Brazil Macro | October 2022

FISCAL POLICY

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INDEX

1. Brief Overview
2. Spending Cap Rule
3. Court-ordered Debt
4. Fiscal Baseline Scenario
5. Public Debt Scenario and Simulations
6. Debt Management
7. Extra-cap expenditures and Others
8. Tables - Forecasts

Brief Overview

01

Summary – Short-Term Strength, Medium-Term Uncertainties

- We continue to forecast a public sector's primary surplus of 1.0% of GDP for 2022, but with a slightly different composition. On the one hand, we have raised our central government primary surplus expectation to BRL45 billion or 0.5% of GDP (from BRL25 billion or 0.3% of GDP), on the heels of higher tax revenues based on the labor market and corporate earnings. On the other hand, we lowered the regional government surplus forecast by BRL15 billion to BRL55 billion (0.5% of GDP), basically owing to lower revenues due to a higher-than-expected effect of the recently implemented VAT (ICMS) cap on essential goods.

- We continue to see a worse budgetary outlook for next year, considering the lingering effects of this year's fiscal stimulus, keeping our primary deficit forecast of -1.4% of GDP for 2023. We now see even more pressure for a "fiscal waiver" (meaning another once-and-for-all increase in the constitutional spending cap) next year, due to a lack of space to accommodate plans of higher spending for 2023 onward. According to our calculations, this lack of space is in part due to the reduction in the IPCA forecast to 5.5%, compared to the 2023 Draft Budget (PLOA) estimate with IPCA at 7.2%. Only than gap in the inflation forecast means a narrowing of about BRL29 billion for the constitutional spending cap next year.

- For the longer term, since we still assume the commodity cycle will gradually fade, we continue to see a risky path toward debt stabilization, in a context of reduced efficacy of the fiscal rules, elevated social pressures to increase spending and natural difficulties to raise taxes. We now estimate the gross general government debt will peak at ~95% of GDP in 2028 (our previous estimate was 98%), with the primary balance only returning to positive ground in 2027. Despite the breathing room on the fiscal side provided by this extended commodity cycle, the high level of mandatory expenses continues to be a problem that needs urgent fixing (via economic reforms to both curb expenses and boost potential GDP).

For details on the results of Brazil's general elections (first round), please refer to our Electoral Map.

Santander Brazil 2022 General Elections Map: "*Main Results (October 2)*" – October 5, 2022 – Available on: https://bit.ly/Std-elections-2022

Fiscal Policy: Surplus On One-offs In 2022, Additional Risks Ahead

Short Term: positive one-offs

2022: Primary Result: +BRL100 bn (+1.0% GDP)

1. Central Gov.: +BRL45 bn (+0.5% GDP)
Higher tax revenues based on the labor market and corporate earnings
Sep-22(e): +BRL25 bn

2. Regional Gov.: +BRL55 bn (+0.5% GDP)
Lower Revenues due to the VAT (ICMS) tax cap – we reduced in BRL15 billion the forecast.

Debt Liquidity Reserves Level

Comfortable levels (more than 10 months of funding) to navigate the uncertainties

Gross Debt: 78.2% of GDP in 2022

Nominal GDP: +11.5%.
BNDES resources: ~BRL90 billion
Voluntary deposits in the BCB: currently at 0.8% of GDP).

2023: Deficit of 1.4% of GDP

Not feasible budget – payback on Revenues and demand for more expenditures
Constitutional Amendment to maintain welfare program value

Medium Term: Bumpy Road Ahead

Risks: Fiscal Stimulus by drop in revenue

Next year: BRL50 bn for Federal Gov. and BRL90 bn for regional government

Fiscal Accounts Unanchored

Inflation-effect: +1.6pp of GDP by 2026. Pressure to change the spending cap rule.

Unpaid Debt – Judicial Claims

We see BRL22 bn unpaid to 2023 (not in Fiscal statistics)

Higher Nominal Deficit (Selic)

Nominal Deficit 2023: above 8.0% of GDP
Lower FX profits from Swap operations

Gross-Debt Peak Estimate

95% of GDP in 2030

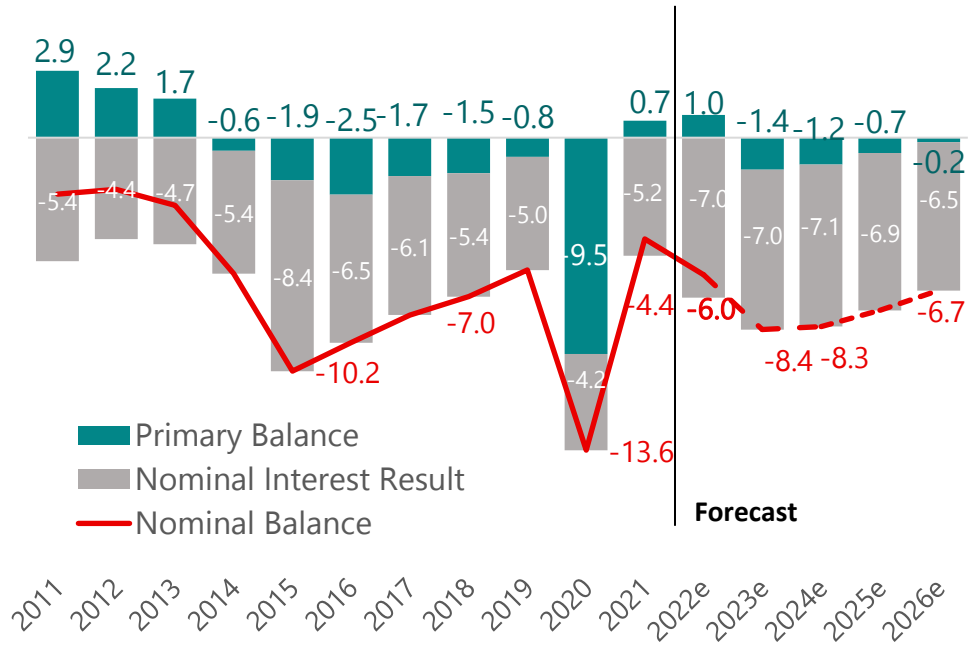
Debt-path: on the edge for convergence

88% of GDP in 2040

Fiscal Policy: A Higher Interest Burden To Weigh On The Debt Dynamics

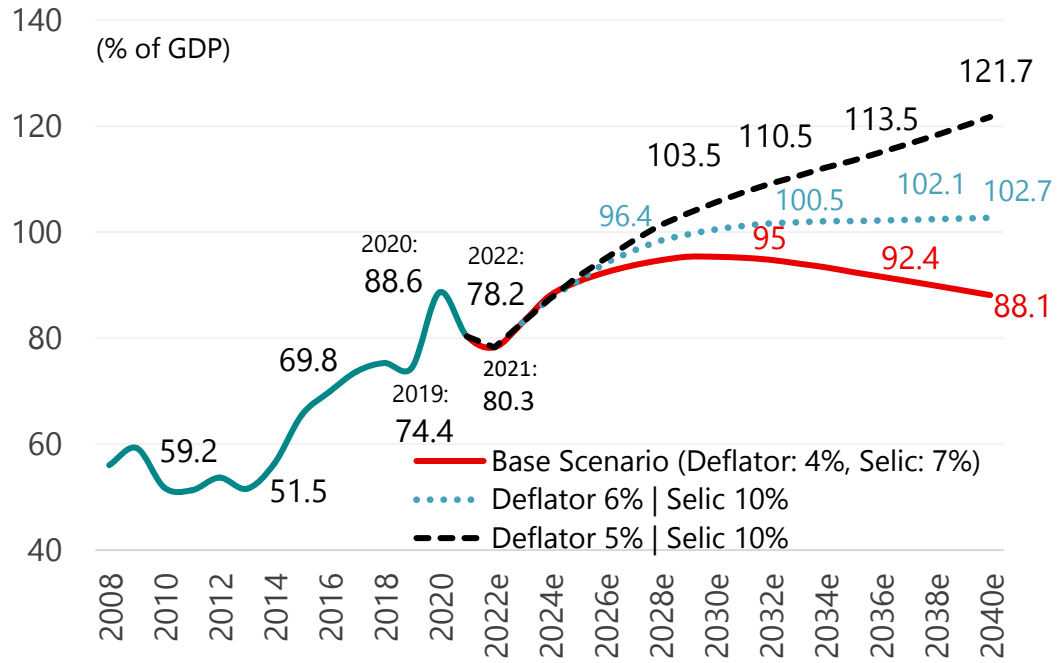
- Interest payments should continue to rise (Selic increase) with the nominal result showing strong deterioration, remaining above 8.0% of GDP in the coming years.
- We simulated scenarios for the debt trajectory: the main debate will be on the structural macroeconomic variables (GDP, Neutral Interest Rate and GDP Deflator). We observe that a higher deflator could keep the debt practically stable (at high levels), yet a scenario with IPCA at 4%, Selic at 10% and GDP at 2%, the debt does not converge.

Public Sector's Financing Needs (% GDP)



Sources: BCB, Santander.

Scenarios - Gross Debt Scenario (% GDP)

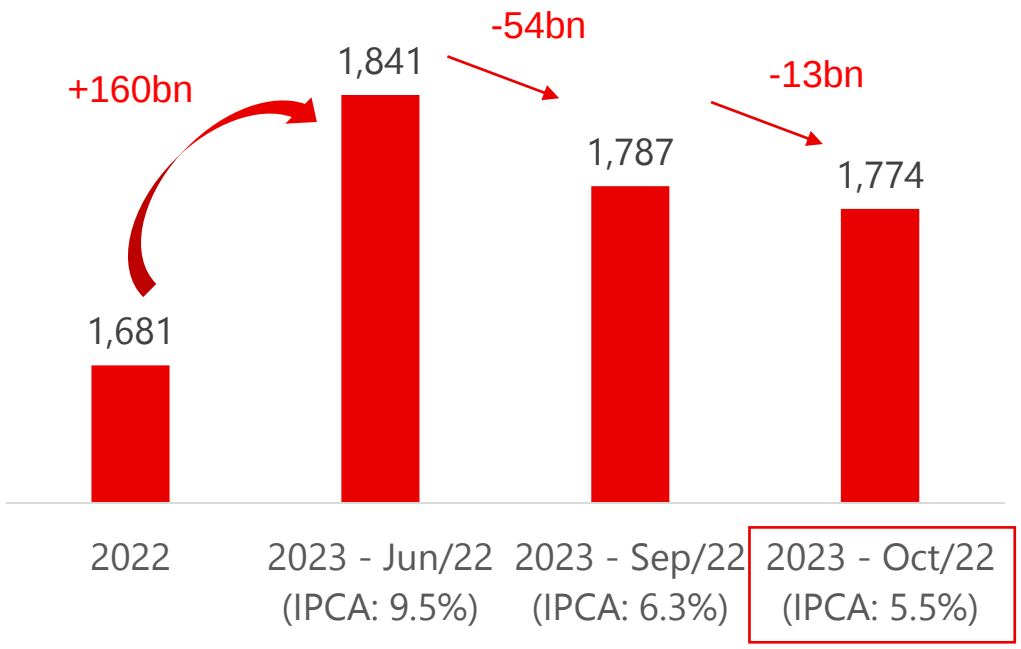


Sources: BCB, Santander

Fiscal Policy: Risks For The 2023 Budget And Fiscal Consolidation

- The 2023 budget proposal is unfeasible. It will be necessary to approve a constitutional amendment to keep *Auxilio Brasil* at BRL600. For 2023, there is a pressure of at least BRL250 billion to be debated, which could lead to further deteriorations in the fiscal scenario.
- The reduction in inflation also reduces the space for new spending next year, coming closer to BRL93 billion with the new inflation projections. Comparing with the indexation rule before the *PEC dos Precatórios*, the current one is BRL15 billion below for new expenses. Since June, the total space reduced by BRL67 billion due to a reduction in the IPCA forecast.

Spending Cap 2023 – Probably Will Be Breached



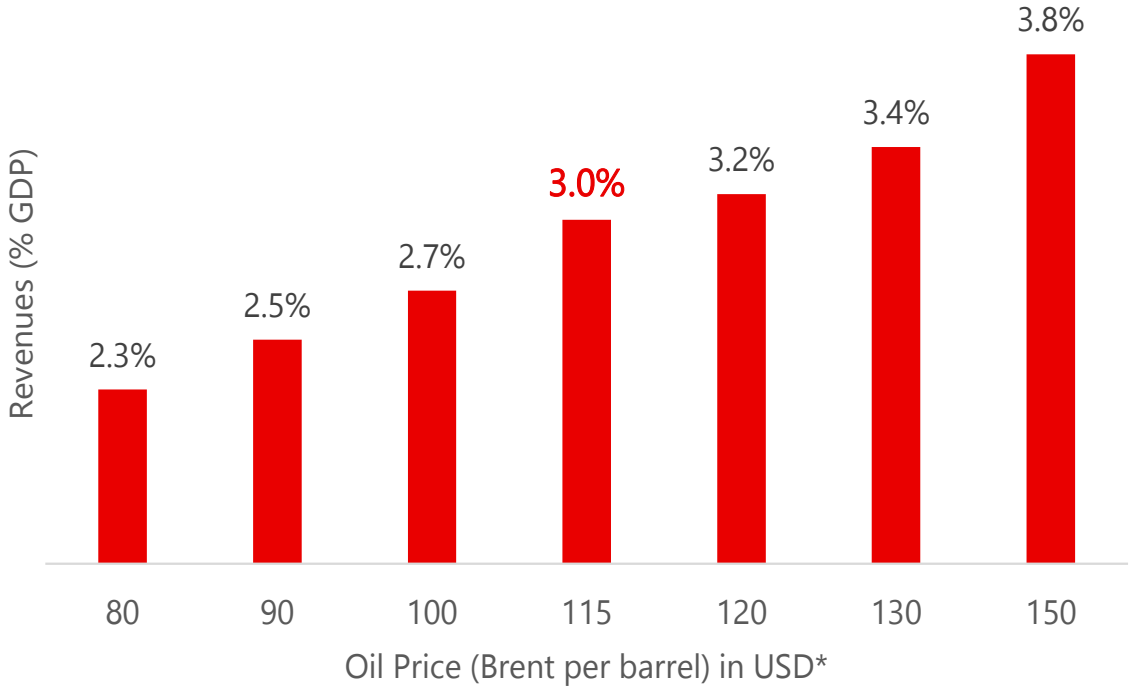
Compared to the 2023 official Budget Proposal (IPCA: 7.2%):
-BRL29 billion

Central Gov. Fiscal Pressures for 2023	
Measures	**BRL bn**
Expenditures (I)	120
Auxilio Brasil (BRL 600)	60
Public Servants Wage increase (5%)	12
Auxílio-Gas extension	4
Cultural Aid	5
2022 ICMS cap Compensation	4
Community health workers wage	4
Ending Queue - BPC and Pensions	11
Increase in Public Investment	10
Subsidy - Eldery transportation	5
Others	5
Revenues Drop (II)	130
35% Reduction in IPI (industrialized tax)	25
Mantain PIS/Cofins = 0 on Fuels	50
Income tax overhaul	25
States not paying (financial revenue) the debt	30
Total (I) + (II)	**250**
Total % GDP	2.6%

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.

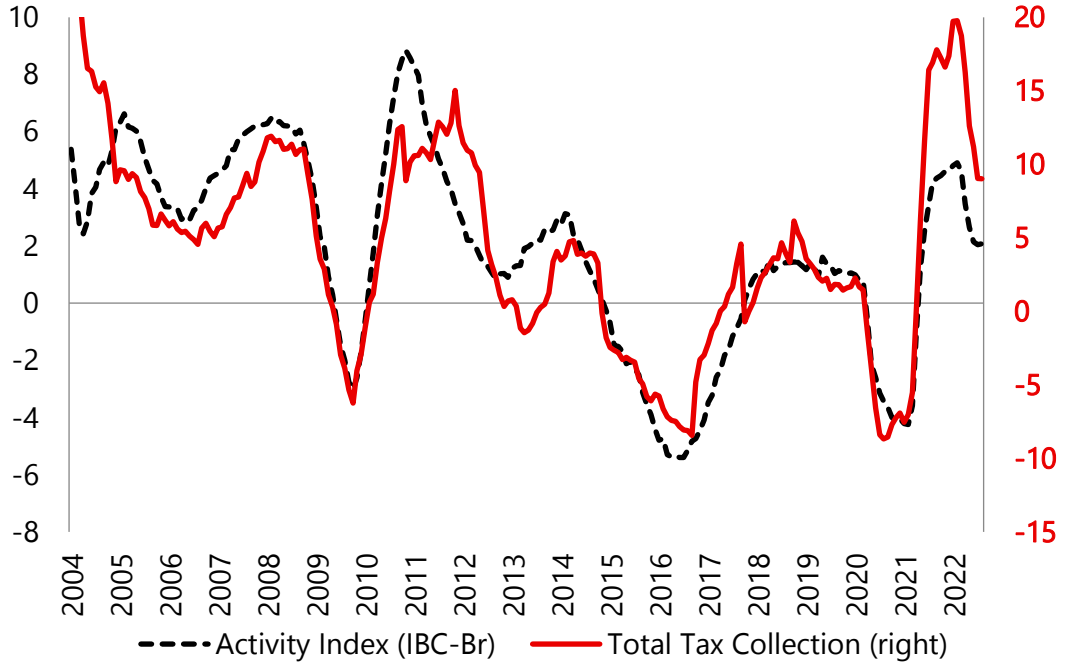
Consolidated Public Sector Oil Revenue – 2022



FX rate maintained at BRL5.30 for 2022

Sources: Confaz, Santander.

