BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

A SURPRISING PRIMARY SURPLUS IN AUGUST

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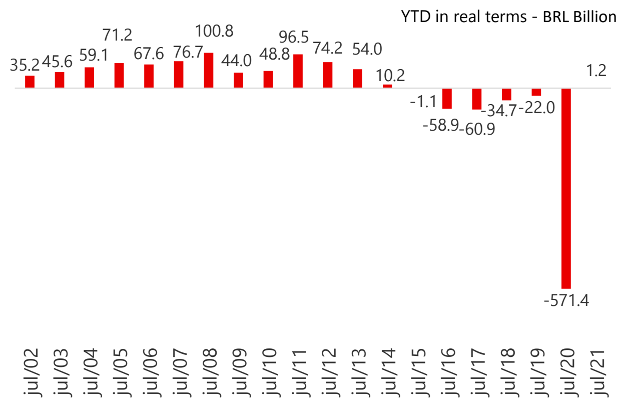
- The consolidated public sector posted a surprising primary surplus of BRL16.7 billion in August, beating our forecast (-BRL2.0 billion) and the market's median estimate (-BRL7.0 billion). This was the best result for August in the historical series. The main surprise was regional governments' primary surplus of +BRL27.3 billion, compared to our estimate of +BRL7.5 billion. This difference is related to the revenue estimate of a public water company concession in Rio de Janeiro state (BRL15 billion) that occurred in April: we had expected a payment in installments throughout the year. This higher revenue (one-off) could imply higher expenditures ahead.
- In YTD terms, with the surprise for regional governments, the public sector result changed to a surplus of BRL1.2 billion (0.02% of GDP) in August, compared to BRL571 billion (11.8% of GDP) in 2020, affected by the massive fiscal stimulus in 2020-21 and BRL21.9 billion (0.45% of GDP) in 2019. Regional governments' surplus continues to register positive primary results, boosted by this one-off concession revenue in August, reaching an all-time high in real terms and as a percentage of GDP.
- For the central government, August's result was result was the best for the month since 2015, "helped" by higher dividends payments (BRL6.5 billion). On the expenditure side: the main highlights were: (i) the extraordinary budget related to the pandemic (BRL15.3 billion); (ii) "normalization" of discretionary expenditures (totaling BRL12 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 13.1% YoY real growth.
- In the coming months, we expect the central government's fiscal results to be affected by higher discretionary spending and the maintenance of extra-cap (Covid-19) spending close to BRL13 billion. On the revenue side, we expect positive results, albeit with some softening of growth compared to recent months.
- In August, we continued to witness a rise in the interest account, which reached BRL46.5 billion in August, compared to BRL34.3 billion in August 2020. The result was affected both by higher inflation numbers and the Selic rate, leading to a rise in the cost of debt. The nominal deficit reached 5.6% of GDP in August, compared to 6.8% in July.
- Debt indicators decreased marginally. Gross debt reached 82.7% of GDP in August, a reduction of 0.4 pp from the July reading — on the heels of the increase in nominal GDP (impact of -1.0 pp). Meanwhile, net debt was 59.3% of GDP, 0.4 pp lower on the same basis of comparison.
- According to our forecasts, the consolidated public sector deficit should likely reach BRL110 billion in 2021 (1.3% of GDP), with a slightly positive bias driven by the recent increase in oil prices and the positive surprise from regional governments.
- We expect gross debt to fall this year to 79.7% of GDP, however, assuming a higher nominal GDP with a 18% increase in 2021 (driven by the price shock). In addition, a reduction of 0.4 pp due to the use of voluntary deposits (which allows the Brazil Central Bank [BCB] to collect excess liquidity reserves, with similar repo remuneration) and reduce repo operations (which increases the country's gross debt), as they are backed by government bonds. Finally, we expect that the BNDES to repay the Treasury a total of BRL100 billion, though we see increasing risks that this could be partially postponed until 2022.

According to data published today by the BCB, the consolidated public sector posted a primary surplus of BRL16.7 billion, beating our forecast (-BRL2.0 billion) and the market's median estimate (-BRL7.0 billion). This was the best result for August in the historical series. In YTD terms, considering the surprising regional governments' results, the public sector primary result changed to a surplus of BRL1.2 billion (0.02% of GDP) in August, compared to a deficit of BRL571 billion (11.8% of GDP) in 2020 for the same period, affected by a massive fiscal stimulus made during the year and -BRL21.9 billion (0.45% of GDP) in 2019.

In the 12-month reading, the primary deficit reached BRL130.3 billion (1.6 % of GDP) in August, compared to BRL234.7 billion (2.9% of GDP) in July, maintaining the downward trajectory after a sharp reduction in the fiscal stimulus comparing 2020 to 2021 (close to 9.0% of GDP summing up both years). 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 BRL110 billion in 2021 (1.3% of GDP). In our view, the primary result could be slightly better if the impact of the commodity boom on revenue is more intense than we currently expect. The recent increase in oil prices and regional governments' results in August imply a slightly positive bias.

