

PUBLIC SECTOR REGISTERS BEST JULY RESULT SINCE 2002

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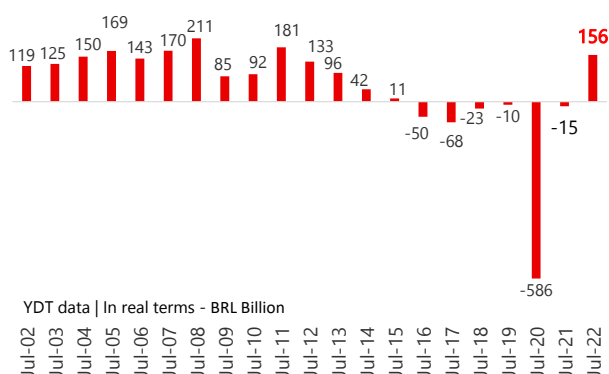
- Today, the Brazil Central Bank (BCB) unveiled the consolidated public sector's fiscal balance for June (delayed due to the BCB workers' strike) and July. In June, the public sector posted a primary surplus of BRL14.4 billion, lower than our forecast (BRL19.4 billion), with a negative surprise in regional government result in the month. In July, the public sector posted a primary surplus of BRL20.4 billion, in line with our forecast (BRL20.9 billion) and the market's median estimate (BRL21 billion). Regional governments result of BRL1.8 billion was in line with expectations, after months with relevant positive surprises.
- According to data published by the Treasury on August 30, the central government posted a primary surplus of BRL19.3 billion in July. In YTD terms, the result totals a primary surplus of BRL73.1 billion, compared to a deficit of -BRL73.1 billion in the same period in 2021 (in nominal terms). This surplus in July was the best result for the month since 2011 and highest since 2012 in YTD terms. With this result, the 12-month rolling balance reached BRL115.6 billion (from BRL75.1 billion in June) or 1.38% of GDP (from 0.93% of GDP). Our tracking is currently pointing to a slight primary surplus (after eight years in red ink) on the heels of higher SOE dividends and reduction in expenditures. However, we still see an increase in fiscal risks, with a substantial part of the recent improvement due to temporary factors, especially on revenues results.
- In July 2022, interest payments totaled BRL42.9 billion, compared to BRL45.1 billion in July 2021. The result last month was probably helped by profits in swap operations with the FX depreciation. In June we observed a total of BRL98.2 billion. In the 12-month period up to July, nominal interest totaled BRL586.4 billion (6.3% of GDP), compared to BRL323.5 billion (3.9% of GDP) through July 2021.
- In the 12-month reading, the public sector primary surplus reached BRL230.6 billion (2.5% of GDP) in July, boosted by regional governments' positive public sector results (BRL115.6 billion, or 1.2% of GDP). The nominal result reached BRL355 billion (3.8% of GDP).
- Debt results went down last month. Gross debt dropped to 77.6% of GDP in July (-0.4 pp from June), on the heels of the increase in nominal GDP. Meanwhile, net debt reached 57.3% of GDP (-0.5 pp from April).
- Our 2022 gross-debt-to-GDP forecast is currently at 79.9%, virtually stable compared to 2021. 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.

Today, the Brazil Central Bank (BCB) unveiled the consolidated public sector's fiscal balance for June (delayed due to the BCB workers' strike) and July. In July, the public sector posted a primary surplus of BRL20.4 billion, in line with our forecast (BRL20.9 billion) and the market median (BRL21 billion). This result represents the best result for the month in the historical series (2002). In July 2021 the result was a BRL10.3 billion deficit. Regional governments' result of BRL1.8 billion was in line with expectations, reducing the positive surprises of the past few months. In the 12-month reading, the public sector primary surplus reached BRL230.6 billion (2.5% of GDP) in July, boosted by regional governments' positive public sector results (BRL115.6 billion or 1.2% of GDP). The nominal result reached BRL355 billion (3.8% of GDP).

