STRONG 4Q20 GDP CAPS A TOUGH YEAR

Ana Paula Vescovi* and
Brazil Macroeconomics Team
anavescovi@santander.com.br
+5511 3553 8567

- Despite the rising trend of commodity prices, the steepening of the U.S. yield curve and doubts about Brazilian economic policy outlook have led the BRL to be one of the worst performers among emerging currencies since last week. The sell-off also spilled over to fixed income, as the nominal yield curve bear-steepened considerably (+31bps), on the back of a higher probability of a more hawkish Brazil Central Bank (BCB) action ahead, an increase in the perception of fiscal risks and the global reflation move.
- Amid rising hospitalizations that prompted some local governments to impose new restrictions, *Butantan* is delivering new vaccines to the Brazilian Ministry of Health. Anvisa granted official approval to the Pfizer vaccine, but those should not available until 2H21. As of February 25, ~7.7 million doses (with 1.5 million as second shot) have been administered in the country.
- Although the USD7.3 billion deficit registered by the Brazilian current account in January 2021 exceeded our expectation (USD6.9 billion deficit), it has continued to shrink in 12-month terms, thus keeping a comfortable trajectory that we expect to continue in the coming months.
- On February 23, the rapporteur unveiled the draft of the constitutional amendment (PEC) to resume the emergency aid in 2021 and create the fiscal triggers (to cut expenses). In our view, the Senate could vote on the PEC *Emergencial* (i.e., the legislation on new fiscal rules) by next week. Also, the central government posted a seasonal primary surplus of BRL43.2 billion, similar to last year's result.
- February's IPCA-15 registered a 0.48% MoM change (4.57% YoY), basically in line with our forecast (0.49%) and the market's expectation (0.50%). Upward pressure on underlying inflation continued, but core measures had a mild deceleration. The picture of IPCA-15 has improved compared to the previous ones, but we maintain our view that the short-term scenario brings upside risks.
- BCB data reveals that bank lending to households decreased again in January. In the corporate segment, new loans decelerated, as additional disbursements from emergency government programs ended in December. The pending end of loan payment deferrals and the end of the emergency stipend suggest NPLs could increase in coming months.
- On activity, the first pieces of FGV's confidence data for February were released this week: the industrial survey showed the second decline in a row, reflecting a reduction in optimism. On the other hand, confidence indexes for consumer and retail increased at the margin, which were the first positive figures since September-20. Yet the indexes remain on a negative trend.
- For the coming week, the IBGE will release on Wednesday (March 3) the GDP numbers for 4Q20 and our projection is 2.8% QoQ-sa, consistent with a full-year drop of 4.2% in 2020. GDP is to show a solid growth in 2H20, though not enough to offset the pandemic's impact, positioning the economy at levels 1.6% below the ones seen before the pandemic (4Q19).

This report uses most information up to the end of Thursday, February 25, 2021.

Figure 1. Brazil Macro Agenda for the Week March 01-05, 2021

Indicators	Source	Reference	Date	Santander Estimate	Prior
Aggregate Business Confidence (points)	FGV	Feb-21	Mon, 01-Mar	--	93
Trade Balance (USD billion)	SECINT	Feb-21	Mon, 01-Mar	0.7	-1.1
GDP (% QoQ)	**IBGE**	**4Q20**	**Wed, 03-Mar**	**2.8**	**7.7**
GDP (% YoY)	**IBGE**	**4Q20**	**Wed, 03-Mar**	**-1.6**	**-3.9**
GDP 4-Quarter Rolling	**IBGE**	**4Q20**	**Wed, 03-Mar**	**-4.2**	**-3.4**
Vehicle Production (thousands)	Anfavea	Feb-21	Fri, 05-Mar	--	200
Industrial Production (% YoY)	**IBGE**	**Jan-21**	**Fri, 05-Mar**	**1.5**	**8.2**
Industrial Production (% MoM)	**IBGE**	**Jan-21**	**Fri, 05-Mar**	**0.2**	**0.9**
Vehicle Sales (thousands)	Fenabrave	Feb-21	01 to 03-Mar	--	171
Fiscal legislation vote on senate floor	-	-	02 to 04-Mar		

Source: Santander Brazil.

