BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

Ítalo Franca*
italo.franca@santander.com.br
+5511 3553 5235

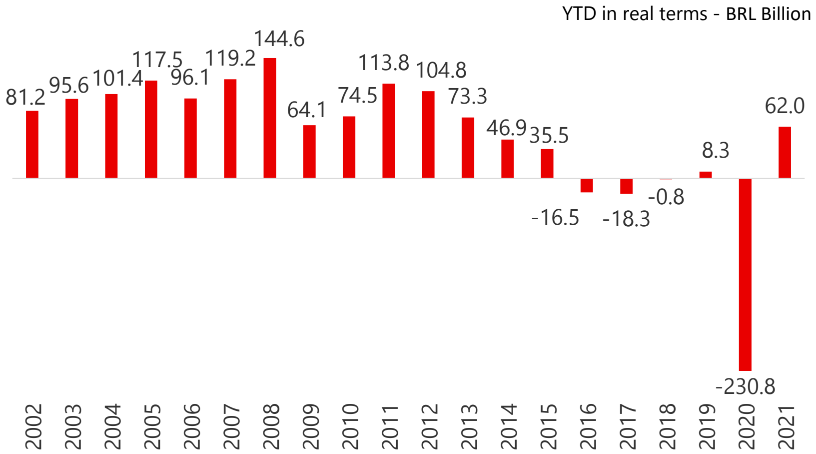
ANOTHER SET OF RESULTS BOOSTED BY PRICE SHOCK

- The consolidated public sector posted a primary deficit of BRL15.5 billion in May, better than our forecast (-BRL17.5 billion) and the market's median estimate (-BRL18.5 billion). In YTD terms, the results of the public accounts were positive (better than our and the market's expectations), showing the best numbers since 2013 in real terms. Surplus of regional governments continues to surprise positively, reaching an all-time high in YTD real terms.
- This result occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of budget 2021), leading to an all-time low in the 12-month reading. The price effect (higher inflation, favorable terms of trade and FX depreciation) also helped the fiscal result from the standpoint of revenue.
- In light of this, we recently reviewed our fiscal scenario in a report (*Fiscal Accounts: Pandemic Impact, Price Shock Contribution, and Outlook,* published June 15) on the heels of a positive revenue. In our view, extrapolating the last positive surprises for the full year continues to demand some caution. On the expenditure side, it is worth mentioning that expenses are expected to increase in the coming months, especially disbursements to mitigate Covid-19 effects (not considered for the spending cap rule), and the "normalized" outlays flow with the sanction of the 2021 budget in the end of April.
- In addition, after the budgetary deadlock seen in 2021 and with discretionary spending at minimum levels, we believe strict fiscal discipline will be important in order to comply with the spending cap rule.
- Debt indicators continue to show a decline with the year's primary surplus and an increase in nominal GDP. Gross debt reached 84.5% of GDP in May, a reduction of 1.1 pp from the April reading — on the heels of the increase in nominal GDP (-1.5pp of impact). Meanwhile, net debt was 59.7% of GDP, 0.1 pp lower on the same basis of comparison.
- According to our forecasts, the consolidated public sector deficit should reach BRL165 billion in 2021 (1.9% of GDP). We expect gross debt to fall this year to 82.2% of GDP, however, assuming a higher nominal GDP (driven by the inflationary 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 BRL15.5 billion, better than our forecast (-BRL17.5 billion) and the market's median estimate (-BRL18.5 billion). In the accumulated result for the year, the consolidated public sector registered a surplus of BRL62.0 billion in real terms, compared to a deficit of BRL231 billion in the same period of 2020, mainly due to the massive fiscal stimulus last year. The emergency aid stipend this year was BRL8.9 billion in May, compared to BRL41 billion in 2020. It was the best result for the period in the BCB series since 2013 (see Figure 1).

The primary deficit reached BRL428.6 billion (5.4% of GDP) in the 12-month reading. The consolidated government's primary target for the year is currently at BRL250 billion (3.0% of GDP). However, we think it is important to note that ~BRL70 billion in expenses will not be considered in the official calculation of the primary target for the central government result, as is legally permitted by recently approved laws (*PEC emergencial* and PLN2/2021). The 12-month nominal deficit was BRL724 billion (9.1% of GDP). We expect the nominal deficit be close to 6.3% of GDP by the end of the year. Additionally, 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 BRL165 billion in 2021 (1.9% 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 expect. In our view, extrapolating the last positive revenue surprise for the full year continues to demand some caution. See details in the link[1].

