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Covid-19: The Dominance of Uncertainty - Updating Brazil Forecasts

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Covid-19: the dominance of uncertainty

Santander Brazil's scenario for 2020 and 2021

Global policies: an unprecedented level of stimulus

Global leaders are pledging to do "whatever it takes."

High level of uncertainty makes it hard to estimate the extent of the economic impact and the pace of recovery

The duration, intensity and effectiveness of the government's measures will determine the economic path. We believe the composition of domestic GDP should help to prevent a harder hit on the local economy but is hardly enough to avoid a recession.

A disinflationary shock: inflation even less of a concern this year

We see anchored inflation expectations, high economic slack and volatile commodity prices resulting in an IPCA far below the mid target (4.0%).

Fiscal policy: (temporarily) changing route

While significant spending is necessary to respond to the crisis, we believe the longer-term goals should remain intact.

Covid-19: the dominance of uncertainty
Santander Brazil's scenario for 2020 and 2021

BCB may add further monetary stimulus to fight the impact of the coronavirus on the Brazilian economy

A new (controversial) framework is being created for the BCB to buy assets to fight effects of Covid-19. We hope this will be temporary.

Credit market: the coronavirus interrupts a credit expansion trend

We view this as a temporary obstacle in an ongoing trend of credit expansion.

FX rate: we will survive

We believe the end of the Covid-19 crisis is likely to ease pressure on the BRL over the medium term.

Current account deficit: A challenging mix of shocks

We expect the collapse of international trade and falling commodity prices to weigh on the current account balance.

Introduction

- ***The Covid-19 pandemic brings social and economic distress across the globe***

Brazil entered the current crisis without having recovered from the previous one, which had been a local crisis. In just over a decade, Brazil has experienced three severe crises: a financial crisis, of a global nature, in 2008-2009; and a fiscal crisis, of a local nature, in 2015-2016. Now the country faces a sanitary crisis, originating from abroad, which starts in 2020 with impacts (global and local) apparently more severe than in previous crises.

Simultaneously, on a temporary basis, countries seek to direct public policy to mitigate the inevitable contagion on the economy; organize logistics to avoid interruption in the production and distribution of essential goods (food, medicine); sustain income for the most vulnerable; mitigate the impact on cash flow of companies and businesses; and ensure the functionality of the markets. In the scope of business and consumers, efforts include the temporary suspension of some financial and tax expenses, which would allow companies to survive and maintain a certain level of financial health for families, making room for a faster recovery after the crisis.

Several measures point in the direction of a massive injection of fiscal, para-fiscal (credit) and financial resources. Those are meant to fill the activity gap generated by the partial closure of the economy. The reaction includes fiscal and monetary impulses, in addition to bold healthcare actions, as never seen by the current generation.

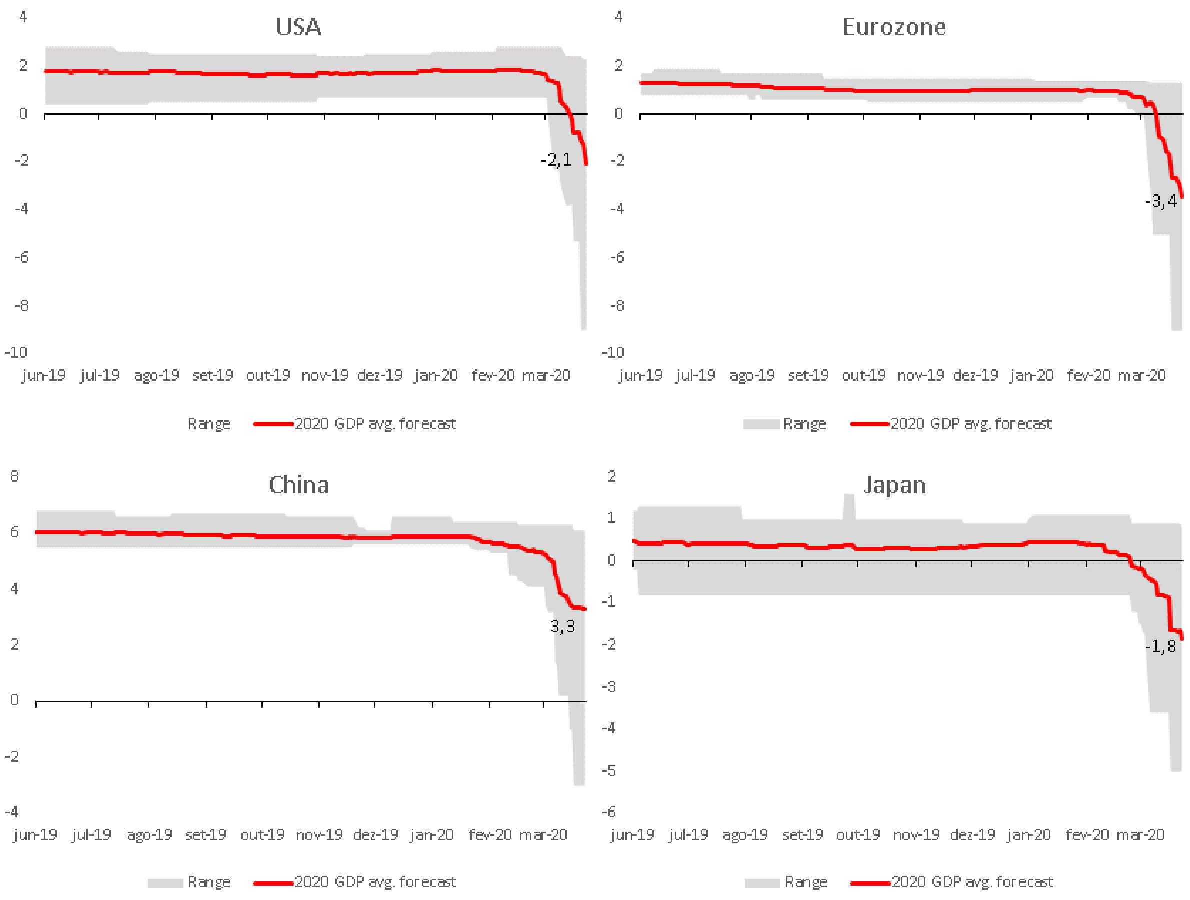
In this report, we present, in a summarized way, existing data through March 31, 2020, outlining the pandemic's numbers and facts. We present the actions taken by several countries and Brazil, which will be the basis for the construction of macroeconomic scenarios by our Santander Brasil macroeconomic research team.

Global: Covid-19 may lead the world into recession

- ***When the recession is self-imposed, policy makers can only help to mitigate it***

Since late January the global economy has been facing its worst slowdown since the great financial crisis, back in 2008/09. The inevitable recession that will take place in the first half of this year will not be caused by the usual late-cycle dynamics but instead by the Covid-19 pandemic, in our view. More specifically, we expect the downturn to come from the measures imposed by governments trying to contain the virus's spread, namely the social distancing strategy. With most countries in almost complete lockout for weeks, their economies (especially services) are shutting down in an unprecedented manner. When looking at the largest economies around the world, we believe a GDP contraction in 2020 will most certainly be the case, except for China, which we expect to slowdown from 6% to somewhere around 2%. With a global recession already in the making, the next question is regarding how severe it will it be, and then when it is going to begin to turn around and, finally, how fast will a recovery be. Yet, with most countries seeing contagion still on the rise, those questions remain unanswered. The only certainty is that central banks and governments will use unprecedented measures to try to mitigate the effects of the recession.

Global growth forecast revisions for 2020



Source: Bloomberg.

Global policies: an unprecedented level of stimulus

- ***Global leaders pledge to do "whatever it takes."***

Ever since it became clear to us that a recession was going to be inevitable (perhaps the recent 30% selloff in equity markets helped strengthen the signal), government authorities started to come together with measures to try to mitigate the effects of the crisis. As usual, central banks came first, led by the Fed. In some countries, interest rates are being slashed to zero; in places where rates were in negative territory, other measures are being taken. Moreover, asset purchase programs are back larger than ever while other liquidity and credit facilities are being reinstated. Emerging economies are following advanced economies and easing monetary policy in most places. On the fiscal side, we are starting to see the passing of large fiscal packages to deal with the Covid-19 crisis. Even though the U.S. has not been the first to resort to budgetary tools, it has certainly announced the mightiest program, with a hefty 9.5% of GDP in stimulus. With all the guns being brought to the table (and this process is still ongoing), the level of monetary and fiscal easing around the world is quickly surpassing that of 2008/09. When the lockdowns start to ease, as the world overcomes the pandemic, we expect this massive stimulus to provide grounds for a faster global recovery.

