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BRAZIL: FISCAL POLICY

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Consolidated Public Sector: Another "Yearly" Deficit in August

August's fiscal performance was slightly better than expected, yet the numbers continue to show a substantial impact on government finances from the COVID-19 crisis. The figures reinforce our forecast that the 2020 public sector primary fiscal deficit will amount to 12.6% of GDP, leading the gross general government debt to nearly 96% of GDP, on the heels of massive spending measures, deferrals of tax payments, as well as a cyclical revenue downturn.

According to data published today by the BCB, the public sector posted a primary budget deficit of BRL87.6 billion in August (see Figure 1A), relatively close to our forecast (BRL90.7 billion) and better than market consensus (BRL98.0 billion). The main surprise was in the Regional Governments result that posted a surplus of BRL9.1 billion, probably impacted by the emergency aid effects on local economies (totaling BRL45.3 billion in August)—improving tax collection—and transfers from the Union to compensate the fall in tax collection (BRL15 billion in August).

The consolidated primary balance headline for August 2020 compares with a full-2019 gap of BRL61.9 billion (0.9% of GDP). It is the fifth consecutive result that the monthly deficit is higher than a full year in recent years. So far in 2020, the public sector's primary fiscal balance is negative in BRL 571.4 billion (12.2% of GDP), the worst mark in the entire historical series. The 12-month primary deficit also points in the same direction, standing at BRL611.3 billion (8.5% of GDP), the lowest balance ever recorded. (See Figure 2A.)

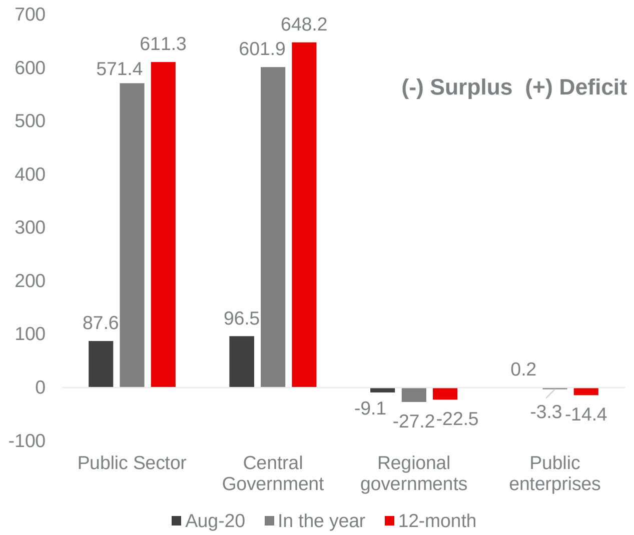
The BCB numbers show a relatively "better" performance from subnational entities (in comparison with the central government) year to date. Altogether, regional governments post a primary fiscal surplus of BRL22.5 billion (0.31% of GDP) over the last 12 months. Government-owned firms posted a primary fiscal surplus of BRL14.4 billion (0.20% of GDP) for the last 12 months. Given the considerable headwinds for the economy and tax collection, we expect a deterioration of the fiscal position of subnational entities—particularly states and municipalities—in coming months. The subnational entities should face a challenge of reestablishing fiscal equilibrium after these fiscal stimuli is over.

Year to date, BCB calculations indicate that the central government's primary fiscal deficit stands at BRL601.9 billion (12.8% of GDP), by far the worst-ever first half of the year for the fiscal accounts since the series 1997 inception. Before 2020, the worst primary balance for first half of the year had been in 2017 (-1.7% of GDP). In 12 months, the central government's fiscal gap (from the standpoint of the BCB estimates) is now BRL648.2 billion, or 9.0% of GDP, also the worst number on record.

In addition, the gross debt reached 88.8% of GDP in August (see Figure 2B), an increase of 13.0 percentage points from the end of last year. Meanwhile, net debt rose to 60.7% of GDP, 5.0 percentage points higher on the same basis of comparison. Both are expected to continue deteriorating in the coming months.

