

# FFR

## Fiscal Follow-Up Report

FEBRUARY 22, 2021 • Nº 49

### HIGHLIGHTS

- The projection of GDP growth in the baseline scenario was revised from 2.8% to 3.0% in 2021.
- In the medium term, the average growth of the product is 2.3% and the real interest rate is 3.4% per year.
- A new projection includes BRL 1,333.3bn for the central government net revenue, in 2021, in the baseline scenario.
- As a proportion of GDP, revenues are expected to undergo gradual recovery in the coming years.
- In the baseline and optimistic scenarios, the IFI forecasts the payment, in 2021, of BRL 18.8bn of deferred taxes in 2020.
- The expenditure ceiling is expected to be met in 2021, with moderate risk of noncompliance.
- The baseline scenario includes spending on the emergency aid in the amount of BRL 34.2bn and not subject to the ceiling.
- Primary deficit target of BRL 247.1bn, in 2021, is also expected to be met.
- In the baseline scenario, gross debt is expected to reach 92.7% of GDP in 2021.
- The baseline scenario forecasts continuous growth of the debt/GDP ratio up to 103.4% in 2030.
- New GDP projections reduce the debt trajectories in the three scenarios, but the situation remains very adverse.



## **FEDERAL SENATE**

### **President of the Federal Senate**

Senator Rodrigo Pacheco (DEM-MG)

## **INDEPENDENT FISCAL INSTITUTION**

### **Executive Director**

Felipe Scudeler Salto

### **Directors**

Daniel Veloso Couri

Josué Alfredo Pellegrini

### **Analysts**

Alessandro Ribeiro de Carvalho Casalecchi

Alexandre Augusto Seijas de Andrade

Luiza Muniz Navarro Mesquita

Pedro Henrique Oliveira de Souza

Rafael da Rocha Mendonça Bacciotti

### **Interns**

Maria Vitória da Silva

Vinícius Quintanilha Nunes

### **Report layout**

COMAP/SECOM and SEFPRO/SEGRAF



## Covering Letter

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The IFI presents, on a semiannual basis, reviews of macro-fiscal scenarios. However, due to the pandemic crisis, the institution presented four revisions of scenarios in 2020. In this edition of the Fiscal Follow-up Report (RAF, in the original acronym), a new round of projections is presented.

The Macroeconomic Environment section indicates that the 2021 GDP will grow 3%, from a 4.5% recession estimated for 2020. The evolution of covid-19 keeps high uncertainty about the GDP scenarios. The speed in vaccinating the entire Brazilian population or a relevant percentage of it is the fundamental point to ensure that the recovery can, in fact, happen.

Regarding the spending ceiling, the IFI expects it to be met in 2021, but with a moderate risk of noncompliance. Evidently, the uncertainty is still great, but less than in last November, when the last scenario revision was made. Thus, the risk went from high to moderate. It is important to highlight that the eventual new emergency aid should cost BRL34.2bn and should not be included in the expenses subject to the ceiling, without which the constitutional rule would be breached.

The primary deficit projection for 2021 is to comply with the fiscal target of the Budget Guidelines Law (LDO, in the original acronym), of BRL247.1bn, highlighting the revision of the revenue projection, which should compensate part of the upward effects on the side of the expenses, including expenses with eventual new aid and fighting covid-19, which are outside the ceiling, but affect the primary deficit.

The baseline scenario is based on the maintenance of a policy of not granting salary increases until 2026, even due to inflation, and the granting of real readjustments to the minimum wage only after 2027. Depending on the decisions of the Executive Branch and the National Congress that affect these two issues, the primary deficit and the spending ceiling could be affected.

The general government gross debt, in turn, is expected to reach 92.7% of GDP in 2021, in the baseline scenario, increasing in relation to 2020, when there was an increase of 15 percentage points in relation to 2019. For the next decade, the IFI forecasts a continuous upward trajectory.

In this context, discussions about the medium-term fiscal adjustment and the measures that will be approved to recover the primary surplus and, with it, the conditions for the sustainability of the public debt, become fundamental. The exception period marked by the pandemic crisis has increased public spending and will make it difficult to converge on this goal. The maintenance of fiscal responsibility and the commitment to control spending and/or increase in revenues would facilitate the rebalancing of public accounts.

