Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

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HIGHLIGHTS

- The Central Bank has ended the cycle of Selic rate hikes that started in March 2021.
- Preliminary data indicate a decline of 0.4% (real terms) in revenues collected by the RFB in September compared to September 2021.
- In the worst-case scenario considered for 2023, the Federal Government's primary deficit could reach 1.0% of GDP.
- Still, in the worst-case scenario, gross debt would rise from 77.3% of GDP in 2022 to 80.7% in 2023.
- Issuance rates of public bonds retreated for the third month in September.
- Average cost of public debt fell in August.
- Most bills to fund the nursing floor are still in the early stages of processing.
- Current government projections show a primary surplus resulting from a significant revenue advance.
- The increase in primary expenditures fiscal impact for 2022 and 2023 still deserves attention.

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REPORT LAYOUT
COMAP/SECOM and SEFPRO/SEGRAF

Covering letter

The Fiscal Follow-up Report (RAF) is the IFI's monthly economic analysis and serves the purposes in art. 1 of Senate Resolution No. 42 of 2016. Periodically, usually in May and November, the RAF also presents a broad review of the fiscal scenario for ten years ahead. Starting in June of this year, we began updating the forecasts every month to capture the short-term dynamics of the economic variables in a timelier manner.

In this RAF, as we did in September, we added an alternative scenario to contemplate the possibility of extending to 2023 the fiscal stimulus measures adopted in 2022, namely tax benefits and an additional R$ 200 per month per family regarding the Auxílio Brasil Program – Brazil Aid (PAB). Given the uncertainty brought about by the electoral context, the elaboration of alternative scenarios sheds light on the possible risks associated with the fiscal impact of these measures.

The first part of the RAF analyzes the macroeconomic context. The GDP growth estimate in 2022 and 2023 remains at 2.6% and 0.6%, respectively. The most recent data already signal lower growth in economic activity during the third quarter. The restrictive monetary policy, the withdrawal of fiscal stimulus, and the slowdown in the global economy reinforce the perspective of a slowdown in the GDP in 2023. In the alternative scenario, the maintenance of the stimulus to aggregate demand would raise the GDP growth rate to 1.0% next year, more than offsetting the negative effect of the increase in domestic fiscal risk and the consequent even more contractionary stance of monetary policy.

The labor market maintains its recovery path. The unemployment rate fell again in August and reached 8.9%, the same level as in mid-2015. The participation rate remained at 62.7%, still below the historical level before the pandemic. The overall real labor income has recovered to the level of early 2020. Despite salaries still under the effect of higher inflation, the pace of hiring guaranteed an advance of 7.7% in real terms compared to August 2021.

Inflation continues to drop after government measures. The Broad Consumer Price Index (IPCA) registered deflation for the third consecutive month (0.29%) and now accumulated a 12-month high of 7.17%. The pass-through of fuel and electricity price cuts to consumers and the reduction in oil prices contributed to another decrease in administered prices (-1.21%). Free prices have also decelerated, rising 0.02% in September, compared to 0.39% in August. In the base scenario, we revised our IPCA estimates for 2022, from 6.4% to 5.8%, and for 2023, from 4.9% to 4.8%.

The second part of the RAF deals with the fiscal scenario. This month we highlight the Union's primary balance from January to September, which, according to preliminary data collected by the IFI, should be R$ 33.5 billion. Primary revenues continue to grow strongly, but the data on the margin (Sep/22–Sep/21) indicate a slight drop in the subgroup of administered revenues, which could represent a reversal in the recent trend. Expenditure, in turn, should increase by 7.8% above inflation without non-recurring expenses (for example, with Covid-19).

In the fiscal scenario section, we also comment on the legislative proposals to finance the impact of the nursing wage floor, which will be R$ 17.4 billion, in the IFI's calculations. Depending on what is approved by Congress, this impact will be reduced to some extent. However, most proposals are still in the early stages of processing; therefore, we have not yet chosen to incorporate these effects in our scenarios.

Finally, we compare the evolution of the government's bimonthly reviews with the original figures in the LOA. The growth of R$ 200.2 billion in the revenue forecast for 2022 is noteworthy. On the other hand, the spending ceiling has not avoided the upward revision of expenses. It is basically due to the exceptions recently created in the rule. Despite the successive need for adjustments in discretionary spending subject to the spending ceiling, the official forecast for total primary expenditures increased by R$ 100 billion between the LOA and the most recent evaluation.

Daniel Veloso Couri
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

Summary

- In the September meeting, Copom decided to maintain the Selic rate at 13.75%, ending the cycle of increases underway since March 2021, when the Selic rate started at 2.0%. In the communication after the meeting, the Central Bank stated that it would evaluate if maintaining the base interest rate at the current level for an extended time would be sufficient to bring inflation to the target within the relevant horizon (first quarter of 2024). We expect the cycle of cuts to start in mid-2023, with the Selic rate ending next year at 11%. **(Page 6)**
- In this edition of the RAF, the IFI updates the scenarios described in the previous edition. Maintaining the Brazil Aid at R$ 600 would imply an additional expense of R$ 51.8 billion. Also considering the effects of the weakening economy and the tax cuts contained in the 2023 PLOA, the central government's primary balance could go from a surplus of 0.5% of the GDP in 2022 to a deficit of 1.0% of the GDP next year. **(Page 19)**
- At the moment, some bills in Congress are considered possible solutions to finance the nursing wage floor. In general, these solutions take the form of financial support from the Union to states, municipalities, and the private sector. Given the uncertainty about which proposal will be approved, the IFI has opted to wait for the progress of the proceedings before incorporating it into the fiscal scenario. **(Page 23)**
- In August and September, there was a decrease in the public bond issue rates. This movement is related to the end of the monetary tightening cycle by the Central Bank and the drop in inflation between July and September. Even if the easing of inflation results in lower interest paid on inflation-linked securities, the Selic rate kept at 13.75% p.a. for several months will affect the portion of debt composed of floating-rate securities. **(Page 29)**
- The shock on the collection forecast for 2022 was substantial. Concerning the LOA's initial figures, the government's current projections show an increase in the main items of primary revenue. The revision in the official primary revenue estimate in 2022, net of transfers, already reaches R$ 200.2 billion. **(Page 33)**
- The spending ceiling, while restrictive, has not prevented an upward revision of total primary expenditures. Despite the successive need for adjustments in expenses subject to commitment limits, the official forecast for total primary spending increased by R$ 100 billion between the LOA and the most recent evaluation. It is worth noting that the LOA already contemplated a higher expenditure than that observed in the LDO and the budget proposal sent by the Executive due to the approval of Constitutional Amendments No. 113 and No. 114, both of December 2021 (court-ordered debts EC). **(Page 33)**

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Table of contents

1. MACROECONOMIC CONTEXT

1.1 Global economy

A slowdown in global growth. In the October World Economic Outlook (WEO)[2], the International Monetary Fund (IMF) assesses that the outlook for the global economy next year has worsened since the last update in July. The broad-based slowdown in economic activity reflects the destabilization generated by Russia's invasion of Ukraine, rapid and synchronized monetary tightening in most advanced economies to moderate persistent inflationary pressures, and the cooling of economic growth in China, reflecting the zero-tolerance Covid-19 policy and the weakening of the property sector. The IMF estimates that world GDP will decelerate from 6.0% in 2021 to 3.2% in 2022 and 2.7% in 2023 (Table 1).

TABLE 1. REAL GDP AND CONSUMER PRICES – IMF'S WORLD ECONOMIC OUTLOOK FORECASTS (OCTOBER)

	Real GDP (annual percent change)			Consumer prices (year-end to year-end changes)		
	2021	2022	2023	2021	2022	2023
World output	**6.0**	**3.2**	**2.7**	**6.4**	**9.1**	**5.1**
Advanced Economies	**5.2**	**2.4**	**1.1**	**5.2**	**7.0**	**3.2**
United States	5.7	1.6	1.0	7.4	6.4	2.3
Euro Area	5.2	3.1	0.5	5.0	8.8	4.5
United Kingdom	7.4	3.6	0.3	5.4	11.3	6.3
Emerging and Developing Economies	**6.6**	**3.7**	**3.7**	**7.3**	**10.6**	**6.4**
China	8.1	3.2	4.4	1.8	2.7	1.8
Brazil	4.6	2.8	1.0	10.1	6.0	4.7

Source: IMF (World Economic Outlook Database). Prepared by IFI.

Euro Area. Russia's invasion of Ukraine has caused a severe energy crisis in Europe, raising the cost of living and weakening economic activity. As the progressive reduction in natural gas supply from Russia caused European economies to seek alternatives for energy generation, prices of liquefied natural gas (LNG) and substitute inputs such as coal also increased, reaching record levels. According to the OECD[3], the natural gas cost in Europe has tripled over the past year, exceeding by ten the average level from 2010 to 2019 by a factor of ten. The war generates severe economic repercussions in Europe, with rising energy prices, declining consumer confidence (with high inflation reducing purchasing power), and weakening economic activity, especially in industry, which absorbs persistent disruptions in supply chains and rising input costs. The challenging inflationary picture in the Euro Area has led the European Central Bank (ECB) to raise interest rates (currently at 1.25% p.a.) to contain demand and anchor inflation expectations. In this environment, the IMF projects real GDP growth in the Euro Zone of 3.1% in 2022, slowing to 0.5% in 2023 (0.7 percentage points below the July estimate).

The United Kingdom. The United Kingdom's growth is estimated to go from 7.4% in 2021 to 3.6% in 2022 and 0.3% in 2023. Since the projection was made before the announcement on September 23 of the fiscal expansion plan (equivalent to 7% of GDP with a focus on subsidies to compensate for higher energy prices and tax cuts to boost GDP), the IMF assigned an upward bias to the short-term growth outlook, warning at the same time that the package may hinder the Bank of England's objective to control rising inflation. The market reacted negatively to the possibility of a rise in the public deficit and fiscal risk, so the sterling depreciated sharply, and short-term interest rates rose.

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[2] Available at: https://www.imf.org/en/Publications/WEO/Issues/2022/10/11/world-economic-outlook-october-2022

[3] OECD Economic Outlook, Interim Report September 2022: Paying the Price of War. Available at: https://www.oecd-ilibrary.org/sites/ae8c39ecen/index.html?itemId=/content/publication/ae8c39ec-en&_csp_=975061244d5d905018ab2bd19cea8c9a&itemIGO=oecd&itemContentType=book

The United States. According to the IMF, growth in the United States is expected to slow from 5.7% in 2021 to 1.6% in 2022 and 1.0% in 2023. The outlook for 2022 is 0.7 p.p. lower than that presented in July, reflecting the real GDP contraction in the second quarter. Disposable income is decreasing, while the worsening financial conditions produced by monetary tightening have been cooling aggregate demand. The Federal Reserve (Fed) has raised interest rates to 3.25% p.a. It has adopted a hawkish discourse regarding the interest rate path to restore price stability. Interest rates will likely continue to rise, so the economy's slowdown will affect inflation. So far, the labor market remains resilient, with job expansion and wage pressures.

China. The IMF's outlook for Chinese growth is for deceleration between 2021 and 2022, from 8.1% to 3.2%, and an advance of 4.4% in 2023, as opposed to a deepening slowdown in advanced economies. Economic activity is suffering from the effects of measures to restrict mobility to curb the transmission of Covid-19 (which reduces demand and limits production), the deepening crisis in the property sector, which has historically sustained Chinese growth, and the worsening performance of the external sector, reflecting reduced demand for tourism and reduced exports of manufactures and commodities in the wake of the global economic slowdown.

1.2 Economic activity

The recent economic activity data suggest a dynamic of lower growth in consumption and GDP in the third quarter, despite the improvement in the labor market and the stimuli to the families' disposable income due to government transfers and the cooling of inflation.

Industrial production declined 0.6% in August. According to the IBGE's PIM (Monthly Industrial Survey), industrial production fell 0.6% from July to August (seasonally adjusted series). In the previous month, the index had grown 0.6%. The month's result reflected the decreases in manufacturing (-3.6%) and mining (-0.2%). The signs were mixed in the breakdown by use categories: expansion of capital goods (+5.2%) and durable goods (6.1%), and contraction of intermediate goods (-1.4%) and non-durable goods (-1.4%). Industrial production is still 1.5% below the level observed before the pandemic (February 2020). With the weak result in August, the statistical carry-over for the third quarter is estimated at zero (below the 0.9% expansion recorded in the second quarter).

Retail Sales also declined in August. The volume of retail sales (PMC – Monthly Trade Survey) varied by -0.1% between July and August in the seasonally adjusted series. In the expanded concept, which includes vehicles and construction materials, the variation was -0.6%, after dropping 0.8% in July. The statistical carry-over for the third quarter is estimated at -2.4% (after being stable in the second quarter), indicating a weakening of consumption.

Service sector revenue advanced 0.7% in August. The volume of services grew 0.7% between July and August on a seasonally adjusted basis, according to data from the IBGE's PMS (Monthly Service Survey). In the previous month, the index had risen 1.3%. The expansion in the services sector revenue in August largely followed the performance of other services (6.7% in comparison with July, on a seasonally adjusted basis) and services provided to households (1.0%). The household services sector, most affected by the health crisis, remains below the pre-pandemic level. Rising for the sixth consecutive month, it has benefited from the end of the mobility restrictions. With the August result, considering the maintenance of the PMS current level in September, the statistical carry-over for the third quarter is estimated at 2.5% (above the 1.4% expansion registered in the second quarter). The sector continues to be the primary driver of GDP growth on the supply side. It will continue to contribute positively to the third quarter result.

Economic activity indicators retreated in August. The Central Bank's Economic Activity Index (IBC-Br), a variable that aggregates information from the GDP on the supply side, presented a contraction of 1.1% between July and August in the seasonally adjusted series. The GDP Monitor, from Fundação Getulio Vargas (FGV), an indicator that seeks to estimate the GDP monthly, registered a drop of 0.7% in the same comparison. The monthly evolution of the consolidated indicators left a carry-over of 1.3% (IBC-Br) and 0.2% (GDP Monitor) for the third quarter (Table 2).

TABLE 2. ECONOMIC ACTIVITY INDEXES

Indexes	MoM		QoQ		12m	Carry-over		
	Jul/22	Aug/22	Jul/22	Aug/22	Aug/22	3rdQ	2022	2023
Industrial production	0.3%	-0.6%	0.6%	0.1%	-2.7%	0.0%	-0.5%	-0.5%
Retail sales	-0.8%	-0.6%	-1.6%	-2.6%	-2.0%	-2.4%	-1.2%	-1.3%
Volume of services	1.3%	0.7%	1.9%	2.3%	8.9%	2.5%	7.7%	1.7%
GDP Monitor (FGV)	**0.5%**	**-0.7%**	**0.2%**	**0.1%**	**2.3%**	**0.2%**	**2.6%**	**0.3%**
IBC-Br	**1.7%**	**-1.1%**	**0.9%**	**1.2%**	**2.1%**	**1.3%**	**2.8%**	**0.6%**

Source: IBGE, FGV and Central Bank. Prepared by IFI.

Confidence indexes referring to September brought mixed signals. The Business Confidence Index (ICE), which consolidates the confidence indexes of the sectors covered by the Business Surveys produced by FGV (industry, services, commerce, and construction), advanced by 0.8 points between August and September, increasing from 100.7 to 101.5 points. The industry was the only sector in which confidence declined, reflecting pessimism in foreign demand, possibly due to the ongoing deceleration of the global economy. On the other hand, the Consumer Confidence Index (ICC), on the rise for the last four months, rose 5.4 points in the same comparison, from 83.6 to 89 points, following the improvement in the current inflation picture and the recovery of the labor market.

Indicators related to the manufacturing industry pointed to a retraction in September, suggesting a negative contribution from the sector to the third quarter GDP. According to the National Association of Automotive Vehicle Manufacturers (Anfavea), vehicle production and the circulation of heavy vehicles (Brazilian Association of Highway Concessionaires – ABCR) dropped, in that order, 4.9% and 0.6% in comparison to August, considering the seasonally adjusted series. Additionally, the level of capacity utilization (Nuci), released by FGV, dropped from 82.2% to 80.8% in the same comparison, indicating, to some degree, a cooling off of activity in the industrial sector.

GDP is expected to grow 2.6% in 2022, slowing to 0.6% in 2023. The IFI's estimate for this year's volume GDP growth remains at 2.6%, considering signs of lower growth in economic activity during the third quarter. The delayed effects of the restrictive monetary policy on the economy and the slowdown in the growth of the global economy (especially of trading partners such as China, the United States, and the Euro Area) reinforce the perspective of a slowdown in GDP in 2023. The lower expansion of domestic activity next year (projection maintained at 0.6%) is also limited by the dissipation of the effect of the reopening of the economy and the withdrawal of fiscal stimulus.

