Drivers of public debt improved forecasts

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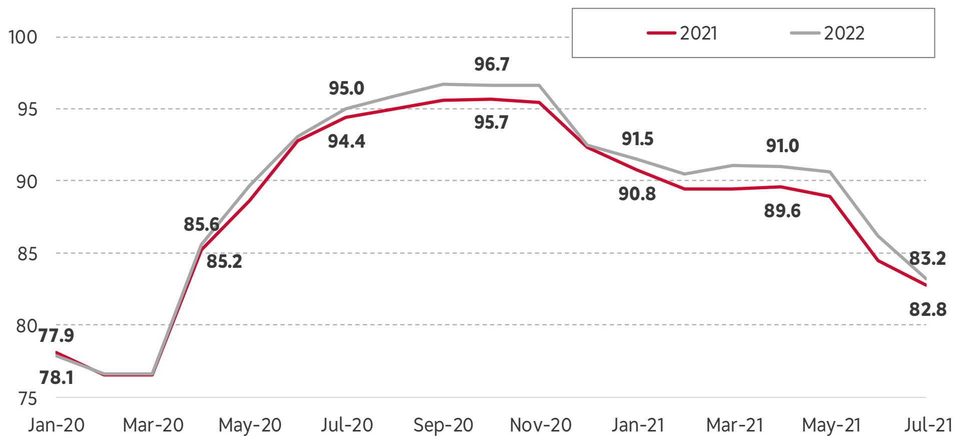
In the last few months, there have been ensuing improved revisions of expectations regarding Brazil's public debt. Since October last year, when the median of Prisma Fiscal's forecasts reached its highest level, the 2021 general government gross debt (DBGG) was revised by -12.9 p.p., while the 2022 DBGG was revised by -13.4 p.p. of the GDP. Most of this reduction is attributed to surprises with nominal growth, which increased both tax collection and the debt-to-GDP denominator.

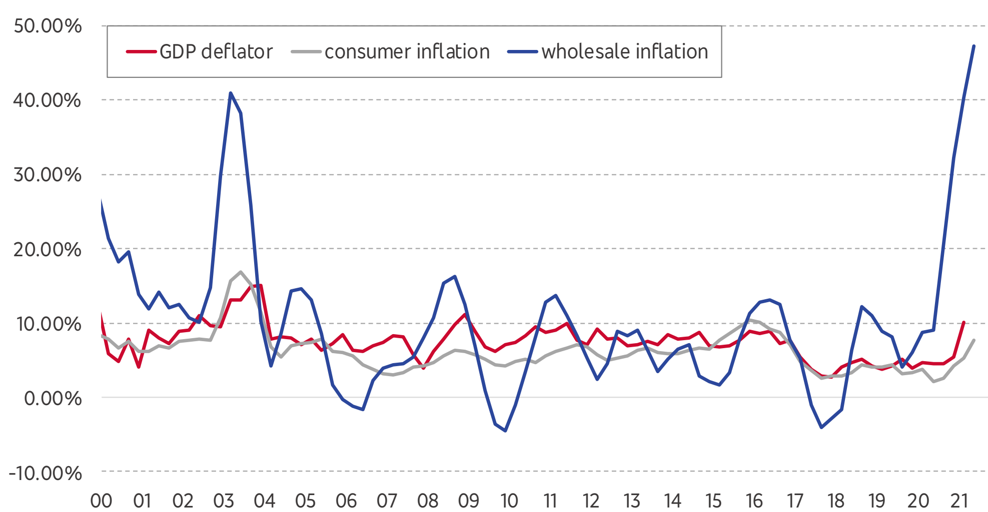
Chart 1: Evolution of median Gross Debt forecasts for 2021 and 2022



Source: Prisma Fiscal, Bradesco

In our base case scenario, the 2021 nominal GDP forecast grew BRL 700 billion compared to what we expected in October last year. The nominal GDP should grow 14% this year. Part of that is due to real GDP revisions, up from 3.5% to 5.2% in our scenario, but there was also a major surprise with inflation – reflected in the GDP deflator. In our view, such unexpected growth of the fiscal denominator translates into -8.3 p.p. of debt-to-GDP, with a contribution of -1.7 p.p. of the real GDP and -6.6 p.p. of the GDP deflator.

Chart 2: Consumer / wholesale inflation and GDP Deflator
YoY % variation per quarter



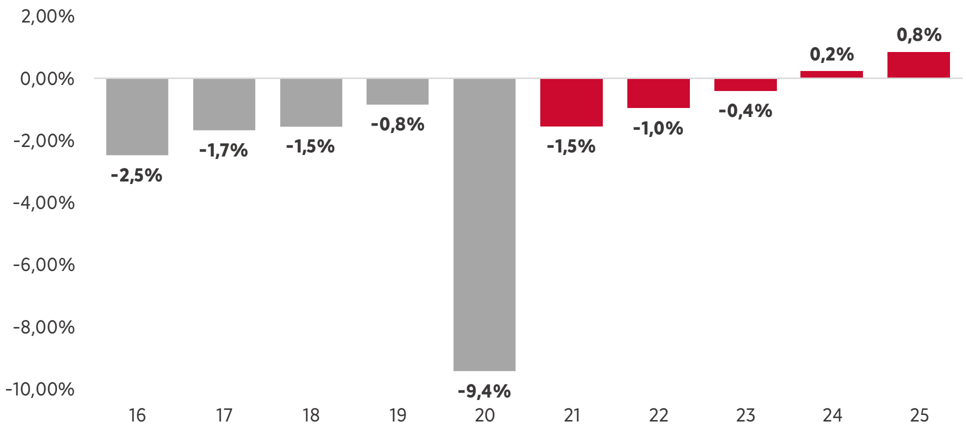
Source: IBGE, FGV, Bradesco

This positive result prompts better fiscal forecasts ahead. Considering the elasticity of revenue in relation to the nominal GDP, this entire gain was reflected in revenue surprises. Not only by the real economic growth, but also the effects of prices to producers and the terms of trade over tax bases. The exchange rate's depreciation and upsurge in commodities also positively impact revenues from the exporting and importing sectors. Back to Prisma Fiscal, median forecasts for 2021 and 2022 net revenue grew BRL 135 billion since October 2020.

