Independent Fiscal Institution

FFR

Fiscal Follow-Up Report

APR 18, 2024 • Nº 87

HIGHLIGHTS

- Cycle of basic rate reduction is affecting interest rates on bank loans.
- The increase in loans is still driven by higher-cost modalities.
- It is expected that the continued decline in the Selic rate will promote credit expansion on more solid foundations.
- The 2025 PLDO have positive aspects, but also concerning ones.
- The revision of primary balance targets for 2025 and 2026 affects the credibility of fiscal policy.
- The stabilization of debt in the Executive's projections results from optimistic parameters.
- The volume of subsidies grew again in 2023, with projections indicating R$ 700 billion in benefits granted, the highest value in the historical series.
- Projections for 2024 indicate a reduction in tax subsidies, but financial and credit subsidies may increase again.

The change of pace in fiscal adjustment and the PLDO 2025

The Independent Fiscal Institution (IFI), within its institutional mission, delivers to the National Congress, the press, and the Brazilian society, the Fiscal Follow-up Report (RAF, kept here in its original acronym, as will all the acronyms of Brazilian institutions, taxes, and programs) no. 87, of April 2024.

The major highlight this month is the shift made by the federal government in the pace of fiscal adjustment, with the alteration of the fiscal targets for 2025 and 2026 carried out in the Budget Guidelines Bill (PLDO 2025), presented on April 15th, in the first year of the new fiscal regime established by Complementary Law No. 200, of 2023.

The change in the fiscal targets for 2025 and 2026, respectively from a surplus of 0.5% of GDP to zero and from a surplus of 1.0% of GDP to a surplus of 0.25% of GDP, represents a loosening of fiscal policy compared to the indication given last year in the 2024 LDO. The achievement of primary surpluses, previously projected for 2026 (LDO 2024), has been postponed to 2027 and 2028. In this way, the executive branch is opting for a slower pace in the fiscal adjustment needed to stabilize the public debt as a proportion of GDP. There will be BRL 159.3 billion in extra spending in the 2025/2026 biennium alone compared to the previous parameters. The justification provided was the pursuit of realistic targets and the institutional environment surrounding the approval of adjustment measures.

The Independent Fiscal Institution estimates that in order to stabilize the debt/GDP ratio, the annual primary surplus required would be 1.5% of GDP. There are still many doubts about the feasibility of achieving a zero deficit as early as 2024, the starting point of the proposed fiscal adjustment, considering the shortfall in expected revenues and the expansion of some expenses, even when considering the 0.25% of GDP margin of tolerance around the target center. The government's retreat regarding the fiscal target set in the LDO 2024 for 2025 and 2026, at the very least, postpones the convergence toward a trajectory of stabilizing public debt growth. The change in targets, a constant in the history of Brazilian fiscal policy, especially in the first year of the new fiscal regime, may influence the formation of expectations among investors and relevant economic agents regarding Brazilian fiscal policy and its multiple consequences.

RAF No. 87 discusses not only the less ambitious primary balance target, but also the economic growth projection in the PLDO 2025, the IFI's projected trajectories for public revenues and expenditures, the possible repercussions of the shift in fiscal policy on monetary policy and interest rates, and the trajectory of the public debt as a result of lower primary fiscal balances and the possible slowdown in the fall in interest rates. (**Page 10**)

RAF 87 also presents an analysis of the role of credit for individuals and legal entities in the dynamics of the Brazilian economy and its impact on GDP growth rates. (**Page 4**)

Another important section of the RAF investigates the behavior of tax, financial and credit subsidies present (or not) in the Federal Government's General Budget. The granting of subsidies is a public policy tool to stimulate economic development by reducing the price of products and services for consumers or their production costs for entrepreneurs. It is expected to grow to around BRL 700 billion by 2023, although the federal government has outlined the reduction of subsidies in the public budget as one of its fiscal adjustment strategies. The report not only describes the trajectory of subsidies, but also points out the side effects and costs of the subsidy policy. (**Page 16**)

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Recent performance of the credit market

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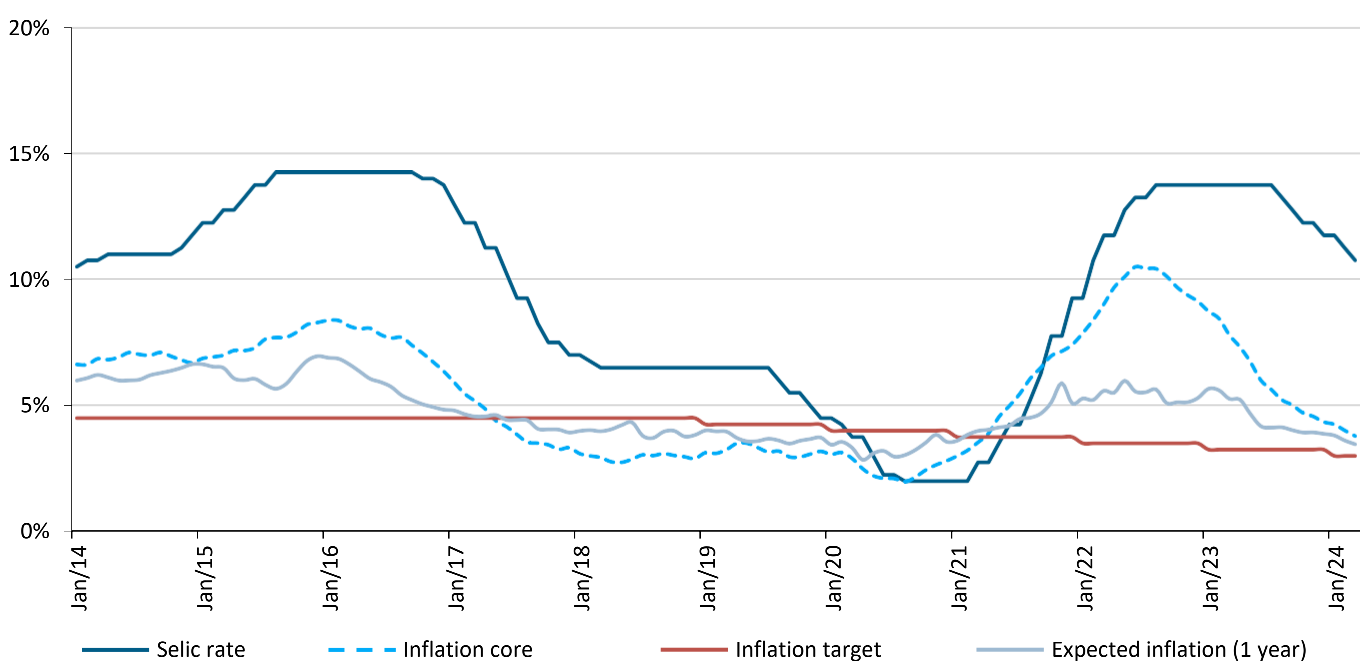
The gradual reduction in the economy's basic interest rate by the Central Bank's Monetary Policy Committee (Copom), since the middle of last year, has begun to be passed on to the bank credit market. There has been an improvement in financing conditions, evidenced by the reduction in interest rates applied to loans and a moderate increase in the average term of operations. At the same time, there has been an increase in new credit concessions, mainly in the form of unsecured credit for individuals, although concessions are being driven by higher-cost lines, such as overdrafts and revolving credit cards. Studies indicate a positive correlation between credit concessions and domestic private demand, highlighting the importance of credit in stimulating economic activity. The continued fall in base interest rates is expected to promote credit expansion on a more solid basis.

Analysis of GDP performance and outlook

Since the middle of last year, the Central Bank's Monetary Policy Committee (Copom) has gradually reduced the economy's base interest rate (Selic). In July 2023, the Selic rate was at 13.75% per year (p.a.), reaching 10.75% p.a. in nominal terms in March 2024. This movement, as illustrated in Graph 1, was stimulated by the reduction in inflationary pressures and inflation expectations, which began to come closer to the target set by the National Monetary Council (CMN). After reducing the Selic rate by 0.5 percentage points (0.5 p.p.) in March, Copom indicated another cut of the same magnitude at the May meeting, conditioning the total magnitude of the cycle on the evolution of the balance of risks for the prospective dynamics of inflation.

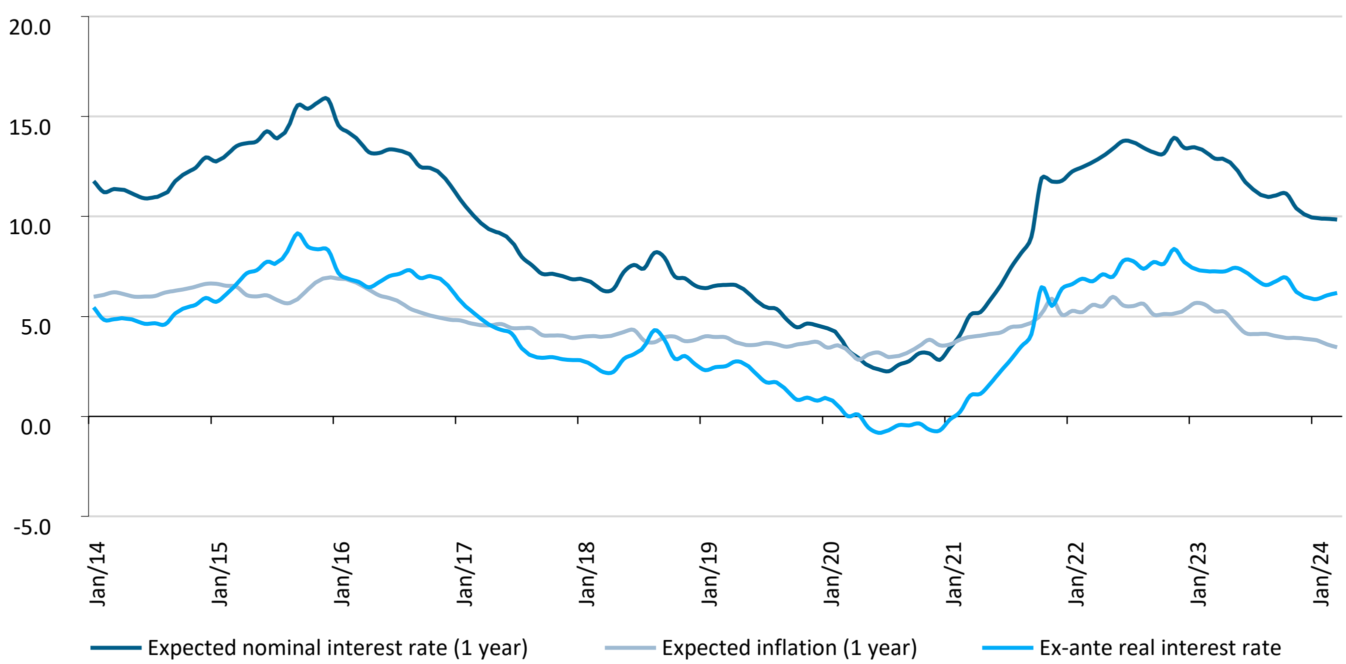
GRAPH 1. SELIC RATE AND INFLATION MEASURES (% P.A.)



Source: Central Bank.

The *ex-ante* real interest rate[1], calculated from the nominal interest rate expected over the next twelve months minus the inflation expected over the same period, fell from 6.9% p.a. in July 2013 to 6.2% p.a. in March 2024, as shown in Graph 2. Although on a moderate downward path, the *ex-ante* real interest rate, which is the relevant variable for making decisions about consumption and investment, remains at high levels and above the neutral point (4.5%)[2] considered by the Central Bank in its inflation projection models. This results in a still restrictive impact of monetary policy on economic activity.

GRAPH 2. REAL INTEREST RATE (% P.A.)



Source: Anbima, Central Bank and IFI.

Despite the still high level of the Selic and real interest rates, the current cycle of monetary policy is starting to have a positive impact on the banking credit market. In the minutes of the March meeting[3], Copom stressed that the resumption of credit, one of the channels through which monetary policy is transmitted to the economy's output and prices, has helped to mitigate the slowdown in economic activity. By reducing the base interest rate, the Central Bank stimulates a reduction in the rates applied to bank loans, which in turn increases the volume of loans granted to families and legal entities to finance consumption and investment.

In the National Financial System (SFN) statistics published by the Central Bank, it is possible to see improvements in credit market conditions, evidenced both by the reduction in interest rates on new loans and the increase, albeit modest, in the average term of these operations.

