Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

JUL 19, 2023 • Nº 78

HIGHLIGHTS

- Reduction in longer-run inflation expectations after the CMN decision raised the probability of a Selic drop in August.
- Labor market data show signs of moderation, with stable employment, a shrinking labor force, and a slowdown in the income mass.
- Exceptions to primary and spending ceiling targets will be crucial to compliance with fiscal rules in 2023.
- Even with the expansion of the spending ceiling due to the Transition PEC, there is a need for blockages during budget execution in 2023.
- Meeting fiscal targets under the framework poses challenges mainly on the revenue side.
- States lost ICMS in the first four months of 2023.
- States' primary outcomes worsen in the first four months of 2023.

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The scenario improves but is still volatile

Dear reader,

The Independent Fiscal Institution (IFI) presents the Fiscal Follow-up Report (RAF, in the original acronym) in its 78th edition. It thus fulfills the mandate received from the Federal Senate, which, through Resolution No. 42 of 2016, outlined its duties concerning the rigorous and independent monitoring of public accounts.

It is worth noting that RAF 78 comes to light exactly when the fiscal agenda is at the center of the decision-making process of Brazilian institutions. It is shown by the fact that the three topics that dominated the agenda of the National Congress at the end of the legislative semester concern various aspects of fiscal policy: tax reform, new fiscal framework, and changes in the deliberative process of the Administrative Council of Tax Appeals (Carf).

So, we are living in a moment of volatility and uncertainty. Even so, this report points out that the deceleration of inflation, the moderate pace of economic growth, and the discreet behavior of the labor market provide the right environment for the monetary authority to start easing monetary policy by reducing the base interest rate. Added to this is the significant gap between the actual interest and neutral rates (Página 4).

From a fiscal point of view, RAF 78 points out that, although the primary deficit is projected to be higher than forecast in the Budget Guidelines Law (LDO) for 2023, the fiscal target should be achieved with relative ease still under the aegis of Constitutional Amendment No. 95 of 2016 (which instituted the expenditure ceiling) and subsequent amendments that expanded the ceiling, removed new items from its calculation and excluded some expenses from the limits provided. However, given the expansion or continuation of other spending, blocking of expenditure may be necessary.

For 2024, under the new fiscal framework, it is estimated that the fulfillment of fiscal targets, particularly the zero primary deficit, will depend heavily on the increase in primary revenues. On the other hand, the primary expenditure projected by the IFI seems compatible with the new fiscal rules (Página 9).

The report also points out that public debt management conditions have improved given the relative decrease in uncertainties and risk premiums, impacting the average cost of debt and its profile. This reinforces the scope for Copom to lower the Selic at its August meeting. The remaining doubt is about the magnitude of the cut in base interest rates, given that resilient inflation persists and essential decisions on the new fiscal framework and the new tax structure are still under consideration in the National Congress (Página 14).

In addition, RAF 78 brings, as a special topic, the analysis of the impacts of the economic environment on state public finances, highlighting the deterioration of primary balances from 2022 to 2023 (Página 18).

With the publication of this fiscal follow-up report, the IFI hopes to contribute to feeding and qualifying the debate on the new Brazilian fiscal environment.

Enjoy your reading!

Marcus Pestana
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

Selic to start falling in August: magnitude of drop still uncertain

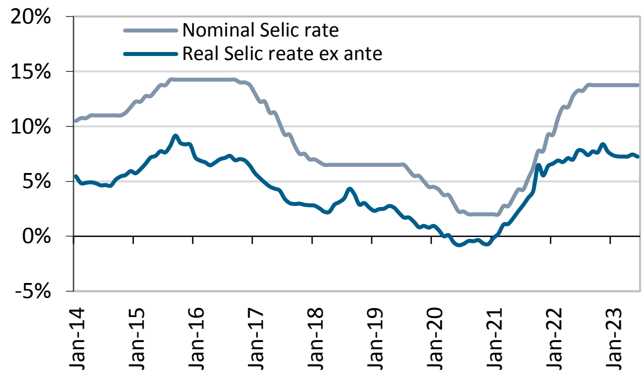
Rafael Bacciotti

The improvement in current inflation, moderating growth in economic activity, and signs of a slowdown in the labor market indicate that there is room for the economy's base interest rate to enter an easing cycle in August. The reduction in longer-run inflation expectations, following the decision by the CMN to keep the parameters of the targeting system unchanged, has increased this probability. The doubt still lies in the magnitude given the resilience of services inflation and the stability of expectations for the IPCA for 2025 and 2026, for now, at 3.5%.

The last weeks of June were marked by relevant events in the field of monetary policy. In addition to the Monetary Policy Committee (Copom) meeting, the release of the minutes of the meeting and the Quarterly Inflation Report (RTI), the National Monetary Council (CMN) set the inflation target for 2026 at 3.0%, with a range of 1.5 percentage points (p.p.) up and down, also confirming the values set for 2024 and 2025.

At the June meeting, Copom decided to maintain the base interest rate of the Brazilian economy (Selic) at 13.75% per year -– stable at this level since August last year (Chart 1). The tone of the statement accompanying the decision was more moderate than the previous one. Copom removed the section that mentioned its alternative, less likely scenario of resuming the interest rate hike cycle if the disinflation process did not proceed as expected. However, it still believes that the current environment, marked by unanchored expectations for longer maturities, requires patience in conducting monetary policy[1].

CHART 1. NOMINAL AND REAL SELIC RATES



Sources: Central Bank and Ipeadata. Elaboration: IFI.

The minutes released the week after the decision pointed out, in paragraph 19, a disagreement among committee members around the degree of signaling regarding the next steps. While one part of the Board believes that there are elements for a gradual start of Selic rate reduction at the August meeting, another, more cautious group believes that it is necessary to accumulate more evidence of disinflation in the components most sensitive to monetary policy, such as services prices and core inflation, and of a stronger re-anchoring of long term expectations.

The RTI, in turn, presented for the first time Copom's projections for 2025 inflation (3.1% in the baseline scenario), the revision of the 2023 GDP growth expectation from 1.2% to 2.0% due to a positive surprise in the 1st quarter, and the update of the assumption for the neutral real interest rate level from 4.0% to 4.8% used in its inflation projections.

TABLE 1. IPCA BREAKDOWN

	In the month		12 months	
	May/23	Jun/23	May/23	Jun/23
IPCA	**0.23%**	**-0.08%**	**3.9%**	**3.2%**
Administered prices*	**0.71%**	**0.06%**	**-0.9%**	**-1.3%**
Gasoline	-1.93%	-1.14%	-26.5%	-26.8%
Residential electricity	0.91%	1.43%	-1.3%	1.2%
Health insurance	1.20%	0.38%	17.5%	14.5%
Pharmaceuticals	0.89%	-0.32%	7.5%	6.5%
Free prices	**0.07%**	**-0.13%**	**5.7%**	**4.8%**
Food	0.00%	-1.07%	4.6%	2.9%
Services	-0.06%	0.62%	6.5%	6.2%
Industrialized	0.30%	-0.60%	5.2%	4.0%
Core average	**0.37%**	**0.20%**	**6.7%**	**6.0%**

Source: IFI.
** Administered prices are composed of 23 items. Gasoline, residential electricity, health insurance and pharmaceuticals are the most important.*

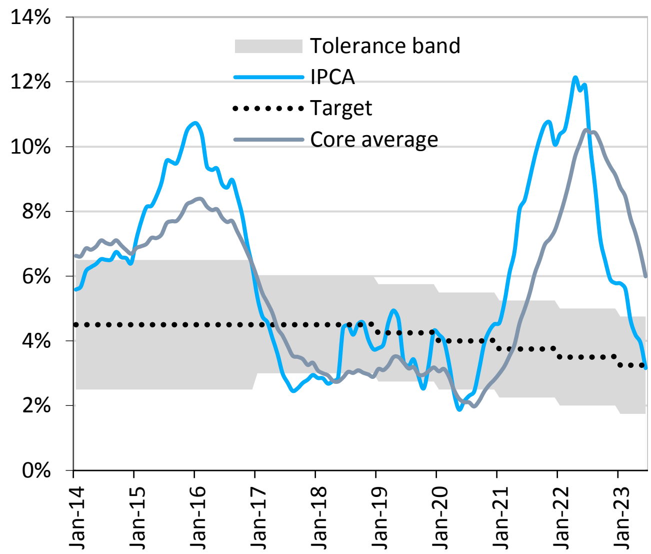
[1] Minutes of the 255th Meeting available at: https://www.bcb.gov.br/content/copom/atascopom/Copom255-not20230621255.pdf.

With data until the first quarter of 2023, the Central Bank obtains from different methodologies[2] a range for the neutral interest rate of 4.1% to 5.5% (median 4.8%). Despite the uncertainty in its estimation, since it is an unobservable variable, it is a guide for the conduct of monetary policy in an inflation targeting regime since it represents the interest rate consistent with GDP growth equal to potential growth and with the inflation rate at the target in the medium term. When the real interest rate is above the neutral interest rate, inflation and aggregate demand decrease. In the report, the Central Bank mentions some structural factors affecting neutral rates, based on international literature: the rising debt-to-GDP ratio (upward effect), increasing income inequality, demographic change and slowing productivity growth (downward effect).

Chart 1 shows the evolution of the nominal Selic rate and the real *ex-ante* interest rate, corresponding to the future interest rate (rate of pre-DI 360-day swap contracts) deflated by inflation expectations for the 12 months ahead. The *ex-ante* real interest rate has been hovering around 7.0%. In June, the real rate reached 7.2%, still above the neutral level, indicating that the monetary policy stance remains on contractionary ground for inflation and economic activity.

Copom's future steps – the timing (August or September meeting) and the magnitude of the first cut (0.25 p.p. or 0.50 p.p.) – are conditioned to inflation dynamics, especially of the components most sensitive to monetary policy, expectations for the IPCA for longer terms, and developments in economic activity and labor market data. In the following, we analyze the recent evolution of these indicators.

