Independent Fiscal Institution

Fiscal Follow-Up Report

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HIGHLIGHTS

- The GDP deflator is slowing down in 2023 due to lower inflation in goods and services consumed by families and in Gross Fixed Capital Formation (FBCF).
- The performance of IRPJ, CSLL, and some unmanaged revenues explain the deceleration observed in primary revenues.
- A proposed change in the legislation regarding interest on equity may have altered the behavior of taxpayers.
- According to the Union's results preview conducted by the IFI, primary expenses showed a real increase of 5.1% in September 2023.
- The expenditure set in the 2024 Budget Proposal is 6.6% higher than the estimate provided by the government in the last bimonthly assessment report of 2023.
- As a percentage of GDP, the expenditure set in the 2024 Budget Proposal and the assessment of the 4th bimester, considering the budgetary blockage, remained relatively stable.
- The increase in inactivity is driven by the aging of the population and the greater focus of adults on domestic tasks.

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The deterioration of the primary balance and the waiting period for legal changes[1]

The Independent Fiscal Institution, fulfilling its institutional mission, delivers to the National Congress and Brazilian society the Fiscal Follow-up Report (RAF) No. 81 published in October 2023.

RAF No. 81 is made public at a time when Brazilian society and economic agents await crucial decisions from the National Congress regarding the new tax system, the set of measures proposed by the Federal Government to increase revenue, and the guiding compasses of public finances in 2024 - the Budgetary Guidelines Law (LDO) and the Annual Budget Law (LOA) - in the first year of the New Fiscal Framework (NAF) introduced by Complementary Law No. 200 of 2023.

The Budget Guidelines Bill (PLDO), consistent with the objectives of the NAF, sets a target of zero primary deficit by 2024. The starting point is marked by recurring deficits between 2014 and 2023, except 2022. We could end up with a negative primary balance of close to 1.0% of the Gross Domestic Product (GDP) this year.

The report seeks to highlight the size of the challenge. Starting from a deficit position in recent years and aiming to regain fiscal balance by 2024, the government is facing a deterioration in the primary balance in the short term, with an increase in expenditure and a reduction in revenue.

The report provides an X-ray of the dynamics of government spending and notes the significant increase in some essential components of public spending, with emphasis on social security expenses, payroll, Bolsa Família Program, the federal supplementation to the und for the Maintenance and Development of Basic Education and Valorization of Education Professionals (Fundeb), federal compensation for the nursing floor, salary allowances and unemployment benefits. Added to this is the resumption of the obligation to link the health and education budgets to revenue. According to the IFI's preliminary survey, primary spending is expected to have grown by 5.1% in real terms in the period from January to September compared to 2022. (Page 13)

On the other hand, there is a worrying drop in revenue, given that the desired balance is anchored in the need for a significant increase in revenue. The performance of revenues - collected or not by the Federal Revenue Office (RFB) appears here to be associated with the fiscal effect of the reduction in inflation, the fall in commodity prices, losses in the collection of Corporate Income Tax (IRPJ), and Social Contribution on Net Profits (CSLL), possible preventive adjustments in the behavior of economic agents about the tax measures under discussion, the reduction in the number of dividends paid to the National Treasury by state-owned companies - mainly due to changes introduced at Petrobras - and the reduction in revenue from special participation in the exploitation of natural resources. For a government that needs to increase revenue well beyond the current level next year, this is a challenging scenario. The current trajectory of income and expenditure is not in line to zero the primary deficit by 2024. (Page 8)

This report also sheds light on the GDP deflator, an important thermometer of general price changes. The analysis confirms the inflation deceleration trend and captures a deterioration in terms of trade in a time of great uncertainty in the international scenario. (Page 17)

Finally, RAF No. 81 publishes an analysis that portrays the favorable momentum of the labor market, despite the restrictive monetary policy and the expectation of a slowdown in economic activity next year. Positive records include the increase in the employed population in the formal sector of the economy, a decrease in discouragement, and the average duration of unemployment. However, it is worth noting the decrease observed in the participation rate, which has not returned to pre-pandemic levels, unlike most countries in the Organization for Economic Cooperation and Development (OECD), and is following a similar trend to that of Chile and Colombia. This reflects an increase in inactivity due to behavioral changes related to the world of work, with a revaluation of domestic and family responsibilities, as well as changes in the demographic profile of the population. (Page 4)

Enjoy your reading!

Marcus Pestana
IFI Executive Director

[1] In compliance with paragraphs 11 and 12 of Art. 1 of Senate Resolution No. 42 of 2016, Director Vilma Pinto's dissenting vote is recorded regarding this Cover Letter, the section "Possible Explanations for the Deceleration in Primary Revenues in 2023," and the table "IFI Projections."

Recent evolution of the GDP deflator

Rafael Bacciotti

The GDP deflator, which assesses the evolution of prices in the economy, has been decelerating in 2023, driven by lower inflation in household goods and services and gross fixed capital formation. On the other hand, the public consumption deflator has helped to curb this trend. Based on the analysis of historical data and the prospect of price index deceleration, especially the IPCA, the estimate for the GDP deflator in 2023 is a 4.8% variation compared to the previous year. With real GDP expected to grow by 3.0%, nominal GDP should increase by 7.9%. For 2024, the projection of 6.1% growth in nominal GDP results from a 4.8% increase in the deflator and a 1.2% real growth.

The GDP deflator is an implicit price index that assesses the average evolution of prices in the economy. It is calculated by dividing nominal GDP (or GDP at current prices) by real GDP (or GDP at constant prices). The GDP deflator provides a comprehensive perspective on inflation as it reflects price variations for all goods and services produced domestically, without being limited to a specific basket. Monitoring the evolution of the GDP deflator is important for building projections for nominal GDP and, thus, for the future trajectory of fiscal indicators expressed to GDP.

In the four quarters ending in June 2023, compared to the previous four quarters, nominal GDP, which represents the monetary value of domestic production, grew by 10.5%. This growth was due to a 3.2% increase in GDP in volume and a 7.1% increase in price levels, as reflected in the GDP deflator. The nominal GDP figures and their rates of change are summarized in Table 1.

TABLE 1. NOMINAL GDP AND VARIATIONS

	Nominal GDP (BRL trillion)	Nominal GDP	GDP in volume	GDP deflator
		Average change (4 quarters compared to the previous 4 quarters)		
2021.I	7,889	5.1%	-3.0%	8.3%
2021.II	8,313	11.8%	2.4%	9.1%
2021.III	8,638	15.4%	4.3%	10.6%
2021.IV	**8,899**	**16.9%**	**5.0%**	**11.4%**
2022.I	9,062	14.9%	5.2%	9.2%
2022.II	9,352	12.5%	3.2%	9.0%
2022.III	9,641	11.6%	3.0%	8.4%
2022.IV	**9,915**	**11.4%**	**2.9%**	**8.3%**
2023.I	10,156	12.1%	3.3%	8.5%
2023.II	10,335	10.5%	3.2%	7.1%

Source: IBGE. Prepared by: IFI.

The GDP deflator, calculated based on the average change over the last four quarters compared to the same period in the previous year, decelerated between the first and second quarters of 2023, dropping from 8.5% to 7.1%. This change can be seen in Table 2, which highlights the variation in prices related to each GDP component from an expenditure perspective.

The main influence on the slowdown in the GDP deflator between the first and second quarters of 2023 was mainly the lower inflation rate for goods and services consumed by households, which fell from 9.1% to 7.1%, and for gross fixed capital formation, which fell from 8.6% to 6.5%. On the other hand, the rate of change in the public consumption deflator remained unchanged at 7.3%, following a trajectory of acceleration that began in the second quarter of 2022, which coincided with the period of salary adjustments for civil servants. When considering the contribution of net exports, the influence of the external sector was practically neutral, although there was a deterioration in the Brazilian economy's terms of trade.

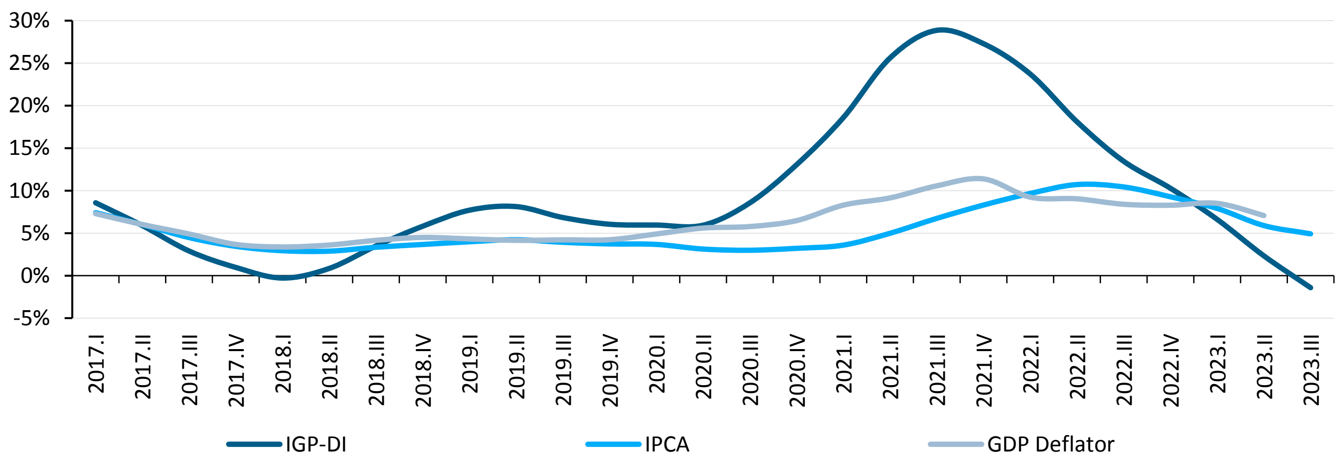
TABLE 2. DEFLATOR OF DEMAND COMPONENTS (AVERAGE CHANGE)

	GDP deflator	Household consumption	Government consumption	FBCF	Net exports	Exports	Imports
Average 1997 - 2020	**7.4%**	**7.0%**	**7.9%**	**7.3%**	**-0.1%**	**8.6%**	**8.6%**
2021.I	8.3%	4.9%	8.5%	15.1%	1.6%	27.7%	25.6%
2021.II	9.1%	6.3%	5.3%	15.8%	4.8%	30.5%	24.5%
2021.III	10.6%	7.8%	4.6%	16.4%	8.2%	32.7%	22.6%
2021.IV	**11.4%**	**9.0%**	**4.5%**	**14.5%**	**7.1%**	**31.3%**	**22.6%**
2022.I	9.2%	10.2%	3.6%	12.3%	3.6%	25.2%	20.8%
2022.II	9.0%	11.4%	5.1%	12.1%	-2.0%	19.6%	22.0%
2022.III	8.4%	11.5%	5.9%	10.6%	-6.2%	14.2%	21.8%
2022.IV	**8.3%**	**10.5%**	**6.3%**	**10.0%**	**-5.5%**	**8.2%**	**14.5%**
2023.I	8.5%	9.1%	7.3%	8.6%	-3.2%	5.3%	8.8%
2023.II	7.1%	7.1%	7.3%	6.5%	-2.3%	-1.1%	1.2%

Source: IBGE. Prepared by: IFI.