In February, as shown in Graph 3, the average interest rate on new loans (excluding revolving credit) followed the Selic trend, reaching 22.4% p.a., down 0.3 p.p. compared to the previous month and 1.2 p.p. in comparison to the same month last year. For operations with legal entities (companies), the average rate reached 15.2% per year, showing a decrease of 0.5 p.p. compared to the previous month, and 2.7 p.p. compared to the same period last year. For loans to individuals (households), the average interest rate was 26.2% p.a., down 0.3 p.p. on the previous month and 0.8 p.p. on February 2023.

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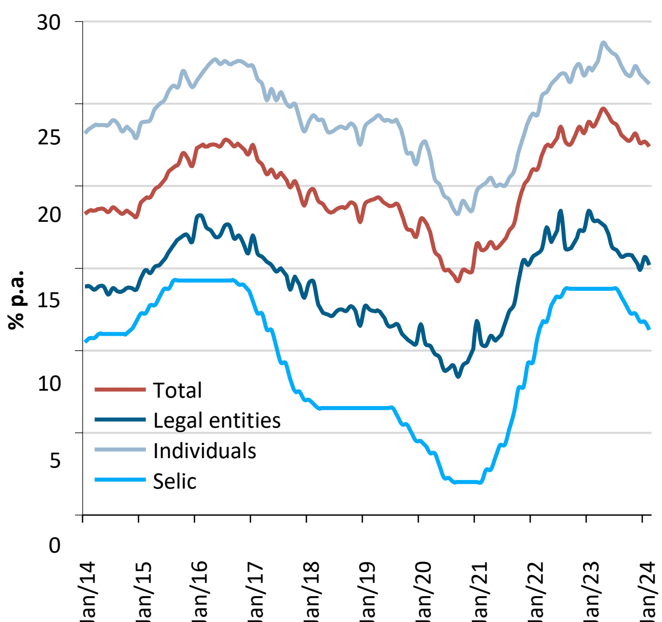
[1] The *ex-ante* real interest rate was measured by the 360-day pre-DI swap rate, which reflects the Selic rate expected over this period plus a risk premium, deflated by the expected inflation rate obtained from the Focus survey.

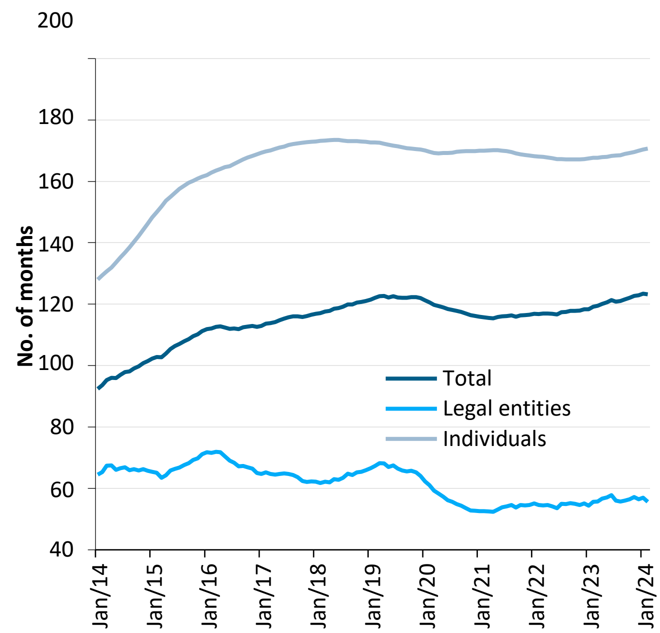
[2] As indicated in the March 2024 Inflation Report, available at: https://tinyurl.com/ycyfn5vu. The neutral real interest rate of the economy can be defined as the one that, in the medium term, is consistent with inflation at the established target and the growth of output equal to the potential growth of the economy. Thus, when the effective real interest rate exceeds the neutral rate, monetary policy is considered contractionary; whereas when it falls below, it is seen as expansionary

[3] Available at: https://tinyurl.com/m59pznzz.

At the same time, the average term of new SFN loans increased from 119 to 123 months between February 2023 and February 2024. This increase was led by the household portfolio, which rose from 168 to 171 months, while the average term of operations with companies remained stable at 56 months.

GRAPH 3. INTEREST RATE AND AVERAGE TERM OF TOTAL CREDIT OPERATIONS

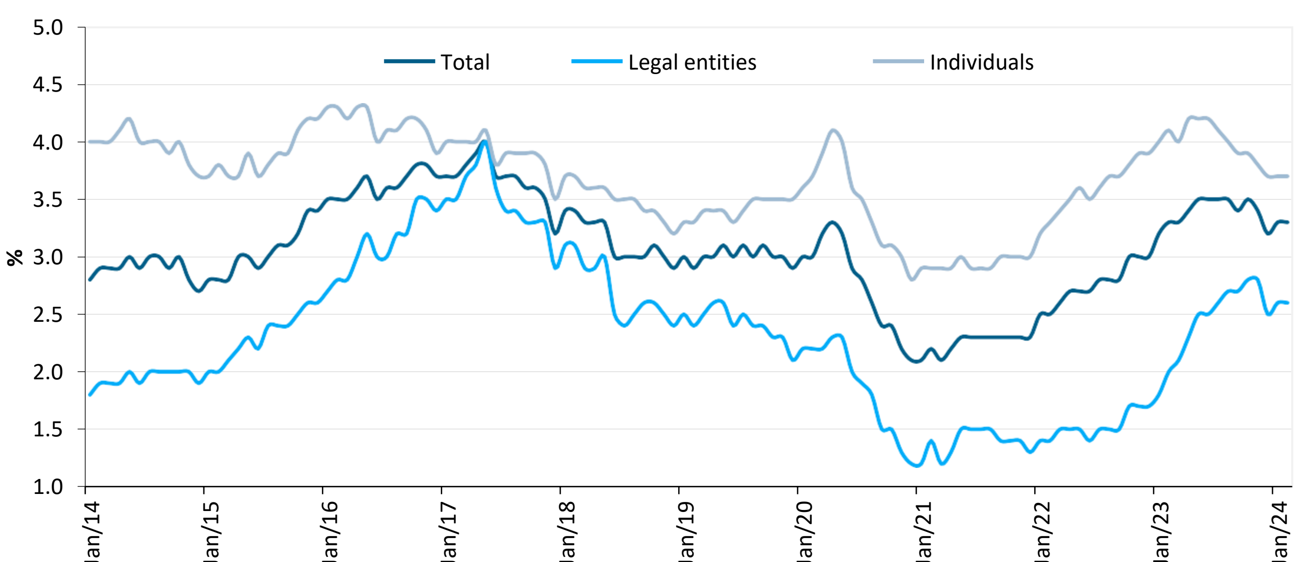




Source: Central Bank.

The default rate in the total credit portfolio, measured as the proportion of balances overdue by more than 90 days, remained stable at 3.3% between January and February, the same level as in February of the previous year. The default rates in the corporate and individual portfolios also showed stability, remaining at 2.6% and 3.7%, respectively, compared to January, although at historically high levels. While defaults in the corporate segment remain above the level of twelve months ago, there is an underlying downward trend in defaults in operations with individuals - a situation that reduces the risk for banks when granting credit.

GRAPH 4. DEFAULT RATE

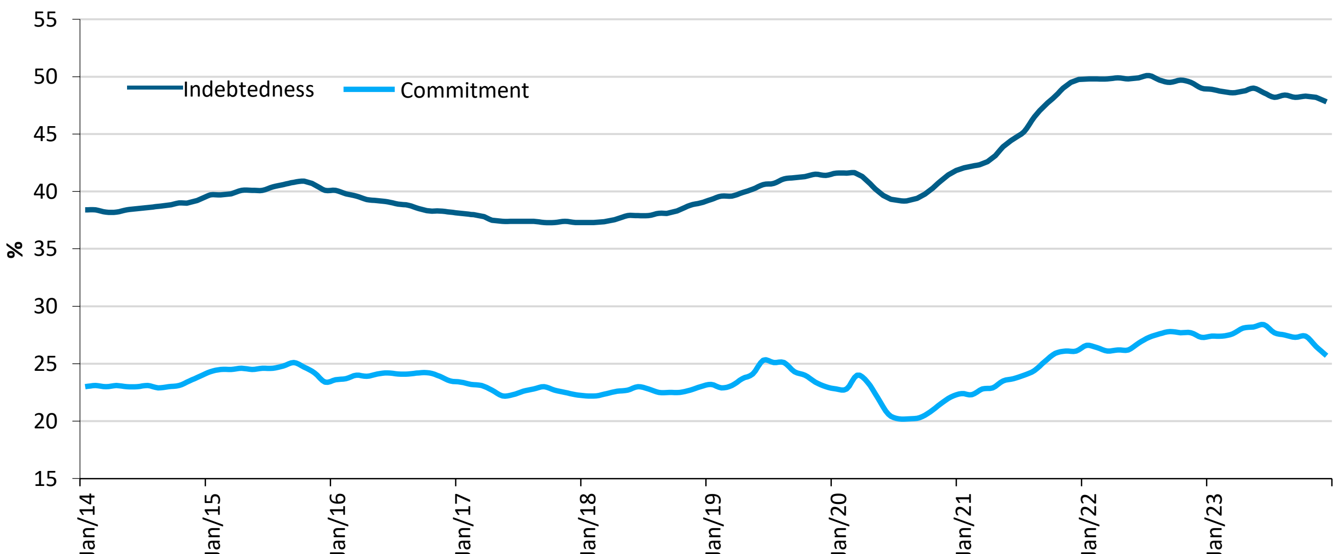


Source: Central Bank.

In addition to relatively more favorable economic conditions, lower inflation and interest rates, the recent drop in defaults may be partly related to the Desenrola Brasil program, implemented by the federal government and in force from July 2023 to May 2024. This program aims to facilitate the renegotiation of debts for individuals with a gross monthly income of up to two minimum wages or who are registered in the Single Registry for Social Programs (CadÚnico).

The decline in defaults on credit lines for households is taking place in an environment of reduced debt and lower income commitments to service debt (Graph 5). Household indebtedness[4], which increased by approximately 10 p.p. between 2020 and 2022 (from 40% to 50% of income), fell slightly to 48% in January 2024. The commitment[5] of income reached the highest value in the historical series in June 2023 (28%) and has been gradually decreasing ever since (25.8% in January), positively influenced by the increased wage bill and better financing conditions.

GRAPH 5. HOUSEHOLD DEBT AND INCOME COMMITMENT



Source: Central Bank.

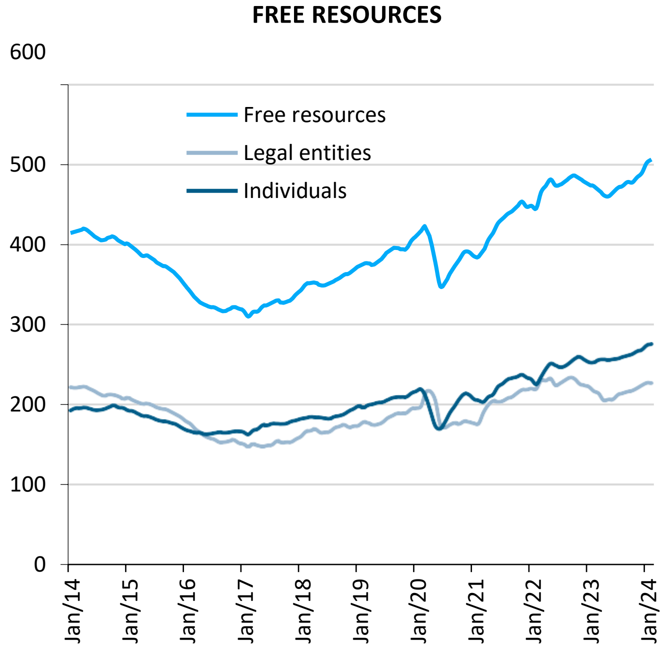
Accompanying the reduction in financing costs, the increase in loan terms and the improvement in economic conditions, especially with BRL rising, there has been an upward trend in the volume of credit granted by the SFN. Graph 6 shows the amounts of new loans - seasonally adjusted and deflated- expressed in quarterly moving averages to smooth out short-term fluctuations. This analysis considers both the origin of resources (free or directed[6]) and the recipients (households and companies). At the margin, there is a clearer trend of expansion in new unsecured loans to households, while operations with companies show a more discreet and gradual evolution.

