Santander

Brazil Macro Outlook I September 2021

Santander's forecasts for Brazil

Macroeconomic variables		Previous	Current
GDP (%)	2021E	5.1	5.1
	2022E	2.0	1.7
	2023E	1.5	1.0
IPCA (%)	2021E	7.3	8.5
	2022E	4.1	4.3
	2023E	3.3	3.3
Selic Rate (% end of period)	2021E	7.50	8.25
	2022E	7.50	8.50
	2023E	7.00	7.00
FX Rate - USDBRL (end of period)	2021E	5.05	5.25
	2022E	5.55	5.55
	2023E	5.20	5.20
Current Account Balance (% of GDP)	2021E	0.0	0.1
	2022E	-0.5	-0.6
	2023E	-1.7	-1.7
Primary Fiscal Balance (% of GDP)	2021E	-1.6	-1.3
	2022E	-1.2	-1.0
	2023E	-0.9	-0.8
Gross Public Debt (% of GDP)	2021E	81.6	79.7
	2022E	83.5	82.2
	2023E	86.2	85.6

Sources Santander

Key hypotheses (baseline scenario)

- Owing to vaccines, the pandemic will remain under control in DMs, even with the emergence of new variants. The Federal Reserve will start tapering asset purchases in December 2021 and won't lift off rates before 2023. Clearer communications about it likely in September.

- Commodities supported by global growth, led by US and China, with fading pressures from 2H21 onwards. Gradual normalization of global production chains and fading of supply constraints is still our baseline, but this process can prove slower than previously thought.

- In Brazil, vaccination pace to hold near 1.5 million shots per day in 2H21, with adult population fully immunized in November. We envision a perennial mobility recovery ahead (with no going back), with "normalization" seen at the end of 3Q21.

- The continuity of the reopening will maintain the higher levels of labor demand, resulting in the normalization of the labor force and better employment conditions at the end of 2021.

- In fiscal accounts, we continue to envision a difficult fiscal consolidation process, with tailwinds proving temporary. Major reforms still in need. Amid a more polarized political and institutional environment, we see risks of fiscal slippage on the rise for the medium run.

- Lingering uncertainties on the fiscal front and tensions on the institutional camp should limit the upside for the BRL, despite an accommodative policy in DMs and better terms of trade. This should contribute to keep the premium in Brazilian assets (FX rate included).

- On inflation, the shocks are proving more persistent than we have been expecting. We mind an apparent backlog of price hikes at **wholesale** and a higher CPI **inertia** for the short-term. These will be important hurdles for an expected slowdown next year. We still see this **cost push inflation as temporary**. While more intense than expected, we still see the electricity shock fading in 2022.

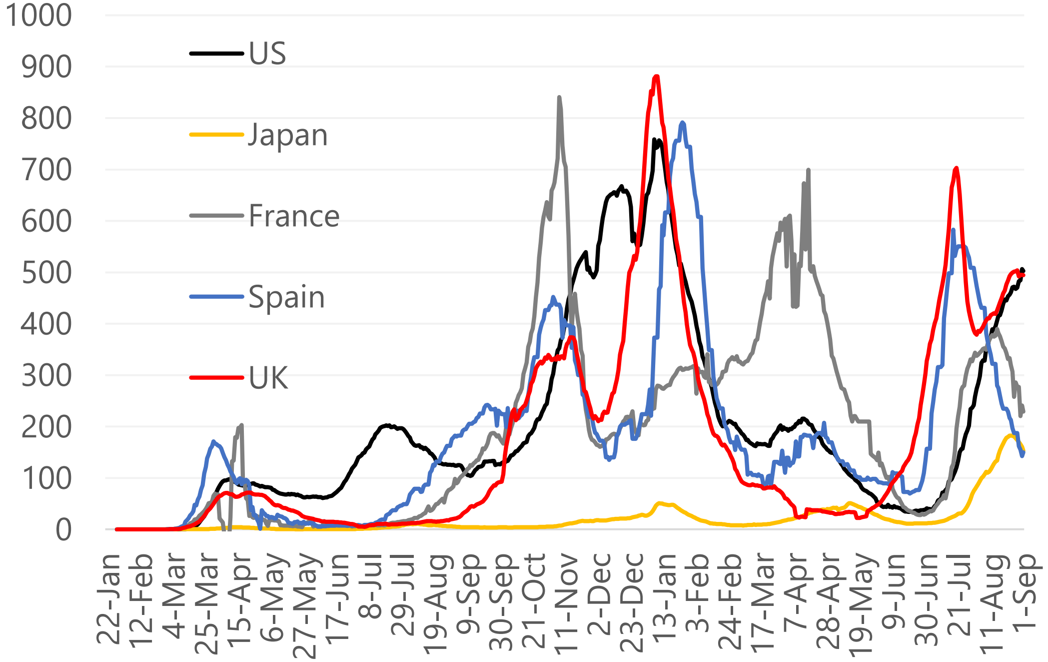
- BCB keen to step up the tightening process (both in speed and size) to avoid a broader de-anchoring of inflation expectations. With policy risks on the rise, the BCB may find it even more difficult to partially accommodate shocks and extend the horizon of convergence for 2023.

GLOBAL CONDITIONS

Delta Variant is still a risk, but concerns are fading at the margin

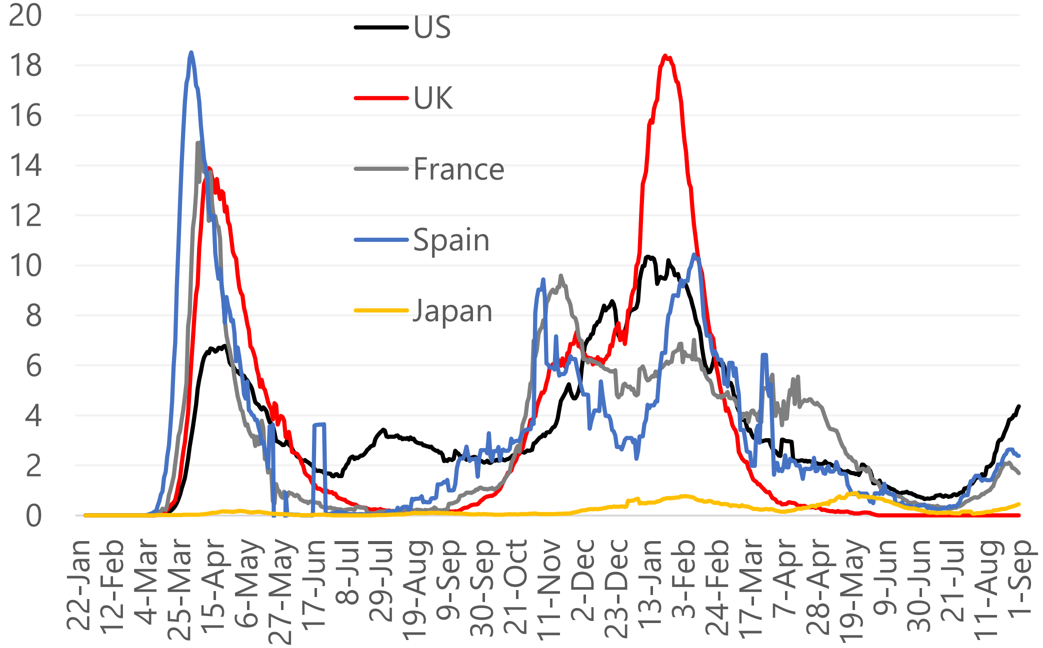
- Infections are still elevated – specially among non-vaccinated.
- Vaccines are helping containing mortality.
- Economic impact should be limited as governments aren't reacting as they did in previous waves.

New Cases (per MM habitants) - World



Sources: Our World in Data

New Deaths (per MM habitants) - World

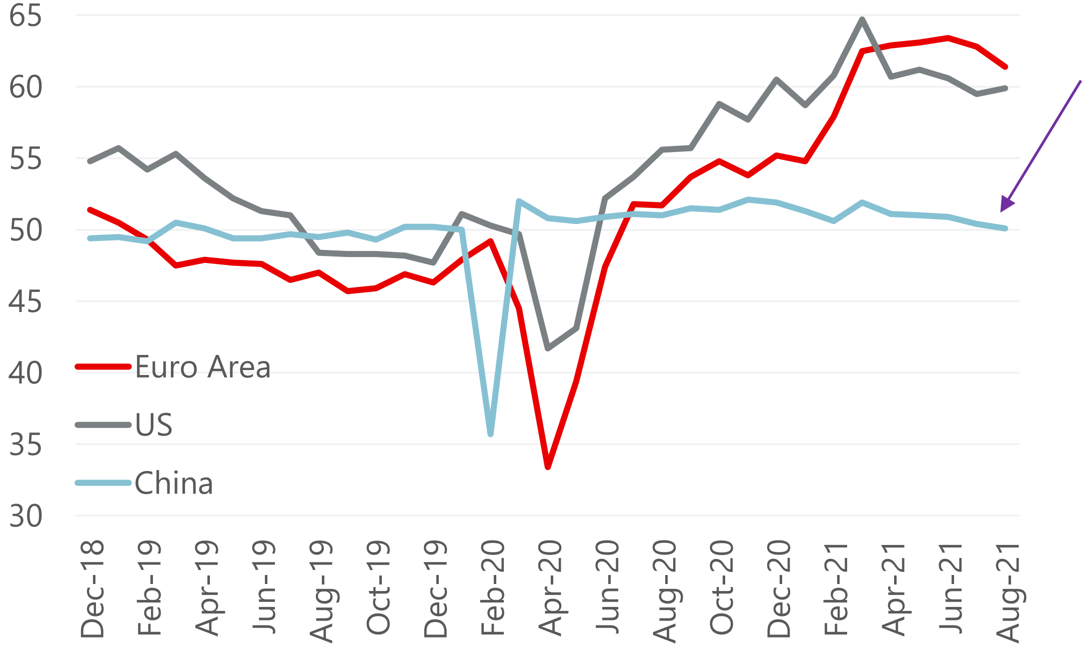


Sources: Goldman Sachs

Global – Growth is slowing

- Activity should remain strong, supported by fiscal stimuli and loose monetary policy.
- China is expected to add fiscal stimulus among growth concerns.
- But reopening impetus saw in H1 should fade away.

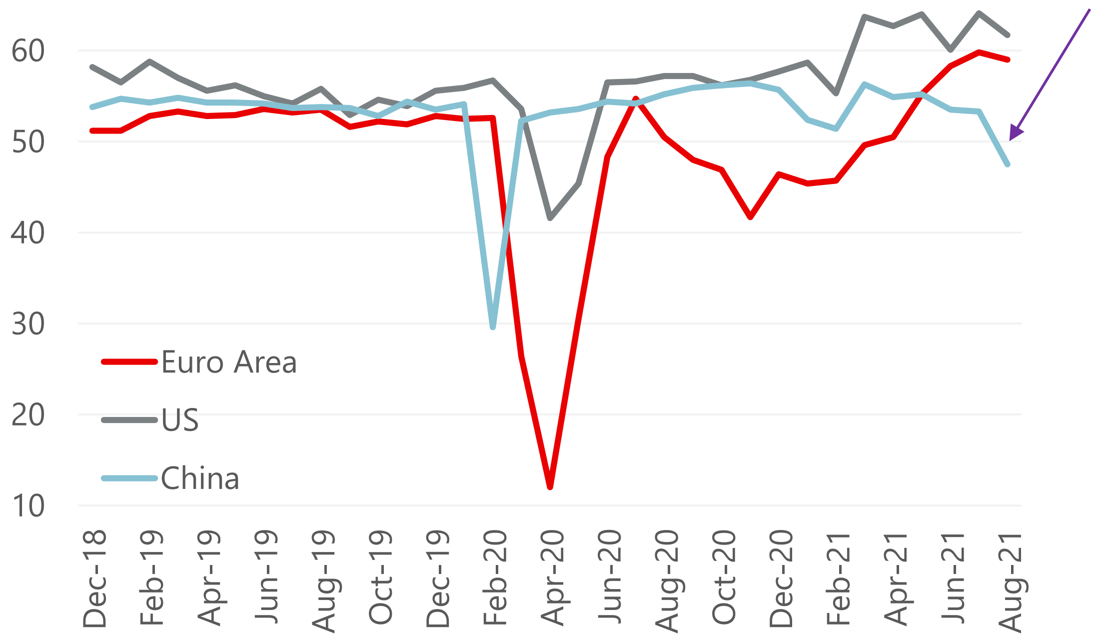
PMI Manufacturing



Sources: Bloomberg, Santander

*ISM for de US

PMI Services



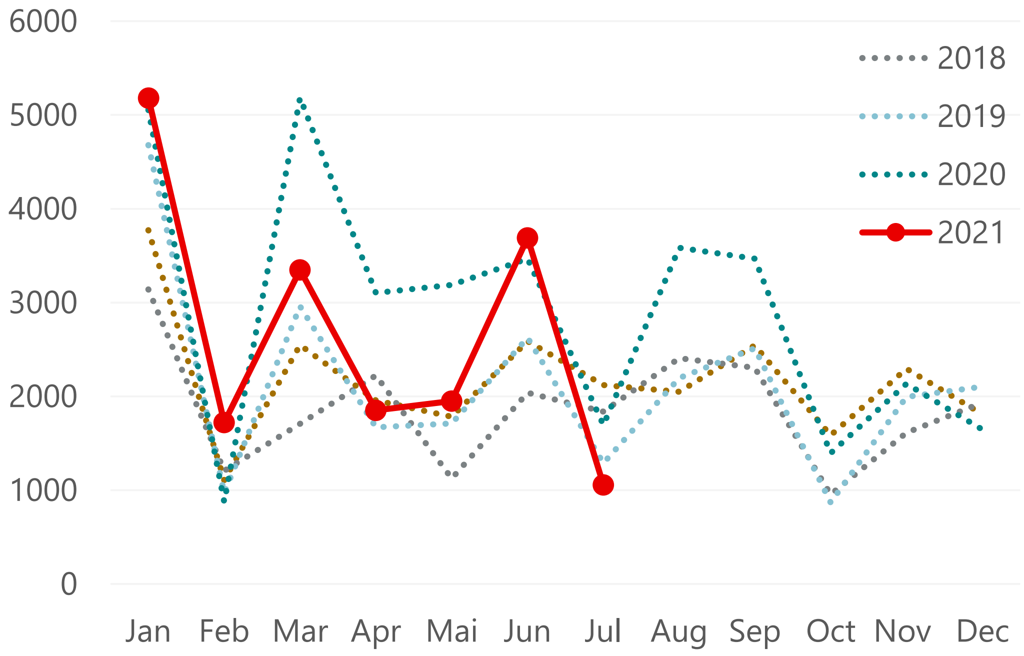
Sources: Bloomberg, Santander

*ISM for the US

China – Government will add stimuli again as activity slowed

- Government was scaling back stimuli as the economy was on track for a strong growth in 2021.
- Delta impact on activity in the beginning of H2 was larger than expected.
- Stimuli will be back as of infrastructure investment and credit.

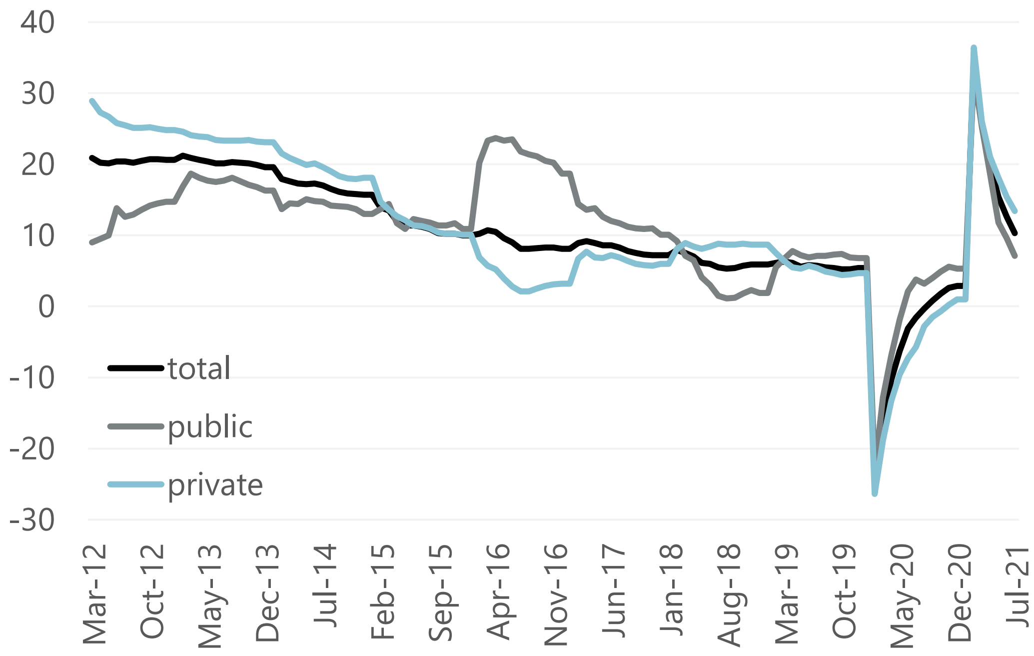
Aggregate Financing (CNY Billions)



Sources: Bloomberg, Santander

*ISM for de US

Fixed Assets Ex-Rural YTD YoY (%)



