



MACRO OUTLOOK

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Chief Economist

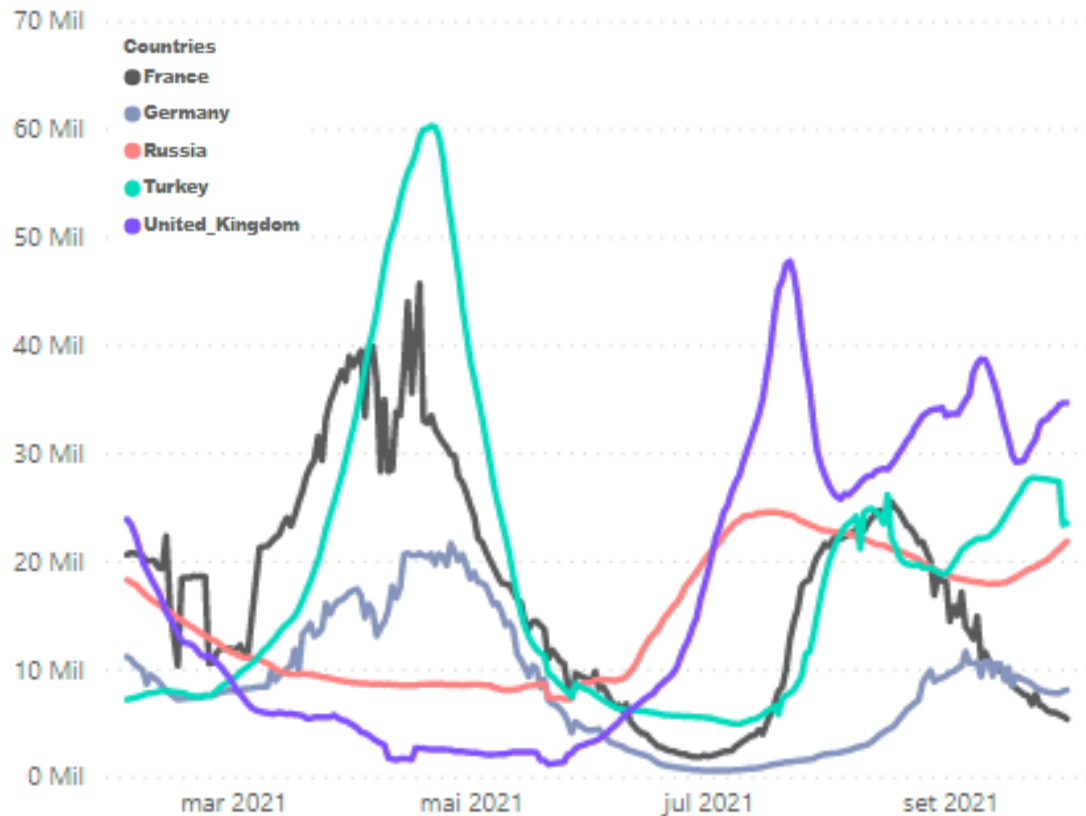
October 2021

- » Covid-19 vaccination campaigns advanced in several countries, but problems with delta variant and the energy crisis entailed downside revisions in activity of some countries;
- » In Brazil, the epidemiological situation continued to improve, with cases and deaths decreasing;
- » Rains in the South region of Brazil and better rain forecasts in October and November reduced rationing risk in 2021;
- » In the 2nd quarter, Brazilian GDP frustrated expectations but the economic activity continues its recovery driven by the services sector;
- » We forecast a GDP growth of 5.2% this year and 1.2% in 2022;
- » We revised up our inflation forecast to 8.8% due to the persistency and the size of industrial goods inflation shock;
- » Our Selic rate projection was revised to 8.25% at the end of 2021 and to 9.5% at the end of 2022;
- » A higher nominal GDP and a more benign fiscal outlook have contributed to a lower debt-to-GDP ratio.

Covid-19

- » Despite a decrease in cases in the United States and France, new waves have been observed in several countries, some of which are already passing while others are still growing, as Delta variant spreads throughout the World.

World –Covid-19 Cases, 7-day moving average



USA –Covid-19 Cases, 7-day moving average



Covid-19

- » In Brazil the number of cases, deaths and Covid-19 hospitalization rate kept their downward trend in September. Both deaths and cases are at their lowest level for 2021.

Brazil – Covid-19 Cases, 7-day moving average

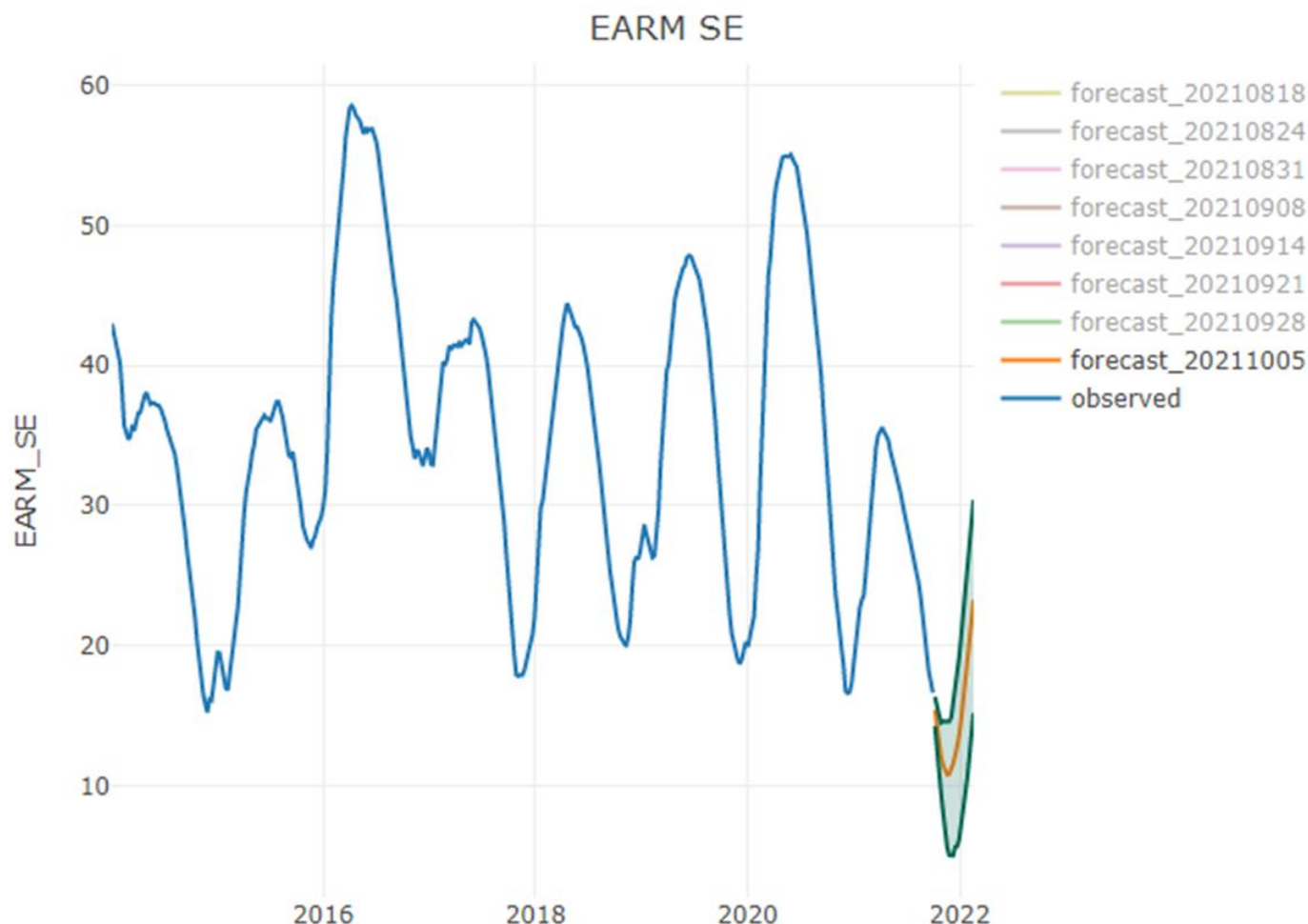


Brazil – Covid-19 Deaths, 7-day moving average



Hydrological Crisis

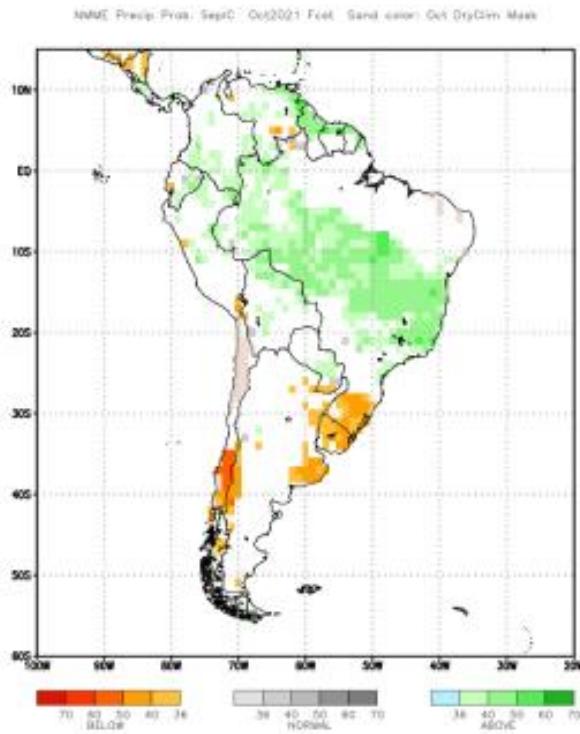
- »» Our reservoir model points to a decrease in reservoir level in Southeast/Midwest (SE/CO) subsystem until mid-November, with its lowest reading being 10.8% (a considerable increase in relation to our most pessimistic forecast made three weeks ago, 7.9%)



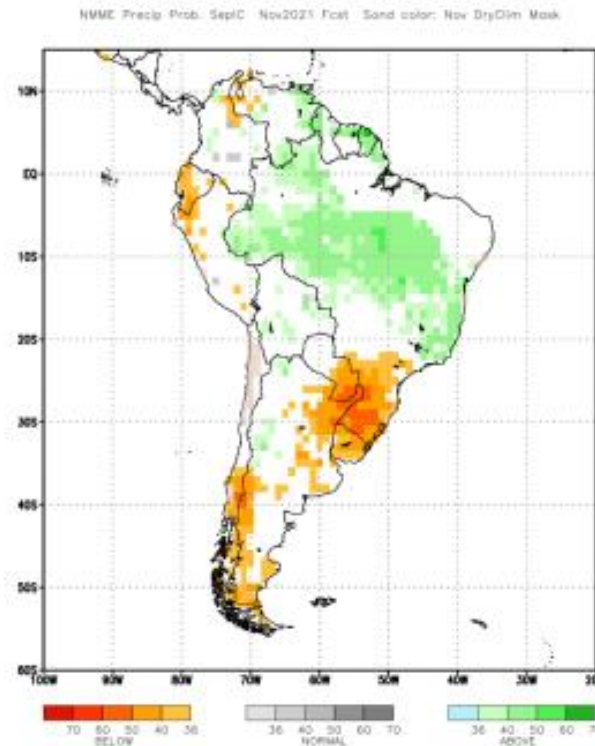
| Stored Energy SE/CO | |
|---------------------|------|
| 12/10/2021 | 14,7 |
| 19/10/2021 | 13,5 |
| 26/10/2021 | 12,5 |
| 02/11/2021 | 11,8 |
| 09/11/2021 | 11,2 |
| 16/11/2021 | 10,9 |
| 23/11/2021 | 10,8 |
| 30/11/2021 | 11,0 |
| 07/12/2021 | 11,4 |
| 14/12/2021 | 11,9 |
| 21/12/2021 | 12,5 |
| 28/12/2021 | 13,3 |
| 04/01/2022 | 14,3 |
| 11/01/2022 | 15,5 |
| 18/01/2022 | 16,8 |
| 25/01/2022 | 18,1 |
| 01/02/2022 | 19,5 |
| 08/02/2022 | 21,1 |
| 15/02/2022 | 22,6 |

- » The graph shows the probability of rains happening in a given interval in relation to the historic average (below average- orange, normal - white/gray and above average - green).
- » The rains are expected to be above average in the hydrological basin 's region in October and partially in November, but in December the forecasts points to average rains.

