Santander Macroeconomic Research

BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

SIX YEARS OF DEFICIT IN ONE

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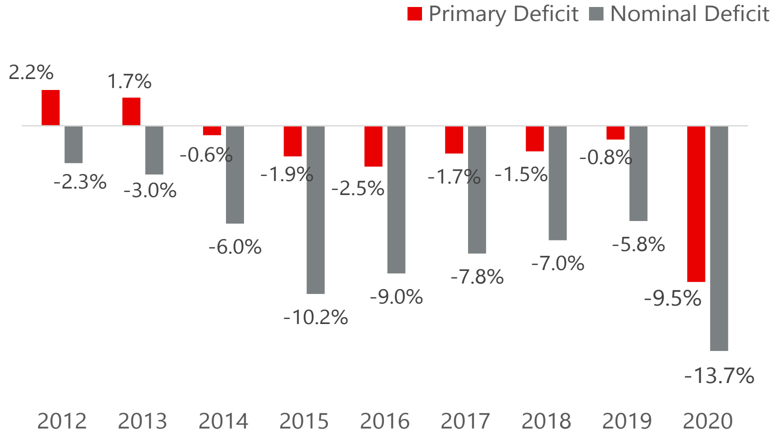
- According to data published today by the BCB, the consolidated public sector posted a full-2020 deficit of BRL703 billion (9.5% of GDP), close to our most recent forecast of a deficit of BRL705 billion (9.5% of GDP) and compared with a deficit of BRL61.9 billion (0.84% of GDP) in 2019.
- The deficit is at an all-time high, meaning an unprecedented deterioration in government finances. The year 2020 was the seventh consecutive year with a deficit, and 2020's deficit is higher than the sum of the six previous years (BRL580.3 billion).
- The nominal deficit was above BRL1.0 trillion (13.7% of GDP), ending 2020 above the previous peak (2015: 10.2% of GDP) since 2002 in the BCB series.
- Gross debt reached 89.3% of GDP in December 2020, an increase of 15.0 percentage points from the end of 2019. Meanwhile, net debt reached 63.0% of GDP, 8.5 percentage points higher on the same basis of comparison.
- According to our forecasts, the deficit should decrease to BRL250 billion in 2021 (3.1% of GDP) – meaning a (rather risky) return to gradual fiscal consolidation after the massive stimulus of 2020. We expect gross debt to remain virtually stable, however, assuming that the BNDES will repay the Treasury BRL100 billion and also that the government will comply with the spending cap.

Government finances registered an unprecedented deterioration in 2020, affected by the fiscal stimulus due to the pandemic. The stimulus ended the year close to 7.5% of GDP (more than double emerging countries' average, 3.4% of GDP). This makes 2020 the seventh consecutive year with a primary deficit, and 2020's deficit (BRL703 billion) is higher than the sum of the six previous years (BRL580.3 billion).

Figure 1 – Consolidated Public Sector Result (% GDP)



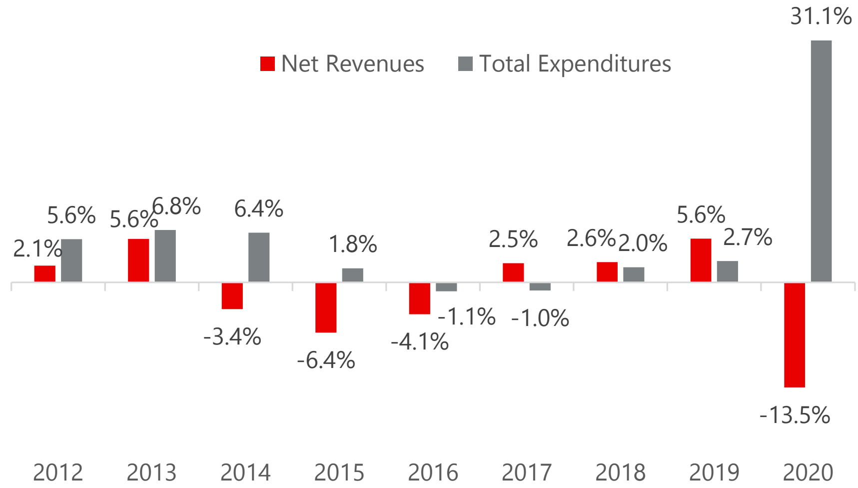
Sources: Brazilian Central Bank, Santander.

