Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

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HIGHLIGHTS

- Worsening of inflation expectations postpones reduction of the Selic rate.
- Tax increase measures are more likely to materialize.
- Revenues not collected by the RFB boost revenue collection in 2022.
- Primary federal expenses should end 2022 at R$ 1,802.4 billion (18.0% of GDP).
- Transition EC and change in the 2022 LDO contributed to generating room in the 2022 spending ceiling.
- The IFI scenario for primary expenditure in 2023 points to an expansion of 0.7 p.p. of GDP compared to 2022.
- IFI's projection for the primary federal deficit is 1.1% of GDP in 2023.
- Recurrent primary expenditure increased by 7.8% in 2022 (real terms).
- Gross debt is expected to close in 2023 at 77.8% of GDP, up 3.6 p.p. of GDP.

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REPORT LAYOUT
COMAP/SECOM and SEFPRO/SEGRAF

Covering letter

Government begins to detail how it will finance expansion prompted by the Transition PEC

The Fiscal Follow-up Report (RAF) is the IFI's monthly economic analysis and serves the purposes of Article 1 of Senate Resolution no. 42 of 2016. In the RAF, the IFI publishes its projections for the Brazilian economy's main macroeconomic and fiscal variables.

In past issues of the RAF, the IFI highlighted the need to advance in defining how the government intends to finance the fiscal expansion promoted by the Transition PEC, converted in December into Constitutional Amendment no. 126 (EC 126). In the absence of compensatory measures, the most likely scenario is a continuous increase in debt and fiscal risk. In the November RAF, our projection for the general government's gross debt in 2031 reached 95.3% of GDP.

The announcement of measures by the Ministry of Finance on January 12 reduces the uncertainty surrounding the financing of the increase in spending promoted by EC 126 and indicates that tax collection will play a significant role in the recovery of fiscal balance in the coming years. Among the actions listed are some low-hanging fruits, such as the return of the collection of PIS-Pasep/Cofins on gasoline and ethanol and the financial income of non-financial institutions. Most, however, will need to be put in motion before their potential effect can be seen, such as the incentive to reduce litigation in the CARF, the collegiate body responsible for administrative judgment in tax and customs matters.

The doubts about the fiscal impact were acknowledged by the Minister of Finance himself. On the day of the presentation, although the numbers showed the possibility of obtaining a primary surplus in 2023, he indicated that the most realistic projection would be a deficit of around 0.5% to 1.0% of GDP.

On the expenditure side, two measures were announced, whose savings would total R$ 50.0 billion. The government expects a permanent reduction of R$25.0 billion in primary expenses with the revision of contracts and programs. In this respect, the promised adoption of the spending review, an instrument used by other countries to incorporate the evaluation of public policies into the budget process, may help. It is also worth remembering that recent analyses suggest that many beneficiaries of Brazil Aid do not meet the legal criteria of the program. Besides the contracts and programs review, R$ 25.0 billion would be obtained through savings in the budget execution, a measure that still needs more detail.

Despite the uncertainty about the actual savings to be generated by the announced actions in the expenditure area, the IFI scenario for primary expenditure already contemplates, in part, its possible effects. The main differences between the 2023 LOA and the IFI projection are the volume of discretionary spending and payroll.

As highlighted in December, the macroeconomic context is challenging. The restrictive effects of monetary policy and the moderating growth of the global economy continue to indicate a slowdown of the domestic economy in 2023 (projection maintained at 0.9%). The central government – which, according to IFI accounts, closed 2022 with a primary surplus of 0.5% of GDP – will register a deficit in 2023 (1.1%).

The general government's gross debt should reach 74.1% of the GDP, accumulating a drop of 4.2 pp of the GDP in 2022. The consolidated public sector should register a primary surplus of 2.5% of the GDP in 2023 to stabilize it, far from the current deficit projection of 1.3%. In our scenario, the gross debt at the end of 2023 should reach 77.8% of the GDP, remaining high compared to other emerging economies.

The need for a new regulatory framework for public accounts remains and goes beyond a fiscal rule. Instruments such as the spending review and medium-term expenditure frameworks (MTEF) are essential for better fiscal governance. In this broader perspective, the role of the IFI is also worth highlighting in safeguarding the fiscal management of the Executive and Legislative branches.

Daniel Veloso Couri
IFI Executive Director

Vilma da Conceição Pinto
IFI Director

Summary

- The IPCA ended 2022 at 5.8%, influenced by fuel tax cuts. Expectations for the IPCA in 2023 and 2024 continue to rise, which limits the space for interest rate cuts. The Focus survey also shows an increase in the projections for 2025, possibly capturing the increase in fiscal risk. For the time being, we assess the postponement of the start and the reduction of the magnitude of the interest rate reduction cycle as the most likely scenario. **(Page 9)**

- Among the measures announced by the Ministry of Finance, IFI considers that the most likely to materialize revenues are those that increase taxes, such as PIS/Cofins levy on fuels and the transfer of funds (PIS-Pasep to the Treasury). Some measures can be considered uncertain given the existence of issues that may hinder the realization of revenues, such as the possibility of litigation. **(Page 11)**

- Of the 1.4 pp of GDP growth of the central government's primary revenue in 2022, the revenues not collected by the Federal Revenue Office (RFB) accounted for 0.8 pp Collections from dividends, concessions, and exploitation of natural resources drove this gain. As discussed in past issues of RAF, the importance of oil revenues is expected to grow in the coming years, in line with the expected growth of national production. **(Page 14)**

- The 2023 Budget Law was approved with a R$ 231.6 billion deficit forecast. EC no. 126 of 2022 (Transition EC) allowed the expansion of primary expenditures without a discussion about its sources of financing. Now, after the fiscal adjustment measures announced by the Ministry of Finance on January 12, we can see the viability of a fiscal deficit lower than the one foreseen in the budget. In part, the IFI's scenario for primary expenditures in 2023 contemplates some effects of the fiscal adjustment actions, mainly in the scope of discretionary spending. **(Page 26)**

- The Central Government's primary balance is expected to register its first surplus since 2014. According to the data officially released by the National Treasury Secretariat (January to November) and the anticipation made by the IFI for December, the Union's primary balance for 2022 should show a surplus of R$ 49.3 billion (0.5% of GDP). **(Page 28)**

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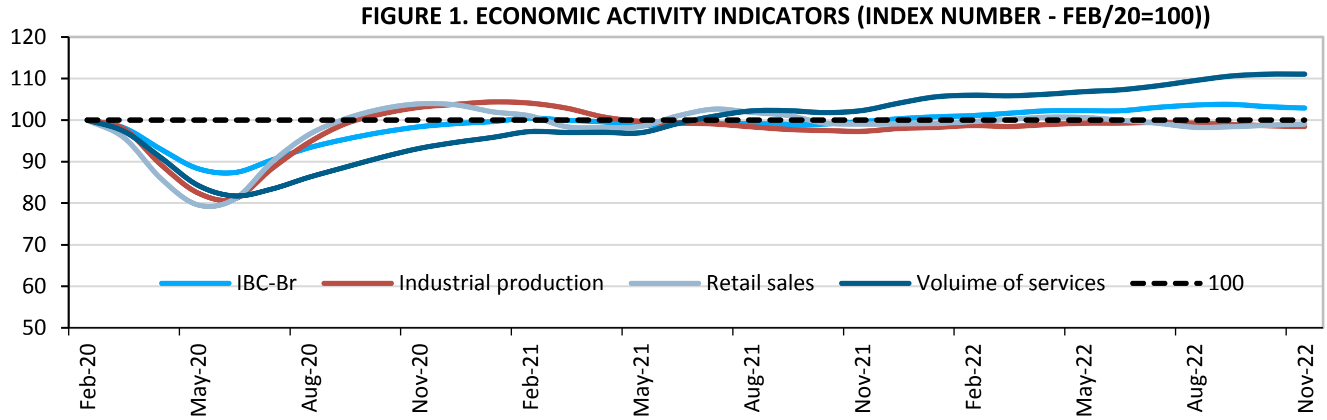
1. MACROECONOMIC CONTEXT

1.1 Short-term forecasts

1.1.1 Economic activity

Economic activity slowdown. The November activity data showed a contraction in the level of industry and retail – which remain below pre-pandemic levels – and accommodation of services at a level significantly higher than in February 2020 (Figure 1). Compared with October, industrial production and retail sales fell by 0.1% and 0.6% after seasonal adjustment, while the revenue volume of the service sector remained stable. The Central Bank's Economic Activity Index (IBC-Br), which aggregates information from GDP sectors on the supply side, fell by 0.5% in the same comparison, leaving a carry-over of -1.1% for the fourth quarter.

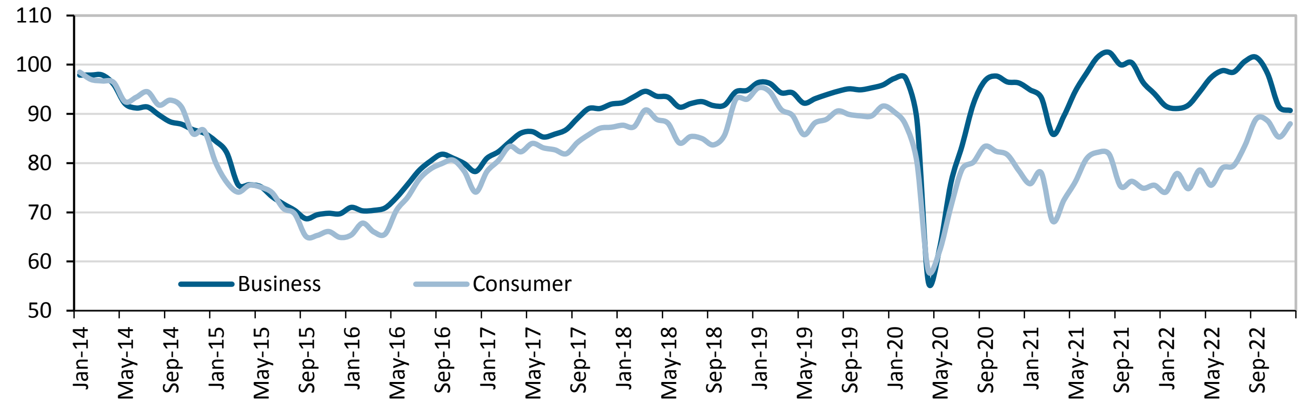
FIGURE 1. ECONOMIC ACTIVITY INDICATORS (INDEX NUMBER - FEB/20=100))



Source: IBGE and IFI. Prepared by: IFI.

GDP is expected to decline in the fourth quarter. Data available for December brought mixed signals, with a reduction in business confidence and the Industry Installed Capacity Usage Level (Nuci), a slowdown in the pace of formal job generation, and an increase in consumer confidence, which recovered some of the losses seen in recent months (Figure 2). IFI projects that GDP will decline by 0.4% in the fourth quarter compared to the immediately preceding period, after seasonal adjustment, after having increased by 1.0% and 0.4% in the second and third quarters, respectively. With these quarterly dynamics, the expectation for the variation of GDP in 2022 (in real terms) remains at 3.0%.

FIGURE 2. CONFIDENCE INDEXES (SEASONALLY ADJUSTED)



Source: FGV: Prepared by: IFI.

The projection for GDP in 2023 and 2024 contemplates growth of 0.9% and 1.6%. Despite the expansion of disposable income (benefiting from the increase in the minimum wage and the continuation of social transfer programs), the restrictive effects of domestic monetary policy on domestic demand and the moderation of global economic growth contribute to the expected slowdown of the economy in 2023 (projection maintained at 0.9%). For 2024, an additional increase of 1.6% is expected due to the marginal improvement expected for household consumption. The contribution of domestic demand to the economy's growth in 2022, 2023, and 2024 is estimated at 2.7 percentage points (pp), 1.1 pp, and 1.5 pp, respectively. In turn, the importance of net exports (external demand) should decrease between 2022 and 2023 (from 0.4 pp to -0.3 pp), estimated at 0.1 pp in 2024, given the prospect of accelerated exports of goods and services.

TABLE 1. GDP VOLUME GROWTH FORECAST

	2021	2022	2023	2024
Volume GDP and demand-side components (% growth)	**5.0%**	**3.0%**	**0.9%**	**1.6%**
Household consumption	3.7%	4.0%	1.0%	1.7%
Government consumption	3.5%	1.4%	1.0%	1.0%
Gross fixed capital formation	16.5%	1.0%	1.5%	1.0%
Exports	5.9%	4.0%	1.8%	3.0%
Imports	12.0%	2.0%	3.0%	2.5%
Contributions to the GDP volume growth (pp)				
Domestic demand	**5.9**	**2.7**	**1.1**	**1.5**
Household consumption	2.4	2.6	0.7	1.1
Government consumption	0.7	0.3	0.2	0.2
Investment (GFCF and changes in inventories)	2.8	-0.1	0.3	0.2
Net exports	**-0.9**	**0.4**	**-0.3**	**0.1**

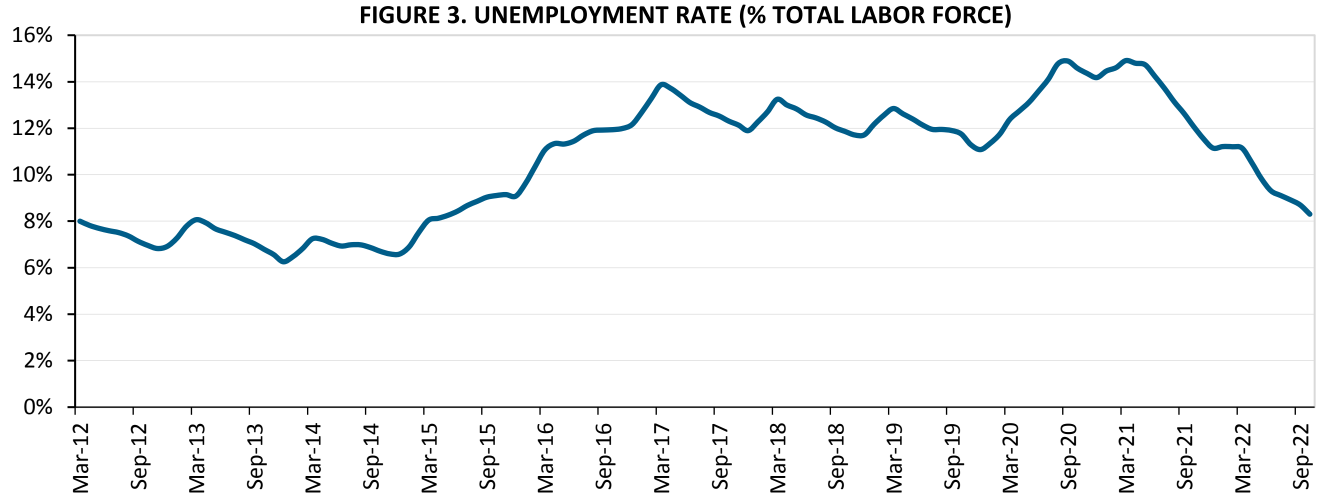
Source IBGE. Prepared by: IFI.

1.1.2 Labor market

The labor market is showing signs of cooling down. The October data[1] from the Continuous National Household Sample Survey (PNAD Continuous) showed a still positive labor market dynamic, marked by expanding the employed population and incomes. The unemployment rate has decreased (from 12.1% in October 2021 to 8.3% in October 2022), favored by more moderate growth in the labor force. The employed population (99.7 million people) increased by 6.1% compared to the same period the previous year, below the variation recorded in September (6.8%), while the labor force (108.7 million people) increased by 1.7% (compared to 2.2%). Although positive, the generation of jobs has been occurring at a slower pace in recent months.

