BRAZIL MACRO March 31, 2023

DATA ANALYSIS – FISCAL POLICY

PUBLIC SECTOR: HIGHEST PRIMARY DEFICIT FOR FEBRUARY

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- Today, the Brazil Central Bank (BCB) released the consolidated public sector's fiscal balance for February. For the month, the public sector posted a primary deficit of BRL26.5 billion, below our forecast of BRL33 billion. This was the highest deficit for February in general. The subnational entities' primary result was the main surprise to our forecast. Regional governments registered a surplus of BRL12 billion beating our call of BRL7.4 billion. We observed a 5.7% 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 continued to surprise to the downside in the month. Despite the positive performance in the year, we expect regional governments to show moderate values going forward due to the tax break effect.

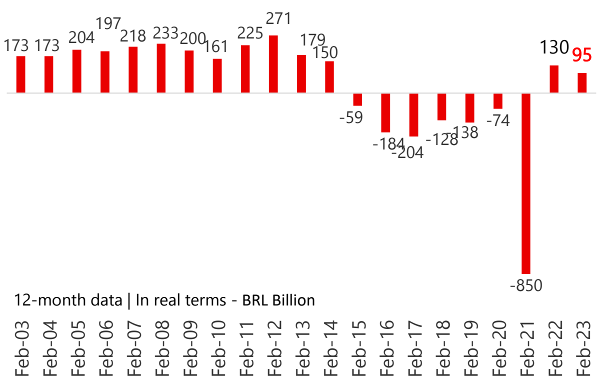
- In the 12-month reading, the public sector's primary surplus reached BRL93 billion (0.9% of GDP), after peaking at 2.4% in July of 2022. Regional governments reached a surplus of BRL58.4 billion (0.6% of GDP) — the peak was registered in May (BRL128.7 billion, or 1.4% of GDP). Despite the solid recent performance, we believe that fiscal expansion already in the pipeline (totaling ~2.0 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), with a downward bias due to labor-linked tax collection performance.

- According to March 30 Treasury data, the central government posted a primary deficit of BRL41 billion in February. In the 12-month reading, the result was a primary surplus of BRL36 billion (0.3% of GDP). This was the highest primary deficit for February 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 February, total revenue registered a real drop of 12.1% YoY. Year-to-date, there is a 3.3% YoY drop in revenues. The main highlights in the monthly comparison are: (i) Reduction in Concessions and Permissions (-BRL11.8 billion) and (ii) decrease in SOE Dividends (-BRL 3.7 billion). On the expenditure side, we observed a drop of 0.9% YoY real, on the heels of the following factors: (i) Reduction of BRL 5.7 billion in the payment of "*Abono salarial*"–wage bonus, due to the new calendar compared to 2022; (ii) reduction in Extraordinary Credits (-BRL 2.9 billion), due to the payment of expenses COVID-19 related; (iii) increase of BRL 5.4 billion in mandatory expenses with flow control, especially those related to the payment of Bolsa Família benefits; and (iv) increase of R$2.8 billion in Social Security Benefits (+4.4% YoY at the margin and +5.4% in YTD-terms). For 2023, we forecast a BRL145 billion primary deficit (-1.5% of GDP).

- Interest payments totaled BRL64 billion in February, compared to BRL26 billion in the same month of last year. In a 12-month reading, the nominal result totaled -BRL565 billion (5.6% 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.

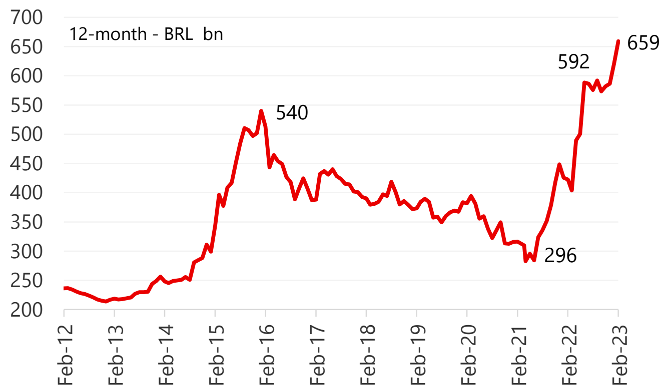
- Debt data registered a rise in February. Gross debt reached 73% of GDP (+0.5 pp in the month), reflecting the interest accrual (+0.6pp). Net debt was 56.6% of GDP, a rise of 0.5pp. Voluntary deposits in the Central Bank (not included in debt statistics) reduced 0.2pp to 0.6% of GDP. Our 2023 gross-debt-to-GDP 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.

Figure 1 – Consolidated Public Sector Result



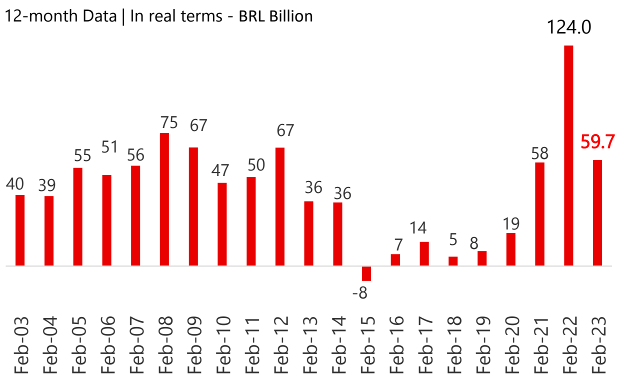
Sources: Brazilian Central Bank, Santander.

