Independent Fiscal Institution

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HIGHLIGHTS

- The GDP growth forecast was revised to 2.3% in 2023 and 1.2% in 2024.
- Revenues need to increase by 0.7 p.p. of GDP to meet the lower limit of the primary balance target in 2024.
- Revision in the revenue projection improved the expectation for the primary balance in the short term.
- IFI's expectation for gross debt is now 76.7% of GDP in 2023.
- Primary balance required to stabilize gross debt in the medium term is 1.4% of GDP.
- Fiscal impulse was slightly expansionary in the first quarter of 2023.

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REPORT LAYOUT
COMAP/SECOM and SEFPRO/SEGRAF

A new look at the Country's economic and fiscal situation

Dear reader,

It is with great satisfaction that we announce the launch of the new *layout* of our Fiscal Follow-Up Report (IFI). This new format aims to provide an enhanced experience to our readers with a more modern, clear and intuitive presentation.

The Fiscal Follow-Up Report (RAF) is the monthly analysis of the IFI's situation and meets the purposes set forth in Article 1 of Federal Senate Resolution No. 42 of 2016. Through the RAF, we convey our projections for the Brazilian economy's main macroeconomic and fiscal variables.

The main goal of this change is to make the report's content even more accessible and understandable to all interested audiences. We seek to offer relevant information about the economic and fiscal situation more concisely and precisely, highlighting the most important analyses and projections.

In addition, the new *report layout* also allows for better organization of sections and the inclusion of charts and data visualizations more effectively. In this way, we hope to facilitate an understanding of the trends and main indicators explored here.

It is worth mentioning that this new format is the result of a survey conducted by IFI from January to February of this year with some of our readers.

Thus, starting this month, the RAF will have four sections: (i) economic conjuncture, (ii) fiscal conjuncture, focusing on financing needs and fiscal rules; (iii) debt sustainability, and (iv) special topic. The goal is to perform a more specific and detailed analysis related to each of the sections mentioned above.

This month, the conjuncture section will analyze the positive surprises of the GDP of the first quarter. The strong growth, driven by agricultural production, led to the revision of the economic activity scenario. The projection for the GDP variation rate in 2023 rose from 1.0% to 2.3% in 2023. For 2024, is expected an additional expansion of 1.2% (Página 4).

The RAF is followed by a section analyzing the 2024 budget, highlighting the risks and impact of the government's announced fiscal measures and the new fiscal framework. According to this section, primary revenues must increase by 0.9 p.p. of GDP for the center of the primary target to be reached (Página 8).

Subsequently, the medium-term scenarios for public debt were revisited. It is worth mentioning that this section has deterministic and stochastic scenarios for the gross debt of the general government. The assessment in this RAF is that the gross debt of the general government (DBGG) for 2023 is expected to reach 76.7% of GDP. By 2024, it should reach 80.9% of GDP (Página 14).

Finally, the section dedicated to special themes will bring a methodological update and results of the Special Study (EE) No. 17, of 2021, on the structural fiscal balance of the Central Government. According to the new IFI estimate, the Union's fiscal impulse was slightly contractionary in 2022 (-0.4 p.p. of GDP) and slightly expansionary in the first quarter of 2023 (+0.3 p.p. of GDP). (Página 18)

In addition, it is worth mentioning that along with this new RAF structure, the instruments for disseminating data in editable format have also been improved. Thus, the electronic spreadsheet file (.xlsx) that accompanies the publications of the RAF will be disseminated in English and Portuguese, in addition to having recurring tables for subsidizing public evaluations. The data series produced by the IFI will continue to be published periodically on the institution's website.

Have a good read!

Vilma da Conceição Pinto
Director of IFI

The positive surprises of the first quarter GDP

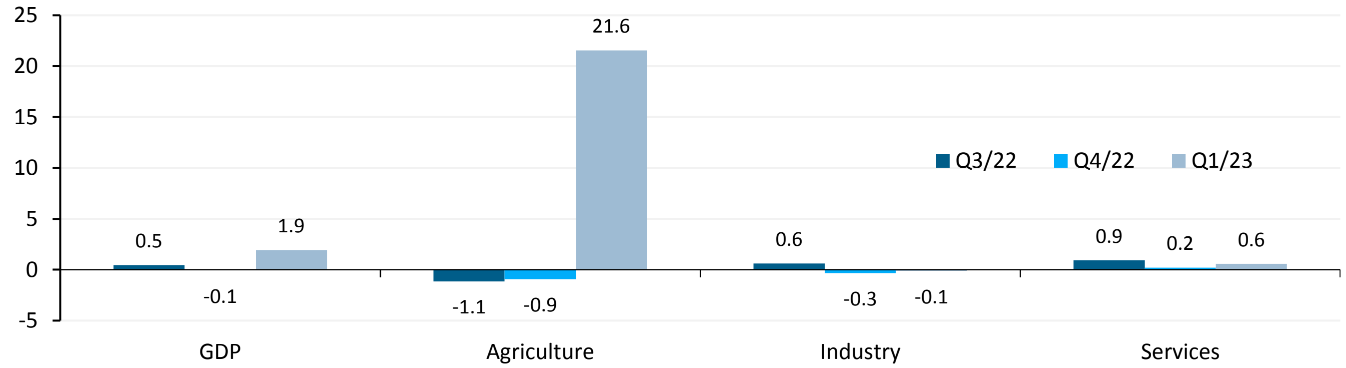
Rafael Bacciotti

The positive GDP surprise in the first quarter was mainly supported by the boost in agricultural production. The result came in well above expectations and led to a review of the economic activity scenario. The IFI raised the projection for 2023 GDP growth from 1.0% to 2.3% in 2023. For 2024, an additional expansion of 1.2% is expected.

According to data from the Quarterly National Accounts released by the Brazilian Institute of Geography and Statistics (IBGE), the Gross Domestic Product (GDP) of the first quarter advanced 1.9% compared to the immediately previous quarter after seasonal adjustment, reversing the 0.1% drop recorded in the fourth quarter of 2022. The result was above the IFI projection (1.0%) and the market projections consolidated by Valor Econômico (around 1.3%). Compared to the first quarter of 2022 (year-on-year comparison), the advance was 4.0%.

On the supply side, the GDP of services and agriculture advanced 0.6% and 21.6% (the largest change since 1997), in that order, while industrial GDP fell 0.1% compared to the fourth quarter of 2022 (Chart 1).

GRAPH 1. SUPPLY SIDE GDP: VAR. (%) AGAINST THE IMMEDIATELY PRECEDING QUARTER



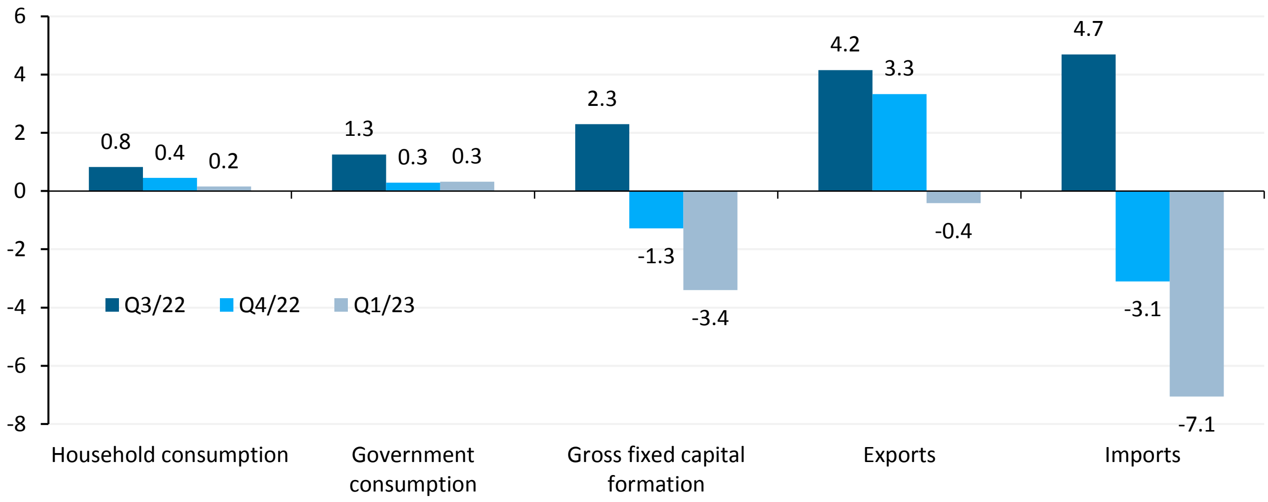
Source: IBGE. Elaboration: IFI.