[1] According to IBGE, the November edition of PNAD Continuous was postponed due to the delay in collecting the 2022 Demographic Census. The November update will take place on 19 January.

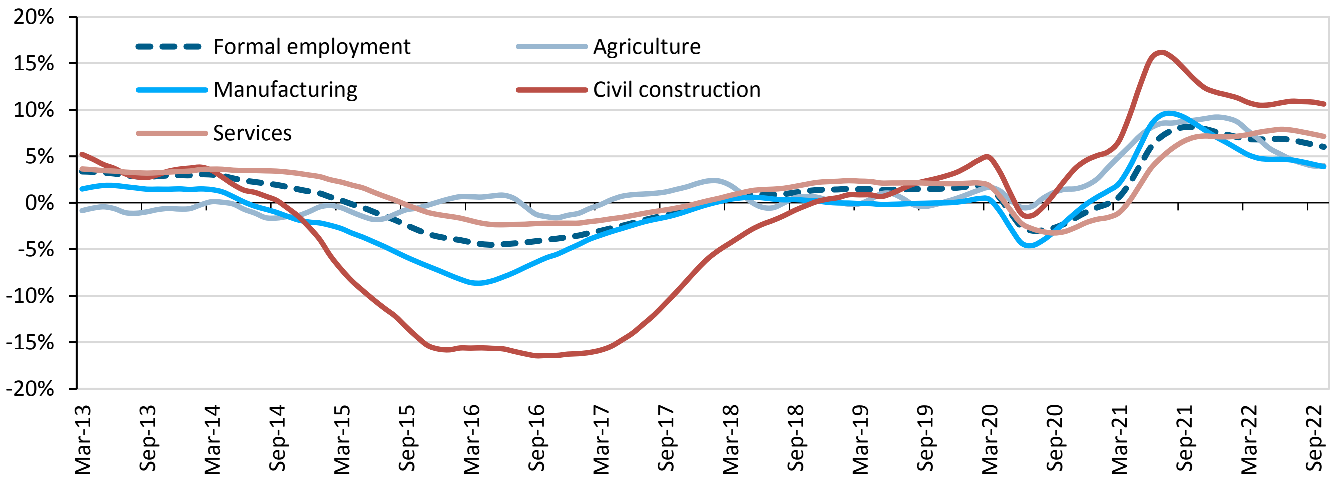
FIGURE 3. UNEMPLOYMENT RATE (% TOTAL LABOR FORCE)



Source: IBGE and IFI. Prepared by: IFI.

The slowdown in formal employment is observed in the main sectors of activity. The generation of formal jobs has also been slowing down in the same comparison with the same period of the previous year (Figure 4). In the quarter ending in November, according to the General Registry of Employed and Unemployed Persons (Caged), the stock of formal workers increased by 5.7% compared to the same period in 2021 (compared to 6.0% in the quarter ending in October). The more moderate pace of employment with a signed card has been occurring in the main sectors of activity, with a focus on agriculture (4.1% in November) and the manufacturing industry (3.6%), with lower variations compared to construction (10.1%) and services (6.8%). It is expected that the labor market's recovery will weaken in the coming months following the trajectory of cooling underway economic activity. It is estimated that the average unemployment rate will reach 9.4% in 2022, rising to 9.8% in 2023 and 9.9% in 2024.

FIGURE 4. FORMAL EMPLOYMENT (YEAR-ON-YEAR CHANGE)

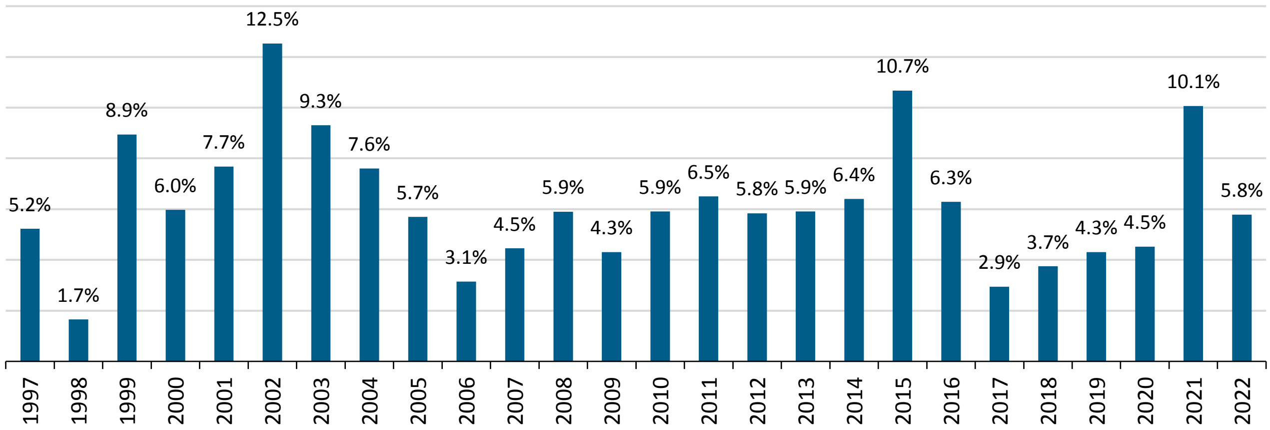


Fonte: Ministry of Labor and Social Security. Prepared by: IFI.

1.1.3 Inflation and monetary policy

IPCA ended 2022 at 5.8%, above the upper limit of the target. Consumer inflation in December, measured by the IPCA, was 0.62%, above the rate recorded in the previous month (0.41%). The accumulated variation in twelve months went from 5.9% in November to 5.8% in December (below the December 2021 result: 10.1%). However, it remained above the upper limit of the inflation target tolerance range of 1.5 pp around the inflation target (3.5%) established by the National Monetary Council (CMN) for 2022.

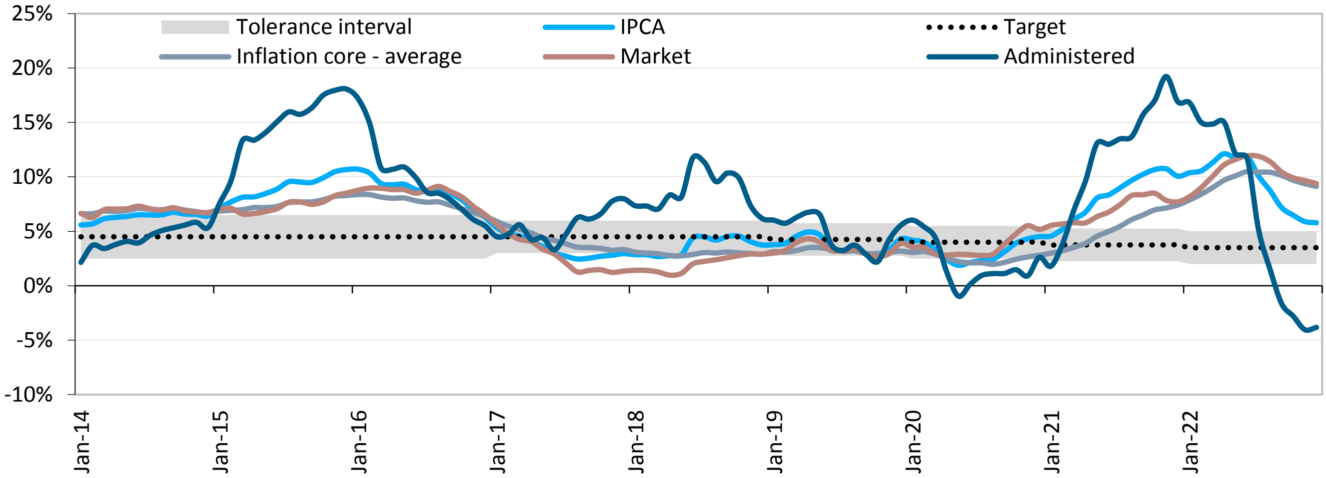
FIGURE 5. IPCA ANNUAL CHANGE



Source: IBGE. Prepared by: IFI.

In twelve months, while administered prices fell by 3.9% (mainly following the performance of gasoline and electricity: -25.8% and -19.0%, respectively), free prices increased by 9.4%, with pressures from food at home (13.2%), industrial goods (9.6%) and services (7.6%). In twelve months, the average of the inflation cores followed by the Central Bank – measures that seek to remove the influence of more volatile items from total inflation – also exceeded the target limit, slowing from 9.4% in November to 9.1% in December (Figure 6).

FIGURE 6. IPCA, INFLATION TARGET, AND TOLERANCE INTERVAL (% 12 MONTHS)



Source: IBGE and Central Bank: Prepared by: IFI

Inertia from the previous year was the main factor for the deviation of inflation from the target. After releasing last year's inflation results, the Central Bank published an open letter[2] to the Minister of Finance (President of the CMN) detailing why the IPCA exceeded the target in 2022 by 2.3 pp. According to the document, the factors that led inflation in 2022 to exceed the upper tolerance limit were: i) inflationary inertia; ii) the increase in commodity prices, especially oil; iii) imbalances between demand and supply of inputs and bottlenecks in global production chains; iv) price shocks affected by climatic issues; and v) the recovery in service demand and employment, reflecting the reduction of Covid-19 cases and increased mobility. IPCA in 2022 was lower due to tax cuts.

In turn, the reasons that acted in the opposite direction, reducing the deviation of inflation from the target, were i) the reduction in taxes on fuels, electricity, and telecommunications; ii) the behavior of the electricity flag, which went from water scarcity to green flag; iii) the exchange rate appreciation; and iv) the persistence of the product gap in the negative field.

The projection for the IPCA in 2023 rose from 4.7% to 5.3%. The government renewed the exemption of PIS/Cofins and Cide on gasoline and alcohol for two more months (until February 28) through Provisional Presidential Decree 1,157/2023. From then on, we consider the end of federal tax exemptions in the base scenario, with an estimated impact on the IPCA of 0.5 pp. The discussion around the increase in ICMS tax[3] on gasoline and alcohol (whose rates were reduced with Supplementary 194/2022, which began to consider fuels, telecommunications, and electricity as essential goods) would put an upward bias on the projection of IPCA 2023, revised from 4.7% to 5.3%. For 2024, the forecast for the IPCA is 3.7%.

Inflation expectations for 2023 and 2024 are above the target (3.25% and 3.0%, respectively). Among the agents who registered their projections in the Central Bank's Focus Bulletin, the average for the IPCA variation in 2023 reached 5.4% on January 16 (a one-standard deviation range between 4.9% and 5.8%). The Focus survey also maintained upward adjustments in inflation expectations in the 2024 horizon, reaching 4.3%. The Central Bank's inflation target for 2023 and 2024 is 3.75% and 3.5%, respectively. The inflationary inertia, as well as the effect on risk premium and exchange rate due to uncertainties related to the sustainability of the public debt trajectory (in a scenario of fiscal stimulus and

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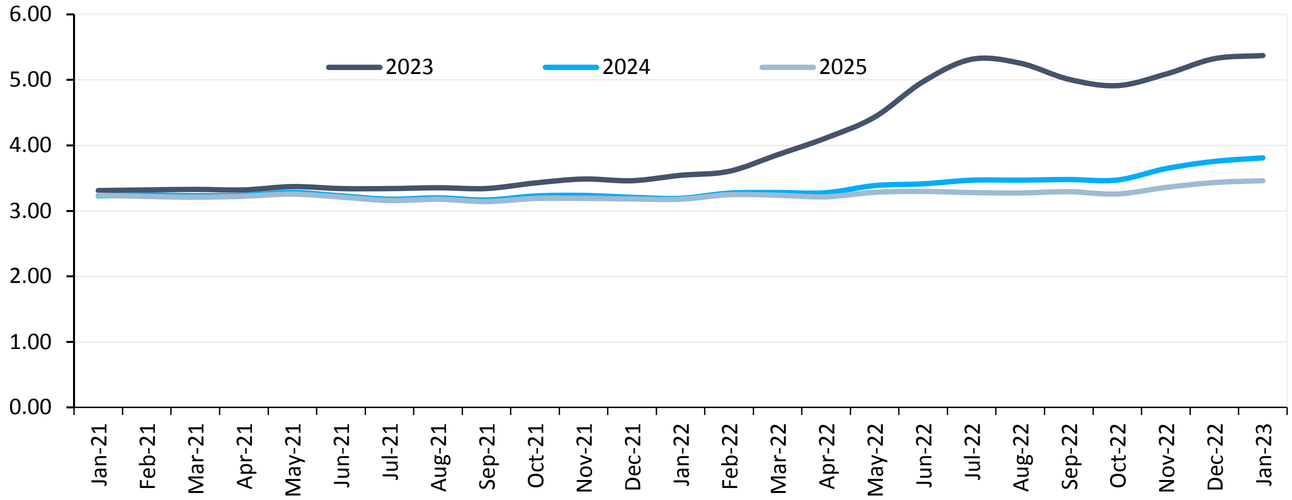
[2] Available at: https://www.bcb.gov.br/detalhenoticia/17814/nota
[3] See the report in Valor Econômico: https://valor.globo.com/brasil/coluna/entre-a-receita-de-icms-e-a-inflacao.ghtml

uncertainty about the design of the new fiscal framework), may be contributing to the maintenance of expectations at higher levels.

FIGURE 7. FOCUS SURVEY- IPCA (2023, 2024 E 2025)



Source: Central Bank: Prepared by: IFI

The IFI scenario envisages that the Selic rate will remain at 13.75% p.a. until mid-2023, falling to 12.0% p.a. by the end of the year (revised from 11.5% p.a.). At its last meeting in 2022, the Monetary Policy Committee (Copom) stated that it would evaluate whether the strategy of maintaining the base interest rate at 13.75% p.a. for an extended period will be sufficient to bring inflation to the target, emphasizing that it will monitor the development of the fiscal situation and its impacts on the level of prices. The increase in projections for the IPCA in the relevant horizon (which includes the years 2023 and 2024) tends to limit the existing space for interest rate reduction made possible by the ongoing disinflation process (seen, for example, in the trajectory of free prices and the average of inflation cores). For this reason, we have adjusted our outlook for the Selic rate in 2023 from 11.5% p.a. to 12.0% p.a. For 2024, the projection for the base interest rate is 9.5% p.a. We evaluate as the most likely scenario the postponing of the start and the reduction of the magnitude of the interest rate reduction cycle, monitoring, in any case, the evolution of expectations and the balance of risks and the communication of the Central Bank.

2. FISCAL SCENARIO

2.1 Considerations on measures for fiscal recovery

This first section of the Fiscal Scenario analyzes the measures announced by the Ministry of Finance on January 12 to reduce the central government's primary deficit projection (R$ 231.6 billion, or 2.2% of GDP) stated in the 2023 Budget Law (LOA 2023)[4].

In general terms, the actions intended by the Executive Branch are concentrated on the tax collection side and involve: (i) tax increases; (ii) changes in the form of calculation of the use of ICMS credits to reduce tax compensations practiced by taxpayers; (iii) transfer of resources from the PIS/Pasep accounts to the Treasury; (iv) changes in procedures for

[4] A page for the content of the measures is available at: https://www.gov.br/fazenda/pt-br/assuntos/noticias/2023/janeiro/fernando-haddad-apresenta-conjunto-de-medidas-para-recuperacao-fiscal.

administrative trials of tax issues; (v) measures to encourage taxpayers to settle debts with the tax authorities; and (vi) use of new revenue projection parameters, which raised the level of this variable in 2023.

On the expenditure side, the intended actions involve the renegotiation of contracts and authorization to execute expenditures in lower amounts than those stipulated in the LOA 2023.

