Independent Fiscal Institution

FFR

# Fiscal Follow-Up Report

APR 19, 2023 • Nº 75

## HIGHLIGHTS

- Commodity prices maintain a downward trajectory, but the future scenario is uncertain.
- IFI's projection for the net primary revenue of the central government in 2024 dropped by R$ 3.0 billion.
- Revenue collection slows down as domestic economic activity cools down.
- IFI estimates for primary deficits in 2023 and 2024 remain at 1.2% and 1.0% of GDP.
- General government gross debt is expected to reach 78.1% of GDP in 2023 and 81.0% in 2024.
- The average cost of public debt rose in February but cooled off in March.
- Primary revenues must grow around 1% of GDP for the deficit to reach zero.
- The 2024 Budget Plan does not consider the effect of real gains in the minimum wage.

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# Covering Letter

The Fiscal Follow-up Report (RAF) s the IFI's monthly conjuncture analysis and meets the purposes in art. 1 of Senate Resolution No. 42 of 2016. Through the RAF, we publish our projections for the Brazilian economy's main macroeconomic and fiscal variables.

The Federal Executive Branch has released the design of the sustainable fiscal regime, as provided in Art. 6 of Constitutional Amendment No. 126 (former Transition PEC), on March 30th. However, the complementary bill (PLP, in the original acronym), with the details of the proposal, was only presented yesterday (April 18). Despite the deadline set by EC [Constitutional Amendment] 126 (August), the earlier disclosure in relation to the deadline provided in the constitutional provision was important to address the doubts about the financing of the spending expansion allowed by EC 126.

Besides the fact that the early disclosure of the new fiscal rule has contributed to ease uncertainties, it was also important to guide the preparation of the Budget Guidelines Bill (PLDO, in the original acronym). The government elaborated the guidelines and set the goals for the 2024 budget considering the current rule, but incorporating some points related to the new fiscal framework. The government has set the primary result target for 2024 at 0% of GDP, and conditioned expenses in the amount of 1.5% of GDP to the approval of the PLP 93 (new fiscal framework).

Despite the positive effect observed in the future yield curve, there are still no signs of a reduction in the basic interest rate in the communications from the Monetary Policy Committee (Copom). The short-term macroeconomic scenario, for now, remains unchanged. The projections for GDP growth remained at 0.9% and 1.4% for this and next year. We have maintained the IPCA projection at 5.6% for 2023 and, for 2024, the projection was revised slightly, from 3.9% to 4.0%. Commodity prices in R$ continued to fall between February and March. On the one hand, monetary tightening in the advanced economies and the prospect of a global economic slowdown are factors holding back commodity prices. On the other hand, China's recovery after the reopening of the economy and the recent OPEC+ decision to reduce oil production are bullish factors. As there are several forces acting on commodity prices, the prospective scenario and the consequent impact on inflation are still uncertain.

An eventual recovery in commodity prices can positively affect revenues, a movement observed in 2021 and 2022. This would help the government to meet, with less difficulty, the fiscal targets presented in the 2024 PLDO. Preliminary calculations made by the IFI indicate that it will be necessary for the government to increase net revenues by about 1 percentage point of GDP in 2024 in order to zero the central government's primary deficit, as set in the fiscal targets annex.

This scenario of uncertainty regarding primary revenues highlights the risk of possible non-compliance with the fiscal rules in the absence of primary revenues needed to achieve the 2024 primary result target. The IFI's projections, made before the release of the PLDO and the new fiscal framework (PLP 93), for the primary deficit of the central government remain at 1.2% and 1.0% of GDP for 2023 and 2024, respectively. With this scenario of a persistent primary deficit and still high levels of the real interest rate, the debt should continue to grow as a proportion of GDP. It is worth saying that this scenario does not consider, yet, the direct effects of the measures presented (PLDO and PLP 93).

Finally, it is worth noting that the path traced for the debt shows the size of the fiscal policy challenge. Note that the PLDO and the new fiscal framework were formally presented to the House of Representatives a few days before the release of this RAF. Thus, although this report covers some relevant points of the new tax rule, the impact simulations and a more precise evaluation of the new rule will be presented later by the IFI, in a specific publication on the subject.

**Vilma da Conceição Pinto**
*IFI Director*

# Summary

- The Commodities Index – Brazil (IC-Br) calculated by the Central Bank dropped 2.8% between February and March. In twelve months, the IC-Br accumulates a contraction of 14.0%. On the one hand, monetary tightening in the advanced economies and the prospect of a global economic slowdown, amplified by volatility in the financial system, are factors holding back commodity prices. On the other hand, China's recovery after the reopening of the economy and the recent decision by OPEC+ to reduce oil production are appreciating factors. As there are several forces acting on commodity prices, the prospective scenario and the consequent impact on inflation are still uncertain. (**Page 6**)
- The incorporation of the information on revenues collected in Siga Brasil and the correction of the personal income tax table, with exemption for individuals with salaries of up to two minimum wages per month, increased the projection made by the IFI for the net primary revenue of the Federal Government in 2023 by R$ 0.4 billion. The projection for next year, however, was reduced by R$ 3.0 billion, based on an impact estimate released by the Brazilian Federal Revenue Office. In any case, the maintenance of the primary expenditure projections left unchanged the estimates for the primary deficits of the central government in the next two years. (**Page 11**)
- According to the Treasury, the average cost of issues of the Federal Domestic Public Securities Debt (DPMFi in the original acronym) in public offers continued to rise in February. On the other hand, there was a downward movement in the bond issue rates in March, according to the IFI's survey of the auctions held by the Treasury. This reduction was greater in securities with shorter maturities and may be related to the disclosure of the new fiscal framework by the Ministry of Finance. (**Page 16**)
- The Executive Branch sent the 2024 PLDO forecasting zero primary deficit in 2024. However, to achieve this result, the government depends on the approval of the new fiscal framework and of measures that permanently increase primary revenues by about 1% of GDP. (**Page 17**)

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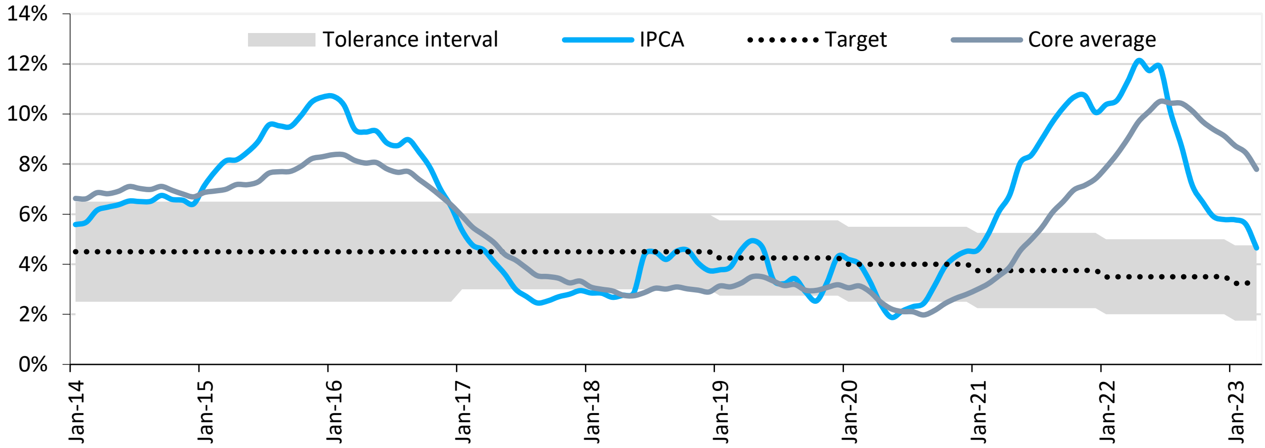
## 1. MACROECONOMIC CONTEXT

**IPCA and average of the cores decelerated in March.** Consumer inflation in March, measured by the IPCA, reached 0.7%, below the rate registered in the previous month (0.8%). The accumulated variation in twelve months went from 5.6% to 4.7%, the lowest level since January 2021, positioning itself within the tolerance band of the 2023 target – 3.25% with a 1.5 percentage point (p.p.) interval up and down. The average of the cores[1] monitored by the Central Bank also decelerated (from 0.7% to 0.4%), decreasing from 8.4% to 7.8% in the twelve-month comparison (Chart 1).