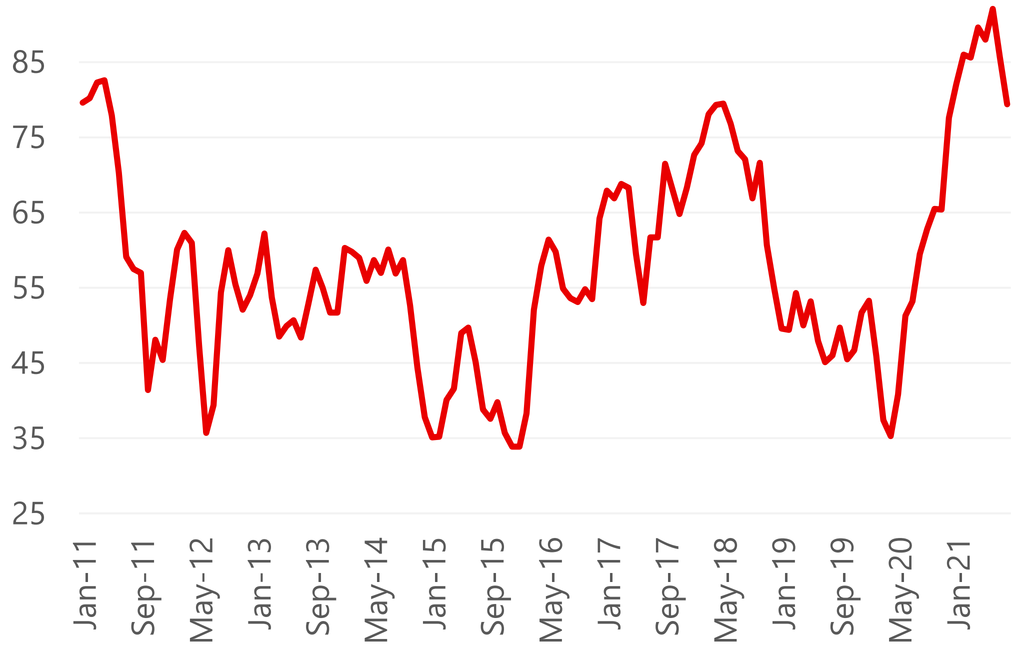
Sources: Bloomberg, Santander

*ISM for the US

US – Inflation is also peaking

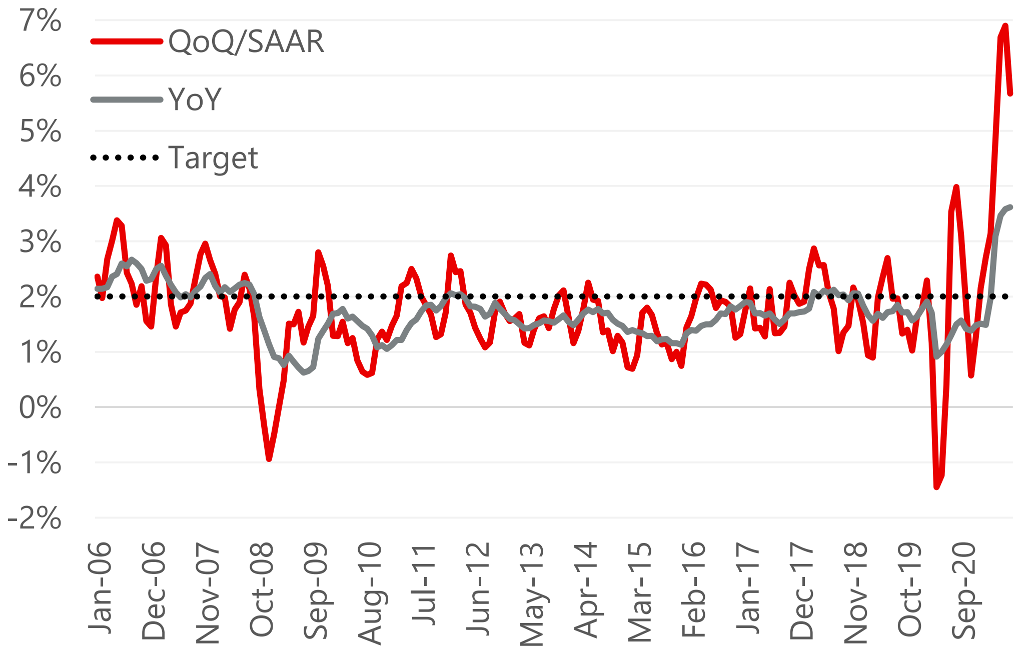
- Inflationary shocks was much stronger than expected.
- Base effects and reopening issues are fading.
- Risks are still skewed to the upside, but much of the shock should dissipate in H2.

ISM Manufacturing – Prices Paid



Sources: Bloomberg, Santander

Core PCE



Sources: Bloomberg, Santander

Forecasts

Baseline Scenario - revised (Sep, 2021)						
	2018	2019	2020	2021	2022	2023
Global GDP (%)	3.5	2.8	-3.5	6.1 ↓	4.5	3.4
China GDP (%)	6.7	6.0	2.3	8.5 ↓	5.6	5.5
US GDP (%)	3.0	2.2	-3.5	6.5 ↓	4.3	2.5
US Inflation (CPI, %)	1.9	2.3	1.4	4.1	2.8	2.1
US Interest Rate (FFR, %)	2.50	1.75	0.25	0.25	0.25	1.00
US Interest Rate (UST10y, %)	2.7	1.9	0.8	1.8 ↓	2.1	2.1
Dollar Index - DXY	96	96	90	95	97	97
Commodity Prices - CRB	409	401	444	541	488	458

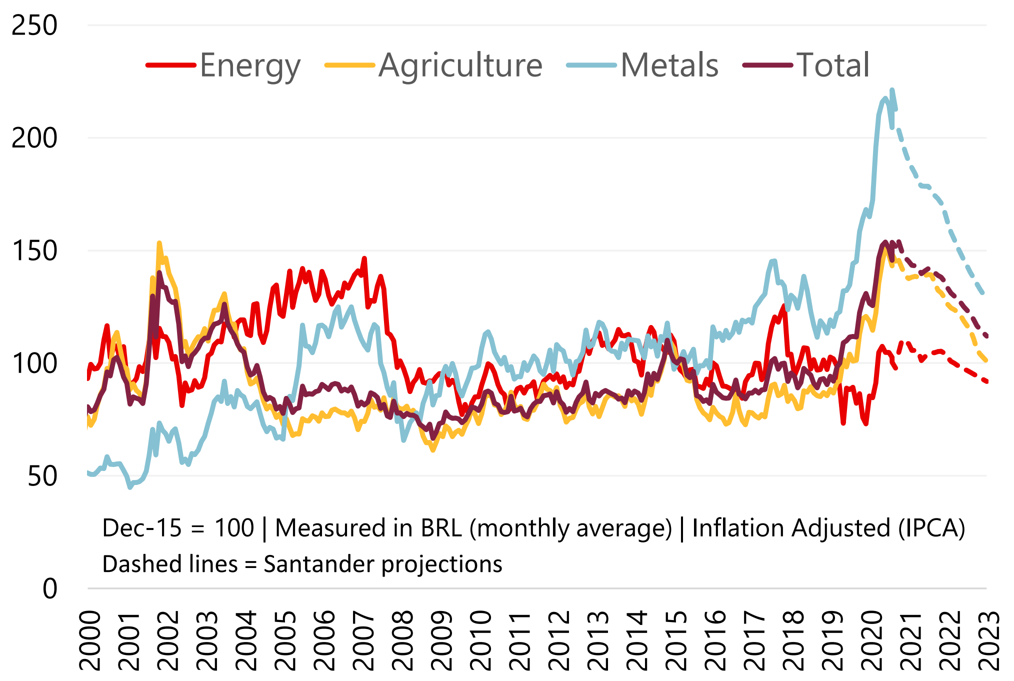
Source: Santander

COMMODITIES

Background – Commodity

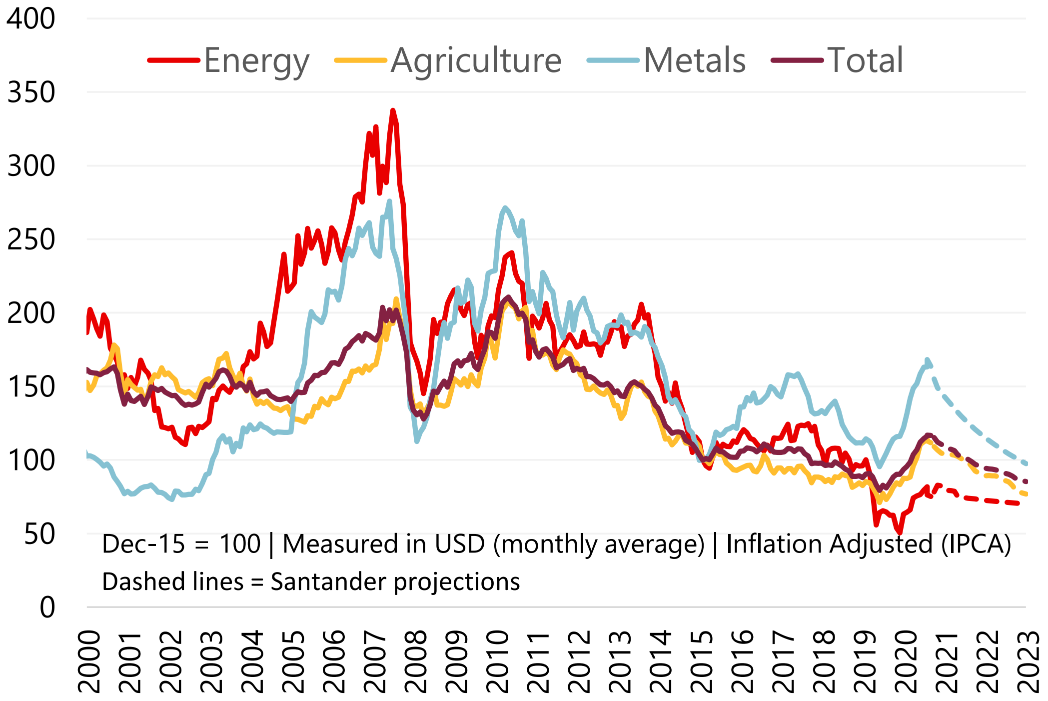
- The fact that the greater gain in terms of trade accompanies higher commodity prices helps to increase revenue for the largest companies related to the sector. It is important to emphasize that Brazilian GDP has a strong positive correlation with the commodity cycle, so the cycle's duration will be a key factor to observe. In our view, it will tend to cool down until 2023, which gives the government time to promote structural changes on the fiscal front.

CRB Commodity Index - BRL



Sources: Bloomberg, Santander.

CRB Commodity Index - USD



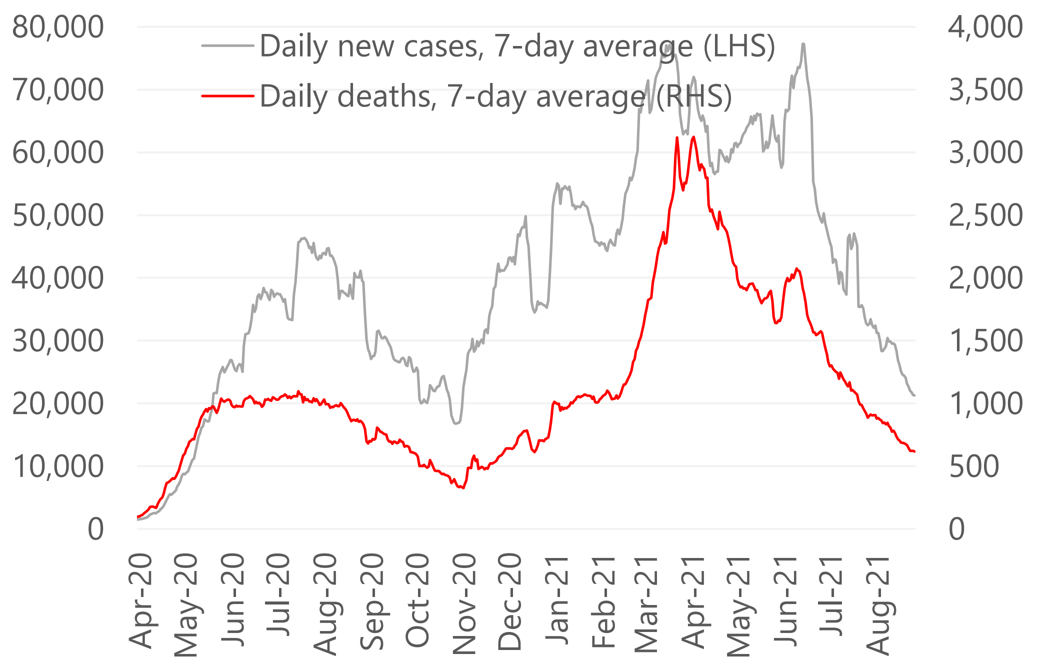
Sources: Bloomberg, Santander.

COVID-19

Covid-19 pandemic gradually easing but delta variant risk remains

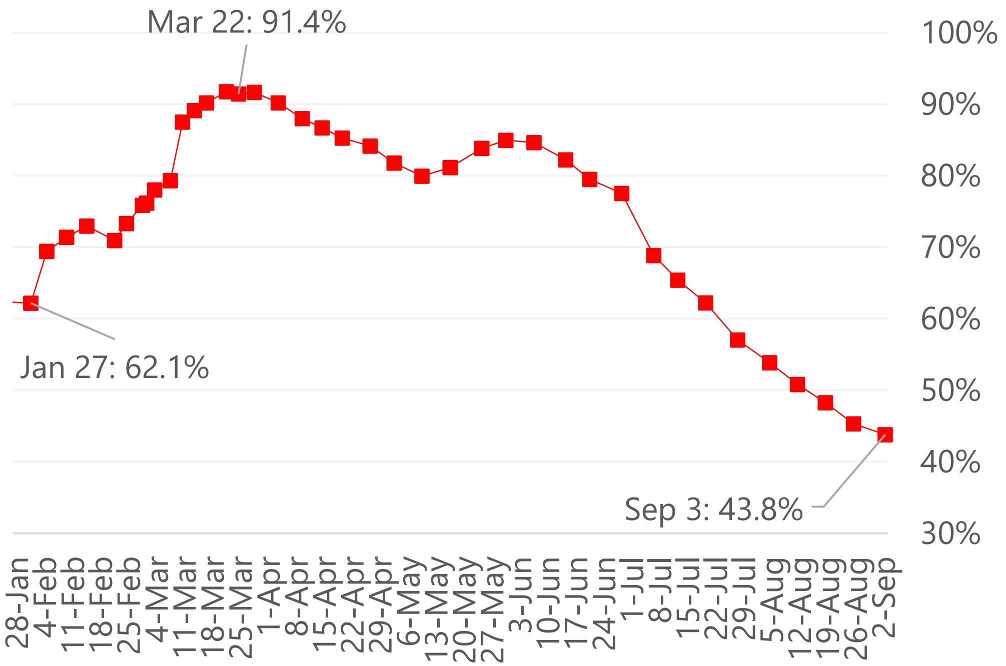
- New cases, hospitalizations and casualties are slowly coming down.
- We believe local governments will probably continue to lift restrictions further.

Daily cases and deaths - Brazil



Sources: Ministry of Health, Santander.

Nationwide Average ICU Occupancy Proxy (%)

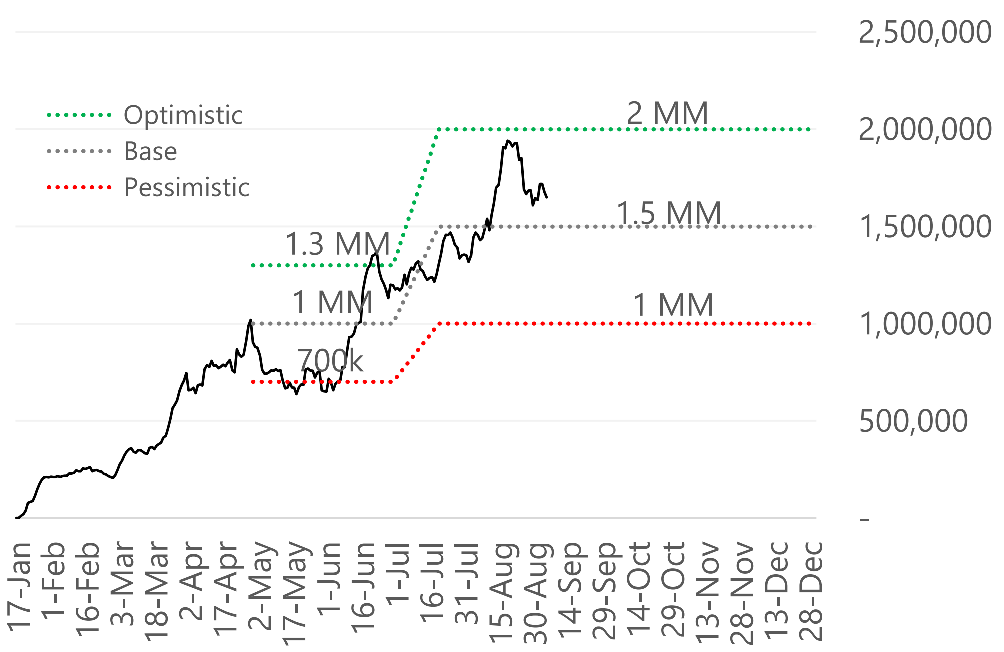


Sources: @coronavirusbra1, Santander.

A stable vaccination path

- The vaccination rate has been holding up at around 1.6 million/day on average, reaffirming a positive outlook for the control of the pandemic and the reopening of the economy in 2H21.
- By end-2021, in the baseline scenario, 89% of the population would be fully vaccinated.

Vaccination Pace (doses administered/day)



Sources: Ministry of Health, Santander.

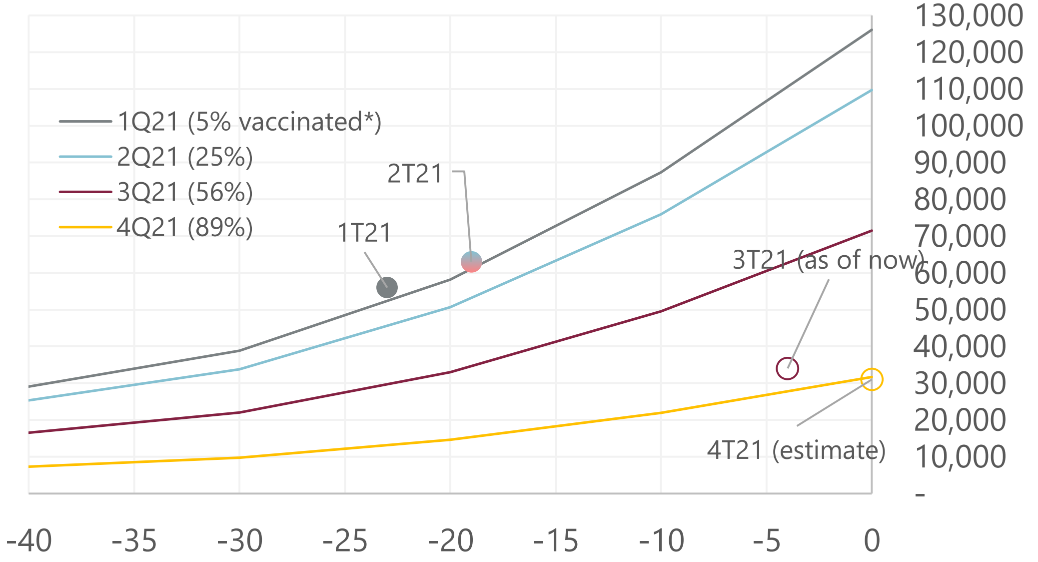
Greater mobility and normalization in 2h21

- Mobility continues to increase as restrictions are lifted.
- The current reopening process has so far not prompted a resurgence in hospital admissions, but the delta variant is a risk.

