

## **PUBLIC SECTOR: POSITIVE SURPRISE IN REGIONAL GOV. RESULT**

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- Today, the Brazil Central Bank (BCB) released the consolidated public sector's fiscal balance for January. For the month, the public sector posted a primary surplus of BRL99 billion, above our forecast (BRL90.2 billion). This was the second highest result for the month. January tends to be seasonally favorable for the fiscal results. The subnational entities primary result was the main surprise to our forecast. Regional governments registered a surplus of BRL22 billion (beating our call of BRL12 billion). We observed a 15% YoY drop in states revenue in nominal terms, considering the impact of legislation that limited ICMS (VAT) tax on essential goods. We believe it likely that the disbursement of expenditures surprised to downside in the month. The municipalities recorded an impressive surplus of BRL4.5 billion, compared to BRL1.7 billion in January 2022. Despite January's positive performance, we expect regional governments to show negative values going forward due to the tax break effect.
- In the 12-month reading, the public sector primary surplus reached BRL123 billion (1.2% of GDP), after peaking at 2.4% in July of 2022. Regional governments reached a surplus of BRL66.7 billion (0.7% of GDP) — the peak was registered in May (BRL128.7 billion, or 1.4% of GDP). Despite the solid performance in 2022 and in January, we believe that fiscal expansion already in the pipeline (totaling ~1.9 p.p. of GDP), in the context of a softening in commodity prices and in real activity, will likely prompt a return to a primary deficit in 2023 (1.4% of GDP).
- According to February 27 Treasury data, the central government posted a primary surplus of BRL78.3 billion in January. In the 12-month reading, the result was a primary surplus of BRL54.5 billion (0.5% of GDP). This was the second higher surplus for the month in the historical series. However, we believe that the monthly result will lose steam ahead with the increase in expenses and with a modest increase in revenue. In January, total revenue delivered a solid performance (+2.7% YoY), "helped" by SOE dividends related to oil (at BRL6.5 billion; in January 2022 there were no dividends registered). On the expenditure side, we observed a 6.0% YoY real rise, on the heels of the following factors: (i) the BRL7.0 billion increase in mandatory expenses, with cash flow control and highlighting the welfare program (*Auxílio Brasil*: +BRL5.7 billion); (ii) increased social security benefit payments, in the amount of BRL3.8 billion, or 6.5% YoY (boosted by a shortened queue for granting the benefit); and (iii) a 2.9% YoY drop in the public payroll. For 2023, we forecast a BRL145 billion primary deficit (-1.5% of GDP).
- Interest payments totaled BRL52 billion in January, compared to BRL18 billion in same month of last year. In 12-month reading, the nominal result totaled -BRL498 billion (5% of GDP). For 2023, we expect an increased cost of debt, owing to the more elevated Selic rate. Thus, we expect the nominal result to reach close to 8.7% of GDP this year.
- Debt data registered a drop in January. Gross debt fell to 73.1% of GDP (-0.3 p.p. in the month), with an increased nominal GDP (-0.6pp impact). Net debt reached 56.6% of GDP (-0.9 p.p. in the month). Voluntary deposits in the BCB (not included in debt statistics) remained at 0.8% of GDP. Our 2023 gross-debt-to-GDP forecast is currently at 78.9%. 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.

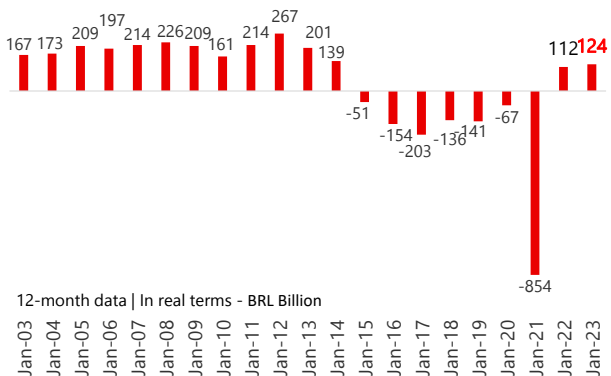
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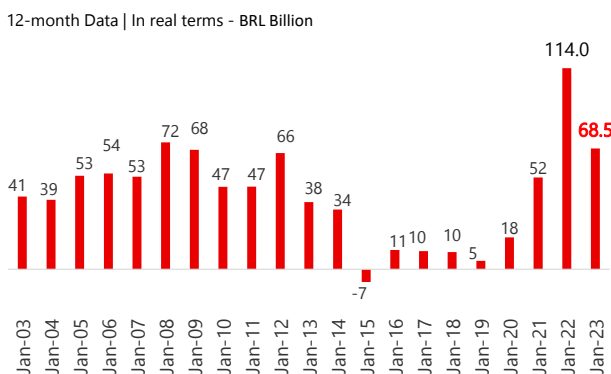