CHART 2. IPCA, TARGET AND CORE INFLATION



Sources: Central Bank and IBGE. Elaboration: IFI.

The June IPCA registered deflation of 0.08%, 0.31 p.p. below the May rate (0.23%), in line with the market forecast (-0.09%, according to the Focus Bulletin) and that of the IFI (-0.12%). The accumulated variation in 12 months rose to 3.2% (compared to 3.9% in May).

Despite still exceeding the upper limit of the target (Chart 2), the declining path of the cores – ongoing for some months – was maintained. Cores are measures of inflation calculated by the Central Bank by excluding items with higher volatility. For this reason, they show a better-defined price trend, with greater adherence to the economic cycle.

The average of the five measures of core inflation (or underlying inflation)[3] currently monitored by the Central Bank to support monetary policy decisions rose from 0.37% in May (6.7% over twelve months) to 0.20% in June (6.0%).

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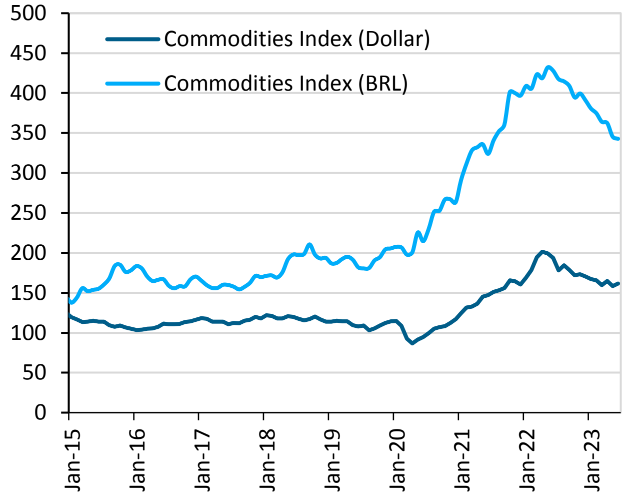
[2] "Medidas de taxa de juros real neutra no Brasil" [Real neutral interest rate measures in Brazil] in Quarterly Inflation Report June 2023, available at: https://www.bcb.gov.br/content/ri/relatorioinflacao/202306/ri202306b6p.pdf

[3] The methodological description of each core inflation measure is available in the following document: https://www.bcb.gov.br/conteudo/relatorioinflacao/EstudosEspeciais/EE102_Atualizacao_conjunto_nucleos_inflacao_comumente_considerados_pelo_BCB_para_analise_de_conjuntura_economica.pdf

The June IPCA result was largely influenced by the dynamics of food prices (-1.07% in the month and 2.9% in 12 months) and industrialized products (-0.60% and 4.0%). The effect of lower commodity prices relevant to Brazilian inflation in the international market, amplified by the appreciation of the Brazilian currency (R$) against the US dollar (Chart 3), and the federal government's program of discounts for the purchase of new vehicles, help explain the lower pressure on goods prices. Services inflation, on the other hand, rose again in June (0.62%), decelerating marginally in the accumulated variation over twelve months.

Within the set of administered (or monitored) prices, responsible for 25% of the IPCA, the behavior of gasoline (-1.14% and -26.8%), the most representative item, followed the cuts made by Petrobras in the price of the liter in the refineries. It is worth remembering that in July gasoline prices should increase due to the effect of the federal tax reoneration.

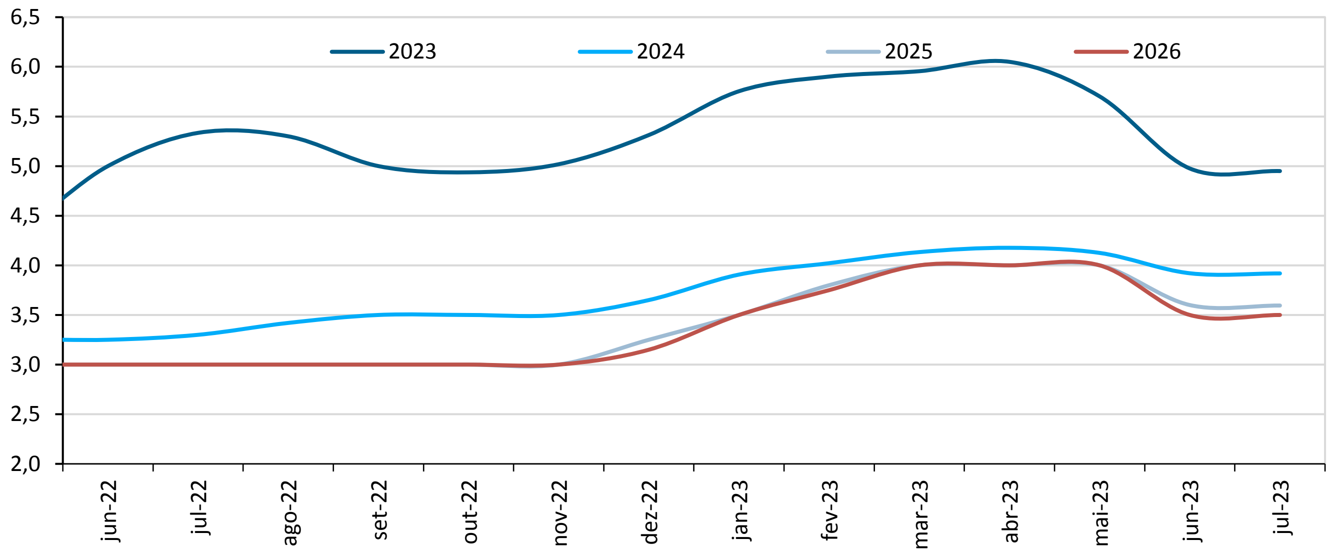
CHART 3. COMMODITY INDEX (IC-BR)



Source: Central Bank. Elaboration: IFI.

Regarding longer-term inflation expectations (less affected by conjunctural issues), it is important to note that the variations for the 2025 and 2026 IPCA obtained from the Focus Bulletin declined after the CMN's decision to maintain the inflation target at 3.0%. The (median) projection for 2025 went from 4.0% in May to 3.6% in June, while that for 2026 decreased from 4.0% to 3.5%. Data from early July point to stability at these new levels (Chart 4).

CHART 4. INFLATION PROJECTIONS: IPCA (% 12 MONTHS) – FOCUS SURVEY



Source: Central Bank. Elaboration: IFI.

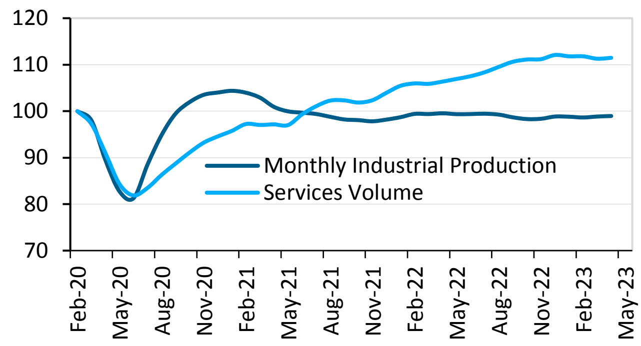
In the field of economic activity, industrial production (PIM – IBGE) advanced 0.3% between April and May in the seasonally adjusted series, partially restoring the 0.6% drop recorded in the previous month. The result was influenced by higher vehicle manufacturing with the expectation of expanding demand provided by government incentives.

The services sector also returned to the positive range. The sector's revenue volume (PMS – IBGE) grew, in real terms, by 0.9% between April and May (after seasonal adjustment), with positive influences from transportation services (2.2%) and services provided to households (1.1%). With May's result, industrial production and the volume of services left a slightly positive statistical carryover[4] for the second quarter (0.3% and 0.2%, respectively).

Chart 5 shows the industrial production and the volume of services series. Despite the slight advance last month, manufacturing and services activities are slow to recover. Industry, at a depressed level, is below the pre-pandemic level. On the other hand, services performed better, rising 11.7% from February 2020.

CHART 5. INDUSTRIAL PRODUCTION AND VOLUME OF SERVICES

INDEX NUMBER FEB/20 = 100 (QUARTERLY MOVING AVERAGE)

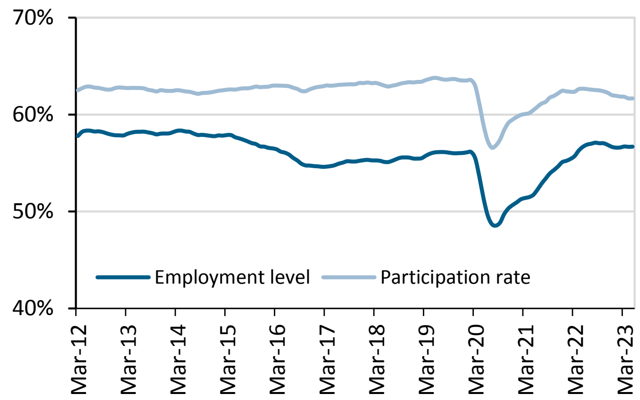


Source: IBGE. Elaboration: IFI.

Labor market data also show signs of moderation: stable employment, a shrinking labor force and a deceleration in the labor income. According to seasonally adjusted data from the Continuous National Household Sample Survey (PNAD Contínua – IBGE), the unemployment rate reached 8.3% of the labor force in May, 1.5 p.p. below the level of the same period last year. In seasonally adjusted terms, in the IFI's calculations, the rate (8.1%) is at the lowest level since April 2015. The data is positive, but in isolation it does not reveal a complete picture of the labor market.

The maintenance of the unemployment rate at historically low levels stems mainly from the exit of people from the labor force, since the proportion of people employed in the economy (ratio of the employed population to people of working age) has been practically stable in recent months (Chart 6).

