ECONOMIC ANALYSIS

Fiscal accounts deteriorated sharply in 2014

Enestor Dos Santos

The combination of weak revenues and robust expenditure generated a significant worsening of fiscal accounts last year: the primary result was negative for the first time ever (-0.6% of GDP), the total deficit reached more than 6.0% of GDP and the gross public debt increased more than 6 p.p. to 63.4% of GDP. The 2014 fiscal deterioration makes the ongoing adjustment in public accounts more indispensable and also more painful in terms of its short-term impact on economic activity. In spite of the worst-than-expected starting point, we expect the recently announced fiscal goals (1.2% of GDP primary surplus in 2015 and 2.0% in 2016 and 2017) to be fulfilled, preventing a further deterioration of public accounts ahead.

The primary surplus turned into a deficit

After generating surpluses of 1.9% of GDP in 2014 and around 3.0% over the previous ten years, the public sector primary result was equal to -0.6% in 2014 (expectations were of a primary outcome around 0%). Such unprecedented result was a consequence of both weaker revenues and robust expenditure. The former as a result of the moderation in economic activity and series of tax breaks and the latter due to to a leaning-against-the-wind fiscal stance. Central government data (unavailable for the whole public sector) show that, in real terms, public revenues dropped 4.0% while expenditure increased 6.0% in 2014. Even though most of the deterioration was due to the central government, regional governments and state-owned companies also contributed to the situation (their primary result was equal to -0.2% and -0.1%, respectively).

The total deficit was the largest in more than ten years

Given the the sharp reduction in the primary surplus and a relevant increase in interest expenditure, which reached 6.1% of GDP, the public sector total deficit closed 2014 at 6.7%. much higher that in 2013 (3.3%) and than in the previous ten years (3.1% on average).

Higher fiscal deficit and lower GDP growth drove up the public debt to GDP ratio

As a consequence of a GDP growth around 0% and a fiscal deficit of 6.7% of GDP, the general government gross debt increased to 63.4% of GDP in December, from 56.7% one year before. The public sector net debt, another commonly used indicator in Brazil which also includes the BCB net debt (and therefore international reserves), increased to 36.7% in 2014, in comparison to 33.6% in 2013. The deterioration revealed by this net debt indicator would have been larger, if it was not by the positive impact of the exchange rate depreciation on fiscal accounts (as the BCB is a net creditor due to international reserves).

The ongoing adjustment should reverse fiscal variables' negative trends in the medium-term

All in all, figures released today by the BCB reveal a sharp (and more significant than expected) deterioration in Brazil's fiscal situation. If the expansive fiscal policy observed in the last few years were left unchanged, insolvency could soon become an issue. This, as well as the need to address other distortions (such as inflation), makes indispensable a fiscal adjustment. The recent measures to control public expenditure and increase revenues and other recent signs show that such adjustment will very likely be implemented in the next few years. We expect the primary surplus targets (1.2% in 2015 and 2.0% in 2016 and 2017) to be fulfilled, in spite of the negative impact on economic activity. This would not prevent a new increase of the public debt in 2015, but should be an important step to reverse its negative trend from 2016 on.

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