The deflator will likely follow a downward trend throughout the second half of the year, in line with what has been observed in other price indices, such as the Extended National Consumer Price Index (IPCA), the General Market Price Index (IGP-M), and the General Price Index - Internal Availability (IGP-DI). In the third quarter, when compared to the same period of the previous year, the IPCA recorded a rate of change of 4.9%, lower than that recorded in the previous quarter (5.9%). In the same comparison, the IGP-DI, calculated by the Getulio Vargas Foundation (FGV), which is sensitive to commodity price fluctuations, went from inflation of 2.3% to deflation of 1.4%.

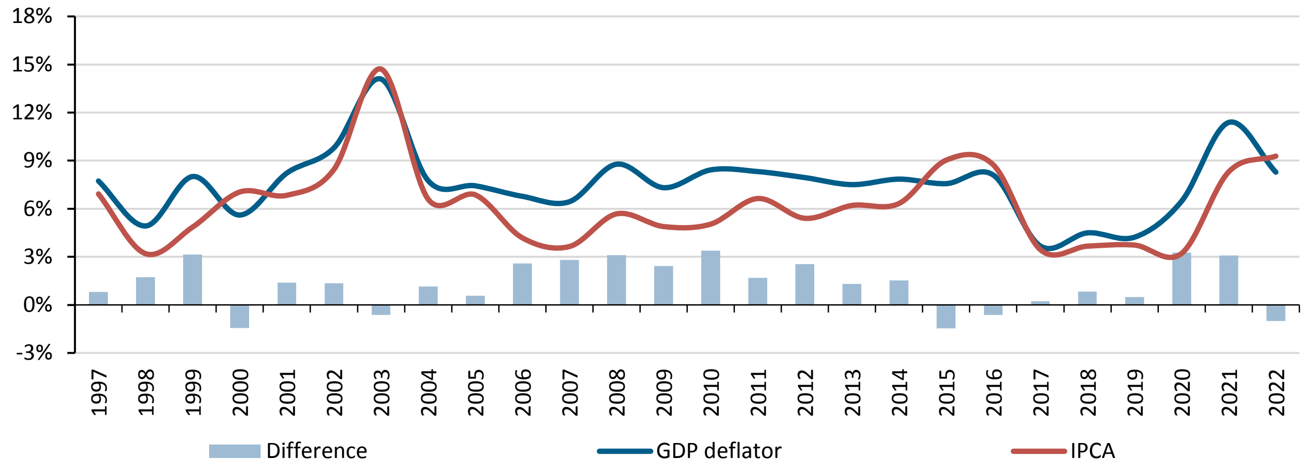
GRAPH 1. PRICE INDICES: AVERAGE CHANGE (4 QUARTERS COMPARED TO THE PREVIOUS 4 QUARTERS)



Source: FGV and IBGE. Prepared by: IFI.

The GDP deflator generally shows higher rates than the consumer price index. Between 1997 and 2020, the rate of change recorded by the GDP deflator, with an average of 7.4% per year, evolved 1.4 percentage points above the IPCA, which had an average change of 6.0%. The periods in which inflation measured by the GDP deflator was below the IPCA were characterized by a worsening of the terms of trade, with negative contributions from net export prices. In recent years, the gap reached 3.3 percentage points (p.p.) in 2021, 3.1 p.p. in 2022, - 1.0 p.p. in 2022, before rising again in 2023, registering an increase of 0.6 p.p. in the first quarter and 1.2 p.p. in the second quarter.

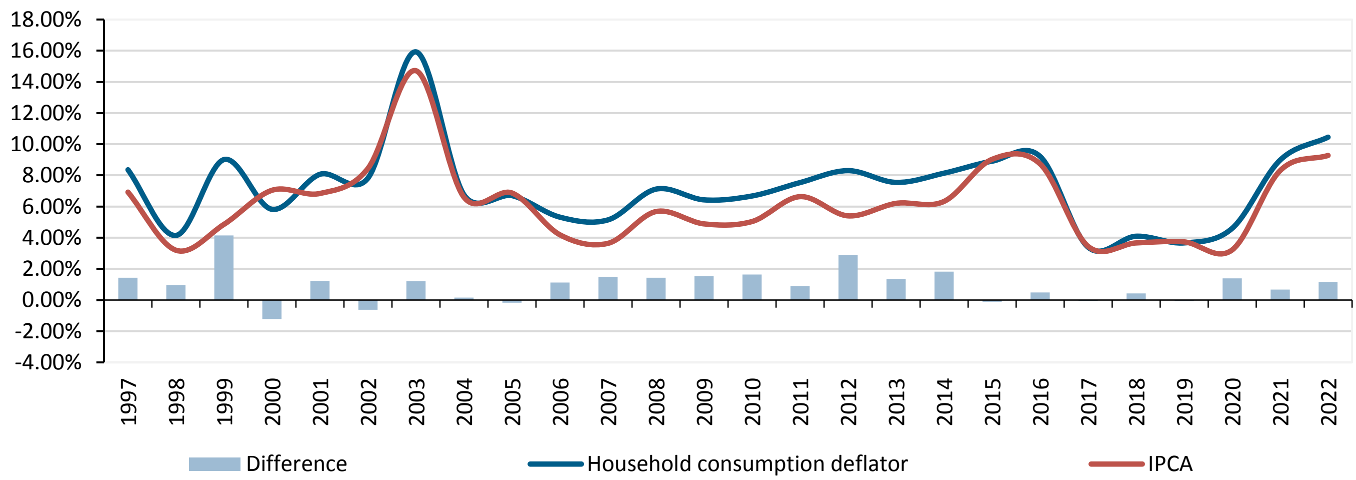
GRAPH 2. GDP DEFLATOR AND IPCA: AVERAGE ANNUAL CHANGE AND DIFFERENCE IN P.P.



Source: IBGE. Prepared by: IFI.

It's interesting to note that historically, the rate of change in the household consumption deflator, which represents a significant portion of GDP from an expenditure perspective, tends to exceed the rate recorded by the IPCA by approximately 1.0 percentage point. Although these indices are conceptually similar as they capture the cost of living from the consumer perspective, a significant part of the historical difference between the household consumption deflator and the IPCA is due to a scope effect[2], mainly associated with items such as imputed rent[3] and indirectly measured financial intermediation services. These items contribute to the fact that the structure of consumption in the National Accounts is different from that observed in the Household Budget Survey (POF) and the IPCA, which only considers the costs of actual rent and bank service fees.

GRAPH 3. HOUSEHOLD CONSUMPTION DEFLATOR AND IPCA: AVERAGE ANNUAL CHANGE AND DIFFERENCE IN P.P.



Source: IBGE. Prepared by: IFI.

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[2] See Technical Note 18: "Discussões sobre a evolução do deflator do PIB" [Discussions on the evolution of the GDP deflator], available at: https://t.ly/BhXDC.

[3] Residential rents are divided into two products: actual rents (actually paid by the occupants of the property) and imputed rents. Imputed rent is an estimate of how much a homeowner would pay in rent for the property they live in, calculated using econometric models. Imputed rent affects household value added and is recorded as household final consumption expenditure.

Based on the analysis of historical data and the prospect of a slowdown in price indices, particularly the IPCA, the projection for the GDP deflator in 2023 is a variation of 4.8% compared to the previous year. For the following year, 2024, the estimate is also 4.8%. Considering the expectation of real GDP growth of 3.0% in 2023 and 1.2% in 2024, nominal GDP should expand by 7.9% and 6.1%, respectively.

Possible explanations for the slowdown in primary revenues in 2023

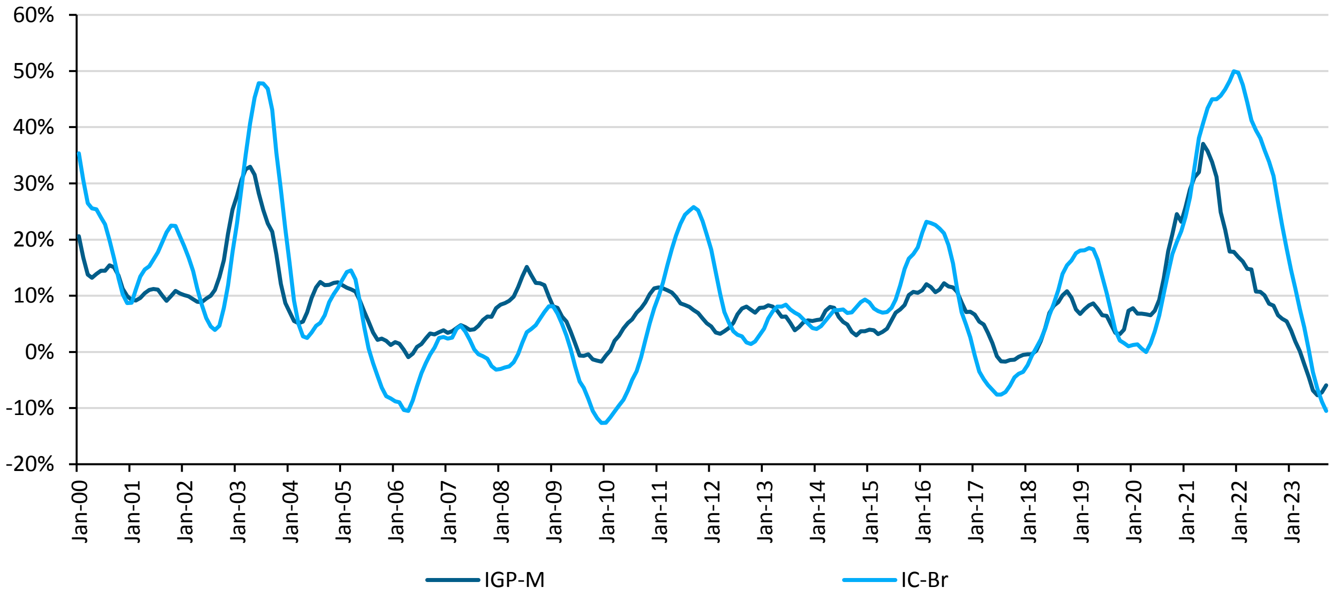
Alexandre Andrade

Data from the Treasury and Siga Brasil show more moderate growth in tax collection this year compared to 2022. The fall in commodity prices and inflation indicators explain part of this movement, as they have helped to increase the tax bases in the last two years. Additionally, smaller dividend payments by state-owned enterprises and the potential change in the deductibility of interest on equity capital may be influencing government revenues.