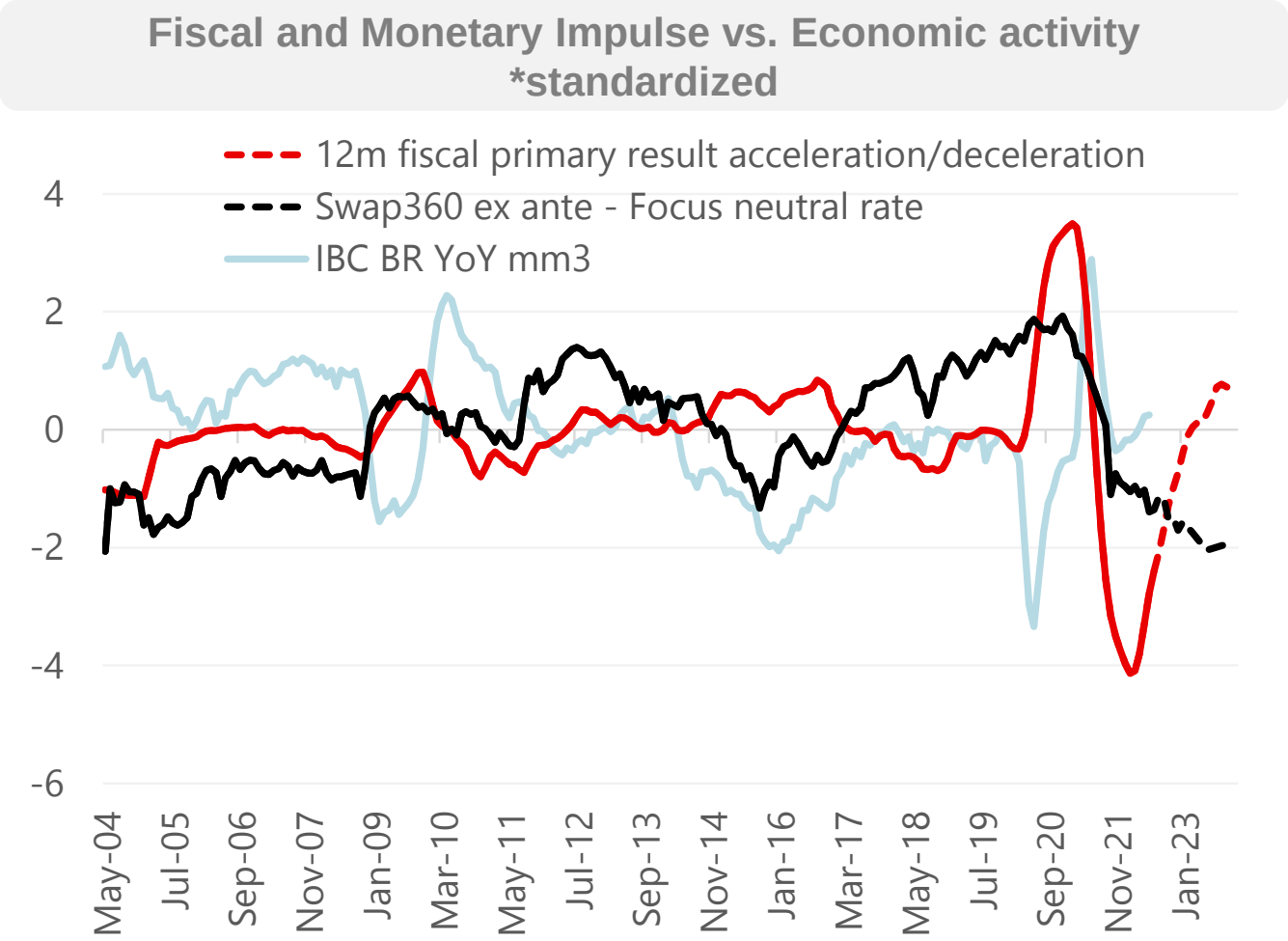
Economic Activity and Tax collection



Sources: National Treasury, Santander.

Fiscal Impulse in the short-term “helping” the activity

- The new fiscal stimulus measures tend to boost activity in the short term.
- For the fiscal policy we used the change in primary result as a proxy for the stimulus. For the monetary policy we use as a proxy an “ex-ante Real Interest Rate”, which is Swap360 minus 12-month ahead inflation expectations.



Sources: BCB, National Treasury, Bloomberg Santander

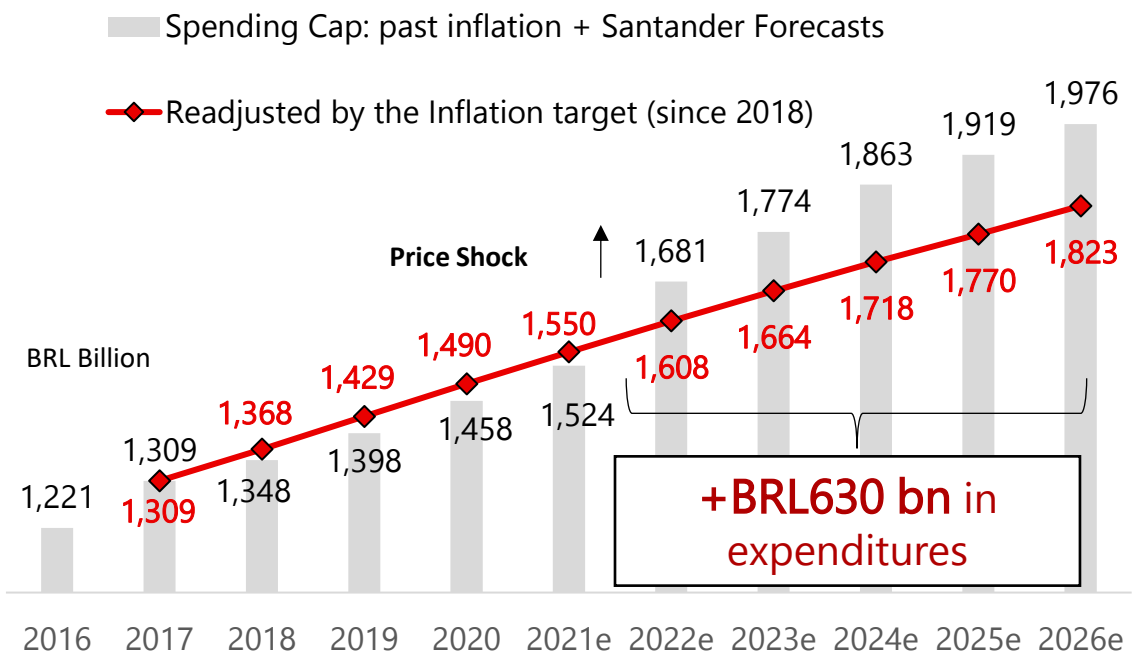
Spending Cap Rule – Lost part of its anchoring power

02

Fiscal – Spending cap rule was affected by the inflationary shock

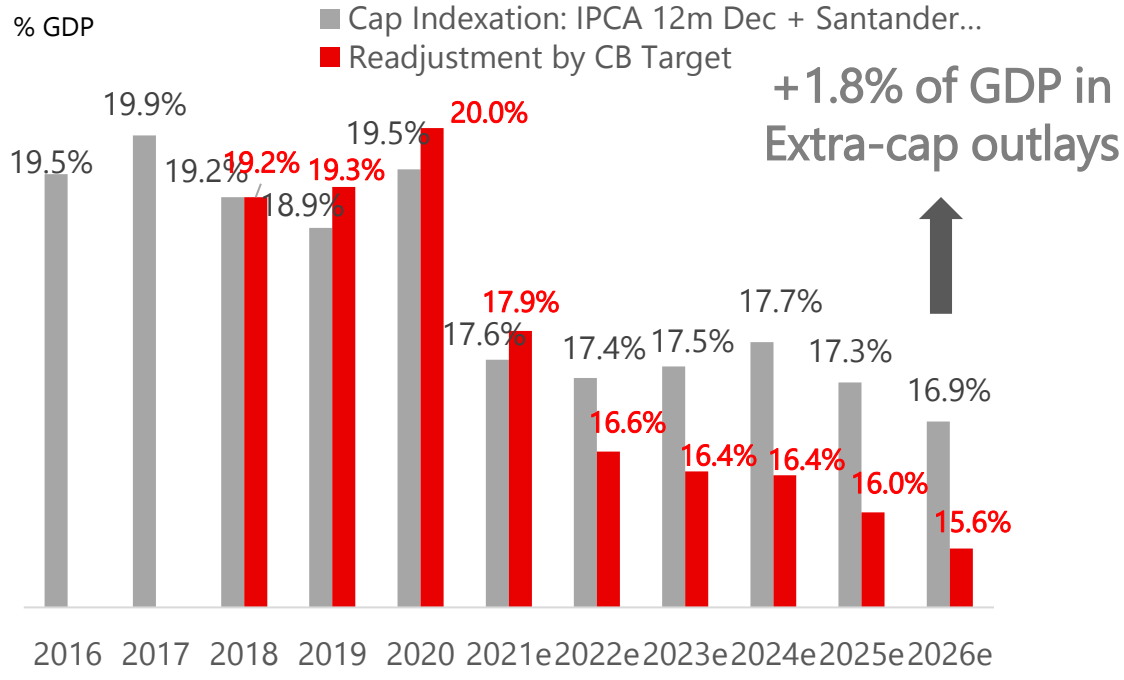
- We believe that the main fiscal anchor lost part of its anchoring power. We calculated close to BRL630 billion in expenditures, compared to the scenario that the spending cap rule is readjusted by the inflation target.
- We see more ~1.8% of GDP in 2026 expenditure forecast, with extra-cap outlays + *Auxilio Brasil* extension, totaling 18.8% expenses to GDP, compared to 19.6% in the 2016-2019 average.

Spending Cap Max. Total Limit



Sources: BCB, National Treasury, Santander

Change in the index of Spending Cap Rule

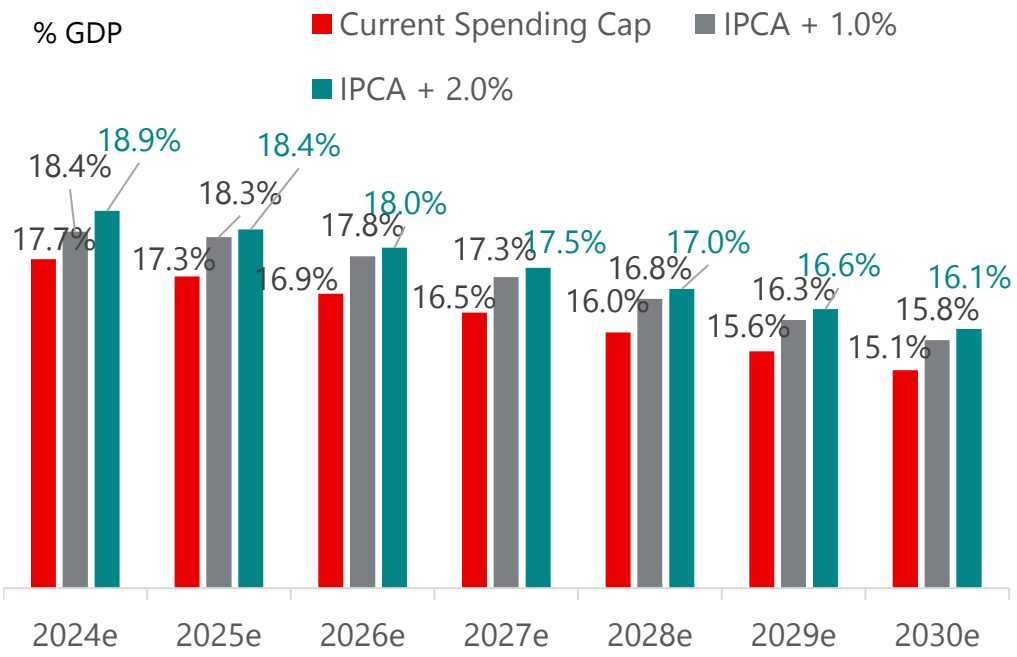


Sources: National Treasury, Santander

Fiscal – Spending cap rule was affected by the inflationary shock

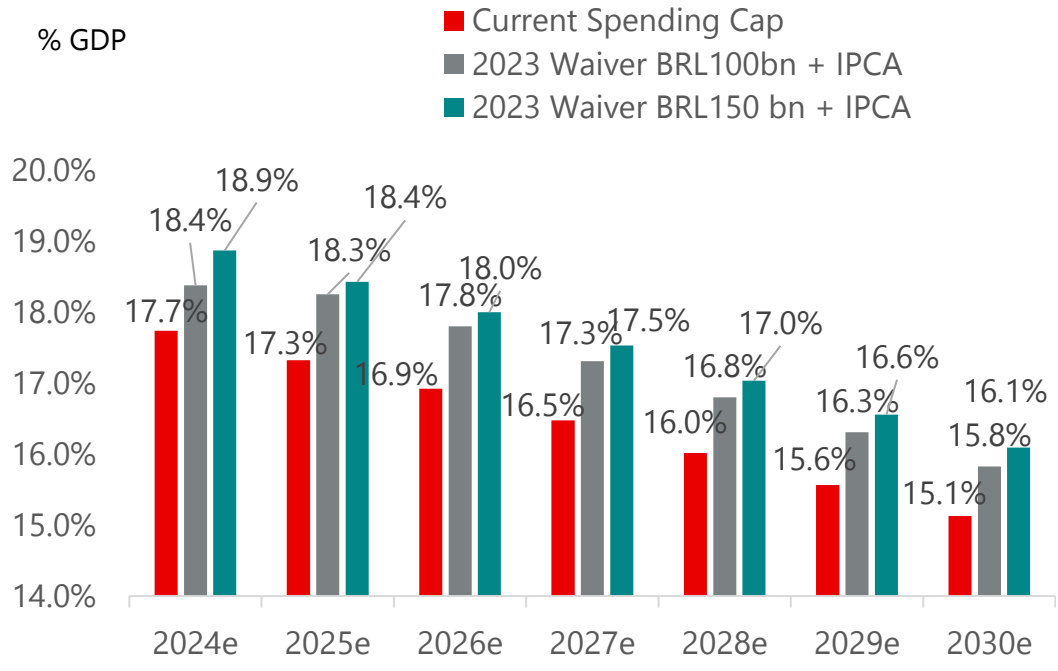
- We believe that the main fiscal anchor lost part of its anchoring power. We calculated close to BRL630 billion in expenditures, compared to the scenario that the spending cap rule is readjusted by the inflation target.
- We simulate changes in indexation and adding a waiver in the rule in 2023