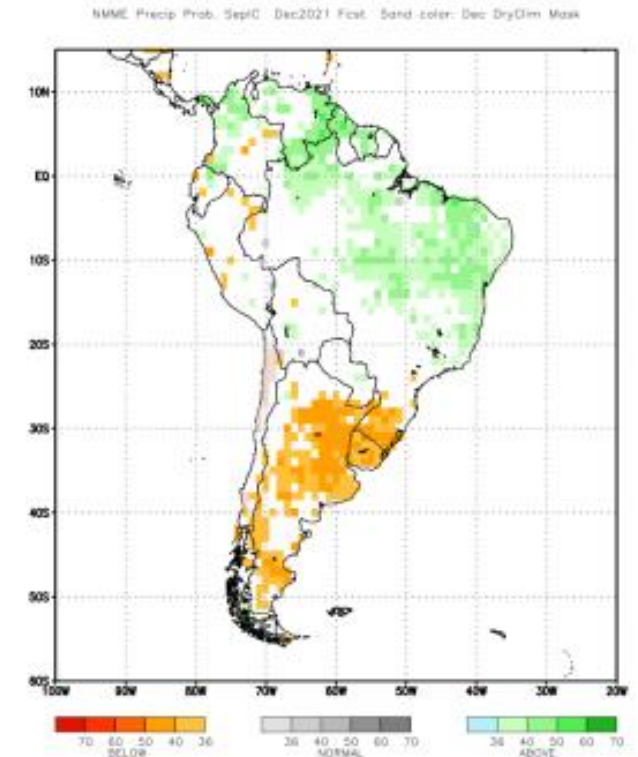
Outubro



Novembro



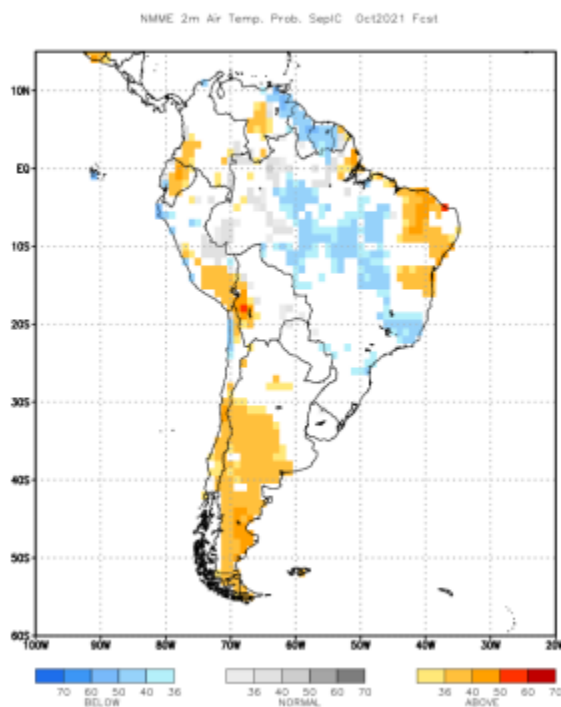
Dezembro



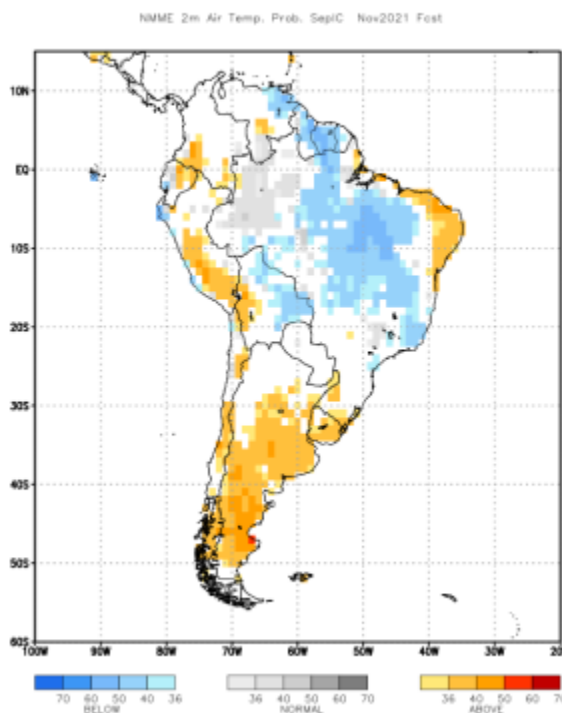
Brasil: Energia

- » With more rains in October and November it becomes more probable for temperatures to stay below average.
- » In December, the graph points to normality in temperatures.

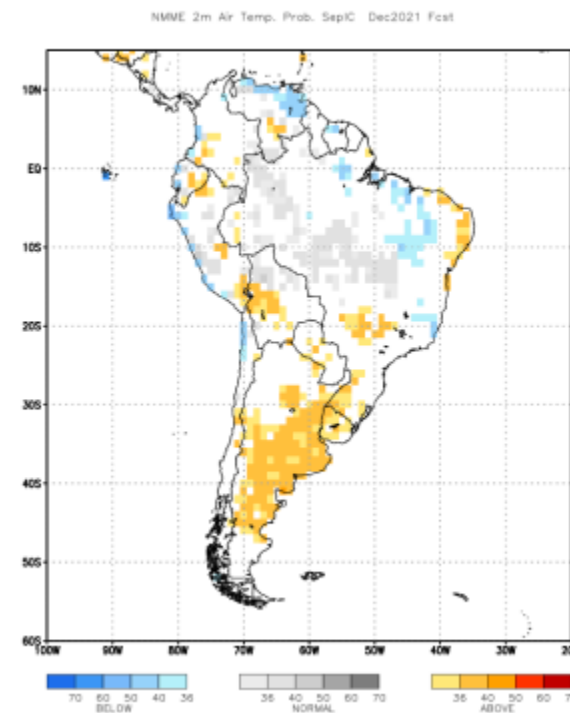
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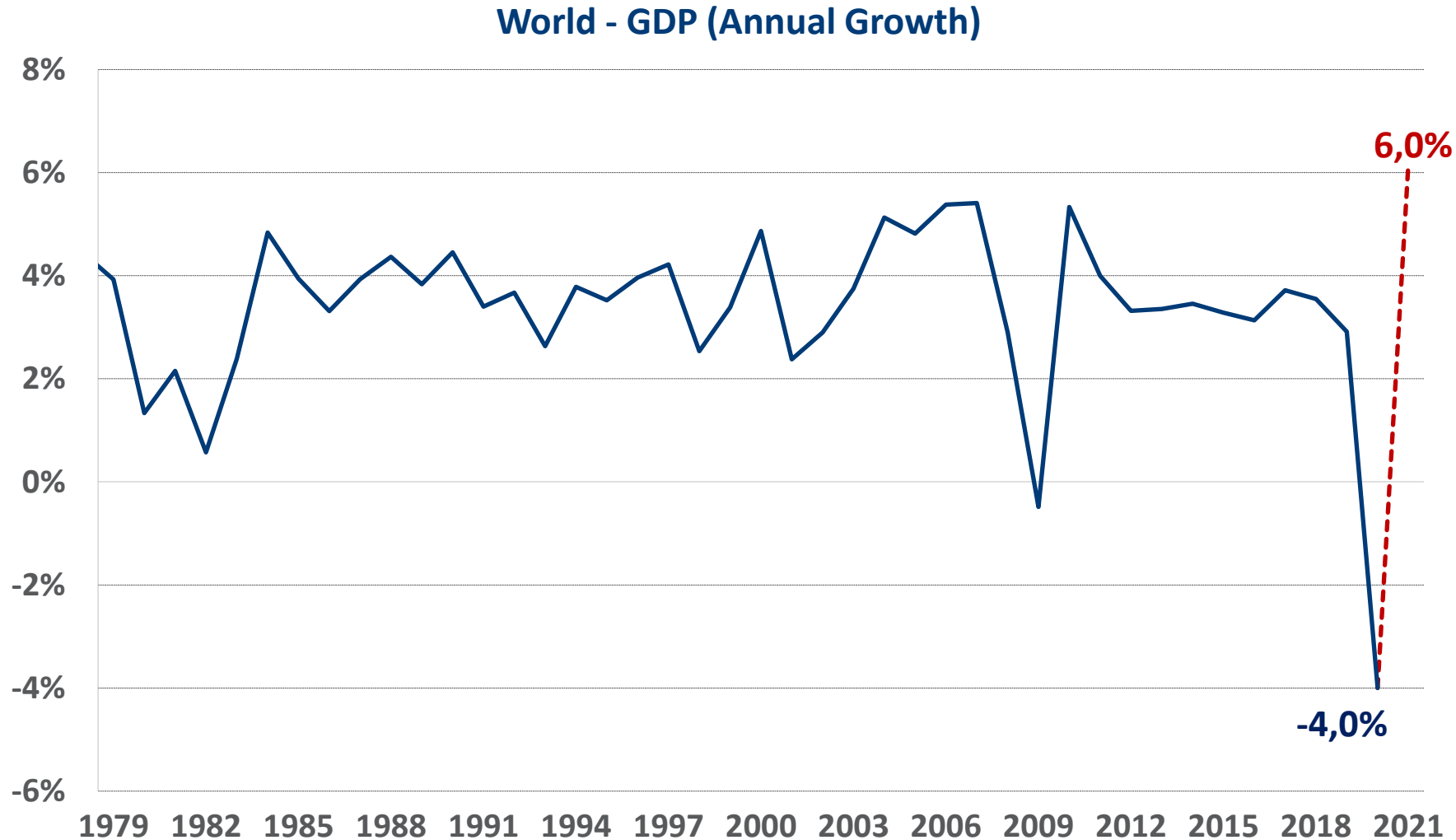


Dezembro



Global: GDP Growth

- » On the back of the economic stimulus and the vaccine rollout, the global growth should be strong in 2021, but unevenly between countries.



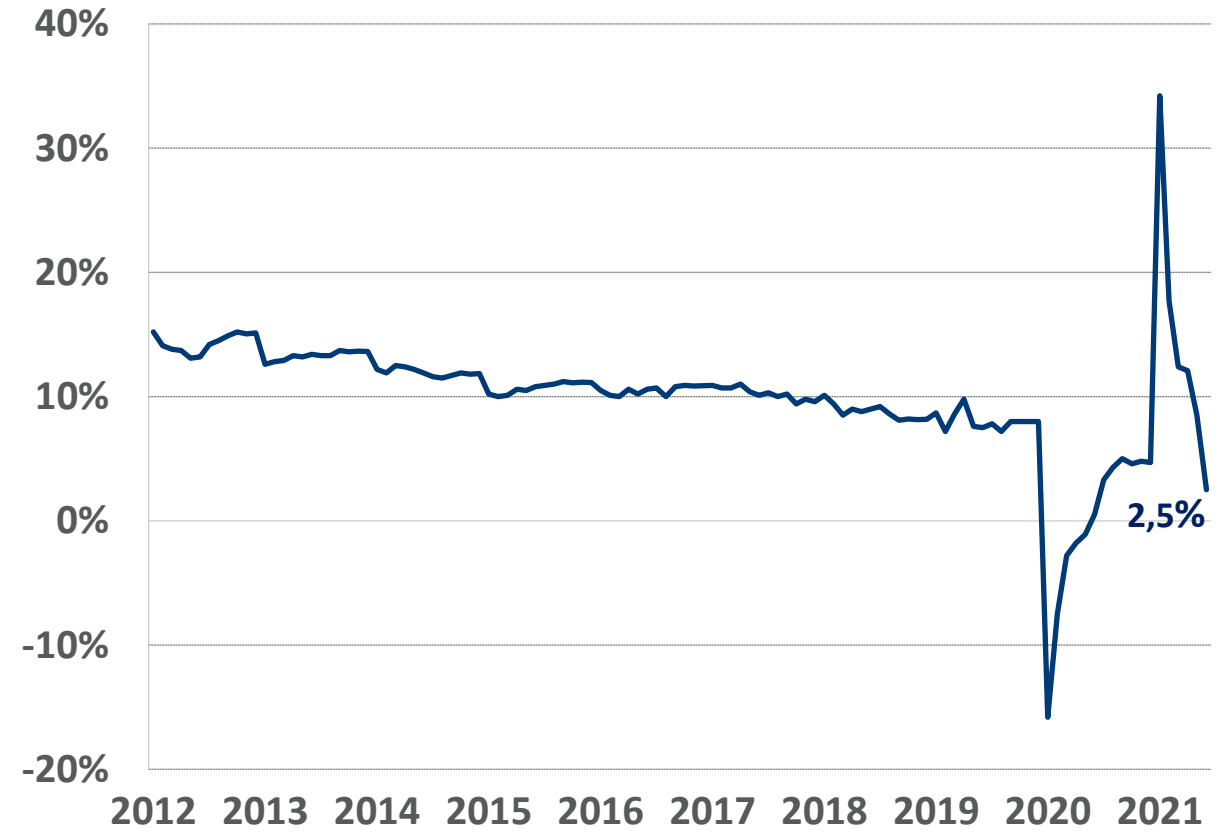
China: Activity

» Recent data point to a slowdown in the recovery of the economic activity.