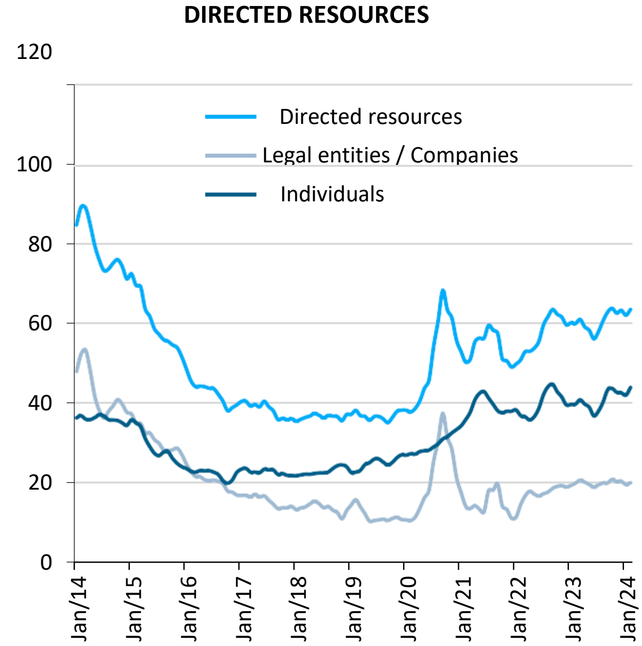
[4] Defined as the ratio between the current value of household debts with the SFN and household income accumulated over the last twelve months.

[5] Defined as the ratio between the value corresponding to the expected payments to service the debt with the SFN and the monthly income of households, as a quarterly moving average, seasonally adjusted.

[6] In the case of loans with free resources, the interest rates are freely agreed between the financial institutions and the borrowers. In the case of lines with directed resources, there is some kind of specific earmarking for the financing, with part of the funds raised from demand deposits and savings accounts, as well as public funds and programs. Therefore, interest rates are not freely negotiated between banks and borrowers, being subject to some form of directed regulation.

GRAPH 6. NEW CREDIT CONCESSIONS (BRL BILLION FEB/2024 - SEASONALLY ADJUSTED 3-MONTH MOVING AVERAGE)

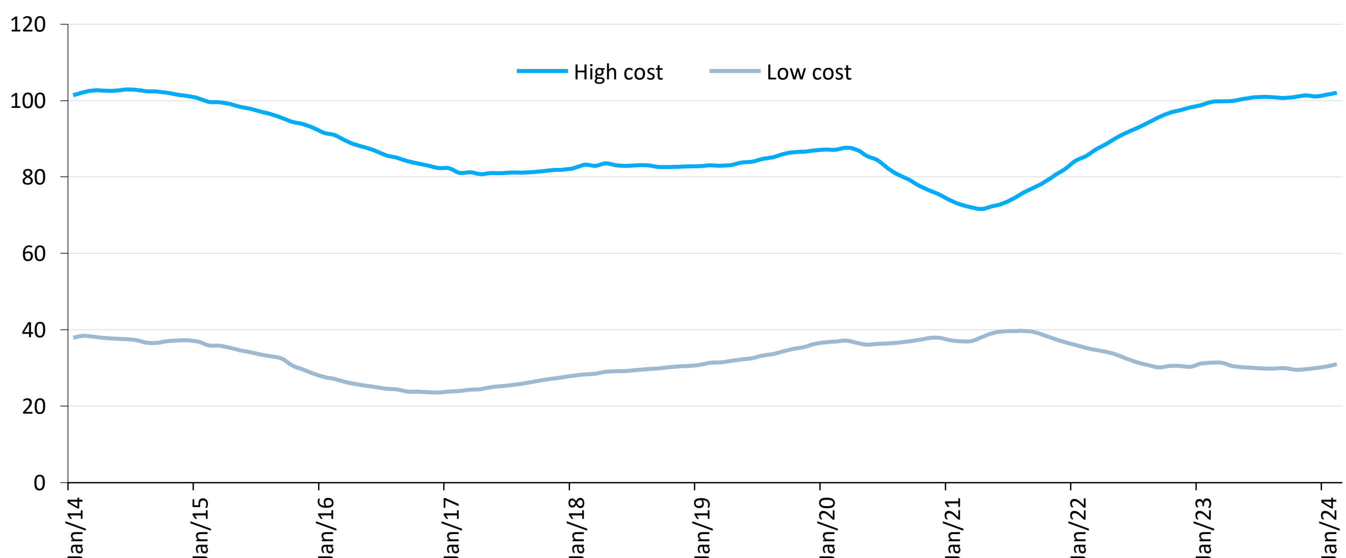




Source: Central Bank.

Graph 7 shows new loans to individuals, segmented into high-cost and low-cost modalities, according to the classification proposed by the Central Bank[7]. Although there is a general trend of expansion in new flows of unsecured credit for individuals, it is interesting to note that revolving credit card and overdraft lines, associated with higher-risk borrowers, are the modalities that still record the highest expansion rates. On the other hand, new grants in low-cost modalities, such as payroll-deductible personal loan and vehicle financing, which are more linked to consumption, although showing a positive trend in the margin, show a more restrained expansion dynamic.

GRAPH 7. NEW UNSECURED CREDIT GRANTS - INDIVIDUALS (BRL BILLIONS, FEB/2024 - 12-MONTH MOVING AVERAGE)



Source: Central Bank. Prepared by: IFI.

[7] In the conjunctural analysis of credit in the Central Bank's Inflation Report, the following classification categories are used. High cost: includes overdrafts, non-payroll-deductible loans, acquisition of other assets, revolving credit cards, installment credit cards and other unsecured credits. Low cost: includes payroll-deductible loans, vehicle financing, leasing and check cashing.

Despite the effects of the reduction in interest rates and the increase in average financing terms resulting from the reduction in the economy's base interest rates, there is still no substantial growth in financing lines with more favorable borrower profiles. In other words, those that involve a risk profile analysis, such as car financing, payroll-deductible loans, and real estate financing, in the case of individuals, and lines aimed at working capital, in the case of companies. The fact that credit growth is still led by riskier lines, such as credit cards and overdrafts, suggests caution in associating it with economic growth and an increase in credit on a more solid footing.

For individuals, obtaining credit for the purchase of durable goods is linked to confidence in the performance of the economy, such as the vigor of the labor market and the maintenance of base interest rates at relatively low levels. Meanwhile, for companies, greater growth in working capital lines indicates confidence in the future performance of the economy.

In any case, some studies[8] have already explored the presence of a positive correlation between the variation in credit concessions and domestic private demand, highlighting the role of credit in stimulating consumption and investment during periods of economic recovery. Despite these observations, the recent performance of the bank credit market, evidenced by the resumption of new loans, represents a possible boost to the level of economic activity, to be consolidated depending on the sustainability of a process of resumption of confidence among agents and a reduction in the levels of household income commitment.

[8] "*Impulso do crédito e atividade econômica*" [*Credit impulse and economic activity]*, BNDES Special Studies, Issue No. 5/2023, available at: https://tinyurl.com/59ebre2r; "*Fluxo Financeiro e Impulso do Crédito*" *[Financial Flow and Credit Boost]*, Inflation Report, September 2021, available at: https://tinyurl.com/5n9abn4b; and Biggs, M., Mayer, T., Pick, A. (2009). *Credit and economic recovery: Demystifying Phoenix Miracles* (Vol. 218). DNB Working Paper. Available at: https://tinyurl.com/tx3h3hhc

Considerations on the PLDO 2025

Marcus Pestana and Alexandre Andrade

The PLDO 2025 contains positive aspects, such as the introduction of the medium-term fiscal framework in the budget process, the setting of fiscal targets over a four-year horizon and the disclosure of gross debt projections for a 10-year interval. However, the revisions made to the primary balance targets for 2025 and 2026 tend to affect the credibility of fiscal policy and have consequences for the domestic economic environment, such as higher interest rates and greater uncertainty.

Introduction

As part of the regulation of the organization of public finances, the Federal Constitution (CF) stipulates that the planning of public policies is carried out through three legal instruments: (i) the Multi-Year Plan; (ii) the budget guidelines; and (iii) the annual budgets.

The Constitution also requires that the Budget Guidelines Bill (PLDO) be sent to Congress by April 15th of the previous year. The budget guidelines include projections for budget parameters, such as macroeconomic variables (GDP, inflation, interest rates, etc.) and fiscal variables (revenue, expenditure, setting the primary balance target), as well as the design of rules that will guide the formulation of the budget.

The Budget Guidelines Law, along with other regulations, anchors the current Brazilian fiscal regime, regulating and governing issues such as public debt, spending limits, taxation and tax exemptions, primary, nominal and structural balances, namely: (i) the Golden Rule (Art. 167, III of the Federal Constitution); (ii) Complementary Law (LC) No. 101, 2000, also known as the Fiscal Responsibility Law (LRF); (iii) LC No. 200, 2023, also known as the Fiscal Responsibility Law (LRF). 167, III of the Federal Constitution); (ii) Complementary Law (LC) 101 of 2000, also known as the Fiscal Responsibility Law (LRF); (iii) LC 200 of 2023, also known as the Sustainable Fiscal Regime, among other rules.

The LRF provides for a balance between income and expenditure in public accounts as a central element of medium- and long-term economic policy. In Section II, Art. 4, the rule imposes that the budget guidelines laws must present a Fiscal Targets Annex with committed results for the year to which it refers and the following three. There is provision for an assessment of compliance with fiscal targets for the previous year and other past exercises, a demonstration of the evolution of net worth, a financial and actuarial assessment of pension regimes and public funds, an explanation and estimate of tax exemptions, an assessment of fiscal risks, the objectives of monetary, credit and exchange rate policies and parameters and projections for the main economic aggregates and the inflation target.

The Sustainable Fiscal Regime (RFS), which replaced the Expenditure Ceiling established by Constitutional Amendment (EC) No. 95 of 2016, reaffirms the limits and constraints on the generation of expenditures and tax waivers contained in the LRF; provides for the maintenance of the public debt at sustainable levels, with the prevention of risks and the promotion of fiscal adjustment measures in the event of deviations, in addition to determining that the LDO will establish guidelines for fiscal policy through annual primary balance targets compatible with the sustainability of the public debt.

General considerations on the PLDO 2025

The PLDO 2025[9] is the first to present fiscal targets for a four-year horizon (in this case 2025, 2026, 2027 and 2028). Until the PLDO 2024, targets were set for a three-year period (the following year and the next two). In practice, this change makes the budget process more transparent.

Another positive aspect of the PLDO 2025 concerns the medium-term fiscal framework, as provided for in Art. 11 of Complementary Law (LC) No. 200 of 2023. This is the incorporation into the Brazilian budget process of an international practice that has been used to improve budget management. This instrument adopts a strategic planning approach to establish priorities in the allocation of resources. The PLDO 2025 includes projections for the main fiscal aggregates that make up the Executive's reference scenarios. The IFI discussed the

[9] Available at the following address: https://tinyurl.com/36rzfpcp.

medium-term expenditure framework in RAF No. 10[10], of November 2017 (page 36, box entitled "Budget multi-annuality").

A third positive aspect of the PLDO 2025 is the projections of the Gross General Government Debt (DBGG) for a 10-year horizon, in compliance with the amendment made by LC 200 to item III of art. 4 of the Fiscal Responsibility Law (LRF). This new rule for the LRF is also in line with increasing transparency in the conduct of fiscal policy by allowing a better assessment of the consistency of the parameters and scenarios considered by the Executive for the years ahead.

On the other hand, it is important to mention aspects of the PLDO 2025 that may be perceived as negative by economic agents. Taking the last scenario released by the IFI in February 2024 as a basis for comparison, the macroeconomic parameters announced by the Executive can be considered relatively optimistic. By way of comparison, for the period from 2024 to 2028, the average annual real growth of the economy projected by the Executive is 2.5%, while the IFI forecasts average annual growth of 1.9% for the period. For the Selic rate, while the government projects an average nominal rate of 7.7% p.a. between 2024 and 2028, the IFI estimates that the economy's base interest rate will stand at 8.2% p.a. over the period. It's worth remembering that the IFI's projections were last updated in February.

The Executive's estimates for fiscal variables seem equally optimistic, based on a comparison with the most recent projections released by the IFI. As will be detailed below, the biggest deviation between the government's and the IFI's estimates is in revenues. As discussed in previous editions of this RAF, this basically stems from the conservatism of the IFI regarding the realization of the revenue increase measures present in the Annual Budget Law (LOA) of 2024 and in the Provisional Measure (MP) No. 1,202 of 2023.

