BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

BETTER PRIMARY RESULT, HIGHER INTEREST PAYMENTS

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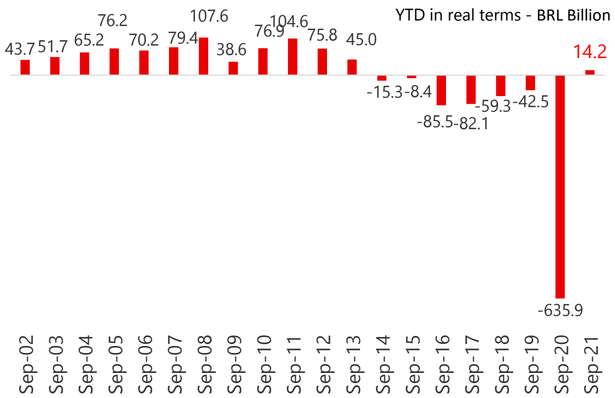
- The consolidated public sector posted a primary surplus of BRL12.9 billion in September, beating our forecast (+BRL6.0 billion) and the market's median estimate (+BRL1.7 billion). This was the best result for September since 2010. The main surprise (again) was regional governments' primary surplus of BRL10.9 billion, compared to our estimate of +BRL7.0 billion.
- In YTD terms, with the positive surprise for regional governments, the public sector achieved a surplus of BRL14.2 billion (0.22% of GDP) in September, compared to a BRL635 billion (11.7% of GDP) deficit in 2020, affected by the massive fiscal stimulus in 2020, and vs. -BRL42.5 billion (-0.7% of GDP) in 2019. The regional governments' surplus continues to register positive primary results, boosted by the one-off concession revenue recorded in August and the inflation effect, reaching an all-time high in real terms and as a percentage of GDP.
- For the central government, September's result was the best for the month since 2012, and it was the first primary surplus for September in nine years. The results continued to be "helped" by the price shock's impact on revenue, and in September we also observed an increase in commodity-related revenue. On the expenditure side, the main highlights were: (i) extraordinary budget item related to the pandemic (BRL13.2 billion); (ii) discretionary expenditures (BRL10.5 billion).
- 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, especially driven by the inflation effect and higher oil prices.
- In September, we continued to witness a rise in the interest account, which reached BRL55.0 billion in the month, compared to BRL38.9 billion in September 2020. The result was affected by both higher inflation numbers and the Selic rate, leading to a rise in the cost of debt. In 12-month terms, the nominal deficit reached 4.8% of GDP in September, compared to 5.6% in August and 6.8% in July.
- Debt indicators registered mixed results. Gross debt reached 83.0% of GDP in September, a rise of 0.3 pp from the August reading—on the heels of the increase in nominal interest payments. Meanwhile, net debt was 58.5% of GDP, 0.8 pp lower on the same basis of comparison, mainly due to a more depreciated FX rate.
- According to our forecasts, the consolidated public sector deficit will likely reach BRL45 billion in 2021 (0.5% of GDP), with a slightly positive bias driven by the recent increase in oil prices and the positive surprise from regional governments. In our view, we cannot rule out a primary surplus this year, given potential further surprises from the effects of inflation, along with higher dividends and tax payments from companies related to the commodity sector. However, we expect higher expenditures next year, implying a higher estimated deficit.
- We expect gross debt to fall this year to 81.2% of GDP, however, assuming higher nominal GDP with an 18% increase in 2021 (driven by the price shock). Finally, we expect the BNDES to repay the Treasury a total of BRL100 billion, though we see increasing risks that part of this payment could be postponed to 2022 or beyond.

According to data published today by the BCB, the consolidated public sector posted a primary surplus of BRL12.9 billion, beating our forecast (+BRL6.0 billion) and the market's median estimate (+BRL1.7 billion). This was the best result for September since 2010. In YTD terms, considering the surprising results for regional governments, the public sector reached a primary surplus of BRL14.2 billion (0.22% of GDP) in September, compared to a deficit of BRL636 billion (11.7% of GDP) in September 2020, affected by a massive fiscal stimulus during that year, and compared to -BRL42.5 billion (0.77% of GDP) in 2019.