Simulation – outlays subjected to the cap



Sources: BCB, National Treasury, Santander

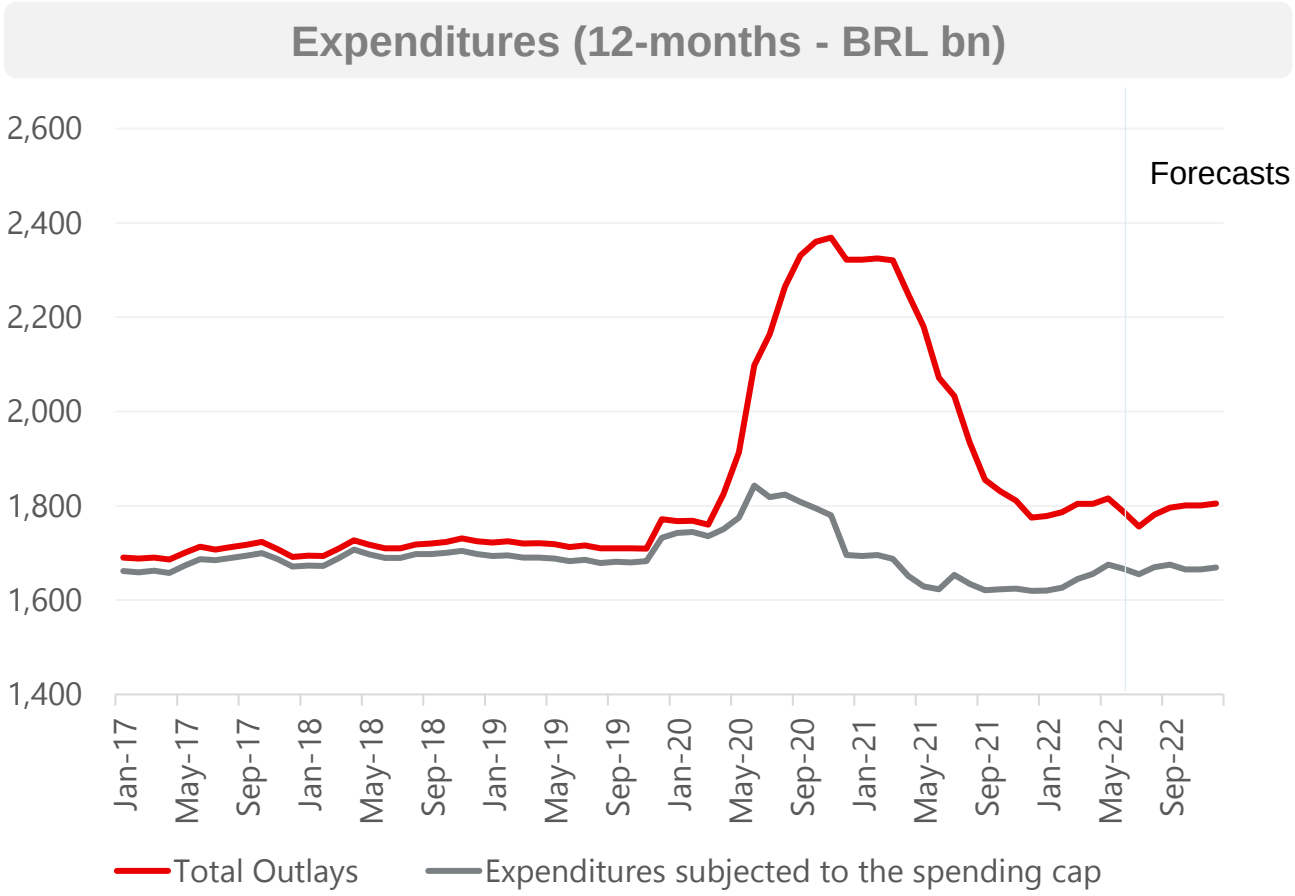
Change in the index of Spending Cap Rule



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

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

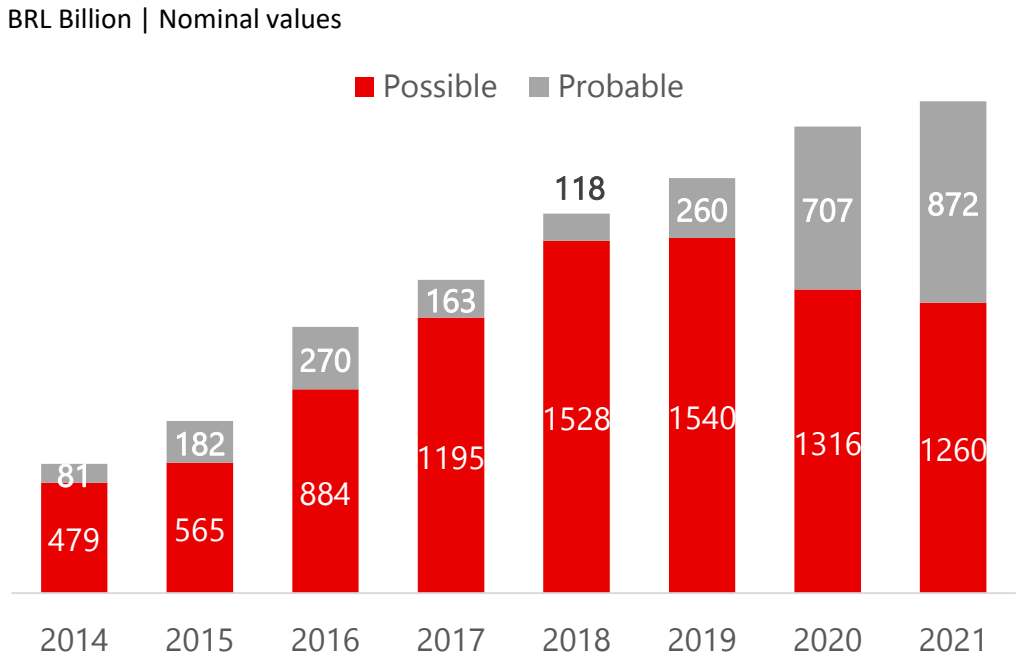
- Regarding probable judicial claims, the amount increased from BRL707.2 billion in 2020 to BRL872 billion in 2021, an increase of 23.3%. Claims of a tax nature correspond to 66.9% of the possible risk and 70.4% of the probable risk.

Judicial Claims Increase – BRL billion

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

Sources: National Treasury, MCM, Santander

LDO Judicial Claims: Probable and Possible Risk



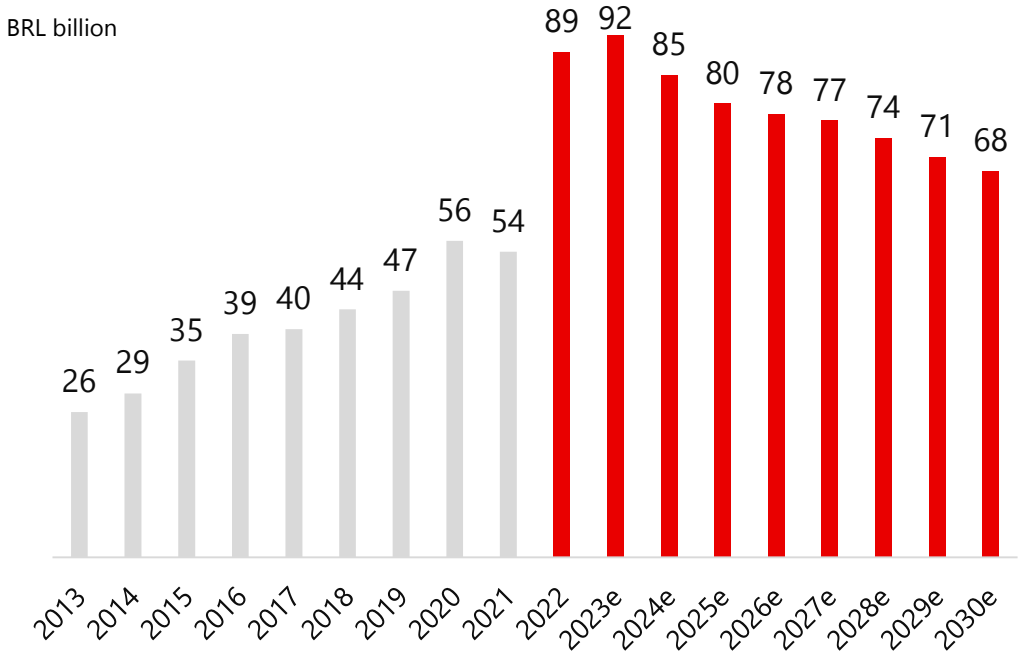
Sources: AGU, LDO 2020, Santander.

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

We estimate an increase in judicial claims over the next years

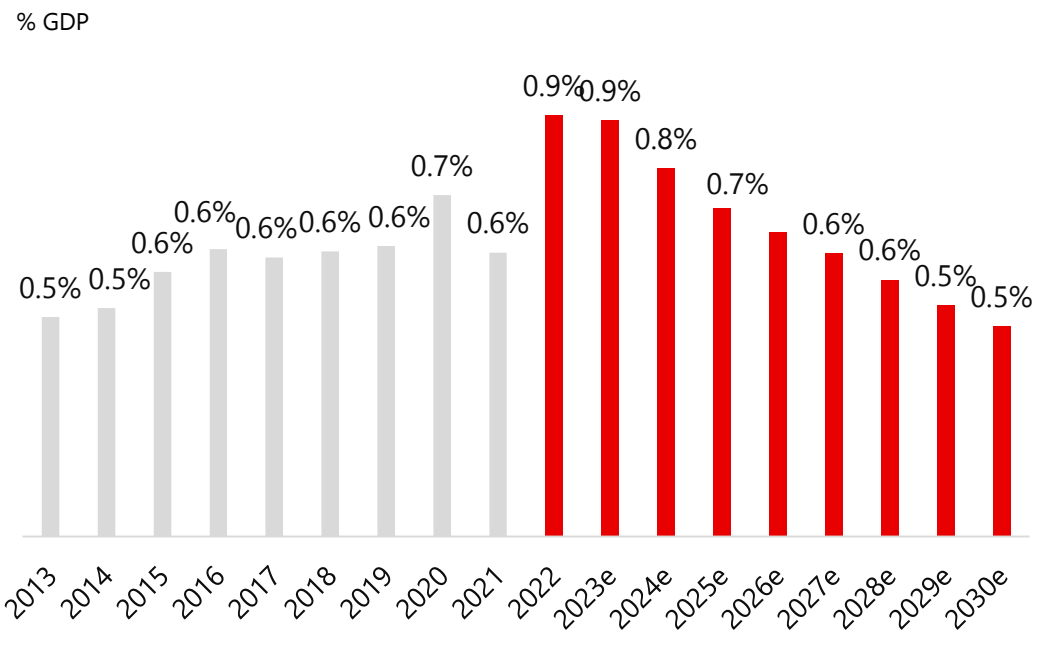
- We constructed a forecast based on the Budget Guidelines (LDO) probable judicial claim for next the years. In the short-run we see more pressure from the Fundef (educational fund) and those related to pension payments.
- Our preliminary estimate is only a preliminary "educated-guess" in view of the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

Our Preliminary Estimates for judicial claims budget



Sources: LDO 2023, Santander

Judicial claims estimates



Sources: LDO 2023, Santander

Based on the PLDO 2023

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)

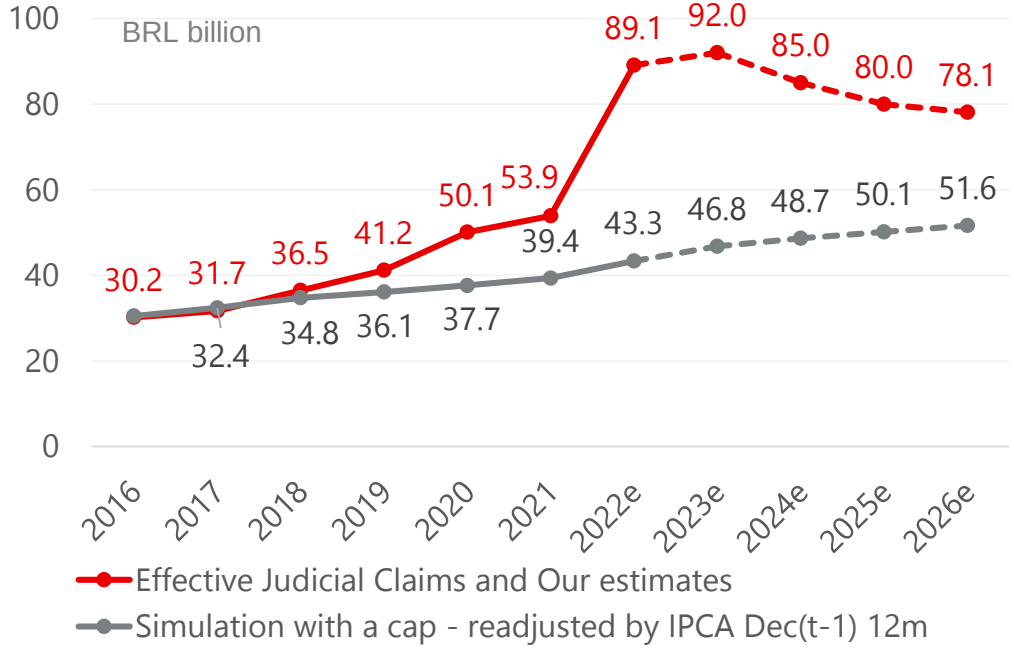
Item	2022	2023
Expected Judicial Claims	89.1	92.1
Subcap (PEC Precatórios)	40.5	43.1
Payments in the year	62.0	61.6
Precatórios unpaid (accumulated)	22.9	57.6

Sources: National Treasury, Santander

Simulation – effects of creating a cap for the payment

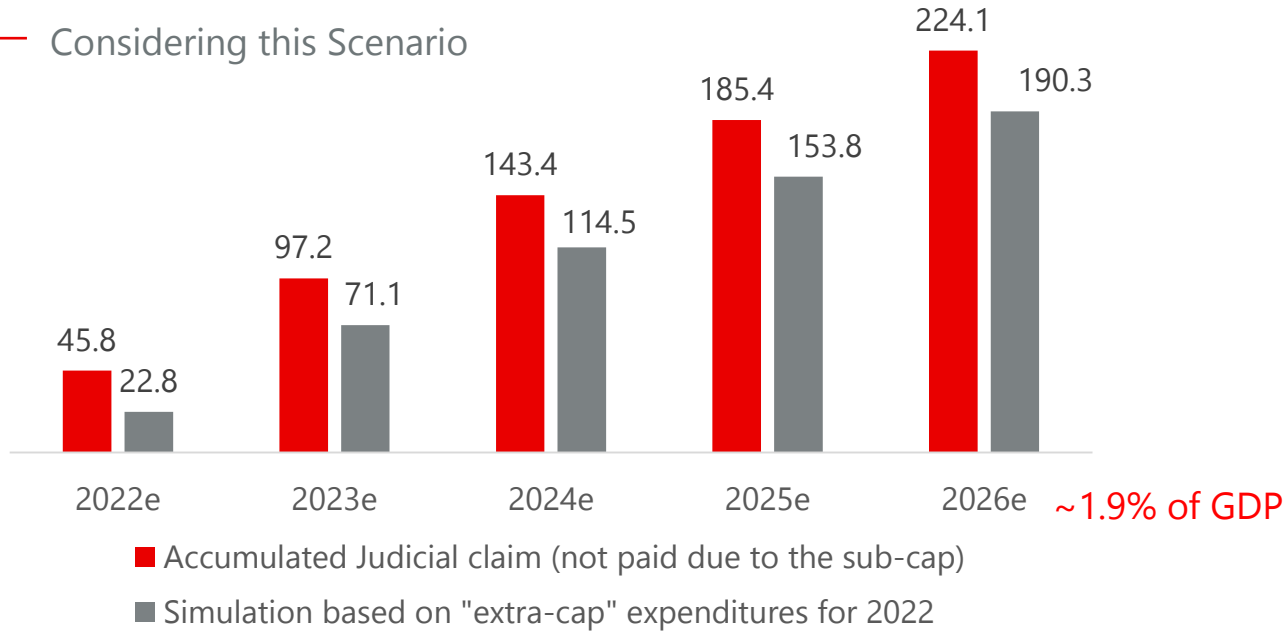
- In order to reduce the judicial claims payments, the government proposed to create a ceiling for these liabilities and postponing the remaining for the next few years (or paying outside the spending cap limit).
- Creating a cap since 2016 would reduce the judicial claim payments in 2022 to close to BRL43 billion, from the BRL89.1 billion official number. The 1.9% of GDP that could be accumulated will not be included in any fiscal statistics (debt and primary).

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 in 2022

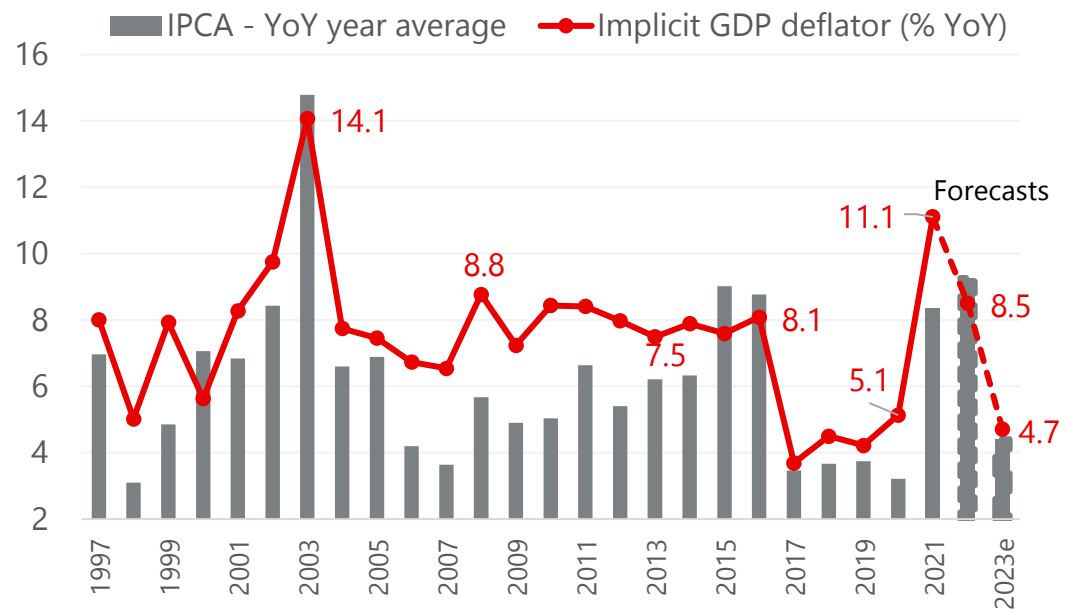
Expenditures	BRL billion	%GDP
Double Auxilio Gas Budget	2	0.0%
Transport for eldery (subsidy)	2.5	0.0%
Truckers voucher (1k benefit)	5.4	0.1%
Taxi Drivers voucher and Alimenta Brasil	2.5	0.0%
Ethanol (subsidy)	3.8	0.0%
Complement to Auxilio Brasil (BRL600) 2022	26	0.3%
Total	**42.2**	**0.4%**

Sources: National Congress, Santander.