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

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**Figure 1 – Consolidated Public Sector Result**

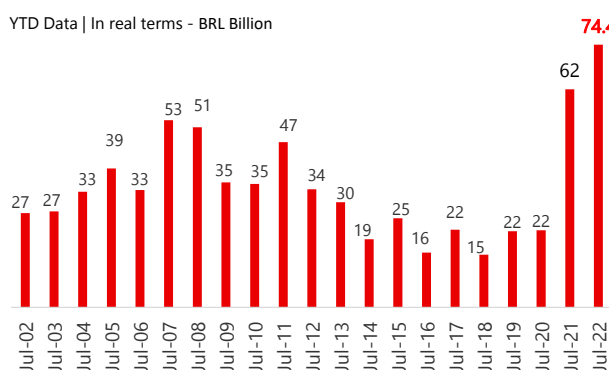
Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion

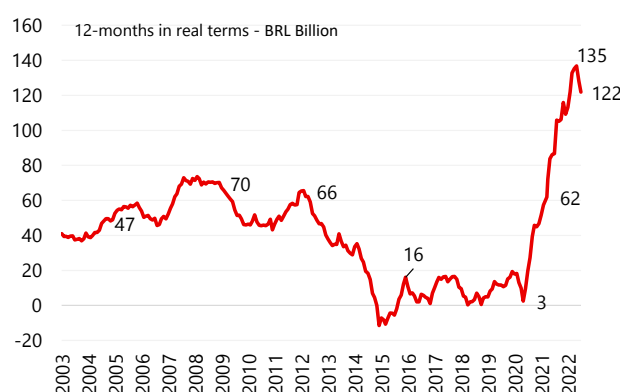
Sources: Brazilian Central Bank, Santander.

Regional governments registered a surplus BRL1.8 billion, after months with relevant the positive surprises. We expect negative values ahead, especially considering the impact of the cap on VAT (ICMS) taxes for essential goods that should reduce 2H22 revenue; the fiscal result of subnational entities is currently showing an impressive surplus of BRL72.3 billion (BRL115.6 billion in the 12-month reading) — we believe the peak of this value was left behind in May, at BRL128.7 billion. The recent Supreme Court (STF) decision to allow the state to not pay the debt owed to the federal government (to compensate for the cap on VAT taxes) will imply a BRL10 billion improvement in subnational entities' 2022 result for 2022. For 2023, the full-year impact could be above BRL70 billion. The outcome of the fiscal impact of the VAT cap is still being debate in the Supreme Court by the states' representatives and the federal government.

In the coming years, however, we believe that regional governments could face the challenge of reestablishing a 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 Gov.– Primary Result – YTD Data

Sources: Brazilian Central Bank, Santander.

Figure 4 – Regional Gov. – Primary Result – 12-Month Data

Sources: Brazilian Central Bank, Santander.

According to Treasury data published on August 30, the central government posted a primary surplus of BRL19.3 billion in July. In YTD terms, the result amounts to a primary surplus of BRL73.1 billion, compared to a deficit of -BRL73.1 billion in the same period in 2021 (in nominal terms). This July surplus was the best result for the month since 2011 and the highest since 2012 in YTD terms. With this result, the 12-month rolling balance reached BRL115.6 billion (from BRL75.1 billion in June), or 1.38% of GDP (from 0.93% of GDP).

With respect to revenue, the result registered a solid performance (+8.7% YoY in the month and +15.1% YoY in YTD terms), particularly thanks to taxes based on corporate profits and labor-related taxes. On the expenditure side (-17.9% YoY in the month and -1.9% YoY in YTD terms), the July highlights were: (i) a drop in payroll outlays (-BRL3.5 billion), mainly due to not readjusting public servants' wages; (ii) a BRL6.0 billion