For details on Santander's economic forecasts for Brazil, please refer to our last scenario review[1]. For our key views and hypotheses for 2021, please refer to our macro propositions[2].

[1] **Santander Brazil - Macroeconomic Scenario: *"The Persistence of (Fiscal) Risks"* –** February 11, 2021- Available on: http://bit.ly/Sant-ScenRev-fev21

[2] **Santander Brazil** - **"Macro Propositions: Groundhog Year?"** – February 03, 2021- Available on: http://bit.ly/Sant-macro-prop-2021

LOCAL MARKETS—FX

Between last Friday and yesterday's trading session (February 25, 2021), the USD/BRL pair continued to register a quite volatile trajectory, as it ranged from 5.37 to 5.53 in intraday terms in the period. The BCB intervened three times in the FX market these days, as it tendered USD1.0 billion in FX swaps last Monday and sold USD1.5 billion in the spot market in two tranches on Thursday. However, these moves did not prevent the BRL from being one of the worst performers among emerging currencies in the last week, having ended Thursday trading session at USD/BRL5.52.

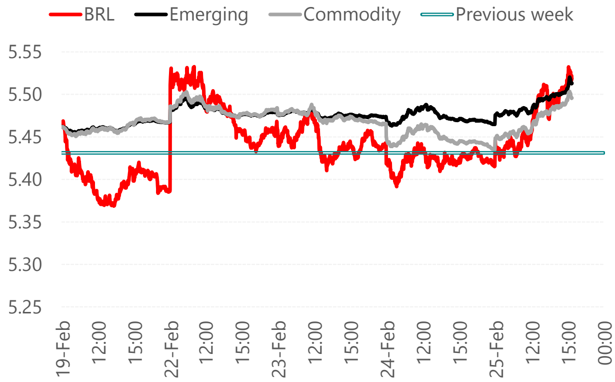
In our view, doubts regarding the outlook for economic policy and the protracted debate in the Congress about the extension of the emergency aid into 2021 and the compensatory measures and reforms to curb public expenditures in the future raised concerns among market participants and contributed to the poor performance of the BRL. Additionally, the steepening of the U.S. yield curve on the heels of the growing perception that the country's economy may gain momentum sooner than anticipated by FOMC members, given the imminent approval of another sizeable fiscal package, also weighed negatively on the dynamics of the domestic FX market and surmounted the (otherwise positive) BRL contribution from a rising trend in commodity prices. This backdrop reinforces our assessment that the room for an appreciation of the BRL in the absence of progress in the reformist agenda has definitely got smaller than we previously thought. See link below[3].

LOCAL MARKETS—Rates

The nominal yield curve bear-steepened considerably. The front end of the curve (Jan-22 DI future) rose 26 bps to 3.66% since our last report, while the back end (Jan-27 DI future) rose to 7.84% (+57 bps since our last report). Hence, the steepness in this segment rose from 387 bps to 418 bps since last Thursday. At the front end, the continuing rise in commodity prices and the poor performance of the BRL prompted the market to price in a higher possibility of a more hawkish action by the BCB in the next Copom meetings. At the long end, markets became more worried about the possible advance of a new round of income emergency aid without a concomitant approval of a measure to reduce expenses in the long-run. Moreover, the global movement of higher nominal yields also contributed to the rise of the yields in Brazil.

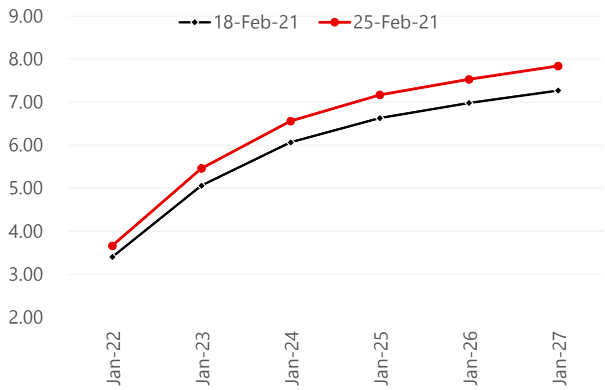
We continue to see the potential for volatility ahead, amid lingering uncertainties about the next fiscal policy steps, especially as the pandemic continues to pose threats to the speed of the reopening process in many regions, which increases the likelihood for a new round of budget stimulus without enough compensation from a long-run fiscal tightening. With markets seeing a higher fiscal risk, the bear-steepening might continue, and this trend may only be aborted if we see positive signs on the fiscal agenda during the next days.