Alternative scenario. The alternative scenario initially presented in the September RAF[4] foresees an expansion of 1.0% for the GDP growth rate in volume by incorporating the possibility of extending until 2023 the exemption of federal taxes on fuels and the additional R$ 200 per month per family referring to the Brazil Aid Program (PAB). In this scenario of more significant stimulus to aggregate demand, it is assumed that the increase in fiscal risk at the domestic level raises the risk premium, putting pressure on the exchange rate and expectations in the horizon in which the Central Bank intends to bring inflation to the target. The increase in disposable income for consumption would offset the negative vector arising from an even more contractionary monetary policy stance.

[4] Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/600153/RAF68_SET2022.pdf

TABLE 3. MACROECONOMIC PARAMETERS 2022 AND 2023 (BASELINE AND ALTERNATIVE SCENARIOS)

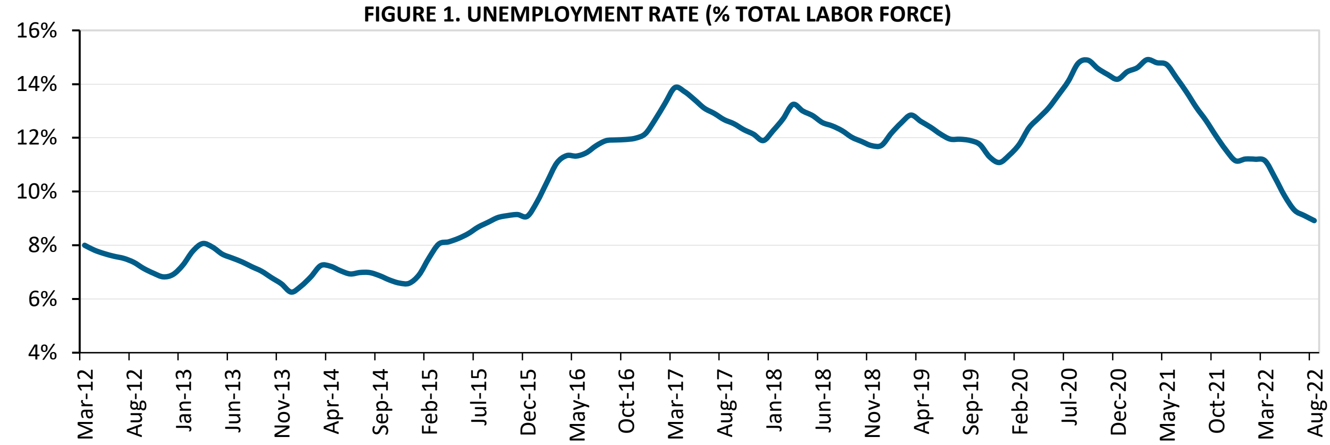
IFI forecasts	2022	2023	
	Baseline	Baseline	Alternative
Nominal GDP (R$ billion)	9,752	10,340	10,366
GDP – real growth (% per year)	2.6	0.6	1
GDP price deflator (% per year)	9.5	5.4	5.2
IPCA (% in the year)	5.8	4.8	4.6
Exchange rate – end-of-period (R$/US$)	5.2	5.27	5.39
Selic rate – end-of-period (% per year)	13.75	11.00	12.00

Source: IFI.

1.3 Labor market

The unemployment rate dropped 4.2 p.p. in the year-on-year comparison. Data from the labor market continued its recovery trajectory. The unemployment rate sustained the downward trend begun in mid-2021 (Figure 1), reaching 8.9% of the labor force in the quarter that ended in August and 4.2 p.p. below the rate recorded in the same period a year earlier (13.1%). The number of unemployed people has also been falling steadily. In the quarter that ended in August, the unemployed population was made up of 9.7 million people, 4.2 million less than in the same period in 2021 (a contraction of 30.1%).

FIGURE 1. UNEMPLOYMENT RATE (% TOTAL LABOR FORCE)



Source: IBGE. Prepared by: IFI.

The reduction in the unemployment rate is the result of the growth in hiring – an employed contingent of 99 million people (a 7.9% expansion to the same period in 2021) – to a greater extent than the increase in the labor force (up 2.9% in the same comparison), composed of people who are employed or seeking employment (unemployed population).

TABLE 4. LABOR MARKET INDICATORS

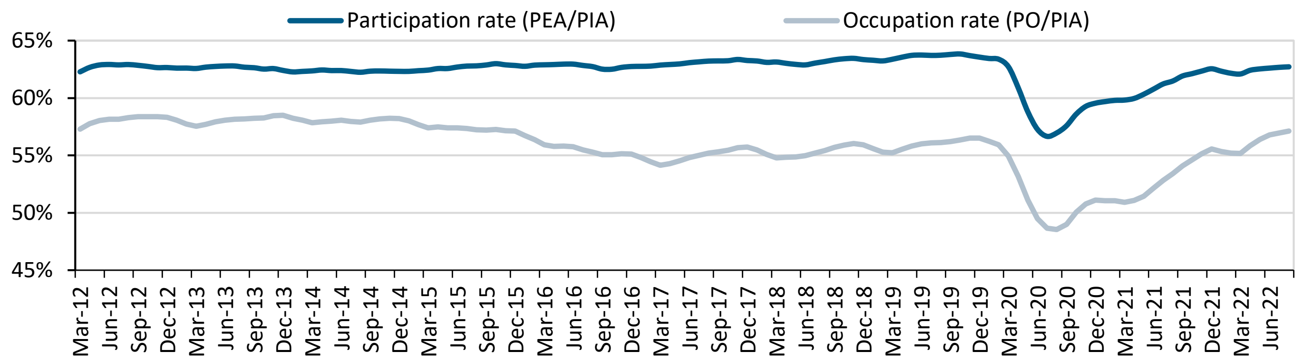
	Values (million)			Quarter x last quarter		
	Aug/20	Aug /21	Aug /22	Aug/20	Aug /21	Aug /22
A – Working-age population	170.1	171.8	173.3	1.0%	1.0%	0.9%
A.1 – People outside the labor force	73.2	66.2	64.6	19.9%	-9.7%	-2.3%
A.2 – Labor force population	96.9	105.6	108.7	-9.7%	9.0%	2.9%
A.2.1 – Unemployment	14.3	13.9	9.7	11.7%	-3.1%	-30.1%
A.2.2 – Employment	82.6	91.7	99.0	-12.6%	11.1%	7.9%
Informal employment	31.1	37.2	39.3	-19.7%	19.7%	5.7%
Formal employment	51.5	54.5	59.7	-7.7%	5.9%	9.5%
Unemployment rate (A.2.1/A.2)	14.8%	13.1%	8.9%	2.8 p.p.	-1.6 p.p.	-4.2 p.p.
Employment rate (A.2.2/A)	48.5%	53.4%	57.1%	-7.6 p.p.	4.9 p.p.	3.7 p.p.
Participation rate (A.2/A)	57.0%	61.5%	62.7%	-6.8 p.p.	4.5 p.p.	1.2 p.p.

Source: IBGE. Prepared by: IFI.

Demand for labor: hiring advances with an emphasis on the acceleration on the formal side of the economy. The population employed in the informal segments of the economy (39.3 million people) grew 5.7% compared to the same period a year earlier. At the same time, formal employment (59.7 million) rose 9.5% in the period. 60.3% of the employees hired in the quarter that ended in August had a signed contract, which represents a slight increase in formalization compared to the same period last year (59.4%). Formal job creation also advanced in the data of the New General Registry of Employed and Unemployed Persons (Novo Caged) of the Ministry of Labor and Social Security (MTP). The stock of formal workers rose 6.1% to the same period in 2021, with highlights to the performance of the civil construction sector (10.7%) and services (7.3%), with higher variations compared to agriculture (3.9%) and the manufacturing industry (4.1%).

The expansion in hiring has positively influenced the occupation level (the ratio between the employed and working-age populations). The indicator rose to 57.1%, 3.7 p.p. above the same period in 2021 and 1.2 p.p. above February 2020 – before the pandemic (55.9%).

FIGURE 2. PARTICIPATION RATE AND OCCUPATION RATE



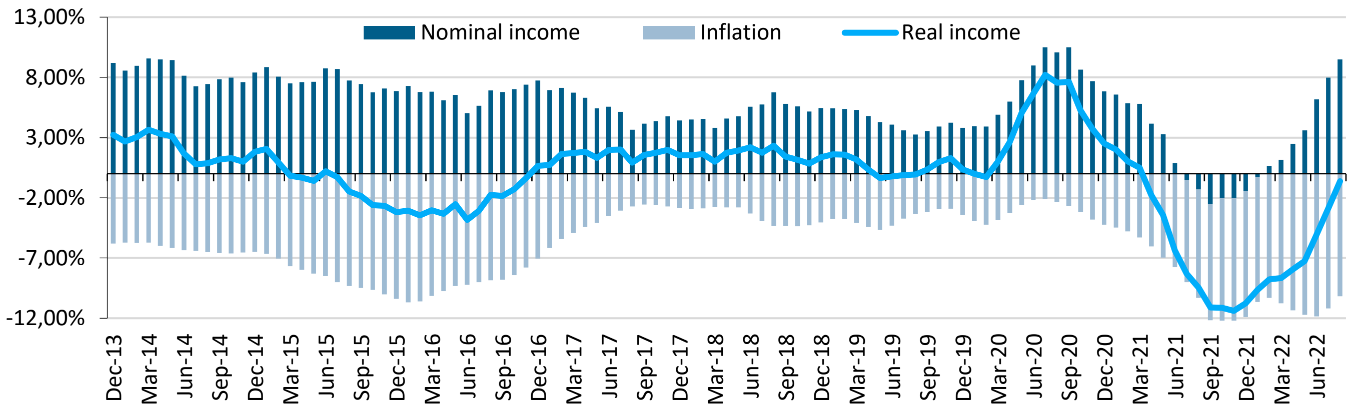
Source: IBGE. Prepared by: IFI.

Labor supply: participation rate slowly moves back to pre-pandemic levels. The growth in the labor force pushes up the participation rate. This measure allows us to track the entry and exit of working-age people from the labor market. The indicator, expressed as the ratio between the number of people in the labor force and the number of people of working age, reached 62.7% in the quarter that ended in August, as shown in Figure 2 (1.2 p.p. above the level in the same period a year earlier).

Maintained the participation rate of February before the pandemic, the unemployment rate in August would have reached 9.9%. The participation rate, however, remains below the pre-pandemic level (63.4%), reflecting, to some extent, the difficulty of workers returning to the labor market. If the participation rate were to remain at the same level as in February 2020, which in absolute terms would represent the incorporation of more than 700 thousand people into the labor market, the unemployment rate in the quarter ending in August would be higher (9.9% of the labor force).

The improvement in short-term inflation should continue to attenuate the drop in income. Also, according to data from PNAD Continuous, the earnings in the quarter that ended in August dropped 0.6% to the same period a year earlier, albeit less sharply than in the previous quarter (2.9%). This movement is favored by the increase in nominal readjustments, although the magnitude is still insufficient to cover inflation (Figure 3).

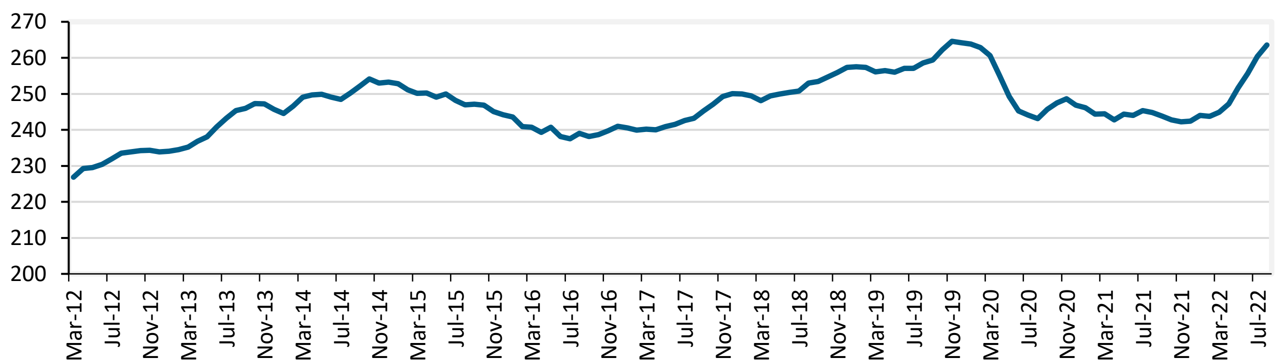
FIGURE 3. LABOR INCOME - ANNUAL GROWTH RATE



Source: IBGE. Prepared by: IFI

Job creation contributes to the expansion of the overall real labor income. The overall real labor income (Figure 4), an indicator that combines the evolution of earnings and the occupied population, advanced 7.7% in real terms in the same comparison, favored by the expansion in hiring.

FIGURE 4. OVERALL LABOR EARNINGS (R$ BI MAY-JULY 2022)



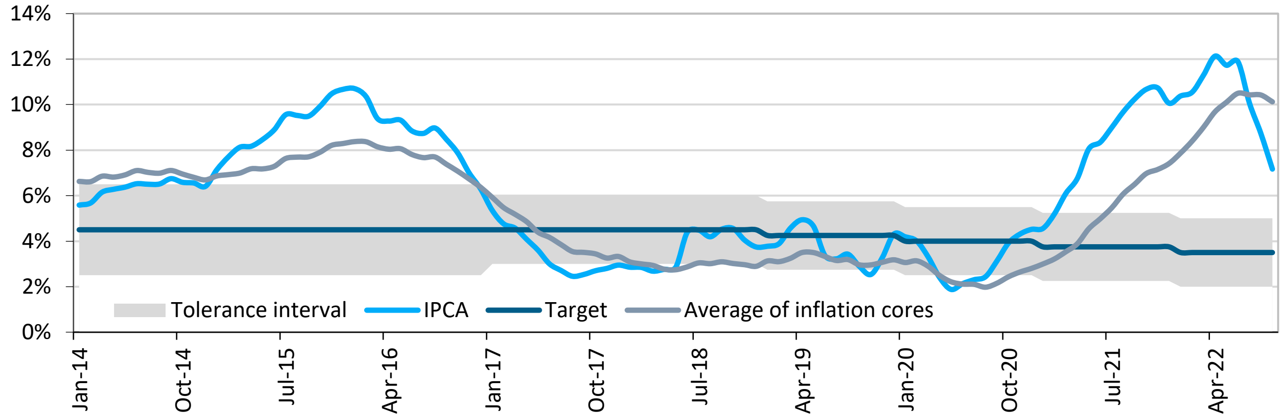
Source: IBGE. Prepared by: IFI.

1.4 Inflation and monetary policy

IPCA deflated again in September. The IPCA fell 0.29% between August and September, with 12-month accumulated inflation of 7.17% (compared to 8.73% in August). There was deflation for the third consecutive month: in July and August, the IPCA had registered variations of -0.68% and -0.36%. The recent data prompted the revision in IFI's projections for IPCA, from 6.4% to 5.8% in 2022 and from 4.9% to 4.8% in 2023.

The average of inflation cores slows down but remains at a high level. The average of the five inflation cores monitored by the Central Bank (EX-0, EX-3, MS, DP, and P55[5]) - measures that seek to remove the influence of more volatile items from total inflation – retreated from 0.66% to 0.41%. In the 12 months that ended in September, the average decelerated from 10.42% in August to 10.12% in September, remaining at a high level, well above the interval compatible with compliance with the 2022 inflation target (Figure 5).

FIGURE 5. IPCA, INFLATION TARGET AND TOLERANCE INTERVAL (% 12 MONTHS)



Source: IBGE and Central Bank. Prepared by:IFI

Administered prices fell in the 12-month accumulated period, in step with the performance of the gasoline and electrical energy items. Between August and September, the change in administered (or monitored) prices, which account for approximately 25% of the total IPCA, went from -2.55% to -1.21% (Table 5), contributing to the IPCA's deflation. The 12-month accumulated change, which in June stood at 11.73%, dropped to -1.67% in September, largely the result of the pass-through to consumers of recently approved tax resumption measures (fuels, residential electrical energy, and telecommunications) and the reduction in prices charged by Petrobras at its refineries due to the drop in oil prices on the international market. In September, gasoline prices, an item that makes up the group of administered prices, registered a variation of -8.33% (-18.65% in 12 months), representing the main negative contribution to the IPCA in the month.

