BRAZIL MACRO

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DATA ANALYSIS – FISCAL POLICY

PRIMARY SURPLUS IS BACK AFTER EIGHT YEARS

Ítalo Franca*
italo.franca@santander.com.br
+5511 3553 5235

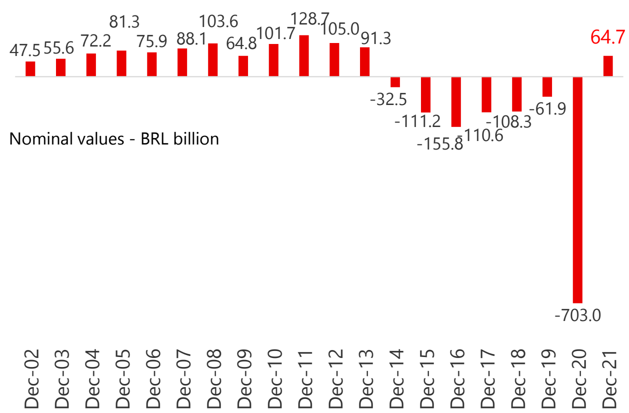
- After seven years with the primary budget surplus in red ink, the public sector result reached a primary surplus of BRL64.7 billion (0.75% of GDP) in 2021, compared to a BRL703 billion (9.4% of GDP) deficit in 2020 (which was affected by the massive fiscal stimulus in that year) and -BRL61 billion (-0.8% of GDP) in 2019. Last year's result was boosted by the price shock effect (inflation and terms of trade) and activity recovery. The highlight was regional governments, with a primary surplus of BRL97 billion (1.1% of GDP), an all-time high in the full-year result. Despite this good result, for this year we estimate a public sector primary deficit of BRL95 billion (1.0% of GDP), considering increased expenditures and some softening revenue growth — although a more lasting price shock effect on revenue could add a downward bias for the deficit estimate.
- In December, the consolidated public sector posted a primary surplus of BRL0.1 billion, worse than our forecast (BRL18.5 billion) and the market's median estimate (BRL10 billion). This was the best result for December since 2013. The main surprise came in the regional governments' result, registering a deficit of BRL12.8 billion, lower than our estimate of +BRL6.0 billion. We believe year-end spending was higher than we projected.
- For the central government, December's result was the best for the month since 2014. The results continued to be "helped" by the price shock's impact on federal tax collection, dividends from state-owned companies and extraordinary revenue. On expenditure side, the main highlight was the "extra-cap" expenditure, which totaled BRL121.4 billion (1.4% of GDP).
- In December, we continued to witness a rise in the interest account, which reached BRL54.4 billion in the month, compared to BRL24.0 billion in December 2020. The result was affected by both higher inflation numbers and the Selic rate, leading to a rise in the cost of debt. In 2021, the nominal deficit reached 4.4% of GDP, compared to 13.6% of GDP in 2020 and 5.8% of GDP in 2019. For 2022, we expect the nominal deficit to be higher than 8.0% of GDP.
- Gross debt reduced to 80.3% of GDP in 2021, compared to 88.6% in 2020 and 74.4% of GDP in 2019. The result for the year was below the estimate at the beginning of last year, about three-fourths of which can be explained by the inflation effect. In this context, nominal GDP, as measured by the Brazil Central Bank (BCB) rose 16.2% in 2021; our forecast at the beginning of 2021 was ~7%. Meanwhile, net debt reached 57.3% of GDP, compared to 62.5% of GDP in 2020 and 54.7% of GDP in 2019.
- We expect gross debt to increase this year, to 85.1% of GDP, considering the increased public sector nominal deficit. In this number, we expect the BNDES to repay the Treasury in ~BRL50 billion.
- We believe that a large proportion of 2021's positive result could be short-lived, due to the fact that the disinflation process (currently at 10.1% in 12-months) and the convergence to the center target will lead to slower revenue growth. In addition, our numbers highly depend on a sustained commodity boom, which we see as temporary; however, we recognize that it could last more in the short run. On the expenditure side, a good amount of mandatory outlays is indexed to inflation, with the spike seen in the following year, and also the change in the current fiscal framework with the possible approval of *PEC dos Precatórios*, allowing more expenditures from 2022 onward.