**FIGURE 1. IPCA (% 12 MONTHS)**




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

**Food, industrial and service pressures reduced.** Between February and March, the variation in the set of administered (or monitored) prices, which account for approximately 25% of the total IPCA, rose from 0.8% to 2.3% (Table 1), with the highlight being the rise in gasoline prices (8.3%) in the context of the return of the collection, albeit partial, of federal taxes (PIS/Cofins). Free prices, on the other hand, decelerated (0.2% versus 0.8%) due to the influence of foodstuffs (from 0.0% to -0.1%), industrial goods (from 0.5% to 0.3%), and services (from 1.4% to 0.3%).

**TABLE 1. IPCA: VARIATION IN THE MONTH AND IN 12 MONTHS**

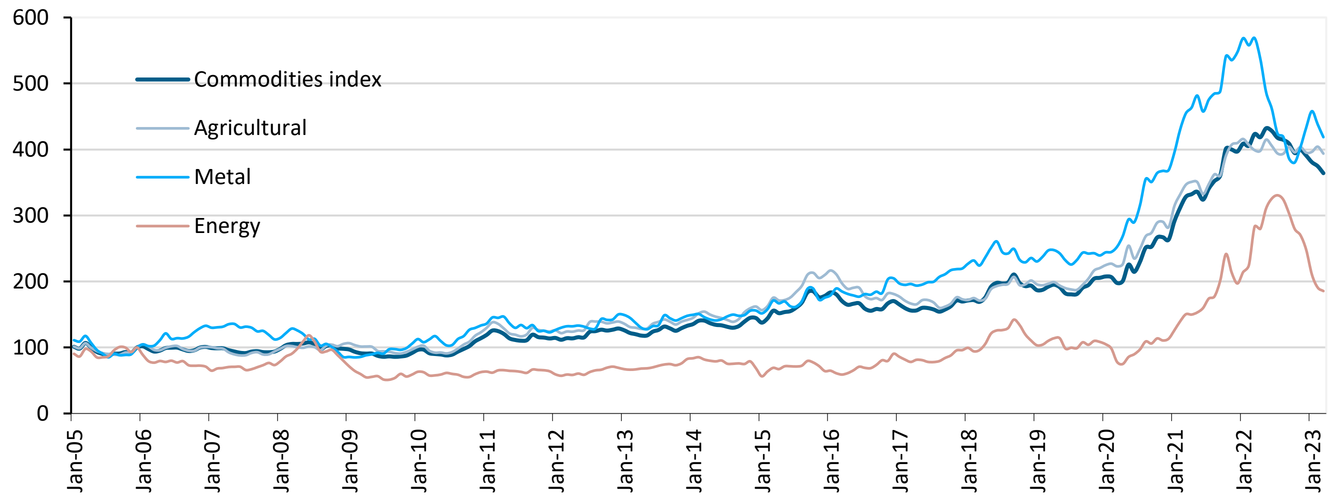
| Consumer Inflation | In the month | | | 12 months | | |
|---|---|---|---|---|---|---|
| | Jan/23 | Feb/23 | Mar/23 | Jan/23 | Feb/23 | Mar/23 |
| **IPCA** | **0.5%** | **0.8%** | **0.7%** | **5.8%** | **5.6%** | **4.7%** |
| **Administered Prices** | **0.7%** | **0.8%** | **2.3%** | **-2.8%** | **-2.1%** | **-2.4%** |
| Gas | 0.8% | 1.2% | 8.3% | -24.3% | -23.1% | -22.1% |
| Residential Electricity | 0.2% | 1.4% | 2.2% | -18.0% | -17.0% | -16.0% |
| **Free pricing** | **0.5%** | **0.8%** | **0.2%** | **9.0%** | **8.4%** | **7.3%** |
| Foodstuff | 0.6% | 0.0% | -0.1% | 12.3% | 10.5% | 7.0% |
| Services | 0.6% | 1.4% | 0.3% | 7.8% | 7.9% | 7.6% |
| Industrialized | 0.2% | 0.5% | 0.3% | 8.5% | 7.9% | 6.9% |
| **Core Average** | **0.5%** | **0.7%** | **0.4%** | **8.7%** | **8.4%** | **7.8%** |

*Source: IBGE. Elaboration: IFI.*

[1] Underlying inflation, or core inflation, is a measure that seeks to remove the influence of more volatile items from total inflation, showing the price trend.

**Commodity prices maintain downward trajectory, but prospective scenario is uncertain.** The Commodities Index – Brazil (IC-Br) calculated by the Central Bank retreated 2.8% between February and March, after falling 1.6% in the previous month (Chart 2). In twelve months, the IC-Br accumulates a contraction of 14.0%. The opening of the index showed a widespread retreat among the components: agricultural commodities (-2.6%), metals (-4.4%), and energy (-2.8%). On the one hand, monetary tightening in the advanced economies and the prospect of a global economic slowdown, amplified by volatility in the financial system, are factors holding back commodity prices. On the other hand, China's strong recovery after the reopening of the economy represents a bullish vector for commodity prices. The decision by the Organization of the Petroleum Exporting Countries and allies (OPEC+) in early April to reduce oil production by 1.1 million barrels per day between May and December represents an additional appreciation factor, not yet captured by the IC-Br. As there are several forces acting on commodity prices, the prospective scenario, as well as the consequent impact on inflation, is still uncertain.

**FIGURE 2. COMMODITIES INDEX IN R$**



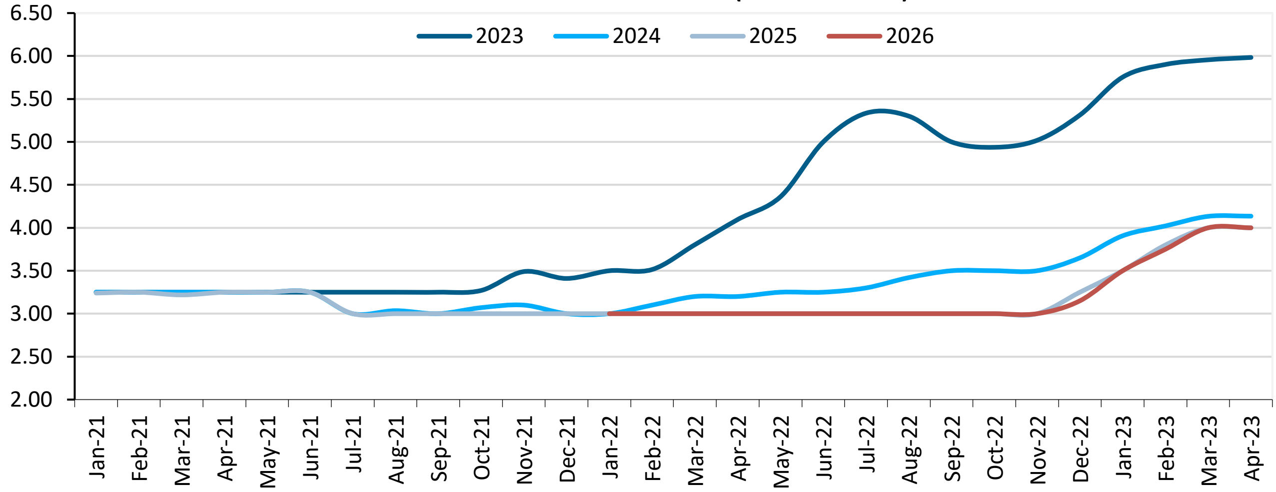

*Source: Central Bank. Prepared by: IFI.*

**Inflation expectations in the Focus survey remain above the target.** Despite the slowdown in current inflation, the outlook for inflation remains above the target in the monetary policy-relevant horizon (2023 and 2024) and also at longer terms (2025 and 2026). In the short term, the change in the ICMS tax on gasoline should add upward pressure on the IPCA. The effect on the IPCA for 2023 is estimated by IFI at 0.22 p.p. The new calculation basis[2] of the state ICMS rate for gasoline was set at R$ 1.22 per liter, applicable from June onwards throughout the country. Currently, the ICMS value is calculated as a percentage on the average price (between 17% and 18% in each state).

In the Focus Bulletin, the median of expectations for the IPCA (Chart 3) is 6.0% for 2023, 4.1% for 2024, and close to 4.0% in the medium term (2025, 2026 and 2027). The median for the Selic rate, in this environment, remains at 12.75% in 2023, with cuts expected for the last three meetings of the year (0.25 p.p. in September and November and 0.5 p.p. in December). For 2024, the median is also unchanged at 10.0%.

