Santander Macroeconomic Research

BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

HIGHER NOMINAL INTEREST RESULT DRIVEN BY RISE IN SELIC AND IPCA

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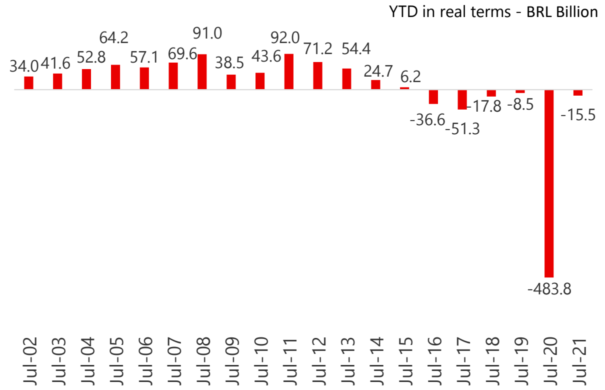
- The consolidated public sector posted a primary deficit of BRL10.3 billion in July, slightly below our forecast (BRL12.3 billion) and the market's median estimate (BRL16.0 billion). In YTD terms, the deficit reached BRL15.5 billion (0.3% of GDP) in July, compared to BRL483 billion (11.6% of GDP) in 2020, affected by a massive fiscal stimulus in 2020-21, and BRL8.5 billion (0.2% of GDP) in 2019. Surplus of regional governments continues to register positive primary results, reaching an all-time high in real terms and as a percentage of GDP.
- For the Central Government, July's result was affected by higher expenses: (i) anticipation of year-end bonuses for pensioners (~BRL18 billion) and (ii) extraordinary budget related to the pandemic (BRL19.3 billion). The price effect (higher inflation and favorable terms of trade) and recovery in cyclical activity continued to "help" the fiscal result from the standpoint of revenue, with 38% YoY real growth.
- In the coming months, we expect the results to be affected by the increase in discretionary spending and higher extra-cap (Covid-19) spending. The fiscal results will not be affected by the anticipation of the payment of pension (13th bonus payment) over expenditures for May to July. On the revenue side, we expect positive results, albeit with some softening in the growth compared to the recent months.
- We witnessed a rise in nominal result in July, affected by an increase in the interest account, which reached BRL45.1 billion in July, compared to BRL5.8 billion in 2020. The result was affected by higher inflation and Selic rate, leading to a rise in the cost of debt, in addition to a loss in foreign exchange swap operations. The nominal deficit reached 6.9% of GDP in July, compared to 7.4% in June.
- Debt indicators reduced marginally. Gross debt reached 83.8% of GDP in July, a reduction of 0.1 pp from the June reading — on the heels of the increase in nominal GDP (-0.9pp of impact). Meanwhile, net debt was 60.3% of GDP, 0.5 pp lower on the same basis of comparison.
- According to our forecasts, the consolidated public sector deficit should likely reach BRL135 billion in 2021 (1.6% of GDP). We expect gross debt to fall this year to 81.6% of GDP, however, assuming a higher nominal GDP (driven by the price shock), and we expect that the BNDES will repay the Treasury a total of BRL100 billion.

According to data published today by the Brazil Central Bank (BCB), the consolidated public sector posted a primary deficit of BRL10.3 billion, slightly better than our forecast (BRL12.3 billion) and the market's median estimate (BRL16.0 billion). In YTD terms, the deficit reached BRL15.5 billion (0.3% of GDP) in July, compared to BRL483 billion (11.6% of GDP) in 2020, affected by a massive fiscal stimulus, and BRL8.5 billion (0.2% of GDP) in 2019.

In the 12-month reading, the primary deficit reached BRL234.7 billion (2.9% of GDP) in July, compared to BRL305.5 billion (3.8% of GDP) in June, maintaining the downward trajectory after a sharp reduction in the fiscal stimulus comparing 2020 to 2021. Considering all the expenses (even those not considered to the calculus of the fiscal rules — the constitutional spending cap and primary target), the consolidated public sector deficit could reach BRL135 billion in 2021 (1.6% of GDP). In our view, the primary result could be slightly better if the impact of the commodity boom on revenues is more intense than we currently expect.

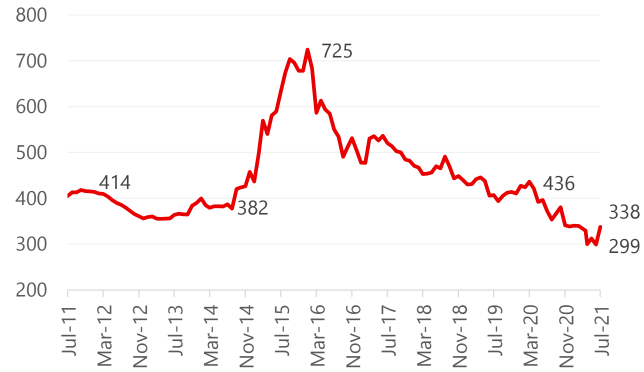
We witnessed a rise in the nominal result in July, affected by an increase in the interest account, which reached BRL45.1 billion in July, compared to BRL5.8 billion in 2020. The result was affected by higher inflation and Selic rate, leading to a rise in the cost of debt, in addition to a loss in foreign exchange swap operations. The 12-month nominal deficit was BRL558.2 billion (6.9% of GDP) in July dropping from BRL589.7 billion (7.4% of GDP) in June. We expect the nominal deficit be close to 5.2% of GDP by the end of the year.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

