Banco MUFG Brasil S.A.

MUFG

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EXECUTIVE SUMMARY

1. Government

- ✓ 2021 fiscal figures better than initially expected
- ✓ On the other hand, 2022 forecasts worsened
- ✓ But, to a level better than the 2020 figures

2. Economic Activity

- ✓ Disappointing monthly data pose downward bias to 2021 GDP
- ✓ 2022 GDP call sustained by agriculture and services
- ✓ But, omicron variant is a risk for this scenario

3. Monetary Policy

- ✓ The Central Bank increased the Selic policy rate by 150 bps to 9.25%
- ✓ Another 150 bps hike in February is expected
- ✓ Our call is 12.25% for the end of the tightening cycle

4. External Sector

- ✓ BRL ended 2021 at 5.58
- ✓ We see weaker BRL at 5.80 at the end of 2022
- ✓ FED actions, presidential elections and fiscal risks might be the major drivers for BRL.

1. A CHALLENGING 2022 IN FISCAL TERMS

The fiscal accounts this year surprised positively as the outcome will be better than initially expected in the beginning of the year. Indeed, chart I and II shows that the nominal and primary balances are coming much better: in the beginning of the year, the median of market expectation was forecasting a nominal deficit around 7.0% of GDP and the primary deficit of around 3.0%, but the most recent data show deficit of, respectively, around 5.5% and 0.5%. Just remind that in 2020, the nominal deficit was 13.6% and the primary's was 9.4%. Two main drivers for this performance: i) better revenues as the economy recovered from the 2020 plunge and tax exempts were lifted, resulting in a soar of 21.9% in the year through November over the same period in 2020 in real terms; ii) the plunge of expenditures related to the pandemic that amounted to -79.3% in Jan-Nov period in real terms. As a consequence, the gross public debt that closed 2020 at 88.8% of GDP is expected to end 2021 at 81% (initial estimates were around 92%).

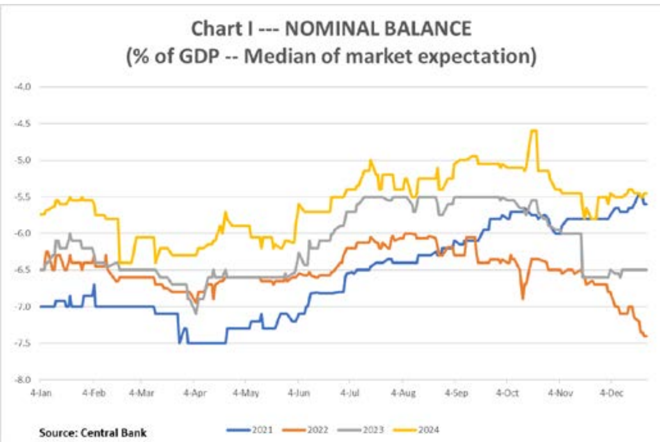


Chart I --- NOMINAL BALANCE
(% of GDP -- Median of market expectation)

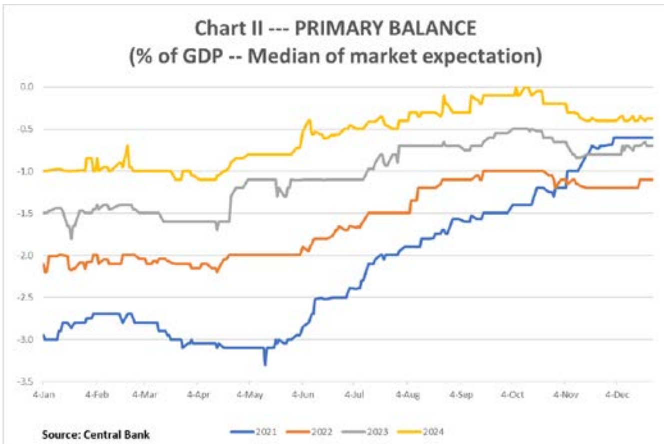


Chart II --- PRIMARY BALANCE
(% of GDP -- Median of market expectation)

The scenario for 2022 is different. The increase of inflation made the Central Bank react through an aggressive policy rate hike, which tightening cycle might continue along the first half of 2022. This monetary policy will have two main fiscal impacts: i) reduce tax collection as economic growth might decelerate and ii) increase the expenditures with interest. Additionally, the difficult discussions of the 2022 budget resulted in a change of the fiscal policy once the Congress approved a bill to change the way the spending cap is calculated, resulting in an increase of expenditures. The final result wasn't ideal because it shows that further changes may be made, but the spending cap is still in place and such alteration wasn't