CHART 6. EMPLOYMENT LEVEL AND PARTICIPATION RATE



Source: IBGE. Elaboration: IFI.

The participation rate (ratio of the number of people in the labor force – working or looking for a job – to the number of people of working age) is decreasing and moving away from the pre-pandemic level. A recent study by FGV[5] indicates that the reduction in the participation rate mainly affects the population with lower income and education.

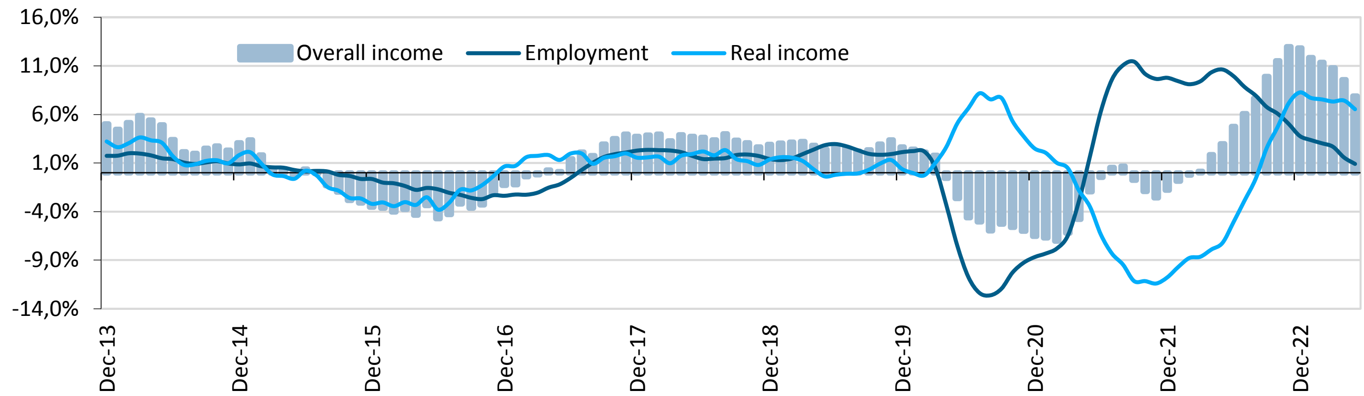
To illustrate the effect of the reduction in the labor force on the unemployment rate, the IFI calculates that the indicator would have been at 11% in May (instead of 8.3%) if the participation rate had been at the pre-pandemic level (February 2020).

Also according to data from the PNAD Contínua, the real labor income mass, resulting from the combination of average earnings and the number of people employed, is still growing significantly (Figure 7). However, the indicator is slowing down compared to the same period last year (7.9% in May compared to 9.6% in April).

[4] The carryover has been calculated assuming the maintenance of the May level, i.e. the seasonally adjusted series with zero growth in June.
[5] Published in the June/2023 IBRE Letter, available at: https://blogdoibre.fgv.br/posts/queda-da-taxa-de-participacao-se-concentra-entre-pobres-e-menos-escolarizados

CHART 7. LABOR INCOME

YEAR-ON-YEAR VARIATION



Source: IBGE. Elaboration: IFI.

Overall, the improvement in the current inflation scenario, the moderation of economic activity growth after a strong first quarter led by the increase in agricultural production, and the more evident signs of a slowdown in the labor market indicate that there is room for the Central Bank to start a cycle of reducing the economy's base interest rate. The gap between the real and neutral interest rates, showing a still very restrictive monetary policy stance towards inflation and aggregate demand, reinforces this diagnosis.

The reduction in longer-run inflation expectations, following the CMN's decision to keep the parameters of the target system unchanged, with the center of the target at 3.0% and a tolerance band of 1.5 p.p. up or down, increased this probability. The doubt still lies in the magnitude given the resilience of services inflation and the stability of expectations for the IPCA for 2025 and 2026, for now, at 3.5%.

The short-term fiscal challenges

Vilma da Conceição Pinto and Alexandre Andrade

This month's section examines the primary federal revenue and expenditure components to identify fiscal compliance risks for this year and the next. The main risks of non-compliance with fiscal targets are associated with the performance of primary revenues since the compositions of primary expenditures projected by the IFI appear to be compatible with the limits proposed in the New Fiscal Framework.

This month's fiscal scenario section aims to explore the federal government's primary revenue and expenditure components to identify the fiscal risks related to compliance with the primary balance rules and expenditure limits for this year and next.

For 2023, the target for the primary balance was set at a deficit of R$ 65.9 billion. The expenditure ceiling, supported by Constitutional Amendment No. 95 of 2016 and subsequent amendments, corresponds to R$ 1,945.3 billion, with the limit for the Executive branch being R$ 1,867.4 billion[6]. However, these targets have caveats allowing the government to achieve higher amounts than the fiscal targets.

Constitutional Amendment No. 126 of 2022 extended the expenditure ceiling by R$ 145 billion and excluded some expenses from the constitutional rule. Some of these exceptions have also been removed from the calculation of the primary outcome targets. Constitutional Amendment No. 127 of 2022 excluded from the expenditure ceiling the costs of providing complementary financial assistance to subnational entities to comply with nursing salary floors (Table 2).

TABLE 2. TARGETS FOR PRIMARY BALANCE AND EXPENDITURE CEILING FOR 2023 (R$ BILLION)

Primary balance targets	2023
Target - Primary balance LDO 2023 (A)	**- 65.9**
Target rebates (B)	**172.1**
Investments related to excess revenue: § 6º-C of Art. 107 of ADCT	22.9
Extension of the Ceiling: Sole Paragraph of Art. 3rd of EC 126 of 2022	145.0
Court ordered debt instruments outside the ceiling - meeting of accounts: art. 2, § 2, of the LDO-2023	0.3
Cultural Sector: Complementary Law No. 195 of 2022	3.9
Target for primary with rebates (C = A - B)	**- 238.0**

Limit for primary expenditure	2023
Expenditure ceiling (A)	**1,800.3**
Extension of the Ceiling: Art. 3rd of EC 126 of 2022	145.0
Extended expenditure ceiling to 2023 (B)	**1,945.3**
New exceptions (ECs 126 and 127) - (C)	**31.9**
Socio-environmental projects: Item I of § 6-A of Art. 107 of ADCT	0.0
Federal educational institutions: Item II of § 6-A of Art. 107 of ADCT	1.7
Engineering works and services: Item III of § 6-A of Art. 107 of ADCT	0.0
Investments related to excess revenue: § 6-B of Art. 107 of ADCT	22.9
Wage floor for nurses: Item VI of § 6 of Art. 107 of ADCT	7.3
Ceiling + Exceptions and extension of ceiling (D = B + C)	**1,977.2**

Sources: Law No. 14,436, of 2022, EC 126, of 2022, EC 127, of 2022 and STN. Elaboration: IFI.

Thus, even with an expected primary deficit higher than the target set in the 2023 LDO, it will be possible to meet the fiscal target with relative ease for this year. Concerning the expenditure ceiling, although the fiscal space has been

[6] Remember that the limits are individualized by branch and/or office.

expanded, other expenditures have been increased and/or extended so that the execution during the year may present periods of need to block budget appropriations, as seen in the assessment of primary revenues and expenditures for the second bimester of 2023[7].

The new fiscal framework will come into force in 2024[8]. Thus, the fiscal targets for 2024 present new outlines compared to this year but can still be summarized in targets for primary balance and expenditure ceiling. The main difference is that the primary balance targets will now have lower and upper limits, as is the case today with inflation targets. Only when the primary balance falls below the lower limit of the tolerance range can the target be considered as not met.

Concerning the expenditure ceiling, there will also be a tolerance range within which expenditure can grow – a minimum of 0.6% and a maximum of 2.5% real growth. In addition, its value will depend on the real growth of primary revenues net of transfers to subnational entities, oil revenues, dividends and concessions[9]. However, the supplementary bill on the New Fiscal Framework (PLP No. 93 of 2023) also provides some exceptions for 2024. The first relates to the index used to deflate primary expenditure and the second relates to the re-estimate of primary revenue that may be used to supplement the 2024 budget.

The IFI analyzed both measures in Technical Note No. 52 of 2023, which sought to explain the text approved by the Chamber of Deputies and which would be subject to consideration by the Federal Senate. With more current figures and with changes promoted by the Senate during the process, it is possible to estimate the expenditure limit for 2024, considering these two exceptions provided for in PLP No. 93, of 2023.

Considering official data released by the National Treasury Secretariat for the period from July to May and the anticipation of SIGA Brasil information for June data, the IFI estimates a nominal growth of 5.9% in primary revenues for the purpose of correcting the New Fiscal Framework in the 12 months accumulated until June. When adjusting for inflation accumulated in 12 months until June 2023, which was 3.2%, and applying the percentage of 70% on the real growth of 2.7%, it results that primary expenditure may grow by 1.9% in real terms, according to the rules defined in the New Fiscal Framework.

The targets for the central government's primary balance, defined in the 2024 Budget Guidelines Bill (PLDO in the original acronym), foresee a zero deficit with a tolerance interval of +/- 0.25 p.p. of GDP.

The mere comparison between the fiscal deficit forecast for 2023 (R$ 136 billion) and the proposed target for 2024 (zero) exposes the size of the fiscal challenge posed for 2024. This fiscal adjustment can occur on both the revenue and expenditure side, and a more qualitative assessment of the expected effects is needed.

Due to the nature of the adjustment proposed in the new fiscal framework[10], the performance of primary revenues will be decisive for the government to be able to meet the stipulated fiscal targets since, as already mentioned, by 2024 the government intends to zero the primary deficit of the central government.