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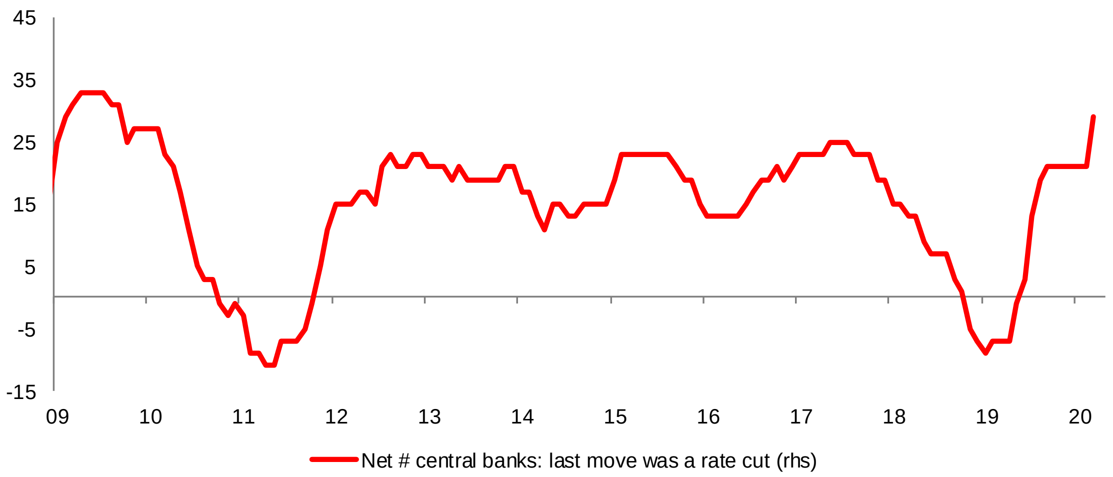
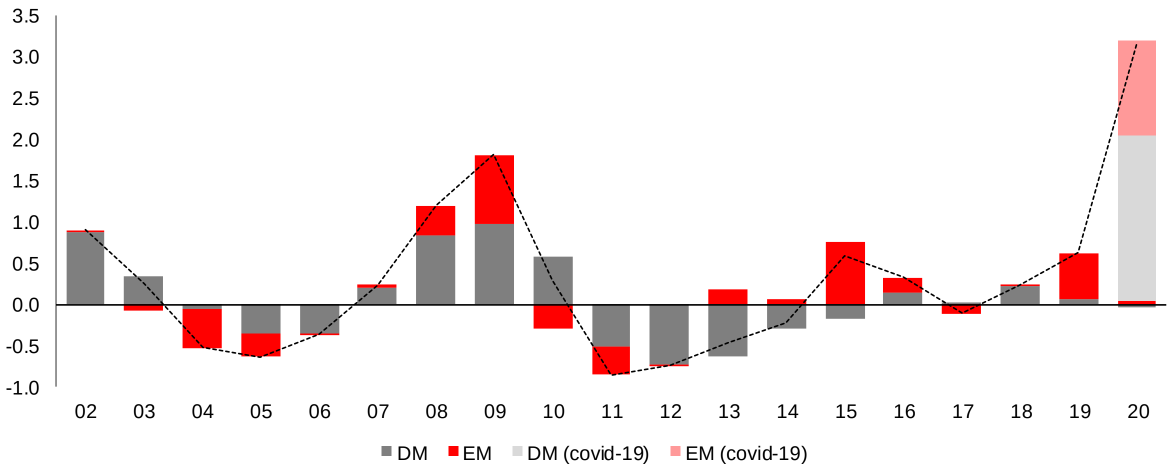
Monetary policy action: CBs cutting minus CBs hiking



Global Fiscal impulse (% of GDP)



Sources: Bloomberg and IMF

Global policies: an unprecedented level of stimulus

Country	Fiscal Policy	Monetary Policy
United States	• **7.4% of GDP. Total $1.6 trillion in spending + $400 billion in loans**. • Phases 1 and 2 ($110bn): Health services, aid to states, paid sick leave and others; • National Emergency ($40-$50bn); • Phase 3 ($2 trillion): individual payments, tax relief and deferrals, industry-level relief, loans and more.	• Fed cut funds rate by 150bps to 0-0.25% range; • Open-ended QE: treasuries, MBS and CMBS; • Lending Facilities: CPFF, PDCF, MMLF, TALF and others; • Other: Repos (+$5tn), FX Swap lines, relaxed capital buffers, lower RRR and discount rate.
Euro Area	• **Germany: 1.9% of GDP** • **France: 2% of GDP** • Italy: 1.4% of GDP • **Spain: 2.6% of GDP** • Euro Area: 0.8% of GDP in guarantees and loans to firms.	• Deposit rate unchanged at -0.5%; • Additional QE: €120bn APP + €750bn PEPP; • Lending: LTROs and TLTRO3 (better conditions); • Other: FX Swap lines.
UK	• **1.4% of GDP (£32bn);** • Extra resources for the health system, sick pay measures, unemployment insurance benefits, tax deferral and guarantees on loans.	• BoE cut bank rate by 0.65 bps to 0.10%; • New QE: £200bn (majority Gilts); • Other: Repos, FX Swap lines, lower capital buffer rate and new term funding scheme (TFS).
Japan	• 0.1% of GDP (¥1 trillion) to wage subsides; • The government is studying a more substantial package.	• Policy rate unchanged at -0.10%; • QE: offered to buy ¥1tn of JGBs (unscheduled); • More active stance on ETF and REIT purchases; • Other: FX Swap line and higher limits of CP and corporate bonds purchases.
China	• **Total (expected): 3% of GDP.** • 1% of GDP increase in the budget deficit and around 2% of GDP in new local bonds (augmented deficit).	• PBOC cut OMO and MLF rate by 10bps; • Cut RRR BY 50-100 bps (RMB 950bn liquidity); • 1-year and 5-year LPRs cut by 10bps and 5bps, respectively; • RMB 1.2 trillion in reverse repo; • RMB 880bn in refinancing to allow banks to lend to large corporates.