Figure 2.A. – USD/BRL Intraday Trends



Sources: Bloomberg, Santander.
Note1: As of the closing of Thursday, February 25, 2021.
Note2: For other currencies, we use USDBRL values as a base-index

Figure 2.B. – Brazilian Domestic Yield Curve (% p.a.)



Sources: Bloomberg, Santander.
Note: As of the closing of Thursday, February 25, 2021.

[3] **Santander Brazil - Macroeconomic Scenario: *"The Persistence of (Fiscal) Risks"* –** February 11, 2021- Available on: http://bit.ly/Sant-ScenRev-fev21

COVID-19 MONITORING

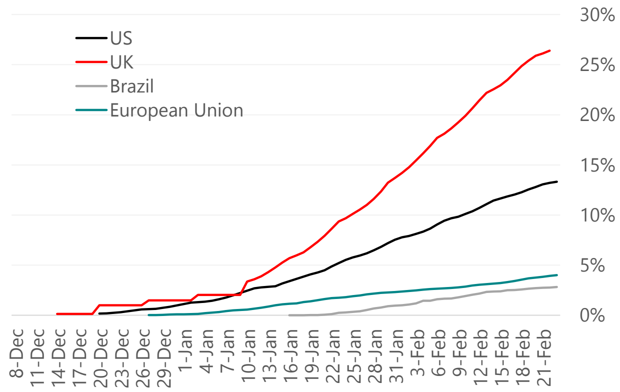
Rising cases of the U.K. variant is a risk in the U.S. amid still favorable trends in infections, deaths and hospitalizations. The severe winter storm likely caused distortions in the data, so the coming days might display a better overview of the pandemic. The pace of vaccinations in the country is currently at 1.5 million/day (7-day moving average), with nearly 13% of the population having received at least one dose. This figure stands at 26% in the U.K. and at only 4% in the European Union. New cases across most Western Europe countries appear to be flattening.

***Butantan* begins a steady delivery (schedule) of vaccines to the Brazilian Ministry of Health.** The institute is set to deliver from February 23 to March 5, 5.6 million doses of *Butantan*/Sinovac's. Another 2 million doses of *Fiocruz*/Astrazeneca's vaccine imported from India landed in Brazil this week. Together, they would bring the total amount of available doses to 19.4 million by March 5. Importantly, *Butantan* pulled forward the delivery deadline of the 100 million doses from end of September to end of August and is close to a 30 million deal with the Brazilian Ministry of Health for the remaining of the year. Lastly, Anvisa (Brazil's national sanitary watchdog) granted official approval to Pfizer, and a 100 million-dose deal of this vaccine is currently being discussed for 2H21.

São Paulo's state government to impose night curfew amid rising ICU occupancy rate. Effective on Friday (February 26), the government will enforce a night curfew from 11:00 pm to 5:00 am in the entire state until March 14. ICU occupancy rate in the state increased 3% from last week, standing at 69%. Other states in the South of Brazil have also seen a surge in ICU occupancy, prompting new restrictions (such as curfews).

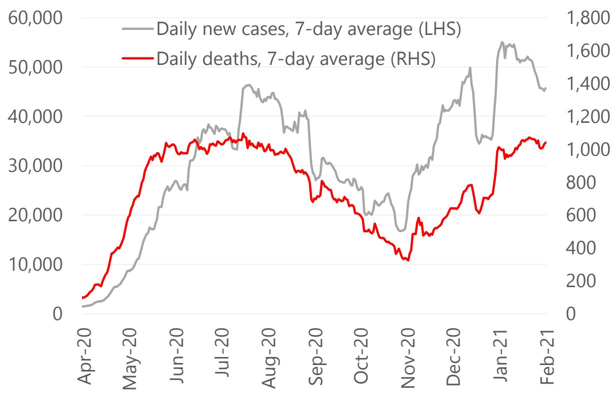
As of Thursday (February 25), 7.7 million doses[4] (out of 12 million available) have been administered in the country, with the pace of vaccination at 241k/day (7-day moving average). Johns Hopkins data for Brazil reports an average of 49k daily new cases (7-day moving average) as of Wednesday (February 24, 2021), up 8.1% from last week, while daily deaths (7-day moving average) stood at 1,124, up 8.7% in the same comparison.