In Brazil, the cooling of prices has had an effect on central government revenue, which includes the National Treasury, the Central Bank, and the National Social Security Institute (INSS), with a slowdown in revenues, both collected and not collected by the Federal Revenue Office. Some of these revenues have seen a drop in collections in 2023, such as dividends, the exploitation of natural resources, IRPJ, and CSLL. The movement observed in these two taxes is not in line with the recent performance of economic activity. This article aims is to discuss some of the evidence regarding the behavior of central government revenues in 2023.

The cooling in prices can be seen in Graph 4, which shows the 12-month evolution of the FGV's IGP-M and the Brazil Commodities Index (IC-Br), calculated by the Central Bank. In the 12 months to September, the IC-Br fell by 10.5%, while the IGP-M fell by 6.0%. The analysis of the behavior of the historical variations of the indices allows us to conclude that the shock in commodity prices that occurred in 2021 and 2022 was significant, which generated impacts on economic activity (GDP growth) and tax collection through direct and indirect means.

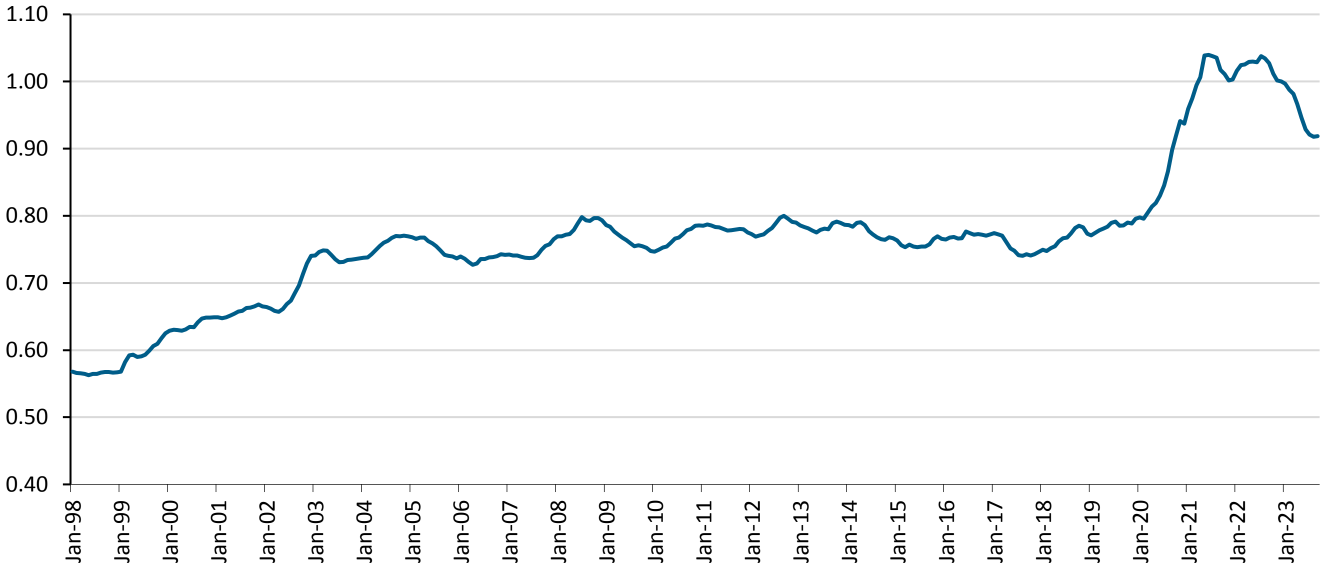
GRAPH 4. 12-MONTH VARIATION IN THE IGP-M AND IC-BR



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

Another way to visualize the extent of the commodity shock on prices and, therefore, on tax bases, is to analyze the evolution of the ratio between the IGP-M and the IPCA, which can represent a *proxy* for the economy's relative prices. Graph 5 shows this ratio. In April 2020, the ratio between IGP-M and IPCA was 0.81, and it increased from that point, reaching 1.04 in June 2021, remaining at a relatively high level until mid-2022 when it started to decline.

GRAPH 5. EVOLUTION OF THE RATIO BETWEEN THE IGP-M AND THE IPCA



Source: FGV and IBGE. Prepared by: IFI.

Considering the *proxy* for the economy's relative prices, there has been a much greater increase in the IGP-M compared to the IPCA over the last three years. From 2020 onwards, the ratio between the two price indices began to rise and reached unprecedented levels by historical standards. Although this ratio began to fall in the second half of 2022, relative prices remain at relatively high levels, which favors tax collection. In any case, the decline that has already occurred may help explain the slowdown in central government revenues in 2023.

Table 3 shows the nominal rates of change in recurrent primary revenue, recurrent transfers, and GDP compared to the same period in the previous year. In addition to the information provided by the National Treasury Secretariat (STN), data extracted by the IFI from the Siga Brasil Portal for September 2023 was also considered. The choice to consider recurring revenues, according to the methodology used by the IFI[4], was made to isolate some effects that could distort the analysis, such as the transfer of funds from unclaimed PIS/PASEP accounts to the Treasury in September 2023, amounting to BRL 26.0 billion. As an illustration, in 2021, 2022, and 2023, in the cumulative period up to September, the central government obtained BRL 50.9 billion, BRL 97.1 billion, and BRL 25.7 billion in non-recurring revenues, respectively[5].

TABLE 3. NOMINAL VARIATION RATES OF RECURRING REVENUES AND GDP IN RELATION TO THE SAME PERIOD OF THE PREVIOUS YEAR.

	2022	1st quarter 2023	2nd quarter 2023	3rd quarter 2023	Jan-Sept 2023
Total primary revenue	**20.0%**	**9.0%**	**3.6%**	**0.1%**	**4.3%**
Revenue collected by RFB	19.5%	8.9%	8.4%	2.5%	6.7%
Net collection for the RGPS	16.0%	11.7%	10.6%	9.6%	10.6%
Revenue not collected by RFB	30.1%	4.5%	-20.7%	-25.1%	-15.3%
Revenue-sharing transfers	27.9%	10.2%	4.4%	-5.2%	3.1%
Net revenue	**18.3%**	**8.7%**	**3.4%**	**1.5%**	**4.5%**
GDP - nominal growth	**11.4%**	**10.4%**	**7.3%**	**6.6%**	**8.2%**

Source: National Treasury Secretariat, Siga Brasil, IBGE, Central Bank and IFI. Prepared by: IFI.

[4] For more information on the methodology, see IFI Special Study No. 17 of December 2021, which can be accessed at the following site: https://t.ly/VUbbP.

[5] For a more detailed explanation, see RAF No. 73 of February 2023, available at: https://t.ly/GINmQ.

While in 2022, central government revenues were growing well above economic activity (20.9%, in nominal terms, compared to 11.4%, also in nominal terms), there was a sharp deceleration in revenue variation in 2023. In the year to September, the central government's total primary revenue grew by 4.3%, compared to the IFI estimate of 8.2% of nominal GDP in the period. Part of this lower growth in central government revenue is explained by the behavior of revenues collected by the Federal Revenue Office (RBF, in the original acronym), which grew by 6.7% in 2023 up to September, with a stronger slowdown in the third quarter (up 2.5% compared to the same period in 2022, below the variations recorded in the two previous quarters).

The largest contribution to primary revenues in 2023 comes from net collections for the General Social Security Policy (RGPS), with a nominal increase of 10.6% in the accumulated figures from January to September. This performance is supported by favorable employment and income conditions in the labor market, especially formal employment, which has driven growth in the economy's employment levels.

About revenues collected by RFB, information from the Treasury and Siga Brasil indicates nominal declines in the collection of IRPJ and CSLL by 7.9% and 5.9%, respectively, year-to-date 2023. However, when considering the recurring values of the two taxes combined, there was an increase of 2.9% on this basis of comparison. The growth of recurring IRPJ/CSLL revenues in 2023 has been much lower than the 38.7% increase recorded in 2022 when these two taxes were driving the performance of central government revenues collected by RBF.

Graph 6 shows the 12-month evolution of recurring IRPJ/CSLL collection at September 2023 prices. The series shows a loss of momentum in 2023, but the drop in collections from May onwards, when they totaled BRL 433.0 billion, is noteworthy. In September, revenue fell to BRL 417.9 billion, according to information from the Treasury and Siga Brasil, a reduction of BRL 15.1 billion compared to May. This movement can be considered atypical, given that there was no substantial change in the macroeconomic and financial conditions of the economy in the second quarter of the year that would justify a drop in company profitability.

GRAPH 6. 12-MONTH EVOLUTION OF RECURRING IRPJ AND CSLL REVENUES (BRL BILLION AT SEP/2023 PRICES)

Source: National Treasury Secretariat, Siga Brasil and IBGE. Prepared by: IFI.

Thus, the movement observed in IRPJ and CSLL payments may be related to other factors. A suggestive explanation, which would need further investigation, could be the government's intention to eliminate the deductibility of interest on equity capital (JCP), as per Bill (PL) No. 4,258 of 2023, sent to Congress on August 29th of last year. The proposal revisits the content of Bill No. 2,337 of 2021[6].