In the past two years, total primary revenues exhibited vigorous growth, which helped the central government achieve a primary surplus of R$ 54.1 billion (0.5% of GDP) in 2022 – the first primary surplus for the central government since the 2014-2016 crisis. As discussed in previous editions of this report, the behavior of commodity prices has favored economic activity and tax collection directly and indirectly, not only in Brazil but also in other countries exporting these products.

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[7] The primary revenue and expenditure assessment report for the second bimester of 2023 indicated the need for a block in the budget appropriations of the Executive branch in the amount of R$ 1.7 billion.

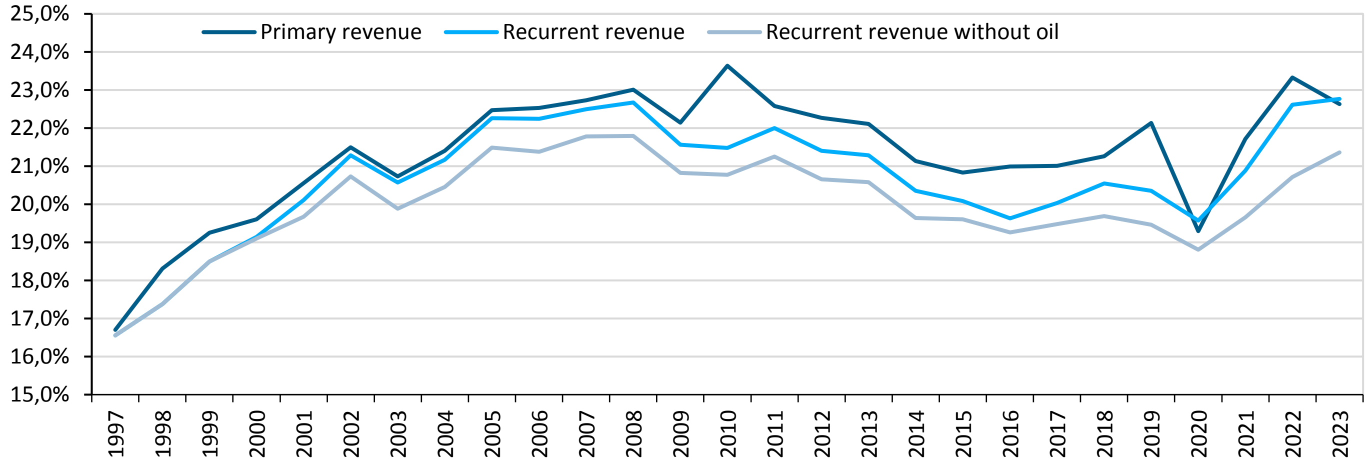
[8] The new fiscal framework was presented by the executive branch, modified and approved by the Chamber of Deputies and the Federal Senate. Although it was approved by both houses, the amendments presented by the Federal Senate still need to be considered by the Chamber of Deputies, in the form of PLP 93, of 2023. Only after the Chamber has considered the amendments approved by the Senate will it be possible to definitively estimate the New Fiscal Framework.

[9] In addition to the revenues listed, revenues from unclaimed PIS/Pasep funds, as well as special installment payments that will be implemented after the publication of the Complementary Law of the New Fiscal Framework, will also be deducted from primary revenue.

[10] A discussion of the fiscal framework, the regime that will replace the expenditure ceiling and which still needs to be approved by the Chamber of Deputies, can be found in IFI Technical Note No. 52, June 2023. Link to access the document: https://www12.senado.leg.br/ifi/notas-tecnicas-ifi.

As an illustration, the total primary revenue of the central government amounted to R$ 2,313.3 billion in 2022, or 23.3% of GDP. Recurrent revenue calculated by IFI[11], which excludes, for example, collections associated with special installment payments (Refis), atypical revenues reported by the Federal Revenue Office in the monthly collection bulletins, among others, totaled R$ 2,242.4 billion (22.6% of GDP). The difference was, therefore, R$ 70.9 billion or 0.7 p.p. of GDP.

CHART 8. ANNUAL EVOLUTION OF TOTAL AND RECURRENT PRIMARY REVENUE (% OF GDP)



Sources: National Treasury Secretariat and IFI. Elaboration: IFI.

An additional exercise consisted of disregarding the revenue from the exploitation of natural resources and the dividends collected by Petrobras in 2022, which amounted to R$ 188.9 billion. The revenue from the exploitation of natural resources considers, in addition to oil, activities related to mining, for example. When subtracting the R$ 188.9 billion from the recurrent primary revenue calculated by the IFI, the sum of R$ 2,053.5 billion (20.7% of GDP) is reached for 2022. That is, disregarding the revenue from the exploitation of natural resources and dividends from Petrobras, recurrent revenue in 2022 would have decreased from 22.6% of GDP to 20.7% of GDP, a difference of 1.9 p.p. of GDP.

Chart 8 shows the annual evolution of central government primary revenue, as well as recurrent revenue and recurrent revenue without natural resource exploitation collections and Petrobras dividends from 1997 to 2023 (year-to-date until May). The analysis of the figure gives an idea of the direct effect that commodities had on the Federal Government's tax collection in the last two years. Indirect effects are more difficult to measure[12].

In the first five months of 2023, recurrent revenue has stabilized at a relatively high level (22.8% of GDP compared to 22.6% of GDP in 2022), indicating a cooling of economic activity. The reduction in collections from the exploitation of natural resources and dividends from Petrobras this year compared to 2022 caused total primary revenue as a proportion of GDP to fall in 2023 compared to 2022.

Without further positive commodity price shocks, the challenges imposed on the government to increase primary revenue as a share of GDP to ensure compliance with the fiscal targets set in the Budget Guidelines Bill (PLDO) for 2024 become clear.

On the primary expenditure side, as already mentioned, the greatest concern is in relation to 2024, since, for the current year, there are constitutional caveats that allow some flexibility in budget execution.

[11] For further explanation of the indicator, see IFI Special Study No. 17, December 2021. Link to access the document: https://www12.senado.leg.br/ifi/publicacoes-estudos-especiais.

[12] For example, tax revenues, such as IRPJ/CSLL and PIS/Cofins, from companies operating in the sector. The National Treasury Secretariat (STN) has released a fiscal projections report which presents an analysis of these revenues. Available at: https://www.tesourotransparente.gov.br/publicacoes/relatorio-de-projecoes-fiscais/2023/20.

With the outlines of the new fiscal framework more clearly defined, it is possible to estimate the risk of non-compliance with the fiscal rule for next year, given the composition of the federal government's primary expenditure.

To calculate the risk of non-compliance with the expenditure ceiling, it will be necessary to estimate the amount of the ceiling for the next fiscal year in light of the new fiscal framework. This step is important because, as the expenditure limit will depend on revenue performance and compliance with the primary balance target, in addition to oscillating between 0.6% and 2.5%, its maximum and/or minimum value will depend on these variables.

Following the version of the Complementary Bill (PLP) No. 93 of 2023, approved by the Chamber of Deputies and adding the amendments made by the Federal Senate, it is possible to estimate the volume of expenses subject to the primary expenditure ceiling.

It is important to mention the amendment approved in the Federal Senate[13] , which removes expenses related to Science, Technology and Innovation from the expenditure ceiling. However, it is unclear which expenditure classification will be used for this item. Thus, depending on the interpretation of amendment No. 5 (which corresponds to amendment No. 39 of the Senate Committee on Economic Affairs – CAE), the amounts to be deducted from the expenses subject to the expenditure ceiling may vary. To better understand this point, Table 3 shows the primary expenditure on Science, Technology and Innovation, considering the expenditure of the Science and Technology function of the Ministry of Science, Technology and Innovation strictly. There is a split of this expenditure between costing and investment.

TABLE 3. PRIMARY EXPENDITURE ON SCIENCE, TECHNOLOGY AND INNOVATION - UPDATED ALLOCATION 2023 (R$ MILLION)

Item	Ministry	Function	Diff. between Classifications
Primary expenditure (except ICTs funded from own revenues)	**10,752**	**9,281**	**1,471**
Payroll and social security charges	2,678	1,146	1,532
Investments and financial investments	1,524	1,578	-54
Other current expenditure	6,549	6,556	-7

Source: STN. Elaboration: IFI.

For this calculation, we used the classification by budget function.

In addition to this change, the amendments approved in the Senate aimed to improve the text approved by the Chamber of Deputies and to promote adjustments in some expenditure items. The main changes in the text approved by the Federal Senate concerning the version of PLP No. 93 of 2023, approved by the Chamber, are described below:

- Constitutional Fund of the Federal District (FCDF): The text approved by the Chamber of Deputies included FCDF expenditures in the list of expenses subject to the expenditure ceiling and changed the correction factor for FCDF expenditures to follow the same system as the ceiling. The text approved by the Federal Senate left the FCDF outside the expenditure ceiling and kept the correction in the original form, that is, without change in relation to what it is currently.
- Federal Supplementation to Fundeb: The text approved by the Chamber included expenses with the Federal Government's supplementation to Fundeb in the list of expenses subject to the expenditure ceiling and added to the ceiling the amount of the increase in the rates of transfers to Fundeb until 2026. The text approved by the Federal Senate left the federal government's supplementation to Fundeb outside the expenditure ceiling and removed the provision that established the increase in the expenditure ceiling in an amount equivalent to the increase in the Fundeb rate.
- Science, Technology and Innovation: The text approved by the Chamber of Deputies removed from the spending ceiling only expenses with federal educational institutions and with Scientific, Technological and Innovation Institutions (ICTs) funded with their own revenues or from donations, agreements, contracts, or other sources, entered into with the other entities of the Federation or private entities. The text approved by the Federal Senate

[13] Available at: https://legis.senado.leg.br/sdleg-getter/documento?dm=9395903&ts=1689257154576&disposition=inline&_gl=1*2rlq8e*_ga*MzQ3ODg3MTI2LjE2ODg0MzM4MDk.*_ga_CW3ZH25XMK*MTY4OTcwMDIzOS4xNy4wLjE2ODk3MDAyMzkuMC4wLjA.

removes all spending on Science, Technology and Innovation. It is unclear from the wording whether this exclusion is about the Ministry or the item.