Figure 3.A. – Population Who Got At Least 1 Dose - %



Sources: Our World in Data, Santander.

Figure 3.B. – Daily COVID-19 Cases, Deaths in Brazil



Sources: Brazil Ministry of Health, Santander.

[4] Out of the 7.7 million shots already administered, about 1.5 million refer to the second dose.

FISCAL POLICY AND POLITICS

The draft of the *PEC Emergencial* – a constitutional amendment setting up conditions and rules for an emergency fiscal regime - was published on February 23. The legislation will allow for the extension of last year’s Covid-19 transfers to households (i.e. the corona voucher) as well as some measures to ease the intertemporal debt impact. The government submitted to Congress a couple of bills that might pave the way for the privatization of state-owned companies such as Eletrobras and Correios. On the data front, the central government posted a seasonally-driven primary surplus of BRL43.2 billion in January, with the twelve-month rolling deficit running at 10% of GDP.

The rapporteur (Senator Marcio Bittar) of the PEC Emergencial formally unveiled his draft on February 23. In our view, the proposal came without major surprises (Figure 4.A)—it includes fiscal triggers (to curb mandatory expenses) for all government levels, which could allow the federal government to comply with the spending cap by 2024. The bill includes “calamity clause” to suspend fiscal rules with countervailing measures to curb mandatory expenses. In addition, there is a waiver on fiscal rules in 2021, including the spending cap, to re-enact the emergency aid—without limiting the value in the proposal and the scope (we consider this a significant risk). The government will send later a provisional measure to define the parameters of the new welfare program. We believe that probably the most controversial proposal was the end of the minimum floor for health and education expenditures for all government levels, which would have an intense debate in Congress. The vote on Senate floor is likely to occur next week if senators find a consensus on the main aspects of the proposal. See link below[5].

On February 23, the government submitted to Congress a provisional measure (MP 1031/2021) dealing the conditions for the privatization of state power holding Eletrobras. The bill includes the company and its subsidiaries in the National Privatization Program (PND). According the Lower House speaker (Arthur Lira), the bill will be on the agenda to be analyzed next week. On February 24, the government presented to Congress a bill (PL 591/2021) to change the postal service regulation in order to allow the future privatization of the postal office (*Correios*). Both measures might potentially mean some steps forward in the privatization agenda, yet it will probably face and intense congressional debate before the final approval, in our view.

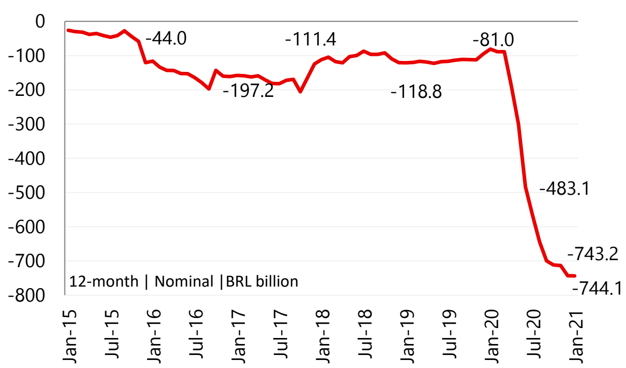
Finally, the central government posted a seasonal primary surplus of BRL43.2 billion in January. This result is similar to that recorded for the month in January 2020, and reflects the recovery in activity in 4Q20 and the sharp reduction in fiscal stimuli. With this result the 12-month deficit reached BRL744.1 billion (all-time high), or 10.0% of GDP. Total revenue dropped -0.1% YoY in the month, while total expenses declined -0.4% YoY, both in real terms. According to our forecasts, the deficit will total BRL255 billion in 2021—meaning a (rather risky) return to gradual fiscal consolidation after the massive stimulus as of 2020. This number already includes the expenditures related to the vaccines (BRL20 billion) and the resumption of the Emergency Aid (BRL30 billion). The main risks are: an unrestricted budget expense in the Emergency Aid resumption, and lower-than-expected recovery in tax revenues (such as a higher use of tax credit by judicial decisions).