In addition to the relatively optimistic macroeconomic and fiscal projections, it is important to consider that the revision of the primary balance targets for 2025 and 2026 made in the PLDO 2025 tends to affect the credibility of fiscal policy by conveying the perception of a lack of commitment to the sustainability of public accounts in the medium term. Moreover, if the lower band is used to meet the primary balance target, the return of primary surpluses will be postponed to the next presidential term.

By way of comparison, in the LDO 2024, the Executive set the primary balance targets for the central government at zero in 2024, 0.5% of GDP in 2025 and 1.0% of GDP in 2026. Now, in the PLDO 2025, the proposed fiscal targets are: zero in 2025, 0.25% of GDP in 2026, 0.50% of GDP in 2027 and 1.0% of GDP in 2028.

The debt projections published in the 2025 budget guidelines, which indicate the sustainability of public accounts in the medium term, are the result of more favorable macroeconomic parameters, especially the growth of the economy and the continued reduction of the Selic rate from 9.63% p.a. in 2024 to 6.77% p.a. in 2028, as well as more optimistic primary balance estimates.

Still in relation to the credibility of fiscal policy, it is worth mentioning the change made to LC 200, of 2023, by Complementary Bill (PLP) 233[11], of 2023, approved by the Chamber of Deputies on April 9, 2024. This amendment brought forward from the second to the first two months of this year the possibility of the Executive opening a credit supplement to increase primary expenditure in 2024 by the amount corresponding to the difference between the maximum growth in expenditure provided for in the framework (2.5% of the previous year's net current revenue) and the growth in expenditure provided for in the 2024 LOA (1.7% of the real growth in revenue).

The change made to LC 200, which still depends on the approval of the Federal Senate, has the potential to increase the spending limits not only for this year, but also for the coming years, making it even more difficult to meet the primary balance targets. It is worth mentioning that the change in the fiscal framework law (LC 200) was made in a favorable context of tax collection in the first two months of 2024, which was boosted by non-recurring events, such as income tax collections on exclusive funds. There is a possibility that the collection performance in the second two months of 2024 will not allow the aforementioned credit supplementation to increase primary expenditure, if the amendment is not confirmed by the Senate.

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[10] Page to access the document: https://tinyurl.com/33a87kyr.
[11] Proposal progress page: https://tinyurl.com/8rvtrn3h.

Comparison between the Executive and the IFI projections

Table 1 and Table 2 show, respectively, a comparison between the IFI's most recent macroeconomic and fiscal projections (updated in February 2024) and the Executive's projections[12].

According to Table 1, the main discrepancies between the IFI's and the Executive's macroeconomic estimates are in the projected growth of the economy and the base interest rate (Selic). Considering the average for the period from 2024 to 2028, the Executive is working with an average real growth in the economy of 2.5% per year, while the IFI's projection is for a 1.9% increase in GDP for the period. This difference explains a significant part of the deviation in revenue projections between the IFI and the Executive, especially in terms of administered revenues (i.e. those collected by the RFB) and net collection for the General Social Security Policy (RGPS).

Another important difference between the Executive's macroeconomic scenario and the IFI's is the estimation of the trajectory of the Selic rate in this and the next few years. For the 2024 to 2028 average, the Executive considers the Selic at 7.7% p.a., while the IFI projects 8.2% p.a. for the indicator. As will be explained below, the Selic rate is an important variable for the trajectory of the public debt.

Turning to the figures presented in Table 2, which include the IFI's and the Executive's primary balance projections measured as a proportion of GDP, it can be seen that the revenue estimates explain almost all of the deviation observed in the central government's primary balance trajectories. Considering the average for the period from 2024 to 2028, the IFI projects total primary revenue to be 22.6% of GDP, while the Executive's estimate considers primary revenue to be higher by 0.4 p.p. of GDP, at 23.1% of GDP.

In net transfer revenues, the IFI's estimate is 0.5 p.p. of GDP lower than the Executive's for the period from 2018 to 2024. While the IFI projects net revenue at 18.2% of GDP, the Executive expects the indicator to stand at 18.8% of GDP on average over the next five years. Thus, and considering average projections of 18.5% of GDP (Executive) and 18.6% of GDP (IFI) for primary expenses, the deviation in the primary balance projection is 0.6 p.p. of GDP, without considering the deduction of court-order debt payments from the target.

Thinking about the expected trajectory for public debt, the aforementioned deviations in the projections for the Selic rate, GDP growth and the central government's primary balance explain the more favorable trajectory expected by the Executive for indebtedness in the coming years. Graph 8 shows the DBGG trajectory as a proportion of GDP up to 2028 in the IFI's baseline scenario, updated last February, and the Executive's scenario, presented in the PLDO 2025.

[12] The estimates for 2024 can be found in the Primary Revenue and Expenditure Assessment Report for the first two months of 2024(https://tinyurl.com/2f9bczv5). The projections presented for the period 2025 to 2028 are in the PLDO 2025).

TABLE 1. COMPARISON OF SOME MACROECONOMIC PROJECTIONS - EXECUTIVE AND IFI (2024 TO 2028)

	2024		2025		2026		2027		2028		Average 2024-2028	
	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI
Real growth (%)	2.2	1.6	2.8	2.0	2.6	2.0	2.6	2.0	2.5	2.0	**2.5**	1.9
Nominal GDP (BRL billion)	11,541.7	11,537.9	12,388.0	12,256.3	13,237.4	13,008.4	14,132.3	13,772.5	15,068.3	14,564.8	13,273.5	13,028.0
IPCA (% var.)	3.5	3.9	3.1	3.5	3.0	3.2	3.0	3.0	3.0	3.0	**3.1**	3.3
Accumulated Selic (% p.a.)	9.6	10.3	8.1	8.8	7.2	7.8	7.0	7.2	6.8	7.0	7.7	8.2
Average exchange rate (BRL/US$)	4.9	4.9	5.0	4.9	5.0	5.0	5.1	5.0	5.1	5.1	**5.0**	**5.0**

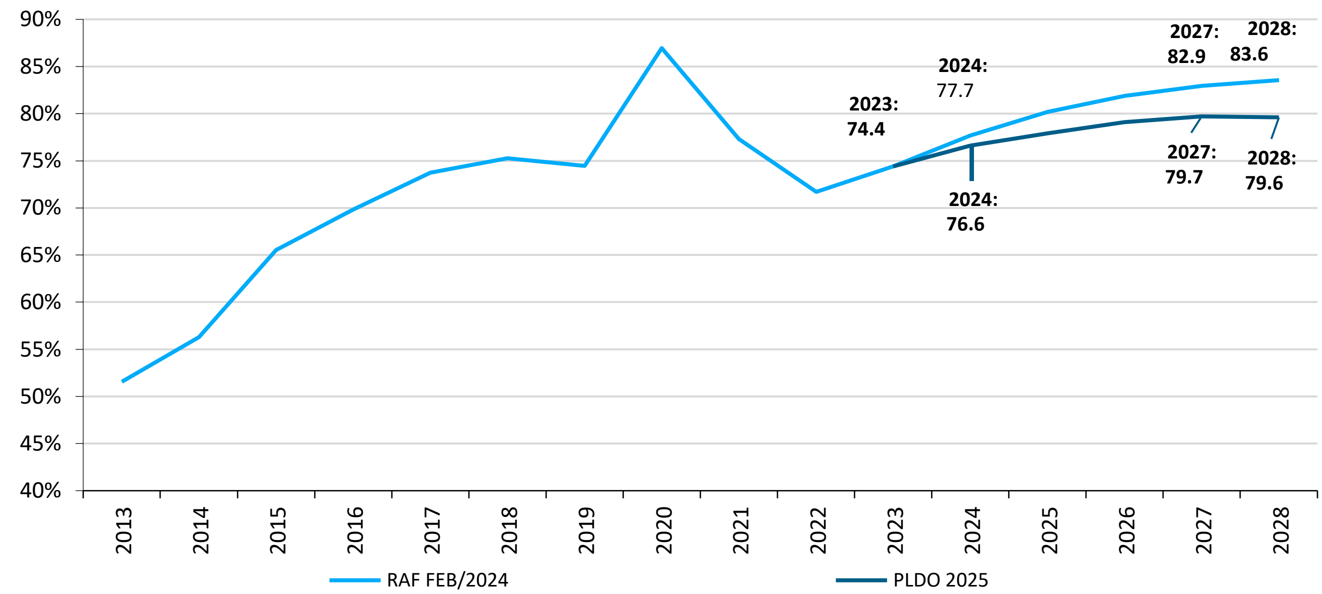
Source: Revenue and Expenditure Assessment Report for the 1st bimester of 2024, PLDO 2025 and IFI. Prepared by: IFI.

TABLE 2. COMPARISON OF CENTRAL GOVERNMENT PRIMARY BALANCE PROJECTIONS - EXECUTIVE AND IFI (2024 TO 2028) - % OF GDP

	2024		2025		2026		2027		2028		Average 2024-2028	
	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI	Executive	IFI
1. Total primary revenue	23.3	22.4	23.1	22.5	23.0	22.6	23.0	22.8	23.1	23.0	**23.1**	**22.6**
2. Revenue-sharing transfers	4.5	4.4	4.3	4.4	4.4	4.4	4.3	4.5	4.3	4.5	**4.3**	**4.4**
3. Net transfer revenues ([1]-[2])	18.9	18.0	18.7	18.1	18.7	18.2	18.7	18.3	18.9	18.5	18.8	**18.2**
4. Primary expenditure	18.9	18.9	19.0	18.9	18.8	18.6	18.2	18.4	17.9	18.2	**18.5**	**18.6**
5. Central government primary balance ([3]-[4])	0.1	0.9	0.2	0.8	0.1	0.4	0.5	0.1	1.0	0.4	0.2	**0.4**
6. Exclusion for target purposes (STF court-ordered payments)*	0.0	0.0	0.3	0.3	0.4	0.4	0.0	0.0	0.0	0.0	0.1	0.1
7. Primary balance after exclusion ([5]+[6])	0.1	0.9	0.1	0.4	0.3	0.0	0.5	0.1	1.0	0.4	**0.4**	**0.2**
8. Primary balance target	0.0	0.0	0.0	0.0	0.3	0.3	0.5	0.5	1.0	1.0	**0.3**	**0.3**

** Exclusion from the calculation of the target determined by Direct Actions of Unconstitutionality No. 7064 and 7047 (STF Court-ordered Debt Payments) Source: PLDO 2025 and IFI. Prepared by: IFI.*

GRAPH 8. IFI PROJECTIONS FOR DBGG IN THE DIFFERENT SCENARIOS (% OF GDP)



Source: Central Bank and PLDO 2025. Prepared by: IFI.

It is worth mentioning that the debt projections consider a sustainability equation, in which economic growth, the real interest rate and primary balances explain the dynamics of indebtedness. For example, the higher the economic growth, the lower the debt/GDP ratio tends to be, all other variables remaining constant. A lower interest rate also benefits debt dynamics, just as generating primary surpluses helps the government manage debt by enabling the payment of debt service.

Based on the baseline scenario projections of the IFI's latest update, gross debt should continue to grow over the next few years. Although not reported in the graph, the debt would continue to rise until 2031, when it would reach 84.3% of GDP, falling slightly from 2033 onwards (to 84.2% of GDP). In other words, it could be said that the debt would be stabilized at the beginning of the next decade. On the other hand, according to the projections released by the Executive in the PLDO 2025, gross debt as a proportion of GDP would be stabilized between 2027 and 2028, which reflects the more optimistic parameters considered by the government.

A discussion of the IFI's most recent projection for the DBGG was presented in RAF No. 85[13] of February 2024. In general terms, nominal GDP growth made an important contribution to the fall in indebtedness between 2021 and 2022, as well as to the more moderate increase in the indicator from 2023 onwards. In any case, the effect of GDP growth on debt is increasingly diminishing. This, added to the increase in public sector interest expenditure, is what caused the gross debt to increase in 2023.

Also in RAF No. 85, the IFI presented a table (Table 9, page 21) with a simulation of the primary balance required to stabilize the gross debt at 74.3% of GDP, which was the value estimated by the IFI for the debt/GDP ratio at the end of 2023. Based on the economy's average annual real growth of 2.0% and implicit real interest rates of 4.1% p.a., average values for these variables in the period from 2025 to 2033, considered medium term, the primary balance needed to stabilize the debt would be 1.5% of GDP.

Considering that the IFI's projection for the primary balance of the consolidated public sector is a deficit of 0.8% of GDP in 2024, the fiscal effort needed to stabilize the public sector's gross debt as a proportion of GDP would be 2.1 p.p. of GDP, equivalent to BRL 270 billion. In the May edition of this RAF, a review of the IFI's macroeconomic and fiscal scenarios will be presented.