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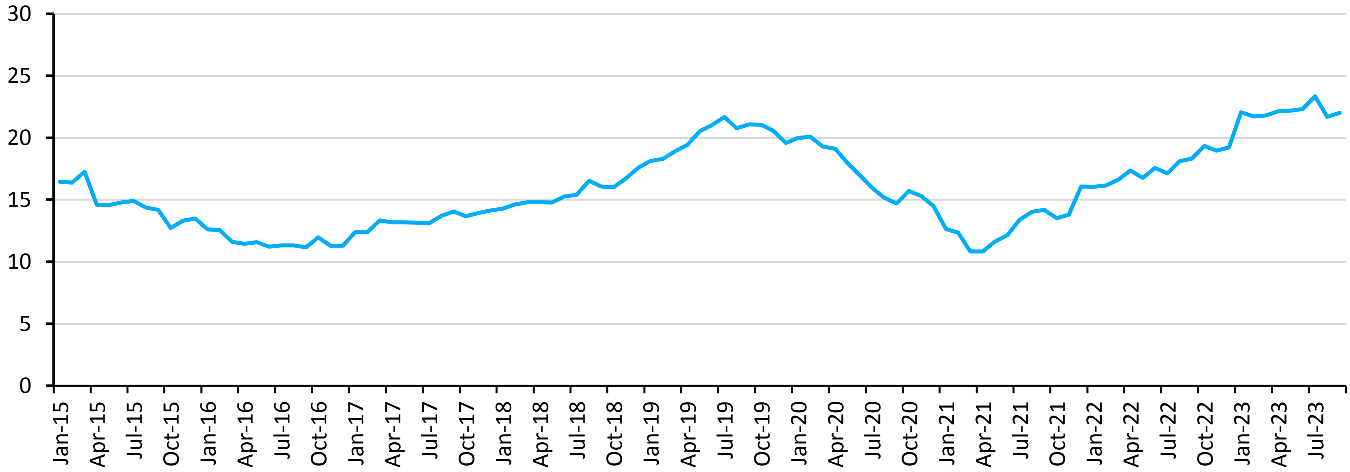
[6] For an analysis of Bill 2.337, of 2021, as well as the impacts of the proposal, see IFI Technical Note (NT) No. 49, of September 29, 2021, available at: https://t.ly/ZzfT8.

Initially, the growth in interest on equity capital (JCP) payments by companies may help explain the decrease in IRPJ and CSLL revenues starting in June 2023. The payment of JCP is subject to taxation for the recipient. Therefore, the effect on the reduction of IRPJ/CSLL would be the resulting value of (i) the taxation of JCP for the recipient (which generates revenue) and (ii) the deduction of JCP for the payer (which reduces revenue). Intuitively, the expected net effect on tax collection would be negative, as the deduction tends to be greater than the collection of interest on capital.

Graph 7 shows the 12-month evolution of Withholding Income Tax (IRRF) - interest on equity capital through the Federal Revenue Collection Document (Darf) at prices as of September 2023. The data was obtained by the IFI from the *Tesouro Gerencial* [Treasury Management] portal. In September, this collection amounted to BRL 22.0 billion and has remained at almost the same level in all months of 2023.

GRAPH 7. 12-MONTH EVOLUTION OF JCP REVENUES (IN BRL BILLION AT PRICES AS OF SEPTEMBER 2023)



Source: Tesouro Gerencial Website and IBGE. Prepared by: IFI.

It's also important to mention the apparent relationship between the collection of JCP and the presentation of Bill No. 2,337, sent by the Executive to Congress on June 25, 2021. Graph 7 shows a sharp increase in tax revenues from the second half of that year onwards, which may indicate a change in taxpayers' behavior given the prospect of a change in legislation concerning the taxation of JCP. In other words, the numbers suggest that companies had the incentive to advance JCP payments before the change in legislation governing the instrument.

Returning to Table 3, it is also possible to identify a significant reduction in recurring non-administered revenues in 2023, with a 15.3% decline in the cumulative total from January to September. This is explained by the decreases in dividend collections, especially from Petrobras, and in the exploration of natural resources due to the lower average oil prices in 2023 compared to 2022.

By way of illustration, Petrobras paid out BRL 50.1 billion in dividends in the first nine months of 2022 and BRL 22.3 billion in the same period of 2023. The methodology used by the IFI considers the advance payment of dividends for the year to be non-recurring revenue. Therefore, considering that there was an advance of BRL 26.4 billion in dividends in the first nine months of 2022 and BRL 7.1 billion in the same period of 2023, to calculate the recurring revenue in this category, the IFI took into account the dividend collection of BRL 23.8 billion by Petrobras in the first nine months of 2022 and BRL 15.2 billion this year[7].

[7] According to the National Treasury Results Bulletin (RTN) from the National Treasury Secretariat, the Federal Government received BRL 50.1 billion from Petrobras in dividends and profits between January and September 2022 and BRL 22.3 billion in the same period in 2023. However, part of these amounts consisted of advance payments of dividends for the respective financial year, as announced by the company. In 2022, this dividend advance took place between June and September and amounted to BRL 26.4 billion. This year, the advance dividends will be paid in August, September, November, and December, totaling an amount of BRL 11.4 billion. Of these, BRL 7.1 billion represents advance dividends paid in August and September. For more information, see the following documents: https://t.ly/MOAX6; https://t.ly/_4ckR; https://t.ly/BtAnR; and https://t.ly/xQexr.

In other words, the number of dividends collected is lower this year compared to 2022. To illustrate the relative weight of dividends on the central government's non-administered revenues, in 2022, Petrobras' dividends accounted for 17.8% of non-administered revenues, a share that fell to 9.5% in the same period this year.

Revenues from the exploitation of natural resources, in turn, fell by 17.7% in the year to September 2023, in nominal terms (Table 3). This reduction is due to lower oil prices on the international market this year compared to last year. According to data from the *Energy Information Administration* (EIA), the average price of a barrel of Brent crude oil was $100.8 last year, falling to $82.1 in the average of the first nine months of 2023.

In summary, the deceleration in primary revenues of the central government in 2023 seems to be related to several factors, such as reduced inflation rates, lower collections of certain non-administered revenues like natural resource exploration and dividends and profit shares, and the potential approval of legal changes regarding the deductibility of interest on equity capital. This factor, as mentioned above, would require further analysis.

Evolution of the Federal Government's primary expenditure: objective and direction

Vilma Pinto

The significant increase in the Federal Government's primary spending projected for 2023 and in the one realized up to September of this year challenge the search for fiscal sustainability, revealing a gap between the objectives of reducing the primary deficit and the direction taken by primary spending in the short term. Primary expenditure grew by 5.1% in the period from January to September 2023, in real terms, compared to 2022.

According to official data from the Federal Executive Branch[8], the Federal Government's primary expenditure should show a nominal increase of 13.9% in 2023 compared to 2022. In 2024, the expected nominal growth is 6.6%. The budgeted expenditure amounts - BRL 2,052.2 billion (19.1% of GDP) for 2023 and BRL 2,188.4 billion (19.2% of GDP) for 2024 - increase the challenges of achieving a sustainable trajectory for public finances in the medium term. To get a better understanding of the expected dynamics for the central government's primary expenses, it's worth revisiting the expenses incurred in the cumulative total of 2023 until September[9] in comparison to the same period of the previous year.

According to the Federal Senate's Siga Brasil portal, the central government's primary expenditure totaled BRL 157.5 billion in September, 10.7% higher than in the same month in 2022, in real terms. Below are some comments that justify this result:

- **Social security benefits:** payment of BRL 69.6 billion was a real increase of 7.1% over September 2022 due to an increase in the number of benefits issued and the above-inflation adjustment of the minimum wage;
- **Payroll and social charges:** spending of BRL 27.4 billion in September represented a real increase of 2.1% compared to the same month last year and reflects the resumption of salary increases for civil servants, as well as an increase in hiring; and
- **Mandatory expenses with flow control:** a total of BRL 41.0 billion (a real increase of 49.7%), influenced by the payment of Bolsa Família [Family Allowance] in the amount of BRL 14.0 billion. Disregarding the amounts related to Auxilio Brasil [Brazil Aid] and Bolsa Família, which last year were paid in part through extraordinary credit, mandatory expenses with flow control would have registered a real increase of 31.2% in September compared to the same month in 2022.

The monthly result follows a trend seen in previous months. The central government's total primary expenditure reached BRL 1,487.3 billion in 2023, a real increase of 5.1% to the expenditure carried out between January and September last year (Table 4). The main factors behind this result were (i) spending on salary allowances and unemployment benefits (which rose by 7.3%, largely as a result of the new policy to increase the minimum wage; (ii) the federal government's supplementation to Fundeb, in a transition period, with a gradual increase in the amount to be transferred to the fund (an increase of 10.6%); (iii) mandatory expenditure with flow control, influenced by spending on the Bolsa Família and Auxílio Brasil programs (20.5%); (iv) and spending on compensating the nursing floor and discretionary spending, which decreased due to budget blockages and the disbursement schedule, which showed an atypical distribution this year compared to last year (Graph 9).

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[8] For 2023, it considers the primary expenses outlined in the Report on the Evaluation of Primary Revenues and Expenses (RARDP) for the fourth bimester of 2023 and Decree No. 11,723, dated September 28, 2023, which amended the budgetary and financial programming decree for 2023 (No. 11,415 of 2023). For 2024, it considers the figures contained in the 2024 Annual Budget Bill (PLOA). Table 5 details these figures.

[9] The official statistics run until August. The September data was anticipated by the IFI, using the Federal Senate's Siga Brasil portal.