In fact, it was expected to be robust agricultural activity growth due to the record grain harvest mapped by the IBGE in the Systematic Survey of Agricultural Production (LSPA), emphasizing the increase in the amount of soybeans produced. However, the expansion's magnitude came in higher than previously thought. According to the IBGE, the recovery of soybean crop productivity in most of the country due to improved weather conditions is the main factor that justifies the increase in production after the crop failure that occurred last year, when the GDP of agriculture shrank 1.7% compared to 2021.

In addition to the direct effect of the increase in agricultural income on GDP, the expansion of the grain harvest, in general, usually benefits the production chain, boosting adjacent sectors, such as transportation and storage services (which had a 1.2% increase in margin). The performance of the extractive industry (oil, gas and ferrous ores) was also a positive highlight in the first quarter GDP result (up 2.3% in margin). The manufacturing industry (-0.6%), construction (-0.8%), and other service activities (-0.5%), segments with greater representation in the product, decreased compared to the fourth quarter of 2022.

From the perspective of demand (Graph 2), household consumption expenditure (0.2%) and government consumption expenditure (0.3%) showed moderate positive changes in relation to the immediately previous quarter, while gross fixed capital formation (-3.4%) and imports of goods and services (-7.1%) fell substantially. The fall in imports is compatible with the weak performance of domestic demand (especially investment) and industrial activity.

GRAPH 2. DEMAND SIDE GDP: VAR. (%) AGAINST THE IMMEDIATELY PRECEDING QUARTER



Source: IBGE. Elaboration: IFI.

Domestic absorption, a concept that corresponds to total expenditure on consumption and investments, including the government, added 3.1 p.p. to the inter-annual variation of GDP (4.0%) in the first quarter, while net exports contributed another 0.9 p.p. Table 1 shows the contributions of each component of aggregate demand to the inter-annual variation of GDP.

TABLE 1. CONTRIBUTIONS TO THE RATE (YOY) OF GDP (IN P.P.)

	4T/21	1T/22	2T/22	3T/22	4T /22	1T/23
PIB	**2,1**	**2,4**	**3,7**	**3,6**	**1,9**	**4,0**
Internal absorption	**2,1**	**-1,0**	**4,5**	**3,9**	**0,6**	**3,1**
Household consumption	1,3	1,5	3,3	2,8	2,8	2,2
Government consumption	0,9	0,6	0,2	0,2	0,1	0,2
Gross fixed capital formation	0,6	-1,2	0,3	1,0	0,6	0,1
Inventory variation	-0,7	-1,9	0,7	-0,1	-2,9	0,5
Net exports	**0,0**	**3,4**	**-0,8**	**-0,3**	**1,3**	**0,9**

Source: IBGE. IFI elaboration.

The analysis of the contributions shows that there was an increase in inventories between the fourth quarter of 2022 and the first quarter of 2023 and that the influence of household consumption (still a vector to sustain growth) and gross fixed capital formation on GDP growth has been losing strength. Although consumption benefits from the increase in the expanded wage bill (labor income and gains received via income transfer) and the resilience of the labor market (seen in the expansion of formal employment and the decline in the unemployment rate), the tightening of financial conditions (high-interest rates and more restrictive credit) makes up a less favorable environment for economic activity.

The strong GDP expansion in the first quarter of this year prompted a round of revisions to market estimates for 2023. The average of the projections contained in the Central Bank's Focus Bulletin rose to 1.8% (range of one standard deviation from 1.3% to 2.4%). In the week leading up to the release of first-quarter GDP, the average for GDP growth in 2023 stood at 1.3 percent, with a range of one standard deviation from 0.8 percent to 1.7 percent.

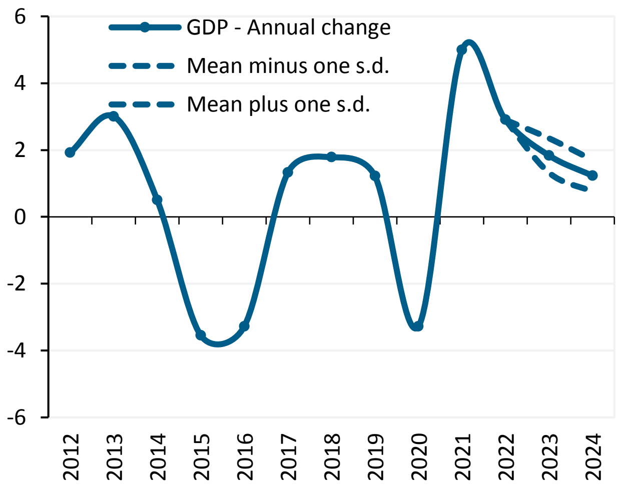
Market estimates for 2023 are likely to continue to rise in the coming weeks as the carry-over left for the year was estimated at 2.4%. It means that if there is no growth over the next three quarters, thus maintaining the level of the period of the beginning of the year, the real variation of GDP in 2023 would be 2.4% only by the effect of statistical loading.

Table 2 shows several possible growth rates for GDP in 2023 generated from different quarterly dynamics. Materializing a scenario of stability of economic activity until the end of the year, GDP growth in volume in 2023 would be 2.4% (exactly the carry-over value).

Given this scenario, the IFI raised the projection from 1.0% to 2.3% in 2023, a variation that embeds a picture of deceleration of economic activity in the second quarter (an increase of 0.2% in the margin) and retraction in the second half (average variation of -0.4%).

For the nominal GDP of 2023, the projection is for an increase of 7.6% (revised from 6.4%), reflecting, in addition to real growth of 2.3%, the implicit deflator of 5.2%. In current values, GDP should reach R$ 10.7 trillion. For 2024, it is expected additional expansion of GDP in volume of 1.2% (revised from 1.4%) and implicit deflator variation of 5.0%, which would take GDP in current values to R$ 11.3 trillion.

GRAPH 3. GDP EXPECTATIONS - FOCUS BULLETIN



Source. IBGE and Central Bank. Elaboration: IFI.

The upward revision in the 2023 economic activity scenario did not alter the outlook of economic agents for the conduct of monetary policy. The positive GDP surprise in the first quarter was mainly supported by the boost in grain production due to more favorable weather conditions, contrasting with the performance of sectors more sensitive to monetary policy. The Focus Bulletin maintained the projection for the Selic rate at the end of this year at 12.50% and 10.00% in 2024.

Although inflation expectations for the coming years (2024 and 2025) are closer to 4.0% (above the target set at 3.0%), the deceleration of current inflation (and core measures) indicates that there is room for the beginning of a process of cutting the basic interest rate currently at 13.75%. The IFI projection for the IPCA (and the Selic rate) in 2023 and 2024 is at 5.5% (12.75%) and 4.0% (10.50%).