[5] Central Bank study with the methodological description of core inflation is available at: https://www.bcb.gov.br/conteudo/relatorioinflacao/EstudosEspeciais/Novas_medidas_nucleo_inflacao.pdf

TABLE 5. MONTH % CHANGE AND 12-MONTH

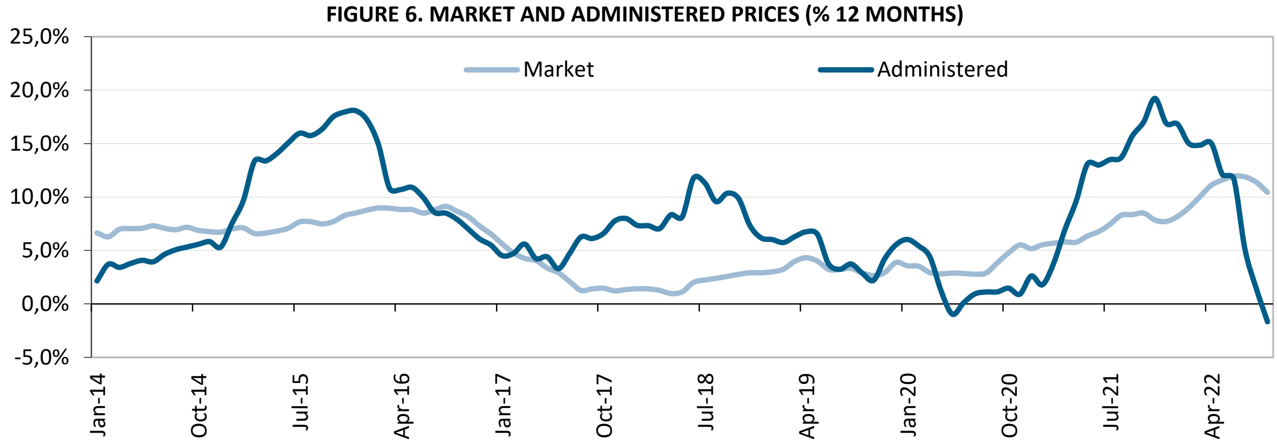
Consumer prices	Month % change			12-month		
	Jul/22	Aug/22	Sep/22	Jul/22	Aug/22	Sep/22
IPCA	**-0.68%**	**-0.36%**	**-0.29%**	**10.07%**	**8.73%**	**7.17%**
Administered prices *	**-4.35%**	**-2.55%**	**-1.21%**	**5.10%**	**1.46%**	**-1.67%**
Gasoline	-15.48%	-11.64%	-8.33%	5.64%	-9.20%	-18.65%
Residential electricity	-5.78%	-1.27%	0.78%	-10.77%	-12.86%	-17.52%
Market prices	**0.65%**	**0.39%**	**0.02%**	**11.89%**	**11.39%**	**10.44%**
Food-at-home	1.47%	0.01%	-0.86%	17.49%	15.62%	13.28%
Services	0.80%	0.28%	0.40%	8.87%	8.75%	8.50%
Industrial goods	-0.11%	0.82%	0.05%	12.83%	12.60%	11.50%
Average of inflation cores	**0.53%**	**0.66%**	**0.41%**	**10.43%**	**10.42%**	**10.12%**

Source: IBGE and Central Bank. Prepared by: IFI.

** The administered prices are composed of more than 20 items. Gasoline and residential electricity have the most significant weight.*

Free prices slowed in September, affected by food-at-home and industrial prices. Free prices rose 0.02%, slowing down against August (0.39%). Over the last 12 months, these prices' variation increased from 11.39% to 10.44%. More significant pressure from services prices (0.40% change in the month and 8.50% in 12 months), reflecting increased demand, was offset by lower inflation in food-at-home (-0.86% and 13.28%) and industrial goods (0.05% and 11.50%).

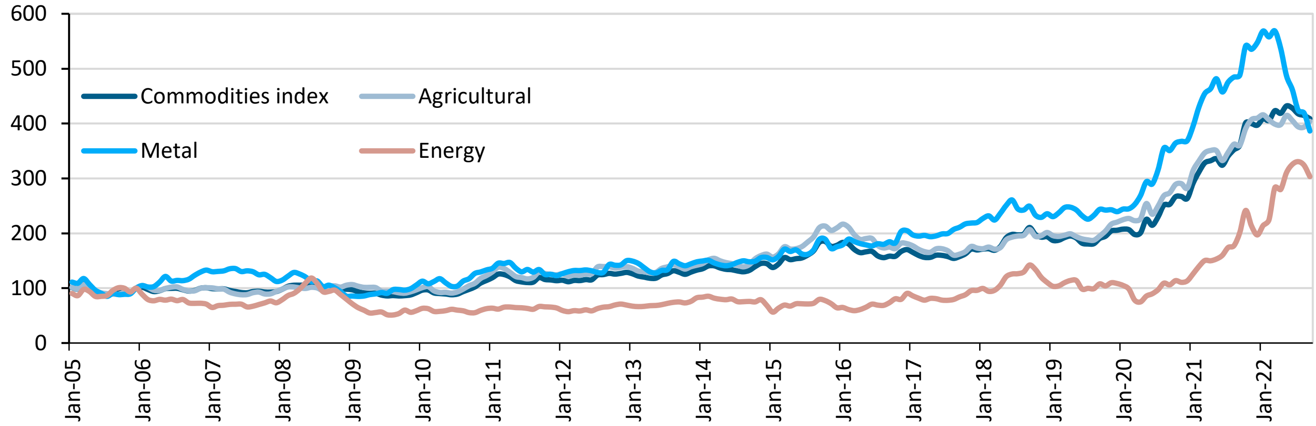
FIGURE 6. MARKET AND ADMINISTERED PRICES (% 12 MONTHS)



Source: Central Bank. Prepared by:IFI.

Commodity prices in reais show a downward trend over the last few months. The Commodities Index – Brazil (IC-Br) calculated by the Central Bank fell 1.38% between August and September after retreating 0.72% in the previous month. In the last 12 months, the IC-Br has accumulated a 13.44% hike, slowing down to August (17.7%). The index breakdown shows an increase in agricultural commodities prices (2.7%), while metal (-7.8%) and energy (-6.4%) prices slid in the same comparison. This performance reflects the reduction in international market prices with the prospect of weakening demand for raw materials. While supply constraints linked to the war in Ukraine support commodity prices, the challenging external environment (in a context of synchronized interest rate tightening in the United States and Europe and the slowing Chinese economy) is a restraining factor by reducing the demand for raw materials. Figure 7 below shows that the aggregate index (in local currency) has retreated in the last four months (accumulated fall of 5.4% between June and September). However, it remains at a high level.

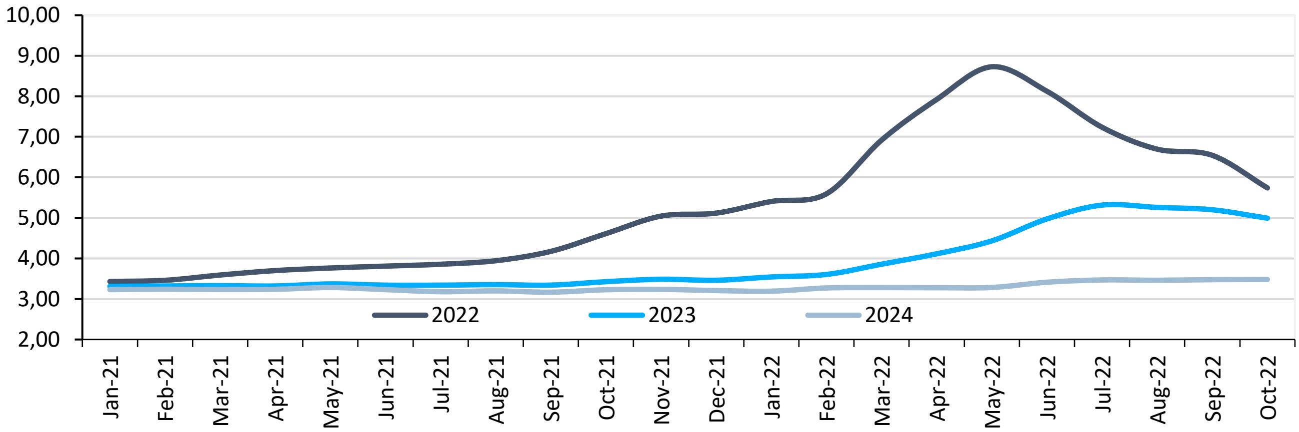
FIGURE 7. COMMODITIES INDEX (IN R$)



Source: Central Bank. Prepared by: IFI.

Inflation expectations are falling over 2022 and 2023, remaining relatively stable (above the target) in 2024. The Central Bank's Focus survey shows a drop in the market's average projection for inflation in 2022 and 2023, currently at 5.7% and 5.0%. At the same time, the perspective for the IPCA in 2024 (the horizon in which the Central Bank intends to anchor inflation expectations[6]) is sustained at around 3.5%, just above the target set by the National Monetary Council (3.0%). The reduction in expectations for next year could be associated with the incorporation by economists of the effect of the extension of federal tax reduction on fuel next year and the lower inertia left by the IPCA for 2022, while the uncertainties related to the fiscal trajectory, to some extent, influence projections for 2024.

FIGURE 8. FOCUS SURVEY - IPCA (2022, 2023 AND, 2024)



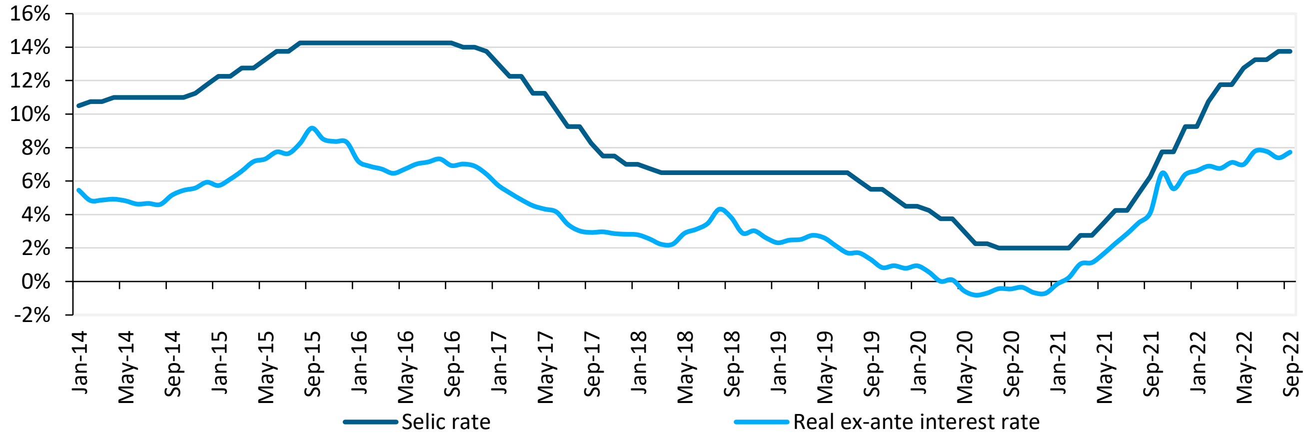
Source: Central Bank. Prepared by: IFI.

[6] According to the 248th Copom Meeting Minutes, "inflation projections for the years of 2022 and 2023 were heavily impacted by temporary tax measures across calendar years. Therefore, the Committee decided to emphasize the projections for 12-month inflation in the first quarter of 2024, which reflects the relevant horizon, smoothens out the primary effects from tax changes, but incorporates their second-round effects on the relevant inflation projections for monetary policy decisions".

Available at: https://www.bcb.gov.br/publicacoes/atascopom.

Copom interrupts the cycle of interest rate hikes, maintaining the Selic rate at 13.75% p.a. In September, Copom kept the base interest rate unchanged at 13.75% p.a., ending the monetary tightening cycle that started in March 2021, when the Selic rate was at 2.0%. In the communication released after the meeting (statement, minutes, and inflation report), the Committee stated that it would assess whether maintaining the base interest rate at the current level for an extended period would be sufficient to bring inflation to the target within the relevant horizon (first quarter of 2024). Copom emphasized that it will not hesitate to resume the adjustment cycle if the disinflation process does not run its course as expected, committing itself to the convergence of inflation to the target. In real terms, the ex-ante interest rate in September obtained based on the pre-DI swap[7] operations for one year (13.2% p.a.) discounted from the projected inflation rate[8] for the same horizon (5.1%), remains around 8% p.a. (Figure 9), staying at a restrictive level.

FIGURE 9. SELIC RATE AND REAL EX-ANTE INTEREST RATE



Source: Central Bank and IFI. Prepared by: IFI

Copom expects inflation to converge to the target in 2024. Copom's inflation projections in the reference scenario, in which the interest rate trajectory extracted from the Focus Survey is used, are 5.8% for 2022, 4.6% for 2023, and 2.8% for 2024. According to the Committee, the uncertainty surrounding the projections is high, and the variance of the balance of risks for future inflation is higher than usual. Among the upside factors, it mentions the more remarkable persistence of global inflationary pressures, uncertainty about the future of the country's fiscal framework, and additional budgetary stimuli that imply sustaining aggregate demand, besides the narrower output gap due to the resilient level of activity in the short term. Among the downside risks, it highlights an additional drop in commodity prices in local currency, a sharper-than-projected deceleration in economic activity, and the reduction of fuel taxes not being reverted as expected.

The IFI's base scenario contemplates that the Selic rate will remain at 13.75% p.a. until mid-2023, dropping back to 11.00% p.a. by the end of next year (revised from 10.50% p.a.). The IFI assesses that the maintenance of expectations for the IPCA of 2024 (relevant horizon) above the target – reflecting uncertainties about fiscal policy sustainability – would limit interest rate reduction over the next year.

[7] Reference rate of the swap contracts between DI and pre-fixed of 360 days: end of the period, obtained in Ipeadata.

[8] IPCA 12 months ahead forecast (smoothed) – Focus survey.

2. FISCAL SCENARIO

2.1 Primary revenues and transfers

Revenues collected by the RFB are expected to decline in September. According to information gathered by the IFI in the portal Siga Brasil of the Federal Senate, the central government's total primary revenue, which includes the federal government, the Central Bank, and the INSS, totaled R$ 177.2 billion in September, a real growth of 8.9% to the same month in 2021. The 0.4% decline in revenues collected by the Federal Revenue Office (RFB) is noteworthy. In comparison, net social security (RGPS) revenues rose by 3.3%, and the revenues not managed by the RFB increased by 81.5%.

In the group of revenues managed by the RFB, the result was influenced by the following taxes:

- **Income tax (IR):** a collection of R$ 42.4 billion in September (a real increase of 7.6% compared to September 2021, below the 22.1% change in August). There were real increases of 7.2% in Corporate Income Tax (IRPJ) collections and 75.5% in Withheld Income tax (IRRF-Capital). There were, however, losses of 3.9% in the IRRF-Wages and 16.8% in the Personal Income Tax (IRPF), which caused the income tax collection in September to slow down compared to previous months;
- **Industrialized Products Tax (IPI):** revenues of R$ 5.4 billion in September, a real decrease of 22.4% compared to the same month in 2021, influenced by the linear reduction of 35% promoted by the Executive Branch in the tax rates;
- **Import Tax (II):** a collection of R$ 5.3 billion in September, a real reduction of 6.2% compared to the same month in 2021, influenced by the drop in the average R$/US$ exchange rate of 2.1% in August 2022, compared to August 2021, in addition to the rate reductions made by the federal government throughout 2022; and
- **PIS/Pasep and Cofins:** collections of R$ 32.8 billion in September, 5.7% below September 2021, in real terms.

Dividends and exploitation of natural resources continued to drive federal tax collections in September. In the group of revenues not managed by the RFB, it is worth mentioning (i) the collection of dividends, on the order of R$ 13.5 billion (against R$ 283.7 million in September 2021), of which R$ 12.6 billion refer to dividends paid by Petrobras for the results of the second quarter of 2022; and (ii) revenues from the exploitation of natural resources, in the amount of R$ 6.9 billion (+31.5% compared to September 2021).

In the year to September 2022, primary revenue reached R$ 1,722.6 billion, a real increase of 13.8% compared to 2021 (Table 6). In the first nine months of the year, the collection continued to reflect the dynamics of the main factors: economic activity, inflation, and commodity prices, although the last two factors already show signs of cooling.