According to BCB data published today, the consolidated public sector posted a primary surplus of BRL0.1 billion in December, worse than our forecast (BRL18.5 billion) and the market's median estimate (+BRL10 billion). This was the best result for December since 2013. In 2021, considering the positive result for regional governments, the public sector reached a primary surplus of BRL64.7 billion (0.75% of GDP), compared to a BRL703 billion (9.4% of GDP) deficit in 2020, which was affected by the massive fiscal stimulus in that year, and -BRL61 billion (-0.8% of GDP) in 2019. The fiscal result is maintaining a downward trajectory after a sharp reduction in fiscal stimulus in 2020 vs. 2021 (close to 9.4% of GDP summing up both years).

We observed in the result a significant price shock effect, along with higher dividends and tax payments from companies involved in the commodity sector. However, we see a potential increase in expenditures in coming years due to the inflation-effect and the possible approval of *PEC dos Precatórios*, which would allow increased expenditures and imply in a with a higher deficit estimate. The primary result could be better if the impact of the commodity boom on revenue is more substantial than we currently expect.

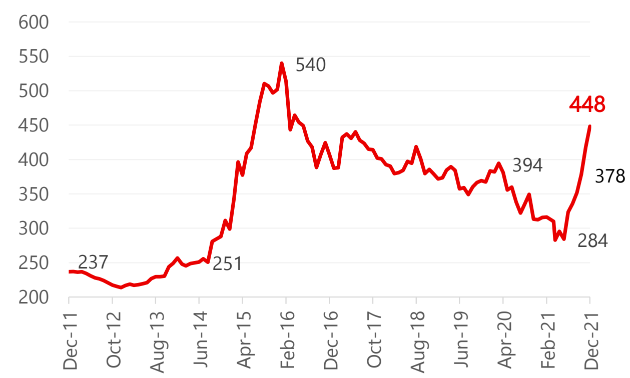
In December, we continued to witness an increase in the interest account, which reached BRL54.4 billion, compared to BRL24.0 billion for the same month in 2020 and BRL24.9 billion registered in December 2019. The result was affected by higher inflation and Selic rate, leading to a rise in the cost of debt at the margin. In 2021, the nominal deficit reached 4.4% of GDP, compared to 13.6% of GDP in 2020 and 5.8% of GDP in 2019. For 2022, we expect the nominal deficit to be higher than 8.0% of GDP, due to the higher Selic rate impact on the debt cost.

Figure 1 – Consolidated Public Sector Result



Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion

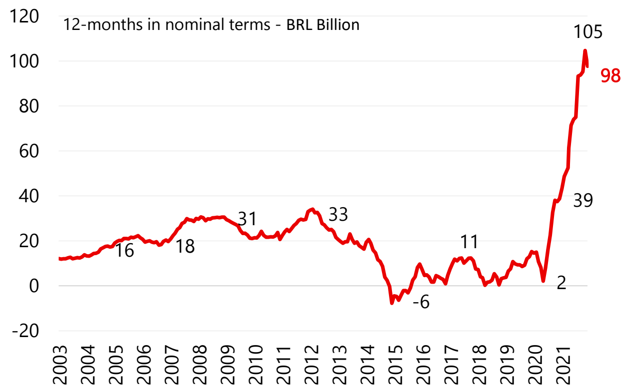


Sources: Brazilian Central Bank, Santander.

In December, regional governments primary result (BRL12.8 billion) was the main surprise to our fiscal forecasts (+BRL6.0 billion). Usually in the month, Brazilian subnational entities register a seasonal deficit, with higher outlays, especially to reach the minimum values (linked to the revenues level) in education and health. We were expecting that part of these higher expenditures would have been made more gradually, implying more disbursements than our forecast. In addition, we were seeing some signs of cooling down revenue in Brazilian states (still quite positive), driven by higher energy prices.

