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SPECIAL REPORT – LABOR AND FISCAL

Gabriel Couto* and Ítalo Franca*
macro.brasil@santander.com.br
+5511 3553 7424

REAL WAGE BILL – OUTLOOK AND SIMULATIONS

- In this report, we have updated our estimates for the "expanded" real wage bill for Brazil, a measure that encompasses workers' salaries, pension contributions, and federal transfers. Since we last reviewed our real wage bill estimates, the labor market has improved considerably, driven by greater urban mobility on the heels of the vaccination campaign and the perception that there will be no further restrictive public health measures. In addition, we simulated the impact on the real wage bill of inflation forecasts, the possibility of increases in the government's welfare program, and the Selic rate.

- The direct fiscal stimulus for formal employment (BEm) ended in August. In our view, it will be important to follow the performance of the formal labor market without the fiscal stimulus (although its partial effect should still be present until the end of the year). We expect some softening ahead in the recovery in formal employment as measured by CAGED. In addition, we believe the current job market situation still shows considerable slack that should gradually subside by mid-2022, as both formal and informal employment remain below the pre-pandemic levels in the PNAD survey.

- We estimate that in 2020 the "expanded" real wage bill showed 3.7% full year growth (from +2.2% in our last revision made in April), considering the massive fiscal stimulus during 2020 (above 8% of GDP, with BRL293 billion in the emergency aid program). In a counterfactual simulation (without fiscal transfers), we calculate a 7.9% drop in the real wage bill for 2020, so that **the benefits more than offset the estimated cyclical drop caused by the pandemic in 2020 (+11.6 positive impulse).** For 2021, we estimate a drop of 5.7%, even considering the welfare program's transfers of ~BRL90 billion during the year. For 2021, in the same counterfactual simulation, growth is 3.3%.

- We also calculated the real wage bill for 2022 and simulated the possible impact of the fiscal transfers, inflation, and the Selic rate. **Considering the scenario as a whole, we observe a possible increase of real growth between 2.9% and 4.1% compared to 2021. In our baseline scenario, considering the welfare program budget of BRL61 billion, the real wage bill is projected to increase by 3.4%.** In our view, the elasticity of the fiscal transfers to the real wage bill is as follows: for every BRL10 billion of fiscal transfers, the real wage bill grows by 0.2% in the year.

- For the Selic rate, we estimate that each 100-bp increase in the Selic implies a 0.4 p.p. negative impact on employment growth. For the IPCA, we estimate that each 100-bp increase in inflation reduces the real wage bill by around 0.6 p.p.

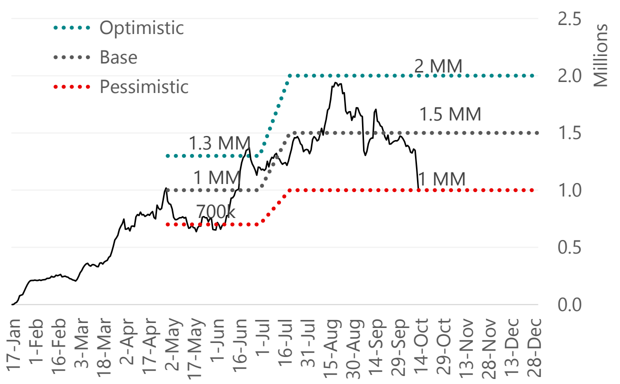
- All in all, we consider that the scenarios for the "expanded" real wage bill are compatible with a 1.1% expansion of household consumption in 2022. We acknowledge that there will be a shift in the demand composition from goods to services, and there is a risk that a reduction in the consumption of goods may have a considerable impact on broad economic activity. However, in our view, the recovery in the consumption of services should overcome these negative effects.

Pandemic Outlook Has Improved in Brazil

One of the main uncertainties at the beginning of the year was how the evolution of the pandemic would affect our estimates. We explored these issues in our report *Labor Market – 2021 Thermometer* (February 4, 2021). See details in the link[1]. However, despite some obstacles faced this year, the vaccination process has advanced at a decent pace, improving the conditions for the recovery of employment and activity. The level of infections, hospitalizations, and deaths continues to gradually ease across the country. We continue to expect an average vaccination rate of 1.5 million shots per day throughout the rest of the year, enough to immunize the adult population. While the Delta variant remains the main risk, given its prevalence in key regions, it has not caused a significant surge in infections so far. As of October 13, about 254 million doses (316 million available) had been administered in the country.

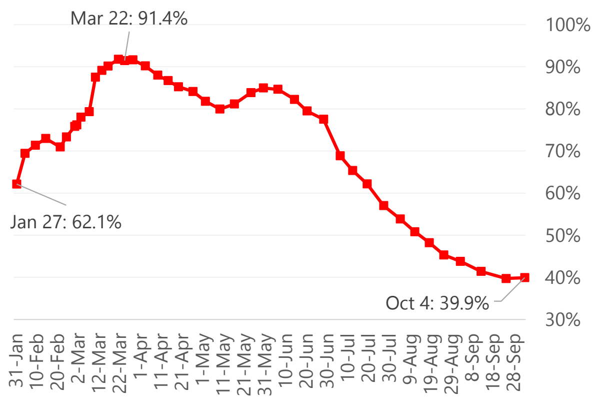
In our view, the numbers suggest that the eventual immunization of a large majority of the population will allow a continued gradual easing of mobility restrictions throughout the rest of the year. We believe this supports our assumption of a broader reopening of socially integrated services in the latter part of the year and "full normalization" in 2H21.

