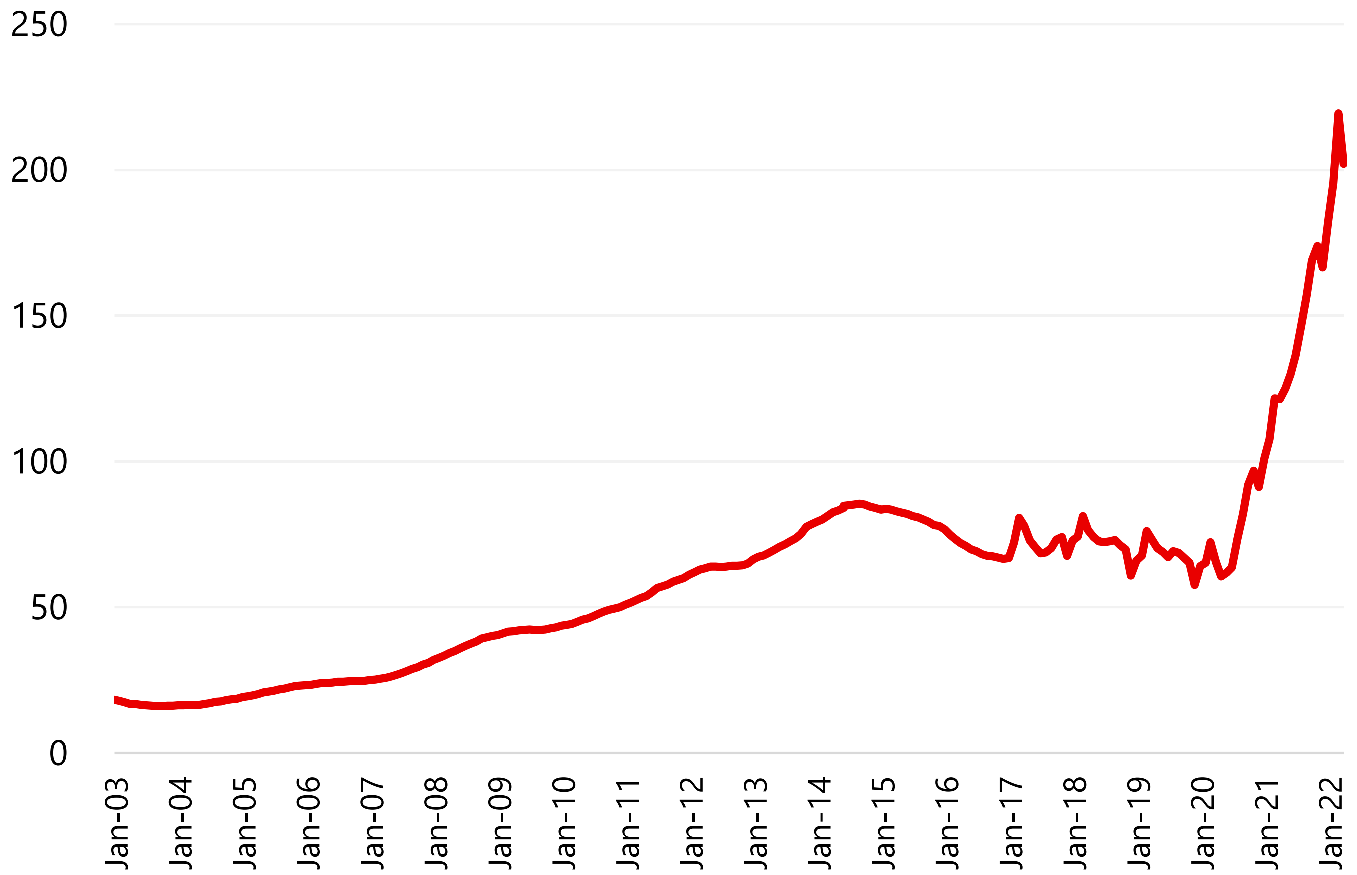
Sources: OGlobo, Estadao, regional governments official websites , Santander.

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

States and municipalities liquidity reserve

- Despite the high growth in the cash availability of states and municipalities, we believe that a good part is linked to some type of expense and especially pension funds (many states approved Pension Reforms – increasing the contribution). In our view, this level helps in the 2022 exemptions, but for 2023 onwards the situation could be more adverse if there is the full effect of the ICMS state cap (VAT).

Proxy of States and Municipalities liquidity reserve (BRL bn)



Sources: BCB, Santander.