Also, the primary balance after the actions would become positive in R$ 11.1 billion, or 0.1% of GDP in the best-case scenario, and a deficit of R$ 104 billion (1.0%) if all the measures did not materialize (statement made by the Minister of Finance during the press conference). For comparison, in December 2022, the IFI projected a primary deficit of R$ 88.6 billion (0.8% of GDP) for 2023, contemplating lower spending execution than the potential enabled by the Constitutional Amendment (EC) no. 126, of December 21, 2022, derived from the Constitutional Amendment Bill (PEC) no. 32, of 2022, known as the Transition PEC.

Table 2 presents the list of announced measures, a qualitative evaluation regarding the feasibility of contributing to the primary budget of the central government, and the values considered by the IFI to change the projections of fiscal variables.

TABLE 2. DESCRIPTION AND EVALUATION OF IMPACT MEASURES ON THE CENTRAL GOVERNMENT'S PRIMARY BALANCE

Measure	Impact announced by the Ministry of Finance (R$ billion)		Value considered for IFI forecasting purposes		Qualitative evaluation
	2023	2024	2023	2024	
Central government primary deficit included in the LOA 2023	**-231.6**				
Extraordinary revenue shares	**73.0**	-	**23.0**		
Revenue from the transfer of PIS/Pasep resources to the Treasury	23.0	-	23.0		Feasible
Extraordinary incentive to reduce litigation in Carf	35.0	-	-		Uncertain
Extraordinary incentive for spontaneous denunciation	15.0	-	-		Uncertain
Permanent revenue actions	**83.3**	**120.9**	**33.3**	**60.5**	
Use of credits from the ICMS	30.0	39.8	-	-	Uncertain
PIS and Cofins on financial revenue	4.4	6.0	4.4	6.0	Feasible
Return of PIS/Cofins on fuels	28.9	54.5	28.9	54.5	Feasible
Permanent effect of the incentive to reduce litigation in the Carf	15.0	15.5	-	-	Uncertain
Permanent effect of the incentive to spontaneous denunciation	5.0	5.2	-	-	Uncertain
Re-estimation of revenues	**36.4**	**37.5**	-	-	
Expenditure reduction actions	**50.0**	**26.6**	-	-	
Permanent effect of contract and program reviews	25.0	26.6	-	-	Uncertain
Execution lower than authorized in the 2023 LOA	25.0	-	-	-	Feasible
Net effect on primary balance	**142.7**	**131.9**	**56.3**	**60.5**	
Final primary balance	**11.1**				

Source: Ministry of Finance. Prepared by: IFI.

Measures that are more likely to materialize are those that increase taxes. From the actions listed by the Ministry of Finance, those that will probably positively affect the primary balance (considered feasible by the IFI) are those that increase taxes, such as the return of the collection of PIS-Pasep/Cofins on gasoline and ethanol and the regulation of a new calculation method in the mechanism of using PIS/Cofins credits by companies due to the removal of ICMS from the calculation base of these taxes.

According to the classification adopted by the Ministry of Finance, among the extraordinary revenue actions (with impact only in 2023), the IFI incorporated in the projection of revenues collected by the RFB for 2023 only the transfer of R$ 23.0 billion from the PIS/Pasep accounts to the Treasury.

There are uncertainties regarding the materialization of some actions in collections. The IFI considers the incentive to reduce litigation in the Carf, in the amount of R$ 35.0 billion, an uncertain effort due to uncertainties regarding parameters such as the taxpayers' adhesion and the amounts received by the tax authorities after this adhesion.

Another uncertainty associated with this type of tax debt refinancing arises from the moral hazard associated with the measure, in which agents stop paying taxes at a certain point, waiting for the government to issue a new installment payment program. The incentive to voluntary disclosure (R$ 15.0 billion) can also be considered uncertain given the unprecedented nature of the measure and the absence of other parameters to estimate this revenue.

Among the actions classified by the Ministry of Finance as being permanent, the IFI considers the change in the tax compensations with the removal of the ICMS from the PIS/Cofins tax base to be an uncertain measure due to factors that may hinder the materialization of this collection, such as, for example, the judicialization by the affected actors. For this reason, we opted to leave this amount out of the update of the revenue estimates.

The measures that involve the collection of PIS/Cofins on fuels and the financial income of companies were fully considered for the revenue estimates purposes, even considering other issues concerning the topic, such as the impact of the return of the collection on inflation, which may affect the implementation of the action by the Ministry of Finance.

In the context of primary expenses, the measures correspond to a review of these expenses. The first measure aims to evaluate unprocessed outstanding liabilities, whose stock registered for 2023 was R$ 173.4 billion. Another action corresponds to reviewing contracts and programs, including the possibility of executing expenses in lower amounts than authorized in the budget proposal.

Despite the uncertainties about the feasibility of executing expenses at a volume lower than authorized in the budget, and in case this issue is overcome, the IFI considers that the execution of primary expenses in an amount lower than that forecast in the budget is feasible, since the volume of primary expenses, especially discretionary expenses, has shown a significant increase in the budget approved for this year, mainly due to EC no. 126, of 2022.

The uncertainties regarding the viability of the measure stem from a change made in article 165 of the Constitution through ECs no. 100 and 102, both of 2019, which included paragraphs 10, 11, and 13 in article 165 of the Constitution, "establishing for the administration the duty to execute the discretionary primary programming of the fiscal and social security budgets, to ensure the effective delivery of goods and services to society." (Letter SEI no. 4,878/2022/ME)

According to Letter no. 4,878, of December 13, 2022, from the Ministry of Economy: "according to paragraph 11 of art. 165, the duty of execution, under the Budget Guidelines Law: is subject to compliance with constitutional and legal provisions that establish fiscal targets or spending limits; does not prevent the cancellation necessary for the opening of additional credits; and does not apply in cases of technical impediments duly justified."[5]

As for the revision of contracts and programs, qualitatively, the IFI considers the measure uncertain, especially for the volume of resources expected to be adjusted with the action.

Before closing this subsection, it is worth noting that the values considered by the IFI to review the central government revenue in 2023 and 2024 take into account the information updated to date, as well as the respective legal frameworks, and may change in the coming months. The IFI's new projections for fiscal variables for this and next year will be detailed later in this text.

2.2 Primary revenues and transfers

Union primary revenue reached 23.1% of GDP in 2022. According to data collected by the IFI in the portal Siga Brasil of the Federal Senate and reported in Table 3, the central government's total primary revenue (federal government,

[5] Letter SEI no. 4878/2022/ME. Available at: https://www1.siop.planejamento.gov.br/siopdoc/lib/exe/fetch.php/acompanhamento_despesas_discricionarias:sei_30227440_oficio_circular_4878.pdf.

Central Bank and INSS) was R$ 2,311.5 billion (23.1% of GDP) in 2022, a real increase of 9.6% compared to 2021 (revenue of R$ 1,932.6 billion or 21.7% of GDP).

Revenues not collected by the Federal Revenue Office (RFB) exerted the most significant influence on the increase in revenue last year. The growth of 1.4 pp of GDP in the Federal Government's primary revenue previous year can be broken down as follows: (i) 0.5 pp of GDP coming from revenues collected by the RFB; (ii) 0.2 pp of GDP coming from the net collection for the RGPS; and (iii) 0.8 pp of GDP coming from revenues not collected by the RFB. This increase in revenues not collected by the RFB will be better explored later in this text.

The transfers by revenue sharing also registered a robust increase last year, rising from 4.0% of GDP in 2021 to 4.6% in 2022. This performance was due to the substantial rise in Income Tax (I.R.) collections, a tax shared by the Union with the subnational entities. Among the taxes administered by the RFB, the Income Tax had the second most significant expansion in 2022, 17.8% in real terms.

Net primary revenue grew 7.6% in real terms in 2022. The central government's net revenue rose 0.8 pp of GDP in 2022 compared to the previous year (a real increase of 7.6% to R$ 1,854.1 billion), discounting the 0.6 pp of GDP increase in transfers from the 1.4 pp of GDP increase in total primary revenue.

Table 3 also displays the information about total and net recurrent primary revenues (free of the influence of non-recurrent factors) for the central government, which rose 1.5 pp of GDP and 0.9 pp of GDP, respectively, in 2022, in line with conventional primary revenues.

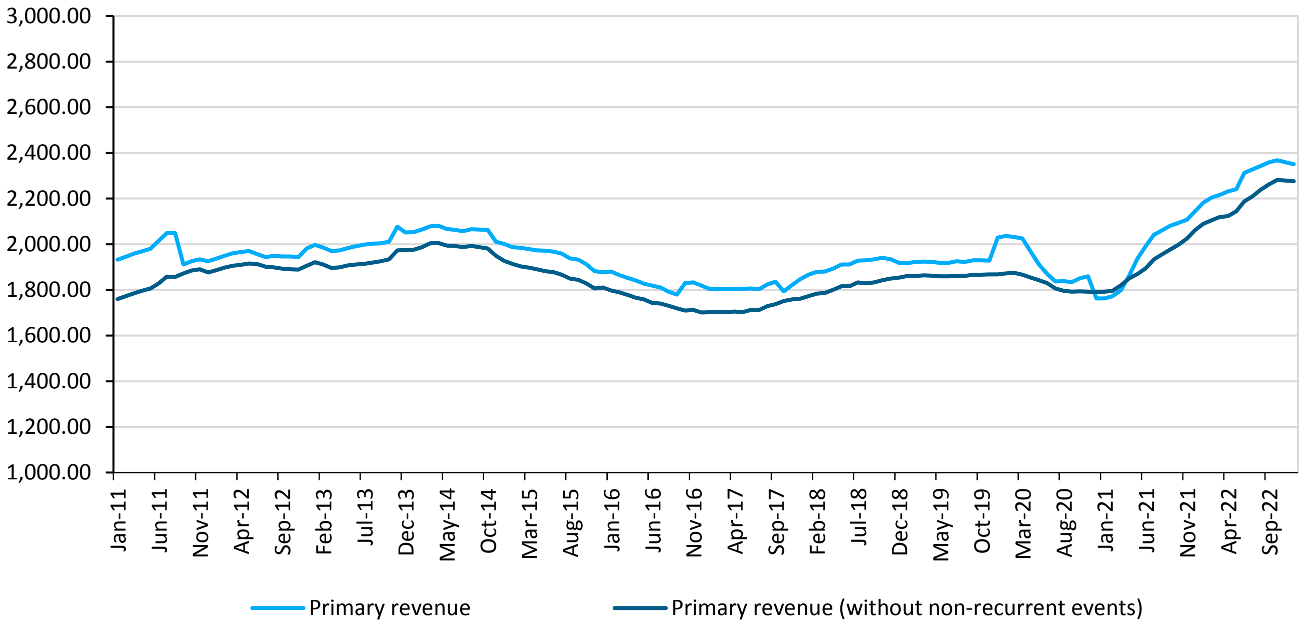
TABLE 3. CENTRAL GOVERNMENT REVENUES – 2020 TO 2022 – JAN. TO DEC. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

	Jan-Dec/20			Jan-Dec/21			Jan-Dec/21		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total revenue	**1,468.1**	**-13.1%**	**0.2**	**1,932.6**	**21.6%**	**0.2**	**2,311.5**	**9.6%**	**0.2**
Revenues Collected by RFB, except RGPS	*899.5*	*-8.1%*	*0.1*	*1,195.7*	*22.9%*	*0.1*	*1,390.5*	*6.5%*	*0.1*
Fiscal incentives	*-0.1*	*-*	*0.0*	*-0.2*	*-*	*0.0*	*-0.1*	*-*	*0.0*
RGPS	*404.8*	*-5.3%*	*0.1*	*462.2*	*5.4%*	*0.1*	*534.3*	*6.0%*	*0.1*
Revenues not Collected by RFB	*163.9*	*-42.2%*	*0.0*	*274.9*	*54.3%*	*0.0*	*386.8*	*29.1%*	*0.0*
Transfers	**263.8**	**-11.4%**	**0.0**	**353.5**	**23.7%**	**0.0**	**458.6**	**18.8%**	**0.0**
Net revenue	**1,204.3**	**-13.5%**	**0.2**	**1,579.1**	**21.1%**	**0.2**	**1,853.0**	**7.6%**	**0.2**
Total revenue without non-recurrent event*	**1,489.6**	**-4.1%**	**0.2**	**1,858.2**	**15.1%**	**0.2**	**2,238.1**	**10.4%**	**0.2**
Net revenue without non-recurrent event *	**1,225.8**	**-3.3%**	**0.2**	**1,504.6**	**13.3%**	**0.2**	**1,779.6**	**8.4%**	**0.2**
GDP (R$ billion)			**7,609.6**			**8,898.7**			**9,990.0**

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

In November and December, there was relative accommodation in primary revenue. Figure 8 shows the evolution, since 2011, of the central government's conventional and recurrent primary revenues at constant December 2022 prices. For comparison purposes, the recurrent primary revenue went from R$ 1,793 billion in January 2021 to R$ 2,276 billion in December 2022. It is possible to notice a relative accommodation of the indicator in the last two months of last year, in line with the slowdown in economic activity and the cooling of inflation.

FIGURE 8. CONVENTIONAL AND RECURRENT PRIMARY REVENUE (12 MONTHS - % OF GDP)



Source: STN. Prepared by: IFI

Table 3 shows the contribution of 0.8 pp of GDP of the revenues not collected by the RFB to the increase of 1.4 pp of GDP of the primary revenue of the central government in 2022. Table 4 shows the sum of revenues not collected by the RFB and some items in the following periods: 2001 to 2010, 2011 to 2020, 2020, 2021, and 2022, as well as their respective shares in GDP.

TABLE 4. CENTRAL GOVERNMENT'S REVENUES NOT COLLECTED BY THE RFB (CURRENT R$ BILLION AND % OF GDP)

	2001-2010		2011-2020		2020		2021		2022	
	R$ B Current	% GDP	R$ B Current	% GDP	R$ B Current	% GDP	R$ B Current	% GDP	R$ B Current	% GDP
Revenues not collected by the RFB	**657.8**	**2.7%**	**1,639.00**	**2.7%**	**163.9**	**2.2%**	**274.9**	**3.1%**	**386.8**	**3.9%**
Concessions and permissions	*22.1*	*0.1%*	*219.5*	*0.4%*	*8.2*	*0.1%*	*9.9*	*0.1%*	*46.8*	*0.5%*
Dividends	*98.6*	*0.4%*	*139.6*	*0.2%*	*6.6*	*0.1%*	*43.5*	*0.5%*	*87*	*0.9%*
Contr. Server's social security plan	*46.2*	*0.2%*	*123*	*0.2%*	*17.4*	*0.2%*	*17.9*	*0.2%*	*17.3*	*0.2%*
Revenues from the exploitation of natural resources	*154.3*	*0.6%*	*408.8*	*0.7%*	*56.5*	*0.7%*	*94.1*	*1.1%*	*132.5*	*1.3%*
Own revenues	*79*	*0.3%*	*144.2*	*0.2%*	*13.3*	*0.2%*	*16.7*	*0.2%*	*21.1*	*0.2%*
Education wage contribution	*64.8*	*0.3%*	*186.9*	*0.3%*	*21.3*	*0.3%*	*24*	*0.3%*	*27.3*	*0.3%*
FGTS supplement	*0*	*0.0%*	*36.1*	*0.1%*	*0*	*0.0%*	*0*	*0.0%*	*0*	*0.0%*
Other revenues not collected by the RFB	*192.8*	*0.8%*	*381*	*0.6%*	*40.7*	*0.5%*	*68.8*	*0.8%*	*54.8*	*0.5%*

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

Dividend collections and natural resource exploitation boosted revenues not collected by the RFB in the recent period. Table 4 shows the contribution of dividend and equity revenues and revenues from natural resource exploration to the growth of revenues not collected by the RFB in the last two years. In 2021, of the 0.9 pp of GDP increase in this revenue, 0.4 pp came from dividends and 0.3 pp from natural resource exploration. In 2022, these contributions were 0.4 pp of GDP and 0.3 pp, in that order.