- Inflation index for ceiling calculation: The text approved by the Chamber provided for the possibility of opening a supplementary credit if inflation accumulated in 12 months until December was higher than inflation accumulated in 12 months until June. The text approved by the Federal Senate allows the annual budget bill to contemplate the estimation of these expenses conditional on the realization of higher inflation.
- Creation of the Fiscal Modernization Committee: Amendment No. 15 (corresponding to CAE amendment No. 82) proposed the creation of a fiscal modernization committee to improve the governance of federal finances and make the planning, execution, and control stages of the budget cycle more transparent and efficient. The creation of this committee was not in the text of the Chamber of Deputies.

Thus, primary expenditure subject to the new expenditure ceiling is now estimated at 18.1% of GDP for 2024, embedding a real growth rate of 1.9% (corresponding to 70% of the real growth of primary revenue) plus a 2 p.p. inflation differential (difference between inflation in 12 months accumulated until June and that accumulated in 12 months until December 2023) for the Executive branch.

It is possible to increase the expenditure foreseen for 2024 if there is a positive surprise in the collection, as advocated by Art. 15 of PLP No. 93 of 2023. The provision states that if an increase in revenue is identified by the second bimonthly assessment of 2024, the difference may be used to increase primary expenditure for the year up to the real growth limit of 2.5%. However, if the positive surprise is not confirmed at the end of the year, the difference should be made up in 2025. According to IFI estimates, this figure could reach around R$ 19 billion.

When comparing this volume of expenses subject to the expenditure ceiling with the primary expenses estimated by the IFI for 2024, the difference between what was projected for discretionary expenses and what is possible to be realized due to the restriction of the new fiscal framework is evident. If the spending limit suffers a real correction of 1.9%, assuming inflation of 3.2% (realized in 12 months until June 2023), discretionary spending should be about R$ 20 billion below the projection for 2024. If the 2 p.p. gap is used as a supplementary credit, it will be possible to more than offset this effect on discretionary expenditure. However, it is also important to note the need to meet primary balance targets.

If, on the revenue side, the challenge is to structurally expand the volume of resources collected, on the expenditure side, the difficulty will be making the new limits compatible with the vegetative growth of primary expenditure and the increases in spending that have been announced so far. The short-term fiscal challenge is large and depends to some extent on additional measures to be effectively met.

Lower uncertainty favors public debt management

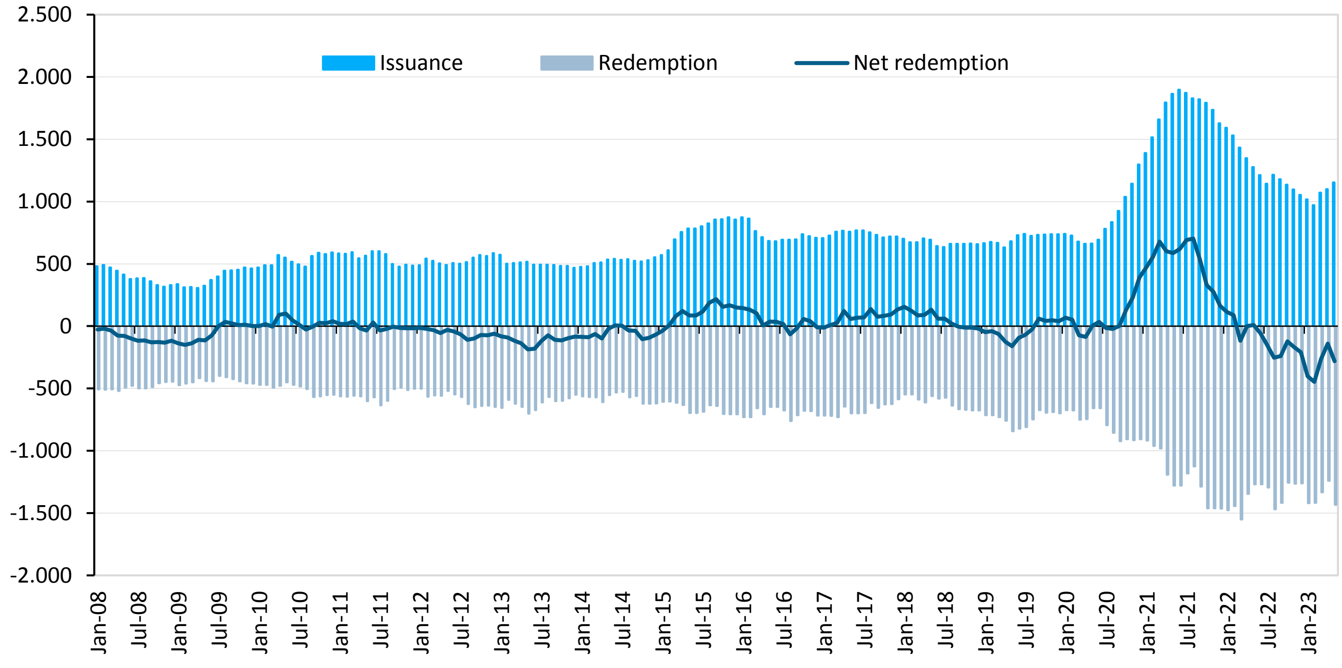
Alexandre Andrade

The Treasury's figures highlight better conditions for public debt management in an environment where uncertainties are dissipating, and risk premiums are falling. The behavior of the average cost of debt in the last three months reflects a more favorable scenario regarding interest and inflation.

The latest data from the National Treasury Secretariat (STN) suggest an increase in net issuance of government bonds from March onwards, while the average cost of the public debt stock started to fall in the period. Everything suggests that the Treasury has taken advantage of a more favorable environment, with reduced uncertainties and risk premiums, to increase issuance and place fixed-rate and price-indexed securities, thus reducing debt exposure to floating-rate securities.

According to the STN, redemptions of Federal Public Debt (DPF) securities exceeded issuances by R$ 75.0 billion in May. It was due to the redemption of Federal Domestic Public Debt (DPMFi in the original acronym) securities in the amount of R$ 214.5 billion, concentrated in inflation-linked securities (NTN-B).

CHART 9. DPMFI ISSUES, REDEMPTIONS AND NET ISSUANCE (R$ BILLION) ACCUMULATED IN 12 MONTHS



Source: National Treasury Secretariat. Elaboration: IFI

In the year to May, DPF bond issuance totaled R$ 582.2 billion, while redemptions totaled R$ 783.0 billion, resulting in negative net issuance of R$ 200.9 billion in the period. In the first five months of 2022, the net issuance of securities by the Treasury was negative at R$ 128.2 billion. As discussed in RAF No 74[14], March 2023, since the beginning of last year, the volume of issuances is lower than that of redemptions. In the second half of 2022, this movement became more pronounced but has been reversed since March.

Disregarding issues and redemptions of the External Federal Public Debt (DPFe), Chart 9, also presented in RAF No. 74, contains the 12-month cumulative sums of DPMFi issues, redemptions, and net issues. The chart indicates that net

[14] Link to access the document: https://www2.senado.leg.br/bdsf/bitstream/handle/id/607069/RAF74_MAR2023.pdf.

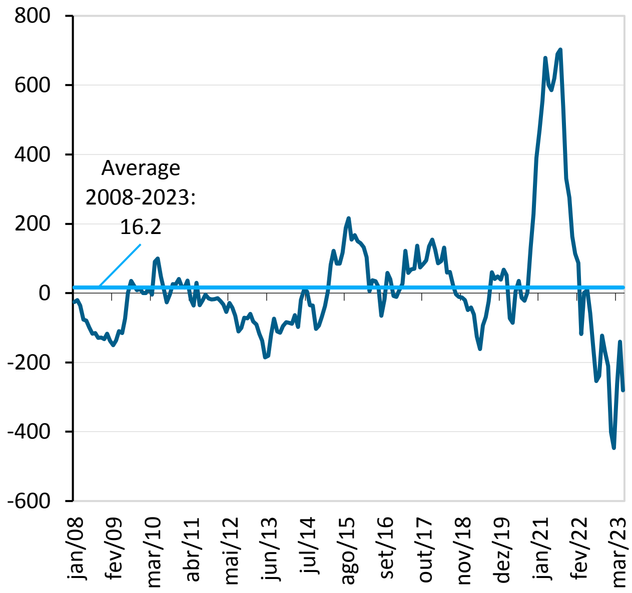
emissions have historically hovered around zero. The exception was during the Covid-19 pandemic: in 2020 and 2021, the government needed to use bond issuances to finance the extraordinary primary expenditure to mitigate the economic and social effects of the health crisis. For this reason, the dark blue curve in Chart 9 moves away from zero, returning to lower levels from 2022 onwards.

In 2022, the government was able to reduce emissions due to a drop in primary spending related to fighting the pandemic. In addition, two of the main indexes for government bonds, the Selic rate and inflation, rose over the past year, worsening the conditions for issuing debt securities, which may have caused the Treasury to reduce the volume of issuances and use other public debt management instruments, such as the liquidity reserve.

Since March 2023, the Treasury has increased bond issuance. Net issuance of DPMFi, in the 12-month comparison, went from a negative volume of R$ 447.0 billion in February to a still negative amount of R$ 262.5 billion in March, R$ 140.4 billion in April, and R$ 280.5 billion in May. This reduction in May, as already explained, was due to the maturity of a large sum of inflation-linked securities in the period. In any case, it seems that the Treasury has taken advantage of a more favorable environment, with reduced uncertainties, cooling inflation, and falling long-term interest rates, to increase the placement of securities.