In August, we continued to witness an increase in the interest account, which reached BRL46.5 billion in August, compared to BRL34.3 billion for the same month in 2020. The result was affected by higher inflation and a higher Selic rate, leading to a rise in the cost of debt at the margin. The 12-month nominal deficit was BRL466 billion (5.6% of GDP) in August, dropping from BRL558.2 billion (6.8% of GDP) in July. We expect the nominal deficit be close to 5.1% of GDP by the end of the year, yet it should increase to higher than 6.0% of GDP in coming years due to the increased Selic rate.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

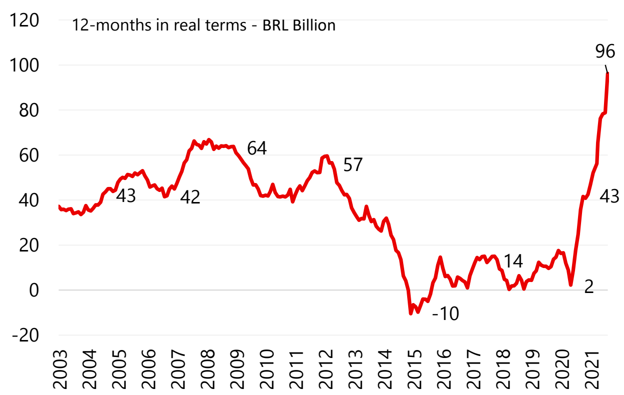
Figure 2 – Nominal Interest Result – BRL billion

Sources: Brazilian Central Bank, Santander.

In August, regional governments continued to show positive primary results (a surplus of BRL27.3 billion compared to a surplus of BRL9.1 billion in August 2020), boosted by fiscal transfers of BRL15 billion. In the month, there was also an elevated one-off revenue (BRL15 billion), regarding a payment of a public water company concession in Rio de Janeiro state that occurred in April. We were considering a payment in installments throughout the year. This higher revenue (one-off) could imply higher expenditures ahead. In addition, 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.

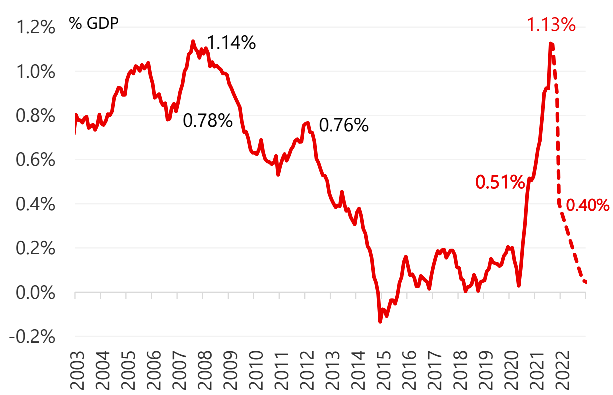
In the YTD reading, regional governments posted a primary fiscal surplus of BRL93.3 billion (1.13% of GDP) and BRL96.2 billion in real terms in the last 12 months, an all-time high. In our view, for now subnational entities should continue to present positive results in the short run. However, in coming periods we believe that regional governments could 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 September 28, the central government registered a deficit of BRL9.9 billion in August, in line with our forecast (BRL9.7 billion) and lower than the market median (BRL14.0 billion). August's result was the best for the month since 2015, "helped" by higher dividends payments (BRL6.5 billion) from an oil company. In YTD terms, it was the best result since 2019, on the heels of a revenue recovery, boosted by the cyclical activity recovery and price shock impact. In the 12-month reading, the deficit reached BRL236.2 billion, or 2.7% of GDP, reducing from BRL328.8 billion or 3.8% of GDP registered in July.

In the month, total revenue rose 13.1% YoY, considering the federal tax collection positive result (boosted by extraordinary revenue and the price effect). Total expenditure dropped 41.2% YoY — though we note that the 2020 comparison base was impacted by massive fiscal stimulus in that year. On the expenditure side: the main highlights were: (i) the extraordinary budget related to the pandemic (BRL15.3 billion), with the largest proportion related to Emergency Aid payments (~BRL8.5 billion); and (ii) the "normalization" of discretionary expenditures (BRL12 billion). Discretionary spending (BRL109 billion in 12 month) increased 27.4% YoY in August and continued to register a drop of 12.6% YoY in YTD terms. This result shows a "normalization" in these outlays after reaching the all-time low registered in May 2021 in 12-month terms reading. It is important to note that up to April, the disbursement was only 1/18 of the budget for these expenses in 2021, as the final budget had not yet been approved.