In the 12-month reading, the primary deficit reached BRL52.9 billion (0.6% of GDP) in September, compared to BRL130.3 billion (1.6% of GDP) in August, maintaining a downward trajectory after a sharp reduction in the fiscal stimulus in 2021 vs. 2020 (close to 9.4% of GDP summing up both years). Considering all the expenses (even those not considered in the calculus of the fiscal rules—the constitutional spending cap and primary target), we estimate that the consolidated public sector deficit could reach BRL45 billion in 2021 (0.5% of GDP). In our view, we cannot rule out a primary surplus this year, given potential further surprises from the effects of inflation, along with higher dividends and tax payments from companies related to the commodity sector. However, we expect higher expenditures next year, implying a higher estimated deficit. The primary result could be better if the impact of the commodity boom on revenue is more substantial than we currently expect. The recent increase in oil prices and in regional governments' results in September implies a positive bias.

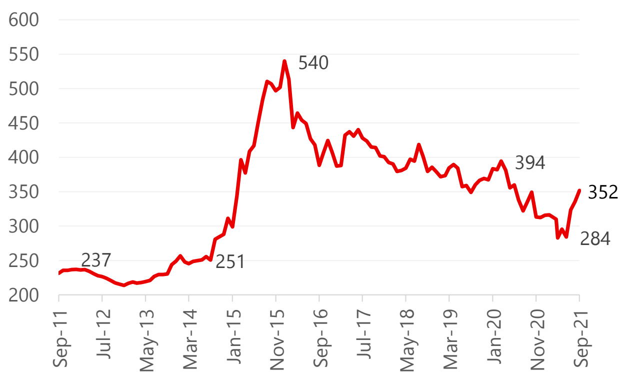
In September, we continued to witness an increase in the interest account, which reached BRL55.0 billion, compared to BRL38.9 billion for the same month in 2020. The result was affected by higher inflation and a higher Selic rate, leading to a rise in the cost of debt at the margin. The 12-month nominal deficit was BRL405 billion (4.8% of GDP) in September, dropping from BRL466 billion (5.6% of GDP) in August. We expect the nominal deficit to be close to 5.5% of GDP by the end of the year, but we estimate it will increase to higher than 8.0% of GDP in the coming years due to the higher Selic rate.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion

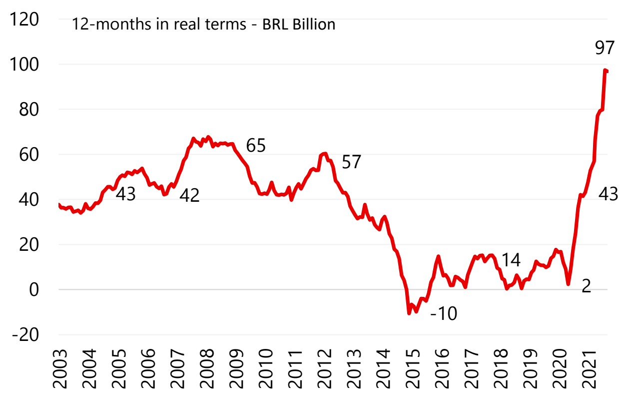


Sources: Brazilian Central Bank, Santander.

In September, regional governments continued to show positive primary results (a surplus of BRL10.4 billion compared to a surplus of BRL9.9 billion in September 2020, although it is worth remembering that the federal government transferred BRL21.3 billion to regional governments in September 2020, boosting the monthly result). Also in September, there was elevated one-off revenue (BRL15 billion) associated with a payment from a public water company concession in Rio de Janeiro state that occurred in April. This higher revenue (one-off) could imply higher expenditures ahead, in our view. In addition, we think the recent results were likely affected by the lagged effects of the 2020-21 fiscal stimulus on local economies, added to the impact of the price shock (terms-of-trade and inflation) on tax collection—and the activity recovery (formal sector) in the last few months.