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

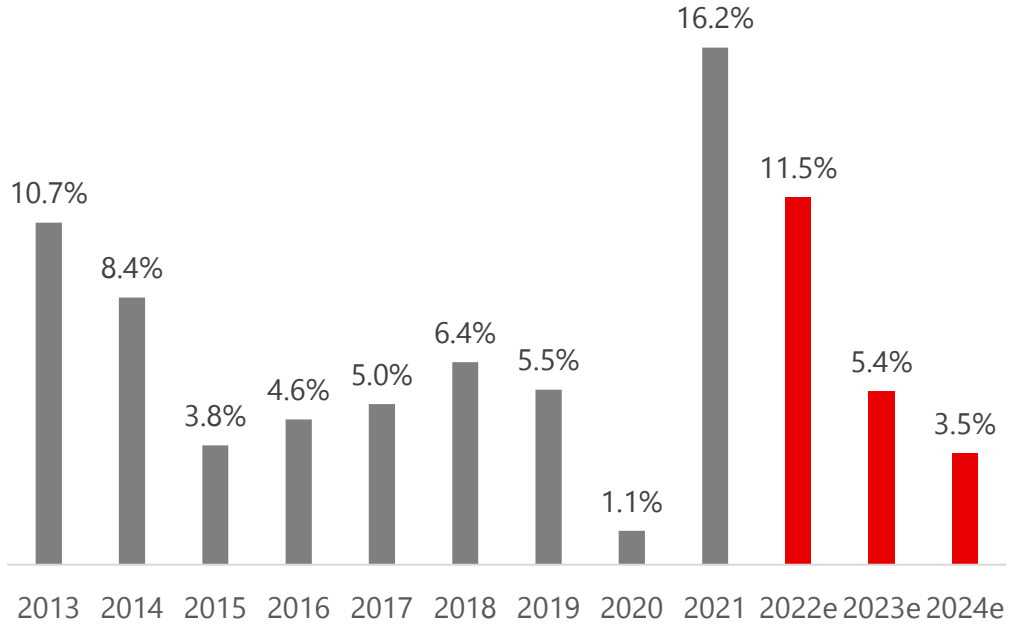
- Inflation played a significant role in improving public accounts in the short run. For 2021, in Mar-21 we estimated nominal GDP at 7%, but it ended the year with a 16.2% increase. The effect of the massive increase in the GDP deflator affected the fiscal-statistics-to-GDP ratio.
- For 2022, we estimate GDP deflator of 8.5% (considering the IPCA year average of 9.3% and the IGP of 11%) . As a consequence, the nominal GDP should rise 11.5%, according to our numbers.

IPCA and GDP Deflator



Sources: IBGE, Santander.

Nominal GDP Increase YoY

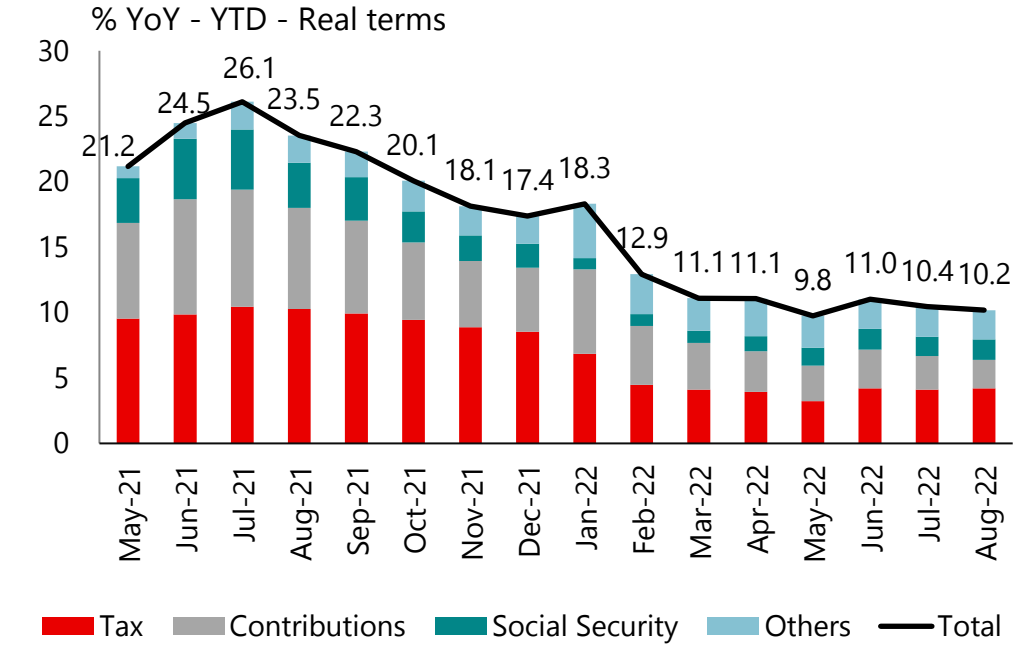


Sources: IBGE, FGV, Santander.

Revenues Impact – Price Effect + Activity Recovery

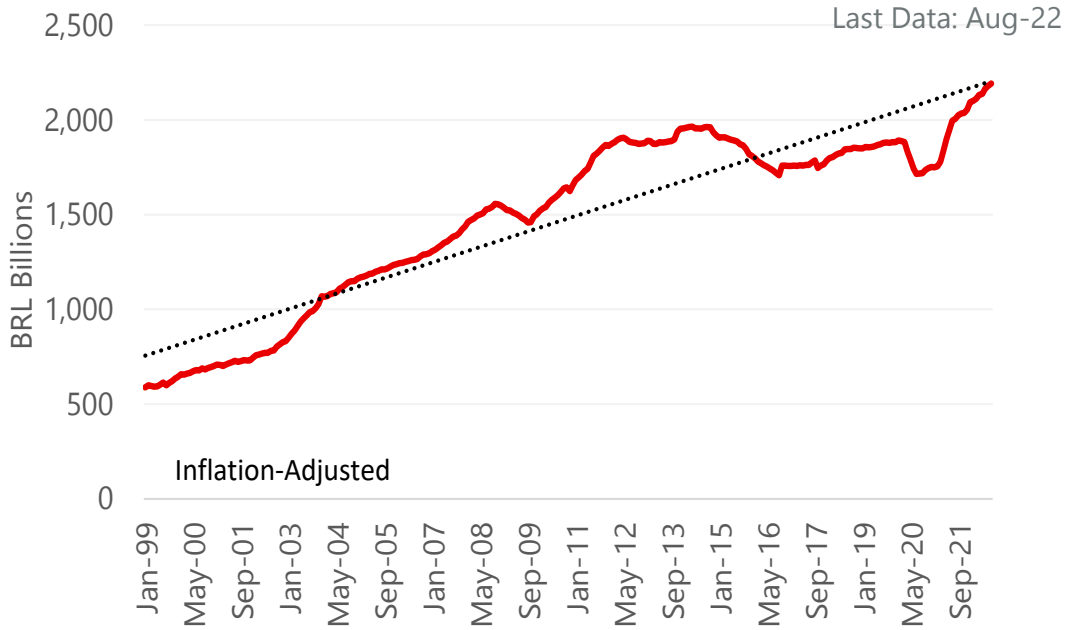
- We see a strong recovery in federal tax collection in recent months, mainly direct taxes linked to the corporate sector, which have posted good results. We can also observe that the increase in tax collection is highly correlated with sectors linked to the commodity boom, especially those related to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

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



Sources: Brazilian IRS, Santander.

Total Federal Tax Collection –

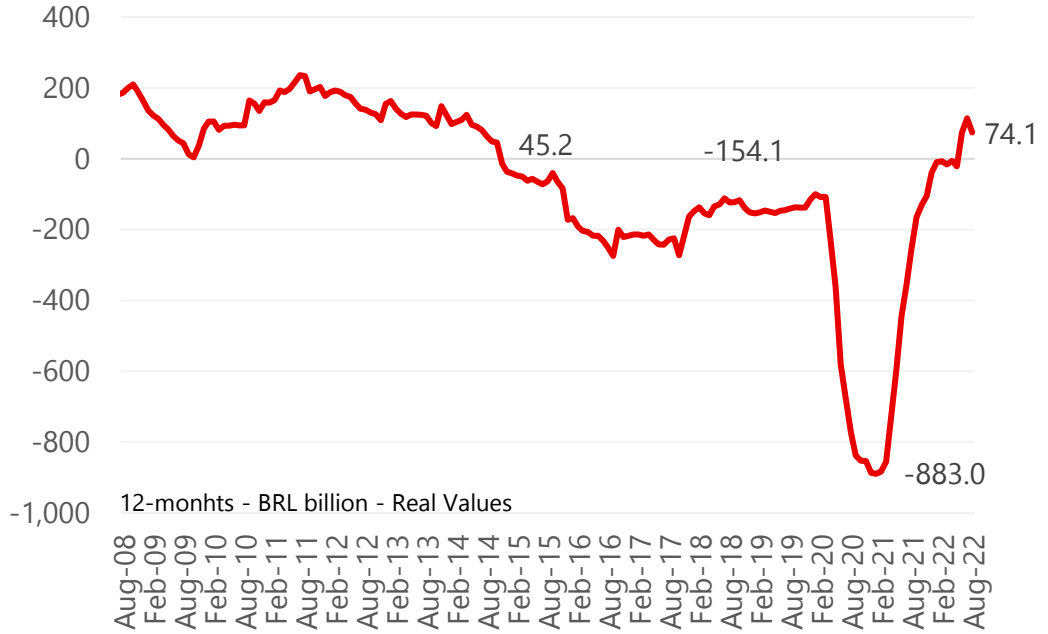


Sources: Brazilian IRS, Santander.

Central Gov. Primary Result

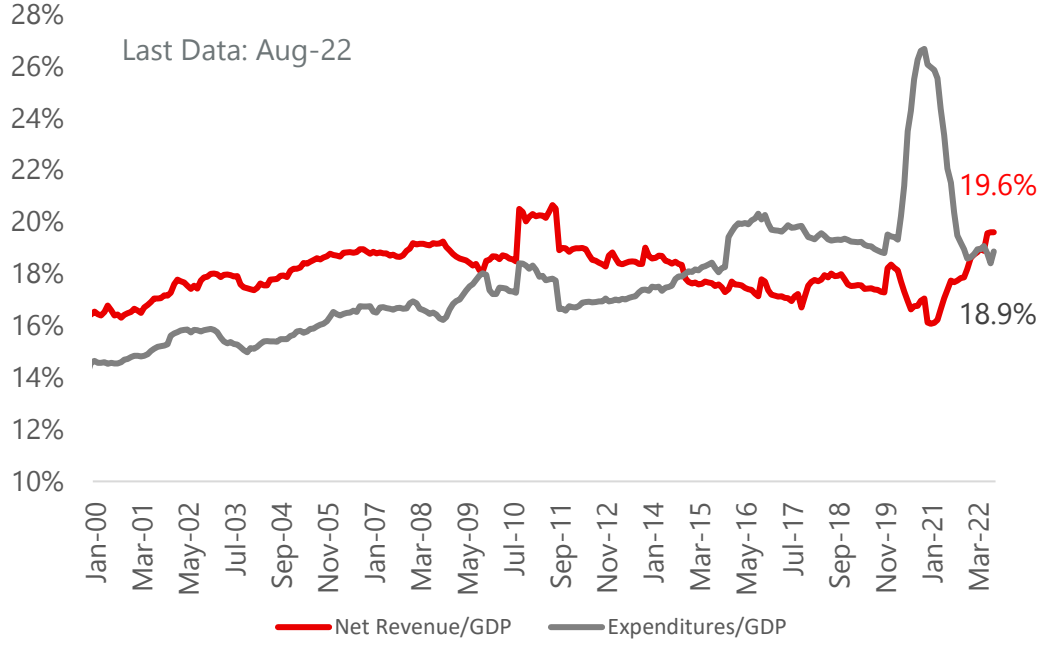
- The Central Government posted a hefty BRL50.0 bn primary deficit in August, close to our forecast (-BRL52.8 bn) and the market median (-BRL49.1 bn). It was the second highest deficit for the month, considering the payment of BRL25.3 billion in court-ordered debts (subjected to the spending cap rule) and the additional BRL23.9 billion in discretionary expenditures from the agreement between São Paulo City Hall and the federal government that ended the dispute over the management of the Campo de Marte region, owing to the cancellation of the municipality's debts with the federal government (should be neutral for the public sector).
- In 12-months reading in real terms, the result rose to a surplus of BRL74.1 bn (from BRL114.2 bn in July) or 0.9% of GDP (from 1.4% of GDP).

Central Gov. Primary Result - 12-month



Sources: National Treasury, Santander.

Breakdown of Fiscal Result

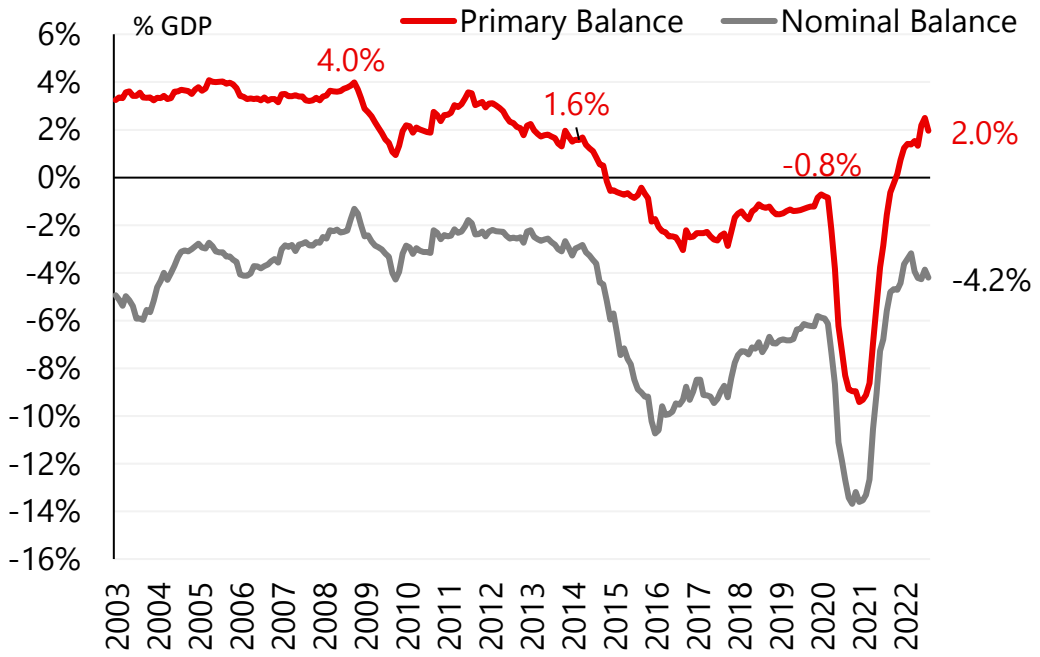


Sources: National Treasury, Santander.