Despite the large deficit for the year, the final figures were below the projections made in 3Q21, which were of a deficit close to BRL880 billion. This was due to a recovery in revenue, driven by the better performance of economic activity and the payment of taxes that had been deferred early in the pandemic.

On the expenditure side, COVID-related expenses (i.e., the so-called war budget) ended 2020 below expectations. Total spending totaled BRL539.4 billion, below the BRL605 billion that had been budgeted (with a more conservative stance on the spending side at the end of 2020). Yet part of that budget will still be executed in 2021, such as BRL20 billion for the purchase of vaccines, already accounted for in the 2021 Budget Guidelines Law (LDO).

In 2020, the central government's total net revenue decreased 13.5%, while total expenses jumped 31.1% (+3.5% without considering COVID-related expenses), according to the National Treasury data published on January 28.

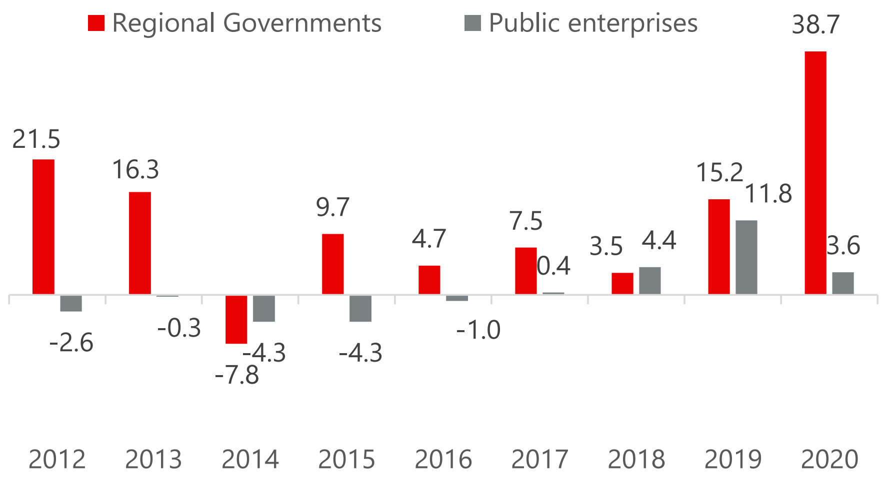
Figure 2 – Central Government Result (annual change - %)



Sources: National Treasury, Santander.

In contrast, the BCB numbers show a relatively "better" performance from subnational entities (in comparison with the central government) year to date. In the full year reading, the regional governments posted a primary fiscal surplus of BRL38.7 billion (0.52% of GDP). In our view, this result was probably affected by the impact of emergency aid on local economies (totaling BRL293 billion in 2020) – which improved tax collection – and transfers from the central government to offset the decline in tax collection (~BRL80 billion). Public enterprises posted a primary fiscal surplus of BRL3.6 billion (0.05% of GDP).

Figure 3 – Primary Balance (BRL billion)



Sources: Brazilian Central Bank, Santander.

Given the considerable headwinds for the economy and tax collection, we expect a deterioration in the fiscal position of subnational entities – particularly states and municipalities – in 2021. Subnational entities will face the challenge of reestablishing fiscal equilibrium after these fiscal stimuli are over, in our view.

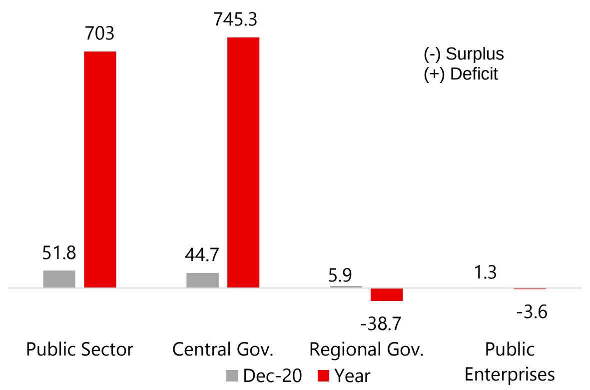
In addition, gross debt reached 89.3% of GDP in October (see Figure 7), an increase of 15.0 percentage points from the end of last year. Despite being below our forecast made in 3Q20 of 95.8% of GDP, almost 4.0 percentage points was due to higher nominal GDP (the IBGE GDP revision and higher deflator). The remainder was mainly due to the lower-than-expected primary result.