	Google Mobility		ICU Occupancy	
	Current	Previous	**Current**	Previous
3T20	**-31**	-31	**57%**	57%
4T20	**-18**	-18	**48%**	48%
1T21	**-23**	-23	**74%**	74%
2T21	**-18**	-20	**81%**	81%
3T21	-4	-8	62%	71%
4T21	0	-3	41%	41%

Sources: Google Mobility, Santander.

Google Mobility and New Cases



*Each curve represents a quarter. Estimated share of fully vaccinated population (end of period) in parenthesis.

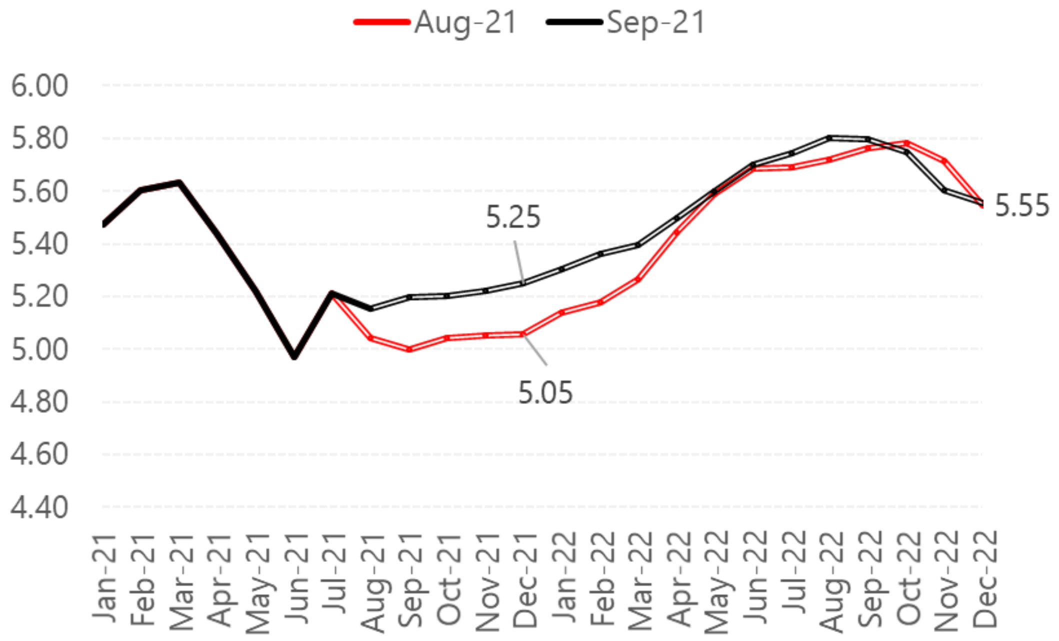
Sources: Google Mobility, Brazilian Ministry of Health, Santander.

EXTERNAL SECTOR

FX Rate with limited room for strengthening, despite the beefy premium

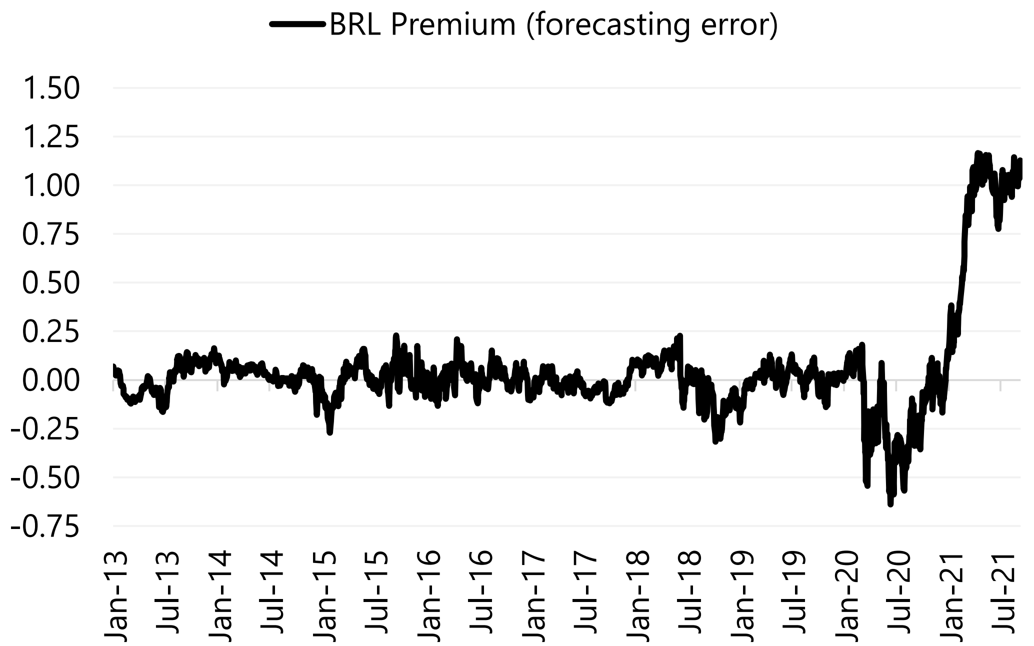
- Recent turbulences have seemingly shifted upwards the level around which the BRL is likely to hover in the coming months. Next year, the presidential race in tandem with a high level of uncertainty on the fiscal front should foster additional weakening of the BRL.

USD/BRL



Fonte: Bloomberg, Santander.

FX Rate "Premium"



Fonte: Santander.

An insulating factor

- Weak currency, gradual economic recovery and strong external demand should keep the current account balance out of markets' concerns for quite some time.

USD billion	2019	2020	2021e	2022e	2023e
Current account balance	-65.0	-25.9	0.8	-9.7	-30.3
Trade balance	26.5	32.4	65.0	61.7	48.5
Exports	225.8	210.7	276.7	288.4	292.3
Imports	199.3	178.3	211.7	226.7	243.8
Services	-35.5	-20.9	-22.9	-28.7	-30.9
Tourism	-11.6	-2.3	-5.8	-9.2	-10.7
Eq. Rental	-14.6	-11.9	-11.1	-15.7	-16.4
Others	-9.3	-6.7	-6.0	-3.9	-3.9
Income	-57.3	-39.7	-44.3	-45.7	-50.8
Profits & Dividends	-31.9	-18.3	-20.6	-28.4	-33.7
Interest payments	-25.5	-21.5	-23.7	-17.3	-17.1
Transfers	1.2	2.3	3.0	3.0	3.0
Direct investment onshore	69.2	44.7	59.5	68.5	71.7
External funding (-ve=shortage / +ve=excess)	4.1	18.7	60.3	58.8	41.3

Fonte: Banco Central do Brasil, Bloomberg, Santander.

An insulating factor

- Weak currency, gradual economic recovery and strong external demand should keep the current account balance out of markets' concerns for quite some time.

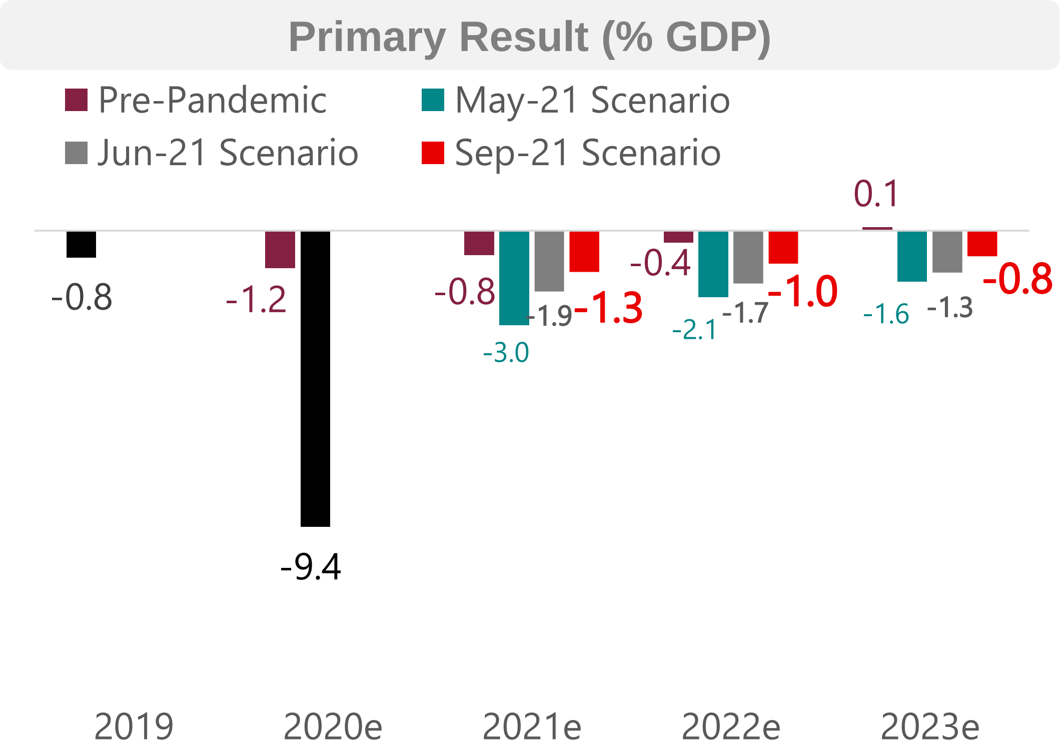
% of GDP	2019	2020	2021e	2022e	2023e
Current account balance	-3.5	-1.8	0.1	-0.6	-1.7
Trade balance	1.4	2.2	4.1	3.9	2.7
Exports	12.0	14.6	17.5	18.2	16.5
Imports	10.6	12.3	13.4	14.3	13.8
Services	-1.9	-1.5	-1.4	-1.8	-1.7
Tourism	-0.6	-0.2	-0.4	-0.6	-0.6
Eq. Rental	-0.8	-0.8	-0.7	-1.0	-0.9
Others	-0.5	-0.5	-0.4	-0.2	-0.2
Income	-3.1	-2.7	-2.8	-2.9	-2.9
Profits & Dividends	-1.7	-1.3	-1.3	-1.8	-1.9
Interest payments	-1.4	-1.5	-1.5	-1.1	-1.0
Transfers	0.1	0.2	0.2	0.2	0.2
Direct investment onshore	3.7	3.1	3.8	4.3	4.0
External funding (-ve=shortage / +ve=excess)	0.2	1.3	3.8	3.7	2.3

Fonte: Banco Central do Brasil, Bloomberg, Santander.

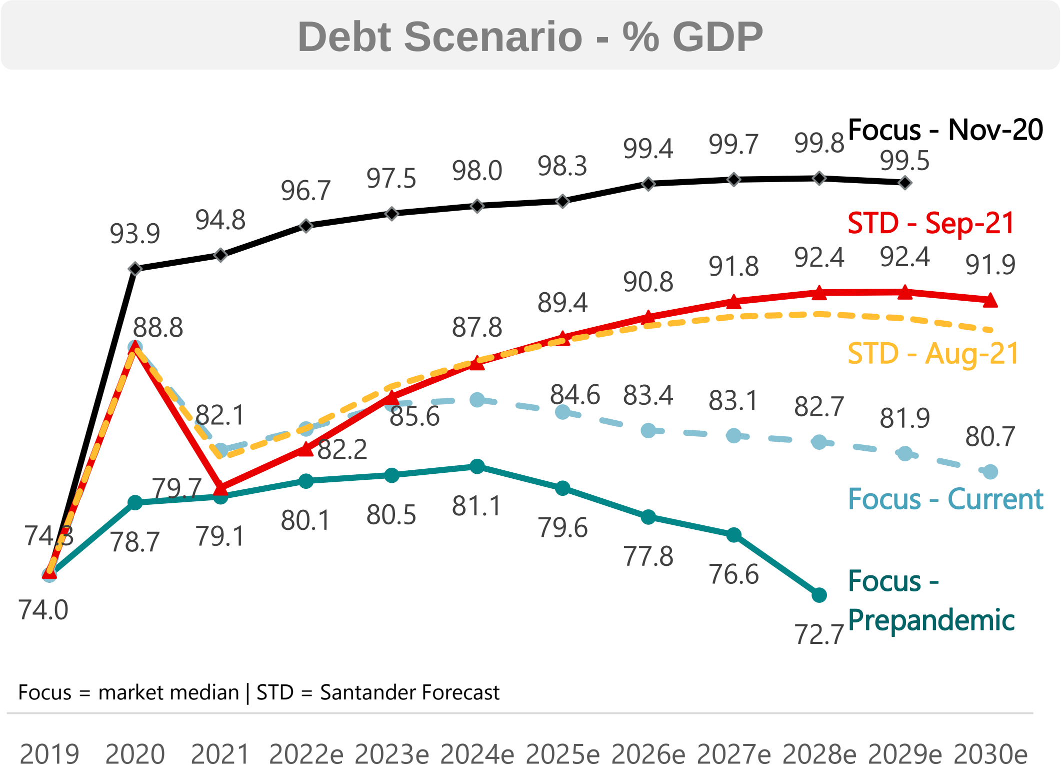
FISCAL

Fiscal – Inflation effect – Two sides of the same coin

- Considering the terms-of-trade and inflation impact on the revenues we improved our forecasts for the primary result. Yet, a more persistent improvement will depend on the commodity boom.
- We estimate that federal net revenue will rise by 0.3 pp of GDP per year, due to the positive shock related to terms of trade, depending on the impact and duration of the commodity boom.
- **The inflation shock directly accounts for ~3/4 of the improvement in the debt-to-GDP ratio (mainly via GDP deflator).**



Sources: BCB, Santander.

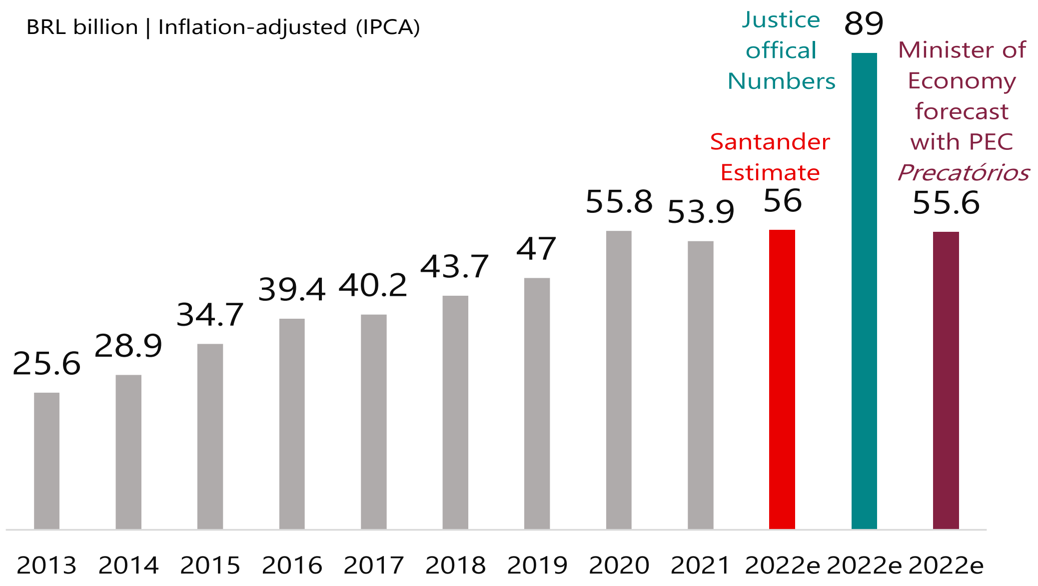


Sources: BCB, Santander

Fiscal – Inflation effect – Two sides of the same coin

- Our INPC forecast rose to 9.0%, from 7.8% in our last scenario. This reduced the spending cap margin to -BRL20 billion, considering the full payment of judicial claims (*Precatórios*).
- In our scenario we consider the *Precatórios* between BRL45-55 billion, opening a margin for BRL14-24 billion for the *Auxílio Brasil* (new welfare program to ~17mi families with a average benefit of BRL270-300 stipend for month).
- We marked down our projection for discretionary outlays in BRL5 billion, since our last scenario revision in August.

Judicial Claims Increase – BRL billion



Average of +12% YoY growth

Sources: Ministry of Economy, Santander

2022 Spending Cap Margin - Simulation

2022 Budget: Spending Cap Margin - BRL bn

Year-end Inflation (INPC | Dec-21)	Court-ordered debts Budget (*"Precatórios"*) BRL bn: 45	55	75	89	90
6.5%	49	39	19	5	4
7.0%	44	34	14	0	-1
7.8%	36	26	6	-8	-9
8.0%	34	24	4	-10	-11
9.0%	24	14	-6	-20	-21
10.0%	16	6	-14	-28	-29

Additional Budget for Auxílio Brasil- BRL bn

Families (millions)	Monthly Average Benefit (BRL/month): 250	270	300	350	400
17	16	20	26	36	47
16	13	17	23	32	42

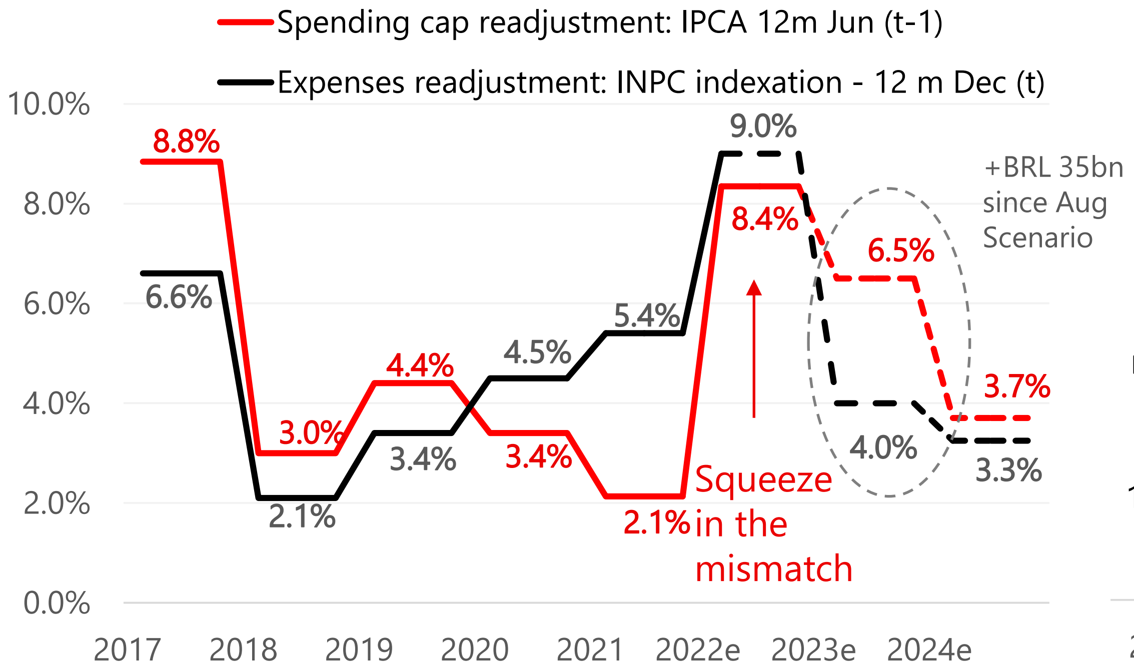
Bolsa Família's current budget (2021): BRL35 billion/year | Total: 14.6 million families