In the latest revision of the macroeconomic and fiscal scenarios, published in the November 2022 edition of the RAF[6], the RAF, the IFI improved the methodology for projecting revenues from the exploitation of natural resources, which include, among others, the collection of royalties and oil participation. The projection of this collection is sensitive to the price of oil on the international market, as well as to the production volume and the R$/US$ exchange rate. It was also shown that the prospect is that the importance of these revenues will increase in the coming years due to the expected increase in domestic production of oil and natural gas[7].

Projections consider the end of the fuel exemption and the transfer of PIS-Pasep resources. Table 5 presents the updated IFI projections for total primary revenue, transfers by revenue breakdown, and net primary revenue of the central government for 2023 and 2024. The baseline scenario incorporates the permanent reduction of the IPI tax by 35%, the return of the PIS/Cofins tax on gasoline and ethanol as of March 2023, and the transfer of R$ 23.0 billion from the PIS-Pasep accounts to the Treasury (Table 2).

TABLE 5. CENTRAL GOVERNMENT'S PRIMARY REVENUE ESTIMATES – BASELINE 2023 AND 2024

Baseline	2023	2024
1. Total primary revenue	**2,308.7**	**2,479.4**
Revenues collected by the RFB	1,438.4	1,521.4
Net social security (RGPS)	567.0	604.2
Revenues not collected by the RFB	303.3	353.7
2. Transfers by revenue sharing	**446.2**	**466.3**
3. Net revenue [1-2]	**1,862.5**	**2,013.1**

Source: IFI.

The IFI's projection for the central government's total primary revenue in 2023 and 2024 is R$ 2,308.7 billion and R$ 2,479.4 billion, respectively. Net revenue is expected to be R$ 1,862.5 billion this year and R$ 2,013.1 billion next year (Table 5). For comparison purposes, the median of the projections contained in the Fiscal Prism Report of January 2023, produced by the Economic Policy Secretariat (SPE) of the Ministry of Finance, is for total primary revenue of the central government of R$ 2,310.0 billion in 2023 and R$ 2,438.2 billion next year. For net revenue, the Fiscal Prism median forecasts R$ 1,886.8 billion in 2023 and R$ 1,998.1 billion in 2024.

The materialization of the global economic crisis imposes a downward bias on the price of oil. It is important to mention the possibility of a low bias in the revenues not collected by the RFB estimates in case a trend of falling oil prices in the international market is confirmed due to a recession in advanced economies is confirmed. The main factor in explaining this phenomenon is the high-interest rates in response to the current inflationary processes in several countries.

2.3 Primary expenditure

Primary expenditures are expected to end 2022 at R$ 1,802.4 billion (18% of GDP), according to the anticipation obtained in Siga Brasil. The Federal Senate's Siga Brasil system allows the consultation of disaggregated data on the federal budget. Every month, the IFI consults Siga Brasil to anticipate the official primary result released by the National

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[6] Link to the document: https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2022/novembro.

[7] See Ibre Letter in the January 2023 edition of Conjuntura Econômica magazine. Link to the text: https://ibre.fgv.br/blog-da-conjuntura-economica/temas/surpresa-fiscal-positiva-ja-foi-em-boa-parte-consumida-por-novos.

Treasury Secretariat (STN). Thus, considering the official data made available by the STN until November and the anticipation made by the IFI for December, the primary expenses of the Federal Government should end 2022 at R$ 1,802.4 billion (18% of GDP). This value represents a real increase of 2.2% over the expenditure in 2021, when there was a 23.6% drop compared to 2020 (Table 6). In general terms, spending is relatively under control in the main groups that compose the central government's primary expenditure:

- **Social security benefits:** volume remained stable at 8.0% of GDP between 2021 and 2022, despite the issues increase in the last months of 2022. For this reason, the Provisional Presidential Decree (MP) no. 1,144, of December 14, 2022, was edited, which opened an extraordinary credit of R$ 7.6 billion in favor of the Ministry of Labor and Social Security;
- **Payroll expenses (active and inactive):** there was a decrease to 3.4% of GDP in 2022, compared to 3.7% of GDP in 2021 and 4.2% of GDP in 2020. This reduction occurred mainly due to the absence of adjustments in civil service wages;
- **Extraordinary credits (except PAC):** expenditure grew in 2020 (5.6% of GDP) because the main expenditures aimed at fighting the pandemic were classified under this heading, having fallen to 1.3% of GDP in 2021 and then to 0.5% last year, as the pandemic expenditures ceased;
- **Mandatory with flow control:** increased from R$ 145.2 billion (1.6% of GDP), in 2021, to R$ 219.4 billion (2.2% of GDP), in 2022, mainly due to the expansion of the Brazil Aid Program, which as of 2022, has a minimum benefit of R$ 400 per family; and
- **Discretionary:** an increase of 0.1 pp of the GDP in 2022 compared to 2021 (to R$ 152.1 billion) was due mainly to compliance with the lawsuit regarding Campo de Marte, which resulted in the payment of R$ 23.9 billion by the Federal Government to the Municipality of São Paulo in August 2022.

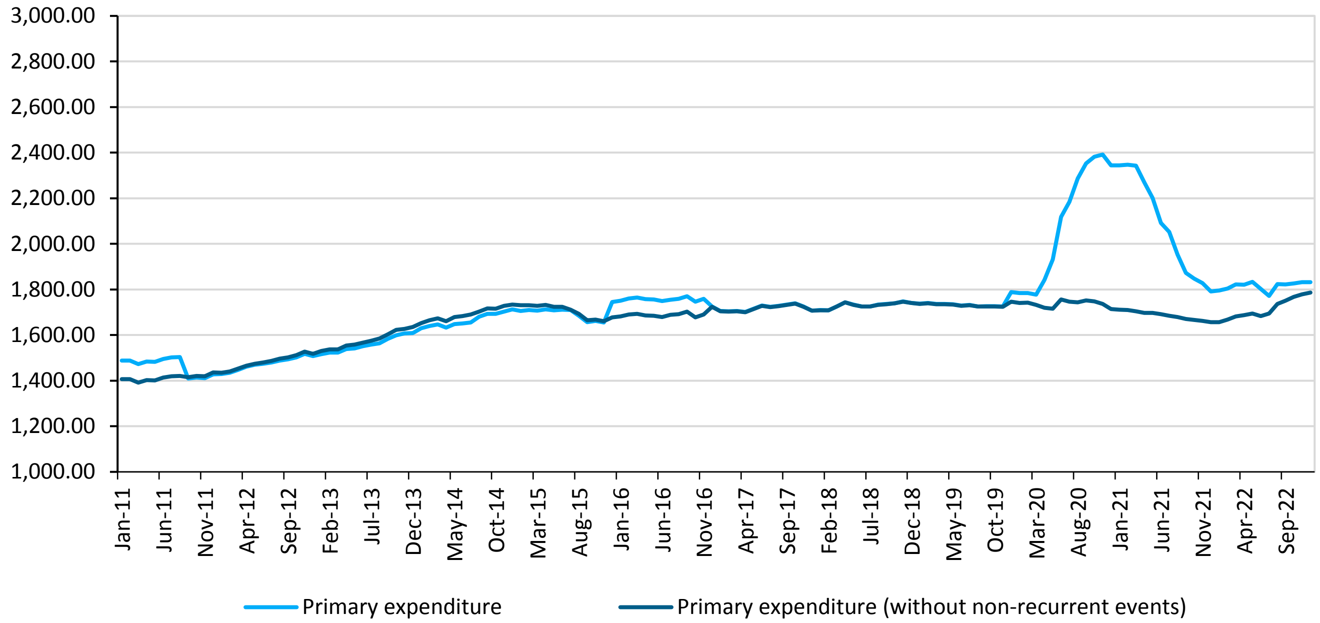
TABLE 6. CENTRAL GOVERNMENT PRIMARY EXPENDITURE – 2020 TO 2022 – JAN. TO DEC. (CURRENT R$ BILLION, REAL % CHANGE AND % OF GDP)

Breakdown	Jan-Dec/20			Jan-Dec/21			Jan-Dec/22		
	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP	R$ B current	Real % change	% GDP
Total expenditure	**1,947.6**	**31.1%**	**25.6%**	**1,614.2**	**-23.6%**	**18.1%**	**1,802.4**	**2.2%**	**18.0%**
Social Security Benefits (RGPS)	*663.9*	*2.8%*	*8.7%*	*709.6*	*-1.3%*	*8.0%*	*796.9*	*2.6%*	*8.0%*
Payroll (working and retired employees)	*321.3*	*-0.6%*	*4.2%*	*329.3*	*-5.4%*	*3.7%*	*338.0*	*-6.1%*	*3.4%*
Salary allowance and unemployment insurance	*59.6*	*3.9%*	*0.8%*	*45.9*	*-28.3%*	*0.5%*	*64.3*	*27.6%*	*0.6%*
Continuous Cash Benefit (BPC)	*62.7*	*1.7%*	*0.8%*	*67.7*	*-0.2%*	*0.8%*	*78.8*	*6.5%*	*0.8%*
Extraordinary Credits (except PAC)	*429.6*	*-*	*5.6%*	*117.2*	*-74.9%*	*1.3%*	*47.0*	*-63.3%*	*0.5%*
Compensation to RGPS for Exemption of Payroll Taxes	*9.4*	*-10.5%*	*0.1%*	*7.3*	*-28.5%*	*0.1%*	*3.1*	*-60.8%*	*0.0%*
Fundeb	*15.0*	*-6.7%*	*0.2%*	*22.0*	*34.9%*	*0.2%*	*32.9*	*37.0%*	*0.3%*
Court Rulings and Court-Ordered Debts (current and capital expenditure)	*22.9*	*44.3%*	*0.3%*	*18.8*	*-24.3%*	*0.2%*	*17.4*	*-16.5%*	*0.2%*
Subsidies, Grants, and Proagro	*21.1*	*81.9%*	*0.3%*	*7.5*	*-67.6%*	*0.1%*	*15.6*	*91.2%*	*0.2%*
Mandatory expenditure	**1,839.2**	**39.6%**	**24.2%**	**1,490.3**	**-25.2%**	**16.7%**	**1,650.3**	**1.2%**	**16.5%**
Mandatory spending with flow control	***133.5***	***-9.5%***	***1.8%***	***145.2***	***0.4%***	***1.6%***	***219.4***	***38.5%***	***2.2%***
Discretionary	**108.4**	**-35.8%**	**1.4%**	**123.9**	**4.5%**	**1.4%**	**152.1**	**13.3%**	**1.5%**
Total expenditure without non-recurrent events*	**1,426.3**	**-1.8%**	**18.7%**	**1,493.3**	**-3.4%**	**16.8%**	**1,757.7**	**7.8%**	**17.6%**
GDP (R$ billion)	**7,609.6**			**8,898.7**			**9,990.0**		

Source: SIGA Brasil, STN, and Central Bank. Prepared by: IFI.

The central government's recurrent primary expenditures, calculated by the IFI based on the methodology published in the E.E. no. 17, December 2021, totaled R$ 1,757.7 billion (17.6% of GDP) in 2022, a real increase of 7.8% over 2021 (Table 6). The calculation considers as non-recurring expenses from Covid-19, the onerous assignment of the pre-salt, the Sovereign Fund of Brazil, the anticipations in the payment of the salary allowance and the RGPS Christmas bonus, and other expenses, such as the payment for the right to use Campo de Marte. In 2022, the non-recurring expenditure events totaled R$ 44.7 billion.

FIGURE 9. TOTAL PRIMARY EXPENDITURE (WITH AND WITHOUT NON-RECURRING EVENTS) – R$ BILLION AT DEC/22 PRICES



Source: STN. Prepared by: IFI.

Recurrent expenditure grew in 2022. We present the trajectory in 12 months of the conventional and recurrent primary expenditure, calculated by the IFI according to the methodology presented in E.E. no.17, December 2021. Figure 9 displays these two series expressed in constant December 2022 prices. Total primary expenditure reached R$ 1,832 billion in December, practically stable to the previous month. Recurrent expenditure has risen continuously since the beginning of 2022, reaching R$ 1,786 billion, in real terms, in December, due to the expenses authorized by Constitutional Amendments 113 and 114.

Figures anticipated by the IFI for 2022 show that the Union's primary expenses should be R$ 23.8 billion below the government's estimate. In December, the Federal Government released an extemporaneous assessment of primary revenues and expenses[8] for the Union with estimates for primary balance in 2022. This evaluation pointed to primary expenditures of R$ 1,826.2 billion, R$ 23.8 billion above the realized expenses. Contributing to this execution lower than projected by the STN were the mandatory expenses with flow control and extraordinary credits. Considering the scenario outlined by the IFI, also for the month of December, the difference between what was projected and what was realized was only R$ 7.2 billion. Table 7 details and compares the realized result with that estimated by the government in the extemporaneous evaluation and that projected by the IFI in the December 2022 issue of the RAF[9].

[8] Available at: https://sisweb.tesouro.gov.br/apex/f?p=2501:9::::9:P9_ID_PUBLICACAO:45732.
[9] Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/603416/RAF71_DEZ2022.pdf.

TABLE 7. FEDERAL PRIMARY EXPENDITURE – IFI BASELINE SCENARIO AND GOVERNMENT PROGRAMMING (R$ BILLION)

Breakdown	2022	Government (Dec/22)	IFI (Dec/22)	Difference (IFI - Gov.)		Difference	
	R$ bi	R$ bi	R$ bi	R$ bi	%	R$ bi	%
Mandatory	1,802.4	1,826.2	1,809.6	**23.9**	**1.3**	**7.2**	**0.4**
Social Security	1,650.3	1,678.2	1,660.6	**28.0**	**1.7**	**10.3**	**0.6**
Payroll	796.9	798.1	796.9	**1.2**	**0.1**	**0.0**	**0.0**
Salary Allowance and Unemployment Benefit	338.0	339.4	336.9	**1.4**	**0.4**	**-1.1**	**-0.3**
BPC	64.3	66.2	64.5	**1.9**	**2.9**	**0.2**	**0.4**
Family Allowance / Brazil Aid	78.8	79.8	78.6	**1.0**	**1.2**	**-0.2**	**-0.3**
Court-ordered debt (current and capital)	88.2	88.4	87.8	**0.2**	**0.2**	**-0.4**	**-0.5**
Supplementation to FUNDEB	17.4	18.0	17.4	**0.6**	**3.3**	**0.0**	**0.0**
Subsidies and Grants	32.9	33.9	33.7	**1.0**	**3.0**	**0.8**	**2.5**
Legislative, Judiciary, MPU and DPU	15.6	16.6	16.2	**1.0**	**6.3**	**0.6**	**3.9**
Payroll tax reduction	15.2	16.9	15.2	**1.7**	**11.4**	**0.0**	**0.1**
Extraordinary credits	3.1	3.1	3.1	**0.0**	**0.0**	**0.0**	**0.1**
Other Compulsory Expenses	47.0	56.4	49.6	**9.4**	**20.1**	**2.6**	**5.6**
Discretionary	152.9	161.6	160.6	**8.7**	**5.7**	**7.7**	**5.0**
Mandatory	152.1	148.0	149.0	**-4.1**	**-2.7**	**-3.1**	**-2.0**

Source: National Treasury, Primary Revenue and Expenditure Evaluation Report, and IFI. Prepared by: IFI.