TABLE 2. GDP GROWTH IN 2023 FOR DIFFERENT VARIATIONS IN QUARTERS

1Q: 1.9%					
		Hypothesis for the 2T variation			
Hypothesis for the mean variation in Q3 and Q4		**-0.5%**	**0.0%**	**0.5%**	**1.0%**
	-1.0%	1.3%	1.7%	2.1%	2.4%
	-0.5%	1.7%	2.1%	2.4%	2.8%
	0.0%	2.1%	2.4%	2.8%	3.2%
	0.5%	2.4%	2.8%	3.2%	3.6%

Source: IFI.

New Fiscal Framework: analysis for the first year of validity (2024)

Alexandre Andrade and Vilma Pinto

The draft of the new fiscal framework (PLP No. 93/2023) determines a transition rule for its first year of validity. In this section, in addition to the simulations made in Technical Note (NT) No. 52 of the IFI, we simulate the effects of the new fiscal framework for its first year of validity (2024).

The Complementary Law Bill (PLP) No. 93 of 2023 creates a new fiscal anchor to replace the current spending ceiling rule. On June 7, the IFI released a technical note with the main points of the project and simulations for the medium term taking as a starting point the year 2024, that is, the first year of validity of the new fiscal rule.

Thus, when based on the first year of the new rule, the technical note did not explore much the transition period from the current fiscal regime to the new fiscal framework. This section of the RAF aims to evaluate and simulate the effects of the new fiscal framework in its first year of validity (2024) in light of the federal government's budgets.

For context, the new fiscal framework provides for combining primary balance targets with limits on real expenditure growth. The main purpose of these rules for flow is to create a stable scenario for the debt-to-GDP ratio.

According to the project, the targets for the primary balance will continue to be defined by the Budget Directives Law (LDO), but with the introduction of tolerance intervals of 0.25 p.p. of GDP.

The Budget Guidelines Bill (PLDO) forwarded by the executive branch in April set an ambitious goal of zero primary deficit for 2024. The amount set in the PLDO is the first to predict the deficit's reversal for the reference year of the law since 2015[1].

This goal of zeroing the primary deficit next year requires a careful analysis of the new fiscal framework – under consideration in the National Congress – and the challenges that must be faced to achieve it. Here, we will also examine the level of revenue required and the fiscal measures announced by the government to meet this primary balance target.

Before entering into the fiscal scenarios for 2024, it is worth a more careful analysis of the primary surplus carried out in 2022, the data carried out in the first months of 2023, and the expectation for this year in light of the government's forecasts.

According to official data released by the National Treasury Secretariat, in 2022, the primary balance of the Union was a surplus of R$ 54.9 billion (0.5% of GDP). However, expectations for 2023 are a deficit of R$ 134.5 billion (1.3% of GDP).

Until April, the last month with available information, the primary balance of the Union had a worsening of 43% in real terms compared to the same period of the previous year. From January to

[1] If considered the revised goal. For more detail, see NT No. 52 of the IFI. Available in: https://www12.senado.leg.br/ifi/publicacoes-1/pasta-notas-tecnicas/2023/junho/nota-tecnica-no-52-novo-arcabouco-fiscal-analise-do-texto-substitutivo-ao-plp-93-de-2023-jun-2023.

April 2022, the surplus had been R$ 79.0 billion; in the first four months of this year, the result was only R$ 47.2 billion.

This clear deceleration was impacted by the commodity cycles and also by the increase in mandatory primary expenses, especially those related to the conditional income transfer benefit (Auxílio Brasil and Bolsa Família Programs), which had a significant increase in the amount paid between the first months of last year and this year (75.5% real increase). The table below shows the composition of the main items of the primary balance in the comparison of the first quarter of 2023 with the same period of 2022.

TABLE 3. PRIMARY BALANCE OF THE CENTRAL GOV. (R$ BILLION AND VAR. %)

	R$ million (Jan-Apr)		% change	
	2022	2023	Nominal	Real
1. TOTAL REVENUE	770,004	791,024	2.7	-2.2
1.1 Revenue Administered by RFB (Except RGPS)	492,606	512,659	4.1	-1.0
1.3 Net Revenue for RGPS	164,602	181,544	10.3	5.0
1.4 Other Revenue	112,795	96,821	-14.2	-18.3
2. Transfers to Subnational Entities	**142,844**	**152,047**	**6.4**	**1.3**
3. Net Revenue (I) - (II)	**627,160**	**638,977**	**1.9**	**-3.0**
4. Expenses	**548,137**	**591,812**	**8.0**	**2.8**
4.1 Social Security Benefits	243,378	260,177	6.9	1.8
4.2 Personnel and Social Charges	103,995	107,543	3.4	-1.6
4.3 Other compulsory expenditure	101,478	86,928	-14.3	-18.6
4.4 Expenses with Flow Control of the Executive Branch	99,285	137,164	38.2	31.6
of which: Auxílio Brasil / Bolsa Família Programs	29,398	54,209	84.4	75.5
5. Central Government Primary	79,023	47,165	-40.3	-43.0
5.1 National Treasury Primary Balance	157,799	125,798	-20.3	-24.0
5.2 Social Security Primary Balance	-78,776	-78,632	-0.2	-4.8

Source: STN. Elaboration: IFI.

This combination of reduced primary revenues and increased primary expenditures contributed to the projected reversal of the 2022 surplus into a deficit for 2023. Thus, based on the government's accounts, disclosed through the budget and financial programming decree No. 11,538 of May 30, 2023, and the scenarios projected for the 2024 Budget Guidelines Bill, compatible with the goal of zero primary deficit, it is possible to know how much will need to be increased in revenues and expenses in light of the Government's scenarios. The Table below performs this comparison for the main revenue and expense items.

TABLE 4. PRIMARY BALANCE OF THE CENTRAL GOV. (R$ BILLION AND % OF GDP)

	R$ million		% of GDP		Difference	
	2023	2024	2023	2024	Where. %	p.p. PIB
1. TOTAL REVENUE	2,367,177	2,682,923	22.0	23.3	13.3	1.3
1.1 Revenue Administered by RFB (Except RGPS)	1,464,975	1,787,383	13.6	15.5	22.0	1.9
1.3 Net Revenue for RGPS	593,391	636,360	5.5	5.5	7.2	0.0
1.4 Other Revenue	308,811	259,180	2.9	2.3	-16.1	-0.6
2. Transfers to Subnational Entities	**455,878**	**533,312**	**4.2**	**4.6**	**17.0**	**0.4**
3. Net Revenue (I) - (II)	**1,911,299**	**2,149,610**	**17.8**	**18.7**	**12.5**	**0.9**
4. Expenses	**2,045,768**	**2,149,610**	**19.0**	**18.7**	**5.1**	**-0.3**
4.1 Social Security Benefits	864,772	918,310	8.0	8.0	6.2	-0.1
4.2 Personnel and Social Charges	363,992	385,746	3.4	3.4	6.0	0.0
4.3 Other compulsory expenditure	294,414	309,973	2.7	2.7	5.3	0.0
4.4 Expenses with Flow Control of the Executive Branch	522,589	535,581	4.9	4.7	2.5	-0.2
5. Central Government Primary	-134,469	0	-1.3	0,0	-100.0	1.3
5.1 National Treasury Primary Balance	136,913	281,950	1.3	2.5	105.9	1.2
5.2 Social Security Primary Balance	-271,381	-281,950	-2.5	-2.5	3.9	0.1

Source: STN. Elaboration: IFI.

Thus, the comparison shows that the government's primary expenditures should have a nominal increase of R$ 103.8 billion (5.1% compared to 2023), and revenues should grow nominally by R$ 238.3 billion (12.5% compared to 2023) so that the deficit is zeroed in the perspective of government accounts. However, this scenario must respect the rules for the new fiscal framework provided for in PLP No. 93 of 2023.