In total, the revised general government primary balance contributed with -1.6 p.p. of the GDP in our gross debt forecasts. What kept such improvement in primary balance forecasts from being even greater were new extraordinary expenses of the Central Government in pandemic actions, which were left out of the spending cap. Nonetheless, such gain in revenue is carried over to forecasts for subsequent years, anticipating the primary surplus by at least two years, in our estimates.

The same trend is seen in local government accounts, which have been showing successive primary surpluses. States and municipalities should accumulate a surplus above 0.3% of the GDP this year, considering surprises with tax revenue and the increase in transfers from the federal government.

Chart 3: Primary balance of the public sector (% of GDP)



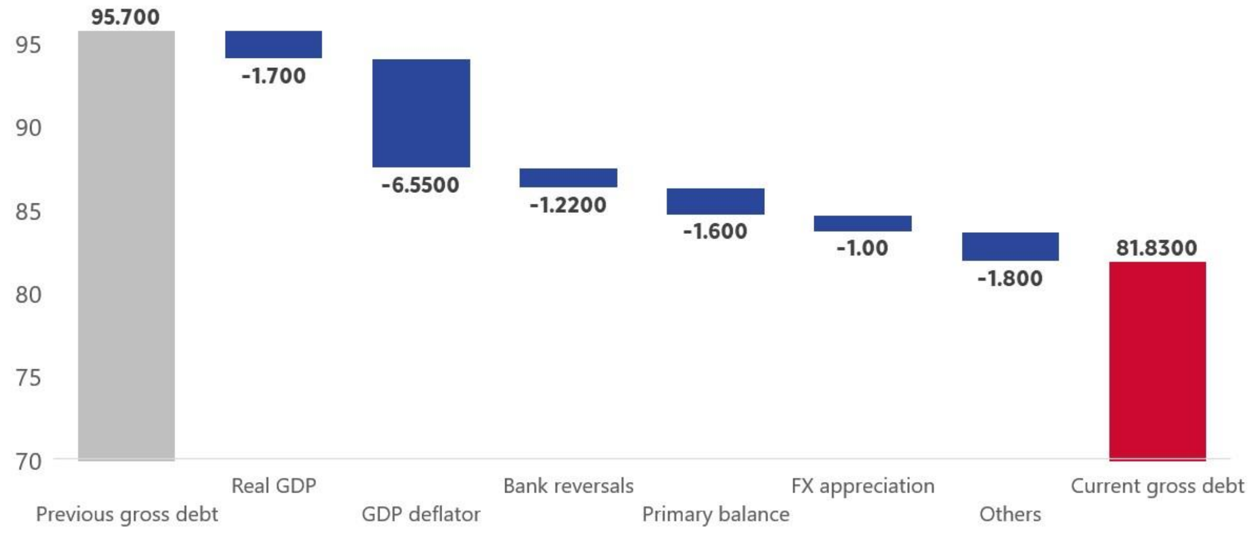
Source: Central Bank of Brazil, Bradesco

Among the other factors that benefitted debt forecasts this year is the reversal of funds from the Brazilian Development Bank (BNDES) and other public banks to the National Treasury. The BNDES has already anticipated the transfer of BRL 38 billion to Treasury this year, complementing the public debt liquidity reserve. Official financial institution reversals should add up to a total of BRL 100 billion in 2021, resulting in -1.2 p.p. of DBGG/GDP. On the other hand, these anticipations do not affect net debt numbers. With these effects combined, the improvement in tax forecasts led to some decompression in the risk premium, particularly in the CDS, exchange rate and the public debt rollover premiums.

Another important point is that such gain in revenue would not have led to a better primary balance were it not for the spending cap. The central government's fiscal target for this year (deficit of BRL 247 billion) still has some room to be completed, even when considering all extraordinary expenses removed from the target throughout the budget process. Were it not for the limitation imposed by the spending cap, we would have likely seen a major upsurge in expenses this year. Once again the spending cap proved to be crucial to prevent bullish pressures on primary spending. Similarly, the fiscal target for next year should consider this expected revenue gain and enable the continuity of fiscal consolidation.

However, most of the improvement in public finances was benefitted by the increase in nominal GDP, rather than advances in fiscal efforts or rules. This is important to consider when assessing the continuing improvement in risk premiums associated to this matter. Perceived as transitory, these improvement factors will not lead to permanent advances in lowering risk if there are setbacks in the fiscal agenda. There was an unequivocal improvement in debt level, but future dynamics remain challenging. Sticking to fiscal consolidation and following the rules is the best strategy to keep the risk dropping and preserve neutral interest rates compatible with the average among emerging nations, which are all necessary conditions to ensure an economic scenario conducive to real GDP growth.

Chart 4: Main factors of variation of the 2021 DBGG forecast
In percentage points of GDP



Source: Bradesco

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