Sources: Santander

Inflation side-effect – Spending cap has lost some of its anchoring power

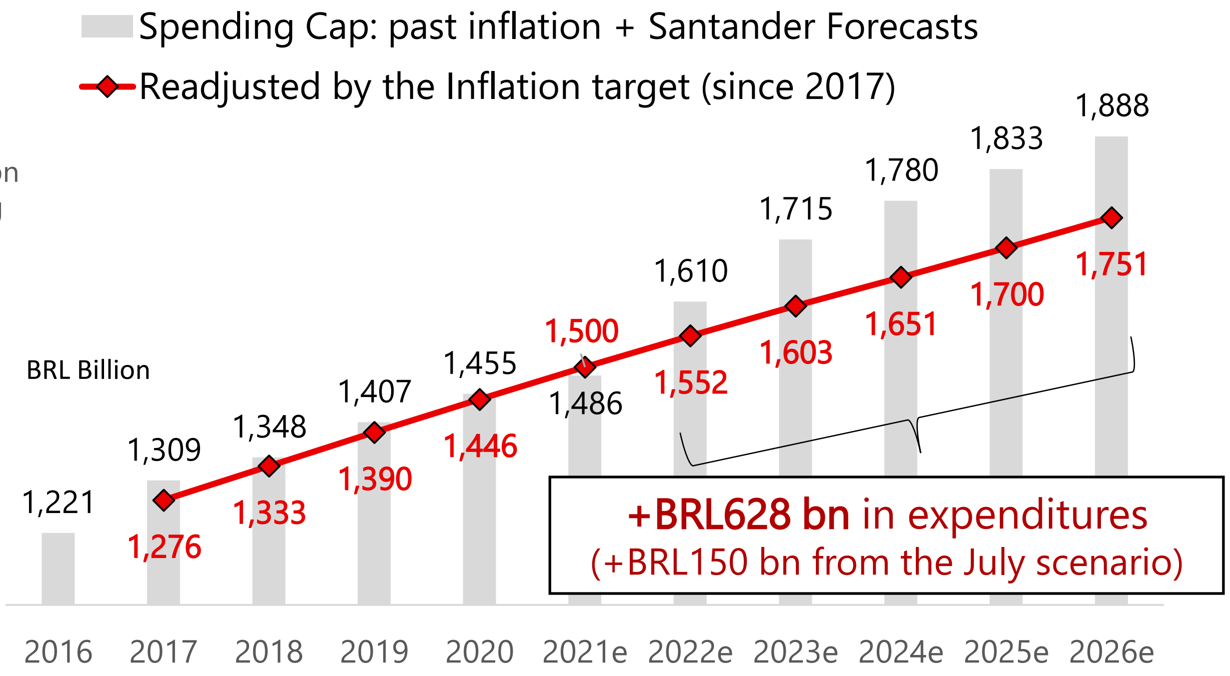
- At the beginning of the year, we estimated that nominal GDP would increase by 7% in 2021; our latest tracking points to a ~18% increase. The main effect was on the GDP deflator, which went from 4.0% to 12.5%, closely related to the commodity shock and an increase in IPCA forecast to 8.5% (September) from 3.6% (February). For 2022, the deflator went up +2pp on higher average inflation.
- Spending cap lost part of its anchoring power, it is possible to increase BRL628 billion during 2022-26 (+BRL150 bn since July estimate).

Spending Cap - Inflation Mismatch



Sources: IBGE, FGV, Santander.

Spending Cap Max. Total Limit



Sources: BCB, Santander.

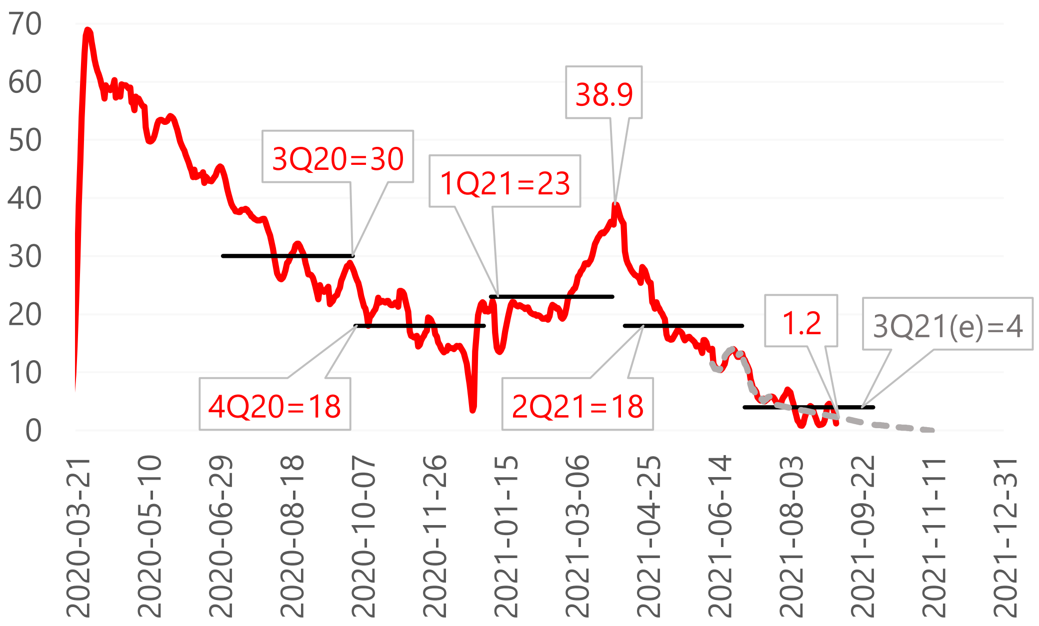
July's IPCA forecasts: 2021: 6.7%, 2022: 4.0%
September's IPCA forecasts: 2021: 8.5%, 2023: 4.3%

ECONOMIC ACTIVITY

Mobility-related services as an important driver of the recovery

- Following the faster-than-expected rise of mobility in 2Q21, we expect maintenance of social interaction recovery pace from onwards, on the heels of advances in the vaccination campaign, reaching levels close to normality in November. The services related to social interaction should be benefited by this recovery, playing an important role in the economic resumption.

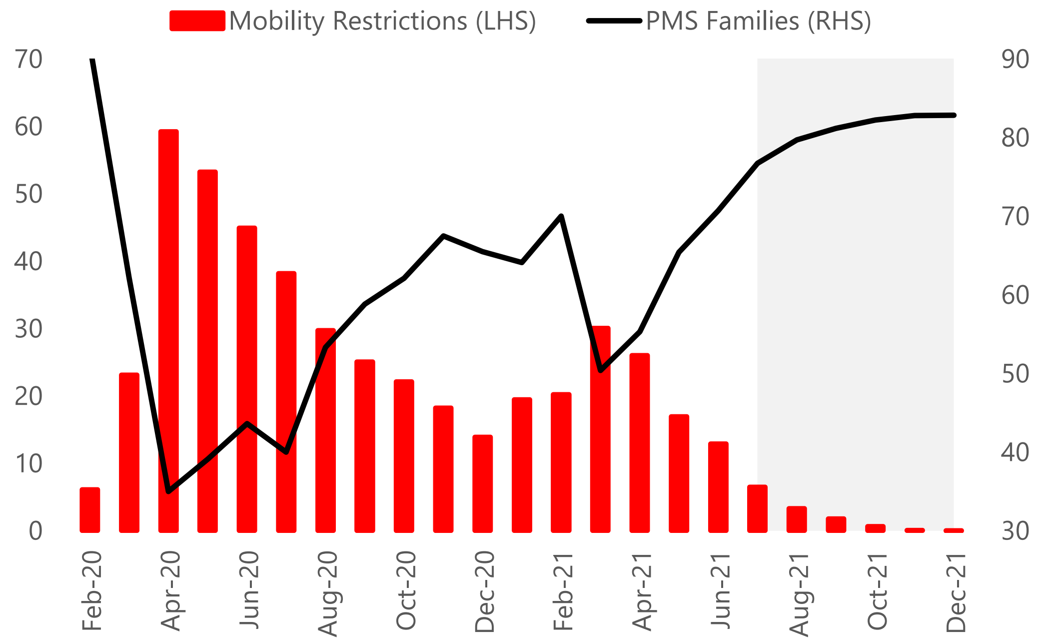
Google Mobility* (Feb/20=0) – 7dmma



Sources: Google, Santander.

* Last observation: September 04, 2021. **Previous: unchanged outlook**

Lockdown Index x Services to Families (sa)



Sources: Google, IBGE, Santander.

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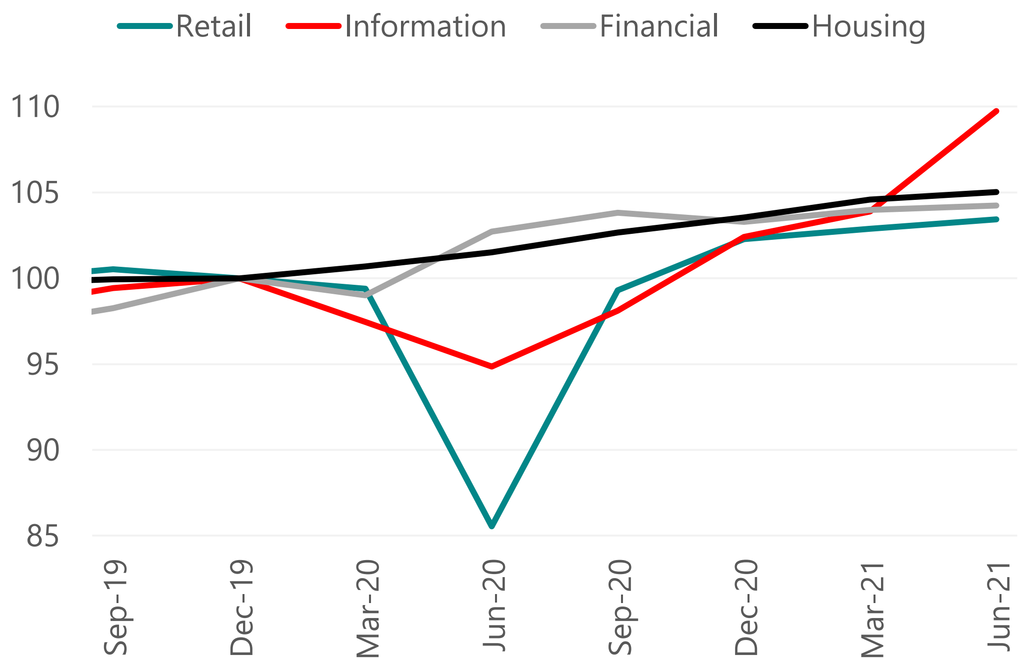
Services segments still at depressed levels and should recovery in 2H21

- Transports, Other Services and Public Services account for nearly 30% of GDP and are running at a well-depressed basis (1.0%,7.2% and 4.5% below 4Q19 level, respectively). We expect these segments to partially fill their pre-pandemic gaps, contributing to the economic recovery from 3Q21 onwards.

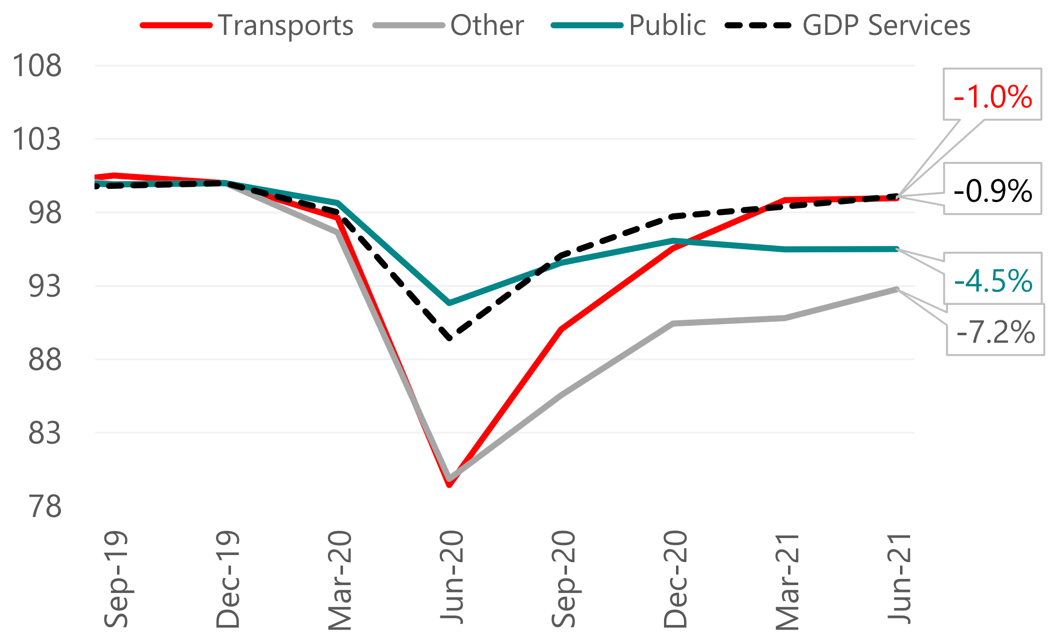
Above the pre-crisis mark (4Q19=100)*



Sources: IBGE, Santander.

* Retail, Information, Financial and Housing account for 13%, 3%, 5% and 9% of GDP, respectively, summing up ~30% of GDP.

Below the pre-crisis mark (4Q19=100)*



Sources: IBGE, Santander.

- Transports, Other Services and Public Services account for 4%, 13% and 15%, respectively, summing up 30% of GDP.
- Other Services: Leisure, restaurants, health and education (mercantile).
- Public Services: Public administration, health and education (non-mercantile).

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Mobility scenario reinforces momentum of economic activity

- For 2H21, higher commodities prices, along with advances in the economy's reopening , should contribute to a better momentum, with the services as the main driver of the resumption. For 2022, a tighter monetary policy path and worse financial conditions prompted us to reduce our GDP estimate to 1.7% from 2.0%, partially mitigating the lingering effects from the favorable terms of trade and expectations of a fully operational economy.

GDP Baseline Scenario

	YoY	QoQ	Full Year
4Q20	-1.2%	3.1%	-4.1%
1Q21	1.0%	1.2%	
2Q21	12.4%	-0.1%	
3Q21	5.2%	0.7%	
4Q21	2.3%	0.2%	5.1%
1Q22	2.2%	0.4%	
2Q22	1.8%	0.4%	
3Q22	1.3%	0.3%	
4Q22	1.4%	0.3%	1.7%

Sources: IBGE, Santander.

GDP Breakdown

	2017	2018	2019	2020	2021e	2022e
GDP	1.3	1.8	1.4	-4.1	5.1	1.7
Agriculture	14.2	1.3	0.6	2.0	2.3	2.0
Industry	-0.5	0.7	0.4	-3.5	5.4	1.6
Services	0.8	2.1	1.7	-4.5	4.4	1.9
Household	2.0	2.4	2.2	-5.5	4.0	2.0
Government	-0.7	0.8	-0.4	-4.7	1.7	1.2
Investments	-2.6	5.2	3.4	-0.8	12.2	2.4
Exports	4.9	4.1	-2.4	-1.8	9.4	1.5
Imports	6.7	7.7	1.1	-10.0	9.9	6.7

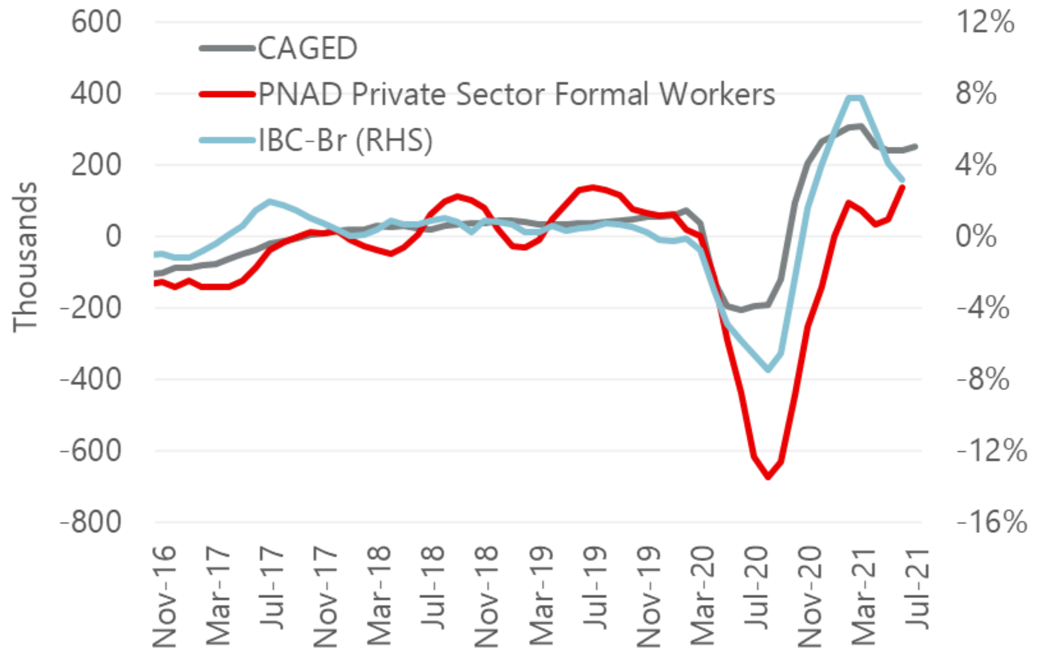
Sources: IBGE, Santander.