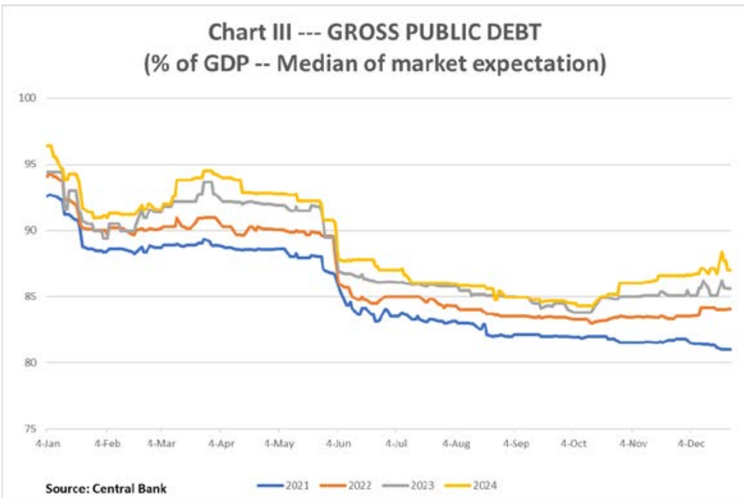
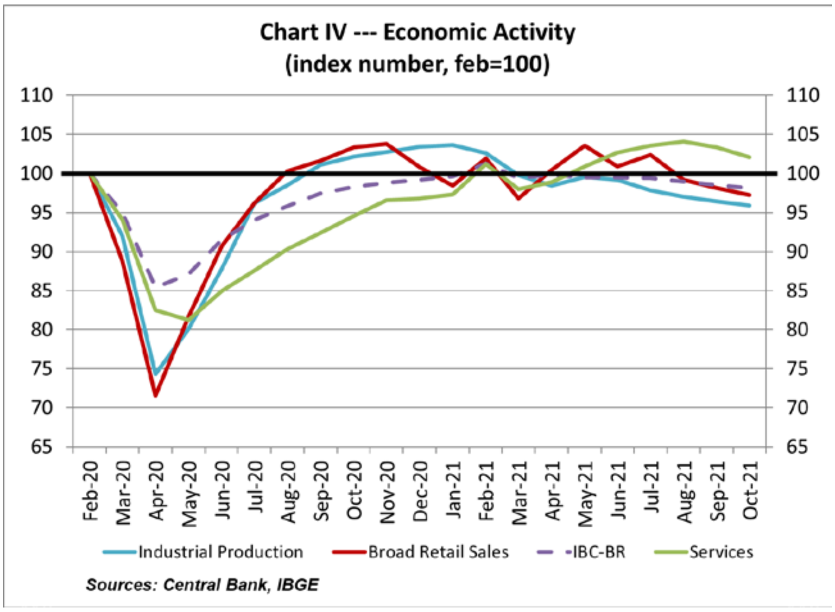


Chart III --- GROSS PUBLIC DEBT
(% of GDP -- Median of market expectation)

enough to make rating agencies take a negative action on Brazil as both S&P and Fitch reaffirmed the sovereign rating at BB- (Fitch with negative outlook and S&P with a stable one). Indeed, market expectations for 2022 nominal balance worsened along the second half, being now at around -7.5% of GDP, while primary balance stopped improving, being now expected at around -3.0%. As a result, gross debt might increase to around 84% (chart III), still well below the 2020 outcome. Looking ahead to 2023 and 2024, assuming that the new administration will pursue an austere fiscal policy, charts I and II show a gradual improvement of both the nominal and primary deficit, but gross debt might continue to grow to estimated 87% in 2024. It is still a challenging situation, but market clearly don't see the fiscal account deterioration back to the 2020 level.