Figure 4.A. – PEC Emergencial Summary

- Allows the Emergency Aid in 2021 (‘waiver for fiscal rules’) – without limit.
- Fiscal triggers when mandatory expenses/Total > 95% (~ in 2023)
- Subnational fiscal triggers (~ in 2023)
- 6 months to create a plan to reduce tax exemptions (needs more enforcement),
- A calamity ‘clause’ that could be used by congress, easing fiscal rules,
- Ends the floor for spending on education and health (both = ~BRL 200 billion)
- Revokes transfers from FAT to BNDES and “Lei Kandir” (transfers);
- Treasury Judicial claims borrowing lines for subnational entities.

Sources: National Congress, Santander.

Figure 4.B. – Central Gov. Primary Fiscal Balance



Sources: National Treasury, Santander.

[5] **Santander Brazil Fiscal - *“Fiscal Policy Chartbook - On a tightrope”* –** February 23, 2021- Available on: http://bit.ly/Sant-fiscal-chart-fev21

INFLATION

February's IPCA-15 registered a 0.48% MoM change (4.57% YoY), basically in line with our forecast (0.49%) and the market's median expectation (0.50%).

On the upside surprises, food-at-home contributed with +6bps—the surprise was scattered among items, but proteins concentrated a great part of the deviation. More importantly (as they are more related to underlying measures), industrial goods contributed with +3bps of surprise to the headline. Finally, services went in the other direction, contributing a significant downside surprise of -10bps—education was the main highlight as regular courses alone, contributing -5bps to the headline deviation.

Underlying measures showed some relief, with the average trend of cores moving from 5.4% to 5.1% (3mma-saar). While industrial goods continued to accelerate in trend terms and went to 7.8% to 8.4%, services cooled down, moving from 3.4% to 2.6%—with the one-off effect of education playing a major role on that deceleration. Diffusion also saw relief, going from 61.8% to 61.3% in seasonally adjusted terms.

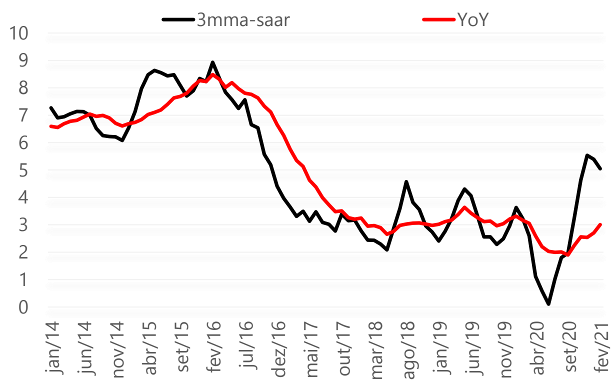
All in all, the picture of IPCA-15 today is better than the last ones, but we do not change our mind that the short-term scenario is still of an upwardly pressured one. Our forecasts follow: 0.62% MoM for January (from 0.65% before), 0.49% MoM for February (from 0.46% before) and 0.39% MoM for March (from 0.40% before). Our high-frequency tracking for IPCA 2021 continued at 4.1% (although the official forecast is lower, at 3.6%). On the balance of risks, it is still tilted to the upside, though this reading reduces a bit the size of that risk. Finally, our forecast for 2022 also remains at 3.2%, but with upside risks coming from higher 2021 inertia. See link below[6].

Figure 5.A. – IPCA by Groups (%)

	MoM			YoY	
	Feb-21	Santander	Dev.	Jan-21	Feb-21
IPCA-15	0.48	0.49	-0.01	4.3	4.6
Administered	0.28	0.26	0.00	2.3	2.3
Free	0.55	0.56	-0.01	5.0	5.4
Food-at-home	0.56	0.15	0.06	18.0	19.1
Industrial goods	0.60	0.48	0.03	3.2	4.1
Services	0.51	0.78	-0.10	1.5	1.3
EX3 Core	0.34	0.42	-0.07	2.5	3.0

Sources: IBGE, Santander.

Figure 5.B. – Core Inflation Average (%)



Sources: IBGE, Brazilian Central Bank, Santander.