Revenues not collected by the RFB show expansion above total primary revenue in 2022. In the year to date, revenues collected by the RFB have grown 8.4% above inflation compared to 2021, net social security rose 6.6%, and revenues not managed by the RFB jumped 51.6%. The growth in revenues not collected by the RFB in the year to September 2022 was driven by dividends and participations (R$ 79.1 billion), concessions and permissions (R$ 42.6 billion), and revenues from the exploration of natural resources (R$ 99.2 billion).

TABLE 6. CENTRAL GOVERNMENT REVENUES - 2020 TO 2022 - JAN. TO SEP. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

	Jan-Sep/20			Jan-Sep/21			Jan-Sep/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total revenue	**1,013.2**	**-13.7%**	**18.6%**	**1,370.4**	**25.9%**	**21.3%**	**1,722.6**	**13.8%**	**24.0%**
Revenues Collected by RFB, except RGPS	*626.5*	*-13.7%*	*11.5%*	*865.1*	*28.6%*	*13.5%*	*1,035.4*	*8.4%*	*14.4%*
Fiscal incentives	*-0.1*	*-*	*0.0%*	*-0.1*	*-*	*0.0%*	*-0.1*	*-*	*0.0%*
RGPS	*266.5*	*-11.5%*	*4.9%*	*320.3*	*11.8%*	*5.0%*	*376.9*	*6.6%*	*5.3%*
Revenues not Collected by RFB	*120.4*	*-17.7%*	*2.2%*	*185.0*	*43.0%*	*2.9%*	*310.4*	*51.6%*	*4.3%*
Transfers	**187.0**	**-10.7%**	**3.4%**	**252.3**	**25.5%**	**3.9%**	**335.3**	**20.3%**	**4.7%**
Net revenue	**826.1**	**-14.3%**	**15.1%**	**1,118.2**	**26.0%**	**17.4%**	**1,387.3**	**12.4%**	**19.4%**
Total revenue without non-recurrent event*	**1,073.8**	**-5.5%**	**19.7%**	**1,319.5**	**14.4%**	**20.5%**	**1,649.9**	**13.2%**	**23.0%**
Net revenue without non-recurrent event *	**886.8**	**-4.3%**	**16.3%**	**1,067.2**	**12.0%**	**16.6%**	**1,314.7**	**11.5%**	**18.3%**
GDP (R$ billion)			**5,456.30**			**6,421.70**			**7,166.10**

*Source: STN, Central Bank, and Siga Brasil. Prepared by: IFI. * The non-recurrent events are presented and described in the IFI's EE no. 17, 2021.*

Income tax and oil revenues boost transfers to subnational entities in 2022. Also, according to Table 6, the transfers by revenue sharing totaled R$ 335.3 billion up to September, a real increase of 20.3% over 2021. This increase in transfers is the result of the rise in the income tax collection and collections from the production of oil and natural gas (Law 9,478 of 1997), as well as Law 14,337 of May 11, 2022, which provides for an additional transfer to the subnational entities regarding the pre-salt auctions of R$ 7.7 billion by way of a special credit, opened with funds from the excess of collection from concessions and permissions.

Considering a primary revenue of R$ 1,722.6 billion between January and September and transfers by revenue sharing of R$ 335.3 billion, the central government's net primary revenue[9] totaled R$ 1,387.3 billion in the period, a real increase of 12.4% compared to 2021.

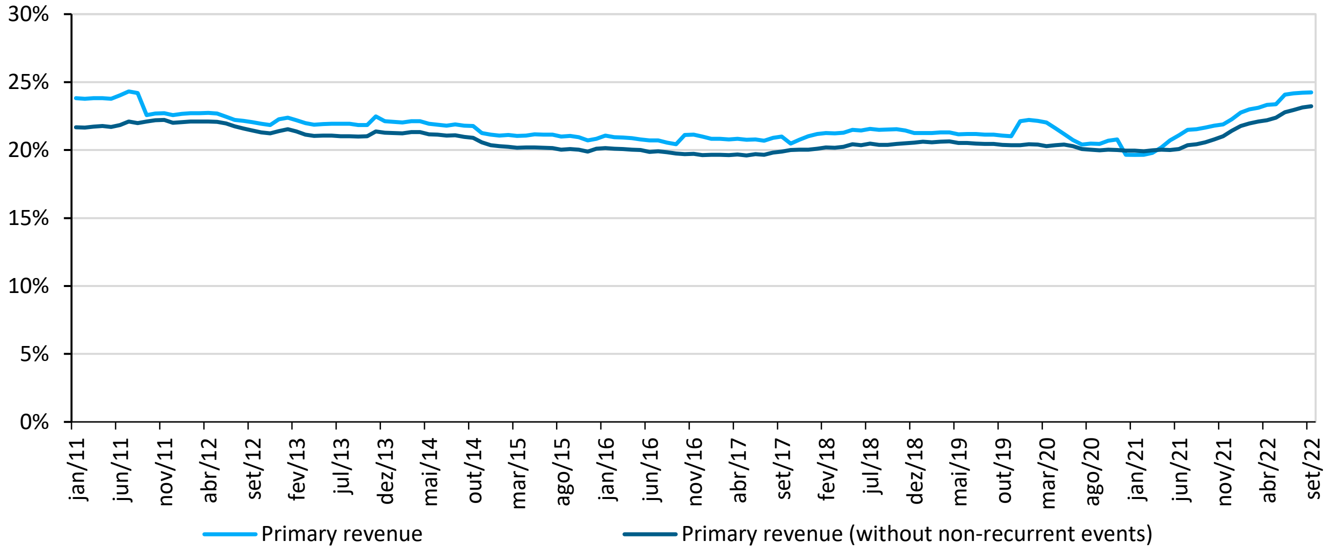
Table 6 also presents total and net recurring revenues (free from the influence of atypical factors), which grew 13.2% and 11.5% (in real terms), in that order, in the year to September. The non-recurring events considered are described in the Special Study (EE) of the IFI No. December 17, 2021,[10] and include collections from fiscal recovery programs (Refis), anticipated dividends, operations with assets, and other atypical collections reported by the RFB.

In the 12-month comparison, central government primary revenue totaled R$ 2,284.8 billion (24.2% of GDP) through September, while recurrent primary revenue reached R$ 2,188.6 billion (23.2% of GDP). Figure 10 shows the evolution, since 2011, of these two series as a proportion of GDP. By comparison, recurrent primary revenue went from 21.8% of GDP in January 2022 to 22.8% of GDP in June and then to 22.9% of GDP in July, 23.1% of GDP in August, and 23.2% of GDP in September.

[9] The net revenue corresponds to the volume of resources available to the Union after sharing revenues with states and municipalities, that is, total revenues minus transfers.

[10] Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/594656/EE17_Resultado_Estrutural.pdf.

FIGURE 10. CONVENTIONAL AND RECURRENT PRIMARY REVENUE (12 MONTHS - % OF GDP)



Source: SIGA Brasil and STN. Prepared by: IFI.

As mentioned in the previous section, inflation and commodity prices started to recede in July, which should produce cooling in tax collection in the coming months. It is worth mentioning that the increase in primary revenue as of the last quarter of 2020, as illustrated in Figure 10, occurred in line with the growth in commodity prices and inflation.

In this edition of the RAF, the IFI updated the projections for central government primary revenues in 2022 and 2023, considering the baseline and alternative scenarios described in RAF No. 68, September 14, 2022[11]. The alternative scenario incorporates the effects of an eventual continuation of some fiscal stimulus measures currently in development, scheduled to end in December.

In the baseline scenario, revenues not collected by the RFB explain the decline in revenue projections between 2022 and 2023. Table 7 presents the forecasts for total primary revenue, transfers by revenue sharing, and net primary revenue in the two scenarios considered. In the baseline scenario, which incorporates the 35% permanent IPI tax exemption, the projection for total primary revenue shows a slight decrease in 2023 compared to this year. Despite the 0.6% growth of GDP in the baseline scenario, this reduction lies in the behavior of revenues not collected by the RFB, which would fall sharply next year. The main reason is the collection of dividends and participations, which would fall from R$ 95.0 billion in 2022 to R$ 38.0 billion in 2023, given the expected drop in oil prices in the international market and the consequent effect on Petrobras' profits and dividend distribution.

[11] Available at: https://www12.senado.leg.br/ifi/relatorio-de-acompanhamento-fiscal.

TABLE 7. REVENUE ESTIMATES - BASELINE AND ALTERNATIVE

	2022		2023	
	Baseline	Alternative	Baseline	Alternative
1. Total primary revenue	**2,322.5**	**2,322.6**	**2,316.0**	**2,246.8**
Revenues collected by the RFB	1,400.0	1,400.0	1,470.4	1,399.8
Net social security (RGPS)	537.2	537.2	558.6	560.0
Revenues not collected by the RFB	385.4	385.4	287.0	287.0
2. Transfers by revenue sharing	**459.1**	**459.1**	**468.4**	**445.9**
3. Net revenue [1-2]	**1,863.4**	**1,863.5**	**1,847.6**	**1,800.9**

Source: IFI.

Revision in the nominal GDP projection and September data explain lower revenue projections to the September RAF. Two factors explain the lower revenues collected by the RFB projections in 2022 and 2023 relative to those published in the September RAF 68. The first factor concerns the lower collection realized in September 2022. Considering the three main groups of revenues (collected, RGPS, and not collected), there was a difference of less than R$10.2 billion between the realized and projected amounts. The second element to explain the downward revision in the estimates was the change in the GDP price deflator and nominal GDP projections. The IFI revised the nominal GDP projection for 2022 from a high of 12.7% to 12.4% in the baseline scenario. For 2023, the projection was revised from 6.4% to 6.0% in the baseline scenario and from 6.6% to 6.3% in the alternative scenario.

In the alternative scenario, which incorporates federal tax exemptions foreseen in the 2023 PLOA, the central government's total primary revenue would be R$ 2,322.6 billion in 2022 and R$ 2,246.8 billion next year, R$ 69.2 billion less than the total revenue projected in the baseline scenario (Table 7). The impact on net revenue would be R$ 46.7 billion (R$ 1,800.9 billion in the alternative scenario versus R$ 1,847.6 billion in the baseline scenario).

It is worth mentioning that, in the alternative scenario, the impact of the tax cuts would be partially offset by higher growth of the economy in 2023 (1.0% versus 0.6% in the baseline scenario), even though the GDP price deflator would be 5.2% in the alternative scenario and 5.4% in the baseline scenario.

By comparison, in October, the median forecast of the economists participating in the Monthly Report from Prisma[12] of the Ministry of Economy was a federal collection of R$ 2,239.5 billion in 2022 and R$ 2,312.9 billion in 2023. In the same report, the average of the projections of the podium (most accurate economists) is R$ 2,278.3 billion in 2022 and R$ 2,336.7 billion in 2023.

On the other hand, the most recent projection of the Executive Branch for 2022, contained in the Primary Revenue and Expenditure Evaluation Report of the 4th Bimester of 2022[13], of September, is total primary revenue of R$ 2,308.3 billion. For 2023, the PLOA 2023 foresees a primary revenue of R$ 2,257.4 billion.

2.2 Primary expenditure

Both mandatory and discretionary spending will grow in 2022. In the baseline scenario, central government primary expenditure is projected to increase by R$ 198.4 billion, or 12.3% (Table 8). In September, the IFI estimated an increase of R$ 208.4 billion in total primary expenditure between 2021 and 2022. As a percentage of GDP, however,

[12] Available at: https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/relatorios-do-prisma-fiscal/relatorio-mensal/2022.

[13] Available at: https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-avaliacao-de-receitas-e-despesas-primarias-rardp/2022/16.

spending would remain at 18.6%, both in 2021 and 2022. The nominal expansion occurs in both mandatory and discretionary spending.

Pandemic-related expenditures fall in 2022 but are partially offset by EC 123. Expenses to face Covid-19 should present a significant reduction to the previous year, even if partially offset by extra spending, in 2022, referring to extraordinary credits approved through Constitutional Amendment (EC) 123 of 2022 and the payment of a court ruling to the municipality of São Paulo regarding Campo de Marte airport (R$ 23.9 billion). This year, the IFI projects around R$ 1,812.6 billion, of which R$ 1,658.8 billion is mandatory and R$ 153.8 billion in discretionary expenses (Table 8).

TABLE 8. PRIMARY EXPENDITURE - BASELINE (R$ BILLION)

Breakdown	2021	2022	Change	
	Realized	IFI forecast	R$ billion	%
Primary expenditure	**1,614.2**	**1,812.6**	**198.4**	**12.3**
Mandatory	1,490.3	1,658.8	168.5	11.3
Social Security Benefits (RGPS)	709.6	792.2	82.6	11.6
Payroll	329.3	337.4	8.1	2.5
Salary allowance and unemployment insurance	45.9	63.2	17.3	37.8
BPC	67.7	78.7	11	16.3
Bolsa Família (Family Allowance)	25.8	97.6	71.8	278.3
Other mandatory	312	289.6	-22.4	-7.2
Discretionary (Executive)	123.9	153.8	29.9	24.1
Memo:				
Facing Covid-19, EC 123 and Campo de Marte	*121.4*	*83.3*	*-38.1*	*-31.4*
Other	*1,492.7*	*1,729.2*	*236.5*	*15.8*

Source: Treasury (2021) and IFI (2022). Prepared by: IFI.

Primary Expenditure drops in September. According to Siga Brasil, in real terms, the central government's primary expenditure totaled R$ 135.2 billion in September, 1.3% lower than in the same month of 2021. Below are some comments regarding some of the expenditure items.

- **Social security benefits:** payment of R$ 61.7 billion represented a real increase of 5.9% over September 2021;
- **Payroll:** expenses of R$ 25.5 billion in September represented a real reduction of 4.8% to the same month last year and reflected the absence of adjustments in civil service wages and restraint in hiring; and
- **Mandatory expenditure with flow control:** volume of R$ 17.2 billion (a real increase of 42.1%) influenced by the payment of the Brazil Aid in R$ 7.0 billion. Disregarding the values referring to the Auxílio, which began to be paid in November 2021, the mandatory expenses with flow control would have registered a real fall of 15.8% in September compared to the same month in 2021.

In the year-to-date, the primary expenditure presents a slight increase. The central government's total primary expense reached R$ 1,353.8 billion in 2022, 2.2% higher in real terms than the expense incurred between January and September last year (Table 9). The highlights for this result are the expenses with salary allowance and unemployment benefit (which accumulate a 31.1% increase, mainly due to the change in the payment schedule of the salary allowance), the Union's supplement to the Fundeb, which is in a transition period, (an increase of 46.4%), the mandatory expenses with flow control, influenced by expenses with the Family Allowance and Brazil Aid programs (43.1%), and the discretionary expenses, which grew due to the atypical expense of R$ 23.9 billion related to the dispute over Campo de Marte.

TABLE 9. CENTRAL GOVERNMENT PRIMARY EXPENDITURE – 2020 TO 2022 – JAN. TO SEP. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

Breakdown	Jan-Sep/20			Jan-Sep/21			Jan-Sep/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total expenditure	**1,503.6**	**44.9%**	**27.6%**	**1,199.7**	**-25.9%**	**18.7%**	**1,353.8**	**2.2%**	**18.9%**
Social Security Benefits (RGPS)	*509.2*	*8.3%*	*9.3%*	*545.6*	*-0.5%*	*8.5%*	*610.7*	*1.3%*	*8.5%*
Payroll (working and retired employees)	*233.4*	*-0.2%*	*4.3%*	*240.4*	*-4.2%*	*3.7%*	*246.1*	*-7.3%*	*3.4%*
Salary allowance and unemployment insurance	*48.1*	*11.6%*	*0.9%*	*37.2*	*-27.5%*	*0.6%*	*54.0*	*31.1%*	*0.8%*
Continuous Cash Benefit (BPC)	*46.9*	*2.3%*	*0.9%*	*50.9*	*0.8%*	*0.8%*	*59.0*	*5.0%*	*0.8%*
Extraordinary Credits (except PAC)	*342.8*	*-*	*6.3%*	*95.9*	*-74.2%*	*1.5%*	*27.9*	*-73.4%*	*0.4%*
Compensation to RGPS for Exemption of Payroll Taxes	*7.5*	*-11.2%*	*0.1%*	*5.8*	*-27.9%*	*0.1%*	*3.1*	*-51.4%*	*0.0%*
Fundeb	*12.5*	*1.8%*	*0.2%*	*15.1*	*13.1%*	*0.2%*	*24.5*	*46.4%*	*0.3%*
Court Rulings and Court-Ordered Debts (current and capital expenditure)	*21.9*	*45.9%*	*0.4%*	*17.9*	*-24.5%*	*0.3%*	*15.9*	*-20.2%*	*0.2%*
Subsidies, Grants, and Proagro	*29.0*	*175.2%*	*0.5%*	*5.2*	*-83.0%*	*0.1%*	*14.1*	*143.0%*	*0.2%*
Mandatory expenditure	**1,431.8**	**48.5%**	**26.2%**	**1,128.4**	**-26.8%**	**17.6%**	**1,238.5**	**-0.6%**	**17.3%**
Mandatory spending with flow control	***92.6***	***-11.5%***	***1.7%***	***101.6***	***2.1%***	***1.6%***	***160.7***	***43.1%***	***2.2%***
Discretionary	**71.8**	**-2.1%**	**1.3%**	**71.3**	**-8.2%**	**1.1%**	**115.4**	**46.6%**	**1.6%**
Total expenditure without non-recurrent events*	**1,042.3**	**0.5%**	**19.1%**	**1,083.3**	**-3.4%**	**16.9%**	**1,289.2**	**7.8%**	**18.0%**
GDP (R$ billion)			**5,456.3**			**6,421.7**			**7,166.1**

** The non-recurrent events are presented and described in the IFI's EE no. 17, 2021.*
Source: SIGA Brasil, STN, and Central Bank. Prepared by: IFI.