Chart 10 presents a historical series of net DPMFi issuance accumulated over 12 months, as well as the average volume for the period from January 2008 to May 2013. The chart clearly shows the large increase in issuance that the Treasury had to make between 2020 and 2021, as shown in Chart 9. Noteworthy, however, is the substantial reduction in net issuance as of the second half of 2022, which fell well below the historical average of R$ 16.2 billion.

CHART 10. NET ISSUANCE OF DPMFI (R$ BILLION) ACCUMULATED IN 12 MONTHS



Source: National Treasury Secretariat. Elaboration: IFI

The reduction in the volume of issuance by the Treasury in the second half of 2022 could be achieved due to the good performance of other sources of funds that make up the liquidity reserve[15], an important instrument for public debt management. Chart 11 shows the evolution of the public debt liquidity ratio, which shows the sufficiency of resources in the liquidity reserve to cover the maturities of DPMFi securities. The indicator is measured in months.

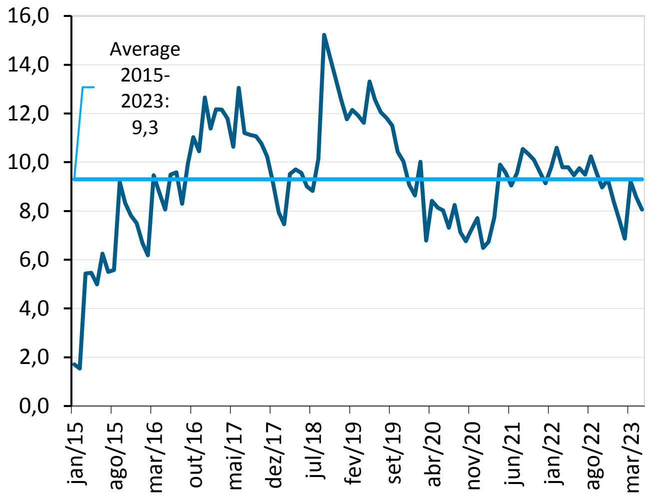
In May, the last month with available information, the liquidity ratio was 8.1, indicating that there were sufficient resources in the liquidity reserve to pay eight months of DPMFi maturities. The index had fallen to 6.9 months in February. On average from 2015 to 2023 until May, the average liquidity ratio was 9.3 months.

[15] According to the Treasury, the liquidity reserve of the public debt, also called the cushion, contains the funds available exclusively for the payment of the debt and the cash balance of the funds from the issuance of securities.

Net issuance affects the liquidity reserve as it integrates the Treasury's cash holdings for debt repayment. In addition to issuance, other variables affect the liquidity reserves, such as the need to cover the primary deficit. In 2022, the central government had a primary surplus of R$ 54.1 billion. Primary surpluses are essential in Brazilian circumstances to help the Treasury manage public debt.

Some budget revenues exclusively for the payment of public debt also affect the liquidity reserve, such as the collection of dividends from state-owned companies, the operating result of the Central Bank, the return on credit operations, and the untying of resources from public funds. Throughout 2022, these sources were positive and allowed the Treasury to reduce the issuance volume in an environment of greater uncertainty, with relatively high Selic and inflation.

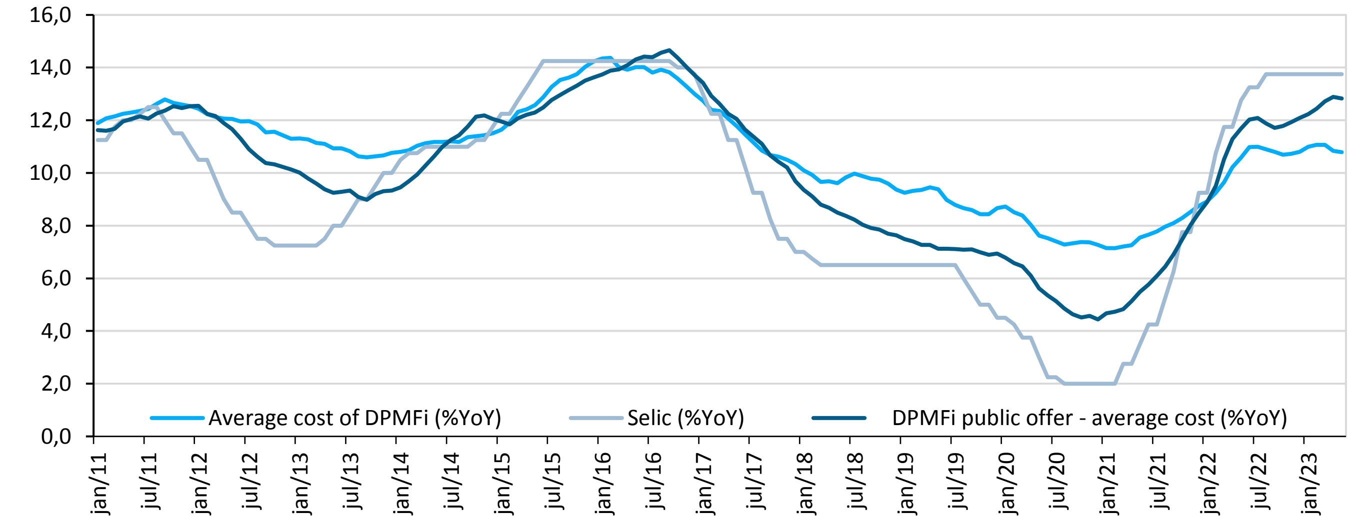
CHART 11. LIQUIDITY RATIO OF GOVERNMENT DEBT (NO. OF MONTHS)



Source: National Treasury Secretariat. Elaboration: IFI

A scenario of higher issuance volume has been favored by the cooling of the average cost of debt. Also according to information from the STN, the average cost of the DPMFi stock fell for the second consecutive month in May in the monthly comparison. In the month, the average cost was 10.79% p.a., compared to 10.84% p.a. in April and 11.06% p.a. in March. At the same time, the average cost of DPMFi public offerings fell from 12.89% p.a. in April to 12.83% p.a. in May (Chart 12).

CHART 12. AVERAGE COST OF PUBLIC DEBT (STOCK AND PUBLIC OFFERS), ACCUMULATED IN THE LAST 12 MONTHS (% PER YEAR) AND SELIC RATE - TARGET (% PER YEAR)



Source: National Treasury Secretariat. Elaboration: IFI.

This relief in the average cost of debt is related to the cooling of inflation and the reduction in future interest rates from March, which reflects an environment of less uncertainty and lower risk premiums.

Information gathered by IFI on the auctions held by the Treasury[16] shows that there was continuity in the falls in DPMFi bond rates in June. For example, the fixed-rate bond maturing on July 1 2026 had an average issuance rate of 11.01% p.a. in June, against 11.54% p.a. in May. Price-index-linked and floating-rate securities also saw reductions in issuance rates in June. Information on securities and their maturities is communicated quarterly by the Treasury and may change over time.

To conclude, data on the average cost and issuance of bonds show a more favorable environment, with lower uncertainty and reduced risk premiums. The uncertainties present at the beginning of the year are being dispelled as economic agendas have advanced in Congress, such as the approval of the fiscal framework and the perspective of voting on the reform of the taxation on consumption.

Falling inflation and lower long rates have already led to some reduction in the cost, which is expected to fall further when the central bank begins its expected monetary easing cycle. At the same time, taking advantage of the improved domestic environment, the Treasury is expected to increase issuance in the coming months. More favorable conditions are expected for the placement of fixed-rate and price-indexed securities, reducing exposure to floating-rate securities (Selic yield).

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

The state accounts: fiscal risks for district and state governments

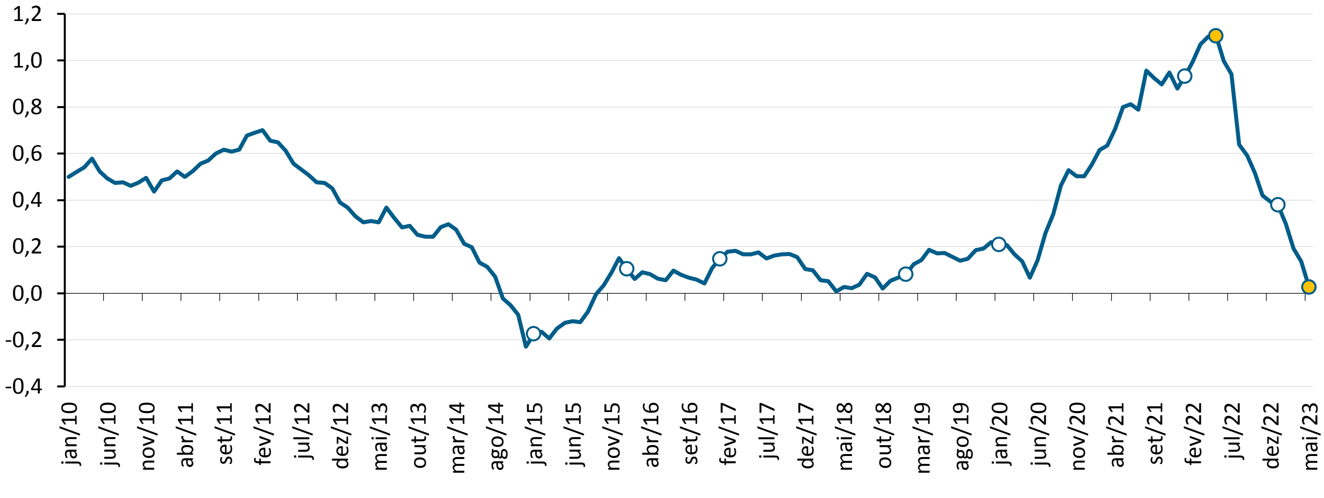
Pedro Souza

Public finance data for state governments and the Federal District showed a worsening of fiscal health in the first four months of 2023. Among the main factors that explain this performance are the salary readjustment of public employees and the losses resulting from the edition of Complementary Law No. 194 of 2022, which reduced the ICMS rates on fuels, electricity, and telecommunications, important sources of tax collection.