Thus, as a general rule, the adjustment of expenses for the current year corresponds to the limit of the previous year adjusted by the rule of 70% or 50[2]% of real revenue growth, respecting the minimum limits of 0.6% and maximum limits of 2.5%. However, for the first year of validity of the rule, the limit of the previous year will not be used, but rather the amounts contained in the Annual Budget Law (LOA) of 2023 plus the supplementary and special credits issued until the promulgation of the new fiscal framework bill.

According to this rule, the basis for calculating the 2024 expense limitation should be R$ 2,013.1 billion. These expenses exclude some items that, despite being classified as primary, are not considered for the purposes of calculating the ceiling rule, such as, for example, transfers by the distribution of Union revenues with subnational entities or extraordinary credits opened to meet unpredictable and urgent expenses.[3]

In the first year of the tax rule, 70% of the real growth of the Union's primary revenue multiplies to such expenditure. According to the bill, the revenues that will be considered for the purposes of calculating the rule should be calculated according to the accumulated in 12 months to June and adjusted for inflation of the same period. According to this calculation system, revenues subject to the rule should grow, in nominal terms, 7.8%, and in real terms, this would be about 4.2%. Thus,

[2] If the primary result of the year prior to the preparation of the LOA was below the lower limit of the tolerance interval, that is, primary target minus 0.25p.p. of GDP, the percentage of 50% of real revenue growth will be used to define the percentage that primary expenditure can grow in real terms. In other cases, the percentage rises to 70%.

[3] A full description of the items that will not go into the calculation basis of the NAF can be found in NT No. 52 of 2023 of the IFI.

when applying the 70% reduction, the increase in expenditure for 2024 could be 2.5% in real terms. In this perspective, the expenses subject to the rule could reach R$ 2,134.6 billion in 2024.

The new fiscal framework also provides for the possibility of increasing expenses based on the following situations:

(i) **Paragraph 1 of Article 4 of PLP 93:** The result of the difference between the IPCA accumulated in 12 months ended in June and the one that ended in December may be used to open additional credit, and only for 2024, the open credits may be used to expand the calculation basis of the following years.

(ii) **Art. 15 of PLP 93:** Allows additional supplementation of 2024 expenses from the difference between the expected revenue growth for the year and the revenue growth used for purposes of setting the limit.

Both cases were explored in the NT of IFI No. 52, but it is worth mentioning that these expansion possibilities are conditioned to the fulfillment of the primary goal. Thus, it can be assumed that the estimated increase in the PLDO in relation to Decree No. 11,538 of 2023 will be maintained, thus leaving an evaluation of the possibilities for increasing revenues based on what has already been announced by the government.

As already highlighted, by the simple comparison between the most recent assessment of the government for 2023 and the numbers provided for in the 2024 PLDO, revenues should be increased by 0.9 p.p. so that the center of the goal is reached. However, the new fiscal framework allows for meeting the primary target considering bands for more or less than 0.25 p.p. of GDP. Adjusting for the lower limit, the minimum revenue the government needs to increase to reach the lower limit of the primary target is 0.7 p.p. of GDP.

So far, the government has announced a series of fiscal measures to boost primary revenues. Most of them are already included in the government's projections since the first report evaluating revenues and expenses. The table below shows the measures that have already been announced with an indicator of what is already in the official government projections and what, in fact, would represent an extra gain to reach the values of 0.9 or 0.7 p.p. of the GDP increment that needs to be realized to achieve the primary targets.

TABLE 5. MEASURES ANNOUNCED BY THE GOVERNMENT FOR THE RECOMPOSITION OF REVENUES AND IMPACTS ESTIMATED BY THE EXECUTIVE AND CONSIDERED BY THE IFI – BASELINE SCENARIO

Measure	Impact announced by the Ministry of Finance (R$ billion)		Value considered for the purpose of IFI projection (R$ billion adjusted for the variation in nominal GDP)		What is already in the government's projections
	2023	2024	2023	2024	
Revenue from transfer of resources from PIS/PASEP to the Treasury	23.0	-	23.0	-	Yes
PIS and Cofins on financial revenue	4.4	6.0	4.4	6.0	Yes
Return of the collection of PIS and Cofins on gasoline and ethanol	28.9	54.5	28.9	34.7	Yes
Return of the collection of PIS and Cofins on diesel oil, cooking gas and aviation kerosene	1.5	18.6	1.5	19.8	Yes
Collection of PIS / Cofins on ICMS credits within the states and the Federal District	31.9	58.0	-	-	Yes
Collection of IRPJ and CSLL on tax benefits under ICMS	47.0	47.0	7.1	12.5	No
Taxation on income earned abroad	3.3	3.6	3.3	3.6	Yes
Update of the exemption range value of the monthly incidence table of the IRPF	-3.2	-5.9	-3.2	-5.9	Yes
Transfer Pricing		70.0		20.0	No
Total	**136.7**	**251.8**	**64.9**	**90.7**	-
% of GDP	**1.3%**	**2.2%**	**0.6%**	**0.8%**	-

Source: Miscellaneous. Elaboration: IFI.

It is worth mentioning that some of the measures represent a punctual collection, such as the transfer of R$ 23 billion of unclaimed accounts of PIS/Pasep to the Treasury, scheduled for 2023. Other measures are already in place, such as the return of the collection of PIS/Cofins on gasoline and ethanol, with potential revenue of R$ 28.9 billion in 2023 and R$ 34.7 billion next year.

It is also planned the return of the collection of PIS and Cofins on diesel oil, cooking gas and aviation kerosene, which initially would occur only in 2024. The return of this charge still in 2023 is justified as a compensatory measure to the tax incentive given by the federal government to the commercialization of automobiles, trucks, and buses.

Some of the measures in Table 5 are of uncertain materialization, according to the Ministry of Finance itself. Some depend on a decision favorable to the Federal Government in actions judged by higher courts regarding the collection of federal taxes levied on operations of benefits and tax incentives under the ICMS. The possibility of collecting IRPJ/CSLL and PIS/Cofins on such operations has a relatively high collection potential for the Federal Government. Due to the uncertainty associated with the materialization of these revenues, the IFI considered, for the purpose of preparing scenarios, an amount lower than that estimated by the State Revenue Office of Brazil (RFB).

The same uncertainty appears in the possibility of obtaining revenues in operations called transfer pricing. The Conversion Bill (PLV) No. 8, of 2023, from MP No. 1,152, of December 28, 2022, which modifies the transfer pricing rules related to IRPJ and CSLL, was approved in Congress in May 2023 and awaits presidential sanction.

According to the Minister of Finance, the government expects a collection of up to R$ 70 billion annually with the change in the system of collection of IRPJ and CSLL. The minister admitted, however, that the government may be unable to reach this revenue. In any case, the measure would produce important revenue gains from next year.

Thus, it is concluded that achieving the primary target for 2024 will depend on the success of the fiscal measures already announced and, probably, on the announcement of new actions.

New horizons for public debt

Alessandro Casalecchi and Alexandre Andrade

The new figures for economic activity have improved the trajectory of GDP and, consequently, fiscal indicators in the short term. As a result, the IFI's projection for public debt was reduced by 1.4 p.p. for 2023 and by 1 p.p. for 2024. The medium-term trajectory, however, did not express a significant change.

This section will present more updated projections for the Gross Debt of the General Government (DBGG), the main indicator of government indebtedness calculated by the Central Bank. The main justification for revising the debt scenario in relation to that presented in the IFI monthly report for May stems from the improvement in the 2023 GDP projection, from an increase of 1.0% to 2.3%.