TABLE 4. CENTRAL GOVERNMENT PRIMARY EXPENDITURE - 2021 TO 2023 - JANUARY TO SEPTEMBER (BRL BILLION SEP/2023, REAL % AND CHANGE)

	Monthly			Accumulated in 12 months		
	Sep/23	Sep/22	Real % change	2023	2022	Real % change
TOTAL EXPENDITURE	**157,503.08**	**142,322.60**	**10.67**	**1,967,782.33**	**1,885,196.02**	**4.38**
Social Security Benefits	**69,551.78**	**64,967.32**	**7.06**	**867,594.70**	**824,940.90**	**5.17**
Payroll and Social Charges	**27,414.22**	**26,857.80**	**2.07**	**351,237.90**	**357,956.61**	**-1.88**
Other Mandatory Expenses	**19,552.43**	**23,124.80**	**-15.45**	**299,650.83**	**305,703.03**	**-1.98**
Allowances and Unemployment Benefits	3,687.87	3,112.56	18.48	72,178.19	66,886.38	7.91
Granted amnesty	13.15	13.08	0.54	169.71	171.17	-0.85
Financial support for states and municipalities	3.09	799.41	-99.61	11,028.11	1,596.50	590.77
Benefits from Special Legislation and Indemnifications	68.23	59.06	15.54	745.59	716.89	4.00
LOAS/RMV Continuing Cash Benefits	8,129.69	7,182.35	13.19	89,144.56	80,819.68	10.30
FGTS supplementation (LC 110/01)	0.00	0.00	-	90.38	35.08	157.67
Extraordinary Credits (except PAC)	182.63	6,619.46	-97.24	21,468.33	52,881.76	-59.40
Compensation to RGPS for Exemption of Payroll Taxes	0.00	0.00	-	0.00	4,918.92	-100.00
Manufacturing of banknotes and coins	0.00	107.54	-100.00	1,035.98	1,069.08	-3.10
Fundeb (Federal Supplementation)	3,074.62	2,956.13	4.01	37,387.44	33,491.22	11.63
DF Constitutional Fund (Cost and Capital)	375.25	203.07	84.79	3,475.78	2,480.83	40.11
Legislative, Judiciary, MPU, and DPU (Cost and Capital)	1,462.53	1,309.15	11.72	16,709.20	14,459.41	15.56
Complementary Laws No. 87/96 and 102/00 (known as Kandir Law) and Complementary Law No. 176 of 2020	331.11	349.57	-5.28	4,056.77	4,259.63	-4.76
Court-ordered debt payments (cost and capital)	357.10	182.86	95.28	20,637.11	17,506.33	17.88
Subsidies, Grants and Proagro	1,728.14	-63.91	-2,803.91	17,870.46	16,167.84	10.53
ANA [National Water Agency] Transfers	15.77	13.42	17.54	153.58	173.11	-11.28
ANEEL [National Electric Energy Agency] Transfers and Fines	123.24	134.94	-8.67	1,770.38	1,566.62	13.01
Primary Impact of FIES	0.00	142.87	-100.00	1,726.01	1,302.18	32.55
Electoral Campaign Financing	0.00	3.26	-100.00	3.24	5,200.41	-99.94
Other	0.00	0.00	-	0.00	0.00	-
Executive Branch Expenditure Subject to Financial Programming	**40,984.65**	**27,372.68**	**49.73**	**449,298.91**	**396,595.49**	**13.29**
Mandatory with Flow Control	27,996.54	18,039.81	55.19	301,404.63	217,561.32	38.54
Discretionary	12,988.11	9,332.87	39.17	147,894.28	179,034.16	-17.39

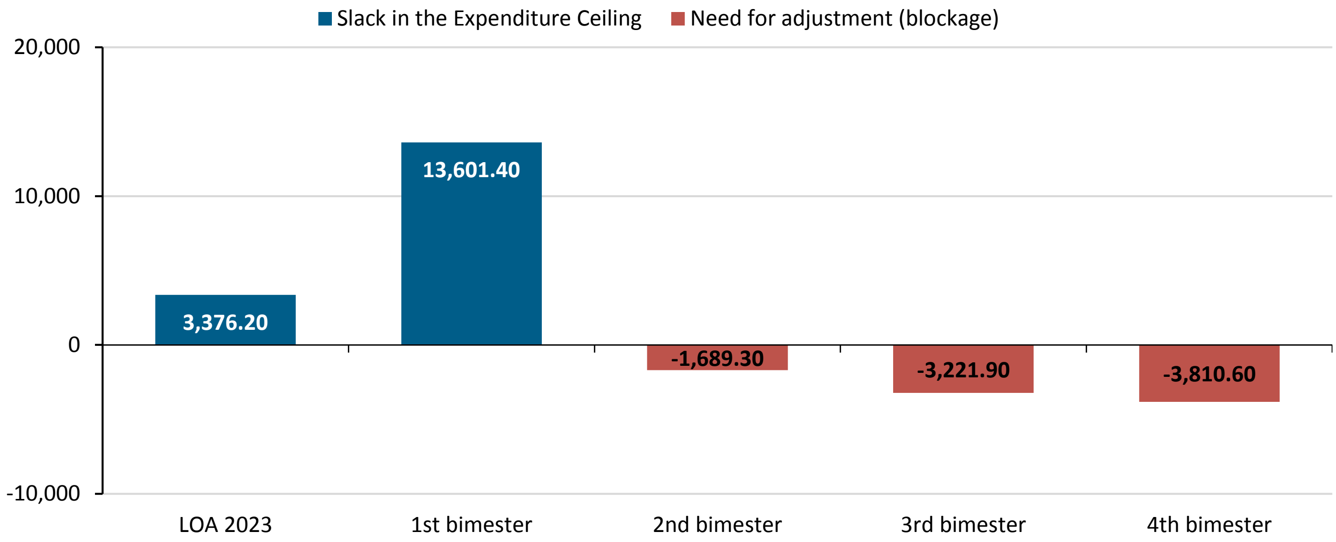
Source: RTN and Siga Brasil. Prepared by: IFI.

The execution of the Federal Government's discretionary spending is directly linked to the monthly disbursement schedule contained in the budget and financial programming decrees. The budget blockages carried out to bring the budget into line with the expenditure ceiling also influence this dynamic. Graph 8 shows the evolution of the Federal Government's bimonthly budget blockages in 2023.

It is worth mentioning the cost-cutting measures contained in the proposal presented by the Executive at the beginning of this year[10]. At that time, several revenue-increasing measures were presented, along with two expenditure reduction measures with effects of BRL 50 billion, of which BRL 25 billion were related to the permanent effect of contract and program revisions, and BRL 25 billion resulted from the authorization for budget execution lower than what was authorized in the Annual Budget Law of 2023 (LOA 2023).

[10] The presentation made in January of this year with details of the measures can be accessed at: https://t.ly/glGhS.

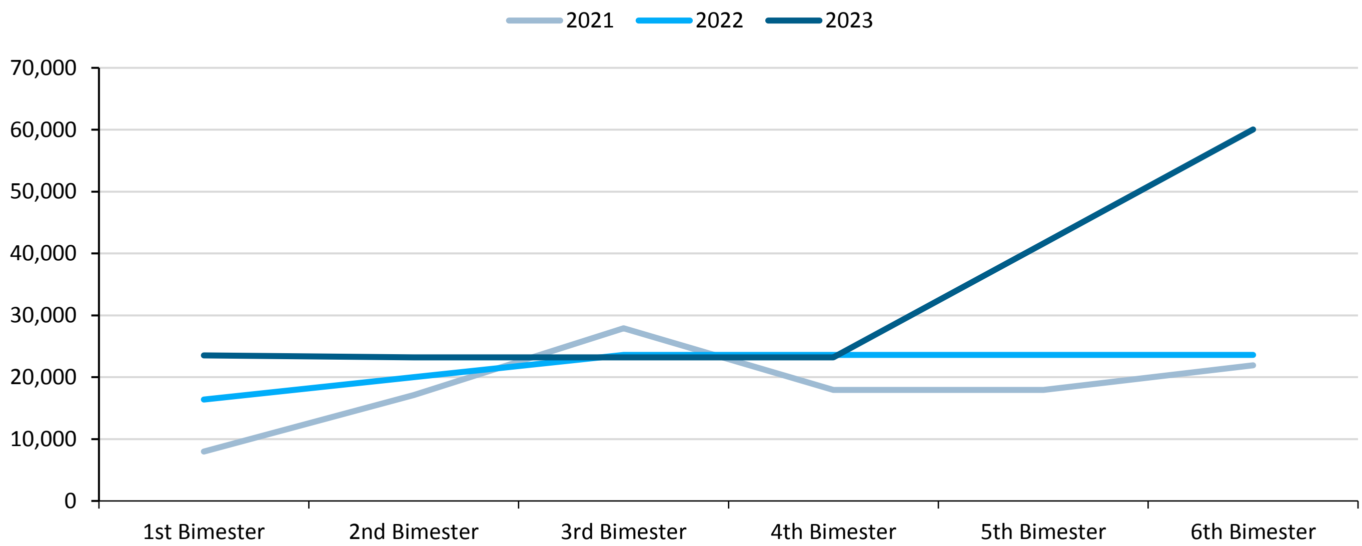
GRAPH 8. EVOLUTION OF BUDGET BLOCKAGES IN 2023 (BRL MILLION)



Source: Decree No. 11.415 of 2023. Prepared by: IFI.

Graph 9 shows the bimonthly distribution of disbursements authorized for discretionary spending, according to the budget and financial programming decrees of the last three years. Differences can be seen in the distribution of amounts over the years, with a greater concentration of amounts in the last two months of each year. This distribution may be, to some extent, related to the set of expenditure containment measures announced by the government at the beginning of the year.

GRAPH 9. FORECAST OF THE CENTRAL GOVERNMENT'S DISCRETIONARY PRIMARY EXPENSES



Source: Decrees No. 10.699, of 2021, No. 10.961, of 2022, and No. 11.415, of 2023. Prepared by: IFI.

Compared to the previous year, real growth in primary expenditure is expected in 2023 and 2024. The Annual Budget Law Proposal for 2024 (PLOA 2024) does, however, present some risks that were detailed in RAF No. 80, published in September 2023. Table 5 details the budget (revised allocation) for 2023 and the one proposed by the government for 2024. Next, some related data are discussed.