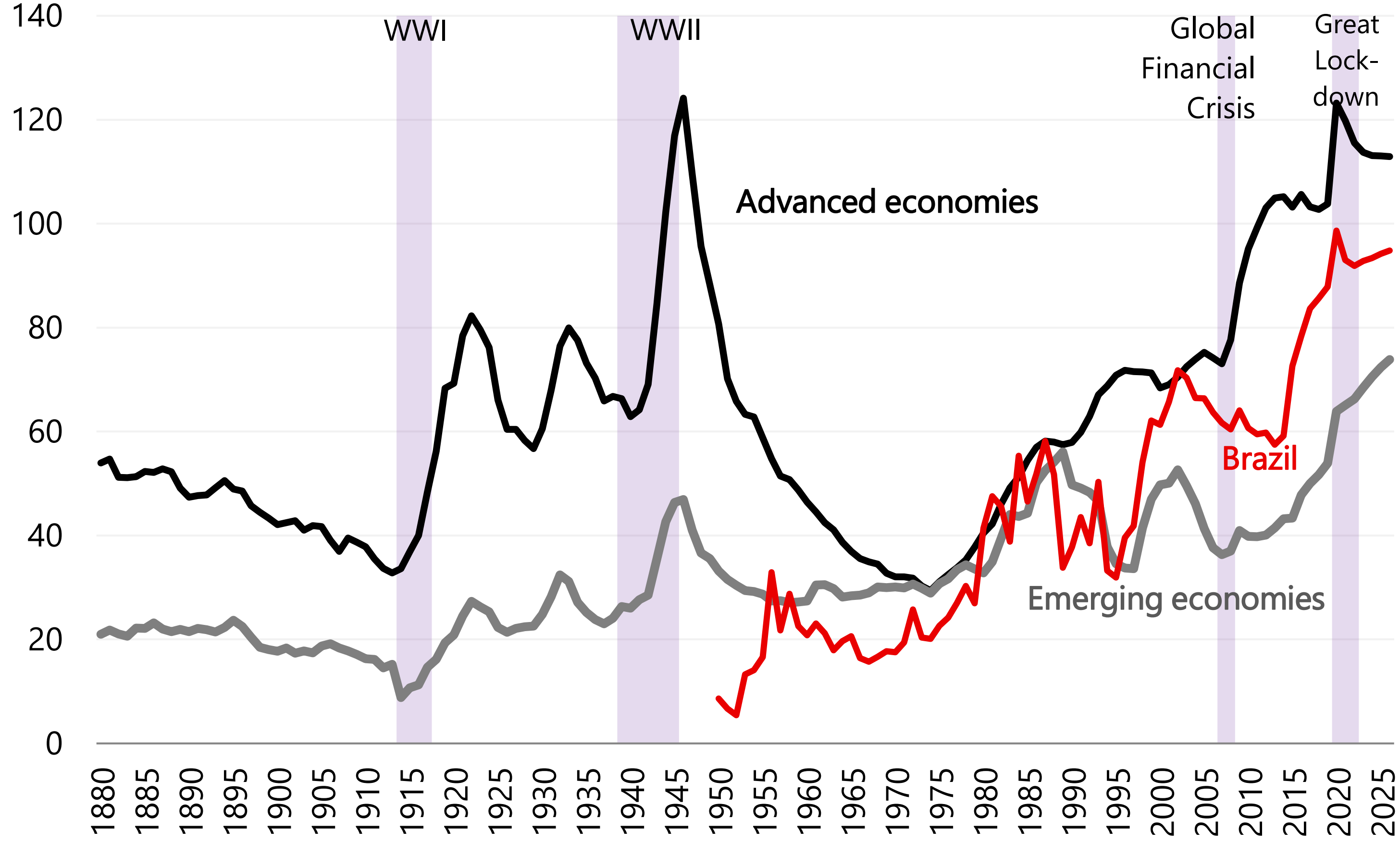
Public Debt Scenario and Simulations

05

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 Accounts: Trajectories for the Brazilian Government Debt

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

Current situation:

. Real interest rate (ex-ante) 1-year: ~8.3%,
. GDP: 1.9% in 2022 and -0.6% in 2023

Liquidity reserves up to 9.5 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% until 2026,

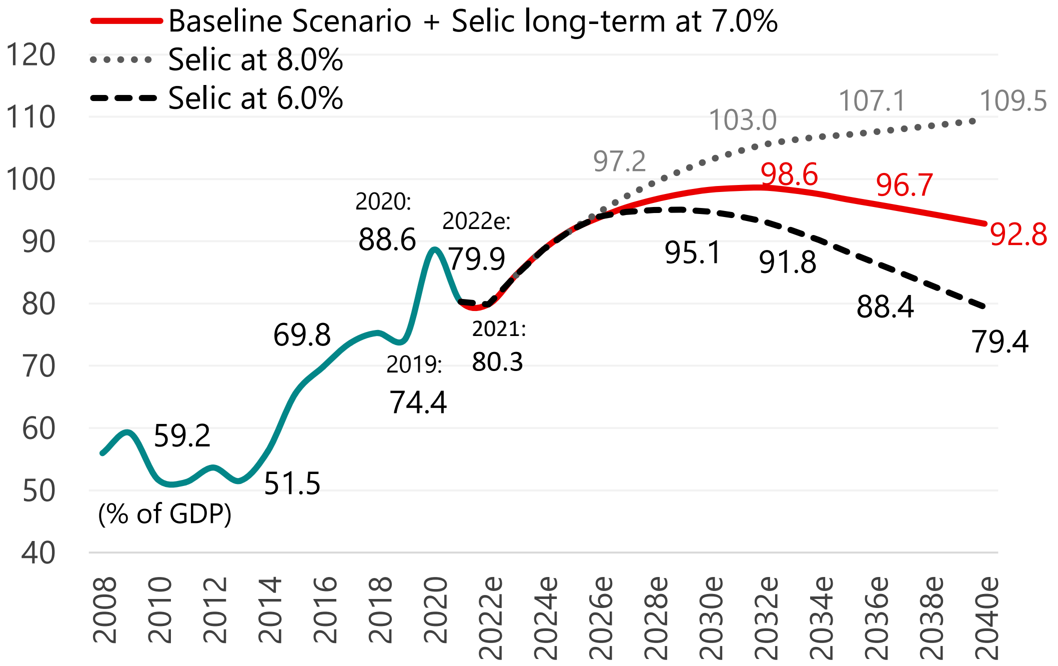
. The primary surplus must reach 1.8-2.2% of GDP to maintain the gross debt stable.

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

Sources: BCB, Santander.