This more optimistic macroeconomic scenario contributed to improving the expectation for the primary revenues of the central government this year and, with it, the primary balance of the Union. IFI's projection for net primary revenue rose from R$ 1,887.7 billion to R$ 1,908.8 billion in 2023. As a proportion of GDP, net revenue was maintained at 17.9%. The main increase in relation to the revision of scenarios presented in May[4] occurred in the administered revenues (+ R$ 29.5 billion), although the expectation of net collection for the INSS (+R$ 3.8 billion) also increased.

The improvement in the revenue scenario in June compared to May and the revision in GDP caused the IFI estimate for the central government's primary deficit in 2023 to decrease from R$ 104.7 billion (1.0% of GDP) to R$ 84.8 billion (0.8% of GDP) in the base scenario. For 2024, the deficit expectation went from R$ 117.4 billion (1.0% of GDP) to R$ 105.5 billion (0.9% of GDP). In the medium term (period from 2025 to 2032), the primary deficit projection remained at 0.4% of GDP, on average.

Even with a better scenario for the flow indicators, the data carried out until the first four-month period of the year indicated a reversal of the downward trajectory of gross debt as a proportion of GDP. Between December 2022 and April, gross debt stock went from 72.9% of GDP to 73.2% of GDP. According to the conditioning factors of gross debt, nominal GDP had a smaller effect on the variation of debt in relation to the conditioning factors, differently from that observed in the last two years.

In the accumulated four months in 2023, nominal GDP growth contributed to decrease the debt-to-GDP ratio by 2.2 p.p. On the other hand, the conditioning factors caused the debt to increase by 2.3 p.p. of GDP between January and April, mainly those related to the payment of nominal interest (+2.7 p.p.). By way of illustration, in the 12-month comparison, public sector interest expenditure increased from 5.9% of GDP in December 2022 to 6.5% of GDP in April. This expenditure has not increased more because there was a slight decrease in the implicit rate of gross debt in April (11.1% p.a.) compared to March (11.2% p.a.).

In May, the IFI updated the DBGG projection to 78.1% of GDP by the end of 2023 in the baseline scenario. From the change in the projections of collection and the primary deficit of the central

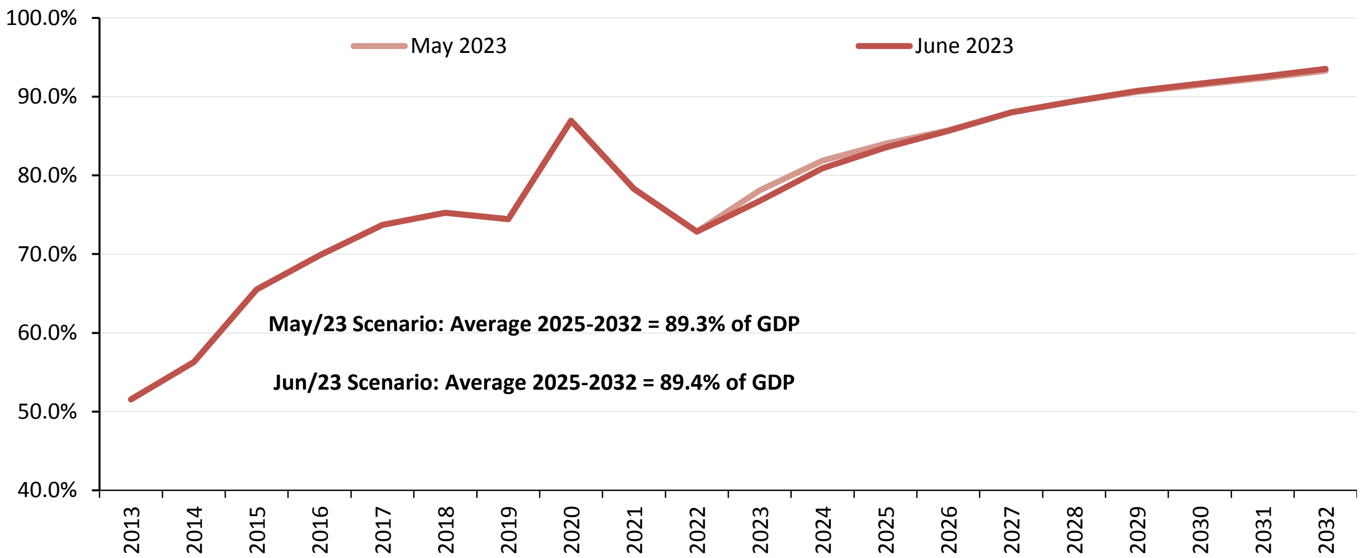
[4] See RAF No. 76, May 2023: https://www2.senado.leg.br/bdsf/bitstream/handle/id/610420/RAF76_MAI2023.pdf.

government of 2023, the projection for the gross debt became 76.7% of GDP at the end of this year. For 2024, the IFI's expectation is now 80.9%, compared to the previous estimate of 81.9% of GDP. In the medium term, the projections were practically the same (Graph 4).

In other words, the improvement in the projection of the primary balance of the central government and, therefore, of the consolidated public sector in 2023 and 2024 caused a slight downward shift in the IFI's estimates for gross debt in the short term. In the medium-term, the projections were very similar (the two lines of Graph 4 are practically overlapping).

Even with a more optimistic short-term scenario, in the medium-term, the parameters of the macroeconomic scenario remained practically the same, that is, nominal GDP should have an average annual growth of 5.9% (compared to 6.0% in the May scenario revision), while the real growth of the economy should converge to rates around 2.0% per year. Such variations are lower than those recorded in the past two years when domestic activity benefited from a positive commodity shock as the effects of the pandemic's isolation dissipated.

GRAPH 4. IFI PROJECTIONS FOR DBGG AT SELECTED TIMES (2023-2032) - % OF GDP – BASELINE SCENARIO



Source: Central Bank. Elaboration: IFI.

Another important piece of evidence extracted from Graph 4 concerns the gross debt growth over the entire projection horizon. It stems mainly from the difficulty of generating primary surpluses by the public sector and, in particular, by the central government at levels compatible with what is necessary to stabilize the debt-to-GDP ratio. In the IFI baseline scenario, in which only the revenue gain measures already announced (which are more likely to be accomplished)[5] and compliance with

[5] For verification of the revenue gain measures announced by the government and considered in the IFI scenarios, see Table 4 on page 13 of the already referenced RAF No. 76 of May 2023.

the new rules limiting real expenditure growth under the new fiscal framework are considered[6], the materialization of positive primary results will depend on the evolution of revenues. As mentioned in RAF No. 76 of May 2023, revenues constitute an important risk factor for achieving the primary balance targets stipulated in the 2024 budget guidelines currently being processed in Congress.

Thus, it would be possible to stabilize the debt-to-GDP ratio over a horizon of up to ten years if the scenario for primary revenues is relatively higher than those considered so far. One way to identify what would be the ideal primary result level for this debt trajectory to be stable over the medium term is by calculating the primary result required to stabilize the debt-to-GDP ratio at the level projected for 2023, given values for economic growth (g) and debt interest (r).

Table 6 updates the exercise conducted by the IFI to illustrate the primary result required to stabilize the DBGG as a proportion of GDP at the level of 76.7%, which is the projection for the indicator in the baseline scenario, at the end of 2023. With an implicit interest rate on gross debt at 3.9% p.a. and GDP growth of 2.0% (average projections for the medium term in the base scenario), the primary surplus required to stabilize the DBGG at 76.7% of GDP is 1.4%.

Table 6 indicates that the higher the interest rate, the higher the primary required to stabilize the debt. On the other hand, higher economic growth decreases the values of the primary result needed for this. In the hypothesis of real interest at 2.0% p.a. and GDP growth of 3.5%, even a primary deficit of 1.1% of GDP would stabilize the gross debt at the level projected by the IFI for December 2023 (76.7% of GDP).

