

XP Macro

Higher inflation, tighter budget



Highlights

- With August's IPCA higher than expected and new cost pressures, **we raised our 2021 IPCA forecast from 7.7% to 8.4%. For INPC, we estimate 8.6%.**
- Higher inflation makes the budget for 2022 even more challenging. We estimate that the current budget proposal will face pressure of nearly 70 billion reais, due to higher inflation forecast and political commitments not included in the budget piece.

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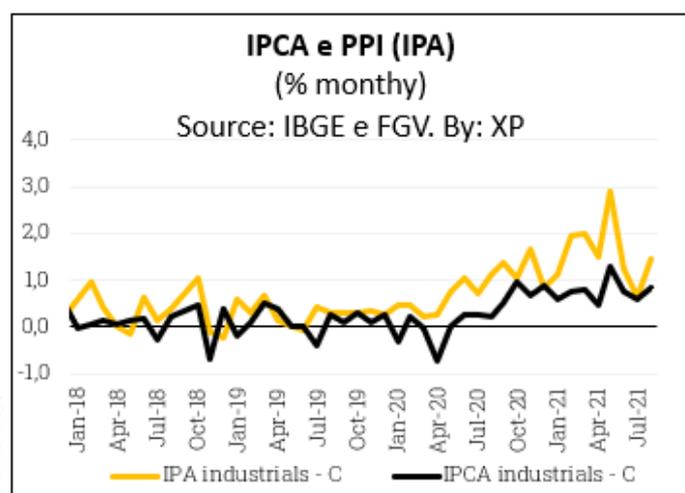
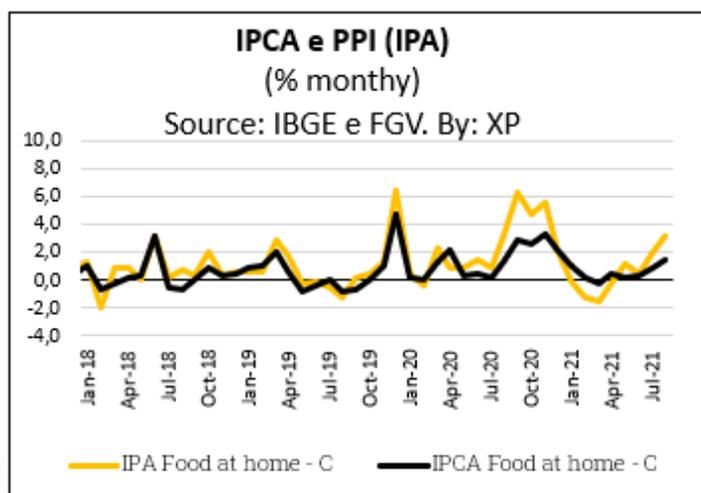
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Upward surprises continue: we raised our 2021 IPCA forecast to 8.4%

Due to the surprise in the August IPCA released today – the index rose 0.87%, while our forecast pointed to 0.65% – we raised our forecast for the year. The main deviation from the forecast was in vehicle fuels (0.08pp) and the remaining 0.14pp was spread among the other items, revealing more challenging inflation dynamics in the short term. By incorporating only the monthly surprise into our forecast, the impact would be +0.22pp.

In addition, the revision also takes into account the IGP-DI result for August released yesterday, which revealed even stronger pressure on producer prices with a correspondence in the IPCA for both industrial goods and foodstuffs, which should translate into higher transfers already in September (see graphs). We can already see this increase in high-frequency surveys of food prices (FGV) and fuels (ANP).



As a result, our forecast for the 2021 IPCA rose to 8.4%, above the previous forecast of 7.7%.

Higher inflation this year generates greater inertia for 2022, posing an upside risk to our forecast of 3.7% for 2022. On the other hand, we are undertaking a more comprehensive review of the scenario - to include the latest political and economic developments. – which will likely include a more intense reaction from the Central Bank.

This review should be completed and posted early next week.

Higher inflation turns fiscal outlook even more challenging

Higher inflation today means higher public expenditures tomorrow.

The majority of the central government's mandatory spending is linked to previous year inflation. In particular, social benefits, including pensions. According to the National Treasury, for each 1pp increase in INPC inflation, expenditures increase by R\$ 7.9 billion.

The government's budget proposal, sent to Congress in August, projects the INPC at 6.2% by the end of the year. As discussed above, we now forecast the 2021 INPC at 8.6%.

Therefore (all else equal), mandatory expenditures should be R\$ 19 billion higher than that contemplated in government's budget proposal, squeezing other expenditures – as total spending is limited by the Constitutional cap. But the budget challenges don't stop there. Important political commitments, such as boosting the cash-transfer program Bolsa Familia and rapporteur amendments, are not included in the current bill. Besides, Congress will also likely approve an extension for the payroll tax-breaks program for selected sectors.

The table below summarizes the budget proposal and its gaps. We estimate that the difference between the official proposal and a "realistic budget" sums R\$ 69.1 billion.