Figure 1. Vaccination Pace (Daily Shots)



Sources: Brazilian Ministry of Health, Santander.

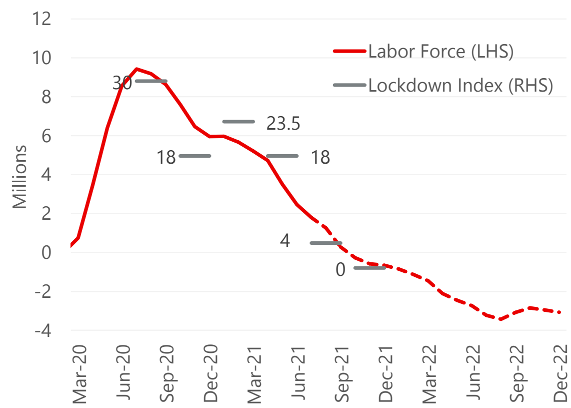
Figure 2. Nationwide ICU Occupancy Rate proxy (%)



Sources: Brazilian Ministry of Health, Santander.

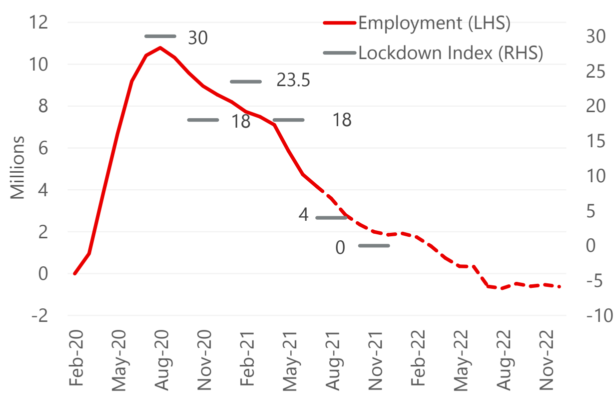
In this context, we have witnessed a more accelerated process of economic reopening, and we expect this to intensify in the coming months. As vaccination advances and mobility recovers, we expect to see higher numbers for both the employed population and the labor force. In the next section we will briefly explore labor market developments in 2021.

Figure 2. Labor Force: Post-Pandemic Accumulated Drop



Sources: Brazilian Ministry of Health, Santander.

Figure 3. Employment: Post-Pandemic Accumulated Drop



Sources: Brazilian Ministry of Health, Santander.

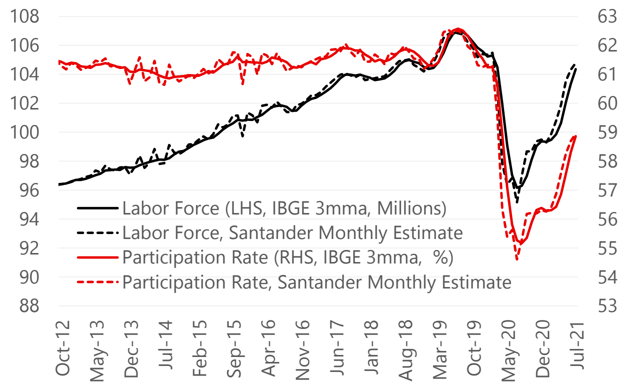
[1] **Santander Brazil Labor Market - *"Labor Market – 2021 Thermometer"* –** February 4, 2021 - Available on: https://bit.ly/Sant-lbrmkt-040221

Labor Market: Overview and Balance of Risks

Since the last review of our real wage bill estimates, the labor market has shown considerable improvement, on the heels of higher urban mobility and the perception that there will be no major setbacks in terms of the easing of restrictive public health measures.

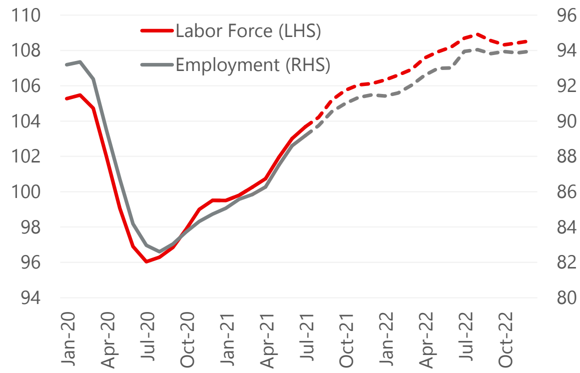
The participation rate indicates a rapid recovery, although still at depressed levels. Employment is recovering at a similar pace, also benefiting from the economic reopening. In our view, the labor force should return to pre-pandemic levels between 3Q21 and 4Q21 (the July figure was less than 1 million people below the pre-pandemic level, in seasonally adjusted terms). The employed population, on the other hand, should return to the February 2020 level only by mid-2022, according to our projections.

Figure 4 – Participation Rate and Labor Force (sa)



Sources: IBGE, Santander.

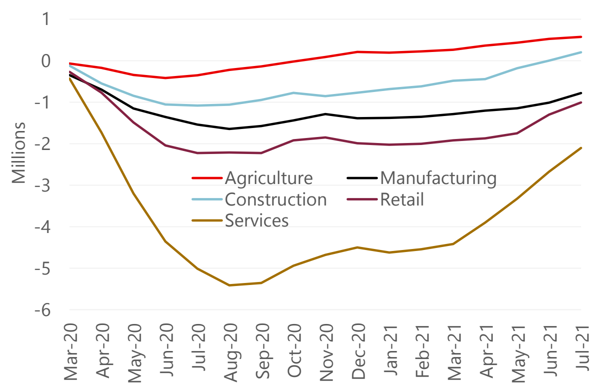
Figure 5 – Labor Force and Employment (millions, sa)



Sources: IBGE, Santander.