Expenses with social security show slight growth in 2021. The IFI estimates that the expenses with social security benefits, including judgments and court-ordered debts, should end 2022 at 8.1% of the GDP (R$ 792.2 billion). This figure incorporates data from January to September and the IFI's projection for the following months. According to data extracted from the Siga Brasil portal[14], in the first nine months of the year, the social security expense grew 1.3%, in real terms, to the same period in 2021. This variation considers eventual expenses related to court rulings or annual bonuses (Christmas).

The first months of the year are usually good predictors of the behavior of the General Social Security System (RGPS) expenses. In October, the IFI marginally reduced the projection for spending on social security benefits this year from R$ 793.6 billion to R$ 792.2 billion, representing an increase of R$ 82.6 billion to 2021 (Table 8). As a percentage of the GDP, there is a slight decrease from 8.2% to 8.1% of the GDP in the period.

Finally, the Central Government's recurrent primary expenditure, calculated by the IFI based on the methodology published in the EE mentioned above no. 17 of December 2021, totaled R$ 1,289.2 billion in the accumulated total for 2022 through September, a real increase of 7.8% over 2021 (Table 9). The calculation considers as non-recurring expenses from Covid-19, the onerous assignment of the pre-salt, the Brazilian Sovereign Fund, the anticipations in the payment of the salary allowance and the RGPS Christmas bonus, and other expenses, such as the payment for the right to use Campo de Marte.

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[14] The search filtered the amounts paid, including outstanding liabilities, in the Budget Unit "Fund for the General Social Security System" from January to August.

In the 12 months that ended September, primary expenditure reached R$ 1,768.2 billion (18.8% of GDP), a reduction of 2.7% compared to the same month in 2021. As presented for revenues, the IFI calculated two scenarios for expenditure in 2022 and 2023, considering the possible impacts if the fiscal stimulus measures are extended into next year, as explained in RAF no. 68, September 2022, already referenced.

Payment of the Brazil Aid of R$ 600 in 2023 has no legal provision yet. Table 10 presents the IFI's total primary expenditure projections for 2022 and 2023 in the baseline and alternative scenarios. As mentioned in RAF no. 68, the estimates do not incorporate the expenditure of Brazil Aid in R$ 600 next year due to the absence of legal provisions for it. An update of the simulation with Brazil Aid at R$ 600 will be presented below. Further explanations regarding the base and alternative scenarios are provided in RAF no. 68.

TABLE 10. CENTRAL GOVERNMENT PRIMARY EXPENDITURE 2022 AND 2023 FORECASTS (R$ BILLION)

Breakdown	2022		2023	
	Baseline	Alternative	Baseline	Alternative
Total expenditure	**1,812.60**	**1,812.60**	**1,852.10**	**1,852.10**
Social Security Benefits (RGPS)	*792.2*	*792.2*	*863.1*	*863.1*
Payroll (working and retired employees)	*337.4*	*337.4*	*370.9*	*370.9*
Salary allowance and unemployment insurance	*63.2*	*63.2*	*67.2*	*67.3*
Continuous Cash Benefit (BPC)	*78.7*	*78.7*	*84.9*	*84.9*
Extraordinary Credits (except PAC)	*53.1*	*53.1*	*2*	*2*
Fundeb	*34.3*	*34.3*	*40*	*40*
Court Rulings and Court-Ordered Debts (current and capital expenditure)	*18.1*	*18.1*	*24.7*	*24.7*
Subsidies, Grants, and Proagro	*19.3*	*19.3*	*19.8*	*19.8*
Mandatory	**1,658.80**	**1,658.80**	**1,739.70**	**1,739.80**
Mandatory spending with flow control	***223.3***	***223.3***	***233.5***	***233.5***
Discretionary	**153.8**	**153.8**	**112.4**	**112.3**

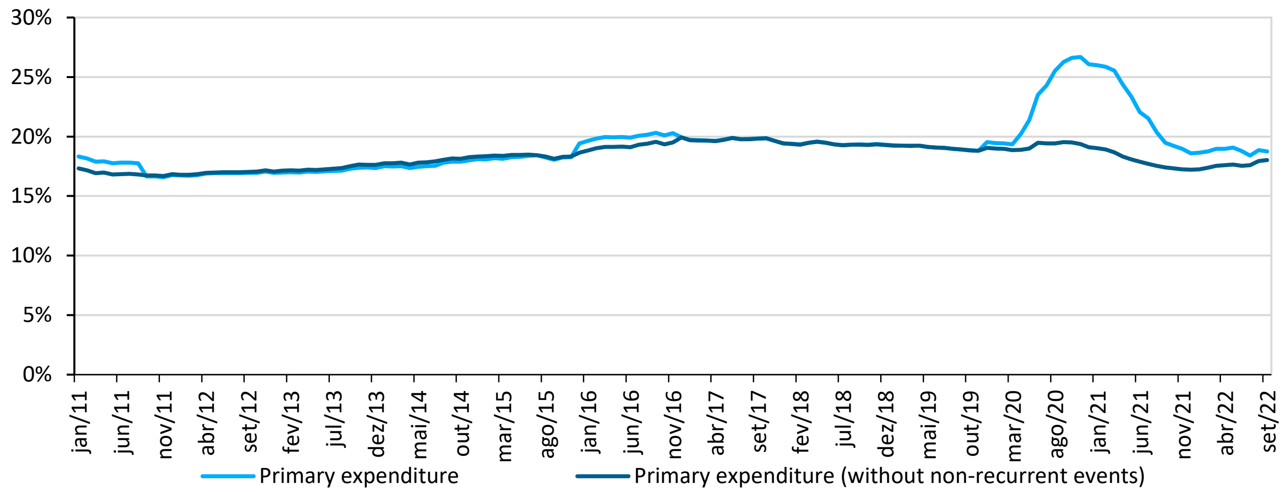
Source: STN. Prepared by: IFI.

The downward revision in the IPCA projection for 2022 affects the estimate for the federal spending ceiling in 2023. The main difference between the primary expenditure projections in the baseline and alternative scenarios in Table 10 lies in the values considered for the IPCA in 2022, which sets the expenditure ceiling for 2023. In October, the IFI revised the projection for the IPCA of 2022 (from 6.4% to 5.8% in both scenarios). It is worth saying that the lower IPCA implies a lower spending ceiling in the following year.

The alternative scenario incorporates the payment of Brazil Aid of R$ 600. The projection for total primary expenditure with the incorporation of the Brazil Aid of R$ 600 being paid outside the expenditure ceiling to 21.6 million families in 2023 is R$ 1,903.9 billion, or 18.4% of GDP, an impact of R$ 51.8 billion, or 0.5% of GDP, compared to the baseline scenario.

To conclude this subsection, we present the 12-month trajectory of the conventional and recurrent primary expenditure calculated by the IFI according to the methodology presented in EE no.17, December 2021. Figure 11 contains these two series measured as a proportion of GDP. Total primary expenditure reached 18.8% of GDP in September, down from 18.9% of GDP in August and 18.4% of GDP in July. Non-typical (or recurrent) expenditure rose from 17.6% of GDP in July to 18.0% in August and remained at this level in September. Both curves indicate that primary spending remains relatively under control.

FIGURE 11. TOTAL PRIMARY EXPENDITURE (WITH AND WITHOUT NON-RECURRING EVENTS) - % OF GDP



Source: STN. Prepared by: IFI.

2.3 The central government and the consolidated public sector balance

After the first nine months of the year, the central government's primary balance remains positive. The data collected by the IFI on the Siga Brasil portal showed a primary surplus of R$ 11.3 billion for the central government in September, compared to a surplus of R$ 590.1 million in the same month of 2021. In the year to September 2022, the central government reported a primary surplus of R$ 33.5 billion, above the R$ 22.2 billion surpluses accumulated through August. Given the spending ceiling, the primary surplus accumulated in 2022 continues to reflect the increase in revenues and the relative control of primary spending.

In the alternative scenario, the primary federal deficit could reach 1.0% of GDP in 2023. In the 12 months that ended in September, the central government reported a primary surplus of R$ 80.0 billion (0.8% of GDP). This year, mainly due to the primary revenues estimates update, the IFI projects a surplus of R$ 50.9 billion (0.5% of GDP) in both scenarios (baseline and alternative). For 2023, however, the forecasts range from a R$ 4.5 billion deficit (0.0% of the GDP) to a R$ 103.0 billion deficit (1.0% of the GDP). Table 11 presents the baseline and alternative, and modified scenarios' values.

TABLE 11. CENTRAL GOVERNMENT PRIMARY BALANCE 2022 AND 2023 ESTIMATES (R$ BILLION)

Discriminação	2022		2023			
	Baseline		Baseline		Alternative	
	Value	% of GDP	Value	% of GDP	Value	% of GDP
Net revenue	1,863.4	19.1	1,847.6	17.9	1,800.9	17.4
Primary expenditure	1,812.6	18.6	1,852.1	17.9	1,903.9	18.4
Primary balance	50.9	0.5	-4.5	0.0	-103.0	-1.0

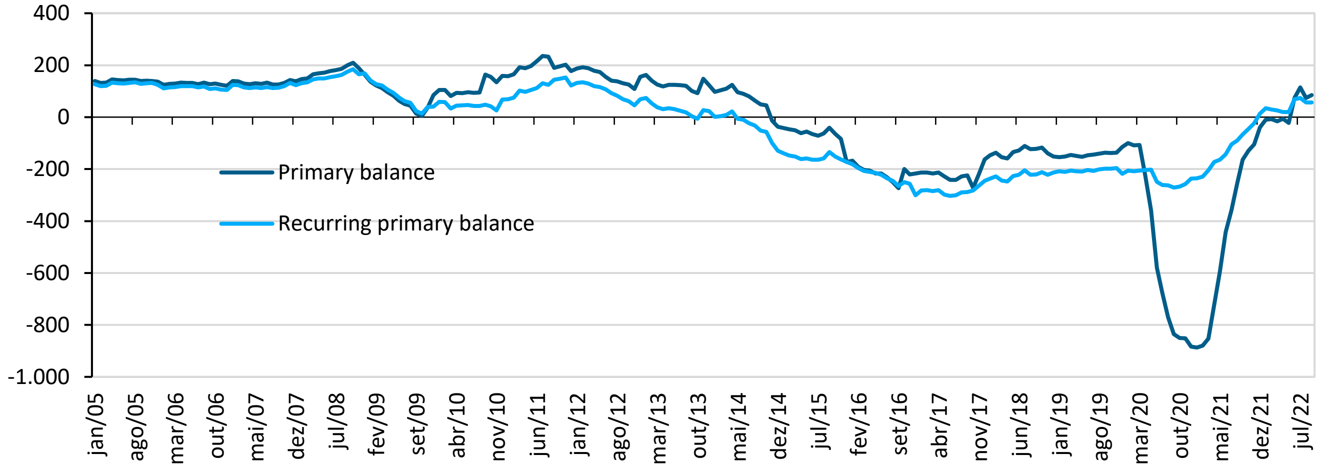
Source: IFI.

The worsening of the primary balance in 2023 would occur due to the lower revenues and the increase in expenditures. Table 11 allows for the following observations: (i) in 2022, the downward revision of the primary revenue reduced IFI's expectation for the central government primary surplus from R$ 71.2 billion to R$ 50.9 billion; (ii) for 2023, in the baseline scenario, IFI's projection for the federal government primary surplus is a deficit of R$ 4.5 billion; and (iii) in the alternative scenario, where the additional benefit of the Brazil Aid is executed outside the ceiling, the primary deficit projected for 2023 increases to R$ 103.0 billion.

Figure 12 presents the 12-month path of the central government's conventional (observed) and recurrent primary balances at September 2022 prices. While the traditional balance was a surplus of R$ 84.6 billion in September, the recurring balance was a positive R$ 56.7 billion. The recurring balance confirmed an improvement in the trajectory of the federal primary surplus as of the last quarter of 2020, when tax collection started to grow at an accelerated pace.

A deceleration in activity and an increase in Brazil Aid represent risks for the accounts next year. As mentioned earlier, the expected slowdown in domestic and foreign economic activity in the coming months due to the tighter monetary policy is a risk to the trajectory of revenues, especially from 2023. On the expenditure side, the possible extension of the Brazil Aid additional benefit in the average monthly amount of R$ 600.00 per family also represents a risk, given the lack of space in the Federal Government's spending ceiling for the execution of this expense. The way this expenditure would be accommodated may influence the credibility of the country's fiscal regime.

FIGURE 12. CENTRAL GOVERNMENT'S PRIMARY BALANCE (WITH AND WITHOUT NON-RECURRING EVENTS) - R$ BILLION AT AUGUST 2022 PRICES)

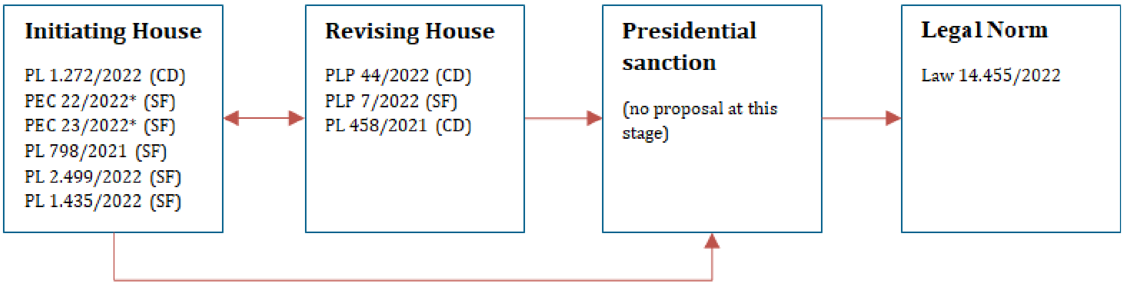


Source: SIGA Brasil, STN and Tesouro Gerencial. Prepared by: IFI.

Indefinite financing of the nursing wage floor prevents estimating the budget impact for 2023. In RAF no. 68, September 2022, we estimated that the total effect of the wage floor (Law no. 14,434/2022) would be R$ 17.4 billion. To guarantee that the subnational entities and the private sector can pay for this wage floor, several proposals are being discussed in the National Congress that foresee compensatory measures or support from the Union. As it is still unclear which proposal will be approved, we have opted to wait for these proceedings and only incorporate more specific budgetary impacts in the following reports.

Figure 1 shows the status of the propositions that have received the most attention from the press and Congress. It is worth remembering that for a bill to become law, it must be approved in both houses of Congress and then sanctioned by the President of the Republic. The arrows in the figure indicate that changes in one House, if they occur, must be reviewed and approved by the other, and only then will the bill be sent to the President for presidential sanction.

CHART 1. NURSING WAGE FLOOR PROPOSALS: STAGE OF PROCESSING



CD = Chamber of Deputies; SF = Federal Senate.
To understand the processing of bills and related ones, access: https://www.camara.leg.br/entenda-o-processo-legislativo/.
**Exception: Constitutional Amendment Bill (PEC) does not depend on the presidential sanction stage because the National Congress enacts such amendments.*
Brief description of the proposals: PL 1,272/2022 - payroll exemption for the health sector; PEC 22/2022 - reallocation of the rapporteur's amendments, already allocated to the Ministry of Health, to pay the nursing floor; PEC 23/2022 - increases the Union's transfer to the Municipalities Participation Fund; PL 798/2021 - reopening of the repatriation of funds abroad program; PL 2, 499/2022 - decentralization of resources from the pre-salt oil surplus; PL 1,435/2022 - a periodic readjustment of the SUS Table. The other proposals are explained in the text.