The recomposition of the Union's discretionary expenses was also made possible by the Transition EC and the change in the LDO. The Union's discretionary expenses should end in 2022 at R$ 152.1 billion. This number is R$ 4.1 billion and R$ 3.1 billion higher than estimated by the government and the IFI in December 2022, respectively. In the budget and financial programming decree of November 2022, however, the amounts authorized to pay discretionary expenses were R$ 137.8 billion. The recomposition of the Union's discretionary expenses to the budgetary and financial programming decree of November occurred due to the following factors:

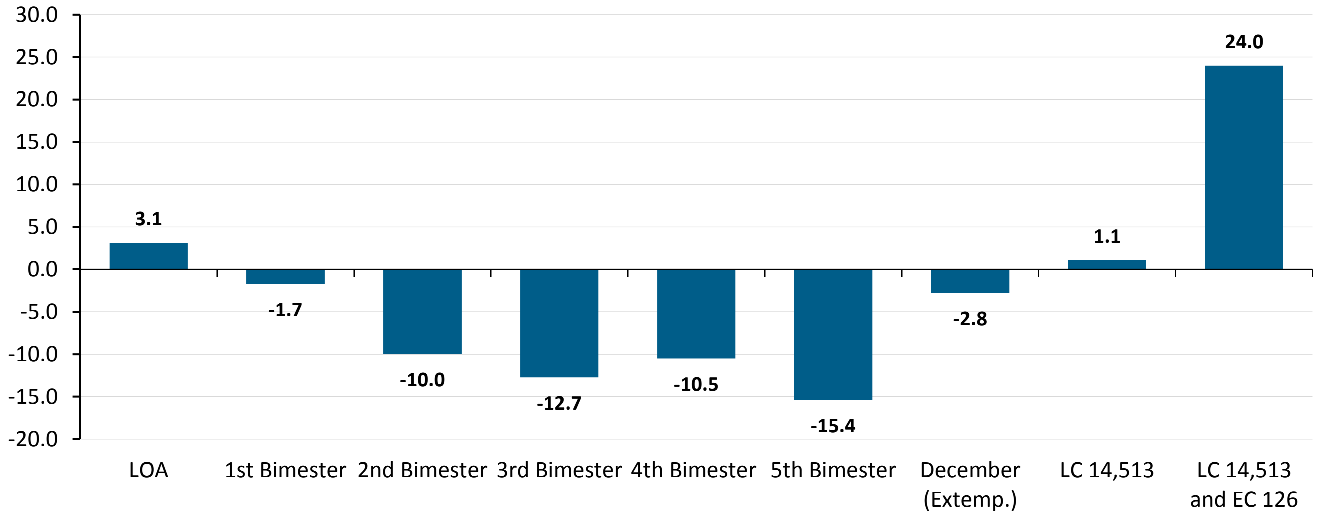
- **Provisional Presidential Decree no. 1,144 of 2022:** The forecast for spending on social security benefits changed little between the 5th bimester evaluation and the extemporaneous one, but MP 1,144 of 2022 opened extraordinary credits of R$ 7.6 billion for the payment of RGPS benefits and the Social Security Compensation (COMPREV), to guarantee the availability of budget appropriations for these expenses. As extraordinary credits are not subject to the spending ceiling, the effects of the MP contributed to the recomposition of discretionary expenses subject to the constitutional spending limit.
- **Law 14,513, of December 27, 2022:** Law 14,513, of 2022 amended the Budget Guidelines Law (LDO) of 2022 to allow the uncommitted balance of the appropriations for mandatory primary expenditures to be deducted from the requirements foreseen in the Primary Revenue and Expenditure Evaluation Report (RARDP) and authorizes this balance to be used to open additional credits to benefit other primary expenditures, provided it does not exceed the expenditure ceiling. Through a Technical Note,[10] the Ministry of Tourism concluded that it would be unfeasible to execute expenses of R$ 3.9 billion related to Supplementary Law no. 195 of 2022, i.e., financial support to subnational entities for emergency actions directed to the cultural sector. This alteration in the 2022 LDO made it possible to make room for the recomposition of discretionary expenses in R$ 3.9 billion.

[10] Technical Note no. 24/2022/SECULT/GAB/SECULT

- **EC no. 126, of December 21, 2022 (Transition EC):** The Transition EC was designed to enable an adjustment of the 2023 budget and the fiscal rules to the demands of the elected government; however, it also made it possible to open a space of R$ 22.9 billion in the 2022 spending ceiling. This change corresponds to the inclusion of § 6-B in art. 107 of the ADCT, which removes from the spending ceiling the expenses with investments in an amount that corresponds to the excess of the current revenue collection of the previous year up to the limit of 6.5% of the excess of the current revenue collection of 2021. Unlike § 6-A, § 6-B does not establish a year as the starting point for the proposed change to take effect. Thus, as the PEC was approved and enacted in 2022, this rule also came into effect for the 2022 fiscal year.

The extemporary report showed the need for an adjustment of R$ 2.8 billion to comply with the spending ceiling. The December Extemporaneous Report evaluated the necessity of spending R$ 2.8 billion above the spending ceiling. This report, however, did not contemplate the effects of two of the three legislations mentioned above, i.e., the change in the LDO through Law 14,513 and the change in the spending ceiling through EC 126. When considering these additional effects, the government would have a space in the spending ceiling of R$ 23.4 billion before an expenditure adjustment of R$ 2.8 billion. Given this picture, the 2022 spending ceiling was met due to changes that altered the rule in the short term. Figure 10 shows the excess or the need for adjustment in expenses subject to the spending ceiling throughout the bimonthly evaluations, the extemporaneous December evaluation, and the potential effects resulting from the changes that occurred at the end of December 2022.

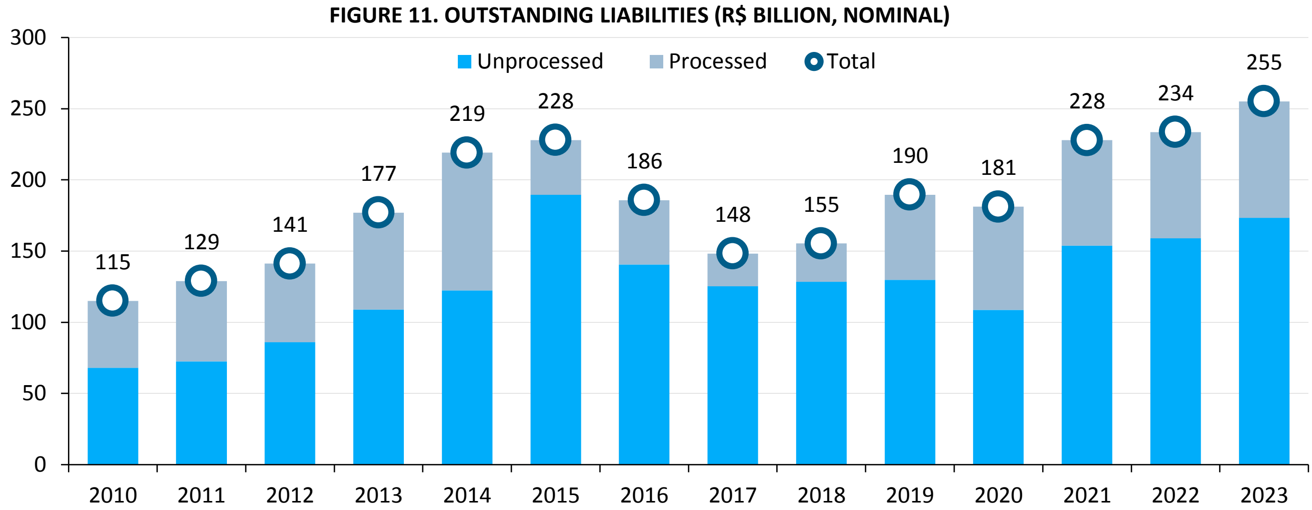
FIGURE 10. ANNUAL ESTIMATED EXCESS (+) / NEED FOR ADJUSTMENT (-) - SPENDING CEILING (R$ BILLION)



Source: December (Extemporaneous) Revenue and Expenditure Assessment Report. Prepared by IFI.

The stock of outstanding liabilities for 2023 was R$ 255.2 billion. For 2023, R$ 255.2 billion of outstanding liabilities (RAP) were registered, representing a nominal increase of R$ 25.6 billion (9.2%) to the 2022 stock. The outstanding liabilities correspond to expenses committed but not liquidated and/or paid until December 31. The RAPs can be segregated between processed and unprocessed. The unprocessed outstanding liabilities correspond to the expenses committed but not settled, while the processed outstanding liabilities correspond to the expenses committed and settled but not paid. Figure 11 shows the nominal evolution of the outstanding liabilities stock as of 2010, separating them into processed and unprocessed.

FIGURE 11. OUTSTANDING LIABILITIES (R$ BILLION, NOMINAL)



Source: SIGA Brasil. Prepared by IFI.

Given the high volume of RAPs, especially the unprocessed ones (RAPNP), the new economic team published Decree no. 11,380 of 2023[11] to create evaluation actions for the maintenance of RAPNP over R$ 1 million. According to the decree, the STN has the attribution to carry out, within five days, the blocking of the Executive RAPNPs enrolled until December 31, 2022. Also, according to the decree, the units responsible for the execution of these expenses may unblock the RAPNP or cancel them if the maintenance of the balances proves to be inadequate. It is worth mentioning that this decree is part of the set of fiscal adjustment measures announced by the Government on January 12.

The processing of the 2023 Budget was greatly affected by the Transition PEC. The proposal, which resulted in Constitutional Amendment no. 126, changed the expenses subject to the Union's spending ceiling, increased the limit of the individual impositive amendments, and exempted from the payment of ITCMD donations to federal educational institutions, socio-environmental and climate change projects. Waiting for the approval of the PEC, the Brazil Aid, of R$ 600.00 per month, the additional R$ 150.00 per child up to 6 years old belonging to the beneficiary family of the Brazil Aid and other demands of the transition team, such as the increase of resources for investments in infrastructure and the recomposition of some sectorial programs (like Popular Pharmacy and school meals). Once the new constitutional commands were promulgated, Congress was finally able to make adjustments to the budget. At the end of the process, the central government's primary deficit for 2023, foreseen in the budget, was R$ 231.6 billion, higher than the R$ 63.7 billion in the proposal sent by the Executive in August and the R$ 49.3 billion surplus calculated by the IFI for 2022 based on data collected in the Siga Brasil. The fiscal picture, already impacted by the recent increase in interest rates, has worsened. This section analyzes the main points of the budget approved by Congress in December.

The approval of the Transition PEC[12] generated a total fiscal space of R$ 161.9 billion in the spending ceiling for 2023. The space results from two changes in the constitutional text. The first is the expansion of the spending ceiling by R$ 145 billion for 2023. The primary expenditures ceiling will correspond to the previous year's limit adjusted for inflation plus R$ 145 billion. The second change is the reclassification of some expenses previously subject to the spending ceiling, but that with the Transition PEC will be classified as expenses outside de spending ceiling. This list of

[11] Available at: https://www.in.gov.br/web/dou/-/decreto-n-11.380-de-12-de-janeiro-de-2023-457677915.

[12] Access the proceedings of the Constitutional Amendment Bill (PEC) no. 32, 2022, known as the Transition PEC, at: https://www.congressonacional.leg.br/materias/materias-bicamerais/-/ver/pec-32-2022. This PEC resulted in Constitutional Amendment no. 126, 2022. The general rapporteur of the budget detailed, by organ, the amendments to meet the transition PEC, as highlighted in the RAF of December 2022.

expenses includes investments made with a current revenue surplus, expenses with donations to socio-environmental projects or projects related to climate change, etc. The total space reached R$ 161.9 billion. In the December RAF, we detailed the origin and destination observed in the 2023 budget piece enabled by the Transition EC

Nine laws increased the remuneration of public servants in the Judiciary, Legislative, MPU, and DPU. The staff of commissioned and effective public servants had readjustments in successive and cumulative installments, resulting from nine legislations, all sanctioned on January 9, 2023.

The IFI's scenario for payroll expenses incorporates the effects of the new laws sanctioned on January 9 of this year. For the Federal Executive Branch staff, the IFI scenario considers that there will be a similar adjustment to that of the other careers, that is, a phased adjustment, but that it will only begin to be effective as of the second half of this year.

Chart 1 details each one of the legislations sanctioned on January 9 corresponding to the item personnel expenses and social charges.

TABLE 1. LEGISLATION REGARDING THE WAGE ADJUSTMENT FOR THE UNION'S CIVIL SERVANTS: EXCEPT FOR THE EXECUTIVE BRANCH

Legislation no.	Power/Body/Position	Description	Adjustment rules	% to the initial allowance	% to the previous year's allowance
Law 14,520 of 2022	STF Justices	Sets the allowance for a Minister of the Supreme Court	Currently: R$ 39,293.32	-	-
			As of April 1, 2023: R$ 41,650.92	6.0%	6.0%
			As of February 1, 2024: R$ 44,008.52	12.0%	5.7%
			As of February 1, 2025: R$ 46,366.19	18.0%	5.4%
Law 14,521 of 2022	General Attorney of the Republic	Sets the salary for the General Attorney of the Republic	Currently: R$ 39,293.32	-	-
			As of April 1, 2023: R$ 41,650.92	6.0%	6.0%
			As of February 1, 2024: R$ 44,008.52	12.0%	5.7%
			As of February 1, 2025: R$ 46,366.19 1	18.0%	5.4%
Law 14,522 of 2022	Federal Public Defender		Currently: R$ 34,694.99	-	-
	The allowance to the Subdefender-General, the Inspector-General of the DPU, and the members of the DPU Special Category will correspond to 95% of the Federal Public Defender's monthly allowance, observing, for the other categories, the percentage of scaling of 10% among them.		As of February 1, 2023: R$ 41,650.92	2.1%	2.1%
			As of February 1, 2024: R$ 44,008.52	5.3%	3.1%
			As of February 1, 2025: R$ 46,366.19	8.5%	3.0%
Legislation no.	**Power/Body/Position**	**Description**	**Adjustment period and % to be adjusted**		
Law 14,523 of 2022	Judiciary	Readjusts the career wages of the public servants in the staff of the Judiciary Branch of the Union.			
Law 14,524 of 2022	MPU and National Council of the Public Prosecutor's Office	Readjusts the career compensation of public servants of the Union Public Prosecutor's Office and the National			

		Council of the Public Prosecutor's Office.	
Law 14,525 of 2022	Office of the Federal Public Defender	Adjusts the remuneration of public servants in the Career and Position Plan of the Office of the Federal Public Defender and of commissioned and trustee positions in the Office of the Federal Public Defender.	- As of February 1, 2023: 6% - As of February 1, 2024: 6% - As of February 1, 2025: 6.13% *in successive and cumulative installments
Law 14,526 of 2022	Federal Senate	Readjusts the Basic Salary Scales for Servants Occupying Permanent Posts in the Personnel of the Federal Senate	
Law 14,527 of 2022	TCU	Readjusts the remuneration of the Servers of the Personnel of the Federal Court of Accounts	
Law 14,528 of 2022	Chamber of Deputies	Readjusts the remuneration of the public servants of the Chamber of Deputies.	

Source: Legislation Portal/Planalto. Elaboration: IFI.

The IFI's scenario for primary federal expenses for 2023 is R$ 1,983.0 billion (18.7% of GDP). The IFI's projections for the Union's primary expenditures are R$ 1,983.0 billion, against R$ 2,037.3 billion foreseen in the Autograph of the 2023 LOA[13]. The difference between the IFI's projections and what is fixed in the budget corresponds mainly to the Federal Executive Branch discretionary expenses and payroll, whose wage adjustments were only confirmed for the Judiciary, Legislative, and MPU branches, TCU and DPU.