TABLE 6. PRIMARY BALANCE REQUIRED TO STABILIZE GROSS DEBT AT 76.7% OF GDP

	DBGG at t	DBGG Implicit Real Interest							
	76.7%	0.5%	1.0%	2.0%	3.5%	3.9%	4.5%	5.0%	5.5%
Real GDP (% p.a.)	0.5%	0.0%	0.4%	1.1%	2.3%	2.6%	3.1%	3.4%	3.8%
	1.0%	-0.4%	0.0%	0.8%	1.9%	2.2%	2.7%	3.0%	3.4%
	1.5%	-0.8%	-0.4%	0.4%	1.5%	1.8%	2.3%	2.6%	3.0%
	2.0%	-1.1%	-0.8%	0.0%	1.1%	1.4%	1.9%	2.3%	2.6%
	2.5%	-1.5%	-1.1%	-0.4%	0.7%	1.0%	1.5%	1.9%	2.2%
	3.0%	-1.9%	-1.5%	-0.7%	0.4%	0.7%	1.1%	1.5%	1.9%
	3.5%	-2.2%	-1.9%	-1.1%	0.0%	0.3%	0.7%	1.1%	1.5%

Source: IFI.

In addition to deterministic scenarios, stochastic scenarios are useful for medium-term projections. Thus, the *fan chart* complements the IFI's base deterministic scenario, generated from 1,500 stochastic scenarios[7] for debt. Stochastic scenarios also make it possible to estimate probabilities related to the trajectory of public debt in the coming years. Given the assumptions in our baseline scenario, the probability of DBGG crossing the threshold of 90% of GDP in some year between 2023 and 2027 was estimated at 42.3%. That is, a virtually very small change, downwards, from the estimate of RAF No. 76, which was 43%.

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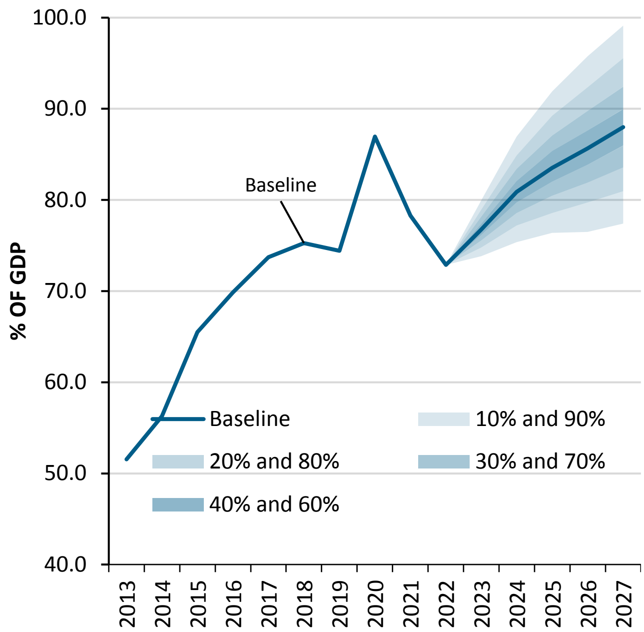
[6] See IFI Technical Note No. 52 at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/611070/NT52_Arcabouco_fiscal.pdf.

[7] For an explanation of the procedure, see subsection 3.3 of RAF No. 70. Available in:
https://www2.senado.leg.br/bdsf/bitstream/handle/id/602493/RAF70_NOV2022.pdf.

In Graph 5, the values on the left axis indicate the percentage that the DBGG represents of GDP. The percentages indicated in the legend at the bottom of the graph indicate which percentile of the 1,500 simulated trajectories each blue band represents. For example, 60% of the simulated values[8] are in the range labeled "40% and 60%" or in the ranges below it. In other words, each year, 40% of the trajectories are above the top line of the range labeled "40% and 60%" – a label that indicates the range within which the percentiles between 40% and 60% are. It should be noted that by 2027, such a line will be practically equal to 90% of GDP.

As already highlighted in RAF No. 76, Graph 5 also suggests that DBGG is unlikely to continue on a downward trajectory in the coming years, as all bands of the *fan chart* point to a resumption of debt growth as a proportion of GDP. In particular, the probability that gross debt in 2027 will be higher than the level at the end of 2022 (72.9% of GDP) was again estimated at 96.9%.

GRAPH 5. BASE SCENARIO AND STOCHASTIC SCENARIOS (FAN CHART) FOR DBGG



Source: IFI.

In short, the figures indicate a reversal in the downward trajectory of DBGG as a proportion of GDP in the first months of 2023 and, considering the macroeconomic and fiscal scenarios of the IFI, a likely increase in the indicator in the coming years. The context is one of difficulty in stabilizing (and even reducing) the debt due to continued primary deficits until 2029, according to the IFI scenario. Of course, the scenario would be better if interest rates are lower and/or the economy's growth is higher, favoring the public sector collection and the prospect of materializing primary surpluses.

[8] To facilitate the visualization of the essential elements, the 1,500 trajectories were not included in the graph.

Structural fiscal outcome: A look without the cyclical and non-recurring effects of government accounts

Alexandre Andrade, Rafael Bacciotti and Vilma Pinto

The structural fiscal balance corresponds to the government's fiscal balance (revenues minus primary expenditures) without the effects of the business cycle and atypical events. In this section, the estimates for the structural balance of the Federal Government are updated based on information available until the first quarter of 2023. The results indicate slight fiscal expansion in this first quarter of 2023 compared to 2022.

The structural fiscal balance is an important thermometer to verify the direction of fiscal policy, that is, whether the policy acts in the expansionary, contractionary, or neutral terrain. Understanding the structural fiscal outcome is essential to guide fiscal policy decisions, such as tax adjustments, public spending and investments, to achieve fiscal balance goals and promote a more responsible management of public accounts.

This section aims to update the estimate of structural fiscal balance for the Federal Government, considering the information available until the first quarter of this year.

Conceptually, the structural primary balance corresponds to the conventional balance, released monthly by the government and used to evaluate fiscal targets, discounting the effects of the economic cycle and fiscal events of a more punctual nature, such as a measure of special installment of taxes or even extraordinary expenses to mitigate the effects of the Covid-19 pandemic.

Although it is conceptually simple, the measurement of the indicator of the structural fiscal balance is complex since it depends on unobservable variables, such as the potential output of the economy, as well as a more discretionary evaluation of what should be considered an atypical event. Here, it is impossible to escape from a certain arbitrariness in classifying this type of event.

In early 2022, the International Monetary Fund (IMF) updated a database regarding the fiscal rules adopted by countries. Along with this update, the agency released the text for the discussion entitled: "Fiscal *Rules and Fiscal Councils Recent Trends and Performance during the COVID-19 Pandemic*."[9]

The study's authors point out that, after the number of countries that began to adopt rules for the balance adjusted by the economic cycle has grown, this number has decreased in recent years. Possibly, this decrease occurred due to the difficulty of implementing the cyclically adjusted deficit limits, given the complexity in the evaluation of the product gap, the treatment of specific factors, and the communication of these adjustments to society.

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[9] Davoodi H. R., P. Elger, A. Fotiou, D. Garcia-Macia, X. Han, A. Lagerborg, W.R. Lam, and P. Medas. 2022. "*Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the Pandemic*", IMF Working Paper No. 22/11, International Monetary Fund, Washington, D.C. Available at: https://www.imf.org/external/datamapper/fiscalrules/map/map.htm.

Despite the factors mentioned above, knowing the structural fiscal balances carried out by public administrations is an important assessment of a country's fiscal health.