China - Industrial Production (YoY)



China - Retail Sales, Consumer Goods (YoY)

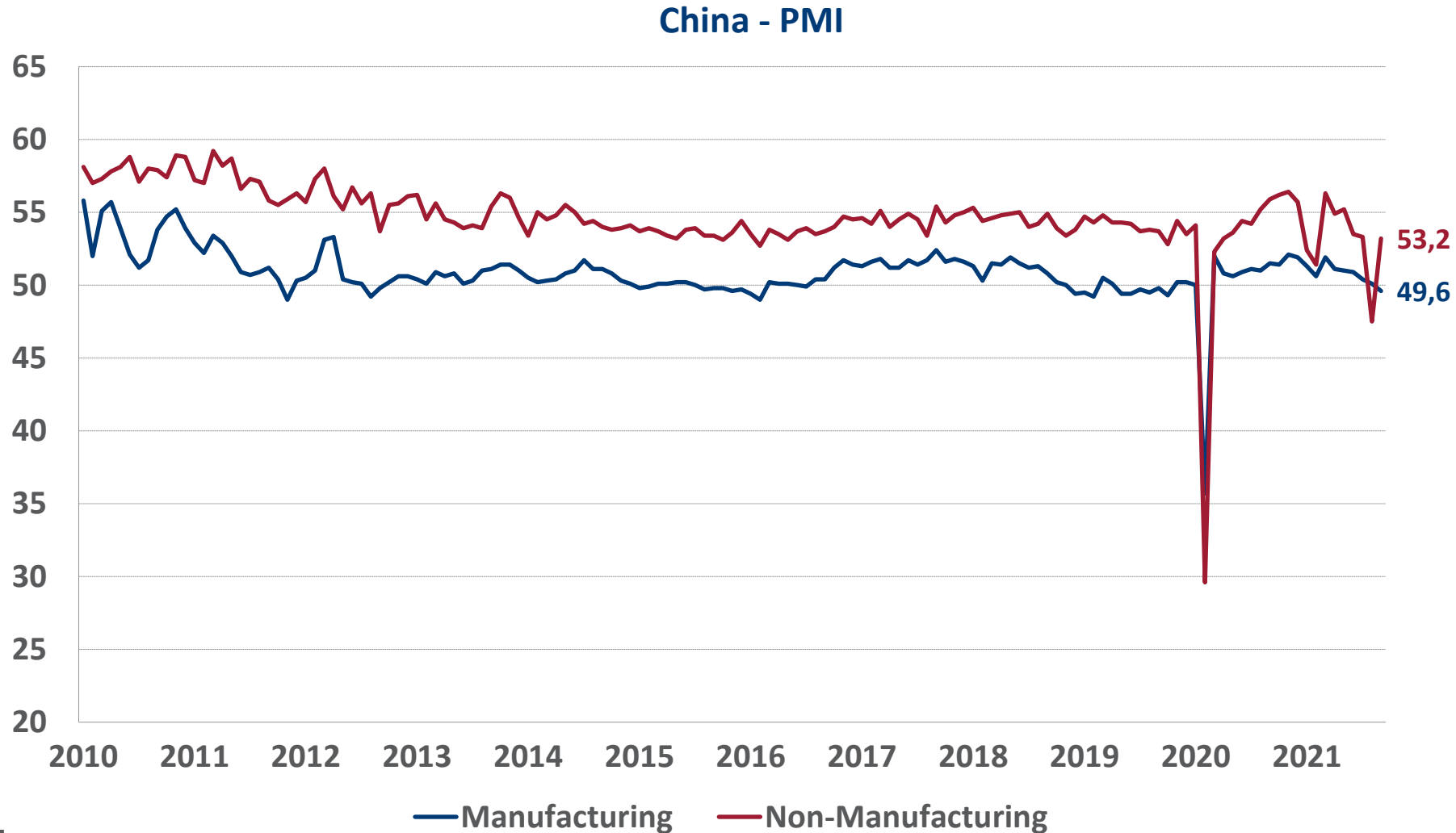


- » We are expecting the Chinese economy to grow 8,3% in 2021 and 5,6% in 2022 due to elevated global uncertainty.



China: PMI

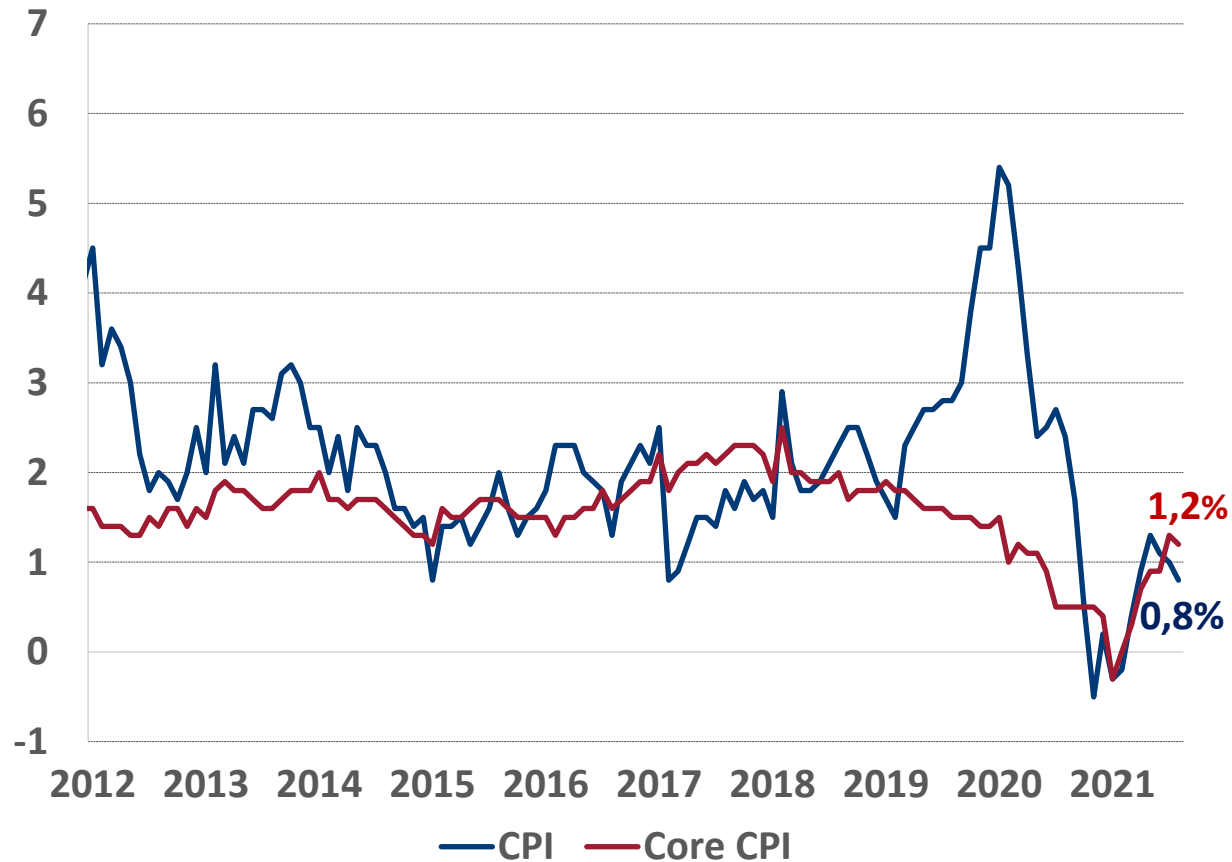
- » Manufacturing PMI dropped below threshold for the first time since the epidemic improved.
- » Non-manufacturing PMI was 53.2%, up 5.7 percentage points from last month.



China: Inflation

» The increase in the producer prices isn't being passed through to the consumer prices index.

China - CPI (YoY, %)

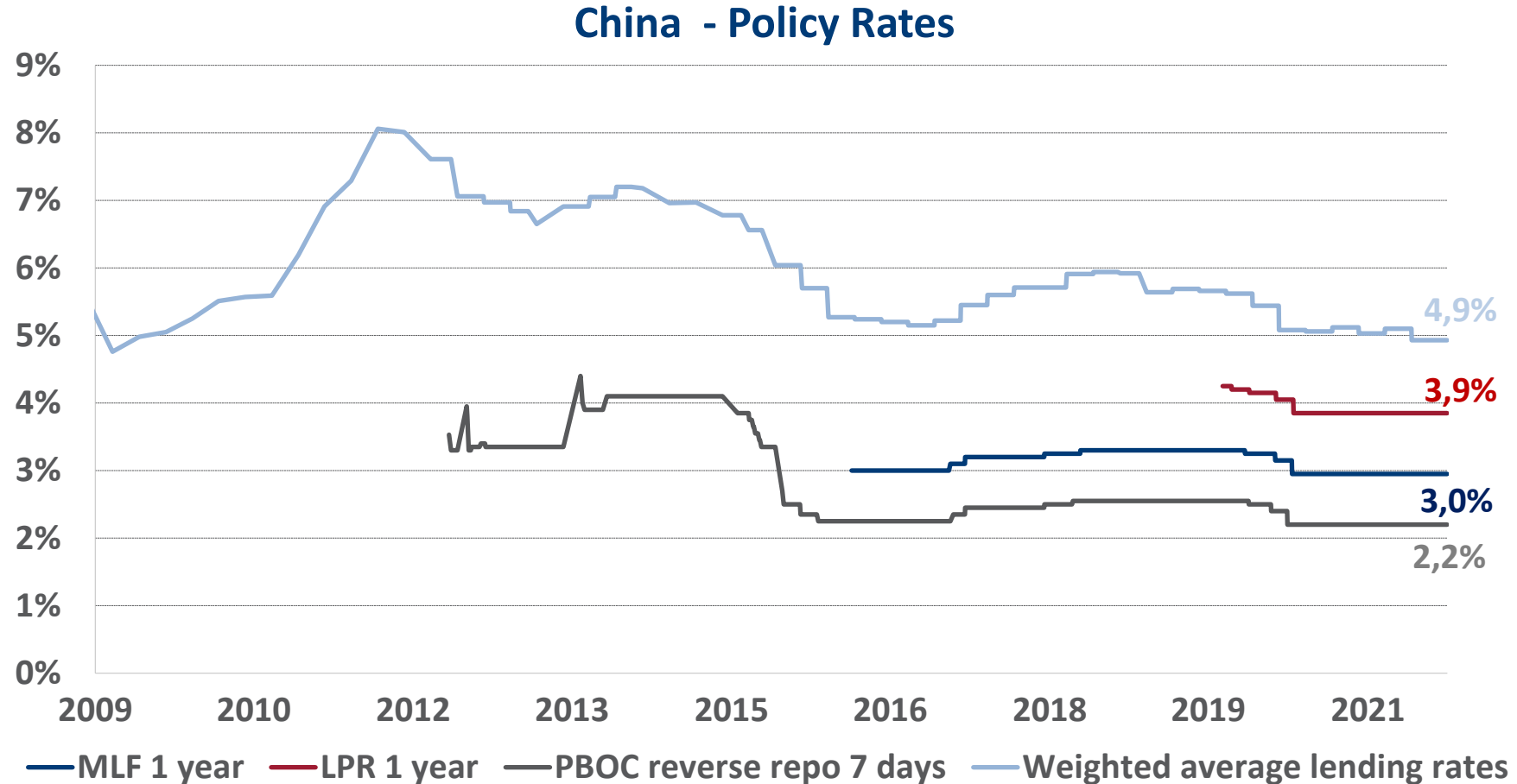


China - Producer Price Index (YoY, %)