Among the fiscal measures announced by the Federal Executive Branch economic team on January 12, the amount of R$ 25 billion is related to the execution of expenditures lower than authorized in the LOA. According to the Finance Minister, there would be no need to spend the volume presented in the 2023 LOA. On this aspect, the IFI warned in the November and December reports that the increase in expenses, especially discretionary ones, foreseen in the 2023 LOA, would represent a high increase in the history of recent years. Thus, given this, the IFI maintained a scenario for primary federal expenses relatively lower than the one projected by the government.

Table 8 compares the IFI's scenario with the 2023 LOA and 2022 realized data.

TABLE 8. FEDERAL PRIMARY EXPENDITURE - IFI BASELINE SCENARIO AND GOVERNMENT PROGRAMMING (R$ BILLION)

Breakdown	2022	Government (LOA 2023)	IFI (Jan/23)	Difference (IFI - Gov.)		Difference (IFI - 2022)	
	R$ bi	R$ bi	R$ bi	R$ bi	%	R$ bi	%
Mandatory	1,802.4	2,037.3	1,983.0	**-54.3**	**-2.7**	**180.6**	**10.0**
Social Security	1,650.3	1,838.2	1,815.3	-22.9	-1.2	165	10.0
Payroll	796.9	864.6	868.4	3.8	0.4	71.5	9.0
Salary Allowance and Unemployment Benefit	338.0	367.8	354.0	-13.8	-3.8	16	4.7
BPC	64.3	70.3	68.1	-2.2	-3.2	3.8	5.9
Family Allowance / Brazil Aid	78.8	87.8	87.0	-0.8	-1	8.1	10.3
Court-ordered debt (current and capital)	88.2	175.7	174.4	-1.3	-0.8	86.2	97.7

[13] It is worth mentioning that the LOA of 2023 was sanctioned with partial vetoes on January 17th, 2023, one day before this report's publication. Because of this, the analyses in this study correspond only to the Autograph to the 2023 LOA.

Supplementation to FUNDEB	17.4	24.7	24.7	0.0	0	7.3	42.0
Subsidies and Grants	32.9	40.0	38.6	-1.4	-3.5	5.7	17.2
Legislative, Judiciary, MPU and DPU	15.6	20.3	20.3	0.0	0	4.7	30.1
Payroll tax reduction	15.2	20.7	16.3	-4.4	-21.4	1.1	7.1
Extraordinary credits	3.1	0.0	0.0	0.0	-	-3.1	-
Other Compulsory Expenses	47.0	0.0	5.0	5.0	-	-42	-89.4
Discretionary	152.9	166.3	158.7	-7.7	-4.6	5.7	3.8
Mandatory	152.1	199.0	167.7	-31.4	-15.8	15.6	10.3

Source: Autógrafo LOA 2023, Siga Brasil, STN e IFI. Prepared by IFI.

The expected increase in the Union's primary expenditure in 2023 is 0.7 pp of GDP. In the forecast update in January, the IFI now foresees a primary expense for the central government of R$ 1,983.0 billion in 2023, R$ 179.6 billion above the 2022 expense (R$ 1,803.5 billion). As a percentage of GDP, spending would grow from 18.0% of GDP in 2022 to 18.7% of GDP in 2023. The nominal expansion occurs in both mandatory and discretionary spending. For 2024, the IFI expects the Federal Government's primary expenditure to fall to 18.5% of GDP, or R$ 2,096.6 billion.

By comparison, the median of the projections of the economists participating in the Fiscal Prism is for a primary expenditure of the central government of R$ 2,016.8 billion in 2023 and R$ 2,115.4 billion next year. The average of the Podium projections of the same report is an expenditure of R$ 2,012.1 billion this year and R$ 2,107.5 billion in 2024.

The following table details, in current values and as a percentage of the GDP, the IFI's scenario for primary expenditures in 2023 and 2024.

TABLE 9. PRIMARY FEDERAL GOVERNMENT EXPENDITURE 2023 AND 2024 – IFI SCENARIO (R$ BILLION AND % OF GDP)

Breakdown	2022		IFI (2023 scenario)		IFI (2024 scenario)		Dif. (pp of GDP)	
	R$ B	% GDP	R$ B	% GDP	R$ B	% GDP	22 - 23	23 - 24
Mandatory	1,802.4	18.0	1,983.0	18.7	**2,096.6**	18.5	**0.7**	**-0.2**
Social Security	1,650.3	16.5	1,815.3	17.1	1,917.9	17.0	**0.6**	**-0.2**
Payroll	796.9	8.0	868.4	8.2	934.3	8.3	**0.2**	**0.1**
Salary Allowance and Unemployment Benefit	338.0	3.4	354.0	3.3	369.0	3.3	**0.0**	**-0.1**
BPC	64.3	0.6	68.1	0.6	72.7	0.6	**0.0**	**0.0**
Family Allowance / Brazil Aid	78.8	0.8	87.0	0.8	93.9	0.8	**0.0**	**0.0**
Court-ordered debt (current and capital)	88.2	0.9	174.4	1.6	172.9	1.5	**0.8**	**-0.1**
Supplementation to FUNDEB	17.4	0.2	24.7	0.2	26.0	0.2	**0.1**	**0.0**
Subsidies and Grants	32.9	0.3	38.6	0.4	45.6	0.4	**0.0**	**0.0**
Legislative, Judiciary, MPU and DPU	15.6	0.2	20.3	0.2	21.0	0.2	**0.0**	**0.0**
Payroll tax reduction	15.2	0.2	16.3	0.2	16.9	0.1	**0.0**	**0.0**
Extraordinary credits	3.1	0.0	0.0	0.0	0.0	0.0	**0.0**	**0.0**
Other Compulsory Expenses	47.0	0.5	5.0	0.0	0.0	0.0	**-0.4**	**0.0**
Discretionary	152.9	1.5	158.7	1.5	165.6	1.5	**0.0**	**0.0**
Mandatory	152.1	1.5	167.7	1.6	178.7	1.6	**0.1**	**0.0**

Source: Siga Brasil, STN and IFI. Prepared by IFI.

2.4 Changes to the spending ceiling

Constitutional Amendment 126 (EC 126), approved in December 2022, was the fifth[14] change in the spending ceiling in the first six years of the rule. EC 126 derived from the so-called Transition PEC (PEC 32/2022), expanding the ceiling for 2023 by R$ 145.0 billion and excluding some expenses from the rule, such as investments (up to a specific limit[15]) and socio-environmental projects funded by donations.

In 2019, Constitutional Amendment 102 (EC 102) had already removed from the spending ceiling transfers to states and municipalities and payments to Petrobras arising from the onerous assignment of research activities and mining of oil, natural gas, and other fluid hydrocarbons. The two expenses totaled R$ 46.1 billion (R$ 56.8 billion at Dec/22 prices).

Later, in March 2021, Constitutional Amendment 109 (EC 109) excluded from the ceiling the expenses of that year with the Covid-19 emergency aid up to the limit of R$ 44.0 billion. Four months later, Decree no. 10,740/2021 extended the benefit by three months, and total spending in 2021 reached R$ 59.7 billion (R$ 66.8 billion at Dec/22 prices). In both cases, the expenditure was made possible by provisional decrees of extraordinary credits, one of the original exceptions to the spending ceiling rule.

The first significant change in the rule occurred in December 2021. The so-called court-ordered debt PEC – converted into Constitutional Amendments 113 and 114 (EC 113 and EC 114) – changed how the ceiling is calculated and established a limit, until 2026, for expenses with judgments and court-ordered debts. Together, the two measures opened a space of R$ 113.1 billion in the spending ceiling for 2022, which was filled by new expenses during the Budget process, such as the Brazil Aid and social security expenses[16].

But what was the practical impact of the court-ordered debt PEC when we analyzed the 2022 data? Concerning the expenses subject to the ceiling, it is possible to compare the expenditures made in 2022 with the value of the spending ceiling if the PEC had not been approved. According to preliminary data gathered by the IFI, the expenditure subject to the ceiling in 2022 was R$ 1,659.4 billion, R$ 49.3 billion above the limit before the approval of the Proposal (R$ 1,610.0 billion).

The new court-ordered debt payment system instituted by EC 114 also excluded part of these expenses from the spending ceiling. They involve the installment payment of judgments and cases in which there is an accounts meeting between the Union and the court-ordered debt creditor (art. 107-A, § 6, ADCT). Preliminary data from the IFI indicate that the two modalities will add up to R$ 35.6 billion in 2022. Of the total primary expenditure in 2022, therefore, about R$ 85.0 billion were made possible by the approval of the court-ordered debt PEC.

In July, Constitutional Amendment 123 (EC 123), known as the State of Emergency PEC, recognized a state of emergency due to the sharp rise in oil and fuel prices and authorized various extraordinary expenses in the last months of 2022, which would not be subject to the spending ceiling. The authorization of expenses reached R$ 41.3 billion, of which R$ 36.4 billion, or 88.1%, were spent during the year (Table 10).

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[14] The so-called court-ordered debt PEC generated two constitutional amendments (113 and 114), which in this report are counted as a single change in the spending ceiling.

[15] The limit corresponds to the excess of the previous year´s current revenue to which the budget law refers that does not exceed 6.5% of the excess of the current revenue observed in 2021.

[16] The January 2022 RAF examined in detail the origin and destination of the fiscal space opened in the 2022 spending ceiling during the Budget process. Available at: https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2022/janeiro/raf-relatorio-de-acompanhamento-fiscal-jan-2022.

TABLE 10. EC 123 SPENDING (R$ MILLION, CURRENT PRICES)

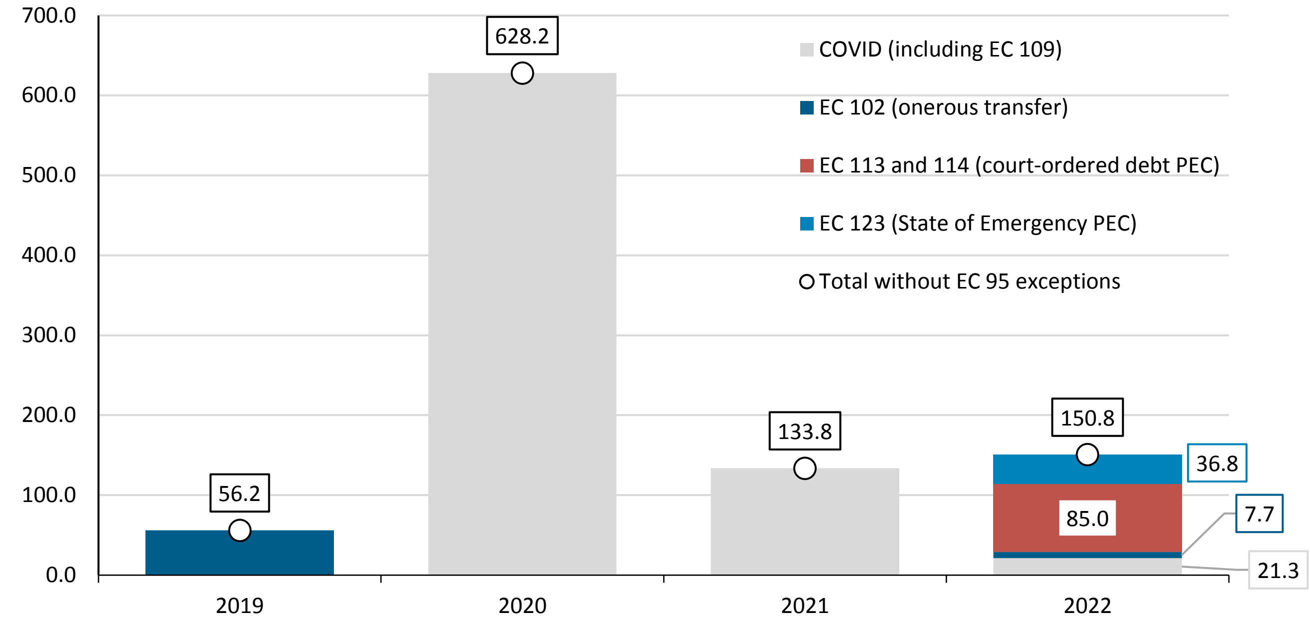
	Authorized	Executed	Authorized / Executed (%)
Brazil Aid Extension	26,000.0	24,929.5	95.9
Aid for gas	1,050.0	1,050.0	100.0
Aid to truck drivers	5,400.0	2,329.7	43.1
Financial support to federal entities to fund public transportation	2,500.0	2,497.1	99.9
Financial aid to states that grant ICMS credits to ethanol producers or distributors	3,800.0	3,617.7	95.2
Aid to taxi drivers	2,000.0	1,877.9	93.9
Supplementation of the Food Program Brazil	500.0	55.1	11.0
Total	**41,250.0**	**36,357.1**	**88.1**

Source: EC 123 and Siga Brasil. Prepared by: IFI.

The exceptions to the spending ceiling created through constitutional amendments between 2019 and 2022 totaled R$ 185.6 billion, already considering inflation. The account includes Constitutional Amendments 102 (onerous transfer), 113 and 114 (court-ordered debt PEC), and 123 (PEC of the State of Emergency). For this survey, we do not consider expenses such as the 2021 emergency aid, made possible by EC 109, given the similarity with other expenses made by extraordinary credits according to criteria initially established by Constitutional Amendment no. 95/2016 (EC 95), which created the spending ceiling. In 2022 alone, the exceptions to the ceiling made through constitutional amendments added up to R$ 129.5 billion, R$ 85.0 billion of which arose from the court-ordered debt PEC and R$ 36.8 billion derived from the PEC of the State of Emergency.

Figure 12 shows the exceptions to the spending ceiling created during the rule's validity and the expenditures with Covid-19, already considering the inflation in the period. Table 11 then details the amount of each exception to the ceiling, including those on the original list in the rule.

FIGURE 12. EXCEPTIONS TO THE SPENDING CEILING CREATED DURING TTHE RULE'S VALIDITY AND SPENDING ON COVID-19 (TOTAL PAYMENTS IN R$ BILLION OF DEC/2022)



Source: Treasury and IFI. Prepared by: IFI.

TABLE 11. EXPENDITURES OUTSIDE THE SPENDING CEILING – 2017 TO 2022 (R$ BILLION) – AT CONSTANT PRICES (DEC/22)

Measure	2017	2018	2019	2020	2021	2022
EC 95 (except Covid)	334,636.6	369,577.6	385,061.2	343,406.3	428,954.8	450,043.3
COVID (including EC 109)	-	-	-	628,216.3	133,837.6	21,345.2
EC 102 (onerous transfer)	-	-	56,152.1	-	-	7,737.2
EC 113 and 114 (court-ordered debt PEC)	-	-	-	-	-	84,973.9
EC 123 (Kamikaze PEC)	-	-	-	-	-	36,762.2
Total	**334,636.6**	**369,577.6**	**441,213.3**	**971,622.6**	**562,792.4**	**600,861.9**
Total without EC 95 exceptions	**-**	**-**	**56,152.1**	**628,216.3**	**133,837.6**	**150,818.5**
Total without EC 95 exceptions and Covid expenses	**-**	**-**	**56,152.1**	**-**	**-**	**129,473.3**

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

2.5 The central government and the consolidated public sector balance

The central government's primary surplus should have reached 0.5% of GDP in 2022. Data collected by the IFI on the Siga Brasil portal indicate that the central government will have a primary surplus of R$ 50.6 billion (0.5% of GDP) in 2022, compared to a deficit of R$ 35.1 billion (0.4% of GDP) in 2021. The 2022 primary balance occurred in a solid revenue expansion and relative expenditure control environment. This dynamic is not expected to occur in 2023 and 2024 due to a slowdown in tax collection and faster expenditure growth.