[6] **Santander Brazil Inflation - *"IPCA-15 February: Underlying Measures Still Suggest a Pressured Inflation Scenario"* –** February 24, 2021- Available on: http://bit.ly/Sant-ipca15-250221

ECONOMIC ACTIVITY

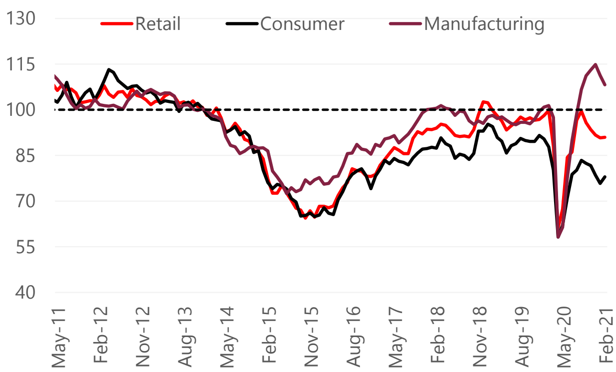
Negative trend recorded in confidence data. The first pieces of FGV's confidence data for February showed a common negative trend recorded among the sectors. The industrial survey preview posted a -2.8% MoM decline in manufacturing confidence, reflecting a reduction in optimist, and although the index is up by 6.7% since February-20 (pre-crisis mark), a deceleration at the margin is recorded, with the 3mma (less-volatile) going down for the first time since June-20. The confidence indexes of consumer and retail posted increases at the margin (2.9% and 0.2%, respectively), but over very depressed basis of comparison. These were the first positive figures after four declines in a row, but the headline indexes are still recording negative trends (-1.6% and -0.6%, respectively).

Our proprietary coincident indicator (IGet) pointed to likely positive activity figures for February-20, though not enough to offset the contraction cumulated in the last three months. Indeed, our monthly tracking for broad retail sales and services provided to families is at 3.8% and 2.5%, respectively. See links below.[7] [8]

A solid growth but with a partial recovery. Following the strong rebound of the previous quarter, the releases of activity indicators suggest solid economic growth in 4Q20. In our view, these figures are coherent with our projection of 4Q20 GDP growth of 2.8% QoQ-sa, implying a full-year contraction of 4.2% in 2020. On the supply side, we expect the services sector to post solid growth (2.6%), on the heels of advances in the economy's reopening process throughout the quarter. Regarding industry, we expect a consolidation of the recovery in 2H20 (with quarterly growth of 1.4%), following the support in goods demand and the inventory replenishment. On the demand side, we highlight investments, which we expect to show strong growth (18.6%), stemming mainly from the increase in capital goods net consumption and from the improvement in the building sector. We also expect household consumption to contribute positively (3.2%), reflecting the effects of the emergency aid and the increase in mobility. Therefore, we expect economic activity to show solid growth in 2H20, though not enough to offset the pandemic's impact, with GDP reaching levels still 1.6% below the pre-crisis mark (4Q19). In terms of outlook, the fourth quarter's result implies a carryover of 3.2% for 2021, which should be partially mitigated by deterioration in economic activity expected for 1Q21 (our estimate is -0.4%), given the materialization of the fiscal cliff and the setback of the economy's reopening process following the resurgence of the pandemic. See link below.[9]

For the coming week, the IBGE will also release Industrial Production for January, and we expect a monthly growth of 0.2% (1.5% YoY), given an inventories replenishment which we expect to support production amid an environment with lower demand for goods.

Figure 6.A. –Confidence Breakdown (sa)



Sources: FGV, Santander.

Figure 6.B. – GDP Projections Breakdown

		4Q20e		2020e
	Weights	% YoY	% QoQ	% Year
GDP	100%	-1.6	2.8	-4.2
Supply				
Taxes	14%	-1.8	3.3	-5.4
Agriculture	6%	0.1	-0.2	2.0
Industry	19%	0.8	1.4	-3.6
Services	62%	-2.4	2.6	-4.5
Demand				
Consumption	62%	-3.2	3.2	-5.5
Government	20%	-3.8	1.3	-4.6
Investments	16%	12.2	18.6	-1.1
Exports	18%	-7.2	-3.0	-2.5
Imports	-14%	0.2	25.5	-9.1

Sources: IBGE, Santander.