[2] For more details: https://www.jota.info/tributos-e-empresas/tributario/icms-dos-combustiveis-entenda-a-nova-aliquota-03042023

FIGURE 3. FOCUS SURVEY - IPCA (% 12 MONTHS)



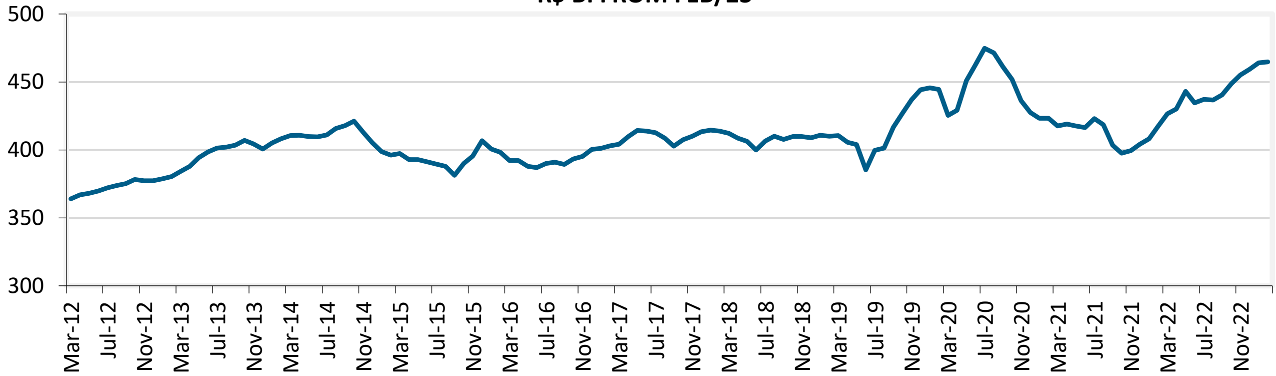

*Source: Central Bank. Prepared by: IFI.*

**The IFI's projection for the IPCA in 2023 was maintained at 5.6% (decelerating to 4.0% in 2024).** The outlook for free prices is conditioned to the hypotheses of (i) relative stability of the nominal exchange rate (R$/US$ 5.25 in 2023 and R$/US$ 5.33 in 2024), (ii) gradual return of commodity prices to historical averages, and (iii) weakening of domestic economic activity, with the output gap going back into negative territory as of the second trimester due to restrictive monetary policy. The projection for administered prices, in turn, is obtained from the Focus survey.

**The projection for GDP growth in 2023 and 2024 was maintained at 0.9% and 1.4%, after expansion of 2.9% in 2022.** January data from industrial production (-0.3% in relation to December, after seasonal adjustment), from expanded retail trade (+0.2%), and from real income from the service sector (-3.1%), published by the IBGE, reinforce the deceleration in the level of activity. In the labor market, the unemployment rate interrupted the downward trend observed between June 2021 and August 2022, remaining around 8.5% (seasonally adjusted) in the last six months. The positive dynamics of the expanded disposable income[3] (Chart 4), on the other hand, influenced by the expansion (i) of the average labor income and (ii) of the income transfers (Bolsa Família [Family Allowance] payments and real increase in the minimum wage), should provide some support to household consumption.

[3] Gross National Available Household Income (RNDBF, in the original acronym) ), calculated by the Central Bank. SGS - Time Series Management System (code 29028).

**FIGURE 4. DISPOSABLE INCOME**
**R$ BI FROM FEB/23**




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

After dropping 0.2% in the fourth quarter, compared to the previous quarter (seasonally adjusted), the GDP is expected to advance punctually in the first quarter of 2023 (projected high of 0.8%), influenced by the record performance of agricultural production. In subsequent quarters, growth is expected to be close to zero, reflecting contractionary monetary policy and slowing global growth, which should prevail over the effects of expansionary fiscal policy measures.

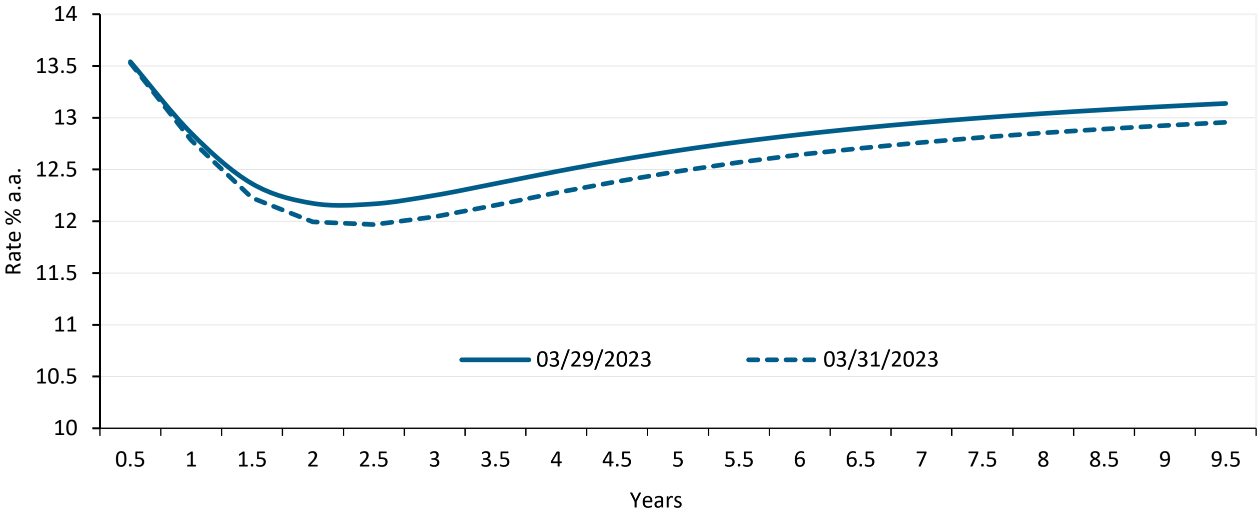
**The Central Bank's Monetary Policy Committee (Copom) maintained the basic interest rate at 13.75% p.a. in March.** The minutes of the meeting and the Quarterly Inflation Report (documents communicating monetary policy decisions) indicate that the committee will pursue the consolidation of the disinflation process and the anchoring of expectations, including raising interest rates if necessary.

**Central Bank inflation projections were revised upward.** Copom's inflation projections in the reference scenario (which include the interest rate trajectory extracted from the Focus survey in mid-March and the exchange rate starting from R$/US$ 5.25) increased to 5.8% in 2023 and 3.6% in 2024, above the assessment presented in February (5.6% and 3.4%), reflecting, mainly, the increase in inflation expectations from the Focus survey (used in the Central Bank's forecast models).

**Balance of risks.** According to the Central Bank, the uncertainty surrounding its projections is greater than usual. Among the upside risks, he mentions (i) the greater persistence of global inflationary pressures, (ii) uncertainty about the country's fiscal framework and the impacts on the trajectory of the public debt, and (iii) a more lasting de-anchoring of inflation expectations, especially at longer maturities. Among the downside risks, he highlights (i) a further drop in commodity prices in local currency, (ii) a more expressive than projected slowdown in global economic activity due to adverse conditions in the global financial system and (iii) a sharper deceleration in domestic credit concessions than would be compatible with the stage of monetary policy.

**Presentation of the new rule had a positive initial reaction.** The partial recomposition of the PIS/Cofins tax rates on fuels and the presentation of the new fiscal rule that replaces the expenditure ceiling – combining primary result targets and limits to the growth of expenses – are signs in the direction of reducing the uncertainties about fiscal policy. In this sense, the initial reaction to the announcement of the new rule, observing, for example, the movement of the future yield curve (Chart 5), was positive. In the minutes of the March meeting, the Central Bank stated that it will continue to monitor the discussion of the new rule in Congress, and the consequent impact on public debt projections and inflation expectations.

**FIGURE 5. YIELD CURVE**




*Source: Anbima. Prepared by: IFI.*

The analysis of the minutes of the March meeting and of the Quarterly Inflation Report suggests that there is little room for the beginning of interest rate cuts in the very short term, making it more likely that the cycle will start in the second half of the year. Despite having included new downside elements in the balance of risks to inflation (adverse conditions in the global financial system and deceleration in domestic credit), the Central Bank remains concerned about the evolution of the fiscal scenario and the deterioration of inflation expectations. For now, we maintain our projection for the Selic rate at 13.00% p.a. at the end of 2023 and 10.00% p.a. in 2024.

Table 2 summarizes the IFI's projections for the main economic variables in 2023 and 2024.