Source: Fed, ECB, Bank of England, Bank of Japan and People's Bank of China

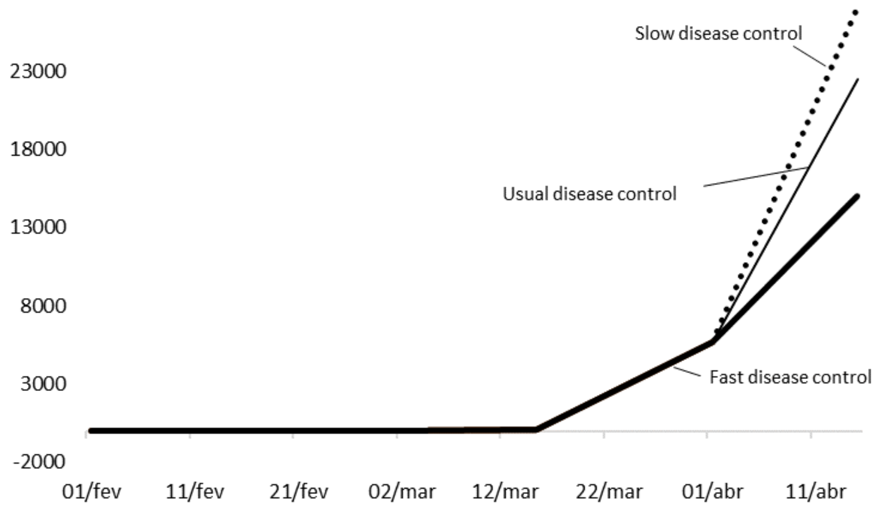
A health crisis arrives in Brazil

- ***Cases are growing, and fast.***

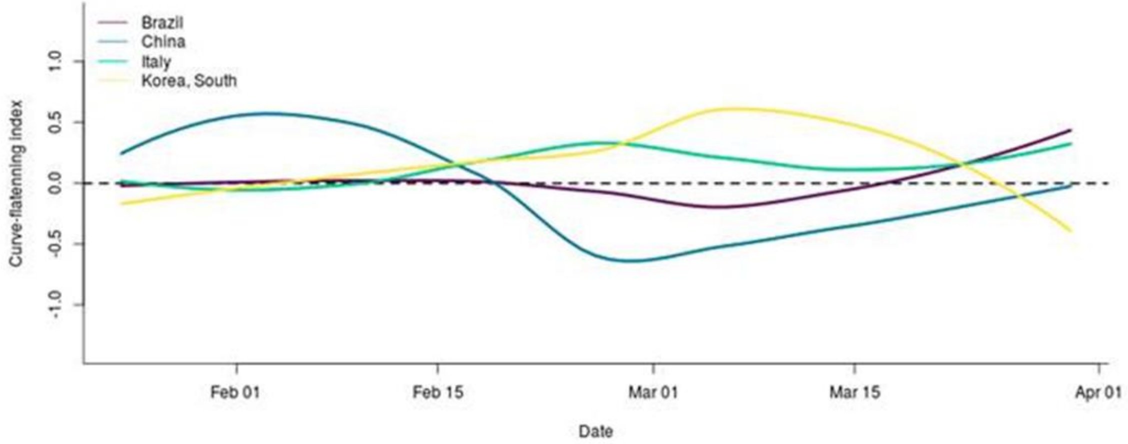
As of March 31, Brazil had reported 4,256 cases and 136 deaths. The behavior of the statistics of the active cases curve in Brazil is very similar to South Korea, but with cases growing at a slightly higher rate and without the mass testing seen in South Korea.

Most health analysts estimate the contagion curve 5 days ahead, since the virus's behavior in the future is still unpredictable. According to epidemiologists from the main universities in the world – including the Brazilian ones, cases in Brazil are expected to double every 5.2 days. With that information, the number of cases in Brazil in the next 10 days could go from about 5.7k to an interval between 17k and 25k. This is the reason why actions to contain the virus spreading and expansion of available hospital beds are so important.

Brazilian cases – Forecast in 10 days



Curve-flattening – Brazil, China, Italy and South Korea



Sources: University of Melbourne.

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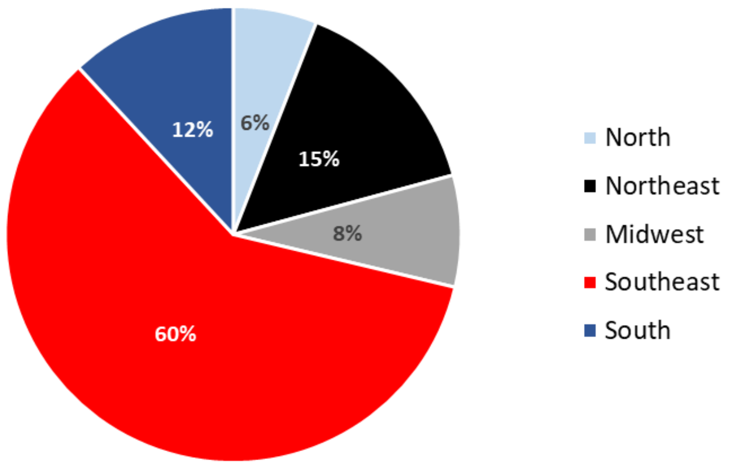
A health crisis arrives in Brazil

- ***(continued)***

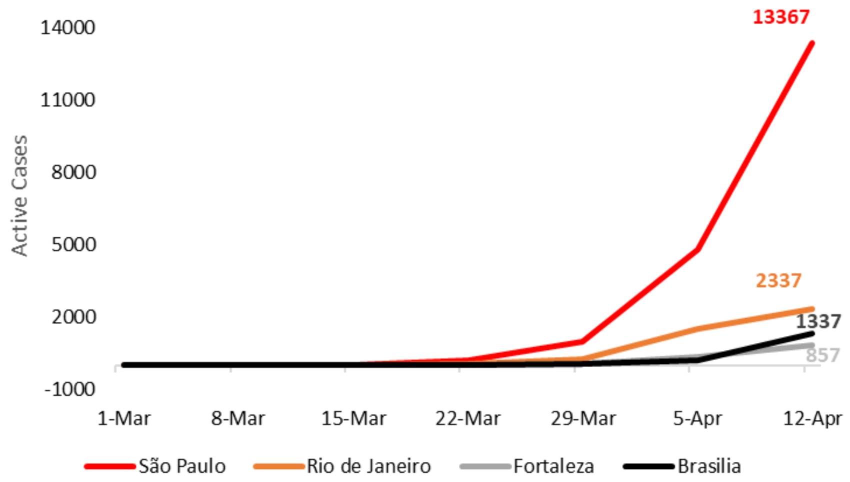
The cases in Brazil are concentrated in the Southeast (accounting for nearly 60% of all cases). However, a major concern with the data released so far is that they could eventually be underestimated given the number of tests performed daily in Brazil (below the average for other countries). Another concern is with the measures taken by state, municipal and federal governments, which may require greater coordination.

We expect more government measures to be announced in order to contain the projected rise in the cases of contagion, such as extending the lockdown and building new hospitals in the most affected regions.

Distribution of cases in Brazil – by region



Total COVID-19 cases and Forecast – by city



Sources: Brazilian Ministry of Healthy and Ribeirão Preto Medicine School - University of São Paulo

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How hard will the Brazilian economy be hit by the coronavirus crisis?

The government's goal is to minimize the demand shock to be as close as possible to the pre-coronavirus crisis level, since a supply shock is practically unavoidable, in our view.

How hard will the Brazilian economy be hit by the coronavirus crisis?

Covid-19

NEGATIVE IMPACTS	NEUTRAL	POSITIVE IMPACTS (LIKELY)
Real Estate	Financial Services	E-commerce, Information and Communication
Manufacturing	Education	Personal and Health care
Automotive	Oil and Gas	Food Processing and Retail
Tourism, Aviation and Leisure	Agriculture	Medical Supply and Services

How hard will the Brazilian economy be hit by the coronavirus crisis?

- ***Many doubts, some assumptions***

The uncertainties regarding this crisis remain extremely high as the development of the disease shows different patterns around the world. In our view, creating scenarios with clear assumptions would be the best approach to estimate the impact of the virus on the economy, as the outlook changes on a daily basis. To simplify such a complex scenario, we take two main assumptions regarding the duration of the crisis and how effective the public measures will be in order to keep firms and jobs. In relation to the duration of the crisis the lockdown period is the most important factor in our view. Nonetheless defining this is not a simple task. The lockdown measures were established in order to prepare the public health system to receive a large amount of urgent cases. The concern is that easing the lockdowns too early would result in a large number of new cases and deaths (possibly related to problems in the health system), meaning that an early relaxation would likely fail to foster a return to normality in economic activity. In any case, it is important to bear in mind that the economy will likely not go back to normality with the end of the lockdown under any circumstances. However, an adequate period of lockdowns may pave the way for a more orderly recovery.

Scenarios and hypotheses

Scenario	Lockdown	Firms and Jobs
Upward II	• Until mid April; • Fully operational by the end of May.	• Almost no damage on corporate balance sheets and employment.
Upward I	• Until end of April; • Fully operational by mid of June.	• Mild deterioration of jobs, most companies preserved.
Baseline	• Until end of April; • Fully operational by end of July.	• Some job losses and a few cases of corporate bankruptcy.
Downward I	• Until mid of May; • Fully operational by September.	• Even further deterioration in labor market; a number of companies close down.
Downward II	• Until mid of June; • Fully operational only in 2021.	• Brisk rise in unemployment and more spread bankruptcy.

Sources: Santander

How hard will the Brazilian economy be hit by the coronavirus crisis?

- ***Despite some cushioners, the economy will be hard hit.***

As per the maintenance of firms and jobs, part of the answer is related to the duration of the lockdowns, since companies cannot withstand long periods with no revenues. Efficient public measures play a key role here.