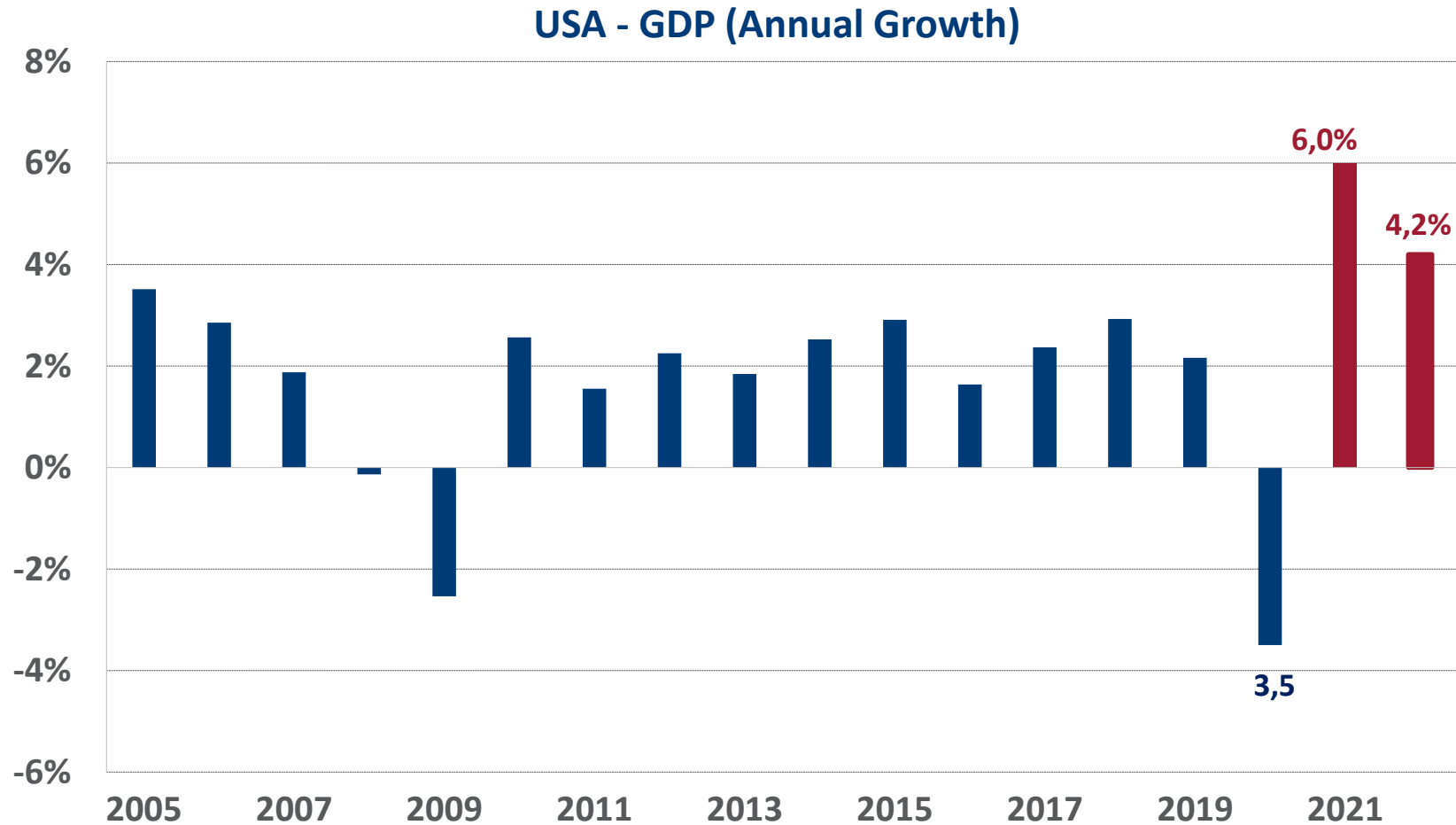
China: Monetary Policy

- » The financial stress and the activity slowdown increase the risk of lowering interest rates. The central bank should continue to inject liquidity in the market.



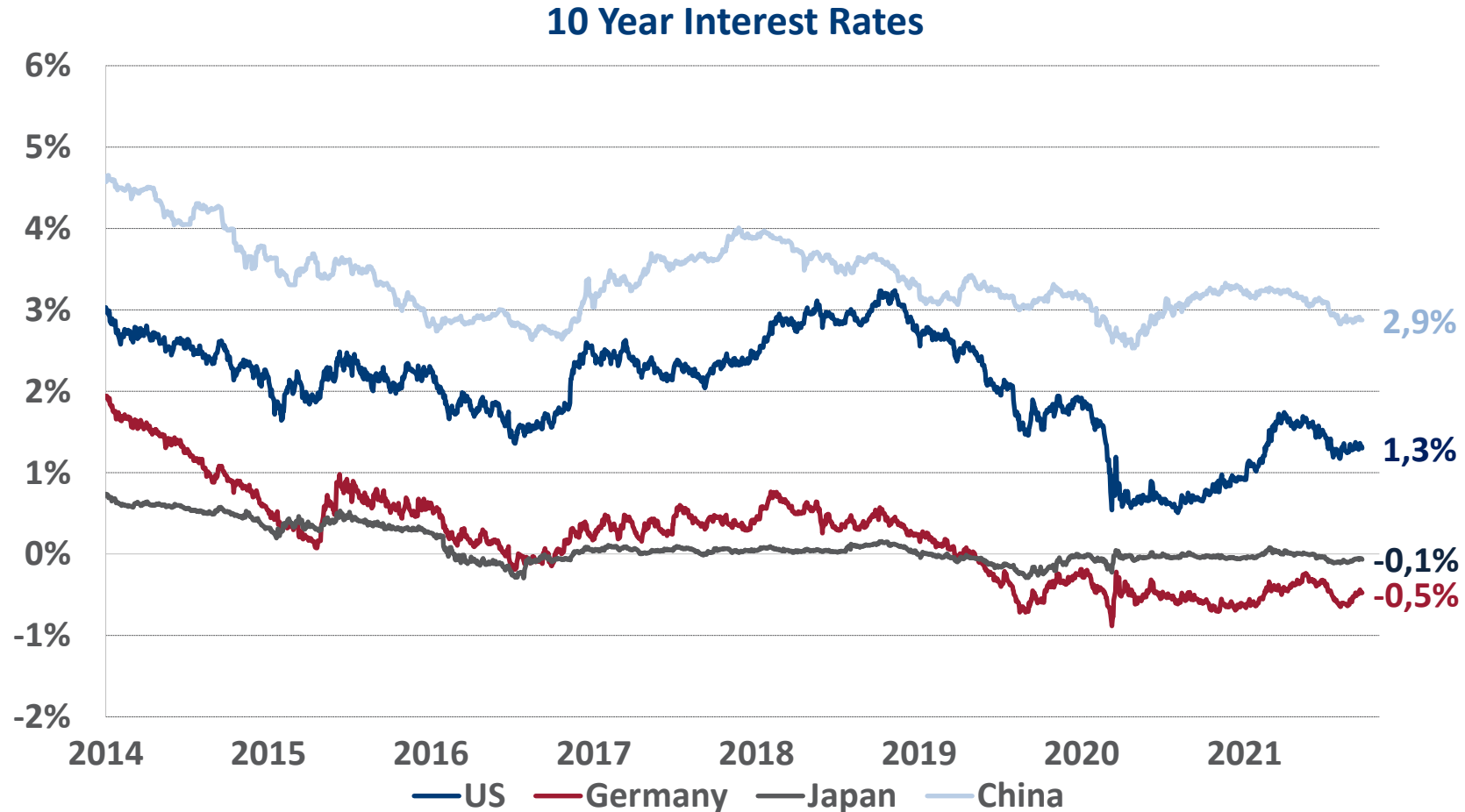
US: 2021 Outlook

»» The US economy should pick up this year with the reopening process and the fiscal stimulus.



Global Interest Rates

»» The interest rates maintain an upward bias, expecting a reduction of monetary stimulus.



Global: Negative Interest Rates

» The volume of negative yielding sovereign debt continue to fall, indicating a less cloudy scenario.

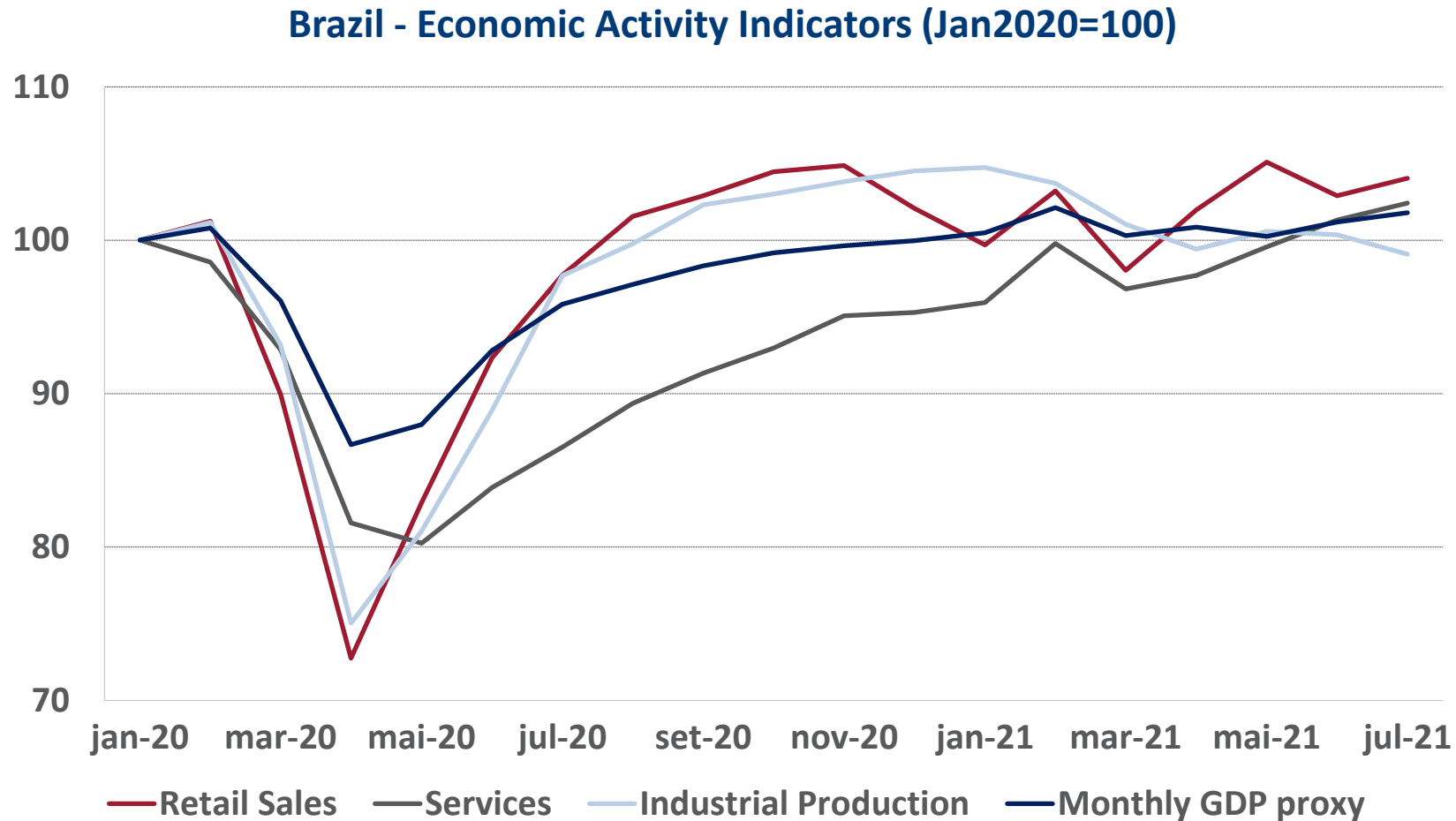


Brazil: Forecasts

| ECONOMIC FORECASTS | 2018 | 2019 | 2020 | 2021F | 2022F |
|------------------------------------|-------|-------|--------|-------|-------|
| GDP Growth (%) | 1,3% | 1,1% | -4,1% | 5,2% | 1,2% |
| Inflation (%) | 3,7% | 4,3% | 4,5% | 8,8% | 4,1% |
| Unemployment Rate, SA (eoy ,%) | 12,2% | 11,7% | 13,9% | 13,5% | 13,0% |
| Policy Rate (eoy, %) | 6,50% | 4,50% | 2,00% | 8,25% | 9,5% |
| External Accounts | | | | | |
| Trade Balance (US\$ bn) | 53 | 48 | 51 | 69 | 46 |
| Current Account Balance (US\$ bn) | -42 | -51 | -13 | -2 | -15 |
| Current Account Balance (% of GDP) | -2,2% | -2,8% | -0,9% | -0,1% | -0,9% |
| Fiscal Policy | | | | | |
| Fiscal Primary Balance (% of GDP) | -1,7% | -1,2% | -10,0% | -1,9% | -1,1% |
| Government Gross Debt (% of GDP) | 75,3% | 74,3% | 88,8% | 80,9% | 82,7% |