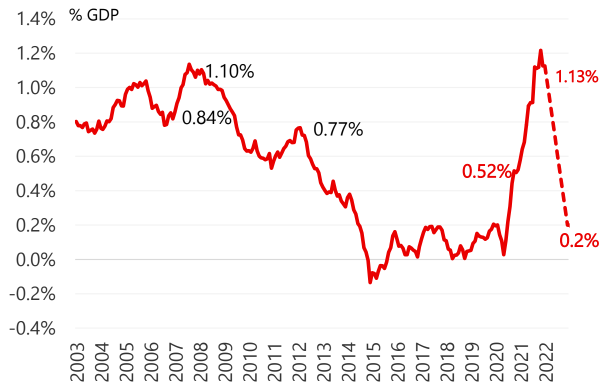
In 2021, regional governments posted a primary fiscal surplus of BRL97.7 billion (1.1% of GDP), for an all-time high as a percentage of GDP and in real values in the full-year result. In 2020, the result was a surplus of BRL38.7 billion, (0.5% of GDP), considering the fiscal stimulus (BRL78.2 billion in directly federal transfers to mitigate the pandemic effects) and activity recovery. In 2019, the result 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 for a surplus of BRL20 billion, though highly dependent on the duration of the price 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.

Additionally, according to National Treasury data published on January 28, the central government registered a primary surplus of +BRL13.8 billion, in line with our forecast (BRL13.8 billion) and a tad higher than the market median (BRL10.6 billion). The full-year (deficit of BRL35 billion or 0.4% of GDP) result was the best since 2014 (deficit of BRL23.5 billion). In revenue, the result registered a solid performance on the heels of the price-shock effect, activity recovery, dividends and extraordinary revenue.

In December, the total of dividends amounted to BRL12.4 billion, and BRL43.5 billion for full year 2021. On the expenditure side, the main highlights were: (i) discretionary expenses of BRL27.9 billion in the month; and (ii) *Auxílio Brasil* outlays reaching BRL5.9 billion — the first month of the BRL400 monthly benefit. In 2021, the “extra-cap” expenditures totaled BRL121.4 billion (1.4% of GDP). According to the Treasury, the gap to reach the spending cap max limit was BRL27.5 billion in 2021. In the December, total real revenue rose +19% YoY, considering the federal tax collection positive result (boosted by price effect and oil revenue), dividends and extraordinary revenue. Total expenditure dropped 17.6% YoY.

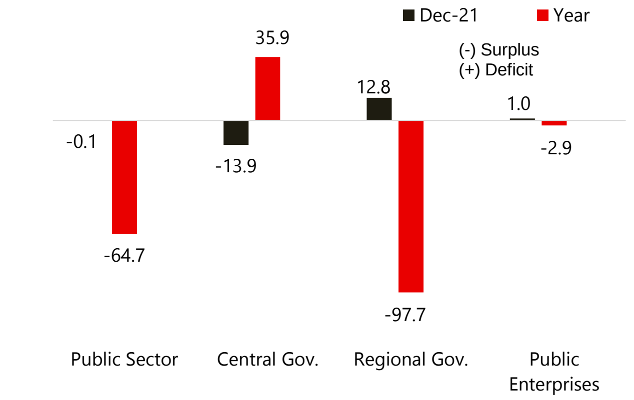
For 2022, we estimate a central government primary deficit of ~BRL115 billion (1.2% of GDP), with a positive bias related to higher oil prices and higher inflation. We believe that the primary deficit could be even smaller if the effect of the commodity boom is greater than we expect. We consider our scenario with oil prices around USD85/barrel, “extra-cap” outlays of BRL20 billion in court-ordered debts and BRL10 billion allocated toward vaccines. Considerable uncertainty remains about the estimates for the coming years, and we believe everything will depend on the impact of the fiscal framework changes. The uncertainty lies in how the fiscal consolidation proposals/debate will be conducted, whether focusing on the (already elevated) tax burden or on the (very rigid) expenditure side.

In addition, while we see the fiscal result becoming even more positive in the course of 2021, a surprise relative to our initial forecasts, there were some factors (possibly temporary) that helped boost the result on both the revenue and expenditure sides. The results occurred on the heels of atypically low discretionary expenses (owing to a tight execution rule before the approval of Budget 2021, approved in April), rising only at the end of the year. We expect some increase in these expenditures due to repressed demand for public services that could appear from 2Q22 onward. We are witnessing demand for a reduction in revenue with tax breaks, in addition to the expenditures increase of about BRL100-120 billion for 2022, maintaining part of the fiscal stimulus post-pandemic. From a revenue standpoint, the price effect (higher inflation and favorable terms of trade) continued to “help” the fiscal result, and we observed extraordinary revenue of BRL40 billion in 2021, compared to BRL8 billion in 2020, which is closely related to corporate restructuring and to IPO and M&A activities.