R\$ Billions					
Expenditures under Const. Cap	Budget Proposal (PLOA 2022)	"Realistic" Budget	B-A	Obs	
Social Security and other benefits	902.5	921.7	19.0	Unrealistic 2021 inflation forecast (6.2% vs 8.6%)	
Public Sector payroll	329.1	329.1	0.0		
Bolsa Familia (Cash-transfer program)	34.7	60.0	25.3	Based on Bolsonaro political promise	
Payroll tax breaks program	3.5	9.3	5.8	Bill extending the program will likely be approved	
Parliamentary budget amendments	16.0	33.0	17.0	Based on 2021 budget negotiation	
Other mandatory exp. under the cap	136.6	138.6	2.0	"Electoral fund" will likely be raised	
Court Ordered Payments (Precatórios)	89.0	89.0	0.0	"PEC dos Precatórios" in Congress	
Other discretionary exp. under the cap	98.6	98.6	0.0	Can be somewhat reduced	
Total (Constitutional Cap)	1610.0		69.1		

Source: Ministry of the Economy, Marcos Mendes, and XP calculations.

The lacking budget could be fixed by approving the Constitutional Amendment (already in the Congress) or a similar legislative alternative that allows the government to postpone part of the court-ordered payments bill. And by reducing other discretionary expenditures (highlighted in the table below).

This, however, would require strong coordination between the Executive, the Judiciary and Congress. The recent political events (in particular the Sept 7 demonstrations) have reduced the likelihood of such an agreement between the Three Powers.

An unrealistic budgeted proposal amidst growing political turmoil, therefore, features as the main risk for the economic scenario going forward.

Appendix: IPCA forecasts breakdown

IPCA	IPCA inflation (%)												2021
	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	
IPCA	0,25	0,86	0,93	0,31	0,83	0,53	0,96	0,87	1,06	0,53	0,39	0,57	8,4
<i>Food and beverages</i>	1,02	0,27	0,13	0,40	0,44	0,43	0,60	1,39	0,97	0,79	0,92	1,03	8,7
<i>Food at home</i>	1,06	0,28	-0,17	0,47	0,23	0,33	0,78	1,63	1,06	0,82	0,98	1,12	8,9
<i>Food away from home</i>	0,91	0,27	0,89	0,23	0,98	0,66	0,14	0,76	0,75	0,70	0,77	0,80	8,1
<i>Housing</i>	-1,07	0,40	0,81	0,22	1,78	1,10	3,10	0,68	2,36	0,58	0,38	0,25	11,0
<i>Electricity</i>	-5,60	-0,71	0,76	-0,04	5,37	1,95	7,88	1,10	6,44	1,01	0,78	0,22	20,1
<i>Articles of residence</i>	0,86	0,66	0,69	0,57	1,25	1,09	0,78	0,99	0,78	0,24	0,08	0,39	8,7
<i>Clothing</i>	-0,07	0,38	0,29	0,47	0,92	1,21	0,53	1,02	0,95	0,85	0,90	1,15	8,9
<i>Transports</i>	0,41	2,28	3,81	-0,08	1,15	0,41	1,52	1,46	1,66	0,78	0,21	0,74	15,3
<i>Gasoline</i>	2,17	7,11	11,26	-0,44	2,87	0,69	1,55	2,80	2,06	0,00	-0,10	-0,25	33,3
<i>Health and personal care</i>	0,32	0,62	-0,02	1,19	0,76	0,51	-0,65	-0,04	0,13	0,21	0,02	0,24	3,3
<i>Personal expenses</i>	0,39	0,17	0,04	0,01	0,21	0,29	0,45	0,64	0,40	0,35	0,47	0,64	4,1
<i>Education</i>	0,13	2,48	-0,52	0,04	0,06	0,05	0,18	0,28	0,10	0,05	0,05	0,07	3,0
<i>Communication</i>	0,02	-0,13	-0,07	0,08	0,21	-0,12	0,12	0,23	0,06	0,00	0,00	-0,01	0,4
<i>Regulated Prices</i>	-0,29	1,69	2,81	0,38	2,11	0,81	1,68	0,95	1,77	0,25	0,13	0,00	12,9
<i>Market-set prices</i>	0,44	0,57	0,27	0,28	0,37	0,43	0,69	0,84	0,81	0,63	0,49	0,78	6,8
<i>Non-durable goods</i>	0,88	0,70	0,32	0,40	0,80	0,51	0,63	1,30	1,05	0,79	0,77	1,00	9,5
<i>Semi-durable goods</i>	0,23	0,37	0,39	0,50	0,85	1,11	0,70	0,95	0,82	0,72	0,73	0,95	8,6
<i>Durable goods</i>	0,91	0,46	0,66	0,73	1,01	0,56	0,94	1,36	1,07	0,40	0,24	0,29	9,0
<i>Services</i>	0,07	0,55	0,12	0,05	-0,15	0,23	0,67	0,39	0,57	0,59	0,34	0,75	3,9
<i>Underlying Services</i>	0,68	0,34	0,50	0,08	0,32	0,44	0,49	0,64	0,44	0,42	0,44	0,50	5,4
<i>Industrials</i>	0,61	0,80	0,81	0,52	1,27	0,80	0,68	1,03	0,99	0,58	0,40	0,60	9,5
<i>Underlying industrials</i>	0,39	0,59	0,27	0,76	0,78	0,71	0,58	0,60	0,66	0,55	0,40	0,65	7,2
Average core inflation	0,44	0,50	0,40	0,32	0,54	0,53	0,57	0,65	0,59	0,48	0,36	0,49	6,0

* FY0 - FY3 MS - DP - B55

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