TABLE 5. SCENARIOS FOR PRIMARY EXPENDITURE: REASSESSMENT OF THE 4TH QUARTER/2023 AND PLOA 2024

Item	Realized in 2022			Updated Appropriation for 2023 (Decree No. 11.723, of 2023)			PLOA 2024		
	BRL billion	% PIB	Share %	BRL billion	% PIB	Share %	BRL billion	% PIB	Share %
Total primary expenditure	**1,802**	**18.2**	**100.0**	**2,052**	**19.1**	**100.0**	**2,188**	**19.2**	**100.0**
Social security benefits	**797**	**8.0**	**44.2**	**870**	**8.1**	**42.4**	**914**	**8.0**	**41.8**
Payroll and social charges	**338**	**3.4**	**18.8**	**359**	**3.3**	**17.5**	**380**	**3.3**	**17.4**
BPC [Continuing benefits]	**79**	**0.8**	**4.4**	**94**	**0.9**	**4.6**	**104**	**0.9**	**4.7**
Salary Allowance and unemployment benefits	**64**	**0.6**	**3.6**	**73**	**0.7**	**3.6**	**79**	**0.7**	**3.6**
Selected mandatory expenses	**203**	**2.1**	**11.3**	**263**	**2.4**	**12.8**	**295**	**2.6**	**13.5**
Supplementation by the Federal Government to Fundeb	33	0.3	1.8	38	0.4	1.9	47	0.4	2.1
DF Constitutional Fund	2	0.0	0.1	5	0.0	0.2	4	0.0	0.2
Kandir Law	4	0.0	0.2	4	0.0	0.2	4	0.0	0.2
Financial support for sub-national entities	6	0.1	0.3	12	0.1	0.6	12	0.1	0.5
Subsidies, grants and Proagro	15	0.2	0.9	22	0.2	1.1	22	0.2	1.0
Court-ordered debt payments (cost and capital)	17	0.2	1.0	25	0.2	1.2	27	0.2	1.3
Public employees' benefits	14	0.1	0.8	15	0.1	0.8	17	0.2	0.8
Health (mandatory)	104	1.1	5.8	129	1.2	6.3	153	1.3	7.0
Education (mandatory)	6	0.1	0.4	12	0.1	0.6	8	0.1	0.4
Other branches (cost and capital)	**15**	**0.2**	**0.8**	**20**	**0.2**	**1.0**	**21**	**0.2**	**1.0**
Extraordinary credit, except PBF	**22**	**0.2**	**1.2**	**5**	**0.1**	**0.3**	**0**	**0.0**	**0.0**
Bolsa Família Program	**113**	**1.1**	**6.3**	**169**	**1.6**	**8.2**	**169**	**1.5**	**7.7**
Ordinary benefit	88	0.9	4.9	169	1.6	8.2	169	1.5	7.7
Extraordinary benefit	25	0.3	1.4	0	0.0	0.0	0	0.0	0.0
Other mandatory expenditure	**18**	**0.2**	**1.0**	**9**	**0.1**	**0.4**	**14**	**0.1**	**0.6**
Discretionary expenditure	**152**	**1.5**	**8.4**	**191**	**1.8**	**9.3**	**212**	**1.9**	**9.7**

Source: Decree No. 11.415, of 2023 and PLOA 2024.

The 2024 budget assumes that primary expenditure will remain at 19.2% of GDP. Its composition, however, reveals some differences. The forecast for social security spending is a reduction from 8.1% of GDP in 2023 to 8.0% of GDP next year. As discussed in RAF 80, the issuance of social security benefits has been accelerating. The new policy for the appreciation of the minimum wage, which provides for real adjustments in line with economic growth, contributes to increasing the average value of the benefit and, consequently, the Federal Government's social security expenditure. By 2024, however, the Executive expects to see a reduction in this expense due to the improvement of registration systems. The success of this measure will be crucial for the expected scenario to materialize.

The Executive foresees an increase of 0.1 percentage points of GDP in mandatory expenses, while for other expenditure groups, the expectation is to maintain spending as a proportion of GDP. Despite the upward directions for primary expenses, such as (i) the expansion of explicit subsidies and grants; (ii) the policy of real minimum wage appreciation; (iii) salary increases for civil servants; (iv) the reestablishment of constitutional minimums for health and education; (v) prioritizing public investments in the budget, among others, it would be important to consider some margin for accommodating unforeseen events in the budget.

Any unexpected factors could contribute to an increase in the central government's primary expenses and, consequently, to a move away from the fiscal targets set out in the 2024 LDO. Regardless of the occurrence of new factors, the current trajectories of primary revenues and expenses suggest a contradiction between objective reality and the goal of achieving a primary surplus in 2024.

Labor market performance has been characterized by an increase in inactivity

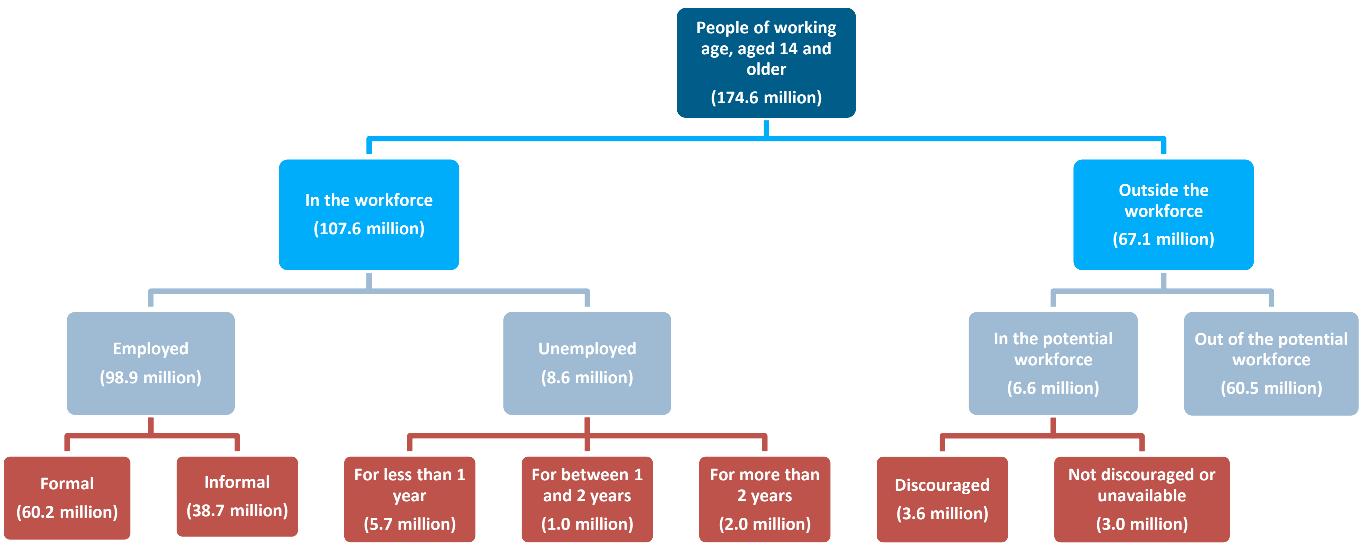
Rafael Bacciotti

The PNAD Continua [Continuous National Household Sample Survey] reveals a favorable scenario in the labor market, characterized by an increase in the population employed in the formal sector and a reduction in long-term unemployment. However, the participation rate remains below pre-pandemic levels, despite the decrease in discouragement, driven by improvements in economic conditions. In this context, the article explores disaggregated data from the IBGE sample survey to identify the reasons behind the increase in inactivity. There is an increase of 6.7 million individuals outside the potential labor force compared to the period before the pandemic, the majority of whom are aged 60 or over, followed by people aged 25 to 59 dedicated to family and household chores.

Recent labor market figures indicate favorable employment and income conditions in the country. The unemployment rate remains at relatively low levels, employment is growing, sustained by formal jobs, and average real income is rising as inflation falls. What is striking, however, is the behavior of the participation rate, which has not yet returned to the levels recorded in the fourth quarter of 2019. Understanding this phenomenon is important because of the medium and long-term consequences for the economy's potential output and social security revenues.

According to the Continuous National Household Sample Survey (PNAD Continua) of the Brazilian Institute of Geography and Statistics (IBGE), in the second quarter of 2023[11], the working-age population, made up of 174.6 million people aged 14 or over, was distributed as follows: 98.9 million were employed, 8.6 million were unemployed and 67.1 million were not in the labor force (Figure 1). Employed individuals, those who are currently working, and unemployed individuals, those who are actively seeking employment and available for work, constitute the labor force, representing the pool of available labor in the economy to produce goods and services.

FIGURE 1. NUMBER OF WORKING-AGE PEOPLE 2ND QUARTER OF 2023



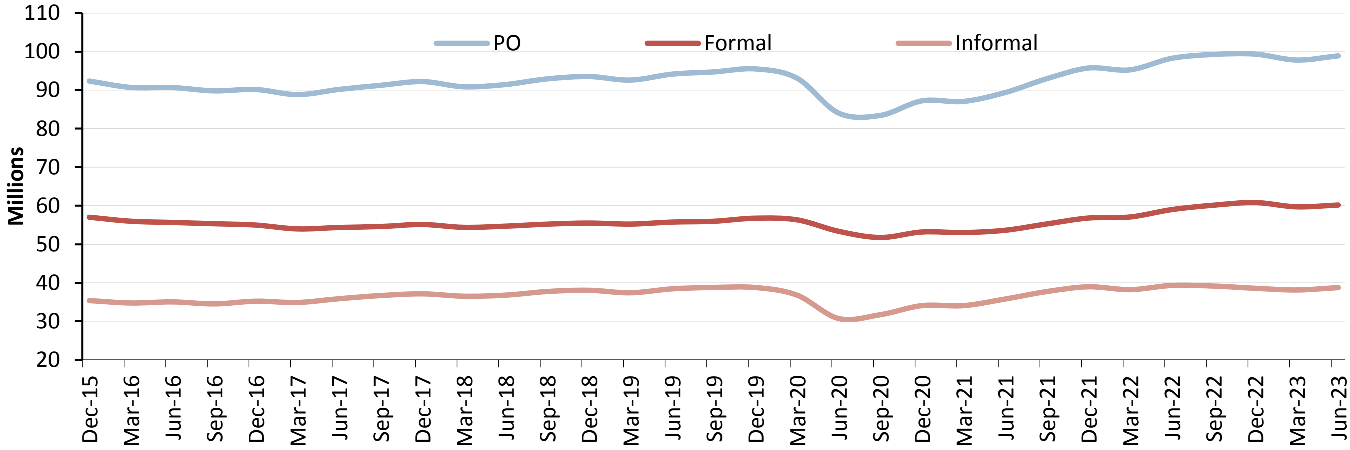
Source: IBGE. Prepared by: IFI.

Of the 98.9 million people employed, 60.2 million were in the formal sector, while 38.7 million, or 39.1%, worked in the informal labor market. Among the 8.6 million unemployed individuals, 5.7 million had been searching for a job

[11] Although the IBGE has already published the monthly PNAD Contínua for August, the quarterly survey (the most recent being for the second quarter of 2023) provides detailed information at the finest level of disaggregation (microdata).

unsuccessfully for less than 1 year, 1.0 million had been in this search for 1 to 2 years, and 2.0 million had been unemployed for more than 2 years.