As per the impact of the Covid-19 on the Brazilian economy, it will surely be strong, but there are some cushioners. In fact, we believe almost half of Brazil's economy should remain unscathed. Agribusiness, for instance, represents approximately 25% of Brazilian GDP and we expect a record-high harvest and no breakdown in logistics, as the entire chain of food supply is spared from lockdowns, judged as an essential activity (even from a health standpoint). Weaker FX also helps producers (and most of the chain). Public Administration and Information & Communication add to 15% of Brazilian GDP altogether, and these are categories that should see growth this year on the back of a more intense use of health services and home offices. But that does not mean the Covid-19 hit will be mild, as the other half of the economy will be hard hit by the lockdown. If companies start laying off employees as the lockdowns make payroll expenses unaffordable, massive job losses will follow. In our baseline scenario joblessness would return to the 4Q19 level only in 1Q22.

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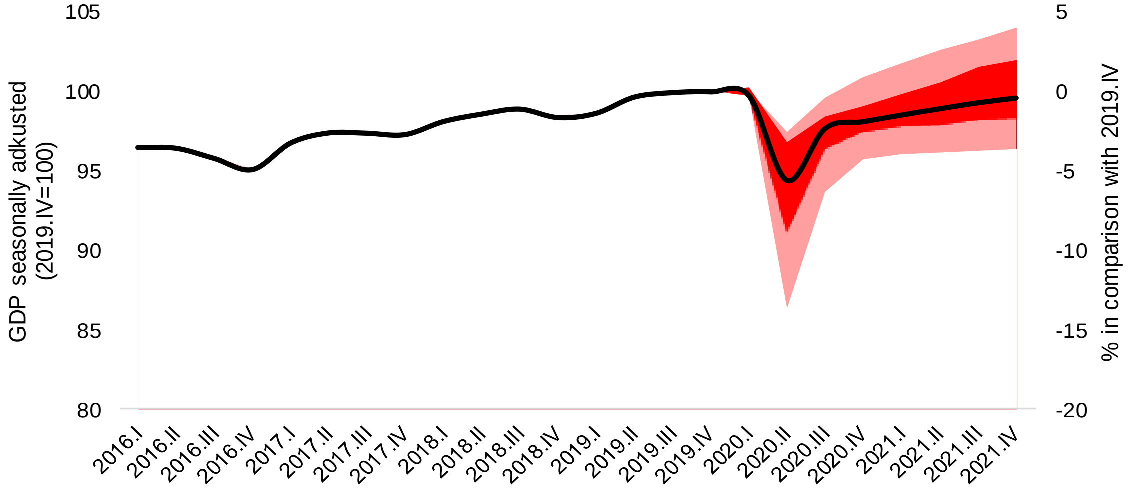
GDP % q/q (seasonally adjusted)

		80%			
			50%		
	25%	30%		20%	5%
2020.I	0.26	0.05	-0.23	-0.31	-0.26
2020.II	-13.40	-8.67	-5.33	-3.47	-2.58
2020.III	8.54	5.82	3.45	1.70	2.21
2020.IV	2.12	1.08	0.43	0.67	1.26
2021.I	0.34	0.32	0.43	0.69	0.90
2021.II	0.14	0.15	0.40	0.82	0.82
2021.III	0.07	0.28	0.38	0.91	0.62
2021.IV	0.16	0.20	0.30	0.49	0.73
GDP %					
2019.IV - 2021.IV	-3.07	-1.34	-0.39	1.43	3.68
2020	-6.00	-3.60	-2.20	-1.50	-0.40
2021	2.80	2.10	1.70	2.40	3.40

GDP Estimates



Sources: Santander

Inflation: Covid-19 means a downward shock in Brazil

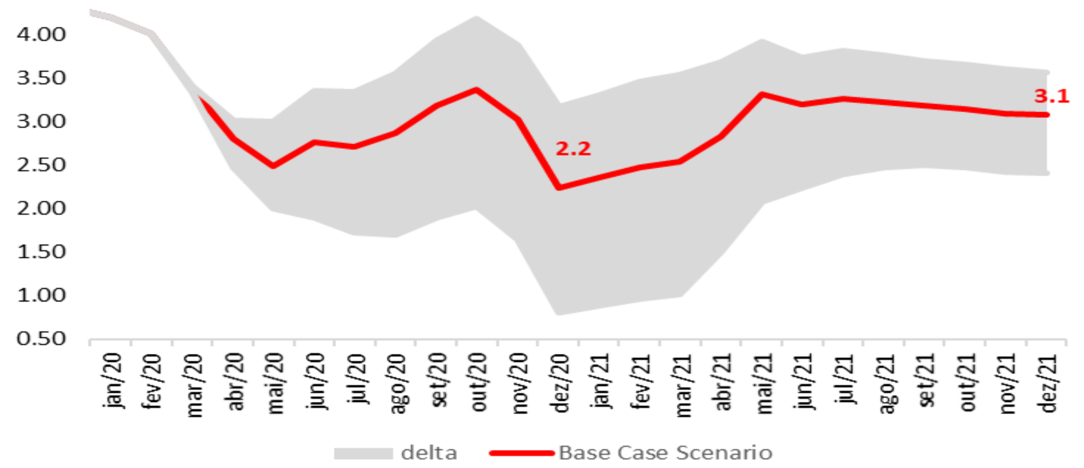
- ***Coronavirus will prompt even lower inflation for 2020, 2021: 2.2% and 3.1% respectively.***

With the bearish shock (from a demand standpoint) from the coronavirus this year, we expect the IPCA to keep running below the target midpoint.

We are now changing our forecast for 2020 to 2.2% from 3.0%, mainly due to a drop in regulated prices and the impact of the measures implemented to prevent the expansion of the virus (lockdowns). Those factors more than offset the inflationary effects from the weaker BRL.

Our estimates for the IPCA EX3 (a core gage, including cyclical goods and services more sensitive to monetary policy swings) are close to 3% for both years. In fact, we believe the demand effect (with an output gap even more open – meaning even greater economic slacks) will prevail on the inflation dynamics, as long as inflation expectations remain well-anchored. For the latter to materialize, it is key that the monetary and fiscal frameworks remain in place, so that the unprecedented anti-Covid19 measures will only be valid for 2020. And this unpredictability leads us to consider different scenarios, with a range of possible CPIs for the next 2 years - detailed in the following figure. The output gap and the slow economic activity recovery for 2020 and 2021 are the main reason this 2021 forecast change: to 3.1% from 3.5%.

Inflation Forecast - YoY



Inflation Forecast – by Group

	2017	2018	2019	Santander Forecast 2020	Santander Forecast 2021
IPCA	2.9	3.7	4.3	2.2	3.1
Food at Home	-4.9	4.5	7.8	4.8	3.2
Meat	-2.5	2.2	32.4	4.2	3.0
Regulated Prices	8.0	6.2	5.5	1.1	3.9
Market Prices	1.3	2.9	3.9	3.1	3.4
Services	4.5	3.3	3.5	3.0	3.5
IPCA EX-3	3.1	2.5	3.5	2.8	3.0

Sources: IBGE and Santander

Fiscal policy: (temporarily) changing route

- ***We believe significant spending is required…***

As Covid-19 cases continue to spread across the country, the Brazilian government has been expanding the scale and scope of emergency relief measures aimed at mitigating the economic and social impacts caused by the epidemiological outbreak. These one-off measures are focused on three pillars: (i) raising resources for the public health system; (ii) keeping employment and income; and (iii) protecting the most vulnerable population by expanding the social safety net. We estimate that the fiscal and quasi-fiscal measures announced so far total around BRL 528 billion (7.3% of GDP), which includes items like advance payment of social benefits and deferred tax payment (i.e. measures that do not represent "new spending"). Regarding the government's initiatives for fiscal and quasi-fiscal impulse, we calculate a total package of BRL 305 billion (4.2% of GDP), of which BRL 73billion (1.0% of GDP) comprise the quasi-fiscal budget and BRL 232 billion impacts the fiscal budget's primary result (3.2% of GDP). We expect further emergency measures to be announced in the coming weeks, such as financial aid to the sectors most severely affected by the crisis. In our scenario, we consider that 2020 central government primary spending will expand by an additional BRL 260 billion (3.6% of GDP).