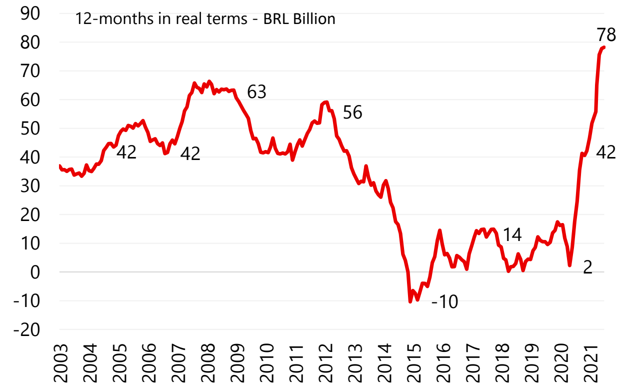
Figure 2 – Nominal Interest Result – BRL billion



Sources: Brazilian Central Bank, Santander.

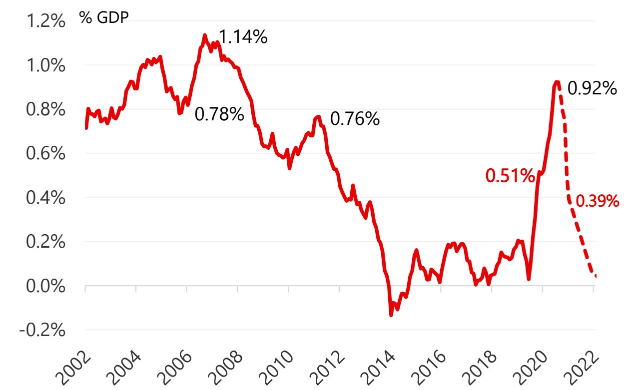
In July, the regional governments continued to show positive primary results (a surplus of BRL7.3 billion compared to a surplus of BRL6.3 billion in July 2020, boosted by fiscal transfers and BRL1.9 billion in July 2019). The recent results were likely affected by the lagged effects of the 2020-21 fiscal stimulus on local economies, added to the effect of the price shock (terms-of-trade and inflation) on tax collection—and the activity recovery (formal sector) in the last few months. In the YTD reading, regional governments posted a primary fiscal surplus of BRL54.3 billion (1.12% of GDP) and BRL78.2 billion in real terms in the last 12 months, an all-time high. In our view, for now the subnational entities should continue to present a positive result in the short run. However, we believe that regional governments will face the challenge of reestablishing fiscal balance in the medium term after the end of fiscal and monetary stimuli, mainly, in our view, because of pressure to increase mandatory expenditures in the next year (for example, pressure to increase public servants' wages, after years without a nominal increase).

Figure 3 – Regional Governments – Primary Result



Sources: Brazilian Central Bank, Santander.

Figure 4 – Regional Governments – Primary Result



Sources: Brazilian Central Bank, Santander.

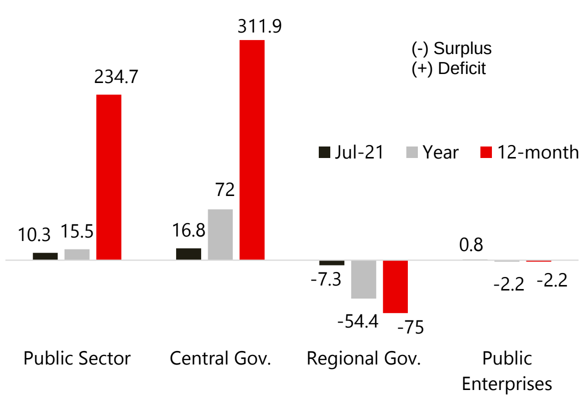
Additionally, according to National Treasury data published on August 30, the central government registered a deficit of BRL19.8 billion in July, above our forecast (BRL12.1 billion) and lower than market median (BRL26.7 billion). The main difference in relation to our forecast (~BRL5 billion) was the disbursements of subsidies. Affected by Covid-related outlays and higher revenues boosted by the price shock, it was the third highest deficit for the month and also the third largest in YTD terms. The highlights on the expenditure side were: (i) anticipation of year-end bonuses for pensioners (~BRL18 billion) and (ii) extraordinary budget related to the pandemic (BRL19.3 billion). In terms of revenue, the result continued to recover due to the price effect (inflation and terms of trade) and extraordinary revenues. During the year, total revenue rose 29.9% YoY, on the heels of positive federal tax collection. Total expenditure dropped 21.4% YoY, driven by lower discretionary spending (-18% YoY in 2021)—currently BRL1.5 billion above the all-time low in 12-month real terms registered in May (BRL103.8 billion). In the 12-month reading, the deficit reached BRL328.8 billion or 3.8% of GDP, reducing from 4.7% of GDP registered in June.