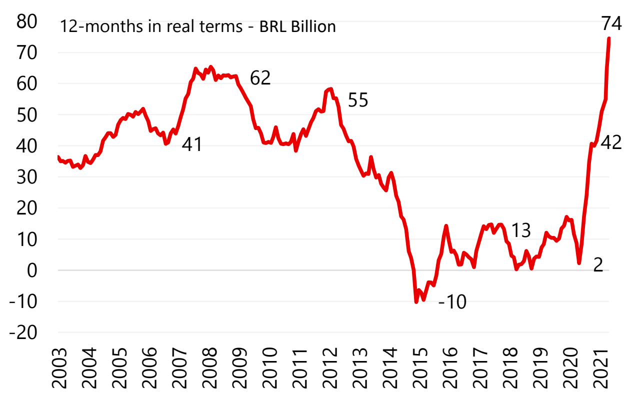
Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

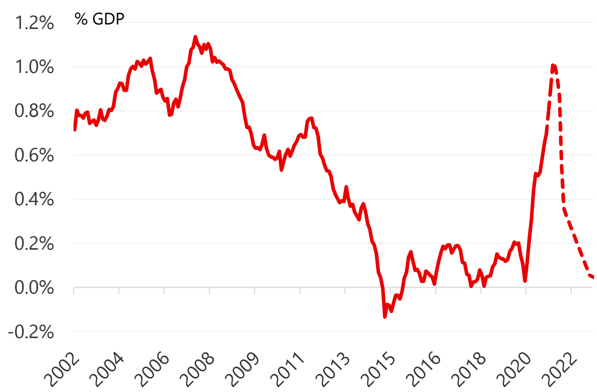
Although the fiscal result was quite positive in the first five months of the year, there are some factors (which may be temporary) that have helped to boost the fiscal result so far. The results occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of budget 2021), leading to an all-time low in the 12-month reading. In May, the regional governments' results were positive surprise again (+BRL5.2 billion compared to a deficit of -BRL4.8 billion in May 2020), probably affected by the lagged effects of the 2020-21 fiscal stimulus on local economies, added to the effect of the inflation shock on tax collection—and the activity recovery in the last few months. In the YTD reading, regional governments posted a primary fiscal surplus of BRL38.6 billion (1.1% of GDP) and BRL74.5 billion in 12 months, the all-time high. In our view, for now the subnational entities should continue to present a positive result in the short run. Yet, 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 2 – Regional Governments – Primary Result



Sources: Brazilian Central Bank, Santander.

Figure 3 – Regional Governments – Primary Result



Sources: Brazilian Central Bank, Santander.

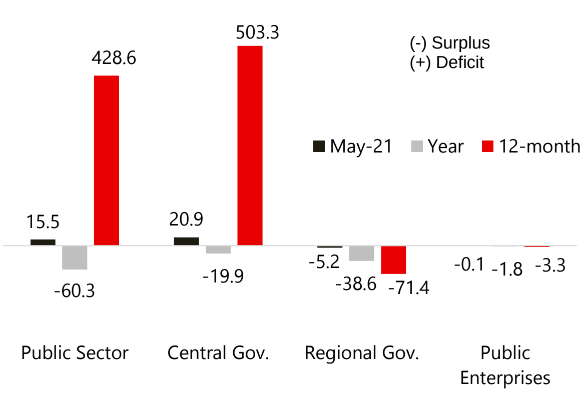
[1] **Santander Brazil Fiscal Policy -** ***"Fiscal Accounts: Pandemic Impact, Price Shock Contribution, and Outlook"*** **–** June 15, 2021 - Available on: http://bit.ly/Std-special-fiscal-061521

Additionally, according to the National Treasury data published on June 30, the central government posted a primary deficit of BRL20.9 billion in May, better than our forecast and the market's median estimate, both at -BRL22.4 billion. In YDT data, it was the best primary result since 2014 for the period. During the period, total revenue rose 24.7% YoY, considering the positive result of federal tax collection (boosted by terms of trade, inflation and FX depreciation), a depressed basis of comparison due to the pandemic, and extraordinary revenue. The total expenditure dropped 17.3% YoY (-31.4% YoY in May). On the expenditure side, a key factor was the lower level of discretionary spending (-30.7% YoY in the year)—currently at the all-time low in 12-month nominal terms (BRL102 billion). In 12-month reading, the deficit reached BRL535 billion (6.3% of GDP).