Figure 2 – Nominal Interest Result – BRL billion



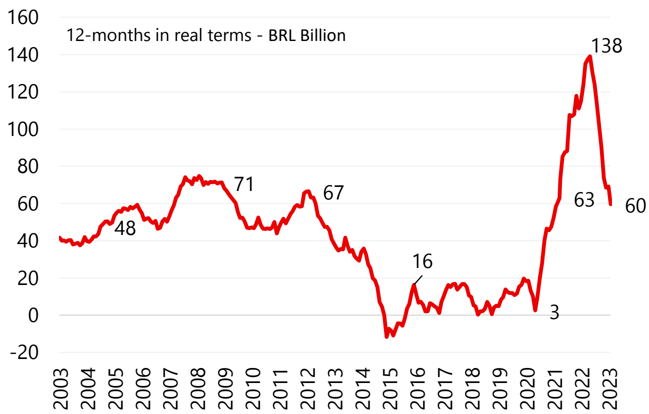
Sources: Brazilian Central Bank, Santander.

Figure 3 – Regional Gov.– Primary Result



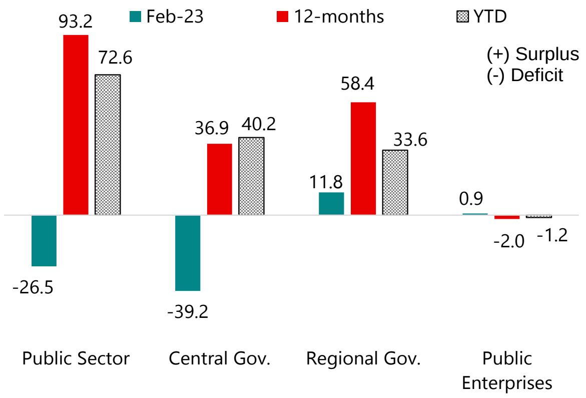
Sources: Brazilian Central Bank, Santander.

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



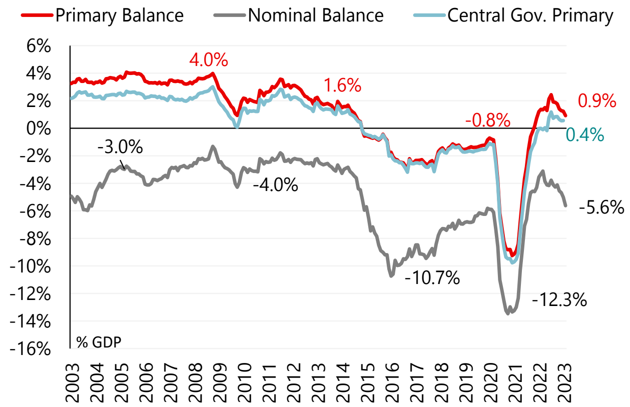
Sources: Brazilian Central Bank, Santander.

Figure 5 – Primary Result (BRL billion)



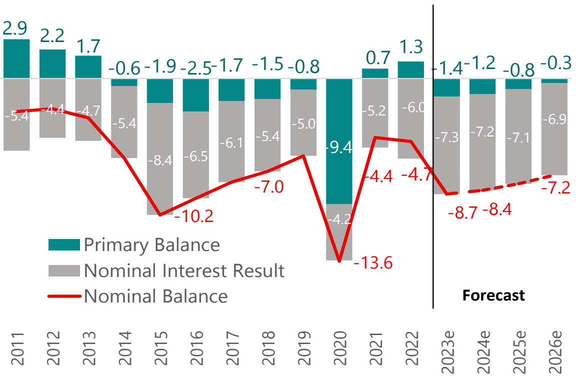
Sources: Brazilian Central Bank, Santander.

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



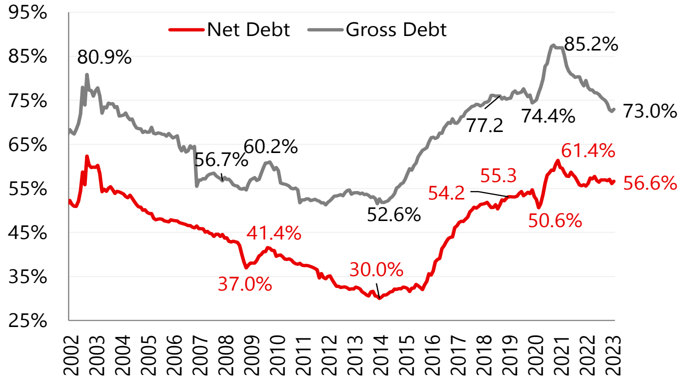
Sources: Brazilian Central Bank, Santander.

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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