Meanwhile, net debt reached 63.0% of GDP, 8.5 percentage points higher on the same basis of comparison. We expect both to continue deteriorating in the coming months – although at a slower pace.

The year 2020 represented an unprecedented deterioration in government finances – six years of deficit in one. The outlook remains challenging in 2021, in our view. In 1H21 we expect some moderation in the recent recovery of tax collections (although we anticipate they will be higher than in 1H20), considering the end of the fiscal stimulus and possible impact of the increase in COVID-19 cases, which may translate into some softening in real activity and tax proceeds. On the other hand, we expect that expenses will be significantly lower than in 2020.

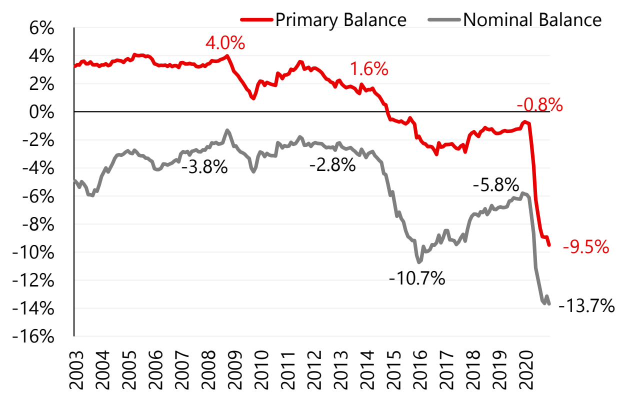
According to our forecasts, the deficit should decrease to BRL250 billion in 2021 (3.1% of GDP) – meaning a (rather risky) return to gradual fiscal consolidation after the massive stimulus of 2020. We expect gross debt to remain virtually stable, however, assuming that the BNDES will repay the Treasury BRL100 billion, and assuming compliance with the spending cap without creating permanent new expenses while failing to curb others.

Figure 4 – Primary Result (BRL billion)



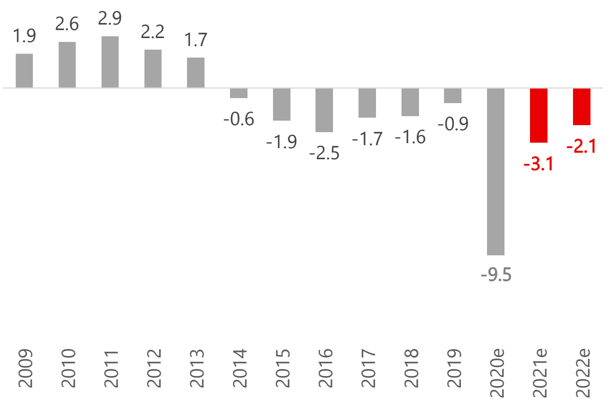
Sources: Brazilian Central Bank, Santander.

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



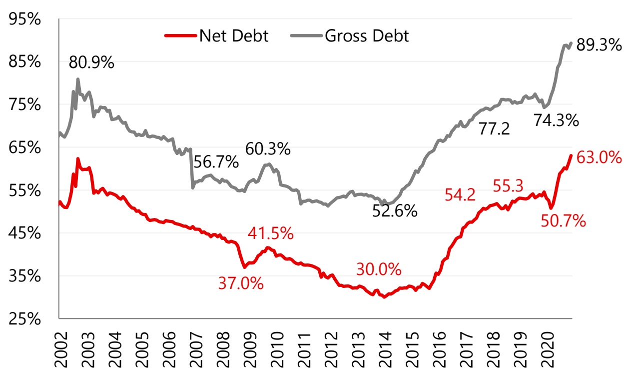
Sources: Brazilian Central Bank, Santander.

Figure 6 – Primary Result Forecast (% GDP)



Sources: Brazilian Central Bank, Santander.

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



Sources: Brazilian Central Bank, Santander.

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