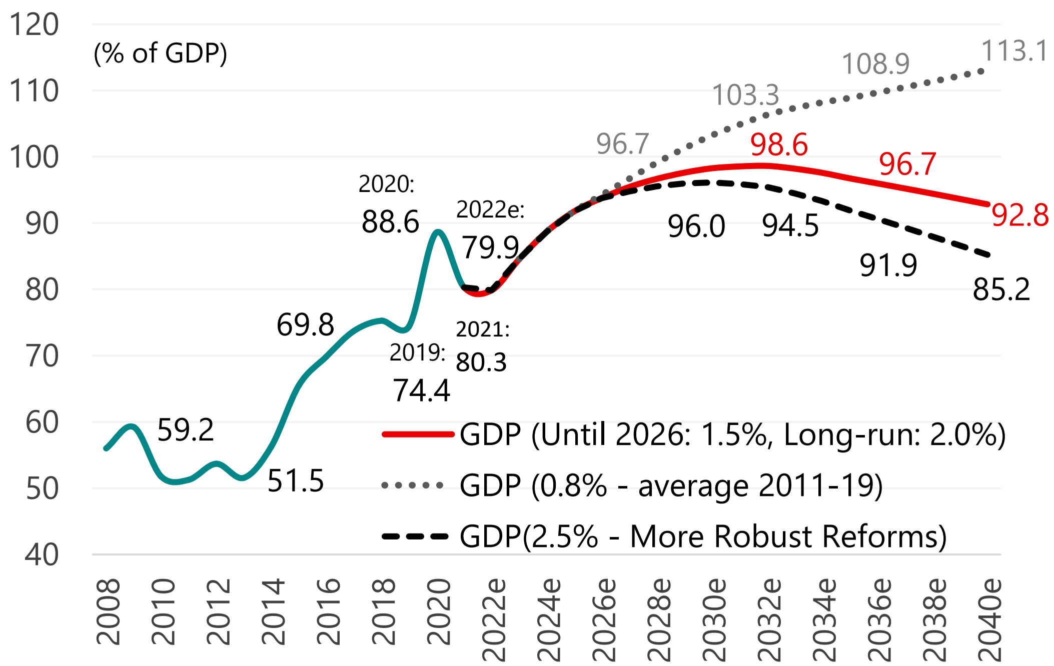
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

Government Debt – Simulations for Selic Rate Hypotheses



Sources: BCB, Santander

Government Debt– Simulating for Trend GDP Hypotheses



Sources: BCB, Santander.

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

PEC Emergencial: Funds (+BRL150 billion for liquidity cushion in 2021 + BRL30 billion in 2022)

2022 GDP Deflator: 10% | GDP: 1.9% | Selic Rate: 14.25%

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

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

06

Annual Borrowing Plan 2022

- The National Treasury released (on January 26) the Annual Borrowing Plan (Portuguese acronym: PAF) for 2022. The total outstanding debt reached ~BRL5.70 trillion in May 2022 and could reach BRL6 trillion this year, according to the fiscal authority's plan. The average maturity is expected to remain close to 4.0 years, according to the PAF. In the debt profile, the National Treasury stated that it intends to increase the floating-rate total relative to fixed-rate bonds.

Annual Borrowing Plan (PAF 2022)

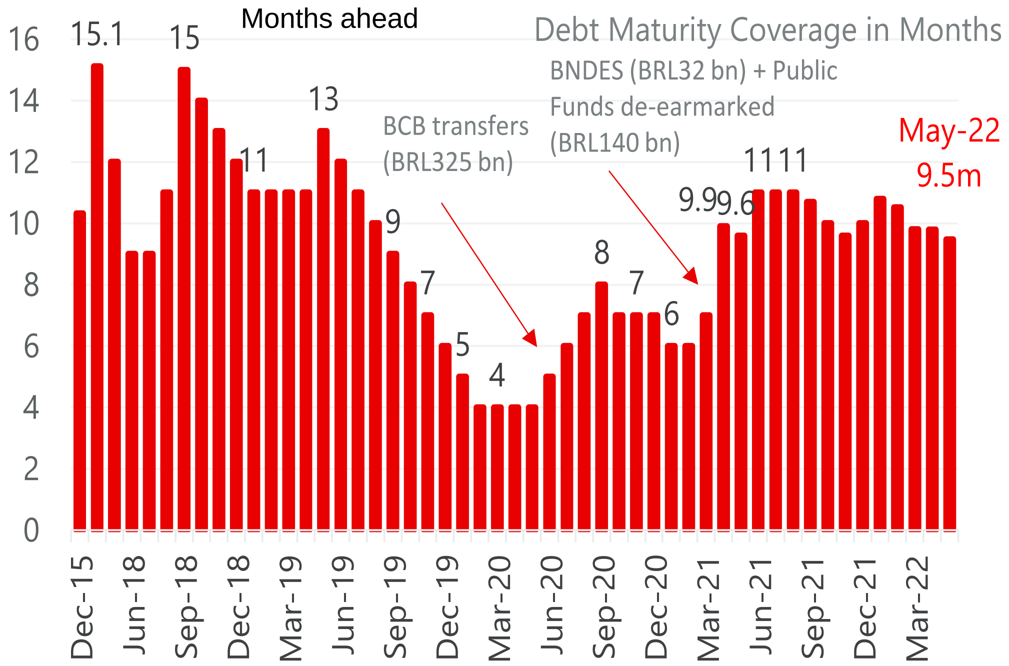
	2020	2021	Apr-22	May-22	PAF 2022 range		PAF 2021 Revised (May21)		PAF 2021 (Jan-21)	
Outstanding volume (BRL billion)					Min	Max	Min	Max	Min	Max
Federal Public Debt	5,010	5,614	5,590	5,702	6,000	6,400	5,500	5,800	5,600	5,900
Composition (%)										
Fixed-rate	34.8	28.9	27.0	27.2	24	28	31	35	38	42
Inflation-linked	25.3	29.3	32.0	31.8	27	31	26	30	24	28
Floating-rate	34.8	36.8	36.7	36.8	38	42	33	37	28	32
FX	5.1	5.0	4.4	4.2	3	7	3	7	3	7
Maturity Structure										
% maturing in 12 months	27.6	21	20.5	23.4	19	23	22	27	24	29
Average maturity (years)	3.6	3.8	4.0	4.0	3.8	4.2	3.4	3.8	3.2	3.6

Sources: National Treasury, Santander.