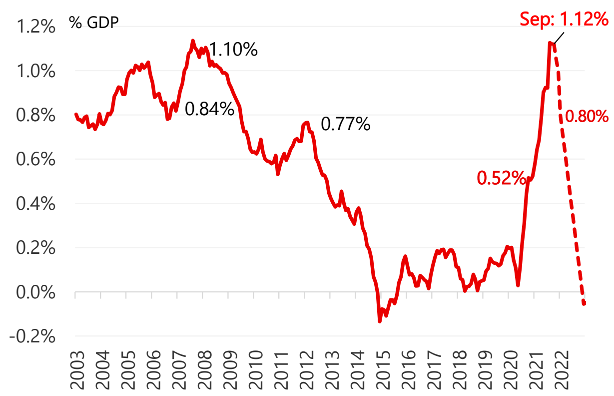
In the YTD reading, regional governments posted a primary fiscal surplus of BRL93.8 billion (1.12% of GDP) and BRL96.9 billion in real terms in the last 12 months, an all-time high. In our view, subnational entities should continue to present positive results in the short run. Our forecast for 2021 is for a surplus of BRL65 billion, but regional governments' surplus could exceed BRL80 billion this year. However, in the coming period 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 October 28, the central government registered a primary surplus of BRL0.3 billion in September, better than our forecast (-BRL4.4 billion) and the market median estimate (BRL6.5 billion). September's result was the best for the month since 2012 and was the first September primary surplus in nine years. The total result reached -BRL82.8 billion in YTD terms (fifth worst in the series since 1997). The 12-month reading is at BRL154.2 billion, or 1.8% of GDP, down from BRL236.2 billion or 2.7% of GDP registered in August.

In the month, total revenue rose 12.9% YoY, reflecting a positive federal tax collection result (boosted by the price effect and oil revenue). Total expenditure dropped 36.4% YoY, although we note that this is in comparison with the massive fiscal stimulus in 2020. Discretionary spending (BRL113 billion in 12 months) showed a 33.7% YoY real increase in September, while again registering a drop of 8.0% YoY in YTD terms. This result shows a "normalization" in these outlays after reaching an all-time low in May 2021 in 12-month terms. It is important to note that until April, the disbursement was only 1/18 of the budget for these expenses in 2021—since the final budget had not been approved. The expenditure (extra-cap) related to the pandemic totaled BRL13.2 billion in September, mostly related to the payment of the Emergency Aid (~BRL8.2 billion).

For 2021, we estimate a central government primary deficit of ~BRL110 billion (1.3% of GDP), with an upward bias related to higher oil prices and higher inflation. We believe that the primary deficit could be even smaller if the effect of the commodity boom is greater than we expect. For 2022, we have increased our primary deficit estimates on the heels of the recent debate regarding the increase in the new welfare program and also due to a compression in the budget for court-ordered debts. There is still considerable uncertainty about the estimates for the coming years, and we believe everything will depend on the impact of the fiscal legislation currently debated in Congress. In any event, we now expect a higher deficit next year compared to 2021.

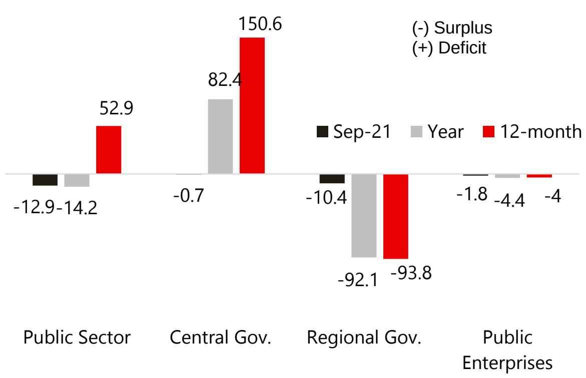
In addition, while we see the fiscal result becoming even more positive in the course of 2021, a surprise relative to our initial forecasts, there were some factors (possibly temporary) that helped boost the result on both the revenue and expenditure sides. The results occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of Budget 2021, approved in April), leading to depressed levels in the 12-month reading. We expect some increase in these expenditures due to the repressed demand for public services that could appear from 4Q21 onward. COVID-19-related extraordinary expenditures reached BRL109 billion YTD in October, although this amount was lower than the value registered YTD in October 2020 (BRL470 billion). We are witnessing demand in Congress for extra expenditures, with the new welfare program, judicial claims, and other expenditures of about BRL70-100 billion for 2022, maintaining part of the fiscal stimulus post-pandemic. From a revenue standpoint, the price effect (higher inflation and favorable terms of trade) continued to "help" the fiscal result, and we observed extraordinary revenue of BRL31 billion through

