Santander
Macroeconomic Research

BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

TAX BREAKS AFFECT REGIONAL GOVERNMENT RESULT

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- Today, the Brazil Central Bank (BCB) unveiled the consolidated public sector's fiscal balance for October. For the month, the public sector posted a primary surplus of BRL27.1 billion, in line with our forecast (BRL26.2 billion) and matching the market median (BRL27.1 billion). Even in a favorable month with respect to seasonality, regional governments registered a deficit of BRL3.9 billion (close to our call of BRL4.3 billion), due to the impact of reduced revenue, after legislation capped the VAT (ICMS) tax on essential goods. In nominal terms, the state's revenue dropped 12.2% YoY in the month.
- According to data published by the Treasury on November 29, the central government posted a primary surplus of BRL30.8 billion in October–the best result for the month since 2016, and since 2012 in YTD terms. Expenditures rose 3.1% YoY in real terms: we observed a decrease in discretionary outlays (-BRL4.6 billion compared to October 2021), a drop in payroll expenditures (-2.2% YoY), and social security benefits increasing 6.4% YoY. Revenue went up 4.4% YoY, particularly thanks to taxes on corporate revenue. In YTD terms, the result totals a primary surplus of BRL64.4 billion, compared to a deficit of BRL53.1 billion in the same period in 2021 (in nominal terms). In the 12-month reading in real terms, the result remained close to a surplus of BRL85.7 billion, or 1.0% of GDP. We forecast a BRL45 billion surplus this year (0.5% of GDP), with the risk tilted to upside.
- In the 12-month reading, the public sector primary surplus reached BRL173 billion (1.8% of GDP) in October, boosted by regional governments' positive public sector results (BRL86.2 billion, or 0.9% of GDP). The public sector's primary surplus seems to have peaked in July, falling by 0.7 p.p. For regional governments, the peak was in May, at 1.4% of GDP. For the public sector, we forecast a BRL100 billion (1.0% of GDP) surplus. While that would still be a solid performance, we believe that fiscal expansion is in the pipeline (totaling ~2 p.p.) and that the fading of commodity and activity cycles will likely prompt a return to a primary deficit in 2023 (1.4% of GDP).
- Interest payments totaled BRL41.6 billion in October, compared to BRL60.4 billion in same month of last year. The decrease was influenced by the result of FX swap operations (a gain of BRL12.8 billion in October 2022 and a loss of BRL12.9 billion in October 2021). In the 12-month period up to October, the nominal result totaled BRL400 billion (4.2% of GDP), up 0.15pp from September.
- Debt registered mixed results last month. Gross debt fell to 76.8% of GDP (-0.3 p.p. in the month), with an increased nominal GDP. Net debt remained flat at 58.3% of GDP. Voluntary deposits in the BCB (not included in debt statistics) shrank 0.2pp, to 0.8% of GDP.
- Our 2022 gross-debt-to-GDP forecast is currently at 78.2%, though a nominal GDP revision by IBGE and the upside bias in primary result poses a downside risk for 2022 estimate. For the medium term, we continue to forecast deterioration in the nominal (headline) budget results due to higher debt costs (associated with the high Selic rate), implying a still steep upward trajectory for government debt.
- In our scenario, we assume a once-and-for-all increase in the spending cap of BRL150 billion (1.5% of GDP), which is consistent with our estimate for a consolidated primary fiscal deficit of 1.4% of GDP next year.

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In the 12-month reading, the public sector primary surplus reached BRL173 billion (1.8% of GDP) in October, boosted by regional governments' positive public sector results (BRL86.2 billion, or 0.9% of GDP). The public sector's primary surplus seems to have peaked in July, falling by 0.7pp compared to October result. While still a solid performance, we believe that fiscal expansion is in the pipeline (totaling ~2pp), and that the fading of commodity and activity cycles will likely prompt a return to a primary deficit in 2023 (1.4% of GDP).