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

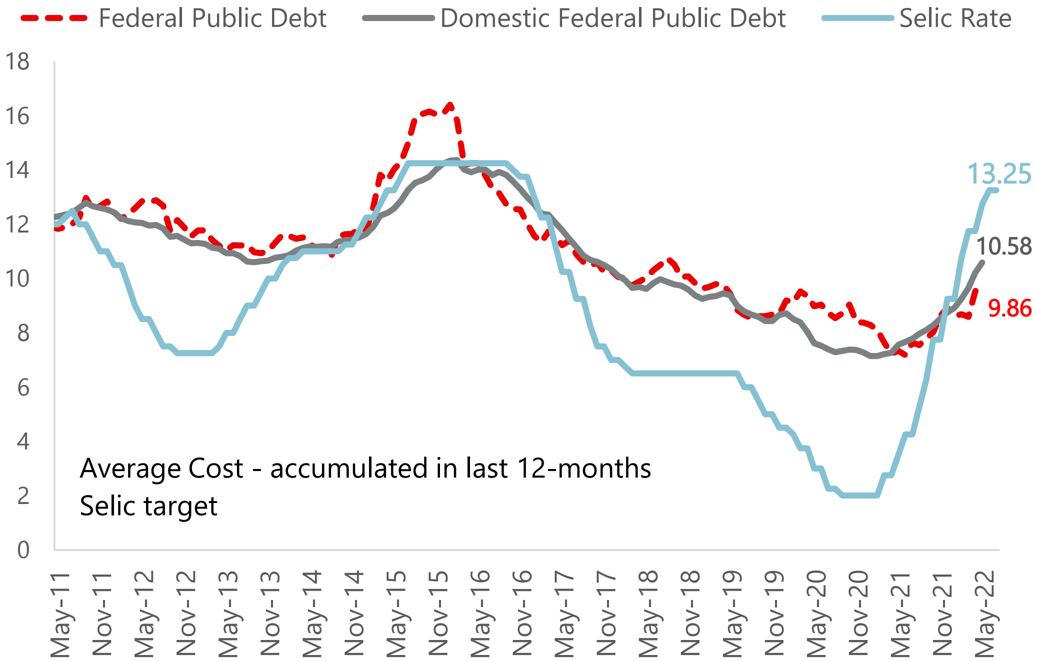
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels.
- The domestic debt cost continued to rise, due to both inflation and Selic increase
- The debt liquidity cushion went up in May compared to April (+BRL71 billion, reaching a total of BRL1,108 billion), reflecting the net issuance in the month. This amount is equivalent to almost 9.5 months of debt maturities.

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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



Sources: National Treasury, Santander.

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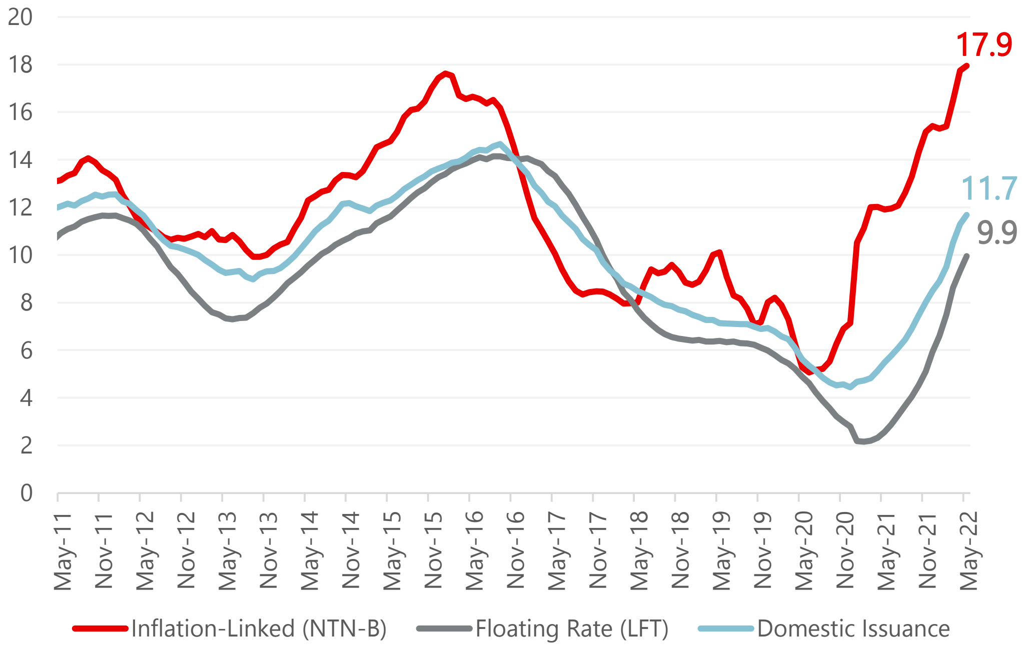
At the margin there is a increase in debt cost related to Selic and Inflation

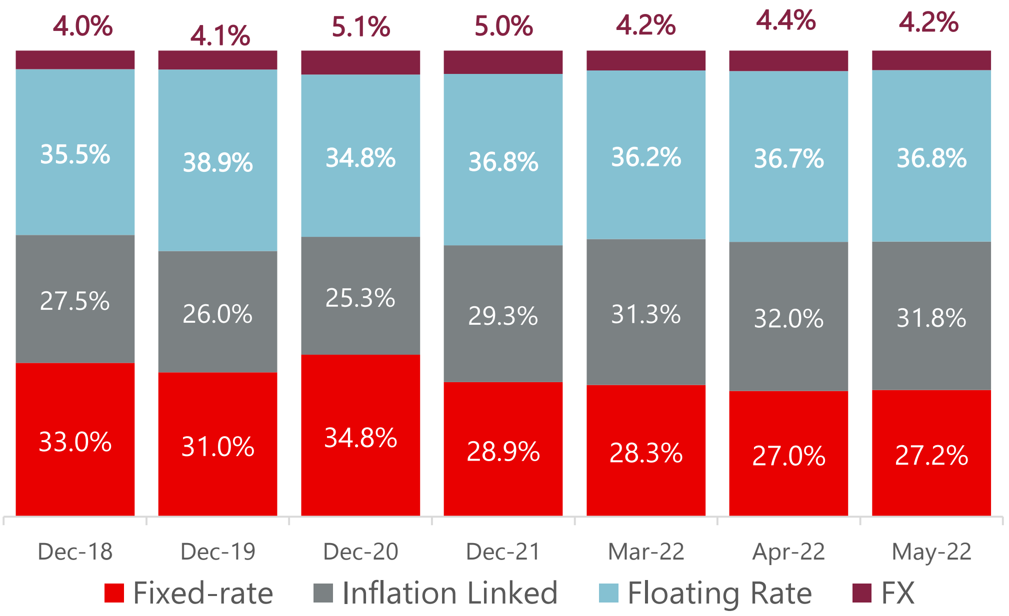
- The cost of domestic new issuances continued to rise (11.7% per year) in the last 12 months, +1.2 pp from March), due to both higher inflation and Selic rate increases. The average cost of the outstanding debt accumulated in 12 months rose to 9.9% (from 8.5% in March). The NTN-B (inflation-linked bonds) cost in the last 12 months reached 17.2% per annum. The cost of LFT (floating rate) in 12 months increased to 8.0% (from 6.5% in March and 4.5% in December 2021), while increases in the Selic rate (currently at 13.25%) could create additional pressure on debt costs in coming months.