LABOR MARKET

Acceleration in labor force and employment recovery

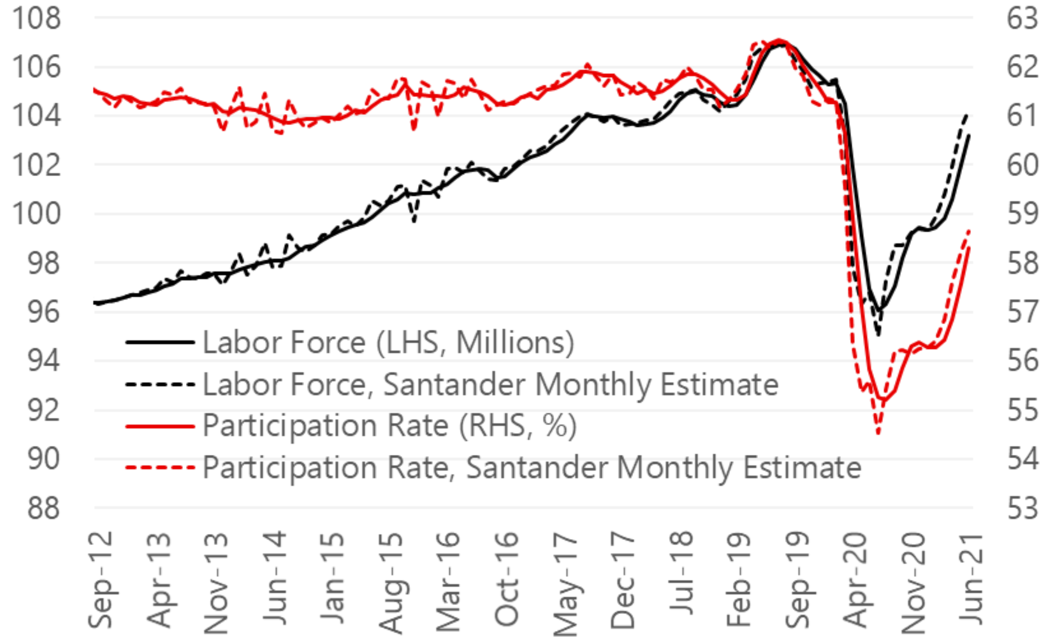
- After some deceleration in the beginning of 2021, labor force has accelerated in April, May and June. As a result, the recovery in participation rate has also picked up, but current levels are still far from the pre-pandemic.

Net Job Creation and IBC-Br (6m)



Sources: IBGE, Ministry of Economy, BCB, Santander.

Participation Rate and Labor Force (s.a.)



Sources: IBGE, Santander.

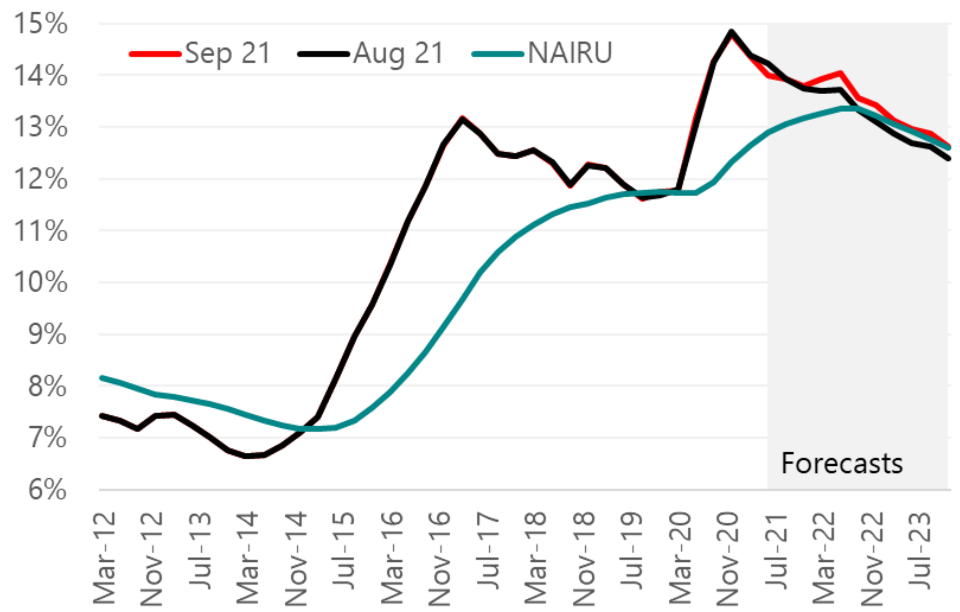
Labor market to recover gradually throughout 2021, 2022 and 2023

- We kept our trajectories for employment unchanged for 2021. For 2022, our tighter monetary policy scenario has led to an upward revision in the unemployment rate forecast. We expect the employment gap to close by end-2022.

		Aug -21	Sep -21
Unemployment Rate (avg)	2021	14.1	14.1
	2022	13.5	13.7
	2023	12.7	12.9
Unemployment Rate (YE, sa)	2021	13.7	13.8
	2022	13.1	13.4
	2023	12.2	12.6
Unemployed (YE, Millions sa)	2021	14.6	14.6
	2022	14.2	14.6
	2023	13.4	13.9

Sources: IBGE, Santander.

New Unemployment Rate Trajectory (SA)

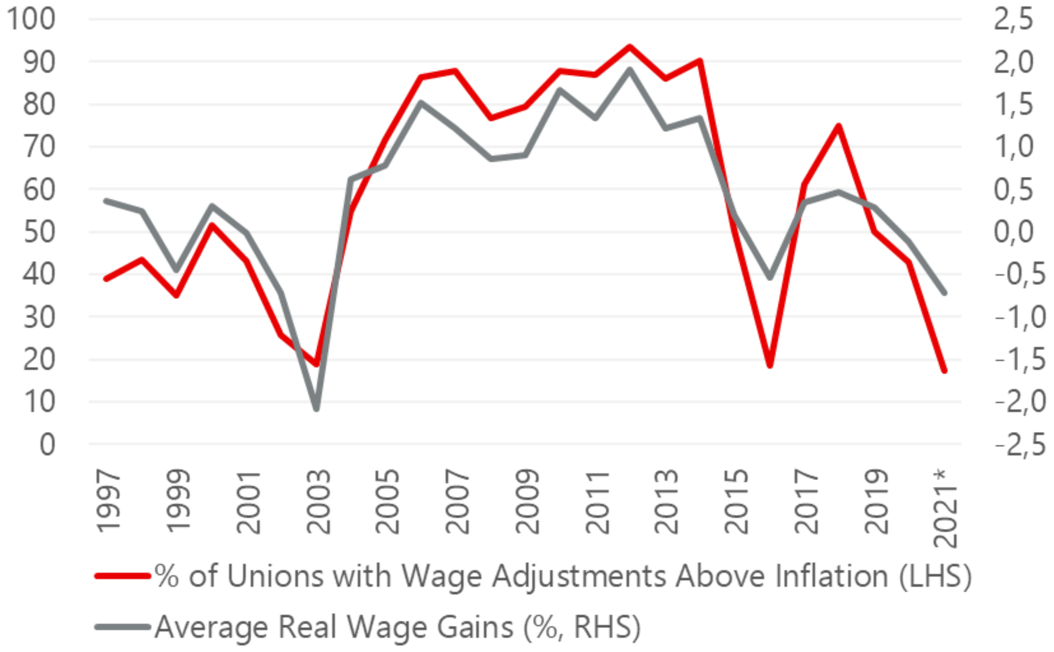


Sources: IBGE, Santander.

No signs of a tight labor market from collective wage agreements

- As of July 2021, the share of wage agreements with gains above inflation is close to the all-time lows. Although most of the agreements occur on the 1st half of the year, some important unions negotiate wages on the 2nd half of the year, such as retail, mining and financial sector workers. Therefore, this picture still can change until the end of the year.

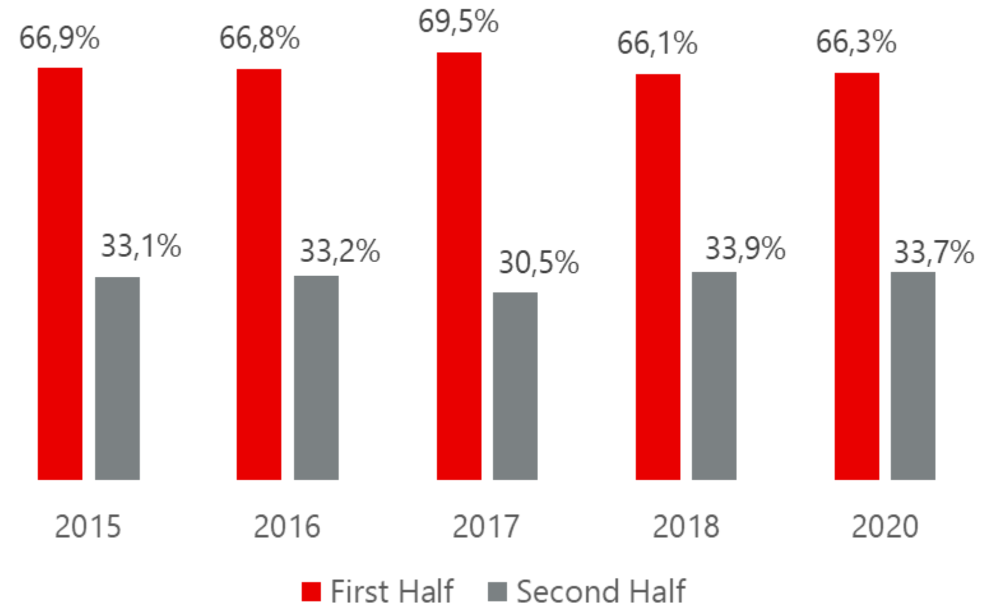
Collective Wage Agreements and Gains



Sources: DIEESE, IBGE, Ministry of Labor, Santander.

*as of July 2021

Wage Agreements Distribution per Period*



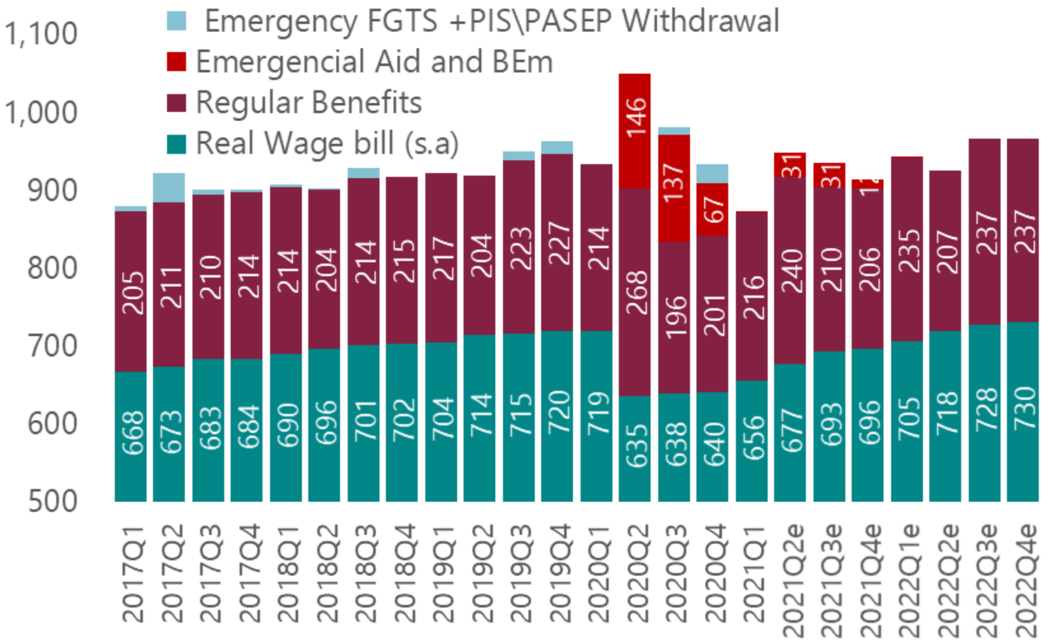
Sources: DIEESE, Ministry of Labor, Santander.

*2019 data not available

“Expanded” real wage bill

- We expect the “Expanded” Real Wage Bill to drop by 5.7% in 2021, driven mainly by the lower disbursements in the Emergency Aid program. In 2022, the size of the welfare program and inflation will play an important part in the Real Wage Bill growth.

“Expanded” Real Wage Bill (BRL billion)



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

“Expanded” Real Wage Bill Growth - Simulations

	2020	2021(E)	2022(E) - Simulation IPCA 3.0%	IPCA +4.3%	IPCA +5.0%
Real Wage Bill (No Fiscal Stimulus)	-7.9%	+3.5%	+6.7%	+5.8%	+5.4%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL35bn)	+3.7%	-5.7%	+3.5%	+2.7%	+2.3%
Real Wage Bill (Fiscal Stimulus + Auxilio Brasil BRL55bn)			+4.1%	+3.2%	+2.8%

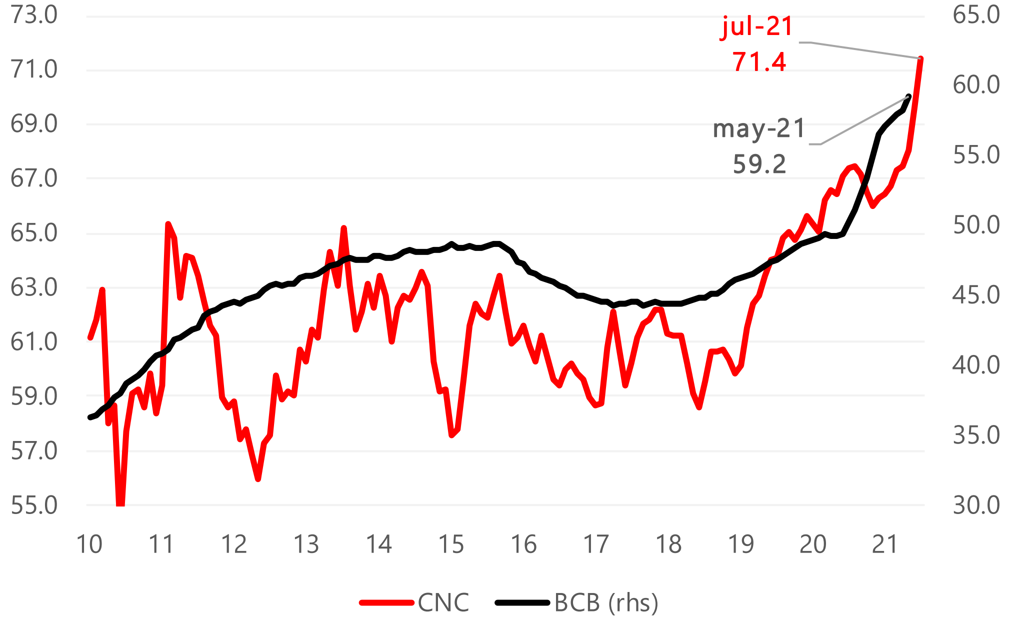
Sources: National Treasury, IBGE, Ministry of Economy, Santander.

CREDIT

Families indebtedness is the main problem

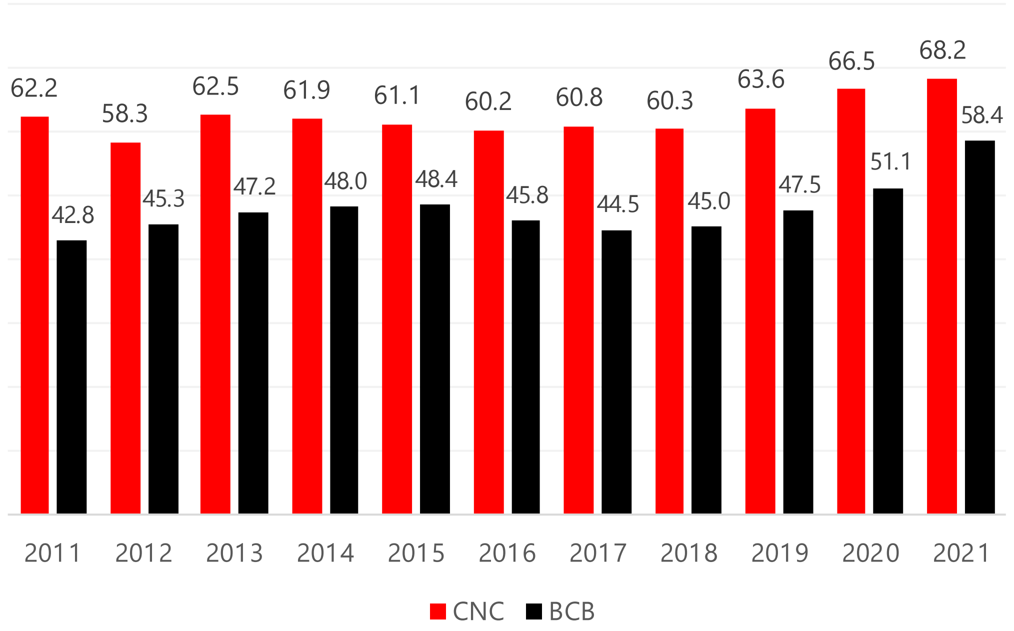
- Household indebtedness keep rising fast since the pandemic onset. The situation is getting worse due to the credit operations increasing and the household income stagnation.

Extended household Indebtedness (%)



Sources: Banco Central, National Confederation of Commerce, Santander.

Extended household Indebtedness (annual avg %)

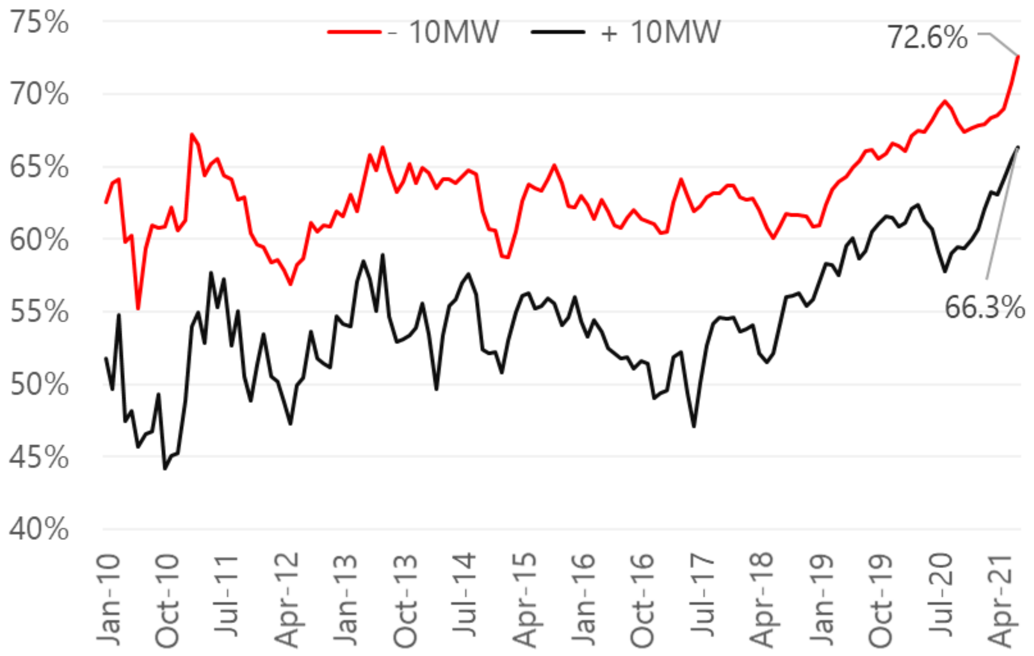


Sources: Banco Central, National Confederation of Commerce, Santander.