Public Sector Primary Result Improving with the Price-effect

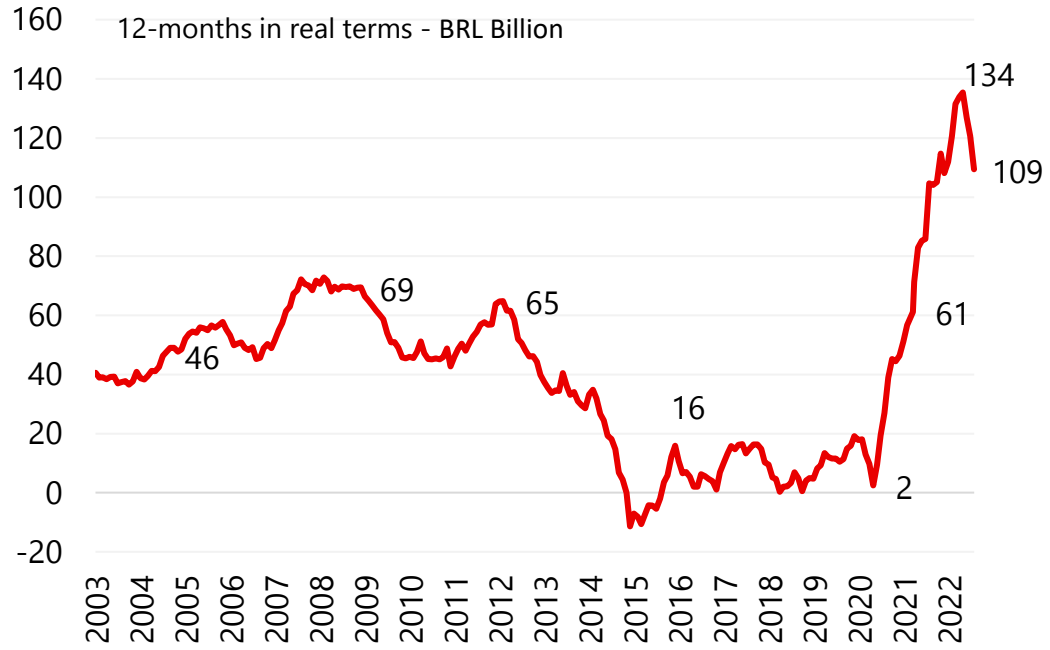
- In August, the public sector posted a primary deficit of BRL30.3 billion, higher than our forecast (BRL26.5 billion). This result represents the second highest deficit for the month in the historical series (beginning in 2002), as a result of payments of court-ordered debt (a change in the year's calendar of payments).
- While that is a still solid performance, we believe that a fiscal expansion in the pipeline (totaling ~2 p.p.) and the fading of commodity and activity cycles will likely prompt a return to a primary deficit in 2023. The nominal result reached BRL392 billion (4.2% of GDP).

Public Sector – 12m % GDP



Sources: Brazilian Central Bank, Santander.

Regional Gov. – Primary Result



Sources: Brazilian Central Bank, Santander.

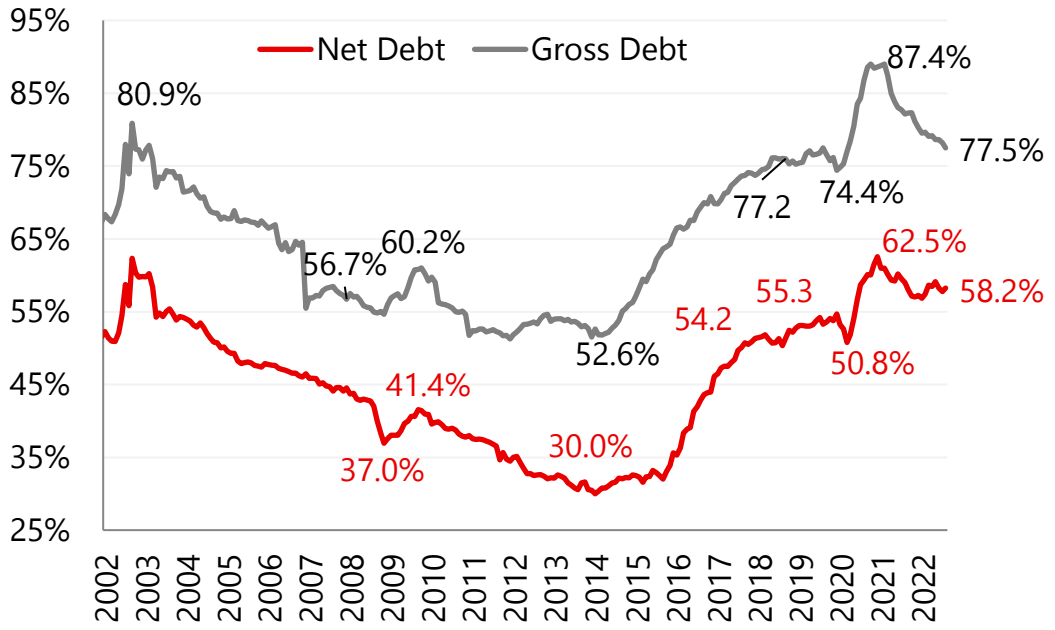
Increase in Interest Payments should pressure the debt ahead

- In August 2022, interest payments totaled BRL35.6 billion, compared to BRL46.5 billion in August 2021. In our view, the result last month was probably helped by profits from swap operations taking advantage of the FX depreciation (BRL11.3 billion gain, vs. a loss of BRL7.6 billion last year). In the 12-month period through August, nominal interest totaled BRL575.6 billion (6.2% of GDP), compared to BRL335.7 billion (4.0% of GDP) through August 2021.
- Debt registered mixed results in August. Gross debt dropped to 77.5% of GDP in August (-0.7 p.p. from July), on the heels of the increase in nominal GDP. Meanwhile, net debt reached 58.2% of GDP (+0.5 p.p. from July).

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)	2017	2018	2019	2020	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	Δ 26-17	Δ 30-17
Total Revenue	21.0	21.2	22.1	19.7	22.3	23.8	22.2	22.7	22.8	22.8	22.9	23.0	23.0	23.0	1.8	2.0
Revenues Collected by the IRS (1)	12.7	12.9	12.8	12.0	13.8	14.0	13.2	13.4	13.5	13.5	13.5	13.5	13.5	13.5	0.8	0.8
Net Social Security Revenues (2)	5.7	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	0.0
Revenues Not Collected by the IRS (3)	2.6	2.7	3.7	2.2	3.2	4.1	3.4	3.6	3.7	3.7	3.7	3.7	3.8	3.8	1.0	1.1
Transfers by Revenue Sharing	3.5	3.7	3.9	3.5	4.0	4.7	4.5	4.3	4.3	4.3	4.3	4.2	4.2	4.1	0.8	0.6
Net Revenue	17.5	17.6	18.2	16.1	18.2	19.0	17.7	18.3	18.5	18.6	18.7	18.7	18.8	18.8	1.0	1.3
Total Expenditure	19.4	19.3	19.5	26.1	18.6	18.6	19.1	19.5	19.2	18.8	18.6	18.4	18.2	17.9	-0.7	-1.5
Social Security Benefits (4)	8.5	8.4	8.5	8.9	8.2	8.1	8.3	8.4	8.5	8.4	8.4	8.3	8.3	8.2	0.0	-0.3
Payroll (5)	4.3	4.3	4.2	4.3	3.8	3.5	3.6	3.8	3.7	3.6	3.6	3.6	3.6	3.5	-0.7	-0.8
Other Mandatory Expenses (6)	3.0	2.9	2.6	9.6	3.5	3.3	3.6	3.8	3.7	3.5	3.4	3.4	3.3	3.3	0.5	0.3
Expenses with Cash Control (7)	1.9	2.0	1.9	1.8	1.7	2.1	2.3	2.3	2.1	2.0	2.0	1.9	1.9	1.8	0.1	0.0
Discretionary Expenses (8)	1.8	1.8	2.2	1.4	1.4	1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	-0.5	-0.6
Central Gov. Primary Balance	-1.9	-1.7	-1.3	-10.0	-0.4	0.5	-1.4	-1.2	-0.7	-0.2	0.0	0.3	0.6	0.9	1.7	2.8
Public Sector Primary Balance	-1.7	-1.5	-0.8	-9.4	0.7	1.0	-1.4	-1.2	-0.6	-0.2	0.0	0.3	0.6	0.9	1.5	2.6
Nominal GDP (BRL billion)	6,585	7,004	7,389	7,468	8,679	9,681	10,207	10,587	11,165	11,774	12,453	13,198	13,987	14,823	5,188	8,237

*IRS - Brazilian Internal Revenue Service

Notes and Hypothesis

(1) Elasticity: Revenues-GDP 2021: 1.7 | 2022: 1.35 | Long-term: 1.05. 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). We included the income tax overhaul totaling BRL25 bn impact.

(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 and 2024, after that is decreasing gradually to 3% 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 1.2% - 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.

List of Social benefit programs in Brazil that could finance a new program

Benefits	Average Monthly Value (BRL)	Beneficiaries (millions)	Total Cost (BRLbillion)	Eligibility
Auxílio Brasil*	607	20.2	150	Extremely poor monthly income of up to BRL105 per person. Poor families with monthly income between R$105 and R$200 per person
BPC (Pension)	1,212	4.8	75.6	Elderly person, 65+ years old, and the disabled person, of any age, with long-term impairments
Salário Família	56	5.6	3.8	Benefit paid to a worker who has a gross monthly income equal to or less than R$1,656 and children under 14 years old or disabled
Seguro-Defeso	280	0.8	2.8	Benefit paid during periods when fishing is prohibited
Abono Salarial	74	23.7	22.8	Benefit ensures the value of an annual minimum wage to Brazilian workers who receive an average of up to two minimum wages
Seguro Desemprego	530	5.7	39.3	Having been dismissed without just cause; Having no personal income; Be unemployed when applying for the benefit;
Salário Maternidade	590	0.1	0.8	Women who need to leave work because of the birth of a child, adoption or even in cases of abortion.
Auxílio Reclusão	1,498	0.0	0.6	Social security benefit paid to dependents of the worker who committed a crime
Auxílio Gás*	110	5.7	3.8	Cooking-gas benefit for families in Cad Único
Farmácia Popular	120	16.4	2.4	Free medication for the treatment of hypertension (high blood pressure), diabetes and asthma.
Total	**178.8**	**73.7**	**302.0**	**-**

* Millions of Families

Sources: The National Treasury Secretariat, Ministry of Economy and Santander estimates.

There is no silver bullet in terms of fiscal reforms

Rolling Impact of some fiscal measures (% GDP)	2023	2024	2025	2026
Revenues				
Tax Reform (Broad Reform)	**0.1**	**0.3**	**0.7**	**0.9**
Profits & Dividends (Aliquot of 15%)	0.3	0.6	0.9	1.1
Personal income tax exemption (BRL1,903 to BRL 2,500 per month)	-0.3	-0.5	-0.8	-1.1
10% linear drop in tax exemptions	0.2	0.4	0.6	0.8
End of JCP payment deduction ("Interest on Equity Capital")	0.1	0.2	0.3	0.4
Limit on tax deductions (private health)	0.1	0.2	0.3	0.3
Changes in Personal Income Tax (35% on earnings > BRL25k per month)	0.1	0.1	0.2	0.2
Eletrobras Capitalization (could happen in 2022, one-off)	0.3	0.0	0.0	0.0
Exclusive Funds (one-off)	0.2	0.0	0.0	0.0
Expenditures				
Administrative Reform	**0.0**	**0.1**	**0.1**	**0.2**
Min. Wage De-indexation (social benefits)	0.2	0.4	0.6	0.8
End of Wage Bonus 'Abono' (for formal workers)	0.2	0.4	0.6	0.7
End of Wage Bonus 'Abono' (only above 1 Min. Wage)	0.1	0.2	0.3	0.4
Extending grace period: unemployment insurance benefit	0.1	0.2	0.3	0.4
Freezing of social security benefits (only above 3 Min. Wages)	0.04	0.07	0.10	0.13
Public sector wage ceiling	0.0	0.1	0.1	0.1

Sources: The National Treasury Secretariat, Ministry of Economy and Santander estimates.

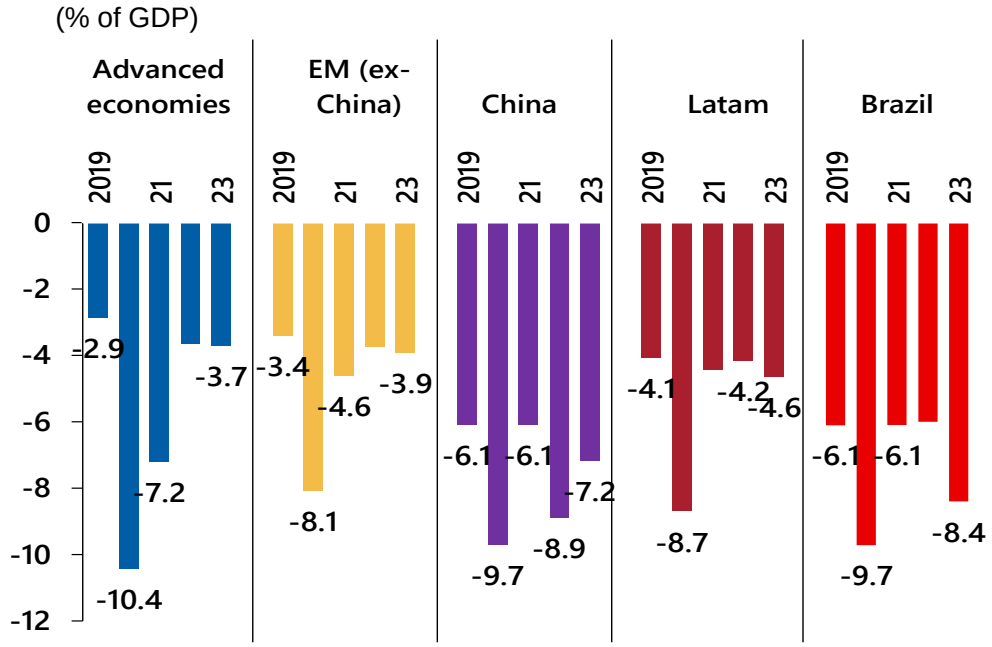
Public Debt Scenario and Simulations

05

International Comparison – Increase in interest rates

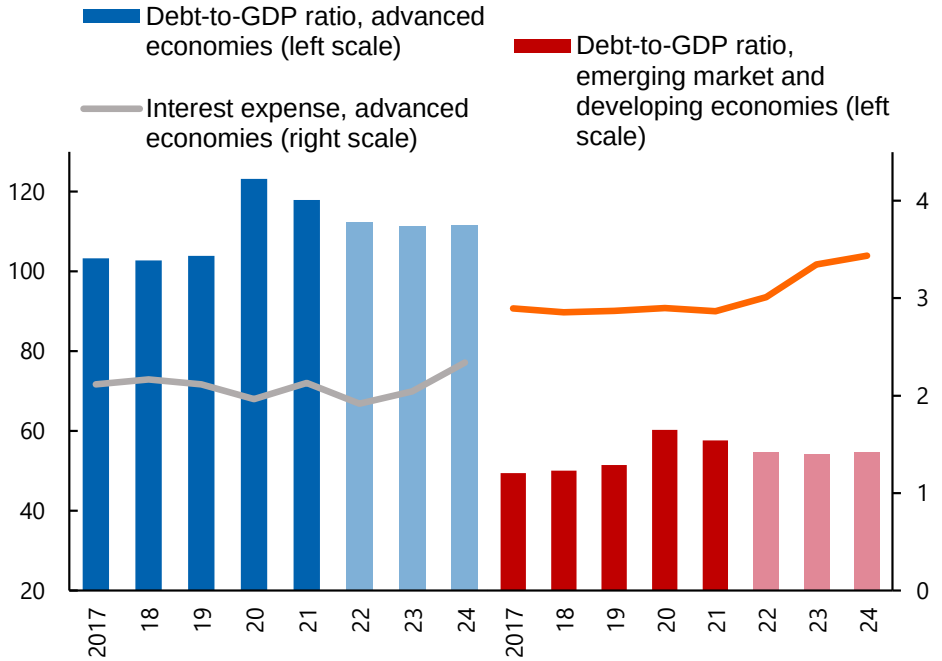
- The effect of current monetary tightening on fiscal accounts

National Budget Balances by Income Group



Sources: IMF, Santander.