Most of the propositions are still being processed in the initiating House, the one in which they were initially proposed. Two of the three bills in the revising House represent a temporary, not permanent, solution for financing the nursing floor. PLP 44/2022 and PLP 7/2022[15] authorize states and municipalities to reallocate resources in their health funds received from the Union in previous years.

The PL 458/2021, also in the revising House, was initially restricted to creating a temporary tax regime in which taxpayers could update or regularize their assets by paying a differentiated income tax rate (Regime Especial de Atualização e Regularização Patrimonial – Rearp). However, in its latest version[16], the project also adjusted the monthly progressive income tax table (among other tax parameters).

The only legal norm in effect among those shown in Figure 1 is Law 14,455/2022, which created the Health and Tourism Lotteries. Although a permanent solution, the lottery would not be able to cover a significant portion of the floor's annual cost, as the following approximation indicates. Given that 5% of the Health Lottery's revenues (in the form of numerical lotteries) would be destined to the National Health Fund[17] to cover the R$ 5.4 billion portion of the impact of the nursing floor (the portion referring to states and municipalities), an annual collection of R$ 108 billion would be necessary with the new lottery. As a reference, this amount is much higher than the collection of one of the main federal lotteries, "Mega-Sena," which reached[18] R$ 6.6 billion in 2021. Therefore, the Health Lottery will not be enough if used to guarantee the floor.

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[15] PLP 44/2022: https://www.camara.leg.br/proposicoesWeb/fichadetramitacao?idProposicao=2335510. PLP 7/2022: https://www.camara.leg.br/proposicoesWeb/fichadetramitacao?idProposicao=2314962.

[16] Advisory Opinion of the Rapporteur, in the form of a Substitute Bill, presented to the Committee on Constitution and Justice and Citizenship (CCJC) of the Chamber of Deputies. Available at: https://www.camara.leg.br/propostas-legislativas/2279186.

[17] According to art. 2, the item I, letter "a" of Law 14,455/2022.
Available at: http://www.planalto.gov.br/ccivil_03/_Ato2019-2022/2022/Lei/L14455.htm.

[18] Information from a report by Caixa Econômica Federal:
https://www.caixa.gov.br/Downloads/caixa-loterias/A_Sorte_em_Numeros_2020_2021.pdf#page=27.

The three projects in the revising House, already mentioned, also don't seem, so far, capable of covering the cost of the floor, even temporarily (in 2023, for example). The PLP 7/2022, in particular, limits the amount to be reallocated to R$ 2 billion, which is less than the amount needed for the non-profit sector to guarantee the wage floor (R$ 6.4 billion per year, according to RAF no. 68). On the other hand, the Rearp (PL 458/2021) would collect less than R$ 1 billion per year[19].

There will likely be news soon in the course of the various projects. It is worth pointing out that the deadline for the various health-related entities to present their estimates of the impact of the salary floor[20] on expenses and employment is imminent (early November). Starting in November, the political pressure for congress members to move forward on the issue may grow, as well as the pressure for the STF to review the matter, now subsidized by the studies. The IFI will continue to monitor the measures and will soon publish a technical note with more analysis.

Subnational entities contribute to the R$ 120.1 billion public sector's primary surplus until August. We will now analyze the data made available by the Central Bank, updated to August 2022, regarding the primary and nominal balances of the consolidated public sector calculated using the below-the-line methodology[21]. In the year to August 2022, the public sector - including the central government, regional governments, and state-owned companies - had a primary surplus of R$ 120.1 billion, against a surplus of R$ 1.2 billion in the first eight months of 2021. The central government recorded a surplus of R$ 24.0 billion, while the states and municipalities accumulated a positive result of R$ 90.8 billion and state companies, R$ 5.3 billion.

In 12 months, the public sector had a surplus of R$ 183.5 billion (2.0% of GDP). According to the Central Bank, the central government (federal government, Central Bank, and INSS) was responsible for a surplus of R$ 71.2 billion (0.8% of GDP), while the regional governments (states and municipalities) and state-owned companies had surpluses of R$ 106.8 billion (1.1% of GDP) and R$ 5.6 billion (0.1% of GDP), respectively. This information is shown in Figure 13.

The subnational primary surplus in 12 months declined for the third consecutive month in August. Also, concerning Figure 13, it is worth noting that the primary surplus of the regional governments fell from 1.4% of GDP in May to 1.3% of GDP in June, then to 1.2% of GDP in July, and finally, 1.1% of GDP in August. In the second half of the year, the innovations brought by Supplementary Law (LC) 194 of June 23, 2022, such as the classification of telecommunications, electricity, fuels, and public transportation as essential goods and services, should reduce the subnational entities' tax revenues, thus affecting the trajectory of the primary surplus.

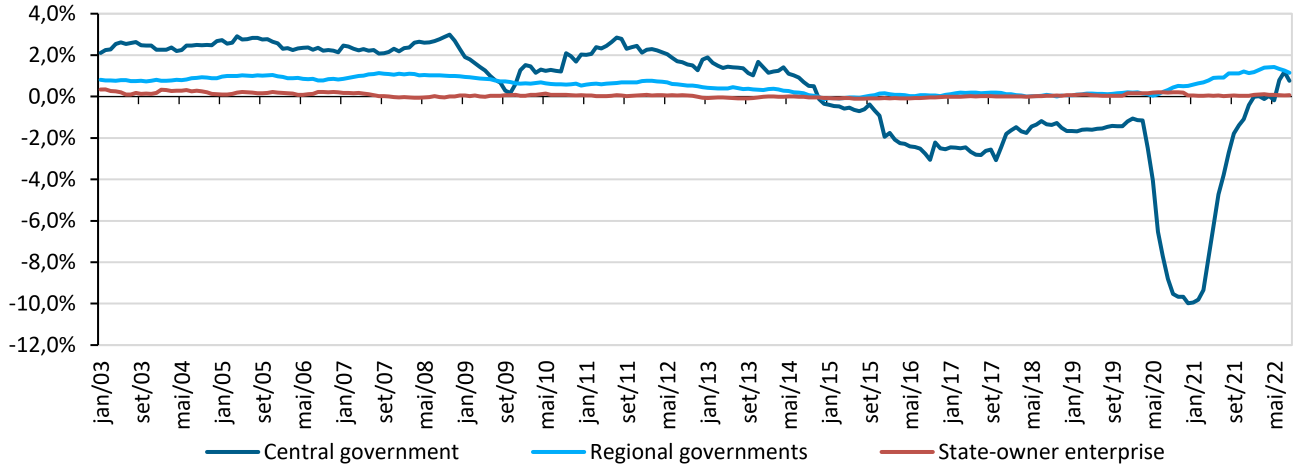
Information from Confaz shows a deceleration in ICMS collections in July and August. As an illustration, according to Confaz, the ICMS collection of the 26 states and the Federal District fell 12.7%, in real terms, in August compared to the same month in 2021. It is worth pointing out the absence of information for four states. In July, there was a real fall of 3.0% in ICMS collection on this basis of comparison. Until June, the tax collections registered an expansion compared to the same month of the previous year. In the year to August, ICMS revenues had a real increase of 1.2%, compared to 3.4% in July and 4.5% in June.

[19] As calculated by the "Consultoria de Orçamentos, Fiscalização e Controle do Senado Federal (CONORF)," contained in one of the advisory opinions to the bill. Available at: https://legis.senado.leg.br/sdleg-getter/documento?dm=8952659&ts=1630443663958&disposition=inline#page=9.

[20] STF decision available at: https://portal.stf.jus.br/processos/detalhe.asp?incidente=6455667.

[21] For a more detailed explanation, access the Manual of Fiscal Statistics of the National Treasury Central Government Primary Balance: https://bit.ly/3pjxgEv.

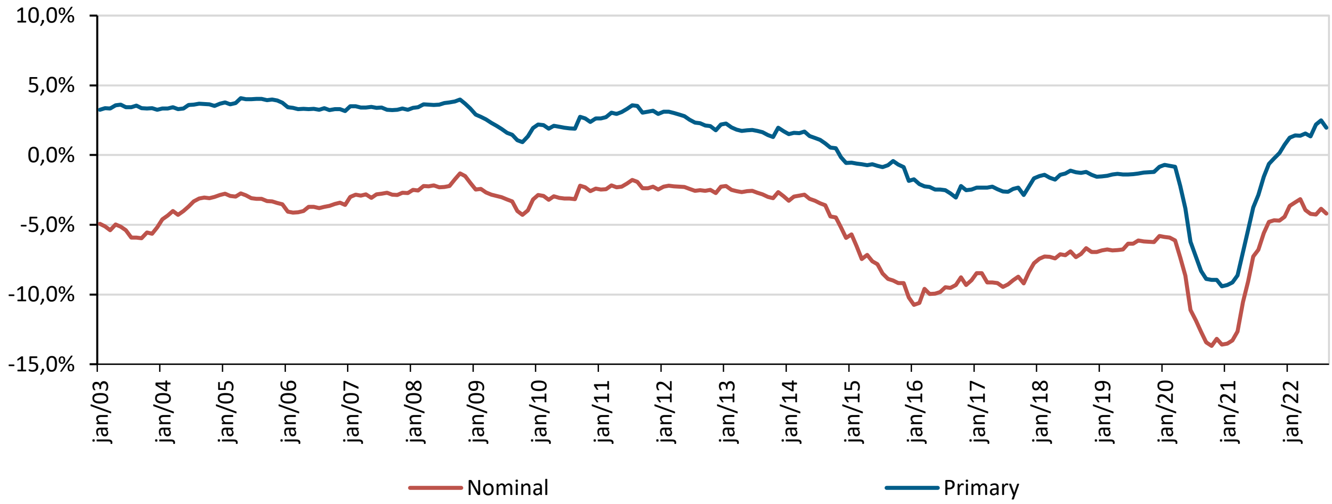
FIGURE 13. CENTRAL GOVERNMENT, REGIONAL GOVERNMENTS, AND STATE-OWNED ENTERPRISE'S PRIMARY BALANCE - 12 MONTHS % (OF GDP)



Source: Central Bank. Prepared by: IFI

Interest expenses of the public sector retreated marginally between July and August. Still considering the 12-month comparison, public sector interest expenditures reached 6.2% of GDP (or R$ 575.6 billion) in August, against 6.4% of GDP (R$ 586.4 billion) in July and 4.0% of GDP (R$ 335.7 billion) in August 2021 (Figure 15). Interest expenditures as a proportion of the GDP reversed the downward trajectory in July of last year when it assumed an upward trend, a movement related to the monetary tightening initiated by the Central Bank in March 2021 and the increase in inflation, two important indexers of public securities. The outlook is that interest expenses will remain at relatively high levels until the average cost of the public debt comes down. It is worth noting that in Figure 15, interest expenses appear with the sign reversed on the axis.

FIGURE 14. CONSOLIDATED PUBLIC SECTOR PRIMARY AND NOMINAL - 12 MONTHS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

The nominal public sector balance - the sum of the primary and interest results - presented a deficit of R$ 392.0 billion (4.2% of GDP) in the 12 months through August. The composition was as follows: central government nominal deficit of 4.6% of GDP; regional government surplus of 0.5% of GDP; and state companies balances of zero. Figures 14 and 15 show that the primary's balance improvement (3.5 p.p. of GDP) between August 2021 and August 2022 more than compensated the increase of interest expenses in the period (2.1 p.p. of GDP), causing the nominal result to improve by 1.4 p.p. of GDP. Contributing to this result was the strong growth in primary revenue of the national entities and the relative expenditure control. In any case, the evolution of interest expenses is crucial because it could make it challenging to stabilize the country's debt levels in an unfavorable economic context.

FIGURE 15. INTEREST EXPENDITURES - 12 MONTHS (% OF GDP)

Source: Central Bank. Prepared by: IFI.

2.4 Public sector indebtedness indicators

In this subsection, we first analyze the Monthly Debt Report (RMD) of the National Treasury Secretariat, with data updated through August.

The high volume of debt redemptions reduced outstanding public debt in August. In August, redemptions of Federal Public Debt (DPF) securities in the primary market transactions exceeded issuances by R$ 56.6 billion. Inflation-linked securities determined these redemptions in the Domestic Federal Public Debt (DPMFi), which registered net redemptions of R$ 162.1 billion in August. According to the Treasury, the maturity of National Treasury Notes Series B (NTN-B) explains the high volume of redemptions in August. Also, in the month, there were net issuances of R$ 58.8 billion in fixed-rate securities and R$ 46.7 billion in floating-rate securities. The net redemptions of securities were partially offset by the appropriation of interest of R$ 33.6 billion, the lowest since January 2021, due to the drop in inflation in the last two months. Overall, the outstanding DPF diminished by R$ 23.0 billion in August compared to July, totaling R$ 5,781.4 billion. In the year to August, the DPF had registered net redemptions of R$ 199.1 billion.

Liquidity reserve rose marginally in August compared to July. The public debt liquidity reserve registered R$ 1,146.0 billion in August, compared to R$ 1,177.7 billion in July and R$ 1,227.3 billion in August 2021. The liquidity reserve (or debt cushion) is part of the Treasury's cash on hand deposited in the Single Account at the Central Bank.

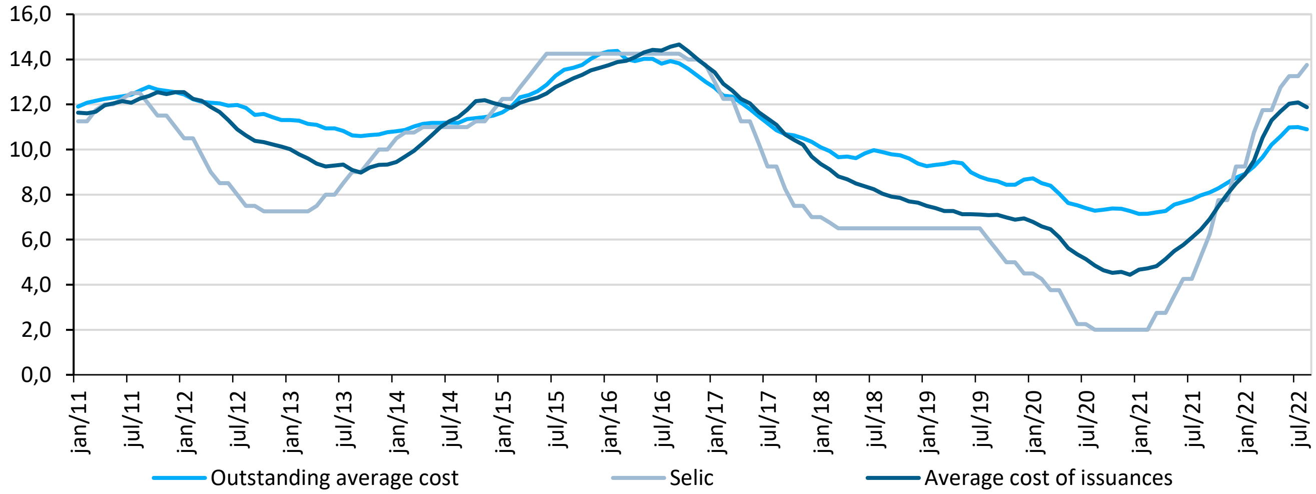
The liquidity reserve is a good indicator of the sufficiency of cash to cover maturities (principal and interest) of securities held by the public and those issued to the Central Bank. When measured in months, this indicator shows how long it can pay the maturing debts with the existing reserve. The Treasury considers a prudential limit a liquidity reserve capable of honoring three months of debt maturities. Thus, the liquidity index reached 10.24 months in August, compared to 9.49 months in July and 10.54 months in August 2021. In other words, in the absence of new issuances in August, the Treasury would be able to pay 10.24 months of DPMFi bond maturities. The prudential value, which corresponds to the payment of three months of DPMFi bonds maturities, stood at R$ 331.7 billion in August, compared to R$ 505.0 billion in July.

Average issue rates of public securities showed a decline in July and August. According to the STN, the average issue rates of the DPMFi dropped in August for the second consecutive month. For 24-month fixed-rate securities (LTN), the average issue rate was 12.29% p.a. in August, against 12.94% p.a. in July. In 48-month fixed-rate bonds, the rate fell from 12.75% p.a. in July to 11.97% p.a. in August. In the 10-year fixed-rate bond, with semi-annual interest payments, the average issue rate fell from 12.93% p.a. in July to 12.24% p.a. in August.