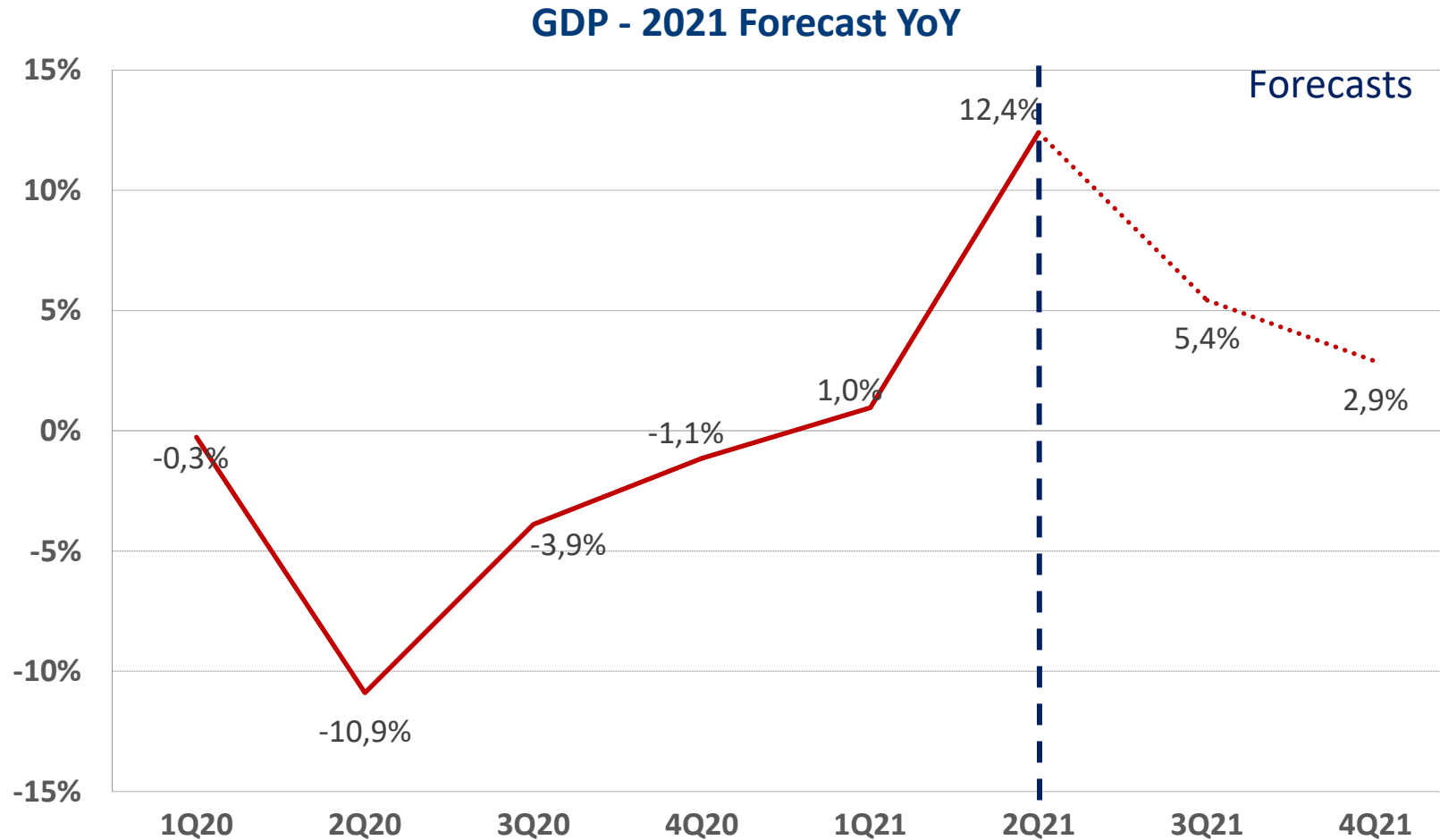
Brazil: Activity

- » Despite the weak result of the industrial production, the activity benefits from services sustained by the reopening process.



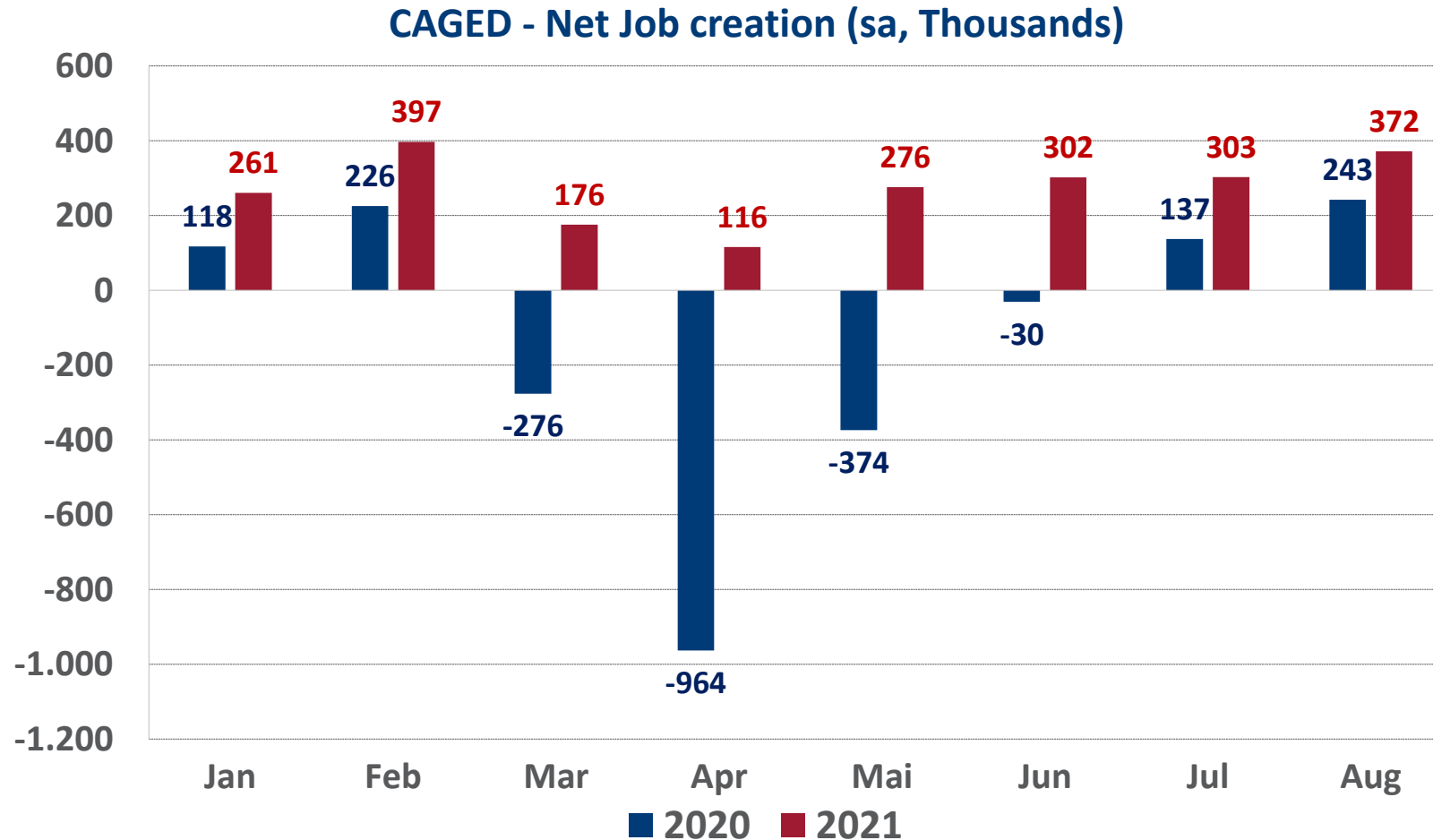
Brazil: Activity

- » In the 2^o quarter, the GDP remained stable growing -0,1% QoQ and 12,4% YoY, driven by the services sector.
- » For 2021, we forecast a GDP growth of 5,2%.



Brazil: Labor Market

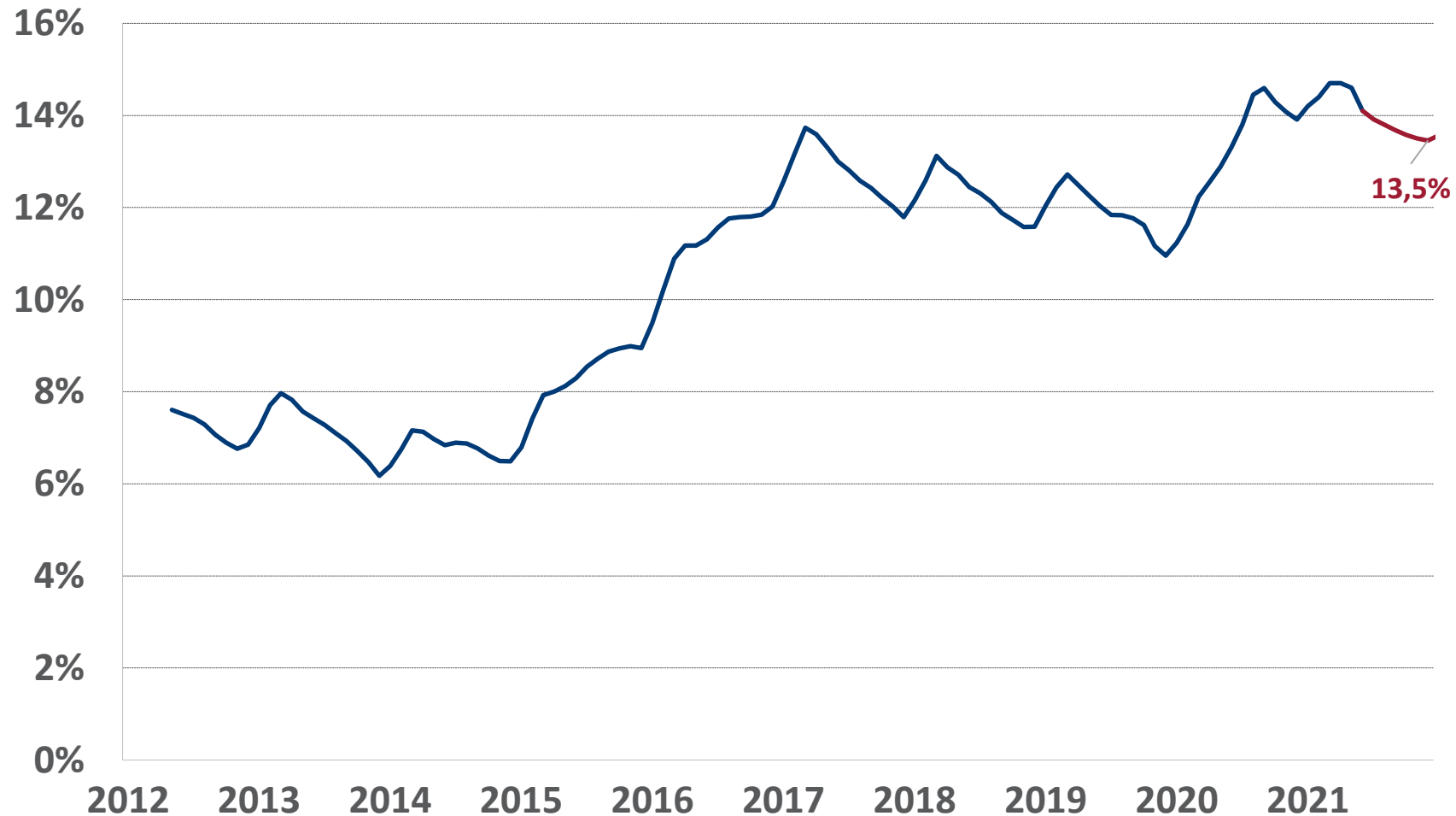
» The formal jobs creation confirms the reading of a recovery, but in a disseminated way across sectors.



Brazil: Labor Market

- » The unemployment rate remains elevated, but it will decrease throughout 2021 with a partial recovery of employment lost during the pandemic.