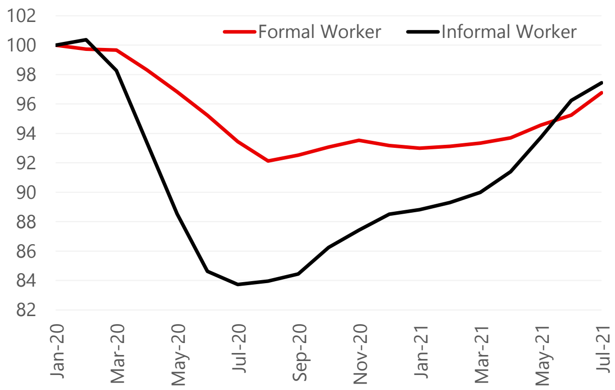
As most of the accumulated job losses during the pandemic are concentrated in segments more dependent on social interaction, we expect the continuation of the economic reopening and the maintenance of the vaccination pace to be crucial for the labor market recovery. We also foresee an increase in informality in the post–pandemic period, as this is a pattern after recessions, and informal jobs already have been leading employment growth in the past few months.

Figure 6 – Post-Pandemic Accum. Job Losses (sa)



Sources: IBGE, Santander.

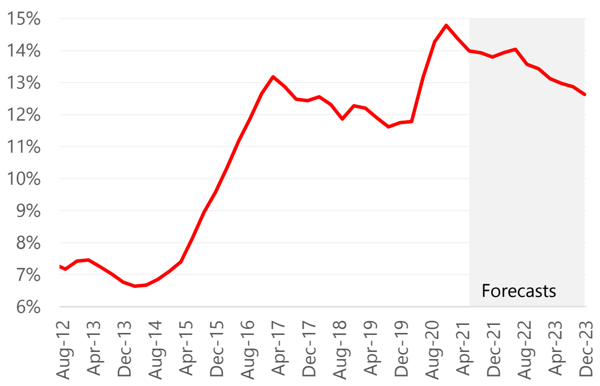
Figure 7 – Employment by Position (sa, Jan-20=100)



Sources: IBGE, Santander.

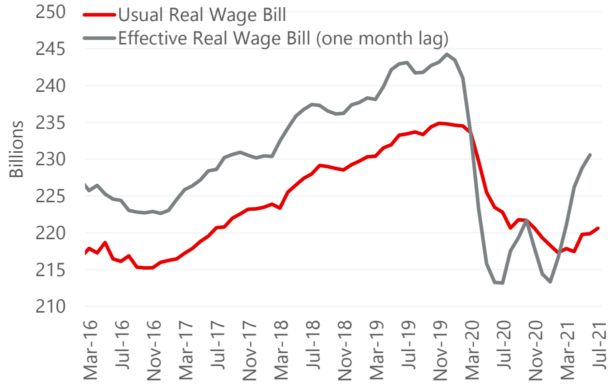
In our view, there is still slack in the labor market, with room for improvement in the next 12 months. Although we do not see the unemployment rate reaching pre-pandemic levels anytime soon, the growth in the employed population should offset the lower average wages, in our view, resulting in a positive impact on the real wage bill.

Figure 6 – Unemployment Rate Trajectory (sa)



Sources: IBGE, Santander.

Figure 7 – Monthly Real Wage Bill (BRL, sa)

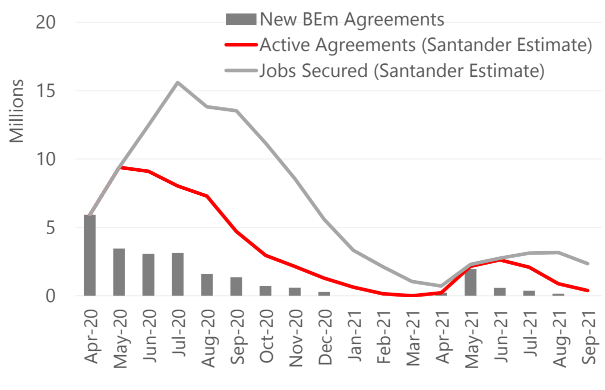


Sources: IBGE, Santander.

Another important factor influencing the labor market was the part of "extra-cap" fiscal stimulus (not considered as falling under the spending cap rule) intended to support formal employment. The formal employment program ("Emergency Benefit for Income and Employment Preservation", or BEm) was intended to contain the effects of the COVID-19 pandemic on the labor market. The benefit is paid when there is an agreement between employees and employers to reduce the working day by 70%, 50%, or 25%, with a proportional reduction in salary or temporary suspension of the employment contract, in exchange for securing the beneficiaries' formal jobs for a period after the agreement is over. The program benefited 9.8 million workers who had their contracts suspended and 1.5 million who signed temporary agreements to reduce working hours and wages. The BEm program was created by the Ministry of Economy in April 2020 and reintroduced in April 2021 by Provisional Measure No. 1.045/2021. The program ended last August, but its effects will last until the beginning of next year (due to the period during which the program's beneficiaries cannot be laid off). The government spent BRL33.5 billion in 2020 on the program (out of a budget of BRL51.5 billion), with YTD outlays of BRL7.2 billion (out of a planned budget of BRL11.7 billion).