[7] **Santander Brazil Economic Activity - *"IGET Fevereiro (Prévia): Varejo devolve parte das perdas"* –** February 19, 2021- Available (in Portuguese) on: http://bit.ly/Sant-iget-previa-fev21
[8] **Santander Brazil Economic Activity - *"IGET Fevereiro (Prévia): Serviços mostram alta na margem"* –** February 19, 2021- Available (in Portuguese) on: http://bit.ly/Sant-iget-serv-fev21
[9] **Santander Brazil Economic Activity - *"Solid growth but with a partial recovery"* –** February 25, 2021- Available on http://bit.ly/Sant-econact-250221

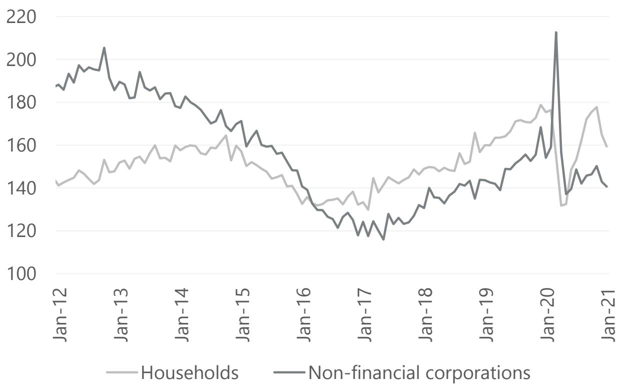
BANK LENDING

Total outstanding loans in the National Financial System (SFN) posted inflation-adjusted growth of 10.8% YoY in January (BRL4.0 trillion), up 6.0% YoY for households and 17.7% YoY for non-financial corporations. For households, non-earmarked new loans saw a decrease of 3.4% MoM-sa in January**, which in our view is likely a result of a slowing demand reflecting the end of the massive fiscal stimulus.** Credit card purchases decreased 1.8% MoM-sa, while vehicles financing declined 6.8% MoM-sa. In the earmarked segment, real estate financing remains high (39.4% YoY), as financial conditions are favorable.

For companies, there was a decrease of 1.6% MoM-sa in the non-earmarked segment, with working capital decelerating. In the earmarked segment, January saw a decrease of 19.3% MoM-sa, as **new disbursements from emergency credit programs came to an end in December.** In our opinion, a slowdown in these pandemic-related credit was expected as economic activity recovers.

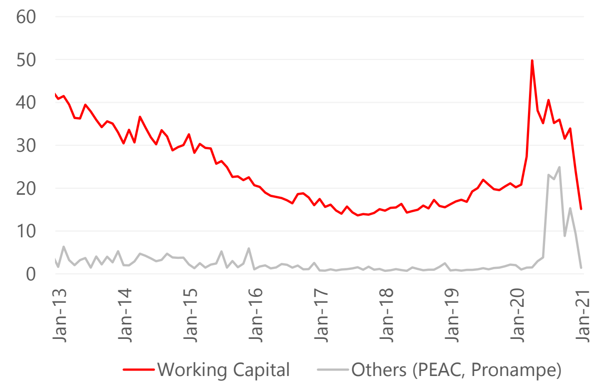
Still with respect to non-earmarked loans, the seasonally adjusted NPL (percentage of 90-day past due loans) dropped another 0.1 p.p. in the month for households, coming in at 4.1%, the lowest value observed for households in the historical series that began in March 2011. For corporations, there was an increase of 0.2 p.p. to 1.6%. **We are still of the view that delinquencies are likely to increase in the coming months due to the pending end of loan payment deferrals and the end of the emergency aid.** See link below[10].

Figure 7.A. – New Loans – Non-Earmarked (adjusted for inflation and seasonality, BRL billion)



Sources: Brazilian Central Bank, Santander.

Figure 7.B. – New Loans – Earmarked (adjusted for inflation and seasonality, BRL billion)



Sources: Brazilian Central Bank, Santander.