Brazil - Unemployment Rate SA (%)



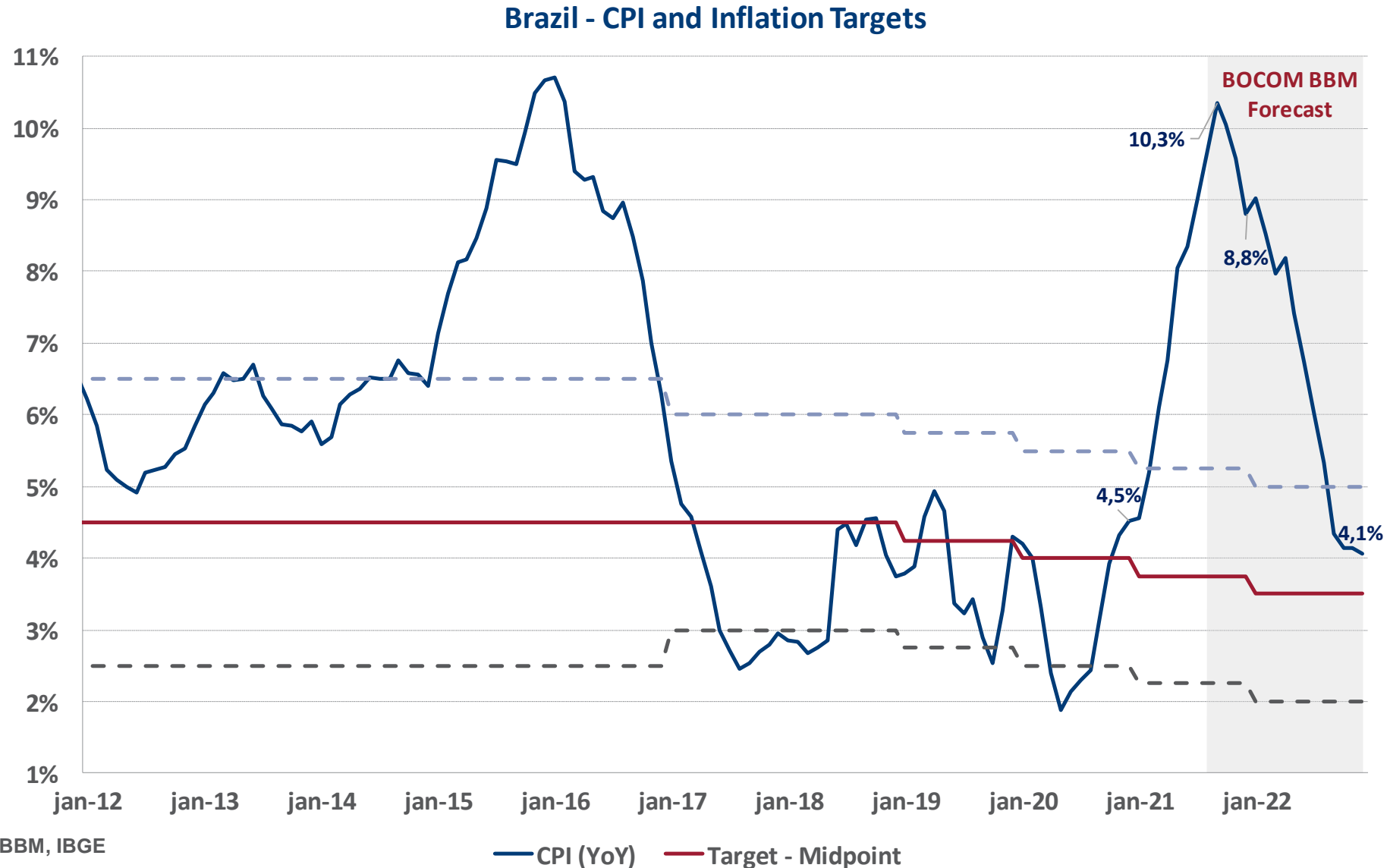
Brazil: Inflation

- » The industrial goods inflation shock, stronger services, non processed food inflation and new electric energy flag tariffs are adding pressure to 2021 CPI.
- » Inflation in 2021 to reach 10,3% in September.

| Baseline Scenario (YoY) | | | | | | |
|-------------------------|-------|-----------|---------------|----------|--------------|---------------------|
| | IPCA | Regulated | Non-Regulated | Services | Food-at-Home | Industrial Products |
| 19 Q4 | 4,3% | 5,5% | 3,9% | 3,5% | 7,8% | 1,7% |
| 20 Q1 | 3,3% | 4,8% | 2,9% | 3,1% | 5,1% | 1,2% |
| 20 Q2 | 2,1% | 2,6% | 2,8% | 2,1% | 9,0% | 0,2% |
| 20 Q3 | 3,1% | 2,1% | 3,8% | 1,1% | 15,4% | 1,3% |
| 20 Q4 | 4,5% | 2,6% | 5,5% | 1,7% | 18,2% | 3,2% |
| 21 Q1 | 6,1% | 7,0% | 6,1% | 1,6% | 17,6% | 5,5% |
| 21 Q2 | 8,3% | 13,0% | 7,0% | 2,2% | 15,3% | 8,8% |
| 21 Q3 | 10,3% | 15,8% | 8,6% | 4,4% | 15,1% | 10,7% |
| 21 Q4 | 8,8% | 13,8% | 7,2% | 4,5% | 8,8% | 10,1% |
| 22 Q1 | 8,0% | 10,1% | 7,2% | 5,4% | 9,0% | 8,8% |
| 22 Q2 | 6,7% | 6,2% | 7,0% | 6,0% | 8,5% | 7,3% |
| 22 Q3 | 4,3% | 3,2% | 4,8% | 5,0% | 3,7% | 5,0% |
| 22 Q4 | 4,1% | 3,8% | 4,2% | 4,3% | 3,9% | 4,1% |

Brazil: Inflation

» Inflation forecast revised to 8.8% in 2021, considerably above the target's upper limit.



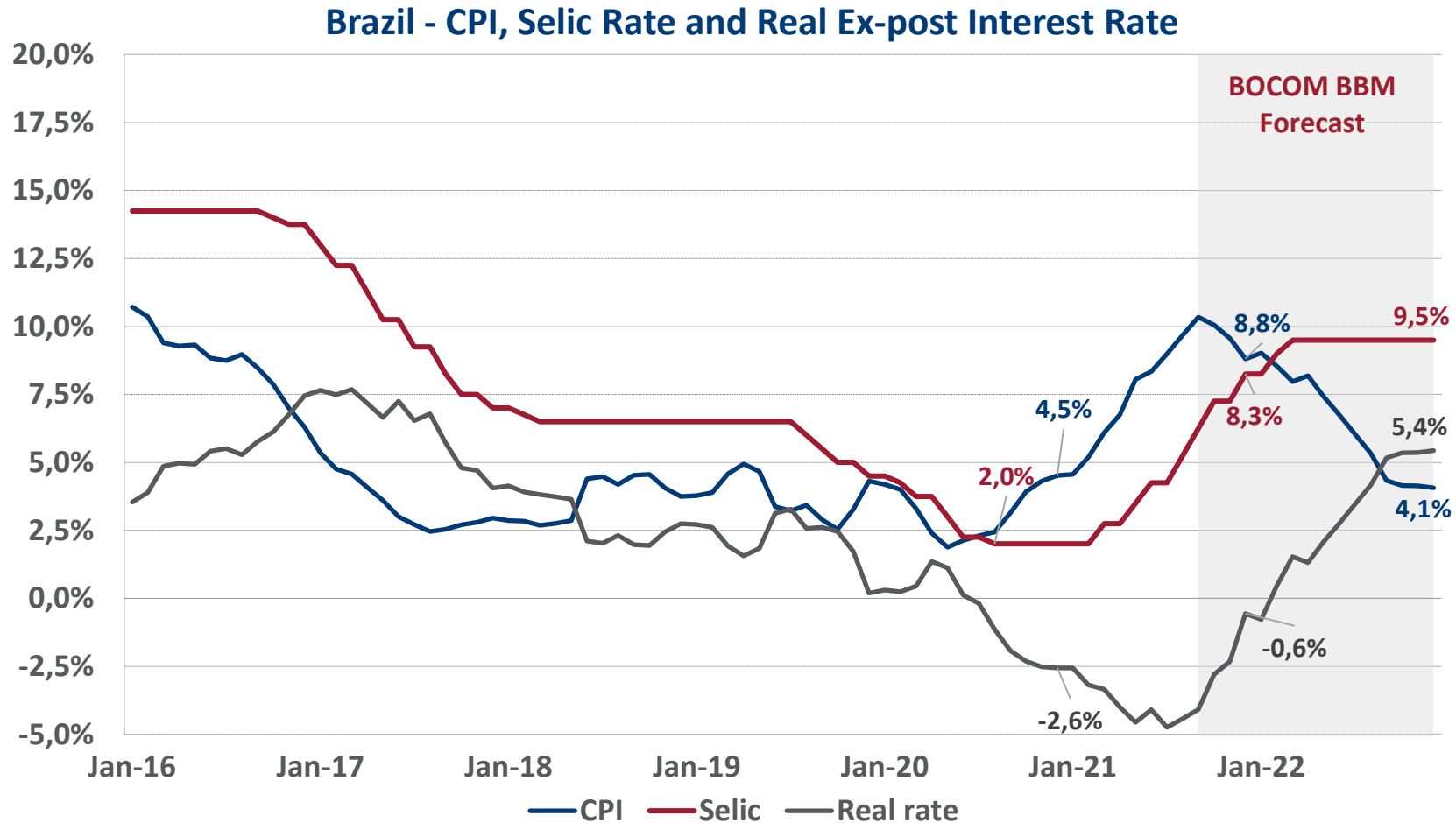
» Inflation forecast is at 8.8% and the principal factors accountable for the CPI above upper limit are:

1. Wholesale inflation passthrough to industrial goods very elevated;
2. Non processed food inflation increased with frosts;
3. Stronger recovery of the service sector;
4. Hydrological scarcity flag in December.

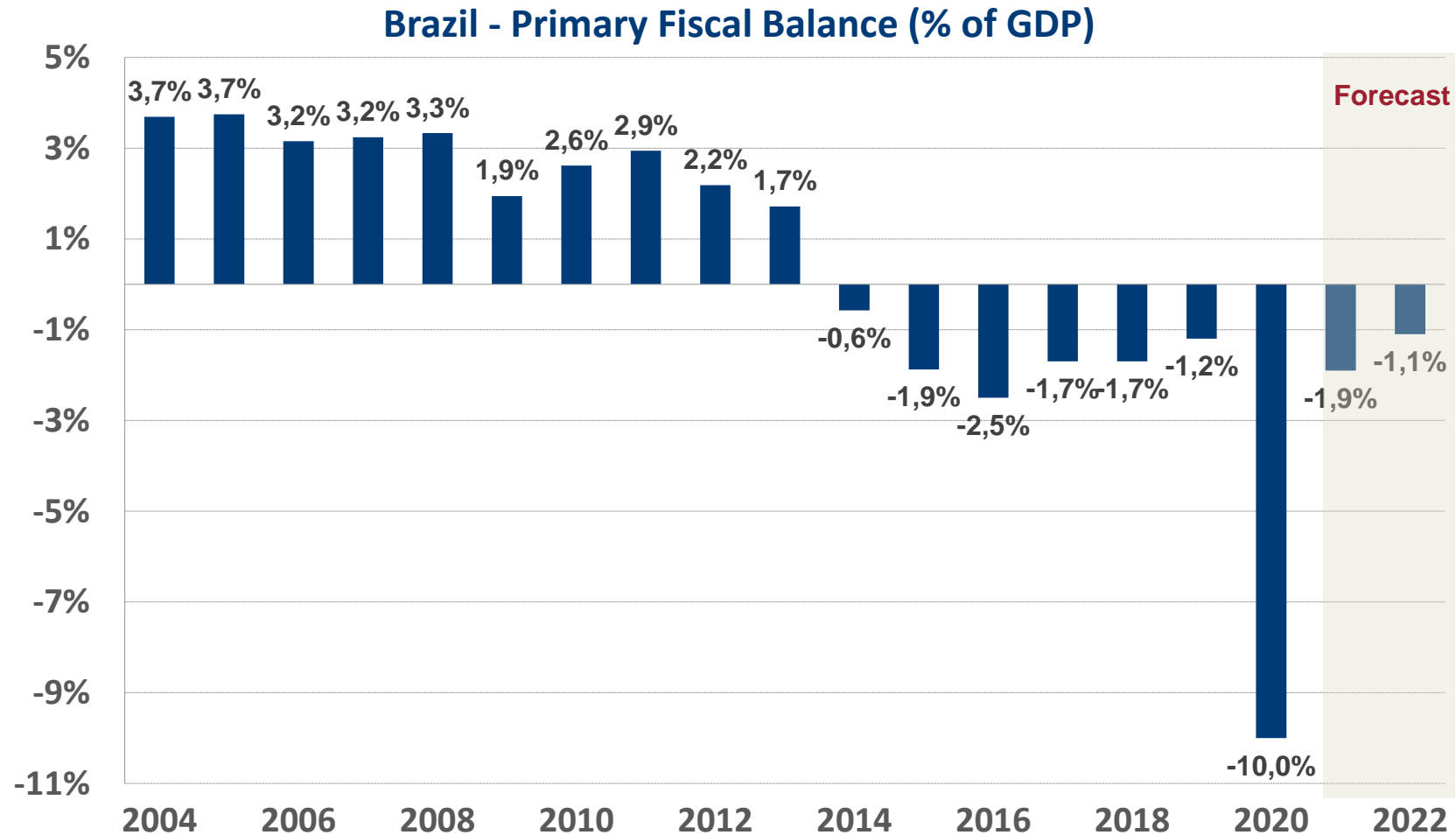
» New hydrological scarcity flag in December 2021 is a downward force for 2022 CPI, but this increase in energy prices should entail increases in prices of the economy. We have also increased our forecast for tariff readjustments of the energy distributors companies.