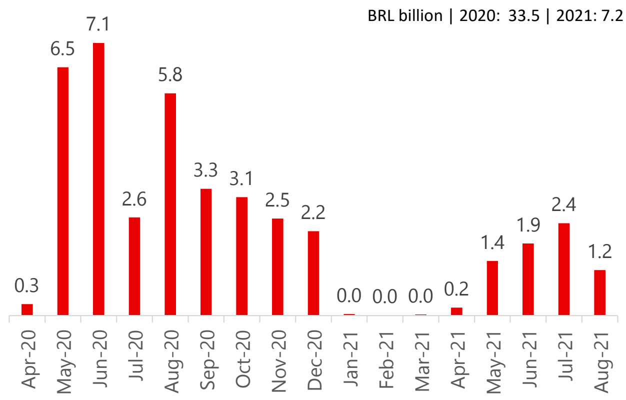
It will be important to follow the performance of the formal labor market after the end of the program (although its lagged effects will still be present for a few months). We expect some softening in the recovery in formal employment as measured by CAGED. In addition, we believe that the current job market still shows considerable slack that should gradually subside by mid-2022, as both formal and informal employment remain below the pre-pandemic levels in the PNAD survey. We estimate an average unemployment rate of 14.1% in 2021 and 13.5% in 2022.

Figure 8 – Formal Job Fiscal Support Program (BEm)



Sources: Ministry of Labor, Santander.

Figure 9 – BEm: Fiscal Stimulus Monthly Stipend



Sources: IBGE, Santander.

The "Expanded" Real Wage Bill: An Update and the Outlook for Further Government Transfers

In this section, our objective is to provide an update on the "expanded" (including social benefits) real wage bill (total wages from work) that was explored in our report *The Real Wage Bill and the Impact of Emergency Aid* (September 16, 2020) and updated in our note *Labor Market – 2021 Thermometer* (February 4, 2021). See the links below[2][3].

The main points in our update are to discuss: (i) updated labor and fiscal data for 2020 and 2021; (ii) the impact of the increase in inflation, which affected both labor income and the series deflator; (iii) the possible impact of the Selic rate on our forecasts for 2022; and finally (iv) the possible impact of fiscal transfers and the outlook into 2022.

The "expanded" real wage bill is the product of the employed population and the real effective average income from work. The series is seasonally adjusted (published in the *PNAD contínua*), adding government benefits, also seasonally adjusted (i.e., pensions, unemployment insurance, and entitlements such as pension benefits—BPC and welfare transfers from the government such as *Bolsa Família,* the Emergency Aid, etc.).

We estimate the "expanded" wage bill rose 3.7% adjusted for inflation for full year 2020 compared to 2019. Our updated estimate is higher than our April estimate (+2.2%), as we raised our measure of the real values for the emergency disbursements. The high inflation in 2021 led us to increase our 2020 estimate in real terms and, consequently, has had a positive impact on our growth projection for full year 2020. This high growth rate "helped" the recovery of domestic activity, especially boosting the retail sector (core retail sales are 7.3% above the pre-pandemic level). For 2021, we expect the expanded measure to show a 5.7% drop (from -6.2% in our last review in April), indicating that the reduction in benefits payments more than offset the estimated cyclical recovery in the labor market. Furthermore, we improved our expected trajectory for employment, which had a positive impact on our estimate for labor income in both 2021 and 2022.

Figure 10 – Annual Growth in "Expanded" Real Wage Bill (average% in the period)

	2020	2021(E)	2022(E)
Wage Bill **(Without Fiscal Aid)**	-7.9%	+3.3%	+5.4%
Wage Bill **(With Fiscal Aid)**	+3.7%	-5.7%	+3.4%

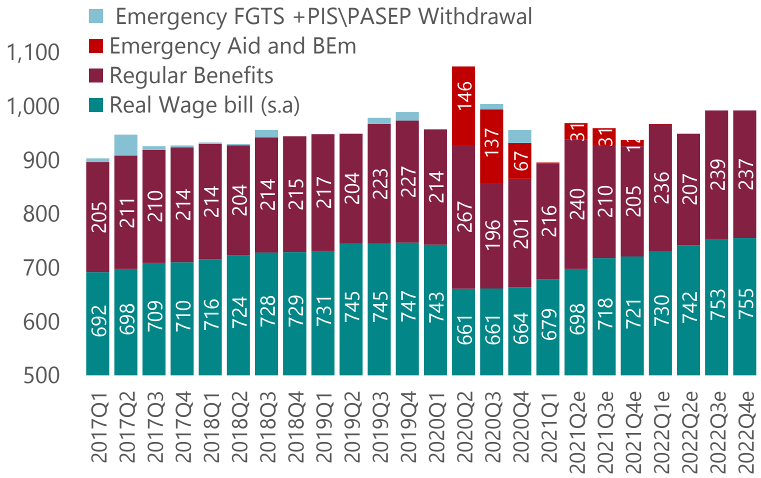
Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

Figure 11 presents our estimate of the evolution of the real seasonally adjusted wage bill and of the welfare programs. In this new update we also consider that the government anticipated the social benefits bonus and the wage bonus (*Abono Salarial*) from 4Q21 to 2Q21 (the same action that was taken in 2020). This did not change the outlook for the year, but it increases the "expanded" real wage bill for 2Q21.