**Felipe Scudeler Salto**  
*IFI Executive Director*

**Josué Alfredo Pellegrini**  
*IFI Director*

**Daniel Veloso Couri**  
*IFI Director*

## Summary

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- After a contraction estimated at 4.5% in 2020, the Brazilian economy is expected to grow 3.0% in 2021 (0.2 percentage point above the estimate presented in the November report) and 2.6% in 2022. GDP is likely to decline in the first quarter of 2021 (preliminary projection of -0.2% in relation to the previous quarter, in the seasonally adjusted series), impacted by the effects, on the consumption of goods and services, of the second wave of the pandemic and the end of the emergency aid granting period. **(Page 7)**
- From the moment the economy's idleness (measured by the output gap) is eliminated (which should occur at the end of 2024, in the baseline scenario), GDP growth follows potential growth (2.3%) and inflation is projected to stay within the target defined by the National Monetary Council (3.25%). We estimate that the interest rate in real terms will stabilize at around 3.5% per year (average from 2023 to 2030), with the nominal Selic rate rising to approximately 7.0%. **(Page 11)**
- A central hypothesis of the IFI's fiscal scenarios has been changed in the current revision of the projections. Instead of the recovery of revenues, as a proportion of GDP, to take place immediately, starting in 2021, it was assumed that this movement will be carried out gradually, in view of the reduction of some tax bases of the economy, in 2020. Contributing to this perception are (i) the fact that the resumption of economic activity is concentrated in some sectors, such as industry and retail trade, and (ii) the high uncertainties regarding the maintenance of this recovery this year. **(Page 12)**
- The revisions on the projections of fiscal revenues in the horizon from 2021 to 2030 occurred due to factors such as the revision of past GDP values, made by the IBGE, last December, as well as the expectation of a smaller contraction of the economy in 2020, the acceleration of prices in the second half of 2020 and the reduction in the inflation target, by the National Monetary Council, starting in 2023. However, there were no changes in the country's potential GDP, which would lead to more profound changes in the trajectory of fiscal revenues. **(Page 12)**
- The spending ceiling is expected to be met in 2021, and the risk of noncompliance has gone from high to moderate. The uncertainty is still great, but less than in last November, when the last scenario revision was made. Recent trend in social security and personnel expenses and

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Contacts: [ifi@senado.leg.br](mailto:ifi@senado.leg.br) | + 55 (61) 3303-2875

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preliminary execution data in 2021 corroborate a more favorable scenario. Higher inflation in June 2021 contributes to meeting the ceiling in 2022 as well. **(Page 30)**

- The baseline scenario includes spending on emergency aid in the amount of BRL34.2bn. This amount is compatible with a monthly benefit of BRL250.00, granted for four months to 45 million people (including Bolsa Família beneficiaries). In alternative scenarios, with different hypotheses for the program, spending ranges from BRL24.2bn, in the optimistic, to BRL58.7bn, in the pessimistic. In the projections, spending on the emergency aid is not subject to the ceiling. **(Page 25)**
- In the baseline scenario, the projection of the primary deficit for 2021 is compatible with the fulfillment of the fiscal target set in the LDO, of BRL247.1bn. It is worth highlighting the revision of the revenue projection, which is expected to offset part of the upward effects on the expenditure side, including the expenditure with the eventual new aid and the fight against the covid-19 pandemic, which are out of the ceiling but affect the primary deficit. For the coming years, the perspective is to reduce the deficit, which, however, should stay negative until at least 2030. **(Page 34)**
- The growth of the gross debt/GDP ratio over the next ten years indicates that the fiscal challenge is complex and will require fiscal consolidation measures in the post-crisis. The effects of the covid-19 crisis on public accounts were significant and led to an increase in gross debt of around 15 percentage points (pp) of GDP between 2019 and 2020. Even though the observed level by the IFI was better than expected last November, due to the higher nominal GDP, the trend continues to be for a strong increase of the indicator in the baseline and pessimistic scenarios. In the optimistic scenario, it would already be possible to start the decline in indebtedness in relation to GDP in 2022. **(Page 39)**

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Translation team:

Laerte Ferreira Morgado (translator);

Ana Cláudia Sardeiro de Alcântara (editing translator);

Elder Loureiro de Barros Correia (translation coordinator).

Federal Senate Translation Service – SETRIN/SGIDOC

March 5, 2021



 /INSTITUCAOFISCALINDEPENDENTE

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[ifi@senado.leg.br](mailto:ifi@senado.leg.br) / +55 (61) 3303-2875