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



Sources: National Treasury, Santander.

Debt Profile - %

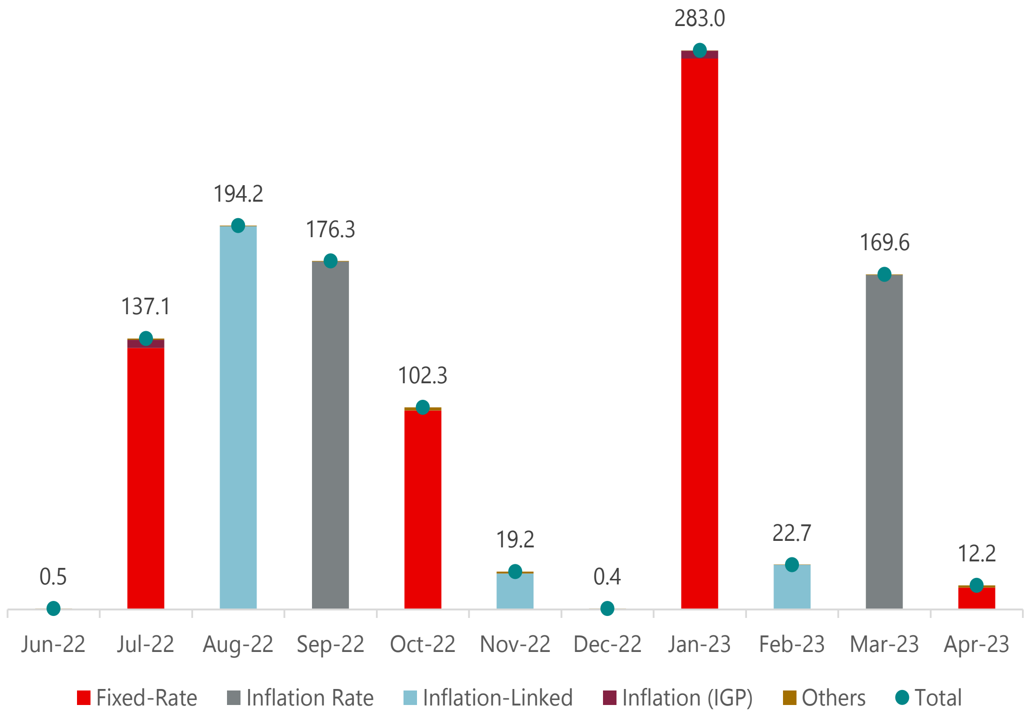


Sources: National Treasury, Santander.

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

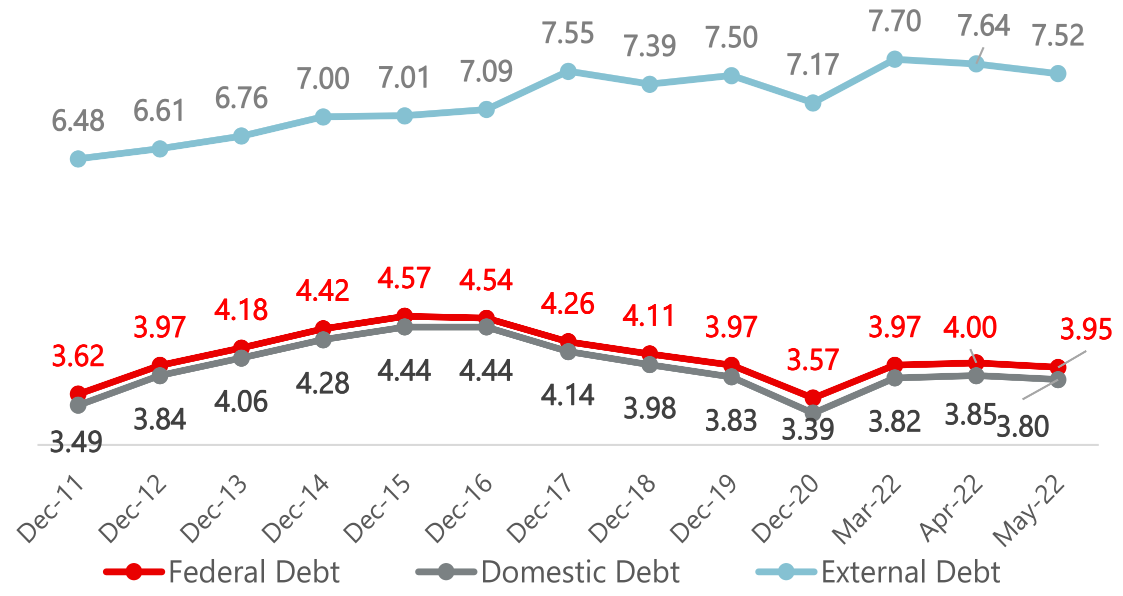
- Despite the increase in liquidity reserves the debt maturity level is still challenging. Structural reforms will help to increase debt maturity and reduce the primary deficit.