**TABLE 2. PROJECTIONS - MACROECONOMIC VARIABLES**

| Projections - macroeconomic variables | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|
| Nominal GDP (R$ billion) | 8,899 | 9,915 | 10,511 | 11,210 |
| Nominal GDP (% average annual variation) | 16.9 | 11.4 | 6.0 | 6.6 |
| Real GDP (% average annual variation) | 5.0 | 2.9 | 0.9 | 1.4 |
| GDP deflator (% average annual variation) | 11.4 | 8.3 | 5.1 | 5.1 |
| IPCA (% average annual variation) | 8.3 | 9.3 | 4.9 | 4.7 |
| IPCA (% variation year on year in December) | 10.1 | 5.8 | 5.7 | 4.0 |
| Unemployment rate (% of labor force) | 13.2 | 9.3 | 9.5 | 9.6 |
| Exchange Rate (R$/US$ end of period) | 5.58 | 5.22 | 5.25 | 5.33 |
| Selic (% end of period) | 9.25 | 13.75 | 13.00 | 10.00 |

*Source: IBGE and Central Bank. Projections: IFI.*

## 2. FISCAL SCENARIO

### 2.1 Primary revenues and transfers

**The IFI's projection for primary revenue in 2024 was reduced by R$ 6 billion due to the correction of the personal income tax table.** The IFI's projection for total primary revenue of the central government in 2023, which includes the National Treasury, the Central Bank and the INSS, rose from R$ 2,315.4 billion to R$ 2,316.0 billion, an increase of R$ 0.7 billion. For 2024, the projection was reduced by R$ 6.0 billion, from R$ 2,484.6 billion to R$ 2,478.6 billion. The projections take into consideration (i) the anticipation of primary revenues and expenses for March, carried out by the IFI in the portal Siga Brasil, of the Federal Senate, and in the Treasury Management; (ii) the update of the macroeconomic projections discussed in the previous section; and (iii) the impact of the correction of the income tax table, with the exemption of the charge for individuals earning up to two minimum wages[4] (Table 3).

**TABLE 3. PROJECTIONS OF PRIMARY REVENUES OF THE CENTRAL GOVERNMENT FOR 2023 AND 2024 IN THE BASELINE SCENARIO (R$ BILLION)**

| Baseline Scenario | 2023 | | | 2024 | | |
|---|---|---|---|---|---|---|
| | Projection Mar/23 | Projection Apr/23 | Variation | Projection Mar/23 | Projection Apr/23 | Variation |
| **1. Total Primary Revenue** | **2,315.4** | **2,316.0** | **0.7** | **2,484.6** | **2,478.6** | **-6.0** |
| Revenues collected by the Federal Revenue Office | 1,443.2 | 1,443.9 | 0.7 | 1,522.0 | 1,516.0 | -6.0 |
| Net collection for the RGPS | 571.7 | 571.7 | 0,0 | 608.6 | 608.6 | 0,0 |
| Revenues not collected by the Federal Revenue Office | 300.4 | 300.4 | 0.0 | 354.1 | 354.0 | 0.0 |
| **2. Revenue-sharing transfer** | **452.9** | **453.1** | **0.3** | **471.1** | **468.1** | **-3.0** |
| **3. Net primary revenue [1-2]** | **1,862.5** | **1,862.9** | **0.4** | **2,013.6** | **2,010.5** | **-3.0** |

*Source: IFI.*

Between February and March, the projections for the main macroeconomic variables considered for the revenue scenarios were maintained, such as real growth, the nominal GDP variation, and the implicit GDP deflator. Other events, however, have affected the projections. The first was the incorporation of the values studied by the IFI as anticipation of central government revenues and expenses for March. These values, together with the values produced in February, resulted in an extra difference of R$ 3.9 billion in total primary revenue under the category of revenue collected by the Federal Revenue Office.

The second factor considered in updating the projections was the incorporation of the estimate released by the Brazilian Federal Revenue Service (RFB) regarding the impact of the exemption from the collection of Personal Income Tax for individuals with monthly earnings of up to two minimum wages. The waiver calculated by RFB was R$ 3.2 billion in 2023 and R$ 6.0 billion in 2024.

**The anticipation of the values in the Siga Brasil and the correction of the income tax table made the primary revenue projection increase by R$ 0.7 billion in 2023.** Considering the update of the amounts based on the anticipation (R$ 3.9 billion) and on the waiver in income tax collection from May onwards (R$ 3.2 billion), the total

[4] See the following news story: https://g1.globo.com/economia/noticia/2023/02/17/a-partir-de-maio-137-milhoes-de-pessoas-deixarao-de-pagar-ir-informa-receita-federal.ghtml.

primary revenue projection for 2023 was R$ 0.7 billion higher compared to the projection released by IFI in the March RAF. For 2024, the difference was R$ 6.0 billion less, due to the correction in the income tax table.

So far, for projection purposes, measures that may affect the tax collection this year and next year have not been considered. Among them are (i) the possible end of the exemption of imports worth up to US$ 50, and/or the related measure of increased inspection on e-commerce companies, and (ii) changes in the IRPJ and CSLL legislations regarding transfer pricing.

**Expectation for 2023 net primary revenue rose R$ 0.4 billion compared to the March estimate.** The IFI's projections for revenue-sharing transfers this year and next year have also changed. For 2023, there was a reduction of R$ 0.3 billion in the projection, while the 2024 projection was reduced by R$ 3.0 billion. Thus, the new projection of net primary revenue for 2023 is now R$ 1,862.9 billion, up R$ 0.4 billion from the estimate released in March. For 2024, the IFI's expectation for net revenue was reduced to R$ 2,010.5 billion (Table 3).

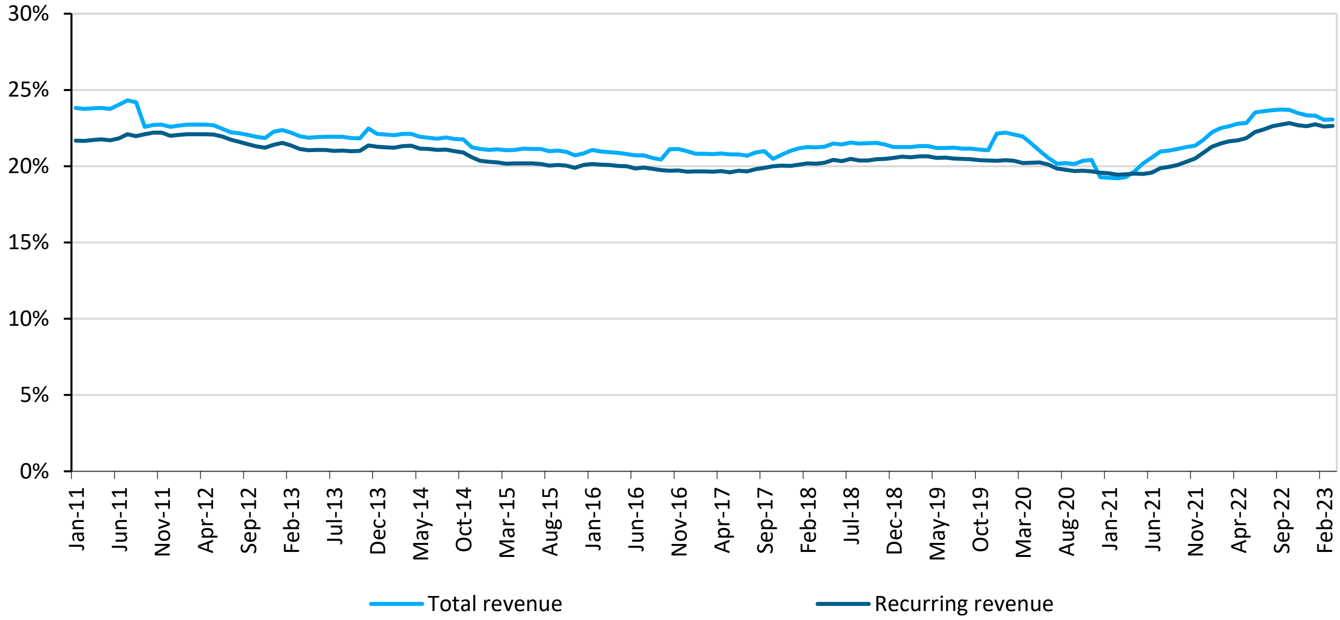
By way of comparison, the median projection of the April 2023 Monthly Report from Prisma Fiscal[5], of the Ministry of Finance, was for federal revenue collections of R$ 2,350.0 billion in 2023 and R$ 2,502.2 billion in 2024. The average forecast of Podium, the group of institutions that are most accurate, is of a total primary revenue of R$ 2,349.0 billion this year and R$ 2,495.3 billion next year.

