DATA ANALYSIS – FISCAL POLICY

JANUARY'S SURPLUS WAS ALL-TIME HIGH FOR THE MONTH

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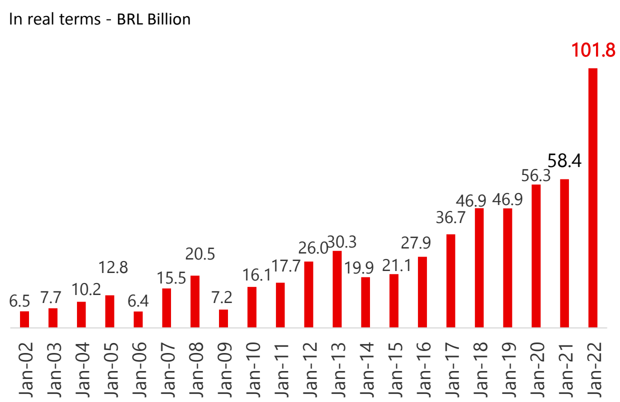
- In January, the public sector posted a primary surplus of BRL101.8 billion, better than our forecast (BRL92.5 billion) and the market's median estimate (BRL81 billion). This was the best monthly result in the historical series (in part reflecting the favorable seasonality for budget performance in the first month of each year). The main surprise came in the regional governments' result, which registered a surplus of BRL20 billion, higher than our call (BRL16.5 billion).
- For the central government, January's result was the best ever for the month and the highest in the historical series since 1997. Revenues registered a solid performance (+17.8% YoY) as a result of the price-shock effect, activity recovery, and extraordinary revenue (BRL12 billion). On the expenditure side, the main highlight was the stipend for the welfare program *Auxilio Brasil*, which reached BRL7.2 billion—January was the first month to include full payment of the BRL400 benefit.
- We project the 2022 public sector primary deficit at BRL75 billion (0.8% of GDP), vs. the BRL95 billion (1.0% of GDP) we estimated in January, considering a subnational primary surplus of BRL25 billion (0.2% of GDP). January`s result adds a positive bias to our estimate.
- In January, interest payments reached BRL17.7 billion, compared to BRL40.4 billion in January 2021. The result of FX swap operations in the period contributed to this reduction (a gain of BRL31.9 billion in January 2022 compared to a loss of BRL16.3 billion in January 2021).
- Gross debt dropped to 79.6% of GDP in January, compared to 80.3% in December. The result was affected by the positive primary surplus in the month and an increase in nominal GDP. Meanwhile, net debt reached 56.6% of GDP, compared to 57.2% of GDP in December.
- We expect gross debt to increase this year, to 84.8% of GDP, considering the increase in the public sector nominal deficit. This number includes our expectation that the BNDES will repay the Treasury ~BRL50 billion during the year. We continue to see an upward trajectory for the medium term, with a risky path to long-term stabilization, in a context of reduced efficacy of the fiscal rules, especially after the recent changes in the fiscal framework.

According to BCB data published today, the consolidated public sector posted a primary surplus of BRL101.8 billion in January, better than our forecast (BRL92.5 billion) and the market's median estimate (BRL81 billion). This was the best monthly result in the historical series (in part reflecting the favorable seasonality for the budget performance in the first month of each year). In 12 months, the public sector reached a primary surplus of BRL108 billion (1.2% of GDP), compared to BRL64.7 billion (0.75% of GDP) in December 2021. The fiscal result is maintaining a downward trajectory after a sharp reduction in fiscal stimulus in 2021 and 2020 (close to 9.4% of GDP including both years).

In January, interest payments reached BRL17.7 billion, compared to BRL40.4 billion in January 2021. The result of FX swap operations in the period contributed to this reduction (a gain of BRL31.9 billion in January 2022 compared to a loss of BRL16.3 billion in January 2021). The nominal interest balance reached BRL317 billion (3.6% of GDP), compared with BRL383 billion (4.4% of GDP) in December.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion

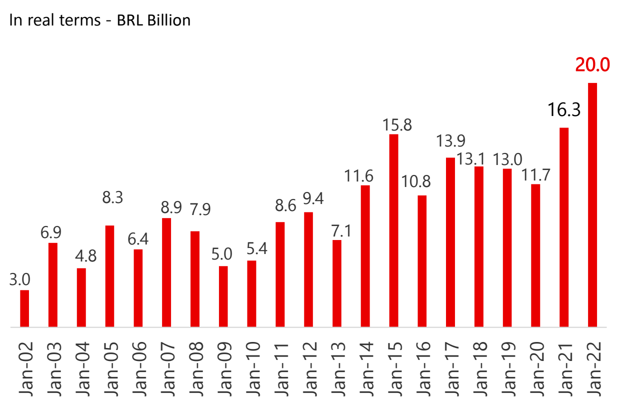
Sources: Brazilian Central Bank, Santander.