Lower revenue collection and expenditure growth will turn the primary balance negative again in 2023. Table 11 presents the central government's primary balance figures in 2021 and 2022, as well as the IFI's baseline scenario projections for 2023 and 2024. In 2023, the IFI's forecast is for a primary deficit of 1.1% of GDP. Contributing to this performance would be the worsening in the projection of net revenues, which would decrease from 18.6% of GDP in 2022 to 17.6% of GDP this year, as well as the expansion in primary expenditure, which would grow 0.6 pp of GDP in 2023, reaching 18.7% of GDP.

The primary deficit would be reduced in 2024 when it would drop to 0.7% of GDP due to a 0.2 pp GDP growth in projected net revenues and a decline of the same magnitude in primary expenditure (Table 12).

TABLE 12. CENTRAL GOVERNMENT PRIMARY BALANCE FORECASTS (2022 AND 2023) UNDER THE BASELINE SCENARIO (R$ BILLION)

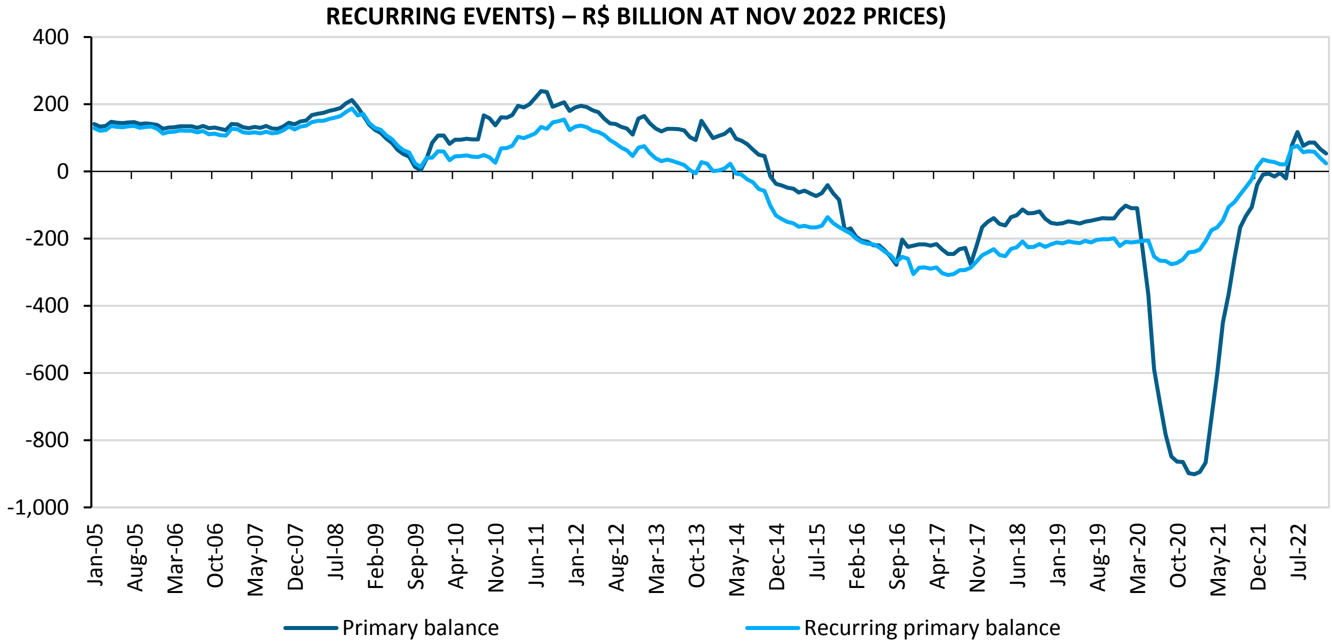
Breakdown	2021		2022		2023*		2024*	
	Value	% of GDP	Value	% of GDP	Value	% of GDP	Value	% of GDP
Net revenue	1,579.1	17.7%	1,853.0	18.5%	1,862.5	17.6%	2,013.1	17.8%
Primary expenditure	1,614.2	18.1%	1,802.4	18.0%	1,983.0	18.7%	2,096.6	18.5%
Primary balance	-35.1	-0.4%	50.6	0.5%	-120.5	-1.1%	-83.6	-0.7%

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

Figure 13 shows the 12-month trajectory of the central government's conventional (observed) and recurrent primary balances at December 2022 prices. While the traditional balance was a surplus of R$ 53.6 billion in December, the recurring balance was positive at R$ 24.2 billion. The recurring balance showed an improvement in the trajectory of the Union primary between the last quarter of 2020 and the third quarter of 2022, when it began to fall with the cooling of tax collection and the increase in the Union's primary expenditure. Throughout 2023, these curves will return to negative values.

Economic deceleration and pressure for increased spending constitute fiscal risks for the coming months. As mentioned above, the expected slowdown in domestic and external economic activity in the coming months due to the tighter monetary policy constitutes a risk for the trajectory of revenues from 2023. On the expenditure side, the creation of expenses with EC no. 126 also represents a risk, given the absence of sources of financing for these expenses. The way these expenses will be accommodated may influence the credibility of the country's fiscal regime.

FIGURE 13. CENTRAL GOVERNMENT'S PRIMARY BALANCE (WITH AND WITHOUT NON-RECURRING EVENTS) – R$ BILLION AT NOV 2022 PRICES)



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

The performance of the central government and subnational entities continued to produce primary public sector surpluses in the year-to-date. We now analyze data made available by the Central Bank, updated through November 2022, regarding the primary and nominal balance of the consolidated public sector calculated using the below-the-line methodology[17]. In the eleven months of 2022, the public sector – including the central government, regional governments, and state-owned companies – had a primary surplus of R$ 137.8 billion, against a surplus of R$ 64.6 billion in the same period of 2021. The central government reported a R$ 48.8 billion surplus, while states and municipalities accumulated a positive balance of R$ 83.5 billion and state companies R$ 5.5 billion.

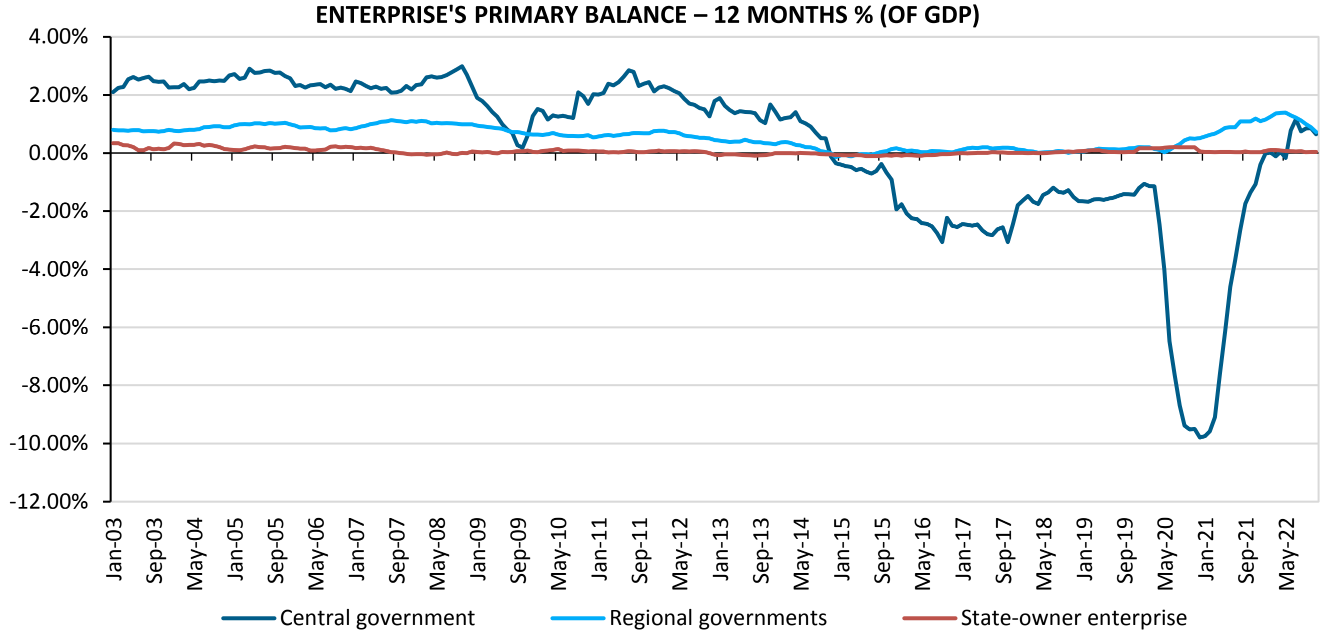
The deceleration in the collection of ICMS has worsened the state's and municipalities' balances. The growth in tax collections explains the primary balance of subnational entities for the same reasons that sustain the dynamics of the Union's primary revenues. However, ICMS collections began to slow down in recent months due to the innovations introduced by Complementary Laws nos. 192 and 194. Complementary Law no. 194 classified the telecommunications, electricity, fuel, and public transport sectors as essential goods and services and set maximum ICMS rates at 17%-18%.

In the 12-month comparison, the primary surplus of subnational entities continued to outpace that of the central government. In the 12 months that ended in November, the central government (federal government, Central Bank, and INSS) reported a primary surplus of R$ 62.7 billion (0.6% of GDP), while the regional governments (states and municipalities) and state companies reported surpluses of R$ 70.7 billion (0.7% of GDP) and R$ 4.5 billion (0.05% of GDP), respectively (Figure 14).

The reduction in the primary balance of states and municipalities began in May. Also, concerning Figure 14, the primary surplus of regional governments reached 1.4% of GDP in May and then began to fall, reaching 0.7% of GDP in November in a 12-month comparison. This trend is related to reducing the ICMS tax rates on telecommunications, fuel, and electric power.

17 For a more detailed explanation, access the Manual of Fiscal Statistics of the Central Government Primary Balance (RTN): https://bit.ly/3pjxgEv.

FIGURE 14. CENTRAL GOVERNMENT, REGIONAL GOVERNMENTS, AND STATE-OWNED ENTERPRISE'S PRIMARY BALANCE – 12 MONTHS % (OF GDP)

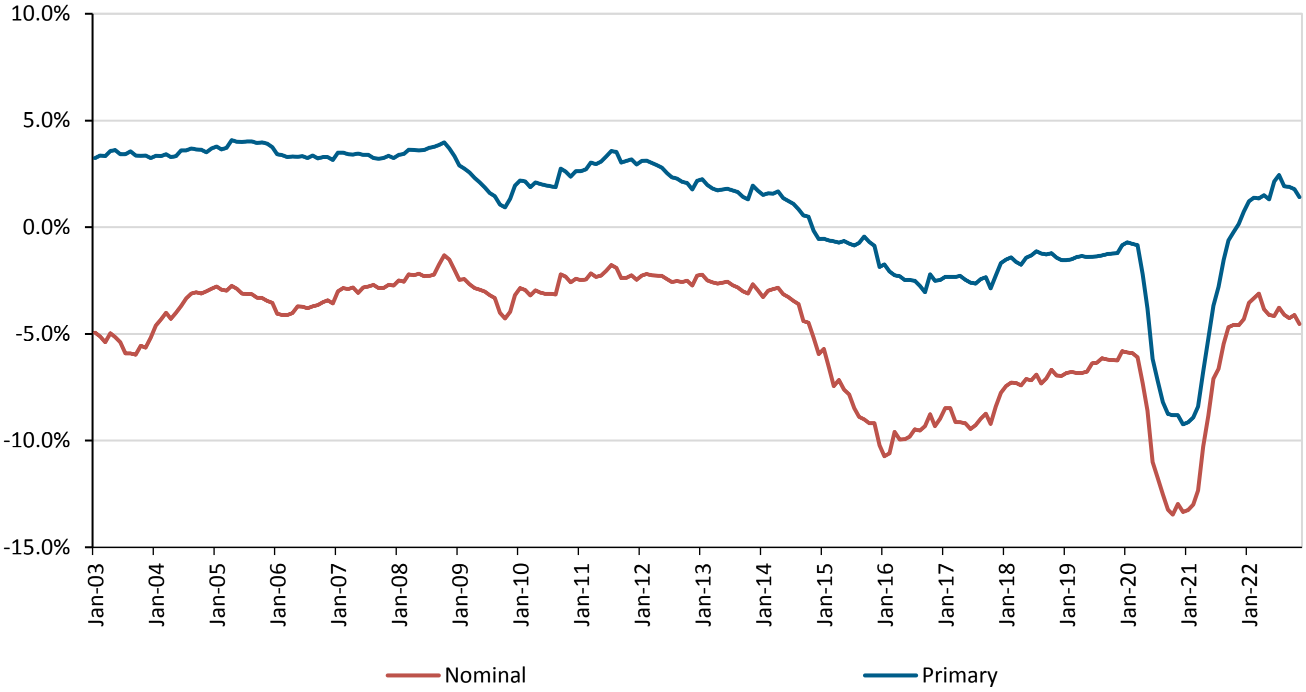


Source: Central Bank. Prepared by IFI.

Figure 15 shows the evolution of the consolidated public sector's primary and nominal results over the 12 months that ended in November. In November, the public sector reported a primary surplus of R$ 137.9 billion (1.4% of GDP), compared to R$ 173.1 billion (1.8% of GDP) in October and R$ 181.4 billion (1.9% of GDP) in September. In November 2021, there was a primary surplus of 0.1% of GDP, equivalent to R$ 12.8 billion. The reduction in the public sector primary surplus from August 2022 onwards results from decreased subnational entities and central government balances.

The nominal public sector balance, which represents the sum of the primary balance and interest expenses, was negative R$ 443.9 billion (4.5% of GDP) in the 12 months that ended in November, a deterioration of 0.4 pp of GDP to October and an improvement of 0.1 pp of GDP compared to the same month in 2021. Figure 15 indicates a worsening of the nominal balance in November compared to the immediately previous months due to the primary balance, which fell 0.4 pp of GDP against October.

FIGURE 15. CONSOLIDATED PUBLIC SECTOR PRIMARY AND NOMINAL – 12 MONTHS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

Interest expenditure was relatively stable in November at a high level. Public sector interest expenditures remained at 5.9% of GDP (or R$ 581.8 billion) in the 12 months that ended in November, the same percentage of GDP registered in October (R$ 573.2 billion) and below the 6.1% of GDP reported in September (R$ 592.0 billion). In November 2021, interest expenditures of R$ 418.0 billion corresponded to 4.7% of GDP (Figure 16). This variable rose from July 2021 to last June due to increases in the Selic rate and inflation, two public securities indexing factors. As of July 2022, interest expenditures began to decline due to the slowdown in inflation, settling at a relatively high level. It is worth noting that interest expenditures appear with the sign inverted on the axis of Figure 16.

FIGURE 16. INTEREST EXPENDITURES - 12 MONTHS (% OF GDP)

Source: Central Bank. Prepared by: IFI.

2.6 Public sector indebtedness indicators

The external scenario continued to show signs of instability and uncertainty in recent months. While risk premiums of emerging markets dropped in November due to more positive inflation and activity data in China and the United States, premiums worsened with the prospect of recession in the central economies in December. In both months, there was an upward shift in the Brazilian futures yield curve.

In this subsection, the first step is to analyze the Monthly Debt Report (RMD) published by the National Treasury Secretariat, with data updated through November.