National Gross Debt and Interest Expense by Income Group

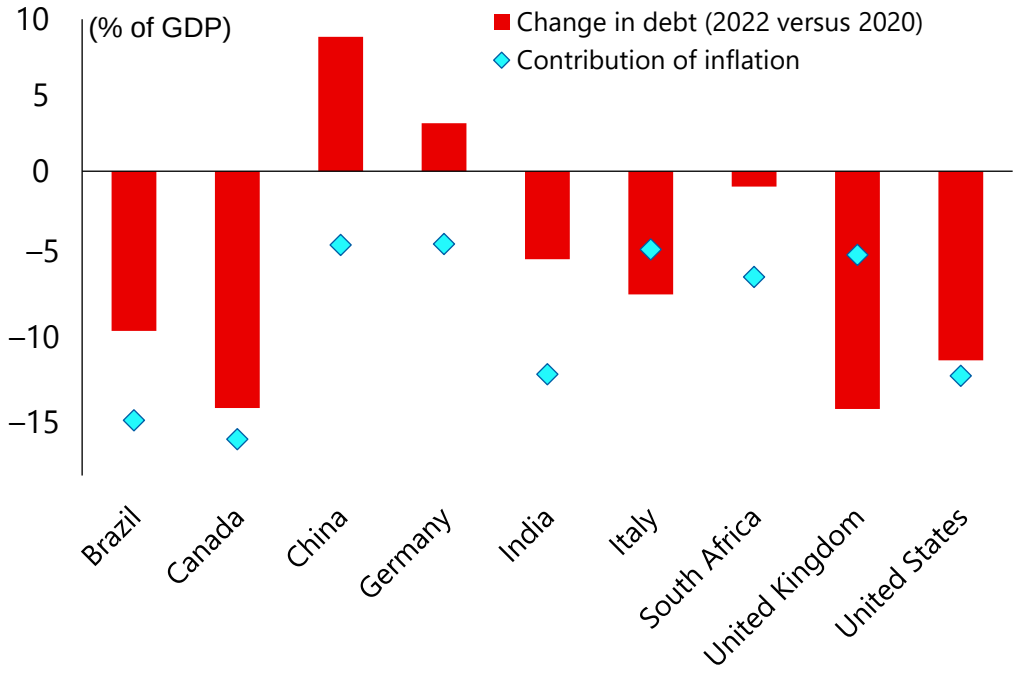


Sources: IMF, World Economic Outlook; IMF staff calculations. Note: China is excluded. Bars for 2022–24 are projected data.

International Comparison – Inflation impact on Fiscal

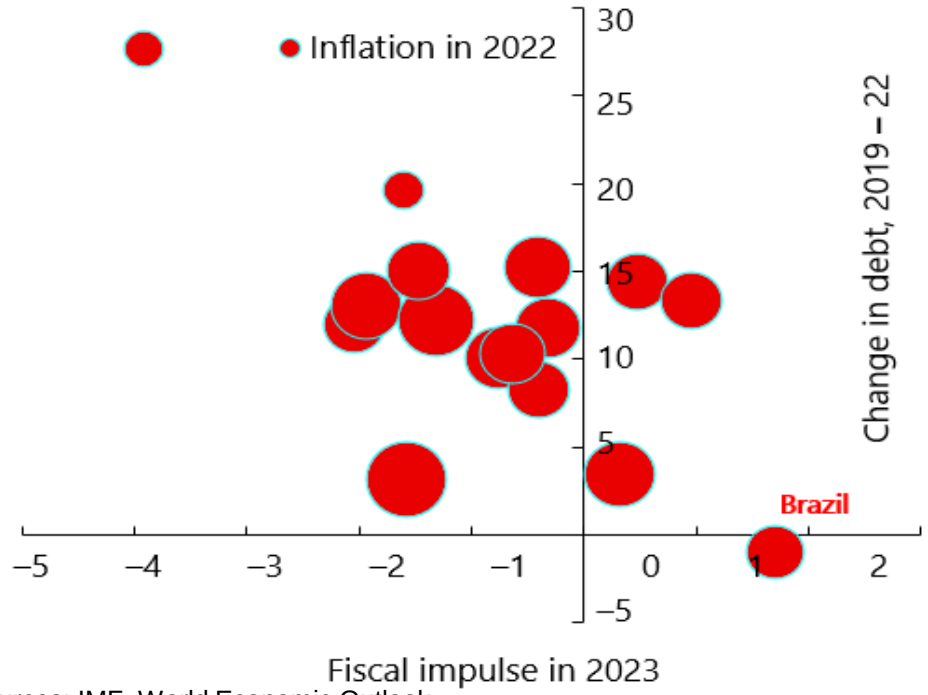
- Inflation had an effect on fiscal accounts.

Effect of Inflation Shock on the Debt Ratio



Sources: IMF, Santander.

Fiscal Impulse, Inflation, and Debt for G20 Countries



Sources: IMF, World Economic Outlook.
Note: Includes Spain; excludes Argentina, Russia, Saudi Arabia, and Tűrkiye. Fiscal impulse is measured by the change in the cyclically-adjusted primary balance. The size of the bubble reflects the inflation rate.

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 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 ~2.5-3.0pp of GDP primary fiscal adjustment, just to stabilize the ratio debt-to-GDP around the level of ~80% of GDP.

- **Current situation:**

. Real interest rate (ex-ante) 1-year: ~7.8%,
. GDP: 2.8% in 2022 and 0.7% in 2023

Liquidity reserves up to 10 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,

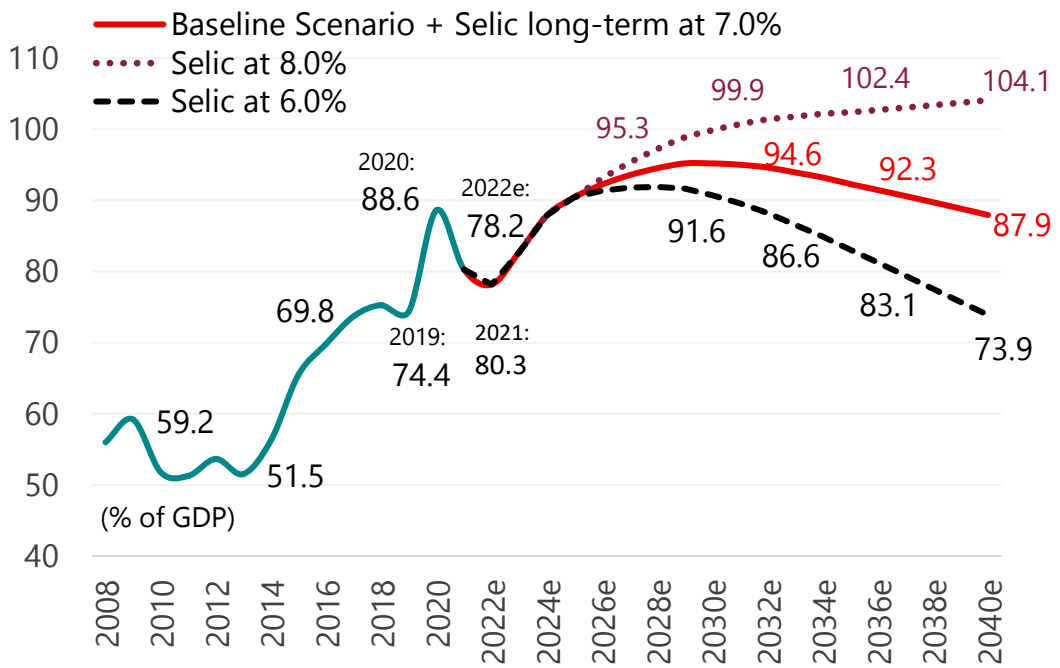
. The primary surplus must reach ~2% of GDP to maintain the gross debt stable.

		Real Interest Rate						
		0.0%	*1.0%*	*2.0%*	*2.5%*	*3.0%*	*4.0%*	*5.0%*
GDP Growth	*0.0%*	0.0	0.8	1.6	2.0	2.4	3.2	4.0
	1.0%	-0.8	0.0	0.8	1.2	1.6	2.4	3.2
	1.5%	-1.2	-0.4	0.4	0.8	1.2	**2.0**	2.8
	2.0%	-1.6	-0.8	0.0	0.4	0.8	1.6	2.4
	2.5%	-2.0	-1.2	-0.4	0.0	0.4	1.2	2.0
	3.5%	-2.7	-1.9	-1.2	-0.8	-0.4	0.4	1.2

Sources: BCB, Santander.

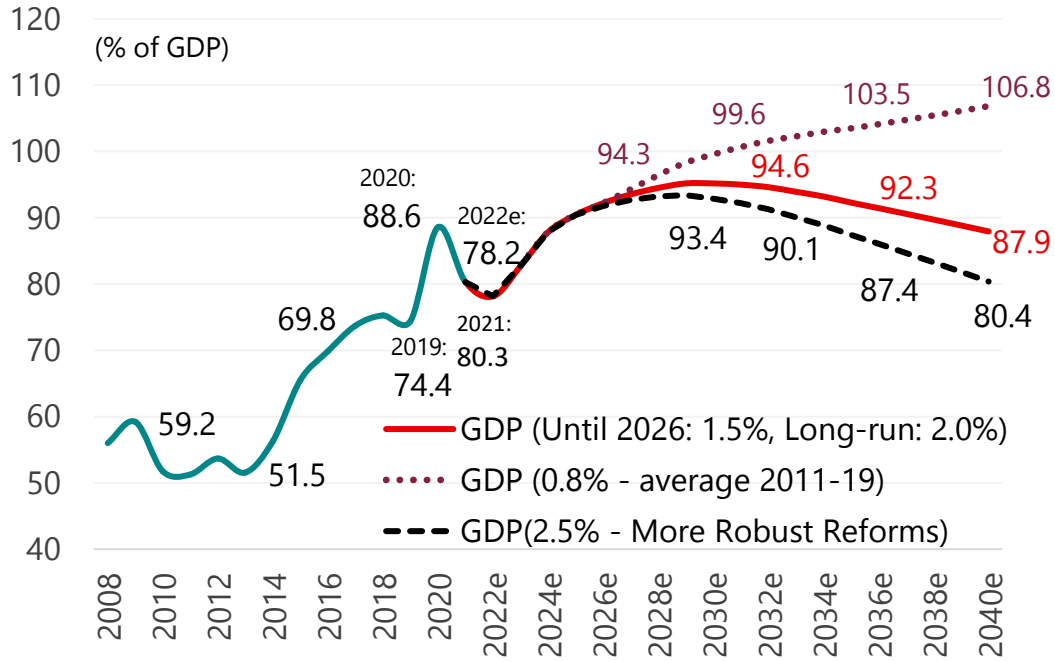
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

Government Debt – Simulations for Selic Rate Hypotheses



Sources: BCB, Santander

Government Debt– Simulating for Trend GDP Hypotheses



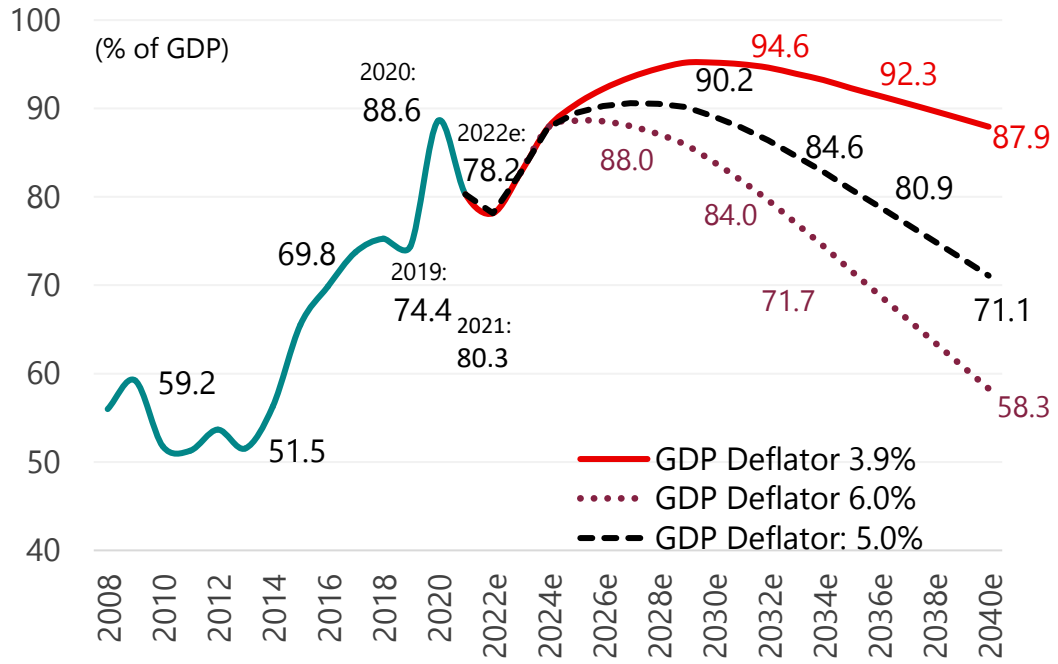
Sources: BCB, Santander.

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 + BRL47 billion in 2022)
2022 GDP Deflator: 8.5% | GDP: 2.8% | Selic Rate: 13.75% | BNDES 90 billion
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)

Santander

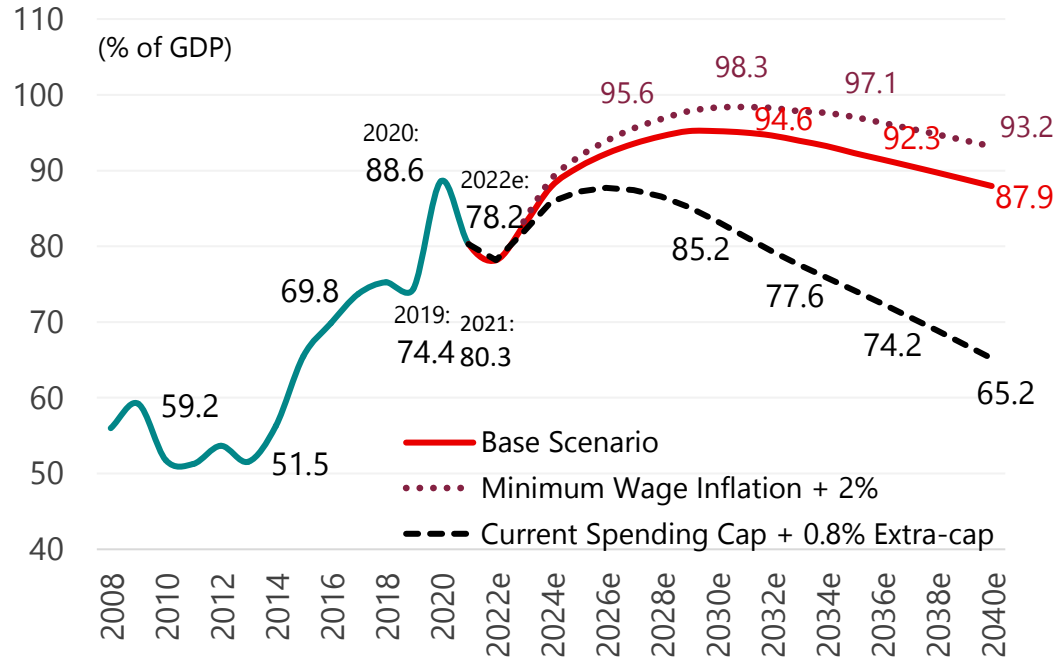
Debt Scenarios: Sensitivity to Changes in the Long Run Macro-outlook

Government Debt – Simulations for GDP Deflator



Sources: BCB, Santander

Government Debt– Scenarios Simulations



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(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

- On September 28, the National Treasury published the monthly debt report for August. Weekly bond issuances reached R$21.5 billion through August, a tad higher than the ~R$19.5 billion per week that we estimate is needed to keep liquidity reserves stable until the end of the year. For September, R$181.8 billion in floating rate (LFT) debt maturities are expected, according to the fiscal authority's data.