2. ECONOMIC ACTIVITY: LOWER GROWTH IN 2022

GDP might post a growth of 4.9% in 2021, recovering from the slump of 3.9% in 2020. This 2021 call has a downward bias once the recent monthly activity indicator readings disappointed (chart IV). But, while this outcome may drag 0.2-0.4 percentage point in 2021 growth, it has a more meaningful impact on 2022 GDP as it might reduce further the carry-over, currently at mere 0.2%. The tightening of the monetary policy well above the neutral level is another factor that impacts negatively the 2022 growth. Our call is 0.8% and the number is not lower because agriculture and services might provide some support to the activity. Indeed, according to the latest report, the 2022 grain production is expected to reach a record of 291 million T, a growth of 15% of the previous crop. In services, the gradual improvement of the labor market might keep payroll growing, beside wages in general might recover the purchasing power lost with the current high inflation. According to Fipe Institute, wages were readjusted by 5.0% in average in Dec/20, what means a reduction of 4.5% in real terms considering an inflation of 10% in 2021. Conversely, wages readjustments now are around 11%, what mean a real gain of 6.7% considering our call of 4% for 2022 inflation.



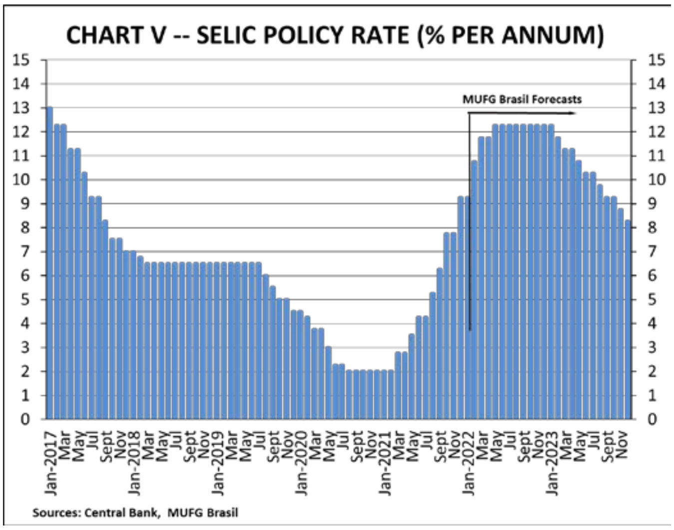
The main risk to the activity scenario is the omicron variant. The direct impact of the worsening of the pandemic would be the imposition of further restrictions, impacting mainly services to households which is the sector that is currently catching up other economic segments. Additionally, in a global deterioration of the pandemic, this bearish possibility would keep for longer the supply chain shock, impacting the industry with the difficulties of getting components. Of course, the presidential election in October 2022 and the FED actions normalizing the monetary policy in the USA are other items to keep an eye on.

3. CENTRAL BANK REINFORCING THE HAWKISH VIEW

On December 08th, the Central Bank (CB) decided unanimously to increase the Selic policy rate by 150 bps to 9.25% and also signaled another 150 bps for the next meeting on February 02nd 2022. The Central Bank reinforced its hawkish tone to advance the process of monetary tightening significantly into the restrictive territory in order to make inflation to converge towards the targets in the next years. CB mentioned the intention to move Selic rate beyond the assumptions in its baseline scenario. Following the statement, we expect another 150 bps hike of the Selic rate in the next meeting to 10.75%, 100 bps hike in March to 11.75%, and a final rate hike by 50 bps to 12.25% in May. Central Bank has a puzzle to solve. On one hand, the current inflation continues mounting and 2022 forecast has been deteriorating, and on the other hand the economic activity is weak and there is uncertainty about the pandemic.

We expect a very slow pace of economic activity recovery (GDP growth as of 0.2%-0.3% per quarter during next year) thus labor market will improve very slowly. Coupled with the still high inflation, we don´t expect a huge pass-through from cost to consumer prices. On the supply side, we assume a favorable rainfall during this wet season leading to the turn off of most expensive thermoelectric plants and resulting in some drop of electric energy price. In such scenario, we assess that the Selic policy rate does not need to go beyond 12.25% level in order to guide inflation expectation. On the fiscal side, we assume no significant change in the fiscal framework from the one already approved by the congress.

Anyway, considering the electoral interests next year, there will be continuous political pressures for higher expenditures. In such scenario of high fiscal risks along with our assumption that pandemic will be under better control allowing a total ease of restrictions to economic activity, we assess that Selic rate will have to be kept at 12.25% until the end of 2022. From 2023 onwards, we keep our view of a gradual reduction of Selic rate ending up the year at 8.25%, assuming that the pandemic will be fully under control, no fiscal slippage, new administration taking office in 2023 committed to the reforms and FED actions to normalize the monetary policy in the US not bringing severe impact on EM economies.