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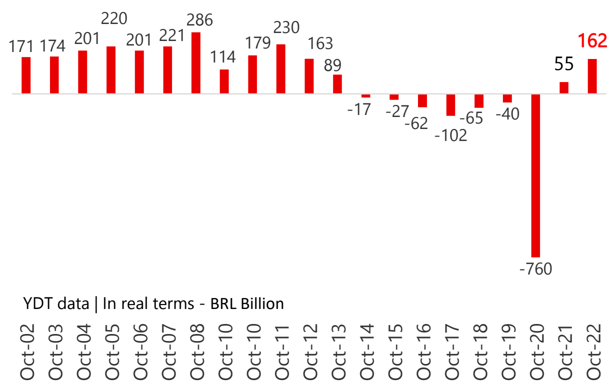
Figure 1 – Consolidated Public Sector Result

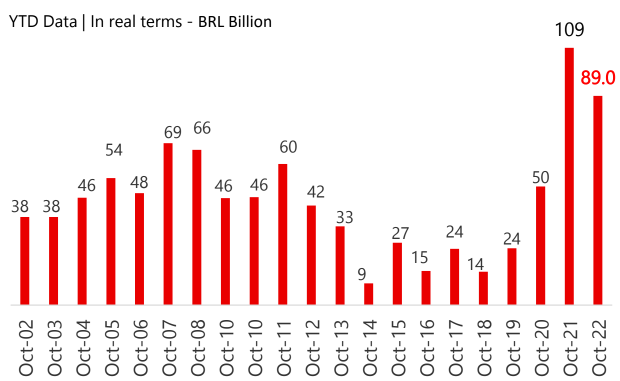


Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion

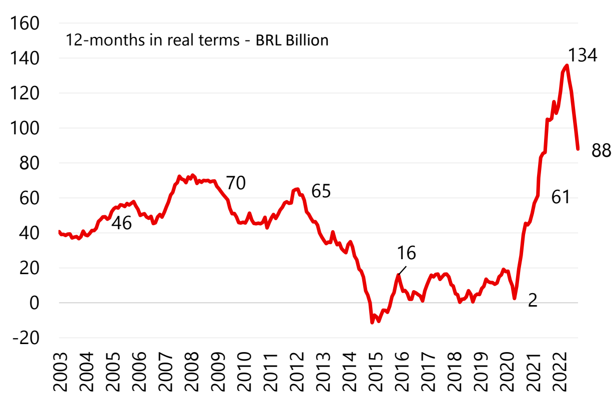
Sources: Brazilian Central Bank, Santander.

Figure 3 – Regional Gov.– Primary Result – YTD Data



Sources: Brazilian Central Bank, Santander.

Figure 4 – Regional Gov. – Primary Result – 12-m



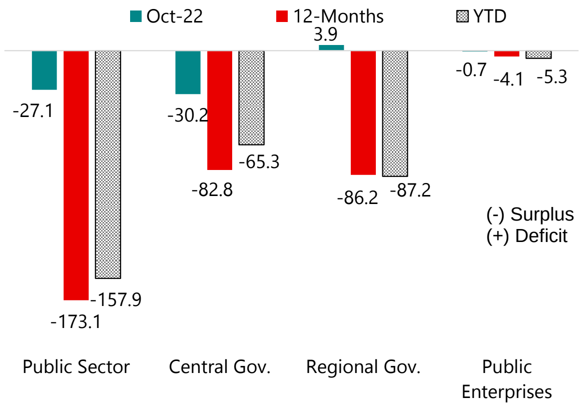
Sources: Brazilian Central Bank, Santander.

According to data published by the Treasury on November 29, the central government posted a primary surplus of BRL30.8 billion in October. It was the best result for the month since 2016, and since 2012 in YTD terms. Expenditures rose 3.1% YoY in real terms: we observed decreased discretionary outlays (-BRL4.6 billion compared to Oct-21), a drop in payroll expenditures (-2.2% YoY), and the social security's benefits increasing 6.4% YoY. Revenue went up 4.4% YoY, particularly thanks to taxes based on corporate revenue. In YTD terms, the result totals a primary surplus of BRL64.4 billion, compared to a deficit of BRL53.1 billion in the same period in 2021 (in nominal terms). In the 12-month reading in real terms, the result remained close to a surplus of BRL85.7 billion or 1.0% of GDP. We forecast a BRL45 billion surplus this year (0.5% of GDP), with the risk tilted to upside. We now see even more pressure for a "fiscal waiver" next year, due to a lack of space to accommodate plans of higher spending for 2023 onward. In our scenario, we assume a once-and-for-all increase in the spending cap of BRL150 billion (1.5% of GDP), which is consistent with our estimate for a consolidated primary fiscal deficit of 1.4% of GDP next year.