[2] **Santander Brazil Activity and Fiscal Policy– *"The Real Wage Bill and the Impact of Emergency Aid"* –** September 16, 2020 - Available on: https://bit.ly/Sant-rwb_Sep20

[3] **Santander Brazil Activity and Fiscal Policy – *"Labor Market – 2021 Thermometer"* –** February 4, 2021- Available on: http://bit.ly/Sant-lbrmkt-040221

Figure 11 – "Expanded" Real Wage Bill and Social Benefits (in real terms, BRL billion)



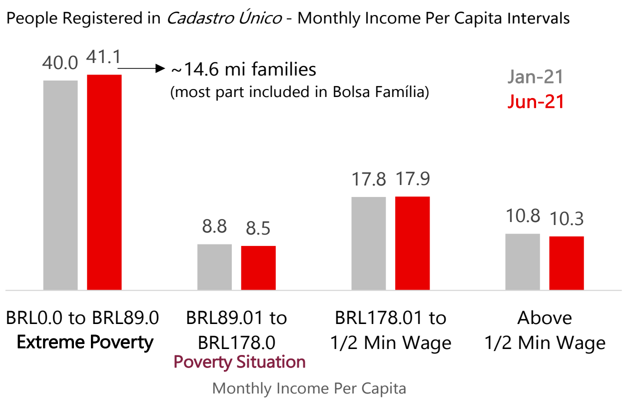
Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

To get an idea of the impact of the fiscal benefits, in 2Q20 transfers represented 16.2% of the effective income bill from all sources, an increase of 10.0% QoQ (+10.3% YoY). The counterfactual scenario without transfers would result in a 5.1% QoQ drop (-5.3% YoY) in the "expanded" real wage bill in 2Q20. For 2021, in looking at Figure 11, the dark grey bars show a gradual recovery, with a more consistent increase in 2H21. In our simulation, the drop in the real wage bill in 1Q21 will be BRL66 billion compared to 4Q20, BRL121 billion compared to 3Q20, and BRL150 billion compared to 2Q20.

For 2021, with the second pandemic wave (more intense than the first), the government resumed the emergency aid after approval of *PEC emergencial* and also extended it until October, through an extraordinary credit (a mechanism for adjusting Brazilian budgetary execution—and not included in the spending cap).

The initial government intention was to extend the Emergency Aid to ~39 million people included in the *Cadastro Único*[4] and not included in the current welfare program *Bolsa Familia*, which is mostly people with informal work or unemployed. Currently, about 5 million beneficiaries have their government transfers blocked. In Figure 12 we show the number of people in the *Cadastro Único*, a government registry database. We see an increase in the number of families classified as being in "extreme poverty", and, in our view, the recent price shock effect (inflation reached more than 10% in 12 months) could further increase the number of people in this condition. It is worth noting that the poverty and extreme poverty classification ranges have not been updated since 2018.

Figure 12 – *Cadastro Único* – Government Registry Database



Sources: Federal Government, Santander.

[4] *Cadastro Único* is a registry database with of information about Brazilian families in situations of poverty and extreme poverty. This information is used by the Federal Government, the States and the municipalities to implement public policies capable of promoting an improvement in the lives of these families.

The government introduced the Emergency Aid program to contain the effects of the pandemic. The initial value of the first four months of the program was BRL600 per month, and the program reached 68 million people at its peak. After September 2020 the aid was reduced to BRL300 monthly and to about 48 million people by its end in December 2020 as the pandemic eased. The total expenditures for Emergency Aid in 2020 were BRL293 billion (3.9% of GDP) out of a budget of BRL322 billion (91% executed). The lower actual expenditure versus the amount budgeted was due to a reduction in the number of beneficiaries at the end of 2020.

For 2021, after the pandemic's resurgence in 1Q21, the government reintroduced the program after the approval of the *PEC emergencial* in March, before the 2021 budget had been approved. The *PEC emergencial* set a total budget of BRL44 billion ("extra-cap"), but with the worsening of the pandemic the government added a new extraordinary credit of BRL20 billion that extended the aid until October 2021. The YTD outlays for the government transfers (considering also *Bolsa Família* payments) are BRL44 billion (0.5% of GDP). By the end of the year we expect that the total expenditure will reach BRL70 billion (0.8% of GDP). Added to the *Bolsa Familia* disbursements in the year (~BRL20 billion), the fiscal transfers should reach BRL90 billion (1.0% of GDP) in 2021, according to our projections.

There is still one uncertainty regarding the payments in November and December after the end of the Emergency Aid—namely, the government intends to create a new welfare program. It is worth noting that any changes in the current welfare program (*Bolsa Família*) must be made during 2021, and its payments must begin this year, because elections will take place in 2022, and the electoral law (Law 9504/97) does not allow the creation and payments of new benefits during an electoral year.

In light of this, on August 9 the government submitted to Congress a provisional measure to create a new welfare program titled *Auxílio Brasil*, to replace the *Bolsa Família* program. The proposed text does not establish the value of the new benefit, and, according to the government, the total budget and parameters will be decided by early 4Q21. The government wants to create the program to cover 17 million families (up from 14.6 million covered by Bolsa Familia) and increase the monthly benefit amount to BRL300 per month (from BRL196 currently).

However, this decision is not trivial and depends on the answers to several important questions: (i) what will be the fiscal margin in the constitutional spending cap considering higher inflation numbers; (ii) how the size of court orders to be paid in 2022 will be defined; and (iii) if it creates the new program, the government will need a source of funding to comply with the fiscal responsibility law, and it is not clear what the source will be. These three points are intertwined, and points two and three may require measures to be approved by Congress.