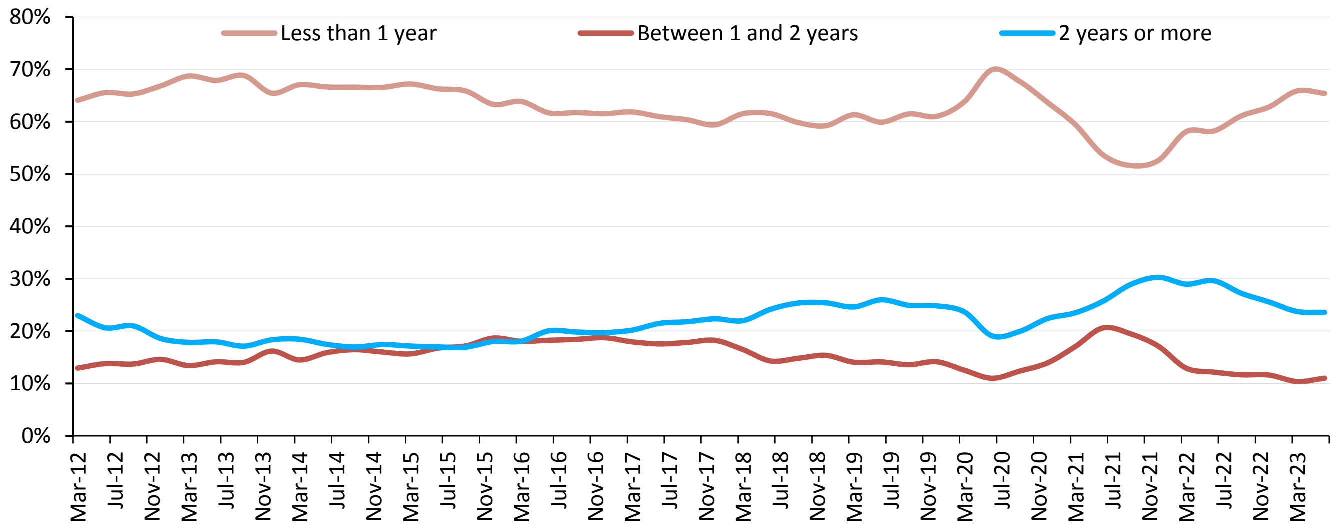
GRAPH 10. NUMBER OF PEOPLE EMPLOYED (PO)



Source: IBGE. Prepared by: IFI.

As for the part of the population that was not included in the labor force, 6.6 million belonged to the potential labor force. This means that they were neither currently employed nor unemployed, but had the potential[12] to become part of the workforce. Within the potential workforce, 3.6 million were classified as discouraged[13]. These people were available for work, but for some reason, they didn't feel encouraged to look for a job. It is important to note that the majority of people out of the labor force, around 60.5 million, were not part of the potential labor force, which indicates weaker ties with the labor market.

GRAPH 11. SHARE OF UNEMPLOYED BY DURATION OF JOB SEARCH



Source: IBGE. Prepared by: IFI.

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[12] See IBGE (2021) for a breakdown of this classification, available at : https://t.ly/snJU2.

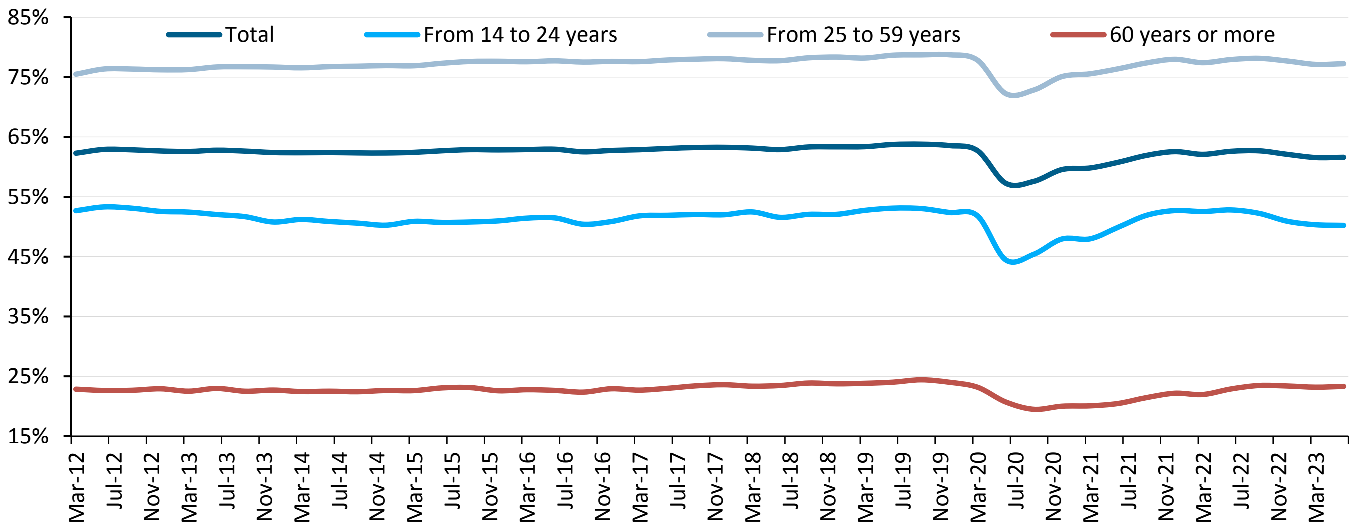
[13] According to the IBGE's definition, following international practices, discouraged individuals are those who, although available for work in the reference week of the survey, did not actively seek employment due to reasons such as not being able to find a suitable job, lacking sufficient work experience or qualifications, not having job opportunities in their residential area, or being considered too young or too old to find employment.

Compared to the second quarter of 2022, the employed population increased by 0.7% to 98.3 million people. This increase in employment was driven by the positive performance of the formal sector[14], which grew by 2.0% in the same comparison. On the other hand, the informal sector fell by 1.4%. It is important to note that job creation in the economy has been slowing down. The accumulated variation in the employed population over four quarters decreased from 7.4% in the fourth quarter of last year to 3.4% in the second quarter of this year. In the formal sector, this variation went from 8.4% to 5.6%, while in the informal sector it fell from 6.0% to 3.0%. While formal employment is above pre-pandemic levels, informal employment is practically at the same level (Graph 10).

Compared to the second quarter of 2022, the number of unemployed people fell by 14.2%, from 10.1 million to 8.6 million. This drop in the total number of unemployed people has been accompanied by a reduction in the average time spent looking for work. Graph 11 shows that the proportion of unemployed people who remain in this situation for more than two years has fallen considerably, from 29.6% of the total unemployed in the second quarter of 2022, which corresponds to 3.0 million people, to 23.6% in the second quarter of 2023 (2.0 million people). This is positive since long-term unemployment undermines the ability to re-enter the job market.

An intriguing issue in the labor market has been the persistence of the participation rate at lower levels than what was observed before the pandemic, especially considering that there has been an increase in labor demand in response to the reopening of the economy. This indicator, which represents the proportion of people in the labor force to the working-age population, increased from 62.3% in the first quarter of 2012 to 63.6% in the fourth quarter of 2019. However, due to the pandemic, the labor market participation rate fell sharply by 6.3 percentage points in June 2020, reaching 57.3%. Subsequently, there was a recovery throughout 2021, when the trend once again turned negative (Graph 12), even with the end of restrictions. In the second quarter of 2023, 61.6% of the population aged 14 and older was in the labor force, which represents stability compared to the first three months of the year, but still 1.0 percentage point below the same period last year and 2.0 percent points below the pre-pandemic level.

GRAPH 12. PARTICIPATION RATE

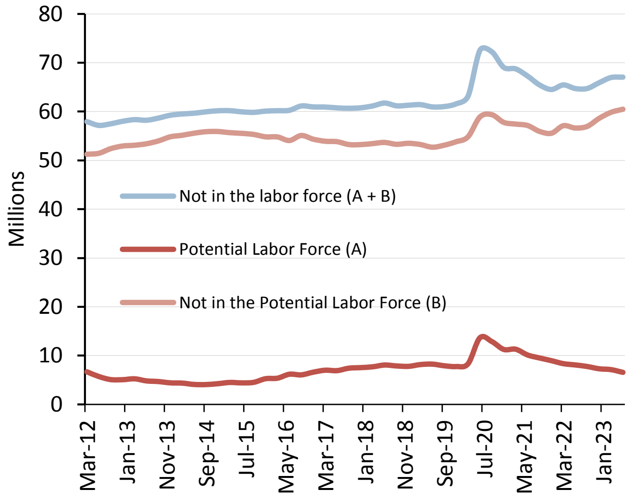


Source: IBGE. Prepared by: IFI.

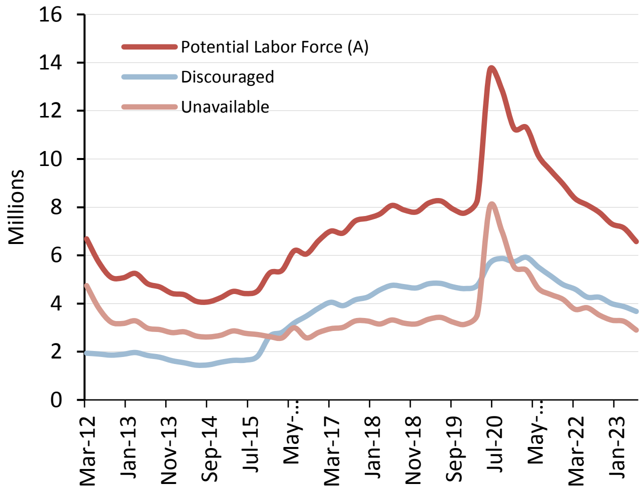
[14] According to the IBGE, the population with formal employment includes the following positions: work with a formal contract in the private and public sectors, military and civil servants, domestic work with a formal contract, employers with a CNPJ [National Register of Legal Entities] and self-employed individuals with a CNPJ.

Data from the PNAD Contínua shows an upward trend in the number of people out of the labor force. This indicator increased significantly in 2020 due to the pandemic, which discouraged active job searchs. Afterward, there was a decrease in 2021, but from mid-2022 onwards it rose again, as shown in Graph 13. In the second quarter of 2023, the population outside the labor force increased by 3.6% compared to the same period of the previous year, standing at 8.9% above the pre-pandemic level.