Falls in issue rates continued in September. Information from the IFI on auctions held by the Treasury[22] indicates new falls in the DPMFi bond yields in September. The average issue rate for fixed-rate bonds maturing on October 1, 2024, was 12.19% p.a. in September, against 12.42% p.a. in August. For the fixed-rate bond maturing on January 1, 2026, the average issue rate fell from 12.08% p.a. in August to 11.81% p.a. in September. Price-indexed securities also registered a reduction in issue rates in August, in line with the drop in inflation in the last few months. The Treasury announces the securities (and their respective maturities) quarterly and can change over time.

The average cost of the domestic public debt also dropped in August, in line with the drop in issue rates. The monthly decline in the average cost of the DPMFi stock was 0.1 p.p. in August, reaching 10.89% p.a. Compared to August 2021, the average cost of the DPMFi stock rose 2.93 p.p. (Figure 16). The average cost of DPMFi public offerings dropped 0.2 p.p. from July to August, reaching 11.88% p.a. Compared to August 2021, the average cost of DPMFi issuances rose 5.44 p.p. (Figure 16). This reduction in the average cost of DPMFi issuances resulted from deflation in the last two months, bringing down the average issuance rate of price-indexed securities.

FIGURE 16. AVERAGE PUBLIC DEBT COST (OUTSTANDING AND ISSUANCES) AND TARGET SELIC RATE



Source: STN. Prepared by: IFI.

The drop in the average cost of the debt reflects the recent trajectory of bond indices, such as inflation. The reduction in the outstanding DPMFi average cost in August reflects the behavior of some of the bond indices, especially the IPCA, which registered deflation in July, August, and September, as well as the Selic, which stopped rising in September and was maintained at 13.75% per year by the Central Bank. The tendency is for some accommodation or

[22] Available at: https://www12.senado.leg.br/ifi/dados/dados.

even a slight drop over the coming months. In any case, this accommodation would occur at a relatively high level, which keeps public sector interest expenses rising.

The Treasury's financing conditions will be relatively favorable in 2022. Despite periods of uncertainty heightened by the conflict in Ukraine and the presidential election in Brazil, there was no need to change the financing strategy presented in the 2022 Annual Borrowing Plan (PAF). The Treasury has managed the liquidity reserve, maintained prudential levels, and gradually lengthened the average maturity of the DPMFi, which was shortened in 2020 due to the uncertainties associated with the pandemic.

It is also important to mention the persistence of uncertainties regarding the Brazilian fiscal framework starting next year. The context is one of many pressures for increased spending. At the same time, part of the increase in tax collection seen in the recent period tends to be transitory because it is related to the behavior of commodity prices, inflation, and economic activity, which tends to cool down next year. Thus, how the country's public accounts sustainability will be addressed in the short term will represent an essential element in dispersing the uncertainties and regaining fiscal policy credibility.

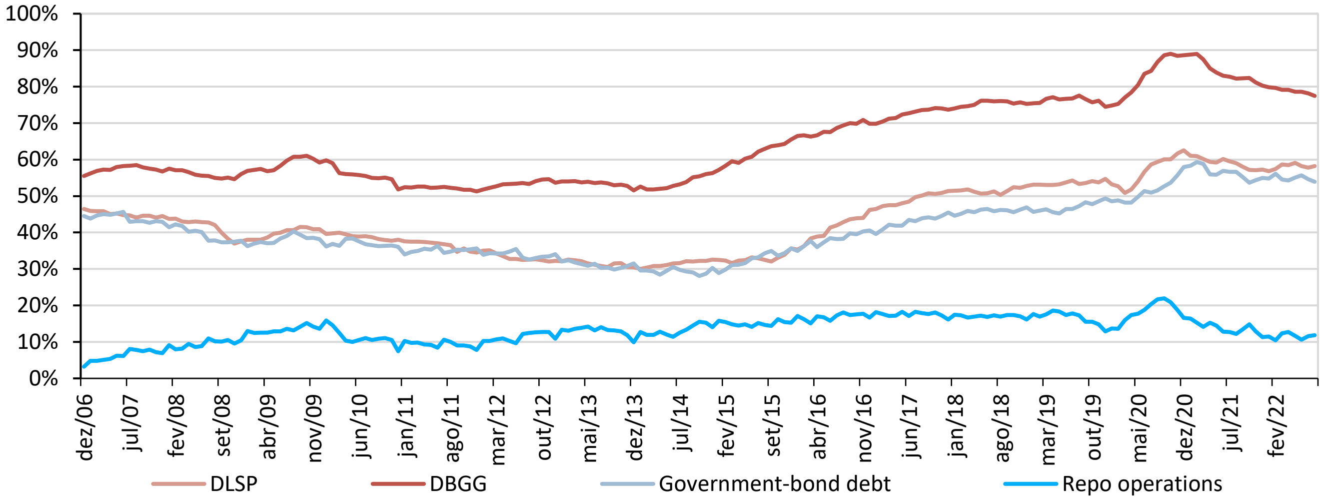
Gross debt as a proportion of GDP registered a new retreat in August. We will now move on to the analysis of debt indicators released by the Central Bank (methodology below the line), with information updated up to August. The General Government Gross Debt slid from 78.2% of GDP (R$ 7,217.1 billion) in July to 77.5% of GDP (R$ 7,231.6 billion) in August (Figure 17). Based on the evolution of debt conditions, according to the Central Bank, the drop in the DBGG in August was influenced by the increase in nominal GDP growth (-0.9 p.p.) and net redemptions of debt (-0.4 p.p.), partially offset by the accrued nominal interest (+0.5 p.p.).

The increase in the GDP has been a determining factor for reducing the gross debt in 2022. In the accumulated figures from January to August, the DBGG fell 2.8 p.p. of GDP due to nominal GDP growth (-5.6 p.p.), net redemptions of debt (-2.0 p.p.) and the accumulated exchange rate appreciation (-0.4 p.p.). The accrued nominal interest partially offsets these effects (+5.2 p.p.). Net redemptions of debt do not necessarily indicate difficulties for the Treasury issuing securities to roll over the public debt. As mentioned previously, the liquidity reserve has allowed the Treasury to maintain the original financing plan in 2022 without carrying out significant issues in an environment of uncertainty and greater volatility.

Unlike gross debt, net debt rose in August. The Public Sector Net Debt (DLSP) rose 0.5 p.p. of GDP in August, against July, to 58.2% of GDP (R$ 5,435.6 billion). Compared to August 2021, there was a reduction of 0.8 p.p. in the indicator (Figure 17). According to the Central Bank, the August public sector net debt growth in the monthly comparison reflected the accrued nominal interest (+0.4 p.p.), the effect of the exchange rate variation in the basket of currencies that make up the net external debt (+0.4 p.p.), the primary deficit (+0.3 p.p.), and the effect of the nominal GDP growth (-0.6 p.p.).

The net debt movement in 2022 differs from the DBGG due to the composition of the indicator. The DLSP consolidates the public sector's liabilities by discounting the credits, such as international reserves and Treasury credits, with BNDES. From January to August, the net debt rose 1.0 p.p. due to the accrued nominal interest (+3.9 p.p.), the exchange rate variation in the basket of currencies that make up the net external debt (+1.3 p.p.), and the 7.2% accumulated exchange rate appreciation (+1.2 p.p.). These movements were partially offset by the nominal GDP growth (-4.0 p.p.) and the accumulated primary surplus (-1.3 p.p.).

FIGURE 17. PUBLIC DEBT INDICATORS AND PRINCIPAL COMPONENTS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

Before concluding, the IFI presents an update of the DBGG estimates in the baseline and alternative scenarios. There are three main differences in the assumptions underlying the scenarios: the consolidated public sector primary balance, the implicit debt rate in real terms, and the economy's growth. Table 12 displays the projections of indicators that influence the debt trajectory and the DBGG estimates in 2022 and 2023.

TABLE 12. GROSS DEBT ESTIMATES - 2022 AND 2023 (R$ BILLION)

Discriminação	2022	2023	
	Baseline	Baseline	Alternative
Consolidated public sector primary balance	1.1%	0.0%	-1.0%
Nominal GDP (R$ billion)	9,751.56	10,339.82	10,366.19
PIB – real growth	2.6%	0.6%	1.0%
GDP price deflator	9.5%	5.4%	5.2%
Real implict rate	4.4%	3.6%	4.8%
DBGG (% of PIB)	**77.3%**	**79.2%**	**80.7%**

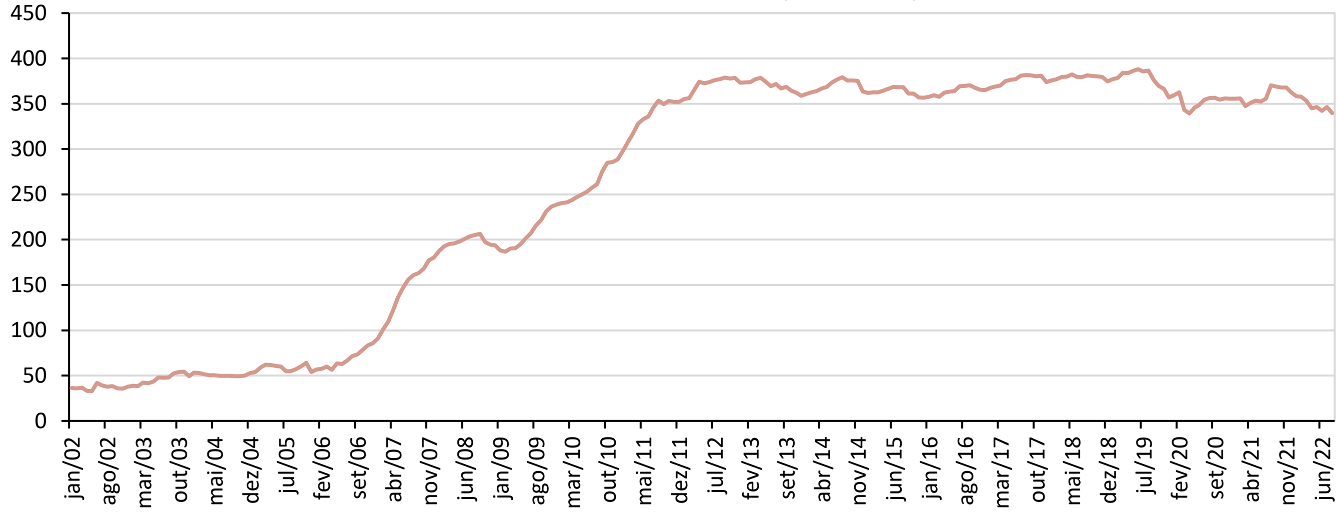
Source: IBGE, Central Bank. *Prepared by: IFI.*

DBGG estimates in 2023 range from 79.2% to 80.7% of GDP. In the base case, DBGG will end 2022 at 77.3% of GDP, increasing to 79.2% next year. In the previous RAF, the IFI expected that DBGG would reach 78.1% of GDP in 2022 and rise to 80.2% in 2023. In the alternative scenario, the DBGG is projected to grow to 80.7% in 2023, mainly due to the worsening of the primary balance.

To close this section, we discuss the recent trajectory of the stock of international reserves in the country and the relation with indebtedness indicators. Reserves are foreign assets under the control of the Central Bank and are readily usable to meet the financing needs of the balance of payments. In this sense, the reserves act as insurance against unexpected interruptions in the country's foreign resource availability, negatively affecting the economy through production, employment, and household consumption.

Between 2006 and 2012, the country accumulated a significant volume of international reserves. Figure 18 displays the evolution of Brazil's international reserves since 2002. Notably, the accumulation of funds began in 2006, a movement that continued until approximately 2012. This accumulation was possible due to the increase in the current account balance and the strong inflow of funds through the balance of payments capital and financial account. Among the determining factors of this movement on the current account, the impulse given to exports due to gains in terms of trade and global economic growth stands out.

FIGURE 18. INTERNACIONAL RESERVES (US$ BILLION)



Source: Central Bank. Prepared by: IFI.

The growth in Brazilian international reserves, which jumped from US$ 85.84 billion in December 2006 to US$ 240.48 billion in December 2010 and then increased even more, reaching the level of US$ 370 billion in the first semester of 2012, was due to the Central Bank and the National Treasury acting in the exchange market to acquire foreign currency to amortize the central government's foreign debt and, in the case of the Central Bank, to increase the country's international reserves.

The increase in international reserves had as its counterpart an increase in gross debt. Although the accumulation of international reserves was initially desirable due to the relatively low balance verified in the early 2000s, the growth in the amount of foreign currency was accompanied by an increase in debt[23]. Between 2006 and 2012, this increase in indebtedness was due to the purchase of new foreign currency flows through the Central Bank's repo operations, which constitute a liquidity management instrument by the monetary authority and are part of the DBGG. In general terms, repo operations consist of a spot purchase operation with the attendant commitment to resell security at a future date[24].

As of 2012, even though new foreign currency flows had ceased to be acquired, the cumulative incidence of the Selic rate on the public debt (repo operations) made the debt continue to grow. In other words, maintaining reserves implies a cost of carrying this insurance.

Figure 18 finds a parallel in Figure 17, which also presents the evolution of repo operations as a proportion of GDP. Repurchase agreements rose from 3.2% of GDP in December 2006 to 15.9% in January 2010. Between 2014 and 2019, this debt instrument remained between 14% and 18% of GDP. In the first months of the pandemic, there was a reduction in reserves due to redemptions made by the Treasury in the Central Bank's Single Account, accompanied by a

[23] For a more in-depth discussion of the evolution of Brazil's international reserves and its benefits and costs, see IFI Special Study (EE) No. 1, March 2017, entitled "Reservas internacionais no Brasil: evolução, nível adequado e custo de carregamento". Available at: https://www12.senado.leg.br/ifi/publicacoes-estudos-especiais.

[24] For more details on repo operations, see IFI's EE No. 3, October 2017, entitled "As operações compromissadas do Banco Central". Available at: https://www12.senado.leg.br/ifi/publicacoes-estudos-especiais.

decrease in repurchase agreements. From April to October 2020, repo operations and international reserves started to grow again.

From the second half of 2021 until this moment on, there is a tendency for international reserves to fall (Figure 18). In August 2021, the reserves reached US$ 370.40 billion, reduced to US$ 339.66 billion in August 2022. Repo operations, in turn, earned 14.8% of the GDP in October 2021 and dropped to 11.8% of the GDP in August 2022. The evolution of repo operations affects both the DBGG and the DLSP.

The recent reduction observed in the reserves seems to be related to the international context. The decrease of this indicator in the medium and long term would translate into a reduction of gross debt. However, the decline in reserves resulting from a government decision is not trivial, given the need to evaluate the costs and benefits of loading this asset. In addition, it is necessary to consider the impact of the sale of reserves on the exchange rate. As the reserves constitute the country's insurance against international crises, the eventual sale beyond optimal levels may increase the country's external vulnerability, compromising the economy's fundamentals.

2.5 The Union's Budget for 2022

Expenses not subject to the spending ceiling significantly impacted the 2022 budget. When approved, the 2022 Budget Law (LOA 2022) projected primary expenses at R$ 1,720 billion (18% of GDP), with a small margin of R$ 3.2 billion in expenditures subject to the spending ceiling for the Executive Branch. Today, the government projects primary expenses at R$ 1,820 billion (18.8% of GDP), equivalent to an increase of R$100 billion to what was foreseen in the LOA, with no margin to the Executive Branch's spending ceiling. At the end of September, the government's most recent evaluation identified the need for a R$ 10.5 billion adjustment in expenses subject to the cap to allow compliance with the rule.

Among the expenses added to the 2022 budget after the approval of the LOA via extraordinary or special credits, three items can be highlighted, which together amount to R$ 87.3 billion (0.9% of GDP): (i) special credit of R$ 23.9 billion referring to the court ruling payment to the municipality of São Paulo; (ii) reopening of extraordinary credits and registration of 2022 outstanding liabilities, mainly referring to the expenses with the confrontation of the Covid-19, of R$ 23.0 billion; and (iii) financial aid arising from Constitutional Amendment No. 123 (EC 123), of 2022, of R$ 40.4 billion[25]. These expenses account for 87.3% of the total increase between the forecast in this year's LOA and the most recent bimonthly evaluation.

A positive surprise in revenue forecasts more than offset the effect of expenses on the 2022 budget. The LOA of 2022 foresaw primary revenue, net of transfers to subnational governments, of R$ 1,644 billion (17.2% of GDP), and now, in the latest bimonthly assessment of primary revenues and expenditures of the Union, the value rose to R$ 1,844 billion (19.1% of GDP). The R$ 200.2 billion increase offsets the increase in the expenditure forecast for 2022. Due to these revisions, the government's primary balance forecast has gone from a deficit of R$ 76.2 billion to a surplus of R$ 24.0 billion.