The first step in estimating the structural outcome is distinguishing the recurrent from the non-recurring balance. According to the Secretariat of Economic Policy (SPE) of the Ministry of Finance[10], the non-recurring component must meet one or more of the criteria below:

i. Effect on public sector equity.
ii. Long-term repetition perspective (recurrence).
iii. Materiality of the values involved.
iv. Availability of public information about the operation.

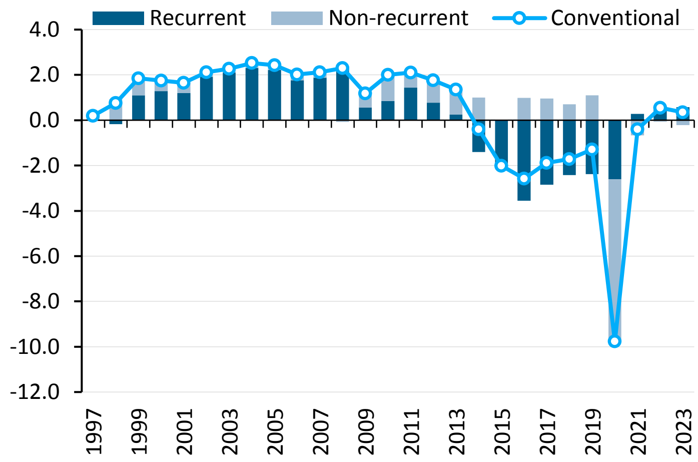
Compliance with the criteria presented by the SPE does not, however, rule out discretion in the classification of recurrent and non-recurrent events in the analysis. The SPE itself mentions this difficulty in the study.

In this section, the IFI promotes the updating of the calculation exercise of the non-recurring primary balance of the central government in light of the indicators presented in the Special Study (EE) of the IFI No. 17 of December 2021[11]. The graph below shows the trajectory of non-recurring, recurrent, and conventional (observed) primary outcomes for the Central Government as a proportion of GDP.

For example, in 2020, the central government had a primary deficit (conventional balance) of 9.8% of GDP. The non-recurring balance that year was a deficit of 7.2% of GDP due to the expenses executed, through extraordinary credits, to mitigate the economic and social impacts resulting from the pandemic outbreak. These expenses are considered non-recurring.

In the first quarter of 2023, on the revenue side, the main non-recurring events considered were R$ 2.6 billion of tax collections under special installments (Refis), R$ 5.0 billion as atypical IRPJ and CSLL collections, in addition to the waiver of R$ 11.2 billion resulting from the reduction to zero of the aliquots of PIS/Cofins incident on fuels. This information was extracted

GRAPH 6. RECURRENT AND NON-RECURRING PRIMARY BALANCE OF CENTRAL GOVERNMENT (% OF GDP)



*Source: IFI. Elaboration: IFI. *2023 corresponds to the accumulated in 4 quarters ended in March.*

[10] SPE – SECRETARIAT OF ECONOMIC POLICY, Structural Fiscal Balance: Presentation of the Estimation Method. Brasília, Secretariat of Economic Policy of the Ministry of Finance (MF/SPE), Methodological Note, May 2017. Available at: https://www.gov.br/fazenda/pt-br/assuntos/politica-fiscal/atuacao-spe/arquivos/nota-metodologica-resultado-fiscal-estrutural-maio-2017.pdf.

[11] Link to access the document: https://www2.senado.leg.br/bdsf/bitstream/handle/id/594656/EE17_Resultado_Estrutural.pdf.

from the monthly collection reports of the State Revenue Office of Brazil (RFB).

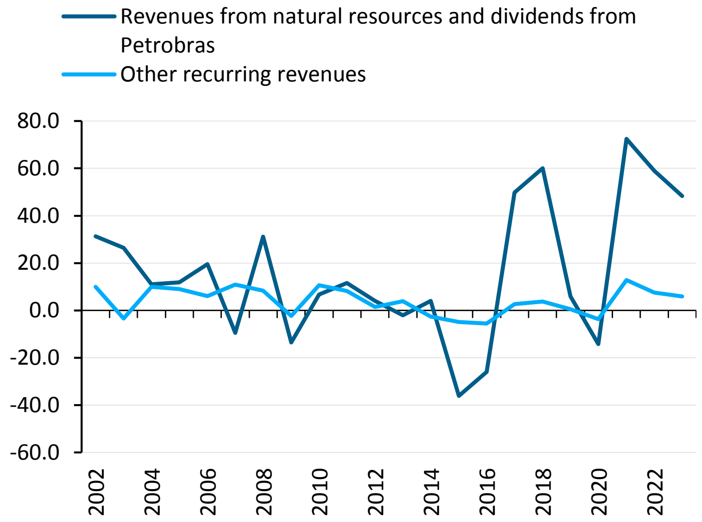
After the adjustments made in the series of primary revenues and expenses for the calculation of the recurring primary balance the following procedure consists of highlighting, in the recurring balance, the series of revenues most sensitive to the commodity cycle, mainly the price of oil, from the other recurring revenues, which will be adjusted by the economic cycle.

Graph 7 shows the real growth rate of recurring primary revenues. Recurring revenues deduct from primary revenues the collection from the exploration of Petrobras' natural resources and dividends in order to highlight the recent contributions these revenue items play to the recurring primary. It is possible to note that the growth of recurring revenues in 2017, 2018, 2021, 2022, and 2023 had a lot of influence from revenues sensitive to the commodity cycle. The cyclical adjustment separating these components is important to obtain a more reliable metric of what the structural fiscal balance of the Federal Government will be.

The third step is to get the potential GDP series and the oil price trend. Traditionally, the calculation of the IFI product gap follows the methodology disclosed in special study No. 4[12], however, as of November 2022, the [13]IFI began to estimate the product gap and, consequently, the potential GDP from the average of several different methodologies[14]. The oil price trend was obtained from the Hodrick-Prescott filter. Graph 8 shows the trend and effective GDP series and the product gap.

Another very important step is to calculate the elasticities of revenues subject to adjustment in relation to GDP and oil price. The calculations follow methodologies detailed in the special studies of IFI No. 16[15], in SPE (2017) and Pinto (2018).[16]

GRAPH 7. CENTRAL GOVERNMENT RECURRING REVENUE (VAR. % REAL)



Source: STN and IFI. Elaboration: IFI.

**2023 corresponds to the cumulative rate in 4 quarters until March.*

[12] Available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/536764/EE_04_2018.pdf

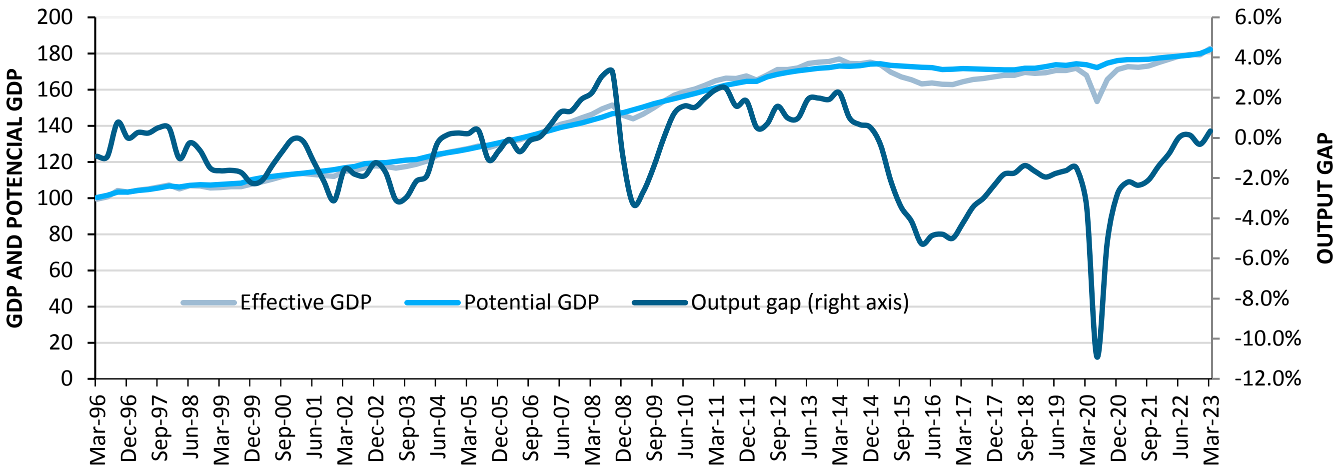
[13] In the Fiscal Monitoring Report No. 70, available at: https://www2.senado.leg.br/bdsf/bitstream/handle/id/602493/RAF70_NOV2022.pdf