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[13] Page to access the document: https://tinyurl.com/5n8vxw7t.

Final considerations

All things considered, the first impressions regarding the PLDO 2025 are that the revisions made to the primary balance targets for 2025 and 2026, namely from 0.5% of GDP to zero and from 1.0% of GDP to 0.25% of GDP, respectively, in comparison with the 2024 LDO, tend to affect the credibility of fiscal policy. The perception is that the effort to achieve sustainable public accounts in the medium term has been postponed.

The loss of credibility of the fiscal framework rule could have consequences for the domestic economic environment. For example, the perception of fiscal fragility in a context of continued contractionary monetary policy in the US may mean that the base interest rates (Selic) don't fall as much, given the inflationary pressures that will arise with the higher dollar.

Moreover, in an environment of greater uncertainty regarding fiscal policy and potentially higher interest rates than initially expected, the planning horizon for households and businesses tends to shorten, and the challenges faced by the Treasury in managing public debt increase.

Finally, it's also important to mention the importance of periodic spending reviews. According to the PLDO, the Executive foresees potential savings of BRL 37.3 billion between 2025 and 2028 with the current reviews carried out on expenses with social security benefits and the Agricultural Activity Guarantee Program (Proagro). This is a relatively modest sum considering the annual amount of social security benefit payments (something around BRL 920 billion). The difficulties in stabilizing the public debt demonstrated in the PLDO 2025 reinforce the need to advance the agenda of periodically reviewing expenditure in order to achieve fiscal consolidation.

Tax, financial and credit subsidies from the Federal Government

Eduardo Nogueira

The volume of tax, financial and credit subsidies has grown again, with projections indicating almost BRL 700 billion in benefits granted in 2023, reaching the highest value in the historical series. Projections for 2024 indicate a reduction in tax subsidies, but financial and credit subsidies may grow again due to the expansion of programs, the reduction in the remuneration rate of funds and programs, and the stabilization at a high level of the opportunity cost of the National Treasury.

Situation in 2023

According to the Technical Manual of Financial and Credit Benefits (MTBFC)[14], drawn up by the Ministry of Planning and Budget (MPO), subsidies are fiscal policy instruments that aim to reduce the price to the consumer or the cost to the producer. Within the federal government, there are subsidies both from the perspective of public expenditure (financial and credit subsidies or benefits) and from the perspective of public revenue (tax subsidies or benefits).

In the macroeconomic context, the granting of subsidies is a form of state intervention aimed at stimulating economic development. This action seeks to correct market distortions or deficiencies, or to mitigate social and regional imbalances[15].

Tax benefits, also known as tax expenditures, are implemented by introducing exceptions to the Reference Tax System (STR)[16] in order to meet economic and social policy goals. They are aligned with the allocative, distributive and stabilizing functions of fiscal policy[17], reducing potential collection and, consequently, affecting the primary balance of the central government.

On the other hand, financial benefits include direct monetary transfers, made through interest or price equalizations, or through the incorporation of financial obligations by the Federal Government. These actions generally[18] have an impact on the primary balance, since they are, in most cases, primary expenditure.

Credit benefits materialize when federal resources are allocated to funds, programs, or credit-granting initiatives, executed under financial conditions favorable to the borrower, typically below the Federal Government's cost of funds. Therefore, as a general rule[19], they do not impact the primary balance, but they increase the implicit interest rate of the Net Public Sector Debt (DLSP)[20] and worsen the state's solvency.

[14] The MTBFC presents the methodology for calculating financial and credit subsidies, and is available at: https://tinyurl.com/35c7e9m3. The methodology for calculating tax expenditures is defined by the Special Secretariat of the Federal Revenue Office of Brazil (RFB), and is available at: https://tinyurl.com/4y7exbpv.

[15] The Federal Constitution (art. 165, § 6) stipulates that the annual budget bill (PLOA) must be accompanied by a regionalized statement of the effect on revenues and expenses resulting from exemptions, amnesties, remissions, subsidies, and benefits of a financial, tax, and credit nature. The Fiscal Responsibility Law (LRF), in its art. 5 (item II) reinforces this obligation.

[16] The definition of a country's Reference Tax System is important because it is from this reference structure that deviations are identified and classified as tax expenditures. Brazil has adopted the legal approach, with a Reference Tax System based on current tax legislation, accounting standards, economic principles, tax principles and specialized doctrine. For more information, see: https://tinyurl.com/4t8bm6de.

[17] For more information, see: https://tinyurl.com/2tk6vd6z.

[18] The MTBFC's main exception is the Salary Variation Compensation Fund (FCVS), which is included as a financial expense in the Federal Government's General Budget and has no impact on the primary balance.

[19] According to the MTBFC, some Funds and Programs are accounted for, in part, with primary impact, such as the Student Financing Fund (Fies), the National Program for Strengthening Family Agriculture (Pronaf), the Export Financing Program (Proex) and the Constitutional Financing Funds (FCF).

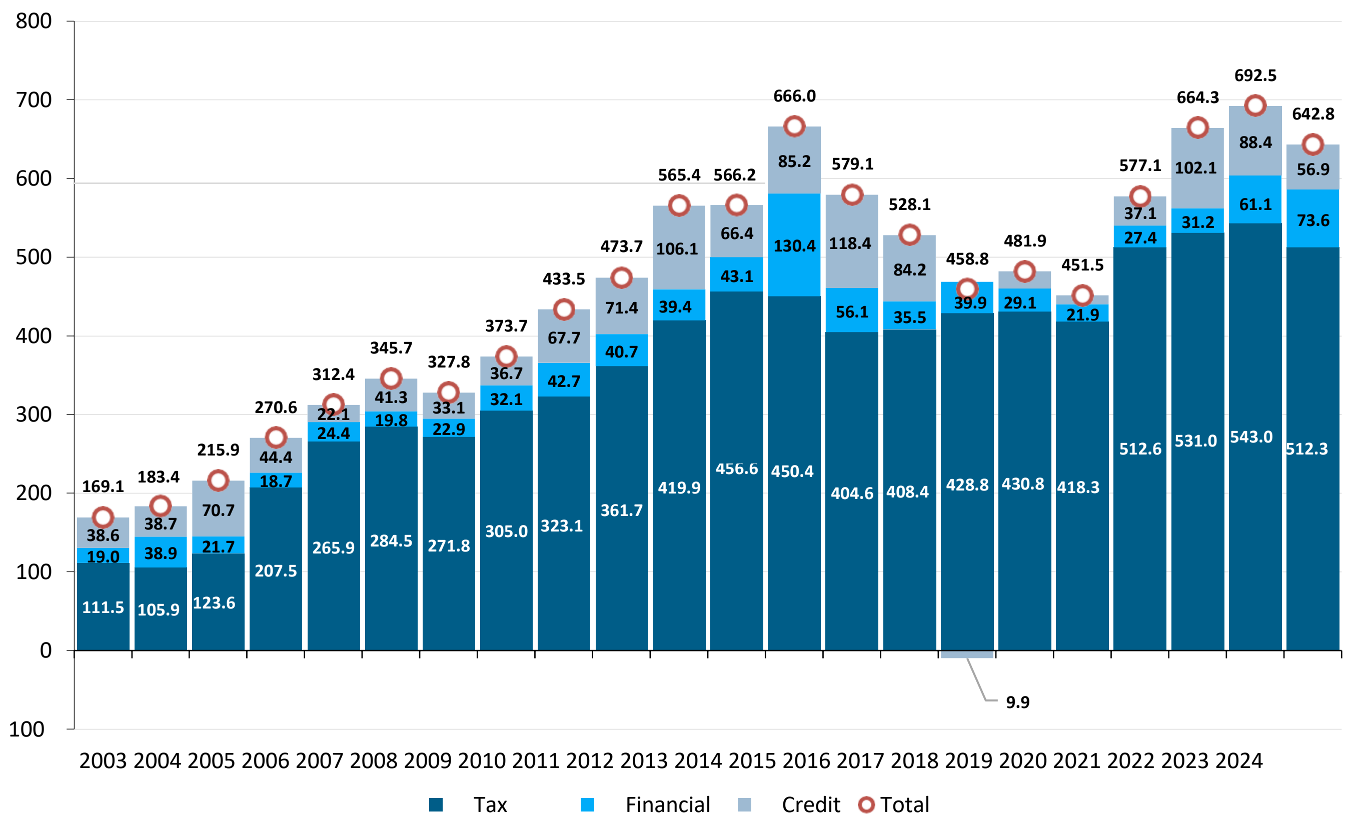
[20] For more information, see: https://tinyurl.com/n7e3t27x.

Another common way of classifying benefits is to divide them into implicit and explicit subsidies in relation to the Federal Government's General Budget (OGU). Tax and credit subsidies[21] are not included in the main part of the OGU and are therefore characterized as implicit. Financial subsidies, as a rule, are included in the OGU's primary expenditure and are therefore classified as explicit.

Evolution of Federal Government Subsidies

The evolution of subsidies from the Federal Government, in real terms, showed an increasing trajectory from 2003 to 2015, rising from BRL 169.1 billion to BRL 666 billion, nearly quadrupling during the period. Between 2016 and 2020 there was a cycle of 32.2% reduction in benefits, falling to BRL 451.5 billion at the end of the period. Between 2021 and 2023 there was another cycle of expansion, with the projection of benefits reaching BRL 692.5 billion in 2023, which represents the highest value in the historical series[22] (an increase of 53.4% since 2020). The projections for 2024 show a reduction of 8.1%, as shown in Graph 9.

GRAPH 9. EVOLUTION OF FEDERAL GOVERNMENT SUBSIDIES (BRL BILLION IPCA)



Source: RFB and MPO. Prepared by: IFI.

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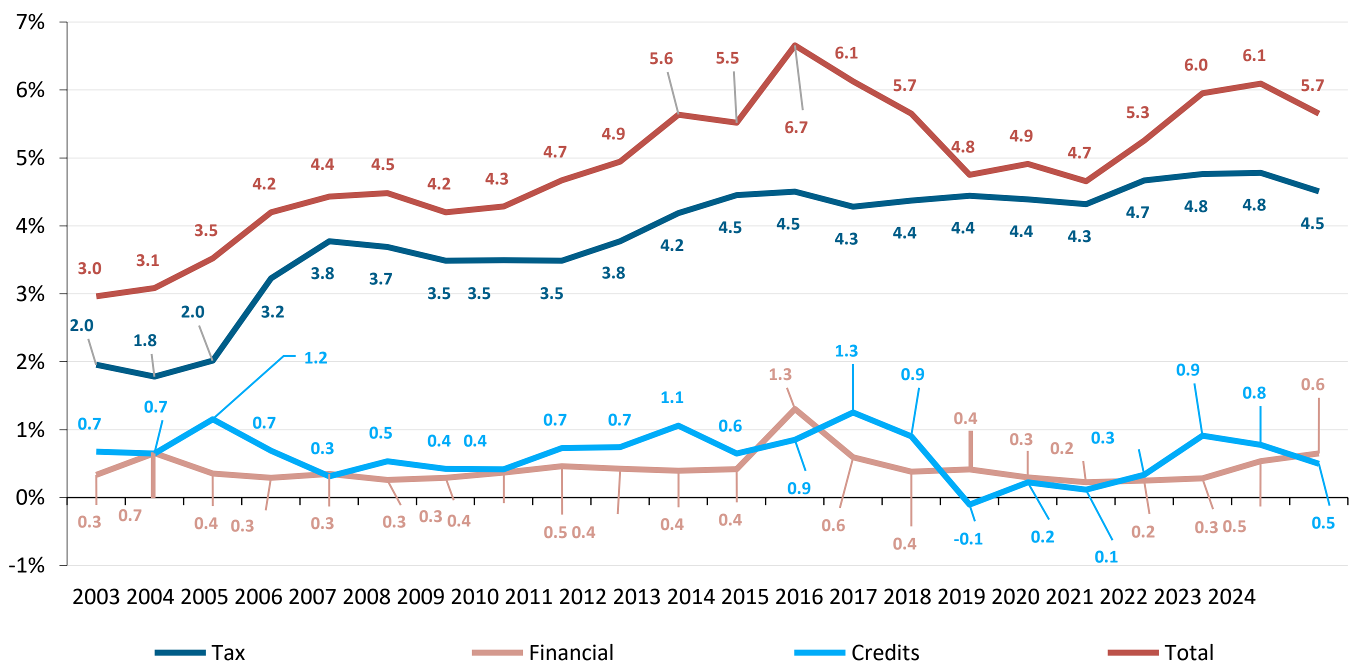
[21] As detailed in the MTBFC, tax and credit subsidies are not included in the Fiscal and Social Security Budgets but are listed in the Statement of Tax Expenditures (DGT) and the Statement of Financial and Credit Benefits (DBFC), respectively, and in the Supplementary Information of the Annual Budget Bill (PLOA). Credit subsidies that have a primary impact component (i.e. the disbursements, contributions, and reimbursements of official credit programs) also appear in the main part through the statement of the Central Government's Primary Balance. In any case, since tax and credit subsidies do not have explicitly associated budgetary actions, they can be classified as implicit subsidies.