Brazil: Monetary Policy

- » We revised our Selic rate projection to 8.25% at the end of 2021 with the cycle's end in 2022.
- » The pace of increase will be of 1% in the next two meetings of 2021.
- » In 2022, we expect one hike of 75 bps and a last one of 50 bps, reaching 9.5% by the end of the cycle.

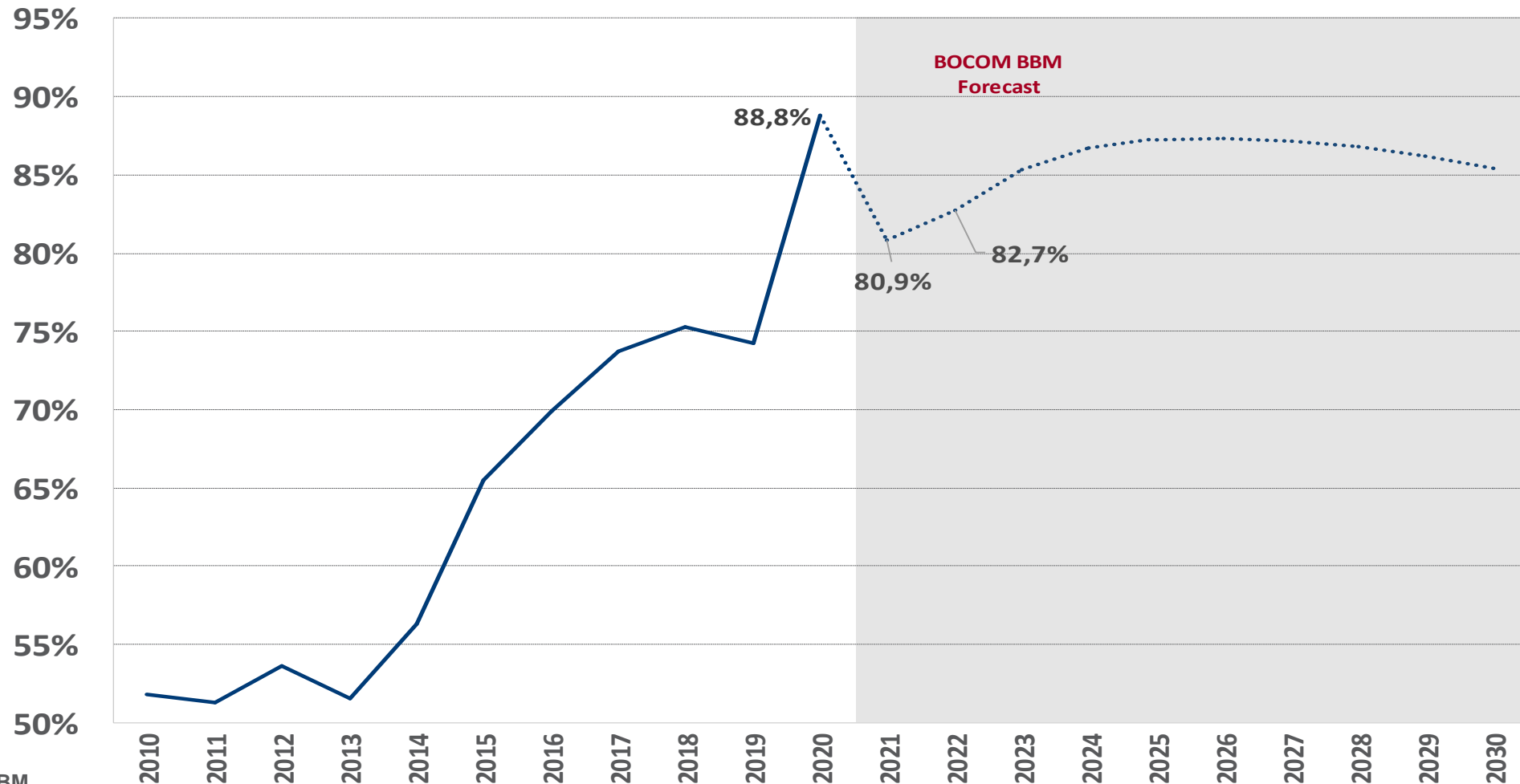


- » Measures to mitigate economic impacts from the pandemic elevated the primary deficit in 2020;
- » This year, with the stronger growth in tax collection, the primary deficit should return to -1,9% of GDP.



- » The smaller fiscal deficit, but also a higher GDP deflator, will decrease the debt-to-GDP ratio this year;
- » But it is important to continue pursuing fiscal consolidation to reduce the elevated public debt.

Brazil - Gross Public Debt-to-GDP



» 'PEC dos Precatórios': Govt's Solution to Court-Ordered Debts

Limit the spending on Court-Ordered Debts (BRL 40 billion)

Outside the cap: 'Encontro de contas' (BRL 10 billion) + 2023 spending (BRL 39 billion)

Most likely solution, largely discussed

» Auxílio Brasil and Tax Reform

Dividend Taxation used as a funding source for Auxílio Brasil

Tax Reform not yet approved

Deadline by the end of the year

» Growing pressure to extend emergency relief

May be extended to April 2022, not confirmed

25 billion people not included in Auxílio Brasil

Fiscal: 2022 Spending Cap

» There's no space in 2022's spending when we consider different inflation (INPC) scenarios.

Court-Ordered Debts: BRL 89,000 Millions (2022); Forecast in red

| (BRL million) | PLOA 2022 + Marcos Mendes |
|-------------------------------------------------------------|---------------------------------|
| Mandatory Expenditure (A = B + C) | 1,453,100 |
| Mandatory Expenditure - with clear growth rules (B) | 1,231,700 |
| Retirement benefits | 765,600 |
| LOAS/BPC | 73,500 |
| Unempl. Insurance and Annual Bonus | 63,500 |
| Payroll | 329,100 |
| Other Mandatory Expenditures (C) | 221,400 |
| Compensation for salary tax benefits | 3,200 |
| Legislative/Judiciary branch | 15,100 |
| Kandir Law | 4,000 |
| Court-ordered debt (current and capital) | 43,700 |
| Subsidies | 13,400 |
| Others | 142,000 |
| Spending Cap (D) | 1,610,012 |
| Free Space(E=D-A) | 156,386 |
| Discretionary Expenditure (F) | 149,500 |
| Expenditures subject to the spending cap (G = A + F) | 1,602,600 |
| Need for adjustment or excess | 7,412 |

Year INPC PLOA 2022: 6.2%

| End-Year INPC [A] | Difference [B = A - 6.2%] | Additional [C] |
|----------------------|------------------------------|-------------------|
| 7.2% | 1.0 | 7,900 |
| 8.3% | 2.1 | 16,590 |
| 9.0% | 2.8 | 22,120 |

Fiscal: Solutions to Court-Ordered Debts

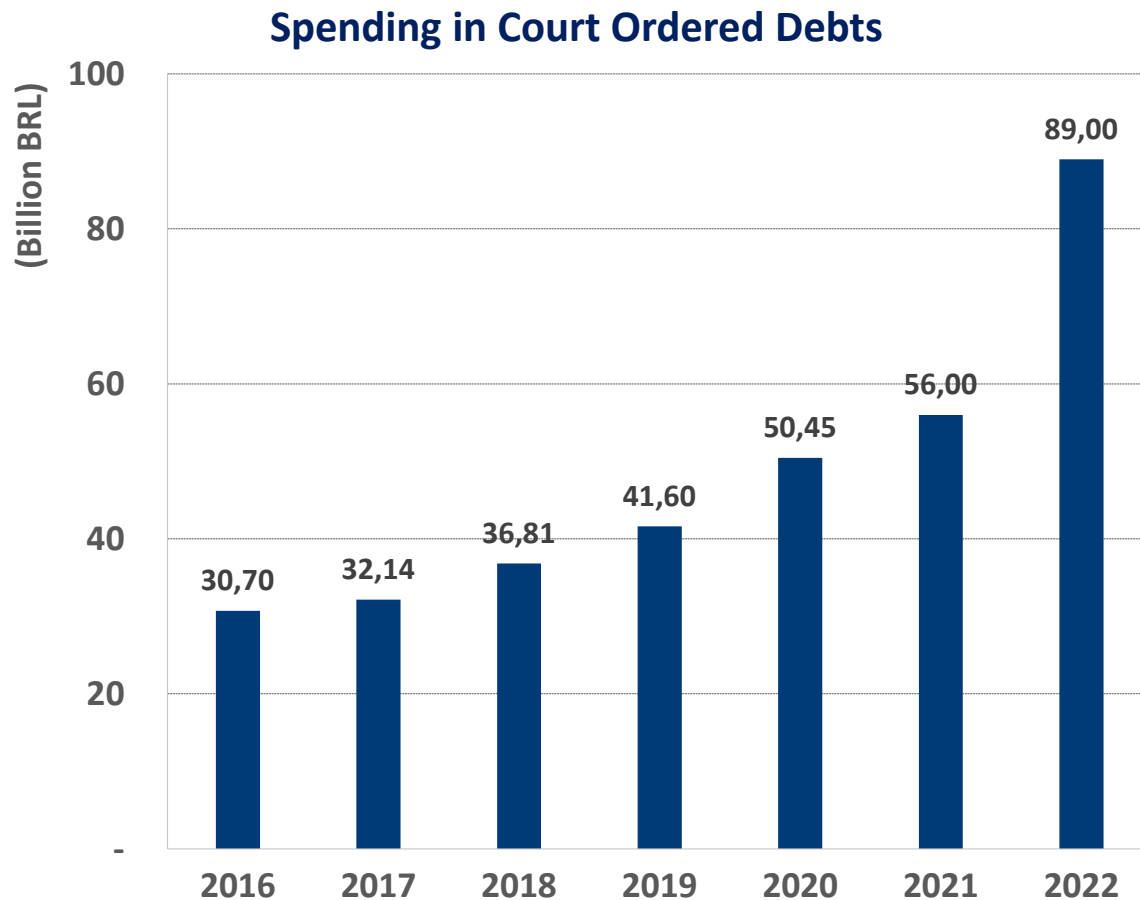
- » The government's updated solution is the one that opens the biggest fiscal space.
- » Even in different INPC scenarios, the space is still considerable.

End-Year INPC 2022: 6.2%

| (BRL million) | PLOA 2022 + Marcos Mendes | PEC Marcelo Ramos | PEC Governo (Original) | Solução CNJ = PEC Governo (Updated) |
|------------------------------------------|------------------------------|----------------------|---------------------------|-------------------------------------------|
| | [A] | [B=A-40] | [C=A] | [D=A] |
| Spending Cap | 1,610,012 | 1,572,627 | 1,610,012 | 1,610,012 |
| | [E] | [F=E-89+40] | [G=E-89+55] | [H=E-89+40] |
| Expenditures subject to the spending cap | 1,602,600 | 1,554,100 | 1,568,600 | 1,554,100 |
| Space(+)/Surplus(-) | 7,412 | 18,527 | 41,412 | 55,912 |
| Outside Spending Cap | 0 | 49,000 | 34,000 | 49,000 |
| End-Year INPC | Fiscal Space | | | |
| 7.2% | -488 | 10,627 | 33,512 | 48,012 |
| 8.3% | -9,178 | 1,937 | 24,822 | 39,322 |
| 9.0% | -14,708 | -3,593 | 19,292 | 33,792 |

Fiscal: Govt Solution in 2023

- » Remaining value increases spending in court-ordered debts in 2023.
- » 2023's court-ordered debt spending limit is corrected for inflation (IPCA).
- » Long term: Court-Ordered Debts snowball.