4. ADVERSE EXTERNAL ENVIRONMENT

In December, BRL appreciated 0.70% to 5.5805 in a volatile month with the rate oscillating between 5.52 and 5.75. The behavior of the external market drove BRL performance during this period. In the domestic market, the fiscal uncertainty was the main issue as politicians have been pressuring the government for higher expenditures in the 2022 election year. The solution found was to increase the spending cap by changing the way it is calculated, so the government could launch a more robust social aid program and politicians got more appropriation to use in projects that benefit their constituents. Remember that next year politicians will be running for president and governors or being reelected as congressmen. The 2022 federal budget finally passed, but the fiscal risk remained as public servants started to pressure for wage readjustment.

In the technical side, the yearend is a traditional period of higher outflow driven by dividend remittances. Indeed, in December through 24th, there was a net outflow of USD 7.2 billion in the FX balance. Another reason for pressuring BRL was the unwind of overhedge position of the banks given the tax overhaul starting in 2022. As a consequence of this scenario, the Central Bank had to intervene in the FX market, selling USD 3.9 billion in the spot market.

For 2022, we see a weaker currency, so our call is a rate at 5.80 at the end of 2022. The main drivers of this weakening trend are: i) FED actions by finishing the tapering and starting raising the fund rates in the US; ii) the political noise provoked by the presidential election once the likely scenario is another polarized campaign, this time between the leftist and former president Lula and the rightist and incumbent Bolsonaro; and iii) fiscal uncertainties once pressure for higher expenditures might continue to mount in the beginning of 2022 and also no clear scenario of fiscal adjustment in the new administration that takes office in January 2023.

MACROECONOMIC DATA FORECAST

	actual data											forecast	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
real GDP growth (%)	7.5	4.0	1.9	3.0	0.5	-3.5	- 3.3	1.3	1.3	1.1	-4.1	4.9	0.8
exchange rate (USDBRL -- yearend)	1.67	1.88	2.04	2.34	2.66	3.90	3.26	3.31	3.87	4.03	5.20	5.50	5.80
(% change)	-4.3	12.6	8.9	14.6	13.4	47.0	-16.5	1.5	17.1	4.1	29.0	5.8	5,5
exchange rate (USDBRL -- average)	1.76	1.67	1.96	2.16	2.35	3.33	3.49	3.19	3.65	3.95	5.15	5.40	5.69
(% change)	-11.8	-4.8	16.7	10.5	9.0	41.5	4.8	-8.6	14.5	8.1	30.4	4.9	5.4
IPCA (%)	5.9	6.5	5.8	5.9	6.4	10.7	6.3	2.9	3.8	4.3	4.5	10.0	4.0
Selic policy rate (% per annum -- yearend)	10.75	11.00	7.25	10.00	11.75	14.25	13.75	7.00	6.50	4.50	2.00	9.25	12.25
Real rate (Selic/IPCA)	4.6	4.2	1.4	3.9	5.0	3.2	7.0	4.0	2.6	0.2	-2.4	-0.7	7.9