[14] The Hodrick–Prescott (HP) filter; the multivariate HP filter, following Areosa (2008); Hamilton's filter, as in Quast and Wolters (2019); and the production function approach with specifications that use HP filter/multivariate HP filter/Hamilton filter and models in the form of state space, as in Orair and Bacciotti (2018), to extract trends in the unemployment rate, the level of installed capacity utilization and of factor total productivity. Trend estimates are obtained from extended historical series to minimize end-of-sample bias.

[15] Available at: https://www12.senado.leg.br/ifi/publicacoes-1/estudos-especiais/2021/novembro/estudo-especial-no-16-a-elasticidade-da-receita-em-relacao-ao-pib-nov-2021.

[16] Available at: https://bibliotecadigital.fgv.br/dspace/bitstream/handle/10438/22979/Dissertacao_Estrutural_FinalVilmaPinto.pdf

GRAPH 8. POTENTIAL, ACTUAL GDP AND PRODUCT GAP (INDEX AND %)



Source: IBGE and IFI. Elaboration: IFI.

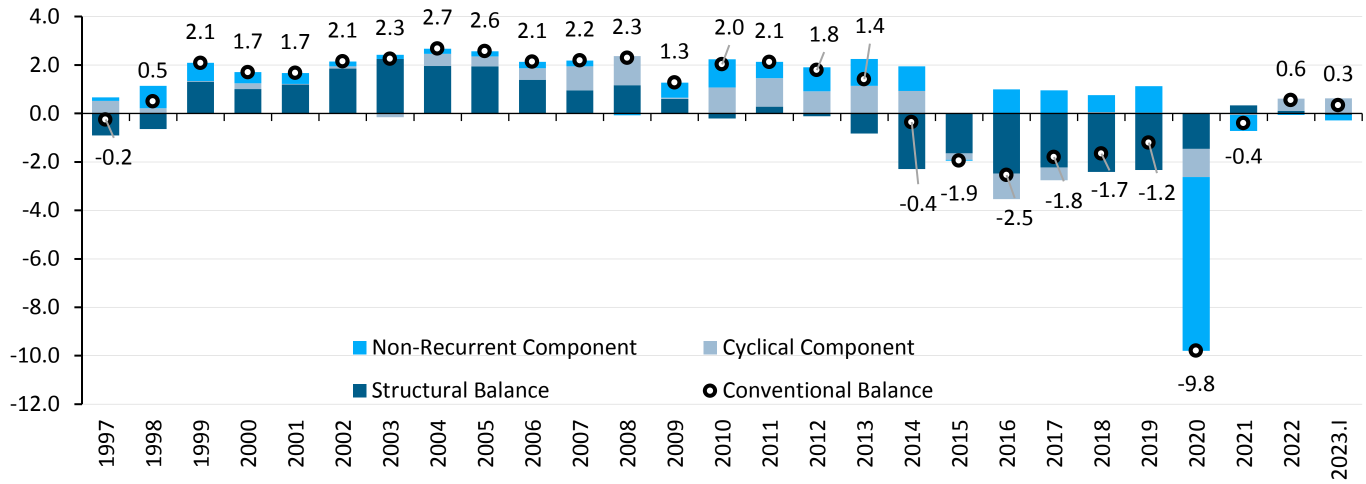
Finally, we proceed with estimating the structural fiscal balance, which consists of decomposing the conventional result into its cyclical, non-recurring, and structural components. The estimation details can be found in the EE of IFI No. 17.

The graph below shows the decomposition of the conventional fiscal balance from its components. In 2020 and 2021, the non-recurring component was negative due to pandemic spending. In 2021, even with a conventional balance having registered a deficit of 0.4% of GDP, the structural component was slightly positive. In 2022 and the first quarter of 2023, considering the accumulated value in four quarters of the year, the results indicated a structural balance close to zero.

Another important observation in relation to the most recent balance corresponds to the deceleration of the conventional balance between the data accumulated in four quarters until December 2022 and the accumulated data in four quarters until the first quarter of 2023. The conventional balance was reduced from 0.6% to 0.3% of GDP, although the cyclical component contributed positively in both periods with similar levels. The negative effect of the non-recurring component weighed in this first quarter of 2023.

In addition to the evolution of the composition of the Federal Government's fiscal balances, the fiscal impulse indicator helps us to understand where fiscal policy stands: whether in a more neutral, contractionary, or expansionary field. The indicator compares the structural fiscal balance between two points in time.

GRAPH 9. COMPOSITION OF THE CONVENTIONAL BALANCE (% OF GDP)



*Source: IFI. Elaboration: IFI. *2023 corresponds to the accumulated in 4 quarters ended in March.*

However, Borges (2021)[17] indicates that to assess the fiscal impulse, it is also necessary to incorporate non-recurring data. According to Borges (2021), "*the fiscal impulse is best approximated by the variation of the full primary balance adjusted by the economic cycle and not by the variation of the structural primary balance (recurrent and adjusted by the cycle).*"

Thus, following Borges (2021), the fiscal impulse for the first quarter of 2023 compared to 2022 corresponded to a fiscal expansion of 0.3 p.p. of GDP.

[17] Available in: https://observatorio-politica-fiscal.ibre.fgv.br/series-historicas/resultado-primario-estrutural/resultado-primario-estrutural-brasileiro.

IFI FORECASTS

SHORT TERM

IFI Forecasts	2023			2024		
	May	June	Comparison	May	June	Comparison
GDP – real growth (% p.a.)	1.04	2.28	▲	1.36	1.22	▼
GDP – nominal (R$ billion)	10,551.39	10,672.73	▲	11,264.90	11,341.24	▲
IPCA – accum. (% in year)	6.02	5.52	▼	4.12	4.00	▼
Exchange rate - end of period (R$/US$)	5.21	5.10	▼	5.30	5.18	▼
Employment- growth (%)	0.68	0.75	▲	0.77	0.68	▼
Wage bill - growth (%)	4.20	4.28	▲	1.37	1.22	▼
Selic – end of period (% p.a.)	13.00	12.75	▼	10.50	10.50	=
Real ex-ante interest (% p.a.)	6.43	6.63	▲	5.29	5.38	▲
Consolidated Public Sector Primary Balance (% of GDP)	-1.39	-1.19	▲	-1.45	-1.33	▲
of which Central Government	-0.99	-0.79	▲	-1.05	-0.93	▲
Net Nominal Interest (% of GDP)	7.46	7.35	▼	6.98	6.88	▼
Nominal Balance (% of GDP)	-8.85	-8.54	▲	-8.42	-8.21	▲
General Government Gross Debt (% of GDP)	78.11	76.74	▼	81.88	80.88	▼

Rosana Cristina da Cunha (translator);
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