September, compared to BRL5.3 billion in 2020, which is closely related to corporate restructuring and to IPO and M&A activities. By the end of the year these revenues could surpass BRL40 billion.

Meanwhile, debt indicators showed mixed results. Gross debt reached 83.0% of GDP in September, an increase of 0.3 pp from August’s reading—on the heels of an increase in the interest account (+0.5 pp). Meanwhile, net debt was 58.5% of GDP, 0.8 pp lower on the same basis of comparison, affected by a more depreciated FX rate (-0.9 pp of impact).

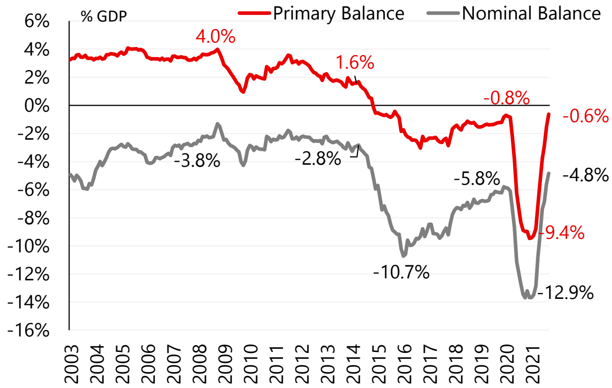
We expect gross debt to fall this year to 81.2% of GDP, however, assuming higher nominal GDP with an 18% increase in 2021 (driven by the price shock). Finally, we expect the BNDES to repay the Treasury a total of BRL100 billion, but we see increasing risks that part of this will be postponed to 2022 or beyond.

Figure 5 – Primary Result (BRL billion)



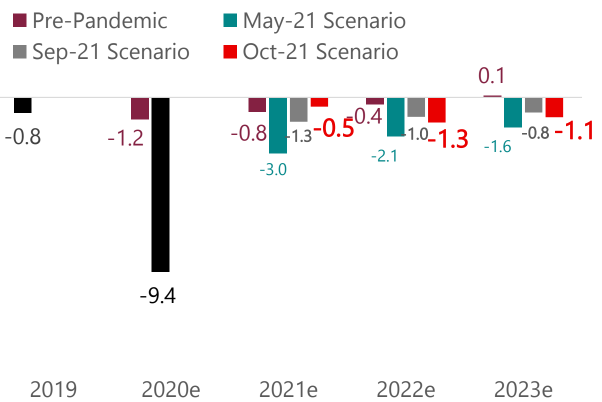
Sources: Brazilian Central Bank, Santander.

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



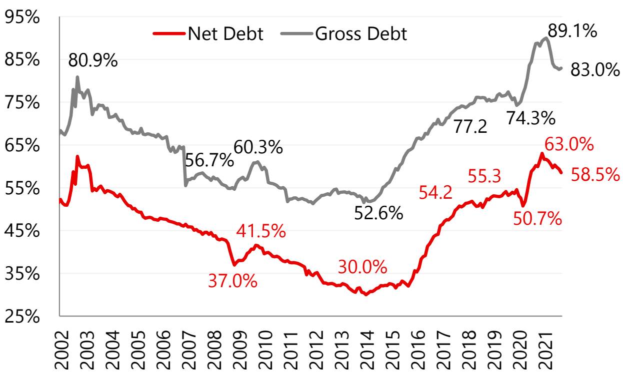
Sources: Brazilian Central Bank, Santander.

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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