In the coming months, we expect the results to be affected by a rise in discretionary spending, extra-cap (Covid-19) spending and the end of anticipation of the payment of pension (13th bonus payment) for May to July. On the revenue side, we expect positive results, albeit with some softening in the growth compared to the recent months. For 2021, we estimate the central government's primary deficit at ~BRL170 billion (2.0% of GDP), with a positive bias due to higher revenues. We believe that the primary deficit could improve if the effect of the commodity boom is more intense than we currently expect. However, in our view, the extrapolation of positive surprises in federal tax collection continues to demand some caution and we see moderate revenue growth (still positive) ahead. While tax revenues should decelerate during the disinflation process, this process could likely be postponed considering the recent price pressure, especially on electricity prices.

In our view, while the fiscal result was positive in the first seven months of the year, there were some factors (which may be temporary) that helped boost the result on both revenue and expenditure sides. The results occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of budget 2021, sanctioned in April), leading to depressed levels in the 12-month reading. The Covid-19 extraordinary expenditure reached BRL68.7 billion until July, although lower than the value registered until July 2020 (BRL273 billion). On the revenue standpoint, the price effect (higher inflation and favorable terms of trade) continued to "help" the fiscal result and we observed an extraordinary revenue of BRL24 billion in 2021, compared to BRL2.8 billion, which is closely related to corporate restructuring and IPO and M&A activities.

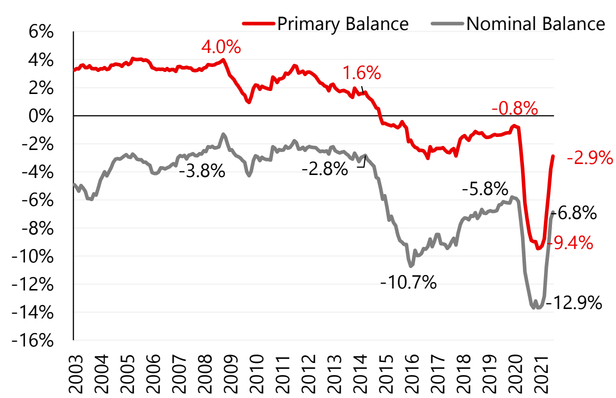
Meanwhile, debt indicators continue to show a marginal decline. Gross debt reached 83.8% of GDP in July, a reduction of 0.1 pp from the June reading — on the heels of an increase in nominal GDP (-0.9 pp of impact). Meanwhile, net debt was 60.3% of GDP, 0.5 pp lower on the same basis of comparison. We expect gross debt to fall this year to 81.6% of GDP, however, assuming a higher nominal GDP (driven by the inflationary shock), and we expect BNDES to repay the Treasury a total of BRL100 billion.

Figure 5 – Primary Result (BRL billion)



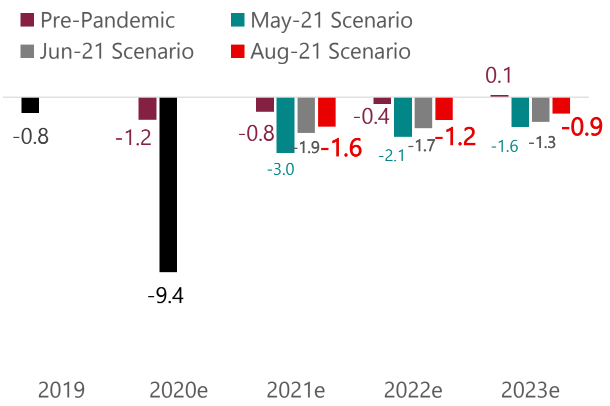
Sources: Brazilian Central Bank, Santander.

Figure 6 – Consolidated Public Sector (12m % GDP)



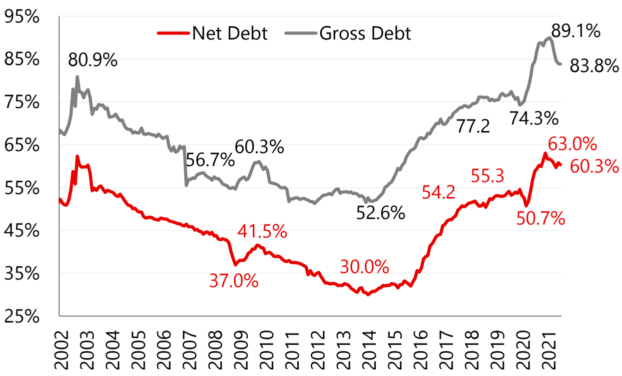
Sources: Brazilian Central Bank, Santander.

Figure 7 – Primary Result Forecast (% GDP)



Sources: Brazilian Central Bank, Santander.

Figure 8 – Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

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