First, the margin is declining due to the inflation mismatch. The constitutional spending cap was readjusted by IPCA 12-month until June (8.4%). This allowed BRL124 billion for new expenditures considered in the fiscal rule for 2022. However, inflationary pressure in 2H21 caused inflation to rise to 9.5% (INPC index that readjusts the social benefits/minimum wage), considering our latest inflation tracking. For each 1.0 pp increase in INPC, the mandatory outlays increase by BRL8.3 billion, according to our estimates. In other words, the increase in INPC will imply higher mandatory outlays (mainly pension expenditures) next year, which increase automatically with inflation and the readjustment in the minimum wage. As a consequence, the fiscal margin for the government to expand the new welfare program, under the limits imposed by the spending cap, will be lower.

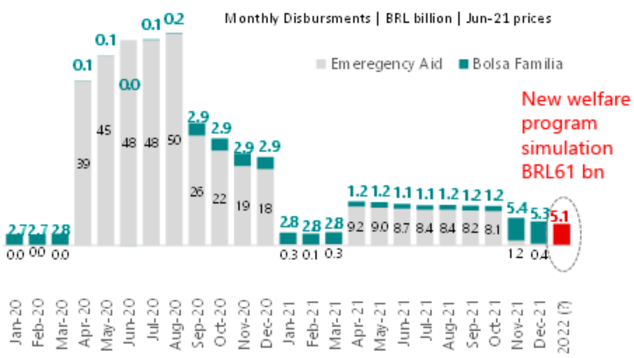
Second, the 2022 estimate for court-ordered debt payments (so-called *Precatórios*) soared, leading to a heated debate on a new framework to deal with these expenses. This follows official estimates pointing to a jump in this spending line to ~BRL 90 billion for 2022, significantly beating the government's initial expectation (~BRL 55 billion). In our view, pushing back the settlement of judicial claims could be seen as a hedge against a potential narrowing of the spending cap margin for 2022 (currently estimated at -BRL24 billion), as inflation expectations for year-end 2021 keep rising.

Finally, the government will also need a permanent source to finance the increase in the program (BRL20-26 billion, added to the current *Bolsa Familia* budget of BRL35 billion). The government has said its intention is to use the increase in dividend taxes in the income tax overhaul currently being debated in Congress. Although changing the tax system will cause a reduction in federal tax collection of about BRL20 billion a year (in the legislation currently being debated), an increase in the tax on dividends could be used by the government to bring the budget into compliance with the Fiscal Responsibility Law as permanent revenue offsetting this new expenditure with the welfare program expansion.

If the income tax overhaul is not approved, the government is currently debating increasing the *Bolsa Família* benefit only by inflation (raising the benefit stipend to BRL230 per month, from BRL196 currently) and including all the families that are in a queue to enter the program (~2 million families currently). This strategy does not need to have a permanent source of financing to comply with the Fiscal Responsibility Law. In addition, to reach the government's goal of achieving a BRL300 benefit in the new welfare program, Congress could create a temporary program (maximum of two years) of ~BRL70 per month, to complement the BRL300 benefit targeted. In this plan, the name of the program would remain the same (*Bolsa Família*) and there would be fewer restrictions based on the Fiscal Responsibility Law. In this sense, the only major fiscal restriction would be complying with the spending cap rule.

This discussion is important for our real wage bill estimate. To give an idea of the impact of fiscal transfers on the "expanded" real wage bill, we calculate the elasticity as follows: for every BRL10 billion of transfers, the real wage bill grows by 0.2% in the year.

Figure 13 – Welfare Transfers from the Government



Sources: National Treasury and Bloomberg.

Figure 14 – 2022 Spending Cap Margin - Simulation

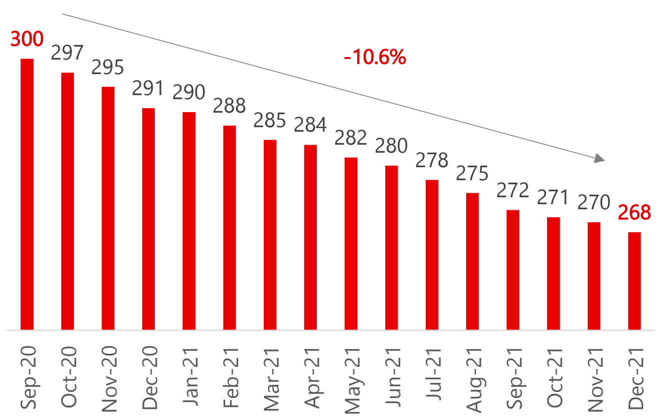
2022 Budget: Spending Cap Margin - BRL bn						
Court-ordered debts Budget (*"Precatórios"*)						
	BRL bn	40	50	75	89	90
Year-end Inflation (INPC | Dec-21)	6.5%	54	44	19	5	4
	7.0%	49	39	14	0	-1
	7.5%	44	34	9	-5	-6
	8.0%	40	30	5	-9	-10
	9.5%	25	15	-10	-24	-25
	10.0%	22	12	-14	-28	-29
Additional Budget for Auxílio Brasil- BRL bn						
Monthly Average Benefit (BRL/month)						
		250	270	300	350	400
Families (millions)	17	16	20	26	36	47
	16	13	17	23	32	42

Bolsa Família's current budget (2021): BRL35 billion/year | Total: 14.6 million families

Sources: National Treasury and Bloomberg.

Finally, Figure 15 provides a simulation to show the effect of inflation, which has increased more significantly since 4Q21, intensifying since the middle of 2021. We can see that according to our calculations, the benefit of BRL300 that started in September 2020 should be worth more than 10% less by the end of the year. In other words, there was a loss in the purchasing power of the beneficiaries of the program, which shows the impact that inflation has had on these people's income. In the next section, we will explore the effects of inflation and interest rate hikes on our expanded wage bill estimates.

