Santander
Macroeconomic Research

BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

POSITIVE SEASONAL PRIMARY SURPLUS IN OCTOBER

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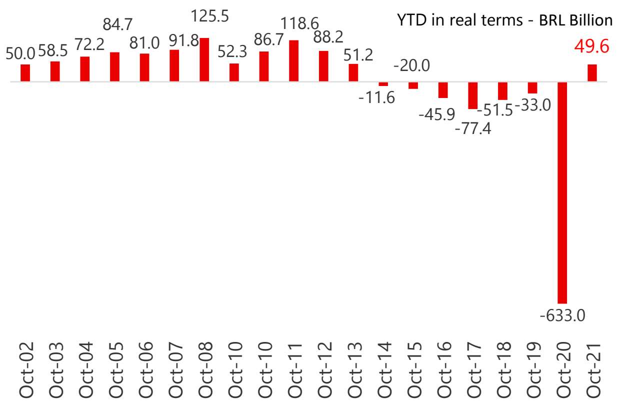
- The consolidated public sector posted a primary surplus of BRL35.4 billion in October, a tad lower than our forecast (BRL37.5 billion) and close the market's median estimate (BRL35.0 billion). This was the best result for October since 2016. The regional governments' primary posted a primary surplus of BRL6.6 billion, lower than our estimate of +BRL7.5 billion, with a possible sign of a slowdown in domestic activity.
- In YTD terms, the public sector result reached a primary surplus of BRL49.6 billion (0.7% of GDP) in October, compared to a BRL633 billion (10.4% of GDP) deficit in October 2020, affected by the massive fiscal stimulus in 2020, and -BRL33.0 billion (-0.5% of GDP) in 2019. The main surprise this year is the regional governments' surplus, reaching an all-time high in real terms and as a percentage of GDP, this result could lead the public sector to register a slight primary surplus in 2021.
- For the central government, October's result was the best for the month since 2016. The results continued to be "helped" by the price shock's impact on revenue and extraordinary revenue. On expenditure side: the main highlights were: (i) extraordinary budget related to the pandemic (BRL12.1 billion); and (ii) discretionary expenditures (BRL11.6 billion).
- In October, we continued to witness a rise in the interest account, which reached BRL60.4 billion in the month, compared to BRL33.9 billion in October 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 4.7% of GDP in October, compared to 4.8% of GDP in September and 5.6% in August.
- Gross debt remained flat at 82.9% of GDP, with the effects of the rise in interest payments being offset by a higher nominal GDP. Meanwhile, net debt dropped to 57.6% of GDP, 1.0 pp lower than September, affected by a more depreciated FX rate (-0.6 pp of impact).
- According to our forecasts, the consolidated public sector deficit will likely reach BRL25 billion in 2021 (0.3% 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 (especially the oil-sector).
- However, we believe that the 2021 positive result could be short-lived, due to the fact that the disinflation process (currently at 10.7% in 12-months) and the convergence to the center target tends to slow down revenue growth. In addition, our numbers highly depend on the duration maintenance of the commodity boom, which we see as temporary. On the expenditure side, a good deal of mandatory outlays is indexed to inflation, with the spike seen in the subsequent year, and also the change in the current fiscal framework with the possible approval of *PEC dos Precatórios*, to allow more expenditures for 2022 onward.
- 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 ~BRL100 billion, already ~BRL60 billion was repaid until October, and the remaining values are expected to be paid in November.

According to data published today by the BCB, the consolidated public sector posted a primary surplus of BRL35.4 billion in October, a tad lower than our forecast (BRL37.5 billion) and close to the market's median estimate (+BRL35.0 billion). This was the best result for October since 2016. In YTD terms, considering the results for regional governments, the public sector reached a primary surplus of BRL49.6 billion (0.7% of GDP) in October, compared to a deficit of BRL633 billion (10.4% of GDP) in October 2020, affected by a massive fiscal stimulus during that year, and compared to -BRL33.0 billion (0.5% of GDP) in 2019.

In the 12-month reading, the primary deficit reached BRL20.4 billion (0.4% of GDP) in October, compared to BRL52.9 billion (0.6% of GDP) in September, maintaining a downward trajectory after a sharp reduction in the fiscal stimulus in 2020 vs. 2021 (close to 9.4% of GDP summing up both years). We estimate that the consolidated public sector deficit could reach BRL25 billion in 2021 (0.3% 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 see a potential increase in expenditures in coming years due to the inflation-effect and the possible approval of *PEC dos Precatórios*, which will allow an increase in expenditures, this will imply in a with a higher deficit estimate. The primary result could be better if the impact of the commodity boom on revenue is more substantial than we currently expect. There is also a relevant uncertainty in year-end expenditures execution, especially those related to the new welfare program, which depends on the constitutional amendment approval. In other words, part of the expenditures could be postponed, improving the 2021 primary result.