In light of this, adding central and regional government estimates for this year, we anticipate a public sector primary deficit of BRL95 billion (1.0% 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 downward bias for the deficit estimate.

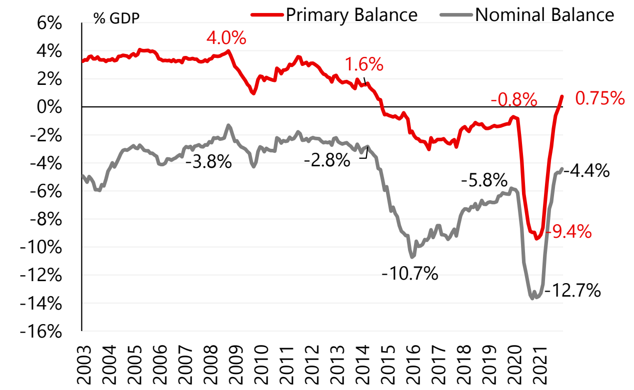
Regarding the debt statistics, gross debt reduced to 80.3% of GDP in 2021, compared to 88.6% in 2020 and 74.4% of GDP in 2019. The result for the year was below the estimate at the beginning of last year, about 3/4 of which can be explained by the price effect. In this context, nominal GDP, as measured by the BCB, rose 16.2% in 2021, vs. our forecast at the beginning of 2021 of ~7%. Meanwhile, net debt reached 57.3% of GDP, compared to 62.5% of GDP in 2020 and 54.7% of GDP in 2019. We expect gross debt to increase this year, to 85.1% of GDP, considering the increase in public sector nominal deficit. In this number, we expect the BNDES to repay the Treasury ~BRL50 billion.

Figure 5 – Primary Result (BRL billion)



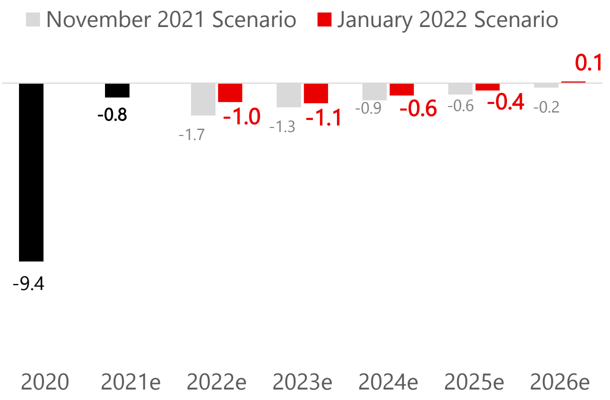
Sources: Brazilian Central Bank, Santander.

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



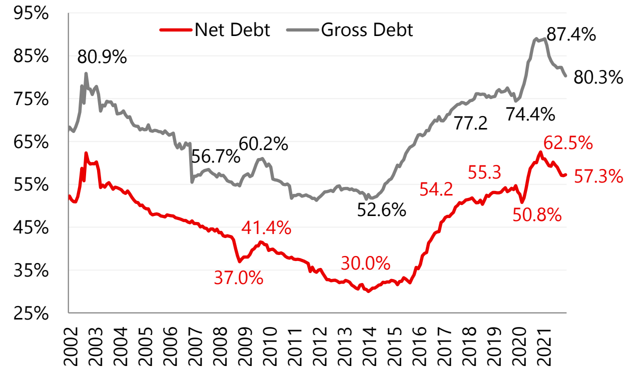
Sources: Brazilian Central Bank, Santander.

Figure 7 – Primary Result Forecast (% GDP)



Sources: Brazilian Central Bank, Santander.

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



Sources: Brazilian Central Bank, Santander.

CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research

Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327

Global 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
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500

Fixed Income Research

Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Oreng*	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
Mariana Cahen Margulies*	Head, Brazil	mmargulies@santander.com.br	5511 3553 1684

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