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Emergency Relief Measures

Fiscal and Quasi-Fiscal Measures	BRL billion	%GDP
1) Fiscal Measures	**455.6**	**6.28**
1.1 Impact on government's primary result	231.5	3.19
1.2 No impact on government's primary result (*liquidity measures*)*	224.1	3.09
2) Quasi-Fiscal Measures	**72.8**	**1.00**
TOTAL	**528.4**	**7.28**

* Advance payment of social benefits, postponment of tax payment, temporary tax exemption, resources reallocation.

Impact on the government's primary result

Fiscal measures impacting the government's primary result	BRL billion	% GDP
Addition of more than 1 million households to the *Bolsa Família* entitlement program	3.1	0.04
Emergency aid for informal workers and unemployed people from low-income households	98.0	1.35
Emergency credit lines for small and medium-sized companies (payroll only)	34.0	0.47
Emergency aid for disabled people who currently wait for the BPC concession	6.8	0.09
Compensation payments for workers with reduced or suspended empolyment contracts	51.6	0.71
Extraordinary funds for the Ministry of Health	5.0	0.07
Temporary exemption of the Financial Transactions Tax for credit operations	7.0	0.10
Securing level of transfers through state and municipal participation funds	16.0	0.22
Resource transfers to the subnational health systems	8.0	0.11
Resource transfers for social assistance expenditures	2.0	0.03
TOTAL	**231.5**	**3.19**

Sources: Ministry of Economy, National Treasury and Santander

Fiscal policy: (temporarily) changing route

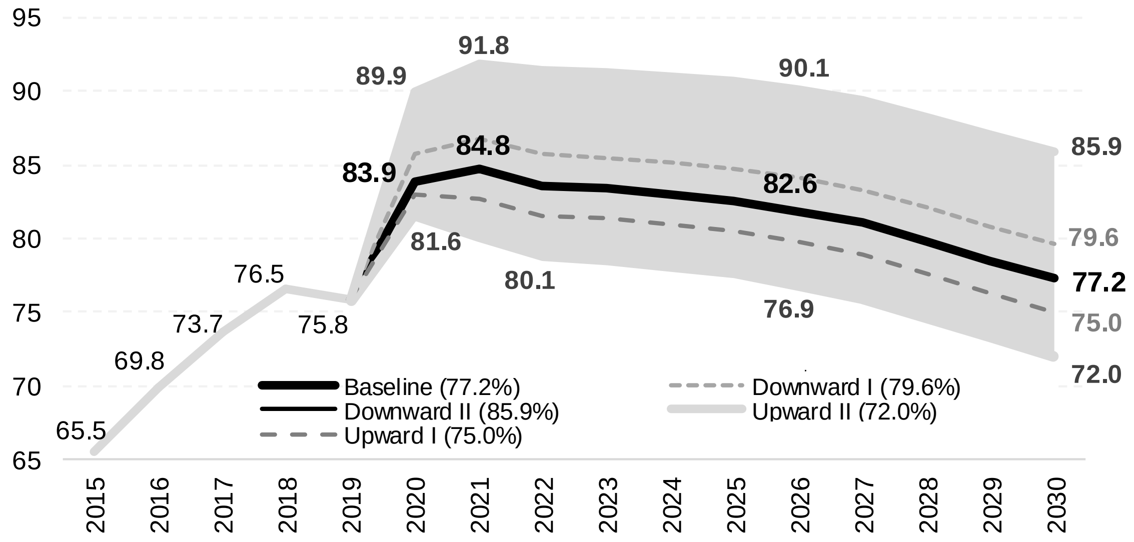
- ***… but the longer-term goals must remain intact.***

In addition to the sharp expansion in public spending, government revenues will deteriorate significantly this year. Lower GDP growth (harming tax collection) and steep declines in international oil prices (harming royalty proceeds) were the main reasons behind the recent downward revision of our forecast for the total primary revenue in 2020 (-BRL 95 billion in the baseline scenario). Hence, we expect the consolidated public sector – including federal government, states, municipalities and state-owned companies – to post a primary fiscal deficit of BRL 452.5 billion (-6.2% of GDP). As an important assumption for our fiscal scenario, we assume that this year's (large) fiscal expansion will be temporary and focused on the core of the problem, keeping the fiscal consolidation framework in place (mainly the constitutional spending cap). In our view, the more intact the fiscal framework, the greater the odds of a more consistent recovery of the Brazilian economy after the Covid-19 crisis. We also believe that, after climbing a lot in two years (+9pp), the gross public debt-to-GDP ratio will resume a gradual downward trend from 2022 onward. Nonetheless, we recognize that the fiscal risks have increased recently, as we believe the likelihood of new structural reforms is dwindling.

Fiscal Policy – Simulation for alternative scenarios

Alternative Scenarios	Real GDP growth (%) in 2020 / 2021	Public Sector's Primary Result in 2020 / 2021 (BRL billion)	Public Sector's Primary Result in 2020 / 2021 (% GDP)
Before COVID-19 outbreak	2.0 / 2.5	-98.5 / -68.0	-1.3 / -0.8
Upward Scenario II	-0.4 / 3.4	-410.5 / -98.7	-5.5 / -1.3
Upward Scenario I	-1.5 / 2.4	-432.7 / -125.6	-5.9 / -1.6
Baseline Scenario	**-2.2 / 1.7**	**-452.5 / -148.3**	**-6.2 / -1.9**
Downward Scenario I	-3.6 / 2.1	-476.8 / -168.4	-6.7 / -2.2
Downward Scenario II	-6.0 / 2.8	-545.0 / -235.0	-7.8 / -3.1

Gross Public Debt (% GDP) – Alternative Scenarios



Sources: National Treasury, Brazilian Central Bank and Santander

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BCB is adding monetary stimulus to fight the impact of the coronavirus on the Brazilian economy

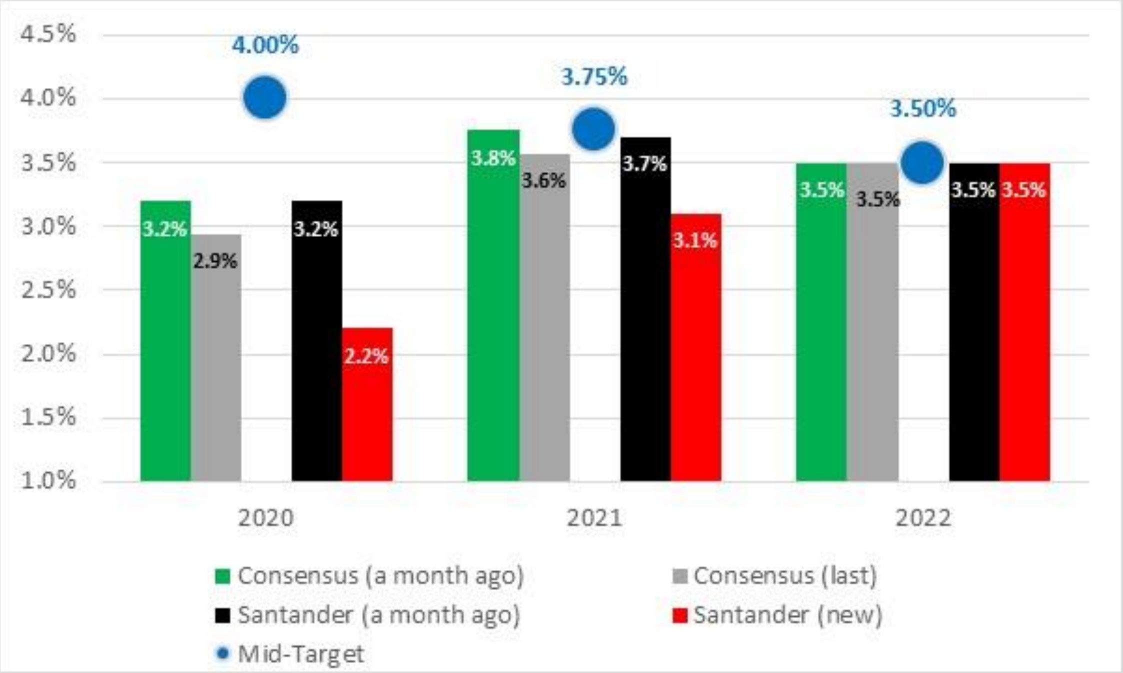
- ***We now project new rate cuts totaling 75bps to 3.00% in 2020...***

In the last policy meeting (March 17-18, 2020), the BCB cut the Selic policy rate by 50bps (to 3.75%), in line with consensus. In the minutes, the authority states that "it would be necessary to reduce the policy rate by more than 0.50 percentage point" to offset the downward demand shock brought by the Covid-19. That shock is seen as deflationary by the BCB (and the market). However, risks of fiscal deterioration amid a worsening external backdrop prevented a more aggressive move, which could become "counterproductive" in the Copom's view.