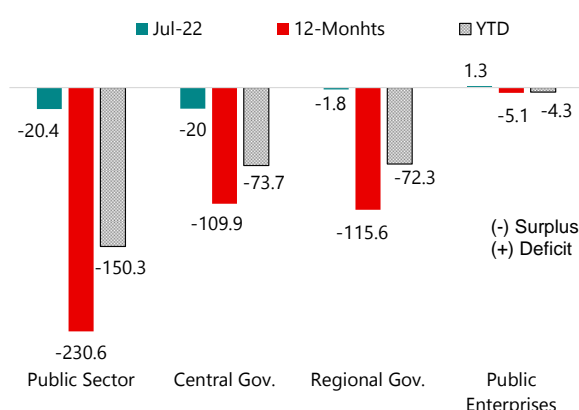
increase related to the welfare program (*Auxílio Brasil*). For August, we expect an increase of BRL24 billion in discretionary expenditures from the agreement between São Paulo City Hall and the federal government that ended the dispute over the management of the *Campo de Marte* region, owing to the cancellation of the municipality's debts with the federal government. In addition, we expect payments of judicial ordered debts in the month, above BRL23 billion. Our tracking is currently pointing to a slight primary surplus (after eight years in red ink) on the heels of higher SOE dividends and reduced expenditures. However, we still anticipate an increase in fiscal risks, with a substantial proportion of the recent improvement due to temporary factors.

The official forecasts for the compliance of the golden rule for 2022 points to a sufficiency of BRL20.7 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.

Regarding debt statistics, gross debt dropped to 77.6% of GDP in July (-0.4 pp from June), on the heels of the increase in nominal GDP. Meanwhile, net debt reached 57.3% of GDP (-0.5 pp from April). Our 2022 gross-debt-to-GDP forecast is currently at 79.9%, virtually stable compared to 2021. 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.

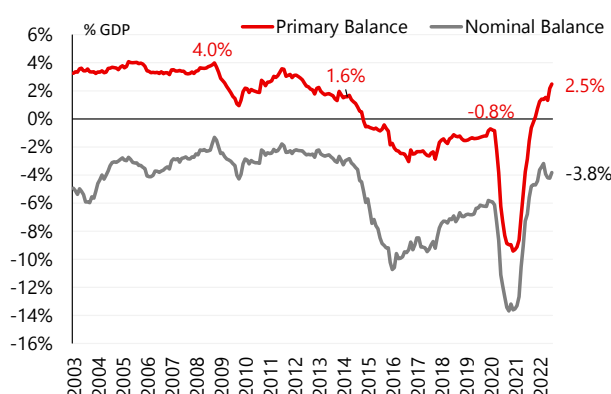
For the long term, since we assume the commodity cycle will, by definition, not be permanent (the cycle typically lasts five years), we continue to see a risky path toward debt stabilization, in a context of less efficacious fiscal rules, along with social pressure to increase expenditures during a period of high inflation. We consider in our scenario that the *Auxílio Brasil's* BRL600 monthly benefit will be maintained for 2023, with the approval of a constitutional amendment to open a fiscal margin to the constitutional spending cap. We include a budget of BRL120 billion, yet if maintained this value could reach BRL150 billion (if not restructuring the benefit).

Figure 5 – Primary Result (BRL billion)



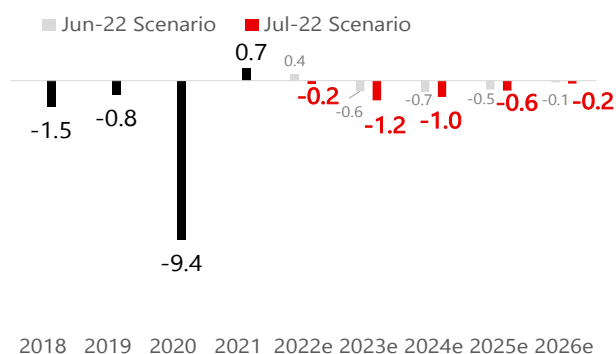
Sources: Brazilian Central Bank, Santander.

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



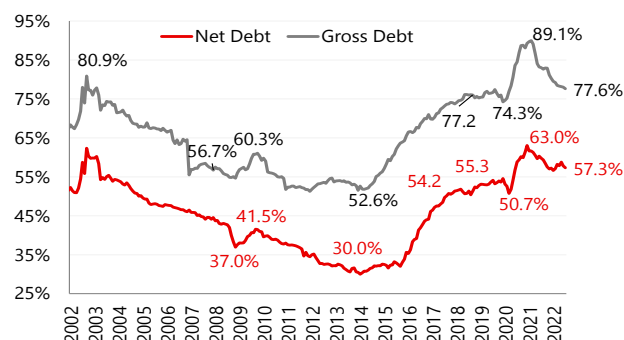
Sources: Brazilian Central Bank, Santander.

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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