In October, we continued to witness an increase in the interest account, which reached BRL60.4 billion, compared to BRL33.9 billion for the same month in 2020 and BRL20.3 billion registered in October 2019. 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 BRL398.7 billion (4.7% of GDP), dropping from BRL405 billion (4.8% of GDP) in September. We expect the nominal deficit to be close to 5.4% of GDP by the end of the year, yet it should increase to higher than 9.0% of GDP in 2022 due to the higher Selic rate estimates.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

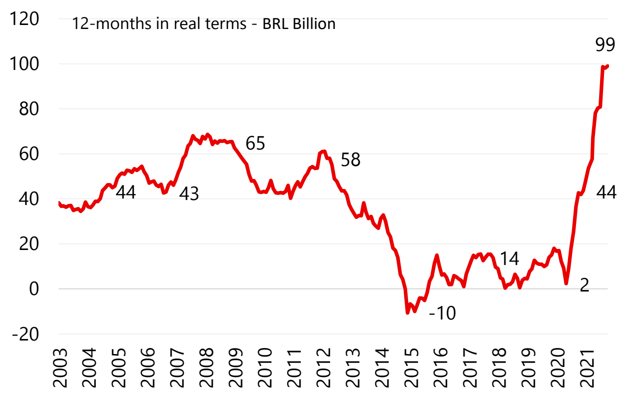
Figure 2 – Nominal Interest Result – BRL billion

Sources: Brazilian Central Bank, Santander.

In October, regional governments continued to show positive primary results (a surplus of BRL6.6 billion compared to a surplus of BRL5.2 billion in October 2020, although it is worth remembering that the federal government transferred BRL3.6 billion to regional governments in this month, boosting the monthly result). 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. More recently the effect of energy prices boosted the revenue. On the other hand, we see some sings of a showdown in the domestic activity and the regional government revenue.

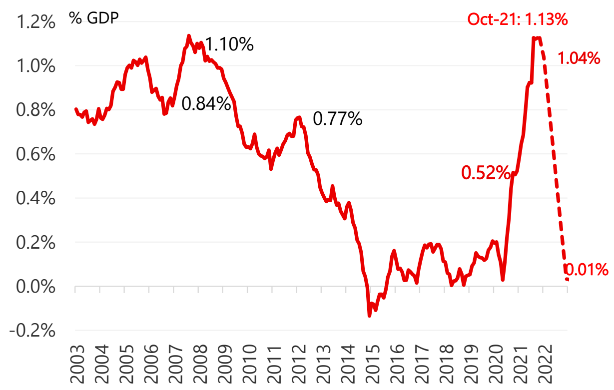
In the YTD reading, regional governments posted a primary fiscal surplus of BRL98.8 billion (1.39% of GDP) and BRL99.0 billion in real terms in the last 12 months, an all-time high. In our view, subnational entities should continue to present positive results in the short run. Our forecast for 2021 is for a surplus of BRL85 billion. However, in the coming months 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 November 29, the central government registered a seasonal primary surplus of BRL28.2 billion in October, a tad better than our forecast (BRL26.7 billion) and the market median estimate (BRL25.8 billion). October's result was the best for the month since 2016. The total result reached -BRL53.4 billion in YTD terms. The 12-month reading continued to decrease, now at BRL123.2 billion or 1.4% of GDP, from BRL154.2 billion or 1.8% of GDP registered in September.

In the month, total revenue rose 7.6% YoY, reflecting a positive federal tax collection result (boosted by the price effect and oil revenue) and extraordinary revenue. In October, there was also revenue from airport concessions in the amount of BRL3.0 billion, which was the main difference to our forecast. Total expenditure dropped 15.4% YoY, although we note that this is in comparison with the massive fiscal stimulus in 2020. Discretionary spending (BRL117 billion in 12 months) showed a 41% YoY real increase in October, while again registering a drop of 3.7% 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 BRL12.1 billion in October, mostly related to the payment of the Emergency Aid (~BRL8.0 billion).