Families indebtednes – By income bracket

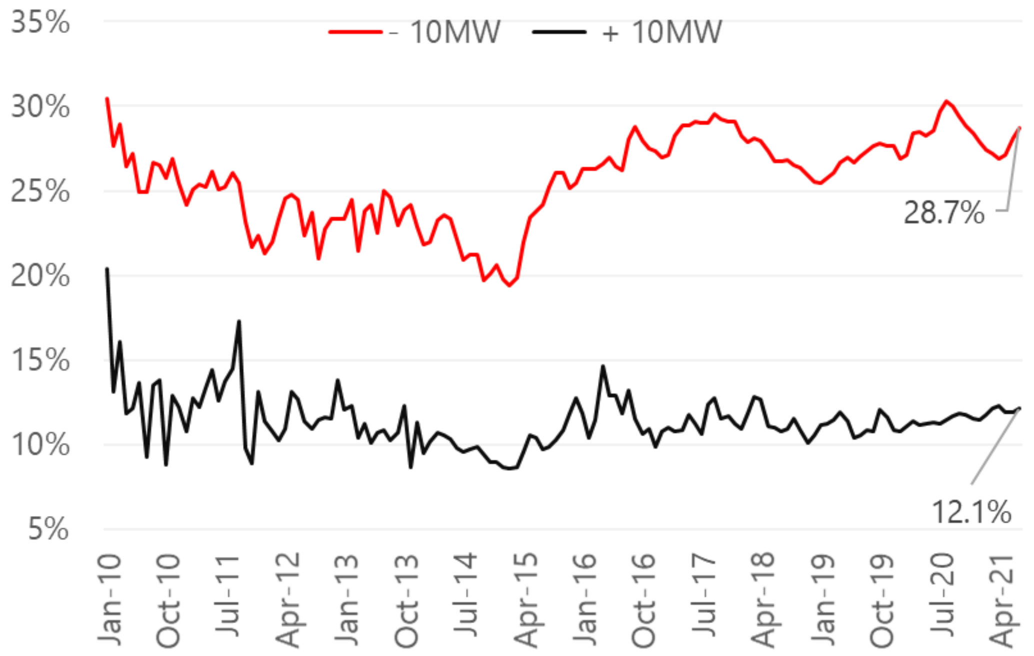
- And naturally the poorest families have suffered the most.

Indebted families



Source: CNC, Santander.

Families with past due debts



Source: CNC, Santander.

Credit forecasts

Credit Outstanding (%YoY)	2018	2019	2020	2021e	2022e	2023e
Total	**5.1**	**6.5**	**15.6**	***13.6***	***9.3***	***9.2***
Household	8.6	11.9	11.2	*14.5*	*10.5*	*11.2*
Non-fin. Corp.	1.2	-0.1	21.8	*12.5*	*7.5*	*6.2*
Nonearmarked	**10.9**	**14**	**15.4**	***10.6***	***9.6***	***9.7***
Household	11.6	16.5	10.8	*10.0*	*9.5*	*9.8*
Non-fin. Corp.	10.1	11	21.2	*11.4*	*9.6*	*9.6*
Earmarked	**-0.9**	**-2.4**	**15.9**	***10.5***	***1.7***	***6.6***
Household	5.4	6.6	11.7	*9.7*	*8.6*	*11.1*
Non-fin. Corp.	-8.1	-14	22.8	*5.1*	*-8.6*	*-1.5*

Other	2018	2019	2020	2021e	2022e	2023e
Delinquencies	**2.9**	**2.9**	**2.1**	***3.2***	***2.9***	***2.9***
Household	4.8	5.0	4.2	*5.1*	*4.9*	*4.8*
Non-fin. Corp.	2.7	2.1	1.5	*3.4*	*3.1*	*3.1*
Household Indeb.	**45.1**	**47.7**	**51.9**	***60.4***	***65.1***	***67.0***
Burden Income	**27.1**	**28.6**	**30.1**	***31.7***	***32.7***	***34.6***

Sources: Banco Central, Santander.

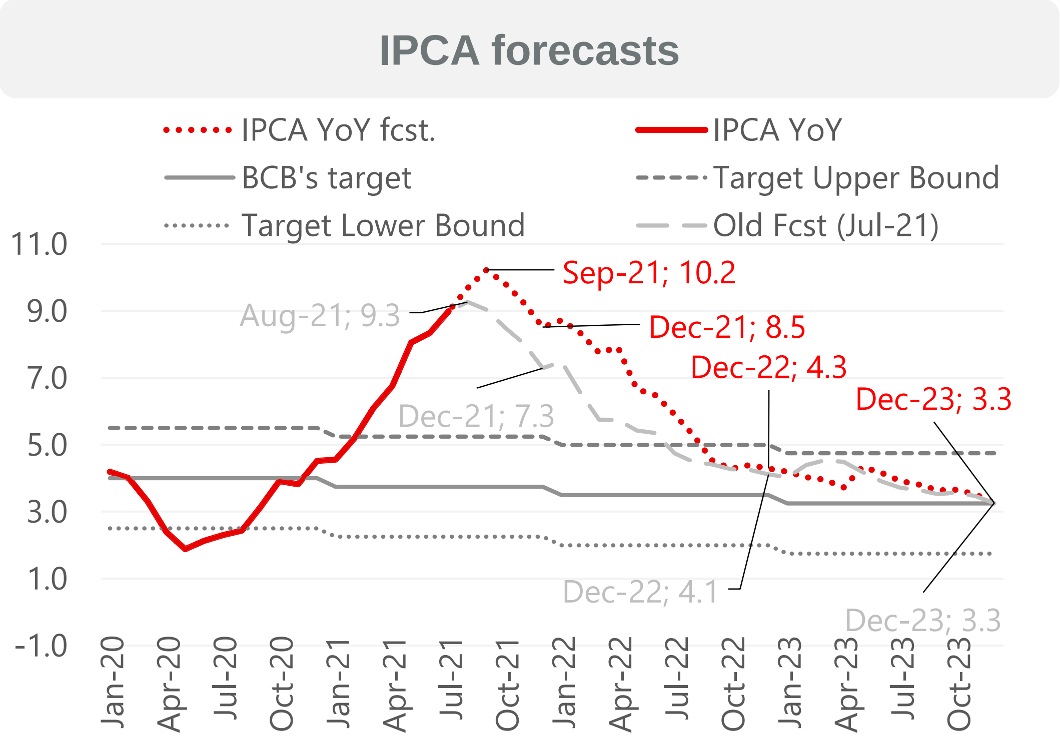
INFLATION

IPCA forecasts: higher inflation for 2021 and 2022

- The peak was postponed from Aug-21, at 9.3%, to Sep-21, at 9.9%, ending 2021 at 8.5%
- IPCA 2022 will be above the target, at 4.3%
- Convergence to the target coming only in 2023

	2017	2018	2019	2020	2021e	2022e	2023e
IPCA	**3.0**	**3.8**	**4.3**	**4.5**	**8.5**	**4.3**	**3.3**
Free prices	**1.3**	**2.9**	**3.9**	**5.2**	**6.7**	**4.5**	**3.3**
Food-at-home	**-4.9**	**4.5**	**7.8**	**18.2**	**8.4**	**3.5**	**3.3**
Industrial goods	**1.1**	**1.1**	**1.7**	**3.2**	**9.2**	**4.7**	**3.3**
Tradables	1.0	1.0	1.7	3.2	9.2	4.7	3.3
Non-Tradables	1.5	1.9	1.8	3.0	9.2	4.7	3.3
Services	**4.5**	**3.4**	**3.5**	**1.8**	**4.2**	**4.8**	**3.3**
Food-service	3.8	3.2	3.8	4.8	8.0	7.2	3.3
Airline tickets	3.1	16.9	2.3	-17.2	43.4	16.0	3.3
Economic activity	4.2	1.7	2.9	0.7	2.3	3.6	3.3
Education	7.6	5.5	5.0	1.1	3.0	5.5	3.3
Inertial	2.6	2.8	3.4	2.9	4.0	4.4	3.3
Salaries	6.3	3.7	3.2	1.8	2.7	3.7	3.3
Administered prices	**8.0**	**6.2**	**5.5**	**2.6**	**13.7**	**3.7**	**3.3**
Gasoline	10.3	7.3	4.0	-0.2	35.6	4.5	3.3
Energy	10.4	8.7	5.0	9.1	19.1	-7.9	3.3
Health insurance	13.5	11.2	8.2	2.5	2.6	9.0	3.3
Bus fares	4.0	6.3	6.6	1.3	1.5	6.4	3.3
Cores	3.6	3.3	3.5	2.8	6.3	4.3	3.3

Sources: IBGE, Santander

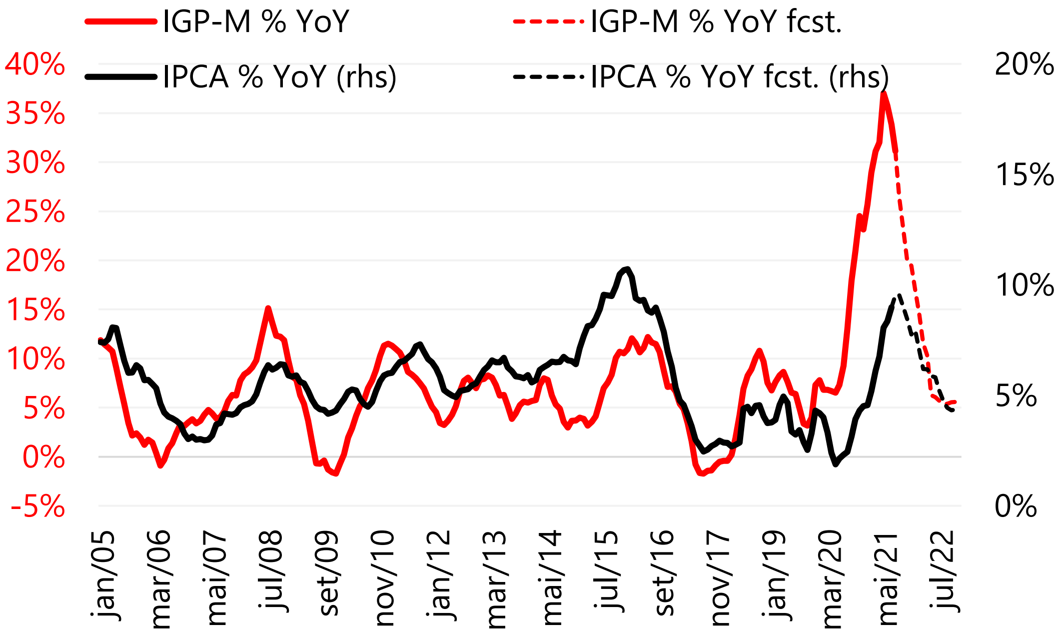


Sources: IBGE, Santander

A risk: distortion of relative price between the wholesale and consumer levels

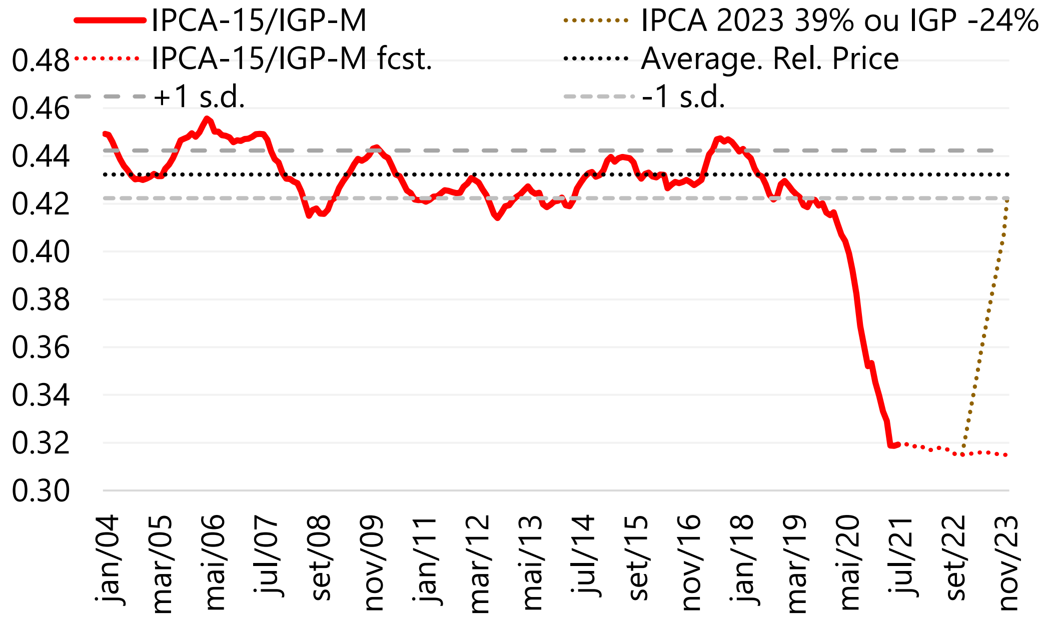
- On top of the usual drivers, we highlight that there is a backlog of rises at the wholesale level that are still to reach the consumers
- For now we assume the distortion will continue until 2023, but there is a risk of a convergence (either by IGP-M deflating or by IPCA accelerating more sharply)

IPCA-15 and IGP-M % YoY



Sources: IBGE, FGV

Relative price level: IPCA-15 (CPI) / IGP-M (PPI)



Sources: IBGE, FGV, Santander

Inflation: Electrical energy hypotheses

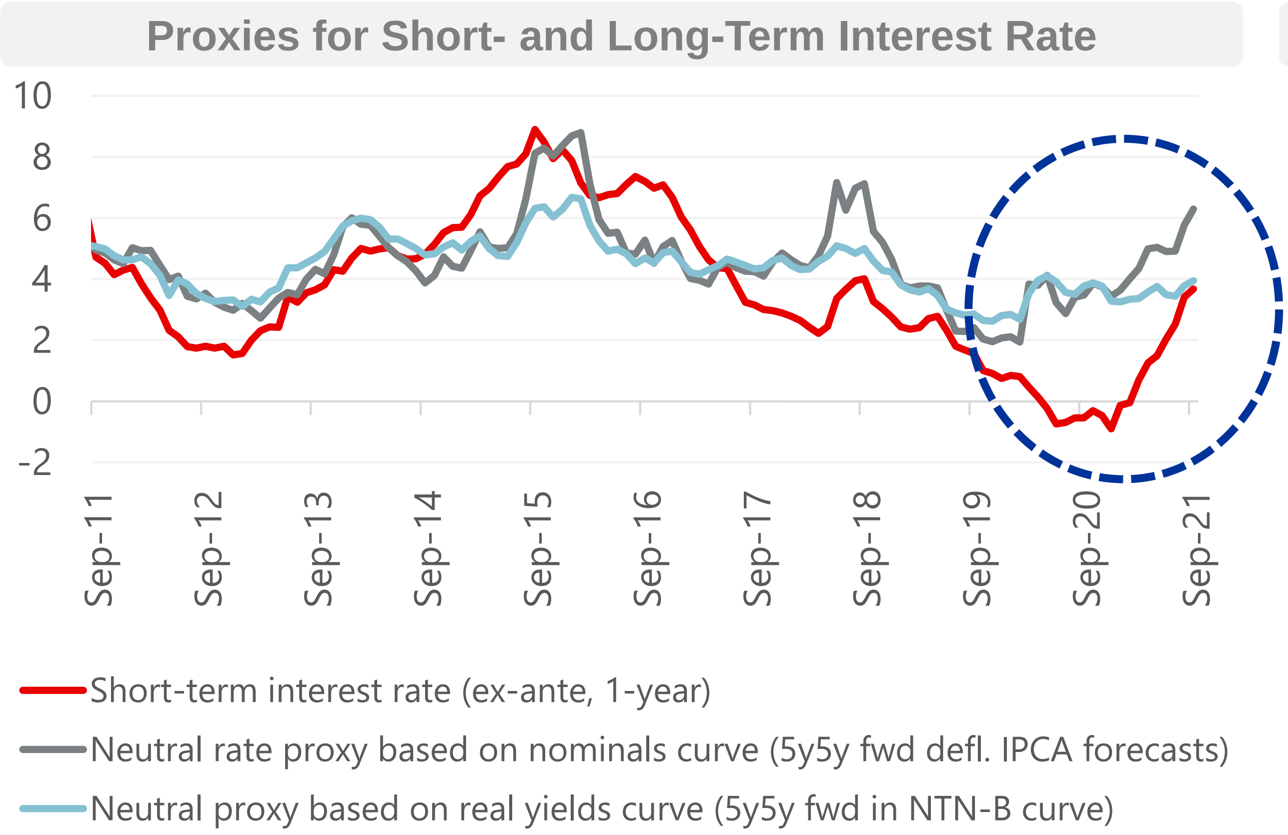
- IPCA 2022: Tariff adjusments +12%, flag effect -19%

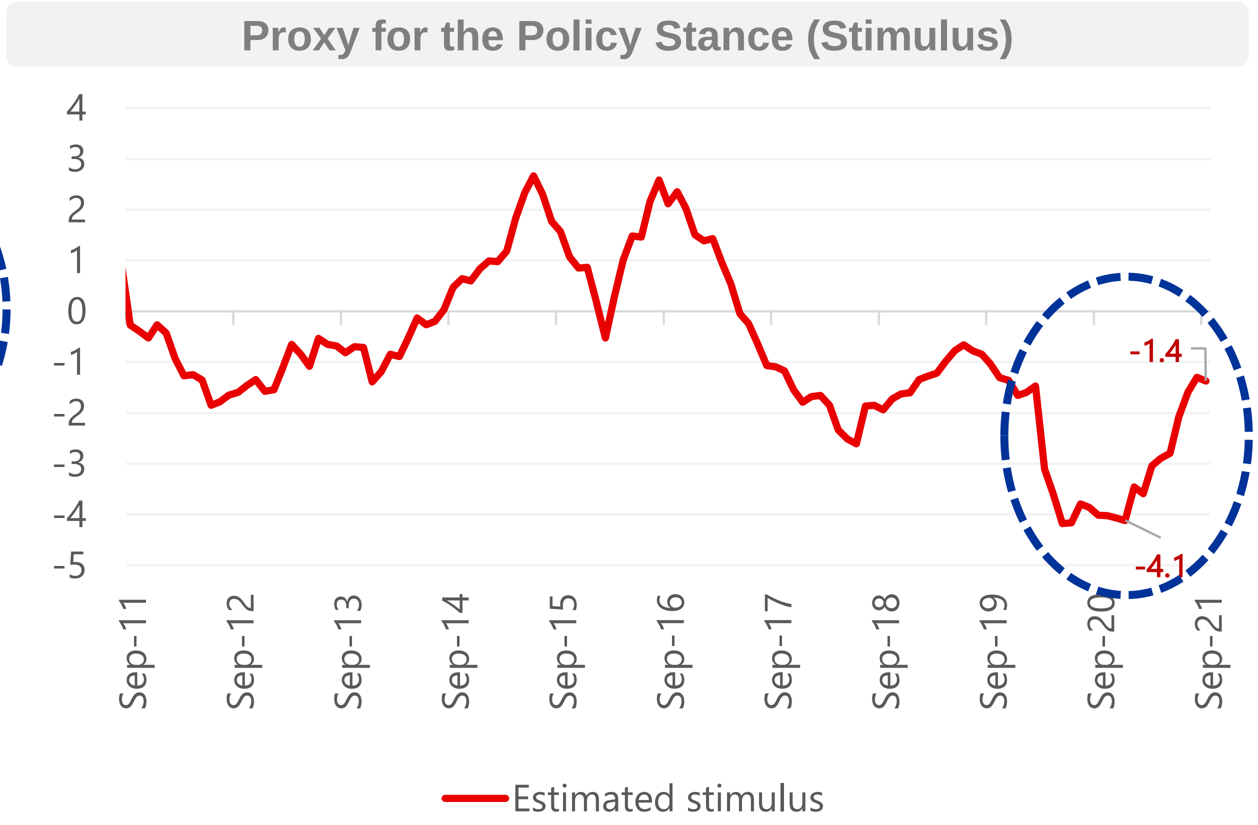
Santander Electricity Tariff Forecasts	
Sep-21	Red 2
Oct-21	Red 2
Nov-21	Red 2
Dec-21	Red 2
Jan-22	Red 2
Feb-22	Red 2
Mar-22	Red 2
Apr-22	Red 2
May-22	Red 1
Jun-22	Red 1
Jul-22	Red 1
Aug-22	Red 1
Sep-22	Red 1
Oct-22	Yellow
Nov-22	Yellow
Dec-22	Yellow

Sources: Santander

MONETARY POLICY

BCB policy stance





Source:BCB, Santander.