Net issuances of securities were concentrated in fixed-rate and floating-rate securities in November. Issuances of Federal Public Debt securities (DPF) on the primary market surpassed redemptions by R$ 41.3 billion in November. Treasury issues in November were concentrated in fixed-rate securities (DPMFi) (net issuance of R$ 12.4 billion) and floating-rate securities (net issuance of R$ 27.9 billion). In the 11 months that ended in 2022, DPF registered net redemptions of R$ 243.3 billion.

Liquidity reserve remained at a relatively comfortable level in November. The federal public debt liquidity reserve totaled R$ 1,142.0 billion in November, compared to R$ 1,028.9 billion in October and R$ 1,096.9 billion in November 2021. The liquidity reserve (also called debt cushion) is part of the Treasury's cash availabilities deposited in the Single Account at the Central Bank.

The liquidity reserve is a good indicator of the sufficiency of cash to cover maturities (principal and interest) of securities held by the public and those issued for the Central Bank. When measured in the number of months, this indicator shows how long it is possible to pay maturing debts with the existing reserve. The Treasury considers as a prudential limit a liquidity reserve capable of honoring three months of debt maturities. Thus, in the number of months, the liquidity ratio reached 9.30 months in November, compared to 8.97 months in October and 9.60 months in November 2021. In other words, if new issuances were not made in November, the Treasury would be able to pay 9.30 months of DPMFi bonds maturities. The prudential value, which corresponds to the payment of three months of DPMFi bonds maturities, reached R$ 335.7 billion in November, compared to R$ 329.7 billion in October.

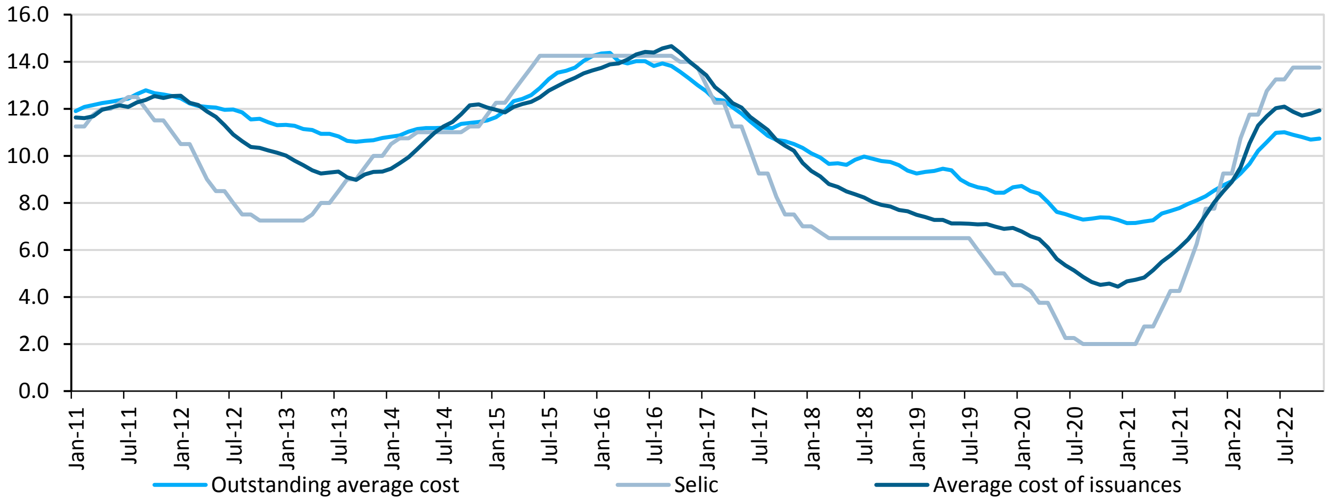
Average issue rates rose across all maturities in November. According to the STN, the average issue rates of the DPMFi rose in November. In 24-month fixed-rate securities (LTN), the average issue rate increased from 11.97% p.a. in October to 13.26% p.a. in November. In 48-month fixed-rate securities, the rate rose from 11.72% p.a. in October to 12.88% p.a. in November. In November, the rate on price-indexed securities reached 6.00% p.a. for five-year maturities (against 5.54% p.a. in October) and 5.97% p.a. for 40-year securities (against 5.78% p.a. in October).

Issuance costs continued to rise in December. Information gathered by the IFI on Treasury auctions[18] indicates increases in the rates of DPMFi bonds in December. Fixed-rate securities maturing on October 1, 2024, had an average issuance rate of 13.52% p.a. in December, against 12.48% p.a. in November. For the fixed-rate security maturing on January 1, 2026, the average issuance rate rose from 11.86% p.a. in November to 13.24% p.a. in December. Price-indexed securities also registered an increase in issuance rates in the period. The Treasury announces bonds (and respective maturities) quarterly and can undergo alterations over time.

The average cost of the outstanding DPMFi has settled at relatively high levels. After three consecutive marginal drops from August to October, the outstanding DPMFi average cost climbed again in November to 10.73% p.a. (compared to 10.69% p.a. in October), suggesting accommodation at a relatively high level. Compared to the same month in 2021, the average cost of the DPMFi rose 2.2 pp in November. The average cost of DPMFi public offerings rose from 11.79% p.a. in October to 11.93% p.a. in November.

As explained in previous issues of RAF, the reduction in the average cost of DPMFi issuances between August and October was the result of deflation in those months, which brought down the average issuance rate of price-indexed securities.

FIGURE 17. AVERAGE PUBLIC DEBT COST (OUTSTANDING AND ISSUANCES) AND TARGET SELIC RATE



Source: STN. Prepared by: IFI.

The expected drop in inflation and stable Selic take pressure off the average cost of debt. In the coming months, the tendency is for some accommodation in the average cost of the outstanding DPMFi and of DPMFi public offerings due

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

to the Central Bank's interruption of the monetary tightening cycle and the prospect of inflation convergence to the target. In any case, this accommodation is relatively high, which puts pressure on public sector interest expenditures.

Gross debt as a proportion of GDP registered a new drop in November. We now move on to the analysis of debt indicators released by the Central Bank (methodology below the line), with information updated through November. The General Government Gross Debt (DBGG) slid from 75.1% of GDP (R$ 7,297.9 billion) in October to 74.5% of GDP (R$ 7,290.9 billion) in November, considering the Central Bank's monthly GDP series updated for the revisions made by the IBGE in the Quarterly National Accounts (Figure 17).

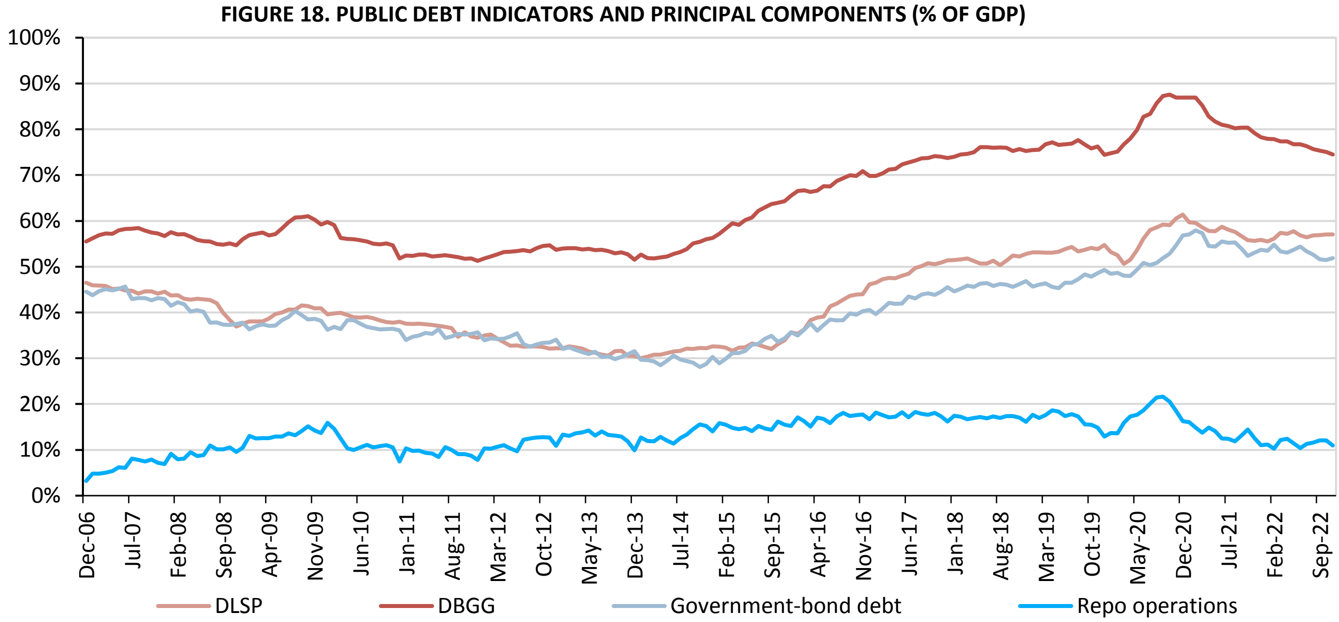
Based on the evolution of debt conditions, according to the Central Bank, the drop in the DBGG in November was influenced by net debt redemptions (-0.8 pp), by nominal GDP growth (-0.5 pp), a movement partially offset by the accrued nominal interest growth (+0.7 pp).

Nominal GDP and net debt redemptions caused the DBGG to drop in 2022. In the accumulated 2022 until November, the DBGG fell 3.8 pp of GDP due to the same factors mentioned above: growth of nominal GDP (-7.1 pp), net redemptions of debt (-3.2 pp), and accrued nominal interest (+6.8 pp).

Net debt was stable in November at a relatively high level. The Public Sector Net Debt (DLSP), which consolidates the public sector's liabilities discounting credits such as international reserves and Treasury loans to BNDES, remained stable for the fourth consecutive month in November (57.0% of GDP). Compared to the same month in 2021, the DLSP grew 1.4 pp of GDP in November (Figure 17). According to the Central Bank, Contributing to this result were the accrued nominal interest (+0.5 pp), the primary deficit (+0.2 pp), the nominal GDP growth (-0.4 pp), and the effect of the variation in the basket of currencies that make up the net external debt (-0.3 pp).

Between January and November, the net debt rose by 1.2 pp of GDP due to the accrued nominal interest (+5.4 pp), the effect of the variation in the basket of currencies that make up the net external debt (+1.5 pp), the accumulated 5.1% appreciation in the exchange rate (+0.8 pp), the increase in nominal GDP (-5.1 pp) and the accumulated primary surplus (-1.4 pp).

FIGURE 18. PUBLIC DEBT INDICATORS AND PRINCIPAL COMPONENTS (% OF GDP)



Source: Central Bank. Prepared by: IFI.

The IFI expects gross debt to grow to 77.8% of GDP in 2023. Before concluding the section, the IFI presents the updated projections for the DBGG in the baseline scenario. Table 13 shows the predictions underlying the indicators influencing the debt and DBGG forecasts in 2022, 2023, and 2024. In the baseline scenario, the DBGG will end 2022 at 74.1% of GDP, increasing to 77.8% in 2023 and 79.8% in 2024.

TABLE 13. DBGG FORECASTS (2022, 2023, AND 2024)

Breakdown	2022	2023	2024
Consolidated public sector primary balance	1.1%	-1.3%	-0.9%
Nominal GDP (R$ billion)	9,990.0	10,606.5	11,305.6
GDP - real growth	3.0%	0.9%	1.6%
Implicit GDP deflator	9.0%	5.2%	4.9%
Implicit real rate	4.5%	4.3%	4.2%
DBGG (% of GDP)	**74.1%**	**77.8%**	**79.8%**

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

Based on the new debt projections, the IFI updated the exercise to measure the primary public sector balance needed to stabilize the debt-to-GDP ratio at 74.1% (forecast at the end of 2022). Table 14 presents the balance required from different trajectories for the volume growth of the economy and the implicit real interest rate on gross debt.

TABLE 14. PRIMARY BALANCE REQUIRED TO STABILIZE THE DEBT-TO-GDP RATIO AT 74.1%

DBGG at		Real Implicit DBGG Interest rate							
74.1%		0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.9%	4.3%
Real GDP growth (% p.a.)	0.5%	0.0%	0.4%	0.7%	1.1%	1.5%	1.8%	2.5%	2.8%
	0.9%	-0.3%	0.1%	0.4%	0.8%	1.2%	1.5%	2.2%	2.5%
	1.5%	-0.7%	-0.4%	0.0%	0.4%	0.7%	1.1%	1.8%	2.0%
	1.9%	-1.0%	-0.7%	-0.3%	0.1%	0.4%	0.8%	1.5%	1.7%
	2.5%	-1.4%	-1.1%	-0.7%	-0.4%	0.0%	0.4%	1.0%	1.3%
	3.0%	-1.8%	-1.4%	-1.1%	-0.7%	-0.4%	0.0%	0.6%	0.9%
	3.5%	-2.1%	-1.8%	-1.4%	-1.1%	-0.7%	-0.4%	0.3%	0.6%

Source: IFI.

The primary result required to stabilize the gross debt in 2023 would be 2.5% of GDP. For the implicit real interest rate on gross debt at 4.3% and volume growth of the economy of 0.9%, IFI projections for 2023, the primary surplus required to stabilize the debt-to-GDP ratio at 74.1% would be 2.5%. For the following years (from 2024 to 2031)[19], the IFI scenario forecasts average real growth of the economy of 1.9% and implicit interest on the debt of 3.9% p.a., which would result in a primary surplus required of 1.5% to stabilize the debt-to-GDP.

To conclude this section, it is essential to mention the uncertainties concerning the Brazilian fiscal framework as of next year. The context is one of many pressures for increased spending. At the same time, tax collection tends to fall next year due to the slowdown in economic activity, the accommodation of inflation at lower levels, and the possibility of reducing commodity prices. Thus, how the government will address the sustainability of the country's public accounts in the short term will represent an essential element in dissipating uncertainty and regaining fiscal policy credibility.

19 See RAF no 70, November 2022. Available at: https://www12.senado.leg.br/ifi/publicacoes-1/relatorio/2022.

Despite the drop in the debt-to-GDP ratio over 2022, the projected worsening of the public sector primary balance in 2023 will cause the debt to rise by almost 4 pp of GDP. As discussed in RAF no. 70, November 2022, which updated the IFI's medium-term projections, in the absence of a rule that limits the evolution of primary expenditure, the prospect is of an accumulation of primary deficit over the entire projection horizon, leading the DBGG to rise continuously.

IFI forecasts

SHORT TERM

IFI forecasts	2023			2024		
	December	January	Comparison	December	January	Comparison
GDP – real growth (% per year)	0.88	0.89	▲	1.70	1.58	▼
Nominal GDP (R$ billion)	10,590.05	10,606.50	▲	10,975.90	11,305.58	▲
IPCA – accum. (% in the year)	4.69	5.30	▲	3.44	3.73	▲
Exchange rate – end-of-period (R$/US$)	5.23	5.26	▲	5.23	5.34	▲
Employment – growth (%)	0.44	0.44	▲	0.85	0.79	▼
Payroll – growth (%) (%)	0.88	0.89	▲	1.70	1.58	▼
Selic rate – end-of-period (% per year)	11.50	12.00	▲	8.50	9.50	▲
Real interest *ex-ante* (% per year)	5.50	6.52	▲	4.19	4.45	▲
Public Sector Consolidated Primary Balance (% of GDP)	-0.84	-1.34	▼	-0.87	-0.94	▼
of which Central Government	-0.84	-1.14	▼	-0.87	-0.74	▲
Net Nominal Interest (% of GDP)	5.68	6.23	▲	5.61	5.91	▲
Nominal Balance (% of GDP)	-6.52	-7.56	▼	-6.48	-6.85	▼
General Government Gross Debt (% of GDP)	77.23	77.79	▲	81.21	79.79	▼

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