In recent communications, the BCB bought itself some flexibility to eventually cut interest rates further amid (what the authority sees as) a disinflationary Covid-19 shock. But this additional easing could require market conditions to calm down and fiscal risks to diminish.

We are now looking for another move of -50bps in May and -25bp for June, projecting Selic at 3.00% for end-2020 and 3.50% for end-2021.

Inflation expectations (and targets)



Sources: Brazilian Central Bank and Santander

Amid global and local uncertainties, we look for moderate reaction in the realm of interest rate

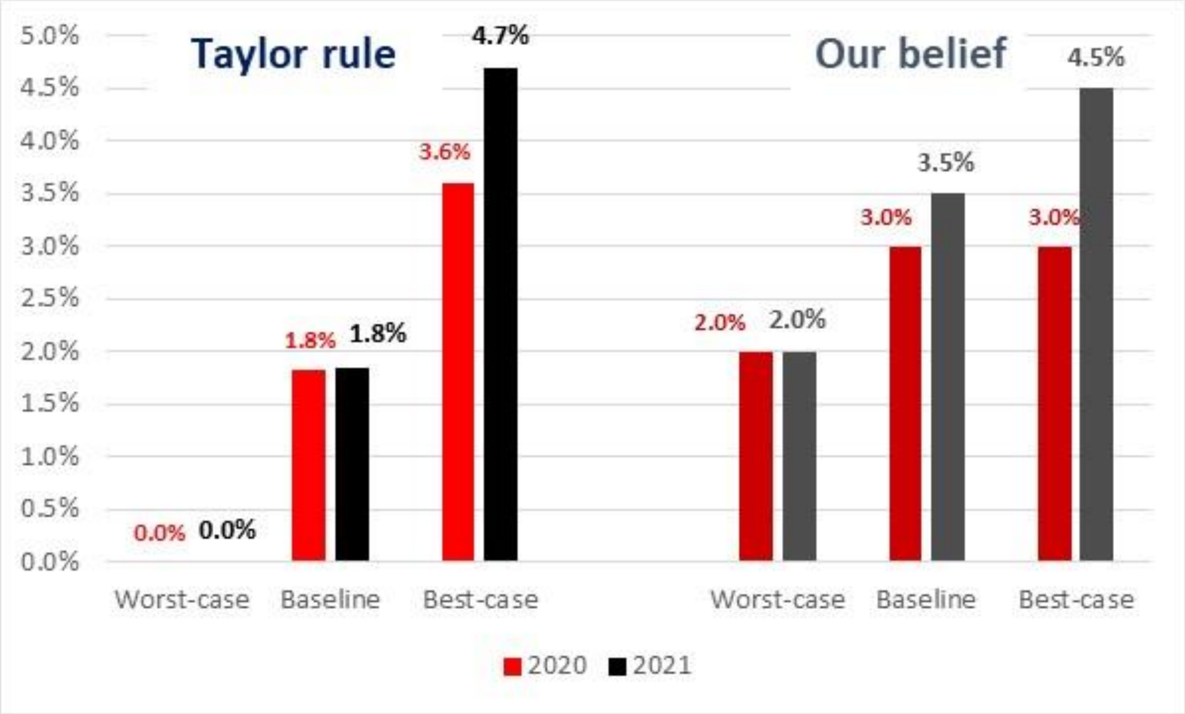
- ***…with a more moderate BCB reaction, amid fiscal risks***

As the BCB tackles the effect of an unprecedented shock, it is hard to predict the next policy steps amid a scenario surrounded by uncertainty.

Given the BCB's communications, we assume the monetary authority will act cautiously, and we expect an asymmetric and non-linear policy reaction across the various possibilities of alternative scenarios we can simulate. With higher risks for the fiscal outlook and amid worsening global conditions, we see the BCB acting less aggressively than usual, so that in our simulations of alternative scenarios, we assume less interest rate cuts than suggested by our own Taylor Rule – a benchmark for the standard policy reaction.

Amid such unusual times, we expect little action from monetary policy (where we see more limited space) and bold moves on the macroprudential and regulatory fronts. In any case, if the medium-term fiscal policy framework is well protected, the deflationary nature of the shock implies that risks are skewed to the downside as per our Selic rate forecasts.

Selic rate simulations (Taylor rule vs. our views)



Sources: Brazilian Central Bank and Santander

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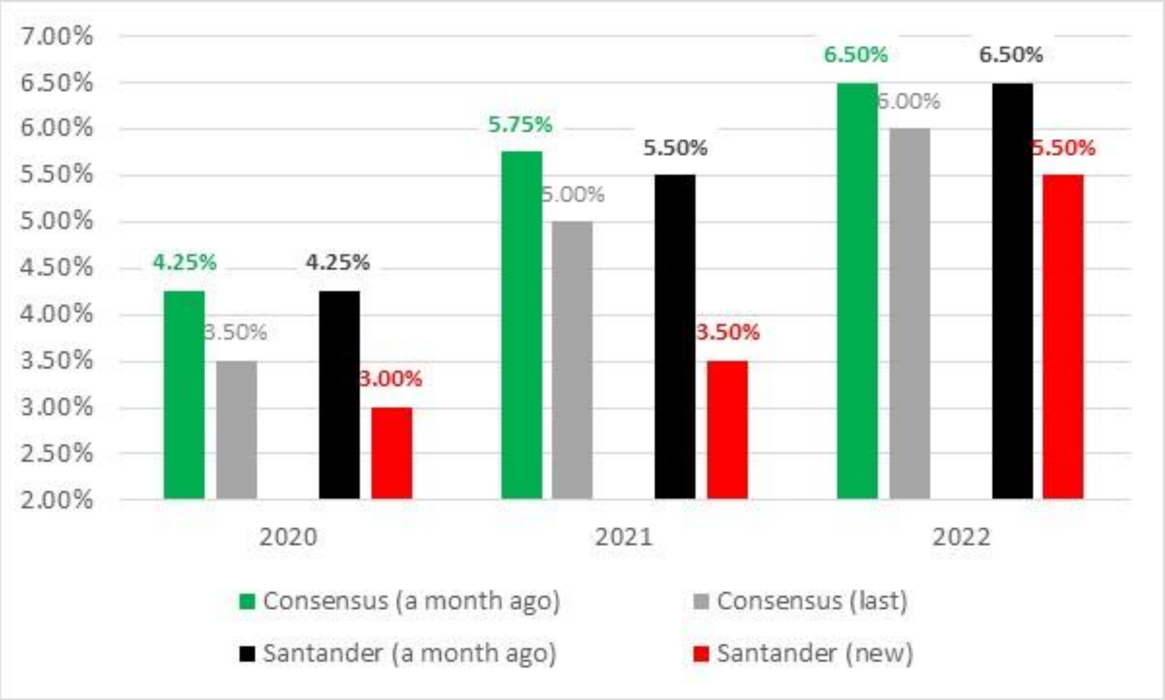
A new (hopefully temporary) framework for BCB asset purchases to fight effects of Covid-19

If we expect no "bazooka" on the interest-rate front, it seems that a more aggressive action will come from initiatives to provide liquidity and guarantee a functional financial system.