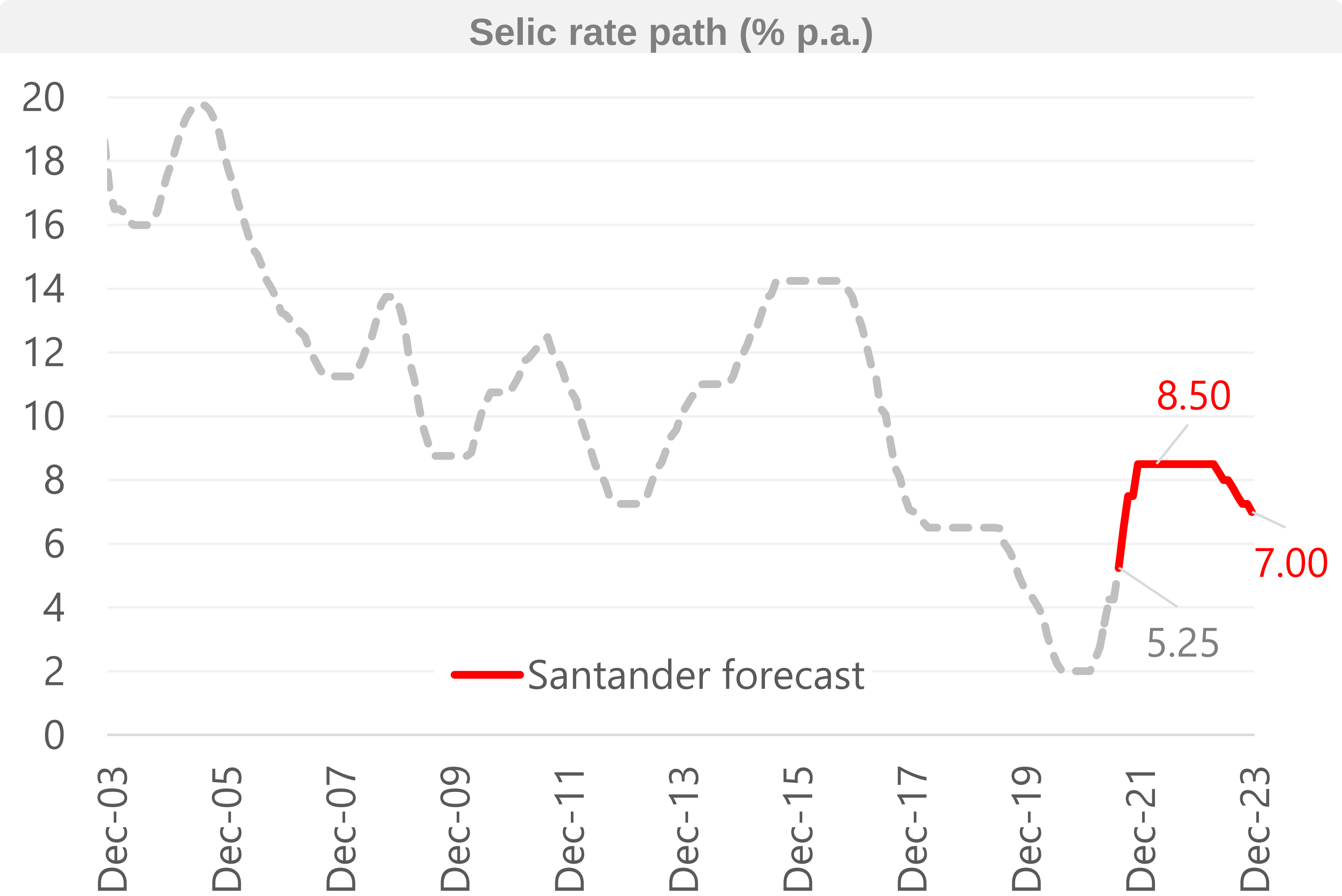
Takeaways from the Copom minutes

13. Next, the Copom discussed the implementation of monetary policy, considering not only the baseline scenario, but also the balance of risks for inflation. According to the baseline scenario, which uses the interest rate path extracted from the Focus survey, the exchange rate at purchasing power parity, and commodity prices in USD stable in real terms, the inflation projections are aligned to the targets for 2022 and 2023. The Committee judged that the fiscal risks continue to imply an **upward bias in the projections. This asymmetry in the balance of risks affects the appropriate degree of monetary stimulus, thus justifying a path for monetary policy that is more restrictive than the one used in the baseline scenario.**

14. Copom then evaluated different tightening paths for monetary policy. Considering the baseline scenario and the balance of risks, the Committee assessed that – should there be no changes in the inflation conditioning factors – subsequent **uninterrupted interest rate increases are required up to a level above the neutral rate**, to obtain projections around the inflation targets in the relevant horizon. Therefore, **a tightening cycle of the policy rate to a level consistent with restrictive monetary policy has become appropriate.** The Committee opted to communicate this decision, maintaining transparency about the monetary policy path implied in its projections, and reaffirming that this view will be systematically reassessed as changes in inflation determinants or in the balance of risks occur.

A faster path and a higher end-point

- Baseline: 3 x 100bp in 2021 and 1 x 25bp in 2022: Selic rate at 8.25% in December 2021; 8.50% (terminal rate) in January 2022.
- Upside risks still there for the terminal Selic rate (and 2022YE).
- Rate cuts and return to neutral (7.00%) only in 2023.



Sources: BCB, Santander.

FORECASTS:
SANTANDER VS CONSENSUS

FORECASTS: SANTANDER VS CONSENSUS 2021

	2021E					
	Consensus			Santander		
	13-Aug-21		10-Sep-21	12-Aug-21		16-Sep-21
IPCA Inflation (%)	7.1	↑	8.0	7.3	↑	8.5
GDP Growth (%)	5.3	↓	5.0	5.1	→	5.1
Selic policy rate (%, year end)	7.50	↑	8.00	7.50	↑	8.25
Exchange rate (USD/BRL, year end)	5.10	↑	5.20	5.05	↑	5.25
Current Account (USD billion)	0.0	↓	-1.6	-0.3	↑	0.8
Primary Budget Balance (% GDP)	-1.8	↑	-1.5	-1.6	↑	-1.3
Net Govt. Debt (% GDP)	61.5	↓	61.0	59.2	↓	58.5

Source: BCB, Santander.

FORECASTS: SANTANDER VS CONSENSUS 2022

	2022E					
	Consensus			Santander		
	13-Aug-21		10-Sep-21	12-Aug-21		16-Sep-21
IPCA Inflation (%)	3.9	↑	4.0	4.1	↑	4.3
GDP Growth (%)	2.0	↓	1.7	2.0	↓	1.7
Selic policy rate (%, year end)	7.50	↑	8.00	7.50	↑	8.50
Exchange rate (USD/BRL, year end)	5.20	→	5.20	5.55	→	5.55
Current Account (USD billion)	-14.3	↓	-18.1	-8.0	↓	-9.7
Primary Budget Balance (% GDP)	-1.2	↑	-1.1	-1.2	↑	-1.0
Net Govt. Debt (% GDP)	63.3	↓	62.6	60.6	↓	59.8

Source: BCB, Santander.

FORECASTS: SANTANDER VS CONSENSUS 2023

	2023E			
	Consensus		Santander	
	13-Aug-21	10-Sep-21	12-Aug-21	16-Sep-21
IPCA Inflation (%)	3.3	3.3	3.3	3.3
GDP Growth (%)	2.5	2.3	1.5	1.0
Selic policy rate (%, year end)	6.50	6.50	7.00	7.00
Exchange rate (USD/BRL, year end)	5.05	5.07	5.20	5.20
Current Account (USD billion)	-24.0	-25.4	-30.4	-30.3
Primary Budget Balance (% GDP)	-0.7	-0.7	-0.9	-0.8
Net Govt. Debt (% GDP)	65.3	64.3	63.2	62.7

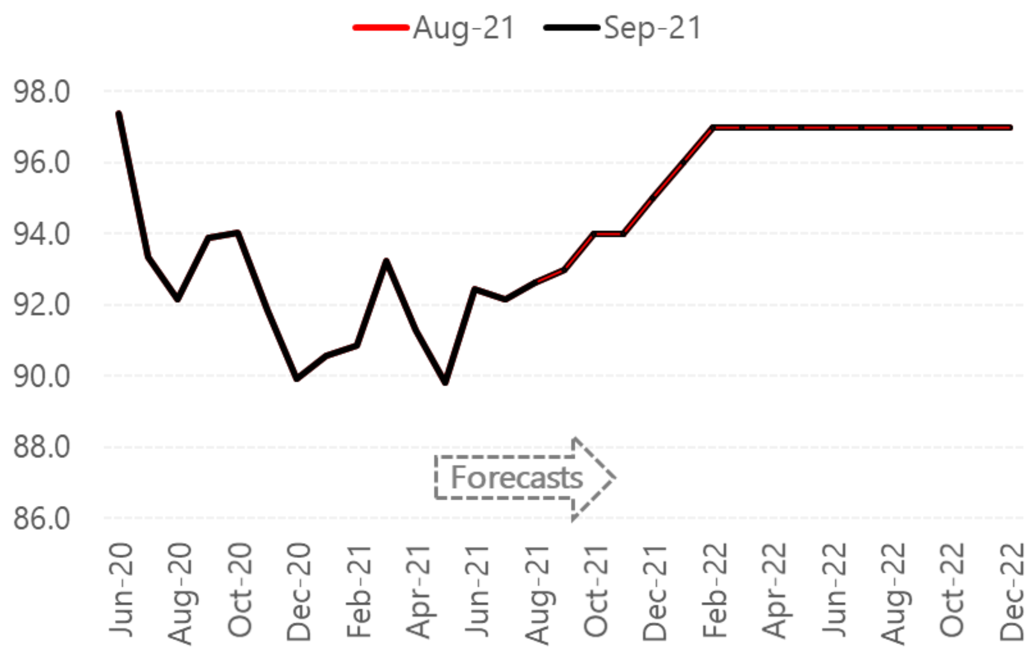
Source: BCB, Santander.

APPENDIX

A constructive international environment…

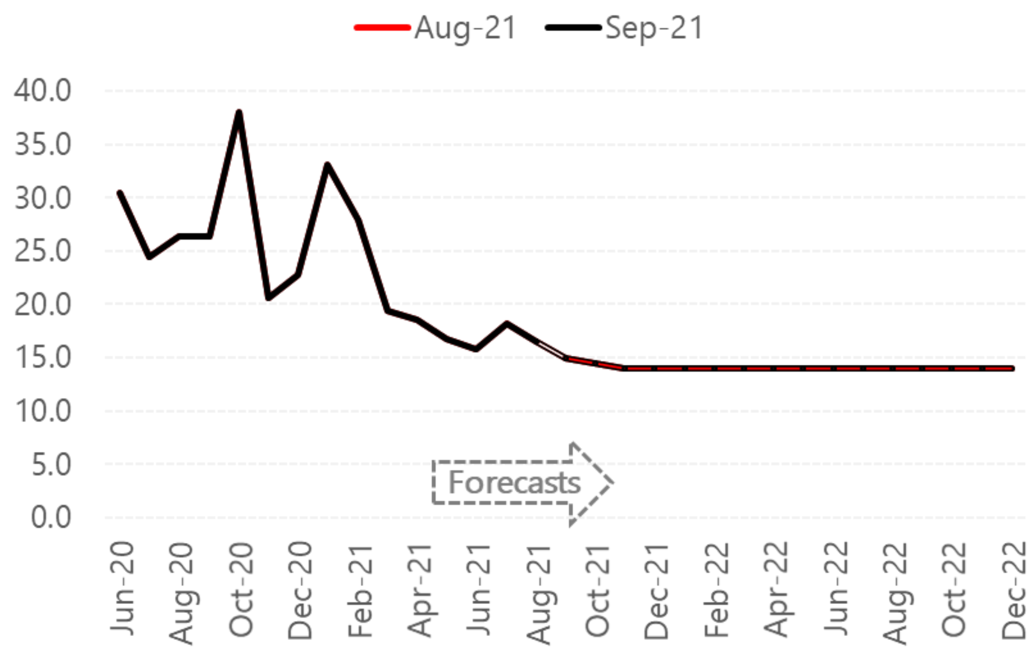
- We expect a protracted normalization of the US monetary policy, which should result in a gradual strengthening of the USD and the maintenance of low level of risk aversion

DXY Index (1973=100)



Source: Blomberg, Santander.

VIX Index (% pa)

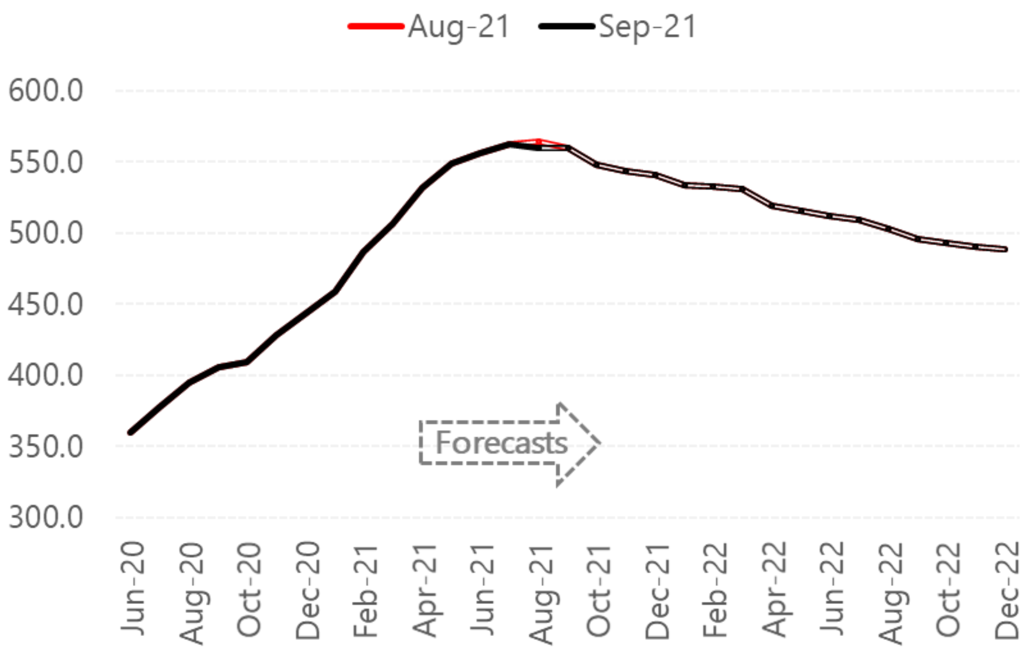


Source: Bloomberg, Santander.

... in all fronts

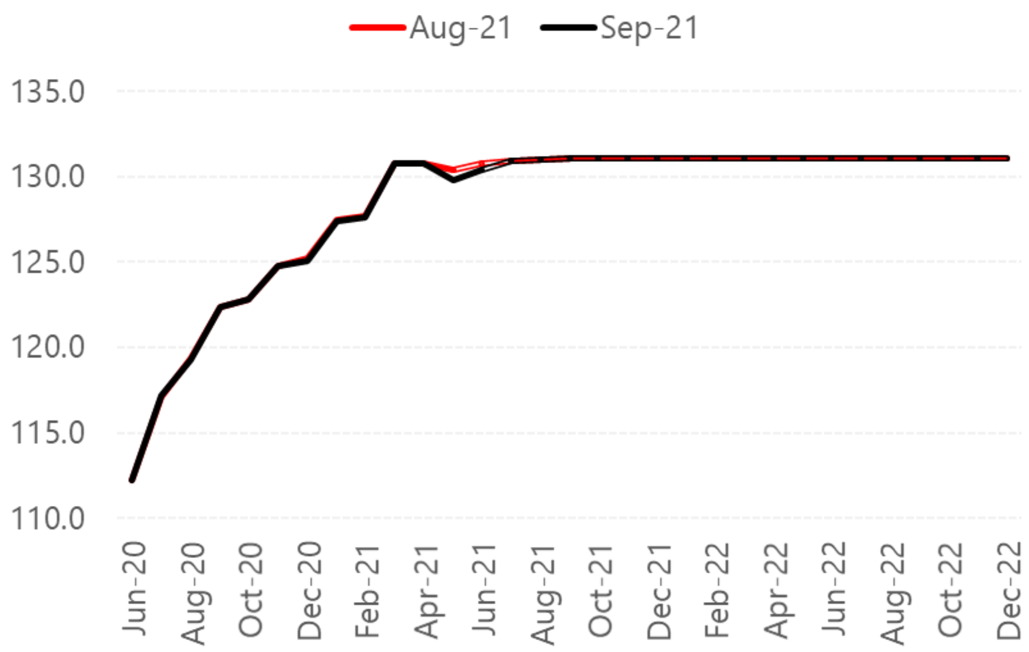
- Commodity prices should stop climbing, but we do not expect them to register a dramatic reversal.
- International trade flows have seemingly levelled off at high levels, which means a steady demand ahead.