The Executive projection for the total primary revenue of the central government in 2023, contained in the Primary Revenues and Expenses Evaluation Report for the 1st Bimester of 2023[6], is R$ 2,375.6 billion. For net revenues in 2023, the Executive's most recent projection is R$ 1,915.7 billion. For 2024, the projection in the Budget Guidelines Bill (PLDO)[7] is for total and net primary revenue of, respectively, R$ 2,682.9 billion and R$ 2,149.6 billion.

**Weakening economic activity produced a slowdown in revenues starting in the last quarter of 2022.** It is important to highlight the deceleration observed in primary revenues in recent months, a behavior in line with the cooling down of domestic economic activity. Chart 6, presented by the IFI in this RAF frequently, contains the series of total and recurrent primary revenues of the central government, measured in 12-month moving windows and as a proportion of nominal GDP. The calculations were made by the IFI based on information made available by the National Treasury Secretariat (STN), in the National Treasury Results Bulletin (RTN), and on data collected on Siga Brasil.

[5] Link to the report: https://www.gov.br/fazenda/pt-br/centrais-de-conteudos/publicacoes/relatorios-do-prisma-fiscal/relatorio-mensal/2023.
[6] Access page for the document: https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-avaliacao-de-receitas-e-despesas-primarias-rardp/2023/13.
[7] Link for access: https://legis.senado.leg.br/sdleg-getter/documento?dm=9316380&ts=1681508512816&disposition=inline.

**FIGURE 6. EVOLUTION IN 12 MONTHS OF CONVENTIONAL AND RECURRENT PRIMARY REVENUE - % OF GDP**




*Source: National Treasury Secretariat and IFI. Prepared by: IFI.*

In the 12 months to March 2023, total primary revenue was 23.1% of GDP, compared to 23.0% of GDP in February. By October 2022, the series had reached 23.7% of GDP, and has been declining since then. Recurring revenue, in turn, registered 22.8% of GDP in October and has been relatively stable since then, declining to 22.6% of GDP in March 2023, according to the IFI estimates.

**Deceleration in primary revenues poses a risk to meeting the fiscal targets in the current and coming years.** The cooling observed in tax collection poses a risk for meeting the fiscal targets this year and next. As explored in previous issues of this RAF, revenue behavior in 2021 and 2022 was influenced not only by economic activity, but also by commodity prices and inflation. This year, the effects of the tightening of monetary policy will be felt by the activity, while the perspective is that commodity prices stand at lower levels than those observed in the last two years.

The recovery of the Chinese economy, after the removal of restrictions on the movement of people and on the operation of sectors of activity in that country, may affect the quotations of commodities, benefiting Brazil. This event, however, is not fully considered in the IFI's macroeconomic projections, which will continue to monitor the evolution of global economic conditions in the coming months. The perspective remains of weakening economies globally, in response to the tightening of monetary policy practiced by central banks around the world to contain inflation.

## 2.2 Primary Expenditure

**The IFI's projections for the Federal Government's primary expenditure in 2023 and 2024 remained the same as in March.** In the absence of events that would justify a revision in the numbers, the IFI maintained the projections for the Federal Government's primary expenditure for 2023 and 2024 at R$ 1,987.5 billion (18.9% of GDP) and R$ 2,122.8 billion (19.0% of GDP), in that order. Table 4 details the main expenditure items in the IFI scenarios for this year and next.

**TABLE 4. FEDERAL PRIMARY EXPENDITURE - IFI BASELINE SCENARIO FOR 2023 AND 2024 (R$ BILLION AND % OF GDP)**

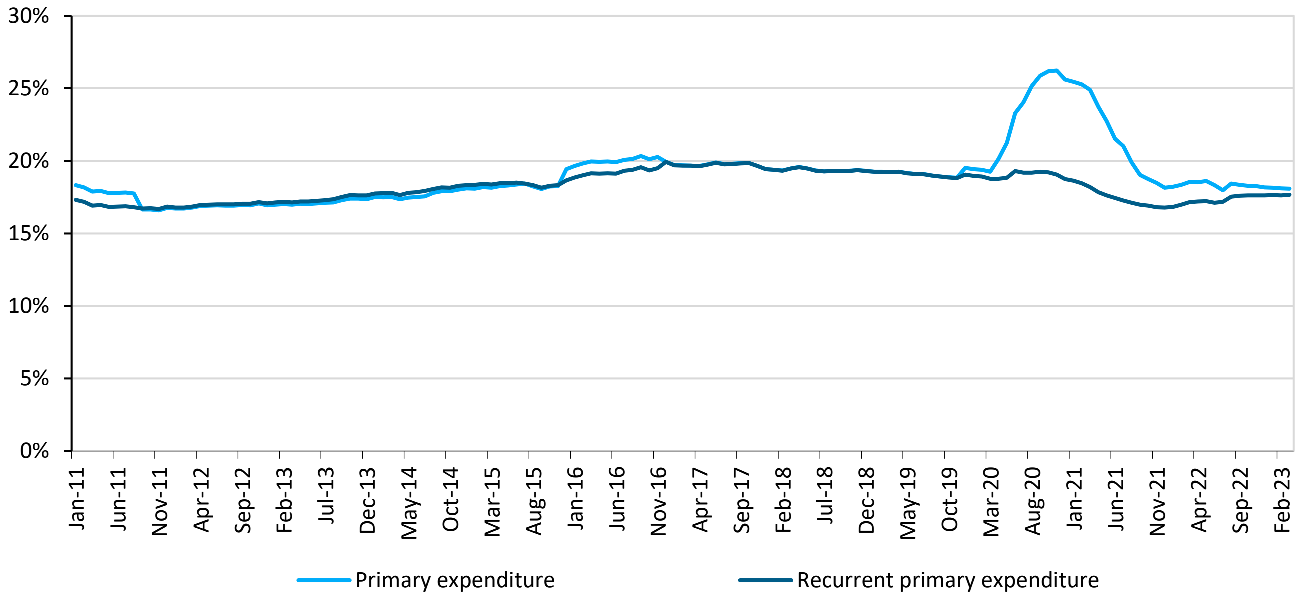
| Breakdown | 2022 (Executed) | | IFI (Scenario 2023) | | IFI (Scenario 2024) | | Difference (p.p. of GDP) | |
|---|---|---|---|---|---|---|---|---|
| | R$ bi | % GDP | R$ bi | % GDP | R$ bi | % GDP | 22 - 23 | 23 - 24 |
| **Primary Expenditure** | **1,802.0** | **18.2** | **1,987.5** | **18.9** | **2,122.8** | **19.0** | **0.7** | **0.0** |
| **Mandatory** | **1,649.9** | **16.6** | **1,821.3** | **17.3** | **1,945.8** | **17.4** | **0.7** | **0.0** |
| Social Security | 797.0 | 8.0 | 866.8 | 8.2 | 936.5 | 8.4 | 0.2 | 0.1 |
| Payroll | 337.9 | 3.4 | 356.4 | 3.4 | 381.6 | 3.4 | 0.0 | 0.0 |
| Salary Allowance and Unemployment Benefit | 64.3 | 0.6 | 69.2 | 0.7 | 74.2 | 0.7 | 0.0 | 0.0 |
| BPC | 78.8 | 0.8 | 86.6 | 0.8 | 93.9 | 0.8 | 0.0 | 0.0 |
| Family Allowance / Brazil Aid | 88.1 | 0.9 | 179.7 | 1.7 | 182.9 | 1.6 | 0.8 | -0.1 |
| Court-ordered debt (cost and capital) | 17.3 | 0.2 | 23.6 | 0.2 | 26.9 | 0.2 | 0.0 | 0.0 |
| Supplementation to Fundeb | 32.9 | 0.3 | 38.7 | 0.4 | 45.6 | 0.4 | 0.0 | 0.0 |
| Subsidies and Grants | 15.3 | 0.2 | 20.3 | 0.2 | 21.1 | 0.2 | 0.0 | 0.0 |
| Legislative, Judiciary, MPU and DPU | 15.0 | 0.2 | 16.1 | 0.2 | 16.7 | 0.1 | 0.0 | 0.0 |
| Payroll tax reduction | 3.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Extraordinary Credits | 47.0 | 0.5 | 5.0 | 0.0 | 0.0 | 0.0 | -0.4 | 0.0 |
| Other Compulsory Expenses | 153.1 | 1.5 | 158.9 | 1.5 | 166.3 | 1.5 | 0.0 | 0.0 |
| **Executive Branch Discretionary** | **152.1** | **1.5** | **166.2** | **1.6** | **177.0** | **1.6** | **0.0** | **0.0** |

*Source: STN and IFI. Elaboration: IFI.*

**Recurrent primary expenditure is stable since September 2022.** The recurrent primary expenditure of the central government, calculated by the IFI based on the methodology published in the EE No. 17, December 2021, totaled R$ 1,787.2 billion (17.7% of GDP) in the 12 months to March 2023. Since September 2022, recurrent primary expenditure has remained stable as a proportion of GDP. The calculation considers as non-recurring: (i) expenses related to Covid-19, (ii) expenses from the onerous assignment of pre-salt, (iii) expenses from the Sovereign Fund of Brazil, (iv) advances in the payment of the salary allowance and the RGPS Christmas bonus, and other expenses, such as (v) the payment for the right to use Campo de Marte and (vi) the aids created by the Constitutional Amendment (EC) No. 123, of 2022, except for the additional R$ 200.00 paid to the beneficiaries of the Brazil Aid (classified as extraordinary credits between August and December 2022).