In January, regional governments' primary result (BRL20 billion) was the main surprise relative to our fiscal forecasts (BRL16.5 billion). Typically, Brazilian subnational entities register a seasonal surplus in the month of January, but the larger than expected number continues to reflect the impact of the price shock on revenue, while expenditures will take some months to increase and begin affecting the monthly reading.

In the 12-month reading, regional governments' surplus reached BRL102.9 billion (1.2% of GDP). In 2021, the subnational entities' primary fiscal surplus was BRL97.7 billion (1.1% of GDP), the all-time high as a percentage of GDP and in terms of real values in the full year result. In 2020, there was a surplus of BRL38.7 billion (0.5% of GDP), considering the fiscal stimulus (BRL78.2 billion in direct federal transfers to mitigate the pandemic's effects) and activity recovery. In 2019, there was a surplus of BRL15.2 billion (0.2% of GDP).

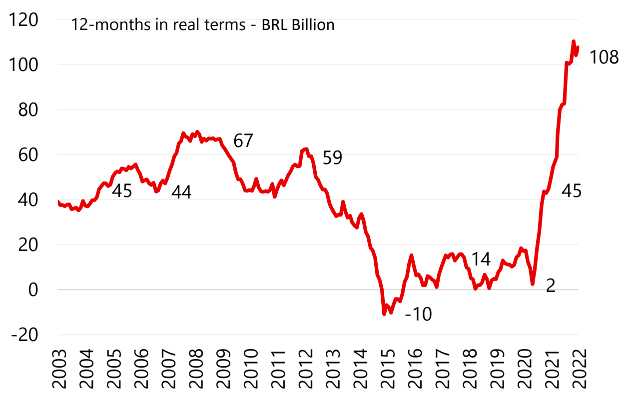
In our view, subnational entities should continue to present positive results in the short run. Our forecast for 2022 is a surplus of BRL25 billion (0.2% of GDP), though this projection is highly dependent on the duration of the price shock effect. However, in the coming years we believe that regional governments could face the challenge of reestablishing the fiscal balance as fiscal and monetary stimuli come to an end—mainly, in our view, because of pressure to increase mandatory expenditures in the following 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.

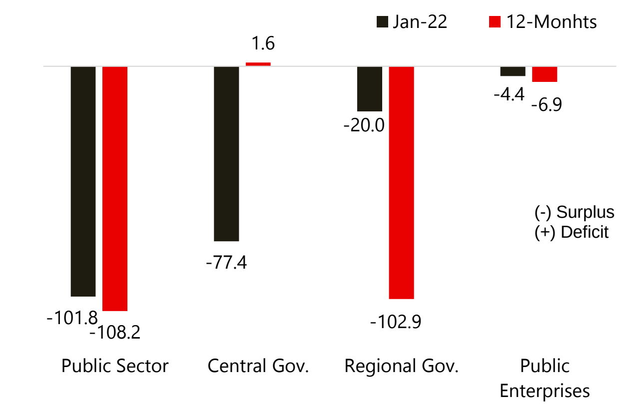
According to the data published by the Treasury on February 24, the central government posted a hefty primary surplus of BRL76.5 billion in January, close to our forecast (BRL73.5 billion) and the market median (BRL71.3 billion). January's surplus was the highest in the historical series since 1997. Revenue registered a solid performance (+17.8% YoY) as a result of the price-shock effect, activity recovery, and extraordinary revenue (BRL12 billion). On the expenditure side, the main highlights were: (i) discretionary expenses were BRL3.2 billion in the month (BRL0.5 billion below January 2021); and (ii) *Auxílio Brasil* outlays reached BRL7.2 billion—January was the first month with full payment of the BRL400 benefit. The "extra-cap" to mitigate the impact of COVID-19 already amounted to BRL7.0 billion by February (vs. BRL27.1 billion expected by the government).