Figure 15 – Simulation of the Inflation Impact on the BRL300 Benefit Value Since September 2020

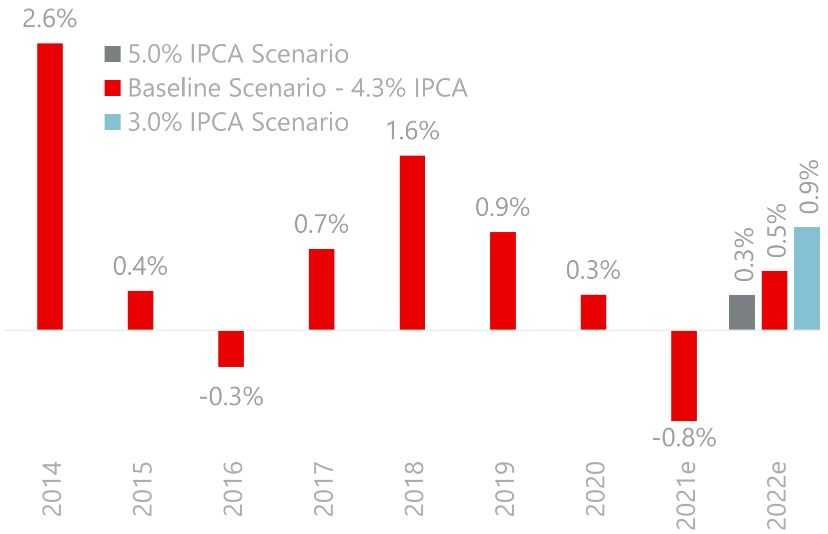


Sources: National Treasury, IBGE, Ministry of Economy, and Santander.

Real Wage Bill: Inflation and Interest Rate Scenarios

Using our base scenario, we tested the sensitivity of the 2022 "expanded" real wage bill to variations in inflation and in the Selic rate. Higher inflation affects the real wage bill by reducing the real growth in average income. Our baseline scenario considers 4.7% inflation for the 2022 IPCA, which is compatible with 0.5% growth in average real income. We simulated scenarios with 3.5% and 5.5% for the IPCA, which generated 0.9% and 0.3% growth in real average income, respectively. As for the "expanded" real wage bill, we expect a range of +2.9% (5.5% IPCA) to +4.1% (3.5% IPCA), already considering BRL 61 billion of disbursement from *Auxílio Brasil* (new welfare program).

Figure 16 – Real Average Income (% Full Year)



Sources: IBGE, Santander.

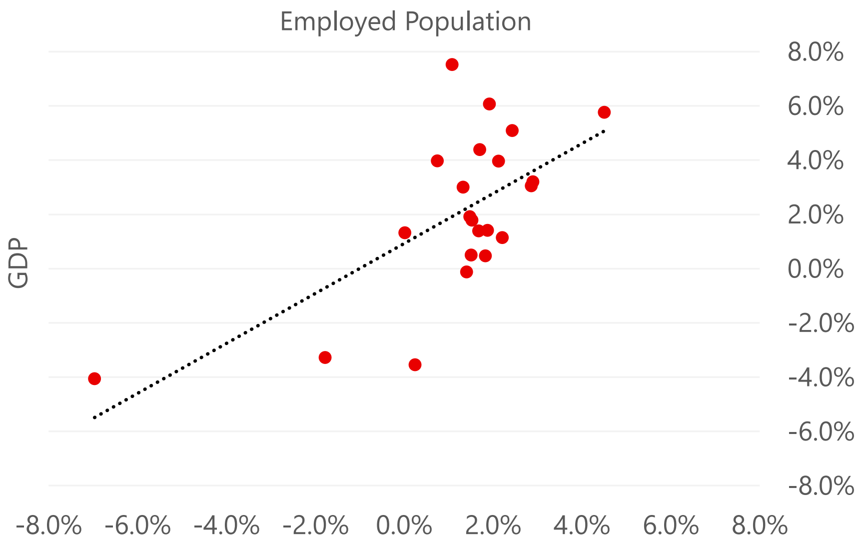
Figure 17 – Inflation Scenario and the Real Wage Bill

	2020	2021(E)	2022(E) - IPCA Simulation 3.50%	4.70%	5.50%
Real Wage Bill (No Fiscal Stimulus)	-7.9%	+3.3%	+6.3%	+5.4%	+5.0%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL35bn)	+3.7%	-5.7%	+3.5%	+2.7%	+2.2%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL61bn)			+4.1%	+3.4%	+2.9%

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

As for the Selic rate, the impact on the real wage bill occurs via GDP and the employed population. We estimate that each 100-bp change in the Selic implies a 0.4 p.p. impact on GDP growth. We consider an elasticity of the employed population to GDP growth close to one (0.92). Therefore, each 100-bp increase in the Selic rate implies a reduction of around 0.4 p.p. in the employed population.