Debt maturity - (BRL billion)



Sources: National Treasury, Santander

Average Maturity (years)



Sources: National Treasury, Santander.

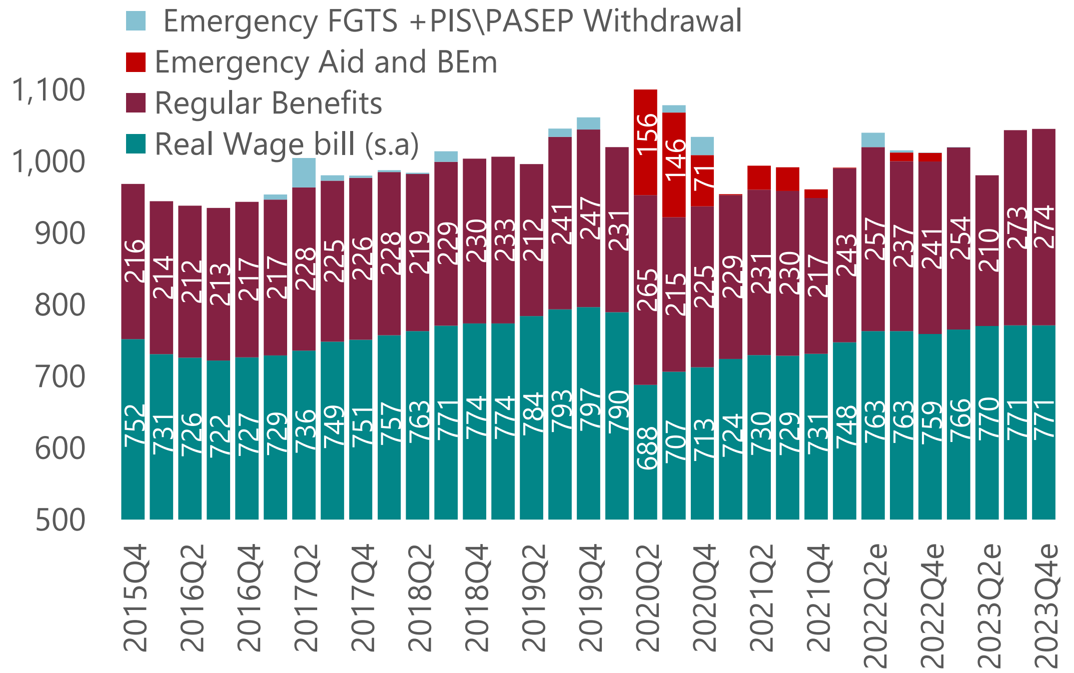
07

Extra-cap expenditures and Others

“Expanded” Real Wage Bill Largely Impacted by Inflation

- As for the real wage bill, the higher employment levels were partially compensated by lower than expected real average wages. Furthermore, new government transfers positively impacted our forecasts for 2022. We project that the “expanded” real wage bill will grow 3.7%, 1.0%, and 1.1% in 2022, 2023, and 2024, respectively (we previously estimated gains of 3.1%, 0.8%, and 1.2%, respectively).

“Expanded” Real Wage Bill (BRL billion)



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

	2021	2022(E)	2023(E)	2024(E)
Real Wage Bill	+0.6%	+4.4%	+1.8%	+1.6%
Real Wage Bill (With Government Transfers)	-8.0%	+3.7%	+1.0%	+1.1%

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

Fiscal Risks – Size Of The Fiscal Stimulus And Leftovers

- The larger part of the worsening of the recent fiscal result was the massive stimulus ("extra-cap" spending) related to Covid-19, which totaled 7.0% of GDP in 2020 and 1.4% in 2021. The trend is for the stimulus to decrease as the effects of the pandemic fade, yet Brazil has changed the fiscal framework to open up more space for spending. We also included the BRL41.2 billion allowed in PEC1/22, expanding the fiscal transfers.

Fiscal Stimulus Measures (BRL billion)

	2020			2021			2022		
In BRL billion - Accumulated	Dec-20	Total Budget	Executed	Dec-21	Total Budget	Executed	Jun-22	Total Budget	Executed
Bem - Employment program (MP 935)	33.5	51.5	65.0%	7.7	10.7	71.5%	0.0	0.2	0.0%
Expansion of Bolsa Família (MP 929)	0.4	0.4	100.0%	-	-	-	-	-	-
Emergency Aid (MP 937) + Auxilio Expansion 22	293.1	322.0	91.0%	60.7	63.9	94.9%	3.3	32.3	10.2%
Truckers Aid (voucher 1k)	-	-	-	-	-	-	-	5.4	-
Other (PEC Auxílio - subsidies)	-	-	-	-	-	-	-	9.8	-
Transfers to regional governments (MP 939)	78.3	79.2	98.8%	-	-	-	-	-	-
Credit for payroll (MP 943)	6.8	6.8	100.0%	-	-	-	-	-	-
Energy Sector (MP 950)	0.9	0.9	100.0%	-	-	-	-	-	-
Ministry of Health and others	42.7	50.8	84.0%	25.8	43.2	59.7%	8.3	10.5	78.6%
Guarantees for credit measures for SME (MP 977)	58.1	58.1	100.0%	5.0	5.0	100.0%	-	-	-
Financing of Tourism Infrastructure (MP 963)	3.1	5.0	61.6%	0.6	1.3	42.3%	-	0.7	-
Emergency Credit Program - "Maquininhas"	5.0	10.0	50.0%	-	-	-	-	-	-
Vaccine Acquisition	2.2	20.0	11.1%	21.8	26.2	83.4%	5.3	10	52.4%
Accumulated Total	524.0	604.7	86.7%	121.4	150.2	80.8%	16.8	68.9	24.4%