Chart 7 shows the 12-month evolution of total and recurrent primary expenditures, measured as a proportion of GDP. Overall, the two expenditure measures show primary spending relatively under control, after the increase seen in the first half of 2022.

FIGURE 7. EVOLUTION IN 12 MONTHS OF TOTAL CONVENTIONAL AND RECURRENT PRIMARY EXPENDITURE - % OF GDP




*Source: National Treasury Secretariat and IFI. Prepared by: IFI.*

## 2.3 Central government primary result

**IFI estimates for the central government primary deficit in 2023 and 2024 remained the same as a proportion of GDP.** Based on the projections presented in the previous two subsections, for the net revenue and primary expenditure of the Federal Government, Table 5 contains a comparison of the values projected in March and April by the IFI for the primary result of the central government in 2023 and 2024. Between March and April, the IFI's expectation for the central government's primary deficit in 2023 and 2024 remained stable at 1.2% of GDP and 1.0% of GDP, in that order.

**TABLE 5. PRIMARY RESULT OF THE CENTRAL GOVERNMENT AND PROJECTIONS FOR 2023 AND 2024, IN THE BASELINE SCENARIO (R$ BILLION)**

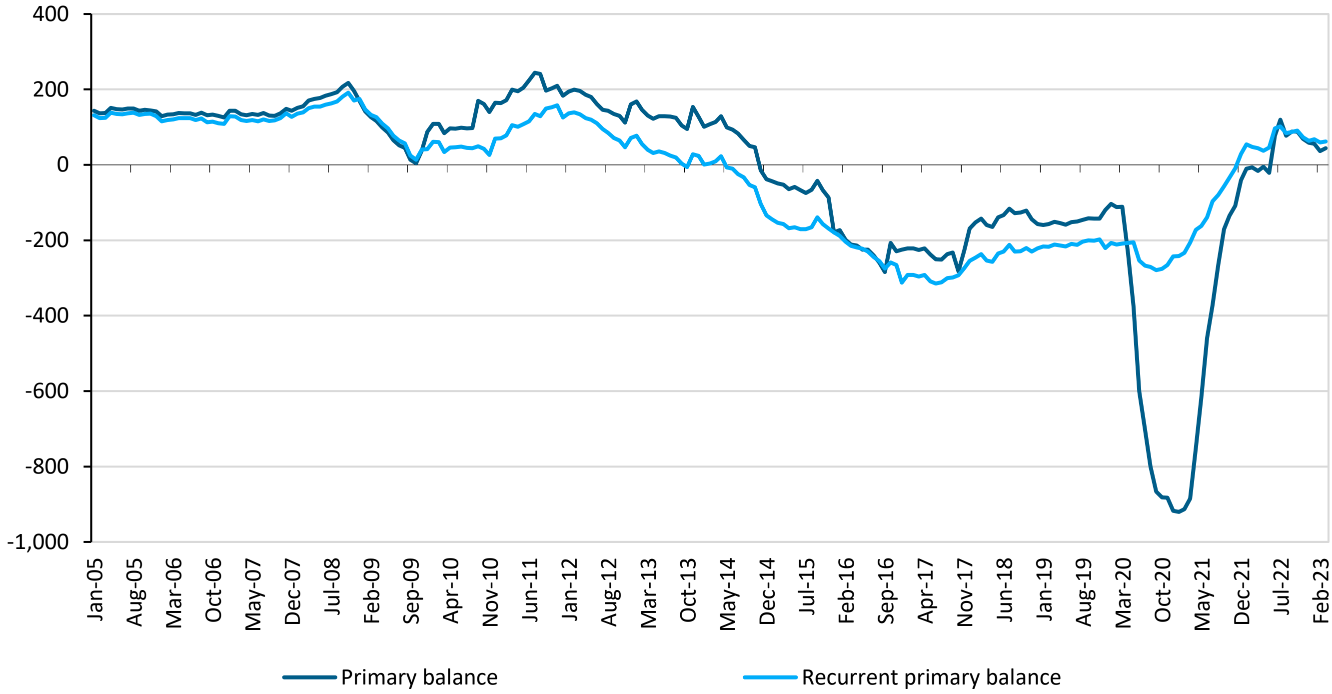
| Breakdown | 2022 | | 2023* | | | | 2024* | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Projection Mar/23 | | Projection Apr/23 | | Projection Mar/23 | | Projection Apr/23 | |
| | Value | % of GDP | Value | % of GDP | Value | % of GDP | Value | % of GDP | Value | % of GDP |
| Net revenue | 1,856.1 | 18.7% | 1,862.5 | 17.7% | 1,862.9 | 17.7% | 2,013.6 | 18.0% | 2,010.5 | 17.9% |
| Primary Expenditure | 1,802.0 | 18.2% | 1,987.5 | 18.9% | 1,987.5 | 18.9% | 2,122.8 | 19.0% | 2,122.8 | 18.9% |
| **Primary result** | **54.1** | **0.5%** | **-125.0** | **-1.2%** | **-124.6** | **-1.2%** | **-109.3** | **-1.0%** | **-112.3** | **-1.0%** |

** 2023 and 2024: projections.*
*Source: IFI.*

**The central government's primary result remained positive in March, but on a downward trajectory.** Chart 8 presents the 12-month path of the central government's conventional (observed) and recurrent primary results, at March 2023 prices. While the conventional result was a surplus of R$ 43.9 billion in March, the recurring result was a positive

R$ 61.8 billion. The two primary result curves show a reduction of the surplus starting in the second half of 2022, due to the growth of expenses compared to net revenues. Throughout 2023, the trajectory of these curves should continue to decline, moving into the negative field.

**FIGURE 8. EVOLUTION IN 12 MONTHS OF THE PRIMARY BALANCE AND OF THE RECURRENT PRIMARY BALANCE OF THE CENTRAL GOVERNMENT (R$ BILLION AT MARCH 2023 PRICES)**




*Source: National Treasury Secretariat, Siga Brasil, and Tesouro Gerencial. Prepared by: IFI.*

**Weakening revenues and the absence of sources for expenses configure risks for the fiscal framework this year.** As repeated in recent issues of the RAF, the expected slowdown in domestic economic activity in the coming months, possibly enhanced by a tightening credit market, constitutes a risk to the trajectory of revenues in 2023. On the expenditure side, there are (i) the expenses created with the Constitutional Amendment (EC) No. 126, which are also a risk, given the lack of clarity about funding sources, and (ii) the potential impact of the measures announced in January by the Ministry of Finance. For the purpose of the revenue projections, the IFI considered only the measure that transfers the resources from the PIS/Pasep accounts to the Treasury, in the announced amount of R$ 23 billion.

The potential effects of the new fiscal anchor (on the trajectory of the debt/GDP ratio) may influence the risk premiums and contribute to coordinate agents' expectations regarding the inflation trajectory, opening space for the Central Bank to reduce the economy's basic interest rates.

## 2.4 Evolution of public sector indebtedness indicators

**Gross debt is expected to reach 78.1% of GDP in 2023 and 81.0% of GDP next year.** The IFI forecasts that General Government Gross Debt (DBGG in the original acronym) will reach 78.1% of GDP in 2023, increasing to 81.0% of GDP in 2024. Underlying the projection of an increase in the gross debt are (i) the expected worsening of the primary result of the consolidated public sector, which should go from a surplus of 1.3% of GDP (2022) to deficits of 1.4% of GDP (2023) and 1.2% of GDP (2024), and (ii) the increase in the implicit real interest rate of the gross debt, from 4.8% p.a. in 2022 to 6.0% p.a. in 2023 (Table 6).