Sources: IBGE; Central Bank; Own Forecast

KEY ECONOMIC AND FINANCIAL INDICATORS

	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov/21	Year-to-Date
01- GDP Growth (%)													
Quarter over the previous quarter (seasonally adjusted)	3.1			1.3			-0.4			-0.1			--x--
Quarter over the same quarter of the previous year	-0.9			1.3			12.3			4.0			--x--
Last 12 months	-3.9			-3.5			1.9			3.9			--x--
02 - Central Bank's Economic Activity Index													
% change over the previous month (seasonally adjusted)	0.37	0.46	1.64	-1.88	0.45	-0.39	0.07	-0.12	-0.45	-0.46	-0.40		4.99
03 - Industrial Production													
% change over the previous month (seasonally adjusted)	0.7	0.2	-1.0	-2.8	-1.4	1.2	-0.3	-1.4	-0.8	-0.6	-0.6		5.73
04 - Vehicle Production (1,000 units -- excluding CKD's)	209.3	199.7	197.0	200.3	190.9	192.8	166.9	163.6	164.0	173.3	179.0	206.0	2033.7
Domestic Sale (1,000 units)	222.9	155.0	153.7	172.0	158.0	169.2	158.1	151.0	149.5	133.2	140.4	148.3	1688.2
Export (1,000 units -- excluding CKD's)	38.4	25.0	33.1	36.8	33.9	37.0	33.5	23.8	29.4	23.6	29.8	28.0	333.9
Import (1,000 units)	21.1	16.2	13.7	17.4	17.1	19.4	24.4	24.5	23.3	21.9	22.0	24.7	224.6
05 - Retail Sales (% change over the previous month -- seasonally adjusted)	-6.2	-0.1	0.6	-1.5	2.4	2.1	-1.3	3.1	-4.1	-1.1	-0.1		2.6
06 - Services Survey (% change over the previous month -- seasonally adjusted)	0.2	0.6	4.0	-3.2	0.9	2.0	1.8	0.9	0.5	-0.7	-1.2		11.0
07 - National Unemployment Rate (%)	14.2	14.5	14.6	14.9	14.8	14.7	14.2	13.7	13.1	12.6	12.1		--x--
08 - Inflation (%)													
IPCA (Brazil Consumer Price Index)	1.35	0.25	0.86	0.93	0.31	0.83	0.53	0.96	0.87	1.16	1.25	0.95	9.26
FIPE (São Paulo City Consumer Price Index)	0.79	0.86	0.23	0.71	0.44	0.41	0.81	1.02	1.44	1.13	1.00	0.72	9.10
IGP-DI (General Price Index)	0.76	2.91	2.71	2.17	2.22	3.40	0.11	1.45	-0.14	-0.55	1.60	-0.58	16.28
IPA-DI (Wholesale Price Index)	0.68	3.92	3.40	2.59	2.90	4.20	-0.26	1.65	-0.42	-1.17	1.90	-1.16	18.80
09 - Overnight (effective % per annum)													
SELIC rate	1.90	1.90	1.90	2.23	2.65	3.29	3.76	4.15	5.01	5.43	6.30	7.65	3.63
CDI (Interbank)	1.90	1.90	1.90	2.23	2.65	3.29	3.76	4.15	5.01	5.43	6.30	7.65	3.63
10 - São Paulo Stock Market Index (% Change)	9.30	-3.32	-4.37	6.00	1.94	6.16	0.46	-3.94	-2.48	-6.57	-6.74	-1.53	-14.37
11 - Exchange Rate (BRL/USD) - End of Period; Selling Rate	5.1967	5.4759	5.5302	5.6973	5.4036	5.2322	5.0022	5.1216	5.1433	5.4394	5.6430	5.6199	--x--
Devaluation (positive) / Appreciation (negative) -- %	-2.53	5.37	0.99	3.02	-5.16	-3.17	-4.40	2.39	0.42	5.76	3.74	-0.41	8.59
12 - SISBACEN Exchange Transactions (USD mio)													
Foreign Trade - Net	-3,932	-825	1,349	5,242	3,502	2,268	1,805	2,740	1,132	2,805	-2,353	-7,174	10,493
Financial - Net	-9,894	3,622	3,009	-3,674	488	-4,089	2,644	-1,909	2,577	-3,975	3,119	3,776	5,587
Overall Balance - Net	-13,826	2,797	4,358	1,568	3,990	-1,821	4,449	831	3,709	-1,170	766	-3,398	16,080
13 - Foreign Reserve -- international liquidity concept (USD bio)	362.0	361.8	359.9	352.6	354.5	356.2	354.4	356.6	371.3	368.9	367.9	367.8	--x--

Sources and Notes: 01 -- IBGE; 02 -- Central Bank, 03 -- IBGE, Year-to-Date: Cumulative data in the year over the same period of the former year; 04 -- Anfavea
05 -- IBGE, Year-to-date: same note of item 03; 06 -- IBGE, Year-to-date: same note of item 03; 07 -- IBGE/PNAD survey (3-month moving average)
08 -- IBGE, FIPE, FGV -- IGP-M is composed by 60% of IPA (Wholesale Price Index); 30% of IPC (Consumer Price Index) and 10% of INCC (National Civil Construction Index)
09 -- Central Bank, Cetip, Year-to-Date: effective rate in the period; 10 -- Bovespa; 11, 12, 13 -- Central Bank