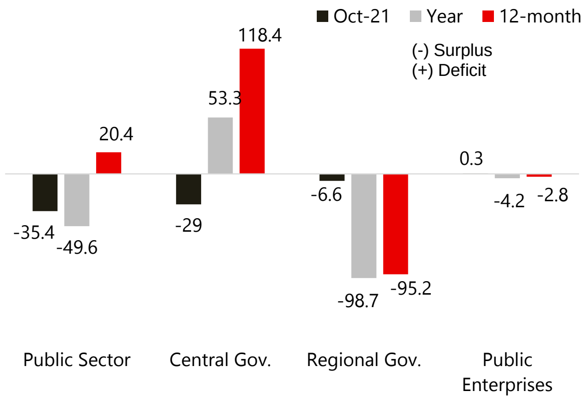
For 2021, we estimate a central government primary deficit of ~BRL110 billion (1.3% of GDP), with an positive bias related to higher oil prices and higher inflation. We believe that the primary deficit could be even smaller if the effect of the commodity boom is greater than we expect. For 2022, we have increased our primary deficit estimates on the heels of the recent debate regarding the increase in the new welfare program, a change in the constitutional spending cap index (to allow more expenditures) and also due to a compression in the budget for court-ordered debts. In our view, there will be a fiscal margin for new expenditures of BRL120 billion if the *PEC dos Precatórios* is approved in its current version. 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. We are witnessing demand in Congress for extra expenditures, with the new welfare program, judicial claims, and other expenditures of about BRL100-120 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 BRL36 billion through October, 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, this revenue could surpass BRL40 billion.

Regarding the debt statistics, gross debt remained at 82.9% of GDP in October, with the effects of the rise in interest payments (+0.6pp impact) being offset by a higher nominal GDP (-0.9pp of impact). Meanwhile, net debt was 57.6% of GDP, 1.0 pp lower on the same basis of comparison, affected by a more depreciated FX rate (-0.6 pp of impact).

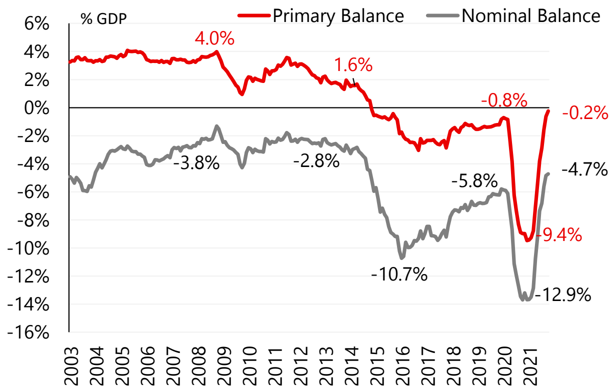
We expect gross debt to fall this year, however, to 81.2% of GDP, assuming higher nominal GDP with an 18% increase in 2021 (driven by the price shock). Finally, we expect the BNDES to repay the Treasury a total of BRL100 billion.

Figure 5 – Primary Result (BRL billion)



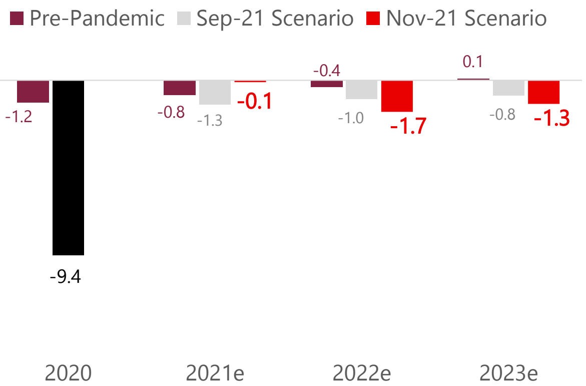
Sources: Brazilian Central Bank, Santander.

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



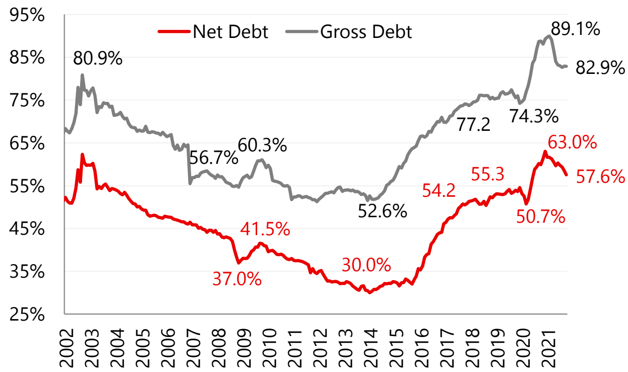
Sources: Brazilian Central Bank, Santander.

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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