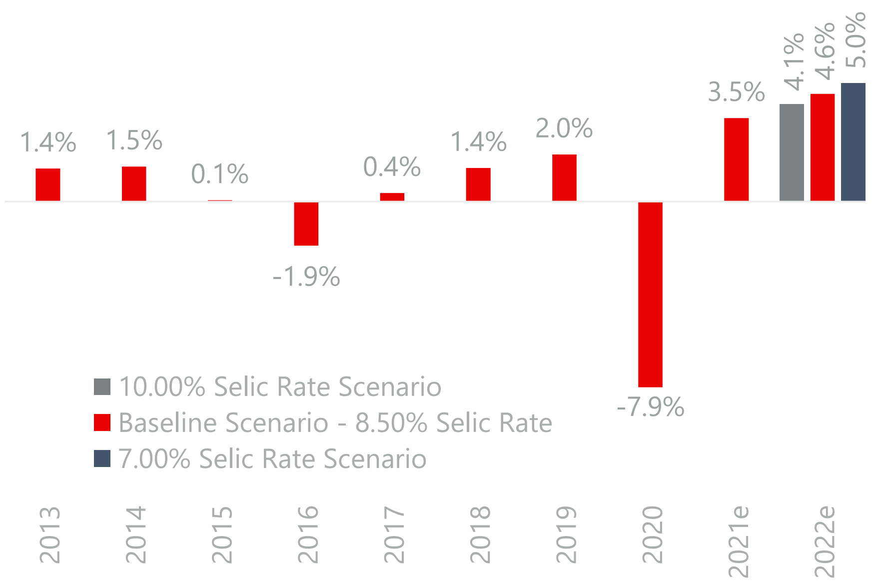
Figure 18 – Employed Population vs GDP Growth (% Full Year)



Sources: IBGE, Santander.

Considering this elasticity simulation, we simulated the "expanded" real wage bill in three different scenarios for the terminal Selic rate in 2022. We consider only the impact on the employed population, which shows growth varying from 4.1% to 5.0%, considering interest rate levels 150 bps above and below our current forecast (8.50%), respectively. Our real wage bill scenario does not change substantially when we consider a higher Selic rate (9.00%), in line with the upside risk of our current interest rate scenario. As a result, growth in the "expanded" real wage bill in 2022 varies from 3.1% to 3.8%, already considering the scenario of a BRL 61 billion *Auxílio Brasil* program.

Figure 19 – Employed Population (% Full Year)



Sources: IBGE, Santander.

Figure 20 – Consumption and Real Wage Bill (% s.a.)

	2020	2021(E)	2022(E) - Selic Rate Simulation 7.00%	8.5-9.0%	10.00%
Real Wage Bill (No Fiscal Stimulus)	-7.9%	+3.3%	+5.9%	+5.4%	+5.0%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL35bn)	+3.7%	-5.7%	+3.0%	+2.6%	+2.3%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL61bn)			+3.8%	+3.4%	+3.1%

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

Conclusion

We consider the behavior of the labor market a key factor in our assessment of the recovery in domestic economic activity. The vaccination rollout was crucial for the recovery of domestic activity and the increase in social mobility. The second wave of the pandemic was more severe than we anticipated, but despite some headwinds on the path to recovery, activity is currently improving at a rate close to what we expected at the beginning of the year.

In light of this, since the last review in our real wage bill estimates, the labor market has shown a considerable improvement, on the heels of greater urban mobility and the perception that there will be no major setbacks in terms of restrictive public health measures. It will be important to follow the performance of the formal labor market after the end of the formal employment program BEm (although its effect should still be present until the end of the year). We expect some softening in the recovery in formal employment as measured by CAGED. In addition, we believe that the current job market situation still shows considerable slack that should gradually subside by mid-2022, as both formal and informal employment remain below the pre-pandemic levels in the PNAD survey. We estimate an average unemployment rate of 14.1% in 2021 and 13.5% in 2022. Three main factors marked our updated outlook for the "expanded real wage bill": (i) updated labor and fiscal data for 2020 and 2021; (ii) impact of the increase in the inflation index, which affected both labor income and the deflator; (iii) the possible impact of the Selic rate on our forecasts for 2022; and finally (iv) the possible impact of the fiscal transfers and the outlook for further government transfers.

Our real full year estimate for the "expanded" wage bill is now +3.7% YoY for 2020, reduced from our April estimate (+2.2%). This reduction was mainly due to the impact of inflation, as we recalculated our measures for the real values of the emergency disbursements (inflating past values). For 2021, we expect the expanded measure to show a 5.7% drop (from -6.2% in our last review in April), indicating that the estimated cyclical recovery in the labor market is not sufficient to offset the reduction in benefits payments. Furthermore, we improved our expected trajectory for employment, which had a positive impact on labor income in both 2021 and 2022. For 2022, the value will depend on the size of the new social program that the government wants to implement (increasing *Bolsa Família*). **In our baseline scenario, considering the welfare program budget of BRL61 billion, we project the real wage bill will increase by 3.4%.** The elasticity of the fiscal transfers to the real wage bill is as follows: for every BRL10 billion of transfers, the real wage bill grows by 0.2% in the year.

Finally, we also explored the impact of both the Selic rate and inflation on the real wage bill. We ran some simulations to analyze the impact of the macro variables. For the Selic rate, the impact on the real wage bill occurs via GDP and the employed population. We estimate that each 100-bp change in the Selic implies a 0.4 p.p. impact on GDP growth and around 0.3 p.p. on the real wage bill. We consider an elasticity of the employed population to GDP growth close to one (0.92). For the IPCA, we estimate that each 100-bp rise in inflation reduces the real wage bill by around 0.6 p.p.

All in all, we consider that the scenarios for the “expanded” real wage bill are compatible with a 1.1% expansion of household consumption in 2022. We acknowledge that there will be a shift in the demand composition from goods to services, and there is a risk that a reduction in the consumption of goods may have a considerable impact on broad economic activity. However, we believe that the recovery in the consumption of services should overcome these negative effects.

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 – Commodities	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Fabiana Moreira*	Economist – Credit	fabiana.de.oliveira@santander.com.br	5511-3553-6120
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
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511-3553-1684
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