The official forecasts for compliance with the so-called "golden rule" (fiscal rule) for 2022 point to a surplus of BRL15 billion. We expect that this fiscal rule will not be binding in 2022 due to higher revenue, especially with a higher level of extraordinary proceeds.

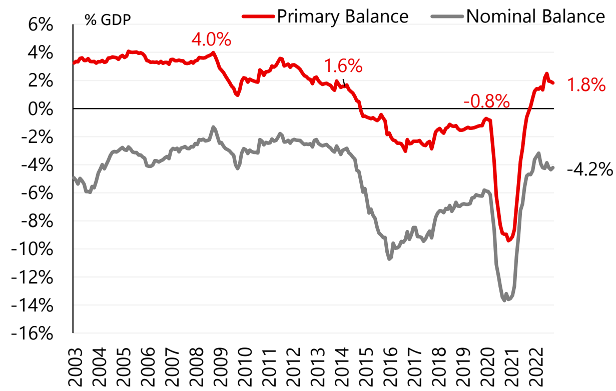
Debt registered mixed results last month: Gross debt fell to 76.8% of GDP (-0.3 p.p. in the month), with the increase in nominal GDP, and net debt remained flat, at 58.3% of GDP. Voluntary deposits in the BCB (not included in debt statistics) shrank 0.2pp, to 0.8% of GDP. We continue to forecast a deterioration in the nominal (headline) budget results due to higher debt costs (associated with the high Selic rate), implying a still steep upward trajectory for government debt in the medium term. For the long term, since we assume the commodity cycle will not, by definition, be permanent (the cycle typically lasts five years), we continue to see a risky path toward debt stabilization, in the context of less efficacious fiscal rules, along with popular pressure to increase expenditures during a period of high inflation. We consider in our scenario that the *Auxílio Brasil*'s BRL600 monthly benefit will be maintained from 2023 onward, with the approval of a constitutional amendment to open a fiscal margin allowing a breach of the constitutional spending cap.

Figure 5 – Primary Result (BRL billion)



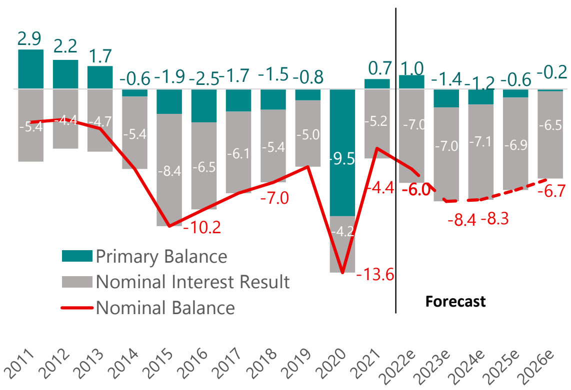
Sources: Brazilian Central Bank, Santander.

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



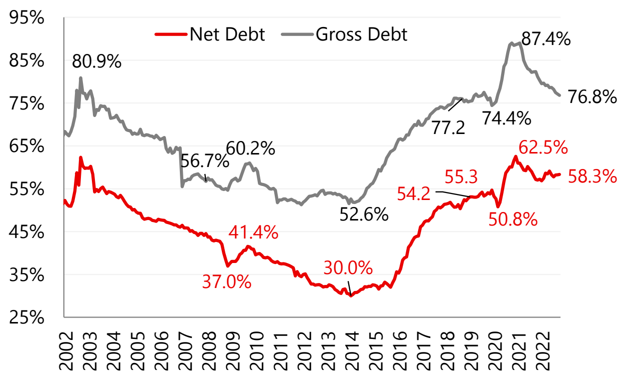
Sources: Brazilian Central Bank, Santander.

Figure 7 – Fiscal Balance (% GDP)



Sources: Brazilian Central Bank, Santander.

Figure 8 – Public Sector Debt (12m % GDP)



Sources: Brazilian Central Bank, Santander.

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