CBR Index (1967=100)



Source: Blomberg, Santander.

CPB Index (2010=100, s.a.)

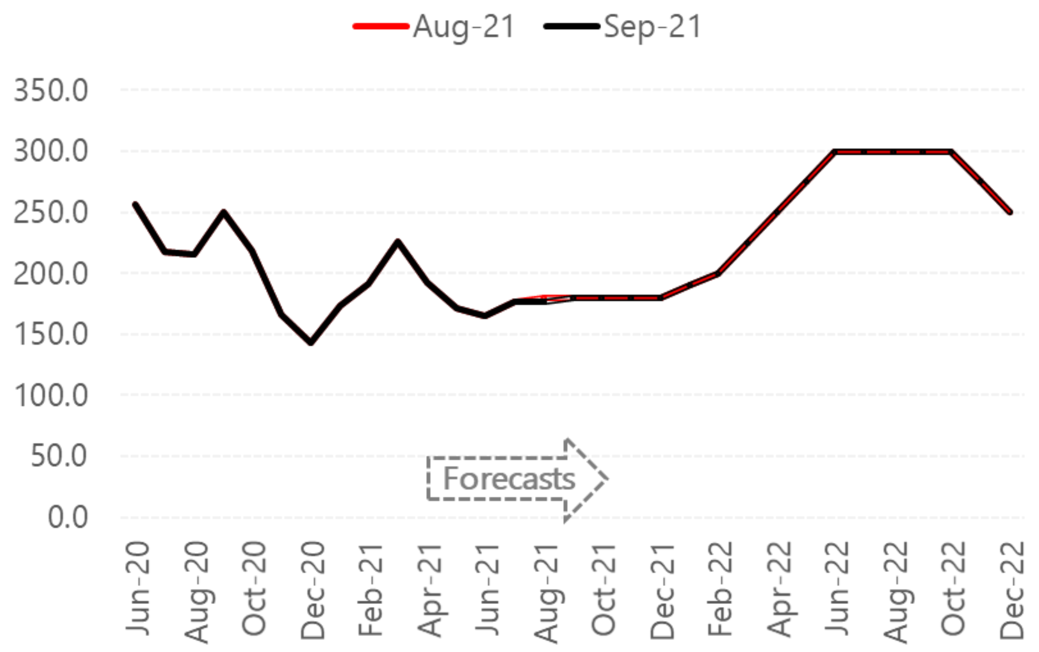


Source: Bloomberg, Santander.

Higher risk, higher return

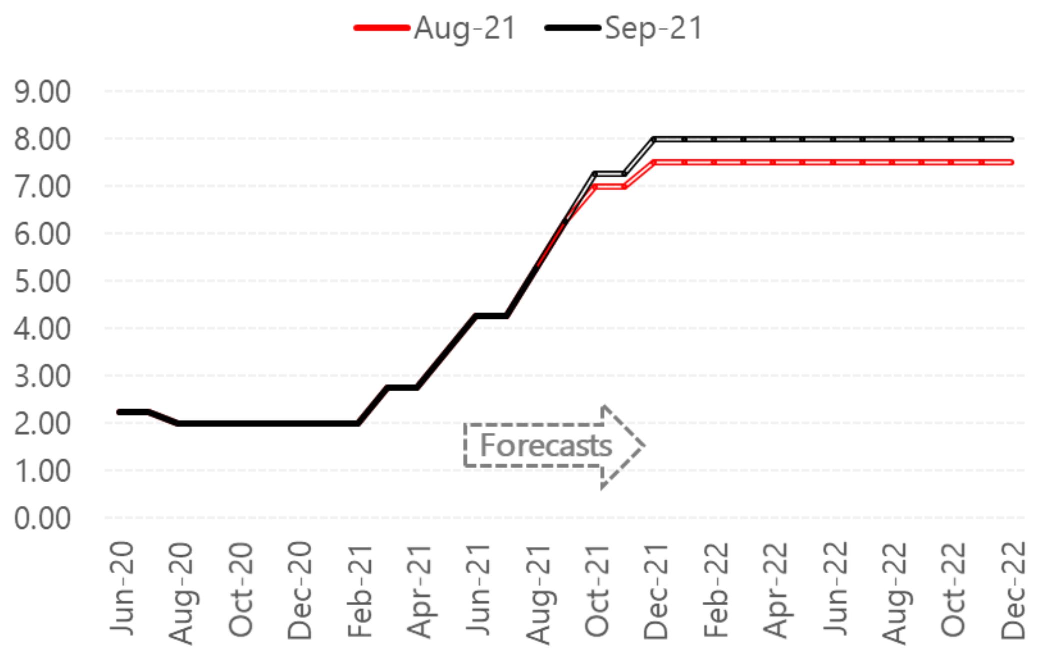
- The distress in the political and institutional fronts should worsen markets' risk assessment, which is likely to weigh on the BRL.
- On the other hand, stronger-than-expected inflationary pressures should require a tighter monetary grip, which should partially offset the weakening of the BRL.

Brazil 5Y CDS Spread (bps)



Source: Blomberg, Santander.

Selic target rate (% pa)



Source: Bloomberg, Santander.

Credit forecasts – Aug/21

Credit Outstanding (%YoY)	2018	2019	2020	2021e	2022e	2023e
Total	**5.1**	**6.5**	**15.6**	***12.5***	***9.7***	***9.4***
Household	8.6	11.9	11.2	*13.5*	*9.6*	*10.0*
Non-fin. Corp.	1.2	-0.1	21.8	*4.7*	*5.5*	*6.2*
Nonearmarked	**10.9**	**14.0**	**15.4**	***13.0***	***11.1***	***10.1***
Household	11.6	16.5	10.7	*11.2*	*9.2*	*8.5*
Non-fin. Corp.	10.1	11.0	21.2	*9.2*	*7.1*	*5.6*
Earmarked	**-0.9**	**-2.4**	**15.9**	***10.5***	***3.7***	***6.6***
Household	5.4	6.6	11.7	*9.7*	*8.6*	*11.1*
Non-fin. Corp.	-8.1	-14.0	22.8	*5.1*	*-4.6*	*-0.5*

Sources: Banco Central, Santander.

Main messages:

- Recent deterioration of inertial components, in a moment of reopening of the service sector, could result in an additional deterioration of inflation expectations

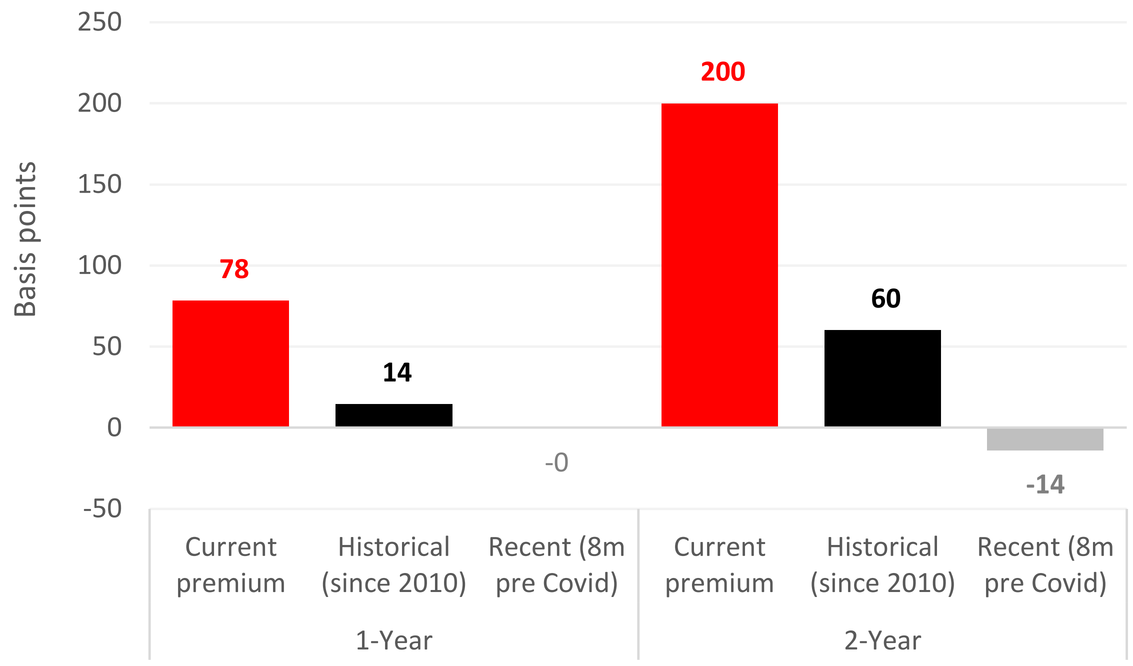
- At this moment, the strategy of a quicker monetary adjustment is the most appropriate to guarantee the anchoring of inflation expectations

- For the next meeting, the Committee foresees **another adjustment of same magnitude (100bps)**

- At this moment, the Copom's baseline scenario and balance of risk indicate as appropriate a tightening cycle of the policy rate to a level **above the neutral (6.50%)**.

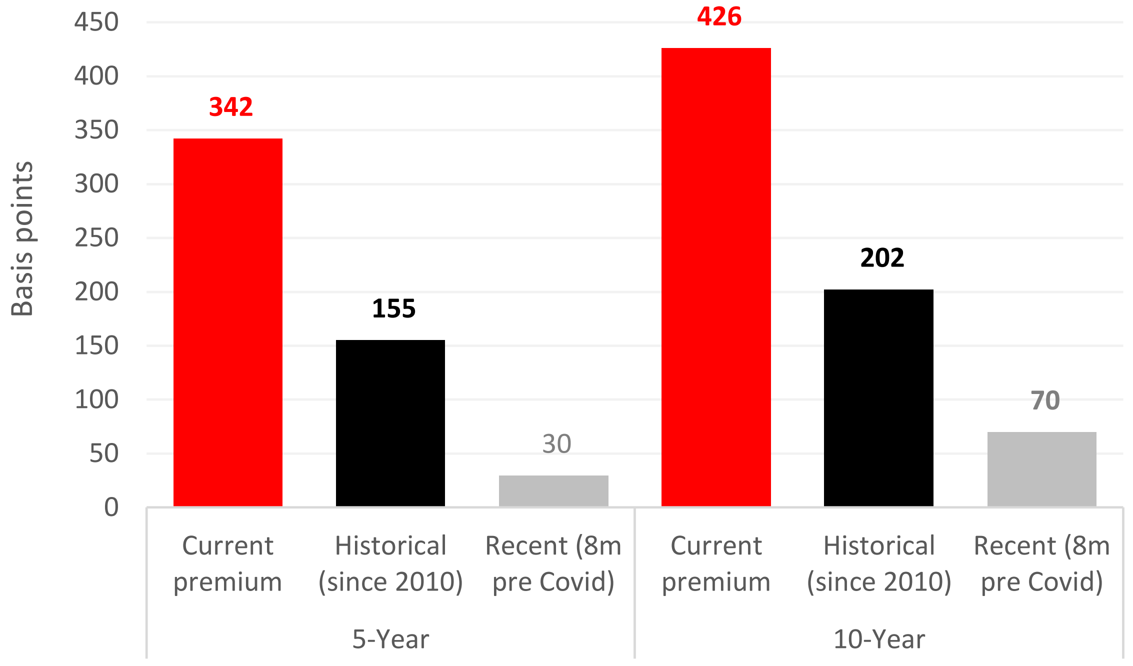
Premium in nominal rates (as of September 3, 2021)

Front end



Source: BCB, Blomberg, Santander.

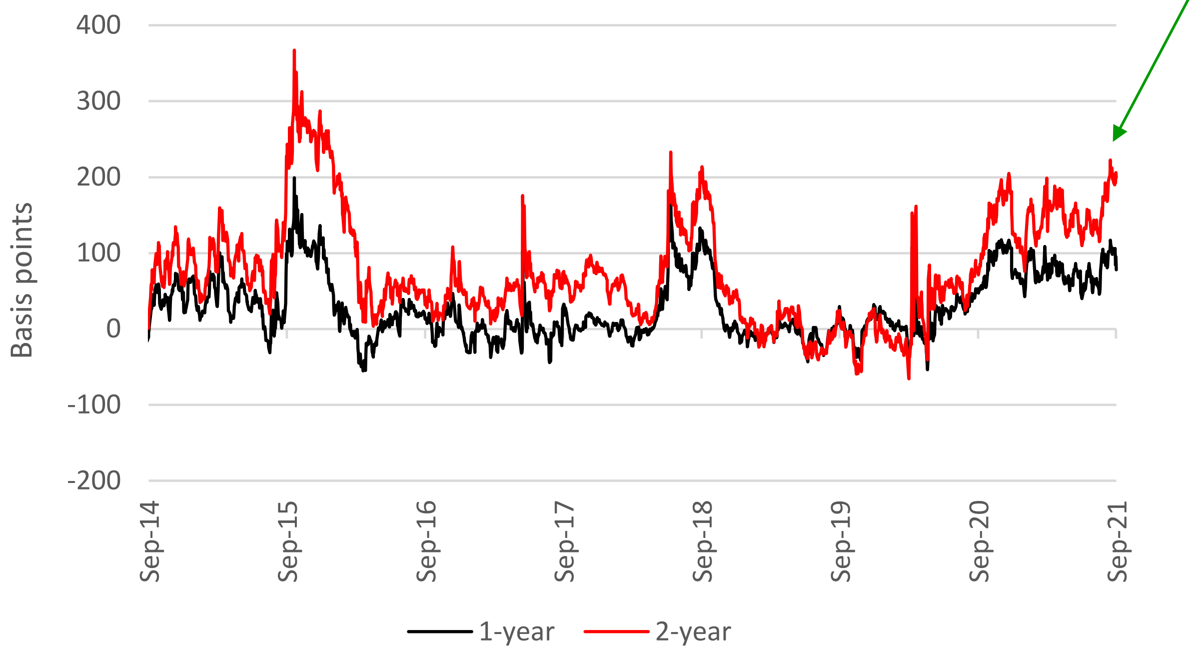
Back end



Source: BCB, Blomberg, Santander.

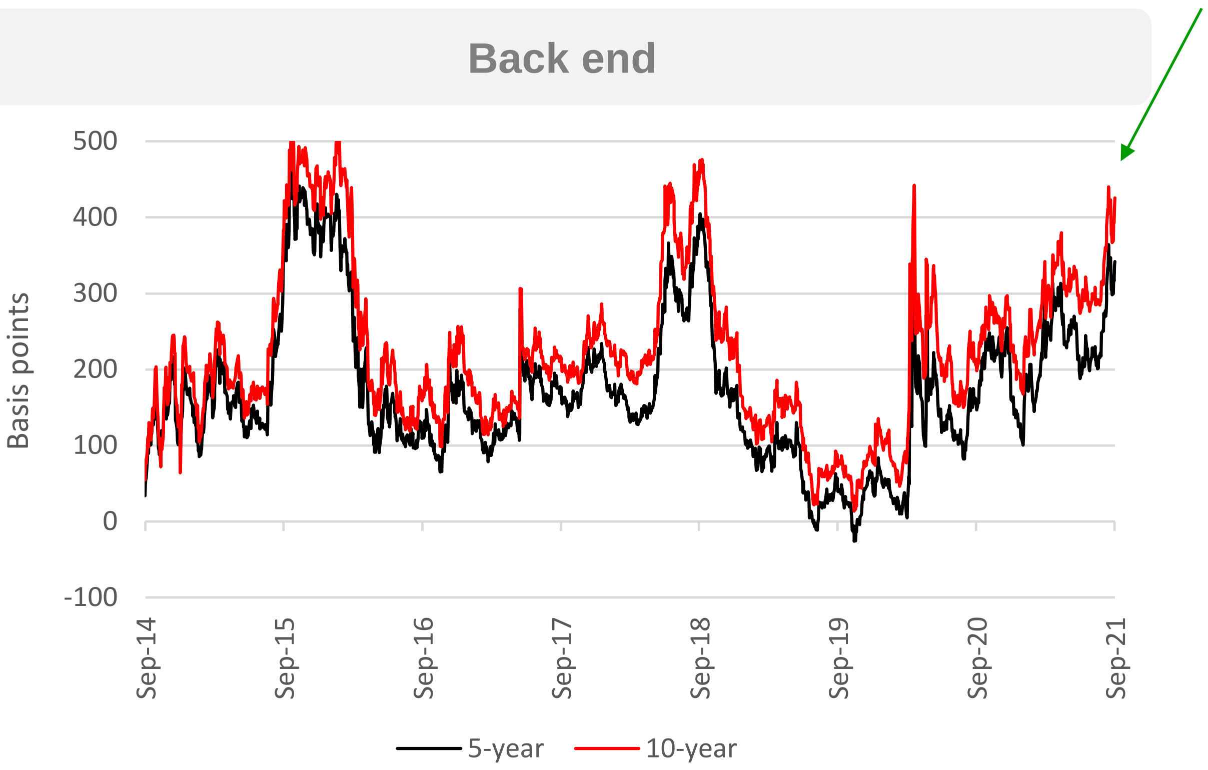
Premium in nominal rates (recent trends)

Front end



Source: BCB, Blomberg, Santander.

Back end



Source: BCB, Blomberg, Santander.

Thank you.

Our purpose is to help people and businesses prosper.

Our culture is based on believing that everything we do should be:

Simple Personal Fair

Santander

Brazil Macroeconomic Research Team

Ana Paula Vescovi
Chief Economist
anavescovi@santander.com.br
+55 (11) 3553-8567

Mauricio Oreng
Head of Macro Research
mauricio.oreng@santander.com.br
+55 (11) 3553-5404

Jankiel Santos
Economist – External Sector
jankiel.santos@santander.com.br
+55 (11) 3012-5726

Ítalo Franca
Economist – Fiscal Policy
italo.franca@santander.com.br
+55 (11) 3553-5235

Tomas Urani
Economist – Global Economics
tomas.urani@santander.com.br
+55 (11) 3553-9520

Daniel Karp Vasquez
Economist - Inflation
daniel.karp@santander.com.br
+55 (11) 3553-9828

Lucas Maynard
Economist – Economic Activity
lucas.maynard.da.silva@santander.com.br
+55 (11) 3553-7495

Felipe Kotinda
Economist - Credit
felipe.kotinda@santander.com.br
+55 (11) 3553-8071

Raissa Freitas
Business Manager
raifreitas@santander.com.br
+55 (11) 3553-7424

Gilmar Lima
Economist – Modeling
gilmar.lima@santander.com.br
+55 (11) 3553-6327

Gabriel Couto
Economist – Special Projects
gabriel.couto@santander.com.br
+55 (11) 3553-8487

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