[22] This text uses the most recent data (4/3/2024) made available by the RFB. Older data may be underestimated, since, according to §2 of art. 136 of Law No. 14.194/2021 (Budget Guidelines Law 2022 - LDO 2022), the differentiated regimes referred to in subitem "d" of item III of art. 146 of the Federal Constitution (*Simples Nacional* [ax regime designed to simplify the tax obligations of small businesses] and Microempreendedor individual (MEI [simplified regime for formalizing small businesses aimed at Brazilian microentrepreneurs]), but the provision was vetoed. In the LDO 2023, §3 of art. 143 established the same proposition, which was again vetoed, so that in the most current publication on tax expenditures prepared by the RFB, the amounts referring to *Simples Nacional* and MEI are once again computed.

In relation to GDP, the same upward trajectory of benefits was observed, more than doubling over the period, from 3% in 2003 to 6.7% in 2015 (the highest value in the series in terms of GDP percentage). Between 2016 and 2020, subsidies fell, reaching 4.7% of GDP in 2020. A new period of expansion was observed between 2021 and 2023, when the estimated benefits reached 6.1% of GDP. A further reduction in benefits is projected for 2024, to 5.7% of GDP, as can be seen in Graph 10.

GRAPH 10. EVOLUTION OF FEDERAL GOVERNMENT SUBSIDIES (% OF GDP)



Source: RFB, MPO and IBGE. Prepared by: IFI.

Tax Expenditure

The order of magnitude of tax benefits is usually much higher than the rest, which is why tax expenditures are always highlighted when evaluating federal subsidies. he IFI, for example, has already addressed these conceptual and methodological aspects and compared international experience in RAF No. 1 of 2017 [23] and No.16 of 2018 [24], and in Technical Note No. 17 of 2018 [25].

The historical series (2003-2022) presented by the 7th Federal Government Subsidy Budget (OSU)[26] demonstrates that, since 2013, tax expenditures on an effective basis represent more than 4% of the Gross Domestic Product (GDP). The current projections prepared by the Brazilian Federal Revenue Office (RFB) indicate that the year 2023 represents the highest level, both in real terms (BRL 519 billion) and as a proportion of GDP (4.8%) and revenue (RA) administered by the RFB (25.5%).

On the other hand, 2003 had the lowest nominal value (BRL 33.6 billion) and 2004 the lowest values in real terms (BRL 105.9 billion) and as a percentage of administered revenue (9.2%) and GDP (1.8%). For 2024, the RFB estimates a decrease of 0.3 p.p. compared to 2023, as shown in Graph 11.

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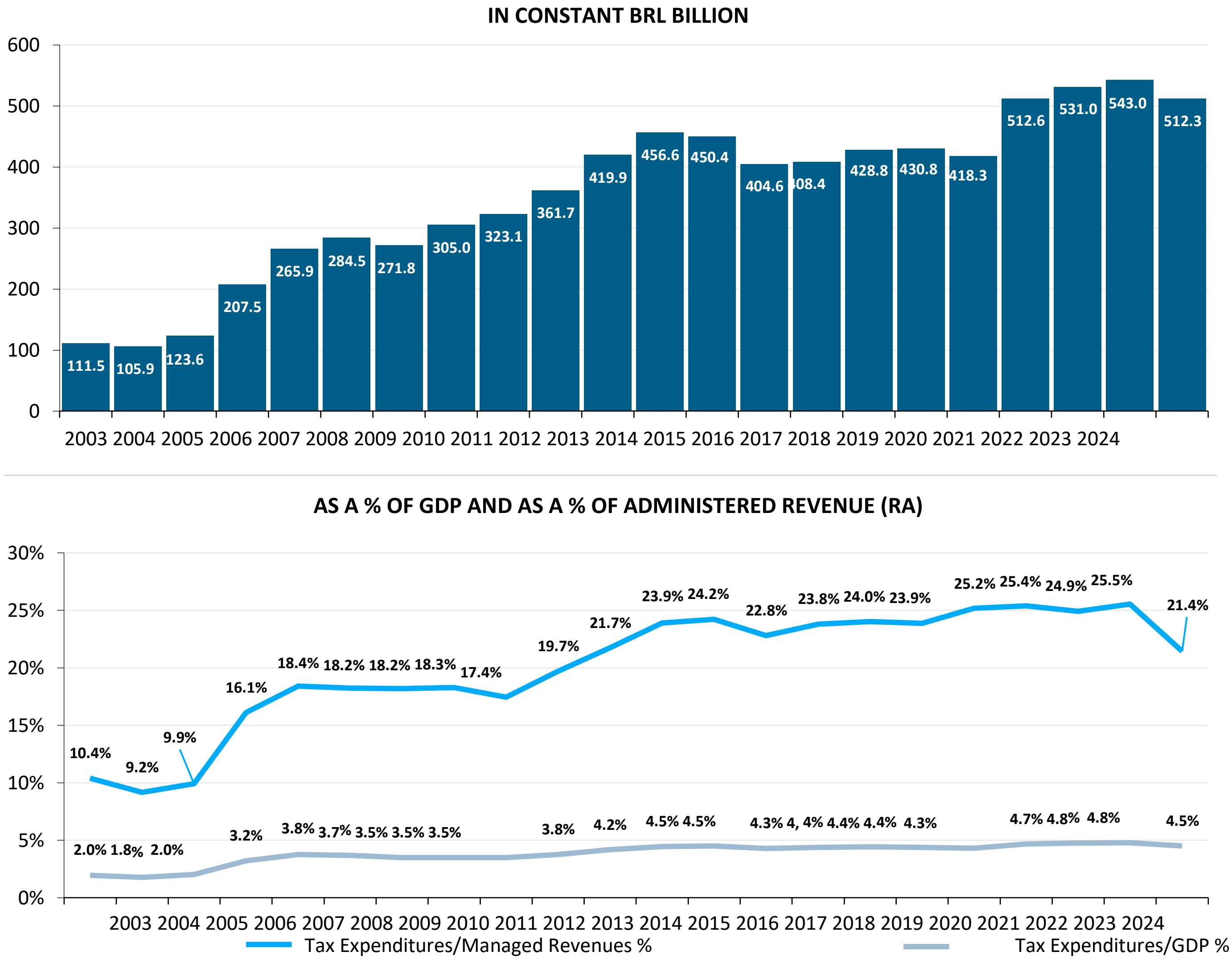
[23] Available at: https://tinyurl.com/3u7c8yd5. [24]
Available at: https://tinyurl.com/3ytxrz5e. [25]
Available at: https://tinyurl.com/5ahccm7s.
[26] Traditionally, the report is published in the second half of the year, covering the period from 2003 to the previous year. The current and previous reports are available at: https://tinyurl.com/mrxsz35h.

It is important to mention that both the Statements of Tax Expenditures (DGT) that accompany the PLOA [27] and the Statements of Tax Expenditures on an Effective Basis (DGT Effective Basis)[28] are estimates of foregone income resulting from the exemption measures in force (differing in that they are calculated on the income estimated in the PLOA and actually collected in the year, respectively), and do not necessarily represent the exact value of the benefits enjoyed by individuals and companies.

GRAPH 11. TAX EXPENDITURES (BRL BILLION IPCA, % OF GDP AND % OF ADMINISTERED REVENUE)



Source: STN, RFB, MPO and IBGE. Prepared by: IFI.

Bill of Law (PL) No. 15 of 2024[29] was presented under constitutional urgency[30] to, among other things, establish an electronic declaration for the control and monitoring of tax incentives, waivers, benefits and immunities, in order to improve management and transparency about the benefits actually enjoyed. According to the Executive Branch[31], the measure is in line with Constitutional Amendment (EC) No. 109 of 2021[32].

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[27] Available at: https://tinyurl.com/bddj5r9f.
[28] Available at: https://tinyurl.com/ya575bd2.
[29] Available at: https://tinyurl.com/3bzyk4ab.
[30] The President of the Republic may request an urgent vote on a bill of his own initiative. n this case, the proposal must be voted on within 45 days, or it will start to block the agenda of either the Chamber of Deputies or the Senate (whichever it is in at the moment). Available at: https://tinyurl.com/5e99b3du.
[31] Available at: https://tinyurl.com/yckehauy.
[32] Available at: https://tinyurl.com/bdfbsmup.

Art. 4 of EC No. 109, of 2021, determined the preparation of an emergency plan for the gradual reduction of federal tax incentives and benefits, which should reduce tax expenditures in force in 2021 from 4.7% of GDP to 2% of GDP in eight years. Observing the constitutional text, the Executive Branch sent Bill 3.203 of 2021[33], which provides for a reduction in tax expenditures of BRL 22.4 billion from 2022 to 2029. The bill is currently being processed in the Chamber of Deputies.

However, it should be noted that the text of EC No. 109 of 2021 provides for a series of exceptions[34] to the limit of 2% of GDP for tax expenditures. In projected figures for 2024, this exception would represent BRL 222.1 billion, which is equivalent to 2% of GDP. In practice, after the exceptions, the level of the constitutional target for reducing tax expenditures of 2% was raised to 4% of GDP, reducing the scope of the measure.

Financial subsidies

According to the Technical Manual for Financial and Credit Benefits (MTBFC), the methodology for calculating financial benefits is divided into the following modalities: (i) interest rate equalization; (ii) price equalization; and (iii) debt assumption. The interest rate equalization[35] corresponds to the difference paid in the year between the final borrower's charge and the cost of the source of funds, plus the remuneration of the agent granting the loan. They are usually carried out through the National Bank for Economic and Social Development (BNDES) and the Financing Agency for Studies and Projects (FINEP), or other official financial institutions.

In turn, price equalization[36] corresponds to an economic subsidy from the National Treasury (TN) to cover the difference between the cost of goods sold and the revenue collected from sales by the company[37]. Another case of price equalization results from the subsidy to electric power concessionaires due to the consumption of low-income households. When calculating debt assumption[38], the amount of the benefit granted is calculated on the basis of the amount of the fund's obligation that can be assumed by the Federal Government.

In real terms, the behavior of financial benefits shows three relatively well-defined cycles, with growth of 226.8% from 2003 (BRL 19.0 billion) to 2014 (BRL 43.1 billion), an atypical year in 2015 (BRL 130.4 billion), followed by a 60.9% retraction between 2016 (BRL 56.1 billion) and 2020 (BRL 21.9 billion). The current cycle of expansion of financial subsidies began in 2021 (BRL 27.4 billion), and the estimate for 2024 is BRL 73.6 billion (268.6% growth in the period), as can be seen in Graph 12 below.

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33 Available at: https://tinyurl.com/4ephs7hj.

34 According to art. 4, §2, items I to VI of Constitutional Amendment No. 109/2021, the following benefits are excluded from the 2% GDP limit: *Simples Nacional*; Microempreendedor individual (MEI); assets, income, or services of political parties, including their foundations, of workers' union entities, of educational and social welfare institutions without profit motives; social security contributions from charitable social assistance entities; financing programs for the productive sector in the North, Northeast, and Central-West regions; Manaus Free Trade Zone and other free trade and duty-free areas; industrial policy for the information and communication technology sector and for the semiconductor sector; products that make up the basic basket; and programs established by law aimed at granting full and partial scholarships to students in higher education courses at private higher education institutions, whether for-profit or not.