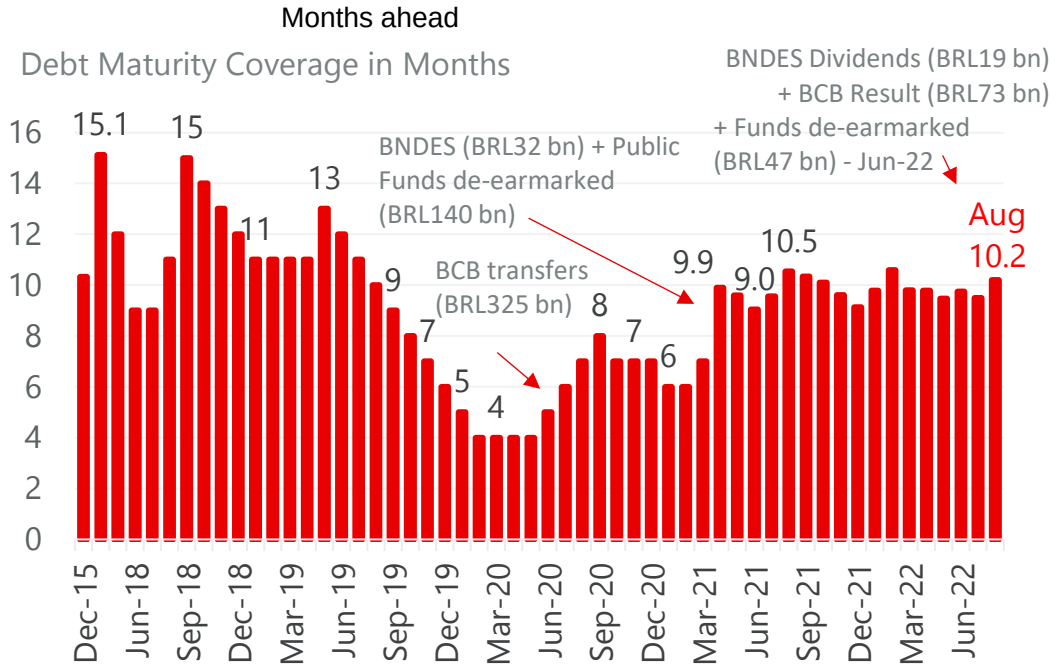
Annual Borrowing Plan (PAF 2022)								
	2020	2021	Jul-22	Aug-22	PAF 2022 range		PAF 2021 Revised (May21)	
Outstanding volume (BRL billion)					Min	Max	Min	Max
Federal Public Debt	5,010	5,614	5,804	5,781	6000	6400	5,500	5,800
Composition (%)								
Fixed-rate	34.8	28.9	25.7	27.1	24	28	31	35
Inflation-linked	25.3	29.3	32.0	29.3	27	31	26	30
Floating-rate	34.8	36.8	37.8	39.2	38	42	33	37
FX	5.1	5.0	4.5	4.5	3	7	3	7
Maturity Structure								
% maturing in 12 months	27.6	21	24.6	21.9	19	23	22	27
Average maturity (years)	3.6	3.8	3.9	4.0	3.8	4.2	3.4	3.8

Sources: National Treasury; Santander

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

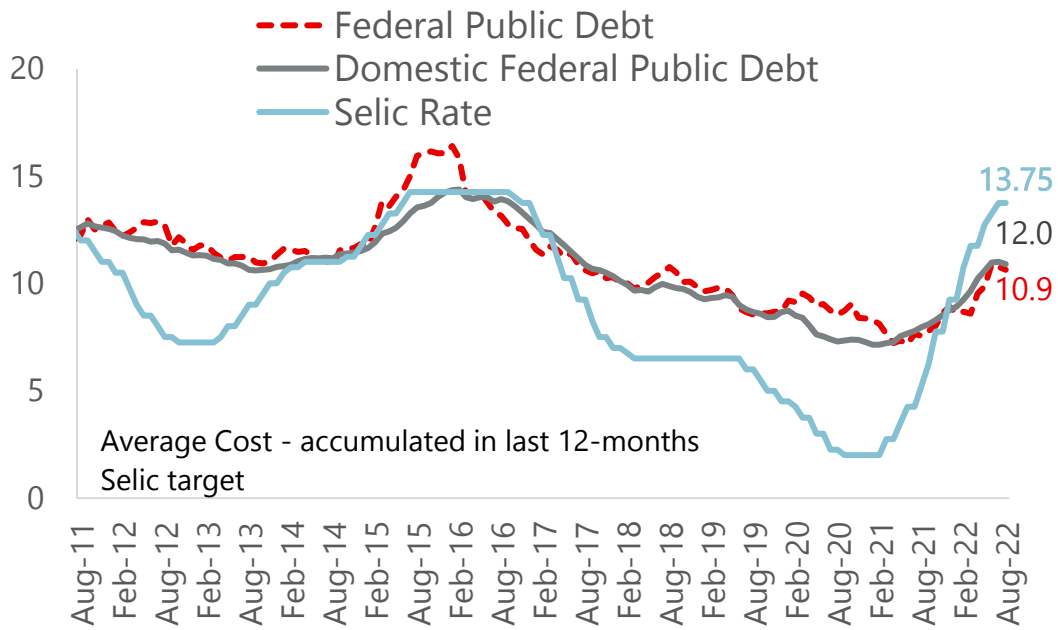
- With debt shortening it is important to keep the level of the liquidity cushion at comfortable levels.
- The domestic debt cost continued to rise, due to both inflation and Selic increase
- Public debt liquidity reserves dropped R$31.6 billion in August, reaching R$1,146 billion and reflecting net issuances with a high level of bond maturities in the month. This level of liquidity reserves covers close to 10.2 months of debt maturities (from 9.5 in July).

Liquidity cushion coverage of domestic debt



Sources: National Treasury, Santander.

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

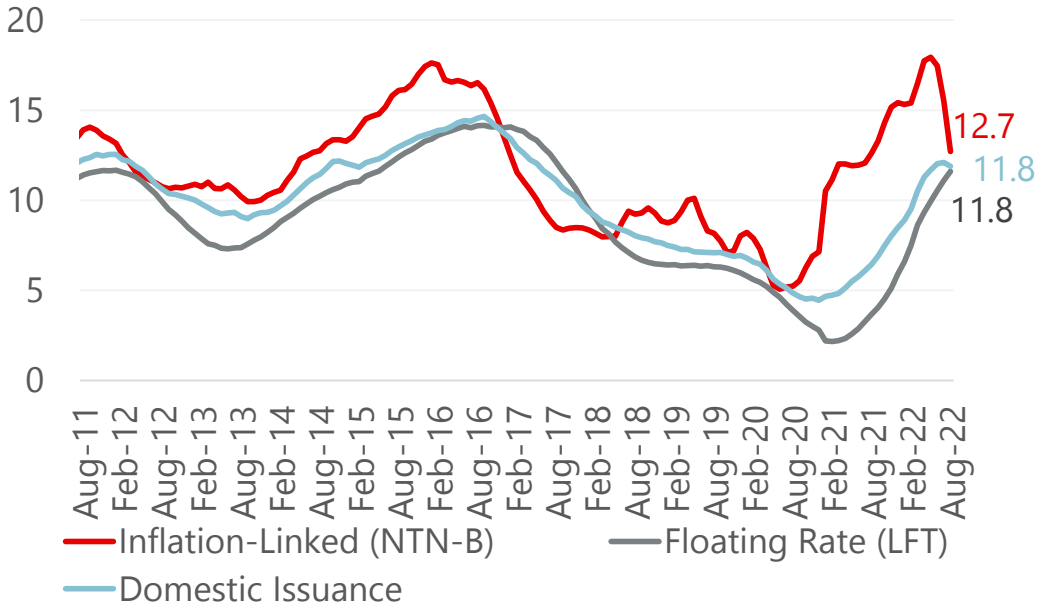


Sources: National Treasury, Santander.

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

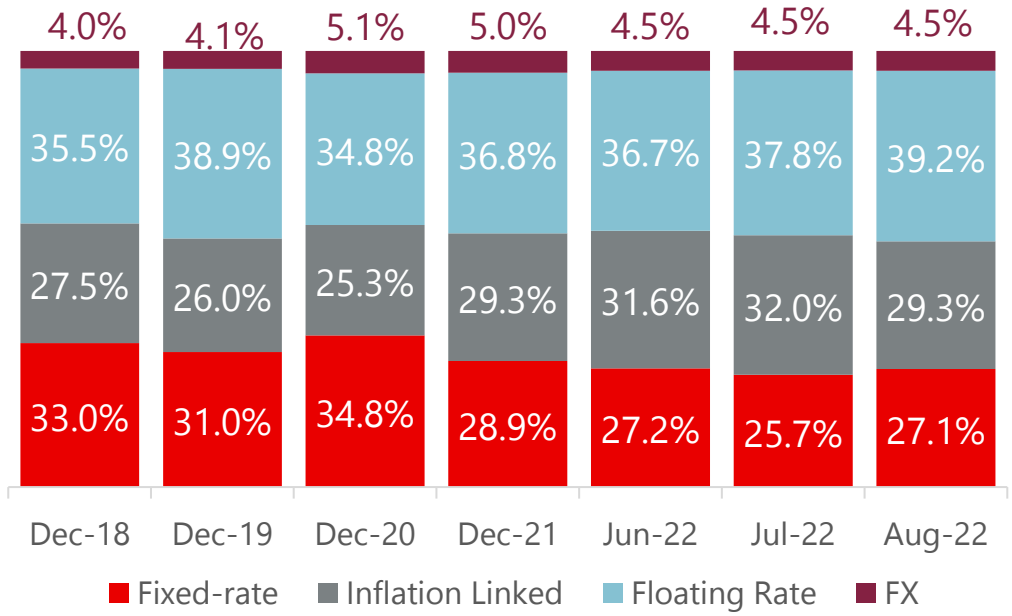
- The cost of new domestic issuances remained stable at 11.9% p.a. vs. 12.1% p.a. in July. The debt cost of LFT bonds accumulated in the last 12 months increased to 10.4% (from 9.5% in July and 4.5% in December 2021), and the recent rise in the Selic rate (currently at 13.25%) could create additional pressure on debt costs in the coming months, in our view.

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



Sources: National Treasury, Santander.

Debt Profile - %

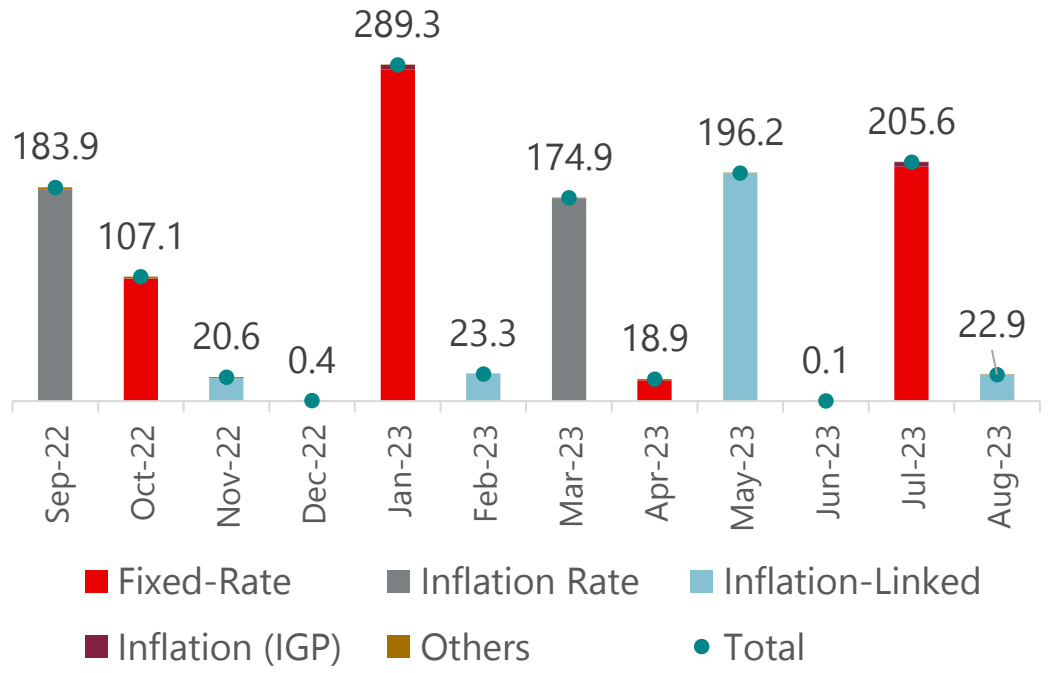


Sources: National Treasury, Santander.

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

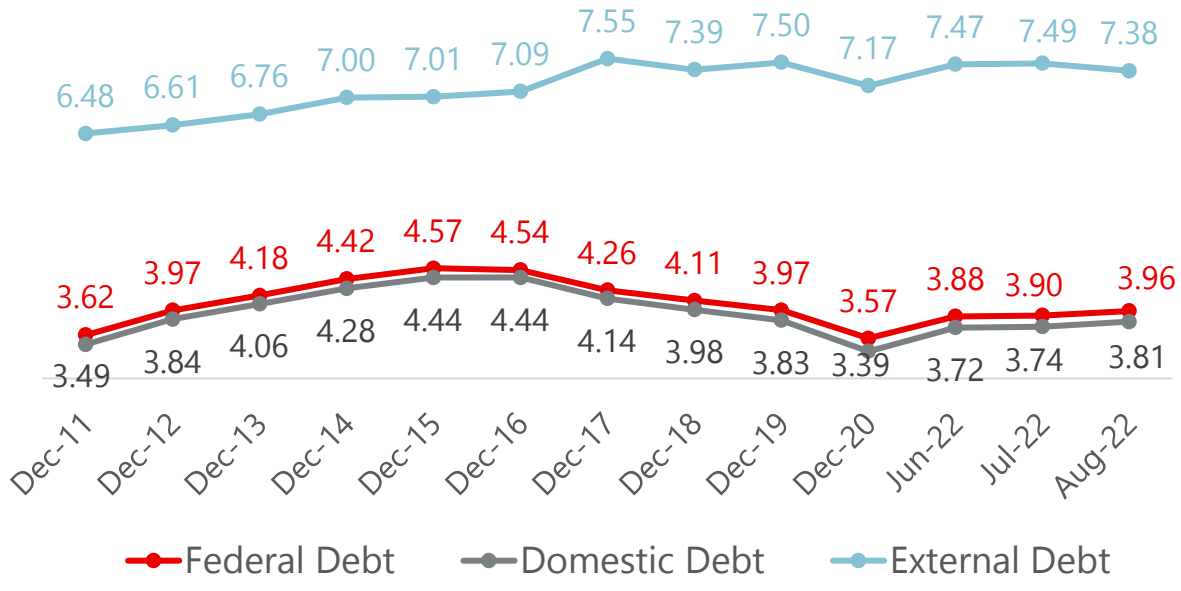
- Despite the increase in liquidity reserves the debt maturity level is still challenging. Structural reforms will help to increase debt maturity and reach a sustainable primary surplus.

Debt maturity - (BRL billion)



Sources: National Treasury, Santander

Average Maturity (years)

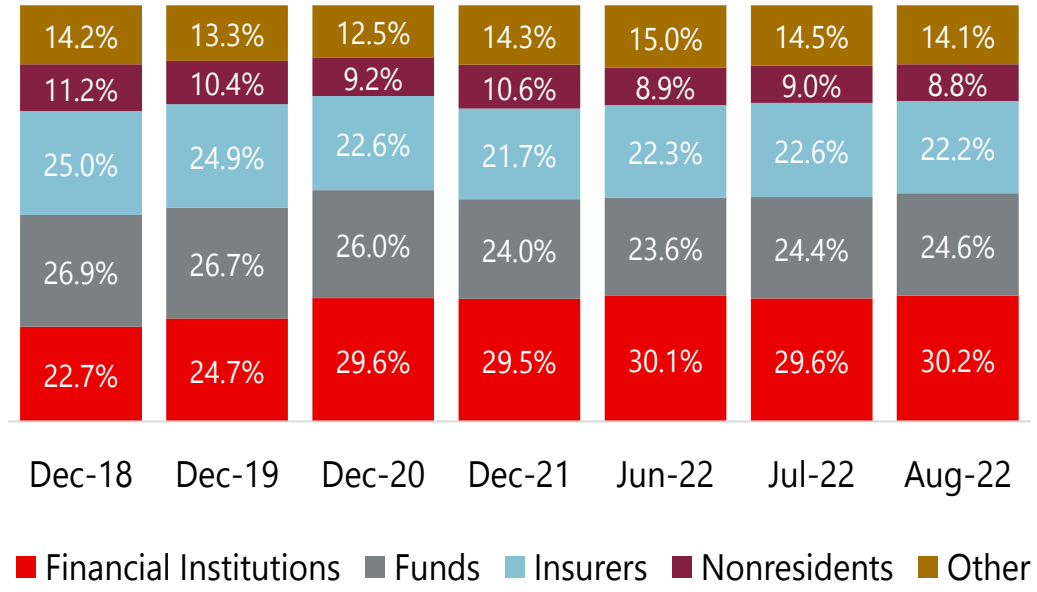


Sources: National Treasury, Santander.

Fiscal – Holders

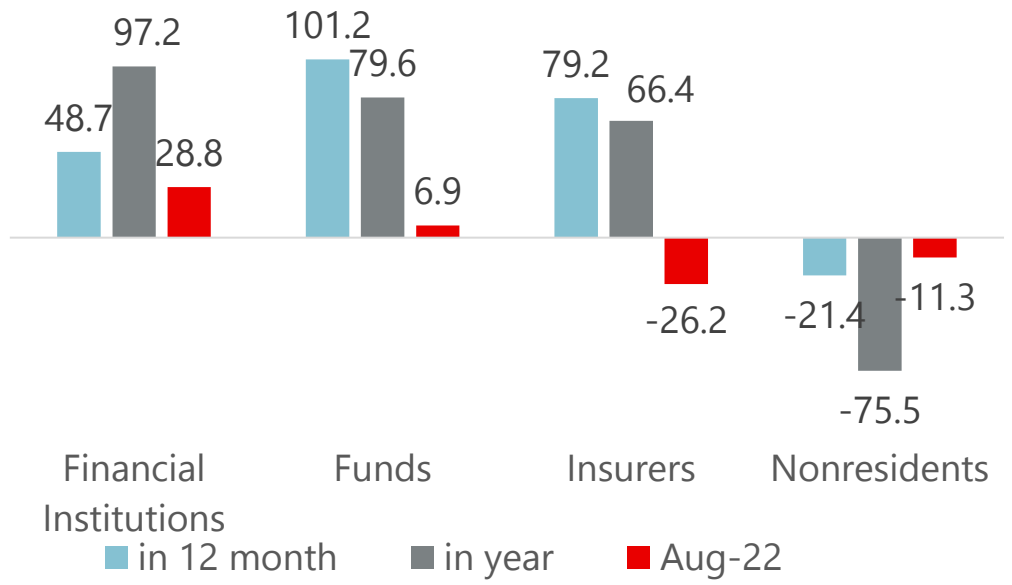
- Non-residents registered a negative flow of R$11.3 billion in August, totaling -R$75.5 billion year-to-date and -R$21.4 billion in the last 12 months, reducing the percentage of non-residents to 8.8% of debt holders, compared to 10.6% in December 2021, 9.2% in December 2020, and 10.4% in December 2019. Financial institutions continue to be the main debt holders at 30.2%.