KEY ECONOMIC AND FINANCIAL INDICATORS

	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov/21	Year-to-Date
14 - Foreign Trade Balance (USD mio)	57	-207	1,832	6,424	9,873	8,610	10,437	7,389	7,638	4,310	1,999	-1,307	56,998
Export	18,471	14,960	16,371	24,286	25,969	26,259	28,281	25,522	27,184	24,272	22,518	20,296	255,919
Import	18,414	15,167	14,539	17,862	16,096	17,648	17,844	18,133	19,547	19,962	20,519	21,603	198,921
15 - Current Account Balance (USD mio)	-8,458	-8,338	-3,973	-5,189	4,325	2,483	1,911	-1,157	377	-1,901	-4,401	-6,522	-22,384
16 - Net Public Security Debt in the market (USD bio)	898.6	836.8	835.3	811.4	861.5	904.1	975.3	955.4	956.2	900.0	862.3	872.9	--x--
17 - Monetary Base (USD bio)	78.9	74.3	70.3	71.2	77.8	77.1	84.4	83.6	79.0	74.2	70.2	73.5	--x--
M1 -- Money Supply (USD bio)	119.8	106.3	103.6	101.2	107.9	111.9	123.4	120.9	119.7	111.7	106.3	106.9	--x--
Saving Passbook Accounts (1)	200.1	187.8	184.3	178.5	189.3	195.9	361.0	204.0	203.0	191.3	183.5	182.4	--x--
Private bonds (2)	447.0	418.2	411.7	408.1	429.3	445.6	477.4	472.8	477.3	464.9	447.8	449.9	--x--
M2 (M1+1+2) (USD bio)	766.9	712.2	699.6	687.8	726.6	753.4	961.8	797.7	800.1	767.9	737.7	739.1	--x--
Fixed Income Mutual Fund (3)	737.3	708.4	706.1	683.5	732.2	768.4	807.8	795.9	802.7	759.0	728.3	752.5	--x--
Repo Operations with Federal Bill/Bond (4)	29.4	30.7	28.2	29.2	32.1	33.9	35.5	35.6	36.0	37.3	34.8	34.8	--x--
Repo Operations with Private Bill/Bond (5)	13.8	11.6	11.0	11.7	11.2	11.6	13.0	15.2	13.9	12.5	11.9	12.0	--x--
M3 (M2+3+4+5) (USD bio)	1,547.5	1,462.9	1,444.9	1,412.2	1,502.1	1,567.3	1,818.1	1,644.3	1,652.6	1,576.6	1,512.7	1,538.5	--x--
T Bill/Bond (6)	82.9	77.5	75.4	102.5	102.6	105.9	111.9	102.0	102.4	120.4	134.0	136.4	--x--
M4 (M3+6) (USD bio)	1,630.4	1,540.4	1,520.3	1,514.7	1,604.7	1,673.3	1,930.0	1,746.3	1,754.9	1,697.0	1,646.7	1,674.9	--x--
18 - Fiscal Balance (% of GDP -- Last 12 Months)													
Nominal Concept	-13.63	-13.52	-13.35	-12.72	-10.59	-9.09	-7.27	-6.79	-5.59	-4.80	-4.68	-4.71	--x--
Federal Government and Central Bank	-13.59	-13.57	-13.46	-12.88	-10.90	-9.52	-7.73	-7.23	-6.25	-5.48	-5.36	-5.48	--x--
State and Municipalities	-0.01	0.08	0.15	0.21	0.33	0.45	0.47	0.48	0.69	0.70	0.71	0.80	--x--
Public Owned Companies	-0.03	-0.03	-0.04	-0.04	-0.02	-0.03	-0.02	-0.04	-0.03	-0.01	-0.03	-0.03	--x--
Primary Concept	-9.44	-9.35	-9.16	-8.67	-6.97	-5.38	-3.77	-2.85	-1.56	-0.63	-0.24	0.15	--x--
Federal Government and Central Bank	-10.01	-9.98	-9.84	-9.38	-7.80	-6.32	-4.73	-3.79	-2.72	-1.79	-1.39	-1.10	--x--
State and Municipalities	0.52	0.58	0.64	0.69	0.79	0.90	0.91	0.91	1.12	1.11	1.12	1.22	--x--
Public Owned Companies	0.05	0.04	0.04	0.03	0.05	0.04	0.05	0.03	0.03	0.05	0.03	0.03	--x--

Sources and Notes: 14 -- Development, Industry and Foreign Trade Ministry; 15, 16, 17 -- Central Bank
18 -- Central Bank -- The Nominal Concept includes all financial cost and the primary concept doesn't

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