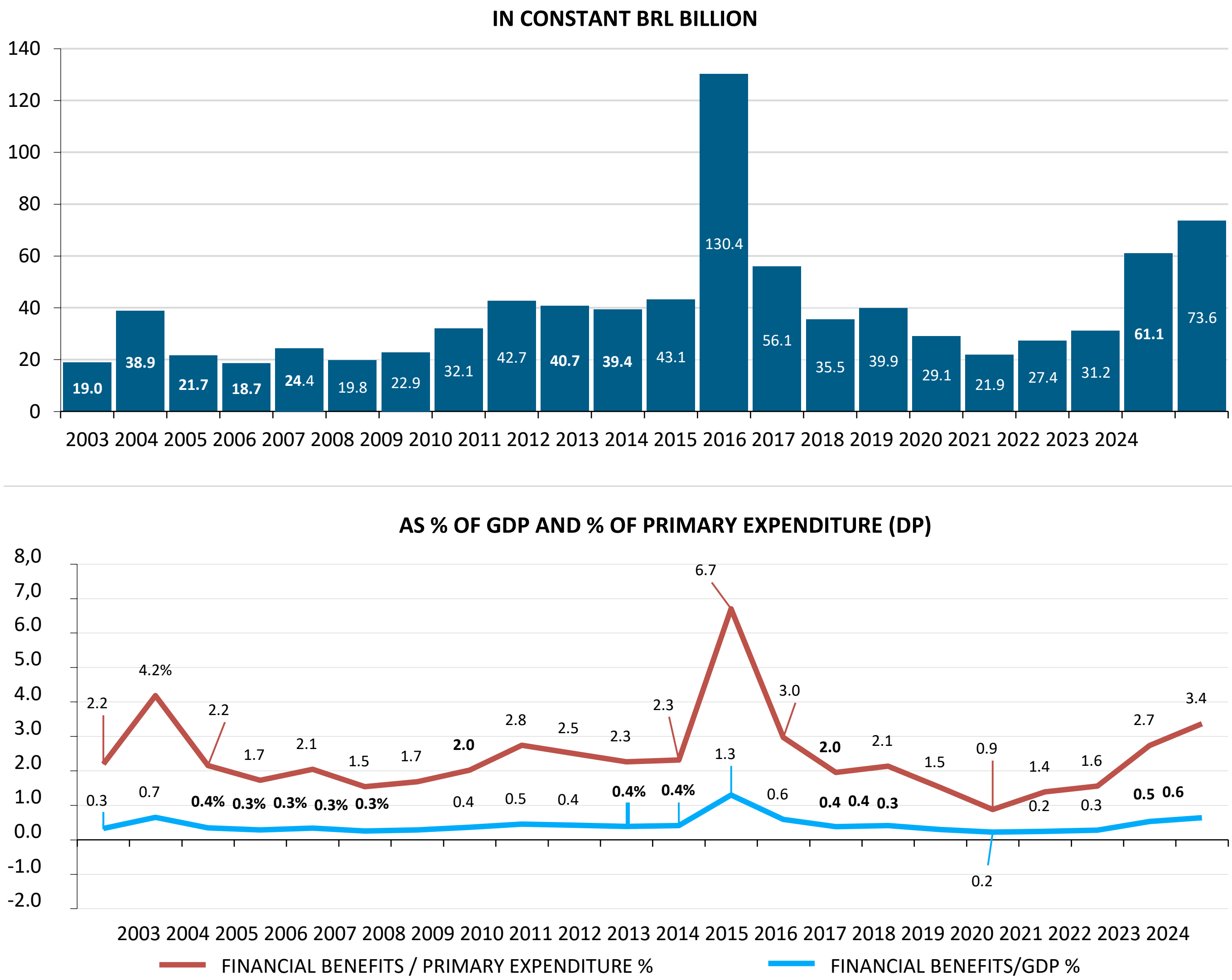
35 We highlight the following programs: *Minha Casa, Minha Vida* [My House, My Life, Program aimed at financing home ownership for low and middle-income families in Brazil] (PMCMV); National Family Agriculture Program (PRONAF); Rural and Agro-Industrial Investment Operations; Export Financing Program (PROEX) and Agricultural Funding Operations.

36 We highlight the following programs: Subsidies for Electricity Consumers in the Low-Income Residential Subclass and Economic Subsidies for Rural Insurance Premiums (PSR).

37 According to the MTBFC, in mathematical terms, it is the sum of the expense incurred in acquiring the products and in keeping them in stock, less the income from selling the stock. This subsidy is generated when the market price is below the minimum price and the company expects to recover it. Thus, the products bought by the government make up its public stock.

38 Of particular note is the Salary Variation Compensation Fund (FCVS).

GRAPH 12. FINANCIAL BENEFITS (BRL BILLION IPCA, % OF GDP AND % OF PRIMARY EXPENDITURE)



Source: STN, MPO and IBGE. Prepared by: IFI.

The supplementary information to the PLOA for 2024[39] shows the following projection for the major financial benefits: Salary Variation Compensation Fund (FCVS) (BRL 37.0 billion); Minha Casa Minha Vida Program (PMCMV) (BRL 13.0 billion); National Family Agriculture Program (PRONAF) (BRL 6.9 billion); subsidies to low-income electricity consumers (BRL 6.1 billion); rural and agro-industrial investment operations (BRL 3.4 billion); PSR (BRL 2.0 billion); PROEX (BRL 1.3 billion) and agricultural funding operations (BRL 1.0 billion).

In terms of nominal variation, in the current expansion cycle (2020 to 2024) we highlight: FCVS, which rose from BRL 2.6 billion to BRL 37.0 billion (1,423.1%); PMCMV, from BRL 2.5 billion to BRL 13.0 billion (520.0%) and PRONAF, from BRL 2.3 billion to BRL 6.9 billion (300.0%).

[39] Available at: https://tinyurl.com/2s3rdy58.

It is important to consider that, as highlighted in the 1st OSU Report[40], the financial benefits data for the period between 2012 and 2014 is underestimated, due to the non-accounting of liabilities owed to public banks[41]. This lack of registration was adjusted all at once in 2015. Thus, the value of the financial benefits for 2015 is overestimated in relation to the fiscal year and the economic effects of these expenses.

Credit subsidies

According to the MTBFC, the calculation of credit benefits reflects the difference between the effective return on the application of the resource transferred by the National Treasury to the fund or program, and the return that would have been obtained if the same resource had been applied at the TN's opportunity cost rate[42]. Thus, for most funds, this calculation is based on the difference between the appreciation that the net asset value (PL) of the fund would have achieved if it had been remunerated at the Federal Government's cost of capital and its actual performance.

In addition, it includes any transfers from the National Treasury to the fund, which may have contributed to the real increase in PL in the period analyzed. Other triggering events that change the fund's net asset value, such as the recognition of new liabilities or the write-off of irrecoverable assets, can also impact the assessment of subsidies.

Thus, there is an implicit subsidy whenever the estimated result, according to the rate representing the cost of public debt and the incorporation of transfers from the National Treasury, is higher than the actual change in the fund's net assets. On the other hand, a negative subsidy means that the fund's net asset value grew, over the year, more than its net asset value from the previous year would have grown if it had earned a return equivalent to the National Treasury's opportunity cost.

Still according to the MTBFC, there are also credit subsidies that impact the primary result, those accounted for under the concept of net lending[43], such as parts of PROEX and PRONAF (which also have portions recorded as financial subsidies). Other examples with their own methodology and primary impact on the expenditure side are the Student Financing Fund (Fies) and the Constitutional Financing Funds[44] (FCF).

In addition, it should be noted that the figures calculated for the primary impact differ from those presented in the OSU, since the credit subsidy captures the entire impact on public debt, including the non-primary part. Therefore, even a program with low default rates (i.e., with little primary impact) will incorporate a credit subsidy if its financial return does not offset the opportunity cost of the allocated budget.

Unlike tax and financial benefits, which have defined growth and retraction cycles, credit subsidies are more variable, probably because they are subject to more volatile conditioning factors (TN opportunity costs and TN transfers to the funds, variation in the funds' net worth and budget execution of the programs), as shown in Graph 13 below.

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[40] This report features a specific section titled "Adjusted Explicit Subsidies" that describes a summary of the history of operations and the consequences in terms of the financial impacts of liabilities not recorded in the Net Public Sector Debt (DLSP). Available at: https://tinyurl.com/2eht7djw.

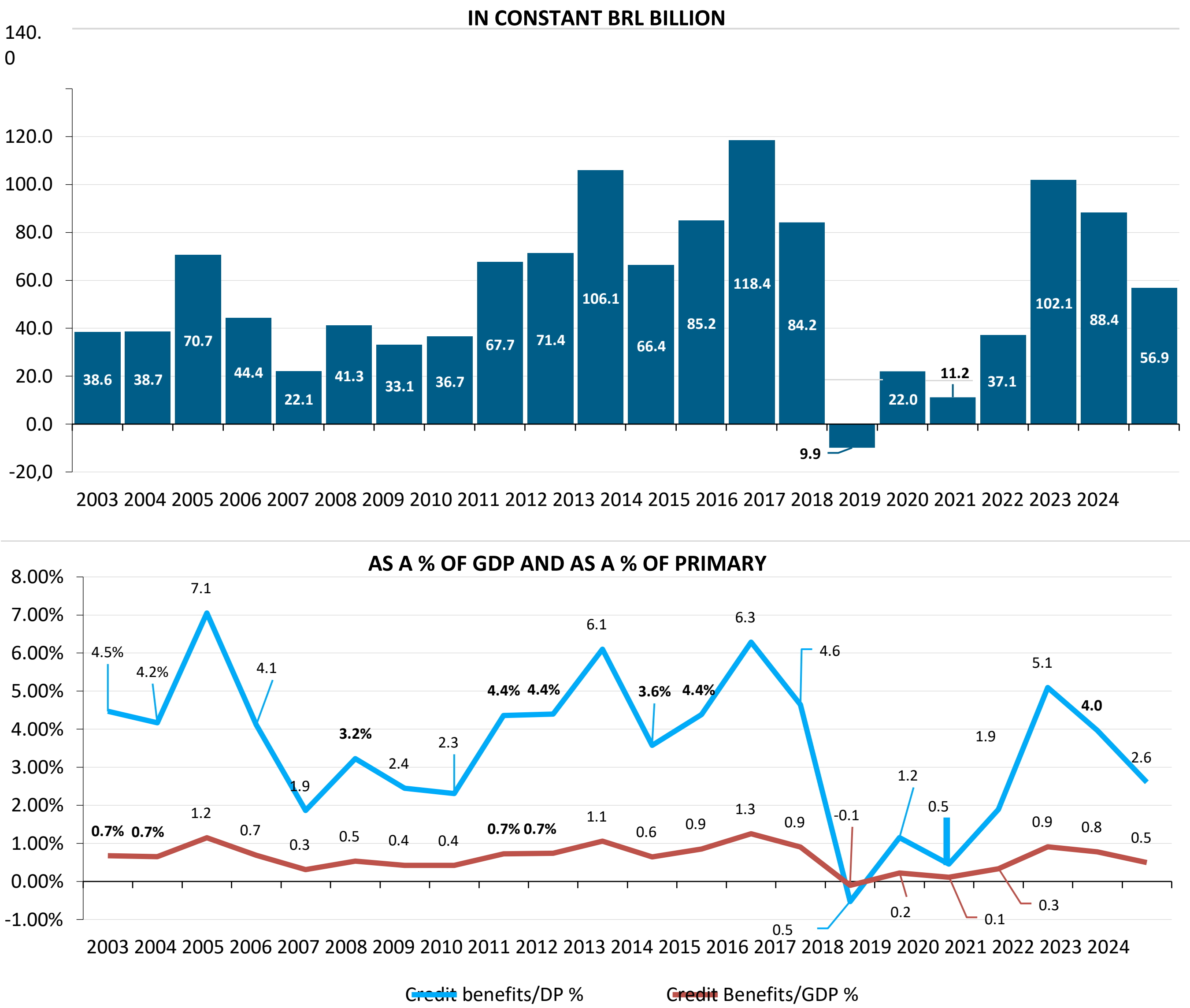
[41] The Federal Accounting Court (TCU), in Ruling No. 825/2015, identified a series of transactions that were not properly recorded, including late payments: (i) to the BNDES, for subsidies related to the PSI; (ii) to the Banco do Brasil (BB), in order to compensate for subsidies related to agricultural and rural credit lines; and (iii) to the Caixa Econômica Federal (CEF) and the Severance Indemnity Fund (FGTS), related to expenses for the Minha Casa, Minha Vida housing program; to delays in social contributions; and to delays in compensation for social benefits paid by the CEF as a government agent (e.g. Bolsa Família Program, Salary Allowance and Unemployment Benefits). Available at: https://tinyurl.com/4zmswnbb.

[42] According to the Methodology for Calculating Public Debt Indicators, the National Treasury's opportunity cost is considered to be the Average Issuance Cost (CME) of the Federal Domestic Public Debt (DPMFi). The average cost of DPMFi public offerings is an indicator that reflects the Internal Rate of Return (IRR) of National Treasury bonds on the domestic market, plus the average variation of their indexing factors, considering only public offerings (auctions and Treasury Direct) over the last 12 months. Available at: https://tinyurl.com/3ycr5rjk.