GRAPH 13. OUTSIDE THE LABOL FORCE



GRAPH 14. POTENTIAL LABOR FORCE

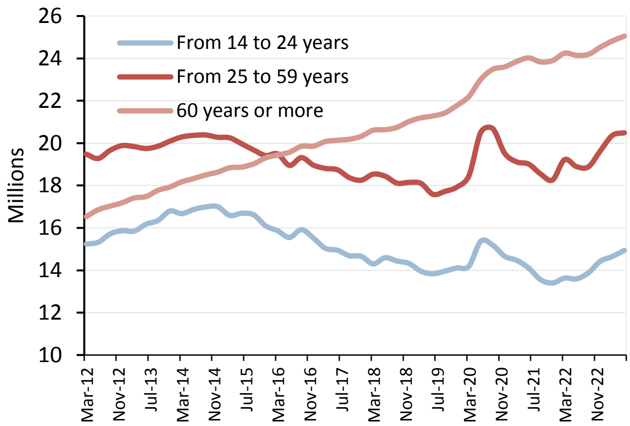


Source: IBGE. Prepared by: IFI.

It is important to note that although there is an increase in total inactivity, this trend reflects different behaviors between people who are part of the potential workforce and those who are not. On the one hand, the potential labor force continues to decrease, which is due to both the reduction in the number of people discouraged from seeking work due to a lack of opportunities and the decrease in the number of people not discouraged or unavailable (Graph 14). This picture is consistent with the expansion in the number of people hired with a formal contract and the shorter duration of unemployment. On the other hand, the trend of reducing the number of people outside the potential labor force, observed in 2021, has been interrupted since then.

Graph 15 shows the number of people outside the potential labor force, broken down by age group. It is noticeable that the expansion observed in the age group of 60 years or older up to the fourth quarter of 2019 intensified during 2020, returning to a pattern similar to what was observed previously. However, the age groups of 15 to 24 years and 25 to 59 years, also affected by the pandemic, started to increase again at the beginning of last year, showing a divergent trend compared to the historical pattern. Since the beginning of the pandemic, there has been an increase of 6.7 million people classified as outside the potential labor force, distributed as follows: 3.3 million are over 60 years old, 2.6 million are in the 25 to 59 age group, and 0.8 million people belong to the 15 to 24 age group.

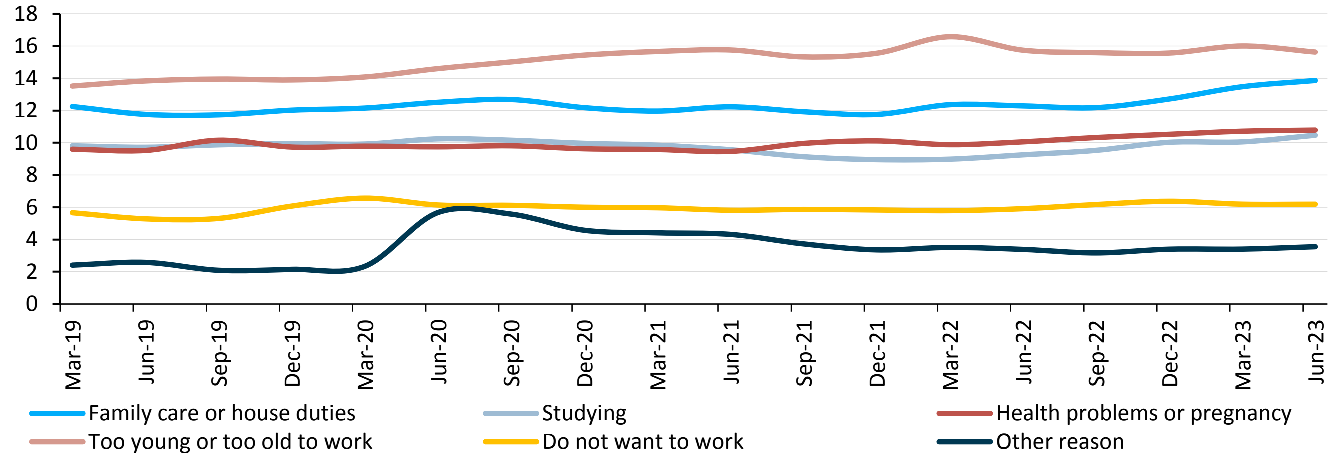
GRAPH 15. NUMBER OF PEOPLE OUTSIDE THE POTENTIAL LABOR FORCE: AGE GROUPS



Source: IBGE. Prepared by: IFI.

The PNAD Contínua microdata allow an analysis of the possible reasons behind the increase in inactivity among the working-age population (Graph 16). The number of people of working age who mentioned, during the survey interview, taking care of domestic and family chores as a reason for their economic inactivity increased by 1.8 million between the fourth quarter of 2019 and the second quarter of 2023. In addition, there was an increase of 1.7 million people citing age as a reason for being inactive, 1.1 million citing health problems or pregnancy, 0.5 million involved in studies, 0.1 million who simply do not want to work, and 1.4 million mentioning other reasons.

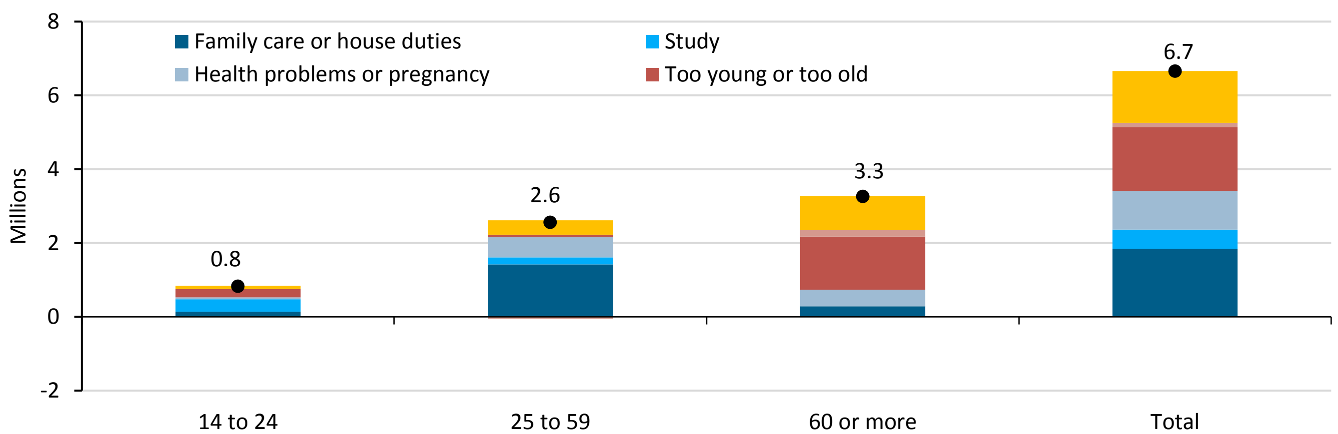
GRAPH 16. NUMBER OF PEOPLE OUTSIDE THE POTENTIAL LABOR FORCE: REASON FOR INACTIVITY



Source: IBGE. Prepared by: IFI.

Graph 17 shows that the increase in inactivity between the fourth quarter of 2019 and the second quarter of 2023 occurred in all three age groups. A portion of those aged between 14 and 24 left the job market to devote themselves to their studies, while those aged between 25 and 59 opted to leave the job market to take on household chores and family responsibilities, or because of health problems or pregnancy. In addition, people aged 60+ have left the workforce due to advancing age and health issues. It is important to note that a considerable portion of the increase in inactivity in all these age groups was associated with other unspecified reasons.

GRAPH 17. CHANGE IN INACTIVITY BETWEEN 4Q/19 AND 2Q/22 BY AGE GROUPS AND REASONS FOR NOT LOOKING FOR A JOB



Source: IBGE. Prepared by: IFI.

The PNAD Contínua reveals a positive scenario in the labor market, characterized by an increase in the population employed in the formal sector and a reduction in long-term unemployment. However, the participation rate remains below pre-pandemic levels, despite the decrease in discouragement favored by improvements in economic conditions, including employment and income. The possibility of labor force participation returning to the levels seen before the pandemic depends on identifying the extent to which the increase in inactivity is due to temporary and cyclical factors that can be reversed, as opposed to more persistent factors.

It is worth noting that in most OECD countries[15], the participation rate has already surpassed pre-COVID-19 levels, with an average increase of 1 percentage point. This indicates that concerns that the pandemic could result in a permanent reduction in engagement in the labor market have not materialized. However, participation rates remain lower than before the crisis in seven member countries, with the biggest declines seen in Latin America, especially Costa Rica, Colombia and Chile.

[15] See "OECD Employment Outlook 2023: Artificial Intelligence and the Labor Market", available at: https://t.ly/VPElN.

IFI projections

SHORT TERM

IFI projections	2023			2024		
	September	October	Comparison	September	October	Comparison
GDP - real growth (% p.a.)	2.97	2.97	=	1.22	1.22	=
GDP - nominal (BRL billion)	10,699.91	10,699.91	=	11,348.79	11,348.79	=
IPCA - accumulated (% in the year)	5.11	5.11	=	3.84	3.84	=
Exchange rate - end of period (BRL/US$)	5.08	5.08	=	5.15	5.15	=
Employment - growth (%)	1.10	1.10	=	0.98	0.98	=
Payroll - growth (%)	5.14	5.14	=	1.28	1.28	=
Selic - end of period (% p.a.)	11.75	11.75	=	9.50	9.50	=
Real interest ex-ante (% p.a.)	6.26	6.26	=	5.33	5.33	=
Consolidated Public Sector Primary Balance (% of GDP)	-1.07	-1.04	▲	-1.04	-0.97	▲
of which Central Government	-0.97	-0.94	▲	-1.24	-1.17	▲
Net Nominal Interest (% of GDP)	6.70	6.72	▲	5.35	5.22	▼
Nominal Result (% of GDP)	-7.77	-7.76	▲	-6.38	-6.18	▲
General Government Gross Debt (% of GDP)	75.83	75.82	▼	78.39	78.19	▼

Angela Silva Brandão (translator);

Elder Loureiro de Barros Correia (translation coordinator).

Federal Senate Translation and Interpretation Service – SETRIN/SGIDOC.

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Independent Fiscal Institution

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