**TABLE 6. PROJECTIONS FOR GENERAL GOVERNMENT GROSS DEBT IN 2023 AND 2024 IN THE BASELINE SCENARIO**

| Breakdown | 2022 | 2023 | | 2024 | |
|---|---|---|---|---|---|
| | | Projection Mar/23 | Projection Apr/23 | Projection Mar/23 | Projection Apr/23 |
| Primary result of the consolidated public sector | -1.2% | -1.4% | -1.4% | -1.2% | -1.2% |
| Nominal GDP (R$ billions) | 9,915.32 | 10,512.46 | 10,511.40 | 11,198.88 | 11,209.94 |
| GDP - real growth | 2.9% | 0.9% | 0.9% | 1.4% | 1.4% |
| GDP price deflator | 8.3% | 5.1% | 5.1% | 5.0% | 5.1% |
| Implicit real rate | 4.8% | 6.0% | 6.0% | 4.9% | 4.8% |
| **DBGG (% of GDP)** | **72.9%** | **78.6%** | **78.1%** | **81.6%** | **81.0%** |

*Source: IBGE, Central Bank and IFI. Elaboration: IFI.*

An important explanation to be made regarding the projection of the General Government Gross Debt in 2023 and 2024 concerns the debt levels as a proportion of GDP. Although the projections for the main variables that affect gross debt have remained the same in April, the projected values for the debt/GDP ratio are lower compared to those presented in March.

This occurred because the IFI mistakenly considered the 73.4% level for gross debt in December 2022, a figure released by the Central Bank in the February Fiscal Statistics Note, which did not consider the release of the IBGE's quarterly national accounts results for the fourth quarter of 2022. With the new national accounts figures, the DBGG calculated as a proportion of GDP was 72.9% last year.

**Growth of interest expenses pressured the nominal result of the public sector in January and February.** To conclude this section, two considerations must be made. The first concerns the increase in public sector interest expenditure as a proportion of GDP in January and February 2023. In the accumulated over 12 months, this expense increased from 5.9% of GDP in December to 6.2% of GDP in January and 6.5% of GDP in February, according to information from the Central Bank. This movement worsened the nominal result of the public sector, which went from 4.6% of GDP in December to 5.6% of GDP in February.

**Debt issue rates ascertained by the IFI in Treasury auctions registered declines in March.** The second consideration concerns the increase in the average cost of the public debt. According to the Treasury's Monthly Debt Report (RMD), the average cost of the Domestic Federal Public Securities Debt (DPMFi) issues in public offers rose from 12.23% p.a. in January to 12.44% p.a. in February. Despite the cooling of inflation, the Selic rate at 13.75% p.a. continues to pressure the average cost of public debt. The information gathered by the IFI on the auctions held by the Treasury[8] indicate reductions in the rates of the DPMFi bonds in March, especially in the shorter maturity papers. This movement may be related to the release of the new fiscal framework by the Ministry of Finance last month.

## 2.5 The Budget Guidelines Bill and the new fiscal framework

The Federal Constitution determines that the Budget Guidelines Bill (PLDO) must be sent to the National Congress by April 15th of the previous year. The PLDO for 2024 was sent by the Executive last Friday (14). The budget guidelines include: projections for budget parameters, such as GDP, inflation, and interest rates; setting the primary deficit target; and designing the rules that will guide the formulation of the budget itself.

[8] Link to access the spreadsheet: https://www12.senado.leg.br/ifi/dados/dados.

EC 126, however, determined that the president of the Republic must submit a proposal for a "sustainable fiscal regime", by means of a Complementary Law Bill (PLP), to substitute the current "new fiscal regime", foreseen in art. 107 of the Transitory Constitutional Dispositions Act (ADCT in the original acronym). Given this, the PLDO was made based on the current fiscal rule (expenditure ceiling), but with provisions to allow changes in the case of approval of the new fiscal rule. This section of the RAF explains the main points of the PLDO related to this new fiscal framework, which is expected to go through Congress in the coming months.

**PLDO 2024 was sent without the new fiscal framework.** This initial stage for the discussion of the 2024 Budget took place without the new fiscal rule having been formally presented in Congress, even though its outlines had been presented by the Executive Branch on March 30[9]. Since the current expenditure ceiling is not compatible with the current primary spending structure, the PLDO was sent with an expenditure volume conditioned to the approval of the new fiscal framework, bypassing this issue. The PLP regarding the sustainable fiscal regime, however, was only presented on April 18, that is, 4 days after the PLDO was sent.

**Primary deficit target for 2024 is 0% of GDP.** The 2024 PLDO indicates a primary deficit target for the central government of R$ 0 billion (0% of GDP) for 2024. The target for the consolidated public sector, which includes states, municipalities, and state-owned companies, is a deficit of R$ 13.3 billion (-0.1% of GDP). As in previous years, the obligation is tied only to the central government's share, but this year's PLDO allows the Union to offset the target using the state-owned companies' one, and vice-versa. Total primary revenues of the central government are estimated at R$ 2,682.9 billion (23.3% of GDP), with net revenues from transfers to subnational entities at R$ 2,149.6 billion (18.7% of GDP) and total primary expenditures also at R$ 2,149.6 billion (18.7% of GDP).

For 2025 and 2026, the targets for the central government were set, respectively, at R$ 61.6 billion (0.5% of GDP) and R$ 130.8 billion (1.0% of GDP). It is worth saying that, in relation to the current system for primary result targets, the PLDO innovated by providing upper and lower limits (of 0.25% of GDP above and below the target) for compliance with this fiscal rule. This tolerance interval is also provided for in the PLP that was presented on the 18th.

In relation to the PLP No. 93, of April 18th, 2023[10], which provides for the Federal Government's new fiscal rule, it is worth noting that it establishes a target for the reference year of the PLDO and projections for the next three fiscal years. The PLP also stipulates that the LDO must show, for the 10-year period, the expected effect of the fiscal targets. Note that to calculate the effects for the 10-year period, the projections previously defined for a four-year period must be extended to meet this measure.

**Primary target for 2024 depends on revenue recomposition and approval of the new fiscal framework.** The target of achieving a zero primary deficit in 2024 depends on the approval of the new fiscal framework, including for (i) the maintenance of the payment of the conditional expenditures that exceed the expenditure ceiling (current rule) foreseen for next year and (ii) the realization of revenues that are capable of sustaining the proposed deficit without having to reduce the projected expenditure.

When comparing the IFI's projections for 2024 with the scenario foreseen in the PLDO for the same year, we observe that revenues need to grow around 1% of GDP for the deficit to reach zero, considering that the entire adjustment occurs on the revenue side.

[9] On March 30th, the federal government held a press conference to announce the general lines of the proposal, but did not present the bill in order to begin discussions and passage through the National Congress. See at: https://www.gov.br/secom/pt-br/assuntos/obrasilvoltou/desenvolvimento/apresentacao-de-proposta-de-novo-arcabouco-fiscal.

[10] Available at: https://www.camara.leg.br/proposicoesWeb/prop_mostrarintegra?codteor=2260147&filename=PLP%2093/2023.

Regarding the first case (item "i" in the second paragraph above), it is worth saying that Constitutional Amendment 126 modified the current expenditure ceiling for the year 2023 and required (see Art. 6 of EC 126) that the Executive Branch submit to Congress, by August of that year, a proposal for a "sustainable fiscal regime" to replace the current rule. After approval and promulgation of the new fiscal rule, to be carried out by means of a Complementary Law, the expenditure ceiling will automatically be extinguished.

Thus, since the exceptions and expansion of the expenditure ceiling were made only for 2023 and most of the expenses made possible by EC 126 for this year are of a permanent nature, the Executive opted to present the general lines of the proposal before having the project discussed or approved in Congress. This way, it was possible to send the PLDO contemplating these extra expenses (example: expansion of the Family Allowance Program) and mentioning the rule provided by EC 126.

If Congress does not approve the PLP, two alternatives are on the table for discussion of the 2024 budget: (i) maintaining the current expenditure ceiling without executing R$ 172 billion (referring to expenses conditioned to the approval of the fiscal rule), leading to the shutdown of the public machine or (ii) changing the expenditure ceiling to open an exception also in the 2024 budget.

It is worth saying that both alternatives are equally worse than the approval of a new fiscal rule. In the first case, to avoid non-compliance with the ceiling, the volume of adjustment needed would have to be very high, leading to a reduction in discretionary spending and jeopardizing the functioning of several agencies. In the absence of approval of the rule, this excess must be offset in discretionary spending.