For 2022, we estimate a central government primary deficit of BRL100 billion (1.0% of GDP), considering an increase in expenditures and some softening in revenue growth. Our scenario assumes oil prices of around USD95/barrel, "extra-cap" outlays of BRL40 billion in court-ordered debts, and expenditures for vaccines and health care. Depending on inflation and commodity prices, this year's result could be better than our forecast. On the other hand, fiscal stimulus via tax breaks could reduce revenue, with the potential for BRL50 billion in exemptions that could eventually be approved by Congress. The list includes: (i) lower federal taxes (PIS/Cofins) on diesel (BRL17 billion); (ii) 25% linear reduction in IPI taxes on manufacturers (BRL10 billion loss for the federal government and a BRL10 billion loss for regional governments); and (iii) inflation correction of income tax brackets (BRL23 billion). For now, except for the IPI reduction, the tax breaks are not included in our scenario.

In light of this, adding central and regional government estimates for this year, we project a 2022 public sector primary deficit at BRL75 billion (0.8% of GDP), considering an increase in expenditures and some softening in revenue growth—although a more lasting price shock effect on revenue could add a positive bias to the deficit estimate. January's result adds a positive bias to our estimate.

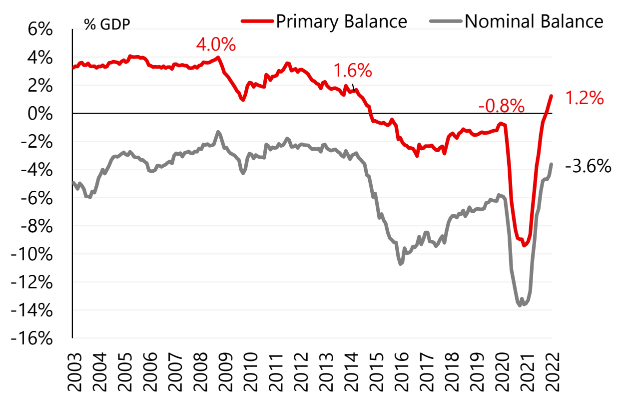
Regarding debt statistics, gross debt declined to 79.6% of GDP in January, compared to 80.3% in December. The result was affected by the increase in the primary result and higher nominal GDP. Meanwhile, net debt reached 56.6% of GDP, 0.6 pp lower than the value registered in December (57.2% of GDP). We expect gross debt to increase this year, to 84.8% of GDP, considering the increase in the public sector nominal deficit. This forecast includes our expectation that the BNDES will repay the Treasury ~BRL50 billion.

Figure 5 – Primary Result (BRL billion)



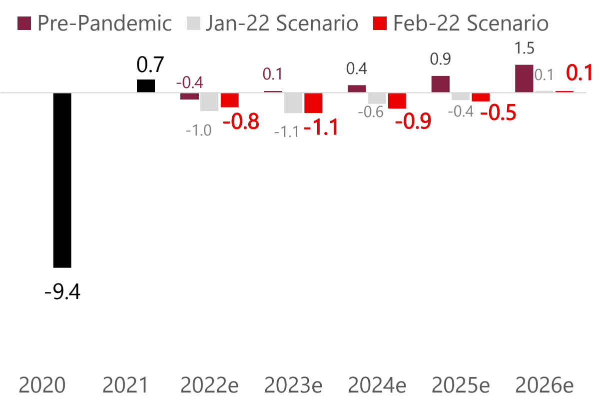
Sources: Brazilian Central Bank, Santander.

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



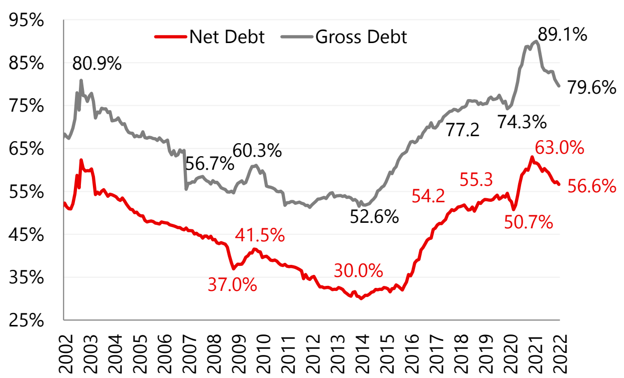
Sources: Brazilian Central Bank, Santander.

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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