[10] **Santander Brazil Credit - *"A Sequential Drop in January"* –** February 25, 2021- Available on: http://bit.ly/Sant-credit-250221

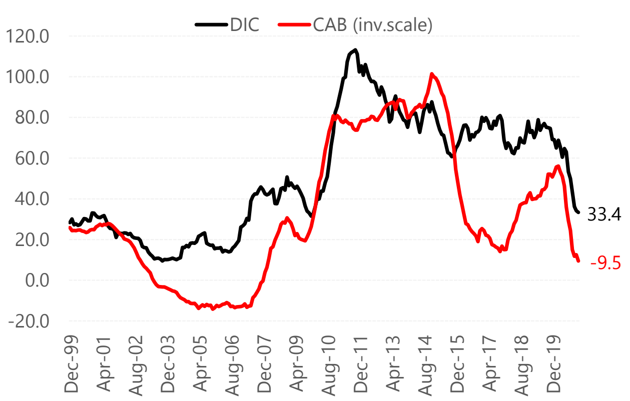
BALANCE OF PAYMENTS

The Brazilian current account balance registered a USD7.3 billion deficit in January 2021, which was a little above our estimate of a USD6.9 billion deficit for the period, due to larger than indicated interest payments in the schedule provided by the BCB. The 3MMA-saar figures of the current account balance registered some deterioration in the margin, but it is important to bear in mind that the import of oil platforms have distorted this gage lately. Incidentally, the trade balance in February 2021 due to be released next Monday (March 1, 2021) will also be influenced by the same type of deal. We forecast the trade balance to register a USD0.7 billion surplus this month. It is true that recent nature of import of oil platforms differs from the one we witnessed in 2020 (see link below[11]), but it continues to be an *ad hoc* operation that does not seem to be related with the underlying dynamics of the trade balance, hence we will continue to factor them out to assess the Brazilian foreign trade.

Taking a look at the financial account, the volume of direct investment in the country (DIC) also frustrated our expectation, as it was nearly half of what we estimated for last month (USD1.8 billion versus USD3.5 billion), which also kept its 12-month-to-date trajectory in a downward trend, although less steeply than the one presented by the current account deficit. Moreover, according to preliminary BCB figures, we are about to see a U-turn in this trend in February 2021—a move that is also indicated by the 3MMA-saar figures of the DIC. That is, we continue to see quite comfortable conditions for the Brazilian external financing needs to be met this year.

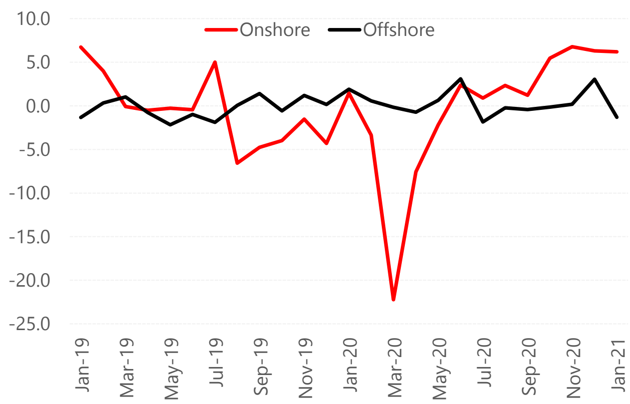
In addition, foreign investors have continued to be net buyers of Brazilian financial assets in the domestic market for the eighth month in a row, which indicates that some of the ample international liquidity has favored the country, in our view. Once again, we think today's data add to the set of signals that BRL weakness is related to something other than the fundamentals of the Brazilian balance of payments. See link below[12].

Figure 8.A. – Current Account Balance vs. Direct Investment in the Country (USD billion, 12M-to-date)



Sources: Brazilian Central Bank, Santander.

Figure 8.B. – Net Foreign Portfolio Monthly Flows (USD billion)



Sources: Brazilian Central Bank, Santander.

[11] **Santander Brazil – External Sector – *"Trade Balance December 2020"* –** January 4, 2020- Available on: http://bit.ly/Sant-tradebal-dec-20
[12] **Santander Brazil – External Sector – *"The Game Goes On"* –** February 24, 2020- Available on: http://bit.ly/Sant-BoP-250221

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research			
Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp Vasquez*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327
Global Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500
Fixed Income Research			
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Equity Research			
Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Daniel Gewehr*	Head, Brazil	dhgewehr@santander.com.br	5511-3012-5787
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