

BRAZIL: FISCAL POLICY**Consolidated Public Sector: Another “Yearly” Deficit in September**

Ítalo Franca*
italo.franca@santander.com.br
(+55 11) 3553 5235

September's fiscal performance was better than expected (due to a surprise in the regional governments result). This was the first month with the reduction in the emergency aid stipend (first month with BRL300 per beneficiary), 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 12.4% of GDP, leading gross general government debt to nearly 95% of GDP, on the heels of massive spending measures, deferrals of tax payments, and use of tax credit, as well as a cyclical revenue downturn.

According to data published today by the BCB, the public sector posted a primary budget deficit of BRL64.6 billion in September (see Figure 1a), relatively better than our forecast (BRL71.4 billion) and the market consensus (BRL70.0 billion). The main surprise was in the regional governments result, which posted a surplus of BRL10.0 billion, probably affected, in our view, by the emergency aid's impact on local economies (totaling BRL24.2 billion in September)—which improved tax collection—and transfers from the central government to offset the decline in tax collection (BRL19.3 billion in September).

The consolidated primary balance headline for September 2020 compares with a full-2019 gap of BRL61.9 billion (0.9% of GDP). This is the sixth consecutive month in which the monthly deficit has been higher than that for a full year (in recent years). So far in 2020, the public sector's primary fiscal balance is a negative BRL635.9 billion (12.0% of GDP), the worst number in the entire historical series. The 12-month primary deficit also points in the same direction, standing at BRL655.3 billion (9.1% of GDP). (See Figure 1b.)

The BCB numbers show a relatively “better” performance from subnational entities (in comparison with the central government) year to date. In the 12-month reading, the regional governments posted a primary fiscal surplus of BRL32.7 billion (0.45% of GDP), while government-owned firms posted a primary fiscal surplus of BRL14.8 billion (0.2% of GDP). 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. The subnational entities will face the challenge of reestablishing fiscal equilibrium after these fiscal stimuli are over, in our view.

Year to date, BCB calculations indicate that the central government's primary fiscal deficit stands at BRL677.0 billion (12.7% of GDP). Before 2020, the worst primary balance for the first half of the year was in 2017 (-1.7% of GDP). For the last 12 months, the central government's fiscal gap (from the standpoint of the BCB estimates) is now BRL702.7 billion, or 9.7% of GDP, also the worst number on record.

In addition, gross debt reached 90.6% of GDP in September (see Figure 2b), an increase of 14.8 percentage points from the end of last year. Meanwhile, net debt rose to 61.4% of GDP, 5.8 percentage points higher on the same basis of comparison. We expect both to continue deteriorating in the coming months.

The primary deficit and debt continue to grow, 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 our opinion. In order to return to the gradual fiscal adjustment, it is important to comply with the spending cap constitutional amendment from 2021 onward, in our view, and in order to address the fiscal rule, it is important to approve fiscal reforms in order to reduce mandatory expenses.

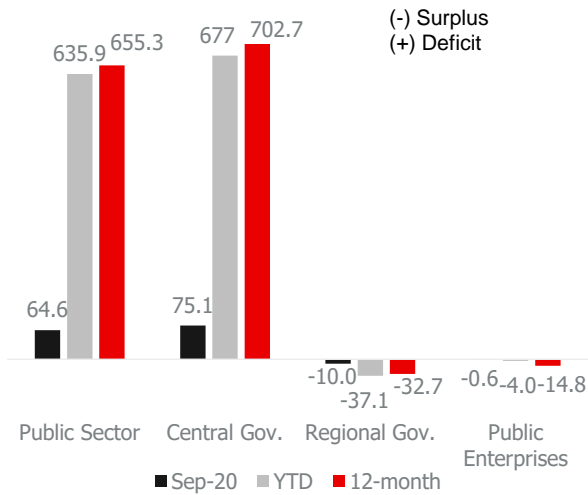
IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE “IMPORTANT DISCLOSURES” SECTION OF THIS REPORT.

U.S. investors' inquiries should be directed to Santander Investment at (212) 350-0707.

* Employed by a non-US affiliate of Santander Investment Securities Inc. and is not registered/qualified as a research analyst under FINRA rules, is not an associated person of the member firm, and therefore may not be subject to FINRA Rules 2241 and 2242 and incorporated NYSE Rule 472 restrictions.

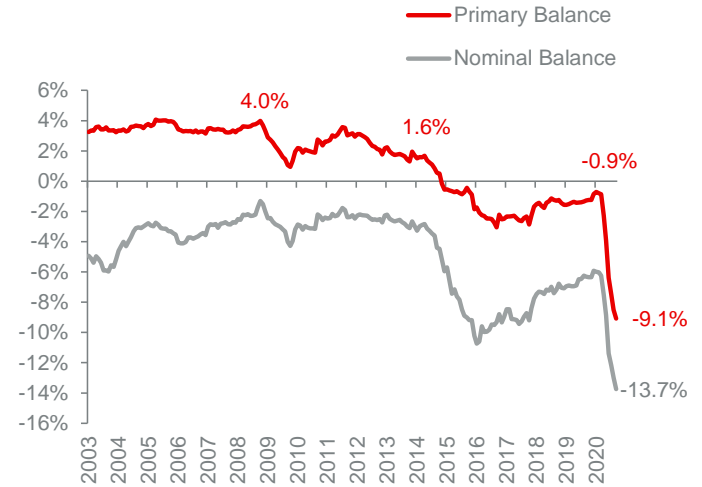


Figure 1a. Primary Result (BRL bn)



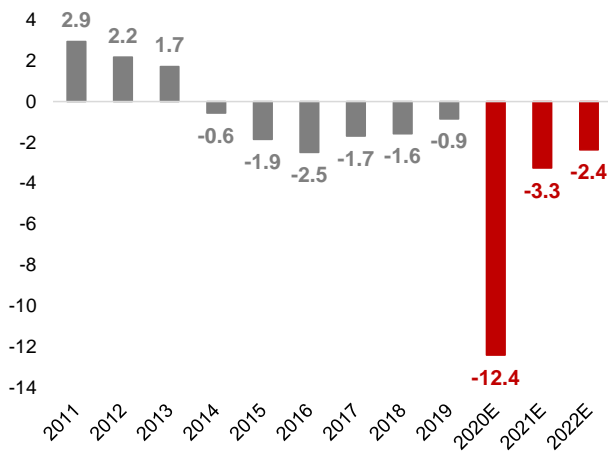
Sources: BCB and Santander.

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.



CONTACTS / IMPORTANT DISCLOSURES

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

Fixed Income Research

Juan Arranz*	Chief Rates & FX Strategist – Argentina& FX	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Orenge*	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
Daniel Gewehr*	Head, Brazil	dhgewehr@santander.com.br	5511-3012-5787

Electronic

Bloomberg
Reuters

SIEQ <GO>
Pages SISEMA through SISEMZ

This report has been prepared by Santander Investment Securities Inc. ("SIS"; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. "Santander"), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. ("Santander Investment Bolsa"), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Italo Franca*.

*Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

© 2020 by Santander Investment Securities Inc. All Rights Reserved.