Debt Holders - (% Total Debt)



Sources: National Treasury, Santander

Debt Holders Change



Sources: National Treasury, Santander.

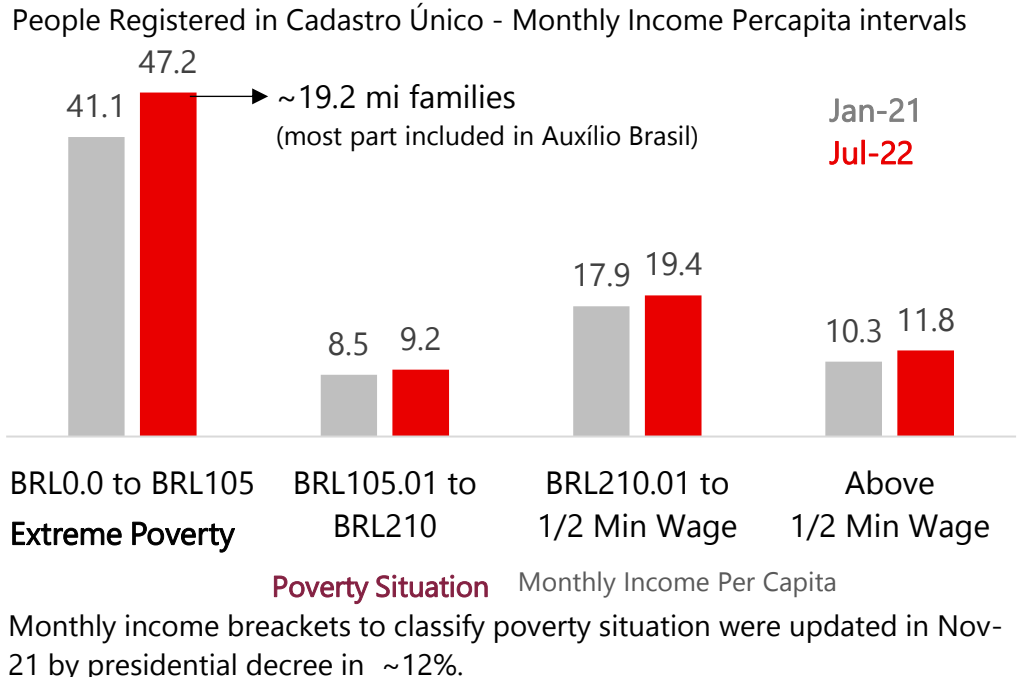
Extra-cap expenditures and Others

07

New welfare program – *Auxílio Brasil*

- Regarding the fiscal transfers, the emergency aid program ended in October 2021. The new welfare program *Auxílio Brasil* started in November 2021, with the BRL400 benefit payments starting in December (post *PEC dos Precatórios*). The government stated that in 2022 Budget there will be ~BRL90 bn 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 budget for 2023 is currently at BRL 105bn. The current monthly average benefit of the welfare program is BRL 605, reaching 21.1 million families.

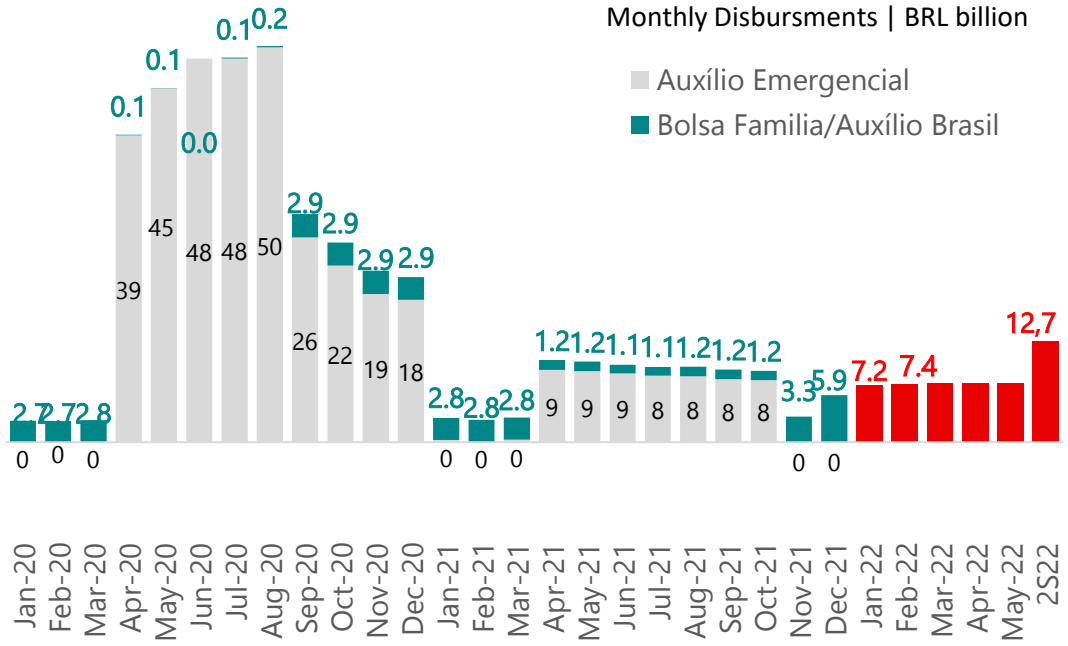
Cadastro Único – Gov. Database



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

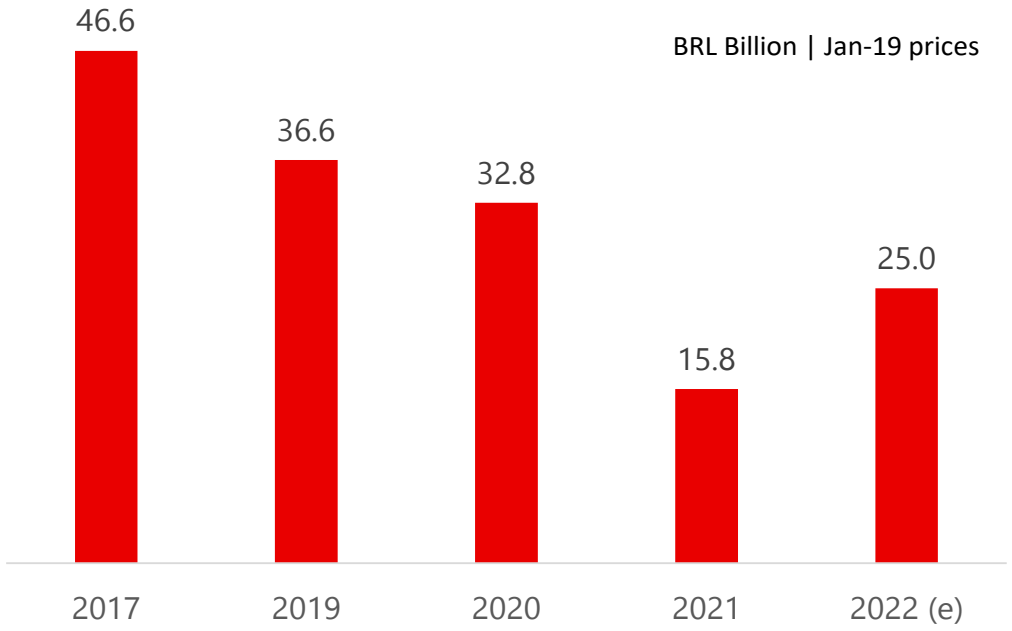


Sources: National Treasury, Santander.

New welfare program – *Auxílio Brasil*

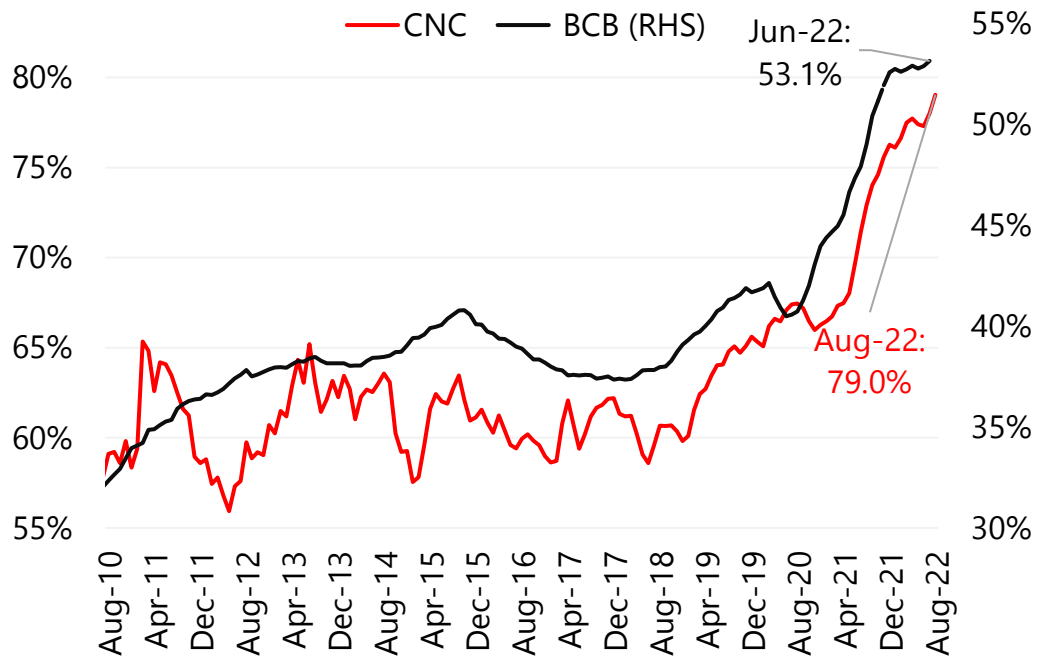
- We estimate that FGTS withdrawals added 0.6 p.p. to the growth of the “expanded” real wage bill.
- According to the BCB’s consumer indebtedness metrics (estimating the ratio of total household debt with financial institutions vis-a-vis disposable income over the past 12 months), the household debt-to-income ratio reached the peak of the series. Excluding real estate financing operations, the number is close to 34% (also a historical peak). In our view, the higher household debt follows a combination of stagnant income and solid loan growth over the last couple of years.

FGTS funds workers withdrawn



Sources: Caixa, MCM, Santander

Extended household Indebtedness (%)

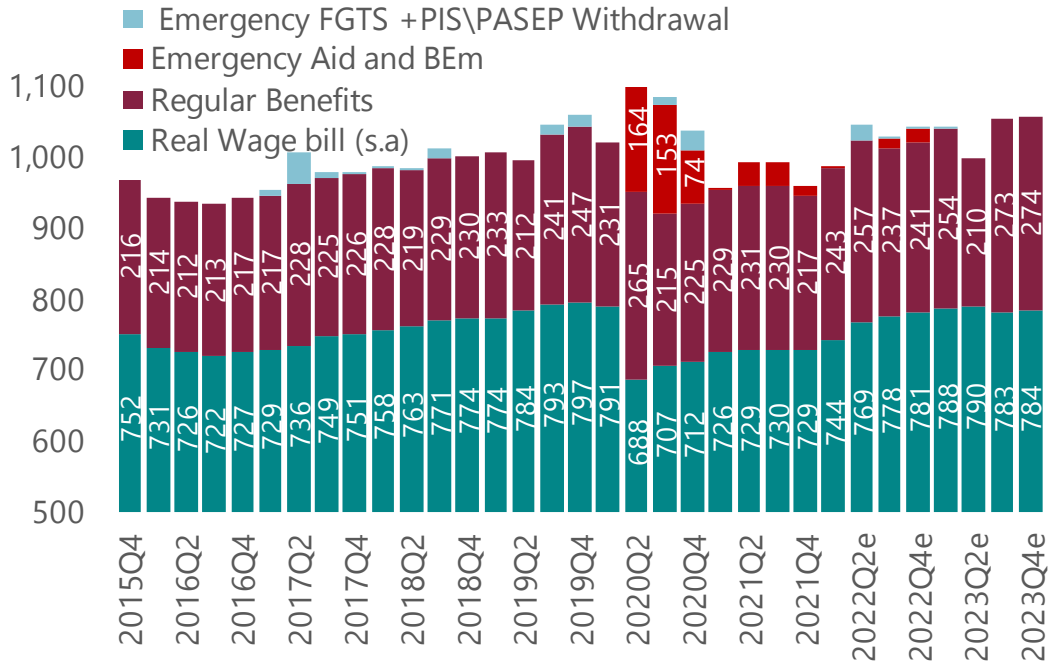


Sources: BCB, CNC , Santander.

Labor Market: All Elements Favoring Higher Total Households' Income

- We revised our “expanded” real wage bill estimates for 2022 and 2023. First, a higher trajectory for the employed population positively impacted to total wages volume. Second, we revised our scenario considering a faster than expected recovery in the average real wages. Third, we incorporated higher government transfers in 2H22 and 2023. Finally, a lower expected trajectory for inflation in the coming quarters also helped to increase the expected real income.

“Expanded” Real Wage Bill (BRL billions)



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

Old

	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%	+3.9%	+1.4%	+1.0%

New

	2021	2022(E)	2023(E)	2024(E)
Real Wage Bill	+0.6%	+5.5%	+2.4%	+1.7%
Real Wage Bill (With Government Transfers)	-8.0%	+5.0%	+2.1%	+1.0%

	QoQ sa
2020Q1	-3.8%
2020Q2	9.3%
2020Q3	-2.7%
2020Q4	-4.5%
2021Q1	-7.8%
2021Q2	4.0%
2021Q3	0.0%
2021Q4	-3.5%
2022Q1	3.0%
2022Q2	5.9%
2022Q3e	-1.4%
2022Q4e	1.0%
2023Q1e	0.0%
2023Q2e	-4.0%
2023Q3e	5.6%
2023Q4e	0.3%

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

Tables - Forecasts

08

MACRO SCENARIO: Forecasts

Macroeconomic Variables		Previous		Current
GDP (%)	2022E	2.6	↑	2.8
	2023E	-0.2	↑	0.7
	2024E	0.5	→	0.5
IPCA (%)	2022E	6.3	↓	5.5
	2023E	5.3	↓	5.0
	2024E	3.0	→	3.0
Selic Rate (% end of period)	2022E	13.75	→	13.75
	2023E	12.00	→	12.00
	2024E	9.00	→	9.00
FX Rate - USDBRL (end of period)	2022E	5.30	→	5.30
	2023E	5.40	→	5.40
	2024E	5.50	→	5.50
Current Account Balance (% of GDP)	2022E	-2.1	→	-2.1
	2023E	-2.2	→	-2.2
	2024E	-2.4	→	-2.4
Primary Fiscal Balance (% of GDP)	2022E	1.0	→	1.0
	2023E	-1.4	→	-1.4
	2024E	-1.2	→	-1.2
Gross Public Debt (% of GDP)	2022E	79.0	↓	78.2
	2023E	83.5	↓	82.8
	2024E	88.9	↓	88.0

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

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

"WAITING FOR THE SIGNS OF ECONOMIC POLICY"
(sent on October 14, 2022)

- **For the full report click on the link:**
- https://bit.ly/Std-scenupdate-oct22

Santander

For details on the results of Brazil's general elections (first round), please refer to our Electoral Map.

Santander Brazil 2022 General Elections Map: "*Main Results (October 2)*" – October 5, 2022 – Available on: https://bit.ly/Std-elections-2022

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	2.4	→	2.2	→	2.0	→	
China GDP (%)	6.7	6.0	2.3	8.1	3.7	→	5.5	→	5.0	→	
US GDP (%)	3.0	2.2	-3.5	5.7	1.7	→	0.2	→	0.7	→	
US Inflation (Core PCE, %)	2.1	1.6	1.5	4.9	4.8	→	3.4	↑	2.3	→	
US Interest Rate (FFR, %)	2.50	1.75	0.25	0.25	4.50	↑	5.00	↑	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	115	↑	105	↑	100	→	
Commodity Prices - CRB	409	401	444	571	555	↓	521	→	461	→	

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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