With a view to (1) make sure that the interest rate stimulus will actually imply lower costs of borrowing (especially for longer horizons) and (2) avoid risks to financial stability by helping companies get funding through this difficult phase of lockdown in economic activity, the government is considering a constitutional amendment that would allow the BCB to buy government and corporate bonds for times of "economic calamity". That would pave the way for a sort of QE in Brazil, complementing the BCB's (likely moderate) action on the interest-rate front.

This controversial initiative has the merit of facilitating the transmission of the monetary policy stimulus, giving the central bank instruments to pressure down the (medium and back-end) segments of the yield curve, a key element in the determination of long term financial costs in the economy. The main risks would be the eventuality of loopholes in the characterization of a state of "economic calamity", which could generate difficulties for both the fiscal and monetary frameworks currently in place, with risks of possible adverse consequences on the inflation front.

Selic rate forecasts (ours and consensus)



Sources: Brazilian Central Bank and Santander

Credit market: Coronavirus interrupts a credit deepening trend

- ***A stone in the middle of a recovery path***

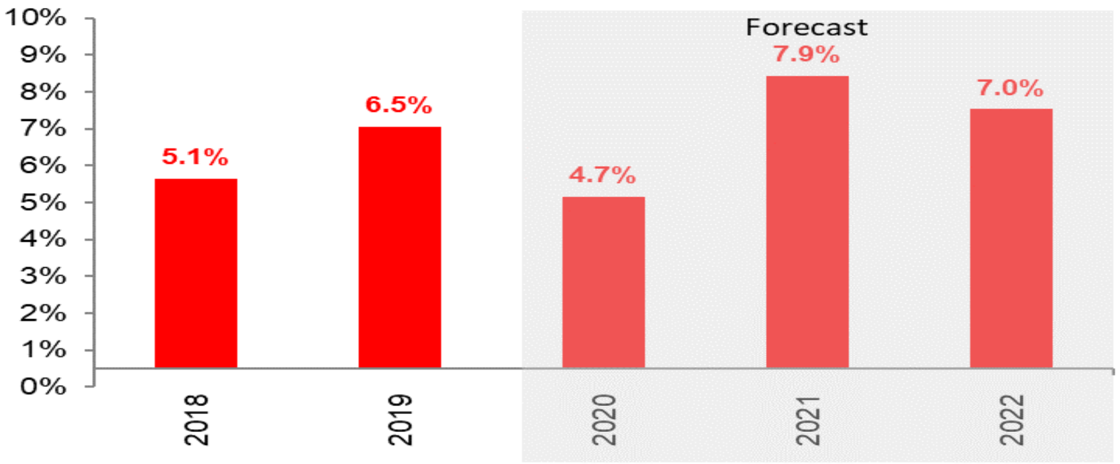
The credit market showed a broad recovery in 2019, mainly in non-earmarked credit for individuals. It was expected that, for 2020, this segment would continue to grow accompanied by significant growth in the granting of credit to companies - our previous forecast for total credit was 8.4%.

With the economic impact of the coronavirus reaching this market, mainly due to the increased grace period in credit lines, we expect a lower risk appetite from financial institutions and an increase in defaults, both for individuals and companies.

On the other hand, we expect loans granted by BNDES to grow again with the launch of aid packages for different sectors of the economy.

Thus, we still see an expansion of the credit sector in 2020; however, at a lower rate than the observed in previous years. In 2021, if our forecast is accurate, we will see a gradual but consistent recovery.

Total Loans Growth



Credit Market Forecast - YoY

	2019	2020F	2021F
Non earmarked credit	14.1%	7.2%	11.2%
Individuals	16.6%	8.4%	13.1%
Corporate	11.1%	5.8%	8.9%
Earmarked credit	-2.4%	1.1%	3.1%
Private banks	15.7%	8.9%	12.0%
Public Banks	-2.2%	-0.1%	2.9%
Total Credit	**6.5%**	**4.7%**	**7.9%**

Sources: Brazilian Central Bank and Santander

Central Bank and government acting on all fronts: measures for the credit sector

Brazilian authorities are also taking aggressive action to tackle the local economic effects of Covid-19. In the realm of bank lending and broader credit, The government and central bank have a good deal of ammunition, and have announced a number of initiatives

Entity	Focus of measures	Description
Brazilian Central Bank (BCB)	• Liquidity	• Reserve requirement + Short-term liquidity : BRL 135 billion • Additional reserve requirement release: BRL 68 billion • LCA (agribusiness letter of credit) flexibility: BRL 2.2 billion • Loan backed by banking guarantees: BRL 670 billion • Commitments to Brazilian repo operations: BRL 50 billion • New DPGE (term deposit with special guarantee): BRL 200 billion • Loan backed by debentures: BRL 91 billion
Brazilian Central Bank (BCB)	• Capital Release	• Over hedge: BRL 520 billion • ACCP (Additional Countercyclical Capital) reduction: BRL 637 billion
Brazilian Central Bank (BCB)	• Other measures	• Dollar swap with the Fed: BRL 60 billion • Credit lines to cover companies' payroll (with 85% financed by the National Treasury and 15% by private banks): BRL 40 billion

Subtotal BCB **BRL 2.5 trillion (34% of GDP)**

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Source: Brazilian Central Bank

Brazilian Central Bank and governments are acting on all fronts: Measures for the credit sector

Entity	Measures	Description
BNDES	• Credit lines	• Transfer of PIS/PASEP (Programs through which companies and public agencies deposit contributions in a fund linked to their employees) resources to the FGTS (mandatory savings for private sector employees): BRL 20 billion • Suspension of payment for direct operations for 6 months: BRL 19 billion • Suspension of payment for indirect operations (transfer via financial agents) for 6 months: BRL 11 billion • Working capital for small and medium-sized enterprises: BRL 5 billion • Drop in interest rates on overdraft and credit card revolving credit to 2.9% (for *Caixa Econômica Federal* - CEF)
Subtotal BNDES		**BRL 50 billion (0.7% of GDP)**
Government	• Credit lines	• Credit line to cover part of the micro and small businesses payroll: BRL 40 billion • Loans for *Santas Casas* (religious hospitals) with interest of 10% per year: BRL 5 billion
Subtotal Government		**BLR 45 billion (0.6% of GDP)**
TOTAL		**BRL 2.6 trillion (35.3% of GDP)**

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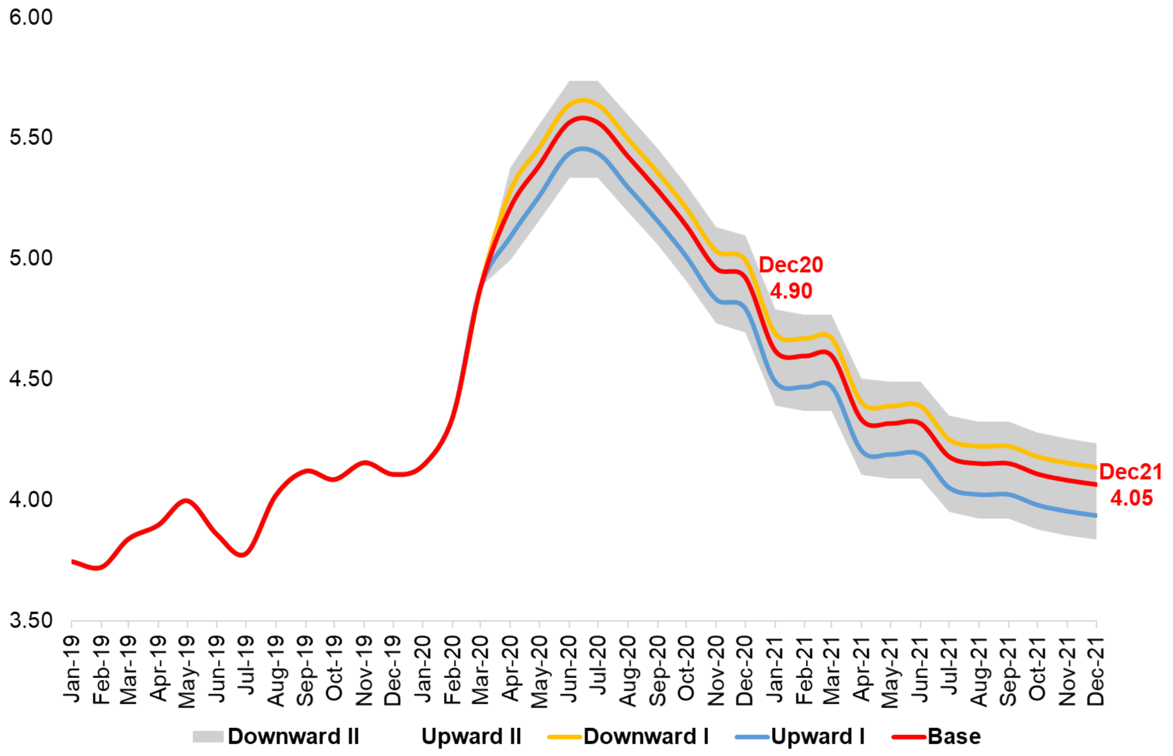
Source: BNDES and Brazilian government