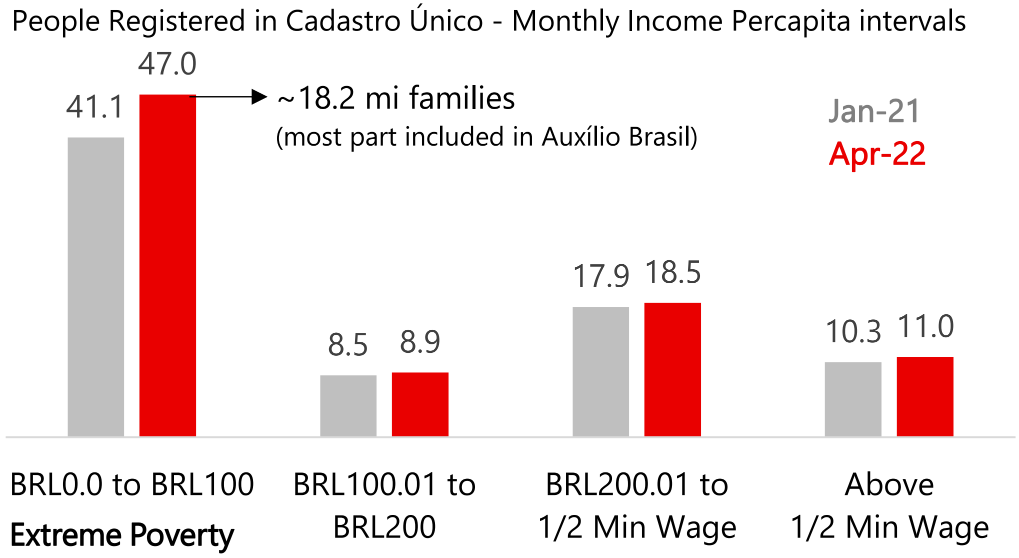
Updated until 7/15/2022

Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

- Regarding the fiscal transfers, the emergency aid program ended in October. The new welfare program *Auxílio Brasil* started in November, with the BRL400 benefit payments starting in December (post *PEC dos Precatórios*). The government stated that in 2022 Budget there will be ~BRL90 billion for the program. PEC1/22 added a complement to increase the benefit value back to BRL600 (Aug to Dec), making the total budget to jump to +BRL26 billion (BRL116 billion).
- The current monthly average benefit of the welfare program is BRL 408, reaching 18 million families.