**Figure 1 – Consolidated Public Sector Result**



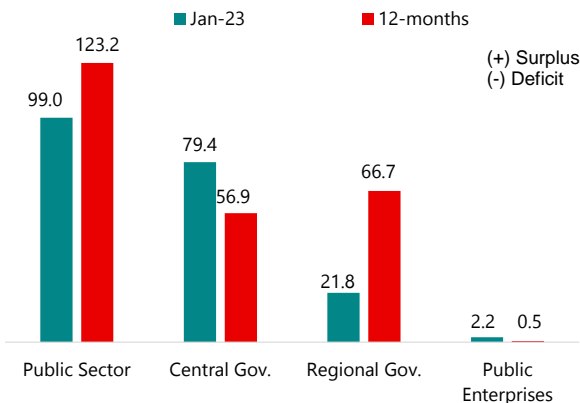
Sources: Brazilian Central Bank, Santander.

**Figure 3 – Regional Gov.– Primary Result**



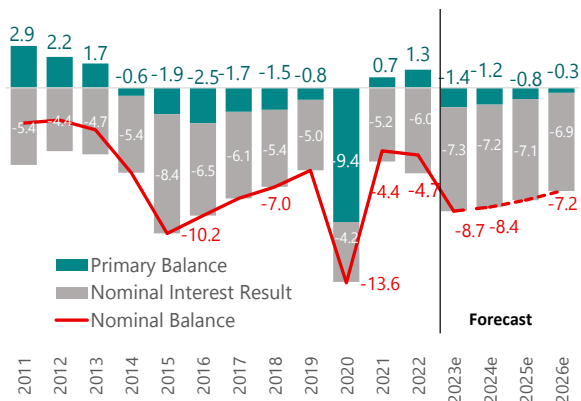
Sources: Brazilian Central Bank, Santander.

**Figure 5 – Primary Result (BRL billion)**



Sources: Brazilian Central Bank, Santander.

**Figure 7 – Fiscal Balance (% GDP)**



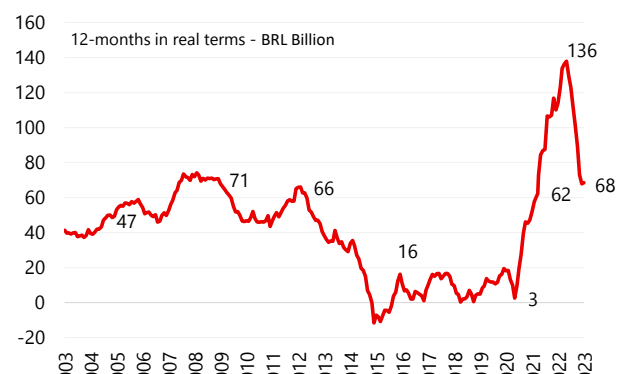
Sources: Brazilian Central Bank, Santander.

**Figure 2 – Interest Payments Result – BRL billion**



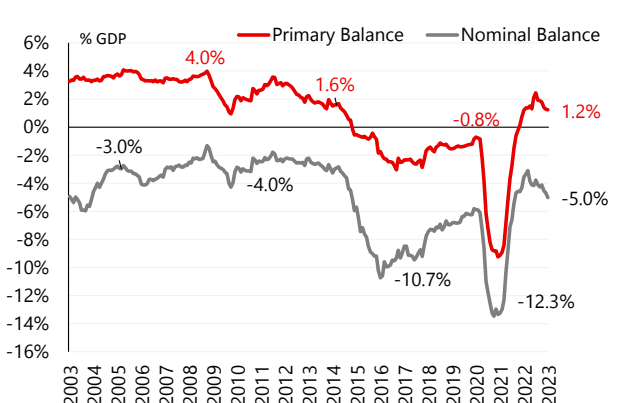
Sources: Brazilian Central Bank, Santander.

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



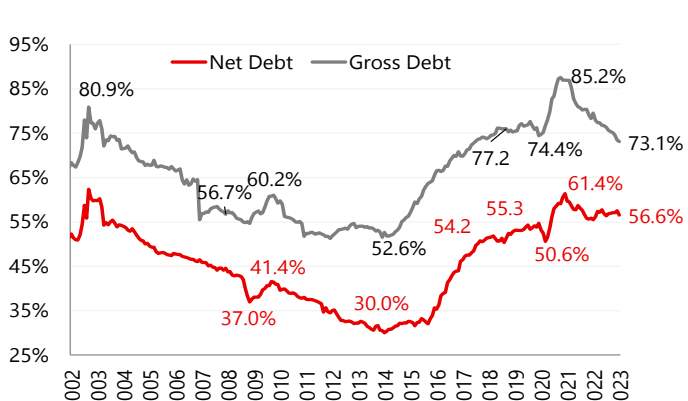
Sources: Brazilian Central Bank, Santander.

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



Sources: Brazilian Central Bank, Santander.

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



Sources: Brazilian Central Bank, Santander.



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