In the coming months, we expect the central government fiscal results to be affected by the increase in discretionary spending (with the 2021 budget sanctioned), higher extra-cap (Covid-19) spending (more than BRL13 billion) and anticipation of the payment of pension (13th bonus payment) for May to July. On the revenue side, it will be important to note the use of the tax credit and the impact of inflation on federal tax collection, and we see some moderation in revenue growth (still positive) ahead. For 2021, we estimate a central government primary deficit of BRL195 billion (2.3% of GDP). In addition, after the budgetary deadlock we have seen in 2021 and with discretionary spending at minimum levels, we believe strict fiscal discipline will be important in order to comply with the spending cap rule.

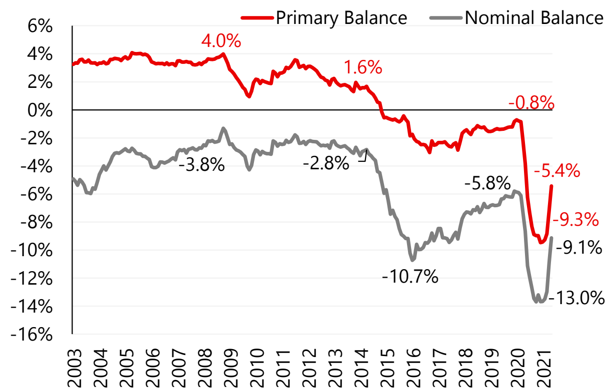
Meanwhile, debt indicators continue to show a decline with the year's primary surplus and an increase in nominal GDP. Gross debt reached 84.5% of GDP in May, a reduction of 1.1 pp from the April reading — on the heels of the increase in nominal GDP (-1.5 pp of impact). Meanwhile, Net debt was 59.7% of GDP, 0.1 pp lower on the same basis of comparison We expect gross debt to fall this year to 82.2% of GDP, however, assuming a higher nominal GDP (driven by the inflationary shock), and we expect that the BNDES will repay the Treasury a total of BRL100 billion.

Figure 4 – Primary Result (BRL billion)



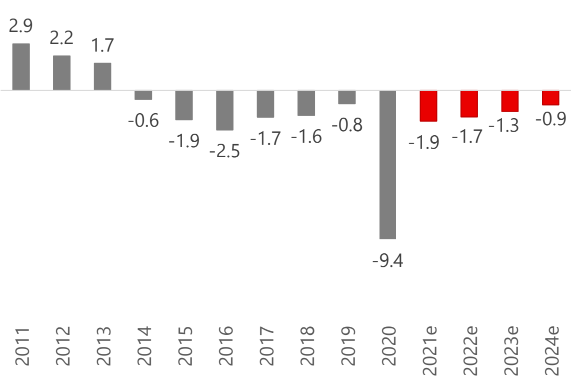
Sources: Brazilian Central Bank, Santander.

Figure 5 – Consolidated Public Sector (12m % GDP)



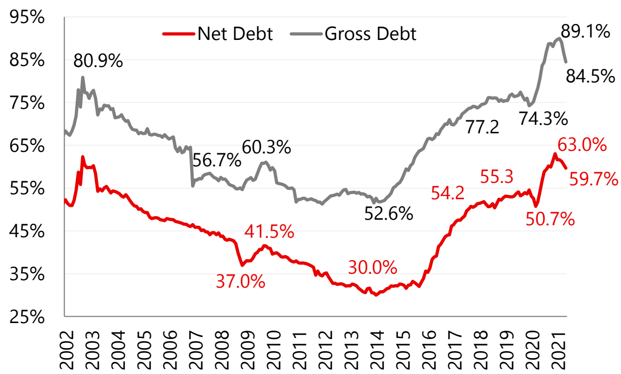
Sources: Brazilian Central Bank, Santander.

Figure 6 – Primary Result Forecast (% GDP)



Sources: Brazilian Central Bank, Santander.

Figure 7 – Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research			
Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327
Global Macro Research			
Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500
Fixed Income Research			
Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778
Equity Research			
Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511 3553 1684

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