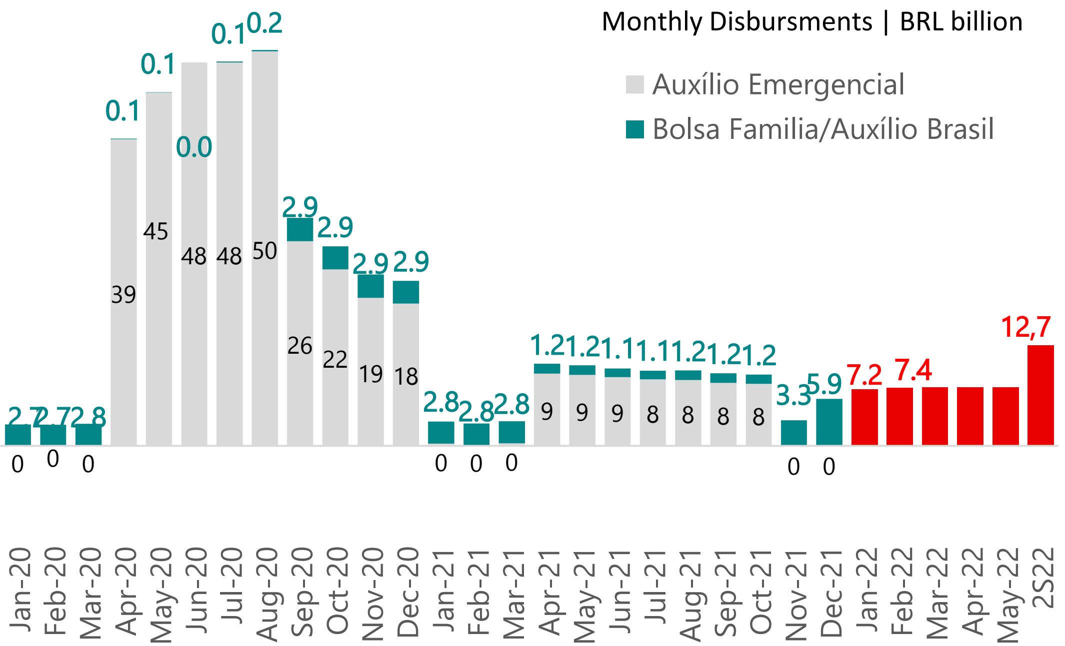
Cadastro Único – Gov. Database



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

Sources: Ministerio da Cidadania, Santander

Welfare program – BRL billion

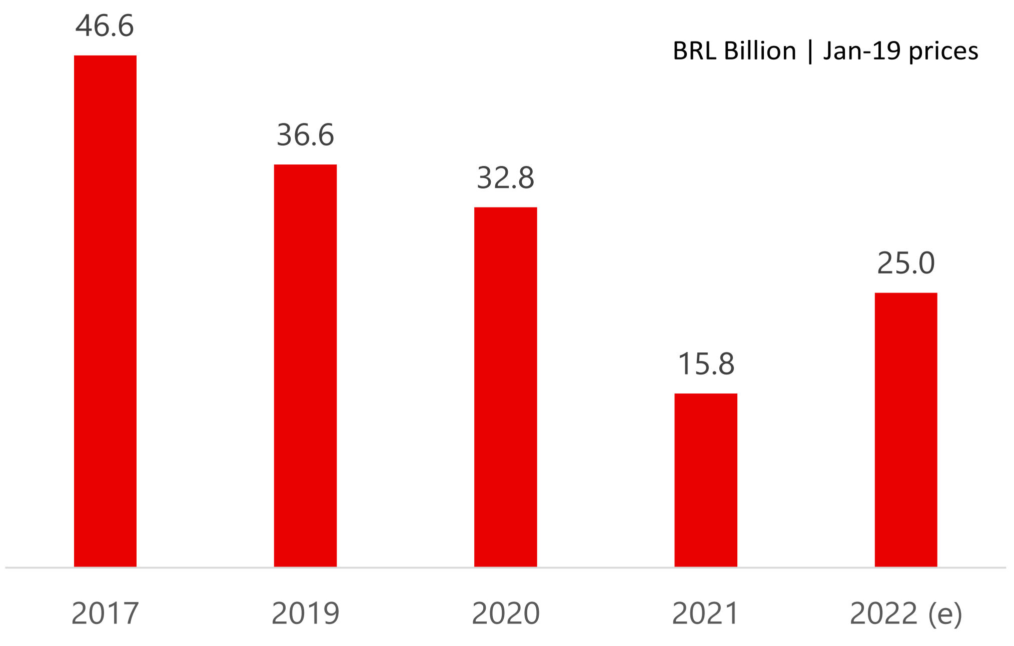


Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

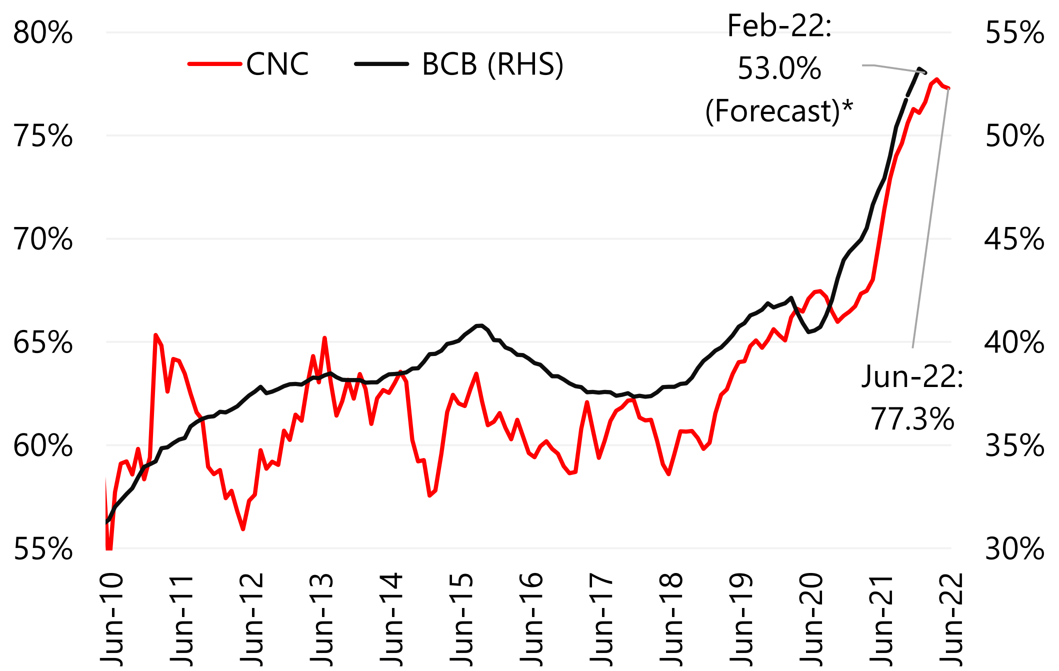
- We estimate that FGTS withdrawals added 0.6 p.p. to the growth of the “expanded” real wage bill.
- Household indebtedness keeps rising fast, we foresee a higher figure for February-22, at 53%. The situation is getting worse due to the credit operations increasing and the household income stagnation.

FGTS funds workers withdrawn



Sources: Caixa, MCM, Santander

Extended household Indebtedness (%)



Sources: BCB, CNC , Santander.

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Tables - Forecasts

08

MACRO SCENARIO: Forecasts

Macroeconomic Variables		Previous		Current
GDP (%)	2022E	1.2	↑	1.9
	2023E	-0.6	→	-0.6
	2024E	0.5	→	0.5
IPCA (%)	2022E	9.5	↓	7.9
	2023E	5.3	↑	5.7
	2024E	3.0	→	3.0
Selic Rate (% end of period)	2022E	13.50	↑	14.25
	2023E	10.50	↑	12.00
	2024E	8.00	↑	9.00
FX Rate - USDBRL (end of period)	2022E	5.15	↑	5.30
	2023E	5.00	↑	5.15
	2024E	5.10	↑	5.20
Current Account Balance (% of GDP)	2022E	-1.4	→	-1.4
	2023E	-1.2	→	-1.2
	2024E	-2.0	→	-2.0
Primary Fiscal Balance (% of GDP)	2022E	0.4	↓	-0.2
	2023E	-0.6	↓	-1.2
	2024E	-0.7	↓	-1.0
Gross Public Debt (% of GDP)	2022E	79.0	↑	79.9
	2023E	83.1	↑	84.6
	2024E	87.2	↑	88.7

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

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

"Better Activity Expected in the Short Term, with Higher Interest Rates (Even) Longer" (sent on July 14, 2022)

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

https://bit.ly/Std-scenupdate-jul22

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

Global Scenario (Baseline)	2018	2019	2020	2021	2022E	2023E	2024E
Global GDP (%)	3.5	2.8	-3.5	5.9	2.6 ↓	2.5 →	2.0 →
China GDP (%)	6.7	6.0	2.3	8.1	4.8 →	5.5 →	5.0 →
US GDP (%)	3.0	2.2	-3.5	5.7	2.2 ↓	0.4 ↓	0.7 ↑
US Inflation (Core PCE, %)	2.1	1.6	1.5	4.9	4.8 ↑	3.2 ↑	2.3 ↑
US Interest Rate (FFR, %)	2.50	1.75	0.25	0.25	4.00 ↑	4.50 →	3.50 →
US Interest Rate (UST10y, %)	2.7	1.9	0.8	1.8	4.0 ↑	4.0 →	3.0 →
Dollar Index - DXY	96	96	90	96	109 ↑	100 ↓	100 →
Commodity Prices - CRB	409	401	444	571	555 ↓	521 ↓	495 →

Sources: Bloomberg, 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:

Simple Personal Fair

Santander

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