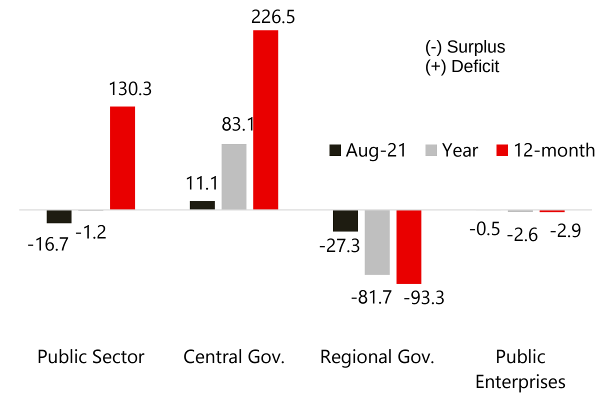
In the coming months, we expect the results to be affected by a rise in discretionary spending and the maintenance of extra-cap (Covid-19) spending close to BRL13 billion. On the revenue side, we expect positive results, albeit with some softening in the growth compared to the recent months. For 2021, we estimate the central government's primary deficit at BRL150 billion (1.7% of GDP), with a slightly positive bias due to higher oil prices that could increase federal revenue. 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 anticipate moderate revenue growth (still positive) ahead. While tax revenue should decelerate during the disinflation process, this process could likely be postponed considering recent price pressure, especially on electricity prices.

In our view, while the fiscal result was positive in the year, surprising our initial forecasts, 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. We expect some payback in these expenditures and repressed demand for public services that could appear from 4Q21 onward. Covid-19-related extraordinary expenditure reached BRL84 billion YTD August, although this amount was lower than the value registered YTD August 2020 (BRL367 billion). Form the revenue standpoint, the price effect (higher inflation and favorable terms of trade) continued to "help" the fiscal result, and we observed extraordinary revenue of BRL29 billion in 2021, compared to BRL2.8 billion in 2020, 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 82.7% of GDP in August, a reduction of 0.4 pp from the July reading — on the heels of an increase in nominal GDP (-1.0 pp of impact). Meanwhile, net debt was 59.3% of GDP, -0.4 pp lower on the same basis of comparison.

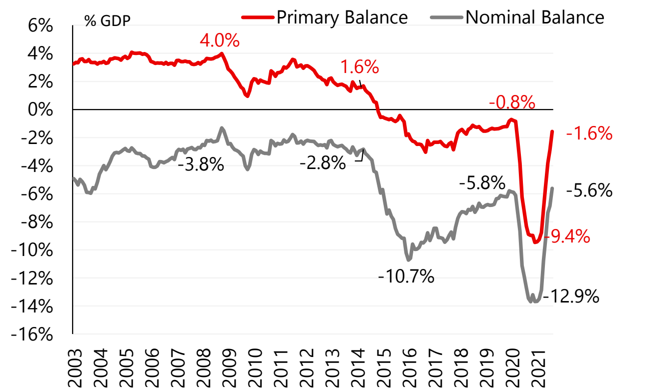
We expect gross debt to fall this year to 79.7% of GDP, however, assuming a higher nominal GDP with a 18% increase in 2021 (driven by the price shock). In addition, a reduction of 0.4 pp, due to the use of voluntary deposits—which allows the BCB to collect excess liquidity reserves (with similar repo remuneration) and reduce repo operations, which increases the country's gross debt, as these are backed by government bonds. Finally, we expect that the BNDES to repay the Treasury a total of BRL100 billion, yet we see increasing risks that this will be partially postponed until 2022.

Figure 5 – Primary Result (BRL billion)



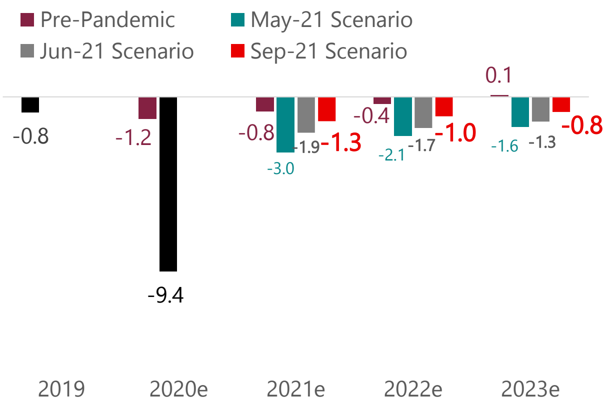
Sources: Brazilian Central Bank, Santander.

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



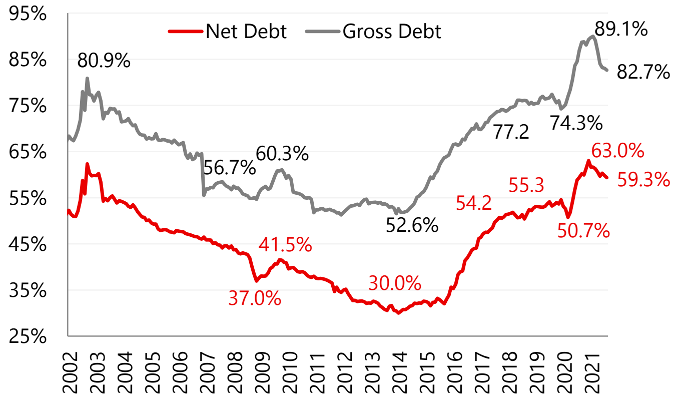
Sources: Brazilian Central Bank, Santander.

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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