Scenario: BRL 40,000 Million paid in 2022 (INPC 6.2%)

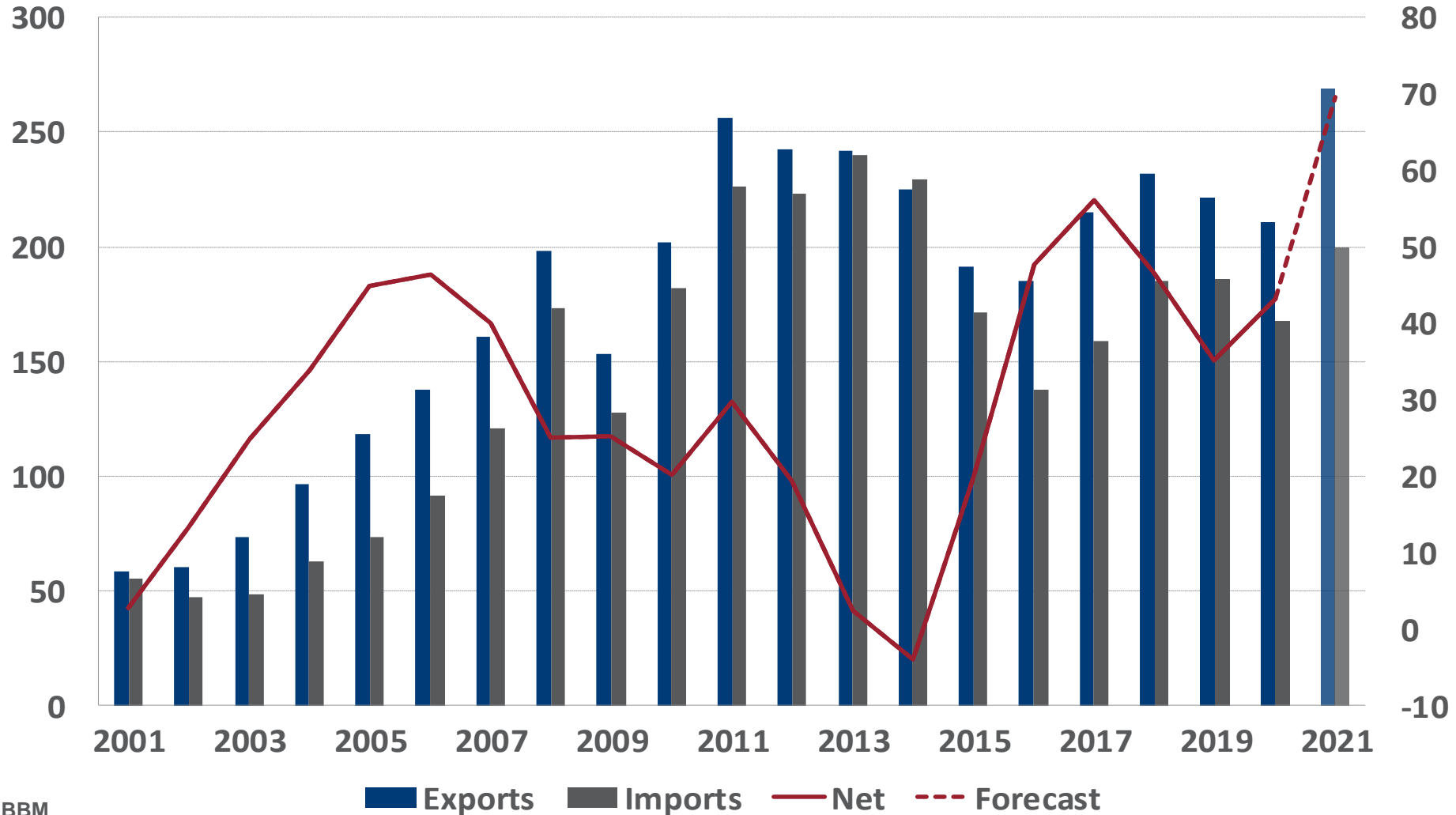
Exceeding: BRL 49,000 Million - 10,000 Million ('encontro de contas')

| 2023/IPCA | 5 | 7 | 9 |
|--------------------------------------|-------|--------|-------|
| Remaining Court-Ordered Debts (2022) | | 39,000 | |
| Limit | 42502 | 43312 | 44122 |
| Space | 3,502 | 4,312 | 5,122 |

Brazil: Trade Balance

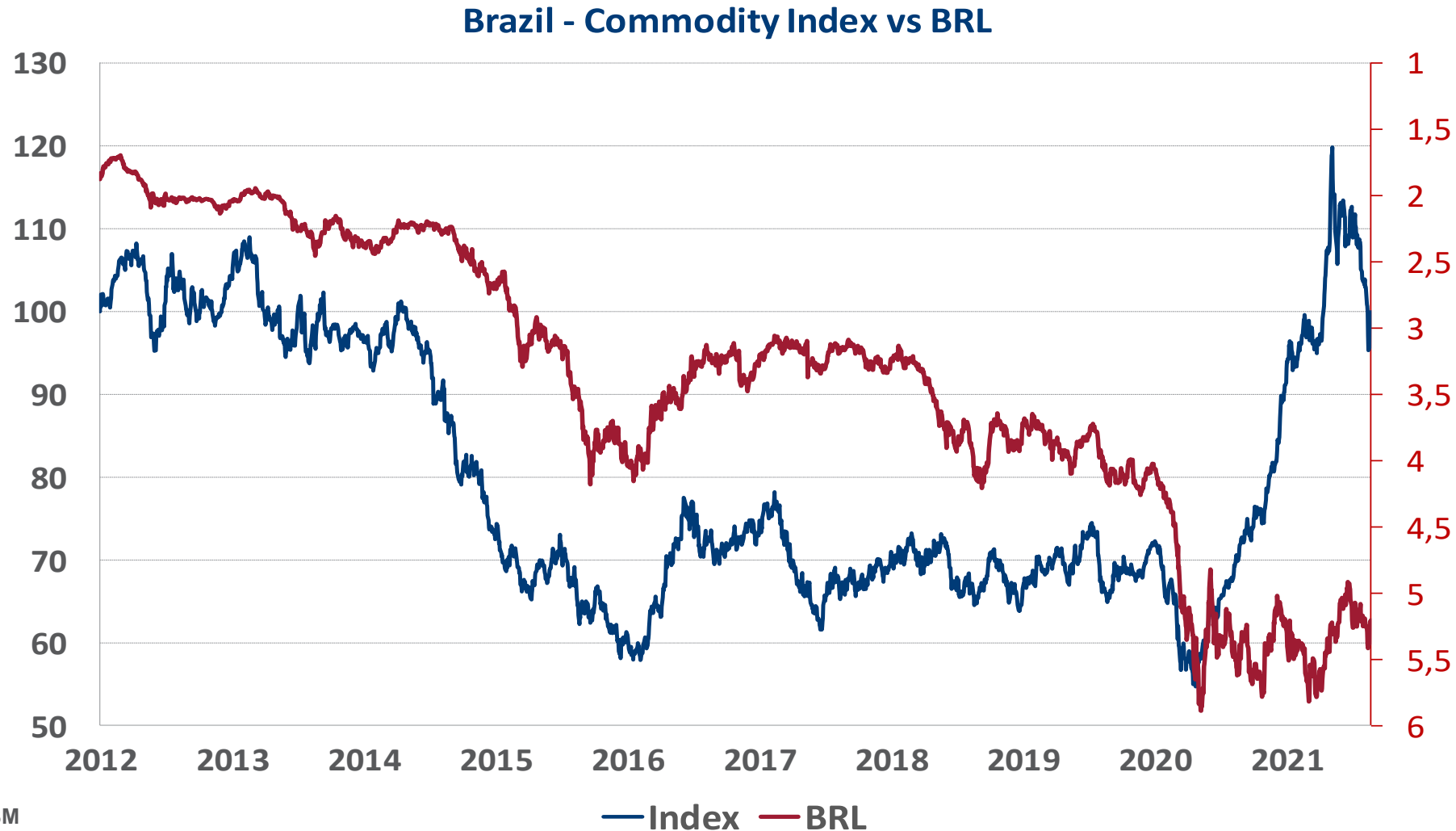
» In September, the trade balance registered another surplus.

Brazil - Trade Balance (US\$ Bi - 12m)



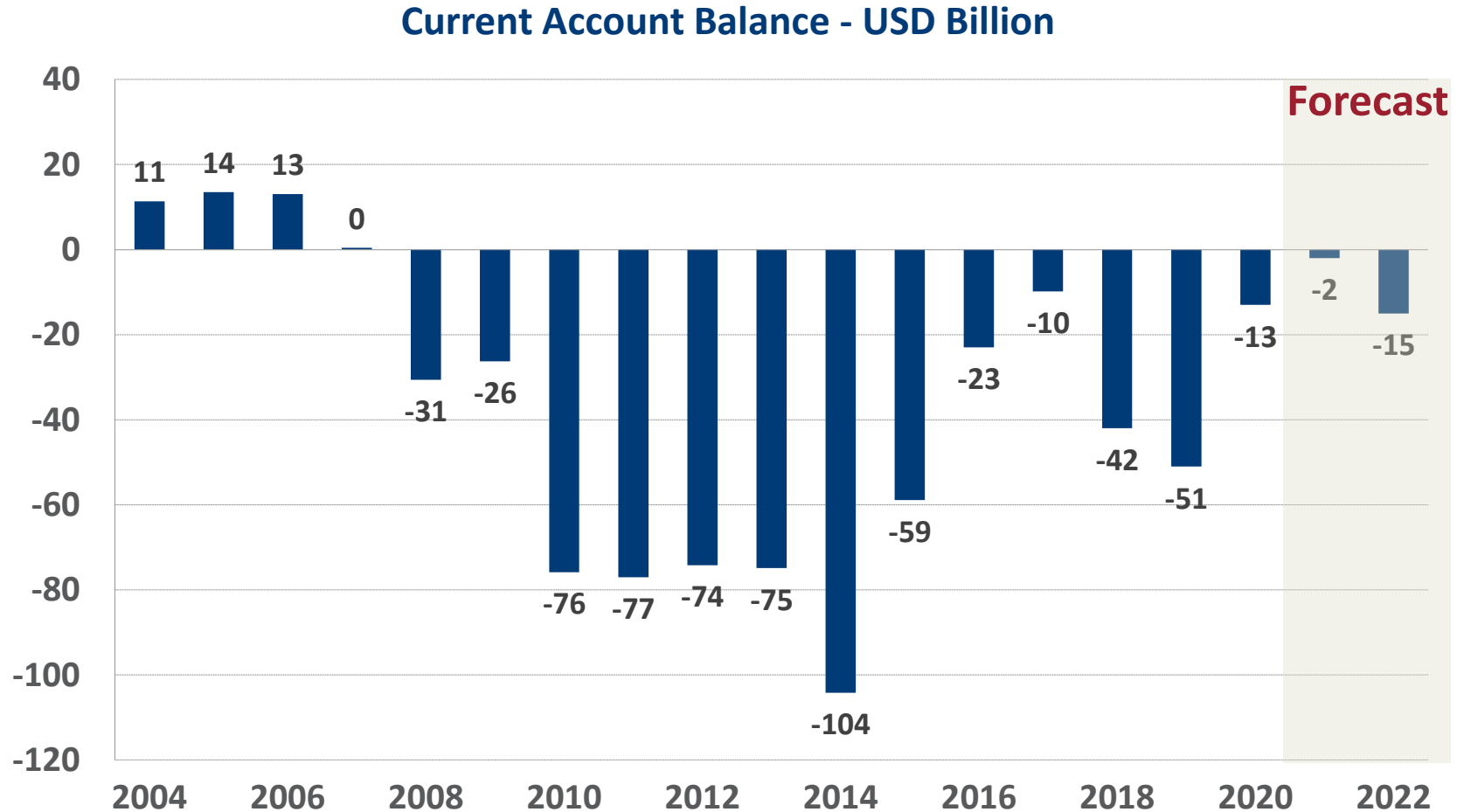
Brazil: Trade Balance

- » The fall in iron ore prices due to Chinese green policy, the Evergrande crisis and the slowdown in China had a considerable impact on the commodity index.



Brazil: Balance of Payments

» The trade balance is the main driver of the current account improvement in 2021.



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