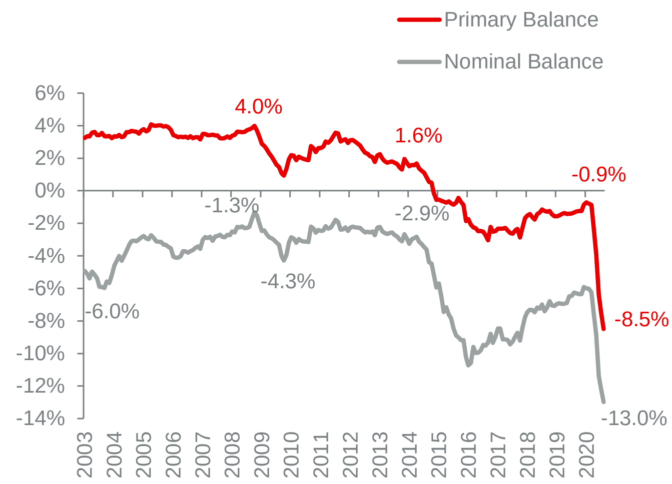
The massive government measures to mitigate the economic and sanitary impact of the outbreak of COVID-19 continue to deteriorate Brazilian fiscal accounts. The primary deficit and debt continue to increase, owing to the extension of the emergency measures. We believe that the massive fiscal stimulus will be temporary, but that the risk of creating new mandatory spending has increased significantly, which could undermine the fiscal consolidation framework. In order to return to the gradual fiscal adjustment is important to comply to the spending cap constitutional amendment from 2021 onwards. To comply to the rule and curb mandatory expenses is essential to approve fiscal reforms.

Figure 1A. Primary Result - (BRL bn) GDP)



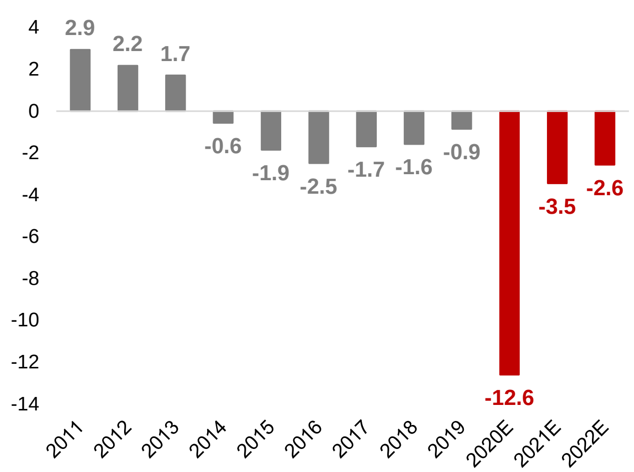
Sources: BCB and Santander

Figure 1B. Consolidated Public Sector - (12m % GDP)



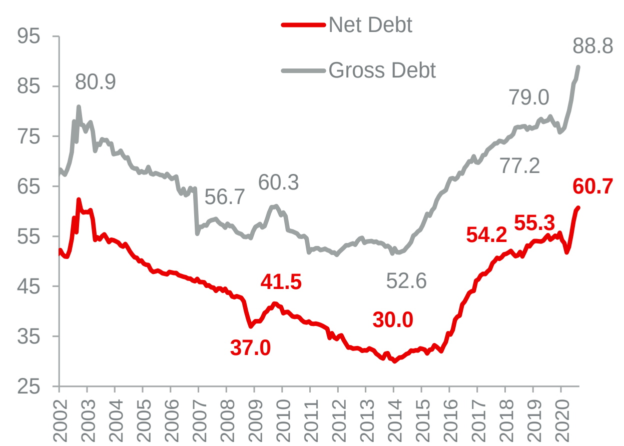
Sources: BCB and Santander

Figure 2A. Primary Result Forecast (% GDP)



Sources: BCB and Santander forecast

Figure 2B. Public Sector Debt (12m % GDP)



Sources: BCB and Santander

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