FX rate: survival expected

- ***Expect the end of Covid-19 to ease pressure on the BRL***

The influence of Covid-19 on international financial conditions seems poised to peak in 2Q20, in our opinion. Thus, we expect market participants' risk aversion to continue treading at current high levels, a backdrop that does not bode well for emerging market currencies such as the BRL. We expect restrictions derived from the measures destined to fight the novel coronavirus to lead to a sharp but temporary reduction of international trade flows and, therefore, of commodity prices, resulting in yet another setback for the Brazilian currency. In our view, this mix is likely to lead the Brazilian FX rate to set new historical highs in the coming months, regardless of (expected) BCB's sporadic interventions, which are focused on avoiding dysfunctionalities in the market rather than on defending a level for the BRL. However, as we expect the resolution of Covid-19 pandemics to begin in 3Q20, the bundle of negative shocks should begin to be undone, thus providing some respite to the currency from then onwards, in our view. The reversal of temporary fiscal incentives and the resumption of discussions about structural reforms should extend that trend to 2021, in our view, thus bringing the USD/BRL pair back to the level observed in early 2020.

Exchange Rate (USD/BRL)



Sources: Brazilian Central Bank and Santander

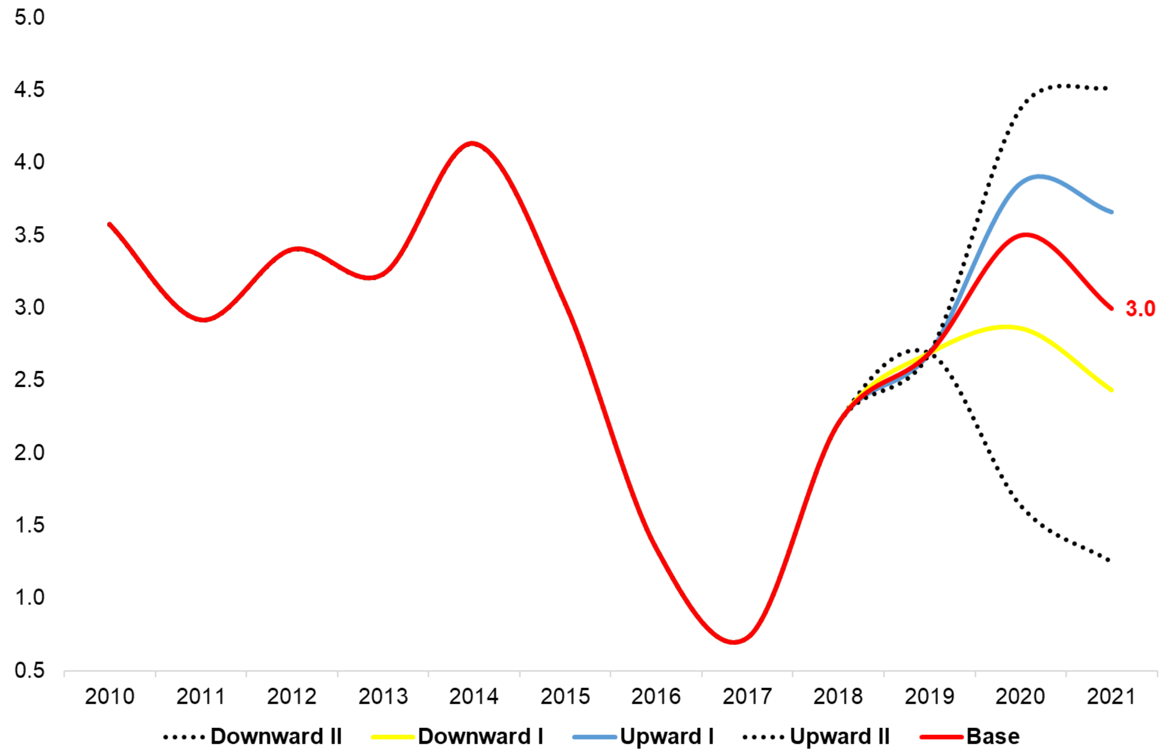
Current account deficit: A challenging mix of shocks

- ***Collapse of international trade and falling commodity prices to weigh on the current account balance***

Despite the favorable contribution of a (projected) weaker currency in tandem with the expected economic contraction in 2020—which should provoke a decline in imports, tourism outlays and remittance of profits and dividends—we believe the collapse of international trade flows is likely to register in 2Q20 and depressed commodity prices should weigh heavily on exports and, consequently on the trade balance surplus this year. Moreover, as we expect the latter effect to outstrip the former, the current account balance should not decline in 2020 as compared with 2019, contrasting with our previous expectation of an improvement for this year. Although relatively stable in absolute terms, we think the projected amount will tally for a bigger chunk of the lower GDP in 2020 (3.5%) and it will face worse financing conditions than previously thought. Hence, **the expected temporary uptick in the current account deficit this year adds upside risk to our projected trajectory for the BRL.**

However, we believe that as international trade flows (and commodity prices) recover, the Brazilian economy should resume growing and the FX rate is likely to get stronger, then reversing the temporary hiccup of 2020.

Current account deficit (% of GDP)



Sources: Brazilian Central Bank and Santander

Santander Macroeconomic Forecasts Comparison

		Old Forecast		Updated Forecast	
	2019	2020	2021	2020	2021
GDP (%)					
GDP Growth	1.1	1.0	2.0	-2.2	1.7
Inflation (%)					
IPCA-IBGE	4.31	3.0	3.5	2.2	3.1
FX Rate					
BRL/USD - end of period	4.03	4.30	4.00	4.90	4.05
Interest Rates (%)					
SELIC - end of period	4.50	3.50	4.00	3.00	3.50
Balance of Payments					
Current Account (% of GDP)	-2.7	-2.2	-2.4	-3.5	-3.0
Fiscal Accounts					
Public Sector's Primary Result (% GDP)	0.9	-2.1	-1.0	-6.2	-1.9
Gross Public Sector Debt (% GDP)	75.8	77.6	75.9	83.9	84.8

Sources: Santander

Santander Macroeconomic Forecasts: Baseline and Alternative Scenarios

Macro Variables		Downward II	Downward I	Baseline	Upward I	Upward II
GDP (%)	2019-2021	-3.1	-1.3	-0.4	1.4	3.7
	2020	-6.0	-3.6	-2.2	-1.5	-0.4
	2021	2.8	2.1	1.7	2.4	3.4
CPI (%)	2020	0.8	1.5	2.2	3.0	3.2
	2021	2.4	2.7	3.1	3.4	3.6
Selic Rate (% - eop)	2020	2.0	2.5	3.0	3.3	3.3
	2021	2.0	2.5	3.5	4.0	4.5
Exchange Rate - BRL/USD (eop)	2020	5.10	5.00	4.90	4.80	4.70
	2021	4.25	4.15	4.05	3.95	3.85
Current Account Balance (% GDP)	2020	-1.6	-2.9	-3.5	-3.9	-4.4
	2021	-1.3	-2.4	-3.0	-3.7	-4.5
Public Sector's Primary Result (% GDP)	2020	-7.8	-6.7	-6.2	-5.9	-5.5
	2021	-3.1	-2.2	-1.9	-1.6	-1.3
Gross Public Debt (% GDP)	2020	90.0	85.7	83.9	82.7	81.6
	2021	91.8	86.8	84.8	82.5	80.1

Sources: Santander

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