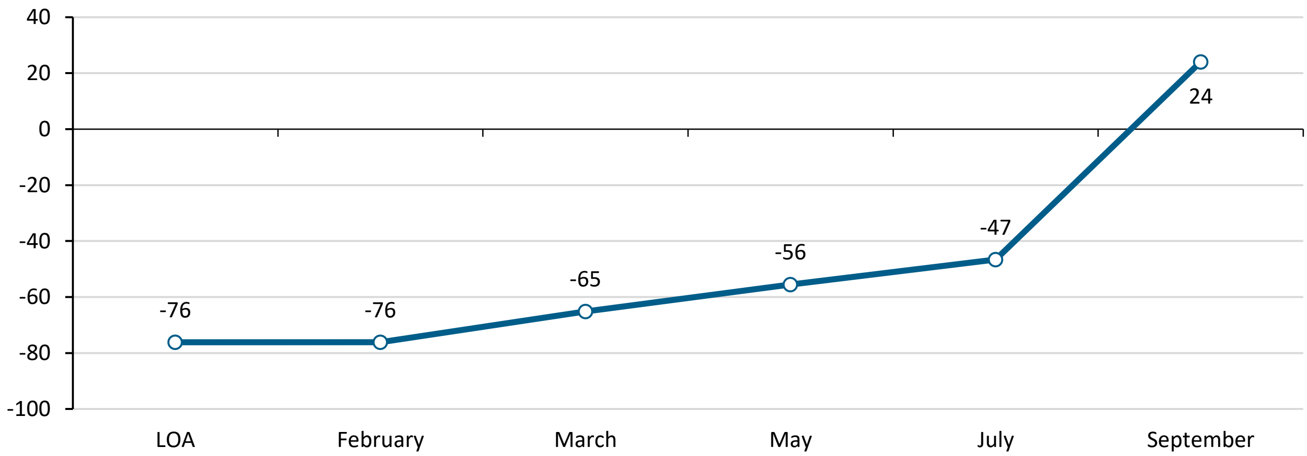
[25] The EC 123 of 2022 authorized the payment of up to R$ 41.25 billion to meet the following actions: (i) R$ 26 billion for payment of an additional R$ 200 per beneficiary family of the Brazil Aid and reduction of the waiting list; (ii) R$ 5.4 billion for payment of aid to autonomous cargo transporters; (iii) R$ 1.05 billion to increase the Brazilians' Gas Aid; (iv) R$ 2.0 billion for payment of aid to cab drivers; (v) R$ 0.5 billion for the purchase and distribution of food from family agriculture; (vi) R$ 3.8 billion for the states and Federal District that grant ICMS credits and; (vii) R$ 2.5 billion for subnational entities that have urban, semi-urban or metropolitan public transport services. However, some credits were not fully opened. The extraordinary credits opened through Provisional Presidential Decree (MPs 1130 and 1131, both of 2022) totaled R$ 40.4 billion, R$ 841 million less than that authorized in EC 123 of 2022.

Revenues linked to oil were the biggest responsible for the revision in the revenue scenario. The revenues associated with the dynamics of commodity prices strongly influenced the changes made by the Federal Government. Dividend revenues were projected at R$ 26.3 billion in the 2022 LOA, updated to R$ 80.5 billion in the 4th bimester revenues and expenses assessment due to the dividends paid by Petrobras, which already totaled R$ 62.7 billion by September. Revenues from royalties and special participations were revised from R$ 95.9 billion to R$ 129.8 billion, i.e., an increase of R$ 33.9 billion due mainly to revised estimates for the Brent oil price and the exchange rate.

The revenues from concessions and permissions also increased their values concerning what was foreseen in the LOA. Initially, the projection went from R$ 5.1 billion to R$ 45.2 billion in this last evaluation, reflecting the new concession contracts for the generation of electric energy with the privatization of Eletrobras and the revenue from the second round of bidding from the onerous transfer.

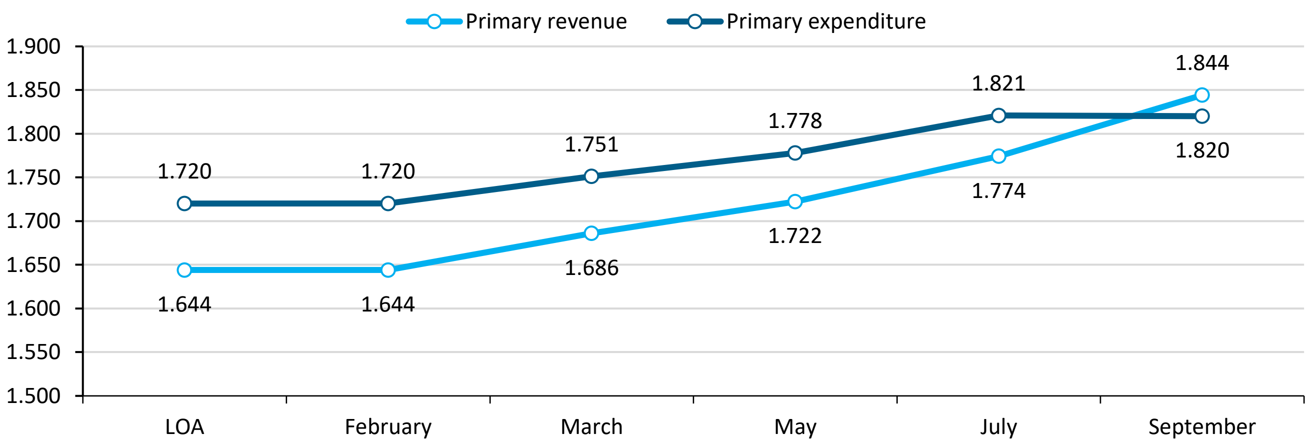
Figures 19 and 20 summarize the revisions in the government's official projections for primary balance, revenues, and expenditures.

FIGURE 19. CENTRAL GOVERNMENT PRIMARY BALANCE - OFFICIAL FORECAST (R$ BILLION)



Source: LOA 2022, Decree 10,961 and modifications. Prepared by IFI.

FIGURE 20. CENTRAL GOVERNMENT PRIMARY REVENUE AND EXPENDITURE - OFFICIAL FORECASTS (R$ BILLION)



Source: LOA 2022, Decree 10,961 and modifications. Prepared by IFI.

The government's scenario for revenues collected by the Federal Revenue Office presents distinct movements. Except for social security revenues, the forecast for the collection of revenues collected by the RFB was revised by R$ 104.8 billion between the LOA and the fourth bimester evaluation. The composition of this revision, however, is quite heterogeneous among taxes. Projections for income tax revenues (IR and CSLL) were revised from R$ 657.8 billion to R$ 839.2 billion, an increase of R$ 181.4 billion. Among the justifications presented in the assessment reports, the improvement in the forecast for tax collection is due to higher-than-expected collections from commodity-related sectors.

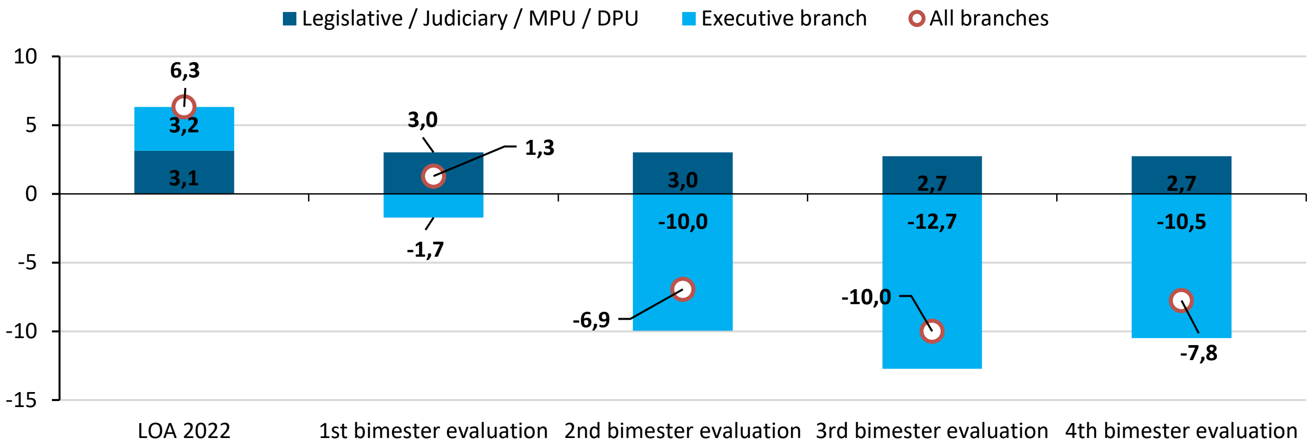
According to the Federal Revenue Office, the value of atypical collections related to commodity-related economic sectors was R$ 35 billion from January to August. When comparing the realized and accumulated amount of IRPJ/CSLL collections by industry in the year (January-August), the Fuel sector stands out in terms of real variation, with an increase of 696.5% to the same period of the previous year, and the Oil and Natural Gas extraction sector, with an increase of 500.6%.

In the opposite direction, the taxes levied on goods and services, i.e., PIS, Cofins, and IPI, jointly presented a reduction to the forecast in the LOA. In the most recent evaluation, the government estimated these taxes at R$ 405.6 billion, while the LOA forecast was R$ 484.0 billion. The report's justification is the linear reduction of the IPI tax rate and the tax exemption concerning PIS/Cofins on fuels.

Even with changes that expanded the space in the spending ceiling, the rule remains restrictive. Constitutional Amendments No. 113 and 114, both from December 2021, created an additional space in the spending ceiling of R$ 113.1 billion, as shown in the RAF of January this year. However, during the budget process, all the space opened in the spending ceiling was consumed by other expenses, either the revision in the mandatory expenses estimates indexed to inflation or the creation or increase in other expenditures, such as the Brazil Aid Program, amendments by the Rapporteur General and campaign financing.

Thus, although the 2022 budget started the year with a spending projection above that estimated before the court-ordered debts ECs, the margin in the Executive Branch spending ceiling needed to be higher. In the LOA, the fiscal margin, the positive difference between the projection of expenses subject to the spending ceiling and the maximum limit established by the rule, was only R$ 3.2 billion. In the very first scenario revision by the Federal Government, the small fiscal margin was changed to the need for an adjustment of R$ 1.7 billion. In the following revisions (of the second and third quarters), this adjustment requirement increased to R$ 10.0 billion and R$ 12.7 billion, and in the most recent evaluation, it was reduced to R$ 10.5 billion (Figure 21).

FIGURE 21. SPENDING CEILING ANNUAL ESTIMATE OF EXCESS (+) / ADJUSTMENT NEED (-) (R$ BILLION)



Source: LOA 2022, Decree 10,961 and modifications. Prepared by IFI.

The restriction imposed by the spending ceiling did not prevent the growth of the total primary expenditures projection. Even with the reports of the previous evaluation indicating a need for adjustment in discretionary primary expenditures subject to the spending ceiling, the total primary expenditure forecast was revised upward, except between the third and fourth re-evaluations. This movement was only possible due to additional legislative changes (such as EC 123) and infra-constitutional rules (such as Law 14,409 of 2022), which authorized the execution of expenditures outside the primary balance and spending ceiling rules.

The primary result target for 2022 should be met comfortably, but the scenario for 2023 is a cause for concern. If there is a restriction in the spending ceiling rule, the same is different for the 2022 primary balance target. The target set in the LDO was a R$ 170.5 billion deficit, but the most recent forecast indicates a primary surplus. As for 2023, the deficit target is lower than the 2022 target, and primary expenditures may be higher than those projected in the Annual Budget Bill (PLOA 2023). The high level of uncertainty regarding the future scenario calls for caution. The September RAF outlined fiscal scenarios (baseline and alternative) for the next fiscal year considering these uncertainties in the budgetary field. If, in the baseline scenario, the government can meet the primary balance target and the spending ceiling, the risk of non-compliance with both the ceiling and primary rules increases in the alternative scenarios. In this report, the IFI has updated these projections, and the diagnosis is the same: the extension of spending and tax benefits for the next fiscal year increases the risk of non-compliance with budgetary rules.

Table 13 consolidates the evaluations conducted by the Executive Branch after the close of the first four quarters of 2022.

TABLE 13. SUMMARY OF BIMONTHLY EVALUATIONS

	LOA		Decree 11,019 (March)		Decree 11,086 (May)		Decree 11,154 (July)		Decree 11,216 (September)	
	R$ bi	% GDP	R$ bi	% GDP	R$ bi	% GDP	R$ bi	% GDP	R$ bi	% GDP
Total Revenue (A)	2,030.5	21.3	2,118.0	22.0	2,167.1	22.3	2,226.1	22.9	2,308.3	23.9
Revenue Collected by RFB, Except RGPS	1,288.9	13.5	1,285.6	13.3	1,332.1	13.7	1,342.6	13.8	1,393.6	14.4
Net social security (RGPS) revenues	499.4	5.2	527.3	5.5	531.5	5.5	536.7	5.5	537.6	5.6
Revenue not managed by RFB	242.3	2.5	305.1	3.2	303.5	3.1	346.9	3.6	377.2	3.9
Transfers by revenue sharing (B)	386.4	4.1	431.9	4.5	444.7	4.6	451.8	4.6	464.0	4.8
Net Revenue (C = A - B)	1,644.1	17.2	1,686.1	17.5	1,722.4	17.7	1,774.4	18.2	1,844.3	19.1
Total Primary Expenditures (D)	1,720.3	18.0	1,751.3	18.2	1,777.9	18.3	1,821.0	18.7	1,820.3	18.8
Social Security Benefits	777.7	8.2	778.1	8.1	788.7	8.1	789.6	8.1	795.3	8.2
Payroll	336.1	3.5	338.6	3.5	341.3	3.5	339.6	3.5	339.1	3.5
Other Mandatory Expenditures	252.5	2.6	282.0	2.9	279.5	2.9	324.7	3.3	317.7	3.3
Expenses subject to the budgetary and financial programming	**354.0**	**3.7**	**352.7**	**3.7**	**368.4**	**3.8**	**367.1**	**3.8**	**368.2**	**3.8**
Mandatory with flow control	223.2	2.3	223.1	2.3	223.2	2.3	225.5	2.3	225.3	2.3
Discretionary of the Executive Branch	130.8	1.4	129.6	1.3	145.3	1.5	141.6	1.5	143.0	1.5
Central Government Primary Balance (E = C - D)	-76.2	-0.8	-65.2	-0.7	-55.5	-0.6	-46.6	-0.5	24.0	0.2
National Treasury Balance	202.2	2.1	185.6	1.9	201.7	2.1	206.3	2.1	281.7	2.9
Social Security Balance	-278.4	-2.9	-250.8	-2.6	-257.2	-2.6	-252.9	-2.6	-257.7	-2.7
Expenditure Ceiling	**1,679.6**	**17.6**	**1,681.0**	**17.4**	**1,681.0**	**17.3**	**1,681.0**	**17.3**	**1,681.2**	**17.4**
Nominal GDP (R$ billion) and Real GDP (%)	9,539.0	2.1	9,647.4	1.5	9,710.9	1.5	9,725.0	2.0	9,660.8	2.7
IPCA % p.a.	4.7		6.6		7.9		7.2		6.3	

Source: LOA 2022, Decree 10,961 and modifications. Prepared by IFI.

IFI forecasts

SHORT-TERM

Projeções da IFI	2022			2023		
	September	October	Comparison	September	October	Comparison
GDP – real growth (% per year)	2.61	2.61	=	0.59	0.59	=
Nominal GDP (R$ billion)	9,784.87	9,751.56	▼	10,407.87	10,339.82	▼
IPCA (% in the year)	6.44	5.78	▼	4.92	4.78	▼
Exchange rate – end-of-period (R$/US$)	5.20	5.21	▲	5.22	5.21	▼
Employment – growth (%)	7.30	7.30	=	0.28	0.28	=
Payroll – growth (%)	4.19	4.62	▲	0.59	0.59	=
Selic rate – end-of-period (% per year)	13.75	13.75	=	10.50	11.00	▲
Real interest *ex-ante* (% per year)	6.03	6.53	▲	4.91	4.78	▼
Public Sector Consolidated Primary Balance (% of GDP)	1.33	1.12	▼	0.07	-0.04	▼
of which Central Government	0.73	0.52	▼	0.07	-0.04	▼
Net Nominal Interest (% of GDP)	7.33	6.17	▼	6.26	5.59	▼
Nominal balance (% of GDP)	-6.00	-5.05	▲	-6.19	-5.63	▲
General Government Gross Debt (% of GDP)	78.05	77.33	▼	80.20	79.19	▼

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