[43] The concept of net lending is applied to cases in which the risk of loss from the financial operation is paid by the Federal Government and, despite its financial nature, disbursements are recorded as primary expenditure and reimbursements as deductions from primary expenditure.

[44] Composed of the Constitutional Financing Fund for the North (FNO), the Constitutional Financing Fund for the Northeast (FNE) and the Constitutional Financing Fund for the Center-West (FCO).

GRAPH 13. CREDIT BENEFITS (BRL BILLION IPCA, % OF GDP AND % OF PRIMARY EXPENDITURE)



Source: STN, MPO and IBGE. Prepared by: IFI.

In 2018, there was an atypical pattern of negative credit subsidies. According to the 3rd OSU[45], among the factors that explained the decrease in credit benefits, the following stand out: a reduction in the opportunity cost of the National Treasury; equity adjustments in some funds, mainly the Workers' Support Fund (FAT); the discontinuation or decrease in the execution of some benefits in the Investment Support Program (PSI) and PRONAF; and the decrease in outstanding loan balances due to their early repayment (return of the loans from the Federal Government to BNDES [46]).

The supplementary information to the PLOA for 2024 shows the following projection for the major credit benefits: FCF (BRL 22.1 billion); FAT (BRL 12.7 billion); Fies (BRL 11.3 billion); Merchant Marine Fund (FMM - BRL 4.8 billion); Development Funds[47] (BRL 1.9 billion) and the Export Guarantee Fund (FGE: BRL 1.5 billion).

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[45] Available at: https://tinyurl.com/mvxzch3s.
[46] Operation detailed in the next topic.
[47] Composed of the Amazon Development Fund (FDA), the Northeast Development Fund (FDNE) and the Central-West Development Fund (FDCO).

National Treasury subsidies under the PSI and in loans to BNDES and FINEP

Law No. 12,096[48] of 2009 authorized the granting of economic subsidies to the BNDES for financing operations aimed at the acquisition and production of capital goods (within the scope of the PSI), and to FINEP for technological innovation. Initially limited to BRL 44.0 billion, in current 2009 values (1.3% of GDP at the time), the limits underwent successive annual increases and reached BRL 452.0 billion (7.5% of current GDP) in 2015 (the year in which new PSI operations were closed). The loans, in general, were remunerated at the Long-Term Interest Rate (TJLP)[49], which was lower, on average, than the interest rates paid on the public debt securities issued by the National Treasury to back these operations.

Although the amounts of the financial and credit subsidies for these programs are included in the OSU, the volume of operations has taken on such a proportion that Law No. 13,132 of 2015 determined the preparation of a specific bimonthly statement[50] to disclose the fiscal impact of the National Treasury's operations with the BNDES and FINEP.

According to the first bi-monthly report[51], the Federal Government's holdings at BNDES amounted to BRL 523.9 billion (8.7% of GDP) as of December 31, 2015. In 2016, the present value of the financial benefits projected until 2060 was BRL 25.1 billion, and of the credit subsidies was BRL 174.9 billion, totaling BRL 200 billion at the time (3.3% of GDP), which is equivalent to BRL 333.9 billion in 2024 values, when adjusted by the IPCA.

Between 2015 and 2023, BNDES renegotiated contracts with the Federal Government and made a series of early payments[52] totaling BRL 738.4 billion in real values (including principal and interest), with BRL 42.5 billion still remaining as Federal Government's holdings at BNDES as of December 31, 2023, according to the report from the sixth bi-monthly period of 2023[53].

Additionally, a final early payment of BRL 24.1 billion was scheduled for November 2023, but BNDES managed to get approval from the TCU[54] for a renegotiated agreement with the National Treasury, which now stipulates the dilution of the payment into eight installments due by 2030. This extension of the repayment of the Federal Government's holdings will increase the cost of the subsidies for the program, which can only be fully calculated in 2041.

As of December 31, 2023, the value of the financial subsidies already incurred was calculated at BRL 100.3 billion and the credit subsidies at BRL 241.9 billion, totaling BRL 342.3 billion. Added to these amounts is the projection, at present value on January 1, 2024, of BRL 961 million and BRL 3.9 billion, respectively, of financial and credit benefits to be funded until 2041[55], totaling another BRL 4.8 billion. Thus, the cost of the PSI subsidies, which were in force for seven years between 2009 and 2015, is estimated at BRL 347.1 billion, in 2024 values.

Thus, even with the renegotiations of terms and rates, and with the advance payments of Federal Government assets, with the aim of reducing subsidies, the current cost of the program is slightly higher (BRL 13.2 billion) than what was forecast in 2016 (at the end of the program), probably[56] due to the use of projections of more positive macroeconomic parameters than those actually realized, especially in terms of interest rates and the opportunity cost of the National Treasury, which are the most impactful elements in these estimates.

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48 Available at: https://tinyurl.com/mpzv48jf.

49 The TJLP was replaced by the TLP (Long-Term Rate) in financing contracts signed as of January 1, 2018, however, the TJLP was maintained until the end of the term of contracts relating to operations approved by the BNDES Board of Directors before January 1, 2018. More details at: https://tinyurl.com/7p54mz48.

50 Carried out through the National Treasury Subsidy Report within the scope of the PSI and loans to the BNDES. Available at: https://tinyurl.com/5n8xbmeb.

51 Available at: https://tinyurl.com/2p8hr9et.

52 These settlements, in nominal values, amount to BRL 546.1 billion: BRL 15.8 billion in 2015, BRL 113.2 billion in 2016; BRL 50 billion in 2017; BRL 130 billion in 2018, BRL 100 billion in 2019, BRL 63 billion in 2021, BRL 72.3 billion in 2022 and BRL 1.8 billion in 2023.

53 Available at: https://tinyurl.com/3emebkez.

54 Ruling 2446/2023 TCU-Plenary. Available at: https://tinyurl.com/4xxmraj4.

55 In order to reduce the cost of subsidies, on October 1, 2018, the financial conditions of contracts between STN and BNDES were renegotiated, changing the remuneration of loans from TN to BNDES and reducing the term of the contracts from 2060 to 2041. More information at: https://tinyurl.com/bd4ncpcm.

56 The grid of macroeconomic parameters that accompanies the PLOA presents projections for a series of indicators, including interest rates (Selic, TR and TJLP), but it does not present the projection for the National Treasury's opportunity cost, nor other conditions (such as TN contributions to

Transparency and evaluation

Art. 4 of EC 109, of 2021, establishes that a Complementary Law must address criteria, objectives and targets for granting or altering tax, financial or credit benefits for legal entities, as well as rules for the periodic and mandatory evaluation and publication of the results of these benefits, in addition to providing for the reduction of tax benefits. Complementary Bill No. 41[57] of 2019, which was already being processed in the Senate, has undergone some changes to incorporate that constitutional determination and is currently being processed in the Chamber of Deputies.

Even before the establishment of the legal requirement, the Executive Branch published, between October 2018 and March 2021, a series of monthly bulletins on federal subsidies[58], with the aim of providing an overview of selected public policies that make up the OSU, presenting information to society about institutional actions related to some public policies funded by these benefits.

Conclusion

Regarding tax benefits, three years after the promulgation of the constitutional amendment brought about by EC No. 109 of 2021, not many practical effects have been observed. 2024 is the first year after the measure was enacted that subsidies are expected to be reduced. The various exceptions to the ceiling of 2% of GDP in tax expenditures diminish the potential impact, but at least 0.5% of GDP (BRL 56.8 billion) must be mandatorily reduced by 2029. Therefore, if the constitutional mandate is followed, a reduction in tax expenditures is expected by 2024 and in the medium term.

The main reasons for the observed reduction in financial and credit subsidies between 2015 and 2020 were: (i) discontinuation of programs, mainly the Investment Support Program; (ii) decreased execution of other programs, such as the Minha Casa, Minha Vida Program and FIES; (iii) early repayment of portions of loans from the Federal Government to BNDES; and (iv) reduction in subsidies due to the transition from TJLP to TLP.

These changes, combined with the reduction in the National Treasury's opportunity cost, which fell from 12.68% p.a. in 2015 to 6.16% p.a. in 2020, allowed for a significant decline in financial and credit subsidies, which were reduced from 2.15% of GDP in 2015 to 0.35% of GDP in 2020.

For 2024 and the following years, the behavior of financial and credit expenditures tends to grow. If, on the one hand, the National Treasury's opportunity cost has stabilized[59], on the other, the resumption and expansion of some subsidized programs could put pressure on spending growth once again.

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to increase the net asset value (NAV) of funds), which were used to estimate the cost of subsidies. Even though the actual opportunity cost incurred in the previous year is already known, it is not possible to know, until the OSU is published, the exact factors that determine the differences between the amounts projected in the PLOA and the ones calculated in the OSU, which can be very different. As an example, credit benefits were estimated in the 2022 PLOA at BRL 28.9 billion, but were calculated in the OSU at BRL 92.2 billion (more than three times higher than estimated). The 2023 OSU is not expected to be published until the second half of 2024.

[57] The bill establishes objective criteria, performance targets and procedures for granting, altering and periodically assessing the economic and social impacts of tax, financial, credit or property incentives or benefits for legal entities that result in a decrease in revenue or an increase in expenditure. The bill therefore deals with almost all subsidies, although art. 6 of the bill categorically excludes the Manaus Free Trade Zone and other free trade areas from the need for monitoring and evaluation. Available at: https://tinyurl.com/bdt5h2mm.

[58] According to the Executive Branch, in addition to the importance of transparency and social control, this initiative could provide instruments for these policies to be subsequently evaluated within the scope of the Monitoring and Evaluation Committee for Federal Subsidies (CMAS). Available at: https://tinyurl.com/bdh6p3sm.

[59] The CME rose 83.1% between 2021 and 2022, from 6.16% p.a. to 11.28% p.a., and remained relatively stable, but at a high level, at 12.24% p.a. in 2023 and 12.11% p.a. until February 2024. Available at: https://tinyurl.com/4rvbwtnv.

Two measures were also approved, reducing the return on loans obtained by the BNDES and FINEP from the Workers' Support Fund (FAT)[60] and the FNDCT[61] respectively. In addition, Bill No. 6,235[62] of 2023, which is being processed on an urgent basis in the Chamber of Deputies, proposes a new calculation formula for the TLP. All these measures should contribute to an increase in financial and credit subsidies in 2024 and in the coming years.

[60] Art. 9 of Law No. 14,592/2023 changed the way loans granted by the FAT to BNDES are remunerated, when destined for innovation and digitization financing operations, which ceased to be corrected by the TJLP and started to be corrected by the TR, which is normally lower. In other words, the net equity of the FAT will be remunerated at a lower rate, increasing the subsidy. Available at: https://tinyurl.com/8722nath.

[61] Art. 4 of Law 14,554/2023 changed the way in which loans granted by the FNDCT to FINEP are remunerated. They are no longer adjusted by the TJLP and are now adjusted by the TR, which is typically lower, meaning that the net asset value of FNDTC will be remunerated at a lower rate, increasing the subsidy. Available at: https://tinyurl.com/36vfhd65.

[62] The bill proposes a series of changes to the calculation of TLP and delegates authority to the National Monetary Council to alter the calculation methodology. Available at: https://tinyurl.com/3t3jwnns.

IFI projections

SHORT TERM

IFI projections	2024			2025		
	Mar/24	Apr/24	Comparison	Mar/24	Apr/24	Comparison
GDP - real growth (% p.a.)	1.65	1.65	=	1.96	1.96	=
GDP - nominal (BRL billion)	11,537.88	11,537.88	=	12,256.27	12,256.27	=
IPCA - accumulated (% in the year)	3.88	3.88	=	3.49	3.49	=
Exchange rate - end of period (BRL/US$)	4.89	4.89	=	4.95	4.95	=
Employment - growth (%)	1.00	1.00	=	1.02	1.02	=
Payroll - growth (%)	2.52	2.52	=	1.96	1.96	=
Selic - end of period (% p.a.)	9.50	9.50	=	8.50	8.50	=
Ex-ante real interest (% p.a.)	5.35	5.35	=	4.22	4.22	=
Consolidated Public Sector Primary Balance (% of GDP)	0.85	0.85	=	0.76	0.76	=
of which Central Government	0.95	0.95	=	0.76	0.76	=
Net Nominal Interest (% of GDP)	5.99	5.99	=	5.56	5.56	=
Nominal Balance (% of GDP)	6.83	6.83	=	6.32	6.32	=
General Government Gross Debt (% of GDP)	77.66	77.66	=	80.19	80.19	=

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May 2, 2024.

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