High-impact fiscal and economic events have affected the finances of federal states in recent years. Transfers from the Federal Government for financial support due to the effects of the Covid-19 pandemic and the positive shock on commodity prices after the most extreme phase of the pandemic had an important effect on the revenues of these entities, mainly through ICMS collections. At the same time, the provisions of Complementary Law (LC) No. 173 of 2020, which prohibited increases in the salaries of public employees, ensured that personnel expenses were relatively controlled, allowing states to achieve primary surpluses until June 2022.

Chart 13 shows the trajectory of the below-the-line primary balance, calculated by the Central Bank, of state governments. The economic crisis of 2014-2016 also affected the finances of subnational entities, which recorded a primary deficit of around 0.2% of GDP, which reverted to a surplus in 2016. The pandemic did not affect much the trajectory of the primary balance of the states due to the financial rescue measures carried out by the Federal Government in 2020. In particular, LC No. 173 was sanctioned, which temporarily suspended the payment of the debts of the States and the Federal District with the Federal Government, made available the payment of financial aid by the Federal Government to subnational entities, and prohibited the possibility for subnational entities to create permanent expenses in the years 2020 and 2021.

CHART 13. STATE GOVERNMENTS' PRIMARY BALANCE BELOW THE LINE (% OF GDP)



Source: Central Bank of Brazil. Elaboration: IFI.

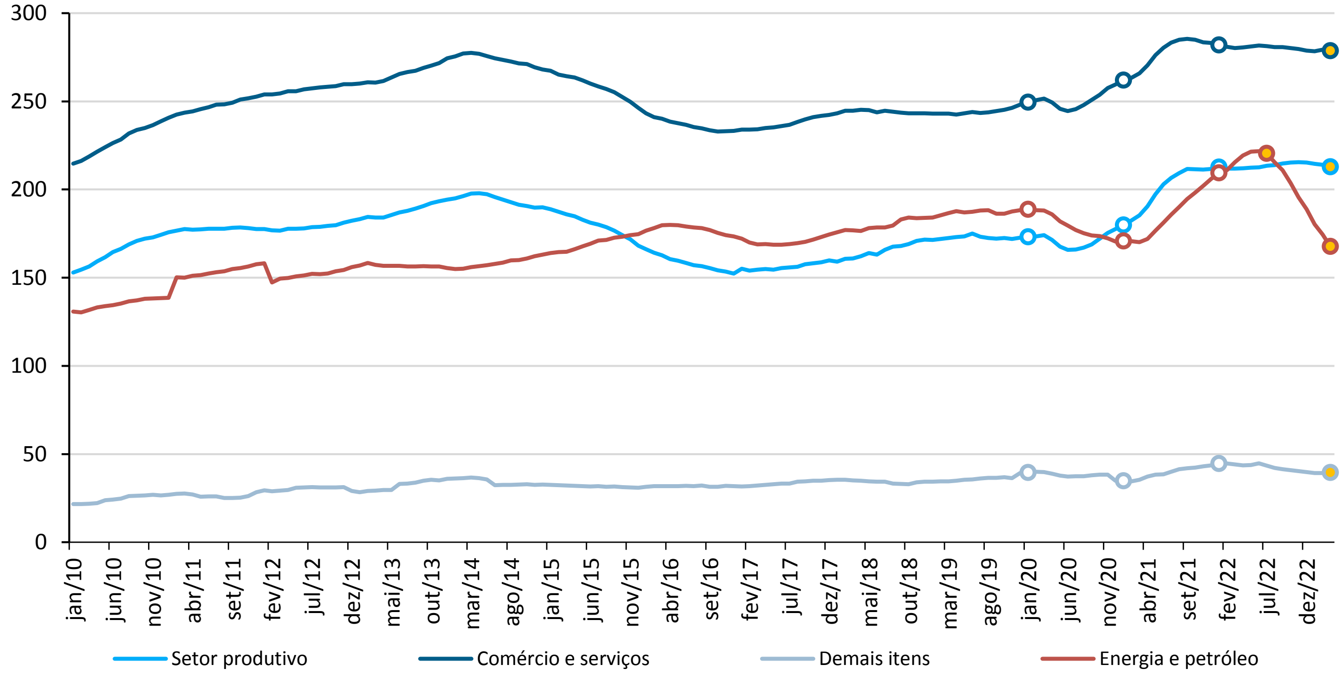
The provisions of LC No. 173 and the positive shock in commodity prices helped states to realize primary surpluses from 2020 until the second quarter of 2022, when the result reached 1.1% of GDP in the 12 months ended in May of that year, according to information from the Central Bank. From July onwards, there was a reversal in the trajectory of the states' primary balance. In December, the surplus had fallen to 0.4% of GDP, and in May 2023, the last month with available information, the primary surplus of the states, by the below-the-line concept, fell to 0.03% of GDP.

The "below-the-line" analysis of the primary balance has the limitation of not allowing the impact of revenue and expenditure flows on the result to be observed, which could be obtained with the "above-the-line" analysis, i.e., the primary balance given by the difference between primary revenue and expenditure. The two ways of obtaining the primary balance may result in different values due to possible statistical discrepancies arising from the way revenues and expenditures are calculated, as well as the scope of the information compilation, which, in the case of the "above-the-line" result, captures only the effects of budget revenues and expenditures, while the "below-the-line" methodology, which measures the result by the change in net debts of entities, discounting the appropriation of nominal interest, also captures the effect of extra-budgetary revenues and expenditures[17]. Thus, in order to observe the effects of fiscal measures on the primary balance, it is important to analyze the revenue and expenditure side.

On the primary revenue side, looking at ICMS revenues, which is the most relevant tax for states, it is important to observe the effect of different goods or sectors on tax collection. Chart 14 shows the evolution of ICMS collections on fuels and electricity. From 2021, after the most severe phase of the pandemic, this collection started to grow, reaching R$ 220.4 billion in the 12 months ending in July 2022. That month, Complementary Laws No. 192 and No. 194 were sanctioned, which changed how ICMS is calculated and classified electricity, fuel, telecommunications, and public transportation services as essential items. Thus, the essential nature of these goods and services implied a limit for the definition of the rates levied on these tax bases, in the amounts of 17% to 18%.

The change in legislation has, therefore, affected state ICMS revenues, decreasing this collection from the second half of 2022 onwards. Until the sanction of these complementary laws, the collection of ICMS on fuels and electricity accounted for 29% of the total tax collection in the country, according to information from the National Council of Finance Policy (Confaz).

CHART 14. ICMS COLLECTION IN 12 MONTHS BY SELECTED SECTORS (R$ BILLION JUNE/2023)



Source: Confaz. Elaboration: IFI.

The productive sectors[18], as well as trade and services[19], also go through the same process of falling revenue during the pandemic, which is reversed from the beginning of 2021. At this time, with the resumption of economic activity, ICMS collection in these sectors begins an upward trajectory until the end of 2021. In 2022, these sectors showed relative stability, with no major variations in collection.

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[17] A comparison of the methodologies can be seen in the Subnational Entity Finance Bulletin 2022, on pages 12 and 13. Available at: https://sisweb.tesouro.gov.br/apex/f?p=2501:9::::9:P9_ID_PUBLICACAO:45586.

[18] The productive sector refers to the sum of the collection of the primary and secondary sectors, except goods and services related to fuels and electricity.

[19] The trade and services sector refers to the tertiary sector, except those related to fuels and electricity.

The remaining items, including active debt and other sources not covered by the other classifications, are not very representative. In January 2020, before the pandemic, revenue from these items totaled R$ 39.5 billion. The movements of falling economic activity and subsequent recovery are also observed under this heading. In January 2022, the tax collection reached R$ 44.5 billion, partially reversed during the year.

Table 4 presents revenue and expenditure figures of states and the Federal District for the first four months of 2022 and 2023. It is clear the impact of complementary laws 192 and 194 on the collection of entities in the period. Primary revenues of state governments and the Federal District fell by 2% in real terms in the first four months of 2023 compared to the same period in 2022. The result reflects a combination of factors, such as the negative change in tax revenue and the positive change in contribution revenue.

In 2023, net revenue from ICMS totaled R$ 120.4 billion in the first four months, a real drop of 19.5% compared to 2022. Collections of other taxes, such as IPVA, ITCD, and IRRF, among others, registered a real increase of 12.3% in 2023 compared to the previous year.

TABLE 4. ABOVE-THE-LINE PRIMARY BALANCE FOR STATES AND THE FEDERAL DISTRICT IN THE FIRST FOUR-MONTH PERIOD (R$ MILLION AS OF JUNE/2023)

Breakdown	2022	2023	Real % change
1 - Total primary revenue	**364,803.17**	**357,499,23**	**-2.0%**
1.1 - Taxes, fees and improvement contributions	211,983.78	190,523.96	-10.1%
1.1.1 - ICMS	149,595.83	120,410.82	-19.5%
1.1.2 - IPVA	27,107.37	31,199.52	15.1%
1.1.3 - ITCD	3,257.64	3,372.65	3.5%
1.1.4 - IRRF	17,819.77	20,476.60	14.9%
1.1.5 - Other tax revenue	14,203.16	15,064.36	6.1%
1.2 - Contributions	21,940.63	35,573.00	62.1%
1.3 - Primary revenue from assets	12,486.66	10,583.07	-15.2%
1.4 - Current transfers	104,327.01	103,269.41	-1.0%
1.4.1 - Share of FPE and FPM	45,373.35	46,879.41	3.3%
1.4.2 - Fundeb transfers	34,657.43	34,525.57	-0.4%
1.4.3 - Other transfers	24,296.23	21,864.43	-10.0%
1.5 - Other current revenue	14,065.10	15,015.24	6.8%
1.6 - Primary capital revenue	0.00	2,534.55	-
2 - Primary expenditure	**290,305.65**	**318,053.02**	**9.6%**
2.1 - Payroll and social charges	162,708.46	197,275.80	21.2%
2.2 - Other current expenditure	98,862.20	94,777.04	-4.1%
2.3 - Investments	25,808.85	23,073.08	-10.6%
2.4 - Financial investments	2,926.14	2,927.11	0.0%
3. Primary balance	**74,497.52**	**39,446.21**	**-47.1%**

Sources: Annex 6 of the RREO and National Treasury Secretariat. Elaboration: IFI.
*** In order to make the data compatible among all states, the account "Constitutional and legal transfers" was deducted from ICMS, and the item "Other current expenses" since there are states that do not present the ICMS account net of transfers to municipalities. In addition, transfers from Fundeb, from STN[20], were charged to current revenue and expenditure in cases where the RREO did not report the amount.*

[20] Available at: https://www.tesourotransparente.gov.br/publicacoes/transferencias-ao-fundo-de-manutencao-e-desenvolvimento-da-educacao-basica-fundeb/.