If the approval of the text produces an effect different from what the Executive Branch calculates, there may also be changes to the planning instruments, should this occur.

In the second case, we highlight the difference between the processes for a Constitutional Amendment Bill (PEC, in the original acronym) versus a Complementary Law Bill (PLP). Table 1 below details some of the stages in the processing of each type of legislative proposition.

**TABLE 1. SOME STEPS IN THE PROCESSING OF A PEC AND A PLP**

| Step | Complementary Law Bill (PLP) | Constitutional Amendment Bill (PEC) |
|---|---|---|
| **Presentation** | It can be presented by the president of the Republic, by any deputy or senator, etc. | It can be presented by:<br>• At least 1/3 of the members of the House of Representatives or the Senate.<br>• President of the Republic.<br>• At least ½ of the Legislative Assemblies of the Federation units.[11] |
| **Committee Analysis** | As a rule, the PLP begins in the House of Representatives, unless introduced by a Senator member.<br>The PLP is distributed to committees according to subject matter. If it deals with issues related to more | **Admissibility**:<br>• The proposal must be examined by the Committee on the Constitution and Justice and Citizenship. (CCJ)<br>**Merits**:<br>• If it passes the CCJ, a Special Commission must discuss the merit of the proposal, and may change it. The deadline is 40 plenary sessions to approve it. |

[11] Each Assembly must speak by the relative majority of its members.

| Step | Complementary Law Bill (PLP) | Constitutional Amendment Bill (PEC) |
|---|---|---|
| **Approval** | A special quorum is required for its approval, which is at least an absolute majority of favorable votes in both houses (41 senators and 257 deputies). | Approval in the Plenary requires 3/5 of the votes, in two rounds of voting. After approval, it is sent to the Reviewing House. If approved in both houses without amendments, the text goes forward for promulgation in a session of Congress. Otherwise, it returns to the House where the proceedings began and the process starts all over again |
| **Sanction and veto** | The President of the Republic has 15 working days to sanction or veto the approved bill. The veto can be total or partial.<br>To reject a veto, Congress must have an absolute majority vote of deputies and senators. | The text is promulgated and/or altered by the National Congress, and is not subject to presidential sanction or veto. |

*Source: House of Representatives. Elaboration: IFI.*

**Budget Bill may be sent with expenses higher than the expenditure ceiling.** According to the PLDO, if the complementary law regarding the new fiscal rule is not approved by the deadline for submitting the Annual Budget Bill (PLOA), the budget can be sent to Congress for processing, foreseeing expenses conditioned to the approval of the new fiscal rule, i.e., creating new exceptions to the current rules (expenditure ceiling and primary result targets) for the submission of the matter. It is worth highlighting the excerpt from the PLDO, which deals with this subject:

> *"Art. 23. In the event that the complementary law referred to in art. 6 of the Amendment to the Constitution 126, of 2022, is not sanctioned until August 31, 2023, the Budget Bill of 2024 may contain primary expenses whose inclusion in the Budget Law of 2024 will be conditioned to the approval of said complementary law.*
>
> *Single paragraph. The expenses referred to in the head of this article shall be shown in the Annual Budget Bill 2024 and and **shall not be considered for purposes** of demonstrating the **compatibility of the bill with the primary result target** established in this Law and with the individualized limits referred to in art. 107 of the Transitional Constitutional Provisions Act."*
>
> *(Art. 23 of PLN 4, of 2023 - PLDO of 2024. Emphasis added)*

**Primary federal expenses do not contemplate the effect of the real gain in the minimum wage.** The 2024 PLDO used the premise that the minimum wage will follow only the inflation adjustment. This scenario, however, may change, since the government has been signalizing its intention to create a minimum wage appreciation policy to be in effect later this year.

The new rule for primary expenditures foresees that the real growth of spending should be around 0.6% and 2.5%. Thus, in order to obtain a sense of the impact that the variation in the minimum wage may have on the budget accounts for 2024, we calculated the effect of a real growth of 0.6% and then another of 2.5%, as it should be expected with the new fiscal rule, if the PLP presented on the 18th is approved. Table 7, below, shows the impact of minimum wage on the 2024 budget, under three hypotheses: (i) increase of only R$ 1 (one real) in the minimum wage; (ii) real gain of 0.6%; and (iii) real gain of 2.5%.

**TABLE 7. IMPACT OF THE REAL READJUSTMENT OF THE MINIMUM WAGE (SM, IN THE ORIGINAL ACRONYM) ON THE FEDERAL BUDGET (R$ BILLION)**

| Heading | R$ 1 increase in the SM | Assumption for real wage growth | |
|---|---|---|---|
| | | 0.6% real gain | 2.5% real gain |
| **I. RGPS Collection** | **6.3** | **47** | **213** |
| **II. Social Security Benefits** | **266** | **1,979** | **8,995** |
| **III. RGPS Deficit (II - I)** | **259.7** | **1,932** | **8,782** |
| **IV. Assistance Benefits** | **68.8** | **512** | **2,326** |
| IV.1 RMV | 0.7 | 5 | 24 |
| IV.2 BPC/LOAS | 68.1 | 507 | 2,303 |
| **V. Workers' Assistance Fund (FAT, in original acronym)** | **40** | **298** | **1,353** |
| V.1 Salary Allowance | 19.5 | 145 | 659 |
| V.2 Unemployment Insurance | 20.5 | 153 | 693 |
| **Total Revenues (I)** | 6.3 | 47 | 213 |
| **Total Expenses (II + IV + V)** | 374.8 | 2,789 | 12,674 |
| **Total Result (III + IV + V)** | 368.5 | 2,742 | 12,461 |

*Source: PLDO and IFI. Elaboration: IFI.*

Thus, it can be observed that, as the projections for the PLDO do not consider a real appreciation of the minimum wage, any measure that creates a well-defined rule and/or system for the appreciation of the minimum wage will put pressure on expenses between R$ 2.9 billion and R$ 12.7 billion, and on revenues between R$ 47 million and R$ 213 million.

It is worth noting that this exercise is intended only to guide a discussion of the fiscal implications associated with any minimum wage increase measures that may be adopted, and therefore does not constitute a public policy recommendation. The IFI will continue to monitor these fiscal impact measures and as they are implemented and/or officially presented, we will carry out the appropriate impact analyses.

Thus, this session sought to evaluate the main points of the PLDO regarding the issues related to the new fiscal framework. As the new fiscal framework was formally presented to the House of Representatives the day before this RAF was released, although this report contemplates some relevant points regarding the new fiscal rule, the impact simulations and a more accurate evaluation of the new rule will be presented later in a publication dedicated to the subject by the IFI.

## IFI Projections

### SHORT TERM

| IFI Projections | 2023 | | | 2024 | | |
|---|---|---|---|---|---|---|
| | March | April | Comparison | March | April | Comparison |
| GDP - real growth (% p.a.) | 0.91 | 0.88 | ▼ | 1.42 | 1.42 | = |
| GDP - nominal (R$ billions) | 10,512.46 | 10,511.40 | ▼ | 11,198.88 | 11,209.94 | ▲ |
| IPCA - accumulated (% in year) | 5.59 | 5.62 | ▲ | 3.92 | 4.05 | ▲ |
| Exchange rate - end of period (R$/US$) | 5.25 | 5.25 | = | 5.32 | 5.33 | ▲ |
| Occupancy - growth (%) | 0.73 | 0.68 | ▼ | 0.79 | 0.80 | ▲ |
| Wage mass - growth (%) | 4.26 | 4.20 | ▼ | 1.42 | 1.42 | = |
| Selic - end of period (% p.a.) | 13.00 | 13.00 | = | 10.00 | 10.00 | = |
| Ex-ante real interest (% p.a.) | 5.95 | 5.88 | ▼ | 5.29 | 5.22 | ▼ |
| Consolidated Public Sector Primary Result (% of GDP) | -1.39 | -1.39 | = | -1.18 | -1.20 | ▼ |
| of which Central Government | -1.19 | -1.19 | = | -0.98 | -1.00 | ▼ |
| Net Nominal Interest (% of GDP) | 6.70 | 7.42 | ▲ | 6.08 | 6.57 | ▲ |
| Nominal Result (% of GDP) | -8.09 | -8.80 | ▼ | -7.25 | -7.77 | ▼ |
| General Government Gross Debt (% of GDP) | 78.64 | 78.07 | ▼ | 81.62 | 81.01 | ▼ |

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Federal Senate Translation and Interpretation Service – SETRIN/SGIDOC

May 03, 2023 (translator)

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