Revenues from contributions totaled R$ 35.6 billion in 2023 until April, a real increase of 62.1%, resulting from the movements of salary increases that occurred in 2023, which affected the contributions related to the RPPS. Transfers received from the Federal Government totaled R$ 103.3 billion, a real decrease of 1.0%, which, among other aspects, comes from gains from the Income Tax and IPI in 2023 and the negative variation of Fundeb, which has a smaller calculation base due to the loss of ICMS, despite a relative increase in the Federal Government's complementation to the fund[21].

States' primary expenditure, meanwhile, grew by 9.6% in real terms in the first four months of 2023. Also according to Table 4, this increase was driven by payroll expenses, which jumped 21.2% in the period, to R$ 197.3 billion. Between last year and this year, state governments have practiced adjustments to the public employees, a measure that affects both active and inactive ones.

Other current expenditure totaled R$ 94.8 billion in the first quarter, a 4.1% decrease compared to 2022. Investment spending, on the other hand, fell by 10.6% to R$ 23.1 billion until April. It should be noted that the amount of investments in 2022, of R$ 25.8 billion, was an increase of 149.4% compared to 2021. Expenditure on financial investments, in turn, totaled R$ 2.9 billion, remaining stable compared to the first four months of 2022.

As mentioned earlier in this analysis, until December 2021, governments were prohibited from granting salary increases to their employees and from creating other expenses of a continuing nature (limitations imposed by Complementary Law No. 173 of 2020). This, coupled with the increase in fuel prices (which boosted ICMS collection), opened space in state budgets for investments in 2022, noting also the fact that it is an election year, in which spending tends to increase.

Thus, the primary balance above the line, in the accumulated of 2023 until April, totaled R$ 39.5 billion, a real decrease of 47.1% against the same period of 2022, influenced mainly by salary readjustments and the reduction of ICMS revenue in 2023.

According to Table 5, there was a relative improvement in primary revenues in 19 of the 27 federal units. These changes stemmed from two movements: on the revenue side, there were gains from contributions and losses from changes in ICMS legislation, the net result of which was a reduction in revenue in all states and the Federal District, while on the expenditure side, there were salary increases granted to public employees. But despite the number of states with revenue gains, the volume of lost revenue was higher, given that some states with revenue losses, such as Sao Paulo, have greater weight in the calculation.

Still in relation to expenditure, not all states had an increase in 2023 compared to 2022. In Alagoas, for example, there was a reduction due to the payment of leftovers in 2022, with no counterpart in 2023. Maranhão showed a reduction due to a drop in investments and other current expenditure in the first four months of 2023. São Paulo, despite the increase in investments and payroll expenses, had a 30.8% reduction in other current expenses. The increase in expenditure in the other states is mainly due to salary adjustments granted by regional governments.

With the combination of factors, almost all states showed a worsening in the primary balance for the first four months of 2023, except for Alagoas, Roraima, Rondônia, Maranhão and Pernambuco, which showed surpluses higher than those observed in 2022.

[21] Constitutional Amendment No. 108 of 2020 determines that the Federal Government's final supplementation to Fundeb will be 23% of the value of the contribution of the States and Municipalities, progressively increasing the percentage, from 12% in 2021, to 23% in 2026..

TABLE 5. PRIMARY BALANCE ABOVE THE LINE IN THE FIRST FOUR-MONTH PERIOD BY STATE (R$ BILLION MAY/2023)

State	2022			2023			Real change %		
	Revenue	Expenditure	Primary	Revenue	Expenditure	Primary	Revenue	Expenditure	Primary
AC	2.8	2.0	0.9	2.9	2.4	0.5	2.2%	22.7%	-45.5%
AL	4.6	4.7	-0.1	5.1	4.5	0.6	11.1%	-5.3%	-531.4%
AM	7.4	6.1	1.3	7.6	7.6	0.0	3.7%	25.6%	-98.7%
AP	2.6	1.4	1.2	2.6	1.8	0.8	-1.6%	27.8%	-35.4%
BA	18.2	14.8	3.4	18.5	17.7	0.8	1.6%	19.6%	-76.1%
CE	10.1	7.9	2.2	10.5	8.9	1.6	3.8%	12.6%	-27.8%
DF	10.1	9.1	1.0	10.4	9.8	0.6	3.5%	7.9%	-37.1%
ES	7.4	6.4	1.0	7.1	7.0	0.1	-3.4%	10.2%	-90.5%
GO	12.3	11.1	1.2	12.7	12.0	0.7	2.9%	8.0%	-43.3%
MA	7.8	6.9	0.9	7.9	6.5	1.3	1.0%	-5.1%	47.8%
MG	32.9	26.9	6.0	33.2	32.1	1.1	0.9%	19.4%	-82.0%
MS	6.4	5.5	0.9	7.3	6.5	0.8	14.1%	19.0%	-15.6%
MT	10.1	6.7	3.4	10.6	9.0	1.6	5.1%	35.2%	-53.8%
PA	12.0	9.1	2.8	12.2	11.5	0.6	1.5%	26.4%	-78.7%
PB	6.1	5.1	1.0	5.7	4.8	0.9	-6.5%	-5.0%	-13.7%
PE	12.8	10.1	2.7	13.8	10.9	2.9	7.9%	8.6%	5.4%
PI	5.0	3.9	1.1	5.9	4.9	1.0	17.1%	26.8%	-15.7%
PR	20.3	14.9	5.4	19.5	17.2	2.3	-4.1%	15.3%	-57.6%
RJ	31.1	22.6	8.5	28.5	23.5	5.1	-8.3%	3.7%	-40.4%
RN	5.0	4.6	0.4	5.8	5.8	0.0	15.0%	24.8%	-96.1%
RO	3.9	3.5	0.4	4.3	3.6	0.7	8.0%	2.1%	57.4%
RR	2.4	1.9	0.5	2.4	1.7	0.7	-0.4%	-11.4%	42.6%
RS	18.8	16.1	2.8	22.9	22.1	0.7	21.4%	37.8%	-73.5%
SC	14.0	11.1	3.0	13.7	11.9	1.9	-2.4%	7.2%	-37.9%
SE	4.1	3.2	0.9	4.4	3.7	0.7	6.4%	16.7%	-29.1%
SP	92.4	71.6	20.8	77.6	66.6	11.0	-16.0%	-7.0%	-47.1%
TO	4.1	3.3	0.8	4.6	3.9	0.7	12.3%	17.8%	-11.8%
Total	**364.8**	**290.3**	**74.5**	**357.5**	**318.1**	**39.4**	**-2.0%**	**9.6%**	**-47.1%**

Source: Annex 6 of the RREO and National Treasury Secretariat. Elaboration: IFI.
** Transfers from Fundeb, from STN, were imputed to current revenues and expenditures in cases where the RREO does not report the amount.*

In short, based on the information provided here, the main challenge for the finances of the states and the Federal District will be to balance the accounts in a context of permanent increase in expenses (arising from the readjustments) and permanent loss of ICMS revenue. In response to this loss, some states have already started a movement to increase the modal ICMS rates, mitigating the impacts on revenues in the coming months. The measure, a priori, does not change the tax rates levied on gasoline, ethanol, diesel oil, natural gas vehicle (NGV), and liquefied natural gas (LNG), on which national single-phase *ad rem* rates are levied, set by Confaz under LC No. 192, but affects the collection of other items not subject to exception.

IFI projections

SHORT TERM

IFI projections	2023			2024		
	June	July	Comparison	June	July	Comparison
GDP - real growth (% p.a.)	2.28	2.28	=	1.22	1.22	=
GDP - nominal (R$ billion)	10,672.73	10,647.66	▼	11,341.24	11,294.10	▼
IPCA - accumulated (% in year)	5.52	5.20	▼	4.00	3.88	▼
Exchange rate - end of period (R$/US$)	5.10	5.02	▼	5.18	5.09	▼
Employment - growth (%)	0.75	0.75	=	0.68	0.68	=
Payroll - growth (%)	4.28	4.28	=	1.22	1.22	=
Selic - end of period (% p.a.)	12.75	12.00	▼	10.50	9.50	▼
Real ex-ante interest (% p.a.)	6.63	6.37	▼	5.38	5.77	▲
Consolidated Public Sector Primary balance (% of GDP)	-1.19	-1.20	▼	-1.33	-1.33	=
of which Central Government	-0.79	-0.80	▼	-0.93	-0.93	=
Net Nominal Interest (% of GDP)	7.35	7.01	▼	6.88	6.09	▼
Nominal Result (% of GDP)	-8.54	-8.20	▲	-8.21	-7.43	▲
General Government Gross Debt (% of GDP)	76.74	76.40	▼	80.88	79.78	▼

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August 01, 2023.

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